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BUSINESS VALUATION » INVESTMENT BANKING | No. 3 | Volume 19 » 2007

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5860 Ridgeway Ctr. Parkway
Suite 400
Memphis, TN 38120
Phone: 901.685.2120
Fax: 901.685.2199

LOUISVILLE OFFICE
511 South 5th Street
Suite 206
Louisville, KY 40202
Phone: 502.585.6340
Fax: 502.585.6345

www.mercercapital.com

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Valuing Independent Trust Companies Requires Special Attention

Excerpted from Mercer Capital's recently published whitepaper, "Understand the Value of Your Trust Company." For the full text, along with other whitepapers in the "Understand the Value of..." series, visit www.mercercapital.com

The rapid expansion of the financial services industry over the past two decades has given rise to a unique hybrid enterprise: the independent trust company. With roots in the departments of commercial banks, independent trust companies occupy an interesting space in the investment management community, positioned somewhere between a family office and an institutional asset manager. As a result, there really is no one-size-fits-all definition of an independent trust company, and recognition of the particular attributes of independent trust companies is significant to understanding their value.

As high net worth clients migrated from the traditional sales mentality investment approach of brokerage firms, the idea of independent investment advisors began to gain steam. The financial advisory business model transformed from cold calling staffs paid by transaction-based commissions to unbiased and credentialed professionals paid on the basis of assets under management by client bases built primarily on referrals. The popularity of Registered Investment Advisors, or RIAs, centered on the fiduciary responsibility associated with such practices, as well as the greater degree of accessibility and high touch nature of the business operations, which often originated in smaller family office operations. Additionally, the smaller size of independent advisors allowed for greater innovation and more specialized services.

The number of total investment advisors registered with the SEC expanded from 6,360 in 1999 to 8,614 in 2005 (excluding all investment advisors only required to register with their respective states). This number expanded by an additional 1,676 in 2006; however, much of this growth was largely attributable to SEC rule modifications requiring hedge fund managers to register as investment advisors. More than 90% of all RIAs reported less than 50 employees.

Assets managed by independent RIAs more than doubled from 2000 to 2006, while their share of investable assets expanded from 9.0% in 2003 to 14% in March of 2007. A comparison of the market share allocations of U.S. investable assets at year end 2003 and March 31, 2007 is shown in Figure One and Figure Two.

Total assets under management (AUM) reported by SEC-registered investment advisors reached an all-time high of $31.4 trillion as of April 2006.

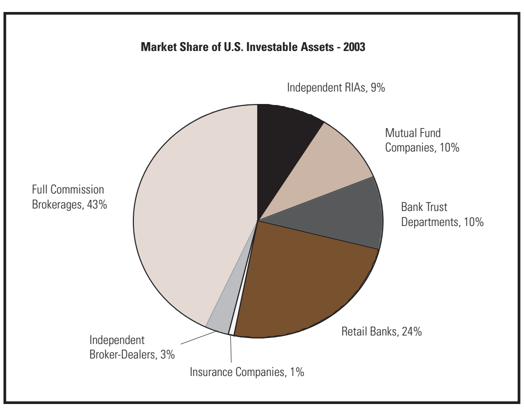


FIGURE ONE

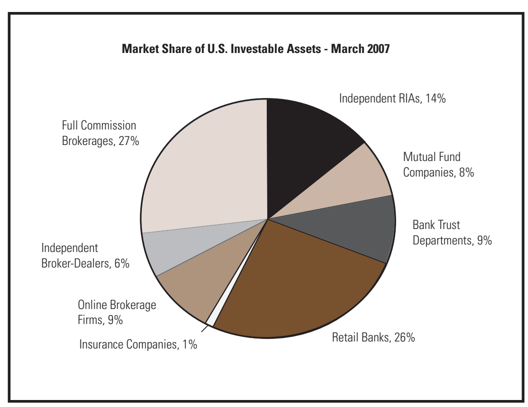


FIGURE TWO

Value Added™

Industry participants often consider the value of investment managers in general, and independent trust companies in particular, using broad-brush metrics referred to as "rules-of-thumb." Such measures cannot begin to address the facts and circumstances specific to a given enterprise.

DISCRETIONARY ASSETS *($ IN TRILLIONS)*			
Category of IA by Assets Under Management (AUM)	**2006 AUM**	**2005 AUM**	**% Change**
>$100 Billion	$12.927	$11.197	15.5%
$50-100 Billion	$4.092	$3.338	22.6%
$10-50 Billion	$6.535	$5.599	16.7%
$5-10 Billion	$1.503	$1.354	11.0%
$1-5 Billion	$2.309	$1.779	29.8%
$100 Million to 1 Billion	$1.110	$0.871	27.4%
$25-100 Million	$0.166	$0.138	20.3%
<$25 Million	$0.007	$0.007	0.0%
Total	**$28.649**	**$24.283**	**18.0%**

FIGURE THREE

Assets held in discretionary accounts grew 18% from $24.3 trillion in 2005 to $28.6 trillion in 2006. Figure Three illustrates the growth in discretionary assets reported by investment advisors in all AUM categories and total assets under management.

In spite of all the changes taking place in recent years, there remains some debate regarding whether the independent trust industry is mature or evolving. On the one hand, the concept of providing comprehensive wealth management within the context of highly personalized customer service is not new, but on the other, the level of sophistication expected across the spectrum of trust services has never been higher and, indeed, seems to be growing at a rapid pace.

RULES OF THUMB

There are both formal and informal approaches to value, and while we at Mercer Capital are obviously more attuned to the former, we do not ignore the latter. Industry participants often consider the value of investment managers in general, and independent trust companies in particular, using broad-brush metrics referred to as "rules-of-thumb." Such measures admittedly exist for a reason, but cannot begin to address the facts and circumstances specific to a given enterprise.

As an example of this, industry participants might consider asset managers as being worth some percentage of assets under management. At one time, investment manager valuations were thought to gravitate toward about 2% of assets under management.

Understanding why such "rules of thumb" exist is a good way to avoid putting too much faith in them. During periods of consolidation, buyers often believe that the customer base of an acquisition candidate can be integrated with the acquiring firm's existing managed assets to generate additional profits in line with industry expectations. So if the investment management industry is priced at, say, 15x earnings and profit margins are 20%, the resulting valuation multiple of revenue is 3.0x. If revenue is generated by fees priced at about 67 basis points of assets under management, then the implied valuation is about 2% of asset under management. Note, however, all the "ifs" required to make the 2% of AUM rule of thumb work. …

To read the complete article as well as the other articles in the "Understand the Value of…" series, visit mercercapital.com.

Kristin C. Beckman
beckmank@mercercapital.com

Matthew R. Crow, ASA, CFA
crowm@mercercapital.com

Mediation As an Alternative to Litigation

Will the number of cases appearing before probate judges increase dramatically in the next several years – specifically estate and trust disputes as well as fiduciary cases? The answer is "yes" according to Kenneth J. Peace, head of the litigation group at Braun Siler Kruzel, PC in Scottsdale, Arizona.

In an article titled "A Call to Mediate," (*Trusts & Estates*, July 2007), Mr. Peace makes this assertion based upon the aging of baby boomers, the rising number of millionaire households, a generation of children born from 1979 to 1994 labeled as the "Entitlement Generation," and a plethora of new litigators eager to profit from family disputes. Mr. Pease posits that the effect of this trend will be to overwhelm the court system, leading to even longer settlement times than currently seen and overburdened and possibly less attentive judges.

AN ALTERNATIVE TO LITIGATION

Litigation is often long, all-consuming, divisive, and potentially very expensive. Mr. Peace, through his article, suggests an alternative to the litigation process – mediation. Mediation offers family members an opportunity for conflict resolution without the negatives of the litigation process. It is a process in which a neutral third party acts as a facilitator to assist in dispute resolution. According to Ray D. Madoff, ("Mediating Probate Disputes: A Study of Court Sponsored Programs," *Real Property, Probate and Trust Journal*, Winter 2004) "Attorneys and judges operating within jurisdictions in which mediation of probate disputes regularly occurs are quite enthusiastic about it."

Mediation is not the same thing as arbitration. Arbitration involves submitting a dispute to one (sometimes more) impartial persons, who then render a final binding decision, often in the form of an "award" to one side or the other. In essence, the arbitrator takes on the role of the judge.

WHO CAN MEDIATE?

Mr. Peace states in his article that "It is important to select one or more mediator(s) with particular experience relevant to an issue that needs resolution, be it a lawyer, a certified public accountant, a financial or business planner, etc." It is important to note that because this process occurs outside the legal arena, there is no designation that qualifies someone to participate in mediation. This allows the parties more flexibility to choose the most qualified person or firm for their specific dispute. In some states, however, courts have a mediation program for contested probate cases.

Disputes regarding estates and trusts commonly involve a business valuation element. In fact, quite often valuation is the point of disagreement. While there are professionals who serve exclusively as mediators, it might not be prudent to hire such a person if he or she has no relevant valuation knowledge or experience. Instead, a business valuation professional with a reputable firm, pertinent valuation experience, and experience in mediation is often far more qualified to bring the parties together.

MERCER CAPITAL AS MEDIATOR

Disputes well-suited for mediation are not limited to estate and trust cases. Mercer Capital recently served in a mediation capacity for a privately held firm who had proposed the repurchase of shares from certain outside shareholders. The firm hired two business appraisers to perform an analysis to ensure the fairness of a proposed transaction. Mercer Capital reviewed the two business valuation reports, and because the values were greater than a predetermined percentage apart, Mercer Capital worked with the business appraisers on both sides to reconcile value.

While no legal experience is necessary to act as a mediator, it is certainly beneficial to have some familiarity with the legal system. Mercer Capital has been providing various litigation support services to attorneys for over 20 years and has been involved in more than one hundred cases.

CONCLUSION

Mediation can be the best alternative for certain disputes. If you are involved in a dispute that is possibly headed to probate court, consider mediation as an alternative to the litigation process. Specifically, if the dispute involves valuation issues, you may want to consider contacting a business valuation expert directly to serve as a mediator. The decision to do so could save precious time, money, and valued relationships.

Mercer Capital has served as a mediator in several previous engagements and would be happy to answer any questions you may have about the mediation process or other valuation services that may be beneficial to a business owner or shareholder involved in a legal dispute. If Mercer Capital can help, give us a call at at 800.769.0967.

Laura J. Hoffmeister
hoffmeisterl@mercercapital.com

Mediation offers family members an opportunity for conflict resolution without the negatives of the litigation process.

TRANSACTION ADVISORY FOCUS

Empirical Evidence Confirming the Importance of a Transaction Advisor

Our analysis revealed that the pricing multiples received by those sellers who retained a transaction advisor were significantly higher than those who took the For Sale By Owner (FSBO) approach, selling their business without hiring a transaction advisor.

A recent study conducted by Mercer Capital found empirical evidence supporting the retention of a financial advisor when selling your business. In this study, the pricing multiples received by those sellers who retained a transaction advisor were compared to those who did not. Our analysis revealed that the pricing multiples received by those sellers who retained a transaction advisor were significantly higher than those who took the For Sale By Owner (FSBO) approach, selling their business without hiring a transaction advisor.

In conducting this analysis, we reviewed transaction data in the banking industry, which is one of the few industries where this type of analysis is possible, particularly for smaller private companies. Factors in the banking industry conducive to this type of analysis include:

» **Readily Available Financial Information**. The banking industry is highly regulated and generally has a large amount of financial information made publicly available. Comparative financial information is difficult to derive for most other industries, particularly for smaller private companies, as most private companies do not make a comparable level of financial disclosure available to the public.

» **Readily Available Transaction Pricing Information**. Pricing multiples are generally readily available and easily accessible to market participants in the banking industry. Transaction information (including whether or not the buyer or seller retained an advisor) was available for over 1,200 deals occurring since 2001. It would be difficult to find this level of detailed pricing information, particularly those involving smaller private companies, in any other industry.

If you own a company in another industry, you may be thinking that our findings do not apply to you. Yet, this analysis is critically important to business owners considering selling their business in any industry. The availability of information in the banking industry allows business owners to have a reasonable idea of the value of a particular banking franchise, and one would suppose that the need for a professional M&A intermediary would be mitigated by the increased knowledge of the parties involved in the transaction. The transaction data analyzed clearly indicates that transaction advisors play a very significant role in helping owners maximize the value received for their banks, despite the increased level of information available. Thus, one can assume that the importance of a transaction advisor would be magnified in transactions in other industries, particularly those industries where both parties have less access to information.

THE STUDY IN DETAIL

Our analysis began with an examination of all bank transactions occurring since 2001. Those sellers who retained a financial advisor were compared to those who did not.[1] In order to control for the difference in size among the acquired banks, our analysis focused on similarly sized financial institutions (with assets between $100 and $500 million).[2] It was found that those sellers who utilized a transaction advisor received substantially higher pricing multiples and were more likely to maximize the value received for their investment. As shown in Figure One, those banks sold with the assistance of a transaction advisor received a 20% higher price to earnings multiple and a 15% higher price to tangible book multiple.

It is interesting to note that those banks sold without retaining a transaction advisor were generally more profitable with a higher median return on average assets

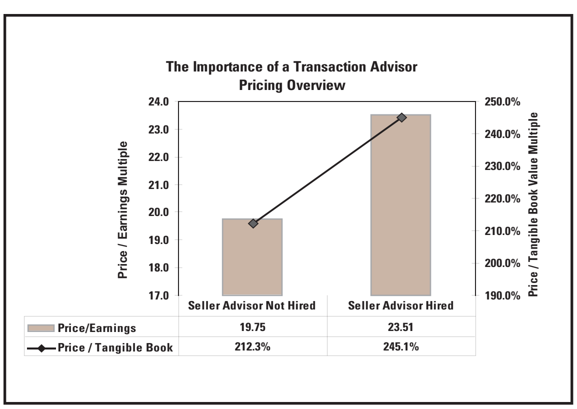


FIGURE ONE

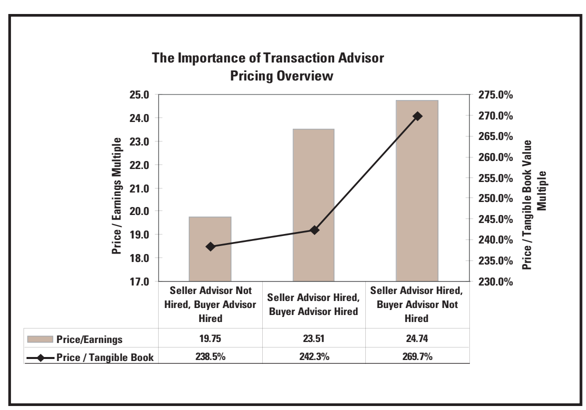


FIGURE TWO

(ROA) and return on average equity (ROE). Typically, a bank's return on equity is directly related to the price to book value measure, but the data indicates that the more profitable banks that elected not to retain a transaction advisor received lower price/tangible book value multiples relative to their less profitable counterparts who sold with the help of a transaction advisor.

One explanation for this trend is that business owners and managers do not often seriously consider selling their business until they are approached by an acquirer. Highly profitable, well-run institutions are more likely to be approached by an acquirer. Yet, the first offer is generally not the best offer available, but rather a starting point for negotiations. The retention of a seasoned professional can serve to attract multiple potential acquirers and develop a competitive bidding situation, which will result in a higher price and allow the seller to determine the true market value of their businesses.

The importance of a transaction advisor is even more pronounced when the seller enters into negotiations without a transaction advisor and the buyer has engaged an advisor or has in-house M&A staff. As shown in Figure Two, the retention of a transaction advisor in these situations improved the pricing received by the seller and even put the seller at a distinct advantage over the buyer when the seller engaged a transaction advisor and the buyer did not.

REAL-WORLD EXAMPLE

To better illustrate the benefits of hiring a transaction advisor, consider the following real-world example. XYZ Bank is considering selling and has the following financial information: total assets of $250 million, earnings of $2 million, and equity of $20 million. XYZ Bank must choose between two different scenarios: one in which they hire a transaction advisor, and another in which they elect not to hire a transaction advisor. Based on the median pricing multiples derived from our study, the bank's net proceeds would be $7 to $8 million higher (after deducting the estimated costs of hiring the transaction advisor) if they retain a transaction advisor.

The Importance of a Transaction Advisor - Real World Example

	Advisor Hired	No Advisor Hired
Bank's Earnings	$2,000,000	$2,000,000
x Median Multiple	23.51	19.75
Deal Value	$47,020,000	$39,500,000
x (1 - Investment Banking Fee)*	0.99	na
Total Net Proceeds	$46,549,800	$39,500,000
	$ Difference: $7,049,800	**% Difference: 17.8%**
	Advisor Hired	No Advisor Hired
Bank's Tangible Book Value	$20,000,000	$20,000,000
x Median Multiple	2.45	2.04
Deal Value	$49,018,000	$40,722,000
x (1 - Investment Banking Fee)*	0.99	na
Total Net Proceeds	$48,527,820	$40,722,000
	$ Difference: $7,805,820	**% Difference: 19.2%**

*The investment banking fee is assumed to be 1% of the total deal value, which is the median transaction advisory fees (as a percentage of deal value) paid by sellers in a prior analysis of bank transactions conducted by Mercer Capital.

CONCLUSION

It is tempting to think that no one knows your business better than you and so no one can sell your business better than you. This thought is only half true. It is true that no one knows your business better than you, but transaction advisors know transactions like you know your business. A transaction advisor can be the difference between getting the price you were offered and the price you want.

Additionally, selling a business takes a great deal of time and energy, which can detract from your ability to effectively run your business. A transaction advisor will allow you to focus on running your business while they focus on getting the maximum value for your business.

Remember our "real-world" example, and pick the right scenario by hiring a transaction advisor to facilitate your transaction. Mercer Capital is regularly engaged to act as advisors to business owners that are considering a sale. Please call us at 800.769.0967 if we can help.

Jay Wilson, Jr.

Jay D. Wilson, Jr.
wilsonj@mercercapital.com

1 *In order to conduct this analysis, we utilized transaction data for financial institutions as reported by SNL Financial. SNL Financial defines the seller advisor field as follows: "Indicates whether the Seller hired a third-party financial advisor. This may include advisory firms engaged from within a deal participant's corporate structure."*

2 *The analysis presented in the remainder of this article focuses on 443 similarly sized institutions with assets between $100 and $500 million in an attempt to derive more meaningful conclusions by controlling for other factors that might explain pricing differentials such as asset size of the target institution. While we focused on this particular asset size group, our overall analysis of over 1,200 bank transactions across all asset sizes occurring since 2001 had similar results.*

The retention of a seasoned professional can serve to attract multiple potential acquirers and develop a competitive bidding situation, which will result in a higher price and allow the seller to determine the true market value of their businesses.

The independence and thoroughness of the Mercer Capital professionals contributed to a final valuation opinion that increased auditor comfort with the Client's financial reporting.

FINANCIAL REPORTING VALUATION FOCUS

Case Study: International Goodwill Impairment

OVERVIEW

European auditors for a wholly-owned subsidiary of a publicly traded international medical equipment manufacturer expressed concerns related to goodwill impairment in the foreign subsidiary during the audit process. Mercer Capital was engaged to perform goodwill impairment testing under tight time restrictions of less than a week.

MERCER CAPITAL'S JOB

To deliver the valuation opinion prior to the deadline, Mercer:

- » Defined the engagement with the client with appropriate scope and timeliness in consideration of the circumstances surrounding the engagement;
- » Designed a reasonable due diligence process in consideration of the timeline;
- » Analyzed all available internal financial information;
- » Reviewed comparable public company data and prior Mercer valuation work for other subsidiaries of the Client;
- » Documented the research and analyses performed in completing the impairment test.

OUTCOME

The following objectives were met:

- » The valuation opinion was delivered prior to the Client's deadline;
- » The valuation opinion satisfied auditor concerns regarding the goodwill carrying value.

KEY POINTS

- » The professionalism and expertise of the Mercer Capital valuation specialists allowed the responsiveness to the Client's tight timeline;
- » Mercer Capital had the institutional flexibility to allocate appropriate resources to meet the Client's needs;
- » The independence and thoroughness of the Mercer Capital professionals contributed to a final valuation opinion that increased auditor comfort with the Client's financial reporting.

For more information about Mercer Capital's Financial Reporting Valuation Services, call Matt Crow or Travis Harms at 800.769.0967.

Mercer Capital Highlights

UPCOMING SPEECHES

October 9, 2007
"The One Percent Solution"
The McGehee Group Conference
Las Vegas, Nevada
Z. Christopher Mercer, ASA, CFA

October 17, 2007
"Corporate Buy-Sell Agreements"
7th Annual MNCPA BV Conference
Golden Valley, Minnesota
Matthew R. Crow, ASA, CFA

October 30, 2007
"Adjusting Multiples from Guideline Public Companies"
2007 ASA Annual BV Conference
San Diego, California
Timothy R. Lee, ASA

October 30, 2007
"The Market Approach vs. The Income Approach"
2007 ASA Annual BV Conference
San Diego, California
Matthew R. Crow, ASA, CFA
Travis W. Harms, CFA, CPA/ABV

November 20, 2007
"Buy-Sell Agreements"
FEI Chapter Meeting
Memphis, Tennessee
Z. Christopher Mercer, ASA, CFA

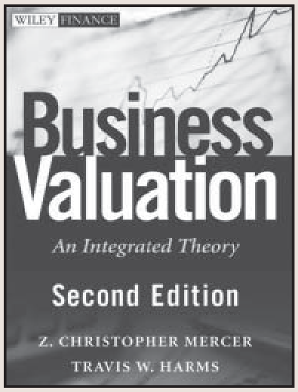
MERCER CAPITAL IN THE NEWS

Mercer Capital professionals achieved a 100% pass rate on Levels 1 and 2 of this year's Chartered Financial Analyst exams, which are sponsored by the CFA Institute.

Megan M. Bartels, Sujan Rajbhandary and **Laura D. Stanford** passed the Level 1 exam, while **Kristin C. Beckman, Brooks K. Hamner, Laura J. Hoffmeister**, and **B. Patrick Lynch** passed the Level 2 exam. In addition, **Lucas M. Parris** passed the Level 3 exam.

The CFA charter is a globally recognized standard of expertise in investment analysis and portfolio management.

MERCER CAPITAL'S THOUGHT LEADERSHIP



JUST RELEASED

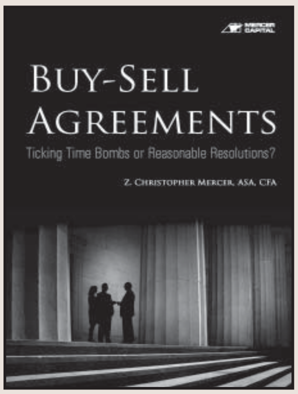
SALE PRICE

$71

Regularly $95
(Plus shipping)

Business Valuation: An Integrated Theory, Second Edition

Whether you are an accountant, auditor, financial planner, or attorney, *Business Valuation: An Integrated Theory, Second Edition* enables you to understand and correctly apply fundamental valuation concepts. Thoroughly revised and expanded, the Second Edition demystifies modern valuation theory, bringing together various valuation concepts to reveal a comprehensive picture of business valuation.



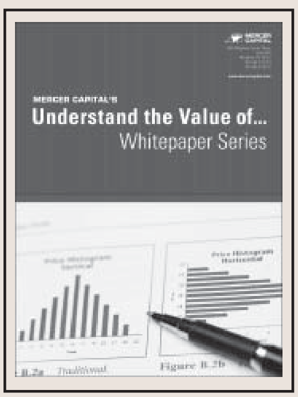
SALE PRICE

$59

Regularly $79
(Plus shipping)

Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?

Written for business owners, attorneys, CPAs, business appraisers, and other professional advisors to business, this book provides a roadmap for you (or your clients) to develop or improve your buy-sell agreement. The first book written from a valuation perspective which is important to note because business appraisers are usually consulted when there is a problem. Learn from our 25 years of experience working with well-constructed and terribly constructed buy-sell agreements (in almost every case no one realized there were problems until a trigger event occurred)!

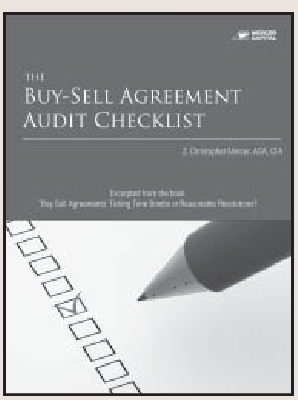


Complimentary

(Delivered electronically)

Whitepaper Series: "Understand the Value of…"

Written for business owners, each article in this series focuses on a particular industry, providing an overview of that industry and the issues that affect the value of businesses within the industry. Each article also reviews the basic concepts of value. Business owners should not miss this valuable resource.



$50

(Delivered electronically)

Buy-Sell Agreement Audit Checklist

Excerpted directly from the book, *Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?*, the *Buy-Sell Agreement Audit Checklist* is a 40-page working document for attorneys, CPAs, planners, and shareholders that addresses the many obvious, yet overlooked, valuation issues related to buy-sell agreements.

LEARN MORE ABOUT THESE AND OTHER TITLES AT WWW.MERCERCAPITAL.COM

MERCER CAPITAL
5860 Ridgeway Center Parkway, Suite 400
Memphis, Tennessee 38120

Value Added™

Valuing Independent Trust Companies Requires Special Attention

LITIGATION SUPPORT FOCUS: Mediation As an Alternative to Litigation

TRANSACTION ADVISORY FOCUS: Empirical Evidence Confirming the Importance of a Transaction Advisor

FINANCIAL REPORTING VALUATION FOCUS: Case Study - International Goodwill Impairment Compliance

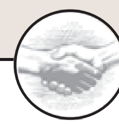
TRANSACTION UPDATE

Mercer Capital Provides Advisory Services to Ohio County Bancshares in Acquisiton by Porter Bancorp

Porter Bancorp, Inc. and Ohio County Bancshares, Inc. recently announced the signing of a definitive agreement for the acquisition of Ohio County Bancshares by Porter Bancorp. Mercer Capital played a pivotal role as financial advisor to Ohio County Bancshares, providing a fairness opinion letter in regards to the proposed transaction.

"The Mercer Capital component would not have been possible without the diligent, timely and knowledgeable professionalism of Andy Gibbs and Kristin Beckman," said Mercer Capital Vice President Jim Graves. "They provided the detailed set-up work which enabled a company visit on an accelerated basis, coupled with the database information to facilitate the decision-making process."

Mercer Capital has provided business valuation and investment banking services to a national and international clientele for over 25 years. For more information, contact Andy Gibbs (gibbsa@mercercapital.com) or Nick Heinz (heinzn@mercercapital.com) at 800.769.0967.



Ohio County Bancshares, Inc.

Beaver Dam, Kentucky

Fairness opinion on behalf of Ohio County Bancshares, Inc., in its proposed acquisition by Porter Bancorp, Inc.

MERCER CAPITAL