Bank M&A: What Can You Negotiate Other than Price to Enhance Value?

Independent Bankers of Colorado’s Annual Convention

Fall 2019

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2. Deal Negotiation Points
SECTION 1
Current M&A Market & Value Drivers
National M&A Volume Quarterly

Source: S&P MI; Data as of 8/30/2019
## Recent National Bank M&A Pricing

### PRICE / LTM EARNINGS (QUARTERLY)

<table>
<thead>
<tr>
<th>Quartile</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1</td>
<td>22.5x</td>
<td>25.6x</td>
<td>21.0x</td>
</tr>
<tr>
<td>Q2</td>
<td>23.3x</td>
<td>23.7x</td>
<td>15.6x</td>
</tr>
<tr>
<td>Q3</td>
<td>18.8x</td>
<td>20.2x</td>
<td>15.3x</td>
</tr>
<tr>
<td>Q4</td>
<td>0.87%</td>
<td>0.72%</td>
<td>1.00%</td>
</tr>
</tbody>
</table>

### PRICE / LTM EARNINGS (QUARTERLY)

<table>
<thead>
<tr>
<th>Quartile</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1</td>
<td>150%</td>
<td>171%</td>
<td>157%</td>
</tr>
<tr>
<td>Q2</td>
<td>163%</td>
<td>171%</td>
<td>167%</td>
</tr>
<tr>
<td>Q3</td>
<td>174%</td>
<td>160%</td>
<td>167%</td>
</tr>
<tr>
<td>Q4</td>
<td>174%</td>
<td>181%</td>
<td>148%</td>
</tr>
</tbody>
</table>

Source: S&P MI; Data as of 8/30/2019

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**Profitability**

**Price / Tangible Book**

- Median Price / Tangible Book Value:
  - < 0.25%: 111%
  - 0.25% - 0.75%: 131%
  - 0.75% - 1.15%: 148%
  - 1.15% - 1.25%: 167%
  - > 1.25%: 180%

**Price / LTM Earnings**

- Median Price / LTM Earnings:
  - 0.00% - 0.25%: 52.3x
  - 0.25% - 0.50%: 35.2x
  - 0.50% - 0.75%: 25.5x
  - 0.75% - 1.15%: 20.9x
  - 1.15% - 1.25%: 15.9x
  - > 1.25%: 13.0x

**Note:** Includes bank and thrift transactions with a reported deal value greater than $50; excludes target banks with assets >$1B; excludes banks without reported ROAA or ROAA >1.50%

S-Corps tax affected at respective tax rates to account for recent tax change

Source: S&P MI; Data as of 8/30/2019

**SIZE PREMIUM**

Includes bank and thrift transactions with a reported deal value greater than $0
Only includes selling banks and thrifts with LTM ROAA >0% and NPAs/Assets <4.0%

Source: S&P MI; Data as of 8/30/2019

**Market Type**

- Rural: 130% (+10%)
- Micro: 143% (+14%)
- Metro: 163%
- Top 30 MSA: 164%

Includes bank and thrift transactions with a reported deal value greater than $0
Only includes selling banks and thrifts with LTM ROAA >0% and NPAs/Assets <4.0%

Source: S&P MI; Data as of 8/30/2019

Branch Size

<table>
<thead>
<tr>
<th>Deposits per Branch</th>
<th>Median Price / Tangible Book Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $20M</td>
<td>125%</td>
</tr>
<tr>
<td>$20M to $40M</td>
<td>145%</td>
</tr>
<tr>
<td>$40M to $65M</td>
<td>167%</td>
</tr>
<tr>
<td>Greater than $65M</td>
<td>184%</td>
</tr>
</tbody>
</table>

Includes bank and thrift transactions with a reported deal value greater than $0
Only includes selling banks and thrifts with LTM ROAA >0% and NPAs/Assets <4.0%

Source: S&P MI; Data as of 8/30/2019

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Asset Growth

Median Price / Tangible Book Value

Asset Growth (1-year prior to sale)

- Less than 0%: 145%
- 0% - 10%: 167%
- Greater than 10%: 184%

Includes bank and thrift transactions with a reported deal value greater than $0
Only includes selling banks and thrifts with LTM ROAA >0% and NPAs/Assets <4.0%

Source: S&P MI; Data as of 8/30/2019
Recent Bank M&A Processes & Outcomes

Average Statistics for our Last 7 Deals

- Total Parties: 35+
- NDAs Signed (% of Total Parties): 42%
- Offers Submitted (% of NDAs Signed): 31%
- Offers % of Total Parties: 13%
Recent Bid Spreads (Our Team’s Last 10 Bank Transactions)

9%

Winning bidder premium over 2ND Place

High Bid  Second  Third  Fourth  Fifth
Our Deal Recent Experience: Negotiating Price Increases

**Recent Example #1**

*Offer Premiums to Lowest Bid*

<table>
<thead>
<tr>
<th>Bid</th>
<th>Low Bid</th>
<th>4th Bid</th>
<th>3rd Bid</th>
<th>2nd Bid</th>
<th>1st Bid</th>
</tr>
</thead>
<tbody>
<tr>
<td>IOIs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revised IOIs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In-Market Bank</td>
<td>0%</td>
<td>7%</td>
<td>10%</td>
<td>10%</td>
<td>23%</td>
</tr>
<tr>
<td>Out-of-Market Bank</td>
<td>10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Out-of-Market Bank</td>
<td>13%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investor Group</td>
<td>10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Out-of-Market Bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>25%</td>
</tr>
</tbody>
</table>
Our Deal Recent Experience: Negotiating Price Increases

**Recent Example #2**

*Offer Premiums to Lowest Bid*

<table>
<thead>
<tr>
<th>Bid Position</th>
<th>Out-of-Market Bank</th>
<th>In-Market Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lowest Bid</td>
<td>0%</td>
<td>5%</td>
</tr>
<tr>
<td>7th Bid</td>
<td>12%</td>
<td>35%</td>
</tr>
<tr>
<td>6th Bid</td>
<td>17%</td>
<td>36%</td>
</tr>
<tr>
<td>5th Bid</td>
<td>19%</td>
<td>37%</td>
</tr>
<tr>
<td>4th Bid</td>
<td>29%</td>
<td>50%</td>
</tr>
<tr>
<td>3rd Bid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2nd Bid</td>
<td>36%</td>
<td></td>
</tr>
<tr>
<td>1st Bid</td>
<td>43%</td>
<td></td>
</tr>
</tbody>
</table>

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IOIs Revised IOIs

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Credit Union
SECTION 2

Deal Negotiation Points
What We Have Successfully Negotiated for Our Clients…
What We Have Successfully Negotiated for Our Clients...
Enhancing Value Through Negotiation

#1 Purchase Price Formula and Transaction Costs
#2 Exchange Ratio
#3 Walk-Away Rights and Break-up Fees
#4 Termination Penalties
#5 Change-in-Control and Deferred Comp Plans
#6 Escrows, Holdbacks, and Asset Exclusions
#7 Financing Contingencies
#1 Purchase Price Formula and Transaction Costs

## Fixed Price vs. Variable Price in Cash Deals

<table>
<thead>
<tr>
<th>Description</th>
<th>Variable Price</th>
<th>Fixed Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Price is set on a minimum tangible equity (fixed dollar or % of equity) and floats until closing</td>
<td></td>
<td>- Price is fixed until closing</td>
</tr>
</tbody>
</table>

### Structure Examples
- Tangible Equity + Fixed Premium
- Minimum Tangible Equity x P/TBV

### Acquirer Rationale
- Able to control premium paid if there are adjustments to equity
- Creates a cap/certainty on price paid
- Acquirer retains excess equity

### Seller Rationale
- Seller keeps excess equity above 8-9%
- Do not have to deliver a minimum tangible equity

### Other Items
- Seller pays all transaction expenses
- Usually there are caps on transaction expenses
- Acquirer assumes transaction expenses

### Adjustments to Equity and Purchase Price

<table>
<thead>
<tr>
<th>Earnings to Close</th>
<th>ALLL Levels</th>
<th>AOCI</th>
<th>Dividends</th>
<th>Transaction Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjustments Apply to Variable Price</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
#1 Purchase Price Formula and Transaction Costs

How Much Does it Cost to Sell a Bank?

Median Total Transaction Costs (including Seller and Buyer costs) as % of Deal Value since 2010\(^{(1)}\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Transaction Cost %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>8.1%</td>
</tr>
<tr>
<td>2011</td>
<td>9.9%</td>
</tr>
<tr>
<td>2012</td>
<td>9.5%</td>
</tr>
<tr>
<td>2013</td>
<td>7.6%</td>
</tr>
<tr>
<td>2014</td>
<td>8.2%</td>
</tr>
<tr>
<td>2015</td>
<td>8.0%</td>
</tr>
<tr>
<td>2016</td>
<td>9.7%</td>
</tr>
<tr>
<td>2017</td>
<td>7.7%</td>
</tr>
<tr>
<td>2018</td>
<td>8.5%</td>
</tr>
<tr>
<td>2019</td>
<td>8.2%</td>
</tr>
</tbody>
</table>

Source: S&P MI; Data as of 8/30/2019; (1) Includes all transaction costs (such as data processing, legal, investment banker, and other extraordinary expenses)
#1 Purchase Price Formula and Transaction Costs

Treatment of Transaction Costs

- When GLC goes to market, we quantify transaction costs in our materials
- Acquirer will “bake” these assumptions into the purchase price
- During diligence, Acquirer will want all transaction costs identified and quantified
- Material differences in estimates vs. actual transaction costs could lead to purchase price reductions

Transaction Cost Examples

Data Processing  
3rd Party Vendors  
Change-in-Control Payments  
Severance / Bonuses  
Accounting Fees  
Legal Fees  
Investment Banker Fees
#2 Exchange Ratio

Stock Consideration in Transactions since 2010

% of Transactions that involve Stock

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>64%</td>
<td>72%</td>
<td>79%</td>
<td>80%</td>
<td>81%</td>
<td>71%</td>
<td>81%</td>
<td>90%</td>
<td>87%</td>
<td>84%</td>
</tr>
</tbody>
</table>

% of Consideration that is Stock

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>86%</td>
<td>78%</td>
<td>74%</td>
<td>75%</td>
<td>78%</td>
<td>78%</td>
<td>78%</td>
<td>84%</td>
<td>83%</td>
<td>81%</td>
</tr>
</tbody>
</table>

Source: S&P MI; Data as of 8/30/2019
Size of Seller Impacts Consideration

Consideration for Announced Transactions Since 2015

<table>
<thead>
<tr>
<th>Size of Seller</th>
<th>All Cash</th>
<th>All Stock or Cash/Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$100M</td>
<td>74%</td>
<td>26%</td>
</tr>
<tr>
<td>$100M - $1B</td>
<td>34%</td>
<td>66%</td>
</tr>
<tr>
<td>&gt;$1B</td>
<td>11%</td>
<td>89%</td>
</tr>
</tbody>
</table>

Note: Only includes bank transactions with deal value and total assets greater than $0 since 12/31/2014

Source: S&P MI; Data as of 8/30/2019
Increasing Public Valuations

S&P 500

Regional Bank Index\(^{(1)}\)

\(^{(1)}\) Includes the following public banks: BANF, BOKF, CFFN, CBSH, EFSC, EQBK, FIBK, GBCI, GSBC, GWB, HTLF, IBTX, MOFG, NBHC, PPBI, PUB, SMBC, TBK, UMBF, WTBA, WAL, ZION

Source: S&P MI; Data as of 8/23/2019
Exchange Ratio and Collar Details in Stock Deals

Exchange Ratio

$35 \times 80\% = 2.625$

Acquirer’s Shares to be Received by Seller

Exchange Ratio Implications

- Seller fixes ownership and dividend level
- Seller bears risk of Acquirer’s stock movement
- Acquirer locks in EPS and TBV per Share accretion
- In 2019, all public stock deals had a fixed exchange ratio

What is a Stock Collar?

Collar creates a floor and ceiling for the risk a Seller and Buyer bear

The Purchase Price will fluctuate in the collar with the Exchange Ratio staying fixed

If the Acquirer’s stock price breaks through the collar, the exchange ratio is adjusted

14% of Public Deals with Stock had Collars in 2019
Example of a Collar with a Stock Deal

**Price is Fixed Above the Collar at $87.9M**
(at $42.04 per share)

**Price is Fixed Below the Collar at $69.0M**
(at $31.08 per share)

*Note: Analysis excludes impact of stock options*

*Source: S&P MI*
Example of a Double Trigger

Seller has the ability to walk away if Acquirer’s stock price has decreased 15%-20% and is 15%-20% lower than an identified index.
### #3 Walk-Away Rights and Break-up Fees

#### Walk-Away Rights and Material Adverse Changes

<table>
<thead>
<tr>
<th>Walk-Away Rights</th>
<th>Material Adverse Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bright Line Test</strong></td>
<td><strong>Non-Bright Line Test</strong></td>
</tr>
<tr>
<td><strong>#1 SHAREHOLDER VOTE</strong></td>
<td>A material element or change that effects the Seller’s valuation</td>
</tr>
<tr>
<td>• Dissenting shareholder vote exceeds 5%</td>
<td>DOES NOT INCLUDE THE FOLLOWING:</td>
</tr>
<tr>
<td>• Seller unable to achieve majority vote to approve transaction (majority defined in operating agreement)</td>
<td><strong>MACROECONOMIC EVENTS</strong></td>
</tr>
<tr>
<td><strong>#2 MINIMUM EQUITY TEST SHORTFALL</strong></td>
<td><strong>WARS</strong></td>
</tr>
<tr>
<td>• Minimum equity test is a condition to closing and buyers request termination rights</td>
<td><strong>GEOPOLITICAL EVENTS</strong></td>
</tr>
<tr>
<td>• Sellers can negotiate any equity shortfall will be a reduction to purchase price</td>
<td><strong>INDUSTRY-SPECIFIC EVENTS</strong></td>
</tr>
</tbody>
</table>
#3 Walk-Away Rights and Break-up Fees

**Typical Break-up Fees**

**Topping Fee**
Triggered if higher offer (unsolicited) is received and accepted by Seller prior to signing of definitive agreement

Protects Acquirer’s investment of time, energy, and expenses

**Financing Contingency**
Rarely Sellers will get break-up fees if an Acquirer is unable to secure financing for the transaction (especially if the Acquirer is an investor group)

**Breach of the Agreement**
Usually in the Agreement as open-ended language that allows one party to sue the other for damages if the Agreement is breached (no break-up fee)

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**Median Break-up Fee as % of Deal Value since 2016**

- 2016: 3.7%
- 2017: 3.2%
- 2018: 3.1%
- 2019: 2.6%

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**% of Deals with Break-up Fees (based on asset size) since 2016**

- All Banks: 73%
- <$250M: 57%
- $250M-$1B: 81%
- >$1B: 90%

Source: S&P MI; Data as of 8/30/2019
#4 Termination Penalties

Treatment of Transaction Costs and Termination Penalties

## Treatment of Termination Penalties

- Termination penalties are a direct negative adjustment to purchase price
- The Seller typically bears all termination penalty costs

## Data Processing Contracts

- Data processing providers are not flexible on termination penalties *(no concessions even if the acquirer is the same processor! Unless already negotiated...)*
- Fees can also include deconversion costs
- Sellers can negotiate for better termination terms when the contract is up for renewal. Terms include:
  - “Adjustment Factors” (e.g., only 60% of remaining contract needs to be paid out upon termination)
  - Walk down of the adjustment factor throughout the life of the contract
  - No penalty (or minimized) if acquirer is same processor

### GLC’s Termination Penalty Shortlist

- Data Processing Contract
- Credit / Debit / ATM Card Relationships (e.g., VISA)
- Online Banking Vendor
- Deposit Programs (e.g., Kasasa)
- Internet / Network Provider / Phone Systems
- Managed Services / Outsourced Provider
- Sponsorships and Advertising
- Risk Management / Credit Software
#4 Termination Penalties

## Recent GLC Process Where Buyers’ Addressed the Termination Penalty

<table>
<thead>
<tr>
<th></th>
<th>Buyer #1</th>
<th>Buyer #2</th>
<th>Buyer #3</th>
<th>Buyer #4</th>
<th>Buyer #5</th>
<th>Buyer #6</th>
<th>Buyer #7</th>
<th>Buyer #8</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Data Processing Contract Treatment:</strong></td>
<td>Seller pays full penalty</td>
<td>Seller pays full penalty</td>
<td>Acquirer has same DP as Seller(^{(1)})</td>
<td>Acquirer has same DP as Seller(^{(1)})</td>
<td>Seller pays full penalty</td>
<td>Buyer to pay DP penalty fee</td>
<td>Acquirer has same DP as Seller(^{(1)})</td>
<td>Operate as independent subsidiary and maintain contract</td>
</tr>
<tr>
<td><strong>Cost to Our Client:</strong></td>
<td>$1M</td>
<td>$1M</td>
<td>$350k</td>
<td>$350k</td>
<td>$1M</td>
<td>$0</td>
<td>$350k</td>
<td>$0</td>
</tr>
</tbody>
</table>

\(^{(1)}\) Seller has negotiated up front with data processing provider to waive the termination penalty if acquired by bank with same core processor
#5 Change-in-Control and Deferred Comp Plans

**Typical Plans**

**Change-in-Control**

Certain rights can be granted to a party involved in a transaction due to a change in ownership or management.

A company’s change of control often occurs due to the selling of its shares, either in the open market or through a private transaction at an agreed price.

**Deferred Comp**

Compensation is often set aside to be paid in the future.

In most cases, taxes on this income are deferred until it is paid out.

Forms of deferred compensation include retirement plans, pension plans and stock-option plans.

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**% of Banks with Deferred Compensation (based on asset size)**

- **All Banks**: 32%
- **<$250M**: 24%
- **$250M-$1B**: 43%
- **>$1B**: 37%

Source: S&P MI; Data as of 8/30/2019
#5 Deferred Comp Example

### Assumptions

- **CEO is 55 years old**
- **CEO has deferred comp plan for 20 years at $150k per year at retirement**
- **CEO has been at the CEO role for 5 years with this deferred comp plan**
- **CEO expects to retire at 65**

### Example

**Current Deferral Plan**

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assumed Interest Rate</td>
<td>6.00%</td>
</tr>
<tr>
<td>Liability at Retirement</td>
<td>$1,720,488</td>
</tr>
<tr>
<td>Life of Plan in Years</td>
<td>15.0</td>
</tr>
<tr>
<td>Annual Expense</td>
<td>$73,917</td>
</tr>
<tr>
<td>Years into Accrual of Plan</td>
<td>5.0</td>
</tr>
<tr>
<td><strong>Current Balance</strong></td>
<td>$416,677</td>
</tr>
<tr>
<td>Assumed tax rate</td>
<td>25.00%</td>
</tr>
<tr>
<td><strong>Current Balance Tax Effected</strong></td>
<td>$312,507</td>
</tr>
</tbody>
</table>

**Change of Control / Plan fully vests**

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assumed Interest Rate</td>
<td>3.50%</td>
</tr>
<tr>
<td>Liability at Retirement</td>
<td>$2,131,860</td>
</tr>
<tr>
<td>Life of Plan in Years</td>
<td>15.0</td>
</tr>
<tr>
<td>Fully Vested Current Balance</td>
<td>$1,511,316</td>
</tr>
<tr>
<td><strong>Tax Effected Vested Balance</strong></td>
<td>$1,133,487</td>
</tr>
<tr>
<td><strong>Reduction to Equity</strong></td>
<td>($820,980)</td>
</tr>
</tbody>
</table>
#6 Escrows, Holdbacks, and Asset Exclusions

**Median Target Statistics since 2016 vs Median Buyer Statistics since 2016**

<table>
<thead>
<tr>
<th>Year</th>
<th>Target</th>
<th>Buyer</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>0.70%</td>
<td>+11%</td>
</tr>
<tr>
<td>2018</td>
<td>0.69%</td>
<td>(3%)</td>
</tr>
<tr>
<td>2019</td>
<td>0.75%</td>
<td>(17%)</td>
</tr>
</tbody>
</table>

Source: S&P MI; Data as of 8/30/2019; Excludes NPAs/Assets > 4.00%
#6 Escrows, Holdbacks, and Asset Exclusions

**Definitions**

**Holdback**
- Similar to Escrow except buyer holds the funds
- Great for simply defined issues
- Lower cost and hassle factor

**Escrow**
- Identified funds with a trustee at a bank
- Third party administer the escrow and works through the mechanics
- Additional cost to pay for third party and legal cost to define/negotiate the escrow mechanics

**Asset Exclusion**
- Take assets as consideration or dividend out prior to closing
- Typically used for valuation differences on long dated non-performing assets
- More likely with smaller, concentrated shareholder bases
#7 Financing Contingencies

**Negotiating Financing Contingencies**

**Seller Beware...**

- Financing Contingencies involve Acquirer needing to borrow or raise capital to fund the deal
- Common with Investor Groups
- Questions to Consider:
  - Does the Acquirer have a clean regulatory record?
  - Does the Acquirer have a track record raising capital?
  - Is there an anchor investor?

**How to De-Risk Financing Contingencies**

- Seller should request financing milestones:
  - Summary list of investors, level of investment, and funding source
  - Provide executed subscription agreements evidencing minimum % of Purchase Price
  - Provide executed subscription agreements evidencing 100% of Purchase Price
- Attempt to negotiate break-up or termination fees in the event of insufficient financing (difficult with investor groups)
Thank You

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