GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Texas, Minnesota, Wisconsin, District of Columbia, Ohio, Tennessee, Washington and Oregon!

MANAGEMENT SUCCESSION

As most *Musings* readers know, management succession is a critical issue for community banks. If we want to keep our banks independent, we must have appropriate succession of management. Otherwise, the board will simply throw its hands up and sell the bank as soon as the CEO announces his or her retirement. How long does it take to implement a succession plan? The normal timeframe is anywhere from one to three years. The first thing the board needs to do, however, is nail down the CEO's retirement plan and then come up with a process by which to fill that slot. And no, finding someone who is exactly like the CEO you currently have is not a good process. Those individuals simply do not exist.

As you are laying out the process, remember that some overlap time between the current CEO and the new CEO is also appropriate. That generally runs six months to a year. So if it takes you six months to find somebody and six months to vet them and six months to get them in, then you are right at 18 months to two years out. The board needs to seriously be contemplating succession for the CEO slot.

While you are considering succession for the CEO slot, do not ignore the other slots in the bank. Many of our clients around the nation have their management team all “bunched up” between 55 and 60. That also needs to be addressed sooner rather than later.

ACQUISITION PRICING

Prices for bank acquisitions are on the rise pretty much no matter what metric you use. Some of the high prices being paid are simply because the buyer wanted to get into a particular market that the buyer perceived as a franchise builder. Some high prices are paid because the buyer is not as sophisticated as they should be (or getting appropriate help). But what about the sellers? I was visiting with a banker in the last couple of weeks who had looked at some acquisition transactions but really found that the seller’s expectations were way beyond what the numbers would pencil out. In other words, the seller sees that somebody else got 160% of book value and, irrespective of the fact that they are overcapitalized or underperforming, they think they should get the same. The disciplined buyer will simply pass on that transaction.

THE INTERESTING MARKETING CONCEPT

I recently facilitated a strategic planning retreat for a rather large community bank. During the discussion on products and services, the group recalled the fact that they were previously having a difficult time getting customers to utilize a number of their deposit products and services, particularly remote deposit capture. Notwithstanding the fact they were giving the remote deposit capture machines to the customers, these machines were simply not being utilized. In an effort to get better utilization of the machines, in early 2015 the bank made what I thought was a counterintuitive strategic decision. The bank decided they were going to start charging customers to use remote deposit capture in an effort to try and get customers to use it. As it turns out, the plan worked better than expected. As one of the planning participants put it, “It is kind of like the old refrigerator by the curb. If you put a sign on it that says free, no one takes it. If you put a sign on it that says $50, it is stolen in ten minutes.”

I certainly thought this was a rather novel approach to what I have seen is a pretty common problem.

AN UNEXPECTED MOVE

Over the past couple of months I have been helping a community bank pursue a purchase of two branches. We have put quite a bit of time and effort into the transaction. We began by running it through our merger models and determining an appropriate price to pay. We approached the seller, executed a non-binding Indication of Interest, and performed due diligence. The transaction was moving along quite nicely, and we presented the proposed Purchase of Assets and Assumption of Liabilities Agreement to the seller near the end of the year. Earlier this week, the seller completely pulled the rug out from under the deal and sent us an email that essentially said, "Thanks for all of your hard work on this, but we have decided we are not going to sell those branches."

It is true that the seller was not under any legal obligation to continue moving forward with the deal. There was no legally binding contract. However, this is still extremely frustrating for our client. They have spent a good amount of time and money pursuing the deal. What is more frustrating is the fact that the seller has really offered zero explanation for why they decided to terminate the transaction.

NOT A BAD PROBLEM TO HAVE

Over the past two to three years, many of my conversations with community bankers have been focused on ways to grow the bank's loan portfolio. Many bankers were simply having a difficult time getting any quality loans on the books. I recently had a conversation with a banker that has the exact opposite problem. This particular bank is really struggling (and I use that term very loosely) with too much loan demand. The problem is that this bank's loan-to-deposit ratio is quickly approaching the board-determined ceiling.

We talked through all of the various resolutions to this "problem." We talked about increasing the deposits to continue enjoying loan demand, but that is going to be one step towards solving this problem. The other is that the bank is going to become much more selective in the credits they do take. Obviously, this will benefit the bank in the form of even better asset quality.

Although not every bank in the country is struggling with excess loan demand, I am beginning to have more conversations like this. There are a number of bankers that are saying loan demand in their markets is strong. That is certainly a welcome change from the not too distant past.

THE SELLING SHAREHOLDER

I was recently with a board talking about acquisitions and all the related issues. One director in particular on this board (he was not a particularly large owner) is bound and determined to put the bank up for sale. This particular director's argument was generally that getting an opinion from an investment banker or somebody in the valuation business really does not tell you what the bank is worth. You will never know what the bank is worth until you test the market, at least in some fashion. The rest of the board recognized the obvious problem with that philosophy is that you test the market and because there are "no secrets in community banking" the entire marketplace knows what is going on, as do your employees and senior officers. If you are not seriously convinced that you want to sell the bank, then do not test the market - it will simply put the bank in play. That was the conclusion of this board, as it is for most.

SUCCESSION

As noted above, senior management succession is one of the most difficult issues facing most community bank boards today. As the population is aging, so are the senior executives at our community banks. As noted above, it is not uncommon to find a bank with all the senior executives "bunched up" in the 55 to 65 year old age range. A smart board is the one that takes it on itself to prepare for succession. It seems like these decisions are never easy, particularly when you have to determine whether an inside executive can move into that CEO slot or whether you need to go outside. I have seen banks do it both ways. Typically, the smaller banks will simply promote from within without doing a search. The larger banks typically will do a nationwide search to make sure that they have a) exercised appropriately their fiduciary duty and b) retained the best executive for their institution.

A BETTER DEAL FOR ALL INVOLVED

In mid-2015, we were representing a seller in a transaction that ultimately fell apart. The deal was terminated well into the process. We had even gone so far as to get shareholder approval of the transaction. As you can imagine, this was frustrating for our client's community bank board. As it turns out, it was really the best thing that could happen. Following the termination of the first deal, we went back to work talking to potential acquirors. These discussions resulted in the board receiving multiple offers for the purchase of the bank, with the offer the board accepted being a better deal for the shareholders than the original transaction. We are now working to get this deal put together, approved, and closed. Assuming we can make that happen, the board has certainly taken lemons and turned them into limoncello.

CONCLUSION

We hope everyone had a great New Year and is looking forward to a healthy and prosperous 2016. As you can tell from the "Greetings" line, we are off and running big time in 2016. Looking forward to assisting many of you this year.

Jeff Gerrish *and* *Greyson Tuck*