Corporate Management

What Is Your Stock Worth?
The Importance of a Formal Valuation Analysis

By Britt Nosher and Scott Martorana, FinPro Capital Advisors, Inc.

Formal valuation analysis by a third-party expert is the single most important step a CEO can take to answer the critical question: What is your stock worth?

For privately held stock corporations, banks traded over-the-counter, and even exchange-listed banks with low levels of daily trading volume, this is not always an easy question to answer. The stock price at which you currently trade is not necessarily indicative of your true value.

It is vital for a bank to know its value, enhance its value, and proactively communicate its value to stockholders and to the market.

Having an independent third-party conduct annual or more frequent stock valuations allows the board of directors to understand what is driving value and how the market for financial stocks is moving. In so doing, the bank can further enhance areas that are creating value and fix areas that are inhibiting it. Market perception is a key driver and determinant in value, so as the bank improves its risk profile and enhances value creators, it is of the utmost importance to communicate these efforts to stockholders.

A stock valuation is also necessary to assess strategic alternatives. For banks interested in buy-side M&A, buyer stock price is one of the most important variables in any transaction with a stock component.

Stock valuations are comprised of two separate but mutually supporting approaches. The first is a comparable group trading approach. While the methodology is relatively straightforward, care must be taken in assembling the comparable trading group. The list should include institutions with similar asset size and quality, as well as any unique business models (mortgage lending or wealth management are two examples). Regional comparable institutions are preferable to a generic national group in any analysis, particularly a trading analysis.

Ideally, the list will contain a minimum of 10 institutions, publicly traded on a major exchange (NASDAQ, NYSE, NYSE-MKT), with reasonable trading liquidity. Utilizing this list of comparable institutions, key areas of the bank are assessed relative to the comparable group, including balance sheet composition, asset quality, capital, market demographics, growth, dividends, and trading liquidity. Upward or downward adjustment factors are applied to each category to derive an aggregate adjustment to the median comparable pricing multiples in order to determine your institution’s value on a market comparable approach.

The second approach is an investment value discounted cash flow analysis. Projections provided by or developed with the institution’s management are utilized to develop terminal values based on two methods: earnings and tangible book value. The investment value of the bank on each of the approaches will rely on terminal value at the assumed ending date of the projections (a minimum of three years out is recommended and five years is preferable). Price to tangible book value and price to earnings trading multiples and a discount rate are utilized to derive the terminal values, which are then discounted back to compute a present value on a stand-alone basis.

Utilizing a range of discount rates and a range of price to earnings and tangible book value multiples will yield different results. FinPro Capital Advisors, Inc., provides a range of terminal multiples and discount rates to show a comprehensive matrix of potential value points. A key point to remember is that the valuation trading approach and the investment value approach must be viewed collectively and weighted subjectively, and neither component should be viewed in isolation from the other.

For private institutions, a formal stock valuation is the best way to determine the value of the stock. For thinly traded banks, trading price is not necessarily reflective of

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customers, as well as position itself as a leading institution in the community.

Oak Ridge Financial has advised and executed offerings for two Illinois community banks in 2016. One bank issued $6.3 million common equity that was purchased primarily by its directors, existing shareholders and new investors within its service area. The capital will support its continuing growth strategy. The other bank is in the process of completing its issuance of $6.5 million preferred equity, which was particularly attractive to fixed-income investors within its service area. Oak Ridge broadened the pool of prospective investors by offering the preferred stock through its retail brokerage division. The capital is intended to support the bank’s organic growth.

true value, as smaller trades can skew overall stock price, so a valuation can provide insight as to whether the bank is overvalued or undervalued when compared to the market. In either case, public or private, a formal stock valuation is a key step in understanding, building, and communicating value.

So, yes, capital is available to community banks! The industry is healthy, and investors like the return they can achieve through a relatively safe investment. Community banks seeking capital are encouraged to explore options through their investment banker, legal advisor and accounting specialists.

Oak Ridge Financial, an IBA Associate Member, is a full-service investment banking firm headquartered in the Twin Cities, Minn., with approximately 45 wealth managers; dedicated equity and fixed-income sales and trading; and a specialized investment banking practice serving community banks in the Upper Midwest. For more information, contact David VanHove at dvanhove@oakridgefinancial.com or 779-475-0688; Craig Mueller at cmueller@oakridgefinancial.com or 763-923-2205; or David Stieber, dstieber@oakridgefinancial.com or 763-923-2291.

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