
Alerus Financial Corporation - Alerus Financial Investor Day

Thursday, 09 December 2021

Operator Good morning and welcome to the conference call to discuss Alerus Financial Corporation plans for a merger to acquire Metro Phoenix Bank holding company. All participants will be listen only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

This call may include forward-looking statements and the company's actual results may differ materially from those indicated in any forward-looking statements. Important factors that could cause actual results to differ materially from those indicated in the forward-looking statements are listed in the press release and the company's FCC filings. I would now like to turn the conference over to Alerus Financial Corporation Chairman, President and CEO, Randy Newman. Please go ahead.

Randy Newman Thank you. Good morning, everyone and thanks for joining us. As you know, yesterday, we announced our intent to acquire Metro Phoenix Bank, the largest community bank, headquartered in Phoenix. Yesterday, we also shared the news with our current staff in Arizona and introduced ourselves to the Metro Bank employees. Both meetings went very well.

I'd like to compliment Metro Bank, their board and CEO, Steve Haggard, who will become our Arizona Market President, on their past success and for their confidence in us, by becoming our first acquisition, who is taking our stock as currency. We are very happy to build our shareholder base in Arizona.

I would also like to recognise Katy Lorenson, currently our CFO but our new CEO, at the beginning of the year. Katy and her team led negotiations and due diligence on this acquisition.

Finally, I would like to thank [unclear], led by Joseph [unclear] and D.A. Davison, led by Tom Hayes, who are our legal and financial advisors. Metro Bank is a first-class, high performing growth community bank that we believe will fit in seamlessly, both culturally and strategically, with our company. We are simply elated to complete this transaction of two high-performing organisations, coming together. We believe we have an exciting future together.

This also caps off an exciting year for Alerus. Another strong year of financial performance, this strategic acquisition, our announcement of three new, very talented corporate directors joining our board. And the announcement of Katy to succeed me as CEO, at the beginning of the year. Let me now turn it over to Katy for more details and then, we will invite your questions.

Katie Lorenson Well, thank you Randy and thank you, everyone, for taking the time to join us on this exciting day. I am going to refer to the slide presentation that summarises the terms and the highlights of the transaction. If you don't have a copy of that presentation, you can find it on the Alerus investor website, at investors dot Alerus dot com, under news and events. Let me start on page two of the slide deck, giving you a brief overview of the strategic transaction and discuss why it is an important step for Alerus franchise, going forward.

As you all know, M&A has been an important part of the Alerus story, and we truly believe that this transaction is a continuation of our long-term plan growth strategy. This is a strategic transaction that will transform our Arizona

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market presence. Alerus has been in the Phoenix, Arizona market since 2009 and for quite some time, we have been seeking and looking for the right partner, that will help us further establish our position in the market.

After many years of looking, we are excited to say that we have found that partner in Metro Phoenix. Metro Phoenix has the largest community bank headquarters in Phoenix MSA, with over 400 million in total assets and is one of the best performing community banks in the country. This combination will nearly triple our footing in Arizona, adding significant scale in one of the most dynamic and fastest growing regions in the United States.

On a pro forma basis, Alerus will have approximately 440 million of loans and 480 million of deposits in the MSA and will rank on the top five, based on deposits, for community banks operating here. Metro Phoenix is a core business banking franchise, focused on commercial business. It is very similar to Alerus in the overall, holistic approach to banking. The bank has a proven track record of strong profitability and quality, sustainable growth since its formation in 2007.

As Randy mentioned, we are very pleased to announce that Metro Phoenix's CEO, Steve Haggard, will assume the role of the Arizona Market President for Alerus. In this role, Steve will oversee growth for the company, in the Arizona market.

After spending time with Steve, throughout the transaction, we are excited to have him leading the team and the franchise.

We are confident in his ability to seamlessly integrate the transaction, retain the talent and the clients, while continuing to grow in the market. For our shareholders, the deal metrics are strong, with 8.5% earnings accretion in the first full year, a 25% plus IRR and a tangible book payback of approximately 2.8 years. Turning to page three, just a quick overview of Metro Phoenix, the franchise and its performance.

Again, it is a high growth, high performing and efficiently single branch business bank. Strong track record of organic growth, with a 20% plus CAGR for both loans and deposits in 2015 and excellent asset quality, with no NPAs. On slide four, the Metro Phoenix commercial client base is very complementary fit with Alerus. We also really like the way in which Metro does business, approaching the clients holistically, albeit with a limited product set at this time.

We have not modelled any revenue synergies from overlaying the Alerus suite of solutions. But we believe the Metro talent is excited to be able to offer and provide comprehensive services that not only generate additional production and revenue but deepen their client relationships.

The combined company will have the human capital infrastructure and technology and product solutions, along with balance sheet capacity and liquidity needed to capture additional market share in Phoenix. On slide five, the geographic fit with the current Alerus Arizona branches was an important consideration when looking at this transaction. Complementary fit with our locations in Scottsdale and Mesa and no branch overlap.

This does add a presence, a physical presence in Metro Phoenix and it increases our Alerus footprint in Arizona, to 15% of total deposits, and further diversifies our strong deposit base. On page six, this slide illustrates the

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meaningful increase this transaction has on our rank in the Phoenix MSA and our tremendous opportunity to gain market share. The transaction moves Alerus from 41st rank up to 24th ranked.

In addition, Metro Phoenix has been focused on developing a leading SBA team and the results and momentum are strong, with Metro Phoenix ranking 12th for SBA loan production in Arizona, outcompeting many large financial institutions. We look forward to combining our recently added Alerus team and continuing on our quest to becoming the premier provider and partner for small businesses.

Shifting to slide seven, this is one of the most exciting slides in the deck and conveys why we are tremendously excited to get to scale and add a strong team in this market. As you can see, Phoenix has been the fastest growing large city in the United States, with over 15% population growth over the last 10 years.

In addition, Phoenix has experienced consistent growth, having been ranked the fastest growing large city in the United States, for five consecutive years. It is important to note that this growth has been supported by billions of dollars in capital investment, from companies that are expanding into the market.

Also significant is Phoenix's ranking as third in the US for small business growth in metropolitan areas. This is extremely important to us, given that providing banking and financial services to those small and medium businesses is core to both Metro Phoenix and the Alerus franchises.

On page eight of the deck, we provide some additional stats on the historical and projected population growth of the Phoenix market, which are both extremely strong. On slide nine, we have the pro forma loan and deposit portfolios and again, reiterating how strong asset quality is, on Metro Phoenix and the attractive core deposit base. Metro Phoenix is a strong asset generator, and the client base is highly attractive to Alerus because of their focus on commercial.

With the Alerus business model, commercial clients are a key opportunity to grow our fee income. When we win the banking business of a commercial company, we earn their trust and the opportunity to expand by partnering with their HR team and providing retirements and benefits. Which then feeds our consumer segment involved with access to the employee base of that company and the opportunity to provide holistic financial planning to those employees.

On slide ten, the transaction overview discusses the structure, key assumptions and the multiples. Again, this acquisition is 100% stock transaction, our first acquisition using Alerus currency. The transaction value for Metro Phoenix shareholder and options is approximately 85 million. As noted below, this transaction is nicely accretive to Alerus earnings, with 5% earnings accretion in '22 and 8.5% in '23, with fully phased-in cost saves

The tangible book dilution is approximately 2.5%, with an earn back of 2.8 years. Moving into the key merger assumptions. We are projecting cost savings of approximately 29%, which will be fully phased in, in 2023. We are estimating a close at the end of the first quarter of 2022, potentially the early beginning of the second quarter of 2022, with a close at the end of Q2 of 2022. We expect approximately 5.2 million in deal costs, which is about 4.3 million in, after tax.

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Lastly, on the due diligence process, we conducted a very thorough due diligence process on Metro Phoenix, which was led by our senior executives, our SBA and our credit teams at Alerus. This due diligence was conducted onsite in Arizona, over the course of several days and included an in-depth review of 60% of the commercial loans, including 80% of the outdoor media loans and over 50% of the SBA loans.

The loan review confirmed that we are aligned in credit culture and policies and are comfortable with the quality of the portfolio. We expect this to allow for a seamless transition for the Metro team members. On page 12, the Alerus growth, that lays out the timeline of acquisitions and the key milestones for Alerus over the past 20 years.

Again, you can see that M&A has been a key component for the Alerus growth strategy, across many business lines, with 25 acquisitions. In conclusion, we believe this is a unique opportunity to acquire a high quality, high growth, high performing business bank in a market that provides enormous growth opportunities.

The transaction is a fantastic fit for Alerus, and we believe that the combination will be accretive to our franchise. The economics of the transaction are very attractive and earnings accretion and growth potential stand to enhance our shareholder value for all Alerus shareholders, over the long-term. We welcome the Metro Phoenix employees to the Alerus team and look forward to completing this transaction, integrating and moving forward. At this point, we'd be happy to answer any questions. Juan, if you would please open up the call.

Operator We will now begin the question and answer session. To ask a question, you may press star, then the number one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star followed by the number two. At this time, we will make a small pause to assemble our roster. Our first question comes from Jeff Rulis from D.A. Davidson. Please Jeff, your line is now open.

Jeff Rulis Thanks. Good morning, Randy and Katy.

Katie Lorenson Good morning. Oh, [unclear].

Jeff Rulis Question on the... Oh, hello, Karen. Katy, maybe if you could just offer some background on the transaction. Sounds like you've led the conversation. Metro Bank's reason for selling. Was this an auction or negotiated? Maybe just some depth of how you met these folks and the process of leading up to the announcement.

Katie Lorenson Yes, certainly. We had initial conversation before this became a process. It did move forward as a bid process and again, Arizona is a key market for us, but we did have a lot of time with the leadership team.

The reasons for selling. Obviously, they're a high growth, high performing company but had gotten to a place where significant investments were going to be needed to move forward. So, from an infrastructure standpoint, they were looking for a partner that could bring that infrastructure, that balance sheet capacity so that they could continue to grow. Along with the technology offerings that we bring to the table.

Jeff Rulis Got it, thanks. I think you mentioned some of the accretion of product suite and rolling that into the platform at Metro isn't included in your accretion assumptions. Just any thoughts on timing of either the

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retirement of benefits or wealth management, the mortgage, all of that. How does that weave into either a timeline or expected impact at the bank?

Katie Lorenson Sure. As we look at integrating the companies, first and foremost, we want our Metro Phoenix talent to be focused on a seamless conversion of those clients and retention of the current clients. And a comfort level, in regard to what's not changing and what has changed.

Then, as we work through that process, which we expect again, to complete at the end of 2022, then we will spend more and more time with our producers, with our revenue generators, educating them on the offerings and the products.

Then, connecting them with that expertise that is here, in their market, as well as across the footprint. Once that trust has formed and those relationships are solid, then we'll start to see the client introductions and the expansion move forward. Again, not anything modelled at any point within the years of the financial model but certainly, something we expect to see as we move forward.

Jeff Rulis Okay, and just to clarify. You mentioned the close date is end of the first quarter, but you said conversion expected by year end.

Katie Lorenson No. By the end of the second quarter, I'm sorry. Yes. We expect to close at the end of the first quarter, conversion end of Q2.

Jeff Rulis Perfect, okay. I'll step back, thank you.

Katie Lorenson Thanks, Jeff.

Operator Thank you. Our next question comes from Nathan Grace, from [unclear]. Please, Nathan, your line is now open.

Nathan Grace Yes. Hello, everyone. Good morning and congrats on what appears to be a solid transaction.

Katie Lorenson Thanks, Nate.

Nathan Grace Was hoping to just start on... I apologise if you guys touched on this. I got on a bit late but in terms of the underlying assumptions, in terms of the SBA data and sale registry. That's been pretty strong at NPA tracks for the last several quarters now. What are the underlying assumptions for '22 and '23 for that line? Also, curious just in terms of expectations for pro forma loan growth, relative to NPA tracks' historical low 20% CAGRs, as you guys thinking about expectations as well, for '22 and '23.

Katie Lorenson Great question. On the SBA gain, this year has been very strong, and it really is the coming together of a great team at Metro Phoenix. So, this year, I believe there are over \$1 million of SBA gains through a reported 930. That will end the year at record levels and in 2022, the SBA gains were about 600,000. We have modelled, going forward, about 1.2 million, which is a million less than what they'll recognise this year.

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So, we believe that to be a conservative, going forward because the momentum they have is really, pretty strong but we wanted to be conservative in that regard. That's the model, going forward, is about the 1.2 million in SBA gains, each year. On the loan growth side, again, this company has grown double digits with a 20% CAGR over the 2015 on loan growth. We moved loan growth in the model down to the mid to high single digits.

Nathan Grace Okay, very helpful.

Perhaps just changing gears and just thinking about the outlook, going forward, in terms of additional excess capital deployment and the acquisition landscape. I imagine, just given the fairly digestible size of this deal, at around 13% of Alerus's balance sheet.

Just given, presumably a limited impact from a TC perspective, with this deal coming online, what are your expectations and outlook. Does this deal preclude you guys from entertaining additional, whether it be whole bank or RBNS acquisitions, going forward?

Katie Lorenson It does not. As you say, it is a fairly small, digestible transaction for us. This again, is our 25th and so, we are built to efficiently and effectively integrate into our company and convert their clients. We will continue to build our prospects list, continue to be having those conversations and continue to be involved in exploring opportunities. In both the fee income, as well as potential branch or bank opportunities.

Nathan Grace Got it, very helpful. I appreciate all the colour and congrats again, on this deal. Thank you.

Katie Lorenson Thank you.

Operator Thank you. Our next question comes from William Wallace, from Raymond James. Please, William, your line is now open.

William Wallace Yes. Hello. Thanks for taking my questions. Katy, just trying to make sure we don't overcount manager's margin related to any PPP fee income or anything. Do you have a core net interest margin at Metro Phoenix that we should use?

Katie Lorenson I do. Their PPP revenue for the year of 2021 is fairly immaterial. Several hundred thousand dollars. So, it does not have a significant impact on their margins for 2021.

William Wallace Okay, and I'm just going to go ahead and apologise if these next two questions are dumb. But can you educate me on outdoor media lending and what those loans look like, how to classify what the pricing is and what the growth prospects are?

Karen Montour Yes, sure, Wally. This is Karen. Outdoor media lending is a niche lending business. It provides billboard financing. So, the acquisition, construction and refinancing of billboard projects. The niche serves companies, nationwide and so, there are currently relationships in over 20 states.

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They finance both traditional billboards, as well as electronic displays that are in some of the larger markets. They really developed a nice niche. They have a great track record of success and an excellent credit quality in this portfolio. We believe that there is significant opportunity out there to continue to grow the business. Particularly with the balance sheet that we bring.

William Wallace How are these loans structured?

Karen Montour They're largely C&I loans. Sometimes there's a real estate component as well and the pricing you asked about is in about the 5% range.

William Wallace Are they priced like a line?

Karen Montour Yes.

William Wallace In other words, do they float, or do they reprice annually or what?

Karen Montour I am not certain on that.

William Wallace Okay. Then, on the SBA business. Is that more of a balance sheet business for Metro Phoenix? You mentioned, in the diligence slide that you did diligence on much of the SBA loans or is that just you're looking at the unguaranteed portion that's on the balance sheet?

Katie Lorenson They've got about 19 million on the balance sheet, in SBA loans and we looked at what was on the balance sheets.

William Wallace Okay. I meant to ask how big is that outdoor media portfolio?

Katie Lorenson It's about 80 million.

William Wallace Okay, and looking at Alerus in Phoenix, prior to this deal. Was that more of a consumer market for you guys or was the structure of the loan portfolio in Phoenix similar to the total organisation's loan mix?

Katie Lorenson No, it's similar to the total mix. Primarily commercial [unclear].

William Wallace You mentioned the HOA deposit business. What's the size of that business and are those low-price sticky core deposits or do those tend to be more price sensitive?

Katie Lorenson No. Those are low cost, overall and so, competitive rate and... I think they're at a competitive rate but when I say low cost, overall, it's because they are sourced, not by individual HOAs but by property managers, who bring on bulk HOAs business. So, from an acquisition cost and from a scalability, very good runway in that regard.

William Wallace What's the size of that portfolio?

Katie Lorenson It's about 40% of the deposit portfolio.

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William Wallace Okay. I've run across this a couple of times, with banks in Florida but I really haven't seen it a lot. Are these annual contracts or do you just get the accounts, and they can leave at any time? How is the business structured?

Katie Lorenson Yes. They are not under contracts, but it is heavily integrated. So, in regard to... They are very sticky, once you win the business because it is an integrated, with the two technologies that the client and the bank bring to the table. So, it takes pretty significant expertise and understanding of the systems. But once you have those relationships, they stick around.

And they tend to grow, as those property managers bring on more and more HOAs into their book.

William Wallace Can the knowledge that you'll gain and the technology that you'll gain with this acquisition be transferred across the rest of your footprint? Could this be a funding source across or outside of Phoenix, for Alerus?

Katie Lorenson Yes, we believe so.

William Wallace Okay. Then, I guess just the last question. You mentioned that you're modelling mid to high single digits down from, I think you said, in the five deck, it says 20% or so CAGR. Certainly seems conservative, which is great. Should this be a 20% growth market for Alerus, two to three years from now, once we integrate everything and we're looking at the number one growing market in the country, etcetera? I mean, do you really think this should be more of an additive to the Alerus growth profile?

Katie Lorenson Yes, we absolutely do. [Overtalking].

William Wallace Or is there a reason that you modelled mid to high?

Katie Lorenson No. We were being conservative. We know that there's disruption here but yes, we absolutely believe, and under Steve's leadership, expect that our team will continue to grow, our presence in the market will continue to grow and our balance sheet growth. This will become an increasingly bigger contributor to our balance sheet and our loan growth.

William Wallace Okay, okay. Thanks very much for taking all my questions. I appreciate it.

Katie Lorenson Thanks, Wally.

Operator Thank you. Our next question comes from Jeff Rulis from D.A. Davidson. Please Jeff, your line is now open.

Jeff Rulis Hello. Just to follow up on the cost savings, the source of that. Doesn't look like a big branch network and you're keeping the Market President. So, just wondered where that's coming from. Largely, back office?

Katie Lorenson Yes. Thank you. The cost savings were from meaningful, pretty meaningful costings from professional services. Of course, data processing, technology expenses, director's fees and then, employee

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compensation. Of course, with Steve assuming the role of the Arizona Market President, that resulted in some synergies and savings on the Alerus side.

Jeff Rulis Got it and then, lastly, Katy, do you have a goodwill estimate that you'd put out there?

Katie Lorenson Yes. Approximately 40 million of additional goodwill.

Jeff Rulis Got it. That's it for me. Thanks.

Katie Lorenson Thanks, Jeff.

Operator Thank you. As a reminder, if you would like to ask any further questions, please press star followed by number one on your telephone keypads now. We currently have no further questions. This concludes our question and answer session. I would like to turn the conference back over to Randy Newman for any closing remarks.

Randy Newman Well, thank you and thanks to all of you for participating, your questions, which we always enjoy and with that, I'll just... We'll conclude the call. If there are any additional, follow-up questions, contact Katy or myself at any time. Thank you.