Financial Institutions: Black Holes of Valuation

Jeff K. Davis, CFA
Mercer Capital Management
615-345-0350 | jeffdavis@mercercapital.com

Black Hole Questions

- What’s the deal with P/TBV?
- Why is leverage easy to hide?
- How are liabilities assets?
- How are assets liabilities?
- What does cash flow mean?
- EBITDA?

Section 1
Business Model

Business Model

Banks (Depositories)

- Bank and parent (BHC) highly regulated
- Bank tier one capital levered upwards of 13:1 (7-8% equity/assets; ~9% norm)
- Low cost/stable deposits (FDIC backed) – core of franchise value for banks
- Commercial loans tend to be at the top of the borrower's capital stack
- CRE theoretically less risk post crisis; HVCRE subject to 150% capital charge
- Bulk of consumer lending shifted to majors and specialty finance

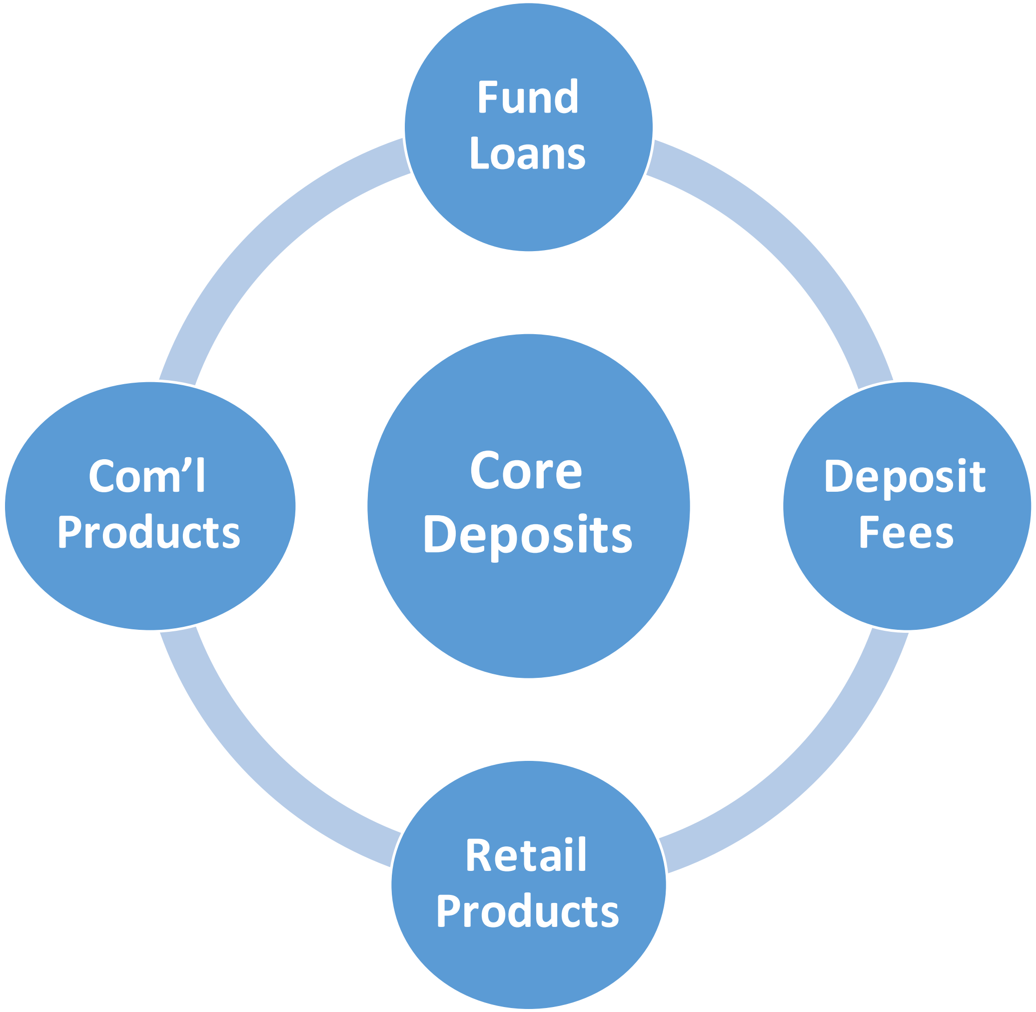
Non-Bank Lenders

- Less regulated than banks
- Less levered due to lenders' willingness re: advance rates and/or regulation (BDC)
- Funding less stable than banks' – push to add long-term debt post crisis, but plenty of ST funding, securitization etc.
- Yields higher than typical bank yield
- Lower fees than banks
- Higher risk = lower P/E than typical bank

Business Model – Leverage!

- Crux of the business model: leverage the equity to produce net interest income, minimize credit losses, charge fees and manage overhead
- Loans can be a “liability” because issues usually are not visible until it is too late
- Bonds produce incremental income but do not add to franchise value and can easily detract
- Core deposits are liabilities but are a key element of earning power and franchise value

	Bank
Liquid Assets	300
Bonds	2,500
Loans	8,500
Other Assets	200
Total Assets	**$11,500**
Deposits	10,000
Borrowings	500
Equity	**1,000**
Loan / Deposits	85%
Equity / Assets	8.7%



- Core deposits are the center of the franchise for most banks
- Lending franchise overlaps but is not 1:1 proposition (excess retail deposits; CRE clients net fund users; commercial mixed)
- Banks with big core deposit base tend to be more highly valued
- But banks in growth markets with strong lending franchise but weak core deposit base may be valuable to certain buyers

Parent Leverage!

- Parent should be evaluated stand-alone basis
- Debt can be used to create equity in bank
- High parent leverage not discernible in consolidation
- Debt service and shareholder cash flow via dividends from the highly-regulated bank

	Bank
Liquid Assets	300
Bonds	2,500
Loans	8,500
Other Assets	200
Total Assets	**$11,500**
Deposits	10,000
Borrowings	500
Equity	**1,000**
Loan / Deposits	85%
Equity / Assets	8.7%

	Parent
Cash	100
Bonds	50
Investment in Bank	1,000
Other Assets	50
	$1,200
Short-Term Debt	100
Long-Term Debt	400
Equity	**700**
Debt / Equity	71%
Double Leverage	143%

	Consolidated
Liquid Assets	400
Bonds	2,550
Loans	8,500
Other Assets	250
Total Assets	**$11,700**
Deposits	10,000
Borrowings	1,000
Equity	**700**
Loan / Deposits	85%
Equity / Assets	6.0%

Business Model – Spread

- Loan spreads over a base rate (e.g. 30D Libor)
- Deposit COF vs capital market rate
- Non-interest bearing deposits very valuable
- Core bank (loan and deposit) net interest margin tends to move with level of short-end of the curve
- Wholesale bank (securities and wholesale borrowings) net interest margin sensitive to the shape of the curve

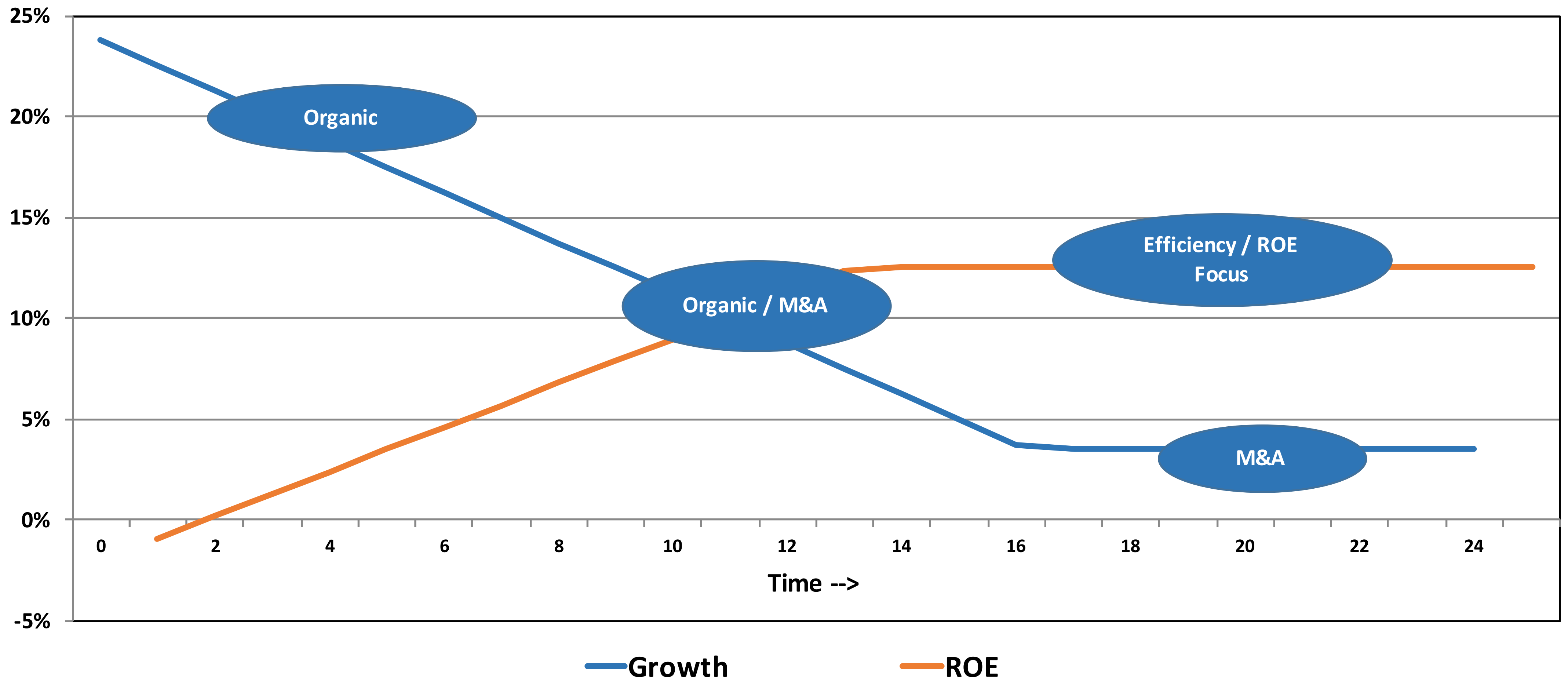
Interest Income	472	4.10%
Interest Expense	(105)	-0.91%
Net Int Income	**367**	**3.19%**
Fee Income	115	1.00%
Operating Expenses	(288)	-2.50%
Pretax Net Rev	**194**	**1.69%**
Provision Expense	(30)	-0.26%
ORE Expense	(2)	-0.02%
Bond Gains / (Loss)	0	0.00%
Pretax Income	162	1.41%
Net Income	**$105**	**0.92%**
Equity / Assets	8.7%	
ROE	**10.5%**	

- Depository can be viewed as two banks
- Core bank = loans funded with core deposits (and maybe supplemental wholesale funding if loan-to-deposit ratio is high)
- Wholesale bank = bonds and other purchased assets that are funded with borrowings unless excess core deposits exist

	2Q16			1Q17			2Q17		
Average Loans	6,107	65.0	4.32%	6,339	71.0	4.44%	6,753	78.0	4.65%
Demand Deposits	1,621	-	0.00%	1,897	-	0.00%	2,010	-	0.00%
Int Bearing Deposits	4,486	(5.6)	-0.51%	4,442	(6.1)	-0.54%	4,743	(7.9)	-0.67%
Borrowings	-	-	-0.84%	-	-	-1.20%	-	-	-1.69%
Net Spread on Lending	**-**	**59.4**	**3.94%**	**-**	**64.9**	**4.06%**	**-**	**70.1**	**4.18%**
Securities - Taxable	1,898	11.0	2.35%	1,741	10.5	2.39%	1,565	9.4	2.42%
Securities - Nontaxable	172	1.8	4.13%	187	1.9	4.04%	182	1.9	4.28%
Liquidity	56	0.1	0.72%	45	0.1	0.87%	44	0.1	0.92%
Excess Deposits	1,112	(1.4)	-0.51%	1,194	(1.6)	-0.54%	1,157	(1.9)	-0.67%
Borrowings	1,014	(2.1)	-0.84%	780	(2.4)	-1.20%	634	(2.7)	-1.69%
Bond Portfolio Spread		**9.4**	**1.78%**		**8.5**	**1.71%**		**6.9**	**1.54%**
Net Interest Income and NIM		**68.7**	**3.39%**		**73.4**	**3.50%**		**77.0**	**3.62%**
Value of NIB Funding Sources			**0.11%**			**0.14%**			**0.18%**
Net Spread			**3.28%**			**3.36%**			**3.44%**
Cost of IB Liabilities			0.71%			0.58%			0.55%
Yield on Earning Assets			4.00%			4.71%			4.60%
Bonds / Earning Assets		**25%**			**23%**			**20%**	
Loans / Deposits		**85%**			**84%**			**85%**	

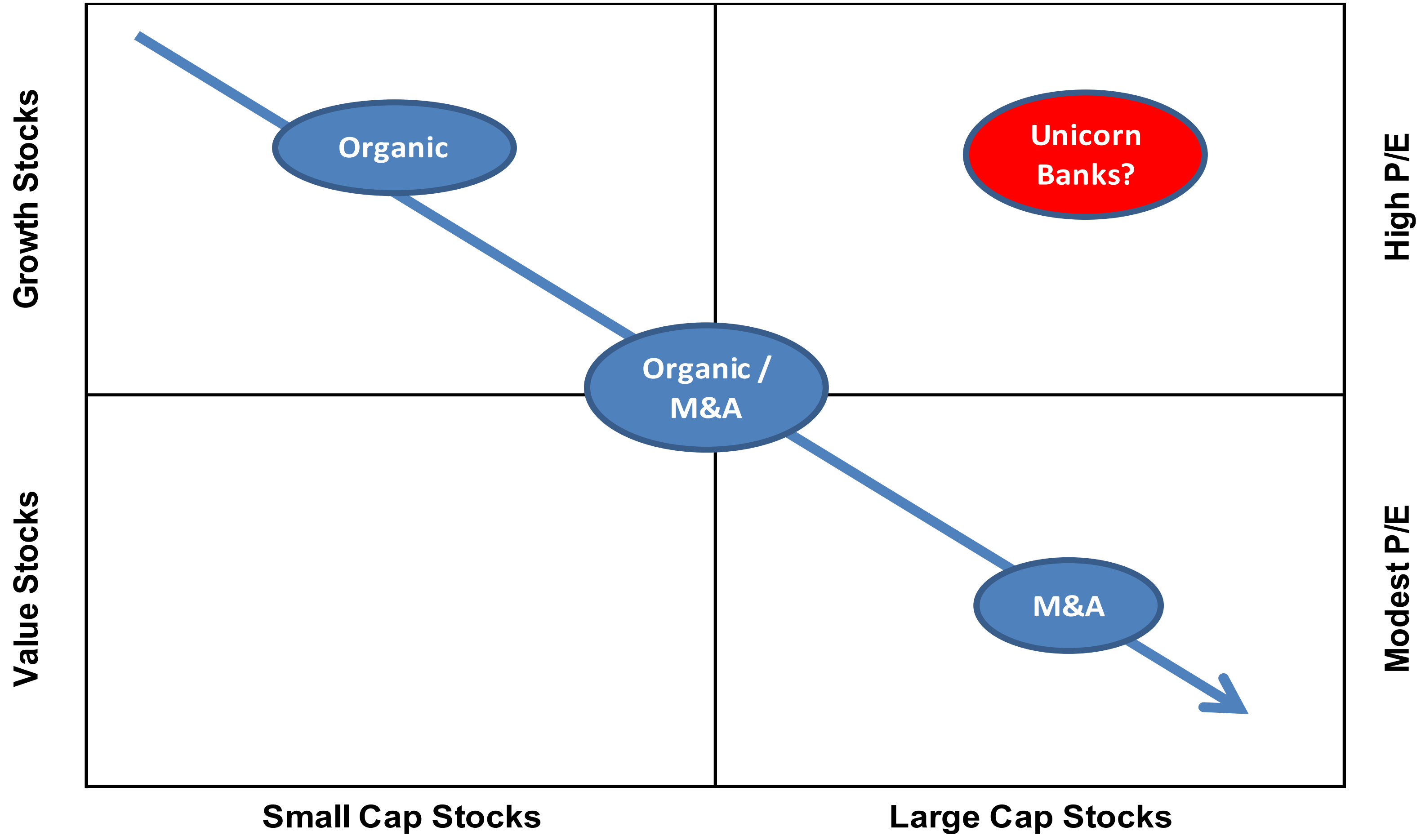
Typical Successful Bank Life-Cycle:

Organic → Organic/M&A → Max ROE or Sell

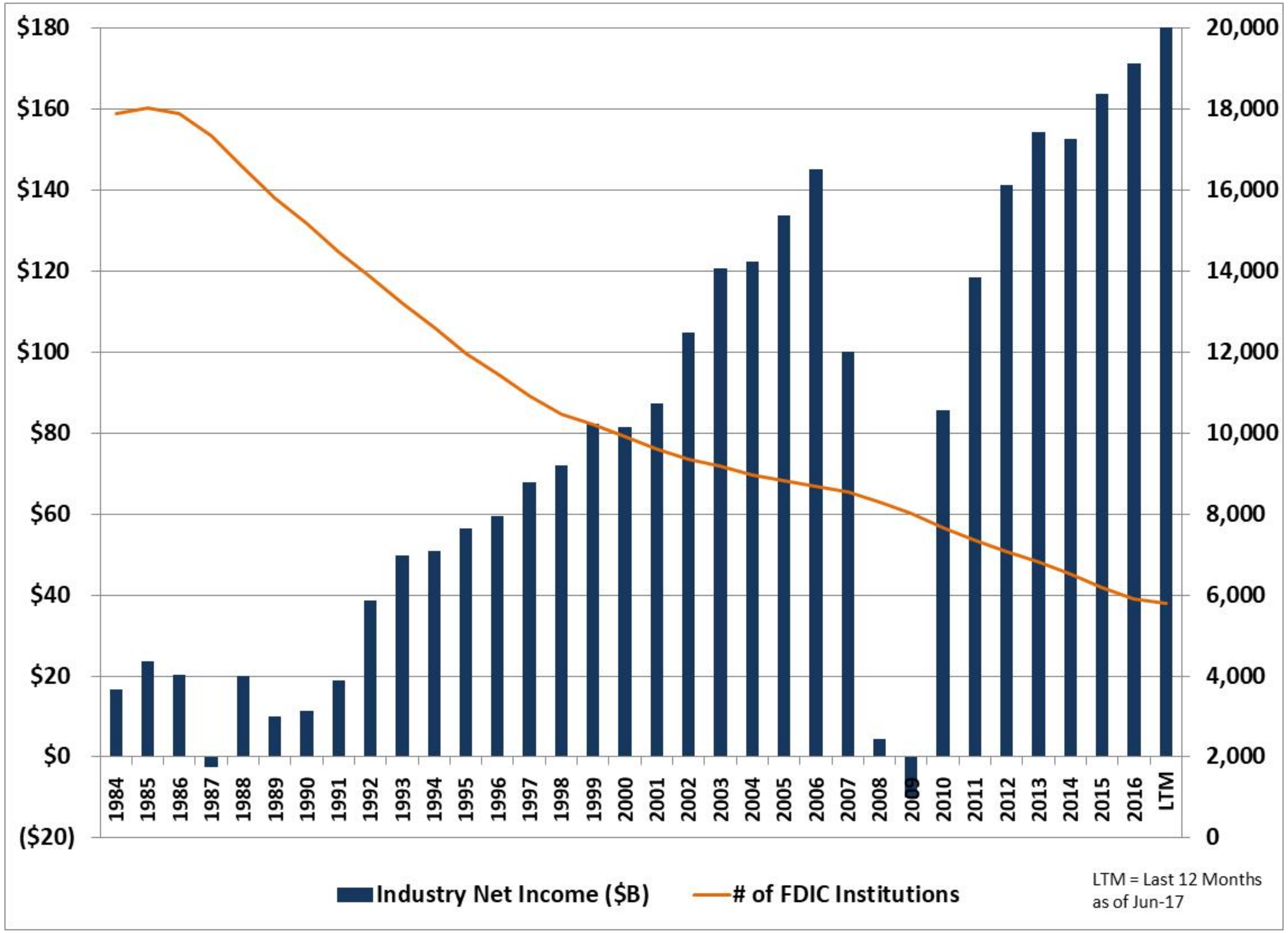


Ownership Changes Too

→ Small Cap Growth → Mid Cap Growth → Large Cap Value



Section 2
Industry Fundamentals



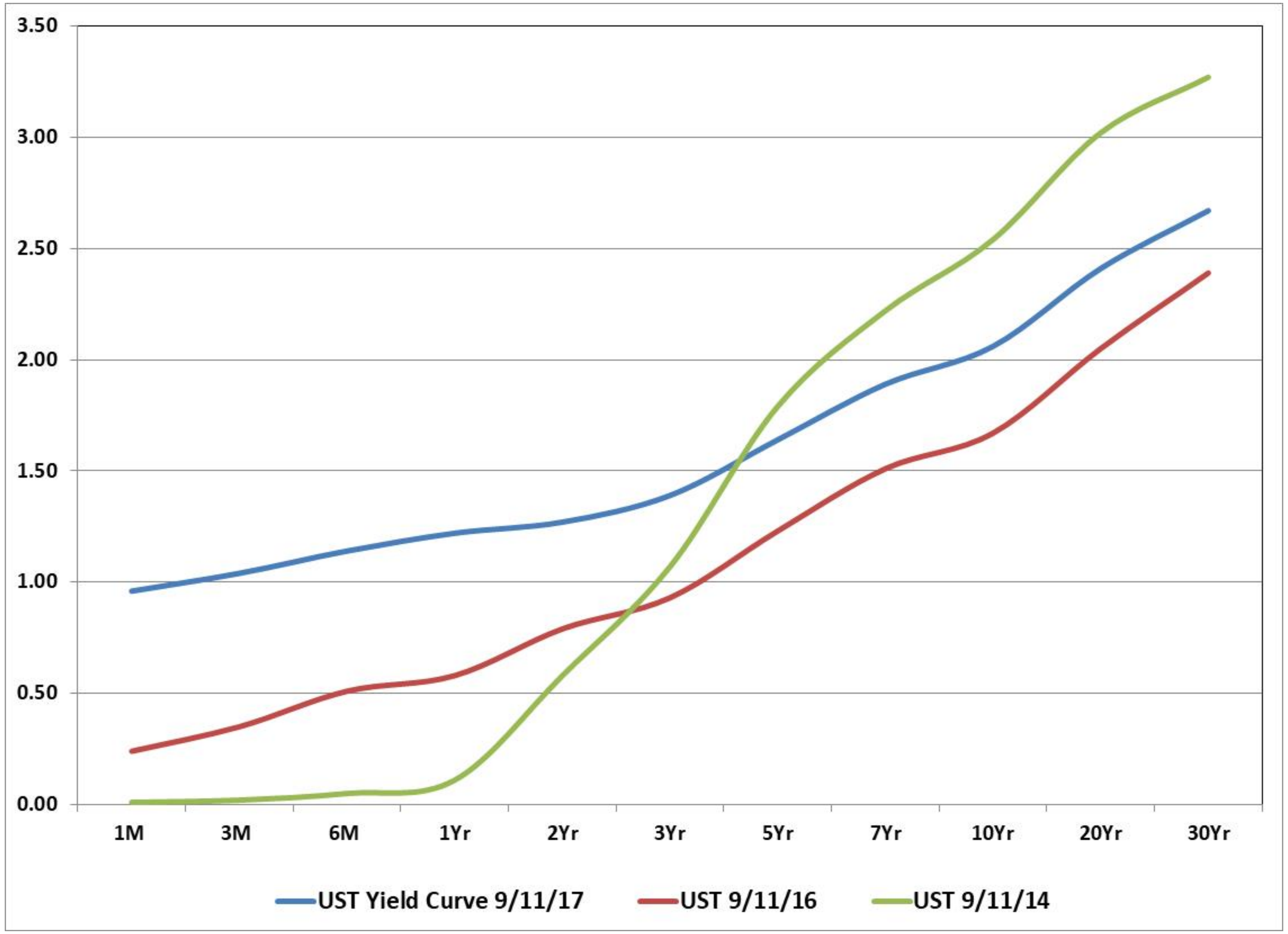
Source: FDIC

- Industry has recovered from 2007-2009 in part because of Fed actions to reflate asset values
- $180 billion industry LTM net income (1.1% ROA; 10% ROE)
- But profitability is less than pre-crisis years because (a) very low interest rates; (b) regulatory costs; (c) more capital

	Assets > $10B		Assets $3B - $10B		Assets $300M - $1B	
	2006	**2016**	**2006**	**2016**	**2006**	**2016**
ROA	1.21%	0.90%	1.12%	1.00%	1.26%	1.06%
ROE	**14.0%**	**8.0%**	**12.4%**	**9.1%**	**13.7%**	**9.9%**
ROTE (~)	**20.5%**	**10.5%**	**16.1%**	**11.5%**	**14.8%**	**10.3%**
Tangible Common / Tang Assets	**5.9%**	**8.6%**	**7.0%**	**8.7%**	**8.5%**	**10.3%**
Net Interest Margin	**3.41%**	**3.06%**	**3.87%**	**3.48%**	**4.21%**	**3.76%**
NIM less Net Charge-Offs	3.18%	2.79%	3.72%	3.36%	4.10%	3.65%
Fee Income / Revenue	36.4%	32.4%	24.6%	22.5%	17.4%	17.7%
Efficiency Ratio	**60.9%**	**64.7%**	**61.2%**	**62.8%**	**59.0%**	**65.6%**
Loans / Assets	62.6%	62.0%	67.6%	71.0%	71.1%	67.5%
NPLs+ORE / Loans+ORE	0.57%	0.88%	0.49%	0.71%	0.71%	1.16%
Net Charge-Offs / Avg Loans	0.23%	0.27%	0.15%	0.12%	0.11%	0.11%
Loan Loss Reserve / Loans	1.11%	1.07%	1.23%	0.99%	1.20%	1.30%

Source: Bank Holding Company Performance Reports and FDIC

- Structural changes post-crisis
- Lower NIM and higher operating costs (efficiency ratio = overhead / rev)
- More capital required
- Result is much lower ROE (ROTE) with implication for P/TBV multiples



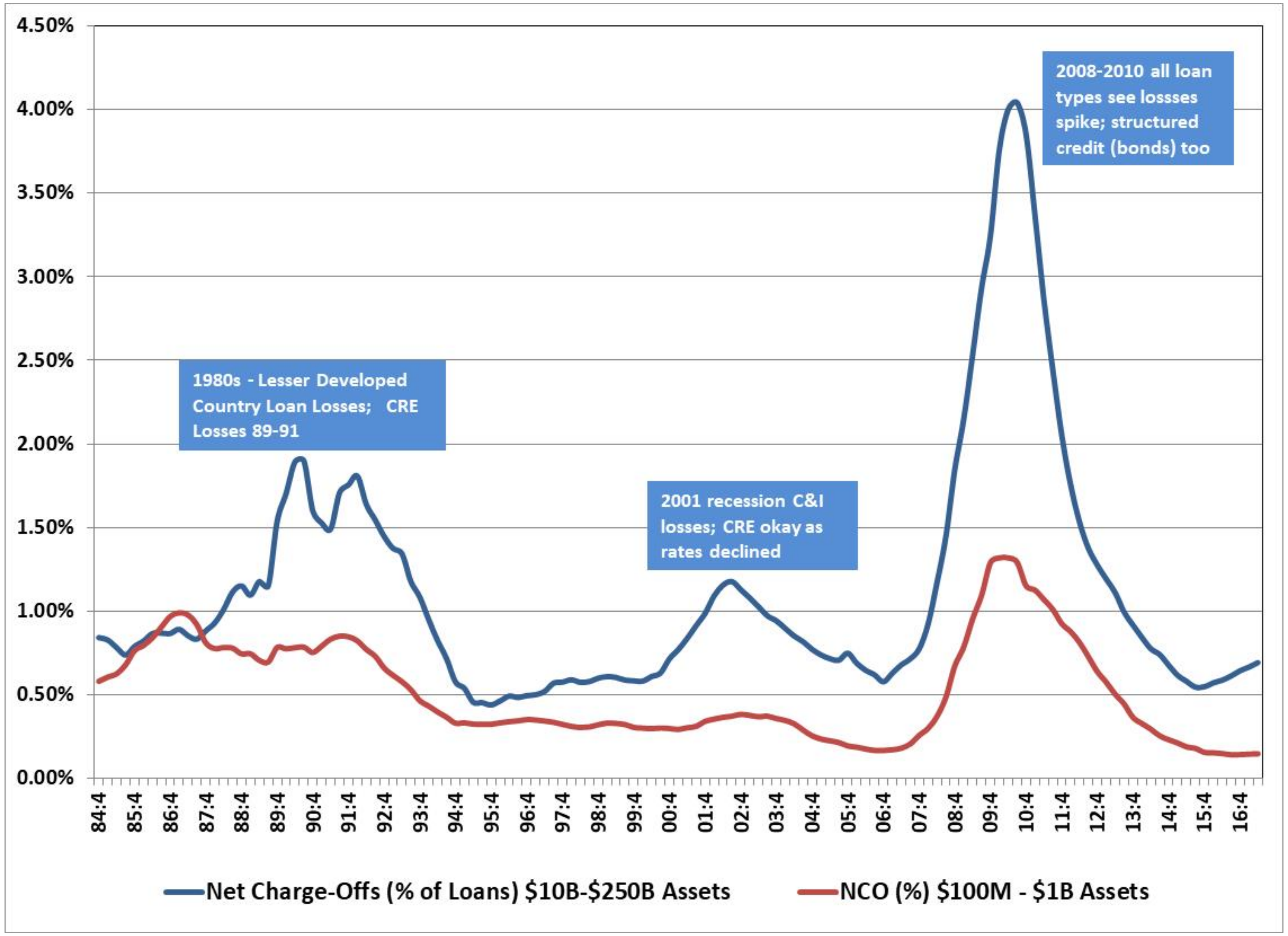
Source: St. Louis Federal Reserve (FRED)

- Shape of yield curve much discussed re: outlook for bank NIMs
- Curve very steep in 2014
- As often occurs curve has flattened since the Fed began to raise short-rates
- Level of short rates more so than shape key NIM for a traditional commercial bank

Jun 76 -Sep 17	10-Yr UST	2-Yr UST	Fed Funds	10/2 Spread	2/FF Spread	10/FF Spread	BAML HY Index Yld	Spread (OAS)
09/09/16	1.59	0.76	0.40	0.83	0.36	1.19	6.34	5.07
09/08/17	**2.07**	**1.29**	**1.15**	**0.78**	**0.14**	**0.92**	**5.62**	**3.87**
Max	15.65	16.92	20.06	2.88	2.79	4.08	22.72	21.31
'76 - '17 Median	6.08	5.54	5.23	0.97	0.46	1.61	8.32	5.13
Min	1.38	0.19	0.05	(2.24)	(7.38)	(7.79)	5.08	2.44
Current v Median	**34%**	**23%**	**22%**	**81%**	**30%**	**57%**	**68%**	**75%**

- 10/2 spread 81% of long-term average (i.e., curve has flattened, but is not flat)
- But in spite of 100bps of Fed Funds target rate hike Funds are 22% of L-T average

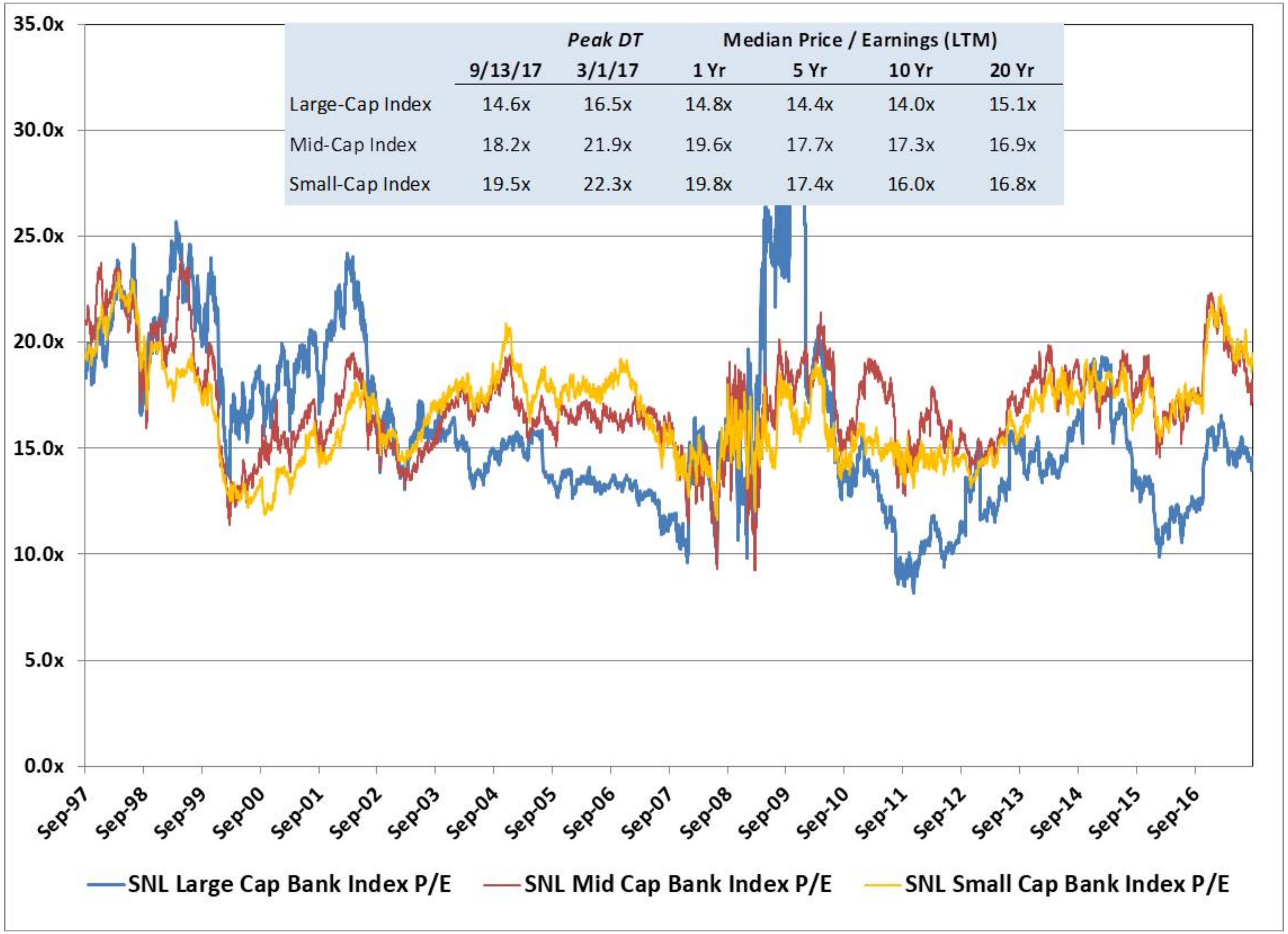
Source: St. Louis Federal Reserve (FRED)



Source: FDIC

- Loss rates tend to be episodic
- Investors tend to focus on the direction of credit losses and implication for forward EPS rather than a normalized loss rate through the credit cycle
- Management and acquirers more focused on cycle view
- Big impact on one's view of a bank's or specialty finance lender's earning power

Section 3
Public Markets

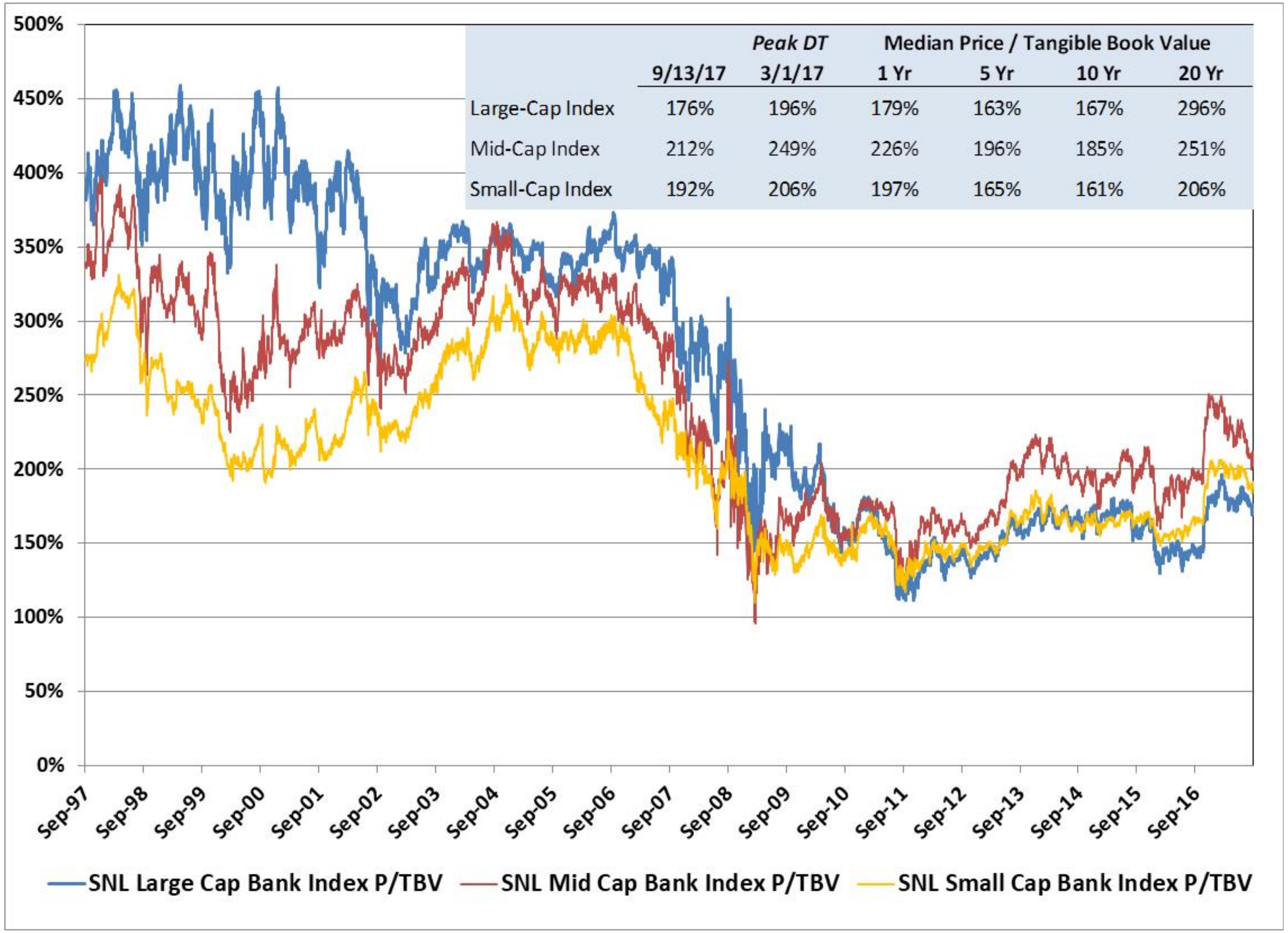


		Peak DT	Median Price / Earnings (LTM)			
	9/13/17	**3/1/17**	**1 Yr**	**5 Yr**	**10 Yr**	**20 Yr**
Large-Cap Index	14.6x	16.5x	14.8x	14.4x	14.0x	15.1x
Mid-Cap Index	18.2x	21.9x	19.6x	17.7x	17.3x	16.9x
Small-Cap Index	19.5x	22.3x	19.8x	17.4x	16.0x	16.8x

Source: SNL Financial

- Long-term median P/E ~15x for large cap banks vs ~17x for mid-cap and small cap index
- Greater credit volatility in large caps vs mid- and small-cap banks results in greater multiple variance
- Significant revaluation from 11/8/16 (12.7x LC, 17.4x MC, 16.9x SC) thru the peak of the "reflation trade" around 3/1

	9/13/17	*Peak DT* 3/1/17	Median Price / Tangible Book Value 1 Yr	5 Yr	10 Yr	20 Yr
Large-Cap Index	176%	196%	179%	163%	167%	296%
Mid-Cap Index	212%	249%	226%	196%	185%	251%
Small-Cap Index	192%	206%	197%	165%	161%	206%



Source: SNL Financial

- Downtrend in P/TBV from late 1990s through 2010 as profitability declined and post-crisis more capital was required
- Trend higher since 2011 reflects somewhat higher P/Es and ROE (primarily due to lower credit costs)
- Market expectation that post-election economic and regulatory backdrop will support higher ROA, but not much capital relief

9/13/2017	P/E LTM	P/E FY17E	P/E FY18E	Price/ TBV	Div'd Yield	2Q17 ROA	2Q17 ROE	2Q17 ROTCE	Y/Y EPS	Y/Y Rev	Y/Y PTPP	Y/Y Loans
Money Center	13.5x	14.1x	13.2x	138%	2.0%	0.86%	8.7%	9.3%	12.2%	1.7%	1.0%	1.3%
Trust Banks	17.5x	15.5x	15.3x	314%	1.9%	1.11%	11.3%	22.4%	4.1%	8.8%	13.4%	-3.1%
Wealth Mng't Banks	18.6x	18.0x	17.3x	242%	2.3%	1.15%	11.8%	13.8%	9.3%	10.7%	15.9%	9.1%
Card Banks	11.4x	10.7x	10.8x	186%	2.0%	2.27%	16.8%	18.3%	0.2%	8.4%	11.8%	9.4%
Super Regionals	16.2x	14.5x	13.8x	168%	2.2%	1.14%	9.6%	13.4%	18.7%	6.3%	9.8%	2.1%
Regional Banks	17.5x	16.4x	16.0x	190%	2.1%	1.05%	8.7%	12.1%	12.2%	8.6%	15.1%	8.6%
Assets $2B - $10B	18.2x	17.6x	17.0x	198%	2.0%	1.05%	9.6%	12.2%	11.1%	9.7%	17.8%	10.7%
Assets $500M - $2B	16.1x	16.2x	17.6x	143%	1.8%	0.88%	9.0%	9.6%	9.6%	8.0%	16.3%	8.3%
Thrifts	20.5x	20.3x	18.5x	140%	1.7%	0.76%	6.6%	7.4%	13.3%	7.5%	14.7%	10.3%

LTM - latest 12 months; PTPP - pre-tax, pre-provision operating income (x-bond gains and non-recurring items)

Source: SNL Financial

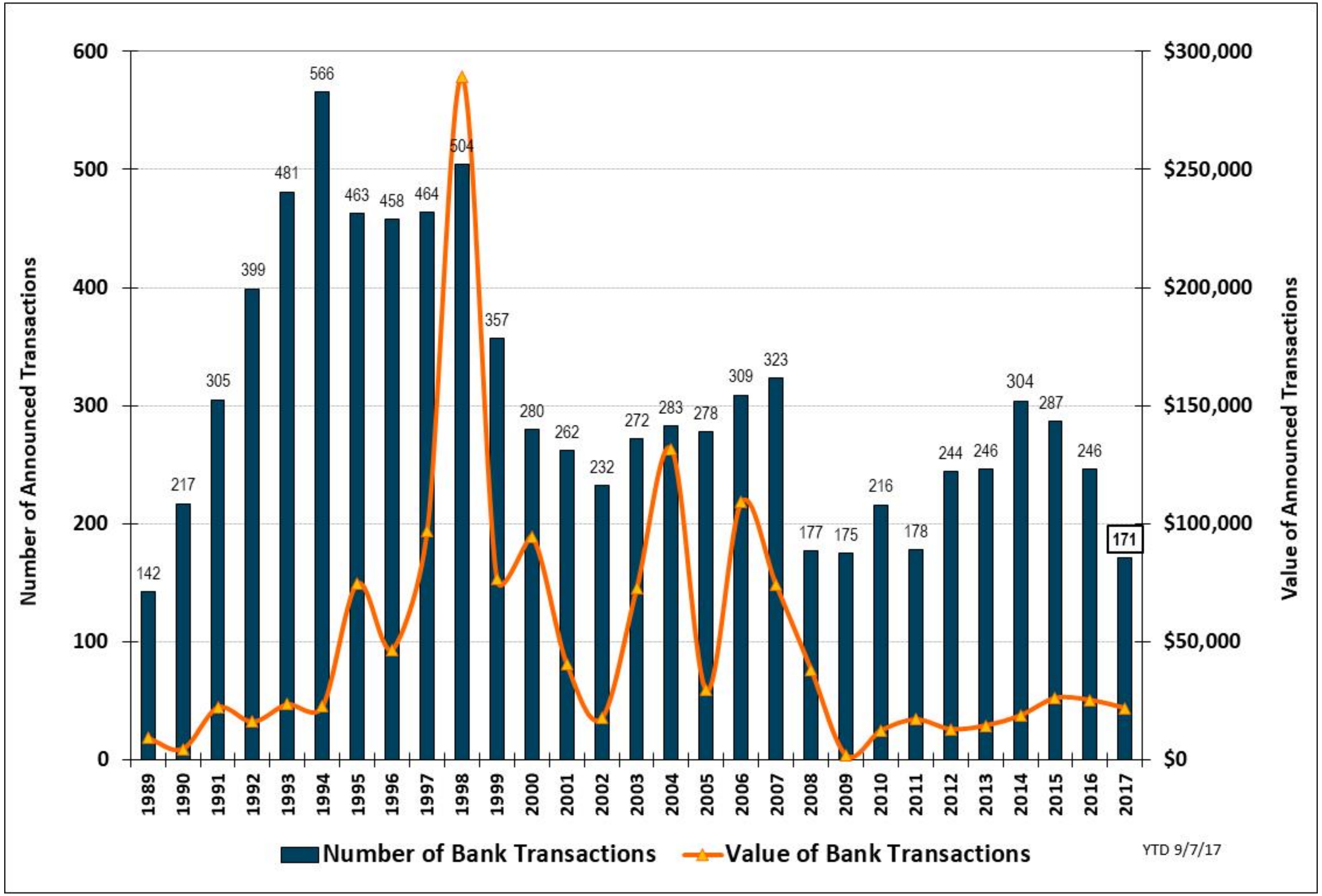
- Segregation of bank universe
- Asset management-focused banks have superior valuation
- Card-oriented banks have moderate multiples due to limited growth and credit concerns

Section 4

M&A

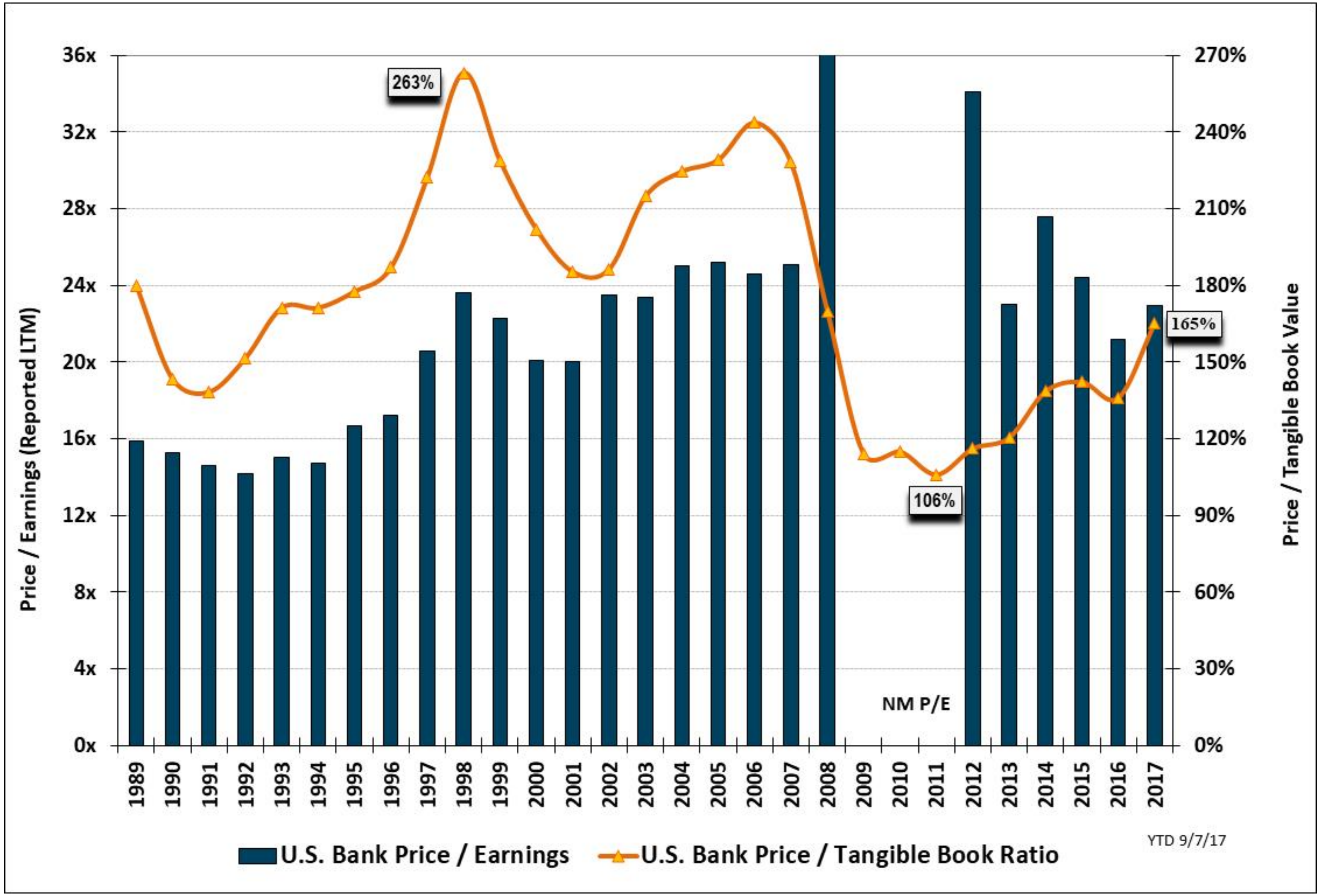
Typical Bank Acquirer Parameters

- Growth market or in-market transaction with significant expense savings
- EPS accretion of 5-15% depending upon deal size and targeted saves
- Recovery of tangible BVPS dilution within 3-5 years using the crossover method
- IRR > cost of capital including all deal costs
- No meaningful reduction in capital ratios unless excessively capitalized
- C&D and CRE as a percent of post-close capital below regulatory thresholds
- Acquisition of low loan-deposit ratio banks increasing on radar of buyers



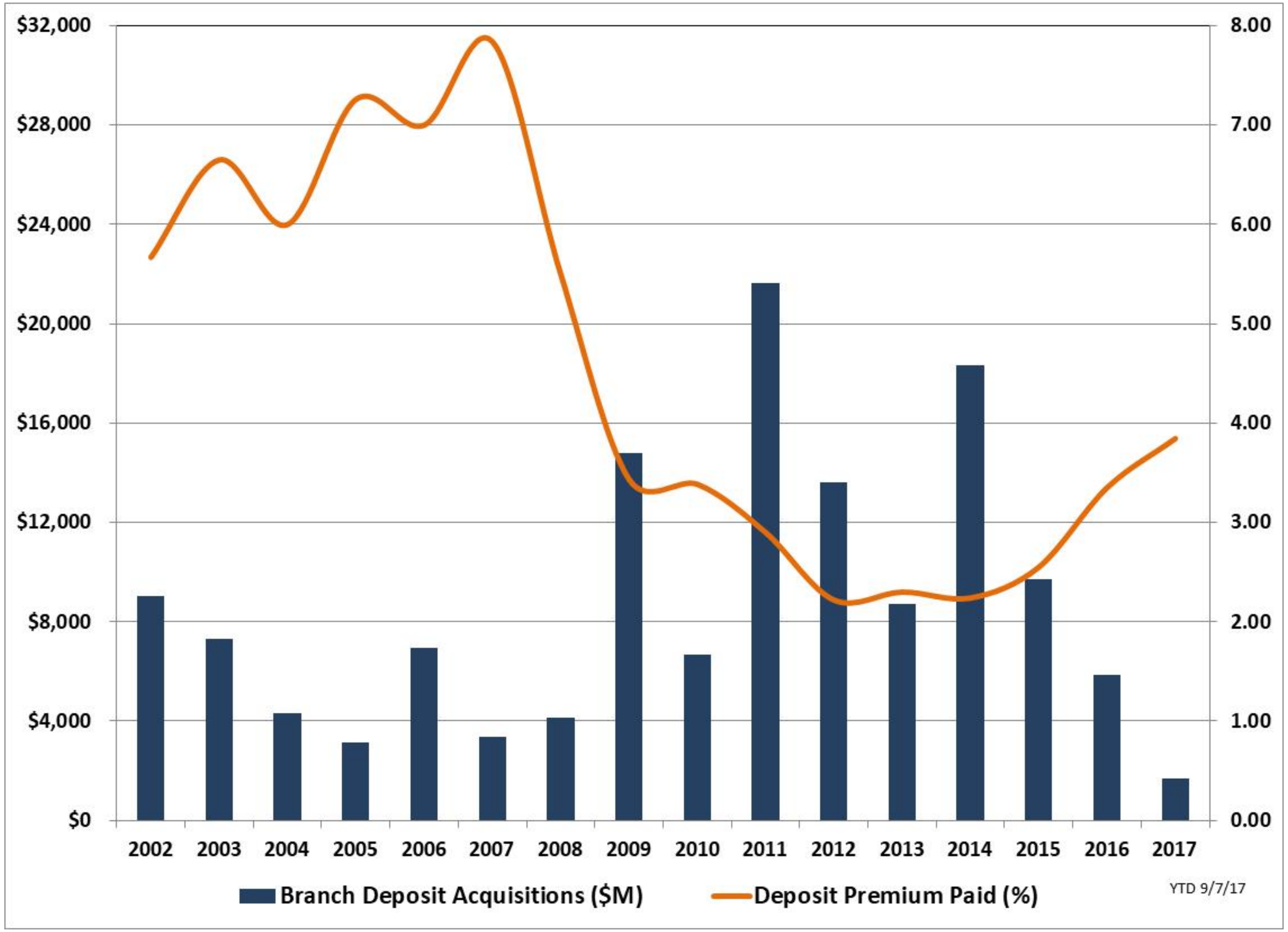
Source: SNL Financial

- Number of transactions has declined with number of banks (5,787 @ 6/30 vs ~14,000 @ 12/85)
- However, 2-4% of institutions are acquired each year
- What has changed is deal values because no mega deals and only episodic large deals post-crisis



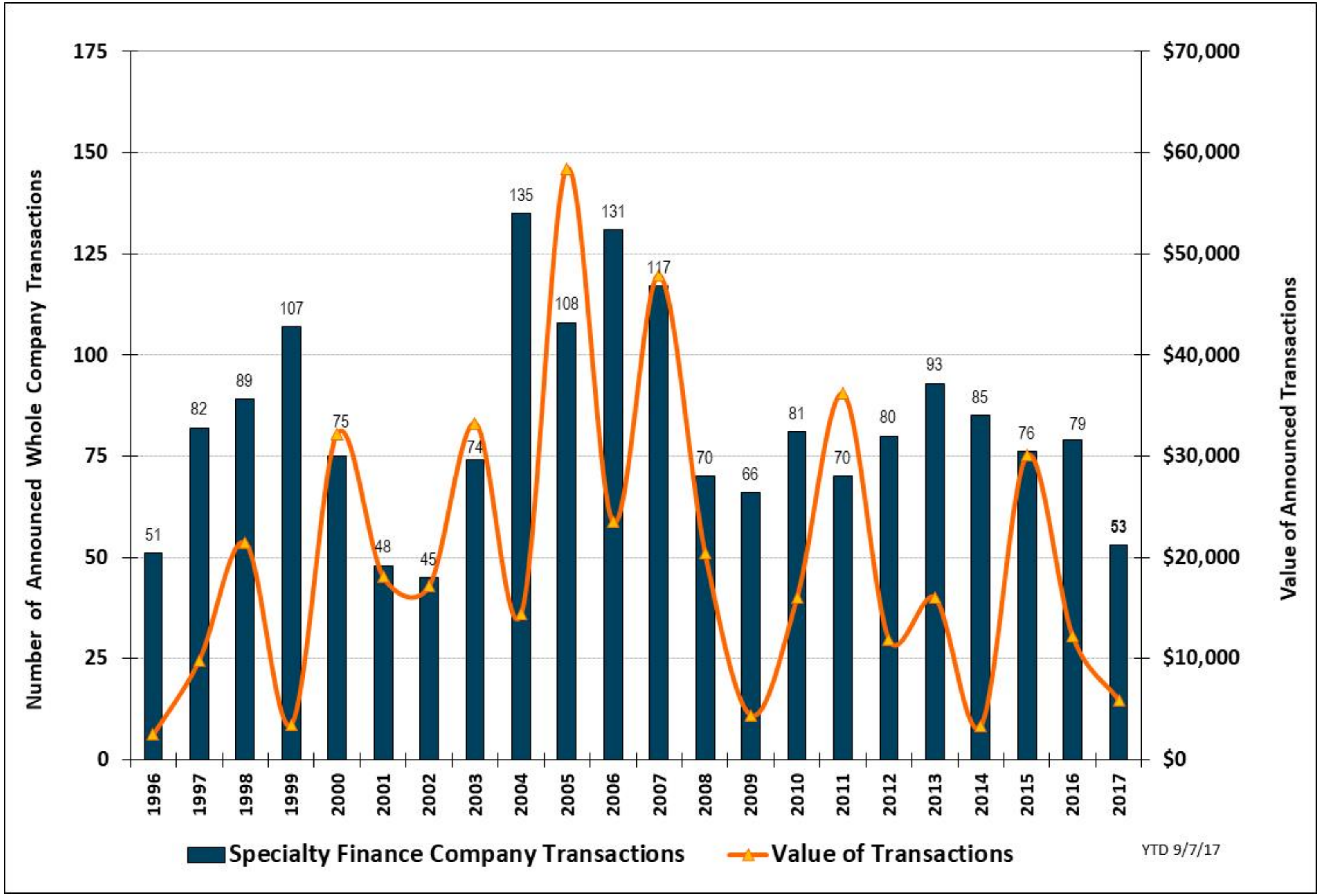
Source: SNL Financial

- Aggregate national price data is skewed to smaller bank transactions because that is what is transacting
- Current low 20s P/E almost back to mid-20s P/E pre-crisis
- P/E for buyer 9-14x with typical 20-40% expense saves
- P/TBV has rebounded from crisis low but is well below the 1998 and 2006 tops because ROTEs are low (lower NIM and more capital)



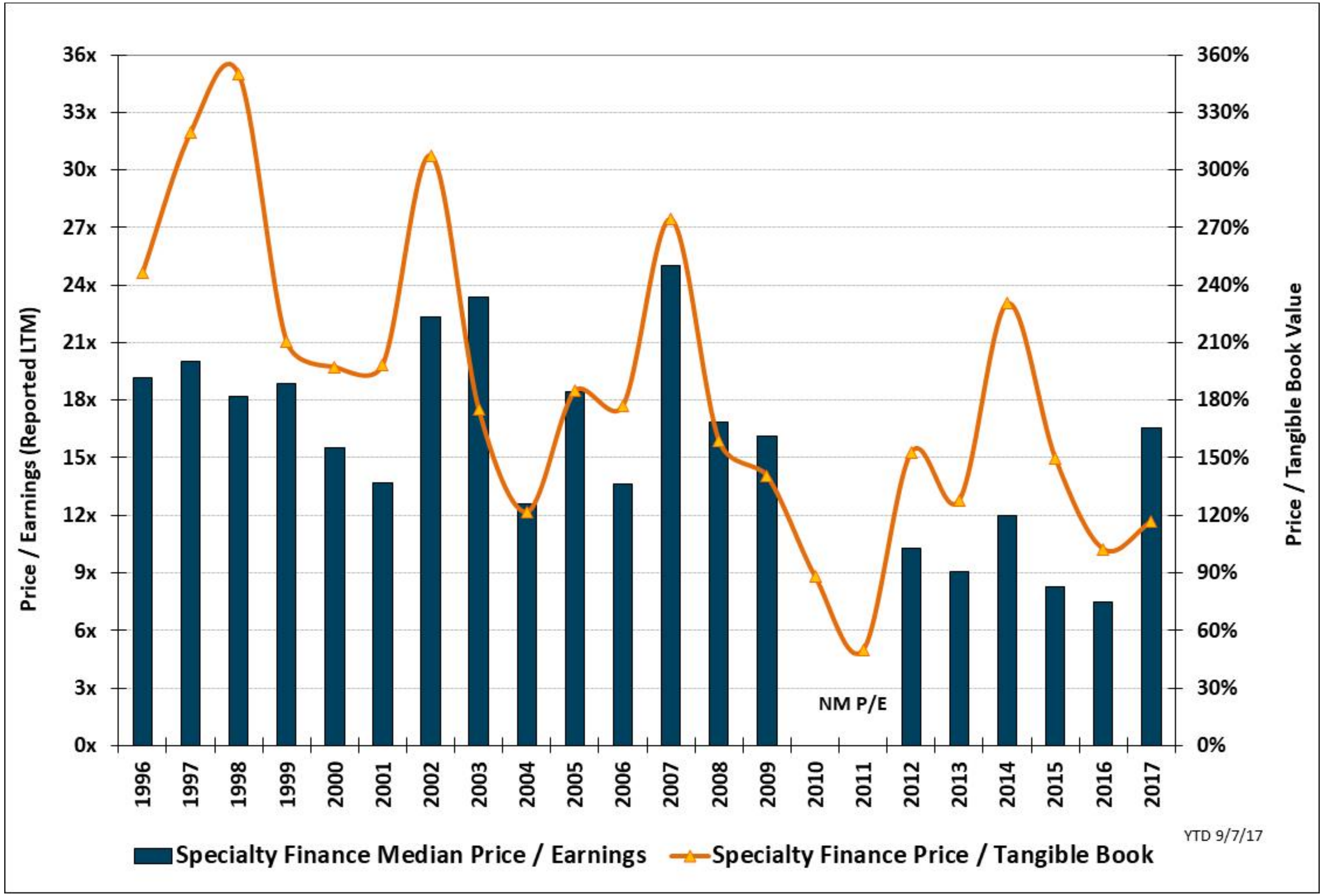
Source: SNL Financial

- Deposits (liabilities) transact, too, usually with branches
- Acquirer assumes the deposit liabilities, which are offset with assets assumed (cash, branches and sometimes loans) net of the deposit premium
- Post-crisis core deposits are worth less because wholesale borrowing rates are very low and because there was less demand as many banks were very liquid post 2008



Source: SNL Financial

- Chart reflects number of companies that transacted; however, a significant amount of assets may transact in any given years via asset sales
- 2005 deal value includes BAC's $35B acquisition of MBNA



Source: SNL Financial

- Aggregate national median multiples impacted by mix of specialty finance companies transacted (e.g., equipment finance vs commercial mortgage)

	100% Stock or Stock/Cash		100% Cash Deals	
	Post-Election	Pre-Election	Post-Election	Pre-Election
Com'l Bank Transactions	101	105	22	44
Median Asset Size	$356	$354	$104	$124
Median ROA	0.80%	0.73%	0.83%	0.69%
Median ROE	7.6%	7.1%	6.2%	5.2%
Median Transaction Value	$59	$41	$11	$15
Median P/BV	161%	137%	123%	115%
Median P/TBV	167%	139%	125%	115%
Adj Price / Core Equity	179%	151%	131%	122%
Median P/E (LTM-Reported)	21.8x	20.1x	17.7x	23.0x
P/E to Buyer w Synergies	NA	NA	NA	NA

1) Post-election 11/9/16 - 9/14/17; pre-election 11/8/15 - 11/8/16

2) Adjusted price / core equity assumes 8% tangible equity ratio with excess capital valued $-for-$

Source: SNL Financial

- Bank sector revalued in the public market post-election on expectation of a) “inflation-trade” and higher economic growth would lead Fed to hike rates faster and higher → higher NIMs; b) lower corporate tax rates; and c) less regulation
- Impact can be seen in acquisition prices to an extent
- Sellers who swap for stock in theory neutral because buyer’s shares have the same benefit; not so for cash sellers

Section 5
Black Hole Valuation Issues

Valuation Methods

Minority

- Net Asset Value
- Transaction Method (in subject)
- Guideline Public Comps
- Earnings Capitalization via Build-Up
- Discounted Cash Flow

Control

- Net Asset Value
- Net Asset Value (recap; quasi-recap)
- Guideline Transactions
- Earnings Capitalization via Build-Up
- Discounted Cash Flow (buyer perspective vs seller perspective)
- When buyer(s) known - Relative Contribution Analysis and Pro Forma Impact

Valuation Perspective

Public Market Value

- Growth record and prospects
- Trend in consensus estimates
- Profitability
- Organic vs. acquisition growth
- Core deposit base
- Credit quality
- Capital
- Revenue mix
- Risk perceptions
- Location

Acquisition Value

- Location and market share
- Core deposits
- Core profitability
- Expense saves (who gets credit?)
- Revenue synergies (reality?)
- Number of bidders
- Alternative targets for bidders
- What a buyer can afford
- Stated multiples to seller vs. pro-forma multiples to buyer (P/E with savings, P/TBV after b/s marks)

Rules of Thumb?

- **Business model of a lender is predicated upon leveraging equity capital**
- Buyers, sellers, investors, directors … tend to quote value as P/TBV
- But … economics are based upon earning power
- P/E a function of risk profile and growth expectations
- P/TBV can be thought of as a proxy for earning power
- ROA x Leverage = ROE … *or* [Net Income / Assets] x [Assets / Equity] = ROE
- **P/E x ROTE = P/TBV**

Rules of Thumb?

P/E

- P/Es within the industry vary
- Low P/Es reflect riskier biz models, limited growth or lower quality earnings
- Above average growth yields above average P/E
- Investors especially value three things: EPS growth, accelerating growth and organic revenue growth provided capital adequate and asset quality is okay

P/TBV

- Goal is to produce a return on shareholders' capital
- P/TBV is a secondary proxy for earning power
  - ROA / TCE % = ROTCE
  - P/E x ROTCE = P/TBV
- High ROTCE yields high P/TBV
- High P/E and ROTCE = very high P/TBV

Cash Flow?

- EBITDA, EBITDA less capex, etc. is meaningless for a bank
- Enterprise value is a nuanced concept – one can view the value of the bank vs the value of the holding company as the sum of the value of the bank less the parent's net debt
- Investors and acquirers view cash flow (aside from amortization of intangibles) as internally-generated capital in excess of a threshold amount that can be distributed
- Excess initial capital potentially represents distributable cash flow, too
- Excess capital/cash flow should be analyzed at the bank-level and parent-level separately

Cash Flow?

- **Key questions to contemplate when considering excess capital:**
  - Will regulators realistically allow excess to be distributed?
  - Do rating agencies have a say?
  - Should excess capital be valued “as-if” cash flow in a minority valuation?
  - Do evolving regulatory policies in DC related to “trapped” capital matter?
  - What is the appropriate opportunity cost for distributed capital?
  - How do strategic buyer synergies factor into excess capital calculations?

Book Value Roll-Forward		**ABC Bank**	**ABC Bancorp**	**Bancorp Shares**	**Per Share**
Reported Common Equity @	**9/30/2016**	**$58,502**	**$54,310**	**165.311**	**$328.53**
Add: 4Q16 & 1Q17 Net Income - Bank		2,524	2,524		
+/-: Bancorp Income (Expenses)			(64)		
Less: 4Q16 Dividends		(749)	(749)		
Less: ABC Transaction Costs		(1,800)	(1,800)		
Reported Common Equity @	3/31/2017	$58,476	$54,220	165.311	$327.99
Less: Goodwill and Core Deposit Intangibles		(10,292)	(11,679)		
Tangible Common Equity @	**3/31/2017**	**$48,184**	**$42,541**	**165.311**	**$257.34**
Add: Proceeds from Option Exercise			1,000	10.000	
Pro Forma Tangible Book Value with Options		**$48,184**	**$43,541**	**175.311**	**$248.37**
Projected Tangible Assets @	3/31/2017	$460,320	$458,933		
Core Equity Capital	**9.0%**	41,429	**41,429**		
Implied Excess Capital		6,756	**2,113**		
Total Tangible Equity Capital		$48,184	**$43,541**		

		Reported Sep-16	Closing Mar-17	9 Months Dec-17	FY Dec-18	FY Dec-19	FY Dec-20	FY Dec-21	Terminal Value
Net Income (C-Corp Basis)		$4,500		$3,197	$4,285	$4,517	$4,789	$4,966	
Return on Assets		0.97%		0.89%	0.86%	0.87%	0.88%	0.87%	
Projected Operating Expenses				12,338	17,187	17,800	18,459	19,200	
Projected Savings (Yr 1 @ 50%)	30%			1,851	5,156	5,340	5,538	5,760	
After-Tax Expense Savings	35%	na		1,203	3,351	3,471	3,600	3,744	
Net Income with Synergies		$4,500		$4,400	$7,637	$7,988	$8,389	$8,710	$8,710
ROA with Synergies		na		1.22%	1.53%	1.53%	1.54%	1.53%	11.0x
									$95,806
Period-End Assets		$461,862	$471,612	$487,347	$509,147	$531,921	$555,715	$580,573	
Tangible Equity (Parent)		42,631	44,158	42,445	43,861	45,823	47,873	50,014	
Net Income				4,400	7,637	7,988	8,389	8,710	
Distribution of Excess Capital	9.0%		(1,713)	(2,984)	(5,675)	(5,938)	(6,247)	(6,472)	
Ending Tangible Equity			42,445	43,861	45,823	47,873	50,014	52,252	
Tangible Equity / Assets		9.2%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	
Interim Cash Flows to Acquirer			$1,713	$2,984	$5,675	$5,938	$6,247	$6,472	
After-Tax Transaction Costs			(6,000)	na	na	na	na	na	
After-Tax Op Cost on Distributed Capital	2.0%			(34)	(94)	(207)	(326)	(451)	
Terminal Value				na	na	na	na	na	$95,806
Total Shareholder Cash Flow			**($4,287)**	**$2,950**	**$5,581**	**$5,730**	**$5,921**	**$6,021**	**$95,806**

Marketability?

- Banks tend to have greater number of shareholders than "typical" private business (not true for specialty lenders, other financial service companies)
- Community interest usually exists; periodic transactions
- Banks tend to pay dividends and periodically offer to repurchase shares
- Consolidating industry in which the logical acquirers (though not necessarily for cash) are identifiable
- Shareholder agreements other than for S-corporations are less common
- Capital calls can occur, especially following deep recessions

Credit?

- Get credit wrong and nothing else matters
- Credit always has been and always will be cyclical
- True-up issues vs earning power issues
- Default probability
- Loss given event of default

	Total Loans ($000)		30-89 Days Past Due		90+ Days Past Due		Non-Accrual Loans		Past-Due & NAL	
	$	%	$	%	$	%	$	%	$	%
1- 4 Residential Mortgage	21,027	0.5%	934	4.4%	453	2.2%	71	0.3%	1,458	6.9%
HELOC	7,016	0.2%	705	10.0%	64	0.9%	0	0.0%	769	11.0%
Construction & Development	**2,543,298**	**56.6%**	**0**	**0.0%**	**0**	**0.0%**	**0**	**0.0%**	**0**	**0.0%**
Multi-Family	1,699,324	37.8%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Commercial Real Estate	160,563	3.6%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Commercial & Industrial	58,814	1.3%	404	0.7%	0	0.0%	0	0.0%	404	0.7%
Consumer Loans	3,397	0.1%	150	4.4%	155	4.6%	0	0.0%	305	9.0%
Total Loans - June 2006	**4,493,739**	**100.0%**	**2,193**	**0.0%**	**672**	**0.0%**	**71**	**0.0%**	**2,936**	**0.1%**
Loan Loss Reserve	**72,354**	**1.57%**								
1- 4 Residential Mortgage	13,292	0.3%	252	1.9%	534	4.0%	0	0.0%	786	5.9%
HELOC	1,804	0.0%	61	3.4%	66	3.7%	0	0.0%	127	7.0%
Construction & Development	**3,934,408**	**87.6%**	**138,607**	**3.5%**	**0**	**0.0%**	**631,931**	**16.1%**	**770,538**	**19.6%**
Multi-Family	565,730	12.6%	14,157	2.5%	0	0.0%	180,007	31.8%	194,164	34.3%
Commercial Real Estate	64,684	1.4%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Commercial & Industrial	32,530	0.7%	1,352	4.2%	2,284	7.0%	28	0.1%	3,664	11.3%
Consumer Loans	1,681	0.0%	68	4.0%	173	10.3%	0	0.0%	241	14.3%
Total Loans - June 2008	**4,614,157**	**100.0%**	**154,497**	**3.3%**	**3,057**	**0.1%**	**811,966**	**17.6%**	**969,520**	**21.0%**
Loan Loss Reserve	**132,099**	**2.86%**								
1- 4 Residential Mortgage	13,292	0.3%	310	2.3%	855	6.4%	0	0.0%	1,165	8.8%
HELOC	1,804	0.0%	32	1.8%	44	2.4%	0	0.0%	76	4.2%
Construction & Development	**3,934,408**	**87.6%**	**0**	**0.0%**	**0**	**0.0%**	**2,317,921**	**58.9%**	**2,317,921**	**58.9%**
Multi-Family	565,730	12.6%	0	0.0%	0	0.0%	303,063	53.6%	303,063	53.6%
Commercial Real Estate	64,684	1.4%	0	0.0%	2,240	3.5%	0	0.0%	2,240	3.5%
Commercial & Industrial	32,530	0.7%	452	1.4%	804	2.5%	0	0.0%	1,256	3.9%
Consumer Loans	1,681	0.0%	23	1.4%	189	11.2%	0	0.0%	212	12.6%
Total Loans - June 2009	**4,614,157**	**100.0%**	**817**	**0.0%**	**4,132**	**0.1%**	**2,620,984**	**56.8%**	**2,625,933**	**56.9%**
Loan Loss Reserve	**259,056**	**5.61%**								

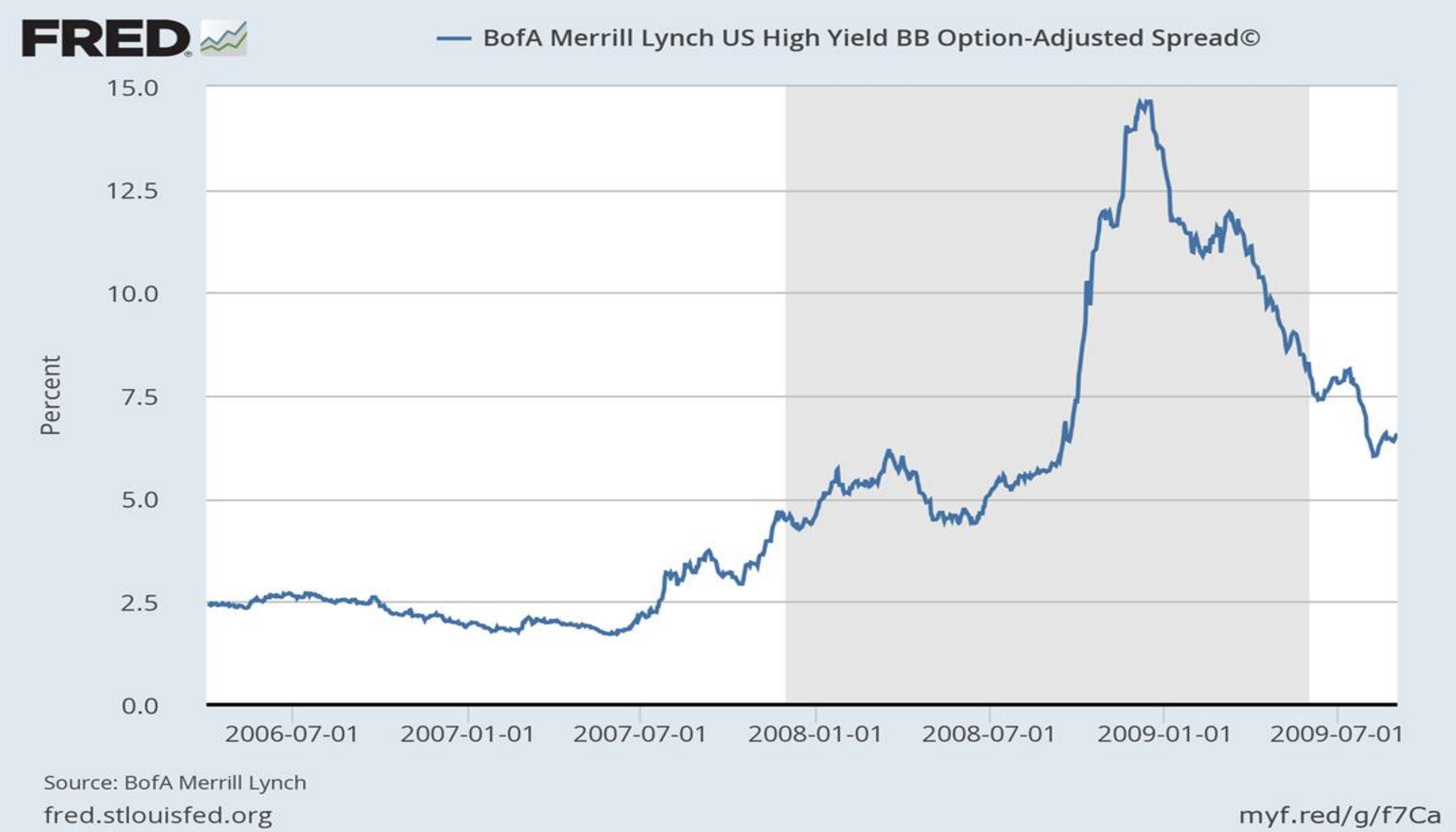
Source: SNL Financial

- Mix
- Concentrations
- Markets
- Past-Due trends
- Market transactions
  - Credit-type
  - Credit spreads
  - Lender's common

Y-9C Data -- Holding Company *Available For Sale*	Cost	2008Q3 Market	Profit (Loss)	Profit as % of Cost
US Treasury Secs	6,936	6,947	11	0.2%
Issd by US Govt Agency	0	0	0	NA
Issd by US Govt Sp Ag	0	0	0	NA
Total State and Political	151,408	145,262	(6,146)	(4.1%)
Total Govt	**158,344**	**152,209**	**(6,135)**	**(3.9%)**
Pass Through RMBS - GNMA	NA	NA	NA	NA
Pass Through RMBS - FNMA/FHLMC	NA	NA	NA	NA
Other RMBS - All Other	705,699	693,857	(11,842)	(1.7%)
Total RMBS	**705,699**	**693,857**	**(11,842)**	**(1.7%)**
Total CMBS	**NA**	**NA**	**NA**	**NA**
Total MBS	**705,699**	**693,857**	**(11,842)**	**(1.7%)**
Credit Card Rec (ABS)	0	0	0	NA
Home Equity Lines (ABS)	0	0	0	NA
Auto loans (ABS)	0	0	0	NA
Other Con Lns (ABS)	0	0	0	NA
Comm & Ind Lns (ABS)	0	0	0	NA
Structured Credit	159,991	87,919	(72,072)	(45.0%)
Total (ABS)	**159,991**	**87,919**	**(72,072)**	**(45.0%)**
US Corporates (Single Issue TuPS)	53,043	43,664	(9,379)	(17.7%)
Foreign Debt Secs	400	400	0	0.0%
Total Other Debt Secs	**53,443**	**44,064**	**(9,379)**	**(17.5%)**
Total Marketable Equity Secs	3,022	3,022	0	0.0%
Total Securities	**1,080,499**	**981,071**	**(99,428)**	**(9.2%)**

Held To Maturity	Cost	Market	Profit (Loss)	Profit as % of Cost
US Treasury Secs	0	0	0	NA
Issd by US Govt Agency	0	0	0	NA
Issd by US Govt Sp Ag	0	0	0	NA
Total State and Political	0	0	0	NA
Total Govt	**0**	**0**	**0**	**NA**
Pass Through RMBS - GNMA	NA	NA	NA	NA
Pass Through RMBS - FNMA/FHLMC	NA	NA	NA	NA
Other RMBS - All Other	NA	NA	NA	NA
Total RMBS	**NA**	**NA**	**NA**	**NA**
Total CMBS	**NA**	**NA**	**NA**	**NA**
Total MBS	**0**	**0**	**0**	**NA**
Credit Card Rec (ABS)	0	0	0	NA
Home Equity Lines (ABS)	0	0	0	NA
Auto loans (ABS)	0	0	0	NA
Other Con Lns (ABS)	0	0	0	NA
Comm & Ind Lns (ABS)	0	0	0	NA
Other (ABS)	266,767	165,300	(101,467)	(38.0%)
Total (ABS)	**266,767**	**165,300**	**(101,467)**	**(38.0%)**
US Debt Secs	45,039	38,071	(6,968)	(15.5%)
Foreign Debt Secs	0	0	0	NA
Total Other Debt Secs	**45,039**	**38,071**	**(6,968)**	**(15.5%)**
Total Securities	**311,806**	**203,371**	**(108,435)**	**(34.8%)**

Source: SNL Financial


FRED
BofA Merrill Lynch US High Yield BB Option-Adjusted Spread©
15.0
12.5
10.0
7.5
5.0
2.5
0.0
Percent
2006-07-01
2007-01-01
2007-07-01
2008-01-01
2008-07-01
2009-01-01
2009-07-01
Source: BofA Merrill Lynch
fred.stlouisfed.org
myf.red/g/f7Ca

Section 6
Up Capital Structure

Up the Capital Stack Consideration

- What entity is the issuer of the preferred or debt (bank or BHC)?
- Financial performance of the operating unit (bank)
- Risk profile of the bank
- Parent leverage
- Ability of bank to pay upstream dividends for debt service
- Regulator view (rating) of bank and parent

Up Capital Stack Valuation Considerations

Valuation as of:	**6/30/2016**
Indicated Value of CLO's Preferred Equity	**$42,930**
Conclusion of Fair Value as % of Par	**94.4%**
Implied IRR	**9.50%**

Sensitivity of Price (% of Par): Premium Over Spot Curve vs. Default Rate

	6.5%	*7.5%*	*8.5%*	*9.5%*	*10.5%*
0.0%	120.8%	113.7%	107.3%	101.3%	95.7%
2.5%	111.4%	105.2%	99.4%	94.0%	89.1%
5.0%	105.6%	99.8%	94.4%	89.4%	84.7%
7.5%	100.8%	95.3%	90.2%	85.5%	81.1%
10.0%	95.9%	90.7%	85.9%	81.5%	77.4%
20.0%	85.7%	81.2%	77.0%	73.2%	69.6%

Sensitivity of IRR: Price Paid vs. Default Rate

	$37,500	*$40,000*	*$42,930*	*$45,000*	*$47,500*
0.0%	14.1%	12.9%	11.7%	10.9%	10.0%
2.5%	12.9%	11.7%	10.4%	9.6%	8.7%
5.0%	11.9%	10.8%	9.5%	8.7%	7.8%
7.5%	11.1%	10.0%	8.7%	7.9%	7.0%
10.0%	10.3%	9.1%	7.8%	7.0%	6.1%
20.0%	8.3%	7.1%	5.9%	5.1%	4.2%

- Cash flows and risk
- New issue rates/terms for similar instruments
- Secondary market trading
- Issuer characteristics re: size, credit, capital and profitability
- Liquidity
- Contact with dealers

Section 7
Big Picture

Value Drivers

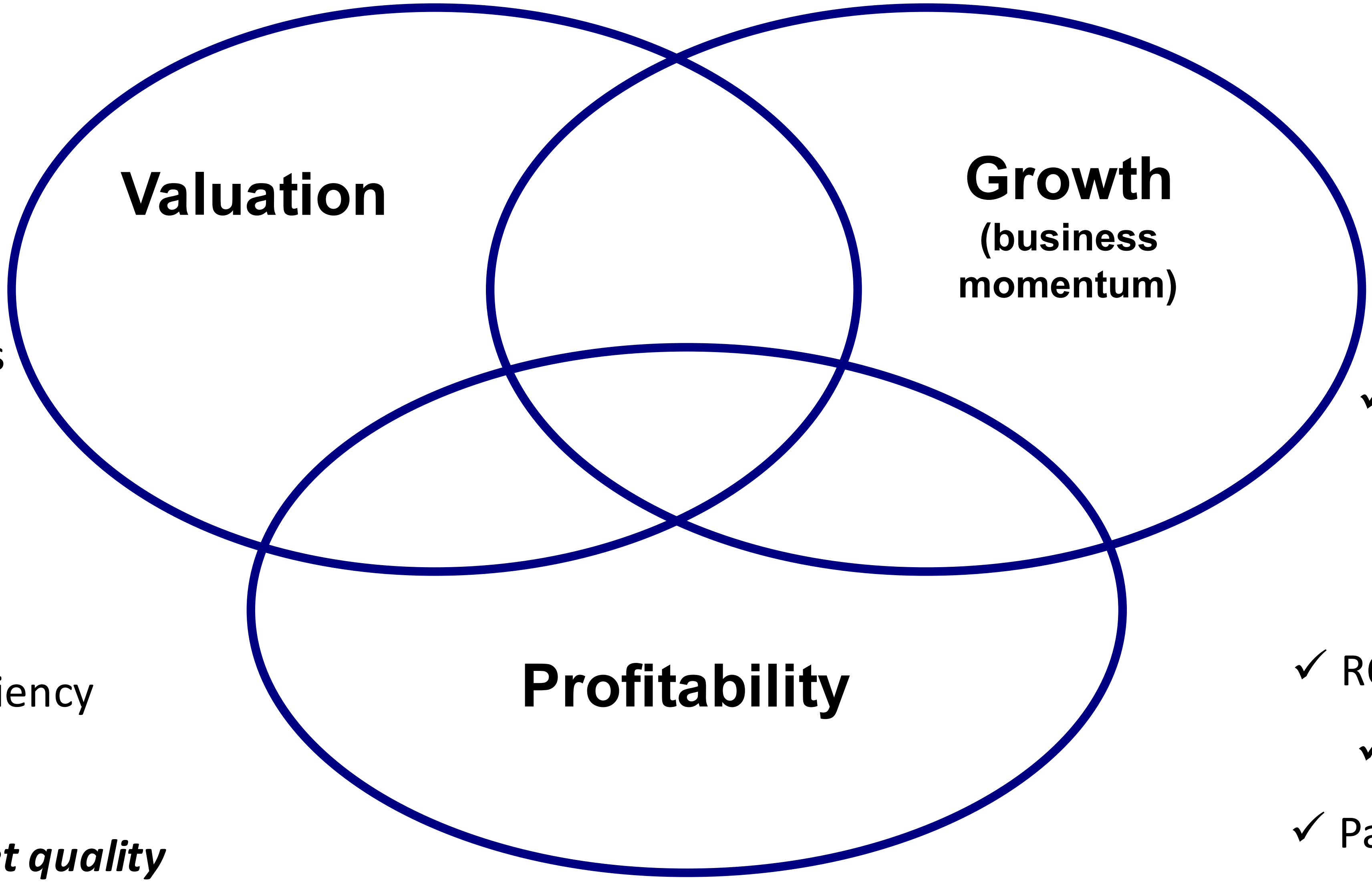
Intrinsic / Investment Value

- ROCE / ROTCE
  - Profitability (ROA)
  - Leverage (capital)
- Growth
  - Organic (primary)
  - Acquisition
- Multiple
  - Expansion v contraction
  - Cost of capital

Franchise Value

- Management
- Market(s)
- Core deposits
- Credit quality
- Adequate-to-ample capital
- Loan origination capacity
- LT superior loss history (yield less net charge-offs)
- High value business units (wealth management and processing)
- Operating leverage (ER)

- Valuation
  - ✓ Absolute
  - ✓ History
  - ✓ Peer
  - ✓ Consensus (trend)



- **Growth**
  - ✓ Organic
  - ✓ M&A
  - ✓ Peer
  - ✓ Potential
  - ✓ Management

- ROA
  - ✓ NIM
  - ✓ Efficiency
  - ✓ Fees
  - ✓ ***Asset quality***

- ROE =
  - ✓ ROA x Leverage
  - ✓ Bank capital
  - ✓ Parent leverage

Jeff K. Davis, CFA

Jeffdavis@mercercapital.com
Twitter @JeffKDavis1
615-345-0350 (O)
615-767-9490 (M)

- Managing Director – Financial Institutions Group (FIG) @ Mercer Capital
- Provides financial advisory services primarily related to the valuation of privately-held equity and debt issued by financial services companies and advisory related to capital structures and M&A
- Clients include public and private financial institutions; private equity and private credit funds
- SNL Financial contributor "Nashville Notes"
- Previously a sell-side analyst covering commercial banks and specialty finance companies for Guggenheim Partners, FTN Financial and J.C. Bradford & Co.
- Rhodes College (BA); Vanderbilt University (MBA)