MERCER CAPITAL

Bank Watch

Second Fairness Opinions

Following a series of large bank acquisitions in the late 1990s that did not live up to expectations, one institutional investor was quoted over a decade ago as saying fairness opinions were not worth the three dollar stationery they are written on. The portfolio manager was expressing disappointment with a bank that was in his fund that had announced a large transaction. Institutional investors are sophisticated investors. For those that do not like a major corporate decision, the "Wall Street Rule" can be exercised: sell the position.

Boards of directors on the other hand rely upon fairness opinions as one element of a decision process that creates a safe harbor related to significant decisions. Fairness opinions are issued by a financial advisor at the request of a board that is contemplating a significant corporate event such as selling, acquiring, going private, raising dilutive capital, and/or repurchasing a large block of shares. Under U.S. case law, the concept of the "business judgment rule" presumes directors will make informed decisions that reflect good faith, care and loyalty to shareholders. Directors are to make informed decisions that are in the best interest of shareholders. Boards that obtain fairness opinions are doing so as part of their broader mandate to make an informed decision.

The fairness opinion states that a transaction is fair from a financial point of view of the subject company's shareholders. The opinion does not express a view about where a security may trade in the future; nor does it offer a view as to why a board elected to take a certain action. Valuation is at the heart of a fairness opinion, though valuation typically is a range concept that may (or may not) encompass the contemplated transaction value.

In addition, process can be an important factor in assessing fairness. This is especially true when a company is contemplating selling. *Revlon* (506A2d 173 (Del. 1986)) is a benchmark Delaware case that nearly 30 years ago established the duty of directors to maximize value when a board seeks to sell or break-up the company. Our lay person interpretation is that if a company is sold for cash or a majority of payment consists of cash, then directors have a higher standard to ensure they have made an informed decision that the highest obtainable value was achieved. How the duties are to be carried out is not prescribed in *Revlon*, including whether a board conducts an auction or other form of market check. Nevertheless, a board that conducts an auction or makes an informal market check with logical alternative acquirers can be an important fairness consideration as certainty about value is strengthened. This would be especially true if value was presumed to be average (or less) when compared to similar transactions. Other factors that would merit consideration include financing arrangements and ability to close.

Alternatively, *Revlon* would not apply in a deal structured as a stock swap because shareholders would continue to own an interest in a corporation that seeks to maximize long-term value; however, different factors will be considered in the context of fairness, including the value of the subject company's shares relative to the value of the shares to be received. Factors to be weighed include growth prospects of the combined companies, potential synergies, dividend paying capacity, earnings and book value accretion (or dilution), relative value compared to peers, trading volume and the like. In effect, it depends because there is not one standard that defines fairness.

Fairness opinions are typically issued by investment bankers who arranged a transaction; however, because most of their fee is contingent upon the successful closing of a transaction, the lead banker's opinion has always had some taint even if the consensus is that a transaction is a good deal. In 2007, the Financial Industry Regulatory Authority ("FINRA") issued Rule 2290, which requires the issuer of a fairness opinion to disclose such conflicts.

It is probably not a coincidence that transparency that is promulgated by Rule 2290 has led to more litigation. The *New York Times* noted on March 8, 2013, that "once you've announced a deal, you are likely to get sued." Academics Matt Cain of the University of Notre Dame and Steven Davidoff of Ohio State University published research in February, 2013, that 59% of all takeovers announced during 2005-2012 over $100 million with an offer price of at least $5 per share involved litigation.

The statistics were telling about the state of the corporate world, including over 200 such transactions in 2006 and 2007 compared to 150 in 2010, 128 in 2011 and just 84 in 2012. Pre-crisis, approximately 40% of the announced mergers entailed litigation; since 2008 the litigation rate has exceeded 84% each year. The average complaints per transaction were five, and 50% involved multi-jurisdictions. The median attorney fees to settle when disclosed were $595 thousand in 2012, which was within the $528 thousand to $638 thousand median band since 2006. "Disclosure-only" settlements (i.e., adding disclosures about the transaction to the proxy statement) accounted for 88% of the settlements in 2012 vs. 12% for settlements that increased the consideration or reduced the termination fee. In 2005 and 2006, "disclosure-only" settlements were only 64% and 58%, respectively.

Given the increase in litigation and greater scrutiny on investment bankers' contingent pay when issuing a fairness opinion, many boards have hired a second (or third) financial advisor that was not involved in arranging, negotiating and/or financing a transaction to issue a fairness opinion. Doing so will not preclude litigation, but boards that hire an independent financial advisor are taking a step to ensure their actions meet the standards of care, loyalty and good faith that form the basis of the Business Judgment Rule.

Mercer Capital is an independent valuation and financial advisory firm. We render hundreds of valuation opinions each year and are regularly engaged by boards to evaluate significant transactions. As part of our financial advisory practice, we regularly issue fairness opinions on behalf of boards that are involved in transactions that span a range of purposes, though M&A is the most common. If your firm is contemplating or has initiated a significant transaction, we would be glad to discuss the matter in confidence.

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What We're Reading

Naomi Snyder conducted an interesting interview with Brad Milsaps of Sandler O'Neill discussing "What Investors Want in M&A"

http://mer.cr/1jwHK9W

The *About that Ratio* blog posted some key takeaways (in text and video) from the recent *Acquire or Be Acquired* (AOBA) conference:

http://mer.cr/1e0LU4Y

The Independent Community Bankers Association (ICBA) released the results of their "2013 ICBA Community Bank Payments Survey (Summary)":

Text here: http://t.co/jtjDF04y6Q
Slides here: http://t.co/TSqTIm7V5M

Tri-State Capital's Acquisition of Chartwell Investment Partners

A Blueprint for Asset Manager Transactions

On January 7, 2014 Tri-State Capital Holdings, Inc. (NASDAQ ticker: TSC), the holding company of Pittsburgh-based TriState Capital Bank, entered a definitive asset-purchase agreement to acquire Chartwell Investment Partners, L.P., a Registered Investment Advisor (RIA) in the Philadelphia area with approximately $7.5 billion in assets under management (AUM). Unlike most acquisitions of closely held RIAs, the terms of the deal were disclosed via a conference call and investor presentation; the details of which are outlined in Figure 1.

TriState Capital Holdings Acquisition of Chartwell Investment Partners – Deal Analysis

	Disclosed 2013E	Est. Ongoing	
Average AUM for 2013	$6,310,000,000	na	Approximate; Disclosed
Current AUM	na	$7,500,000,000	Approximate; Disclosed
Realized Average Fee	0.396%	0.400%	Higher fees on Equity AUM
Revenue	$25,000,000	$30,000,000	Revenue grows with AUM
Implied Operating Expense	$19,000,000	$21,375,000	Assumes 12.5% Δ in Ongoing OpX
EBITDA	**$6,000,000**	**$8,625,000**	2013 Disclosed; Implied Ongoing
EBITDA Margin	***24.0%***	***40.4%***	2013 Disclosed; Implied Ongoing
Initial Consideration	$45,000,000	$45,000,000	Disclosed
Earnout	na	15,000,000	Earnout if 2014 EBITDA > $8.5MM
Total Consideration	**$45,000,000**	**$60,000,000**	Earnout likely to be paid
Implied Multiple	***7.5***	***7.0***	Earnout 6x Δ in EBITDA

Figure 1

In the call and presentation, management delineated how Chartwell's attributes met Tri-State's investing criteria (as shown in Figure 2). Many of these features are what makes many asset managers (not just Chartwell) so appealing to both banks and non-banks – growth potential, fee income exposure, high margins, scalability, operating leverage, adhesive clientele base, and minimal capital requirements. Few businesses possess all these characteristics, making many investment advisors like Chartwell the focal point of would-be acquirers with capital to spare.

Of the nearly 11,000 RIAs nationwide, typically less than 100 (<1%) transact in a given year, and the terms of these deals are very rarely disclosed to the public. Perhaps the biggest obstacle to effectively acquiring these businesses is the difficulty and uncertainty involved with ensuring that an asset manager's clients, staff, and operational autonomy will be preserved post transaction. In a business totally dependent upon the investing acumen and long-term client relationships of a few key individuals, executive retention is critical yet often elusive if the firm's independence is compromised by a prospective acquirer.

TriState Capital Criteria	Chartwell Characteristics
Critical mass ($3-$10B AUM)	$7.5B in AUM from $5.2B in 2012 and $4.8B in 2011
Demonstrated history of growth	AUM growth from $4.8B in 2011 to ~$7.5B at closing
Continued growth potential	Ongoing revenue estimated at $30M compared to $25M in 2013
Credible track record of investment performance	Favorable performance against 1, 3, & 5 year benchmarks
Significant fee income contributor	Diversifies Tri-State Capital's revenues, improving its risk profile
Profitable	Adjusted 2013 EBITDA margin of ~24%
Immediately accretive to EPS	Projected first full year accretion ~25%
Attractive internal rate of return	Projected IRR ~25%
Capital light	Minimal capital requirements

Figure 2

Because of these circumstances, the transactions that do take place are often complemented with contingencies based on staff and client retention with some part of the consideration structured as an earn-out to ensure financial performance holds up post transaction. Tri-State's acquisition of Chartwell contains all these provisions and relatively favorable pricing, making it a viable prototype for deal structure in asset manager transactions.

Although RIA acquisitions have been relatively scarce in recent years, the outlook is perhaps more optimistic for 2014 as AUM balances and valuations at all-time highs may induce an aging ownership base to exit the business. With so much at stake, prospective buyers and sellers should utilize the Tri-State-Chartwell acquisition blueprint in negotiating a successful transaction for both parties.

To discuss a transaction or valuation need in confidence, contact us at 901.685.2120.

To subscribe to the **Asset Management Industry newsletter**, in which this article originally appeared, visit www.mercercapital.com.

To download a copy of the deck "**Bank Acquisitions of Asset Management Firms**," visit http://www.mercercapital.com/media/bank-acquisitions-of-asset-management-firms/.

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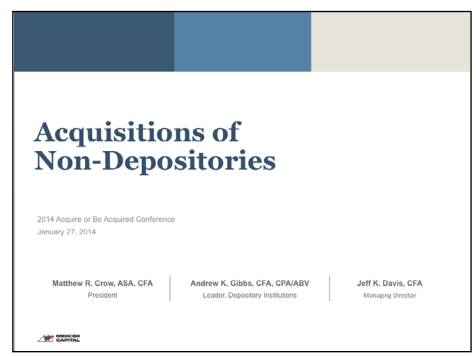
Download AOBA 2014 Presentation

Acquisitions of Non-Depositories

An acquisition of a non-depository, such as an insurance agency, specialty finance company, trust company, or asset management firm, by a bank is an important decision.

This topic was presented at the *2014 Acquire or Be Acquire* conference sponsored by Bank Director magazine and discusses the unique opportunities and challenges of such acquisitions.

To download the presentation, visit www.mercercapital.com/media/acquisitions-of-non-depositories/.



Recent Transactions

To discuss a transaction need in confidence, contact Jeff Davis at 615.345.0350.

CenterState BANK

Davenport, Florida

acquired

First Southern Bank

Boca Raton, Florida

Mercer Capital issued a fairness opinion on behalf of First Southern Bancorp

ILTS®

International Lottery & Totalizator Systems, Inc.

Vista, California

Mercer Capital served as the financial advisor to the Special Committee of the Board of Directors and issued a fairness opinion on behalf of the minority shareholders in a Going Private transaction

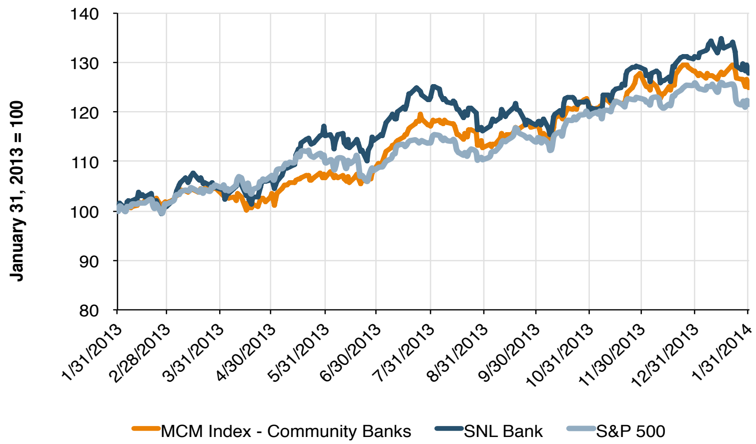
Transaction Advisory Services for Banks

In addition to valuation services, Mercer Capital provides transaction advisory and financial advisory services to banks, thrifts, and credit unions.

Mercer Capital has experience assisting depository institutions with significant corporate transactions. Whether considering an acquisition, a sale, or simply planning for future growth, Mercer Capital has the experience required to help financial institutions accomplish their financial objectives.

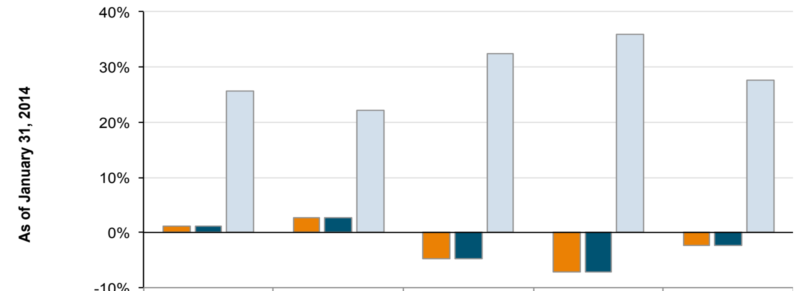
- Merger & Acquisition Advisory
- Fairness Opinions
- Solvency Opinions
- Distressed Institutions Assistance
- Board Presentations

Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size



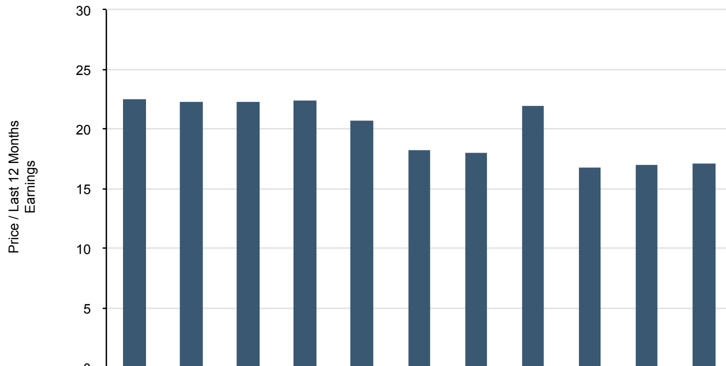
	Assets $250 - $500 MM	Assets $500 MM - $1 BN	Assets $1 - $5 BN	Assets $5 - $10 BN	Assets > $10 BN
Month-to-Date	1.18%	2.58%	-4.73%	-7.27%	-2.26%
Year-to-Date	1.18%	2.58%	-4.73%	-7.27%	-2.26%
Last 12 Months	25.58%	22.18%	32.47%	35.96%	27.62%

Median Valuation Multiples

	Median Total Return			Median Valuation Multiples as of January 31, 2014					
Indices	Month-to-Date	Year-to-Date	Last 12 Months	Price/ LTM EPS	Price / 2014 (E) EPS	Price / 2015 (E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	-1.25%	-1.25%	19.24%	14.01	15.71	13.46	107.7%	115.9%	2.2%
Midwest Index	-0.09%	-0.09%	36.81%	12.85	13.62	12.21	115.7%	122.8%	2.2%
Northeast Index	-3.98%	-3.98%	21.46%	14.16	14.08	12.52	123.2%	129.3%	3.1%
Southeast Index	-3.76%	-3.76%	23.16%	13.81	15.56	13.15	117.4%	129.4%	2.0%
West Index	-1.57%	-1.57%	25.78%	16.86	16.68	13.81	127.6%	138.3%	1.8%
Community Bank Index	-2.58%	-2.58%	24.90%	14.08	15.38	13.12	117.1%	128.5%	2.2%
SNL Bank Index	**-2.52%**	**-2.52%**	**27.78%**	**na**	**na**	**na**	**na**	**na**	**na**

Median Price/Earnings Multiples

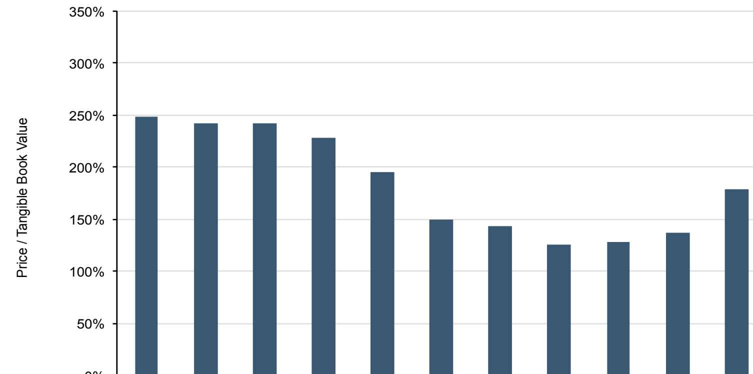
Target Banks Assets <$5BN and LTM ROE >5%



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
U.S.	22.6	22.2	22.2	22.4	20.7	18.2	18.1	21.9	16.8	17.0	17.1

Median Price/Tangible Book Value Multiples

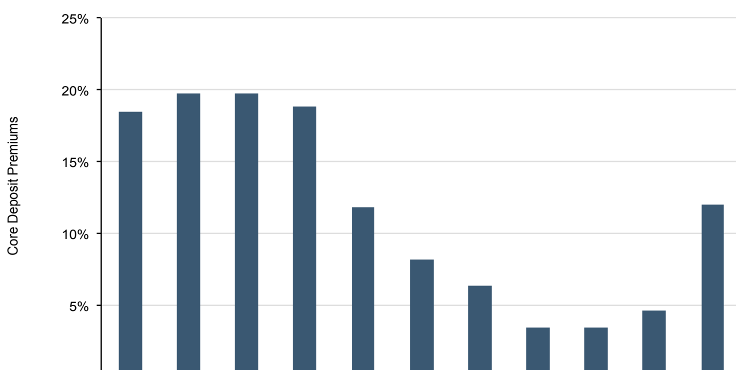
Target Banks Assets <$5BN and LTM ROE >5%



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
U.S.	248%	242%	242%	229%	195%	150%	143%	125%	128%	137%	179%

Median Core Deposit Multiples

Target Banks Assets <$5BN and LTM ROE >5%



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
U.S.	18.5%	19.7%	19.7%	18.9%	11.9%	8.2%	6.4%	3.5%	3.5%	4.7%	12.1%

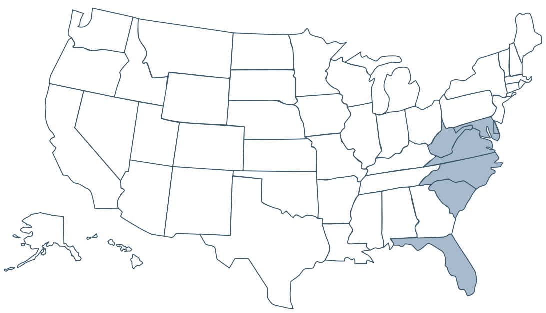
Median Valuation Multiples for M&A Deals

Target Banks Assets <$5BN and LTM ROE >5%, through January, 2014

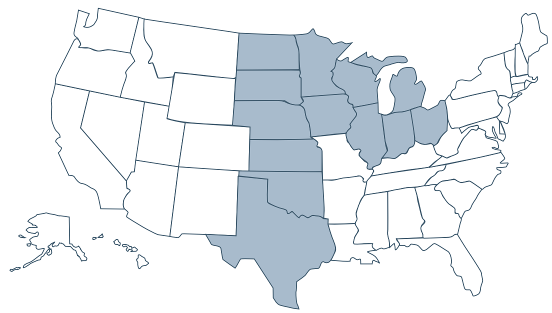
Regions	Price / LTM Earnings	Price / Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value	Target's Median Assets	Target's Median LTM ROAE (%)
Atlantic Coast	nm	nm	nm	0	nm	nm	nm
Midwest	20.27	1.93	12.1%	3	189.47	918,832	9.71%
Northeast	21.82	1.79	na	1	239.70	1,242,673	8.96%
Southeast	15.83	1.73	12.5%	3	157.78	856,664	10.52%
West	60.00	na	5.3%	1	3.46	95,951	na
Nat'l Community Banks	**17.10**	**1.79**	**12.1%**	**8**	**169.41**	**887,748**	**9.96%**

Mercer Capital's Regional Public Bank Peer Reports

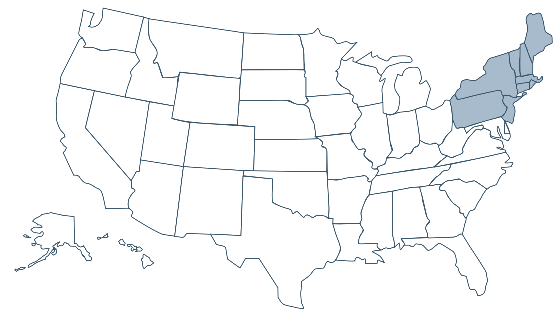
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



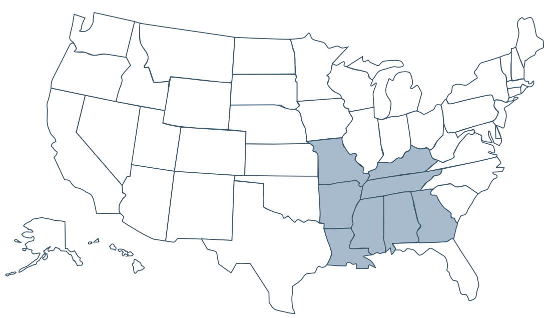
Atlantic Coast



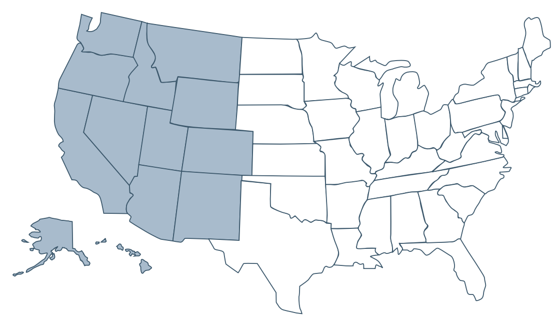
Midwest



Northeast



Southeast



West

Mercer Capital

Financial Institutions Services

Mercer Capital assists banks, thrifts, and credit unions with significant corporate valuation requirements, transactional advisory services, and other strategic decisions.

Mercer Capital pairs analytical rigor with industry knowledge to deliver unique insight into issues facing banks. These insights underpin the valuation analyses that are at the heart of Mercer Capital's services to depository institutions.

Mercer Capital is a thought-leader among valuation firms in the banking industry. In addition to scores of articles and books, *The ESOP Handbook for Banks* (2011), *Acquiring a Failed Bank* (2010), *The Bank Director's Valuation Handbook* (2009), and *Valuing Financial Institutions* (1992), Mercer Capital professionals speak at industry and educational conferences.

The Financial Institutions Group of Mercer Capital publishes *Bank Watch*, a monthly e-mail newsletter covering five U.S. regions. In addition, Jeff Davis, Managing Director, is a regular contributor to SNL Financial.

For more information about Mercer Capital, visit www.mercercapital.com.

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