

What Determines Value in a Bank? Purchase Price Allocation Trends and Tips

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The webinar will start at 11:00 am CT



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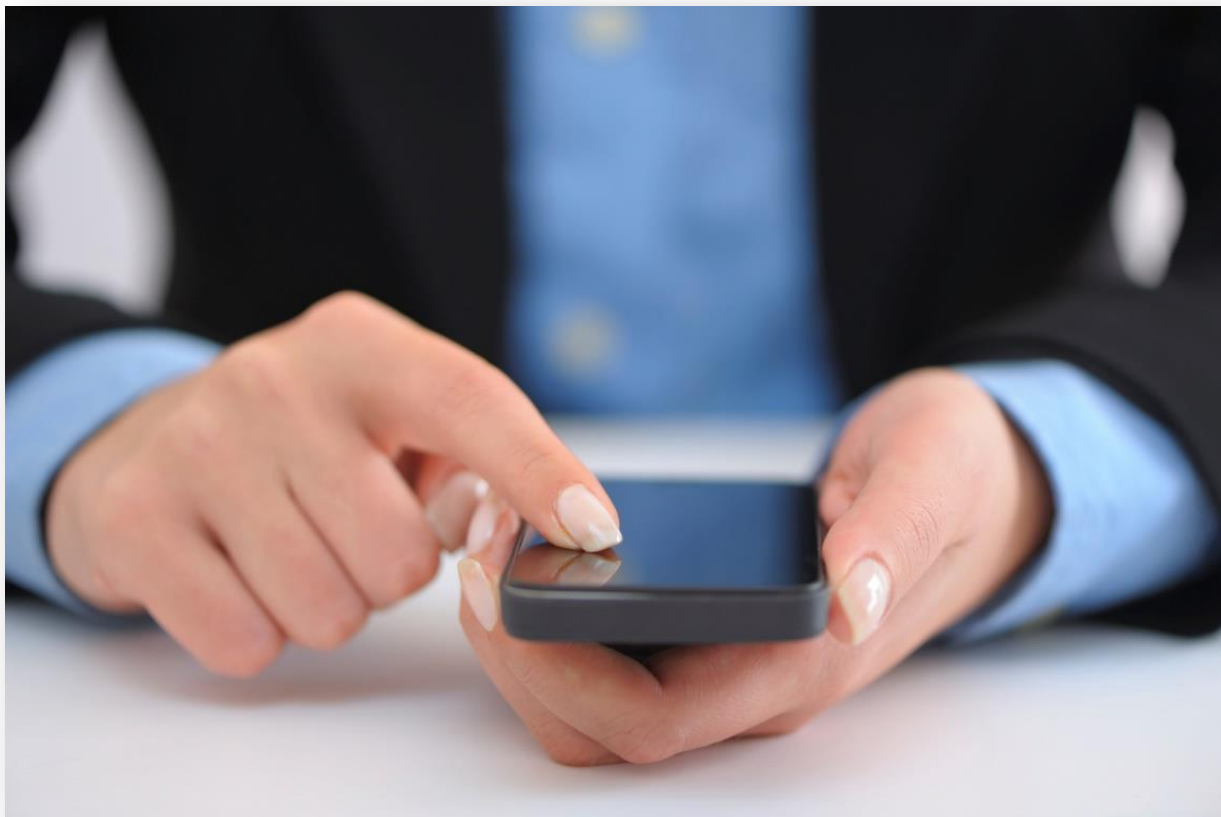
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About the Speaker



Holly Rook

Corporate Finance Consultant

More than 10 yrs. in business valuation

ASC 805 & 350 compliance

Accredited Senior Appraiser (ASA)

Learning Objectives

Understand how analysts determine the current value of banks based on results in the market

Recognize the key value drivers that influence bank value

Examine opportunities and common pitfalls in the typical due diligence process for a bank

Identify the steps in a purchase price allocation of an acquired bank

Learn the benefits of doing a purchase price allocation

Polling Question #1

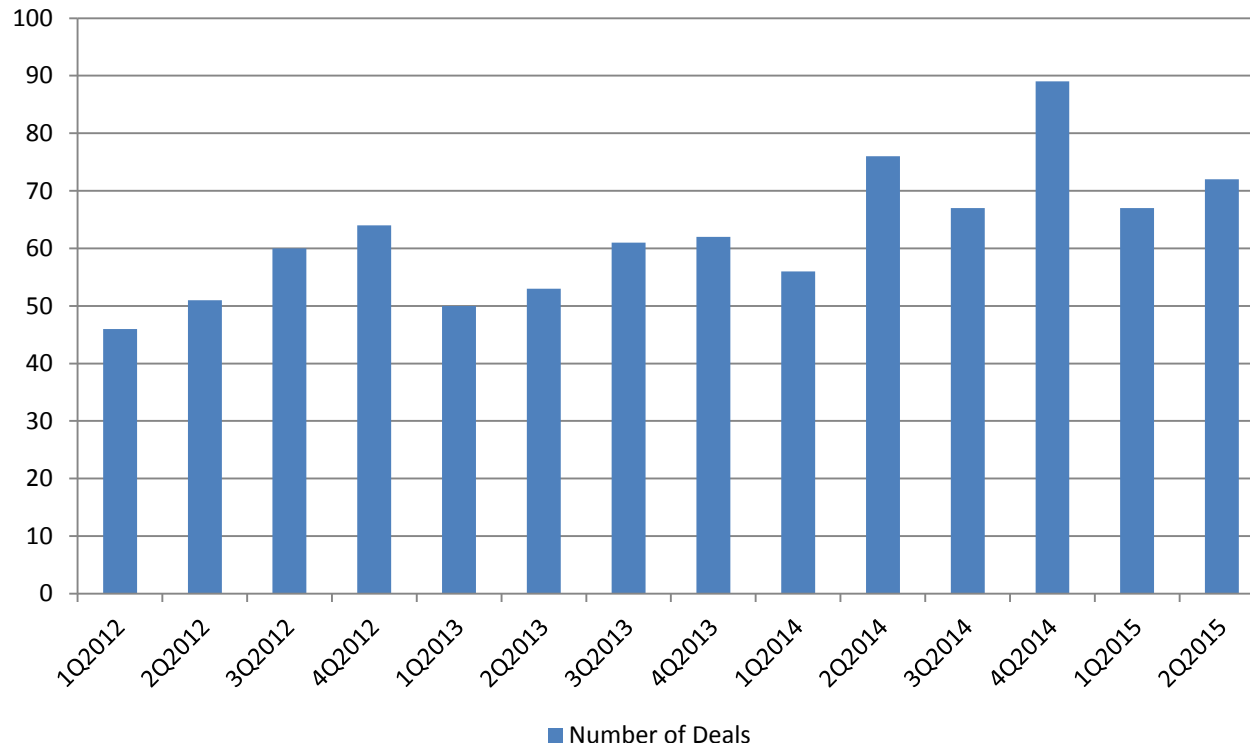
Market and Industry Trends

- Compliance becoming greater burden
- Net interest margins continue to be squeezed
- Smaller banks (less than \$250M in assets) are attractive acquisition targets
- Consolidation, as measured by acquisition announcements in 2015, is a bit higher than 2014.

Acquisition activity

Bank acquisitions began to show an uptick beginning in the 2nd Quarter of 2014.

Number of Deals by Quarter



Key Bank Valuation Metrics

Price to Tangible Book Value (P/TBV)

- A company's total book value less the value of intangible assets

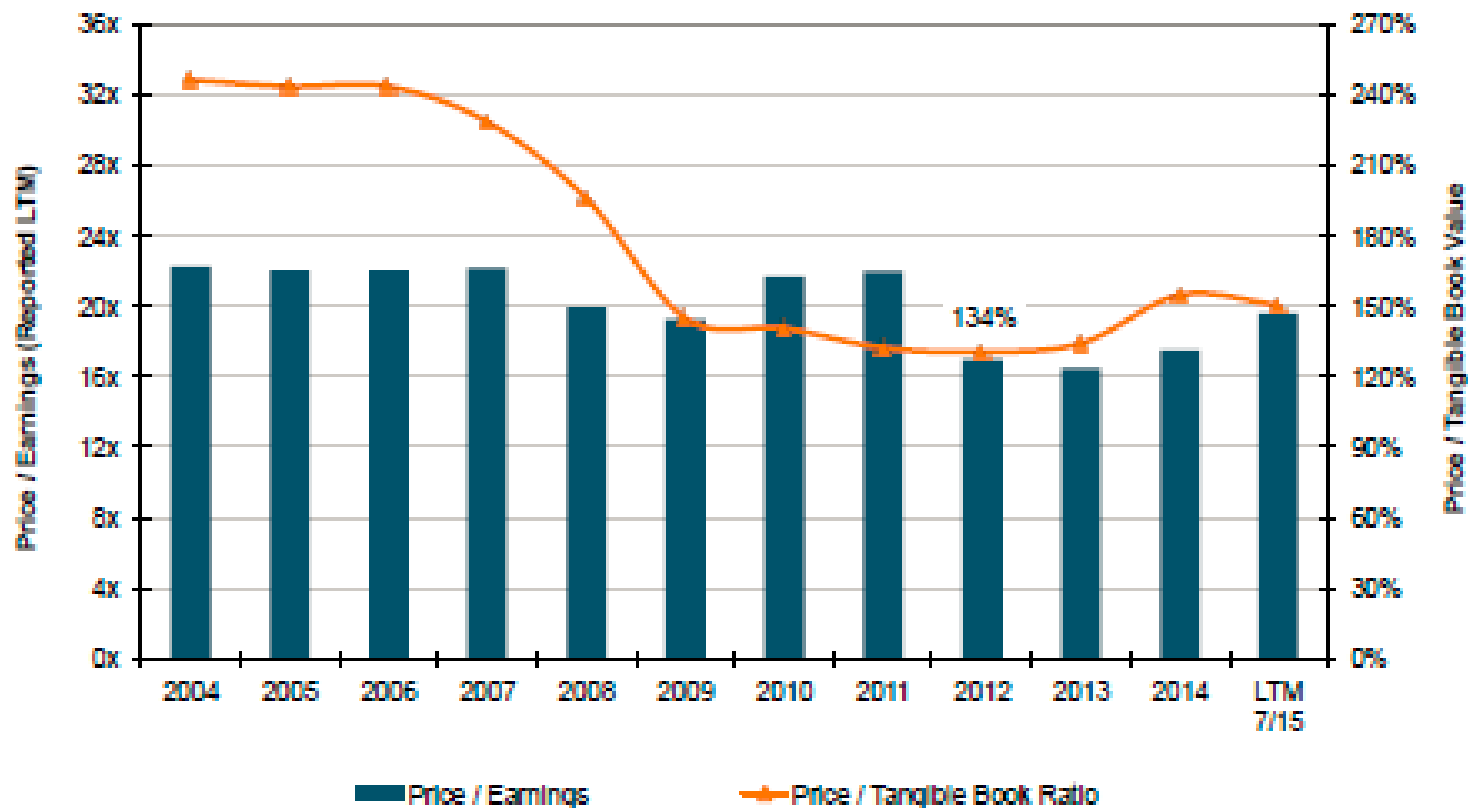
Price to Earnings (P/E)

- Market price divided by annual earnings per share

P/E & P/TBV

Figure 3: Community Bank Deal Activity Overview: P/E & P/TBV Multiples

Banks with Assets < \$5 Billion and LTM ROE > 5%



Source: Mercer Capital's August 2015 Bank Watch newsletter.

M&A Activity in the Midwest

Median Valuation Multiples for M&A Deals

Target Banks' Assets <\$5B and LTM ROE >5%, 12 months ended July 2015

Regions	Price / LTM Earnings	Price / Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value	Target's Median Assets	Target's Median LTM ROAE (%)
Atlantic Coast	21.89	1.61	7.7%	14	71.16	479,979	7.38%
Midwest	17.69	1.55	7.3%	69	33.55	104,786	8.77%
Northeast	20.03	1.67	9.5%	5	126.00	492,002	6.69%
Southeast	17.85	1.40	6.1%	30	29.82	186,921	8.15%
West	20.13	1.48	7.4%	17	58.98	253,143	9.16%
Nat'l Community Banks	19.59	1.50	7.3%	135	41.92	179,459	8.29%

Source: Per SNL Financial

Source: Mercer Capital's August 2015 Bank Watch newsletter.



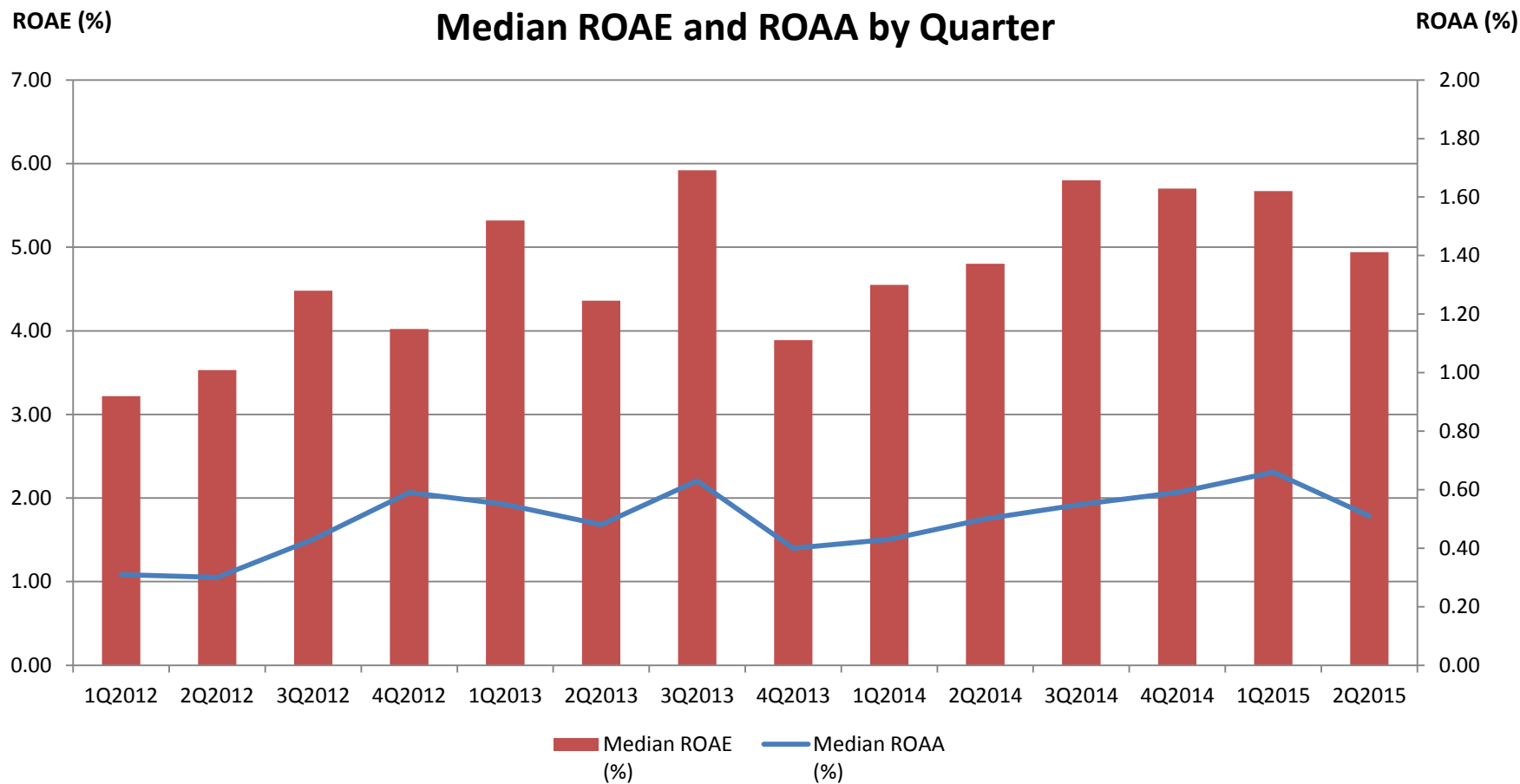
Polling Question #2

According to Warren ...

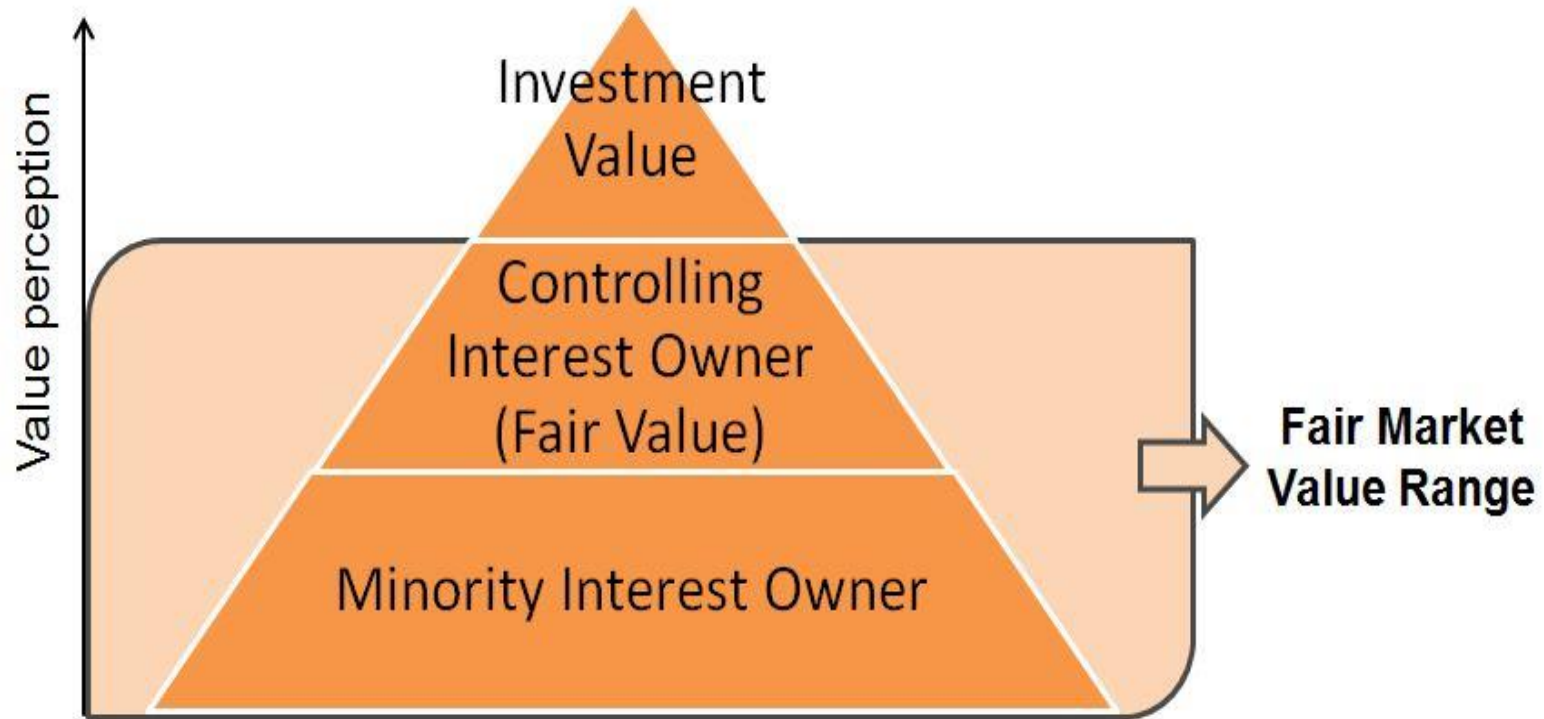
“Book value is not key to valuing banks.
Earnings are key to valuing banks.”

-- Warren Buffet

Return on Equity and Assets



Fair Market Value vs. Investment Value





Value Drivers


- Reduce risk
- Increase growth/returns

What Are Key value drivers?


1. Diverse and cohesive management team
2. Asset/liability pricing strategy
3. Healthy and diversified loan and deposit portfolios
4. Bank branch/es appearance and locations as well as online presence

Tip: Subscribe to Allen, Gibbs and Houlik's Banking Insights newsletter to get recent articles from McGladrey and AGH thought leaders.

Management Team Do's and Don'ts




Do have a diverse team with a variety of skill sets.




Don't rely too much on one key person.

Management Team Do's and Don'ts




Do operate as a cohesive team.




Don't let each team member operate in a vacuum.

Management Team Do's and Don'ts



Do have a management succession strategy in place.

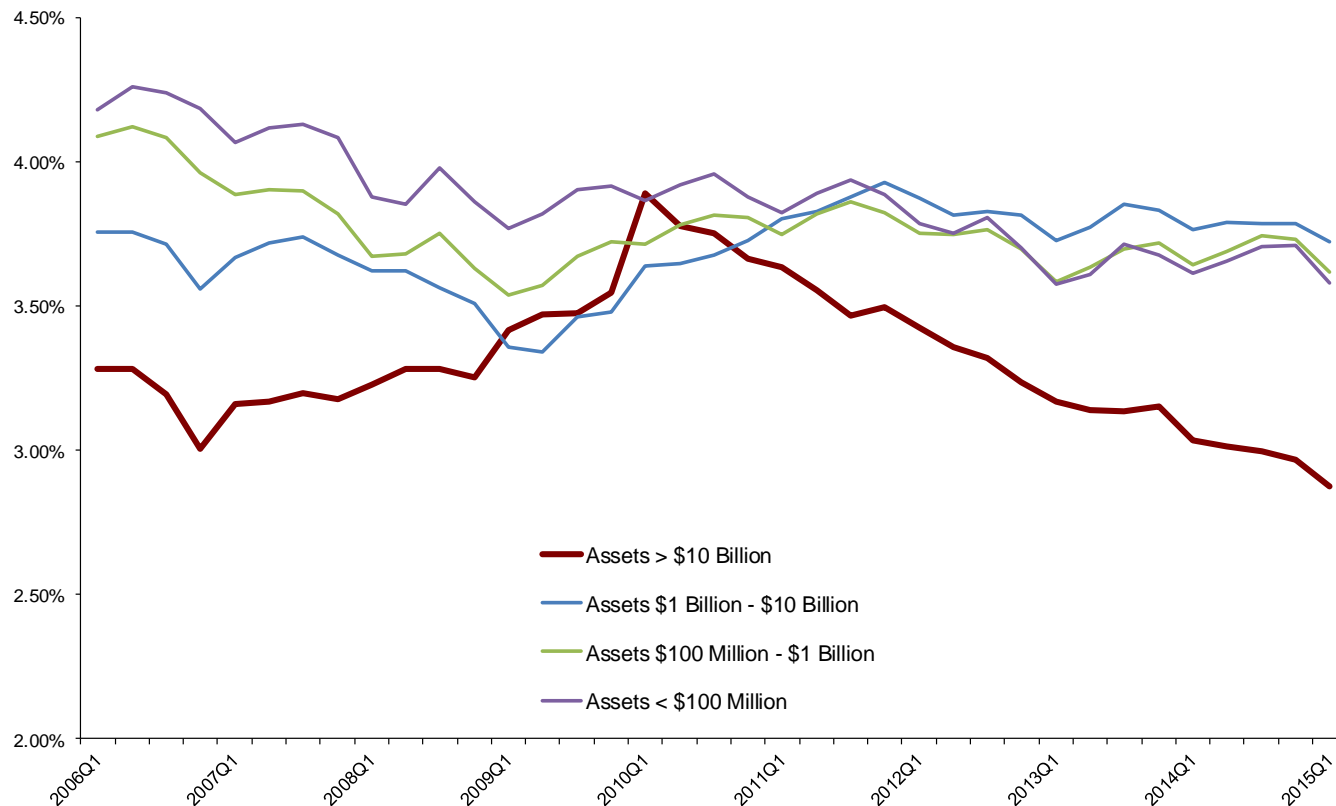


Don't forgo a formal plan for transitioning leadership.

Asset/liability pricing

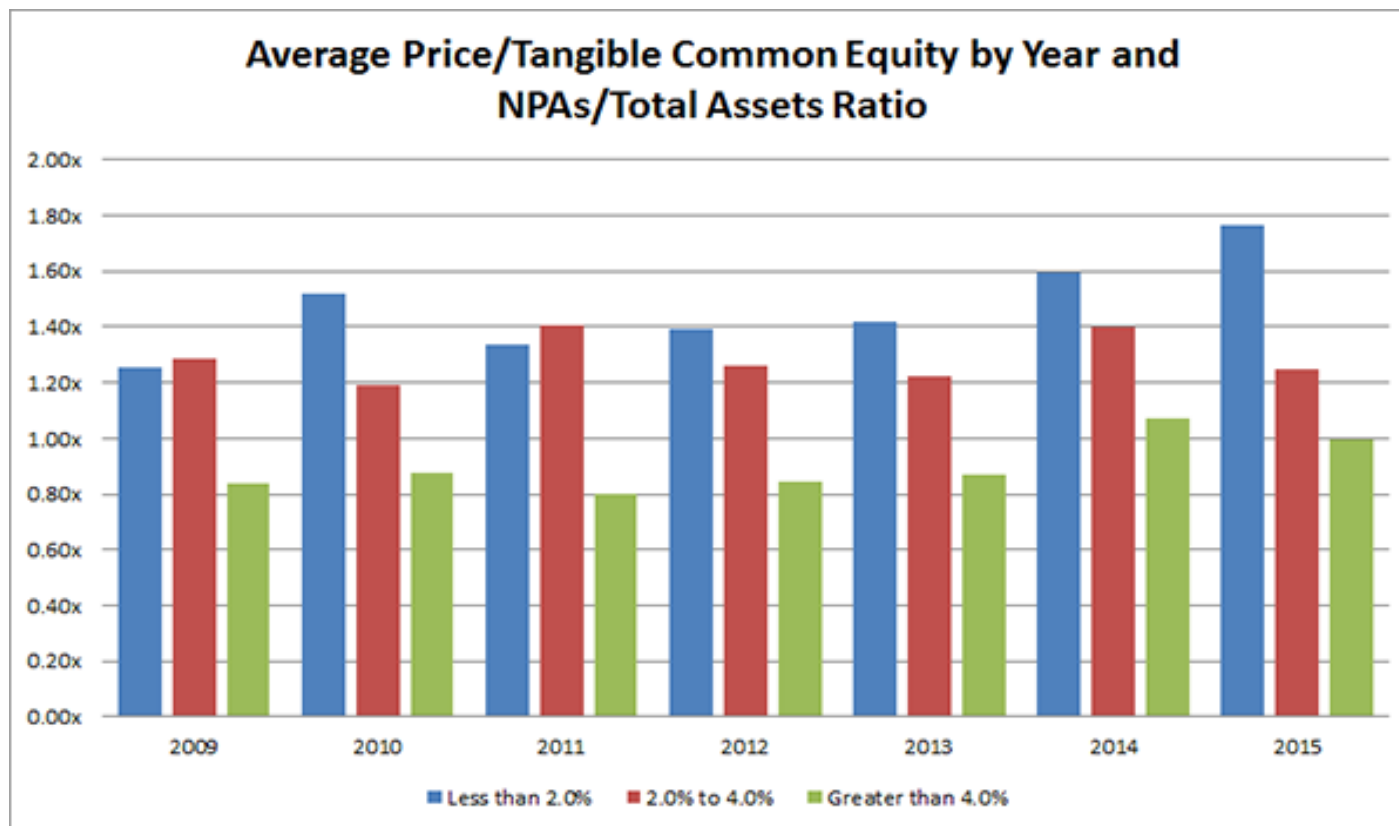
Sweet spot may be that \$1-10B in assets range.

Quarterly Net Interest Margin (NIM)



Loan quality

As non-performing assets/assets have declined, pricing multiples have risen for performing banks.



Source: McGladrey's Financial Institutions Insights April 2015 article, *M&A and Banks: What's new?*

Deposit Portfolio

- Does the Bank have the right Relationships?
- What are the demographics of deposit customers?
- Is it easy or difficult for customers to close account and open with a competitor?

Brick & mortar locations and Internet

- Banks are cutting non-essential locations
- Banks offer a high level of service to differentiate
- A comprehensive online presence improves efficiency

Polling Question #3

What you can do in the interim

Now



Potential
Sale



Annual Returns

$$\frac{\text{Dividends} + \text{Increase/decrease from PY value}}{\text{PY Value}}$$

We like to compare the annual returns to similar returns on a public stock index

After the definitive agreement...

Once the ink has dried, you need to hire an appraiser.

Why?





Tips for a successful PPA

- Assemble your all-star team (bank contact, auditor, valuation specialist)
- Decide on the timeline
- Determine if work will be done as of a preliminary date
- Provide information to specialist
- Determine your assumptions

Tips for a successful PPA

- Discuss deliverables for the analysis
- Discuss deliverables for Day 2 accounting schedules

Bonus Tip: AGH provides an assumption checklist to be agreed-upon by management when beginning the process.

Pitfalls to avoid

- Not letting the team talk or hindering access to key people
- Providing bad information to the appraiser
- Revising the books on your end once preliminary information has been provided
- Not considering the analysis of certain assets to save on the budget
- Avoid pre-planning



Benefits of doing a PPA

- Tapered amortization of the CDI
- Add support to your calculations
- Satisfy regulators
- Appraiser can guide you through the process, eliminating headaches after closing
- Less time burden on you and your staff

Polling Question #4

Thank you!

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