

Acquire or Be Acquired

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The Path to Recovery – Building Value in a Changing Environment

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A Broader PerspectiveSM

Welcome and Introduction

Concept of Value

- Current price v. future value
- Measurement Ratios: Result, not cause
- Acquirer or Investor: If I entrust you with my money, what will I get back?

Concept of Value (cont'd)

- Different metrics for publicly-traded banks; quasi-public banks; community-owned banks; and private banks
- Roles of “Sector Funds” and of mega bank prices

Concept of Strategy

- Assumes a defined objective
 - Opening doors at 9 and hoping something happens is not enough
- What are you trying to achieve?

Concept of Strategy (cont'd)

- Any strategy is subject to forces outside bank: Hard to beat local economy.
- Setting a realistic strategy requires a clear vision of the environment in which strategy will be implemented.

The Current Environment

- “Publicly vilified, rigorously regulated and modestly profitable [small- to mid-cap] banks enter 2012 in better stead versus 2011.”*
- 6,800 banks (91% of all U.S. banks) have assets of less than \$1 billion, 560 banks have assets between \$1 billion and \$10 billion, and only 106 institutions have assets greater than \$10 billion.
- 2,500 banks (33% of all U.S. banks) have assets less than \$100 million.

**KBW Regional Bank Sector Outlook, December 15, 2011*

The Current Environment (cont'd)

At the end of third quarter 2011*:

- The number of banks on FDIC's "problem list" declined from 865 to 844. These banks held \$340 billion of assets.
- For only the second time in 39 years, no new charters were added during the quarter.
- 2,109,911 people were employed full time at FDIC-insured institutions.

*FDIC – Industry Analysis

The Current Environment (cont'd)

- Both ROE and ROA for banks with less than \$10 billion in assets improved in 2011, but still were about 65%-70% of historical averages.
- Economists surveyed by *The Wall Street Journal* expect U.S. GDP growth of just 2.3% for 2012.*
- 380 small- and mid-size institutions still hold \$17 billion in TARP capital, with dividends set to increase from 5% to 9% by early 2014. Treasury has recently indicated strong interest in winding down TARP.

**The Wall Street Journal*, December 22, 2011

The Current Environment (cont'd)

- Economic uncertainty, the effect of purchase accounting, and concern over imbedded credit risk in loan portfolios, continue to overhang the open bank M&A market.
- Strategic planning has become a challenging exercise for boards of community and regional banks.
- Most of these banks and their investors need to accept lower returns, but for how long?

2012 Bryan Cave Survey

Annual Bryan Cave exercise to prepare for strategic advice to clients.

2012 Bryan Cave Survey Results

What level or pace of growth do you anticipate in the U.S. economy and in bank assets over the next 3 years?

- Survey respondents consistently predicted the pace of growth in the U.S. economy over the next 3 years to be between 2% and 3%.
- Estimates for growth in bank assets ranged from 2% to 5% in 2012, and from 3% to 5% in years 2013 and 2014.

2012 Bryan Cave Survey Results

“Almost all community bank budgets for 2012 have shown zero loan growth, but improved earnings through cost control and normalized provisioning. Margins may improve slightly as NPAs resolve.”

Jim Stokes, SunTrust Robinson Humphrey

2012 Bryan Cave Survey Results

What changes should be expected in profitability for top quartile performance banks by year end 2014?

- For banks under \$500 million in assets, survey respondents predicted 2014 ROA in a range of 60 bps to 90 bps. ROE was predicted to be between 8% and 10%.
- For banks between \$500 million and \$1 billion in assets, survey respondents predicted 2014 ROA in a range of 70 bps to 100 bps. ROE was predicted to be between 9% and 11%.

2012 Bryan Cave Survey Results

- For banks between \$1 billion and \$10 billion in assets, expectations for ROA in 2014 were in a range of 100 bps to 125 bps, with ROE between 12% and 15%.
- For banks with assets over \$10 billion, 2014 predictions for ROA ranged between 115 bps to 130 bps, with ROE between 12% and 15%.



"Don't anybody move: this is a merger."

2012 Bryan Cave Survey Results

What acquisition multiples do you foresee by year-end 2014 for solid banks in these categories?

- For well performing banks with under \$1 billion in assets, survey respondents predicted a range of 1.25 x – 1.50 x book and 12 x – 14 x earnings by 2014.

2012 Bryan Cave Survey Results

- Again this year, a number of our survey respondents shared the view that the greatest likelihood for “premium” pricing will be with banks between \$1 billion and \$10 billion in assets. A range of 1.50 x to 1.75 x book was predicted for banks in this size range, with the possibility of 1.75 x to 2.00 x book for the very strongest. Price to earnings predictions ranged from 13.5 x to 18 x.

2012 Bryan Cave Survey Results

What trading multiples do you foresee by year-end 2014 for solid banks in these size categories?

- As in 2011, 1.5 x book is the new 2.5 x book.
- Wide disparity of projections based on bank size (\$1-10B sweet spot), market condition, capital strength, core business and earnings.

2012 Bryan Cave Survey Results

What conditions will need to exist before the open bank M&A market becomes vibrant again, and when do you think that may happen?

2012 Bryan Cave Survey Results

“In my opinion, the calendar just needs to turn another 3 to 6 more months and more signs of credit stabilization just need to naturally occur. We think folks will be pleasantly surprised to see the natural “mating process” happen on its own in 2012. [This will] start really slow but moderately gain momentum as 2013 unfolds, and by 2014 it will be a great deal different.”

Chris Marinac, FIG Partners

2012 Bryan Cave Survey Results

“Rising collateral values (real estate) are the key. ALL of the buyers we speak to are at best suspicious of the marks that targets have taken. Sellers need to become realistic about the pricing conditions. Fair value accounting and weak real estate conditions remain the biggest hurdles to clear.”

Peyton Green, Sterne Agee

2012 Bryan Cave Survey Results

“Failed bank opportunities need to disappear (still two more years of this in the Southeast); more healthy buyers need to appear; private equity will become much more involved; buyers prices need to improve; Banks with TARP will likely have to sell as capital markets will not open up in time.”

Bill Wagner, Raymond James

2012 Bryan Cave Survey Results

Assuming adequate capital and the absence of any special regulatory restrictions, what are the most important steps that a bank with \$250 million in assets could take over the next few years to build greater market value in its franchise?

2012 Bryan Cave Survey Results

“Dominate its ‘micro’ market as it relates to deposits and their lending competency and try to achieve critical mass (~\$750m).”

Jeff Brand, KBW

“. . . Clean house on the credit side until you have a pristine portfolio. Take the pain as soon as possible. [If you] have ability to expand the franchise . . . be in the most desirable locations (although that is a moving target).”

Mark Ross, Stifel Nicolaus

2012 Bryan Cave Survey Results

“For a bank <\$250MM in assets, preserve capital by managing NPAs and expenses closely while building local deposit market share. Growth will continue to be constrained by increased demands for higher capital ratios and lack of access to outside capital. By building a local deposit base, there is a higher likelihood you become a favored target in your market. You can then take the capital you have preserved and “invest it” in the larger buyer’s liquid currency.”

Bill Herrell, Morgan Keegan

2012 Bryan Cave Survey Results

“Organic loan growth is quickly becoming the key to community bank profitability. If the current low-interest rate environment persists, the ability to generate loans will become the distinguishing characteristic of profitable banks. Consequently, those banks with proven loan generation capability will fetch the highest prices in mergers.”

Curtis Carpenter, Sheshunoff

2012 Bryan Cave Survey Results

How would your answer change for a bank with \$1 billion in assets?

“The same [as for smaller banks], except with a greater ability to expand de novo locations to optimize desirability to an acquirer or make small acquisitions of branches. . .”

Mark Ross, Stifel Nicolaus

2012 Bryan Cave Survey Results

“Need to hire a very good treasurer who sees an investment portfolio as a viable alternative for long term objectives so we don’t chase every new fad. Need to revisit investing capital in brick and mortar. No more columns and elevators. Need to be leaner and more techno savvy. . . . Technology will be the key to growth. Need to also identify your profitable [customers]. Since banks this size are typically inefficient, there are a number of smaller [customers] that are a net cost to the bank they cannot afford.”

Sal Inserra, Crowe Horwath



*"I'll have someone from my generation get in touch
with someone from your generation."*

2012 Bryan Cave Survey Results

“Banks with healthy capital should be buying back stock more aggressively when trading at discounts to TBV. Need to have faith that terminal values for healthy banks (1.6x TBV in Northeast) will at least hold steady over the next several years. Buying back shares below TBV is a safe and well received use of capital. Also shows the investment community your own positive view on valuation and future value.”

Matt Kelley, Sterne Agee



“New from accounting, sir. Two and two is four again.”

2012 Bryan Cave Survey Results

What are the most significant factors in achieving enhanced profitability for a typical bank with \$250 million in assets?

- Focus on efficiency: “For every dollar of expense we are going to get \$2.00 to \$2.50 of revenue.”
- Don’t be afraid to consolidate jobs.
- Focus on non-interest income.
- Exercise tight control on cost of funds (deposit pricing)
- Most important factor is credit quality, since the profit equation is so fragile.

2012 Bryan Cave Survey Results

Are there different factors for a bank with \$1 billion in assets?

- Greater emphasis on inexpensive core funding.
- Develop a robust wealth management practice. This service can deepen the client relationship and provide consistent fees.
- Don't be afraid to try new initiatives.
- Efficiency is key at this level, given lower yields on larger credits.

2012 Bryan Cave Survey Results

Any other advice for bank management?

“Let’s get the boards and management to think about strategy as a series of options versus sequential decisions. If the chosen strategic path doesn’t work then the other options may have expired by the time you decide to pursue them. Making either/or decisions on strategy assumes options are mutually exclusive. In volatile times like these, execution on any option is difficult so we need to pursue various options simultaneously. The capital markets, regulators and competition are too dynamic to pursue options sequentially.”

Bill Herrell, Morgan Keegan

2012 Bryan Cave Survey Results

“Sometimes the blocking and tackling basics are a competitive advantage – provide the services desired on par with the big banks with care and concern.”

Phil Moore, Porter Keadle Moore

“I don’t know what the PV of owning 100% of the risk and waiting for better market multiples is, but I think that it’s not as much as perceived. Therefore, we would advise most of our clients to consider seeking partnerships now – it’s likely to remain a buyer’s market for the foreseeable future.”

Paula Johannsen, Carson Medlin

2012 Bryan Cave Survey Results

“Determine if your bank intends to remain independent. If so, the best way to control your own destiny is to achieve high performance. Define your metrics for high performance.”

Gerri Forehand, Sheshunoff

“Rule of 12s – 12% capital ratio; 12% ROE; 12 x earnings; 12% of deposits in securities (i.e. 88% ln/dp ratio).”

Jeff Brand, KBW

Debunking “Conventional Wisdom” About Community Banks

- Community banks will not be able to compete for capital.
- Community banks will not be able to compete for qualified employees.
- Community banks will not be able to compete for borrowers and depositors.

Debunking “Conventional Wisdom” About Community Banks (cont’d)

- Community banks will not be able to compete for fee income opportunities.
- Community banks cannot adequately control their expenses, especially compliance expenses, to earn a profit.

Debunking “Conventional Wisdom” About Community Banks (cont’d)

- The regulators want to shut down all banks under \$1 billion.
- Compare 1990.

Critical Factors for Determining Your Strategy (in addition to typical SWOT Factors)

- What are the liquidity demands of your shareholder base?
- What is the ability of your management team to aggressively implement 3-5 year plan?

Critical Factors for Determining Your Strategy (in addition to typical SWOT Factors) (cont'd)

- How realistic is your Board's understanding of the market data reflected in the Bryan Cave Survey?
- Does your bank have the internal financial strength to implement necessary changes?



Creating an Effective Process for Your Bank and Board

CONCLUSIONS

Our Financial Institutions Practice—Community Based, Nationally Recognized

Over the past decade, our financial institutions practice has become recognized as the top community banking practice in the Southeast and one of the top deal-making banking practices in the nation. Our 24 core banking attorneys focus on regulatory, corporate, operational and securities matters for more than 400 financial institution clients.

Approximately 50 other Bryan Cave attorneys regularly provide significant litigation, lending, work-out, bankruptcy, employment law, employee benefit, intellectual property, tax, fiduciary law (including personal estate planning for bankers), real estate and similar legal specialty work for our financial institution clients.

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Our Financial Institutions Practice

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We enjoy being able to say that whatever problem a banker may have, we have a lawyer who has worked on a similar problem for a banker!

The members of our financial institutions group offer clients across the United States a broad spectrum of practical experience and legal knowledge of the governance, structure and regulation of financial institutions. We emphasize hands-on experience. Our team includes numerous 25-year+ veterans of banking law, many of whom have prior real world experience as investment bankers, regulators, bank officers and CPA's who formerly audited banks.

Our broad experience, coupled with our innovative solutions and our long standing ties to regulators, trade associations and service providers, make us an invaluable asset to our clients



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Money Transmitter Licensing | Privacy and Data Security | Patents and Intellectual Property | Litigation Strategy and Defense



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A Broader Perspective™

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