February 2019

MARKET STATISTICS

Our Local Experience

The Capital Corporation
www.thecapitalcorporation.com

The first question we often get from bankers is - *What are banks selling for today?*

Because the Midwest market is so different from the national market (more below on that) we like to look at the pricing in the Midwest.

Additionally, we believe many of the reported transactions are not accurate so we want to provide as true market pricing as we can.

This newsletter reports on our 2018 statistics and compares them to our 2017 statistics.

VALUATION BACKGROUND

Everyone looks at the multiple of book value when we see a transaction reported. But much more goes into the value of an individual bank than the level of its capital.

Earnings, location, viability of community, management, loan and core deposits, credit quality, historic and future growth and other factors all have a significant impact on the value of an organization.

Nevertheless, market statistics of actual transactions are relevant and provide a baseline when analyzing the value of a financial institution – plus they are what everyone wants to talk about.

OUR TRANSACTIONS

In the past year we were directly involved in 20 whole bank transactions that were announced and/or closed in 2018 or where we have a Letter of Intent and pricing is established, but has not been announced.

Several transactions that will close in 2019 are included in the 2018's statistics because we include announced deals where the final purchase price is set. We believe the larger the pool the more accurate and relevant it is for you.

While the parties in most of our transactions are disclosed it is our policy to not release pricing on specific transactions. For that reason everything provided below is in summary format.

All of the banks in our analysis were located in Kansas, Missouri, Colorado, Oklahoma or Arkansas. They range in approximate size from $35,000,000 in assets to $900,000,000 in assets. The average size was approximately $173,000,000 with a median size of approximately $118,000,000.

The pricing is based upon the amount actually paid by the buyer to the seller; not what was originally offered; unless the transaction has not closed yet.

One bank was under a regulatory order. Four of the targets were either not profitable or just barely profitable. We removed these five from our analysis of the earnings multiples.

The average price to capital based on 8% capital for the whole bank transactions was 1.53. Many community banks have significant excess capital which can alter the true multiple. Most of our deals either require a dividend of the excess capital before closing or excess capital is paid dollar for dollar above 8%. Therefore, we focus pricing based on 8% capital.

The range of the transactions was a low of 1.02 to a high of 2.05 times 8% capital. Eight of the transactions were at or above the average; and the median multiple of 8% capital was 1.51. As you can see, the average (1.53) and the median (1.51) were very similar.

In comparison, the multiples on total capital (which is what is normally reported) ranged from 1.02 to 1.81. The average and the median were both 1.42.

Excluding the five transactions mentioned above, the earnings multiples ranged from a low of 9.18 to a high of 30.12. All earnings for S corporation banks have been adjusted to C corporation earnings. The average was 19.27 and median was 19.46. We believe this is a fairly accurate reflection of the market for normal earning banks.

It is a strange concept, but strong earning banks typically sell for lower P/E ratios than lower earning banks. For example, let's compare two $100,000,000 banks; both C corporations and each with $8,000,000 in capital. One earning 0.3 ROAA ($300,000) and the other earning 1.2 ROAA ($1,200,000). At a 15 P/E value, the first bank would trade for $4,500,000 or approximately 52% of capital. The second, at the same 15 P/E, would trade at $18,000,000 or 225% of capital.

Looking at it from the capital aspect – if the first bank trades at book value, it would trade at 26.6 times earnings. Whereas, if the second bank traded at 2 times book, it would trade at only 13.3 times earnings. Therefore, when looking at earnings multiples it is important to understand the earnings of the banks contained in the transaction pool and especially the specific bank being valued.

When we look at earnings and multiples we also look at the premium as a percentage of the core deposits. When evaluating a whole bank transaction as a premium on core deposits, you take the purchase price less the tangible capital to determine the premium and then divide that premium by the core deposits. The purchase price is the premium on core deposits plus the tangible capital.

Therefore, if you analyze the whole bank transactions as a premium on core deposits, the average premium on deposits in those transactions was 5.15%. The range on these transactions was 0.22% to 11.00%. The median was 5.01%. We also had a couple of branch sales and the average premium on deposits was 5%.

A breakdown of the pricing for the past two years follows.

The Capital Corporation Assisted Transactions 2018

Whole Bank Deals (20 deals):

Average Price to Capital:	1.53 (based upon 8% capital)
Median Price to Capital:	1.51 (based upon 8% capital)
Average Price to Earnings:	19.45
Median Price to Earnings:	19.27
Multiple of Capital Range:	1.02 to 2.05 (based upon 8% capital)

Premium on Deposits:

Average - Whole Bank:	5.15%
Median – Whole Bank:	5.01%
Range – Whole Bank:	0.22% to 11.00%

By comparison the chart of our transactions from 2017 is below.

The Capital Corporation Assisted Transactions 2017

Whole Bank Deals (16 deals):

Average Price to Capital:	1.44 (based upon 8% capital)
Median Price to Capital:	1.39 (based upon 8% capital)
Average Price to Earnings:	24.07
Median Price to Earnings:	19.18
Multiple of Capital Range:	1.02 to 1.98 (based upon 8% capital)

Premium on Deposits:

Average - Whole Bank:	4.46%
Median – Whole Bank:	3.61%
Range – Whole Bank:	0.22% to 9.94%

In this newsletter last year, we commented that overall optimism had increased following the presidential election and was staying strong going into 2019 with the tax law changes. We predicted that if that optimism continued through 2018 we would continue to see strong or potentially even an increase in values. This held true although it started to falter somewhat when public financial stocks dropped significantly in the fourth quarter.

When comparing the above two charts, the prices on our transactions increased approximately 6% to 8% from 2017 to 2018. The earnings multiples dropped, but we believe that is caused primarily by the increase in bank earnings driven by the lower tax rates and strong loan demand in 2018.

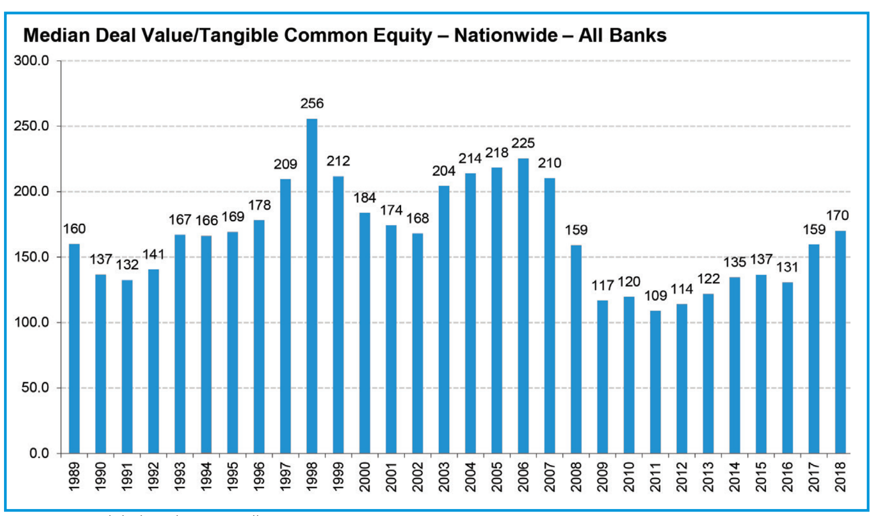
We certainly hope the optimism continues in 2019. A strong market with high prices benefits all bankers. Strong banks benefit our communities, customers, employees and stockholders.

Bank multiples very closely follow economic cycles. Historically they have run in 8 to 10 year cycles between peaks. The chart below shows approximately 30 years of bank multiples. Clearly the "Trump Bump" reversed the downward trend of 2016 and the tax law change for 2018 also helped. For a while 2015 looked like another peak.

As you can see from the chart below, the median price was 1.70 times total tangible capital, which is higher than our median pricing. It is important to remember that the larger asset sized institutions typically receive a larger premium. This was especially true in most of 2018 as publicly traded financial stock values increased allowing public buyers to pay higher premiums when using their stock as part or all of the consideration. The publicly traded stocks fell significantly in the fourth quarter of 2018 and if that continues into 2019 it will likely have a negative impact on valuations moving forward.

Publicly traded institutions are typically larger institutions and they tend to acquire larger targets. It would be very rare for a $30 billion institution to acquire a bank with $100 to $200 million in assets. Therefore, most buyers of what we would consider to be "community banks" are smaller institutions and in most cases are cash buyers limiting their ability to pay large premiums.

As mentioned above, the Midwest banking market is very different than the banking market in other areas of the country. This is primarily because of the large number of community banks located in the Midwest when compared to other states.



Source: S&P Global Marketing Intelligence

To put it in perspective, here are the number of individual charters located in several Midwestern states as of December 31, 2018:

Arkansas	93
Iowa	286
Kansas	235
Minnesota	293
Missouri	256
Nebraska	169
Oklahoma	201

Source: FDIC

While this number of charters may not seem unusual to us, it is noticeably different from other states at December 31, 2018. For example:

California	155
New York	144
Florida	116
Indiana	103
Michigan	93
Colorado	78
North Carolina	47
Nevada	19
Arizona	15

Source: FDIC

To put this into even more perspective, the population in Kansas is a little under 3,000,000 people. This equates to one bank for every 12,766 people. In Missouri, it is one bank for every 23,867 people based on a state population of 6,110,000.

California has a population of approximately 40 million people. This results in one bank charter for every 258,065 people. In Arizona it is one bank for every 468,000 people.

Why is this important to market pricing? Two primary reasons. First, as banks continue to consolidate the consolidation will occur primarily in the Midwest based on the number of charters. The industry average for the past 13 years is 266 banks per year being consolidated. In 2018, approximately 5% of the banks nationwide were merged out of existence.

Based on this average, in ten years we will have approximately 136 charters in Kansas – a reduction of about 100 charters. In Missouri, we are projected to have 150 charters, a reduction of 106 charters. You can run the numbers for the other states as well. Unfortunately, the Midwest will lose a very large percentage of their banks in the next 10 years.

Economics 101 – Supply and Demand. With this much supply, and the demand dropping as the buyers consolidate, we expect industry multiples to fall – much as it has over the past 30 years as the industry has consolidated.

The second reason the Midwest bank pricing market is different is due to the high number of smaller banks in the Midwest. We have always believed, in general, that size has as much to do with valuation as location. Therefore, in our analysis we have always included size as variable in determining value.

The table on the next page shows the impact asset size of the target has on the median pricing of transactions for the year ended December 31, 2018.

Target Assets Range		# of Deals	Price/TCE (x)	Price/Earnings (x)	Premium on Core Deposits
Min ($M)	**Max ($M)**				
Below	**100**	73	125.63	19.07	4.13
100	**250**	80	155.01	24.14	8.67
250	**500**	44	170.46	20.97	9.13
500	**1,000**	30	178.82	28.06	12.97
Above	**1,000**	32	203.61	24.19	14.60

Source: S&P Global Marketing Intelligence

Although one of our prime lines of business is bank mergers, each of us has been personally tied to community banking. This is still true today as a division of a family owned community bank. Our goal is not to consolidate as many banks as possible, but to rather help facilitate an event if and when a shareholder base determines it needs liquidity.

We are big proponents of ownership planning to allow you to control your destiny with your bank in one way or another. If we can help you please let us know. Thank you for letting us share our thoughts on the banking industry with you.

If you have any questions or comments, please feel free to give us a call.

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