STELLARSTRATEGIC

STELLAR INSIGHTS

SUMMER 2018

Welcome to our Summer 2018 Edition of *Stellar Insights*

Wow, half the year is already gone.

Given the timing of this edition of *Stellar Insights*, we decided to focus on issues that may be helpful as you start thinking about strategic planning for the upcoming budgeting season. It will be here before you know it!

The articles in this edition are based on topics generated from our clients and prospects as well as input from select strategic partners. Regardless of whom we spoke to, the list seems to be consistent. The four areas of focus are core deposits, overdraft fee income, market disruption and growing profitable auto loan portfolios. In each case, we will attempt to share best practices based on our client experiences as well as evolving market conditions that are driving change.

We are excited to have two guest contributors in this edition that I consider industry experts in their field. Richard (Dick) Miller, from John M. Floyd & Associates, will be sharing best practices related to the value of a well-managed overdraft program. Dick's 37 years of industry experience on non-interest income growth gives him a wealth of experience to shape his point-of-view.

In addition, we are extremely fortunate to have one of the most successful investment bankers in the industry who brings over 35 years of investment banking experience to the table. Roger G. Powell will be sharing his thoughts on a topic every community banker needs to consider in today's world – disruption. Market disruption, due to branch consolidation and expanded M&A activity, offers tremendous growth potential to those community banking institutions that monitor future activity and react aggressively when the marketing opportunity arises.

Finally, we have a big announcement to make. August 1st, we will launch SALrefi.com in support of our Stellar Auto Loans product. We made the decision late last year to expand our support of our auto loan refinance clients by launching our own branded website.

This new site affords us a unique opportunity to utilize digital, social, print, radio, and cable in our marketing efforts to drive a much higher volume of very profitable auto loan applications for our clients. At the same time, it provides a valuable and much-needed community service to consumers (through savings on monthly auto loan payments) in client markets. Please visit our site and tell us what you think. After all, we built it for you!

We sincerely thank Dick Miller and Roger Powell for taking the time to contribute to this edition of *Stellar Insights.*

Enjoy the rest of your Summer!

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Upcoming Events

September 23-25
ABA Bank Marketing Conference 2018
Marriott Waterfront, Baltimore, MD

October 3-5
MACUMA 2018 Annual Leadership Conference
Kingsmill Resort, Williamsburg, VA

Today's Market for Driving Low-Cost Core Deposits

By Craig Simmers, Founder of Stellar Strategic Group

Over the last 18 years of working with community banking institutions, we have not experienced a better market to drive low-cost core deposits than we have today. Yet, it is surprising to me how few are taking advantage of this opportunity. There are numerous factors contributing to the current core deposit environment detailed in this article.

Having built a business strictly on helping community banking institutions, I sincerely hope sharing what we see nationwide will not only be thought-provoking but move many of you to take advantage of the opportunity that exists.

Let's start by examining market conditions in the early 2000s and identifying the tools that were available for growing core deposits. A highly competitive market existed before the near crash of the banking industry in 2009 – one that was not favorable for community banking institutions. Deposit products and pricing were virtually the same regardless of whether you were a community, regional or national banking institution. Practically everyone offered free checking; many began to offer a version of a free rewards-based or interest checking product, plus there was a battle for new deposits with high-dollar incentives.

In short, community banking institutions had very little to offer that differentiated them from the big banks. Additionally, they lacked the ancillary technology-driven services and the convenience factor based on (in most instances) smaller branch and ATM footprints. With the rise of online and mobile banking, along with the decline of consumer reliance on in-branch transactions, the market changed drastically during the period from 2009 to 2011. At this point, the competitive advantage shifted positively to community banking institutions.

'Free Checking' as a viable checking product, was part of the model adopted by many institutions throughout the 80s, 90s and early 2000s. Therefore, we had conditioned consumer expectations that checking accounts be free of charge. That all changed in 2009 when several large banks abruptly converted to a fee-based account in place of free checking. This change created a massive opportunity for those that maintained free checking as an estimated 30 million accounts fled the larger regional and national banks.

Unfortunately, many community-based institutions that were well-positioned in their market cut their marketing budgets and didn't take advantage of this windfall. Those that maintained an aggressive marketing approach reaped huge market share growth. The good news is we still see this as an opportunity today… and given the loan growth over the past few years, many institutions are now faced with the need to grow core deposits.

Fortunately for community institutions, there are some additional advantages today that did not exist just a few years ago. As consumers spend more time online, new digital and social marketing capabilities can be utilized to effectively target new opportunities. This approach has enabled many smaller institutions (with fewer traditional marketing options due to economies of scale) to develop cost-effective growth strategies.

Just a few years ago, our company's solution for growing low-cost core deposits required at least ten branches to produce an aggressive ROI. That requirement for a minimum branch footprint is now gone. Also, institutions that struggled with low brand awareness now have multiple options to build this critical component for growth.

Today, we firmly believe any institution can market efficiently - and most importantly - in a more cost-effective manner than a few years back. These new tools exist and can be very productive for a community-based institution when driven by a proper and proven analytical approach in growing core deposits and profitability.

Let's get specific and identify some of the essential tools that are changing the core deposit landscape regarding banking services and marketing:

- **Online Account Opening Capabilities**. Increasingly necessary regardless of market!
- **Email Capture**. A critical component in creating an effective cross-sell program is to capture emails via e-statements or other online banking activities.
- **Facebook**. Extensive targeting capabilities and relatively inexpensive.
- **Digital Geo-Fencing.** Based on behavioral history and enables high frequency messaging.
- **IP Targeting.** Household specific targeting.
- **Digital print messaging**. Allows for one-to-one messaging.
- **Credit Reporting Data.** Utilized to target millennial and Gen Z targeting.
- **Mobile Device ID Targeting.** Pinpoint location-based mobile ads.
- **Direct Mail.** Yes, direct mail! (Combined with digital and social media marketing, direct mail can be even more powerful and efficient today.)

From the previous list, **none of these can be productive alone** and only represent part of a cost-effective, guaranteed ROI approach to growth. The following list is the intelligence needed to apply the essential tools effectively:

- **Current account opening trends.** This is a definitive indication of future growth.
- **Who are your vulnerable competitors?** Key ingredient and often misunderstood.
- **How do current penetration levels affect future growth?** The secret sauce!!!
- **Product offer.** What product is most heavily weighted in determining targeting?
- **Where can't you grow?** Attrition plays a key role in growth.
- **Can you grow?** Growth is not something you turn on.
- **Brand awareness.** Should this be step one?

The easiest part of designing an effective marketing program for core deposits is identifying the possible tools to be used. However, real success is in determining how and where to apply those tools.

We constantly hear the phrase artificial intelligence. I would suggest starting with the intelligence we have at our fingertips today and honing that intelligence to maximize your current marketing results.

The opportunity exists for any community banking institution to grow core deposits and retail market share. The question is who will decide to take advantage of this limited opportunity? Given the expansive regulatory issues we are faced with today - as well as skyrocketing loan to deposit ratios - failure to seriously consider your growth strategies is a missed opportunity for success.

In summary, the disruption we will experience over the next two years in terms of bank mergers and branch divestitures will be unprecedented. Having a plan in place to react quickly will generate a disproportionate share of growth for your institution. The opportunities exist, are you up for the challenge?

Craig Simmers is Founder of Stellar Strategic Group. Craig can be contacted via email at craig.simmers@stellarstrategic.com or call 410-990-0172.

Are You Maximizing Your New Membership Potential?

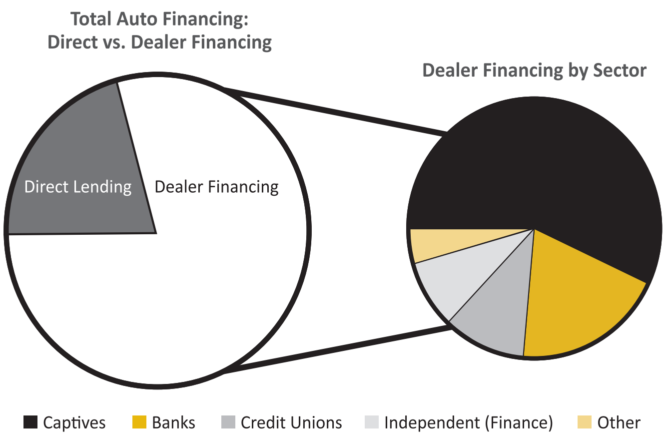
By George Monnier, Founding Partner Stellar Auto Loans

Credit unions are in the business of educating. Much of that education is centered around the advantages and benefits of credit union membership as well as adopting strategies to help serve the underserved in their market.

Relying on traditional SEG-based growth in today's market may not be enough for all credit unions. In order to increase their membership base, a large number of institutions have applied and received defined community charter footprints. Other institutions have adopted easy-to-join association affiliates as part of their association base - many even pay the membership dues for the first year.

With these potential new member sources, it is crucial to target members that will benefit from a relationship with the credit union, as well as providing the credit union with growth opportunities from new memberships. As membership restrictions decrease, it becomes increasingly important to develop strategies on how best to target the neighbors of your current members.

One successful tactic to grow membership is to refocus and redirect energies to the auto loan vertical. There is a substantial opportunity in this vertical considering that 80 percent of cars financed in the United States is through a dealer.[1] In fact, more than 75% of dealer funded loans are through captives and banks with only around 10% of these dealership loans financed by credit unions.



Many consumers, in their excitement, want to drive off the lot with a new car that day. They may simply trust the dealer to give them the best rate, or assume all lender options are the same. In reality, they may pay upwards of 200 basis points more in APR from the lowest promoted rate and those with less-than-perfect credit are likely paying an additional 400 or 500 basis points. Others only compare stated interest rates, and neglect to calculate in other dealership fees on a new auto loan. Those extra fees from the F&I department can account for over half of the dealership's profit on a new auto loan, and certainly impact the consumer's wallet.

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The bottom line is - most potential members are NOT focused on interest rates. Instead, they are focused on monthly payments. Many follow the suggestions of the dealership to reduce their monthly payments by extending the loan repayment period - apparent from the increase observed in 84-month financing over the last few years.

At the same time, these consumers are being squeezed financially as new auto loan pricing is on the rise. In addition, more and more households are living from paycheck to paycheck. "Almost half of the consumers in the U.S. have less than $400 disposable income above their monthly budget, and, they would need to find alternative financing if an emergency occurred with a cost greater than this amount."[2]

Sure, credit unions can compete in the indirect world. However, we suggest credit unions develop plans to target prospective members missed by their indirect efforts. These direct relationships tend to be far more profitable and provide real membership growth.

There is a considerable number of potential members that can save a significant portion of their monthly payment by refinancing with their local credit union. We commonly see an average of 500 basis point savings, which equates to a $75 monthly savings for the same loan volume and term length. Our research shows that nationwide, there are roughly 3.1 million members that can save $50 or more a month with the local credit union's auto loan rates. That is over 56 BILLION dollars in loans! In addition, these same members can save even more by purchasing GAP, MBI, AD&D from the credit union, usually at half the cost compared to the dealership for the same service.

When marketing, it is possible to show each member their potential savings each month. By analyzing credit data, we can determine the interest rate on a consumer's auto loan. The next step is to match up the consumer's credit score and derogatories with the institution's current rates, credit score buckets, and other criteria so that non-members within these charter/market footprints can be uniquely targeted.

MONEY TALKS! It is our experience that the bigger the savings, the better the response rates. Showing the monthly savings amount makes it easy for the consumer to immediately recognize the value in your offer. Compare that to messaging on interest rates. Our focus groups show that few consumers know the actual interest rate on their vehicle loan. (Again, dealerships are not focusing on the loan rate, but the monthly payments.) Most consumers, however, DO KNOW their monthly payments, since that is often one of the top 3 monthly payments for household bills.

Additionally, direct loans bring more growth potential to your credit union. These new members may have visited your institution, talked with your staff directly, and are giving you the chance to develop a personal relationship for future banking needs. New memberships driven by direct auto loans are far more likely to generate secondary relationships. Typically, less than 5% of indirect loans establish secondary products and services.[3]

In summary, it would be wise to analyze your community charter or membership associations to determine the potential number of households that can save significantly on their auto loan payments. Remember, your most important competitors are banks and captives that support the lion's share of loans financed through dealerships. Use the data available to develop solid marketing plans that will help serve the underserved to maximize your new membership potential. Going directly to those consumers (who can save monthly) will provide excellent results for both the consumer and the credit union!

[1] *The State of Lending in America & its Impact on U.S. Households. Center for Responsible Lending. www.responsiblelending.org.*

[2] *The Atlantic: The Secret Shame of Middle-Class Americans: May 2016*

[3] *CUNA.org: 2017 Lending Outlook, This Month in Credit Union Magazine: November 2016*

George Monnier has spent over 17 years helping financial institutions generate new deposits and loans. He is a founding partner of Stellar Auto Loans, a division of Stellar Strategic Group, which offers pay-for-performance auto refinance programs to the banking industry. To learn more about Stellar Auto Loans^{sm}, please contact george.monnier@stellarstrategic.com or 402-708-2425.

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Does Your Overdraft Program Place Value Above Fees?

By Richard Miller, Executive Vice President at John M. Floyd and Associates

In the past few years, big banks have made it increasingly difficult for Americans to keep a basic free checking account. Consider the following:

- Institutions like Bank of America announced more requirements to waive their monthly maintenance fee.
- Over the past five years, bank fees have increased across the board: Monthly maintenance fees are up eight percent, overdraft fees are up 9.4 percent and ATM fees are up 10.7 percent.
- Less than 30 percent of all checking accounts are now "free," with that number on the decline.

This presents an opportunity for your bank or credit union to shine. By evaluating all fees—including your overdraft fee—and focusing on serving your account holders in a responsible, informative way, you will experience an increase in business and account holder satisfaction.

Protecting income and delivering better service continue to be primary focuses for just about every bank or credit union. The structure of your overdraft program can make all the difference, especially if account holders see the value of the service. Here are three points to ponder:

Do you have a fully disclosed overdraft program?

When changes to Regulation E were implemented back in 2010, banks and credit unions were required to obtain an affirmative opt-in from account holders to charge overdraft fees on debit card point-of-sale and ATM transactions. Educating your account holders about this service goes much more smoothly with a fully disclosed overdraft program.

Are you aware of your real competition?

Your competition is not necessarily other financial institutions in your area. Rather, your competition is what your account holders are using instead of your services to meet their needs. If you charge a reasonable fee that is equal to or less than a car loan late charge or a credit card late fee — and that helps account holders avoid a negative impact to their credit score — they'll choose your solution. By having a fully disclosed overdraft program that provides account holders with a clear understanding of limits and fees, you can differentiate your bank or credit union from any and all competitive options.

Are your fees reasonable for the service provided?

Account holders will appreciate a value-added service with a reasonable fee that is disclosed at the outset. But they will likely avoid a service with excessive or undisclosed fees. In the end, it will always come back to the importance of looking at your services and fees from the perspective of your account holders. Doing so demonstrates your commitment to providing disclosed value above fees. It also helps to avoid dissatisfaction and disloyalty among account holders and undue pressure for employees to explain the unexplainable.

Richard Miller joined JMFA after a 23-year career in banking, providing JMFA and their clients a broad base of management experience in community banking, from chief lending officer to president of small and medium-sized financial institutions. For more information on how JMFA can help your institution maximize overdraft income, contact Dick Miller at 800-809-2307 or email info@jmfa.com.

The Opportunity in Disruption

By Roger G. Powell, Corporate Consultant and Investment Banker

It is impossible to avoid the word 'disruption' in any business conversation. Each generation coins a new term for the process – call it 'opportunity' or 'creative destruction,' it is happening every day. You need to make it an opportunity rather than distress. How do you take advantage of disruption? Make it part of your strategy, then find a way to enhance your profits and franchise.

MBNA, FirstUSA and CapitalOne all emerged from disruption: they stole market share from Citibank and Bank of America. A convergence of improved marketing and processing technology, emerging securitization techniques and the market leaders' inability to respond created that opportunity.

The factors which converged:

• Improved technology: the development of mainframe processing lowered the cost of account acquisition as well as the cost of account maintenance and transaction processing to a new normal. Small portfolios had low cost and risk in adopting the latest technology and could grow quickly at low marginal cost, whereas embedded portfolios had massive conversion expenses and significant risk in the conversion of large numbers of accounts.

• Securitization techniques: institutional investors were open to the purchase of engineered structures of whole loan portfolios, made possible by statistically significant analysis techniques. Assets amenable to systematic risk management could be efficiently extracted from the bank balance sheet.

• Inability to respond by the market leaders: neither Citi nor Bank of America could respond. They needed the high coupon earnings from their credit card portfolios while absorbing loan losses from real estate and 'less-developed countries' lending. They were further hampered by the effort and risk of adopting new processing and marketing techniques.

These factors have changed the face of competition across a range of products. However, the resources to take advantage of them are not evenly distributed. Engaging in the newest technology is expensive and risky, and new customers may not come simply because you build it.

How do you find disruption opportunities around which you can succeed?

- Inventory your skills. Look for areas where you are already efficient and control risks well. Any learning curve is expensive, but you already know 'best practices' in things you do well. Find a way to expand beyond your physical footprint using technology already proven.
- Leverage your resources. Your marginal cost is low where you increase volume to utilize your existing infrastructure, processes, and people fully. Measure marginal costs and profits and pay attention to the details.
- Look for competitors who are unable or unwilling to respond. Look for changes in brand or leadership, profit dependence on undisrupted pricing or risk-in-process migration. Understanding competitor constraints allow you to map your competitive advantage.

Here are two cases:

1. Washington County, MD: Acquisition of major competitor leaves market share vulnerable.
Susquehanna Bank had a stronghold in Hagerstown, Maryland – the county seat of Washington County. They and their regional bank competitors, M&T Bank and The Columbia Bank (trade name for Fulton Financial) each had more than 20% of the market in 2006. PNC acquired a 10% market share in 2008.

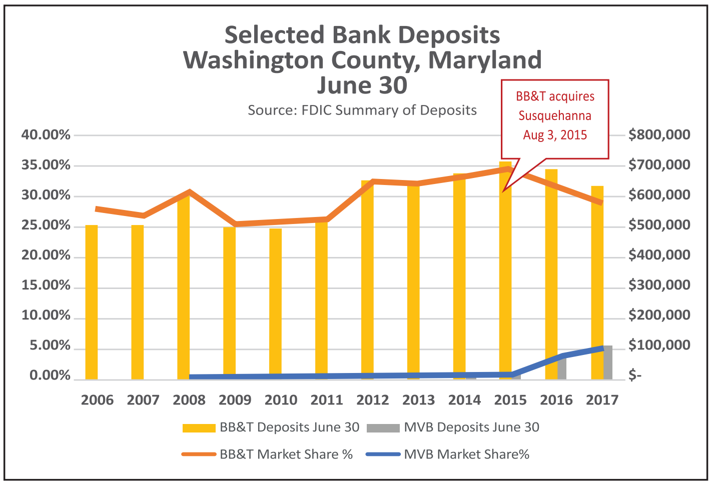
Susquehanna was acquired by BB&T on August 3, 2015; the transaction was announced in November 2014. Please note that the change in market share was over 5%, or $80 million in deposits between June 30, 2015, and 2017. While insignificant to BB&T, these deposits are meaningful to the major beneficiary: Middletown Valley Bank.

		Washington County, Maryland				
Institution Name	No. of Offices	Deposits $,000	Market Share	10-year CAGR	Share Change 16 -'17	15-'17
Branch Banking and Trust Company	12	634,922	28.78%	2.26%	-2.78%	-5.83%
The Columbia Bank	9	510,959	23.16%	2.05%	1.45%	1.12%
Manufacturers and Traders Trust Company	10	427,998	19.40%	0.77%	0.26%	-0.16%
PNC Bank, National Association	4	222,524	10.09%	-0.37%	0.66%	0.69%
Middletown Valley Bank[1]	2	111,998	5.08%	NA	1.35%	4.29%
First United Bank & Trust	3	89,058	4.04%	3.56%	0.30%	0.18%
United Bank	2	84,072	3.81%	9.25%	0.22%	0.59%
CNB Bank, Inc.	3	61,811	2.80%	8.24%	0.20%	1.08%
Orrstown Bank	1	33,764	1.53%	15.35%	0.20%	0.39%
Bank of Charles Town[2]	1	20,522	0.93%	72.00%	0.03%	0.41%
Jefferson Security Bank	1	8,249	0.37%	5.67%	-0.03%	-0.03%
Number of Institutions in the Market: 11	48	2,205,877		1.55%		

Notes:
1. Middletown Valley Bank opened Washington County, MD in 2008; the CAGR for 9 years is 44.7%.
2. Bank of Charles Town opened Washington County, MD in 2012; the CAGR for 3 years is 72.0%.
Source: FDIC Summary of Deposits June 30, 2017

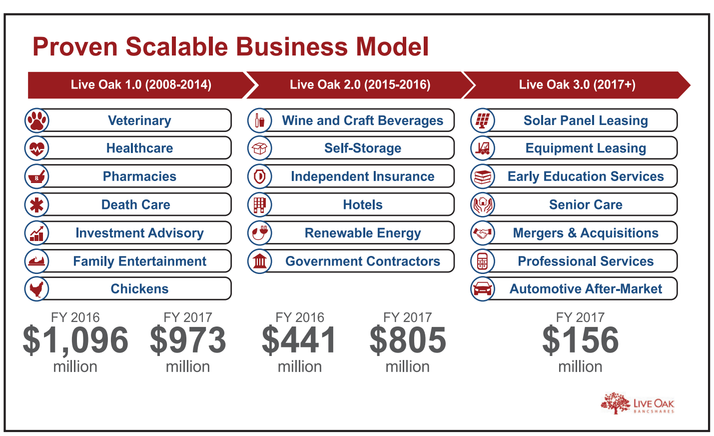
Middletown Valley approached Hagerstown and Washington County as a 'hometown' bank allowing superior total growth in a small footprint in central Maryland. They are currently (i) building existing business lines that (ii) they fund and control with existing infrastructure (iii) at the expense of a competitor which is unable or unwilling to respond effectively.

Is BB&T unable to respond? No. They are unwilling because the balances in Washington County are insignificant to them; they cannot bring commercial focus to one market of its size. They must manage to a standard across all similar markets and are at a scale where it is difficult to respond to threat on a Washington County scale. The benefit to Middletown Valley is substantial, while the loss to BB&T is small.



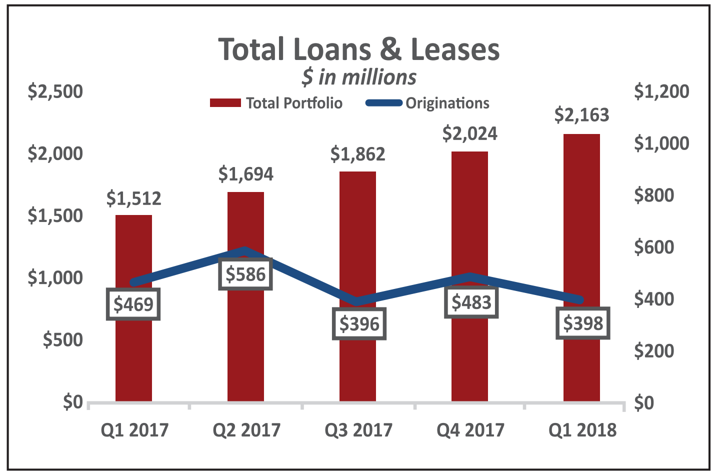
While the shift in market share is nearly symmetrical, Middletown Valley must be careful that they are not taking the customers that BB&T would like to lose. They must not underestimate their competitor.

2. Nationwide: Product expertise allows effective asset growth.
Live Oak Banking Company (NASDAQ:LOB) was chartered in 2008 with a business plan based on efficient SBA lending in selected niches. Entry during the Great Recession enabled robust growth as legacy competitors focused on credit deterioration in their portfolios. Live Oak's niche strategy development from founding to 4Q:2017 is illustrated in their investor presentation of January 25, 2018:



Source: http://investor.liveoakbank.com/phoenix.zhtml?c=253224&p=irol-calendar

Note that the volumes of origination for each set of specialties is laid out below the segments, e.g. "Live Oak 1.0" showed $1,096 million in 2016 and slowed to $973 million in 2017 while "Live Oak 2.0" ramped up from $441 million to $805 million in the respective periods –Live Oak's press release of June 14, 2018 announced $500 million in renewable energy loans - and "Live Oak 3.0," begun in 2017 has already reported significant growth. This niche attack strategy leads to specialization expertise to manage risk and to the record of loan and lease growth exhibited in the Company's 1Q:2018 CFO Highlights accompanying their earnings release.



Live Oak has developed software, processes and staff to steal a march on traditional SBA lenders and others and become an instrument of disruptive change.

Conclusion

Change will not stop; we call it 'the future' because we don't know what it holds. But 'here and now' is the platform from which you leap into your future - you must use what you do well to make that leap. Measure your success and analyze the factors that deliver results. Keep your strategy and tactics consistent with your resources and constraints. Be aware of the weaknesses and constraints impacting your competitors. In the end, strategic utilization of your strengths and weaknesses is necessary in order to seize opportunities that disruption puts in your path.

Roger Powell is an independent corporate consultant and investment banker. His 35 years of experience as an investment banker (with Deutsche Bank Securities and Alex. Brown & Sons) and entrepreneur have made him a sought-after director and counselor to Boards and "C" suite executives in strategy, M&A, tactical planning, investor communication and governance. Contact Roger Powell at 443-253-4516 or email roger.powell@rogerpowell.com.

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ABOUT US

Our Beginning

In 2000, our founder had a vision of applying what he had developed in the newspaper industry to acquire new customers and duplicate it in the banking industry. Never did he envision we would have been fortunate enough to have worked with over 1,700 institutions since that time.

Relationships

Achieving strong, long-lasting relationships with our clients is a top priority for Stellar Strategic Group. Simply stated, we continually evolve our product line to meet the ever changing market demands our clients face. Plus, we work to deliver the projected ROI promised, and treat your budget as if it's our own. The bottom line is that we care about each of our clients and it shows in how we partner with you to achieve your goals every step of the way.

Market Growth

Today we offer a suite of products that do one thing extremely well. That one thing is helping our clients grow retail market share at a pace that exceeds that of their competitors. If you have an interest in working with a company that successfully combines traditional marketing approaches with the ever-changing digital marketing revolution, Stellar Strategic Group can help.

Partnership

If you appreciate working with a partner as opposed to a vendor, Stellar Strategic Group is definitely that company. We are committed to building strong, mutually beneficial relationships and recognize not all client projects can be handled the same way. That's why we work closely with you to meet your individual needs.

Put the power of Stellar Strategic Group to work for your institution. Contact us today.

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