

Leveraging FinTech to Survive & Thrive in the Digital Age

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About the Presenters



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Jay Wilson, Vice President, is a senior member of Mercer Capital’s Depository Institutions practice. Jay also leads Mercer Capital’s Financial Technology industry team and publishes research related to the FinTech industry. He is also the author of the book, *Creating Strategic Value through Financial Technology* (Wiley Finance Series).

Jay’s practice involves providing valuation, financial advisory, and consulting services to depository institutions and FinTech companies, from start-ups to more mature companies, for a variety of purposes including ESOPs, mergers and acquisitions, estate and gift tax planning, financial statement reporting (purchase price allocations), and corporate/strategic planning.

About the Presenters



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Andy Gibbs leads Mercer Capital's Depository Institutions Group. Andy provides valuation and corporate advisory services to financial institutions for purposes including mergers and acquisitions, employee stock ownership plans, profit sharing plans, estate and gift tax planning and compliance matters, corporate planning and reorganizations.

He leads projects involving compliance with ASC 805 and ASC 350, which entail, for example, the identification and valuation of intangible assets under ASC 805 and impairment testing under ASC 350.

He also works with financial institutions in merger and acquisition advisory engagements. He assists buyers in evaluating the attractiveness of acquisition candidates, determining a price for the target institution, structuring the transaction, and evaluating different forms of financing. For sell-side clients, Andy analyzes the potential value that the institution may receive upon a sale, assists in locating potential buyers, and participates in negotiating a final transaction price and merger agreement.

Outline of Today's Presentation

- It Is an Exciting Time to Be a Community Bank!
- But, Why Do Large Banks Outperform?
- How FinTech Can Help?
- FinTech Case Studies
- Overview of FinTech M&A & Valuation Trends
- Conclusion / Questions

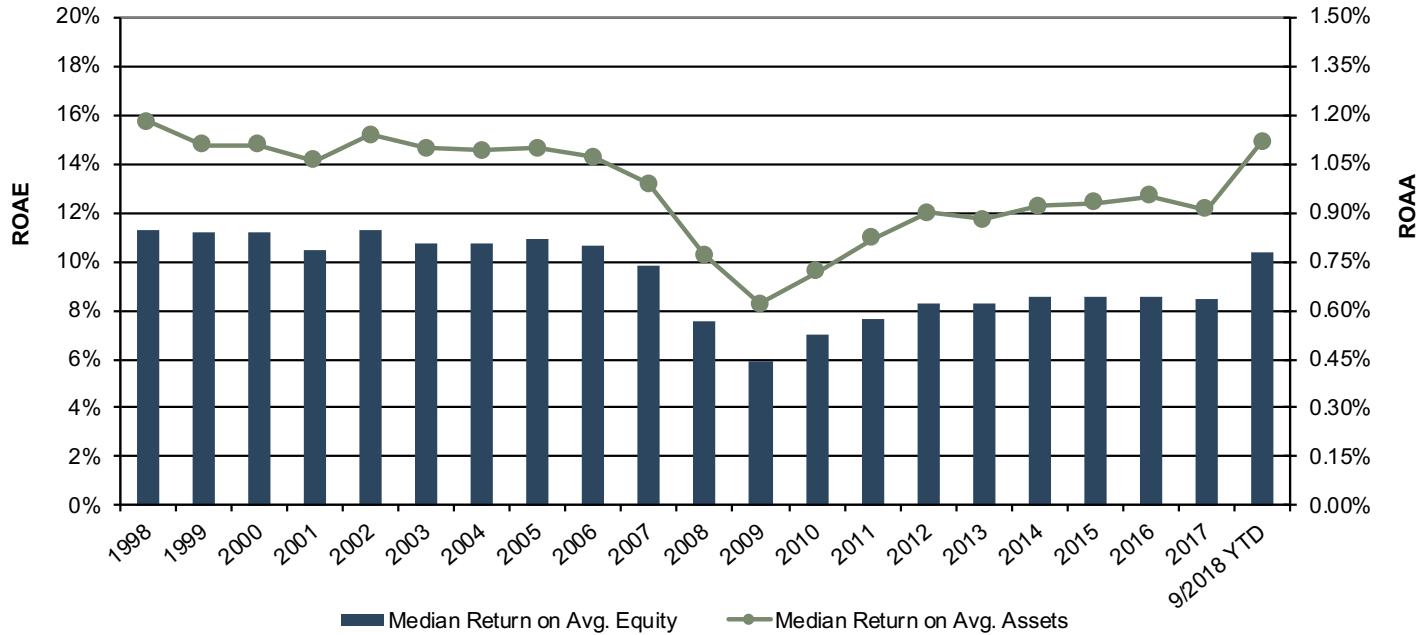
SECTION 1

It Is an Exciting Time to Be a Community Bank!



Community Bank Earnings Are Improving...

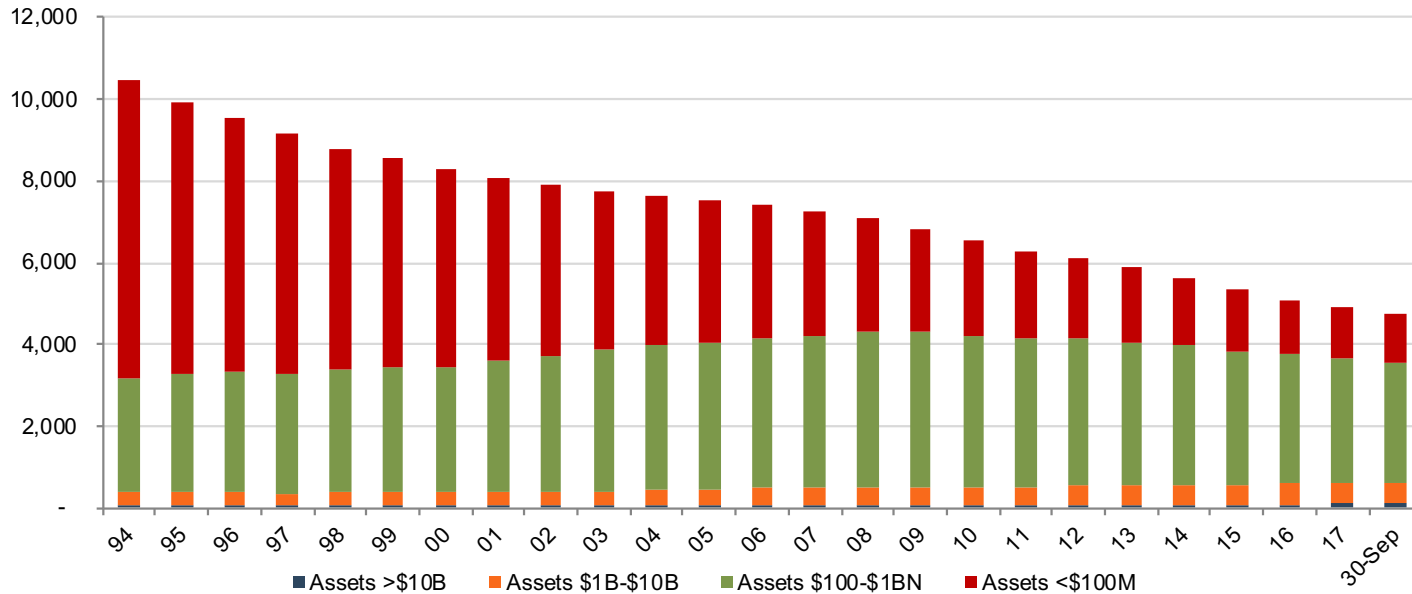
Community Bank Industry Profitability Trends



Source: Mercer Capital Research and S&P Global Market Intelligence

As the Number of Banks Contract...

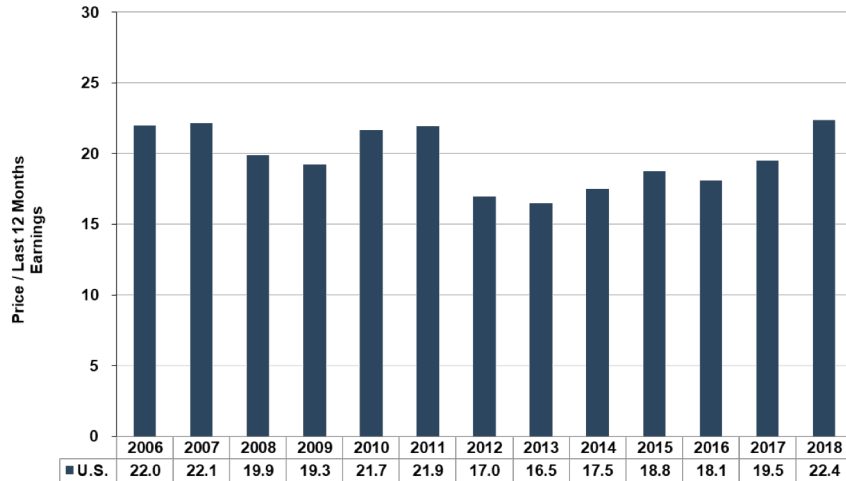
Number of U.S. Banks



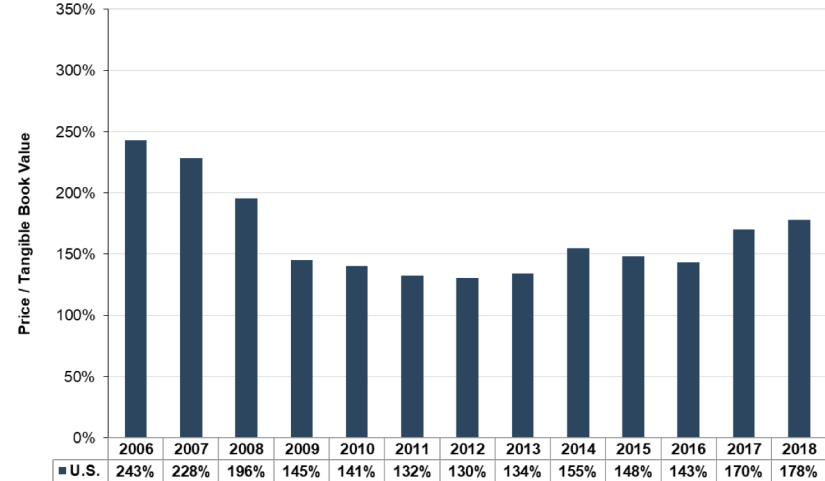
Source: QBPR, www.fdic.gov

M&A Valuations Have Improved...

Community Bank M&A Trends
P/E Multiples



Community Bank M&A Trends
P/TBV Multiples



Source: Mercer Capital Research & S&P Global Market Intelligence

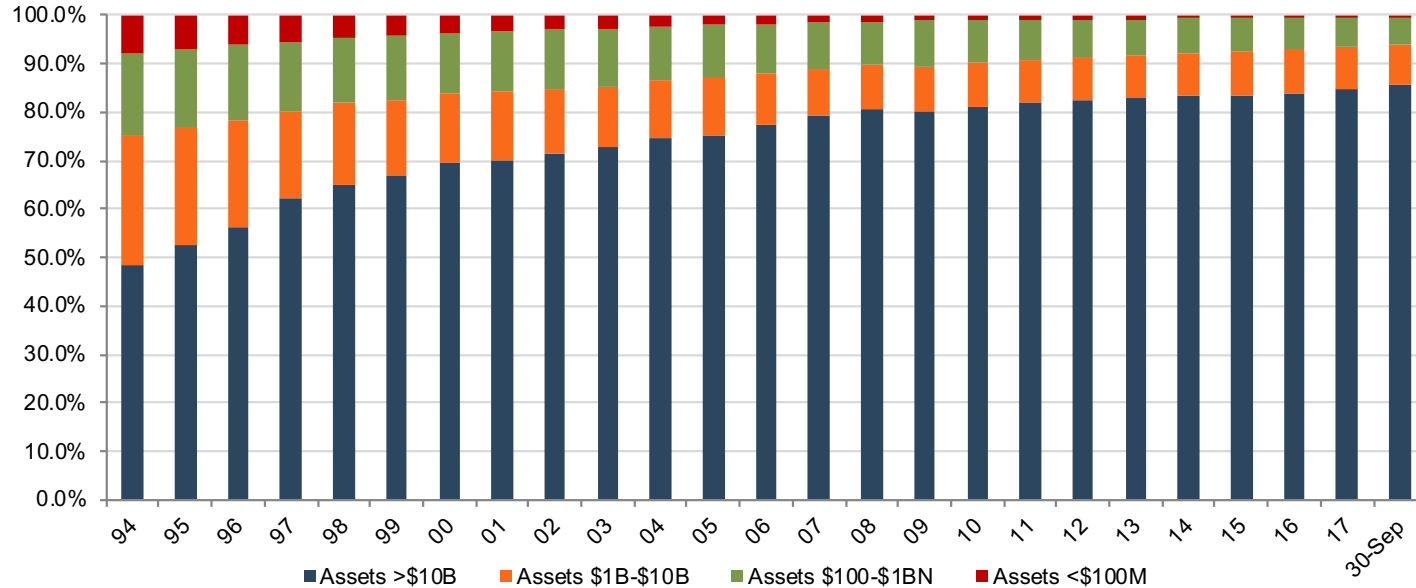
SECTION 2

But Why Do Large Banks Outperform?



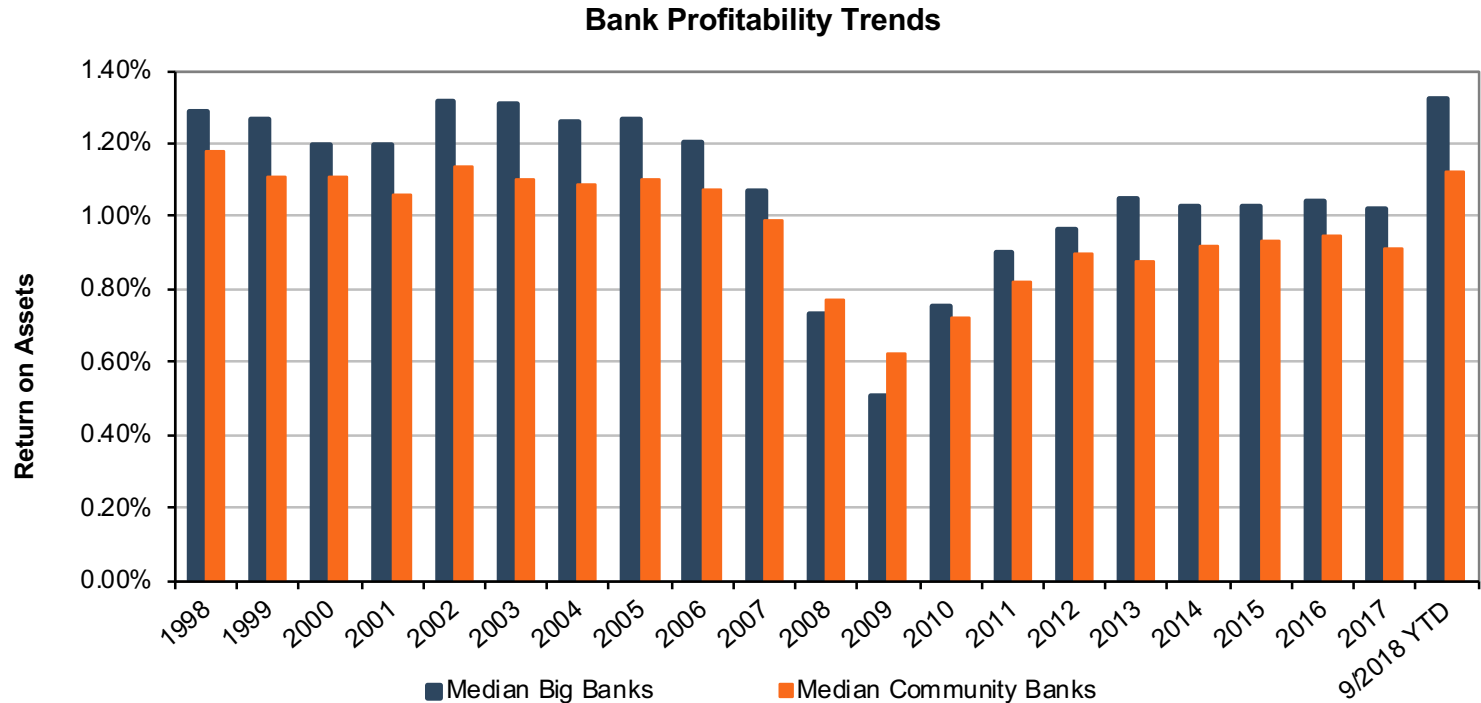
Larger Banks Hold Rising Market Share, and...

Percentage of Total Assets



Source: QBPR, www.fdic.gov

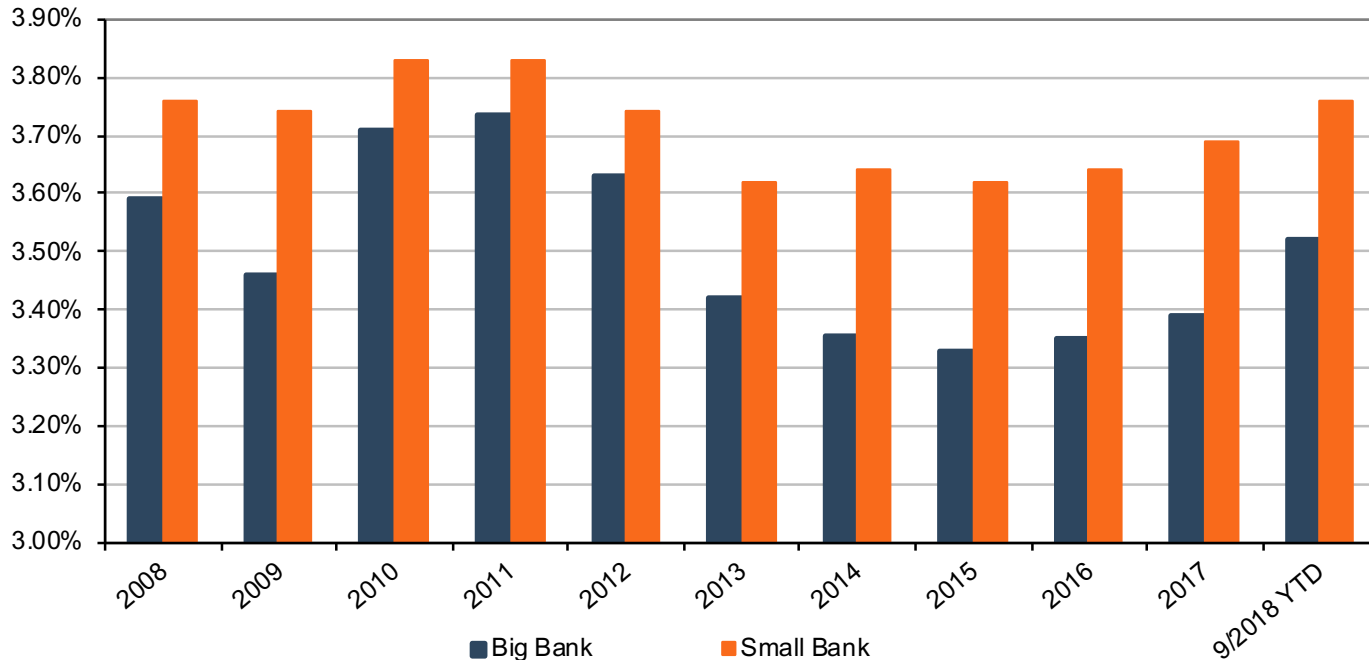
Are More Profitable...



Source: Mercer Capital Research and S&P Global Market Intelligence | Big Banks are Assets Greater than \$5BN and Community Banks are \$100M-\$5BN

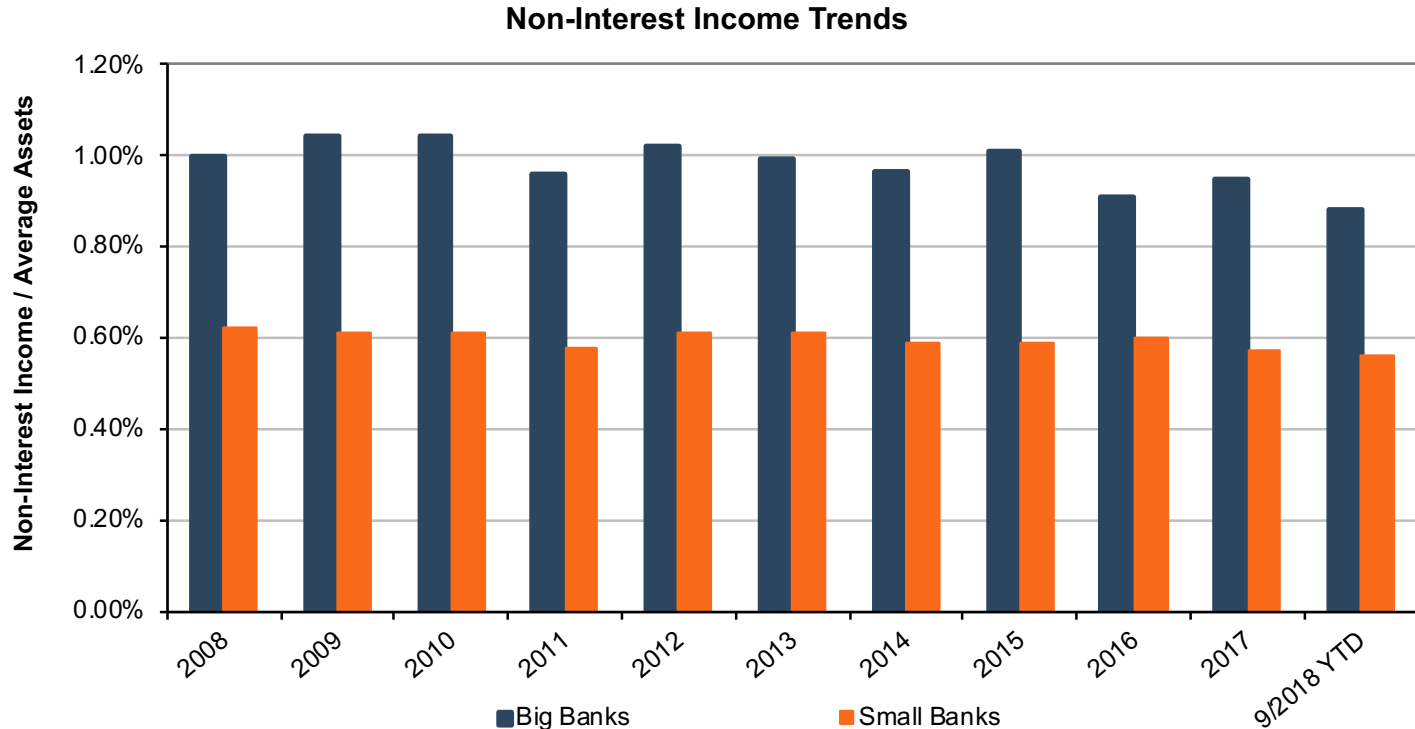
Why Do Large Banks Outperform?

Trend in Net Interest Margin



Source: Mercer Capital Research and S&P Global Market Intelligence | Big Banks are Assets Greater than \$5BN and Community Banks are \$100M-\$5BN

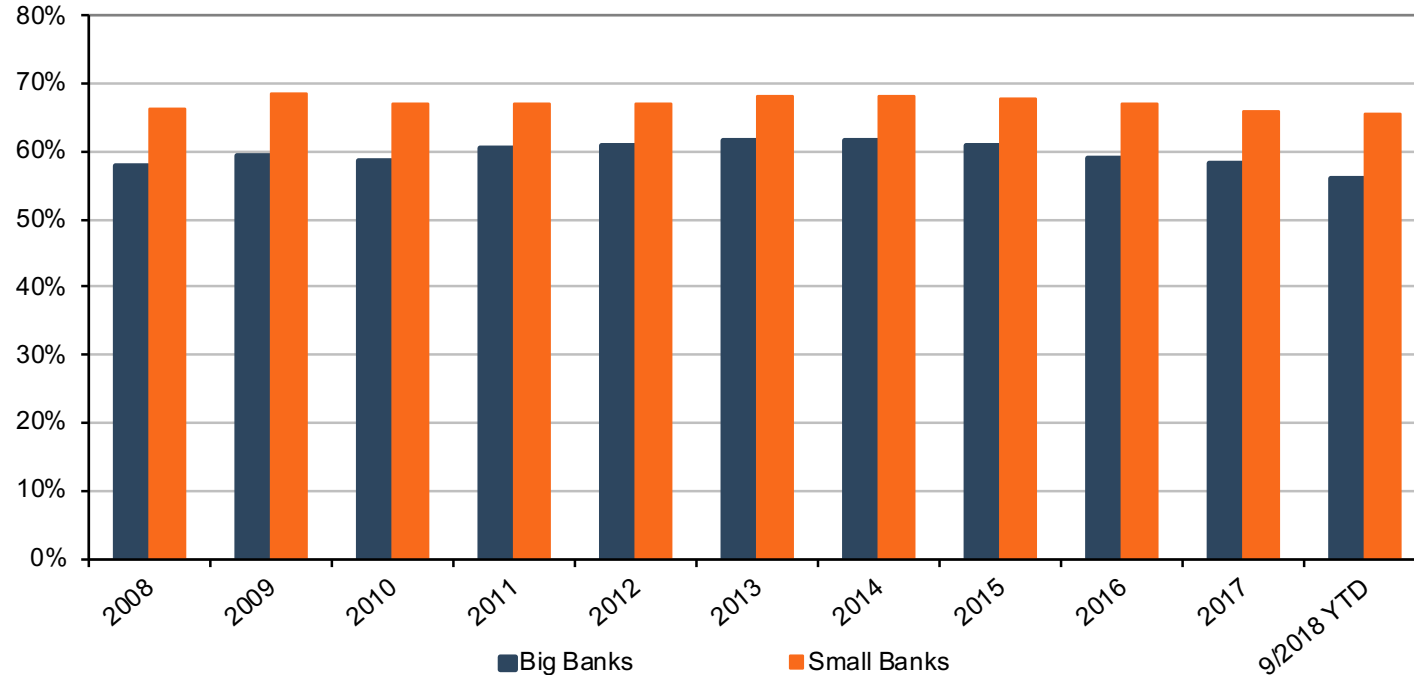
Why Do Large Banks Outperform?



Source: Mercer Capital Research and S&P Global Market Intelligence | Big Banks are Assets Greater than \$5BN and Community Banks are \$100M-\$5BN

Why Do Large Banks Outperform?

Trend in Efficiency Ratio



Source: Mercer Capital Research and S&P Global Market Intelligence | Big Banks are Assets Greater than \$5BN and Community Banks are \$100M-\$5BN

Big Banks Invest Heavily in Technology...

Large and small banks spend a comparable amount on technology (~4-5% of revenues or 0.20% of assets)

The aggregate spending is starkly different, though

- For example, the largest publicly traded banks (assets over \$10 billion) spent over \$17 billion on technology in 2017, as compared to \$39 million spent by publicly traded community banks with assets between \$500 million and \$1 billion (per SEC filings)

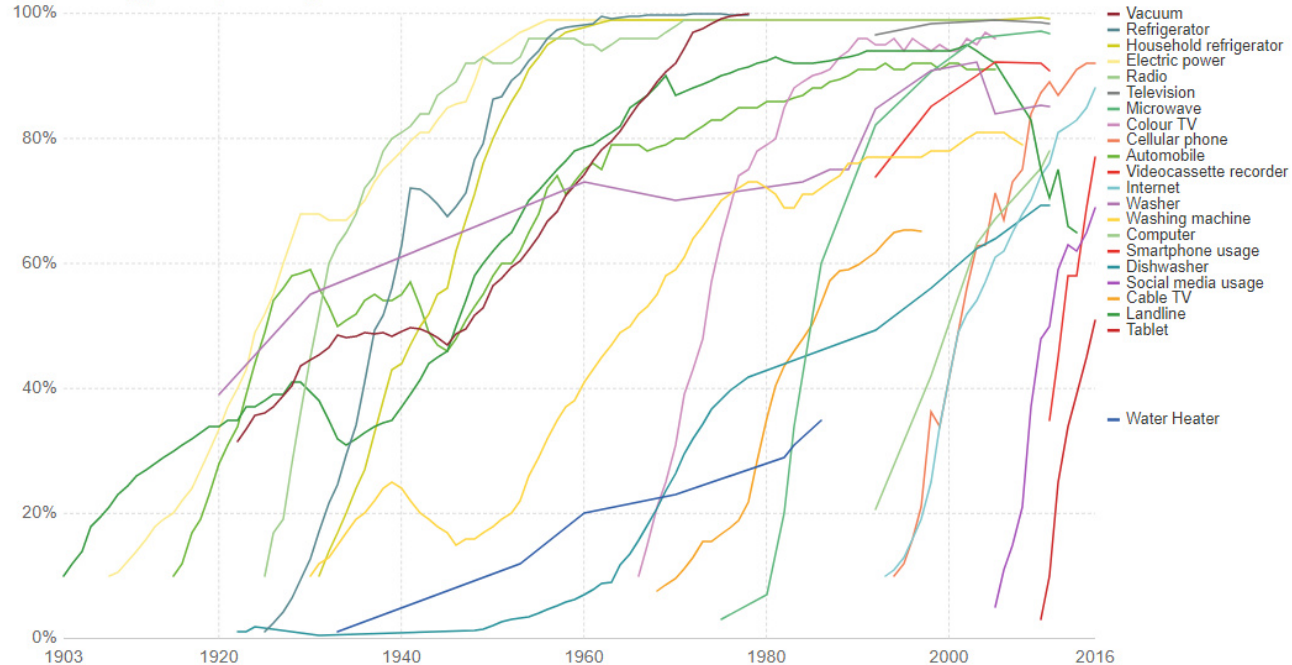
Additionally, the largest banks have announced a combination of FinTech strategies

- Developing technologies in-house
- Partnering with, investing in, or acquiring FinTech companies
- Funding accelerators to advance FinTech products

In 2018, JPM announced a successful a digital bank pilot and ensuing national rollout, Goldman announced expansion of its Marcus platform to the UK, and Citi announced a digital-only bank

Technological Adoption Is Increasing at a Rapid Pace...

Technology adoption by households in the United States



Source: <https://www.visualcapitalist.com/rising-speed-technological-adoption/>



SECTION 3

How FinTech Can Create Strategic Value

How FinTech Can Help Create Strategic Value

Enhance Customer Satisfaction and Reduce Cost (i.e., improve efficiency)...

Costs to Service Deposits	\$4.00
Costs to Service Digital Deposits	\$0.15
<i>Difference</i>	<u>\$3.85</u>
<i># of Deposit Accounts</i>	20,000
<i>Transactions Shifted to Mobile/Month</i>	2
Pre-Tax Cost Savings Per Month	\$154,000
Pre-Tax Cost Savings to the Bank	<u>\$1,848,000</u>

Source: Creating Strategic Value Through Financial Technology

How FinTech Can Help Create Strategic Value

Valuation Multiple Expansion...

Holding size constant, higher multiples observed for banks with lower efficiency ratios, higher non-interest income, and above average technology spending

Is your bank a “triple-threat” bank? If not, how can you get there?

	National Community Banks	Community Bank Peer Group Subset			
		Higher Fee Income ^[1]	Low Efficiency Ratio ^[2]	Higher Tech Spending ^[3]	"Triple Threat" Banks ^[4]
Price / 2019 (E) EPS	10.9x	11.4x	10.7x	11.5x	12.2x
Price / Tangible BV	137%	145%	152%	145%	183%

Median Valuation Multiples as of December 31, 2018

^[1] High fee income banks have non-interest income > 1% of average assets in the last twelve months period

^[2] Efficiency ratio < 65% in the last twelve months period

^[3] Technological expenses > 0.20% of average assets in the last twelve months period

^[4] "Triple Threat" community banks meet all three criteria: High Fee Income, Low Efficiency Ratio, and Higher Tech Expenses

Source: Mercer Capital Research & S&P Capital IQ Market Intelligence

Themes from the “Triple Threat” Banks

“Niches to Riches”

- Most, if not all, of the banks developed one or more differentiated niches
 - Wealth management / trust
 - SBA / small business lending
 - Equipment financing / leasing
 - Industry-specialized commercial banking
 - Mortgage
 - Insurance
- Many augmented their particular specialization with relevant FinTech products

Themes from the “Triple Threat” Banks

Several executed FinTech initiatives/strategies:

- ***Esquire Financial Holdings, Inc. (ESQ)*** announced a partnership with Base Commerce, a technology-driven payment processing company, and a partnership/investment in Litify, a technology solution for automating law practices
- ***Citizens & Northern Corporation (CZNC)*** was one of twelve members of the Alloy Labs Alliance, a platform for banks to collaborate with FinTech start-ups

How to Develop a FinTech Framework

1. Evaluate the bank's existing strategic plan
2. Identify FinTech companies
3. Develop a business case
 - Examine buy, build, or partner (and possibly invest) alternatives
 - May use capital budgeting tools, as for other capital expenditures
4. Execute optimal strategies

Step 1. Strategic Plan Review

Why consider FinTech?

1. Keep up with competitors
2. Complement or enhance existing services
3. Offer entirely new services, target a new market, or expand to different customer segments
4. Reduce back-office costs and improve efficiency

SWOT

Strengths

FinTech products that build a “moat” around the bank’s strengths

Weaknesses

FinTech products that address weaknesses

Opportunities

FinTech products that seize identified opportunities

Threats

FinTech products that forestall erosion of existing revenues or customers

Step 1. Strategic Plan Review

Most community banks cannot compete with large banks in terms of branch counts and retail footprint

FinTech investments should cohere with the bank's competitive posture. For example, does the bank emphasize retail or commercial customers?

Community banks distinguish themselves via the customer experience. How can FinTech enhance this advantage?

FinTech Ideas for Retail or Commercial Strategies

Retail Emphasis

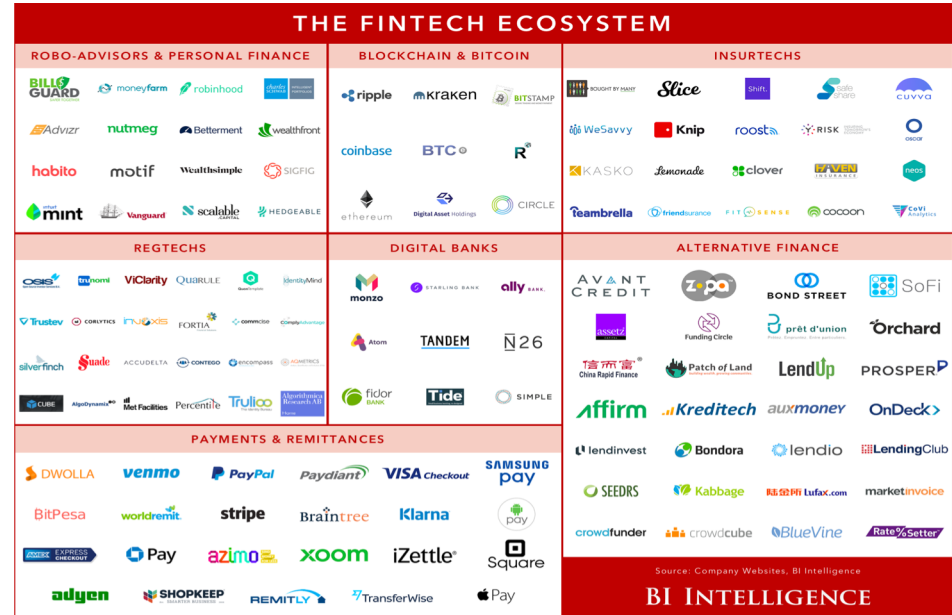
1. Small dollar consumer lending
2. Online account opening and on-boarding
3. Personal financial management
4. Automated savings and investment
5. Online residential mortgage

Commercial Emphasis

1. Underwriting efficiency and turn-around times
2. Business cash flow forecasting and management
3. Accounting, budgeting, and payroll tools
4. Payments
5. Small dollar C&I lending

Step 2. Identify FinTech Companies

Many FinTech companies are focused on areas where community banks have historically underperformed: efficiency and non-interest revenues...



Source: "The Future of Financial Services and Technology Explained," BI Intelligence, April 7, 2016
<http://www.businessinsider.com/fintech-ecosystem-financial-technology-explained-2016-3>

Step 3. Develop a Business Case

How does the bank currently make capital expenditure decisions?

- For example, how does the bank decide to construct a branch in a new location?

In a sense, FinTech is just another CapEx decision

For example, compare the cost of the FinTech investment to:

1. The profits generated from a product expansion
2. The profits protected from offering a product delivered by competitors
3. The costs saved from operating more efficiently

Step 3. Develop a Business Case

“Capital budgeting” techniques can range from the simple to complex

- **Simple:** Payback period on investment
- **Complex:** Rank ordering of various alternatives based on their potential returns on investment and related risk

FinTech strategies also offer innumerable potential structures

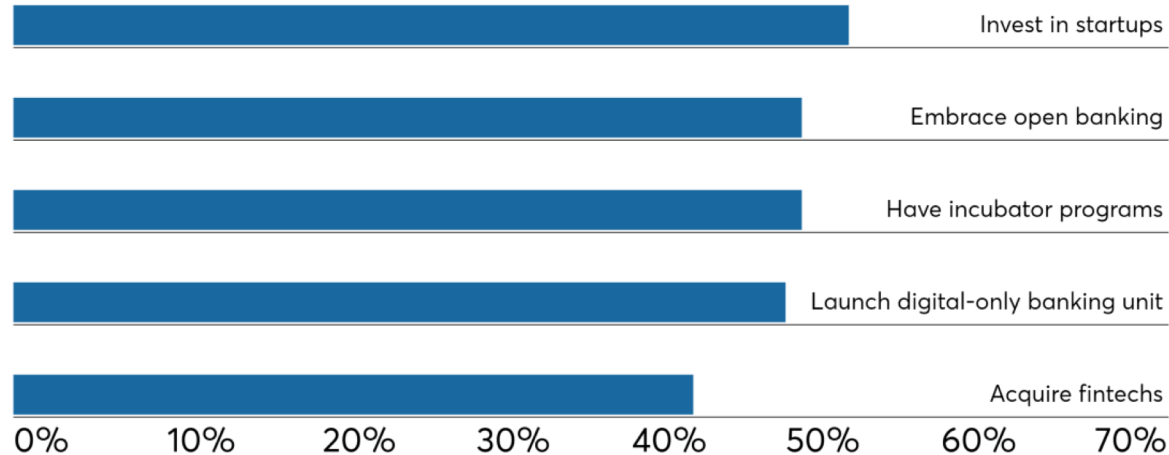
- **Vendor Relationship:** Bank buys a product from FinTech
- **Partner Relationship:** Greater integration with FinTech & potential ownership
- **Investor Relationship:** Bank takes a stake in FinTech & shares upside

SECTION 4

FinTech Case Studies for Community Banks

How Are Banks Approaching FinTech?

Asked how they are spurring innovation at their banks, executives in a survey were split between nurturing in-house projects or acquiring young fintechs



Source: The Economist Intelligence Unit

Source: "How the build-or-buy debate in bank tech is evolving," by American Banker, January 8, 2019
<https://www.americanbanker.com/news/how-the-build-or-buy-debate-in-bank-tech-is-evolving>

Radius Bank: Examples of FinTech Partners

Bottom Line Technologies	Offers e-payment, invoice, and document automation solutions
Level Up & NYC Currency Exchange	Shared deposit ATM network to make deposits and withdrawals at ATMs
Aspiration	High yield checking account through an online investment firm
Prosper	Personal loans between \$2-\$35 thousand
Alloy	Uses an API to automate account opening and manage identity verification through customer lifecycle

CBW Bank: Examples of FinTech Partners

Yantra	Develops banking and electronic payment systems
Moven	Mobile banking app that lets consumers bank remotely
Ripple	Facilitates a real-time settlement system, currency exchange, and remittance network
Omney	Provides instant payment capabilities to large enterprise clients

Nbkc Bank: Examples of FinTech Partners/Initiatives

Established an Accelerator (Fountain City FinTech)	Accelerator provides early access to FinTech companies/solutions; FinTechs receive seed capital and tap bank executives' expertise
ProPair	An AI company that connects mortgage leads to lending staff
Track	Assist self-employer workers with tax preparation
Greenlight Financial Technology	Provides a smart debit card for kids and young adults that parents manage from their phones

Potential FinTech Partners

P2B Investor	Launched a partnership program in 7/18; offers crowdsourced, asset-secured lines of credit to growing companies
SmartBiz	Helps banks process SBA loans more efficiently by reducing the complexity and cost of origination, compliance, underwriting, and application
Bolts Technologies	Developed a new account opening system
Autobooks	Fully integrated payments and accounting platform for small businesses that is delivered through a bank's online banking platform; cloud-based account platform
BillGo	B2B payments engine where customers can send invoices and receive payment more quickly

Potential FinTech Partners

AbeAI	Makes AI powered conversational banking software for banks to engage and support customers
Cline	Implements AI with Alexa, allowing customers to have real-life conversations with a chat-bot and ask questions about personal budgeting or finances
Insuritas	Provides a digital insurance agency solution for financial institutions
Meed	Provides mobile banking solutions that offer services such as instant money transfers, savings goals, secured credit, life insurance, bill pay, and checking
Maluzai	Provides digital banking solutions for community financial institutions

Potential FinTech Partners

Biz2Credit	Provides an analytics and technology platform to process small business loans
Fundation	Digital small business lending software provider
RC Giltner	Provides a digital consumer lending, digital small business lending, and mobile overdraft product suite
Numerated	Small business lending software
LendingFront	Small business lending software

FinTech Partnership Examples: Wealth Management

Personal Capital	Started in 2009, this robo-advisor announced a partnership with AlliancePartners to offer its digital wealth management platform to approximately 200 community banks
Marstone	An enterprise FinTech, enabling community banks to launch a branded digital advice/wealth management platform

Other robo-advisory partnership examples involving larger financial services companies include:

- UBS / SigFig
- Wells Fargo / SigFig
- RBC / Future Advisor
- BBVA Compass / LPL
- JP Morgan / Motif

SECTION 5

FinTech M&A & Valuation Trends

Early Stage FinTechs

Due Diligence / Valuation Considerations for Partnerships & Investments

Early stage FinTech company valuations should consider many factors, including:

- Market characteristics and potential impact
- Management team
- Intellectual property and intangible assets
- Stages of development and milestones completed
- Regulatory considerations
- Potential exits and timeline to potential exits

FinTech Trends – Funding

Strong U.S. FinTech Funding Activity in 2018

\$14.2 billion invested in U.S. FinTechs in 1H18 across 427 deals

Larger deals/fundings occurred across several subsectors:

- Blockchain (Circle Internet)
- Crypto (Basis)
- Insurtech (Lemonade)
- Wealth management (Robinhood)
- Payments

Niches to watch going forward include: blockchain, regtech, insurtech, and AI

Two notable FinTech IPOs in 1H18 as well: Evo Payments and GreenSky

Source: KPMG Pulse of FinTech

U.S. FinTech Unicorns

Company	Reported Valuation	Brief Description
Stripe	\$9.2 billion	Payment processing helping businesses accept credit cards online
SoFi	\$4.4 billion	Online lender focused on refinancing student loans and mortgages
Credit Karma	\$3.5 billion	Credit score/reporting/monitoring
Circle	\$3.0 billion	Cryptocurrency investment platform
Oscar	\$2.7 billion	Health insurance company selling plans on a user-friendly digital interface
Avant	\$ 2.0 billion	Personal loan company using mix of AI and consumer data to establish interest rates for customers
Apptus	\$1.9 billion	Uses AI to make sales contract process more efficient
Coinbase	\$1.6 billion	Cryptocurrency exchange
Toast	\$1.4 billion	Restaurant POS and management software system
Avidxchange	\$1.4 billion	Enterprise tech company that offers A/P and invoice management services
Robinhood	\$1.3 billion	Discount online stock brokerage
Kabbage	\$1.3 billion	Automated lending platform for small businesses; Lent more than \$3.5 BN since launch
Clover Health	\$1.2 billion	Health insurance company
Brex	\$1.1 billion	Corporate credit cards for startups
Tradeshift	\$1.1 billion	Open-source trade platform
Total	\$37.1 billion	

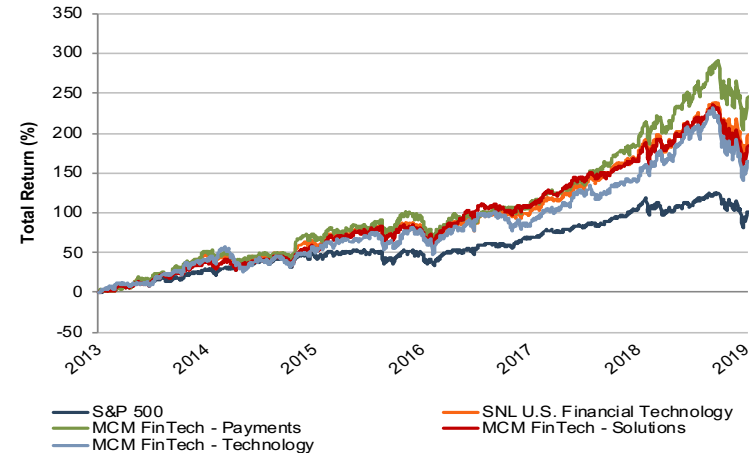
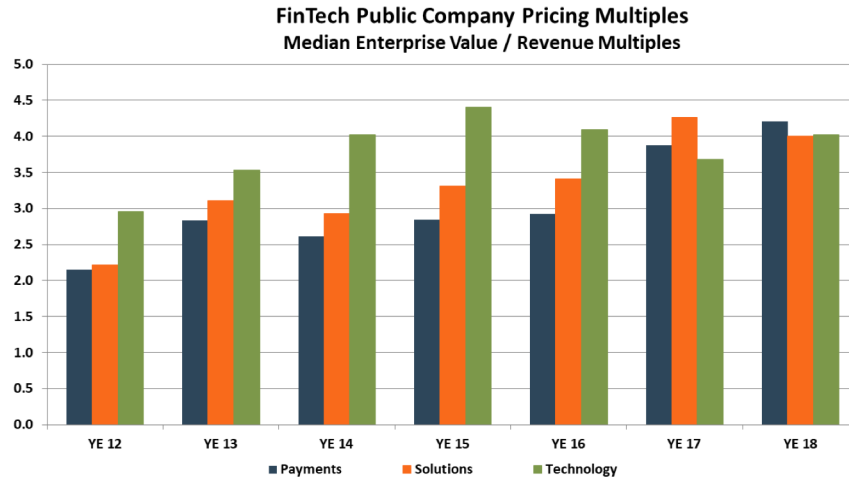
Sources:

<https://www.inc.com/business-insider/fintech-unicorn-startups-most-valuable-clover-health-stripe-coinbase-sofi-robinhood-oscar.html>

<https://www.inc.com/business-insider/35-us-tech-startups-that-reached-unicorn-status-in-2018.html>

FinTech Trends – Public Markets

FinTech returns outpaced broad market and bank indices
Expanding valuation multiples for U.S. FinTechs



Source: Mercer Capital Research and S&P Global Market Intelligence

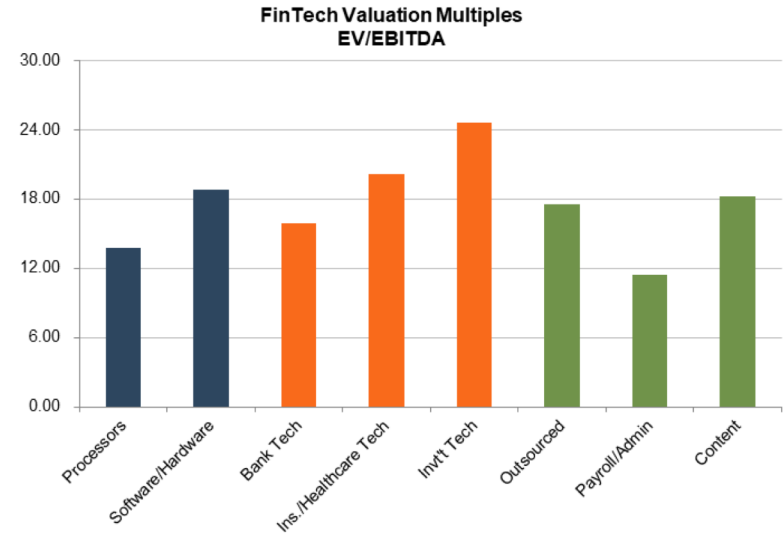
FinTech Trends – Public Markets

Multiples vary across FinTech sectors but generally exceed broader market

Valuation Multiples as of December 31, 2018

Segment	Price/ LTM EPS	Price / 2019 (E) EPS	Ent'p Value / LTM EBITDA	Ent'p Value / FY19 (E) EBITDA	Ent'p Value / LTM Revenue
FinTech - Payments	29.5	19.9	15.6	13.1	4.2
FinTech - Solutions	28.0	22.0	17.6	13.7	4.0
FinTech - Technology	37.1	27.8	20.0	16.2	4.0

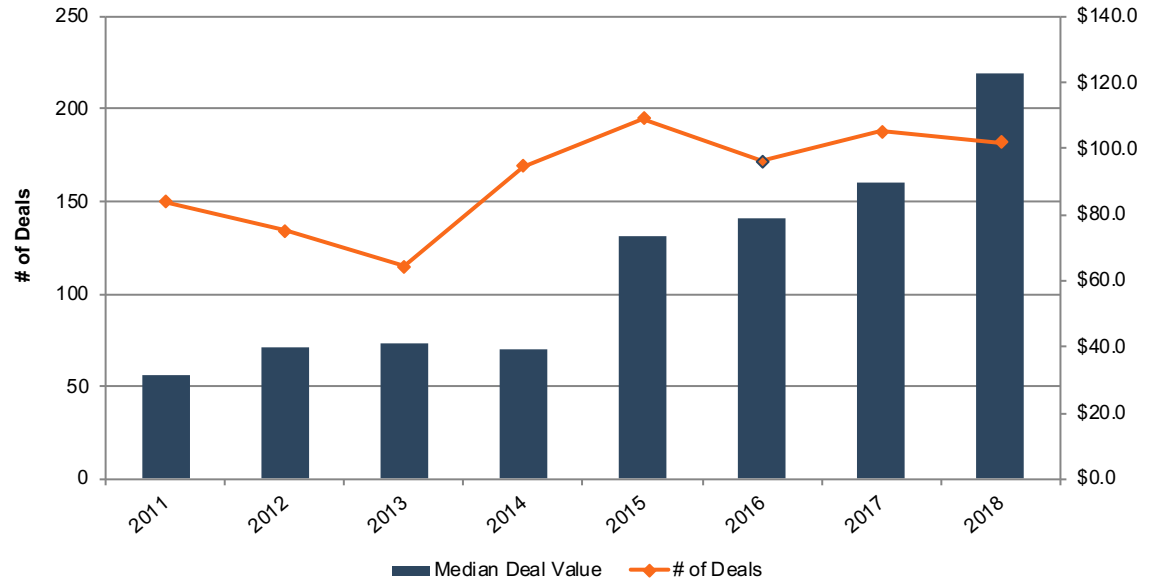
Source: Mercer Capital Research and S&P Global Market Intelligence



FinTech Trends – M&A Overview

Activity (# of deals) has been stable since 2014; however, deal size has increased

U.S. FinTech M&A Overview 2011 - 2018



Source: Mercer Capital Research and S&P Global Market Intelligence

FinTech Trends – M&A Overview

Valuations have trended higher as larger exits have occurred

Deal Activity By FinTech Industry Niche	2016	2017	2018	% Chg. 17 / 18
Payments Total	35	44	39	-11%
Technology Total	106	104	92	-12%
Solutions Total	53	40	51	28%
Median Pricing Metrics				
Deal Value / Revenue	2.3x	3.1x	4.1x	30%
Number of Deals with Deal Values Greater Than:				
\$ 1 Billion	3	4	15	275%
\$500 Million	6	9	17	89%
\$50 Million	29	38	42	11%

Source: Mercer Capital Research and S&P Global Market Intelligence

What You Can Do Now

- Get educated
- Integrate FinTech strategy into your strategic plan
- Determine what your customers want/need
- Identify potential FinTech partners
 - Reach out to them and begin due diligence/discussions



What We've Covered Today

- Community banks are facing improved but challenging conditions
- Large banks do outperform community banks, but there is hope
- FinTech can narrow the performance gap with larger banks and create strategic value for community banks
- How to develop a FinTech framework and examples of FinTech strategies/partnerships
- Trends in U.S. FinTech trading markets and M&A activity

How Mercer Capital Can Help

To help banks and FinTech companies develop optimal strategies and create value for shareholders, Mercer Capital offers a number of solutions. We authored a book that describes the history and outlook for the FinTech industry and contains targeted information that answers bankers key strategic questions.

Mercer Capital has a long history of working with banks. We are aware of the challenges facing community banks. With ROEs for many banks below 10% and their cost of capital, delivering adequate shareholder returns is difficult despite low credit costs. Delivering both high service to the community and strong shareholder returns presents a difficult challenge. Confronting the challenge requires combining the right strategy with the right team to execute that strategy.

Mercer Capital can help craft a comprehensive value creation strategy that properly aligns your business, financial, and investor goals. Given the growing importance of FinTech solutions to the banking sector, a sound value creation strategy needs to incorporate FinTech. Mercer Capital can help.

- We provide board/management education regarding the opportunities and challenges FinTech presents for your institution
- We help your bank identify appropriate FinTech niches given the bank's market opportunities
- We help your bank identify FinTech companies offering the greatest potential partnership opportunities
- We provide valuation assistance regarding investments in or acquisitions of FinTech companies

No one understands community banks and FinTech as well as Mercer Capital. We are happy to help. Contact us at 901.685.2120 to discuss your needs.

Questions?

Thank you for attending today's session



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