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Silver, Freedman, Taff & Tiernan LLP
3299 K St, N.W.
Suite 100
Washington, DC 20007-4444

Silver, Freedman, Taff & Tiernan LLP
Our Knowledge and Judgment
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A Community Banker’s Pocket Guide to Mergers and Acquisitions

Tel: 202-295-4513

This is the first pocket guide for executive officers of financial institutions designed to highlight M&A considerations, including planning, selecting an investment banker, compensation issues, deal structure methods to limit your risk and other negotiation pointers. It is designed to provide executive officers and directors of the buyer or seller an overview of some of the key issues that arise.

The conqueror, Frederick the Great, said "It is pardonable to be defeated, but never to be surprised." This wisdom applies equally well today as competitive and harsh and demanding regulatory environment spurs consolidation in the banking industry. As a survivor of a severe recession, you are facing a low interest rate environment and uncertain economy resulting in declining operating revenue and challenges to your ability to generate assets meeting your investment objectives. Conditions are unlikely to improve as Basel III is implemented and more Dodd Frank rules increase compliance costs. As banking becomes more and more about scale and efficiency, the inability of many depository institutions to overcome these challenges has resulted in a significant increase in merger and acquisition ("M&A") activity. These inevitable changes give rise to the following questions:

- Are you and your institution well positioned for this consolidation?
- Do you know the factors to consider in a potential merger or acquisition?
- Do you know how to negotiate a merger or acquisition?
- Do you know how to protect your interests?
- How much compensation should you expect to receive in a merger or acquisition?
- Do you know the benefit plans that are available?

Determining your strategic direction

Strategic planning should encompass a review of all three scenarios: remaining independent, being a buyer or being a seller. However, whether you believe that your institution will remain independent or be a buyer or seller, you need to be prepared. The planning process is a long-term process and the Board and senior management should start the process well in advance, especially if you are likely to be a seller. First and foremost, management and the Board need to determine what the institution's objectives and strategy are by developing a realistic business plan. The goal should always be to control your own destiny even if that destiny is not to remain independent.

Financial institutions which seek to become or are buyers generally do so for one or more of the following reasons:

- Need to improve operating efficiency, leverage fixed costs and seeking economics of scale;
- Need to increase market share;
- Need to expand into more attractive markets;
- Need to develop fee-based and other non-interest income;
- Need to leverage capital and improve ROE;
- Need to move into more attractive business lines;
- Need to grow to justify independence; and
- Desire to more effectively and attractively position the institution for future sale.

In order to be an attractive buyer to a potential seller consider how to differentiate your merger strategy from that of other buyers, especially larger institutions. If you do not fit the potential seller's merger strategies practice how you can articulate a vision making yourself more attractive as a potential buyer. You need to realistically appraise your franchise value, know what makes you attractive to potential buyers, how can that attractiveness be enhanced and what will reduce such attractiveness.

For example, consider your:

- Ability for significant growth vis-à-vis organic growth;
- Ownership dilution depending on various pricing and structures;
- Effect the merger will have on capital ratios;
- Integration requirements; and
- The value of your stock currency.

Financial institutions which elect to be acquired or merge with a strategic partner often do so because of one or more of the following reasons:

- Concern about being able to maintain long-term competitiveness;
- The commoditization of the industry;
- Increasing regulatory burden and costs of compliance;
- Belief that merger multiples are attractive now and may decline in the future;
- Concern that the universe of potential buyers will diminish significantly-especially in markets with a smaller number of institutions holding a majority of the deposit market share;
- Desire for greater liquidity for shareholders;
- Concerns about management and board succession;
- Favorable tax treatment on realized gain on exchange of stock;
- Realize a substantial improvement in dividend yield; and
- Potential to realize a double-dip (for a stock-based transaction) if the buyer is acquired subsequent to sale.

For example, consider your:

- Ability to create a larger institution with improved operating efficiencies;
- Provide liquidity for shareholders with potential for increased value in future;
- Ability to raise significant capital and the resultant dilution necessary to maintain an independent course; and
- Loss of control.

Being prepared should include the following:

- Establishing a committee of the Board with senior management which will be responsible for initially addressing potential transactions (whether as a buyer or seller);
- Establishing the procedure to address all inquiries about potential acquisitions;
- Adopting a policy of not commenting on potential transactions;
- Engaging counsel and investment advisors experienced in structuring and negotiating merger transactions;
- Educating your Board about how the merger and acquisition process works and discuss the various social and financial issues that are likely to arise in any transaction; and
- Analyze merger scenarios, both buying and selling; identify your likely targets or merger partners; and
- consider the effects on all your shareholders (stockholders, employees, management, customers).

The next guide will discuss the planning process.