The Aspen Institute
Business Ownership Initiative (BOI)
Economic Opportunities Program

Financial Tools for Evaluating CDFI Mergers and Acquisitions

Business Ownership Initiative (BOI)
The Aspen Institute, Economic Opportunities Program

SPEAKERS

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AGENDA

Six key stages for evaluating CDFI mergers and acquisitions.

01	02	03	04	05	06
Introduction	M&A Context and Research	Steps for Analysis	Example Analysis	Intangibles & Probability of Success	Applications & Next Steps

METRICS THAT MATTER SERIES

Metrics that Matter: Improving Financial Analysis of CDFI Small Business Lenders



MTM FOUNDATION: The Six-Variable Framework

Connecting all parts of the financials into a complete picture

VARIABLE 6

TOTAL PORTFOLIO AUM

Scale baseline weighting all percentage operations across entities.

Earned Revenue Yield	VARIABLE 1
– Cost of Funds	VARIABLE 2
= Net Margin	(Earning Spread)
– Provision Expense	VARIABLE 3
= Risk Adj Net Margin	(Credit-Adjusted Spread)
– Opex Ratio	VARIABLE 4
= Total Portfolio Return	(Structural Operating Result)
+ Rate of Contributions (Philanthropy)	VARIABLE 5
= Total Return on All Activity	(Net Institutional Margin)

Future Webinar Topics

- Assessing and Processing Portfolio Acquisitions
- Funding and Implementing Innovation
- Revisiting Financial Analysis Tools with **Benchmarks**
- Product Mapping Tools: Identifying Partnership and Technology Opportunities
- Measuring What You Do Best (And Cutting the Rest)
- Measuring Revenue Resilience for Leadership Transitions
- Board Tools to Drive Results

GOAL FOR TODAY

Quickly Analyze Prospects

Our goal is that by the end of any “Metrics that Matter” webinar you have a tool or idea you can apply tomorrow. For mergers and acquisitions, the tool is a a method to quickly analyze the prospects for a merger and pinpoint what would need to change to make it worth pursuing.

Guiding Exploration

This is not the final budget forecast or projected “synergies” for a merger. But it should guide your exploration of the upside and downside.

Baseline Calculation

If you haven’t reviewed the first webinar on financial analysis, you’ll need to go back and calculate those key variables for this exercise

WHY START WITH THE MONEY?

We assume you have done some work already on mission alignment.

THE MISSION QUESTION

“What can we provide (or avoid) together — that we couldn’t provide apart — that helps our target communities thrive?”

THE MARGIN REALITY

“Does the move make financial sense?”

For CDFIs, the mission question very quickly — in parallel — becomes a margin question.

DO MERGERS WORK?

Sort of...examining empirical failure and reversal rates across sectors.

20%

achieve their stated strategic and financial targets.

60%

fail to generate any net tangible economic or mission value.

50%

are ultimately restructured, dismantled, or reversed.

CORE PRINCIPLE: You are statistically more likely to destroy value than create it.

PROBABILITIES MATTER

May the odds be ever in your favor

The Reality of the Odds

- Participants are typically wrong about projected synergies.
- Participants systematically underestimate odds of failure (and overestimate odds of success).

Focusing on Expected Returns

Calibrating against expected returns avoids common forecasting biases and prevents leadership from wasting valuable bandwidth.

A REAL WORLD LESSON

Fifth Third and Comerica merger: Examining who captured the value.

SHAREHOLDER GROUP	$ VALUE CHANGE	% OF TOTAL VALUE	WHAT THAT MEANS
Comerica Shareholders	**+$1.37B**	**154%**	Captured 100% of expected synergies plus the merger premium
Fifth Third Shareholders	**-$0.48B**	**-54%**	Absorbed dilution / integration effective merger premium
Total Combined Market	**+$0.89B**	**100%**	**Net market value created across both entities**

TRANSLATE THE ANALYSIS TO CDFIs

1
Assess Baseline

Assess market average equity before the transaction.

Assess CDFI average performance

2
Adjust Terms

Adjust amounts to reflect negotiated purchase & integration terms.

Merge CDFI performance and weight properly

3
Measure Movement

Track actual market movements

Measure what outcomes are possible for key variables

START WITH WHAT WE KNOW

Translating high-level concepts into five practical steps.

01 Get the 6 variables from financial analysis and average them over time and as a combined entity

02 Create worse and better case changes for each variable

03 Review philanthropic value “capture” across grant categories

04 Create probabilities and compare them directly against transaction/integration costs

05 Review quantitative results against qualitative intangibles!

RUN THE BASIC NUMBERS

Combine them as dollars first!

A $100M lender merging with a $20M lender does not achieve a 50/50 blended ratio. By doing dollars first, the results are automatically averaged. Use the combined average portfolio AUM for the ratio calculations.

RUN THE BASIC NUMBERS

AVERAGE RATIO	CDFI 1	CDFI 2	COMBINED ENTITY
Earned Revenue Yield	17.97%	14.28%	15.24%
Cost of Funds	2.10%	1.75%	1.84%
Net Margin	15.87%	12.53%	13.40%
Provision Expense Rate	3.66%	4.47%	4.26%
Risk Adjusted Net Margin	12.21%	8.05%	9.14%
Opex Ratio	27.45%	17.94%	20.43%
Total Return on Portfolio	-15.24%	-9.88%	-11.28%
Contributed Revenue Yield	20.47%	12.51%	14.59%
Total Return on All Activity	5.22%	2.63%	3.31%

HOW TO ESTIMATE CHANGES

Baseline Weighting

Adjust up and down from the combined ratio. It is already weighted by dollars.

The “Better” Case

If one lender is much better on a ratio, consider how their advantage translates into the combined entity. Can they pull the combined ratio in the better direction? How could their advantage be adopted?

The “Worse” Case

If one lender is much worse on a ratio, would their challenge become a struggle for the combined entity? Use this as the “worse” case scenario when unsure how to assess.

EARNED REVENUE

Analyzing lending yield and product-line sustainability.

Product & Pricing Levers

- Does one entity have a new product that will drive earned revenue up? (+)
- Does one entity need lower rates to preserve public subsidy, pulling rates down? (-)
- **Is any earned revenue niche that cannot be grown across the combined footprint? (-)**

Combined Baseline: **15.24%**

Better Case: **16.24%**

Worse Case: **14.24%**

COST OF FUNDS

Evaluating debt facility exposure and borrowing costs.

Debt & Lender Dynamics

- Do the entities share debtholders who are adverse to exposure increasing? (+)
- Have they moved to a scale where cheap CRA debt is no longer available? (+)
- **Most cost of funds will stay the same or go up, but not down.**

Combined Baseline: **1.84%**

Better Case: **1.84%**

Worse Case: **3.84%**

NET MARGIN

Evaluating earning spread across combined operations.

13.4%

COMBINED ENTITY

Basic weighted combination baseline.

14.4%

BETTER CASE

Projected upside earning spread.

10.4%

WORSE CASE

Compressed downside net margin.

PROVISION RATE

Assessing credit risk, delinquencies, and portfolio trajectory.

Credit & Servicing Realities

- Does one entity have a better track record of managing delinquency & charge offs? (-)
- Is one portfolio “messier” requiring intensive workout focus? (+)
- **Generally, the die are already cast for existing risk; focus on shifting long-term trajectory.**

Combined Baseline: **4.26%**

Better Case: **3.66%**

Worse Case: **4.47%**

RISK ADJUSTED NET MARGIN

Evaluating margin after credit loss provision expenses.

9.14%

COMBINED ENTITY

Basic weighted combination.

10.74%

BETTER CASE

Projected upside margin.

5.93%

WORSE CASE

Compressed downside spread.

OPEX RATIO

Analyzing operating expenses, fixed costs, and headcount implications.

Operational Cost Drivers

- Personnel and technology tend to be the biggest focal areas.
- Better case saves $3.65M annually in practice!
- One entity at 27% and one at 18%, points to likely challenges.
- **Even a 1.4% change could comprise $250k tech consolidation + elimination of >20 FTEs.**

Combined Baseline: **20.43%**

Better Case: **19.00%**

Worse Case: **25.43%**

TOTAL PORTFOLIO RETURN

Evaluating core portfolio structural deficit prior to contributed revenue.

-11.28%

COMBINED ENTITY

Basic structural deficit.

-8.26%

BETTER CASE

Reduced structural deficit.

-19.50%

WORSE CASE

Expanded operational deficit.

HOW TO SORT PHILANTHROPY

Philanthropic revenue is a key piece of the business model but requires more detailed review.

Public: Entity-Based (ex. CDFI Fund)

Usually cut in half upon combination — combined entity only receives one award.

Public: Volume-Based (ex. SBA TA Grant)

Scales with portfolio volume; only cut if institution hits maximum program cap.

Private: No Donor Duplication

Assume full combination; partner continues giving to enlarged footprint.

Private: Donor Duplication

Combine and apply haircut (e.g. 25%–50% reduction) to avoid double-counting.

CONTRIBUTED REVENUE YIELD

The Philanthropic Capture

Major Overlap Reality

- Estimated 24% reduction in total philanthropic revenue in worse case.
- **Philanthropy "captures" can be very large. To calculate the capture, take the total reduction in contributed revenue and divide by the total savings shown in the Total Portfolio AUM. In scenarios with high overlap, this capture rate can approach, and even exceed, 100% of operational savings.**
- **In some nonprofit mergers, donors are the primary beneficiaries of the value created.**

Combined Baseline: **14.59%**

Better Case: **11.85%**

Worse Case: **11.06%**

TOTAL RETURN ON ALL ACTIVITY

Bottom-line institutional return under probability test.

3.31%

COMBINED ENTITY

Weighted baseline return.

3.59%

BETTER CASE

Optimistic upside net return.

-8.43%

WORSE CASE

Downside deficit due to negative combination characteristics.

M&A ISN'T FREE!

Closing requires legal counsel, board bandwidth, audit expenses, and transition costs.

COMPLEXITY	DESCRIPTION	COST (% OF COMBINED OPEX)
Low	Low staff impact, no offices to combine, easy tech combo	1%
Normal	Typical consolidation challenges ($5M in example)	2%
High	Major office shifts, HQ relocation, management team overhaul	3%+

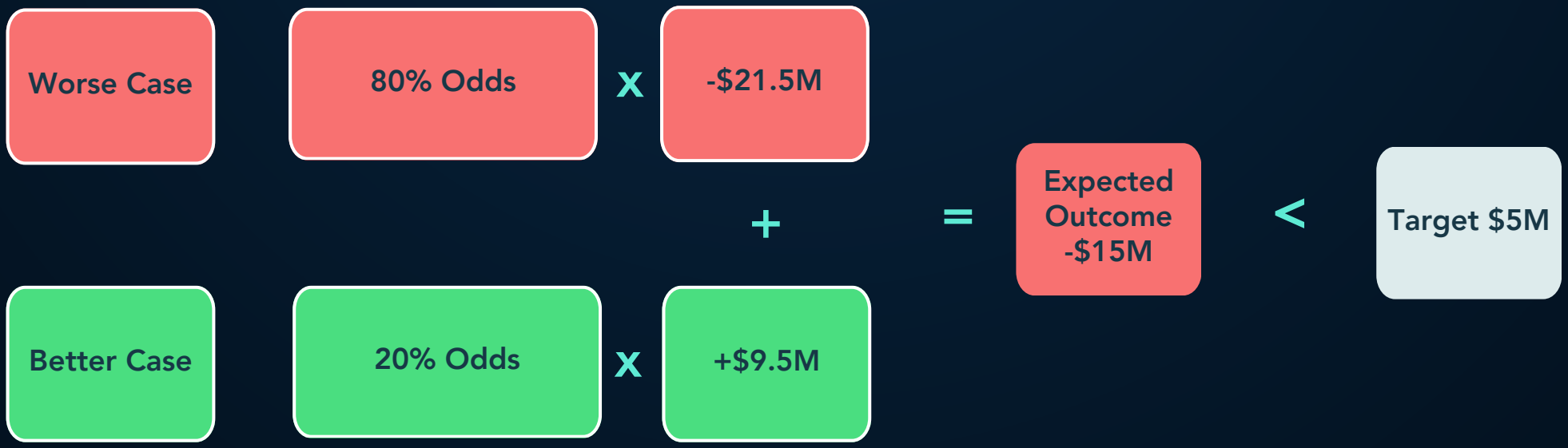
Assume no less than $500,000 baseline regardless of size.

Management time is the highest hidden friction cost.

PUTTING IT ALL TOGETHER

Use odds of success as a starting point. Target expected return against cost.

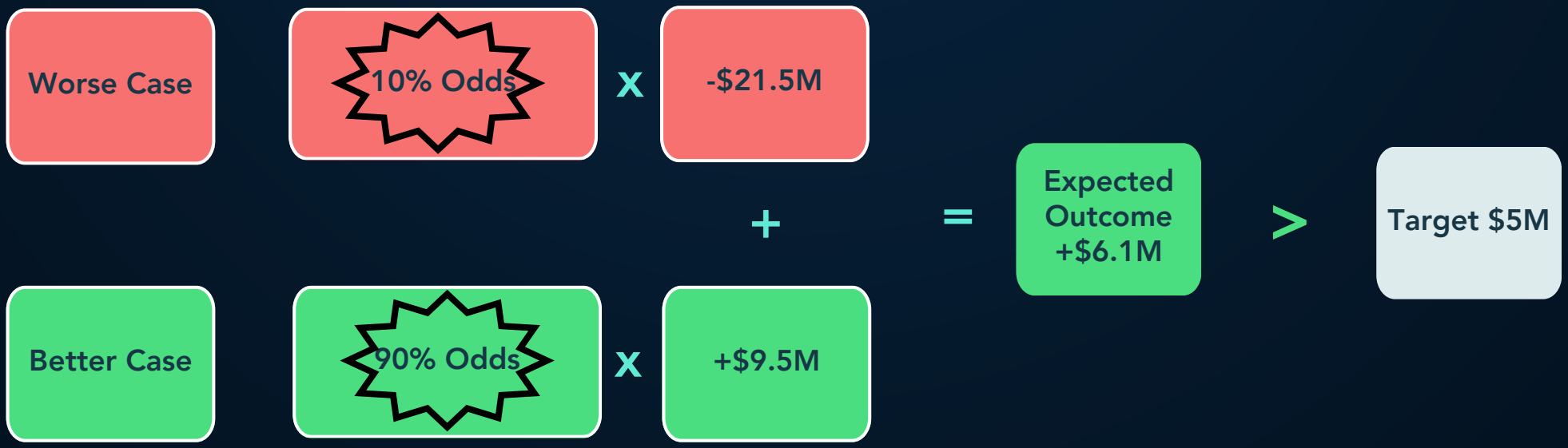
Cost Estimate $5 Million (Direct + Indirect Friction)



PUTTING IT ALL TOGETHER

Use odds of success as a starting point. Target expected return against cost.

Cost Estimate $5 Million (Direct + Indirect Friction)



PUTTING IT ALL TOGETHER

Experiment to understand key drivers and build a strategy around how to make them a reality

STANDARD FAILURE ODDS (80/20)

-$15.0M

Expected Net Value Outcome
(Target < $5M friction cost)

OPTIMISTIC ODDS (10/90)

+$6.1M

Expected Net Value Outcome
(Target > $5M friction cost)

- Is there good cultural alignment or the leaders have experience together?
- Are the boards experienced with a merger?
- Do both organizations use the same technology or already share services?
- The above reversal from 80/20 to 10/90 is highly unlikely. But going from 20% odds of success to 30% or 40% might be justified.
- Use the probabilities to drive a realistic conversation about what is truly possible AND develop a strategy.

KEY TAKEAWAYS AND NEXT STEPS

Translating the financial analysis into organizational strategy.

1. Establish the Baseline

Run the 6 key variables on historical audited financials before projecting any synergies.

Always weight combined metrics by actual portfolio dollars rather than averaging ratios.

2. Make the Case

Create business logic for why you think variables will move and in what manner.

Be sure to move beyond generalizations and into the details when reviewing contributed revenue and philanthropic capture.

3. ITERATE!

The expected returns help you get a sense of what is possible. But your first pass will need refinement. Test what variables have the biggest impact on your probability of success.

The 80/20 ratio for probabilities forces you to focus only on high value options. Only adjust ths rate on the margins when you have good reason to be optimistic.

QUESTIONS AND FEEDBACK

NEXT SERIES TOPICS

- **Assessing and Processing Portfolio Acquisitions**
- Funding and Implementing Innovation
- Revisiting Financial Analysis Tools with **Benchmarks**
- Product Mapping Tools: Identifying Partnership and Technology Opportunities
- Measuring What You Do Best (And Cutting the Rest)
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