

Public versus Private

The regulatory environment heats up the debate



By Bill Sammon

Compliance with the Sarbanes-Oxley Act of 2002 has intensified the debate over whether community banks should remain public or access the public markets for capital.

Since 2003, more than 60 banks have opted to go private, many citing increased audit fees and management man-hours. Others remain committed to reaping the benefits of being a publicly traded company, despite mounting compliance obligations and costs. As community banks contemplate their choice, this column hopes to give light to some of the factors in play for that decision.

First a recap of the criteria banks must meet before going or staying private. The going-private process, in its simplest terms, means any



transaction that drives the number of shareholders of record for a public company below 300. At that point, the company would be allowed to de-register with the SEC. Staying private is accomplished when a non-SEC reporting bank continues to have less than 500 shareholders of record.

Sarbanes-Oxley is far and away the largest reason banks have made the decision to de-register over the past two years. In the accompanying chart, are some of the customary expenses associated with SEC compliance. These costs can be extremely prohibitive, especially if the bank is in a non-growth market. While these costs have been the recent drivers in the decision-making process, the following are a few of

ESTIMATED ANNUAL SEC COMPLIANCE COSTS			
	LOW	HIGH	AVERAGE
Legal	\$1,000	\$90,000	\$26,000
Audit	5,000	175,000	48,000
404 Consulting	15,000	345,000	108,000
Printing/Mailing	3,000	102,500	27,500
Management Time	10,000	350,000	63,000
TOTAL	34,000	1,062,500	272,500

Community bank going-private transactions filed with the SEC since Jan. 1, 2003
 Courtesy of Powell Goldstein LLP

Making strategic decisions that create a growing, more profitable and independent community bank is always good for shareholder value.

the other reasons why a company may choose to go private:

1 Long-Term Focus. A private company with no outside investors is not under as much pressure to perform on a quarter-to-quarter basis. These banks have more flexibility to make strategic decisions that can enhance shareholder value in the long run, but may hinder short-term results. This is not always the case with the public bank, especially if research analysts are publishing quarterly earnings estimates on the company.

For a public company to make these same decisions, management would need to spend time educating its investors on why these are sound moves or risk seeing a possible downturn in its stock.

2 Decreased Investor Scrutiny. A private company has the ability to focus on running the organization day-to-day without the burden of communicating with its shareholders or research analysts. For a public company this communication is critical in determining the price of a stock and the multiples of book and earnings at which it trades. Even the best run company will trade below its peer group in the public markets if it does a poor job of communicating to the street. A private company does not need to conduct road shows or speak at investor conferences—activities that take management out of the bank.

3 Trading Over the Counter. A number of these de-registered or private banks have effectively used the OTC Bulletin Board or the Pink Sheets to help facilitate trades for shareholders after a deregistration. The Bulletin Board and Pink Sheets allow market makers to continue to post quotes for a company's stock even though they are not SEC reporting. While a stock may not be as liquid as when the bank was public, having some market for the shareholders helps with trading concerns.

While these are all good reasons to consider a going private transaction, there are still more than 1,100 banks that are SEC reporting. Even with the increased cost of being public, the following three reasons are among many that explain why these banks remain public and why five banks have completed initial public offerings to date in 2005:

A Valuation. When this article was written, the average community bank between \$250 and \$1 billion in assets was trading at 16.7 times trailing 12 months earnings and 181 percent of its stated book value. Bank stocks have enjoyed a great run over the past five years and from 2000 to 2004 significantly outperformed the S&P 500. This performance has created a tremendous amount of shareholder value and enriched the communities where these banks

operate. Banks that enjoy a strong local shareholder base oftentimes find this helps tie their customers to the bank.

B Liquidity. This issue impacts both shareholders and insiders. Allowing your shareholders to more easily move into and out of a stock broadens the pool of potential people or institutions interested in the bank and is a significant perk of public companies. In addition, the only historic way for the insiders of a private company to realize any of the value they have created over the years is to sell the bank.

While there are many reasons why a community bank chooses to sell, a public company allows insiders the opportunity to execute trades in the stock under certain SEC guidelines. This gives management more flexibility in realizing value without an all-or-none approach. A publicly traded stock can also be an effective tool for recruiting and retaining talent at the bank through stock options.

C Access to Capital and Acquisition Currency. While the trust preferred and private equity market have allowed private banks easier access to the capital markets in recent years, the most efficient way to raise capital for a bank is the public market. This is especially important for banks that have opportunities to grow. These banks need the ability to raise money at a valuation that will create the least dilution for their current shareholders.

If you look at the 22 secondary

offerings for public banks transacted in 2004, on average, these banks sold their stock to the public at 207 percent of book value and 19.7 times trailing 12 months earnings. It is this same pricing that gives public banks an attractive currency when looking to acquire other organizations. Many sellers not only want a tax-free exchange of stock, they want liquidity in a deal going forward. Being public can give a bank a leg up when competing for the deal that will enhance its franchise.

There are numerous other reasons on both sides of this debate. What's most critical when exploring either of these options is getting good advice and making sure you and your board have explored all strategic options.

Choosing an investment banker and attorney who has experience in both of these can help management avoid mistakes other banks have made and also help clarify the bank's strategic plan. It can also help determine the most effective way to execute its plan.

Whether the decision is to go private, remain public or take your company to the public market, making strategic decisions that create a growing, more profitable and independent community bank is always good for shareholder value. **ib**

Bill Sammon is the director of Capital Markets for ICBA Securities, ICBA's portfolio management services corporation in Memphis with Howe Barnes. Reach him at gsammon@icbasecurities.com.

Advertiser Name	Page #	Web site
Advanced Financial Solutions	2	www.afsimage.com
AFP Solutions Inc.	89	www.afpsolutionsinc.com
Alex Sheshunoff Management Services	90	www.sheshunoffmanagement.com
American Banker	105	www.americanbanker.com
Austin & Williams	77	www.austin-williams.com
BancIntelligence.com	34	www.bancintelligence.com
Bankers Systems Inc.	79	www.bankerssystems.com
BNK Advisory Group	62	www.bnkadvisorygroup.com
BSI Financial Services, Inc.	83	www.bsimortgage.com
Century Securities Associates Inc.	89	www.centurysecurities.com
Certegy Card Services	C2,7	www.certegy.com
Computer Services Inc.	69	www.csiweb.com
Cypress Software Systems	47	www.go-cypress.com
Data Center Inc.	101	www.datacenterinc.com
Didier Printing	51	www.didierprinting.com
Elan Financial Services	8	www.elanfinancialservices.com
eVault	4	www.evault.com/ib
Fair Isaac Corporation	43	www.fairisaac.com
Fannie Mae	6	www.efanniemae.com
Fidelity Information Services	40,41	www.fidelity-ifs.com
Financial & Professional Risk Solutions	95	www.floodwatch.fprsi.com
Financial Tools Inc.	70	www.financialtools.com
First Data	86	www.greatcollaborations.com
First National Merchant Solutions	73	www.fnms.com
Freddie Mac	93	www.freddiemac.com
Gilbertson Advertising	5	www.gilbertsonadv.com
Harland Delivery	53	www.harland.com
ICBA Bancard	10,85	www.icbabancard.org
ICBA Financial Services	107	www.icbafinancial.com
ICBA Mortgage	98	www.icbamortgage.com
ICBA Reinsurance	108	www.icbareinsurance.com
ICBA Services Network	c4	www.icba.org
Information Technology Inc.	31	www.itiwnet.com
Jack Henry & Associates	18	www.jackhenry.com
Kirchman Corp.	c3	www.kirchman.com
LHR Inc.	100	www.lhrinc.com
MGIC	72	www.mgic.com
Modern Banking Systems	81	www.modernbanking.com
Mortgagebot LLC	12	www.mortgagebot.com
NADA Used Car Guide Co.	52	www.nada.com/b2b
Network Center, Inc.	48	www.netcenter.net
NYCE Corporation	33	www.nyce.net
Oliphant Financial Corporation	92	www.oliphantfinancial.com
Open Solutions Inc.	22	www.opensolutions.com
PBiz	14	www.pbizinc.com
Perimeter Internetworking	39	www.perimeterusa.com
Plansmith Corp.	9,21	www.bankgps.com
PMA Financial	99	www.bankfunding.com
Precision Computer Systems	65	www.pcs-sd.com
ProfitStar Inc.	68	www.profitstar.com
Pulse EFT Association	17	www.pulse-eft.com
R. Kinney Williams and Assoc.	94	www.internetbankingaudits.com
SCAN COIN	62	www.scancoin-cds.com
SHAZAM Inc.	49	www.shazam.net
St. Paul Travelers	35	www.stpaultravelers.com
Strohl Systems	57	www.planetstrohl.com
Student Loan Finance Corp.	92	www.brainscratch.com
T&M Enterprises	77	www.popcornmachinesdirect.com
The Kansas Bankers Surety Co	96	
The TODD Organization	71	www.toddorg.com
Tranax Technologies Inc.	94	www.tranax.com
Universal Valve	48	www.universalsignage.com
Venture Insurance Programs	20	www.ventureprograms.com
Visa USA	27	www.volenroll.com
Vision Software Solutions	59	www.visionsoftwaresolutions.com
Young & Associates	83	www.younginc.com