



Western
Independent
Bankers

Current M&A Environment – Deal Considerations

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Overview

- Current Environment
- Diligence Considerations/Checklist
- Corporate Governance Considerations
- Structure Issues
 - Cash Transactions
 - Stock Transactions
 - Closing Conditions / Deal Terms

Current Environment – Can Deals Get Done?

- Environment currently favors opportunistic buyers
 - Low multiples enticing
- New buyers may enter the market
 - Foreign banks who have minimized/limited exposure to troublesome US products
 - Private equity
- Regulatory environment may encourage
- Favorable characteristics tempered by concerns over continuing asset deterioration and few financing alternatives



Diligence Considerations

- Diligence takes on heightened importance
 - will take longer in current environment
- Expectation of enhanced diligence by sellers in stock transactions
- Increased use of outside experts

Diligence Checklist– Corporate/Operations

- Minutes
 - Issues with regulators or auditors
 - Material/undisclosed contingent liabilities
 - Errors in financial statements or issues with accounting controls
 - Need for asset write-downs
 - Board level disputes
- Insurance
 - Existing programs/claims
 - Tail insurance availability
- Internal Audit
 - Outside firm or internal personnel
 - Depth of coverage and reports



Diligence Checklist – Lending

- Exposure to commercial real estate lending—
 - of particular concern to regulators and rating agencies and downgrades can continue to be expected for banks with significant concentrations
 - most difficult sectors include residential real estate, raw land and retail
- Recent changes in reserving methodologies or practices—
 - this has been of particular concern to the Securities and Exchange Commission of late
- “Hidden” exposure to subprime sector—
 - examination of investment portfolio may disclose exposure to troubled sectors even where loan portfolio doesn’t
 - CDOs, CMOs and similar securities might purport to hold a particular high-quality asset class, but frequently the programs permit smaller percentages of other, lower quality assets



Corporate Governance Considerations

- Environment may provide an uptick in unfriendly approaches
 - Low multiples likely to produce unwilling sellers and eager buyers
 - Strategies designed to entice sellers into friendly deals
 - Regulatory environment may aid buyers
- Companies need to be evaluating their defensive profiles
- Boards should discuss their posture and positioning before they need to

Structure Issues – Increased Use of Cash

- Depressed stock price multiples may lead to increased use of cash
- Favors acquirers with the strongest balance sheets
- Backlog in leveraged acquisition financing and commitments and continuing concern that commitments will not be funded
- Concerns relating to asset deterioration have led to near freeze in leveraged bank financing for acquisitions
- If financing is available, target's assets may be looked to for security
 - Need to evaluate existence of prior liens/covenants
 - FHLB blanket lien programs



Structure Issues – Stock Deals

Intense focus on exchange ratio mechanisms in stock Transactions:

- Fixed Exchange Ratio:
 - Single Trigger/Double Trigger
- Floating Exchange Ratio
 - Collars
- Walk-Aways / Top-Ups
- Mixed Consideration: Allocation Issues



Structure Issues – Closing Conditions

- Heightened importance of the MAE
 - Typically a seller favorable term, buyers will try to make more objective
 - Difficult to establish
- Pre-closing operating covenants are heavily negotiated
- Deal protection issues are becoming less controversial
 - Fiduciary Outs
 - “No Shop” / “Go Shop” Provisions
- Return of financing contingencies in cash transactions for smaller party deals

