QwickViews for banks

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Bank Valuation: Why and How to Value Your Stock

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For community banks, knowing the value of your institution – and particularly its stock value – can be vital for many reasons. Valuation is often a key consideration in strategic initiatives that can range from mergers and acquisitions to raising capital. If your bank's stock isn't publicly traded, performing valuations internally can be a risky undertaking.

When should you seek a qualified, outside resource to perform your stock valuation? This QwickViews article offers some insights, along with an overview of what that process might entail.

Items typically requiring an independent stock valuation

It's best to engage an independent valuation expert to provide your bank's stock value when considering any of the following corporate actions.

- Stock offerings (Common, Convertible Preferred, Convertible Subordinated Debentures)
- Stock warrants included in an offering
- Stock options, stock appreciation rights
- Acquisitions utilizing stock (buyers issuing stock; sellers taking stock)
- Employee Stock Ownership Plans (ESOPs)
- Employee Benefit Plans utilizing stock (i.e. 401(k) plans)
- Stock repurchase programs
- Shareholder reporting (i.e. IRA reporting)
- Dissenter rights (Buyout of Minority Shareholders, stockholder disputes, etc.)
- Estate and gift taxes

Defining value and the factors contributing to a bank's stock value

Fair market value is generally defined as the price at which a stock would change hands between a willing buyer and seller when neither is under pressure to make the transaction and both have a reasonable knowledge of the relevant facts. Fair market value and fair value, an accounting concept, are not the same thing. According to IRS Revenue Ruling 59-60 guidelines, the following factors should be considered when valuing the stock of a closely held company:

- The company's nature and history since inception
- Current economic conditions and industry outlook
- Market prices of similar companies' traded stocks
- The company's book value and financial condition
- Earnings, dividend capacity and intangible assets
- Stock sales and size of the block being valued

Stock Valuation *at a Glance:*

- Stock valuations are used for many strategic purposes
- Objective, independent valuations are critical when stock is not publicly traded
- Proper valuation includes consideration of financial, non-financial and franchise factors
- Specialized expertise is needed to determine accurate fair market value
- Banks acting without outside expertise could lead to an under- or over- valuation of their stock – with unintended results
- Valuation experts should be credentialed, comply with standards, and have industry knowledge

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Bank Valuation:
Why and How to Value Your Stock

In determining a bank's stock value further consideration is given to a combination of financial, non-financial and franchise factors including:

1. **Environmental factors** such as the overall economy and bank stock trading levels.
2. **Market factors** such as diversity in the local economy, demographics, market share and the competitive landscape.
3. **Bank-specific factors** including profitability, future earnings potential, asset quality, capital, and loan/deposit diversity and cost structure, as well as management quality and the customer base mix.

The levels of value and valuation approaches

Different levels of value, discounts and methodologies are often involved in stock valuations. Certain valuations may require a minority interest value (i.e. a trading value) while others may call for a controlling interest value (i.e. a sale of control value). There are three major valuation approaches, income, market, and asset. The income approach utilizes a bank's earnings to determine value. The market approach relies on a bank's value as reflected by the price at which its common stock trades or by comparison to market values of publicly traded banks. The asset approach concentrates on the value of a bank's assets and liabilities, either as stated or as adjusted for current market and economic. An experienced valuation analyst will correctly identify the proper level of value and most appropriate valuation approach to ensure proper valuation.

Common mistakes made by banks handling valuations internally

Banks that determine a stock value internally may face the risk of undervaluing or overvaluing their stocks. Undervaluation may result in too many shares issued in a merger or capital raise, increasing the potential dilution to existing shareholders. Overvaluation results in lower potential value appreciation leading to investor dissatisfaction. In the case of stock options, an improperly high valuation may result in management dissatisfaction and potential turnover. Overvaluation may also thwart attempts to raise capital, increasing the risk profile for the bank and its current shareholders.

What to look for in valuation services provider

Valuation service providers may include CPAs, investment banking firms and valuation firms. With so many options available, how do you select the right one? Here are some basic considerations:

- **Professional Credentials** – Your advisor should hold nationally recognized certifications and/or accreditations such as:
  - *ASA - Accredited Senior Appraiser, granted by the American Society of Appraisers*
  - *ABV – Accredited in Business Valuation, granted by the American Institute of Certified Public Accountants (AICPA)*
  - *CBA – Certified Business Appraiser, granted by the Institute of Business Appraisers*

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Review Webinar for more information

In January 2013, experts from Monroe Financial Partners gave a 60-minute presentation explaining valuation models and a sample valuation of a privately held bank's stock. To view this informative Webinar, go to http://www.qwickrate.com/replaybankwebinar. And to learn more about this QwickRate-recommended a dvisor, call Paula Johansen at 813.289.1154.

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- *CVA – Certified Valuation Analyst, granted by the National Association of Certified Valuation Analysts (NACVA)*
- *CFA – Chartered Financial Analyst, granted by the CFA Institute*

- **Objectivity** – Insist on independence and objectivity free from conflicts of interest.
- **Standards Compliance** – Adherence to professional and regulatory standards are a must.
  - Uniform Standards of Professional Appraisal Practice (USPAP) of the multidisciplinary Appraisal Foundation
  - AICPA Statement of Standards for Valuation Services (SSVS)
  - Business Valuation Standards of the American Society of Appraisers
- **Industry Knowledge** – Select a banking industry expert, not just a valuation expert.

About Monroe Financial Partners

Monroe Financial Partners, Inc. has more than 70 years of experience serving the capital, liquidity and investment needs of financial institutions. Monroe (formerly known as Monroe Securities, Inc.), is a boutique investment banking firm focused exclusively on community banks, including investment banking, market making and asset management. Monroe has been one of the nation's most active bank merger advisors, as well as very experienced in providing valuations, appraisals and fairness opinions. The firm's valuation experts hold specialized valuation credentials and strictly adhere to accepted valuation standards. Banks nationwide have relied on their strong advisory and valuation experience to produce reliable results for over two decades.

About *QwickRate*

QwickRate, an ICBA Preferred Service Provider, is the premier, non-brokered CD marketplace for institutional funding and investing. We provide more than 3,300 members with a cost-effective way to gain direct access to a nationwide CD market to help proactively manage their liquidity needs. QwickRate is one source of contingency funding that is always available to FDIC insured banks, which makes it an important component of your diversified funding strategy. For more information, visit www.qwickrate.com or call 800.285.8626.

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