

BankDirector.

Breakout 4: How Banks Should Make the Decision to Buy or Sell

Josh McNulty

Hunton Andrews Kurth LLP

Beth Whitaker

Hunton Andrews Kurth LLP

#A0BA24

How Banks Should Make the Decision to Buy or Sell

Acquire or Be Acquired Conference

Phoenix, Arizona

January 28, 2024

Joshua T. McNulty

Hunton Andrews Kurth LLP
1445 Ross Avenue, Suite 3700
Dallas, TX 75202
214-468-8223
jmcnulty@huntonAK.com

Beth A. Whitaker

Hunton Andrews Kurth LLP
1445 Ross Avenue, Suite 3700
Dallas, TX 75202
214-468-3575
bwhitaker@huntonAK.com

Joshua McNulty



PRACTICES

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

CONTACT

jmcnulty@huntonak.com
1445 Ross Avenue, #3700
Dallas, TX 75202
p 214.979.8223

EDUCATION

JD, Loyola University Chicago School of
Law, 2010
BA, University of Arizona, 2007

BAR ADMISSIONS

Texas, Michigan

Josh's practice focuses on corporate governance, mergers and acquisitions, securities, and regulatory representation for state and national banks, holding companies, and other financial institutions. Josh counsels state and national banks, holding companies and other financial institutions on state and federal regulatory compliance issues, including all aspects of regulatory matters involving the Federal Deposit Insurance Corporation, the Federal Reserve, the Office of the Comptroller of the Currency, the Texas Department of Banking and the Consumer Financial Protection Bureau. He also advises clients on corporate governance, stockholder matters, shareholder agreements, fiduciary obligations and a broad range of public and private capital market transactions, including initial public offerings and private placements.

Relevant Experience

- Represented Allegiance Bancshares, Inc. in its \$864 million merger of equals with CBTX, Inc. (forming Stellar Bancorp, Inc.)
- Represented Pioneer Bancshares, Inc. in its \$218 million sale to FirstSun Capital Bancorp
- Represented Friendswood Capital Corporation in its \$66.5 million sale to Home Bancorp, Inc.
- Represented Texas Citizens Bancorp, Inc. in its sale to Business First Bancshares, Inc.
- Represented a community bank in purchase of a factoring company
- Represented a national bank in the creation of an Opportunity Zone Fund
- Represented Allegiance Bancshares, Inc. in its acquisition of Post Oak Bancshares, Inc.
- Represented Woodforest National Bank in the sale of its asset-based and equipment finance lending businesses, including \$495 million loan portfolio, to Sterling National Bank
- Represented issuers and investment bankers in numerous financial institution capital transactions (public and private)

Speaking Engagements & Publications

- "Key Need to Know Information for New Board Members," Southwest Graduate School of Banking, Dallas, TX, November 2023
- "Bank Failures Lead to a Changing Industry – What to Expect", May 2023
- "Federal Reserve Launches New Bank Term Facility Program" March 2023
- "Critical Issues Facing Community Banks," Kansas Bankers Association, February 2023
- "How Banks Should Make the Decision to Buy or Sell," BankDirector – Acquire or be Acquired, Phoenix, AZ, January 2023

Beth Whitaker



PRACTICES

Banking and Finance

Financial Institutions Corporate and
Regulatory

Mergers and Acquisitions

Corporate

Capital Markets and Securities

Environmental, Social and Governance
(ESG)

CONTACT

bwhitaker@huntonAK.com

1445 Ross Avenue, #3700

Dallas, TX 75202

p 214.468.3575

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 its initial public offering (2019)
- Represented Trinity Capital Corporation in its sale to Enterprise Financial Services Corp (2019)

Speaking Engagements & Publications

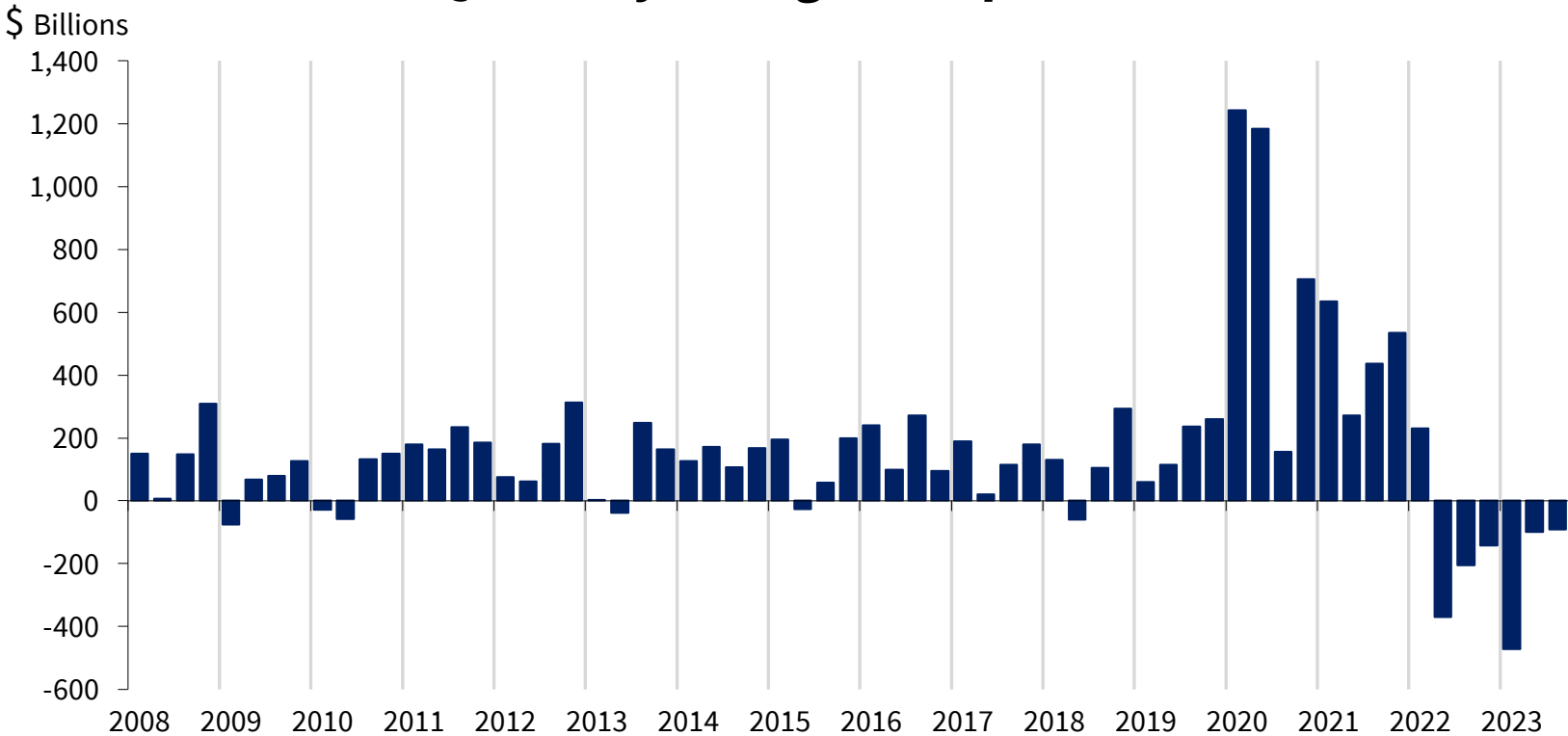
- "Legal Trends in Banking," FORVIS 2023 Financial Services Virtual Symposium, November 2023
- "How Banks Should Make the Decision to Buy or Sell," BankDirector – Bank Board Training Forum, Nashville, TN, September 2023
- "How Banks Should Make the Decision to Buy or Sell," BankDirector – Acquire or be Acquired, Phoenix, AZ, January 2023
- "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

Where Are We Now?

Liquidity and Credit

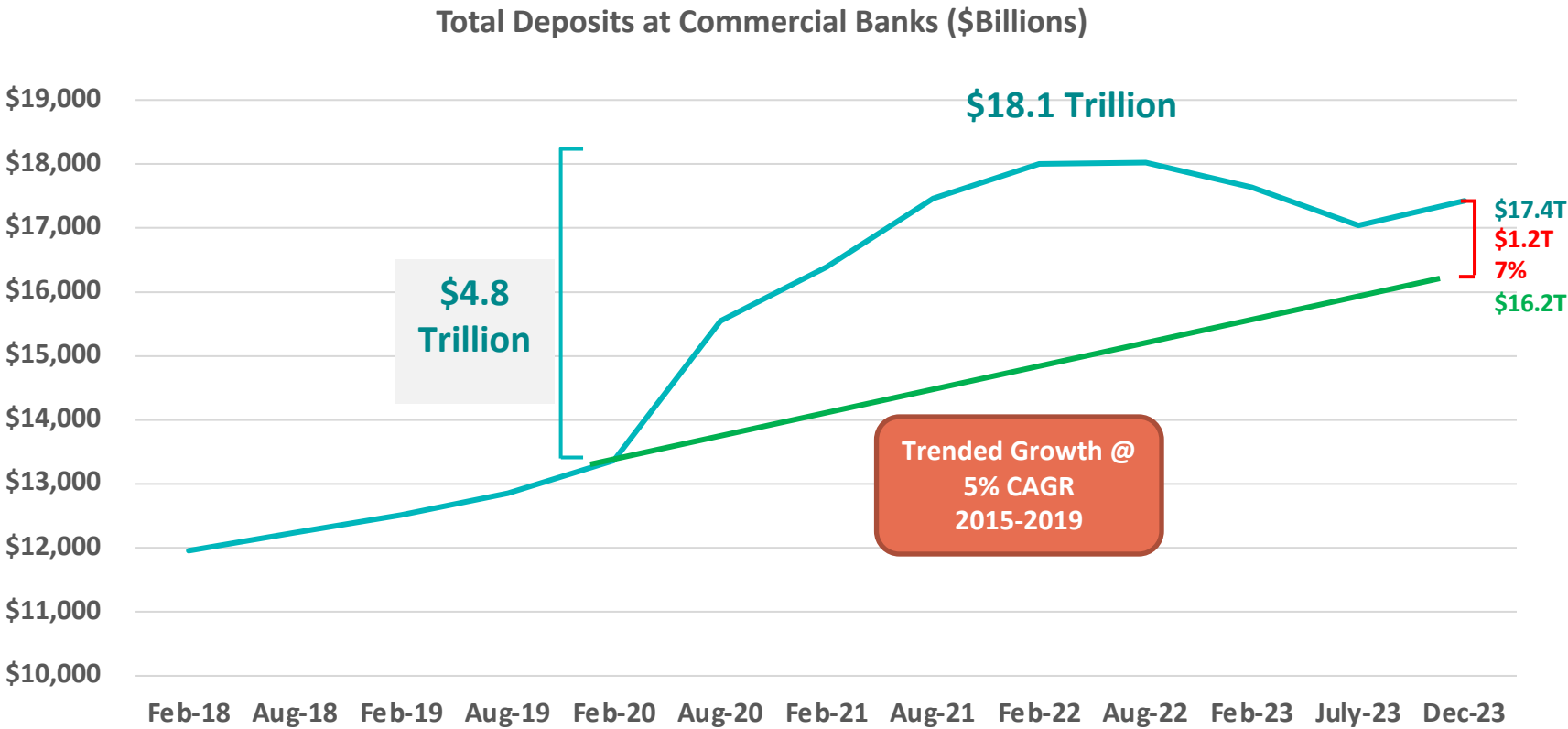
Community Bank Report – FDIC –2023

Quarterly Change in Deposits



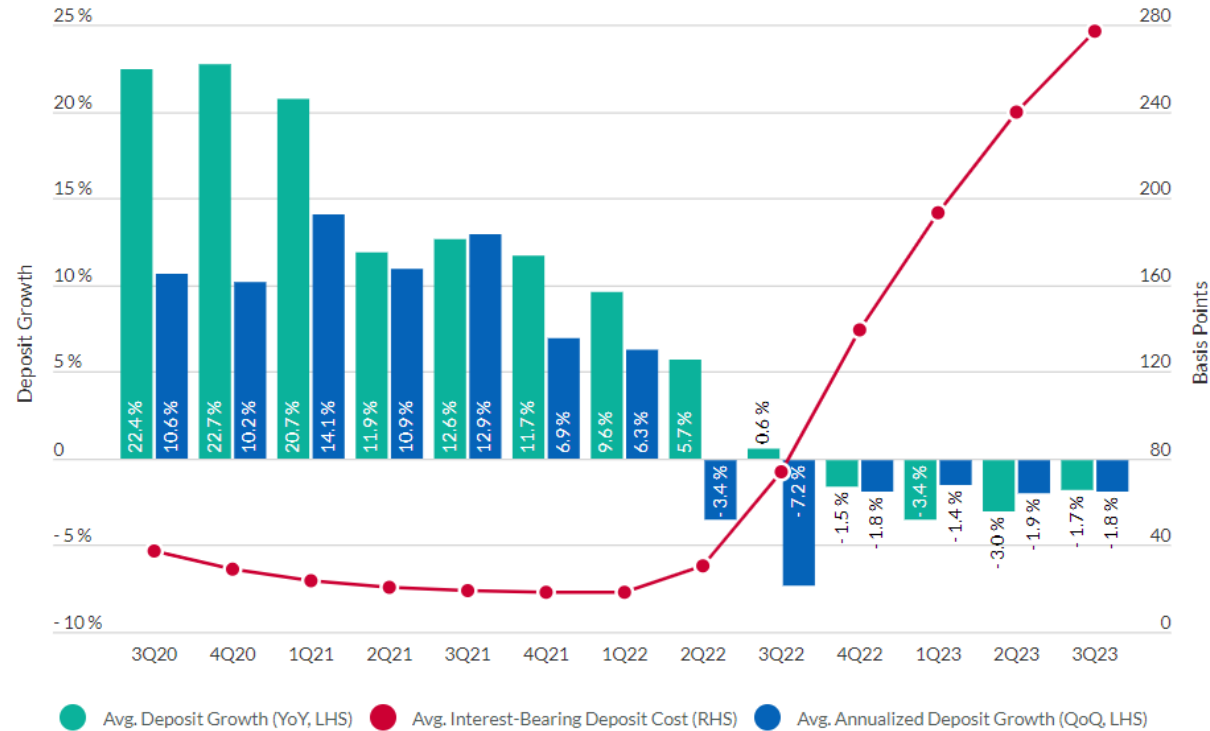
Source: FDIC.

Deposits are Shrinking with \$1.2T to go....



U.S. Bank Deposit Outflows Should Continue to Stabilize into 2024

Interest-Bearing Deposit Costs for 3Q23 are 3.7x Higher YoY

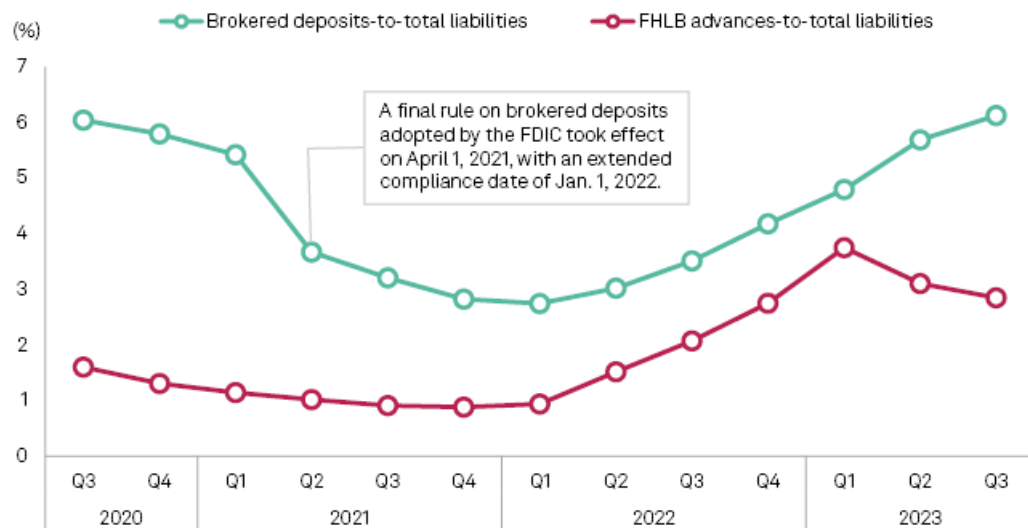


Note: Banks include: AXP, ALLY, BAC, CFG, C, DFS, FITB, HBAN, JPM, KEY, MTB, PNC, RF, TFC, USB, WFC.

Source: Fitch Ratings.

Brokered Deposits and FHLB Advances at US Banks (%)

Brokered deposits and FHLB advances at US banks



Data compiled Dec. 11, 2023.

FHLB = Federal Home Loan Bank.

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

A final rule on brokered deposits that apply to insured depository institutions adopted by the Federal Deposit Insurance Corp. on Dec. 15, 2020, took effect on April 1, 2021, with an extended compliance date of Jan. 1, 2022. This establishes a new framework for analyzing certain parts of the "deposit broker" definition.

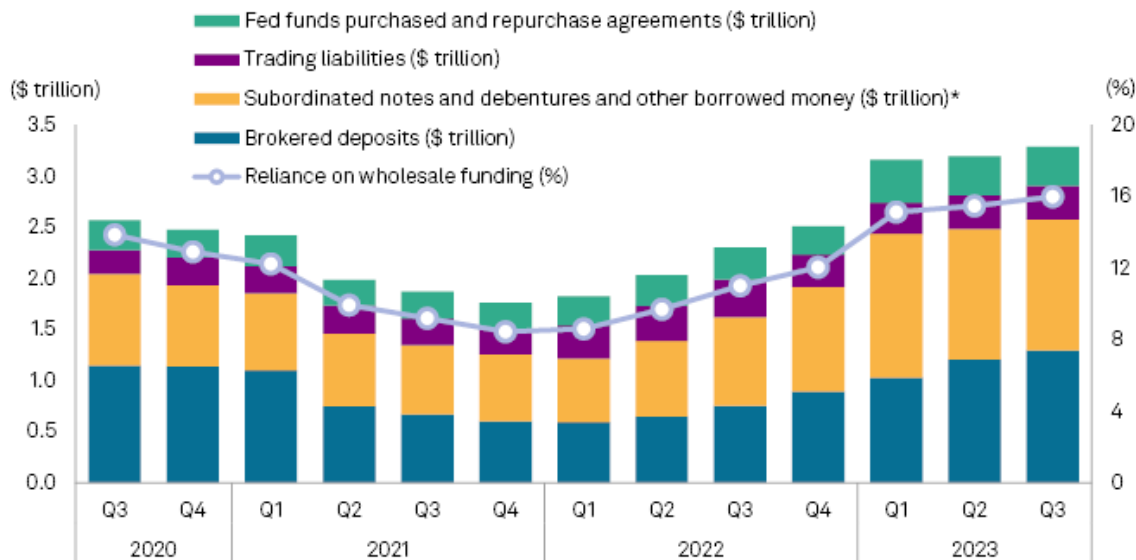
Data based on regulatory filings.

Source: S&P Global Market Intelligence.

© 2023 S&P Global.

Wholesale Funds Trends at US Banks

Wholesale funding trends at US banks



Data compiled Dec. 11, 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.

* Other borrowed money includes mortgage indebtedness and obligations under capitalized leases.

Data based on regulatory filings.

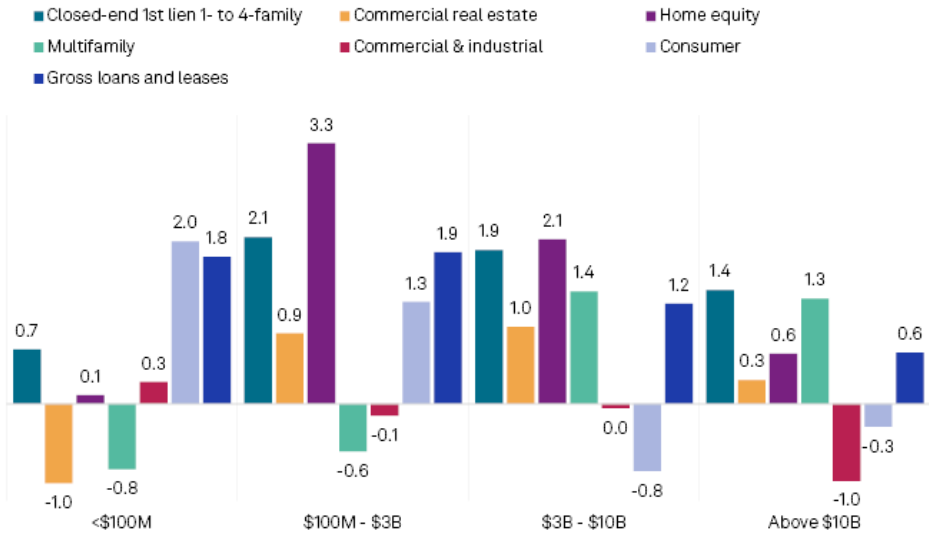
Source: S&P Global Market Intelligence.

© 2023 S&P Global.

Median Loan Growth by Bank Asset Size and Type (%)

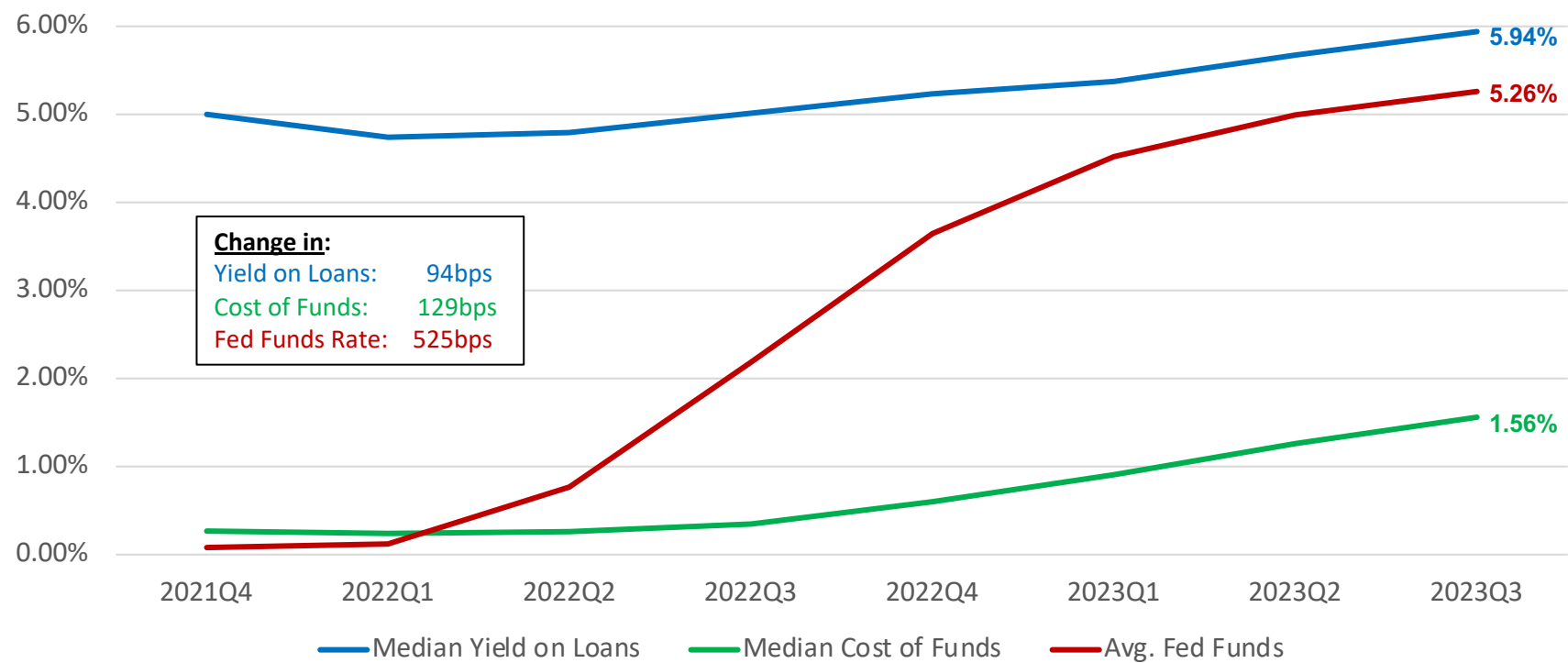
Median loan growth by bank asset size, type (%)

Q3 2023 vs. Q2 2023 change



Data compiled Nov. 13, 2023.
Consumer loans exclude home equity loans.
Home equity loans include revolving open-end one- to four-family loans (home equity lines) and closed-end junior lien one- to four-family loans.
Analysis includes US commercial banks, savings banks, and savings and loan associations.
Nondepository trusts and banks with a foreign banking organization charter are excluded.
Data based on regulatory filings as of Sept. 30, 2023.
Loan categories are not representative of the entire loan portfolios.
Source: S&P Global Market Intelligence.
© 2023 S&P Global.

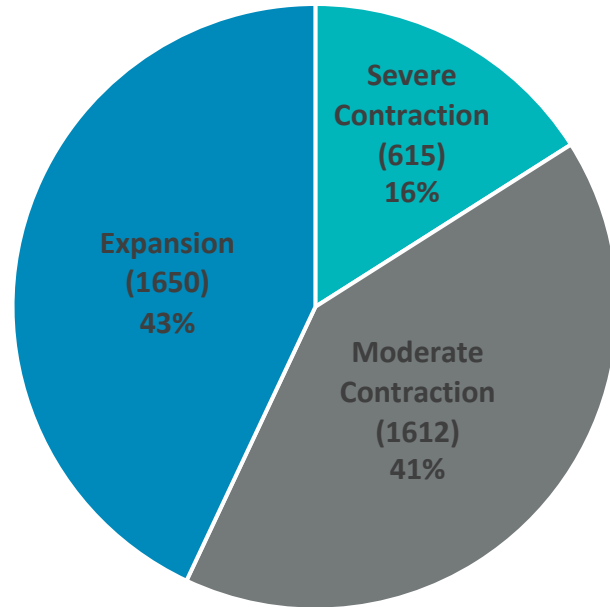
Loan Yields and Cost of Funds vs. Fed Funds Rate



Note: Includes all commercial banks and savings banks (top tier consolidated only) with assets less than \$20B. Avg. Fed Funds Effective Rate is an Average for each respective quarter.
Source: S&P Capital IQ Pro; Federal Reserve Bank of St. Louis. Data as of 09/30/2023

Net Interest Margin Contraction/Expansion

The industry is bifurcated: 43% of banks expanded NIM in Q3 2023



Q3 2023 Change in NIM:

Expansion (1650):	>0.00%
Moderate Contraction (1612):	(0.20%) – 0.00%
Severe Contraction (615):	<(0.20%)

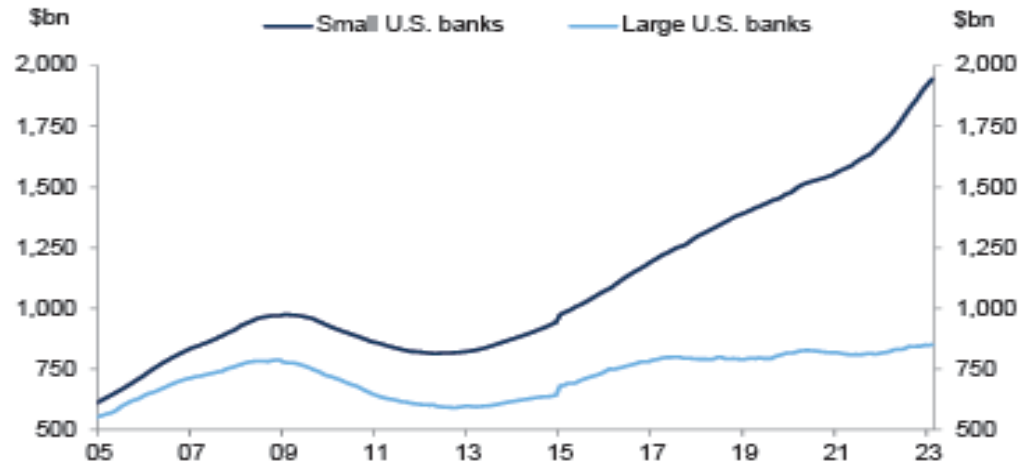
- The majority of the banking industry experienced NIM contraction in the third quarter of 2023.
- 43% of banks experienced NIM expansion.
- 16% of banks experienced NIM contraction greater than 20 bps. On average these banks' NIM decreased by 40 bps.

Note: Includes all commercial banks and savings banks (top tier consolidated only) with assets less than \$50B. Grouping based on change in Q3 2023 Net Interest Margin.

Source: S&P Capital IQ Pro; Data as of 09/30/2023

CRE Exposure to Banks

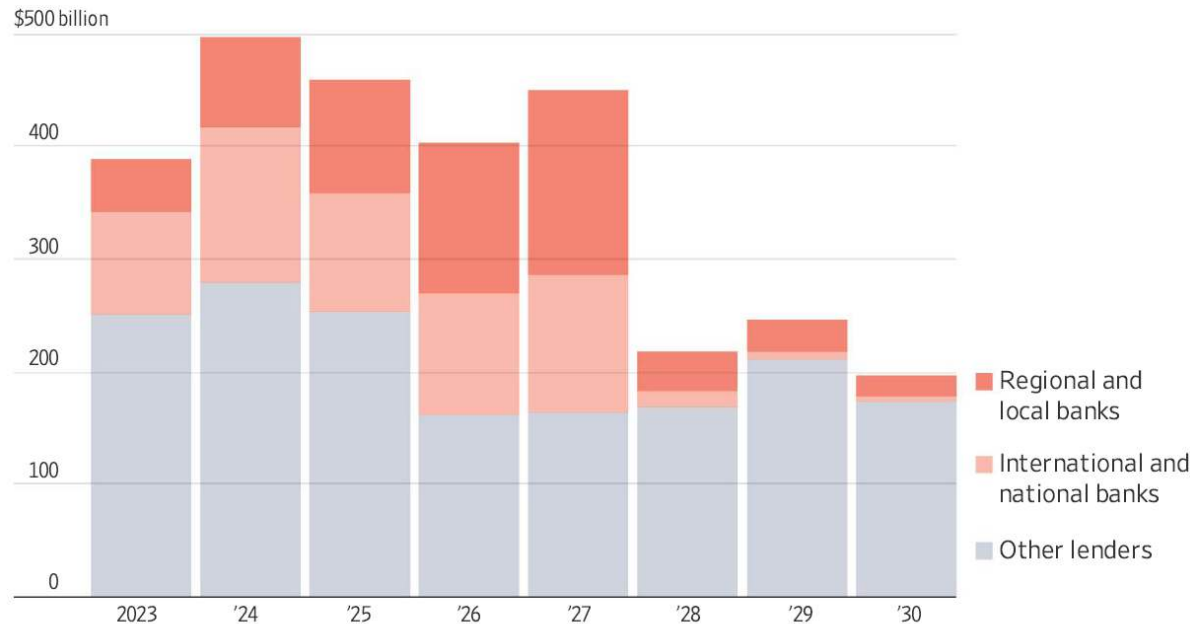
- Small banks have increased their share of commercial mortgages vs. large bank peers



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.



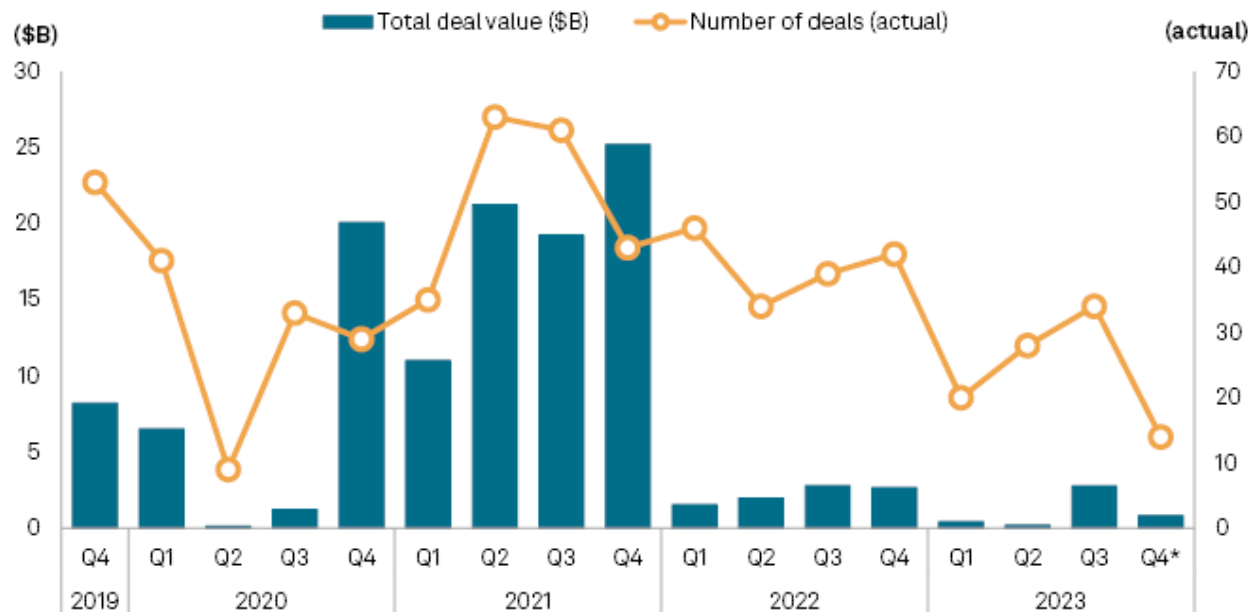
Note: Other lenders include commercial mortgage backed securities, insurance companies and private and government lenders.

Source: MSCI Real Assets

M&A Activity

M&A for 2023

14 US bank deals were announced in Q4 2023



Data compiled Dec. 26, 2023.

* Quarter to date as of Dec. 25, 2023.

Deal values are as of the announcement date.

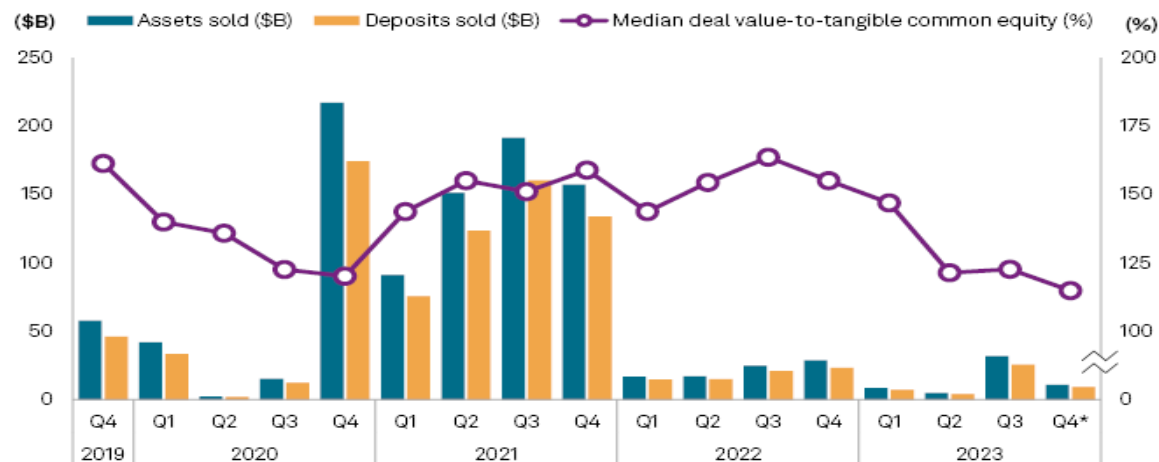
Source: S&P Global Market Intelligence.

© 2023 S&P Global.

M&A for 2023 (cont.)

US bank deal statistics

	Q4 2019	2020	2021	2022	2023*
Number of deals (actual)	53	112	202	161	96
Total deal value (\$B)	8.21	27.93	76.69	8.95	4.21
Assets sold (\$B)	57.74	276.00	590.73	86.95	55.65
Deposits sold (\$B)	46.04	221.65	493.08	73.74	45.84
Median deal value-to-tangible common equity (%)	161.3	134.8	151.8	153.4	124.5



Data compiled Dec. 26, 2023.

Includes US-based whole company, minority stake, and franchise bank and thrift deals that were announced between Oct. 1, 2019, and Dec. 25, 2023. Excludes branch, government-assisted and terminated deals, and thrift merger conversions.

All metrics are as of the announcement date.

* Year to date and quarter to date through Dec. 25, 2023.

Deal value-to-tangible common equity is the deal value as a percentage of tangible common equity acquired; derived from per-share values when all ratio components are available; otherwise, aggregate values are used.

Source: S&P Global Market Intelligence.

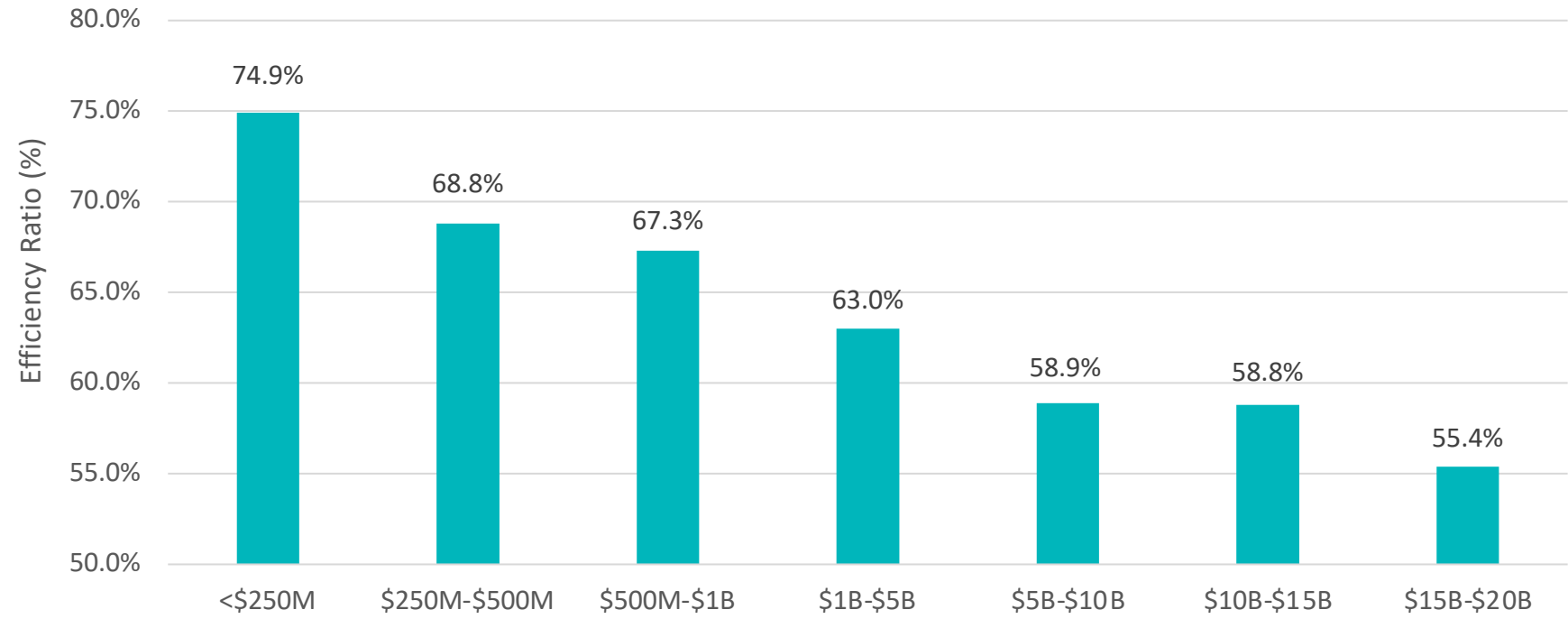
© 2023 S&P Global.

Why M&A for Buyers?

- Greater Scale and Efficiency – overall operating costs keep increasing, especially labor and energy
- Potential funding source
- Concentration relief
- Net Interest Margins (NIMs) are continuing to contract
- Loan demand is picking back up / New loans at FMV help offset legacy loan rates
- Many banks will not be able to grow earnings
- Geographic expansion/diversity

Achieving Economies of Scale With Size

Median Most Recent Fiscal Year Efficiency Ratio by Asset Size



Source: S&P Capital IQ as of Q4 2023

Why M&A for Sellers?

- Concentrations limit the ability to grow loans
- Cost-cutting has reached its limits and is reversing; sellers have 10%+ higher efficiency ratios than buyers
- Shrinking NIMs / rising Cost of Funds (COFs)
- Regulatory pressure / 0% tangible capital
- Coming decline in quality buyers?
- Management succession
- Excess liquidity has dissipated

Recent M&A Challenges

- Sufficient Capital
- Fluctuating bond portfolios / AOCI
- Fixed rate loan portfolios and delayed “churn”
- Deposit decay and core deposit intangible
- “Adjusted shareholders’ equity”
- Regulatory delays and increased scrutiny
- Overcoming credit concerns
- Employee retention
- Cost savings vs. needed investments

Expectations for 2024

- Pace of M&A to pick up at end of the year; pent-up demand
- Appreciating bank stock values allow publicly-traded buyers to return to market
- AOCI marks will continue to dissuade some would be M&A participants
- Bond distribution as part of merger consideration
- Buyers continue to expect 2-3 year Tangible Book Value (TBV) earnback
- Increase in MOEs/strategic combinations, especially of < \$500mm banks
- Investor groups buy small banks in lieu of forming de novos
- More FDIC-assisted transactions; shelf charter opportunities
- More branch transactions

Branch Transactions

- Exiting markets
- Increase Capital
- Reduce Expenses/Overhead
- Variable deposit pricing
- Selection of Assets to be Sold
- Concerns:
 - Concentrations?
 - Post-transaction ratios? Are assets matching deposits?
 - Composition of remaining assets?

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
- Creates risk to various constituencies

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
- Assistance from investment banker

Preparing to be a Seller

- Consider time horizon
- 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
- Consider the use of a special board committee

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
- Prepare for diligence

Evaluating the Dance Partners

For potential sellers:

- Existing management/KSOP/community
- Merger of Equals
- Investor groups
- Traditional bank acquirer
- 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

Consider various acquisition opportunities:

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

For Potential Buyers – What To Do?

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

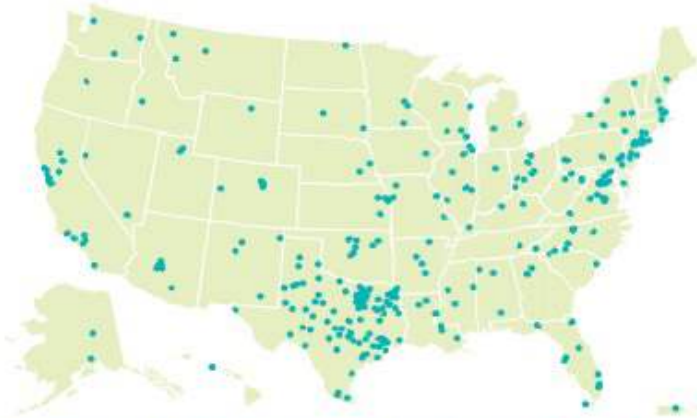
For Potential Buyers – What To Do?

(cont'd)

- Strategic Plan / Integration
- Analysis of pro forma business plan and financials
 - Confirm transaction falls within current capital plan or outline plan to return
 - Evaluate target deposit stability (decay)
 - Combined on-balance sheet liquidity
 - Address current regulator concerns and ratios in application
 - Telegraph updated risk limits around liquidity and interest rate sensitivity
 - Provide pro forma stress testing

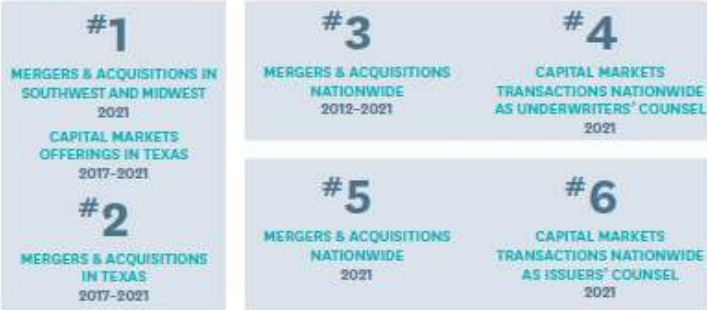
Our National Reach

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



DISCLAIMER

This PowerPoint presentation is an educational tool that is general in nature and for purposes of illustration only. The materials in this presentation are not exhaustive, do not constitute legal advice and should not be considered a substitute for consulting with legal counsel. If legal advice or other expert assistance is required, the services of a competent professional should be sought. Certain materials presented in this presentation were developed by industry sources or obtained from industry publications and research reports prepared for other purposes.

BankDirector.

Breakout 4: How Banks Should Make the Decision to Buy or Sell

Scan here to fill out
the evaluation for
this session.



Josh McNulty

Hunton Andrews Kurth LLP

Beth Whitaker

Hunton Andrews Kurth LLP

#A0BA24