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Advisory Services

SPRING 2009

Bank Stock Valuation

Market Studies

Merger/Acquisition Consulting

Singin' the Blues

You know times are tough when they start singing songs about it.[1] Neil Young has "Cough Up the Bucks", which includes "Where did all the money go? / Where did all the cash flow? / Where did all the revenue stream?". In "A Lot to Drink About", Jimmy Buffet sings, "Madoff made off with all the money / Now his clients are down to skunkweed / It's so easy to see / We're only talking simple greed." If you prefer country, there's John Rich's "Shuttin Detroit Down", which includes, "They're living it up on Wall Street…Here in the real world, they're shutting Detroit down." While its safe to say none will probably go down as timeless classics, there's no question they reflect the sentiments of many people throughout the country.

"Where did all the cash flow?"

"Where did all the revenue stream?"

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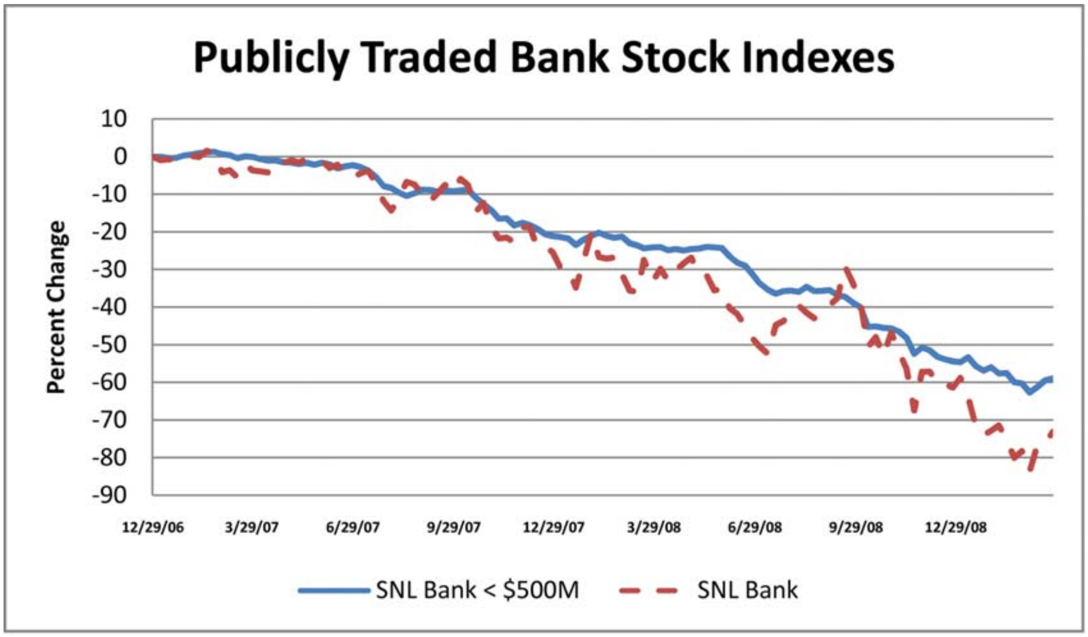
[1] May 28, 2009 Rolling Stone

From December 29, 2006 through the end of the first quarter of 2009, the SNL Bank index of publicly traded bank stocks was down just a shade over 74%. Like any market cap weighted index, the SNL Bank index best mirrors the performance of the largest banks in the country, and everyone who has turned on the evening news more than a few times in the last two years knows they haven't exactly been doing well. At BankValue Advisory Services, we're more interested in how smaller banks are doing, and unfortunately, the news there wasn't very good either. During the same period, the SNL Bank index of publicly traded banks with total assets less than $500 million was down 59%.

Another way to gauge prices, or values, for community banks is to look at the M&A market. Until recently, community banks had been selling at very high valuation levels, as



Source: SNL Financial

Price-to-Basic Capital Paid (by Asset Size)

	2006			2007			20088		
	Ratio		# of	Ratio		# of	Ratio		# of
Total Assets	Avg.	Med.	Trans.	Avg.	Med.	Trans.	Avg.	Med.	Trans.
$0-25 million	1.77	1.70	7	2.00	2.00	1	1.68	1.63	4
$26-50 million	1.86	1.90	4	1.99	1.85	11	1.72	1.72	2
$51-100 million	2.13	2.07	9	2.11	1.88	4	1.83	1.69	7
$100 million+	1.89	1.76	9	2.38	2.44	8	1.77	1.56	7
Total	1.93	1.85	29	2.14	1.94	24	1.77	1.60	20

Price-to-Basic Capital Paid (by Community Size)

	2006			2007			2008		
Community	Ratio		# of	Ratio		# of	Ratio		# of
Population	Avg.	Med.	Trans.	Avg.	Med.	Trans.	Avg.	Med.	Trans.
less than 1,000	1.79	1.78	11	1.85	1.85	2	1.72	1.72	6
1,001 - 3,500	1.64	1.84	5	2.07	2.04	7	2.03	2.08	5
3,501 - 10,000	2.17	2.01	4	2.06	1.88	6	1.29	1.26	3
> 10,000	2.16	2.14	9	2.31	2.13	9	1.84	1.65	6
Total	1.93	1.85	29	2.14	1.94	24	1.77	1.60	20

measured by price to earnings and price to capital ratios.

In our own database, among other valuation metrics, we track price to last 12-months' earnings and price to "basic" capital (using 8% as base capital). The top table on page 2 presents price to basic capital ratios segregated by asset size of the acquired bank. Three things are apparent from viewing this table: 1) There were fewer deals in 2008, 2) price to basic capital ratios are down from previous years, and 3) the decline occurred across all asset sizes.

The second table at the bottom of page 2 presents price to basic capital ratios broken down by size of the community in which the bank is chartered. In normal times, there has been a trend of higher multiples being paid for banks located in larger communities, which makes sense intuitively. Perhaps it's another reminder that 2008 was anything but normal when we see the highest multiples in towns of 1,000-3,500 people. Obviously that is not a meaningful statistic. In fact, when looking deeper into the numbers, we note that none of the five transactions occurred later than March 2008, well before things really started to get ugly. More meaningful is the relatively low median price to basic capital multiple paid for banks located in towns with more than 10,000, a segment that previously tended to have the highest multiples.

We also reviewed the price to last 12-months' earnings ratios from our database, presented in the table below.

Like price/equity ratios, price/earnings ratios were also down in 2008, though not as sharply. One reason why the ratios didn't fall even more is that denominator, earnings, was down significantly during the year.

One might comment that twenty transactions is a pretty small sample size, and also that the data in the table only represents a small slice of the national bank M&A market. However, the trends hold for the national market as well. Consider the table below, which includes all bank M&A transactions in the country since the beginning of 2002.[3] The red line is the number of deals in the year, and the blue bar is the average price to tangible book value ratio.

The sharp drop in valuations occurring in 2008 and continuing into the first quarter of 2009 is striking, but so is the strong correlation between deal volume and valuation. One thing a valuation analyst can struggle with during times like these is a lack of good transaction data. However, sometimes the lack of data in itself can be useful. In this case, the fact that there is very little M&A occurring is a strong indicator that values are down. It is worth noting that, nationally, the average price to tangible book value ratio was just below 1.00 in the first quarter of 2009 – quite a drop from the high of nearly 2.50 in 2006![4]

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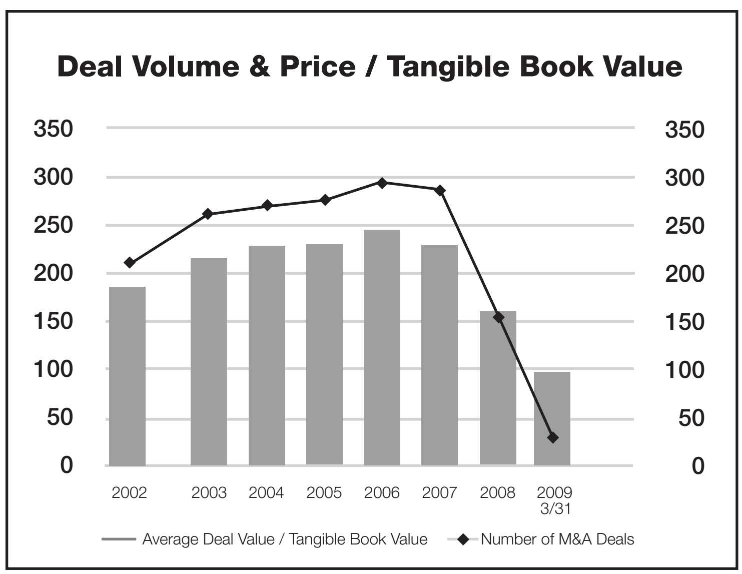

Source: SNL Financial

[2] Total assets less than $400 million located in Illinois, Iowa, Minnesota, Montana, North Dakota, South Dakota, or Wisconsin. Price to basic capital ratios below 1.10 and price to last 12-month earnings ratios over 50 were considered not meaningful and were excluded.
[3-4] SNL Financial

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Outlook

Some analysts are predicting a rebound in M&A activity as strong banks take advantage of low valuations to expand their markets. However, in the near term, there is no indication that is happening. Buyers are generally remaining on the sidelines taking care of their own problems, conserving capital, or, at the stronger institutions, using their capital to build loan volume in what has become a less competitive market. Transaction financing remains tight as creditors continue to be risk averse. Owners of healthy institutions that may be interested in selling are generally not receiving bids that are high enough to entice them to sell. We are hearing of many potential deals that break down well into the negotiations as one side or the other gets cold feet. Many of the deals that get done in 2009 are likely to involve troubled institutions that have to sell. It may be some time before the M&A market returns to "normal", and even longer before we see valuations similar to what we saw in 2004-2007. ■