Align Multi-Year Forecasts with Tactical Plans and Operational Budgets

Presenters:
Peri Pierone, CEO, Axiom EPM
Laura Roberts, SVP Financial Planning & Analysis Sterling Bank
Agenda

- Setting a Context within Finance
- Case Study – Sterling Bank
- Closing Remarks
The Strategic Role of Finance….

How is that evolving in your organization?

- **As a Data Steward**
  - Increasingly ‘own’ data to drive decisions
  - Own ‘non-GL’ systems, (i.e., cost accounting)

- **As a Partner to Operations**
  - Educating managers on cost realities
  - Supporting the monitoring function (policing)

- **As a Strategic Advisor to the Organization**
  - Being more agile and responsive to needs
  - Supporting data-driven decision making
The Changing Role of Finance

**Analytic Capability**

**Strategic Partner**
- Advising
- Growth focused
- Risk aware
- Present & future
- Connected

**Controller**
- Gatekeeper
- Expense focused
- Governance
- Retrospective

**Scorekeeper**
- Reporting
- Accuracy
- Retrospective
- Disconnected

**Analyst**
- Measuring
- Planning
- Calculating
- Modeling
- Past and future

**Quadrant 4**
Embodies all the characteristics of the other three quadrants plus leadership and outbound activities.

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The Linkage Between Strategy, Planning, Budgets

- Developing a strong link between strategy, plans, budgets and forecasts: 46.8%
- Publishing more relevant information to users: 44.8%
- Reducing the time it takes to complete the budget: 43.1%
- Getting a better handle on measuring and understanding profitability: 25.0%
- Further define key performance indicators (KPIs) and operating metrics: 24.6%
- Deploy Rolling Rolling Forecasts: 23.3%

* Axiom EPM Global Survey 2012
Best Practices in Planning

1. Driver-based intelligent modeling
   - Financials are outcomes and should be treated as such

2. Scenario-based planning – sensitivity analysis

3. Initiative-based planning

4. Rolling forecasts
Driver-based Planning is the Key

Insurance Income Statement:

**UNDERWRITING INCOME**
- Written/Earned Premiums
- Losses Incurred
- Loss Expenses Incurred
- Other UW Expenses Incurred
- Aggregate Write Ins for Underwriting Deductions
- Net Underwriting Gain (Loss)

**INVESTMENT INCOME**
- Net Investment Income Earned
- Net Realized Capital Gains (Losses)
- Net Investment Gain (Loss)

**OTHER INCOME**
- Net Gain (Loss) from Agents’ or Premium Balances Charged Off Finance and Service Fees Not Included in Premiums
- Aggregate Write Ins for Miscellaneous Income
- Total Other Income
- Dividends to Policyholders
- Net Income, after Dividends to Policyholders
- Federal & Foreign Income Taxes Incurred
- Net Income

ROA / ROE

**Key Drivers:**
- Number of Agents
- Applications Per Agent
- Policies In Force
- Rate Changes
- Commission Rates
- Customer Retention
- Producer Retention
- Consumer/Producer Price Index
- Loss Frequency
- Loss Severity
- Claim Cycle Time
- # of Claims
- # of Adjusters
- # of Underwriters
- # of Customer Service Reps
- Adjuster/UW/CSR Productivity
- Attorneys Rates
- Medical Examination Rates
Best Practices in Planning

Driver Based Planning Revenue / COS / Margin

Gross Margin Analysis
Model: A4 2013MY

<table>
<thead>
<tr>
<th></th>
<th>JAN</th>
<th>FEB</th>
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<tbody>
<tr>
<td><strong>Volume</strong></td>
<td></td>
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<tr>
<td></td>
<td>8,600</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regular Sales with Options</td>
<td>143,190,184</td>
<td>164,935,436</td>
</tr>
<tr>
<td>Port Installed Options Rev</td>
<td>710,400</td>
<td>839,400</td>
</tr>
<tr>
<td>Equalized Freight Revenue</td>
<td>6,210,000</td>
<td>7,227,000</td>
</tr>
<tr>
<td>Returns</td>
<td>33,034</td>
<td>38,618</td>
</tr>
<tr>
<td><strong>Cost of Sales</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regular Cost with Options</td>
<td>118,771,950</td>
<td>136,408,137</td>
</tr>
<tr>
<td>COS - Port Installed Options</td>
<td>107,409,194</td>
<td>123,268,414</td>
</tr>
<tr>
<td>COS - Equalized Freight</td>
<td>(207,624)</td>
<td>(224,436)</td>
</tr>
<tr>
<td>Pre-Deliv Inspections Cost</td>
<td>2,662,406</td>
<td>3,062,158</td>
</tr>
<tr>
<td>Marine Insurance Cost</td>
<td>1,128,320</td>
<td>1,312,000</td>
</tr>
<tr>
<td>Marine Freight Costs</td>
<td>48,442</td>
<td>55,594</td>
</tr>
<tr>
<td>Duty Costs</td>
<td>3,633,002</td>
<td>4,195,456</td>
</tr>
<tr>
<td>Port Processing Costs</td>
<td>2,819,491</td>
<td>3,235,796</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Margin %</td>
<td>17.05%</td>
<td>17.30%</td>
</tr>
<tr>
<td>Revenue Per Unit</td>
<td>16,650</td>
<td>16,494</td>
</tr>
<tr>
<td>COS Per Unit</td>
<td>13,811</td>
<td>13,641</td>
</tr>
<tr>
<td>Gross Margin per Unit</td>
<td>2,839</td>
<td>2,853</td>
</tr>
</tbody>
</table>

- Unit Forecast
- Wholesale Pricing
- Manufacturer’s Cost
- Per Unit Stats – Options, Freight, Port Processing, Incentives etc.
Best Practices in Planning

Scenario Planning and Uncertainty

- The notion of uncertainty is at the crux of both finance and risk management domains.
- Even so when it comes to strategic planning, budgeting and forecasting, most practitioners are content with completing the “the budget” or “the forecast” without addressing the issue of uncertainty.
- There is false sense of security when underlying assumptions are treated as facts vs. assumptions – masking both exposure and opportunity.

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90%  
...Of the organizations surveyed take at least 2 months to complete a budget – many more than 4 months.

8%  
...Only 8% of organizations surveyed do scenario planning regularly.

Source: Business Finance, April 2012
Best Practices in Planning

Single Variable Sensitivity Analysis

- Easiest to set up and process
- Useful in quantifying the impact of a particular DV
- Can be a great educational tool
- Primary criticism is its simplicity – market variables seldom move on a stand-alone basis

### Sensitivity Analysis - Altering the Level of Interest Rates

<table>
<thead>
<tr>
<th></th>
<th>Down 100 BPS</th>
<th>Down 50 BPS</th>
<th>Flat</th>
<th>Up 50 BPS</th>
<th>Up 100 BPS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Income</td>
<td>$275,380,358</td>
<td>$300,744,467</td>
<td>$319,645,090</td>
<td>$337,918,172</td>
<td>$355,563,712</td>
</tr>
<tr>
<td>Loan Fees</td>
<td>$46,120,377</td>
<td>$44,520,377</td>
<td>$42,920,377</td>
<td>$44,041,498</td>
<td>$45,162,619</td>
</tr>
<tr>
<td>Non Interest Income</td>
<td>$55,885,970</td>
<td>$57,410,970</td>
<td>$58,935,970</td>
<td>$59,435,970</td>
<td>$60,045,970</td>
</tr>
<tr>
<td>Service Charges</td>
<td>$27,946,157</td>
<td>$27,946,157</td>
<td>$27,946,157</td>
<td>$27,946,157</td>
<td>$27,946,157</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>$406,332,862</td>
<td>$430,621,971</td>
<td>$449,447,594</td>
<td>$469,341,797</td>
<td>$488,718,458</td>
</tr>
<tr>
<td><strong>Expense</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Expense</td>
<td>$40,354,902</td>
<td>$44,529,548</td>
<td>$52,680,584</td>
<td>$65,204,519</td>
<td>$79,318,257</td>
</tr>
<tr>
<td>Non Interest Expense</td>
<td>$267,294,049</td>
<td>$267,294,049</td>
<td>$267,294,049</td>
<td>$267,294,049</td>
<td>$267,294,049</td>
</tr>
<tr>
<td>Taxes</td>
<td>$985,258</td>
<td>$1,254,141</td>
<td>$1,419,450</td>
<td>$1,869,450</td>
<td>$2,169,450</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$35,038,740</td>
<td>$54,884,321</td>
<td>$65,393,599</td>
<td>$72,313,866</td>
<td>$77,276,789</td>
</tr>
</tbody>
</table>

### Key Performance Ratios

<table>
<thead>
<tr>
<th></th>
<th>Down 100 BPS</th>
<th>Down 50 BPS</th>
<th>Flat</th>
<th>Up 50 BPS</th>
<th>Up 100 BPS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yield on Earning Assets</td>
<td>3.63%</td>
<td>3.95%</td>
<td>4.20%</td>
<td>4.44%</td>
<td>4.67%</td>
</tr>
<tr>
<td>Cost of Paying Liabilities</td>
<td>0.58%</td>
<td>0.64%</td>
<td>0.76%</td>
<td>0.94%</td>
<td>1.14%</td>
</tr>
<tr>
<td>Net Interest Spread</td>
<td>3.05%</td>
<td>3.31%</td>
<td>3.44%</td>
<td>3.50%</td>
<td>3.53%</td>
</tr>
<tr>
<td>Net Interest Margin</td>
<td>3.12%</td>
<td>3.38%</td>
<td>3.51%</td>
<td>3.57%</td>
<td>3.60%</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>0.42%</td>
<td>0.65%</td>
<td>0.76%</td>
<td>0.86%</td>
<td>0.92%</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>4.43%</td>
<td>6.94%</td>
<td>8.09%</td>
<td>9.15%</td>
<td>9.78%</td>
</tr>
<tr>
<td>Earnings Per Share</td>
<td>$2.30</td>
<td>$3.60</td>
<td>$4.29</td>
<td>$4.74</td>
<td>$5.06</td>
</tr>
</tbody>
</table>
### Best Practices in Planning

**Two Variable Example – Nine Box**

#### Scenario Key

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Benefit %</th>
<th>Merit % 2.0%</th>
<th>Merit % 3.0%</th>
<th>Merit % 4.0%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario 1</td>
<td>10.00%</td>
<td>48,473,930</td>
<td>48,776,995</td>
<td>49,079,906</td>
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<tr>
<td>Scenario 2</td>
<td>5.00%</td>
<td>48,254,150</td>
<td>48,557,215</td>
<td>48,860,126</td>
</tr>
<tr>
<td>Scenario 3</td>
<td>3.00%</td>
<td>48,166,238</td>
<td>48,469,303</td>
<td>48,772,214</td>
</tr>
</tbody>
</table>

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Best Practices in Planning

Initiative Based Scenario Planning

Base Case
Given current trends, what is our financial outlook 3-10 years?

Forecasting Methods Include:
- Statistically-Driven Modeling
- Payor Mix and Revenue Forecasting
- Labor Rate & Efficiency Targets
- Cost Modeling

Initiatives
As we prioritize growth or cost containment initiatives, what is the incremental impact?

Examples:
- Re-Design ER, Flow Thru Implications
- Expand Cardiac Cath Lab
- Open an OP Urgent Care (Northside)

Scenarios
What is the impact on our baseline projections given the initiatives we’ve proposed?

Analysis Contains:
1. Income Statement
2. Balance Sheet
3. Cash Flow
4. Key Ratios
Best Practices in Planning

Rolling Forecasts

- Rolling nature provides consistent business outlook
- Tends to be more accurate than aspirational budgets
- Enables waterfall analysis and trending
# Setting Context within the Finance Calendar

<table>
<thead>
<tr>
<th>JAN</th>
<th>FEB</th>
<th>MAR</th>
<th>APR</th>
<th>MAY</th>
<th>JUN</th>
<th>JUL</th>
<th>AUG</th>
<th>SEP</th>
<th>OCT</th>
<th>NOV</th>
<th>DEC</th>
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<tr>
<td>Q1</td>
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<td>Q2</td>
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<td>Q3</td>
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<td>Q4</td>
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</tbody>
</table>

- **Sales & Volume Forecast Cycles**
- **Rolling Financial Forecast Cycles**
- **Strategic Planning Cycle**
- **Capital Budget Cycle**
- **Annual Budget Cycle**
- **Monthly Mang Reporting Cycle**
- **Quarterly Reporting Cycle**
- **Ad Hoc Analysis**

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**AFP® Annual Conference**
Agenda

- Setting a Context within Finance
- Case Study – Sterling Bank

Laura Roberts
SVP Financial Planning & Analysis
2013 Sterling Franchise at a Glance

- Based in Spokane, Wash., Sterling is one of the largest commercial banks headquartered in the Pacific Northwest (1)
- Approximately 56,000 commercial transaction accounts and 272,000 retail transaction accounts
- $6.6 billion of deposits with an average cost of 0.37% (2)
- Market cap of $1.5 billion (3)

Key Statistics as of 6/30/13 (billions)

<table>
<thead>
<tr>
<th>Statistic</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>$9.9</td>
</tr>
<tr>
<td>Total deposits</td>
<td>$6.6</td>
</tr>
<tr>
<td>Net loans</td>
<td>$6.9</td>
</tr>
</tbody>
</table>

(1) Pacific Northwest defined as Idaho, Oregon and Washington.
(2) For the quarter ended June 30, 2013.
(3) As of June 30, 2013.
(4) Source: SNL, as of June 30, 2012. Pro forma deposit market share data includes Borrego, BPFH and CNBF.
Goals for BI and EPM at Sterling Bank

- **Decrease the number of application systems**
  - Remove silos /pockets of tool sets

- **Data Standardization**
  - Data Centralization and Consolidation of numerous disparate data sources
    - Financial and Organizational Data
  - Eliminate Rogue Data Stores
  - Implement Data Governance Plan

- **Enterprise Reporting Capabilities**
  - Implement Centralized Report Repository
  - Develop & Implement Enterprise Report Request / Development Process
  - Reporting requirements increase at $10B in assets – more holistic approach

- **Robust security**

- **Increase utilization of staff’s expertise & core competencies**
  - Less reporting building/extracting and more analysis
Sterling Bank

**Project Approach**

- Reporting Workshops
- Inventory of systems
- RFP and Vendor selection
- Pre-Road mapping with vendors
- Road mapping with vendors
- Coordinated touch points
- Split project plans
Sterling Bank

Current State of Sterling BI and EPM Landscape

Point to Point Data Integration
Future State of our Finance BI and EPM Landscape

3rd Party Applications
Loan Origination Systems
General Ledger
Human Resource
Construction
Core Banking
Mergers & Acquisitions

Master Data Layer

EPM/BI

Profitability Measurement; FTP, Economic Capital
Loan Quality Migration Analysis
Budgeting & Forecasting
Incentive Compensation Management
Strategy & Capital Management
Interactive Reporting & Analytics

Centralized Data Integration

MIAC SQL
Business Intelligence
Asset / Liability (ALM) Sendero
Sterling Bank

Planning Requirements Overview

• Sterling is implementing Axiom to support their Annual Budget Process as well as Funds Transfer Pricing and Incentive Compensation Management
• To leverage their investment,
• Axiom reviewed Sterling’s financial projection processes including:
  • Capital Planning (regulatory risk analysis)
  • Periodic (Monthly) Forecasting
  • Mergers and Acquisitions
  • Strategic Forecasts
• Identified common elements that could be used to drive projections and report results for each process:
  • Assumptions (macro economic forecasts of interest rates, CPI, HPI, unemployment, etc.)
  • Drivers which translate assumptions into business related effects
  • Key Performance Indicators that should be common to each of these processes
<table>
<thead>
<tr>
<th>Purpose</th>
<th>Capital Plan</th>
<th>M and A Modeling</th>
<th>Monthly Forecasts</th>
<th>Annual Budget</th>
<th>Strategic Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory Risk Management</td>
<td>Evaluate Targets and Establish Goals</td>
<td>Provide Cadence and Forward Looking Analysis</td>
<td>Establish tactical plan to execute strategic plan</td>
<td>Evaluate multiple strategic initiatives and establish direction</td>
<td></td>
</tr>
<tr>
<td>9 Quarters/ 13 quarters for loan loss provisioning</td>
<td>1-3 Annual</td>
<td>6-18 months Monthly</td>
<td>15 months Monthly</td>
<td>3 years Initiatives -3 years Monthly summarized to Quarters</td>
<td></td>
</tr>
<tr>
<td>Provided by Federal Reserve for Base, Adverse and Severely Adverse. Interest Rates, CPI, HPI, Unemployment rates,</td>
<td>Price, Cash vs. Stock, Sterling Budget/Forecast and Target Public Data</td>
<td>Interest Rates, macro economic direction, strategic plan and M&amp;A updates</td>
<td>Interest Rates, macro economic direction, strategic plan and M&amp;A updates</td>
<td>Interest Rates, macro economic direction and M&amp;A updates</td>
<td></td>
</tr>
<tr>
<td>Asset quality, new volume, prepayment, Expense growth, MBO activity</td>
<td>Target specific attributes, market overlap, Expected cost savings</td>
<td>Future rate curves, asset quality, prepayment, originations volumes, approved initiatives of a larger scale</td>
<td>Future rate curves, asset quality, prepayment, originations volumes, deposits, initiatives, yield on sales of loans, salary and benefit planning</td>
<td>Future rate curves, asset quality originations volumes, merit and incentives, strategic initiatives</td>
<td></td>
</tr>
<tr>
<td>Multiple scenarios with balance sheet and income statement</td>
<td>Summary level annual performance expectations, and simple payback measures</td>
<td>Actual results combined with projected balances and net income by business unit</td>
<td>Projected balances and net income by department, business unit and consolidated</td>
<td>Multiple base and initiative scenarios in different combinations</td>
<td></td>
</tr>
</tbody>
</table>
Sterling Bank

Capital Plan - Process

• Assumptions provided by Federal Reserve for Base, Adverse and Severely Adverse scenarios
• Assumptions are macro economic measures like interest rates, consumer price index, home price index, unemployment rates, etc.
• Bank management translates assumptions into drivers that will affect asset quality, new volume pricing, prepayment speeds, level of new volume activity, expense increase rates.
• Drivers feed calculation engines generating credit loss projections and balance sheet net interest margin projections for each scenario
• Balance Sheet modeled through IRR Model in all scenarios
• Key performance indicators
  • Capital ratios (Basel III), ROA, ROE, NIM, NCO
• Process requires baseline actual results
• In addition to modeling business activity, projection includes mitigating strategies to preserve capital (stock issuance, dividend constraints, balance sheet restructuring)
• Process is repeated twice a year
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Merger and Acquisition Modeling - Process

• Many targets are evaluated, but only 10-20% become closed deals
• Confidentiality is critical
• Results driven more by deal structure and expected cost savings than macroeconomic assumptions
• There is some variability between deals in terms of approach and drivers
• Analysis is focused on measuring return on investment metrics
• When deal goes through due diligence, adjustments to expectations may become apparent from new details
• Once deal is negotiated and announced, target’s financial projections need to be added to Corporation’s projections (forecasts, budgets and capital plans)
  • Balances, income statement, drivers
• May occur at anytime of the year…unpredictable
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Monthly Forecast - Process

• Establish a cadence about forward looking analysis of financial results
  • “Don’t tell me what happened, tell me how it affects the future”
• Create a nimble process that generates a credible result
• Time horizon through end of current year for March through June forecasts
  • Extend through next year beginning with July forecast
• Approved initiatives are included
  • But focus is on execution, not “what if”
• Assumptions include macro economic elements like rates, CPI, HPI, unemployment rate and net charge offs
• Translate assumptions into drivers such as mortgage backed originations, prepayment speeds, average deposit account size, expense growth assumptions
• Collaborate with business lines for interpretation of drivers into financial projections
• Measure results against KPI’s consistent with strategic plan, capital plan and budget
• Comparative reports to historical, budget and prior forecasts
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Detail Budget - Process

• Annual process finalized with board approval
  • Incentive and bonus pools are synced with the budget
• Assumptions for rates, CPI, HPI, losses, approved strategic initiatives to be included
• Greater level of detail and drivers including:
  • Future yield curves
  • Prepayment assumptions
  • Merit increases
  • Bonus pool and employee benefit rates
  • Net charge offs
  • Fee and expense growth rates
  • Fixed asset cost estimates
  • Loan Origination Volumes
  • Deposit Growth
• Deeper financial projection to detail department and account
• Customer account level balance and interest projections to support balance sheet and margin (Cash Flow Forecasting)
  • New volume assumptions based on new account origination projections
• Tactical initiatives (less than $150m) proposed for approval in budget
• Employee costs calculated at individual level with proposed staff additions
• KPI’s compared to strategic and include growth measures
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Strategic Forecast - Process

• Top of the house and nimble model to support what if analysis
  • Includes ability to overlay initiatives
  • Initiative template approach allows for consistent comparative analysis using a common set of calculation rules
  • Purpose is to evaluate initiatives returns and risks and evaluate them for return on investment and fit with the strategic direction of the company
• Assumptions regarding rates, CPI, HPI and losses are explicit
• Model is highly driver based with multiple baselines to support what-if analysis
• Strategic initiatives can be added discreetly and analyzed on an ROI basis
  • Each initiative can be compared and evaluated on its own merits
  • Initiatives can be combined in several distinct scenarios
  • Scenarios can be compared and evaluated for overall strategic fit
• KPI’s include capital ratios, EPS, NIM, ROA, ROE
• Resulting strategic forecast and approved initiatives provide direction to the company’s budget and forecasts
Sterling Bank

Financial Projection Calendar

- Forecast Current Year
- Forecast with Next Year
- Capital Plan
- Strategic Forecast

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Agenda

- Setting a Context within Finance
- Case Study – Sterling Bank
- Closing Remarks
About Axiom EPM

Our Focus

1. Innovation in Enterprise Performance Management Software
2. Superlative customer experience (sales, services, support)
3. Industry Specialization

Our Differentiators

- Our software is based on a comprehensive all-in-one design where usability and ownership by the business users is paramount
- Our service (implementation & support) is designed to be highly personalized where our success is measured by yours

Agile, Responsive, Intuitive. Does this describe your performance management solution?
More Information

Learn more: Visit our website www.axiomepm.com

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Laura Roberts, SVP Financial Planning & Analysis, Sterling Bank
laura.roberts@bankwithsterling.com