

2022 Acquire or Be Acquired

# A Primer on a Growing Breed of Bank Acquirers

Credit Unions & FinTech Companies

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# Outline for Today's Presentation

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1

Background & Why the Emerging Trend?

2

Overview of Key Valuation Considerations

3

Overview of Key Legal/Structural Considerations

4

Takeaways from Recent Transactions

5

Questions & Answers

# Background & Key Reasons for the Trend?

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## SECTION I

# Background on the Trend

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While still making up a small proportion of overall deal activity (<10% of total deal volume in 2021), acquisitions of banks by both CUs and FinTechs have been increasing in recent years

The first credit union to acquire a bank occurred in 2011/12

Since then, approximately ~55 whole bank transactions have been announced with the peaks occurring in 2019 (14 transactions) and 2021 (13 transactions announced).

The first announced FinTech acquisition of a bank was Green Dot's purchase of a small bank back in 2010 for \$15 million. There were also several online brokers that acquired banks from the late 90's to mid-2000s. In 2021, there was a marked increase with six announced transactions whereby FinTechs announced acquisitions of banks.

This emerging breed of bank acquirers (CUs and FinTechs) provides bank sellers with an additional pool of potential buyers to consider when evaluating strategic options and liquidity events.

## Why is this trend emerging?

# Strategic Considerations

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## For Credit Unions

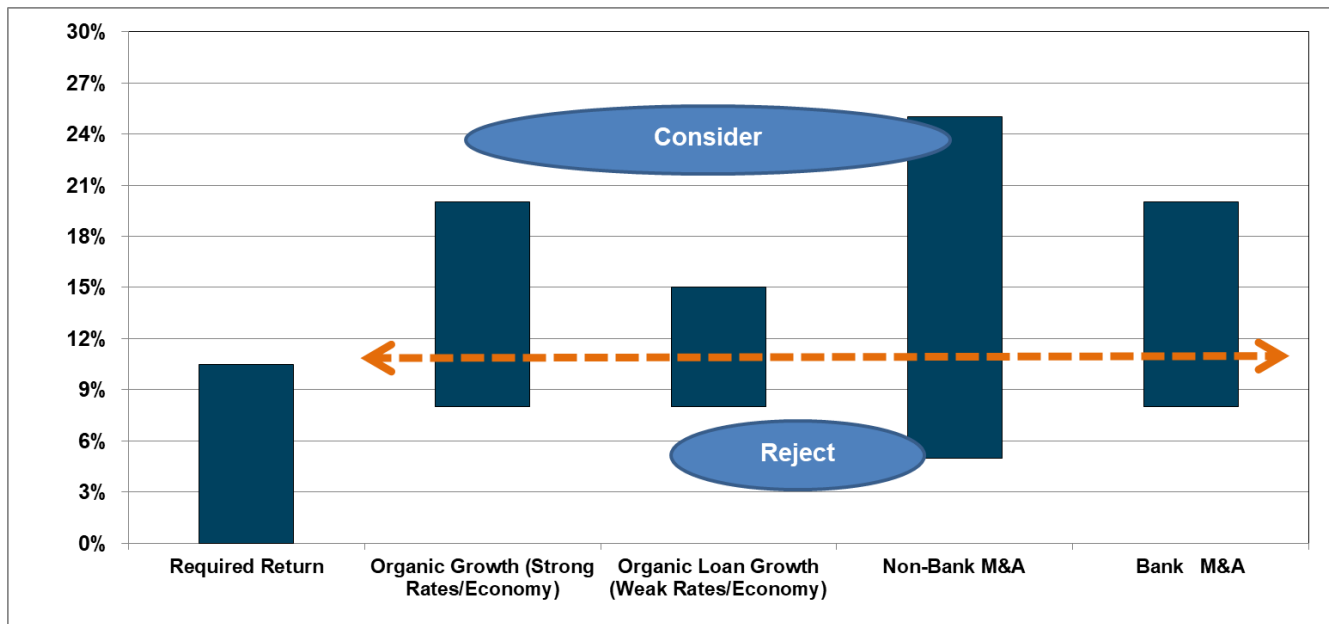
- Market Growth / Expansion
  - Organic growth alone can be challenging and slower vs. acquisition
- Loan Portfolio Diversification & Expansion
- Enhanced Scale / Efficiency
- Defensive - In Response to Perceived Threats from FinTech and Larger Banks

## For FinTechs

- Market Growth / Expansion – Acquire Customers & Scale
- Bank Charter – may be part of business plan, need to access deposits, payment rail networks or Fed's discount window
- Deposits – find stable source of funding and eliminate revenue share or payment to bank partner

# Financial Considerations

Generate a Solid Return on Investment



# Market/Industry Conditions

Will Continue to Drive M&A in 2022

Revenue/profitability pressures may intensify as mortgage and PPP cool

- NIM – pressured from rates at historically low levels
- Loan demand weak in some parts of country and price competition is intense
- Outsized mortgage and PPP income will fade and service charges are soft

Credit conditions are manageable/benign at present

FinTech / digital challenge accelerates

Aging depositor and shareholder demographics (for some)

Public banks valuation/pricing lifted in '21 relative to '20

Community bank M&A activity/pricing also lifted in '21 relative to '20 but still below 2018/2019 levels

***If bank stock prices perform reasonably well in 2022, then activity will probably trend higher***

# Positives to Bank Seller from This Trend

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Added interest from CUs & FinTechs expands pool of acquirers and has potential to broaden marketing process and increase demand for selling bank and ultimately price/proceeds

Typically, all cash (CUs) or predominately cash (FinTech) deals –

- Provides certainty of proceeds/liquidity to seller

Additionally, for transactions involving CUs:

- Retention of most, if not all, staff
- Most, if not all, branches remain open
- Communities remain an integral part of the business plan/mission for CU acquirers



# Overview of Key Valuation Issues

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## SECTION II

# Valuation Overview

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Every industry has a rule-of-thumb for valuation and a preferred valuation metric; most only indirectly speak to economics

Banking's metric is tangible (common) equity and the most widely quoted metric is P/TBV

But, equity per se is not the point; it is the base of the business model –what matters is the a) earnings stream; b) the risk profile of the business to produce the earnings; and c) expected growth over time

P/Es vary within the industry and are impacted by risk vs. growth considerations

- Low P/Es reflect riskier biz models, limited growth or lower quality earnings
- Above average P/E usually reflects better than average growth

Valuation approaches tend to include both a market approach (comp transaction multiples applied to subject bank) and an income approach (discounted cash flow model)

A reasonable valuation also considers both quantitative and qualitative factors

# Top Three Financial Considerations

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1. Developing a Reasonable Valuation Range for the Target

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2. Appropriately Consider the Strategic Fit/Earning Power of the Target

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3. Evaluating the Key Deal Metrics Implied by the Bank Acquisition

# Value Drivers

## Intrinsic (Investment) Value

### Return on Equity (ROE)

- Profitability (ROA)
- Leverage (Capital)

### Growth

- Organic (primary)
- Acquisition

### Earnings Multiple (P/E)

- Cost of Capital
- Long-term growth rate

## Deal Considerations

Employment agreements, vendor contract terminations, expense savings/synergies

## Franchise Value

Management (long-term execution)

Markets

Core deposits

Loan origination capacity

Loss history (yield less net charge-offs)

Operating leverage (ER)

Non-interest income (fee businesses)

## CU Specific Drivers

1. Geography/Markets
2. Assets/Liabilities
3. Employee Talent & Organization Capability
4. Leveraging CU products/services post-closing

# Earning Power Overview

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Earning power reflects an estimate of ongoing earnings through a full business/credit cycle

Earning power is derived from an analysis of core earnings over the past 3-5 years combined with an earnings forecast over the next 1-2 years

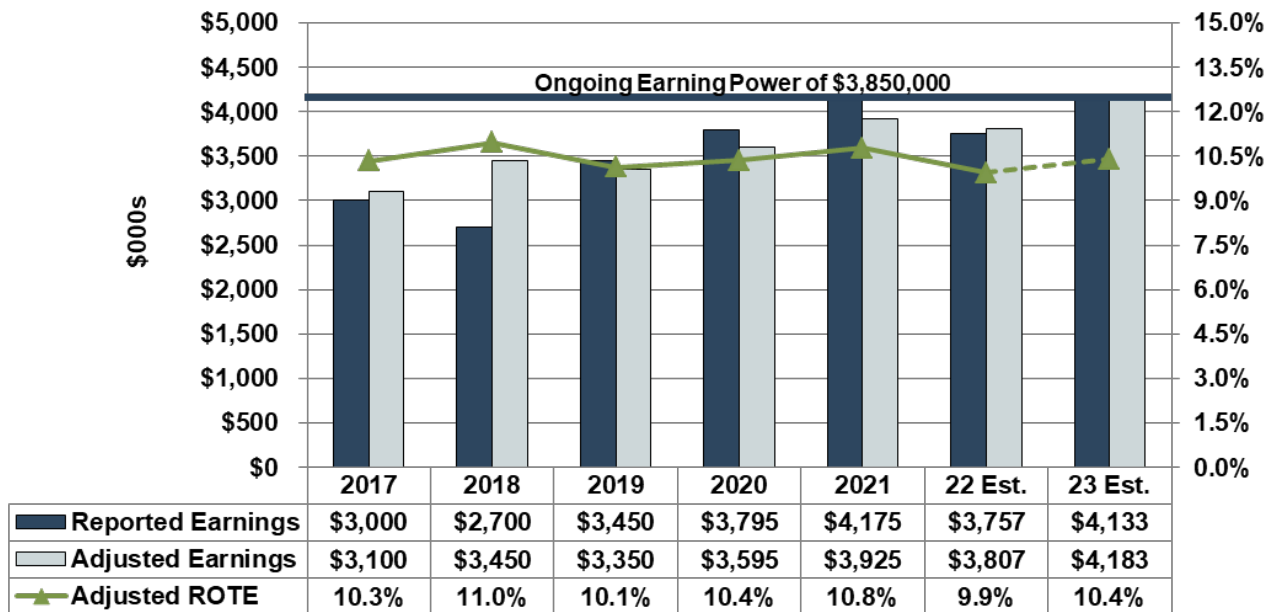
The most significant variables for a bank will be a) the expected range of credit losses; b) net interest margin (NIM); and c) volume of loans and core deposits

The challenge of estimating a bank's earning power is that credit losses tend to be episodic (i.e., very low for years then very big) and the current rate environment that devalues low cost deposits

In valuing a bank target, an additional challenge can be estimating cost savings/synergies and earning power inclusive and exclusive of synergies

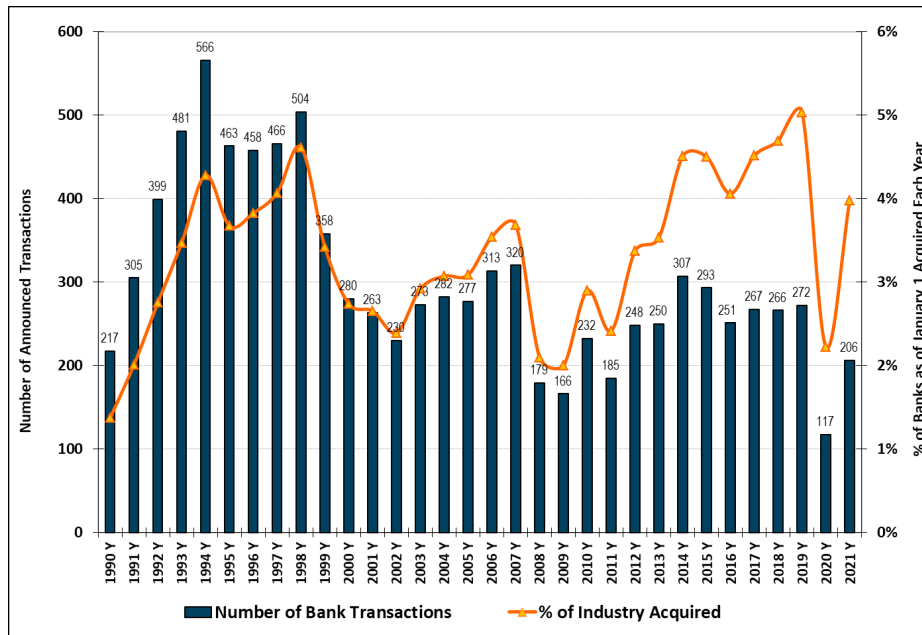
# Core Earning Power Example

Earnings Overview (\$000s)



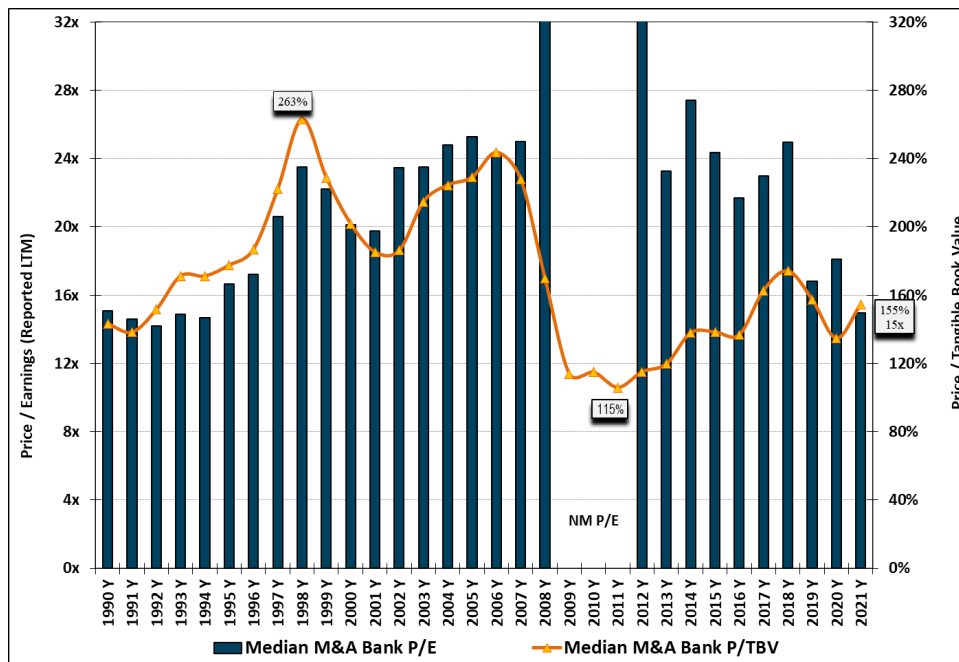
# Market Approach

Where Are We in the Cycle? Volumes and Activity Are Up in '21 Vs. '20' But Still Below Pre-covid Levels



# Market Approach

Pricing Reflects a Similar Trend with P/TBV Multiples Up in '21 Relative to '20 But Below '18/'19 Levels; P/Es Varied Over Time

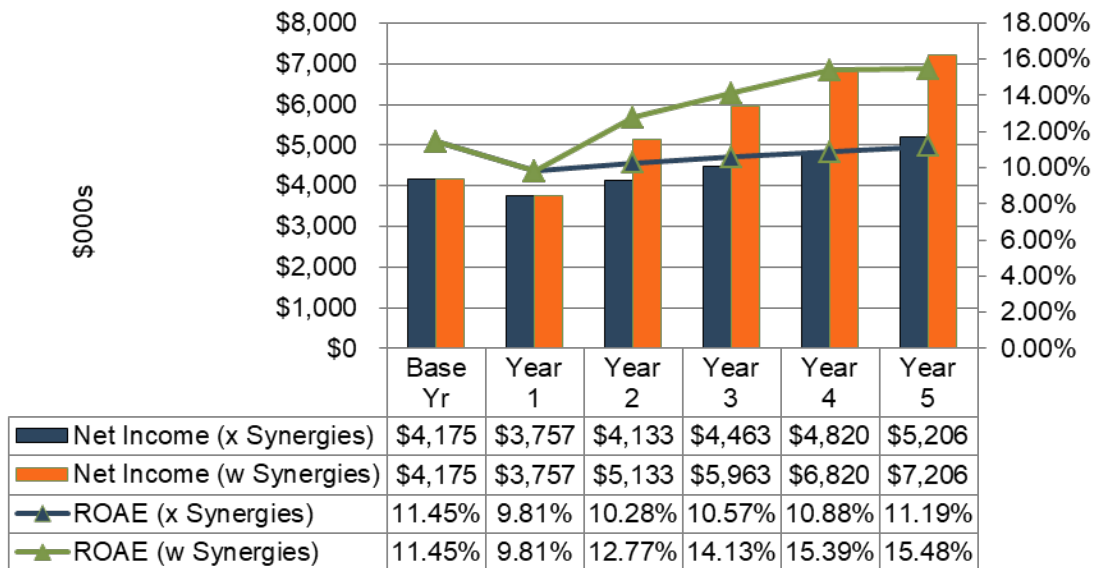




# Income Approach

Discounted Cash Flow Analysis Develops a Valuation Range by Considering Future Earning Power of Target

### Projected Income Statement Overview



# Typical Pricing Parameters

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**Pricing:** Consider multiples of earnings (with & without expense saves) and multiples of book value

**Expense Savings:** Still a primary factor but may be less for CU or FinTech acquirers than traditional banks as many CU/FinTech acquisitions are strategic, out-of-market deals

**Revenue Synergies:** Sometimes but may be more common with CU and FinTech acquirers than traditional bank acquirers

**Capital Dilution & Earn-Back:** Still a primary focus for CU acquirers but may be less so for FinTechs

**Internal Rate of Return:** Typically targeted to be comfortably above the acquirer's cost of capital (which may vary for FinTechs/CUs vs Banks)

**Capital/Net Worth:** Varies but often targeted to be at or above the 8-9% range for CU acquirers

# Overview of Key Legal Considerations

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## SECTION III

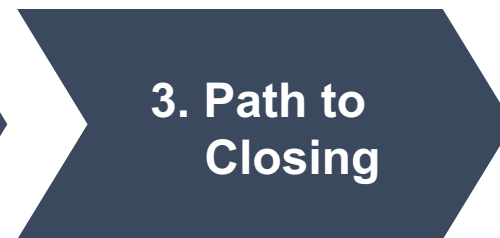
# Overview of Process



NDA (Non-Disclosure Agreements) Executed  
Formal Discussions Begin  
Preliminary Due Diligence  
LOI (Letter of Intent) In Place



Formal Due Diligence  
Formal Discussions Continue  
Board Approvals  
Definitive Agreement Executed



Regulatory Approval  
Closing

# Overview of Structure

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## Transactions Involving CUs

- Structured typically as an asset purchase whereby CU acquires majority of bank's assets and liabilities
  - Mergers are possible in some states
- May be some discussion around particular assets and liabilities that can't or won't be acquired

## Transactions Involving FinTechs

- Varies

# Top Legal Considerations

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Safety and Soundness

Customers/Field of Membership

Impermissible Assets

# Takeaways from Recent Transactions Involving CU and FinTech Acquirers

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## SECTION IV

# Credit Union Acquirers

## Overview of Announced CU Acquisitions of Banks in 2021 (U.S.)

Deal Announcement	Buyer	Target	Deal Summary Highlights				
			Deal Value (\$000)	P/E (x)	P/TBV (%)	Target Assets (\$000s)	Target LTM ROE (%)
1/25/2021	Wings Financial CU	Brainerd S&L Association	NA	NA	NA	\$70,298	-0.3
3/31/2021	VyStar CU	Heritage Southeast Bancorp.	\$194.4	43.6	183.5	\$1,571,190	3.2
5/25/2021	GreenState CU	Oxford Bank & Trust	NA	NA	NA	\$759,350	17.9
5/25/2021	GreenState CU	Premier Bank	NA	NA	NA	\$383,298	10.5
6/16/2021	Lake Michigan CU	Pilot Bancshares Inc.	\$99.9	12.3	187.0	\$656,023	16.4
8/5/2021	Alabama CU	Security FSB	\$7.0	NA	151.5	\$38,989	-1.1
8/11/2021	Orion FCU	Financial Federal Bank	NA	NA	NA	\$751,177	14.9
8/12/2021	Royal CU	Lake Area Bank	NA	NA	NA	\$438,392	27.7
8/19/2021	FAIRWINDS CU	Citizens Bank of Florida	NA	NA	NA	\$491,657	9.3
8/20/2021	Scott CU	Tempo Bank	\$14.3	10.3	135.8	\$92,895	14.4
9/30/2021	Dupaco Community CU	Home SB	\$36.2	48.0	197.5	\$182,680	4.2
10/25/2021	GreenState CU	Midwest Community Bank	NA	NA	NA	\$367,092	67.0
12/17/2021	Avadian CU	Citizens State Bank	NA	NA	NA	\$85,407	6.8

Source: S&P Global Market Intelligence



# Takeaways from Recent CU/Bank Transactions

1

A number of bank targets were larger, more profitable, and in bigger metros in 2021 relative to prior years where many bank targets of CUs were smaller, less profitable, and in more rural areas

2

Pricing/valuations for those announced transactions where info was available was largely in line with broader market

3

Structure continues to be predominately all cash, which is often viewed attractively by the selling bank

4

Still make up a small proportion of overall deal activity (~6% of total deal volume) but are growing in number (14 announced deals in '21 is the second highest, up from 2020 but below peak in 2019) and expanding to more states/regions

# FinTech Acquirers

## Overview of Recent FinTech Acquisitions of Banks (U.S.)

Deal Announcement	Buyer	Target	Deal Summary Highlights				
			Deal Value (\$000)	P/E (x)	P/TBV (%)	Target Assets (\$000s)	Target LTM ROE (%)
11/6/2018	Jiko Group Inc.	Mid-Central Federal Savings Bank	NA	NA	NA	\$115,449	7.3
2/18/2020	LendingClub Corp.	Radius Bancorp	\$188.3	35.4	179.5	\$1,390,254	4.1
3/9/2021	SoFi Technologies	Golden Pacific Bancorp	\$22.3	NA	152.3	\$151,515	-0.3
5/11/2021	M1 Finance	The First National Bank of Buhl	NA	NA	NA	\$31,659	2.8
6/14/2021	Cornerstone Home Lending	The Roscoe State Bank	NA	NA	NA	\$212,594	10.4
6/15/2021	KMD Partners	Liberty Bank	NA	NA	NA	\$11,697	-84.4
8/2/2021	Newtek Business Services Corp.	National Bank of New York City	\$20.0	20.6	54.9	\$203,570	3.3
11/15/2021	BM Technologies	First Sound Bank	\$23.0	52.1	165.0	\$154,129	3.2

Source: S&P Global Market Intelligence

# Takeaways from Recent FinTech/Bank Transactions

1

Similar to CU deals, make up a small proportion of overall deal activity (<5% of total deal volume) but are growing in number with 2021 being the peak

2

Pricing and structure information was limited for a number of deals but appear to be primarily cash consideration with pricing consistent with market/industry trends

3

Majority of targets appear to be smaller banks (<\$200 million) with limited branches/ loan infrastructure

4

Primary driver would appear to be bank charter/deposits, which helps to facilitate more stable source of funding, remove payment to a bank partner for holding and servicing, and provide access to the national payment rail networks and Fed's discount window for liquidity – can result in favorable deal metrics for FinTech

# Q&A

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Jay D. Wilson is Senior Vice President of Mercer Capital and a senior member of the firm's Financial Institutions and FinTech practice.

Mr. Wilson regularly works with financial institutions (Banks & CUs) in valuation and M&A engagements. He assists banks and CUs in evaluating the attractiveness of acquisition candidates (whole banks, branches, or merger partners), determining a valuation for the target, structuring/modeling the transaction, and estimating fair value marks for financial assets (loans, core deposit intangibles) and liabilities (CD portfolio) acquired for financial statement reporting purposes.

Mr. Wilson also values financial institutions and FinTech companies for a variety of other purposes including, estate and gift tax planning, profit sharing or option plans such as ESOPs, corporate/strategic planning, and compliance matters.

He also publishes articles on the community bank, credit union, and FinTech industry and is the author of *Creating Strategic Value Through Financial Technology* (John Wiley & Sons, 2017).

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In order to provide the very best legal and strategic advice, Mr. Bell uses his personal experience as an entrepreneur to examine the business side of the legal issues his clients encounter and works to fully understand each individual and the inner workings of his or her company.