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Advisers rewriting bank M&A handbook

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Looking for the highest price and finding a buyer by casting a wide net are two approaches that are not always necessary in the current bank and thrift M&A environment.

During a FinPro Inc. bank and thrift M&A conference on May 19, Silver Freedman Taff & Tiernan LLP Partner Raymond Tiernan noted that many buyers have seen their stock prices rise after announcing transactions. The increased value of acquirers' currency can serve as good news for their targets if they are receiving equity in transactions, a practice that has become more common in bank and thrift M&A.

However, not all buyers have enjoyed rising stock prices as some have seen the value of their shares drop when the market does not like a deal. For instance, shares of Southside Bancshares Inc. closed down 8.6% on April 29, the day the company announced its roughly $307 million deal for OmniAmerican Bancorp Inc., from the closing price on April 28, and shares of Valley National Bancorp closed down 2.9% on May 8, the day the company announced its roughly $312 million deal for 1st United Bancorp Inc., from its closing price on May 7.

But investors will still reward buyers — and sellers — in deals that they feel are well-structured and fairly priced, according to attendees at the FinPro event. In order to help ensure a favorable market reaction, Tiernan said some of his bank clients have been instructed not to fight for the highest price in a deal.

"It's very counterintuitive," Tiernan said. "But I've sat in meetings where bankers said, 'Don't push for another buck a share. If you do, you're going to give it up on the first trade.'"

Of course, price is still important in deals, and no one was suggesting sellers settle for prices far below market value. Rather, advisers are reminding clients that it's also important to think about what type of currency sellers are receiving in deals.

"If you're going to be accepting a stock that is not going to be moving up with the market, in many cases you might be better off being with someone who is not the absolute high price," said FinPro Managing Director Dennis Gibney.

Buyers too are better off finding targets that can help boost their stock prices, and when they believe they do, many are asking potential sellers to enter into exclusive negotiated transactions in an effort to prevent the deal proceedings from turning into auctions. Indeed, the percentage of negotiated transactions has increased significantly to 61.3% in 2013, up from 55.0% in 2012 and 12.5% in 2011, on

deals in which merger background information was disclosed and valuations topped $50 million, according to an April presentation from Joseph Berry Jr., managing director and co-head of depositories investment banking at Keefe Bruyette & Woods Inc.

At the FinPro event, Gibney said he has also noticed the increase in negotiated transactions. He said historically the only reason sellers entered into exclusive negotiations was to protect against social issues, such as ensuring executives and directors were playing a role in the combined entity. However, he said sellers are now more apt to enter into exclusive negotiations if they believe a potential buyer can bring good value to shareholders.

An auction process can certainly lead to a higher bid price in the near term, but it could also put the seller in a situation in which it's forced to accept a deal with a buyer that might not offer the best long-term value. Gibney noted that sellers are thinking about which partner can present the best long-term value since they are increasingly accepting stock from buyers.

Still, Gibney said entering into exclusive negotiations can present risks. "You do have that situation where you have a third party lob something over the wall, and you have to deal with it," he said.

Even if a bid from a third party does not prevail, the competing bid could drive up deal costs and invite scrutiny. The same could be said for potential litigation or pushback that can arise from shareholders who would rather see an auction and not an exclusively negotiated deal.

Silver Freedman Taff & Tiernan LLP Partner Philip Bevan said a company's shareholder base could factor into the seller's decision on whether to pursue an exclusively negotiated deal. "If you have a small shareholder base, your risk is probably lower than a public company with a broad-based, maybe institutional, shareholder base or activists," Bevan said.

Still, the parties in large deals do not always have to run a complete auction process. For instance, the $2.4 billion sale of CapitalSource Inc. to PacWest Bancorp was announced less than four months after their respective CEOs met to discuss a potential transaction, and the seller's financial adviser, J.P. Morgan Securities LLC, "was not authorized to and did not solicit any expressions of interest from any other parties with respect to the sale of all or any part of CapitalSource or any other alternative transaction," according to a Form S-4 filed with the SEC in September 2013.

Bevan said that some deals include aspects of negotiated transactions but allow sellers to perform a so-called market check, which gives them the ability to contact other potential buyers to see if they might have interest. "In a true exclusive, you don't have a market check," Bevan said.

But adding provisions like a market check can help protect sellers from a legal challenge by allowing them to show they made efforts to ensure they received a fair price. Other protections can include adding a go-shop clause for the seller or a below-market termination fee, Bevan said. Of course, buyers might object to those sorts of provisions since they give sellers more flexibility to respond to third-party bidders.

But sellers might not need to negotiate for those types of provisions in an all-stock transaction or deal that consists of mostly stock. Tiernan noted that courts have supported single-bidder deals that are all or mostly stock transactions because they view those as equity exchanges and not cashing-out transactions. "This is not a sale where you're liquidating your investment," Tiernan said.

Obviously, courts will likely have a much different viewpoint on all-cash transactions, and those deals are not good candidates for exclusive negotiations, Tiernan said. Sellers could also subject themselves to scrutiny if they entertained just one bid when they knew they had multiple suitors.

"It gets more difficult … when you know there are three or four interested buyers out there in your market," Tiernan said. "[If] they've told you, 'If you ever sell, please call me,' it gets a lot harder [to defend exclusive negotiations]."

Still, Tiernan expects more negotiated transactions to take place in the bank space because it remains a buyers' market with more sellers than acquirers. In a buyers' market, sellers might feel compelled to enter into exclusive negotiations in order to prevent an attractive buyer from moving to another target.

Also, in a buyer's market, sellers are likely to receive a price lower than they desire, but the market can eventually turn. If it does, a seller in the current environment that links with the right buyer could potentially land a much more favorable sales price down the road.

"We're in a consolidating industry," Tiernan said. "You don't have to ignore the fact that … many of the acquirers will someday be targets."