

August 25, 2008

Why Don't They Love Us Anymore?

For old banks, new banks, big banks, and small banks, the story is the same - investors seem to have lost interest for the time being; and we can only hope it is just for the time being. With few exceptions, investors are unwilling to pay much more than book value for bank stocks and many banks are selling for far less.

This disappointing investor attitude is quite evident when looking at the stock prices of new banks. Regardless of when your new bank opened, in 2007 or in the early 1990's, if your bank has a stock that trades, your stock price is probably stuck at around 100% of book value. To illustrate, we took all the new banks in this report with a traded stock and arrayed them into four groups based on the year that they opened.

Year Opened and Stock Pricing Medians

<u>Year Opened</u>	Number of New Banks That <u>Trade</u>	Median			
		<u>Price/ Earnings</u>	<u>Price/ Tang. Book</u>	<u>Avg. Daily Volume</u>	<u>ROE</u>
2006 to 2008	12	-	98%	487	(5.18)%
2001 to 2005	37	23.9X	96	469	(0.04)
1996 to 2000	67	15.2	98	1,767	6.06
1990 to 1995	<u>12</u>	13.1	<u>101</u>	1,666	7.38
Total/median	128		97%		
ROE above 10%	9	11.6	123%	450	11.90%

Source: SNL Financial, Charlottesville, Virginia.

Regardless of when a bank started, the result in terms of pricing was remarkable in its uniformity and for the little credit investors gave to those with actual earnings. For banks that opened in 2006-2008, 2001-2005 or 1996-2000, the median price as a percent of tangible book is 96% to 98%. This is despite the fact that the oldest of these three groups, the 67 banks that started in 1996-2000, produced a median return on equity of 6%. A fourth group of even "older" new banks, comprised of the 12 banks that opened in 1990-1995, had a median valuation of only 101% of tangible book, even with a median return on equity of 7.38%.

However, if focusing only on the “star” performers – there were nine new banks with returns on equity of more than 10% – investors take a slightly more positive view. More positive, though, was only 123% of book and 11.6 times real earnings. Also, consider that only nine out of the 128 new banks with a tradable stock had returns on equity of more than 10% - as a group, this is not inspiring.

Bank stock pricing in the future should be better, but how much better and when this “future” will actually arrive are open questions. In terms of how much better, it is likely that going forward only those banks with a good return on equity will also trade at good multiples of earnings and book. The days of having a stock price above 200% of book and getting a sale price of 250% to 300% of book may be gone forever except in unique situations. Thus, good investor returns will have to be produced the old-fashioned way. As to when bank pricing improves, this is a harder question, but it should begin before the economy truly recovers.

As to what is the “old-fashioned way,” it is a return on equity in the 12% to 16% range that either produces good annual dividends and/or adds significantly to book value per share. At 12 times earnings, this will create investment values in the 145% to 190% of book range.

Creating these earnings will be difficult. Only a few new banks, as mentioned earlier, have managed to achieve returns on equity in excess of 10%. Most are stuck with lower than anticipated deposit and loan growth, lower than expected margins and an overhead structure which anticipated neither. So, at the moment, it is not that hard to understand “Why don’t they love us anymore?”

Sincerely,

A handwritten signature in blue ink that reads "Dave Danielson". The signature is written in a cursive, flowing style.

David G. Danielson
President
Danielson Associates, LLC