

BankDirector.

Breakout 2:
**How Banks Should
Make the Decision to
Buy or Sell**

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#BBTF23

How Banks Should Make the Decision to Buy or Sell

Bank Director – Bank Board Training Forum
Nashville, Tennessee
September 11, 2023

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Peter Weinstock



PRACTICES

Banking and Finance
Financial Institutions Corporate and
Regulatory
Fair Lending
Consumer Financial Compliance and
Litigation

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EDUCATION

JD, Duke University School of Law, 1985
BA, State University of New York, 1982

BAR ADMISSIONS

Texas

CHAMBERS

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Peter's practice focuses on corporate and regulatory representation of small to large regional and national financial institution franchises. During the past several years, Peter has devoted substantial time to bank, M+A, Capital raising, FinTech, Baas, regulatory, compliance and enforcement. He is Co-Practice Group Leader of the Financial Institutions Section. He has counseled institutions on more than 300 M&A transactions, as well as provided representation on over 250 securities offerings as well as capital planning.

Relevant Experience

Representation includes:

- lead counsel in \$3 billion transaction in Wisconsin 2022 merger of equals;
- lead counsel in merger of equals creating a \$13 billion bank in California and in 2022 creating \$3.0 + billion bank in Wisconsin;
- lead counsel on the North American Corporate Deal of the Year (Middle Market) – The M&A Atlas Awards – for Cascade Bancorp, Inc.'s successful topping bid to acquire Home Federal Bancorp, Inc., a NASDAQ-listed bank; also, Finance Monthly Deal Maker of the Year Award 2014 ;
- more topping bid transactions as buyer or seller than any other banking firm over the past 20 years;
- more M&A transactions than any firm over the last 20 years (according to *S&P Global Market Intelligence*);
- 22 bank M&A transactions in 2019, including six bank mergers of equals over the last five years;
- hundreds of capital offerings;
- hundreds of fair lending, CMPs, and other enforcement actions;
- testimony before Panel of the House Judiciary Committee regarding Operation "Choke Point" in July 2014;
- myriad compliance issues before all of the federal bank regulatory authorities, including the CFPB; and negotiations of administrative actions; and
- representation of 8% of Fintech platform banks.

For the 22 years of its existence ending in 2019, he served as co-editor of ICBA's Newsletter, "SUBCHAPTER S: THE NEXT GENERATION." He is the author of numerous articles in law and banking publications, including forthcoming *Banking Law Journal* article "A Rosetta Stone for Credit: 2022 Policy Statement on CRE Loan Workouts and Accommodations." His article, "Acquisitions of Failed Banks – Present Risk and Opportunity," was voted the second best article appearing in The Risk Managers Association Journal of 2011. He has spoken at over 250 banking conferences and seminars. Mr. Weinstock is listed in Chambers USA "Leaders in Their Field" for banking and "Fintech" and as AV Preeminent in Martindale-Hubbell®. He was also named to the *National Law Journal's* list of Mergers & Acquisitions and Antitrust Trailblazers for 2018.

Beth Whitaker



PRACTICES

Banking and Finance

Financial Institutions Corporate and
Regulatory

Mergers and Acquisitions

Corporate

Capital Markets and Securities

Environmental, Social and Governance
(ESG)

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EDUCATION

JD, Charleston School of Law, cum laude,

Chief Justice, Moot Court Board, 2008

BA, International Studies and Spanish, Elon

University, magna cum laude, 2004

BAR ADMISSIONS

Texas

Beth’s practice focuses on corporate transactions and securities and regulatory representation of commercial banks, holding companies, credit unions and other financial institutions, including mergers and acquisitions, joint ventures, and corporate finance transactions. Beth advises clients on structuring and raising capital through public and private debt and equity offerings, including eight IPOs. She also advises publicly traded clients on securities law compliance and reporting obligations. Beth further advises clients on corporate governance and shareholder matters, including share repurchases and tender offers, as well as succession planning.

Relevant Experience

- Represented BankFirst Capital Corporation in its acquisition of Mechanics Banc Holding Company and Tate Financial Corporation (both in 2022)
- Represented Spirit of Texas Bancshares, Inc. in its sale to Simmons First National Corporation (2021)
- Served as underwriters’ counsel in initial public offering of FinWise Bancorp (2021)
- Served as underwriters’ counsel in initial public offering of CrossFirst Bankshares, Inc. (2019)
- Represented Spirit of Texas Bancshares, Inc. in its acquisition of three separate Texas banks (2018 – 2019)
- Represented Tectonic Financial, Inc. in initial public offering (2019)
- Represented Trinity Capital Corporation in its sale to Enterprise Financial Services Corp (2019)

Events

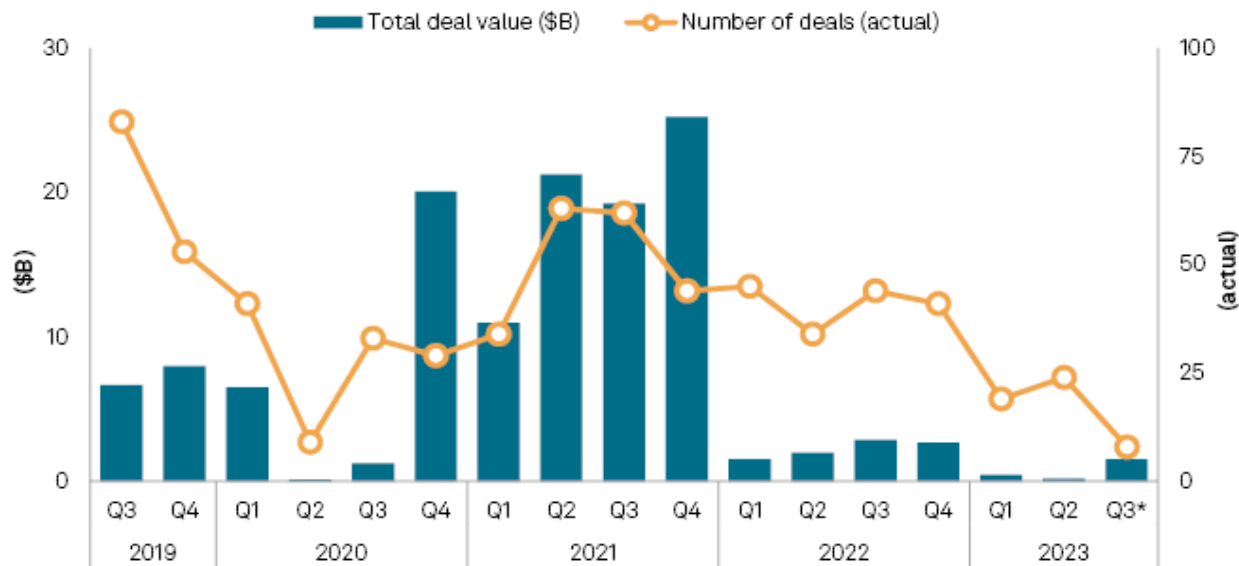
- “How Banks Should Make the Decision to Buy or Sell,” BankDirector – Bank Board Training Forum, Nashville, TN, September 2022
- “How to Grow and Keep on Growing,” BankDirector – Acquire or be Acquired, Phoenix, AZ, January 2022
- “What Banks Need To Do and/or Change to Continue Growing,” Bank Director –Acquire or Be Acquired, Phoenix, Arizona, January 2020
- “Planning for Asset Growth: What To Do At Each Ledge of Asset Size,” Bank Director –Acquire or Be Acquired, Phoenix, Arizona, January 2019
- “How Things Change: Considerations for Different Asset Thresholds,” Bank Director –Acquire or Be Acquired, Phoenix, Arizona, January 2018
- “Capital Planning and M&A Update,” South Carolina Bankers Association – CFO Conference, Columbia, South Carolina, September 2017
- “Capital Planning for Community Banks: All Regulatory Roads Lead to Your Capital Plan,” Oregon Bankers Association – Finance & Accounting Conference, Portland, Oregon, March 2017
- “Capital and Management,” South Carolina Bankers Association - Safety & Soundness Conference, Columbia, South Carolina, February 2017

Where Are We Now?

The Economy, Interest Rates and M&A

Deal Stats – Through July 31, 2023

8 US bank deals announced in July 2023



Data compiled Aug. 4, 2023.

Analysis limited to US-based whole company, minority stake, and franchise bank and thrift deals that were announced between July 1, 2019, and July 31, 2023. Excludes branch, government-assisted and terminated deals, as well as bids and thrift merger conversions.

* Quarter to date through July 31, 2023.

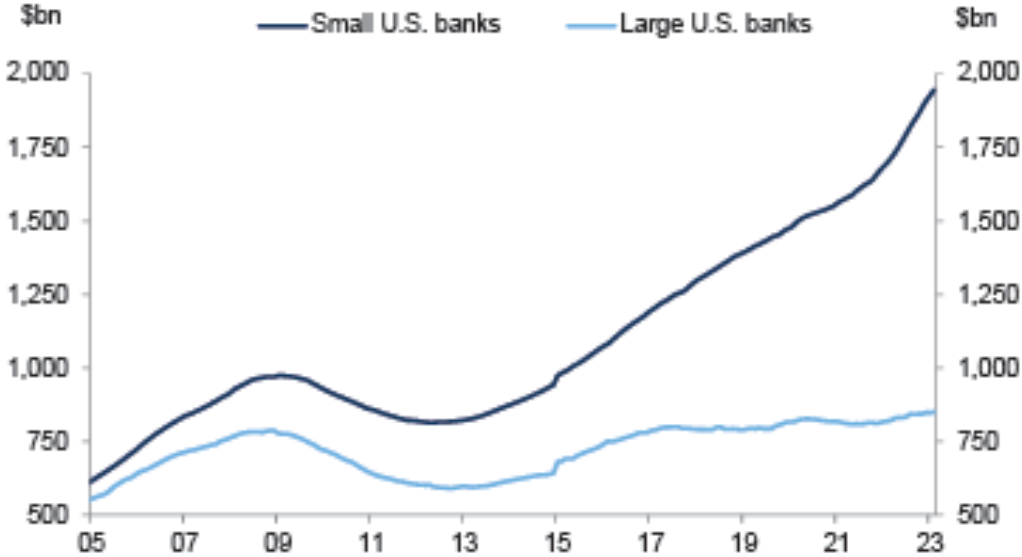
Deal values are as of the announcement date.

Source: S&P Global Market Intelligence.

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CRE Exposure to Banks

Small banks have increased their share of commercial mortgages vs. large bank peers

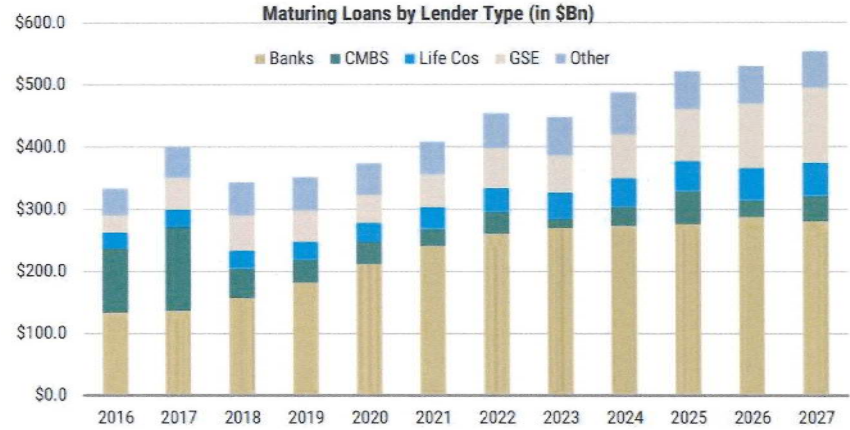


Source: Federal Reserve Board, Goldman Sachs Global Investment Research

CRE Maturities

In addition, almost \$500 billion of loans will come due in 2024, and a total of \$2.5 trillion in debt comes due over the next five years according to Morgan Stanley.

CRE Debt Maturities: \$2.5tn in next 5 years

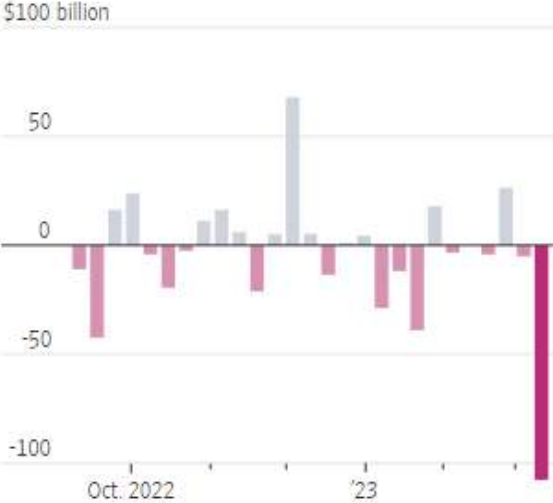


Source: Trepp, Morgan Stanley Research

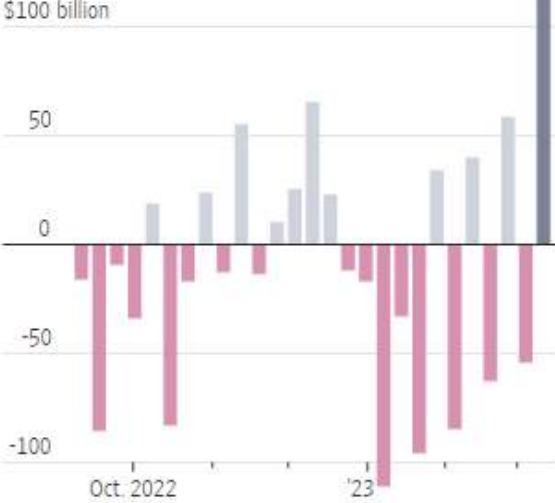
Small and Large Bank Deposits

Deposits, change from a week earlier

SMALL BANKS



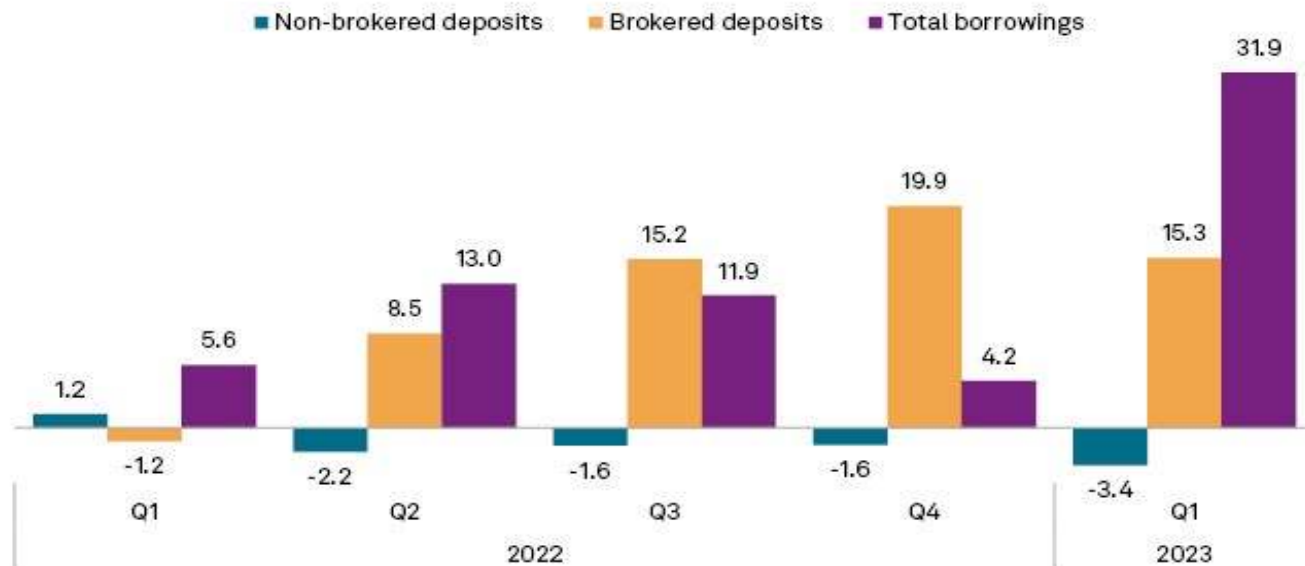
LARGE BANKS



Note: Includes domestically chartered commercial banks. Large banks are defined as the top 25 ranked by domestic assets. Small banks are those not in the top 25.
 Source: Federal Reserve
 Nate Rattner/THE WALL STREET JOURNAL

Funding Composition

QOQ changes in US bank aggregate funding composition (%)



Data compiled May 8, 2023.

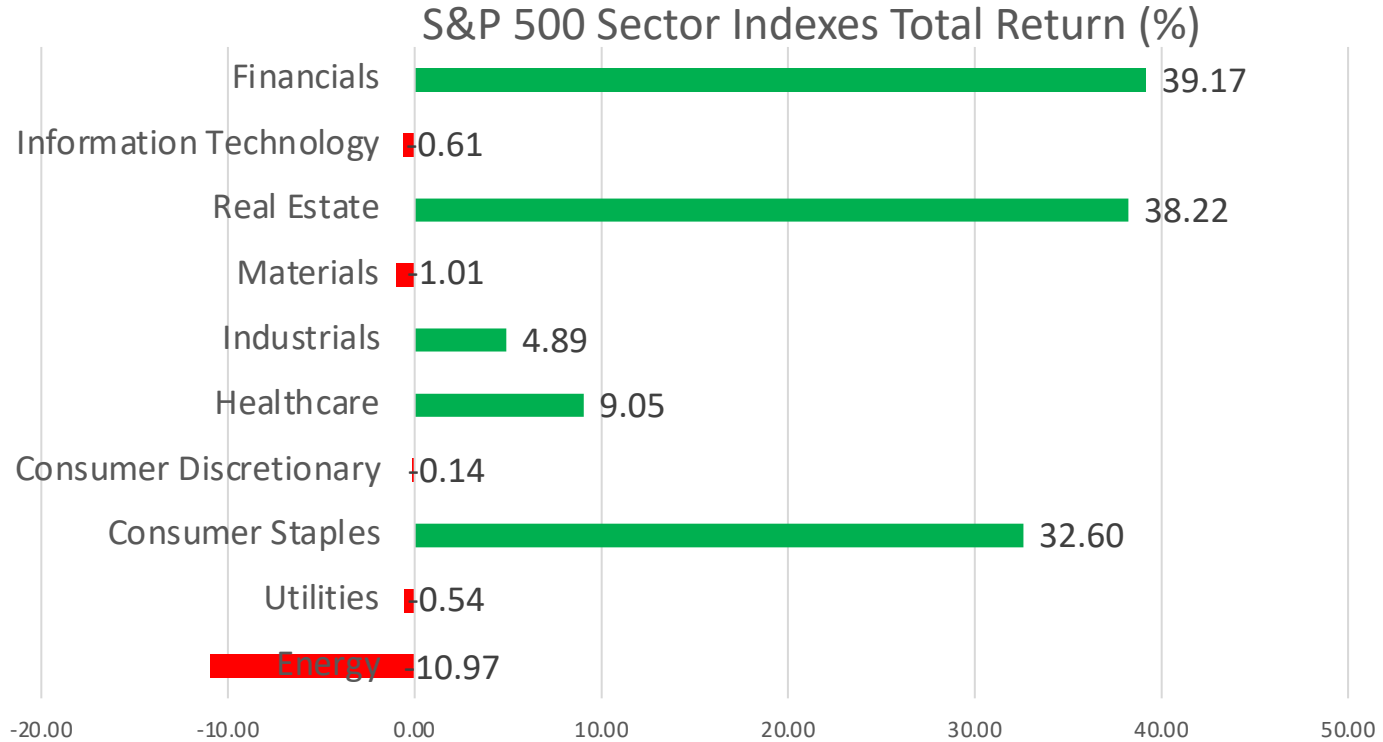
Analysis includes US commercial banks, savings banks, and savings and loan associations. Nondepository trusts and companies with a foreign banking organization charter are excluded.

Data based on regulatory filings as of March 31, 2023.

Source: S&P Global Market Intelligence.

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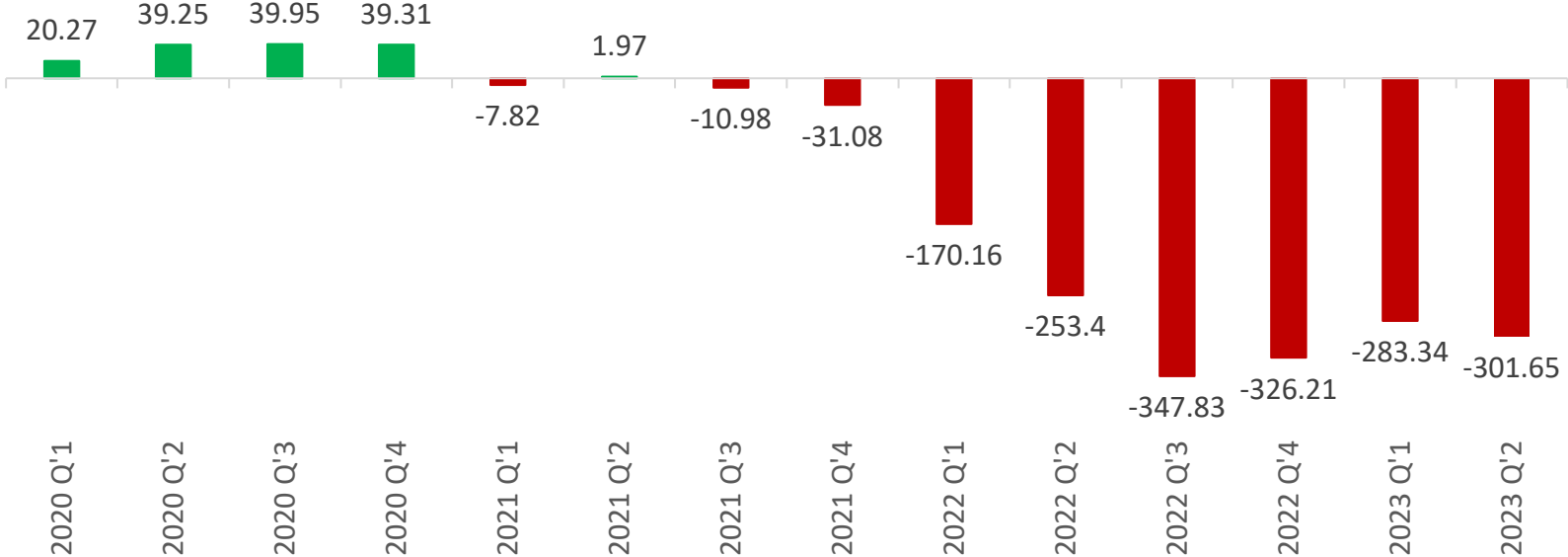
Financials Have Begun to Rebound, BUT (%)



Total Return Year-to-Date 2023; Data compiled August 16, 2023
Source: S&P Global

AOCI Impact on M&A

Total Accumulated Other Comprehensive Income at US Banks
(\$B)



Data compiled August 17, 2023
 Analysis includes U.S. commercial banks, savings banks, and savings and loan associations; excludes nondepository trusts and companies with a foreign banking organization charter.
 Data based on regulatory filings.
 Source: S&P Global Market Intelligence

Impact of AOCI on M&A

- All securities reported at fair value at acquisition.
- AOCI of seller is removed upon acquisition.
- Unrealized losses (gains) for all securities – transfer to the buyer as a discount (premium)
- Discount (premium) accreted into income using the effective interest method without tax

Impact of AOCI on M&A

Positive Considerations:

- Discount will increase future income
- Effective interest rate results in yields consistent with current market rates at acquisition

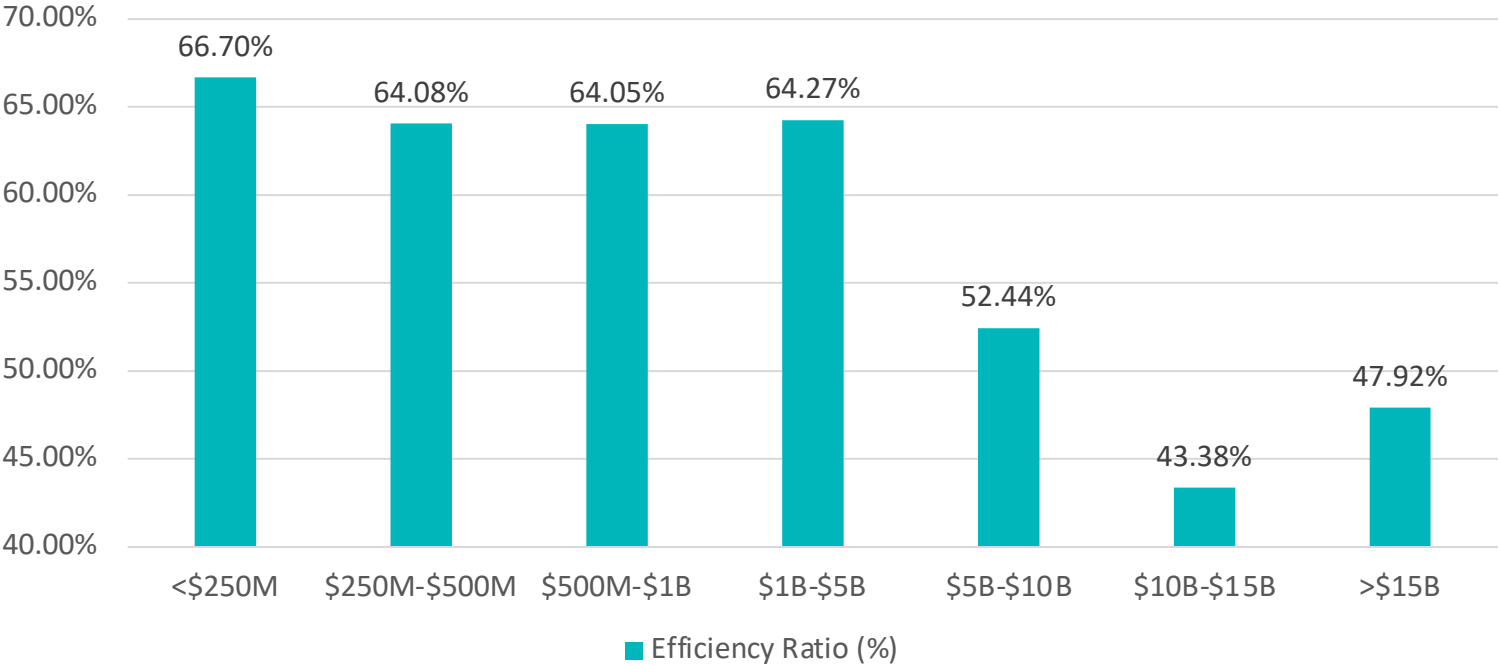
Negative Considerations:

- Increases buyer's goodwill (if purchase price is not adjusted)
- Temporary hit to tangible capital
 - Temporary hit is removed through discount accretion over life of portfolio
- Current double count on loans (mark down + allowance)

So Why M&A for Buyers?

- Asset quality has stayed pristine
- NIMs starting to decline and are expected to fall further
- Scale and Efficiency – overall costs keep increasing, especially deposits, labor and energy
- Loan demand is up (other than mortgages), but nonbank lending competition remains
- Absent M&A, many public banks will not be able to grow earnings 5%+
- Geographic expansion/diversity

Achieving Economies of Scale With Size



Note: Includes all commercial banks and savings banks (top tier consolidated only)
Source: S&P Global Market Intelligence; Data YTD as of August 2023

So Why M&A for Sellers?

- Rising cost of funds; shrinking NIMs
- Loan demand is up, other than mortgages, but pricing has not kept up
- Cost-cutting has reached its limits and is reversing; sellers have 10%+ higher efficiency ratios than buyers
- Tax “windfall” is reversing
- Regulatory pressure
- Coming decline in quality buyers?
- Management succession
- Excess liquidity is dissipating

Expectations for 2023

- Stock repurchase programs have become aggressive
- AOCI marks will dissuade some would be sellers
- Pace of M&A to pick up late in 2023, beginning in 2024; pent-up demand
- M&A pricing starting to recover with third quarter stock market recovery
- Buyers continue to expect cost savings (35% in 2019-2021)
- Increase in MOEs/strategic combinations, especially of < \$500mm banks
- Investor groups buy small banks in lieu of forming de novos
- CIC/composition programs continue to reflect consolidation with more reflecting best practices
- Seeds for shareholder activism

What To Do?

- Aggressive stock buybacks
- Retain structural defenses (or consider adding to them)
- Consider amending the bylaws to:
 - Eliminate removal of directors by shareholders without cause
 - Eliminate shareholder action by consent
 - Extend advance notice to make proposals and structure
 - Extend advance notice to nominate directors
 - Require director nominee disclosure
 - Institute director qualifications (third-party compensation)
 - Adopt exclusive forum for shareholder class action
 - Provide structure around proxy access, shareholder meetings, etc.

What To Do?

(cont'd)

Consider amending articles/certificates:

- Shareholder percentage to call meeting
- Staggered board
- Super majority voting
- Fair price provision
- Drag/tag agreements and ROFO agreements
- ESOP

Timing

- When should banks consider selling?
- vs.
- When do banks consider selling?
- Do not start the process just to see what the bank may be worth
- Risks to employees / customers / shareholders of the consideration of a sale
- Role of the strategic plan

Unsolicited Offers

Directors have no absolute legal duty to:

- Explore a proposal to buy the bank,
- Meet with, discuss or negotiate a bid, or
- Submit a bid to shareholders, even if the bid is a premium to market.

Strategic Plan

Decision to “just say no” is a fiduciary decision. It must be:

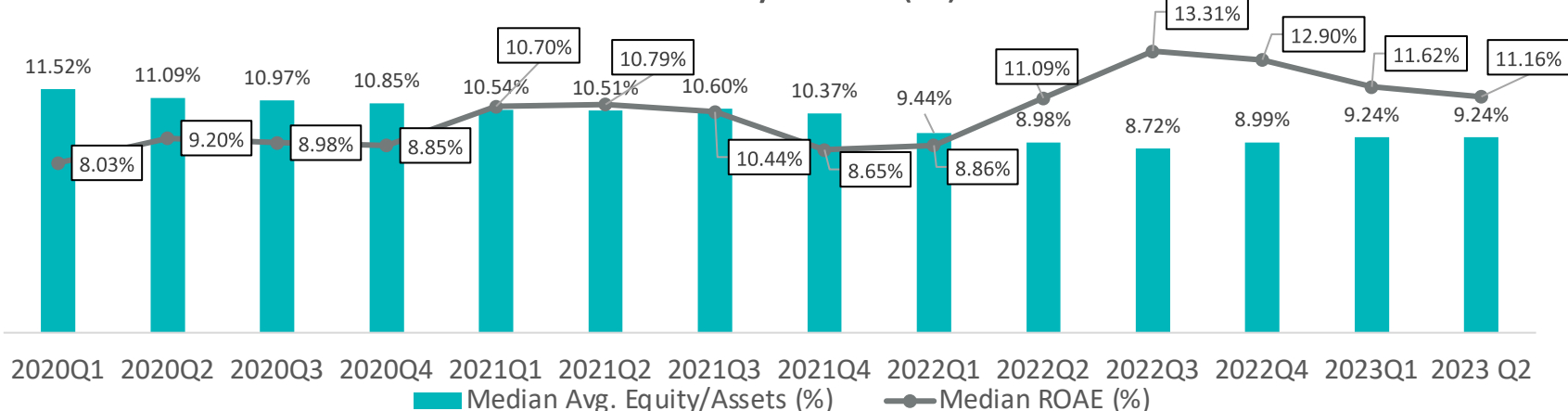
- Well informed
- Based on strategic plan
- Supported by projections

Key to strategic plan:

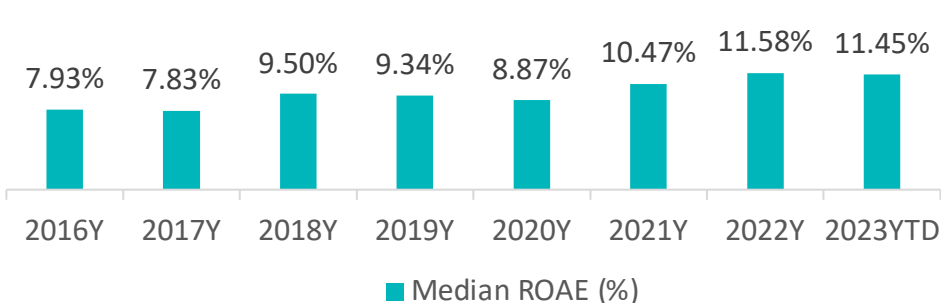
- Plan should consider short- and long-term interests
- Analyze the data (historical and prospective)
- True road map for asset and earnings growth based on reasonable assumptions
- Risk appetite
- Subchapter S
- Assistance from investment banker?

Community Bank Return on Average Equity

Quarterly ROAE (%)



Yearly ROAE (%)



- Median values are derived from a nationwide population of regulated depositories with total assets under \$10.0B in the respective time period shown
- As of Q2'23, there are 4,878 regulated depositories with assets under \$10.0B

Source: S&P Capital IQ Pro
 Top Tier Consolidated Bank Holding Companies, Savings & Loan Companies, Commercial Banks, Savings Banks, and Savings & Loan Associations with total Assets < \$10B in the respective time period shown.

Strategic Plan

What to do?

- Nothing – we already chin the bar on 8.0% ROAE
- Nothing – when we clean up our problems, we will chin the bar
- Nothing – we are Subchapter S and we are clipping our coupons
- Take action to invest in the future because we are not generating a 8.0% ROAE

Preparing to be a Seller

- Consider time horizon
 - 1, 2 and 3 year steps, e.g., stock buybacks; ESOPs
- Employee agreements, severance, etc.
 - What is in place gets paid
- Run 280(g) calculations/valuations
- Facilitate exercise of stock options and warrants
- Address Articles and Bylaws
 - Indemnification
 - Exculpation
- If Subchapter S, confirm no inadvertent ownership issues

Preparing to be a Seller

(cont'd)

- “Fatten the hen”
- “Clean the cupboard”:
 - Clean up credit files and identify and work problem loans
 - Sell OREO
 - Manage portfolio to avoid risk
- Avoid capital investments and branching
- Address overstaffing
- Address compliance issues
- Address director confidentiality
- Care in selecting investment bankers

Seller Steps in an M&A Transaction

- Establish a special committee?
- Hire an investment banker?
- Negotiate one-on-one with limited group of prospective bidders or auction?
- Nondisclosure agreement/maybe marketing materials/limited data room
- Merger consideration composition and valuation
- Expression of interest or letter of intent
- Due diligence – more robust – fill the data room

How to Pick an Investment Banker

- Negotiate investment banker agreements
- Insist on valuation before marketing effort
- Structure pricing to align investment banker compensation with seller's interests

Evaluating the Dance Partners

For potential sellers:

- Existing management/KSOP/community
- MOE – understand role of investment banker
- One-on-one negotiations
- Limited “auction”
- Full auction
- Pre-qualify buyers to confirm:
 - Sufficient pro forma capital to “write the check”
 - Asset quality and liquidity ratios are consistent with approval
 - No outstanding compliance issues
 - No competitive effects

Preparing to be a Buyer

What purchasers should do to prepare for acquisition?

- BaaS
- Branching (de novo or P&A)
- Organic growth / digital
- Deposit strategies
- “Lift outs”
- Mortgage, leasing, factoring, wealth management, consumer and SBA

For Potential Buyers – What To Do?

- Strategic plan/M&A roadmap – rural rollup, fill in and adjacent markets, stock buyer, etc.
- Apprise team and regulators
- Board buy-in
- Capital plan
- Is your house “clean”?
 - Asset quality
 - Pro forma capital and concentration ratios
 - Compliance/BSA/ Fair Lending
- Consider the bank’s “compensation stack”
- Conducive culture

For Potential Buyers – What To Do?

(cont'd)

- Does the bank's name travel?
- Team in place, especially diligence and integration
- Free up talent for evaluations
- Stock authorized?
- Look for strategic fit
- Identify candidates
- Network
- Consider a financial advisor to assist in evaluations
- Understand value of buyer stock
- NDAs may lay dormant like shingles

Recent Buyer Issues

- Fluctuating bond portfolios / AOCI
- Credit/interest rate marks
- Core deposit intangibles
- Deposit decay
- Subchapter S – tax benefits/inadvertent termination
- “Adjusted shareholders’ equity”
- Blanket bond
- Bonus/retention pool/agreements
- Cost savings vs. needed investments – McKinsey
- Vendor contracts – understanding beyond termination fees
- Regulatory delays

Integration

- Well-thought-out internal and external PR and outreach
- Written integration plan
- Functioning integration committees
- Change management plan for target/culture
- Systems conversion should not “wag the dog”

Our National Reach

Represented banks in all 50 states and Puerto Rico.



Hunton Andrews Kurth is consistently ranked at the top of national league tables based on number of deals for banks.

S&P Global

#1
MERGERS & ACQUISITIONS IN
SOUTHWEST AND MIDWEST
2021
CAPITAL MARKETS
OFFERINGS IN TEXAS
2017-2021

#3
MERGERS & ACQUISITIONS
NATIONWIDE
2012-2021

#4
CAPITAL MARKETS
TRANSACTIONS NATIONWIDE
AS UNDERWRITERS' COUNSEL
2021

#5
MERGERS & ACQUISITIONS
NATIONWIDE
2021

#6
CAPITAL MARKETS
TRANSACTIONS NATIONWIDE
AS ISSUERS' COUNSEL
2021

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