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TRAVILLIAN

TECH-FORWARD BANK INDEX

FEATURING:

COASTAL FINANCIAL CORPORATION

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ABOUT TRAVILLIAN

Travillian is a nationally focused executive search and talent advisory boutique dedicated to exclusively serving the financial services industry. We have helped the corporations, service providers and investors within these sectors improve their businesses since our establishment in 1988. We have an excellent reputation and adhere to the highest ethical standards.

INTRODUCING COASTAL FINANCIAL CORP.

Dynamic franchise and fintech leadership positions CCB at the nexus of banking's future. The Travillian Tech-Forward Bank Index was created to identify a select group of banks that appear to be best positioned at the forefront of the convergence of traditional banking and fintech. That said, the transformative process through which technology and innovation are altering the banking landscape is still in its early stages, and as a result, endgame visibility remains limited. With a strong foundation in community banking coupled with differentiated fintech expertise these "best of breed" tech-forward banks are further along the path of understanding (and thus helping to illuminate for others) what the future of banking will ultimately entail.

At the nexus of this conversation is Coastal Financial Corp., which arguably as much as any bank today truly embodies the melding of traditional community banking with a forward-thinking, fintech-oriented approach. The company operates a highly profitable, dynamic community bank franchise in the Pacific Northwest, and was among a small group of banks nationwide that recognized (and fully embraced) the technologically-driven transformation that has since transpired. Today, Coastal operates a differentiated business model, having further enhanced the value proposition of its dynamic community bank operation, while also carving a niche for itself as a leader in the Banking as a Service (BaaS) segment, and more recently through its emerging digital bank. Notably, unlike many others that looked to fintech out of weakness or desperation to compensate for a perceived lack of opportunity and/or subpar performance in its core community bank operation, Coastal pivoted from a position of strength. As a result, the company is very unique, even amongst its tech-forward peers, in that it operates a valuable and very profitable stand-alone traditional community bank in addition to a thriving, industry-leading fintech vertical.

Also, through our research for this report, we found the story of Coastal to be instructive, in the sense that at first glance, one might surmise that the company's current leadership standing within the fintech vertical is solely a function of its early pivot to, and embrace of, a tech-forward approach. While this was undoubtedly a contributing factor, we also found several developments throughout the entirety of the company's life cycle that helped to establish the values, culture, leadership, and decision-making processes that ultimately positioned the company to identify and execute on fintech opportunities as they emerged.

This is the story of Coastal Financial Corp.

Eric Sprink, President & CEO at Coastal Community Bank

THE EARLY YEARS

A promising start for a de novo bank with an atypical playbook. The circumstances that led to the formation of Coastal in 1997 were not unlike those of hundreds of other de novo community banks that formed over the past several decades. In 1996, Wells Fargo Bank of California acquired First Interstate Bancorp, which employed an executive named Lee Pintar. A spate of consolidation activity in and around Snohomish County (led by out-of-state conglomerate-type acquirers) had left the area almost completely devoid of locally-based community banks. This, coupled with the well-regarded Mr. Pintar's availability following the First Interstate deal, led a group of local businesspeople to approach Mr. Pintar with a request to start a new community bank in Everett, Washington, the largest city in Snohomish County. Following a capital raise of $8.2 mil. (at $2.31 per share; or $11.55 on an apples-to-apples basis with today's price), Coastal Community Bank was established and opened for business on April 1, 1997. Their focus was serving small to medium-sized businesses within the Puget Sound region with "a flavor that is uniquely Snohomish County", per Mr. Pintar at the time.

The "playbook" for most de novo banks of that era was fairly straight-forward. Larger, well-established public banks generally traded at higher valuations than they do today, so the opportunity to invest in a de novo bank, effectively at book value, was very compelling. When paired with a high probability that the company would be sold within a decade or so of its founding, oftentimes at several multiples of book value, the opportunity became particularly enticing. This type of transaction would typically afford the senior executives and investors of the target bank an opportunity to start a new company and repeat the process.

This practice came to a screeching halt with the onset of the Great Recession in 2008, but even setting that aside, Coastal was unique in the sense that the typical de novo playbook described above was not part of the longer-term plan. Several of the founding Board members and businesspeople that encouraged Mr. Pintar to start the bank were younger in age, and were inclined to continue to build the company, eschewing a sale. They opted instead to recruit Mr. Pintar's successor as CEO, with the idea that he would groom the younger executive to eventually assume the leadership reins. With that plan in mind, the company recruited current CEO Eric Sprink, aged 34 at the time, to join Coastal as President and Chief Operating Officer in late 2006.

OPPORTUNITY AND REINVENTION FOLLOWING A STUMBLE

Like virtually all regional peers, the company struggled mightily through the Great Recession and its aftermath...

As the financial crisis began to unfold in 2008, what happened next for the country at large and particularly hard-hit geographic regions such as the Pacific Northwest is of course well-documented at this point. Specifically, as it relates to Coastal, we note that the number of banks based in Snohomish County was halved (from 14 to 7) during the crisis period. While Coastal Community Bank obviously survived, the company was not immune to the travails experienced by nearly all of its regional peers. A high concentration of construction and development loans heading into the financial crisis proved particularly problematic, and the rationalization of this exposure under the direction of new CEO Eric Sprink (elevated to that role in 2010) was a primary focus.

…but at the same time, new leadership was positioning the company for future growth. Concomitant with the company's risk mitigation efforts during this period, however, was a bold and ultimately successful attempt to position Coastal for future growth. Saddled with a regulatory order (which was removed in 2012), management embarked on what in retrospect proved to be a shrewd approach to recapitalization. For several years, beginning in mid-2008, the company raised capital on an "as needed" or "just in time" basis. The thought was that a portion of the capital infusion would help absorb losses, stabilize the company (total assets were reduced by about $50 mil. to $200 mil. through the initial recapitalization phase) and solidify the capital base. The remainder would be utilized to allow the company to assume a more offensive growth posture.

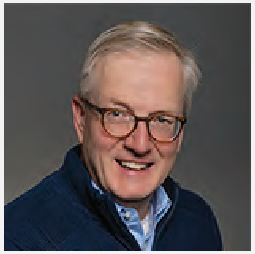
For instance, in 2010, Coastal lost $6 mil. but grew its FTE base by nearly 50% (and by almost 250% over the next 5 years), on its way to nearly doubling its branch count by 2015 (to 12 from 7) and tripling its deposit market share in the process. Coastal eventually emerged as the largest bank based in Snohomish County. The ranks of senior management were further bolstered during this period as well, with the addition of multiple key executives, including current CFO Joel Edwards, COO John Dickson, and Chief Lending Officer Russ Keithley.

As noted above, new equity capital was issued every year from 2008 through 2014 on an "as needed" basis, and was thoughtfully considered and executed, as were all aspects of the strategic recovery plan under new CEO Sprink. Rather than simply engaging an investment banking firm and soliciting new defensive capital by any means necessary, as so many companies did during this period, the company sought out strategic investors with a longer investment horizon. These investors joined the Board and helped bring a perspective that we find is often lacking at smaller community banks. Specifically, private equity investors Gapstow Capital Partners (represented on Coastal's Board by Jack Thompson) and Montlake Capital (represented by Andy Dale), alongside long-term veteran bank investor and investment banker Steven Hovde, effectively recapitalized the company and joined the Board. Mr. Hovde today is Coastal's largest individual shareholder and remains on the Board.

So in effect, the company emerged from a devastating event with its foundation fortified, a new dynamic leader and management team in place, highly sophisticated expertise at the Board level with significant skin in the game, and a thoughtful, growth-oriented strategic plan. Within the broader regional banking landscape, the financial crisis also proved fortuitous for Coastal in the sense that it opened a lane for the company to thrive as the largest community bank based in a market that was severely dislocated due to the outright collapse of most smaller competitors (and an iconic one in Washington Mutual), but yet was still among the most attractive in the country from a demographic standpoint and which was quickly emerging as a technological hub to rival even Silicon Valley.

EXECUTIVE OFFICERS

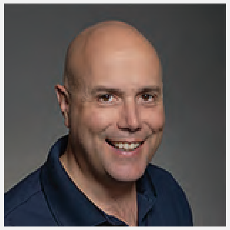
Eric Sprink
President & CEO



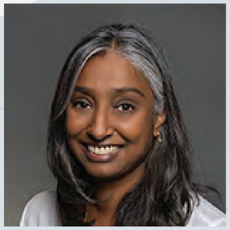
Joel G. Edwards
CFO

BOARD OF DIRECTORS

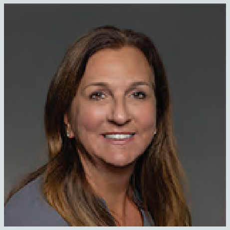
Christopher D. Adams
Chairman



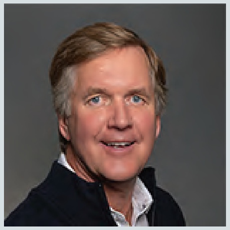
Andrew P. Skotdal
Vice Chairman



Sadhana Akella-Mishra



Rilla Delorier

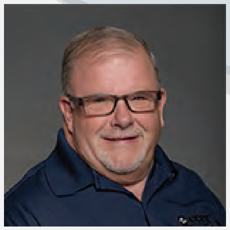


Steven D. Hovde

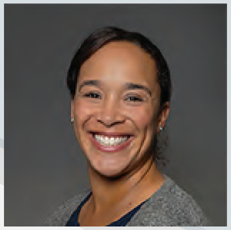
Thomas D. Lane

Erik Sprink

Stephan Klee



Gregory A. Tisdel



Pam Unger

LEADING WITH PEOPLE AND FITTING FOR CULTURE FIRST

Coastal's already-dynamic culture and operating philosophy was further cultivated during this period and provided the foundation for what came next. As indicated at the outset of this report, one of the main takeaways from our research was that while the company's technological prowess and overall tech-forward approach has undoubtedly been a contributing factor to its success to date, these were not the only factors. The values, culture, leadership, decision-making processes, and "can-do" attitude that have been cultivated at the company since inception, have been equally important. Indeed, we note that the company's core values today – (1) Stay flexible; (2) Take care of each other; (3) Embrace gray thinking; (4) Be relentless; (5) Be the best; (6) Be un-bankey – were developed by the company's founding Board members. We were struck by how often these themes were emphasized and reiterated in our many conversations with senior management and key employees.

VALUES CULTURE LEADERSHIP

From its start, the company "always led with people" and emphasized a recruitment strategy that "fit for culture first", according to Laura Byers, currently Coastal's Chief Digital Banking Officer and a nearly 17-year veteran of the company. Early on, the company would identify people and teams that it believed were a good cultural fit, and new branches would be built around these key personnel. The company prides itself on its "can-do" attitude and opportunistic approach, with management noting that...

> ...the company's branch in Darrington was "started on a card table in the back of a hardware store when Bank of America pulled up stakes, leaving the town without any banking option", while on Camano Island, "we saw the fastest way to start helping small businesses was to set up shop out of a car, and so we did."

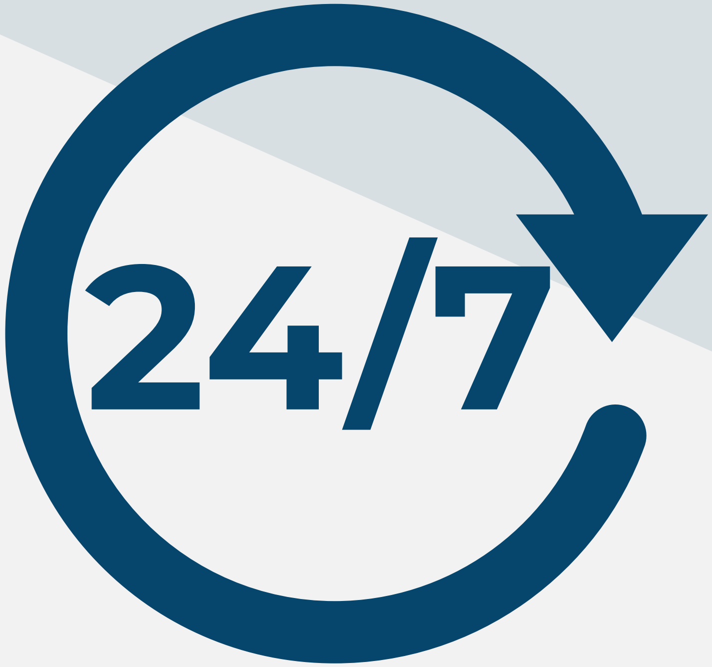
The company's marketing literature also recounts how, during the 2008 crisis, its bankers worked closely with small business clients, with one customer noting that "without Coastal's counsel and cheerleading we'd have been toast". In short, we noted through our research an unusual focus on serving the customer, to help them "find a way", which if one stops to think about it, really speaks more to a traditional service ethos and a willingness to think outside the box of traditional banking than it does any sort of advanced technological capabilities. In its marketing literature and through our conversations with the company, management notes a willingness to "embrace gray thinking", in the sense that employees are encouraged to use their instincts as much as spreadsheets to make decisions and to help solve customers' issues at the line level.

With banking products that are largely commoditized for all industry players, management believes that the "Coastal difference" is in outworking competitors to deliver products and services that give business clients an advantage, whereas other banks are bound by rigid process and an unwillingness to push for a solution. Both management and employees consistently reference a desire to be "un-bankey" (see this short video – https://youtu.be/HmS4znIphiw), with "bankey" referring to tradition and standard modes of operation in the banking industry that can sometimes be destructive because these practices make life easier for the bank, at the expense of the customer.

POWERED BY SBA
U.S. Small Business Administration

Without understanding this background and cultural ethos, one might be inclined (as we were initially) to simply attribute the company's recent successes solely to technological prowess, while giving short shrift to other attributes that deserve equal billing and should be attainable for any company with the drive, determination, and hustle that never seem to be in short supply at Coastal. For example, on a "pound-for-pound" basis, Coastal was arguably as successful in its administration of the PPP (Payroll Protection Program) as any bank in the country. As of 3/31/21, as a preferred SBA lender, the company had funded a total of $737 mil. (representing roughly 2/3 of the company's total asset base heading into the pandemic) in financial assistance to existing and new small business customers through the PPP, with nearly $25 mil. in net deferred loan fees.

From our conversations with the company, we learned that management attributes roughly 90% of Coastal's success with PPP to "hustle" and the attitude of its people and leadership team, with only 10% attributable to any tech-related advantages. While admittedly the company enjoyed some built-in advantages as a preferred SBA lender with a tech-forward approach, management notes the "all-hands-on-deck" mentality with respect to PPP, and how the decision was made early on that Coastal would be "all-in" on the program. For instance, the company decided it wouldn't impose limitations on non-customers (as did many other banks), senior management (including the CEO and Chairman) were calling customers, and interns were immediately hired to help wherever needed, etc. Bottom line, it was a "7 days a week, 24 hour per day effort", according to management, and that, more than anything else, drove the highly successful outcome.



Coastal's approach to acquiring, retaining, and repurposing talent is also unique, and, again, pre-dates the company's interest in fintech. This further suggests that the relative advantages the company enjoys today are just as much a function of its culture and philosophy as it is any "leg up" the company may possess with respect to technological aptitude. Dating back to the financial crisis more than a decade ago, the company was opportunistic in its hiring from local failed and struggling banks. Coastal recognized that bank failures are oftentimes a function of having been caught up in a macro crisis, as opposed to mismanagement by senior execs at the failed institution and this enabled them to pick up "A-list" talent. Management also seemed to recognize, to its credit, that even in the event of failure, many banks possessed talent in other areas that were completely unrelated to the reasons for the company's seizure by regulators.

Management notes that during the crisis period, the company added teams focused on SBA and Treasury Management, as well as individuals on a one-off basis that have since emerged as key executives, sometimes in areas that are distinct from that executive's prior experience.

More recently, Coastal's opportunistic approach was again evident as the company sprang into action following the acquisition of BBVA USA by The PNC Financial Services Group, Inc. BBVA operated BBVA Open Platform, Inc., which was a wholly owned subsidiary that is now winding down their operations and no longer accepting new customers. BBVA Open was very similar to Coastal's CCBX unit, and so upon learning this news, Coastal execs quickly met to decide on an action plan, utilizing contacts at BBVA Open, LinkedIn pages, literally anything that would allow for Coastal execs to get in front of these former BBVA Open employees as quickly as possible. In addition to BBVA Open, the company had a direct-to-consumer platform called Simple, a dynamic neobank based in Portland, Oregon, and Azlo, a direct-to-business arm. Ultimately, Coastal wound up hiring from each of these three units in what management describes as a culturally synergistic acquisition that resulted in a near re-creation of BBVA's well-regarded tech-forward operation.

CORE VALUES

- Stay Flexible
- Take Care of Each Other
- Embrace Gray Thinking
- Be Relentless
- Be the Best
- Be Un-Bankey

Another misconception we had prior to our in-depth conversations with the company is that a youthful senior management team and Board – not just at Coastal but for most successful tech-forward banks – was among the distinguishing characteristics of banks that had achieved success in fintech. On the surface, and anecdotally-speaking, it would seem to make sense that younger people are generally more open to utilize technology in their personal lives and by extension, in their "work-life". Reinforcing this assumption is the simple observation (again, just anecdotal) that many tech-forward banks seem to be led by CEO's and senior execs that are generally younger than the average bank CEO. However, despite personally fitting the anecdotal narrative and while acknowledging that age can sometimes be a "complicating factor", Coastal CEO Eric Sprink pushed back vigorously on our preconceived notion that relative youth and fintech success were highly correlated. Per Mr. Sprink, the key ingredient is "not youth, but entrepreneurial spirit," with the "cultural thing" more than the "age thing" representing the key determining factor for success. This concept is also interchangeable in terms of the approach that Coastal employs with respect to talent recruitment and retainment and customer focus.

Mr. Sprink notes that companies such as Square, Paypal, and Facebook have transcended age groups and that "heat maps" of Coastal's fintech customers evidence more of a cultural focus than a specific age demographic. For instance, he notes that a 70-year-old of either gender that is concerned about environmental issues might choose to bank with Aspiration (a banking-as-a-service client of Coastal and a company that is keenly focused on this issue), whereas a 40 year old female entrepreneur might choose Ellevest (co-founded and run by former Citigroup CEO Sallie Krawcheck), a digital financial advisor for women.

Coastal utilizes a similar approach in recruiting talent, at the Board level, and in its ranks of senior and middle management. Mr. Sprink cites the example of the aforementioned Mr. Dickson who, after a nearly 40-year career steeped in traditional banking, is now among the company's integral senior executives in all things fintech-related. While one might presume that the company's physical location, amidst a dynamic tech-hub like Seattle, is among the reasons for its considerable success in this area, Coastal management points out that recruitment from traditional community banks has contributed "at least as much and possibly more" talent than the local tech-focused community.

> Eric (Sprink) has built a culture of taking pride in what you do and doing something different, and as a result, we look for people that have those skills.
>
> Laura Byers,
> Coastal's Chief Digital Banking Officer

With an eye toward talent retention, particularly among the middle management and millennial ranks, the company seeks to avoid a siloed, hierarchical structure, as is typically found in many community banks, whereby younger employees are forced to "wait their turn", irrespective of their talent, in favor of older employees that may simply just have more experience. At Coastal, middle managers and younger employees tend to see opportunity, due in part to management's insistence that all employees should not feel as though they're "kept in a box" and constrained by their job description. "Entrepreneurial know-how" is key to the culture, with all employees encouraged to bring an idea to the footprint, without fear of "stepping on people's toes". Ms. Byers indicated to us that "there is a real passion for the company and a commitment to each other, and these are traits that tend to resonate with all employees, as opposed to just showing up and doing your job."

THE PIVOT TO FINTECH

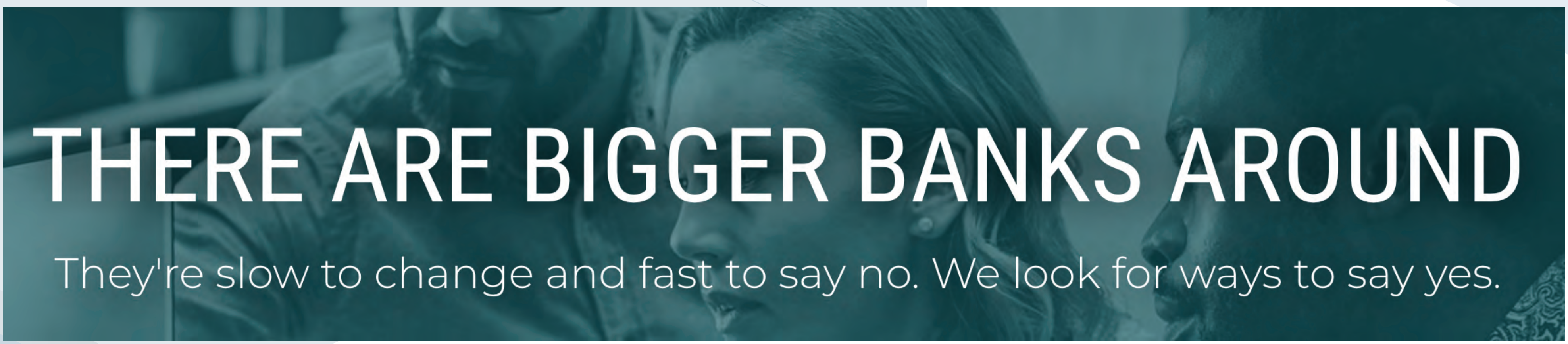
The pivot to fintech was based on a confluence of factors and, for Coastal, was made from a position of strength.

Earlier in this report, we noted what we think is an important distinction for Coastal vis a vis many of its peers. Recently, many banks have entered the fintech arena with what we would term a "window dressing" strategy. Specifically, that the bank's publicly announced entry into fintech is designed in part to give said company, or its stock a "buzz" in the marketplace. Others have looked to fintech not just for the "buzz" factor but with an eye also toward curing a potentially longer-term, fatal flaw in their core banking business. Perhaps the company is in slow growth markets and lacks the ability to improve its growth profile or is a poor fundamental performer looking to the stronger performance of successful tech-forward banks for inspiration.

Whatever the reason, many seem to be embarking on a fintech strategy without a clearly articulated or executable plan and/or from a position of weakness in their core business.

This isn't to say that some of these companies won't ultimately be successful in their new endeavors, and/or that their strategic pivot is misguided. However, it does seem logical to us that a purposeful decision, embarked on from a position of strength, and with a defined and executable strategy – not to mention a lower risk profile to the overall business model stemming from the inherent value of the core banking business as a "fall-back" – is suggestive of a higher likelihood of longer-term success.

Coastal fits the latter description, in the sense that while a confluence of factors and events drove the pivot to fintech, the decision was made from a position of relative strength, and as a result, today, the company is unique – even amongst its tech-forward peers – in operating a valuable and highly profitable stand-alone traditional community bank in addition to its now-thriving, industry-leading fintech vertical. In fact, one could probably argue that Coastal's fintech initiatives have been dilutive to the overall profitability profile to date, given the significant costs related to the build-out of the fintech vertical. If accurate, then the traditional banking business at Coastal is likely among the most highly profitable in the nation.



The story of Coastal's pivot to fintech is an interesting one, and like other major milestones throughout the company's life cycle, is a function of several factors, but mostly in our view ties back to the opportunism and open-mindedness embedded in the company's culture and overall strategic approach. Coastal senior management and its Board were wrestling with several emerging issues and new developments that seemed to coalesce roughly around the same time, in 2016 – 2017.

01

First, the investors that provided the company with its start-up capital nearly twenty years earlier were still "underwater" on their initial investment. For perspective, the de novo capital raise was completed at a split-adjusted price (apples-to-apples with today's pricing) at $11.55, whereas the most recent capital infusion around that time – in December 2014 – was completed at a split-adjusted price of $6.25. The discounted price nearly twenty years post-founding of course reflected the company's aforementioned struggles during The Great Recession and subsequent actions taken to recapitalize the company, a process that was severely dilutive to pre-2008 investors.

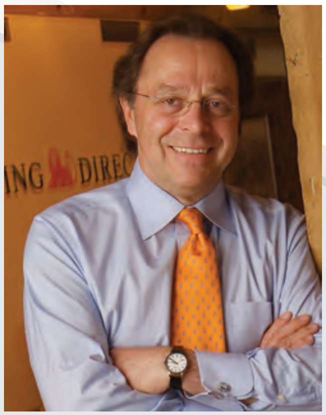
02

Second, while we noted earlier that the capital provided for the recapitalization was sourced from private equity-type investors with a much longer time horizon than the average institutional investor, the time horizon for these investors was by no means infinite. As the company approached the seven-year anniversary of the initial recapitalization, as is typically the case in a private equity bank recap scenario, pressure was building for a liquidity event – namely either a sale of the company or an IPO. So, the question before the Board was, in effect, to either (1) sell the company, which at that point had a terrific franchise, solid operating metrics, and a nascent fintech operation (more on this below); or (2) compete an IPO, in pursuit of a complete transformation of the company and business model, one which would hopefully garner a stand-alone "super-premium" valuation multiple. The decision wasn't an easy one, given all that had been accomplished since the financial crisis, coupled with the fact that the company would likely have commanded a sizeable premium in a standard M&A transaction, just by virtue of its solid fundamental performance and immense franchise scarcity value in a dynamic market. Further to that point, we note that the "recap investors" established their position in the stock at around $5 per share, on average, and the likely sale price if the Board chose that route, would have been lucrative for these investors.

03

Third, having said all of that, while these deliberations were taking place at the Board level, conversations about a more meaningful strategic pivot were well-underway (see below for the story on that), and safe to say, were a significant contributing factor informing the Board's decision. An initial public offering was completed in July 2018, raising $27.4 mil. at $14.50 per share. This offering simultaneously delivered a liquidity event to early investors, at a premium, despite the aforementioned dilution years earlier, and to the "recap investors", who reaped significant gains, having roughly tripled their initial investment.

The strategic pivot to fintech began about six years ago, in 2015, when Coastal and a company called ZenBanx each expressed interest in acquiring a small bank in Seattle that ultimately was sold to another party. ZenBanx, an early pioneer in mobile banking, was founded by Arkadi Kuhlman, who had been instrumental in the buildout of online bank ING Direct, and was now seeking to partner with or acquire a small U.S.-based bank as part of an initiative related to foreign currency transactions and the facilitation of money movement from the U.S. side. Through this process, Coastal was introduced to ZenBanx – its first exposure to fintech -- and subsequently pursued an acquisition of that company, only to be outbid by SoFi, which acquired ZenBanx and then shuttered the brand.



Zenbanx®

Arkadi Kuhlman, Founder of Zenbank

Despite this setback, Coastal's senior management team and Board were intrigued. Per CEO Sprink (according to a recently published article and confirmed in our conversations with the company), "we retained the knowledge we had learned through the dance", and the longer-term opportunity and possibilities compelled the Board to reconsider its decision to sell the company in favor of pursuing a strategy centered on the concept of Banking-as-a-Service (BaaS). So literally on a whiteboard during a Coastal Board meeting nearly five years ago, the CEO detailed a plan from which Coastal would make a strategic pivot.

What is Banking as a Service (BaaS)?

Before continuing with the Coastal story, we offer a very brief sidebar on the concept of Banking as a Service – we'll delve into this topic in more detail in a follow-up standalone report. Essentially, the "service" is provided by a bank within the regulated banking system that offers its bank charter, banking services, and infrastructure – the "plumbing" or "pipes" of the banking system, for lack of a better term – in a partnership with a non-bank, unregulated company or brand seeking to provide financial services to its customer base. The non-bank company pays a basic fee for these services and typically also negotiates a revenue-share agreement with its bank partner based on the success of the overall endeavor.

The concept has grown in popularity in recent years, particularly with Fintechs that can offer an outstanding product and/or front-end customer experience, but lack a banking charter, regulatory "acceptance", FDIC-insurance protection, costly infrastructure, and institutional know-how that would otherwise take years to build out on their own and could potentially also distract from their core product offering, value proposition to customers, and cultural uniqueness.

The attractive features to the regulated bank partner might include a fintech's markedly lower customer acquisition costs, enhanced service quality, focus on a coveted niche demographic, and fee income revenue stream that is uncorrelated to trends in the traditional spread banking business. In the Banking as a Service realm, smaller banks (less than $10 billion in assets) are also at a distinct advantage relative to larger banks, given the former's exemption from the Durbin Amendment, which governs the terms around interchange fees.

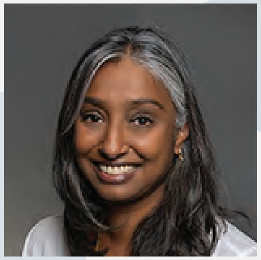
A THRIVING INDUSTRY LEADER

Coastal's history, culture, strategic plan, and opportunity coalesce as it embarks on a new journey. We noted earlier in this report how the values, culture, leadership, and decision-making processes at Coastal were integral to the company's success and standing today as a tech-forward leader in the banking space, as much if not more so than any specific tech-related expertise the company possessed or acquired along the way. So, in effect, the company's opportunistic and open-minded approach was married to the specific Fintech-related opportunity when it arose.

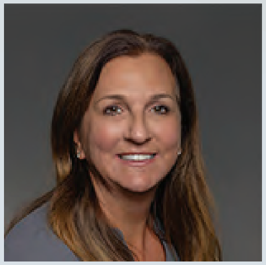
The setback related to Coastal's failed pursuit of the aforementioned small Seattle bank and then of ZenBanx was short-lived. Coastal's Board and senior management team was increasingly intrigued by the possibility of expanding into BaaS as a means to maximize shareholder return over time. While the regulators had looked askance at the company's initial foray into the Fintech realm with the pursuit of ZenBanx, there wasn't outright opposition to pursuing other opportunities. At this point, Coastal set out to add the requisite talent – within the ranks of management and on the Board – and build the infrastructure necessary to not only pass regulatory muster but also to enhance its own understanding of the opportunity.

Having established a relationship with ZenBanx through the courtship process, the company turned now to its contacts within that organization following its acquisition (and the shutdown of the brand) by SoFi.

Stephan Klee had served as CFO of ZenBanx and prior to that was Chief of Staff at ING Direct, alongside ZenBanx founder Arkadi Kuhlmann at both stops. Mr. Klee joined Coastal's Board in mid-2018, just as the company completed its IPO. Also joining Coastal's Board was Sadhana Akella-Mishra, who served as Chief Compliance Officer of ZenBanx and was with the company from 2013 to 2016, and is now Chief Information Security and Compliance Officer for Finxact, Inc., a core banking software company. Other additions to the Board in recent years include Rilla Delorier, who previously led innovation initiatives at Umpqua Bank (as Chief Strategy Officer) and SunTrust Bank (as Chief Marketing Officer), and also currently serves as Independent Board Director at Nymbus, a leading provider of banking technology solutions for financial institutions.


Sadhana Akella-Mishra


Stephan Klee


Rilla Delorier

These additions over the past several years, which complemented the previously mentioned adds in the years following The Great Recession, have helped to transition Coastal's Board of Directors to now reflect a combination of legacy directors and the core community bank, sophisticated investors with capital markets experience and significant "skin in the game", experts that are at the forefront of the convergence of community banking and technology, and others with the requisite regulatory and compliance expertise to help guide the company through these unchartered waters, with an eye towards scaling the opportunity over time.

It was through one of these contacts – Stephan Klee – that Coastal was referred to the company that would become its first BaaS client, Aspiration. Aspiration is an online investment platform that offers socially-conscious and sustainable banking and investing. The company had decided to seek a partner to replace the bank it had been working with to that point. Following Mr. Klee's introduction, Coastal CEO Eric Sprink emphasized to Aspiration that while Coastal was new to BaaS, it would like to help them "find a way", which again, speaks less to technological expertise and more to the company's approach with all of its clients (recall the earlier discussion about how Coastal looks to be "unbankey" problem solvers). Aspiration was added as the company's first "Banking as a Service" partner in May 2018 within its newly created Wholesale Banking Group, just two months prior to Coastal's IPO.

Aspiration

Do Well. Do Good.

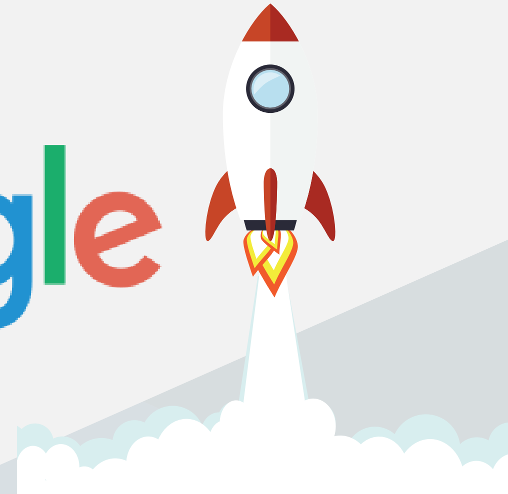
From that point, Coastal learned quickly that the world of fintech companies and challenger banks is a close-knit community and that good performance would lead to additional referrals. The company began the build-out of its new Wholesale Banking Group, which has since been rebranded as its CCBX Division (in January 2020), with the "X" in CCBX representing the technology services provided by its partners. To date, the company has interacted with over 900 Fintech and Brand companies – of those, the company has had 200+ presented to pipeline, and conducted deep diligence on 50+, ultimately resulting in 24 partners as of 6/30/21, up from 15 at year-end 2020 and 7 at 3/31/20.

In contrast to other partner banking providers in the BaaS realm, Coastal doesn't seek to build software and "own the stack", a la some of the older and larger players in the space, such as Cross River for example. Again, harkening back to its deeply ingrained approach of providing flexibility and solutions for its customers, Coastal's BaaS offering works with a multitude of core operating systems, providing optionality and a customized product to its fintech and neobank customer base. The objective, per CEO Sprink, is not to build systems, but rather to ensure that they are integrated and working harmoniously on behalf of the fintech partner, while also ensuring that appropriate regulatory and compliance protocols are adhered to.

In a new and rapidly changing environment, regulatory compliance matters are always in focus.

Coastal's CEO Eric Sprink makes the point that while speed to market, growth, and profitability are vitally important, the penalty for a misstep would be severe. Moreover, given the rapidity of the changes that are occurring, the regulatory framework continues to evolve, so while adherence to current compliance requirements is obviously pertinent, so too is anticipating and planning accordingly for where things may be headed.

Coastal has hired a Chief Risk Officer – unusual for a community bank of its size – along with others holding advanced degrees in Artificial Intelligence to help ensure that services are performed in a safe and sound manner. Mr. Sprink also notes that the company is in communication with its regulators constantly (both state and federal), and that whenever it is considering bringing on a new partner, the regulators are made aware, and the client is also asked to meet with regional and state regulators, so that they can also better understand from regulators directly what will be required of them and their bank partner. Mr. Sprink also makes the very valid point that 85% of all fintechs fail, and while there are obvious implications on the business front from a potentially diminished revenue stream for Coastal, there could be implications on the regulatory and compliance front as well if there were missteps along the way. The bottom line is that while Coastal obviously isn't able to protect against every contingency, the overarching goal is to at least ensure that the company is engaging (and is fully transparent) with regulators through the process.



Ramping up the digital bank (CCDB), the third component of Coastal's strategic plan, in anticipation of the Google launch. Coastal aims to drive value for shareholders through a three-prong strategy:

01 First, through its dynamic and highly profitable traditional community bank operation, dubbed CCB.

02 Second, through the aforementioned Banking-as-a-Service, its CCBX division, which generates fee and interest income for the company by enabling its fintech and neobank partners to offer banking services to their clients.

03 Third, through its newest division, CCDB, which houses the company's digital banking operations, and through which it plans to introduce digital banking accounts later this year or early next in collaboration with Google.

The company has been aggressively adding talent to staff the digital division – CEO Sprink has indicated that over 80 people were hired in the 2Q, mostly within CCBX and CCDB, bringing company-wide FTE's to nearly 420 in total. Despite the technological connotation of these divisions, additional staffing for the digital bank of late has been mostly centered in accounting, operations, and compliance, in keeping with the company's intention of hiring people with a banking background that also have the ability to work with the company's tech and digitally focused client base. These efforts are primarily in anticipation of the launch of Coastal's previously announced collaborative partnership with Google early next year, and the continued growth of CCBX.

Taking a step back and per our conversation with the company, we note that the Google relationship essentially began at the Money 20/20 event in October 2019 (Money 20/20 is a Fintech and Payments-oriented conference held annually). Coastal's Chief Digital Banking Officer Laura Byers and Chief Operating Officer John Dickson were attending the event and received a message from a rep in Google's business development division, asking if Coastal would be interested in a business proposition. Generally speaking, Google was looking to partner with banks across the size spectrum (Citigroup and BMO Harris, for instance, are also partner banks) that were forward-thinking, nimble, and able to move relatively quickly. Early the next year, conversations between Coastal and Google picked up "in earnest", per Coastal management, including the details of the contract, the terms of the relationship, etc. These discussions were subsequently finalized, with the partnership announced publicly in July 2020.

None of the partner banks – Coastal included – have publicly disclosed very much about the Google relationship. We suspect this likely comes at the request of Google itself and is understandable since the new accounts have yet to launch. Partner banks also are not providing any sort of projections as to the potential financial implications of the relationship. What we do know is that Coastal is working with Google on new accounts known as

Google Plex, which will be integrated with Google Pay. For Coastal, this collaboration – which is housed in CCDB and is not considered a Banking-As-A-Service partnership – will help to expand the company's reach and build additional households.

Per CEO Eric Sprink, the relationship with Google is all about helping customers understand their financial situation and should provide an opportunity for Coastal to access tech-savvy households and businesses nationwide, a demographic that has proved elusive to traditional community banks, most of whom are completely missing the digital revolution. So essentially, Google will be the face of the banking relationship to the customer, providing a front-end user experience and all that it entails. Coastal will provide digital bank accounts, built off its infrastructure – similar in concept but not entirely in practice to the service it provides to its BaaS fintech partners.

Prioritizing diverse communities through BaaS is a key strategic focus. As Coastal onboarded new BaaS partners, the company gained an increasing appreciation for the commitment many fintechs have with respect to providing financial services for the under-banked and un-banked. The company clearly states in its marketing literature that it believes that financial inclusion is key to reducing poverty and inequities and it observed the impact that its partners were having on a variety of underserved constituents. As a result, Coastal began to actively solicit like-branded fintechs to help them with the resources they needed to go to market.

In partnering with companies through the CCBX division that are focused on financial inclusion, Coastal management sees an opportunity to broaden its impact on a scale and speed that it would not otherwise be able to realize as a traditional community bank. CCBX is thus uniquely positioned to bring value to inclusion-focused challenger banks, as it tailors its approach to fit the needs of each fintech partner in the process of bringing it to market. Coastal offers many services, which are incorporated throughout the fintech partnering process, as part of its diversity and inclusion initiatives. These include: financial literacy for at-risk communities, small dollar lending programs for underserved communities, environment and social governance programs for environmental sustainability, green financing and responsible investments, and no overdraft fees. The company further notes that roughly three-fourths of its CCBX partners have a diverse CEO (minority or female) and 88% have a diverse co-founder.

Per CEO Eric Sprink, Coastal seeks to understand how to bank these diverse communities through its partnerships, noting the need for adjustments to its typical onboarding process and the likelihood that new approaches to banking oversight will be required. Some of Coastal's diverse partners within CCBX (and this is by no means a complete list) that have been publicly disclosed include Greenwood, a black and brown bank based in Atlanta; Ellevest, a financial company "for women by women"; Fair, a Muslim-focused bank headquartered in Houston; Cheese, which works primarily with Chinese immigrants; Till, which is focused on financial literacy for at-risk communities; and Possible Finance, which offers small dollar lending nationwide.

CCBX
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LOOKING TO THE FUTURE

Creating a financial marketplace. While Coastal management was understandably guarded in its willingness to discuss the future (for competitive reasons), we did get a sense for the longer-term, big-picture objective. The broader mission seems clear: to continue scaling its industry-leading BaaS operation, but with what management describes as the "right partners" as opposed to a set target number of clients or the "shiniest" current financial performers. Rather, the company looks to be the aggregator of a very diverse client base – termed by CEO Sprink as "the Noah's Ark approach" – whereby the company can ultimately create a one-stop financial marketplace for consumers and businesses to shop for customized financial services, diversified by product, payment system, and culture.

We look forward to providing a more in-depth look at the future of banking from Coastal's perspective in the coming months. Until then, we will continue to track the progress of this dynamic, tech-forward industry leader.

Joe Fenech is the Managing Principal of SMBT Consulting, LLC, which provides consulting services to banks. The report represents the views and beliefs of Mr. Fenech and does not purport to be complete. The information in this report is provided to you as of the dates indicated and the data and facts presented herein may change. You should not rely on this report as the basis upon which to make an investment decision; this report is not intended to provide, and should not be relied upon for, tax, legal, accounting or investment advice. Mr. Fenech is also the Chief Investment Officer and Managing Member of GenOpp Capital Management LLC, an investment adviser that maintains exempt reporting status in the State of Indiana. As of the date of publication of this report, affiliates of SMBT Consulting, LLC hold a long position in the security of Coastal Financial Corporation.