

MAY 2022

Bank Watch

ARTICLE

Specialty Finance Acquisitions

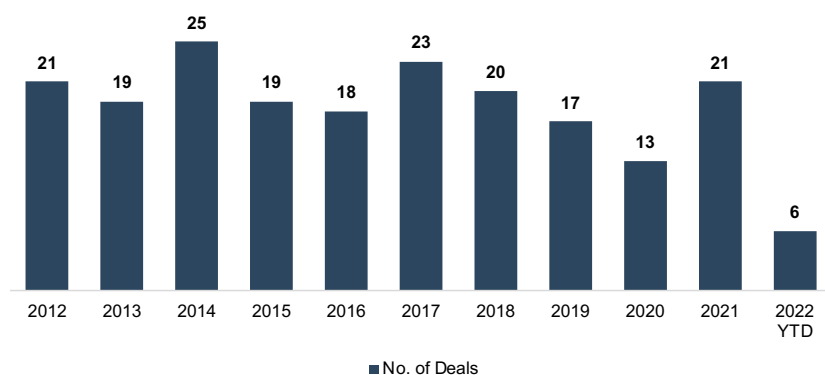
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Specialty Finance Acquisitions

In 2021, there were 21 deals announced with a U.S. bank or thrift buyer and a specialty lender target. This represents a significant uptick from the prior two years and the highest level since 2017. Deals in 2021 were largely driven by a desire to deploy excess liquidity and grow loans. Other drivers of deal activity include efforts to find a niche in the face of competition or diversify revenue and earnings. Through May 19, six deals had been announced in 2022.

Bank & Thrift Acquisitions of Specialty Lenders

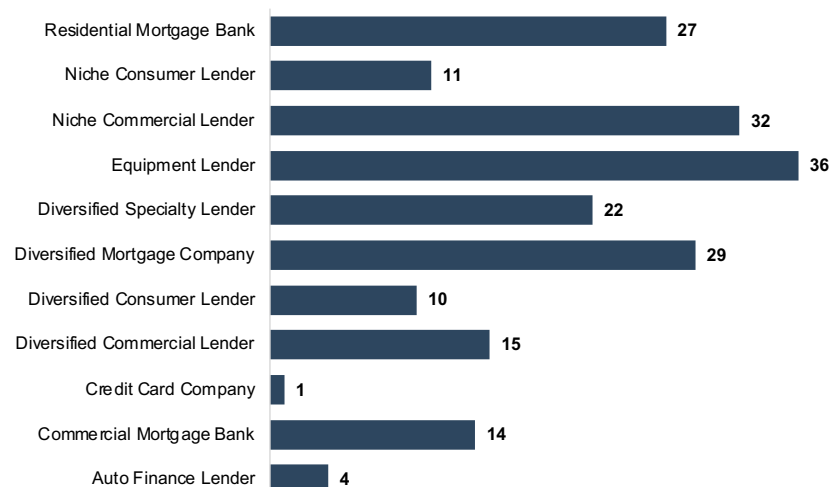


Source: S&P Capital IQ Pro

Specialty lenders encompass a variety of business models including mortgage companies, equipment finance, and auto lenders, among others. Over the past ten years, equipment lenders have been the most popular targets for bank acquirers. Other popular categories include niche commercial lenders and diversified mortgage companies.

Acquisitions by Target Focus

2012-YTD '22



Source: S&P Capital IQ Pro

Rationale

The premise for a bank/specialty lender deal is intuitive: higher yielding loans funded with cheap/excess deposits. Such a deal also allows the acquirer to diversify the exposure in their loan portfolio. One reason equipment lender deals in particular have been more common is the generally steady demand for equipment. Companies are buying equipment as they expand in good times, but critical purchases cannot be scrapped in a downturn either.

According to the FDIC's Quarterly Banking Profile, banks with assets of \$100 million to \$1 billion reported a median earning asset yield of 3.57% as of the fourth quarter of 2021. The cost of funding earning assets for these institutions was approximately 30 basis points. Yields on specialty finance assets can range from 6% to 7% on equipment leases to more than 20% on unsecured consumer loans in some cases. However, these assets are not funded with cheap deposits.

For example, Ohio-based Peoples Bancorp Inc. (PEBO) announced the acquisition of equipment lender Vantage Financial in February. Peoples' CEO commented on the first quarter earnings call that the Vantage portfolio was expected to yield about 7% in 2022 with an additional 5% from the income based on residual values at the ending of the leases. This compares to Peoples' reported earning asset yield of 3.61% for the first quarter. In addition, Peoples acquired small ticket equipment leases from North Star Leasing in 2021, and these assets were yielding approximately 15% as of 1Q22.

On the liability side, Vantage's funding situation was not disclosed beyond the \$21 million recourse loan paid off by Peoples at closing. It is safe to assume that Vantage's debt was more expensive than Peoples' total deposit cost of 14 basis points. These funding synergies were expected to lead to 3% earnings accretion in 2022 and 6% accretion in 2023.

Another benefit to acquirers is the opportunity to cross-sell by providing traditional banking products that a specialty lender could not provide. While additional revenue from these opportunities is usually not factored into the deal math, it is an important strategic consideration. Regions acquired home improvement lender EnerBank in 2021, and management framed the deal in terms of Regions' plan to deepen relationships with EnerBank customers by providing a comprehensive suite of banking services

Risks

Banks considering a specialty lender acquisition need to be aware of the potential risks as well. A trade off exists between risk and reward with higher yields compensating the originator for greater credit risk. Specialty finance assets exist on a risk spectrum, ranging from assets such as home improvement loans to borrowers with generally clean credit history to consumer loans to those with poor or no credit history.

EnerBank, the home improvement business acquired by Regions, reported an average customer FICO score of 763 at the time of announcement, and average annual net losses of approximately 1.5%. CURO Group Holdings (CURO), a consumer finance business, estimates net charge-offs in its U.S. Direct Lending business of 11% to 13% of average loans.

For comparison, net charge-offs represented 0.08% of loans for banks with assets of \$100 million to \$1 billion and 0.14% of loans for banks with assets of \$1 billion to \$10 billion as of 4Q21. The credit concern may be especially pertinent in the current setting as the benign environment over the past few years is due to normalize at some point.

In addition to credit quality, bank acquirers should be aware of the potential regulatory implications of acquiring a specialty lender. Regulatory agencies have stepped up scrutiny of banks as of late, prompting many banks to reexamine their practices related to consumers (note the large number of banks doing away with overdraft and NSF fees). Acquirers should be comfortable with the credit and regulatory risk profile of the target, making sure the overall risk level will be acceptable in context of the bank's total portfolio.

Recent Bank/Specialty Finance Deals

Ann. Date	Buyer	Target	Deal Value (\$M)	Target Focus
1/14/21	First Community Bancorp, Inc.	A Mortgage Boutique, LLC	NA	Diversified Mortgage Company
1/14/21	Watford City Bancshares, Inc.	Assets of Sodak Home Loans, LLC	NA	Residential Mortgage Bank
1/29/21	TCF Financial Corporation	BB&T Commercial Equipment Capital Corp.	NA	Diversified Specialty Lender
2/1/21	PacWest Bancorp	Civic Financial Services, LLC	159.24	Residential Mortgage Bank
2/6/21	Lake Shore III Corporation	Five-Lakes Financial, Inc.	NA	Equipment Lender
2/16/21	Teachers Insurance and Annuity Association of America	Greenworks Lending, LLC	NA	Niche Commercial Lender
2/16/21	Western Alliance Bancorporation	AmeriHome Mortgage Company, LLC	1,000.00	Diversified Mortgage Company
5/3/21	SmartFinancial, Inc.	Fountain Leasing, LLC	20.00	Auto Finance Lender
5/4/21	1st Financial Bank USA	Premier Financial Services, LLC	NA	Auto Finance Lender
6/10/21	Stearns Financial Services, Inc.	South End Capital Corporation	NA	Diversified Specialty Lender
6/24/21	Tectonic Financial, Inc.	Integra Funding Solutions, LLC	6.97	Diversified Commercial Lender
7/2/21	Banco Santander, S.A.	Santander Consumer USA Holdings Inc.	2,526.47	Diversified Consumer Lender
7/29/21	First Mid Bancshares, Inc.	Loan & deposit portfolio	NA	Not Classified
8/10/21	Truist Financial Corporation	Service Finance Company, LLC	2,000.00	Diversified Mortgage Company
9/21/21	Veritex Holdings, Inc.	North Avenue Capital, LLC	62.50	Diversified Specialty Lender
9/30/21	First National Corporation	Loan portfolio and certain fixed assets	NA	Niche Consumer Lender
10/4/21	Regions Financial Corporation	Sabal Capital Partners LLC	NA	Commercial Mortgage Bank
10/15/21	Popular, Inc.	K2 Capital Group LLC	188.00	Equipment Lender
10/26/21	Dickinson Financial Corporation II	Residential mortgage operations	NA	Residential Mortgage Bank
10/31/21	Community Investors Bancorp, Inc.	Lighthouse Commercial Mortgage	NA	Diversified Specialty Lender
12/7/21	First Financial Bancorp.	Summit Funding Group, Inc.	121.28	Equipment Lender
1/3/22	American Bank Holding Corporation	ACG Equipment Finance	NA	Commercial Mortgage Bank
1/19/22	Fifth Third Bancorp	Dividend Finance, LLC	NA	Niche Consumer Lender
2/16/22	Peoples Bancorp Inc.	Vantage Financial, LLC	54.00	Diversified Commercial Lender
3/1/22	Renasant Corporation	Southeastern Commercial Finance, LLC	NA	Commercial Mortgage Bank
4/4/22	Oxford Bank Corporation	Factors Southwest L.L.C.	0.99	Diversified Commercial Lender
4/28/22	Primis Financial Corp.	SeaTrust Mortgage Company	7.00	Residential Mortgage Bank

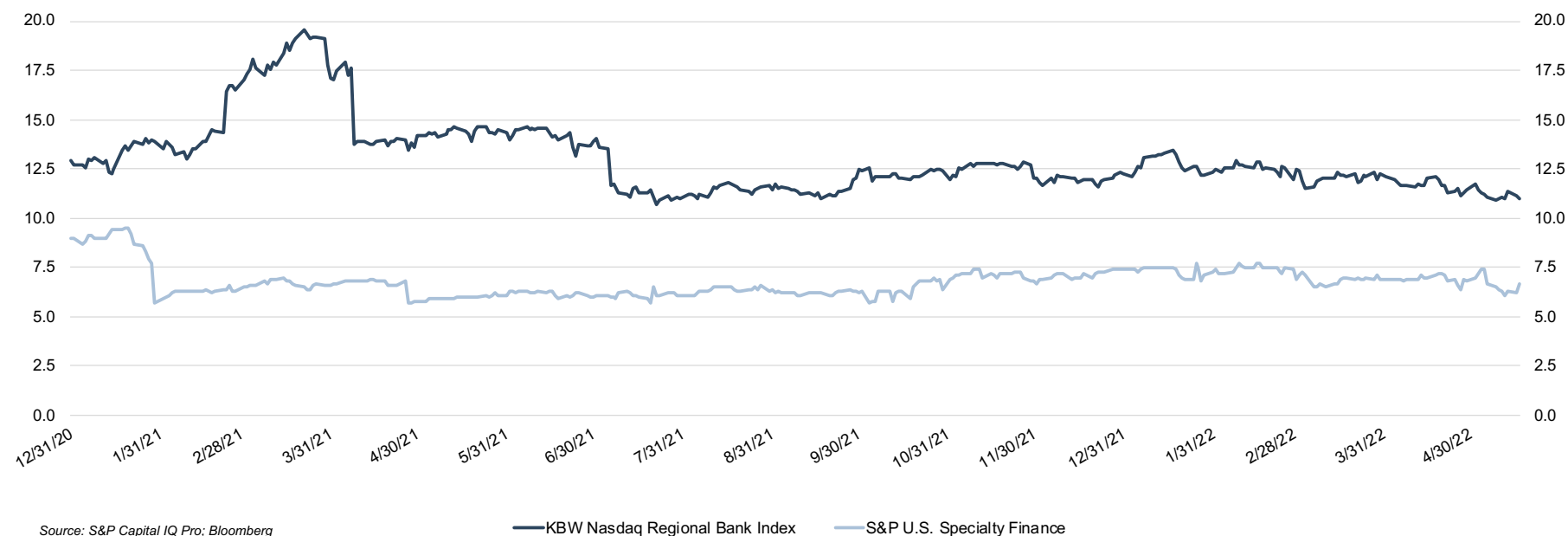
Valuation

While pricing data for specialty finance acquisitions is limited, these businesses tend to transact at lower multiples largely due to the risk factor. The price to earnings multiple for the S&P U.S. Specialty Finance Index was 6.7x as of May 17, and the price to book multiple was 1.7x. For publicly traded specialty lenders (based on S&P Capital IQ Pro classifications), the median P/E was 8.2x, and the median P/B was

0.93x. This compares to P/E and P/B multiples on the KBW NASDAQ Regional Bank Index of 11.0x and 1.2x, respectively.

Comparisons should be made with caution, as the homogeneity in the banking sector does not apply to the same degree in specialty finance.

Price / Earnings (x)



Conclusion

In summary, a specialty finance acquisition may not be right for every institution, but for the right buyer it can provide a new growth channel and help diversify revenue and earnings. Mercer Capital has significant experience in valuing and evaluating a range of financial service companies for banks.

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WHAT WE'RE READING

Bank regulatory agencies issued a **proposal** to revamp the Community Reinvestment Act with an eye towards **modernizing** the framework for mobile banking, among other goals.

The Senate held a **confirmation hearing** for Michael Barr, nominee for Fed Vice Chair of Supervision, earlier this month. Jerome Powell was **confirmed** for a second term as Fed chair, and Philp Jefferson and Lisa Cook were confirmed to the board of governors.

Banks are considering the possibility of **deposit outflows** as the Fed raises rates, leading some to limit securities purchases (subscription required).

Transaction of Note



Pinnacle Financial Partners

Nashville, Tennessee

acquired



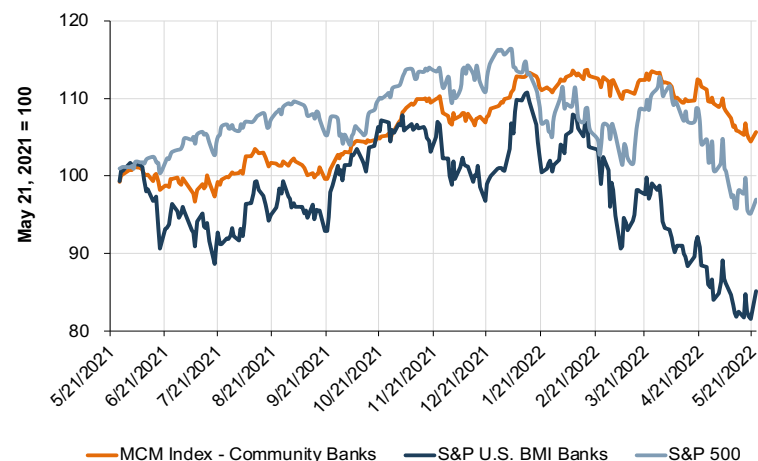
Advocate Capital, Inc.

Nashville, Tennessee

Mercer Capital served as
exclusive financial advisor to
Advocate Capital, Inc.

– July 2019 –

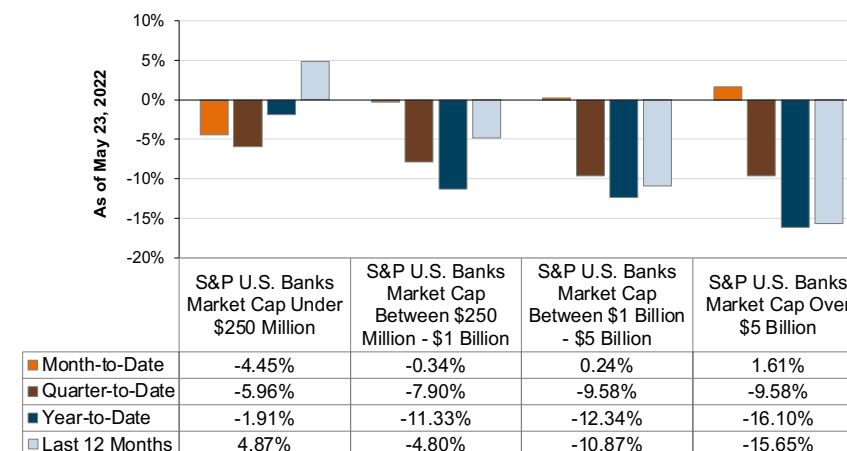
Mercer Capital's Bank Group Index Overview



Source: S&P Capital IQ Pro.

Return Stratification of U.S. Banks

by Market Cap



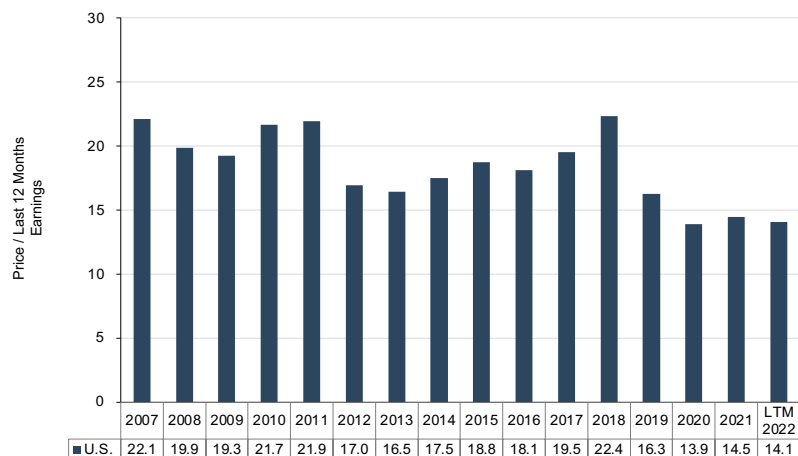
Source: S&P Capital IQ Pro.

	Total Return				Regional Index Data as of May 23, 2022					
	Month-to-Date	Quarter-to-Date	Year-to-Date	Last 12 Months	Price/LTM EPS	Price / 2022 (E) EPS	Price / 2023 (E) EPS	Price / Book Value	Tangible Book Value	Dividend Yield
Atlantic Coast Index	-4.9%	-6.3%	-6.8%	2.1%	9.7x	10.1x	9.4x	119%	125%	2.7%
Midwest Index	-2.6%	-3.8%	-0.9%	8.4%	9.3x	9.7x	8.9x	104%	123%	2.7%
Northeast Index	-2.9%	-3.8%	-3.2%	6.0%	9.1x	9.0x	8.7x	112%	120%	3.0%
Southeast Index	1.1%	-1.3%	7.4%	9.1%	12.1x	10.4x	9.0x	118%	126%	2.3%
West Index	-5.0%	-10.9%	-8.4%	5.0%	10.1x	9.2x	8.0x	109%	113%	2.8%
Community Bank Index	-3.3%	-5.6%	-3.8%	5.7%	9.6x	9.6x	8.8x	113%	122%	2.7%
S&P U.S. BMI Banks	1.3%	-9.5%	-15.4%	-14.9%	na	na	na	na	na	na

Source: S&P Capital IQ Pro.

Median Price/Earnings Multiples

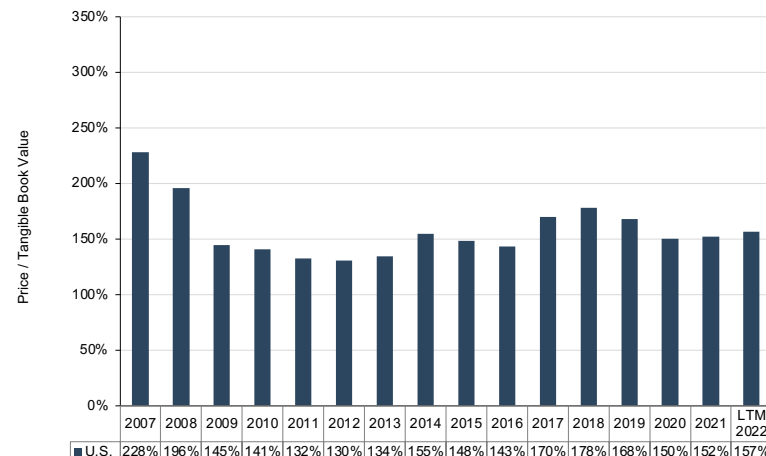
Target Banks' Assets <\$5B and LTM ROE >5%



Source: S&P Capital IQ Pro.

Median Price/Tangible Book Value Multiples

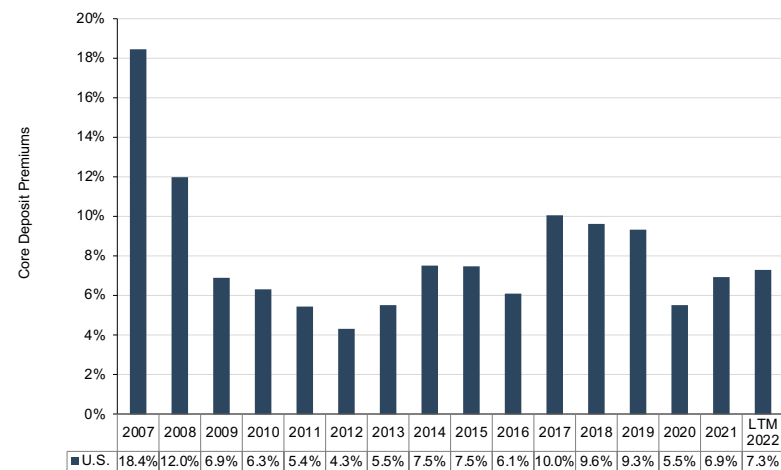
Target Banks' Assets <\$5B and LTM ROE >5%



Source: S&P Capital IQ Pro.

Median Core Deposit Premiums

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



Source: S&P Capital IQ Pro.

Median Valuation Multiples for M&A Deals

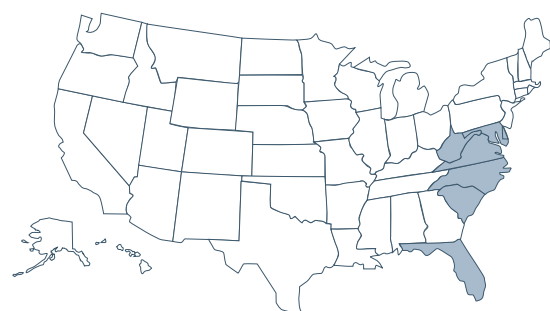
Target Banks' Assets <\$5B and LTM ROE >5%, 12 months ended May 24, 2022

Regions	Price / LTM Earnings	Price/ Tang. BV	Price / Core Dep Premium	No. of Deals	Median Deal Value (\$M)	Target's Median Assets (\$000)	Target's Median LTM ROAE
Atlantic Coast	17.2x	184%	9.5%	15	173.2	752,284	10.6%
Midwest	16.1x	152%	7.3%	53	116.6	213,455	10.1%
Northeast	12.2x	124%	3.2%	8	106.8	750,988	10.4%
Southeast	13.2x	161%	7.9%	28	146.4	409,123	12.3%
West	13.0x	161%	7.8%	20	90.0	540,658	13.4%
National Community Banks	14.1x	157%	7.3%	124	127.7	400,099	10.9%

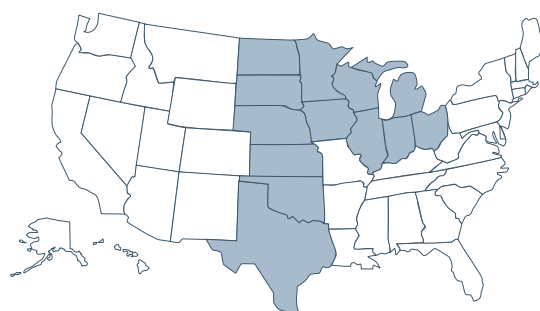
Source: S&P Capital IQ Pro.

Mercer Capital's Regional Public Bank Peer Reports

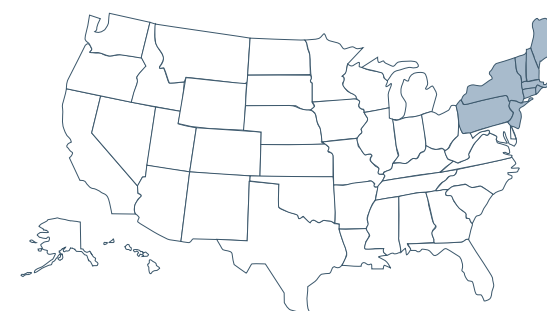
Updated weekly, Mercer Capital's Regional Public Bank Peer Reports offer a closer look at the market pricing and performance of publicly traded banks in the states of five U.S. regions. Click on the map to view the reports from the representative region.



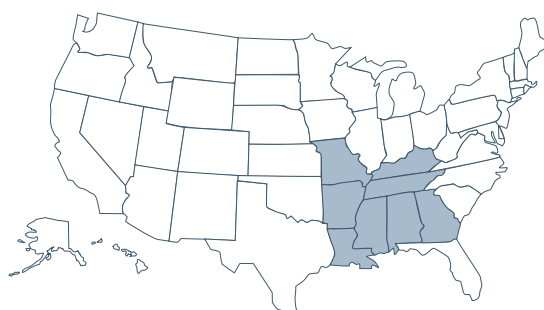
Atlantic Coast



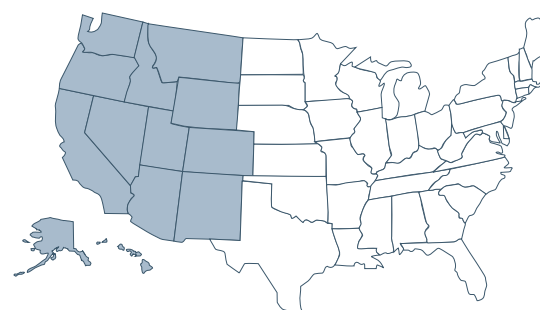
Midwest



Northeast



Southeast



West

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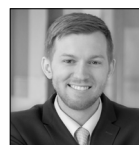
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