

COMMON MISTAKES OF BUYERS AND SELLERS IN AN ACQUISITION

Through the unique combination of our consulting firm and law firm, we have been fortunate to represent both buyers and sellers in the merger and acquisition process from an investment banking, consulting, business advisor and legal advisor standpoint. During 2006, Gerrish McCreary Smith was the only company ranked as both financial and legal advisors among top firms. However, from that unique perspective, there are some common errors we see being made by both buyers and sellers. Set forth below is a summary of five of the most common mistakes made by buyers and sellers in the acquisition context. This is a "Top Ten" list you certainly want to avoid. We trust that these pointers will help you as you confront buy or sell decisions in 2007 and beyond. If you would like a copy of the full article, please email us at psmith@gerrish.com.

Five Common Mistakes of Sellers

1. Pricing expectations beyond what the market will bear. Everybody likes to think their bank is unique, their bank is different, they have a special story to tell. Everybody thinks their bank deserves the best premium ever paid "for a bank of our size with our uniqueness". As a result, many boards unfortunately begin with an expectation of value that is beyond what the market will bear. The result is often a board and

management disappointed with the amount and type of offers received (if any). Therefore, the key is to set your expectations appropriately according to current market conditions, take an objective view of your organization and engage in the process with a large dose of reality.

2. Not understanding how banks are valued.

Too often, we see institutions that look at the trade journals and see that pricing multiples average about two times book value and, therefore, simply double their equity account and assume that is the value of their organization. Nothing could be farther from the truth. Purchasers do not buy capital, they buy future earnings potential. Having too much capital as a selling institution is just as much of a problem as having too little capital if you are a buyer. A selling institution would be better off in the planning process to put any "excess" capital to better use by making acquisitions, repurchasing shares or taking other steps that get value out of that money that will otherwise be lost if it is merely excess capital in a sale.

3. Structuring a merger of equals. Let us set the record straight. There is no such thing as a "merger of equals".

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Many folks have begun with the assumption that they weren't really selling their organization, but simply engaging in an affiliation with a like-minded institution. Wrong! A sale by any other name is still a sale. We try to encourage institutions that may be thinking about some type of general "affiliation" with another institution to realize that you are either a buyer or a seller. If a board of directors does not want to sell, but is willing to consider a merger of equals, we advise them that they really do not want to sell and they should apply their efforts elsewhere.

4. Timing. Another common mistake that many sellers make is in timing. Achieving the best value for your organization may not always be a function of having the perfect organization to sell. Unless there are buyers, your perfect bank does not stand a chance. The goal is to time the market so that your bank has some "sizzle" to sell and someone willing to pay for it. Timing is about making sure your institution is in the optimum condition given market circumstances and the number of potential buyers. Maximizing value may come, not following the year in which you have your greatest earnings, but following a year in which earnings are fairly strong, there are also a number of suitors and market conditions otherwise indicate that the future may not present an equally viable acquisition window.

5. Not getting value from your professionals. Sometimes, institutions make the fatal mistake of assuming that, if they have received a few expressions of interest, they could save themselves a lot of time and money by simply negotiating on their own with the potential buyer cutting a deal and selling the institution with little professional assistance. However, professionals should add value to the overall transaction, rather than taking from the value. As an example, through our investment banking and consulting practices, we strive to provide additional value to the sellers in terms of soliciting potential buyers and working to negotiate the best deal for the client to, hopefully, drive the value up. It is a win-win situation and you should make sure you similarly get value from your professionals.

If a scenario for a possible sale presents itself, please consider these cautionary issues and avoid making these mistakes.

Five Common Mistakes of Buyers

1. Getting the board ahead of the numbers.

This might be akin to getting the "cart before the horse". Too often, we see institutions get into a "buying frenzy" and start down the acquisition road without even knowing if they can afford it, if it is a good fit geographically, strategically or otherwise. The first step should be to conduct an in-depth financial analysis to determine the price that the company or bank could pay, how it would fund any acquisition and if the transaction makes sense in terms of adding to the buyer's bottom line earnings per share and enhancing shareholder value.

2. Failure to lock up key individuals.

Too many buyers fail to appreciate the impact that an acquisition has from a seller's standpoint. Key management personnel and even general staff in an organization may be critical to its ongoing efficiency. A buyer that fails to lock up senior management through employment contracts or otherwise may find that the earnings stream it had hoped to purchase in the deal no longer exists because key producers have taken positions elsewhere.

It is also critical for a buyer to ensure that non-compete agreements exist for key personnel of the seller otherwise key management of the seller may accept their cash in the buy-out and simply walk across the street and open a new bank. Similarly, the directors of the seller should be required to vote their shares in favor of the transaction (a Joinder Agreement) and also should execute a Non-Compete Agreement.

3. Not conducting adequate due diligence.

The key purpose in making an acquisition is (or should be) to add to the buyer's bottom line. Most sellers recognize that and try to make their organization as free as possible from "warts and wrinkles" during the acquisition process. However, it is incumbent upon buyers to thoroughly conduct a due diligence to make sure that the target organization is as represented.

Buyers should make sure that the seller is free from regulatory and legal problems, that its loan loss reserve is adequately funded, future earnings potential is

COMMON MISTAKES OF BUYERS AND SELLERS IN AN ACQUISITION (CONT.)

as expected, that anticipated cost savings can truly be generated and, most importantly, a thorough “scrubbing” of the loan portfolio needs to be conducted.

4. Using the wrong method of payment. From a buyer’s standpoint, consideration needs to be given to whether a seller wants stock from a buyer, cash or some combination. In most community bank situations, the seller is only interested in cash from another community organization but might be willing to consider publicly traded stock. From the buyer’s standpoint, the buyer should consider whether any cash that is going to be paid will come from the buyer’s excess capital resources, a correspondent loan or some third party funding such as trust preferred securities. Banks should consider all of their options in order to optimize their purchasing power.

5. Why buy it if you can steal it? Too often, buyers, particularly those in the same market, may aggressively pursue an acquisition as a method of eliminating competition from coming into the market. In some circumstances, that may be a valid option. However, if the acquisition does not truly fit within an organization’s overall strategic plan, caution should be taken in pursuing an acquisition just for those purposes. The organization would be better off simply picking up or “stealing” all of the business once a new competitor does come into the market rather than paying for it on the front-end. Also, simply adding a loan production office or new branch location in an area may be preferable to buying a bank in that area.

As you navigate the merger and acquisition environment, keep these common pitfalls in mind. If we can be of assistance in helping you along the way, please contact Jeff Gerrish or Philip Smith (901-767-0900 or jgerrish@gerrish.com and psmith@gerrish.com).

RESOURCE MATERIALS

Gerrish McCreary Smith, Consultants and Attorneys, in connection with various speaking engagements around the country, have created high quality “handout” booklets. The titles for some of these publications are listed below.

All publications are available for a nominal charge. Please call or email Linda Dandridge at (901) 684-2323 or ldandridge@gerrish.com.

[Controlling Your Destiny](#) – Washington Bankers Association

[Corporate Governance: What is a Director to Do? Realities Post-Enron](#) – American Bankers Association

[Directors Responsibilities in Mergers & Acquisitions: Responding to the Unsolicited Offer](#) – The Assemblies for Bank Directors

[Directors’ Liability](#) – Arkansas Bankers Association

[Environment in 2020](#) – Community Bankers Association of Illinois

[Practical Benefits and Uses of a Bank Holding Company](#) – Western Independent Bankers

[Is Your Strategic Planning a Waste of Time?](#) – American Bankers Association

[Managing Through the Current Regulatory Environment](#) – Virginia Bankers Association

[Mastering the Mundane: Excelling at the Unusual](#) (includes discussion of general duties, mergers and acquisitions, stock redemptions, regulatory enforcement actions) – Independent Community Bankers of America

[Matters of Importance to Community Banks](#) (focusing on 10 specific issues for community banks) – Independent Community Bankers of America

[Overview of the Role of the Community Bank Director](#) – Community Bankers Association of Georgia

[Stock Ownership of Community Banks](#) – Independent Community Bankers of America

[Strategic Planning Today](#) – Independent Community Bankers of America

[10 Issues of Critical Importance for Profitable Community Banking](#) – West Virginia Association of Community Bankers

[Ten Essentials for Community Bank Directors](#) – Tennessee Bankers Association

[The Primary Role of the Director: Enhancing Shareholder Value](#) – Missouri Independent Bankers Association

[Trust Preferred Securities](#) – Independent Community Bankers of America

WHAT TO DO WHEN THE EXAMINERS COME FOR YOU

The examiners are coming! The examiners are coming! This is becoming a familiar cry from community banks that have significant investments in commercial real estate and land development loans. The examiners are clearly increasing their scrutiny of community bank asset quality, and we are beginning to see more enforcement actions regarding safety and soundness issues. So, what should you do if the examiners tell you that your bank is about to receive a composite “3” rating or worse, and may be subject to an enforcement action?

No Personal Attacks

We never recommend that our clients make personal attacks on the examiners, even if they are justified. It is easy to fall into this trap, however, because the examiners will undoubtedly be very critical of management and unfairly pile on with trivial matters once asset quality problems are identified. It is our experience that personal attacks on the examiners never work and merely undermine the credibility that the Board and management may have with the examiner’s supervisors.

Get to Work

Before the examiners leave, we recommend that our clients begin addressing the criticisms that were mentioned during the examination. If at all possible, you should try to obtain a list of those criticisms from the examiners. Then you should prioritize the criticisms, begin corrective action, and retain documentation supporting how the issue is being addressed. This type of documentation should be presented at the exit review meeting with the examiner’s superiors to build credibility

that the Board and management are on top of the issues. This additional credibility will give the Board and management some leverage in trying to negotiate more favorable requirements under any proposed enforcement action.

Obtain Outside Help

We believe that outside experts can be very beneficial in assisting community banks in minimizing the requirements of a proposed enforcement action. In addition, these outside experts can assist the bank in correcting asset quality problems and complying with the requirements of the enforcement action. We believe that it is best to employ an outside expert experienced in helping community banks with asset quality problems and negotiating enforcement actions. You should make sure that the individual has a good background in community banking, previous experience as an examiner, and a good knowledge of banking laws and regulations. Our firms have experienced banking attorneys, consultants, bankers and former bank regulators. We stand ready to assist.

SUB S STILL HOT

The reorganization of many community banks into Subchapter S status remains a hot topic for 2007. However, many organizations still do not fully understand the process. You do not have to go out and voluntarily ask each stockholder to consent. A transaction can be structured to guarantee 100% consent. Also, did you know you can eliminate stockholders who live out-of-state or do not do business with your organization? For further information about how to properly structure a Subchapter S transaction for your organization, please contact Jeff Gerrish or Philip Smith (901-767-0900 or jjerrish@gerrish.com and psmith@gerrish.com).

Please visit our web site at: www.gerrish.com
We would appreciate your feedback.



Need Merger and Acquisition Help?

CALL US - We Can ...

- Find the buyer or seller
- Run the numbers
 - Negotiate the transaction
 - Do the legal and regulatory work

ALL IN ONE STOP!

Call Jeff Gerrish (901) 684-2315
or Philip Smith (901) 684-2313

2006 M&A RANKINGS

Gerrish McCreary Smith was ranked in the top 15 legal advisors and the top 35 financial advisors in mergers and acquisitions in 2006. We are proud to announce that we were the only firm ranked in both categories!!!

Coming Soon!

Clients and Friends Insider

Gerrish McCreary Smith will soon be publishing a new monthly bulletin on key issues impacting community banks. As a companion piece to Gerrish's Musings (see page 7), the Clients and Friends Insider will provide subscribers detailed "inside information" on one or two topics monthly. Want to know how to eliminate out-of-state stockholders? Want to know our recommendation on restricted stock versus stock options? Then, this publication is for you. To get on the initial subscription list and receive the first edition FREE, contact Philip Smith at psmith@gerrish.com.



Books Available

- The Bank Directors Bible: Commandments for Community Bank Directors, 2nd Edition – A compilation of "Ten Commandment" articles for bank directors and officers on everything from strategic planning to mergers and acquisitions.
- Gerrish's Glossary for Bank Directors – A readable glossary. All relevant terms defined with a little bit of fun thrown in. A must for your bank directors.

To obtain information about purchasing either of these books, please contact Linda Dandridge at (901) 684-2323 or ldandridge@gerrish.com.

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Please address comments or questions regarding the newsletter to Jeffrey C. Gerrish, Gerrish McCreary Smith, PC, 700 Colonial Road, Suite 200, Memphis, TN 38117, or to our email address: gms@gerrish.com.

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THE NEW POLICY STATEMENT ON THE ALLL

In December 2006, the bank regulators issued an Interagency Policy Statement on the Allowance for Loan and Lease Losses (ALLL). The Policy Statement and the accompanying questions and answers should be carefully read and understood by all bank directors and senior officers. Since the Policy Statement runs about 22 pages with another 12 pages of Q and A, it cannot effectively be summarized in a brief article. So, here are some key points and observations:

- The loan and lease portfolio is of utmost importance. Loan quality will make or break your bank.
- An adequate ALLL is essential, so the profitability of your bank and the viability of your strategies can be accurately measured and evaluated. And, needless to say, bank regulators and generally accepted accounting principles (GAAP) require you to maintain an adequate ALLL.
- The Policy Statement recognizes that the ALLL is an “estimate” of credit losses, and it emphasizes that the estimate is to be “an estimate of the current amount of loans that it is probable the institution will be unable to collect given facts and circumstances as of the evaluation date”. Further, the Policy Statement says “. . . it must be probable that one or more future events will occur confirming the fact of the loss. . . . and the purpose of the ALLL is not to absorb all of the risk in the loan portfolio, but to cover probable credit losses that have already been incurred.”

The Policy Statement provides substantial guidance about how to determine the appropriate level of the ALLL and the amount of the provision for loan and lease losses (PLLL) needed for a relevant reporting period. You should study this carefully.

In addition to the responsibilities of management, the Policy Statement recognizes that the bank’s board of directors has an important role regarding the ALLL, and sets forth the following:

“The board of directors is responsible for the oversight of management’s significant judgments and estimates pertaining to the determination of the ALLL, including, but not limited to:

- Reviewing and approving the institution’s written ALLL policies and procedures at least annually.
- Reviewing management’s assessment and justification that the loan review system is sound and appropriate for the size and complexity of the institution.
- Reviewing management’s assessment and justification for the amounts estimated and reported each period for the PLLL and the ALLL.
- Requiring management to periodically validate and, when appropriate, revise the ALLL methodology.

Failure to analyze the collectability of the loan portfolio and maintain and support an appropriate ALLL in accordance with GAAP and supervisory guidance is likely to be deemed an unsafe and unsound practice, which can, at the very least, ruin your day.

Study the Policy Statement, and let us know if we can help.

GERRISH McCREARY SMITH AFFILIATED RESOURCES

Over the last 20 years or so of exclusively helping community banks across the nation, we have developed relationships with various service providers who we believe provide the best services in their particular niche. This includes branch location specialists, appraisers, fairness opinion providers, IPO managers, equipment lease sales, securities transfer agents, loan review, compliance review, auditors, executive placement and the like.

If you need any of these services and are not sure who to call, please let me know and we will provide some recommendations.

Jeff Gerrish

GERRISH'S MUSINGS

Gerrish's Musings is a twice-per-month subscription newsletter based on Jeff Gerrish's practical experiences (usually within the two weeks of the newsletter) with community banks around the country. It is designed for bank directors and officers and is "choked full" of Jeff's real life current experiences with community bank boards.

Gerrish's Musings is available by email at a nominal subscription price. For further information, please contact Linda Dandridge at (901) 684-2323 or ldandridge@gerrish.com.

VIDEOS AVAILABLE

- Directors' Duties in the Acquisition Context
- Risks for Directors Associated with the Lending Function
- Bank and Holding Company Directors' Duties in an Uncertain Time
- Corporate Governance: What Is A Director To Do?

AUDIO TAPES AVAILABLE

- General Duties for Bank Directors
- Corporate Governance
- Function of Strategic Planning
- M & A Issues for Directors
- Ownership & Structure Issues for Community Banks
- Board Meetings 101 for Bank Directors
- Using the Holding Company to Increase Shareholder Value
- Sarbanes-Oxley Update

For further information, please contact Linda Dandridge at ldandridge@gerrish.com or (901) 684-2323.

CUSTOM DIRECTOR PROGRAMS & PRESENTATIONS

In addition to facilitating numerous strategic planning retreats and proprietary director and officer training sessions, Gerrish McCreary Smith also has recently provided speakers for the following trade associations:

- American Bankers Association
- Arkansas Bankers Association
- Bank Holding Companies Association
- California Independent Bankers
- Community Bankers Association of Alabama
- Community Bankers Association of Georgia
- Community Bankers Association of Illinois
- Community Bankers Association of Indiana
- Federal Home Loan Bank of Kansas City
- Federal Home Loan Bank of Seattle
- Independent Bankers of Colorado
- Independent Community Bankers of America
- Independent Community Banks of North Dakota
- Independent Community Banks of South Dakota
- Indiana Bankers Association
- Iowa Independent Bankers
- Louisiana Bankers Association
- Missouri Independent Bankers Association
- Montana Independent Bankers
- National Bankers Association
- Tennessee Bankers Association
- Texas Bankers Association
- Virginia Association of Community Banks
- Washington Bankers Association
- Washington Independent Community Bankers Association
- West Virginia Association of Community Bankers
- Western Independent Bankers

Topics include enhancing shareholder value with or without sale, corporate governance, strategic planning, mergers and acquisitions, employee benefits, mediation and other dispute resolutions, and similar topics.

Please email us for a complete listing of upcoming conferences and seminars at which we will be providing speakers. Gerrish McCreary Smith, Consultants and Attorneys, is also available to facilitate strategic planning retreats and proprietary director training designed for your board of directors.

Please contact Linda Dandridge for further information at ldandridge@gerrish.com or (901) 684-2323.

NEWSLETTER HIGHLIGHTS

- Common Mistakes of Buyers and Sellers in an Acquisition
- The New Policy Statement on the ALLL
- What to do When the Examiners Come for You
- Sub S Still Hot
- GMS 2006 Legal and Financial Advisor Ranking

AREAS OF SERVICE

Gerrish McCreary Smith Consultants, LLC and Gerrish McCreary Smith, PC, Attorneys are committed to the delivery of the highest quality, timely and most effective consulting and legal services **exclusively to community financial institutions** in the following areas:

INVESTMENT BANKING/ADVISORY/ CONSULTING SERVICES

Financial Modeling & Analysis	Executive Compensation
Strategic Planning	Employee Benefits
Capital Planning	Estate Planning
Tax Planning	Mergers & Acquisitions
S Corporations	New Bank Formations
Going Private	

LEGAL SERVICES

Mergers and Acquisitions	Securities Offerings
New Bank Formations	Holding Company Formations
Dealing with Regulators	Director and Officer Liability
Regulatory Enforcement Action	Fair Lending
Employee Benefits	Executive Compensation
ESOPs	Federal and State Taxation
Private Securities Placements	General Corporate & Securities
Estate Planning for Executives	Probate
S Corp Formations	Going Private

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