



**RP<sup>®</sup> Financial, LC.**  
**Mutual-to-Stock Conversion**  
**Appraisal Process**

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# ROLE & CHARACTERISTICS OF THE APPRAISER



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# Role & Characteristics of the Appraiser: General

- Appraiser is a required participant to determine the initial offering range and the final number of shares to be issued at closing in thrift mutual-to-stock conversion transactions
- Independent appraisal required for all these conversion transactions types –
  - Standard mutual-to-stock conversions
  - Minority stock (“first step”) offerings by mutual holding companies (MHCs)
  - “Second step” conversions of MHC thrifts
  - Secondary offerings of MHC thrifts while remaining in MHC form
- Participates in the mutual-to-stock conversion process along with other professionals engaged for transaction (“conversion team”)
  - Issuer’s counsel
  - Investment banker (underwriter)
  - Underwriter’s counsel
  - Outside accounting firm
  - Business planning firm
- Appraisal firm must be independent of all participants in terms of ownership, determination of appraised value and non-contingent fee structure



# Role & Characteristics of the Appraiser: Specific

- Prepare market based valuation consistent with regulatory valuation guidelines for conversion transactions
  - Original valuation – sets forth midpoint valuation and range of value
  - Interim valuation updates – revises midpoint valuation and range of value based on subsequent changes in financial characteristics of the converting thrift and the selected peer group and changes in stock market environment
  - Final valuation update – sets valuation for the shares to be issued at closing
- Interaction with other parties regarding valuation
  - Converting thrift – present appraisal and updates to Board of Directors and senior management
  - Other members of the conversion team regarding due diligence, structure of conversion transaction
  - Regulators – seek approval of appraisal and updates
- Review prospectus disclosure and financial statements
- Prepare pro forma schedules for prospectus reflecting valuation range



# Typical Appraisal Timetable

- All valuation work and required approvals must be received prior to the “stale date”, which is 135 days after the date of the financial information in prospectus
- Illustrative timetable for appraiser – assumes financial statements as of December 31<sup>st</sup>
  - January Collect data and begin preliminary document due diligence
  - February Conduct on-site due diligence, prepare draft of appraisal
  - February (late) Prepare pro forma data for prospectus (draft basis)
  - March (early) Present appraisal to Board of Directors
  - March (middle) Finalize appraisal for filing with regulatory application
  - April (mid/late) Update appraisal for changes in financial data and stock market
  - May (middle) Gain regulatory approval of appraisal before 135 day stale date
  - May/June Observe changes in stock market during offering process
  - June (late) Prepare closing update at end of offering for closing purposes



# Appraisal Process Summary

**Due Diligence Phase**: gather documents, management interviews, evaluate market area

**Appraisal Preparation Phase**: draft appraisal document, select peer group, develop appraised value & present to board prior to regulatory filing

**Regulatory Approval Phase**: seek to gain regulatory approval of appraisal & updates

**Final Update Phase**: Prepare final appraisal update in conjunction with closing of offering, incorporating offering results



# Data Bases & Valuation Models

- **Data bases required**
  - Public thrift financial information on a quarterly basis
  - Stock price information for public thrifts (daily) and industry price indices
  - Initial public offering pricing and market environment
  - Merger activity in regional area and pricing
  - Economic, demographic and competitive data (locally, regionally, nationally)
- **Valuation models: Pricing models consistent with regulatory guidelines for –**
  - Standard mutual-to-stock conversions
  - “First step” offerings by mutual thrifts and “second step” conversions by MHCs
  - Secondary offerings by MHCs (while remaining in MHC form)
  - Simultaneous cash and/or stock acquisitions of other financial institutions concurrent with stock offerings
- **Typical 3<sup>rd</sup> party data base sources**
  - SNL Financial
  - Public company filings (10-Ks, 10-Qs, proxy materials, press releases, etc.)
  - Governmental data bases (e.g., FDIC, US Census Bureau, Bureau of Labor Statistics)



# APPRAISAL METHODOLOGY



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# Appraisal Methodology: Regulatory Appraisal Guidelines

- **Appraisal requirement**
  - Required to conform with federal appraisal guidelines developed by Office of Thrift Supervision (OTS) – endorsed by FDIC and other federal and state banking agencies
- **Key components of appraisal guidelines**
  - Valuation formulas, methodology and assumptions
  - Appraisal report content
  - General peer group selection criteria
  - Key valuation factors
- **Appraisal must incorporate key transaction characteristics**
  - Transaction expenses
  - Terms of stock benefit plans – employee stock ownership plan (ESOP), reward and recognition plan (RRP) and stock option plan (SOP)
  - Use of proceeds (reinvestment rate) and marginal tax rate
  - Formation of charitable foundation funded with cash and/or stock
  - Simultaneous cash and/or stock acquisition of another financial institution
- **Valuation guidelines applicable to all conversion types**



# Appraisal Methodology: Valuation Approach

- **Market value approach**
  - Based on market pricing of a peer group of similar publicly-traded thrifts, after incorporating adjustments for key differences between the converting thrift and the peer group
- **Pro forma basis**
  - Appraisal prepared on a pro forma basis, incorporating the pro forma impact of the to-be-issued shares, including impact on equity, earnings and assets
- **Appraised value and range**
  - Appraisal establishes “midpoint” value
  - Conversion regulations establish range of value
- **Appraisal update process**
  - Reflects change in valuation factors, typically –
    - Financial condition and profitability of converting thrift and peer group
    - Stock market pricing of peer group
    - Overall stock market environment for existing thrifts
    - New issue market for converting thrifts



# Appraisal Methodology: Key Pricing Ratios Considered

- **Pro Forma Price/Earnings (P/E) Multiple**
  - Historically preferred valuation approach (consistent with regulatory valuation guidelines)
  - New conversions often trade with premium P/E ratios, reflecting market expectations that earnings will grow with reinvestment and leveraging of new equity raised in conversion
  - Valuation earnings base adjusted for large one-time items on an after-tax basis
- **Pro Forma Price/Book (P/B) Ratio**
  - Historically a less reliable indicator of value, but in recent years has become key benchmark of value for converting thrifts
  - Since the P/B ratio for a converting thrift is significantly impacted by the offering proceeds in both the numerator and the denominator, the pro forma P/B is typically discounted from the peer group's P/B since the peer group is not raising equity
  - P/B ratio is adjusted for intangible assets, resulting in Price/Tangible Book (P/B) ratio
- **Pro Forma Price/Assets (P/A) Ratio**
  - Generally a less reliable indicator of value since P/A does not accurately portray credit risk, interest risk, and earnings capacity



# Appraisal Methodology: MHC Related Transactions

- **Unique valuation considerations of MHCs**
  - Mutual thrifts completing “first step” MHC conversions or MHC thrifts completing “second step” conversions have unique valuation considerations
- **Mutual thrifts completing “first step” MHC conversions**
  - Mutual thrift is valued on a “fully converted” basis
  - Peer group is comprised of publicly-traded MHC thrifts with pricing adjusted to a “fully converted” equivalent basis
  - Pricing ratios of mutual thrift and publicly-traded MHC thrifts are evaluated on a “fully converted” basis and on an MHC (or “nominal”) basis
- **MHC thrifts completing “second step” conversions**
  - MHC thrift is valued taking into account the pro forma impact of the sale of the MHC’s ownership interest
  - All current shareholders receive an “exchange ratio” to preserve their ownership interest (adjusted for the regulatory dividend waiver policy, if appropriate)
  - Peer group is comprised of fully converted thrifts (no MHCs) because the converting MHC thrift will be a full stock company after the “second step” offering



# Appraisal Methodology: Simultaneous Acquisitions

- **Unique valuation considerations for acquisitions simultaneous with offerings**
  - Takes into account the cash and/or stock consideration paid in acquisition transaction
  - Shares issued to acquisition target shareholders must represent less than 50% of total pro forma public shares (based on regulatory policy)
- **Appraisal takes into consideration the acquisition consideration paid**
  - Acquisition consideration paid effectively incorporates the stand-alone appraisal of the converting mutual thrift (“first step”) or converting MHC thrift (“second step”)
  - Resulting intangible assets, including core deposit intangible and goodwill, are considered in the appraisal conclusion
  - Appraisal includes purchase accounting adjustments and other merger related adjustments (contract payouts, transaction expenses, etc.)
  - Appraisal considers the prospects for merger synergies, although not specifically quantified in valuation earnings base



# PEER GROUP SELECTION



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# Appraisal Methodology: Peer Group Selection

- **General objectives**
  - Identify a peer group of public thrifts whose operations are relatively comparable to the converting thrift
  - Exclude those public thrifts which are –
    - Subject to acquisition or enforcement actions
    - Subject to unusual financial or operating characteristics
    - Recently converted thrifts (lack of market seasoning, under 1 year proceeds use)
    - In a standard or second step conversion – exclude MHCs
    - In an MHC conversion – exclude full stock thrifts
- **Specific objectives: seek a “best fit” group of at least 10 similar public thrifts –**
  - Regional market area – economic, demographic and competitive characteristics
  - Asset size, balance sheet mix, growth trends, capitalization, credit quality
  - Profitability, key income statement ratios, interest rate risk
  - Operating strategy, business plan, management, government limitations (if any)
  - Market capitalization, pricing, stock liquidity, dividend characteristics
- **Consider valuation adjustments to account for key differences from “best fit” group**