

Economic Indicators

“Economic Indicators: An Update for the 7 Rivers Region” reports on a long-term study of regional economic indicators. The research is ongoing and spans a period of time to enable us to understand and report trends. This project is expected to continuously build on a base of economic information and provide decision makers with valuable tools for strategic planning. The information will also provide a basis for comparison with other regions and a measure of our progress.

State Bank Financial sponsors this research project in collaboration with the University of Wisconsin-La Crosse College of Business Administration and the *La Crosse Tribune*. These programs will continuously build on a base of information and provide decision makers like you with valuable tools for strategic planning.

Specific goals of this project are:

- Support business owners in their business decisions by gathering key local economic indicators and trend information.
- Develop specific economic indicators for this region that are not readily available to decision makers.
- Develop tools to assess our progress in economic growth. Prepare baseline measures that will allow comparison with other regions and measure future progress of the region.
- Track the region’s participation in the “new economy” and development in the high tech arena.
- Bring professionals together with business owners for discussion about the local economy and related critical issues.
- Create a business recruitment and retention tool by publishing the information.

Core economic indicators cover the following areas:

- Employment
- Income
- Cost of Living
- Consumer Attitude and Behavior
- Real Estate and Housing
- Interest Rates
- Equity Performance

Economic Indicators and Trends

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Core economic indicators have been tracked since 2001 to have objective measures for our 7 Rivers Region economy. The special focus of the spring meeting is the local impact of income inequality.

Please note: Dr. Brooks occasionally writes on the 7 Rivers Region Economics blog, which will contain ideas and writings that may or may not be included in this publication provided at the Economic Indicators breakfast meetings. Dr. Brooks will use the blog to track different topics and collect ideas. The Web address is: <http://sevenriversecon.blogspot.com/>.

April 2012

Income Inequality

Eminent jurist Louis D. Brandeis once said,

“We may have democracy, or we may have wealth concentrated in the hands of a few, but we cannot have both.”

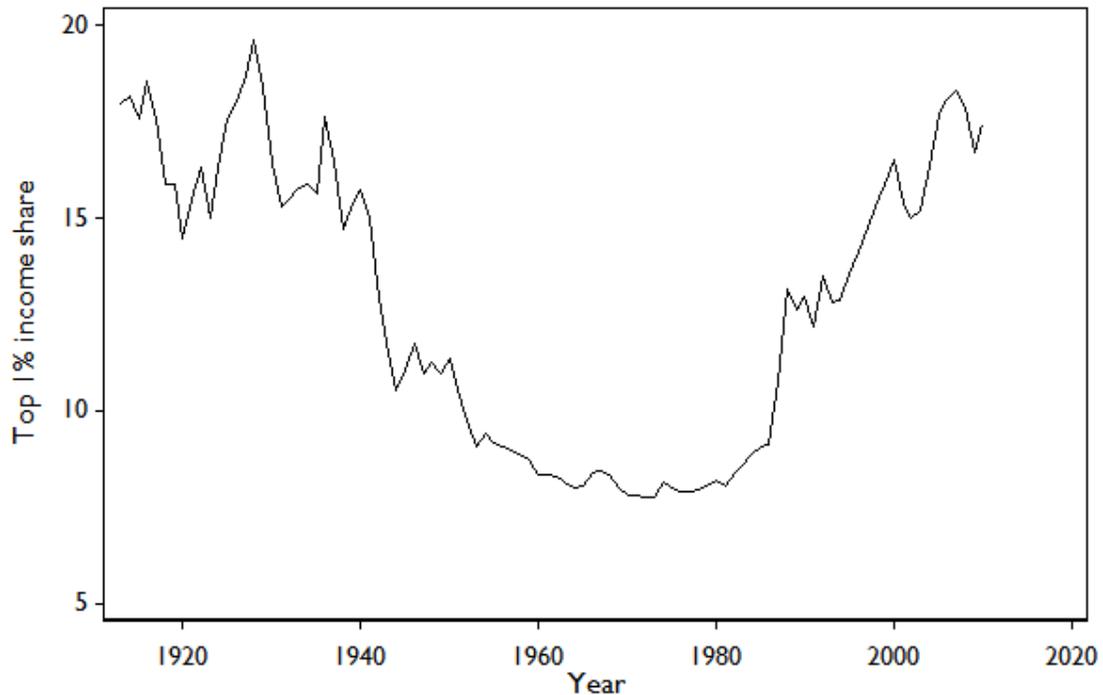
The focus of the spring meeting is income inequality, the causes, consequences and its local impact. To be clear income inequality is not bad per se. The degree to which it provides incentives for increasing productivity, investment, and innovation makes us all better off. However, too much inequality - as Brandeis notes - can result in the beneficial effects being outweighed by the negative effects. Those negative effects include among other things the increasing efforts to expropriate income from others. This could be illegally through property theft, extortion, or common swindling. Or it could occur legally through rent seeking behavior commonly engaged in by lobbyists, and other special interest groups.

Inequality can also be a reflection of bad institutions or bad social behavior. Markets can fail, such as is often suggested in the market for college financing, or markets can be imperfect and result in differential impacts on the poor. Another form of income inequality can arise when people are discriminated against, a social ill that many would find offensive in a modern democratic society.

Before we talk about the potential causes I would like to share some data to demonstrate that income inequality has in fact been rising. I must admit, for a long time I was a “denier.” I was suspicious of the data on income, as the nature of income changed dramatically in the 90’s and early 00’s. Our homes were rising in value, representing large gains in wealth, which were not captured in our income measures. Our incomes were growing far less rapidly than our non-wage incomes, such as our health care benefits, and those benefits were poorly measured. The volatility of income at the upper end of the distribution had dramatically increased with the advent of stock options and other contingent income. Yet, despite some of those issues, income inequality is still rising, but as I will note it is not entirely an American phenomenon.

Let me begin by sharing the data on inequality in the US over time. Graph I depicts the top 1% of income earner's share of total US income. It is clear that after reaching the peak in 1928, when the top 1% took 19.6% of all income, inequality in the US began to fall. It fell until about 1981, when the top 1% took only 8.0% of all income. After 1981 inequality began to rise again, with the most recent data suggesting in 2010 that the top 1% took 17.4% of all income.

Graph I: Top 1% of Income Earners Share of Total US Income¹



There are many sources that document the changes in the United States' income distribution. The Congressional Budget Office,² in a recent report documents the changes for household income, rather than individual income taxes as we have in the above graph. The findings are consistent. They look at market income (before taxes and transfers), and find the same rise. They also look at income after taxes and transfers, which both work to reduce inequality. However the effect of taxes and transfers has become less redistributive over time, reinforcing the rise in inequality.

The magazine *Mother Jones*³ provides a comprehensive list of graphics and sources which document the changes in income and wealth as well. From that resource I include Graph 2 which depicts the occupations of the top 1% of earners.

¹ Data are from: Alvaredo, Facundo, Anthony B. Atkinson, Thomas Piketty and Emmanuel Saez, *The World Top Incomes Database*, <http://g-mond.parisschoolofeconomics.eu/topincomes>, 03/01/2012

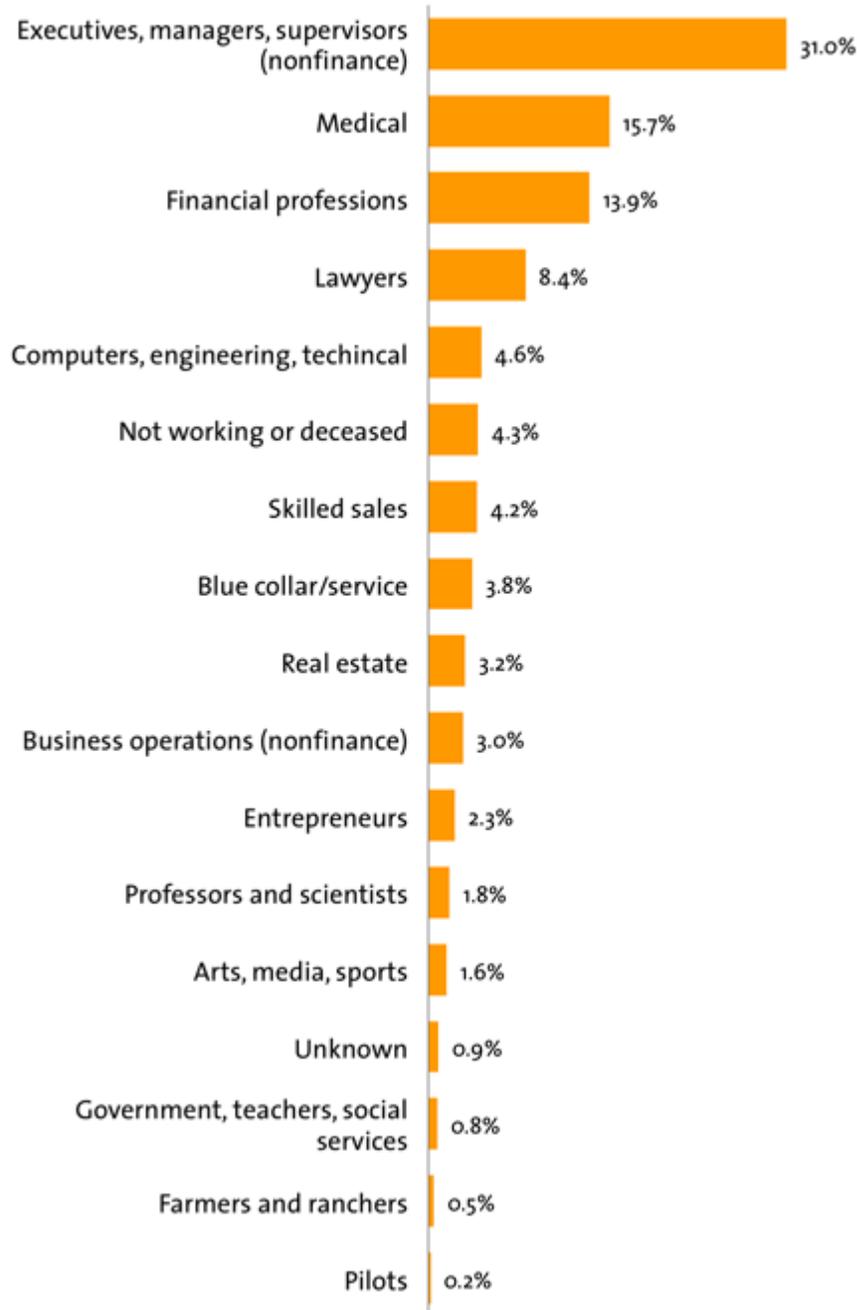
² <http://www.cbo.gov/doc.cfm?index=12485>

³ <http://motherjones.com/politics/2011/02/income-inequality-in-america-chart-graph>,

Graph 2: Occupations of the Top 1 Percent of Income Earners⁴

WHO ARE THE 1 PERCENT?

 OCCUPATIONS OF TAXPAYERS IN TOP 1 PERCENT OF INCOME



⁴ Here: <http://web.williams.edu/Economics/wp/BakijaColeHeimJobsIncomeGrowthTopEarners.pdf> and <http://motherjones.com/politics/2011/02/income-inequality-in-america-chart-graph>

While the top earners have taken a larger share of total income there have been changes in the volatility of their income relative to the rest of the distribution. They are bearing more risk than ever, which is one of the explanations for their higher returns. This increase in volatility has been documented in the pages of *The New York Times*⁵ and in a paper by Jonathan A. Parker, and Annette Vissing-Jorgensen.⁶ They describe the changes:

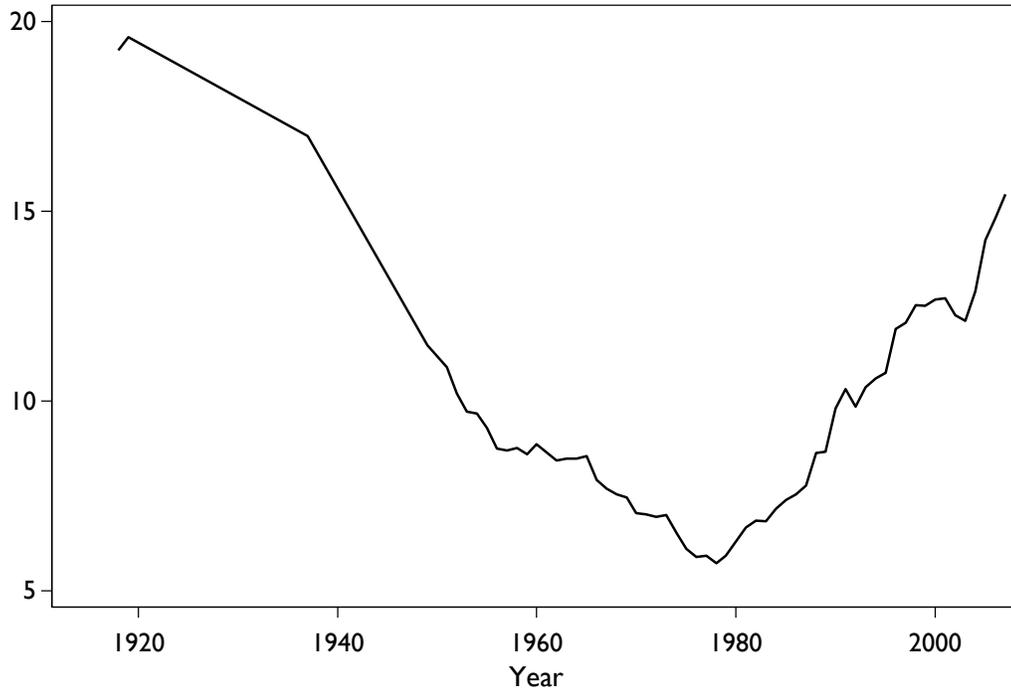
We document that there has been a large increase in the cyclicality of the incomes of high-income households that has coincided with the rise in the share of income earned by these households. In the U.S., since top income shares began to rise rapidly in the early 1980's, the income of those in the top 1% of the income distribution has averaged 11 times average income and been 2.4 times more cyclical. Prior to the early 1980s, the income of the top 1% was slightly less cyclical than that of the average household. The increase in the income cyclicality of the top 1% is to a large extent due to an increase in the share and cyclicality of wages and salaries. This high cyclicality among top incomes is also found i) for households without stock options, ii) for changes in income for the same set of households over time, iii) for post-tax, post-transfer income, and iv) for consumption. We contrast the cyclicalities of the top 1% with the cyclicalities of groups further down the income distribution, and reconcile our findings with the earlier literature. We show that recent increases in top-income shares and top-income cyclicality are tightly linked: greater top-income share is associated with greater top-income cyclicality across decades, across subgroups of top incomes, and, in changes, across countries. This close relationship suggests a common cause, which we conjecture is that information and communication technologies have increased the optimal production scale of the most talented and argue that this naturally increases the exposure of top incomes to fluctuations.

But the changes in inequality are not uniquely American, and thus one should guard against explanations that are US centric. Below in graphs 3 and 4 I plot the change in the share of income of the top 1% of income earners in both the UK and Australia. While the levels are not what they are in the US, the general trend is nearly identical. Both countries reach their low point around 1980 and have been rising since.

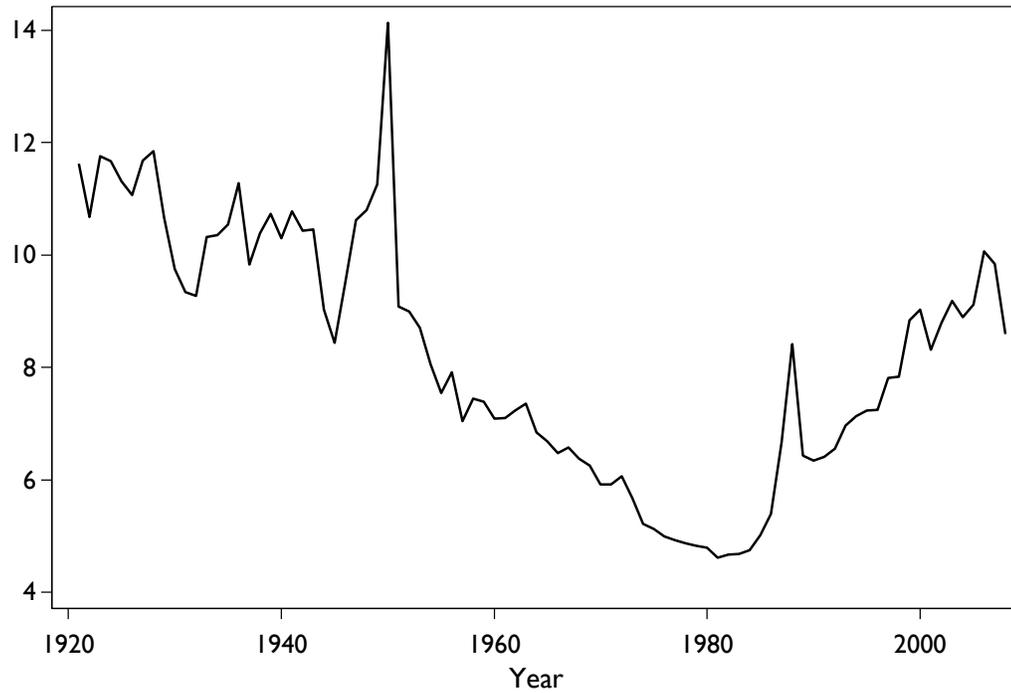
⁵ http://www.nytimes.com/2011/12/13/business/economy/recession-crimped-incomes-of-the-richest-americans.html?_r=1&hp

⁶ The paper is available here:
<http://www.kellogg.northwestern.edu/faculty/vissing/html/ParkerVissing%20BPEA%20Conference%20Version.pdf>

Graph 3: Top 1% of Income Earners Share of Total UK Income

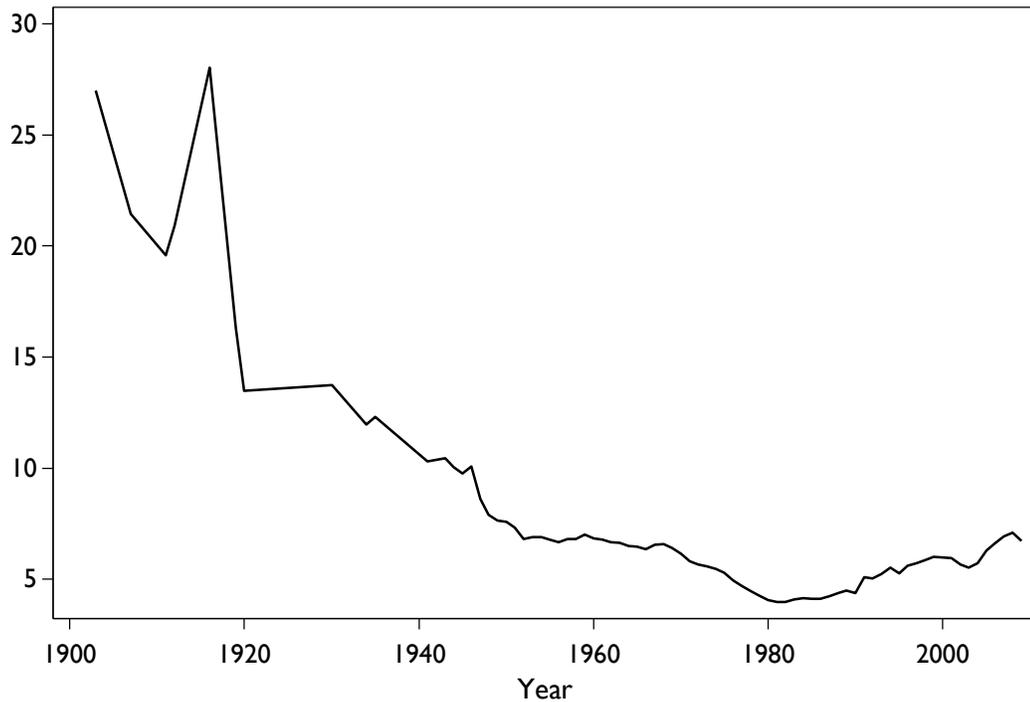


Graph 4: Top 1% of Income Earners Share of Total Australia Income



That said, not all countries have experienced the rise that we have. Sweden for example has barely experienced any increase.

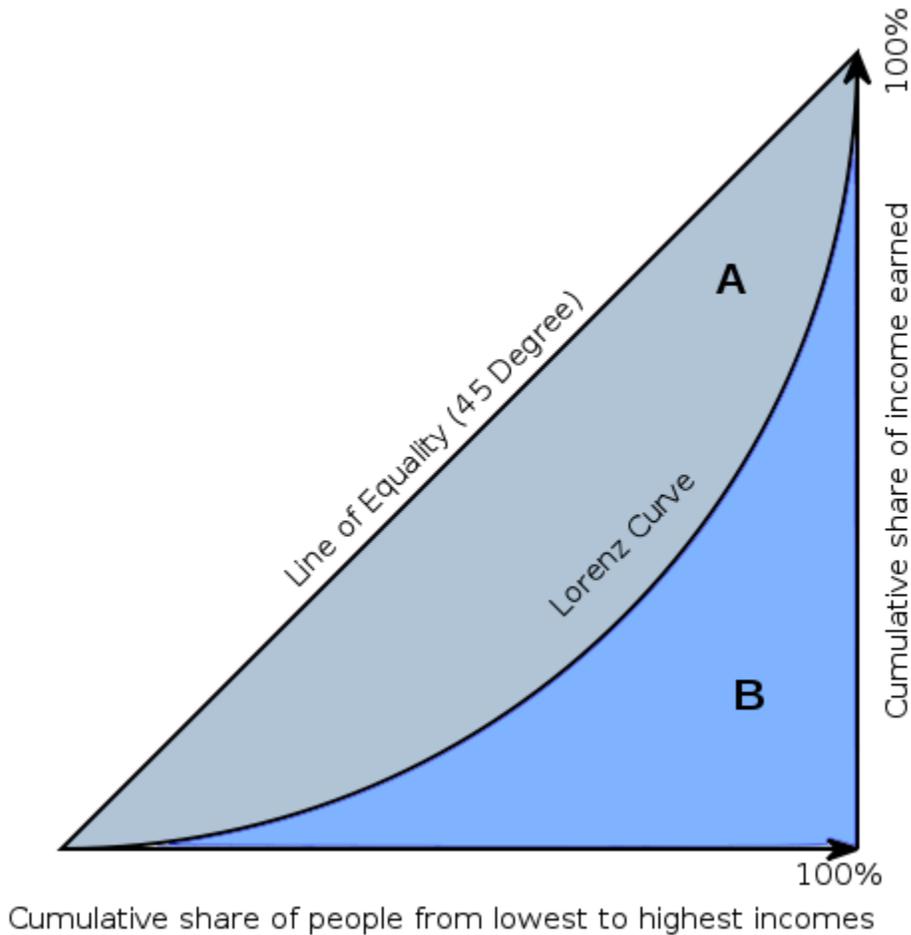
Graph 5: Top 1% of Income Earners Share of Total Sweden Income



While we have been looking at the share of income earned by the top 1% of income earners, we could also look at the top 10% or top 25% of the income distribution to look at the changes over time. Another common measure of income distribution which captures - in a single number - the entire distribution is the Gini coefficient. The Gini coefficient is based on the Lorenz curve depicted below. The curve represents the cumulative share of income received by the given percent of earners. So if the bottom 10% of the income distribution take 10% of total income, then the Lorenz Curve is on the 45 degree line, and the Gini coefficient is equal to 0.

The Gini coefficient ranges from 0 to 1 (sometimes multiplied by 100 for readability purposes) and it represents the area below and to the right of the 45 degree line, but above and to the left of the Lorenz curve, as a ratio of the total area below the 45 line. Perfectly equal income distribution would mean a Lorenz curve that sits on the 45 degree line and thus the area between would be 0, while one earner earning 100% of the income would mean a Gini of 1. While the Gini coefficient allows you to compare easily across countries, states or counties, you should be careful in interpreting differences because it says nothing about the average difference income between those groups, it only tells you about income differences *within* groups. Two areas could have similar distribution of income within an area but one could have a far higher average level of income than the other.

Graph 6: The Gini Coefficient



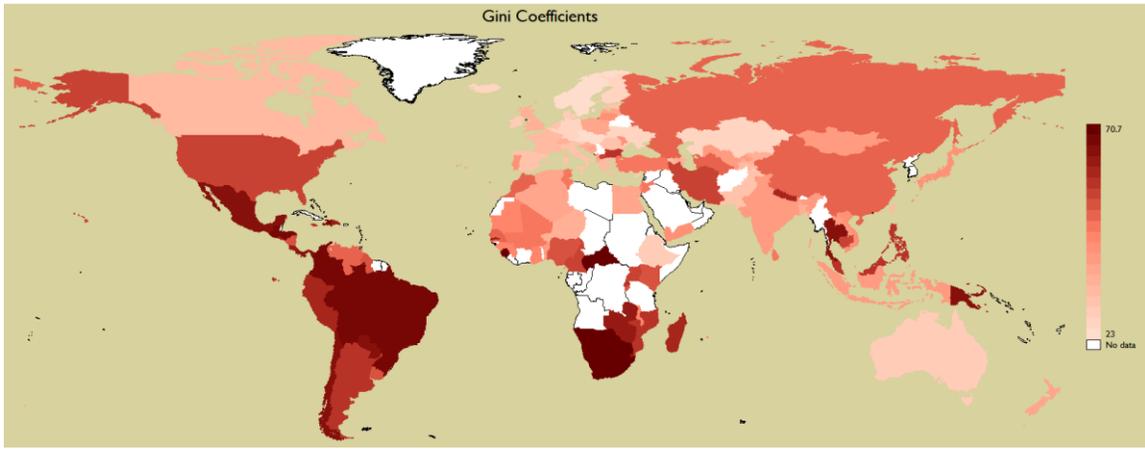
A graphic description of the Gini coefficient is found above. The Gini coefficient is equal to the ratio of areas $A/(A+B)$.⁷

Below is Graph 7, which depicts the Gini coefficients across the globe using data from the CIA fact book. The lowest level of inequality (or most equitable distribution of income) occurs in Sweden with a Gini of 23.0 (.23) and the least equitable distribution is Namibia at 70.7. For comparison the US has a Gini of 45.0.⁸ The graph depicts large Ginis with darker colors.

⁷ http://en.wikipedia.org/wiki/File:Economics_Gini_coefficient2.svg

⁸ http://en.wikipedia.org/wiki/List_of_countries_by_income_equality

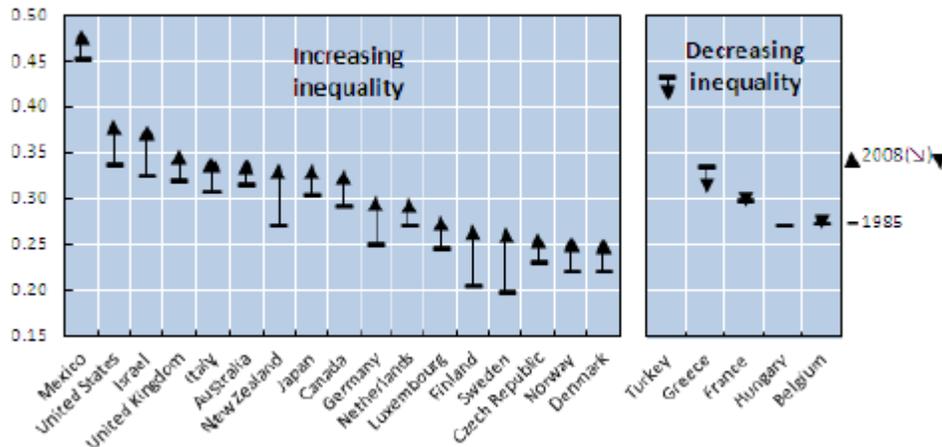
Graph 7: Gini Coefficients for Countries



However, it is worth noting that world income inequality has actually decreased during the 1990s, even while inequality within many developed countries has increased.⁹ This has occurred largely because of the gains in income by China and India. Using the Gini coefficient we can look at changes over time for several countries. *The Economist* magazine¹⁰ recently ran the following graphic which depicts the amount of change in Gini coefficients from the mid-1980s to the late 2000s. They use income based on income after taxes and transfers to define the Gini coefficient.

Graph 8:

Gini coefficients of income inequality, mid-1980s and late 2000s

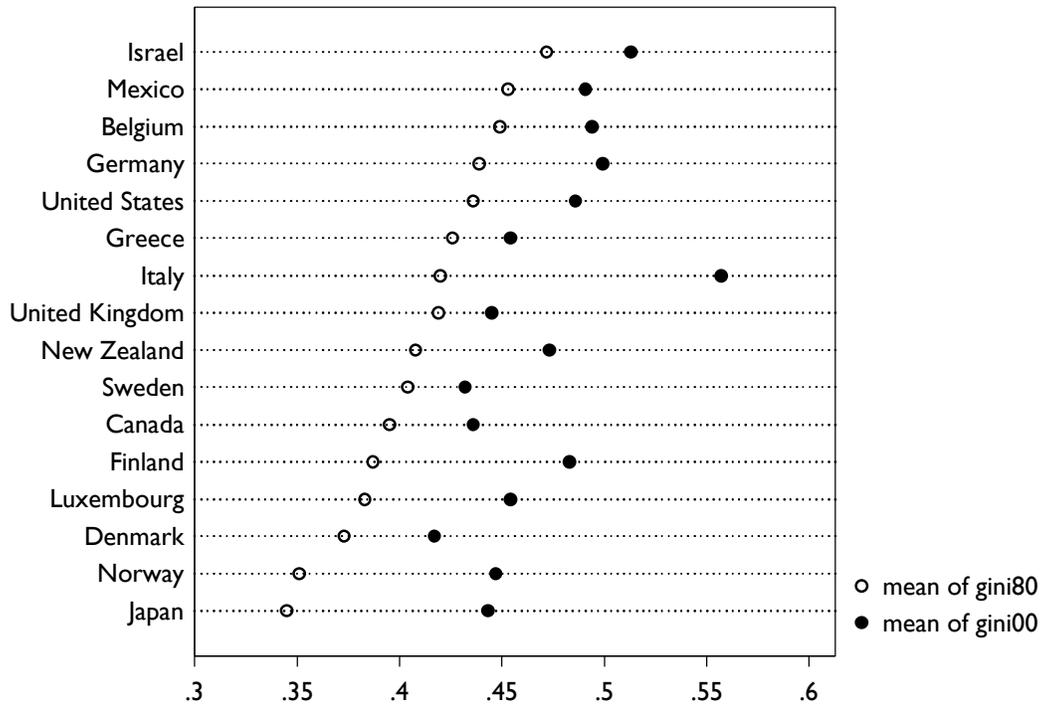


Graph 9 presents the changes using data based on income *before* taxes and transfers for the same period. In all countries income inequality has risen, as indicated by a rising Gini.

⁹ <http://www.nber.org/papers/w8904.pdf>

¹⁰ <http://www.economist.com/node/21515775>

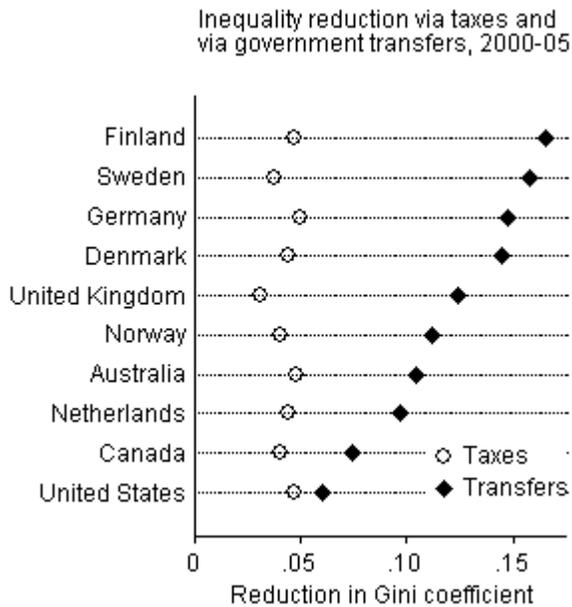
Graph 9: OECD Gini Coefficients Based on Pre-Tax, Pre-Transfer Income



Taxes/Transfers

The difference in the two graphs makes an important point. Some countries are far more successful than others at changing inequality using taxes and transfers.

Graph 10:



Graph 10 comes from a blog post by Lane Kenworthy.¹¹ It depicts the reduction in inequality achieved by taxes and transfers separately. As you can see most countries achieve some reductions in income inequality through taxes, but the amount of the reductions achieved are fairly consistent across countries. The large differences across countries occur in their ability to reduce income inequality through transfers. The US achieves the least amount of income inequality reduction through transfers.

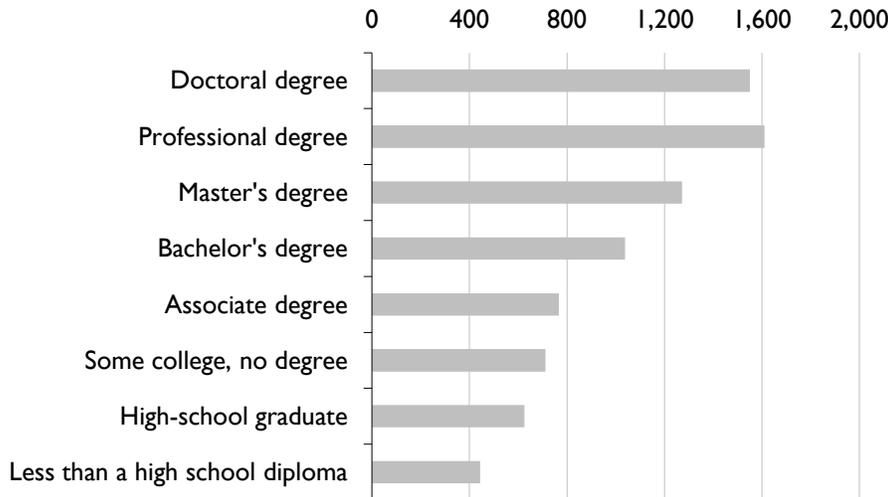
Some Causes of Inequality:

The “causes” of inequality fall into a few broad categories. It can be caused by inequality in inputs into the wage production process. Education or “human capital” being the primary means of altering the inputs along with hours worked. Of course other non-cognitive skills can be important as well to the wage production process. Inequality can also be a function of the market institutions and their valuation of productivity and labor. Finally if we are referring to household income then household formation and household dynamics can play a role as well.

Returns to Education

The data on the returns to education has been documented in many different places. The returns to a college degree relative to those with only a high school degree have been rising over time. Below in graph 11 I share the weekly earnings by degree. One way to reduce income inequality is then to reduce education inequality.

Graph 11: Earnings by Degree



2010 Median Weekly Earnings by Degree

In addition to the returns to schooling and in particular to college appear increasing; the number of high school drop outs also has increased. In other words the tails of the education distribution and therefore the income distribution are become fatter.

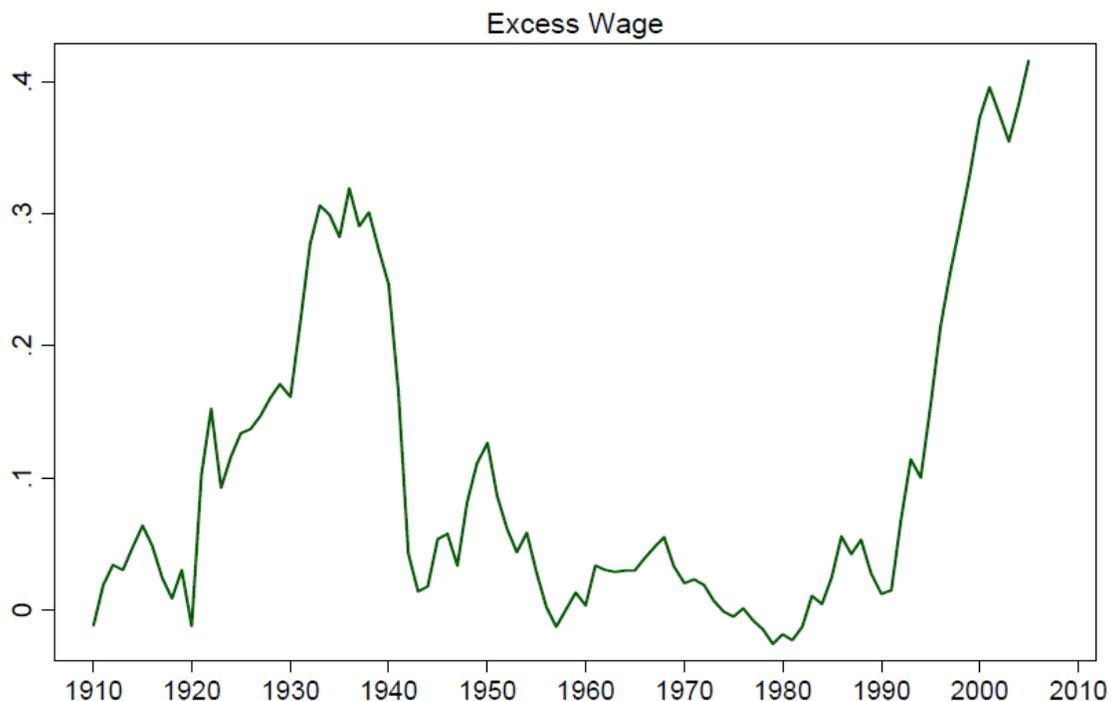
¹¹ <http://lanekenworthy.net/2008/02/10/taxes-and-inequality-lessons-from-abroad/>

Returns to Financial Sector Employment Have Grown

One argument for the increase in inequality has been an increase in “excess” returns to certain occupations. In particular the occupations of the financial sector appear to have seen a large growth in wages that cannot be explained by fundamentals such as skill and productivity.¹²

Graph 12: Excess Wages in Financial Sector

Figure 11: Historical Excess Wage in the Financial Sector



The Economics of Superstars

Another explanation is the rise of “superstar markets.” Sherwin Rosen (1981) argues that in certain markets, small differences in talent can translate into large differences in income. This has been termed the economics of superstars.

Rosen points out that "...sellers of higher talent charge only slightly higher prices than those of lower talent, but sell much larger quantities; their greater earnings come overwhelmingly from selling larger quantities than from charging higher prices."

¹² There are several background links for this idea: <http://www.ecb.int/press/key/date/2010/html/sp100415.en.html> and here: <http://voxeu.org/index.php?q=node/2292> and here <http://sternfinance.blogspot.com/2008/11/are-banker-over-paid-thomas-philippon.html>, finally the academic paper from which Figure 11 is derived is here: http://pages.stern.nyu.edu/~tphilipp/papers/pr_rev15.pdf

Robert Frank and Philip Cook's book "The Winner-Take-All Society" describes how a small number of superstars have come to dominate in the artistic and cultural sphere: "Winner-take-all markets have proliferated in part because technology has greatly extended the power and reach of the planet's most gifted performers....Now that most music we listen to is prerecorded...the world's best tenor can be literally everywhere at once." Alan B. Krueger's studies of the concept of the "superstar" in popular music indicate that "the top 5% of revenue generators took in 62% of concert revenue in 1982 and 84% in 2003", as demand for "superstar" performers increased.¹³

As Frank and Cook point out the rise in winner take all markets has been due in part to technology and increasing globalization. Of course there are many other potential culprits, such as changes in regulation, changes in global growth, and a host of others.

Solutions to the problem of income distribution:

The solutions - like the problems - can occur at several levels. First we could try to counter the outcomes of market wages. One solution that has been proposed is a tax that is a function of the income distribution.¹⁴ The tax would only be enacted when the income distribution hit a predetermined level of inequality. This has been referred to as the Brandies tax after Supreme Court jurist Louis D. Brandeis whose quote appears above. In the US we could also increase transfers to people in the lower end of the distribution. This after income transfer could work to counteract the outcome of the market.

On the input side we could address differences in human capital acquisition. The inequality in education is an important place to start. This could involve overhauling education, extending the school day and year. Investing more in early childhood education, such as the types of interventions that occur before age 5, like those done in the Harlem Children's Zone. In fact many economists would argue that the best way to reduce inequality on the input side - before income is earned - would be to address differences in education.

Local Data on Inequality¹⁵

Turning to local data on inequality, we have the Gini coefficient by county. Below is the La Crosse county Gini, which is the same as San Bernardino County in California. With a Gini of 0.422 only 29% of populous counties have a more equal distribution of income than we do. Unfortunately, we don't have good Gini measures on the other counties in the region.

¹³ <http://en.wikipedia.org/wiki/Superstar>

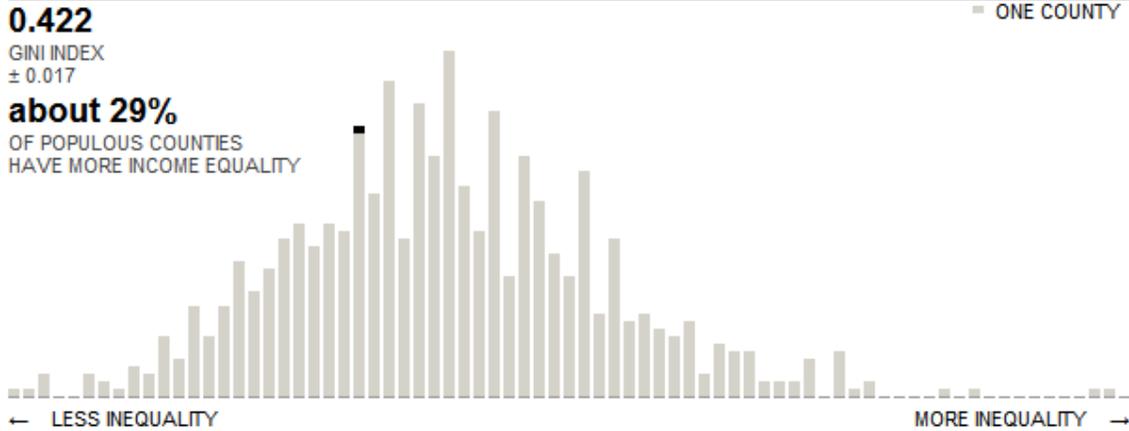
¹⁴ <http://www.nytimes.com/2011/12/19/opinion/dont-tax-the-rich-tax-inequality-itself.html>

¹⁵ Gini by US county can be found here <http://www.census.gov/prod/2012pubs/acsbr10-18.pdf>.

Graph 13: La Crosse County Gini Coefficient¹⁶

Enter an address or ZIP code. Examples: 5046 S. Greenwood Ave Chicago, IL or 11222

La Crosse County, Wis.



Source: U.S. Census 2010 American Community Survey 1-Year Estimates

More Local Data: Free and Reduced Lunch

Another local measure of income inequality is the number of children in public schools who receive free or reduced lunch. Data for this come from the Wisconsin Department of Public Instruction¹⁷ and Minnesota Department of Education. Eligibility for both free and reduced-price lunch is determined by an application process in which students or their parents show annual household income to be at or below 185% of the federal poverty line.¹⁸

FAMILY PERCENT OF POVERTY GUIDELINE							
SIZE	100%	135%	150%	175%	185%	200%	250%
1	10,830.00	14,620.50	16,245.00	18,952.50	20,035.50	21,660.00	27,075.00
2	14,570.00	19,669.50	21,855.00	25,497.50	26,954.50	29,140.00	36,425.00
3	18,310.00	24,718.50	27,465.00	32,042.50	33,873.50	36,620.00	45,775.00
4	22,050.00	29,767.50	33,075.00	38,587.50	40,792.50	44,100.00	55,125.00

Note: For family units of more than 8 members, add \$3,740 for each additional member.

For reference La Crosse County¹⁹ has 13.5% of the population and Houston County²⁰ has 9.2% of the population below the federal poverty line.

¹⁶ <http://www.propublica.org/article/income-inequality-near-you>

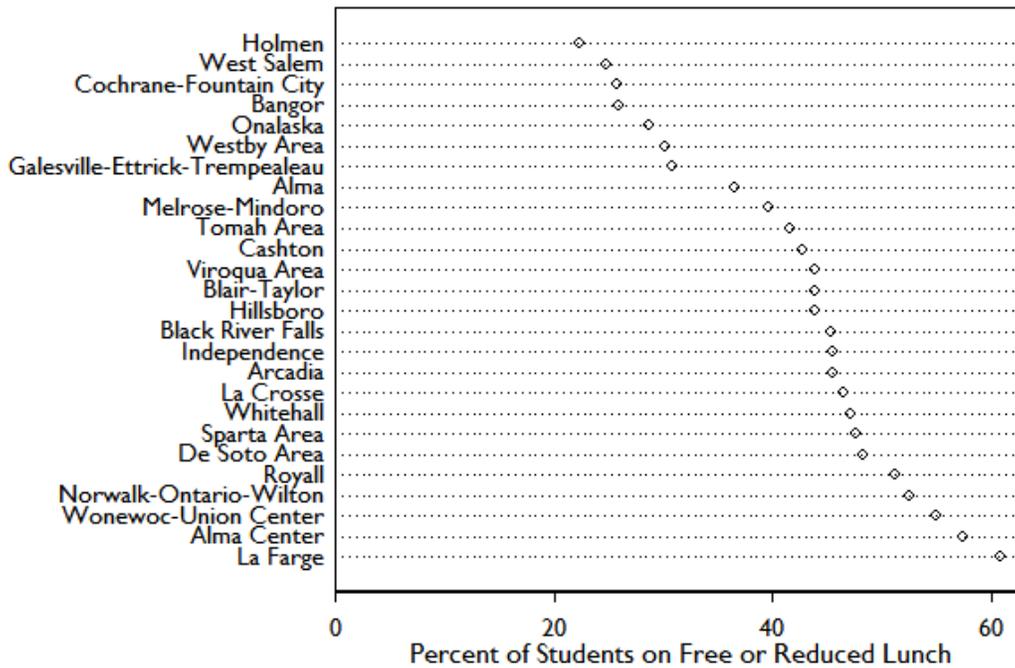
¹⁷ www.dpi.state.wi.us

¹⁸ <https://www.cms.gov/MedicaidEligibility/downloads/POV10Combo.pdf>

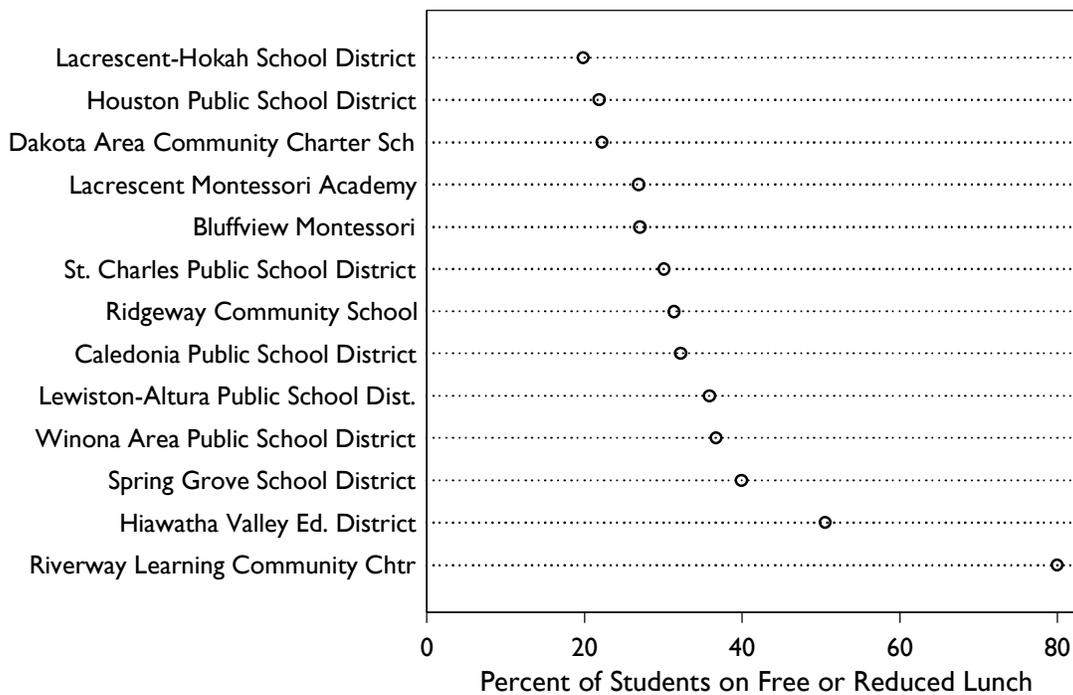
¹⁹ <http://quickfacts.census.gov/qfd/states/55/55063.html>

²⁰ <http://quickfacts.census.gov/qfd/states/27/27055.html>

Graph 14: Percent of Students on Free or Reduced Lunch by Wisconsin School District

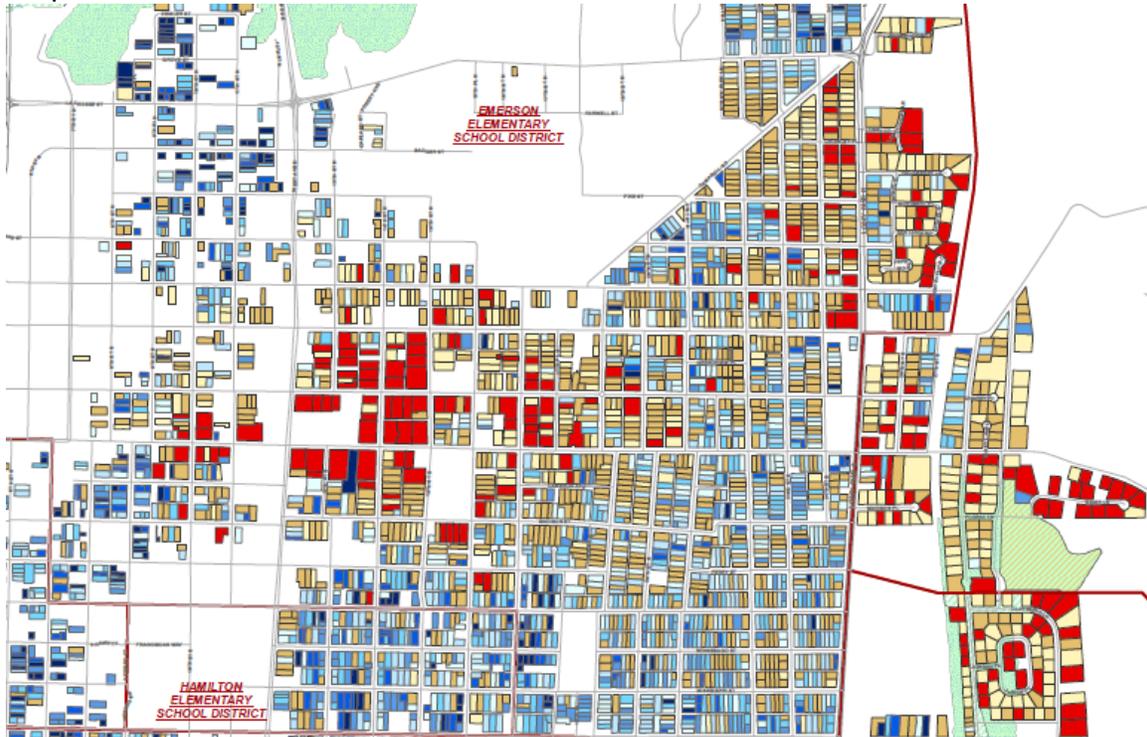


Graph 15: Percent of Students on Free or Reduced Lunch by Minnesota School District



Another local view of inequality can be found by looking at the geographic dispersion of home values.²¹

Graph I6: South Side of La Crosse Home Values



Local Perceptions:

The following questions come from an addendum to the five questions that make up the recurring consumer sentiment survey. The survey was emailed February 23, 2012 to a list of 770 past participants in the Economic Indicators Breakfast meetings. There were 229 surveys completed yielding a response rate of 29.7%. These additional questions were motivated by the Pew Research Center's survey on social trends.²²

The first question asks:

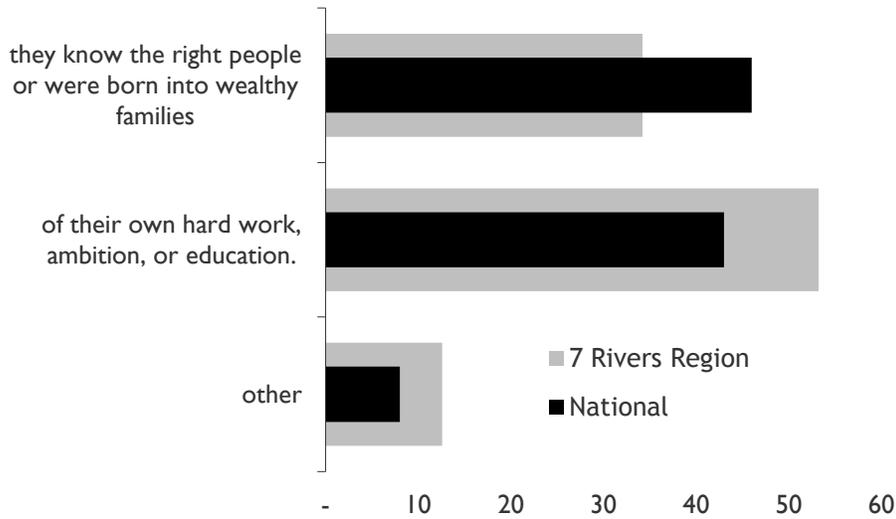
“Which of these statements comes closer to your own views—even if neither is exactly right: Most rich people today are wealthy mainly because of their own hard work, ambition or education ... or... Most rich people today are wealthy mainly because they know the right people or were born into wealthy families.”

²¹ The more complete picture of the south side is here: http://lacrosse.uwex.edu/files/2010/05/Appendix2S.Side_.pdf and the north side is here http://lacrosse.uwex.edu/files/2010/05/Appendix1N.Side_.pdf

²² <http://www.pewsocialtrends.org/2012/01/11/rising-share-of-americans-see-conflict-between-rich-and-poor/>

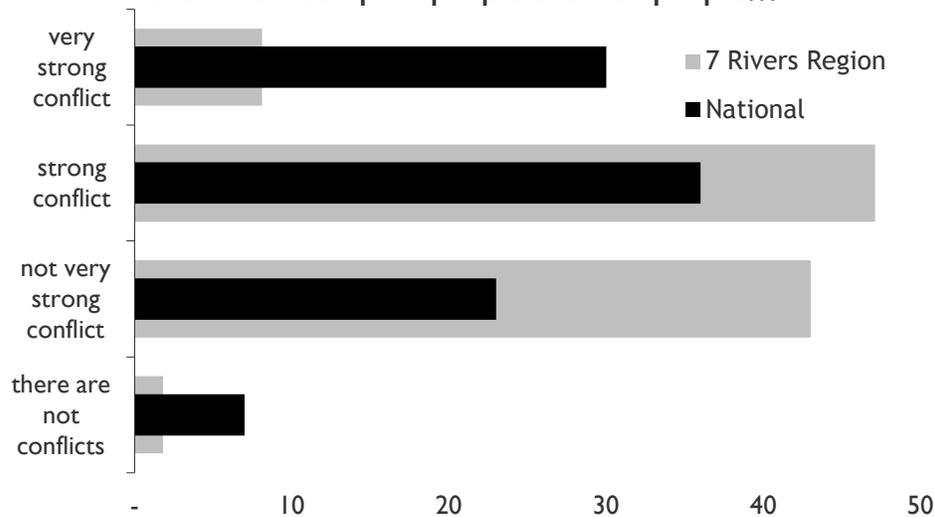
Participants in the Economics Indicator Breakfast meetings are significantly more likely than the national respondents to believe that rich people are rich because of their hard work. This could be a cultural difference, i.e. local respondents are “Midwestern nice,” or a reflection of the backgrounds of the respondents.

Most rich people are rich because...



The next question asks about the level of conflict between rich and poor. The results clearly suggest local attitudes are much less extreme relative to the rest of the country. Local respondents were far less likely to say there is very strong conflict.

In your opinion, in AMERICA, how much conflict is there between poor people and rich people...



The final special question also comes from the same survey and asks for an open ended text response. The question is: “Now thinking more broadly, what would you say worries you most about the national economy at this time?”

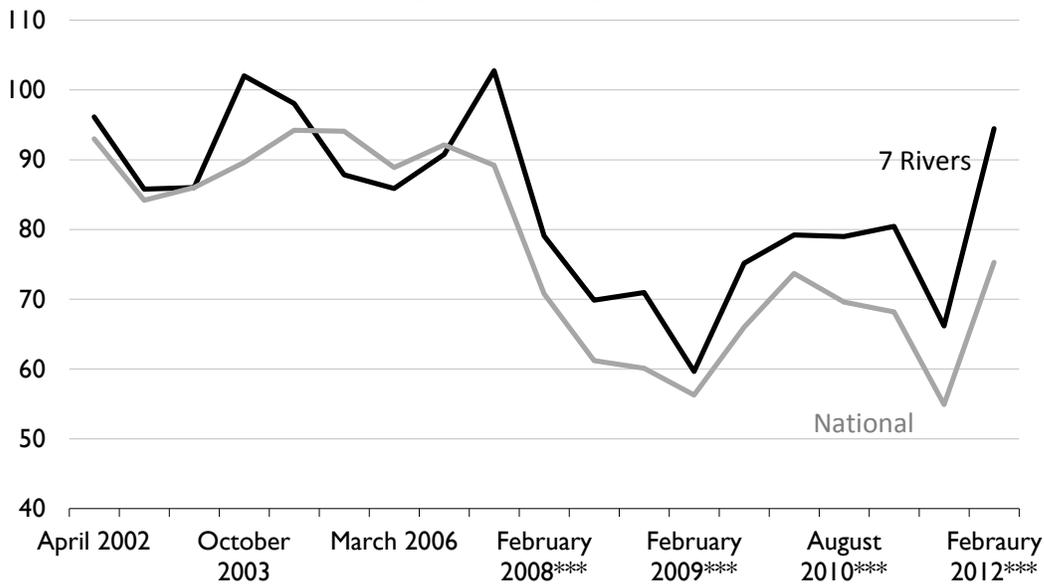
A simple word cloud is presented where the frequency of mention is used to scale the font size. Larger fonts represent higher frequencies for the word. A note of caution: If one person says, I worry about debt, and another says I don’t care about debt, they both count as mentions of “debt”, though the underlying sentiment is clearly contradictory.



Consumer Sentiment Survey

Turning to the original five questions in the consumer sentiment survey we again see the 7 Rivers Region data mirrors the national data. The overall sentiment index increased from 66.2 to 94.4, and the gains appear to have come – almost equally – through both the current conditions index and the consumer expectations.

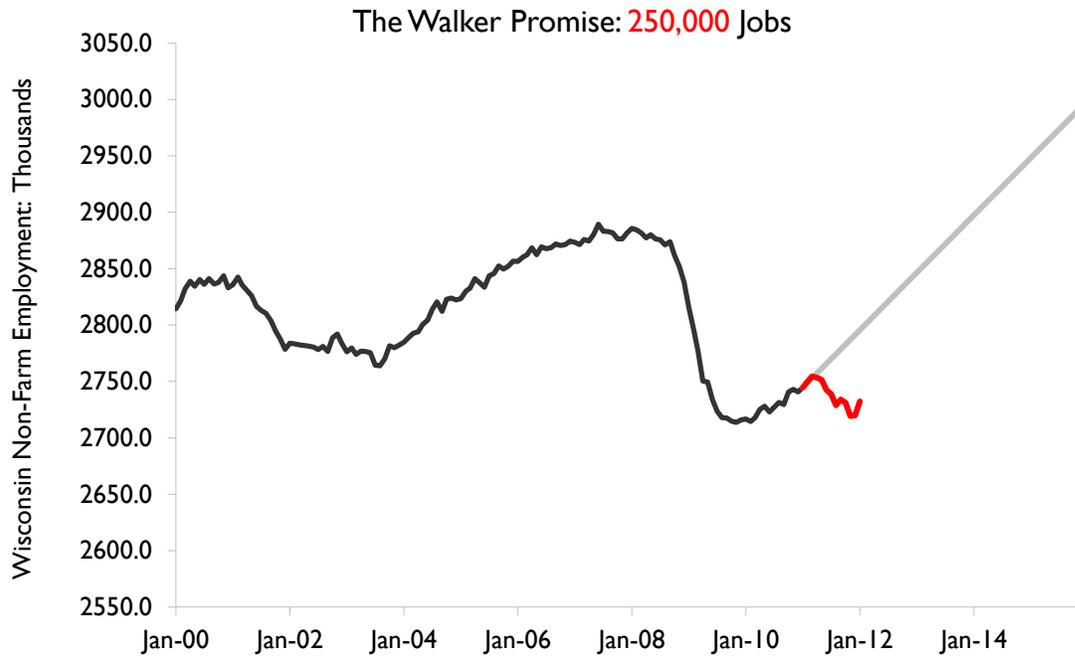
7 Rivers Consumer Sentiment Index



*** Survey moves to web

The Labor Market

Data revisions have not been kind to Scott Walker’s pledge to add 250,000 jobs in his four year term.²³ Employment is 2,732,300 down from a revised 2,744,800 at the beginning of his term, and 63,000²⁴ jobs behind the pace required to achieve 250,000 new jobs in 4 years. This problem for the labor market appears to be uniquely Wisconsin’s, inviting speculation as to the causes. A recent article in the *Journal Sentinel*²⁵ lists everything from political uncertainty due to the recall efforts, to the austerity of the budget, to the removal of collective bargaining rights.



Source: BLS, <http://goo.gl/IE69o>

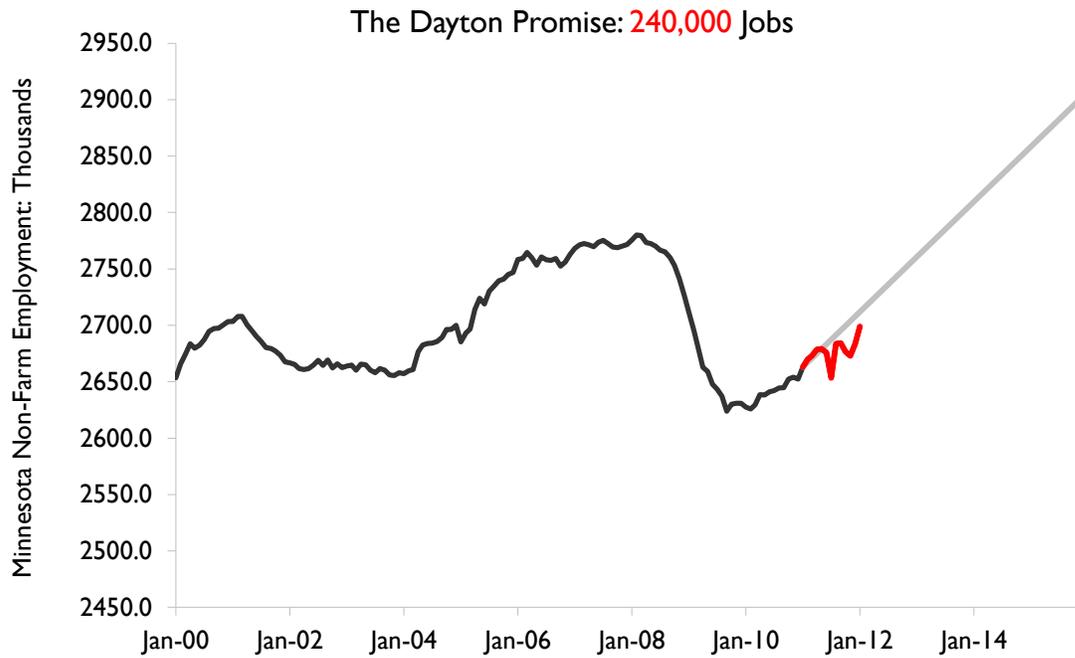
Frankly it is hard to tell what the reasons are for lack of job growth in the state. Many of the reasons given have also been experienced in other states as well, yet they have not experienced the same underwhelming performance. For now it appears to be somewhat of an unresolved puzzle, or rather I’m unwilling to commit to an explanation without further data and study.

Minnesota, who also experienced political turmoil last year, a divided government and a government shutdown, has not had as slow a labor market rebound as Wisconsin has had.

²³ <http://www.politifact.com/wisconsin/promises/walk-o-meter/promise/526/create-250000-new-jobs/>

²⁴ <http://www.economonitor.com/blog/2012/03/wisconsin-employment-climbs-to-12500-below-january-2011-levels/>

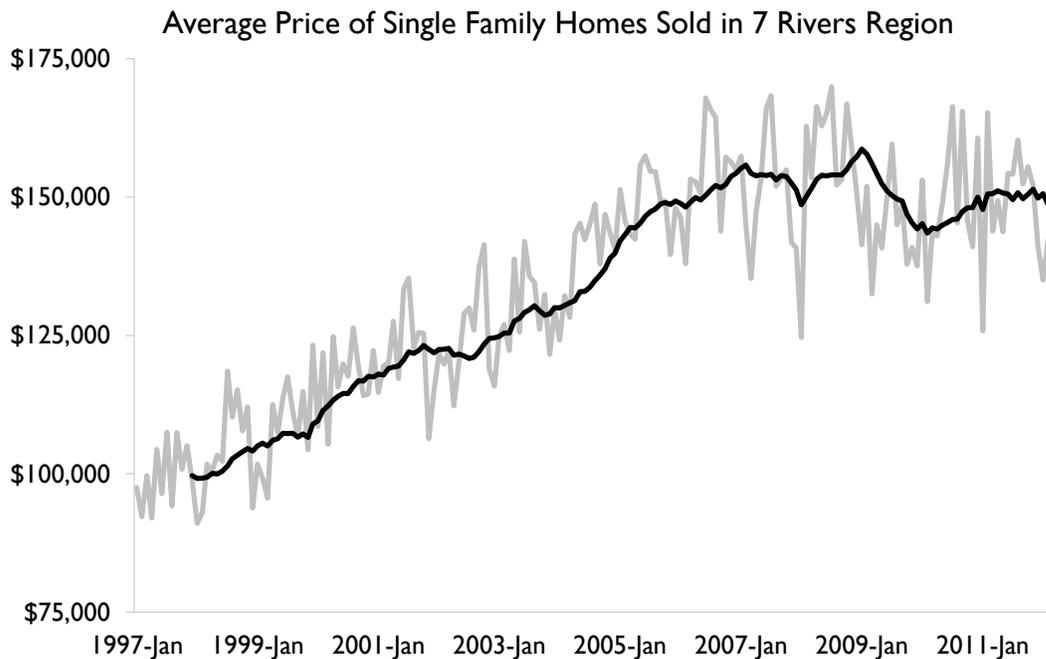
²⁵ <http://www.jsonline.com/business/us-adding-jobs-while-state-loses-114c8qp-141333083.html>



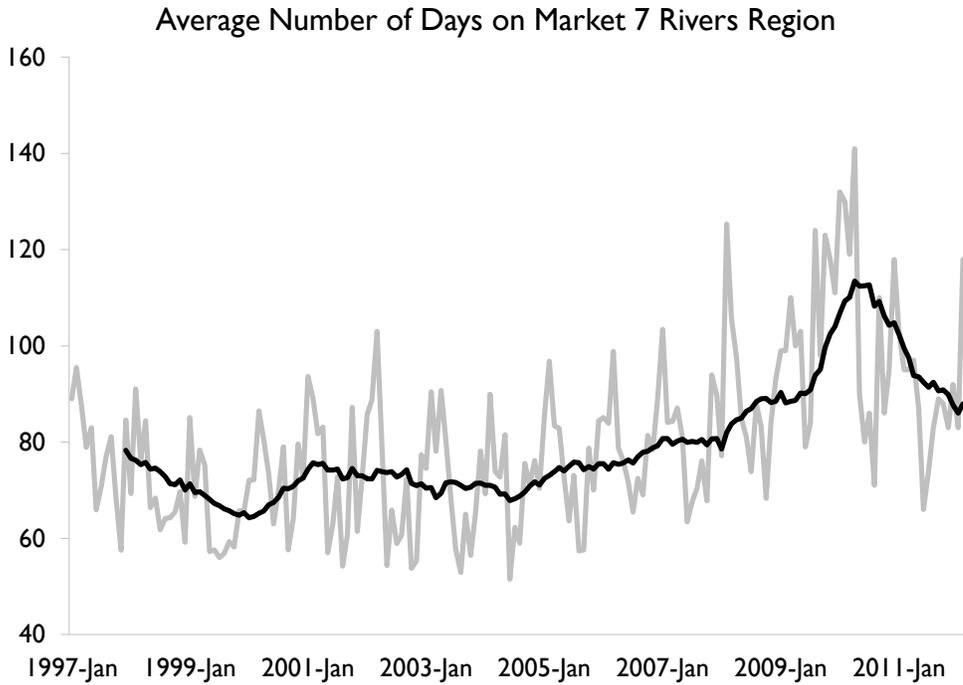
Source: BLS, <http://goo.gl/IE69o>

Housing Market

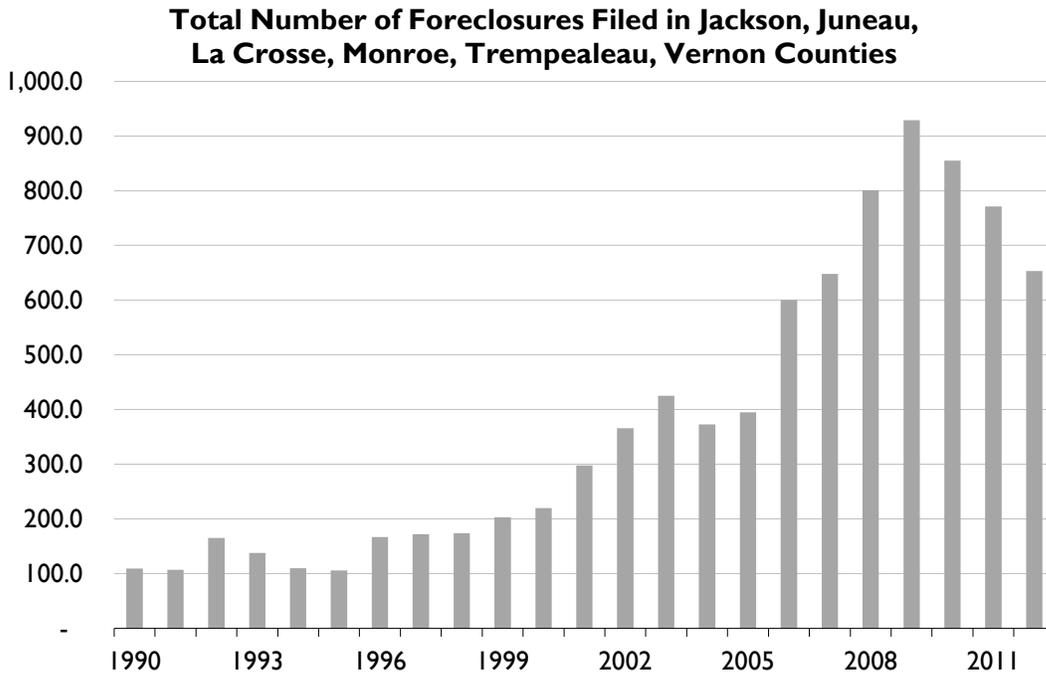
The local housing market continues to sluggishly gain ground. The average selling price has reversed some of the declines of late 2008 and 2009.



Also the average number of days on the market has fallen substantially.

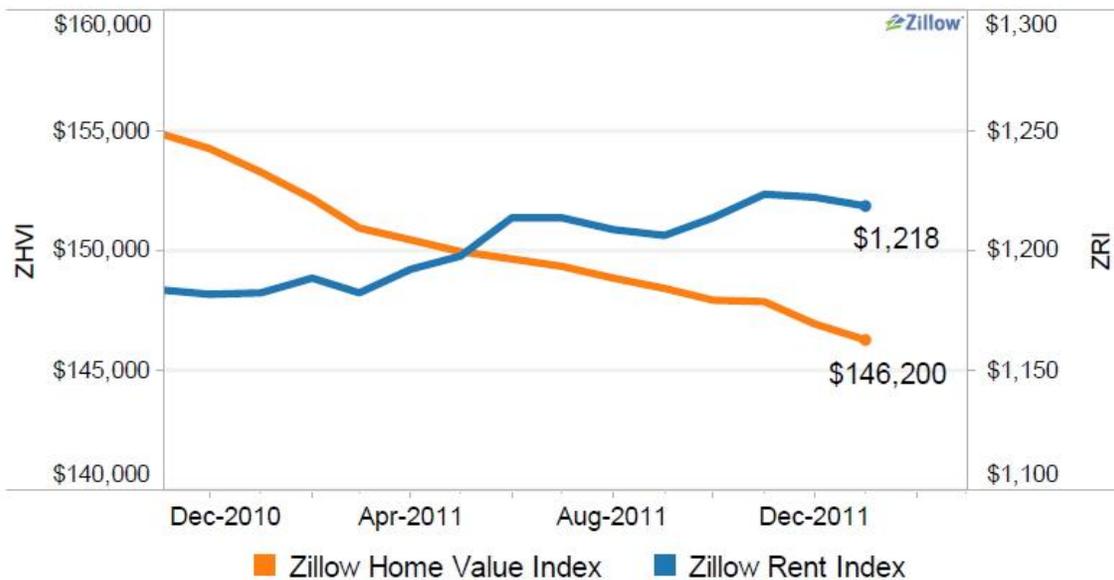


And finally the number of foreclosures has begun to decline in the region, though I will note that the county of La Crosse continues to experience peak foreclosures. (See Appendix.)



At the peak of the housing bubble home prices exceeded the rent that could be generated from them at market rental rates. This suggested that they were option values on future appreciation. In the long run, rents and home values cannot get too far apart. A recent article by Zillow.com,²⁶ the home price website, finds that rents have begun to exceed the cost of buying a home, suggesting that buying a home to rent out is more profitable. Part of this change is a reflection of the public changing their preferences. After all, many people have recently had the experience of having a home underwater, and don't wish to relieve that. This increased demand for rentals relative to homes for purchases has continued to drive up rental rates. We would expect to see a mini construction boom in the rental market in response.

Figure 1: U.S. Zillow Home Value Index and U.S. Zillow Rent Index
January 2012



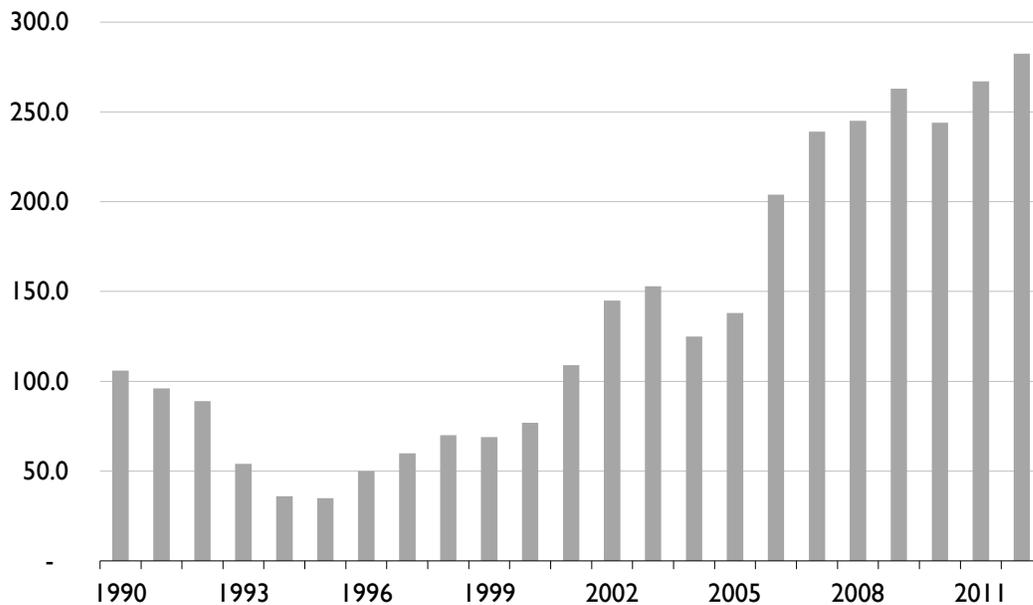
²⁶ <http://www.zillow.com/blog/research/2012/03/12/newly-released-zillow-rent-index-shows-rental-markets-heating-up-nationwide-but-home-values-continue-to-decline/>

Appendix:

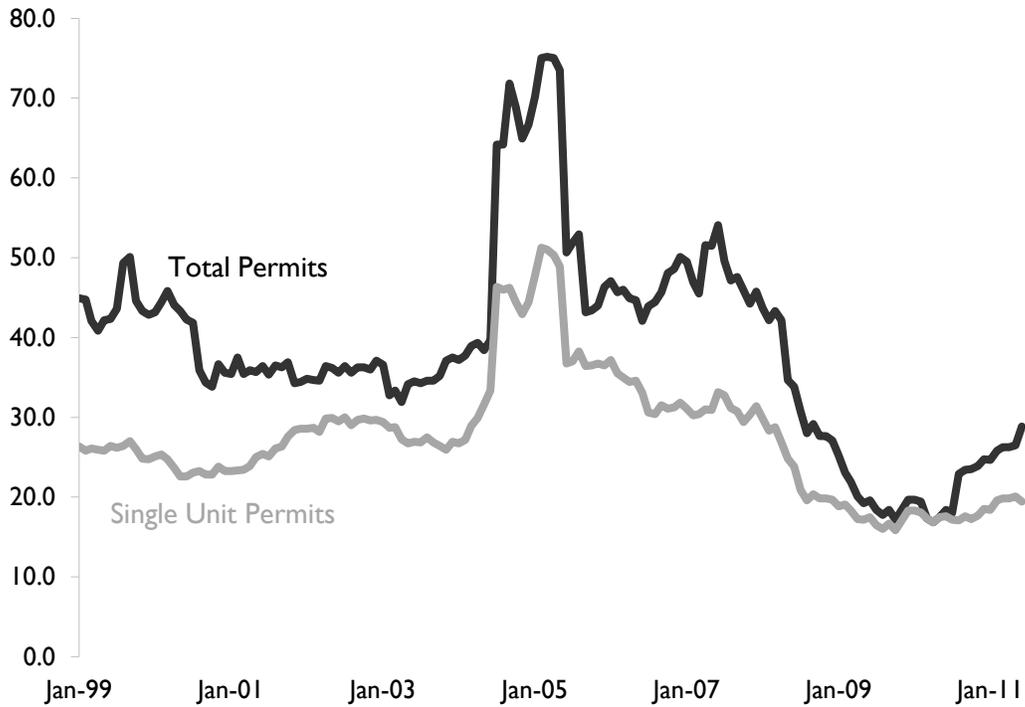
	Consumer Sentiment		Current Conditions		Consumer Expectations	
	7 Rivers	National	7 Rivers	National	7 Rivers	National
April 2002	96.1	93	94.7	99.2	97.1	89.1
November 2002	85.8	84.2	97.0	93.1	78.6	78.5
April 2003	86.0	86	94.4	96.4	80.6	79.3
October 2003	102.0	89.6	104.6	99.9	100.4	83.0
April 2004	98.1	94.2	102.9	105	95.0	87.3
February 2005	87.9	94.1	100.7	109.2	79.6	84.4
March 2006	85.9	88.9	107.6	109.1	71.9	76.0
November 2006	90.8	92.1	96.7	106	86.9	83.2
April 2007***	102.7	89.2	113.7	111.1	95.7	75.1
February 2008***	79.1	70.8	91.3	83.8	71.2	62.4
August 2008***	69.9	61.2	76.5	73.1	65.6	53.5
December 2008***	70.9	60.1	87.0	69.5	60.6	57.8
February 2009***	59.7	56.3	75.9	65.5	49.2	50.5
July 2009***	75.2	66	83.7	70.5	69.7	63.2
February 2010***	79.2	73.7	91.8	84.1	71.2	66.9
August 2010***	79.0	69.6	91.5	69.0	70.9	64.1
April 2011***	80.5	68.2	88.2	83.6	75.5	58.3
August 2011 ***	66.2	54.9	80.8	69.3	56.8	45.7
February 2012 ***	94.4	75.3	102.4	83.0	89.3	70.3

*** Survey moved to the web.

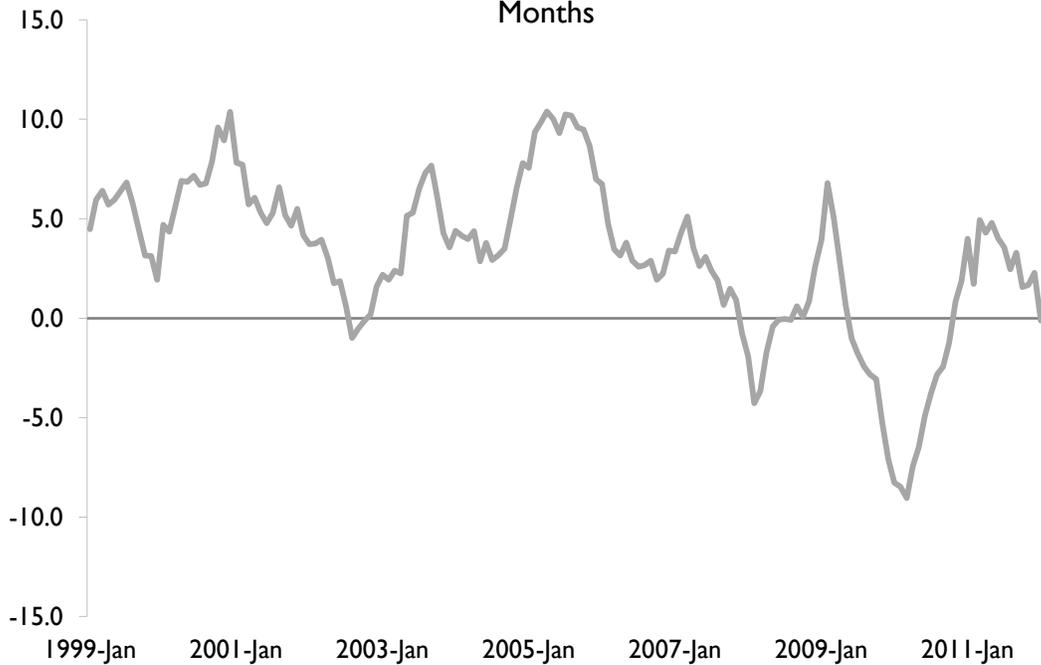
La Crosse Foreclosures Filed



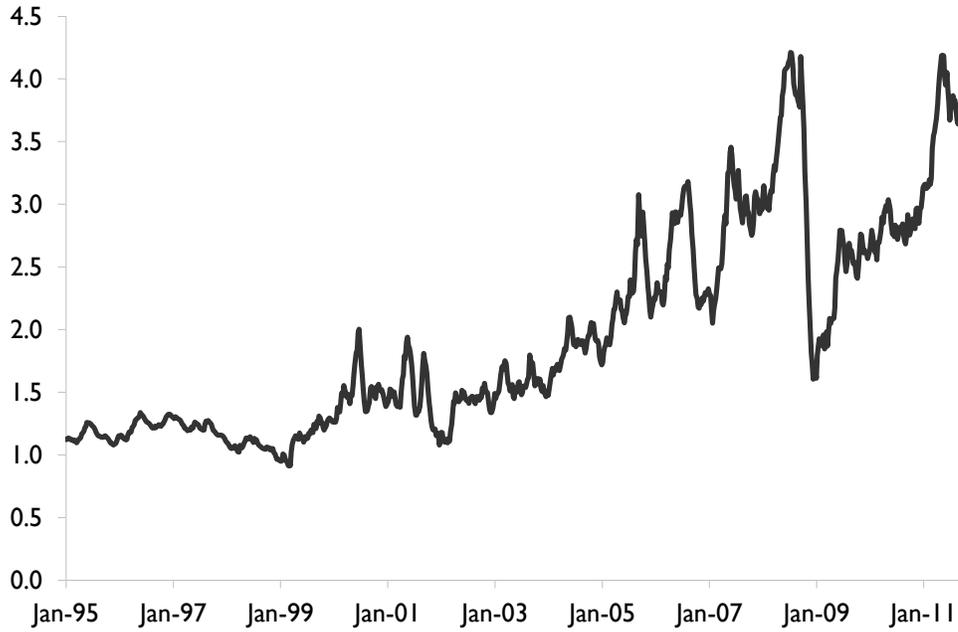
Number of Building Permits in La Crosse MSA



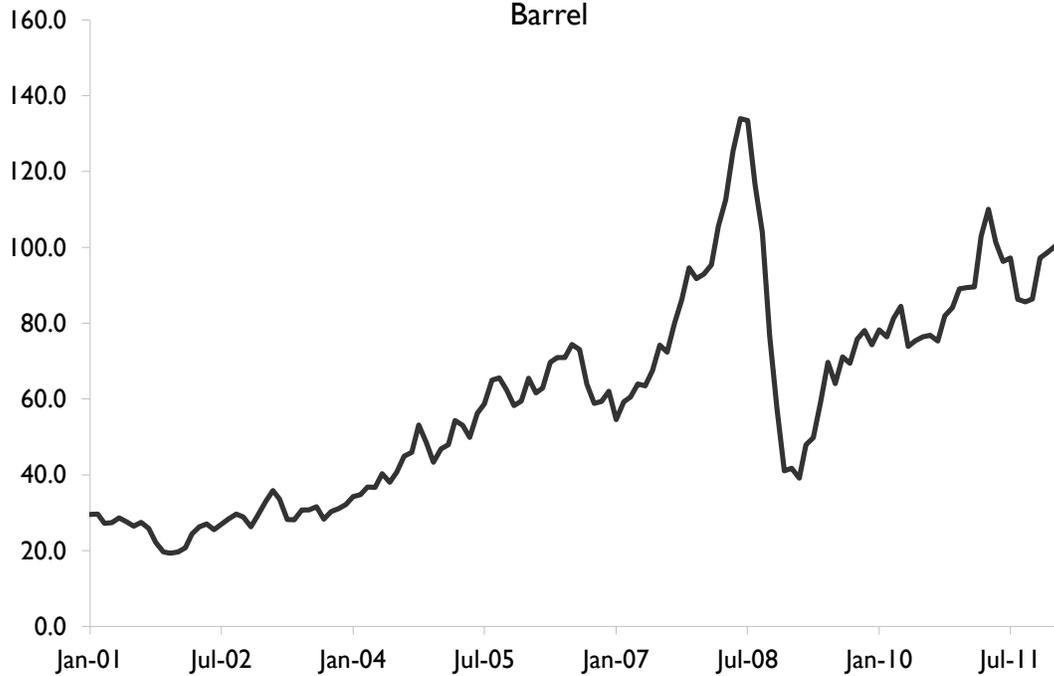
7 Rivers Region Percentage Increase in Selling Price for Previous 12 Months



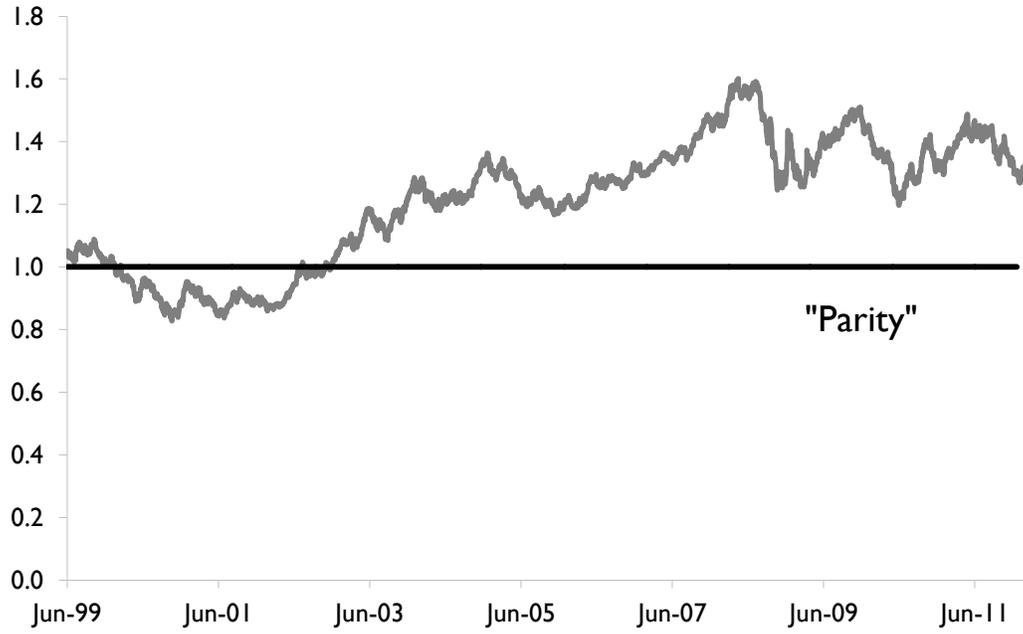
Midwest Regular Reformulated Retail Gasoline Prices (\$/gal)



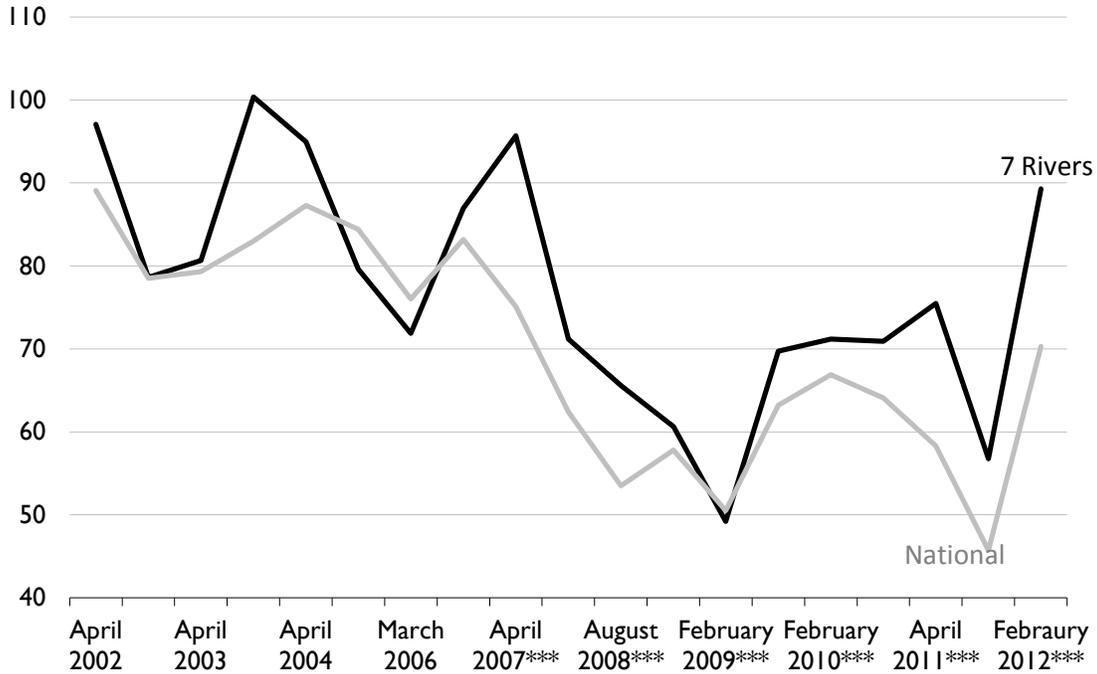
Price of West Texas Intermediate Crude: Monthly NSA, Dollars Per Barrel



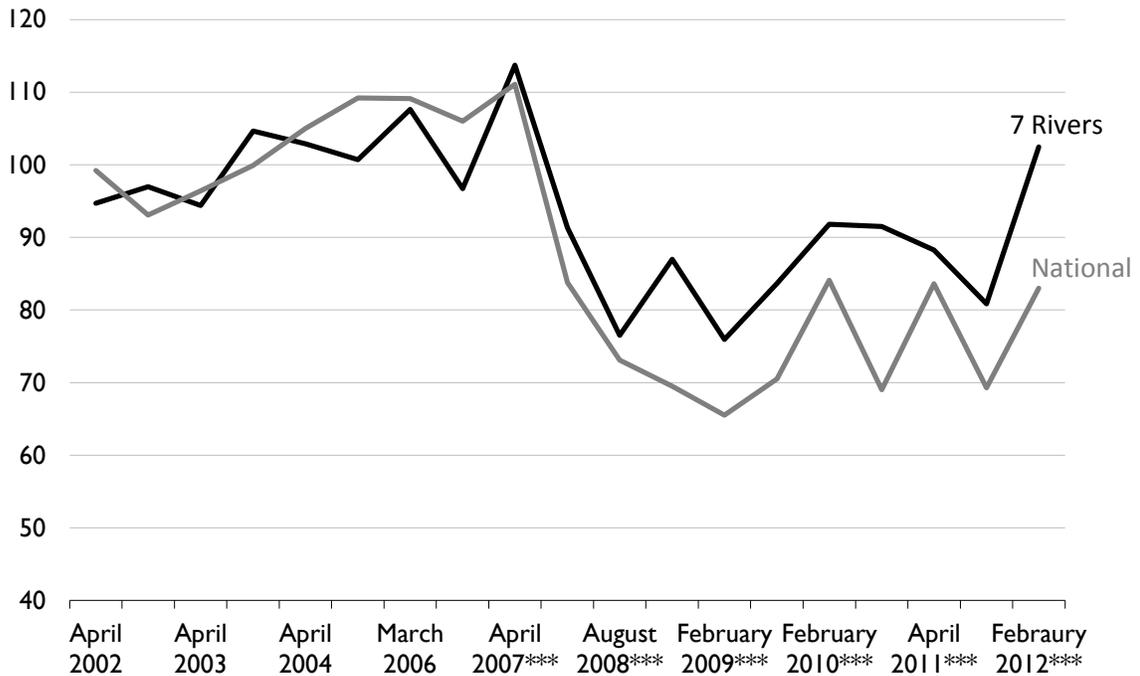
U.S. Dollars to One Euro



Consumer Expectations Index



Current Conditions Index



7 Rivers Equity Index Update: Continued Economic Recovery and Acquisitions Improve Index Outlook

Shane Van Dalsem, Ph.D., UW-La Crosse Finance Department

Introduction

Tracking of the 7 Rivers Equity Index (SREI) began in 2000 as a way to provide information concerning publicly-traded firms headquartered in the 7 Rivers Region to investors and the business community. The value of the index is that it provides a measure of the economic health of the region as several of the businesses within the index have a significant impact on the region. These firms affect the economy of the region in two important ways. First, ownership of the firms is concentrated at higher amounts within the area of the firm's headquarters due to the stock ownership of the founders, management, and employees of the firm. As stock returns increase, wealth is imported into the region. Second--to the degree at which the firms' operations occur within the region--profits, cash flows, and investments of the firms are a measure of economic activity and health of the region.

This report covers the financial information for the index and its components for the past five years (ending March 1, 2012 for stock returns). During this time period, the country and region fell into and emerged from one of the largest recessions in the nation's history. During the most recent year, Renaissance Learning Inc. was acquired in a unique enough fashion to merit two articles in the Wall Street Journal. Another firm, Great Wolf Resorts, Inc., appears to be in negotiations to be acquired by Apollo Management Group, LLC. The acquisition of Renaissance Learning improved the performance of the SREI and the acquisition of Great Wolf Resorts is expected to as well.

Construction of the Index and Index Components

Using the methodology developed by Dr. Thomas Krueger, the SREI consists of the exchange-traded firms that are headquartered within 100 miles of La Crosse, WI. *ReferencesUSA* was used to identify the firms that fulfill the criteria to be included in the index. The firms identified using these criteria are as follows:

Non-Financial Firms:

- Fastenal, Inc.
- Flexsteel Industries, Inc.
- Great Wolf Resorts, Inc.
- Hormel Foods Corporation
- Marten Transport Ltd.
- National Presto Industries, Inc.
- Renaissance Learning, Inc.²⁷
- Rochester Medical Corporation

²⁷ Renaissance Learning, Inc. was acquired by Permira Funds on Oct. 17, 2011.

Financial Services Firms:

Citizens Community Bancorp, Inc.
Heartland Financial USA, Inc.
HMN Financial, Inc.

A brief profile of each of the firms in the index is provided in the Appendix. Of the eleven firms that make up the index, seven of the firms are traded on the NASDAQ, three are traded on the NYSE, and one, Renaissance Learning, was acquired by another firm in late 2011. Using Standard and Poors' guidelines, two of the firms (Fastenal and Hormel) are large cap firms, two (Marten Transport and National Presto) are small cap firms, and the remaining six are micro cap firms.

Stock Performance

Calculation of Returns

The SREI is an equally-weighted index, meaning that it is assumed that an equal dollar amount is invested in each of the stocks at the beginning of the measurement period. The returns for the index were calculated on a monthly basis for a five-year period beginning on March 1, 2007 and ending March 1, 2012. The monthly returns are calculated as the change in the adjusted price on *Yahoo! Finance* from one month to the next. The adjusted price incorporates cash dividends paid, stock splits, reverse stock splits, and stock dividends into the price of the stock, so the return calculated assumes that any dividends paid were reinvested back into the firm, thereby calculating the total return to the investor.

Benchmarks

For comparison purposes, I chose four benchmarks for the index, two for the total index and two for the financial firms. As mentioned above and shown in the Appendix, the index consists primarily of smaller firms. Standard benchmarks such as the S&P 500 and Dow Jones Industrial Index consist solely of large cap firms. Small firms tend to have greater price volatility and higher returns when compared to large firms, so the S&P 500 and Dow Jones Index were not used.

The two benchmarks chosen for the total index are the iShares S&P 1500 Index Fund (Ticker: ISI) and the iShares Russell Microcap Index (Ticker: IWC). The S&P 1500 index tracks the combined performance of the S&P 500 (LargeCap), S&P 400 (MidCap), and S&P 600 (SmallCap) indices. The Russell Microcap Index currently consists of 1,389 of the smallest exchange-traded firms. Criteria for the Russell Microcap Index is that the firm must be traded on a US exchange (AMSE, NYSE, or NASDAQ) and have a market capitalization of \$300 million or less.

The financial services industry is unique from other industries due to its high level of regulation and differing response to market events. As such, firms in this industry are often analyzed separately from firms in other industries. The benchmarks used for this subsection of the index are the NASDAQ Financial 100 index (Ticker: IXF) and the FBR Small Cap Financial Fund (Ticker: FBRSX). The NASDAQ Financial 100 Index consists of the largest 100 financial services firms by market cap traded on the NASDAQ exchange. The FBR fund is a mutual fund that invests primarily in small cap financial services firms.

Index Performance

Table I provides the returns for each firm in the SREI, the returns for the index, and the returns for the S&P 1500 and Microcap indices for each year beginning March 1, 2007 and ending March 1, 2012.

According to the National Bureau of Economic Research, the most recent recession began in December of 2007 and ended in June of 2009.²⁸ The performance of the SREI and the benchmarks reflects this recession period with the return for the SREI at -16.90% for the period ending 3/1/2008 and -45.66% for the period ending 3/1/2009. The three firms that most contributed to these negative returns were Great Wolf Resorts (-72.93% and -100.73%), HMN Financial (-34.69% and -197.68%) and Flexsteel Industries (-9.02% and -91.26%). These results are not surprising as the three firms represent the recreation, financial, and consumer discretionary spending industries, respectively. The first and last are typically hard hit during recessions and the financial industry was particularly hard hit during the most recent recession.

Table I. Annual Returns for SREI Components and Benchmarks

SREI Components	For the Period Ending March 1,				
	2008	2009	2010	2011	2012
Citizens Community Bancorp	-12.76%	-24.78%	-42.88%	23.12%	15.04%
Fastenal Co.	28.13%	-34.17%	42.00%	31.74%	50.57%
Flexsteel Industries	-9.02%	-91.26%	99.21%	12.15%	13.06%
Great Wolf Resorts	-72.93%	-100.73%	31.10%	-41.02%	65.94%
Heartland Financial USA	-21.60%	-42.42%	19.21%	8.71%	-5.72%
HMN Financial	-34.69%	-197.68%	57.33%	-69.31%	-36.97%
Hormel Foods	13.00%	-25.10%	30.33%	30.13%	3.70%
Marten Transport	-2.30%	18.57%	5.34%	12.63%	-5.73%
National Presto	-8.16%	23.96%	73.26%	1.41%	-23.36%
Renaissance Learning	14.81%	-36.38%	62.19%	-14.86%	60.41%
Rochester Medical	-80.35%	7.73%	15.13%	-11.04%	-18.09%
Median	-9.02%	-34.17%	31.10%	8.71%	3.70%
Average (Index Return)	-16.90%	-45.66%	35.66%	-1.49%	10.80%
S&P 1500 Index	-6.69%	-48.50%	41.52%	15.08%	4.87%
Russell MicroCap Index	-23.09%	-56.12%	49.66%	22.30%	-5.69%

While the SREI did produce negative returns for investors during the recessionary period, it also outperformed the Russell MicroCap Index for the first period and both benchmarks in the second.

For the first two years in the post-recession period, the SREI underperformed the benchmarks, due largely to the poor performance of financial firms. In the first year (the year ending March 1, 2010), the only firm in the index that had a negative return was Citizens Community Bancorp

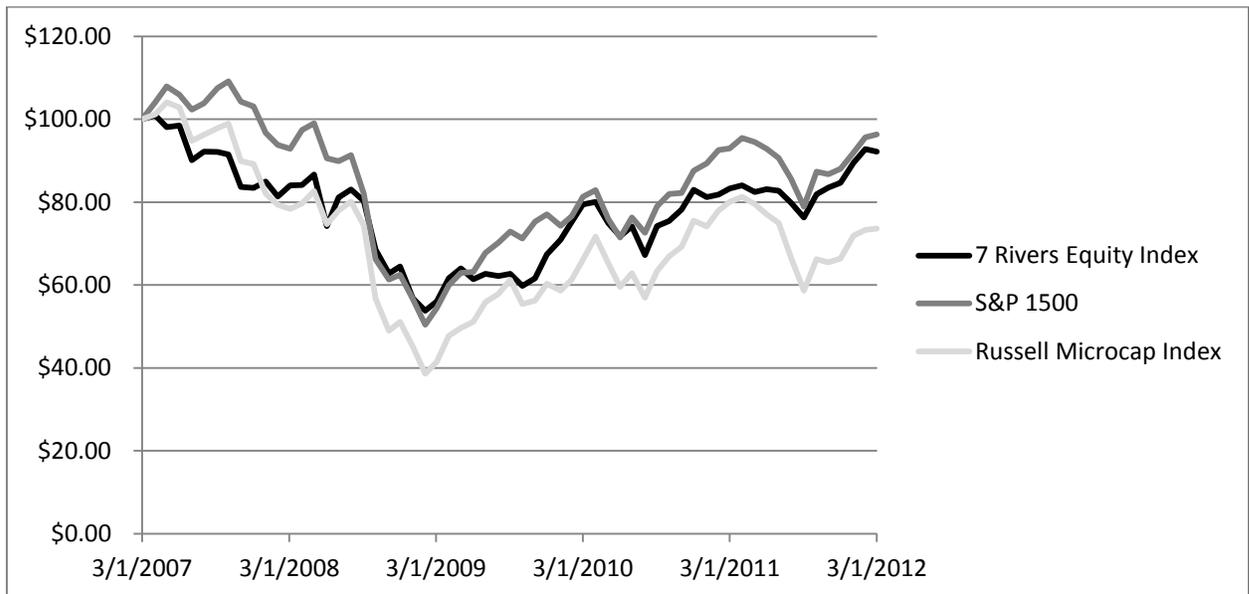
²⁸ "US Business Cycle Expansions and Contractions" available at: www.nber.org/cycles.html

(-42.88%). For the second year the worst performing firms were HMN Financial (-69.31%), Great Wolf Resort (-41.02%), and Renaissance Learning (-14.86%).

During the most recent year, the acquisition of Renaissance Learning on October 17, 2011 and a strong earnings announcement by Great Wolf Resorts on February 22, 2012 resulted in the index outperforming the benchmarks for the period.²⁹

While the SREI did slightly underperform the S&P 1500 index during the five year period, the index also provided lower volatility, which might make the index more attractive for a conservative investor. Figure 1 shows the change in value of \$100 invested in the SREI and the two benchmarks for the five year period ending July 1, 2011. The ending value of the index was \$92.14, for the S&P 1500 it was \$96.32, and for the Russell Microcap Index \$73.58.

Figure 1. Growth of \$100 Invested in the 7 Rivers Index and Comparative Benchmarks



Financial Firms’ Performance

To analyze the performance of the financial services industry firms within the SREI, an equally-weighted portfolio was created using the returns of Citizens Community Bancorp, Heartland Financial USA, and HMN Financial. As seen in Table 2, the performance of this index underperformed the benchmarks for every annual period with the exception of the 12 months ending March 1, 2012, during which period the index outperformed the FBR Small Cap Financial Fund. None of the financial firms in the SREI escaped the measurement period unscathed.

²⁹ The amount of the index invested in Renaissance Learning was equally distributed across the remaining firms as of November 1, 2011 for the calculation of the index value.

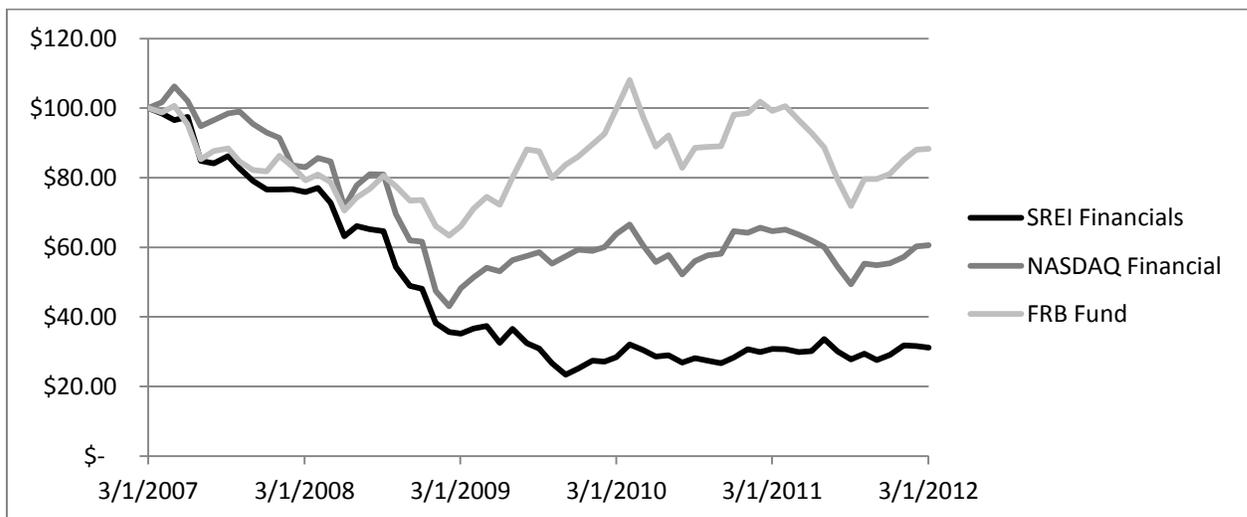
Table 2. Annual Returns for SREI Financials and Benchmarks

SREI Financial Components	Annual Total Return for the 12 Months Ending March 1,				
	2008	2009	2010	2011	2012
Citizens Community Bancorp	-12.76%	-24.78%	-42.88%	23.12%	15.04%
Heartland Financial	-21.60%	-42.42%	19.21%	8.71%	-5.72%
HMN Financial	-34.69%	-197.68%	57.33%	-69.31%	-36.97%
Median	-21.60%	-42.42%	19.21%	8.71%	-5.72%
Average (Index Return)	-23.02%	-88.29%	11.22%	-12.49%	-9.22%
FBRSX	-22.02%	-16.24%	43.61%	2.09%	-9.54%
IXF	-17.61%	-46.32%	28.83%	3.71%	-4.59%

The post-recession period was mixed for each of the firms. Citizens experienced a significant increase in returns in the past two years, likely due to a change in top management in 2009 and a change in direction for the firm. HMN Financial's poor results in the last two periods were triggered by increased supervision by the Federal Reserve in February of 2011 followed by a deferment in paying preferred dividends leading to a turnover in the CEO and Chairperson position in April of 2011.

Figure 2 shows the results of investing \$100 in the 7 Rivers Financial Index and into each of the two benchmarks. The \$100 initially invested in the 7 Rivers Financial Index would have only been worth \$31.22 at the end of the measurement period. The same \$100 would have been worth \$60.58 if invested in the NASDAQ Financial Index and \$88.28 if invested in the FRB Fund.

Figure 2. Growth of \$100 Invested in the 7 Rivers Index Financials and Comparative Benchmarks



Accounting Measure Performance

Tables 3, 4 and 5 present income statement information, balance sheet information, and cash flow statement information, respectively, for each of the firms in the index and the median and average results for the non-financial and financial firms separately. Reuters, company annual reports, and 10-k reports filed with the SEC were the sources of the information used to complete these tables. Information was gathered for each of the past three fiscal year ends for each firm.

Income Statement Performance

For the non-financial firms, revenues rose consistently across the three-year time period for all of the firms except for National Presto Industries. The financial institutions fared worse during the period. Revenues for Heartland Financial fell in 2010 from the 2009 level and increased by an insignificant amount in 2011 from the previous year. Revenues for HMN Financial slid consistently during the period due to increasing loan losses and a reduced ability to generate income from loans.

The decrease in median and average return on equity during the period was due largely by the high ROE for Renaissance Learning in FY 2009 followed by a lack of ROE in the following two years. The high ROE in 2009 and lack of ROE for the 2010 and 2011 for Renaissance Learning was driven by significant stock repurchases over the past several years. Since the value of the stock repurchased was recorded at the cost of the stock in the market, the total value of the stock repurchases was greater than the book value of equity of the firm for Renaissance, resulting in negative book value of equity values for 2010 and 2011. Stock repurchases are usually seen as a positive sign for a firm.

Great Wolf Resorts stands out as being troubled based on their financial results during the period. The firm had both significantly negative net profit margins and negative returns on equity, despite rising revenues during the three year period. This poor performance has been driven by increasing selling, general, and administrative expenses during the period. Rochester Medical also experienced a declining net profit margin and return on equity during the three year period. For 2009, the decrease was largely due to decreasing revenue. The decrease in the net profit margins for 2010 and 2011 were driven by significant increases in selling, general, and administrative expenses.

With the exceptions of Flexsteel and National Presto Industries, which had slightly lower net profit margins in 2011, the rest of the non-financial firms in the index have shown increasing net profit margins and returns on equity for the three year period, which is consistent with a rebounding economy.

The bottom-line results for the financial firms correspond with the discouraging trend observed in the stock returns. While Heartland Financial's net profit margin and return on equity bounced back to above pre-recession levels in 2010, these measures for HMN Financial and Citizens Community continued to decline in 2010, with a net profit margin of -55.39% and a return on equity of -44.23% for HMN Financial for 2010 and a net profit margin of -26.26% and a return on equity of -13.48% for Citizens Community in 2010. For 2011, both measures entered positive territory for Citizens, but remained significantly negative for HMN Financial.

The poor performance of HMN Financial can be attributed directly to increasing loan losses during the three year period resulting in a memorandum of understanding between the firm and the Office of Thrift Supervision in February of 2009 and culminating into a supervisory agreement between the two in February of 2011. This supervisory agreement requires the firm to improve its capital ratios prior to paying dividends in the future. In April of 2011, the firm suspended payment of preferred dividends and the CEO and Chairperson, Timothy Geisler, was replaced.

The net interest margin is calculated as the net interest income (interest income less interest expense) divided by the average interest-earning assets during the period. This is a common evaluation measure for financial institutions as the majority of their income comes from interest on loans and the ability to maintain profitability depends on their ability to loan money out at a higher rate of interest than they have to pay to use the funds. As can be seen in Table 3, this measure consistently increased during the three year period and was not the cause of the disappointing results of two of the firms. The increase in net interest margins was consistent with a national trend of rising net interest margins after almost two decades of falling net interest margins. The increase in net interest margins is largely due to the cost of funds (largely interest rates on deposits) falling faster and more significantly than the rate at which the funds are lent out.

Table 3. Income Statement Measures of SREI Component Firms

Non-Financial Firms

	Revenues (in millions)			Gross Profit Margin			Net Profit Margin			Return on Equity		
	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011
Fastenal	\$1,930	\$2,269	\$2,766	50.95%	51.77%	51.83%	9.55%	11.69%	12.94%	15.48%	20.69%	24.53%
Flexsteel Industries	\$324.1	\$326.4	\$339.4	18.84%	22.91%	22.77%	-0.47%	3.31%	3.07%	3.17%	9.18%	8.10%
Great Wolf Resorts	\$264.0	\$284.2	\$296.7	58.68%	68.46%	66.96%	-22.15%	-17.95%	-8.65%	-27.23%	-30.77%	-18.09%
Hormel Foods Corp	\$6,533	\$7,220	\$7,895	16.82%	17.16%	16.90%	5.25%	5.86%	6.01%	16.15%	17.61%	17.85%
Marten Transport	\$505.9	\$516.9	\$603.7	31.76%	30.97%	29.84%	3.22%	3.82%	4.02%	5.96%	6.71%	7.63%
National Presto Industries	\$478.5	\$479.0	\$425.5 ^a	23.01%	23.71%	21.30% ^a	13.08%	13.26%	11.23% ^a	18.63%	18.47%	12.57% ^a
Renaissance Learning Inc.	\$121.5	\$130.0	N/A	79.08%	78.99%	N/A	16.39%	18.36%	N/A	250.5%	N/A	N/A
Rochester Medical Corp.	\$34.80	\$41.44	\$52.92	48.36%	47.54%	49.31%	0.32%	-0.60%	-2.48%	0.16%	-0.36%	-1.99%
Median	\$401.3	\$402.7	\$425.6	40.06%	39.25%	29.84%	4.24%	4.84%	4.02%	10.72%	9.18%	8.10%
Average	\$1,274	\$1,408	\$1,769	40.94%	42.69%	36.99%	3.15%	4.72%	3.73%	35.36%	5.93%	7.23%

Financial Firms

	Revenues (in millions)			Net Interest Margin			Net Profit Margin			Return on Equity		
	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011
Citizens Community Bancorp	\$25.71	\$27.01	\$31.89	3.28%	3.84%	4.83%	-12.38%	-26.26%	0.61%	-5.18%	-13.48%	0.36%
Heartland Financial	\$256.0	\$251.3	\$251.3	3.99%	4.12%	4.16%	0.48%	7.39%	11.14%	1.99%	7.26%	7.94%
HMN Financial	\$59.96	\$55.54	\$46.41	3.33%	3.36%	3.78%	-20.92%	-55.39%	-24.90%	-12.55%	-44.23%	-20.25%
Median	\$59.96	\$55.54	\$46.41	3.33%	3.84%	4.16%	-12.38%	-26.26%	0.61%	-5.18%	-13.48%	0.36%
Average	\$113.9	\$111.3	\$109.9	3.53%	3.77%	4.26%	-10.94%	-24.75%	-4.38%	-5.25%	-16.82%	-3.98%

^a Number is for the trailing twelve months ending the third quarter of 2011.

Balance Sheet Analysis

Table 4 provides the balance sheet ratios for the years 2009-2011 for the firms that comprise the SREI. The current ratio is a measure of the liquidity of the firm and is calculated as current assets divided by current liabilities. The current ratio measures how well a firm could pay its liabilities that are expected to come due in the next year with assets that are expected to be liquidated in the next year. While having a higher current ratio may sound beneficial, and generally does reduce risk, it also reduces the returns to shareholders as liquid assets typically provide little, if any, return. The long-term debt ratio is calculated as the amount of debt that has a maturity date of greater than one year divided by the total assets of the firm. A higher debt ratio may result in a higher risk of default and bankruptcy. Conversely, a greater amount of debt in the capital structure concentrates the earnings of the firm to fewer equity holders and increases the return on equity for the firm. Total asset turnover is calculated as sales divided by total assets. It is used as a measure of how well management is utilizing assets to generate sales.

The average current ratio among the non-financial firms increased between 2009 and 2011. The significant drop in the current ratio for Rochester Medical in 2011 was due to a significant increase in short term debt.

Surprisingly, five of the seven remaining non-financial firms in the SREI have no long-term debt. Of the remaining firms, Great Wolf Resorts decreased their long-term debt ratio in 2011 by not replacing the debt which is amortizing and Hormel has been consistently decreasing their long-term debt ratio through increases in assets and debt reductions.

The overall trend for the non-financial firms with regard to the total asset turnover has been positive, with the exception of a reduction in the measure for National Presto in 2011.

For the financial firms, I included the loans-to-assets ratio, provision for loan loss-to-total loans and the equity-to-assets ratio of the firms. The loans-to-assets ratio is a measure of the percent of the firm's assets that are productive with a higher number usually indicating more productive assets. The provision for loan loss is an income statement account that shows how much the firm is setting aside for future anticipated loan losses. This ratio provides insight into the quality and safety of the loans that the firm has made. The equity-to-assets ratio is a measure of the safety of the firm as a higher ratio gives the firm a larger cushion that can absorb future losses. However, a higher ratio also decreases return on equity and may be the result of regulatory action due to poor asset quality.

Table 4. Balance Sheet Ratios of SREI Component Firms

Non-Financial Firms

	Current Ratio			Long-Term Debt Ratio			Total Asset Turnover		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
Fastenal	8.22	6.69	6.58	0.00%	0.00%	0.00%	1.45	1.55	1.64
Flexsteel Industries	3.16	3.93	4.64	6.62%	0.00%	0.00%	2.04	1.99	2.06
Great Wolf Resorts	0.72	0.47	0.48	68.27%	71.61%	62.91%	0.31	0.34	0.42
Hormel Foods Corp	2.3	1.69	2.57	9.48%	8.63%	5.89%	1.77	1.78	1.86
Marten Transport	1.34	1.28	2.19	13.41%	19.10%	0.00%	1.22	1.12	1.12
National Presto Industries	5.60	5.18	5.75 [†]	0.00%	0.00%	0.00% [†]	1.15	1.32	1.12 ^α
Renaissance Learning Inc.	1.02	0.46	N/A	0.00%	0.00%	N/A	2.26	2.61	N/A
Rochester Medical Corp.	9.00	8.07	2.45	5.02%	3.49%	0.00%	0.47	0.44	0.58
Median	2.73	2.81	2.57	5.82%	1.75%	0.00%	1.34	1.44	1.28
Average	3.92	3.47	3.52	12.85%	12.85%	9.83%	1.33	1.39	1.28

Financial Firms

	Loans-to-Assets			Provision for Loan Loss /Total Loans			Equity-to-Assets		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
Citizens Community Bancorp	0.77	0.77	0.80	0.31%	1.51%	1.36%	0.10	0.08	0.10
Heartland Financial	0.59	0.60	0.58	1.65%	1.36%	1.19%	0.08	0.08	0.08
HMN Financial	0.77	0.76	0.71	4.16%	4.12%	3.09%	0.10	0.08	0.07
Median	0.77	0.77	0.71	1.65%	1.51%	1.36%	0.10	0.08	0.08
Average	0.77	0.77	0.70	2.04%	2.29%	1.88%	0.09	0.08	0.08

[†]Number is for the third quarter of 2011.

^αNumber is for the trailing twelve months ending the third quarter of 2011.

The loans-to-assets increased for Citizens Community, remained relatively stable for Heartland Financial, and fell for HMN Financial during the three-year period. The decrease for HMN Financial is likely due to the regulatory action taken against them in 2011.

The average provision for loan loss as a percent of total loans improved for both Heartland Financial and HMN Financial, with a significant increase for Citizens Community Bancorp in 2010. The ratio for HMN Financial was quite high compared to a historical benchmark of 1.20% to 1.25% for this industry. This high ratio is consistent with poor loan quality.

The average equity-to-assets ratio fell between FY 2009 and FY 2010 due to a decrease for Citizens Community and HMN Financial. HMN Financial saw a consistent decrease during the period. The increase in the provision for loan loss likely contributed to this by deteriorating the profit margin and the resulting level of retained earnings.

Cash Flows Analysis

The operating cash flows, level of capital expenditures, and free cash flows are provided in Table 5. The free cash flows for this table are calculated as operating cash flows less capital expenditures. If not used for paying down debt, paying interest on debt, or held for future investment purposes, free cash flows are cash flows that are available for distribution to stockholders through dividends or stock repurchases. Consistent and growing free cash flows increase the returns to shareholders.

Free Cash Flows for the non-financial firms were inconsistent during the period. Fastenal's increasing operating cash flows were moderated by increasing capital expenditures. National Presto faced declining operating cash flows and increasing capital expenditures during the three year period. For the financial firms, average operating cash flows and free cash flows increased consistently over the three year period. This was due to improved performance for Citizens Community and Heartland Financial over the years. Operating cash flows and free cash flows fell considerably for HMN Financial in 2011.

Table 5. Cash Flow Analysis of SREI Component Firms

Non-Financial Firms

	Operating Cash Flows (in millions)			Capital Expenditures (in millions)			Free Cash Flow (in millions)		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
Fastenal	\$306.1	\$240.5	\$286.5	\$52.54	\$73.60	\$120.04	\$253.5	\$166.9	\$166.5
Flexsteel Industries	\$17.31	\$19.12	\$13.80	\$1.20	\$1.25	\$2.57	\$16.11	\$17.87	\$11.23
Great Wolf Resorts	\$12.21	\$29.11	\$28.87	\$49.26	\$8.68	\$9.32	(\$37.05)	\$20.43	\$8.44
Hormel Foods Corp	\$558.8	\$485.5	\$490.5	\$96.96	\$89.82	\$96.91	\$461.8	\$395.7	\$393.6
Marten Transport	\$81.69	\$64.52	\$86.21	\$79.91	\$81.24	\$84.91	\$1.78	(\$16.72)	\$1.30
National Presto Industries	\$62.15	\$57.77	\$33.98 [†]	\$3.34	\$17.97	\$19.86 [†]	\$58.81	\$39.80	\$14.12 [†]
Renaissance Learning Inc.	\$34.35	\$45.72	N/A	\$1.08	\$1.75	N/A	\$33.27	\$43.97	N/A
Rochester Medical Corp.	\$1.68	\$3.12	\$2.65	\$1.23	\$1.83	\$1.76	\$0.45	\$1.29	\$0.89
Median	\$48.25	\$51.75	\$33.98	\$26.30	\$13.33	\$19.86	\$24.69	\$30.12	\$11.23
Average	\$134.28	\$118.17	\$134.64	\$35.69	\$34.52	\$47.91	\$98.59	\$83.66	\$85.14

Financial Firms

	Operating Cash Flows (in millions)			Capital Expenditures (in millions)			Free Cash Flow (in millions)		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
Citizens Community Bancorp	\$3.78	\$6.43	\$11.47	\$3.07	\$0.31	\$0.58	\$0.71	\$6.12	\$10.89
Heartland Financial	\$39.88	\$80.44	\$103.2	\$6.60	\$9.61	\$6.36	\$33.28	\$70.83	\$96.79
HMN Financial	\$15.45	\$25.56	\$17.34	\$0.56	\$0.29	\$0.20	\$14.89	\$25.26	\$17.14
Median	\$15.45	\$25.56	\$17.34	\$3.07	\$0.31	\$0.58	\$14.89	\$25.26	\$17.14
Average	\$19.70	\$37.48	\$43.99	\$3.41	\$3.40	\$2.38	\$16.29	\$34.07	\$41.61

[†]Number is for trailing twelve months ending in the third quarter for 2011.

Acquisition of Renaissance Learning by Permira³⁰

The completion of the acquisition of Renaissance Learning by Permira Funds on October 17, 2011 concluded a short, but intense, conflict between Renaissance and Plato Learning, Inc. The initial merger agreement, submitted by Permira on August 15, 2011 provided Renaissance shareholders with a price per share of \$14.85. On August 24, Plato Learning, Inc. submitted an unsolicited bid to acquire Renaissance for \$15.50 per share. The principals of Renaissance, Judi and Terry Paul, who owned 69% of Renaissance's stock, were unsupportive of Plato's bid although it provided a greater return for them and the non-controlling shareholders of the firm.

Permira provided a counter offer of \$16.60 per share to the non-controlling shareholders and \$15.00 per share to the Pauls on September 27th. The average value per share would have matched Plato's offer of \$15.50 per share. This was a unique situation in which the controlling shareholders were willing to take a lower price than the original offer and less than the amount received by the non-controlling shareholders in order to subsidize the offer provided by Permira to make it palatable to the non-controlling shareholders. In their discussions with the media, the Pauls insinuated that their overwhelming preference for Permira was because Permira would keep Renaissance jobs in Wisconsin and because Permira's vision for Renaissance was more in line with the vision the Pauls had for the company than was Plato's.

On September 28th, Plato countered Permira's offer by offering \$15.10 per share for the Pauls' shares and \$18.00 per share for all other shares. After a further rejection of their offer, Plato and Data Key Partners, a minority owner of Renaissance, initiated lawsuits against Renaissance, claiming that Renaissance violated Wisconsin law by colluding with Permira to reduce competition for purchasing Renaissance and that the Renaissance board of directors violated their fiduciary responsibility by rejecting a superior bid by Plato.

On October 10th, Plato offered an additional counter offer of \$16.90 for all shares, including those of the Pauls, thereby raising the average offering price from \$16.01 per share from their previous offer. On October 14th, the Western District of Wisconsin rejected Data Key Partners' lawsuit and allowed the vote for the acquisition of Renaissance to go forward. On October 17th, the shareholders of Renaissance voted for the acquisition by Permira.

Concluding Remarks

The 7 Rivers Equity Index consists of generally strong non-financial firms, weighed down by two weak financial firms, Citizens Community Bancorp and HMN Financial. The weakest non-financial firm, Great Wolf Resorts, Inc. is currently entertaining an offer to be acquired by Apollo Management Group, which is currently being challenged by shareholders and may result in a bidding war similar to what occurred for Renaissance Learning. The initial bid of \$5.00 per share by Apollo resulted in a one-day return on the stock of almost 20% on March 13th and subsequent increases since then.

³⁰ Information for this section was taken from Renaissance Learning's 8-k statements during the period.

APPENDIX

Non-Financial Firms

Company: **Fastenal Corporation**
Ticker: FAST
Exchange: NASDAQ
Market Cap: \$15.5 Billion
Description: Wholesaler and retailer of industrial and construction supplies. Product lines include fasteners, hydraulic and pneumatic tools, janitorial supplies, and welding equipment.
Institutional Ownership: 85%
Date started trading: March 26, 1990

Company: **Flexsteel Industries, Inc.**
Ticker: FLXS
Exchange: NASDAQ
Market Cap: \$116 Million
Description: Manufacturer, importer, and marketer of residential and commercial furniture. Product lines include upholstered and wood furniture, desks, dining tables and chairs, and bedroom furniture.
Institutional Ownership: 45%
Date started trading: February 25, 1992

Company: **Great Wolf Resorts, Inc.**
Ticker: WOLF
Exchange: NASDAQ
Market Cap: \$177 Million
Description: Developer, owner, licensor, and operator of family resorts that feature indoor water parks and other entertainment options. The company currently operates or has a licensing agreement with twelve resorts across the United States.
Institutional Ownership: 60%
Date started trading: December 15, 2004

Company: **Hormel Foods Corporation**
Ticker: HRL
Exchange: NYSE
Market Cap: \$7.5 Billion
Description: Producer and marketer of meat and food products worldwide. Business segments include: grocery products, refrigerated foods, Jennie-O Turkey Stores, and specialty foods.
Institutional Ownership: 32%
Date started trading: January 2, 1990



Economic Indicators
April 11, 2012

Company: **Marten Transport Ltd.**
Ticker: MRTN
Exchange: NASDAQ
Market Cap: \$495 Million
Description: Truckload carrier that specializes in transporting consumer goods that require a temperature-controlled or insulated environment across North America and Mexico. Business segments are trucking and logistics.
Institutional Ownership: 68%
Date started trading: February 27, 1992

Company: **National Presto Industries, Inc.**
Ticker: NPK
Exchange: NYSE
Market Cap: \$542 Million
Description: Manufacturer of housewares and electrical appliances; defense-related products, such as: training ammunition, fuzes, firing devices, and initiators; and diapers and adult incontinence products.
Institutional Ownership: 50%
Date started trading: December 30, 1987

Company: **Renaissance Learning, Inc.**
Ticker: N/A
Exchange: Acquired and taken private
Market Cap: N/A
Description: Provider of computer-based assessment technology for schools and school districts for grades pre-kindergarten through senior high school.
Institutional Ownership: N/A
Date started trading: June 3, 1998

Company: **Rochester Medical Corporation**
Ticker: ROCM
Exchange: NASDAQ
Market Cap: \$117 Million
Description: Manufacturer and marketer of PVC and latex-free urinary continence and urine drainage care products.
Institutional Ownership: 36%
Date started trading: August 18, 1995

Financial Services Firms

Company: **Citizens Community Bancorp Inc.**
Ticker: CZWI
Exchange: NASDAQ
Market Cap: \$30 Million
Description: Provider of consumer banking services through 18 in-store Wal-Mart Supercenter locations and eight branches in Wisconsin, Minnesota, and Michigan.
Institutional Ownership: 7%
Date started trading: March 30, 2004



Economic Indicators
April 11, 2012

Company: **Heartland Financial USA Inc.**
Ticker: HTLF
Exchange: NASDAQ
Market Cap: \$274 Million
Description: A multi-bank holding company that has subsidiaries in Iowa, Illinois, Wisconsin, New Mexico, Arizona, Montana, Colorado, and Minnesota.
Institutional Ownership: 34%
Date started trading: January 7, 2000

Company: **HMN Financial, Inc.**
Ticker: HMNF
Exchange: NASDAQ
Market Cap: \$9 Million
Description: Operator of retail banking and loan production facilities in Minnesota and Iowa.
Institutional Ownership: 26%
Date started trading: July 30, 1994