

Solving the Middle Market Investment Banking Riddle

October 2008

Greenwich Associates Consulting: Middle Market Investment Banking

Greenwich Associates' Middle Market Investment Banking Consulting Program was created for a single purpose: To help our clients source and win investment banking deals from U.S. middle market businesses.

Every year, we interview more than 3,400 companies with annual sales of \$50–\$500 million. In addition to a series of questions in which these companies are asked to name and rate their banks and other financial service providers, we ask participants to predict whether they will need the services of an advisor on an M&A or equity transaction in the next three years.

Based on the results of this research, we help our clients determine:

- Which middle market companies expect to hire an advisor on an M&A or equity deal within the next three years? Greenwich Associates' clients receive this information on an account-by-account basis.
- Which middle market industries and size segments will produce the highest levels of demand for investment banking products in the next three years?
- Which banks are best positioned to win future middle market investment banking business? Which banks hold lead bank relationships with the most companies identifying themselves as likely investment banking prospects?
- How does your franchise compare to those of your competitors?
- How can your bank be more effective in mining your own client list and the broad universe of middle market companies to identify and capture investment banking deal flow?

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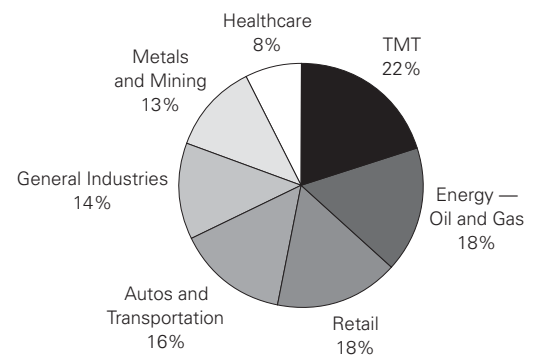
Middle market investment banking is likely to take on new prominence for Wall Street and the nation's large banks as financial service companies look for new sources of revenue to replace lost mortgage and credit businesses. However, despite the huge potential profits to be made in advising mid-cap companies on mergers & acquisitions and initial public offerings, the middle market has proven a tough nut for most banks to crack. In short, both big investment/universal banks and regional commercial banks have struggled to find the right model for sourcing and capturing the investment banking business of middle market companies.

New research from Greenwich Associates helps explain why. From January to June Greenwich Associates surveyed more than 20,700 middle market companies in the U.S.

about a range of issues concerning their businesses and their banks. Participants were asked to name and rate the banks they use for a variety of products and services, to comment on current market trends, and to predict whether they will need the services of an advisor on an M&A or equity transaction in the next three years.

Expected M&A Activity

National Overview of Middle Market Companies (\$50–500 million)



Respondents were asked from "1" very unlikely to "5" very likely, within the next 36 months how likely are you to sell your business, merge with another company, or acquire a company? Only responses of 4 or 5 are shown.

Approximately 15% of the companies surveyed say they are likely or very likely to hire an advisor on an M&A deal in the next two to three years and about 3% say they are likely or very likely to need a manager for an IPO. What complicates matters from the perspective of banks hoping to win this business, however, is the fact that this deal flow will be spread across a huge number of companies of differing size, industry and location:

- Expected demand for M&A services ranges from slightly less than 10% to slightly more than 20% of middle market companies across the 16 industry classifications used by Greenwich Associates.
- Expected IPO demand ranges from about 3-5% in all industries except energy/oil & gas, where it peaks at 13%.

A close analysis of the data does reveal the areas likely to be most lucrative over the next three years for banks in search of middle marketing investment banking deals:

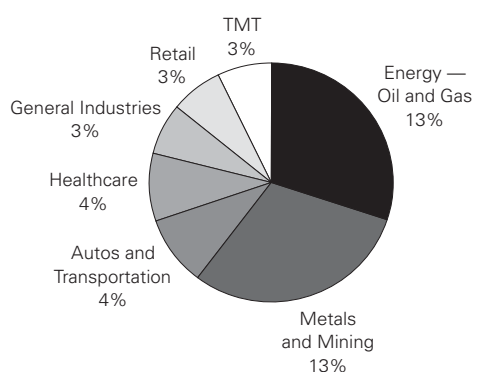
- The biggest demand will come from the upper end of the middle market. Among companies with \$150–500

million in annual sales, 16% expect to use an M&A advisor in the next three years and 5% expect to use an IPO manager.

- The most promising industry for middle market M&A is tech/media/telecom, in which 22% of companies expect to hire an M&A advisor in the next two to three years. Close behind, approximately 20% of companies in wholesale durables say they plan to hire an M&A advisor in that timeframe, as do nearly the same proportion in machinery/metal fabricating, retail trade and energy/oil and gas.

Expected IPO Activity

National Overview of Middle Market Companies (\$50–500 million)



Respondents were asked from “1” very unlikely to “5” very likely, within the next 36 months how likely are you to issue equity through an initial public offering? Only responses of 4 or 5 are shown.

“Beyond these select industries and segments there is little concentration in projected deal flows, which means there is no magic bullet for banks,” says Greenwich Associates consultant Jesse Neumyer. “With thousands of companies to cover across millions of miles in the United States, banks cannot hope to capture significant amounts of middle market investment banking business by focusing on a handful of industries. A serious commitment to this business requires banks to somehow locate and win deals as they emerge throughout this incredibly diverse universe of companies.”

Bank of America Well Positioned in Middle Market Investment Banking

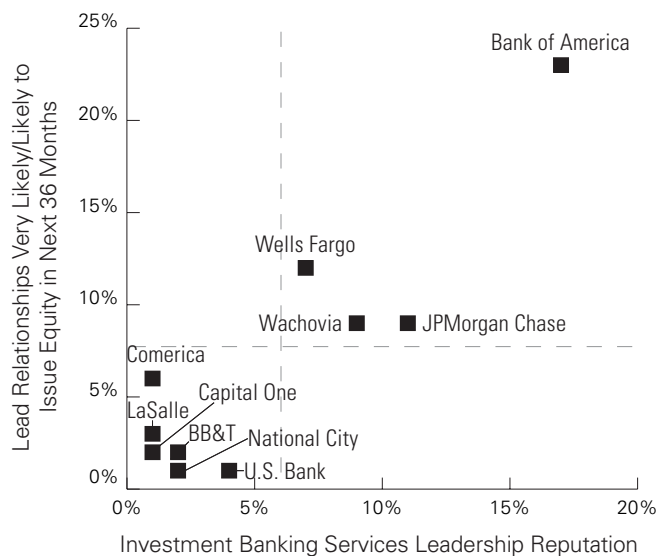
Of course, certain banks have a built in advantage: existing middle market business banking relationships. “The vast majority of middle market investment banking business is never put out to bid,” says Greenwich Associates consultant Don Raftery. “This isn’t public deal flow. You have to have your foot in the door to know about it, and the best way to do that is by building lead relationships with middle market businesses in traditional products like credit and cash management.”

Bank of America is in a strong position in having developed lead commercial banking relationships with a large number of companies across the country. Seventy-one of the middle market companies participating in the Greenwich Associates survey name Bank of America as their lead bank and also say they plan to sell their businesses in the next three years. That number exceeds the 58 self-identified M&A prospects that use JPMorgan Chase as their lead bank. At the same time, 19 companies that name Bank of America as their lead bank say they plan to hire an IPO manager in the next three years — again far ahead of the 14 Wells Fargo lead banking clients and 13 JPMorgan Chase clients reporting plans to go public in the next three years.

Bank of America also comes out on top in terms of reputation among middle market companies in investment banking. The bank ranks first in investment banking reputation among all survey participants and also receives particularly high scores for reputation among its own commercial banking clients. JPMorgan Chase ranks second in overall reputation among all survey participants and essentially ties with Wachovia with about one third of its own commercial banking clients citing it as one of the leaders of the investment banking industry.

Issue Equity vs. Leadership Reputation

National — \$50–500 Million



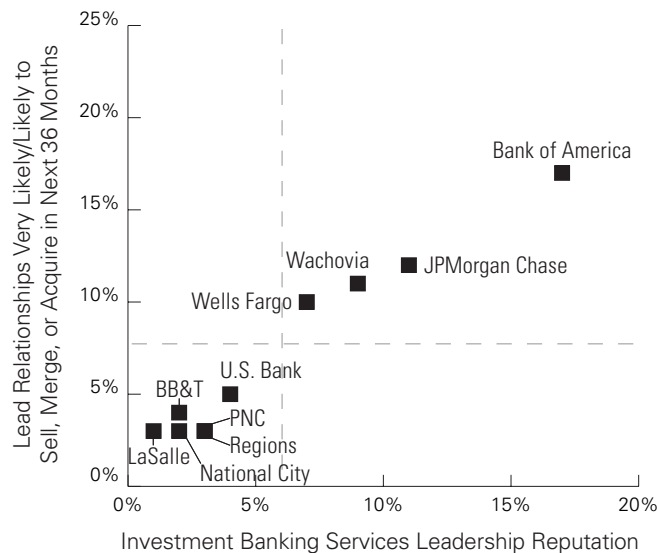
Questions:
From “1” very unlikely to “5” very likely, within the next 36 months how likely are you to issue equity through an initial public offering (IPO)? Considering all of the banks and non-banks in your region, which 2 or 3 do you consider to be the leading providers of investment banking services?

It is interesting to note that Bank of America’s lead in reputation disappears entirely when the question is limited to existing investment banking clients. Among existing

IB clients, Bank of America is essentially tied in reputation scores with JPMorgan Chase, Wachovia and Comerica, and all of these banks do not have a distinct reputation advantage over large regionals' like SunTrust, TD Commerce Bank, Capital One, PNC bank, and M&T Bank. "The research results make clear that many middle market businesses see the regional banks with whom they do

Sell Your Business or M&A vs. Leadership Reputation

National — \$50–500 Million



Questions:

From "1" very unlikely to "5" very likely, within the next 36 months how likely are you to sell your business, merge with another company, or acquire a company? Considering all of the banks and non-banks in your region, which 2 or 3 do you consider to be the leading providers of investment banking services?

business as just as good or better than national banks when it comes to investment banking," says Greenwich Associates consultant Pete Garrison.

Despite the strong reputations of some regional banks, the simple breadth of national banks' client bases will give these large players a significant advantage in the competition for middle market investment banking deals. That advantage could be expanding. As the global credit crisis persists and the economy continues to slow, many middle market companies are adding new banking relationships to diversify their credit bases and ensure continued access to affordable credit. As they do so, many are turning to larger banks that they perceive as more stable. In the long-term, this expansion of the client base in lending will result in more opportunities for big banks to originate high-margin M&A and equity transactions.

"Over the next three years, businesses that use Bank of America as their lead bank will constitute 17% of expected middle market demand for M&A and 23% of expected IPO demand," says Greenwich Associates consultant Chris McDonnell. "Those kinds of numbers give the Bank of

America's of the world a big head start — but the extent to which they can actually take advantage of it remains to be seen."

The Right Model

Banks both large and small have struggled to devise a coverage model that can generate investment banking deal flow out of the middle market in a cost-effective and logistically practical manner. Small and regional banks source investment banking deals by relying on their deep relationships with middle market businesses as lenders and providers of treasury management and other core banking services. While these relationships — along with their local presence — help keep regional banks attuned to investment banking opportunities among their middle market clients, the nature of these relationships can sometimes make it difficult to capitalize on those opportunities when they do arise.

"In middle market banking relationships are usually between the bank's relationship manager and the treasurer," says Jesse Neumyer. "It can be difficult for a relationship manager to spend the morning talking cash management with a company's treasurer and then walk down the hall to talk about M&A strategy or an IPO with the CFO or CEO. In addition, many are not looking out far enough and asking the business owners what are their strategic plans for the company downstream."

Most large financial firms seek to overcome this type of disconnect by using their business banking and/or dedicated middle market specialists to source deals and then calling in large-cap investment bankers from the appropriate industry group to sell and execute the deal. "While the large-cap bankers have the industry knowledge and access to exceptional resources, they often have little historic knowledge of the companies they are calling on," says Don Raftery. "As a result, the match between them and middle market CEOs and CFOs is also not always a perfect one. Furthermore, these smaller deals are often treated more as a hobby by the traditional investment bankers than their main event."

For some banks, past difficulties in tapping into middle market deal flow are being exacerbated by the current financial crisis. Over the past six months, poor business performance has led some banks to reduce the frequency with which they call on middle market clients and prospects. While understandable in the context of the sometimes existential challenges facing certain banks, this move will prove counterproductive over the long term. Prospects and clients do not exist in a vacuum. They will get information about bank performance and strategy, either from the media and peers, or in a worst case, from competing banks. "You can't hide from your performance," says Pete Garrison. "The only question is whether you're going to explain the facts to clients and prospects,

or if they're going to get their information from your competitors and the press."

Also, banks that cut back on calls to clients and prospects take themselves out of the information loop — a departure that could prove fatal to efforts to build out a middle market investment banking business. "The realities of this business are simple: If you're not talking to the market, you are missing out on the best strategic opportunities," says Chris McDonnell.

Conclusion: Effective Coverage Rests on Good Information

In such an expansive market, the effectiveness of coverage models and overall strategy will depend largely on the quality of information a bank is able to compile on prospects and business opportunities. Banks with a clear understanding of where demand is likely to emerge will be at a significant advantage in the competition for deals. Taking that statement one step farther, banks that know exactly which companies are planning to sell their businesses, make an acquisition or go public in the near future will be able to direct sales and investment banking resources with maximum precision.

"Our Middle Market Investment Banking Consulting Program exists to meet just this need," says Jesse Neumyer. "We tell our clients the names of the middle market companies planning to use investment banking products in the next 24–36 months, we tell them which of their own business banking customers are the best prospects and we tell them which industries and segments they should be targeting to capture future business. This allows our banking clients to focus their efforts on building relationships with the middle market companies we've identified and winning investment banking deals."

Greenwich Associates consultant, Jesse Neumyer, Pete Garrison, Don Raftery and Chris McDonnell advise on community banking in the United States.

Methodology

Greenwich Associates surveyed 20,700 companies, with sales sizes of \$10–\$500 million (\$5–\$500 million in select markets) in the business services, wholesale and manufacturing sectors. Interviews were conducted with the primary decision-maker for financial services relationships, usually the owner, CEO, or CFO/senior financial officer. Surveys were conducted over the phone from January through July 2008.

About Greenwich Associates

Greenwich Associates is the premier strategic consulting and research source for providers and users of institutional financial services worldwide. Founded in 1972, Greenwich provides institutional financial services firms and those who participate in its research with accurate, systematic management information that helps them meet their global business needs.

The firm's research and consulting services span the following markets:

- investment management
- foreign exchange
- equities
- derivatives
- fixed income
- cash management
- investment banking
- commercial banking
- large corporate banking
- insurance

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