

Bank Watch



December 2014

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Bank Watch

Second Fairness Opinions

Following a series of large bank acquisitions in the late 1990s that did not live up to expectations, one institutional investor was quoted over a decade ago as saying fairness opinions were not worth the three dollar stationery they are written on. The portfolio manager was expressing disappointment with a bank that was in his fund that had announced a large transaction. Institutional investors are sophisticated investors. For those that do not like a major corporate decision, the “Wall Street Rule” can be exercised: sell the position.

Boards of directors on the other hand rely upon fairness opinions as one element of a decision process that creates a safe harbor related to significant decisions. Fairness opinions are issued by a financial advisor at the request of a board that is contemplating a significant corporate event such as selling, acquiring, going private, raising dilutive capital, and/or repurchasing a large block of shares. Under U.S. case law, the concept of the “business judgment rule” presumes directors will make informed decisions that reflect good faith, care and loyalty to shareholders. Directors are to make informed decisions that are in the best interest of shareholders. Boards that obtain fairness opinions are doing so as part of their broader mandate to make an informed decision.

The fairness opinion states that a transaction is fair from a financial point of view of the subject company’s shareholders. The opinion does not express a view about where a security may trade in the future; nor does it offer a view as to why a board elected to take a certain action. **Valuation is at the heart of a fairness opinion, though valuation typically is a range concept that may (or may not) encompass the contemplated transaction value.**

In addition, process can be an important factor in assessing fairness. This is especially true when a company is contemplating selling. Our lay-person view of case law is that boards have some flexibility around marketing a company when entering into a merger that is structured as a stock swap because shareholders will swap common shares; however, **when the predominant consideration to be received is cash there is a presumption that an auction was conducted to obtain the best value.** Other factors that may be considered include financial interests of insiders, the ability of an acquirer to obtain financing to close, the investment attributes of the buyer’s shares after giving effect to the merger for such factors as relative valuation compared to peers, dividend paying capacity, trading volume, and dilution or accretion to earnings per share and book value per share.

Fairness opinions are typically issued by investment bankers who arranged a transaction; however, because most of their fee is contingent upon the successful closing of a transaction, the lead banker's opinion has always had some taint even if the consensus is that a transaction is a good deal. In 2007, the Financial Industry Regulatory Authority ("FINRA") issued Rule 2290, which requires the issuer of a fairness opinion to disclose such conflicts.

It is probably not a coincidence that transparency that is promulgated by Rule 2290 has led to more litigation. *The New York Times* noted on March 8, 2013, that "once you've announced a deal, you are likely to get sued." Academics Matt Cain of the University of Notre Dame and Steven Davidoff of Ohio State University published research in February 2013, that 59% of all takeovers announced during 2005-2012, over \$100 million with an offer price of at least \$5 per share, involved litigation.

Pre-crisis, approximately 40% of the announced mergers entailed litigation; since 2008 the litigation rate has exceeded 84% each year. The average complaints per transaction were five, and 50% involved multi-jurisdictions. The median attorney fees to settle when disclosed were \$595 thousand in 2012, which was within the \$528 thousand to \$638 thousand median band since 2006. "Disclosure-only" settlements (i.e., adding disclosures about the transaction to the proxy statement) accounted for 88% of the settlements in 2012 vs. 12% for settlements that increased the consideration or reduced the termination fee. In 2005 and 2006, "disclosure-only" settlements were only 64% and 58%, respectively.

The current poster-child for financial advisor conflict is a March 7, 2014, opinion by Vice Chancellor Travis Laster of the Delaware Court of Chancery regarding the acquisition of Rural/Metro Corporation by an affiliate of Warburg Pincus LLC on June 30, 2011, for \$17.25 per share in cash. The Court's decision walks through a minefield of a poorly structured sales process, a skewed valuation, inadequate oversight of the fairness opinion process, and advisor and director conflicts.

Although the acquisition price represented a 37% premium, the Court found that RBC Capital Markets as financial advisor to Rural/Metro allowed its interest in pursuing (unsuccessful) financing roles to the buyer of Rural/Metro and a competitor that was on the block to negatively impact the sales process to the detriment of the shareholders. RBC stood to make upwards of \$55 million in financing fees, which were 11x its advisory fee. The board was not informed of the conflicts, and some members of the board were viewed as conflicted and disinterested.

Recent Bank Speech

Andy Gibbs Presents

"Bank Valuation: Financial Issues, Valuation Implications"

Andrew K. Gibbs, CFA, CPA/ABV, leader of Mercer Capital's Depository Institutions Team spoke at the 2014 AICPA Forensic & Valuation Services Conference in November 2014 on the topic of bank valuation.

With the banking industry facing new regulations and other pressures, this session focused on the current environment at banks and valuation techniques appropriate for rendering valuation opinions that are consistent with this environment.

Download the slides at <http://mer.cr/1EVqRRf>.

Articles of Interest

Jeff K. Davis, Featured in *BankDirector*

Jeff K. Davis, CFA, in the second quarter "Analyst Forum," shares with readers about one of his favorite bank stocks, Investbanc Shares Corp. View his comments at <http://mer.cr/1vHxC1Q>.

In the third quarter of *BankDirector*, Davis reflects on Investbanc Shares Corp.'s performance. Subsequent to publishing the update, Intervest agreed to be acquired by Bank of the Ozarks. View his comments at <http://mer.cr/1DhTvyH>.

In the fourth quarter publication, Davis provides insight on IPOs and Franklin Synergy Bank in Emily McCormick's article "Is It Time to Take the IPO Plunge?" The Franklin-based bank plans an IPO within the next year due to its high-growth trajectory. Davis remarks on the nature of the IPO market and why financial institutions pursue IPOs. He warns, however, that going public means increased costs, risks, and scrutiny for financial institutions.

Read the full article at <http://mer.cr/1GplnvY>.

Further, the valuation was found to be “belated and skewed” such that the valuation was pushed lower to conform to the proposed acquisition price. The directors settled before the trial for \$6.6 million, while secondary advisor Moelis & Company settled for \$5 million. In October, the Court found RBC Capital Markets liable for \$76 million in damages based upon his finding that the company’s value was \$21.42 per share.

In the case of Rural/Metro, the second fairness opinion from a financial advisor that was not conflicted did not negate the factors that resulted in the Court’s view that shareholder value was not maximized; rather, the Court focused on the how the conflicts and faulty board oversight harmed shareholders. That said the competing interests in Rural/Metro point to why corporate transactions increasingly include a second (or third) fairness opinion from a financial advisor that does not stand to benefit from a success fee or fee from arranging financing. Boards that recognize conflicts and which actively manage the transaction process may strengthen their position of having made an informed decision to thereby ensure their actions meet the standards of care, loyalty and good faith.

Mercer Capital is an independent valuation and financial advisory firm. We render hundreds of valuation opinions each year and are regularly engaged by boards to evaluate significant transactions. As part of our financial advisory practice, we regularly issue fairness opinions on behalf of boards that are involved in transactions that span a range of purposes, though M&A is the most common. If your firm is contemplating or has initiated a significant transaction, we would be glad to discuss the matter in confidence.



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What We’re Reading

BankDirector has a piece on key due diligence issues to consider on the deposit side in an M&A transaction in a piece titled “Don’t Forget to Consider Deposits in an Acquisition.”

<http://mer.cr/1D0GQ30>

Rebeca Romero-Rainey, CEO of Centinel Bank (Taos, NM) has some advice for “How Community Banks Can Get Millenials to Go Local.”

<http://mer.cr/1yJ6ZPN>

Naomi Snyder of *BankDirector* takes a look at recent trends in bank executive pay.

<http://mer.cr/1ucbexT>

Mercer Capital's Resources for Depository Institutions

The Financial Institutions Group of Mercer Capital works with hundreds of depository institutions and other financial institutions annually providing a broad range of specialized resources for the financial services industry.

Newest Webinar



Sponsored by SNL Financial
Presenters from Mercer Capital and
Sutherland Asbill & Brennan

An Introduction to Business Development Companies

In the hunt for yield, investors are increasingly setting their sights on business development companies (BDCs), which offer public equity investors access to portfolios of private equity investments. This webinar explored the features that have contributed to the growth in BDCs, underlying asset classes to which BDCs offer investors exposure, and highlighted the key performance metrics for evaluating BDCs. Our panel discussed relevant regulatory developments affecting BDCs, reviewed the portfolio valuation procedures and assumptions that influence quarterly profits, and explored the relative performance of key market benchmarks.

*View webinar on SNL Financial's site at <http://mer.cr/ZnauO7>
Complimentary Download of Slides at <http://mer.cr/1tuwzal>*

Webinars Available for Replay

An Overview of the Leveraged Lending Market and Bank Participation in the Market

There has been a flurry of media reports this year that regulators—especially the OCC—are intensifying scrutiny of leveraged lending. In this webinar we took a look at one of the fastest growing markets that has emerged post crisis.

*View webinar on SNL Financial's site
at <http://mer.cr/VRc9JV>*

Understanding Deal Considerations

Key issues that we see when banks combine as it relates to valuing and evaluating a combination are reviewed. This is particularly critical when the consideration consists of shares issued by a buyer (or senior merger partner) whose shares are either privately held or are thinly traded.

View replay at <http://mer.cr/bnkweb2>

Basel III Capital Rules Finally Final: What Does It Mean for Community Banks?

Finalized at last, the regulations provide direction for bank capital management decisions. This webinar, co-sponsored by Mercer Capital and Jones Day, reviews the final rules and assesses their impact on community banks.

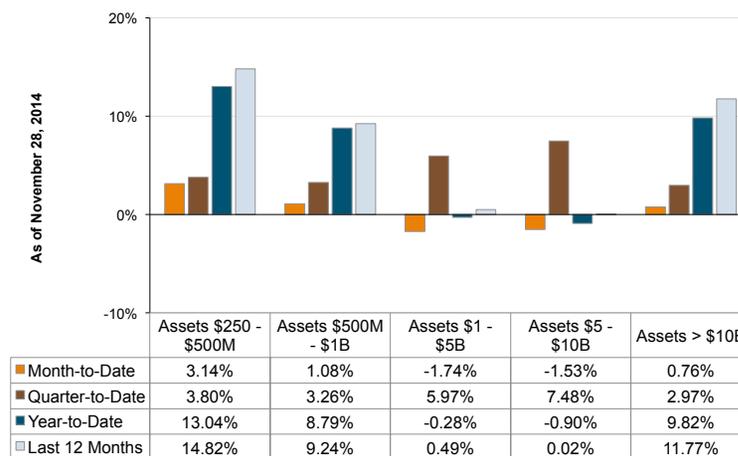
View replay at <http://mer.cr/capital-rules-webinar>

Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size

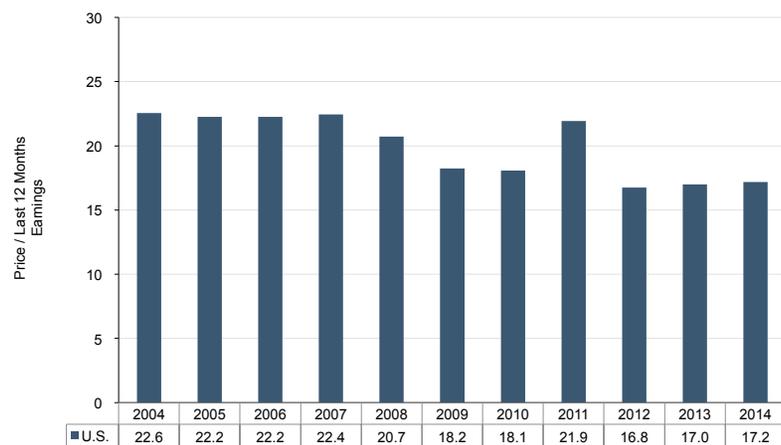


Median Valuation Multiples

Indices	Median Total Return				Median Valuation Multiples as of November 28, 2014					
	Month-to-Date	Quarter-to-Date	Year-to-Date	Last 12 Months	Price / LTM EPS	Price / 2014 (E) EPS	Price / 2015 (E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	-0.84%	7.47%	6.42%	6.55%	16.58	19.21	14.73	109.9%	127.0%	2.2%
Midwest Index	-1.47%	2.46%	3.87%	3.38%	13.94	13.52	12.55	112.8%	128.4%	2.1%
Northeast Index	-1.59%	5.75%	1.75%	2.31%	13.77	14.53	12.68	115.5%	124.6%	3.0%
Southeast Index	-0.84%	5.03%	6.75%	6.59%	12.98	13.31	13.04	113.5%	119.1%	1.6%
West Index	-2.54%	4.59%	4.49%	4.65%	15.80	16.06	13.81	117.9%	133.9%	1.9%
Community Bank Index	-1.49%	5.29%	3.27%	3.55%	14.72	15.30	13.54	115.0%	127.0%	2.2%
SNL Bank Index	0.60%	3.20%	9.06%	10.91%						

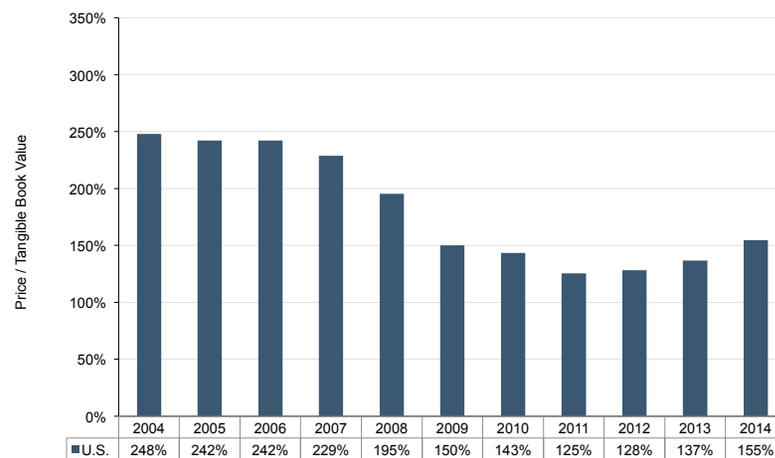
Median Price/Earnings Multiples

Target Banks' Assets <\$5B and LTM ROE >5%



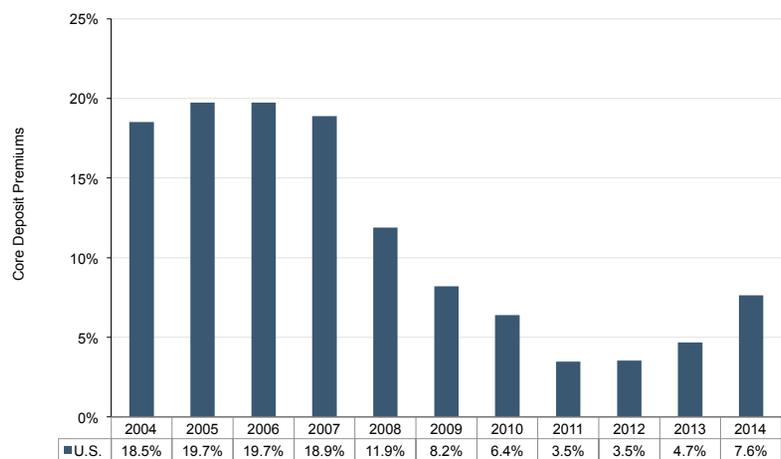
Median Price/Tangible Book Value Multiples

Target Banks' Assets <\$5B and LTM ROE >5%



Median Core Deposit Multiples

Target Banks' Assets <\$5B and LTM ROE >5%



Median Valuation Multiples for M&A Deals

Target Banks' Assets <\$5B and LTM ROE >5%, through November 2014

Regions	Price / LTM Earnings	Price / Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value	Target's Median Assets	Target's Median LTM ROE (%)
Atlantic Coast	19.90	1.64	9.2%	10	61.20	378,757	8.99%
Midwest	17.67	1.52	6.9%	53	46.39	117,155	8.93%
Northeast	17.33	1.87	11.2%	8	106.07	615,348	8.66%
Southeast	14.83	1.61	8.4%	28	74.37	214,315	9.62%
West	19.00	1.45	6.6%	16	59.83	410,128	8.07%
Nat'l Community Banks	17.17	1.55	7.6%	115	57.00	227,358	8.95%

Source: Per SNL Financial

Mercer Capital's Regional Public Bank Peer Reports

Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



Atlantic Coast



Midwest



Northeast



Southeast



West

Mercer Capital

Financial Institutions Services

Mercer Capital assists banks, thrifts, and credit unions with significant corporate valuation requirements, transactional advisory services, and other strategic decisions.

Mercer Capital pairs analytical rigor with industry knowledge to deliver unique insight into issues facing banks. These insights underpin the valuation analyses that are at the heart of Mercer Capital's services to depository institutions.

Mercer Capital is a thought-leader among valuation firms in the banking industry. In addition to scores of articles and books, *The ESOP Handbook for Banks* (2011), *Acquiring a Failed Bank* (2010), *The Bank Director's Valuation Handbook* (2009), and *Valuing Financial Institutions* (1992), Mercer Capital professionals speak at industry and educational conferences.

The Financial Institutions Group of Mercer Capital publishes *Bank Watch*, a monthly e-mail newsletter covering five U.S. regions. In addition, Jeff Davis, Managing Director, is a regular contributor to SNL Financial.

For more information about Mercer Capital, visit www.mercercapital.com.

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MERCER CAPITAL'S Industry Coverage

Mercer Capital's industry publications are featured below. Having built a substantial client base in various industries, we have formalized our research efforts to provide a regular, detailed overview of pertinent issues and relevant current events in each covered industry. These industry newsletters also offer a regular perspective on valuation issues pertinent to various industry groups and sectors.

Financial Institutions



Asset Management



Banks



Business Development Companies



FinTech



Insurance

Operating Companies



Agribusiness



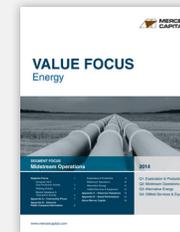
Animal Health



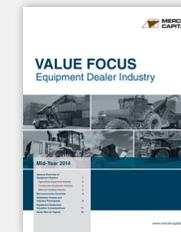
Auto Dealers



Convenience Stores



Energy



Equipment Dealers



Food & Beverage



Healthcare Facilities



Laboratory Services



Medical Device



Medical Technology



Professional Services



Real Estate

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