

Publicly Traded Banks Hope for a Better Year in 2008



By Bill Sammon

For anyone running a publicly traded community bank, changing the calendar to 2008 will be a welcome exercise. By any measure, 2007 was a difficult year that saw prices fall and investors moving out of the sector. At press time, the NASDAQ bank index was off 17.9 percent for the year versus the S&P 500, up 4.6 percent.

In Table I below, you can see that banks of all sizes were not immune to the downturn. Leading the way on the downside were banks with total assets between \$1 billion and \$5 billion. Unfortunately for these banks, they not only were caught up in the overall sell off in the market, but are just large enough in many cases

that investors can borrow their stocks and sell them short.

The results for the publicly traded community banks helped explain the exodus of investment dollars away from the sector. Credit quality deterioration and net interest margin pressure led to a large number of companies missing earning expectations, and it put further pressure on multiples.

The majority of the credit issues were related to weakness in residential development portfolios. Management teams identified relationships that were either substantially impacted by the current state of the housing market or beginning to show signs of strain. This has led to concerns by many investors that high levels of provisions will be prevalent over the foreseeable future and as credit costs rise and underwriting standards tighten, loan growth will continue to slow.

Net interest margins (Table 2, page 77) showed declines due to the current shape of the yield curve, competitive deposit pricing, challenges with funding loan growth and the cost of carrying higher non-performing assets. Returns on equity (ROE) and returns on assets also were under pressure. These matrices are critical in how investors view the banking space, and with an industry now showing less than a 10 percent ROE, it remains difficult to grab investors' attention.

A bigger concern for multiples is the decline in core earnings per

Table 1

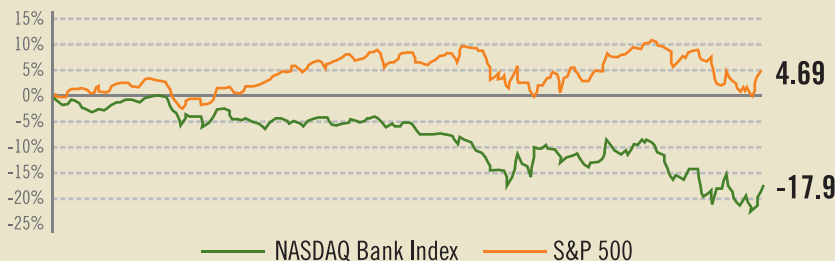
YTD Relative Index Performance

PERFORMANCE STATISTICS

Price Appreciation	YTD 2007 ⁽¹⁾
NASDAQ Bank Index	(17.9%)
S&P 500 Index	(4.6%)
SNL Bank Indexes	
Assets > \$10B	(18.5%)
Assets of \$5B - \$10B	(17.9%)
Assets of \$1B - \$5B	(25.4%)
Assets of \$500M - \$1B	(17.5%)
Assets < \$500M	(17.6%)

⁽¹⁾YTD period as of 11/30/2007

YTD* RELATIVE INDEX PERFORMANCE



Source: SNL Financial

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Jack Henry & Associates	7	www.jackhenry.com
LendingTools.com	17	www.lendingtools.com
Microfinance International Corp.	65	www.ariasfs.com
ProfitStars - A Jack Henry Co.	19	www.profitstars.com
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Risk Management Group	45	www.yourauditors.com
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Taylor Bean & Whitaker	12	www.taylorbean.com
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share growth. With 2007 showing negative numbers, convincing investors to pay double digit (price/earnings) multiples will be difficult. From a valuation standpoint, these factors have led to a market trapped between two styles of investing. The growth buyers that have fueled the run up in valuations over the past seven years have walked away, but the market hasn't corrected enough in most cases to intrigue the value investors.

We have seen a rise in the level of shareholder activity by outside investors and other bank holding companies, which often happens when markets are under pressure. As the market for mergers and acquisitions remains strong, many investors are asking companies whose fundamentals are under pressure to explore their options. We are also aware of more unsolicited bids for companies by other bank holding companies.

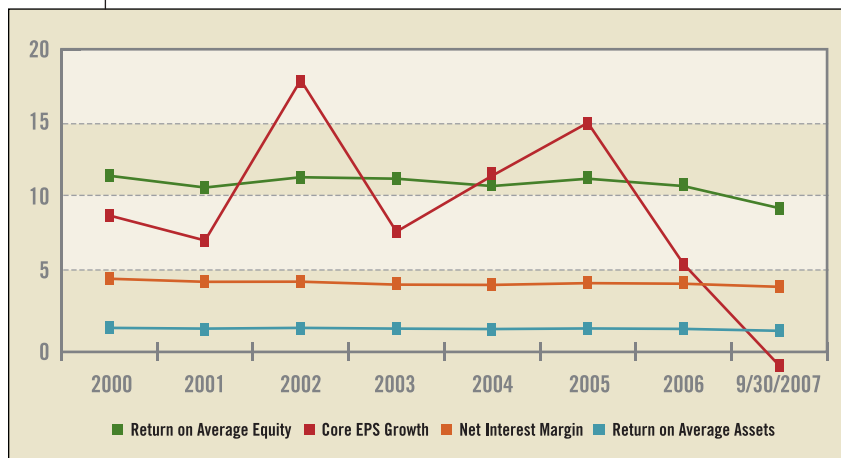
When stocks are down, these banks know it is difficult for a board to not take a serious look at any reasonable offer.

What Will 2008 Bring?

The biggest buyer of community banks stocks last year was community banks (Table 3). Many bankers look at the downturn in their stock as an opportunity to use excess capital to reinvest in their own company. Repurchase activity executed at these valuations can lead to stronger ROE and higher earnings per share growth. It also sends a strong signal to the market that the company believes the market is affording it a unique opportunity to buy.

The one concern when looking at buybacks is the difficulty

Table 2 **Public Bank Fundamental Performance**



Source: SNL Financial

banks that have strong fundamental performance.

This year could also turn out to be the tale of the haves and the have-nots. In contrast to the overall downturn for bank stocks in 2007, any movement on the upside in 2008 is likely to be very selective. Investors coming back to the space will look for talented management teams, healthy capital positions, good revenue diversification and a competitive advantage through product and service differentiation. The biggest theme from last year will still be the one to watch in 2008—credit quality. Until community banks on the whole can demonstrate that provisioning has slowed or will return to more normalized levels, investors will stay away.

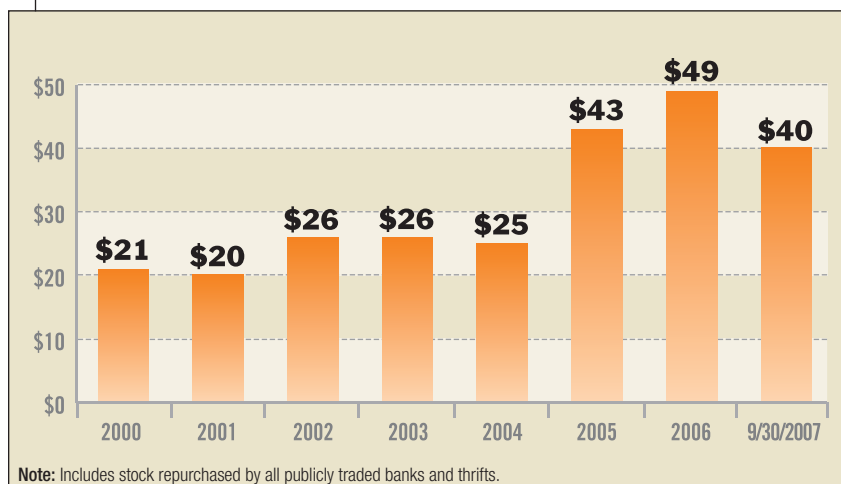
If you and your board feel the market is unfairly valuing your stock, 2008 brings a great opportunity to get out and tell your story. Even in difficult markets, investors are always looking for inefficiencies. Communicating to your

current shareholder base about the state of your bank or finding new investors is time well spent. It may also allow you to take advantage of other opportunities that might come your way throughout the year.

Good riddance 2007. May 2008 be much, much better. **ib**

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Table 3 **Total Dollar Amount of Common Stock Repurchased**



Note: Includes stock repurchased by all publicly traded banks and thrifts.

Source: SNL Financial

in accessing capital given the current environment. Trust preferreds have become more expensive due to the credit crunch and less readily available to community banks. If companies can't find sources for cash to repurchase their stock, this volume may slow. I expect banks will continue to be opportunistic when buying back stock until the investing public assigns valuations where the impact of repurchasing to fundamentals is no longer compelling.

Valuations in the merger and acquisition space remained strong through 2007 with median price to tangible book on deals done around 225 percent and price-to-earnings multiples at 24 percent. Investors continue to watch this activity closely for any indication these multiples are under pressure. If 2008 sees declines in deal pricing, companies that have remained on the sidelines, not willing to pay high multiples for acquisitions may be presented with opportunities, in the new year, especially those