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Tuesdays with Laurie: To MHC or not to MHC, that is the question

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By Laurie Hunsicker

Laurie Hunsicker spoke with some of the industry's "top conversion gurus" for this week's roundtable, discussing the pros and cons of the mutual holding company corporate structure.

Laurie is a former senior financial services equity research analyst whose career on the sell-side spans 17 years, the last seven of which she was a managing director and co-head of the financial services group research department at FBR Capital Markets Corp., a majority-owned subsidiary of Friedman Billings Ramsey Group Inc.

Ron Riggins is the founder, president and managing director of RP Financial, which provides financial and management consulting, merger advisory and valuation services to the financial services industry. The firm assists clients with de novo charters, IPOs, mergers and acquisitions, branching, strategic planning, capital planning and reorganizations. Riggins has been serving as an adviser, strategist and financial analyst since 1980 and has extensive capital markets experience.

Alan Schick is a partner with the law firm of Luse Gorman Pomerenk & Schick. He represents financial institutions and specializes in mergers and acquisitions, public and private capital raising, corporate and securities law, executive compensation and general bank regulatory matters.

Mark Cohen is a managing director at Stifel Nicolaus & Co. Inc., having joined the firm in connection with the acquisition of Ryan Beck in 2003. Prior to joining Ryan Beck, Cohen was partner and co-founder of Adams Cohen Venture Capital LLC. Mark co-founded Adams Cohen Securities in 1984 and led it to the top of the industry rankings in handling mutual-to-stock transactions. Over the course of 10 years, Adams Cohen raised more than $7 billion in capital for thrifts and banks. In 1995, Cohen merged Adams Cohen & Associates and Adams Cohen Securities with Sandler O'Neill & Partners LP. Mark served as a principal at Sandler from 1995 through 2001, where he had the responsibility of handling all conversion transactions.

The final panelist in this week's Tuesdays with Laurie, Larry Seidman, has made a name for himself as an activist shareholder, engaging in proxy battles, working his way onto company boards and urging certain institutions to find ways to increase shareholder value, often through M&A transactions. Since 1995, Seidman has been the principal of numerous investment vehicles, including Seidman & Associates LLC and Seidman Investment Partnership. Since the start of his career in 1977 as a staff attorney for the SEC, with an emphasis on real estate syndications investigations, Seidman has worn various hats, ranging from private-practice lawyer to real estate developer to legal and financial consultant for an environmental company. He currently serves on the board of Center Bancorp Inc., his eighth board appointment.

What follows is an edited transcript of their May 5 conversation.

Laurie: Thank you for joining us. We've got a fabulous lineup of what I'd would say are some of the top conversion gurus. Today's roundtable is going to focus on the [mutual holding company]. There have been three first-step MHC IPOs in 2008, and despite a reduced appraisal, two of those three, Meridian Interstate Bancorp Inc. (MHC) and Sound Financial Inc. (MHC), are trading below issue. Last year, in 2007, 11 MHCs came to market, and of that group, six are trading below issue: LaPorte Bancorp Inc. (MHC), FSB Community Bankshares Inc. (MHC), Hometown Bancorp Inc. (MHC), Sugar Creek Financial Corp. (MHC), Delanco Bancorp Inc. (MHC) and Polonia Bancorp (MHC). In a strong market, MHCs outperform because they are a leveraged play off of appraised values. In a weak market, like the present, they underperform. Ron, will you take us through the relationship of the public MHC thrift price performance relative to the market pricing for other banks and thrifts?

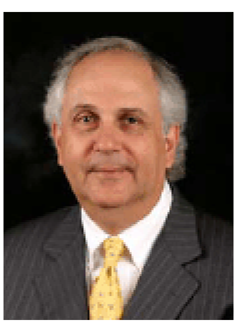
Ron: Sure. Good morning, Laurie, thank you. Historically, the pricing of public MHCs has tended to be more volatile than full stock thrifts and banks â€” the reason, the price of public MHCs is based on the expectations of completing a second-step conversion. There's always the uncertainty as to the timing of the second step and the uncertainty of the market conditions at the time of the second step. Typically, when we have a stronger overall market and a stronger IPO market, we wind up with stronger pricing for MHCs. Conversely, when we have a weak overall market with a weak offering market for thrift stocks, we wind up with weakened MHC pricing. Now the ones that you mentioned Laurie, the majority of those were smaller MHCs that are listed on the OTC Bulletin Board, so they don't have the same type of liquidity as larger MHC offerings completed during 2007 who have had better price performance than those listed on the OTC Bulletin Board.

Now, despite everything I just said in terms of the general volatility of MHC stocks, during the last three years the MHC index has outperformed bank and thrift stocks whether we're looking at 2008 year-to-date, one year, two years or even three years back. So, typically I would expect greater MHC price volatility but we haven't seen that this year.

Laurie: Sure.

Mark: Laurie, I was just going to say that I agree with Ron, but I was going to ask about those names. It seems to me there are a lot of small names in there, and there's a prejudice in the market against the smaller names for some of the reasons that Ron mentioned. Also those companies, even full conversions that are small, tend to not have research coverage [and] don't tend to have an institutional following, [and] they sort of get lost in the mix and drift lower. It's not that their prices are driven lower, it's just that there's not a lot of support to boost them up in this kind of market.

Laurie: Yes.



"I don't think that I have seen that big a difference between the managements that do full and the managements that do partials to start … I think more than anything this has to do with where you start your life as a public company … this is a wonderful time to be doing a full conversion or the first step of an MHC, and of course the hope is that you wouldn't be doing a second step of an MHC at 65% of book. You'd do the first step at 65% of book and the second step at 125% of book or more."
Mark Cohen

Alan: I would also like to pick up on what both Mark and Ron said. If you look at recent conversion activity, full conversions as well as MHCs, as of the end of last month, three of the five most recent conversion and mutual holding company offerings to come to market traded down. Cape Bancorp Inc. has returned to its IPO price or a couple of pennies higher. So I think that while clearly there is more volatility for MHC stock prices, what we're seeing in conversion offerings that have come to market during the fall and winter relates to the fact that we've just had valuations get very high while the market turned negative for financial institution stocks.

Laurie: Yeah.

"I think over the last 15 years the MHC structure has become very well established. Many mutual institutions prefer the mutual holding company structure because of the fact that they raise less capital, so a lot of the fears they have as to what to do with being grossly overcapitalized are minimized. The OTS has been an extremely good regulator of MHCs."
Alan Schick

Ron: So, if we look at one that has recently completed in this post sell-off period, William Penn Bancorp Inc. (MHC), they wound up closing at about a 56.5% price to book and they have since traded up about 35%. So they've had the benefit of completing in this post-correction market.

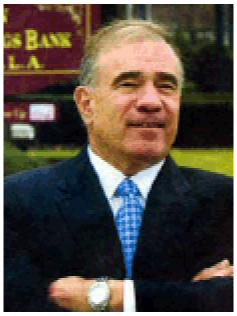
"Certainly today for a small thrift looking to go public, if they're looking at an MHC transaction, they would wind up having a discounted price-to-book ratio compared to a full conversion that would create a more liquid stock. Some of the other determinants of value for MHCs are the amount of the ownership ratio by the current MHC … the amount of pre-offering capital that the MHC currently has going into the second-step offering is a big influence, the higher the capital that they have, the more capital they're going to raise in the offering, and they wind up depressing their return on equity."
Ron Riggins

Laurie: Ron, if we could go back to something you said earlier, I want to talk about some of the key determinants as far as market pricing. I think one thing that you all three have echoed here is smaller asset size obviously is hurting these companies in terms of after market performance. So wouldn't smaller asset size then really dictate a very sharply reduced appraisal in this sort of market? Ron, possibly you could touch on some of the other key determinants of market pricing in public MHCs?

Ron: Yes. The size of the offering is a big determinant. It depends on the type of market environment that we're in as to whether offering size would be as much of an influence as it might today. Certainly today for a small thrift looking to go public, if they're looking at an MHC transaction, they would wind up having a discounted price-to-book ratio compared to a full conversion that would create a more liquid stock.

Some of the other determinants of value for MHCs are the amount of the ownership ratio by the current MHC â€” the greater the ownership ratio the greater the offering size that we will have and that has an influence on the price-to-book ratio. Also, the amount of pre-offering capital that the MHC currently has going into the second-step offering is a big influence. The higher the capital that they have, the more capital they're going to raise in the offering, and they wind up depressing their return on equity. So certainly going into the offering, MHCs are able to leverage their equity or to repurchase shares being perhaps in a better position in terms of second-step pricing. Growth in the market area that they operate in is also a big factor. Those that are in more urban markets have greater capacity for growth, and typically they will have much higher pricing.

Laurie: Great. Does anyone else want to comment?



"What you really have is a system that is socialism, that is really, basically a regulatory created ownership structure. The regulators, law firms and the investment bankers have created and exploded this system and have continued the system when in reality, if the depositors are really the owners of these institutions, then why should they pay to get IPO stock? The depositors should be given the stock."
Larry B. Seidman

Larry: I have a question. Ron? How are you doing?

Ron: Fine, Larry. How are you?

Larry: I have a question for the three other participants. Who do you really represent, Ron? Do you represent the depositors or the management? Because there's a conflict of interest between those two.

Ron: From an appraisal point of view, we represent RP Financial in terms of determining an appraisal independent of all parties. Independent of the investment banker. Independent of the bank.

Mark: At Stifel? At Stifel Nicolaus we represent the issuer, and of course when we're selling in a syndicate we represent the future shareholders. But our first allegiance is to the issuer.

Larry: Well, who is the issuer?

Mark: The bank's holding company.

Larry: Well, who is the bank? Is it the new shareholders, the depositors or is it a select group of management who are paying you, basically hiring you? Because the valuation for a depositor, the lower the better. What does he care? The only reason the managements care about getting a higher appraisal is so their benefit plans will be higher.

Mark: Well, Larry you're covering a whole bunch of things all at the same time. First of all, the appraisal is an independent appraisal, that's done by people like Ron, and we have no influence on what the appraised value is and where the market is at the time that the deal is being done. As to who we represent, the bank's depositors are represented by a board and the board votes, usually unanimously to convert the company either in a full conversion or in a first step of an MHC and where the value is at the time is a determinate, I guess, in their thought process as to whether or not they decide that it's right to convert or not to convert. So I'm not sure what the issue is that you're looking for?

Larry: There's a big issue. What you really have is a system that is socialism. That is really basically a regulatory-created ownership structure. The regulators, law firms and the investment bankers have created and exploded this system and have continued the system when in reality if the depositors are really the owners of these institutions then why should they pay to get IPO stock? The depositors should be given the stock.

Mark: Larry, first of all, the depositors are not the owners of the institution. The depositors are creditors of the institution. They're entitled to their money back plus interest. There's no question about ownership as a depositor. And secondly, you know they put together with lawyers â€” and Alan can comment on this â€” a prospectus that covers their past five years of operating history, tells you their story, tells you what they've been doing and that they've been in business for a 100 years, that's who they are. And to tell you the truth, for people like you to get involved in their stock and then expect them to change their spots the next week or the next month is also a little bit unfair. I don't want to call it socialism, but it's some other kind of word that isn't right. â€¦ It's bullyism.

Larry: Well, let me respond to what you just said, then we can hear the lawyer's view. You don't find it almost insulting, take Kearny Financial Corp. (MHC), where the president of the institution earned last year $2.6 million and the company's net income was approximately, let's say around $1.8 million. Now there's no way that the shareholders who own this stock can do anything because of the MHC corporate structure. There is no other system in the world that has a public company really being a private enterprise that was created by a regulatory agency.

Alan: Let me comment on what Larry's saying. Larry, I've read things you've said in the past and I've heard your views on MHCs. As a policy matter 20 years ago Congress authorized this type of a structure and since that time the OTS and the FDIC and a number of states have recognized that form of corporate structure. Quite frankly, under corporate law there's precedent for allowing controlled shareholder forms of corporate ownership. Over the last 15 years we have not seen the kinds of abuses that you argue are systemic in the MHC structure, and in fact we can point to a large number of instances where the MHC structure has allowed community banks to grow their franchises and thrive and provide good returns to shareholders.

Finally in response to what you said, nobody's ever played hide the ball with the investing public. Prospectuses clearly indicate the fact that there is a control shareholder in the MHC, so investors know the nature of their investment. Also, ongoing securities reports make it very clear that the mutual holding company is the majority shareholder. If the abuses that you cite were so prevalent, I would suspect that there would have been lawsuits against the MHC structure or the corporate governance scheme that would have been successfully prosecuted by now. That's not been the case. I also think that the regulatory agencies themselves would have been more proactive in changing the rules governing MHCs. Quite frankly, over time the regulatory agencies have reviewed corporate governance in the MHC structure, and where they deemed it appropriate, made policy or regulatory changes. But the system works and as a policy matter, the agencies have decided that there are interests associated with permitting the MHC structure to exist that are in addition to interests of shareholders. If an investor believes that his right as a shareholder is paramount over the other considerations a company may have in running its business, they should find another kind of investment.

Larry: Well, I beg to differ. You say that these are community banks and the policy is that you need community banks. I'll bet you if you did a study, and I did a random study in New Jersey, you will find that most of the small mutuals and mutual holding companies charge more for their lending products than most of the larger institutions which could also be defined as a community bank. The system is outdated. It's a dinosaur. It's only been perpetuated by the professionals. Now you didn't answer my question. Can you justify Kearny Financial paying a person $2.6 million when the company only earned approximately $1.8 million? You didn't answer that question. Could you please answer that question?

Alan: It's a red herring question. If there was a breach of fiduciary duty, any shareholder has a right to file a lawsuit and ...

Larry: Alan, you didn't answer my question. I asked you: is it unconscionable for that to occur in this age of transparency and accountability? You want people to spend all this money on a litigation when it's really the obligation of the people representing us, you said or someone said before, you represent the shareholders of this institution. I asked you a very simple question...

Alan: I'm not going to answer a question about Kearney.

Larry: Why not? I thought it was a simple thing.

Mark: Larry, there are so many companies in this country where the CEOs are making a ton of money while the companies are losing money. It happens all the time; it's got nothing to do with Kearney.

Larry: It has a big difference. You want to know why, Mark? Because those companies where those people are making that money, the shareholders have the ability to throw them out. In Kearny because of the structure the shareholders have no ability to throw these people out. That's why it's a travesty.

Mark: The shareholders knew that going in, before buying in their MHC transaction.

Laurie: Let me just jump in. Larry, I know you're not a fan of the mutual holding company structure.

Larry: That's right.

Laurie: Maybe you can take us through the several reasons why you don't like the MHC structure.

Larry: One, I'll tell you one part I do like and I haven't figured out who said it before. From a sheer economics standpoint, it's a great structure because you get the greatest leverage. The problem with the structure is that you allow people, especially in the very small mutuals that do these mutual holding companies who don't even have the ability to run a candy store, to run institutions and make exorbitant amounts of money at the expense of shareholders without any accountability. That's the problem. So if you want to have a mutual holding company create accountability, then it's a great structure. Without accountability, it's a lousy structure. That's really the problem I have with the structure.

Laurie: OK. And Larry, I've got another question for you. If we look in today's environment, can an investment in a mutual holding company offering generate a higher return for shareholders, assuming a subsequent second-step conversion, than in a standard conversion scenario?

Larry: Yes.

Laurie: But you prefer a standard full-conversion scenario?

Larry: I prefer a full conversion but you're correct, properly operated with competent management, it's been proven as some people said before that MHCs make more money because of the leverage.

Laurie: Because of the leveraged math on the exchange ratio. Because of the leverage, right.

Larry: Because of the leverage. But what you're really doing is saying to people who are running these institutions to please do the right thing, but if they don't want to do the right thing and they just want to really glom all this money from the shareholders, there's nothing that can be done to them.

Laurie: But unlike when we invested in mutual holding companies in the '90s, and we were unclear of the structure or even unclear of the second-step math, at this point obviously there is a precedent. So if you buy so much as one share of a mutual holding company, don't you know what you're getting? You understand ahead of time when you purchase that share that there is not full accountability.

Larry: Well, I will answer you with a story about a statement made when I worked at the SEC by the SEC's chief enforcement officer to a lawyer who once said to him, "The SEC is strictly a disclosure statute and if my client discloses that he's going to commit a fraud then you can't do anything to him," and the SEC's enforcement officer responded, "If your client discloses that he's going to commit a fraud, that's a fraud." This is a system that is so flawed for a lack of transparency and accountability it allows people who are basically not businessmen and are not providing any great service to any community to basically make millions and millions of dollars for providing very little back to the community.

Mark: Larry, I don't think that answers Laurie's question. We've been doing mutual holding companies for fully 20 years and there is plenty of transparency. I think what she said is correct. You know when you buy the stock of a mutual holding company what you're getting, and if you don't like it, you shouldn't be buying the stock in a mutual holding company; you should save your powder for the full conversions if that's what you like.

Larry: My answer to you is that that's not how you create systems, by saying "Hey if you don't like it, don't invest," that's not a proper response because the depositors are the ones who created the value in those institutions, and they're the ones who are really getting screwed royally by the system.

Alan: I don't believe over the last 15 years you've seen compensation for management of mutual holding companies as being higher when compared to compensation paid to managements of fully converted institutions. In fact, throughout the 1990s, a drawback of the MHC structure was that the value of stock benefits available to management was far less than would be the case for a mutual undertaking a full conversion. I don't believe the kind of oversight that you think that you, as an activist investor, Larry, bring to the table would have an appreciable difference at the end of the day in compensation paid for the management of mutual holding companies. Having said that, I recognize that you know you could look at a particular institution and say, "If they were fully converted, I certainly would be more inclined to challenge management's decisions."

Larry: Well, Alan, I didn't want to bring this up but I have to bring it up because of your statement. Your firm represented Investors Bancorp Inc. (MHC) when Investors disclosed in their public IPO prospectus specifically how the benefit plan was going to be created, how many shares were going to be options and how many shares were going to be MRPs. Then, in the proxy materials, when they go out to get the plans approved, they say the MHC is going to vote for these plans, the board has over 50% and "we're going to vote for these ourselves and we're changing it to the tune of costing the shareholders approximately $17 million by taking shares out of the option plan and putting them into the MRP." Then they have the audacity to tell people that "we really didn't change anything even though it's $17 million more in cost because the MRPs don't have a strike price but we're going to vote for it ourselves."

And I'm sure you don't see that as a conflict or a problem. I am sure that's because you make money off representing those people. So I think your view is colored. Second, I don't see how any law firm can represent in a second-step conversion the present management and the potential new shareholders. Can you tell me there's no conflict of interest between the people buying the stock and the person owning the stock?

Alan: Absolutely not. I'll go right out there and say that as an attorney I represent the company and I give my best advice to the company's board and management, and the board and management make the decision. OK?

Larry: OK.

Alan: Where I differ with you is I take a look at what the corporate, regulatory and legislative structure permits, and we all understand that there were policy reasons for setting up the mutual holding company structure, including permitting mutual institutions some degree of control over the amount of capital raised, maintaining membership rights and having a long-term alternative to a full conversion. These policies have been vetted, are established and the procedures for carrying out the policies are in place. I advise a mutual institution as to what are the pros and cons of the various structural alternatives. I get back from them feedback as to where they see their business plan taking the institution, and we proceed from there. I really think it's a false argument to say that the professional advisers and regulators are just turning a blind eye to where compensation is and that should be an indictment of this corporate structure. I think that the OTS, for example, has looked at this and said, "You know what, we see a point in requiring a majority of the minority shares to be voted in favor of these benefit plans in order for their approval to be obtained." So there's an example of where the regulatory agencies have codified their stance over time.

Mark: I'll tell you what â€" something else. Incidentally, even in full conversions, I'm not aware of any full conversions that don't have their plans voted in place by the majority of the shareholders. Even the full conversions, Larry, which I think negates your point.

Larry: No, it doesn't, because remember one thing about a full conversion, after the plans are approved they vest over five years so if they're not doing a good job you can remove people and therefore, if they're only there a year, they lose fourth-fifths of their benefits by removing them from the board.

Mark: I'm not aware of people being removed from a board. Any of the conversions that have occurred subsequent to 1990 when JSB Financial Inc. came public are essentially community bank control conversions with foundations and all of these [employee stock ownership plans], [management recognition programs], option plans, etc. I'm not aware of any single management team that's been removed from a company because of these kinds of things. I'm just not aware of it.

Larry: Well, you have the ability to do it, whereas in the mutual holding company who's going to run a proxy contest other than a few, you know, a very select group of people?

Mark: In reality you don't really have the ability to do it in a full conversion. [In] a full conversion, as Alan well knows, with a Delaware charter or even a lot of the state charters, there's an 80% super majority provision for changing control, there's a 10% perpetual charter provision against voting more than 10% if you're an outsider.

Larry: Who's talking about that? No, I'm talking about voting.

Mark: The fact is in the full conversion and the controlled conversions that are done as full conversions, you have about as much control over what happens at the corporate governance level as you do in an MHC.

Laurie: Actually, I happen to agree with Larry here. Because we have seen a couple of conversions where there have been substantial changes in management and the board, really as a result of credit issues. While shareholders never pushed management out, there seems to be a higher degree of accountability to shareholders. Two that come to mind are Berkshire Hills Bancorp Inc. and also Avondale. Berkshire Hills had a massive change to management and board composition. Avondale ended up selling. Both of these companies used their conversion proceeds to grow in two very toxic areas in the subprime auto and subprime credit card.

Mark: Laurie, just to make a point and not to be argumentative about it, but you're citing a couple of examples in literally hundreds and hundreds of cases.

Laurie: You're right. I agree we've seen 600 conversions since 1990. But I'm saying when you have an extreme situation at a standard conversion, the shareholder can call for change. In a mutual holding company, that change has to come from the board. The board votes the majority of shares, and so there is no change. I would tend to agree with Larry in terms of the accountability issue. But where I side with you and Alan is that the shareholder knows ahead of time when he purchases a mutual holding company stock. He or she knows ahead of time what they're getting in for. I'd like to hear, Mark, from you, and Alan and Ron, about your thoughts on the pros and cons of the mutual holding company structure. Particularly as you're out there in the market arguably pitching this as one of the conversion options. And Mark, maybe we could start with you.

Mark: I'll be happy to start. And I'll tell you I'm not wild about mutual holding companies for different reasons from Larry. But first of all, I think they grew up in this sort of environment where managements would sort of get into the shallow end of the pool before they jumped into the deep end and try their hand at being a public company or at least try their hand at being half pregnant. So I'm not wild about that. I'm also not wild about the fact that when you create a mutual holding company, you essentially create an island that you really can't get off of unless you do a second step. You really can't sell it; you can't merge it; it's not really an acquisition vehicle because you don't have enough stock to really do any kind of meaningful acquisition. So as a vehicle, I think it's a way to test the waters and start your public life but I don't see it as the be all and end all, and I think over the course of my career I probably have done many more full conversions than I have mutual holding companies. However, it is right for many institutions.

Alan: I'd like to chime in here and say that you know my experience has been a little different. I am a big proponent of mutual holding companies. I have seen a lot of boards and management do a first step and get some capital in the door and grow their franchises far beyond what they could have done as a mutual and probably far beyond what they would have done had they undertaken a full conversion. I'll give you a couple of examples.

Back in the early '90s when MHCs were first starting, we did the first step for Fidelity Federal Bank & Trust in West Palm Beach, [Fla.]. They were a $600 million mutual institution, they levered their capital and built out a franchise and did a second step in 2001. When they finally decided to sell the institution in 2006 to 2007 to National City Corp., they had grown to over $4 billion in assets. Clearly management had done more at that institution than you ever would have expected, and they established quite a nice presence in southeast Florida. More recently up in Westchester, N.Y., back in 1998 Sound Federal Savings sold stock as an MHC. Here you had a long-standing mutual board, they had an introduction to having a stockholder constituency, but were able to remain focused on their longer-term goals to build their franchise. Over time, they grew the institution from $200 million in assets to over a billion in assets.

And finally, as an example of a mutual institution that successfully grew their franchise after starting as a mutual holding company, look at Hudson City Bancorp Inc. right now. I mean they've done a great job, I think, in building that franchise. So I think a big plus of the mutual holding company structure for a mutual institution is that you can take some capital in and follow a business plan that may not be short-term in nature, it may be on a three- to five-year time horizon and results in building a franchise that goes far beyond where the institution otherwise would have gone had the institution stayed mutual, or where they would have had an opportunity to go had the institution completed a full conversion.

Laurie: So Alan, let me ask you just a straight return question. All of the names that you've mentioned that have performed are no longer still MHCs. They've all second stepped. And like you said, it was an incremental use of capital and they made that decision. But when you say you are a proponent of the structure, when you look at the MHC today, then do you look at it very much in the path of a subsequent second-step conversion. Is that correct?

Alan: Not necessarily. I mean, many institutions decided to remain in the MHC structure and I think you could find more smaller institutions that like the MHC structure and feel comfortable that they can raise some capital, but not necessarily with a second step in the back of their minds. Again what I typically would do is sit down with the board of directors and find out where they see their business plan going, what their hot buttons are in terms of growing the franchise, potentially doing acquisitions and the like, and then of course you bring in the investment bankers and you bring in the appraisers and get a sense as to how much capital would be raised and what the institution in question could do with the capital.

Laurie: OK.

Mark: I would just say that I agree with Alan. There are plenty of companies that have stayed in the MHC format that have done very well, Bank Mutual Corp. is one. I think Northwest Bancorp Inc. (MHC) is another one. Even People's United Financial Inc. for which we did this huge second step last year, for 18 years, it was the very first mutual holding company and stayed in that format for 18 years. So there are plenty of examples of companies that are very comfortable in that format.

Ron: In terms of looking at some of the returns too, I think it depends on the execution of the business plan. Provident New York Bancorp is someone we've represented through their first offering, some acquisitions and subsequent second-step offering. And when you go back and you look at their return they've got about a 400% return on their investment since they went public. When you look at the SNL Thrift Index it's only up about 40% over the same time. And so clearly it's in the execution of the business plan, the ability to grow and to implement acquisitions, but sometimes those are difficult to find initially. But there's an example of a very committed management team, and I think many of these mutual holding companies do go in with a very sound business plan to implement growth, to repurchase shares, to complete acquisitions. Sometimes it just takes a little longer to execute that.

Laurie: And Ron maybe you could give us some conversion pricing, generally. I mean obviously standard, mutual holding companies and second steps are all interconnected. Maybe you could provide us with a snapshot in terms of history and price-to-tangible book ratios in first-step offerings and second-step conversions.

Ron: Sure. Let me just start with 1997. With 1997 we had standard conversions completing at that point in time at about a 72% price to book, second steps were at about 93% price to book, and MHCs were at about 67% price to book. We then hit a peak period during 1998 where the pricing crept up, peaking at 76% price to tangible book for standard conversions, 107% for second steps and a 70% for MHCs. We went through the recessionary environment during 2000, 2001 and then we hit 2004 with peak pricing for standard conversions at about 86%, second steps at 124% and MHCs at about 86%.

If we look at, say, the last six months, we've seen a pull back in that pricing and we're looking at about an 81% price to tangible book for standard conversions, 80% for second steps and 74% for MHCs. In today's environment, however, because we've had continued adjustments during this quarter, if there were a new entity going to market for a standard conversion we would probably be looking at about a 65% price to book and for an MHC that has a reasonable degree of liquidity probably in the range of about 60%. And historically we've seen that the MHCs carry a discount to the standard conversion market. So that is part of where you get your return is that as they become a full stock company they pick up that discount in their initial pricing.

Laurie: OK. Ron, just to clarify â€” if we saw a bank that was second stepping, as the gap in appraisal has seemingly narrowed between where a standard and a second step come, is it safe to assume that we'd also see a second step come at about 65% of book?

Ron: I think we would probably be looking a little above 65% price to book, 65% perhaps to 70%. It depends on the individual entity and some of those factors that I outlined before in terms of the ownership ratio pre second step equity ratio use of proceeds.

Laurie: Larry, you are the investor on the panel. If you were looking at buying a first-step MHC, a standard or a second step, what are your thoughts on buying at those pricing metrics?

Larry: I think they're great metrics. I hope Ron's correct in his metrics. And my view is that this is the perfect time for every mutual to go public either as an MHC or full conversion because of the pricing metrics. This is the perfect time because you can raise less capital. Many of the companies have only been able to do the minimum and the less capital you have the less growth you need to make a good return for your shareholder. And one other comment the three panelists mentioned a number of companies that have done well and they've all picked excellent companies. The key thing is all those companies had good management. From my perspective as an investor they're doing a great job for their shareholders. The difference with the mutual holding company structure is that if the management is poor then you're out of luck because there's nothing you can do to them. So they have total control over all this money but no accountability. I mean, Ron mentioned a great company up in New York state, as I agree the company has a great management team. Therefore, you don't mind if they do a first step. They mentioned Hudson City, phenomenal management team and they were up front about everything they did. So therefore if you have good management and you have performance. Performance will always win and stop anybody from giving any management a hard time.

Mark: Well, Larry, I would say that qualitatively I don't think that I have seen that big a difference between the managements that do full and the managements that do partials to start. I think the guys have picked very good companies which is natural. I think more than anything this has to do with where you start your life as a public company, and I think you're correct, this is a wonderful time to be doing a full conversion or the first step of an MHC, and of course the hope is that you wouldn't be doing a second step of an MHC at 65% of book, you'd do the first step at 65% of book and you do the second step at 125% of book or more. And there have been plenty of those. So I don't think it's so much that the management has been so different, I think that it's a matter of the timing for a lot of these institutions. Less is more.

Larry: Mark, I would agree with you up to the point where you said the managements are not different. I think the thing that differentiates the valuations and the success is the competency of the managements and therefore the smaller mutuals. Most of those really provide no service to the community; they don't have good management, so they're really going public one way or the other, first step, second step, basically so the managements can get the rewards that in most instances they're not really entitled to. The companies that were mentioned before do not fit into that category because they all had excellent management teams. Because of the comments made by the other panelist, why don't we just have a preschool for mutual people just like before you go to kindergarten so they can learn how to be a public company? If you're a public company, you're a public company. That's the bottom line and you have accountability to your shareholders. [That is the] only reason I object.

Laurie: Larry, if you were to give advice to a mutual board or a mutual management team, regardless of size, and they were considering converting to stock form, what would be your top one or two pieces of advice?

Larry: One, is that you have to look at what your business plan is, how you grow the institution, and if you don't have the ability to grow don't go public, just sell your company to a company that can use the assets. Hey there's a deal done in New Jersey, I know Alan's firm, I think Alan's firm represented them, the Summit deal, I mean I have no objection to that type of deal. It's a small mutual basically selling to a mutual holding company. Great. But they're giving it to people who at least have the ability possibly to create value. I don't think that the mutual would have any ability to create value. So that's great. The second thing is it's impossible for these companies to change from a mutual if they're small to a commercial bank. So don't keep telling everybody you want to change. When you get the opportunity buy back every share you can. That's my advice.

Laurie: Well Larry, I agree with you on the buyback. I do love the buyback. One question I would like to throw out to everybody. Certainly the mutual holding company structure without a doubt is controversial and harder to value in a volatile market. And it has largely been an OTS-sponsored program right from the beginning. The individual states have sometimes come along grudgingly. The FDIC does not have the same affinity for the program given their bent towards the larger stocks. What happens to the mutual holding companies if the OTS does in fact disappear? What happens to those companies that are thinking about a second step, what's their exit plan?

Alan: I'd like to take a first stab at that. I for one think that, number one, MHCs shouldn't been seen as controversial. Larry's comments notwithstanding, I think over the last 15 years the MHC structure has become very well established. Many mutual institutions prefer the mutual holding company structure because of the fact that they raise less capital, so a lot of the fears they have as to what to do with being grossly overcapitalized are minimized. The OTS has been an extremely good regulator of MHCs. Having said that you know there is a constituency of mutual holding companies that are out there. I think any successor regulatory agency, if the OTS were to be absorbed by the OCC or another agency, would be mindful of the constituency of financial institutions in the MHC structure. There will be a vested interest of any successor regulatory agency in maintaining the mutual holding company structure. So I believe that MHCs will continue even if the OTS were to disappear.

Laurie: OK, good thoughts.

Mark: Let me keep on the same subject. I also agree with Alan. I don't think there's a controversy relative to the fact that MHCs will be in existence and will be here. First of all, part of this is we've all been hearing about OTS disappearing now for about 15 years, and I'll believe that when I see it. But we do have to go back to thinking about the FDIC and their white paper. I think if we do truly get regulatory reform this is a whole new horizon for not only MHCs but full conversions as well. The fact is that this baby has grown up under the OTS and the federal home loan bank board before that and I think all bets come off if the states or some other super agency takes a fresh look at the mutual holding company and the full conversion business. So I'm hoping that doesn't happen for quite a long time. And the other thing that we haven't touched on here yet either is the fact that at some point you know we're going to see credit unions enter the fray in a much more organized way. So there's a lot at stake with a brand new agency rewriting history.

Laurie: Good points. Anyone else want to weigh in?

Ron: A couple of things. First, there's a difference in policy on the treatment of waived dividends between the OTS and the FDIC. If the OTS were to disappear, that would raise some questions as to whether the OTS-regulated thrifts would benefit from grandfathering on their dividend waiver treatment or whether they would have to conform with the FDIC and the Federal Reserve requirements for dividend waivers. So that may lead to less MHC activity and perhaps more second-step activity.

Also, there's been a bias by the OTS historically for well-capitalized thrifts to pursue an MHC transaction alone, in which they would actually challenge thrifts in terms of their intention to pursue a standard conversion for fear of raising too much capital and related safety and soundness issues â€” raising too much capital and too quickly putting that capital to work. Today the OTS's bias has basically dissipated, especially over the last two to three years â€” the FDIC has never expressed that particular concern. So in the event that the FDIC were to be the primary agency of review, I think we would possibly see more standard conversions because of that earlier OTS bias, which still lingers but not to the degree that it did once before.

Larry: If the system was really fair and the mutual managements wanted to reward the people who created the value, they would just give the stock to the depositors. And if the mutual needed additional capital, do a simultaneous capital raise from depositors and the public. This would limit the amount of benefits that would be available to the management of any mutual and therefore the idea has very little chance of being implemented. Maybe Congress will make the banking industry look more like the insurance industry where the policyholders receive stock without compensation. I think that if you want to stop having too much capital in these institutions, very simple, give the stock to the depositors.

Mark: Oh good grief.

Laurie: That's what they do in the U.K., Larry.

Larry: Yeah. Give the stock.

Laurie: Despite the varying viewpoints here I think there is one thing we can all agree on, that anytime we're in a low environment it's the perfect time to convert. Would you all concur?

Mark: Absolutely.

Laurie: I should clarify that by saying first step or mutual holding company, certainly not second step.

Larry: I'd say give the stock to the shareholders [depositors].

Mark: First step or a full conversion, I think, is what you meant to say.

Laurie: Yes, you're right. First step MHC or standard full conversion, correct. Exactly. Just not a second step. Yes. This is a great time for mutuals to get a low appraisal.

Mark: Right.

Laurie: Well, gentlemen, thank you very much. This has been a lot of fun.

Alan Schick, or a member of his household, has a financial interest in the securities of Cape Savings in the form of a long position in such securities.