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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

The Federal Deposit Insurance Corporation ("FDIC") reports that the number of insured institutions has declined over 62% since 1992. As of January 3, 2019, there were 5,430 of FDIC insured institutions which reflects a decline of 233 (4%)
insured institutions since the beginning of 2018.

The banking industry continues to consolidate throughout the United States, but at a 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. In some cases, the regulatory compliance cost for small community banks has caused them to seek merger partners.

During the financial crisis, there were only 146 whole bank transactions in 2008 and only 110 whole bank transactions in 2009. The average price to tangible book was 1.1 to 1.6 during the financial crisis. Probably the most significant factor in the decline in merger and acquisition activity during the financial crisis was from the closure of banks by the FDIC resulting in acquirers for banks purchasing the assets of the closed bank at a modest premium on the deposits, and the FDIC entering into a loss-sharing agreement with the acquirer in connection with potential loan and asset losses.

The year 2018 reflected a slightly smaller number of whole bank transactions of 259 compared to 262 transactions that were announced during 2017. The average price to tangible book was 1.7% with an average price/earnings ratio of 23.8 during 2018 for whole bank transactions with disclosed terms.

The medium seller in bank transactions during 2018 had approximately $195 million in assets compared to $203 million in assets in bank transactions for 2017. The average price to tangible book was 1.6% with an average price/earnings of 21.7 during 2017 for whole bank transactions with disclosed terms.

Recent surveys indicate that the minimum asset level a community bank must achieve to remain independent is at least $1 billion or more. Because of regulatory reform and compliance costs, many community banks may be active in seeking a merger partner. Surveys reflect regulatory compliance

continues to be an impediment for growth within community banks.

Prior to 2007 there had not been a bank failure since the second quarter of 2004. The number of bank failures peaked in 2010 when there were 157 failures.

During 2015, there were 8 bank failures with the largest being Doral Bank En Espanol located in San Juan, Puerto Rico, with assets of approximately $5.9 billion and deposits of approximately $4.1 billion. Of the other seven banks that failed, each had assets of less than $294.2 million.

During 2016, there were 5 bank failures with the largest being First Cornerstone Bank located in King of Prussia, Pennsylvania, with assets of approximately $103.3 million and deposits of approximately $101.0 million. It is noteworthy that the other four banks that failed had assets of less than $67.1 million.

Only 8 banks failed during 2017 with the largest being First NBC Bank located in New Orleans, Louisiana, with assets of approximately $4.74 billion and deposits of approximately $3.54 billion. Of the other 7 bank that failed, five of them had assets of less than $166.3 million.

There were no bank failures during 2018.

The number of institutions on the FDIC's problem list declined to 71 during the third quarter of 2017. During the recent financial crisis, the number of problem banks reached a high of 888 at the end of the first quarter of 2011. Problem banks are characterized as those institutions having a risk of failing and being closed by the FDIC.

As in the past, probably one of the biggest issues 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. Our firm is experienced and available to answer questions regarding the raising and placement of capital and matters relating to merger and acquisition transactions.

Noncumulative Perpetual Preferred Stock

During the foreseeable future, capital may be the biggest issue facing community banks. Noncumulative perpetual preferred stock ("Noncumulative Preferred") is an excellent alternative for bank holding companies that need capital.

Although common stock should generally be the dominate form of capital for a bank holding company, Noncumulative Preferred qualifies as capital. Noncumulative Preferred may be issued at both the bank holding company level and the bank level in order to increase capital.

Because Noncumulative Preferred is considered a separate class of stock, Subchapter S corporations are not eligible since they can only have one class of stock. A coupon payment on Noncumulative Preferred is similar to trust preferred, and the issuer has the option to call the securities after five (5) years.

Any redemption of Noncumulative Preferred is subject to regulatory approval. Noncumulative Preferred has no voting rights and is perpetual, meaning that it has no final maturity date.

Quarterly dividends are subject to board approval and are noncumulative if not paid. Unlike dividends paid on trust preferred securities, dividends paid on Noncumulative Preferred are not a tax deductible interest expense.

Noncumulative Preferred is an excellent vehicle for increasing capital, maintaining shareholder ownership, funding

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acquisitions, stock repurchases and providing funds for internal growth. Our firm is available to answer questions on the benefits of issuing Noncumulative Preferred and the placement of these securities with third parties.

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