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

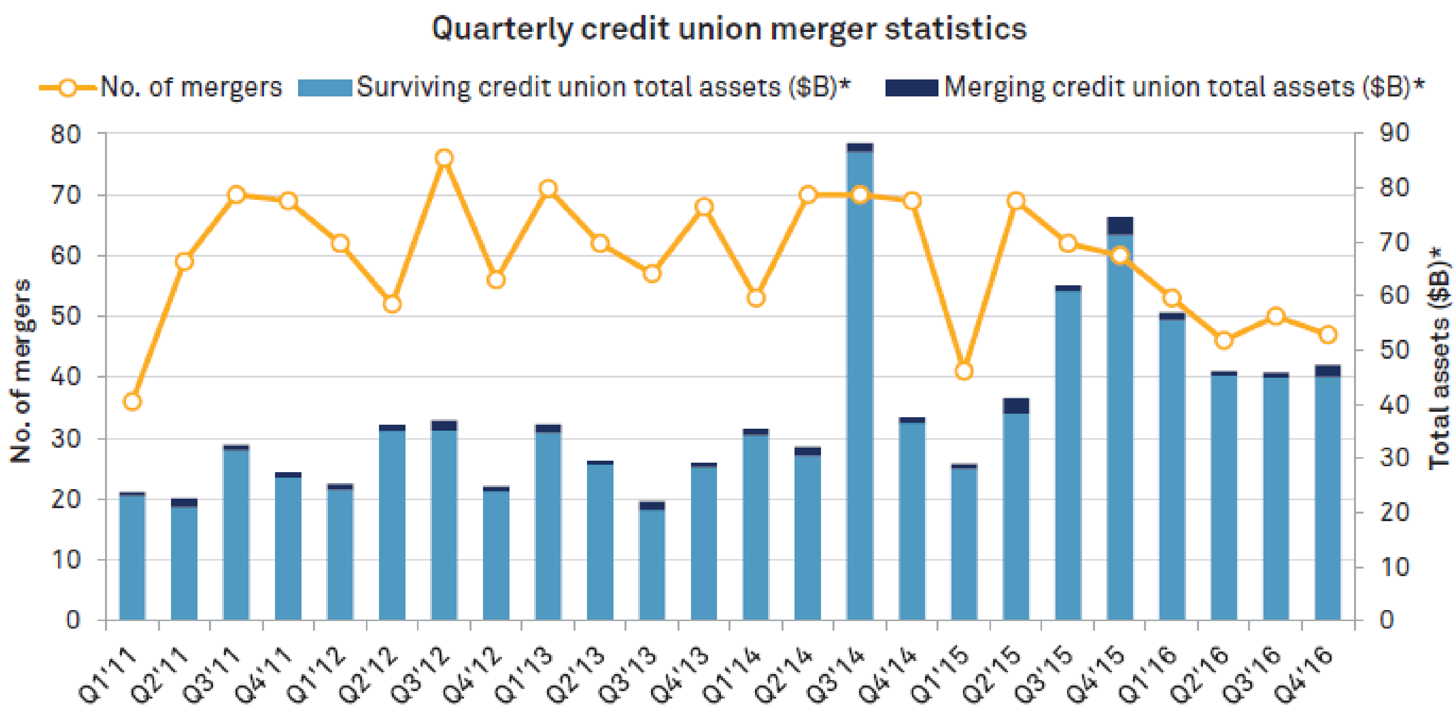
- Credit union M&A landscape
- Identifying the right bank target and getting the deal done, while limiting risk
- Key merger accounting considerations

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

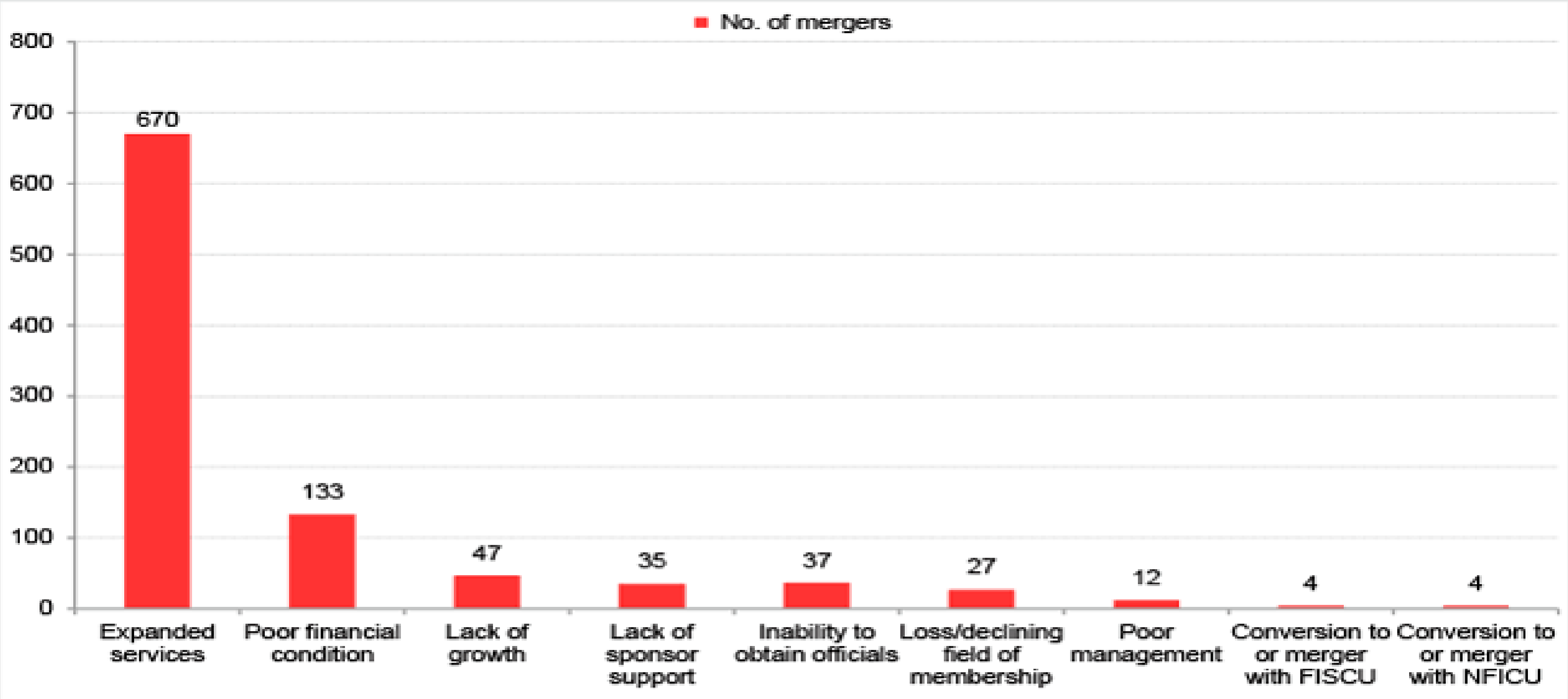


Data compiled Feb. 1, 2017.
Includes mergers approved from Jan. 1, 2011, through Dec. 31, 2016.
* As of merger approval.

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



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

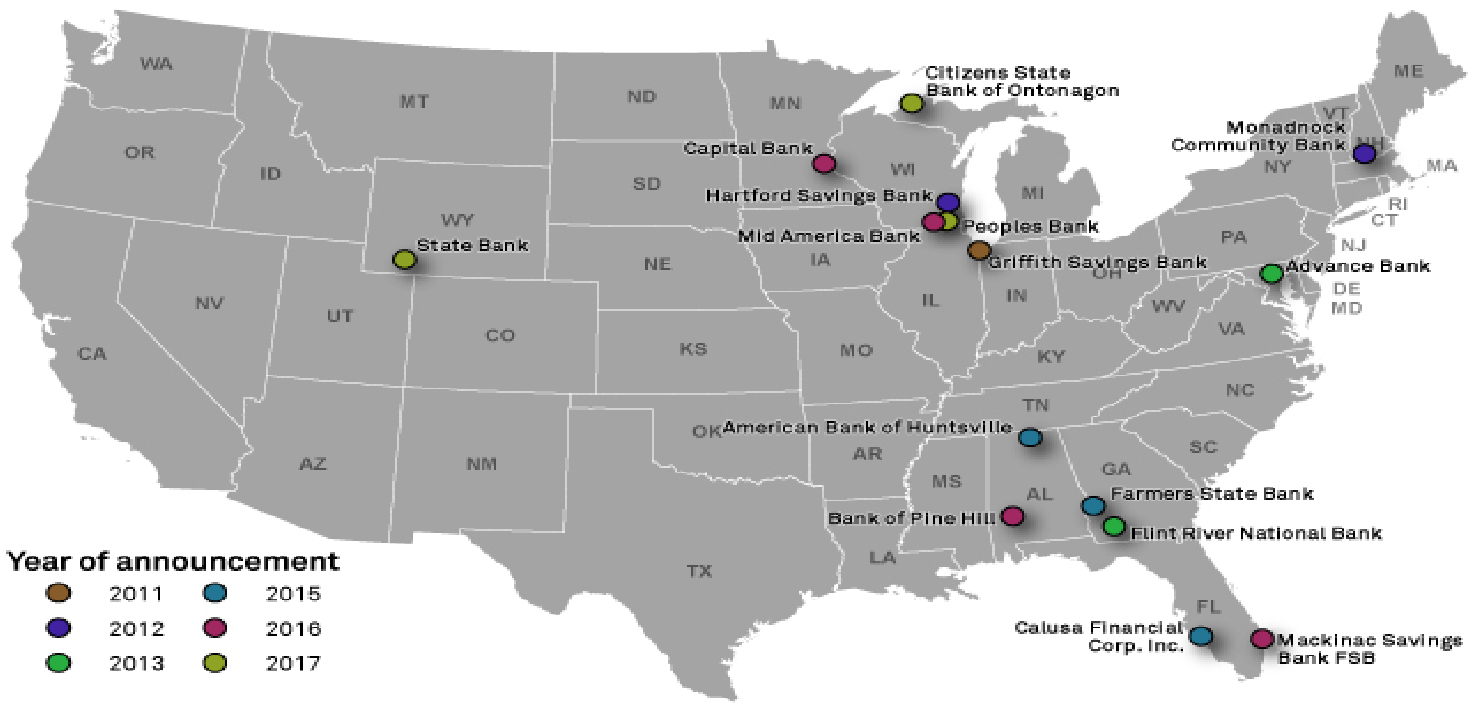
Credit unions buying banks
Sorted by deal announcement date

Buyer	Target	Target ownership structure	Target state	Announcement date	Deal status	At announcement ($M) Deal value	Target total assets	Buyer total assets
Honor CU	Citizens State Bank of Ontonagon	Stock corporation	MI	05/05/17	Pending	NA	56.1	734.9
Trona Valley Community FCU	State Bank	Tax-free partnership	WY	05/04/17	Pending	NA	37.0	189.1
Advia CU	Peoples Bank	Stock corporation	WI	01/09/17	Pending	NA	232.8	1,342.1
IBM Southeast Employees' CU	Mackinac Savings Bank FSB	Tax-free partnership	FL	10/21/16	Pending	12.0	109.5	946.7
Family Security CU	Bank of Pine Hill	Stock corporation	AL	08/26/16	Completed 03/03/17	1.7	24.8	577.1
Royal CU	Capital Bank	Tax-free partnership	MN	04/27/16	Completed 08/26/16	NA	35.9	1,788.7
Advia CU	Mid America Bank	Stock corporation	WI	02/18/16	Completed 08/01/16	NA	83.4	1,184.1
Avadian CU	American Bank of Huntsville	Stock corporation	AL	08/24/15	Completed 04/30/16	9.2	123.1	607.0
Achieva CU	Calusa Financial Corp. Inc.	Stock corporation	FL	05/05/15	Completed 11/30/15	23.2	166.1	1,125.7
Five Star CU	Farmers State Bank	Stock corporation	GA	02/18/15	Completed 11/01/15	NA	47.2	317.7
Five Star CU	Flint River National Bank	Stock corporation	GA	09/03/13	Completed 06/01/14	NA	22.8	255.9
Municipal Employees CU of Baltimore Inc.	Advance Bank	Mutual/co-op	MD	04/04/13	Completed 12/12/13	NA	60.8	1,224.7
Landmark CU	Hartford Savings Bank	Mutual/co-op	WI	09/25/12	Completed 02/28/14	NA	194.0	1,979.9
GFA FCU	Monadnock Community Bank	Stock corporation	NH	03/01/12	Completed 12/28/12	6.4	82.6	345.1
United FCU	Griffith Savings Bank	Mutual/co-op	IN	07/27/11	Completed 01/01/12	0.3	86.5	1,262.8

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



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?

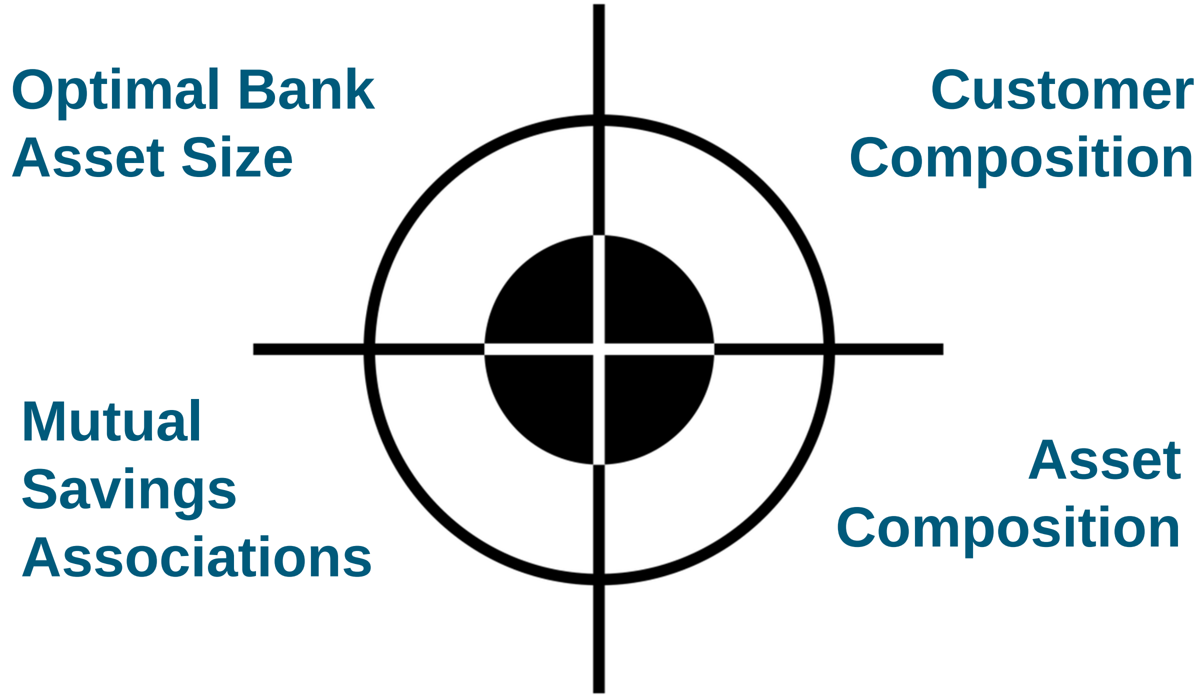
- More banks are selling
  - Earnings pressure and regulatory burdens
  - Human capital constraints/management succession issues
  - Prices of community bank stocks have risen
- Larger banks are not interested in smaller banks
- Credit union buyers are attractive to banks
  - Ability to pay more (lower 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



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

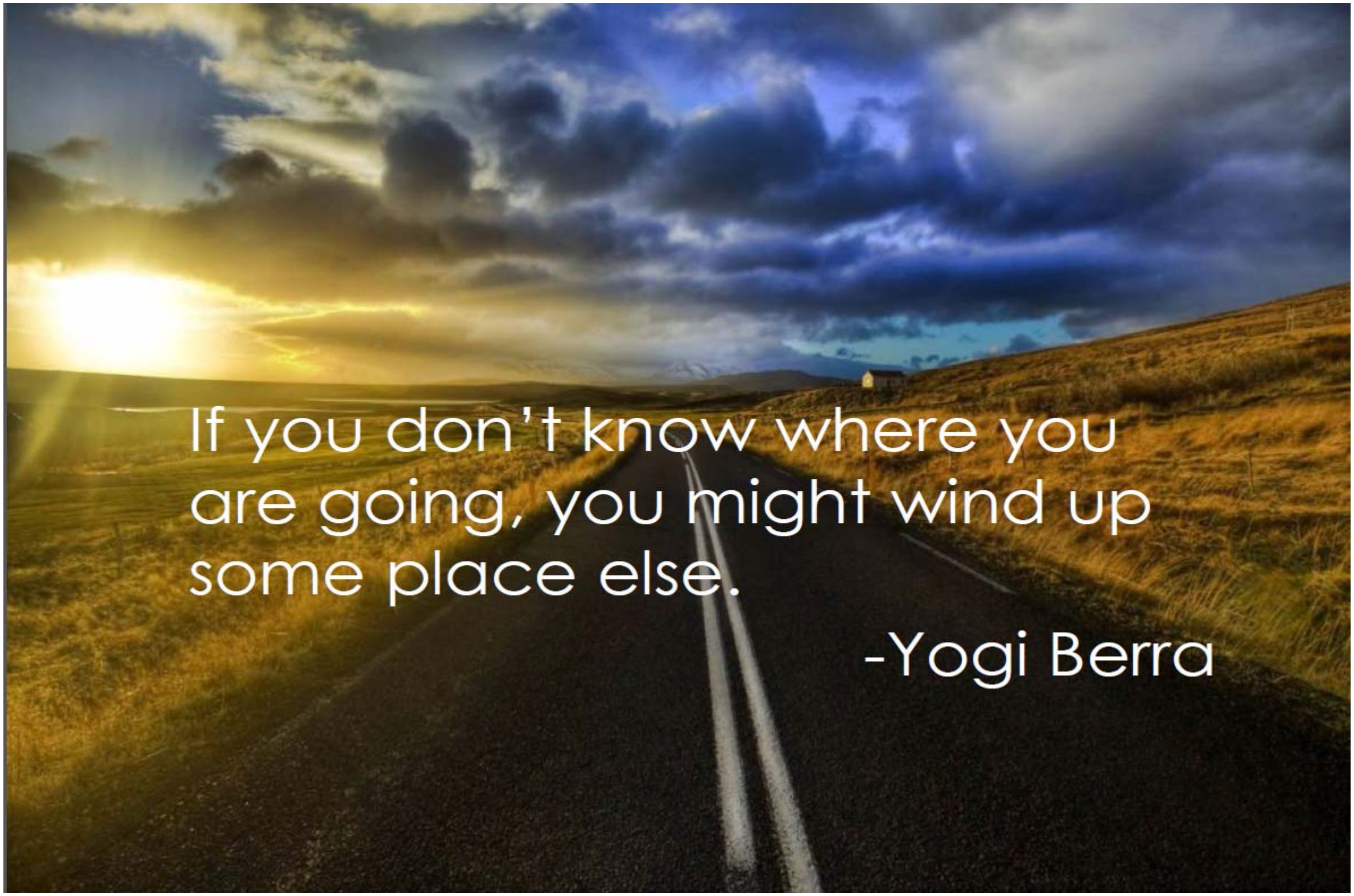
- Transaction structure (S Corp Banks make great CU targets)
- Purchase agreement issues
- Break-up fee / deposit

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

Purchase Consideration	$ XX,XXX
Less: Net Assets Acquired	($XX,XXX)
Goodwill/(Bargain Purchase Gain)	$ X,XXX

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, Earn-outs, 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

Takeaway

- 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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