# GERRISH'S MUSINGS

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

June 29, 2018, Volume 371

Dear Subscriber:

Greetings from Minnesota, Wisconsin, Illinois, Tennessee, Georgia, Florida, Louisiana, and Michigan!

## LET'S DO THINGS DIFFERENTLY

We received a couple emails in the last couple of weeks about clients who were looking to engage our firm to facilitate their strategic planning but wanted to do things "differently." They had previously used facilitators who had either been so "by the book" that they were in a rut, or the session had simply turned into some kind of "entertainment" session. They wanted to take a different approach. Surprisingly, I suggested a focus on the substantive strategic issues, not on the entertainment, past history, or operational and tactical questions, and they decided that was a good direction. We will see how it goes.

## HOW BIG IS TOO BIG?

I was recently with a board of a community bank that consisted of nearly 20 members. All directors were contributing, but still, the board generally acknowledged that it was probably "too large." As part of the executive session discussion, I asked each of the directors individually if they had any plans to retire. It did turn out that four or five of them were planning to do that, which will certainly reduce the board size down to a more manageable number. The discussion then progressed to what type of new director would be appropriate to bring on and whether it would be necessary to have overlap with the director going off and the new director coming on. The group discussed at some length the characteristics of the ideal director -

---

skillsets, personality, and the like - and then decided that the size of the board probably made overlap unnecessary. In other words, once the board identified a good candidate, the new director could simply serve alongside the other well-seasoned, well-trained directors and be brought up-to-speed without needing to overlap with the director being replaced. Good decision.

## MERGER OF EQUALS?

More talk of mergers of equals. I was recently with a bank that did not want to "sell" but they did want to do a "merger of equals" with a like-sized and like-minded institution. I began to inquire along some of the traditional lines. How is this merger of equals going to work? Who is going to run the company? Where is the world headquarters going to be located? What is the name of the resulting company going to be? Who is going to sit on the board of directors? How much will each of the legacy shareholders own of the resulting company?

The Chairman with whom I was visiting did not have any really good answers to any of those questions. I suggested to him that he begin to explore those questions before ever worrying about the ultimate question of pricing. In other words, let's work out the social issues first before we get to the financial issues, which are much more objective. Most mergers of equals fall apart over discussions of social issues. Each side typically wants to engage in a merger of equals as long as they are the "more equal" partner. We will see how this one goes. Generally, if the social issues are worked out, the financial issues are pretty easy to come together. I will let you know.

## CORPORATE DOCUMENTS

We have mentioned in *Musings* over the past several months that we believe it is a good idea to have your community bank and holding company corporate documents reviewed, particularly those that have not been "tuned up" in a long time. We have been reviewing many of our clients' corporate documents, which includes primarily the holding company Articles of Incorporation and Bylaws, as well as the bank's Charter and Bylaws. We have found that many of these documents need to be improved. Either they were created so long ago that they do not reflect the modern state of corporate governance, or they simply fail to include items such as how to call a special shareholders meeting, how to get rid of a director, how to properly raise business at a shareholders meeting, etc. It is not a lot of heavy lifting (or expense) to have this done. Your bank and holding company should think about it.

  

## ASSUMPTION OF TARGET DEBT

We were recently in a meeting with a group of community bankers to discuss a potential acquisition opportunity. The meeting was typical for its kind. We met in person to allow for introductions of the parties and to allow each party to better understand the other and the proposed transaction. As we discussed the transaction, an issue came up that is fairly common - assumption of the potential target's holding company debt.

One of the tenets of the transaction proposal is for the acquirer to assume the target holding company's Trust Preferred Securities. The interesting part of the discussion, which is not all that uncommon in this situation, is whether the assumption of this debt should count as part of the "transaction consideration." Our view on this is yes - the acquirer's assumption of the target debt should be considered by the target as part of the transaction consideration. At some point after closing, the acquirer is going to have to come out of pocket with cash to pay off the debt, just the same as they have to come out of pocket with cash to pay the transaction consideration.

In our minds, this is not much different than assuming a mortgage when you buy a home. If you purchase a home by giving $400,000 cash to the seller and assume the seller's $100,000 mortgage on the home, our view is that the seller has received a $500,000 benefit in the transaction. That's the total purchase price.

## DOES EVERYBODY WANT ONE?

Does *everybody* want a small bank? Apparently a lot of people do. We have received yet additional calls from people with $10 million or $15 million in their pocket that are chomping at the bit to write a check for a small bank just to obtain the charter. Historically, these types were mortgage bankers looking for a cheap source of funds. Now, they are other creative entrepreneurs who, for the most part, do not understand what they are asking for. Most notably, they do not fully understand the regulated banking environment. We still search for the small charters to provide them the opportunities as we, for the most part, watch them walk away. If anybody knows of a small charter available (a bank less than $50 million in total assets) please let us know.

  

## TRANSACTION SPEED

A common question in an acquisition transaction relates to the timing of the transaction. Acquirers, particularly those that have not been through the process before, want to know how long the process will take. The reality is there is no standard transaction speed. Some transactions happen very quickly. For instance, we will close in the next couple weeks a transaction that came together in early May. We also expect to close sometime in the next couple months a transaction that has been working for almost a year. The former is certainly a quick timeframe, and the latter is a little bit on the slower side.

Ultimately every transaction seems to take on a life of its own. Some move rather quickly, while others take a little bit longer than anticipated.

## THE ROADBLOCK

I was recently with a high-performing bank (with a good young management team and excellent board of directors to boot) facilitating a discussion as to what to do with the bank's life. Unfortunately, there was one characteristic of this particular bank that really served as a roadblock for strategic decisions. Roadblocks can be anything from lack of management, to lack of capital, to contingent liabilities, to other issues that may stop a bank in its tracks until they are resolved. This particular bank had one of those. Removal of the roadblock was paramount to any type of strategic initiatives. My encouragement to the board was to work toward addressing the roadblock to free up the bank to make appropriate strategic moves for the future. We will see what happens.

## THE DAY IS FINALLY HERE

I recently had an interesting discussion with a community bank CFO. He emailed me and asked if we could set up a discussion to talk about stock repurchase transactions. I, of course, was happy to have the discussion. When we had our call, the CFO essentially said the day they have been anticipating for a long time is finally here. He then went on to explain how the holding company has an aging shareholder base, and some of the larger of these shareholders are beginning to look for liquidity in their stock. There is no real market liquidity, so the holding company is looking to act as the source of liquidity for these shareholders.

I told the CFO I saw two real upsides here. The first is that the holding company has been aware of this and expecting it for some time. The second is that they are set up perfectly to be able to accommodate these shareholders' needs. This particular bank has plenty of capital and no bank holding company debt. Its asset quality and earnings are good, so it can use whatever "excess capital" exists in the organization and/or bank holding company debt to provide these shareholders the liquidity they need.

This is not an uncommon situation in community banking today. If you have not done so already, my strong suggestion is that you take a look at your shareholder list and get an idea for what type of liquidity needs may be coming towards you in the near future.

## ESOPs vs. KSOPs

We have recently been assisting a board of directors in evaluating the implementation of an Employee Stock Ownership Plan. This particular community bank is looking to implement the ESOP in order to improve their stock liquidity and to provide their employees share ownership and the ability to participate in the increase in the value of the corporation. The board has been kicking around whether they ought to implement the ESOP as a "plain vanilla ESOP" or whether they ought to structure it as a KSOP, which is an ESOP with a 401(k) feature.

There really is not a major difference between an ESOP and a KSOP except as relates to the possible sources of funding (other than leverage) for the purchase of the shares. In a plain vanilla ESOP, all of the cash used to purchase shares for the benefit of the ESOP participants comes from the bank in the form of tax deductible contributions. In a KSOP, the source of cash is both the bank tax deductible contributions and the employee elective deferrals in their 401(k) account. In other words, a KSOP essentially adds the holding company's stock to the menu of available investment alternatives for the employee 401(k) plan where an ESOP does not.

This is this particular bank's first foray into this type of program. What I expect will ultimately happen is that the bank will implement a plain vanilla ESOP, which will be set up to be converted to a KSOP at some point in the future. This makes sense in this situation, because it allows the company to proceed at an appropriate speed for them.

## CONCLUSION

It is hard to believe that it is the end of the second quarter of 2018 already and nearly the 4th of July. We thank all those of you who have served our country with pride and distinction. A safe, happy, and healthy 4th of July to all!

See you in two weeks.

*Jeff Gerrish* *Philip Smith* *Greyson Tuck*