Bank Acquisitions of Asset Management Firms

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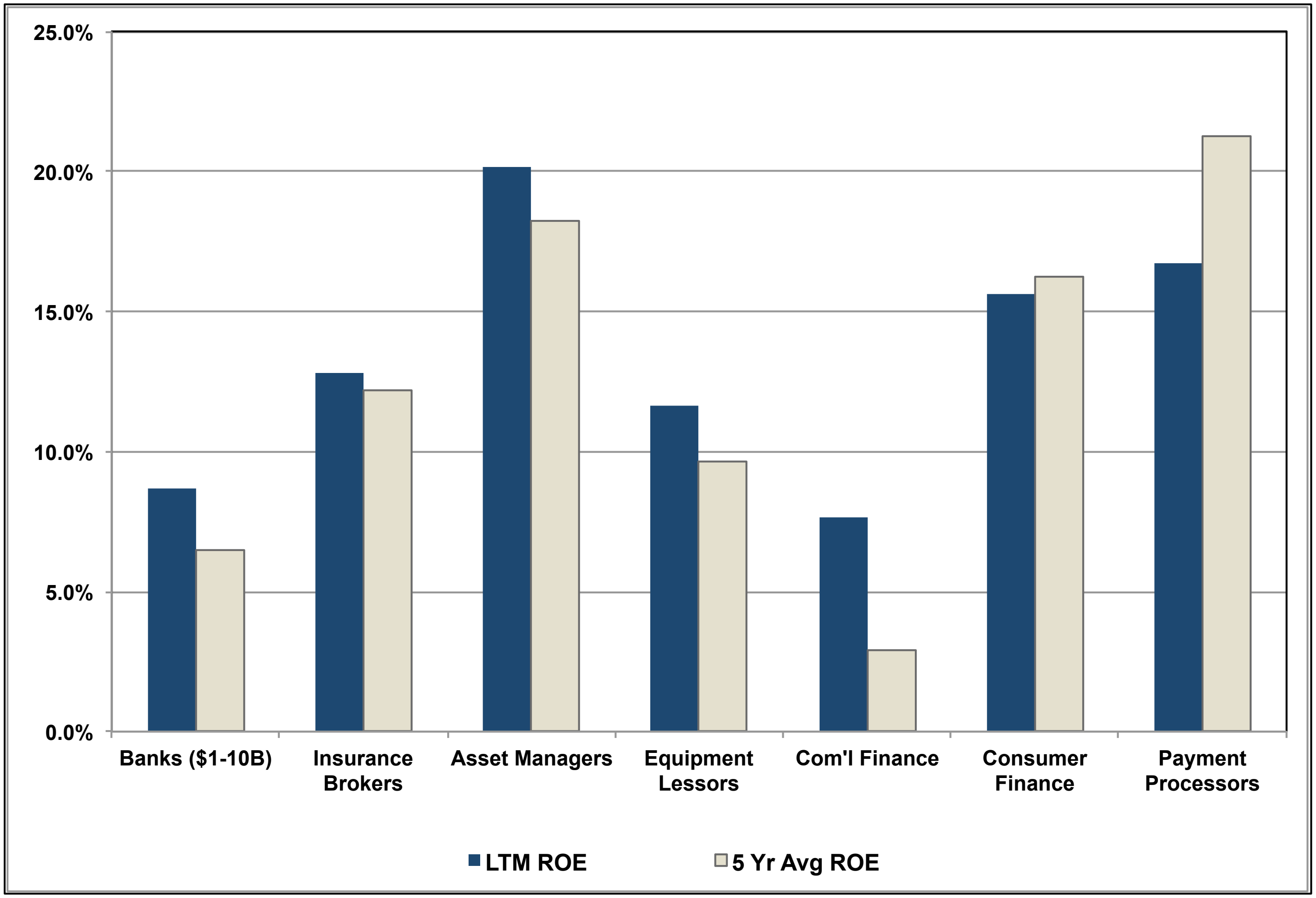
Opportunities

- Deployment of excess capital to drive growth
- Revenue and earnings diversification
- Improve return on capital
- Cross-sell existing customers
- Improve the bank's valuation
- Target as a subsidiary of the bank

Issues

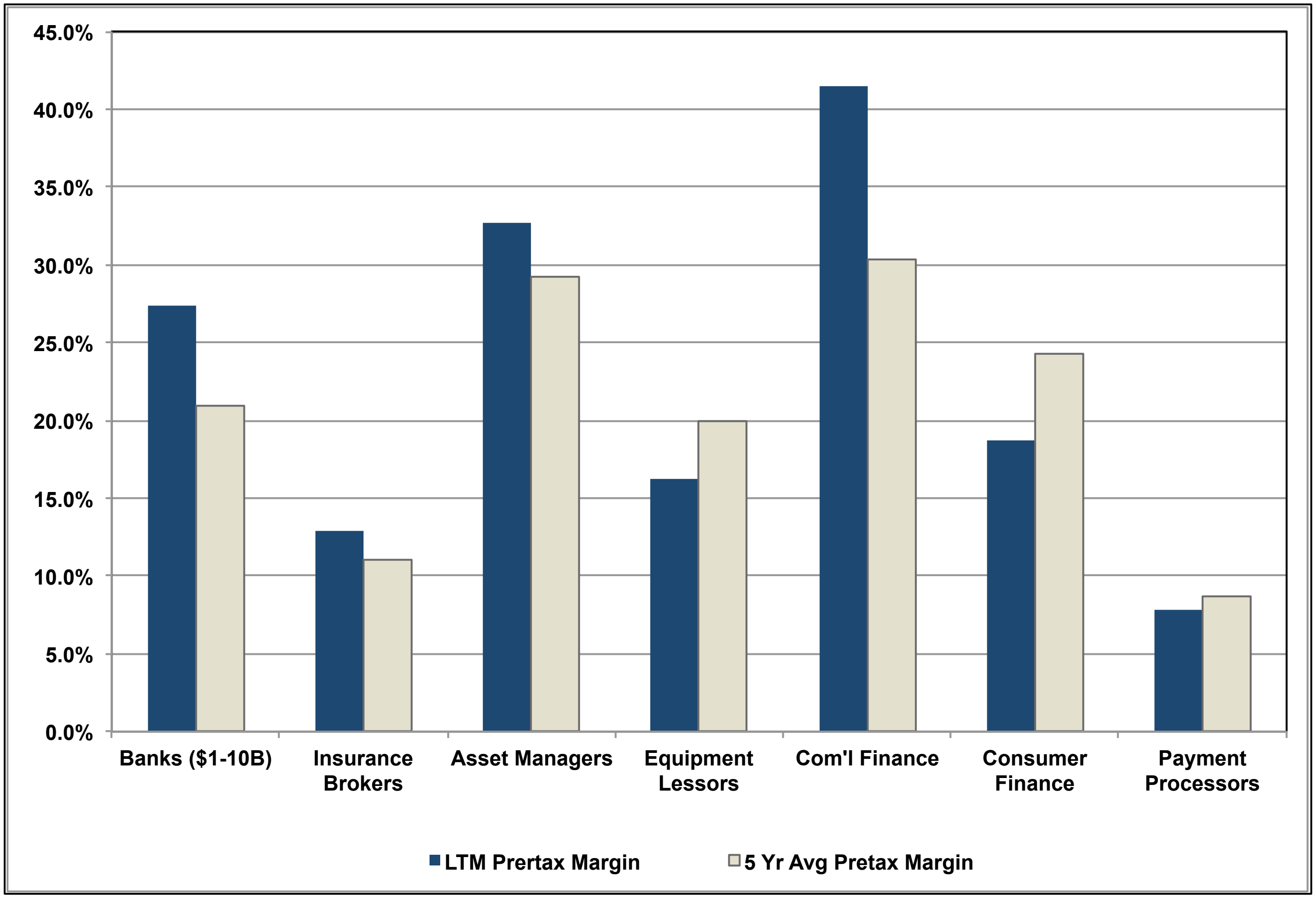
- Execution risks
- Culture
- Dilution (ownership, focus and franchise value)
- Enough scale to matter
- Contingent liabilities
- Will key principals still work hard?
- Limitations on the size of bank subsidiaries relative to the bank
- Regulatory pressure on banks as fiduciaries

Comparative ROEs



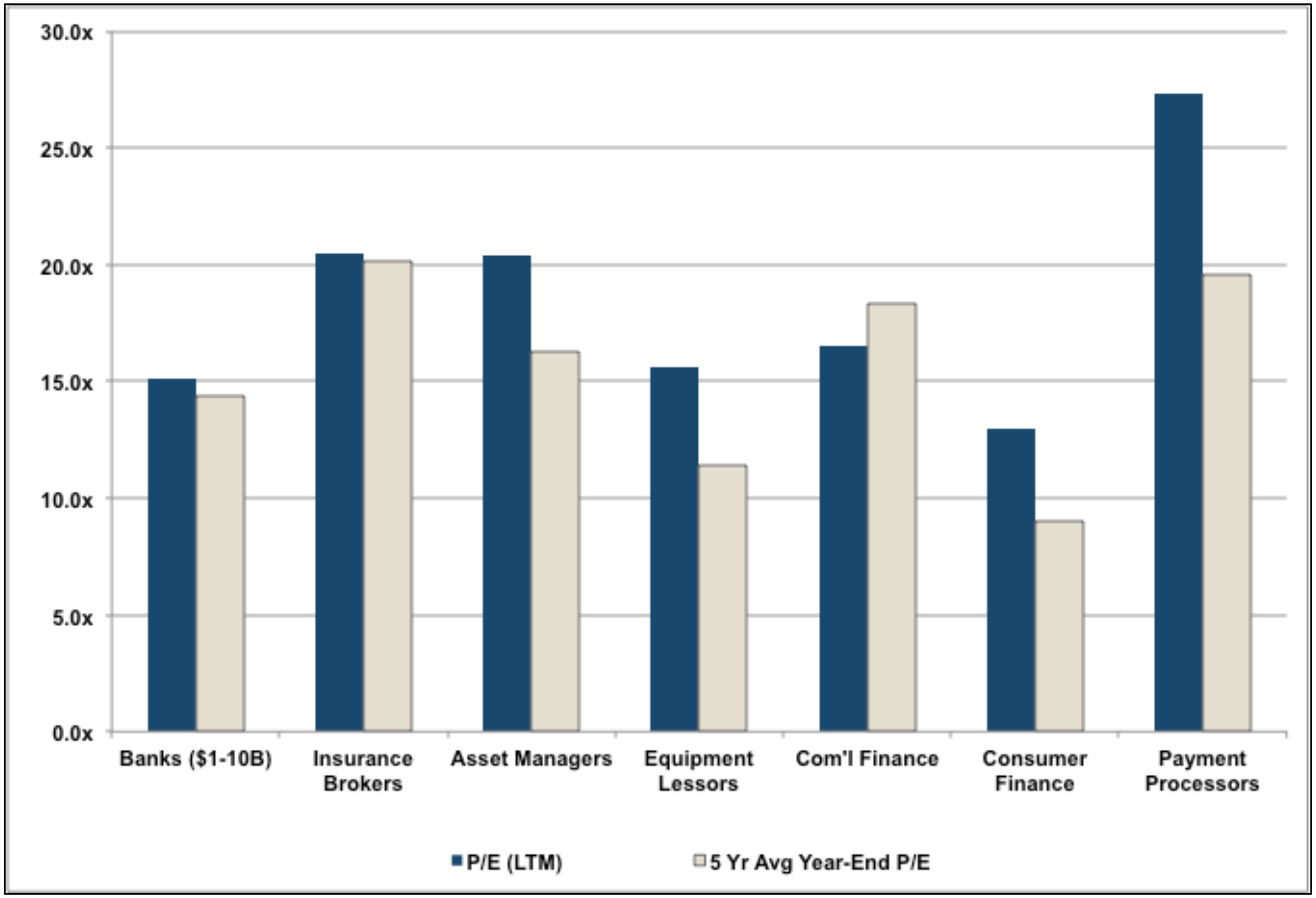
Source: SNL Financial

Comparative Pretax Margins



Source: SNL Financial

Comparative P/Es



Source: SNL Financial

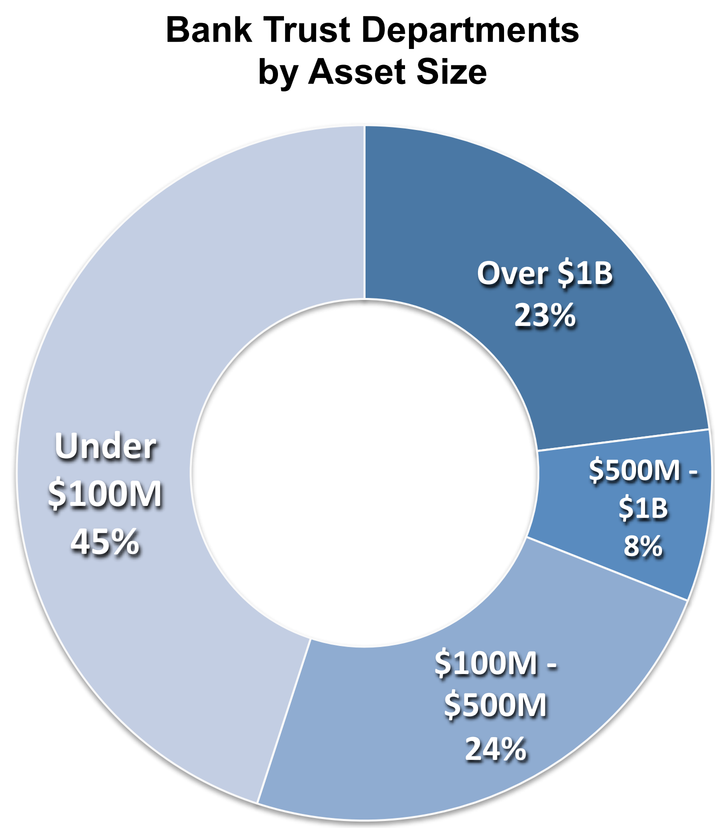
Banks Interested in Asset Managers…

			AUM	Deal Value /				Deal Val.	Type of Consideration ($ Mil.)		
Announced	Acquirer	Target	($ Mil)	AUM/AUA (%)	Revenue	EBITDA	Net Inc.	(S Mil.)	Cash	Stock	Earnout
02/21/2011	IBERIABANK Corporation	Bank of Florida Trust Company	415	0.30	0.78	NA	NM	1.4	0.7	NA	0.7
02/03/2012	Bryn Mawr Bank Corporation	Davidson Trust Company	1,000	1.05	NA	NA	NA	10.5	7.4	NA	3.2
10/31/2012	Atlas Banc Holdings Corp.	Halen Capital Management, Inc.	NA	NA	NA	NM	NM	0.1	NA	NA	NA
12/6/12	Toronto-Dominion Bank	Epoch Holding Corporation	24,534	2.77	6.54	13.23	23.53	668.4	664.1	NA	NA
04/28/2011	Bank of New York Mellon Corporation	Talon Asset Mgmt. (Wealth Mgmt Dept.)	800	2.00	NA	NA	NA	16.0	11.0	NA	5.0
04/11/2013	Canadian Imperial Bank of Commerce	Atlantic Trust Group, Inc.	NA	1.03	NA	NA	NA	210.0	NA	NA	NA
02/15/2013	New Hampshire Thrift Bancshares	Charter Holding Corp.	NA	0.83	NA	NA	NA	6.2	NA	NA	NA
10/1/11	Wells Fargo & Company	Golden Capital Management, LLC	2,918	NA	NA	NA	NA	NA	NA	NA	NA
04/05/2010	Legacy Bancorp, Inc.	Renaissance Investment Group, LLC	195	NA	NA	NA	NA	NA	NA	NA	NA
8/29/11	U.S. Bancorp	Institutional Trust Business of Union Bank	NA	NA	NA	NA	NA	NA	NA	NA	NA
10/09/2012	Orange County Bancorp, Inc.	Hudson Valley Investment Advisors, LLC	272	NA	NA	NA	NA	NA	NA	NA	NA
1/8/13	Tri-State Capital Holdings, Inc.	Chartwell Investment Partners, L.P.	7,500	0.80	2.00	6.96		60.0	45.0	9.0	15.0
			Median Multiples Paid	**1.03**	**2.00 x**	**10.10 x**					

Trust Departments: Build-up or Shut-down?

» Roughly 1,500 Banks have trust departments
  - But only ~30% are large enough to be consistently profitable (>$500MM)

» Roughly 10,500 Registered Investment Advisers (RIAs)
  - But only ~40% are large enough to be consistently profitable (>$500MM)



Asset management can be attractive…

- Enhance non-interest fee income – easily accretive
- Asset management revenue has different market sensitivity – lowering overall revenue risk to changes in interest rates
- Asset management has minimal capital requirements – improving ROE
- Asset management has attractive internal rates of return – recurring revenue stream and substantial margins
- Leverages bank model as a distributor of financial services – through financial intermediaries like trust, other RIAs, broker-dealers, and family offices

In both cases, assets drive earnings, but returns to capital and labor vary widely

Bank Economics		Asset Manager Economics	
Earning Assets	$1,000,000,000	AUM/AUA/AUC	$1,000,000,000
x Net Interest Margin	3.50%	x Realized Fee Schedule	0.60%
= Revenue	$35,000,000	= Revenue	$6,000,000
- Operating Expenses*	30,000,000	- Operating Expenses**	4,000,000
= Pre-Tax, Pre-Provision Income	$5,000,000	= Operating Income (EBIT)	$2,000,000
Implied Margin	*14.3%*	*Implied Margin*	*33.3%*
Required Equity Capital	$100,000,000	Required Equity Capital	$1,000,000
* ~250 Employees, 15 branches		** < 20 employees, one office	
Implied Profit Per Employee	*$20,000*	*Implied Profit Per Employee*	*$100,000*

Both exhibit revenue sensitivity to the market, but in different ways

For Banks…

- » Net Interest Margin affected by loan and deposit pricing competition, shape of the yield curve, mix of loans vs. bonds, and deposit vs. wholesale funding
- » Volume of assets generally unaffected by market

For Asset Managers…

- » AUM primarily affected by market conditions
- » Fee schedule typically changes little over time

Pro: Can determine run-rate profitability every day

Con: Can't forecast reliably because market direction is unknowable

Pricing of services works very differently…

Banks

» Net Interest Margin

Asset Managers

» Realized Fee Schedule
  - Graduated for larger accounts
  - Often negotiated
  - Fairly consistent over time

» Fee schedules NEVER improve

» Indexing and ETFs haven't put pressure on active management fees yet…

…but asset attrition matters to both

Banks

- Scheduled Asset Attrition
  - Loan Amortization
- Unscheduled Asset Attrition
  - Refinancing

Asset Managers

- Scheduled Distributions
  - Trust / endowment payouts
  - Pension obligations
  - Older clients spend down assets
- Unscheduled Asset Attrition
  - Manager termination
  - Asset allocation rebalancing

- Asset Attrition is real

Sometimes failures of marketing are masked by the success in the market…

	2013	2012	2011	2010	2009	Cumulative
Starting Assets Under Management (AUM)	**1,237,500,000**	**1,172,500,000**	**1,140,000,000**	**1,110,000,000**	**1,000,000,000**	
New Business	5,000,000	0	10,000,000	15,000,000	5,000,000	**35,000,000**
Client Contributions (Withdrawals)	10,000,000	5,000,000	7,500,000	(5,000,000)	(15,000,000)	**2,500,000**
Terminations	(15,000,000)	(20,000,000)	(15,000,000)	(55,000,000)	(30,000,000)	**(135,000,000)**
Net Business Gained / Lost	**0**	**(15,000,000)**	**2,500,000**	**(45,000,000)**	**(40,000,000)**	**(97,500,000)**
Change in Market Value	**150,000,000**	**80,000,000**	**30,000,000**	**75,000,000**	**150,000,000**	**485,000,000**
Ending AUM (Starting AUM + Net Flows + Δ in MV)	**1,387,500,000**	**1,237,500,000**	**1,172,500,000**	**1,140,000,000**	**1,110,000,000**	
Management Fee Revenue	$7,000,000	$6,300,000	$6,100,000	$6,000,000	$5,750,000	
÷ Average AUM	1,312,500,000	1,205,000,000	1,156,250,000	1,125,000,000	1,110,000,000	
= Approximate Realized Fee	0.53%	0.52%	0.53%	0.53%	0.52%	

Both business models are labor intensive, but in different ways

Banks are labor intensive

- Lots of people

Asset managers are labor intensive

- Expensive people
- Ties back to profit per person

- Primary source of cultural conflict
- Commonly represents 70% to 80% of operating expenses

Asset managers complain about regulation, until they learn what bankers endure…

Bank Regulatory Capital

» High and rising (?)

Asset Manager Regulatory Capital

» Varies, and is rising

» But still minimal by comparison

» Much more significant for trust services

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For both, scale matters…

Scale matters for Banks

- Hence this conference

Scale matters for Asset Managers

- Scale >> Margin >> Risk
- Operating leverage play: to a point
- $300MM AUM to be viable
- $500MM AUM to be consistently profitable
- Margins tend to max out between $3B and $5B AUM

- Operating leverage is often over-promised and over-forecast

Although the P&L starts with assets, value is a function of earnings

Banks

- Just as bank transactions are cited in terms of price to book…

Asset Managers

- ... Asset manager transactions are often disclosed as price to AUM
  - But "Activity" metrics are commonly misleading
  - And whisper numbers are often overstated
    - Earnouts included as if fully earned and undiscounted
    - Actual multiples paid are rarely reported

- Total consideration usually 6x-12x EBITDA

But deal structure in asset managers is very different from bank transactions

Banks

» Earnouts are very rare in bank transactions

Asset Managers

» Earnouts are the norm in asset manager transactions
  - Relational, performance based business
  - Commonly 30%-50% of deal value

» Don’t pay twice!

And due diligence is very different…

Banks

» Bank acquisition due diligence focuses on downside protection
  - Credit risk
  - Compliance

Asset Managers

» Asset manager acquisition due diligence focuses on upside protection
  - Clients must consent to move accounts
  - Staff retention maintains intellectual capital and relationships
  - 3rd party verification of investment performance

» Audits from a reputable firm and 3rd party custody of client assets

Tri-State Capital announces purchase of Chartwell Investment Partners (January 8, 2014)

- Tri-State Capital Holdings (TSC)
  - Pittsburgh bank with assets of $2.2 billion and equity of $290 million
  - IPO last year; implied market capitalization of ~$350MM
  - No-branch model looking for ways to leverage bank for high value added relationships in a financial services distribution model
- Chartwell Investment Partners
  - Founded 1997 and based in Philadelphia area
  - Provides Small to Mid-Cap Equity and fixed income management for ~ 150 institutional and private investors
  - Mutual Fund Product – Chartwell Small Cap Value Fund (CWSVX)

TSC acquisition of Chartwell

	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

TSC acquisition of Chartwell

For TSC

- Diversified revenue
- Added non-interest income
- Capital commitment minimal
- Accretive to earnings
- Styles the bank as upscale distributor of value-added financial services

For CIP

- Owners take money off the table, but stay involved
- Upside potential if they can tap bank's client base to distribute products through other channels
- Earnout all but assured

Final Thoughts

» **#1 determinant of return that investors and buyers control is the purchase price**

» Don’t lie to yourself to win the deal

» Price cures price … margin of safety matters

» Realistic assessment of the target’s earning power and synergies

» Do not let other peoples problems become your problem

Q & A

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