Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

November 22, 1994

To: ALL FIRMS ENGAGED IN MUTUAL TO STOCK CONVERSION APPRAISALS

The Appraisal Guidelines, revised as of October 21, 1994, has been updated to appropriately and accurately reflect our past and current requirement of a full appraisal report when the pro forma market value is reviewed in mutual to stock conversions.

The OTS recently adopted interim and final rules designed to update, clarify and strengthen the standards of mutual to stock conversions and to ensure the integrity of the conversion process. Among other things, Section 563b.7(f)(1)(ii) of the conversion regulations was amended by deleting suggestions that the appraisal report need only be a "brief summary" and specifying that a full appraisal report is required. The revised language codifies the current practice of OTS staff requiring a more complete and detailed description of the elements that make up an appraisal report and justification for the methodology.

As discussed in the preamble to the interim and final rules, the integrity of the conversion process rests, in large part, on the accuracy of the appraised value of the converting association. No method of conversion could be considered equitable unless the conversion stock is accurately appraised and sold at its pro forma market value, eliminating any "windfall" distribution in the value of the converting association. The OTS is concerned that appraisal reports may have set pro forma market values below the true value of the converting associations. At the same time, OTS is just as concerned when values fall below the initial price offering. In order that the conversion stock be sold at its pro forma market value, reliance is placed on the independent appraiser to recommend a value that is impartial, objective and arrived at independently, without undue influence from the converting association or any of its agents.

The guidelines should be carefully read to determine if additional exhibits, tables and narrative descriptions are required, which may be more extensive from appraisal reports previously submitted.

As always, your cooperation is requested, as uniformity in the appraisal reports to the extent possible, will assist our staff in their review. If you have any questions regarding the guidelines, please contact Fred Cortese (202-906-7096) or Leon Pleasants (202-906-6414).

Very truly yours,

/S/

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GUIDELINES FOR APPRAISAL REPORTS FOR THE VALUATION OF SAVINGS INSTITUTIONS CONVERTING FROM THE MUTUAL TO THE STOCK FORM OF ORGANIZATION

Revised October 21, 1994

INTRODUCTION:

These guidelines set forth requirements for appraisal reports submitted to the Office of Thrift Supervision ("OTS") as part of applications for mutual to stock conversion under 12 CFR Parts 563b (standard conversions) and 575 (mutual holding company subsidiary stock offerings).

An issue of great concern to the OTS in the conversion process is the correct pricing of conversion stock. The OTS's conversion regulations are based on the premise that the underpricing of conversion stock results in potential "windfall" distributions of the value of a converting association. In order to ensure that conversions are fair and equitable transactions, the regulations require that conversion stock be accurately appraised and sold at its pro forma market value. The regulations further require that the determination of fair market value be made by a qualified independent appraiser.[1]

The OTS is concerned that recent conversions have exhibited significant increases in the immediate post-conversion trading market for the stock. Although some of the increases can be explained by the high level of speculation that has existed recently in the market for financial institution stocks, the OTS is concerned that many of the appraisal reports may have set pro forma market values that were significantly below the true value of the converting associations. In such cases, the converting association is harmed because the new proceeds from the conversion, and the association's resulting capital levels, are lower as a result of its stock being undervalued upon issuance. In addition, insiders and other investors can accrue undeserved financial benefits.

Appraiser's Independence

The conversion regulations require that the appraisal be prepared by persons independent of the applicant, expert in the area of corporate appraisals and acceptable to the OTS. The OTS relies on the appraiser to submit an impartial, objective and independent report. Since the calculation of pro forma market value is derived, in large part, from the appraiser's professional judgment, it is vital that the appraiser's conclusions be impartial and free of undue influence. The estimated pro forma market value is, therefore, required to be solely the opinion of the appraiser although in the normal course of due diligence, the appraiser should consult with the applicant and the applicant's agents, the law firm, the selling agent and the accountants.

1. See 12 CFR § 563b.7(f)(1)(i).

In cases where there appears to be a consistent pattern of undervaluation on the part of an appraiser, the OTS may conclude that the appraiser has not acted independently or competently. In such cases and in cases where the initial appraisal report is deemed to be materially deficient, the OTS may deem the entire conversion application to be substantially incomplete and in accordance with the OTS application processing rules, decline to further process the application. In more egregious cases, the OTS also may determine to censure, suspend or bar an appraiser from practicing before the OTS under the OTS rules of practice, 12 CFR Part 513.

Appraisal Report

The appraisal report should clearly and concisely justify the appraised value and fully explain and document the method by which the value was derived. The appraisal report should reflect the premise that it rests both on a body of facts about the subject company and similar companies already publicly traded, and upon the professional judgment of the appraiser. An appraisal cannot be based upon a mechanical application of certain rules or formulas, rather it must embody a well-reasoned evaluation by the appraiser.

The appraisal document, in conjunction with the offering materials, should contain sufficient information and analyses to allow the reader to evaluate the reasonableness of the appraised value. The data assembled and the analyses developed must be professionally acceptable in terms of relevancy and accuracy. Appraisal reports submitted to the OTS also must be signed by a principal of the firm. (See Attachment I for standard exhibits that should be included in the report.)

Incorporated and included as part of these guidelines are provisions in the business appraisal standards of the Uniform Standards of Professional Appraisal Practice ("USPAP"), adopted by the Appraisal Standards Board of the Appraisal Foundation. In developing the appraisal report, the appraiser needs to consider and conform to Standards 9 and 10 of the USPAP. These standards have been developed for ethical conduct and offer general guidance to good appraisal practices.

Pre-filing Requirements

As a policy matter, the OTS requires an appraiser who is submitting an appraisal report pursuant to Section 563b.7 of the OTS regulations to present certain credentials that must be accepted by the OTS. Such credentials should include the following:

A. An affidavit of independence must be submitted for each appraisal report and shall state: (1) that the pro forma market value represents the appraiser's independent judgment; (2) that the amount of remuneration is not related to the final value estimated by the appraiser; (3) that the appraiser is independent and has fully disclosed in a written statement to the OTS any relationships that may have a material bearing upon the question of independence; (4) that any indemnity agreement with the applicant has been fully disclosed in a written statement to the OTS; and (5) that the appraiser has not been unduly influenced by the converting association, the selling agent, the applicant's law firm or any other agent connected with the conversion.

B. The appraiser's resume that contains a description of his/her background and qualifications, including (1) dates of attendance at educational institutions and courses taken relevant to the valuation of securities; (2) dates of employment and names of employers for the past ten years, including job title or function performed for each employer, noting experience that is relevant to the valuation of securities; (3) academic degrees and professional designations; (4) special courses and training; and (5) names and dates of other securities appraisal or valuation reports prepared.

C. A copy of a recently prepared appraisal report prepared by the appraiser (if the appraiser has not had a recent or previous working relationship with the OTS).

D. An executed RB-20 certification.

APPRAISAL METHODOLOGY:

The valuation of a mutual association converting to stock form involves analytical judgments of the financial position, operations, economic environment and market analysis of a conversion candidate. The judgments are the same components of analyses that a "rational investor" must make when deciding to invest in any equity. An appraiser's valuation constitutes an informed estimate of how the marketplace will receive and assess the value of the converting institution.

Appraisal of conversion securities is an assessment of the viability and development of the association now and in the future, and must be based on facts available at the date of appraisal. A determination of fair market value will depend upon the specific circumstances in each case. A sound appraisal will be based upon all relevant facts but the elements of common sense, informed judgment and reasonableness must enter into the process of weighing the facts and determining their aggregate significance.

Appraisals generally should employ three fundamental valuation ratios: price/earnings (P/E), price-to-book-value (P/BV) and price/assets (P/A). Any one of the ratios may be emphasized as a primary valuation methodology provided support for the methodology selected is documented in the appraisal report and the appraiser explains the implications the valuation methodology has for the comparison of the converting institution and the comparable group.

When both the converting institution and the comparable companies are recording "normal" earnings, a P/E approach may be the simplest and most direct method of valuation. When earnings are low or negative, however, this approach may not be appropriate and greater consideration should be given to the P/BV approach.

When discussing earnings, even if the P/E approach is not the central valuation methodology, the appraiser should explicitly consider such factors as the relative level and stability of earnings, the differential effects of taxation and regulation, competition, liquidity, portfolio structure, yield-cost spreads, operating efficiency and cash flow.

A second valuation method is the P/BV approach. The P/BV approach works best when the converting institution and the comparables have a normal amount of book value. The P/BV approach could seriously understate the value of an institution that has almost no book value but has an outstanding future earnings potential. For converting institutions with high net worth, the appraiser may have difficulty in arriving at a pro forma market value because of pressure placed on the P/E multiple as higher P/BV levels are required to reflect a similar P/BV ratio as the peer group average. The P/BV approach also suffers from the use of historical cost accounting data. The valuation of two firms with identical book values should clearly not be the same if the firms have significantly different yield-cost spreads and net interest margins. The appraiser should evaluate the differential effect of historical cost accounting methods and goodwill on the converting institution and the comparable companies.

A third valuation method is the P/A approach. This approach remedies the problems of a small base that can occur with the P/BV approach, but the approach has many of the other limitations of the latter approach.

The most important factor in the valuation is the selected price multiple (typically either the P/E, P/B Value, or P/A ratio). If the comparable group of companies is satisfactorily put together and if appropriate and consistent adjustments are made to the financial statements of the converting company and the comparable companies, the appropriate price multiple for the converting institution should be the mean or median of the price multiple for the comparable group. An exhibit should be included in the report showing the calculation of the average multiple. Any discount or premium applied to the multiple must be discussed and justified.

Typically, a set of comparable companies similar to the subject company in all the important factors is difficult to find. Consequently, the appraiser's judgment needs to be considered. In general, the appraiser applies judgment in three basic areas: (1) making adjustments to the financial statements, (2) selecting the comparable companies and (3) selecting the method of valuation and the specific value of the respective ratios. When the P/E approach is used, the historical earnings base will ordinarily be the 12-month trailing earnings of the subject thrift. Special circumstances may dictate that the income base be modified. Non-recurrent income or expense items should be excluded or reduced to "normally expected levels." Adjustments must be applied consistently for the converting institution and for all the comparable companies.

Basic Considerations:

The following factors are fundamental, though not all inclusive, elements of valuation analysis upon which an appraisal should be based:

1) origin and development of the institution;

2) past and projected economic conditions for the national economy, the thrift industry, the state, region and primary market area;

3) financial condition of the institution;

4) earning capacity of the institution;

5) asset size and efficiency of asset utilization;

6) projected dividend-paying capacity of the institution and its intended dividend policy;

7) intangible value of the institution;

8) marketability and liquidity of the stock to be issued;

9) comparison of the converting institution to similar publicly traded financial institutions and initial public offerings of public companies generally; and a summary of adjustments in comparing the converting institution to a comparable group;

10) management and key personnel;

11) effect of government regulation on the institution;

12) plans for the future of the institution;

13) competition from other financial institutions; and

14) level and direction of stock market and price trends.

Detailed guidance on these factors is contained in Attachment II.

Initial Offering Price Discount

The appraiser often sets the initial offering price of an institution on the basis of that for comparable institutions with "seasoned" common stock that preferably trade frequently in liquid markets. A discount from the estimated pro forma market value is sometimes used in setting the initial offering price to reflect the "unseasoned" nature of the stock offering. Such discounts act as an inducement to investors to take on the additional risk associated with a new public offering.

In the IPO of a private company, potential investors often lack key information, such as a lengthy track record of publicly disclosed accounting results, and have a limited ability to assess the quality of the information provided by incumbent management. Because of such uncertainty, initial public offerings of private firms in recent years have tended to be underpriced on average by approximately 11 percent.

Three factors make the 11 percent average underpricing for all firms too high a figure for an appropriate initial offering discount for a mutual to stock conversion. First, unlike most private companies, converting mutual institutions have a significant history of publicly available accounting and performance information. Second, the homogeneous nature of the thrift industry reduces some of the uncertainty and ambiguity in appraising the value of the converting institution relative to its comparables. Third, the owners of private companies generally seek to set the initial offering price as high as possible in selling part of their firms to the public so as to maximize their own profits. The latter incentive is missing in a mutual conversion because converting mutual institutions have no sellers, only buyers.

Net Conversion Proceeds

In all cases, the converting institution will generate a significant amount of new capital for which the appraiser must account. In this regard, the OTS generally requires that the appraisal report include standard exhibits containing pro forma and other post conversion analysis. (See Attachments III.A. - C.)

In preparing exhibits, an analysis of the yield on net proceeds requires a review as to how the funds will be invested for the long term, not just initially. The return on net proceeds is a significant factor in the calculation of pro forma net income. Too often, yields for the first year are based on investments for the first 30 or 90 days. It is presumed that management, acting in the best interests of its stockholders and in accordance with its fiduciary responsibilities, will turn over lower yielding investments for higher returns at a later date. Using a lower yield will result in lower pro forma income with a subsequently higher P/E multiple. It is expected that the appraiser also will examine the converting institution's past policy of investments to determine whether the anticipated yields are realistic for the full year.

Post Conversion Monitoring

The OTS pays close attention to the price appreciation of the converting institution's shares immediately following the initial public offering. The price appreciation is measured by the difference between the initial offering price and the first subsequent stable market-determined price.

For the most liquid, frequently-traded issues (i.e., those traded on a national exchange or on the NASDAQ/National Market System), the OTS monitors the cumulative percent change from the initial offering price to the close of business on the second day of trading. Other, less liquid securities are examined over slightly longer time periods because their interim prices do not yet reflect a stable market equilibrium. Generally, longer time frames are only used in those cases where the lack of liquidity or trading frequency demands it. The measurement of price appreciation over the shortest feasible time period following the initial public offering minimizes the possibility of subsequent firm or market developments affecting the price of the stock.

The percent change in the aftermarket for the price of the thrift's shares is compared to the percent change in an appropriate broad market index, e.g., the S&P 500 or the NASDAQ Composite. The price appreciation is also compared to the percent change in an appropriate index of thrift share prices.

A single bright line test for price appreciation does not exist. The amount of price appreciation, net of market, is, however, compared to the price appreciation for thrift conversion and other IPO offerings and the OTS also considers the possible effects of the relative amount of pre-existing equity in the firm and the outlook for new thrift portfolio investments.

Mutual Holding Companies

An appraisal of a mutual holding company ("MHC") is more complex than an appraisal of a standard conversion. Although the financial analysis is similar in both situations, there are additional considerations when a thrift issues minority stock. There is normally a significant difference in value between controlling shares and minority shares. After a standard conversion, stockholders hold the entire claim on equity. After formation of a MHC, stockholders, as a group, have only a partial claim on equity. In addition, many MHC offerings emphasize business diversification and takeover protection rather than the raising of capital. MHC offerings are usually anti-dilutive, which is a side benefit for investors. The appraiser should review the MHC's business plan with management to find out the possibility of future equity financings, affiliate transactions, stock repurchases, dividend increases and mergers and acquisitions that may affect the appraisal.

It is inappropriate to apply a heavy discount to MHC shares simply because they constitute a minority interest. MHC stockholders do not face the usual hazards of a minority issuance because management of the converting associations usually have a significant stake in the minority shares themselves, and they generally are the management of both the MHC and its thrift subsidiary.

Appraisal Update

An appraisal filed with the OTS needs to be updated twice - once before the actual sale of the stock because of changes in market conditions and/or the applicant's financial statement, and a second time to set the final price. The first update may occur subsequent to OTS approval of the conversion plan but prior to declaring the subscription offering materials effective. The second update occurs promptly after the termination of the subscription offering period.

The methodology for updating an appraisal necessarily depends upon the methodology employed in the original valuation. Neither the first nor the second updated reports need be full appraisal reports. The following developments, however, should be fully discussed: 1) changes in market conditions since the original appraisal; 2) recent changes in financial condition of the converting institution; 3) updated comparison of comparable companies; and 4) description and impact of the subscription and community sales offerings.

LIST OF EXHIBITS FOR INCLUSION IN APPRAISAL REPORTS:

1. condensed and consolidated balance sheet--5 years;

2. consolidated statements of income and expenses--5 years;

3. loan portfolio composition--3 years;

4. loan originations, purchases and sales activity--3 years;

5. classified assets--3 years;

6. investment portfolio composition--3 years;

7. loss allowance activity--3 years;

8. non-performing assets categorized as to type of investment--3 years;

9. fixed and adjustable rate loans given as to category as of the latest financial period;

10. loan portfolio maturity from one year to twenty years and over 20 years as of latest period;

11. interest sensitivity of each category in interest earning assets and interest bearing liabilities from within six months, six months to one year, one to three years, three to five years, five to ten years, over ten years and total as of latest financial period;

12. historical earnings adjustments to calculate normalized earnings for three years;

13. key operating ratios for five years;

14. borrowed funds outstanding - 3 years categorized as maximum borrowed amount during any period, average balance of borrowings and approximate weighted average interest rate paid;

15. list of properties owned, year acquired, net book value and square footage. If market value significantly exceeds net book value, give estimated value;

16. list of management (Officers and Directors) as to age, position, length of term as director or management position;

17. regulatory capital ratios as to percentage of pre and post conversion and percentage of surplus over regulatory requirement;

18. list of thrift acquisitions and pending acquisitions in converting institution's, city, market area, and county. Asset size of acquiror and acquired as well as purchase price, target price P/E and P/BV;

19. major sources of personal income in U.S., state, county and city;

20. unemployment rates in U.S., state, county and city;

21. new housing permits and growth rates for last three years for one-to-four family dwellings and commercial buildings;

22. market share by deposit of converting institution within county;

23. national interest rates by quarter for last three years of prime rate, 90 day treasury bills, one year and 30 year treasuries;

24. yields and costs of converting institution categorized as to yield on investments, mortgage backed securities, loans, cost of savings, cost of borrowings, cost of funds and yield/cost spread;

25. converting institution's comparative operations as a percentage of average assets for three years;

26. pricing fundamental ratios of thrifts listed on NASDAQ, NYSE and ASE, categorized as to assets, insurance, the region and state;

27. comparable companies listing name, trading symbol, asset size, location, price per share and market capitalization;

28. list of companies considered but not included in comparable group with reasons for exclusion;

29. comparable group's mean and median ratios compared to the thrift universe as to reported P/E, P/BV, P/TBV, P/A and dividend yield;

30. the converting institution's financial comparison to the comparable group giving selected balance sheet and operation data as follows: assets; deposits; equity; goodwill & intangibles; regulatory, tangible, core and risk-based capital ratios; non-performing assets/assets; loan loss reserves/loans; loan loss reserves/non-performing loans; total interest-earning assets; loan loss reserves/non-performing assets; book value per share; tangible book value per share; historical income; reported net income; adjusted net income; normalized net income; return on average assets, return on average equity, interest rate spread, loan loss provision/average assets; non-interest income/average assets; non-interest expense/average assets; charge offs/average loans; earnings per share; cash dividends per share; dividend payout ratio;

31. list of converting institution's risk assets as a percentage of total assets with a comparison to the comparable companies and a comparison of the converting institution's loan portfolio to the comparable companies; and

32. a brief comparison of the converting institution's market area to the market areas of the comparable group.

THE FOLLOWING IS A BRIEF DISCUSSION OF EACH OF THE FACTORS THAT NEED TO BE CONSIDERED BY THE APPRAISER IN FORMULATING THE MATERIAL IN THE APPRAISAL REPORT.

1) Origin and development of the association.

A description of the organization, including its location and size, must be reviewed where it is relevant to the association's future prospects. The origin and history of subsidiaries, service corporations, branch offices and other developmental factors must be reviewed. Appraisers should refer to the instructions for Item 7 in the Proxy Statement in the conversion regulations for the details required.

A brief history of the association is required to show its past stability, growth and diversity of its operations, or lack thereof, and other facts needed to form an opinion of the degree of risk involved in the business. Any material changes in organization or development must be specified and analyzed for their effects on value. The analysis should be increasingly detailed as the cut-off date for conversion approaches since more recent events are likely to have a larger impact on the future value of the institution. Events of the past that are unlikely to recur should be discounted. Discussion and interpretation of the past and present financial conditions are required to relate these data to value.

2) Past and projected economic conditions for the national economy, the thrift industry, the state, region and primary market area.

A sound appraisal of a converting thrift must consider current and prospective economic conditions as of the date of the appraisal, for the national economy, the thrift industry, the state, the region and the primary market area. The objective is to assess the prospects of the converting institution in relation to national and other trends. In matters relating to the economy, the appraiser should consider trends toward economic expansion or contraction, unemployment, savings, spending and interest rates. With respect to the industry, the appraiser should consider consolidation of the industry, technological advances and legislative changes.

Primary consideration should be given to the thrift's market area in comparison to the state and the nation. The economic data should include population, unemployment rates, civilian labor force, major employers, per capita and median household income, major sources of personal income, and new housing permits, information provided on market share and deposit growth rates should be compared to competitors.

The national economic conditions and outlook section should include a discussion of interest rates, such as the discount rate, prime rates and rates on overnight funds, treasury bills, five year and 30 year treasury bonds.

Thrift industry conditions and outlook should be analyzed and should focus on current economic and regulatory conditions affecting the industry as well as market conditions for thrift stocks and thrift conversion activity.

The appraiser should provide a list of all publicly traded thrifts with their names, locations, price per share, total assets, total market value, return on average assets, return on average equity, dividend yield, non-performing assets, price to earnings multiple for last four quarters and most recent quarter for reported and normalized earnings, with price to book and tangible book value.

The appraiser should submit a list of conversion applicants that closed their offerings in the last six months, including the institutions' names, locations, IPO prices, P/E, P/BV, P/TBV, P/A, and the trading prices after one day, one week and one month of trading. In addition, a comparison of the IPO prices to the trading prices, as to the P/E, P/BV, P/TBV, P/A ratios and the percentage of increase or decrease for one day, one week and one month should be made.

Names of institutions in the primary market area that were acquired or received offers to purchase their stock in the last year should also be listed, giving the prices prior to the announcements and the offering prices. At the offering prices, give the P/E, P/PBV, P/TBV and P/A.

3) Financial Condition of the Institution

There are at least five distinct operating strategies for thrifts: mortgage banking, consumer banking, real estate development, commercial banking (to a limited extent) and traditional thrift operations. The appraiser needs to explain the institution's past and expected operational strategy. If past strategies are to be abandoned and new types of operations are to commence, a full discussion of such events should be given.

Balance sheet trends need to be analyzed over a selected time period. If asset shrinkage has been pursued by the institution, a discussion of the effect on operations now and in the future should be given. Income and expense trends need to be analyzed with a coordinated discussion of strategies and the effect on income.

A summary balance sheet should be presented for five years and any stub period. At a minimum, it should include the following: total assets, loan receivables, mortgage backed securities, other investment securities, other interest earning assets, intangibles, deposits, borrowed money and retained income. In addition, compound annual growth rates should be given for each of the above selected items.

Operating data and key operating ratios should be presented for five years and any stub period. At the minimum, the operating data should include the following: total interest income, total interest expense, provision for loan losses, net interest income after provision for loan losses, non-performing assets, general valuation allowances, non-interest income, operating expenses, non-operating income, non-operating expenses, income before income tax expense, income tax expense and net income.

Key Operating Ratios should include the following: return on average assets, return on average equity, average equity to average assets, non-interest income to average assets, interest rate spread, non-interest expense to average assets, net interest margin, allowance for loan losses to loans at end of period, non-performing assets to total assets at end of period, general valuation allowances to total assets at end of period, general valuation allowances to non-performing assets, operating expenses to average assets and average interest earning assets to average interest bearing liabilities.

A table of past yields earned and rates paid on a weighted average basis for at least three years (preferably five years) and the stub period should be provided which should include the following: interest earning assets, mortgage loans, share loans, mortgage-backed securities, investment securities, interest bearing deposits, total interest-earning assets, interest-bearing liabilities, savings deposits, time deposits, total interest-bearing liabilities, interest rate spread and interest rate margin.

Discussions should also be given of interest rate risk, lending activities and strategy, asset quality, subsidiary operations and effect on consolidated statements and deposit composition and strategy.

4) Earning Capacity of the Converting Institution

The appraisal report should explain any unusual items, high fee income, sale of assets, intangible expense, provision for loan losses, increased general valuation allowances, increase or decrease in non-performing assets and any unusual variance in the level of several components of net income. These may be caused by such factors as the establishment or the sale of branches or securities as well as one time accounting changes, extraordinary items, reduction or increase in goodwill and any other large non-recurring items. To facilitate comparisons of the converting institution with other institutions, the appraisal should present analyses detailing major expense items as a proportion of total expenses, major income sources as a proportion of total income, yield-cost spread information and other such ratios as may be appropriate.

The converting institution may have been affected by non-recurring and volatile items such as provision for loan losses, sale of assets, REO related income and expense. The appraiser should exclude such non-recurring or unpredictable items (and their tax effects) to arrive at a normalized earnings base. The adjusted earnings will be used to arrive at a normalized earnings P/E. [When a normalized earnings P/E is used,] The comparable group's income also needs to be revised to a normalized earnings base for proper comparison.

Normalized earnings of the converting institution as well as the comparable group should be explicitly stated, specifying the adjustments for each institution for the trailing twelve months, and should be included in a spread sheet with appropriate calculation of taxes.

5) Asset Size and Efficiency of Asset Utilization

The appraiser should address the issue relating to the size and efficiency of the converting institution. The appraiser may find economies of scale or the lack thereof. The appraisal report should show the appraiser's conclusion about the thrift's relative size and efficiency in the use of its assets.

6) Projected Dividend Capacity and Intended Dividend Policy

Consideration should be given to the dividend-paying capacity of the institution. Recognition must be given to the necessity of retaining a reasonable portion of profits to meet regulatory net worth requirements. The expected dividend policy of the current management and the prospects for its achievement must be considered. Payment of dividends are generally given less weight than the institution's earning power. Institutions that pay dividends usually have higher fundamental ratios than those who do not. For further guidance, the appraiser should refer to Section 563b.3(g) of the Regulations (restrictions on payment of dividends).

7) Intangible Value

In addition to considerations such as earnings and book value, appraisers must assess the ability of the association to obtain in excess of a fair rate of return on equity--ie., intangible value. The appraiser must examine contributing factors, such as the converting institution's prestige in the local community and its record of successful operation over a prolonged period. An analysis of the economics and demographics in the primary market area may be essential to the formation of valid opinion concerning intangible value. Appraisers will need to review off-balance sheet items and not rely exclusively on financial statements. Consideration should be given to any unrealized appreciation in real estate, investment securities, mortgage loan servicing and any other items, including intangible items, considered important.

8) Marketability of the Issued Stock

When the size of the prospective stock issuance is small, and when no public offering of the stock is contemplated, a formal trading market in the stock may not be expected to develop. As a result, the stock may be difficult to sell later if an investor finds it desirable or necessary to do so. If appropriate, the appraiser must consider the stock's lack of liquidity and the effect of the lack of a market for the stock. Because investors have a strong preference for liquidity in the secondary market for their shares, illiquid shares are frequently discounted by business appraisers.

9) Review of Publicly Traded Comparable Financial Institutions and Summary of Adjustments

In appraising the converting institution, the value of the stock of corporations engaged in the same or a similar type of financial business should be taken into consideration as a basis of comparison. Comparison is the best means by which to appraise, after adjusting for differences in size, operating characteristics, market area, financial performance, interest rate sensitivity and other considerations. An important consideration is that other thrifts used for comparison should have capital stocks that are actively traded in the public market. Thrift stocks listed on an exchange or NASDAQ satisfy this requirement.

The broadest possible universe of companies in the thrift business should be obtained and analyzed by appraisers. From this list, they should choose at least ten companies that are more similar to the subject company than all of the others in the universe. It is important to consider stock associations with similar modes of operation, asset composition, location, market area, size and other characteristics similar to the converting association. The appraiser should identify and quantify as well as give an explanation of all the financial parameters used to determine the peer group so that there is a clear understanding of how these comparables were selected.

For the comparable companies, the appraiser should provide, as of the appraisal date, the association's name, location (city and state) stock symbol, asset size, price per share, market capitalization, price to earnings multiple for the last four quarters as to reported and normalized income, price/book value, price/tangible book value, price/assets, dividend yield, equity/assets, return on average assets, return on average equity and non-performing assets/assets.

A wide array of selective comparative ratios is needed to justify the inclusion of selected thrifts in the comparable group. The appraiser should provide a balance sheet comparison, in percentages, where appropriate, in the following categories, as of the date of the financials: total assets, cash and investments, mortgage backed securities, net loans, real estate, capitalized loan servicing, goodwill and intangibles, other assets, deposits, borrowings, subordinated debt, subsidiary preferred stock, other liabilities, total liabilities, preferred equity, common equity, total equity, tangible equity, tangible, core and risk based capital, earning assets/costing liabilities, loan servicing for others/assets, unused tax loss carry forwards and assets per employee.

Similarly, as a percentage of average assets where appropriate, income comparisons should be given in the following categories: date and earnings for four quarters ended, average assets, reported income, earnings per share, interest income, interest expense, net interest income, loss provision, net gain on sales, real estate income, other income, operating expense, goodwill amortization, non-recurring expense, net income before taxes, taxes, net income after taxes, extraordinary items, preferred stock dividends, common stock dividends, retained earnings, reported income, reported ROAA, normalized earnings ROAA, reported ROAE, normalized earnings ROAE, yield on assets, cost of funds, interest rate spread, effective tax rate, dividend payout ratio, net charge offs/loans, and provisions of loan losses/net charge offs.

Positive or negative adjustments need to be considered with a discussion as to why the appraiser is taking each approach. These adjustments need to be adequately supported with logical conclusions and reasoning for discounts and premiums. If converting institutions with superior financial positions are discounted to the peer group, the rationale for arriving at such conclusions needs to be fully explained. Adjustments should be considered for financial condition, profitability, growth and viability of earnings, asset growth, primary market area, dividends, liquidity of the shares and marketing of the issue. New issue discounts need to be quantified and any assignment of such discount need to be clearly identified in terms of percentage.

Stock associations in the primary market area of the converting thrift not chosen as comparables, and other associations considered but not selected as comparables should be listed and a notation made as to why they were not selected.

10) Management

Appraisers should refer to Form PS, Items 5, 6 and 7, for the relevant data concerning management and key personnel. Appraisers must discuss any management studies or surveys in which the institution participated, and the likelihood of maintaining continuity in the converting institution's operations in case one or two key persons were to leave the institution.

Specifically, concerning the management team, the appraiser should note academic backgrounds, special expertise or special designations (such as M.A.I., S.R.A., C.F.A., etc.), ages, length of service to the association and any special business-generating traits of members of the management team. The type, number and relationship of key persons to others in the company should be noted.

11) Effect of Government Regulation and Regulatory Reform

Government regulation has an important effect on the fortunes of a company. The converting institution should be compared with the selected publicly traded companies in matters concerning federal and state regulation and taxation. Major differences in these matters between the converting institution and the comparables should be highlighted and analyzed by the appraiser.

12) Converting Institution's Future Plans

Insofar as it is possible, the appraiser should determine the converting institution's major plans for expansion and growth and the consequent effect on earnings. If there are no plans for expansion, an attempt should be made to determine whether the association has reached its peak growth within its community and primary market area. Consideration should be given to the expected leveraging of the net conversion proceeds and the consequent effect on earnings. Changes in the revenue and expense mix that occurred in the recent past are relevant as they relate to expectations in the future.

13) Competition from Other Financial Institutions

The appraiser must develop and analyze data on the number and size of significant competitors in the mortgage and deposit markets in the association's primary market area. Both the degree of competition and the potential change in the degree may have important effects on the converting institution's value.

14) Price Trends in Direction and Level of Stock Market

New issues of stock moving into the hands of investors must compete with all other issues of securities being traded daily in the securities markets. General stock price trends may be different from trends in thrift stock prices. Since thrift stocks are interest sensitive, the appraiser should consider the securities price factors as shown in leading indices in the few months preceding the appraisal date. The level and the direction of movement may be important considerations in estimating the receptiveness of investors for the shares of the converting institution's stock. Review of the S&P 500 Index, NASDAQ and a Thrift Index on a quarterly basis will need to be documented in the report.

Methodology Conclusion

The appraiser will need to summarize all the salient points relative to why the pro forma market value was recommended.

The converting institution's P/E and P/BV premiums and discounts to the comparable group should be fully explained as should the effect that such premiums and discounts will have on the aftermarket price. The appraiser will need to compare the subject's financial ratios to the comparable group's composite ratios with an explanation of how the market will assess the financial ratios of the converting institution as it relates to market price. If there are premiums to the P/E and discounts to the P/BV, an assessment will need to be made as to the market's acceptability with a discussion of how the market may consider the relative size of the premiums and discounts.

Earning power is usually the most important factor influencing stock prices and in some cases, merger activity. The valuation of converting institutions entails the consideration of all relevant factors. Primary consideration, however, is usually given to the earning power of the association and secondary consideration is usually given to net worth. Ideally, there is a balance between the two, but thrifts that have low income and significant net worth will result in a high P/E multiple and a low P/BV ratio. If the income is an anomaly for the year, the appraiser will need to consider the reaction of the market of premium to the P/E and a discount to the P/BV. In evaluating the pro forma market value, investors may disregard, or disregard to a certain extent, the premiums to the P/E, when there are significant discounts to the P/BV ratio. In such cases, the investor may presume that the low P/BV overshadows any appraiser's calculations of P/E premiums and the reaction of the market may lead to the conclusion that the initial offering has been underpriced.

The appraiser should discuss the disparity between the P/E multiple and the P/BV as discussed above and the reasons behind such disparity.

PRO FORMA ANALYSIS SHEET
Name of Institution
Date

Price Multiple:	Symbols	Subject[1]	Comparable Companies Mean	Comparable Companies Median	State Mean	State Median	ALL SAIF Companies Mean	ALL SAIF Companies Median
Price-earnings ratio	= P/E							
Price-book ratio	= P/B							
Price-assets ratio	= P/A							

Valuation Parameters

Pre-Conv Earnings (Y)	$	Est ESOP Borrowings (E)_____	$
Pre-Conv Book Value (B)	$	Cost of ESOP Borrowings (S)[5]	%
Pre-Conv Assets (A)	$	Amort of ESOP Borrowings (T)	___Years
Reinvestment Rate (R)[2]	%		
Est Conversion Exp (X)[3]	$		
Proceeds Not Reinvested (Z)[4]	$		

Calculation of Pro Forma Value After Conversion

1. $V = \dfrac{P/E\ (Y-R(X+Z)-ES-(1-TAX)E/T-(1-TAX)}{1-(P/E)R}$ V = $

2. $V = \dfrac{P/B\ (B-X-E)}{1-P/B}$ V = $

3. $V = \dfrac{P/A\ (A-X)}{1-P/A}$ V = $

Conclusion	Total Shares	Price Per Share	Total Value
Appraised Value		$	$
Range:			
- Minimum		$	$
- Maximum		$	$
- Superrange *		$	$

(1) Pricing ratios shown reflect the midpoint appraised value.
(2) Net return assumes a reinvestment rate of _____ percent, and a tax rate of _____ percent.
(3) Conversion expenses reflect estimated expenses as presented in the offering document.
(4) Only, if applicable.
(5) Assumes a borrowings cost of _____ percent and a tax rate of _____ percent.
*Superrange is an over allotment option that is 15% above the maximum amount.

PRO FORMA EFFECT OF CONVERSION PROCEEDS
Name of Institution
Date
At the Minimum, Midpoint, Maximum and Superrange

1. Conversion Proceeds
   Pro Forma market value ______________ $
   Less: Estimated offering expenses ______________ ______

   Net Conversion Proceeds ______________ $

2. Estimated Additional Income from Conversion Proceeds

   Net Conversion Proceeds ______________ $
   Less: Held in Non-Earning Assets[1] ________ ______

   Net Proceeds Reinvested ______________
   Estimated net incremental rate of return ________ ______ %

   Earnings Increase ______________ $
   Less: Estimated cost of ESOP borrowings[1] ______
   Less: Amortization of ESOP borrowings[2] ______
   ______

   Net Earnings Increase ______________ $

3. Pro Forma Earnings

Period		Before Conversion	After Conversion
12 Months ended		$	$
12 Months ended	(normalized)	$	$

4. Pro Forma Net Worth[3]

Date		Before Conversion	Conversion Proceeds	After Conversion
		$	$	$
	(Tangible)	$	$	$

5. Pro Forma Net Assets

Date	Before Conversion	Conversion Proceeds	After Conversion
	$	$	$

(Only if Applicable)

(1) Estimated ESOP borrowings of $ _____ with an after-tax cost of _____ percent, assuming a borrowing cost of _____ percent and a tax rate of _____ percent.
(2) ESOP borrowings are amortized over _____ years, amortization is _____ tax-effected.
(3) ESOP borrowings of $ _____ are omitted from net worth.

Pricing Ratios for Minimum, Midpoint, Maximum and Superrange

	Pricing Ratios of [Name of Institution]	Premium/(discount) from Comparable Companies Mean	Median
Reported Price/Earnings			
Adjusted Price/Earnings			
Core Price/Earnings			
Price/Book Value			
Price/Tangible Book Value			
Price/Assets			
Overall Premium/(Discount)			

POST-CONVERSION FILING

Name of Appraisal Firm: ______________________________
Name of Institution: ______________________________
Date of Stock Sale: ______________________________
Issue Price of Stock: ______________________________

	One Day After Sale	Percent Change	One Week After Sale	Percent Change	One Month After Sale	Percent Change
Closing Price						
Per Share Price of Comparables						
List Name of Comparables						
Thrift Index						
NASDAQ						
S&P 500						

The price of the comparable group used for the percentage of change for one day, one week and one month should be the last price given in the final updated appraisal.