

## GETTING YOUR BANK READY FOR INCREASED M&A

First in a series about community bank consolidation, for all players

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How long have folks been predicting a wave of community bank mergers? How should you be preparing for it?

This is the beginning of a series of blogs on community bank merger and acquisition issues. I will discuss the issues of buying, selling, or remaining independent; how to respond to an unsolicited offer; how to know if the price your organization is receiving is "fair"; or if you are buying, how do you know you are not overpaying for the target; and the importance of due diligence.

I will also look at these issues: what steps to follow if you actually are looking for a purchaser for your bank; what steps to follow if you are looking to acquire another bank; what kind of documents would you expect to see; and what integration issues you'll face if you actually buy a bank.

And we'll also consider where your professionals fit in, as mergers and acquisitions occur.

But let's begin at the beginning.

Which side of the desk will you be on?

The place to start, however, is to create the fundamental strategy decision as to whether the bank and its holding company will be a buyer, a seller, or a long-term independent organization subject to the receipt of an unsolicited offer.

First of all, understand that I do not want anything I put in any of this series of blogs to encourage any community banker to sell their bank.

I am passionate about community banking and believe there is a long-term place for community banking in the financial services industry. I am also a realist and realize there are circumstances where banks will sell.

Three major seller inducements are present today:

- • "The usual suspects": Community banks are currently deciding to sell or merge for all the traditional reasons, i.e. no management succession, no board succession, no share liquidity, too little cash flow coming off the shares, not enough return, no family succession in the family-run bank, no way to make share ownership transition effectively, and the like.

- &bull; "The no-choice scenario": Some community banks are selling today because they have to. There are still close to 800 banks on the FDIC troubled bank list, meaning that they are significantly capital impaired. The only source of capital for those banks, if any, is likely a sale. Or there's recapitalization from another organization or group, which amounts to a sale.

- &bull; "The exhaustion scenario": The third category of sellers in this environment is a new one. It is bankers and boards who have "had all the fun they can stand," notwithstanding the modest, by historical measure, pricing for their institution they could obtain.

The board's decision points

In any event, the board needs to decide on its fundamental strategy.

Does it attempt to expand, grow assets, and grow through the acquisition of another bank? Is it time to let somebody else try to do a better job for your shareholders than you can do? Or is the board's strategy simply to remain independent subject to the receipt of an unsolicited offer?

The strategy of "independence" at all costs is not a strategy within the fiduciary duty of board members.

You can only play the die hard if you and fellow board members are the bank's sole shareholders. Even a strategy of

independence has to be subject to the receipt of an unsolicited offer, at which point the organization must do what is right for its shareholders. (I will deal with the unsolicited offer issue in a subsequent blog.)

In any event, the board needs to fundamentally declare its strategy.

Starting as you mean to go ... or go

In the declaration of a strategy, it will decide the basis of long-term plans for the organization, its access to capital, its human resources, i.e., does it have the ability to do an acquisition, its market area, and dozens of other things we assess for our clients when they are trying to determine the strategy.

The board needs to determine a strategy, however.

- &bull; If the strategy is to sell, then I will address in a later blog, as a practical matter, how that occurs.
  
- &bull; If the strategy is to buy, then a number of issues will be addressed.

- &bull; If the strategy is to remain independent, then management and the board need to fully understand that the way a community bank stays independent is to "earn" its independence. That is through financial performance. The board must provide better return for its shareholders than they could get with an alternative investment.

My "independence test"

There's intent, there's wishful thinking, there's hope, and there's reality.

My test for whether or not the bank is enhancing shareholder value consists of four parts:

1. Are earnings per share growing at a reasonable rate (8% to 10% a year)?

2. Is the return on equity north of 10%?

3. Is the bank providing liquidity for its shareholders, i.e. the ability of a shareholder to sell its shares at a fair price any time they want?

4. Is the bank providing reasonable after-tax cash flow to the shareholder?

To remain independent, the community bank will need to understand all of the above issues.

Ultimately, the board's real job is to determine whether the bank and holding company can do a better job for its shareholders than receiving the stock or cash of another institution.

You can also catch the article, "Don't slouch towards sale: Put your bank's best face forward for buyers" in the ABA BJ November 2012 Digital Magazine.

#### About Jeff Gerrish

Jeff Gerrish is chairman of the board of Gerrish McCreary Smith Consultants, LLC, and a member of the Memphis-based law firm of Gerrish McCreary Smith, PC, Attorneys. He is a frequent contributor to ABA Banking Journal and ABA Bank Directors Briefing, and frequently speaks at ABA events and telephone briefings.

Gerrish's consulting and law firms have assisted over 1,500 community banks in all 50 states across the nation since their formation in 1988. Gerrish formerly served as regional counsel for the Memphis regional office of the FDIC and with the FDIC in Washington, D.C. with nationwide responsibility for litigation against directors of failed banks. Currently, Gerrish's practice involves mergers and acquisitions, strategic planning, capital raising, and general consulting with community financial institutions

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