PEOPLE *to* KNOW

2014 STATE OF THE INDUSTRY

BANKING EDITION

The **3 KEY AREAS** impacting **banking** today.

CLARK SCHAEFER HACKETT
CPAs & BUSINESS CONSULTANTS

BANKING LEADERS
AROUND THE TABLE

Michael Adelman
CEO
Ohio Bankers League

Mark Butterworth
Principal
Innovation Forward, LLC

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Jennifer Griffith
Regional President
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James Klein
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Parker MacDonell
Principal
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David McKee
Vice President
Priority Mortgage Corp.

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Manager
Clark Schaefer Hackett

Leonard Wagers
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Management
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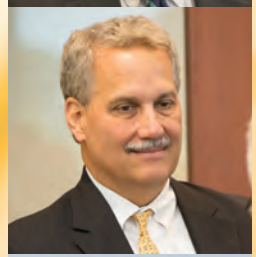


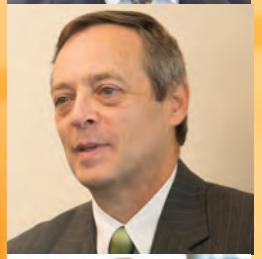
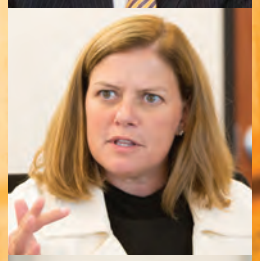

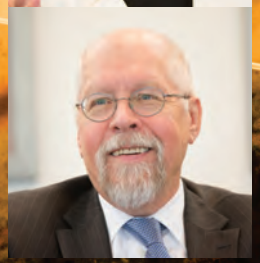

2014 **STATE OF THE INDUSTRY**
BANKING EDITION

Welcome to our *lite* **paper, an observation on the state of the industry, offered by** People to Know in Banking.

At Clark Schaefer Hackett, we're proud to be industry specialists. We dig deeply into the industries we serve and share the resulting insight for the good of our clients and communities.

When we gathered the select few recently named "People to Know in Banking," we were privy to profound thought, unique perspectives, and intelligent understanding.

These banking leaders, recognized as the most influential in Central Ohio, illuminated the universal trends, challenges and opportunities seen nationally across the sector today.

The issues impacting banking today, also reflect our society, business and culture.

Exactly how these issues will shape our future is the question that remains.

2014 STATE OF THE INDUSTRY
BANKING EDITION

The banking industry has experienced **dynamic conditions** in the six years since the financial downturn. With **improving credit quality, a stronger national economy and prominent merger and acquisition (M&A) activity,** banks have had to react to a rapidly changing landscape.

They've done so, even as regulations put in place after the 2008 financial crisis have challenged their ability to **thrive in this challenging environment.**

The good news for this sector is that the terms and lending standards for commercial and industrial loans have eased and the **demand for loans is increasing,** according to a July survey by the Federal Reserve Board of senior loan officers of banking practices. An August study published by the Federal Reserve Bank of San Francisco reports that while the level of lending has increased, and with better terms during the past five years, historically those loans cost the consumer more than in the past.

For the loan-seeking consumer, **access to capital is better,** but it remains uncertain in some arenas, and banks are still facing increased government regulations, plus a need to show a profit. The two have yet to come into balance since the financial crisis six years ago, and the disconnect has had **widespread effects.**

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ACCESSING CAPITAL

David McKee
Priority Mortgage Co.

It is still a tight market out there. In our business, the first product line we lost was construction loans, and they will probably be the last product line we get back. Many builders can't get the loans for spec construction, and there is a shortage of inventory in market. Many of the smaller builders are pushing their customers to secure their own construction loans, and of course not everyone can do that.

Michael Adelman
Ohio Bankers League

From a national perspective, and overall in Ohio, **the banking industry is growing** with a lot of diversity and options for consumers to access capital and loans. There are pockets of Ohio where the economies are challenged, but Central Ohio is different because of the economy's diversity. Its success isn't relegated to a single sector. Insurance, medical and government, for example, each contribute to the mix. Overall, the loan-to-deposit ratio right now is low. Banks are looking for opportunities to make loans. Not so long ago, **capital was very difficult to raise.** But the larger you were, the more opportunities you had available to do that. We did see instances locally where capital just wasn't in the institutions, and in that regard, I think there are still some difficulties out there.

Jennifer Griffith
Commerce National Bank

The appetite to lend money is strong. There is not a bank in town that is not trying to lend money. But the regulation increases the parameters: It has to have historical cash flow; it has to have more collateral coverage than ever before; it has to appraise at today's market; and you have to put 30 percent down when you used to put 15 percent down. Who covers that gap? If you are a medical practitioner and you need $300,000, you're not going to the market asking for $300,000 and funding that gap, the smaller ticket gaps. You have owners who did use personal wealth. As they recover, they are recovering at a 2 percent rate and we doubled the amount of equity they need. Those two ideas haven't married yet. A primary difficulty is in understanding the underwriting restrictions that treat every single case the exact same way across the board.

ACCESSING CAPITAL

Mark Butterworth
Innovation Forward, LLC

There is this emerging non-bank lending going on that works like project financing and is a newer avenue available in securing money for startups and early-stage companies. For instance, two Central Ohio angel fund companies invested in a company that got a $3 million purchase order and couldn't afford to buy the inventory, which really was a case of the dog catching the car. They had to go out and raise $2 million with private investors and had to give up 2 to 3 percent equity coverage. **That wouldn't have happened five years ago.** Overall, capital always flows to the best idea. The question becomes whether the idea or opportunity is cash flow positive or negative. It's also a place where ideas fall apart. If companies are consistently cash flow positive, they can get financing pretty much anywhere they want. Startups are typically cash flow negative and their capital is normally found within an hour's drive of the company. If Ohio really wants to get behind startups, it must examine whether there are ways to increase the amount of capital available within that hour drive, because **investors want to be close enough** to keep an eye on the company and their investment.

Parker MacDonell
Invergarry Partners, LLC

Ohio's been known for a long time as a fly-over state for growth-stage venture capital, but there is a lot of value to be unlocked between the coasts. Most of the venture capital money is on the coasts, although it is heartening to see what regional funds like Drive Capital and Draper Triangle Ventures have accomplished, **raising millions in venture capital to invest.** Ohio has been the envy of many at the annual summit of Angel Capital Association, which is the North American trade association for accredited angel investors. Through funding of companies and venture development organizations from the Third Frontier Fund, the state's technology investment tax credit and the Ohio Capital Fund, the state created a really great ecosystem. While I understand the state's recent moves to lessen the dependency of the angel and the venture capital industries in Ohio on public support, we must be careful not to take away too much of this support, lest we see Ohio's momentum stall. For more information about these topics, I refer you to a group that was founded in 2014 called Venture Ohio. **They are working very hard** to make sure Ohio continues to do the right things for the early stage company capital space. The economics of VC

funds dictate that they are trying to hit a home run with every investment. They have to try to get a 10-times return on every deal that they invest in, which leads to the expectation of higher sale prices. History tells us that most companies based in Ohio won't sell for a billion dollars.

James Klein
Finance Fund

We look for opportunities to move capital into local communities because local communities are the key to economic prosperity in this country. We've seen a flight of capital away from communities, not because of some particular strategy by capital investors, but because of the basic principles of economics. Low-income communities have lost the physical assets and human value normally found in prospering neighborhoods. There is capital in these struggling neighborhoods, but there are no mechanisms that capture those streams of capital and keep them circulating locally. **We do that by creating specific kinds of assets.** It's the small mechanisms, such as a small business or healthcare facility, a fresh food grocer or a community center, that can capture and recirculate local capital, provide good quality jobs and begin to stabilize local economies.

IMPACT OF REGULATIONS

Jennifer Griffith
Commerce National Bank

From a profitability standpoint, **the cost of deteriorating credit is behind most of us,** which is where many difficult conversations between bankers and regulators evolved. For instance, a bank believed an account was in good standing and the regulator thought it was in bad standing. The cost of that is material. With the credit costs behind us, the return is not coming anywhere near as fast as the credit costs that went down.

Michael Adelman
Ohio Bankers League

The biggest point is the market uncertainty and what we see today versus what we were seeing 10 years ago. Too often the bankers are wondering about how regulators are going to view a loan, or what they will think about a new product. Having to seek regulators' permission before acting is what creates uncertainty in the banks. **It hampers innovation.** You don't want to shut off the smaller banks trying to fill a niche with new products, but that is what's happening.

James Klein
Finance Fund

The challenge is always ideology. When you get into this space, it is always about ideology. We have our ideology that drives us to do the kinds of things we do, and others have their own ideology. Evidence might suggest that Washington has a different ideology. If not, lawmakers may have handled the whole idea of bank regulation a little bit differently than they did. I believe that if we, as an industry, are adopting a philosophy of change, then we must look beyond our own little worlds to those who share similar ideologies, so that we can create a momentum in this country that has been lost. If we are ever going to move beyond where we are today, we must begin some types of cross-pollination, where we are collaborating with others and **creating that momentum.**

THINKING ABOUT TOMORROW

Michael Adelman
Ohio Bankers League

The idea of consolidation is an ever-present issue, but right now it's not as robust as everybody would like, for a variety of factors. For the merger and acquisition industry, the Ohio Bankers League has done some analysis. There were nine so far this year, nine in all of 2013 and seven in 2012. More are expected by the end of the year, but it's doubtful it will double last year's total. Regardless, there will always be discussions in this realm, and part of those talks stem from the attention directed toward Central Ohio. Fortunately and simply, everyone wants to be here. They want to be part of this really diverse, vibrant, younger ecosystem called Central Ohio. However, **there are real obstacles that blunt M&A activity,** and one of them is compliance costs, which are prohibitive. Smaller institutions, for instance, can't afford the price tag of having a full-time compliance officer, while the larger institutions can and they find the right people by being able to pay higher salaries. Another driver for activity is succession planning, which is an issue the Bankers League is focusing on this year. It's heartbreaking to hear the story of the 65- or 70-year-old person who, for whatever reason, can't retire when he or she planned. Maybe they have a personal loan they must repay, a portfolio to replenish or a need to stick around until the bank gets on solid footing. **Other states have a more rapid consolidation market than Ohio.**

Mark Butterworth
Innovation Forward, LLC

There is an abundance of asset-based lending for small companies. But many of the companies we work with have assets that are all intellectual property—patents or software development. Organizations like the Finance Fund are advocates with the U.S. Treasury and others to try to get additional products out to finance that, which should be expanded nationwide. Is there a way we can put more capital to work? **Working capital requirements are naturally the most risky part of any loan,** and over the last 10 years there has been less of it available for startups through the SBA and other federal programs.

THINKING ABOUT TOMORROW

James Klein
Finance Fund

Folks who invest with Finance Fund want yield. The difference is that they want more than one type of yield – beyond just capital investments; they want some social return. We are basically a social impact organization. We deliver a return on investment, but we also deliver a double bottom line, sometimes a triple bottom line. **Sometimes it's a social return and sometimes it's an environmental return.** This is the segment of the investment market that we serve. Our strategy is a little different from the norm, and over 27 years it has changed, as have our partners. We had partners that were at one point philanthropic in nature. Today, we're finding a lot more normal capital market investors are coming into our arena because we are able to help mitigate risk, we help bring in more favorable capital or pseudo-equity-type capital that allows bank investors and other types of investors to be able to gain their yield targets and risk targets through partnerships – and we deliver on that double or triple bottom line.

Jennifer Griffith
Commerce National Bank

Good will is going to become one of the most valuable assets on your balance sheet and the banking industry is going to have to figure out how to finance it. The banking industry is going to have to get on board and they are going to have to participate. Right now I feel like the conventional banks are not helping the intangible space at all. In our space as an FDIC bank, we can provide a little bit of cash flow leverage, but we can't provide a lot of cash flow leverage. If the valuation is still taking companies to seven multiples, and we are packed at a 2.5 multiple, we are not helping, not participating, and we are hurting and damaging the value of a company because we can't fully invest in it. Good will is going to matter down the road, and quite possibly will create the type of impact for social change and energy necessary to **reinvest, attract commerce and raise awareness.**

ABOUT **CLARK SCHAEFER HACKETT**

It's not easy being a bank. You are in a heavily regulated industry where compliance issues are particularly important right now. Everyone is watching, waiting to see how you fare. You're wondering if you're on the right path, do you have the right tools in place to not just survive, but prosper? With so many issues, where do you even begin? At Clark Schaefer Hackett, our Financial Institutions Group has been successful for more than a quarter of a century. We will weather this with you.

OUR FIRM Founded in 1938, Clark Schaefer Hackett is one of the 65 largest CPA and advisory firms in the U.S. We offer best-in-class technical expertise in audit and assurance, risk management, benefit plan consulting, forensic and litigation support, valuation and transaction services. We combine the insights and ideas of multiple disciplines to provide solutions in a wide range of industries, including manufacturing, construction and real estate, distribution, healthcare, financial services, as well as government entities, higher education institutions and not-for-profit organizations.

INDUSTRY SPECIALIZATION We align resources by industry to better serve the needs of our clientele. Specialization permits us to develop deep knowledge of the issues facing our clients and to anticipate needs based on our understanding of industry trends. We select a team that best fits the needs of the client from our strong bench of firmwide industry specialists.

RELATIONSHIPS MATTER We believe that doing the work and serving the client are not necessarily the same thing. One is about a talent for numbers, the other is about interacting with people. At CSH, relationships matter, and we believe that creating a supportive, helpful, working relationship is perhaps the most valuable talent we can offer.

LEARN MORE AT **WWW.CSHCO.COM.**

CSH AROUND THE TABLE **FOR BANKING**

SCOTT DETERS
Shareholder
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Scott Deters chairs the Firm's Financial Institutions Service Group and is the primary advisor to its full service community bank clients. He has nearly 20 years of financial institutions experience. As an audit professional, Scott offers his customers an objective assessment of their institution, as well as compliance with requirements, standards and regulations. When a bank merger or branch acquisition is being considered, Scott offers experienced due diligence services. But Scott also brings a tax background to the table, so that his clients can rely on him to be the lead contact person for all of their needs.

CARL COBURN
President
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Carl Coburn is president of Clark Schaefer Hackett. Prior to stepping into this role in 2008, Carl led the Firm's Financial Institutions Practice and served as Shareholder-in-Charge of the Cincinnati office. During his more than 25 years of practice, Carl has developed a reputation for advocacy on behalf of clients and a commitment to ethics and professionalism. He has strong ties to many executives in the legal and financial communities. Carl is an alumnus of Leadership Cincinnati and is an officer of the Community Banking Advisory Network (CBAN). He joined CSH in 1986 after nine years with a national accounting firm.

ERIC STEINHOFF
Manager
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Eric Steinhoff's primary responsibilities include providing audit, review and compilation services to closely-held business, financial institutions, nonprofit organizations, and employee benefit plans. He is also experienced in personal, corporate and partnership taxation. He has successfully directed compliance with regulatory supervision remedial action plans involving a memorandum of understanding. He is also proficient at directors' examinations and collateral verification.

LEONARD WAGERS
Manager
lwagers@shco.com

Leonard Wagers joined CSH in 2007 with 17 years of experience conducting internal audit and profitability analysis for financial institutions. He is responsible for various tasks including conducting and facilitating an activity-based profitability system for a large regional bank. He has a keen understanding of the industry and goals of financial institutions through his previous experiences and roles in senior management. Leonard has had the opportunity to serve as an adjunct professor at Northern Kentucky University instructing undergraduate and MBA accounting classes.

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