

Choosing Liquidity Channels

Weighing the pros and cons of various stock exchange options

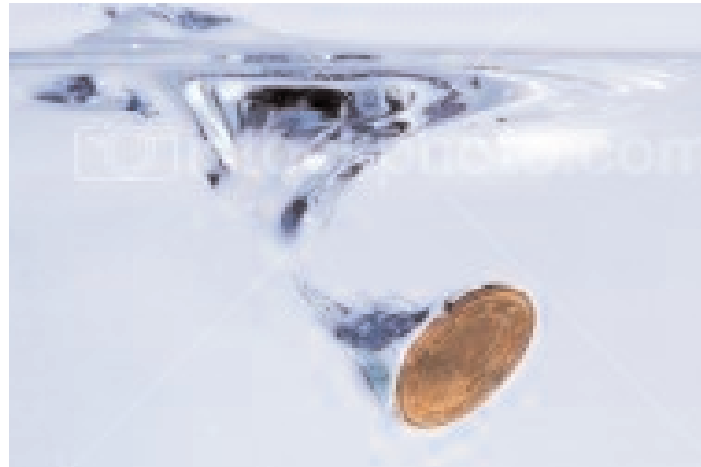


By Bill Sammon

Liquidity is an important part of shareholder value. It allows banks flexibility when dealing with their current shareholders, when trying to attract new investors, and when attempting to use their stock as a currency to help grow the organization through acquisitions. Consequently more than 1,400 bank and thrift holding companies trade on a public market and report to the Securities and Exchange Commission (SEC).

Reporting to the SEC adds transparency to core fundamentals and helps the investing public better understand a potential investment. Having a liquid stock can be beneficial to current shareholders as evidenced by a review of where bank stocks are trading today versus historical price-to-book and price-to-earnings multiples (see Table 1).

While these are all benefits of being publicly traded, there are associated costs. Public banks not only have to worry about the fundamentals of their organization, they must concern themselves with investor relations on a day-to-day basis as well. Management teams at SEC reporting companies must also deal with Sarbanes-Oxley Act requirements, at significant time and expense. Management is also tasked with protecting the company's stock price, which often translates into countless hours on the road talking to institutional investors, making presentations at investor forums and



cultivating relationships with broker/dealers who will tell their story and potentially write research.

Choosing a Market

Most community banks that report to the SEC list their shares on either the American Stock Exchange or the NASDAQ as few have a large enough market capitalization to qualify for the New York Stock Exchange. The American Stock Exchange, which employs a specialist to keep orderly and efficient markets, currently has 31 community banks and thrifts that list their shares on the exchange. The specialist has the ability to act as both broker and dealer. This means he can match public orders or use his own account to ensure best execution.

The NASDAQ is the largest electronic exchange in the United States. Here, broker/dealers can meet to execute trades for their clients. On the NASDAQ, a market maker is the key player for ensuring

liquidity. Market makers can use their own capital to keep orderly and efficient markets. It is that capital that allows a community bank's stock to trade without wild swings in price. The key for a community bank that has its shares traded on the NASDAQ is to find a market maker that will use its capital to keep these fair markets. In today's marketplace that may be easier said than done.

"I see less capital being committed to this sector today than even five years ago," says Greg Gersack, head of sales and trading for Howe Barnes Investments who makes market in more than 300 community bank stocks. "Changes in the trading rules and consolidation of regional brokers have led to shallower markets for these stocks." With this in mind, finding a market maker that will take a risk and make sure a community bank's

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story is being told is crucial in creating real liquidity for shareholders.

Other Options

There are many community banks that do not qualify for one of these markets and do not want

bulletin board provides investors access to more than 3,300 listings.

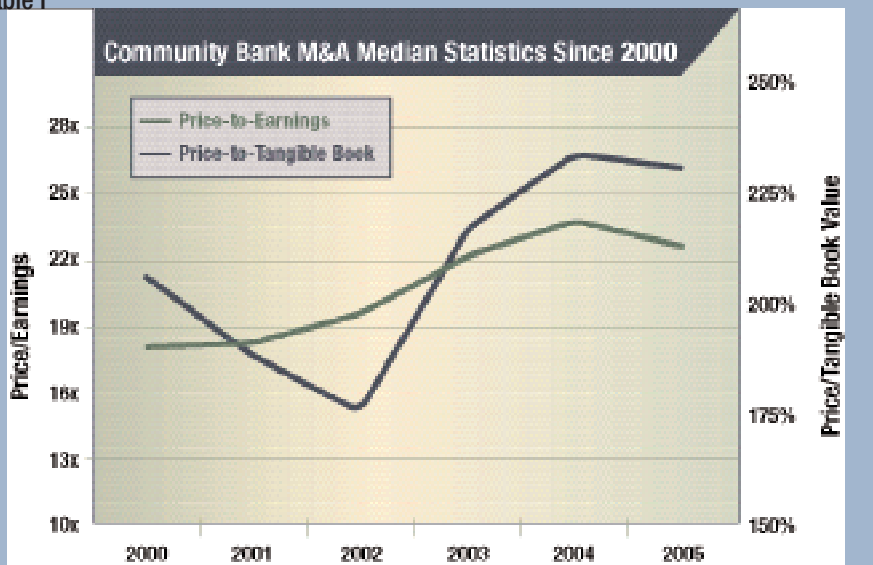
There are both positives and negatives to a bulletin board listing. Looking at all the banks and thrifts that currently trade on the Bulletin Board, on average they are trading at 198 percent of

company must understand there will be a partial loss of control when engaging a market maker and that other market makers can register for the stock. Also, there is a slight increase in transaction cost to selling shareholders. Bulletin

Board stocks can trade with wide spreads and that cost is borne by the seller. In many cases, the listing on the Bulletin Board is a bid only market, which means a market maker is only willing to buy shares at a given price and is not offering shares.

While not perfect, many companies have used the OTC Bulletin Board as a stepping stone to one of the larger markets. A listing gives management a better understanding

Table I



Source: SNL Financial

to report to the SEC. These are the companies who have 100 or more shareholders and have historically traded shares out of the CEO's desk drawer. So what are the options for these companies given the relative importance of creating more liquidity?

Many (over 450 community banks and thrifts) have listed their shares on the Over the Counter (OTC) Bulletin Board and have engaged a market maker to trade their shares. In June 1990, the OTC Bulletin Board began operations on a test basis to help provide more transparency in the over-the-counter market. The SEC approved the operation on a permanent basis in April 1997 and today, the

tangible book value and 19.6 times last 12 months' earnings. These are attractive multiples and allow a shareholder some measure of liquidity without the significant illiquidity discount.

A bulletin board listing can help a company facilitate a share repurchase program and offers anonymity for the selling shareholder. Such a listing also eases some of the liability a management team takes on when making their own market. In addition, having a market maker that will commit capital allows for more timely execution of trades.

As with a public listing there are also disadvantages to an OTC Bulletin Board listing. A

of how the markets work and can help facilitate future access to the capital markets. It also gives bankers an opportunity to interact with a broker dealer and analyze if they are a good partner to work with.

In any form, providing more liquidity for shareholders is a way to create more value. The key is to weigh the pros and cons of a more public stock and to find the right partner to help you through this process. **ib**

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