

Value: The Community Bank Wall Street Report



ACBQ • CAPITAL MARKETS • ACB INVESTOR CONFERENCES

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Next IR Conference In NYC in November

Community bankers will have another chance to learn about investor relations and tell their story to Wall Street when America's Community Bankers' Community Bank Investor Conference returns to New York on November 1-2.

Kicking off the conference will be the Investor Relations Boot Camp, where community bankers can get practical tips to enhance communications with shareholders, securities analysts and institutional investors, and also learn about IR resources available to listed companies from NASDAQ. A panel discussion will feature buy-side and sell-side analysts who track community bank stocks.

On Day Two, ACB member banks will have an opportunity to make presentations to audiences of securities analysts, mutual fund managers, hedge fund managers and other investment professionals. The presentations will be webcast.

Companies interested in attending the IR Boot Camp and/or presenting at the November conference, which will take place at the Westin New York at Times Square, should contact Helen Sullivan at hsullivan@acbankers.org or (202) 857-3157.

Variety of Bank Strategies on Stage At ACB's Sixth Investor Conference

By John Koegel

Securities analysts and investors attending ACB's Sixth Community Bank Investor Conference in New York in May had a chance to hear a variety of growth stories presented by the participating banks.

The nine presentations represented community banks from seven states as far west as California and Oregon and south to Alabama, Florida, Georgia and North Carolina. California and New York were represented by two banks apiece.

Appalachian Bancshares

Joseph T. Moss, Jr., president and COO of Appalachian Bancshares (APAB), Ellijay, Ga., told the audience how his bank competes on service, not price, in the rapidly growing scenic mountain communities an hour's drive north of Atlanta. He explained how the three principal Georgia counties that Appalachian Bancshares serves are among the 100 fastest-growing in the United States. The bank generates customer relationship with a sales force led by a professional sales manager

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Richard D. Aldred, CFO, Fidelity Bankshares, Inc., presents to analysts at the well-attended conference.

1Q Analysis of Community Bank Earnings

By Richard D. Weiss, senior analyst,
Janney Montgomery Scott, Philadelphia



There are likely to be clear winners and losers in 2006, as banks adopt different strategies to cope with conflicting interest rate forecasts that seem to fluctuate on a daily basis. In general, the lack of spread between short- and long-term

rates has caused the industry to aggressively seek loan growth, which has intensified competition and caused even more pricing pressure. Because we don't think growth can fully overcome the lack of spread in 2006, we project earnings per share growth of only 5 percent to 7 percent for the full year.

For the quarter ending March 31, 2006, the reported median year-over-year earnings per

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who is not a banker.

"We provide value to our customers and give our employees the flexibility to negotiate fees for loans and deposits," he said. "Price is about third on the list."

Bank of Commerce Holdings

Construction and real estate loans are among the principal products of Bank of Commerce Holdings (BOCH), Redding, Calif.

To help differentiate his bank and provide a consistent message to prospective investors, Michael C. Mayer, president and CEO, told his bank's growth story by showing a presentation on DVD.

"We wanted to broaden our shareholder base by telling our story in an easily replicable manner," said Mayer. Working with an experienced audio/video vendor, Mayer wrote the professionally narrated script and oversaw the development of the 15-minute presentation.

Responding to a question from the audience, Mayer said that the DVD took six weeks to produce and cost between \$8,000 and \$9,000 – a fraction of bank's market capitalization. He added that the bank plans to update the DVD as quarterly results become available.

Fidelity Bankshares, Inc.

Vince A. Elhilow, chairman and CEO, and Richard D. Aldred, chief financial officer, told analysts and investors how Fidelity Bankshares Inc. (FFFL), headquartered in West Palm Beach, plans to gain even greater market share.

Already the third-largest Florida-based thrift, Fidelity is expanding south to Broward County, where it had an loan production office and many customers. The bank has leased a major office building in downtown Fort Lauderdale's financial district that became available after a merger of two larger rivals. In addition, the bank has opened two branches in northern Broward County that generated more than \$50 million in deposits within 30 days. "Broward has one of the country's highest concentrations of small businesses," said Elhilow, a key customer segment for the bank.

Pacific Premier Bancorp, Inc.

Steven R. Gardner, president and CEO of Pacific Premier Bancorp, Inc. (PPBI), Costa Mesa, Calif., told analysts and investors that his bank is transitioning its business model from that of a nationwide subprime lender to a diversified Southern California community bank.

"We've completed the first two phases of our transition," said Gardner, who emphasized that building teamwork among the bank's staff is essential to its future success. "We're now in phase three, diversifying our loan portfolio, developing more customer relationships and expanding our branch network in Orange County, which has one of the most dynamic economies in the state."

Gardner explained that while the bank continues to focus on multi-family apartments in urban locations, Pacific Premier is including more commercial real estate in its loan portfolio. In addition, the bank is ramping up a relationship marketing



Michael C. Mayer, president and CEO, Bank of Commerce Holdings.

program that includes cars and minivans "wrapped" in vinyl posters promoting the bank's latest product offers for retail and commercial customers.

Nexity Financial Corp.

Greg L. Lee, chairman and CEO of Nexity Financial Corp. (NXTY), Birmingham, Ala., had a different story to tell about his bank. Nexity is a correspondent bank for other community banks.

Founded in 1999 by its current management team, Nexity has 170 community bank customers throughout the southeast and Texas, including some 30 de novo banks. It buys and sells loan participations, provides fixed-income investment services and funds management programs. Nexity funds itself with "branchless deposits" via the Internet.

"At one time, community banks were comfortable obtaining correspondent services from the large regional banks," said Lee. "But today, many of those banks have disappeared through consolidation, while others have opened branches across the street."

Other Presenters, Sponsors

Also presenting were: **Columbia Bancorp (CBBO)**, The Dalles, Ore.; **Cooperative Bankshares, Inc. (COOP)**, Wilmington, N.C.; **Evans Bancorp, Inc. (EVBN)**, Angola, N.Y.; and **Flushing Financial Corp. (FFIC)**, Lake Success, N.Y.

The conference was sponsored by **Grant Thornton LLP, Meyer-Chatfield and NASDAQ.** «



Steven R. Gardner, president and CEO, Pacific Premier Bancorp, Inc.

Comparison of ACB NASDAQ with Selected Indexes

Index	YTD '06	2005	2004	Cumulative*
ACB NASDAQ	4.76	0.53	18.44	26.99
NASDAQ Composite	3.72	3.27	8.99	21.72
S&P 500	5.61	4.91	NA	NA
Russell 3000	6.46	5.98	11.94	28.08

As of April 28, 2006. Total return basis. *Since inception of ACB NASDAQ Index, 12/5/2003.

Accounting for Taxes Under Sec. 404 Not an Easy Task

By Ted Thomas, tax senior manager,
Grant Thornton LLP



One of the most re-sounding messages heard about implementation of the Sarbanes-Oxley Act's section 404 is that accounting for income taxes is not an easy task. In fact, for some of the country's largest publicly traded corporations, accurately accounting for income taxes has proved to be quite difficult. Sarbanes-Oxley accelerated filers have cited material weakness in internal control over financial reporting of income taxes more often than any other accounting area.

A review of management's reports found material weakness assessments in accounting for income taxes - about 150 to date - provides insight into the various causes of those material weaknesses. The review also provides all companies, both public and private, with valuable lessons for improving corporate tax department policies and procedures.

Resources and Oversight

Personnel, staffing and oversight issues are among the most prevalent material weaknesses in internal controls related to accounting for income taxes. In some cases, these weaknesses resulted from inadequate resources in the corporate tax department, including insufficient personnel or a lack of specific expertise, such as experience with Financial Ac-

counting Standard No. 109 or international tax issues.

Additionally, inadequate oversight or a lack of understanding by management of complex tax calculations prepared by the tax department caused material weaknesses. This type of weakness was also reported in some cases where the tax function was outsourced, with inadequate oversight of the third-party tax consultant or lack of understanding of the calculations prepared by the third-party tax consultant. Furthermore, for corporations with complex structures, lack of proper oversight in tax reporting by subsidiaries resulted in material weaknesses.

Other Material Weaknesses

The failure to properly calculate, disclose or update valuation allowances against deferred tax assets was also a frequently cited problem. Reports filed by accelerated filers revealed that inadequate management oversight contributed significantly to errors in valuation allowance calculations. In some cases, these allowances may have been properly calculated in the year the allowance was first recorded, but management failed to consider subsequent changes, such as changes in business profitability or expiration of loss carryforwards, that may have impacted the allowance in subsequent years.

Companies also disclosed several material weaknesses in reconciling information used in the provision calculation to the supporting detail, the provision cal-

ulation to the tax return filings and the amounts recorded in the general ledger to the supporting provision calculation.

A Common Theme

Even when personnel, staffing and oversight were not reported as material weaknesses in and of themselves, resource constraints in these areas likely contributed to the material weaknesses that were reported. And, it is probable that many corporations found similar issues that were graded only as significant deficiencies, and therefore, were not reported publicly. While accelerated filers may have been caught off guard by resource issues, non-accelerated filers should take notice of the significance of the control weaknesses their brethren have disclosed.

With the premium placed on specialized tax accounting resources by accelerated filers who are remediating material weaknesses and significant deficiencies related to tax resources, non-accelerated filers are well-advised to deal with those issues now. A proactive stance will go a long way toward preventing not only resource-related weaknesses and deficiencies, but the variety of control problems that accompany a lack of qualified resources.

More information is available on accounting for income taxes as part of the implementation of section 404 from Grant Thornton's Financial Industry Practice at (877) 835-1723 or financialservices@gt.com. «

Reich Says Business Strategy Influences Stock Valuations

By John Koegel

Refuting a longstanding industry misconception, John M. Reich, director of the Office of Thrift Supervision, told bankers, securities analysts and investors attending ACB's Sixth Community Bank Investor Conference that differences in stock valuations between banks and thrifts are the result of business strategies and portfolio holdings, not charter type.

"There is a lingering perception, in place for a number of years, that the thrift charter trades at a discount compared to the bank charter," said Reich. "Based on our research, the facts suggest otherwise."

Citing an "event study" conducted by OTS economists of the performance of stock prices before and after the announcement of the conversion of some high profile thrift-to-bank conversions over the past decade, Reich noted that the conversion event itself has minimal

impact on the market's valuation of an institution.

"In one case where stock price did increase after a conversion, the facts appear to demonstrate the notion that the business strategy followed by the converting institution had a far more significant influence on stock price than



charter type," said Reich. "While the market made no price correction upon the announcement of the charter flip, two weeks later it responded very favorably to a glowing earnings report bolstered by a diversified operating strategy,

implemented many months earlier, away from an exclusive reliance on traditional mortgage lending.

"In the two other cases, it appears that stock repurchase programs announced at or near the time of the conversion significantly influenced the stock price of the institutions after the announcement of the conversion and led some to believe, erroneously, that rising stock values were attributable to the charter change."

Reich also noted that a comparison between the valuation of select national banks with relatively high concentrations in mortgage assets to the valuation of savings associations found them to be trading in a similar range based on their P/E ratios.

"This is not surprising," Reich said. "The market determines valuation on an institution-by-institution basis, based on operating strategy and performance, not according to charter type." «

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share growth rates for mid-cap banks, small-cap banks and thrifts crawled to 4.0 percent, 6.8 percent and 0 percent, respectively, versus 11.2 percent, 8.4 percent and 13.7 percent, as of the same time last year for the same companies.

Despite much slower earnings growth, bank valuations have become even more expensive due to widespread belief that the end is near regarding Fed interest rate hikes, rather than an improvement in bank fundamentals. As of May 8, 2006, mid-cap banks, small-cap banks and thrifts traded at 15.0 times, 15.2 times, and 15.8 times estimated 2006 earnings. At this time last year, the numbers were 14.1 times, 14.4 times and 14.2 times estimated 2005 earnings.

Outlook

Our 2006 forecast could prove optimistic, particularly if asset quality deteriorates, which we do not envision over

the next six to nine months. Loan loss reserve levels, in general, will continue to lag loan growth. Earnings growth rates seem likely to slow further, even if asset quality does not deteriorate. If and when asset quality deteriorates, we expect that earnings volatility will increase because unallocated loan loss reserves are lower than historical averages and companies will need to reserve more at that time.

Valuation

We consider pricing multiples rich. Valuation metrics have increased from the same time last year, despite reduced earnings expectations. As of May 8, 2006, price-to-earnings multiples for mid-cap banks, small-cap banks and thrifts were between 15 and 16 times estimated 2006 earnings.

Bank and thrift stock price performance was generally strong over the first three months of 2006, despite unfavorable interest rates and generally high bank stock valuations. As of May

8, 2006, the median year-to-date price increases for mid-cap banks, small-cap banks and thrifts were 4.2 percent, 3.5 percent and 5.5 percent, respectively. These stocks have gained momentum since the end of January.

Investment Summary

Earnings challenges abound because funding costs continue to rise without a commensurate increase in the yields on interest-earning assets. Not surprisingly, net interest margins are adversely affected by the flat, or inverted yield curve; mortgage banking income is materially lower as higher shorter-term interest rates caused refinancing to drop. Higher compliance and regulatory burdens continue, but companies still benefited from low credit costs due to strong asset quality. In general, non-interest expenses were controlled and institutions with excess capital were able to help support their stock prices through repurchase programs. «

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