M&A

How regulations drove a digital bank into unlikely hands

By John Reosti
March 08, 2017

Luvleen Sidhu admits she is disappointed BankMobile is being forced to part ways with its corporate parent, Customers Bancorp, but Sidhu calls its prospective buyer, Flagship Bank, the perfect new business partner.

When the $9.4 billion-asset Customers in Wyomissing, Pa., decided last fall to spin off BankMobile, one of the key attributes it looked for in a purchaser was size – in this case the smaller the better.

"We expect [BankMobile] to remain a high-growth company, so we wanted to position ourselves to remain under $10 billion of assets" for as long as possible to avoid regulatory strictures that would have kicked in at that size, Sidhu said Wednesday in an interview after the deal with Flagship in Clearwater, Fla., was announced.

Consider that box checked.

The 11-year-old Flagship, which has two branches and just $113 million of assets, certainly qualifies as small. Indeed, the $260 million-plus that Flagship is seeking to raise in a private placement to pay for BankMobile is 20 times the $13.2 million of capital it held as of Dec. 31, according to Federal Deposit Insurance Corp. figures.

The $10 billion-asset threshold, of course, is the mark at which the Durbin amendment and its 44-cent cap on interchange fees kicks in for banks. Continued growth at the holding company level created a huge challenge for BankMobile, where debit card fee income is a make-or-break component of its revenue stream.

With Flagship – which plans to adopt BankMobile as its corporate name – as its parent, the two-year-old digital-only bank will not have to worry again about bumping up against the Durbin amendment for several years. Even so, Sidhu said she regrets things came to this pass.

"It's unfortunate," she said. "If the regulation was different, we definitely would have chosen to stay with Customers."

Ironically, Flagship also recognized BankMobile's predicament as a strategic inflection point.

Flagship is well capitalized, and it has been profitable, earning $1.3 million the past five years. Still, board members were concerned about its future, Frank Burke, its chairman, president and CEO, said Wednesday.

"We looked at our long-term prospects," Burke said. "We're a small bank, and while we're well capitalized, the opportunities to keep growing in this market and to continue raising capital were limited."

The board explored various M&A alternatives, but when the BankMobile opportunity surfaced, Burke said it seemed to offer the "best of both worlds" – the chance to continue operating as a local community bank while at the same time hitching its wagon to a rapidly growing national digital banking franchise, which has reached $500 million in deposits in just two years of operation.

Flagship had $93.2 million of deposits at Dec. 31.

With BankMobile's 1.7 million customer accounts dwarfing Flagship's book, agreeing to change the corporate name to BankMobile was a no-brainer, Burke said.

Flagship has agreed to pay $175 million for BankMobile. That price works out to about a 25% core deposit premium, according to Sandler O'Neill analyst Frank Schiraldi. While that might seem high at first glance, Schiraldi wrote in a research note Wednesday it could be supported, provided Customers stays on its present high-growth path.

"Though BankMobile has a short track record, in the past management has said it believes the model can earn [approximately] $30 million by 2018 or 2019, which would put the purchase price at six times estimated earnings," Schiraldi wrote.

He added that Customers' shareholders will likely support the deal since the company's after-tax take will add more than $2 per share to tangible book value.

BankMobile has been something of a labor of love for Sidhu and her father, Customers Chairman and CEO Jay Sidhu. They dreamed up the idea for a digital-only bank in 2014, opened it in January 2015 and have been expanding it steadily since. The unit lost $4.8 million last year, but that can be partly blamed on growth-minded investments.

In August 2015, the father-daughter team created a 12-person, in-house innovation team. Four months later, they agreed to acquire Higher One's student loan disbursement business, which was ultimately folded into BankMobile in June and was a big source of new accounts and deposits.

The Sidhus may rue the necessity of selling BankMobile, but they are not leaving it

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behind. The deal is expected to close before the end of the third quarter and when it does, Jay Sidhu will serve as the merged company's chairman, and he will remain chairman and CEO of Customers. Luvleen Sidhu will serve as president and chief strategy officer for BankMobile's digital division, while Burke will continue to run the community banking operation.

Flagship has also agreed to retain all of BankMobile's 220 employees. The goal is to make the transition as seamless as possible for customers, Luvleen Sidhu said.

"We'll be a division of the new BankMobile going forward, but nothing about the customer experience will really change," she said.

REVENUE AND EXPENSES

Banc of California cutting costs after years of rapid growth

By Paul Davis, Allison Prang
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Banc of California in Irvine is planning to eliminate jobs as part of a broader effort to substantially reduce its overhead.

Just days after announcing plans to sell its mortgage operation, the $11.2 billion-asset company disclosed in a regulatory filing Monday that it will further cut costs by shrinking its headcount, consolidating and eliminating departments and reviewing vendor relationships.

Appearing Tuesday at an investor conference hosted by Sandler O'Neill, company officials also said that Banc of California would bring in additional income by leasing out space in its executive offices that it no longer needs.

Banc of California's presentation said that the planned cost-cutting efforts would save it $20 million annually, with an ultimate goal of lowering its efficiency ratio to below 60%. It stood at 67% on Dec. 31.

A company spokesman said he could not comment on how many jobs might be cut.

The moves make sense as Banc of California looks to "rightsize" its operations and focus on less-volatile businesses, said Jacquelynne Bohlen, an analyst at Keefe, Bruyette & Woods.

"The more simplistic [an] operating model is, the easier it is to maintain control and have strong corporate governance," she said.

Banc of California expanded aggressively after Steven Sugarman became CEO in 2012, less than two years after COR Capital, where he is a managing member, recapitalized the former First PacTrust. The company's assets have increased sevenfold in the last four years.

Banc of California is showing signs that it wants to slim down, selling its Commercial Equipment Finance unit and $242 million of leases to Hanmi Financial late last year.

The company has also agreed to sell its mortgage unit and $36 million of mortgage-servicing rights to Caliber Home Loans in Irving, Texas, in deals that will reduce its annual noninterest expenses by more than $160 million, largely by halving its headcount. Caliber will pay Banc of California $25 million in cash, plus $2.7 million to cover the net book value of certain assets.

The mortgage deals will likely lead to $9.5 million of one-time costs in the first quarter, Banc of California disclosed in its recent presentation. The company also expects to incur $7.5 million in charges tied to severance costs.

Banc of California should be able to offset the costs with the premium it will receive from selling its mortgage division.

The timing of the moves is noteworthy given recent negative headlines and the fact that the company is operating with an interim management team, said Timur Braziler, an analyst at Wells Fargo Securities.

The company's board recently completed an investigation into claims that certain executives and directors had improper dealings with third parties. An anonymous blogger also alleged last fall that the company had ties to Jason Galanas, a Los Angeles financier who had been charged with defrauding investors.

The probe, handled by a law firm with no prior ties to the company, determined that no laws were violated and nothing happened to impair any director's independence. The report also concluded that Galanis had no indirect or direct control or undue influence over the company.

Still, the investigation determined that Banc of California gave "inaccurate" information to shareholders about its initial efforts to debunk the blogger's claims, misrepresenting its initial probe as an independent one.

The company said in January that the Securities and Exchange Commission had launched its own investigation into those questionable statements.

Sugarman resigned as chairman and CEO shortly after the SEC probe was disclosed. Robert Sznewajs, a veteran banker who once ran West Coast Bancorp in Lake Oswego, Ore., was named chairman, and Hugh Boyle, Banc of California's chief risk officer, became interim CEO. (Banc of California agreed to pay Sugarman about $4.3 million over the next year, including his $1.5 million bonus for 2016.)

Boyle was one of the executives who attended the recent Sandler conference, a spokesman said.

Banc of California disclosed in its presentation that the special investigation will likely cost it $5 million in the first quarter.

"I think that they're in a mode where they're trying to put as much emphasis on what they're doing from an operational standpoint and trying to divert some of the attention away from the headline news that had been popping up ... since August," Braziler said.

"The thing that makes me scratch my head a little bit is that a lot of these changes are taking place without a permanent CEO," Braziler added. "At the same time, I get the rationale."

Many of the moves have taken place since Legion Partners Asset Management in Beverly Hills, Calif., which owns about 6.3% of Banc of California's stock, began pushing the board to hire an independent financial adviser and form a special committee "to consider all strategic alternatives ... including a possible sale."

The company has also taken heat for a stadium naming rights deal with the Los Angeles Football Club, a professional soccer franchise, largely due to the $100 million price tag and because Sugarman's