

Acquiring Failed Banks: A Live Webinar

Presented by Austin Associates, LLC

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Failed Bank Opportunities

- History
- Current industry outlook for failures
- The resolution process
- Failed bank deal structures
- P&A agreement terms
- Valuation & accounting
- Case study
- Post-failure opportunities

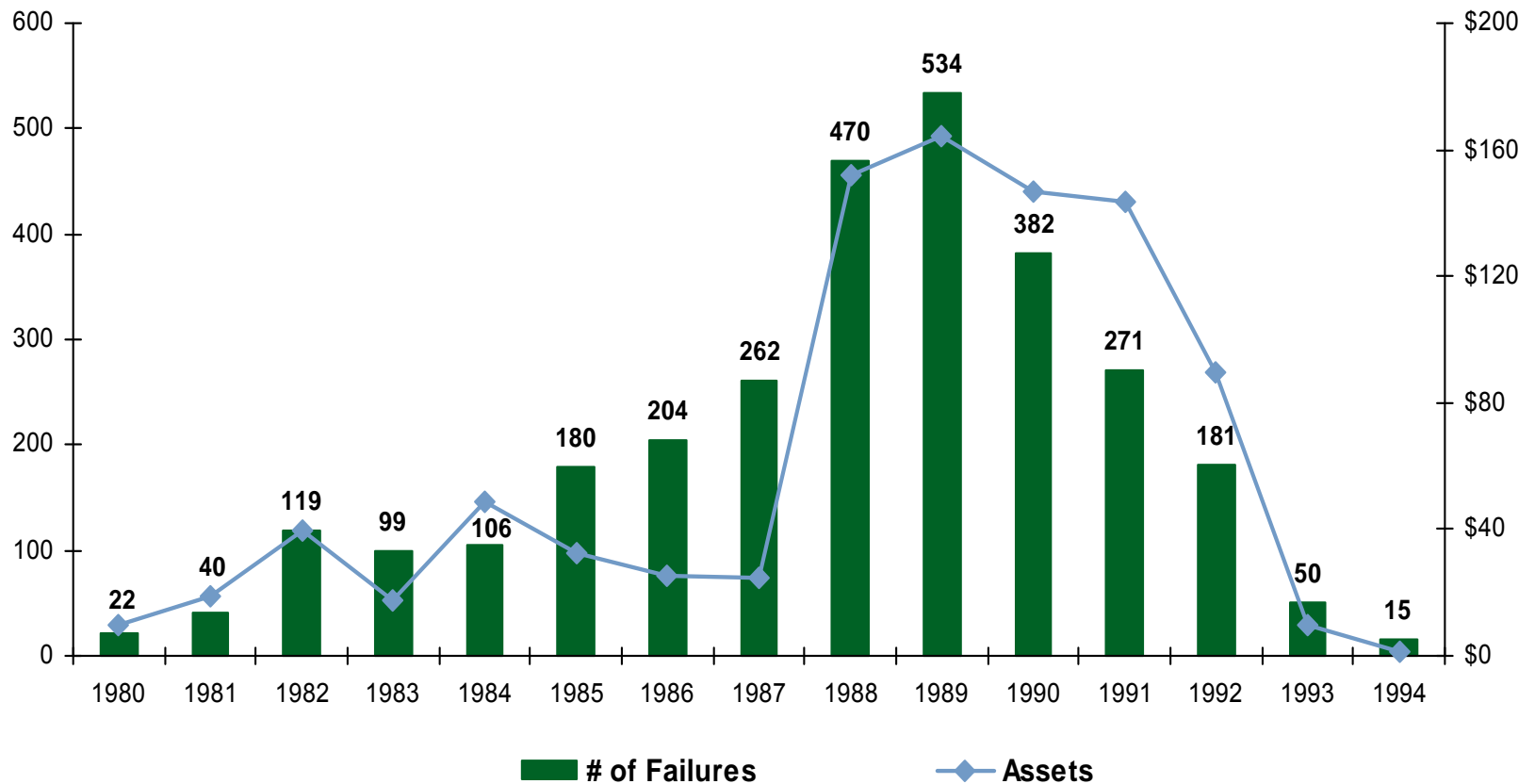
A Little History

- Between 1930 & 1933, more than 9,000 of the nation's 24,000 banks failed
- FDIC created in 1933
- 18,727 banks and thrifts in 1979
- 2,912 banks and thrifts failed from 1980-1994
- 11,070 banks and thrifts in 1995

Total Failures & Assistance Transactions (Banks and S&L's) 1980 - 1994

of Failures

Assets (\$bil)

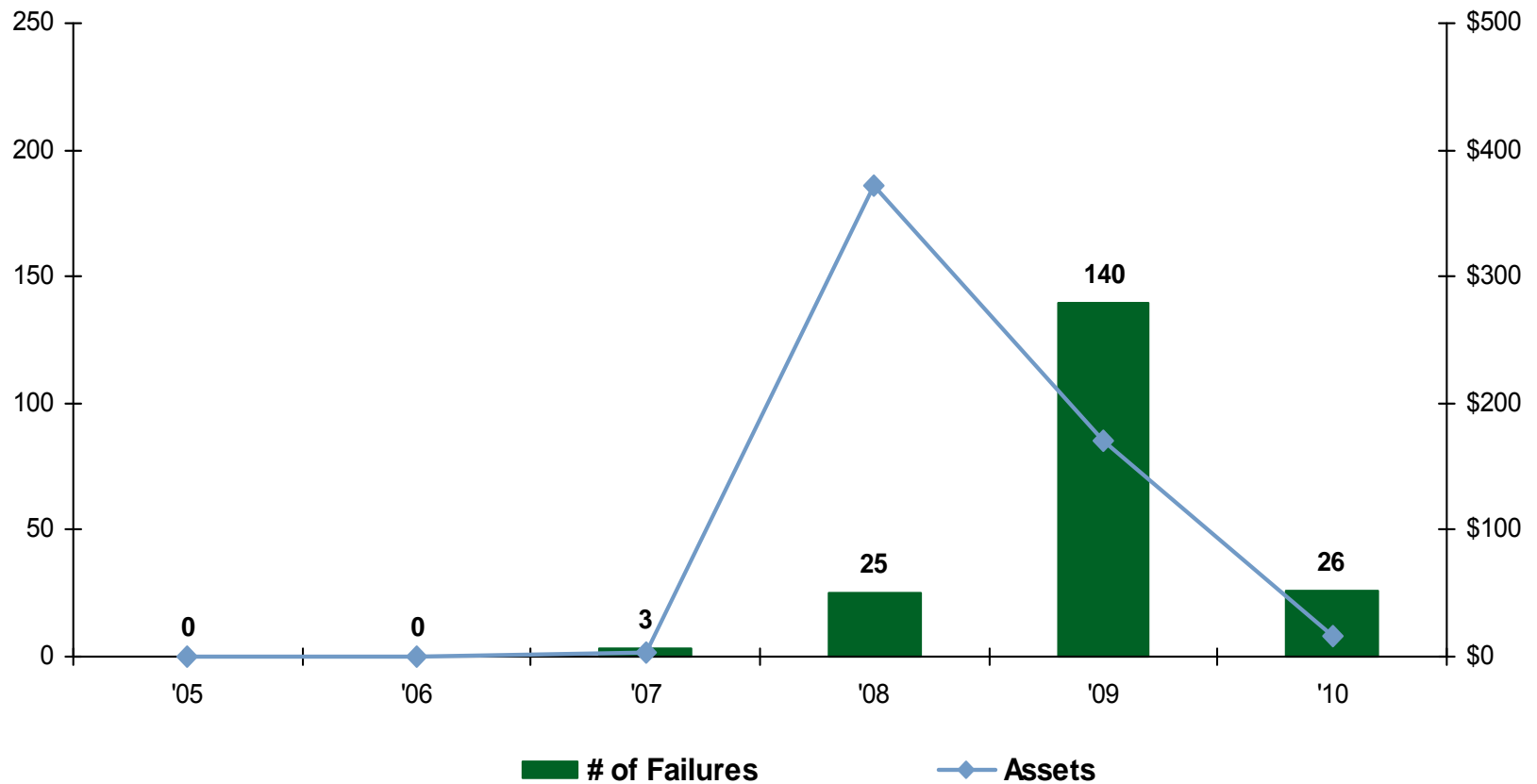


Source: FDIC Failures and Assistance Transactions.

Total Failed Bank Transactions (Banks and S&L's) 2005 – YTD 03/05/10

of Failures

Assets (\$mil)



Source: FDIC Failures and Assistance Transactions.

Failed Bank Transactions

Asset Discount and Deposit Premiums

	# of Transactions	Median Asset Discount	Median Deposit Premium
YTD 03/05/10	26	11.3%	0.31%
2009Y	140	12.0%	0.22%
2008Y	25	11.6%	1.15%
2008 – YTD 2010	191	11.6%	0.33%

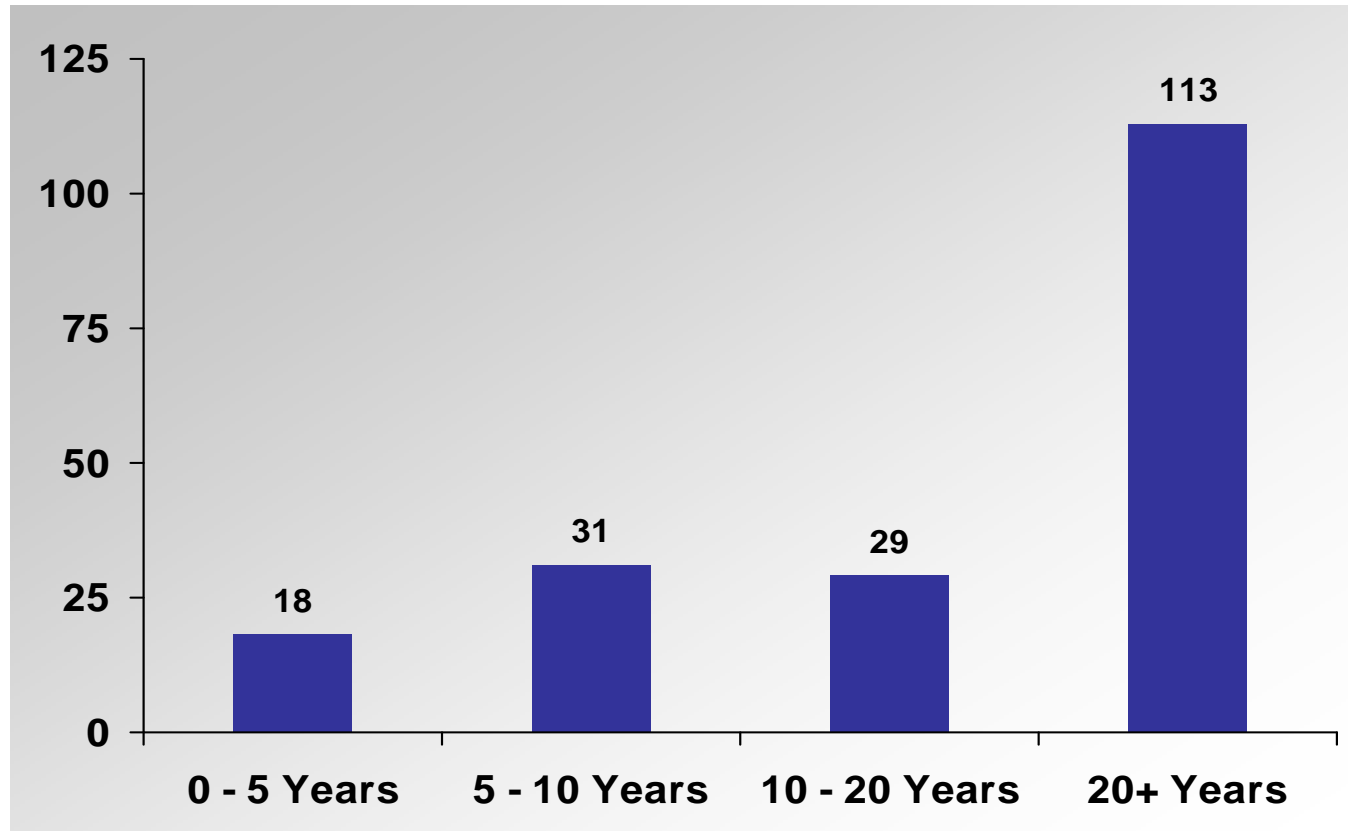
Source: SNL Financial

Number of transactions includes all transactions within the given time period.

Median statistics based on those transactions in which pricing information is available.

2008 & YTD 03/05/10 Failures by Age

(Based on establishment date & date of failure)



As % of all banks in age group

2.3%

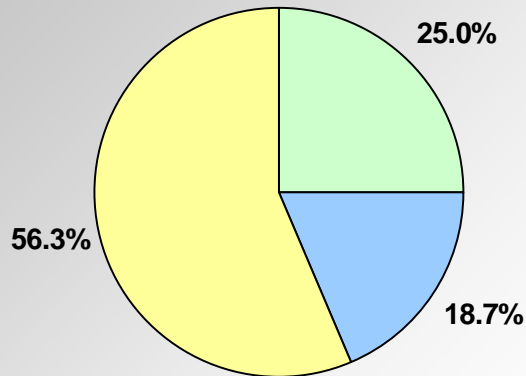
5.0%

4.1%

1.6%

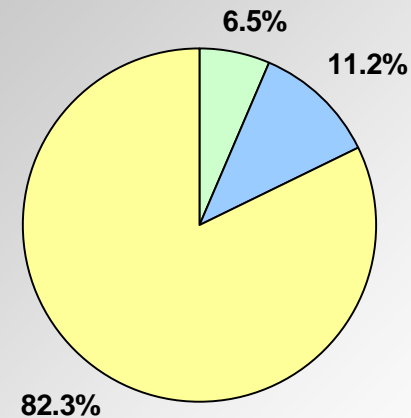
2009 Failures by Loan Mix

12/31/08 Loan Mix
for 2009 Failed Banks



■ C&D Loans ■ Other CRE Guidance Loans ■ All Other

12/31/08 Loan Mix for All
Profitable Banks for the
2009Y Period



■ C&D Loans ■ Other CRE Guidance Loans ■ All Other

Loan Mix information based on median loan mix data as of 12/31/2008.

C&D Loans = Construction & Development.

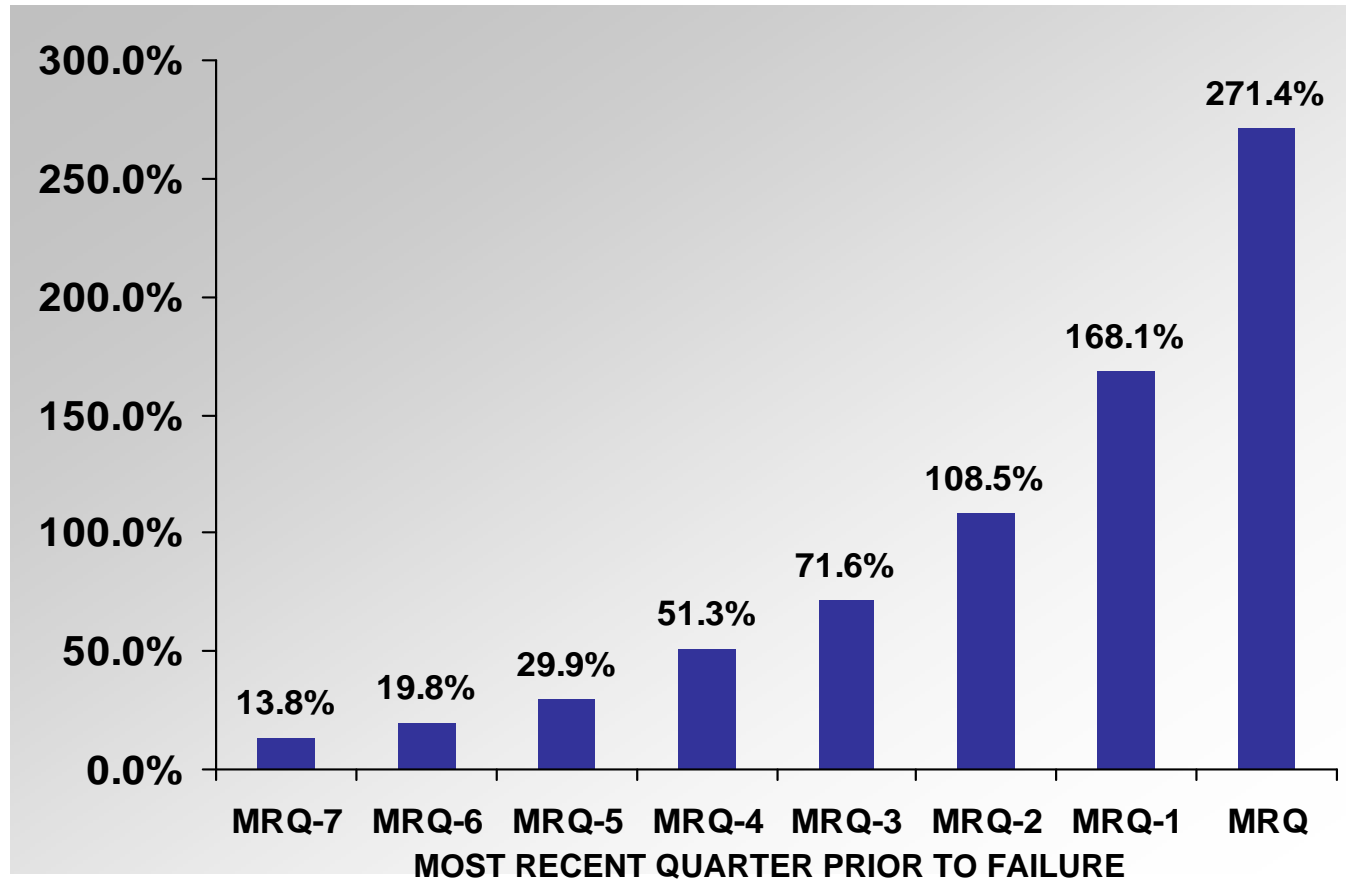
Other CRE Guidance Loans = Non-Owner Occupied CRE Loans + Multifamily + Unsecured CRE Loans.

Warning: Pay Attention to the “Texas” Ratio

- Early warning signal for bank failure risk
- Texas Ratio = NPA's/Capital (tangible equity + ALLL)
- Texas Ratio > 100% = elevated risk of failure
- The 165 bank failures in 2008 and 2009 reported a median Texas ratio of 51% four quarters prior to failure

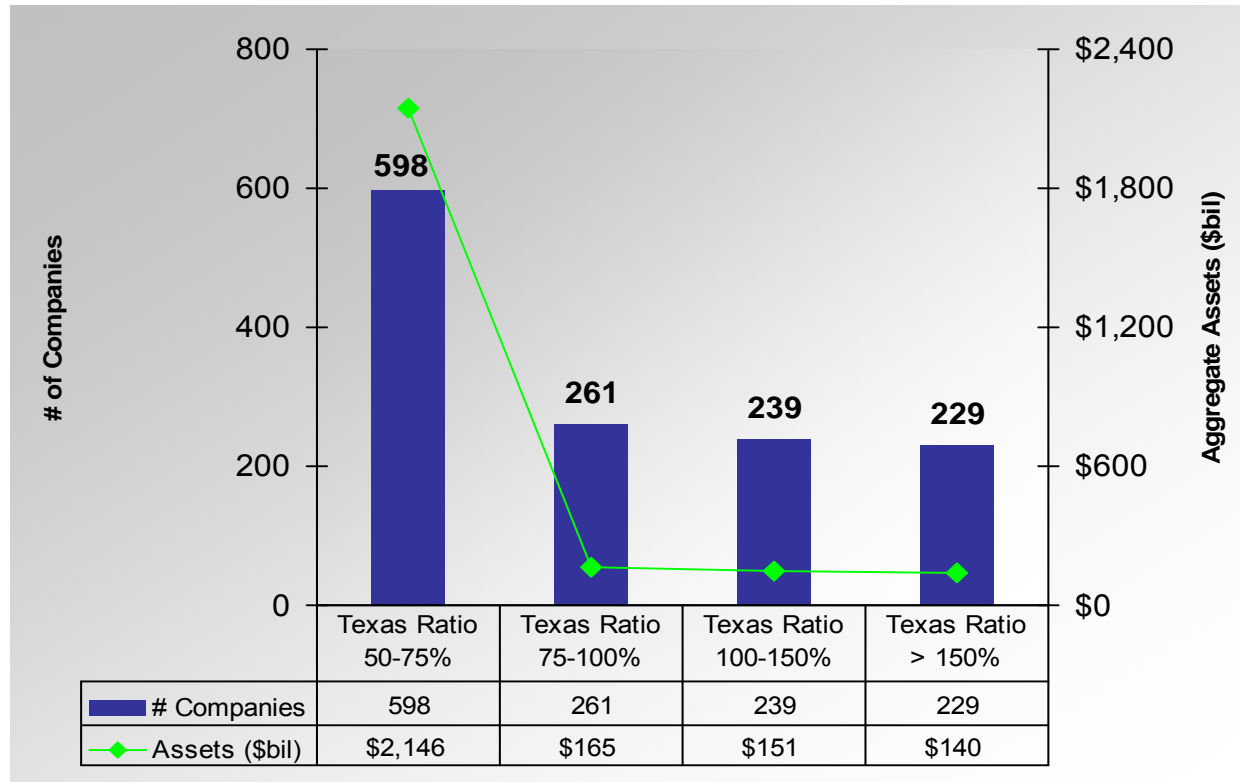
Source: SNL

Texas Ratio Migration (Median Statistics) All 2008 & 2009 Bank Failures



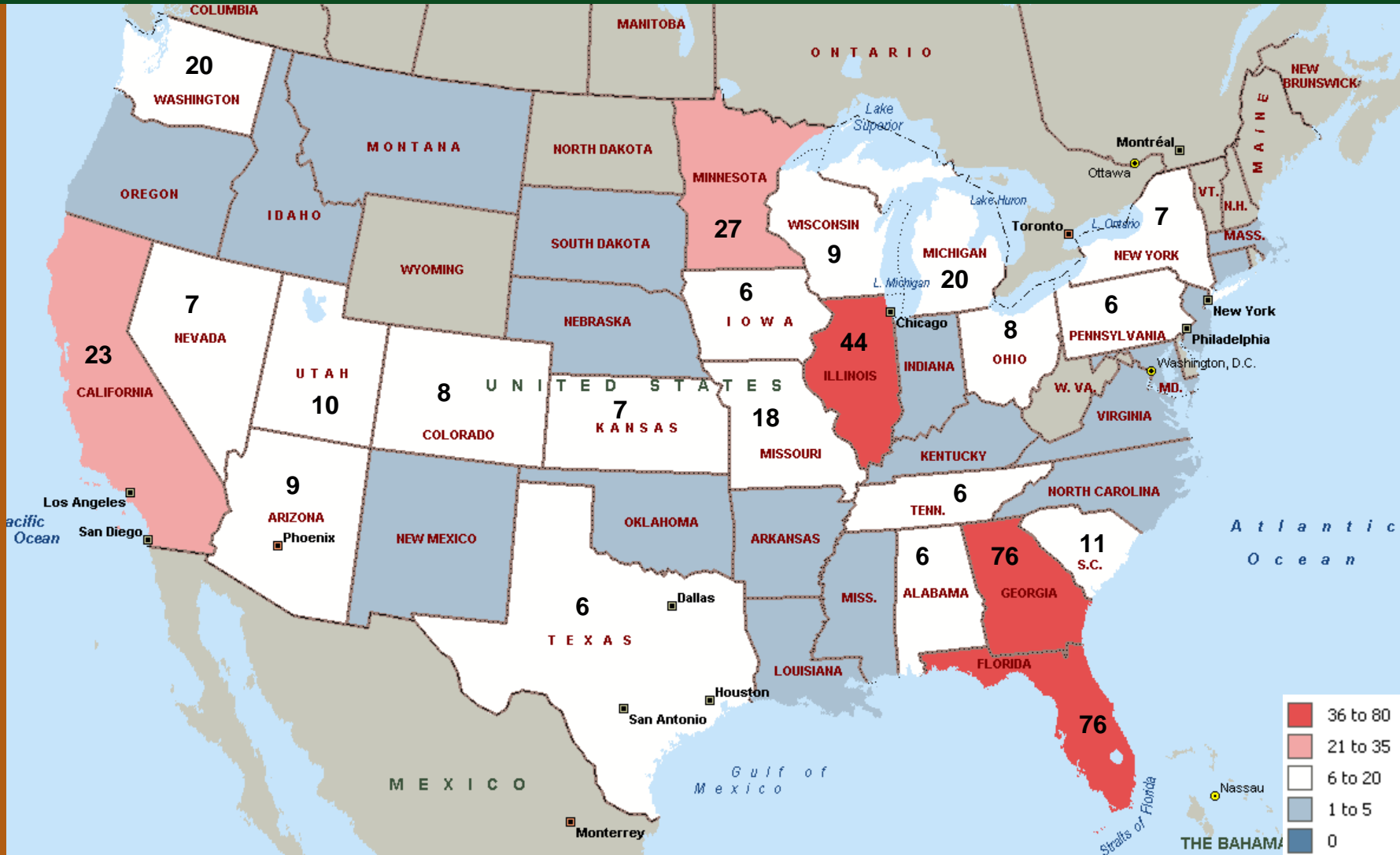
*Texas Ratio: $\text{NPAs} + 90\text{Days PD} / (\text{Tangible Equity} + \text{LLR})$.

Texas Ratio Industry Data as of 12/31/09



Note: Based on operating commercial banks, savings banks and savings institutions as of 03/05/2010.

Texas Ratio > 100% By State (12/31/09 Data)



Total Banks with Texas Ratio > 100% @ 12/31/09 = 468

Interested in Becoming a Bidder for a Failed Bank

- Register with FDIC (www2.fdicconnect.gov)
- Resource Info: www.fdic.gov/bank/historical/reshandbook/
- Establish your failed bank team (credit team, financial/accounting, operations). Consider assigning a project manager to the deal.
- Determine what you want (target size, geography, etc.)
- Meet with your primary regulators to determine if you are approvable
- Know supervisory criteria to become a bidder (e.g., CAMELS 1 or 2, CAMELS 3 case-by-case, CRA rating, BSA rating, etc.)
- Be ready and able to react quickly

Failed Bank Acquisition Opportunities

Recommendations

- Your Failed Bank Team Needs to Be Prepared
 - Due diligence (credit)
 - Integration (technology; marketing and PR; human resources)
 - Legal
 - Financial advisory
 - Accounting

- Identify Target Banks
 - Texas ratio
 - Tangible common equity/Tier 1 leverage ratio
 - NPAs/Assets
 - Pre-provision net revenue/average assets

Resolutions Timeline (1-2 Months)

Action Timing

- | | |
|---|-----------------------|
| 1. Interested acquirers register with FDIC | Before process |
| 2. Primary regulator sends FDIC a failing notice | Day 1 |
| 3. FDIC assembles information/transaction structure | 1-2 weeks |
| 4. FDIC e-mails potential bidders (interested acquirers sign confidentiality agreement) | 1-2 weeks |
| 5. Due diligence (learn how to use IntraLinks) team allowed 2-3 days | 2-8 weeks |
| 6. Bidder Board must adopt resolutions | When bid is submitted |
| 7. File regulatory application | With bid |
| 8. Bids due | Monday/Tuesday |
| 9. Winning bidder signs documents | Wednesday/Thursday |
| 10. Closing date | Friday |

FDIC Action on “Black Friday”

- Assumes control of premises, records, loans and other assets
- Posts notices
- Changes locks
- Counts the cash
- Resolution team may number 50-100 people for a “typical” community bank

Key Agreement Terms

- P&A Agreement is not negotiable
- Loss Sharing Agreements are not negotiable
- No obligations with respect to employee benefit plans
- Option to purchase/lease premises (typically 90 days)
- Option to assume leased DP equipment (typically 90 days)
- Option to assume/terminate contracts for service (typically 30 days)
- Provide list of employees not hired (typically 5 days after closing)
- Depositor notice within 7 days after closing
- Reprice deposits immediately, subject to conditions

Failed Bank Deal Structures

- P&A (Purchase of Assets and Assumption of Liabilities)
- Deposit Payoff
 - No bidders, or
 - Discount on assets is so great that a payoff in the “least cost alternative”
 - FDIC pays off depositors directly
- Open Bank Assistance (“OBA”)
 - Technically still available, but not used anymore
 - FDI Act of 1993 prohibited FDIC from using insurance money to benefit any shareholder of an institution that had failed or was in danger of failing

Failed Bank Deal Structures

	<u>2009</u>	<u>2010</u>
➤ P&A All Deposits with Loss Share	90	21
➤ P&A All Deposits without Loss Share	36	2
➤ P&A Insured Deposits Only without Loss Share	2	0
➤ Deposit Payout	11	3
➤ Insured Deposit Transfer	1	0

Settlement Statement

Deposits assumed	\$100,000
Loans/Assets purchased	(\$40,000)
Loan/Asset discount	\$5,000
Deposit premium	<u>(\$1,000)</u>
Cash due to purchaser	\$64,000

Option to purchase premises at “fair market value” is a post-closing transaction

Loss Share Rationale

➤ Regulator Benefits

- Less costly than assuming a failed bank's assets and liquidating them over time
- Keeps troubled assets in private sector
- Accelerates resolution

➤ Acquirer Benefits

- Credit loss exposure is limited
- Infrastructure already in place to service & manage assets
- Projected IRR at very high levels
- Potential increase in capital through creation of negative goodwill

P&A with Loss Sharing Agreement

Loss Sharing Framework

- “First Loss Tranche” – typically calculated to be less than zero (FDIC wires amount to buyer)

First Loss Tranche = Asset Premium (Discount) + Deposit Premium + Equity Adjustment (assets purchased less liabilities assumed)

- “Stated Threshold” – a specified dollar amount set by the FDIC (has averaged about 25% of loans purchased)
- 80% of losses covered up to the Stated Threshold
- 95% of losses covered in excess of Stated Threshold

P&A with Loss Sharing Agreement

Loss Share Agreement: 2 Asset Pools

Single Family	Commercial
<ul style="list-style-type: none">• 10-year agreement• Must follow FDIC loan modification program• Credit loss coverage provided when:<ul style="list-style-type: none">– Loans are modified– Short sale– Foreclosed real estate is sold– Loans are sold at end of contract (with FDIC concurrence)– Bulk loan sales (with FDIC concurrence)• Credit loss coverage includes up to 3 months of accrued but unpaid interest• Qualifying expenses to third parties and most loan modification expenses are capitalized	<ul style="list-style-type: none">• 5-year agreement for losses, 3 more years for recoveries• Credit loss coverage provided when:<ul style="list-style-type: none">– Assets are written down according to examination criteria of the purchaser's primary regulator– Assets are sold (bulk sales require FDIC approval)• When assets are initially written down, credit loss coverage includes up to 3 months of accrued but unpaid interest• Qualifying expenses to third parties are capitalized or treated as a covered loss

Loss Share Example

Book Value of Loans	\$100,000
First Loss Tranche	\$0
Stated Threshold	<u>\$25,000</u>

Maximum Loss Calculation

Max. loss up to Stated Threshold	\$5,000 (20% of \$25,000)
Max. loss on remaining portfolio	<u>\$3,750</u> (5% of \$75,000)
Maximum credit loss	<u><u>\$8,750</u></u>

Maximum Credit Loss as Percent of Loans	<u><u>8.75%</u></u>
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Failed Banks in Florida (August 2009 – February 2010)

DEALS WITH LOSS SHARE AGREEMENTS						
Name	Assets Sold (\$Mil)	Threshold as % of Assets Sold	Deposit Premium	Discount on Assets Sold	Maximum Credit Loss	Spread
Marco Community Bank	\$120	38.5%	1.50%	10.17%	10.15%	0.02%
Florida Community Bank	\$499	28.3%	0.40%	11.62%	7.30%	4.32%
Premier American Bank	\$351	26.8%	0.00%	18.83%	8.29%	10.54%
Peoples First Community Bank	\$1,600	24.1%	1.00%	14.75%	7.98%	6.77%
Republic Federal Bank, NA	\$425	8.5%	1.01%	8.88%	3.75%	5.13%
Commerce Bank of SW Florida	\$80	22.6%	0.00%	18.57%	7.20%	11.37%
Orion Bank	\$2,300	23.9%	-1.50%	12.59%	7.72%	4.87%
Century Bank	\$789	36.1%	-1.50%	16.59%	9.57%	7.02%
Flagship National Bank	\$190	26.8%	0.00%	15.89%	7.44%	8.45%
Community N.B of Sarasota County	\$94	19.1%	0.25%	17.02%	7.07%	9.95%
First State Bank	\$451	23.5%	0.25%	15.30%	7.56%	7.74%
Florida Median (11)	\$425	24.1%	0.25%	14.41%	8.74%	5.67%
National Median (2010 Deals) (20)	\$420	23.7%	0.00%	11.41%	7.71%	2.65%

True-Up Provision

True-Up Payment to FDIC shall be calculated as follows:

50% of the excess of:

(i) 20% of the Stated Threshold

Less,

(ii) the sum of:

(a) 25% of the Asset Premium (Discount)

(b) 25% of the Cumulative Shared-Loss Payments

(c) the Cumulative Servicing Amount (1.0% of average covered assets in each period)

True-Up Payment Matrix

Assumptions:

Stated Threshold = 25% of Covered Assets

Cumulative Servicing Amount = 3.0% of Covered Assets

		Asset Discount				
		0%	5%	10%	15%	20%
Cumulative Shared Loss Payment as % of Loss Share Assets	0%	1.000%	1.625%	2.250%	2.875%	3.500%
	5%	0.375%	1.000%	1.625%	2.250%	2.875%
	10%	0.000%	0.375%	1.000%	1.625%	2.250%
	15%	0.000%	0.000%	0.375%	1.000%	1.625%
	20%	0.000%	0.000%	0.000%	0.375%	1.000%
	25%	0.000%	0.000%	0.000%	0.000%	0.375%
	30%	0.000%	0.000%	0.000%	0.000%	0.000%

Accounting Considerations

- Statement of Financial Accounting Standards No. 141R, Business Combinations (SFAS 141R)
- Acquisition date and post-acquisition date issues
- Impaired loan treatment under SOP 03-3
- Acquirer must record purchased loans, other assets and liabilities at “fair value” or the amount that would be received upon sale in a market transaction
- Fair value of loss share indemnification accounted for separately

Loan Portfolio Valuation

- Credit risk
- Estimate of cash flows
- Discount rate
- Example calculation of value

Loan Portfolio “Fair Value” Calculation

Assumptions

- Loss share agreement for loans with book value of \$1,000
- Acquirer agrees to purchase assets at 20% discount
- Portfolio interest rate of 6% amortized over a four-year term to maturity
- Loan loss estimated at 10% of the portfolio each year
- Loan discount rate of 8% (intended to reflect “market rate”)

Loan Portfolio Amortization

Expected Credit Losses & Principal Payments

	Beginning Portfolio	Principal Loss	Performing Portfolio	Interest Payment	Principal Payment	Ending Portfolio
Beginning Portfolio						1,000
Year 1	1,000	100	900	54	230	670
Year 2	670	67	603	36	205	398
Year 3	398	40	358	21	180	178
Year 4	178	18	160	10	160	0
		<u>225</u>			<u>775</u>	

Loan Portfolio “Fair Value” Calculation

Cash Flow Projection & DCF Value

	Year 1	Year 2	Year 3	Year 4
Principal Cash Flow	230	205	180	160
Interest Cash Flow	54	36	21	10
Total Cash Flow	284	241	201	170
Period	1	2	3	4
Discount Factor @ 8.0%	0.9259	0.8573	0.7938	0.7350
Present Value of Cash Flow	263	207	160	125

"Fair Value" of Portfolio **754** = Sum of PV of Cash Flows

Loss Share “Fair Value” Calculation

Assumptions

- “Loss Share” starts with first dollar of loss
- Stated threshold set by FDIC at \$250
- “Loss Share” of 80% on first \$250 of loss
- “Loss Share” of 95% on losses over \$250
- “Loss Share” discount rate of 4%

Loss Share “Fair Value” Calculation

Cash Flow Projections from Loss Share & DCF Value

	Year 1	Year 2	Year 3	Year 4
Projected Losses	100	67	40	18
FDIC Coverage Percentage	80%	80%	80%	80%
Cash Flow from Loss Share	80	54	32	14
Period	1	2	3	4
Discount Factor @ 4.0%	0.9615	0.9246	0.8890	0.8548
Present Value of Cash Flow	77	50	28	12

"Fair Value" of Loss Share 167 = Sum of PV of Cash Flows

Net Value Creation from Negative Goodwill

Loan "Fair Value"	754	= based on "fair value" analysis
Loss Share "Fair Value"	167	= based on "fair value" analysis
"Fair Value" of Assets Acquired	921	
Cash Payment to FDIC	800	= based on Bid Amount (20% Discount)
Net Value Created	121	= Negative Goodwill
Net After-Tax Gain	79	= Tax effected at 35%

SFAS 141R requires negative goodwill to be recorded as a "gain", thus resulting in an increase in equity capital

Post Acquisition Accounting

Loan Portfolio Accounting

	Beginning Balance	Interest @ Discount Rate	Cash Interest	Accretion of Loan Discount	Principal Payment	Ending Balance
Beginning Portfolio						754
Year 1	754	60	54	6	230	531
Year 2	531	42	36	6	205	332
Year 3	332	27	21	5	180	157
Year 4	157	13	10	3	160	-
		142	121	20	775	

Reconciliation

- Beginning Balance
- PLUS Accretion of Loan Discount
- LESS Principal Payment
- EQUALS Ending Balance

Post Acquisition Accounting

Loss Share Accounting

	<u>Beginning Balance</u>	<u>Interest @ Discount Rate</u>	<u>Amount Collected from FDIC</u>	<u>Ending Balance</u>
Beginning Asset				167
Year 1	167	7	80	94
Year 2	94	4	54	44
Year 3	44	2	32	14
Year 4	14	1	14	(0)
		<u>14</u>	<u>180</u>	

Reconciliation

- Beginning Balance
- PLUS Interest Accrual at Discount Rate
- LESS Loss Share Amount Collected from FDIC
- EQUALS Ending Balance

Case Study

First Financial Bancorp (symbol “FFBC”)

FDIC Assisted Acquisition of

Irwin Union Bank, Indianapolis, Indiana

Effective September 18, 2009

Case Study: FFBC Acquisition of Irwin Union Bank

Transaction Overview

- Approximately \$2.5 billion of deposits were assumed and approximately \$2.5 billion of assets were purchased
- Transaction excluded nonperforming loans, OREO, construction & development loans, and land loans
- Winning bid included loss sharing protection from FDIC
 - No first loss position
 - 80% of losses covered up to Stated Threshold of \$636 million
 - 95% of losses covered thereafter
- Bid Components
 - Deposit Premium \$14 million
 - Asset Discount \$652 million
- Announced cost to FDIC \$850 million (asset discount less deposit premium plus estimated cost from liquidation of other assets)

Source: FFBC Investor Presentation

Case Study: FFBC Acquisition of Irwin Union Bank

Summary of Estimated Key Deal Terms		Estimated Maximum Credit Loss Exposure	
(\$ in millions)		(\$ in millions)	
Covered Assets	\$2,500	FDIC Stated Loss Threshold	\$636
Asset Discount	\$652	FFBC Share @20%	127
Deposit Premium ¹	\$14	FDIC Share @ 80%	509
FFBC Loss at Stated Threshold	\$127	Max. Additional Losses	\$1,864
		FFBC Share @ 5%	93
Maximum Possible Loss ²	\$220	FDIC Share @ 95%	1,771
		Maximum Possible Loss²	\$220
FDIC Stated Loss Threshold as a Percent of estimated Covered Assets = 25.44%			

Estimated based on information received from the FDIC and Company estimates.

1. Based on FFBC's bid of a 1% deposit premium on \$1.4 billion of core deposits at Irwin Union Bank and Trust per FDIC provided data. No deposit premium paid for the deposits of Irwin Union Bank F.S.B.
2. Assuming 100% loss on covered assets.

Source: FFBC Investor Presentation

Case Study: FFBC Acquisition of Irwin Union Bank

Estimated Value Creation	
<i>(\$ in millions)</i>	
Asset Discount	\$652
Fair Value Adjustment	(636)
FDIC Indemnification Asset	509
Pre-tax Value Created	\$525
After-tax Value Created	\$341

- Value creation will be allocated between immediate gain as a result of negative goodwill and yield enhancement over time on covered assets
- Calculations and conclusions based on current accounting rules and sample fair values – actual fair values may be materially different

Source: FFBC Investor Presentation

First Financial Bancorp 2009 Highlights

- Assets increased 80.6%
- Earnings per share of \$5.33 on beginning tangible book value per share of \$6.43.
- Return on Average Equity of 52.04%
- Market price went from a low of \$5.58 in March 2009 to a high of \$15.48 in December 2009.
- Two capital raises:
 - \$103.5 million in May 2009 at \$7.50 per share
 - \$96.5 million in January 2009 at \$15.14 per share
- Repaid \$80.0 million in TARP in February 2010

How to Price a Failed Bank Opportunity

- Market Approach: Guideline Transactions
- Asset Approach: Net present value of Assets
- Income Approach: Present value of earnings/cash flows
- Pro forma impact to earnings, book value and capital based on a range of Bid Amounts
- Calculate IRR (Internal Rate of Return) based on range of Bid Amounts
- Multiple bids may be submitted on each deal

New Twists . . .

- New York Community Bancorp, Inc. acquisition of AmTrust Bank, Cleveland, on December 4, 2009
- NYCB proposed that FDIC participate in share value appreciation if NYCB stock rose above \$12.33 per share between December 4 and December 23 (payable in cash or stock at NYCB's option)
- FDIC realized gain of \$23.3 million
- FDIC Toolbox . . . What has been used in 2009
 - True-up provision for loss share agreements
 - FDIC takes ownership in a failed bank's asset sale
- Expect more creative techniques to be developed
 - Branch break-ups

Post Failure Opportunities

- Purchase loans/REO directly from FDIC
- Purchase branch real property
- Acquire subsidiary of failed bank
- Hire key employees of failed bank (consider restrictions in confidentiality agreement)
- Pursue loan and deposit customers of failed bank (consider restrictions in confidentiality agreement)

Q & A