

# Southern Bank Acquisition

## PROJECT FILE

*Private & Confidential*

Northern Bank  
October 2000

### **The Merger Plan Simulation**

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This work, entitled

"Knowledge codification, process routinization and the creation of organizational capabilities:  
post-acquisition management in the US banking industry"  
forms the basis for the content of this simulation.

## Northern Bank - Internal Memo

TO Chris Wycliff - Integration Manager  
FROM Jon Pettinger - CEO  
DATE October 16<sup>th</sup> 2000  
SUBJECT Southern Bank Acquisition

Dear Chris,

Following Southern Bank's acceptance of our offer, I wanted to confirm the Board's decision to give you responsibility for the integration of Southern's operations with our own over the next few months.

As you know, we have been in talks with Southern Bank since early this year, and rumours of some forthcoming regulatory changes merely accelerated the process. The main objective is a consolidation of our operations, to leverage synergy opportunities from complementary branch networks and customer bases, and strengthen our defences to the threat from Eastern Bank, which has recently announced its merger with Western.

As we wait for regulatory and formal shareholder approval on this deal, it is essential that we establish a clear integration plan, and build consensus on it with our colleagues at Northern Bank, our shareholders, key Southern personnel, as well as relevant external "stakeholders". The deal is expected to be cleared early in January 2001. At that time, I have promised to give the Board a finalised plan, as well as confirmation that the people I have identified as stakeholders in this acquisition are in support of it.

I have great pleasure in giving you full responsibility for this mission, to be completed by December 22<sup>nd</sup> 2000. I am sure you will be able to judge how to obtain everyone's full support; in my view, a mixture of consultation, communication and appropriate modifications to the plan will be key. The remainder of this file contains information on the deal, a detailed profile of the two banks, and what I believe to be the key post-acquisition management decisions that need to be taken. I have also added some background information on the people you will be dealing with.

A last point - Northern's experience with recent mergers has taught us that building consensus on the integration process is a prerequisite for protecting and growing our revenue base.

The best of luck, and don't hesitate to call if you need any advice.

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## Acquisition Outline

The following outline provides some basic information on the Southern Bank transaction.

### Background

Informal discussion of a potential merger started in early 2000 following an initial approach by Northern. The first reaction of Southern management was quite cool, but it evolved to be much more positive as nationwide M&A activity increased and rumours of a possible combination of Western Bank and Eastern Bank spread in April. The strategic logic of a possible transaction was fairly clear to both sides: it would be difficult to compete against the scale advantages and the geographic coverage of a combined Western and Eastern Bank (about twice as large as either Northern or Southern), should their merger be finalized. In addition, both Northern and Southern could clearly see numerous opportunities for significant cost savings and cross-selling activities from a combination of their two franchises. The real arguments of contention were the usual ones: the governance structure of the combined entity, the value of both franchises, the strategic approach to take in the eventual post-combination period, etc..

### Negotiation Process

Formal negotiations started at the beginning of June, and a brief due diligence exercise was conducted in the first week of July (for Northern) and the third week of July (for Southern). The due diligence process was based on a letter of intent signed by Northern on June 29<sup>th</sup> which included a preliminary, non-binding, consideration of \$1.35 billion in stock. Overall attitude was relatively friendly. The bid was uncontested, no other bank was approached or involved in the negotiation.

Date of signature of the agreement to merge: September 12<sup>th</sup> 2000

Price paid: \$ 1.5 billion in stock, based on Northern Bank share price at close of trading on September 12<sup>th</sup> 2000.

### Advisors

Northern Bank's advisors	Investment Bank Consultant	Golding Ritter Sergeant & Co.
Southern Bank's advisors	Investment Bank Consultant	Fortstein Berger Thornton & Nickle

### Pre-acquisition profiles - Introduction

The following profiles were prepared by Sergeant's New York M&A team, based on a comparative analysis of Northern and Southern, using August 31<sup>st</sup> 2000 data.

### Pre-acquisition profiles - Key Figures

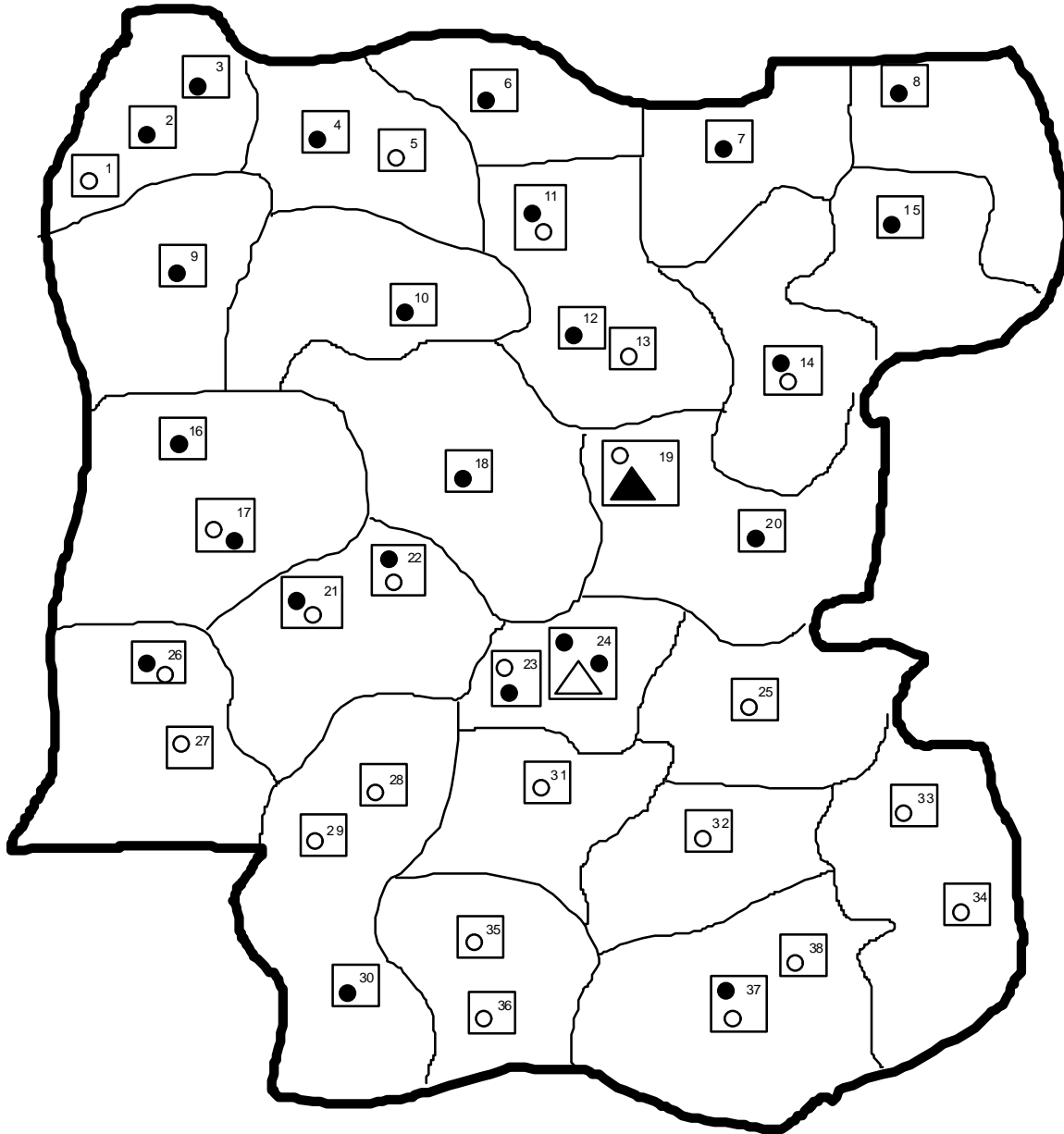
	<i>Northern</i>	<i>Southern</i>
<i>Ownership</i>		
Public - Institutions with >5%	23 %	12 %
Public - Other	63 %	69 %
Founding Family	0 %	12 %
Management	<u>14 %</u>	<u>7 %</u>
	100 %	100 %
<i>Financials (at June 30<sup>th</sup> 2000)</i>		
Net Interest Income	\$ 314 m	\$ 231 m
Non-Interest Income	<u>\$ 91 m</u>	<u>\$ 106 m</u>
Total Income	\$ 405 m	\$ 337 m
Non-Interest expenses	\$ 239 m	\$ 229 m
Taxes	<u>\$ 54 m</u>	<u>\$ 23 m</u>
Net Earnings	\$ 112 m	\$ 85 m
Shareholders' Equity	\$ 850 m	\$ 502 m
Non-performing loans (90 days)	\$ 72 m	\$ 68 m
Total Loan Portfolio	\$ 6.9 bn	\$ 5.4 bn
Total Assets	\$ 10.4 bn	\$ 8.6 bn
Stock Market Value (Sep 12 <sup>th</sup> )	\$ 1.8 bn	\$ 1.2 bn

### Pre-acquisition profiles – Qualitative Assessments



*The relative effectiveness of the following operating functions and the quality of the following resources was assessed through a benchmarking exercise with the relevant competitors (“1” = much worse, “3” = similar, “5” = much better).*

Operations (back-office)	4	2
Administration (accounting, audit)	3	2
Credit underwriting policies	4	3
Marketing & Advertising	3	4
Customer Service (i.e. tellers, phone)	3	4
Information Systems	3	2
Location / Facilities	3	4

**Pre-acquisition profiles - Branch Networks**



● Northern Bank branch	○ Southern Bank branch
▲ Northern Bank HQ	△ Southern Bank HQ

<table border="1"> <tr> <td>3</td> <td>Town &amp; town reference number</td> </tr> </table>	3	Town & town reference number	 <b>State Boundary</b>  <b>County Boundary</b>
3	Town & town reference number		

Branch List

County		Town		Northern Bank Ref / Performance Index		Southern Bank Ref / Performance Index	
A	Worcester	01	Shelbey			S 01	2
		02	Hibbing	N 01	3		
		03	Boisevain	N 02	4		
B	Montagu	04	Maple Creek	N 03	4		
		05	St Joseph			S 02	3
C	Adelaide	06	White River	N 04	3		
D	Esshow	07	Cobalt	N 05	2		
E	Middel	08	Antigo	N 06	5		
F	Rusten	09	Baraboo	N 07	5		
G	Douglas	10	Randall	N 08	4		
H	Jones	11	Greeley	N 09	1	S 03	3
		12	Fort Scott	N 10	2		
		13	Newport			S 04	3
I	Fontein	14	Ardmore	N 11	5	S 05	4
J	Scotts	15	Perryton	N 12	4		
K	Suffolk	16	Hobbs	N 13	4		
		17	Pecos	N 14	5	S 06	4
L	Warring	18	Deming	N 15	4		
M	Tobol	19	Mesa	N 16	3	S 07	4
		20	Platte	N 17	3		
N	Sutherland	21	Warren	N 18	4	S 08	5
		22	Rutland	N 19	4	S 09	4
O	Enard	23	Joliette	N 20	5	S 10	4
		24	Bangor	N 21	3	S 11	5
				N 22	2		
P	Trotter	25	Dayton			S 12	4
Q	Strathe	26	Grangeville	N 23	3	S 13	4
		27	Klamath			S 14	4
R	Cromden	28	Franklin			S 15	4
		29	Puyalop			S 16	5
		30	Bessemar	N 24	3		
S	Oriol	31	Cordell			S 17	3
T	Morar	32	Salt Fork			S 18	4
U	Snizort	33	Leadville			S 19	4
		34	Sheridan			S 20	3
V	Boulder	35	Redwing			S 21	5
		36	Harrisonburg			S 22	5
W	Dee	37	Orangeton	N 25	4	S 23	4
		38	Eagle Pass			S 24	3

Performance index based on combination of profitability and last 3 yrs' growth in \$ value of all retail and corporate loan applications

## Pre-acquisition profiles - Human Resource Practices

	<i>Northern</i>	<i>Southern</i>
Salaries	Close to Industry average	Above Industry average
	Fixed for each of 17 grades	Individually negotiated
Bonus Scheme	Partly based on individual performance for most employees	Bank level profit-related bonus for management
Contracts	Fixed for each grade	Individually negotiated
Benefits		
- Company car	Above grade 12	Directors
- Low-interest loan	All	No
Expenses	Corporate Expense card	Reimbursed
Pensions	Voluntary contributions deducted from salary	Bank contributes 3% of annual salary to employees with more than 2 years' seniority
Holidays	20 days + public holidays	18 days + public holidays

**Pre-acquisition profiles - Loan Approval Processes**

	<i>Northern</i>	<i>Southern</i>
EFFECTIVENESS level of Credit underwriting policies	4	3
<i>Loans up to .....</i>	<i>require approval of .....</i>	
\$ 100,000	Branch manager	Branch manager
\$ 1 million	Branch manager	County manager
\$ 5 million	County manager	Head of Corporate Banking
\$ 50 million	Head of Corporate Banking	CFO
Primary evaluation criteria	Cashflows	Collateral
Total customer profitability evaluated ?	Yes	No
Approval level dependent on client history ?	Yes	Yes

## Pre-acquisition profiles - IT Systems

	<i>Northern</i>	<i>Southern</i>
<i>Computer system</i>		
No. of servers	5	1
Server operating system	Unix	Unix
No. of PC's	408	321
Operating system(s)	Windows 95/98	Windows 3.1
No. of software programs in use		
- Off-the-shelf	33	15
- Custom	4	0
Performance Rating	3	2
 <i>Automated Teller Machines</i>		
Number of locations	56	24
Performance Rating	4	3
 <i>Telephone system</i>		
Type	PABX in each branch	Corporate PABX
Supplier	Mixed	Teletel
Call centres	3	1
Handsets	800	600
Performance Rating	4	5

### **Pre-acquisition profiles - Management**

	<i>Northern</i>	<i>Southern</i>
Total number	56	47
Management style	Participative	Directive
Average skill levels		
- at HQ	4	5
- in branches	3	3

### **Pre-acquisition profiles - Employees**

	<i>Northern</i>	<i>Southern</i>
Total number	850	635
Members of BEU (Bank Employees Union)	24 %	56 %
Average skill levels		
- at HQ	4	4
- in branches	3	4

## Pre-acquisition profiles - Product Portfolios

	<i>Northern</i>	<i>Southern</i>
<i>Deposit Portfolio (by \$ size)</i>		
Current Accounts	56 %	24 %
Savings Accounts	44 %	76 %
<i>Deposit Portfolio (profitability rating)</i>		
Current Accounts	4	3
Savings Accounts	4	5
<i>Loan Portfolio (by \$ size)</i>		
Commercial/corporate lending	64 %	15 %
Consumer/retail lending	30 %	78 %
Mortgage/real estate		5 %
Other	6 %	2 %
<i>Loan Portfolio (profitability rating)</i>		
Commercial/corporate lending	4	4
Consumer/retail lending	3	4
Mortgage/real estate		2
Other	3	2

Each of the banks' deposit and loan 'products' corresponds to a given set of options, terms and conditions (e.g. interest rate calculation, payment period, guarantee requirements, etc..)

## Post-acquisition Management Decisions

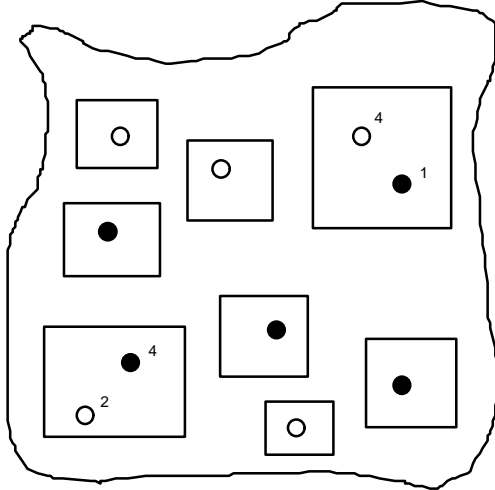
The following are the 10 key decisions that make up the integration plan:

### 1) Branch Networks

Southern Bank's branches will be ...

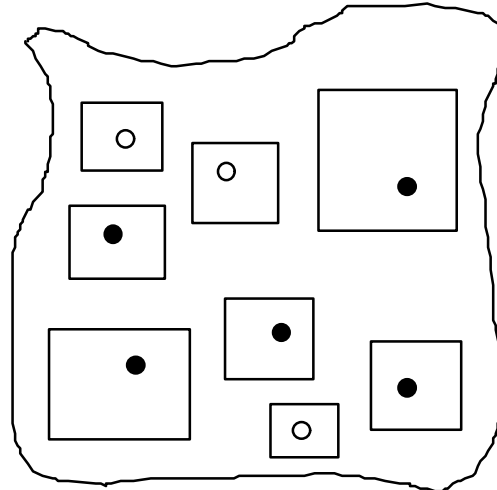
#### RETAINED

All branches retained, no integration



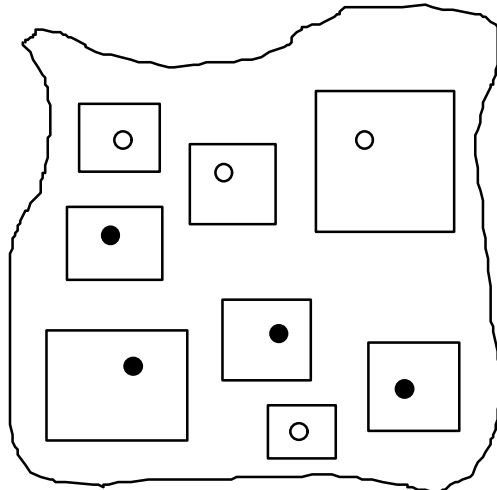
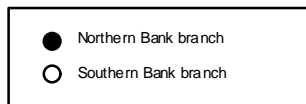
#### CLOSED

All Southern branches present in a town with a Northern branch are closed



#### RATIONALISED

Best branches retained in each town, whether Northern or Southern; if equal, Northern branch is retained



An imaginary branch network is shown here, for explanation of the three options; the numbers next to the branches indicate example performance indices. Closing duplicate Southern branches is expected to reduce Southern's cost structure (non-interest expenses) by about 10%. Rationalising would cut 4% of the combined cost structure.

## 2) Human Resource Practices

Southern Bank's Human Resource Practices will be ...

RETAINED - All practices retained, no alignment (e.g. of salaries)

REPLACED - Southern's practices replaced with Northern's

## 3) Loan Approval Processes

Southern Bank's Loan Approval Processes will be ...

RETAINED - Both processes retained, no integration. Southern procedures and decisional autonomy are preserved.

LINKED - Southern's process retained but linked to Northern's. New procedures will be designed in order to ensure timely and effective exchange of information among the two loan processing units and to facilitate the harmonisation of the procedures in the medium/long term.

REPLACED - Southern's process replaced with Northern's. Centralisation of the loan approval process will save about 4% of the combined cost structure.

## 4) IT Systems

Southern Bank's IT Systems will be ...

RETAINED - Both systems retained, no integration. The two systems will be run as autonomous units.

LINKED - Southern's system retained but linked to Northern's. A sophisticated interface will be designed to translate Southern's data outputs to formats understandable by Northern's system.

REPLACED - Southern's system replaced with Northern's. The replacement of Southern's system is estimated to save about 22% of Southern's non-interest expenses.

## 5) Management

The proportion of Southern's Managers replaced will be ... 0, 5, ..... , 95, 100 %  
Total compensation costs for the management team at Southern amount to 6% of its cost structure.

## 6) Employees

The proportion of Southern's Employees replaced will be ... 0, 5, ..... , 95, 100 %  
Total compensation costs for Southern's employees account for 32% of its cost structure.

## 7) Product Portfolio

Southern Bank's Product Portfolio will be ...

RETAINED - All products retained as part of merged bank's offering

REPLACED - merged bank will only offer Northern's products

RATIONALISED - for each product category, 'best practice' products offered

The financial impact of product portfolio decisions is hard to quantify at this stage of the process.

## 8) Replacement Announcement

'Replacement' is one of our euphemisms for layoffs. The announcement of replacement decisions will be ... 1, 2, ..... , 11, 12 weeks after January 1<sup>st</sup> 2001

## 9) Implementation Start Date

The start date of implementation of Integration Decisions will be ...  
1, 2, ..... , 11, 12 weeks after January 1<sup>st</sup> 2001

## 10) Implementation Period

The period for implementation of Integration Decisions will be ... 1, 2, ..... , 19, 20 weeks

## **Northern Bank - Key Personnel Profiles**

### Chris Wycliff (you !)

Current Position : Northern Bank, Integration Manager

Responsibilities : Management of the integration of Northern Bank's acquisitions

Date of Birth - June 4<sup>th</sup> 1957

Personal Status - Married, two daughters

Nationality - US

Languages - English, Spanish

#### Education

1986 - Wharton MBA

1978 - UCLA BA in Physics

#### Past Experience

1994 - 99 Senior Project Manager - Sura Insurance

1989 - 94 Vice-President - McTill Consulting

1987 - 89 Manager - McTill Consulting

### Jon Pettinger

Current Position : Northern Bank, Chief Executive Officer

Responsibilities : All Northern Bank operations

Date of Birth - August 23<sup>rd</sup> 1945

Personal Status - Married, one son

Nationality - Canadian

Languages - English, French

#### Education

1965 - University of Toronto BA in Finance

#### Past Experience

1985 - 91 Chief Financial Officer

1980 - 85 Head of Corporate Banking

## **Memorandums sent to Stakeholders**

*Northern Bank - Internal Memorandum*

TO                Lorenzo Stanio  
                      Bernie Stalton  
                      Randy Dufarl  
                      Simon Porter  
                      John Paulton Jnr  
                      Tonia Yoshiro  
                      Elaine Bolta

FROM             Jon Pettinger

DATE             October 9<sup>th</sup> 2000

SUBJECT         Southern Bank Acquisition

Dear Colleagues,

As you know, Southern Bank's Board has recently accepted our friendly offer to acquire a controlling interest, with Northern stock. We are now waiting for agreement from the regulator, as well as formal shareholder approval, both of which we expect by the end of the year. All Northern and Southern employees were informed last week of this provisional acceptance.

An acquisition raises some obvious and immediate concerns from the employees involved, and you will all have received individually addressed letters confirming that you will be part of the team of key managers taking this organisation forward.

Northern's acquisition experience has convinced us of the need for a consultative approach to establishing a detailed integration plan, so I would like to take this opportunity to introduce to you Chris Wycliff, our specialist Integration Manager, who will be leading the integration of Southern's operations with our own over the next few months, and more particularly, contacting you over the next few weeks in order to come up with a plan that reflects your concerns.

The plan will be 'set in stone' just before Christmas; until that time, please use the opportunity of your discussions with Chris to share your views on the various key decisions that need to be taken as part of the plan. I look forward to continuing to work with you all over the coming years as part of the new Northern Bank, and thank you in advance for your participation in this process.

*Northern Bank - External Memorandum*

TO Marie Calperra - American Banking Authority  
Patrick Green - Dott Manufacturing  
Nicholas Collyn III - Sergeant & Co.  
Pattie Mehrer - The Daily Post  
Hank Johnson - Sunrise Pension Fund

FROM Jon Pettinger - CEO, Northern Bank

DATE October 12<sup>th</sup> 2000

SUBJECT Southern Bank Acquisition

As you know, Southern Bank's Board has recently accepted our friendly offer to acquire a controlling interest, with Northern stock. We are now waiting for agreement from the regulator, as well as formal shareholder approval, both of which we expect by the end of the year. All Northern and Southern employees were informed last week of this provisional acceptance.

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The plan will be 'set in stone' just before Christmas; until that time, please use the opportunity of your discussions with Chris to share your views on the various key decisions that need to be taken as part of the plan.

Thank you in advance for your participation in this process.

## **Stakeholder Profiles**

### Northern Bank

Lorenzo Stanio

Head of Retail Banking

Lorenzo has been with Northern for over 10 years; his main responsibility as Head of Retail Banking is the profitability of the division. He tends to spend most of his time at our headquarters in Mesa, and there are some branches that Lorenzo has never visited ! There is a quarterly meeting at headquarters which all the branch managers are expected to attend though. Lorenzo has launched a project recently to review the effectiveness of the loan approval process.

### Northern Bank

Bernie Stalton

HR Director

Bernie is a skilled 'people' person, and has played a pro-active role in moulding Northern's HR practices to be, at least in his view, in line with both the bank's and its employees' interests. For instance, he has recently launched a training programme to raise the skills of branch employees. Bernie does not give much weight to project management style; it's concrete results and the views of the other people concerned by this takeover that count! His previous job was HR Director in a small insurance company.

### Northern Bank

Randy Dufarl

IT Director

Randy is responsible for all aspects of Northern's computer and telephone systems. He has been exploring the possibility of setting up a corporate Intranet, but it is not even at the prototype stage, and the recent upgrade from Windows 3.1 to 95/98 has taken much longer than we expected. Randy tends to focus on a very narrow range of issues in considering the merits of a proposal (maybe he spends a little too much time in front of a computer screen!); for example, he is not going to pay much attention to what anyone else thinks in this kind of project.

Northern Bank

Simon Porter

Chief Financial Officer

Simon manages our investor relationships, and was instrumental in obtaining support for the acquisition from Southern's shareholders. His key attribute is his knowledge of finance and accounting, and he tends to try and interpret everything in terms of numbers; for instance, he will always look at the cost implications of a given proposal. Simon is also the kind of manager to make up his own mind when assessing a business decision.

Southern Bank

John Paulton Jnr

Chief Executive Officer

John and I studied at college together, way back in the sixties in California. He was my main contact at Southern during the acquisition negotiations, and it was he in fact who suggested the idea of a merger late last year. John is a pragmatist, and has built his reputation as a manager who acts primarily in his shareholders' interests. He is one of those guys who can see the woods and the trees: both the details of the plan and what his colleagues think of it will be of interest.

Southern Bank

Tonia Yoshiro

Head of Retail Banking

Tonia has recently taken on this role, having spent most of her career in the division; given the weight of the retail loan portfolio, she has considerable power at Southern. Tonia is a hands-on manager, spending most of her time visiting the branches; she has nevertheless been very keen to delegate as much decision-making power as possible to branch managers. I don't think she is the kind of manager who will worry too much about communication style, but the views of her colleagues and clients are likely to be given a lot of weight.

### Southern Bank

Elaine Bolta

HR Director

Elaine has not been in her position long, and has not had time to change much amongst the HR practices inherited from her predecessor. She was not directly involved in the takeover discussions, but has already expressed a number of concerns about the risk of layoffs amongst Southern's personnel following the takeover. Elaine has been criticised for the comparatively low skill levels of Southern's branch managers, but I'm told she works hard to improve the image of HR.

### American Banking Authority

Marie Calperra - State Representative

Marie's primary responsibility is to enforce National Banking Laws, which define the legal framework under which Northern Bank and other commercial banks operate. A key priority is enforcing the 'no cross-subsidy' regulation, covering subsidies across corporate, retail and mortgage activities. She has hinted at forthcoming regulatory changes that will reduce hurdles to consolidation in the banking sector. Marie's team conducts an annual regulatory audit at Northern; they have been very responsive to our criticisms of current regulations governing intra-state banking restrictions. She will like an effective communication strategy in this kind of complex situation.

### Dott Manufacturing

Patrick Green - CEO

Dott manufactures railway rolling stock, is a key supplier to most American railway companies, and is technically quite sophisticated. The firm is Southern's most important customer in terms of last year's \$ revenue, and Southern has developed several customised products for them. Patrick is likely to want to avoid any disruption to the bank's product lines, and has given the acquisition only cautious support so far.

Sergeant & Co.

Nicholas Collyn III - M&A Vice-President

Sergeant's M&A team has six full-time professionals focusing on the banking sector, and they have been instrumental in the Southern Bank transaction, as you can see from their significant input to the project file. Nicholas has been Northern's key contact since January of this year, and this is the second Northern acquisition that he has been involved with. Nicholas is likely to have strong views on the various integration decisions that lie ahead of us; for example, he is a supporter of limited personnel shakeups.

The Daily Post

Pattie Mehrer - Editor

The Daily Post is a well-respected business-oriented daily newspaper, whose main editorial theme is de-regulation, free trade and competition; it has taken a generally pro-bank line since its founding. Pattie Mehrer has written a number of articles about the acquisition, some rather sceptical about our announcement of 'a merger of equals'; however, I've heard that she thinks quite highly of Northern's past acquisition performance, in terms of community impact. She will not reject layoffs outright, but there are limits.

Sunrise Pension Fund

Hank Johnson - Fund Director

The Sunrise Pension Fund holds 12% of Northern shares, before the acquisition, and is the biggest shareholder in Northern. It has a team of internal investment analysts, with a reputation for interpreting pretty accurately the impact on the share price of different strategic moves. Hank has been at Sunrise for nearly three years, and the Southern Bank acquisition is the second one he has been involved in as Northern's main contact at Sunrise. Hank is very much in the camp of hands-on investors, who won't hesitate to push his weight around if he perceives it to be necessary - he will not care much what anyone else thinks of your proposals, and will not want branches duplicated without a very good reason.