Potential Shareholders Among Today's Institutional Investors

By Bill Sammon

All of us have seen proxy fights or read about activist investors making trouble or demanding changes at a bank. These stories catch headlines, but they also create an environment where all "institutional" investors are painted with the same brush.

The portfolios of today's institutional investors represent a wide range. They range from mutual funds that once dominated the world, and which most people think of as institutional money, to hedge funds created specifically to invest in community banks. They also include large pension funds that invest in the sector as well as index funds—passively managed funds that try to mirror the performance of a specific index—that own community bank stocks.

For non-SEC reporting companies, many private equity funds have been formed over the past few years to provide capital and bridge the gap until a company is ready to go public or sell. This only scratches the surface of potential institutional money. The chart below brings into focus the reason why all of these investors remain interested in the community bank sector.

Motivating Interest

Many community banks have a strong base of local shareholders who, for the most part, view their investment in the bank with an emotional lens; meaning, they don't focus on the price-to-book, price-to-earnings or return-on-equity every quarter. These shareholders own a piece of the local bank because the bank is important to their community and they want everyone to know them when they walk into the lobby.

Investing for institutions, conversely, is not emotional (although I have seen portfolio

Performance Statistics

Price Appreciation	2006	2005	2004	2003	5-Year Average
NASDAQ Bank Index	11.0%	4.3%	11.0%	29.9%	10.4%
S&P 500 Index	13.6%	3.0%	9.0%	26.4%	0.6%
SNL Indexes					
Assets > $10B	13.3%	1.9%	7.6%	30.4%	4.1%
Assets of $5B-$10B	5.4%	5.4%	14.5%	34.9%	10.6%
Assets of $1B-$5B	13.3%	3.7%	20.9%	32.9%	16.6%
Assets of $500M-$1B	11.5%	1.8%	10.9%	41.2%	21.0%
Assets of < $500M	3.4%	4.5%	13.1%	43.7%	24.4%

Source: Howe Barnes

The key to having a good relationship with institutional investors is finding and attracting investors whose investment philosophy matches the strategic plan and vision of the bank.

managers root for companies they really like); rather, it is about returns to their investors. These motivations are not too different from those of boards of directors at publicly traded companies. It is a board's fiduciary duty to do what is in the best interests of all shareholders and focus on creating shareholder value. The key to having a good relationship with institutional investors is finding and attracting investors whose investment philosophy matches the strategic plan and vision of the bank.

Just like there are many different kinds of institutional investors, there are also many different styles of institutional investing. Going beyond the value, growth and income sectors, there are investors that take a very long-term approach to investing and those who move in and out of a stock in a day.

Why You Want Them

There are a number of reasons why a management team might want institutional investors to have a strong interest in their bank:

- First, these investors typically buy in large quantities. This can help stabilize the price of a stock. Even better, as an institutional investor buys, the stock price usually moves higher.

- Second, where institutions invest their money is not lost on the rest of the investing public. Strong backing by institutions lends credibility to a bank and may lead other investors, both large and small, to look at the story.

- Third, the institutional market's familiarity with a bank's management and vision allows for future, successful access to the capital markets. Any bank that has gone through an initial public offering can tell you they spent a lot of time on the road explaining their story to these same institutions. Companies that have already built that bridge can access the market in a more efficient and cost-effective way.

- Lastly, portfolio managers are, by and large, very intelligent people who understand the market values and can be a resource to management teams for good ideas.

How to Attract Them

Attracting any investor always starts with performance. Companies that perform at a high level always get more looks than lower-performing banks. Publicly traded companies that are poor performers might attract institutional interest for reasons they don't want. Poor performers typically trade at a discount to the market and may be viewed as a take out target.

It is always preferable to approach any investor from a position of strength and convince him or her (or it) of the merits of holding the stock over the long term.

The way a management team projects itself to the outside world is also critical in attracting the *right* investor. Companies, that have defined strategic plans or visions for their company and, more importantly, that have successfully promoted that vision to the street, have a better shot at attracting the right type of investor. If your company is more comfortable making decisions that will benefit the corporation long term but could dampen short-term earnings, it is best to communicate that clearly and dissuade investors who are looking for very short-term results. Problems typically arise when investors are promised one thing and then get something distinctly different.

Analyst coverage is another good way to receive more interest from institutions. Many portfolio managers rely on sell-side research to find new ideas. Getting analyst coverage can be difficult for smaller community banks, which are often overlooked because of illiquidity in their stock. It is important to find a firm that values your company and that is interested in getting your company's story told. Having the firm not only write stand-alone research but take you on the road is a big step in getting that introduction to the institutional world.

Best Foot Forward

Some banks are lucky enough to have both portfolio managers and brokers knocking on their door.

Just like there are many different kinds of institutional investors, there are also many different styles of institutional investing.

For those banks that aren't so lucky, it is important to be proactive when marketing the attractiveness of the bank as an investment. Identify analysts that follow the sector and call them directly. Explain that you are interested in coming to visit them and tell them your story.

Also, seize opportunities to tell the story in large groups at conferences or investor forums. This work, while not part of the typical job description for a CEO, goes a long way toward building value for the organization.

Publicly traded companies cannot control who buys and sells their stock, but what can be controlled is the time management spends trying to attract institutional investors. If you are new to the public market, or have historically not had strong institutional sponsorship, a great place to start is by asking experienced CEOs or management teams for advice. Most will tell you that while it's demanding, cultivating strong ties to the right institutional investors can pay significant dividends over the long term. ib

Bill Sammon is the director of Capital Markets for ICBA Securities, ICBA's institutional broker-dealer in Memphis. Reach him at bsammon@icbasecurities.com or (800) 880-4693.