GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Colorado, Montana, Wisconsin, Illinois, Minnesota, Missouri, Kansas, Ohio and Kentucky!

NEW DIRECTORS

I have been with a number of community bank boards lately that are searching for new directors. At one of the recent meetings, the incoming Chairman of this particular community bank board asked me whether the board should be focusing on needed skillsets for new directors or geography. My response was something along the lines of "the smaller community banks will nearly always focus on geography so they have a presence in the communities they are in. As the bank gets larger, however, and may be in 15 or 20 different communities, focusing on geography totally is nearly impossible (unless you want a board of 15 of 20 people)." At that point, the board really needs to focus on necessary skills needed to move the bank forward and provide board oversight. For most, this seems to be technology skills or insight, of late.

I also suggested to this group, which is a good-sized community bank headed toward $1 billion, that they might want to think about making their bank board more geographically diverse, and their holding company board more strategic. This would mean populating the holding company board with those individuals with the skillsets necessary to provide appropriate oversight going forward. We will see what happens.

WELLS FARGO

It seems that Wells Fargo is constantly in the news. As I travel around to community banks, the general mantra of those community banks, senior officers and boards when discussing a sales culture or cross-selling is, "We don't want to be like 'Wells Fargo.'" In one of those discussions, one of the senior officers, instead of saying he did not want the bank to be like Wells Fargo, said he did not want to be like "Sells Fargo." I thought that was a pretty good name for that large bank.

SURPRISE, SURPRISE!

I had the opportunity in the last few weeks to spend some time with the Board of Directors of a very well-performing community bank. The purpose of the meeting was to assist them in figuring out what to do with the bank's life.

Interestingly, this has been a good long-time client of our firm. Over the years, we have engaged in various issues with them, including looking at acquisitions. A couple years ago, however, I did a similar planning session for them. In the interest of not reinventing the wheel, I was in the process of quizzing them about a few of the things they told me they were going to implement as strategies at the last planning session to see if they had executed on them. To my pleasant surprise, they had executed on all of them very well. This is one situation where the action plans were fulfilled and the strategies were implemented. I congratulated the Board on this. They told me to assure other *Musings* readers that they are "the best community bank board in the country." I told them there may be some pushback or dispute on that from other *Musings* readers, but I did deliver their message.

FDIC APPEALS PROCEDURE

For those of you who are interested, the FDIC within the last couple weeks put out a fresh and new appeals procedure. The problem with the last appeals procedure, which they have had for a number of years now, is it was basically totally worthless. When I checked on how many banks had won appeals, out of the 40 appeals made over the last couple of years, a single bank had won a "half" of one issue. Not a very good track record. Much more like a kangaroo court.

The new FDIC appeals procedure is designed to be a little bit more user-friendly. It appears to be such. There is an expanded list of matters that can be appealed in addition to simply CAMELS ratings and the like. Now, the FDIC's position on enforcement actions and a few other things can also be appealed.

If you are having a difficulty with the FDIC in connection with your examination or results, you may want to review whether it is worth appealing. I cannot guarantee that it is still not going to be a kangaroo court, but it appears to be a little more productive process than they had in the past.

THE UNSOLICITED OFFER STRATEGY

I recently facilitated a strategic planning retreat for a community bank that has viewed themselves as an acquirer for some time. This particular bank has tried to put a couple of deals together over the past couple of years, but for one reason or another has not been able to get one much past the initial discussions. During the strategic planning retreat, the top item of discussion was another acquisition opportunity. The bank would like to approach another community bank in their area with what can only be described as an unsolicited offer. One of the issues the board wrestled with for some time was how best to approach the potential target's board of directors to pitch the idea of a transaction.

During the planning session, one of the directors asked me to describe the "standard process" for pursuing an unsolicited offer. My response was that there really is no standard process under these types of circumstances. Instead, my recommendation to the board was that we figure out the approach that gives us the highest likelihood of getting the answer we want. We talked about that for some time, and it was finally determined that a couple of our directors that have good relationships with a couple of their directors would discuss the potential transaction on what could be best described as a semi-formal basis. These directors are not going to present these other directors with a lengthy Indication of Interest, but they are not going to come emptyhanded either. The board decided it best to strike a balance between using the existing relationships and approaching those directors while also having in hand some type of overview document that explains what we are thinking.

We are working to finalize the specifics of this strategy in an effort to bring the deal together. I will keep you updated on where it goes.

BRANCH ACQUISITION OPPORTUNITIES

We are currently assisting a couple clients in evaluating different branch acquisition opportunities. The deals we are currently helping clients consider are what I would classify as fairly small deals. In most of these deals, the target branches have between $10 million and $25 million in deposits and what have decent but not superb loan balances. What has struck me about each of these opportunities is the relatively strong financial returns that our models show for the transactions. These deals do not project out to be huge money makers in terms of actual dollars. However, in terms of a return on investment, the returns are very good. The numbers we are seeing are showing returns on investment from about 25% to, in one case, over 50%. Certainly these returns are not assured, but we run our models on a conservative basis and feel like we are pretty close to the mark.

If you are presented with an opportunity to acquire a small branch, do not just dismiss it out of hand. These can actually end up being pretty good acquisitions. The returns in terms of actual dollars likely will not blow you away. However, the returns on investment are typically very strong by any measure.

SHAREHOLDER SUCCESSION PLANNING

I recently facilitated a planning session for a community bank that has a pretty concentrated ownership group. In this holding company, one of the large blocks of stock is owned by an aging individual. During the planning session, we talked about the plan for this block of stock once the current owner passes away. The stock will be split between the four children of the current owner. The board believes at least two of the four children are long-term players. What the other two will do with their stock is really anyone's guess. The board made what I believe to be a very smart decision and established essentially a Plan A and Plan B for the common stock. Plan A is the best case scenario, where all four of the kids hold onto the shares. Plan B involves utilizing the holding company's existing line of credit to repurchase the shares in the event any of the kids decide it is more fun to have cash than community bank stock.

This is a perfect example of appropriately planning for shareholder succession. If you have a concentrated ownership group and you think a large block of stock may be transferring ownership in the near future, do not forget to plan for all the contingencies. It is prudent to hope for the best and plan for the worst.

THE PLAN

I was recently with the Board of Directors of a not terribly high-performing community bank. The bank was populated by good people and had a good foundation, but it simply was not putting up the numbers it should have. As a result of that, and for a few other reasons, they had some disgruntled shareholders who were making noise that they should go ahead and sell. I assisted the Board in working through the issues with respect to sell now, don't sell and don't change, or don't sell and change the business model to improve profitability and long-term future value.

This Board wrestled through the issues and basically unanimously decided that it was time to change the business model and move toward high performance. They did give themselves somewhat of a deadline, however, on achieving the results of those goals. If the goals are not achieved, then my guess is they will figure out they are not able to do it themselves and sell the bank to somebody who can.

THE AGGRESSIVE ACQUISITION STRATEGY

I recently had an opportunity to visit with a Board specifically as it related to acquisition strategy. This Board was leaning toward an aggressive acquisition strategy. Fortunately for them, they were able to combine an aggressive acquisition strategy with excess capital, significant leveraging ability, and even the ability to sell some shares to raise cash or to use in an acquisition going forward. They also had multiple opportunities from multiple available banks in their market area, all of which would be a good fit (some better than others). It will be interesting to see how this aggressive acquisition strategy works out. I did caution them that aggressive does not mean doing a deal that is not smart. The primary obligation is still to do a transaction that would make your shareholders better off than they would have been if you did not do it. The Board seemed to fully understand that. We will see what happens.

AGGRESSIVE ACQUISITION STRATEGY PART II: WHAT DO WE DO NOW?

I was with yet another institution that also had an aggressive acquisition strategy. The Board really wanted to move forward and make some acquisitions. They also had an abundance of capital and ability to generate cash at their holding company through a variety of sources.

The biggest issue I saw was whether or not the bank had the human resources to engage in an aggressive acquisition strategy. The current management team, at least the ones who were in the room at that time, looked like deer in the headlights when talking about an aggressive acquisition strategy. They all had their plates full at the current time. Does the CEO have time to take away from her duties to move forward with courting potential acquisition partners, creating bids, negotiating the transaction (with help), and the like? That is my biggest concern for that bank - they need to free up some time for that particular executive to focus on the strategy they have established, which is aggressively be proactive toward acquisitions. Hopefully they will do that. If not, I am afraid they will have a bad result, either for the existing bank or for the transactions.

FRAUD

I was recently having discussions with a long time client and friend who told me that they had recently discovered one of their loan officers had been making fictitious loans. This apparently had gone on for a period of years. The real difficulty was that this particular individual had worked at the bank for a long time and worked with several people at the bank even longer at various places.

It was difficult to believe that this individual had done what he had done. This was not simply a small slip-up by an individual with one or two nominee loans. Apparently, this was a pretty significant fraud with the creation of false identities, theft of identifies, money laundering, falsification of bank records, falsification of tax returns, collateral documents, you name it. This guy apparently was pretty smart and pretty meticulous, but he finally got caught.

This matter has not been resolved yet, and I am not sure the bank knows exactly how deep the hole is. As I mention often in *Musings*, it surprises me that I saw very little fraud, garden variety or otherwise, during the recession, but now it seems to be about every other month one of our clients is suffering some type of garden variety fraud. Keep your eye out.

ACTIVIST SHAREHOLDERS

I have a number of clients across the country who, for a variety of reasons, have an activist shareholder on their board. Some of these involve the typical "well known" activist shareholders that many of us have dealt with over the years. Some of them are local, yet still activists. I have found the activist shareholders, for the most part, are cordial, pleasant, smart, and engaging. The only concern I have with any of them is that no matter the question, the answer is always "sell the bank."

I understand that activist shareholders are to be true to their retainer, but the refrain often becomes somewhat tiresome.

CONCLUSION

Here we are at the end of the third quarter of 2017 already. A lot of us will be making a push in the fourth quarter to complete transactions and the like. Enjoy the Fall, whatever part of the country you are in. I look forward to seeing many of you soon.

Jeff Gerrish *and* *Greyson Tuck*