

# Breakout I: What The Board Needs To Know In 2023

#A0BA23

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**Bank**Director.

## Acquire or Be Acquired:

# What The Board Needs To Know in 2023

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# Introduction / Highlights

## 2023 – Hunkering Down?

### ▪ Politics/Regulation

- New / old faces in the crowd
  - Impact of mid-terms will take some time
- More regulation and less bank “friendly”?
  - Few troubled banks (for now)
  - Applications vs. safety & soundness vs. compliance
  - Return to in-person examinations
  - Strong regulatory relationships are important as ever
  - Don’t give the regulators a reason to slow approvals on M&A/strategy

### ▪ Financial

- Interest rate increases
- Deterioration of common equity through AOCI
- Deposit and loan beta
- Economic uncertainty
- Asset quality
- Volatility of stock prices
- Stock repurchases and return of capital

### ▪ “New” partnerships and products

- Outsiders and those new to banking
- Fintech
- Banking-as-a-service (BaaS)

### ▪ Board dynamics

- ESG has a firm hold and will continue to grow in importance
- Directors continue to be more vocal

### ▪ Strategic considerations

- Core funding
- M&A activity
  - Pressure to just do a transaction seems to have diminished
  - Buyers showing restraint but lower prices will have less goodwill
  - Negotiate AOCI movements in pricing
  - Sellers being methodical
  - More starts / stops and “pauses”
  - Time to begin dialogue and develop relationships
  - Prepare for unsolicited approaches

### ▪ Cash buyers should be competitive

- Credit unions + privately-held entities will continue to be consistent community bank buyers

## M&A – Expect Different Headlines in '23

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# Optionality for Acquisitions

## Executive Summary

### Bolt-on Bank Acquisition



- Execution is more manageable given natural extension or in-market
- Leverage existing knowledge of market
- Achievable cost saves
- Target banks with good deposit base
- May be better received during economic uncertainty

### Fintech Acquisition



- More polarizing today than over the last couple of years
- Remains a hot topic in boardroom discussion
- Same opportunity can be viewed by the board of directors:
  - Enhancing growth
  - Keeping up with the larger competitors
  - Differentiation versus existing competitors
  - Significantly more diligence questions
  - Regulatory considerations can not be overlooked

### Merger of Equals



- Significant potential upside to pro forma shareholders after the merger is complete
- Current investor focus is time period for regulatory approval process
- Risk/reward is higher than bolt-on
- Longer-term can create significant franchise value as pro forma entity is integrated

# Three Possible Routes for a Seller

















*Hypothetical results and considerations of 3 transactions where a target sells to a relatively larger bank, sells to a bank twice its size, and a transformational/MOE deal*

- The financial summary table highlights short term versus the longer term valuation creation opportunity
- Assuming the P/E multiples remain constant the transformational transactions can create significant upside

## Illustrative Financial Consideration Scenarios

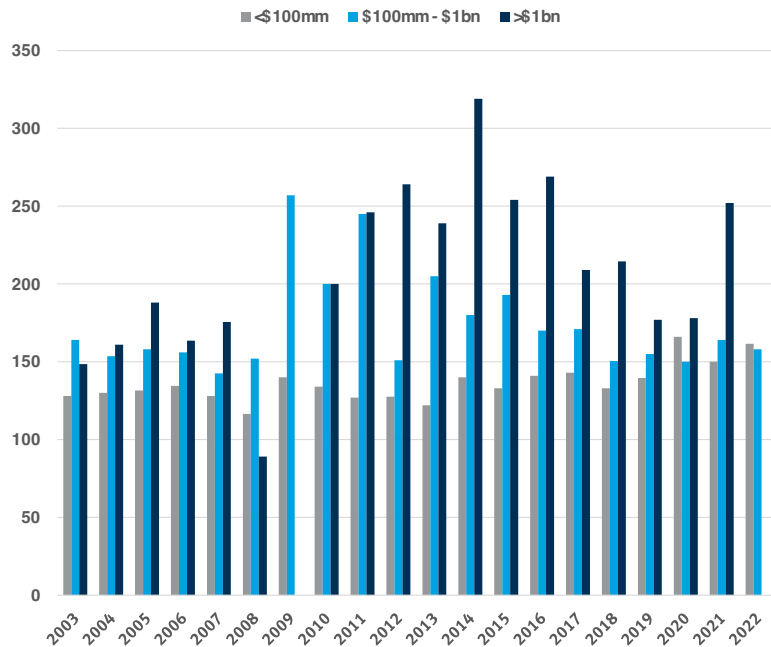
	Larger Buyer	Buyer 2x Size	MOE
Initial Premium	20-40%	15-30%	0-15%
Buyer EPS Accretion	5-10% / 2.5-7.5% <sup>(1)</sup>	10-20% / 5-15% <sup>(1)</sup>	20-30% / 10-30% <sup>(1)</sup>
Buyer TBV Earnback	1-2 Years	2-3 Years	2-4 Years
Buyer TBV Dilution	2-3% / 0-2% <sup>(1)</sup>	3-5% / 2-3% <sup>(1)</sup>	10% / 2-4% <sup>(1)</sup>

## Non-Financial Considerations

	Larger Buyer	Buyer 2x Size	MOE
Corporate Structure			
Corporate Name			
Ownership / Control			
Headquarters			
Board Composition			
Liquidity to seller			

<sup>(1)</sup> Excluding interest rate marks

### Number of Days From Deal Announcement to Deal Completion<sup>(1)(2)</sup>



Source: S&P Market Intelligence and FactSet; Data as of 12/31/2022

Note: Transactions include bank, savings bank and thrift transactions; Excludes non-full bank transactions. Transactions grouped by announced deal value.

Note: Median values shown for number of days from deal announcement to deal completion

(1) Incomplete deals announced before 6/1/2021 assume completion date of 1/18/2022 to reasonably measure lengthiness of approval process for incomplete deals for illustrative purposes

(2) M&T Bank Corporation/Hudson City Bancorp, Inc. excluded due to idiosyncratic regulatory issues

Generally, larger transactions will take longer, but increasingly more random

### Median Number of Days From Deal Announcement to Deal Completion

Deal Value	2003 - 2022	2021 & 2022	▲ from '03 - '22 to '21 - '22
<\$100mm	134	156	22
\$100mm - \$1bn	164	161	(3)
>\$1bn	192	252	60

### Extensive Due Diligence is Expected

- More economic uncertainty will create more diligence
  - 3<sup>rd</sup> Party loan review
  - Multiple management meetings
  - Operational matters stressed (IT, contracts, real estate, etc.)
- Anti-trust evaluation is critical
- Regulatory relationships are key
  - Can impact deal structure
  - Stay away from D.C.
- No Shortcuts!

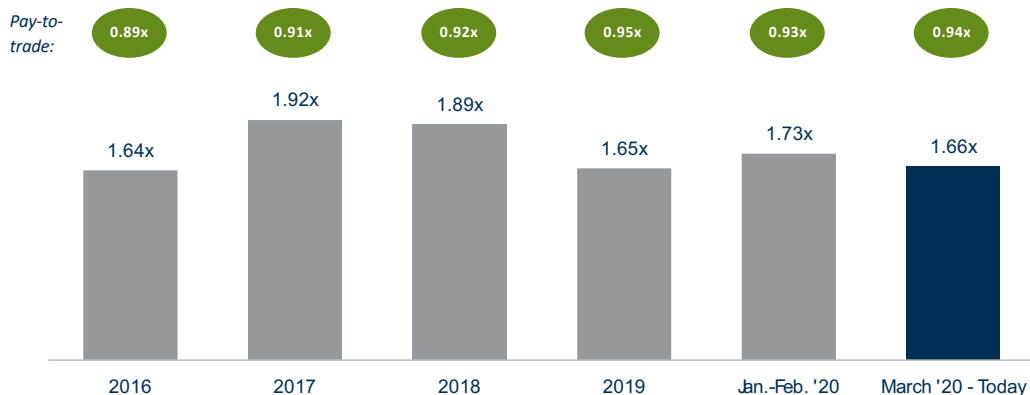


# Rethinking M&A Valuation

## It's All Relative

- M&A is **governed by valuation**
  - M&A pay-to-trade generally range between 0.9x and 1.0x of the buyer's P/TBV multiple
- Expect M&A process to experience more **speed bumps** than normal
- There is natural resistance of sellers to accept lower price and buyers to issue stock at depressed valuations
- In today's environment, **M&A valuation** needs to be **viewed through the lens of relative ownership and valuation**
  - What % of the pro forma company are you getting relative to contribution or historical valuation
  - Higher interest rates creating purchase accounting triggers
  - **Economic uncertainty** generally slowing down M&A

### Historical Tangible Book Value Multiples<sup>(1)</sup>



- Current environment should lend itself to more **selective merger processes** with fewer conversations as opposed to broad auction processes
- New **1% excise tax** on cash portion of consideration applicable in many instances involving public companies
- **Negative operating leverage** should continue to drive bank M&A conversations over time

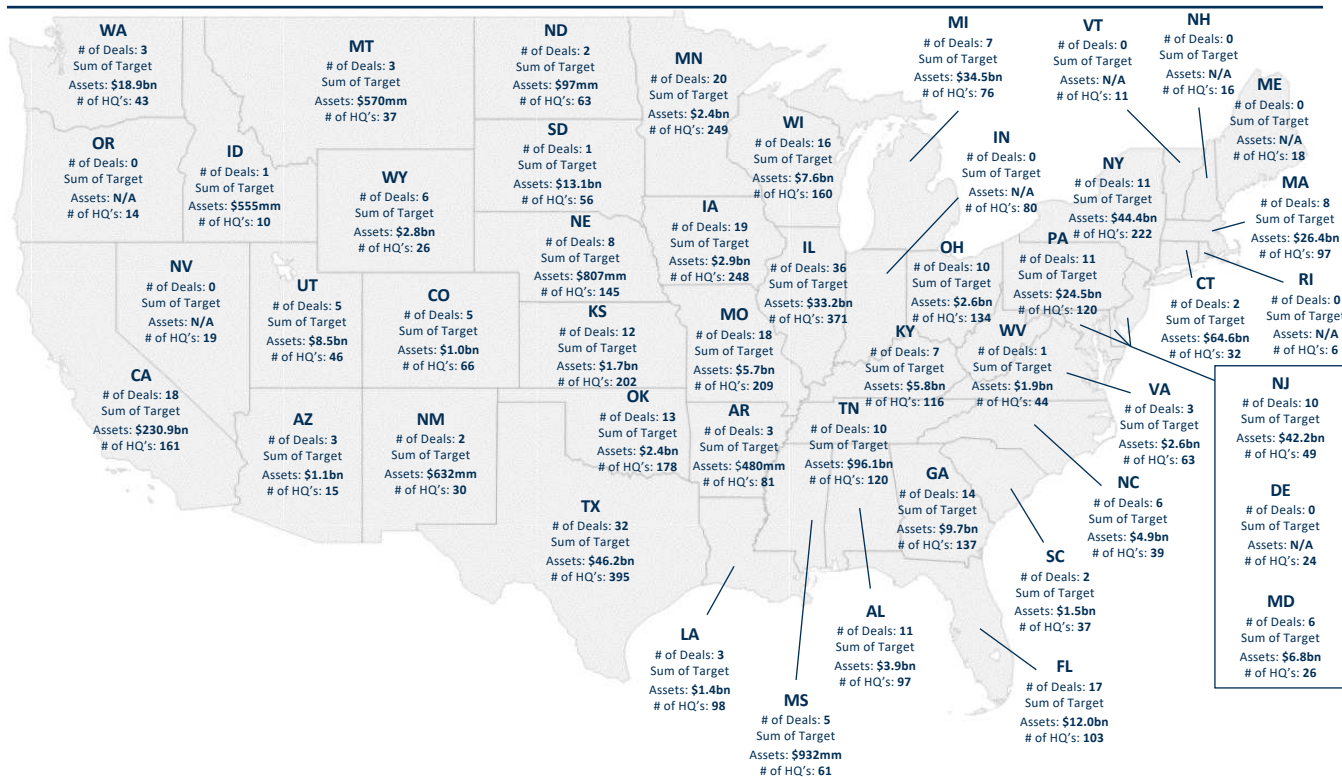
Source: S&P Global Market Intelligence, FactSet and Company documents. M&A data as of 12/31/22; Market data as 12/30/22

(1) Includes nationwide transactions since 1/1/16 with announced deal values \$50M+

# Where The M&A Activity is

*High correlation of number of M&A bank mergers to number of banks headquartered in each state*

## Cumulative U.S. Transactions since 1/1/2021

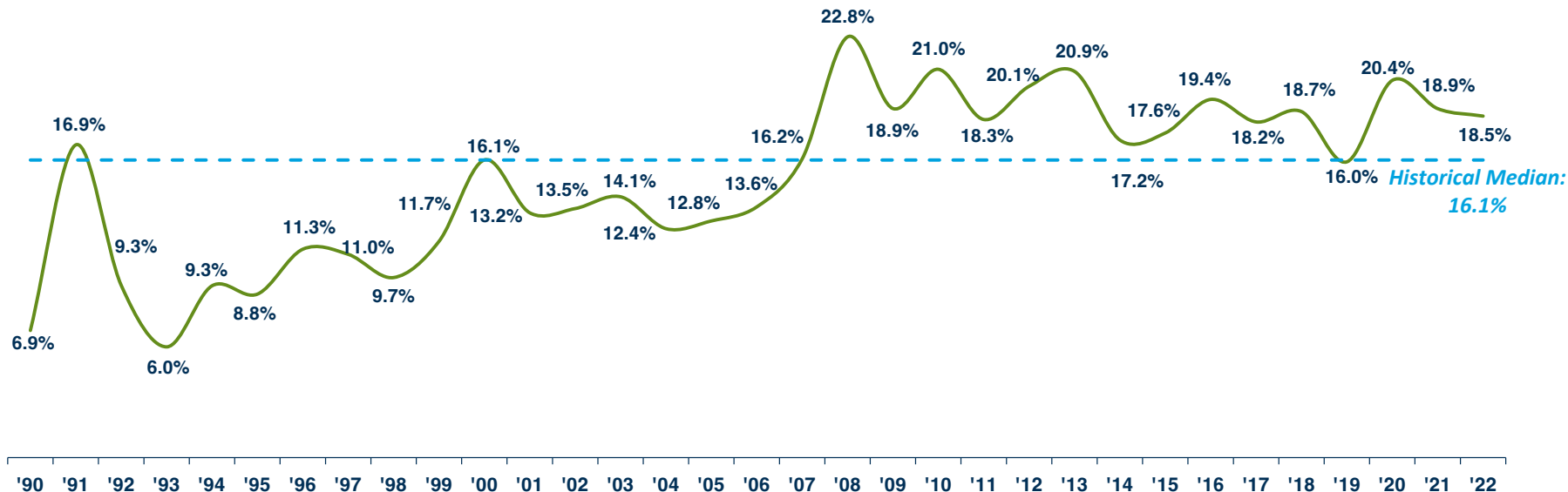


Source: S&P Capital IQ Pro

Note: Cumulative transaction count, target asset, and headquarter data as of 12/31/22

Note: Excludes transaction data from Alaska, Hawaii, and U.S. territories

## Median Target Assets / Buyer Assets (%)



Source: S&P Global Market Intelligence  
Includes all announced deals 1/1/1990 to 12/31/2022, excluding recapitalizations



# Types of M&A Processes – From Seller Perspective

	Pros	Cons
<b>Negotiated Transaction</b>	<ul style="list-style-type: none"> <li>✓ Best way to ensure a preferred outcome</li> <li>✓ Leverage is maintained by the threat of opening it up</li> <li>✓ Some buyers are more inclined to participate if promised a good look</li> <li>✓ Maximum opportunity to extract social issues</li> <li>✓ Limits risk of leaks</li> <li>✓ Can be turned into an auction</li> </ul>	<ul style="list-style-type: none"> <li>✗ Requires a continuation of interest</li> <li>✗ Prevents the possibility of a bidding frenzy</li> <li>✗ Not appropriate when indifferent to which buyer wins</li> <li>✗ Greater risk of investor scrutiny</li> <li>✗ Need to carefully evaluate board's fiduciary duties</li> </ul>
<b>Limited Auction</b>	<ul style="list-style-type: none"> <li>✓ Similar to a "full auction"</li> <li>✓ Risk of leaks is slightly lower than with a full auction</li> <li>✓ Sensitive buyers may be more likely to engage if promised the whole world is not participating</li> <li>✓ The presence of the top players means competitive dynamics are nearly maximized</li> </ul>	<ul style="list-style-type: none"> <li>✗ Similar to a "full auction"</li> <li>✗ Not appropriate when possibility of a wild card bidder is present</li> <li>✗ As with a full auction, certain buyers may lose enthusiasm because of the loss of the collaborative spirit in a negotiated deal</li> </ul>
<b>Full Auction</b>	<ul style="list-style-type: none"> <li>✓ Builds a record that is easy to explain to shareholders and meets fiduciary duties</li> <li>✓ Especially appropriate when there is uncertainty as to how many and to what degree institutions will be interested</li> <li>✓ Greatest potential for competition</li> </ul>	<ul style="list-style-type: none"> <li>✗ Greatest risk for leaks</li> <li>✗ Social issues take a greater backseat to price</li> <li>✗ Some buyers feel it is not worth their time given lower likelihood of success and lack of commitment from seller</li> </ul>

# M&A – Expect Different Headlines in '23

## *Other Observations*

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- **Board politics** are more pronounced than ever
- Board members are **more inquisitive**
- **Social considerations** matter a lot especially for those that are the decision makers at various points in the process
  - Evaluate state law / governance documents for clarity to consider non-financial factors
- **Compensation/titles/roles** matter
- **Lawsuits** are still being filed and some are becoming more sophisticated
  - Don't panic!
  - Can affirmatively do things to minimize risk
  - Consider communication among decision makers – assume discoverable
- **New entrants** provide unique opportunities and challenges
- **Regulators** hold the keys
  - Influence of non-regulatory ratios?
  - CRA
  - Anti-trust

## Fintech – It's Not All Crypto

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# Fintech – It's not all Crypto

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- **Has evolved to impact every part of a financial institution's business**
  - Basic core processing
  - Banking-as-a-Service
  - Lending
  - Underwriting
  - Payments
  - Investments in Fintech funds
  - Cryptocurrency and blockchain
    - Recent headlines will lead to more questions
  - Artificial Intelligence
- **Fintech adoption has obviously increased at an accelerated rate over the last several years**
  - Many experts believe this trend will continue for the foreseeable future
  - Longer-term question remains how will the banking industry continue to implement technology – outsource, partnership and/or customize
- **Opportunities to respond and react**
  - Partner with a company which may include equity ownership
  - Acquire technology
  - Develop own technology
    - Own use
    - Sell to other financial institutions
  - Due diligence and regulatory considerations
  - Assume Fintech partner does not fully appreciate regulatory expectations
  - Negotiate contract carefully
    - Include future audit/ diligence rights
- **Board training is critical**
  - Size and current technical capabilities is irrelevant
  - Need to understand opportunities and competition

# A Broad Set of Themes Drives Fintech M&A

Increasing Focus on B2B	Verticalization of Payments	The Search for Growth	Value Chain Integration
<ul style="list-style-type: none"> <li>– Position towards <b>structural growth</b> of A2A payments</li> <li>– Address the <b>B2B opportunity</b> where A2A becoming increasingly relevant</li> <li>– Offer customer choice and innovative products beyond cards</li> </ul>	<ul style="list-style-type: none"> <li>– Capture additional processing volumes in <b>target verticals</b></li> <li>– Offered vertical focused solution</li> <li>– Be the <b>payment method of choice</b> where the business and consumer transacts</li> </ul>	<ul style="list-style-type: none"> <li>– Large players positioning towards fast-growing Fintech verticals</li> <li>– Addressing growing needs of small and medium sized businesses &amp; consumers, <b>online and offline</b></li> <li>– Cross-sell opportunities across <b>expanded customer base</b></li> </ul>	<ul style="list-style-type: none"> <li>– Achieve greater coverage of the <b>solutions value chain</b></li> <li>– Deliver <b>greater value</b> and pricing to customers</li> <li>– Cross-sell opportunities across expanded customer base</li> </ul>

Source: Analyst reports, press release



# Investor Appetite For Fintech Challengers Has Fluctuated Recently

PayPal, Square & Chime Market Cap vs. Top 25 Publicly Traded U.S. Banks<sup>(1)</sup>

Market Cap Rank	Institutions	Headquarters	Market Cap (\$bn)	Years Since Established
1	JPMorgan Chase & Co.	New York, NY	\$394.8	223
2	Bank of America Corporation	Charlotte, NC	267.5	24
3	Wells Fargo & Company	San Francisco, CA	160.4	170
4	Citigroup Inc.	New York, NY	89.8	210
	<b>PayPal Holdings, Inc.</b>	<b>San Jose, CA</b>	<b>83.6</b>	<b>24</b>
5	The PNC Financial Services Group, Inc.	Pittsburgh, PA	66.3	170
6	U.S. Bancorp	Minneapolis, MN	64.7	159
7	Truist Financial Corporation	Charlotte, NC	57.1	150
8	Capital One Financial Corporation	McLean, VA	38.5	34
	<b>Square, Inc.</b>	<b>San Francisco, CA</b>	<b>37.5</b>	<b>13</b>
	<b>Chime Financial, Inc.<sup>(2)</sup></b>	<b>San Francisco, CA</b>	<b>25.0</b>	<b>10</b>
9	Fifth Third Bancorp	Cincinnati, OH	22.4	164
10	First Republic Bank	San Francisco, CA	21.8	37
11	Regions Financial Corporation	Birmingham, AL	20.3	52
12	Huntington Bancshares Incorporated	Columbus, OH	20.3	156
13	M&T Bank Corporation	Buffalo, NY	18.7	166
14	Citizens Financial Group, Inc.	Providence, RI	16.6	194
15	KeyCorp	Cleveland, OH	16.2	173
16	SVB Financial Group	Santa Clara, CA	13.5	39
17	First Horizon Corporation	Memphis, TN	13.1	158
18	East West Bancorp, Inc.	Pasadena, CA	9.4	24
19	Comerica Incorporated	Dallas, TX	8.7	173
20	Cullen/Frost Bankers, Inc.	San Antonio, TX	8.5	154
21	Commerce Bancshares, Inc.	Kansas City, MO	8.3	157
22	Zions Bancorporation, National Association	Salt Lake City, UT	7.5	149
23	BOK Financial Corporation	Tulsa, OK	7.1	112
24	Signature Bank	New York, NY	7.0	21
25	Prosperity Bancshares, Inc.	Houston, TX	6.7	39

Source: S&P Global Market Intelligence. Market data as of 12/30/2022

Note: The KBW Regional Banking Index (KRX) includes 50 U.S.-based regional banks with assets between \$8 and \$75 billion

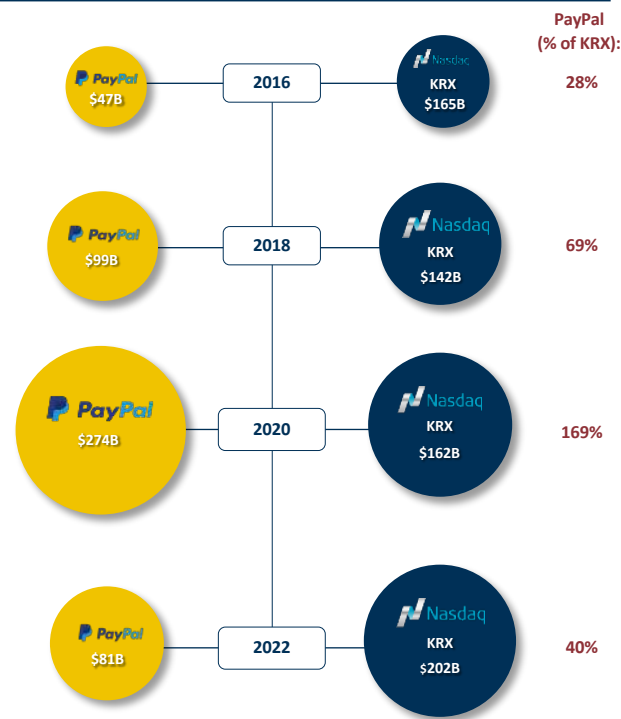
(1) Excludes BK, STT and NTRS

(2) Chime Financial, Inc. valued at approximately \$25 billion per last round of funding 8/13/2021

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(1) Dollars represent market capitalizations; Market data as of 12/30/2022, 12/31/2020, 12/31/2018, 12/31/2016, accordingly

Evolution of PayPal Market Cap vs. KRX Over Time<sup>(3)</sup>

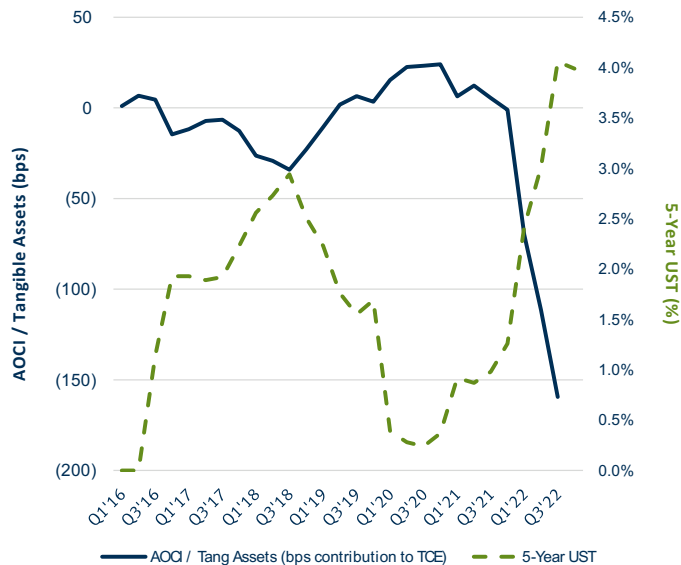


## Current Themes – AOCI, Liquidity, and Passive Investing

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# TCE Impacted By Falling AOCI (Bond Mark-to-Market)

## Industry AOCI Contribution to TCE (AOCI / Tangible Assets)

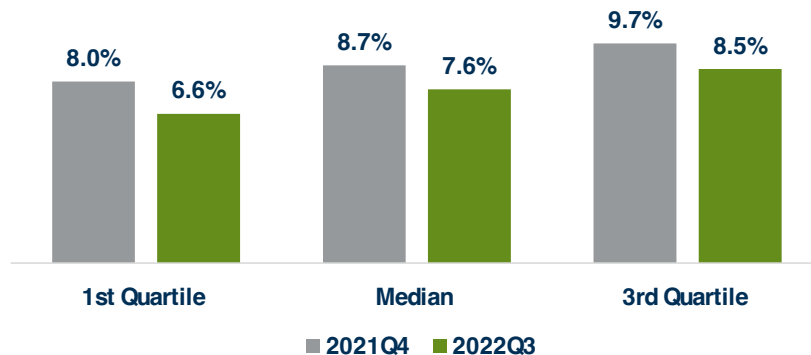


5-Year UST has moved **up +273 bps** since 12/31/21 – indicating a material move in MTM values in Q1

## Hard to ignore:

- Multiple consecutive quarters of **AOCI hits**
- **Declining TCE** into a predicted recession
- Resulting in **higher price** to tangible book for value investors
- How will **regulators respond**?

## TCE / TA Ratios are down from 2021 Q4

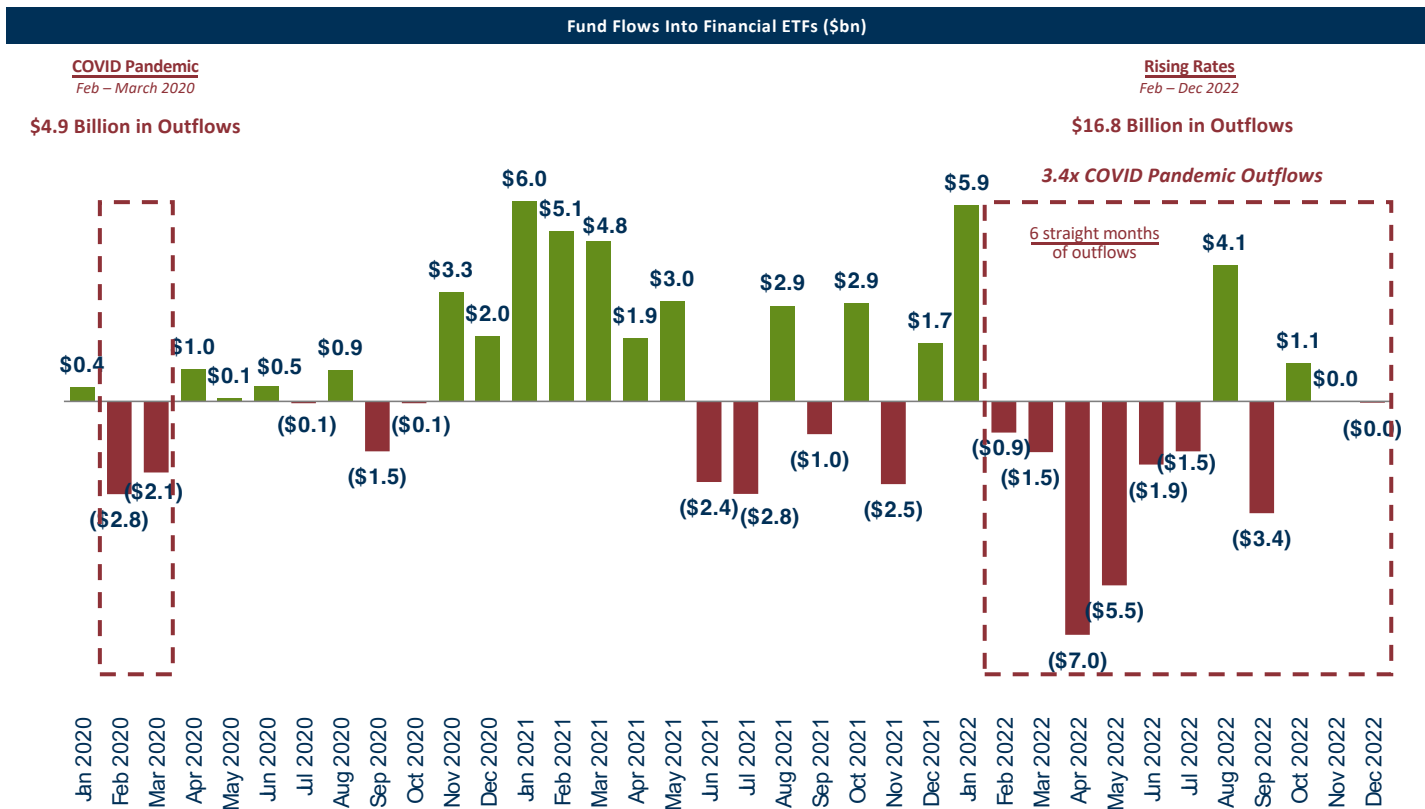


Source: S&P Capital IQ Pro. Financial data as of 9/30/22. TCE as defined by S&P Capital IQ Pro

Note: Data set includes nationwide major exchange traded banks with MRQ total assets \$2.5B-\$50.0B. Excludes merger targets

# Bank Investor Thinking

## Financial ETFs Outflows



Source: KBW Research published January 4, 2023

## Other Key Considerations for 2023

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# ESG – Increasing Relevance

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- **Not new to financial institutions**

- The S (Social) and the G (Governance) have been a focus
- The E (Environmental) has taken hold and will trickle down to regional / community banks
- Impact on public and private companies are beginning to line up

- **Important for all banks to act on diversity**

- Makeup of the board
- Employee base
- Methods to communicate commitment
- Reporting on diversity of talent, experience and competence

- **Different constituents with different impacts**

- Regulators
  - Banking regulators
  - SEC / Nasdaq / NYSE
- States
  - Board requirements
  - Reporting requirements
- Customers
- Investors – Evolving and not a precise definition
  - Retail
  - Institutional
  - ESG Funds

# Legal Potpourri

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## ▪ Employment matters

- Compensation matters
  - Tight labor market
  - Inflation increasing expenses
  - Pay vs performance reporting
  - Claw backs
- Developments with restrictive covenants
  - Many states have enhanced enforcement / interpretation
  - Feds getting in the action
- **Time to review agreements and plans!**

## ▪ Succession planning

- Board
- Executives
- Key operational / compliance roles

## ▪ Bank regulatory hot issues

- BSA / AML
- CRA
- Cybersecurity
- Vendor management
- CFPB

## ▪ Class action lawsuits continue

- Overdraft charges remain a focus
- Evaluate customer contracts and prepare



## Presenter Biographies

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## Presenter Biography



**Robert M. Fleetwood**

*Co-Chairman,  
Financial Institutions Group*

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### Career Background

Robert M. Fleetwood is the co-Chairman of the firm's Financial Institutions Group. He concentrates his practice on advising financial institutions on strategic, securities, and general corporate matters. Rob regularly represents financial institutions on public and private securities offerings, recapitalizations, mergers and acquisitions and contract negotiations. Additionally, Rob works closely with clients on their continued compliance with federal and state securities laws, including reporting under the Securities Exchange Act and with corporate governance.

Rob is an adjunct professor in banking law at the Northwestern University Pritzker School of Law. He was an adjunct professor of securities law in the graduate program in financial services law at the Chicago Kent College of Law for five years. Rob is also a frequent speaker in the financial institutions and securities law areas to trade associations and professionals.

Our 30+ attorney Group has represented more than 250 financial institutions across the country. Our M&A experience is unparalleled—over the past 5 years we were the **#3 legal advisor in the U.S. and #1 in the Midwest** by announced bank and thrift M&A transactions—according to *S&P Global Market Intelligence*.

### Education

B.A., University of Michigan

J.D., Northwestern University Pritzker School of Law

# Presenter Biography



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*Managing Director*

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**Focus at KBW**

Al Laufenberg advises board of directors, special committees and senior executive offerings of public and privately-owned financial institutions on a wide range of alternatives including M&A and capital raising. In addition, Al leads the firm's market leading business development companies (BDCs) investment banking initiative.

**Career Background**

Al is a Managing Director based in Chicago, focusing on full advisory services to depositories and specialty finance (BDCs), and is a member of the firm's fairness opinion committee.

Al Laufenberg has represented numerous financial institutions (buy and sell side) as well as working with special committees for over 25 years. KBW/Stifel has become an BDC investment banking industry leader under Mr. Laufenberg's leadership. Al has worked on successfully completing over 300 transactions exceeding \$60 billion in transaction value for financial institutions. Mr. Laufenberg has worked with KBW/Stifel since the 2005 Stifel acquisition of the Legg Mason capital markets division. Earlier in his career, Al was an investment banker at EVEREN Securities and First Union (now known as Wells Fargo). Mr. Laufenberg has an B.B.A. Finance from University of Wisconsin-Whitewater where he was a Kemper Scholar.

**Select Transaction Experience**

- West Suburban Bancorp, Inc. sale to Old Second Bancorp, Inc.
- Private placement agent for Standard Bancshares, Inc. - equity raise
- Sole bookrunner – Old Second Bancorp, Inc. subordinated debt
- Acquisition by QCR Holdings, Inc. of Springfield Bancshares, Inc.
- Special committee advisor on Oaktree Specialty Lending Corporation acquisition of Oaktree Strategic Income Corporation
- Acquisition by Nicolet Bankshares Inc. of County Bancorp, Inc.
- Sole placement agent - Old Second Bancorp, Inc. subordinated debt
- Acquisition by First Community Financial Partners, Inc. of minority ownership in various subsidiaries
- Placement agent – BankFinancial subordinated debt
- Trinity Capital Inc. – Bookrunner or sole agent on 7 separate transactions raising over \$700 million in aggregate over 36 months
- Lead bookrunner – HBT Financial, Inc. IPO
- InterLINK sale to Webster Financial Corporation
- Town and Country Financial Corporation sale to HBT Financial Inc.
- Sole Placement agent – First Business Financial Services Inc. noncumulative preferred and subordinated debt

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