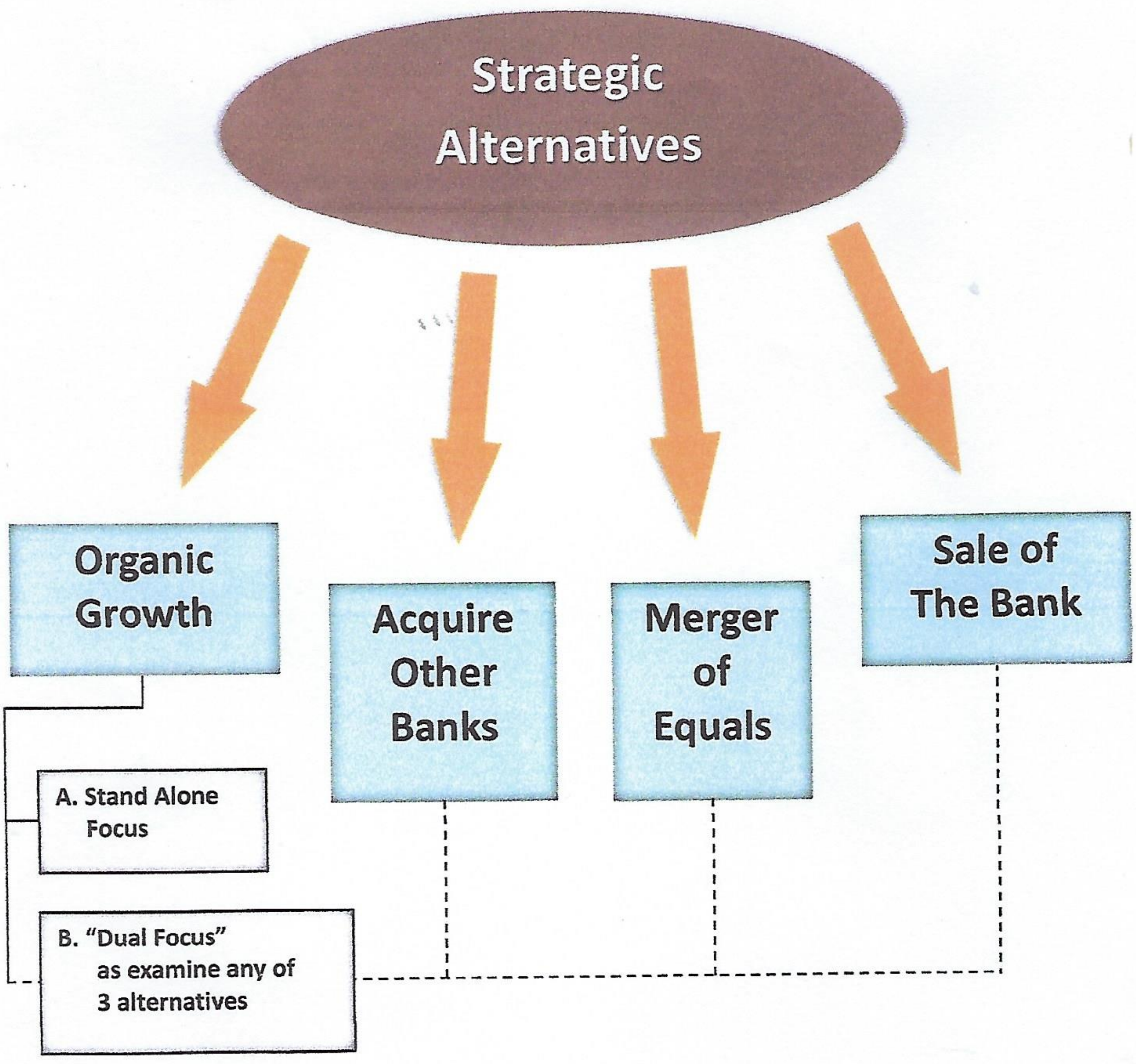
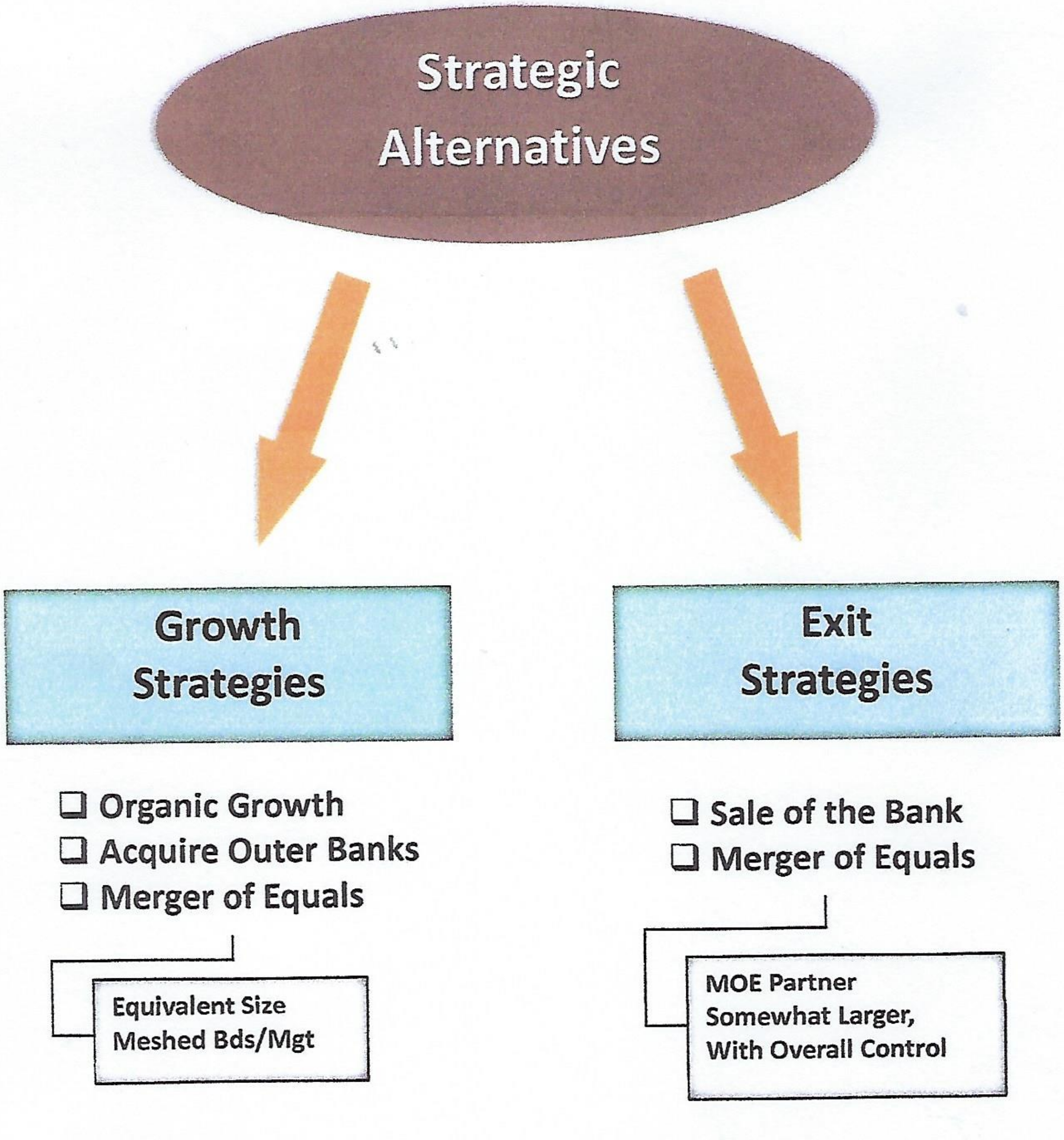
Community Banking, 2022

Four Primary Strategic Alternatives



Community Banking, 2022

Four Primary Strategic Alternatives
"Growth vs. Exit"



Strategic Alternative: "Organic Growth"

Theoretically:

. With *right conditions* present, should create value via:
. improved loan and deposit mix
. improved profitability
. concentration of assets and deposits in attractive markets
. significantly smaller investments than an acquisition
. de novo growth, including branch purchases and/or loan production offices

. May require specific investments to remain competitive

. Possibly the best strategy *if* a bank's profitability and financial condition are expected to improve materially

. Not dependent upon other parties (as in Acquisition or Merger of Equals)

Risks:

. *Strategic Planning process* does not receive regular, laser focus and there is failure by management to EXECUTE bank's STRATEGY via select number of key goals, each with detailed tactical actions

. Do CEO/board have willingness, drive and budget to overhaul customer- facing and back office technology?

. May take years to reach critical mass

. Today, following an 'organic growth-only' strategy doesn't overcome real world of low interest rates, declining NIM/earnings, loan concentration challenges, regulatory costs

. Success is highly dependent on 'growing and/or recruiting' "A-Level" management talent
. banks have primarily turned to competitors to ID/recruit "A" lending talent TEAMS
. community banks have cut/reduced internal training & are not as liberal in support of GOOD external training
. beware the evidence: banking is no longer viewed as 'hot' industry by Millennials

. Core deposit growth takes time/effort (much more difficult than loan growth)

. May require additional capital (IT upgrades, digital focus, additional branches)

. While generally assumes smaller investment than a merger transaction, this strategic alternative still carries significant 'execution risk'
(stated another way: 'headwinds of going it alone')

Strategic Alternative: "Acquisition"

Theoretically:

ALL IN ALL, opportunity for a bank < $1b to ACHIEVE SCALE
Generally, larger banks are perceived to be more valuable according to indicators of open market trades of bank stocks and in bank merger pricing

. GOOD *if*:
. truly a strong strategic and cultural fit... priced right... creates additional shareholder value... increase in EPS and increased growth in TBV/share... helps achieve wider strategic goals and sustainable growth BEYOND just creating bigger balance sheet

. There may be acquisition *whole bank* or *branch(es)* 'targets' within Bank's market area

. Could provide opportunity to strengthen current/next generation of leadership

. *"Could offer opportunity to identify a strong, strategic partner to create a TRANSFORMATIONAL DEAL (where target bank is ~ 35-40% the size of acquiring bank with potential to significantly move the needle, leveraging operating expenses, new products, risk management, funding and asset generation)"*
From: *Bank Director* Magazine, 1Q15

. Could provide additional capital for offensive or cushion purposes

. Could add additional 'lines of niche businesses' to an expanded organization

. Challenge: 'could' set bank back in terms of technology capabilities: all time dedicated to uniting two back offices is time that IT staff isn't working on building better digital experience for customers

. Challenge: for successful integration, company must expend substantial resources to integrate acquired bank A failure to integrate an acquired bank may adversely affect the bank's results of operations/financial condition

. Requires greater investment (cost) than de novo branching/opening loan production offices

. Could provide greater liquidity for stock (if stock)

THREAT: Cybersecurity Risk
In general and especially during acquisition's operational merger/core systems conversion when may be more vulnerable to outside hacking

Andy's Experience with Community Banks Following This Strategy:

. It is important to 'engage' federal and state regulators so they are aware this strategic alternative is being considered, can offer feedback and can review 'stress testing' of the combined banks that supports an acquisition

. Expect regulators to closely observe 'execution' of deal...
with 'x' period of time to pass before there is willingness to approve any additional acquisition

. Many acquisitions are poorly managed. Why? Lack of attention to DETAILS

. Often, there is insufficient *pre-deal* and *post-deal* integration planning

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Strategic Alternative: "Acquisition", continued
Key Considerations:

. **"Six Golden Rules in Deciding on an Acquisition"**
"Connecting the Dots", John Chambers, 2018
. acquiree must align with acquiror's vision and strategy
. focus on technology disruptions
. create win-win for both companies... leaders, investors, employees, customers
. prioritize acquisition targets that FIT
. look for strong cultural match
. geographic proximity to hdqtrs is important to how you keep employees engaged

. Establish 'tests'/parameters which any acquisition should meet. Examples:
. less than 10% dilutive to TBV
. immediately accretive to EPS, excluding merger charges
. less than 5 yr payback and IRR of at least x%

. Perform proper due diligence (across the organization) BEFORE arriving at opinion of value

. Acquisition *could* increase acquiring bank's "risk" as viewed by shareholders/investors
('Acquisition Risk' relates to potential increased operational, cultural, customer and financial risk)

. Will the combined organization have *real* and *perceived* 'value'?
(shareholder value and franchise value)

. Existing shareholder dilution: for 'acquisition' to be superior strategy, need to overcome dilution and produce a higher 'future share' value than a 'sale' strategy

" 5 Questions Directors Should Ask About Acquisitions"
Bank Director Magazine, 1Q15
#1: what impact does this have on our shareholders?
#2: what is rationale for doing this deal, strategic or otherwise?
#3: how will this impact our bank?
#4: what kind of due diligence has been done (or needs to be done)?
#5: what are the integration challenges we will face?

"During an *acquisition due diligence*, look at history of *deposit mix* in addition to loan mix and model what % is likely to migrate into other categories."
Banc Investment Daily, PCBB, April 8, 2015

"Top Reasons to Pursue Acquisition Strategy" *Bank Director* Magazine, 2015
. increase EPS (51%)
. supplement or replace organic growth (48%)
. expand geographically (42%)
. increase market share in existing markets (40%)
. rationalize operating and/or regulatory costs over wider base (40%)

"What were the Most Difficult Aspects (of an Acquisition)?" *Bank Director* Magazine, 2015
. post-merger integration (60%)
. assessing credit quality issues at acquired bank (40%)
. negotiating the price (35%)
. cultural compatibility (34%)
. social issues (30%)
. thorough due diligence (27%)

Strategic Alternative: "Merger of Equals"

Theoretically:

. It's rare to find a *true* merger of equals, but it is an accurate description of two subjects:
#1: combination of two similar-sized banks, OR
#2: combination of one bank with a somewhat larger (1.5-2X) bank

. It is intended to create a larger, more valuable, profitable and viable combined bank

. As with 'acquisition' strategy, important to 'engage' federal and state regulators so they are aware this strategic alternative is being considered, can offer feedback and can review 'stress testing' of the combined banks that supports an MOE

. As with acquisition strategy...
. deal should set the combined bank up to achieve wider strategic goals/sustainable growth BEYOND just creating bigger balance sheet

. Generally, larger banks are perceived to be more valuable
according to indicators of open market trades of bank stocks and in bank merger pricing

. Of prime importance: leadership role of both CEOs
Odds of success improve where there is role clarity and a tight, complementary relationship

. THREAT: Cybersecurity Risk
In general and especially during merger press when e-mail/core systems may be more vulnerable to outside hacking

. Shareholders benefit from merger synergies and cost savings rather than a larger sale premium *(delayed anticipated payoff down the road)*

. Builds franchise *more quickly* than 'organic' or 'acquisition' strategies

. Success dependent upon extremely careful consideration given at earliest stages to alignment/integration of new roles by *both CEOs, boards and management*

. Success dependent upon strong alignment of cultures, business strategies, philosophies, and social issues... and success is often not evident until some period post-deal

. Usually a combined stock/cash swap
(exchange ratio is set to exchange one bank's shares for the other's... exchange ratio is intended to minimize EPS/book value dilution for both parties, but compromise is often required)

. Can create scale, efficiency, increased market cap, stock liquidity, higher legal lending limit and expanded retail franchise to serve customers

Strategic Alternative:
"Sale to a Larger Bank"

Theoretically:

. An opportunity to explore when views are that bank may enhance shareholder value more via sale than by remaining independent

. Generally, larger banks are perceived to be more valuable
according to indicators of open market trades of bank stocks and in bank merger pricing

. Sale by many community banks to larger banks is due in part to increased stress and pressure tied to regulations, costs, competition

. *STRATEGY STATEMENT (within Strategic Plan) is important:*
. if exit is desired/being actively considered, verbiage in this format effectively puts a 'for sale' sign on the bank:
"We are exploring a full range of strategic and financial alternatives to increase shareholder value."

BUT a statement like this, as part of a dual strategy (with organic growth) is more neutral:
"We will evaluate accretive opportunities that may arise and which would improve the Company's strategic position".

. This could be a good strategy if there is belief that a *specific* larger bank will perform better than your bank operating via its own existing 'organic' growth strategy
(better able to compete as part of larger organization… more products/services, economies of scale, customer convenience, brand recognition, higher lending limit)

. Sale price contingent upon:
. buyer's assessment of bank's balance sheet risk
. strategic importance to buyer (market area, size)
. anticipated synergies achieved via merger

. Not all potential acquirers have liquid, publicly-traded stocks

. May be a less risky strategy: less dependent upon future events
(ability to meet financial projections, future capital markets' conditions)

. Combined entity could, with focus, still be a 'community bank' with similar impact within *and* support from existing local communities
(many banks > $1b effectively 'act' as community banks)

.Opportunity to receive a more liquid currency:
possible future double or even triple-dip event(s)