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Send in the Money!

By Peter Lynch

The virtue of thrifts, take four. You might not have been paying attention, but your neighbors have.

Since my very first Worth article, in the summer of 1992, I've been talking about the remarkable opportunity presented to investors when thrifts (the term covers savings and loans, savings banks, and some other institutions) go public. Thrift conversions are a rare and lovely reversal of the normal order: a great opportunity that seeks you.

But even I didn't realize quite how exceptional these investments have been until recently, when some questions from readers inspired me to make a call to SNL Securities, the financial-advisory firm that has been my leading source on all things thrift related. I asked SNL to look at the five calendar years starting in 1992. It turns out that, from 1992 through 1996, 445 thrifts went public. Of the 313 for which current pricing is available, the average increase in value is 98 percent. But that's not even the most remarkable part of the story. Of these 313 thrifts, only five are trading below their initial-public-offering price. Two are trading at their IPO price. So 306 of 313 are winners. You'll have to do a lot of looking to find another group in which 97.7 percent of the stocks have risen in value over five years. (As for the 132 thrifts no longer trading, most of them have been bought out by banks and other thrifts. Given the prices they've been bringing, that's good news.)

In what sense is thrift conversion an opportunity that seeks out the investor rather than vice versa? In the sense that if you are a depositor in a thrift that is planning a conversion everything you need to know will come through your mail chute. Anytime a thrift goes public, depositors get first crack--the only crack, usually--at buying shares at the IPO price. For most of these depositors, it's the first and only time they've been guaranteed precedence over the pros who usually make their way to the front of every line. Unfortunately, most depositors don't read the news they get from their thrift, or don't quite believe it, or for some other reason don't say yes to the opportunity. No one has exact numbers, but the guess is that 90 percent or more of thrift depositors don't buy shares when their thrifts go public. It's a real shame. In 1995 and 1996, thrift IPOs experienced an average first-day gain of 14.2 percent, and in the fourth quarter of last year, the average was 25.5 percent. Imagine someone who holds a savings account at one of those thrifts. Say the account pays 3.5 percent annually. The depositor can take that money out of savings for one day to make six years' worth of interest.

That's why I've made it my business to encourage investors to scout the places they live, work, and vacation for thrifts that aren't publicly owned and to consider opening accounts in them. If you've kept a reasonable amount of money (generally a couple thousand dollars) in a thrift for a

reasonable length of time (generally a year), you'll be given a shot at shares should the thrift go public. And if it doesn't, you'll have earned some interest while you waited.

The pace of conversion slowed somewhat last year--74 thrifts went public, compared with 97 in 1995--but the fourth quarter was strong, and SNL notes that the thrifts going public now tend to be among the largest and best capitalized. SNL still counts 925 privately held thrifts. It would be a mistake to assume that all of these are moving inexorably toward public status, but a large number will choose that course eventually, because like so many small businesses they need access to public capital in order to compete and grow. As it has twice before, SNL has come up with a list of candidates for conversion. (See "Top 50 Conversion Candidates" on page 36.) No guarantees, of course, but of the 189 thrifts to appear on SNL's previous lists, published in 1994 and 1995 (11 thrifts were on both lists), 24 have already made the conversion.

One of those, from the 1994 list, is the Roslyn Savings Bank (now Roslyn Bancorp) of Roslyn, New York, which went public in January 1997. Roslyn is a good study on a couple of levels. First, it demonstrates that the rules of the game have changed a little. Second, and more important, it shows how and why a thrift IPO works as an investment.

To set the stage: Roslyn was a big thrift, the second largest yet to go public, with \$1.8 billion in total assets. Just as important, it had more than 112,000 depositors and was in what Chris Smith of SNL calls a "conversion-savvy neighborhood." (Greater New York City, in other words.) What's more, a couple of other large, successful conversions had recently taken place in the area, and the media were in high alert. Stories about Roslyn's impending IPO ran in all the papers and on the local news.

There was one more factor at play in Roslyn: the heavy interest of what Chris Smith calls "professional depositors." These are people who, rather than looking locally for thrifts that might someday go public, look all over the country. They leave small deposits wherever they can, and that certainly included Roslyn.

So what happened when Roslyn announced it was ready to go public, with 42.3 million shares available at \$10 apiece? Answer: The thrift received buy orders for \$1.7 billion worth of shares. As a matter of fact, it was flooded with \$1.7 billion in cash, because the only way to order shares for a thrift IPO is to send in the money. Send in the money: Now there's a good barometer of investor passion if ever I saw one.

Oversubscription--more buy orders than shares offered--is a common enough phenomenon these days with thrift conversions, but not on the scale of the Roslyn IPO. To distribute its shares, Roslyn had to establish criteria for deservedness, based on the size of deposits. Basically, for every \$170 on deposit, an investor was allowed to buy 100 shares. A deposit of \$1,000 entitled you to buy roughly 588 shares; \$10,000 was good for about 5,880 shares. To buy 67,500 shares, the maximum number available to an individual, you had to have a little better than \$110,000 on deposit with Roslyn.

The formula reflected Roslyn's attitude toward professional depositors-- which was, basically, the heck with them. Pros who had never committed more than a few hundred dollars to the

bank's well-being walked away frustrated, while most people who had maintained real relationships with the bank were satisfied. Chris Smith says professional depositors are the largest reason most thrifts now require higher deposits to secure a full allocation of stock than their peers did a few years back. Still, the barriers aren't terribly high. "In the majority of cases," Smith says, "a \$1,000 to \$2,000 account balance should be sufficient to receive most or all of the stock you are entitled to, though sometimes you will need more."

Two notes: First, a lot of thrifts have begun rejecting the money of people they think may be professional depositors, usually by requiring that new customers live or work in the bank's home county. Second, and more important, it's a shame Roslyn wasn't oversubscribed by more than it was. Never mind the pros. More ordinary depositors should have been in there requesting all the shares they could afford. Those \$10 Roslyn shares were worth \$15.70 after the first day of trading--a 57 percent gain.

Why did Roslyn pop that much on its first day out? The first part of the answer has to do with all the attention Roslyn received and its strength in its market. The second part has to do with the nature of thrifts themselves.

A thrift is essentially a cooperative--it's owned by no one, really. So what happens with the money raised in an IPO if there are no founders or owners to pay off? The money goes right into the company till, and the company's net worth jumps by that amount. The new shareholders have just given themselves a great thrift-warming present. Investors in the secondary market see this and bid up the price.

In Roslyn's case, the thrift had a stated net worth of about \$222 million at the time of conversion. The IPO raised \$423 million. Boom-- Roslyn was now worth \$645 million. Let the bidding begin. And though Roslyn's one-day pop might suggest otherwise, this IPO was conservatively priced. The stock was priced at 73.5 percent of book value--slightly higher than the 1996 industry average of 70.5 percent and a lot higher than was typical in the early part of this decade, when depositors were sometimes able to buy a thrift for half of what it was worth.

Take a look at the list of SNL's conversion candidates and see if any are your neighbors. Are any near the place where you work? Or near your regular vacation spot? If so, I can't imagine why they wouldn't welcome you as a new account holder. What thrifts are looking for, very simply, are depositors with legitimate connections to the institution and the community.

Here is how to think about the measures listed on the chart. "Total Assets" is self-explanatory. Beyond that:

*You want to see a high equity-to-assets ratio. This is the most basic measure of a bank's strength--its firepower, if you will. Anything below a 5 is cause for concern. Citicorp, one of the strongest of the big banks, has a ratio of 7.39. Some thrifts, because they've retained a lot of earnings over the years and haven't been aggressive about making loans, have ratios of 10 or even 20 or more.

*You also want to see a high return on assets, the basic measure of profitability. A return on assets of zero translates into zero profits. Healthy thrifts and banks have a return on assets of at least 1 percent.

There is, however, a potentially profitable exception. Say a thrift's return on assets is low, maybe even below zero, but is moving up. Take a quick look at the equity-to-assets ratio. If it's high, you may have found a rewarding combination--the thrift may have enough equity to sustain it through a recovery. When I see a thrift or bank with a lot of equity and a low return on assets, my first question is: If this thing can turn around and make 1 percent on assets, what will it earn?

*You want a low percentage of nonperforming assets--loans that won't be repaid at 100 cents on the dollar. If a thrift has mostly written mortgages, you shouldn't see a problem. Commercial lending, on the other hand, is a hole many thrifts fell into during the 1980s. Nonperforming assets above 0.5 percent should make you wonder just what this thrift has been up to.

Another profitable exception: A very strong equity-to-assets standing gives a thrift a couple of ways to clean up a nonperforming-assets problem. It can write off the bad loans without too much damage to its equity-to-assets ratio. It can even sell the loans at 50 cents on the dollar and put the proceeds to work creating earnings.

That's a starting point. A great deal more information will become available should your thrift file plans to convert. You should confirm, at the very least, that the bank's officers and directors are buying stock in the offering and that they were involved in pricing it. It's worth something to know you're all on the same side of the table.

Let's look at the worst-case scenario in a conversion, because I don't want to give the impression that this is the one investment you don't have to think about and can't lose money on. (I haven't found that investment yet.) Let's imagine that a public offering is the thrift's last chance of getting enough money to stay afloat--it has written off so many commercial loans that it actually has no net worth, and at the same time it isn't making any money. Such a thrift may use an IPO to raise \$40 million and be worth \$30 million when it's over. You don't want any part of that. Fortunately, that's a rare case these days.

Traditionally, when I look at the issue of thrift conversions, I also look at thrifts that are already publicly traded. That short-term pop from an IPO is nice, but don't let it distract you from the long-term potential of thrifts, whether or not you buy them young. One last statistic from SNL proves this point: The five best-performing converted thrifts of the past five years have returned on average 558.5 percent. So what if you missed the IPO? Imagine if you'd caught even the last half of the ride.

In the past, the research lists have done pretty well, as you'll see in the three tables labeled "Update." On this page is a 1997 research list containing ten new names. Of these, I own Ambanc and Cameron Financial.

For all the stocks on this list, the most alluring quality is a high equity-to-assets ratio--as high as 24.7 in the case of Cameron. As I've noted, overcapitalization covers a lot of sins. And each of

these stocks sells at or below book value in an industry in which the typical thrift trades at 1.23 times book. On the other hand, none of these stocks can truly be called a bargain--they're all fully priced on current earnings. On past research lists, at least a few stocks have traded at single-digit price-to-earnings ratios, but that's not the case this time. Again, this is a research list. Don't invest in any of these companies unless and until you learn more about them--and in particular about whether their strengths are offset by their weaknesses.

I mentioned earlier that a lot of thrifts disappear from the stock tables because they're bought up. Six of the 10 thrifts from my 1992 research list have been acquired or have merged with other institutions, as have 5 of the 15 from the 1994 list and 2 of the 15 from the 1995 list. In most cases, this has produced another quick pop for investors, because thrifts are almost always acquired at prices comfortably in excess of book value. The average takeover price last year, for example, was 149 percent of book, and early this year, Summit Bancorp, a large New Jersey bank, agreed to pay more than 2.3 times book value to acquire Collective Bancorp.

Some people--professional depositors, certainly--are saying that thrift investing isn't what it used to be now that the rules on IPOs are tightening and more people are in on the secret. I don't agree. I see years' worth of opportunity in such offerings, and I see continued consolidation.

Late last year, I even saw a couple pieces of legislative good news. The most important of these, the Deposit Insurance Funds Act of 1996, concerns federal insurance for deposits. It hit thrifts with a big onetime charge to gas up the deposit-insurance fund, but in return it dropped the ongoing premium. Thrifts used to pay 23 to 31 basis points per dollar on deposit; now they pay zero to 27 points, and 95 percent of them pay zero. Imagine a thrift with a return on assets of 1 percent, or 100 basis points. If you lower the thrift's insurance expenses--which come out of earnings--by 23 basis points, those earnings go up by 23 percent.

Thrift investors have been living through a golden period--five solid years of a decent economy and low inflation. It would be foolish not to think about what happens when the economy begins to give out. A recession would be tough on thrifts (and on a lot of other stocks, of course). A sharp jump in inflation would be tough on thrifts, too (and on nearly all stocks). In either case, the 1997 research list probably wouldn't be a star group, though it could very well be when the economic weather turned again.

Thrifts that come public during a downturn will still be good investments. Maybe fewer thrifts will convert in that kind of environment, but maybe, on the other hand, oversubscription will ease up, and you, as a depositor, will be able to buy more shares. Whatever happens, keep checking the mail.

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Update: the 1992 List

Thrift	Research Price	Recent Price	Percent gain
Ameriana Bancorp (Nasdaq: ASBI)	\$8.33	\$15.75	89%

Bankers Corp. (Nasdaq: BKCO)	9.19	25.00	172
Bell Bancorp*	17.38	37.50	116
Charter FSB Bancorp**	15.50	45.05	191
Eagle Financial (Nasdaq: EGFC)	13.13	29.13	122
Germantown Savings***	23.50	62.00	164
Liberty Bancorp#	16.25	53.29	222
NS Bancorp##	24.13	53.87	123
People's Savings Fin. (Nasdaq: PBNB)	14.00	31.00	121
UF Bancorp###	16.63	54.13	226

Research prices as of 7/31/92. Recent prices as of 3/13/97. The thrifts whose names appear in green have been bought for cash or stock since 1992. *Bell was acquired by Standard Federal Bancorp for \$37.50 cash a share in June 1996. **Charter was acquired by Sovereign Bancorp on 11/1/94; recent price reflects the exchange of Charter's stock. ***Germantown was acquired by CoreStates Financial for \$62 cash a share on 12/2/94. #Liberty merged with Banc One on 12/30/96; recent price reflects the exchange of Liberty's stock. ##NS Bancorp merged with MAF Bancorp on 5/30/96; recent price reflects the exchange of NS's stock. ###UF Bancorp was acquired by CNB Bancshares on 8/4/95; recent price reflects the exchange of UF's stock.

Update: the 1994 List

Thrift	Research Price	Recent Price	Percent Gain
Ameribanc Investors Group*	\$1.81	\$3.00	66%
Astoria Financial (Nasdaq: ASFC)	14.06	39.56	181
Bay View Capital (Nasdaq: BVFS)	19.75	54.63	177
California Financial (Nasdaq: CFHC)	16.50	29.00	76
CENFED Finan. Corp. (Nasdaq: CENF)	15.91	33.63	111
Crossland Savings**	33.50	41.50	24
FFY Financial Corp. (Nasdaq: FFYF)	14.63	25.25	73
Fidelity New York, SFB***	17.25	29.00	68
GP Financial#	18.50	56.50	205
Lakeview Savings Bk. (Nasdaq: LVSB)	10.70	33.50	213
Mid-Iowa Financial (Nasdaq: MIFC)	3.63	8.25	128
North Side Savings Bank##	17.91	64.38	260
Pamrapo Bancorp (Nasdaq: PBCI)	14.63	23.25	59
Queens Cty. Bancorp (Nasdaq: QCSB)	18.13	57.75	219
Sunrise Federal ###	16.00	32.00	100

Research prices as of 3/31/94. Recent prices as of 3/13/97. The thrifts whose names appear in orange have been bought for cash or stock since 1994. *Ameribanc was acquired by First Union for \$3 a share in cash on 4/1/95. **Crossland was acquired by Republic New York for \$41.50 a share in cash on 1/31/95. ***Fidelity was acquired by Astoria Financial for \$29 a share in cash

on 1/31/95. #GP Financial changed its name to GreenPoint Financial. ##North Side was acquired by North Fork Bancorp on 1/2/97; recent price reflects exchange of North Side's stock. ###Sunrise was acquired by Reliance Bancorp for \$32 a share on 1/11/96.

Update: the 1995 List

Thrift	Research Price	Recent Price	Percent Gain
Albank Financial Corp. (Nasdaq: ALBK)	\$25.00	\$34.75	39%
Astoria Financial (Nasdaq: ASFC)	21.31	39.56	86
Cameron Financial (Nasdaq: CMRN)	14.50	16.38	13
Carver Fed Savings (Nasdaq: CARV)	9.88	10.13	3
Charter One Financial (Nasdaq: COFI)	28.09	45.25	61
First Federal Financial (NYSE: FED)	15.63	27.25	74
GP Financial*	27.63	56.50	105
Home Financial Corp.**	15.38	19.68	28
ISB Financial (Nasdaq: ISBF)	15.75	26.13	66
Leader Financial***	34.63	68.63	98
Portsmouth Bank (Nasdaq: POBS)	13.28	15.75	19
Quaker City (Nasdaq: QCBC)	14.00	19.00	36
Queens Cty. Bancorp (Nasdaq: QCSB)	29.91	57.75	93
Standard Federal Bank (NYSE: SFB)	39.00	57.75	48
Washington Mutual (Nasdaq: WAMU)	26.50	51.63	95

Research prices as of 9/29/95. Recent prices as of 3/13/97. Thrifts whose names appear in green have been bought for cash or stock since 1995. *GP Financial changed its name to GreenPoint Financial. **Home Financial was acquired by First Union on 11/26/96; recent price reflects exchange of Home's stock. ***Leader was acquired by Union Planters on 10/1/96; recent price reflects exchange of Leader's stock.

Top 50 conversion candidates

Rank	Institution	Location
1	Hudson City Savings Bank	Paramus, NJ
2	Third FS&LA;	Cleveland
3	Capitol FS&LA;	Topeka, KS
4	Independence Savings Bank*	Brooklyn
5	Investors Savings Bank*	Millburn, NJ
6	Dollar Bank, FSB	Pittsburgh
7	Eastern Bank*	Lynn, MA
8	Provident Savings Bank	Jersey City
9	New Haven Savings Bank	New Haven, CT
10	Ridgewood Savings Bank	Ridgewood, NY

11	Staten Island Savings Bank	Stapleton, NY
12	Columbia Savings Bank*	Fair Lawn, NJ
13	Beneficial Savings Bank	Philadelphia
14	American Savings Bank	New Britain, CT
15	Middlesex Savings Bank	Natick, MA
16	Liberty Bank	Middletown, CT
17	Home Federal Bank of Tennessee, FSB	Knoxville, TN
18	North Shore Bank, FSB	Brookfield, WI
19	Mutual Saving	Milwaukee
20	Financial FT&SB; of Olympia Fields	Olympia Fields, IL
21	Lockport Savings Bank	Lockport, NY
22	Home Savings & Loan Co.	Youngstown, OH
23	Cambridge Savings Bank	Cambridge, MA
24	Compass Bank for Savings*	New Bedford, MA
25	Savings Bank of Manchester	Manchester, CT
26	Richmond County Savings Bank	W. New Brighton, NY
27	Savings Bank of Utica	Utica, NY
28	First Federal Lincoln Bank	Lincoln, NE
29	Salem Five Cents Savings Bank	Salem, MA
30	Maspeth FS&LA;	Maspeth, NY
31	Spencer Savings Bank, SLA	Garfield, NJ
32	Bangor Savings Bank	Bangor, ME
33	First FS&LA;	Lakewood, OH
34	Yakima FS&LA;	Yakima, WA
35	Kearny Federal Savings Bank	Kearny, NJ
36	Piedmont FS&LA;	Winston-Salem, NC
37	Cape Cod Five Cents Savings Bank	Harwich Port, MA
38	Brookline Savings Bank	Brookline, MA
39	Troy Savings Bank	Troy, NY
40	Plymouth Savings Bank	Wareham, MA
41	Hudson City Savings Institution	Hudson, NY
42	Citizens Financial Services, FSB	Hohman, IN
43	Union Savings Bank of Danbury	Danbury, CT
44	Franklin FS&LA;	Glen Allen, VA
45	Provident Bank	Haverstraw, NY
46	Keystone Savings Bank	Bethlehem, PA
47	Fidelity Homestead Assn.	New Orleans
48	Oritani Savings Bank	Hackensack, NJ

- 49 Gate City Federal Savings Bank Fargo, ND
 50 Liberty Bank for Savings Chicago

*Indicates a wholly owned subsidiary of a mutual holding company. Source: SNL Securities.

1997 Research List						
Institution (Exchange: Ticker)	State	Recent Price	Equity to Assets	Price to Book	P/E Ratio	Assets (\$mil)
Ambanc (Nasdaq: AHCI)	NY	14.25	14.2	98.8	29.7	496.5
Bank West Financial (Nasdaq: BWFC)	MI	11.63	15.9	93.2	13.8	143.2
Cameron Financial (Nasdaq: CMRN)	MO	16.38	24.7	98.4	17.1	191.9
Classic Bancshares (Nasdaq: CLAS)	KY	13.50	14.9	93.2	16.1	128.4
MBLA Financial (Nasdaq: MBLF)	MO	20.75	13.6	97.7	14.0	208.9
MFB (Nasdaq: MFBC)	IN	18.88	15.4	97.1	18.2	223.9
Mississippi View Holding (Nasdaq: MIVI)	MN	15.13	18.5	99.2	18.0	70.3
Pennwood Bancorp (Nasdaq: PWBK)	PA	14.00	20.1	91.1	15.2	46.7
StateFed Financial (Nasdaq: SFFC)	IA	17.75	17.8	94.5	13.1	82.8
Tri-County Bancorp (Nasdaq: TRIC)	WY	18.50	15.3	85.7	12.5	85.9/td>

Recent prices as of 3/13/97. Source: SNL Securities.