Capital Management:

Alternatives & Uncertainties

MERCER CAPITAL

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Acquire or Be Acquired Conference // January 28, 2013

Current Challenges

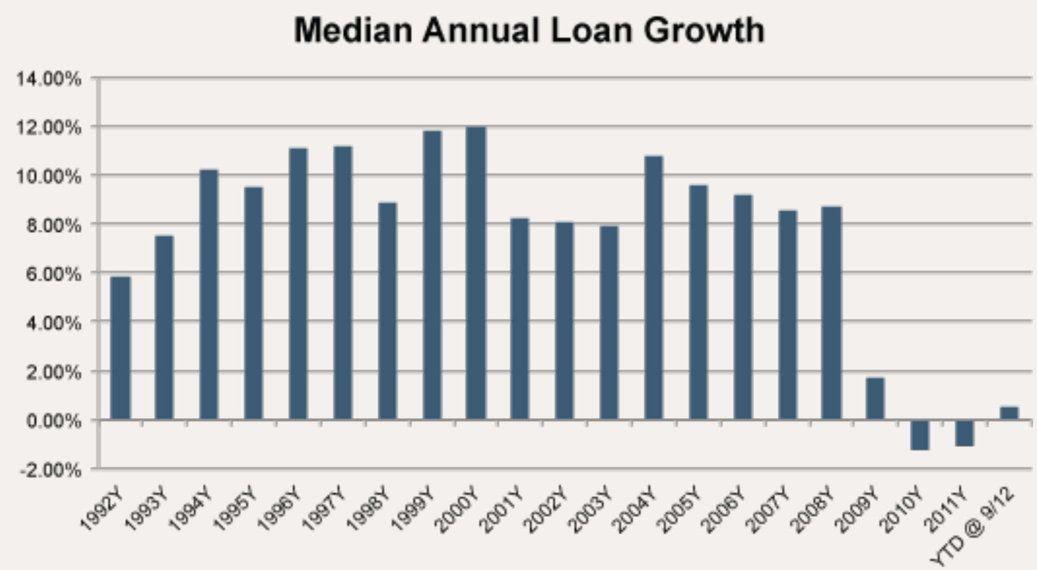
- Discerning a reasonable ROE in a zero-rate environment with evolving capital requirements
- Excess capital for many banks is building given little loan growth—what to do with it?
- Is the capital calculus too tough if capital decisions are subject to cost of capital analyses?

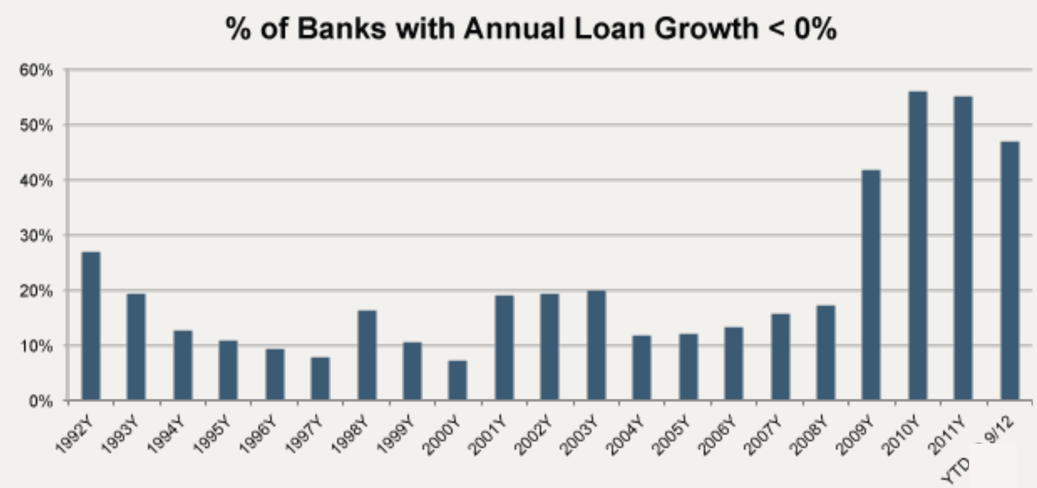
Current Challenges

- ROE under cyclical and secular pressure
  - Yield induced NIM compression via the Fed
  - Loan demand weak in most regions
  - Mortgage gains are supporting fee income, but the refi wave will fade
  - Operating leverage is tough to achieve given pressure on revenues and rising compliance expenses
  - Regulatory expectations regarding higher capital ratios (and more common equity within the capital structure)

Loan Growth

- ~50% of community banks reported lower loans in 2010 and 2011
- Limited improvement in 2012 loan growth reflects C&I growth and 1-4 mortgage retention for some, plus stabilization in CRE/ C&D books for many

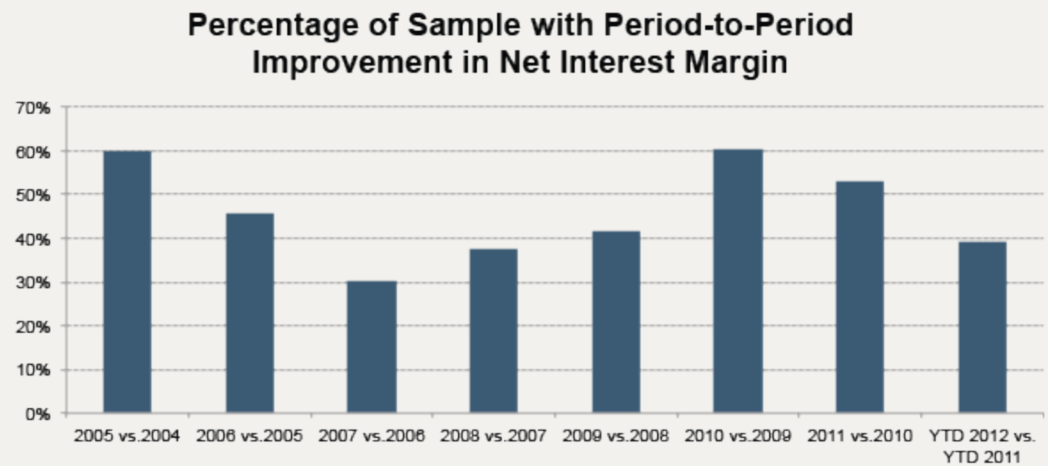




Peer group consists of approximately 3,600 banks with assets between $100 million and $5 billion

Net Interest Margin

- 61% of the banks had a lower YTD NIM vs. last YTD thru 9/11
- More pressure to come given loan pricing competition and low reinvestment rates for bond cash flows, while COF leverage is limited



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Net Interest Margin

- Declining loan yields given current base rates and competitive pressures will weigh on NIMs in 2013 and 2014
- Can community banks push deeper into C&I, asset-backed lending?

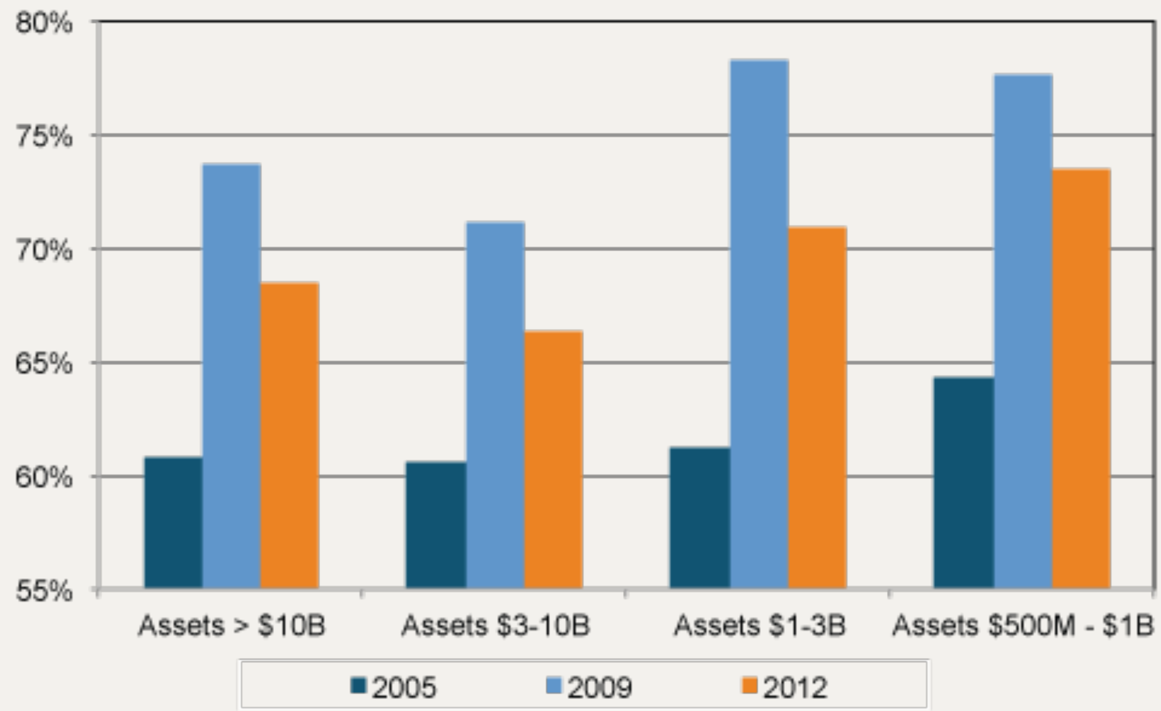
	Assets $300M - $1B			Assets > $10B			Commerce Bank ($20B)			KeyBank ($82B)		
	YTD	LYTD	Δ	YTD	LYTD	Δ	YTD	LYTD	Δ	YTD	LYTD	Δ
C&I Yield	5.77%	5.94%	-0.17%	4.68%	4.91%	-0.23%	3.73%	3.67%	0.06%	3.92%	4.21%	-0.29%
CRE Yield	5.63%	5.77%	-0.14%	4.98%	4.95%	0.03%	4.35%	4.63%	-0.28%	4.43%	4.42%	0.01%
1-4 Secured	5.58%	5.76%	-0.18%	4.72%	4.90%	-0.18%	4.63%	5.01%	-0.38%	4.33%	4.48%	-0.15%
Total Loans	5.67%	5.94%	-0.27%	5.09%	5.25%	-0.16%	4.93%	5.14%	-0.21%	3.87%	4.08%	-0.21%
Treasury & Agency	1.80%	2.16%	-0.36%	1.50%	1.74%	-0.24%	2.57%	4.30%	-1.73%	1.46%	1.99%	-0.53%
MBS	2.45%	3.25%	-0.80%	2.78%	3.34%	-0.56%	2.75%	3.40%	-0.65%	2.88%	3.21%	-0.33%
Total Securities (TE)	2.79%	3.28%	-0.49%	2.63%	2.87%	-0.24%	2.52%	3.08%	-0.56%	2.90%	3.21%	-0.31%
COF - IB Deposits	0.79%	1.07%	-0.28%	0.50%	0.56%	-0.06%	0.22%	0.33%	-0.11%	0.45%	0.69%	-0.24%
Cost of Funds - IBL	0.88%	1.16%	-0.28%	0.69%	0.75%	-0.06%	0.23%	0.35%	-0.12%	0.49%	0.70%	-0.21%
COF / Earning Assets	0.73%	1.00%	-0.27%	0.58%	0.64%	-0.06%	0.20%	0.30%	-0.10%	0.46%	0.64%	-0.18%
Net Interest Margin	3.84%	3.87%	-0.03%	3.55%	3.70%	-0.15%	3.46%	3.76%	-0.30%	3.08%	3.10%	-0.02%

30-Day LIBOR	0.32%	0.29%	0.03%	<> base for C&I loans
5 Year Swap	1.04%	1.61%	-0.57%	<> base for 5-year CRE loans

Source: FDIC, Commerce Bancshares and KeyCorp; YTD thru Sep-12; LYTD thru Sep-11

Efficiency Ratio

- Operating leverage is directionally negative post-crisis
- Small banks are at a competitive disadvantage

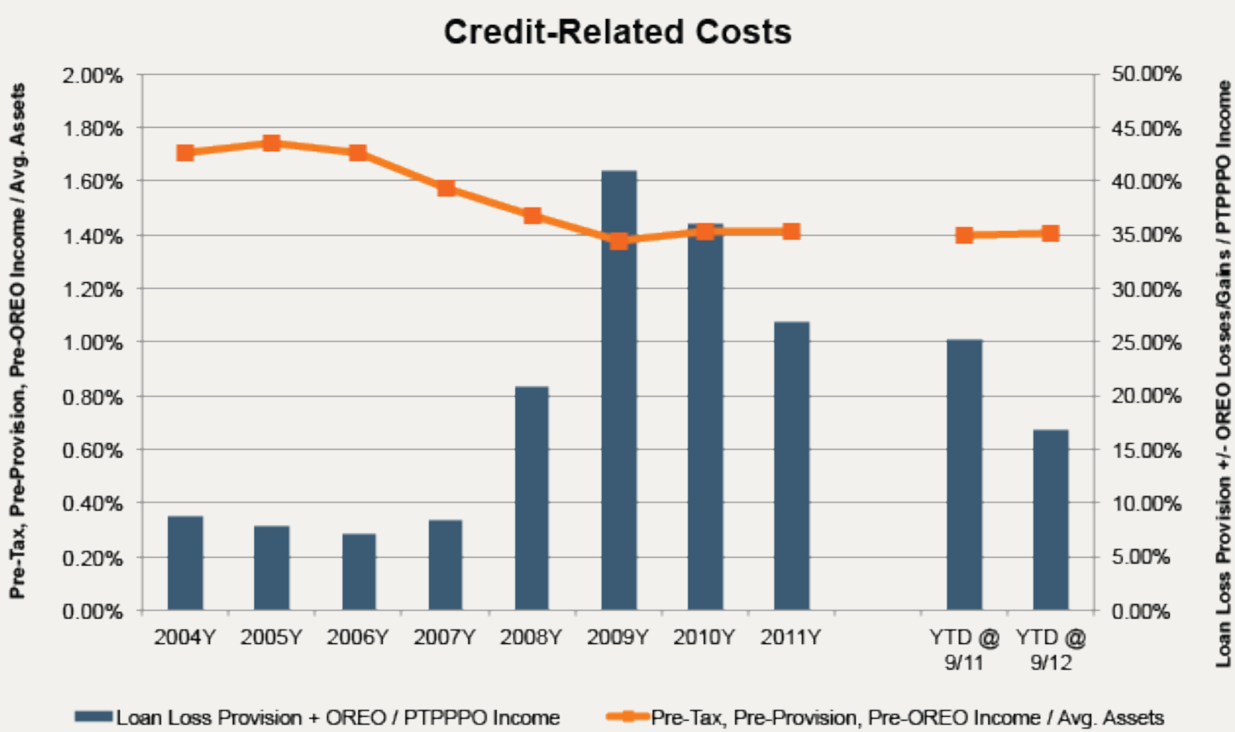


Source: Bank Holding Company Performance Reports

Credit Costs

» Credit-related costs have trended down, offsetting pressure on PPOI, but…

» …Credit leverage is limited going forward



Peer group consists of approximately 3,600 banks with assets between $100 million and $5 billion

Basel III Capital Regulations

» Core equity requirements are increasing

- Minimum 7.0% tier one common with 2.5% buffer
- Minimum 8.5% tier one and 10.5% total capital

» Push to reduce parent company leverage

- Trust preferred phase-out
- Parent companies to hold more liquidity

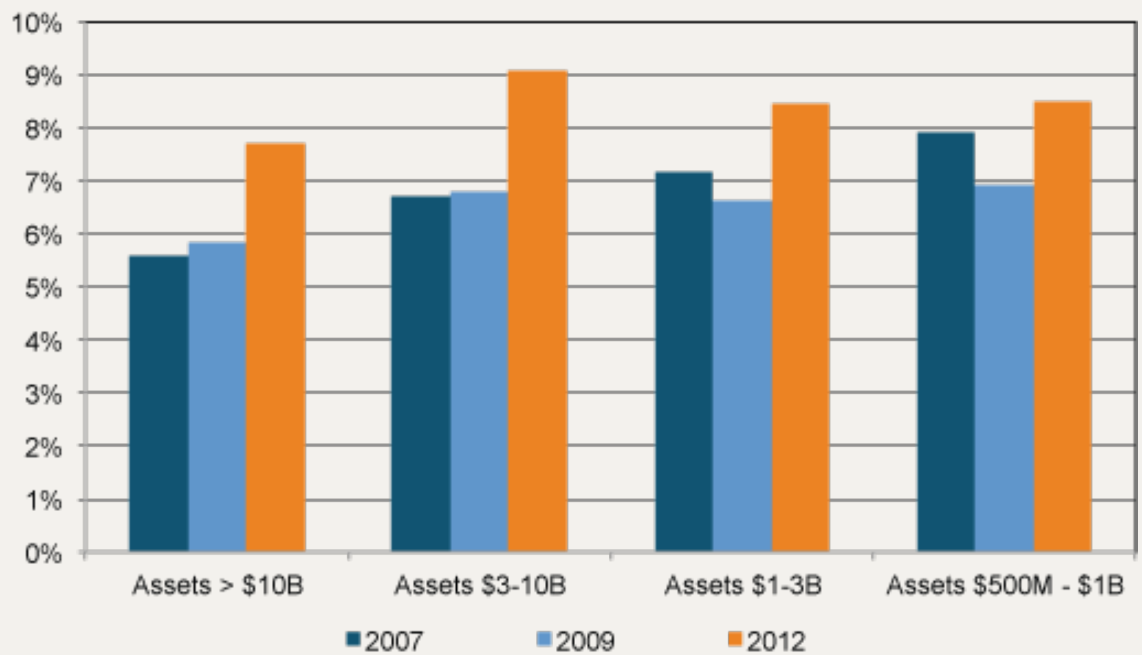
» Reworking of asset risk weights creates potential issue

- Heavier RW for NPAs create pro-cyclical capital requirements
- Community banks are heavily invested in CRE

Tangible Common Equity

- TCE / TA above pre-crisis levels and
  is rising given limited loan growth

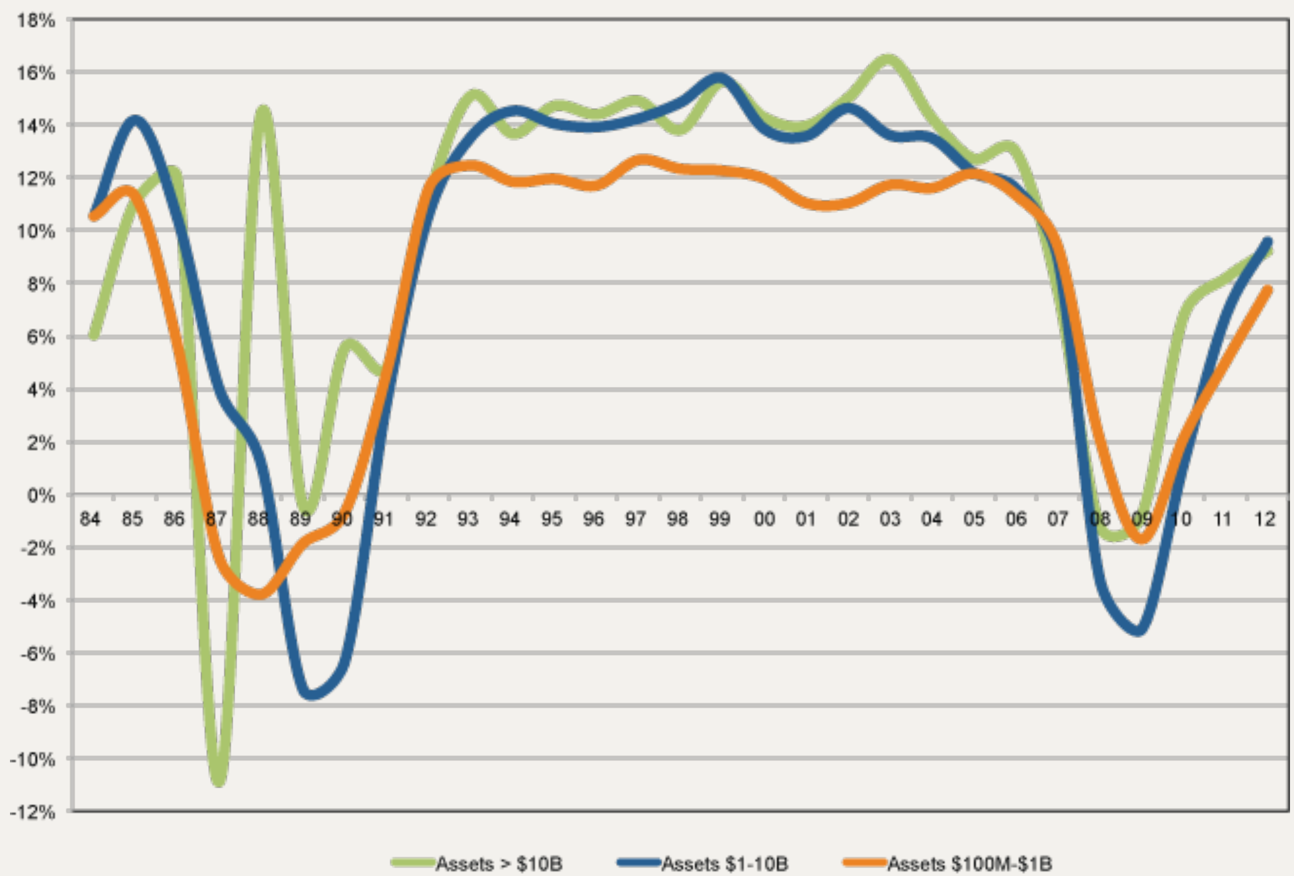
- Tier one common / risk weighted assets ranges from 11.7% to 13.3% @ Sep-12 vs. Basel III threshold of 7.0% with buffer



Source: Bank Holding Company Performance Reports

Return on Equity

- ROE has rebounded
- 70s & 80s saw ROE volatility via three recessions and sharp rate moves
- 90-06 “great moderation”



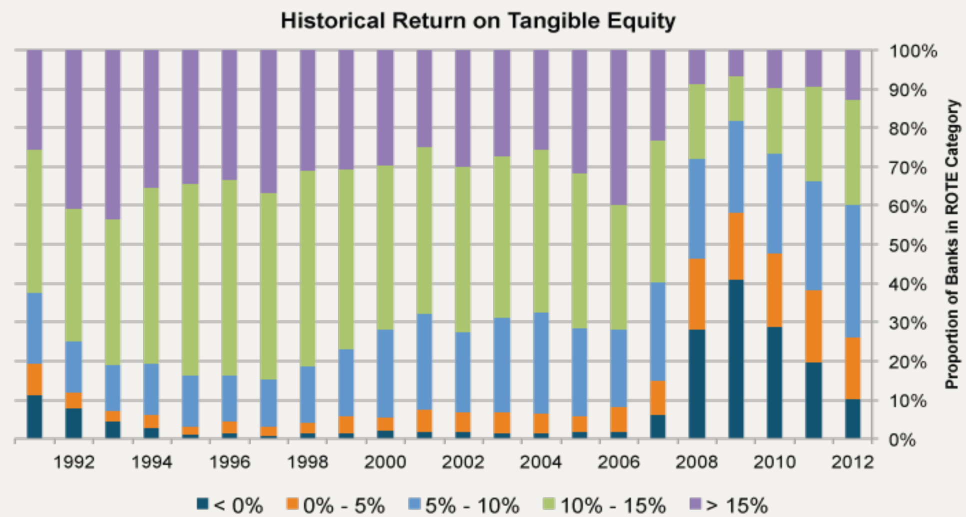
Source: FDIC

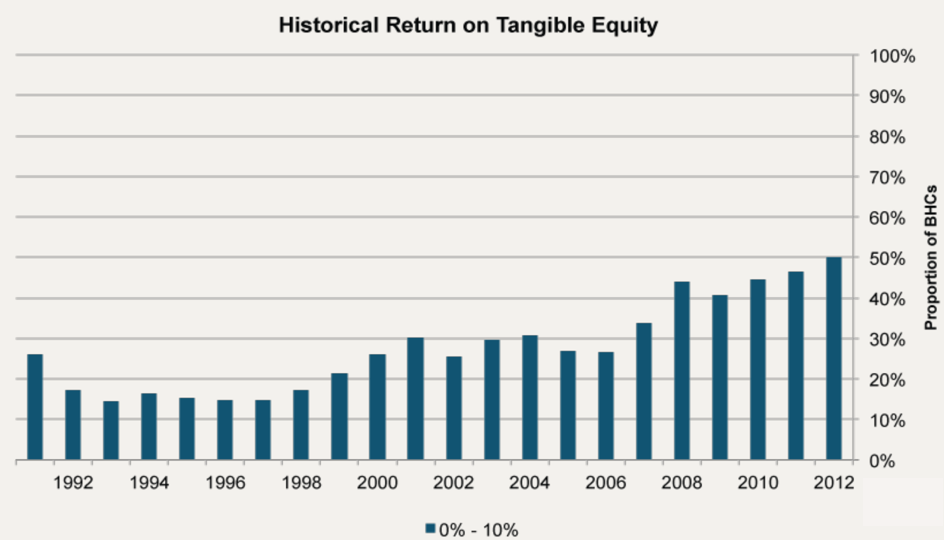
Return on Tangible Equity

» YTD through September 2012, ~50% of the bank holding companies surveyed reported ROTE of 0-10%, representing the highest proportion over the 1991 to 2012 period

» Proportion with negative ROEs fell from 41% in 2009 to 10% in 2012

Data set includes bank holding companies filing Form FR Y-9C with less than $5 billion of assets at September 30, 2012 (approximately 1,000 holding companies)





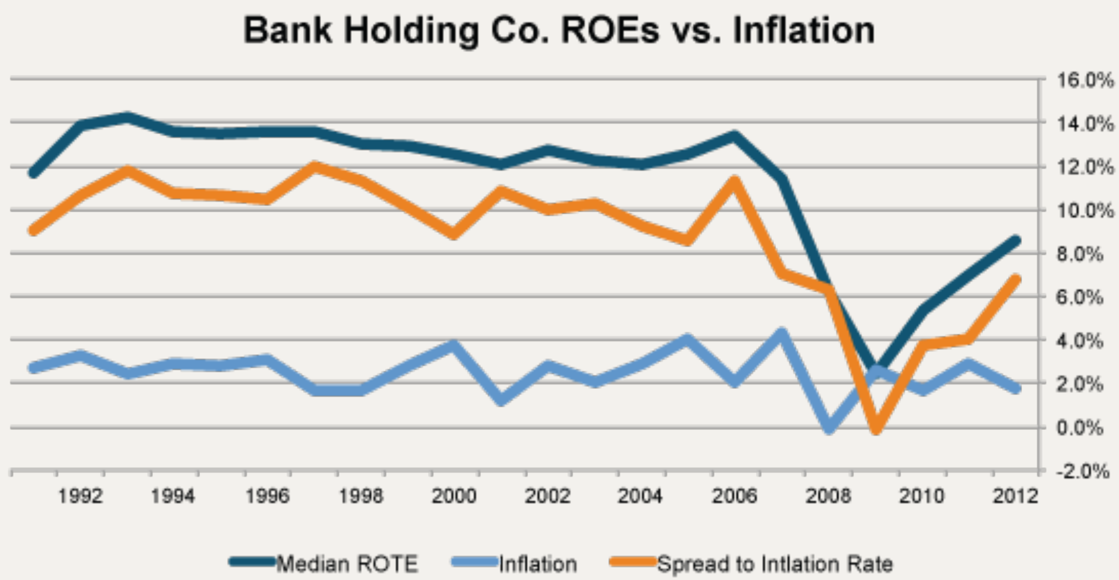
Goal Setting

Target Return on Equity

- What ROE should a community bank target?
- Potential comparative metrics
  - Bank's ROE history and relative to peers
  - Inflation
  - U.S. Treasuries
  - Corporate Bonds
  - Preferred Stock Yields
  - Cross-Industry Returns
- ROE is not the cost of equity capital required by an investor

Target Return on Equity

- Inflation may represent the minimum ROE
- Between 1991 and 2006, ROEs exceeded the inflation rate by 10%, on average
- Spread between ROE and inflation in 2012 is 7%



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Target Return on Equity

» ROE spread over 10-year UST similar to relative analysis for bonds

» Wide spread via Greenspan's "great moderation" 90-99 (~7%) and 00-07 (~8.4%), but lending is a cyclical business … 84-12 (5-7%)

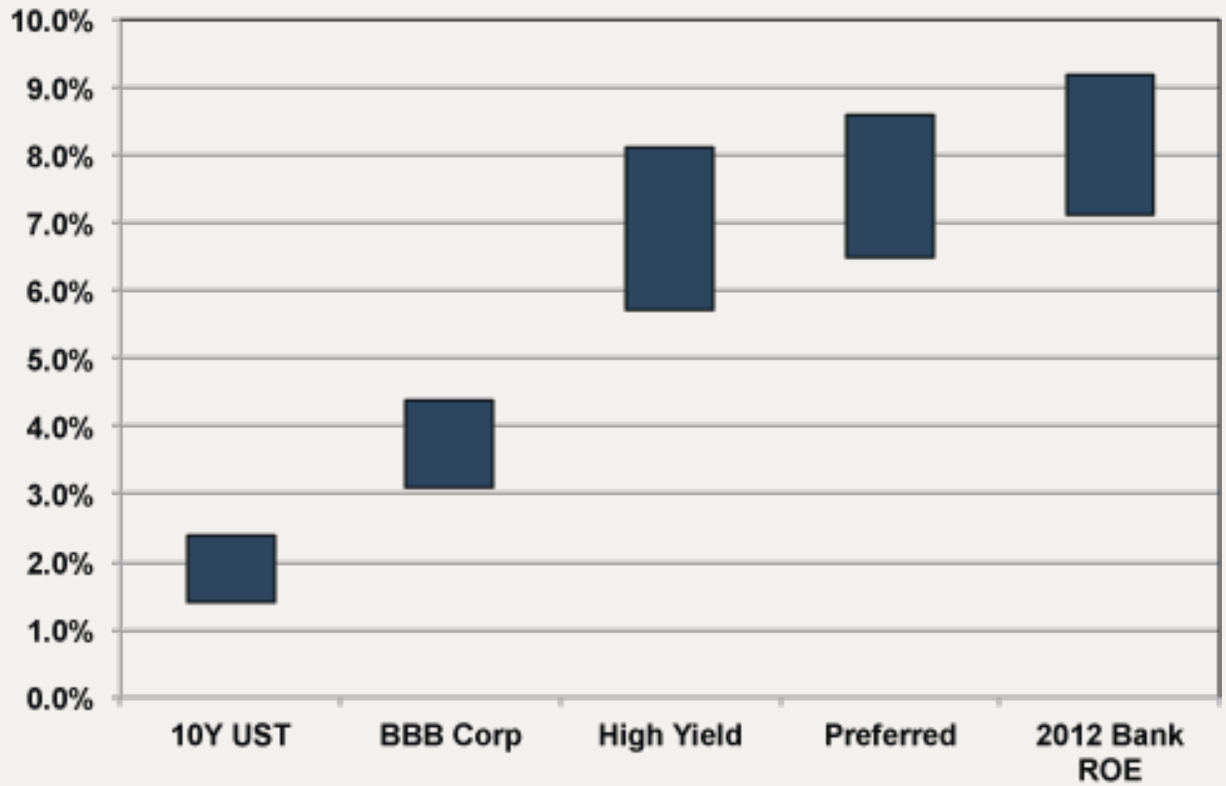
» YTD ROE spread of 6-8% is in-line with long-term history … implies 8-9% ROE, which is okay but not great

	84-89	90-99	00-07	08-12	00-12	84-12	YTD ROE	10Y UST	Current Spread	Current vs. 84-12
Assets > $10B	1.7%	7.4%	9.1%	3.3%	7.6%	7.1%	9.1%	1.8%	7.2%	0.2%
Assets $1-10B	-1.7%	7.6%	8.3%	-1.5%	6.9%	5.6%	9.9%	1.8%	8.1%	2.5%
Assets $100M-$1B	-4.6%	5.7%	6.6%	0.4%	5.8%	5.0%	7.7%	1.8%	5.9%	0.9%
Assets < $100M	-2.5%	3.8%	3.3%	0.5%	2.9%	2.3%	6.2%	1.8%	4.4%	2.1%
All Insured Institutions	**-3.0%**	**7.1%**	**8.4%**	**2.2%**	**7.2%**	**6.6%**	**9.0%**	**1.8%**	**7.2%**	**0.6%**

Source: FDIC and Federal Reserve's H.15

Target Return on Equity

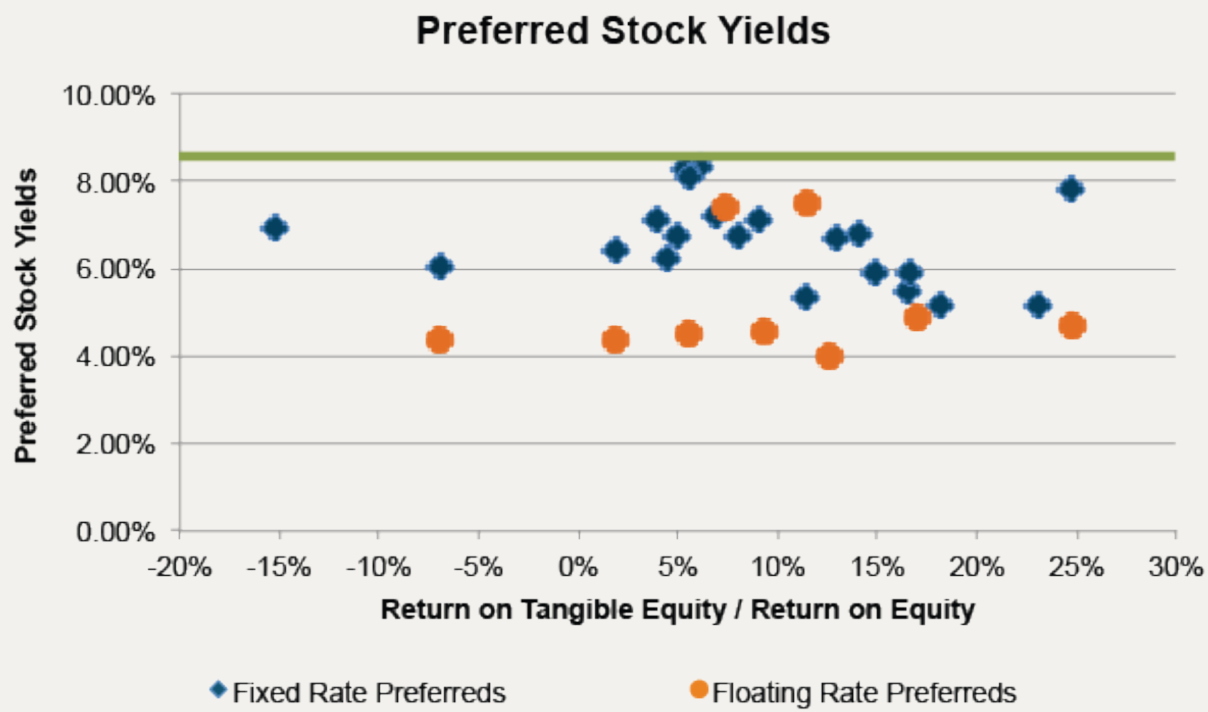
- 2012 yield ranges vs. median ROE for four BHC groups ($500M to > $10B)
- Tom Garrott (CEO NBC Memphis) rule: ROE vs. prevailing CD rates



Source: Wall Street Journal, SNL Financial and FFIEC

Target Return on Equity

Preferred stock yields in the 4% to 6% range for floating rate issues and the 5% to 8% range for fixed rate issues



Note: Preferred stock yields calculated as the median of the yields for each issuer's outstanding preferred stock issues (an issuer with multiple fixed rate preferred stock issues would be reported once in the chart, for example). Source: SNL Financial

Target Return on Equity

» 9% YTD bank ROE compares unfavorably to investment companies, mReits, specialty finance companies, and asset mangers, though mReits face lower ROEs without more leverage

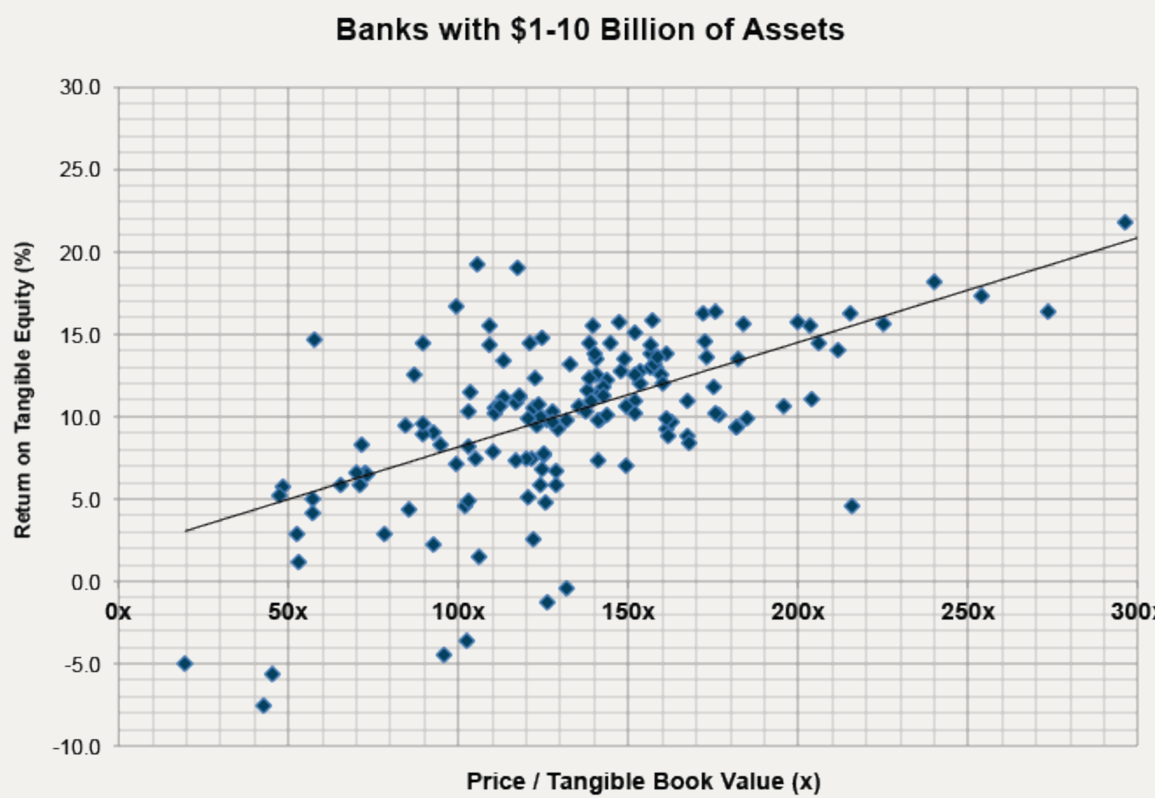
Non-Bank Financial Services Companies	Return on Tangible Equity	Price / Tangible Book Value	Price / Earnings	Dividend Yield	Total Shareholder Returns (Price Appreciation & Dividends) 1 Year	3 Years	5 Years
Specialty Finance Companies - Consumer Emphasis	17.6%	202%	10.1	0.0%	28%	93%	126%
Specialty Finance Companies - Commercial Emphasis	13.0%	157%	14.5	0.0%	23%	63%	59%
Mortgage REITs	11.4%	99%	8.0	10.4%	35%	51%	48%
Investment Companies	10.0%	103%	8.7	8.8%	27%	72%	20%
Property & Casualty Insurers	10.0%	103%	11.2	2.0%	19%	44%	19%
Investment Managers	19.7%	339%	17.4	2.4%	27%	28%	3%
Life & Health Insurers	6.4%	71%	12.2	1.7%	17%	22%	-8%
Broker/Dealers	5.5%	118%	22.8	1.4%	4%	-24%	-29%
Publicly Traded Banks							
- Assets Less Than $1 Billion	5.5%	98%	14.9	1.0%	22%	32%	18%
- Assets $1 - $10 Billion	10.4%	125%	13.5	1.9%	22%	46%	10%
- Assets > $10 Billion	10.7%	142%	13.8	1.9%	14%	17%	-6%
Broad Market							
S&P 500					16%	37%	17%
Russell 2000					17%	42%	34%

Notes:
a) Return on equity used if return on tangible equity unavailable
b) Publicly traded companies with market capitalizations less than $50 million were excluded from the analysis

Source: SNL Financial

Public Market Valuation

- P/TBV rises +/- with ROTE
- ROA x Leverage = ROE;
- ROE x P/E = P/BV
- Multiple trends up with TCE and fewer NPAs



Source: SNL Financial

Reactions

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Do Nothing?

- For some banks, maybe …
- Banking is a highly cyclical industry given variability of credit losses and leveraging of equity capital
- Environment with short-rates anchored near zero, loan demand weak and the Fed competing for Agency MBS is unusual and transitory
- Dodd-Frank and Basel III rules remain to be finalized
- Capital is king in the public markets with high capital, low NPA banks awarded above average valuations

ROE / Capital Management Issues

» Define ROE and ROTE Target Ranges

- How is it achieved?
- Is it competitive vs. peers, risks taken, etc.?

» Capital Targets

- Heavy emphasis on tier one common subject to leverage minimum
- Recognize pro-cyclical impact of NPA treatment in a recession
- Internal buffer needed for acquirers … ROE drag from excess is okay with expectation that it will be deployed to acquire

» Deployment of Excess Capital

ROE / Capital Management

Organic Loan Growth	Usually highest return, lowest risk if pricing generates ROE target
Acquire Banks	Higher risk, but can improve buyer's growth, returns and exit attractiveness … expected return must exceed cost of capital
Acquire Fee Businesses	Return on invested capital can be high for asset / wealth managers and insurance agencies, but culture differences tough to navigate
Acquire Specialty Finance	Lending diversification and yield pick-up, but culture differences and losses may surprise in a downturn
Branch Acquisitions	Large banks will aggressively pare … ONB-BAC, FNFB/ KEY -HSBC

ROE / Capital Management

Divest	Free capital by divesting branches, small trust department … redeploy or return
Bulk Sale of NPAs	Usually lifts shares if investors view balance sheet issues as resolved
Repurchase Shares	Good use of capital if no M&A plans and if projected IRR > cost of capital … usually ++ if price < TBVPS … must avoid buying when prices are high
Special Dividends	No question about value of dividends as $ for $ proposition … possible revaluation higher given yield play
Parent Capital Structure	Does not have to be common-only … fixed-rate preferred interesting

Cost of Capital– Optimize Capital

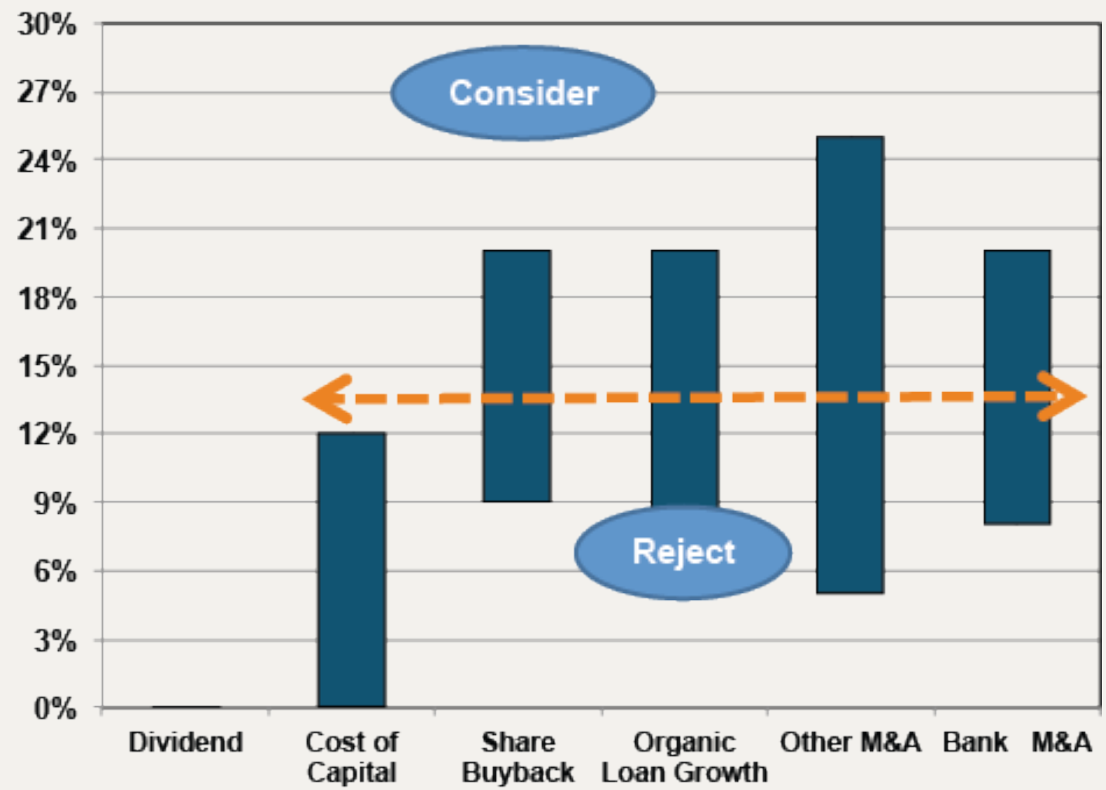
- Estimating the cost of capital for acquisitions and capital actions
- Cost of capital varies based upon risk profile
- Discount rate is applied to expected interim cash flows & terminal value

Equity Discount Rate		Large Cap Public Co	Small Cap Public Co	Low Risk Private	High Risk Private	
Yield to Maturity on Long-Term UST Bonds		2.37%	2.37%	2.37%	2.37%	<> YTM on 20-year US Treasuries
+ Multi-Yr Common Stock Premium	5.37%					<> Per Mercer analyses of Ibbotson
x Industry Beta	1.49x					<> Elevated vs. LT history since 2007
= Beta Adjusted Equity Premium		8.00%	8.00%	8.00%	8.00%	
+ Small Capitalization Stock Premium		0.00%	2.80%	2.80%	2.80%	<> Per Mercer analyses of Ibbotson
+ Specific Risk Associated with Subject		0.00%	0.00%	1.00%	3.00%	<> Cannot easily diversify private cos.
= Discount Rate		**10.37%**	**13.17%**	**14.17%**	**16.17%**	
… and P/E sensitivity to growth						
Long-Term Sustainable Growth Rate		3.00%	5.00%	5.00%	3.00%	<> Sustainable growth and P/Es are inversely related
Cap Factor (1 / Discount Rate - Growth)		**13.6x**	**12.2x**	**10.9x**	**7.6x**	

Source: Mercer Capital

Capital Allocation – IRR Ranking

- IRR from investment should > cost of capital given price and realistic projections
- M&A risks argue for higher hurdle rate vs. share repurchases and loan growth



Source: Mercer Capital

Capital Allocation – IRR Expectation

» Street is focused on management's IRR expectations, but price paid is key

Date	Buyer	Seller	Action	Price ($M)	P/TBV	Targeted IRR	Comments
May-06	Wachovia	Golden West	M&A	$26,000	2.8x	17%	WB release noted GDW diversified WB's b/s by adding "higher yielding, lower risk assets"
Oct-08	PNC	National City	M&A	$5,600	0.4x	15%	IRR estimate probably conservative given uncertainty that existed post-Lehman
FY08-11	Fly Leasing	Investors	Repurchase	$64	0.6x	NA	FLY repurchased ~25% of its shares @ ~$8.00 p/s. Also, repurchased notes at $86M discount
Oct-10	Old National	Monroe Bancorp	M&A	$91	1.5x	18%	Expansion into Bloomington (college town), subsequent credit marks were higher than initially estimated
Dec-10	Hancock	Whitney	M&A	$1,768	1.6x	18%	Strategic acquisition (quasi MOE); Whitney weakened by its 15% exposure to Florida
Aug-11	First Niagara	HSBC	Branch Sale	$737	NA	20%	Street panned the deal due to 6.7% premium, ~17% TBVPS dilution and drop in rates for cash investment
Aug-12	M&T	Hudson City	M&A	$3,700	0.8x	18%	Street liked deal due to capital accretion for MTB and perceived low-risk deal due to nature of HCBK's b/s
FY11-12	CapitalSource	Investors	Repurchase	$730	0.9x	NA	CSE repurchased 113M shares (35%) for $6.46 p/s through Sep-12

Source: Company reports via SNL Financial

Capital Deployment to Produce Value

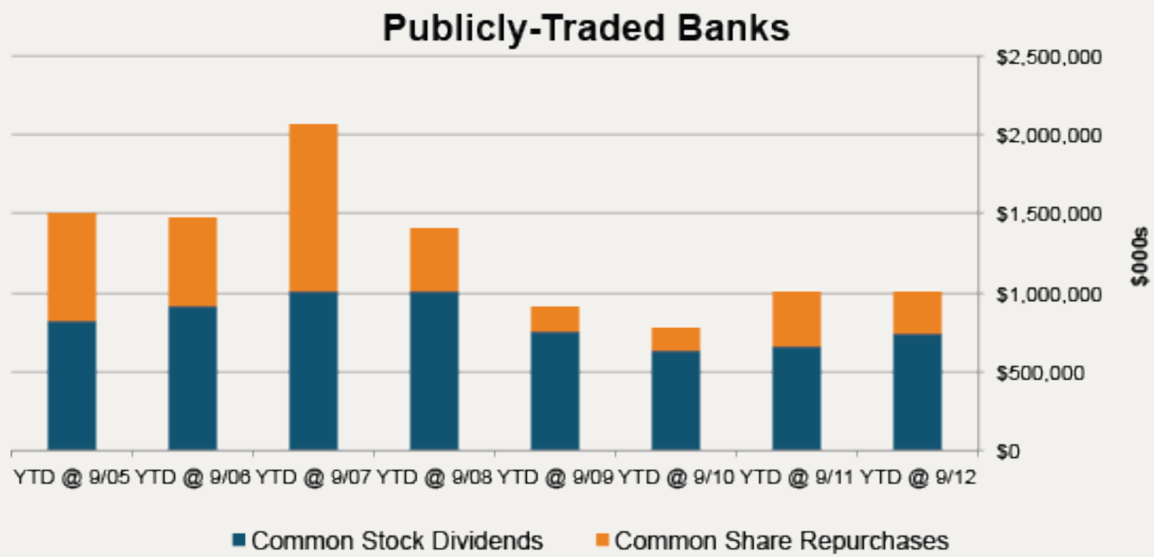
	Assets ($M)	LTM ROA	LTM ROE	Y/Y Loan Growth	NPAs/ Loans	TCE/ Assets	Price/ TBV	P/E LTM	Div'd Yield	LTM Payout	LTM Buyback	Total Return 1 Year	Total Return 3 Year	Total Return 5 Year
Strong Organic Loan Growth														
Signature Bank	$16,459	1.14%	11.8%	34.6%	0.91%	9.6%	220%	20.4x	0.0%	0%	0%	18%	131%	116%
Texas Capital Bancshares	$9,882	1.36%	17.5%	29.9%	0.91%	7.9%	240%	15.7x	0.0%	0%	0%	43%	229%	175%
Western Alliance Bancorp	$7,404	0.74%	7.8%	17.8%	5.41%	7.2%	182%	20.2x	0.0%	0%	0%	56%	157%	-27%
Heartland Financial USA	$4,593	0.83%	9.8%	13.6%	3.56%	6.2%	157%	14.2x	1.5%	13%	0%	65%	102%	66%
High Dividend Payout Ratios														
Trustmark Corporation	$9,872	1.18%	9.2%	-1.2%	2.77%	10.1%	158%	13.3x	3.9%	50%	0%	-4%	13%	26%
First Financial Bancorp	$6,235	1.05%	9.3%	-4.6%	2.83%	10.0%	141%	13.0x	7.6%	103%	0%	-10%	19%	75%
NBT Bancorp Inc.	$6,029	1.02%	10.6%	14.6%	1.05%	7.0%	173%	11.9x	3.8%	49%	2%	-5%	17%	21%
Share Repurchases														
CapitalSource Inc.	$8,677	5.34%	27.7%	17.2%	5.07%	18.5%	107%	4.1x	0.5%	2%	13%	25%	85%	-44%
BCB Bancorp	$1,155	0.39%	4.8%	12.9%	7.26%	7.2%	96%	19.0x	5.1%	0%	11%	-3%	20%	-13%
Active Acquirers														
SCBT Financial Corporation	$4,325	0.78%	8.0%	6.3%	3.29%	8.4%	176%	18.5x	1.7%	31%	0%	37%	47%	43%
Great Southern Bancorp	$4,057	0.50%	5.8%	19.2%	6.76%	7.3%	121%	19.0x	2.7%	21%	0%	14%	38%	80%
Home BancShares	$3,888	1.59%	12.8%	6.2%	4.50%	11.1%	225%	15.5x	1.5%	20%	0%	31%	55%	108%
Bank of the Ozarks	$3,823	1.99%	17.1%	-1.6%	1.11%	12.3%	254%	15.7x	1.8%	22%	0%	13%	140%	245%
$1-10B Assets (Median)	**$2,443**	**0.89%**	**8.5%**	**3.5%**	**3.37%**	**8.4%**	**128%**	**13.3x**	**1.9%**	**0%**	**0%**	**22%**	**41%**	**-6%**

Source: Company reports via SNL Financial

Dividends & Share Repurchases

Publicly traded bank holding companies with assets between $500 million and $5 billion

- Increase in aggregate dividends through September 30, 2012, compared to the same period in 2011, represents the first significant increase in dividends since 2007
- Analysis does not include effect of special dividends announced by some banks in late 2012
- Share repurchases lower in 2012, potentially due to rising stock prices

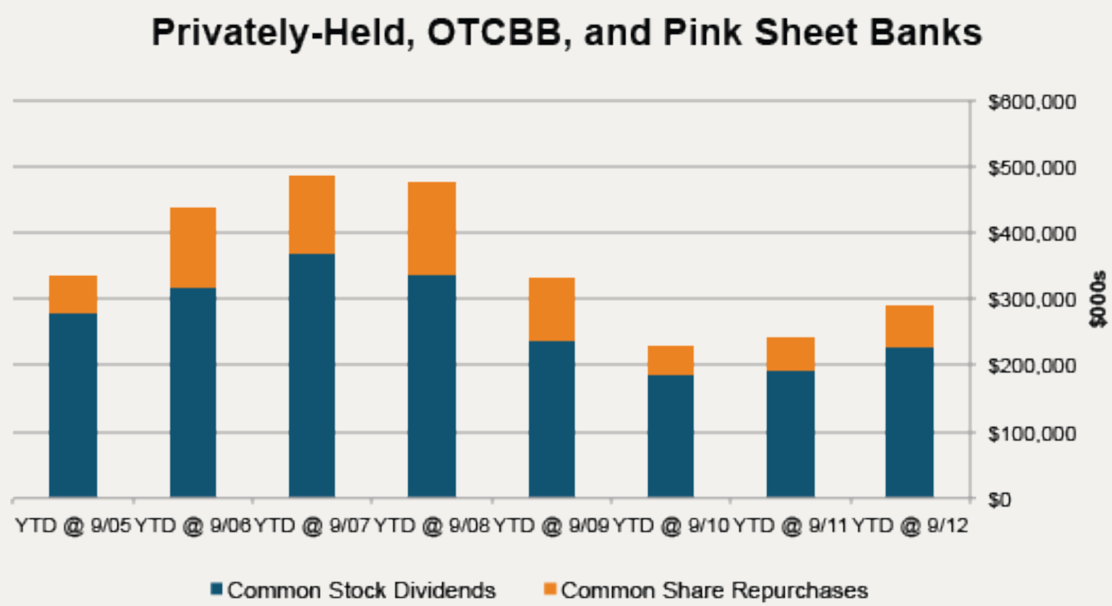


Source: Company SEC reports via SNL Financial

Dividends & Share Repurchases

Privately held, OTC bulletin board, and pink sheet bank holding companies with assets between $500 million and $5 billion (S corporations excluded)

- » Share repurchases rising, up 24% in current year-to-date period versus same period in 2011
- » Aggregate dividends increased by 18% between 2011 and 2012

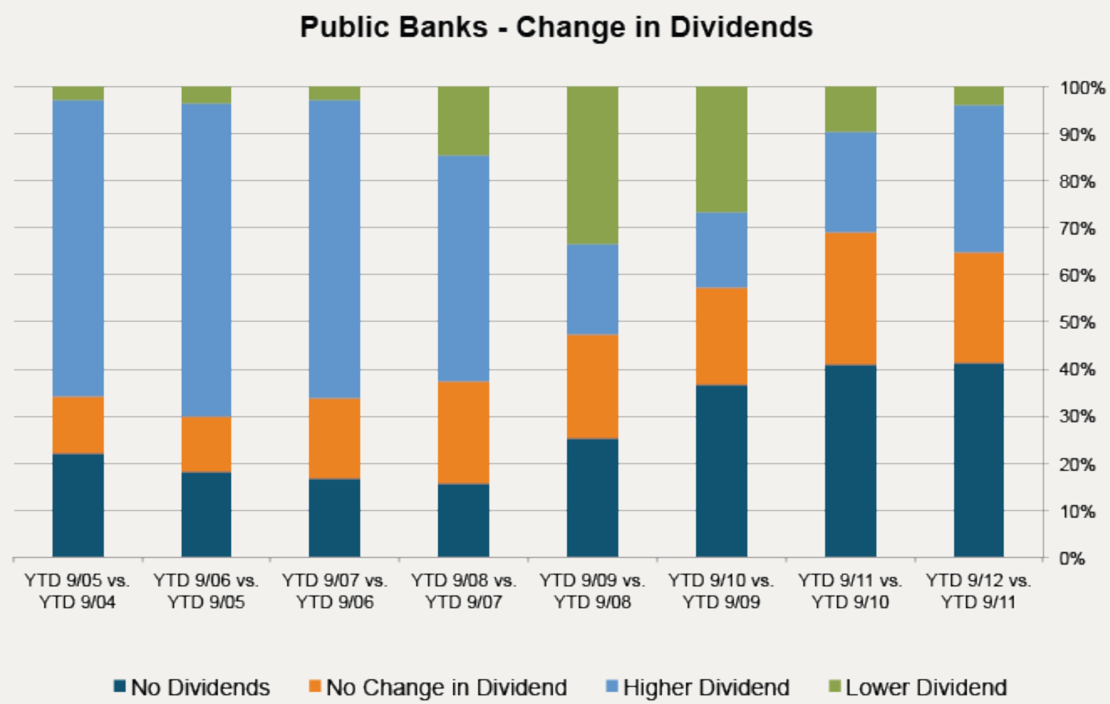


Source: FR Y-9C filings; SNL Financial

Dividends & Share Repurchases

Publicly traded bank holding companies with assets between $500 million and $5 billion

- Approximately 40% of the banks reported no dividends through the first nine months of 2012, the same as in 2011
- 31% of banks raised their dividends in 2012, up from 21% in the 2011 period
- Only 4% lowered their dividend, versus 10% in the 2011 period



Capital Management

» Privately held, OTC bulletin board, and pink sheet bank holding companies with assets between $500 million and $5 billion (S corporations excluded)

- Similar to the publicly-traded banks, the number of banks with higher dividends is rising
- More difficult to analyze for the privately-held banks, because dividend payments may occur annually, instead of quarterly

	YTD 9/05 vs. YTD 9/04	YTD 9/06 vs. YTD 9/05	YTD 9/07 vs. YTD 9/06	YTD 9/08 vs. YTD 9/07	YTD 9/09 vs. YTD 9/08	YTD 9/10 vs. YTD 9/09	YTD 9/11 vs. YTD 9/10	YTD 9/12 vs. YTD 9/11
# of Banks Paying Higher Dividends	379	315	327	254	144	166	233	294
# of Banks with Greater Than 10% Dividend Increase	230	182	174	117	42	78	113	165
Number of Reporting Banks in Both Periods	675	531	536	562	602	667	711	765
% of Banks with Higher Dividends	**56%**	**59%**	**61%**	**45%**	**24%**	**25%**	**33%**	**38%**
% of Banks with Greater Than 10% Dividend Increase	**34%**	**34%**	**32%**	**21%**	**7%**	**12%**	**16%**	**22%**

Final Thoughts

- **#1 determinant of return that investors and buyers control is the purchase price**
- Price cures price … margin of safety matters
- Industry is forever cyclical
- Some excess capital = capital flexibility and an ability to buy when others have to sell

Questions?

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Mercer Capital's Financial Institutions Group

Mercer Capital's ability to understand and determine the value of a financial institution is the cornerstone of the firm's services and has been its core expertise since its founding.

The Financial Institutions Group of Mercer Capital provides a broad range of specialized advisory services to the financial services industry. Mercer Capital has 30 years of experience assisting financial institutions with significant corporate valuation, transactions and other strategic decisions. Mercer Capital provides hundreds of sound, well-documented financial analyses and valuation opinions for financial institutions large and small. In addition, we have a wealth of transaction experience helping clients with mergers, acquisitions, recapitalizations and other substantial transactions.

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