State of the Capital Markets for Community Banks

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Confidential

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***Data source utilized throughout presentation – SNL Securities, FDIC**

1. Community Bank Environment

Current Macro Issues Facing Community Banks

- Economic headwinds (domestic and global)
- Regulatory pressure
- Legislative uncertainty (Dodd-Frank, CFPB, Durbin Amendment, etc.)
- Historically high levels of loan delinquencies and credit costs persist, though improving
- Continued softness in real estate and collateral valuations
- Limited quality loan growth opportunities and aggressive pricing by nationals and regionals
- Challenging capital raising environment for small community banks
  - Difficult to raise any capital outside of the local community
  - Unfavorable pricing in most offerings
  - Bank valuations down significantly in 2012 despite general improvement in fundamentals

These issues have led to increased costs, decreased profitability, increasing capital ratio expectations/requirements, and general uncertainty – all of which have negatively impacted small banks' equity valuations

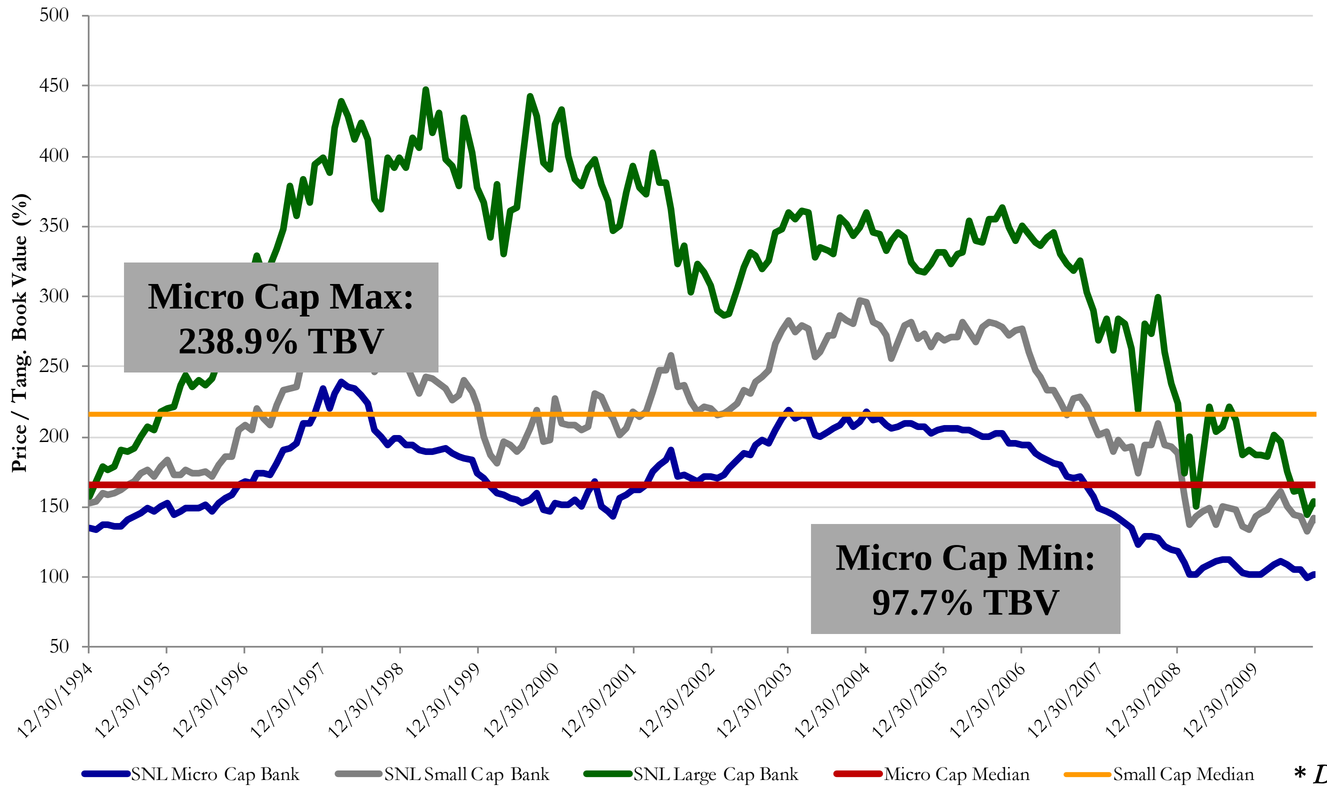
Historically Low Bank Stock Valuations

S&P 500: 204.72% cumulative return since 12/31/1994

SNL U.S. Bank and Thrift Index: 89.8% cumulative return

The S&P 500 has significantly outperformed the SNL U.S. Bank Index in this credit cycle, despite a rebound in bank stocks in late 2011/2012

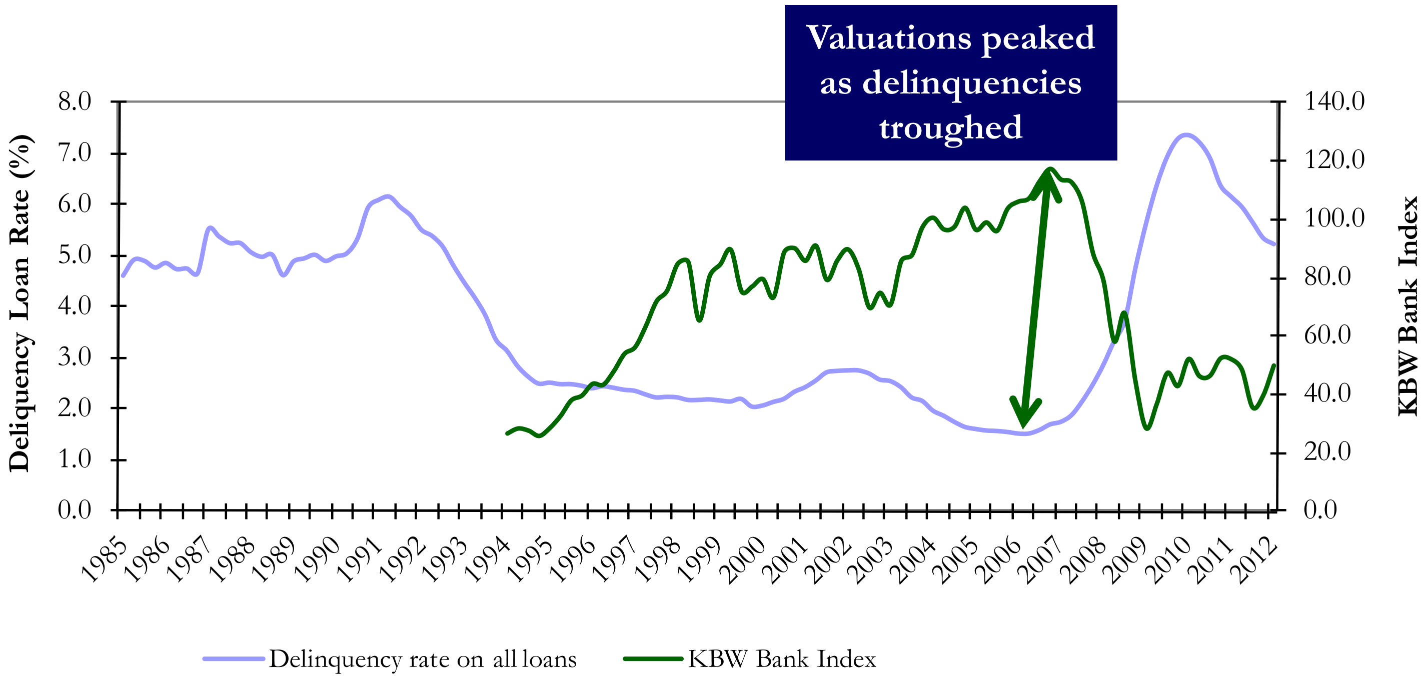
Historical Valuation Multiples of Bank Stocks



** Data is monthly*

"Micro Cap" (defined as banks with less than $250mm market capitalization) bank stocks are being valued near historical lows

Improving Credit Should = Improving Valuations



Note: Delinquent loans are those past due thirty days or more and still accruing interest as well as those in nonaccrual status.

There is a high historical correlation between the value of bank stocks and credit quality, however, the small community bank stock prices have not rebounded back this cycle to the extent of the larger banks

Improving Fundamentals – SNL U.S. Bank and Thrift Index

Period Ended	12/31/2006	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	3/31/2012	6/30/2012
Number of Companies	610	591	549	520	493	470	470	460
ROAA (%)	1.32	0.74	(0.25)	0.15	0.49	0.68	0.78	0.85
Core ROAA (%)	**1.23**	**0.76**	**(0.05)**	**0.20**	**0.54**	**0.65**	**0.69**	**0.84**
ROAE (%)	15.04	8.66	(2.85)	1.53	5.11	6.77	7.58	8.15
Core ROAE (%)	**14.10**	**8.90**	**(0.64)**	**2.07**	**5.67**	**6.58**	**6.82**	**8.21**
Net Interest Margin (%)	**3.04**	**2.91**	**3.21**	**3.21**	**3.33**	**3.13**	**3.10**	**3.01**
Efficiency Ratio (%)	**58.18**	**62.22**	**65.81**	**56.87**	**59.24**	**66.95**	**68.44**	**65.48**
Noninterest Inc/ Operating Rev (%)	48.79	44.78	35.18	45.48	43.28	42.52	43.54	43.59
Net Operating Expense/ Avg Assets (%)	0.86	0.91	1.40	0.64	0.85	1.21	1.24	1.08
NPLs/ Loans (%)	**0.60**	**1.23**	**2.36**	**4.78**	**4.70**	**4.17**	**4.08**	**3.86**
NPAs/ Assets (%)	0.37	0.73	1.37	2.46	2.44	2.09	2.00	1.91
NPAs & 90+ PD/ Assets (%)	**0.48**	**0.85**	**1.60**	**2.67**	**2.69**	**2.27**	**2.16**	**2.06**
Reserves/ NPAs (%)	161.26	98.77	93.79	70.59	71.95	65.61	64.10	64.20
Reserves/ NPAs & 90+ PD (%)	**123.92**	**84.56**	**80.53**	**63.40**	**65.26**	**60.38**	**59.26**	**59.64**
Loan Loss Reserves/ Gross Loans (%)	**1.13**	**1.38**	**2.51**	**3.63**	**3.66**	**2.94**	**2.81**	**2.64**
NCOs/ Avg Loans (%)	**0.48**	**0.68**	**1.63**	**2.84**	**2.89**	**1.78**	**1.37**	**1.22**
Loan Loss Provision/ NCO (%)	**103.64**	**157.58**	**175.87**	**133.28**	**83.60**	**65.96**	**64.86**	**67.36**
Total Equity/ Total Assets (%)	8.99	8.43	8.93	9.69	9.95	10.22	10.26	10.41
Tangible Equity/ Tangible Assets (%)	**5.66**	**5.04**	**6.02**	**6.86**	**7.29**	**7.70**	**7.80**	**7.95**
Securities/ Assets (%)	25.09	25.63	25.33	27.87	28.29	28.03	28.72	27.96
Loans/ Deposits (%)	**93.98**	**97.86**	**93.59**	**82.61**	**83.00**	**77.13**	**76.17**	**76.73**

Note: The Aggregates are size weighted, calculated by consolidating all companies into a single entity.

The past couple of years have seen improving profitability, credit quality, and capital levels; however, challenges still remain in a low interest rate, low growth environment with increasing costs of banking

Relevant Community Bank Performance Metrics by Geography

Median Results for Respective Comparable Sets
($ in 000s)

			Balance Sheet				Capital Adequacy		
Median Results	**# of Banks**	**% of Banks with TARP**	**Assets**	**Deposits**	**LTM Asset Growth**	**LTM Net Loan Growth**	**Tier 1 Leverage Ratio**	**TCE / Tang. Assets**	**Adj. Texas Ratio**
National Banks (1)	753	18.06%	$590,656	$478,267	2.46%	0.46%	9.81%	9.03%	24.27%
Midwest (2)	183	19.67%	649,840	511,063	1.84%	-1.11%	9.37%	8.94%	28.23%
Illinois (3)	24	33.33%	594,577	487,776	-0.52%	-3.62%	9.24%	8.91%	36.40%

Footnotes:

(1) Public community bank stocks nationally with less than $10 billion in assets and avg. daily trading volume greater than 100 over the past month.

(2) Public community bank stocks in the Midwest with less than $10 billion in assets and avg. daily trading volume greater than 100 over the past month.

(3) Public community bank stocks in Illinois with less than $10 billion in assets and avg. daily trading volume greater than 100 over the past month.

Based on the median, Illinois banks have exhibited lower asset/loan growth, lower capital ratios, and higher Texas Ratios* than their Midwest and National peers

* Texas Ratio defined as sum of nonperforming assets + OREO divided by the sum of tangible equity + loan loss reserves

Relevant Community Bank Performance Metrics by Geography

Median Results for Respective Comparable Sets
($ in 000s)

			Performance Analysis				Valuation Metrics	
Median Results	**# of Banks**	**% of Banks with TARP**	**Pre-Pre ROAA**	**LTM ROAA**	**LTM Net Interest Margin**	**LTM Efficiency Ratio**	**P / BV**	**P / TBV**
National Banks [1]	753	18.06%	1.28%	0.61%	3.69%	70.06%	**84.88%**	**89.67%**
Midwest [2]	183	19.67%	1.38%	0.67%	3.62%	68.32%	**76.99%**	**83.27%**
Illinois [3]	24	33.33%	1.21%	0.23%	3.43%	69.25%	**63.48%**	**69.53%**

Footnotes:

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(3) Public community bank stocks in Illinois with less than $10 billion in assets and avg. daily trading volume greater than 100 over the past month.

Based on the median, Illinois banks have experienced lower earnings and trade at a significant discount to their Midwest and National peers

2012 Illinois Banking Profile – Slowly Improving

Q2 2012

	Assets ($000s)	Deposits ($000s)	Net Income - MRQ ($000s)	Efficiency Ratio (%)	ROAA (%)	ROAE (%)	Leverage Ratio (%)	Risk-Based Capital Ratio (%)	Adj. NPAs / Assets (%)	Reserves / Adj. NPAs + 90 PD (%)	Q2 2012 Texas Ratio (%)
Median	$133,057	$115,385	$202	67.49%	0.74%	6.85%	9.53%	16.69%	1.67%	42.20%	16.28%
Average	$692,176	$562,606	$1,228	71.66%	0.60%	3.98%	10.38%	20.41%	3.06%	103.87%	31.90%

Q1 2012

	Assets ($000s)	Deposits ($000s)	Net Income - MRQ ($000s)	Efficiency Ratio (%)	ROAA (%)	ROAE (%)	Leverage Ratio (%)	Risk-Based Capital Ratio (%)	Adj. NPAs / Assets (%)	Reserves / Adj. NPAs + 90 PD (%)	Q1 2012 Texas Ratio (%)
Median	$135,069	$114,669	$204	67.87%	0.74%	6.90%	9.47%	16.42%	1.67%	42.20%	16.29%
Average	$690,367	$561,499	$1,110	71.57%	0.67%	4.93%	10.32%	20.27%	3.12%	103.87%	32.10%

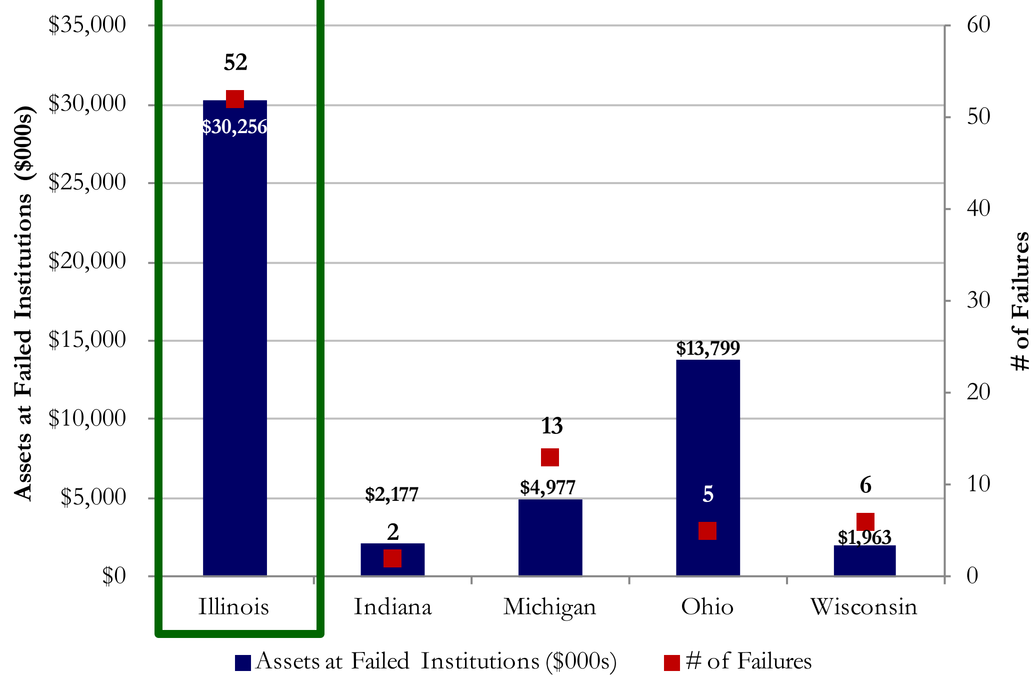
Q4 2011

	Assets ($000s)	Deposits ($000s)	Net Income - MRQ ($000s)	Efficiency Ratio (%)	ROAA (%)	ROAE (%)	Leverage Ratio (%)	Risk-Based Capital Ratio (%)	Adj. NPAs / Assets (%)	Reserves / Adj. NPAs + 90 PD (%)	Q4 2011 Texas Ratio (%)
Median	$130,566	$110,800	$153	69.15%	0.65%	5.94%	9.46%	16.30%	1.62%	42.20%	16.45%
Average	$706,231	$576,915	$856	74.44%	0.10%	-3.00%	10.29%	19.67%	3.06%	103.87%	32.43%

Great Lakes Bank Failures in This Cycle

Although Illinois has seen the most bank failures of the Great Lakes states in this credit cycle, only 7 banks have failed in 2012. There are still 37 Illinois banks with Texas Ratios greater than 100% as of June 30, 2012 and 17 banks have Tier 1 Leverage Ratios less than 5.0%.

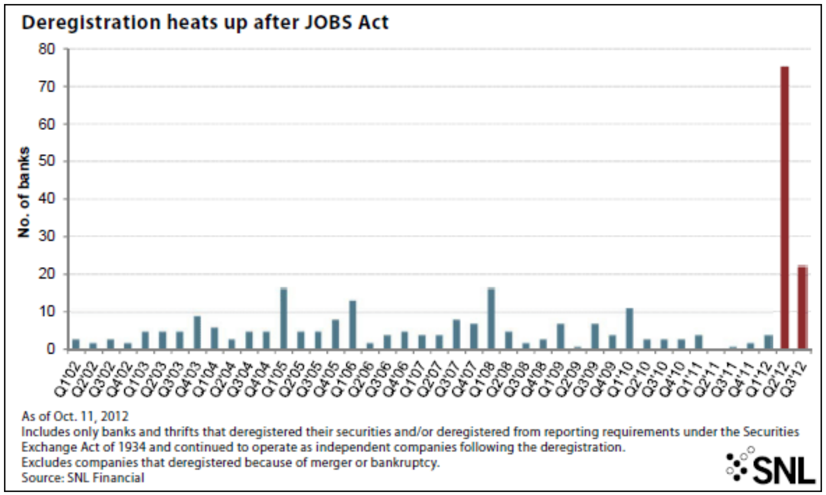
	Illinois	Indiana	Michigan	Ohio	Wisconsin	Total
# of Failures	52	2	13	5	6	78
Assets at Failed Institutions ($000s)	$30,256	$2,177	$4,977	$13,799	$1,963	$53,172

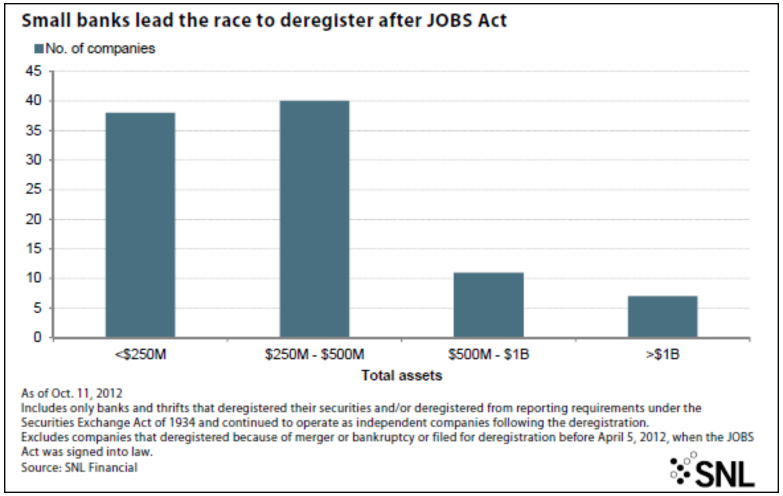


2. Capital Raising Environment

JOBS Act

- JOBS Act eased regulatory burdens by increasing the threshold under which a bank or bank holding co. may terminate registration of its securities
  - Can terminate registration if have 1,200 shareholders or less (previous law was 300)
- JOBS Act also raised the threshold requiring banking companies to register under the Exchange Act to 2,000 shareholders from 500





The JOBS Act has allowed nearly 100 banks to deregister its stock, saving what can be significant cost and time. It also allows banks to raise capital from larger numbers of shareholders (if necessary) without being forced to file with the SEC.

Capital Guideline Review

With Basel III suggesting that community banks will need to raise their capital levels, in addition to the phasing out of Trust Preferred Securities counting as capital, many institutions will need to raise capital in the coming years.

		Current Standards		
Ratio	Regulatory Guidance	Well-Capitalized	Capital Adequacy	Under Capitalized
Tier 1 Leverage	8.0%	5.0%	4.0%	3.0%
Tier 1 Risk-Based Capital	9.0%	6.0%	4.0%	3.0%
Total Risk-Based Capital	12.0%	10.0%	8.0%	6.0%

Capital Raise – Pros and Cons

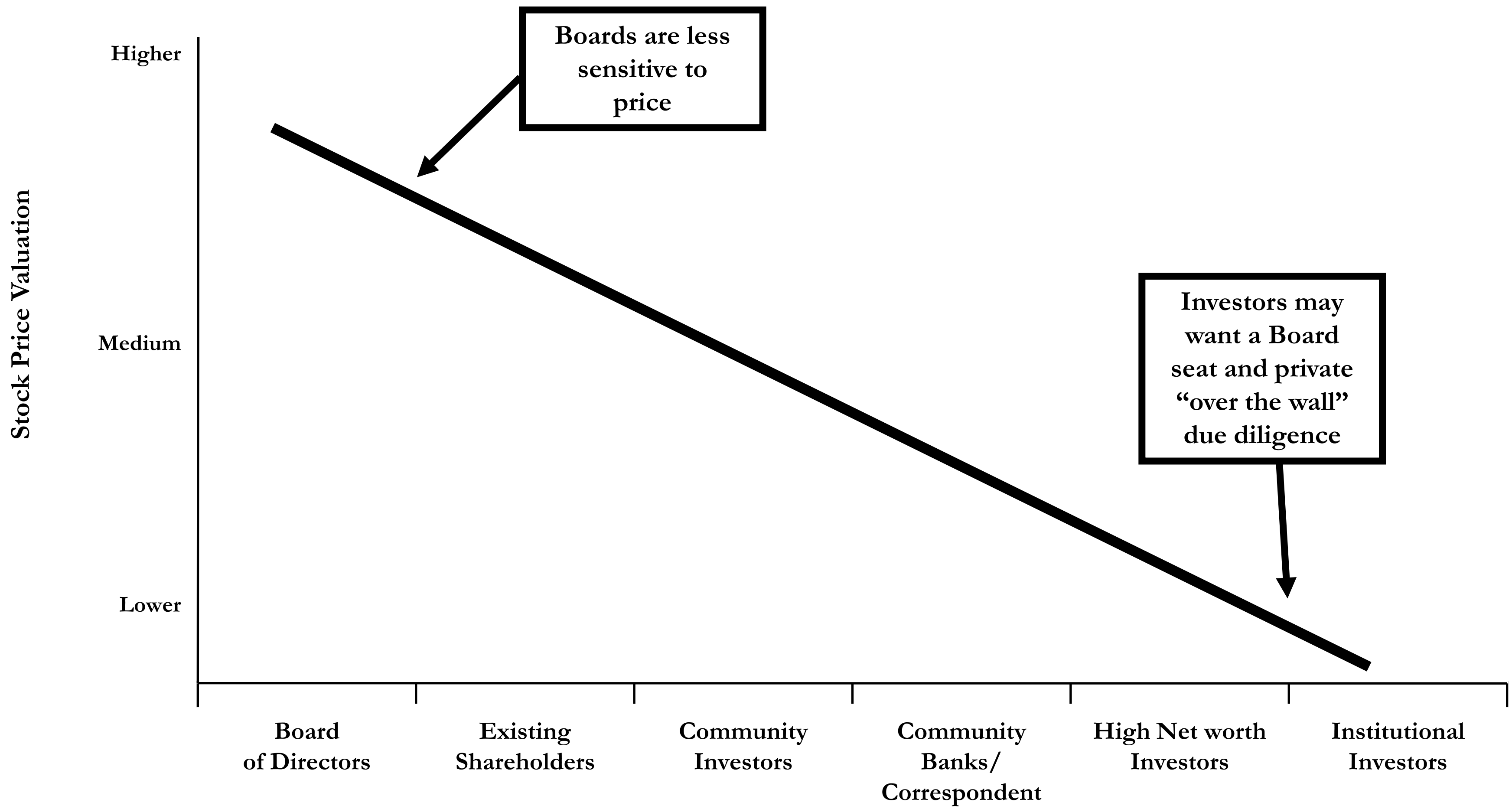
Positives

- Bank remains independent
- Management can pursue growth opportunities when some peer banks are impaired
- Community investors and existing shareholders could participate in a capital offering
- Possible upside by investing "at the bottom" of the cycle
- Management and Board remain in place
- Satisfy regulators / legislative demands for new "normal" for capital ratios

Negatives

- Low valuations
- Failure to raise capital risk
- Significant shareholder dilution to current shareholders
- Difficult market conditions for small banks, outside of the current shareholders and local community
- May not be able to grow bank to critical mass necessary in today's banking environment depending on amount of capital raised
- Possible loss of control

Common Stock – Pricing Matrix



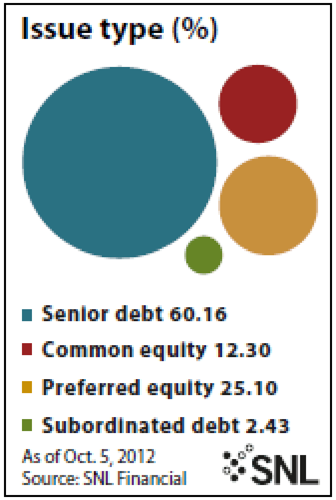
Capital Markets Overview

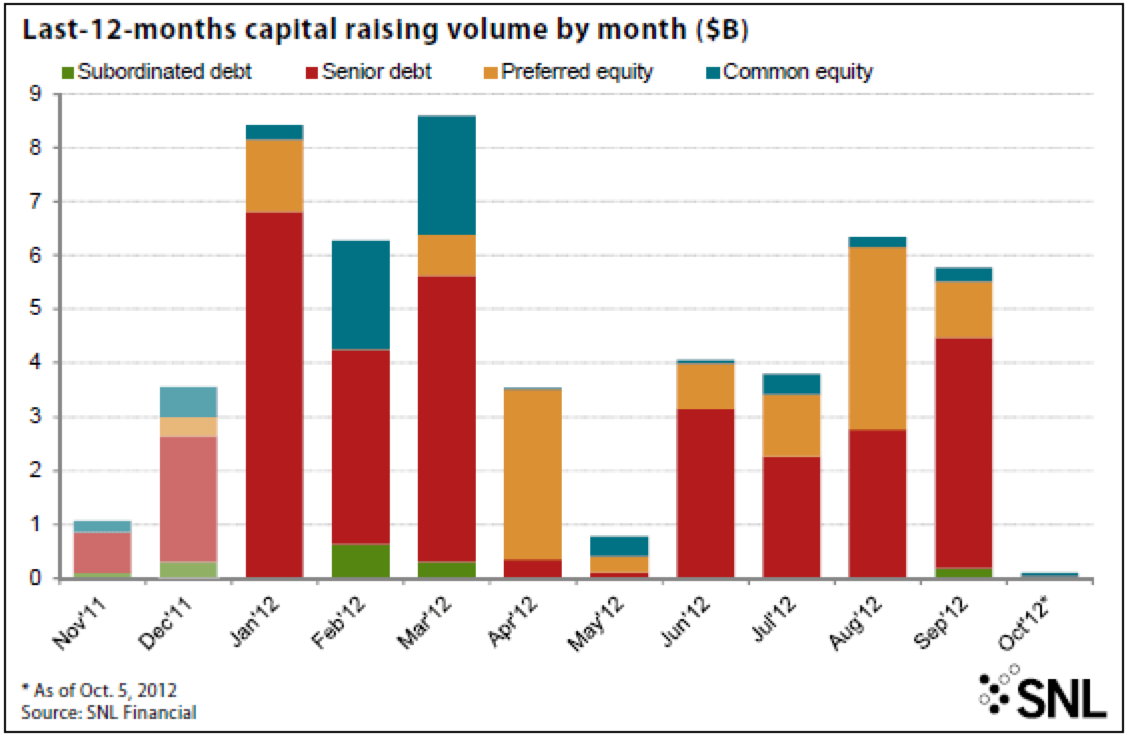
Less Capital Treatment; Less EPS Dilution	Senior Debt	Subordinated Debt	Trust Preferred	Preferred	Convertible Preferred	Common Equity	Higher Capital Treatment; More EPS Dilution

	Benefits	Issues
Common Equity (through rights offering, public offering or private placement)	▲ Easy for market to understand ▲ Increases tangible book value ("TBV") ▲ Immediately improves all capital ratios ▲ Purest form of equity	▼ High dilution to EPS, book value and tangible book value per share ▼ Ownership dilution to existing shareholders, except possibly in a rights offering ▼ Could be priced at a discount to market
Convertible Preferred (public offering or private placement)	▲ Shares are issued in the future, usually at a premium to market ▲ Less EPS, TBV per share and ownership dilution than common equity ▲ Enhances Tier 1 as preferred equity and becomes common equity when converted	▼ Moderate to high EPS dilution ▼ Low to moderate TBV per share dilution ▼ Not tax deductible
Convertible Trust Preferred (private placement)	▲ Receives Tier 1 capital treatment up to 25% of core capital. Excess counts as Tier 2 ▲ Tax deductible dividends (and cumulative) ▲ Non-dilutive expansion of Tier 1 capital base ▪ Low-cost and long-term source of capital ▪ No financial covenants	▼ Limitation on inclusion in Tier 1 ▼ More expensive than issuing straight subordinated debt – considered junior subordinated debt ▼ Moderate to high EPS dilution ▼ Low to moderate TBV per share dilution
Subordinated Debt (public offering or private placement)	▲ Least EPS dilution of the options providing regulatory capital ▲ No TBV per share or ownership dilution ▲ Enhances Tier 2 Capital	▼ Public market is effectively closed or cost is high unless security is coupled with an equity issuance of warrants or stock
Holding Co. Senior Debt (public offering or private placement)	▲ Low EPS dilution ▲ Could be pushed down as common equity to bank ▲ No TBV per share or ownership dilution	▼ Cost would be high in the current market ▼ Would not improve capital ratios at the holding company

Recent Capital Raising for Banks

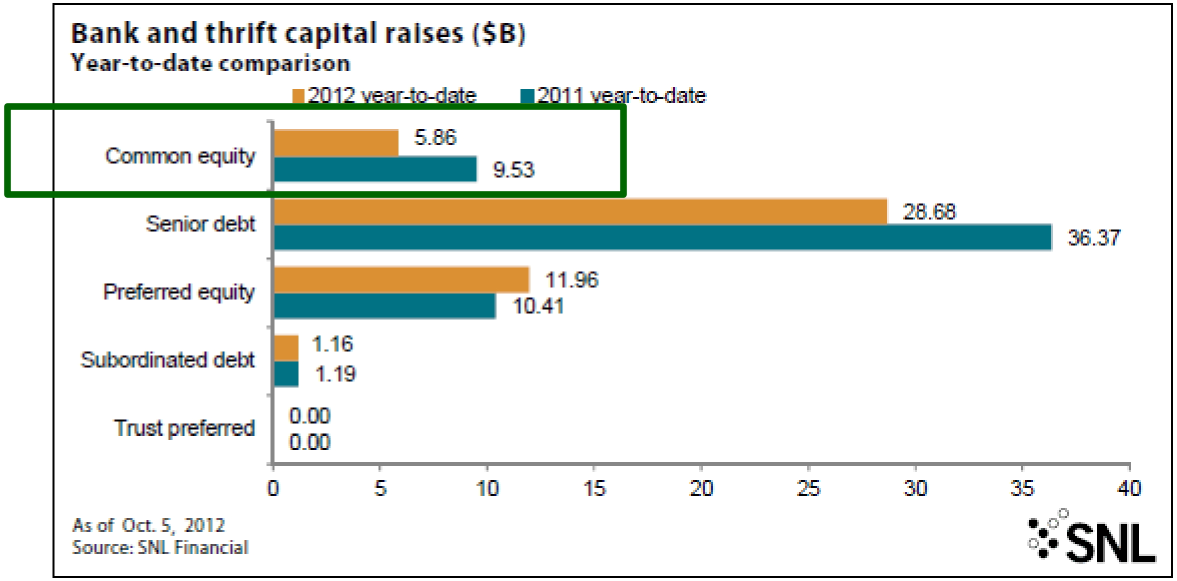
As displayed in the charts below, common equity raises represented only 12.3% of the total capital raised for banks year-to-date in 2012 (in aggregate this amount is $5.86 billion). Raising other forms of capital for community banks is challenging.





Recent Capital Raising for Banks

Capital raising for banks and thrifts has been difficult in 2012 and is down year-over-year, particularly common equity which is down more than 60%.



Capital Markets Overview – Common Stock

Senior Debt → Subordinated Debt → Trust Preferred → N.C. Convertible Preferred → **Common Stock**

Basic Features

Description	▪ Perpetual security ▪ Most permanent and most junior security in the capital structure ▪ Voting rights ▪ Equity upside ▪ No obligation to pay dividends ▪ Dividends are not tax-deductible for issuer
Advantages	▪ 100% tier 1 capital credit, without limitation ▪ Needs to be the dominant element in tier 1 ▪ 100% equity credit given by rating agencies ▪ Permanent ▪ Ability to absorb loss ▪ Additional common equity expands a bank's capacity to issue additional hybrids
Disadvantages	▪ High risk requires a commensurate return, making common equity the most expensive form of capital ▪ New issuance is the most dilutive alternative to the existing common equity holders ▪ Investors demanding discount to TBV

Current market commentary

- Recent offerings being issued at discounts to current trading levels and often TBV
- Wall-crossing structures with key investors is an increasingly common practice
- Increased analyst focus on common equity importance for financial institutions
- Many current common stock offerings are being pursued by banks/investors to purchase failed institutions from the FDIC and pursue normal M&A activities
- Significant competition for capital in the markets
- In many cases, it has been easier to raise larger sums of capital rather than smaller sums of capital as investors want to put more money to work and try to overcapitalize institutions to take advantage of opportunities and work through problem assets

Recent issuance summary

See Following Page

Current Institutional Investment Market

23 community banks (<$5bb in assets) have been able to successfully raise common stock in 2012 (>$5mm), at a median price of 87.5% of pro forma TBV

Company	Ticker	Location	Announcement Date	Completion Date	Total Assets ($000s)	NPAs/ Assets (%)	Gross Amount Offered ($000s)	Offer Price per Share ($)	Offer Price/ Pro Forma TBV (%)
Hampton Roads Bankshares, Inc.	HMPR	Norfolk, VA	5/21/2012	9/27/2012	$2,070,945	9.21%	$14,700	0.70	55.5%
Hampton Roads Bankshares, Inc.	HMPR	Norfolk, VA	5/21/2012	9/27/2012	2,070,945	9.21%	30,301	0.70	59.4%
Suffolk Bancorp	SUBK	Riverhead, NY	9/20/2012	9/19/2012	1,558,402	4.72%	24,071	13.50	95.7%
Customers Bancorp, Inc.	CUUU	Wyomissing, PA	8/28/2012	9/14/2012	2,283,032	1.71%	59,131	14.00	101.1%
Customers Bancorp, Inc.		Wyomissing, PA	8/28/2012	9/14/2012	2,283,032	1.71%	25,869	14.00	101.3%
Customers Bancorp, Inc.	CUUU	Wyomissing, PA	8/14/2012	8/31/2012	2,283,032	1.71%	9,940	NA	NA
Lakeland Bancorp, Inc.	LBAI	Oak Ridge, NJ	8/28/2012	8/29/2012	2,853,202	1.61%	19,139	9.65	156.2%
Lakeland Bancorp, Inc.	LBAI	Oak Ridge, NJ	8/28/2012	8/29/2012	2,853,202	1.61%	6,000	9.65	160.7%
Central Federal Corporation	CFBK	Fairlawn, OH	10/21/2011	8/14/2012	225,615	6.07%	18,000	1.50	100.9%
Mackinac Financial Corporation	MFNC	Manistique, MI	8/14/2012	8/10/2012	524,366	1.70%	5,306	5.75	45.7%
Provident New York Bancorp	PBNY	Montebello, NY	8/7/2012	8/7/2012	3,150,040	1.91%	46,000	7.35	99.5%
First Community Corporation	FCCO	Lexington, SC	5/15/2012	7/23/2012	598,014	2.37%	15,000	8.00	76.2%
Howard Bancorp, Inc.	HBMD	Ellicott City, MD	11/28/2011	7/20/2012	347,820	2.23%	6,043	7.30	83.4%
Mackinac Financial Corporation	MFNC	Manistique, MI	3/28/2012	7/16/2012	506,496	2.04%	7,000	5.75	51.2%
Hampton Roads Bankshares, Inc.	HMPR	Norfolk, VA	5/21/2012	6/27/2012	2,133,027	9.56%	50,000	0.70	49.0%
FNB United Corp.	FNBN	Asheboro, NC	5/21/2012	6/26/2012	2,387,946	8.89%	7,290	NA	NA
First National Corporation	FXNC	Strasburg, VA	5/8/2012	6/25/2012	528,243	3.28%	6,083	4.00	64.5%
Northeast Bancorp	NBN	Lewiston, ME	3/19/2012	5/16/2012	594,952	1.04%	47,459	8.00	68.2%
Northeast Bancorp		Lewiston, ME	3/19/2012	5/16/2012	594,952	1.04%	7,048	8.00	55.8%
MetroCorp Bancshares, Inc.	MCBI	Houston, TX	5/15/2012	5/16/2012	1,501,007	3.83%	46,006	9.00	103.9%
1st Enterprise Bank	FENB	Los Angeles, CA	5/16/2012	5/16/2012	578,961	0.41%	12,500	13.00	104.9%
First Capital Bancorp, Inc.	FCVA	Glen Allen, VA	1/19/2012	5/11/2012	530,053	4.95%	8,089	2.00	36.2%
First Capital Bancorp, Inc.	FCVA	Glen Allen, VA	1/19/2012	5/11/2012	530,053	4.95%	9,738	2.00	38.8%
Meta Financial Group, Inc.	CASH	Sioux Falls, SD	5/10/2012	5/9/2012	1,359,205	1.41%	7,622	20.60	80.1%
Pacific Mercantile Bancorp	PMBC	Costa Mesa, CA	8/26/2011	4/20/2012	1,024,552	5.07%	26,300	6.26	100.0%
Central Pacific Financial Corp.	CPF	Honolulu, HI	3/29/2012	3/29/2012	4,132,865	4.93%	36,427	13.15	123.6%
Tompkins Financial Corporation	TMP	Ithaca, NY	3/27/2012	3/28/2012	3,400,248	1.22%	40,250	40.00	164.8%
CoBiz Financial Inc.	COBZ	Denver, CO	3/19/2012	3/19/2012	2,423,504	2.73%	12,600	6.00	136.8%
HomeStreet, Inc.	HMST	Seattle, WA	5/6/2011	2/10/2012	2,316,839	9.95%	95,960	44.00	NA
Intermountain Community Bancorp	IMCBD	Sandpoint, ID	4/7/2011	1/23/2012	926,523	2.17%	12,350	1.00	28.3%
New Resource Bank	NWBN	San Francisco, CA	1/26/2012	1/20/2012	160,648	0.79%	7,700	4.40	91.6%
Maximum					**$4,132,865**	**9.95%**	**$95,960**		**164.8%**
Average					**$1,571,991**	**3.68%**	**$23,223**		**86.9%**
Median					**$1,501,007**	**2.23%**	**$14,700**		**87.5%**
Minimum					**$160,648**	**0.41%**	**$5,306**		**28.3%**

**Publicly reported data*

Current Institutional Investment Market

- Difficult environment to raise money for smaller banks
  - Particularly if it is not being deployed for immediate growth/acquisitions
- Pricing is unfavorable in most cases for bank
  - Expect a discount to market and book value in most cases
- Board representation requirement
- Exit strategy in next 1-7 years needs to be defined (depending on investor)
- Some historic community bank investors low on funds / currently fundraising
- Some newer institutional investors looking at bank investments

Common Investment Themes of Institutional Investors

Positives	Negatives
✓ Effective deployment of capital	o C&D / Investor CRE / HELOC loans
✓ Focused growth strategy	o Distressed loan portfolio
✓ Experienced management team with local knowledge and relationships	o Negative trending asset quality migration
✓ Strong core deposit franchise	o Reliance on brokered / wholesale funding
✓ Loan portfolio diversification with particular emphasis on C&I / owner-occupied CRE	o Declining loan portfolio
✓ Good relationship with regulators	o Ineffective branch system
✓ Critical risk management processes in place	o Convoluted capital structure (TARP preferred, Trust Preferred, sub debt)
✓ Steady stream of secondary income sources (mortgage origination, trust, wealth management)	o Concentrated shareholder ownership
	o Sensitivity to investment price

3. Merger & Acquisition Market Update

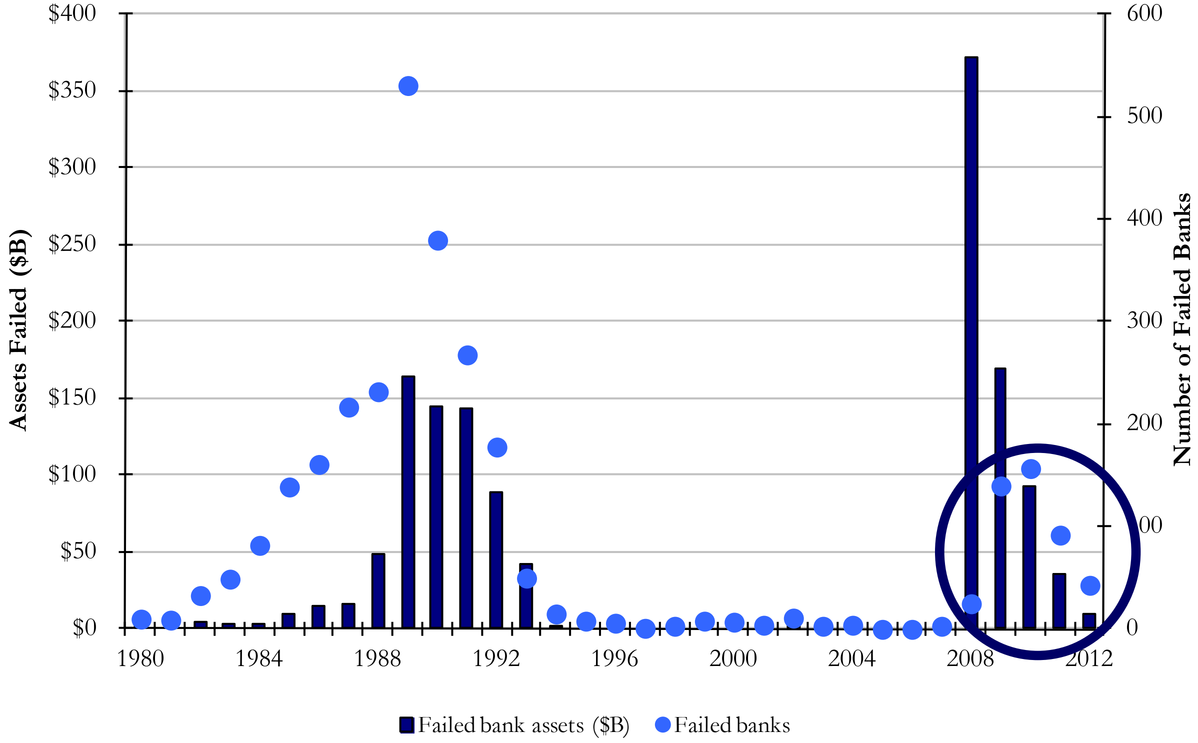
Merger & Acquisition Market Update

- 2009-2011 M&A market dominated by FDIC-assisted transactions; 2012 showing a slowdown in bank failures
- Unassisted M&A transactions began to pick up in second half 2010
    - Acquirer stock has been a major component of consideration offered
- Deal values are well below pricing multiples seen up through 2007 ("book to book")
- Depressed stock currencies have forced many would-be buyers to sit on the sidelines until the market for their own stock improves
- Fair value accounting plays a crucial role in determining M&A viability for many participants – often forcing a concurrent capital raise
- Mergers of equals possible, but difficult to close – "social" issues need to be overcome
- An acquisition that is priced appropriately has the potential to be a less dilutive source of capital

Many factors are leading to a rebound in strategic open-bank M&A (improving economy, credit quality, stock prices, costs of banking, etc.) and we expect this trend to continue and actually hasten.

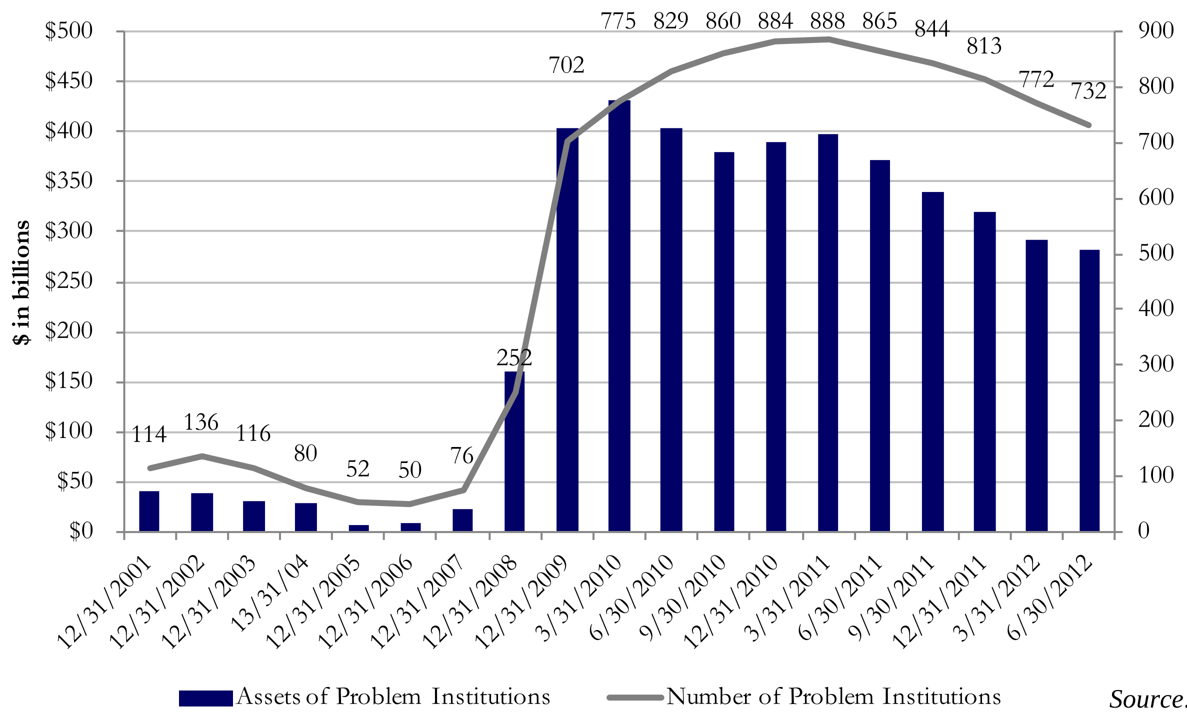
Historical Bank Failures

The number of bank failures peaked in 2010 at 157, declining to 92 in 2011 and 43 year-to-date through October 12, 2012. The FDIC's Problem Institution List remains high, but also is declining – however, we still expect more bank failures as capital options remains limited for distressed institutions.



FDIC Problem List Remains High

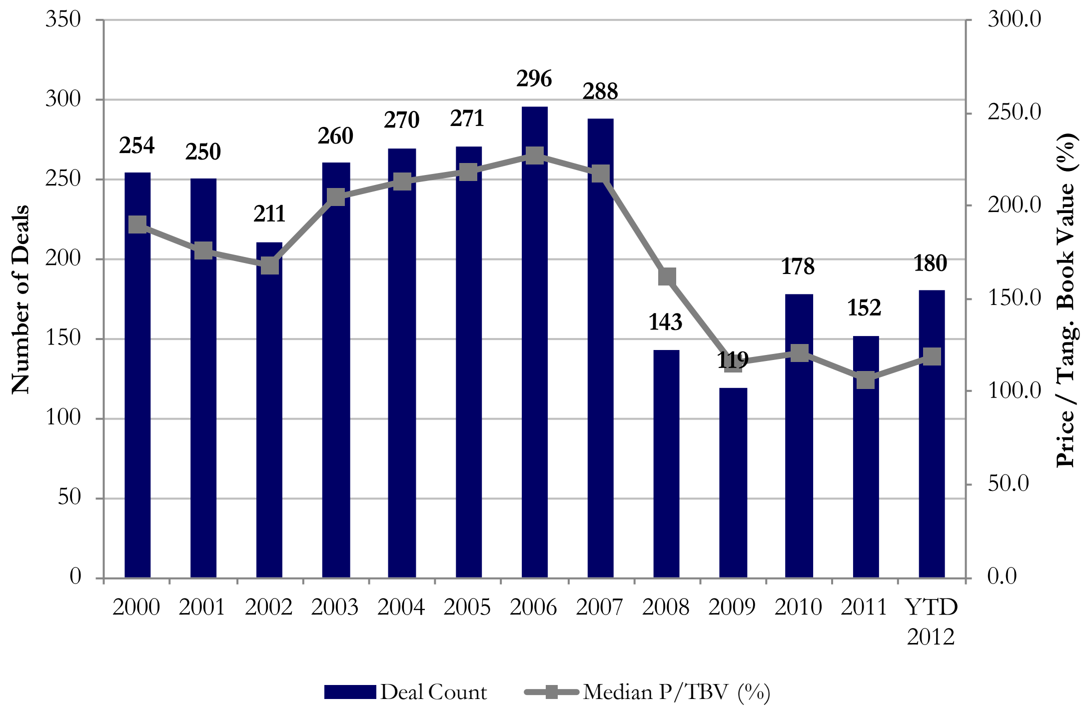
The FDIC Problem Institution List continues to decline – however this list indicates that more than 10% of the nation's banks are constrained in their lending abilities. These institutions may not ultimately fail, but rather may become acquisition targets.



Source: FDIC

Unassisted Strategic M&A Rebounding

As the economy continues to improve and bank fundamentals strengthen, the level of failed bank opportunities will continue to decline and the likelihood of normal-course strategic M&A to increase is very high.



Community Bank Merger & Acquisition Market Update

Historically low transaction multiples can be intriguing to consolidators, however extensive loan diligence and fair value accounting are critical to a successful transaction. Often times there is a disconnect between the buyer and seller expectations with respect to valuation – this is slowing up deal activity across the nation.

The table below depicts unassisted M&A transaction metrics nationally since September 30, 2011 for banks with less than $5.0 billion of assets:

		Median Results					
Target Asset Size	# of Transactions	Target Assets ($000s)	NPAs / Assets (%)	Price / Book Value (%)	Price / Tang. Book Value (%)	Premium / Core Deposits (%)	One-Day Premium (%)
$1.0bb-$5.0bb	13	$1,603,759	2.63%	146.63%	160.94%	5.34%	36.44%
$500mm-$1.0bb	15	$712,945	3.96%	112.92%	112.92%	0.54%	23.58%
$250mm-$500mm	26	$347,829	3.67%	112.13%	116.16%	2.31%	32.36%
$100mm-$250mm	42	$154,802	2.96%	102.44%	102.44%	0.42%	nmf
< $100mm *	71	$47,021	1.50%	111.25%	111.25%	1.95%	nmf

Capital Markets Transactions – Importance of Loan Diligence

- Modern day fair value accounting can potentially leave a large hole in the pro forma capital structure - extensive loan diligence is critical
- In a very simplistic manner, some banks are valued using the following structure:

Tier 1 Common Capital

Add:

Core Deposit Premium:

Noninterest Bearing
Other Transaction
Money Market & Savings
Retail Time Deposits
Jumbo Time Deposits

Less:

Fair Value Marks on NPAs

Less:

Fair Value Marks on Other Loans/Assets

=

FRANCHISE VALUE

Capital Markets Transactions – Importance of Loan Diligence

- Capital markets valuations typically based on expected credit losses in the loan portfolio
- All watch list, nonperforming loans, and OREO will be heavily reviewed for proper documentation, updated appraisals, audited and updated internal financial statements, cash flow forecasts, etc.
- Extensive on-site loan due diligence – typically will try to review 50-75% of the gross loan portfolio
- Outside loan review consultants are typically engaged by potential buyer/investor
- Loans will be re-graded to reflect the underwriting standards of the potential buyer/investor
- Additional loan reserve is often suggested based on diligence

Due to adverse loan due diligence results and fair value accounting a concurrent capital raise is often needed to support the M&A transaction

Merger of Equals Concept

- Merger of equals can help two smaller banks gain the scale necessary to combat the increasing costs of banking
- Often contemplated on a "book-to book" valuation basis based on the "true" book values of each partner
- While a novel concept, a merger of equals is much more complex to facilitate for some of the following reasons:
  - Social/cultural issues
  - Fair value accounting may leave a hole in the consolidated capital structure – particularly an issue for two banks with "thin" capital ratios
  - Will a capital hole or aggregated credit problems leave the consolidated bank in a lower regulatory standing?

As regulatory and legislative activity in the banking area continues, we expect the "cost of banking" to become burdensome enough to increase the frequency of the merger of equals consolidation activity

Other Market Opportunities

- Branch transactions
  - Since 2010, the median branch transaction has been at a deposit premium of less than 2.0% - like other M&A, transaction premiums have fallen significantly in recent years
  - Typical branch transactions in the current market are deposit only – if loans are involved, a buyer will likely only purchase the best performing loans, but this can present an opportunity to generate accretive loan growth
  - Many struggling banks can not sell branches without loans due to liquidity concerns
- Buy/Sell subsidiary banks / mortgage / wealth management / trust groups
  - May not be an option for many banks
  - Will often have to sell off an operation that was a net positive to the profitability of the consolidated bank

Capital Markets Summary

Capital Raising Environment

- Common equity is the primary capital raising tool for community banks today
- Low valuations (particularly the further one gets from local investors)
- Difficult to raise "fill the hole" capital
- Scale is of increasing importance to many bank investors and PE groups
- Opportunities for banks that can raise capital to increase shareholder value

Merger and Acquisition Activity

- FDIC-assisted transactions dominated M&A landscape (2008-2010)
- Increasing levels of non-assisted transactions – particularly as stock prices rebound for potential buyers
- Transaction multiples lower than past, though largely higher than publicly traded values
- Fair value accounting and adverse loan due diligence create a hurdle to deal activity
- **Tremendous opportunities to gain scale and create shareholder value through M&A either through being an acquirer or the acquired**
- **Branch transactions / asset dispositions increasing as means to raise capital**

4. Profiling the Market and Creating Shareholder Value

Relevant Community Bank Performance Metrics by Size

The chart above illustrates that smaller banks trade at significantly lower valuations than larger banks as investors anticipate that the increased costs of banking will reduce future profitability of smaller banks – gaining scale not only generally leads to improved profitability, but also valuation expansion in the public markets

($ in 000s)

			Balance Sheet		Performance Analysis				Valuation Metrics	
Median Results	# of Banks	% of Banks with TARP	Assets	Deposits	LTM ROAA	LTM ROAE	LTM Net Interest Margin	LTM Efficiency Ratio	Price / Book Value	Price / Tang. Book Value
Small Cap [1]	177	14.69%	$1,928,399	$1,455,674	0.85%	8.05%	3.77%	63.75%	111.19%	123.72%
Micro Cap [2]	246	10.16%	523,980	420,752	0.75%	7.12%	3.69%	68.18%	85.91%	90.28%

Footnotes:

[1] Small cap comparable group set includes all public banks with assets between $1 and $5 billion, NPAs/assets less than 5%, and tang. equity greater than 6%

[2] Micro cap comparable group set includes all public banks with assets between $250 million and $1 billion, NPAs/assets less than 5%, and tang. equity greater than 6%

How do Community Banks Close the Valuation Gap?

A. Obtain scale (> $1 billion in assets) that allows banks to absorb the increasing costs of banking and produce adequate shareholder returns (through organic growth opportunities or partnering with another institution)

OR

B. Prove to investors that your bank can operate with consistently high levels of profitability at a smaller asset size (< $500 million in assets)

The investment community believes that most banks will have to choose option A and are investing in larger banks or banks with clear growth strategies to become a bank with scale (> $1 billion in assets)

How do Community Banks Close the Valuation Gap?

Potential growth activities to achieve scale and close "the gap":

- Open new branches
- Increase asset size through:
  - Increasing core deposit base in anticipation of renewed quality lending opportunities
  - Hire additional lending teams
  - Purchase in-market loan participations
- Increase non-interest income generating activities

Capital Required

- Buy branches from another institution
- Acquire another bank in an FDIC-assisted transaction
- Acquire another bank in a non-assisted transaction
- Merge with a like-size bank near your market ("Merger of Equals")
- Sell to a larger institution

Capital Required / M&A Activity

Large Disconnect between Public Market and M&A Markets Valuations

Low valuations in the publicly traded market and/or no access to reasonably priced capital has led some banks to decide selling the bank for a premium is the best alternative for shareholder value creation – the median one-day trading premium for all M&A transactions since Sept. 30, 2011 for banks with less than $5.0 billion in assets is 33.0%

The chart below shows the difference between current valuations in the publicly traded market and the M&A market for banks with less than $5.0 billion in assets that have sold since September 30, 2011:

	Median Results				
			Valuation Metrics		
	Assets ($000s)	NPAs / Assets (%)	Price / Book Value (%)	Price / Tang. Book Value (%)	Price / LTM EPS (x)
Comparable Company Median	$556,642	2.60%	83.92%	88.20%	13.06x
Comparable Acquisition Median	$123,281	2.30%	115.32%	116.05%	28.12x

Helpful Tips in Promoting Your Stock

- Establish relationships with local brokers and market makers
- Communicate regularly with shareholders:
  - Quarterly shareholder letter with financial statements
  - Quarterly call with major/all shareholders
  - Shareholder "module" on website
  - Investor presentation
- Remain active in the local communities that you serve (Rotary, Chamber, Trade Associations, Schools, etc.)
- Publish press releases detailing achievements
- Publish peer comparison reports that are composed of public knowledge

5. Strengthening Franchise Value

Strengthening Franchise Value

Securities

- ✓ Goal is to utilize securities to maintain proper level of liquidity given deposit/liability composition while minimizing risk
- ✓ Laddered maturities in treasuries, agencies, GSA, plain-vanilla MBS; no TruPS pooled investments or other exotic equity/debt investments

Loans

- ✓ Diversified loan portfolio with no significant concentrations in any particular area (ensure adherence to regulatory levels)
- ✓ C&D and investor CRE have been of concern recently, but may not be taboo in 5 years from now if underwritten properly after recessionary credit cycle (if done in moderation)
- ✓ Proper underwriting/documentation for all loans (recent appraisals for all real estate loans, financial statements/audits for C&I, guarantors, etc.)
- ✓ Low exposure to purchased participations – unless from strong institutions and banks HCB is familiar with

Strengthening Franchise Value

Credit Quality

- ✓ Strong credit quality key to premium valuation
- ✓ Adequate/supportable loan loss reserve
- ✓ Loans underwritten post-recession should not have any credit troubles (unusual circumstances excluded)
- ✓ Return to "normalized" level of provision expense / net chargeoffs

Other

- ✓ Strong, well-located branch network that allows for brand recognition but maintains appropriate level of branch profitability
  - If branches are leased, no long-term, above-market lease agreements
- ✓ Treasury management services, remote deposit capture, other industry-leading banking products – particularly for C&I customers
- ✓ Ancillary products/services to promote cross-selling within the organization (mortgage origination, trust, wealth management)

Deposits

- ✓ Focus should be on having above-peer level of core deposits, particularly noninterest-bearing, checking, and savings accounts
- ✓ Customers with long-tenured relationship with HCB and more than one deposit account
- ✓ Multiple deposit/loan products within a deposit relationship is a positive
- ✓ Cost of interest-bearing deposit relationships, particularly core relationships, should be below peer
- ✓ Retail CDs should have a balanced maturity schedule and should not be used to attract out-of-market customers via above-market interest rates
- ✓ Brokered/Internet CDs should only be used in an effort to improve ALM or take advantage of short-term opportunities – should not be integral to long-term focus

Other Borrowings

- ✓ Other borrowings should be used to bridge a funding gap, take advantage of a market opportunity, or to effectively manage asset-liability mix
- ✓ The less reliance on subordinated debt / TruPS, the better – a straightforward capital structure will be much preferred in a more regulated environment

Capital Structure

- ✓ Focus will be on tangible common equity
  - Should prepare strategy to ensure tangible capital levels are in line with Basel III Accord – Tier 1 Common Capital will be primary focus (7%)
- ✓ The simpler the capital structure, the better
  - Subordinated debt/TruPS will murky the capital structure
- ✓ Avoid issuing any potentially dilutive convertible securities (noncum, convert. preferred)
- ✓ Exercisable options/warrants should generally not exceed 10% of outstanding shares
- ✓ Diversified shareholder ownership is generally preferable

Other Considerations

- ✓ Does the bank have change-in-control agreements for senior management?
- ✓ Does the bank have a solid branch infrastructure?
- ✓ Does the bank utilize a recognized data processing/technology provider?
  - Termination fees for contract?
- ✓ Objective senior management / Board of Directors with combined minority stake in the bank
- ✓ Does the bank have non-compete agreements in place with key personnel?

Income Statement

- ✓ Core earnings ability (pre-tax, pre-provision, excluding nonrecurring income/expenses) will be the primary focus
- ✓ Ancillary income from mortgage origination, trust, wealth management, insurance is favorable
- ✓ Core operating expenses should be in line with peer, or better
  - Any above-market contracts (lease, data processing, etc.) with onerous termination costs may be a deal-breaker
- ✓ Ability to use any deferred tax benefits (NOL, DTA)

6. Overview of Donnelly Penman & Partners

Overview of Donnelly Penman & Partners

- Located in Grosse Pointe, Michigan.
- One of the largest independent investment banking firms headquartered in Midwest.
- Registered broker/dealer with the Financial Industry Regulatory Authority (FINRA).
- Manager of Donnelly Penman Financial Services Fund, a $28 million private equity fund dedicated to investing in community bank equities across the nation.
- Provide comprehensive advisory services to both public and private companies:
  - **Merger and Acquisitions**
  - **Capital Raising**
  - **Fairness Opinions/Valuations**
  - **Financial Advisory**
  - **Market Making**
- Owned by employees of the firm.
- Participated in over 225 transactions since 2000.
- Organized into industry groups, with a specialty in financial institutions.

Overview of Donnelly Penman & Partners

- Donnelly Penman staff consists of 10 professionals including an attorney; 2 CPAs; 3 MBAs; 2 Chartered Financial Analysts (CFA) and 1 CFA level III candidate.

- 8 of our professionals are Series 7 and 63 licensed, 3 are Series 24 licensed and 1 is Series 55 (trading) licensed and two are series 27 licensed (finance and operations).

- Donnelly Penman's Messrs. Donnelly and Penman were also members of the 9-person Executive Committee for Roney & Co., Michigan's largest broker/dealer at the time of its sale to Raymond James & Associates in 1998.

Donnelly Penman & Partners – *Financial Institutions Group*

Donnelly Penman provides a full range of financial advisory services to banks, mortgage companies and specialty finance companies.

Mergers & Acquisitions	Capital Raising		Financial Advisory		
Sell Side/Buy Side	Public Offerings	Private Offering	Fairness Opinions	Valuations	General
• Identify, analyze and initiate transaction • Advise on deal structure • Assist with negotiations • Merger of equals expertise • Special Committee assignments	• Common Stock • Subordinated Debt • Preferred Stock • Warrants & Rights Offerings	• Private Equity Placements • Private Debt Placements	• Merger and Acquisitions • Stock Repurchase Plans • Privatizations	• ESOP Programs • Estate Planning • Leveraged Buyouts • Strategic Alternatives	• M&A Due Diligence Advisory Services • Recapitalizations • Transaction Options • Capital Planning

- DP&P are recognized experts in financial institutions, with a focus on the Midwest, Southeast, Texas and California.
- DP&P manages a private equity fund devoted solely to investing in financial institutions
- DP&P prides itself on long-term relationships as evidenced by significant repeat business

Financial Institutions Group – *Community Bank Expertise*

Recognized Leader in Financial Institutions Investment Banking Expertise

- Focused on community banks, mortgage companies and specialty finance companies.
- Focused on the Midwest, Southeast, Texas and California.
- Participated in over 40 capital raising transactions, raising over $300 million in gross proceeds, since 2000.
- Strong relationships with institutional investors through recent capital raising activity and the Donnelly Penman Financial Services Fund.
- Ranked in the top 10 nationally for Midwest merger and acquisitions and #1 in Michigan over the last five years as ranked by SNL for number of banking transactions completed.
- Provide numerous financial institutions with annual and special situation valuation opinions, including fairness opinions.
- Served as M&A advisor in over $650 million of total deal volume since 1997.