GERRISH'S MUSINGS

Jeffrey C. Gerrish
Greyson E. Tuck
Gerrish Smith Tuck
Attorneys/Consultants
700 Colonial Road, Suite 200, Memphis, TN 38117
♦ (901) 767-0900 ♦ Fax: (901) 684-2339
♦ Email: jgerrish@gerrish.com ♦ gtuck@gerrish.com ♦ www.gerrish.com

March 31, 2017, Volume 341

Dear Subscriber:

Greetings from Texas, Iowa, Illinois, Florida, Tennessee, South Dakota and Wisconsin!

THE SHAREHOLDERS MEETING

It is our general firm practice when we are working on an acquisition transaction to attend the shareholders meeting at which the shareholders vote to approve the transaction. This is basically to answer questions and to provide insurance to the board of directors in case anyone is concerned about the terms of the transaction, the process, when they are going to get their money, and those types of things.

I recently attended one of those meetings for a bank where our consulting and law firms provided financial advisory services and legal services in connection with its sale. The meeting could only be described as a "love fest/family reunion." The board of directors, as they would normally at their annual shareholders meeting, had a nice dinner for all of the shareholders. Fifty or so people attended. The business meeting was held with a vote of nearly 100% of the shares of the company voting in favor. It was a nice outcome and a nice reunion for these shareholders.

IF IT AIN'T BROKE

In the last month I had a planning session with a good sized, well run community bank. As I began to review and prepare for the planning session, I felt that this would be one where there would not be any major changes in strategic direction. Just a few "tweaks." That is basically what happened. All of the directors and officers provided input, but no dramatic changes were set forth. I advised the group that long-term planning is often confirming that the bank is headed in the right strategic direction and should continue in that direction. It does not absolutely mean that you have to change direction in any fashion. The board and senior officers were cognizant that the environment is changing, and they will have to make changes as a result of that. With that said, the overall business plan and strategy moving forward was pretty much the same. Interestingly, I had been with this group a couple years prior to this meeting for the same purpose (i.e., long-term planning). During that meeting a couple years ago, they did make some fairly dramatic changes, which they executed on prior to this meeting. It is good to see a productive result from those types of meetings.

OTHER LINES OF BUSINESS

Recently I have visited with numerous banks to discuss whether or not the bank should be involved in a line of business other than its core banking business. Mortgage seemed to be a favorite. Of course, that is closely aligned to the core banking business. I was with one bank that had a fairly significant mortgage presence (not a separate company or division) and portfolioed all of its loans hedged against Federal Home Loan Bank advances to deal with interest rate risk. That seems to work. I was with another bank that sold all of their loans on the secondary market and took in the fee income. Both of them realized that as rates rise, the mortgage business is going to be more difficult (i.e., less refinances, possibly less new home financing, and the like). Both of them have structured their mortgage groups to be able to make cuts quickly and effectively.

These banks also discussed other lines of business in addition to mortgage, such as wealth management, trust, and insurance, in particular. Neither of these groups had any interest in any of those. Frankly, neither bank had any in-house expertise with respect to any of these lines of business. Neither had any appetite to begin to build a wealth management group from the ground up, for example. None of them had any interest or knowledge about how insurance agencies work. The general strategy for both companies was to "stick to their knitting."

MUTUALS

I have had the opportunity to work with a number of mutually owned banks over the last several months. For those of you who are uninitiated as it relates to mutuals, these are financial institutions owned by their depositors. They have no shareholders. How is that for exciting? The interesting thing about mutuals is that part of their mission is to give back to their communities. These are not "not for profit" entities like credit unions. Mutuals pay taxes and give back to their communities. It is interesting to watch the "commitment" to mutuality when the issues are discussed with these mutual boards. Many of these mutuals in various parts of the country, from New England to the Southwest, have been in business for long, long time. We put a number of them in mutual holding companies (similar to a bank holding company) where they can leverage capital into the subsidiary mutual bank without having to go public. Mutuals are very interesting entities.

IS IT TIME TO SELL?

Those of you who know me know well that I am a staunch supporter of independent community banks. I have found over the last few years, however, that with the "greying" of the ownership and management of our community banks that many of those banks are looking for partners for all the traditional reasons. In the last couple months, I was with one of these groups where one of the older shareholders asked me as it related to the sale of the bank what I would do. He asked me this knowing that I was a staunch supporter of independent community banks. I told him I did not have a dog in the hunt (i.e., it was his decision), but if it was my decision, at his age and stage in life, with no successor ownership or successor management, and no good prospects of obtaining it other than through an acquisition, then I would probably look to cash-out at this stage. He said he understood that.

The discussion with respect to whether the bank should remain independent or sell by this board of directors was interesting. The board discussed the issue of their ages, the lack of management succession, the future of the industry, and the like. I could tell many of the directors were very reluctant to be the cause of there being "one less" community bank in the nation. They did not want to be responsible for that outcome.

Notwithstanding the discussion and the good reasons to remain independent, they felt that they really had no choice but to look for a merger partner. We are in the process of looking for a buyer.

THE PATRIARCH

I was recently visiting a bank which for a number of years had a patriarch who ruled the bank with an iron hand. The patriarch, in his early 90s, recently passed away. The patriarch had been the former CEO. He moved up to chairman and pretty much ruled the board with an iron hand as well. If the board was going to take any action, the only thing they were going to do was "rubber stamp" what he proposed. As he got older and more frail, it appears that the bank was not even keeping up with the times. He had a close rein on the purse strings and was not a big fan of technology and other issues.

Since his passing, the bank has really opened up. It has gotten much more technologically advanced. The board is forward thinking. He would never allow them to participate any type of long-term planning. They are now going to do that. Although I have been told by the officers that everyone just loved this former chairman, they are also happy to see the bank making progress and moving at least into the 19th century.

INCENTIVE COMPENSATION ISSUES

Over the past couple months we have been assisting a client in developing an incentive compensation plan for its president. This particular president is what I would classify as a hot commodity in today's industry. He is very young and talented. The board saw that it was important to get him what he wanted, so they brought us in to work as a sort of intermediary between the board and president to develop a compensation plan that works for everyone.

Based on extensive discussions with the board and the president, we have developed an annual cash compensation program that is driven by the bank's net income, loan growth, CAMELS rating, and shareholder distributions. The plan essentially sets benchmarks for each of these four components, and the annual cash bonus is dependent on how the bank performs compared to those benchmarks.

In addition to providing a cash bonus, the board and this executive also wanted to provide some longer term synthetic equity compensation. To get this done, the plan awards Stock Appreciation Rights Units on an annual basis in an amount equal to 10% of the cash bonus. These SAR Units are essentially a long-term cash bonus that is equal to the increase in value of the holding company common stock over the next ten years.

This compensation plan really works well for all involved because it achieves the goals of everyone. If you are thinking about trying to tie down younger talent, you may want to consider putting something like this in place. It is a good mixture of cash and equity compensation, and it should promote keeping this younger talent in the bank for a long time.

THE STRONG UNSOLICITED OFFER

We are currently assisting a client in responding to what I would classify as a strong unsolicited offer. This situation is somewhat unique because this is the second unsolicited offer from this potential acquirer the holding company has received. What makes this situation even more unique is that the holding company is right now in the middle of a transaction that, once completed, will provide a significant increase to the economic value of the organization.

What is the appropriate response in this type of situation? Our recommendation was to contact the company making the unsolicited offer and indicate to them that a transaction could not be completed at this time due to other pending transactions, but that following the successful completion of the transaction the company would consider the proposal. The board meets next week to consider our recommendation. We will keep you updated as to what ultimately transpires.

ANTI-TAKEOVER PLANNING

On a related note, since unsolicited offers are so prevalent in today's environment, we have a number of clients that are asking us about anti-takeover planning. This is essentially the numerous steps that a holding company and bank can take to protect itself against hostile or unwanted takeovers. The available options are numerous, and all of them are designed primarily to force the potential buyer into the boardroom instead of out directly to the shareholders. These options are generally incorporated in the holding company and bank charter and bylaws, and they promote the existing shareholders' ability to make decisions and protect the company in the event of a hostile or unwanted takeover attempt. Please let us know if you have any questions or would like to further discuss anti-takeover planning for your organization.

DISSENTERS' RIGHTS

Our firm has been forming bank holding companies for a long time. Each of these holding company reorganizations is completed in substantially the same manner, which is to exchange the bank stock for the holding company stock on a one share-for-one share exchange basis. This means the bank shareholders no longer own shares of the bank, but own an identical number of shares in a company that owns 100% of the bank. Every one of these transactions provides the shareholders the right to dissent from the transaction and take the fair value of their stock in cash as opposed to the holding company stock because the applicable state and federal laws require the provision of dissenters' rights. Over the last 35 years or so, we have never had more than a handful of dissenters in a holding company reorganization. However, in a holding company we are currently working to complete, a shareholder has exercised their right to dissent. It is not because the shareholder thinks the transaction is unfair. It is simply because the shareholder wants cash for its bank stock and is using the dissenters' rights as a "jumping off" point. The bank can certainly handle cashing out the shareholder. However, what I think is likely to happen is for the shareholder simply to sell its shares to another shareholder that wants to buy more stock. This will resolve the situation and keep everyone as happy as possible.

CONCLUSION

The end of the first quarter is here. It has been a quick one. Most colleges and universities are or have been on Spring Break. Look out for the kids. Surely by now it is time to get back to work/school.

See you in two weeks.

Jeff Gerrish *and* *Greyson Tuck*

