

APRIL 2019

# Bank Watch

ARTICLE

The Importance of Fairness Opinions in Transactions

## In This Issue

The Importance of Fairness Opinions in Transactions	1
Public Market Indicators	4
M&A Market Indicators	5
Regional Public Bank Peer Reports	6
About Mercer Capital	7

# The Importance of Fairness Opinions in Transactions

It has been 34 years since the Delaware Supreme Court ruled in the landmark case *Smith v. Van Gorkom*, (Trans Union), (488 A. 2d Del. 1985) and thereby made the issuance of fairness opinions de rigeur in M&A and other significant corporate transactions. The backstory of Trans Union is the board approved an LBO that was engineered by the CEO without hiring a financial advisor to vet a transaction that was presented to them without any supporting materials.

Why would the board approve a transaction without extensive review? Perhaps there were multiple reasons, but bad advice and price probably were driving factors. An attorney told the board they could be sued if they did not approve a transaction that provided a hefty premium (\$55 per share vs a trading range in the high \$30s).

Although the Delaware Supreme Court found that the board acted in good faith, they had been grossly negligent in approving the offer. The Court expanded the concept of the Business Judgment Rule to include the duty of care in addition to the duties to act in good faith and loyalty. The Trans Union board did not make an informed decision even though the takeover price was attractive. The process by which a board goes about reaching a decision can be just as important as the decision itself.

Directors are generally shielded from challenges to corporate actions the board approves under the Business Judgment Rule provided there is not a breach of one of the three duties; however, once any of the three duties is breached the burden of

proof shifts from the plaintiffs to the directors. In Trans Union the Court suggested had the board obtained a fairness opinion it would have been protected from liability for breach of the duty of care.

The suggestion was consequential. Fairness opinions are now issued in significant corporate transactions for virtually all public companies and many private companies and banks with minority shareholders that are considering a take-over, material acquisition, or other significant transaction.

## When to Get a Fairness Opinion

Although not as widely practiced, there has been a growing trend for fairness opinions to be issued by independent financial advisors who are hired to solely evaluate the transaction as opposed to the banker who is paid a success fee in addition to receiving a fee for issuing a fairness opinion.

While the following is not a complete list, consideration should be given to obtaining a fairness opinion if one or more of these situations are present:

- » There is only one offer for the bank and competing bids have not been solicited
- » Competing bids have been received that are different in price and structure (e.g., cash vs stock)

- » The shares to be received from the acquiring bank are not publicly traded and, therefore, the value ascribed to the shares is open to interpretation
- » Insiders negotiated the transaction or are proposing to acquire the bank
- » Shareholders face dilution from additional capital that will be provided by insiders
- » Varying offers are made to different classes of shareholders
- » There is concern that the shareholders fully understand that considerable efforts were expended to assure fairness to all parties

- » Financial performance and factors impacting earnings
- » Management's current year budget and multi-year forecast
- » Valuation analysis that considers multiple methods that provide the basis to develop a range of value to compare with the proposed transaction price
- » The investment characteristics of the shares to be received (or issued), including the pro-forma impact on the buyer's capital structure, regulatory capital ratios, earnings capacity, accretion/dilution to EPS, TBVPS, DPS
- » Address the source of funds for the buyer and any risk funding may not be available

## What's Included (and What's Not) in a Fairness Opinion

A fairness opinion involves a review of a transaction from a financial point of view that considers value (as a range concept) and the process the board followed. The financial advisor must look at pricing, terms, and consideration received in the context of the market for similar banks. The advisor then opines that the consideration to be received (sell-side) or paid (buy-side) is fair from a financial point of view of shareholders (particularly minority shareholders) provided the analysis leads to such a conclusion.

The fairness opinion is a short document, typically a letter. The supporting work behind the fairness opinion letter is substantial, however, and is presented in a separate fairness memorandum or equivalent document.

A well-developed fairness opinion will be based upon the following considerations that are expounded upon in an analysis that accompanies the opinion:

- » A review of the proposed transaction, including terms and price and the process the board followed to reach an agreement
- » The subject company's capital table/structure

### Recent Transactions

Mercer Capital rendered a fairness opinion to Sharonville, Ohio-based DCP Holding Company (the parent company of The Dental Care Plus Group), which announced on March 14, 2019, that it had entered into a definitive merger agreement with Boston-based DentaQuest, LLC. The transaction is expected to close during the second or third quarter of 2019.

[Learn More about our Transaction Advisory Services >](#)

**DentaQuest**™

**DentaQuest, LLC**

Boston, Massachusetts

has agreed to acquire

**The Dental Care PLUS GROUP**

**DCP Holding Company**

Sharonville, Ohio

Mercer Capital served as financial advisor and rendered a fairness opinion on behalf of DCP Holding Company.

– March 2019 –

It is important to note what a fairness opinion does not prescribe, including:

- » What the highest obtainable price may be
- » The advisability of the action the board is taking versus an alternative
- » Where a company's shares may trade in the future
- » How shareholders should vote a proxy
- » The reasonableness of compensation that may be paid to executives as a result of the transaction

Due diligence work is crucial to the development of the fairness opinion because there is no bright line test that consideration to be received or paid is fair or not. Mercer Capital has nearly four decades of experience in assessing bank (and non-bank) transactions and the issuance of fairness opinions. Please call if we can assist your board.



**Jeff K. Davis, CFA**

615.345.0350 | jeffdavis@mercercapital.com

## What We're Reading

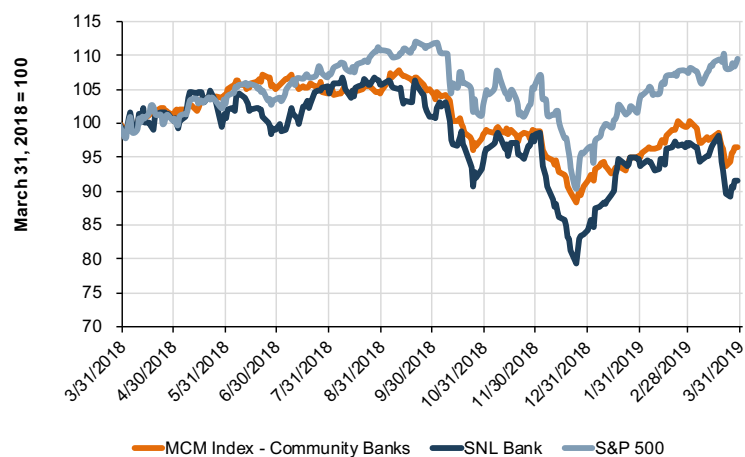
As investors wait for first quarter earnings releases, **bank stocks** are currently at the widest discount to the S&P 500 since the early 2000s amid concerns over the flattened yield curve and the current credit cycle.

*S&P Global Market Intelligence* **reviews the three community banks atop its list** of highest performing banks under \$3 billion in assets.

(subscription required)

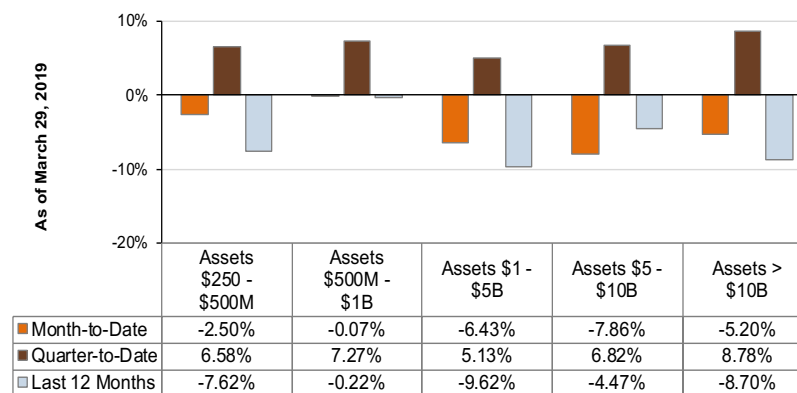
Given the focus on deposit bases in the current M&A market, *Bank Director* delves deeper into what to look for in **deposit-driven deals** when TBV payback periods and EPS accretion are not as useful.

Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size

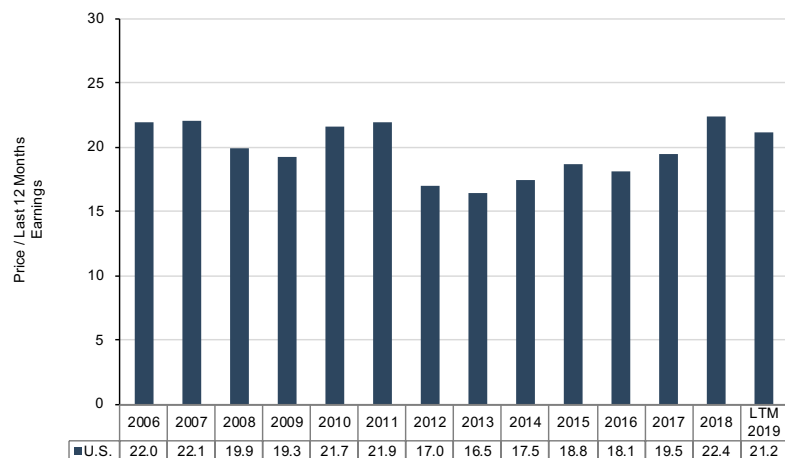


Median Valuation Multiples

Indices	Median Total Return as of March 29, 2019			Median Valuation Multiples as of March 29, 2019					
	Month-to-Date	Quarter-to-Date	Last 12 Months	Price/LTM EPS	Price / 2019 (E) EPS	Price / 2020 (E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	-4.1%	4.2%	-9.7%	13.1x	11.8x	11.1x	116%	130%	2.3%
Midwest Index	-3.6%	6.3%	-7.4%	12.7x	11.0x	10.3x	131%	151%	2.5%
Northeast Index	-1.6%	8.5%	7.4%	13.3x	12.1x	10.7x	126%	134%	2.6%
Southeast Index	-3.9%	3.0%	-7.2%	13.7x	11.7x	10.8x	124%	135%	1.7%
West Index	-3.0%	-1.5%	-12.9%	12.4x	11.9x	11.2x	122%	132%	2.0%
Community Bank Index	-3.2%	5.4%	-3.6%	13.1x	11.5x	10.7x	122%	135%	2.3%
<b>SNL Bank Index</b>	<b>-5.3%</b>	<b>8.6%</b>	<b>-8.5%</b>						

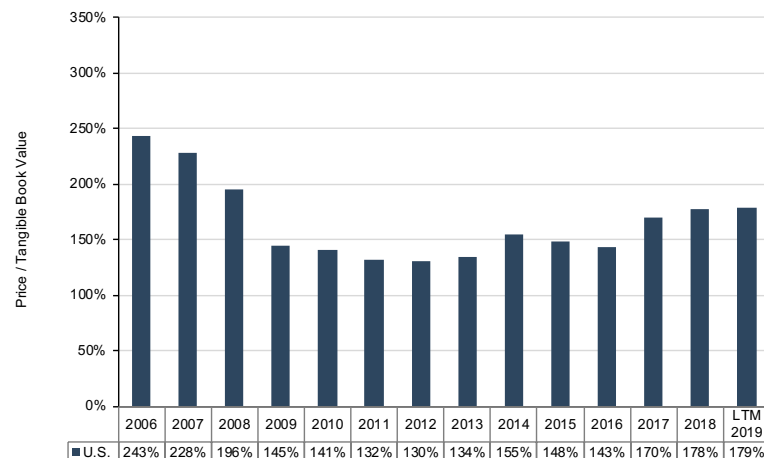
### Median Price/Earnings Multiples

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



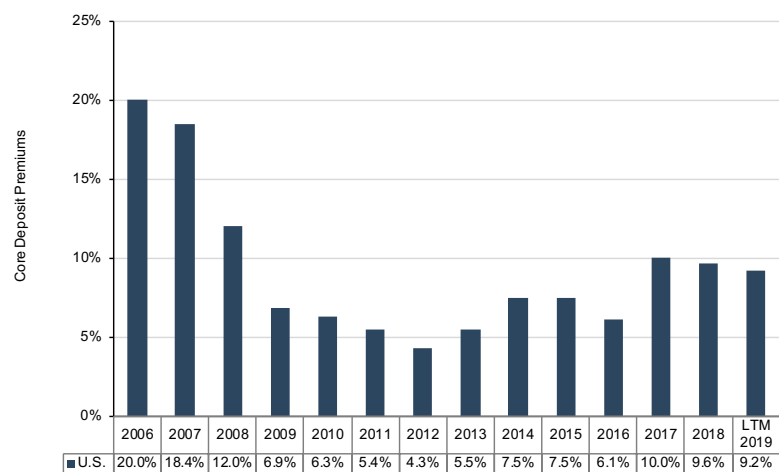
### Median Price/Tangible Book Value Multiples

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

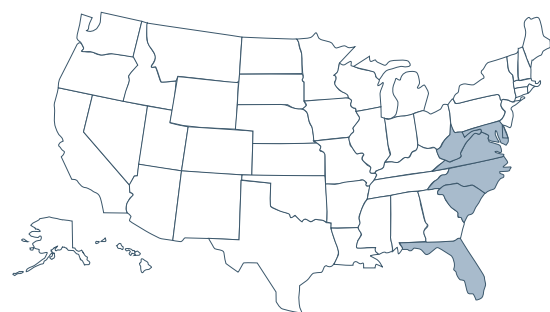
Target Banks' Assets <\$5B and LTM ROE >5%, 12 months ended March 2019

Regions	Price / LTM Earnings	Price/ Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value (\$M)	Target's Median Assets (\$000)	Target's Median LTM ROAE
Atlantic Coast	21.3x	178%	11.2%	14	98.1	375,818	11.0%
Midwest	19.1x	164%	7.4%	80	40.6	162,983	10.2%
Northeast	23.4x	189%	11.1%	12	67.2	491,588	7.6%
Southeast	21.2x	181%	9.7%	30	50.8	243,096	9.5%
West	24.3x	208%	10.9%	18	76.0	259,228	8.6%
<b>National Community Banks</b>	<b>21.2x</b>	<b>179%</b>	<b>9.2%</b>	<b>154</b>	<b>56.3</b>	<b>218,048</b>	<b>9.7%</b>

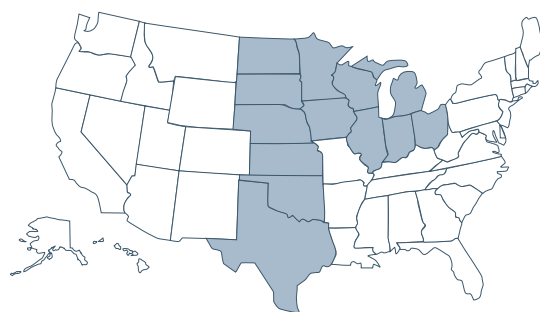
Source: S&P Global Market Intelligence

# Mercer Capital's Regional Public Bank Peer Reports

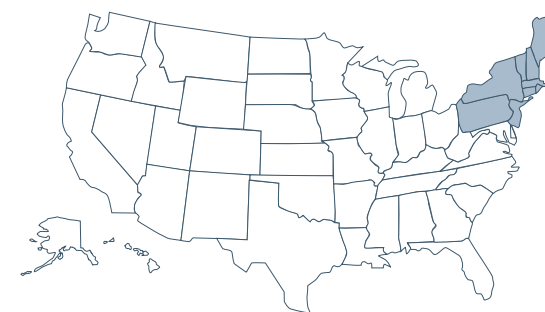
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



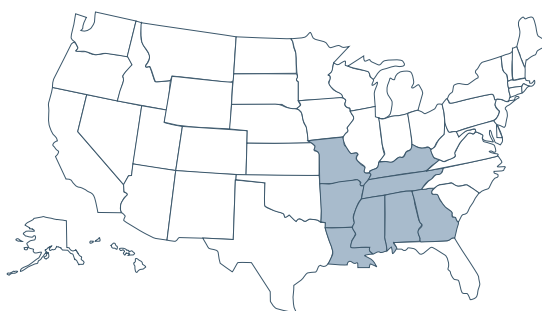
**Atlantic Coast**



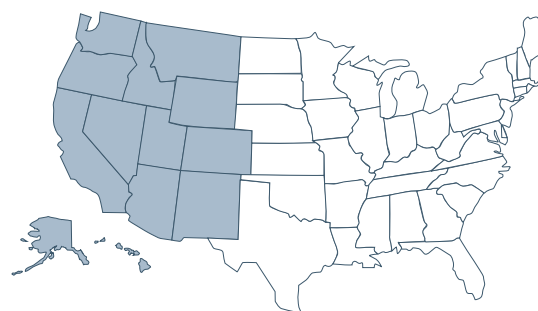
**Midwest**



**Northeast**



**Southeast**



**West**

MERCER CAPITAL

# Depository Institutions Services

Mercer Capital assists banks, thrifts, and credit unions with significant corporate valuation requirements, transaction 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.

- » Bank valuation
- » Financial reporting for banks
- » Goodwill impairment
- » Litigation support
- » Stress Testing
- » Loan portfolio valuation
- » Tax compliance
- » Transaction advisory
- » Strategic planning

## Depository Institutions Team



**Jeff K. Davis, CFA**  
615.345.0350  
jeffdavis@mercercapital.com



**Andrew K. Gibbs, CFA, CPA/ABV**  
901.322.9726  
gibbsa@mercercapital.com



**Jay D. Wilson, Jr., CFA, ASA, CBA**  
469.778.5860  
wilsonj@mercercapital.com



**Eden G. Stanton, CFA**  
901.270.7250  
stantone@mercercapital.com



**Mary Grace Arehart**  
901.322.9720  
arehartm@mercercapital.com



**Madeleine G. Davis**  
901.322.9715  
davism@mercercapital.com



**Brian F. Adams**  
901.322.9706  
adamsb@mercercapital.com



**William C. Tobermann**  
901.322.9707  
tobermannw@mercercapital.com

[www.mercercapital.com](http://www.mercercapital.com)





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