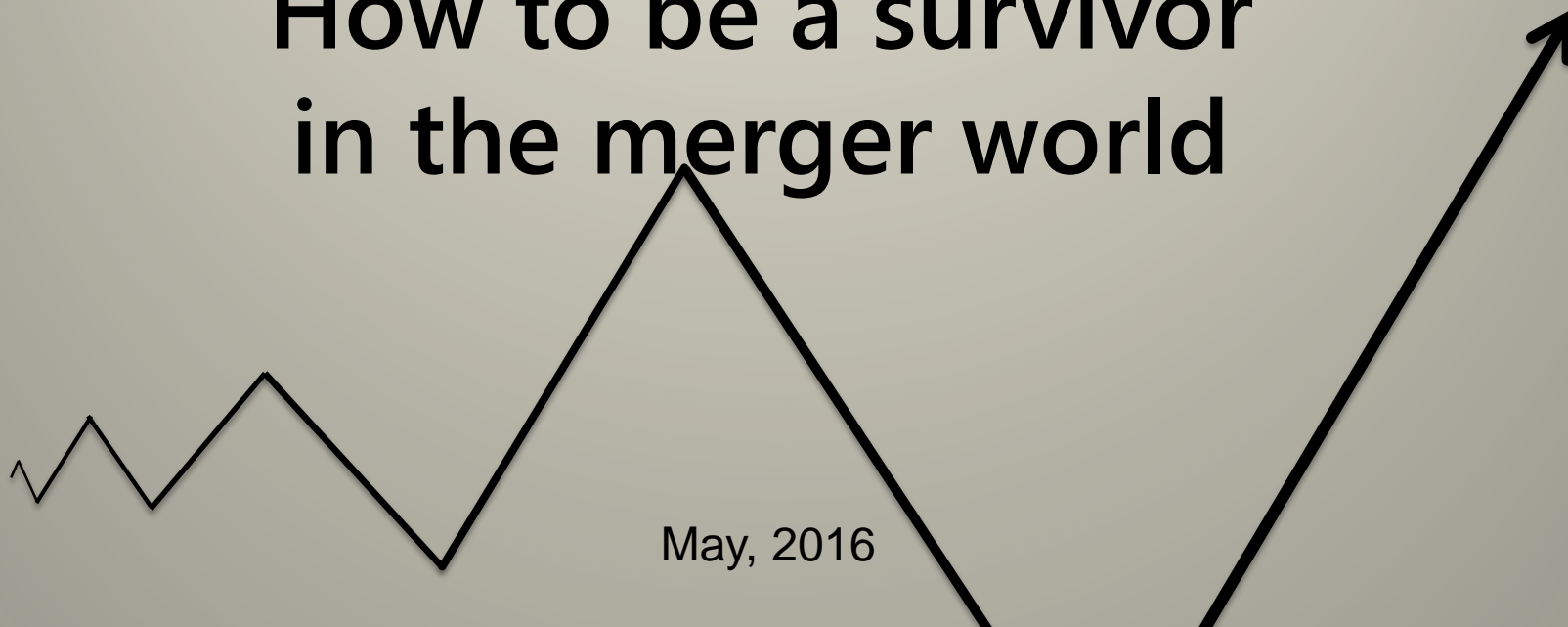


Profitability & How to be a survivor in the merger world



Charley McQueen

McQueen
Financial Advisors

McQueen Financial Advisors

SEC Registered

Investment Advisor

- \$4 Billion + under management
- Municipal & Corporate Credit Reviews
- Comprehensive Reporting
- Alternative Portfolios

Valuations

- Credit Union Mergers
- Branch Sales
- Mortgage Servicing Rights
- Complex Investments

Consulting

- Strategic Planning
- Branch Analysis
- Board Training
- Policy Development
- Exam Preparation

Risk Analysis

- Asset Liability Management
- Liquidity Stress Testing
- Core Deposit Studies
- Assumption Sensitivity Analysis
- Prepay Speed Analysis
- ALM Validations
- Back Testing Analysis

Today's Agenda

Economic Update

- Economic Indicators
- Interest Rate Projection

Industry Trends

- Merger Mania
- How to attract a CU
- How to be a Survivor

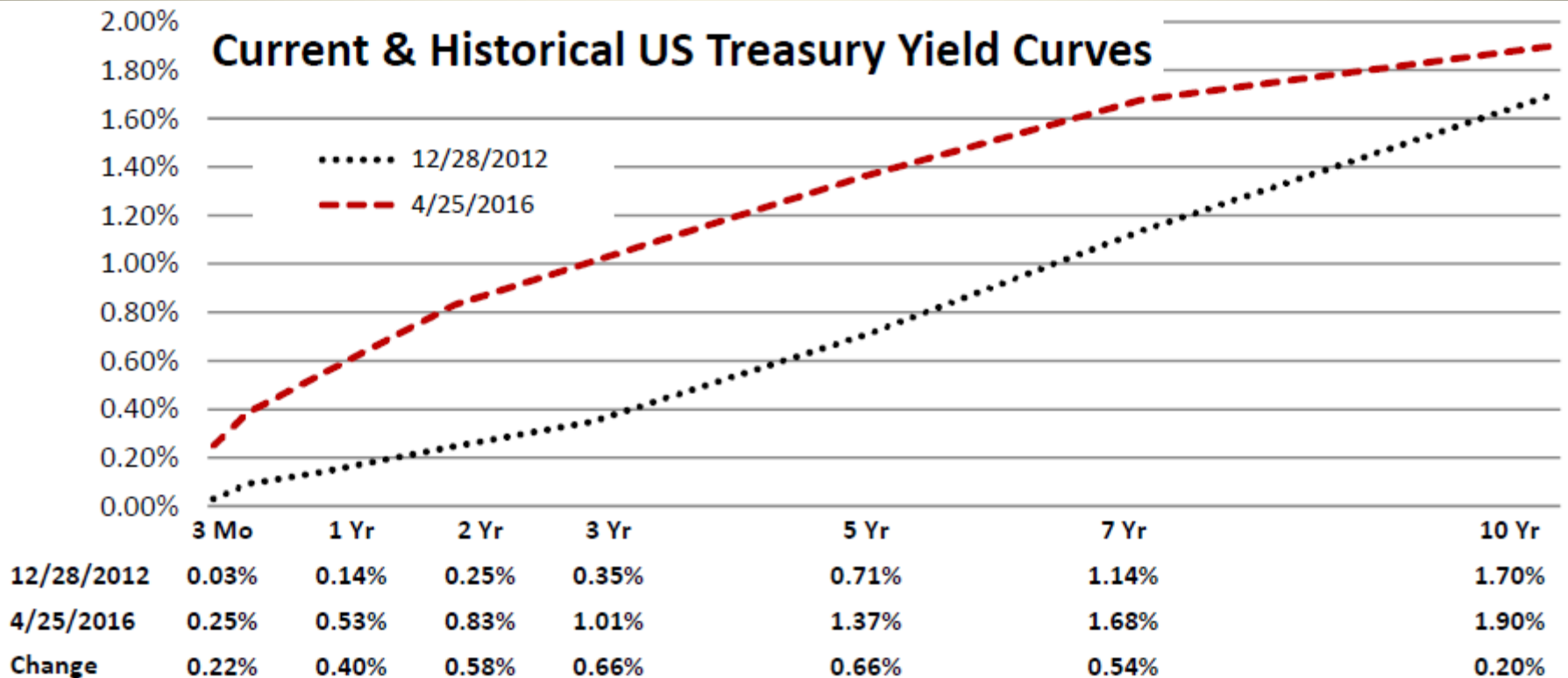
8 Points of Profitability

- Non-interest income
- Lending
- Investments
- Liability Structure
- Technology
- Branches
- People
- Asset Liability Management

Strategic Partners

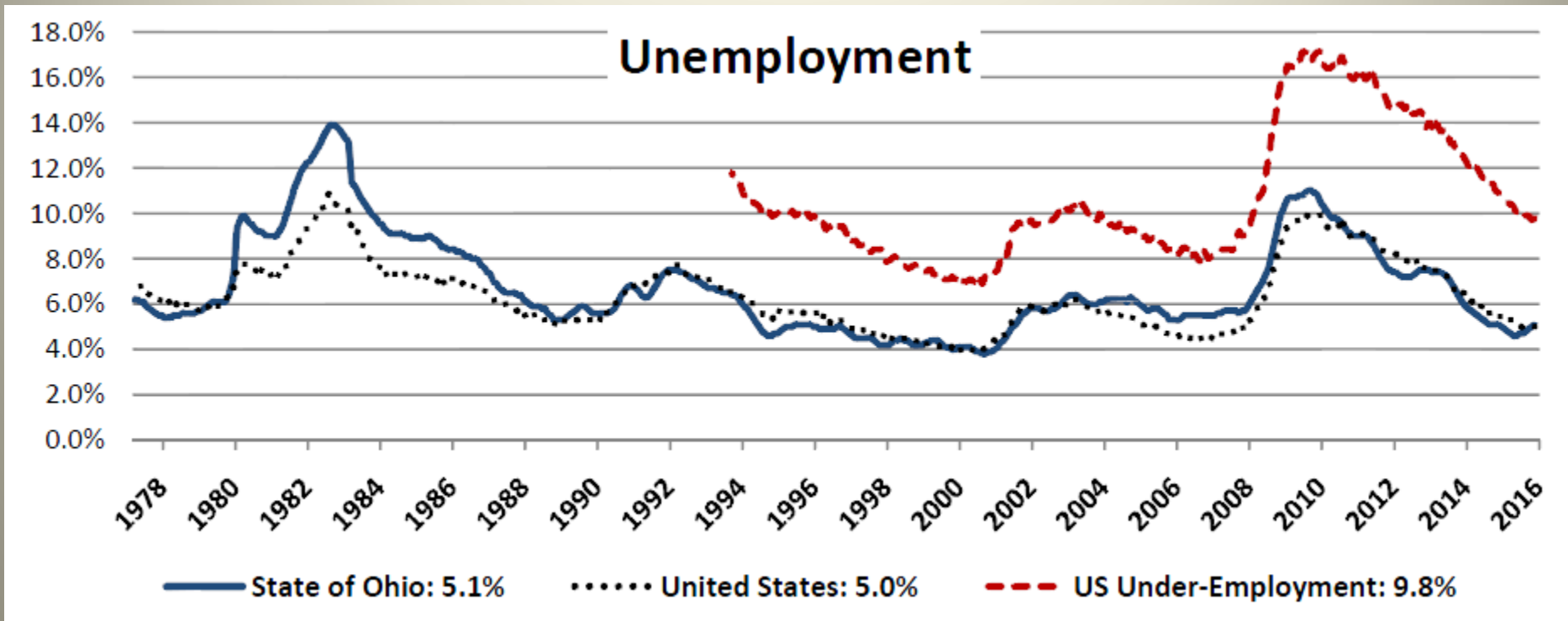
- CU*Answers
- McQueen Financial Advisors

Uncertain Interest Rate Environment



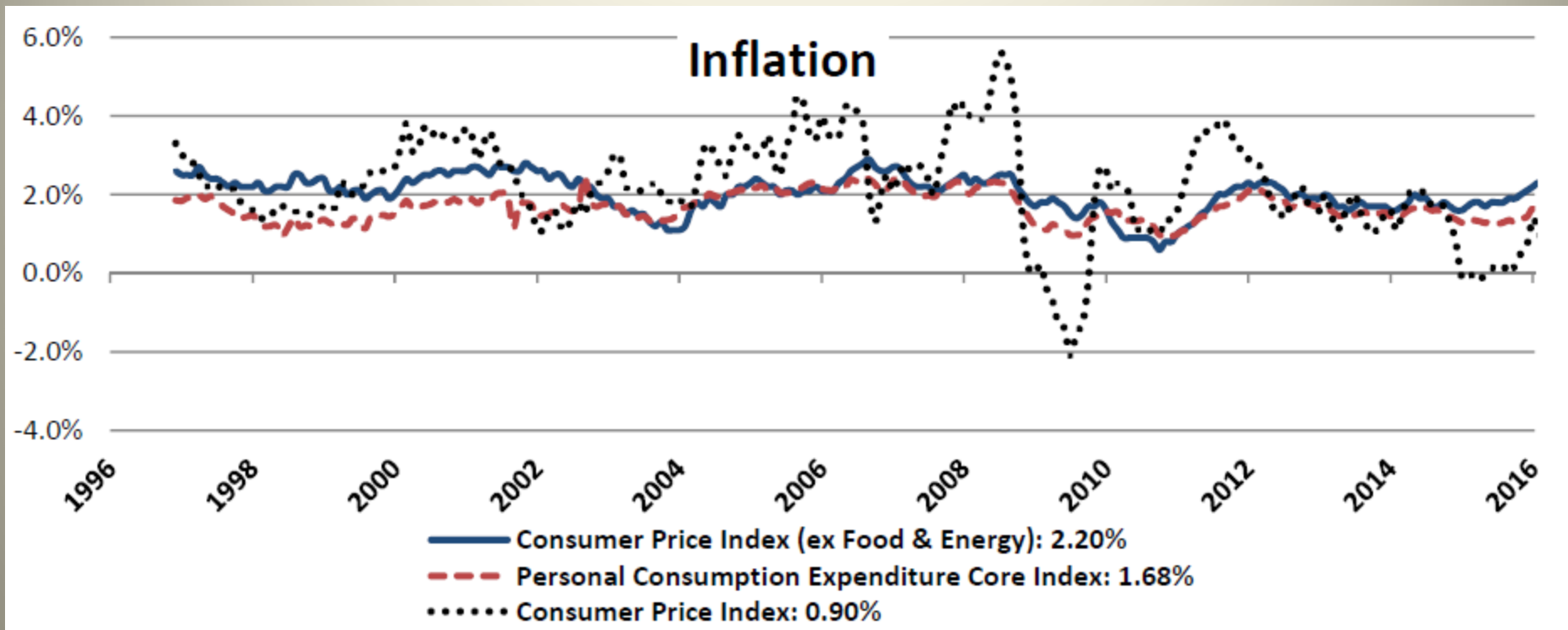
Flatter yield curve may result in margin compression

Uncertain Interest Rate Environment



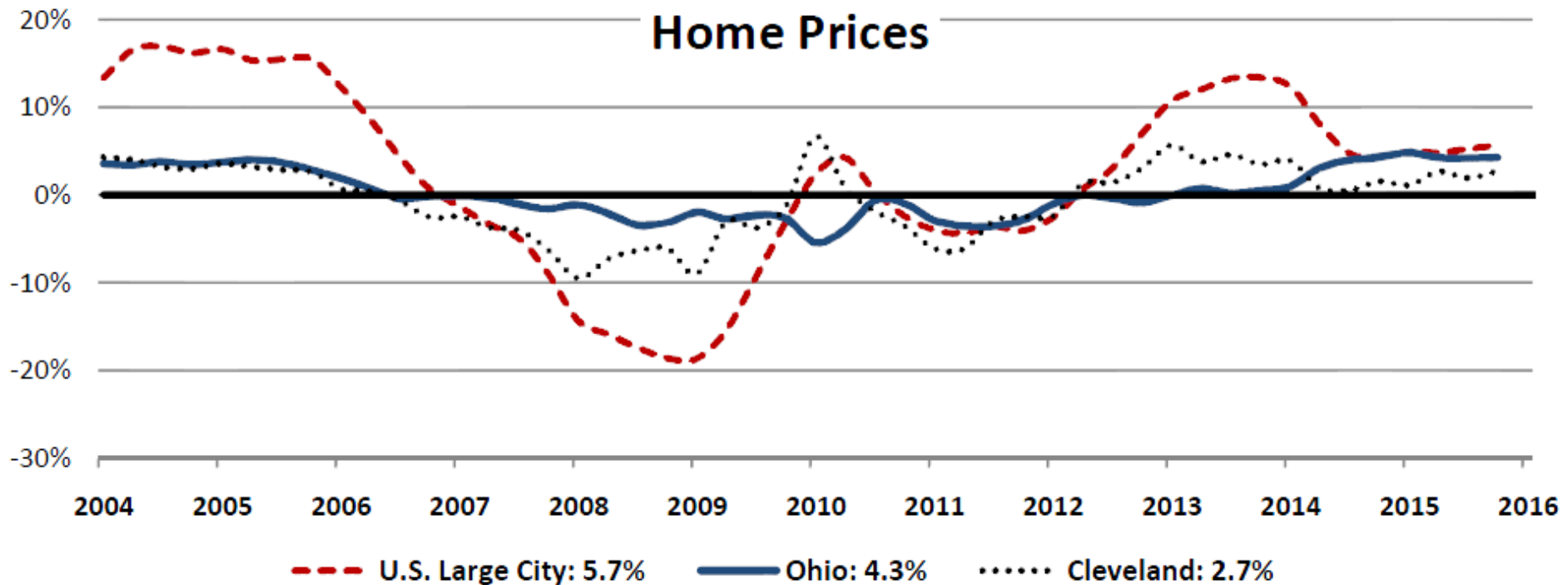
Unemployment rate has improved, but
underemployment rate is still too high

Uncertain Interest Rate Environment



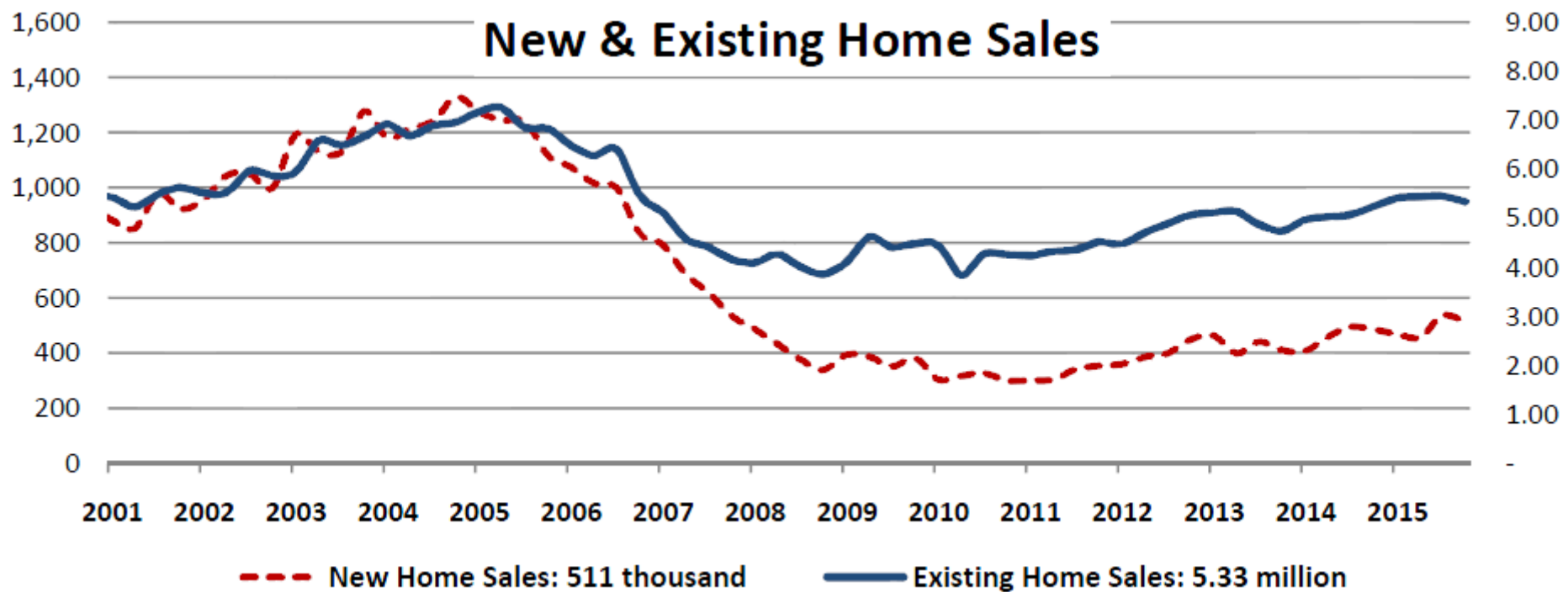
The Fed's primary measure of inflation
is slightly below the target of 2%

Uncertain Interest Rate Environment



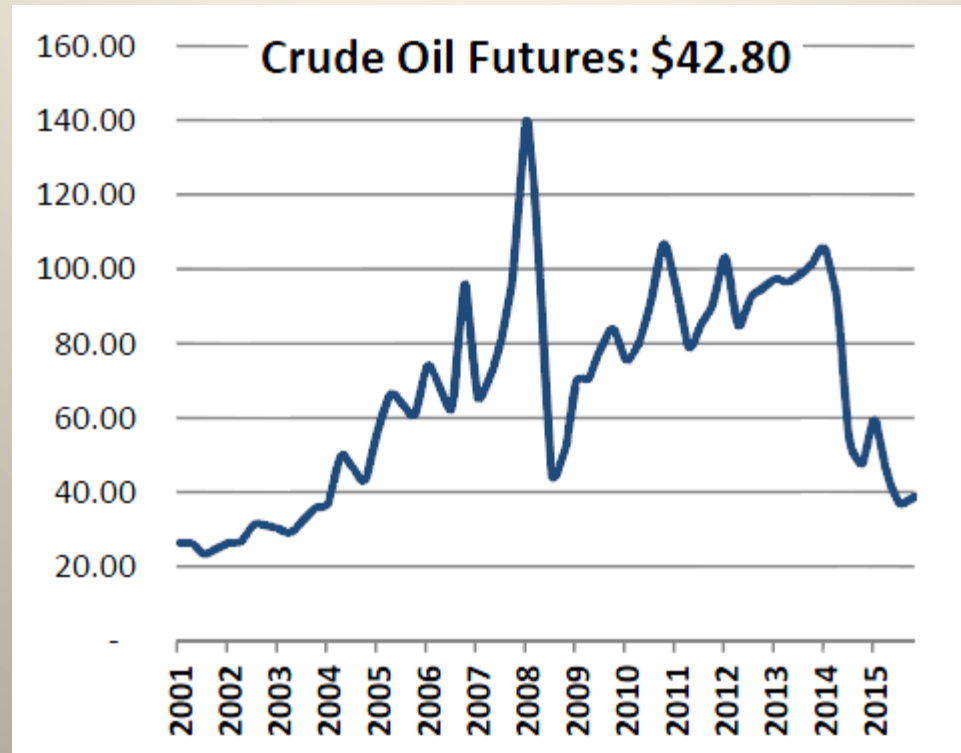
High and rising home prices
generally good for lending

Uncertain Interest Rate Environment



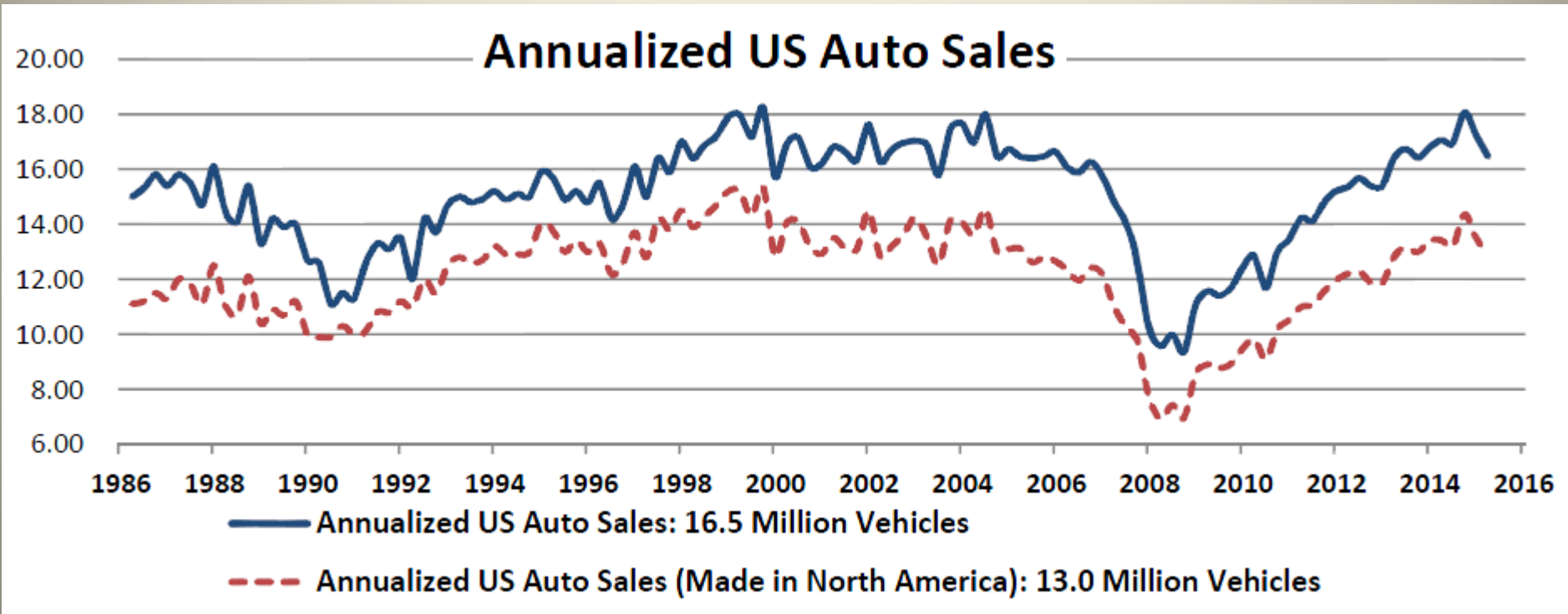
New home sales on the rise,
but still below trend

Uncertain Interest Rate Environment



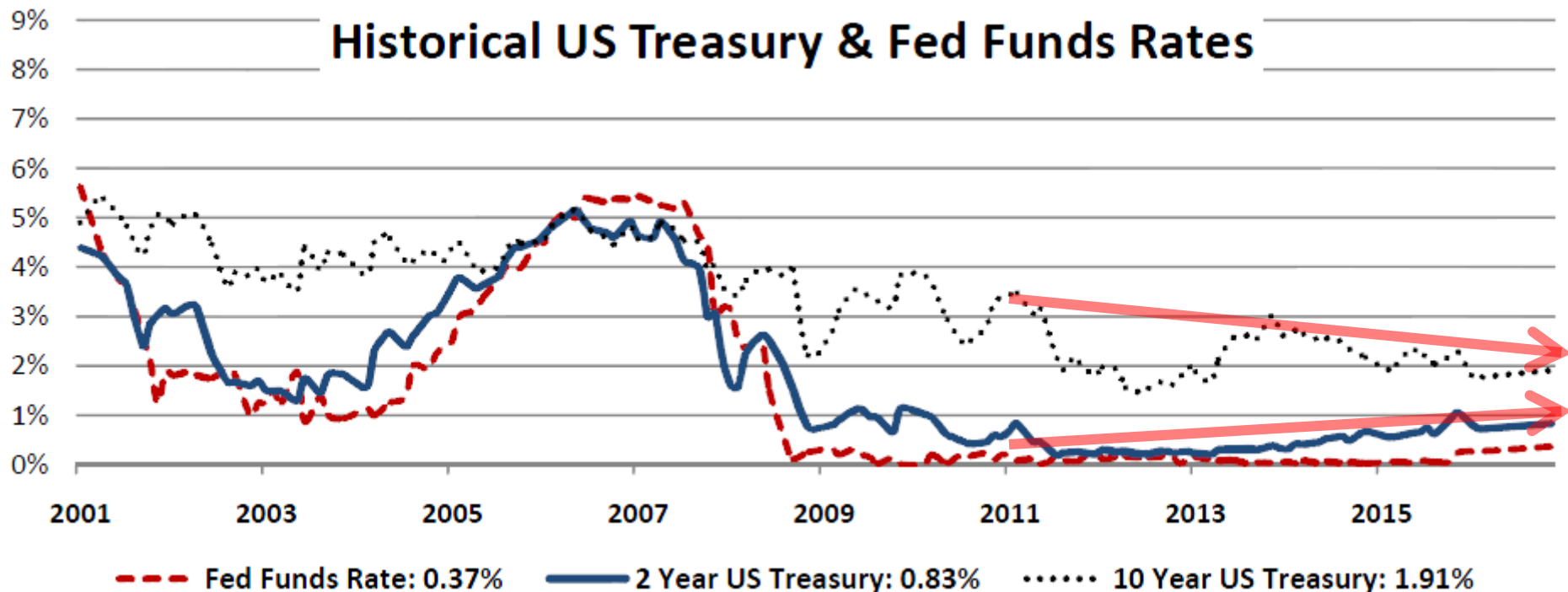
Cheap gas is good for members,
but not likely to last.

Uncertain Interest Rate Environment



2015 was a record year for the auto industry

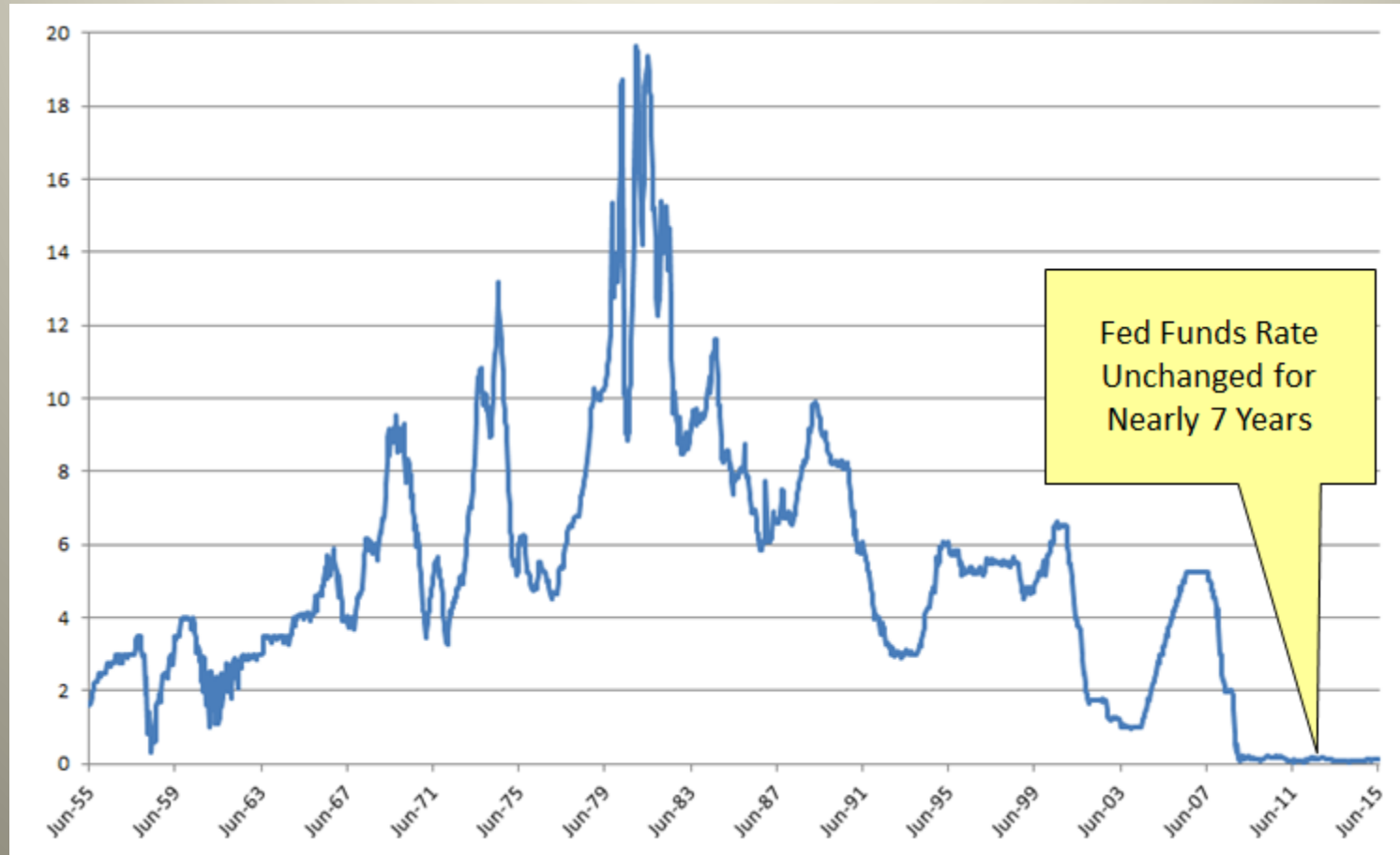
Uncertain Interest Rate Environment



Long term yields trending lower.
Short term yields trending higher.

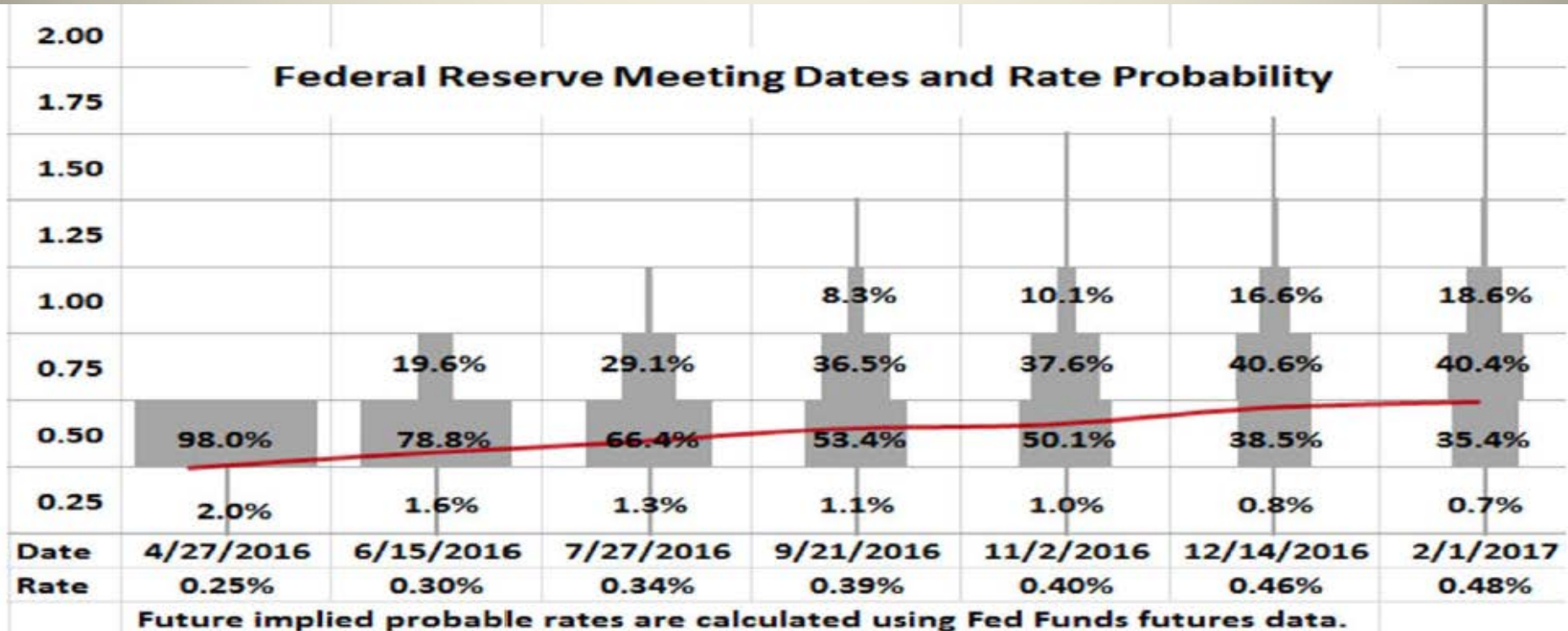
Uncertain Interest Rate Environment

Historical Fed Funds Rate 1955 to 2015



Uncertain Interest Rate Environment

Federal Reserve Meeting Dates and Rate Probability



Fed not likely to increase rates substantially this year

Uncertain Interest Rate Environment

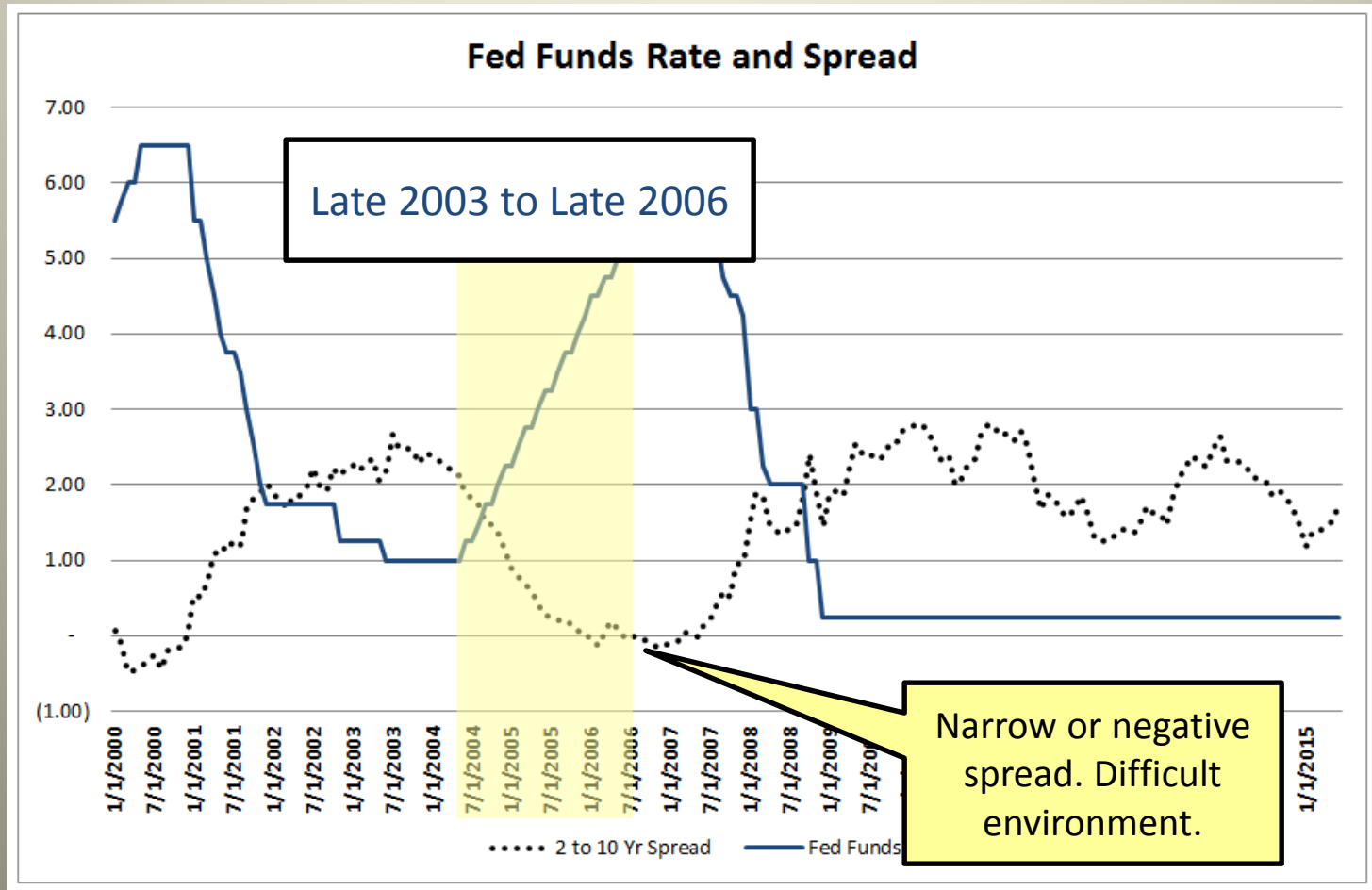
When will interest rates change and by how much?



Economic indicators will continued to be released.
Markets and the Federal Reserve Bank will react.

Challenges

Historical Impact of Higher Interest Rates



Challenges

Risk to Income: One Year Time Horizon

As interest rates change, the Credit Union's income may also change. Risk to income is measured using both gradual and shock parallel tests. The gradual tests assume that all rates will rise slowly for a full year. The shock tests assume an immediate and sustained rate change. For example, if all market rates immediately rose 300 basis points (shock test), net interest income would be expected to fall by 2.6%.

Gradual Income Simulation

Change	NII	% Ch	Limit
+500	25,081	-0.2%	NA
+400	25,121	-0.1%	NA
+300	25,153	0.0%	NA
+200	25,168	0.1%	NA
+100	25,165	0.1%	NA
Base	25,142		
-100	24,688	-1.8%	NA

Shock Income Simulation

Change	NII	% Ch	Limit	
+500	23,944	-4.8%	-9.0%	✓
+400	24,222	-3.7%	-9.0%	✓
+300	24,490	-2.6%	-9.0%	✓
+200	24,734	-1.6%	-6.0%	✓
+100	24,952	-0.8%	-3.0%	✓
Base	25,142			
-100	24,251	-3.5%	-3.0%	✗

Important to review income sensitivity
and trend over time.

Challenges

Risk to Net Economic Value of Equity

Net economic value of equity (NEVE) is the net present value of the balance sheet's cash flow. It is calculated by discounting anticipated principal and interest cash flow under a variety of interest rate scenarios. NEVE tests are based on parallel rate shocks. For example, if all rates increased by 300 basis points, NEVE would be expected to fall by 10.5%.

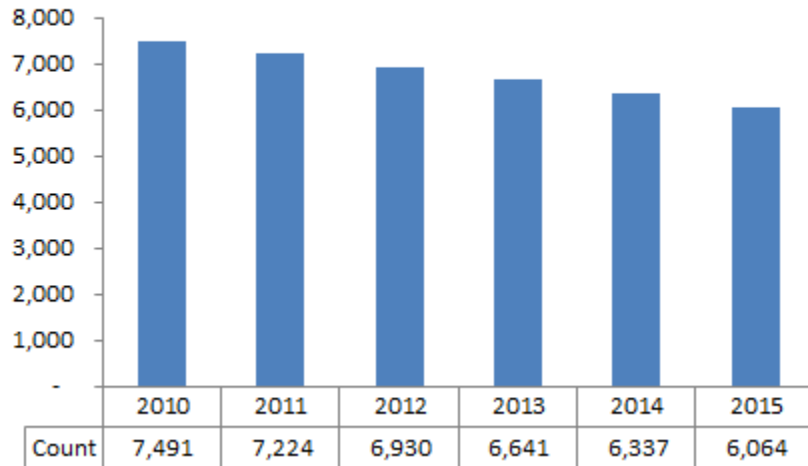
NEVE Sensitivity: Shock Tests

Change	NEVE	% Ch	Limit		NEVE Ratio
+500	67,982	-17.7%	-50.0%	✓	11.2%
+400	70,859	-14.2%	-50.0%	✓	11.4%
+300	73,966	-10.5%	-35.0%	✓	11.7%
+200	77,052	-6.7%	-35.0%	✓	11.9%
+100	79,972	-3.2%	-35.0%	✓	12.1%
Base	82,607				12.3%
-100	86,686	4.9%	-35.0%	✓	12.7%

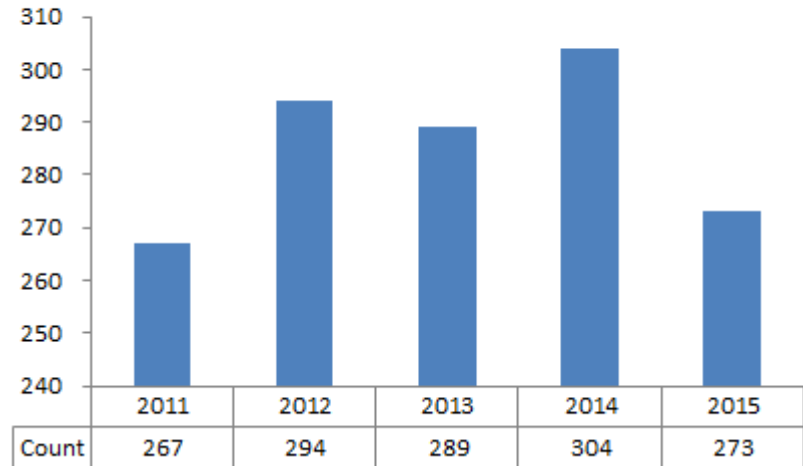
Important to review value sensitivity and trend over time.

Industry Trends

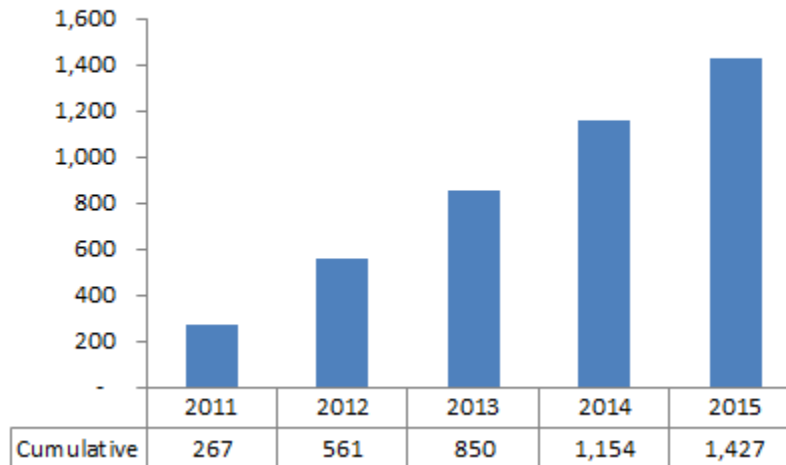
of Credit Unions



Merged or Closed



Cumulative Merged or Closed



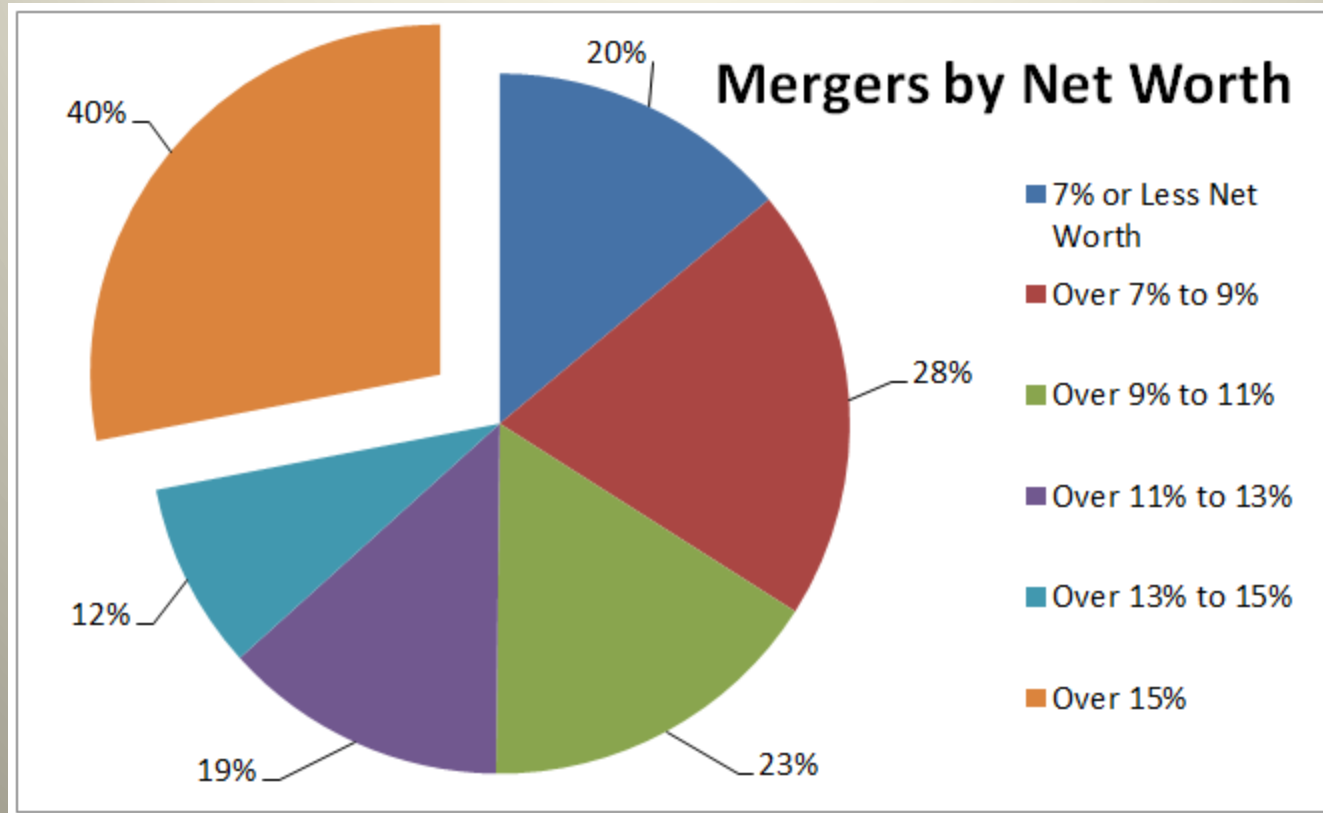
Industry Trends

Other than size, what factors may make a merger more likely?

We will look at:

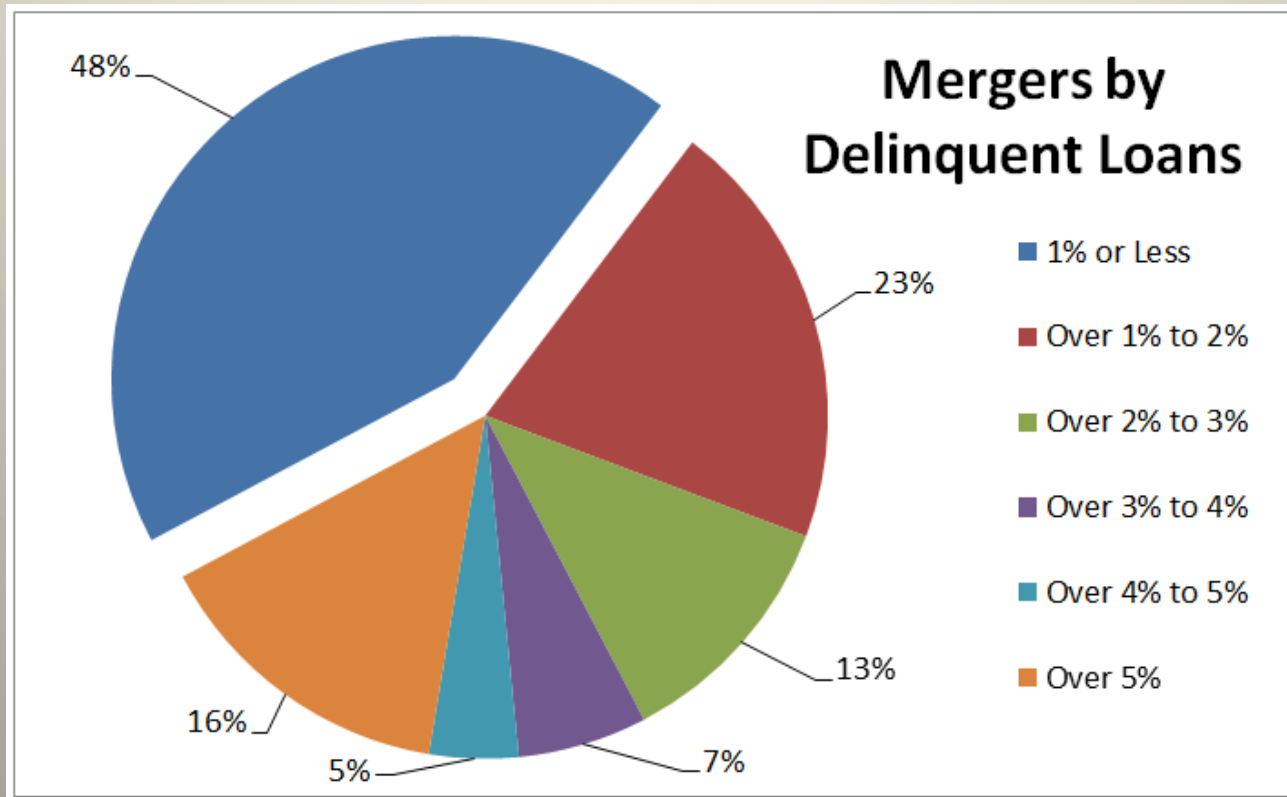
- Net Worth
- Delinquent Loans
- Loan to Deposit Ratio
- Location

Industry Trends



Within the past 5 years, 40% of merged credit unions had net worth of at least 15%

Industry Trends



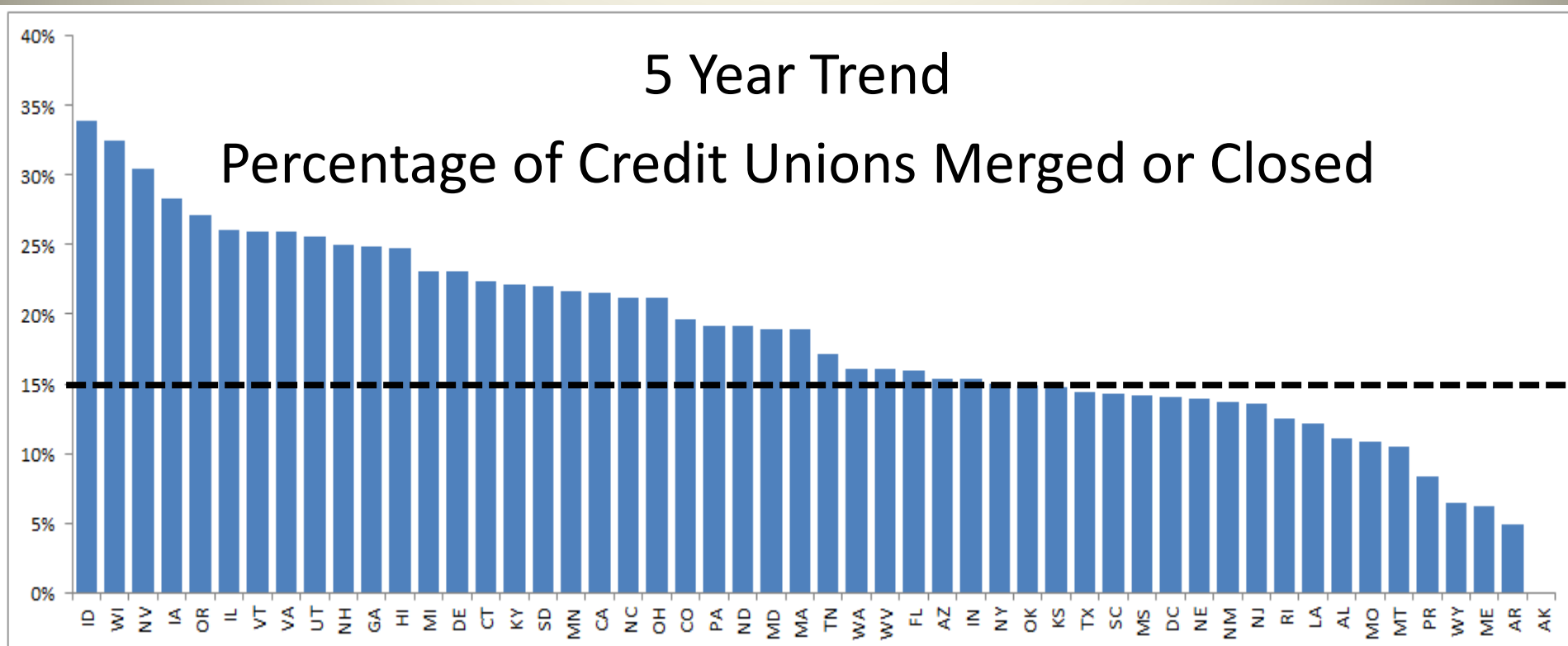
Within the past 5 years, 48% of merged credit unions had loan delinquency of 1% or less

Industry Trends

Year	# Closed	Average			
		Assets (Million)	Net Worth	Delinquency	Loans To Deposits
2011	267	38.1	14.3%	2.64%	62.1%
2012	294	21.4	12.5%	3.12%	55.1%
2013	289	54.1	13.3%	2.43%	52.4%
2014	304	42.4	14.1%	2.57%	49.2%
2015	273	57.3	13.5%	2.68%	50.9%

Industry Trends

5 Year Trend
Percentage of Credit Unions Merged or Closed



In over half of US States,
15% of credit unions have merged or closed

How to be a Survivor

How to be the survivor and merge other CU's into your CU:

- Be financially strong
- Have good people
- Have good products
- Have a plan
- Have an energetic strategic Board of Directors

How to be a Survivor

What do I mean have a plan?:

- Strategic plan
- Loan growth plan
- Succession plan
- Technology plan
- Board of Directors replacement plan

How to be a Survivor

What can CU* Answers do to help you be a survivor?

- Marketing tools
- Loan growth tools
- Deals (\$\$\$\$\$) when merging CU's in

Focus on the 8 points of Profitability

1. Non Interest Income
2. Lending
3. Investments
4. Liability Structure
5. Technology
6. Branches
7. People
8. Asset Liability Management

#1 - Non-Interest Income

1. Overdraft protection
2. Credit card and Debit card interchange
3. Gain on Sale Mortgage Loans
4. Insurance
5. Brokerage
6. Car warranty sales
7. Properly pricing products

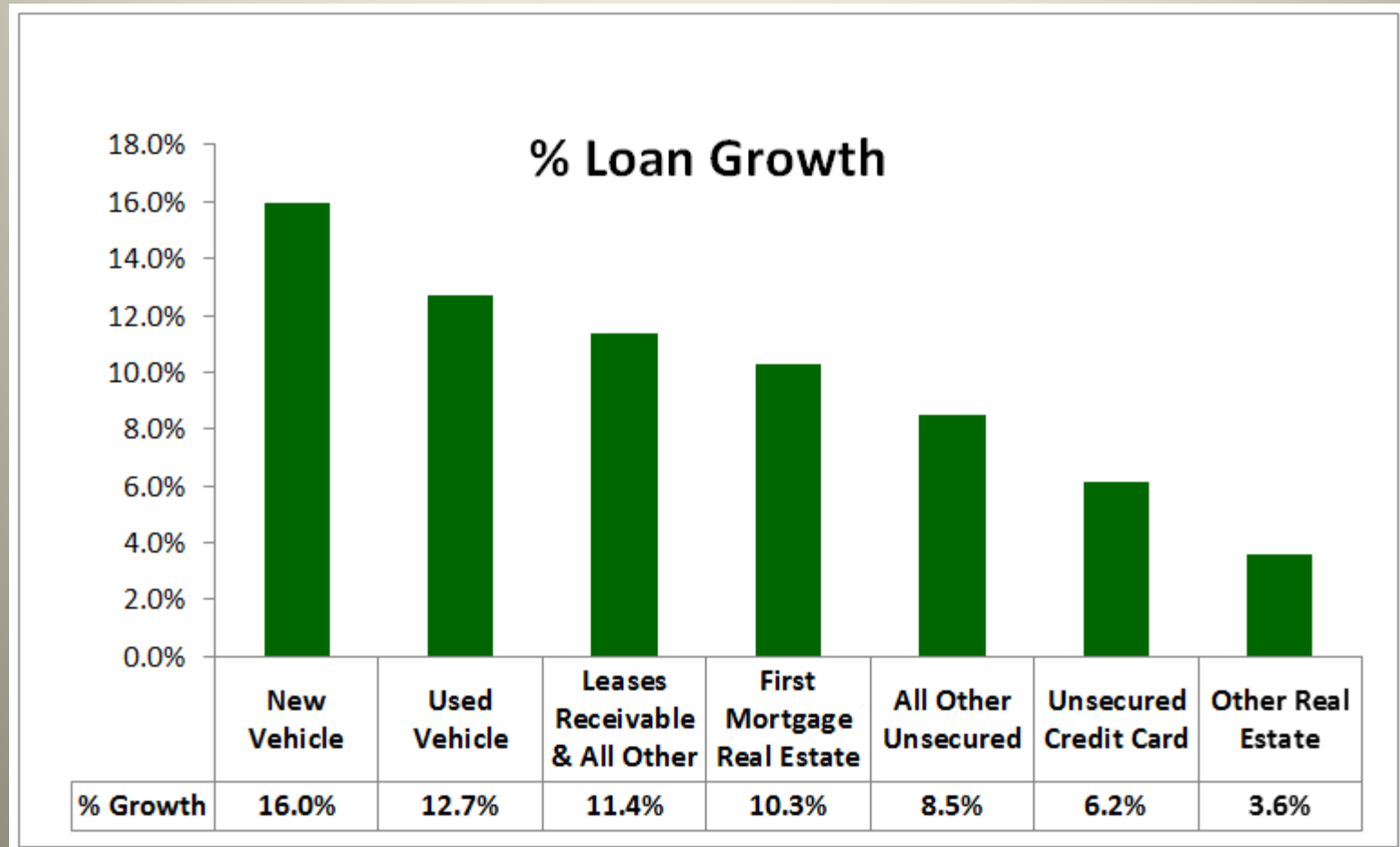
#1 - Non-Interest Income

What do I mean by “properly pricing products”?

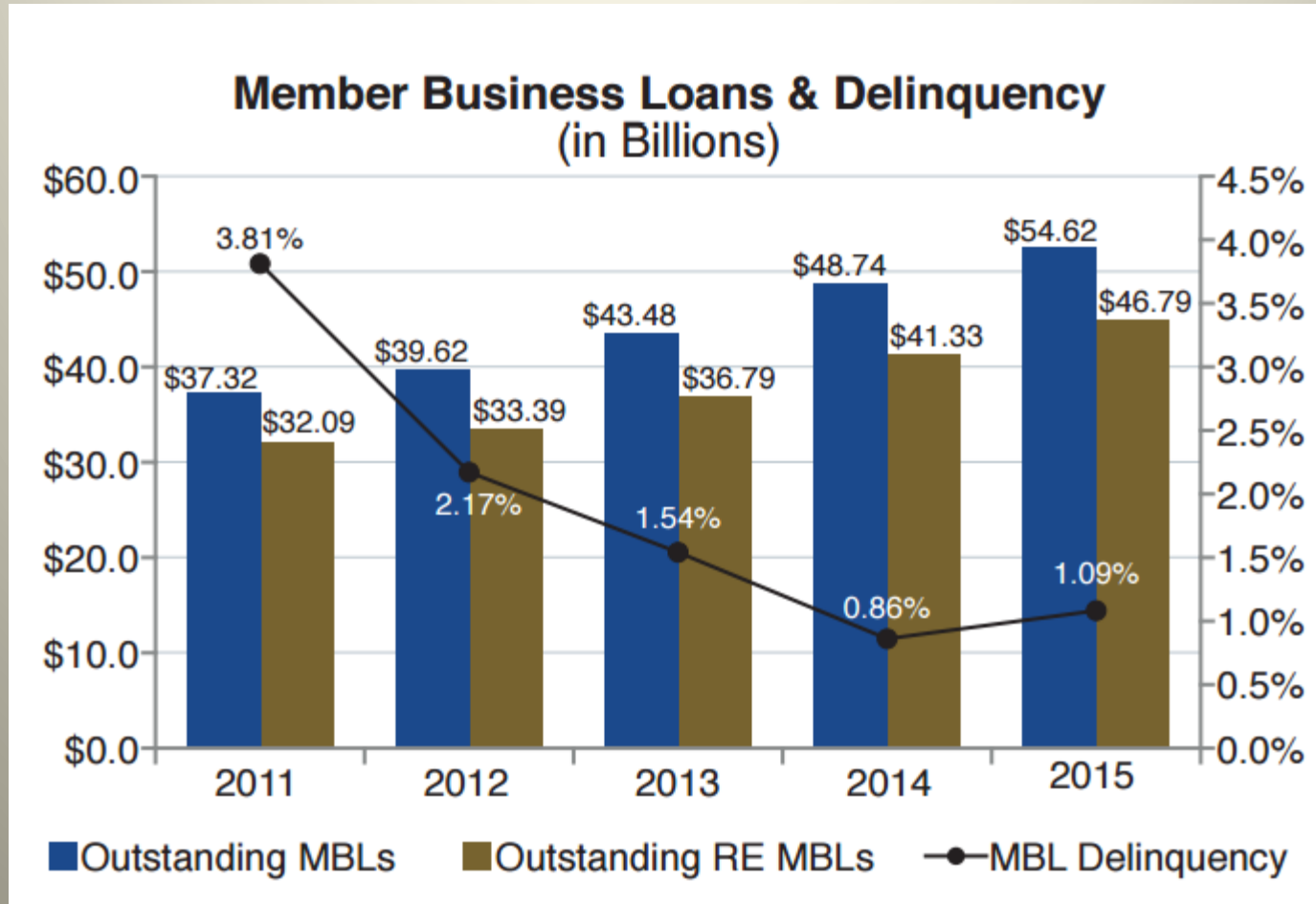
1. GAP insurance and toothpaste
2. Fees and competition
3. Value versus costs

#2 - Lending

Double digit growth in many categories in 2015

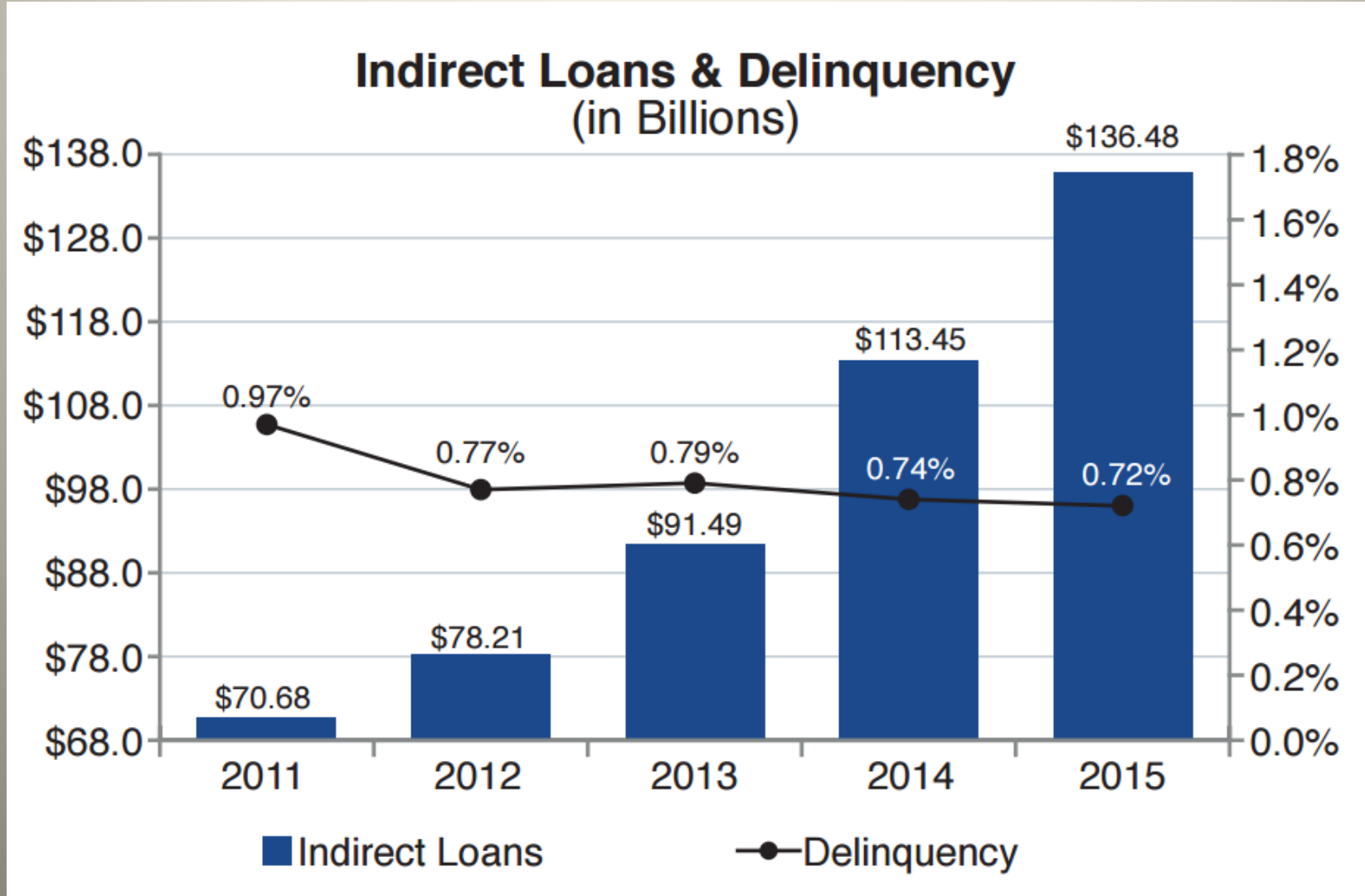


#2 - Lending



Member Business Lending Balances Improving

#2 - Lending



#3 - Investments

- Fills in what is left after loans...
- Maximize income
- Correct risk
- Correct duration
- Alternative Investments

#3 - Investments

Alternative Investments

- Benefit funding
- 457 funding
- 401(k) funding
- Additional yield

#3 - Investments

Investment keys

- Buy bonds – Do not be sold...
- Consider Option (Call) Risk
- Pre-purchase due diligence
- Risk and reward of step up bonds
- Understand prepayment risk of mortgage backed securities
- Understand credit risk (if any)

#4 - Liability Structure

- Non-maturity deposits
 - Core local non-maturity deposits offer significant value
 - Rates not likely to increase solely based on rate
- Term deposits
 - Very difficult to achieve growth
 - Do not promote unless necessary
- Borrowings
 - Effective for managing ALM position
 - Easily fill 'gaps' to meet funding needs

#4 - Liability Structure

Borrowing Preference

- FHLB
 - Quick turn-around
 - Nearly any structure
- Brokered CD's
 - Consider fees and compare to FHLB
 - Longer lead-time than FHLB advances

#4 - Liability Structure

What are you doing to make your deposits more sticky?

- Remote deposit by scanner / phone
- Smart phone apps
- Savings clubs / lottery
- Rewards

#5 -Technology

- Constant improvement
- Promote ease of use
- Measure & analyze data
 - Know where your member banks
 - Credit report data
 - Adjust marketing campaigns
 - Share of wallet information

#6 - Branches

Branching Decisions

- Measure Branch Profitability
- Number: Can we close a branch?
- Location: Should we move a branch?
- Structure: Close all drive through lanes
- Size: Branch or sales center (loan production office)?

#7 – Asset Liability Management

Used as a decision making tool:

- Selection of products
- Determination on pricing
- Balance sheet mix
- Product profitability
- Maximization of income consistent with risk limits
- Understanding risk-reward of various asset classes

#8 - People

Importance of Succession Planning

- Good people lead to success
- Management training program
- Management succession
- Board succession

Summation

- Economic expansion or end of the run?
- Mergers, and how to be a survivor
- CU* Answers tools
- Profitability

Questions



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