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Breakout 3:
**The Return of M&A:
Have the Rules of the
Game Changed?**

Tom Hayes

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Chuck Stubbs

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PRESENTATION FOR:

ACQUIRE OR BE ACQUIRED

THE RETURN OF M&A:
HAVE THE RULES OF THE GAME
CHANGED?

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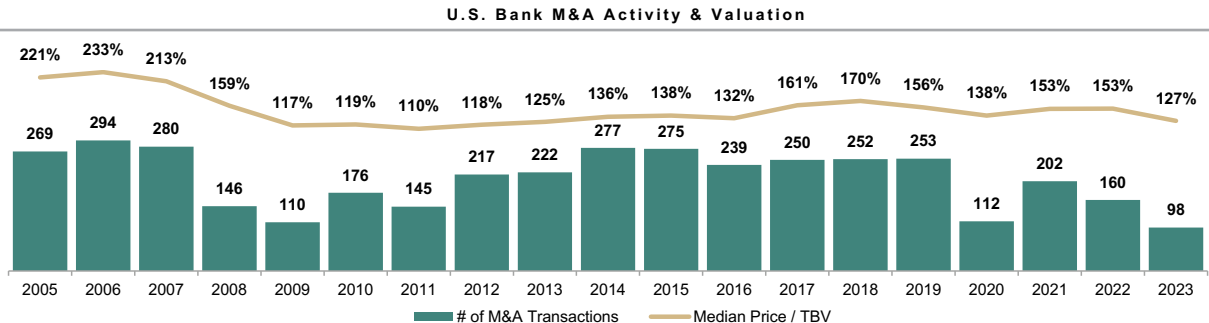
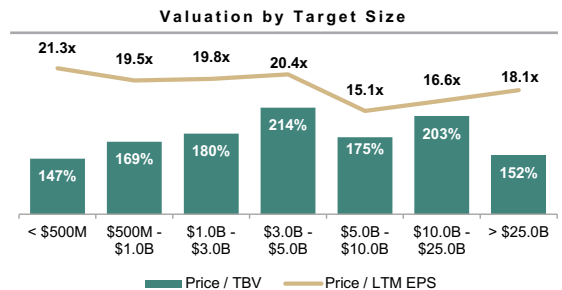
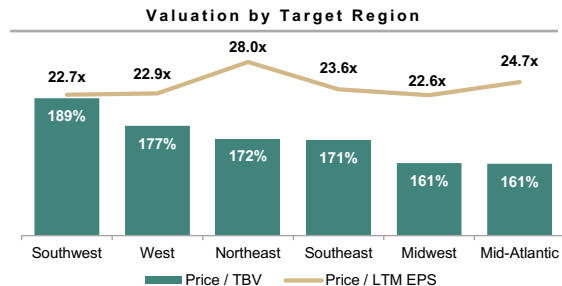
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U.S. Bank M&A Environment

- M&A activity in 2023 was down significantly from historical norms
 - Large AOCI losses and loan interest rate marks
 - Lower acquirer trading valuations
 - Difficult capital markets
 - 4 bank failures in 2023
- Acquirers are in search of scale and EPS accretion
- EPS accretion and tangible book value dilution earnback period remain key drivers of valuation for buyers
- Scarcity value through size, profitability and geography help drive premium valuations for sellers
- Core deposits are valuable again



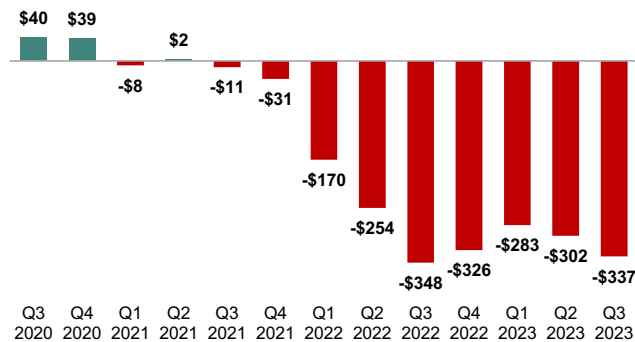
Source: S&P Capital IQ Pro, market data as of 1/5/2024
 Note: S-corp P/E multiples adjusted to reflect C-corp tax rate



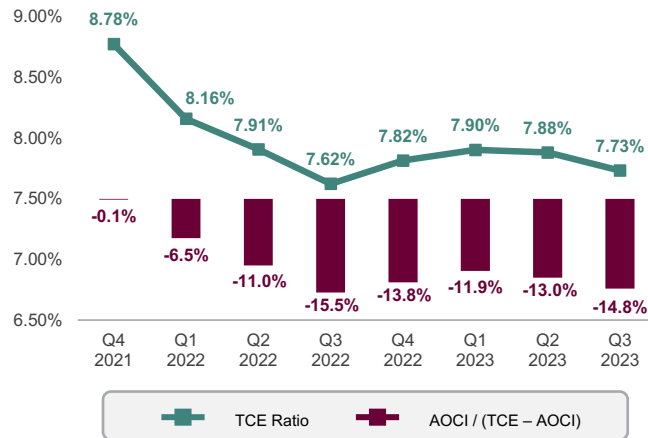
Rising Rates Have Crushed Securities Portfolios... But Help is on the Way

- Rapid rise in interest rates – eroded shareholder equity, although regulatory capital remains protected
- However, a recent rally in bond values reduced unrealized losses
- Restructurings in which certain bonds sold at a loss are being reinvested at today's higher interest rates
 - Expect lower yield investment securities to continue rolling off the balance sheet in 2024 and 2025

Accumulated Other Comprehensive Income at U.S. Banks (\$B)



TCE as a % of AOCI – Last 8 Quarters





Impact of Interest Rate Environment on M&A

- The recent rise in interest rates has impacted the reported financial metrics in M&A transactions
- Interest rate marks on the securities and loan portfolios of acquired companies have the following impacts:
 - Increased initial tangible book value dilution
 - Increased earnings accretion
 - Extended tangible book value earnback periods
 - A decrease of pro forma capital ratios at transaction closing
- A significant amount of earnings accretion is generated as a result of purchasing accounting with no execution risk

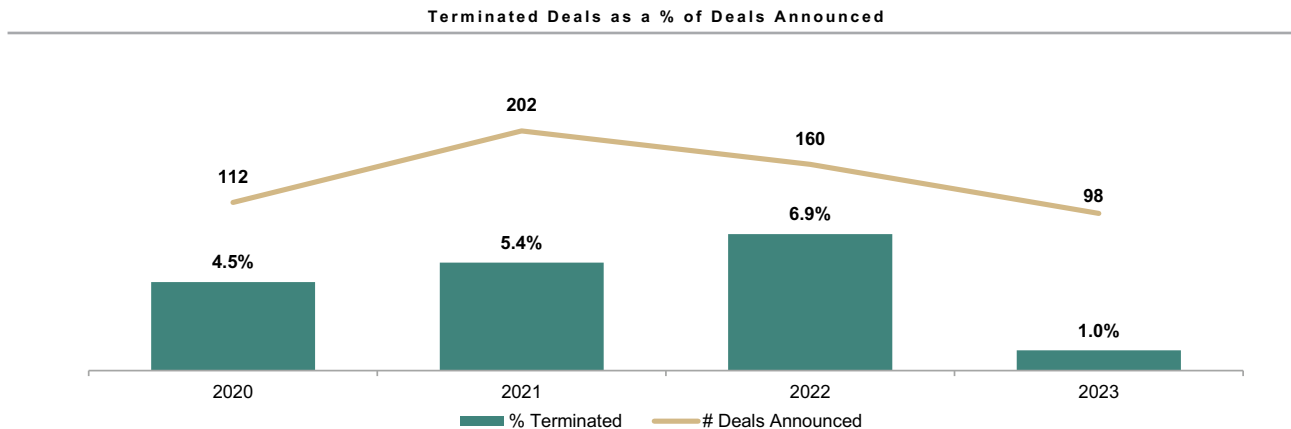
Creates significant “noise”
in pro forma financial
results

Merger Model Changes	2019	Now	Impact to Pro Forma Model	Commentary
Loan Portfolio Fair market value (“FMV”) interest rate risk	0.50% +/-	3.00% - 8.00%	<ul style="list-style-type: none"> • Day-1 decrease to TCE, which can be material • Increases earnings, as it is recaptured through earnings as accretable yield 	<ul style="list-style-type: none"> • Example – a fixed rate loan from 2021 is lower than current market rate, so the principal balance is marked down to result in higher yield
Investment Securities Unrealized losses (“AOCI”)	< 2% of equity Not a material impact	~20% of equity	<ul style="list-style-type: none"> • AOCI is eliminated, but no impact to TCE since already accounted for in GAAP Equity • Decrease to regulatory Tier-1 Capital as the add-back is now \$0 • Increases earnings, as it is recaptured through accretable yield 	<ul style="list-style-type: none"> • AOCI losses have increased significantly • With M&A accounting, the AOCI effectively becomes a realized loss • Earnings accretion viewed as subjective
Deposits Core deposit intangible asset (CDI)	1.00% to 1.50%	3.50% +	<ul style="list-style-type: none"> • Higher amortization expense, which decreases earnings 	<ul style="list-style-type: none"> • Higher CDI due to higher value of core deposits



Recent Terminated Bank M&A Transactions

- Almost 7% of bank M&A transactions in 2022 were subsequently terminated
- Issues impacting deal termination include:
 - Regulatory scrutiny surrounding acquirer’s BSA/AML capabilities
 - Pro forma capital too low
 - Material weakness in acquirer stock price since deal announcement
 - Failed holding company applications by investor groups
 - Regulators not approving acquisitions by credit unions





Revised Merger Guidelines Could Create M&A Headwinds

- On December 18, 2023 the Department of Justice and the Federal Trade Commission issued updated Merger Guidelines identifying the procedures and enforcement practices the agencies most often use to investigate whether mergers violate the antitrust laws
- The most notable changes in the updated guidelines are:
 - Lowering the HHI increase threshold in concentrated markets (HHI above 1,800) from +200 points to +100 points
 - Adding a new indicator allowing the agencies to examine pro forma market share as a gauge for market competition
 - Under the new market share indicator, a merger where the buyer has 30%+ market share on a pro forma basis, and the market HHI increases by more than 100 points, could be presumed to substantially lessen competition or create a monopoly

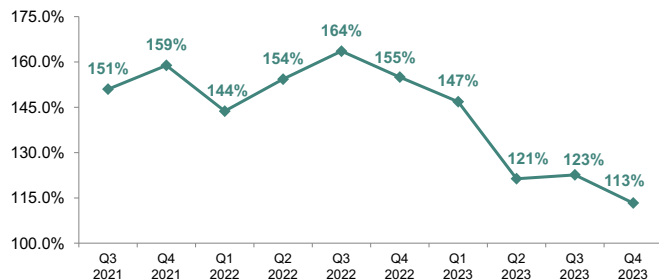
Old HHI Guidelines	
Indicator	Threshold for Structural Presumption
Post-merger HHI	Market HHI greater than 1,800 AND Change in HHI greater than 200

Updated HHI Guidelines (12/18/2023)	
Indicator	Threshold for Structural Presumption
Post-merger HHI	Market HHI greater than 1,800 AND Change in HHI greater than 100
Merged Firm's Market Share	Market share greater than 30% AND Change in HHI greater than 100

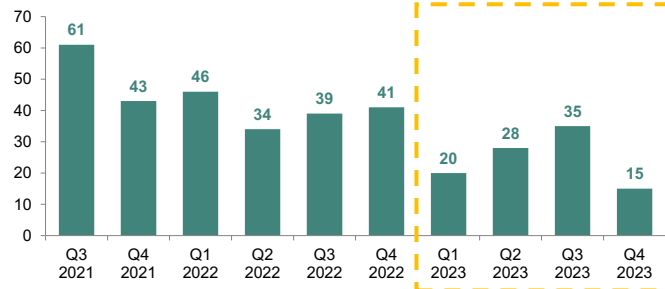


Bank M&A Activity – Last 10 Quarters

M&A Valuation – Price / Tangible Book Value (TBV)



Number of M&A Deals



Transaction Statistics – Last 10 Quarters

	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023
All Bank M&A										
Number of Deals	61	43	46	34	39	41	20	28	35	15
Price/TBV	151%	159%	144%	154%	164%	155%	147%	121%	123%	113%
Price/Earnings	13x	15x	18x	14x	14x	13x	10x	12x	17x	9x
# of Deals by Price/TBV										
Price/TBV 100-150%	13	6	8	4	3	5	2	4	8	4
Price/TBV 150-200%	15	9	7	8	5	9	2	0	3	1
Price/TBV 200-300%	0	0	1	2	4	1	0	0	0	0
Seller \$2B - \$5B Assets										
Number of Deals	4	3	0	0	1	2	1	0	2	2
Price/TBV	158%	183%	NM	NM	216%	156%	NM	NM	150%	110%
Price/Earnings	13x	11x	NM	NM	23x	11x	NM	NM	10x	9x
Seller \$500M - \$2B Assets										
Number of Deals	11	8	13	12	8	10	4	1	5	3
Price/TBV	154%	159%	151%	169%	164%	155%	147%	147%	115%	110%
Price/Earnings	11x	16x	14x	15x	14x	14x	10x	10x	14x	9x

Source: S&P Capital IQ Pro, as of 1/5/2024
 Note: Median data, Announced since 9/30/2021
 Note: Excludes FDIC-assisted transactions



Impact of Tangible Book Value Dilution in Recent M&A – Largest 10 Deals in 2023⁽¹⁾

- Tangible book value dilution is a large focus for investors when looking at M&A deal announcements – investors are comfortable with a 3.0-year earnback or less
 - Majority of deals announced in 2023 landed around a 2.5-year earnback

Announced: Dec. 12, 2023 ⁽²⁾	Announced: Oct. 26, 2023 ⁽²⁾	Announced: Oct. 10, 2023 ⁽²⁾	Announced: Sept. 27, 2023 ⁽²⁾	Announced: Sept. 19, 2023 ⁽²⁾
TBV Dilution: -20.9%	TBV Dilution: -1.8%	TBV Dilution: -18.7%	TBV Dilution: -11.3%	TBV Dilution: -7.5%
TBV Payback: 2.6 years	TBV Payback: 2.0 years	TBV Payback: 2.4 years	TBV Payback: 2.4 years	TBV Payback: 2.8 years
Buyer 5-Day Perf.⁽³⁾: 11.6%	Buyer 5-Day Perf.⁽³⁾: -0.2%	Buyer 5-Day Perf.⁽³⁾: 13.1%	Buyer 5-Day Perf.⁽³⁾: -6.3%	Buyer 5-Day Perf.⁽³⁾: -3.6%
<hr/>				
Announced: Aug. 24, 2023 ⁽²⁾	Announced: July 25, 2023	Announced: July 25, 2023 ⁽²⁾	Announced: March. 21, 2023	Announced: Feb. 22, 2023
TBV Dilution: -12.7%	TBV Dilution: Accretive	TBV Dilution: -9.7%	TBV Dilution: -7.7%	TBV Dilution: -14.0%
TBV Payback: 1.2 years	TBV Payback: Accretive	TBV Payback: 3.0 years	TBV Payback: 1.9 years	TBV Payback: 2.7 years
Buyer 5-Day Perf.⁽³⁾: -1.2%	Buyer 5-Day Perf.⁽³⁾: -4.9%	Buyer 5-Day Perf.⁽³⁾: -2.7%	Buyer 5-Day Perf.⁽³⁾: -2.0%	Buyer 5-Day Perf.⁽³⁾: -0.8%

Source: S&P Capital IQ Pro, publicly filed Investor Presentations, market data as of 1/5/2023

(1) Largest 10 deals by aggregate deal value, excluding deals where TBV dilution detail was not disclosed

(2) Indicates transaction is pending

(3) 5-Day relative performance versus the S&P U.S. BMI Banks Index

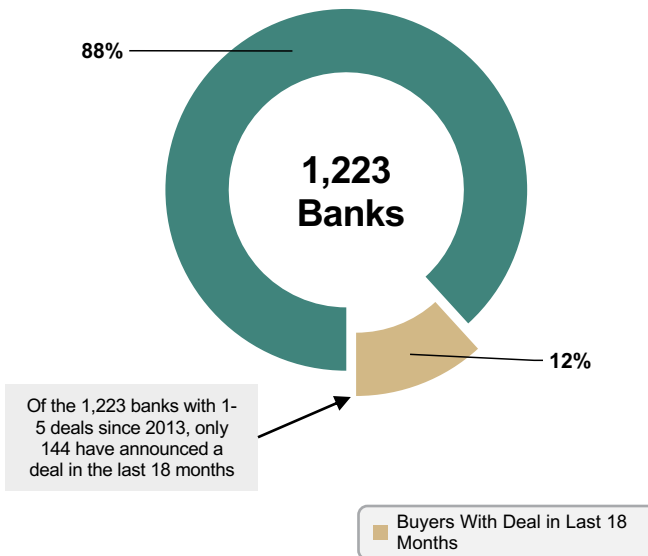


Serial Acquirers on the Sidelines

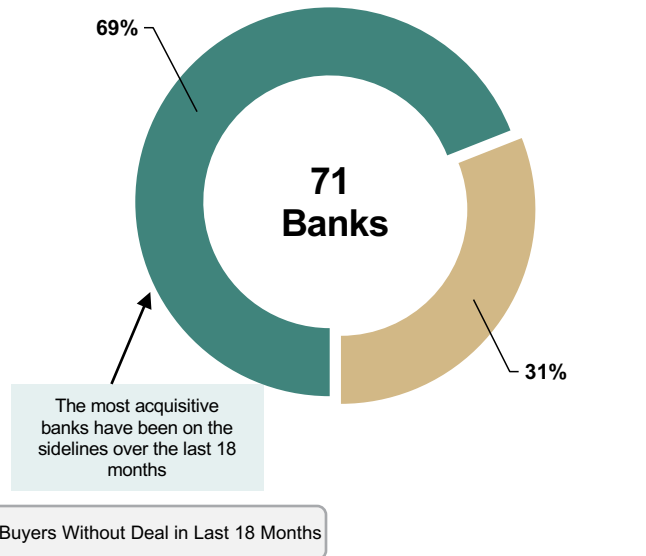
- There is pent-up demand for deal making from the most acquisitive banks
- Since 2013, 71 buyers have announced 5 or more deals, however, only 22 of these buyers have announced a deal over the last 18 months

Buyers With	Deals Since 2013		
	# of Buyers		
	Since 12/31/2012	Since 7/1/2022	% of Total Buyers
1 - 5 Deals	1,223	144	12%
5 + Deals	71	22	31%

Buyers With 1-5 Deals Since 2013



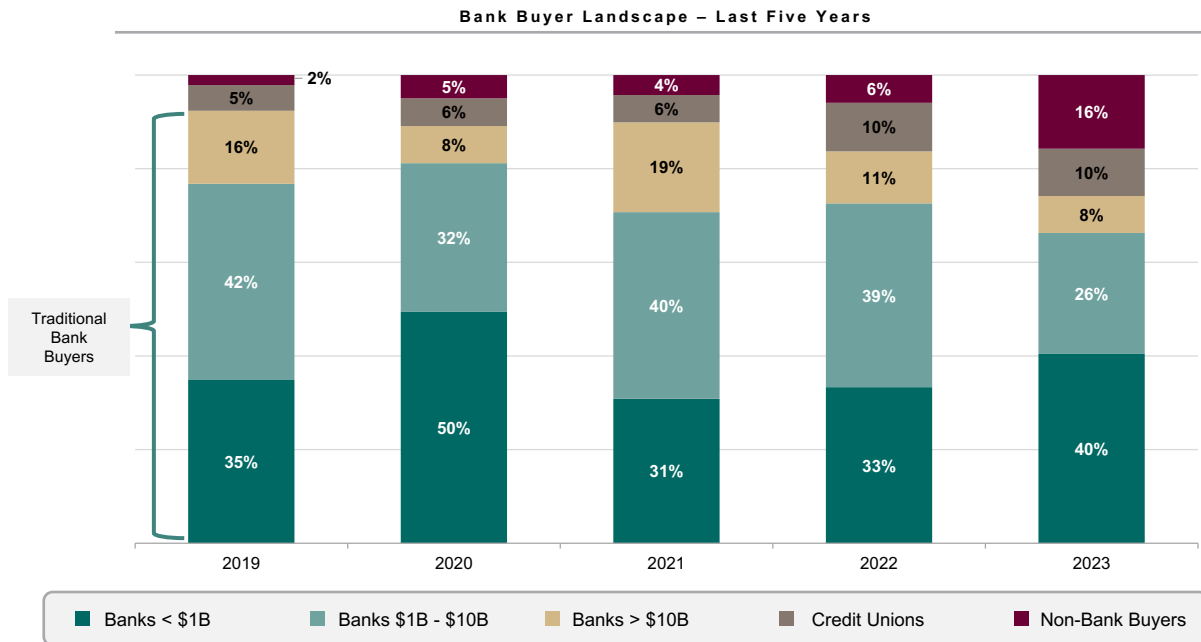
Buyers With 5+ Deals Since 2013





Historical Bank M&A by Type of Buyer – Last Five Years

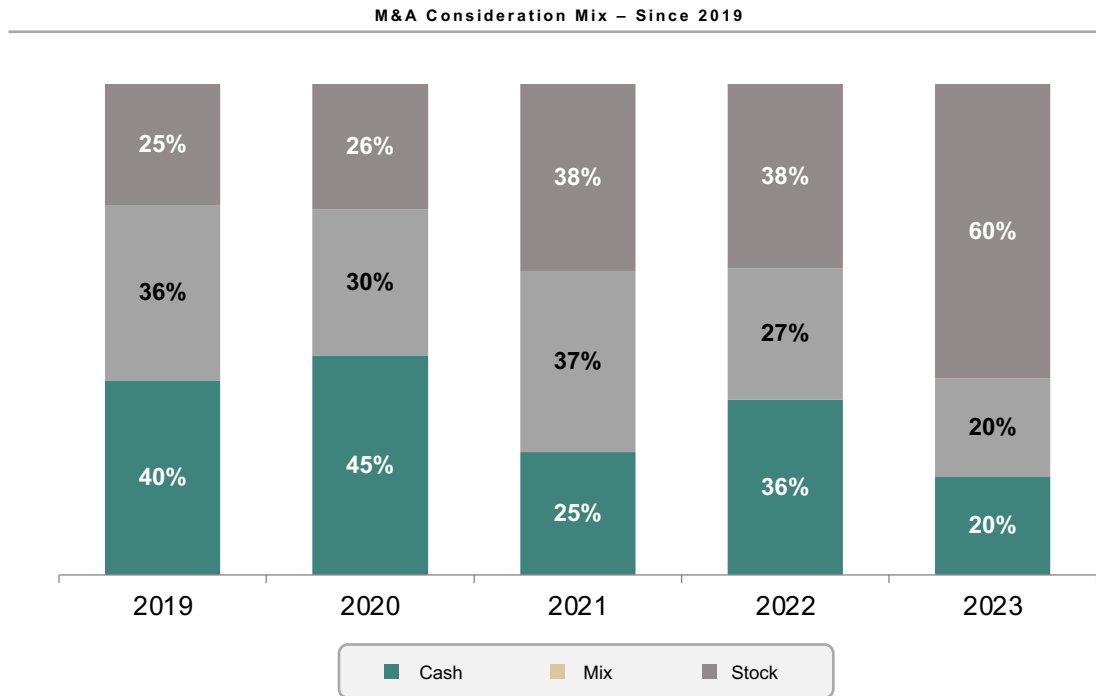
- Most active acquirers are banks with less than \$10 billion in assets
- Credit unions and non-bank buyers (i.e., individuals, private investor groups, fintech companies, etc.) have increased their activity as acquirers on a relative basis in 2022 and 2023





Merger Consideration Analysis – Last Five Years

- Over the past few years, 55% - 80% of M&A deals included stock as part of the form of consideration and 20% - 45% of the deals were all cash





Seeing Light at the End of the Tunnel for Bank Stocks

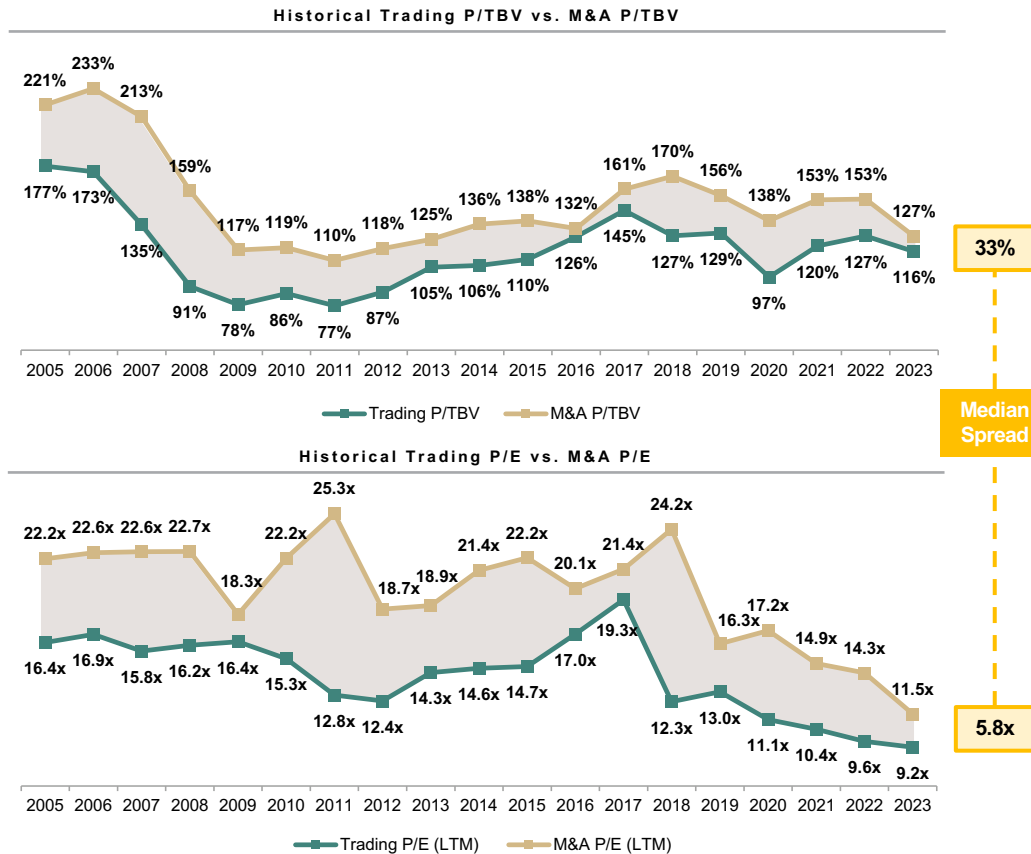
- Higher valuations increase acquirers' ability to pay
- Stronger valuations will foster more robust merger discussions in 2024





Bank Trading Multiples vs. M&A Multiples

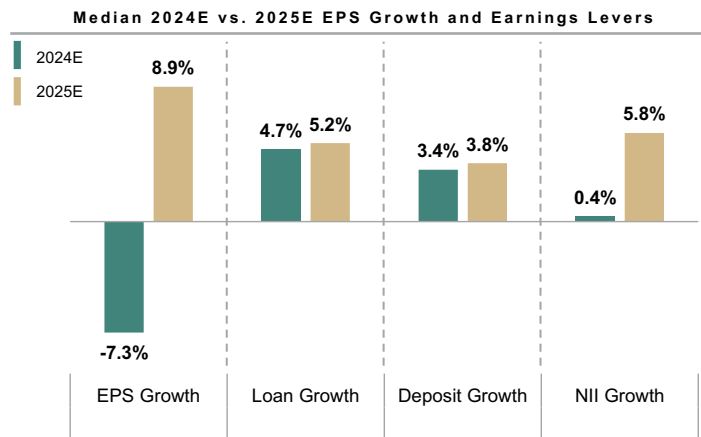
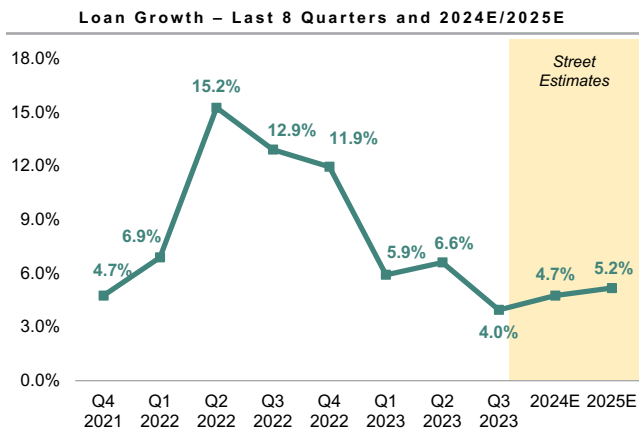
- The prevailing public trading value for banks is an excellent indicator for M&A pricing
- As bank currencies increase in value, M&A values increase as well (the converse is also true)
- Median M&A multiples have been 33% higher on tangible book and 5.8x higher on earnings compared to trading multiples due to the control premium paid in an acquisition





Near-Term Earnings Per Share Headwinds Will Fuel M&A Activity

- 2023 was a tumultuous year for banks and will likely have long-term ramifications from a capital/funding/regulatory perspective – however, banks are broadly on firm footing entering 2024
- Loan growth slowed in 2023 due to increased funding competition and heightened concerns of a potential recession
- Tougher operating environment will create headwinds for banks to earn their independence





Investor Perspectives on Bank Stocks – Bulls vs. Bears

Upside – Case for Bulls

- Fed hikes are likely done; lower rates in 2024
- AOCI recovery re-builds tangible book value
- NIM stabilizes and begins to increase – new loans are booked, securities mature and deposit cost peaks
- Core deposits provide an advantage for NIM expansion
- Strong deposit inflows and incremental loan growth
- No recession
- M&A activity increases
- Commercial real estate successfully reprices

Visibility for earnings improvement and TBV growth

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S.

Downside – Case for Bears

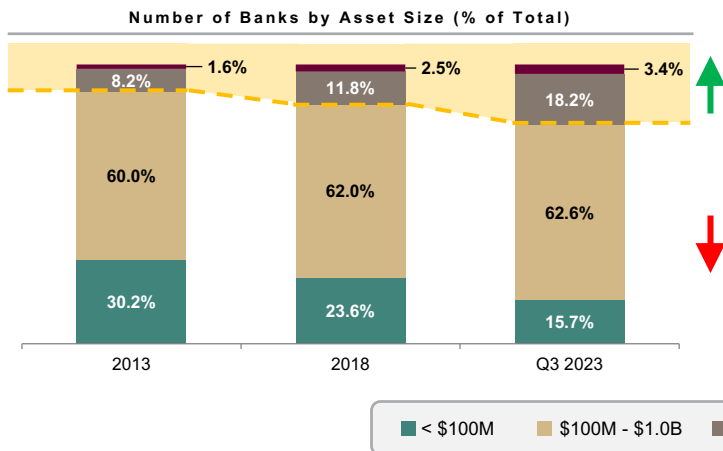
- Fed holding pattern with *higher-for-longer* environment
- Continued NIM pressure and extended AOCI recovery
- Limited loan growth opportunities
- Regulatory rule changes in reaction to 2023 bank failures and AOCI losses
- Credit quality deterioration
- Distressed, dilutive capital offerings
- Ongoing macro-economic uncertainty

Earnings pressure support lower valuation multiples

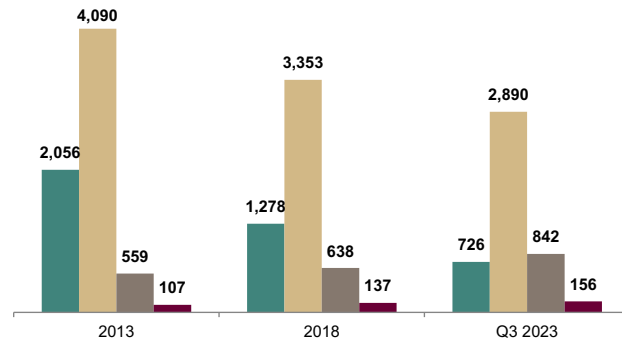


Historical Asset Size Breakdown – Last Ten Years

- Total number of banks nationwide is down from 6,812 to 4,614 banks (last ten years)
- The number of banks below \$1.0 billion assets has fallen over the last ten years, while number of banks above \$1.0 billion assets has grown – bank M&A was the catalyst
- As more bank consolidation occurs, banks with more than \$10.0 billion in assets take a larger share of the pie – look for trend to continue over the next ten years



Number of Banks by Asset Size (Ten Years Ago vs. Today)



Summary Table

Asset Size	# of Banks			Total Assets (\$B)		
	2013	2018	Q3 2023	2013	2018	Q3 2023
< \$100M	2,056	1,278	726	\$ 120	\$ 76	\$ 44
\$100M - \$1.0B	4,090	3,353	2,890	\$ 1,246	\$ 1,109	\$ 1,072
\$1.0B - \$10.0B	559	638	842	\$ 1,469	\$ 1,735	\$ 2,335
> \$10.0B	107	137	156	\$ 11,888	\$ 15,024	\$ 19,957
Grand Total	6,812	5,406	4,614	\$ 14,723	\$ 17,943	\$ 23,409

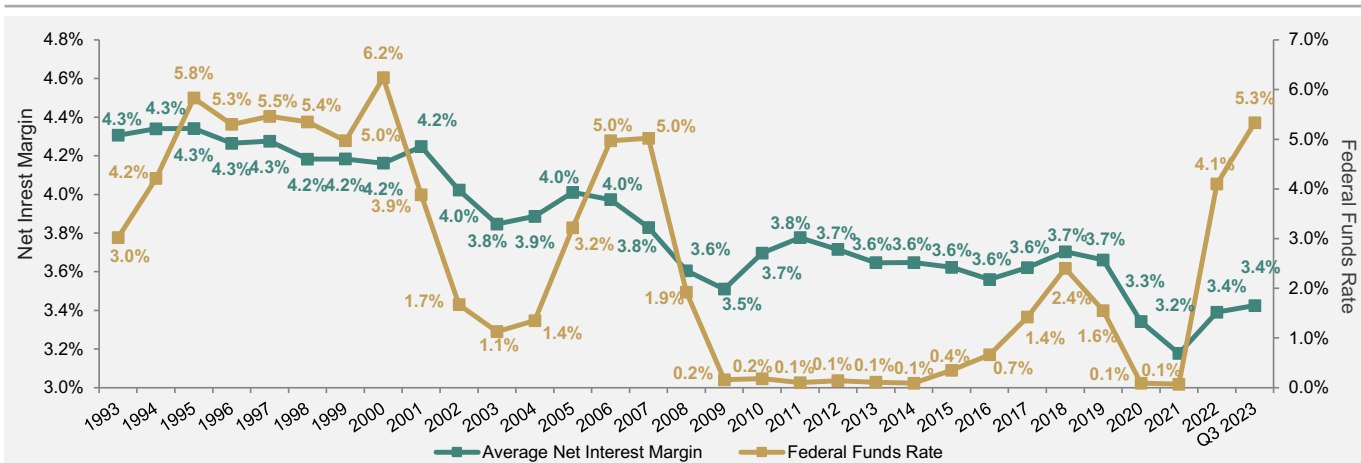


Community Banking Headwinds Persist

Considerations

- Higher funding cost / deposit competition
- Margin pressure
- Slowing loan growth
- CRE / office space concerns
- Declining consumer spending
- Possible recession
- Ability to raise equity / debt
- Regulation
- Cybersecurity
- Technology cost
- Future role of branches
- Stiff competition
- Slow M&A activity
- Loan interest rate marks
- AOCI losses
- Low buyer valuations
- Negative, but improving, bank investor sentiment

Avg. Net Interest Margin of U.S. Banks





Concluding Thoughts

- Bank M&A activity was at a multi-decade low in 2023

- We believe bank M&A activity will pick up in 2024 for several reasons:
 - Less economic uncertainty with flat to declining interest rates and an expected soft landing
 - Earnings headwinds will drive buyers and sellers
 - Higher buyers stock prices will increase ability to pay
 - Serial acquirers that have been on the sideline are starting to be more active
 - Core deposits are back to being important, helping drive demand for sellers
 - Dust off the rural (inexpensive funding) vs. metro (loan growth) play book?

- The biggest headwinds to an uptick in M&A in the next two years is a possible recession, and regulatory uncertainty / greater scrutiny on every deal

ATLANTA, GEORGIA

BOSTON, MASSACHUSETTS

CHICAGO, ILLINOIS

DENVER, COLORADO

GREAT FALLS, MONTANA

NEW YORK, NEW YORK

ORANGE COUNTY, CALIFORNIA

PORTLAND, OREGON

SALT LAKE CITY, UTAH

SEATTLE, WASHINGTON



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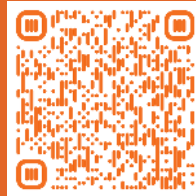
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