# M&A Discussion – KeyBank's \$4.1 Billion Acquisition of First Niagara

Presentation to the Board of Directors

#### M&A Recommendation and Executive Summary

- We recommend **against** pursuing this \$4.1 billion acquisition of First Niagara, as the company is ~45% overvalued at that price, and the deal is dependent on Cost Synergies that represent 40% of First Niagara's Non-Interest Expense
- Similar, recent deals in the sector have had *projected* Cost Synergies estimated at ~30% of the Seller's Non-Interest Expense; the average over the past ~20 years is closer to 25%
- Not only is First Niagara overvalued at the Offer Price of \$11.40 / share, but its ROE, ROA, ROTCE, and regulatory capital ratios are all worse than KeyBank's
- First Niagara is more of a pure-play commercial bank, but KeyBank has been diversifying and moving away from that model; ~55% of its Revenue comes from Net Interest Income vs. ~80% for First Niagara
- First Niagara would not deliver lower funding costs, higher Asset Growth, or valuable IP for KeyBank; the only benefits would be modest geographic expansion and a slightly more diversified loan portfolio
- This transaction would make sense only if the Purchase Price were significantly lower or far lower Cost Synergies were required for significant EPS accretion and improvement in the Returns-based financial metrics

### Valuation: Summary of Dividend Discount Model Assumptions

**Total Asset Growth Rate** 

Between 1% and 2%; declines to 1.5% by FY 26

Risk-Weighted Assets % Total Assets

■ 73-74% over the 12 years in the explicit forecast period (FY 15 – FY 26)

Targeted CET 1 Ratio

• 9.0% (Slightly above company's current target of 8.5%)

Return on Average Assets

0.60% increasing to 0.83% by FY 26

**Dividend Payout Ratio** 

65-70% increasing to 80% by FY 26

Cost of Equity

• 8.97% in all periods (2.1% RFR, 5.8% ERP, and 1.19 Levered Beta)

Terminal P / TBV Multiple

 1.33x based on 1.6% NI to Common Growth, 11.42% ROTCE, and 8.97% Cost of Equity; implied Terminal P / E multiple of 11.8x

### Dividend Discount Model Output

(\$ USD in Millions except for \$ per Share Figures)

As a standalone entity, First Niagara is almost certainly overvalued at its undisturbed share price of \$8.96, let alone the Offer Price of \$11.40:

Discount Rate (Cost of Equity):																			
		8.	.00%	8.	25%	8.	.50%	8.	75%	9.	00%	9.	25%	9.	.50%	9.	75%	10	.00%
	1.50 x	\$	9.15	\$	8.95	\$	8.75	\$	8.56	\$	8.38	\$	8.20	\$	8.02	\$	7.85	\$	7.68
	1.45 x		8.97		8.78		8.59		8.40		8.22		8.04		7.87		7.71		7.54
	1.40 x		8.80		8.61		8.42		8.24		8.07		7.89		7.73		7.56		7.40
Terminal P / TBV Multiple:	1.35 x		8.63		8.44		8.26		8.08		7.91		7.74		7.58		7.42		7.27
	1.30 x		8.45		8.27		8.09		7.92		7.75		7.59		7.43		7.28		7.13
	1.25 x		8.28		8.10		7.93		7.76		7.60		7.44		7.28		7.13		6.99
	1.20 x		8.11		7.93		7.77		7.60		7.44		7.29		7.14		6.99		6.85

	Discount Rate (Cost of Equity):																		
		8	3.00%	8	3.25%	8	.50%	8	8.75%	9	.00%	9	.25%	9	9.50%	9	.75%	10	0.00%
	10.50%	\$	8.41	\$	8.21	\$	8.02	\$	7.84	\$	7.66	\$	7.49	\$	7.32	\$	7.16	\$	7.00
	10.00%		8.46		8.27		8.08		7.90		7.73		7.56		7.39		7.23		7.07
	9.50%		8.51		8.33		8.14		7.97		7.79		7.62		7.46		7.30		7.14
CET 1 Target:	9.00%		8.57		8.38		8.20		8.03		7.86		7.69		7.53		7.37		7.22
	8.50%		8.62		8.44		8.26		8.09		7.92		7.76		7.60		7.44		7.29
	8.00%		8.67		8.49		8.32		8.15		7.98		7.82		7.67		7.51		7.36
	7.50%		8.73		8.55		8.38		8.21		8.05		7.89		7.73		7.58		7.44

- However, with the full Cost Synergies factored in (40% of its Non-Interest Expense, or ~\$400 million per year), the company's implied share price jumps up to approximately \$18.00 ...
- If we attribute 100% of the Cost Synergies to First Niagara and ignore all the other acquisition effects which is questionable

### Comparable Public Companies

(\$ USD in Millions except for \$ per Share Figures)

Despite significantly worse Returns-based metrics and capital ratios, First Niagara trades above or in-line with the P / E and P / TBV multiple of its peer companies (Data from one day before announcement date):

Comparable Companies - U.S.-Based Regional Banks with Between \$20 Billion and \$150 Billion in Total Assets (\$ in Millions USD Except Per Share Data)

Operating Statistics:	<u>Capi</u>	talization & A	ssets							TCE /	Common	Tier 1
	Equity	Tangible	Total	<u>P / E</u>	P / TBV	ROAT	TCE	ROA	ROE	Tangible	Equity	Leverage
Company Name	Value	<b>Book Value</b>	Assets	FY16	LTM	LTM	FY16	LTM	LTM	Assets	Tier 1 %	Ratio
M&T Bank Corporation	\$ 15,079.8	\$ 6,957.0	\$122,787.9	14.7 x	2.2 x	13.0%	14.2%	1.16%	8.9%	7.5%	9.8%	10.2%
Comerica, Inc.	7,843.7	6,973.0	71,012.0	14.1 x	1.1 x	7.8%	7.8%	0.76%	7.2%	9.9%	10.6%	10.3%
Zions Bancorporation	6,002.3	5,601.3	58,410.9	15.0 x	1.1 x	6.1%	7.1%	0.69%	5.3%	9.8%	12.2%	11.6%
BOK Financial Corporation	4,499.3	2,946.7	30,600.0	13.9 x	1.5 x	10.3%	10.6%	0.96%	8.8%	9.8%	12.8%	9.6%
Cullen/Frost Bankers, Inc.	4,342.3	2,096.2	28,341.4	14.6 x	2.1 x	14.3%	13.9%	1.09%	10.6%	7.6%	11.6%	7.9%
Associated Banc-Corp	2,971.2	1,846.6	27,467.2	14.9 x	1.6 x	10.6%	10.4%	0.71%	6.6%	7.0%	9.4%	7.5%
First Horizon National Corporation	3,395.9	2,017.7	25,387.3	15.3 x	1.7 x	13.7%	10.8%	1.01%	11.4%	8.0%	10.8%	10.0%
Webster Bank, N.A.	3,526.8	1,700.5	24,069.8	16.0 x	2.1 x	11.9%	12.5%	0.88%	8.7%	7.2%	10.8%	8.4%
Maximum:	15,079.8	6,973.0	122,787.9	16.0 x	2.2 x	14.3%	14.2%	1.16%	11.4%	9.9%	12.8%	11.6%
75th Percentile:	6,462.7	5,940.2	61,561.2	15.1 x	2.1 x	13.2%	12.9%	1.03%	9.3%	9.8%	11.8%	10.2%
Median:	\$ 4,420.8	\$ 2,521.5	\$ 29,470.7	14.8 x	1.6 x	11.3%	10.7%	0.92%	8.8%	7.8%	10.8%	9.8%
25th Percentile:	3,494.1	1,974.9	26,947.2	14.5 x	1.4 x	9.7%	9.8%	0.75%	7.1%	7.4%	10.4%	8.3%
Minimum:	2,971.2	1,700.5	24,069.8	13.9 x	1.1 x	6.1%	7.1%	0.69%	5.3%	7.0%	9.4%	7.5%
First Niagara Financial Group, Inc.	\$ 3,203.1	\$ 2,401.0	\$ 39,413.0	15.6 x	1.3 x	9.8%	7.7%	0.63%	5.9%	6.3%	8.5%	7.6%

Valuation Multiples:	Current Price:	Offer Price:	Public Comps:	Buyer:
Forward Year 1 (2016-12-31) P / TBV:	1.2 x	1.5 x	N/A	1.2 x
Forward Year 1 (2016-12-31) P / BV:	0.8 x	1.0 x	N/A	1.1 x
Forward Year 1 (2016-12-31) P / E:	15.6 x	19.9 x	14.8 x	11.8 x
Forward Year 2 (2017-12-31) P / TBV:	1.2 x	1.5 x	N/A	1.2 x
Forward Year 2 (2017-12-31) P / BV:	0.8 x	1.0 x	N/A	1.1 x
Forward Year 2 (2017-12-31) P / E:	14.6 x	18.6 x	N/A	11.2 x

### Summary of Merger Model Assumptions

Offer Price and Premium

\$11.40 / Share (\$4.1 billion Equity Purchase Price); 27% premium

Cash / Stock Mix

20% Cash and 80% Stock; Cash funding via 7.5% Fixed-Rate Debt

Targeted CET 1 Ratio

■ 10.0% (Equity capital infusions assumed if CET 1 Ratio falls below this level)

Cost Savings

 40.0% of Seller's Non-Interest Expense (\$426 million); 50% Realization in Year 1 and 100% in Year 2 and beyond

**Restructuring Costs** 

■ 137.5% of fully-phased-in Synergies; \$567 million pre-tax charge in Year 1

Core Deposit Intangibles

1.5% of Core Deposits (\$360 Million); Straight-line amortization over 10 years

Mark-to-Market Adjustments

 3.1% Loan Mark; ~1% on Debt, Deposits, and Investments; 6-year amortization for Loan Mark

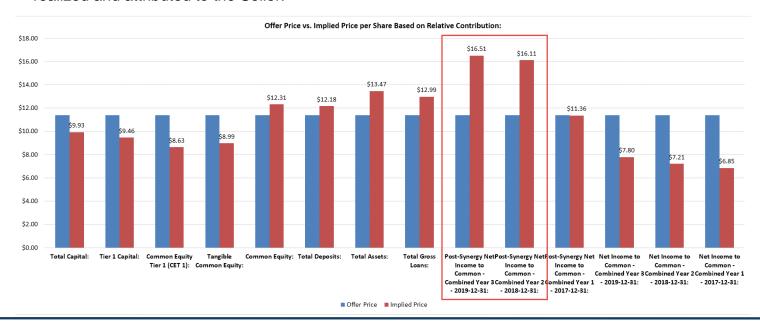
## Merger Model Output

(\$ USD in Millions except for \$ per Share Figures)

■ If the Cost Savings represent 10-20% of the Seller's Non-Interest Expense, the Year 2 EPS accretion declines to 0-5%:

				Cost	Synergies % S	Seller's Non-I	nterest Expen	se:		
		-	5.0%	10.0%	15.0%	20.0%	25.0%	30.0%	35.0%	40.0%
	35.0%	(7.4%)	(4.9%)	(2.4%)	0.1%	2.6%	5.1%	7.7%	10.2%	12.7%
	32.5%	(6.9%)	(4.4%)	(1.8%)	0.7%	3.2%	5.8%	8.3%	10.8%	13.3%
	30.0%	(6.3%)	(3.8%)	(1.3%)	1.3%	3.8%	6.4%	8.9%	11.5%	14.0%
Purchase Premium to Seller's Undisturbed Share	27.5%	(5.8%)	(3.2%)	(0.7%)	1.9%	4.4%	7.0%	9.5%	12.1%	14.7%
Price:	25.0%	(5.2%)	(2.7%)	(0.1%)	2.5%	5.0%	7.6%	10.2%	12.8%	15.3%
File.	22.5%	(4.7%)	(2.1%)	0.5%	3.1%	5.7%	8.2%	10.8%	13.4%	16.0%
	20.0%	(4.1%)	(1.5%)	1.1%	3.7%	6.3%	8.9%	11.5%	14.1%	16.7%
	17.5%	(3.5%)	(0.9%)	1.7%	4.3%	6.9%	9.5%	12.1%	14.8%	17.4%
	15.0%	(2.9%)	(0.3%)	2.3%	4.9%	7.6%	10.2%	12.8%	15.4%	18.1%

A Relative Contribution Analysis also confirms that the \$11.40 Offer Price makes sense only if full Cost Synergies are realized and attributed to the Seller:



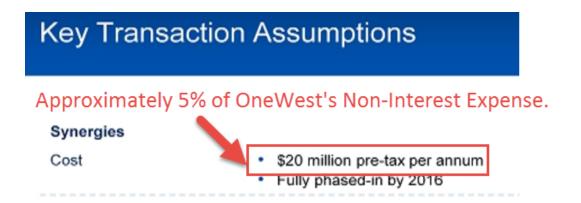
### Are the Cost Synergy Figures Realistic?

Recent M&A deals, such as BB&T's acquisitions and CIT / OneWest, have had significantly lower projected Cost Synergies as percentages of the Seller's Non-Interest Expense:

BB&T expects to incur pre-tax merger and integration costs of approximately \$100 million and expects to achieve annual cost savings of approximately \$65 million (approximately 30 percent of National Penn's non-interest expenses). BB&T expects this acquisition to be accretive to earnings per share in the first full year excluding one-time charges and expects the transaction to exceed its IRR hurdle.

BB&T expects to incur pre-tax merger and integration costs of approximately \$250 million and expects to achieve annual cost savings of approximately \$160 million (approximately 32% of Susquehanna's non-interest expenses).

BB&T expects this acquisition to be accretive to earnings per share in the first full year excluding one-time charges and expects the transaction to exceed its IRR hurdle.



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### Are the Cost Synergy Figures Realistic?

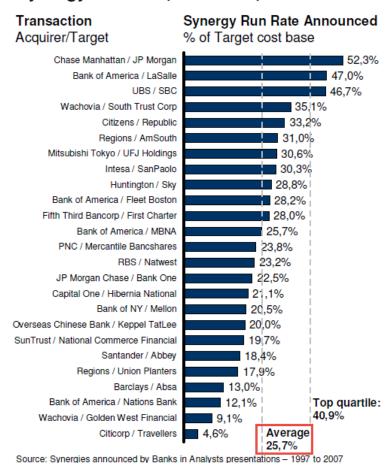
 Even in much frothier periods, such as the pre-Lehman decade, the average expected Cost Synergies in bank M&A deals was only ~25% of the Seller's Non-Interest Expense

#### **Significant Value Created from Cost Savings**

Unlocked value from cost synergies provides strong upside for shareholders

- High degree of market overlap accelerates benefit realization
   > 30% of FNFG branches within two miles of a Key branch
- FNFG's technology infrastructure largely outsourced → Key has opportunity to efficiently scale our existing platform
- KeyBank's logic doesn't make much sense; even if 30% of FNFG's branches are within two miles of a KeyBank branch, that won't result in 30% cost savings – some employees must be retained
- And the details of the technology/infrastructure scaling are too vague to factor into the analysis – which specific expenses can KeyBank cut from the combined company?
- Based on this, we find the 40% Cost Synergy estimate highly unrealistic; 20-25% might be more reasonable

#### Synergy run rate (1997-2007)



## Our M&A Metrics vs. KeyBank's Estimates

	Our Estimates	KeyBank's Estimates
ROTCE, FY 18	<ul><li>2% Improvement</li></ul>	<ul><li>2% Improvement</li></ul>
Cash Efficiency Ratio, FY 18	■ 6% Improvement	<ul><li>3% Improvement</li></ul>
EPS Accretion, FY 18	<b>•</b> 15%	<b>•</b> 5%
IRR (10 Years, Slowing Dividend Growth, 10x P / E)	<b>11-13%</b>	<b>•</b> 15%
Post-Deal TBVPS Dilution	<b>11</b> %	<b>12</b> %
Regulatory Capital Ratios	<ul><li>CET 1: 9.5%</li><li>Tier 1: 10.5%</li><li>Leverage: 9.3%</li></ul>	<ul><li>CET 1: 9.5%</li><li>Tier 1: 10.0%</li><li>Leverage: 9.5%</li></ul>

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#### Why the Discrepancies?

- Broadly speaking, our Balance Sheet and regulatory figures line up with the company's, but most of our Income Statement metrics significantly exceed theirs
- The most likely **explanation** is that we have factored in items that the company did not, such as true Debt funding, the impact of the Federal Funding Differential, the Amortization of the Mark-to-Market Adjustments, and possible Equity Capital Infusions
- However, if we removed the Income Statement impact of all those items, the EPS accretion would still be ~15%
- Our Best Guess: It's some combination of those factors, potentially a different tax rate (35% in investor presentation vs. 25% historically), and different Income Statement projections for both companies
- If anything, the company's numbers make the deal look even worse at 5% EPS accretion, 20% Cost Synergies rather than 40% would almost certainly make the deal dilutive to FY 18 EPS
- To further address these discrepancies, we would need more detailed projections and schedules from KeyBank

### **Summary and Recommendations**

#1

We Recommend AGAINST This Deal

\$11.40 Offer Price overvalues First Niagara by ~45%, the deal is dependent on unrealistically high Cost Synergies (40% of FNFG Non-Interest Expense), and FNFG doesn't add much to KEY's core business and long-term strategy

#2

Cost Synergies Are Unrealistically High Similar, recent deals (BB&T's acquisitions) have had ~30% projected Cost Synergies; KeyBank's logic for the 40% number doesn't make sense, and there aren't enough specifics to justify it

#3

FNFG Delivers Few, If Any, Benefits

It is smaller than KEY, has lower Asset Growth, lower ROE, ROA, ROTCE, and lower capital ratios; only benefit is modest geographic/loan diversification

#4

Deal is Unlikely to Meet Financial Criteria

At 30% Synergies, IRR drops to 10.1% vs. KEY's 9.5% Cost of Equity; at 20%, it falls to 8.1%; Year 2-3 EPS accretion/dilution is closer to neutral as well