Book Your Stock Valuation Consultation Today

Understanding the Three Factors That Influence the Value of Your Bank Stock

Stock valuation is the cornerstone of shareholder success. There are three key factors underlying bank stock valuations – financial performance, risk, and growth. It is important for bank leadership to have a firm understanding of how these factors influence bank stock valuation.

Financial Performance
For community banks, "book value" is the key stock valuation benchmark. The potential measures of book value include:

- Shareholders' equity as stated in your institution's financial statements.
- Tangible book value, which deducts purchase accounting intangible assets from stated shareholders' equity.
- Tier 1 common equity, which is a regulatory capital measure that is less commonly used as a valuation metric

Investors tend to be forward-looking and as such focus primarily on an institution's earnings and the growth associated with it. In their view, bank earnings are ultimately the primary source of returns to shareholders.

Growth
Understandably, investors appreciate growing earnings and cash returns such as dividends or share repurchases. In order to provide these, a sustainable base of strong earnings is necessary. Since banks derive most of their revenues from interest spreads, it

makes sense that bank investors focus on net income and earnings per share.

Investors look for growth in their investments and higher expected growth rates produce higher valuation multiples. Further, price/earnings multiples expand at an increasing rate. The opposite is true, too, as slowing growth reduces the price/earnings.

The most relevant growth indicators for investors include:

- Balance sheet components like loans and deposits, which drive revenue growth.
- Asset quality and capital adequacy.
- Pre-tax, pre-provision operating income, which smooths earnings fluctuations caused by periodic volatility in provisions for loan losses.
- Net income per share.
- Dividends per share
- Tangible book value per share

Since valuation is inherently forward-looking historical growth rates are useful to help predict future growth. Most investors understand that there is some tradeoff between earnings today and investing for higher earnings in the future. While some near-term pressure on earnings from an expansion strategy is acceptable, strategic investments should not continually be used to explain below average profitability.

Risk
Risk management is an overarching responsibility of bank management and the board of directors. It is also crucial for long-term shareholder returns. The following forms of risk must be managed in order to provide investors with the highest return for the least risk:

Credit risk. i.e. risk that the bank's investments in loans and other assets may not be repaid in full or on a timely basis.

Liquidity risk. i.e. the risk that arises from transforming liabilities that are due on demand (deposits) into illiquid assets (loans).

Interest rate risk. i.e. the risk attributable to assets and liabilities with mismatched pricing structures or durations.

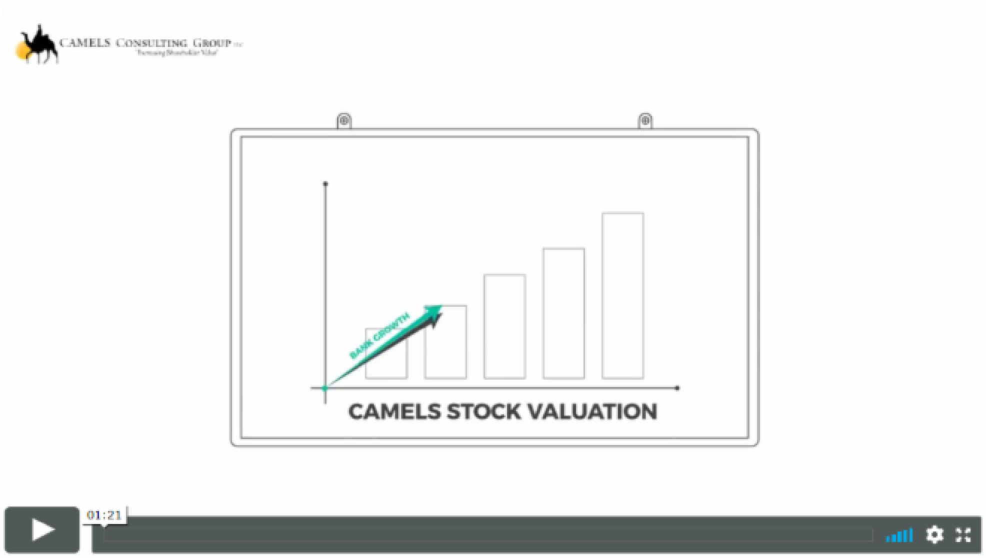
Operational risk. i.e. such as from malevolent actors like computer hackers

An important observation is that in the minds of investors, banks with the lower risk profile would be worthy of a higher price/earnings multiple than those with more risk. As such, bank stock prices and pricing multiples can be particularly volatile for banks in periods of economic uncertainty or distress, such as our current market.

Conclusion
While these three factors are universal to stock valuations, it is important to understand that they influence every bank uniquely. CAMELS Group's extensive experience in stock valuation can help your bank understand how these factors integrate and influence the current value of your bank's stock and how they may impact the future financial health and independence of your institution.

Book a CAMELS Stock Valuation

See why stock valuation is critical to your institution's long-term success.
Click on the video to view it on our website, camelsgroup.com.



Schedule a Complimentary Consultation Now

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Edward E. Schmidt (Ed) has more than 40 years of executive experience in the banking industry. He has managed bank turnarounds, opened 15 de novo institutions, and helped his clients raise $375 million in capital.

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