

ACQUIRE OR BE ACQUIRED

EXPLORING YOUR GROWTH OPTIONS

Acquisition Opportunities for Failed Bank Franchises and Assets

Sunday, January 31, 2010
8:15 a.m. – 10:15 a.m.



Presenters

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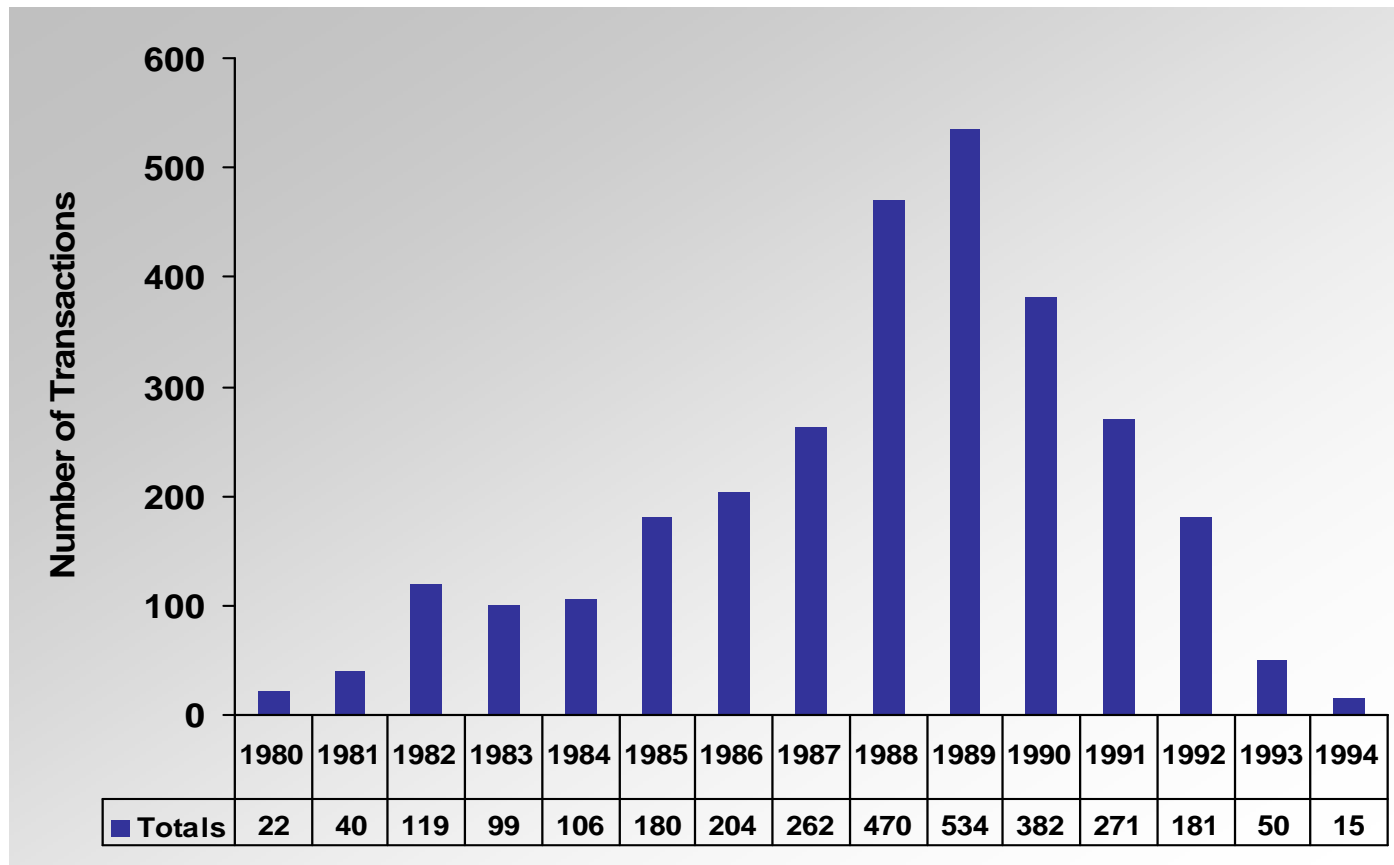
Failed Bank Opportunities

- History
- Current industry outlook for failures
- The resolution process
- Failed bank deal structures
- Legal issues
- Valuation & accounting
- Case study
- Post-failure opportunities

A Little History

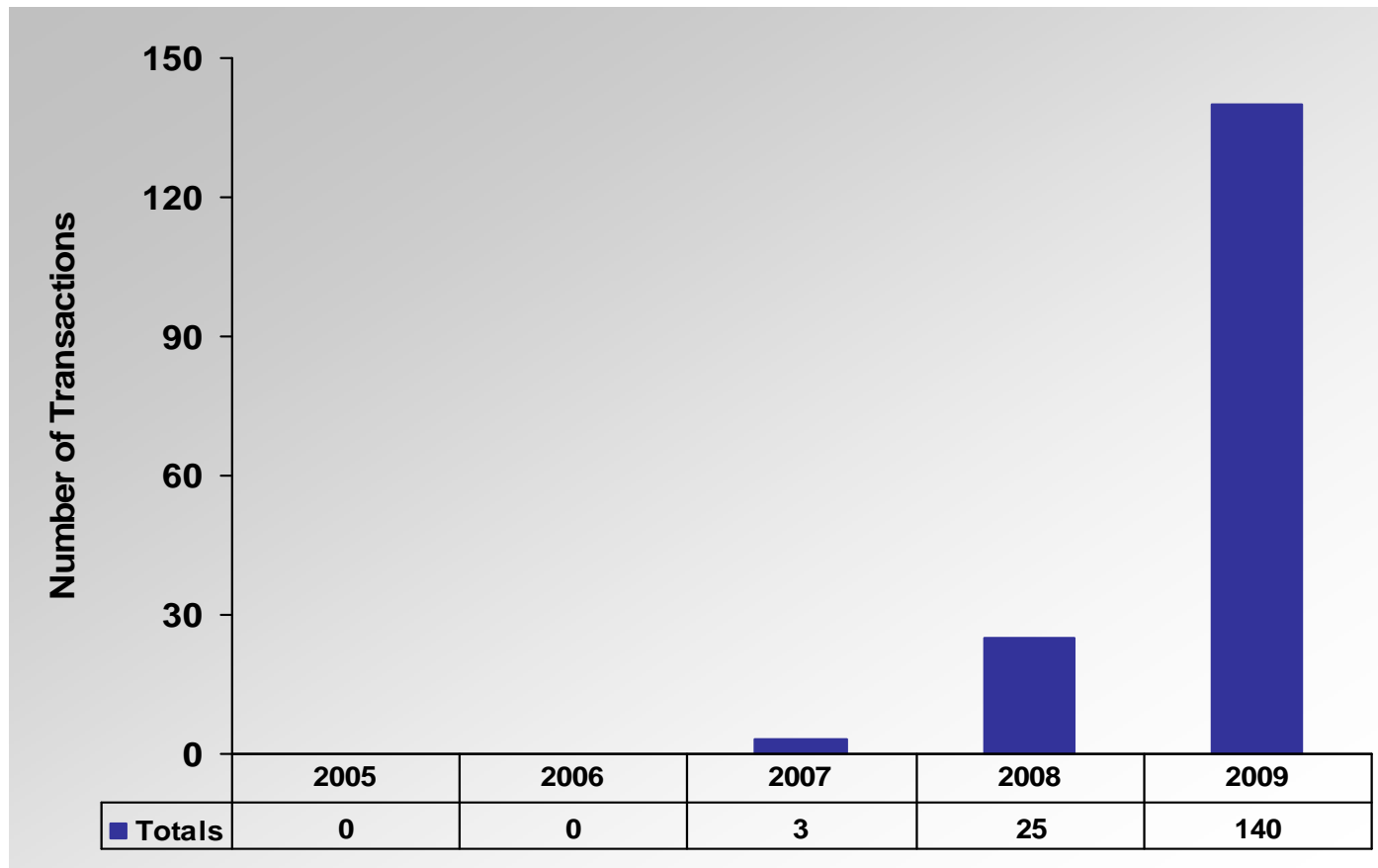
- Between 1930 & 1933, more than 9,000 of the nation's 24,000 banks failed
- FDIC created in 1933
- 18,727 banks and thrifts in 1979
- 2,912 banks and thrifts failed from 1980-1994
- 11,070 banks and thrifts in 1995

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



Source: FDIC Failures and Assistance Transactions.

Total Failures (Banks and S&L's) 2005 - 2009



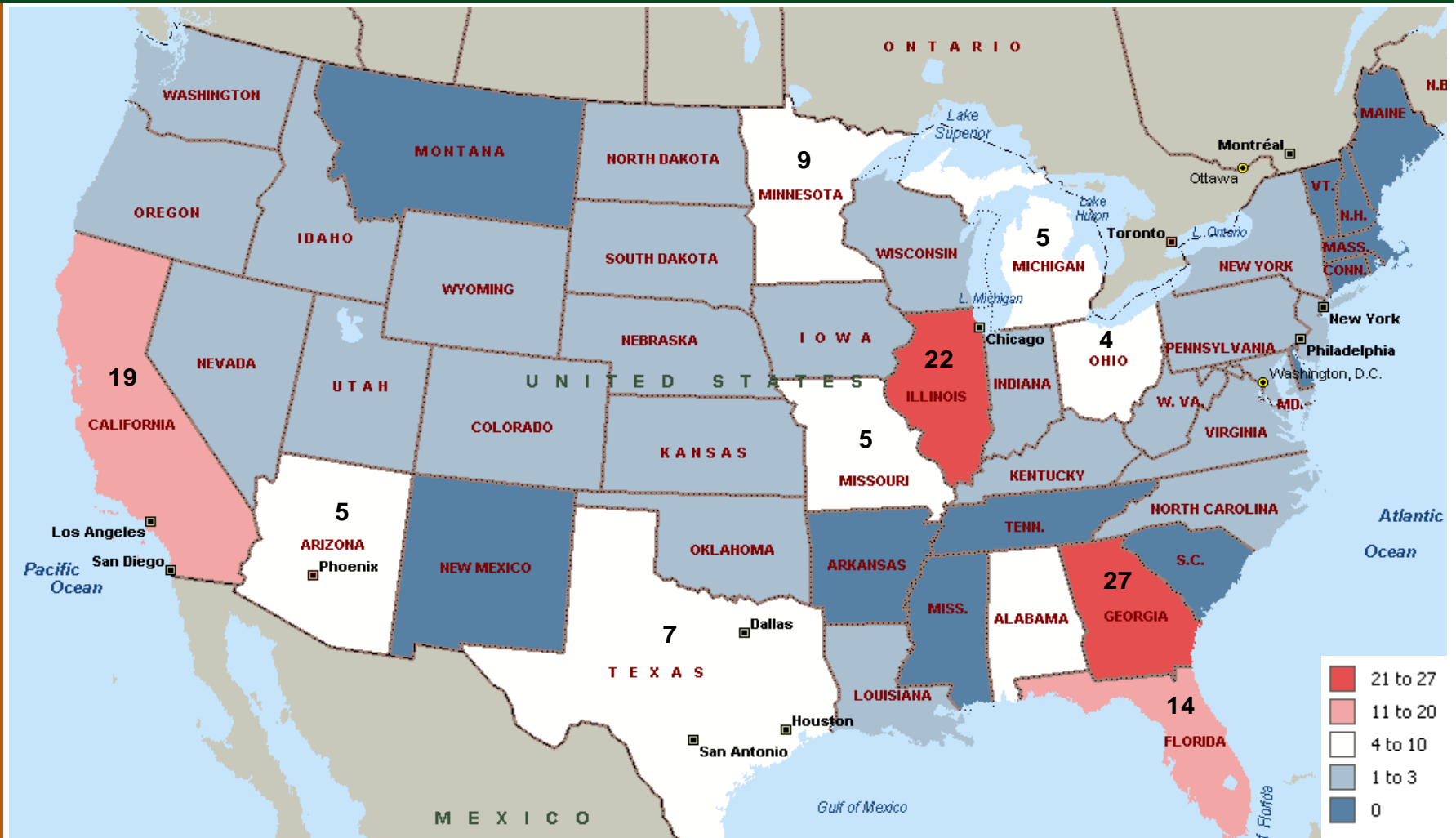
Source: FDIC Failures and Assistance Transactions.

2009 Failed Bank Transactions Asset Discount and Deposit Premiums

Assets at Failed Bank	# of Transactions	Median Asset Discount	Median Deposit Premium
More than \$10 Billion	6	8.5%	0.00%
\$1 - \$10 Billion	14	12.6%	0.00%
\$500 Million - \$1 Billion	15	12.2%	0.27%
\$250 - \$500 Million	18	11.9%	0.40%
\$100 - \$250 Million	34	12.3%	0.43%
Less than \$100 Million	<u>24</u>	<u>11.8%</u>	<u>0.10%</u>
All	111	11.9%	0.20%

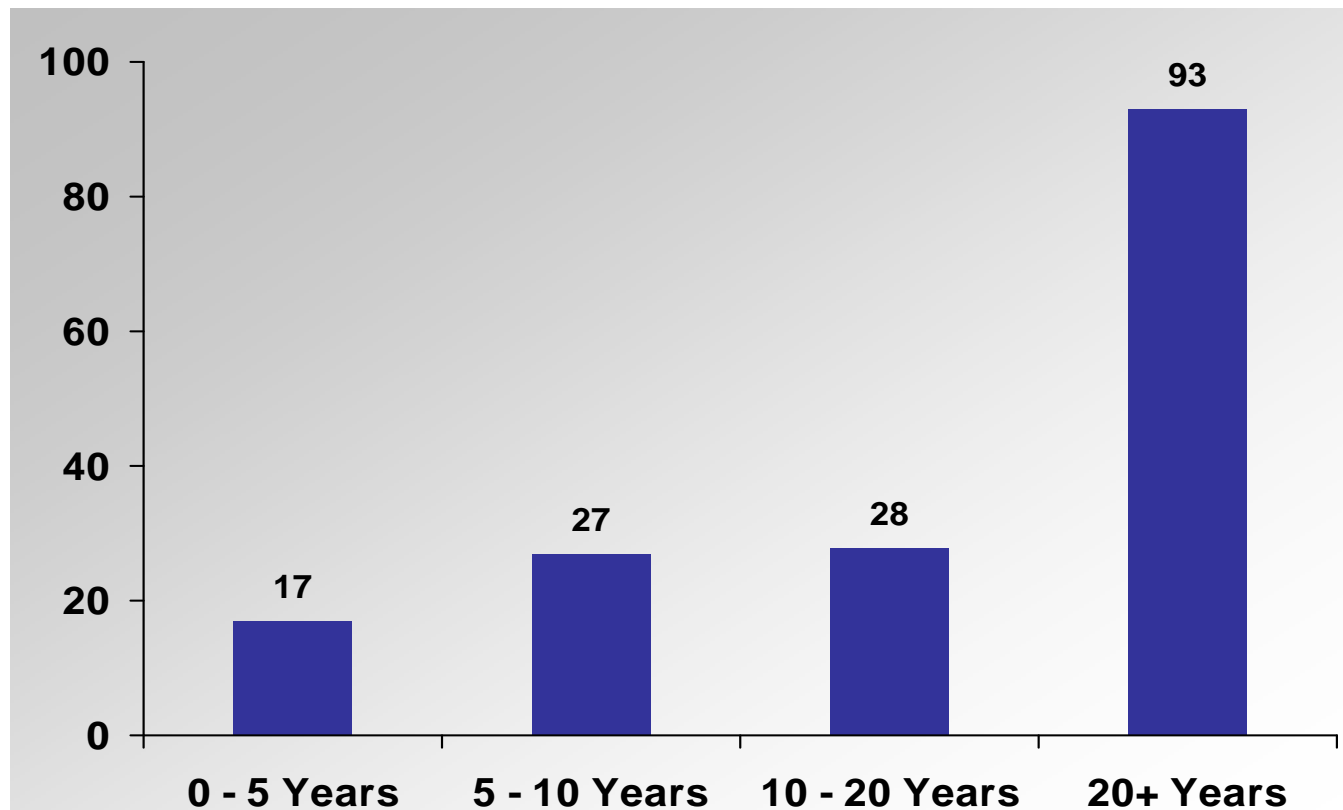
Note: # of transactions include only transactions with pricing information and combines bank failures in which one Buyer bought several subsidiaries.

2008 & 2009 Failures by State



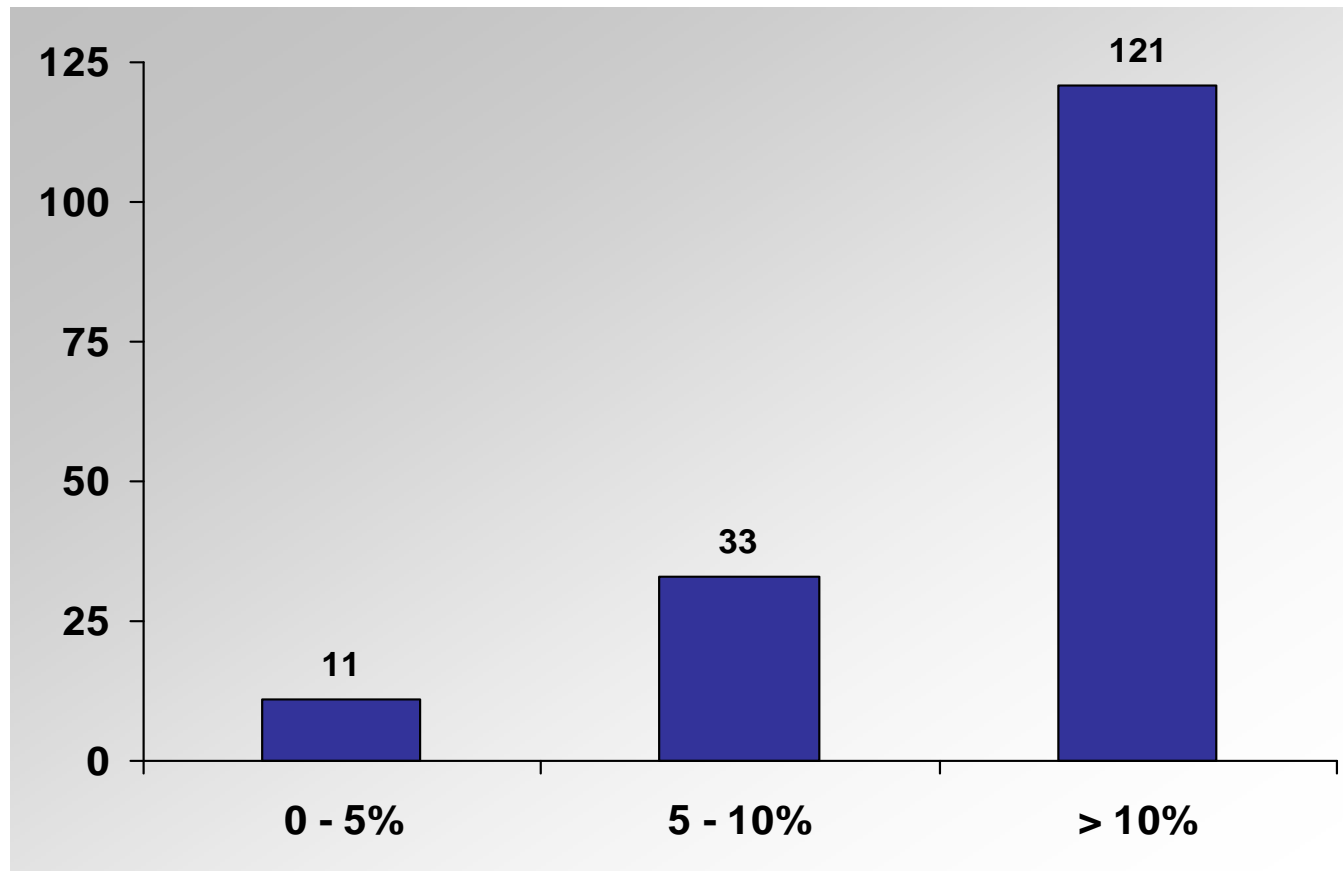
2008 & 2009 Failures by Age

(based on establishment date & date of failure)



As % of all banks in age group	0 - 5 Years	5 - 10 Years	10 - 20 Years	20+ Years
	2.2%	4.4%	4.0%	1.3%

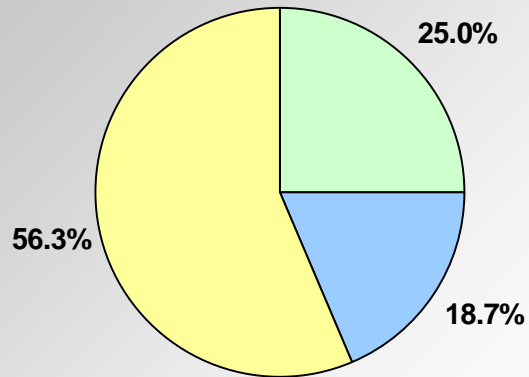
2008 & 2009 Failures by NPAs/Assets



*Based on NPAs/Assets of most recent quarter before failure.

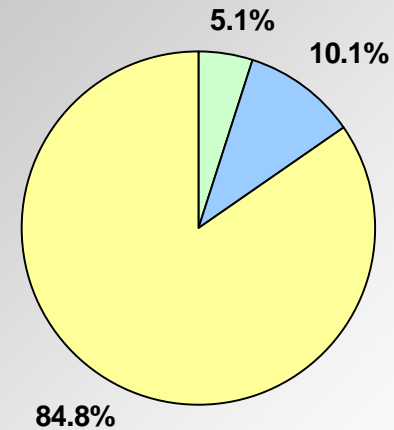
2009 Failures by Loan Mix

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
YTD 09/09 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.

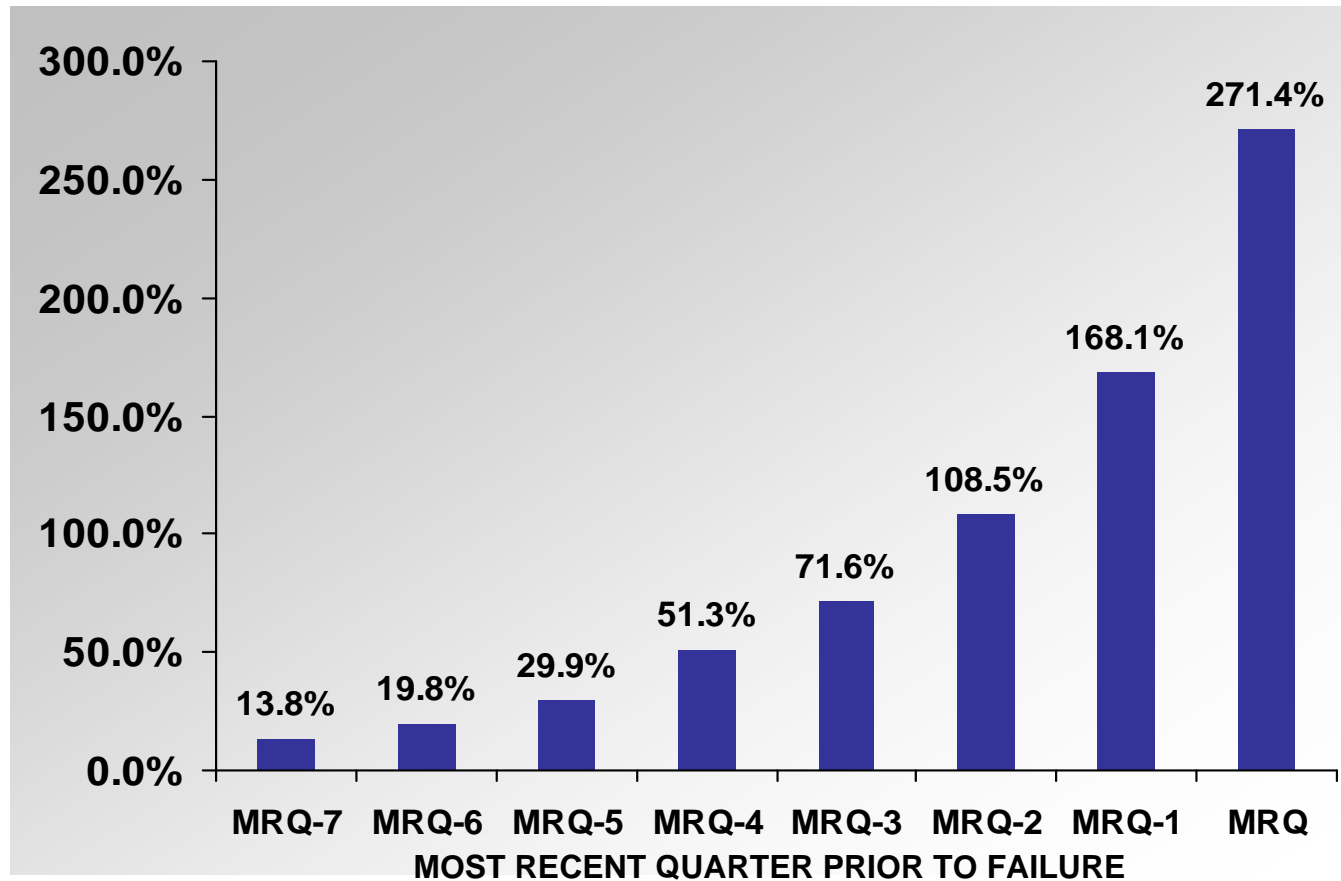
Other CRE Guidance Loans = Non-Owner Occupied CRE Loans + Multifamily + Unsecured CRE Loans.

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

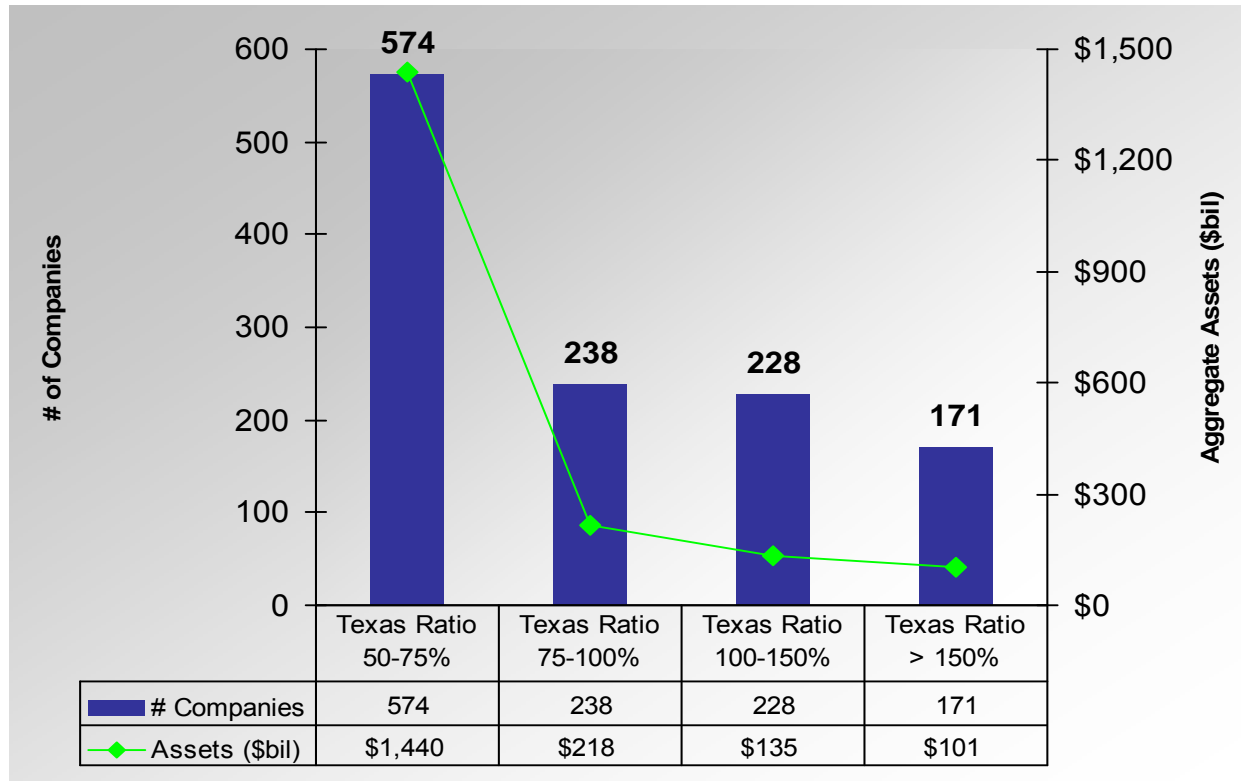
Source: SNL

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



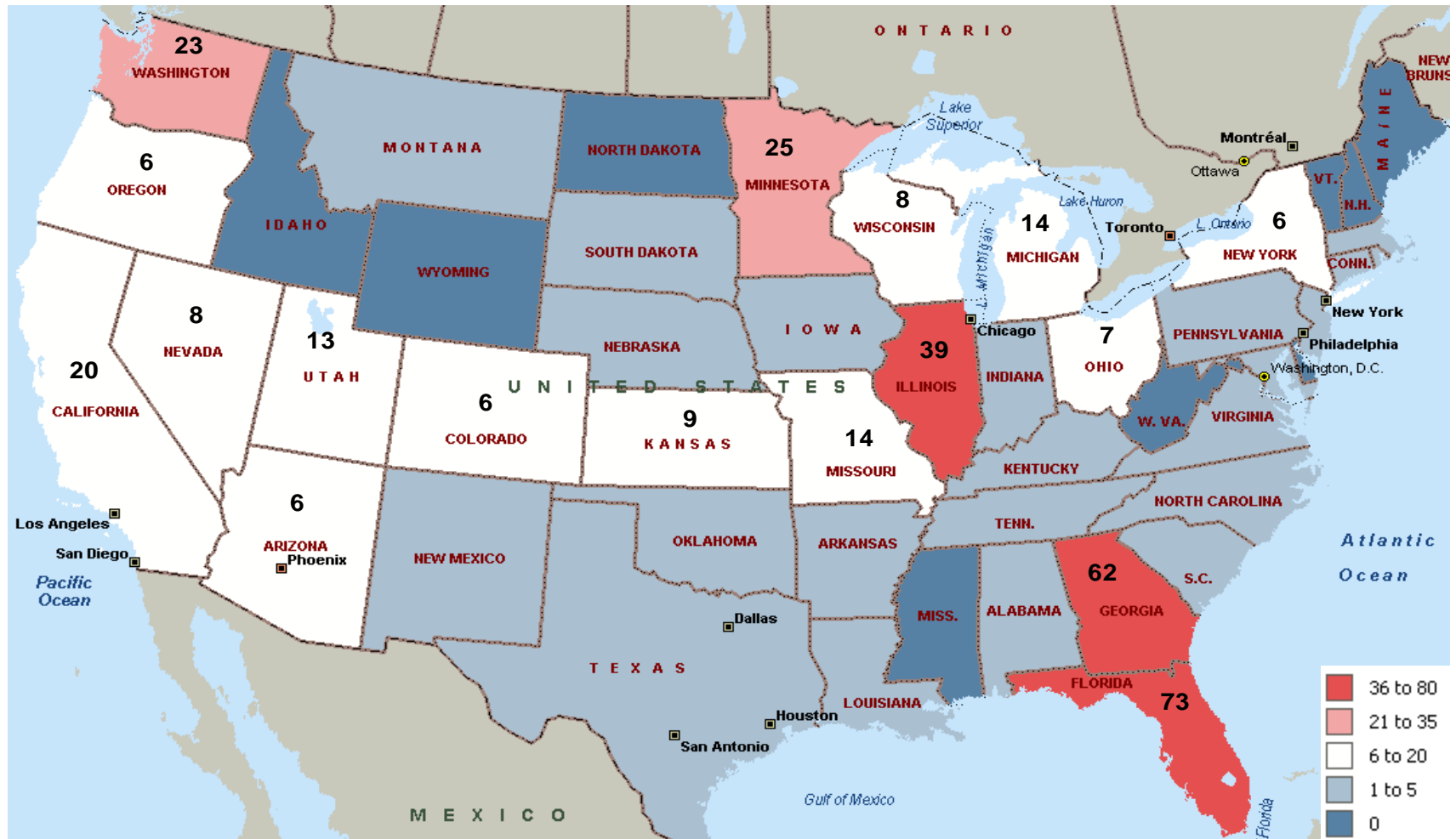
*Texas Ratio: $\text{NPAs} + 90\text{Days PD} / (\text{Tangible Equity} + \text{LLR})$.

Texas Ratio Industry Data as of 9/30/09



Note: Based on operating commercial banks, savings banks and savings institutions as of 01/04/2010.

Texas Ratio > 100% By State (9/30/09 Data)



Total Banks with Texas Ratio > 100% @ 09/30/09 = 399

Interested in Becoming a Bidder for a Failed Bank

- Register with FDIC (www2.fdicconnect.gov)
- Establish your own failed bank team
- Determine what you want (size, product mix and geography for a target, 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.)
- Know total asset size and geographic criteria (e.g., you must have double core deposits of failing bank or higher if not in your market, etc.)
- Be ready and able to react quickly

Private Equity Acquirers

- Goal to attract non-traditional investors, with appropriate safeguards
- Regulations require adequate capital, stability in management, prudent lending and business strategies
 - Capital support – 10% leverage ratio first three years
 - Cross guarantees – apply if 80% owned by common investors
 - Transactions with affiliates – new extension of credit prohibited for 10%+ investor
 - Continuity of investment – three-year holding period requirement

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 |

The Resolution Process

- FDIC has “virtually complete responsibility for resolving failed federally insured depository institutions” with “expansive powers to ensure the efficiency of the process”
- Least cost test
- We won – now what?
- Assemble your team (public relations component of team very important now)
- Sign P&A Agreement (know excluded assets because you own the rest)
- Be ready to assemble your team on site for Black 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

Priority of Payment

- 1st Administrative expenses of FDIC
- 2nd Insured Depositors
- 3rd Other general/senior liabilities
- 4th Subordinated obligations
- 5th Shareholders are last in line and nothing is left

Legal Issues

- Anti-Injunction 12 USC 1821(j)
- Stay of remedies 12 USC 1821(e)(13)(C)(i)
- Side agreements 12 USC 1823(e)
- Contract repudiation/enforcement 12 USC 1821(e)(1)
- Removal 12 USC 1819(b)(2)(B)
- Exemptions 12 USC 1821(b)
 - State and local taxes levy, garnishment, attachment or foreclosure
 - Penalties or fines
- Improperly documented agreements unenforceable 12 USC 1821(e)

Failed Bank Deal Structures

- P&A (Purchase of Assets and Assumption of Liabilities)
- Deposit Payoff
- Open Bank Assistance (“OBA”)
- 2009 Failed Bank Structures
 - P&A All Deposits with Loss Share 90
 - P&A All Deposits without Loss Share 36
 - P&A Insured Deposits Only without Loss Share 2
 - Deposit Payout 11
 - Insured Deposit Transfer 1

Failed Bank Deal Structures

- Deposit payoff
 - No bidders, or
 - Discount on assets is so great that a payoff is the “least cost alternative”
 - FDIC pays off depositors directly
- Open bank assistance
 - 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
- Bridge bank
 - Temporary bank created by FDIC to facilitate a resolution

Failed Bank Deal Structures

Practically speaking . . . there are 2 basic structures to acquire a failed bank...

...and both are P&A transactions

- Straight P&A with no loss sharing
 - 36% of 2009 bank failures
- P&A with loss sharing
 - 64% of 2009 bank failures

Straight P&A

- Assume deposits (all or insured deposits only)
- Purchase assets (optional loan pools)
- Bid Amount:
 - Deposit Premium
 - Discount Bid for Loans/Assets
 - Depending on deal structure, bid form may ask for a combined Bid Amount
- Reconcile cash at closing
- Option to purchase banking premises at “fair market value”

Settlement Statement

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

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

P&A Transaction - The Legal Document

- P&A Agreement
- Generally not negotiable
- Key legal terms
- Key legal risks

P&A with Loss Sharing Agreement

Loss Sharing Framework

- “First Loss Tranche” – typically zero
- “Stated Threshold” – a specified dollar amount by FDIC (has tended to equal about 25% of loans purchased)
- 80% of losses covered up to the Stated Threshold
- 95% of losses covered in excess of Stated Threshold
- Loss share typically extends for 5 years on non-single family loans and 10 years on single family loans

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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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

Accounting Considerations

- Statement of Financial Accounting Standards No. 141R, Business Combinations (SFAS 141R)
- Acquisition date and post-acquisition date issues
- 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	<u>921</u>	
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
<p>FDIC Stated Loss Threshold as a Percent of estimated Covered Assets = 25.44%</p>				

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	
(\$ in millions)	
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's 3Q09 Results

	<u>06/30/09</u>	<u>09/30/09</u>	<u>12/31/09</u>	<u>% Change</u>
Assets	\$3,783	\$7,259		91.9%
Equity	\$446	\$671		50.4%
Capital Raise ⁽¹⁾		\$98		
Net Income	\$1	\$226		
EPS	\$0.01	\$4.38		
Tangible BVPS	\$6.61	\$10.48		58.5%
Market Price	\$7.50	\$12.00	\$14.56	94.1%

(1) FFBC issued 13.8 million shares at \$7.50 in June 2009; net proceeds = \$98 million

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

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