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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Consolidation in Banking *(Pricing of Banks)*

The banking industry continues to consolidate throughout the United States, but at a much slower pace than in the past two decades and in particular since 2007. Consolidation occurs from a number of factors with banks experiencing loan and securities portfolio problems resulting in inadequate capital on one hand and the pricing of banks in acquisition transactions on the other hand. The Federal Deposit Insurance Corporation ("FDIC") reports that the number of insured institutions has declined over 40% since 1992.

In some cases, depressed stock prices for publically traded financial institutions is a factor in the decline in merger and acquisition activity because there is less buying power by an acquirer with the result that a healthy institution is unwilling to accept a lower price. Probably the most significant factor in the decline is the closure of banks by the FDIC resulting in acquirers for banks purchasing the assets of the closed bank at a modest premium of the deposits, and the FDIC entering into a loss-sharing agreement with the acquirer on potential loan and asset losses. Because of FDIC closure of banks and the utilization of loss-sharing agreements, acquirers have in some cases either excluded or escrowed problem assets in making an acquisition of a healthy bank thereby leaving the risk of collection of the problem assets with the shareholders of the acquired institution.

The number of transactions have continued to decline since 2006 when there were 275 bank and thrift transactions announced with a price/book multiple of 2.36 and price/earnings ratio of 27.87. In 2007 there were 272 bank and thrift transactions announced with a price/book multiple of 2.20 and a price/earnings ratio of 22.65.

For the four year period beginning with 2008 and ending in 2011, there were only 487 transactions announced with an average price/tangible book of 1.25. The number of transactions announced in 2011 was only 107, and the price/tangible book dropped to 1.11 compared to the 275 transactions in 2006 at a 2.81 price/tangible book. The numbers reflect that it is clearly an acquirer's market.

Although there are still acquirers for banks, they are much more selective in the acquisitions that are being made.

Prior to 2007 there had not been a bank failure since the second quarter of 2004. During 2007 there were three bank failures with the largest being NetBank located in Georgia with approximately $2.5 billion in assets and $2.3 billion in total deposits.

During 2008 there were twenty-six bank failures with the largest being Washington

Mutual Bank located in Washington with approximately $307 billion in assets and $188 billion in deposits. During 2009 there were one-hundred forty bank failures with the largest being Colonial Bank located in Alabama with approximately $25 billion in assets and $20 billion in deposits. During 2010, there were one-hundred fifty-seven bank failures with the largest being AmTrust Bank located in Cleveland, Ohio with approximately $12 billion in assets and $8 billion in deposits. During 2011, there were ninety bank failures with the largest being Superior Bank located in Birmingham, Alabama with approximately $3 billion in assets and $2.7 billion in deposits.

The FDIC reports that there are still a large number of problem institutions. Problem institutions are characterized as those institutions having a risk of failing and being closed by the FDIC.

Probably the biggest issue facing banks during the coming year will be the ability to raise capital, not only for acquisitions but for credit quality issues relating to loan portfolios and securities portfolios. Banks will need to look for alternatives for capital, one of which would be the private placement of its equity, debt or hybrid (trust preferred and noncumulative perpetual preferred) securities with local investors, existing shareholders and major customers.

Our firm is experienced and available to answer questions regarding the benefits of raising capital and the placement of securities.

Report on TARP

The Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") has released the latest Quarterly Report to Congress. SIGTARP was established as part of the Troubled Asset Relief Program Act of 2009 with the duty to conduct, supervise and coordinate audits and investigations of the Troubled Asset Relief Program ("TARP").

Under the Capital Purchase Program, the Treasury purchased either preferred stock or subordinated debentures and invested $204.9 billion in 707 institutions. The Treasury has received $185.5 billion in principal repayments and other proceeds. Of this amount, $2.2 billion came from 137 institutions that exited TARP by refinancing their TARP investment into the Small Business Lending Fund which was a subsequent program managed by the Treasury. In addition, 28 of the institutions in TARP converted $363.3 million of TARP into the Community Development Capital Initiative which was another subsequent program managed by the Treasury. There is $19.5 billion owed by institutions to the Treasury as of December 31, 2011.

The report states that TARP will exist for years with 371 banks left in TARP with no concrete plan to help struggling community banks. SIGTARP recommended to the Treasury to come up with an exit strategy from TARP for banks which would take into account different categories of banks such as permitting banks that are under regulatory orders to retain capital and repaying TARP gradually.

Following SIGTARP's recommendation, the Treasury has hired Houlihan Lokey, Inc. as a financial agent related to the management and disposition of the remaining TARP investments in financial institutions at a flat fee of $375,000 per month. In November 2011, the Treasury sent a letter to the banks remaining in TARP about the agreement with Houlihan Lokey and to explore options for the management and ultimate recovery of the investments made by the Treasury in the banks. Houlihan Lokey will be dealing with financial institutions on a case by case basis and making recommendations to the Treasury.