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Financial Managers Society

New York/New Jersey Chapter

FMS Financial Managers Society

April 18, 2014

Capital is King: Balancing Regulatory Capital Requirements and Sustainable Growth

Performance Measurement

Strategic Management

Profit & Process Improvement

Board & Management Advisory Services

Financial Advisory

The Great Capital Debate

Discussion Agenda

The purpose of today's presentation is to provide a brief overview of the challenges facing depository institutions in balancing regulatory capital requirements with the need to generate sustainable growth.

Draft materials as of 04/14/14; Subject to Change

Key Takeaways from Today's Discussion:

- **Strategic:** *The Great Capital Debate* ---> capital levels, formation, management, measurement and risk appetite?
- **Strategic**: *Sustaining Growth* ---> what is growth and how is growth achieved by the banking industry?
- **Tactical**: *Achieving Growth* ---> applying strategic thinking to tactical initiatives to generate sustainable growth

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The Great Capital Debate

Setting the Stage

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1

Final Rule on Enhanced Regulatory Capital Standards–Implications for Community Banking Organizations

On July 2, 2013, the Federal Reserve Board approved a final rule that implements changes to the regulatory capital framework for all banking organizations.[1] This table highlights the provisions that are most relevant to smaller, non-complex banking organizations and compares the new capital requirements to the current standards.

	Current Treatment	Treatment in Final Rule	Section(s) in Rule Text
Minimum Regulatory Capital Ratios and Capital Buffer			
Common equity tier 1 capital (CET1) ratio	N/A	4.5%	Subpart B, § 10
Tier 1 capital ratio	4%	6%	
Total capital ratio	8%	8% (no change)	
Leverage ratio	4% (or 3%)[2]	4%	
Capital conservation buffer	N/A	Capital conservation buffer (composed of CET1 capital) equivalent to 2.5% of risk-weighted assets in addition to the minimum CET1, tier 1, and total capital ratios	Subpart B, § 11
Definition of Capital			
CET1	No specific definition	Common stock (plus related surplus) and retained earnings less the majority of the regulatory deductions	Subpart C, § 20(b) and § 22
Tier 1 capital	Common stock (plus related surplus) and retained earnings plus preferred stock and trust-preferred securities (for bank	CET1 plus non-cumulative perpetual preferred stock and grandfathered trust-preferred and other securities,	Subpart C, § 20(c) and § 22

2

Tuesday, July 09, 2013 10:03 AM ET

Regulators propose doubling leverage ratio for big U.S. banks

Article | Related Content

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By Lindsey White

The OCC, Federal Reserve and FDIC on July 9 proposed doubling the leverage ratio for large, interconnected U.S. banks.

Under the proposed rule, bank holding companies with more than $700 billion in consolidated total assets or $10 trillion in assets under custody would be required to maintain a tier 1 capital leverage buffer of at least 2% above the minimum supplementary leverage ratio requirement of 3%, for a total of 5%. Failure to meet the 5% ratio would subject these bank holding companies to restrictions on discretionary bonus payments and capital distributions.

The proposed rule would currently apply to eight bank holding companies, OCC spokesman Bryan Hubbard told SNL. The insured depository institutions under these bank holding companies would be required to have a 6% leverage ratio to be considered well-capitalized under regulators' prompt corrective action framework. This is double the 3% required under international Basel rules.

Tools

Related Companies		
Bank of America Corp. (BAC)	$ 13.33	0.34%
Bank of New York Mellon Corp. (BK)	$ 29.18	0.21%
Citigroup Inc. (C)	$ 49.89	0.75%

Last Updated: 7/9/2013 10:00 AM

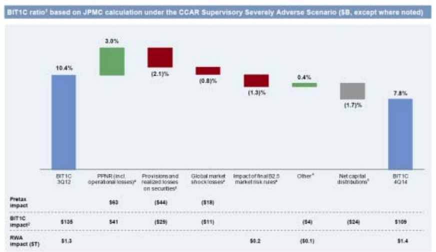
More>>

3

Supervisory Severely Adverse Scenario Results – P&L

JPMC calculated cumulative P&L metrics (from 4Q12 through 4Q14)

	$B	% Avg Assets[1]
Pre-provision Net Revenue[2]	$63.0	2.7%
Other Revenue[3]	0.0	
Less:		
Provisions	42.2	
Realized Gains/Losses on Securities	2.0	
Trading and Counterparty Losses[4]	17.5	
Other Losses/Gains[5]	1.6	
Equals:		
Net Income Before Taxes	**($0.2)**	**(0.9)%**



4

SNL **Bank & Thrift Weekly**

NORTHEASTERN EDITION

Monday, April 29, 2013

Senators propose 15% capital requirement for megabanks

by Lindsey White

New bipartisan legislation takes another whack at ending the "too big to fail" problem once and for all.

U.S. Sens. Sherrod Brown, D-Ohio, and David Vitter, R-La., formally unveiled the Terminating Bailouts for Taxpayer Fairness Act on April 24.

During a press conference, Brown said the legislation presents big banks with a clear choice: "Either have enough of your own capital to cover your potential losses, or downsize until you are no longer a risk to taxpayers."

The bill sets capital standards depending on the size and complexity of an institution. Megabanks — those institutions with more than $500 billion in assets — would be required to meet a new 15% capital requirement, while midsize and regional banks would be required to hold 8% in capital to cover their assets. The legislation would not change the capital requirements for community banks,

continued on page 2

Merger Stories

Deal Announcement

Citigroup Inc. C (B) NY
Close: $46.92 +1.89 (+4.2%) Vol: 112,951,233 (62% of Avg.)
ING Groep NV INGA Netherlands

Apr 26, 13 Citigroup Inc.'s securities and fund services signed a definitive agreement to acquire the custody and securities services business of ING Groep NV in seven central and eastern European markets, according to an April 26 news release.

The deal includes ING's local custody and securities services businesses in Bulgaria, the Czech Republic, Hungary, Romania, Russia, Slovakia and Ukraine. Once implemented, the addition of Bulgaria will extend Citi's custody network coverage to over 95 markets and its proprietary custody network will be expanded to 62 markets.

ING said in a separate news release that the sale does not impact its retail banking operations or the insurance and investment management businesses in the central and eastern European region.

ING custody services offers a range of products to mainly institutional clients, including safekeeping of securities, settlement of securities transactions and collecting information and income on

5

Fed Forces Anchor in Wisconsin to Default on $176M in Debt

Anchor BanCorp Wisconsin (ABCW) has defaulted on a loan from a group of banks led by U.S. Bancorp (USB) after the Federal Reserve Board rejected a request to extend the loan.

The Madison, Wis., company owed $116 million in principal — plus $60 million of interest and fees — under a revolving loan that was due on June 30, Anchor disclosed in a regulatory filing. Anchor and its lenders had extended the loan's due date six times since 2008 and were prepared to do so again, the filing said.

Anchor is operating under a 2009 cease-and-desist order that requires it to get the Fed's approval before taking on debt.

"Obviously, we were a little surprised and disappointed, because US Bank and the bank group were being quite cooperative, and had agreed to the extension," said Anchor Chief Executive Chris Bauer. "But this action does not disrupt in any way the operation of the holding company or the operation of the bank."

As a result of Anchor's default, the lenders can terminate the loan or demand immediate repayment of the balance. The lenders have not told Anchor that they intend to take either step, Bauer said.

The default also caused the interest rate on the unpaid principal to rise by 200 basis points, to 19% a year. Bauer said he does not expect the default to have any further immediate financial impact on the company.

Anchor said it is working to raise the needed capital, and is discussing alternatives with its lenders.

Anchor has strengthened its loan portfolio over the past year, but still recorded a $17.5 million loss in the first quarter, compared to a $15 million loss in the fourth quarter. In December, the company prepaid $150 million worth of advances from the Federal Home Loan Bank.

RELATED

Anchor in Wisconsin Reports Another Quarterly Loss

Anchor in Wis. Reports Loss Despite Credit Improvement

Anchor in Wisconsin Prepays $150 Million in FHLB Advances

Chief What Officer? Banking's New Executive Jobs

Too Big to Jail? Not These Bankers

Foreign Banks See U.S. as Growth Market

Source: Board of Governors of the Federal Reserve System, JP Morgan Chase & Co *"DFAST 2012" Materials*; SNL Financial LC

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The Great Capital Debate

Setting the Stage – Coming out of the Great Recession

Phase I

Regenerate capital

- TARP
- SBLF
- Common equity

Phase II

Restructure capital

- Trust preferred phase-outs (Dodd-Frank more meaningful than Basel III)
- Grandfathering for non-SIFI

Phase III

Remeasure capital

- DFAST
- Basel III pillaring
- Capital cushions and quality

Phase IV

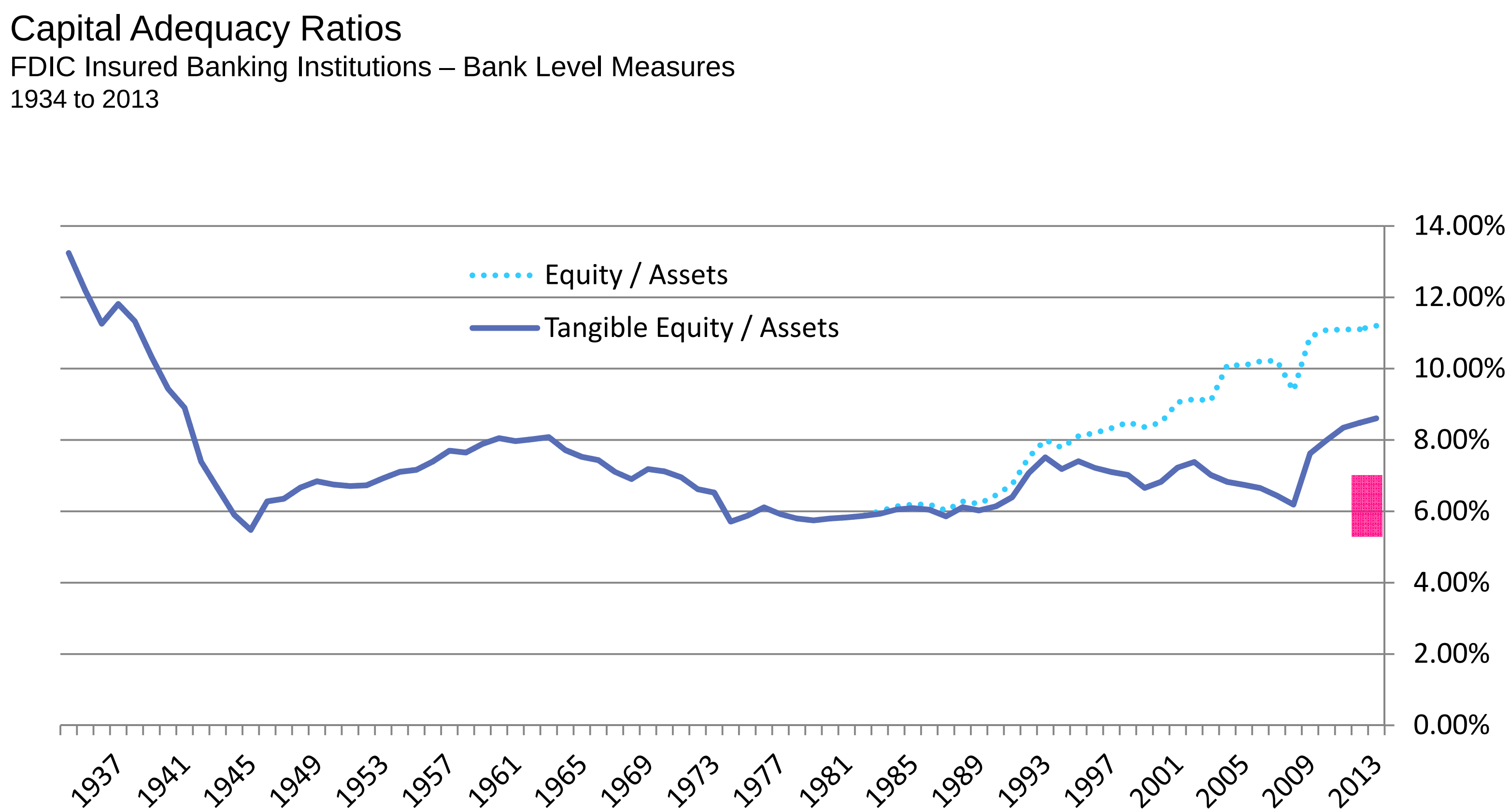
Respond

- Risk management (the “Volcker Rule”)
- Growth (risk-taking in core businesses)
- Divestitures and capital reallocation
- Capital distribution

Source: TKG

The Great Capital Debate

The Perceived and Real Capital Ratios



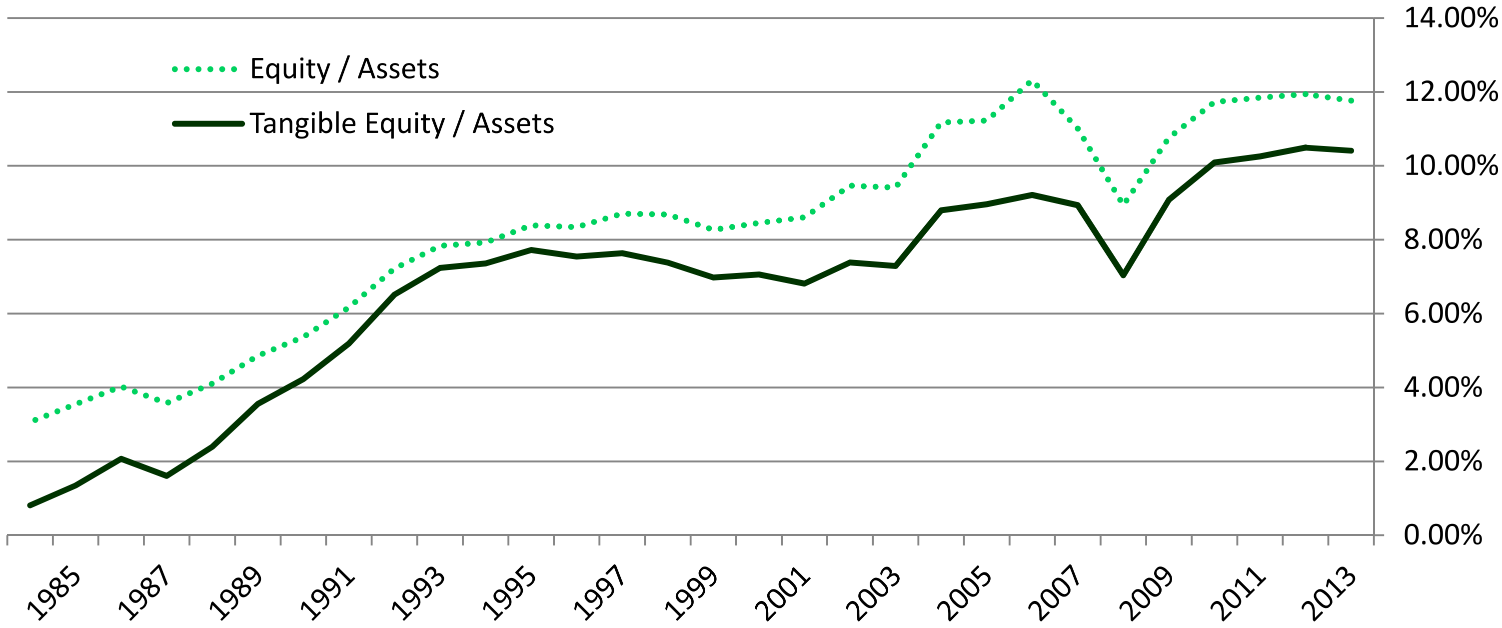
Source: TKG analysis of FDIC data

Draft materials as of 04/14/14; Subject to Change

The Great Capital Debate

The Perceived and Real Capital Ratios

Capital Adequacy Ratios
FDIC Insured Savings Institutions –Savings Bank Level Measures
1984 to 2013



Source: TKG analysis of FDIC data

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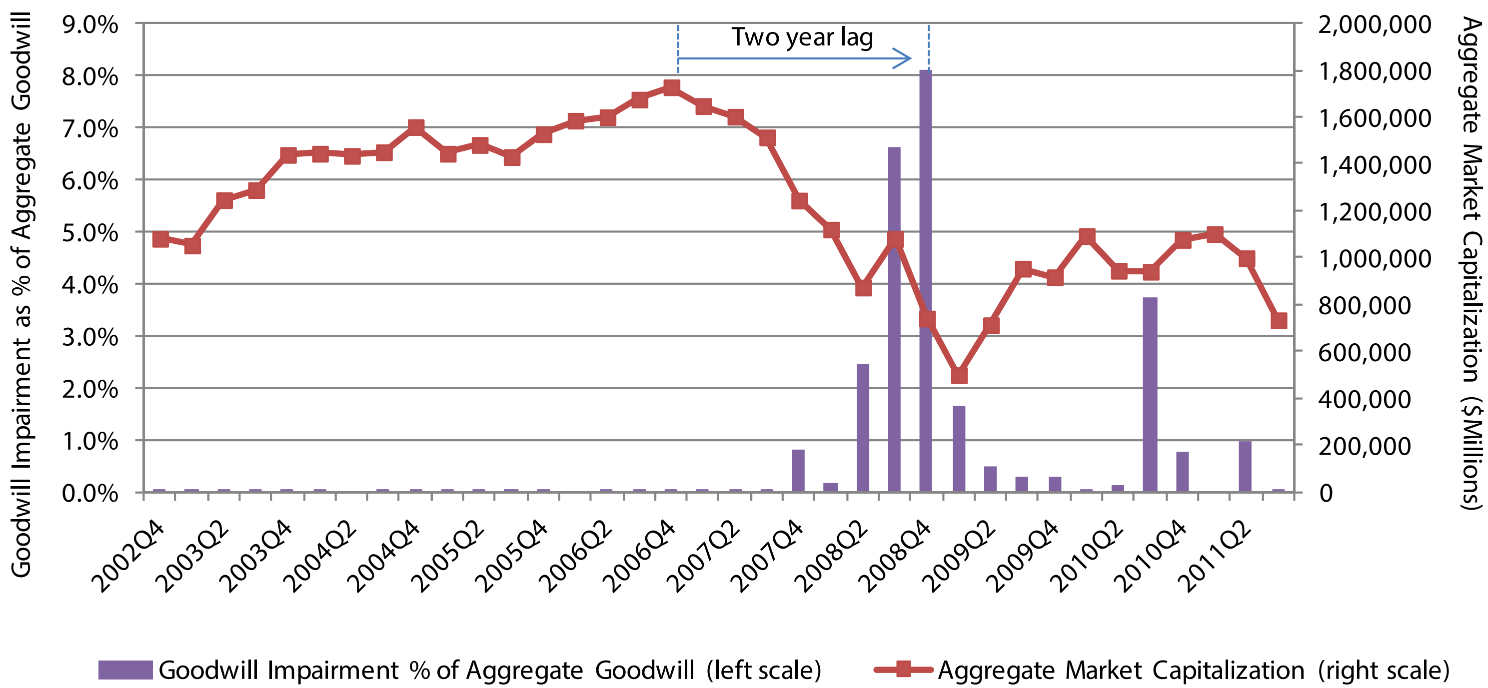
The Great Capital Debate

The Impact of Goodwill Impairment on Capital

Goodwill Impairment Charges and Market Capitalization

Market capitalization measured on a daily basis; quarterly goodwill impairment charges expressed as % of aggregate goodwill

January 1, 2002 to June 30, 2012



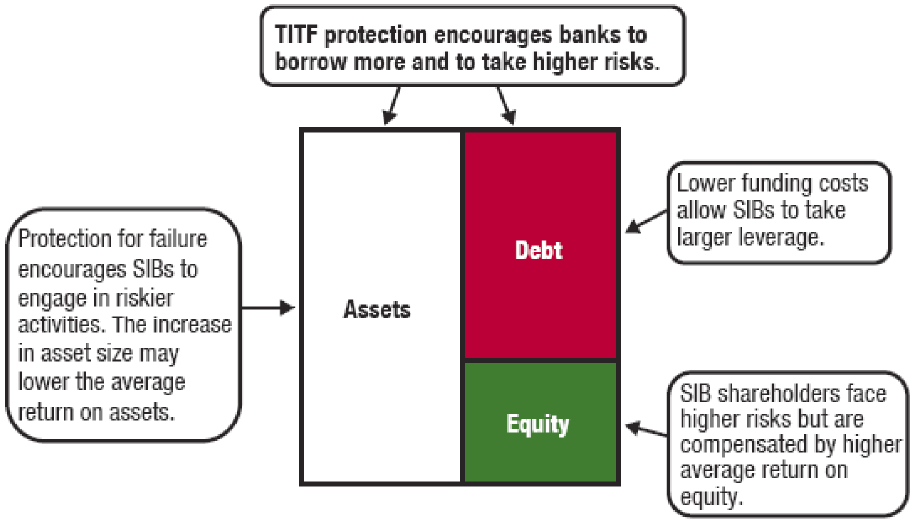
Source: TKG analysis of SNL Financial LC data, Company report and FDIC data

Draft materials as of 04/14/14; Subject to Change

The Great Capital Debate

Too Important to Fail

Effects of Too-Important-to-Fail Protection on a Simplified Bank Balance Sheet
Simplified Bank Balance Sheet



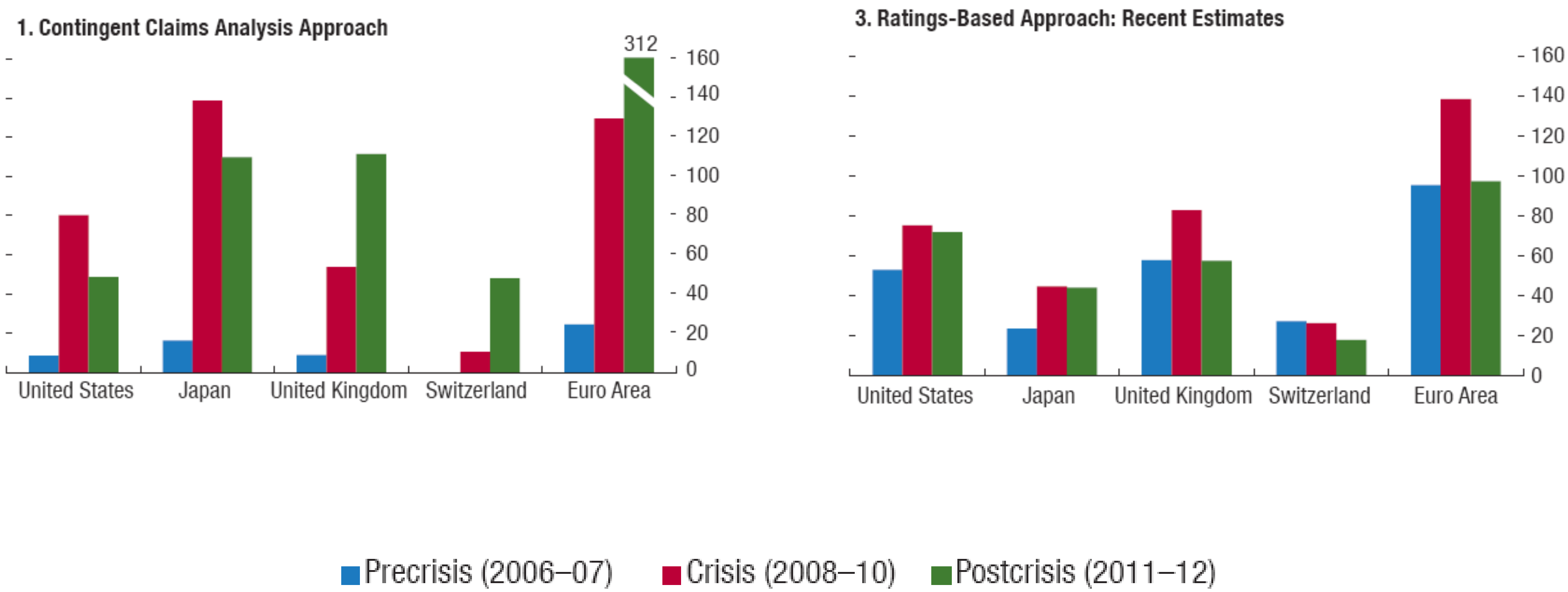
Source: IMF staff.
Note: SIB = systematically important bank; TITF = too important to fail.

Source: International Monetary Fund, Global Financial Stability Report, March 2014, Chapter 3 "HOW BIG IS THE IMPLICIT SUBSIDY FOR BANKS CONSIDERED TOO IMPORTANT TO FAIL?", pg. 3

The Great Capital Debate

Too Important to Fail (continued)

Implicit Subsidy Values for Global Systemically Important Banks
PreCrisis vs. Crisis vs. Post Crisis
Billions of U.S. Dollars

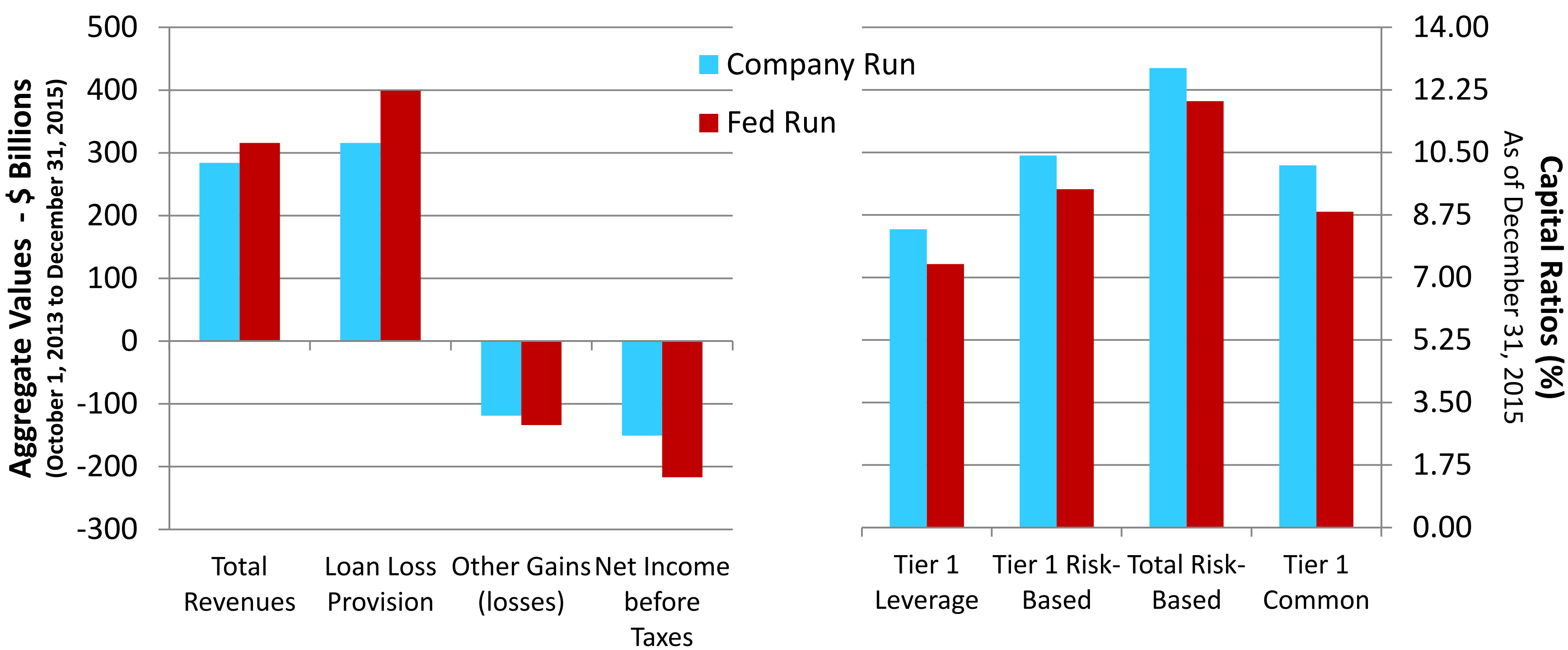


Source: International Monetary Fund, Global Financial Stability Report, March 2014, Chapter 3 “HOW BIG IS THE IMPLICIT SUBSIDY FOR BANKS CONSIDERED TOO IMPORTANT TO FAIL?”, pg. 19

The Great Capital Debate

2014 DFAST Submission – Two Very Different Views

Results from DFAST – 2014 Submission for Public Filers
Severely Adverse Scenario
Comparison of Results: Fed Run vs. Company Run



Source: TKG analysis of SNL Financial, L.C. data; Dodd-Frank Act Stress Test 2014: Supervisory Stress Test Methodology and Results March 2014, Board of Governors of the Federal Reserve System

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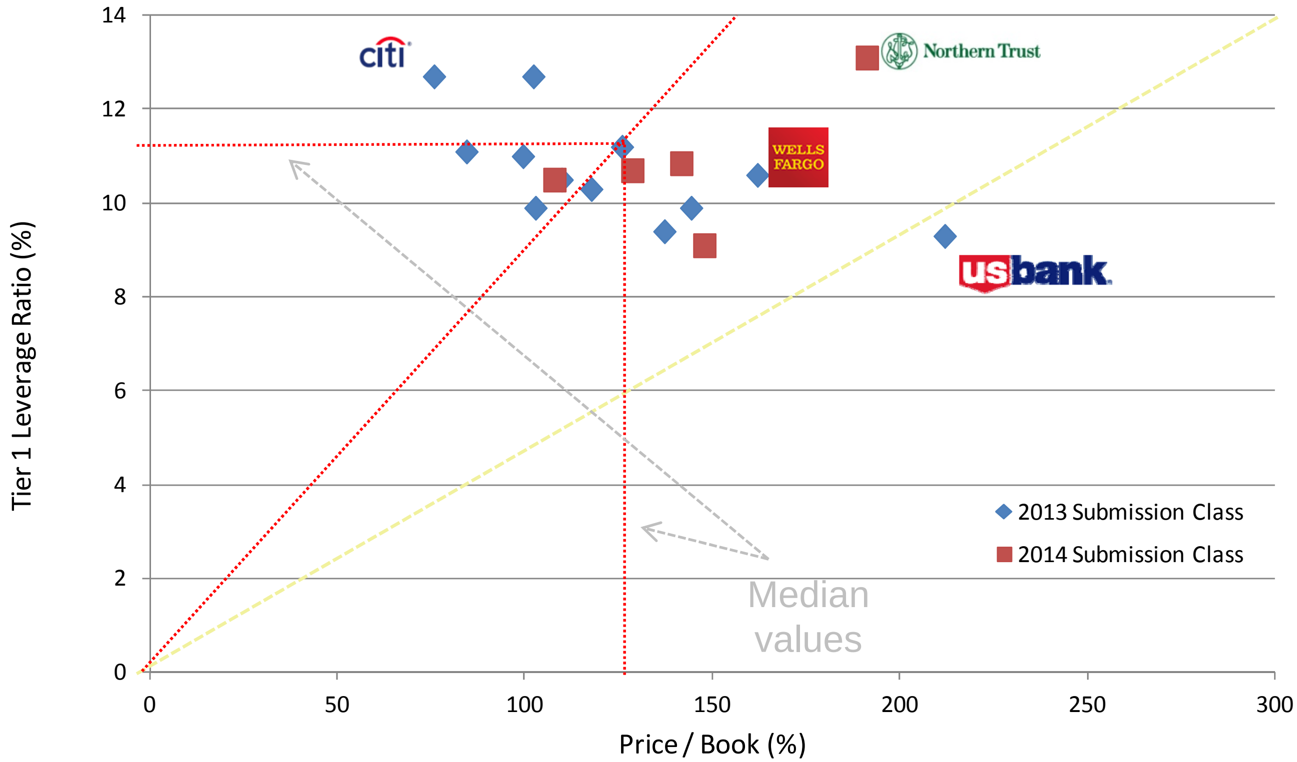
The Great Capital Debate

Moving to the Next Stage of the Discussion

How Does the Market Value Highly Capitalized Institutions?
Shown by Dodd-Frank Act Submission Class (U.S.-based, Public Filers Only)
Financial Data as of December 31, 2013; Price/Book Multiple as of March 20, 2014



Source: TKG analysis of SNL Financial, LC data as of March 20, 2014 (report released circa March 20, 2014)

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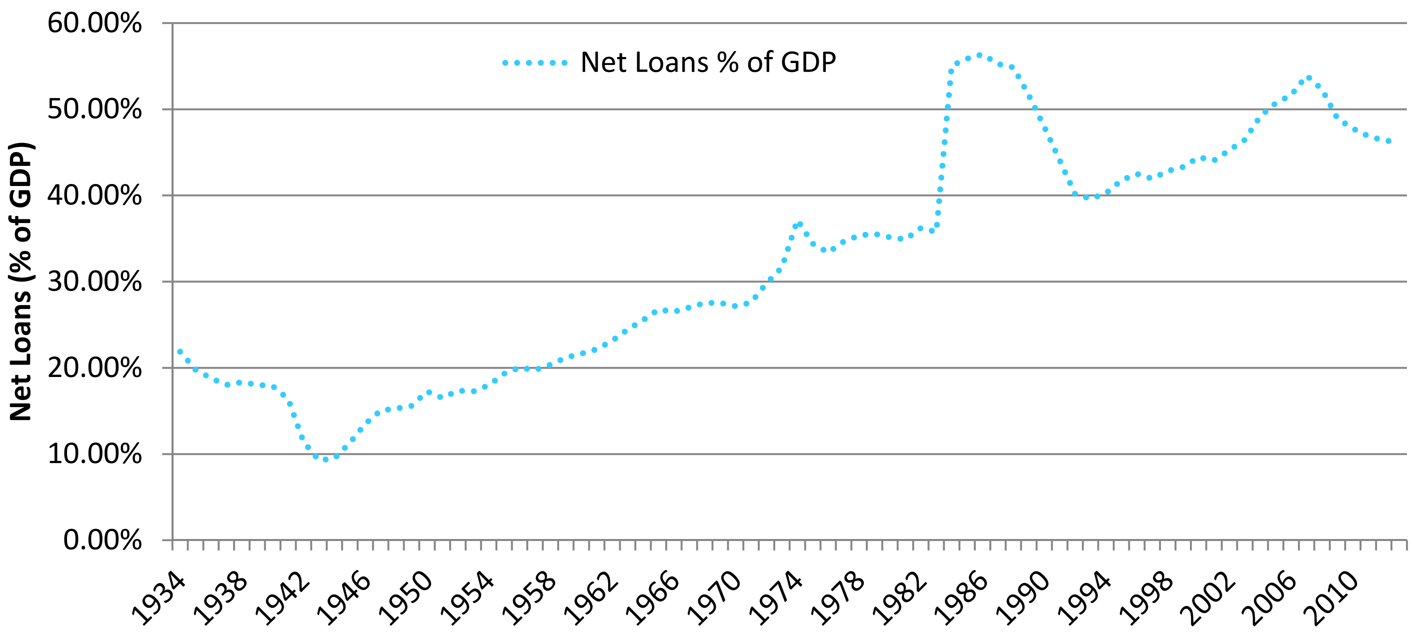
Sustaining Growth

Relationship between Growth in GDP, Industry Earnings and Loans

Net Loans as % of GDP
All FDIC Insured Institutions – Bank Level Measures
1934 to 2013



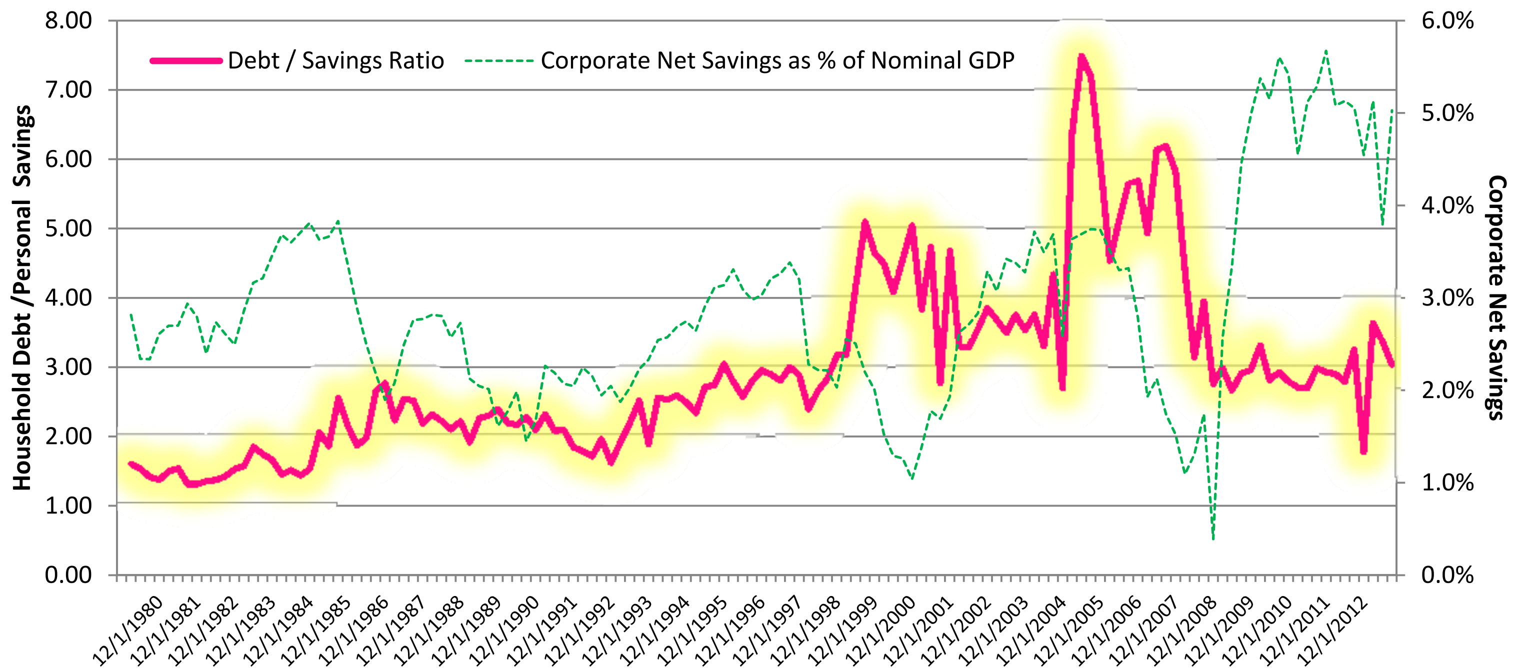
Draft materials as of 04/14/14; Subject to Change

Source: TKG analysis of FDIC data; Bureau of Economic Analysis data

Sustaining Growth

Financial Health Measures

Trends in Financial Health
Consumers and Corporate America
1980 to 2013 (by Quarter)



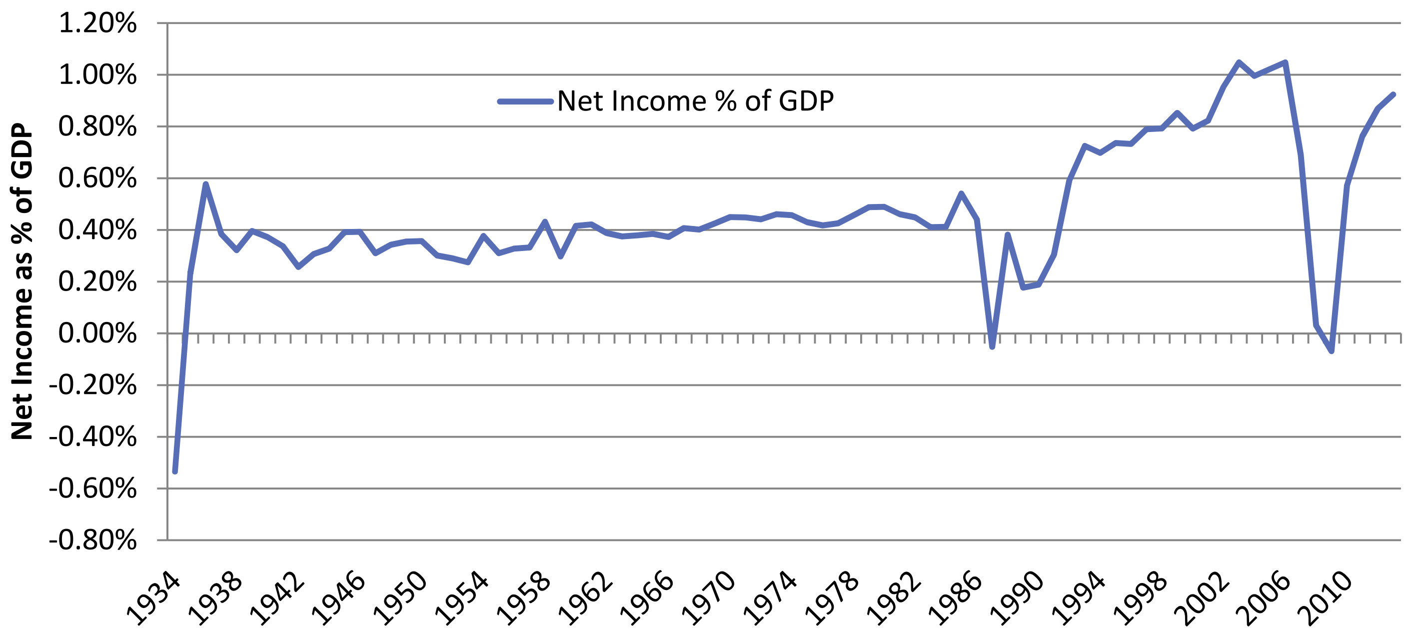
Source: TKG analysis of Federal Reserve and the U.S. Department of Commerce Bureau of Economic Analysis data

Draft materials as of 04/14/14; Subject to Change

Sustaining Growth

Relationship between Growth in GDP, Industry Earnings and Loans

Net Income as % of GDP
All FDIC Insured Institutions – Bank Level Measures
1934 to 2013



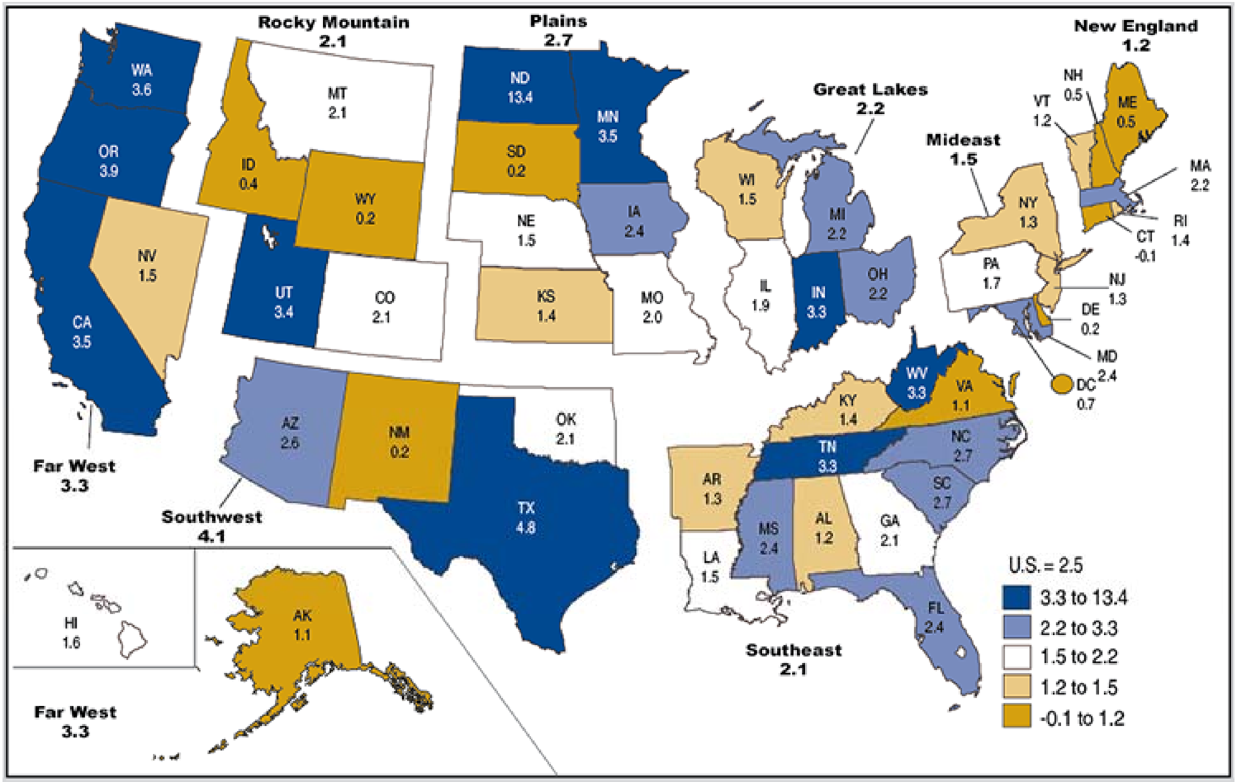
Draft materials as of 04/14/14; Subject to Change

Source: TKG analysis of FDIC data; Bureau of Economic Analysis data

Sustaining Growth

Disparity among Regions and States

Percentage Change in Real GDP by State
2011 - 2012

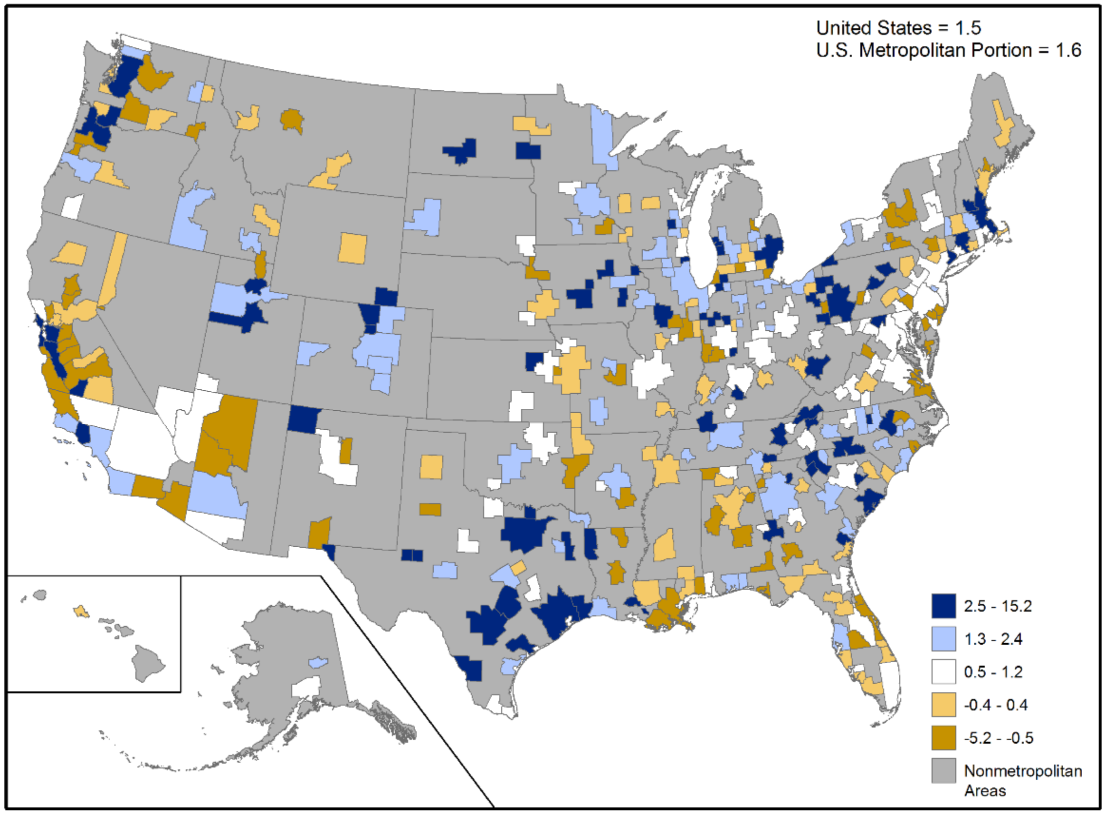


Source: U.S. Department of Commerce, Bureau of Economic

Sustaining Growth

Local Economies

Percentage Change in Real GDP by Metropolitan Statistical Area (MSA)
2011 - 2012

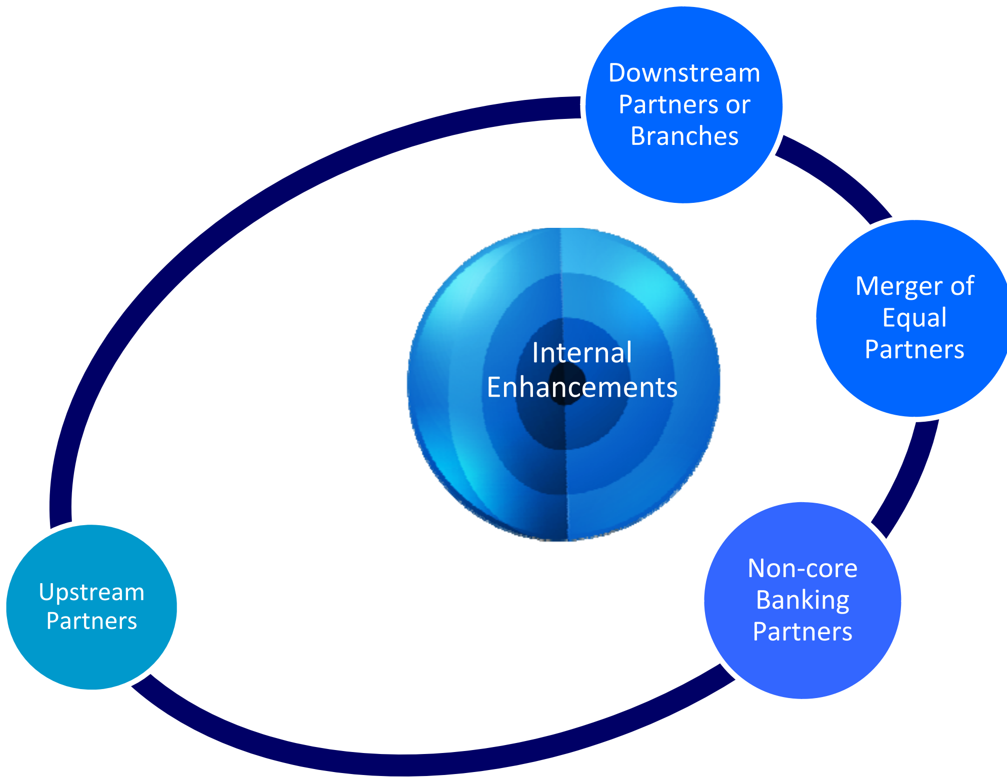


Source: U.S. Department of Commerce, Bureau of Economic

Sustaining Growth

Growth Paths

These generic strategic alternatives are aligned with how to best alter the trajectory of an institution's earnings growth.



Exit Strategies:

External strategies:
- Find upstream partner (change of control or strategic investor)
- Financial investor and change of board/management (succession)

Enhance the Company Strategies:

External strategies:
- Whole institution acquisitions
- Mergers with similarly sized institutions (MOEs)
- Acquisition of branches, loans or lines of business (insurance distribution, asset management)

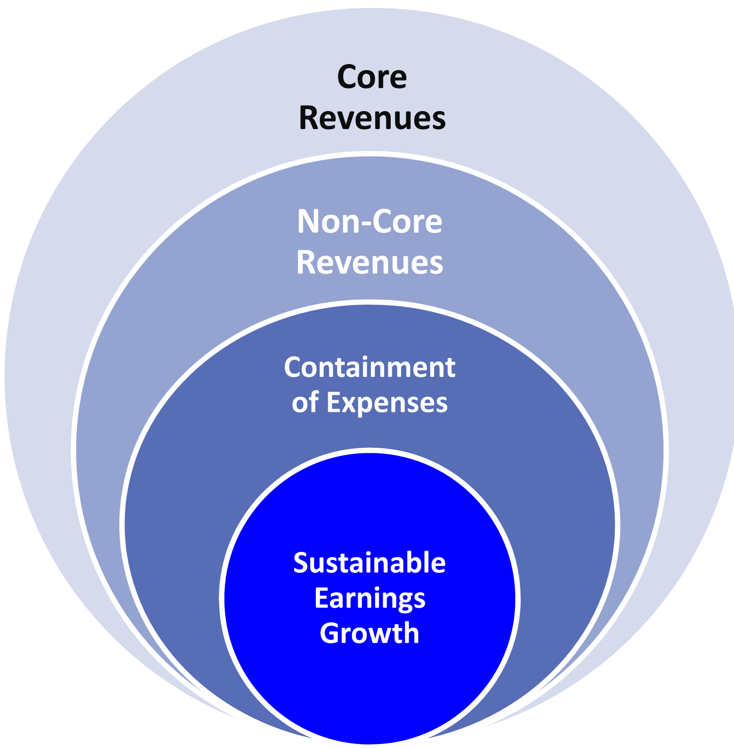
Internal enhancements:
- Investment in franchise (new branches, LPOs, personnel in new lines of business, etc.)
- Capital strategies (stock or cash dividends)
- Process improvement

Source: TKG

Sustaining Growth

Types of Growth

Financial Measures



Non-Financial Measures

- Competitive position (by geography or product segment)
- New product introductions
- Management and board

Source: TKG

Sustaining Growth

Factors Impacting Current State of Banking Merger and Acquisition Activity

- Banking industry financial performance improving relative to Great Recession
- Valuation multiples increasing for the sector, leading to more buyer power
- Regulatory pressures and compliance expenses driving some deal flow while also slowing down the due diligence and closing time horizons (longer time to get deal done)
- Increasing level of activity and modest increase in control premiums (prices paid)
- Shift from "distressed transactions" to transactions involving healthy institutions
- Sellers becoming more proactive in controlling their future (negotiated transactions)

Source: TKG

Sustaining Growth

Increasing Buyer Power helping push M&A

Change in Valuation Metrics

U.S. Public Filers, by Industry and Market Capitalization Cohort
December 31, 2010 vs. December 27, 2013

Segment	Aggregage Market Capitalization ($ Millions)	Valuation Metrics - 12/31/2010 Price / LTM Earnings (X)	Price / Book	Price / Tangible Book	Valuation Metrics - 12/27/2013 Price / LTM Earnings (X)	Price / Book	Price / Tangible Book	Change in Metrics Price / LTM Earnings (X)	Price / Book	Price / Tangible Book
Commercial Banks	$1,393,879									
SNL U.S. Bank < $250M	2,345	15.3	64.4%	64.5%	13.6	80.4%	80.4%	(1.7)	16.0%	15.9%
SNL U.S. Bank $250M-$500M	4,803	13.5	76.7%	77.9%	12.5	94.1%	94.4%	(1.0)	17.4%	16.5%
SNL U.S. Bank $500M-$1B	10,216	11.6	82.9%	88.2%	12.2	101.7%	107.4%	0.5	18.8%	19.1%
SNL U.S. Bank $1B-$5B	58,814	14.3	104.2%	119.3%	15.2	134.1%	148.5%	0.9	29.9%	29.2%
SNL U.S. Bank $5B-$10B	44,523	17.7	117.6%	152.0%	18.4	152.3%	210.9%	0.7	34.8%	58.9%
SNL U.S. Bank > $10B	1,273,178	17.5	113.8%	155.5%	16.2	133.0%	184.4%	(1.3)	19.2%	28.9%
Sector median		*14.2*	*86.5%*	*93.4%*	*14.3*	*106.4%*	*113.0%*	*0.1*	*19.9%*	*19.6%*
Valid count (across all asset sizes)	735	472	689	689	615	699	694			
Savings Banks	$47,949									
SNL U.S. Thrift < $250M	691	16.7	58.7%	58.2%	18.4	77.6%	75.4%	1.6	18.8%	17.2%
SNL U.S. Thrift $250M-$500M	2,139	14.2	69.6%	73.0%	18.0	89.1%	91.0%	3.8	19.5%	18.0%
SNL U.S. Thrift $500M-$1B	2,541	15.2	72.2%	76.5%	17.4	94.4%	100.2%	2.2	22.3%	23.7%
SNL U.S. Thrift $1B-$5B	13,448	18.8	106.6%	112.5%	17.8	119.3%	121.5%	(1.0)	12.6%	9.0%
SNL U.S. Thrift $5B-$10B	5,034	22.4	98.6%	130.0%	19.2	113.1%	157.7%	(3.1)	14.5%	27.6%
SNL U.S. Thrift > $10B	24,097	20.6	129.1%	157.3%	22.1	129.6%	189.1%	1.5	0.5%	31.7%
Median		*16.9*	*77.4%*	*79.4%*	*18.0*	*95.8%*	*99.0%*	*1.1*	*18.3%*	*19.6%*
Valid count (across all asset sizes)	179	118	153	151	135	173	172			

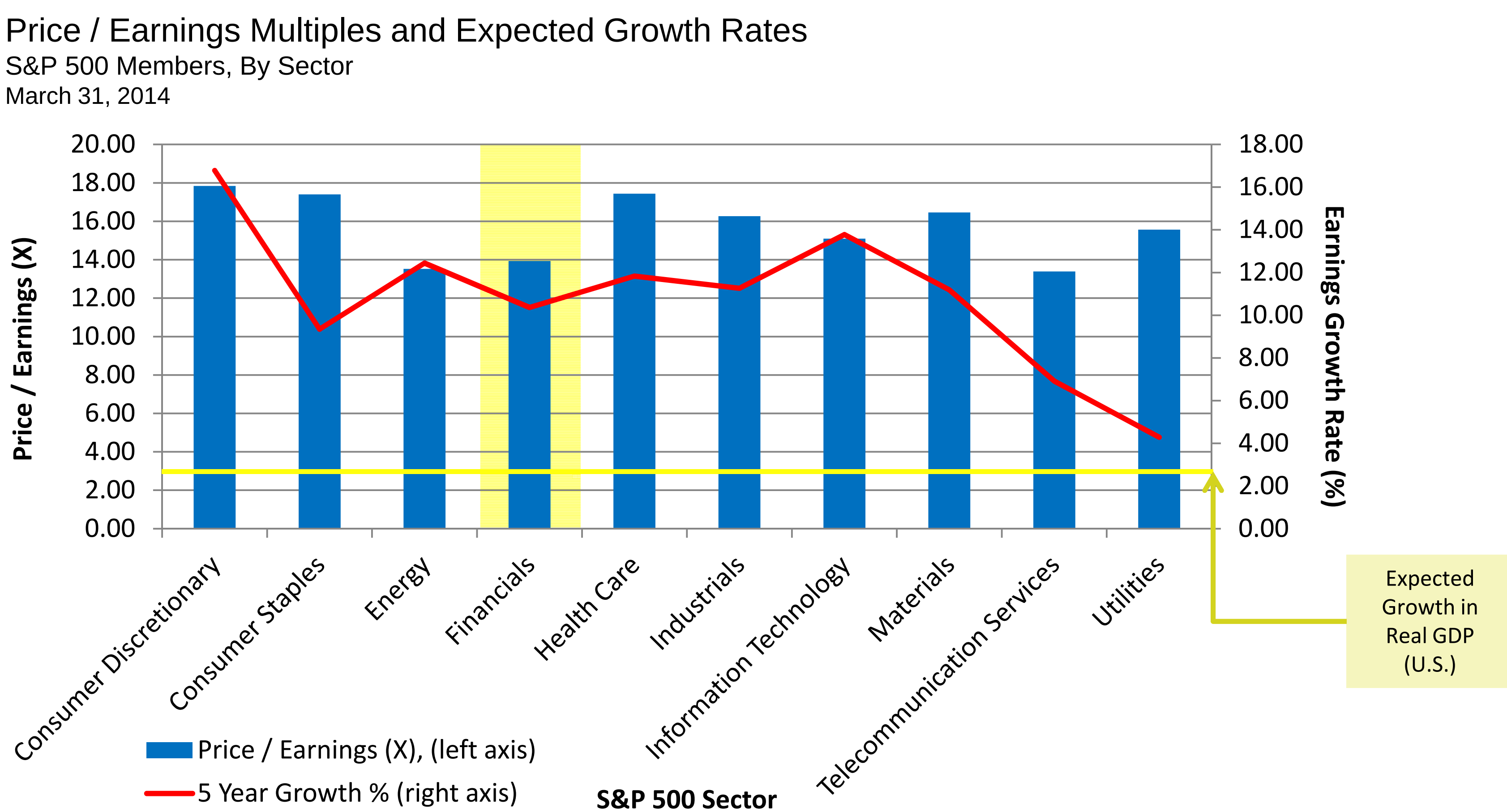
Increased buying power for key segment

Source: TKG analysis of SNL Financial, LC data; median values shown for each segment

Draft materials as of 04/14/14; Subject to Change

Sustaining Growth

Capital Market Conditions – Between Industries

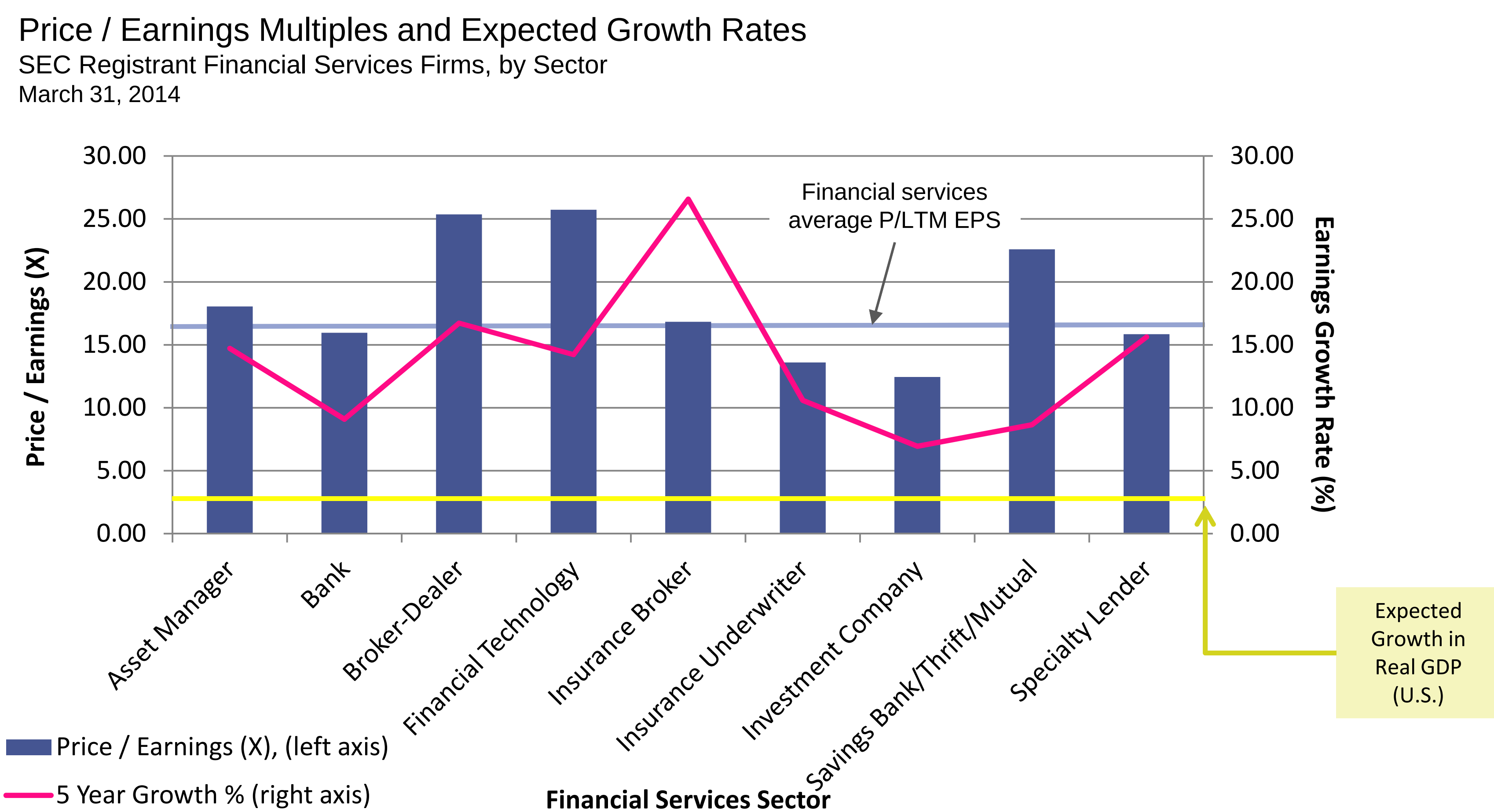


Draft materials as of 04/14/14; Subject to Change

Source: TKG analysis of S&P data; Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters, February 14, 2014, pp. 1-2

Sustaining Growth

Capital Market Conditions – Financial Services Industry Firms



Source: TKG analysis of SNL Financial, LC data

Draft materials as of 04/14/14; Subject to Change

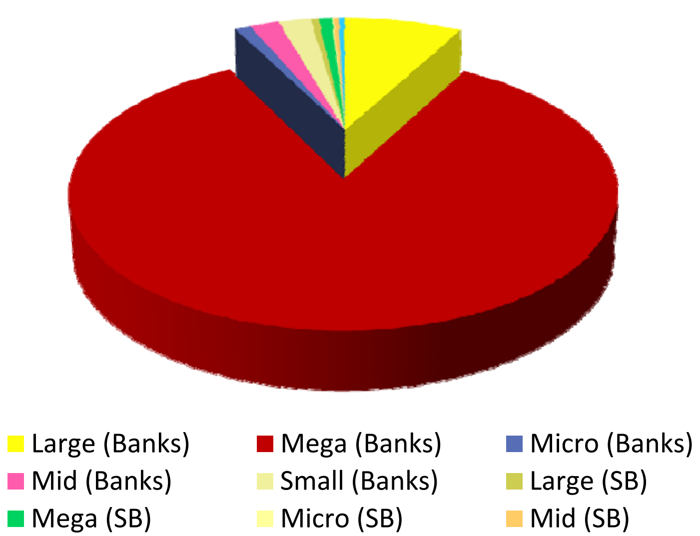
Sustaining Growth

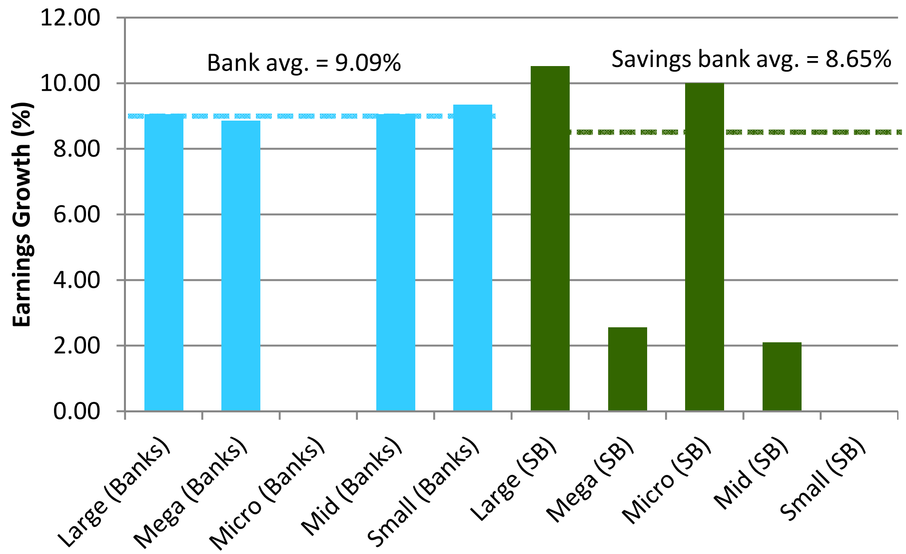
Capital Market Conditions

Net Income and Growth by Market Capitalization Cohort *

Banks vs. Savings Banks

Net Income for the year ended 12/31/2013 and 5 Year Earnings Growth (as applicable)





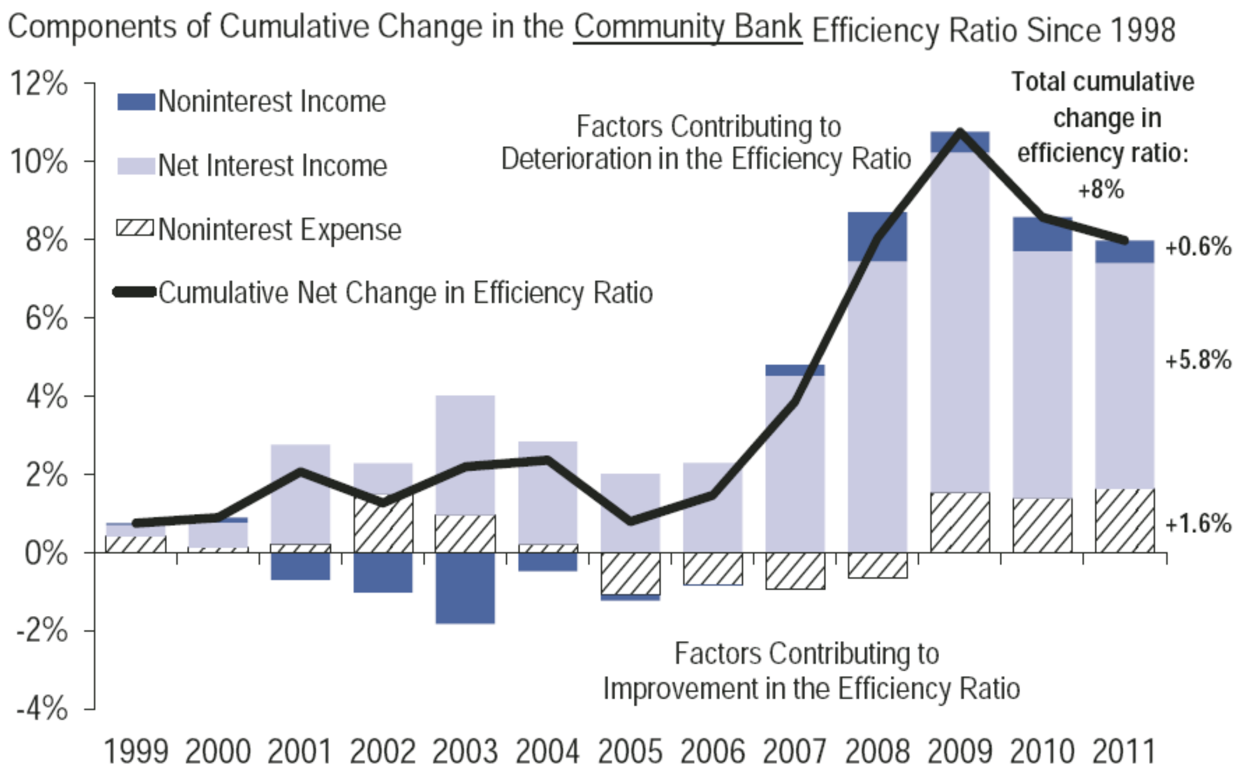
** Market capitalization cohorts: Mega cap > $5 billion; Large $1 billion to $5 billion; Mid $500 million to $1 billion; Small $100 million to $500 million; Micro $.01 million to $100 million*

Source: TKG analysis of SNL Financial, LC data

Sustaining Growth

The Effects of the Shifts in Banking Industry Structure

The Sources of the Disparity in Efficiency Ratio
Between Community Banks and Non Community Banks
1998-2011



Source: FDIC 2012 Community Banking Study (chart 2.11)

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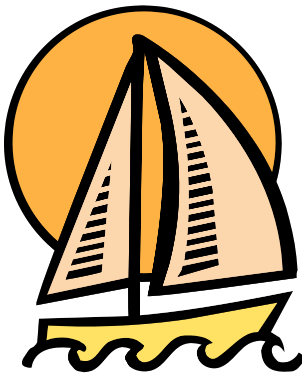
Achieving Growth

How Growth Occurred and may Occur

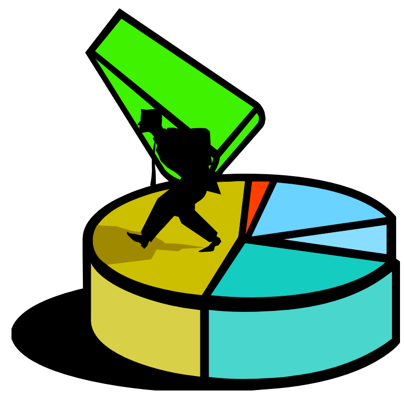
Draft materials as of 04/14/14; Subject to Change

The Past



Rising tide lifts all boats (today's rising tide is "easy money")

The Future



Enhance competitive position; market share growth from competitors in an excess-capacity environment (re-allocating the competitive pie)

Achieving Growth

Potential Paths Forward for the U.S. Economy … in the view of Banking Regulators

Economic Stress Test Variables

Current Readings vs. those Prescribed by the Federal Reserve for October 1, 2013 to December 31, 2015

		DFAST Scenario (covering October 1, 2013 to December 31, 2015)		
Economic Framework	**Current Readings**	**Baseline**	**Adverse**	**Severely Adverse**
Real GDP growth	**2.4% (2nd Q4 '13)**	**2.4% to 2.9%**	**-2.1% to 2.6%**	**-6.1% to 3.0%**
Nominal GDP growth	4.0% (2nd Q4 '13)	3.8% to 5.1%	0.0% to 4.1%	-4.0% to 4.1%
Real disposable income growth	**.7% (2013)**	**2.4% to 3.1%**	**0.4% to 2.7%**	**-2.4% to 1.6%**
Nominal disposable income growth	2.8% (2013)	3.8% to 5.2%	1.8% to 3.7%	-1.9% to 2.9%
Unemployment rate	**6.7% (Feb. '14)**	**6.3% to 7.3%**	**7.7% to 9.3%**	**8.1% to 11.3%**
CPI inflation rate	1.6% (YOY Jan. '14)	1.7% to 2.3%	1.1% to 2.0%	0.4% to 1.6%
3-month Treasury rate	**.05% (Feb. '14)**	**0.1% to 1.1%**	**0.1% to 0.1%**	**0.1% to 0.1%**
5-year Treasury yield	1.52% (Feb. '14)	1.8% to 2.8%	2.7% to 4.6%	0.6% to 0.8%
10-year Treasury yield	**2.71% (Feb. '14)**	**2.8% to 3.8%**	**3.5% to 5.8%**	**1.0% to 1.6%**
BBB corporate yield	3.64% (Feb. 28, '14)	4.9% to 5.6%	6.5% to 9.2%	5.0% to 6.2%
Mortgage rate (30 yr. fixed)	**4.30% (Feb. '14)**	**4.5% to 5.5%**	**5.4% to 7.8%**	**4.2% to 4.4%**
Prime rate	3.25% (Feb. '14)	3.2% to 4.2%	3.3% to 3.3%	3.3% to 3.3%
Dow Jones Total Stock Market Index	**19,637.68 (Fed. 28, '14)**	**17,169.2 to 19,045.8**	**11,402.7 to 15,605.5**	**8,943.3 to 13,016.5**
House Price Index	151.52 (Oct. '13)	159.7 to 168.8	137.3 to 157.6	118.5 to 156.4
Commercial Real Estate Price Index	217.0 (Oct. '13)	**219.7 to 238.0**	**175.2 to 219.7**	**141.5 to 219.7**
Market Volatility Index (VIX)	14.3 (Feb. 28, '14)	17.0 to 19.2	19.2 to 35.3	19.3 to 67.9

The Dow Jones Total Stock Market Index already exceeds the level forecast by the Federal Reserve.

Source: Board of Governors of the Federal Reserve System

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Achieving Growth

Capital

Capital Definitions

Common Equity Tier 1 Capital

The sum of common stock instruments and related surplus net of treasury stock, retained earnings, AOCI, and qualifying minority interests – less applicable regulatory adjustments and deductions that include AOCI (if irrevocable option to neutralize AOCI is exercised).

Mortgage-servicing assets, deferred tax assets, and investments in financial institutions are limited to 15 percent of CET1 and 10 percent of CET1 individually.

Additional Tier 1 Capital

Noncumulative perpetual preferred stock, tier 1 minority interests, grandfathered TRuPS, and Troubled Asset Relief Program instruments – less applicable regulatory adjustments and deductions.

Tier 2 Capital

Subordinated debt and preferred stock, total capital minority interests not included in tier 1, allowance for loan and lease losses not exceeding 1.25 percent of risk-weighted assets – less applicable regulatory adjustments and deductions.

Capital Conservation Buffer

The new rule requires banks to hold CET1 in excess of minimum risk-based capital ratios by at least 2.5 percent to avoid limits on capital distributions and certain discretionary bonus payments to executive officers and similar employees.

Capital Conservation Buffer (as a percentage of RWA)	Maximum Payout Ratio (as a % of the previous four quarters of net income)
Greater than 2.5%	No payout limitation applies
Less than or equal to 2.5% and greater than 1.875%	60%
Less than or equal to 1.875% and greater than 1.25%	40%
Less than or equal to 1.25% and greater than 0.625%	20%
Less than or equal to 0.625%	0%

Source: Office of the Comptroller of Currency

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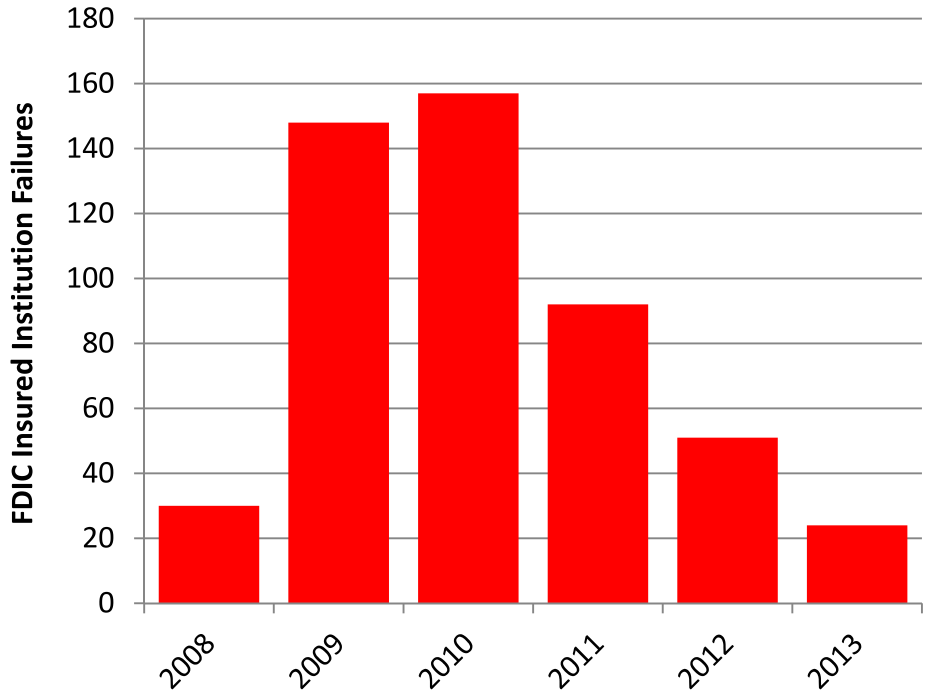
The Real Prices of Failure – Attracting Future Common Equity

FDIC Insured Institution Failures
The Great Recession (June 2007 to December 2009)
January 1, 2008 to December 31, 2013



A

489 Failed Institutions = $83.1 billion in cost to DIF

Public policy and perception (distrust); standby support in form of taxpayer subsidies

B

Nearly $11 billion in initial investments in denovo institutions and follow on offerings

Nearly $100 billion in lost value in the form of “distressed” transactions (big one: Wells Fargo and Wachovia)

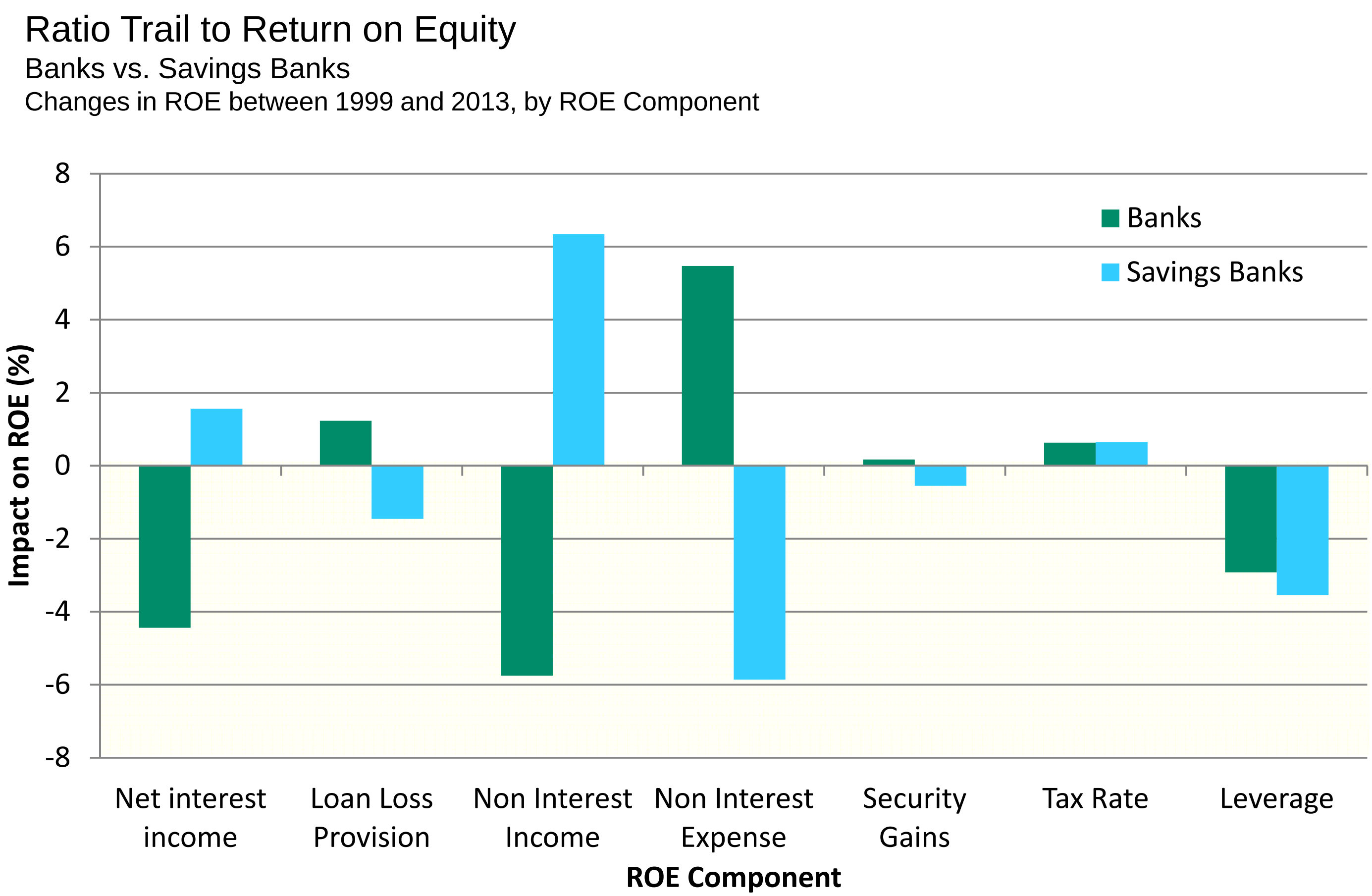
C

Nearly no impact on depositors; minimal disruption to debt holders

Source: TKG analysis of FDIC and SNL Financial, LC. data; data through December 31, 2013

Achieving Growth

Value Drivers - the Impact of Asset Leverage (or lack thereof) on Returns



Positive impact on ROE

Negative impact on ROE

Source: TKG analysis of FDIC data

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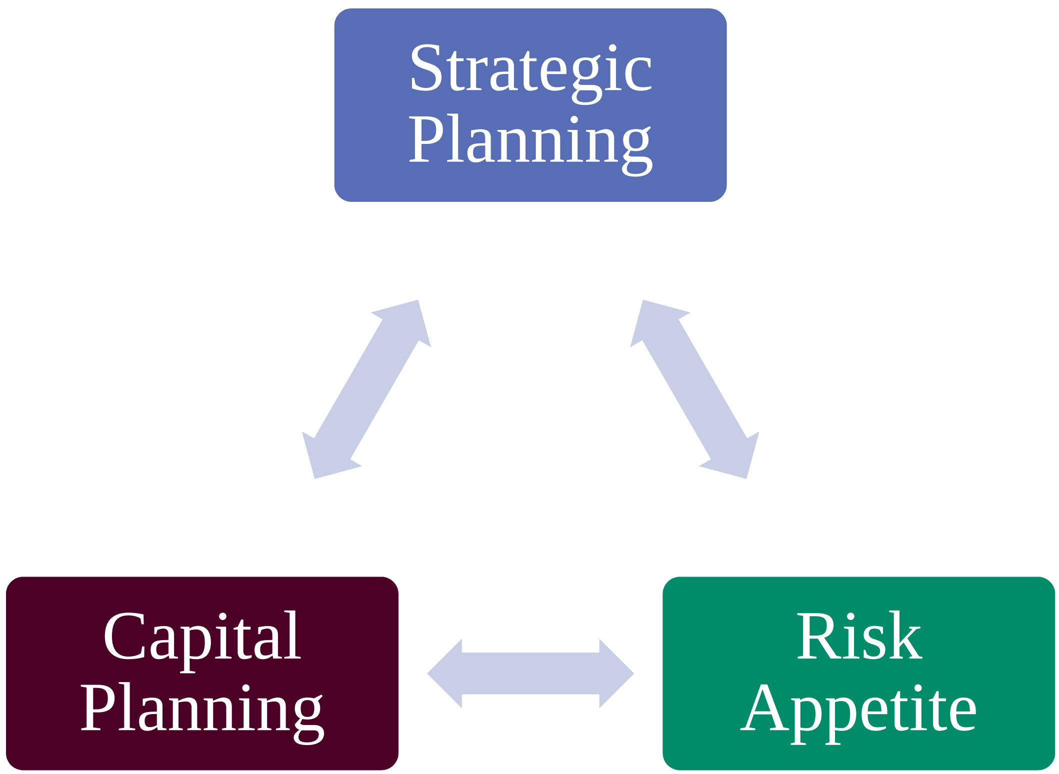
Aligning Planning and Risk Appetites



Source: TKG

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Preparing Multi-Purpose Financial Projections

- Should represent “stretch”, not budgets
- Board sets higher level financial goals (ROE target, loan growth target, composition of revenue target, earnings growth target, etc.)
- Operating plan and financials developed to meet/exceed targets
- Can be developed for multiple scenarios (not just “business as usual”)
- Can be developed first, and the operating plan is developed to “hit the targets”, or …
- Can de developed after operating plan, incorporating impact from initiatives

Achieving Growth

The Strategy Value Gap – The Basics

The strategy value gap analysis asks: what is the value gap, on a per share and percentage basis, of our current strategy relative to the value that could be created through a strategic alternative? There are two general approaches to measure this gap:

Naïve Approach (per share) Quantifies Magnitude of Difference (now)	
Value per share of strategic alternative	$15.00
Value per share of strategic plan	$13.00
Value gap per share	$2.00
Value gap (% of strategic plan)	15.00%
Compared to Board expectation of +/-5% relative to value created by strategic plan	

IRR Approach (per share) Incorporates Investment Time Horizon (how long)	
Value per share of strategic alternative	$15.00
Value per share of strategic plan	$13.00
Value gap per share	$2.00
Time horizon for holding investment (at 11% discount rate)	**5 years**
Required EPS growth rate (annual)	9.28%
Compared to Board expectation of 7% growth rate in earnings per share	

For Illustrative and Discussion Purposes Only

Source: TKG

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The Strategy Value Gap (continued)

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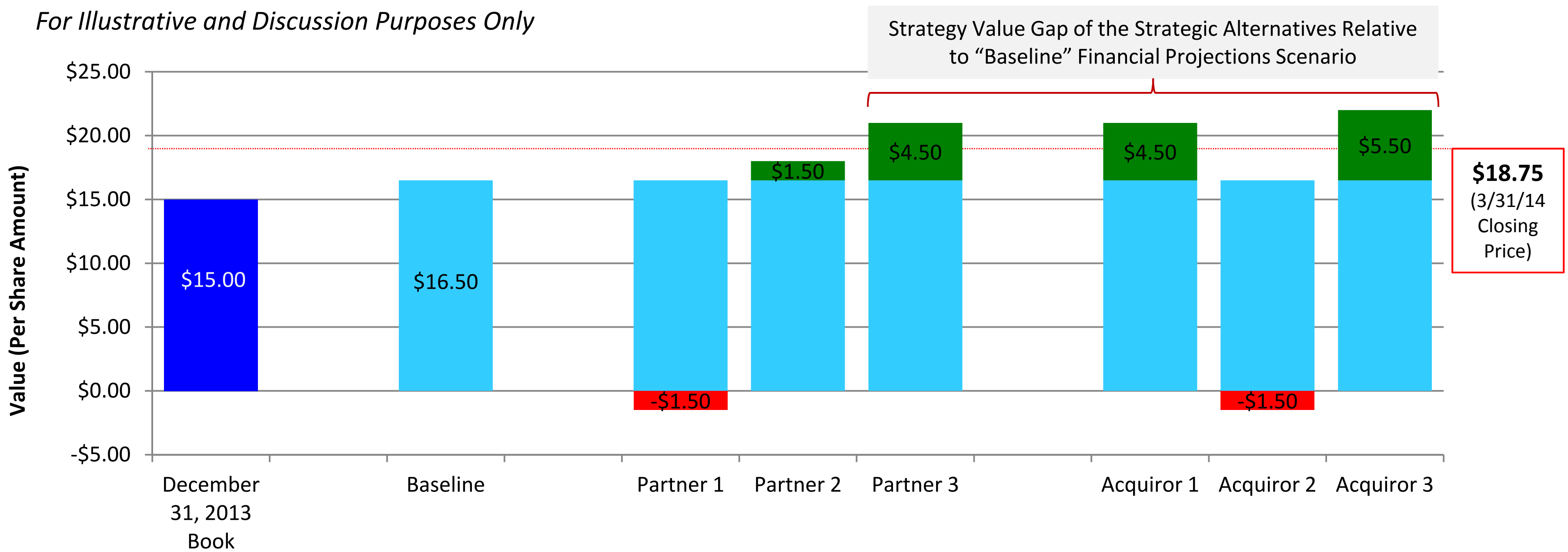

	As Acquiror				As Target		
Strategy Value Gap (per share)	**($1.50)**	**$1.50**	**$4.50**		**$4.50**	**($1.50)**	**$5.50**
Strategy Value Gap per Share as % of Stand Alone (Naïve approach)	-9.1%	9.1%	27.3%		27.3%	-9.1%	33.3%
2014-2018 Required Earnings Growth Rate vs. 10.5% in "Baseline" (IRR approach)	9.3%	12.6%	15.6%		15.6%	9.3%	16.4%

Source: TKG

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The Strategy Value Gap (continued)

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- Observations on the strategy value gap itself:
  - ✓ Compare the known risk of achieving your growth rates vs. the risk of achieving the growth rates with the partners (relative risk vs. return)
  - ✓ The strategy value gap is dynamic and changes as factors within, and outside of, management's control change
  - ✓ The strategy value gap is cumulative; achievement of targeted strategic plan goals reduce risk of the strategy value gap widening over time
  - ✓ The value gaps would be higher if the "capacity to pay" price was used (as opposed to a 140% p/b)

- Options to bridge the strategy value gap (what can be done to close the value gap):
  - ✓ Strategic investments to accelerate revenue and earnings growth (raise capital to accelerate loan growth)
  - ✓ Cost cutting to accelerate earnings growth
  - ✓ Margin expansion initiatives
  - ✓ Profitable fee income initiatives
  - ✓ Strategic acquisition to accelerate earnings growth (seek to expand non-banking lines of business)
  - ✓ Seek affiliation with upstream partner

Achieving Growth

Developing Long-Term Expectations

Bank Earnings Expectations	Pre-2008	Today
Net Interest Margin	3.80% - 4.00%	3.40% - 3.80%
Efficiency Ratio	55% - 60%	60% - 64%
Tangible Common Equity	6% - 7%	7% - 9%
Return on Average Assets	1.00% - 1.10%	0.80% - 1.00%
Return on Average Equity	12% - 14%	8% - 10%
Annual EPS Growth	8% - 10%	4% - 5%

Downward shift in internal capital generation

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Source: TKG

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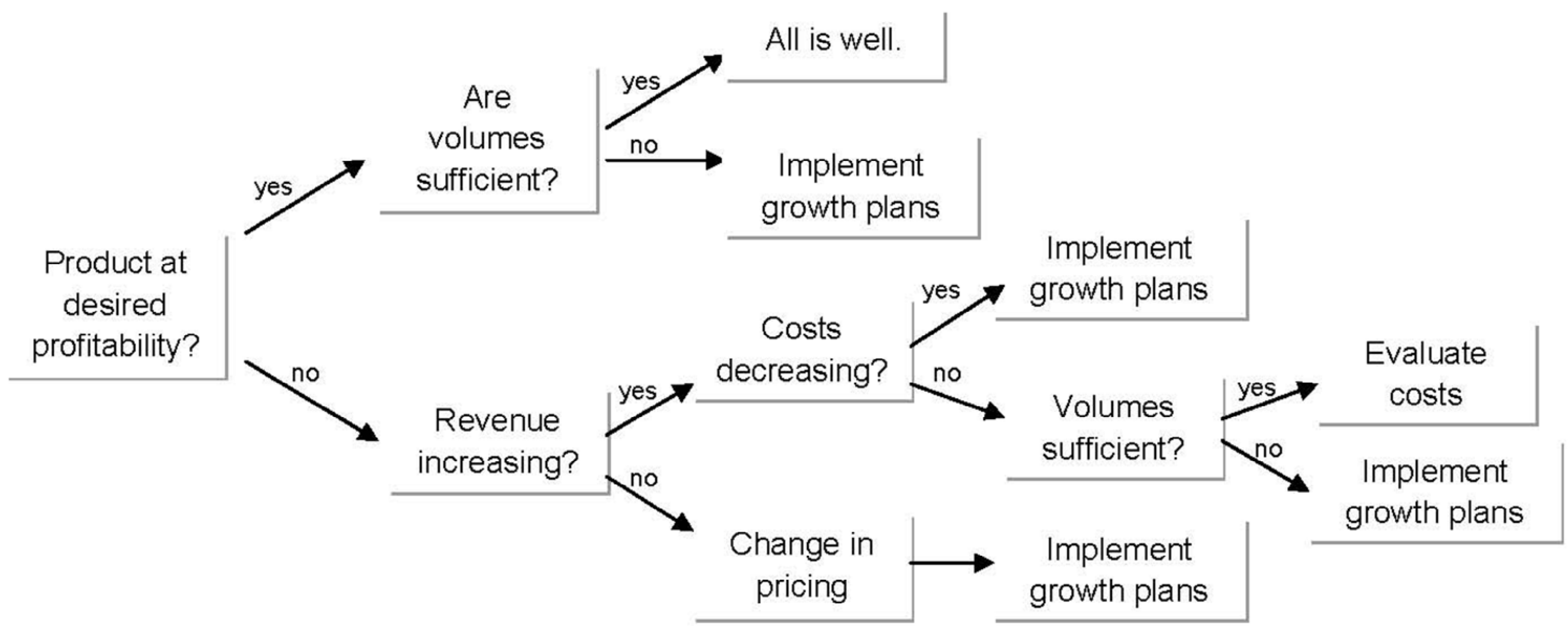
Measuring Performance - Product Profitability Decision Tree



Draft materials as of 04/14/14; Subject to Change

Source: TKG

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Concluding Remarks - Valuation

- Does the “New World” of capital help clarify issues for bank investors?
- Will the “New World” of capital force a change in valuation approaches?
- What are the tangential issues brought about by the “New World” of capital

Achieving Growth

Concluding Remarks

- The whole topic is a bit of to do about nothing … industry growth; hard to see asset growth accelerating and if it does, the securitization markets will reopen

- Capital will be king; those that have access to quality capital and can deploy it effectively (generate returns) will get access to more; those that can't, won't.

- Growth will continue to be bifurcated; core banking business and top line revenues vs. growth in non-interest sources and control of expenses to generate earnings

- Growth comes from accountability in the strategic plan

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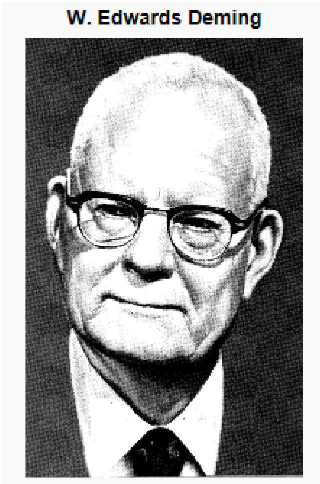
Guiding Principles to Converting Strategic Objectives to Tactical



"It does not happen all at once. There is no instant pudding."

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Appendix

The Kafafian Group, Inc.

About TKG

Firm Overview – Kafafiangroup.com

Home Services About Team Publications Contact

Helping banks perform better

The Kafafian Group, Inc. ("TKG") was established to help community financial institutions solve their challenges and take advantage of their opportunities in a constantly changing industry and economic environment.

Find out more

Meet The Kafafian Group

We serve community financial institutions by helping senior leaders develop strategies that lead to long-term success. We do this by:

- Providing end to end strategic planning, including components to strategy such as capital plans and enterprise risk management.
- Constructing granular profitability information to foster a performance culture.
- Identifying operational efficiencies.
- Advising institutions on M&A opportunities and a balanced approach to strategic alternatives analysis.
- Assisting boards of directors and senior managers on improving their effectiveness, satisfying regulatory orders, and creating franchise value.

Find out more

Speaking and Teaching Engagements

March 12, 2014
Financial Managers Society - Financial Industry Update
Union League
Philadelphia, PA

March 12, 2014
Washington Bankers Association - Executive Development Program
Washington Athletic Club
Seattle, WA

March 14, 2014
Utah Bankers Association - Executive Development Program
Wasatch Retreat & Conference Center
Utah, NV

Conferences, Conventions & Other Events

January 15, 2014
Financial Managers Society Philadelphia Chapter
Radnor Hotel
St Davids, PA

January 15, 2014
Financial Managers Society New York/New Jersey Chapter
The Stony Hill Inn
Hackensack, NJ

February 12, 2014
Financial Managers Society Philadelphia Chapter
Radnor Hotel
St Davids, PA

About TKG

Our Services

Performance Measurement

- Profitability outsourcing and service bureau
- Funds transfer pricing
- Cost and capital assignments (risk adjusted return on capital)
- Profitability implementation
- Peer group and results analysis
- Performance measurement reporting

Strategic Management

- Strategic planning (consolidated or lines of business)
- Capital allocation and capital management strategies
- Management and board retreat facilitation

Profit & Process Improvement

- Operational analyses (whole bank, line of business or department studies)
- System audits
- Vendor analysis and contract negotiations

Regulatory Assistance

- Compliance with regulatory-directed orders
- Board and management studies
- Capital planning and profit planning
- Stress testing, model validation and documentation

Financial Advisory

- Acquisitions and divestitures
- Whole bank M&A (buy-side and sell-side)
- Branch purchase or sale
- Fee-based line-of-business purchase or sale
- Valuation analyses (ESOP, S-corporations, etc.)
- Fairness opinions

About TKG

Today's Presenter

Richard B. Trauger, Jr.

Managing Director

Email: rtrauger@kafafiangroup.com
Phone: 973-299-0300 x113

Mr. Trauger is a Managing Director of TKG. Mr. Trauger participates in all facets of TKG's service line and is primarily responsible for TKG's valuation and capital strategies practice, financial analytics and model development and is a member of TKG's financial advisory services team.

During his 25 year financial services industry career, Mr. Trauger has developed his skill set as a financial analyst within a large community banking organization and as an investment banker, where he has successfully completed over three dozen merger and acquisition, capital market, and financial advisory assignments for financial and non-financial corporations, with an aggregate transaction value of approximately $1.5 billion.

Mr. Trauger's proficiency in data acquisition, utilization, transference and use of financial analytic and statistical procedures has produced client-specific solutions for a wide range of financial services industry participants. Specifically, Mr. Trauger specializes in many sectors of the financial industry, including commercial banks, savings banks, credit unions, insurance underwriting and distribution firms, and investment and asset management firms. He is also a subject matter expert for SNL Financial, L.C. on the topic of advanced bank valuation and has served in the capacity of an expert witness for matters involving financial services industry firms.

Mr. Trauger holds an undergraduate degree from Penn State University (Harrisburg). Mr. Trauger also holds the Certified Valuation Analyst (CVA®), Chartered Financial Consultant (ChFC®), and CERTIFIED FINANCIAL PLANNER™ (CFP®) designations.

Mr. Trauger has successfully completed the Uniform CPA Examination and is actively pursuing Certified Public Accountant licensure. He also continues to pursue additional levels of education and has passed the Level I and Level II exam as administered by the CFA Institute.

He is a practitioner member of the National Association of Certified Valuators and Analysts, a member of the CFA Institute, the CFA Society of Philadelphia, an associate member of the AICPA and a member of the PICPA.