BankDirector

Breakout 5:
Lessons Learned From a Cross-Border Acquisition of a Specialty Finance Lender That Became an Operating Subsidiary of a National Bank

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#AOBA24

Cross-Border Acquisition of a Non-Bank Lender

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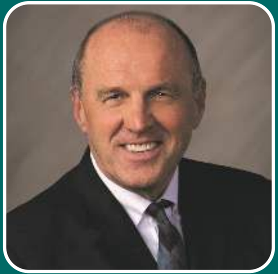

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Acquirors

STEARNS FINANCIAL SERVICES, INC

- A Minnesota corporation and registered bank holding company
- Employee-owned, customer-driven
- Headquartered in St. Cloud, MN
- Owns three subsidiary national banks
- Strong capital position with $2.9 billon in assets

STEARNS BANK N.A.

Member FDIC | Equal Housing Lender

- Established in 1912
- 6 branches in 3 states (Minnesota, Arizona, Florida)
- Outstanding personal service – we answer on the 1st ring!
- Specialists in SBA, Acquisitions & Development, Affordable Housing, Nonprofits and Equipment Finance

Nationwide Programs & Acquisition History

- Equipment leasing:
  - ≈ $975 MM Net Receivables
- Affordable housing, construction & CRE financing:
  - ≈ $500 MM originations/year
- SBA:
  - ≈ $500 MM Loan Portfolio

- Over the past 15 years, Stearns Bank has acquired 12 institutions for a total of $2.2 billion in assets.
- Active FinTech acquiror and investor: enabling cost-efficient and personalized architectural solutions.
- Specialty financing offered nationally for both banks and niche lenders.
- Nationwide appetite for M&A opportunities for either banks or niche lenders.
- Offer innovative options that serve unique customer needs.

Target Corporations

- a Canadian corporation incorporated and headquartered in Ontario
- holding company for US subsidiary corporations
- taxable in Canada
- owned primarily by Canadians

Contract Capital Corporation (“CCC”)

- a Delaware corporation and wholly-owned subsidiary of CCI

CCI One Corp. (“CCI One”)

- a Delaware corporation, special purpose entity and wholly-owned subsidiary of CCC

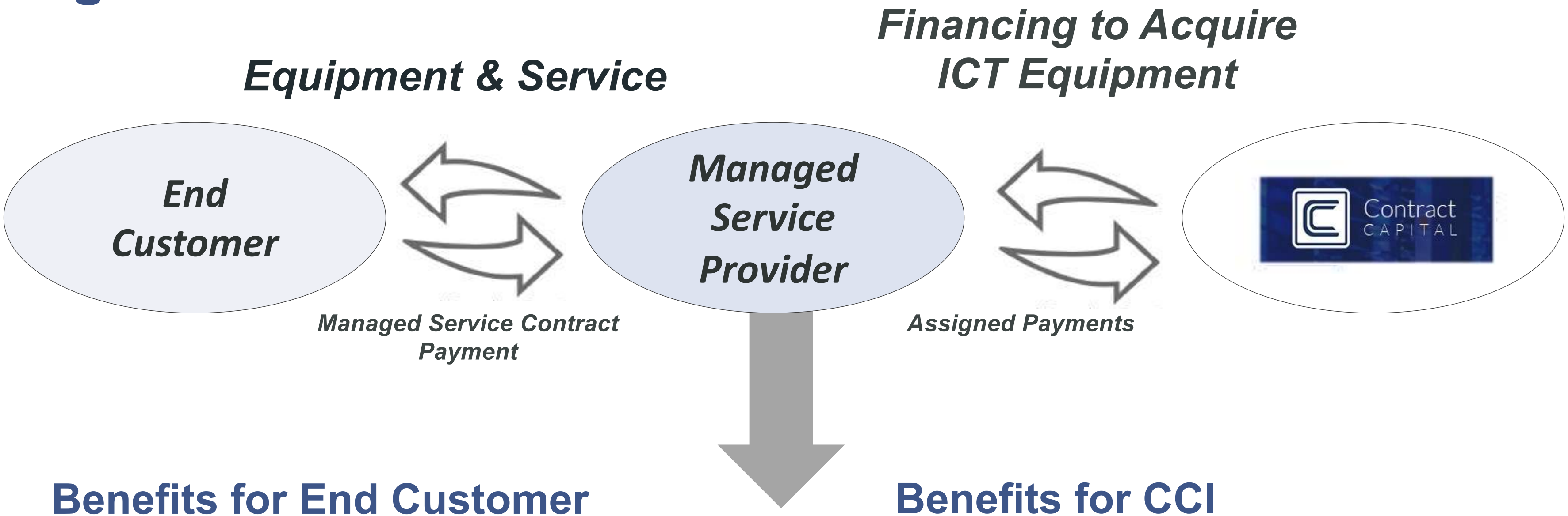
CCC and CCI One are specialty finance companies for Cloud Service Providers

- Rapidly growing companies operating in a niche market
- ≈$80 MM portfolio of specialty equipment leases in USA
- ≈ 200 active customers
- ≈ 400 active lease agreement

Financing The Cloud

- Lease financing funds essential Information Communication and Technology (“ICT”) infrastructure.
- Customers are cloud-based managed service providers (“MSPs”) and Original Equipment Manufacturers (“OEMs”).
- Customers are U.S. corporations.
- Heavily leveraged and capital intensive business.
- Experiencing rapid growth and ever expanding need for capital.

Target Business Model



Benefits for End Customer

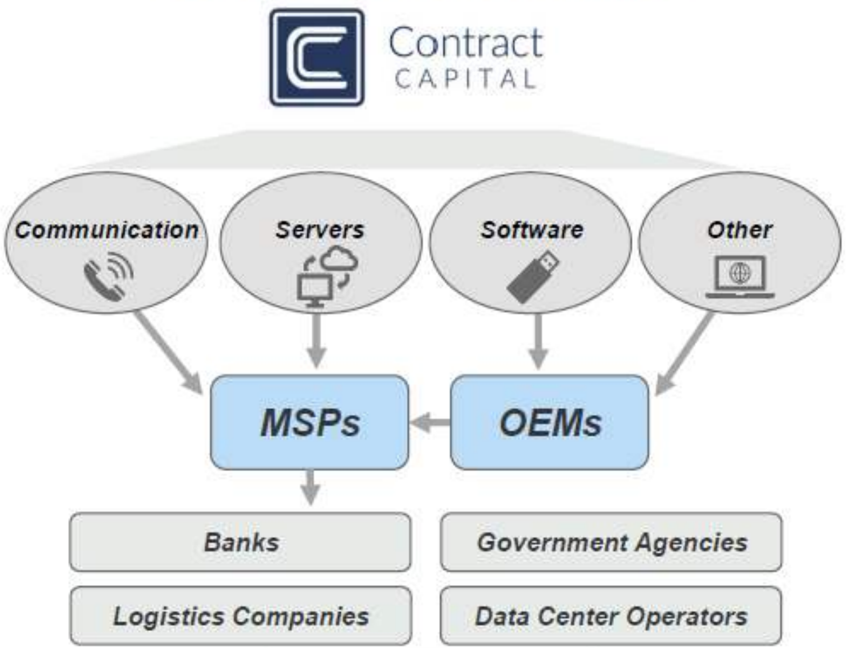
- ✓ Single Managed Service Contract Payment
- ✓ Simple Billing and Collections
- ✓ Quality Service

Benefits for CCI

- ✓ High Quality End Payer
- ✓ Security Interests
- ✓ Downside Protections
- ✓ Above-Market Returns

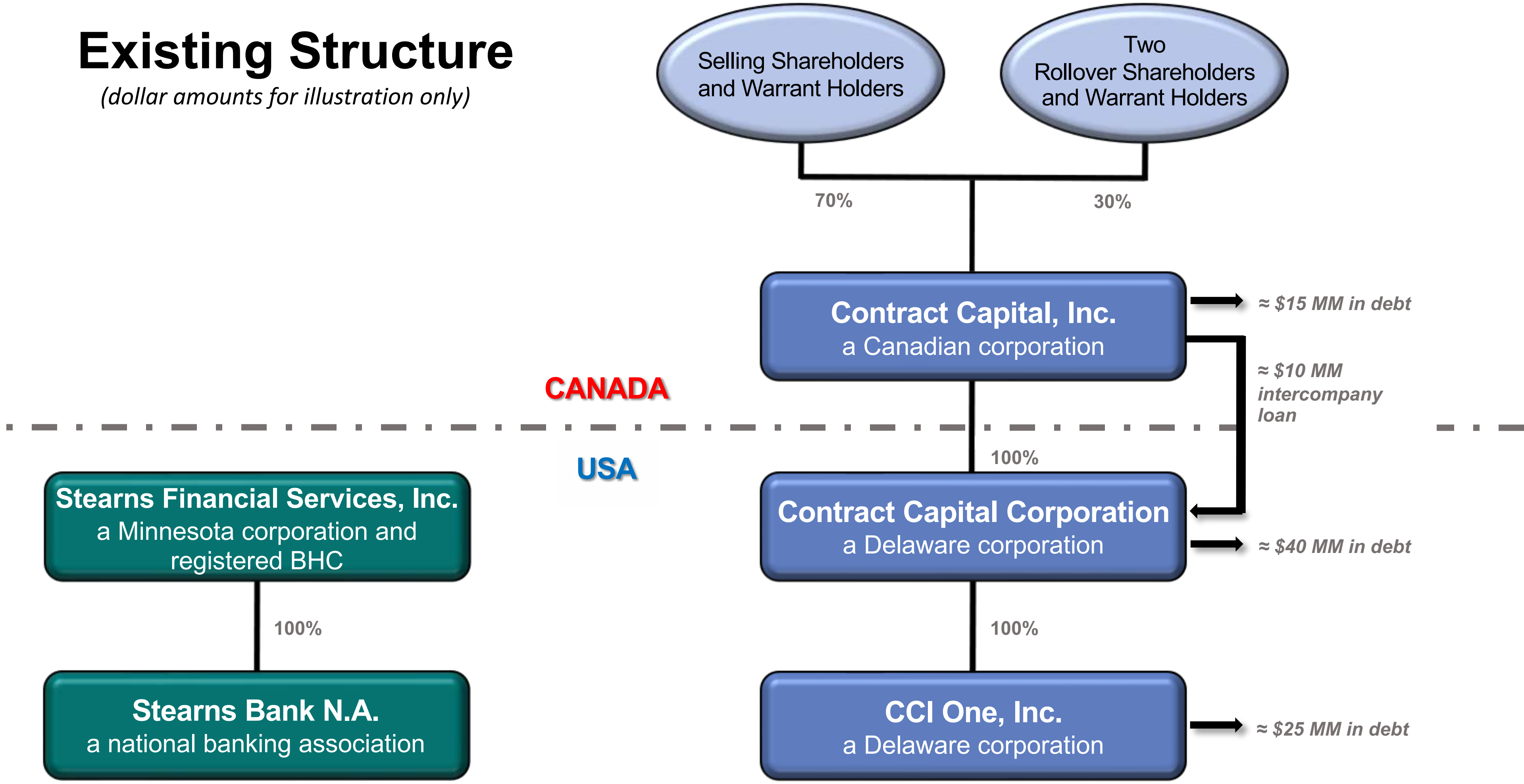
Targets' Customers

Highly Scalable Vendor Finance Company Serving the IT Industry



Existing Structure

(dollar amounts for illustration only)



Challenges Faced by Targets

- Complex capital and ownership structure with intercompany loans and outstanding equity warrants.
- Heavily funded with debt (USD and CAD) and rising interest rates.
- CCI owned by Canadians and taxed in Canada.
- CCC and CCI One operate and taxed in USA.
- A majority (70%) of CCI shareholders wanted to sell (“Selling Shareholders”).
- Two key managers/minority shareholders (30%) wanted to retain their equity and continue working after acquisition (“Rollover Shareholders”).

Business Case for Acquisition

- Stearns Bank already has nationwide leasing expertise.
- Stearns Bank has capital, liquidity, and a lower cost of funds.
  - ➢ refinance Target Company debt with lower interest rate loans
  - ➢ margins on specialty finance leases increase substantially
  - ➢ able to fund business expansion
- Stearns Bank, and CCC and CCI One’s business, are:
  - ➢ all located in USA
  - ➢ not taxable in Canada

Challenges to Structuring Acquisition

A Canadian corporation cannot merge with a US corporation.

Regulation W (Transactions with Affiliates) considerations:

- SFSI considered acquisition of CCI or CCC as subsidiaries (to operate them as sister affiliates of Stearns Bank).
- But loans to a sister affiliate are “covered transactions” - inefficient, cannot access lower cost of funds.
    - ➢ Subject to loans to one borrower rule
    - ➢ Must be on arms-length market terms
    - ➢ Requires 130% over collateralization

Tax Challenges to Structuring Acquisition

- Desire to avoid double taxation to CCI's Selling Shareholders.
- Desire of Rollover Shareholders to pay no taxes on acquisition.
- Desire of Stearns Bank to create amortizable goodwill.
  - ➢ Purchase price becomes Stearns Bank's basis in CCC stock.
  - ➢ no amortizable goodwill created because not an asset purchase transaction
  - ➢ no way to make 338(h)(10) election
- If Rollover Shareholders retain 30%, CCC cannot be consolidated with SFSI's income tax return.

Cross-Border Tax Challenges

- CCI and CCC file separate tax returns in Canada and United States.
- Costly to move money across the border: tax toll on repatriations.
- Avoid a “Canadian corporate sandwich” (very tax inefficient).
- CCC’s employees are in Canada.
- SFSI and Stearns Bank did not want to own a Canadian corporation.
  - Avoid Canadian tax returns
  - Avoid regulation in Canada

Structuring Solutions

- CCI sells 70% of CCC stock to Stearns Bank (taxable).
  - ➢ CCC and CCI One become Operating Subsidiaries of Stearns Bank
  - ➢ Consolidated with Stearns Bank and SFSI for GAAP & RAP (but not on income tax return because < 80% ownership)
- Avoids Regulation W concerns.
- Stearns Bank can refinance all CCC and CCI One debt with a lower cost of funds.

- CCI uses proceeds of sale to:
  - ➢ pay off its debt
  - ➢ redeem warrants
  - ➢ redeem CCI shares (70%) from the Selling Shareholders
- Rollover Shareholders become sole shareholders of CCI and indirectly, 30% owners of CCC.
- Formation of Newco Canada to employ Canadian personnel.

Primary Transaction Documents

Agreement and Plan of Reorganization

- sets forth the sequence of multi-step acquisition
- ties together all Transaction Documents

Stock Purchase Agreement

- commitment of Stearns Bank to purchase and CCI to sell 70% of stock of CCC
- location of primary representations, warranties, covenants and indemnification

Share Redemption Agreement

- commitment of CCI to redeem shares from the Selling Shareholders with net proceeds of sale of 70% CCC stock
- commitment of Selling Shareholders to sell their shares, subject to closing of acquisition by Stearns Bank

Commercial Loan Agreement

- loan made prior to closing by Stearns Bank to CCC to repay intercompany debt
- loan made post closing by Stearns Bank to CCC to refinance CCC and CCI One debt at a lower interest rate

Step 1 – Pre-Acquisition Loan

(dollar amounts for illustration only)

- Stearns Bank loans CCC ≈ $15 MM
  - ➢ Commercial Loan Agreement, Promissory Note, Security Agreement
  - ➢ Guaranty by CCI, secured by Stock Pledge Agreement with CCC stock
- CCC uses proceeds of Stearns Bank's loan to:
  - ➢ repay ≈ $10 MM intercompany loan from CCI
  - ➢ pay a ≈ $5 MM special dividend to CCI
- CCI uses proceeds of loan and dividend to repay $15 million of CCI indebtedness to 5 creditors of CCI (in USD and CAD)

Step 1 – Pre-Acquisition Loan

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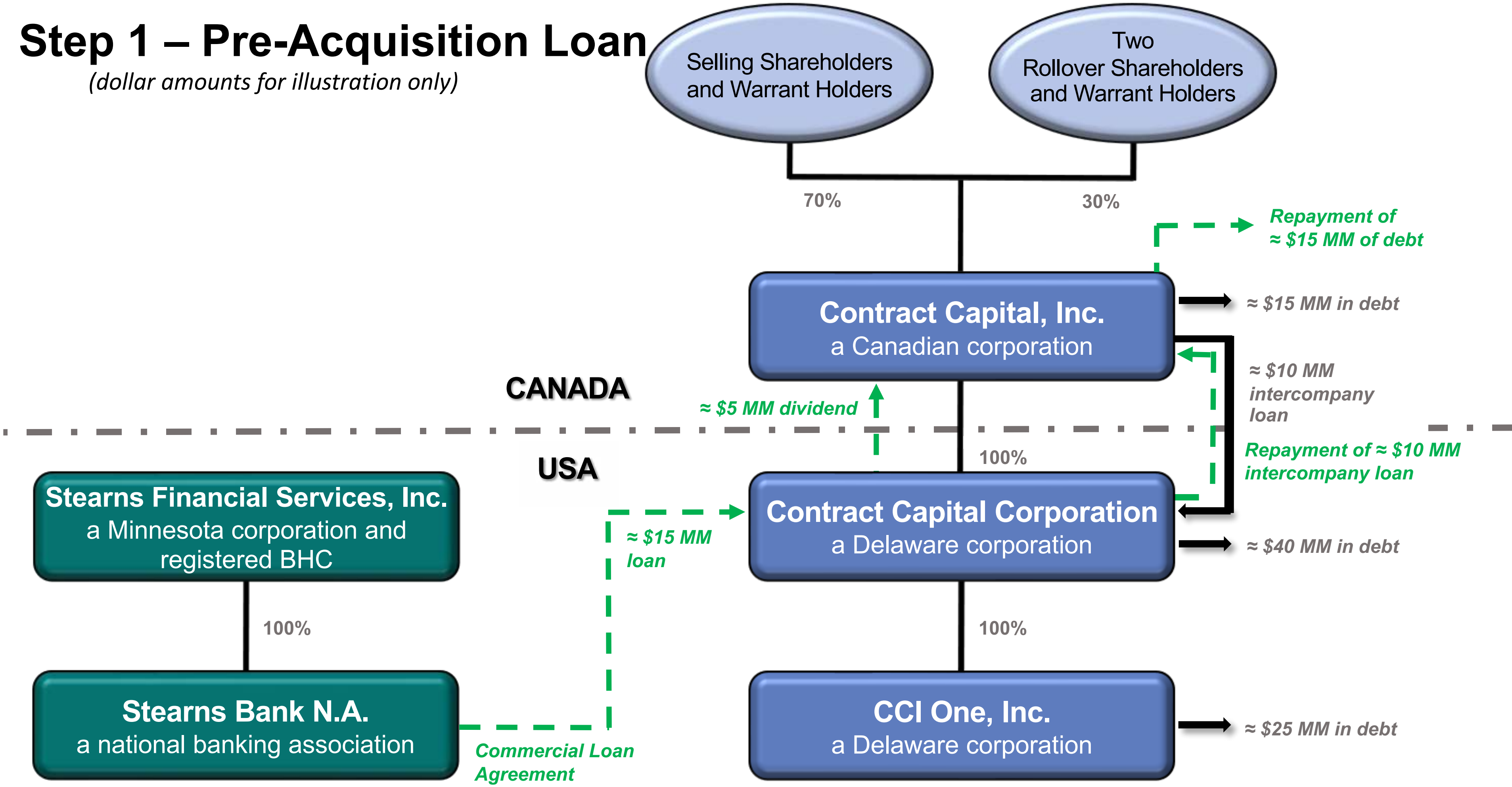
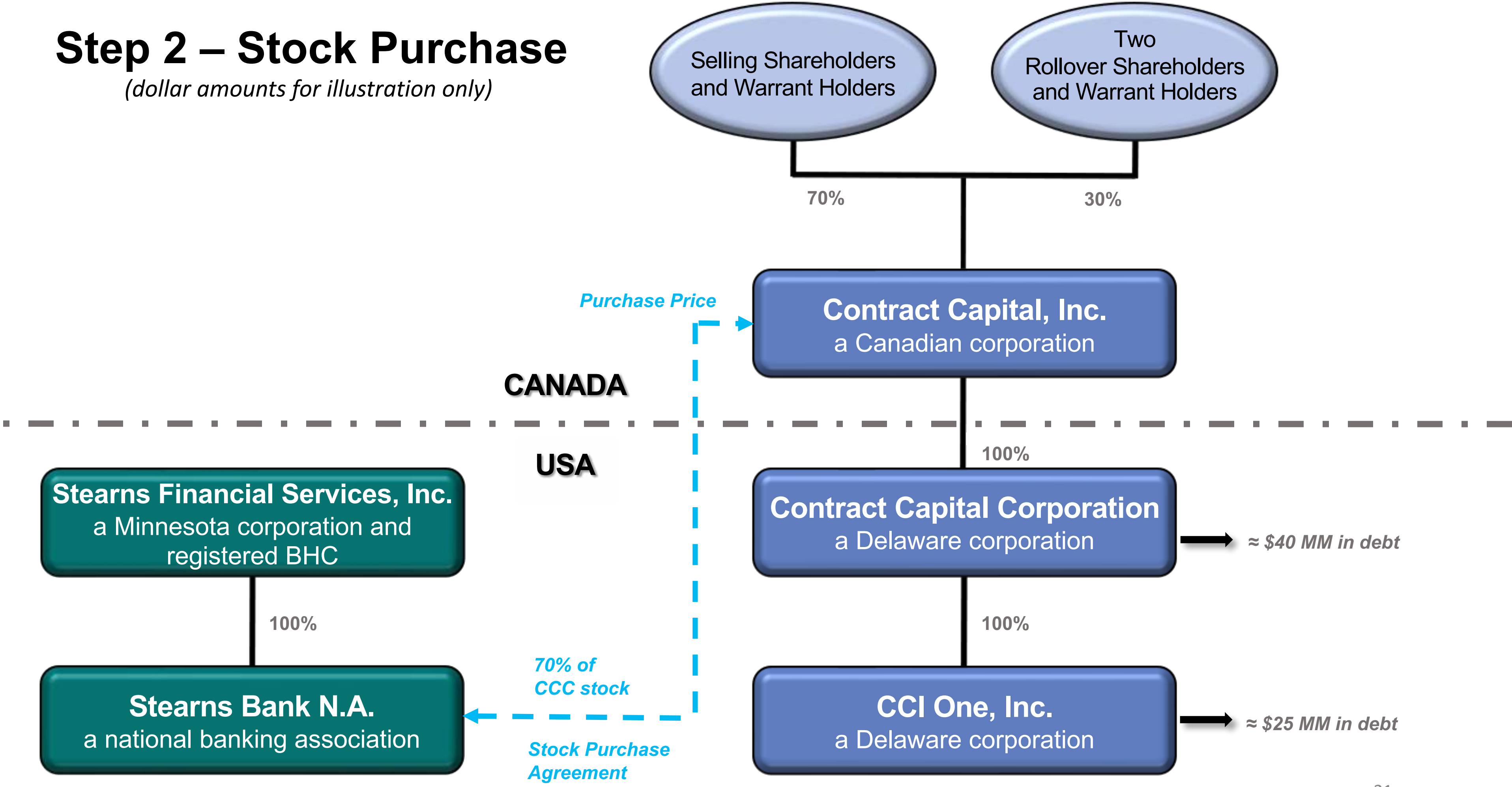


Step 2 – Stock Purchase

- After funding the Pre-Acquisition Loan, parties closed the stock purchase.
  - CCI sells 70% of stock of CCC to Stearns Bank
  - Purchase Price: $XX MM (all cash)
  - CCI retains 30% ownership interest in CCC
- CCI pays or accrues for all Canadian taxes due as a result of the stock sale.
- CCI released from Guaranty of commercial loan.
- Ancillary documents include:
  - Shareholders Agreement
  - Master Services Agreement

Step 2 – Stock Purchase

(dollar amounts for illustration only)



Canadian Employees

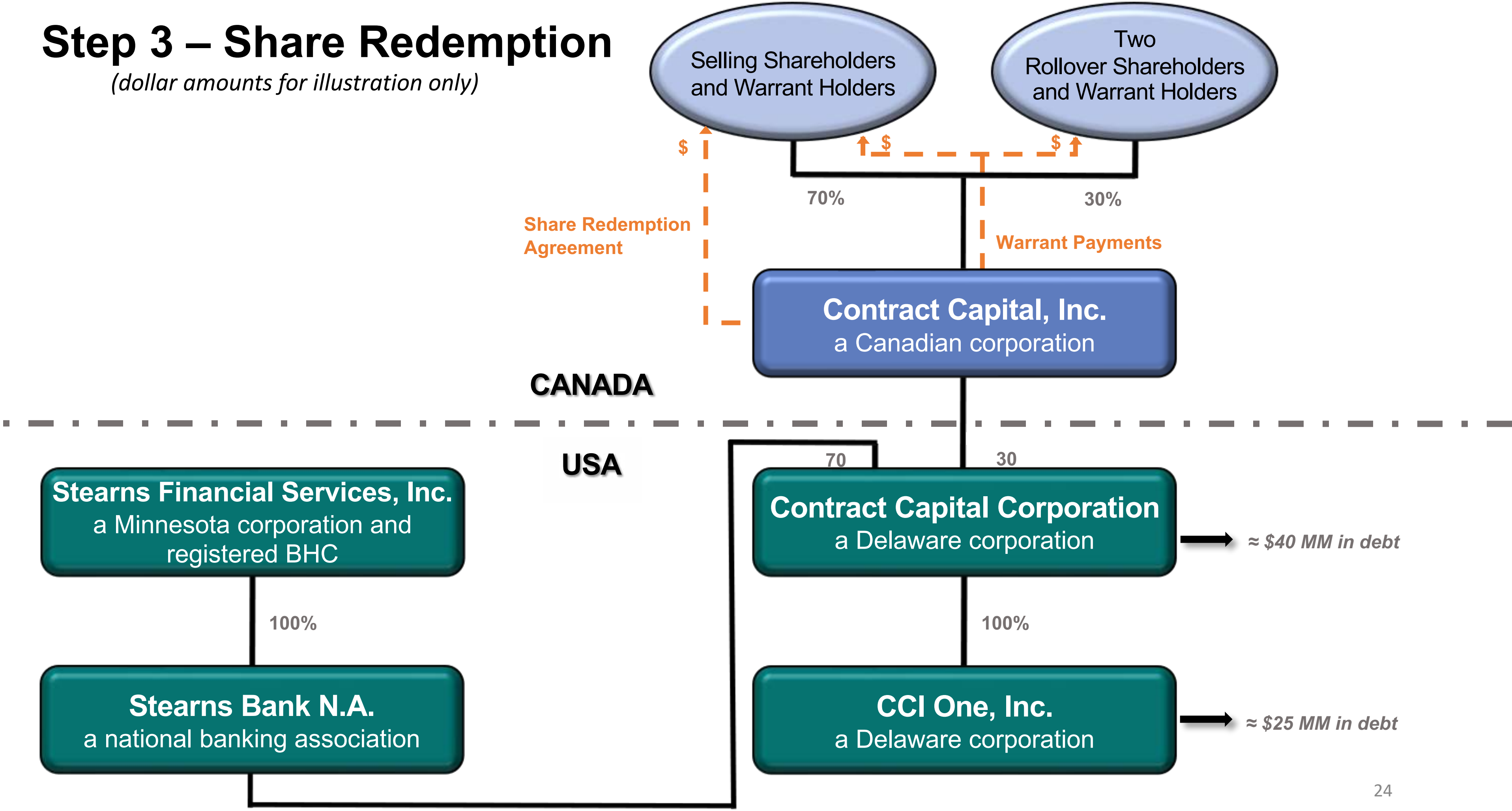
- Prior to closing, CCC formed a new Canadian corporation, Contract Capital Canada, Inc. ("Newco Canada"), as its wholly-owned subsidiary.
- Upon closing the stock purchase, all Canadian employees of CCI became employees of Newco Canada.
- Rollover Shareholders (key executives) enter into employment agreements with Newco Canada.

Step 3 – Share Redemptions & Warrant Payouts

- CCI receives proceeds from sale of CCC shares
- CCI uses net proceeds (after taxes) to:
  - redeem all CCI shares from the Selling Shareholders (70%)
  - redeem and retire all outstanding CCI Warrants
- As a result of the redemptions:
  - Rollover Shareholders own 100% of CCI and 30% of CCC (indirectly) without incurring any tax liability in Canada or US

Step 3 – Share Redemption

(dollar amounts for illustration only)



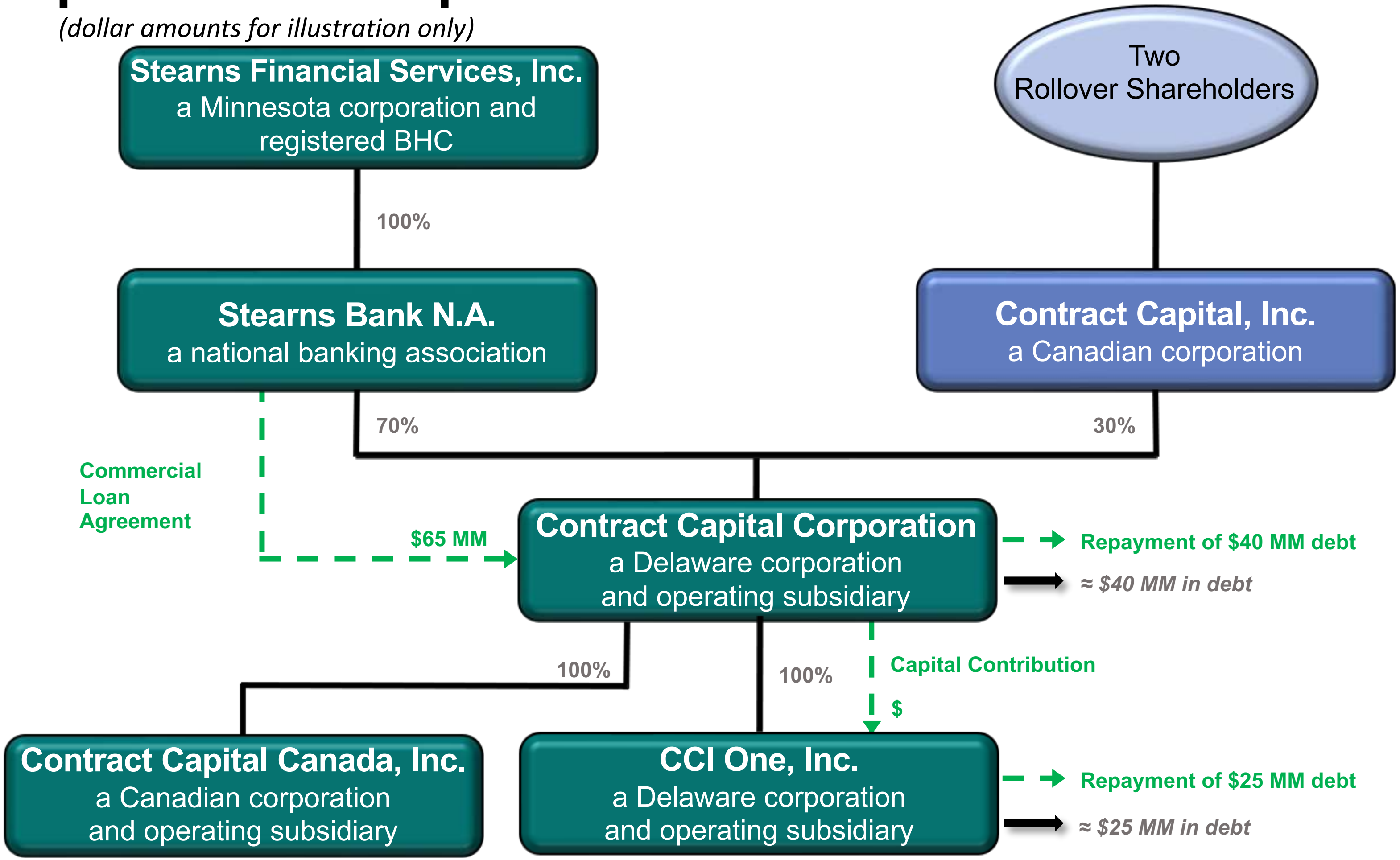
Step 4 – Post-Acquisition Operations

- CCC, CCI One and Newco Canada become operating subsidiaries of Stearns Bank.
  - Stearns Bank gave after-the-fact notice to OCC
- Avoid Reg W (transactions with affiliates) constraints.
- No limit on amounts that Stearns Bank may lend to CCC and CCI One to support growth.

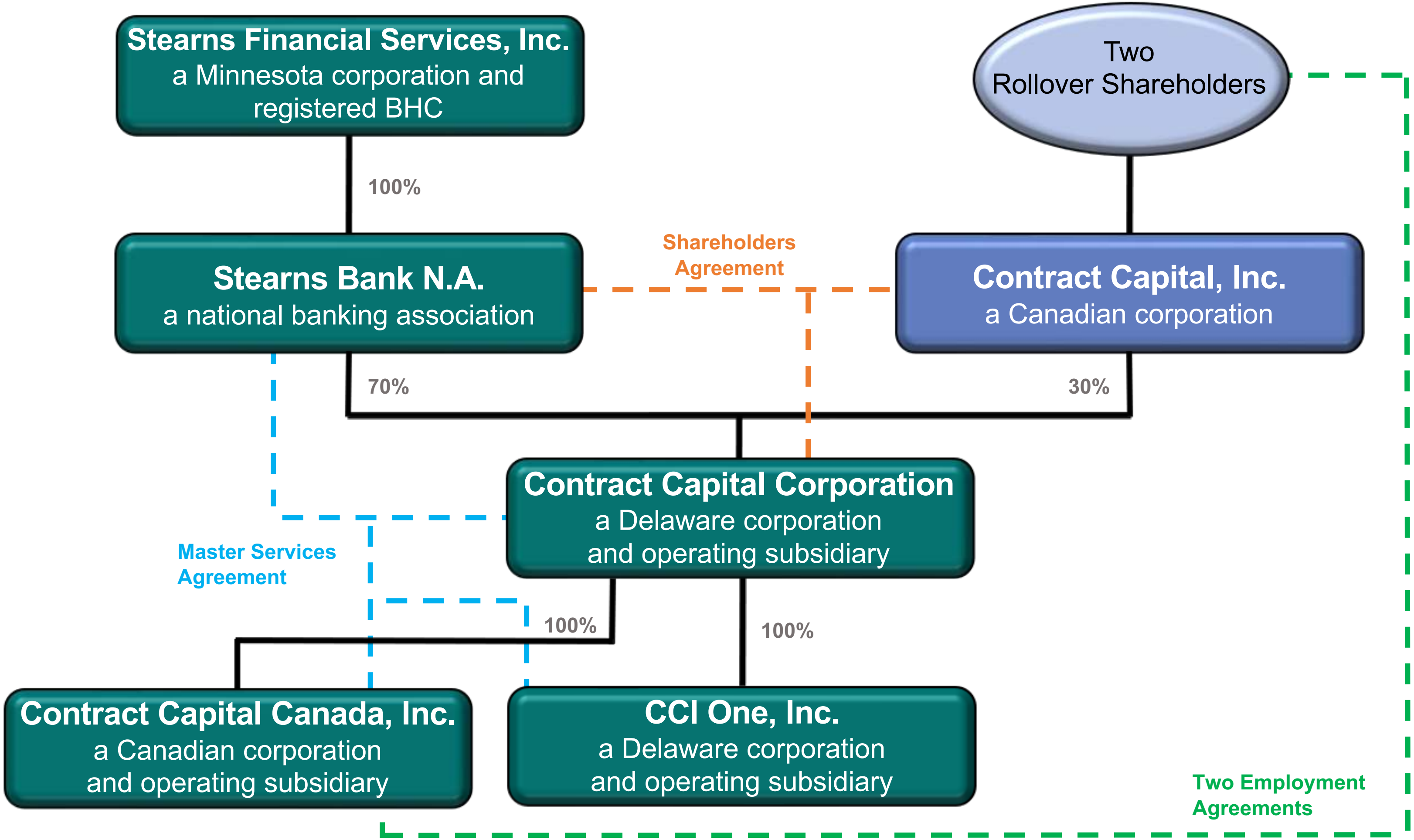
- Stearns Bank loaned an additional $65MM to CCC to refinance $40MM of CCC debt and $25 MM of CCI One debt.
- Structure did not result in amortizable goodwill.
- Master Services Agreement provided for CCC to pay a Special Management Fee to Stearns Bank before 70/30 profit split.

Step 4 – Post-Acquisition Loan

(dollar amounts for illustration only)



Post Acquisition Structure & Agreements



Financial Statements and Tax Returns

- CCC, CCI One, and Newco Canada are consolidated in Stearns Bank and SFSI's GAAP financial statements.
- CCC and CCI One will file a consolidated US income tax return, but are not consolidated with SFSI and Stearns Bank's US income tax return.
- Stearns Bank qualifies for the 65% dividends-received deductions on dividends paid by CCC.
- All interest earned by Stearns Bank on $80 MM intercompany loan to CCC is taxable income.
- Payments made by CCC to Newco Canada for use of Canadian employees are deductible on CCC's US income tax return.

Is the Acquisition Working?

- Acquisition was completed September 13, 2023.
- As of December 31, 2023, CCC and CCI One had:
  - ≈ $90 MM of specialty equipment leases
  - 252 active customers and 376 active leases
- CCC's borrowing costs decreased by 850 bps.
- Retained all CCI employees.
- Projected 2024 growth of CCC portfolio is ≈ 20%.

Questions for the Panel?

Thank You

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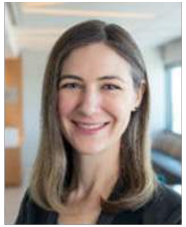

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