
M&A: DON'T BYPASS DUE DILIGENCE--EVEN IF YOU'RE A SELLER

Even selling for cash demands due diligence

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As noted in previous blogs, the merger and acquisition wave is beginning to come ashore. I've dealt previously with the five common mistakes of buyers and five common mistakes of sellers. And yes, there are many more than those on both sides, preliminarily dealing with due diligence. So I thought it would be appropriate to deal in more depth with the entire issue of acquisition due diligence.

A board of directors whose strategic goal is to acquire another institution or a branch often finds itself with a bias toward acquisition. This generally means that the board assumes things are "OK" with the deal before due diligence is even conducted, let alone completed.

Even the board of directors of the seller often does not contemplate the need for thorough due diligence. This is when they are selling their bank and holding company to a larger public, SEC-reporting, NASDAQ- or New York Stock Exchange-listed company, and receiving stock in exchange, or when they are selling their bank and holding company to either a public or private company for cash.

What surprises most of the boards is when you advise them that in all of those circumstances, due diligence is paramount.

Buy-side due diligence

If the bank holding company is operating on the "buy side," due diligence is simply designed to provide the buyer with confirmation that the public or other private information received is accurate, i.e., it really reflects the condition of the bank and its holding company. (Private material is subject to a Confidentiality Agreement.)

There are generally 12 typical areas of due diligence that an acquiring bank will review in detail. These include:

- • Legal, e.g., material contracts, corporate documents, securities filings, etc.
- • Compliance, e.g., fair-lending, unfair and deceptive practices reviews
- • Credit, e.g., loan review, allowance methodology calculation, quality of lenders, quality of loan administration
- • Bank information systems
- • Service center operations
- • Properties, e.g., condition, environmental issues
- • Risk management, e.g., insurance
- • Internal audit, e.g., tax returns, financials, board package
- • Human resources, e.g., benefit packages, obligations to retirees, compensation plans, change in control payments
- • The core bank, e.g., operating expenses, account data, and the like
- • Investments
- • Trust activity, if any

Sell-side due diligence

Most buyers realize the importance of due diligence. Often, the sellers do not.

Whether you are a buyer or a seller, due diligence of the other party is critical. If you are a seller to a public company for stock, then your shareholders become a partner with that company. That's because they are receiving, in all likelihood, a significant amount (and value) of the seller's shares. For that reason, your bank will want to do a due diligence of that public company.

The due diligence of that public company is significantly different than the due diligence that it may conduct of you as a target bank. The due diligence of the large company typically involves an interview with the top officers; the outside accountants; outside law firms, review of the SEC filings; review of the Board Minutes; examination reports (yes, they are reviewed); and the like.

If your bank is selling to another bank for cash, due diligence is also required.

Surprised? Frankly, it's because you want to make sure the purchaser has, or can raise, the cash. That, and to be sure that the purchaser can obtain regulatory approval without unacceptable conditions or conditions that may slow the transaction significantly.

A necessary exercise

Due diligence is primarily the area that everyone "loves to hate" in acquisition transactions.

It can result in the deal breaking up, in the price being adjusted, in people being unhappy because they thought they had a deal, and the like.

Do not ignore it just because it is may be difficult or unpleasant.

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