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Recent flurry of bank sales to credit unions sparks national trend, deal-makers say

Analysis

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- Regional trend expected to spread across US.
- Credit unions seeking banks' commercial lending and digital lending capabilities.
- Texas, Pennsylvania ripe for bank sales to CUs.

Acquisition accounting benefits, expertise in business lending and digital lending, and efficient geographic expansion are drawing credit unions toward acquiring banks, deal makers say.

"This is a trend that's going to be bigger and more national in scope over time," said Anton Schutz, senior portfolio manager at RMB Capital Management. "This is going to happen until something gets in their way."

This year has seen a record deal flow of credit unions' acquisitions of banks, said Michael Bell, an attorney and counselor at Howard & Howard. He has observed 14 deals so far this year, compared to nine deals announced last year and 40 deals in total since 2010.

Credit unions with more than USD 700m in assets tend to be buyers, and banks with less than USD 500m in assets are ideal targets for them, said Bell, who has advised on the majority of these deals.

There are 434 credit unions with more than USD 700m in assets and nearly three-quarters of all banks (3,856) below the USD 500m-asset mark, according to regulatory data.

More than a quarter of credit unions' acquisitions of banks have taken place in Florida due to its strong economy, growing population and favorable regulatory environment, said Dennis Holthaus, a managing director at Skyway Capital Markets in Tampa, Florida.

Credit unions in Florida could start to seek bank buys in other states when Florida runs out of inventory of small bank targets, Holthaus said. For example, Tallahassee, Florida-based First Commerce Credit Union in September announced its plans to acquire The Citizens Bank based in Nashville, Georgia. Skyway advised First Commerce in the deal.

Schutz said he expects to see this type of transaction become more robust in other small-bank heavy states such as Texas and Pennsylvania and then spread across the country.

Transaction methods aid credit unions as buyers

Credit unions have found it more convenient to buy a bank than merge with another credit union, said John Stockamp, a director in West Monroe Partners' financial services practice. Acquiring banks usually requires board approval from the credit union bidder; however, in a transaction between two credit unions, both parties need to convince their board members and all depositors, he said.

Accounting methods also favor credit unions that seek bank buys as they can count banks' goodwill as capital in the transaction, Schutz said.

The standard transaction is an all-cash deal with an earnout period of three to five years, said Bell. For bank sellers, it's beneficial to add cash buyer credit unions to their bidder list as bank buyers sometimes pay in stock, Bell added.

Bell said he has seen banks being sold at 1.4x to 2.3x book value to credit unions over the past one and a half year, and believes valuations are in line with how much banks are sold to other banks.

The medium bank sales multiple is around 2x book value in Florida and 1.5x to 1.6x book value in other states, Holthaus said. As cash bidders, credit unions should be able to pay less than other bank bidders, but many strategic benefits make credit unions willing to pay the average banking industry multiples, he said.

Bank sellers that are afraid of the future markets usually see all-cash transaction attractive, but those trying to defer taxes may want to get shares from the bidders, Schutz noted.

Bank targets offer cheap entry into business lending, geographies

Credit unions are on the lookout for growth catalysts, and banks' commercial lending and digital lending capabilities are attractive.

Historically, credit unions don't have as much experience in commercial and business lending as banks, Bell said.

Higher-yielding commercial lending such as real estate and construction loans can bring higher returns than the lower-yielding consumer lending such as mortgage and auto loans, said Schutz, even though higher-yielding lending brings greater risk. There's "a brave new world" to combine commercial lending expertise with credit unions' own credit analysis skills, which can lead to a lot of growth, he said.

Meanwhile, as credit unions continuously look for digital upgrades, banks' technology capability is an additional bonus for them, Bell said. Credit unions have been forming Credit Union Service Organizations (CUSOs) to invest in fintech firms, he said, pointing to the deal that Jacksonville, Florida-based VyStar Credit Union in August announced a USD 10m investment in Payveris via CUSO.

Schutz said he sees CUSO investment more as venture capital investment than a M&A, but agrees it suggests that credit unions are aggressively seeking revenue ambitions and digital expertise.

Banks with digital initiatives in loan origination, loan application, account signup, peer-to-peer payments and work flow management are attractive for credit unions, Stockamp said.

For geographic expansion, acquiring banks is always cheaper versus organic growth, Bell said. If a credit union chooses to buy land, build a branch, hire employees and attract customers, it will probably need seven to 10 years for the branch to become profitable, he said.

Credit unions can only use retained earnings to finance bank acquisitions. "Once they build it, they have very few ways to spend it," Bell said. "This is one of the ways they can spend it… and earn it back quickly."

by Xinyi Jiang in Charlottesville, Virginia

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