# THE COST OF IPO SUCCESS

by Steve Brown

A couple of popular iPhone games have users running a small business, with the goal of building a major corporation and then taking it public. Each user starts out in a select industry, such as burgers, newspapers, car repair or tanning salons. The fun part about these games is that every 60 seconds, players have to make critical decisions about capital, production, customer service, logistics, marketing and sales. The games are touted as realistic and designed by MBAs, which is ironic in that these MBAs picked a set of industries that haven't seen an IPO in 20+ years (or ever in the case of tanning salons). In addition, these games are a little misleading - as in banking, it seems we have to make critical decisions every 30 seconds. Aside from all of that, another problem with these games is the fact that they treat going public as virtually free. A recent study by Ernst & Young (E&Y) caught our eye that sheds light on this very topic and shows how wrong this assumption really is. The study looked at data from 26 companies (including several banks) that went public in the past 2Ys to see the average cost required to actually take a company public. For banks, we usually advise the ball park cost is around $1mm, due to legal fees, SEC compliance and regulatory requirements associated with Sarbanes-Oxley. However, the E&Y study found that this figure was closer to an average of $2.5mm. The difference between our $1mm assumption and $2.5mm made us dig into the details, which produced some interesting findings. First, while E&Y concluded that compliance and legal costs increased, they highlighted the fact that taking a company public also required more finance professionals, more consultants and, interestingly, higher compensation for CEOs, CFOs and Board members. To that last point, when it comes to the board, E&Y concluded that 80% of companies that went public increased the number of board members, in order to expand the board's level of expertise. This not only drove up costs, but it also triggered a board compensation review, which then triggered a management compensation review. In addition to management and board costs, the study found that the average company that went public used 13 third-party advisors to help with compensation levels, audits, legal, investor relations and our favorite - road show consultants. Finally, another major cost we hadn't considered is the investment in technology that is often required to increase capacity in accounting, core processing or enterprise risk management. This can add another $50k to $300k. All told, while a ball park initial cost is in the $2.5mm range, after the first year, costs seem to drop to the $100k to $1mm range per annum, largely driven by additional personnel. However, the real ongoing cost is the new management focus of now having to consider how all those critical decisions will not only impact the stock price, but how to explain it to your shareholders. When you add in the time it takes for investor calls, road shows, analyst forums and press release reviews, these shareholder actions burn up about 30% of executive management time, by our estimation. While going public can deliver a bank additional capital and liquidity, it is not without its burdens. Thanks to the study, it seems that $2.5mm the first year and $1mm thereafter, is a good rule of thumb for calculating the direct cost. Since this is too rich for our blood at this time, we will be staying private, running virtual tanning salons in our spare time and helping those that produce these games realize their IPO dreams.

## BANK NEWS

**M&A**

AmericanWest ($2.3B, WA) completed its acquisition of Viking Bank ($387mm, WA).

**No M&A**

Eagle Bancorp ($3.2B, MD) & Alliance Bankshares ($536mm, MD) called off their merger announced last July, due to the inability to mutually agree on a value.

**First Ever**

The NCUA will allow United Federal Credit Union to purchase a bank ($81mm Griffith Savings Bank) for the first time in history, subject to certain requirements (divestiture of some loans that are not permissible and other factors). The $1.3B credit union is now awaiting FDIC approval. Last year, Royal Credit Union in Wisconsin acquired 11 branches and 20,000 customer accounts from Anchor Bank, but did not acquire the whole bank.

**Pay Us Back**

The Treasury reportedly sent letters to the remaining 380 banks that still hold TARP, telling them it has hired an investment advisory firm to explore options and ultimately get repaid on the investments. Experts say the letter sends the message the Treasury wants banks to figure out how to repay the money, so they can wind the program down. Of note, under the terms of the investment agreement the Treasury cannot require banks to repay TARP and any such repayment also would require regulatory approval (bank regulators aren't likely to want to see capital levels decline right now), so much remains in flux.

**Citibank Cross-sell**

The Bank has one of the highest cash back rewards that we track. If you qualify and open a Citigold account package (7 different products), choose to enroll in Thankyou Rewards (their loyalty point program) and complete 2 consecutive months of direct deposit plus bill pay, you can earn $400.