



Financial Institutions M&A Webcast Series:

The Transaction: Accounting, valuation and corporate governance considerations

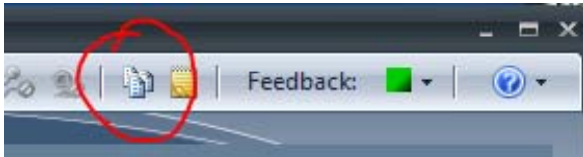
June 20, 2013



Assurance ■ Tax ■ Consulting

Housekeeping

- Today's webinar will last for approximately 60 minutes
- To submit questions, please type them into the "Q&A" box
- Each participant will receive a link to the recording of today's presentation and the PowerPoint slides via email
- Today's PowerPoint presentation may be downloaded by clicking the "sheets of paper" icon in the upper right of your screen



- Additional webcast topic and timing:
 - **August 1, 2013:** 100 days to success: Integration and growth

Today's Financial Institutions Panel



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Agenda

Today we will be discussing:

- Accounting considerations for transactions
- Valuation considerations given the transaction accounting
- Corporate governance considerations to consider following a transaction

Accounting Considerations

Overview

A. Purchase consideration paid

- Cash, debt, and/or stock
- Non-contingent and contingent
 - Measured at acquisition date fair value

B. Net assets acquired at acquisition date fair value

C. Goodwill = A less B

■ Acquisition costs

- Must be expensed when incurred
- No capitalization of or netting against purchase consideration

Goodwill

- Excess of consideration paid $>$ net fair value of identified acquired assets (tangible & intangible) and liabilities assumed
- Provisional 1 year period
 - Acquisition date matters only
 - Restate acquisition period financials for final fair value marks
- Bargain purchase gain
 - Consideration paid $<$ Fair value of net assets acquired
 - Expected occurrence is rare
 - Recognized through earnings
 - Regulatory capital inclusion – May or may not be allowed
 - FDIC assisted acquisitions
 - Indemnification asset

Sample Bank Acquisition Assumptions

Sample bank asset size (\$000s)

\$ 2,000,000

Target bank asset size (\$000s)

\$ 500,000

Consideration paid (\$000s)

\$ 69,000

Percent of consideration from external financing

40%

Purchase Price Multiples

Price to Tangible Assets	14%
Price to Tangible Equity	132%
Price to Base Capital (@ 7%)	150%
Price to Pre-Merger Assets	3%

Target Balance Sheet

Acquisition Proforma (\$000s)

Assets	Historical	Acquisition Adjustments	Pro Forma
Cash and due from banks	\$ 45,000	\$ -	\$ 45,000
Federal funds sold	1,550	-	1,550
Securities	152,290	-	152,290
Loans & Loans Held for Sale	269,999	(2,484)	267,515
Allowance for loan losses	(4,914)	4,914	-
Net loans	265,085	2,430	267,515
Bank premises and equipment	12,150	1,215	13,365
Accrued interest and other assets	7,575	-	7,575
Other real estate owned	3,350	-	3,350
Core deposit intangible	6,750	1,789 (6,750)	1,789
Cash value of life insurance	-	-	-
Goodwill	6,250	11,990 (6,250)	11,990
Total other assets	36,075	1,994	38,069
	\$ 500,000	\$ 4,424	\$ 504,424
Liabilities and Stockholders' Equity			
Deposits	\$ 394,999	\$ 1,975	\$ 396,974
Short-term borrowings	12,500	-	12,500
Other borrowings	25,000	350	25,350
Other liabilities	600	-	600
Total other liabilities	38,100	350	38,450
	433,099	2,325	435,424
Stockholders' equity	65,151	10,185 4,914 (13,000)	69,000
Accumulated other comprehensive income	1,750	1,750 (1,750)	-
Total stockholder's equity	66,901	2,099	69,000
	\$ 500,000	\$ 4,424	\$ 504,424

Acquirer's Balance Sheet

Post Acquisition (\$000s)

Assets	Sample Bank			Proforma Target Bank			Eliminations	Pro Forma Consolidated
	Historical	Pro Forma Adjustments	Pro Forma	Historical	Acquisition Adjustments	Pro Forma		
Cash and due from banks	\$ 207,615	(41,400)	\$ 166,215	\$ 45,000	\$ -	\$ 45,000	\$ -	\$ 211,215
Federal funds sold	612	-	612	1,550	-	1,550	-	2,162
Securities	475,864	-	475,864	152,290	-	152,290	-	628,153
Investment in bank subsidiary	-	69,000	69,000	-	-	-	(69,000)	-
Total Investments	475,864	69,000	544,864	152,290	-	152,290	(69,000)	628,153
Loans & Loans Held for Sale	1,224,640	-	1,224,640	269,999	(2,484)	267,515	-	1,492,156
Allowance for loan losses	(21,554)	-	(21,554)	(4,914)	4,914	-	-	(21,554)
Net Loans	1,203,087	-	1,203,087	265,085	2,430	267,515	-	1,470,602
Bank premises and equipment	56,535	-	56,535	12,150	1,215	13,365	-	69,900
Accrued interest and other assets	17,877	-	17,877	7,575	-	7,575	-	25,452
Other real estate owned	6,665	-	6,665	3,350	-	3,350	-	10,015
Core deposit intangible	-	-	-	6,750	1,789	1,789	-	1,789
					(6,750)			
Cash value of life insurance	20,846	-	20,846	-	-	-	-	20,846
Goodwill	10,899	-	10,899	6,250	11,990	11,990	-	22,889
					(6,250)			
Total other assets	112,823	-	112,823	36,075	1,994	38,069	-	150,892
	\$ 2,000,000	\$ 27,600	\$ 2,027,600	\$ 500,000	\$ 4,424	\$ 504,424	\$ (69,000)	\$ 2,463,025
Liabilities and Stockholders' Equity								
Deposits	\$ 1,515,322	-	\$ 1,515,322	\$ 394,999	\$ 1,975	\$ 396,974	\$ -	\$ 1,912,297
Short-term borrowings	214,026	-	214,026	12,500	-	12,500	-	226,525
Other borrowings	70,684	27,600	98,284	25,000	350	25,350	-	123,634
Other liabilities	7,241	-	7,241	600	-	600	-	7,842
Total other liabilities	291,950	27,600	319,550	38,100	350	38,450	-	358,001
	1,807,272	27,600	1,834,872	433,099	2,325	435,424	-	2,270,297
Stockholders' equity	190,056	-	190,056	65,151	10,185	69,000	(69,000)	190,056
					4,914			
					(13,000)			
					1,750			
Accumulated other comprehensive income	2,672	-	2,672	1,750	(1,750)	-	-	2,672
Total stockholder's equity	192,728	-	192,728	66,901	2,099	69,000	(69,000)	192,728
	\$ 2,000,000	\$ 27,600	\$ 2,027,600	\$ 500,000	\$ 4,424	\$ 504,424	\$ (69,000)	\$ 2,463,025

Capital Ratios – Pre & Post Acquisition

	Pre-Acquisition Sample Bank	Proforma Target Bank		Post-Acquisition Sample Bank
		Historical	Pro Forma	Consolidated
Tier 1 risk weighted	12.6%	16.1%	17.1%	9.5%
Total risk weighted	13.9%	17.3%	17.1%	10.7%
Leverage	9.3%	10.8%	11.4%	6.8%

Basis Point Change in Capital Ratios

Tier 1 risk weighted	-3.12
Total risk weighted	-3.14
Leverage	-2.43

Allowance for Loan Losses to Total Loans	1.8%	1.8%	0.0%	1.4%
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Allowance for Loan Losses to Total Loans	-0.32
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Purchase Price Multiples	
Price to Tangible Assets	14%
Price to Tangible Equity	132%
Price to Base Capital (@ 7%)	150%
Price to Pre-Merger Assets	3%

“Day 2” – Accounting Considerations

- Accounting treatment
 - Pooled acquired loans (homogenous)
 - Specific loan (commercial, ag, cre, etc.)
- Performing loans
 - Accretable yield (fair value adjustment) policy election
 - Contractual cash flows (ASC 310-20)
 - Expected cash flows (ASC 310-30)
- Loans acquired with deteriorated credit quality
 - Nonaccretable & accretable discounts
 - Accounting definition of “impaired loan”
 - No longer considered impaired as long as borrower performance supports “Day 1” acquisition cash flow assumptions
 - Regulators will still consider the loans to be impaired
 - Subsequent impairment = “Day 2” allowance

Business Combination Guidance

- McGladrey's *"A Guide to Accounting for Business Combinations – Second Edition"*:
 - <http://mcgladrey.com/Accounting-Publications/A-Guide-to-Accounting-for-Business-Combinations-Second-Edition>

Valuation Considerations

Valuation considerations

- Assets to be valued include:
 - Investments
 - Loan portfolio
 - OREO
 - Core deposit intangible
 - Favorable/unfavorable leases
 - Other intangibles – non-competes
 - Fixed assets – real estate, equipment, etc.
 - Indemnification asset (Loss share receivable)
- Liabilities to be valued include:
 - Time deposits
 - FHLB advances and other borrowings
 - Trust preferred securities
 - Contingent consideration (earn-outs)

Valuation - Loan Portfolio

- Discounted cash flow method – present value projected cash flows at a risk-adjusted discount rate
- Projected cash flows incorporate:
 - Terms of loans
 - Prepayment expectations
 - Probability and timing of default
 - Loss given default/Loss severity
 - Recovery period from time of default
- Discount rate
 - Incorporates current market conditions and interest rate market
 - Considers liquidity and other risk factors inherent in projected cash flows

Valuation - Core Deposit Intangible

- Discounted cash flow method
- Value by category of deposit (DDA, NOW, MMDA, Savings)
- Analyze historical retention rates by deposit type to use as a proxy for future retention, however other factors should be considered
- Compare actual net costs of core deposits to cost of replacement funding (FHLB advances, time deposits)
- Present value projected cost savings at a risk-adjusted discount rate to calculate value

Corporate Governance Considerations

Corporate Governance Considerations

- Board considerations
 - Review of board charters
 - Review of board member bios
 - Understand committee structure
 - Evaluate management's integration plan
- Senior management considerations
 - Identification of risk assessment/monitoring activities in each organization
 - Identification of key risk areas that should be monitored during integration
 - Development of integration plan to maximize enterprise risk management efforts

Corporate Governance Considerations

- Risk committee
 - Dodd Frank Wall Street Reform and Consumer Protection Act
 - Generally publically traded bank holding companies with \$10 billion or more in assets
 - Publically traded non-bank financial companies supervised by the Federal Reserve

Corporate Governance Considerations

- Risk assessment/monitoring activities
 - Enterprise risk management (ERM)
 - Regulatory compliance
 - Internal audit
 - Loan review
 - Sarbanes-Oxley assessments
 - Other

Contact us

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