“What a Long Strange Trip It’s Been”

Presentation for:
MBA Bank Management & Directors Conference
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BankValue Advisory Services
Today’s Agenda

• Bank Performance
  – Where are we at in the Recovery?
    • We look at performance trends sliced and diced a few different ways.
  – Size Differences at Michigan Community banks
  – High Performing Michigan Banks

• Bank Valuation Trends – Public and Private Bank Prices
“The Collapse” (September 2008)

- Fannie & Freddie placed into conservatorship; Treasury eliminates dividends
- Lehman Brothers fails
- Reserve Fund (MMMF) breaks “the buck”
- B of A acquires Merrill Lynch
- SEC bans short selling on certain stocks
- Goldman & Morgan convert to BHCs
- WAMU fails (assets acquired by JP Morgan Chase)
- FED lends $85 billion to AIG; effective conservatorship

BUT - One positive event in Michigan this month!!!
Visual Representation of the Impact of the 2008 Financial Crisis on Banking Industry...
Regional Performance
Asset Quality Getting Better…

NON PERFORMING ASSETS/ (LOANS + OREO)

Source: SNL Financial
## Texas Ratios by State

<table>
<thead>
<tr>
<th>State</th>
<th>12/31/10</th>
<th>12/31/11</th>
<th>12/31/12</th>
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<tr>
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<tr>
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<td>7</td>
<td>6</td>
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<td>Wisconsin</td>
<td>23</td>
<td>27</td>
<td>21</td>
<td>11</td>
<td>6</td>
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</table>

Texas Ratio: Total non-performing assets plus loans 90 days past due and still accruing interest/tangible equity plus the reserve for loan and lease losses

Source: SNL Financial
Profits - Not Bad, But Not That Great, Either...

RETURN ON AVERAGE ASSETS

Source: SNL Financial
Especially Considering This...

**PROVISION EXPENSE/ AVERAGE ASSETS**

With provisions this low, wouldn’t you expect earnings to be stronger?!

Source: SNL Financial
Easy Spending Cuts Have Been Made

Efficiency Ratio

Source: SNL Financial
NIM Bouncing Off The Bottom?

Michigan finally stabilizing???

Source: SNL Financial
Margin Compression Loosening?

YIELD/ COST SPREAD


Wisconsin  Michigan  Indiana  Ohio  Illinois
Loan Levels – Moving in the Wrong Direction for MI?

LOANS/ ASSETS

Source: SNL Financial
Putting Cash to Work
CASH & INT BEAR DEPOSITS/ASSETS

Source: SNL Financial
New Fed Study On Low Net Interest Income at Community Banks

• Net interest income near 40 year low, but not unusual given economic conditions

• Better than after previous severe recessions (‘73-’75, ‘81-’82)

• Due to low interest rates, “flat yield curve”, weak lending

• “Should rebound significantly as the economy improves and FRB normalizes monetary policy.”
What About Other Revenue Sources?

NON-INTEREST INCOME

Source: SNL Financial
Big Macro Trend

SERVICE CHARGES/ ASSETS

Some “Big Thinkers” Need to Get Working on This One!

Source: SNL Financial
Broad Performance Trend - Conclusions

• Asset quality continues to **SLOWLY** improve across the board.

• **Low (ZERO!) provisions** propping up earnings.

• Generally **Flat** Net Interest Margins (A positive development!)
  
  – **Loan growth** helping.
  
  – Better **asset mix** (Putting funds to work is making a difference).
  
  – Margin compressing maxed out?

• **Deposit Service Charges** waning permanently? – Look to other sources for revenue? Or, **can we charge more than we think?** Get creative!
Michigan Bank Performance: Does Size Matter?
Michigan Community Banks – Size Focus

• The “Bigs” – 8 Michigan Banks over $1 Billion

• 35 Banks $250 Million to $1 Billion
• 44 Banks $100 Million to $250 Million
• 32 Banks under $100 Million
Net Interest Margin

Typically, smallest banks have HIGHER NIMs...

Source: SNL Financial
NIM Ingredients – Cost of Funds

COST OF INTEREST BEARING FUNDS

Tough to cut rates when you know every single one of your depositors?

Source: SNL Financial
NIM Ingredient 2 – Loan Yield

Pressure to grow loan volume? Working with larger, more demanding customers?

Source: SNL Financial
NIM Ingredient 3 – Asset Mix!

LOAN/ DEPOSITS

Asset mix holding margins down.

2014L3

< $100MM  $100MM - $250MM  $250MM - $1B

Source: SNL Financial
Interest Bearing Bal/ Assets

Source: SNL Financial
Total Securities/Assets

2014L3

- < $100MM: 23.10
- $100MM - $250MM: 16.24
- $250MM - $1B: 14.94

Inches to Millimeters Conversion:
- 2310 inches = 58660 millimeters
- 1624 inches = 41280 millimeters
- 1494 inches = 38000 millimeters

< $100MM: Blue
$100MM - $250MM: Red
$250MM - $1B: Green
The Biggest Advantage of Size?

NON-INTEREST INCOME/AV. ASSETS

- Insurance,
- Trust,
- Investment,
- Res Mortgages

<table>
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<tr>
<th>Category</th>
<th>2014L3</th>
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<tbody>
<tr>
<td>&lt; $100MM</td>
<td>0.45</td>
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<tr>
<td>$100MM - $250MM</td>
<td>0.70</td>
</tr>
<tr>
<td>$250MM - $1B</td>
<td>0.71</td>
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</tbody>
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First for Your Success™
Size & Efficiency

EFFICIENCY RATIO

At Smallest Banks, the Relationship is Clear

Source: SNL Financial
In this instance, this time period...

RETURN ON AVERAGE ASSETS

- < $100MM
- $100MM - $250MM
- $250MM - $1B
Size and Performance - Observations

• Generally, the small banks have better Net Interest Margins – you better, that’s where you make your money!
  – Tough to keep deposit rates as low as you’d like due to relationships.
  – Flip side is that you tend to get better loan yields due to those same relationships.
  – Profit margin (ROAA) often boils down to the question of “How lean do you want to run?”
  – Asset mix is big factor in Michigan banks for differing NIMs.

• Larger banks have different issues:
  – There are opportunities on the revenue side, but that can be expensive to get up and running.
  – Constant need for substantial loan origination volume to offset paydowns while hitting growth targets often necessitates aggressive pricing.
  – There may be more “fat to trim” on the expense side than you realize.
Michigan’s “Fab-Five” Banks

Superior Natl B&TC
- US Branches: Current
Gogebic Range Bank
- US Branches: Current
Upper Peninsula State Bank
- US Branches: Current
Bank of Holland
- US Branches: Current
First Bank Upper Michigan
- US Branches: Current
Top Performing Banks in Michigan

• Five banks with highest ROAA over last 5+years

• Locations: 4 in U.P. and 1 in “Mitten”

• Broad size range: $64M – $716M
The Top MI Performers – Where They’re Different

Loans Yields

Yield on Loans (%)

Net Interest Margin

Net Interest Margin (%)

NPAs

NPAs/ (Loans+OREO) (%)

Leverage Ratio

Leverage Ratio (%)
...And Where “The Fab 5” Are Not So Great...

**5Yr Deposit Growth**
- 31%
- 36%

**5Yr Loan Growth**
- 12%
- 14%

**Cost - Interest Bearing Deposits**
- 0.84
- 0.57

**Noninterest Income**
- 0.76
- 1.13
The Biggest Single Factors

Balance Sheet Management
(Also more aggressive?)

Loans/ Deposits (%)

Low Overhead Expenses

Efficiency Ratio (FTE) (%)

53.22
76.51

83.90
75.51
Bank Prices, Values, M&A Activity

Wall Street, circa 2008-2009
Public Bank Returns

Micro Cap Bank Index Up 16.32%
Public Bank Returns

Micro Cap Up 16.32%

Large Cap Up 16.33%

SNL Large Cap U.S. Bank

SNL Micro Cap U.S. Bank
Public Banks – Price/Tang. Book

Large Cap Bank Index about 1.67x

Micro Cap Bank Index about 1.27x

Source: SNL Financial
Public Banks – Price/LTME

- Large Cap Bank Index about 15.2x
- Micro Cap Bank Index about 14.9x

Source: SNL Financial
M & A Trends
Long Term Trend In P/TB Ratios

Source: SNL Financial
M&A – Some Thoughts

• Some smaller banks looking for “partners”
  – Should we SELL or BUY?
• Larger community banks interested in BUYING
  – Growth
  – Perceived Value
• Valuations in some markets NOT always reflected in the data
A Few Words on Consolidation

• Nationally, the number of banks peaked at 15,814 in 1984.
• About 5,400 banks disappeared over the next five years.
• Down to 6,279 by mid 2014 (60% drop)
• 503 banks failed since 2008

What Does the Future Hold???
Total Number of Banks – US

- **S&L Crisis**
- **Tech Bubble Pops**
- **Farm Crisis**
- **Relative Stability in Numbers**
- **Financial Crisis and “Great Recession”**

Date:
- 03/01/80
- 02/01/81
- 01/01/82
- 12/01/82
- 11/01/83
- 10/01/84
- 09/01/85
- 08/01/86
- 07/01/87
- 06/01/88
- 05/01/89
- 04/01/90
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- 09/01/07
- 08/01/08
- 07/01/09
- 06/01/10
- 05/01/11
- 04/01/12
- 03/01/13
- 02/01/14
Bank Charters in Michigan

Trend Line is Flattening Quickly

- Only 42 more from 1999-2009
- 166 banks gone 1986-1995
- Financial Crisis and “Great Recession”
What’s the next stop on this “long, strange trip?”
“A thought for my fellow CEOs: Of course, the immediate future is uncertain; America has faced the unknown since 1776. It’s just that sometimes people focus on the myriad of uncertainties that always exist while at other times they ignore them. American business will do fine over time. Periodic setbacks will occur, yes, but investors and managers are in a game that is heavily stacked in their favor.

I made my first stock purchase in the spring of 1942 when the U.S. was suffering major losses throughout the Pacific war zone. Each day’s headlines told of more setbacks. Even so, there was no talk about uncertainty; every American I knew believed we would prevail. The country’s success since that perilous time boggles the mind: On an inflation-adjusted basis, GDP per capita more than quadrupled between 1941 and 2012. Throughout that period, every tomorrow has been uncertain. America’s destiny, however, has always been clear: ever-increasing abundance.
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