

Some Good Skills to learn in Business Administration



One of our favorite conferences each year is the Bank Director's Acquire or Be Acquired Conference (AOBA). While the material is a little redundant (there are only so many slides you can see on bank multiple trends), they keep the conference moving so you never get bored. Bank Director also does one of the best jobs in the industry of actually working practicing banks into the panels, so you hear firsthand how they do it and not just some vendor's theory.

However, the best part of the conference is the sheer energy level. Everyone is in deal mode. Not to say that there are a lot of deals that get done there (there are some), but you only come to that conference if you are serious about acquiring, selling or NOT being acquired. Like that African proverb, it doesn't matter if you are a lion or a gazelle – when the sun comes up – you better start running. That is the sentiment that is evident at AOBA – bankers were constantly in motion.

The Essence of the Conference

AOBA tends to attract banks that take performance and the creation of franchise value seriously. And, in case you forget, there are enough consultants and high-powered investment bankers running around to tell you often what you are doing right or... wrong. At over 1,100 attendees, the place is packed, and it is not only educational to be able to

speak with the nation's top performing bank CEOs all in one place, but also to have conversations with their board members. Board members will often give you the "behind the scenes" opinion on how the bank really operates. There is no surprise that most every top performing bank CEO we spoke with, we were also equally impressed by the quality of their board members. While some conferences attract bankers and Directors that want a vacation, AOBA attracts bankers and Directors that want to create alpha.

The Summary

The overarching undercurrent of the conference was optimism. In fact, that is an understatement, as bankers were more giddy about the future than a bunch of 12-year old girls at a 5 Seconds of Summer concert. That audacity of hope (yes, we realize the irony of that phrase) led most to believe that bank's current equity valuations will lead to more deals getting done, by larger banks and at higher multiples compared to last year (despite the fact that there are fewer banks).

More capital, higher quality credit, greater liquidity and that rough optimism for a stronger economy and higher rates has many banks in a better position to make stronger bids. Aging management teams, the burden of regulation, competition and the expectations of higher multiples motivated the sellers. You have to love when you go to a M&A conference, and both buyers AND sellers feel it is the right time to take action. If that wasn't enough, it seemed like everyone wanted to raise relatively cheap capital. It was no wonder why the I-bankers were so happy.

Next, to the obvious M&A topics, there was a large emphasis placed on fintech. While not much new ground was broken, it seems like the conversation of partnering with fintech players has evolved where bankers are now starting to figure out (and have figured out) how to successfully pull off partnerships.

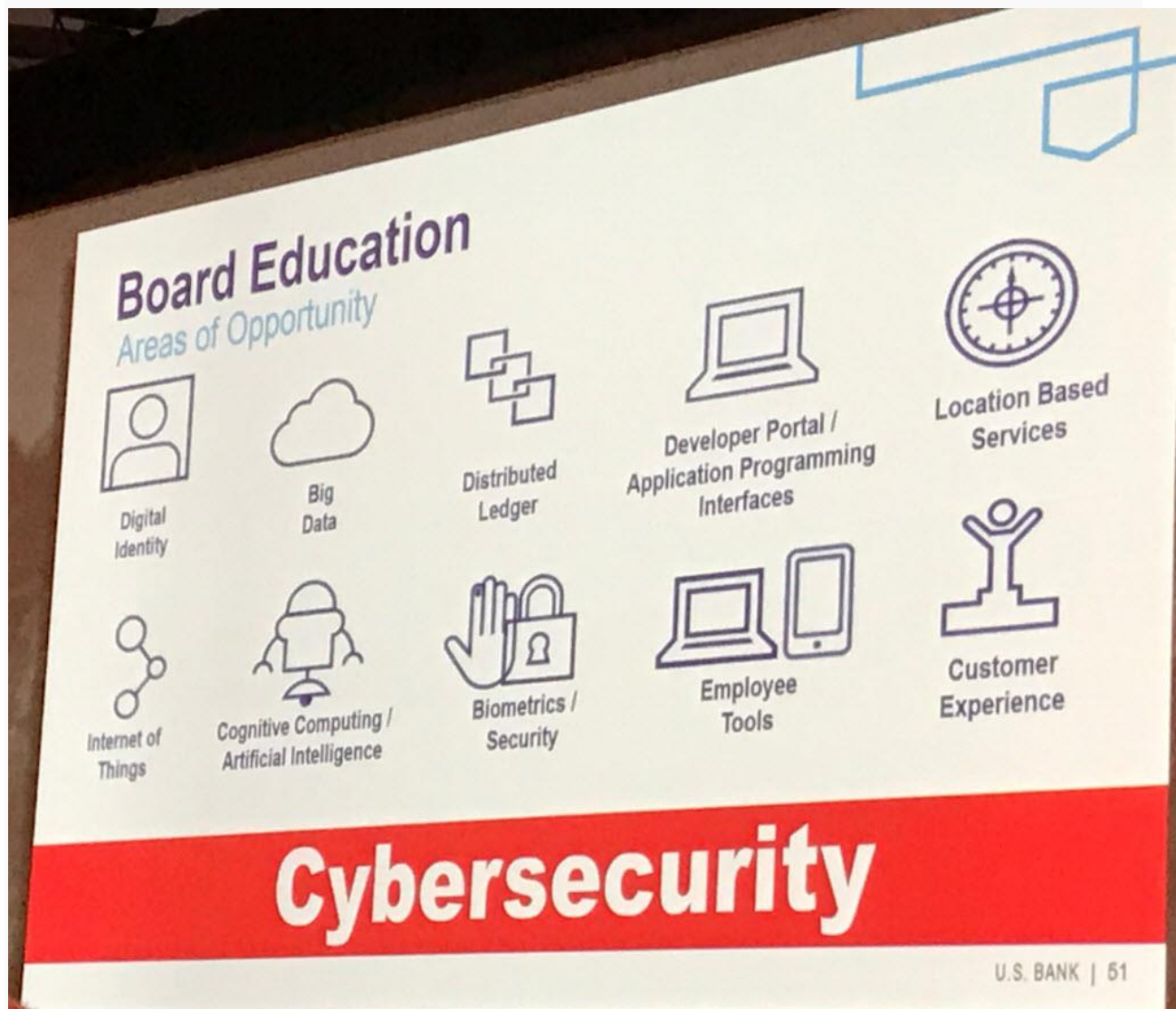
Our Top 10 Slides and Wisdom

In addition to the themes above, here is our list of the ten most important things we learned or had reinforced at the conference:

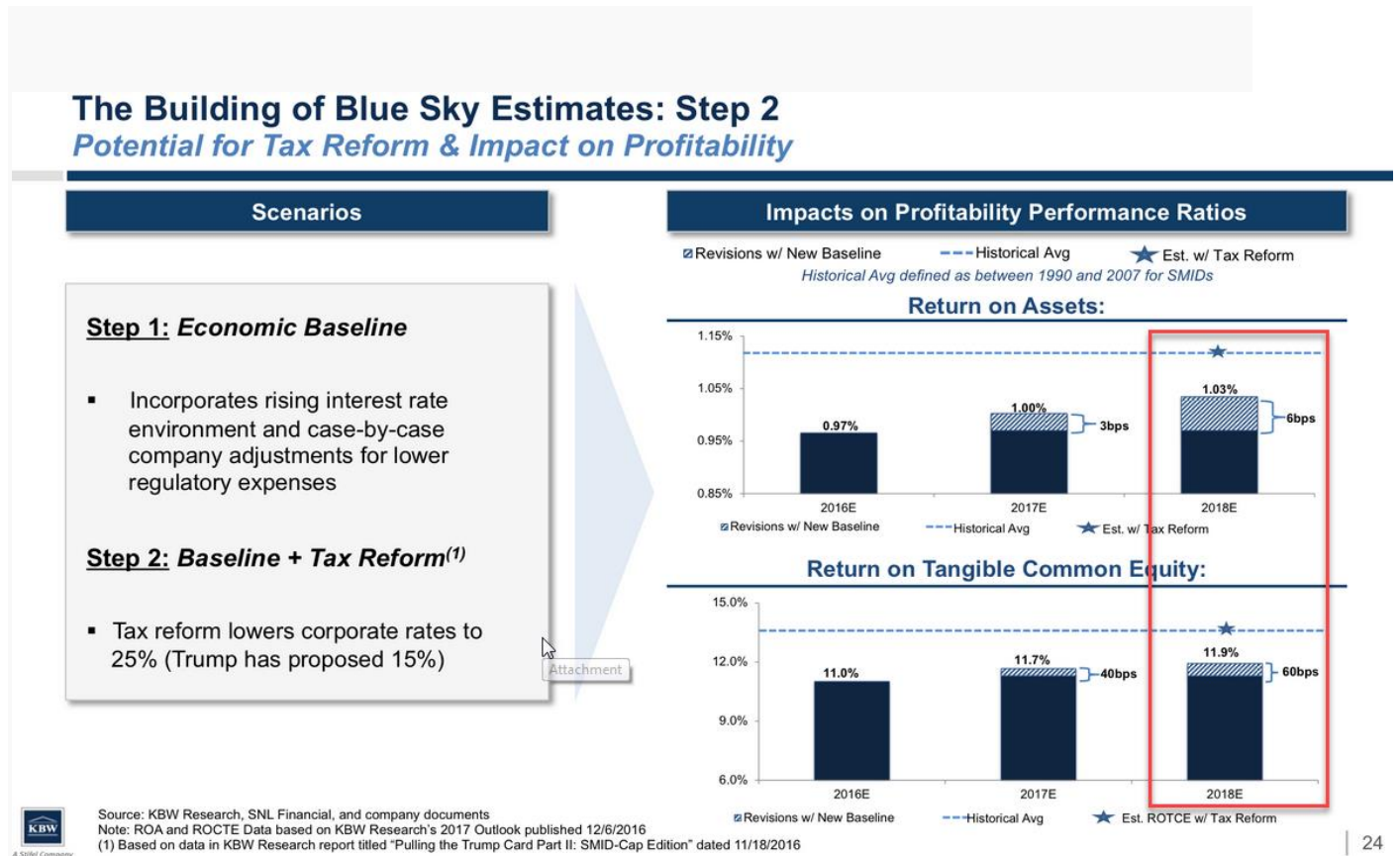
- **Change as a Skill:** While somewhat evident given President Trump, being able to adapt to change is a success factor that all banks need to think through and practice.

The ability to see how the play might change, to be able to pivot and to skate where the puck is going to be, will be the key to success for the next four years. This point was driven home as the travel ban news broke and a handful of CEOs at the conference got asked their position by their board, employees or news media. Having to interpret the news and walk the political line for all stakeholders may be a new skill we all need to develop.

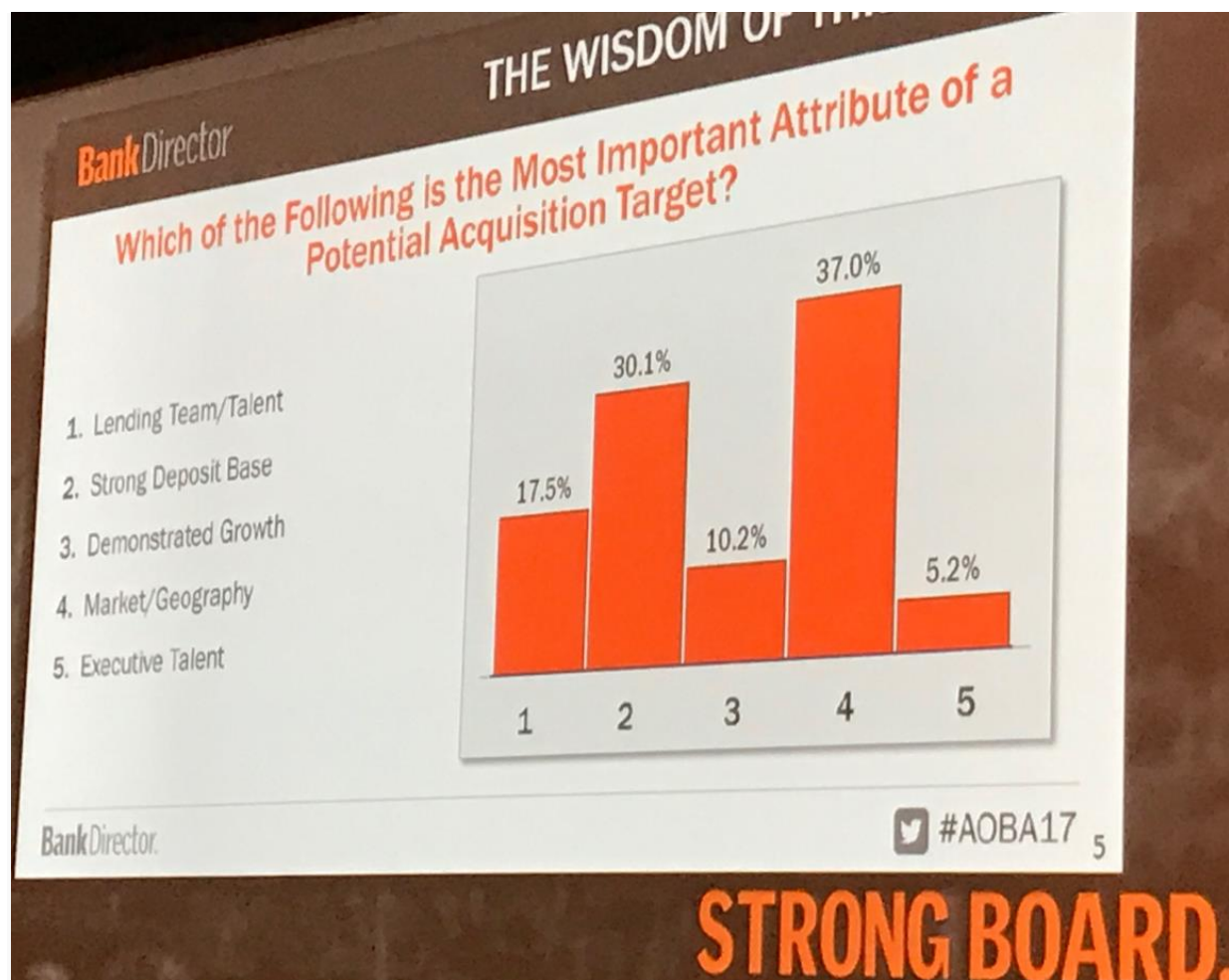
- **Board Education:** US Bank's Board Education Plan made us want to update the level of technology awareness for our board.



- **Trump Bump Pump:** The value of President Trump was interestingly quantified by KBW (about 6 bps in ROE and 60 bps in TCE).



- **Growth & Talent:** Our fellow bankers don't appreciate talent or the ability to generate growth as much as we do.

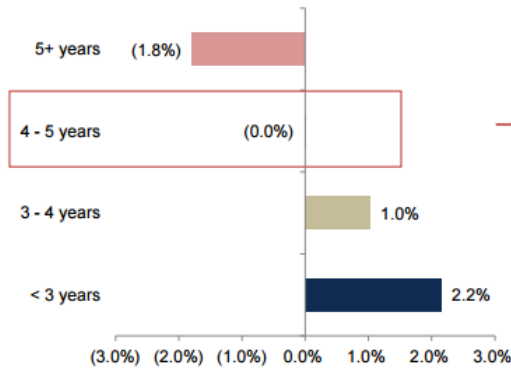


- **TBV Earnback:** We need to get more granular in our analysis when a target falls within the dreaded 4 to 5 year breakeven period and make sure we are clear on our strategic intent.

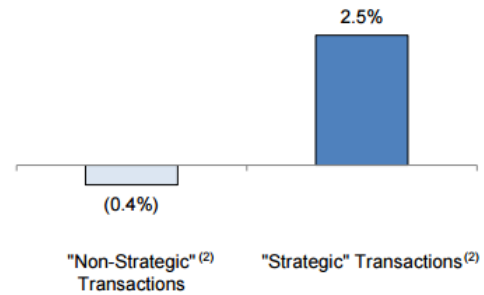
The Newest Financial Guardrail: Focus on TBV Earnback

- Investors are focusing on 5 years as an acceptable TBV earnback period
- As TBV earnback gets closer to 5 years, strategic transactions are treated more favorably

Buyer Relative 1 Month Performance Stratified by TBV Earnback Period ⁽¹⁾ (%)



Buyer Relative 1 Month Performance Stratified by Target Pro Forma Asset Contribution (%)



Financial and Company SEC filings; Includes transactions since 1/1/13 with deal values greater than \$50 million and disclosed earnback periods

Note: Price performance data reflects medians

(1) Represents stock price performance relative to the NASDAQ Bank Index one month after deal announcement date; for transactions announced within the last month, represents relative performance since announcement

(2) "Strategic" transactions include transactions where target assets \geq 20% Pro Forma assets; "Non-Strategic" transactions include transactions where target assets < 20% Pro Forma assets



A S&P 500 Company

- **Compensation:** We must get more creative in custom designing compensation packages to attract and retain key talent. Talent is everything.

What Do Employees “Value”

34 & Under	35 – 49	50-64	65+
Base Pay	Base Pay	Base Pay	Base Pay
Career Opportunities	Retirement Plan	Retirement Plan	Retirement Plan
Retirement Plan	Low Health Care Costs	Low Health Care Costs	Type of Work
Low Health Care Costs	Bonus/ Incentive	Bonus/ Incentive	Bonus/ Incentive
Bonus/ Incentive	Paid Time Off	Paid Time Off	Low Health Care Costs
Flexible Schedule	Flexible Schedule	Type of Work	Working for a Respectable Organization

Mercer 2015 Survey

2017 Acquire or Be Acquired Conference

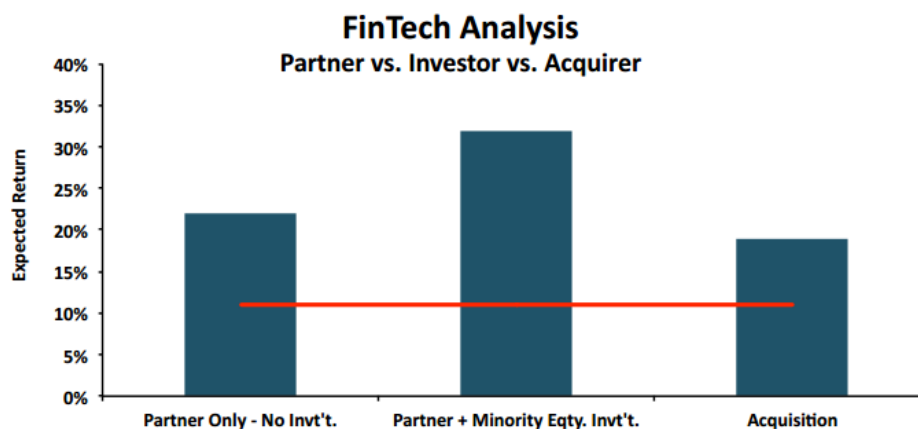
Finding Solutions Others Miss

 **Compensation
Advisors**
A Member of Meyer Chaffield Group

- **Strategic Value:** We partnered with Mercer Capital and presented our “Strategic Value Efficient Growth Differential Equation” which we will highlight in a later post. We also quantified ROI on a potential fintech partnership and its alternatives. In our real-life example, we asked the question, "Should we partner with a robo-advisor and if so what structure?"

Step 3. Develop a Business Case

IRR Comparisons of Different Approaches



- **Activism:** Bank shareholder activism works to a much greater extent than we previously believed and the slide below sums up the challenge and the mitigation nicely.

Preparedness

Assemble Advance Preparation Team

- Composed of management, lawyers, bankers, proxy solicitors and public relations firm
- Team should develop Day 1 response plan

Be Aware of Chatter About the Company

- Listen to what is said about you, your peers and your industry (analyst reports, the financial press, shareholder meetings, investor conferences, etc.)

Identify / Address Potential Vulnerabilities

- Think like an activist –identify issues that a short-term financial investor would seize upon and prepare responses
 - Stock underperformance
 - Opportunities for a quick return (special dividend/ share buy-back opportunities, opportunities for cost cutting, divestitures/spin-offs, etc.)

Engage with Shareholders

- Reach out to/meet with investors “on a clear day” (even smaller investors who might have been below the IR “radar screen” in the past)
- Meet with ISS and Glass Lewis periodically

Develop Consistent and Coherent Message

- Construct and articulate clear and effective strategy for sustainable long-term growth
- Outline key strategies and address potential concerns/ vulnerabilities
- Use investor conferences, etc. to make key points



A KBW Company

Review Structural Defenses

- Review at least annually and consider the consequences of removing or enhancing, including potential regulatory issues
- Recognize the limitations of “takeover” defenses in the context of an activist campaign

Track Shareholder Base Frequently

- Maintain state-of-the-art stock watch programs
 - Involve stock watch and proxy solicitors actively
 - Keep track of participants on conference calls, investor meetings, etc.
 - Monitor 13D/13G/13F filings

Keep Directors Involved

- Directors should be regularly updated and be:
 - Warned that stockholders occasionally contact outside directors directly
 - Reminded that communications should be referred to the CEO or relevant IR personnel

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- Price Certainty:** Due to lofty equity levels, acquiring banks need to be prepared to offer fixed price or collars on their offering equity price as more sellers will be concerned that bank equity valuations can only go down from here.
- Credit Unions:** One of our favorite mind-bending topics from the Conference - Should banks be buying credit unions?

Business Considerations in Acquisitions

Selected Opportunities

- **Traditional Motivations**
(e.g. growth/scale, earnings, new markets, distribution, reduces competition, etc.)
- **Product Niches**
(e.g. Auto loans—direct or indirect, Payday alternative loans, other consumer products, etc.)
- **Customer Acquisition & Cross-Sale Opportunities**
- **Fee Income**
- **Community Development & CRA**
(e.g. serving LMI communities, etc.)
- **Specialized Industries**
(e.g. medical, manufacturing, etc.)

Selected Challenges

- **Traditional Risks in all deals**
- **Transition Risk**
- **Different Cultures**
(employee & “member”)
 - Credit Culture
- **Specialized Due Diligence**
(e.g. NCUA vs. FDIC insurance.; “members” vs. customer implications; regulatory/compliance implications in products & services; revenue/cost differences, etc.)
- **Prior Member Product/Pricing Expectations**