Why Two Community Banks Raised Debt to Repurchase Shares

By: Kiah Lau Haslett, managing editor for Bank Director
September 18th, 2020

The coronavirus pandemic has motivated some banks to raise capital (https://www.bankdirector.com/issues/strategy/banks-tap-capital-markets-to-raise-pandemic-capital/) and others to repurchase shares (https://www.bankdirector.com/issues/strategy/community-banks-are-buying-back-stock-should-you/).

Two banks opted to do both.

These institutions recently paired subordinated debt raises to buy back discounted shares in immediately accretive transactions. Leadership of both banks attribute the pair of opportunities — and the pricing they were able to obtain — to the pandemic, and other community banks could make a similar trade.

“**What had happened was a perfect storm of an opportunity to buy back at a pretty good discount because of the Covid-19 impact on financial stocks, and the popularity or the market that had developed for subordinated debt**,” says Paul Brunkhorst, CEO of Crazy Woman Creek Bancorp in Buffalo, Wyoming.

The bank constructed a twofer trade that would leverage investors’ demand for yield while capitalizing on the persistent discount in its shares. Brunkhorst reached out to a larger in-state financial institution about a $2 million private placement of its subordinated debt at a 5% rate; he says the direct placement kept pricing low for the $138 million bank. Crazy Woman Creek then repurchased 15% of its outstanding common stock. The transactions were included in the same Aug. 18 release (https://www.buffalofed.com/Media/BuffaloFederal/pdf/CRZY-sub-debt-press-release.pdf).

“It wasn’t taken lightly. **We are affecting shareholder value in a positive manner**. We’re also incurring this debt, so we better be darn sure of the capital position, the asset quality and the regional economy,” he says. “We were comfortable going after the subordinated debt with the primary reason of repurchasing those shares.”

Executives at Easton, Maryland-based Shore Bancshares decided to pad robust capital levels with an additional $25 million in subordinated debt (http://www.snl.com/IRW/file/1027751/Index?KeyFile=405087652) as “safety capital” at the end of August.

So far, the safety capital hasn’t been needed. Second loan modification requests declined to about 10%, and the $1.7 billion bank has yet to experience defaults. Management decided to deploy $5.5 million of those newly raised funds toward restarting its halted share repurchase program (http://www.snl.com/IRW/file/1027751/Index?KeyFile=405158150) at the beginning of September.

The repurchase, which required sign off from the Federal Reserve, was immediately accretive to tangible book value. If fully exercised, the buyback would reduce share count by 4.5%.

“**When you can buy stock back at 60% or 70% of tangible book, that’s probably the best thing you could ever do for your shareholders**,” says CEO Lloyd “Scott” Beatty Jr. “In terms of rewarding them, I can’t think of a better way to do it.”

Both executives say shareholders have been pleased with the buyback announcements. They also found the capital raise to be straightforward and relatively quick, with healthy demand and pricing. Brunkhorst says he’s surprised more banks haven’t cut out the middleman to solicit demand and conduct their own private placements. It was Shore’s first time raising sub debt; its offering carried a rating from Kroll Bond Rating Agency and a price of 5.38%.

“I would say probably if you’re thinking about [raising capital], I’d get out there as soon as possible. There’s a lot of activity in this,” Beatty says. “I’d be inclined to pick your investment banker and get out and enter the market as quickly as you can.”

Kiah Lau Haslett is the Managing Editor of Bank Director. Kiah is responsible for editing web content and works with other members of the editorial team to produce articles featured online and published in the magazine. Her areas of focus include bank accounting policy, operations, strategy, and trends in mergers and acquisitions.