

KLAMATH FIRST BANCORP INC

Form 425

July 15, 2003

Filed by Sterling Financial Corporation

Pursuant to Rule 425 of the Securities Act of 1933, as Amended

Subject Company: Klamath First Bancorp, Inc.

Commission File No. 0-26556

July 15, 2003

Except for historical information, all other information in this filing consists of forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about (i) the benefits of the merger between Sterling Financial Corporation ("Sterling") and Klamath First Bancorp, Inc. ("Klamath"), including future financial and operating results, cost savings enhancements to revenue and accretion to reported earnings that may be realized from the merger; (ii) Sterling's and Klamath's plans, objectives, expectations and intentions and other statements contained in this presentation that are not historical facts; and (iii) other statements identified by words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," or words of similar meaning generally intended to identify forward-looking statements. These forward-looking statements are based upon the current beliefs and expectations of the management of Sterling and Klamath and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. Actual results may differ materially from the anticipated results discussed in these forward-looking statements because of numerous possible uncertainties.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements: (1) the businesses of Sterling and Klamath may not be combined successfully, or such combination may take longer, be more difficult, time-consuming or costly to accomplish than expected; (2) the expected growth opportunities or cost savings from the merger may not be fully realized or may take longer to realize than expected; (3) operating costs, customer losses and business disruption following the merger, including adverse effects on relationships with employees, may be greater than expected; (4) governmental approvals of the merger may not be obtained, or adverse regulatory conditions may be imposed in connection with governmental approvals of the merger; (5) the shareholders of Sterling or Klamath may fail to approve the merger; (6) adverse governmental or regulatory policies may be enacted; (7) the interest rate environment may further compress margins and adversely affect net interest income; (8) results may be adversely affected by continued diversification of assets and adverse changes to credit quality; (9) competition from other financial services companies in Sterling's and Klamath's markets may increase significantly and could adversely affect operations; and (10) an economic slowdown, either nationally or in the market in which Sterling does business, could adversely affect credit quality and loan originations. Additional factors, that could cause actual results to differ materially from those expressed in the forward-looking statements are discussed in Sterling's and Klamath's reports (such as Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K) filed with the Securities and Exchange Commission and available on the SEC's Internet site (<http://www.sec.gov>). In addition, documents filed with the SEC by Sterling can be obtained, without charge, by directing a request to Sterling Financial Corporation, 111 North Wall Street, Spokane, Washington 99201, Attn: Heidi B. Stanley, telephone (509) 358-6160. In addition, documents filed with the SEC by Klamath can be obtained, without charge, by directing a request to Klamath First Bancorp, Inc., 540 Main Street, Klamath Falls, Oregon 97601, Attn: Craig M. Moore, Corporate Secretary, telephone (541) 882-3444.

Sterling and Klamath caution that the foregoing list of factors is not exclusive. All subsequent written and oral forward-looking statements concerning the proposed transaction or other matters

attributable to Sterling or Klamath or any person acting on their behalf are expressly qualified in their entirety by the cautionary statements above. Sterling and Klamath do not undertake any obligation to update any forward-looking statement to reflect circumstances or events that occur after the date the forward-looking statements are made.

The proposed transaction will be submitted to Klamath's shareholders for their consideration. Sterling and Klamath will file a registration statement, a joint prospectus/proxy statement and other relevant documents concerning the proposed transaction with the SEC.

SHAREHOLDERS OF KLAMATH ARE URGED TO READ THE REGISTRATION STATEMENT AND THE PROSPECTUS/PROXY STATEMENT WHEN IT BECOMES AVAILABLE AND ANY OTHER RELEVANT DOCUMENTS FILED WITH THE SEC AS WELL AS ANY AMENDMENTS OR SUPPLEMENTS TO THOSE DOCUMENTS, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION. Shareholders may obtain a free copy of the prospectus/proxy statement and other documents containing information about Sterling and Klamath when they become available on the SEC's Internet site at (<http://www.sec.gov>).

Sterling and its directors and executive officers may be deemed to be participants in the solicitation of proxies from the shareholders of Sterling in connection with the Merger. Information about the directors and executive officers of Sterling and their ownership of Sterling common stock is set forth in Sterling's proxy statement, dated March 21, 2003, for Sterling's 2003 annual meeting of shareholders, as filed with the SEC on Schedule 14A. Additional information regarding the interests of these participants may be obtained by reading the joint prospectus/proxy statement regarding this transaction when it becomes available.

Klamath and its directors and executive officers may be deemed to be participants in the solicitation of proxies from the shareholders of Klamath in connection with the Merger. Information about the directors and executive officers of Klamath and their ownership of Klamath common stock is set forth in Klamath's proxy statement, dated December 27, 2002, for Klamath's 2003 annual meeting of shareholders, as filed with the SEC on Schedule 14A. Additional information regarding the interests of these participants may be obtained by reading the joint prospectus/proxy statement regarding this transaction when it becomes available.

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**STERLING**  
**Financial Corporation**

announces the acquisition of:

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Investor Presentation

July 15, 2003

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**Transaction Rationale**

Attractive Financial Results

Attractive Multiples

Accretive to earnings per share in 2004

Expands Northwest Community Bank Franchise

Opportunity to extend additional loan and deposit products to Klamath customers

Solid foundation for growth in Oregon communities

Unique opportunity to build a bank for all of Oregon

Low Risk Integration

Sterling has successfully integrated 13 companies since 1983, including Empire Federal Bancorp which closed in February 2003

Conservative cost savings estimates validated through due diligence

Excellent asset quality at Klamath

**Franchise Enhancing**

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[GRAPHIC]

143 branch offices in Washington, Oregon, Idaho and Montana

**Why Klamath?**

Natural extension of Sterling's recent expansion of Corporate and Business banking in Oregon

Completes Oregon component of Northwest regional footprint

Market Share Opportunity

Sterling's Oregon market share increases from 0.5% to approximately 4%

Opportunities for increased earnings per share growth with increased market share opportunities

Opportunities for cost savings

Similar branch system

Excellent deposit base

Thrift-to-bank transition begun by Klamath can be accelerated by Sterling

Significant product expansion opportunities

Business Lending

Commercial Checking & Sweep Accounts

Cash Management, increased Internet Banking services

Direct Deposit, ACH & 24 hour Anytime Line Access

Merchant Accounts

International Banking

Extends Real Estate Lending Opportunities for Action Mortgage and Interest

## **Transaction Terms and Pricing**

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**Transaction Summary**

|                              |  |
|------------------------------|--|
| Exchange Ratio Per Share:    | 0.77 Shares of Sterling Common Stock   |
| Transaction Price Per Share: | \$20.44 / Share (1)  |
| Aggregate Transaction Value: | \$146.9 Million (2)  |
| Consideration:               | 100% Sterling Common Stock   |
| Transaction Structure:       | Tax-free exchange of stock   |
| Treatment of Options:        | Klamath options are to be converted into options for Sterling common stock based upon the exchange ratio   |
| Board Representation:        | One Klamath board member will join Sterling Financial Corporation's Board<br>Two Klamath board members will join Sterling Savings Bank's Board<br>Remaining Klamath directors will join Sterling's Oregon Advisory Board |

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(1) Based upon Sterling's stock price of \$26.55 as of July 14, 2003

(2) Based upon 6.96 million Klamath common shares outstanding and 642,940 options with an average strike price of \$13.27

Walk-away Right: Klamath will have the right to terminate the agreement if, at the time of determination, Sterling's stock price has declined below \$20.53 and Sterling's stock price has underperformed an index of regional financial institutions by more than 15%. This termination right can be cured by Sterling if Sterling elects to increase the exchange ratio by an adjustment factor.

Deal Protection: \$6 million termination fee to be paid to Sterling if, among other things, Klamath terminates transaction to pursue another combination.

Anticipated Closing: First Quarter 2004



**Deal Pricing**

Purchase Price Per Klamath Share (1): \$20.44 / Share

|  | Sterling/<br>Klamath | Nationwide<br>Median (2) |
|--|----------------------|--------------------------|
| Price / LTM Earnings Per Share: (3)        | 18.8x                | 16.5x                    |
| Price / Book Value: (4)                    | 111.7%               | 162.1%                   |
| Price / Tangible Book Value: (4)           | 165.1%               | 164.5%                   |
| Tangible Book Premium / Core Deposits: (5) | 6.2%                 | 15.6%                    |
| Premium to Market: (6)                     | 17.2%                | 22.5%                    |

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- (1) Based upon Sterling's stock price of \$26.55 as of July 14, 2003
- (2) Reflects median multiples for 13 nationwide savings institution transactions announced since January 1, 2003 with a deal value greater than \$15 million
- (3) Based upon Klamath's trailing twelve month earnings per share of \$1.09 as of March 31, 2003
- (4) Based upon Klamath's stated book value of \$18.30 and tangible book value of \$12.38 as of March 31, 2003
- (5) Core deposits exclude jumbo time deposits
- (6) Based upon Klamath's closing stock price of \$17.45 on July 14, 2003

## **Pro Forma Financial Impact**

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**Pro Forma Earnings Impact**

| (\$ in millions)<br>Earnings Projections    | Projected for<br>Fiscal Year 2004 |
|---|-----------------------------------|
| Sterling Earnings (1)                       | \$ 38.2                           |
| Klamath Earnings (2)                        | 7.6                               |
| Estimated Expense Savings (3)               | 5.2                               |
| Net Accretion of Fair Value Adjustments (4) | 2.6                               |
| Reversal of Klamath Amortization (5)        | 2.3                               |
| CDI Amortization Expense (6)                | (1.1)                             |
| Other Integration Expenses                  | (0.6)                             |
| <b>Pro Forma Net Income</b>                 | <b>\$ 54.2</b>                    |

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(1) Based on I/B/E/S mean EPS Estimate for 2004 of \$2.50 and assuming 15.3 million fully diluted shares for Sterling.

(2) Based on I/B/E/S mean EPS Estimate for 2004 of \$1.10 and assuming 6.9 million fully diluted shares for Klamath.

(3) Assumes cost savings equivalent to approximately 17% of Klamath's estimated non-interest expense

(4) Reflects net accretion from fair value adjustments to Klamath's security portfolio and FHLB borrowings

(5) Reflects Klamath's anticipated intangible amortization of \$3.6 million net of tax at 36%

(6) The core deposit intangible is estimated to be 2.5% of Klamath's non-CD deposits and is assumed to be amortized straight-line over 10 years

**Immediately Accretive to Earnings Per Share**

| Earnings per Share Projections    | Projected for<br>Fiscal Year 2004 |      |
|-----------------------------------|-----------------------------------|------|
| Current Sterling EPS Estimate (1) | \$                                | 2.50 |
| Pro Forma Sterling EPS (2)        |                                   | 2.60 |
| Accretion to Sterling EPS (\$)    | \$                                | 0.10 |
| Accretion to Sterling EPS (%)     |                                   | 4%   |

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(1) Based on Sterling's mean I/B/E/S EPS Estimate for 2004.

(2) Assumes 5,358,355 shares will be issued to Klamath stockholders and approximately 200,000 projected share equivalents for Sterling on a diluted basis as a result of rolled options

**Estimated Cost Savings**

| (\$ in millions)<br>Sources of Cost Savings | Savings Projected for<br>Fiscal Year 2004 | Percent of<br>Klamath Expense |
|---|---|-------------------------------|
| Compensation & Benefits                     | \$ 4.5                                    | 20%                           |
| ESOP/MRDP                                   | \$ 1.4                                    | 100%                          |
| Other Operating                             | \$ 2.2                                    | 10%                           |
| <b>Total Cost Savings (Pre-tax)</b>         | <b>\$ 8.1</b>                             | <b>17%</b>                    |
| <b>Total Cost Savings (After-tax) (1)</b>   | <b>\$ 5.2</b>                             |                               |

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(1) Assumes an effective tax rate of 36%.

**Estimated Restructuring Costs**

Sterling estimates pre-tax merger costs of approximately \$19.2 million

| (\$ in millions)                          | Cost           |
|---|----------------|
| Transaction Costs                         | \$ 2.9         |
| Conversion / Integration Costs            | 6.9            |
| Employee-Related Costs (1)                | 9.4            |
| <b>Total Merger Costs (Pre-tax)</b>       | <b>\$ 19.2</b> |
| Taxes                                     | 6.2            |
| <b>Total Merger Costs (After-tax) (2)</b> | <b>\$ 13.0</b> |

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(1) Does not include the termination of ESOP and MRDP plans, which are reflected in the transaction value

(2) Assumes employee-related costs, conversion/integration costs and some transaction costs are fully tax-deductible at a tax rate of 36%.

**Summary Financial Impact**

| (\$ in millions) |    | <b>Sterling</b> | <b>Klamath</b> | <b>Pro Forma (1)</b> |
|------------------|----|-----------------|----------------|----------------------|
| Assets           | \$ | 3,821           | \$ 1,478       | \$ 5,299             |
| Loans            |    | 2,562           | 573            | 3,135                |
| Deposits         |    | 2,281           | 1,100          | 3,381                |
| Borrowings       |    | 1,184           | 210            | 1,394                |
| Equity           |    | 241             | 119            | 388                  |
| Market Cap. (2)  |    | 392             | 120            | 535                  |
| Branches         |    | 85              | 58             | 143                  |

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Data as of March 31, 2003. Source: SNL Financial. Market data as of July 14, 2003.

- (1) Every pro forma number except for equity excludes purchase accounting adjustments.
- (2) The calculation of pro forma market capitalization assume that Klamath shareholders receive approximately 5.4 million shares of Sterling common stock

## **Appendix**

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## Sterling's Historical Balance Sheet

| (\$ in thousands)                     | As of December 31,  |                     |                     | As of March 31,     |
|---------------------------------------|---------------------|---------------------|---------------------|---------------------|
|                                       | 2000                | 2001                | 2002                | 2003                |
| <b>Assets</b>                         |                     |                     |                     |                     |
| Cash and Equivalents                  | \$ 62,510           | \$ 67,181           | \$ 78,591           | \$ 69,990           |
| Securities                            | 486,182             | 694,048             | 830,168             | 988,097             |
| <b>Total Cash and Securities</b>      | <b>\$ 548,692</b>   | <b>\$ 761,229</b>   | <b>\$ 908,759</b>   | <b>\$ 1,058,087</b> |
| <b>Loans</b>                          |                     |                     |                     |                     |
| Gross Loans                           | \$ 1,984,156        | 2,142,155           | \$ 2,440,678        | \$ 2,592,365        |
| Loan Loss Reserves                    | (16,740)            | (20,599)            | (27,866)            | (30,562)            |
| <b>Total Net Loans</b>                | <b>\$ 1,967,416</b> | <b>\$ 2,121,556</b> | <b>\$ 2,412,812</b> | <b>\$ 2,561,803</b> |
| <b>Other Assets</b>                   |                     |                     |                     |                     |
| Real Estate Owned                     | \$ 6,407            | \$ 2,982            | \$ 3,953            | \$ 4,248            |
| Total Intangibles                     | 50,347              | 45,615              | 45,657              | 50,191              |
| Other Assets                          | 79,847              | 107,211             | 134,883             | 146,890             |
| <b>Total Assets</b>                   | <b>\$ 2,652,709</b> | <b>\$ 3,038,593</b> | <b>\$ 3,506,064</b> | <b>\$ 3,821,219</b> |
| <b>Liabilities</b>                    |                     |                     |                     |                     |
| Deposits                              | \$ 1,724,219        | \$ 1,853,536        | \$ 2,014,096        | \$ 2,281,471        |
| Total Borrowings                      | 710,978             | 915,103             | 1,187,966           | 1,184,392           |
| Other Liabilities                     | 76,174              | 104,264             | 100,346             | 114,220             |
| <b>Total Liabilities</b>              | <b>\$ 2,511,371</b> | <b>\$ 2,872,903</b> | <b>\$ 3,302,408</b> | <b>\$ 3,580,083</b> |
| <b>Equity</b>                         | <b>\$ 141,338</b>   | <b>\$ 165,690</b>   | <b>\$ 203,656</b>   | <b>\$ 241,136</b>   |
| <b>Total Liabilities &amp; Equity</b> | <b>\$ 2,652,709</b> | <b>\$ 3,038,593</b> | <b>\$ 3,506,064</b> | <b>\$ 3,821,219</b> |

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Source: Sterling Financial Corporation

## Sterling's Historical Income Statement

| (\$ in thousands)          | For the Year Ended December 31, |                  |                   | For the Three Mos Ended March 31, |                  |
|----------------------------|---------------------------------|------------------|-------------------|-----------------------------------|------------------|
|                            | 2000                            | 2001             | 2002              | 2002                              | 2003             |
| Total Interest Inc         | \$ 205,310                      | \$ 201,385       | \$ 197,313        | \$ 48,166                         | \$ 51,485        |
| Total Interest Exp         | 125,544                         | 116,516          | 96,965            | 24,777                            | 22,914           |
| <b>Net Interest Inc</b>    | <b>\$ 79,766</b>                | <b>\$ 84,869</b> | <b>\$ 100,348</b> | <b>\$ 23,389</b>                  | <b>\$ 28,571</b> |
| Loan Loss Provision        | \$ 4,600                        | \$ 8,000         | \$ 11,867         | \$ 2,086                          | \$ 2,250         |
| <b>Non-int Income</b>      | <b>\$ 14,487</b>                | <b>\$ 17,275</b> | <b>\$ 26,155</b>  | <b>\$ 5,743</b>                   | <b>\$ 5,749</b>  |
| Gain on Sale of Securities | \$ 1                            | \$ 3,746         | \$ 2,925          | \$ 86                             | \$ 1,360         |
| Gain on Sale of Loans      | \$ 0                            | \$ 0             | \$ 0              | \$ 0                              | \$ 0             |
| Comp and Benefits          | \$ 31,771                       | \$ 35,291        | \$ 42,861         | \$ 10,618                         | \$ 11,958        |
| Occupancy and Equip        | 10,359                          | 11,161           | 12,534            | 3,014                             | 3,507            |
| Other Non-interest Exp     | 25,838                          | 26,841           | 25,548            | 6,035                             | 5,946            |
| <b>Non-int Exp</b>         | <b>\$ 67,968</b>                | <b>\$ 73,293</b> | <b>\$ 80,943</b>  | <b>\$ 19,667</b>                  | <b>\$ 21,411</b> |
| Net Income Before Taxes    | \$ 21,686                       | \$ 24,597        | \$ 36,619         | \$ 7,465                          | \$ 12,019        |
| Income Taxes               | 8,033                           | 8,409            | 11,031            | 1,884                             | 4,236            |
| <b>Net Income</b>          | <b>\$ 13,653</b>                | <b>\$ 16,188</b> | <b>\$ 25,588</b>  | <b>\$ 5,581</b>                   | <b>\$ 7,783</b>  |

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Source: Sterling Financial Corporation

## Klamath's Historical Balance Sheet

| (\$ in thousands)                     | As of             |                       |                     |                     |
|---------------------------------------|-------------------|-----------------------|---------------------|---------------------|
|                                       | 2000              | September 30,<br>2001 | 2002                | March 31,<br>2003   |
| <b>Assets</b>                         |                   |                       |                     |                     |
| Cash and Equivalents                  | \$ 29,947         | \$ 118,389            | \$ 45,792           | \$ 53,044           |
| Securities                            | 206,720           | 590,767               | 783,849             | 760,019             |
| Total Cash and Securities             | \$ 236,667        | \$ 709,156            | \$ 829,641          | \$ 813,063          |
| Gross Loans                           | \$ 733,119        | \$ 687,941            | \$ 614,841          | \$ 580,630          |
| Loan Loss Reserves                    | (4,082)           | (7,951)               | (7,376)             | (7,234)             |
| Total Net Loans                       | \$ 729,037        | \$ 679,990            | \$ 607,465          | \$ 573,396          |
| Real Estate Owned                     | \$ 788            | \$ 446                | \$ 759              | \$ 656              |
| Total Intangibles                     | 8,126             | 44,089                | 40,299              | 38,475              |
| Other Assets                          | 20,957            | 34,891                | 35,331              | 52,050              |
| <b>Total Assets</b>                   | <b>\$ 995,575</b> | <b>\$ 1,468,572</b>   | <b>\$ 1,513,495</b> | <b>\$ 1,477,640</b> |
| <b>Liabilities</b>                    |                   |                       |                     |                     |
| Deposits                              | \$ 695,381        | \$ 1,152,824          | \$ 1,142,006        | \$ 1,099,728        |
| Total Borrowings                      | 176,000           | 169,700               | 206,950             | 209,700             |
| Other Liabilities                     | 15,469            | 31,907                | 44,601              | 49,232              |
| <b>Total Liabilities</b>              | <b>\$ 886,850</b> | <b>\$ 1,354,431</b>   | <b>\$ 1,393,557</b> | <b>\$ 1,358,660</b> |
| <b>Equity</b>                         | <b>\$ 108,725</b> | <b>\$ 114,141</b>     | <b>\$ 119,938</b>   | <b>\$ 118,980</b>   |
| <b>Total Liabilities &amp; Equity</b> | <b>\$ 995,575</b> | <b>\$ 1,468,572</b>   | <b>\$ 1,513,495</b> | <b>\$ 1,477,640</b> |

Source: Klamath First Bancorp's 2002 Annual Report and Form 10-Q for the period ended March 31, 2003

## Klamath's Historical Income Statement

| (\$ in thousands)          | For the Year Ended September 30, |                  |                  | For the Six Mos Ended March 31, |                  |
|----------------------------|----------------------------------|------------------|------------------|---------------------------------|------------------|
|                            | 2000                             | 2001             | 2002             | 2002                            | 2003             |
| Total Interest Inc         | \$ 72,158                        | \$ 70,133        | \$ 87,293        | \$ 44,916                       | \$ 36,998        |
| Total Interest Exp         | 40,757                           | 40,751           | 39,531           | 21,615                          | 15,578           |
| <b>Net Interest Inc</b>    | <b>\$ 31,401</b>                 | <b>\$ 29,382</b> | <b>\$ 47,762</b> | <b>\$ 23,301</b>                | <b>\$ 21,420</b> |
| Loan Loss Provision        | \$ 1,764                         | \$ 387           | \$ 156           | \$ 156                          | \$ 0             |
| Gain on Sale of Securities | \$ 7                             | \$ 5,375         | \$ 1,707         | \$ 119                          | \$ 885           |
| Gain on Sale of Loans      | \$ 87                            | \$ 574           | \$ 1,077         | \$ 463                          | \$ 1,017         |
| Fees and Service Charges   | 3,212                            | 4,294            | 7,877            | 2,328                           | 3,102            |
| Other Income               | 789                              | 770              | 1,953            | 2,293                           | 3,113            |
| <b>Non-int Income</b>      | <b>\$ 4,095</b>                  | <b>\$ 11,013</b> | <b>\$ 12,614</b> | <b>\$ 5,203</b>                 | <b>\$ 8,117</b>  |
| Comp and Benefits          | \$ 11,898                        | \$ 14,449        | \$ 22,125        | \$ 10,899                       | \$ 12,083        |
| Occupancy and Equip        | 2,413                            | 2,859            | 4,811            | 2,361                           | 2,576            |
| Other Non-interest Exp     | 9,462                            | 11,412           | 23,235           | 11,266                          | 10,758           |
| <b>Non-int Exp</b>         | <b>\$ 23,773</b>                 | <b>\$ 28,720</b> | <b>\$ 50,171</b> | <b>\$ 24,526</b>                | <b>\$ 25,417</b> |
| Net Income Before Taxes    | \$ 9,959                         | \$ 11,288        | \$ 10,049        | \$ 3,822                        | \$ 4,120         |
| Income Taxes               | 3,533                            | 3,717            | 3,260            | 1,330                           | 1,273            |
| <b>Net Income</b>          | <b>\$ 6,426</b>                  | <b>\$ 7,571</b>  | <b>\$ 6,789</b>  | <b>\$ 2,492</b>                 | <b>\$ 2,847</b>  |

Source: Klamath First Bancorp's 2002 Annual Report and Form 10-Q for the period ended March 31, 2003