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What Is Your Bank Worth?

By Kevin Janke, Partner

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The economy has battered many industries but is hopefully improving after three years of recessionary forces. Your bank may be one of many that struggled greatly based on your loan portfolio and the industries you work with. You may be one of the fortunate ones whose income and loan portfolio were not really affected. Most likely, you are somewhere in the middle and have had some loan problems and, as a result, an increase in your loan loss provision has reduced your earnings.

With the recent economy, how do you value your bank? There are things you can control within the bank, and there are things you cannot control, such as the economy and how the market is pricing banks.

Let's review what other community banks are selling for. Over the last couple years, the number of transactions involving community banks has decreased. We believe the reason is twofold. First, many of the logical buyers have had internal issues to deal with, so they were not interested in looking at acquisitions or were not allowed to by their regulators. As a result, with fewer buyers, the price paid decreased.

Secondly, the banks that continued to perform well were not interested in selling. As a result, the ones that did sell were troubled institutions or banks that were not doing that well. The multiple paid for these types of banks was less than what would have been paid for high-earning banks. Nontroubled institutions recently had price-to-earnings multiples of 12 to over 20 and price-to-book multiples of 120% to 160%.

If we switch our focus to the prices being paid for publicly traded banks, we see price-to-book multiples at near historic lows. A recent project yielded a price-to-book multiple of approximately 0.70 on a minority, marketable basis. The price-to-earnings multiple, which I prefer, was approximately 16. For banks whose earnings have struggled, these multiples may yield conclusions that are similar to one another and may be reasonable. For banks that continue to perform well, the conclusion may be very different, proving a disconnect. The price-to-earnings multiples, I believe, are better indications of value for stronger banks.

If a bank was to take a lack of marketability discount from the price-to-earnings multiples listed earlier, the minority, nonmarketable conclusion is less than 50% of book value and would imply a majority, marketable conclusion of approximately 100% of bank value—perhaps good numbers for a weak performer but certainly not for a strong performer.

If your bank continues to perform well, the price-to-earnings multiple of 16 may yield a conclusion that approximates book value or slightly more than when a control premium is applied; the conclusion is similar to a bank sale of 120% to 160%. A lack of marketability discount causes minority, nonmarketable value to range from 75% of book value to slightly over book value.

The two prior methods discussed are what are known as market approaches. Another method used is an income approach. The income approach attempts to determine what an investor would be willing to pay for the bank given an earnings stream. The earnings stream can be based on historical financial statements with the understanding that the past is indicative of the future or based on projections. The problem with projections is that many banks can provide a budget for next year but cannot, with any certainty, provide a forecast for two or more years down the road . . . and who can blame them . . . did anyone see the economic uncertainty of 2008 and 2009 coming? The income statements from the past can be used, but the question becomes, should a weighted average or simple average be used and over how many years? We have been hesitant to use the income approach with the exception of de novo banks. Our experience has been that the income approach undervalues strong-performing banks, and if there really isn't much profit in the poor-performing banks, the method does not apply to them.

In past years, the rules of thumb regarding multiples of book value were used prevalently and may have been quite accurate, but given the variable in today's quickly changing environment, it's quite dangerous to use those rules of thumb in making decisions. The adage "every case is different" certainly applies to banks today.

Additional items to consider in establishing value today include the following items. The list is not meant to be all inclusive, but rather it provides some items an appraiser will consider.

- Does the bank rely on key management or key employees who do not have backup?
- What is the quality of the loan portfolio?
- What are the prospects for growth?
- Is the bank under any enforcement actions?
- Are the facilities adequate for expected growth?
- Are large expected capital expenditures needed?
- Is the bank or holding company involved in any out-of-the-ordinary litigation?
- Are there restrictions on the sale or transfer of stock?
- How is the bank doing in comparison to the peer group?
- Does the bank have exposure to risk based on its funding sources or capital levels?
- What is the level of technology?

A lot can be made of the last few years and how they have affected your bank and the banking industry. Perhaps more importantly, given the weaknesses in certain institutions, the consolidation in the industry, and the need to adapt to changing customer needs, going forward a tremendous opportunities exist for your bank to grow and prosper.

About the Author

Kevin Janke is a partner and leader of Wipfli's Business Valuation Practice. Kevin has performed over 1,000 business appraisals for numerous industries throughout the nation. In addition to his extensive experience, Kevin has qualifications that include Accreditation in Business Valuation by the American Institute of Certified Public Accountants and Accreditation as a Senior Appraiser by the American Society of Appraisers. He is also a licensed real estate broker.

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