



Merger & Acquisition, Bank Valuation and Capital Markets Update

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Current Community Bank Environment

- The value of community banks continues to be very attractive since the election and now with the new tax law
- Diminishing number of banks means fewer opportunities for buyers and sellers – scarcity value?
- Building scale is driving most of the smaller M&A transactions
- If you are a seller, the best time to sell is often dictated by an approach by a motivated buyer
- Publicly traded banks with strong currencies are a market unto themselves in the world of M&A
- Negotiated deals are more common than auctions
- Additional capital is available; sub debt and in some cases equity (although you may not like the pricing)

Industry Performance – 2017

| | Under\$1 Billion | Over \$1 Billion |
|--------------------------------------------|------------------|------------------|
| ROAA (1) | 0.81% | 0.92% |
| ROAE (1) | 7.29% | 8.47% |
| Net Interest Margin | 3.70% | 3.49% |
| Efficiency Ratio | 67.35% | 60.65% |
| Net Charge-Offs/Average Loans | 0.05% | 0.08% |
| Nonperforming Assets/Total Assets | 0.67% | 0.62% |
| Loan Loss Provision Expense/Average Assets | 0.07% | 0.10% |
| Tier 1 Leverage Ratio | 10.58% | 9.96% |
| Loan Growth Rate | 5.52% | 8.78% |
| Deposit Growth Rate | 3.41% | 6.56% |

Median for all commercial & savings banks

(1) S-Corporation companies adjusted to C-Corporation status

Source: SNL Financial

What Drives Bank Valuation

What Drives Value

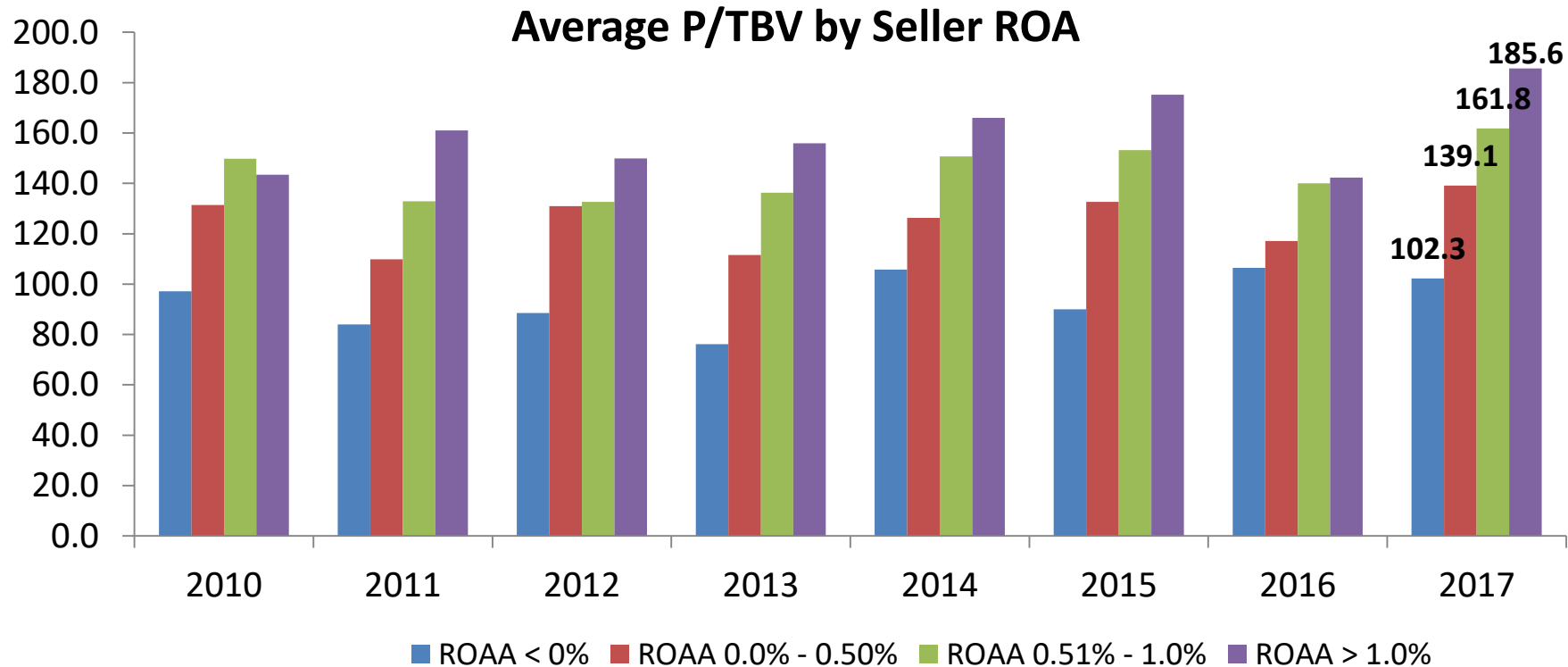
- Core Earnings
- Earnings potential
- Core deposits & customers
- Good markets/locations
- Experienced and motivated staff
- Excellent asset quality

What Doesn't

- Excess capital
- Inadequate loan loss reserves
- Hot money
- Significant investment in fixed assets
- Lack of flexibility to restructure balance sheet
- Unusually high level of potential transaction costs

Earnings are Driver for Bank Valuations

- Earnings have re-emerged as the primary driver of bank valuations
- In 2017, banks with LTM ROAA above 1.00% sold at an median P/TBV of 186%
- Comparatively, the median P/TBV for banks with LTM ROAAs between 0% to 0.50% was only 139%



Source: SNL Financial

Larger, More Efficient Banks Tend to Perform Better

Median ROAA of All Banks and Thrifts

| Assets | 1990 | 2000 | 2010 | 2015 | 2017 |
|-----------------|------|------|------|------|------|
| > \$20B | 0.42 | 0.83 | 0.35 | 0.94 | 0.96 |
| \$5-\$20B | 1.00 | 1.31 | 0.62 | 1.00 | 1.03 |
| \$2-\$5 B | 0.94 | 1.11 | 0.56 | 0.92 | 0.93 |
| \$1-\$2 B | 0.91 | 1.15 | 0.43 | 0.88 | 0.90 |
| \$500M - \$1B | 1.01 | 1.07 | 0.41 | 0.81 | 0.91 |
| \$250M - \$500M | 0.99 | 1.07 | 0.50 | 0.74 | 0.95 |
| < \$250M | 0.78 | 0.97 | 0.23 | 0.62 | 0.85 |

Source: SNL Financial

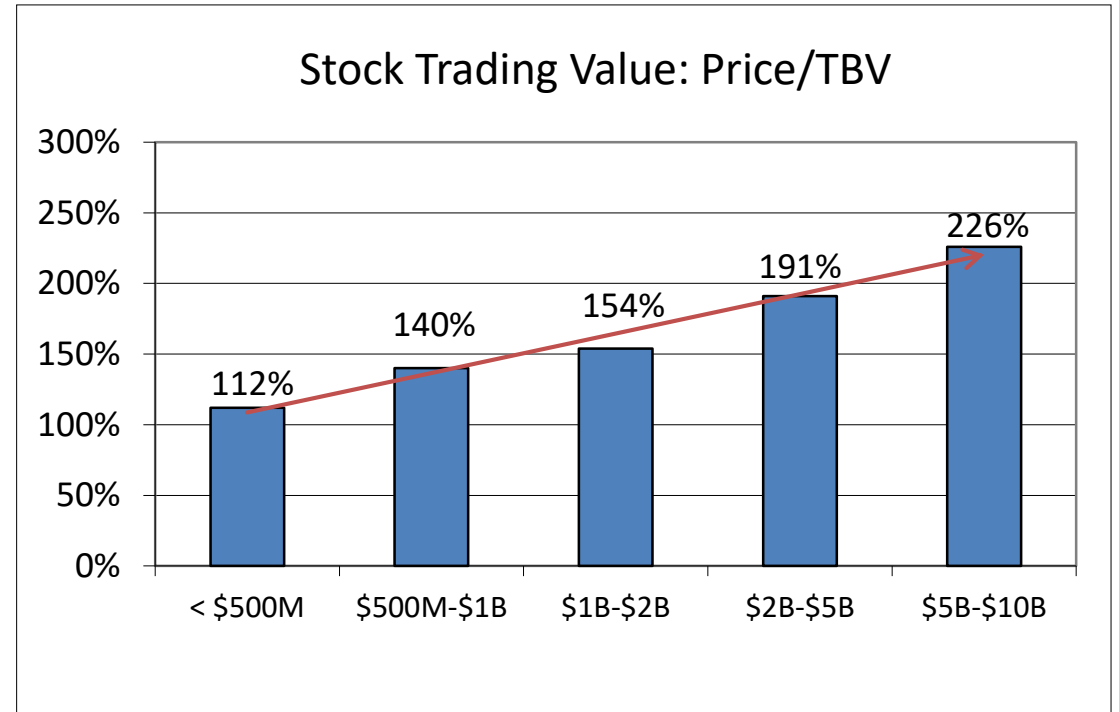
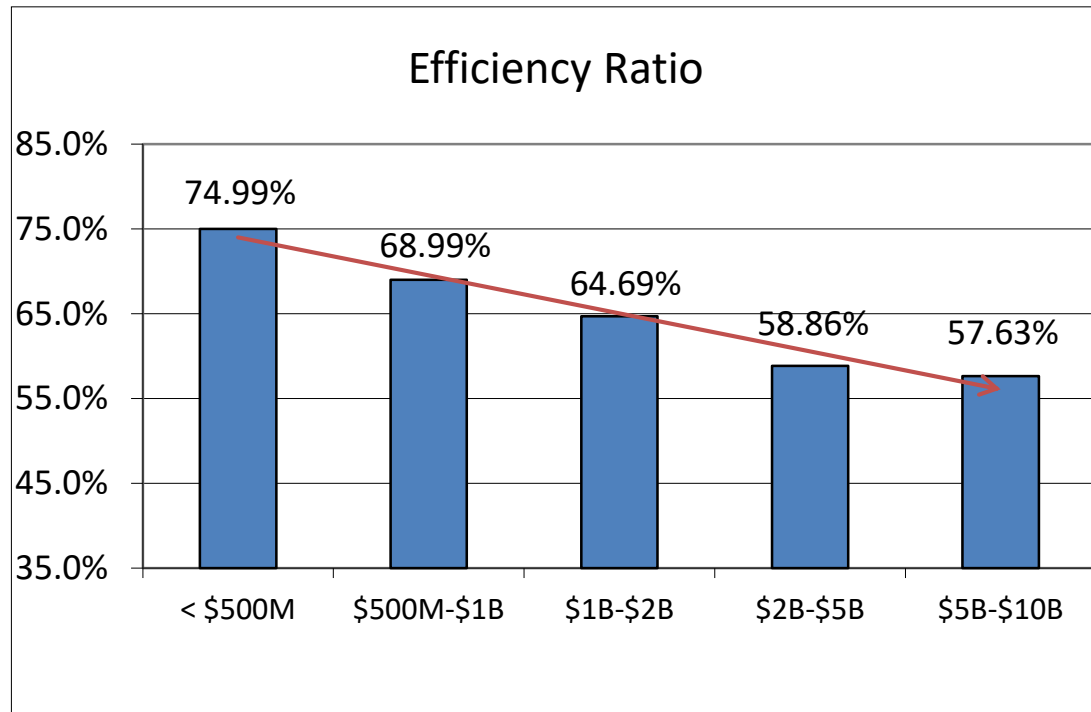
Larger, More Efficient Banks Tend to Perform Better

Median ROAE of All Banks and Thrifts

| Assets | 1990 | 2000 | 2010 | 2015 | 2017 |
|-----------------|-------|-------|------|------|------|
| > \$20B | 5.94 | 7.84 | 3.07 | 8.65 | 9.08 |
| \$5-\$20B | 13.46 | 17.18 | 5.26 | 8.81 | 8.29 |
| \$2-\$5 B | 11.81 | 13.32 | 5.24 | 8.65 | 8.91 |
| \$1-\$2 B | 12.03 | 14.42 | 4.77 | 8.52 | 8.56 |
| \$500M - \$1B | 11.33 | 11.91 | 4.54 | 8.06 | 8.50 |
| \$250M - \$500M | 11.70 | 12.05 | 5.11 | 7.46 | 8.73 |
| < \$250M | 8.63 | 9.64 | 2.09 | 5.51 | 7.27 |

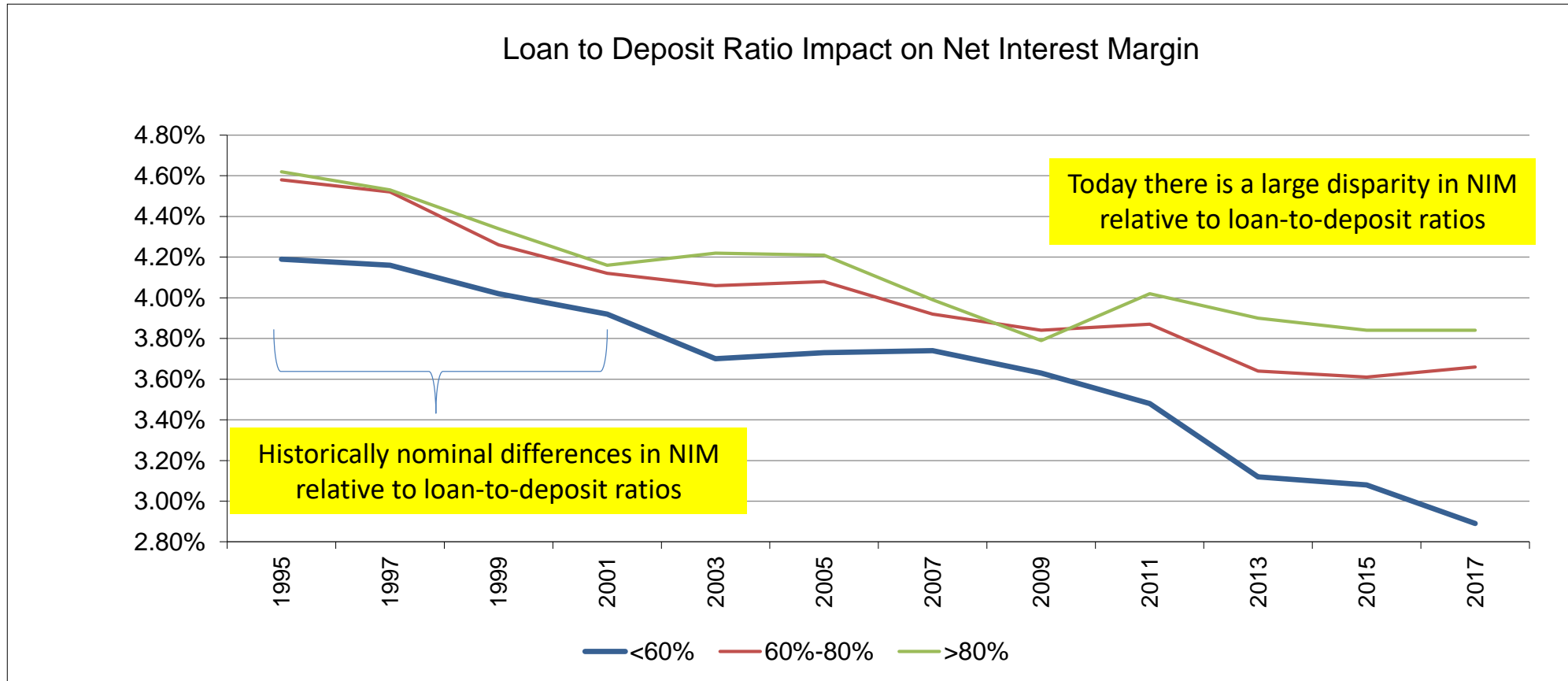
Source: SNL Financial

Importance of Scale



Higher Loan to Deposit Ratios Have Become Critical to NIM

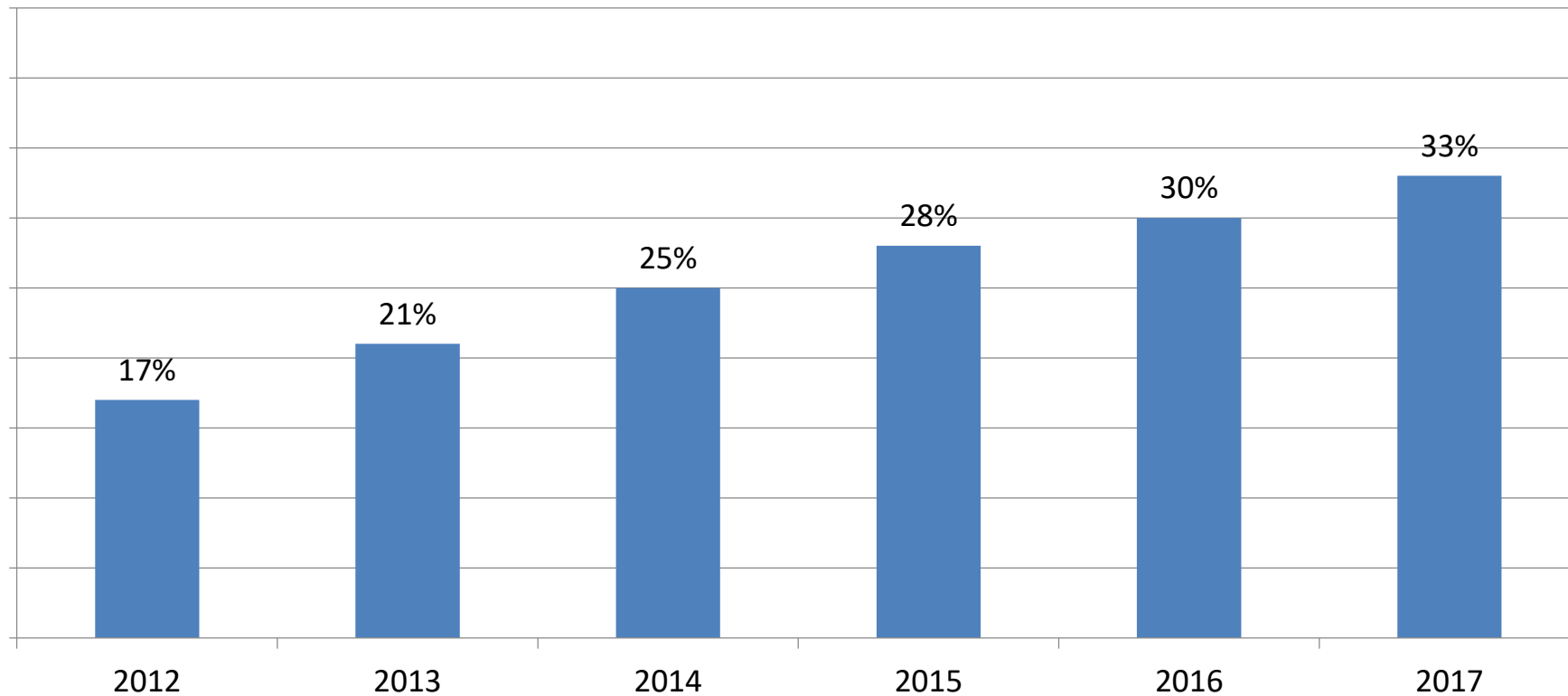
The low interest rate environment has challenged the operating philosophy of many banks and it has become more difficult to maintain net interest margins without growing loan balances



Source: SNL Financial

Percentage of Banks with Loans/Deposits > 90%

The declining number of banks and improving economy are increasing the demand for deposits



Source: SNL Financial

Levels of Fair Market Value

- 1. Change of control transactions.
- 2. Marketable minority interest plus control premium.

**Control Value
(Acquisition Value)**

Value of the enterprise as a whole.

- 1. Control value less minority interest discount.
- 2. Comparison of pricing parameters of publicly traded securities.

**Marketable
Minority
Interest**

Value of a non-control interest with a liquid market.

- 1. Marketable minority interest less marketability discount.
- 2. Control value less minority discount less marketability discount.

**Non-marketable
Minority
Interest**

Value of a non-control interest without a liquid market.

Minority Interest Discount

Control
Premium

Fair Value.

Marketability Discount

Parameters in Bank M&A Today

Earnings Accretion

- Year one or year two earnings accretion needs to be meaningful and continues to be important
- EPS accretion must justify or counteract any TBV dilution
- Market wants to see a strong IRR of 15%+

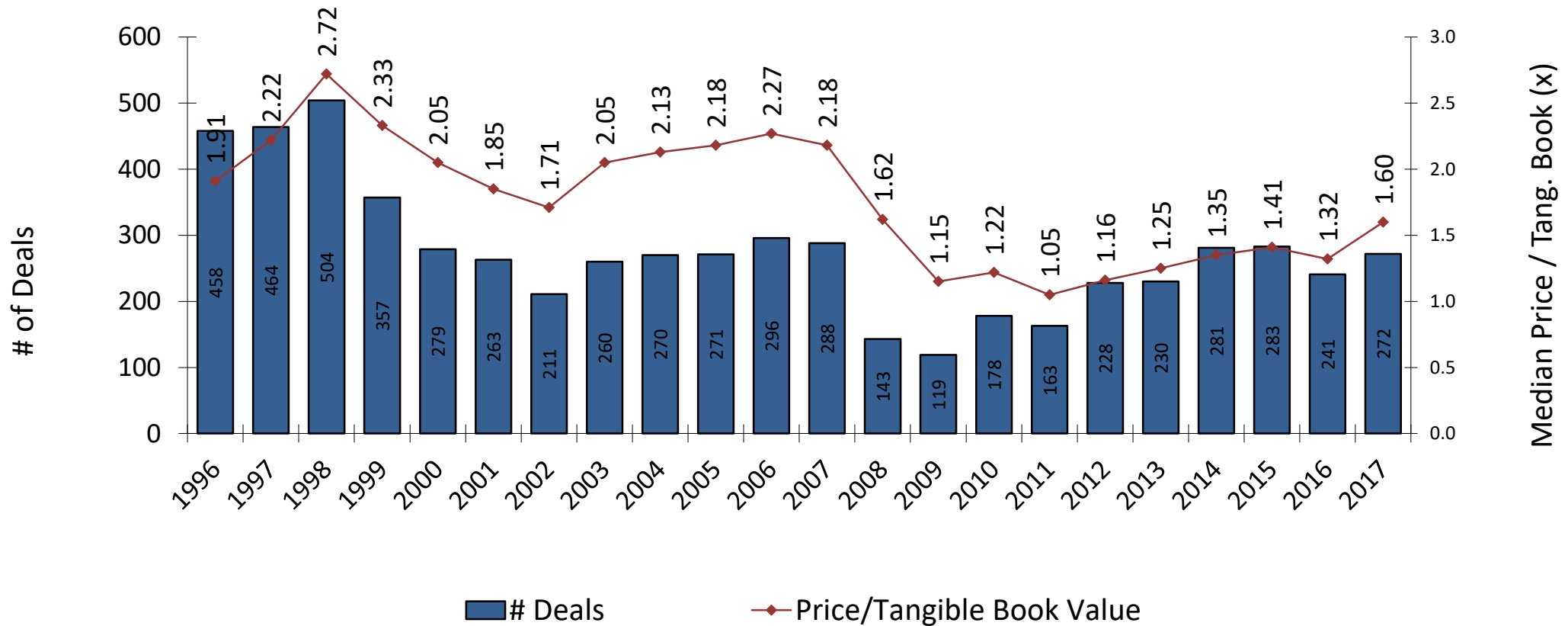
TBV Dilution

- Analysts and sophisticated investors generally want to see a sub-5 year earnback period

Efficiency & Cost Savings

- Buyers want to see sufficient cost savings and revenue enhancements to justify premium paid
- Average expected cost savings/revenue enhancements in last three years were over 30%, the highest in recent years

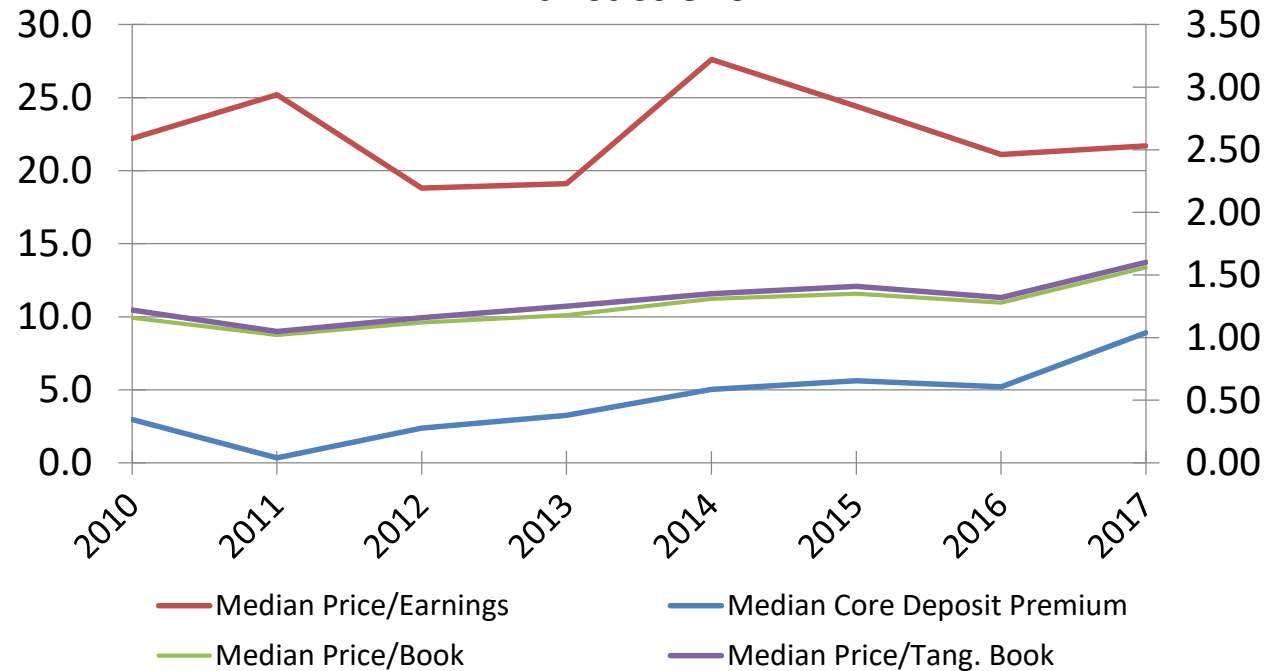
Mergers & Acquisitions- U.S. Banks & Thrifts



Source: SNL Financial

Merger & Acquisition Pricing Trends- U.S. Banks & Thrifts

Acquisition Multiples for Bank & Thrift Transactions

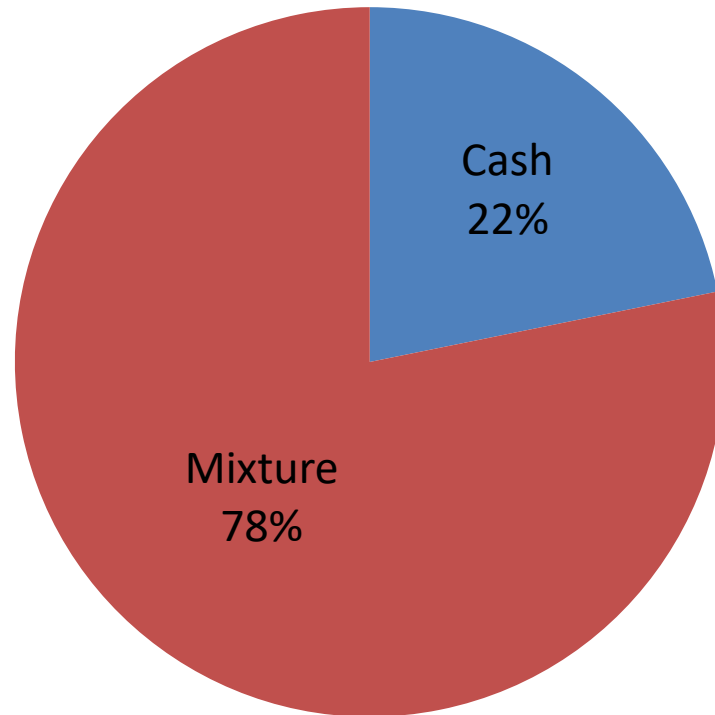


| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---------------------------------|------|------|------|------|------|------|------|------|
| Median Price/Book (x) | 1.16 | 1.02 | 1.12 | 1.18 | 1.27 | 1.35 | 1.26 | 1.56 |
| Median Price/Tang. Book (x) | 1.22 | 1.05 | 1.16 | 1.25 | 1.34 | 1.41 | 1.30 | 1.60 |
| Median Price/Earnings (x) | 22.2 | 25.2 | 18.8 | 19.1 | 21.4 | 24.4 | 20.0 | 21.7 |
| Median Core Deposit Premium (%) | 3.0 | 0.3 | 2.4 | 3.3 | 4.8 | 5.7 | 4.9 | 8.9 |

Source: SNL Financial

Consideration Type Impacts Pricing

Consideration Type-2017



| | Cash | Mixture |
|-------------------------|-------------|-------------|
| Median Buyer Assets | \$1,164,023 | \$2,794,456 |
| Median Seller Assets | \$162,916 | \$373,458 |
| Median Price/Book | 1.40x | 1.62x |
| Median Price/Tang. Book | 1.60x | 1.67x |
| Median Price/Earnings | 17.5x | 22.5 |

Cash versus Stock Transactions

Cash Buyer

- Buyer must be substantially larger than target
- Buyer will experience immediate tangible book value dilution based on current premiums being paid
- Buyer needs immediate EPS accretion

Stock Buyer

- Buyer should have a high trading value and can be closer in size to target
- Intangibles from the purchase are offset by the value of the Buyer's stock
- EPS accretion is impacted by new shares issued

Bank & Thrift Deal Count by Pricing

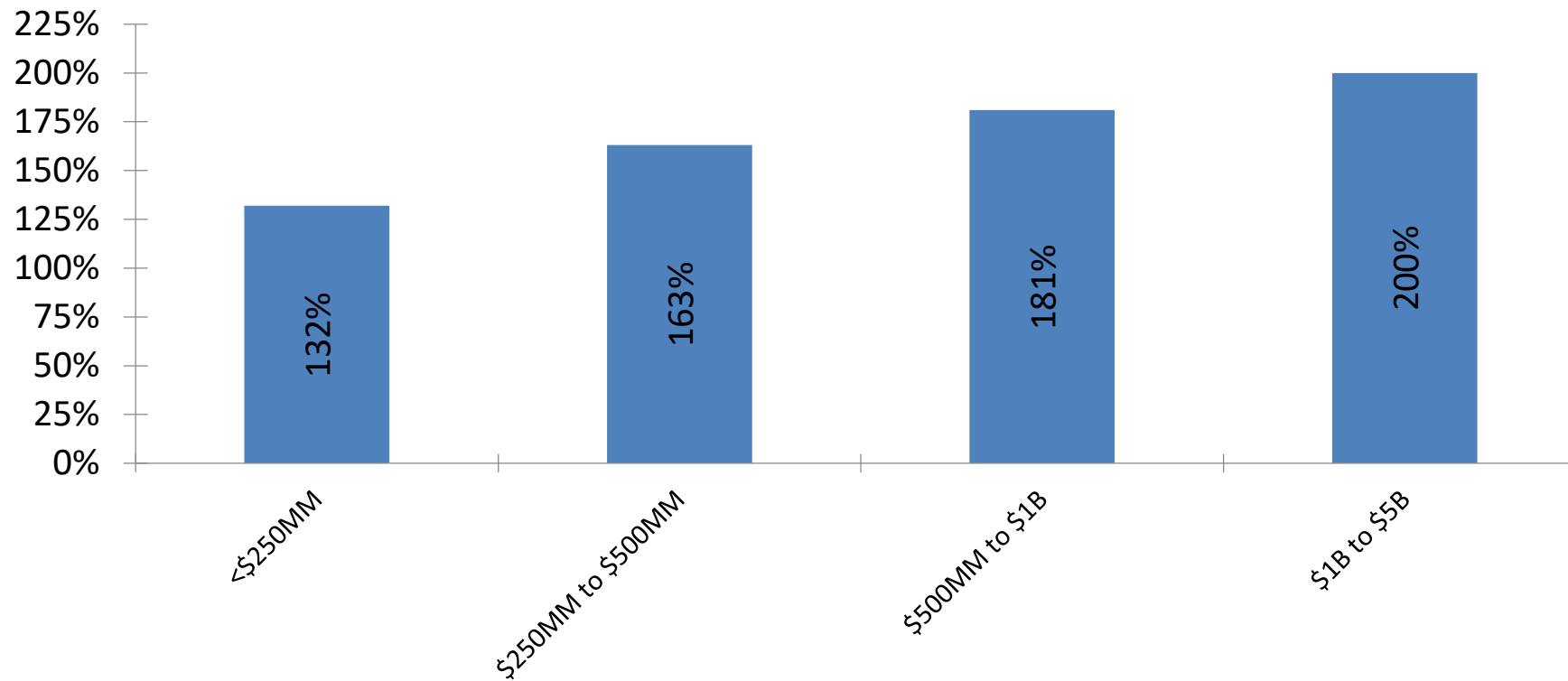
Transactions Announced in 2017



Source: SNL Financial

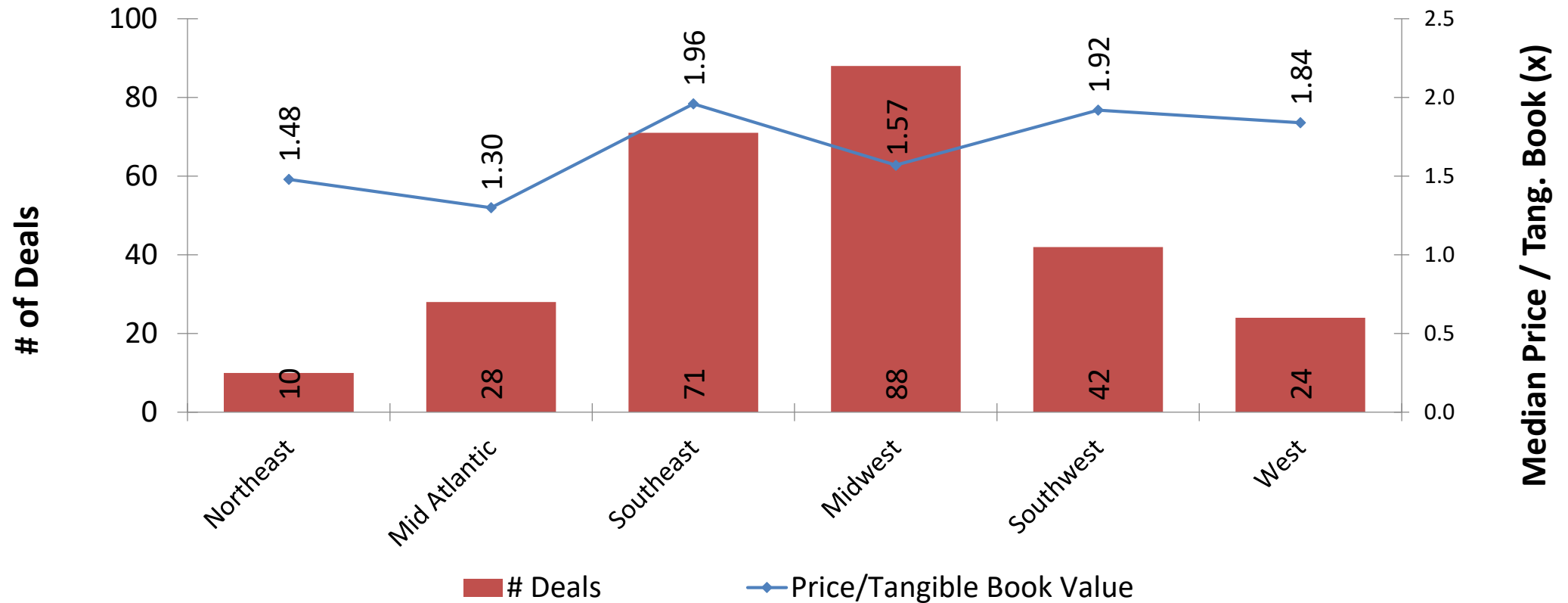
Size of Seller Impacts Pricing

Median Price/Tangible Book Value by Asset Size



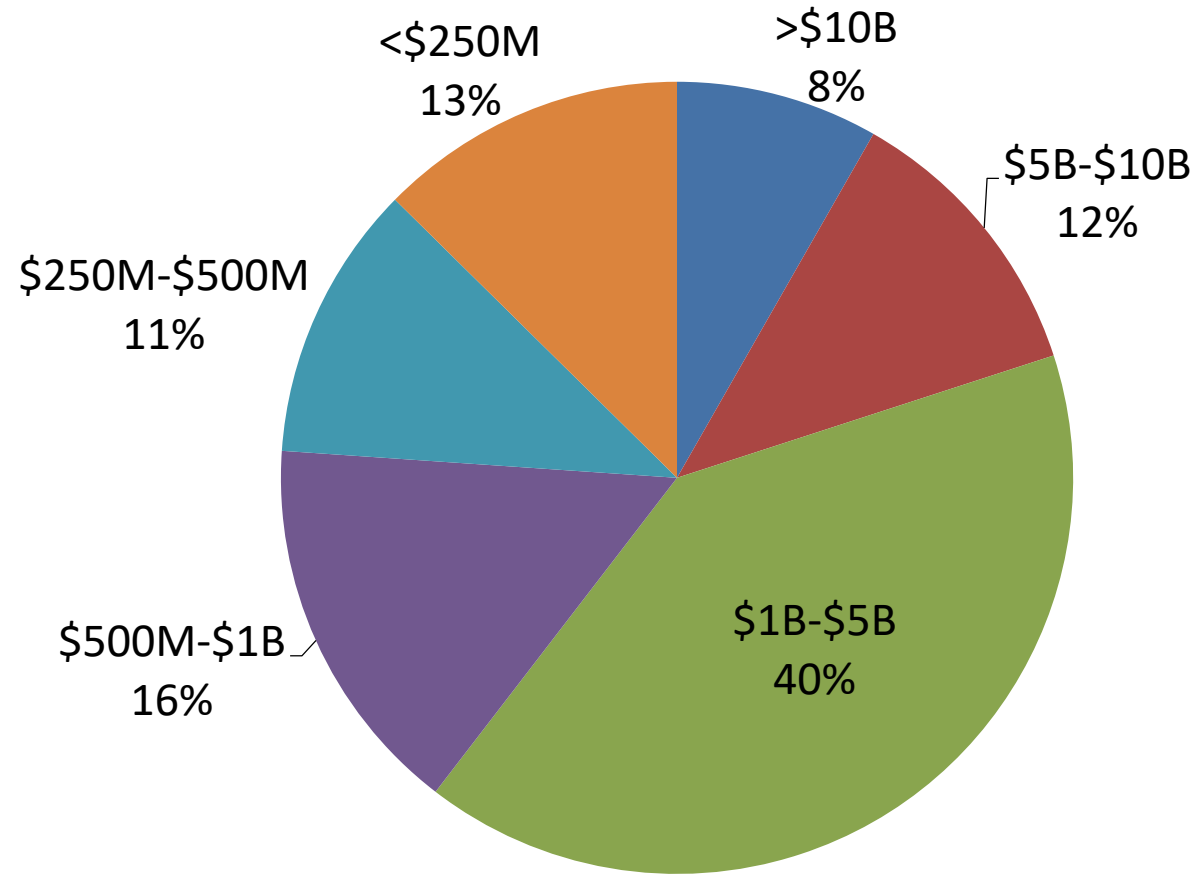
Source: SNL Financial

Geography Impacts Pricing



Source: SNL Financial

Stratification of Buyer's Asset Size



Source: SNL Financial

Typical Pricing Terms

Cash and Cash/Stock Mixture Transaction Example

Fixed Price plus Interim Earnings:

- Interim earnings are typically from the date (quarter end) of agreement through closing
- Interim earnings excludes (or prohibits) nonrecurring gains
- Carve-out for transaction related costs (professional fees, contract termination fees, change in control/severance payments, etc.)

Fixed Price with Minimum Equity Provision:

- Minimum equity typically established as of the most recent quarter or month end prior to agreement
- Minimum equity can be a price adjustment or a closing condition
- Carve-out for transaction related costs (professional fees, contract termination fees, change in control/severance payments, etc.)

Remember-Every Deal is Unique

- M&A multiples (especially book value multiples) can be deceiving
- Geography matters- sellers located in a metropolitan statistical area reported a median price to tangible book of 164% versus non-MSA sellers that reported a median price to tangible book of 126%
- Size matters- a \$50 million community bank should not expect the same valuation as a \$500 million bank; banks with assets less than \$250 million sold for a median of 132% tangible book and banks with assets greater than \$1 billion sold for a median of 200% of tangible book
- Small banks may have higher market values as platforms in lieu of de novos; seeing more migration deals

Buyer Considerations

Reasons to Buy

- Not getting growth, particularly loan growth
- Access to core deposits
- Size and scale; improved earnings over larger platform (efficiency ratio)
- New/better geographic markets
- Consolidation in an existing market
- New product lines/cross sell existing product lines

Reasons Not to Buy

- Economic uncertainty in existing and target markets
- Difference in pricing expectations
- Buyer “currency” valuation impact on deal metrics (EPS accretion/TBV dilution/earnback)
- Regulatory road blocks to timely completion
- Need for additional capital
- Management team doesn’t have the necessary experience and drive

Hidden Costs of M&A

- Employment contracts
- Stock options
- Executive salary continuation agreements (SERP)
- BOLI
- Director retirement agreements (DRP)
- Key employees (pay to stay, severance pay, change-of-control payments)
- 280G tax issues
- Data processing break-up fees
- Problem loan sales
- Professional fees
- Merger run-off / employee pirating
- Mark to market issues (FAS 141R)

Acquisition Mistakes

- Sellers have been “dressed up” for sale; core earnings and estimated future earnings are overstated
- Overestimate synergies
- Overlook cultural differences
- Neglect loan officers and middle managers
- Cut costs so deeply that growth is stunted
- Dismiss soft issues
- Acquirer arrogance or “ego”
- Lack of flexibility in price adjustments; both buyer and seller

Additional Buyer Considerations

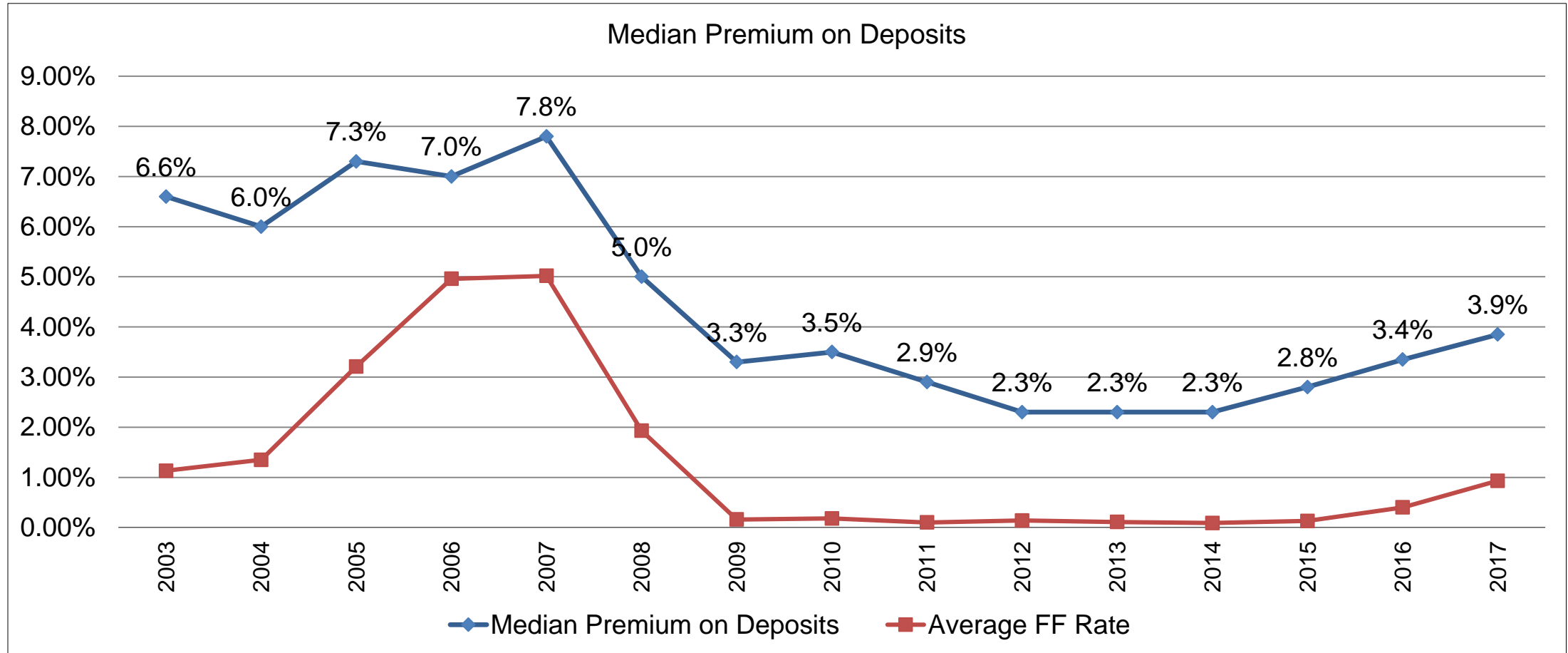
- People matter; biggest risk is not retaining key employees, particularly good lenders
- Involve regulators early and often
- Understand compensation issues; change-of-control contracts, SERPS, potential severance, stay bonuses, new employee agreements, 280G issues
- Systems can make or break strategy
 - Unsung heroes are the systems conversion team
 - Can your system handle the level of account growth/loan types/compatibility analysis
- Implementing your culture is critical; 1/3 seller employees will embrace change/new culture, 1/3 “on the fence” and 1/3 may resist changes
- Be sure to consider “mark-to-market” adjustments
- No deal is better than a bad deal

Branch Acquisitions

Bidding Considerations:

- Premium for deposits
- Premium/discount for loans, along with any put-back provisions
- Amount to be paid for fixed assets
- Plans for keeping employees, severance policies
- Need for “staying bonuses”
- Employee benefits plans, crediting for years of prior service, etc.
- CRA ratings, assessment of regulatory relationships
- Antitrust issues (HHI)
- Ability to finance the deal and attain prompt regulatory approvals

Branch Sales: Premium on Deposits



Source: SNL Financial

Capital Alternatives

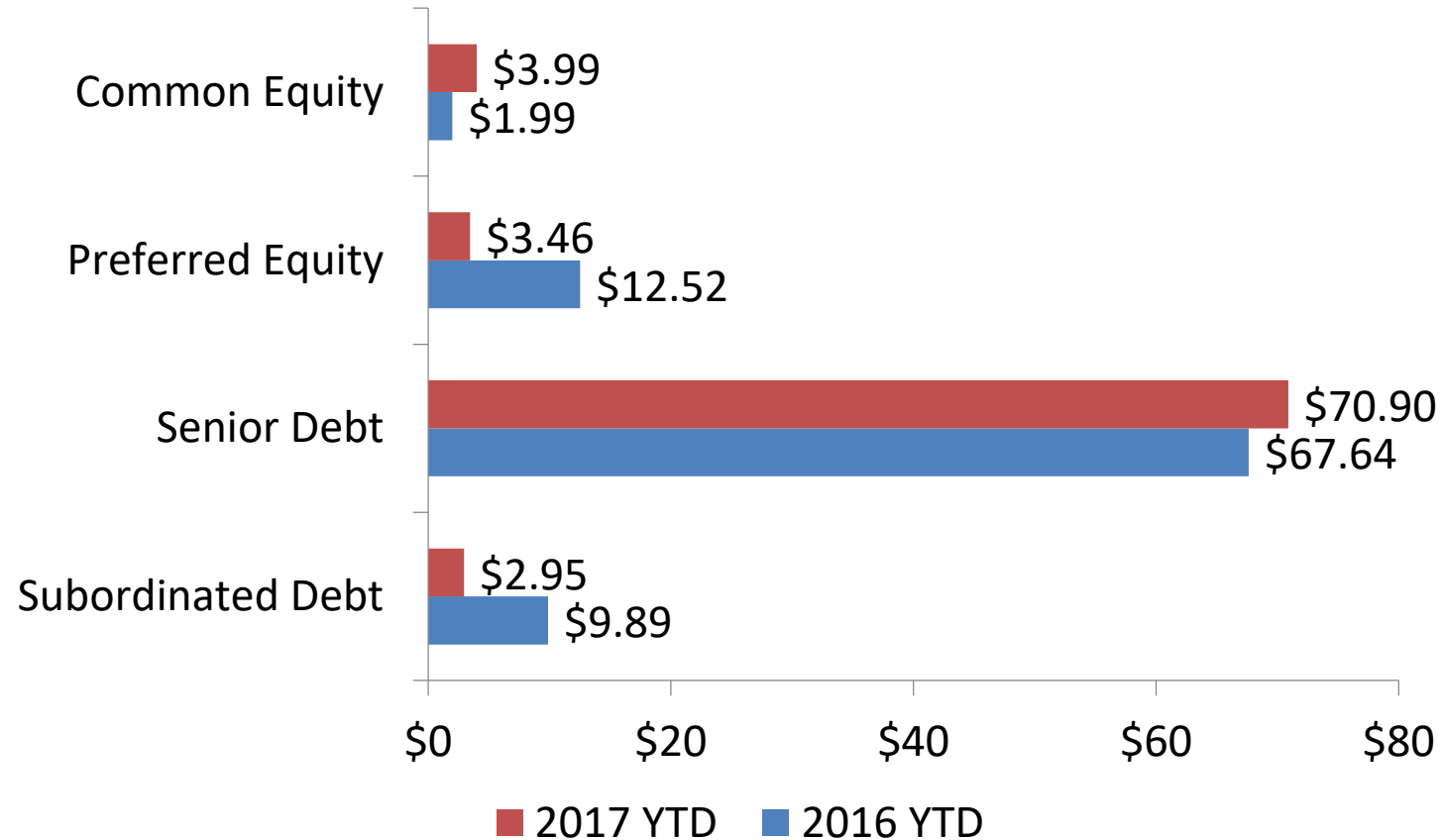
- The equity capital and debt markets are available for banks looking to raise capital for organic growth, acquisition financing and for liquidity
- IPO activity remains strong as evidenced by favorable pricing and aftermarket performance relative to the bank indices; but primarily for larger, regional institutions that plan to use common stock for future mergers & acquisitions
- The market currently appears to be priced for tax reform and potential regulatory relief
- As industry consolidation persists, acquisitive institutions may continue to access the capital markets for growth and M&A

Private Equity/Institutional Investors Focus on Strategic Relevance

Market Valuation:

- Returns are a function of five factors: entry point, growth, dividends, exit point and time horizon
- With industry growth and exit multiples uncertain, investors are more focused on entry points
- Focus on lack of liquidity may cause asset size to increase

Bank Capital Offerings YTD (\$B)

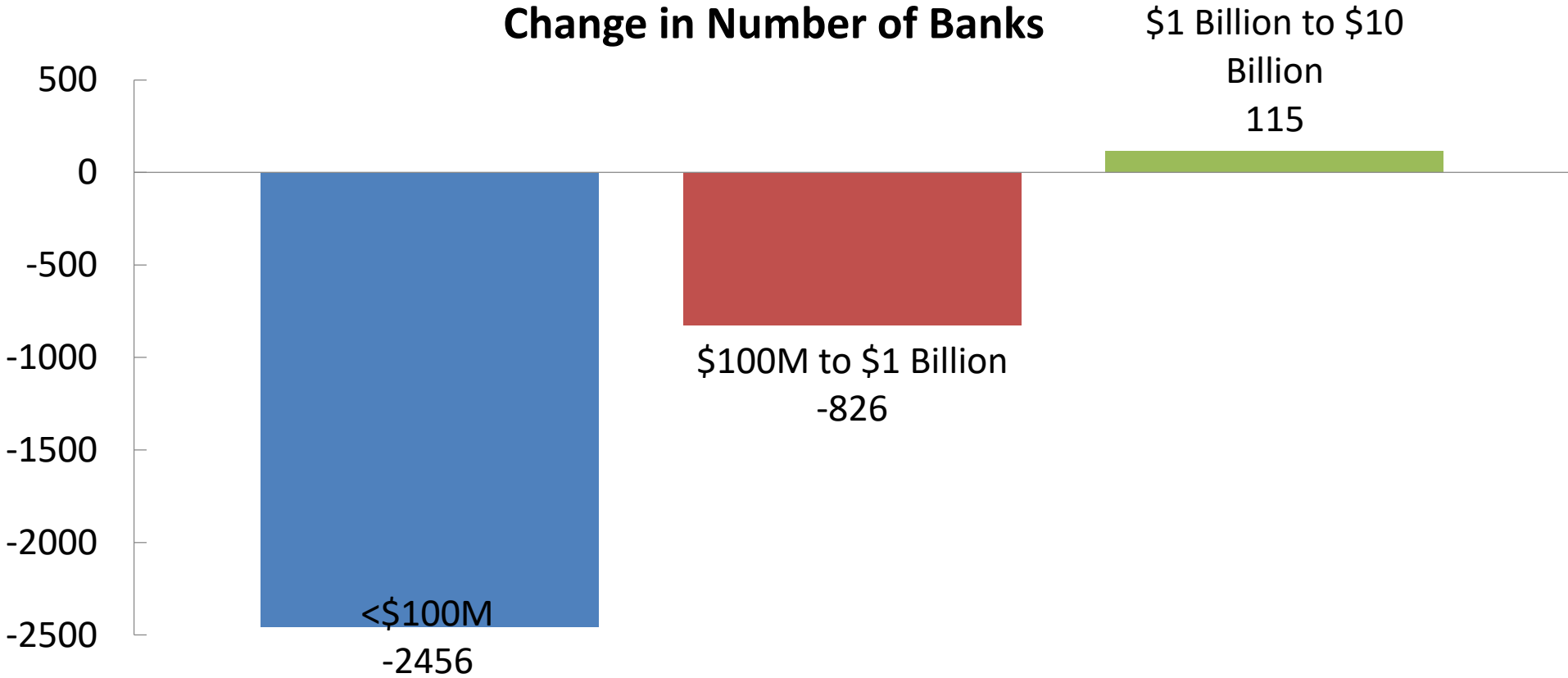


Source: SNL Financial

Capital Alternatives: Subordinated Debt

- There is an open market for subordinated debt
- Subordinated debt has a lower cost of capital than equity and there is no dilution to existing shareholders
- Certain institutional investors will invest in both equity and debt
- However, subordinated debt does not increase consolidated tangible common equity or tier 1 capital at the holding company

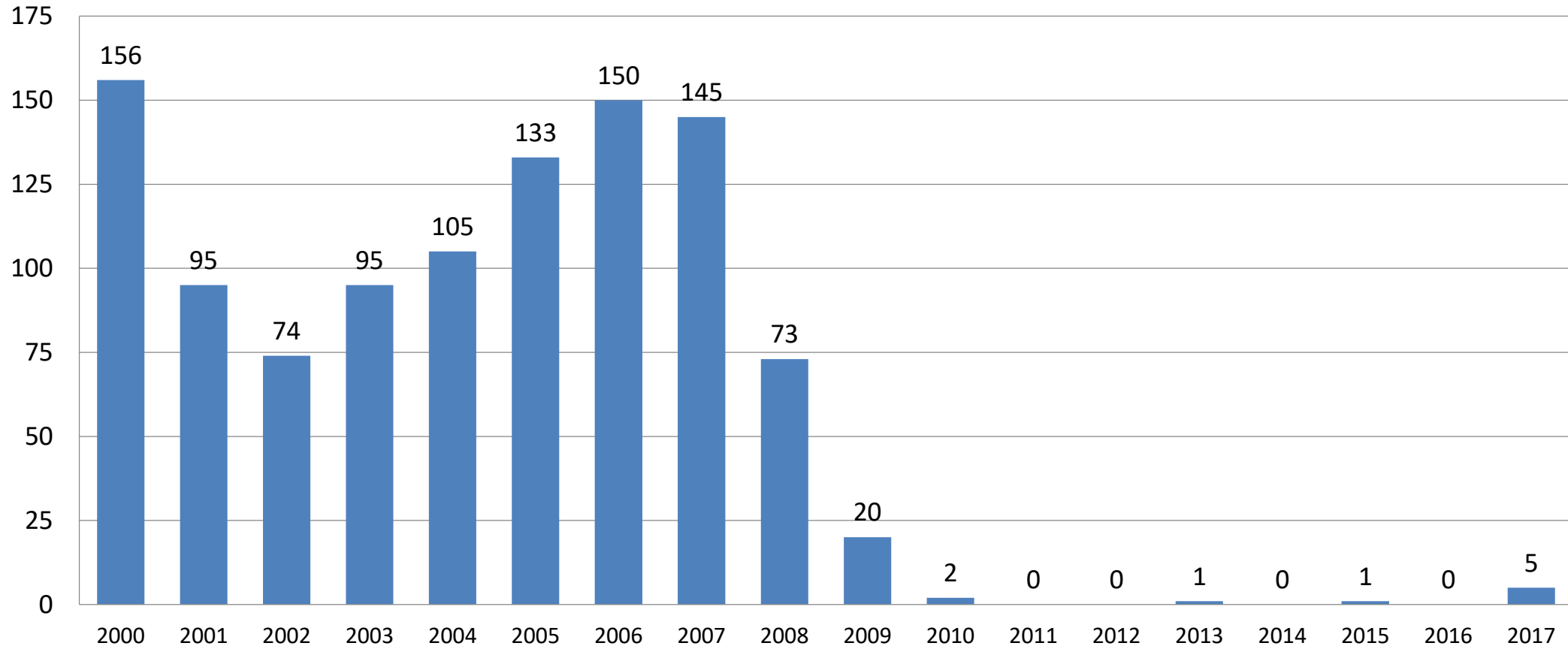
Trend in Number of Banks (12/31/05 to 12/31/17)



Source: SNL Financial

De Novo Activity Since 2000

Of the 1,054 new banks formed since 2000, 561 are still active

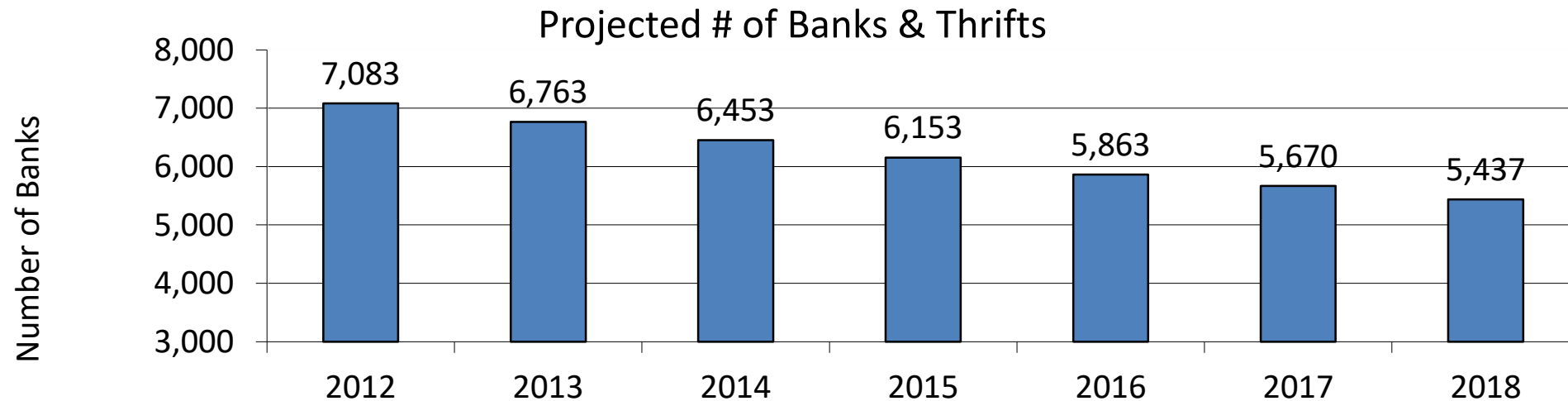


Source: SNL Financial

How Many Banks Will Be Left?

Assumptions:

- Assumes 200 acquisitions per year
- Assumes 30 strategic mergers
- Assumes 8 failures (currently 95 institutions on FDIC problem list)
- Assumes 5 de novo institutions (5 de novos in 2017)



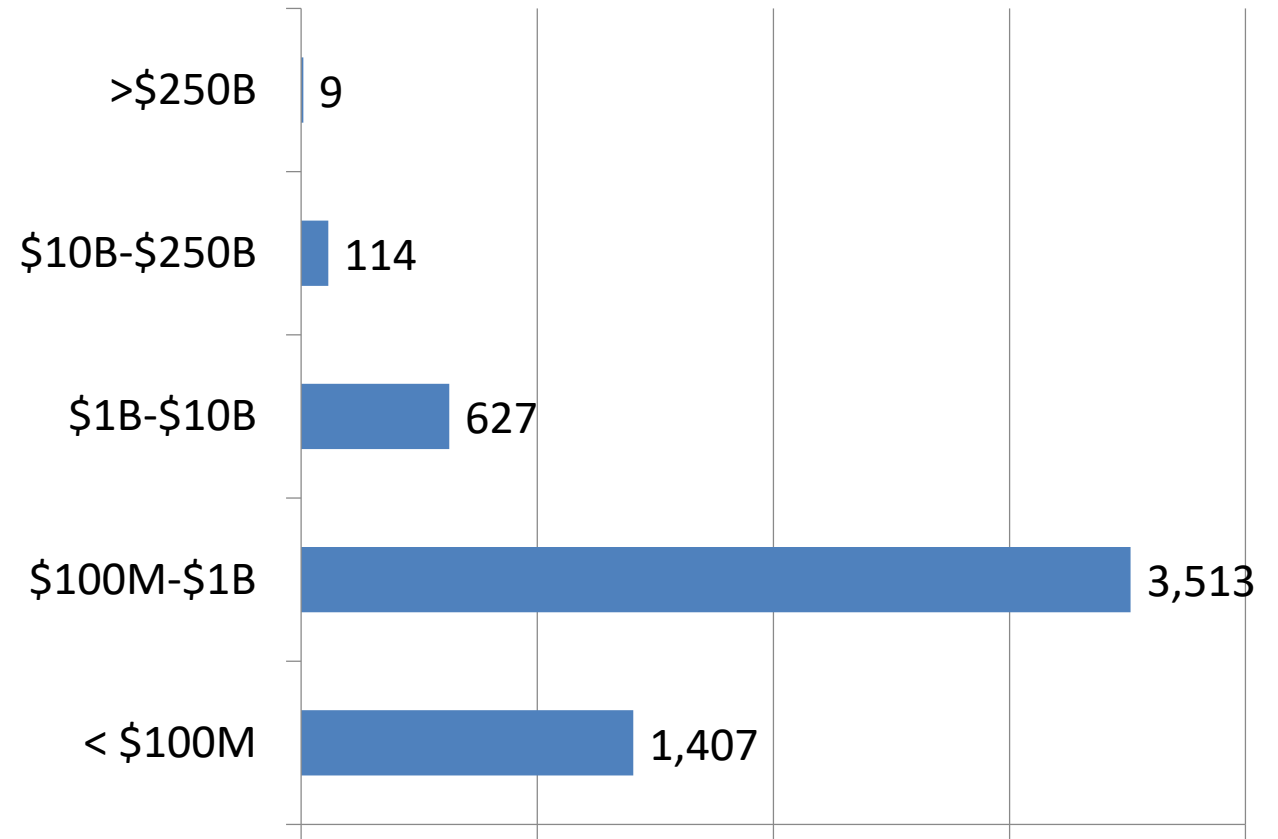
Source: SNL Financial

Projected Community Bank Consolidation

Consolidation is expected to be higher for smaller asset-size companies for a number of reasons including:

- Lack of efficiency
- Unfavorable demographics
- CEO/Board/Shareholder fatigue/age

U.S. Banking Companies by Assets



Summary of Banking Markets

| Rank | State | 2017 Deposits (\$ billions) | Current Population (000s) | 2018-2023 Proj. Population Change (%) | Median Household Income (\$) | # Banks & Thrifts HQ in State | Top 10 Deposit Market Share (%) |
|------|------------|-----------------------------|---------------------------|---------------------------------------|------------------------------|-------------------------------|---------------------------------|
| 1 | New York | 1,683 | 19,788 | 1.30 | 66,418 | 92 | 79.2 |
| 2 | California | 1,354 | 39,696 | 4.06 | 71,061 | 142 | 77.1 |
| 3 | Texas | 818 | 28,532 | 7.10 | 61,175 | 430 | 67.1 |
| 4 | Florida | 564 | 21,107 | 6.73 | 53,657 | 110 | 68.4 |
| 5 | Illinois | 479 | 12,768 | (0.18) | 64,872 | 380 | 63.7 |

Source: SNL Financial

Expectations for 2018

- Deal volume is steady
- Higher prices for sellers in metro areas with growth potential and lending opportunities
- Rural bank prices are hurt by negative demographic trends and a declining number of potential buyers
- Potential “double-dip” for smaller sellers
- Focus on building scale and limited M&A prospects may prompt more mergers of equals; however they remain difficult due to social issues
- The number of de novo banks will be limited and those that are successful will occur in metro areas, have strong management teams and have a lot of capital

Questions?

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