GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Tennessee, Wisconsin and Florida!

GERRISH McCREARY SMITH NEWS

As many *Musings*' readers know, I formed the firm of Gerrish & McCreary in 1988. One of the partners at that time was my long-time business partner and friend J. Franklin McCreary. Frank and I had been together three or four years before that and carried over into the new firm. Shortly after the firm was formed, we hired a young lawyer/consultant named Philip Smith. Ten to 15 years after that we amended the name of the firm to Gerrish McCreary Smith. My long-time business partner Frank McCreary has now decided to retire (retiring his number is the way I refer to it). As a result of that, and as a result of my newest up and coming partner Greyson Tuck, we are amending the name of the firm to Gerrish Smith Tuck effective the 1st of January or so. Many of you know Greyson personally since he has done work for your community bank. You also know that Greyson has helped me with *Musings* for the last couple of years or so. Greyson fits in the category of "I always like to hire somebody smarter than I am." As I have been told, it is getting easier these days.

Anyway, this is just a way to get the *Musings*' readers up to date on what is happening in our firm before we email the masses. Keep in mind that our firm's tagline is "The Client's Needs Come First," and there will be no changes in service, quality, personnel, or anything else other than the change of the name. Please congratulate Greyson at your convenience.

APOLOGY FROM AN INVESTMENT BANKER?

As I put in prior *Musings*, a couple of our clients have received unsolicited inquiries or offers in the last month or so. One of them last week really stuck out. First of all, you would not think the week before Christmas a purchaser would give a community bank an unsolicited offer. Second, you would not think the week before Christmas they would give you an eight-page letter of intent along with this unsolicited offer. The third thing that struck me about this is that these two institutions had very little communication with one another prior to the time the lengthy letter of intent was received by our client's (the target) Board of Directors.

We put our "financial advisory" hats on, looked at the unsolicited offer from a financial point of view, and determined it was not something our client needed to accept. I conveyed that back to the investment banker working for the other side. I also told him that it really aggravated our client to get such a detailed and lengthy offer without at least a little bit of "courting" ahead of time. He understood and apologized. He said he had some bad information that the board may have been expecting the offer and his client just wanted to cut to the chase.

I told him he had probably "poisoned the well" on this one and they just needed to back off. He apologized and agreed. An apology from an investment banker? Wow!

THE FAMILY-OWNED BANK

I spent a good amount of time this week on lengthy telephone discussions with the chairman/owner of a high-performing, family-owned bank. This owner is approaching retirement age and enlisted my assistance in making the transition to his adult children. He owns 100% of the bank, so he can do what he wants as a practical matter. That said, he also does not want to destroy an asset he has created over the last 40 years by giving it to the kids who cannot handle it.

We are working on a transition plan. As you can imagine, the adult children are different in their perspectives. One of them wants to run the bank. The other one is artsy, is good at marketing, etc., but has no clue what a financial statement looks like. From our brief discussions, it is pretty obvious which one we are going to target to move into the senior management slot.

The issues that are facing this particular owner/CEO are not unusual for family-run banks. Fortunately, he has two adult children that are interested in staying in the bank. Many of the family-owned banks we deal with have none, which means they basically will sell the institution because it is not likely that the majority owner is going to allow someone else to manage his investment if he is not on the scene on a daily basis. Also, the issue of stock ownership needs to be addressed. In this particular situation, most of the stock is still with the chief executive and his wife and needs to be dribbled via an appropriate estate planning method to the adult children eventually. I say eventually because I am aware of several (or more than a handful) situations where the parents have given the stock to the kids and the kids have immediately turned around and kicked the parents out of the bank. Not a real good result.

SHARE LIQUIDITY ISSUES / THE TRUMP EFFECT

For those of you *Musings*' readers who might be interested, I have done a couple of recent blogs for *Banking Exchange (http://www.bankingexchange.com)* on the Trump effect on the future of community banking. My general conclusion is that it is likely to be positive. I think it will have somewhat of a dual-edged effect on mergers and acquisitions. As mentioned in prior *Musings*, it has caused a number of banks who may have contemplated selling to hold out and see what happens. It has also caused the stock prices of larger banks to increase, which gives them better currency to use to make a higher priced offer, which has moved them into the buyer category.

Share liquidity for the typical community bank will also be an enhanced issue in 2017. Assuming that the tax rates drop – certainly the corporate income tax, the personal tax rate, and possibly the capital gains rate – then it is likely that shareholders who may have been holding onto their stock to avoid a large tax may be willing to sell in a new tax environment. Because of that, it is important that each community bank have some plan for share liquidity going forward. After all, our job is to enhance the value for our shareholders, and one of those criteria is to set up a mechanism where a shareholder can sell a share of stock (or lots of them) at a fair price when they want to. Because most community banks do not have true market liquidity, there needs to be a mechanism set up to create liquidity for our shareholders. I anticipate this will be a more pronounced need in 2017 and beyond.

Begin to think about it now.

STAY BONUSES

In every acquisition we did in 2016, the issue of stay bonuses for employees or Change in Control payments for senior officers came into play. No matter what you hear, in this environment those payments are generally considered a reduction in purchase price by the purchaser. This is primarily because the price, as a practical matter, in most of the agreements is tied to maintaining a certain level of capital and a multiple of that level of capital. The excess capital comes out normally through an extraordinary dividend or distribution. So if you pay your employees $1 million to stick around to get the deal done, then that is a $1 million reduction in the purchase price.

My recommendation to you is not to look at stay bonuses as a hindrance simply because it serves as a reduction of the purchase price. After all, stay bonuses and Change in Control payments are simply used to protect the deal. When you make a deal with a buyer to buy your bank, the purchasing bank is buying your bank for its personnel, not its fancy buildings. If those personnel are not there or leave prior to closing, then the seller risks the possibility of having a material adverse change in the transaction that could kill the deal completely. Stay bonuses are not just a reward for loyal employees in the hope they stick around. Stay bonuses are critical to holding a deal together until it gets closed.

Two dynamics are at work here. During the term of the stay bonus (i.e., how long it takes the deal to get closed), the purchaser can do whatever it has to do in order to encourage those employees to stay around after the transaction. The second thing is once the transaction closes, assuming it is for cash, the selling community bank frankly does not really care whether those employees stick around or not (in a stock deal, you will think differently, but in a cash deal, you get your cash and walk away).

If you are in an acquisition transaction, do not begrudge stay bonuses. They help you get the deal done.

A BANK FAILURE RELIVED

We are currently assisting one of our clients through a strategic merger with another community bank. One of our client's directors was an executive officer at a bank that failed seven or eight years ago. This individual has been serving as a member of our client's board of directors for an extended period of time, and the regulators have never raised any issue concerning this individual's service on the board. That recently changed. The regulators are holding the application to merge the two banks hostage until this individual is removed from the board of directors. The regulators have indicated they will not approve the transaction of the merger of the banks if this former executive officer of a failed bank is to continue as a director.

It is interesting to me that the regulators have had no issue with this individual serving as a director of the stand-alone institution for a number of years. However, they are taking issue with him serving as a director of the combined institution.

INTERESTING ACQUISITION ISSUES

We are currently assisting one of our clients in acquiring another community bank. The target bank is in what I would describe to be a seriously troubled condition. They have regulatory, asset quality, and earnings problems.

Our client submitted a non-binding Indication of Interest for the acquisition of the potential target a couple months ago. This Indication of Interest relied on the seller's assurances that they had their profitability issues under control and would be able to operate the bank at essentially a breakeven level moving forward. That has ultimately proved not to be the case. The target bank continues to lose a lot of money each month. The purchase price that was contemplated in the original Indication of Interest, which the seller had still not accepted, no longer makes sense. We are currently working with our client and the seller to try and put the deal together in a way that makes sense for everyone. I hope we are able to make that happen, because if we do not somebody will be buying this bank from the FDIC.

DON'T FORGET THE SECURITIES LAWS

Over the past couple of weeks we have helped several clients through some year-end tax planning related to the purchase and sale of holding company common stock. We have several different directors and officers that are looking to either buy or sell shares prior to the end of the year. If you are considering doing the same, keep in mind there are a number of applicable securities laws and regulations that must be followed.

The most important thing to keep in mind is that as a director or officer any shares you own are considered "control" securities. It is also possible that the shares you hold are "restricted" securities, which are shares acquired through any means other than a sale of common stock that is registered with the SEC. Any time control or restricted securities are sold, the sale must comply with SEC Rule 144. This rule places certain limitations on the volume, trading price, sale timing, and the like. Please let us know if you have any questions or need additional information regarding SEC Rule 144 or the other issues associated with the purchase or sell of restricted or control securities.

TAKING SECURITIES LOSSES

I recently received an email from a client indicating their bond portfolio manager recommended the bank sell a number of securities at a loss to take advantage of the losses in 2016. The portfolio manager's reasoning was that corporate tax rates are going to fall in 2017 after the election of Donald Trump, and the losses are more valuable today with higher tax rates than they will be in 2017. Our client's major concern was how the regulators would view this type of strategic action. They were concerned that their regulators would criticize their profitability if they took these losses. My advice to the client was not to have too much concern on that particular issue. This bank has good profitability, and if they take some strategic losses in the bond portfolio to take advantage of higher tax rates, the regulators will be understanding of that. The important thing is that the regulators understand the bank's board of directors and management thoroughly thought through this decision and understood its ramifications.

CONCLUSION

I hope all *Musings*' readers had a wonderful Christmas and/or Hanukkah season. I also hope all of you will have a very safe New Year. Look out for the intoxicated drivers (and please don't be one). You are too important to your banks and your families to run the reputation risk associated with a New Year's Eve event.

Have a great New Year's Eve and Day. Enjoy some football. See you in two weeks.

Jeff Gerrish *and* *Greyson Tuck*

