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BUSINESS VALUATION &
FINANCIAL ADVISORY SERVICES

Bank Watch

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Are Robo-Advisors on Any Banker's Wish List?

Christmas appears to have come early for some bankers and their investors with the SNL Bank index up over 30% from the November 8, 2016 election to mid-December. While optimism abounds, one inconvenient truth remains for the time being: ROEs for the banking industry as a whole remain below pre-financial crisis levels despite credit costs that are below most historical standards. The factors challenging ROEs for the sector are numerous but include: compressed net interest margins from a historically low rate environment, enhanced competition from non-banks, a challenging regulatory and compliance environment, and evolving consumer preferences regarding the delivery of financial services.

These factors are particularly acute for most community banks that depend heavily on spread income and do not have the scale to absorb expense pressures as easily as their larger brethren. Further, many community banks are at a crossroad because their ROE consistently has fallen below the cost of capital, which in turn is forcing boards to consider strategic options like outright sales or potentially risky acquisition strategies to obtain scale.

In an ideal world, community banks could easily add fee businesses that are capital-light, such as wealth management and trust operations, to boost returns. By pairing traditional banking services with other financial services like wealth management, banks can obtain more touch points for customer relationships, enhance revenue, and potentially improve the bank's valuation. While we have previously spoken about the potential benefits to community banks of acquiring or building out a traditional wealth management operation, we have not addressed emerging FinTech companies, like robo-advisors, that are focused on the wealth management space.

While there has been a race to partner and/or acquire robo-advisors by many of the larger asset managers and banks, there have also been some interesting partnerships with community banks. One such **partnership struck is among Cambridge Savings Bank**, a $3.5 billion bank located near Boston, and SigFig, a robo-advisor founded in 2007. While SigFig has relationships with UBS and Wells Fargo, its partnership with Cambridge Savings is notable because the two built a service called "ConnectInvest." When announced in the spring of 2016, the partnership was described as the "first automated investment service integrated and bundled directly into a retail bank's product offerings in the U.S." ConnectInvest, which is available to Cambridge's customers digitally (mobile and website), "allows customers to easily open, fund, and manage an automated investment account tailored to their goals." Cambridge's customers are interested in the offering and have started using it. The goal is get up to 10% of its customer base using ConnectInvest.

With this example in mind, the remainder of this article offers an overview of the robo-advisory space for our community bank readers so that they may gain a better understanding of the key players and their service offerings and assess whether their bank could benefit from leveraging opportunities in this area.

An Overview of Robo-Advisors

Robo-advisors were noted by the CFA Institute as the FinTech innovation most likely to have the greatest impact on the financial services industry in the short-term (one year) and medium-term (five years). Robo-advisory has gained traction in the past several years as a niche within the FinTech industry by offering online wealth management tools powered by sophisticated algorithms that can help investors manage their portfolios at very low costs and with minimal need for human contact or advice. Technological advances that make the business model possible, coupled with a loss of consumer trust in the wealth management industry in the wake of the financial crisis, have created a favorable environment for robo-advisory startups to disrupt financial advisories, RIAs, and wealth managers. This growth is forcing traditional incumbents to confront the new entrants by adding the service via acquisition or partnership rather than dismiss it as a passing fad.

Robo-advisors have been successful for a number of reasons, though like many digital products low-cost, convenience, and transparency are common attributes.

- **Low Cost.** Automated, algorithm-driven decision-making greatly lowers the cost of financial advice and portfolio management.
- **Accessible.** As a result of the lowered cost of financial advice, advanced investment strategies are more accessible to a wider customer base.
- **Personalized Strategies.** Sophisticated algorithms and computer systems create personalized investment strategies that are highly tailored to the specific needs of individual investors.
- **Transparent.** Through online platforms and mobile apps, clients are able to view information about their portfolios and enjoy visibility in regard to the way their money is being managed.
- **Convenient.** Portfolio information and management becomes available on-demand through online platforms and mobile apps.

Consistent with the rise in consumer demand for robo-advisory, investor interest has grown steadily. While robo-advisory has not drawn the levels of investment seen in other niches (such as online lending platforms), venture capital funding of robo-advisories has skyrocketed from almost non-existent levels ten years ago to hundreds of millions of dollars invested annually the last few years. 2016 saw several notable rounds of

What We're Reading

BankDirector released their **2017 Bank M&A Survey** report which provides some interesting insights into the outlook for M&A activity this year.

Naomi Snyder at *BankDirector* provides her perspective on the OCC's recent announcement that they would start to accept applications for special bank charters for FinTech companies in a piece entitled "**What to Know about the New FinTech Charter.**"

Lastly, Jack Milligan at *BankDirector* takes a look at an interesting question in his article "**Do the Regulators Want Bigger Banks?**"

investment into not only some of the industry's largest and most mature players (including rounds of $100 million for Betterment and $75 million for Personal Capital), but also for innovative startups just getting off the ground (such as SigFig and Vestmark).

The table to the right provides an overview of the fee schedules, assets under management and account opening minimums for several of the larger robo-advisors. The robo-advisors are separated into three tiers. Tier I consists of early robo-advisory firms who have positioned themselves at the top of the industry. Tier II consists of more recent robo-advisory startups that are experiencing rapid growth and are ripe for partnership. Tier III consists of robo-advisory services of traditional players who have decided to build and run their own technology in-house.

As shown, account opening sizes and fee schedules are lower than many traditional wealth management firms. The strategic challenge for a number of the FinTech startups in Tiers I and II is generating enough AUM and scale to produce revenue sufficient to maintain the significantly lower fee schedules. This can be challenging since the cost to acquire a new customer can be significant and each of these startups has required significant venture capital funding to develop. For example, each of these companies has raised over $100 million of venture capital funding since inception.

Comparison of Key Metrics of Selected Robo-Advisory Services

	AUM (B)	Fee Structure	Account Minimum
Tier I			
Betterment	$4	0.35% annual fee on <$10k, 0.25% on $10k to $100k, 0.15% on $100k+	$0
WealthFront	$3	0.25% on all accounts	$500
Personal Capital	$2	0.89% annually on <$1MM, 0.79% on $3MM, 0.69% on $5MM, 0.59% on <$10MM, 0.49% on >$10MM	$25,000
Tier II			
FutureAdvisor	$1	0.5% Annual Fee of assets managed	$0
SigFig	$0	No fee on first $10k, 0.25% annual fee on accounts over $10k	$2,000
Tier III			
Vanguard Personal Advisor	$31	0.30% annually	$50,000
Schwab Intelligent Portfolio	$5	No fees for account management and service	$5,000

Source: Mercer Capital Research, Company Websites, as of June 2016

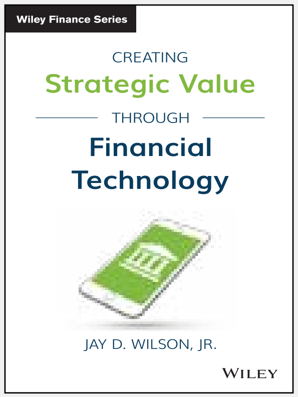
Key Potential Effects of Robo-Advisory

We see five potential effects of robo-advisors entering the financial services landscape.

1. **Fee pressure.** Robo-advisors may be a niche area for the time being, but the emergence and success of a technology-driven solution that challenges an age-old business (wealth management) epitomizes what has long been associated with internet (and digital) delivery of services: faster, better, and cheaper.

NEW BOOK COMING IN SPRING 2017

Creating Strategic Value Through Financial Technology



While many bankers view FinTech as a potential threat, FinTech offers the potential to improve the health of community banks for those banks that can selectively leverage FinTech to enhance performance, customer satisfaction, and improve profitability and returns. FinTech can also help level the playing field for community banks to compete more effectively with larger banks and non-bank lenders.

Creating Strategic Value Through Financial Technology illustrates the potential benefits of FinTech to banks, both large and small, so that they can gain a better understanding of FinTech and how it can create value for their shareholders and enhance the health and profitability of their institutions.

The book contains 13 chapters broken into three sections. Section I introduces FinTech. Section II explores FinTech niches such as bank technology, alternative lending, payments, wealth management, and insurance niches. Section III illustrates how both community banks and FinTech companies can create strategic value.

Learn More & Pre-Order

2. **The Democratization of Wealth Management.** As a result of the low costs of robo-advisory services, new investors have been able to gain access to sophisticated investment strategies that, in the past, have only been available to high net worth, accredited investors.

3. **Holistic Financial Life Management.** As more people have access to financial advice through robo-advisors, traditional financial advisors are being forced to move away from return-driven goals for clients and pivot towards offering a more complete picture of a client's financial well-being as clients save for milestones such as retirement, a child's education, and a new house. This phenomenon has increased the differentiation pressure on traditional financial advisors and RIAs, as robo-advisors can offer a holistic snapshot in a manner that is comprehensive and easy to understand

4. **Drivers of the Changing Role of the Traditional Financial Advisor.** The potential shift away from return-driven goals could leave the role of the traditional financial advisor in limbo. This raises the question of what traditional wealth managers will look like going forward. One potential answer is traditional financial advisors will tackle more complex issues, such as tax and estate planning, and leave the more programmed decision-making to robo-advisors.

5. **Build, Buy, Partner, or Wait and See.** As the role of the financial advisor changes, traditional incumbents like community banks are faced with determining what they want their relationship with robo-advisory to look like. In short, incumbents are left with four options: build their own robo-advisory in-house, buy a startup and adopt its technology, create a strategic partnership with a startup, or stay in a holding pattern in regard to robo-advisory and continue business as usual.

Robo-advisory is an exciting development for wealth managers and offers opportunities potentially for bankers to expand or develop their offerings in this area. Similar to any

Mercer Capital Sponsoring and Speaking at the Financial Industry's Premier Bank M&A + Growth Event

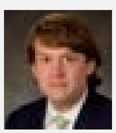
Acquire or Be Acquired Conference

Monday, January 30, 2017 | Phoenix, AZ

How to Create Strategic Value in the Current Environment

Against a backdrop of compressed net interest margins, enhanced competition from non-banks, rising regulatory and compliance costs and evolving consumer preferences regarding the delivery of financial services, many community banks find themselves at a significant inflection point where traditional growth strategies like building or acquiring an expansive, and often expensive, branch network are being reexamined. In this session, we examine how banks can utilize a hybrid approach and co-opt, partner with, or acquire fintech companies, wealth management and trust operations, and insurance brokerages.

Presented By



Andrew K. Gibbs
Senior Vice President
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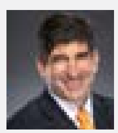
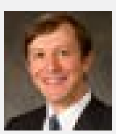


Chris Nichols
Chief Strategy Officer
CenterState Banks, Inc.



Jay D. Wilson, Jr.
Vice President
Mercer Capital

We will post the slide deck shortly after the conference on www.mercercapital.com

other growth strategy, the goal will ultimately be for the bank to enhance profitability and shareholder value by adding desired customer services.

For those bankers who may want to add a robo-advisor to their wish list, the key question of whether to build, buy, or partner is a challenging one. We will be speaking at the annual **Acquire or Be Acquired (AOBA) conference** in January on the topic of how to develop a framework to better assess this question. Additionally, for those who may go the investment route via a minority investment or outright acquisition, we offer some perspective on how to value and structure investments in FinTech companies like robo-advisors. Given the vast array of FinTech companies emerging in different areas of financial services, it will be important for bankers to develop a framework for both assessing potential opportunities and focusing in on those that provide the greatest potential to enhance profitability and shareholder value. We will post our slide deck from our AOBA session and make it accessible to BankWatch readers in the first quarter of 2017, so stay tuned.

Additionally, we have a new book coming in the spring of 2017 – **Creating Strategic Value Through Financial Technology** (see page 4). In this book, we illustrate the potential benefits of FinTech to banks, both large and small, so that they can gain a better understanding of FinTech and how it can create value for their shareholders and enhance the health and profitability of their institutions.

As always, please do not hesitate to contact us if we can help in any way.

Jay Wilson, Jr.

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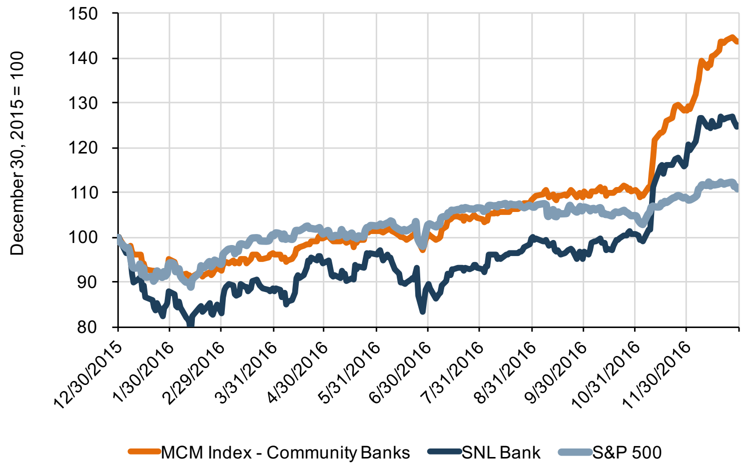
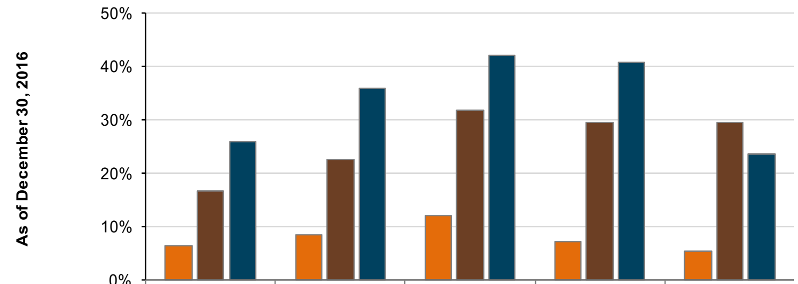
Mercer Capital's Bank Group Index Overview



Return Stratification of U.S. Banks

by Asset Size



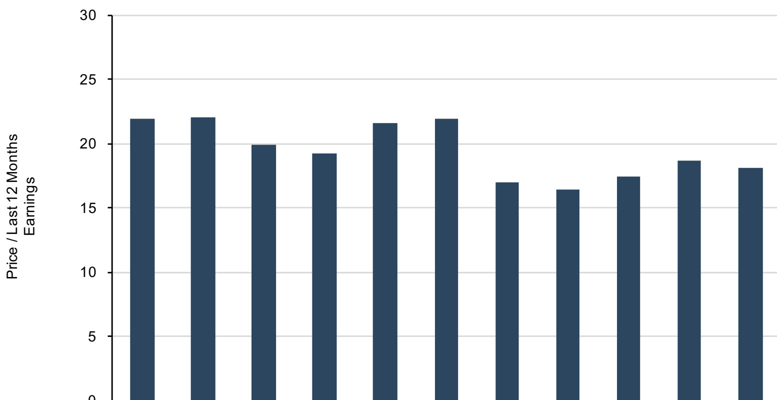
	Assets $250 - $500M	Assets $500M - $1B	Assets $1 - $5B	Assets $5 - $10B	Assets > $10B
Month-to-Date	6.56%	8.61%	12.11%	7.37%	5.38%
Quarter-to-Date	16.75%	22.52%	31.83%	29.48%	29.43%
Year-to-Date	25.95%	36.00%	42.05%	40.84%	23.73%

Median Valuation Multiples

	Median Total Return as of December 30, 2016			Median Valuation Multiples as of December 30, 2016				
Indices	Month-to-Date	Quarter-to-Date	Year-to-Date	Price/ LTM EPS	Price / 17(E) EPS	Price / Book Value	Price / Tangible Book Value	Dividend Yield
Atlantic Coast Index	9.44%	27.54%	40.66%	20.2x	17.8x	139%	155%	1.6%
Midwest Index	14.67%	31.46%	49.11%	19.2x	16.7x	166%	185%	1.8%
Northeast Index	11.19%	28.41%	46.23%	19.2x	16.8x	151%	166%	2.4%
Southeast Index	11.75%	29.32%	38.36%	17.9x	17.3x	134%	134%	1.2%
West Index	13.44%	33.99%	41.92%	20.6x	18.4x	164%	167%	1.5%
Community Bank Index	12.15%	30.22%	43.71%	19.2x	17.5x	150%	167%	1.6%
SNL Bank Index	**5.70%**	**29.48%**	**25.10%**					

Median Price/Earnings Multiples

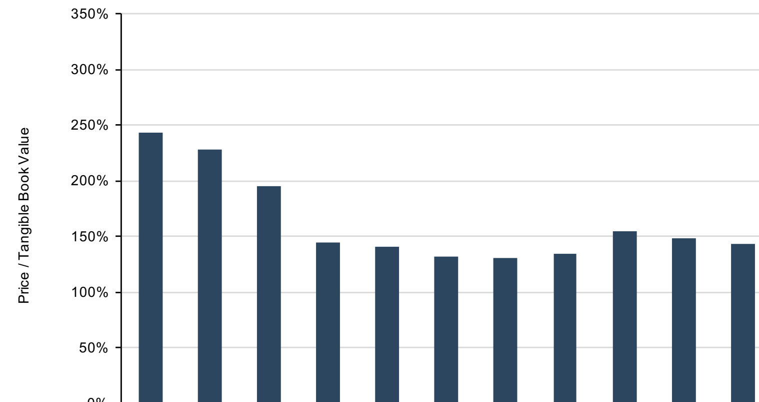
Target Banks' Assets <$5B and LTM ROE >5%



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
U.S.	22.0	22.1	19.9	19.3	21.7	21.9	17.0	16.5	17.5	18.8	18.1

Median Price/Tangible Book Value Multiples

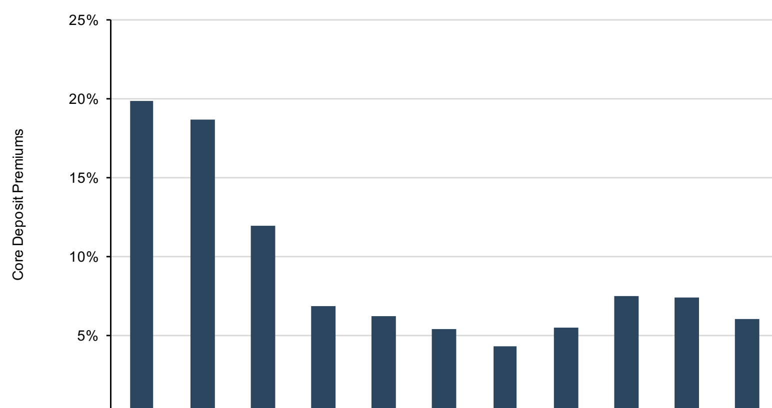
Target Banks' Assets <$5B and LTM ROE >5%



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
U.S.	243%	228%	196%	145%	141%	132%	130%	134%	155%	148%	143%

Median Core Deposit Multiples

Target Banks' Assets <$5B and LTM ROE >5%



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
U.S.	19.9%	18.7%	12.0%	6.9%	6.3%	5.4%	4.3%	5.5%	7.5%	7.5%	6.1%

Median Valuation Multiples for M&A Deals

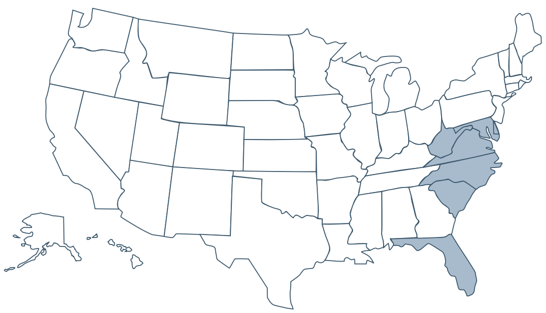
Target Banks' Assets <$5B and LTM ROE >5%, 12 months ended December 2016

Regions	Price / LTM Earnings	Price/ Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value	Target's Median Assets	Target's Median LTM ROAE
Atlantic Coast	19.9x	154%	6.8%	18	42.99	395,420	7.38%
Midwest	17.3x	141%	5.8%	65	24.76	113,139	8.02%
Northeast	20.7x	152%	7.4%	6	104.40	735,240	8.28%
Southeast	16.7x	137%	5.7%	22	63.21	185,088	8.07%
West	17.5x	155%	7.2%	14	34.24	196,512	10.77%
National Community Banks	**18.1x**	**143%**	**6.1%**	**125**	**33.76**	**178,318**	**8.21%**

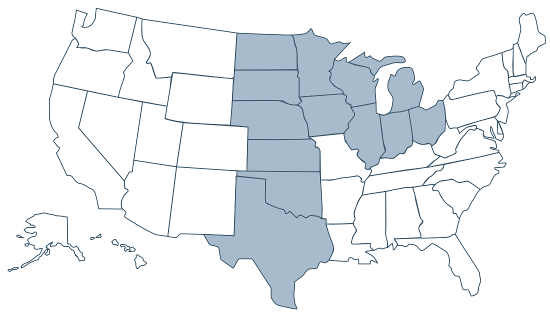
Source: SNL Financial

Mercer Capital's Regional Public Bank Peer Reports

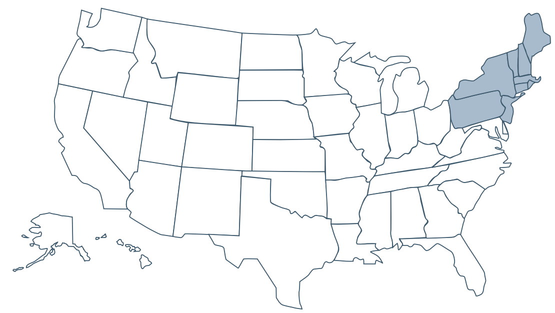
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



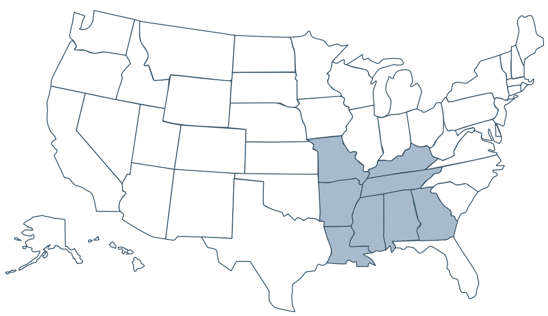
Atlantic Coast



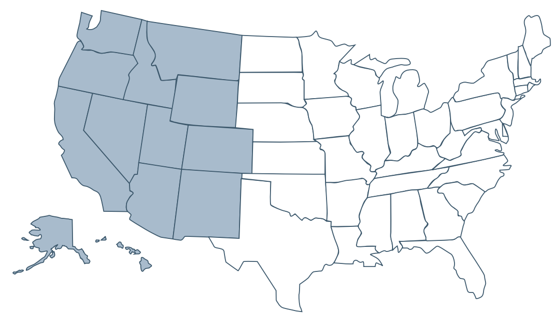
Midwest



Northeast



Southeast



West

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