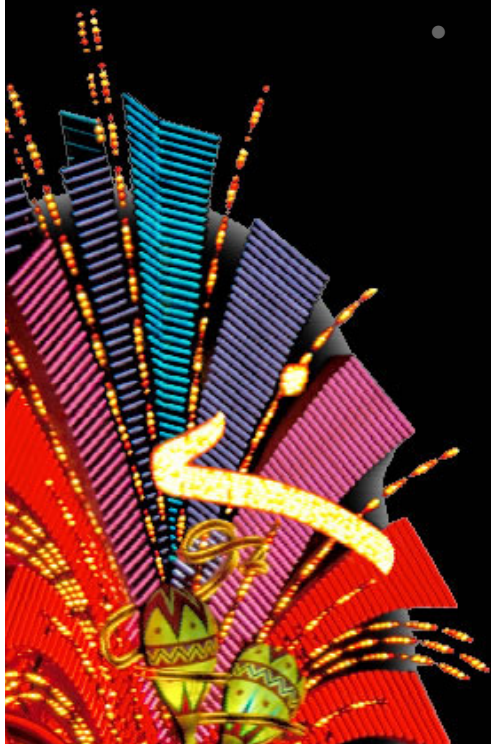


Taking a Long-Term View of Branch Network Performance

- Bill Simmons, Pitney Bowes Business Insight



MapWorld⁰⁸
LIVE IN LAS VEGAS

G1 customer conference **08**
LIVE IN LAS VEGAS

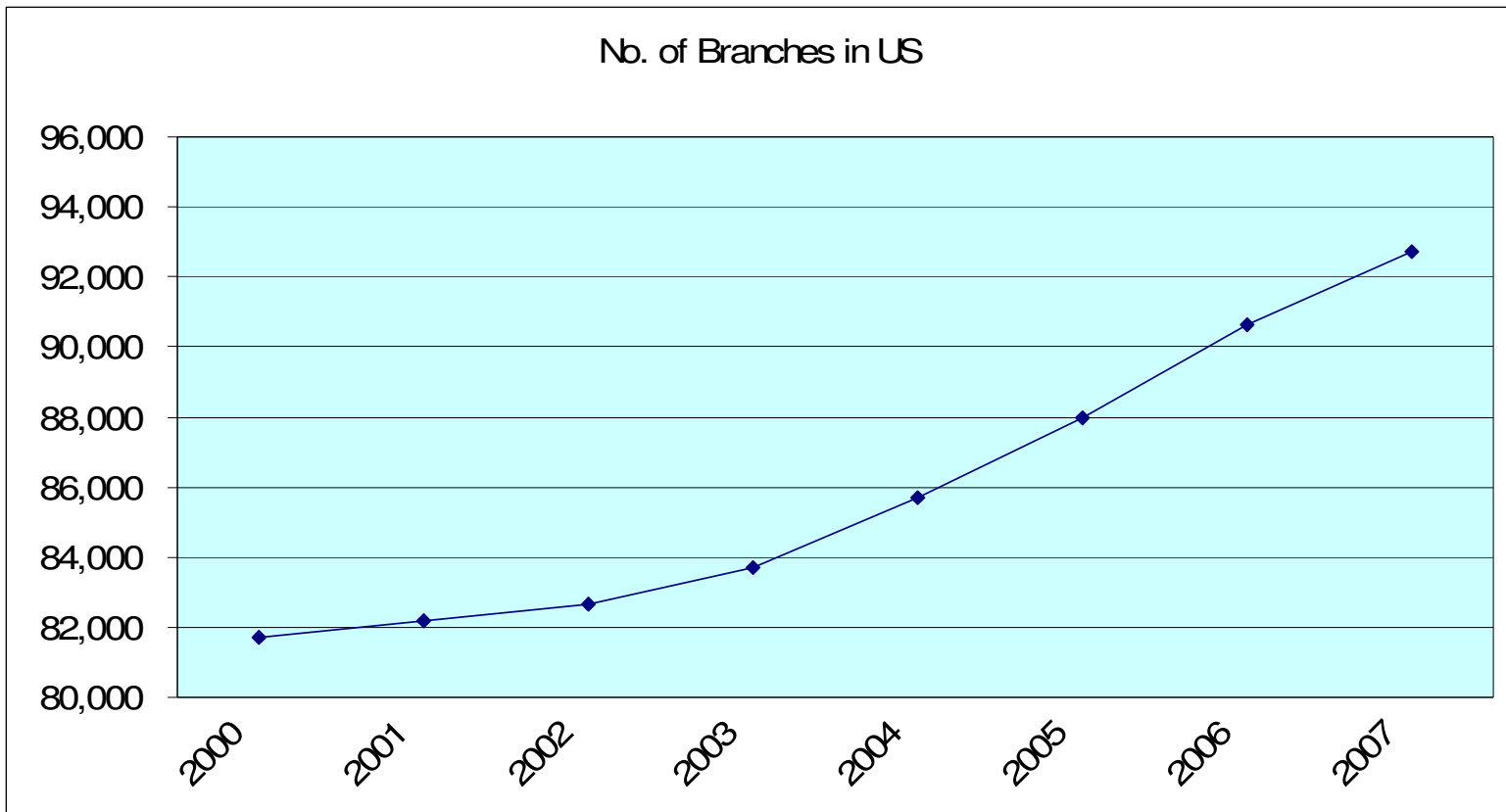
Agenda

- Value of Branch Network
- Network and Branch Economics
- Branch Growth = Bank Growth
- Branch Consolidations

- Key Bank

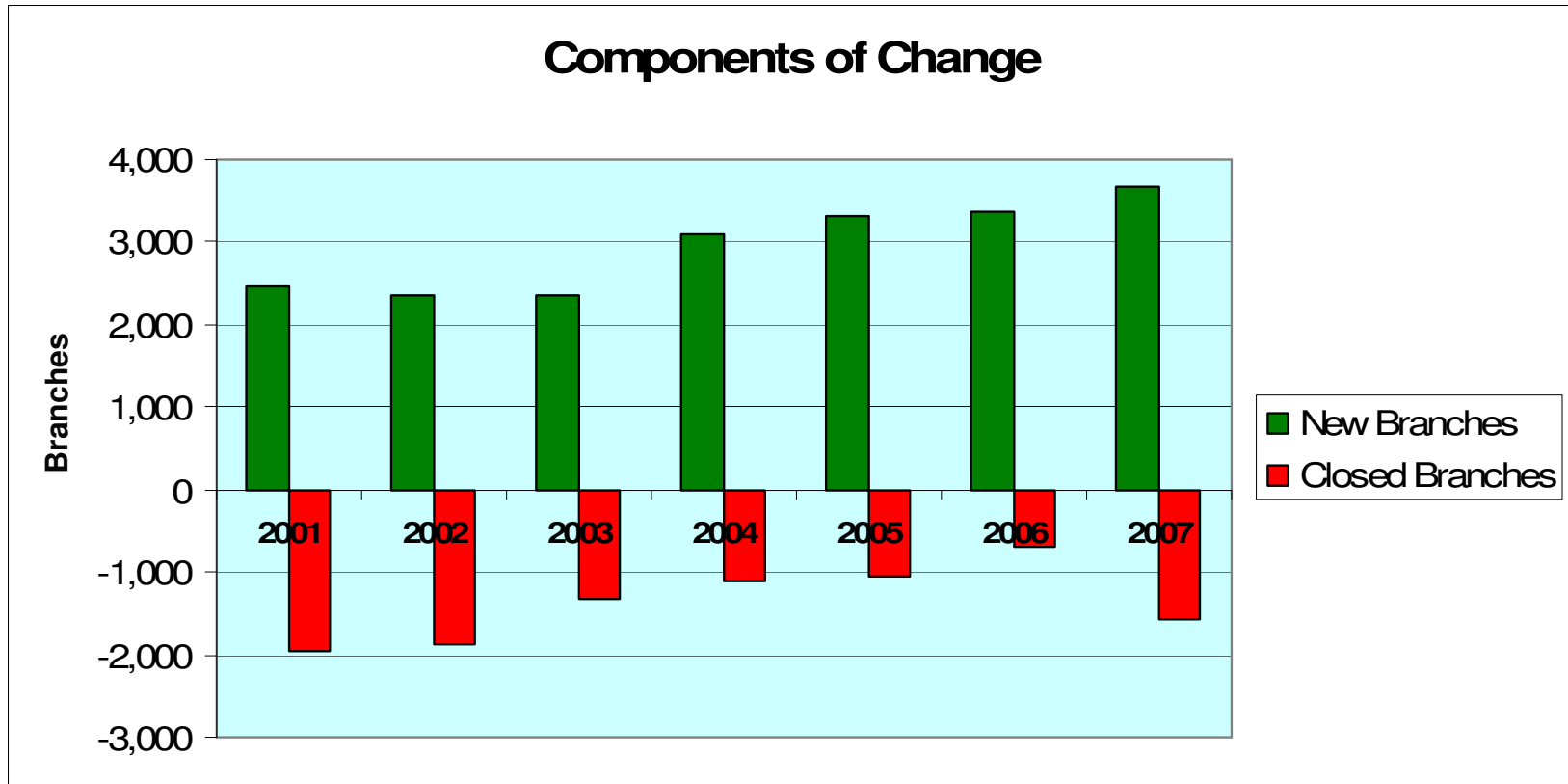


Branch Expansion



Nationally the net number of branches has been increasing at a rate of more than 30 branches per week over the past seven years. Last year (2006-07) the rate slowed to 40/week down from 51/week the previous year.

Branch Expansion



While the number of new branches has increased, there were more closures in 2006-07 than any year since 2001-02. Is the trend about to reverse?

Branch Expansion

	<u>2000</u>	<u>2007</u>	<u>CAGR</u>
Total US Branches	81,688	92,715	1.8%
US Population	282.2 million	301.6 million	1.0%
Population per Branch	3,455	3,253	-1.5%
FDIC Deposits	\$4.003 TR	\$6.702 TR	7.6%
Deposits per Branch	\$49.0 mm	\$72.3 mm	5.7%

Are we approaching saturation?

Will we see a reversal of the trend and experience a new round of consolidations and branch network rationalization?

While the number of branches and population has been relatively steady, deposit growth continues.



Branch Network Economics

New branches as % of total branches	4.0%
Closures as % of total branches	1.8%
500 branch network:	
New branches	20
Closures	9
Capital Expenditures @ \$2.5 mm	\$50 mm
Annual Operating Expenses @ \$450,000	\$ 9.0 mm
Net of closures @ \$300,000	<u>(\$2.7 mm)</u>
	\$6.3 mm

Note: Does not consider sale of asset associated with closed branches.

Why Have a Branch Network?

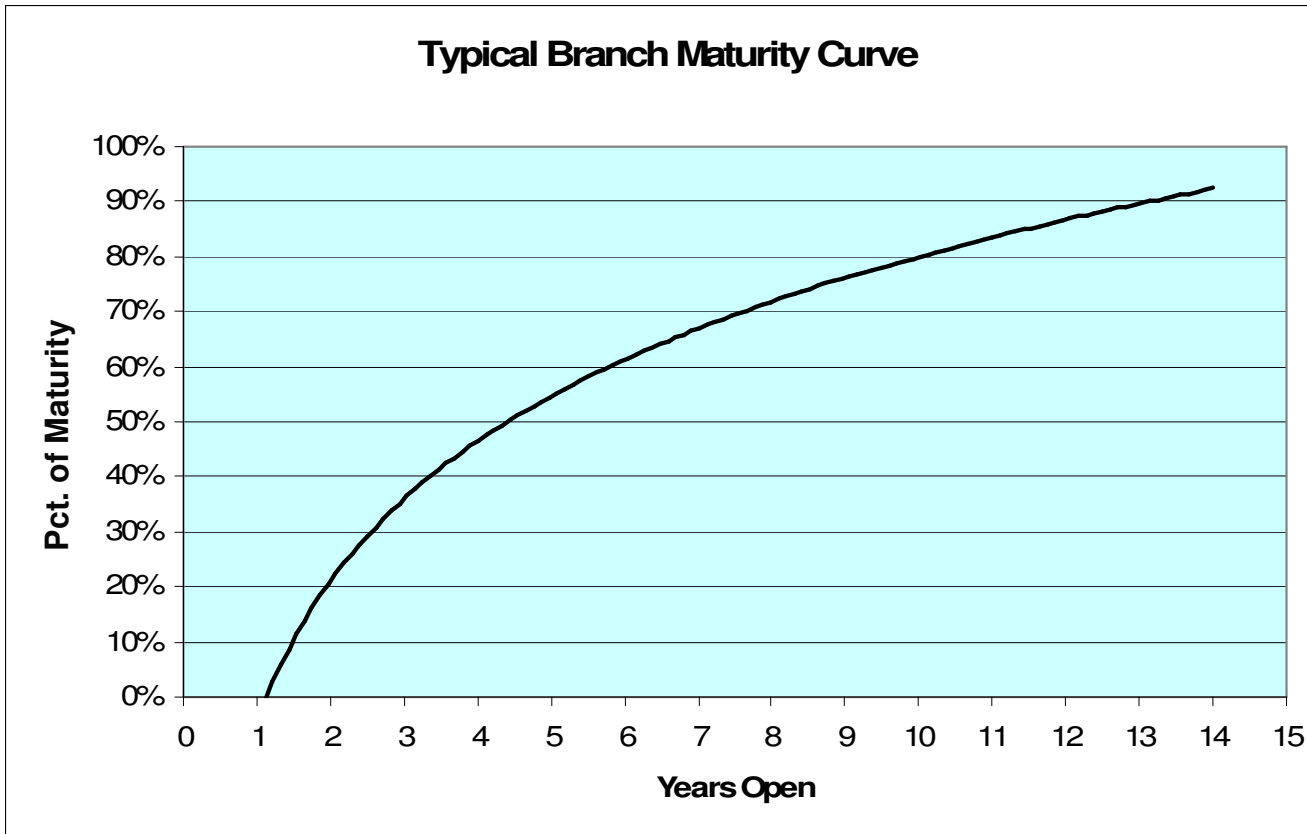
- Most accounts still open through branches
- Convenience is still identified as a major reason for choosing a primary financial institution
- Point of Differentiation from Competitors
- Personal Selling
- “Billboard Effect”





How do you financially justify a branch?

Branch Maturation



Branch maturation typically occurs after 10-12 years. As a long-term investment, net profitability will take longer than some desire and expect.

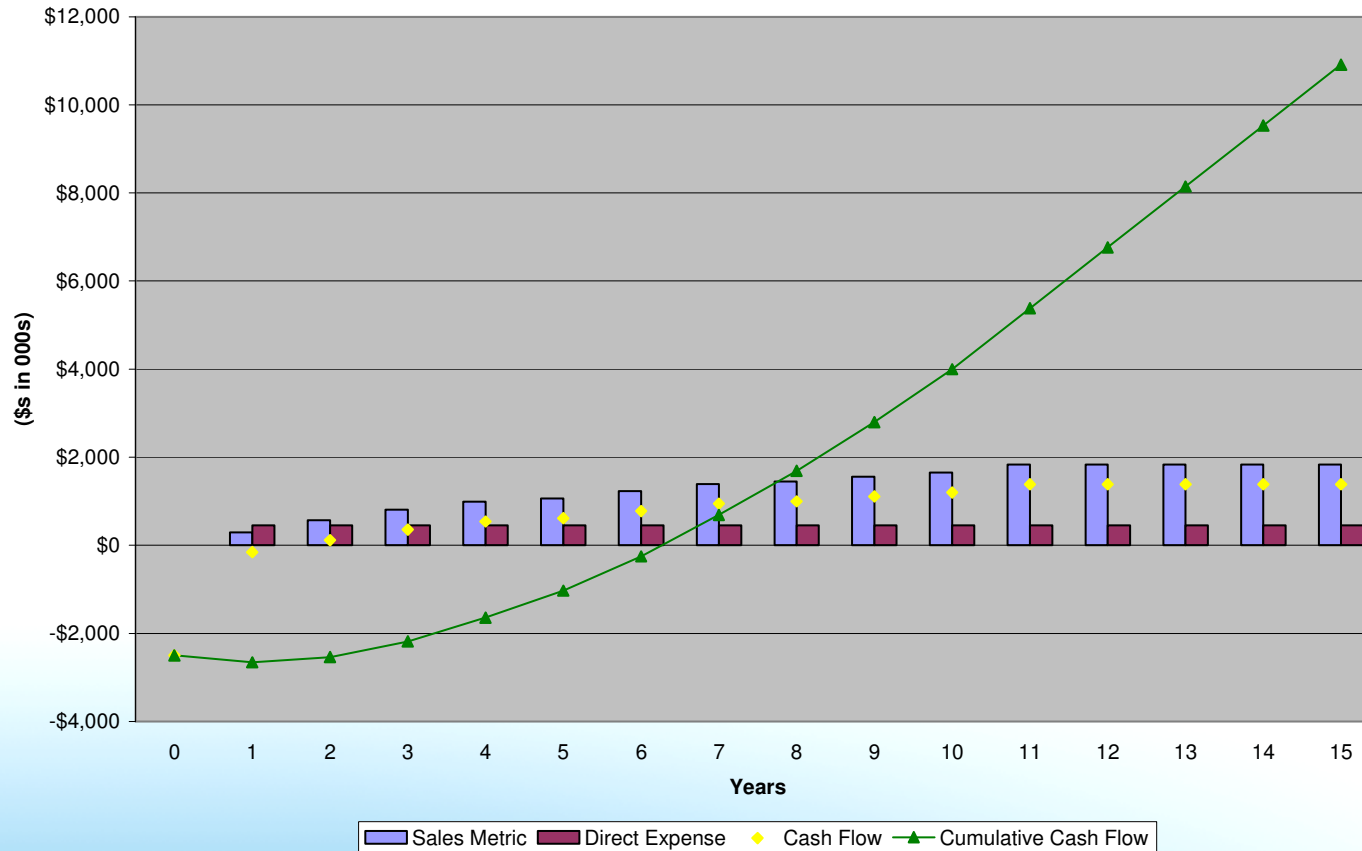
Branch Cash Flow

Capital Expenditure	\$2.5 mm
Ongoing Operating Expense	\$450,000
Deposits at Maturity	\$42.2 mm
Revenue at Maturity	\$1.83 mm
NPV (DR=12.5%)	\$3.73 mm

WINNER

Ongoing revenue BE in Year 2

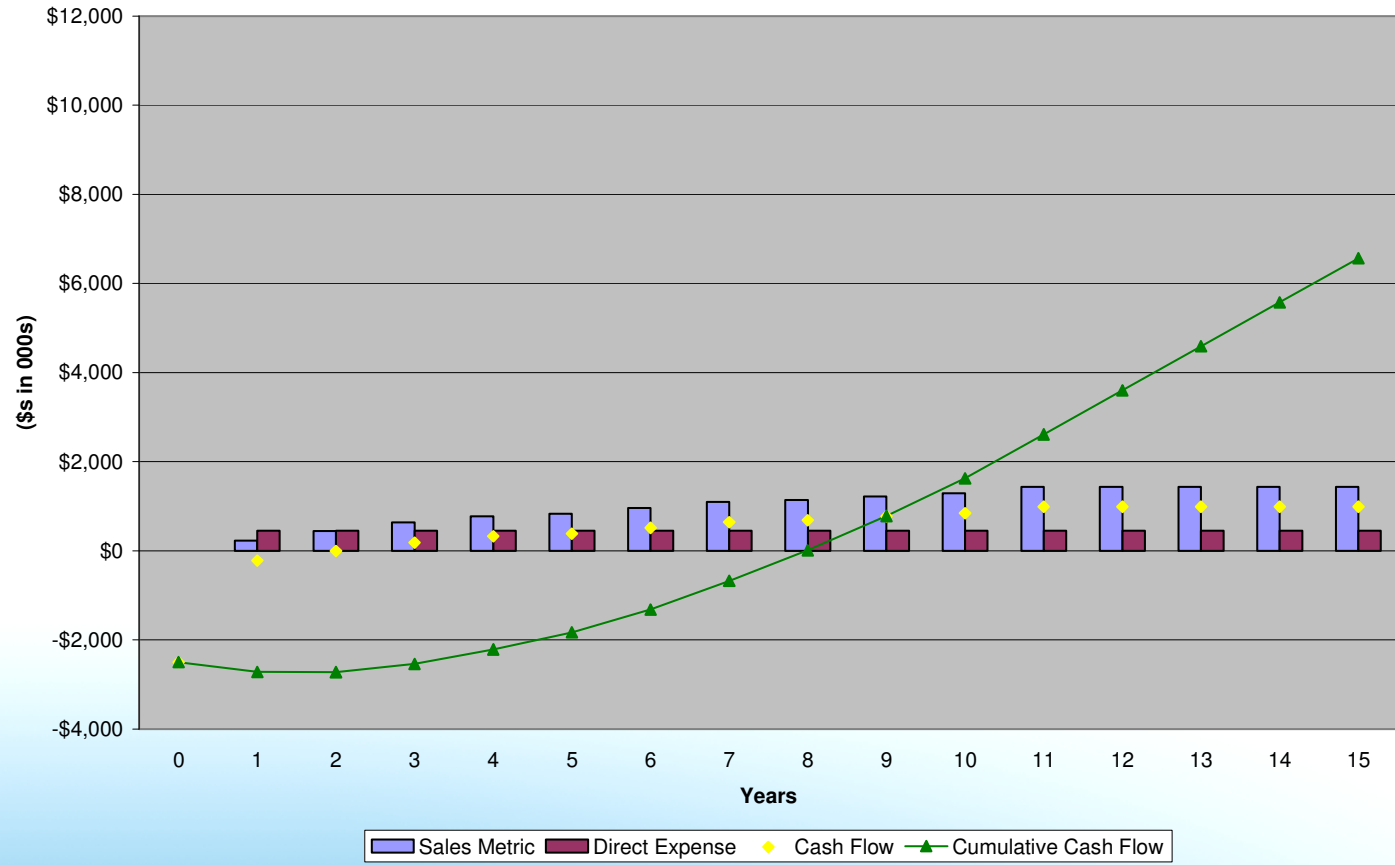
Payback in year 7



Branch Cash Flow

Capital Expenditure	\$2.5 mm
Ongoing Operating Expense	\$450,000
Deposits at Maturity	\$33.1 mm
Revenue at Maturity	\$1.44 mm
NPV (DR=12.5%)	\$1.61 mm

AVERAGE PERFORMER
Ongoing revenue BE in Year 3
Payback in year 8





Cost of Branching

Margin of Error: Difference between *Winner* and *Break-Even*

Incremental Revenue	\$690,000
At \$500 annual revenue/household:	
Net new HHs after 10 yrs	1,380
Annually	138
Households/branch	3,000
Attrition (17%)	(510)
Gross New HHs	648
Net	<u>138</u>

648 households = 27 new accounts/week*

*2.20 accts/household

The price for success is high!

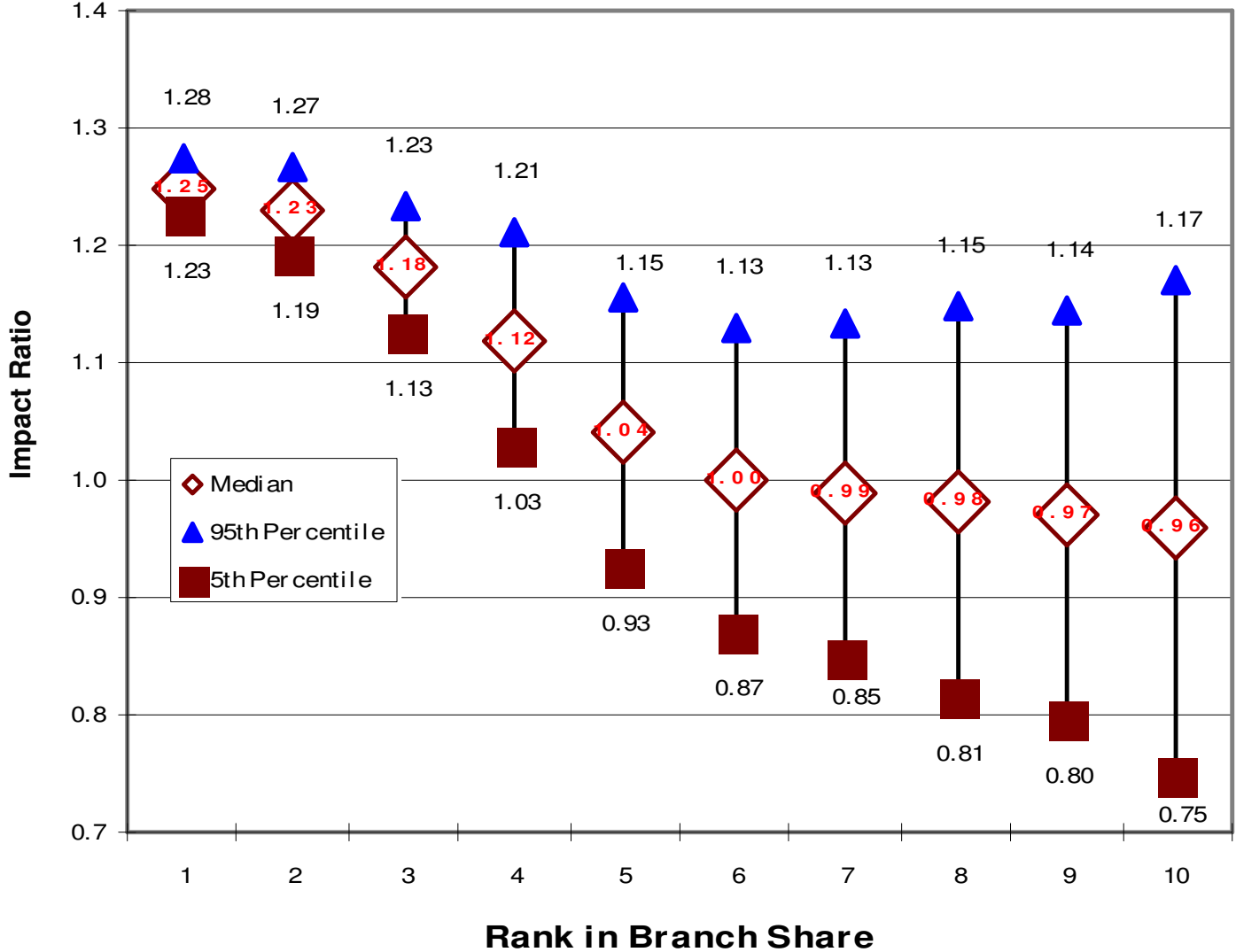
Bank Growth = Branch Growth: The Value of Market Coverage

S-Curve

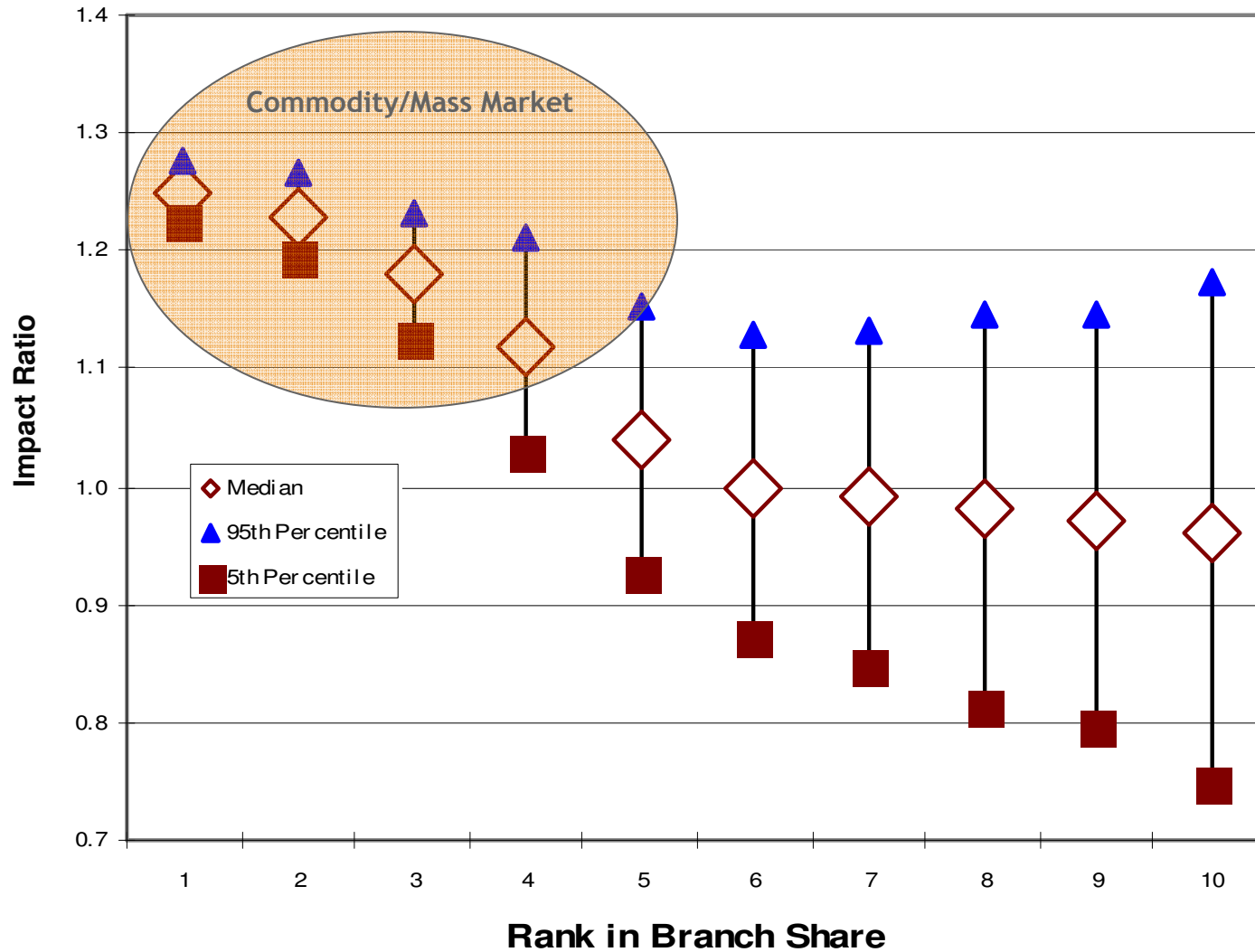
- **Market Level Measure**
- **Rank in Branch Share vs. Impact Ratio**
- **Impact Ratio = Share of Deposits / Share of Branches**

*Relationship Between Market Position
and Branch Strategy*

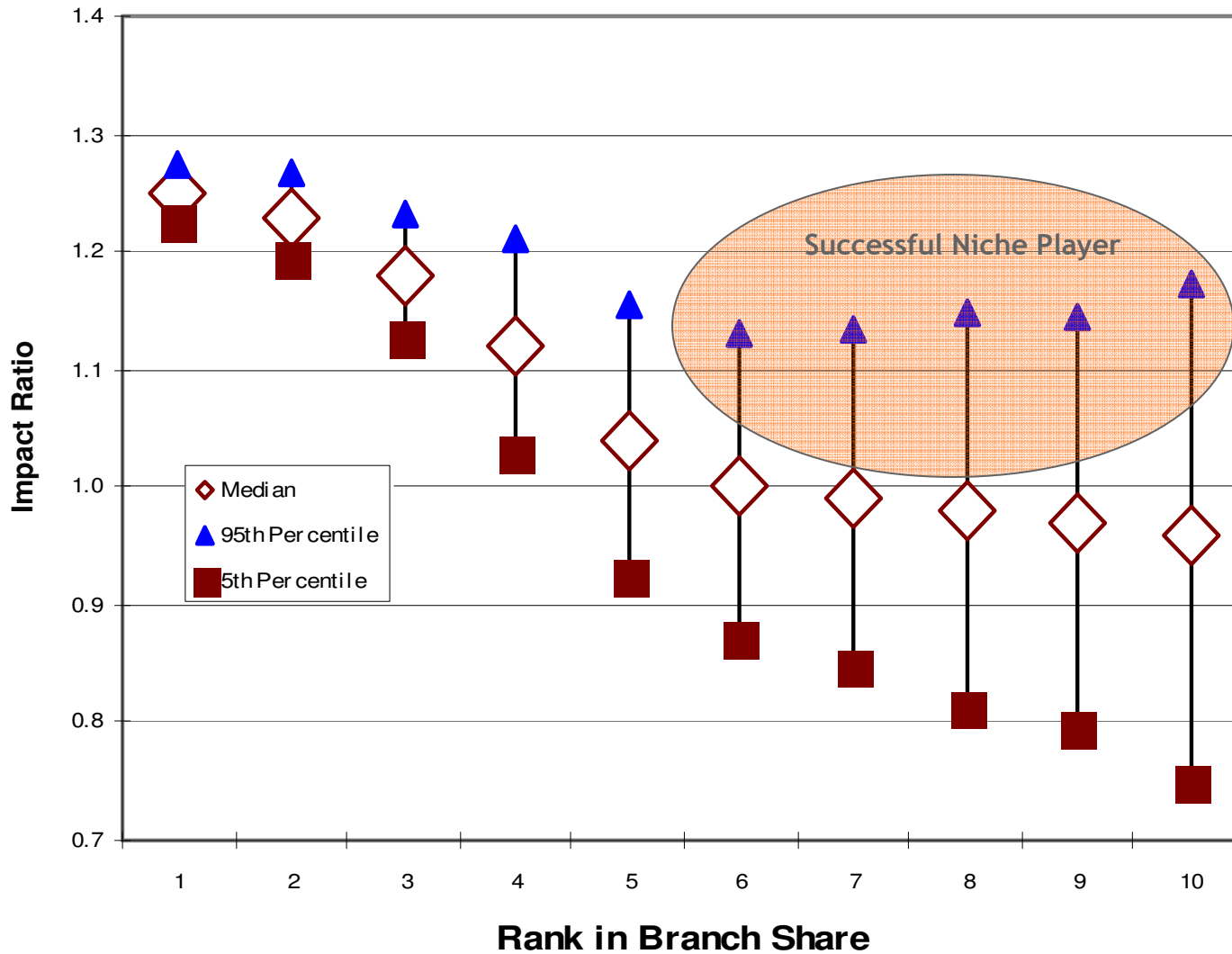
Impact Ratio and the S-Curve



Location/Convenience Strategy



Differentiated Offering Strategy





Two Dimensions of Branch Expansion

In Market Expansion

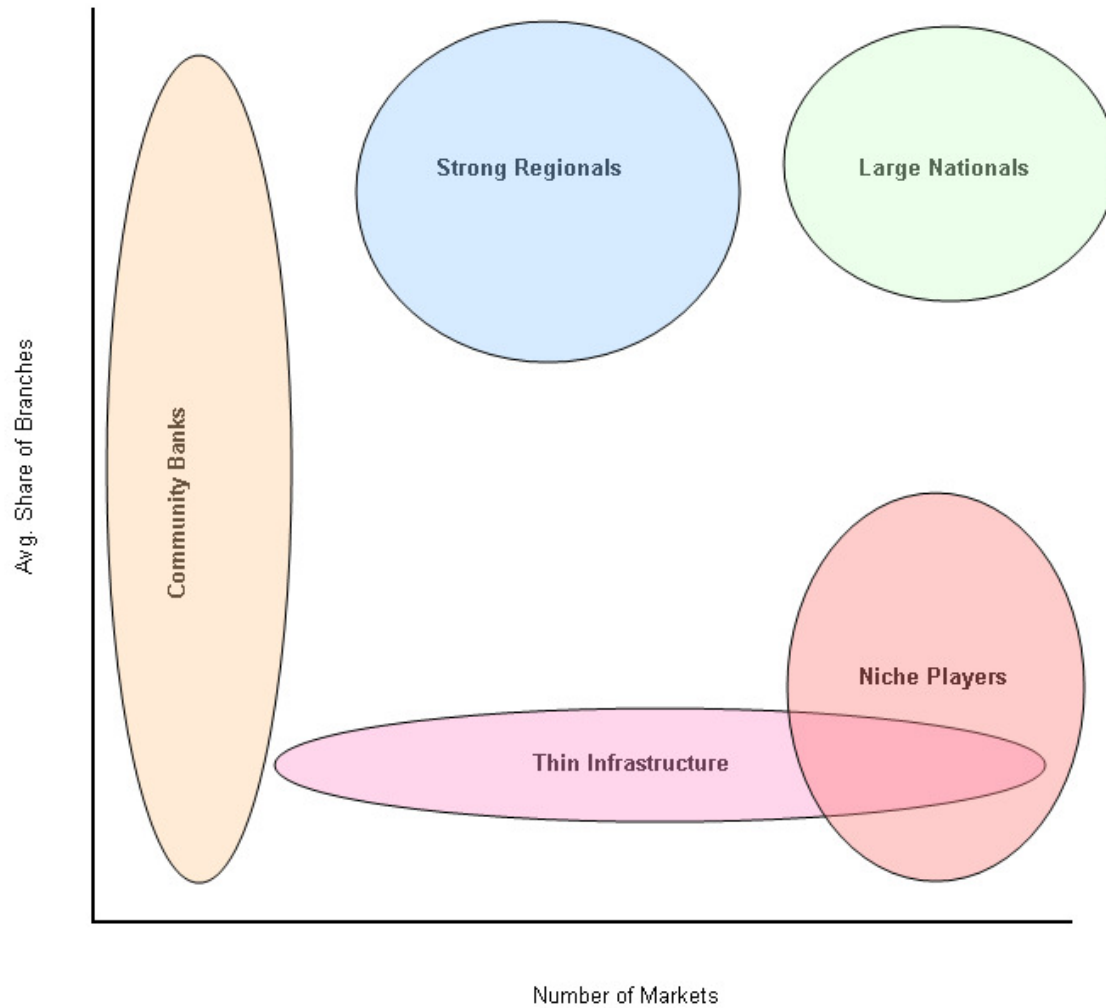
- Strengthen presence in existing markets
- Fill geographic market voids in existing network
- Leverage brand equity/marketing
- Benefit from S-curve

Expand to New Markets

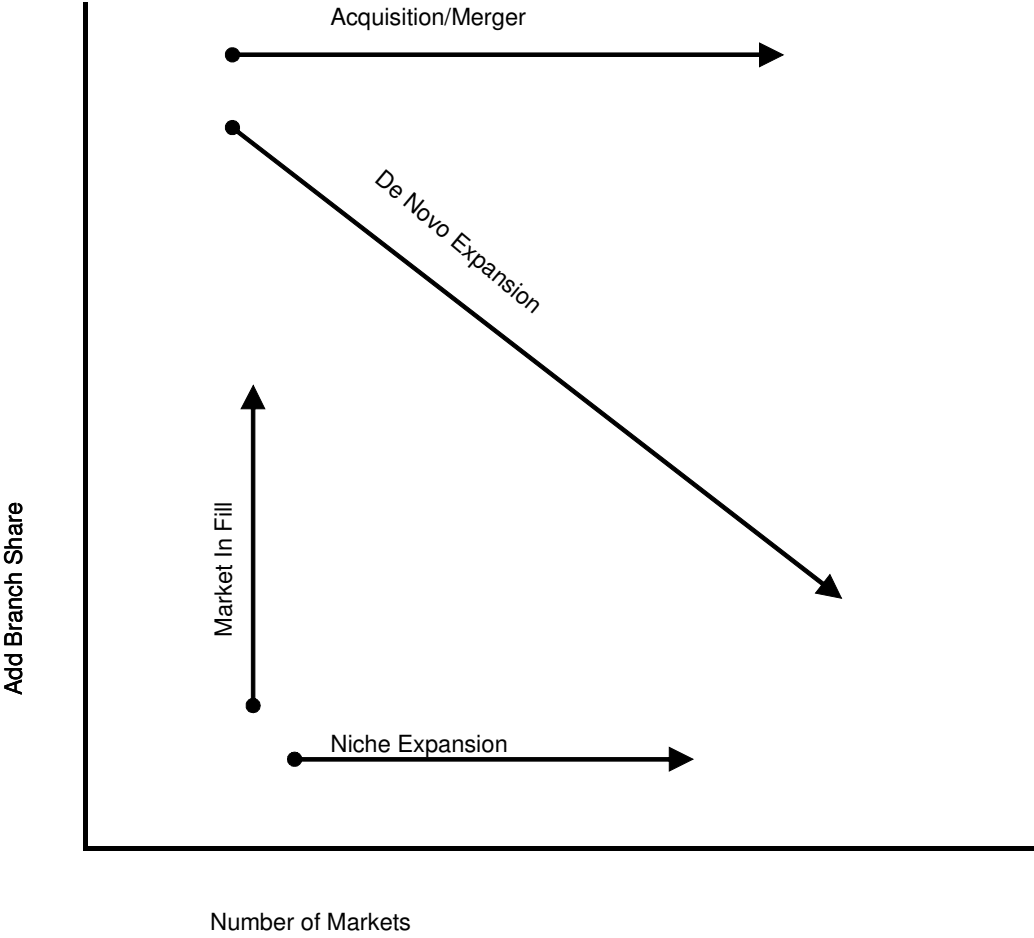
- New geographic extents
- Expand to contiguous or nearby markets
- Export niche to new markets
- Target niche customer segment

-
- **What is the relationship between these two tactics?**
 - **How can they be used to develop an expansion strategy?**

In Market vs. New Market Expansion



Growth Strategies



Movement Between Positions

From ↓	To →	1-Low Branch Share / Few Markets	2-High Branch Share / Few Markets	3-Low Branch Share / Many Markets	4-High Branch Share / Many Markets
1-Low Branch Share / Few Markets			<ul style="list-style-type: none"> >Natural expansion in home markets >Modest investment in capital >In-market acquisition 	<ul style="list-style-type: none"> >Expansion into nearby or other markets >Thin infrastructure within markets >Usually a niche player focusing on product or price 	<ul style="list-style-type: none"> >Movement usually due to be being acquired by large, market leader
2-High Branch Share / Few Markets		<ul style="list-style-type: none"> >Retrenching >Network rationalization in home markets 		<ul style="list-style-type: none"> >After reaching dominance in home markets expand into new markets >Sacrificing relative share initially, but creating new opportunities >Can be achieved through acquisition or branch expansion 	<ul style="list-style-type: none"> >Difficult to achieve quickly >Usually requires movement to 3 first >Can be achieved through acquisition/merger >Aggressive expansion with significant capital outlay
3-Low Branch Share / Many Markets		<ul style="list-style-type: none"> >Selling off small presence in select markets where niche strategy isn't working 	<ul style="list-style-type: none"> >Selling off small presence in select markets >Retrenching back into home market 		<ul style="list-style-type: none"> >Usually achieved through acquisition >Some high achievers are in 3 en route to 4 >Slow expansion into multiple markets
4-High Branch Share / Many Markets			<ul style="list-style-type: none"> >Major shift in focus >Selling off pieces of franchise 	<ul style="list-style-type: none"> >Loss of dominance in some markets through continued expansion into new markets >Network-wide rationalization 	





Position Suggests Natural Strategic Focus

1-Low Branch Share / Few Markets

- Create niche based on narrow geographic focus
- Community roots
- Nimble

2-High Branch Share / Few Markets

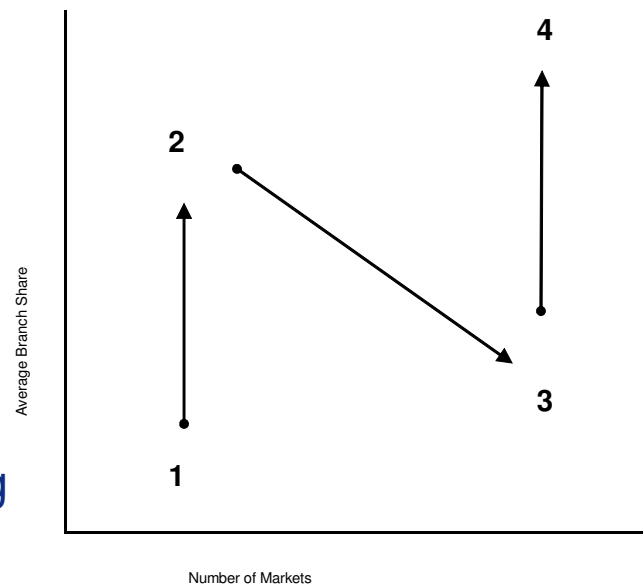
- Location convenience
- Manageable span of control

3-Low Branch Share / Many Markets

- Create niche based on product and/or pricing
- Reliance on promotion

4-High Branch Share / Many Markets

- Location convenience
- Economies of scale



Are we entering another phase of branch rationalization?



Branch Consolidations

What determines when a branch should close?

When a branch does not add enough incremental revenue to the network to cover their incremental costs

How do you measure the effect?

- Incremental cost is easy
- Incremental revenue
 - Retention measures what you keep, not what you loose
 - Deposit run-off
 - Loan run-off
- Without the branch, you are not adding new customers—
opportunity cost

Recapture vs. Retention

Standard Branch Closure Revenue Loss Phase-In	
Year	Phase In Attrition ⁽¹⁾
0	
1	25%
2	45%
3	60%
4	75%
5	90%
6	100%

(1) Percent of cumulative attrition

Retention is the metric used by most banks to determine lost revenue resulting from a branch closure.

Recapture is better measure of the net effect of closing a branch

- **Recapture Rate = % of mature branch revenue put at risk, that remains with the network after closure**
- **Measures the impact at maturity after customers re-choose**
- **17% churn rate implies that each year the closed branch is not capturing new customers equivalent to 17% of the closed branch's customer base**



Mature Recapture Rate vs. Annual Retention Rate													
Year	Recapture Rate												
	90%	80%	70%	60%	50%	40%	30%	20%	10%				
0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0	\$ 100.0
1	\$ 97.5	\$ 95.0	\$ 92.5	\$ 90.0	\$ 87.5	\$ 85.0	\$ 82.5	\$ 80.0	\$ 77.5	\$ 75.0	\$ 72.5	\$ 70.0	\$ 67.5
2	\$ 95.5	\$ 91.0	\$ 86.5	\$ 82.0	\$ 77.5	\$ 73.0	\$ 68.5	\$ 64.0	\$ 59.5	\$ 55.0	\$ 50.5	\$ 46.0	\$ 41.5
3	\$ 94.0	\$ 88.0	\$ 82.0	\$ 76.0	\$ 70.0	\$ 64.0	\$ 58.0	\$ 52.0	\$ 46.0	\$ 40.0	\$ 34.0	\$ 28.0	\$ 22.0
4	\$ 92.5	\$ 85.0	\$ 77.5	\$ 70.0	\$ 62.5	\$ 55.0	\$ 47.5	\$ 40.0	\$ 32.5	\$ 25.0	\$ 17.5	\$ 10.0	\$ 2.5
5	\$ 91.0	\$ 82.0	\$ 73.0	\$ 64.0	\$ 55.0	\$ 46.0	\$ 37.0	\$ 28.0	\$ 19.0	\$ 10.0	\$ 1.0	\$ 0.0	\$ 0.0
6	\$ 90.0	\$ 80.0	\$ 70.0	\$ 60.0	\$ 50.0	\$ 40.0	\$ 30.0	\$ 20.0	\$ 10.0	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0
Equivalent 1st year net attrition==>	2.5%	5.0%	7.5%	10.0%	12.5%	15.0%	17.5%	20.0%	22.5%				



Network Optimization

- In long-term, both expansion and consolidation are necessary tactics required to achieve success.
- Each tactic has an affect on the other.
- Only by taking a holistic view and evaluating tactics simultaneously, will a branch network reach its optimal configuration.



THANK YOU!

Bill Simmons

919.676.2500 ext. 21

Recapture vs. Retention

RECAPTURE RATE CALCULATION	
Revenue	
Target Branch	\$600,000
10 Branch Network	\$10,000,000
Close Branch	
Target Branch	\$0
10 Branch Network	\$9,750,000
Recapture Rate	
Loss to Network	(\$250,000)
Recapture Rate	58%
	(\$350k/\$600k)

