

# What's Ahead For Mergers & Acquisitions

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# Effects of Dodd-Frank on Community Bank Strategic Planning and M&A

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- New capital requirements, focus on equity as Tier 1 capital
- Regulatory consolidation and Consumer Financial Protection Bureau
- Stricter holding company regulation
- More active compliance enforcement by Federal banking regulators
- More scrutiny over executive compensation / corporate governance
- More regulatory scrutiny over M&A, particularly larger M&A deals
- Increased pressure on smaller banks to consolidate as they incur greater compliance costs

# New Capital Requirements

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- Regulators must establish new minimum leverage and risk-based capital requirements for banks, holding companies at no less than current levels.
- Consolidated holding company capital must be at least at bank levels, hybrid capital (trust preferred / debt) no longer “Tier 1” capital (subject to phase-out period).
- Regulators must establish “activity-based” capital requirements to address risks like investment in derivatives, transactions in securitized products, financial guarantees, repurchase agreements, concentrations of assets.
- Regulators to establish “countercyclical capital principles” – additional capital during expansion periods, less capital needed during downturns.
- FRB expects to finalize rule implementing Basel III and new capital rules by 2012 with implementation in 2013.

# New Capital Requirements

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## Effective Dates For Consolidated Holding Company Requirements:

- Debt / Hybrid Instruments issued **on/after** May 19, 2010 – **not** grandfathered
- Debt / Hybrid Instruments issued **before** May 19, 2010 held by BHCs **at/over** \$15B (as of 12/09) – **not grandfathered**, subject to phase out capital treatment over 3 years starting January 1, 2013
- Debt / Hybrid Instruments issued **before** May 19, 2010 held by BHCs **under** \$15B – grandfathered
- Holding companies not regulated by the FRB as of May 19, 2010 – new capital requirements will not apply for 5 years (all SLHCs)
- Small BHCs (under \$500M but not SLHCs) still not subject to new consolidated capital requirements, FRB policy continues
- Instruments issued to US Government (TARP, CCP, SBLF, etc.) not subject to new requirements

# New Capital Requirements

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No Mandated Timetable For New Capital Requirements:

- No timetable **BUT** higher requirements already imposed through examination / application process – regulators want 10% (Tier 1) and 10-12% (Risk-based), de novos now need 10-12% capital
- Many expect higher requirements will come through adjustment of risk weightings and added “activity risk” or “countercyclical” components

# Regulatory Consolidation - Summary

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- OTS merged into OCC on July 21, 2011
- OTS authority over federal thrifts given to OCC
- OTS authority over state S&Ls given to FDIC
- OTS authority over SLHCs given to FRB
- Home Owners' Loan Act preserved, federal thrift and SLHC charters preserved (mutual/stock), dual banking system preserved (state charter still an option)

# Regulatory Consolidation

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- OTS orders, determinations, regulations, agreements and interpretations are treated as if issued by OCC, FDIC or FRB (as applicable) and remain effective “until modified, terminated or superseded” by the OCC, FDIC and FRB
- OCC, FDIC and FRB have incorporated regulations of the OTS that they will enforce and have published that list in the Federal Register
- New Deputy Comptroller for federal thrifts
- While HOLA has not been amended and general powers of thrifts and savings and loan holding companies have not been revised - OCC, FRB and FDIC now have an opportunity to revise all the regulations and policies of OTS

# Bank and Holding Company Regulation

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- No new “non-bank” banks – FDIC prohibited for 3 years from insuring industrial banks, credit card banks or trust banks controlled by “commercial firm” (15% test)
- FRB can regulate and examine all holding company subsidiaries, including functionally regulated subsidiaries, must coordinate with other regulators
- Source of Strength Doctrine now codified - all BHCs and SLHCs must act as source of strength for bank subs, must provide financial assistance during “financial distress” of bank subsidiary
- Regulators may not approve any interstate bank acquisition by BHC unless the BHC is “well capitalized” and “well managed” and the resulting bank must continue to be “well capitalized” and “well managed”

# Bank and Holding Company Regulation

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- 10% nationwide concentration limit – cannot acquire if consolidated liabilities would exceed 10% of all financial companies or if would result in 10% of deposits nationwide
- Broadens scope of 23A and 23B – adds to list of “covered transactions” with affiliates, transactions involving securities borrowings/lending and derivative transactions
- National bank lending limits to be revised to include credit exposures arising from derivative transactions, repurchase agreements, reverse repurchase agreement, and securities borrowing and lending as credit extensions – state banks may only engage in derivative transactions if state lending laws take credit exposure into account (effective July 2011 for national banks and 18 months for state banks)

# Bank and Holding Company Regulation

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- No charter conversions if subject to supervisory action, agreement or order, except in cases where both chartering authorities agree to change
- Savings associations that convert to banks may continue any branch maintained at time of conversion and open new branches in state to same extent as bank chartered in such state
- National and state banks can branch *de novo* if under laws of state where branch to be located, a state bank chartered in such state can open branch in that state (i.e. anywhere)

# Bank and Holding Company Regulation

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- All BHCs and SLHCs >\$10B in assets must conduct annual stress tests and report results to the FRB and its primary federal regulatory authority
- FDIC granted back-up examination and enforcement authority with respect to all depository institution holding companies, but not as to a holding company “that is generally in sound condition and whose conduct does not pose a foreseeable and material risk of loss to the DIF”
- New penalties for failing QTL Test - failure will result in immediate restrictions and possible enforcement action rather than just requiring the thrift to become a bank within 12 months or becoming subject to certain asset growth restrictions

# Bank and Holding Company Regulation

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- QTL failure imposes limitation on dividends to holding company - dividends may only be paid if: 1) amounts would be payable by a national bank, 2) dividend is necessary for holding company to pay its obligations, and 3) if approved by the OCC and FRB
- Effect of any new QTL failure penalties and restrictions on “Section 10L holding companies” (SLHCs with state bank chartered subsidiaries) is somewhat unclear

# Compliance and Enforcement

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- Federal banking regulators have issued hundreds of formal enforcement orders
  - Banks no longer receive the benefit of the doubt
  - All issues regarding compliance and safety and soundness are on the table
- Closer scrutiny by regulators of staffing, internal controls, policies and procedures
- Compliance issues can derail an M&A transaction – acquirors need to demonstrate they can manage an acquisition
- Safety and soundness and compliance issues with seller can affect the regulatory approvals for buyers

# Corporate Governance/Executive Compensation

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## Bank and Holding Company Compensation Standards:

- Dodd-Frank required FRB, in consultation with OCC and FDIC, to issue rules prohibiting unsafe and unsound compensation practices by BHCs
- March 30, 2011 Proposed Rule issued by all federal bank regulators
- Explicitly applies to BHCs and banks over \$1 billion but rules will likely be applied to all BHCs and banks through examination process
- Provides more detail on what is “excessive” and what promotes risk, imposes new procedures and reporting requirements

# Effect on Strategic Planning and M&A

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- M&A activity is at decreased levels due to asset quality issues and economic stress
  - Due diligence is more critical than ever before
  - Loan portfolio review; compliance concerns; benefit plan administration; executive compensation issues
  - Due diligence will drive substantive merger agreement provisions, e.g., definition of MAE, negative covenants
- Pricing has declined (even though premiums to market can still be significant), as both acquisition multiples and buyer currency (stock price) have declined
- Novel deal structures and terms are being used to get deals done

# Effect on Strategic Planning and M&A

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- Regulatory scrutiny and review is more demanding
  - Required capital ratios have increased across the board, and pro forma capital ratios will be closely scrutinized
  - Pro forma loan concentrations and asset quality issues will be scrutinized
  - Regulatory consolidation and uncertainty complicate the landscape –raises substantive and timing issues; Bureau of Consumer Financial Protection could have significant impact
  - Capital requirements with respect to SLHCs are not effective for 5 years - will FRB consider holding company capital levels or other regulatory issues for SLHCs involved in M&A?

## Effect on Strategic Planning and M&A

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- Regulators seem less tolerant of smaller banks inability to have adequate earnings, lower capital and robust compliance programs – “we cannot afford it” is not an acceptable excuse
- Regulatory processing and review is taking much longer

# Effect on Strategic Planning and M&A

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- Dodd-Frank will require new disclosures and a shareholder vote on golden parachute payments in merger transactions for all SEC reporting companies
  - For shareholder meetings on or after January 21, 2011 that relate to shareholder approval of an acquisition, merger, sale or disposition of assets, disclosures in “clear and simple terms” of all payments to NEOs that are based on or related to the transaction must be provided
  - The proxy statement must include a nonbinding proposal enabling shareholders to vote to approve the golden parachute payments, unless the arrangements have previously been subject to a say on pay vote
- The SEC has adopted new golden parachute disclosure rules for annual meeting proxy statements and for merger proxy statements

# Effect on Strategic Planning and M&A

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- Opportunistic acquisitions and creative transaction features have developed
  - First Niagara's acquisition of Harleystown, and the "ratchet" stock pricing – the exchange ratio for First Niagara shares (the purchase price) declined as Harleystown's NPAs increased over a threshold level
  - People's United (Connecticut) acquisition of \$2.4B Smithtown Bancorp (NY) for an aggregate purchase price of \$30 million, in cash and People's stock
  - M&T acquisition of Wilmington Trust for tangible book value per share - \$10.4 billion of assets, \$58 billion of assets under management, acquired for \$320 million of M&T stock

# Effect on Strategic Planning and M&A

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- De-banking transactions – troubled institution sold by holding company, with holding company retaining deposit premium and problem assets. BB&T – Bank Atlantic Bancorp, Inc.
- Purchase agreement that provides additional consideration to shareholders based on performance of problem assets. Sterling Financial Corporation – First Independent Investment Group.
- Merger agreement that provides for the simultaneous agreement to sell problem loans and real estate to third party hedge fund. Investors Bancorp acquisition of BFS Bancorp/Brooklyn Federal Savings

## Effect on Strategic Planning and M&A

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- M&A activity likely to accelerate as regulatory/compliance burdens increase, profitability is squeezed and scale becomes more important. Dodd-Frank may be “last straw” for many smaller banks that have insufficient scale to absorb new compliance costs
- For community bank acquirors, critical issue typically is book valuation dilution (assuming that the transaction is earnings accretive) and the time period for recoupment

# Effect on Strategic Planning and M&A

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## Regulatory Review and Processing:

- Greater scrutiny over post-transaction business plans
- Focus on pro-forma capital (need to show 9-10%)
- Focus on termination provisions
- Longer application review and processing times
- Review of executive compensation / severance
- Need for pre-filing meetings more important than ever

# Effect on Strategic Planning and M&A

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## Transactions Involving “Troubled” Banks:

- Restriction on “golden parachute” severance, even if contractual agreement exists (TARP / CCP have added restrictions)
- 280G / 409A planning more difficult
- Keeping target as separate subsidiary may not be an option
- Acquiror will need to show how deal “fixes” regulatory problems
- Keeping old management team may not be an option
- Typical deal termination payments may not be payable without regulatory approval

# Effect on Strategic Planning and M&A

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## Increased Litigation and NASDAQ / SEC Investigations:

- Many deals now face litigation (or announcement of investigation by plaintiff law firms) that Board breached its fiduciary duty to get best price or alleging flaws in process
- Litigation will slow processing and movement of deal due to distraction, add cost and may raise regulatory questions
- Many deals will prompt NASDAQ / Stock Exchange investigation into trading
- If finding of suspicious activity, SEC investigation may follow, will not prevent closing but will be a distraction

# Effect on Strategic Planning and M&A

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- Getting Your House in Order - Acquirors
- Review internal controls, policies and procedures
- Review staffing and personnel
  - Do you have capacity to absorb another company?
- Address any unresolved supervisory issues and communicate with your regulator
- Review your business plan
  - An acquisition may require an updated or new business plan
- Have periodic reviews of the market and deal issues with legal and financial advisers
- Know what types of institutions you may acquire

# Effect on Strategic Planning and M&A

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- Getting Your House in Order – Sellers
- Assess your franchise value
  - Analyze your standing in the market place, level of core deposits, customer relationships, quality of loan assets and investment securities portfolio
- Review and update all employment and change-in-control agreements and benefit plans
- Legal review of your corporate documents – charters, bylaws, minutes, etc.
- Know what types of institutions can acquire you
- Regulatory review of ROE and any directives and/or orders

# Effect on Strategic Planning and M&A

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## M&A Planning and Execution:

- Get compensation house in order - check all “change in control” definitions for consistency and make sure you have “regulatory outs” in agreements
- Create good record of “shopping” a target and detail reasons why certain measures to shop or not to shop the target were taken
- Consider creation of independent committee to run the process and keep independent directors (or at least the lead independent director) involved with investment bankers and lawyers
- Understand directors’ fiduciary duties and responsibilities
- Advise or meet with regulators BEFORE executing merger agreement

# Effect on Planning and M&A

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- Directors need to know their fiduciary responsibilities
  - Directors have a fiduciary duty of loyalty to the corporation and a fiduciary duty of due care in the administration of corporate affairs
  - In a legal “sale” transaction (e.g., a cash transaction) the board has the duty to obtain the best value reasonably available under the circumstances
  - A stock for stock merger transaction where there is no majority (or significant controlling) stockholder on a post-transaction basis is not a “sale of control” and will not require the board to obtain the best price reasonably available

## Effect on Planning and M&A

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- In a “sale” transaction, there is no single blueprint that directors must follow to satisfy the duty to obtain the best value reasonably available – a public auction, canvassing the market and “go shop provisions” are typical practices
- Case law suggests that every merger agreement, whether involving a “sale of control” or not, must include a “fiduciary-out” clause enabling the target board to agree to a superior proposal if one is forthcoming from a third-party

# Effect on Planning and M&A

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- A board of directors “is under no obligation, in the abstract, to submit to a sale of control”
  - A board of directors may determine in good faith that the continuing independence of the corporation is in the long-term best interests of the corporation and its stockholders
- A board is not obligated to accept or pursue an offer because it represents a premium over a current market price, and such refusal is not evidence of a breach of fiduciary duty
  - except in a “sale of control,” the board is not under a duty to maximize shareholder value in the short-term, even in the context of a takeover
- A board is under no legal duty to engage in discussions or to negotiate with an interested party - the business judgment rule applies to the “just say no” defense

# Mergers and Acquisitions – The Process

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- Presentations by financial advisors from time to time to management and Board as to M&A market, pricing analyses, recent transactions and “dry run” examples is a recommended practice – enables management and Board of targets and acquirors to be informed and make “informed” decisions
- Possible acquisition targets can be prioritized in order of strategic importance based on preliminary analyses
  - Any deal takes significant time and effort and likely takes the company out of the market until completed
  - But a bird in hand.....

# Mergers and Acquisitions – The Process

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- Executive compensation and employee benefits are important components of every M&A transaction and involve tax, accounting, disclosure, ERISA, legal, regulatory and document review and drafting issues
  - Golden Parachute Rules (Part 359; IRC §280G);  
Deferred Compensation Limitations (IRC § 409A);  
Employment and Change in Control agreements;  
TARP considerations
- Identification, interpretation and quantification of compensation plans and arrangements
  - Due diligence, merger agreement drafting, pricing

# Mergers and Acquisitions –Target Process

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- Typically process begins with target Board consideration of strategic alternatives and determination to initiate process to solicit interests from potential acquirors and engage an investment banker
  - Investment banker will compile “book,” and with company counsel draft confidentiality agreement to provide interested parties
  - Parties to be approached are identified by investment banker
  - Non-binding indications of interest are requested by date certain
  - One or more parties may be invited to conduct due diligence and to present final offer
  - Insiders in trading blackout

# Mergers and Acquisitions – Acquiror Process

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- Unless CEOs are already “dancing,” process for acquiror usually begins with request from investment banker for confidentiality agreement (CA) to review “book” on target
  - Board should have discussed its willingness to participate in M&A market and be aware that from time to time management may enter into CA for possible M&A transactions
  - Prior board approval not required, provided Board is informed
  - Many potential acquirors will likely be solicited regarding a CA
  - There can be exclusive negotiations between parties, especially if stock is significant portion of merger consideration

# Mergers and Acquisitions – Acquiror Process

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- If there is interest, discussion with and report to Board (or executive or M&A committee) to approve preliminary due diligence investigation
  - Investment banker may want engagement agreement at this point
  - Target may request preliminary pricing indication, letter of interest/term sheet before further due diligence allowed
  - Management and advisors conduct preliminary due diligence
  - Virtual data room is becoming common practice
  - Extensive review of loan and investment portfolios, compliance records, and benefit plans
  - Insider trading blackout commences
  - Due diligence more important than ever

# Mergers and Acquisitions – The Process

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- If there is continued interest, proposed pricing and other deal points developed, summarized and presented to Board, along with results of due diligence
  - Stock and/or cash; exchange ratio; fixed or floating; caps and/or collars; break-up fee
  - Social issues and costs discussed – board seats; management positions; contract payouts
  - Cost savings analyzed and quantified
  - Special diligence issues identified/quantified
  - Board authorizes final term sheet or nonbinding letter of interest
  - Diligence continues until deal signed

# Mergers and Acquisitions – The Process

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- Merger agreement drafting and negotiation between the attorneys and bankers is likely next step
  - Agreement provisions should match the negotiated final term sheet and results of due diligence
  - Terms of the agreement reviewed in detail with the Board
  - Agreement will limit operations of target pending regulatory and shareholder approvals
  - There will be a Material Adverse Effect (MAE) termination provision
  - Investment bankers opine as to fairness of transaction

# Mergers and Acquisitions – The Process

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- Merger Agreement presented to and approved by both companies' board of directors and executed, followed by press release and (for public companies) an 8-K
  - Press release typically issued following close of market or before opening of market
  - An investor presentation is often utilized and filed with the 8-K, and an investor conference may be arranged – depending on materiality of the transaction
- The time period from CA to merger agreement execution can take as little as a week to several weeks or a month or more
  - Confidentiality and rumors are always a concern
  - Employee communication plan should be prepared

# Mergers and Acquisitions – The Process

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- If acquiror is public and issues shares in the merger representing 20% or more of its outstanding shares, acquiror shareholder approval required
  - A Nasdaq, NYSE and Delaware law requirement
- Acquiror shareholder approval not otherwise required and not required for a cash transaction
- Target shareholder approval always required

# Mergers and Acquisitions – The Process

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- If acquiror shares are issued, a registration statement/prospectus will be filed with the SEC and will include pro forma financial statements and target financial statements
  - If acquiror shareholder approval is required, there will also be an acquiror proxy statement
  - The history/background of the transaction will be disclosed, as well as the material terms of the merger agreement, and the compensation payments to target management
- Target shareholder approval always required and involves a proxy statement, which may be a joint document with the acquiror's prospectus/registration statement

# Mergers and Acquisitions – The Process

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- Regulatory approval is required from the primary federal regulator of the acquiring holding company and/or the bank, and any applicable state regulator
- Regulatory approval typically requires 4-6 months
- Regulatory and shareholder approvals proceed on parallel tracks

# Who Are Potential Acquirors and Targets?

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- Mutual institutions
  - May be acquired by mutual institutions and MHCs only
    - How do these transactions differ from stock company deals?
- Mutual Holding Companies
  - May be acquired by mutual institutions and MHCs only
    - See Investors Bancorp, MHC announced acquisition of Brooklyn Federal
    - Special challenges
- Credit Unions
  - May be acquired by mutual and stock institutions
- Stock Institutions and Holding Companies
  - May be acquired by other mutual and stock institutions

**New York Bankers Association**

**2011 Financial Services Forum**

**What's Next for M&A?**

November 11, 2011

Catherine A. Lawton  
Principal  
Sandler O'Neill & Partners, L.P.

# Market Update

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# Market Update

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## *Macroeconomic Environment Improving, But Effects of the Recession Linger*

- ❑ Significant hurdles ahead
  - Structural problems remain: Leverage and unemployment
  - Unprecedented damage to housing sector, the largest asset/credit class
  - Consumers still lack confidence and are looking to delever, which will curtail spending
  - Inflation beginning to take root
  - Significant long-term interest rate risk
  
- ❑ Key elements of recovery
  - Consumer and business confidence!
  - Job growth is a critical component
  - Creative solutions to housing debacle – will not recover on its own for years
  - Increased globalization of liquidity flows will be a significant factor
  - US Government policies on revenues and spending

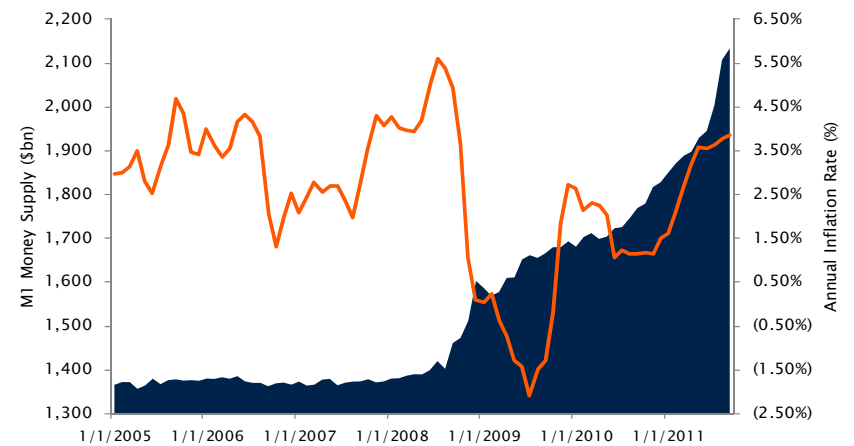
# Market Update

*Macroeconomic Environment Improving, But Effects of the Recession Linger*

## Positive Year/Year GDP Growth for the Past Eight Quarters



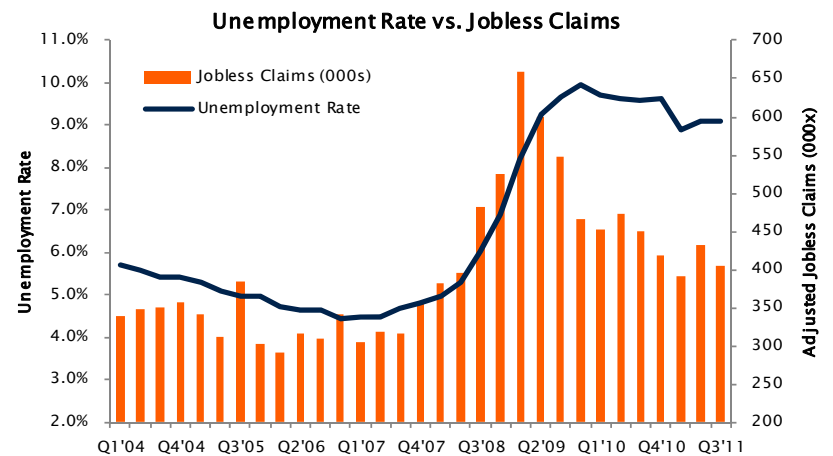
## Concerns About Inflation



## Europe is Causing Global Volatility



## U.S. Employment is Not Improving



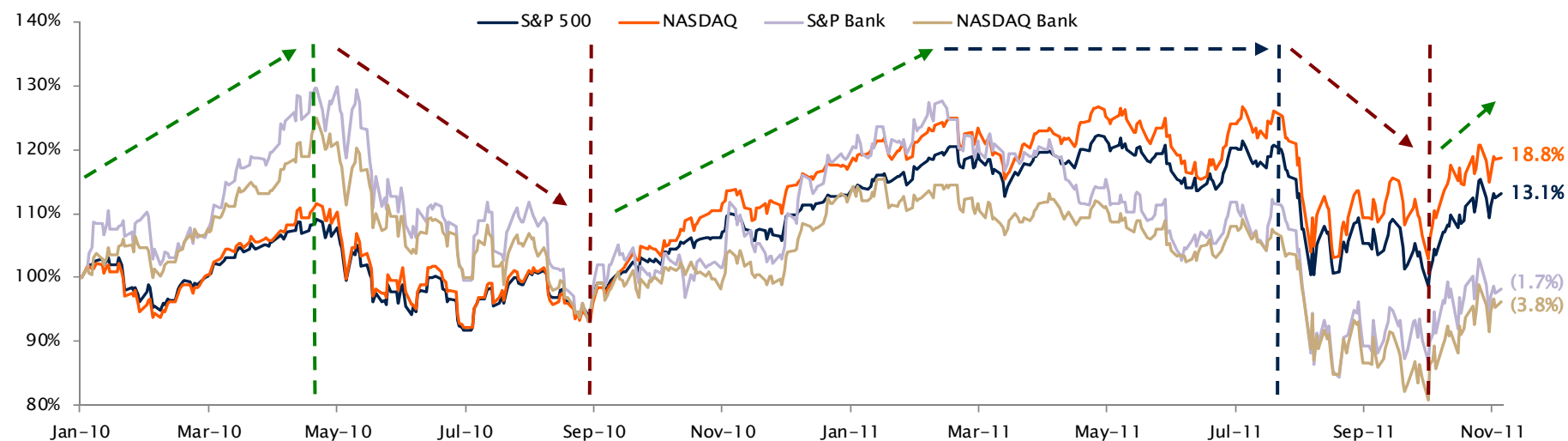
# Market Update

## Overview of Equity Market – Volatile and Directionless

### Select Equity Index Performance

	Index Value 11/7/11	Percentage of 52-Week		Index Performance					Five Recent Markets				
		High	Low	2007	2008	2009	2010	YTD 2011	1/1/10- 4/23/10	4/24/10- 8/31/10	9/1/10- 7/22/11	7/23/11- 10/3/11	10/4/11- Current
Dow Jones Industrials	12,068.39	94.2%	113.3%	6.4%	(33.8%)	18.8%	11.0%	4.2%	7.4%	(10.6%)	26.6%	(16.0%)	13.3%
NASDAQ Composite	2,695.25	93.8%	115.4%	9.8%	(40.5%)	43.9%	16.9%	1.6%	11.5%	(16.4%)	35.2%	(18.3%)	15.4%
S&P 500	1,261.12	92.5%	114.7%	3.5%	(38.5%)	23.5%	12.8%	0.3%	9.2%	(13.8%)	28.2%	(18.3%)	14.7%
Russell 2000	1,851.79	86.1%	122.3%	(2.7%)	(34.8%)	25.2%	25.3%	(4.9%)	18.6%	(18.9%)	39.8%	(27.6%)	22.3%
NASDAQ Bank	1,587.85	83.2%	118.8%	(22.1%)	(23.9%)	(18.5%)	11.9%	(14.0%)	24.9%	(24.9%)	14.1%	(24.4%)	18.8%
S&P Bank	123.16	77.0%	116.5%	(32.5%)	(49.9%)	(8.9%)	18.7%	(17.2%)	29.7%	(27.5%)	18.7%	(22.2%)	13.2%

### Comparative Price Appreciation: 1/1/10 – YTD 2011



# Market Update

## *Financial Stocks Impacted by Growth Headwinds and Recent Volatility*

### Observations





- ❑ Investors remain largely under-weight financials, driven by the view that there is a lack of catalysts to drive future growth
  - Impact of prolonged low interest rates
  - Increased cost of regulations
  - A huge overhang of residential and commercial real estate remains
  - Unemployment and lost income will continue to drag on the consumer, which represents 2/3 of the economy – can the private sector create jobs fast enough?
  
- ❑ Investors remain hesitant to put new capital to work in the financial sector
  - Especially reluctant to commit capital where asset quality issues are present
  - Substantial discounts for market illiquidity

# Market Update






## *Size and Capital Strength Are Key*

- Bank valuations are now driven by size/scale (assumed ability to grow) and capital strength

### Market Valuation Relative to Asset Size and TCE Ratio

Total Assets		Median Price / TBV
> \$10bn		124%
\$5 – \$10bn		141%
\$1 – \$5bn		100%
< \$1bn		69%

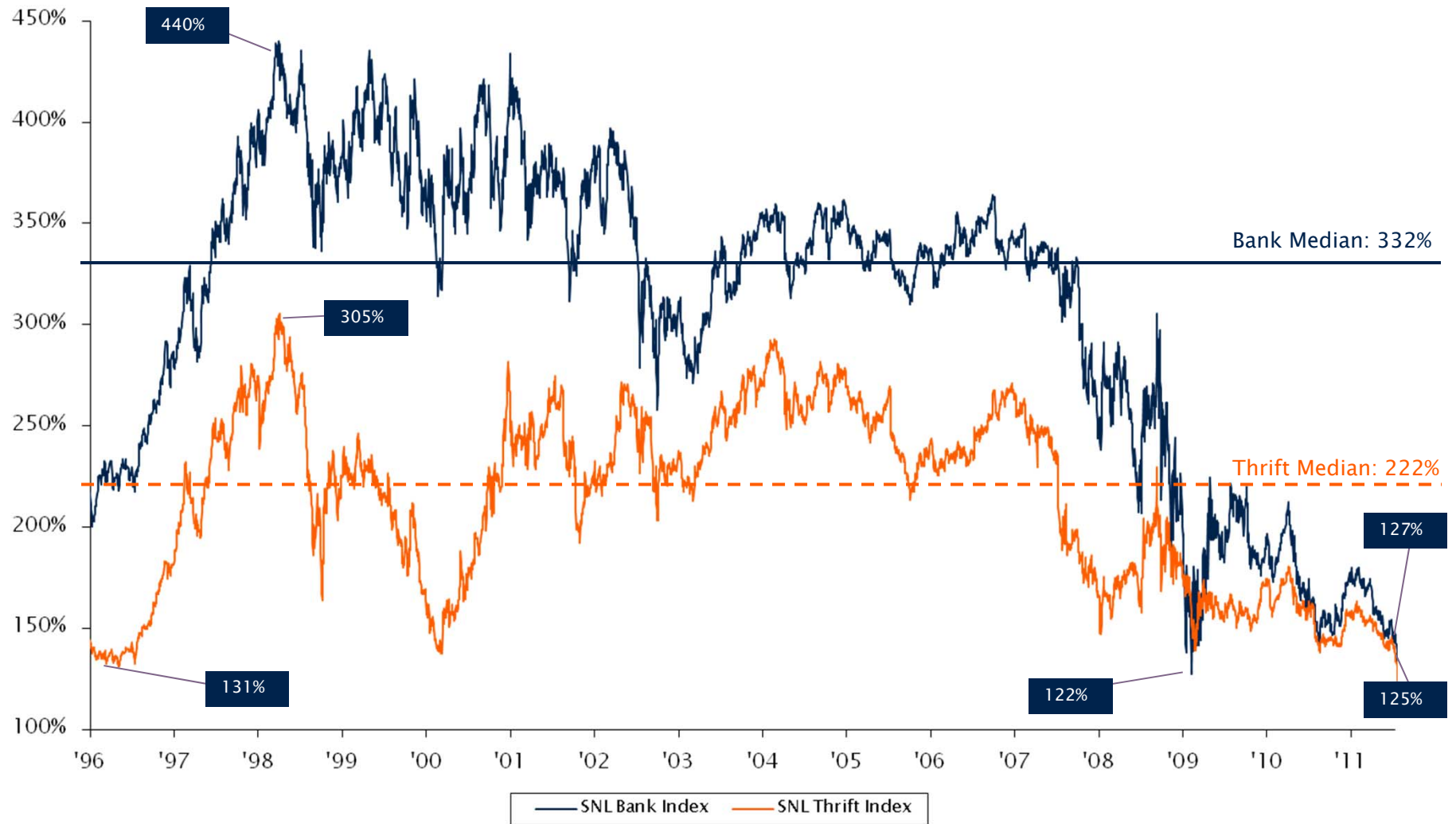
TCE Ratio		Median Price / TBV
> 7%		96%
6% – 7%		81%
5% – 6%		58%
4% – 5%		59%
< 4%		35%

Note: Includes all nationwide banks and thrifts traded on the Nasdaq, NYSE, or NYSE Amex  
 Financial data as of most recent quarter; market data as of November 7, 2011  
 Source: SNL Financial

# Market Update

*Banks Still being Valued on TBV; Multiples have Declined Dramatically*

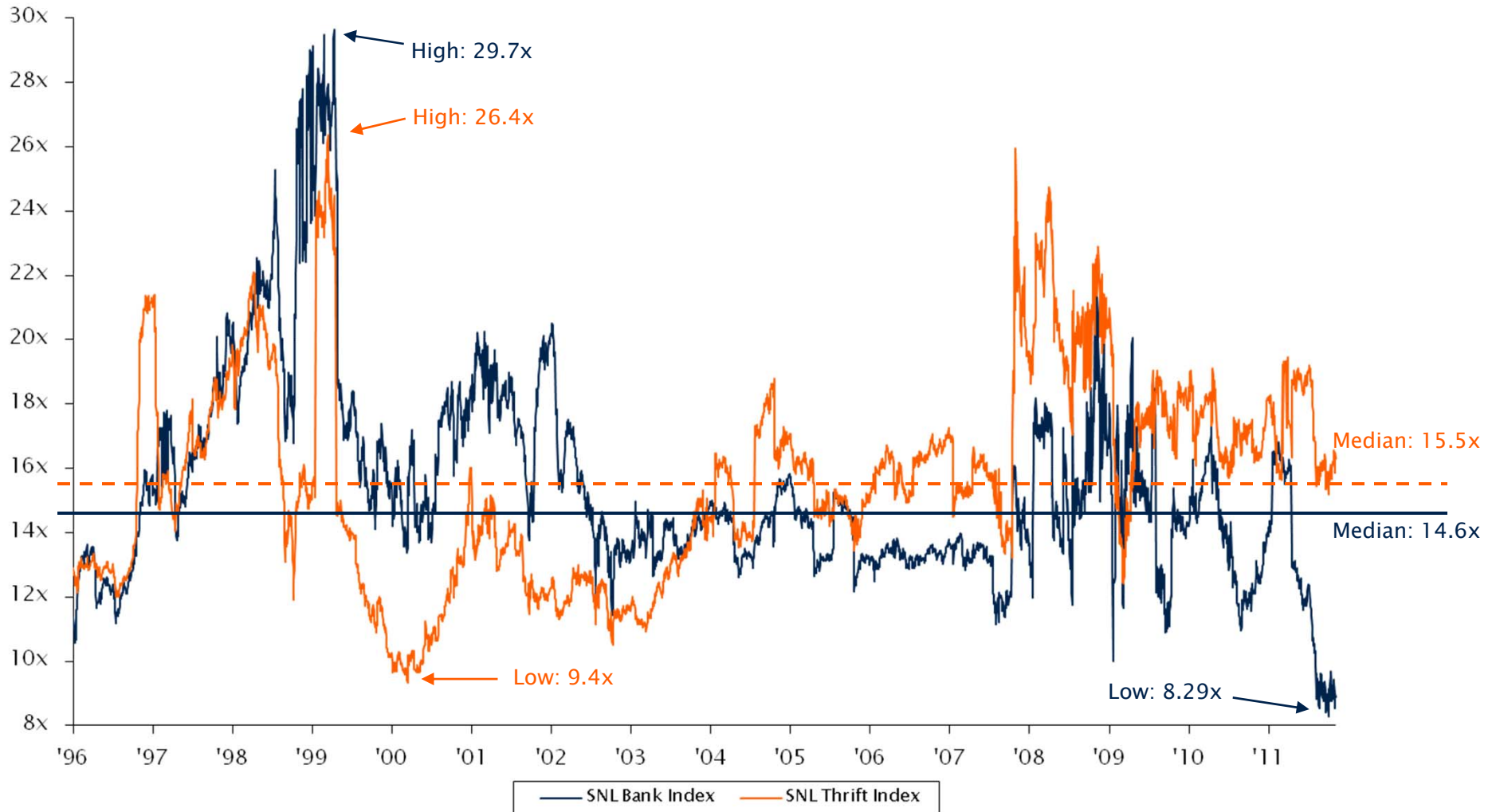
SNL Bank & Thrift Indices: Price/Tangible Book Value (%) Multiples from January 1996 to Present



# Market Update

*As Earnings Clarity Emerges, Transition Back to Emphasis on P/E Multiples*

## SNL Bank & Thrift Indices: Price/Earnings (x) Multiples from January 1996 to Present



# Market Update

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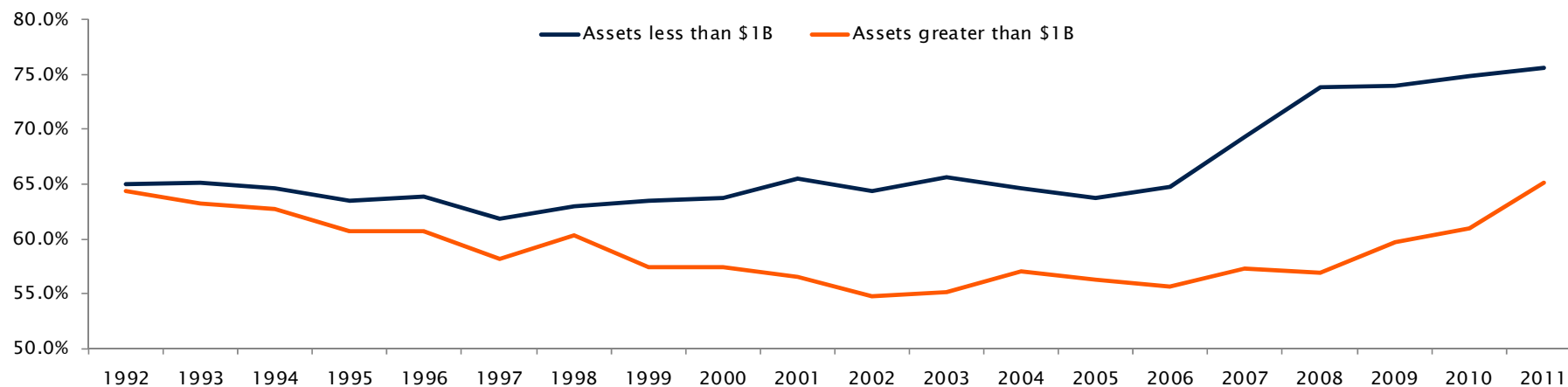
## *The Industry: The New Realities*

- ❑ Regulatory reform just beginning to unfold
  - Increase in required capital levels and renewed emphasis on common stock as dominant form of capital
  - Change in federal regulators for thrifts and thrift holding companies creating significant uncertainty
  - Regulators increasing their scrutiny
- ❑ Capital remains a key to relevance
  - Access to capital will become even more important: very tough environment for small banks
  - TARP repayment looms and community banks have been slow to repay (Only 275 of the 685 total bank issuers have repaid TARP)<sup>1</sup>
- ❑ Operating pressures abound...
  - A prolonged recession with the consumer on the sideline portends anemic loan growth
  - Consumer protection measures and the impact on fee revenue
  - A flatter yield curve and inevitable increases in interest rates will present NIM challenges
  - Rising costs are inevitable: personnel, regulatory, technology, FDIC insurance
- ❑ The timeline for a return to "normalized" earnings has been elongated and the capacity for profitability permanently impaired

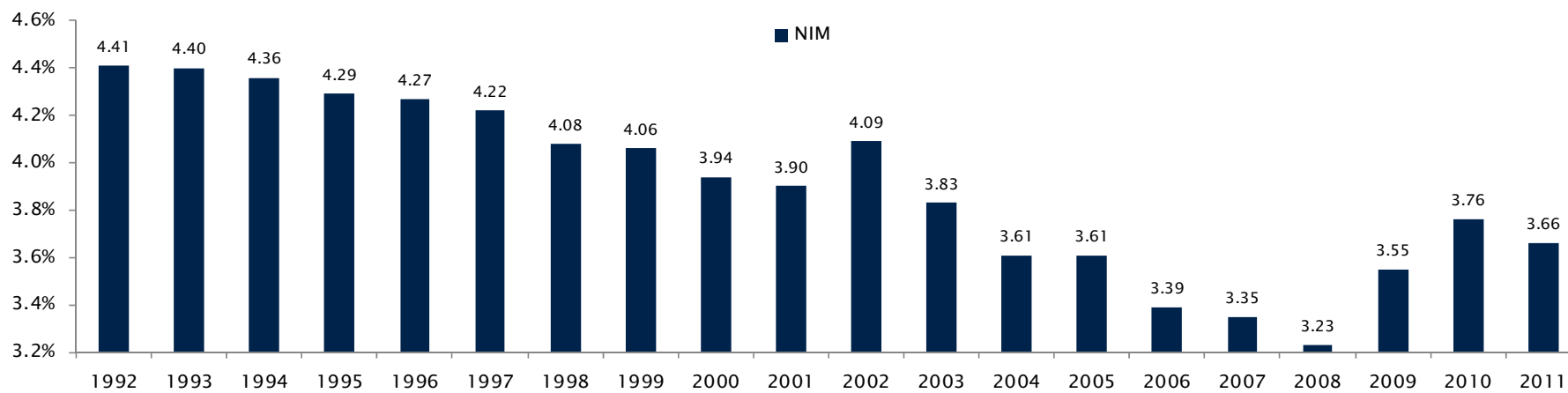
# Market Update

*Need for Size and Scale Driven by...*

## A Wide Gap: The Efficiency Ratios between Large and Small FDIC Insured Commercial Banks



## Historical Net Interest Margin Levels: FDIC Insured Commercial Banks

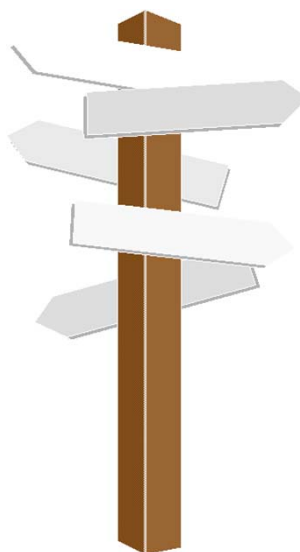


# Market Update

*With the Banking Industry at a Crossroads, Participants Can Be Broadly Divided...*

## The "Have"s

- 1) Sufficient size and scale to effectively manage through increased regulatory oversight and costs
- 2) Multiple, readily accessible sources of capital
- 3) Disciplined, proactive approach to credit, liquidity and capital management
- 4) Viable and relevant franchise with a balanced business mix
- 5) Scalable operating platform capable of accommodating growth and acquisitions
- 6) Management credibility with regulators and investors



## The "Have-Not"s

- 1) Significant asset quality issues that have consumed management's attention and focus to the detriment of the core business
- 2) Lack of scale, both from an operating and regulatory perspective
- 3) Capital need that cannot be readily met through public or private markets
- 4) Lack of funding diversity
- 5) Inability to attract and retain talent throughout the organization to tackle challenges

As the dividing line becomes more clearly delineated, consolidation across and among these groups is a likely outcome

# Overview of Bank M&A Market

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# Overview of Bank M&A Market

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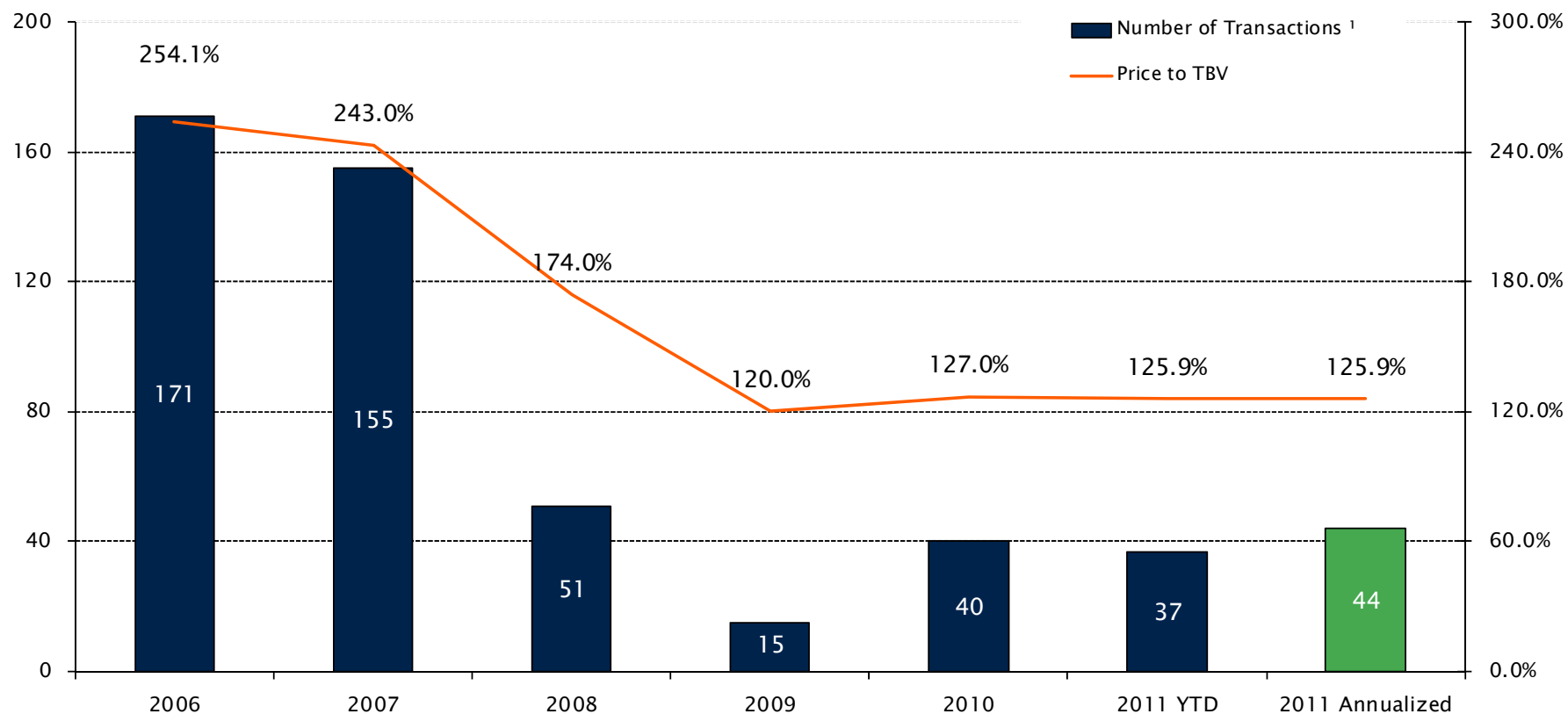
## *Recent Activity*

- ❑ FDIC-assisted transactions have led the way
  - Assisted deals will continue through 2012, but limited closures in the Northeast
- ❑ After a 19-year low in 2009, unassisted M&A activity is slowly returning as asset quality stabilizes and bank stock values have increased
  - Buyers seeking loan growth and earnings accretion in slow growth environment
  - Buyers using acquisition of well-capitalized banks to enhance capital vs. raising capital from investors
- ❑ Small/mid-sized banks are slowly warming to the idea of selling or merging
  - Board and management team “fatigue” after 3+ years of credit and regulatory challenges
    - ✓ Rising capital requirements
    - ✓ Ongoing profitability challenges – slower growth, regulatory/compliance expense burden, competition
  - Directors & officers of potential failures seeking to limit future liability (post-FDIC seizure)
  - Recapitalization alternatives are limited and very resource intensive for small banks
- ❑ Although recent market volatility and declines in market valuations have dampened activity, consensus continues to be that the industry must and will consolidate, enhanced by the need for greater scale
  - Most of the recently announced transactions are smaller community banks

# Overview of Bank M&A Market

*M&A Multiples and Appetites Still Recovering*

The Industry is Still Waiting for the Resurgence in Bank M&A



Aggregate M&A Transaction Value (\$B)

\$108.2B

\$71.5B

\$35.1B

\$1.1B

\$9.7B

\$16.2B

\$19.5B

As of November 4, 2011

(1) Nationwide bank & thrift transactions announced in the given year with publicly-disclosed deal value greater than \$15 million

Source: SNL Financial



# Overview of Bank M&A Market

## Deal Activity by Size

### 2010 – YTD 2011 Bank and Thrift Transactions

	Announced Transaction Value			
	< \$25	\$25 – \$100	\$100 – \$500	\$500 +
<b>Announced Transactions</b>	72 / 57.1%	33 / 26.2%	14 / 11.1%	7 / 5.6%
<b>Transaction Multiples<sup>1</sup></b>				
Price / Book	115%	120%	135%	100%
Price / Tangible Book	106%	121%	162%	102%
Price / LTM Earnings	20.5x	26.6x	23.7x	28.2x
Price / LTM Core Earnings	28.9x	36.4x	26.8x	28.2x
Price / Est. EPS	NA	18.3x	22.1x	21.6x
Market Premium	68.5%	53.8%	46.5%	34.9%
Core Deposit Premium	0.6%	2.3%	9.3%	0.0%

(1) Does not include transactions for which the deal value was not disclosed  
 Note: Transaction multiples represent median values. Dollars in millions  
 As of November 7, 2011  
 Source: SNL Financial

# Overview of Bank M&A Market

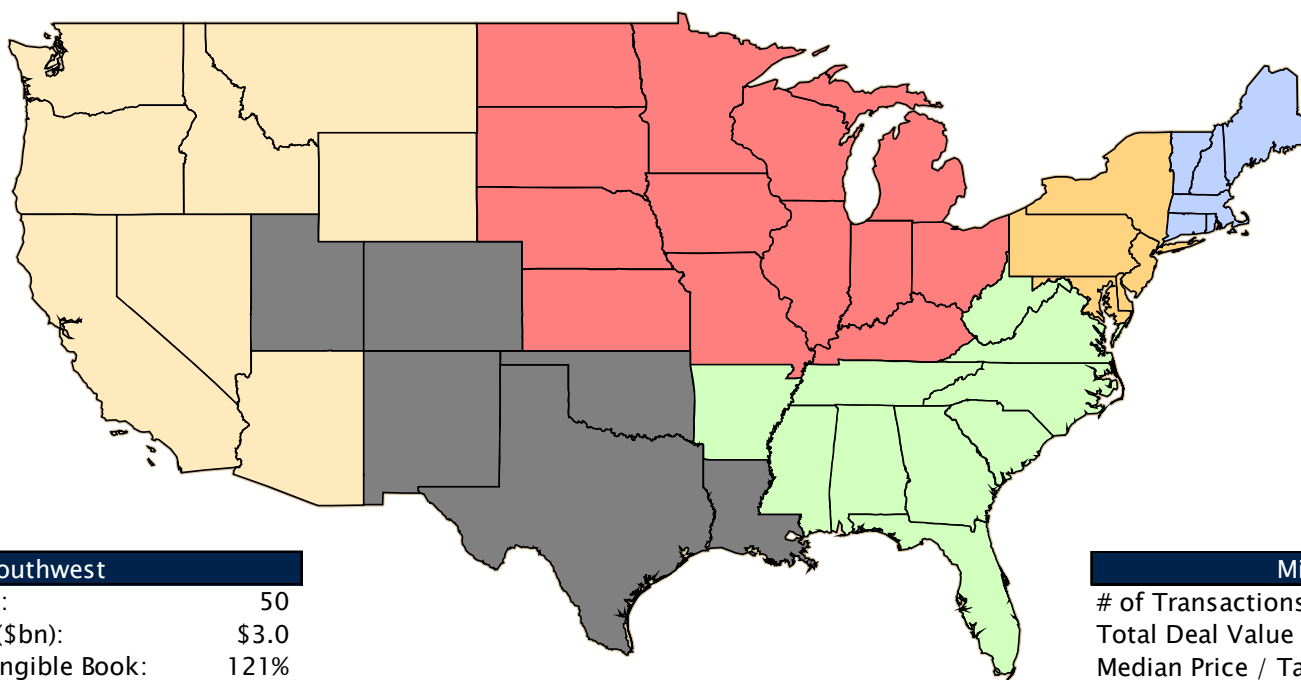
## *Mid-Atlantic Market Overview*

- ❑ The Mid-Atlantic is among the healthiest banking regions in the country
  - Median NPAs/Assets for all banks and thrifts in the region is 1.55% vs. NPAs/Assets of 1.81% nationwide<sup>1</sup>
- ❑ Abundance of “healthy” buyers
  - There are 75 banks greater than \$1bn in assets with TCE/TA greater than 8.0%
- ❑ Of the 865 institutions on the FDIC Problem Institutions List, Sandler O’Neill estimates that approximately 6% of the banks are headquartered in the Mid-Atlantic
- ❑ 29 transactions for banks and thrifts in the New England and Mid-Atlantic regions since 2010 with total volume of \$13.8 billion<sup>2</sup>

# Overview of Bank M&A Market

## 2010 – YTD 2011 M&A Activity By Region

West		Midwest		New England	
# of Transactions:	24	# of Transactions:	84	# of Transactions:	18
Total Deal Value (\$bn):	\$0.3	Total Deal Value (\$bn):	\$4.6	Total Deal Value (\$bn):	\$2.7
Median Price / Tangible Book:	95%	Median Price / Tangible Book:	119%	Median Price / Tangible Book:	149%
Median Price / LTM Earnings:	45.6x	Median Price / LTM Earnings:	17.3x	Median Price / LTM Earnings:	24.6x
Core Deposit Premium:	(1.0%)	Core Deposit Premium:	2.4%	Core Deposit Premium:	5.9%



Southwest	
# of Transactions:	50
Total Deal Value (\$bn):	\$3.0
Median Price / Tangible Book:	121%
Median Price / LTM Earnings:	21.8x
Core Deposit Premium:	4.5%

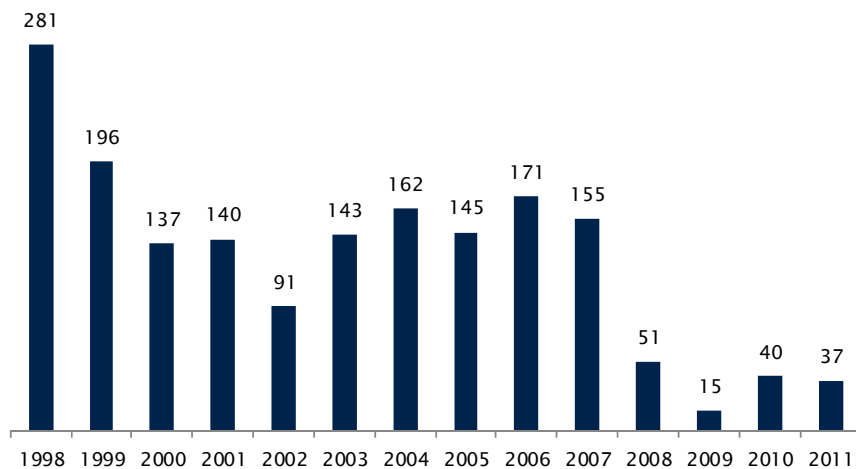
Southeast	
# of Transactions:	58
Total Deal Value (\$bn):	\$4.3
Median Price / Tangible Book:	74%
Median Price / LTM Earnings:	26.6x
Core Deposit Premium:	(1.2%)

Mid Atlantic	
# of Transactions:	38
Total Deal Value (\$bn):	\$11.6
Median Price / Tangible Book:	124%
Median Price / LTM Earnings:	24.6x
Core Deposit Premium:	2.2%

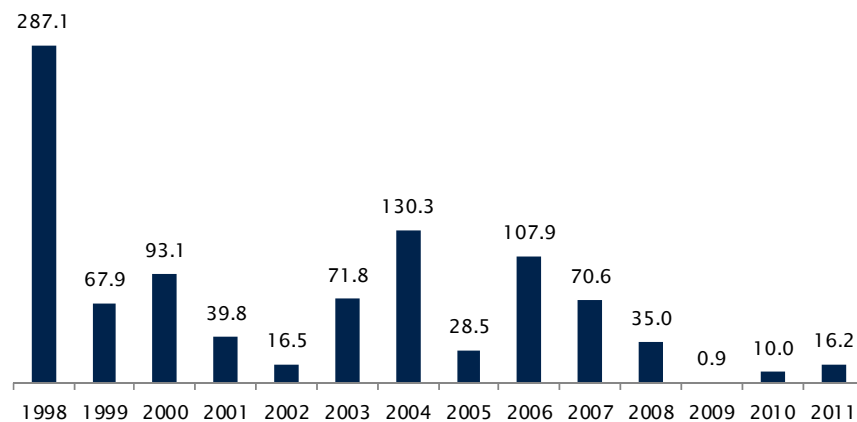
# Overview of Bank M&A Market

Since 1998

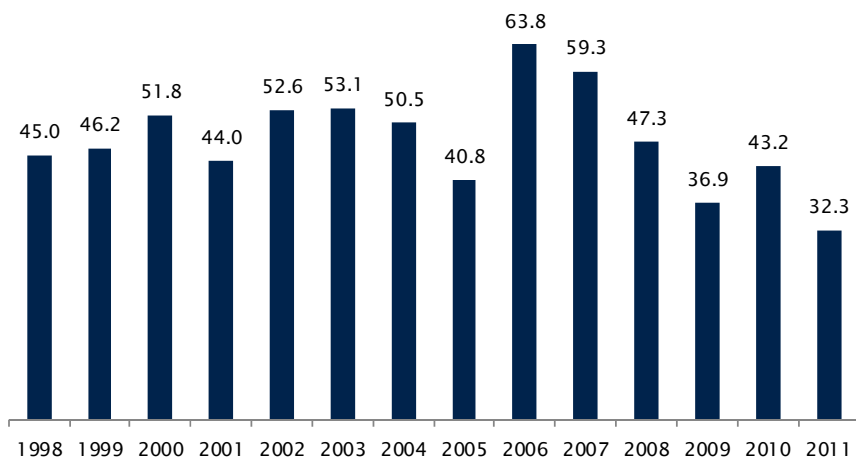
Number of Transactions



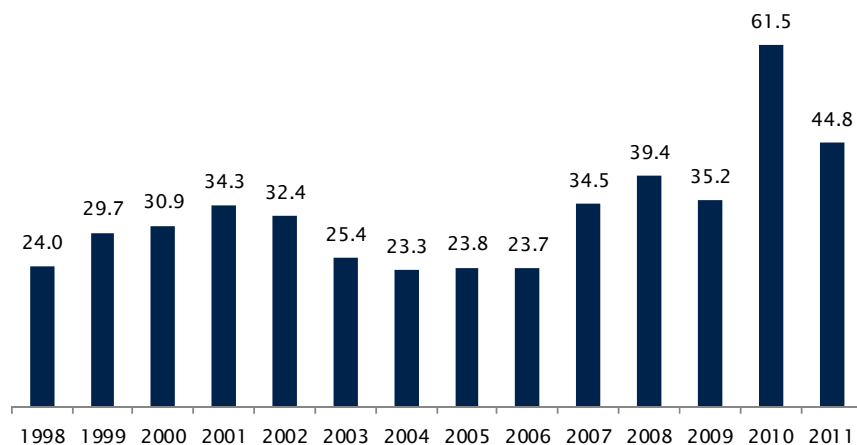
Transaction Volume (\$bn)



Median Transaction Value (\$mm)



5 Day Market Premium (%)

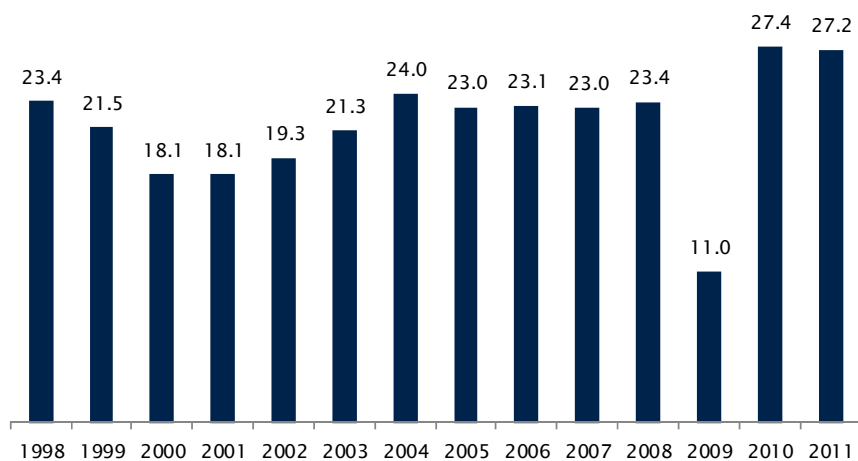


Includes all nationwide bank and thrift deals with announced deal value greater than \$15mm  
As of November 7, 2011  
Source: SNL Financial

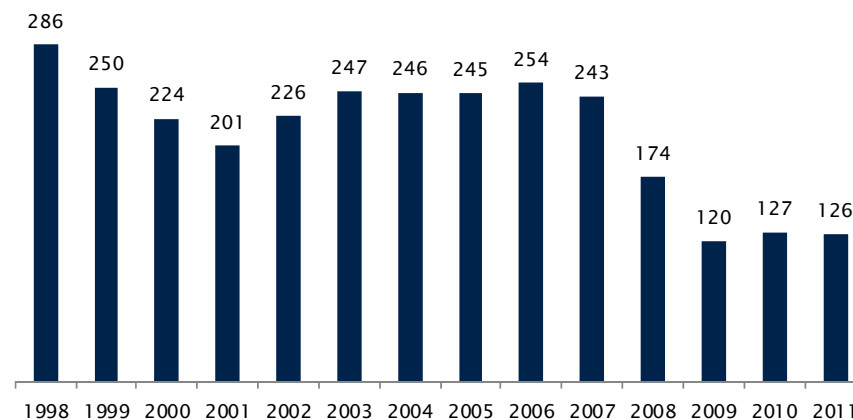
# Overview of Bank M&A Market

Since 1998

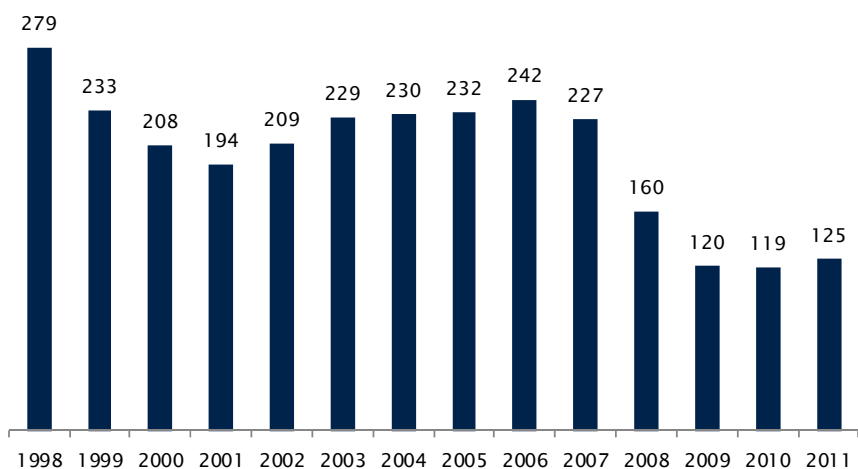
Price / LTM EPS (x)



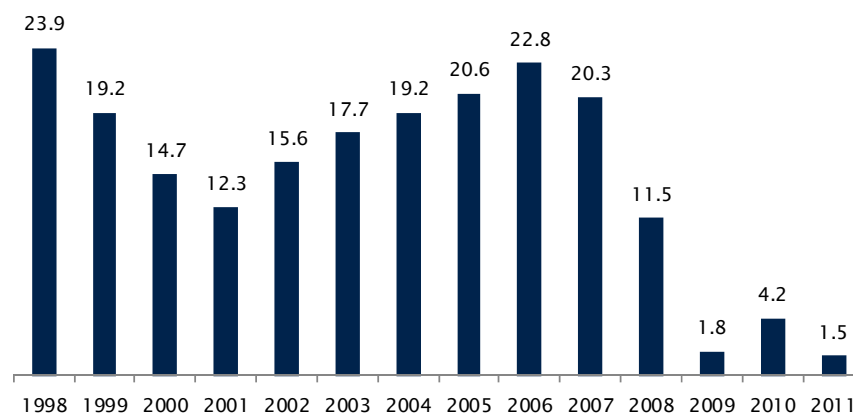
Price / Tangible Book (%)



Price / Book (%)



Core Deposit Premium (%)



# Overview of Bank M&A Market

*Where Will the Opportunities Be in 2011 and Beyond?*

The current turmoil will present opportunities for those who are well-positioned

- ❑ Healthy Deals
  - Buyers will be very selective
  - Sellers must re-evaluate what is a good and fair transaction
- ❑ Strategic Transactions / Mergers of Equals
  - Management and boards of directors could pursue strategic mergers as a means to increase long-term franchise and shareholder value in this difficult environment while postponing a full premium sale
- ❑ Institutions Facing Pressure to Sell or Raise Capital
  - Mounting pressure from third parties (regulators, shareholders) to merge with a larger, more stable institution with the ability to absorb increasing difficulties and enhance long-term value for all parties
- ❑ Transactions with the FDIC (but regional opportunities will be limited and competitive)
- ❑ Branch Divestitures
  - Banks may be looking into branch sales as a means to free up capital
- ❑ Hiring Talented Individuals
  - The current environment may have forced some banks in the area to let go of key employees, creating an opportunity for them to become part of your team



2011 Financial Services Forum  
**What's Ahead For M&A**

November 11, 2011

The New York Bankers Association

Arthur L. Loomis, II  
President  
Northeast Capital & Advisory, Inc.

**NYBA**

**NORTH**  
*Capital & Advisory, Inc.*  
**EAST**  
a subsidiary of Loomis & Co. Inc.

# Agenda

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- I. Catalysts of Consolidation
- II. Required Ingredients For Robust M&A Activity
- III. What Drives Pricing
- IV. Quality Premiums Still Exist
- V. Why The Economy Matters
- VI. Branch Divestitures
- VII. Mutuals
- VIII. Noninterest Income Acquisitions
- IX. How Boards Evaluate Strategic Alternatives

## Catalysts of Consolidation

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- ❑ **Net Interest Margin Shrinking**
- ❑ **Compliance Costs Soaring**
- ❑ **Overall Operating Costs Rising 2x Faster Than Inflation**
- ❑ **Non-Interest Income Not Keeping Up**
- ❑ **Best Thrift Customers Dying**
- ❑ **Small Banks Used to Outperform, But No Longer**

# Required Ingredients For Robust M&A Activity

## For Buyers

- ❑ **Excess capital**

NY Community Banks		
	18 Months Ago	Now
Median TE/ TA	9%	10%
Excess Capital	\$5.7B	\$8.2B

- ❑ **Access to capital**

- \$250 B raised last 18 months  
(vs. \$110 B in 08-09)

- ❑ **Absence of regulatory problems**

- Compliance C&D = penalty box

- ❑ **Acceptable TBV dilution earn back period**

## For Sellers

- ❑ **Durable core earnings/ customer**

- ❑ **Good asset quality**

- ❑ **Multiple qualified and willing buyers**

- ❑ **Realistic seller price expectations**

## For Both

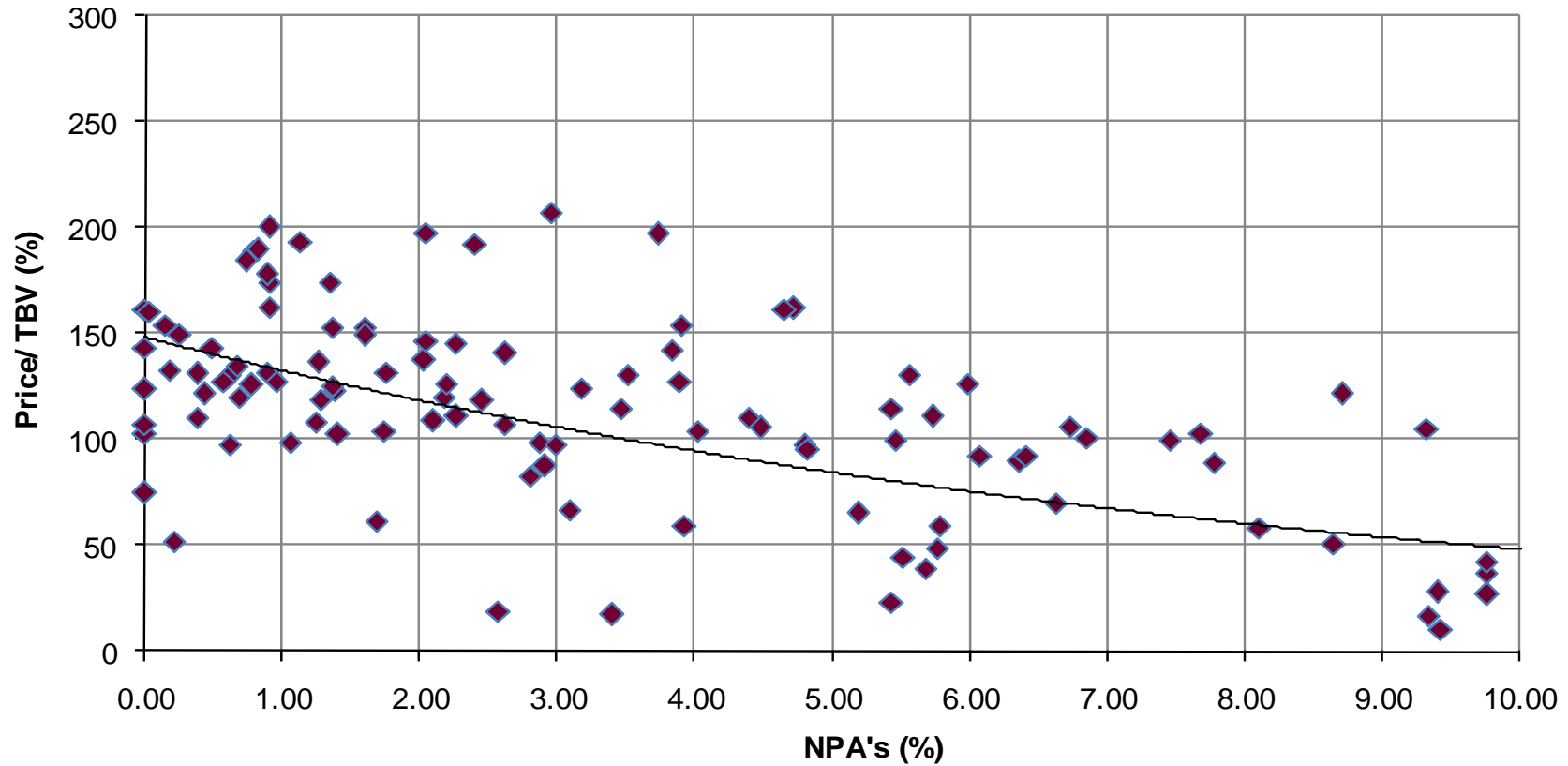
- ❑ **Limited supply**

- ❑ **Economic stability**

- ❑ **Buyer stock price**

# What Drives Pricing

## National deals 2010-Present

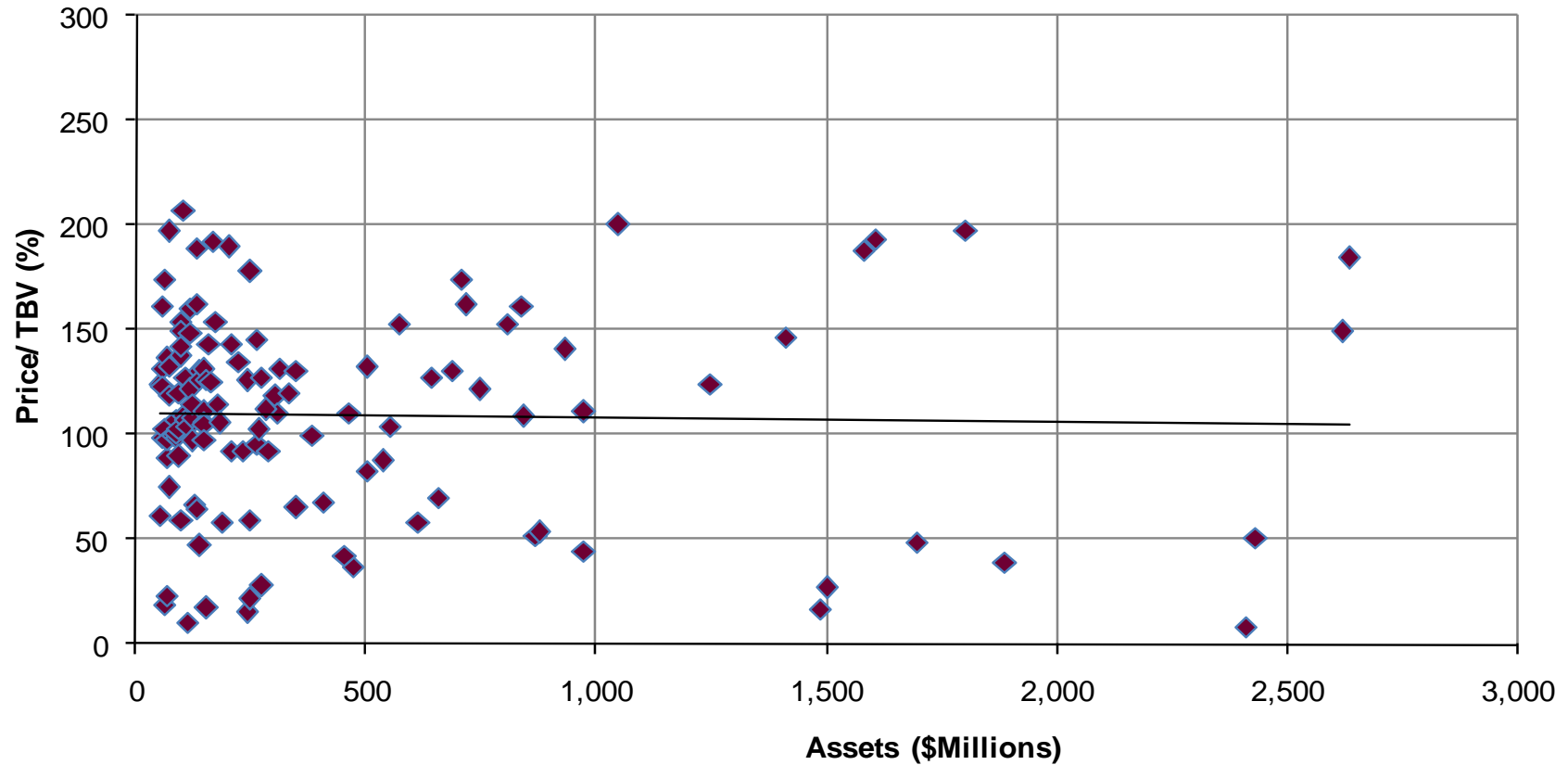


Source: SNL Financial, Northeast Capital Research

✓ Strong Correlation to Asset Quality

# What Drives Pricing

## National deals 2010-Present

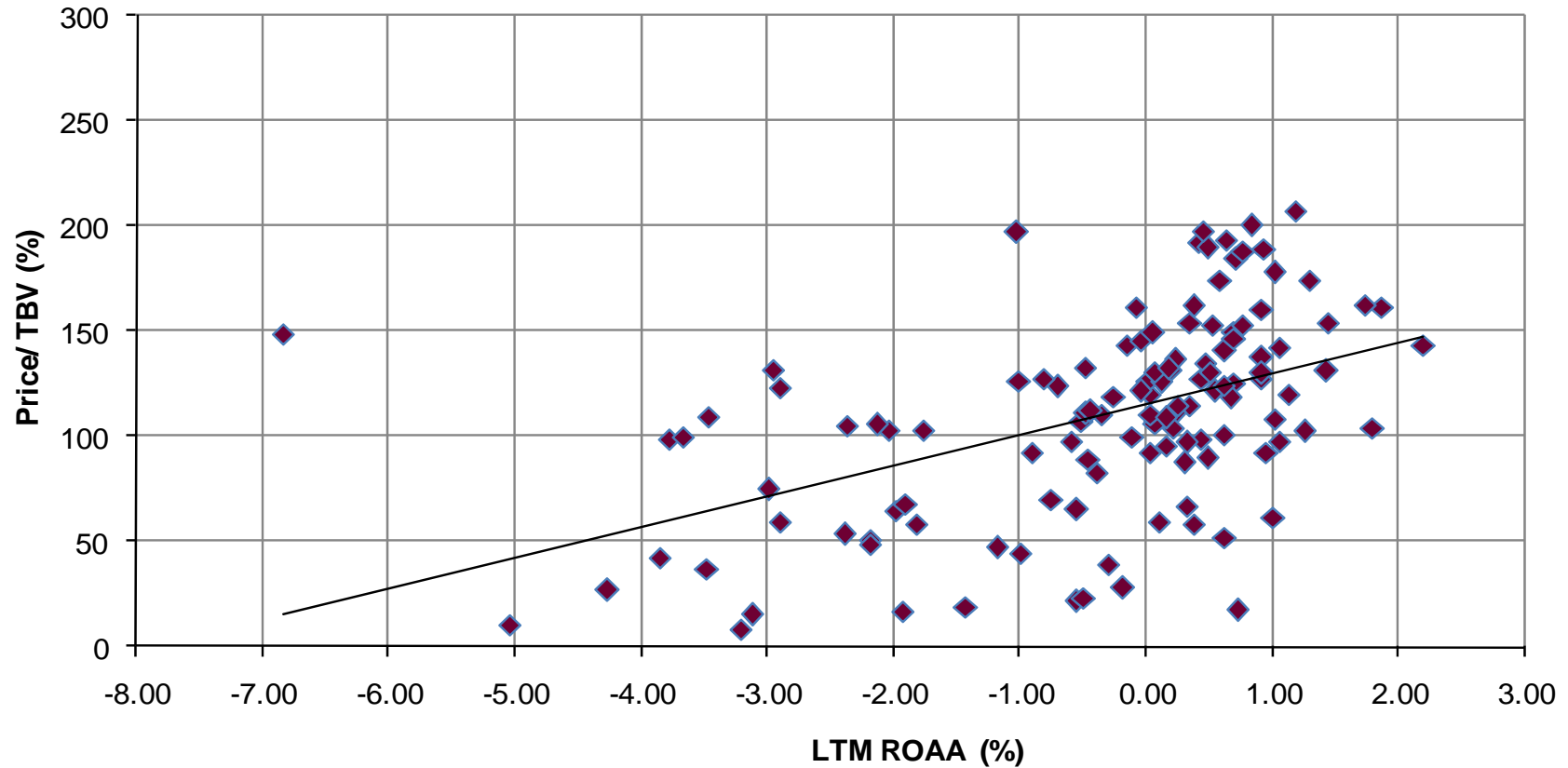


Source: SNL Financial, Northeast Capital Research

✓ No Correlation to Size

# What Drives Pricing

## National deals 2010-Present



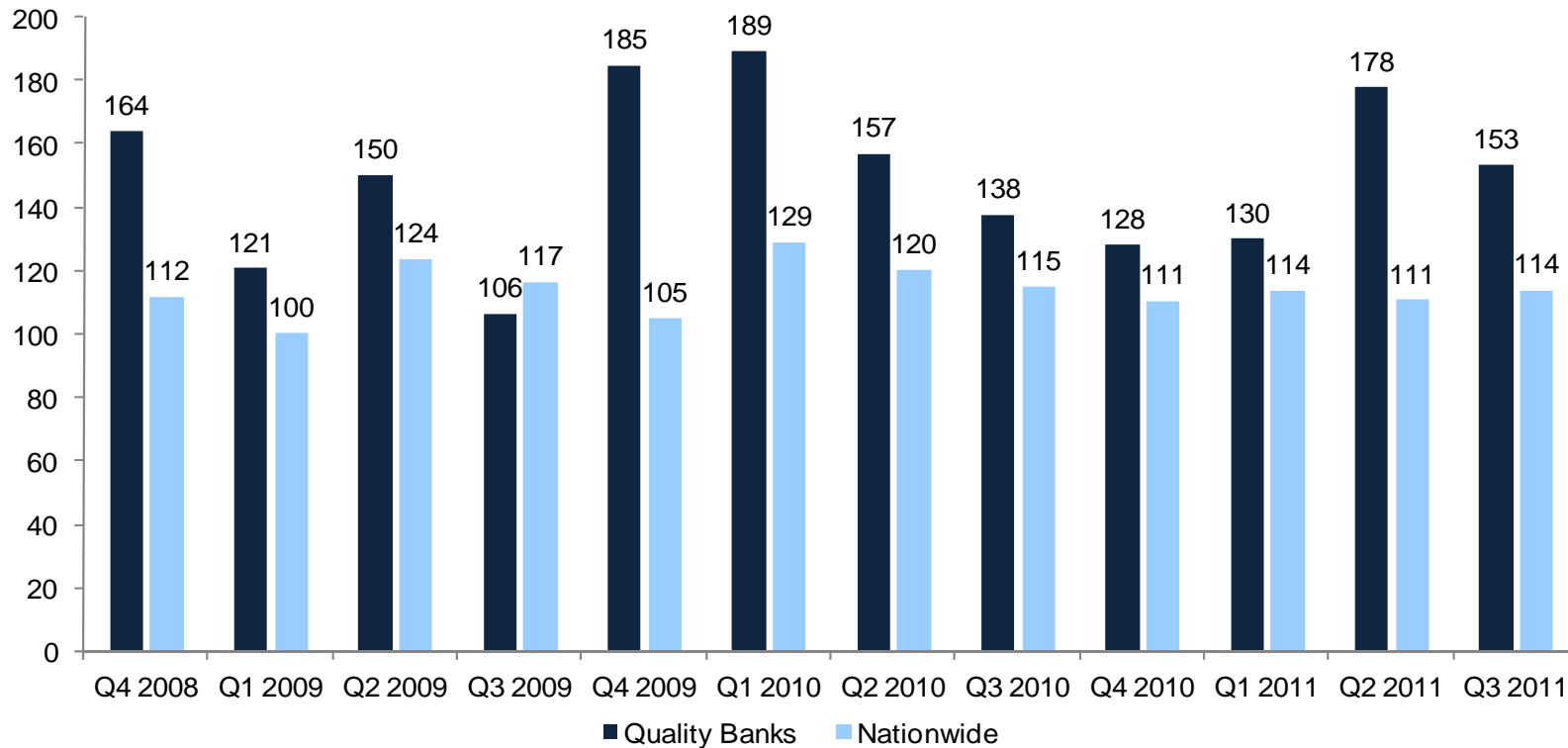
Source: SNL Financial, Northeast Capital Research

✓ Strong Correlation to Earnings

# Quality Premiums Still Exist

## Price/ TBV

➤ *Quality Banks = ROA > 0.50%, NPA 's < 3.0%, Tangible Equity > 6.0%*



Source: SNL Financial, Northeast Capital Research

## Quality Premiums Still Exist

### *Recent Regional Transactions*

#### Danvers

- Greater Boston Market
- \$2.6 B in Assets
- 0.52% NPA' s
- ROAA (3 yr. avg) = 0.42%

- 5 Parties Contacted
- *3 Bids Submitted*
- 1 Finalists Selected

184% TBV, 45% Cash

#### Bancorp Rhode Island

- Providence Market
- \$1.6 B in Assets
- 1.10% NPA' s
- ROAA (3 yr. avg) = 0.53%

- 4 Parties Contacted
- *3 Bids Submitted*
- 2 Finalists Selected

193% TBV, 50% Cash

# Quality Premiums Still Exist

## Recent Regional Transactions

### Wainwright

- Boston Market
- \$1 B in Assets
- 0.90% NPA' s
- ROAA (3 yr. avg) = 0.66%
  
- 6 Parties Contacted
- *5 Bids Submitted*
- 2 Finalists Selected

200% TBV Cash

### Parkvale Financial

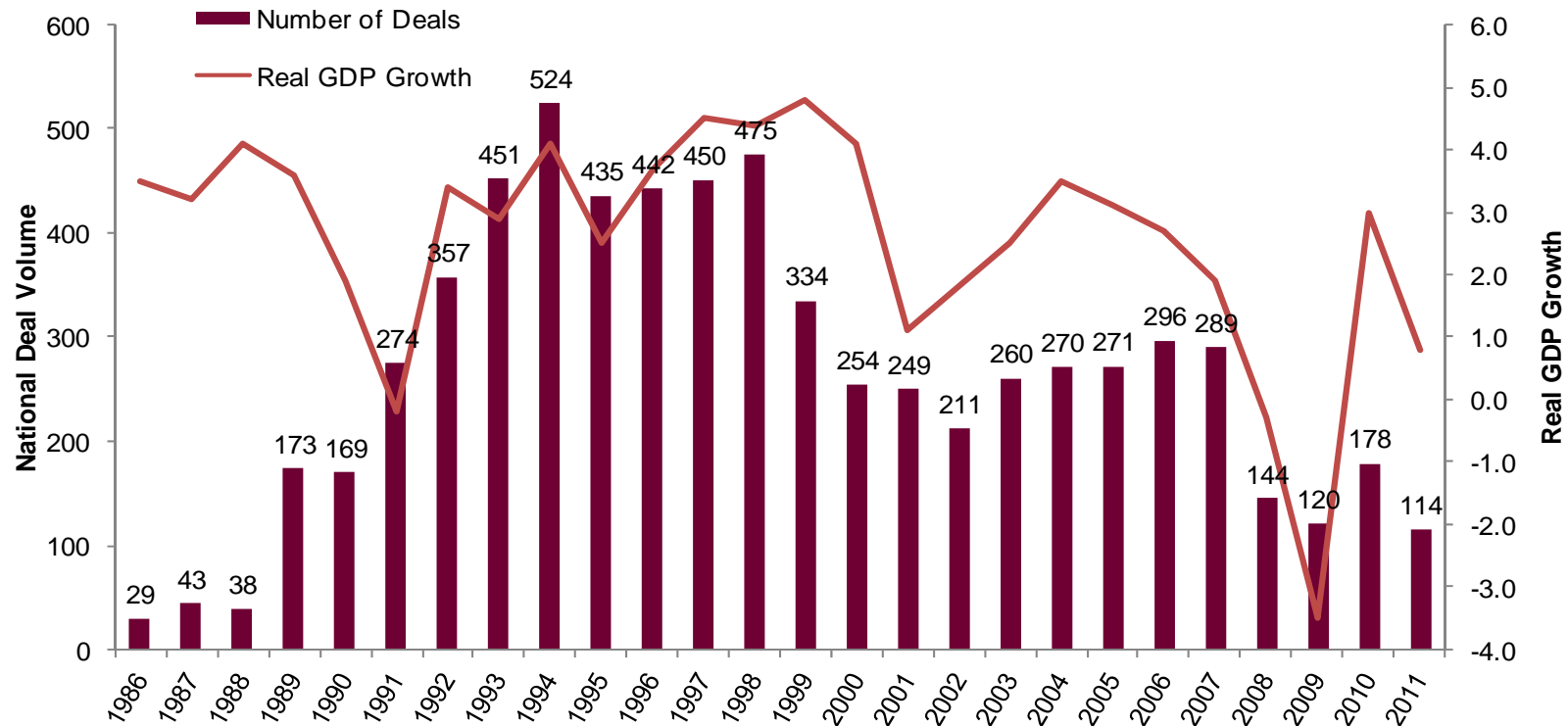
- Pittsburgh Market
- \$1.8B in Assets
- 2.05% NPA' s
- ROAA (3 yr. avg) = 0.50%
  
- 8 Parties Contacted
- *4 Bids Submitted*
- 2 Finalists Selected

198% TBV Stock

# Why The Economy Matters

## Deal Volume Correlation with Economic Growth

### ➤ All Deals National



Source: SNL Financial, Northeast Capital Research

## Branch Divestitures

### Recent NY & New England Divestitures

Buyer	Seller	Announce Date	Target State	Deposits Transferred (Reported)	Franchise Premium/Deposits (%)	Loans Included
Skowhegan Savings Bank	Border Bancshares, Inc.	04/07/10	ME	22,290	5.50	Yes
Ponce De Leon Federal Bank	Northeast Community Bancorp	06/24/10	NY	28,600	6.00	No
Lazares & Company, LLC	Investors Bancorp, Inc. (MHC)	10/15/10	MA	82,000	0.11	No
BankAsiana	Hudson Valley Holding Corp.	12/23/10	NY	900	NA	No
Union Bankshares, Inc.	Northway Financial, Inc.	03/16/11	NH	80,900	6.00	Yes
Leader Bancorp Inc.	Stoneham Savings Bank	03/22/11	MA	19,565	NA	No
Hometown Bancorp, Inc. (MHC)	First Fed Sav of Middletown	04/29/11	NY	19,300	4.00	No
NBT Bancorp Inc.	Berkshire Hills Bancorp, Inc.	07/13/11	MA	158,000	6.00	Yes
First Niagara Financial Group	HSBC USA Inc.	07/30/11	NY	15,000,000	6.67	Yes
NBT Bancorp Inc.	Berkshire Hills Bancorp, Inc.	10/25/11	NY	57,000	2.50	Yes
<b>Median</b>				<b>28,600</b>	<b>6.00</b>	

Source: SNL Financial, Northeast Capital Research

# Branch Divestitures

## Current Situation in New York

- ❑ **Large (>\$50B) national banks operate 2,300 branches under \$100 million in deposits**
  - \$103 billion in deposits
  - Average \$42 million per branch
- ❑ **Approximately 1/2 of these branches with \$47 billion in deposits have grown less than 2% CAGR or shrunk over 5 years**
- ❑ **If the large banks sold the underperforming branches to community banks for a 6% premium:**
  - Would raise \$2.8 billion in capital
  - Would free up an additional \$2.8 billion in committed capital
  - All of which would further improve earnings performance

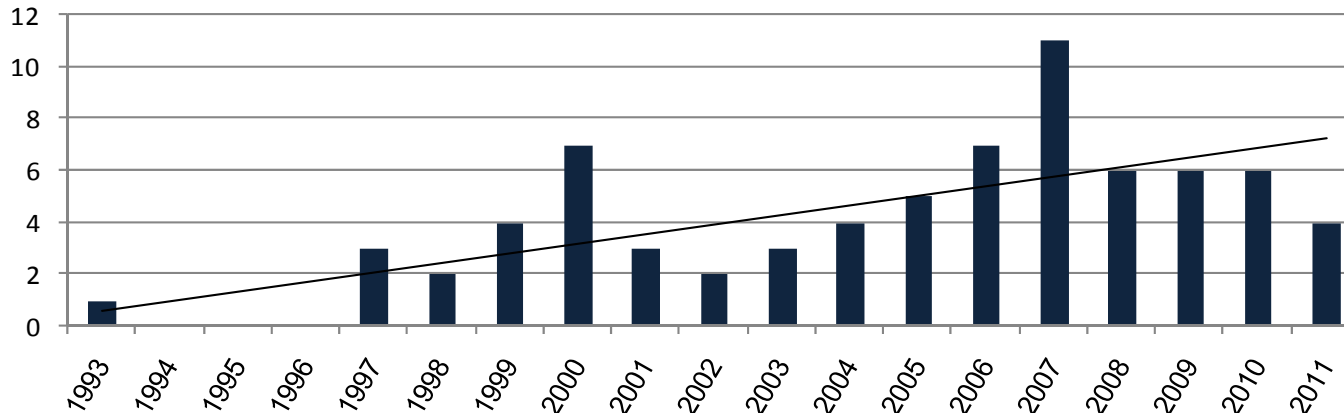
### ❑ Large banks with sub-performing branches in NY

	<u>Branches</u>	<u>Deposits (\$B)</u>
JPMorgan	214	11.30
Key	178	6.70
Citizens	118	4.41
M&T Bank	113	4.00
Capital One	48	3.00
Bank of America	76	2.62
Wells Fargo	27	1.76
Citigroup	16	1.12
TD Bank	25	1.00

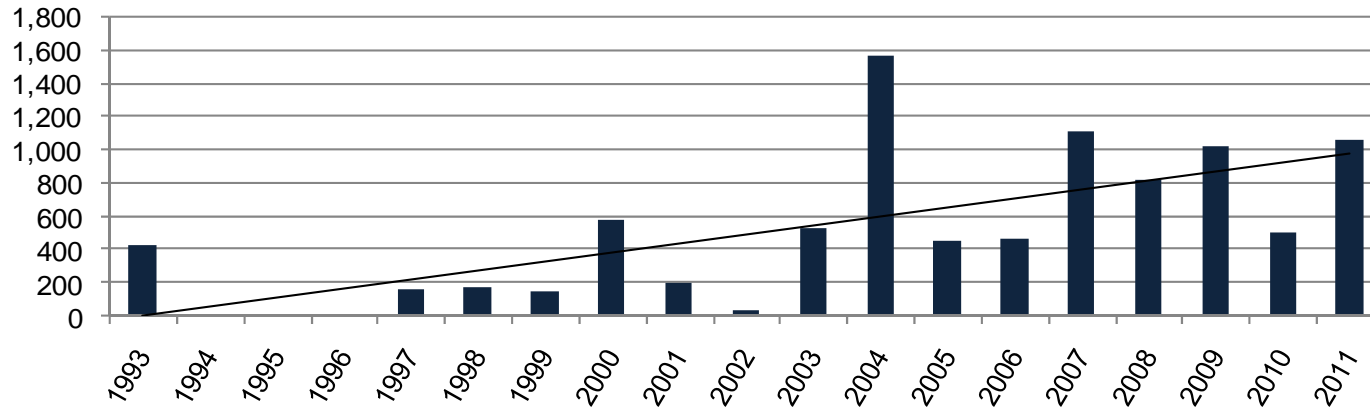
# Mutuals

## Consolidation Trend

### Number of Mutual Combinations



### Mutual Combinations (\$Millions in Assets)



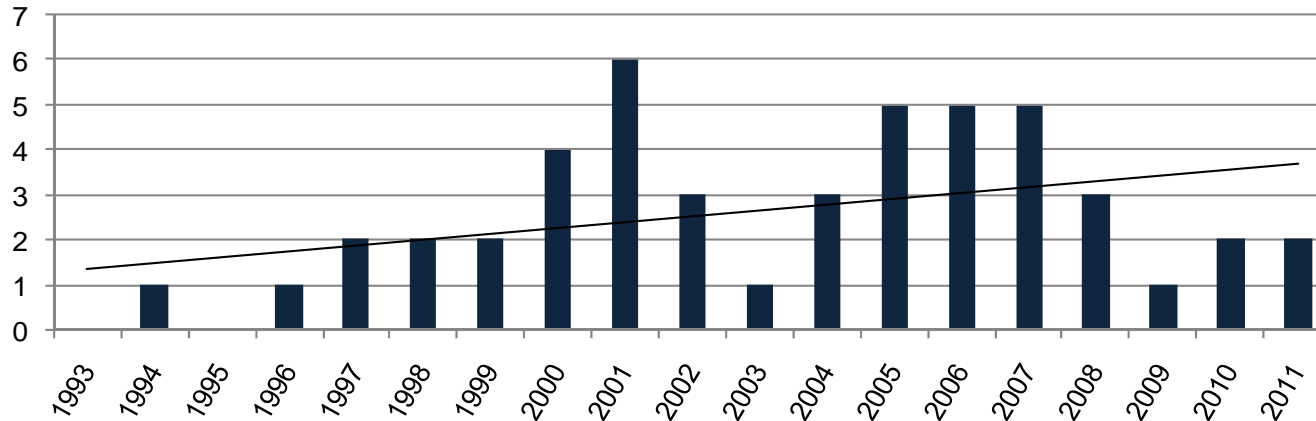
Source: SNL Financial, Northeast Capital Research

✓ Frequency increasing, as is median size (from \$40-80 million to \$100-300 million now)

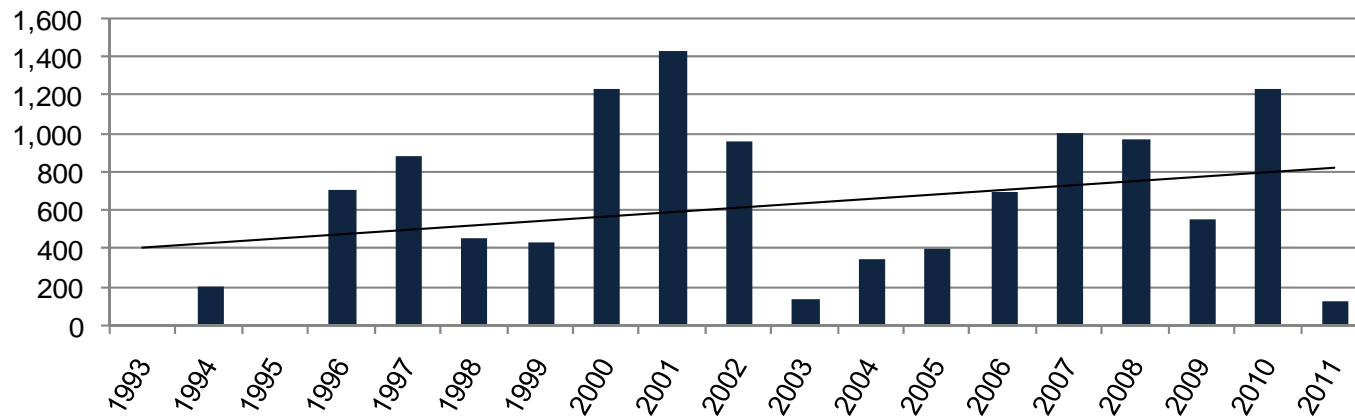
# Mutuals

## Consolidation Trend

### Number of Stock Bank Acquisitions By Mutuals



### Stock Bank Acquisitions By Mutuals (\$Millions in Assets)



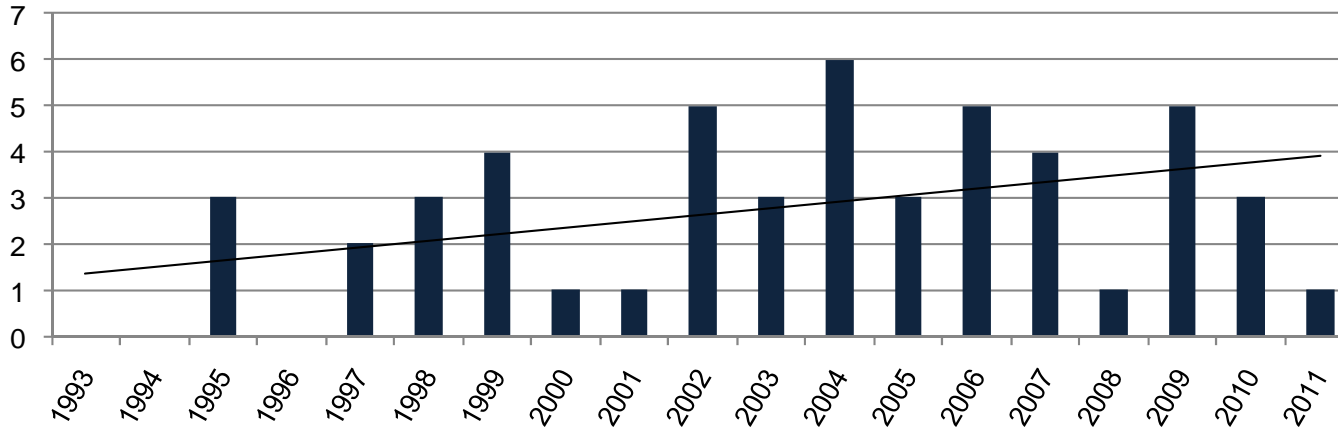
Source: SNL Financial, Northeast Capital Research

✓ Frequency increasing, although median size has no clear trend

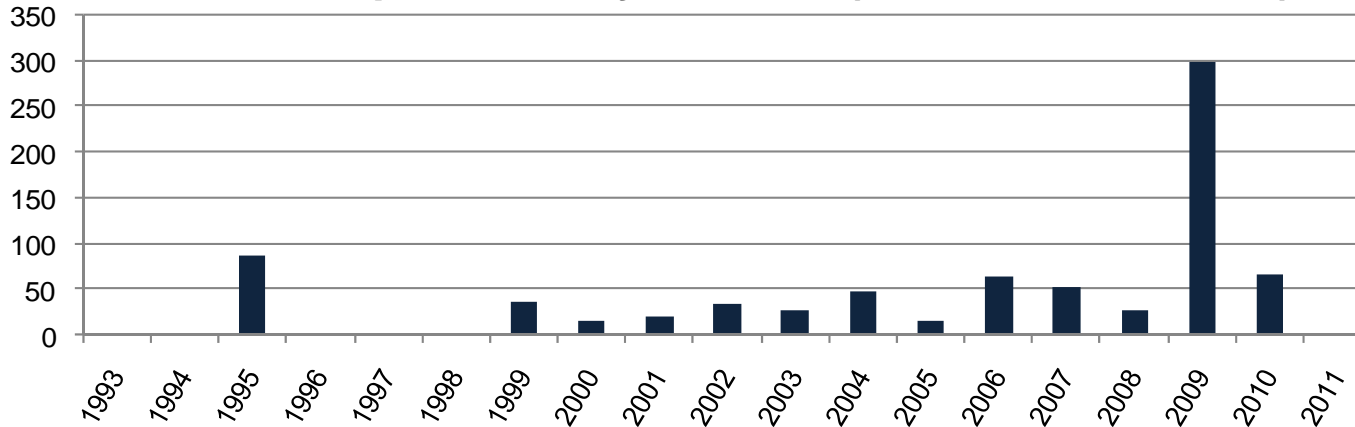
# Mutuals

## Consolidation Trend

### Number of Branch Acquisitions By Mutuals



### Branch Acquisitions by Mutuals (\$Millions in Assets)



Source: SNL Financial, Northeast Capital Research

✓ Frequency increasing, although median branch size is normally in \$10-20 million range

## Mutuals

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### *What They Are Saying – Quotes from 3 mutuals who have recently merged*

- ❑ Adams Cooperative Bank

*“We were looking at it and saying, we're the smallest players in the area, and on a go-forward basis, **we need to do something to try to get to a point where we can be competitive**”*

- ❑ South Adams Savings Bank

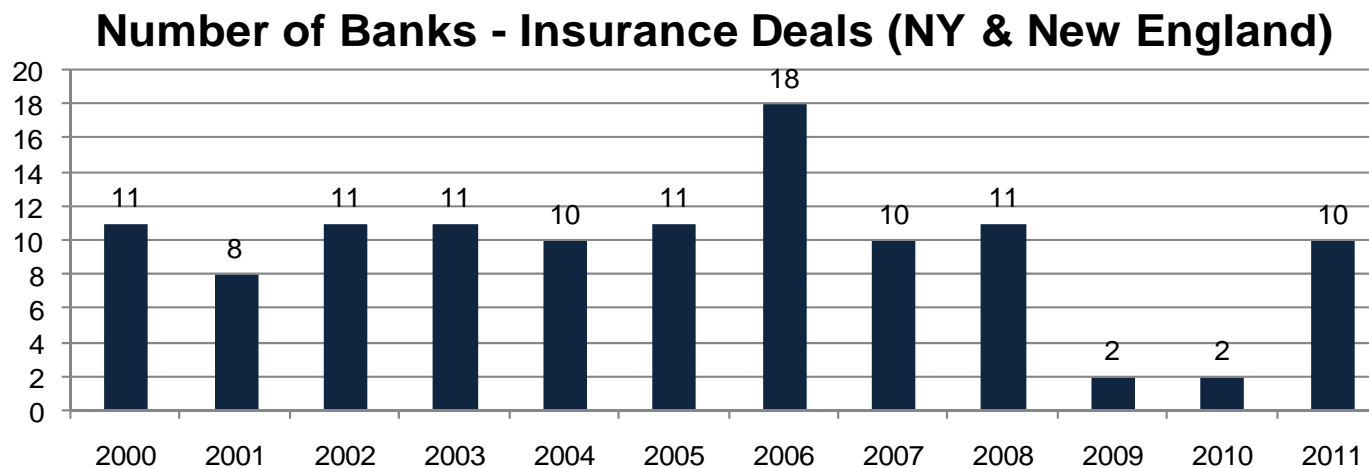
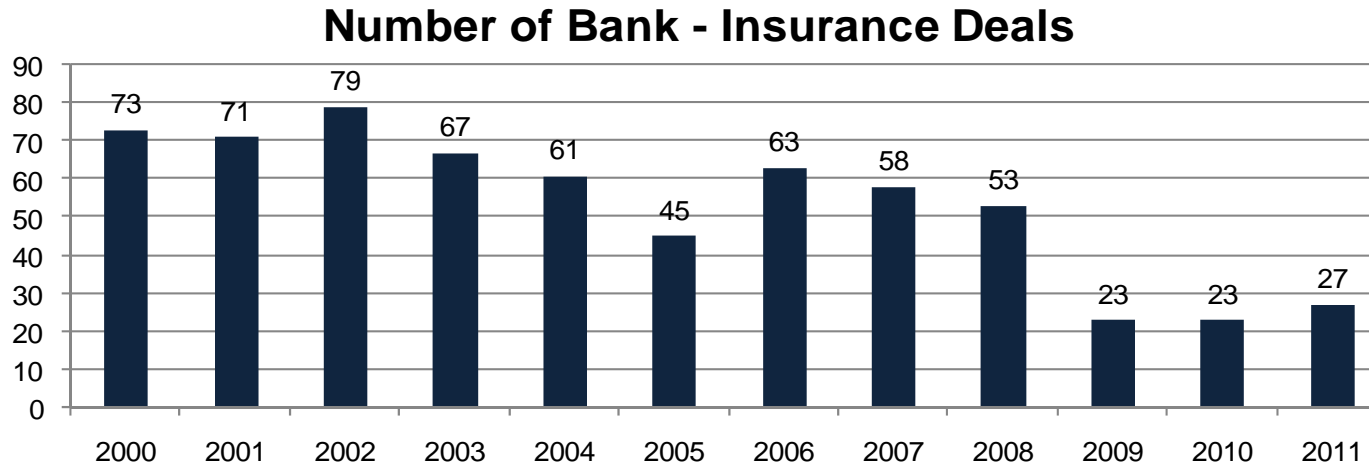
*“the bank had analyzed its market position and found that a **\$200 million institution would be challenged** in 10 or 20 years”*

- ❑ Hometown Bank A Co-Op Bank

*“the bank's merger was an answer to “all of the pressures” facing the smaller institution. **“A sub-\$100 million bank is getting it from all angles,”** he said. “Not that the rest of us aren't, but at least as you get up the scale of asset size, you're gaining efficiencies.”*

# Noninterest Income Acquisitions

Deal flow down over last 3 years



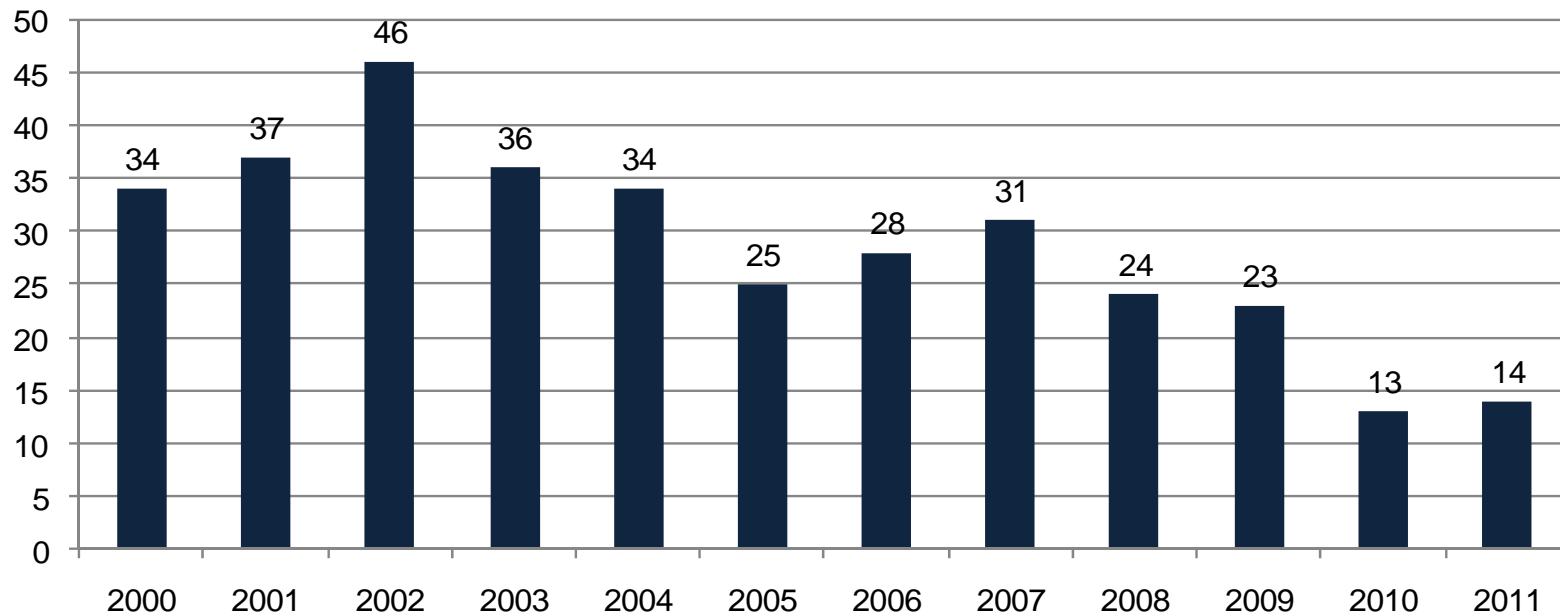
Source: SNL Financial, Northeast Capital Research

- ✓ Pent up supply ⇒ Expect increased deal activity with attractive pricing
- ✓ Most buyers > \$5 billion in total assets

# Noninterest Income Acquisitions

*Deal flow down over last 3 years*

## Number of Bank - Asset Manager Deals



*Source: SNL Financial, Northeast Capital Research*

- ✓ Pent up supply ⇒ Expect increased deal activity with attractive pricing
- ✓ Buyer asset size trending upwards to \$11-45 billion from \$2.5-4.7 billion

# How Boards Evaluate Strategic Alternatives

## Best Practices

### ❑ Option 1 ⇒ They Rarely Do

- Triggering event such as Bear Hug Letter
- Defense is long term shareholder or stakeholder value

### ❑ Option 2 ⇒ Periodic Review

- Confirm business/ strategic plan
- Assess expected present value of business/ strategic plan

