Mergers & Acquisitions in the New Financial World

“Forget Organic Growth; Buy a Bank!”

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Forget Organic Growth; Buy a Bank!

Discussion Agenda

• Credit union M&A landscape

• Identifying the right bank target and getting the deal done, while limiting risk

• Key merger accounting considerations
Credit Union M&A Landscape
Credit Union Mergers – It’s All About the Members!

• Approximately 200 mergers between CU’s annually

• Reasons for credit mergers:
  • Expand/improve services to its members
  • Expand a CU’s field of membership
  • Ensure a succession plan
  • Achieve economies of scale and improve financial condition
  • Maximize member value

• General characteristics of merged credit unions:
  • Smaller size – Total assets < $50 million
  • Deteriorating member base
  • Deteriorating financial condition
Credit Union Merger Statistics

Quarterly credit union merger statistics

- No. of mergers
- Surviving credit union total assets ($B)*
- Merging credit union total assets ($B)*

* As of merger approval.

Sources: SNL Financial, an offering of S&P Global Market Intelligence;
National Credit Union Administration
Why are Credit Unions Merging?

Credit union merger approvals by type, January 2013 to January 2017

- Expanded services: 670
- Poor financial condition: 133
- Lack of growth: 47
- Lack of sponsor support: 35
- Inability to obtain officials: 37
- Loss/declining field of membership: 27
- Poor management: 12
- Conversion to or merger with FISCU: 4
- Conversion to or merger with NFICU: 4

Data compiled March 1, 2017.
Includes credit union mergers approved by the NCUA from Jan. 1, 2013, through Jan. 31, 2017.
FISCU = federally insured state-chartered credit union
NFICU = non-federally insured credit union
NCUA = National Credit Union Administration
Source: SNL Financial, an offering of S&P Global Market Intelligence; NCUA
Credit Union Merger Challenges

- Number of targets is declining
  - Improved financial performance throughout industry
  - Consistent merger activity = smaller population of smaller credit unions
  - Barriers to entry for new credit union charters

- Incentives are not there for key decision makers
  - Loss of roles/responsibilities
  - No or limited financial windfalls

- Misalignment between credit unions
  - Culture
  - Strategic vision and direction
Credit Unions are Buying Banks

<table>
<thead>
<tr>
<th>Buyer</th>
<th>Target</th>
<th>Target ownership structure</th>
<th>Target state</th>
<th>Announcement date</th>
<th>Deal status</th>
<th>At announcement ($M)</th>
<th>Deal value</th>
<th>Target total assets</th>
<th>Buyer total assets</th>
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Data compiled May 9, 2017.
Includes bank and thrift whole-company deal announcements from Jan. 1, 2011, to May 9, 2017, where the buyer is a credit union.
Total assets as of most recent quarter prior to deal announcement date.
NA = not available
Source: S&P Global Market Intelligence
Credit Unions are Buying Banks

Bank & thrift acquisitions by credit unions since 2011

Year of announcement
- 2011
- 2015
- 2012
- 2016
- 2013
- 2017

*S&P Global*
Market Intelligence
Data compiled May 9, 2017.
Includes bank and thrift whole-company deal announcements from Jan. 1, 2011, to May 9, 2017, where the buyer is a credit union.
Source: S&P Global Market Intelligence
Map credit: Alip Artates
Why Do Credit Unions Buy Banks?

• More banks are selling
  • Earnings pressure and regulatory burdens
  • Human capital constraints/management succession issues
  • Prices of community bank stocks have risen

• Larger banks are not interested in smaller banks

• Credit union buyers are attractive to banks
  • Ability to pay more (lower required ROI due to no taxes)
  • Ability to pay all cash

• Number of viable credit union targets is diminishing
Why Do Credit Unions Buy Banks?

- Improves the balance sheet
  - Instant growth
  - Diversification of earning assets for risk based capital concerns
  - Leverage excess capital
- Provides for a competitive advantage
  - Increase market share/geographic expansion
  - Acquire expertise in commercial lending and an existing commercial loan portfolio
  - Eliminate in-market competition
Identifying the Right Bank Target and Getting the Deal Done, While Limiting Risk
Identify the Right Bank Target

- Optimal Bank Asset Size
- Mutual Savings Associations
- Customer Composition
- Asset Composition
Identify the Right Bank Target

- $25 - $200 Million assets
- Well capitalized
- Strong regulatory history
Identify the Right Bank Target

- Customer composition
- Business loans/ concentrations
- Acquire commercial lenders/department
- Heavy consumer deposit base
- Residential mtg./ auto loans
- Field of membership limits
- Adjacent markets
Identify the Right Bank Target

ASSET COMPOSITION

• Business/CRE/consumer loans

• Business accounts

• Existing experience
Get the Deal and Get It Done

- Bidding strategy (rural banks have limited buyers; CU’s are often best buyers)

- Negotiate the best deal

- Obtaining regulatory approval
Getting the Deal – Bidding Strategy

- Investment bankers’ lists
- Sufficient due diligence
- Premium pricing over bank bidders
Getting It Done and Limiting Risk – Negotiating Strategy

- Transaction structure (S Corp Banks make great CU targets)
- Purchase agreement issues
- Break-up fee / deposit
Getting It Done and Limiting Risk – Regulatory Strategy

- NCUA
- FDIC
- Notices and timing
A New Growth Strategy

• Find the right deal
• Get the deal
• Get it done while limiting risk
If you don’t know where you are going, you might wind up some place else.

-Yogi Berra
Pending Transaction

- CU buying bank in a purchase & assumption transaction
  - Seller is S-Corporation Bank
- Regulatory Concerns-FDIC Insurance
  - Fund Vs. NCUA Insurance
- Potential Depositor Flight
- Retention of Borrowers and Loans
- Employee Considerations
- Field of membership Issues
- In-market Transaction
- Acquiring Commercial Lending Department
- Cost-Savings
Key Merger Accounting Considerations
Acquisition vs. Pooling of Interest

- Historically accounted for mergers as Pooling of Interest
  - Relatively straightforward combining of book values
  - GAAP no longer allows pooling of interests method (since 2009)

- Acquisition Accounting for Business Combinations
  - More complex
  - Assets acquired and liabilities assumed marked to Fair Value
  - Often involves recognition of intangible assets; CDI, Goodwill
  - Accounting guidance ASC 805
Fair Value Considerations

- Assets of the acquired entity are marked to Fair Value
  - Loans – performing vs. nonperforming
  - Allowance for Loan Loss does not carry over
  - Recognition of intangible assets at fair value (e.g. core deposit intangibles and mortgage servicing rights, etc.)

- Liabilities assumed are marked to Fair Value
  - Deposit accounts
  - Debt
  - Commitments (earn-outs, etc.)
Fair Value Considerations

• Purchase Consideration
  • Unlike credit union mergers, bank acquisitions often involve purchase price – Purchase Consideration

• Goodwill vs. Bargain Purchase Gain

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase Consideration</td>
<td>$ XX,XXX</td>
</tr>
<tr>
<td>Less: Net Assets Acquired</td>
<td>($XX,XXX)</td>
</tr>
<tr>
<td>Goodwill/(Bargain Purchase Gain)</td>
<td>$ X,XXX</td>
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</tbody>
</table>
Use of Specialists

• Fair value determinations can be complex
• Requirement for supportable estimates
• Use of qualified valuation firm
  • Provide quality reporting and supportable estimates
  • Experience with similar transactions
  • Engage early
  • Help you identify and work through issues
Day 1 & Day 2 Concept

- Day 1 Accounting
  - Initial Recognition of Assets/Liabilities at Fair Value
  - Record Goodwill, Core Deposit Intangible, Earnouts, etc.

- Day 2 Accounting
  - Ongoing effects of Day 1 entries
  - Income Statement Impacts – amortization and accretion, yields
  - Balance Sheet Impacts – ongoing assessment of impairment
  - Financial Reporting
• Infrastructure necessary to integrate acquisition
• Use specialists in process
  • Valuation
  • Due diligence
• Core Processing Systems
• Business Lending (Commercial)
  • Need for strong credit culture
  • Retain key lenders, underwriters
  • Business lending requires ongoing/continuous monitoring
  • Covenants, covenants, covenants
Questions?

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