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Current Market Conditions Offer Smaller Mutuals Unique Opportunities to Raise Capital and Grow

Market conditions for savings banks that want to raise capital have never been better. The SNL Thrift Index, which measures the value of all publicly traded thrift stocks, has increased by approximately 45% since January 2003. Similarly, the SNL MHC Index has increased by nearly 62% during this time. Moreover, during the past year nearly every mutual holding company ("MHC") stock offering or mutual-to-stock conversion ("standard conversion") by mutual savings institutions has been over-subscribed by depositors at the "super-maximum" of the valuation range. The aftermarket performance of these stocks also has been exceptional.

The principal beneficiaries of this market, of course, have been stockholders and those savings institutions that have taken advantage of the strong market by either forming MHCs or undertaking standard conversions. While current market conditions offer all mutual institutions unique opportunities to raise capital, they are particularly attractive for smaller institutions that would be unable to raise enough capital under weaker market conditions to make either a standard conversion or MHC offering worthwhile. Smaller institutions need to grow to improve operating efficiencies, services and earnings, and capital is the key to such growth.

What are the New Opportunities?

Under current market conditions, *nearly all mutual institutions can readily sell* their stock to depositors and customers in a standard conversion or MHC offering. The advantages to smaller mutual institutions created by a strong market for thrift stocks include the following:

- *More capital is raised and, therefore, the cost per dollar of capital raised is less.* Many of the costs of a standard conversion or MHC stock offering are fixed. So increasing the amount of capital raised will have only a modest effect on the cost of raising such capital. (Note that the cost of raising capital is not expensed, and, instead is netted against the capital raised.)

- *Smaller mutual institutions can now raise enough capital to acquire stock competitors that were previously too large to acquire.* Acquisitions can be an effective way of growing and improving earnings, and mutuals are often surprised at how many acquisition opportunities arise after a conversion or MHC stock offering.

- *Smaller institutions may be able to sell enough stock to have their shares listed on the Nasdaq National or SmallCap Market.* This improves liquidity and allows investors to readily access trading information in an institution's stock.

- *More shares will be issued, thereby creating more liquidity in the stock.* A more liquid stock is more attractive to investors because it facilitates the transferability of the stock.

- *A strong market increases the size of stock-based benefit plans (an ESOP, stock recognition and award plans, and stock option plans).* These plans are an effective means of attracting and retaining qualified management and of making employees, officers and directors the largest stock-holders of an institution.

How Do Mutuals Raise More Capital?

Mutual institutions that either form an MHC or undertake a standard conversion must sell their stock based upon an independent appraisal of the pro forma market value of the institution as a stock entity. The independent appraisal is based on the financial condition and operations of the mutual institution, including its book value and earnings, as well as market conditions for comparable thrift stocks. In a weaker market for thrift and bank stocks, converting institutions will raise less capital because the market values of comparable thrift stocks (on which the value is based) have diminished.

For example, assume a mutual institution with net worth of $4 million and assets of $50 million is considering a standard conversion or an MHC stock offering.

- If the institution had converted on December 31, 2000, it would have been valued at $4.0 million, or approximately 50% of pro forma book value, based on market conditions at that time ($4.0 million is 50% of $8.0 million). In other words, it would have raised $4.0 million in a standard conversion and its pro forma capital would have been $8.0 million upon completion of the conversion. Similarly, if the institution had formed an MHC, it would have raised $2.0 million if it sold approximately 49% of its stock.

- If the same institution had converted on January 1, 2003, it would have been valued at approximately 66⅔% of pro forma book value, which means it would have raised $8.0 million in a standard conversion (instead of $4.0 million in 2000), and would have had pro forma capital of $12.0 million. Similarly, it would have raised $4.0 million (instead of $2.0 million) in an MHC stock offering (assuming the sale of 49% of its stock).

- If the same mutual institution converted today, it would be valued at approximately 75% of pro forma book value, which means it would raise $12.0 million (instead of $4.0 million in 2000) in a standard conversion, and $6.0 million (instead of $2.0 million in 2000) in an MHC stock offering, assuming it sells 49% of its stock.

The difference in the amount of capital raised in these examples is significant. As important, in the current market, mutuals can be confident of a successful stock offering.

Mutuals *Can* Acquire Stock Institutions

Many mutual institutions do not fully realize their potential purchasing power and how they can raise enough capital to acquire other stock institutions. We would encourage mutual institutions with assets of less than $100 million to carefully consider today's unique market opportunities to grow, offer new services and improve earnings. We also recommend that mutual institution boards periodically review their business strategy with experienced financial advisers to evaluate their growth and expansion opportunities.

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Luse Gorman Pomerenk & Schick is the nation's leading firm in MHC and standard conversion transactions. We were ranked number one in 2001, 2002 and 2003. We would look forward to reviewing this information with you, and please do not hesitate to contact any of the undersigned if you have any questions.

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