

Industry Update

Mergers and Acquisitions Perspective

Observations on 2003 -- Expectations for 2004

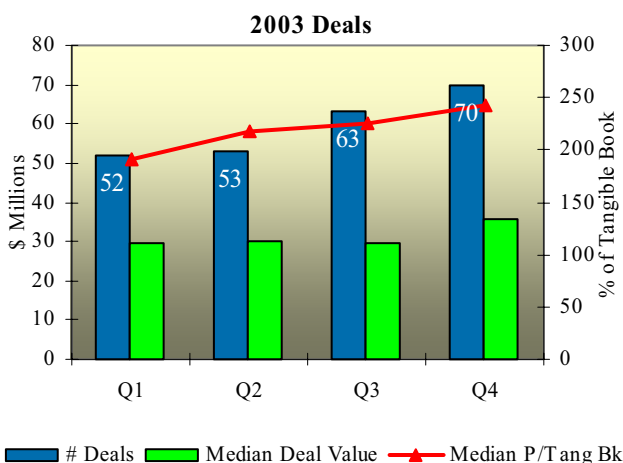
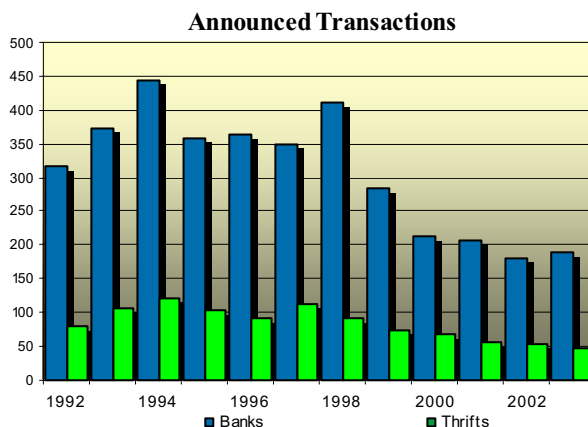
January 2004

After a rather sluggish start, the M&A market for financial institutions ended 2003 with a rally. The economy received a lift during the past year with the easing of major conflict in Iraq followed by massive amounts of fiscal and federal stimulus. In 2003, the banking industry experienced significant stock price appreciation: the average bank stock increased by 27% and the average thrift stock increased by 35%. This appreciation, combined with the easing of credit quality concerns, continued low interest rates, net interest margin compression and overall market trends, created a more active M&A marketplace for financial institutions.

TRANSACTION LEVELS SLIGHTLY HIGHER

For the first time in four years, the number of bank and thrift transactions in 2003 did not decline from the previous year and instead experienced a slight increase to 238 from 231 in 2002. Four out of five transactions involved a selling institution with assets of less than \$500 million. Institutions with assets of \$1-5 billion proved to be the most active group of acquirers, accounting for one-third of all transactions. Although the number of M&A transactions is still less than half the number seen during the period 1993 through 1998, a steady increase in both the number of transactions and pricing was evident as the year progressed.

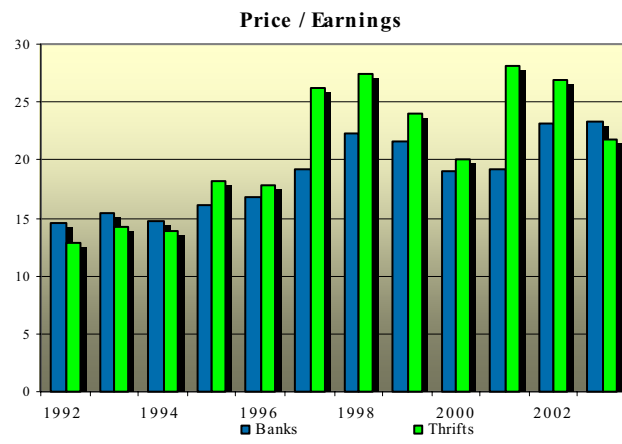
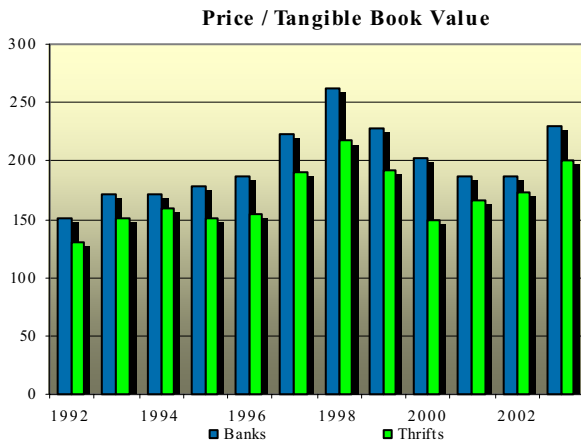
A variety of factors contributed to this quarter-over-quarter increase in the number of transactions. Bank stock prices rose steadily for the last year, which, as seen in 1996 through 1998, generally leads to an increase in M&A activity due to the increased value and buying power of publicly traded bank stocks. Under pressure to achieve earnings growth amidst margin compression and lackluster loan growth, some institutions are turning to acquisitions as the primary means to achieve earnings growth. These conditions are also influencing institutions whose earnings have flat-lined to explore a sale as a way to maximize shareholder value.



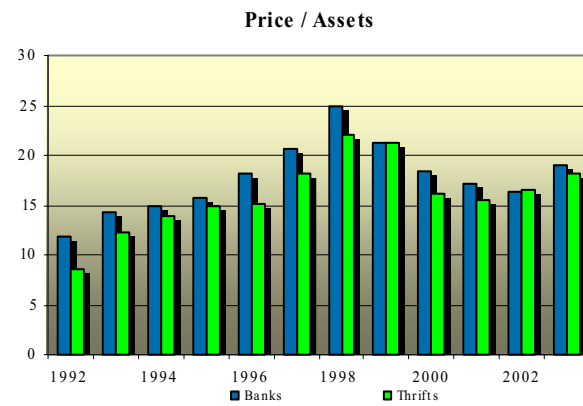
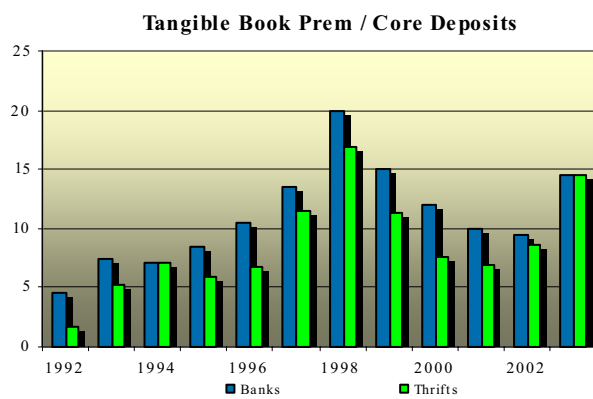
Easing economic and credit concerns are also a factor in the recent deal activity. Although a number of economic concerns currently exist, those relating to asset quality deterioration and the potential of slipping into a deflationary cycle have now lessened to the extent that institutions are more comfortable acquiring the balance sheet and credit risks of another institution.

Another factor is that the pool of buyers has recently increased in size. After spending the last few years digesting previous acquisitions, institutions that were active acquirers during the late 1990s are regaining their appetites. Some foreign institutions have also unexpectedly become active acquirers in the U.S. market, such as Rabobank, the Royal Bank of Scotland, the Bank of Montreal and the Royal Bank of Canada.

PRICING: THINGS ARE LOOKING UP



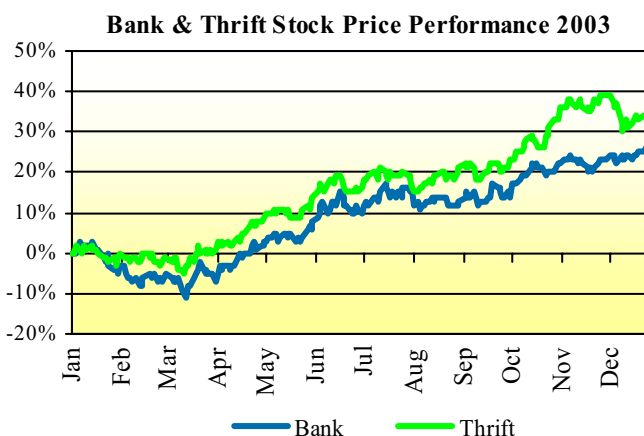
Overall pricing increased throughout the past year to a level substantially higher than seen in the three previous years. On a price-to-tangible book and a tangible book premium-to-core deposits basis, pricing is still slightly down from the levels of 1998; however, on a price-to-earnings basis, current pricing for banks (but not thrifts) is at an all-time high. Overall, current pricing is meaningfully higher than historical averages and certain markets are experiencing record pricing.



One of the primary factors underlying the recent upturn in M&A pricing is that buyers are now able to pay more to sellers. This increased ability to pay has been driven by two circumstances. First, bank and thrift stock prices rose strongly from the beginning of the second quarter through the end of the year, enabling stock buyers to pay relatively higher prices without diluting their earnings per share – i.e., the buyers’ P/E ratios were higher.

The second circumstance propelling the increase in M&A pricing is unique and rather unexpected: the current benefits of using cash as a form of consideration in deals. When

pooling was eliminated in 2001, it was assumed that M&A pricing would decline due to the fact that high deal pricing would result in post-merger charges to earnings in the form of goodwill amortization. This pricing decline did initially occur. However, an unexpected event occurred that has allowed acquirers using cash to pay very aggressive premiums: a collapse of interest rates to 45-year lows. This collapse, combined with a lack of strong loan growth, is prompting institutions to factor into their analyses a “give-up yield” of only 4% on the cash being paid to the shareholders of selling institutions.



With most acquirers having excess capital and liquidity, and with investment returns yielding only 3 – 4%, many acquirers would rather use that additional liquidity to purchase another institution. This low rate of return environment allows buyers to pay aggressive deal pricing that is still accretive to the acquirers’ earnings per share.

Buyers’ strategic rationale has also become an important factor in the recent pricing increase. The desire of institutions to achieve a certain “critical mass” drove much of the activity in the late 1990s. Now, with many acquirers having achieved that mass and the corresponding economies of scale, buyers have become more focused and selective in making acquisitions. Whether seeking a particular niche, vying for a premium franchise, or entering a market with highly favorable demographics, these buyers are paying significant premiums for institutions that “fit” properly within their strategic plan. An example of this is the acquisition of Peoples Florida Banking Corp. by Synovus Financial Corp., in which Hovde Financial acted as the seller’s advisor. Synovus wanted to acquire a solid platform upon which to build in the demographically appealing Tampa MSA market and was willing to pay a significant premium to acquire this high quality organization. As shown below, this transaction represented the highest price-to-tangible book value of the year.

5 Highest Price/Tangible Book for 2003

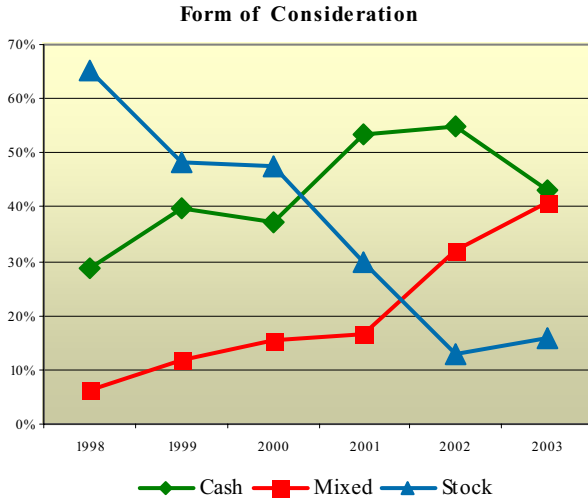
Buyer	St	Seller	St	Seller Assets	Price/Tang Bk	Price/LTM Earn	Price/Assets
Synovus Financial Corp.	GA	Peoples Florida Banking Corporation **	FL	230,664	479.88	28.18	33.65
United Bankshares, Inc.	WV	Sequoia Bancshares, Inc.	MD	523,800	435.32	24.25	21.42
Colonial BancGroup, Inc.	AL	P.C.B. Bancorp, Inc. **	FL	660,113	416.03	24.86	21.45
F.N.B. Corp.	FL	Charter Banking Corp. **	FL	645,578	391.55	36.67	23.28
Susquehanna Bancshares, Inc.	PA	Patriot Bank Corp.	PA	1,011,121	383.04	23.38	20.26

** Represented by Hovde Financial

CONSIDERATION: THINGS ARE INCREASINGLY MIXED UP

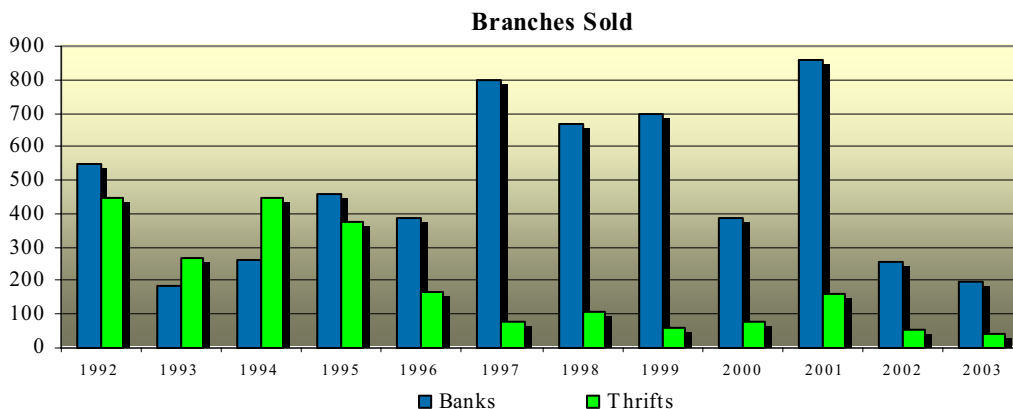
The upward trend of using a combination of cash and stock as deal consideration continued for the past year, increasing to 43% of all transactions. Prior to the recent rise in bank and thrift stock prices, many acquirers chose to increase the cash component rather than pay with what they considered to be undervalued stock. Even with this recent appreciation, cash and stock combinations are increasingly popular because of the “win-win” created for buyers and sellers alike. From a buyer’s perspective, for reasons explained above, the low interest rates provide

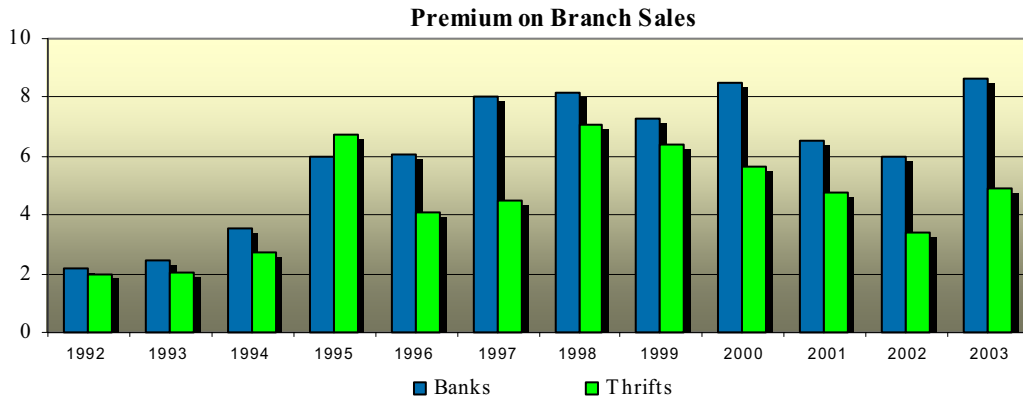
incentive to use more cash and issue fewer shares, which will result in higher levels of earnings accretion, higher returns on equity, and lower levels of ownership dilution. From a seller’s perspective, with the long-term capital gains tax rate having been reduced to 15%, receiving cash is not as onerous from a tax perspective as it was historically. Moreover, equally compelling from a seller’s perspective, is that cash provides “known economics” to a seller, as the day-to-day changes in a buyer’s stock price do not impact the nominal cash consideration a seller receives.



BRANCH SALES

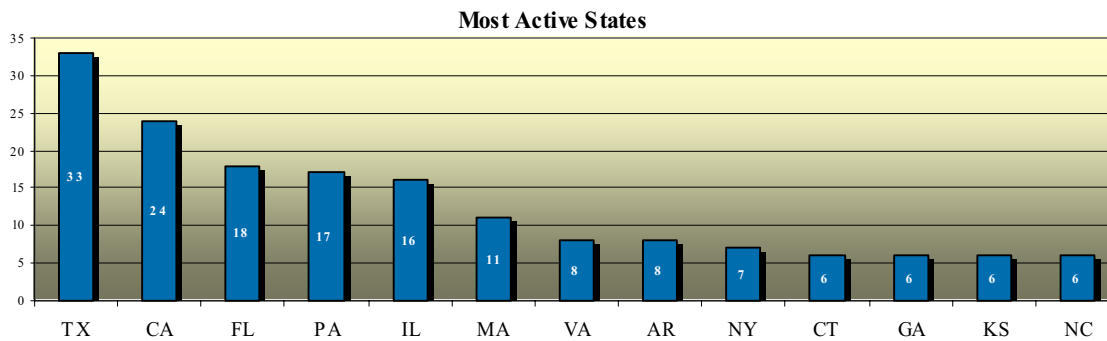
The number of branches sold in 2003 was down approximately 25% from the previous year, and the number of individual transactions hit its lowest level in more than 10 years. Premiums paid, however, were at the highest level in several years for bank branches and up substantially for thrifts over the previous year. Given that deposits are generally more valuable when loan growth is strong and interest rates higher, the current all-time high level of pricing is unusual. Factors that may explain this dichotomy include: 1) strategic buyers are paying premiums for the proper “fit”; 2) institutions that are heavily tied to the mortgage lending area and have experienced strong loan growth are paying premiums for much-needed additional funding; and 3) banks and thrifts that have become over reliant upon wholesale funding over the past five years are paying premiums to improve their funding structure.



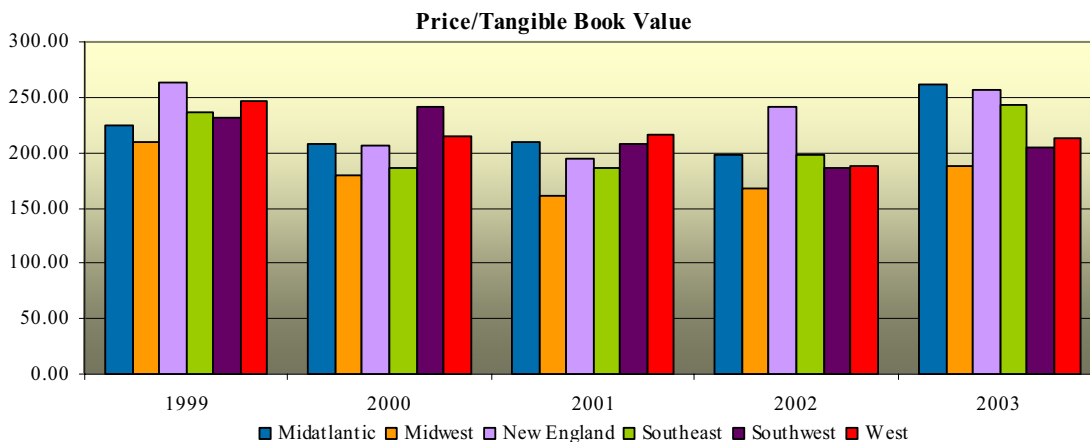


REGIONAL ACTIVITY

The most active states continue to be Texas and California, and Florida has moved back into its traditional third place. In addition to experiencing a doubling in the number of transactions compared to the previous year, Massachusetts was home to the year's largest transaction between Bank of America Corp. and FleetBoston Financial Corp.



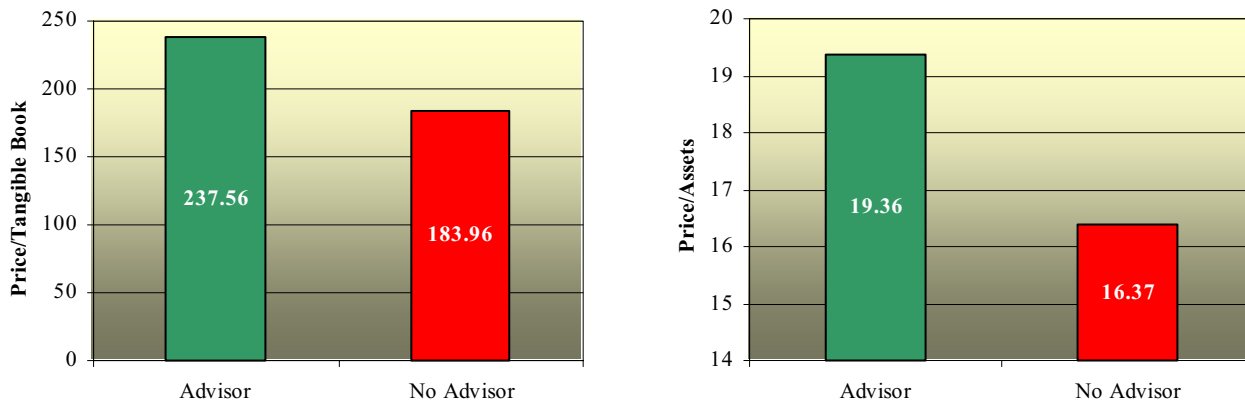
While pricing levels increased in all regions, the Midatlantic and Southeast experienced the greatest increases. Four of the year's 10 highest-priced transactions occurred in the Midatlantic region and four occurred in the Southeast.



FINANCIAL ADVISORS CREATE VALUE

For the eleventh consecutive year, financial advisors have added value. In the year 2003, sellers that chose to engage a financial advisor realized significantly more in value than those without a financial advisor. Based on a comparison of price-to-assets, for example, a \$300 million institution would have received nearly \$9 million more in value. That is nearly \$3 million more per hundred million in assets. Based on a price-to-tangible book value, sellers with a financial advisor received a price 29% higher than those institutions without an advisor. Regardless of the measurement or year chosen, financial advisors consistently add significant value. Even on intangibles such as management contracts, board representation, coverage for benefit plans and resolutions of other social issues, the objective participation of a financial advisor during the merger process can add significant value. With transactions becoming more complex and the need to identify the strongest acquirers becoming more important, the difference in value to shareholders is likely to increase.

Financial Advisor Results



2004: THE LOOK AHEAD

The surge of M&A activity in the fourth quarter of 2003 has carried forward into 2004. The historical trend for transaction levels to move in correlation to bank equity valuations indicates that increased activity is likely. Naturally, the economy, interest rates and the natural supply-demand dynamics will be key factors on the level of consolidation. The two events most able to prevent a robust M&A market in 2004 are a downturn in the economy and/or an increase in interest rates. While neither is expected in the first half of 2004, an increase in interest rates, which would affect M&A pricing because of the resulting increase in the “give-up yield” cost of cash for acquirers, becomes more likely in the latter part of the year.

Many banks and thrifts may find it increasingly difficult to meet the expectations of shareholders and board members through internal initiatives alone. As a result of excess capacity in the broader financial services industry, generating loan growth will be very challenging, especially with the recent hyperactivity in mortgage lending beginning to diminish. For some institutions, this will provide an incentive to acquire, while for others it will provide incentive to be acquired. A returning appetite for some of the aggressive acquirers of the late 1990s further increases the likelihood of a higher level of activity and, perhaps, larger transactions.

Another issue management and boards should monitor is the upcoming presidential election. Those wondering how it factors into M&A activity need only consider the potential tax consequences. With the capital gains tax rate currently at 15%, now is a particularly attractive time to sell a company for cash. However, it is well known that most Democratic candidates support a repeal of many of the tax cuts enacted by the current administration, including the reduction in the capital gains tax rate. Therefore, if whoever emerges as the Democratic challenger becomes a viable threat against Bush, it should draw into question for management and boards the potential tax ramifications of deferring a sale.

Assuming bank valuations do not decrease and the cost of cash remains relatively low, pricing is expected to remain at attractive levels. Acquirers are expected to continue insisting on a proper strategic “fit” and be willing to pay a premium for quality institutions. Pricing can change very quickly due to any number of events, however, such as another terrorist incident, various global economic occurrences that could throw the economy back into recession, or, as mentioned above, a rising interest rate environment, which would affect the stock prices of publicly traded companies and increase the cost of cash, resulting in a negative and material effect on M&A pricing. Nevertheless, for those boards and managements interested in exploring a sale, current timing is ideal.

If you would find it helpful to discuss the M&A environment for financial institutions in more detail, we would welcome the opportunity to meet with you. Please feel free to contact us in Washington, D.C. at 202-775-8109, in Chicago at 847-991-6622, in Newport Beach at 949-566-9454, or in Palm Beach at 561-279-7199.

Founded in 1987, the Hovde organization is headquartered in Washington, D.C. with additional offices in Chicago, Newport Beach, and Palm Beach. Hovde has a unique focus on the financial services industry, particularly in the areas of: Investment Banking, Asset Management, Merchant Banking, and Trust Preferred Securities.

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