BankDirector. Strong Board. Strong Bank.

ACQUIRE OR BE ACQUIRED

21st Annual

Exploring Your Growth Options

2015

GRIFFIN FINANCIAL GROUP LLC

Understanding M & A Vocabulary – The Substance Behind the Form

Mark R. McCollom and Richard L. Quad
Co-Heads, Financial Institutions

What We Hope To Accomplish

GRIFFIN FINANCIAL GROUP LLC

- Banking, like any industry, is highly complex, with its own unique set of terminology (NIM, BASEL, CET1, PD / LGD, BSA)

- Just when Board members are settling in to the unique lingo and cadence of the industry, the Company embarks on something strategic ("inorganic growth") which triggers a whole new set of terms and benchmarks

- This session hopes to de-mystify some of the key terminology that investment bankers, lawyers, CFOs, and others throw around
  - Which metrics really matter, and why?
  - As a CEO or Board member, how should I sift through the financial and legal "noise," and weigh these factors against the strategic value of a deal?

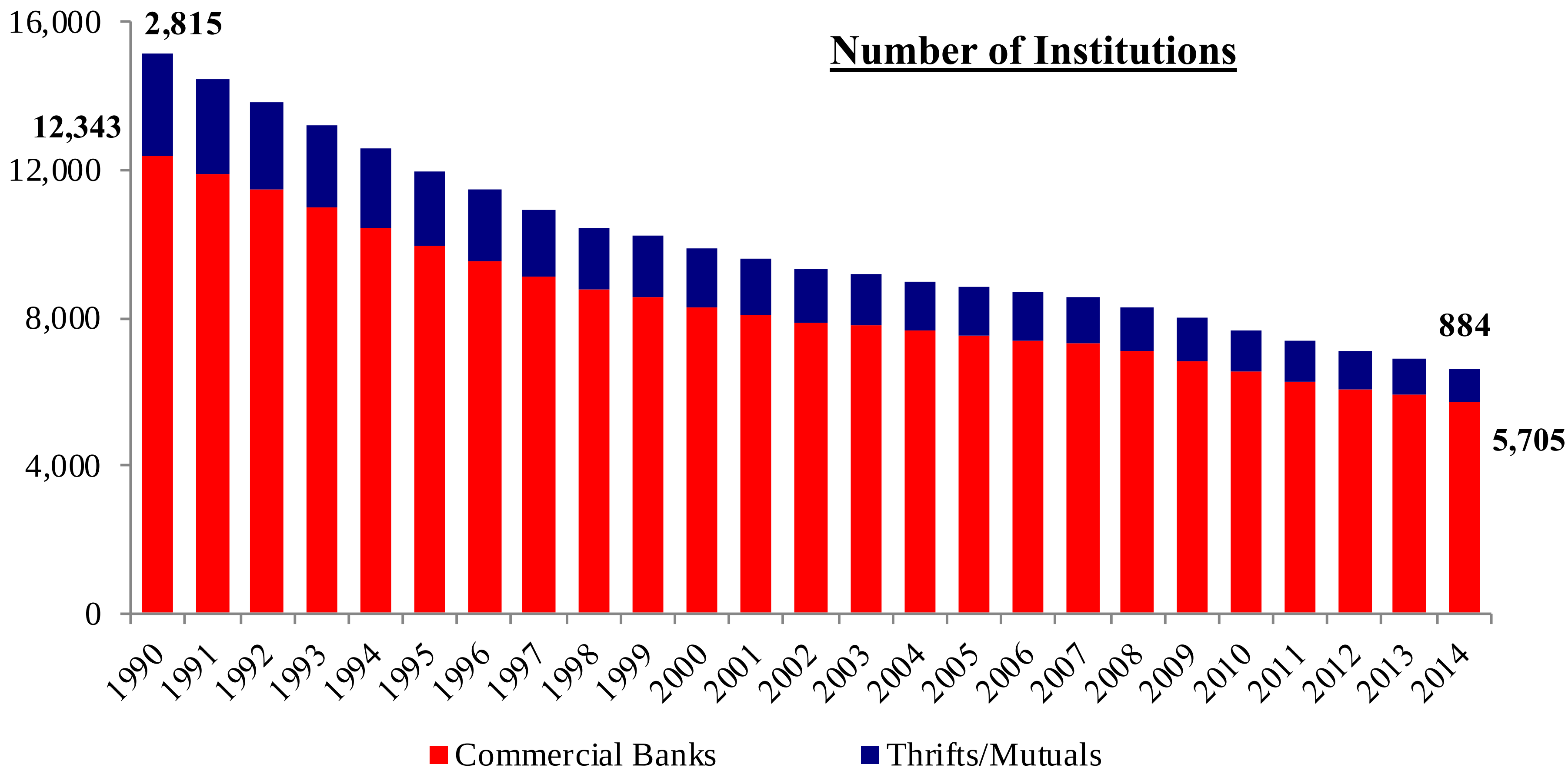
Table of Contents

The Banking Industry – Material Operating Trends 1990 - 2014

The Banking Industry is Consolidating

GRIFFIN FINANCIAL GROUP LLC

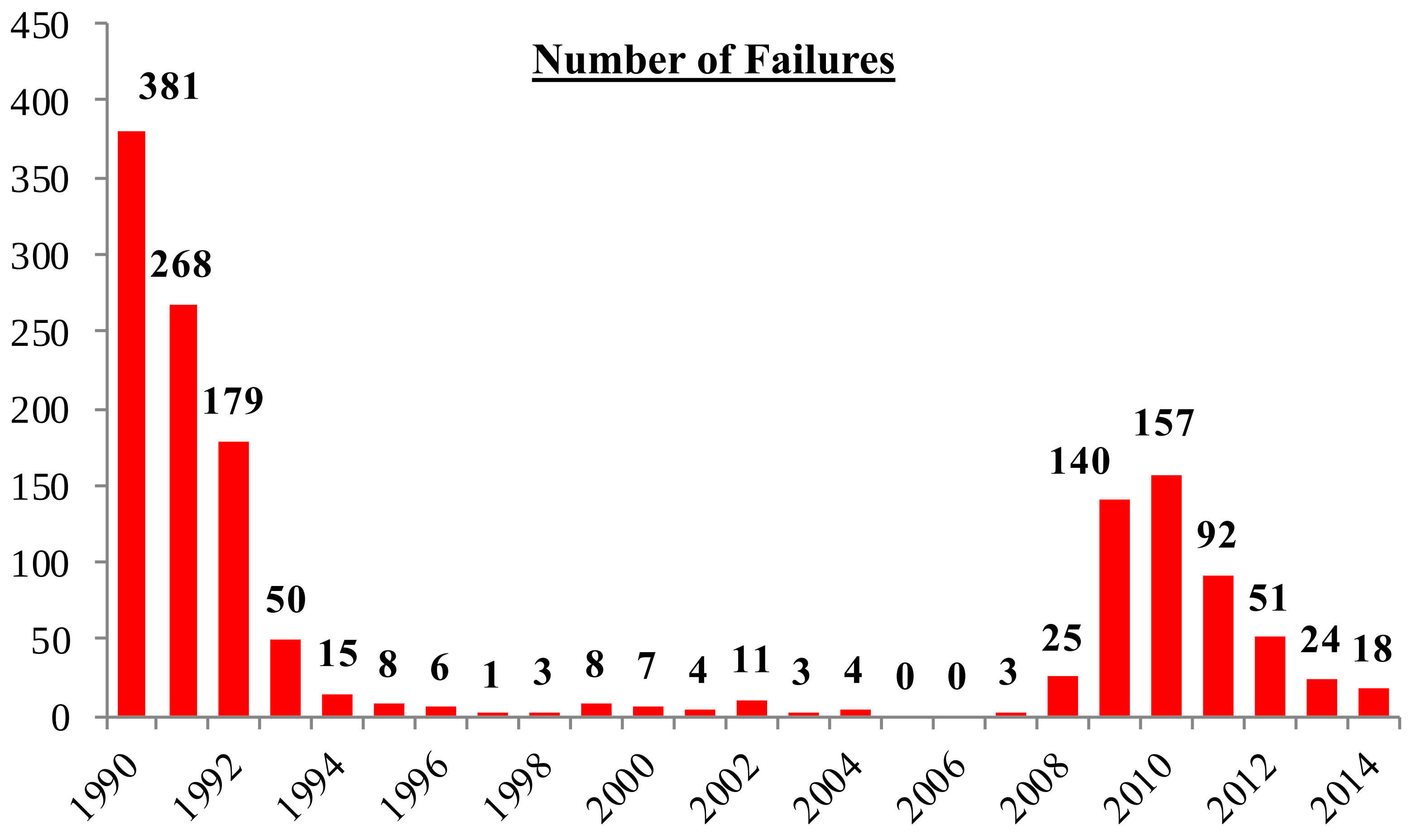
- Net reduction of 8,569 companies over 24 years; net reduction of 287 in the last year;
- 43% of institutions remain compared to 1990;
  - 46% of commercial banks; 31% of thrifts/mutuals



Source: FDIC Statistics at a Glance as of 12/31/2014

While Failures Have Had a Hand in the Consolidation...

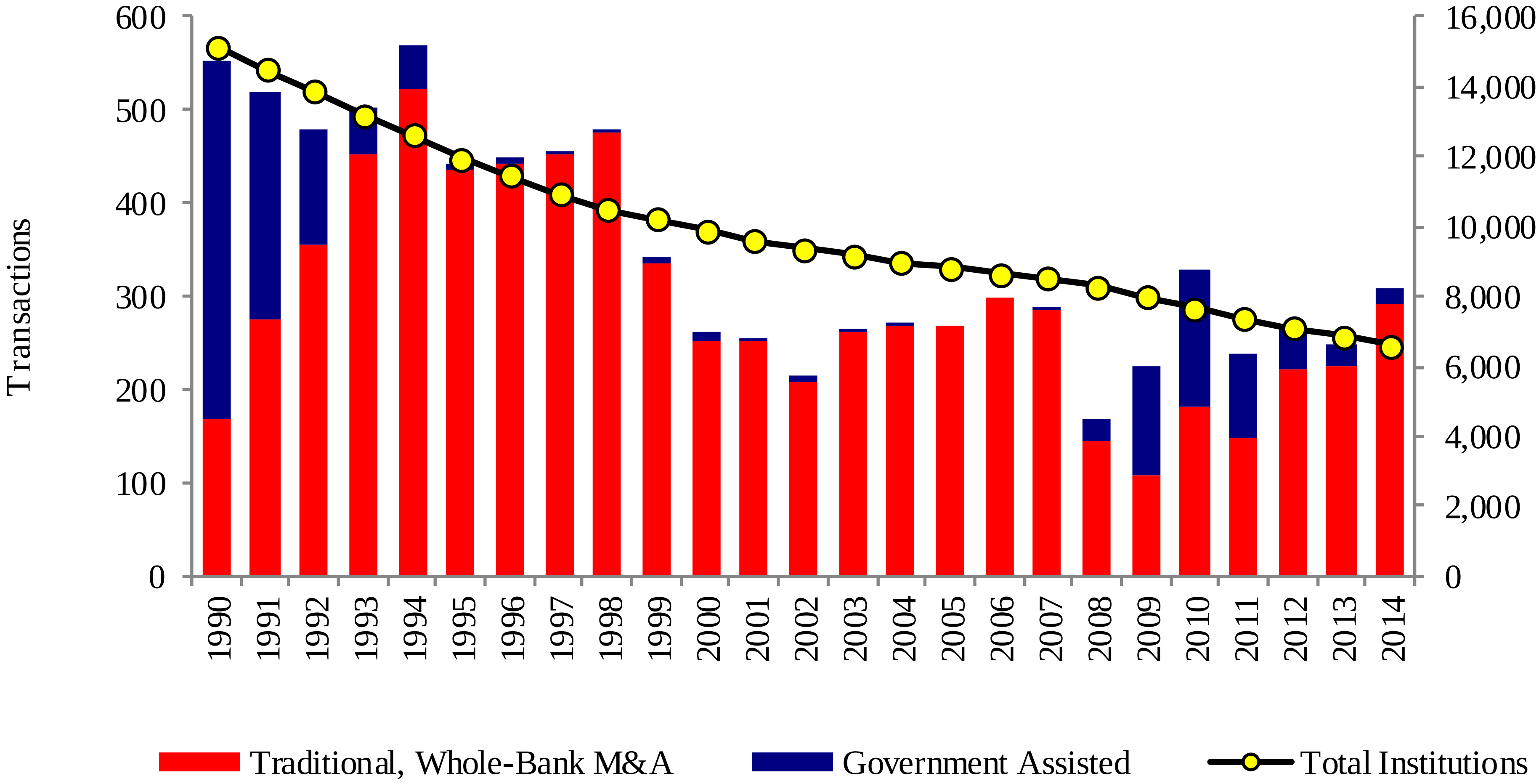
- Failures during RTC era: 878, or a loss of 5.6% of outstanding institutions in 1989;
- Failures during Great Recession era (‘09 – ’12): 414,
  - A loss of 5.3% of pre-crisis (2008) institutions



Source: FDIC Statistics at a Glance as of 12/31/2014

...Mergers and Acquisitions Have Been the Primary Driver

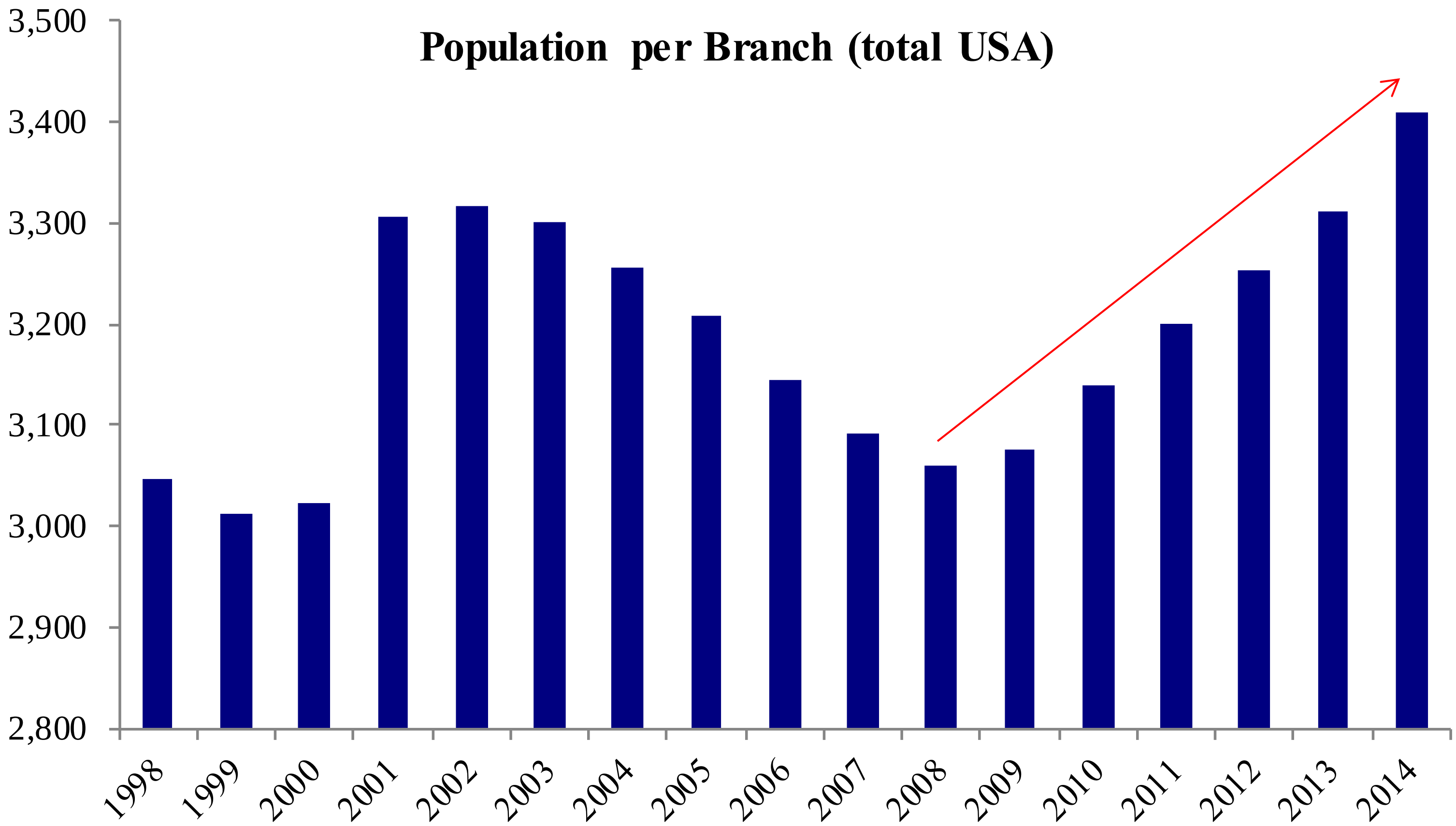
Number of Transactions and Institutions



Source: FDIC Statistics at a Glance as of 12/31/2014

Are We Still Overbanked in the US?

- It appears banks are reacting appropriately to the over-building that occurred in the mid-00s, but does recent explosion in mobile and online banking dictate further moves?



Source: SNL U.S. Deposit Market Share Summary Report

There is no Denying the Trend…

Citi Waves Bye-Bye to Branches and Hello to Digital

BofA at Forefront of Branch Reduction Trend

PNC to Reduce Tellers / Shed Branches

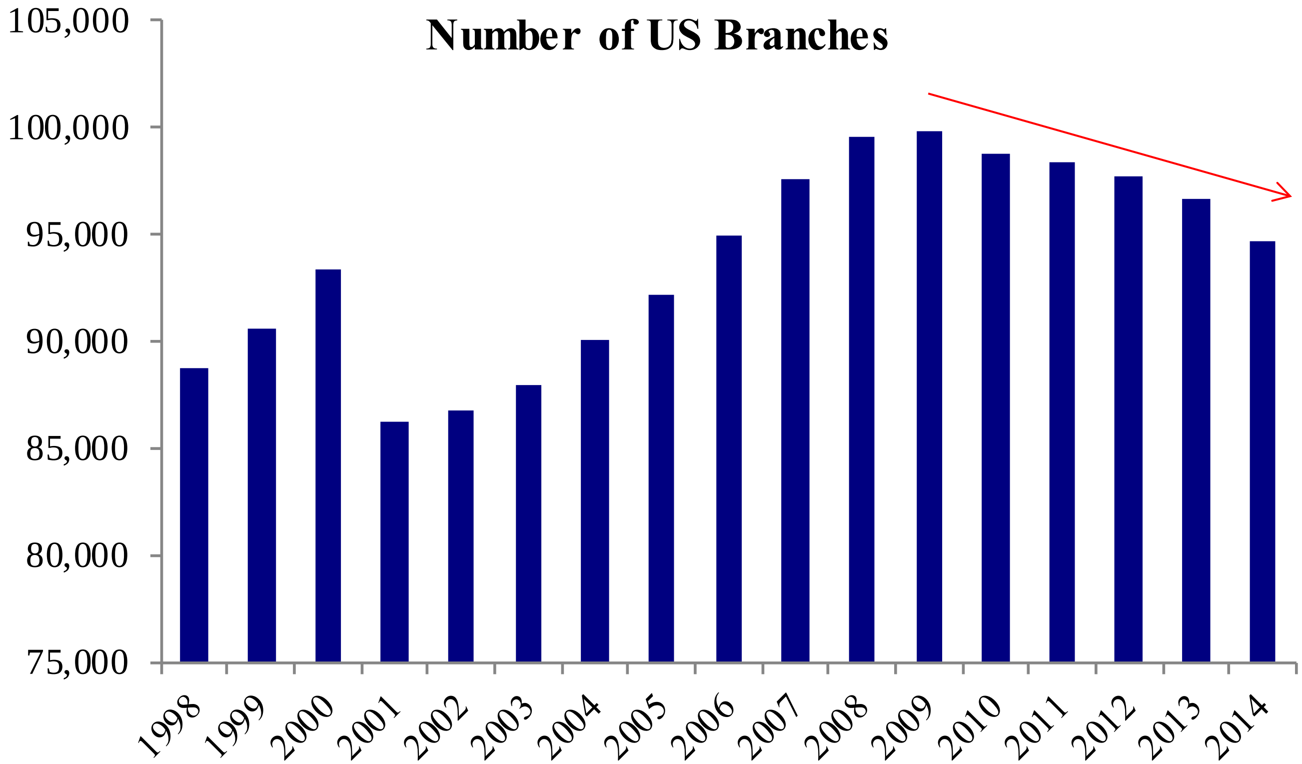
JPMorgan Chase Cutting Jobs, Slimming Branches

Is Wells Fargo Attempting to Eliminate Bank Branches Altogether?

The Issue We are All Quietly Whispering

GRIFFIN FINANCIAL GROUP LLC

- We need to re-invent ourselves as an industry
- The primary way in which we interact with our customer is changing...permanently
- Over the next decade, we will have tens of millions of excess square feet of real estate to shed, retrofit, reallocate…something
- And, we'll be spending hundreds of millions of dollars on anti-fraud measures for mobile and online banking

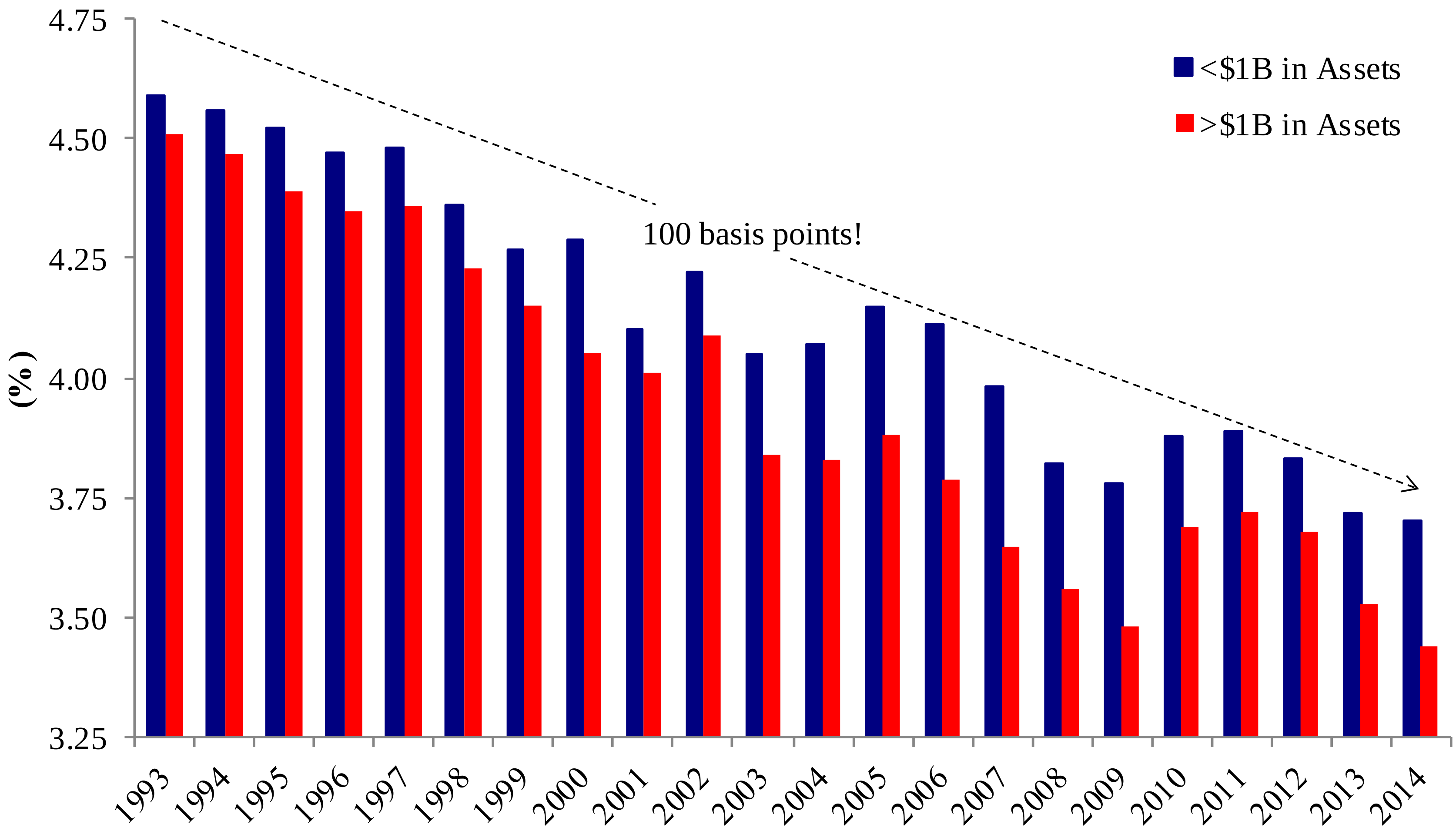


Source: SNL U.S. Deposit Market Share Summary Report

Net Interest Margin – No Near-Term Relief in Sight

GRIFFIN FINANCIAL GROUP LLC

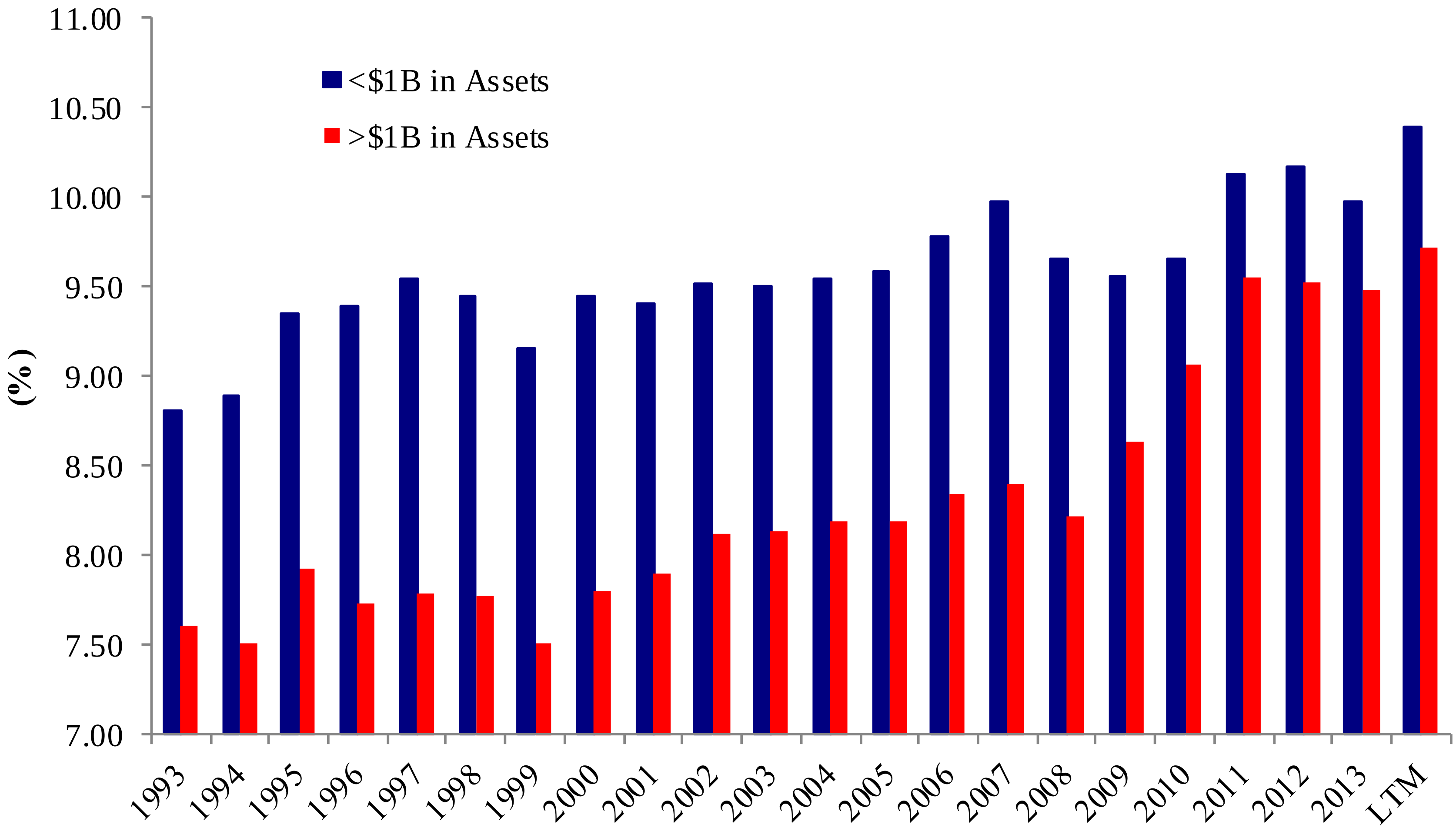
- For banks less than $1 billion, this represents on average 83.7% of their revenues, and for banks $1 - $20 billion, it represents 78.0%. Therefore, this is a major problem!



Source: SNL Financial

Tangible Common Equity

- We are currently at the highest level of capital in our industry since the Great Depression – good news if you're a regulator, bad news if you're trying to earn a return on that capital!



Source: SNL Financial

Oh, yeah…the Regulators…

GRIFFIN FINANCIAL GROUP LLC

C'mon, man!

Basel III,
Double Trouble

FDIC, OCC Join
Fed's Push for Stricter
Liquidity Rules

CFPB Vows More Actions
on Credit Reporting

Stress-Test Surprises Could
Weigh on 2015 Capital Plans

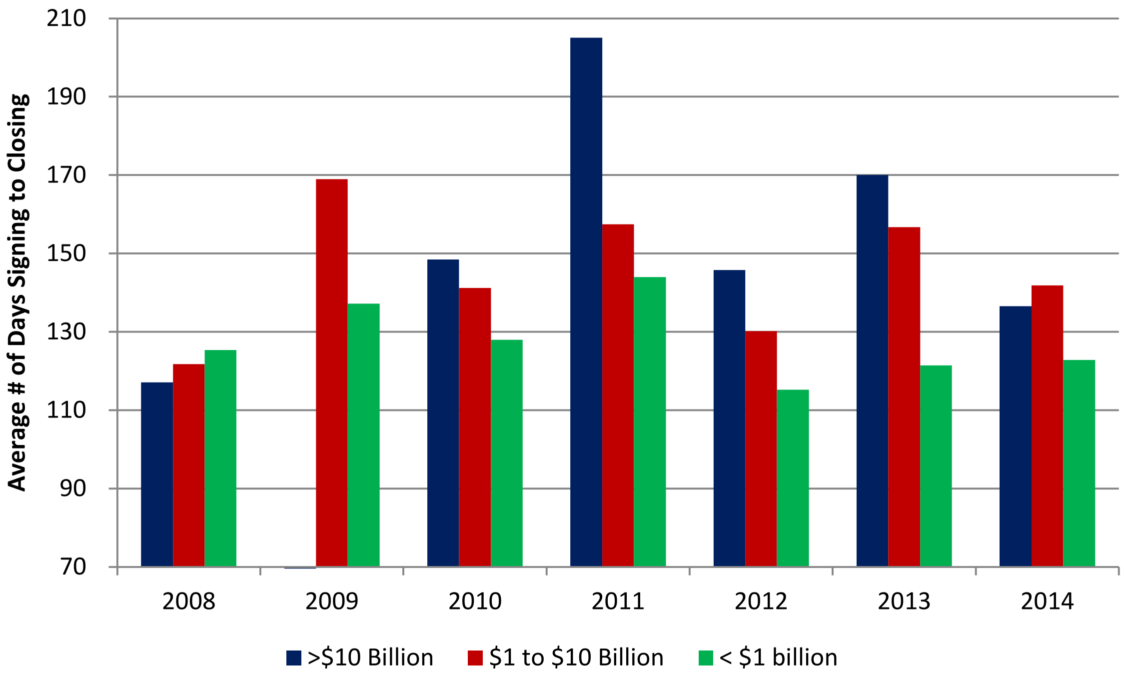
Risk and Compliance
Specialists in High
Demand at Banks

Small Banks Stall in
Basel III Progress

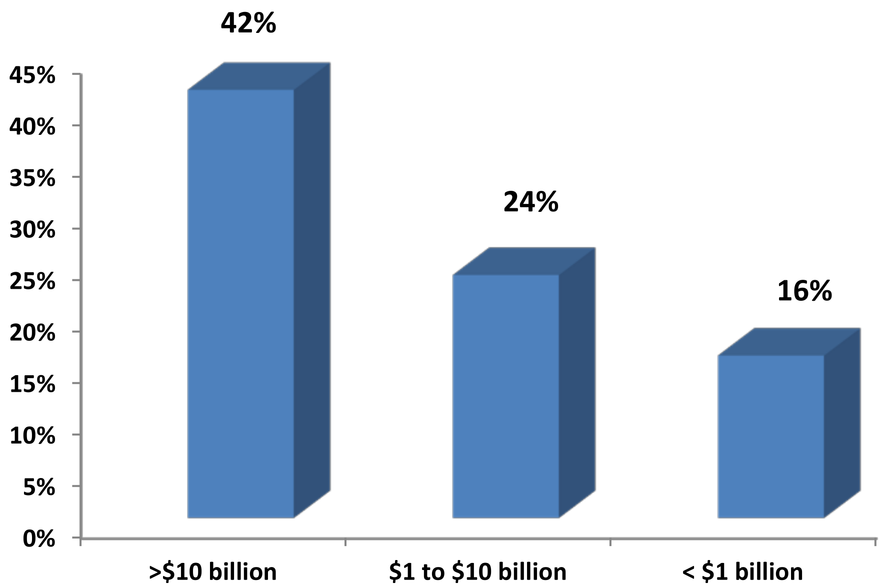
Dodd-Frank's
Regulatory Morass

Stressing Out

Regulatory Approval of M&A – Time To Completion



Average days signing to closing by asset size of the buyer



<u>Cumulative Since 2011</u>

% of deals taking at least six months from signing to closing, by asset size of the buyer

Summary Strategic Thoughts for the Sector

GRIFFIN FINANCIAL GROUP LLC

A need to reinvent ourselves from a delivery standpoint

+

A 25-year trend of declining margins due to technology/competition

+

Too much capital chasing too few loans (more recently)

=

Pressure to grow…hence, here we are

So How Have We Reacted?

- The big banks have gotten bigger…much bigger
- In comparing the top 10 banks (by asset size) 20 years ago, to the top 10 banks today, we see that deposit market share has increased by 40%

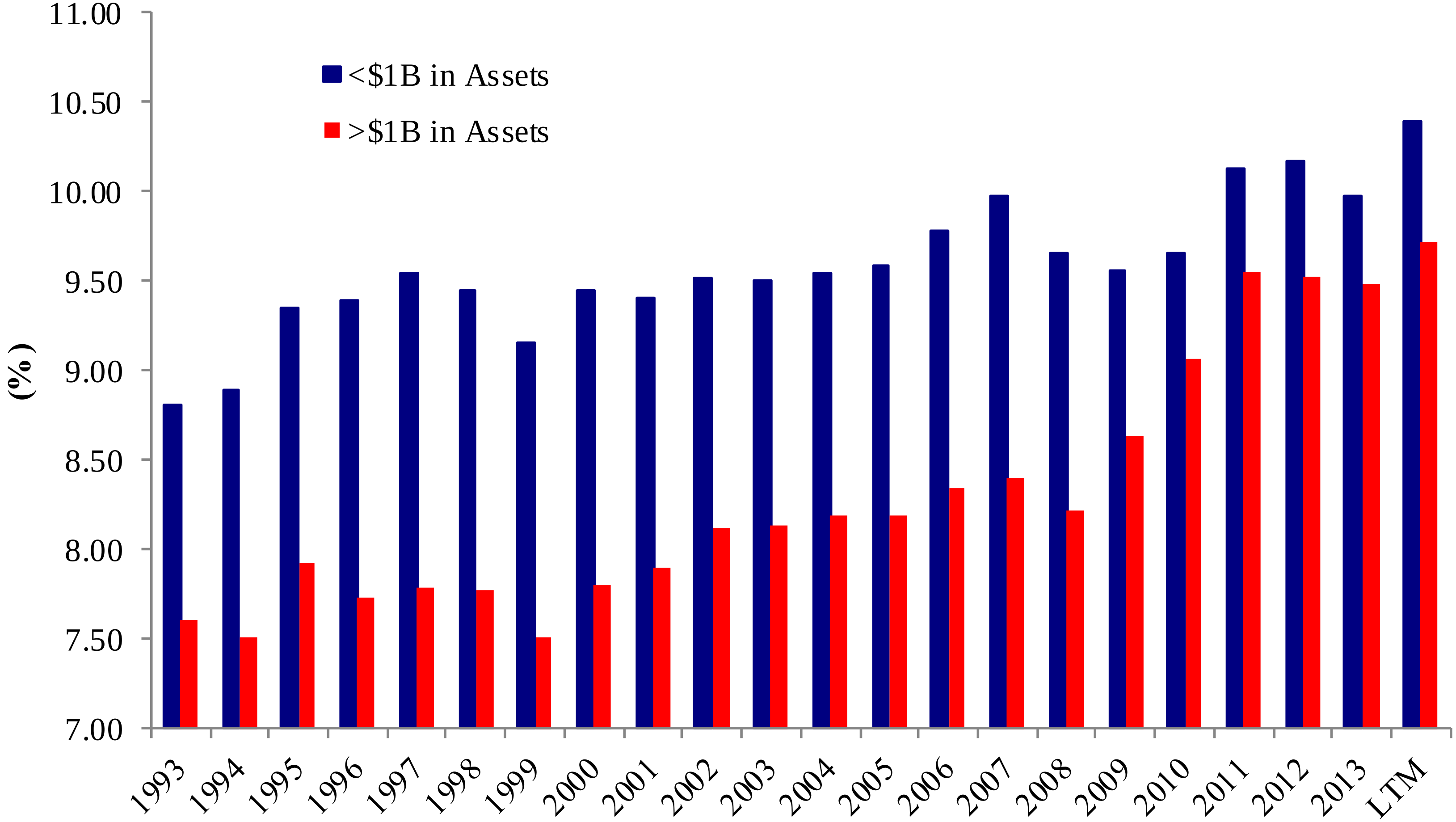
1994				2014			
Rank	Company Name	Total Deposits ($)	Deposit Market Share (%)	Rank	Company Name	Total Deposits ($)	Deposit Market Share (%)
1	Bank of America Corporation	100,470,395	2.97	1	JPMorgan Chase & Co.	1,334,534,000	12.0
2	JPMorgan Chase & Co.	96,506,000	2.86	2	Wells Fargo & Company	1,131,068,000	10.2
3	KeyCorp	48,564,237	1.44	3	Bank of America Corporation	1,114,330,000	10.0
4	Wells Fargo & Company	36,424,000	1.08	4	Citigroup Inc.	942,655,000	8.5
5	PNC Financial Services Group, Inc.	35,038,417	1.04	5	U.S. Bancorp	273,097,000	2.5
6	Bank of New York Mellon Corporation	34,090,658	1.01	6	Bank of New York Mellon Corporation	264,913,000	2.4
7	SunTrust Banks, Inc.	32,211,364	0.95	7	PNC Financial Services Group, Inc.	226,483,039	2.0
8	Deutsche Bank Trust Corporation	24,940,000	0.74	8	State Street Corporation	207,967,596	1.9
9	Comerica Incorporated	22,432,316	0.66	9	Capital One Financial Corporation	204,513,452	1.8
10	U.S. Bancorp	18,791,000	0.56	10	TD Bank US Holding Company	202,766,632	1.8
		$449,468,387	**13.3%**			**$5,902,327,719**	**53.2%**

Top 50	**19.6%**	Top 50	**74.6%**
Top 100	**21.3%**	Top 100	**80.4%**

Source: SNL Financial and www.fdic.gov

It All Comes Back to Capital . . . and “Capital is King”

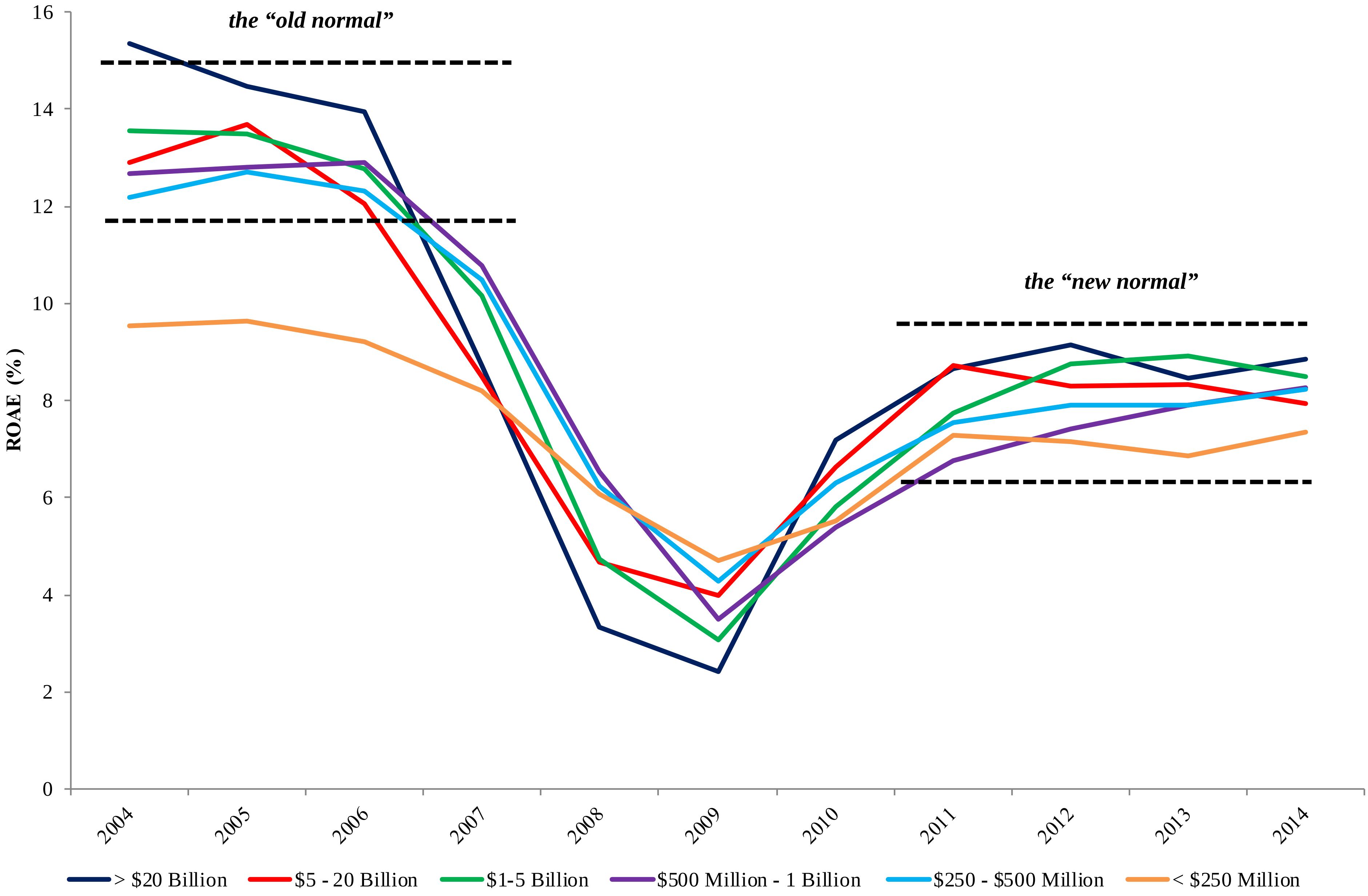
Let's revisit page 13…. Tangible Common Equity



- This results in ROE pressure sector-wide

Source: SNL Financial

Median Return on Average Equity – by Asset Size



Our First Point to Remember – ROE is Priority #1

- We are all stewards of other people's money
- They all have other options in which to entrust their investments
- As an industry, we tend to focus on ROA, which, while interesting and easier to wrap our heads around, does not matter to the investors in your company

A Strong ROA Doesn't Always Trump a Strong ROE

GRIFFIN FINANCIAL GROUP LLC

- Bank A:

Cash + Investments	$ 75	Deposits	$ 370	Assets:	500,000
Loans	385	Borrowings	40	Equity:	80,000
Allowance	(5)	Other Liabilities	10	Income:	5,000
Intangibles	10	Total Liabilities	420	**TCE/TA:**	**14.29%**
Other Assets	35	Equity	80	**ROA:**	**1.00%**
	$ 500		$ 500	**ROE:**	**6.25%**

- Bank B

Cash + Investments	$ 75	Deposits	$ 410	Assets:	500,000
Loans	385	Borrowings	40	Equity:	40,000
Allowance	(5)	Other Liabilities	10	Income:	3,000
Intangibles	10	Total Liabilities	460	**TCE/TA:**	**6.12%**
Other Assets	35	Equity	40	**ROA:**	**0.80%**
	$ 500		$ 500	**ROE:**	**10.00%**

Dollars in millions, other than per share amounts

Your Equity Cost of Capital – Your Strategic Compass

- Also related to, but slightly different than, your WACC – "Weighted Average Cost of Capital"

  - Equity COC is the required return your equity holders demand

  - WACC incorporates the hurdle rates of other parts of your capitalization – preferred holders, senior debt, subordinated debt, etc.

- This should be your guide for every strategic decision you make – will this improve our return on capital, and on a stand-alone basis, does the decision (a loan, a new branch, an acquisition) generate a return in excess of our cost of capital?

The Components of Your WACC

$$r_f + \beta\left(r_m - r_f\right),$$

where:

r_f = annual risk-free rate of return,

β = regression coefficient of the daily change in price of the Company's stock with the daily change in price of the broad stock market,

r_m = expected annual return of the stock market, and

$\left(r_m - r_f\right)$ is known as the equity risk premium.

- In addition, many banks also need a small bank or illiquidity premium added to their number, as investors must be compensated for the incremental risk they take to hold an illiquid security
- In today's numbers, most banks in the audience would have a WACC ranging from **9%-13%**

Is your ROE in excess of your cost of capital?

GRIFFIN FINANCIAL GROUP LLC

M&A Vocabulary: Deal Structure and Diligence

M & A Vocabulary – Deal Structure

GRIFFIN FINANCIAL GROUP LLC

- Some basic (and not-so-basic) terms:

  - Asset purchase versus stock (or equity) purchase

  - Acquisition versus merger

  - Reverse merger

  - Triangular mergers (forward and reverse)

M & A Vocabulary – Deal Structure

GRIFFIN FINANCIAL GROUP LLC

- **Asset Purchases**
  - Any purchase or acquisition that does not involve the purchase of the target company's equity
  - Examples include branch sales, or bulk purchases of loans
  - Some ancillary financial services businesses can be sold in this fashion, as well, especially if concentrated ownership of the seller
  - Generally, no carry-over liability from the target company
  - Taxable transaction to the seller

- **Stock / Equity Purchases**
  - Purchase of all (or substantially all) of the target company's equity
  - Results in carry-over liability to the buyer
  - May or may not be a taxable transaction to the seller

- **Acquisition versus Merger**
  - No hard and fast rule, but generally, "acquisition" implies control, so usually refers to a deal where the buyer has greater than 60% control of the pro forma entity
  - "Merger" implies shared control
  - "Merger of Equals" (MOE) generally used when pro forma metrics (market cap, earnings, assets, etc.) are between 40 – 60% for each party in the transaction.

M & A Vocabulary – Deal Structure

	Contribution ($000)			Contribution (%)	
	Bank A	Bank B	Pro Forma	Bank A	Bank B
Shares Outstanding	4,000,000	8,000,000			
Market Capitalization	$ 100,000	$ 144,000	$ 244,000	41%	59%
Total Assets	$ 1,000,000	$ 1,500,000	$ 2,500,000	40%	60%
Total Net Loans	$ 650,000	$ 800,000	$ 1,450,000	45%	55%
Total Deposits	$ 700,000	$ 950,000	$ 1,650,000	42%	58%
Core Deposits	$ 725,000	$ 975,000	$ 1,700,000	43%	57%
Common Equity	$ 100,000	$ 110,000	$ 210,000	48%	52%
Tangible Equity	$ 90,000	$ 100,000	$ 190,000	47%	53%
Tangible Common Equity	$ 95,000	$ 105,000	$ 200,000	48%	53%
Net Interest Income (LTM)	$ 30,000	$ 35,000	$ 65,000	46%	54%
Net Interest Income (YTD)	$ 23,000	$ 25,000	$ 48,000	48%	52%
Non-Interest Income (LTM)	$ 10,000	$ 15,000	$ 25,000	40%	60%
Non-Interest Income (YTD)	$ 8,000	$ 12,000	$ 20,000	40%	60%
Pre-Provision Net Revenue (LTM)	$ 10,000	$ 15,000	$ 25,000	40%	60%
Pre-Provision Net Revenue (YTD)	$ 8,000	$ 12,000	$ 20,000	40%	60%
Non-Interest Expense (LTM)	$ 25,000	$ 30,000	$ 55,000	45%	55%
Net Income to Common (LTM)	$ 8,000	$ 12,000	$ 20,000	40%	60%
Net Income to Common (YTD)	$ 7,000	$ 10,000	$ 17,000	41%	59%

- In a MOE, generally neither side receives a premium on their stock, because in theory both are sharing control of the ongoing entity, so no "control premium" should be offered
- MOEs can be powerful tools to quickly grow and gain efficiencies of scale, but are heavily reliant upon both parties' abilities to concede on social issues

M & A Vocabulary – Deal Structure

GRIFFIN FINANCIAL GROUP LLC

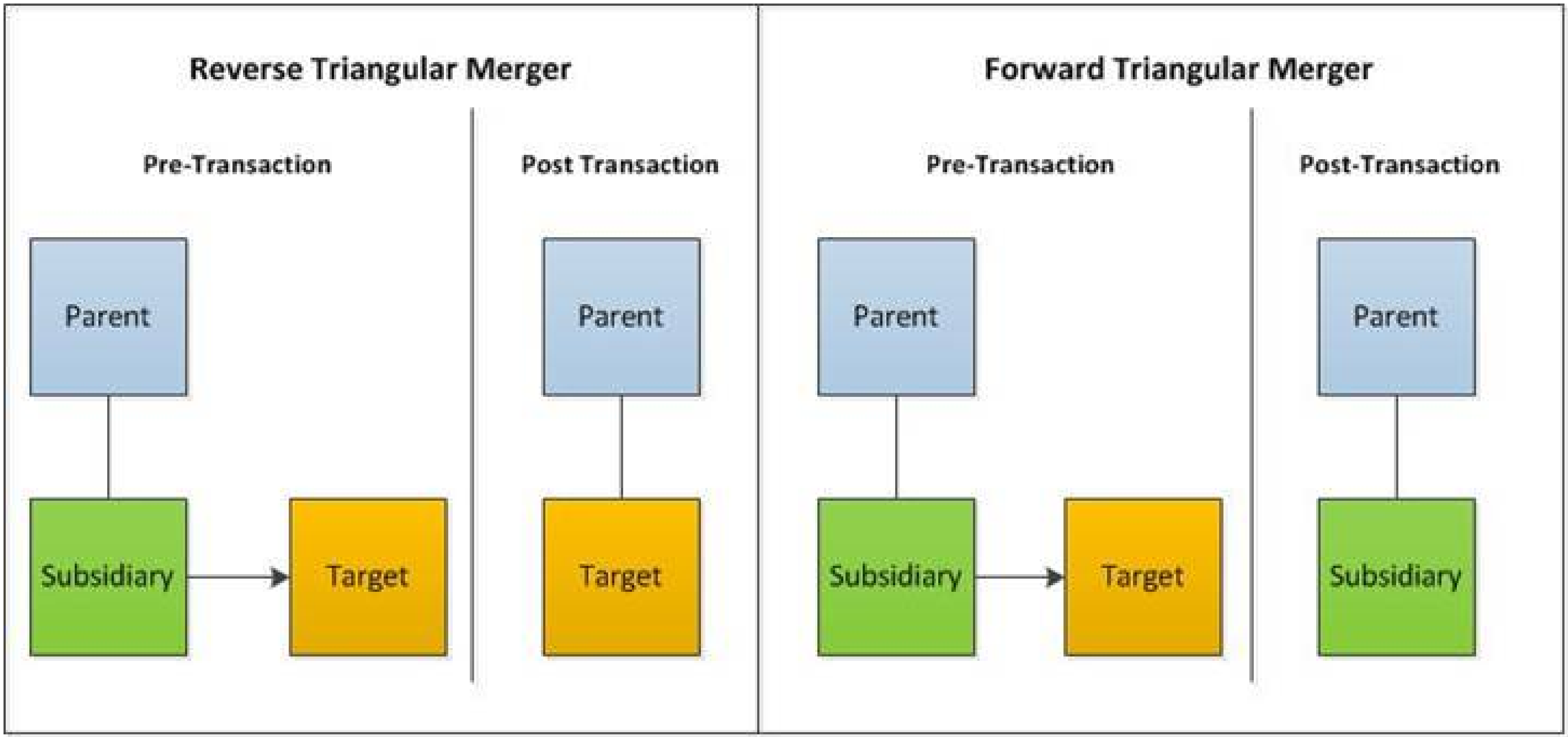
- "Reverse" Mergers

Company A	Company B
Public, SEC registrant	Privately held
Aging management with succession issues	Strong, young management team
Weaker market area, history of slower growth	Track record of growth

- Company A buys Company B, but Company B management survives (and in many cases, Company B's name, culture, etc., survive as well)

M & A Vocabulary – Deal Structure

- Triangular Mergers
  - Generally, used to preserve a certain tax treatment at either the buyer or seller
  - In a Reverse Triangular Merger, the target survives, whereas in a Forward Triangular Merger, the original subsidiary survives



M & A Vocabulary – Due Diligence

- Due Diligence – key considerations
  - Credit due diligence – consider outside assistance;
  - Line up your investment banker early – i-bankers are consolidating, too, and conflicts are increasing;
  - Utilize senior management – they will "own" this after the deal, so get their buy-in upfront;
  - No question is a bad question...due diligence is not the forum to show how smart you are...listen, dig deep, ask questions;
  - Give your regulators a "seat at the table" early in the process (pre-due diligence).

M & A Vocabulary – Due Diligence

- CAs / NDAs
  - Confidentiality (or "Non-disclosure") agreements spell out the rules of engagement during the due diligence phase and beyond
  - Provides for all non-public information about each company (usually, they are reciprocal) to be kept quiet, and only discloseable to decision-makers on either side of the deal and their advisors, or if required by law
  - Non-solicitation of customers and employees – critical issue

M & A Vocabulary – Due Diligence

- Data Rooms
  - Most due diligence processes today are conducted online – credit reviews are the only major exception to this, but some target companies now have fully electronic loan and credit files, as well;
  - The "rooms" are a secure website containing a table of contents and the ability to upload and archive thousands of target company documents for review;
  - Data rooms are password secured, and many reputable companies offer this service – your i-banker will be able to recommend one to use.

M & A Vocabulary – Due Diligence

GRIFFIN FINANCIAL GROUP LLC

- "CIMs" – Confidential Information Memorandums
  - These are usually 20-50 page Powerpoint presentations prepared by the target company (usually by their financial advisor);
  - They provide an overview of the Company, and highlight the key investment merits of the company that is for sale, as well as outlining the sales process, key contacts, and milestone dates;
  - Keep in mind – they are written with seller bias – they do not replace buyer's need for complete due diligence.

M & A Vocabulary – Due Diligence

- LOIs / IOIs
  - "Letters of Intent" or "Indications of Interest" spell out key terms of a potential deal:
    - Structure, pricing, form of consideration, source(s) of funding, deal contingencies, roles for target company management, pro forma Board composition, approvals required, and anticipated timing, among other things;
  - They clearly state that they are preliminary and non-binding;
  - Generally, used at the end of "Round 1" in an auction process, to limit the bidder population to 2-4 parties to perform detailed due diligence, and used again after due diligence to select a party with whom to proceed;
  - Can also be used in a negotiated deal to formerly show the buyer's intent, and outline key considerations for the Board to deliberate upon.

M & A Vocabulary – Reverse Diligence

- Reverse Diligence
  - This is the seller's opportunity to perform due diligence on the buying company;
  - Takes on enhanced importance when the buyer is offering its shares as consideration in the deal – sellers will become shareholders in the pro forma company;
  - Even in an all-cash deal, seller needs to assess buyer's ability to close the transaction.

GRIFFIN FINANCIAL GROUP LLC

M&A Vocabulary: Deal Pricing

M & A Vocabulary – Deal Pricing

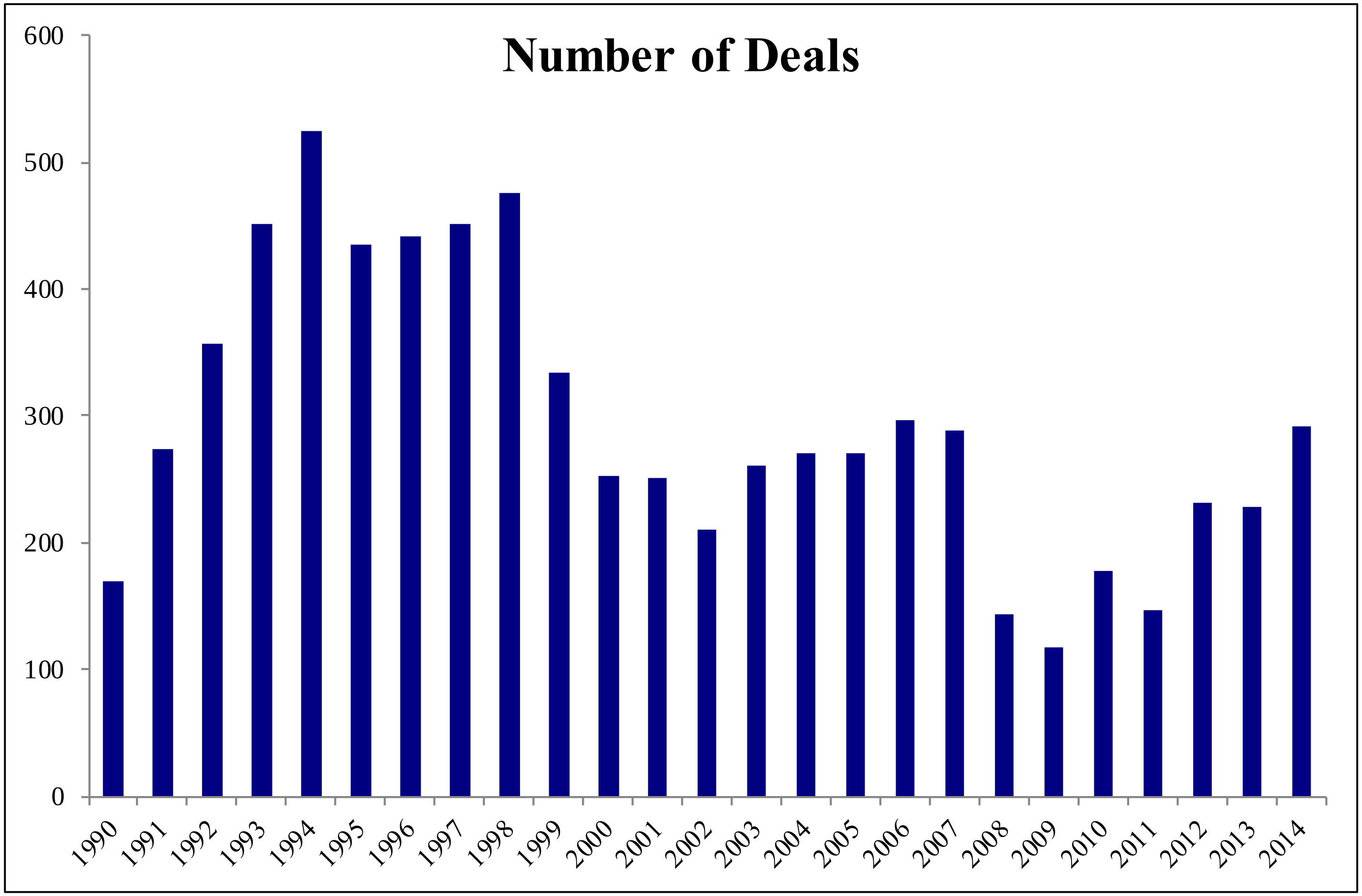
GRIFFIN FINANCIAL GROUP LLC

- While a definitive merger agreement will contain many non-financial sections of the deal (representations and warranties, covenants, conditions precedent, "no-shop" clauses, which we'll discuss later), in this section we will be focusing on the key financial terms discussed in this document:

  - P / TBV
  - P / E
  - Mix of Consideration
  - Fixed Price vs. Fixed Exchange
  - Caps, Collars, and Floors
  - Walk-away Provisions

M&A Vocabulary – Deal Pricing

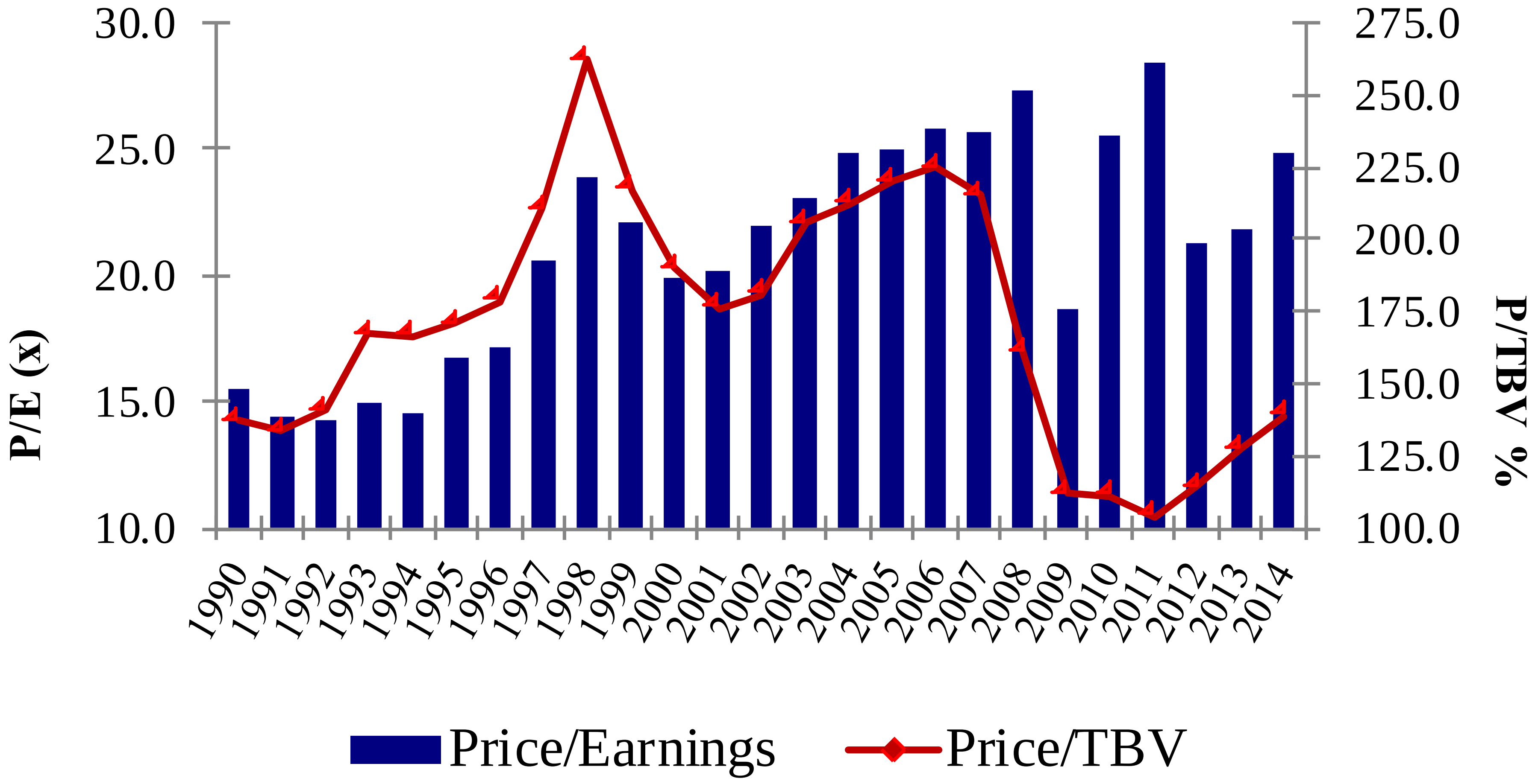
- Banks used to be valued on a P/E basis, and P / TBV was largely not considered
- Pre-2000, pooling of interest rules also made acquisitions less costly for buyers than they are today (more on this in a moment)



Source: SNL Financial

GRIFFIN FINANCIAL GROUP LLC

Historic P/ TBV and P/ E levels



Source: SNL Financial

M&A Vocabulary – Deal Pricing

The Recession Caused Investors to Flee to Safety of the Balance Sheet

- Bank valuations, and bank mergers, were historically based on earnings

- The Great Recession casted doubt on the predictability of those earnings, and investors turned to the balance sheet for safety – equity investors began to think like bondholders

- Because of this, P / TBV became the driving metric for bank valuations and bank merger pricing

- While larger, liquid banks are once again trading largely on a P/E basis, smaller, less liquid names are still valued on a P/ TBV basis

M & A Vocabulary – Deal Pricing

- Price to TBV – what is it? – a simple illustration

Cash + Investments	$ 75		Deposits	$ 400	
Loans	385		Borrowings	40	
Allowance	(5)		Other Liabilities	10	
Intangibles	10		Total Liabilities	450	
Other Assets	35		Equity	50	
	$ 500			$ 500	

- Shares outstanding: 2,500,000
- 2014 earnings: 60 bp ROA, or $3.0 million
- 2015 earnings (est.): $3.5 million

Dollars in millions, other than per share amounts

M & A Vocabulary – Deal Pricing

GRIFFIN FINANCIAL GROUP LLC

- So, let's start playing with some of the numbers….

Cash + Investments	$	75	Deposits	$	400
Loans		385	Borrowings		40
Allowance		(5)	Other Liabilities		10
Intangibles		10	Total Liabilities		450
Other Assets		35	Equity		50
	$	500		$	500

- What is the Target Bank's current TBV and TBV/share?
- Shares outstanding: 2,500,000

	$	Per Share		
Equity	50	$20.00	←	Book Value Per Share
Less: Intangibles	(10)			
Equals: Current TBV	40	$16.00	←	Tangible Book Value Per Share

Dollars in millions, other than per share amounts

M & A Vocabulary – Deal Pricing

GRIFFIN FINANCIAL GROUP LLC

- Now assume a buyer offers $26.00 per share…what does this number equate to?

Cash + Investments	$	75	Deposits	$	400
Loans		385	Borrowings		40
Allowance		(5)	Other Liabilities		10
Intangibles		10	Total Liabilities		450
Other Assets		35	Equity		50
	$	500		$	500

- Shares outstanding: 2,500,000
- 2014 earnings: 60 bp ROA, or $3.0 million
- 2015 earnings (est.): $3.5 million
- A $26.00 offer equals:
  - $65 million deal ($26.00 * 2.5 million shares)
  - 130% of "Book" ($26.00 / $20.00)
  - 163% of "Tangible Book" ($26.00 / $16.00)
  - 21.7 times ("LTM") earnings ($3M / 2.5M shares) = $1.20 EPS

    $26.00 / $1.20 = **21.7x**
  - 18.6 times 2015, or "forward" earnings ($3.5M / 2.5M shares) = $1.40 EPS,

    $26.00 / $1.40 = **18.6x**

Dollars in millions, other than per share amounts

M&A Vocabulary – Deal Pricing

GRIFFIN FINANCIAL GROUP LLC

“Adjusted TBV” – the REAL price to a Buyer

Balance Sheet			Fair Value Adjustments	Adjusted Balance Sheet		
Cash + Investments	$	75		Cash + Investments	$	75
Loans		385	(10)	Loans		375
Allowance		(5)	5	Allowance		-
Intangibles		10	22	Intangibles		32
Other Assets		35	4	Other Assets		39
	$	500	21		$	521
Deposits		400	4	Deposits		404
Borrowings		40	2	Borrowings		42
Other Liabilities		10		Other Liabilities		10
Equity		50	15	Equity		65
	$	500	21		$	521
Tangible Book Value		**40**	**(7)**			**33**
TBV Per Share	**$**	**16.00**	**$ (2.80)**		**$**	**13.20**

- Buyer must “mark-to-market,” or “fair value adjust” Target’s Balance Sheet
- Net impact of balance sheet adjustments – reduces Target’s TBV from $40 million to ~$33 million, or $13.20 per share
- Pricing to Adjusted TBV is as follows:
  - $26.00 / $13.20 = 197% vs. 163% of stated TBV

M&A Vocabulary – Deal Pricing

GRIFFIN FINANCIAL GROUP LLC

Another Way to Look at Adjusted TBV

- In addition to balance sheet fair value adjustments, restructuring ("merger" or "one time") charges can also impact a deal

- Examples of restructuring charges include:

  - Executive employment agreements
  - Severance
  - Contract terminations
  - Branch closures
  - Systems conversions

M&A Vocabulary – Deal Pricing

GRIFFIN FINANCIAL GROUP LLC

Merger Charges and Adjusted TBV

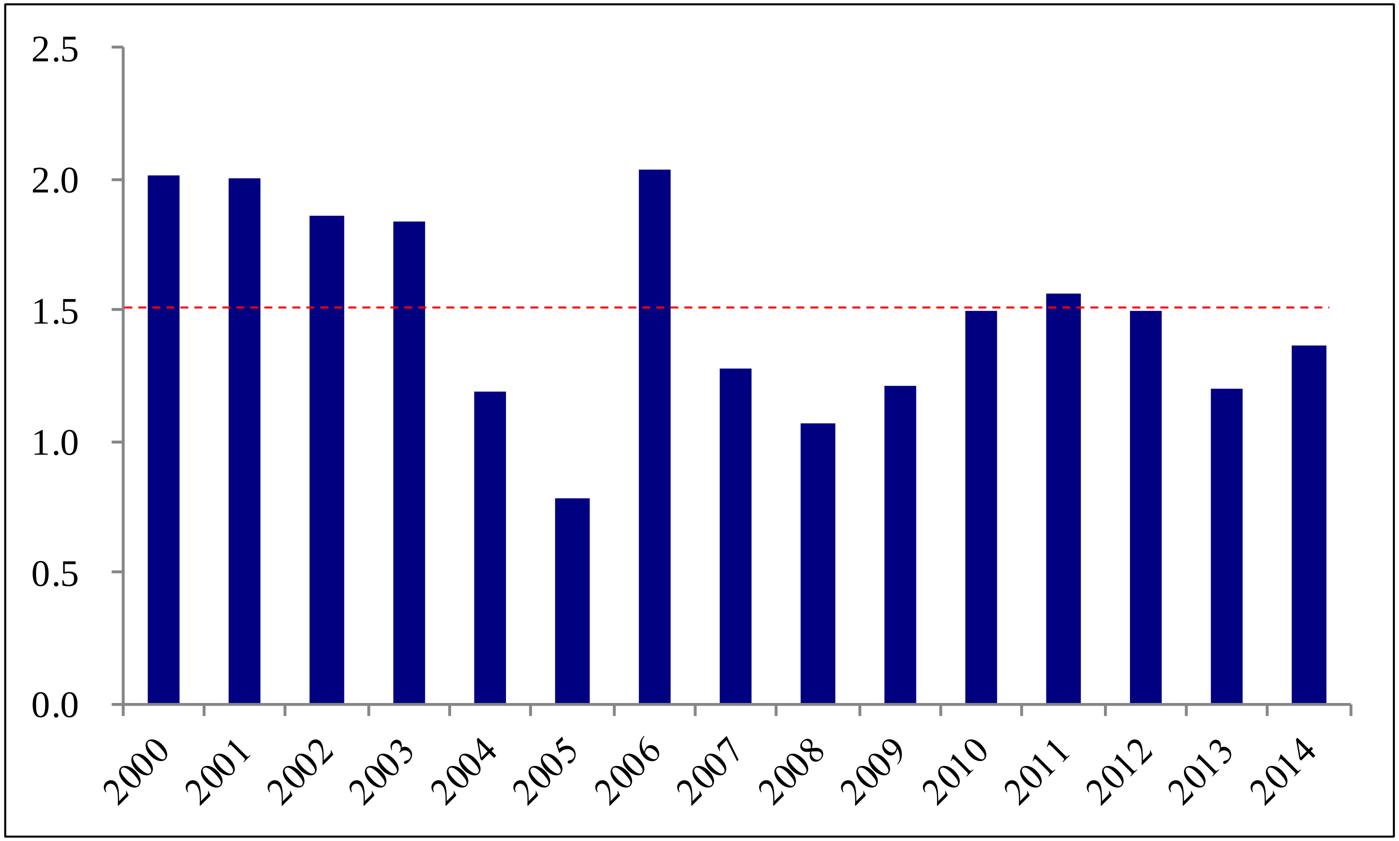
- While adjusted TBV is generally not reported or disclosed, its impact on the Buyer is real, especially when calculating the TBV dilution and earn-back (more on those terms later)
- Restructuring charges such as data processing contract termination and severance also serve to dilute TBV

TBV after fair value adjustments:	$33 million
Assumed restrucuring charges:	($3 million) after tax
Adjusted TBV, net of restructuring charges:	$30 million
Purchase price:	$65 million
Price/Adjusted "Final" TBV:	**217%**

M&A Vocabulary – Deal Pricing

GRIFFIN FINANCIAL GROUP LLC

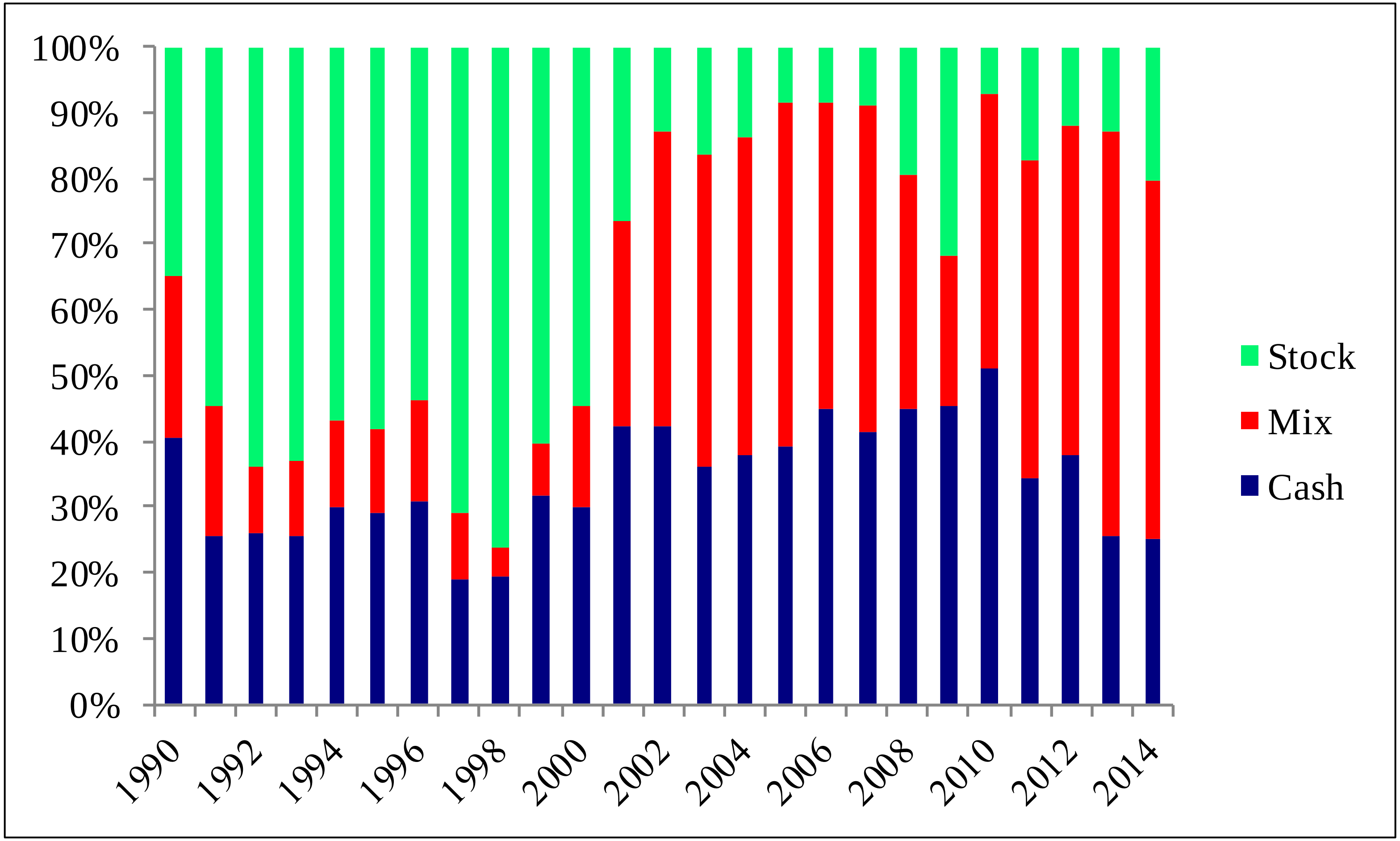
One-Time Merger Charges as % of Annual Cost Savings



*For nationwide deals of any size where both merger charges and cost savings were available, based on median values.

M&A Vocabulary - Consideration Mix

- Deals would be easy if they were all cash, all the time;
- However, the need to capitalize the Target's balance sheet, the increased cost of deals due to mark-to-market rules, and tax considerations, make most deals stock-based.



*Average consideration mix with minimum deal value of $10M.

M&A Vocabulary – Consideration Mix

Let's Revisit Our $65 Million Deal

- Buyer's stock currently trades at $40.00 / share
- Assume deal is 100% stock
- Target S/H would receive 1.625 million shares of Buyer stock ($65M / $40.00)
- "Exchange Ratio" is .6500 (1.625M Buyer shares / 2.500M Target shares)
- But what happens if Buyer's stock price drops?
- Seller **THINKS** they are getting 163% of TBV for their S/H ($26.00 / current TBV / Share of $16.00) – Are they? It depends on our next concept…

Fixed Price vs. Fixed Exchange

- **Fixed Price** – It is what you think it is! Same as a cash price
- Considerations for Buyers and Sellers

	Pros	Cons
Buyer	If stock price goes up during executory period, deal becomes more accretive	If stock price declines, deal becomes more expensive
Seller	Price certainty	Could be leaving money on the table, if Buyer stock performs well

M&A Vocabulary – Exchange Ratio and Price Protection

GRIFFIN FINANCIAL GROUP LLC

Fixed Price vs. Fixed Exchange

- **Fixed Exchange Ratio** – Seller receives a fixed number of Buyer shares for each share
- Final pricing metrics (P/ TBV, P/ E) are not known until deal closes, although levels at announcement are a good proxy

	Pros	Cons
Buyer	Deal economics are "locked in" – set number of shares being issued, regardless of executory price performance. EPS accretion, TBV dilution is more certain	If the market, or Buyer specifically, performs well during executory period, Buyer could end up "paying" more for Target franchise (although, with a stronger currency)
Seller	Seller gets to participate in upside of Buyer from time of setting of exchange ratio	Seller gets to participate in downside of Buyer as well

M&A Vocabulary – Exchange Ratio and Price Protection

GRIFFIN FINANCIAL GROUP LLC

Caps, Floors, Collars and Walkaways

- **Caps** - One sided protection that limits upside a Target can receive (and a Buyer must pay) in a deal
  - Example: Fixed exchange of .625 shares, up to a Buyer stock price of $44.00
  - Above $44.00 Buyer stock price, deal to target becomes fixed price at $28.60 ($44 / $40 times $26.00 offer)
- **Floors** - One-sided protection that limits downside a Target can receive
  - Fixed exchange of .625 shares, down to a Buyer stock price of $36.00
  - Below a $36.00 Buyer stock price, deal to Target becomes a fixed price at $23.40 ($36 / $40 times $26.00 offer)
- **Collars**
  - Combination of a cap and a floor
  - Almost all deals that employ price protection use collars, in order to offer two-sided protection
  - Collars can be used on fixed price (fixed price within collars, fixed exchange thereafter) or fixed exchange deals (fixed exchange within collars, fixed price outside the collars)

M&A Vocabulary – Exchange Ratio and Price Protection

How Common is Price Protection?

- Fixed value transactions (floating exchange ratio) are most common in bull markets or in periods where buyers expect their stock price will rise. A fixed value coupled with a rising stock price will result in a more accretive deal value for the buyer at closing.
- Fixed value transactions often include total value collars – a cap and floor set on the exchange ratio to protect against excessive ownership and TBV dilution. This protects the buyer if its stock price declines and the target if the price increases
- Fixed exchange transactions are most common in a bear market or periods of high volatility. A fixed exchange coupled with a rising stock price will result in a higher deal value at closing.
- Fixed exchange transactions are often collared such that the exchange ratio is only fixed providing the buyer's stock price stays within a certain range. Changes within the range do not impact the exchange ratio, so the total deal value floats within the range
- Walk away provisions for pricing changes that violate the collars can provide additional protection, but add to execution risk
- Coming out of the recession, buyers are more wary of price volatility and downside to their stock price, and are therefore more eager to lock in EPS and TBV numbers upfront, resulting in a sharp increase in fixed exchange ratio deals

M&A Vocabulary – Exchange Ratio and Price Protection

GRIFFIN FINANCIAL GROUP LLC

Walk away / Termination Provisions

- In addition to various legal causes for termination, stock-based deals also typically have a "**walk away**" provision giving the seller the right to terminate the deal if:
  - The Buyer's stock falls by greater than an absolute amount (usually negotiated somewhere in the range of 15-25%);
  - The Buyer's stock falls a certain amount relative to a benchmark index
    - This could be a common market index (such as the Nasdaq Bank Index), or it could be a custom list of banks by size and/or geography
    - The % decline relative to the index may be the same as the absolute decline, or a separately negotiated level, but it generally also falls in the same 15-25% range
  - The existence of both measures is commonly referred to as a "dual trigger" or "double trigger" walk-away provision

- What buyers and sellers want here depends on the deal structure:
  - In a fixed exchange ratio deal, buyers have more certainty and therefore want a higher threshold before walk away rights are triggered;
  - In a fixed price deal, there is more price pressure on the buyer who therefore might want a lower threshold, especially if no other price protection is present and they have concerns over pro forma EPS accretion.

GRIFFIN FINANCIAL GROUP LLC

M&A Vocabulary: Other Considerations

M&A Vocabulary – Merger Agreement

- **Reps and Warranties**
  - These are factual statements about your bank – its assets, its liabilities, its contingencies – that you are willing to put to writing
  - In many agreements, these statements tend to be reciprocal (the buyer will represent the same things you do), but if your bank is struggling, expect a longer list
- **Covenants**
  - This list of items generally dictates the rules of the road between the date of signing and closing (the "executory period")
  - Items such as monthly reports the seller will provide the buyer, access to meetings, what things the seller can do without the buyer's consent, etc., plus many other items (D & O insurance, employee-related matters)
  - The "no-shop" provision limiting the seller's ability to shop the company for a better bid is one of the more carefully negotiated covenants

M&A Vocabulary – Merger Agreement

- **Conditions**
  - This section lists specific things that must happen before the closing date
  - Shareholder approvals, regulatory approvals, do certain financial thresholds need to be met, etc.
- **Disclosure Schedules**
  - A sometimes forgotten but critical piece of the puzzle
  - Many agreements contain lengthy reps and warranties with positive affirmations (“we have no stock options outstanding…”), with a disclosure schedule as the “out” (“…other than the options listed on Disclosure Schedule 4.12”)
  - It is important to sync up your due diligence request list with your disclosure schedule list – this can save valuable time (and headaches) at the end of the merger agreement process

M&A Vocabulary – Compensation Issues

GRIFFIN FINANCIAL GROUP LLC

- **Executive Compensation**

  - Critical to understand the size and nature of these arrangements early on – many deals crater due to excessive management contracts, SERPs, and otherwise that increase the "price to adjusted TBV" a buyer is paying;

  - IRS section 280(G) (one of the key laws for executive compensation) is complex, but most M & A law firms and advisors are facile on these statutes and can step you through the rules – proper planning can save buyers the 20% excise tax, or more if "gross up" language exists in management contracts;

  - The general rule of 280(G) – if the contract is for two times annual base or less, there probably won't be an issue, unless the executive has a large amount of equity-based compensation flowing through their W-2 earnings within the past five years. If the contract reads 2.99 times payout, you may likely fall into 280(G), unless the executive has had very small W-2 increases in the most recent five years.

- **Employee Severance**

  - Many target companies do not have a rank-and-file severance plan;

  - If none exists, a market standard is two weeks of pay for every year of service, up to a maximum of six months.

M&A Vocabulary – Compensation Issues

- **Stay bonuses / retention pool**

  - Money set aside by buyer to incent key individuals to stay past closing through other key benchmark dates, including operational conversion;

  - Amount of the pool most often negotiated up front; buyer and seller work jointly to figure out who to incent and how to allocate.

- **New employment agreements**

  - Many times it can be critical to ensure that key executives of the seller remain following closing, by executing new employment agreements;

  - Depending on the nature of the existing employment agreements of these executives (single trigger, double trigger), it may often be the case that these individuals get paid out their existing agreement plus sign a new one;

  - These agreements should be signed concurrent with the merger agreement. Do NOT figure on handling these later as part of integration. The buyer has the most leverage before the merger agreement is signed, and the ability of executives to hold the deal hostage after the fact if employment agreements need to be negotiated then is high.

GRIFFIN FINANCIAL GROUP LLC

M&A Vocabulary: Pro Forma Results

M&A Vocabulary – Pro Forma Results

GRIFFIN FINANCIAL GROUP LLC

EPS Accretion / Dilution – Where It All Comes Together

- Buyer's shares outstanding: 10,000,000
- Buyer's market price - $24.00
- Buyer's market cap – 10,000,000 multiplied by $24.00 = $240 million
- Buyer P/ TBV – 160%
- 2015 estimated earnings: $16 million
- Buyer's stand-alone 2015 EPS: $16.0 million / 10.0 million shares O/S = $1.60 EPS
- Shares issued to target ($65 million deal / $24.00 stock) = 2,708,333 new shares
- Pro forma shares outstanding: 12,708,333
- Pro forma earnings:
  - Stand-alone earnings: $16.0 million
  - Target earnings: $ 3.5 million
  - Cost savings, net: $ 1.6 million ($12 million of Target NIE x 20% savings, after tax)
  - Total earnings $21.1 million
- Pro forma EPS: $21.1 million / 12.708 million shares O/S = $1.66
- EPS Accretion / Dilution: **$.06 accretive, or 3.75% accretive**

M&A Vocabulary – Pro Forma Results

EPS Accretion / Dilution – Many Ways to Skin the Cat

- When disclosing EPS accretion / dilution, many companies report the numbers in different ways, perhaps crafting the narrative to fit their story…
  - EPS accretion can be measured / disclosed :
    - **Pro forma combined** – accountants love this method (and is required for certain SEC filings), but bears little resemblance to reality, as it applies the effects of the merger to historical periods
    - **Calendar year basis** – shows expected future effects of the deal on a quarterly progression. Helpful in understanding the incremental pick-up from a deal, if it is closing mid-year. However, merger costs and the lack of fully phased-in cost savings could cloud the first few quarters after closing the deal
    - **First year of combined operations** – projects the first four quarters after the deal closes

M&A Vocabulary – Pro Forma Results

GRIFFIN FINANCIAL GROUP LLC

What Are They Saying?

- **“The deal is expected to be accretive to EPS within the first year”**
  - This means, it may be dilutive to EPS for the first three quarters after closing, but by the fourth quarter, it will be additive to where the Buyer was expecting to be on a stand-alone basis
  - To be clearer, some Buyers will add the phrase “accretive on a run-rate basis,” but not all make it this clear
- **“The deal is expected to be accretive to the first year of combined operations”**
  - This means, during the first four quarters after closing, the net impact of the deal will be accretive to EPS vs. the stand-alone forecast of the Buyer
- Either of the above statements can be further enhanced (clouded?) by adding the phrase “**accretive, net of one-time merger charges**”
  - Because most merger charges are required to be recorded on a “pay-as-you-go” basis, the impact of these charges can cloud “normal” business results for several quarters after a merger closes
  - No set rules to govern this, although if you are a SEC registrant, your materials need to clearly disclose any non-GAAP measurements that management deems relevant to an investor’s evaluation of the company.

M&A Vocabulary – Pro Forma Results

GRIFFIN FINANCIAL GROUP LLC

Tangible Book Value Dilution – Where it All Comes Together

	Buyer	Target	Purchase Accounting Adjustments	Pro Forma
Cash + Investments	$ 225	75	-	$ 300
Loans	1,155	385	(10)	1,530
Allowance	(15)	(5)	5	(15)
Intangibles	-	10	22	32
Other Assets	135	35	4	174
	$ 1,500	$ 500	$ 21	$ 2,021
Deposits	1,200	400	4	1,604
Borrowings	120	40	2	162
Other Liabilities	30	10		40
Equity	150	50	15	215
	$ 1,500	$ 500	$ 21	$ 2,021
Shares	10,000,000	2,500,000	208,333	12,708,333
Tangible Book Value	**150**	**40**	**(7)**	**183**
TBV Per Share	**$ 15.00**	**$ 16.00**		**$ 14.40**

- Assumes an all stock acquisition by an institution 3x the size of our target bank
- Assumes the buyer's stock trades at 160% of TBV, or $24.00 per share
- Buyer TBV is diluted $7 by fair value adjustments and issues 2,708,333 new shares, resulting in TBV per share dilution of 4%
- Using cash as consideration will result in dollar for dollar additional TBV dilution, offset by a reduction in required new shares
- A stronger or weaker buyer share price will also alter the number of new shares required and per share dilution

M&A Vocabulary – Pro Forma Results

<u>The Relationship between EPS, TBV dilution, and consideration mix</u>

- **Deals that will result in <u>more</u> initial TBV dilution**:
  - 100% cash deals
    - But, they will produce immediate EPS accretion (assuming the Target has positive earnings!)
  - 100% stock deals where the per share value of the Buyer's currency is less than the adjusted TBV of the price for the Target

- **Deals that will result in <u>less</u> initial TBV accretion**:
  - 100% stock deals where the per share value of the Buyer's stock is in excess of the adjusted TBV of the price for the Target

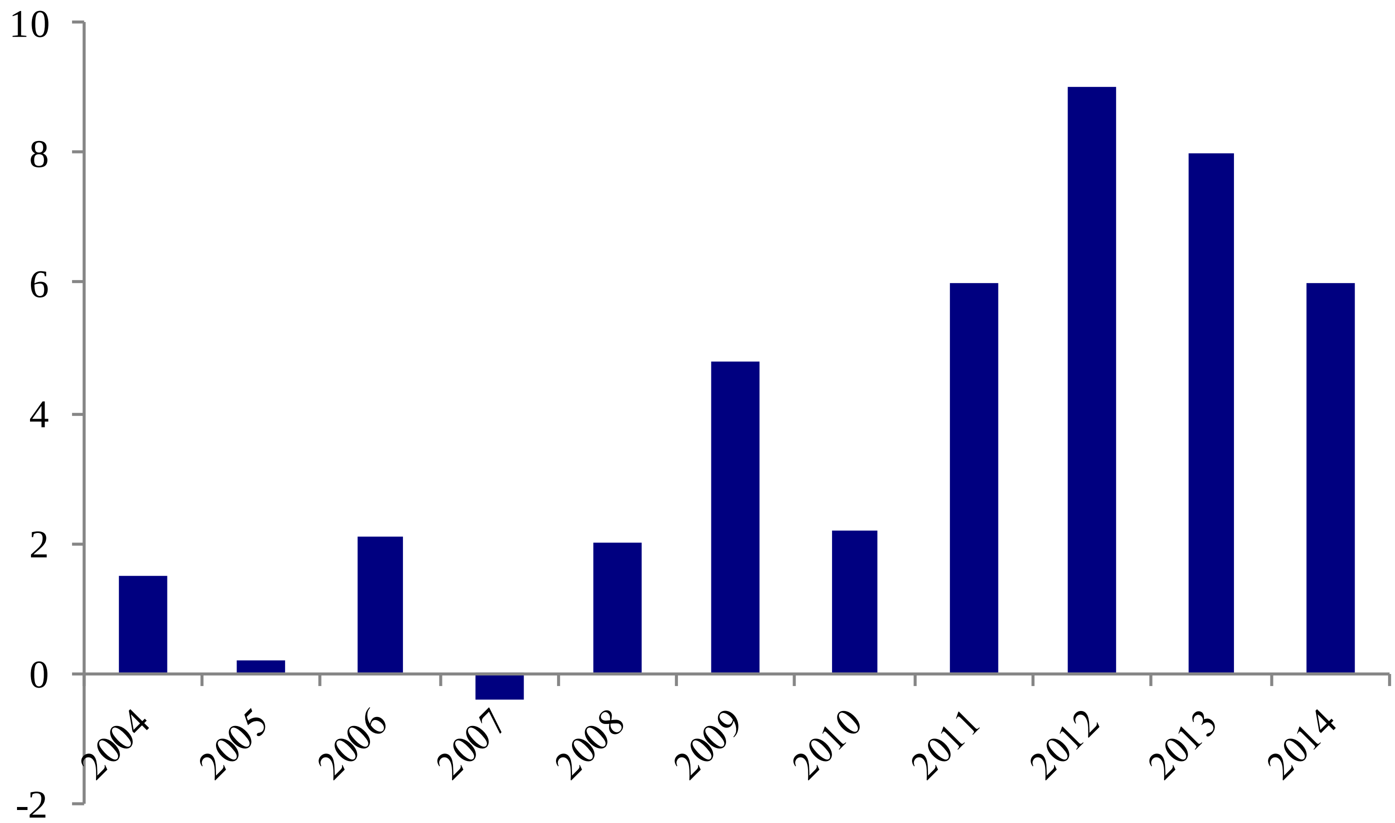
- **With mixed consideration…it depends**; but most deals result in some level of TBV dilution, especially in the post-2000 accounting environment, where fair value adjustments erode TBV

M&A Vocabulary – "Normal" TBV Dilution

- The "comfort level" for a buyer in thinking about TBV dilution can be impacted by many things:
  - Expected impact on earnings and TBV dilution earn back period
  - Strategic importance of the target
  - Shareholder sensitivities to dilution
- However in general, banks' willingness to dilute shareholder TBV wavers when approaching 10%
- In 2014, the median TBV per share dilution reported was 3%, with a median earn back period of approximately 3 years
- Note that TBV dilution earn back can mean a variety of things.
  - A pure recover analysis would mean the period required to build TBV back to pre-merger levels – "static"
  - A "crossover" approach is most widely used, which compares projected stand alone TBV to projected combined TBV – "dynamic"
- However, note that the greater the dilution and the longer the earn back, the less likely the amounts are to be reported
- Contrast this with transactions 20 years ago, where TBV dilution was rarely reported and all investors seemed to care about was earnings – because P/E ratio and not P/TBV was the dominant valuation metric

M&A Vocabulary – EPS Accretion

- The industry has long focused on earnings accretion resulting from M&A transactions. The table below shows reported EPS accretion expectations for transactions occurring over the last ten years where data was available:



*For nationwide deals of any size, based on median values.

GRIFFIN FINANCIAL GROUP LLC

Some Benchmarks To Consider

Some Benchmarks to Consider

TBV Dilution	< 5%	5-10%	> 10%
EPS Accretion	> 2%	0-2%	< 0%
Cost Savings *(% of Target's Non-Interest Expense)*	< 25%	25-40%	> 40%
Merger Costs *(Multiple of Estimated Cost Savings)*	< 1x	1.0-1.5x	> 1.5x
IRR	> 15%	10-15%	< 10%

GRIFFIN FINANCIAL GROUP LLC

The Ten Commandments of M & A

The Ten Commandments of M & A

- In order to earn the right to acquire someone else, you first need to prove that you can run your own bank day-to-day

- A low performing bank can’t buy someone else to become a better bank – you just become a larger poor performing bank!

- A bank with weak metrics is a seller, not a buyer

The Ten Commandments of M & A

- The target bank should augment and improve components of your existing business model (better growth in earning assets, better market share, better efficiency)
- Or, it should accelerate other components of your business plan (entering a new market, launching new products or services)
- It is not a business plan unto itself – it is a tool to help you get to your pre-existing plans
- One exception to this – at times, a purely financially-motivated deal (a smartly priced small deal, but in a non-strategic market) may be a way to reach your ultimate goal (resultant larger market cap brings more strategic targets into play)

The Ten Commandments of M & A

- Have the corporate humility and honesty to know what you are good at…and what you're not good at
- Don't do a deal that pulls you into new markets or new lines of business if you don't have the expertise to manage it
- A bank that does a few things very well generally out-performs a bank that does many things not-so-well

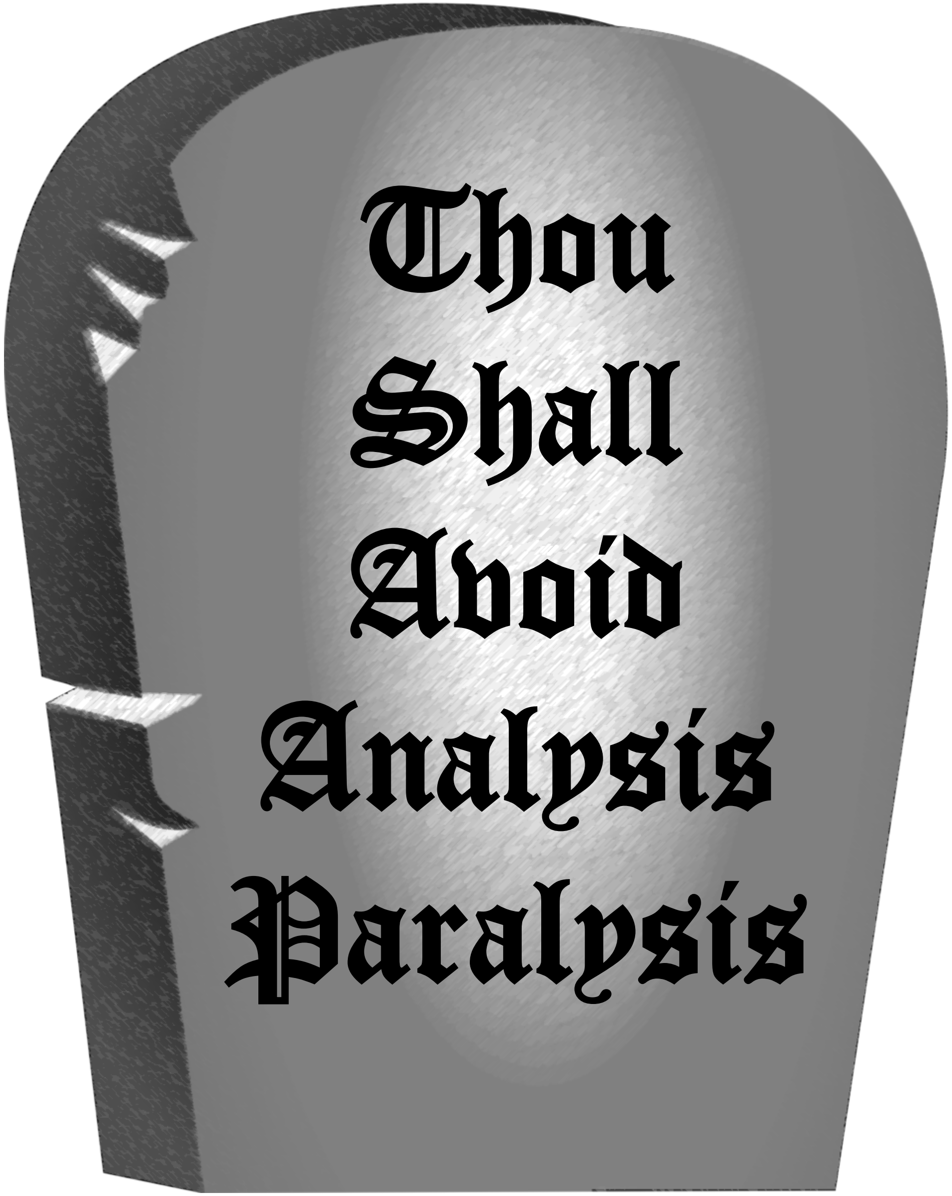
The Ten Commandments of M & A

- The buyer is not necessarily smarter or better than the target bank across the board – just bigger
- Have the humility to truly employ best practices – which may require tough decisions
- Highlights the need to assess cultural fit as strongly as financial and strategic fit

GRIFFIN FINANCIAL GROUP LLC

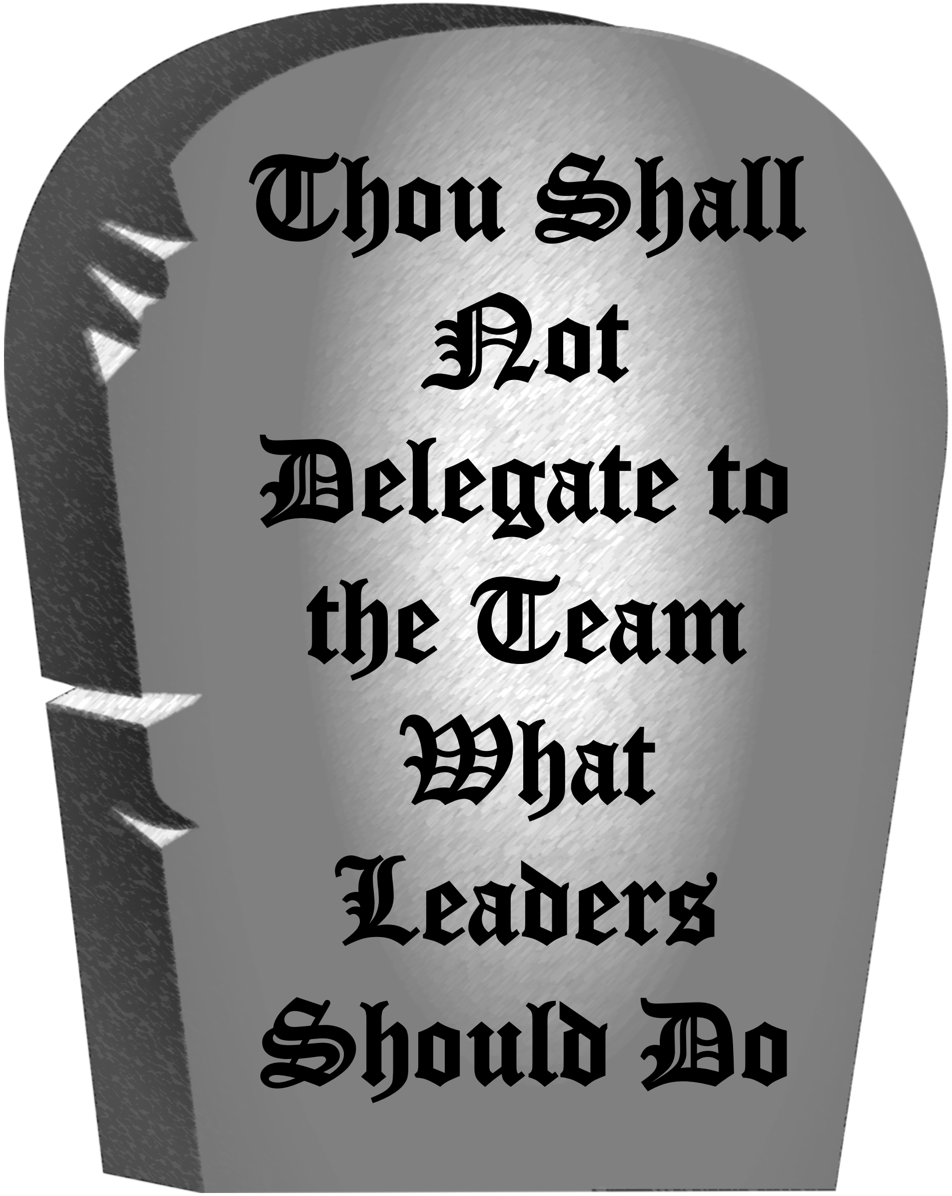
- You may have always wanted this target, but if the numbers don’t work, walk away
- Strategic opportunities tend to be like taxi cabs – there’s usually another one coming around the corner sooner than you think
- Discuss with your Board and advisors what your strategic criteria should be
- But…

The Ten Commandments of M & A



- M & A requires quick, decisive leadership to be successful
- Nothing good generally happens in M & A with the passage of time – sellers get cold feet, buyers get “buyer’s remorse,” new bidders may emerge
- Periodic pre-screening of target lists (if you’re a buyer) or buyer lists (if you’re a seller) can make banks more responsive when strategic opportunities emerge

The Ten Commandments of M & A



- CEOs drive the culture and the vision for the bank, and need to be at the bow of the ship for any M & A process

- Your due diligence team must include the senior staff of your bank

- They will "own" their piece of this after the deal, so it is critical to get their buy-in upfront

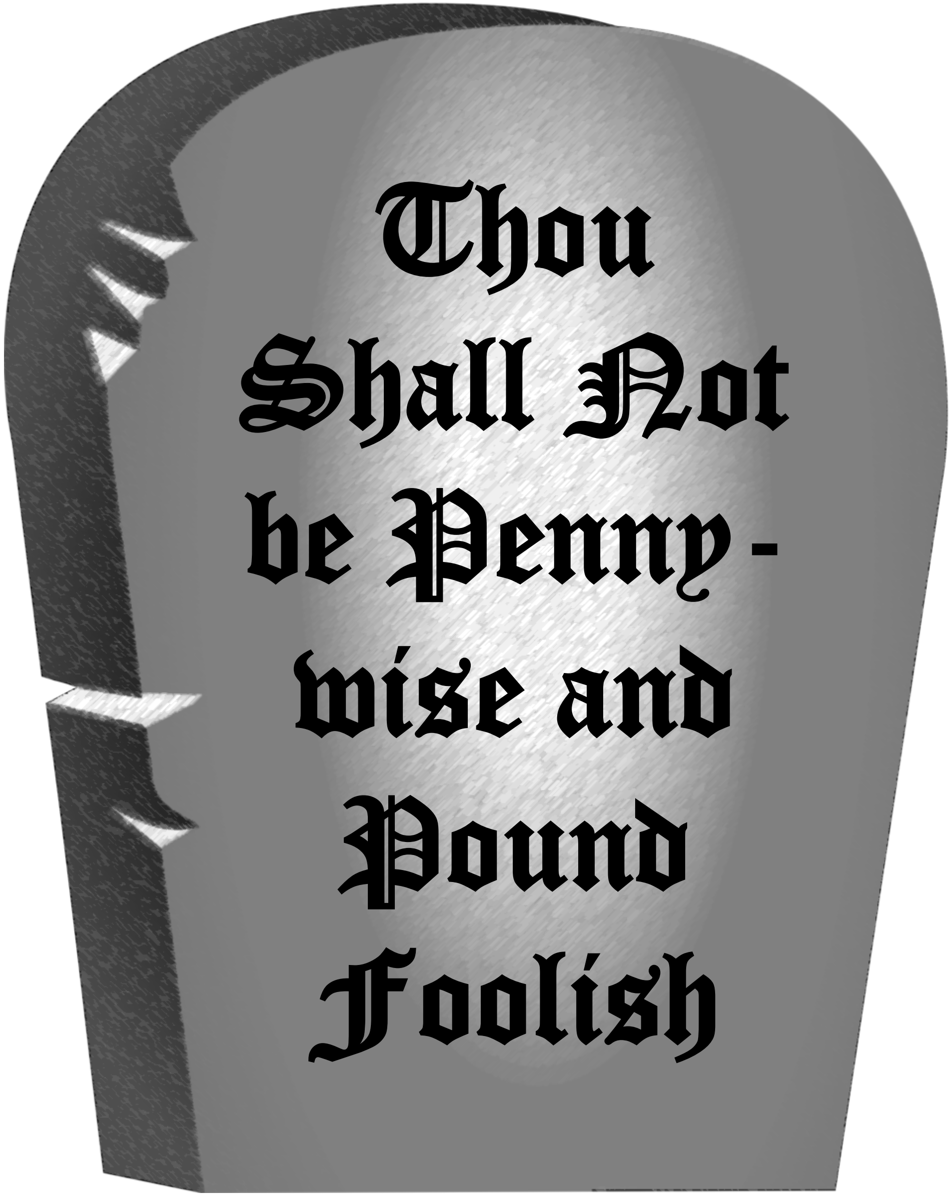
- But…

The Ten Commandments of M & A

- Pay attention to what your credit folks and your IT folks find during due diligence – closely

- The devil is always in the details of any transaction

- Ignoring credit, IT, or compliance concerns can turn a good deal into a very bad deal – quickly



- Preserving the long-term strategic elements of a deal is more important than next quarter's EPS
- If a deal is close, it is generally better to give financially (pay an extra $ to the seller, keep an extra branch open for a period of time) than to give on strategic factors (who will be the CEO, exiting a non-core, risky line of business, Board seats, etc.)
- Shareholders will be more rewarded short, medium, and long-term if a company's vision, mission, culture and operating philosophies remain focused and true to "who you are"

The Ten Commandments of M & A

- Your banker brings unique perspectives to the transaction
- We do this 365 days a year – you may sell your bank once, or buy someone else once a year
- Do not substitute your lawyer for your banker, or your banker for your lawyer – each have critical roles to perform

GRIFFIN FINANCIAL GROUP LLC

Speaker Biographies

Speaker Biography

Mark R. McCollom
Senior Managing Director, Co-Head of Financial Institutions Group
Griffin Financial Group, LLC
Phone: (6106) 478-2106
mrm@griffinfingroup.com

Mark McCollom is a senior member of Griffin's Financial Institutions Group, where he provides merger and acquisition advisory, capital formation, and strategic alternative services to bank executives, directors, stockholders, and investors. Calling on his more than 25 years of experience as a senior financial executive in the banking industry, Mark works with both regional and community banks and thrifts, specialty lenders, and asset managers.

Over the course of his career, Mark has coordinated the financial and operational aspects of more than 50 acquisitions encompassing $57.3 billion in assets with a combined transaction value in excess of $6 billion. Additionally he coordinated over 20 debt and equity financings totaling in excess of $10 billion.

Prior to joining Griffin, Mark was Chief Financial Officer for Sovereign Bancorp, Inc. and Sovereign Bank, a financial institution with approximately $90 billion in assets and 12,000 team members with principal markets in the Northeastern United States. During his tenure at Sovereign, he was responsible for corporate strategy and development; the treasury, accounting and financial reporting functions; investor relations and management reporting; budgeting; corporate real estate; and tax.

Mark was instrumental in executing Sovereign's acquisition and capital markets programs, which permitted Sovereign to grow from less than $500 million to approximately $90 billion in assets with total shareholder returns exceeding sector and broader market indices during his tenure. Prior to joining Sovereign, Mark was a senior corporate development officer at Meridian Bancorp.

A CPA, Mark is a member of the American Institute of Certified Public Accountants and the Pennsylvania Institute of Certified Public Accountants. He is also a member of the CFO Councils for both the Financial Services Roundtable and the BAI. He serves in a leadership capacity in several nonprofit organizations.

Mark received a B.S., with high distinction, from the Pennsylvania State University. He is a licensed General Securities Principal.

Speaker Biography

Richard L. Quad
Senior Managing Director, Co-Head of Financial Institutions Group
Griffin Financial Group, LLC
Phone: (646) 254-6387
Cell: (917) 796-7396
rlq@griffinfingroup.com

Mr. Quad is a Senior Managing Director and Co-Head of the Financial Institutions Group at Griffin Financial, where he is a trusted advisor to management teams and boards of directors of banks largely $10 billion in assets and below, located in the Northeast and other select geographies. Mr. Quad joined Griffin in August 2012, prior to which he was most recently Managing Director and Head of U.S. Financial Institutions M&A for RBC Capital Markets, where he had been since 2001. Mr. Quad joined RBC following its acquisition of Tucker Anthony Sutro, where he was a Vice President in the Financial Institutions Group.

Mr. Quad has completed buy-side and sell-side acquisitions, common stock, preferred and trust preferred offerings, and general advisory engagements for clients throughout the Eastern and Midwestern United States. Some of the assignments that Mr. Quad has completed include the sale of RBC Bank USA to PNC Financial Corporation, the FDIC-assisted acquisitions of Wakulla Bank and Gulf State Community Bank by Home BancShares, Inc., book run common stock offerings for Bar Harbor Bankshares, CNB Financial Corporation, Wintrust Financial Corporation, Home BancShares, Inc., Metro Bancorp, Inc. and Republic First Bancorp; a contingent convertible senior note offering for Alesco Financial Inc., the merger of Westborough Financial Services, Inc. into Assabet Valley Bancorp, the sale of Capital Crossing Bank to Lehman Brothers; the sale of Community Capital Bank to Carver Bancorp, Inc.; the sale of Mystic Financial, Inc. to Brookline Bancorp; an offering of REIT preferred securities for Capital Crossing Bank; the sale of specialty lender AmeriFee Corporation to Capital One Financial Corporation; the acquisition by Richmond County Financial Corporation of seven branches from FleetBoston Financial Corporation; a trust preferred offering for Sovereign Bancorp; and the acquisitions of North American Bank Corporation and thirteen branches of Shawmut Bank for Banknorth Group, Inc. while running Bankorth's internal M&A function.

Prior to joining Tucker Anthony Sutro, Mr. Quad was a Vice President in the Financial Institutions Group at Advest, Inc., where he also worked with financial institutions clients. Preceding Advest, Mr. Quad was Vice President and Director of Mergers and Acquisitions for Banknorth Group, Inc., at the time a $2 billion bank holding company headquartered in Burlington, Vermont, where he founded the company's internal M&A function and coordinated the bank's first two acquisitions and an internal restructuring of the company's trust subsidiaries. At Banknorth, Mr. Quad also gained valuable experience in cost accounting and budgeting, asset/liability management, consolidation accounting and SEC and regulatory reporting.

Mr. Quad holds a B.S. in Business Administration from The University of Vermont, magna cum laude, and an M.B.A. from Cornell University, with distinction. Mr. Quad is a Series 7 and Series 63 registered representative.

Disclosure Statement

This presentation is not considered complete without the accompanying oral presentation made by Griffin Financial Group LLC ("Griffin").

Any projections or recommendations contained herein involve many assumptions regarding trends, company-specific operating characteristics, financial market perceptions and the general state of the economy as well as internal factors within management control, such as capital investment. As such, any projections contained herein represent only one of an infinite number of outcomes and should not be construed as the only possible outcome.

The information contained in this presentation and attached exhibits have been obtained from sources that are believed to be reliable. Griffin makes no representations or warranties as to the accuracy or completeness of the information herein.

All terms and conditions contained herein are based upon current market conditions and are estimates based upon prevailing market rates. Any or all estimates may or may not change as market conditions dictate. As such, any or all terms and conditions presented herein are preliminary in nature and should not be construed, either in whole or in part, as a commitment to perform or provide any specific services. Any and all services that may be provided by Griffin or any other entity referred to in this discussion outline will be contingent upon the signing of a proposal or contract.

Griffin does not provide legal, tax or accounting advice. Any statement contained in this communication (including any attachments) concerning U.S. tax matters was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code, and was written to support the promotion or marketing of the transaction(s) or matter(s) addressed. Clients of Griffin Financial Group LLC should obtain their own independent tax and legal advice based on their particular circumstances.