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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 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. This is sometimes referred to as the *good bank bad bank* with the shareholders of the selling bank retaining certain of the nonperforming assets. Some examples involve: (i) the acquisition of Southern Community Financial Corp., shareholders are to receive non-transferable contingent rights to receive payments over a five year period based on savings achieved in the collection of assets, (ii) the acquisition of South Valley Bancorp of Klamath Falls, Oregon, shareholders are to receive contingent cash earn-out payments based on collections in a pool of assets and (iii) the acquisition of Florida Gulf Bancorp, shareholders are to receive additional payments based on the resolution of certain loans over a three year period.

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. During the first six months of 2012 there were 106 transactions announced with the average price to tangible book of 1.26 during the first quarter.

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-five 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 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 Alabama with approximately $3 billion in assets and $2.7 billion in deposits.

During the first seven months of 2012, there were 39 bank failures with the largest being Tennessee Commerce Bank located in Tennessee with approximately $1.19 in assets and $1.16 in deposits. During the first five months of 2012, it is noteworthy that deposit premiums were only paid twice, and there were only nine loss sharing agreements in connection with the FDIC bank closures.

The FDIC reports that there are still 772 institutions on its *problem bank list*. 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.

Our firm is experienced and available to answer questions regarding the raising and placement of capital and matters relating to merger and acquisition transactions.

TARP Auctions

Earlier this year the Treasury Department notified the remaining 343 banks in the TARP Capital Purchase Program of its intention to exit the program through the auction of TARP securities. The auctions would not involve TARP securities held by the Treasury under the Community Development Capital Initiative ("CDCI"). It is believed that the disposition of the CDCI securities will be addressed by the Treasury at a later time.

The first three rounds of auctions by the Treasury involved the securities of 20 publically traded institutions with an average discount of 10%. In the fourth round which included 1 publically traded institution and 11 privately held institutions (3 of which were subchapter S corporations) the average discount was 18%. In this fourth round, the securities of 2 institutions were removed because the bids received were below the minimum price set by the Treasury.

During June 2012 the Treasury sent letters to approximately 200 banks of its intent to sale the securities of these institutions in pooled auctions. These banks have been given the opportunity to opt-out of the pooled auctions by making a bid to repurchase their TARP securities or alternatively, by designating an outside investor to make a bid to purchase the securities on their behalf.

 Comments, ideas, opinions and questions - email gbinns@ddh-ar.com - telephone (501) 978-9923 - facsimile (501) 375-6484.