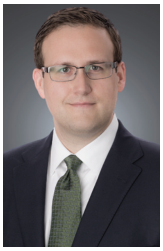

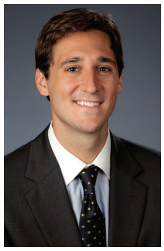

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Strategic Growth: Is a Merger of Equals Right for Your Organization?

In today's complex regulatory and business environment, many community banks are considering either growing through acquisition or selling to a larger institution. As an alternative to these transactions, we are seeing an increase in community banks considering strategic mergers with similarly sized banks that would otherwise be competitors. These "mergers of equals" or "strategic mergers" are attractive because they allow two institutions to combine resources and gain market share, with the goal of creating a larger, stronger organization that is still locally owned and managed. If the right partner can be identified and an agreement reached on post-consummation strategy and operations, the combined institution can be better positioned to maximize long-term value for the shareholders of each bank.

Transaction Structure

In a merger of equals, one of the entities involved will need to be the "survivor" of the merger for legal, regulatory and accounting purposes. Generally, mergers of equals are stock transactions in which the surviving holding company issues shares to the shareholders of the non-survivor in exchange for their current shares. The ownership split in the surviving entity will typically be based upon the value that each party brings to the pro forma business. In addition to the issuance of stock by the surviving entity, the parties may specify amounts of cash for use by one or both parties to pay special dividends to shareholders prior to closing or for shareholder redemptions. With survivor stock as a large percentage of the merger consideration, desirable IRS tax-free reorganization treatment can be achieved for mergers of equals. Tax-free reorganizations include no corporate-level tax at the survivor or target level, and the shareholders exchanging their shares for stock are able to defer any taxable gains until a future disposition of their shares.

Benefits of a Strategic Merger

Strategic merger partners will benefit from leveraging their respective fixed costs over their larger, combined asset base. It should be noted, however, that because the combined bank typically continues the prior businesses of each party relatively unchanged, the economies of scale developed from mergers of equals are generally less than those established in traditional deals where the buyer is significantly larger than the seller.

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Banks engaging in a merger of equals may also benefit from increased market or product diversification. This arises when the two banks have different but complementary strengths, which are often geographic in nature or are related to either bank's success with various market segments or products. Merger partners are able to more quickly diversify than they could through organic growth, which can enhance profitability and limit risk.

A strategic merger is an opportunity for succession planning. By combining boards and management teams, each bank will have the opportunity to identify the most capable personnel to run the combined bank. Such a merger also removes much of the pressure associated with choosing successors within a bank's current roster of employees or members of a controlling family.

Participating in a merger of equals may also allow privately owned banks to provide liquidity to shareholders. While strategic mergers are primarily stock deals, many contain an option for a limited number of shareholders to receive cash in exchange for their current shares. Even if there is no liquidity event built into the transaction, the increased number of shareholders and size of the combined organization can lead to future liquidity opportunities through private sales to other shareholders or redemptions.

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Merger of Equals Deal Points

Many of the legal, regulatory, shareholder approval and disclosure issues in a merger of equals are the same as those in a standard stock-for-stock acquisition. Despite the similarities, mergers of equals can be much more complicated to negotiate than a typical transaction in which the seller will not have a say in the post-closing business. A strategic merger involves many social issues that are key to the success of the combined institution. These issues usually include the following:

- Who will be on the board of directors?
- Who will fill the key executive management positions?
- Where will the combined bank's headquarters be located?
- Will any overlapping branches be closed?
- What name will be used by the combined bank?
- Will all employees be retained?
- What employee benefits will be offered?
- What will the charter documents and bylaws look like?
- Will the combined organization be a C corporation or S corporation?
- Who will be the combined organization's regulators?
- What data processing and other key vendors will be used?

There are many potential areas for disagreement regarding these and other social issues, especially given that a merger of equals often involves direct competitors. It is therefore important to agree on the social issues most important to your bank upfront in a letter of intent or term sheet before spending time and money negotiating a definitive agreement. The parties should then work with legal counsel to ensure that decisions on key social issues are covered in the covenants of the definitive agreement so that the parties are contractually obligated to carry out the combination as proposed. In addition, major organizational issues like board composition should be included in the combined institution's charter and bylaw documents so that any post-closing change requires input of representatives of both parties. A successful merger of equals is built on mutual trust that the survivor will carry out the parties' combined vision. BN