
Advance Planning for a Successful M&A Transaction

Bank Director
Acquire or Be Acquired Conference
JW Marriott Phoenix Desert Ridge
January 27 - 29, 2019

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LUSE GORMAN

Luse Gorman, PC

Washington, D.C. based law firm specializing in community banks and other financial institutions

National leader in mergers and acquisitions, capital raising, corporate governance, executive compensation, regulatory and enforcement and general corporate and securities law

Represent over 250 financial institutions nationwide ranging from \$50 million to \$25 billion in assets

No. 1 law firm for bank M&A in 2018, 2017, 2016 and 2015

Top 10 law firm for bank M&A every year since 2001

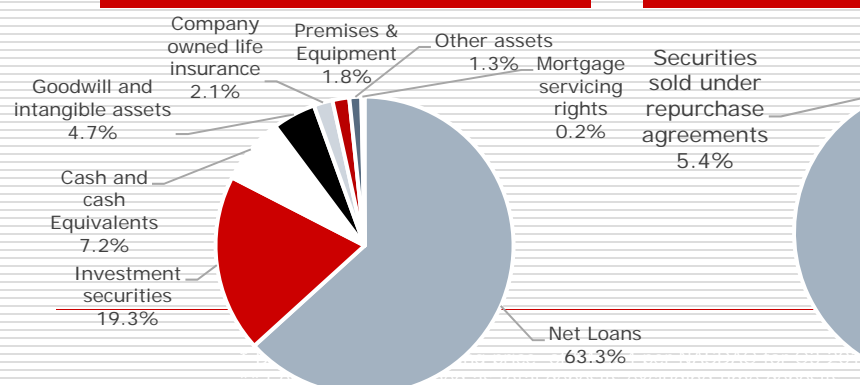
No. 1 law firm for community bank capital raising since 2000

Overview –First Interstate BancSystem

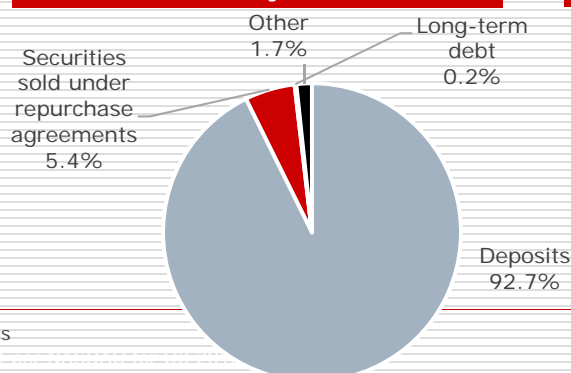
Overview	
Headquarters	Billings, MT
Kroll Rating	BBB+
Market cap	\$2.44 billion
P / TBV	2.48
Dividend Yield*	2.51%
50 Day Average Volume	249,732
Total Assets	\$13,349 billion
Trust Assets Under Management	\$5.228 billion
Total Core Deposits**	\$10.349 billion

Description	
○ Headquartered in Billings, MT and focused on regional community banking in Idaho, Montana, Oregon, South Dakota, Washington, and Wyoming:	
▪ Over 145 banking offices	
▪ 238 ATMs, plus 24,000 MoneyPass ATMs	
○ Offering a full suite of products:	
▪ Commercial Banking	▪ Retail and small business
▪ Credit Card Products	▪ SBA Lending
▪ Indirect Lending	▪ Treasury Management
▪ Mortgage	▪ Wealth Management
○ Guided by four strategic imperatives:	
▪ Employer of choice	
▪ Best in class client relationship management	
▪ Operational excellence	
▪ Financial excellence	

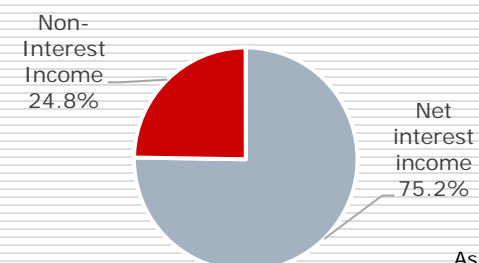
Asset Mix



Liability Mix

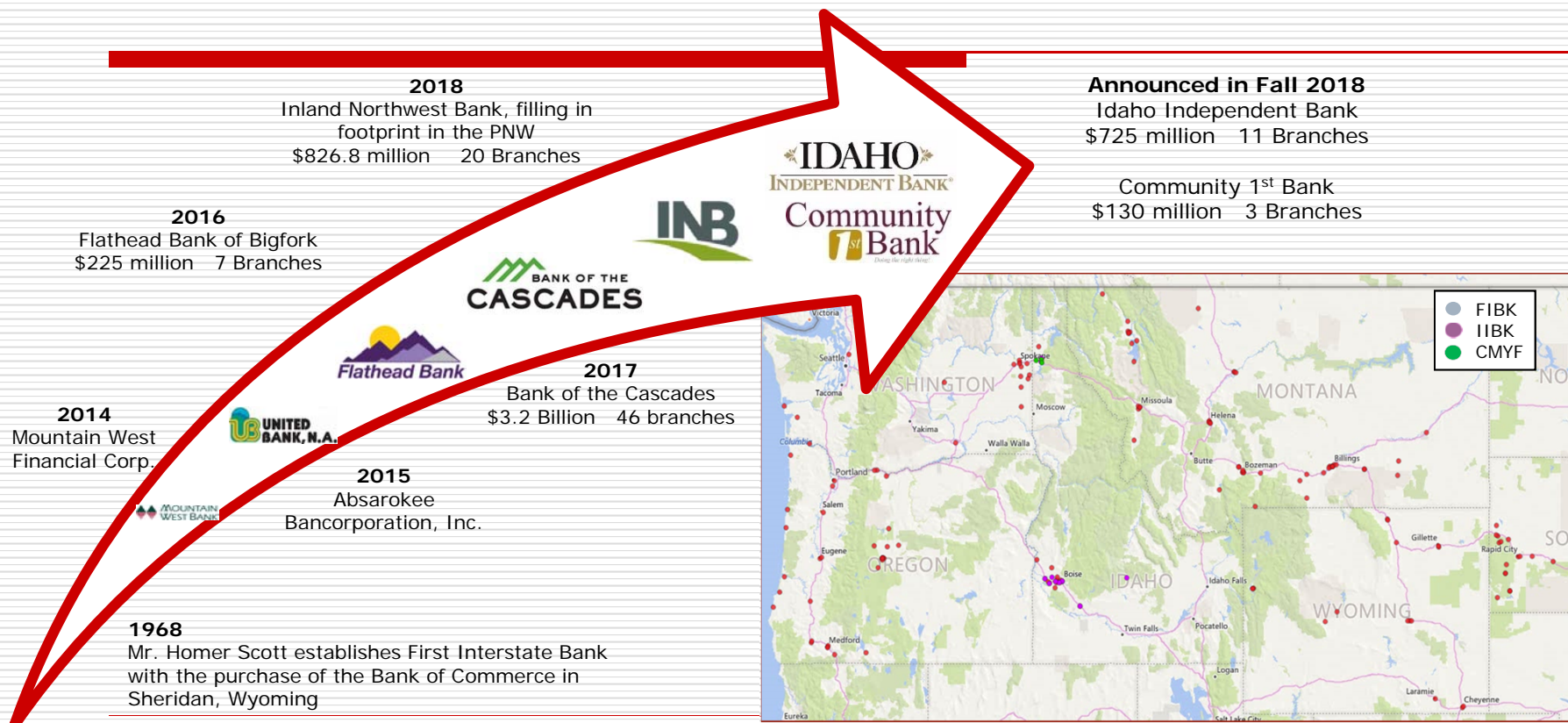


Q3 2018 Revenue Breakdown



As of 09/30/18

First Interstate BancSystem- History of Successful Acquisitions



Topics Covered

- M&A Environment
- Board Responsibilities/Fiduciary Duties
- Advance Planning – Seller
- Advance Planning – Buyer
- The M&A Process
- Critical Elements of Successful M&A
- Common M&A Pitfalls

M&A Environment

- M&A activity continues to be robust as regulatory/compliance burdens remain, NIMs are narrowing, profitability is squeezed, older management teams phase-out and scale continues to be important
- Aggregate deal values have trended higher again – there have been several “large” M&A transactions (consideration >\$1B) as the stress test and SIFI thresholds have been increased
- For most buyers, book valuation dilution and “earn back” period remain critical (assuming transaction is accretive)
 - Market is accepting slightly longer earn back periods
- Prior to the recent downturn in bank stocks, acquisition multiples had strengthened
- More focus on core funding and liquidity, deposit franchises becoming more valuable, lesser focus on asset generators

M&A Environment

Year	Announced Deals	Aggregate Deal Volume (\$millions)	Deal Value (\$millions)	Median		
				Deal Value/ Tangible Book (%)	Core Deposit Premium (%)	Deal Value/ Earnings (x)
2000	254	93,770	20.2	178	11.2	18.1
2001	251	40,423	21.4	177	9.5	18.7
2002	209	16,944	13.9	166	8.8	19.2
2003	262	72,378	25.4	210	13.7	21.3
2004	269	130,777	31.5	221	15.3	22.5
2005	269	29,181	27.3	223	16.4	22.6
2006	300	108,868	25.1	230	18.0	22.6
2007	285	71,402	26.7	214	15.5	22.6
2008	144	35,606	13.5	160	9.4	22.7
2009	110	1,308	7.3	117	1.9	18.3
2010	181	10,011	10.0	120	3.0	22.2
2011	150	17,150	15.5	109	1.1	25.3
2012	221	12,824	18.0	117	2.4	18.6
2013	224	14,391	25.4	124	3.4	18.8
2014	282	19,003	32.5	135	5.0	21.3
2015	278	24,510	29.7	137	5.7	22.3
2016	240	26,800	31.1	133	4.6	20.2
2017	260	26,466	46.9	160	9.1	22.7
2018	259	29,649	54.1	170	9.6	23.9

M&A Environment

2018 Regional Details	Announced Deals	Aggregate Deal Volume (\$millions)	Median			
			Deal Value (\$millions)	Deal Value/ Tangible Book (%)	Core Deposit Premium (%)	Deal Value/ Earnings (x)
Midwest	115	8,761	34.0	160	8.1	19.8
Southeast	52	8,812	44.7	176	10.1	25.1
Southwest	37	4,233	59.8	188	9.4	20.9
West	23	3,288	76.6	191	11.4	26.3
Mid Atlantic	20	2,399	57.5	164	8.8	24.6
Northeast	12	2,156	95.2	176	13.0	32.4

M&A Environment

Year	Number of Deals	Price/ Earnings	Price/ Tangible Common Book (%)	Core Deposit Premium (%)	Buyer's Assets (in millions)	Seller's Assets (in millions)	Seller's LTM ROE	Seller's NPA's/ Assets
Highest 3rd								
2018*	46	24.2X	216%	15.1%	\$7,124	\$ 628	7.74%	.65%
2017	47	21.9	209	14.6	6,857	1,010	10.17	.61
2016	38	20.3	179	10.7	5,015	805	9.25	.81
2015	47	23.7	181	11.6	5,948	647	8.09	.95
Middle 3rd								
2018*	46	24.8X	173%	10.1%	\$3,716	\$ 451	7.72%	.47%
2017	47	22.9	167	9.8	2,794	346	7.35	1.03
2016	39	20.0	141	5.8	2,481	311	7.14	1.03
2015	46	22.8	143	7.3	2,790	330	5.77	1.36
Lowest 3rd								
2018*	46	24.7X	134%	5.4%	\$1,344	\$ 193	5.88%	1.06%
2017	47	20.8	132	5.2	1,226	198	6.11	1.14
2016	39	18.2	116	2.1	1,225	186	5.67	1.54
2015	46	23.4	118	2.8	953	205	3.47	1.66
*Excludes transactions under \$10 million, mutual transactions and mergers of equals. Pricing and financial data are medians. Source for Slides 7-9: S&P Global Market Intelligence								

Advanced Planning for Successful M&A

Board Responsibilities/Fiduciary Duties

- Conduct Board presentation (or “refresher”) – especially for seller - on fiduciary duties before sale process begins
- M&A counsel should prepare and present
- Make sure presentation is documented in minutes

Board Responsibilities/Fiduciary Duties

- Fundamental Role of Board - oversight, including in M&A
- In Theory: Board's role and duties are no different in the context of M&A (except for Revlon duties)
- In Reality: Stakes are higher and more likelihood for lawsuits and scrutiny of Board
- Fiduciary Duties of Loyalty and Due Care:
 - Duty of Loyalty - requires independent and disinterested directors acting in good faith on their belief as to what is in the best interests of the company and its stockholders – stock ownership and equity acceleration are not disqualifying interests
 - Duty of Due Care - requires a board to make informed decisions, and is very much a question of process and the written record of decision making

Board Responsibilities/Fiduciary Duties

- *Revlon* Duty - Board's fiduciary duties have to be exercised to obtain best price "reasonably available"
 - *Revlon* duty applies when there is a "sale of control" – a cash or predominantly cash transaction
 - No single blueprint directors must follow to satisfy *Revlon* duties, board behavior has to be reasonable, not perfect
 - Board liability requires a knowing, intentional violation - bad faith
 - Not all jurisdictions mandate *Revlon* but...
- Fiduciary Out - Most merger agreements, whether involving a "sale of control" or not, will include a "fiduciary-out" clause enabling target board to agree to higher offer from a third-party after merger agreement signing but prior to the meeting of stockholders – conditioned on payment of break-up fee

Board Responsibilities/Fiduciary Duties

Is there a Duty to Sell?

- Board “is under no obligation, in the abstract, to submit to an external summons to the auction block or otherwise transfer control of the corporation’s assets”
- Board may determine in good faith that continuing independence is in the long-term best interests of company
- Board is not obligated to accept or pursue offers because they are at a premium over market, and refusal is not evidence of a breach of fiduciary duty
- Except for “sale of control,” Board has no duty to maximize shareholder value in short-term, even in context of takeovers
- Board has no duty to engage in discussions or to negotiate with an interested party; Business Judgment Rule applies to the “just say no” defense

Advanced Planning for Successful M&A

Sellers – Banks are typically “sold” not “bought”

- Assemble team of experienced legal and financial advisors
 - Review of investment banker engagement contract and prior contacts with potential counterparties is important
- Make sure Board and management are on same page regarding potential sale and timing
 - Lack of unanimity can result in problems in sale process and due diligence
- Assess your franchise value, strengths and weaknesses
 - Analyze your standing in marketplace, level of core deposits, customer relationships, quality and value of loan and investment securities portfolios
- Review M&A activity in your marketplace with IB
 - Review recent transactions and related transaction multiples
 - Consider ability to pay of potential buyers

Advanced Planning for Successful M&A

Sellers

- Get your “mind right” about pricing:
 - Board and management need to manage expectations, not just assess market pricing but what bank is really worth and to whom
 - Understand that for stock deals (as compared to cash deals) you are not selling the bank – you are trading into another currency
 - Understand that the highest price is not always the best price - a stock deal that is too good for the seller may adversely affect the currency of buyer and, therefore, hurt merger consideration received by seller

Advanced Planning for Successful M&A

Sellers

- Identify cost savings that can be realized in sale
- Understand termination costs and renewals of significant vendor contracts (e.g., data processing, leases)
- Undertake 280G analysis for key executives (and possibly directors), determine if special planning is needed
 - Compensation and benefits are key issues in every M&A deal, involve tax, accounting, disclosure, ERISA, legal, regulatory and document review and drafting issues
 - Quantification of plan termination and severance costs is critical and should be done before contacting parties
 - Termination costs often greater than amounts reflected on balance sheet (discount rate for termination may differ from accrual rate)
 - Do not rely on proxy disclosure - conduct real-life analysis with W-2s and expected pricing and vesting

Advanced Planning for Successful M&A

Buyers

- Keep board engaged; review M&A activity in your marketplace; understand multiples paid; identify strategic purposes of M&A
 - Should not need board meeting to execute typical NDAs
- Keep regulatory house in order and communications open
 - Regulatory risk remains – M&A should be built into strategic plan
 - Bank cannot participate in M&A with significant unresolved supervisory issues
 - Review your most recent ROE and impact acquisition would have on comments raised/MRAs – e.g., core funding
 - Pre-merger regulatory communication now more critical than ever – especially for Buyer – should be on-going process
- Assemble diligence team and determine if third party assistance needed - if so, identify the outside parties that would be used

Advanced Planning for Successful M&A

Preparation – Buyers and Sellers

- Buyers - Cultivate your targets
 - may take years and many meals but it may avoid bidding contests or give you key advantage in competitive situation
 - trust and a track record can often be the deciding factor
 - prioritize targets
- Sellers - Pick your buyer
 - some buyers will not participate in a bidding process or will half-heartedly participate and just kick the tires
 - know the currency you want to trade into

Advanced Planning for Successful M&A

There are several solicitation processes that can be utilized by a seller for an M&A transaction:

1. “Limited Shop” - most common
2. “Negotiated” or “One-on-One”- sometimes utilized in strategic, stock for stock combinations; standard in mutual to mutual transactions
3. “Full Auction/Shop” – rare; typically used with troubled target situations; sometimes forced by activist shareholder

Most mergers are acquisitions, but a “merger of equals” is usually characterized by an exchange of stock and the absence of an acquisition premium

Advanced Planning for Successful M&A

- For Sellers, process typically begins with Target Board considering strategic alternatives, Board determining to solicit interest and engaging an investment banker:
 - Investment banker compiles “confidential information memorandum” (CIM)
 - Company counsel drafts confidentiality agreement (CA) to provide interested parties
 - Parties to be approached are identified by investment banker (and bank possibly)
 - Non-binding indications of interest requested by return date
 - One or more parties are invited to conduct due diligence and to present final offer
 - Stock trading black-out commences
 - CA typically includes “standstill” provisions (as to hostile actions, employees and customers)

Advanced Planning for Successful M&A

- For Buyer, unless CEOs are already “dancing,” process usually begins with request from investment banker to execute CA to permit review of Target’s CIM
 - Specific board approval should not be necessary for execution of CA - Board should authorize CEO to participate in M&A market reviews and, from time to time, enter into CAs to assess possible transactions
 - Many potential buyers will likely be solicited to execute the CA and many may be provided Target’s CIM
 - There can be exclusive negotiations between parties, especially if stock is predominant portion of merger consideration
 - Initial bid is typically based only on CIM information with more diligence information being in later rounds and bids

Advanced Planning for Successful M&A

- For Buyer, if there is interest in bidding, discussion with/report to Board (or executive or M&A Committee) to discuss due diligence, pricing and terms of non-binding “bid letter”
 - Investment banker will want formal engagement agreement at this point
 - Non-binding bid letter will cover all major deal points requested by Target, including preliminary pricing, treatment of employees, material contingencies
 - Bid “offer” will be subject to further due diligence (now typically via virtual data room, with possible on-site)
 - Extensive review of loan and investment portfolios, compliance records, and benefit plans
 - Due diligence more important than ever
 - Stock trading black-out triggered for acquiror

Advanced Planning for Successful M&A

- For Buyer, if continued interest, proposed pricing and other deal points developed, summarized and presented to Board, along with results of further due diligence
 - Stock and/or cash; exchange ratio; fixed or floating; caps and/or collars; break-up fee
 - Social issues and costs discussed – board seats; management positions; contract payouts
 - Cost savings analyzed and quantified
 - Special diligence issues identified/quantified
 - Board authorizes final non-binding bid letter
 - If final bid letter accepted, buyer may want exclusivity period (30-60 days)
 - Merger agreement drafted (by buyer's counsel) and negotiated

Critical Elements of Successful M&A

Due Diligence (Buyer and Seller)

- Must be thorough before signing – typically very high standard to terminate (Material Adverse Effect - MAE) for errors in representations
- Diligence findings may kill deal, substantially affect pricing or result in special merger agreement terms
- Use of outside experts - Buyer may want to use third parties to complement staff review (for loans, special portfolios or lines of business)
- Seller should be prepared to populate data room with relevant documents and whatever information buyer wants – almost nothing is “off limits”
- Seller’s data room may be “view” into Seller’s operations and overall soundness

Critical Elements of Successful M&A

Due Diligence – Areas of Concentration

- Legal / Regulatory
 - Regulatory/compliance
 - Benefit plans cost and termination/integration
 - Significant contracts
 - Corporate structure
- Financial
 - Balance sheet valuations – loan portfolio, securities portfolio, deposit base, borrowings
 - Cost savings; earnings dilution/accretion; book value dilution/accretion; earn back
 - Pricing determinations – stock/cash; caps/collars
- Cultural / People
 - Assessing “fit” and caliber of people you are acquiring for purposes of potential integration and what you are actually buying

Critical Elements of Successful M&A

Communication in Pre-Merger Planning

- How and when do you widen the circle?
- Who is a “need to know” person?
- When should regulators be approached? (buyer and seller)
- How should large stockholders be handled? (buyer and seller)

Critical Elements of Successful M&A

Communication in Pre-merger Planning:

- Identifying and locking up key people (Seller)
 - Need to incent key players to stay through sale process and closing well in advance of sale discussions
 - Delicate balance between providing too much leverage and running risk of defections
- Identifying and locking up key people (Buyer)
 - Need to identify through due diligence interview process
 - Need to lock up (as best possible) before merger agreement is executed

Critical Elements of Successful M&A

Execution and Delivery

- Successful M&A begets further M&A opportunity
 - The market rewards successful aggregators with higher trading multiples, enhancing ability to do further deals
- Promptly file regulatory applications and address significant diligence and regulatory concerns
 - Time period between filing and approval is shortening
- Employee integration and satisfaction is key to customer retention
- Deliver to shareholders
 - Under promise and over deliver as to cost savings, earnings accretion and book value dilution earn back

Common M&A Pitfalls

- Executive compensation complications
 - Golden Parachute Rules (IRC §280G); Deferred Compensation Limitations (IRC § 409A)
 - Inability to deliver, or additional costs of delivering, promised executive benefits
- Failure to identify issues/problems in diligence
 - Absence of merger agreement triggers and adjustment mechanism
- Regulatory issues arise at buyer after signing
 - Examination likely to occur between signing and closing
- Clash of cultures
- Failure to deliver promised financial benefits of transaction
- Failure to lock down key employees / teams

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