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Silver, Freedman, Taff & Tiernan LLP
Our Knowledge and Judgment
Foster Speed and Results



A Community Banker’s Pocket Guide to Mergers and Acquisitions



Volume III

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This is the third installment of our pocket guide for bank directors and executive officers designed to highlight merger and acquisition (“M&A”) considerations.

Preparation as a buyer or seller entails a number of matters and involves realistically reviewing the company’s strengths and weaknesses and obtaining professional assistance. Good advisors are essential for you to understand the various options available in structuring a transaction including the form of consideration, the tax ramifications of the merger consideration and structure, the pricing protections that can be built into the deal, the nature of any termination fees, and the effect on employment/severance contracts and employee benefit plans. Although all deals are different, the M&A process will typically take from six to nine months from beginning to end, assuming no significant delays due to governmental approvals.

HIRING A FINANCIAL ADVISER

Once your board has decided to consider a possible M&A transaction, the next step often is engaging an investment banker to provide advice. Typically investment bankers represent the seller although they may also represent a buyer. Usually the seller will contact a number of investment banker candidates, some of which may be known to the seller’s management or controlling stockholders from prior deals. Each investment banker will submit an engagement letter with its proposed terms and conditions, which will be negotiated with the seller and its counsel. The negotiated terms of the engagement letter typically include:

- whether the investment banker will be paid a cash retainer upon signing the engagement letter, which may be netted against the “success fee” or only a “success fee”;
- the amount and structure of the “success fee” payable to the financial adviser upon the closing of a M&A sale transaction (which may be a fixed amount or calculated as a percentage of the total purchase price);
- the cap on the investment banker’s expenses that will be reimbursed by the seller, if any; and
- the term of the engagement, including the length of any “tail period” after the end of the engagement during which the investment banker receives a fee if the seller enters into a M&A sale transaction.

An investment banker can assist your company in determining its strategic direction. If your company

has decided to be a buyer, the investment banker can assist you in:

- developing realistic pricing expectations taking into account current market conditions;
- understanding who your M&A competition is and their ability and willingness to pay;
- analyzing the expected cost savings and in what time frames they will be achieved; and
- determining how you will finance the transaction, especially if you will need to conduct a debt and/or equity offering in order to effect the transaction.

If your company is considering the possibility of a sale, the investment banker can assist you in:

- understanding your company’s value and whether to sell now or in the future;
- developing your pricing expectations and how they mesh with reality of the market;
- understanding who the likely buyers will be and their ability to pay;
- understanding the quality of a possible buyers’ stock currency – absolute and relative;
- determining the method of sale – auction, a limited and select sale process or an exclusive negotiated sale; and
- determining the preferred consideration – cash, stock, or a mix.

THE INITIAL M&A PROCESS

One of the main roles of an investment banker in a M&A transaction is the rendering of a “fairness opinion” to its client that the consideration to be received by or paid to the seller’s stockholders is fair from a financial point of view. Prior to rendering an opinion, they help manage the M&A process with your counsel. The typical M&A process includes buyer due diligence followed by receipt of an indication of interest from an interested buyer which is negotiated and, if accepted, leads to negotiation of definitive transaction documents.

Teaser/Confidential Information Memorandum.

Sometimes the investment banker may work with the seller to prepare a brief, two to three page “teaser” summary of the seller’s business (which won’t include any confidential information about the seller and may not identify the seller). The investment banker will supply the teaser summary to a group of potential likely buyers to enable them to do a preliminary evaluation without being required to sign a non-disclosure agreement (“NDA”) that is typically negotiated by your counsel with each party. Those buyers wishing to

proceed will have to execute a NDA. The NDA requires the potential buyer to keep confidential information obtained from you, including the fact that you are entertaining a proposed transaction. Prospective buyers that execute a NDA will receive from the investment banker a more detailed information memorandum (which will include confidential information about the seller) prepared by the investment banker with your assistance. The investment banker will also provide potential buyers with instructions relating to the timing and content of written indications of interest.

Indication of Interest. After reviewing the confidential information received, interested buyers will submit an indication of interest (although in some instances, if pricing terms are agreed to a definitive transaction document may be submitted instead). The terms of an indication of interest typically state it is non-binding, subject to continued due diligence and include:

- price, form of consideration and structure of transaction;
- deal exclusivity and for how long;
- deal protection provisions such as lock-up agreements and termination fees; and
- social issues: board and management composition.

Due Diligence. Based on the indications of interest received, you and your investment banker will determine which buyers may conduct due diligence. Typically a potential buyer will provide a due diligence list outlining legal, accounting/financial and business matters related to the seller it wants to analyze. The seller will respond either by supplying copies of documents, inviting the buyer’s representatives to visit the seller’s offices to review the documents on-site, or posting the documents in an online virtual data room (although access to the virtual data room may also have been provided to all buyers signing a NDA). Calls and meetings between the buyer and the seller’s executive officers also occur.

Follow-up requests are common as the buyer’s due diligence process will typically continue after submission of an indication of interest and preparation of the transaction documents, and may continue right up to closing.

The next guide will discuss M&A pricing and deal structure considerations.