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*Farmers State Bank
of Hartland sold
to employee-led
investor group*

Leadership of the
Farmers State Bank
of Hartland, Minn.:
President/CFO Mark
Heinemann (left)
and Chairman/CEO
Daniel Otten.

Transaction Account

By Tom Bengtson

TIMING IS EVERYTHING and for Nancy Skophammer, Daniel Otten and Mark Heinemann, opportune chronology resulted in the preservation of Farmers State Bank as a community financial institution serving southern Minnesota. Skophammer, who was in the twilight of her career, Otten

who was at the height of his, and Heinemann who was just beginning to hit his stride, made the most of their common interests to work an unusual deal for the sale of the 102-year-old \$91 million bank. The deal, which took a little more than 15 months to orchestrate, closed April 11.

Farmers State Bank of Hartland had been in the Skophammer family since 1987 when her father gained controlling interest after accumulating shares over the years since starting to work at the bank in 1929. Nancy, who had joined the bank's board in 1984, took up full-time work at Farm-

ers State Bank in 1994, leaving behind a career as a psychologist with the White Bear Lake school system in the Twin Cities. She became president in 2001 after a three-month period when her 94-year-old father passed away and the bank's chief lender was killed in a snowmobile accident.

Nancy Skophammer owned the bank with her two sisters, who were not involved in its operation. Skophammer oversaw remodeling of the banks' Hartland office in 1996, and the acquisition of its Freeborn branch in 1999. She was president when the bank added a *de novo* branch in Albert Lea.

Otten joined the bank in 2001, first on a consulting basis, then as a board member, and by 2004 as an employee. Later in 2004, Otten hired Heinemann, a promising newbie with a degree from Augustana College in Sioux Falls, S.D. His only professional experience was selling cell phones out of a kiosk at a shopping mall, but Heinemann took to banking like a fish takes to water. Heinemann and Otten, an industry veteran who had seen the inside of several banks as either consultant or employee, worked together well. Heinemann proved to be a jack of all trades, and after he completed a distance-learning MBA program with the University of Nebraska in 2012, the pair visited with Skophammer about their future. Farmers State Bank had just celebrated its 100th anniversary. Skophammer, who served as chair of the Independent Community Bankers of Minnesota in 2011-12, was spending less time in the bank. Heinemann was looking to advance in his career. Otten, then 52, knew it was time to make something more of the three decades of industry experi-

ence he had built in Albert Lea and California.

Five days before Christmas of 2012, the pair expressed their interest in buying the bank; Nancy, 60 at the time, was surprised, but listened to their plan. They would approach customers, community leaders, family and other potential investors to raise money to buy the bank. They would maintain the bank's farm-focused business plan, and Hartland, Freeborn and Albert Lea would keep their community bank. Skophammer agreed to let them pursue their plan, setting aside other offers that periodically came in for the bank.

Skophammer said she had planned to retire in five years anyway and decided she had little to gain by retaining ownership for another few years. Skophammer, who thought the deal had about a fifty-fifty chance of succeeding, said she was willing to exchange the ongoing stress of bank ownership for a deal that put the bank in the hands of two capable, ambitious bank employees.

A good story

The Farmers State Bank has a steady history of respectable earnings, even during the financial crisis and subsequent recession. In 2013, the bank reported net income of \$1.03 million, return on assets of 1.06 percent and return on equity of 11.14 percent. The bank's name is a tribute to the local ag economy, which has provided a reliable operating environment for more than a century. Skophammer said the bank was cleaner than it had been in a long time, making it a prime time to sell.

Otten understands the farm economy, having grown up in Nebraska and worked as a lender for

the Farm Credit System in California. He came to Albert Lea, where his wife grew up, in the early 1990s. He worked at the Americana State Bank, helping to grow it to \$80 million in assets before the bank and its leader, Jon R. Lindeman, ran into regulatory trouble. Otten left the bank to join Skophammer's organization, three years before Americana State Bank was sold in 2004. Skophammer hired Otten to establish a new branch in Albert Lea, a community where Otten had built a reputation as a good lender and reliable banker. In addition to bringing his ag lending experience to Farmers State Bank, Otten had asset/liability expertise, a skill he shared as a bank consultant between his full-time employment at Americana and Farmers State Bank.

After that December 2012 meeting with Skophammer, Otten began to put his ideas on paper. He had been thinking for a long time how he would structure a deal, should he ever get the opportunity. He quickly came up with 200 names of potential investors. He knew he wanted broad ownership but fewer than 100 shareholders in order to meet the rules for subchapter S incorporation. He thought he had a good story and he looked forward to sharing it with potential investors.

By spring, a letter of intent was signed and work began on a purchase agreement. During negotiations, employees wondered what was going on as they noticed an increased number of closed-door



Nancy Skophammer

meetings involving Otten, Heinemann and Skophammer. Otten and Heinemann were frequently away from their offices. Skophammer broke the news to the staff of 20 at a meeting in May. Otten said many came to him saying they wanted to work for him and the new owners. Otten responded by re-assuring his colleagues, saying there were no plans to lay off any employees and that they'd even be given a chance to buy shares, if they wanted. About a half-dozen of them eventually would buy shares.

Working with the Minneapolis law firm of Winthrop and Weinstine, a private placement memorandum was prepared by Oct. 21, 2013. Pages and pages of description that Otten had written were reduced to about three pages, and then supplemented with financials and boilerplate legalese that ultimately produced a document of some 70 pages. The purchase agreement gave Otten five months to raise the purchase price. Otten worked with Bridgewater Bank in Bloomington, Minn., to arrange for a bank stock loan to cover part of the cost, but still millions would need to be raised from investors.

Jerry Baack, president, CEO and founder of Bridgewater Bank, was one of Otten's inspirations. Baack was the chief lending officer at Commerce Bank, one of Otten's consulting clients. Otten watched as Baack left the bank's Edina, Minn., office to start Bridgewater in 2005. Baack raised some \$13 million in about a month from 125 shareholders to start the bank which today has \$680 million in assets.

Although Otten and Heinemann would be the personalities behind the acquisition effort, most of the capital-raising fell on Otten. He called relatives, including his moth-

er in Nebraska. He called customers and people he knew from his consulting work. He talked for hours on the phone to dozens of people. He agreed to meet with people in their homes and local cafes. Each had to sign a confidentiality agreement before he could tell them anything. When they signed, he provided a copy of the private placement memorandum and supplemented it with his commentary.

Otten said the response was overwhelming. He said just about everyone who listened to his story wanted to invest. "The only ones who didn't," he said, "didn't have the money." The minimum investment was \$50,000. Investors were not allowed to borrow to buy stock and they couldn't use IRA money. Many of the potential investors asked about liquidity, always an issue with stock that is not traded on an exchange. Otten explained the long-term nature of the investment but also described the potential for buy-back through the holding company or directly from Otten and Heinemann.

Otten raised the money in 65 days from 78 investors, including himself and Heinemann.

The closing took place on April 11 in the offices of Winthrop and Weinstine. Otten and Heinemann were there the day before to pre-sign many of the documents. Skophammer presented Otten and Heinemann ledgers articulating shareholders who had been involved with the bank since 1912. The shareholder agreement fashioned by Otten and Heinemann prevents them from disclosing their list of investors.

Post-transaction

Many members of the shareholder group, made up of people from 63 families, met each other

for the first time on May 10, when the bank hosted a recognition event at the golf course in Albert Lea. It was raining, which meant that farmers who bought stock couldn't be in their fields that day so they were available to come to the event. People shook hands and shared stories as they responded to the question, "How did you get involved?" Many responded that they support Otten or Heinemann, but nearly all said it was because they wanted to keep a community bank in their town.

Only about half of the shareholders are bank customers, and in remarks to the group Otten made a comment about converting the other half to customers.

Otten said the ag environment in southern Minnesota remains strong and he continues to expect it to provide a solid foundation for the bank for years to come. The bank's business plan will largely reflect past practices; there have been no changes in staffing, although Otten now carries the titles chairman and CEO, while Heinemann, 32, is called president and CFO. Otten said he appreciates the need to keep up with technology, and he expects to leverage Heinemann's skills in an effort to do so.

Two months after the closing, Skophammer said her phone is ringing a lot less. She said she is unsure about her next career move, although she said she would like to remain active in the community banking industry. She is in the process of selling her home in Albert Lea to move to the Twin Cities.

"People ask me how we did it," Otten reflected. "Well, the answer is you have to have a seller like Nancy who was committed to keeping the bank a community institution." ■