

BUILDING CAPITAL IN WISCONSIN BANKS

*Surviving or Thriving –
Your Choice*

*WBA Bank Executives
Conference*

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Surviving or Thriving—Your Choice

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*With special thanks to Howe Barnes Hoefler & Arnett for help on Slides 6, 11, 12, 13,14 & 17.

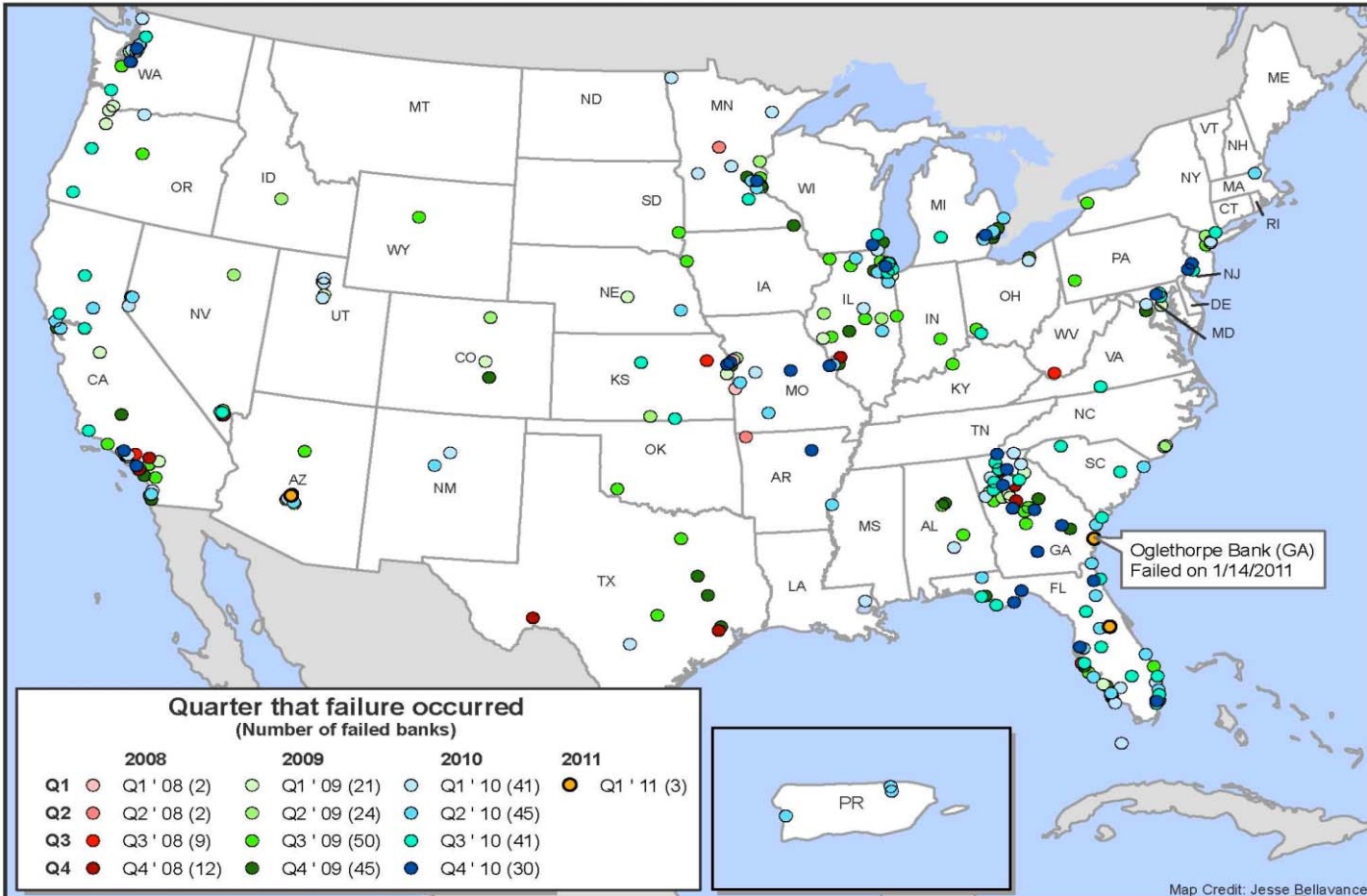
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I. What does the current landscape in our industry look like? – Here's what we see:

- **Bank Failures in this Cycle**
 - 2008 – 26
 - 2009 – 140
 - 2010 – 154
 - 2011 – 14 as of 2/4/11

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Bank and thrift failures since 2008



As of: Jan. 14, 2011
Source: SNL Financial

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- **Banks with High Texas Ratios (are not all located in Texas)**
 - Texas Ratios of 100%+
 - Texas Ratios of 50% to 100%

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- **How Deep is the Capital Hole for Community Banks?**

As of 9/30/10, 43% of all banks with <\$1 Billion in assets will need to raise capital (\$11.8 Billion).

Thirty-eight percent of all banks with <\$10B will need to raise capital (\$29.5B) including \$8.7 billion of TARP.

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Community Banks Needing Capital* (as of 9/30/2010)

Size of Banks In Assets	Total Number of Banks	Total Assets (\$B)	Capital Needed (\$B)**	Number Needing Capital	Percent of Banks
<\$100 MM	2,330	131	0.5	628	27
\$100MM to \$250 MM	2,092	337	2.3	764	37
\$250MM to \$500MM	961	335	2.9	434	45
\$500MM to \$1B	538	377	6.1	332	62
\$1B to \$5B	<u>402</u>	<u>791</u>	<u>14.3</u>	<u>254</u>	<u>63</u>
TOTAL	6,323	\$1,971	\$26.1	2,412	38

*Consolidated non-mutual US depositories only; **All TARP repaid at par, minimum capital ratios of 7% TCE, 8% leverage, 12% total, minimum LLR of 1.50%, 20% losses on all past due assets. Sources: SNL Financial as of 9/30/2010 and Howe Barnes Hoefler & Arnett, John F. Schramm, Managing Director.

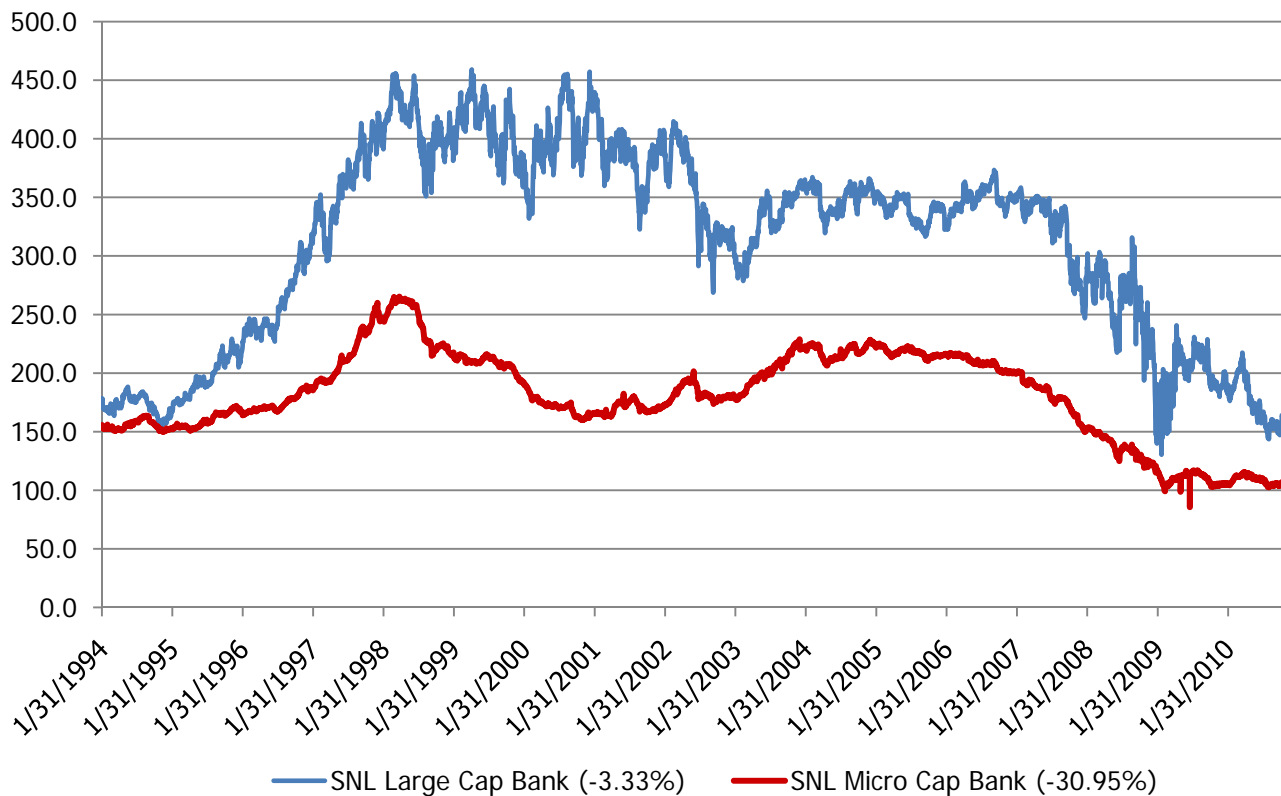
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- What or Who Will Be the Source of Community Bank Capital?
 - ❖ Shrink
 - ❖ Retained Earnings
 - ❖ **Investors**
 - ❖ Institutional—Lots of cash, not interested in small, illiquid names, significant minimum investment (~\$20 MM)
 - ❖ Retail—Hurt by stock market & financial crisis, still bank-shy, very limited interest now (~\$5 MM to ~\$20MM)
 - ❖ Friends & Family—Passing the hat, especially around the board table. Good source but limited capacity. (~\$1MM to ~\$5 MM)
 - ❖ **SBLF—Should you take it? YES!!!! (If you don't mind the government as a partner.)** http://www.treasury.gov/resource-center/sb-programs/Documents/SLBF_Getting_Started_Guide_Final.pdf
 - ❖ **Acquisitions**

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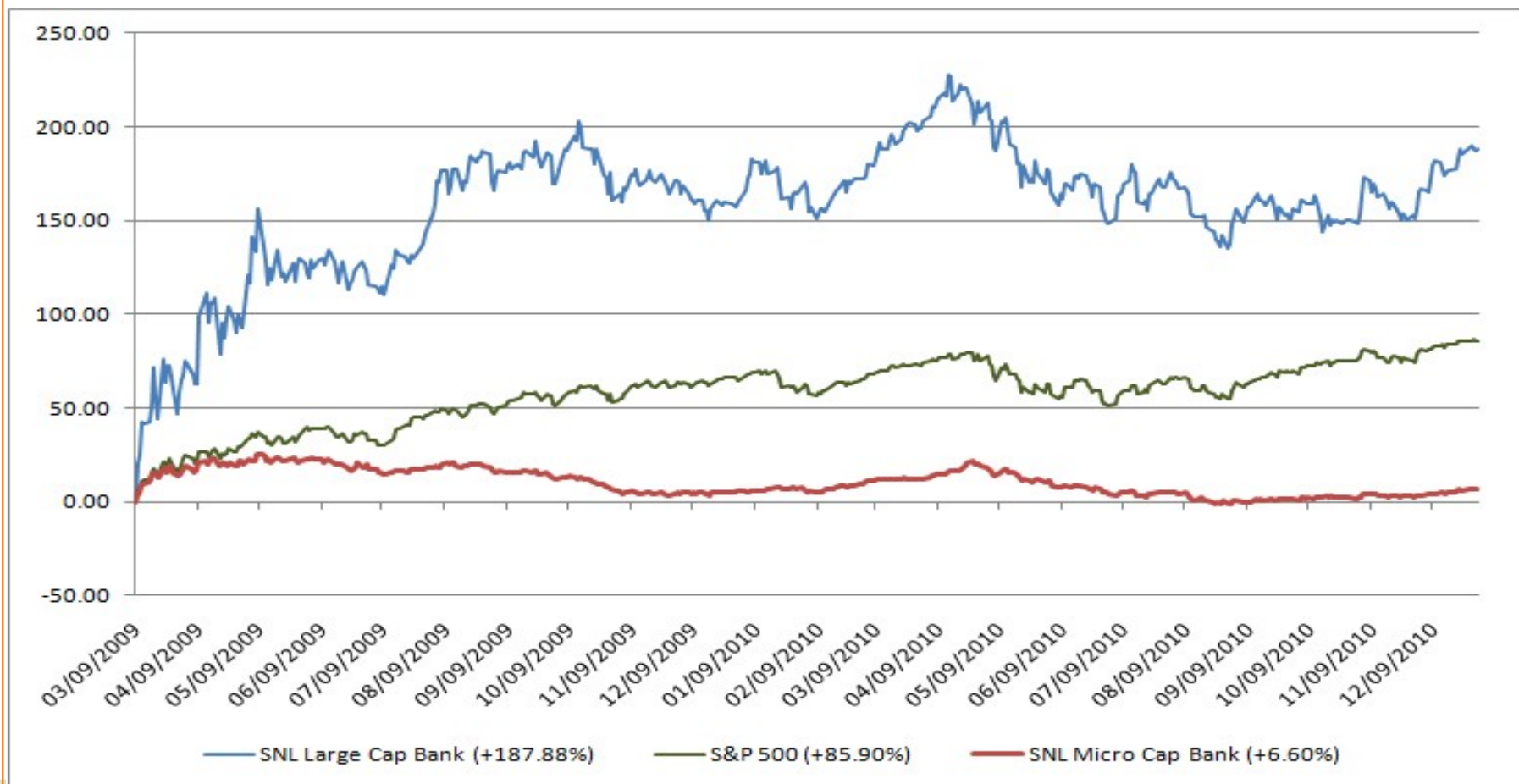
- What Have Historical Pricing Metrics Looked Like for Community Banks Over the Past 20 Years?

Stock Price Performance 1994-2010



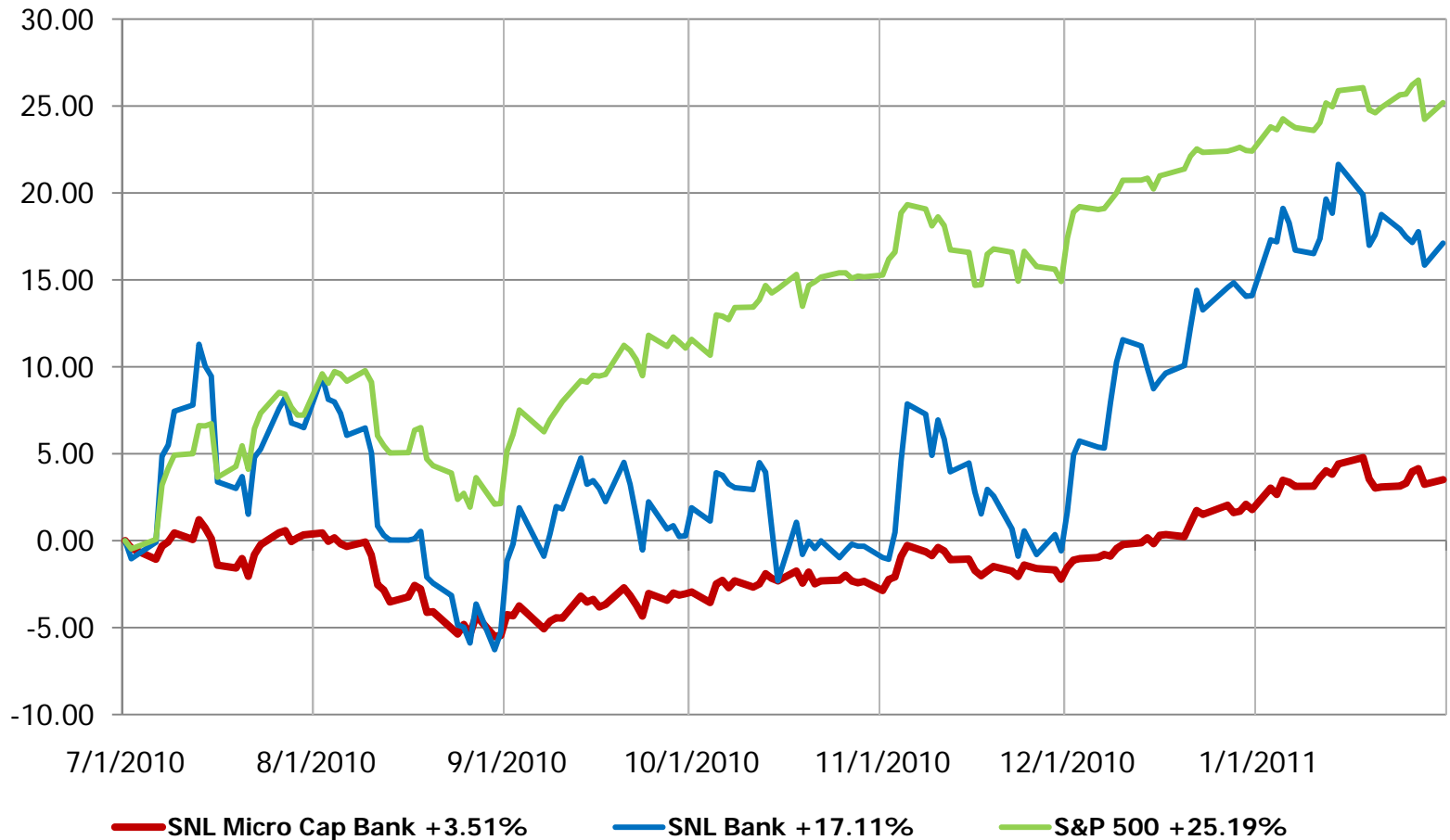
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- How Have Bank Stock Prices Performed Since March 9, 2009 to December 31, 2010?



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- What Has Pricing Looked Like Recently?
For the Seven Months Ended January 31, 2011



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What Kind of Business Model are Bank Investors Demanding

A Pre-2008 vs. Post-2008 View

	Pre-2008	Post-2008
Scale	<ul style="list-style-type: none"> •Less important due to ability to grow •Availability of capital allowed for growth 	<ul style="list-style-type: none"> •Necessary to have critical mass •Market share more important
Management	Strong reputation in local markets	<ul style="list-style-type: none"> •Experienced, talented professional managers •Strong operating results & shareholder returns
Lending	<ul style="list-style-type: none"> •Real estate focused •Underwriting more collateral value focused 	<ul style="list-style-type: none"> •Diversified mix •Global cash flow underwriting
Deposit Sources	<ul style="list-style-type: none"> •Wholesale funding •CD advertising 	<ul style="list-style-type: none"> •Strong core deposit focus •Especially DDA and transaction A/Cs
Fee Income	<ul style="list-style-type: none"> •Limited focus, ancillary lines unprofitable •Table funding of mortgage loans •Small scale SBA 	<ul style="list-style-type: none"> •Can mitigate Dodd-Frank impact •Significant revenue diversification •Run ancillary businesses well
Operating Systems	Often key positions & systems absent or deficient	Investments in systems and people
Shareholder	<ul style="list-style-type: none"> •Limited liquidity in stock •Stock dividends 	<ul style="list-style-type: none"> •Liquid stock w/major institutional ownership •Cash dividends
Capital	<ul style="list-style-type: none"> •Minimize common equity •Just in time capital 	<ul style="list-style-type: none"> •Maintain a comfortable capital cushion •TCE>7%

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NO Access to Capital

Failing Institutions	Orphan Banks
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<i>CHARACTERISTICS</i>	<i>CHARACTERISTICS</i>
<ul style="list-style-type: none"> • Insolvent • Low/negative core profitability • Unattractive Balance Sheet 	<ul style="list-style-type: none"> • Manageable asset quality • Depressed earnings or lack of path to significant earnings • Need capital to grow or repay TARP • Need management and new strategy • May be too small • Wrong market

<i>SOURCES OF CAPITAL</i>	<i>SOURCES OF CAPITAL</i>
<ul style="list-style-type: none"> • None 	<ul style="list-style-type: none"> • Limited • Local investors

Access to Capital

Turnaround Situations	Dominant Survivors
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<i>CHARACTERISTICS</i>	<i>CHARACTERISTICS</i>
<ul style="list-style-type: none"> • Severe financial challenges • Significant capital & management needs • Survival possible with additional capital • Large enough to attract investor interest • Strong core franchise 	<ul style="list-style-type: none"> • Well capitalized • Access to capital • Clean asset quality • Infrastructure to lead consolidation • Ability to do FDIC deals • Generally “trade” at a premium to book value

<i>SOURCES OF CAPITAL</i>	<i>SOURCES OF CAPITAL</i>
<ul style="list-style-type: none"> • Control related transact. funded w/ private capital 	<ul style="list-style-type: none"> • Public offerings • Private equity investors

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- **Will Growth (or Lack) Impact Your Ability to Survive?**

The evidence suggests there is a strong relationship
between size and efficiency up to \$5B in assets

(Sources: SNL Financial data as of 9/30/2010, Howe Barnes Hoefler & Arnett charts.)

	Up to \$100MM	\$100MM to \$500MM	\$500 MM to \$1B	\$1B to \$5B
Efficiency Ratio	73.0%	69.0%	68.5%	66.3%
Non-Interest Expense to Average Assets	3.13%	2.98%	2.94%	2.92%
Assets/Employee	3.4	3.9	4.1	4.5
Pre-Tax, Pre-LLP Core Income/ Average Assets	1.60%	1.83%	1.89%	2.00%

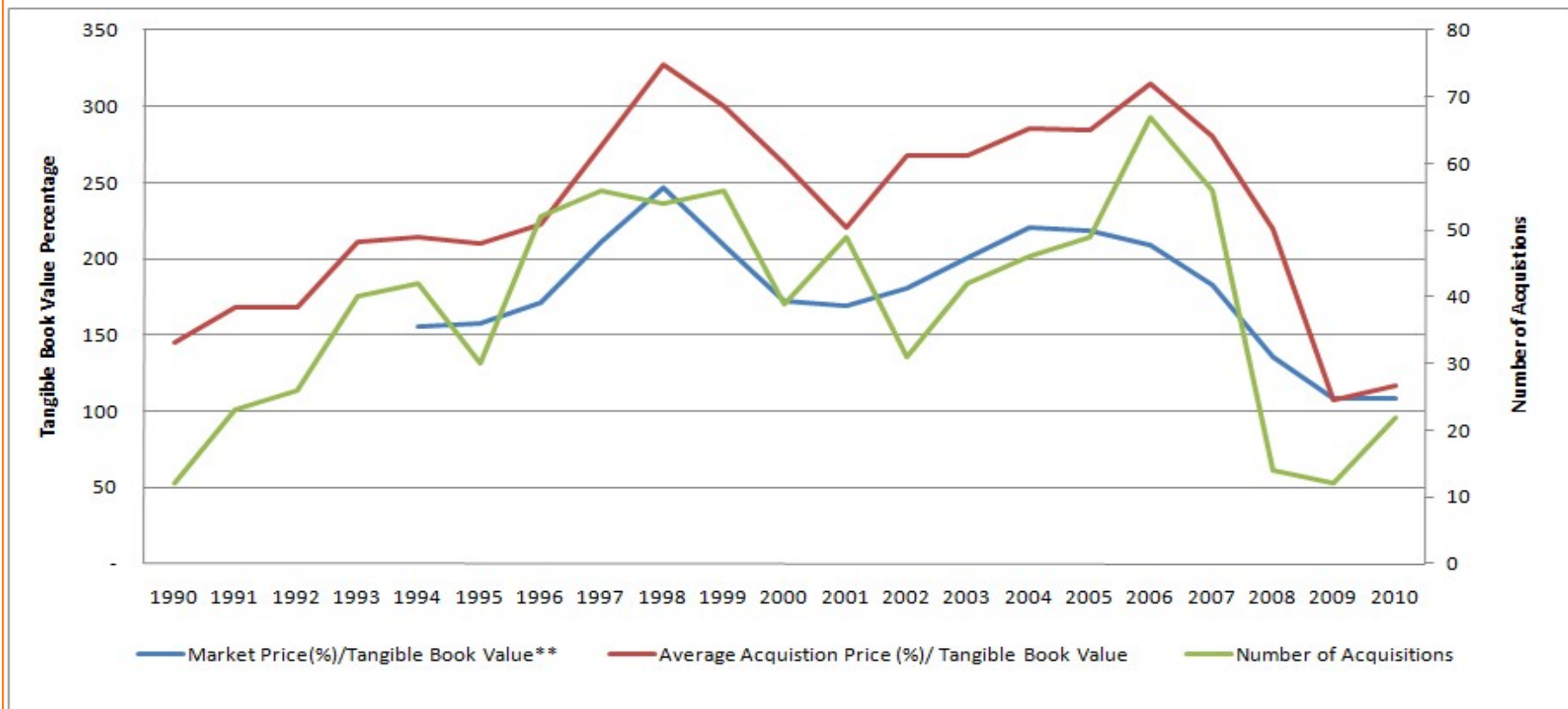
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- **What Role Will Consolidation Play in Our Industry?**
 - **There will be a significant wave of consolidation among community banks because—**
 - **Limited access to capital**
 - **A search for increased earnings through efficiency**
 - **Lack of attractive exit opportunities (regional bank acquirers) for institutions of the current size**
 - **The Consolidators**
 - **Larger community banks will acquire smaller community banks or MOE >5,900 banks: <\$100MM to \$1B**
 - **Emerging consolidators with access to capital ~ 980 banks: >\$500MM to \$10B**
 - **Regional bank consolidators—110 banks : \$5B to \$25B +**

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- What Has Transaction Volume and Pricing Looked Like Over the Past 20 Years?

Stock Price Performance vs. Average Acquisition Prices 1990-2010



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- **How Will the Dynamics in Mergers & Acquisitions Change in this Brave New World? *It's a buyers market !***
 - ❖ **Banks will be bought rather than sold**
 - ❖ **Many benefits will flow to buyers rather than sellers**
 - ❖ **No earnings dilution or tangible book value dilution**
 - ❖ **Cost savings will not be highly compensated**
 - ❖ **Most acquisitions will be all stock deals**
 - ❖ **Capital is scarce limiting cash as a consideration**
 - ❖ **Limited cash will keep pricing more rational**
 - ❖ **Regulatory framework favors strong banks**
 - ❖ **Only CAMELS 1 or 2 banks may acquire other banks (very limited exceptions)**
 - ❖ **Clean credit metrics must be maintained by acquirers of troubled banks**
 - ❖ **Capital requirements are higher so most troubled bank acquisitions will require external capital**

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- **What Role Will Private Equity Capital Play in Community Banks?**
 - ❖ **Negotiating power has shifted to the consolidators – focusing on larger targets to grow quickly.**
 - ❖ **Are banks with <\$1 billion in assets stuck in the backwater?**
 - ❖ **Market inefficiency for smaller sized investments will create attractive returns**
 - ❖ **Focus on larger opportunities will drive up pricing**
 - ❖ **Bank funds like Fortress Partners Banc Ventures III will back smaller consolidators who are willing to do the work to roll up scores of institutions.**

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- **The Banking Industry – Our View:** *A diverse and competitive banking system is the foundation of a strong, free economy.*

We continue to deal with a banking environment more difficult than we've experienced in our lifetimes. Good bankers have successfully guided their institutions through the worst of the financial crisis and must now prepare for the future.

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- **The Banking Industry in Wisconsin – An environment more difficult than I’ve seen in my 48 year career**
 - The 59 (now 58) Wisconsin banks with Texas Ratios >50% (as of 9/30/10) don’t have enough but may not have acknowledged the need to be recapitalized.
Here’s why:
 - Average tangible common equity is 8.8% - just enough to make the BASEL III regs plus a bit of cushion
 - Average Texas Ratio is 67%
 - I KNOW THAT MANY OF THESE BANKS HAVE NOT CHARGED DOWN OR OFF A SUFFICIENT # AND \$\$ AMOUNT OF LOANS.

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- The 15 banks with Texas Ratios $>100\%$ may not make it, without a major recapitalization (one failed last month)--we've talked with prospective acquirers and most are waiting for an FDIC assisted deal.

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II. If Capital is King, then Credit is *Queen!*

WE WILL NOT (NOR WILL MOST EXPERIENCED BANK INVESTORS) INVEST IN ANY COMMUNITY BANK THAT DOES NOT HAVE A BOARD ORDERED THIRD PARTY REVIEW OF ITS LOAN PORTFOLIO PERFORMED BY EX-BANKERS WITH A STRONG REPUTATION FOR CREDIT QUALITY!

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THIRD PARTY REVIEW

- **MUST BE DONE AT LEAST TWICE PER YEAR AND PREFERABLY QUARTERLY**
- **MUST REVIEW THE ADEQUACY OF YOUR CREDIT POLICY**
- **MUST REVIEW ADHERENCE IN EVERY WAY TO YOUR POLICY**
- **MUST ASSURE THAT YOUR PROCEDURES ARE IRON-CLAD**
- **MUST BE HIRED BY AND REPORT TO THE BOARD**
- **RECOMMENDATIONS MUST BE FOLLOWED BY MANAGEMENT AND THE BOARD**

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III. So If That's the Landscape, What Can You Do About It?

Is failing to plan, really planning to fail?

- **Strategic Assessment of Your Bank** – What is the current state of play at your bank?
 - **What do your shareholders expect?**
 - ROE
 - Earning growth
 - Capital efficiency
 - Risk management
 - Shareholder/franchise value

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- **What do your regulators expect?**
 - Compliance with consent orders
 - Capital order
 - Three year plan status
 - Credit risk management improvement
 - Administrative practices improvement
 - Working relationship

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- **Your Board's Performance (Bank and BHC)**
 - Effectiveness
 - Insider/outsider balance
 - Engagement
 - Advise on strategic direction and risk appetite
 - Governance/oversight role
 - Ambassador/business development role

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- **How Are You and Your Management Team Viewed?**
 - Leadership effectiveness
 - Senior Management
 - Middle Management
 - Teamwork effectiveness

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- **How Is Your Non-Management Staff Viewed?**
 - Producers
 - Front-line staff
 - Back office/administrative staff
 - Are they effective as a team?

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- **What Do Your Customers Think About Your Bank?**
 - Service quality
 - Satisfaction
 - Loyalty
 - Is this supported by the % of customer wallets owned?

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- **Strategic Assessment of Your Bank** – Is it where you want it to be; if not, how will you get there?
 - In one year? - Survival
 - In three years? – Surviving to Thriving
 - In five year? – Thriving

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- **Your Planning Process**
 - Who runs your planning session(s)?
 - With what frequency do you plan?
 - Who's involved?
 - What are the contents?

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- **Can you (or *should you*) create a strategic plan integrated with a capital plan without third party assistance?**
 - Can you be truly objective?
 - If you have regulatory orders to raise capital, why haven't you done so?

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- **What role does capital play?** – Whether you have plenty or not, capital will dictate your future!

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- How much capital do you really have? *(We've been over this before)*
 - The 59 (58 now) Wisconsin banks with Texas Ratios >50% (as of 9/30/10) don't have enough but may not have acknowledged the need to be recapitalized. Here's why:
 - Average tangible common equity is 8.8% - just enough to make the BASEL III regs plus a bit of cushion
 - Average Texas Ratio 67%
 - I KNOW THAT MANY OF THESE BANKS HAVE NOT CHARGED DOWN OR OFF A SUFFICIENT # & AMOUNT OF LOANS.

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- The 15 banks with Texas Ratios $>100\%$ may not make it (one failed last month), with or without a major recapitalization – we've talked with prospective acquirers in Wisconsin and most are waiting for an FDIC assisted deal.

Surviving or Thriving—Your Choice

- **How do you measure up?**
 - **Surviving** – How much capital is enough?
 - ✓ For banks with regulatory orders, 8% to 10%, TCE.
 - ✓ For banks without orders, 7% to 8% TCE may be just fine.

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- **Thriving** – How much capital is enough?
 - ✓ If growth is organic and not opportunistic – 8% TCE with earnings retention will likely be just fine.
 - ✓ If growth is organic and you are in a market where a large competitor may have just been acquired, 15% or 20% may not be enough.
 - ✓ If growth is by acquisition, the method of payment and the capital ratio of the target will determine your capital need.

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IV. With a plan in hand and loan problems identified, what are the next steps in the capital raising process?

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- **Shrink the %#?@\$* BANK?!!?**
 - **Sell NPL's at a discount**
 - **Sell securities at a gain**
 - **Let deposits run off**
 - **Sell branches**
- **SBLF—replace 100% of TARP**
 - **Must be CAMELS 1 or 2**
 - **Want to grow C & I**
 - **Non-dilutive, low rate**
 - **Buys time until a non-dilutive common raise can be effected to pay off SBLF.**

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- **If you intend to sell new shares, you should engage a third party (avoid DIY) to:**
 - Determine the value of your existing shares
 - Assist in the determining of the price at which to sell new shares
 - Assist in determining who the prospective buyers will be:
 - Pass the hat around the board table
 - Rights offering all shareholders
 - Community offering
 - Private placement
 - Combination of the above

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- ❖ Make sure that whatever firm you select has access to data bases providing information on offerings for community banks and
- ❖ That it has skills to assist the marketing of shares to your existing shareholder base, and if necessary, beyond:
 - In a private placement
 - In a limited public offering

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V. Ingredients for a successful capital raise

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FOUR THINGS YOU CAN DO NOW

1. Loan portfolio – Completely scrubbed portfolio by a respected third party with strong bank credit skills.
2. Scrub your investment portfolio
3. Develop a credible Strategic Capital Plan (SCP)

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4. Third party advisor that can:
 - a. Assist in the development of the SCP
 - b. Assist in writing your offering document
 - c. Assist in pricing of your new shares
 - d. Assist with the offering to:
 - Board members
 - Shareholders
 - Community
 - Private placement

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QUESTIONS

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