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Long-term goals led to stock offering

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The growing tension in finance between investors hungry for short-term gains and public companies committed to long-term goals is playing out for one Sioux Falls bank and its far-away shareholders.

The centerpiece of the clash of values is a scathing three-page letter addressed to Home Federal Financial Corp.'s board of directors. It is from one of the largest investors in the Sioux Falls bank, PL Capital Group, a hedge fund based in Illinois and New Jersey, and was filed last month with the SEC.

The investors behind the letter expressed deep concern that the company went forth with a stock offering, at a low price, to raise capital.

In November, after almost six months of preparation and a week of meeting with potential investors in New York City, executives at Home Federal approved an offering of 2.875 million shares for net proceeds of \$20.744 million at \$7.22 per issued share. The bank increased its outstanding shares by 70 percent and sold them for 45 percent of tangible book value per share, according to PL Capital.

The price of about \$8 per share was "hugely disappointing," said Curtis Hage, president and CEO of Home Federal Financial Corp. "It was disappointing to me and to our board. But in our assessment in terms of our strategy, even though it was expensive, it was worth it to us for our future growth."

PL Capital disagreed.

The letter said, in part, "We believe the transaction is so dilutive to existing shareholders that the Board should have never approved it, and now that the offering is completed we see no viable way for the company to offset it in any reasonable time frame."

It continues by alleging the board breached its fiduciary duty to shareholders by inexplicably issuing stock at \$8 per share, that the capital raise was a discretionary and unnecessary destruction of shareholder value and calls for a 30 percent reduction on executive compensation to account for the same percentage drop in the stock price.

The letter concludes: "It is obvious to us that the Board and management are either incapable of understanding the concept of shareholder value, or do understand, but don't care."

Increased scrutiny on company actions

But some who watch the industry said chances are that "value" has entirely different meanings to each side in the dispute.

"There is more and more pressure to manage your business to meet monthly expectations and that encourages a short-term focus," said Angeline Lavin, a professor of finance at the University of South Dakota.

"That is exacerbated for hedge funds. They charge big fees and they have to earn their fees. They can't afford to lose their investors - who tend to be sophisticated investors."

Lavin pointed out that with so much more real-time tracking of a company's health - from stock price to quarterly, even monthly numbers - there is greater scrutiny of companies and higher expectations from investors.

"It has heightened the focus on the 'what have you done for me lately?' " from investors, Lavin said. "It gets away from the long-term vision of investors. It is harder for managers of companies who are trying to maintain a long-term course because they are dealing with the daily noise and it distracts from the goal."

Rare opportunity to grow, Hage says

For Hage and his colleagues at Home Federal, the long-term goal is growth. Home Federal Financial Corp. had total assets of \$1.2 billion and stockholders' equity of \$68.7 million (as of mid-summer) and is the largest publicly traded financial institution based in South Dakota. It paid back \$25 million it took as a part of a government program to capitalize healthy institutions in 2008.

The bank, originally a savings and loan established in 1929 that went public in 1992, expanded during the savings and loan crisis in the 1980s, acquiring four thrifts. That gave it a much larger footprint in this area. Now it wants to take advantage of a similar opportunity.

"The opportunity to acquire FDIC-assisted properties is, most analysts will tell you, is a once-in-20-year chance," Hage said. "We successfully did that in the '80s."

But once a failed bank has fallen into the hands of the FDIC, the sale to an interested buyer happens fast, Lavin said. The capital must be available.

For a company the size of Home Federal to raise money takes time, almost six months. Executives were not interested in missing out on this chance for acquisitions and growth.

According to Hage, the money was used for four things:

To pay back a \$6 million line of credit that Home Federal took out in the spring.

To take advantage of its footprint by competing for customers being shed by other banks choosing to contract to raise capital.

To be a ready and competitive bidder for failed banks in the region offered through FDIC-assisted sales.

To build its capital reserves for future growth.

These goals - and Home Federal's means to accomplish them - are at odds with the short-term investing strategy of a company such as PL Capital, which first invested in the bank a year ago and, according to its own reporting, owns 490,721 shares of common stock in Home Federal acquired at an aggregate cost of \$4,850,163.

After PL Capital invested in Home Federal, Hage said, "We had a raft of people calling us, saying these are bad people and they have a long history of causing problems. We're not the only company, there are others. They don't provide any value, it benefits them only in the short term."

One of the signatories of the letter, John W. Palmer, a partner at PL Capital, said that neither he nor his company could comment on the letter because of an agreement it signed with Home Federal prohibiting discussion of the company with anyone other than management.

Complaints about other banks

PL Capital has been known to fire off a letter or two in its 14 years. In 2006, it objected to the board of State Bancorp, a Long Island, N.Y., bank, complaining about the compensation package for an incoming executive.

The firm is included in a book by Ronald D. Orol, "Extreme Value Hedging: How Activist Hedge Fund Managers Are Taking on the World." A selection featuring PL Capital Partners, John Palmer and Richard Lashley: "All their research has led Palmer and Lashley to one important conclusion, which they claim has held true since PL Capital's inception: The banking industry will continue to consolidate, though sometimes it needs a little push along the way. That trend, for Lashley, means that activist investors in the industry can generate good returns, particularly if they can encourage consolidation."

Still, in all its activism, the partners of PL Capital, said in the letter to Home Federal's board that "we cannot recall another comparable discretionary capital raise that was as dilutive and ill-advised in our collective 52 years of experience."

"No one likes to see their name used by someone to say, 'We've lost confidence in you and we can do your job better than you,' " Hage said.

Home Federal's long-term goals are a "thought-out strategy," Hage said. "We have a good understanding about banking and know how to identify opportunity."

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