M&A Discussion – KeyBank’s $4.1 Billion Acquisition of First Niagara

Presentation to the Board of Directors

Goldman Stanley
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
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:

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
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):

<table>
<thead>
<tr>
<th>Operating Statistics:</th>
<th>Capitalization &amp; Assets:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Name</td>
<td>Equity Value (USD in millions)</td>
</tr>
<tr>
<td>-----------------------</td>
<td>-------------------------------</td>
</tr>
<tr>
<td>M&amp;T Bank Corporation</td>
<td>$15,079.8</td>
</tr>
<tr>
<td>Comerica, Inc.</td>
<td>7,843.7</td>
</tr>
<tr>
<td>Zions Bancorporation</td>
<td>6,002.3</td>
</tr>
<tr>
<td>BOK Financial Corporation</td>
<td>4,499.3</td>
</tr>
<tr>
<td>Cullen/Frost Bankers, Inc.</td>
<td>4,342.3</td>
</tr>
<tr>
<td>Associated Banc-Corp</td>
<td>2,971.2</td>
</tr>
<tr>
<td>First Horizon National Corporation</td>
<td>3,395.9</td>
</tr>
<tr>
<td>Webster Bank, N.A.</td>
<td>3,526.8</td>
</tr>
</tbody>
</table>

**Maximum:**
- Equity Value: $15,079.8
- P/E: 14.7x
- P/TBV: 2.2x

**75th Percentiles:**
- Equity Value: $4,420.8
- P/E: 14.8x
- P/TBV: 2.1x

**Median:**
- Equity Value: $3,203.1
- P/E: 15.6x
- P/TBV: 1.3x

**Minimum:**
- Equity Value: $2,401.0
- P/E: 9.8x
- P/TBV: 1.1x

---

**Valuation Multiples:**

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

- 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:

[Graph and table showing the relationship between offer price and implied price per share based on relative contribution.]
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.

Key Transaction Assumptions

- Approximately 5% of OneWest's Non-Interest Expense.

  Synergies
  Cost
  - $20 million pre-tax per annum
  - Fully phased-in by 2016
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.
## Our M&A Metrics vs. KeyBank’s Estimates

<table>
<thead>
<tr>
<th>Metric</th>
<th>Our Estimates</th>
<th>KeyBank’s Estimates</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROTCE, FY 18</td>
<td>2% Improvement</td>
<td>2% Improvement</td>
</tr>
<tr>
<td>Cash Efficiency Ratio, FY 18</td>
<td>6% Improvement</td>
<td>3% Improvement</td>
</tr>
<tr>
<td>EPS Accretion, FY 18</td>
<td>15%</td>
<td>5%</td>
</tr>
<tr>
<td>IRR (10 Years, Slowing Dividend Growth, 10x P / E)</td>
<td>11-13%</td>
<td>15%</td>
</tr>
<tr>
<td>Post-Deal TBVPS Dilution</td>
<td>11%</td>
<td>12%</td>
</tr>
<tr>
<td>Regulatory Capital Ratios</td>
<td>CET 1: 9.5%</td>
<td>CET 1: 9.5%</td>
</tr>
<tr>
<td></td>
<td>Tier 1: 10.5%</td>
<td>Tier 1: 10.0%</td>
</tr>
<tr>
<td></td>
<td>Leverage: 9.3%</td>
<td>Leverage: 9.5%</td>
</tr>
</tbody>
</table>
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

<table>
<thead>
<tr>
<th>#</th>
<th>Recommendation</th>
<th>Reasoning</th>
</tr>
</thead>
<tbody>
<tr>
<td>#1</td>
<td>We Recommend AGAINST This Deal</td>
<td>$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</td>
</tr>
<tr>
<td>#2</td>
<td>Cost Synergies Are Unrealistically High</td>
<td>Similar, recent deals (BB&amp;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</td>
</tr>
<tr>
<td>#3</td>
<td>FNFG Delivers Few, If Any, Benefits</td>
<td>It is smaller than KEY, has lower Asset Growth, lower ROE, ROA, ROTCE, and lower capital ratios; only benefit is modest geographic/loan diversification</td>
</tr>
<tr>
<td>#4</td>
<td>Deal is Unlikely to Meet Financial Criteria</td>
<td>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</td>
</tr>
</tbody>
</table>