Danielson Associates Inc.
6001 Montrose Road, Suite 405
Rockville, Maryland 20852
(301) 468-4884 phone
(301) 468-0013 fax

November 28, 2005

Dear Banker,

In Pennsylvania, and nationwide, new banks are more meaningful than ever as the total number of banks has decreased dramatically and most of the historic local leaders have been replaced by large out-of-area banks. As a result, new banks are increasingly the local banking alternative to the giant banks.

This enhanced role has been accompanied by capital being raised in amounts that were previously unimaginable and sale prices that are eye-catching to say the least. Initial capital raised by new banks is routinely now in excess of $10 million, and they are frequently back for more within a year or two. When it comes time to sell, many of these banks are getting prices in excess of three times book.

This report written by Arnold Danielson talks about the new banks in Pennsylvania and puts them in a historical perspective. As the report shows, the new bank "craze" of today is not all that new with the openings in the 1990s being down from the previous three decades, but with less mid-sized, local competition and extensive capital, today's new banks are not taking as long to make their presence felt.

Respectfully yours,

Dave Danielson

David G. Danielson
President

November 28, 2005

Pennsylvania New Bank Report

New Banks: More Meaningful Than Ever

By:
Arnold G. Danielson
Chairman
Danielson Associates Inc.

For more than twenty years I have been writing banking reports about the changes in the state and regional banking structures. Usually the reports have been about the spread of interstate banking, the disappearance of local banks and, for a time in the early 1990s, the battle for survival of banks and thrifts in a difficult economy. These reports almost wrote themselves each year up through 2000 as the disappearance of local banking leaders had a major impact on the local banking structure. Since 2000, Bank of America has changed the dynamics somewhat in Pennsylvania by buying Fleet, but chronicling the battle at the top between Bank of America, Wachovia, the Royal Bank of Scotland and PNC is getting a little stale, and probably of only passing interest to most readers.

So what are the interesting stories in Pennsylvania banking? Between Commerce and Sovereign, there are few dull moments, and it is unlikely PNC can persist forever in an environment increasingly stacked against it. It also is only a matter of time before the leading locally-based regional banks face the inevitable and do what their peers have done in almost every other East Coast state – take the money and run. As for the New Jersey-based Commerce, it is shifting its expansion focus to Florida and the Washington area. So, until PNC makes a move and the Sovereign saga plays out, the most interesting local banking story that does not involve speculation or rumors is the growing importance of new banks.

This is hardly a new story as bank openings and sales were much more common in the 1960s, 1970s and 1980s than in the last fifteen years, but what is different today is the amount of money involved. Since the start of 2004, the six banks that opened in Pennsylvania have raised more than $90 million. On the sales end, FirstService, Premier and First Heritage have been sold in the last three years for a combined $267 million and an average price of 311% of book. These are attention-getting numbers.

Banks opened since 1985 also are more than 40% of the independent Pennsylvania-based banks based in the southeastern portion of the state and the immediate Pittsburgh area. This growing importance of new banks is a national trend with similar numbers in nearby New Jersey and Maryland.

Historical Perspective-National

New banks have long been an important part of the American banking scene replacing tired banks that were sold with more energetic entities that usually were more in-tune with the banking needs of the time. In the 1960s and 1970s, more banks were opened than were sold nationwide, and, as a result, the number of banks in the country increased by more than 1,000 in these years – although many of the new banks in those years were opened by holding companies taking advantage of new state laws that allowed them to open separately chartered banks across county lines, but not branches. Virginia, Florida and Texas led the way with the holding company inspired new bank activity.

It was in the 1980s, though, that bank openings hit an all-time peak with 2,700 new banks commencing operations, and except in Texas, this was legitimate new banks – not holding company expansion. That decade also set a new high for mergers at 4,271, and, as a result, despite the accelerated opening of banks, the total number of banks fell by more than 1,600.

The 1990s seemed like a continuation of the 1980s relative to bank openings, but nationally there was a substantial drop in such activity. The number of new charters fell from 2,700 in the 1980s to 1,315 in the 1990s – a drop of more than 50%. Much of the decline, though, was caused by a bad banking environment from 1990 to 1993 that lowered the interest in opening banks until the late 1990s. From the beginning of 1997 through 1999, there were 614 banks opened across the country, and if they were spread across a full decade, it would have been more than 2,000 new banks.

Change in the Number of Banks, 1950 to 2002

	New Charters	Conversions	Mergers	No. of Institutions*
2000-02	412	51	1,110	7,887
1990-99	1,315	284	5,413	8,581
1980-89	2,700	205	4,271	12,715
1970-79	2,224	58	1,366	14,364
1960-69	1,552	236	1,391	13,473
1950-59	763	385	1,429	13,114

Note: Does not include failures and an FDIC classification for "other".

*End of period.

Source: FDIC: Historical Statistics on Banking.

This relatively small number of openings in the 1990s received more attention than their numbers may have merited partly because of the decline in the overall number of banks. Bank openings were halved relative to the previous decade, but the number of banks exiting by mergers increased by more than 1,000. There were 5,413 banks sold in the 1990s, which, even with more than 1,300 new banks opening and 284 thrifts converting to bank charters, reduced the total number of banks from 12,715 in 1989 to 8,581 at the end of 1999. This usually increased the importance of most new banks in their home markets.

The FDIC data on new charters and mergers only goes up to 2002, but the pattern of bank openings in the first three years of the new millennium was similar to the late 1990s. Bank sales ran ahead of banks openings by an almost three-to-one margin, but if the first three years are any indication of the entire decade, then there will be another 1,300 banks opened. It does not take a mathematical genius to see the growing importance of new banks as the banking alternative to PNC and the large out-of-state banks that account for 50% of the regional deposit base.

Historical Perspective-Pennsylvania

The new bank activity in Pennsylvania has been a little different than the national trend. The 1960s and 1970s saw minimal new bank activity, and when new bank mania finally arrived in the 1980s, it was only a prelude to even more new banks in the 1990s. Only four banks began operating in Pennsylvania in the 1970s, but there were 21 openings in the 1980s and 24 more in the 1990s. Though the first six years of the new millennium there have been 15 banks opened, and if this pace continues, there would be 25 bank openings from 2000 through 2009.

Pennsylvania Banks – New and Existing

	Banks Opened		Existing Banks	
	Total	Urban	Total	Urban*
2000-05	15	13	15	13
1990-99	24	18	12	10
1980-89	21	21	3	3
1970-79	4	4	-	-
1960-69	6	6	1	1
1940-59	n/a	n/a	2	-
1900-39	n/a	n/a	71	17
1800's	n/a	n/a	42	17
	70	62	146	61

*Southeast Pennsylvania from the Lehigh Valley to the Capital Area, including York County and the immediate Pittsburgh area.

Source: Various Sources.

Most of the new banks in Pennsylvania, as elsewhere, open in urban areas, particularly the faster growing suburbs of the largest cities. Of the 70 opened in Pennsylvania since 1960, 62 were in southeast Pennsylvania and the Pittsburgh area. This includes all but two opened since 2000.

While new banks are part of the regenerative process within the banking system, most are sold within twenty years – and often much sooner. Of the ten banks opened in the 1960s and 1970s, only one – Royal Bank – is still around. From the 1980s class of 21 new banks all but three – Commerce Bank/Harrisburg, First Republic and Eagle National – have been sold.

The trend is the same for banks opened in the 1990s. There were 12 banks opened in Pennsylvania from 1990 through 1996, and nine already have exited though a sale. All that remains from this group are United Bank, a minority-owned bank in Philadelphia; Woodlands Bank in Williamsport; and East Penn Bank up in the Lehigh Valley. Of the dozen opened in the last three years of the decade, three have already been sold.

Rising Cost of Entry

One of the things that makes the new banks of today so different from those of the past is the amount of initial capital raised – and the pressure that puts on these new banks to produce. In the 1960s, a bank could open with a capital investment of $1 to $1.5 million, and some started with less. The cost edged up in the 1970s, but only slightly to $1.5 to $2 million, and even in the early 1980s the initial capital needed was less than $3 million. This was a lot of money in those days, but far below the $10 million plus that is commonplace today.

Pennsylvania New Bank Starting Capital

2001-05	$10 to $15 million
1996-00	$7 to $10 million
1984-95	$4 to $6 million
1980-83	$2 to $3 million
1970-79	$1.5 to $2 million
1960-69	$1 to $1.5 million

Source: Various sources.

In 2004, Penn Liberty in the Philadelphia suburbs reached a new high for starting capital for a Pennsylvania bank raising about $28 million in its initial offering, but it was far from alone in raising a lot of money. Gateway Bank in the Pittsburgh suburbs raised almost $17 million in that same year, and Bucks County Bank raised $15 million.

Others opened with more modest capital, but most of them were quick to get back into the capital market to take advantage of readily available money. Embassy Bank in Allentown opened with $10 million in starting capital in 2001, but has since added another $11 million. Integrity Bank in Camp Hill supplemented its initial investment of $8.4 million in 2003 with an additional $9 million a year later.

Why this rapid rise in the initial capital of new banks reaching levels that would have been hard to imagine only a few years ago and secondary offerings that made the initial offerings look modest coming within a year or two of opening? Inflation caused most of the increase in the 1970s and 1980s, but certainly not in recent years. Some of the recent rise came via regulatory requirements and the willingness of new banks to accept much larger early losses than in the past, but that is only a part of the story since the regulators only require a new bank to have about $8 million in starting capital.

What has triggered the higher capital investment in new banks since 2000 has been a booming real estate market that facilitated rapid growth and sale prices that created investor returns that were not matched in many other areas. The trend toward increasingly large cash components in sale prices also made more money available for the next investment. Investors who have been successful investing in a new bank frequently recycle their money into the next new bank.

New Bank Sale Prices

Pennsylvania has not yet had a new bank break the $200 million plus sale barrier like a couple of banks have done in the Baltimore-Washington corridor, but what has been lacking in deal values, have been made up in the number of deals and pricing multiples. Since 1998, there have been fourteen Pennsylvania banks opened since 1988 that have been sold of which five – Pennsylvania State, FirstService, Premier, First Commercial and Ambassador – were sold at prices in excess of 300% of book. All but one was sold at price in excess of 240% of book. Four new banks sales represented by Danielson Associates in the last three years in the Middle Atlantic states – two of which were in Pennsylvania – had returns that were at least five times the original investment.

Pennsylvania New Bank Sales

Buyer/Seller	Deal Value (in mill.)	Price/ Times Earnings	Price/ Percent of Book	Year Annc'd	Year Opened
Sterlling/Pennsylvania State	$47	32.2X	307%	2004	1989
Leesport/Madison	41	21.6	245	2004	1989
Comm. Bank Syst./First Heritage	80	20.3	249	2004	1994
Harleysville Nat'l./Millennium	48	-	244	2003	1998
Univest/Suburban Community	24	28.1	252	2003	1996
Nat'l. Penn/Hometowne Herit.	38	-	268	2003	1999
Fulton/Premier	92	23.1	352	2003	1992
Univest/First County	30	-	257	2003	1996
National Penn/FirstService	95	32.5	332	2002	1995
Three Rivers/Pa. Capital	20	21.3	204	2001	1990
HSBC/First Commercial	24	17.4	300	1998	1989
Susquehanna/First Capitol	27	39.6	256	1998	1988
JeffBanks/Regent	53	-	293	1998	1989
Fulton/Ambassador	77	32.2	315	1998	1990

Source: SNL Financial, Charlottesville, Virginia.

The urge to sell appears to have slowed in 2005, but 2003 and 2004 were busy years for new bank sales in Pennsylvania. There were five new bank sales in the state in 2003, and three more in 2004. All but one was in the Philadelphia area, and that one, Hometown Heritage, was only about ten miles west of the Chester County line.

What Does the Future Hold for New Banks?

New banks will continue to sprout up as long as capital is readily available. There is no shortage of bankers that would like to run their own show if someone gives them the financial backing, and there is a real demand for banks that understand local commercial real estate markets and small business lending. As for capital availability, it will be there as long as banks are being sold for prices upward of 20 times earnings, and probably for a couple of years after pricing multiples fall as bank investors are usually slow to recognize, or even believe, there has been a downturn in sale values. Bank sale prices appear to have peaked in late 2003 and 2004, but they are holding at, or near, this level in 2005.

Since bank sale prices tend to move in tandem with bank stock prices, there should not be a big drop in sale values until economic conditions bring bank earnings and stock prices down. These are events that normally reflect rising interest rates and/or a depressed economy. Today's rising interest rate environment has done some damage to bank stock prices, but whether this impacts new bank start-ups depends on just how high interest rates go and how it affects loan demand, particularly in the real estate area.

New Bank History – Pennsylvania*

	Opened	2005 Assets** (in millions)
1963		
Bank of King of Prussia (Royal Bank)	12/63	$1,243
Commercial Bank & Trust, Pittsburgh	3/63	Sold
1964		
Three Rivers Bank, Jefferson	5/64	Sold
Lincoln Bank, Philadelphia	9/64	Sold
1968		
Commercial Bank & Trust, Pittsburgh	3/68	Sold
1969		
The Suburban Bank, Norristown	11/69	Sold
1970		
Huntington National Bank, Uniontown	3/70	Sold
1974		
Jefferson Bank, Haverford	10/74	Sold
1975		
New World National Bank, Pittsburgh	3/75	Sold
Yough Valley National Bank, Connellsville	12/75	Sold
1985		
Commerce Bank/Harrisburg	6/85	$1,450
National Bank of the Main Line, Wayne	3/85	Sold
Chestnut Hill National, Philadelphia	5/85	Sold
1986		
Constitution Bank, Philadelphia	6/86	Sold

New Bank History – Pennsylvania (Cont'd.)*

	Opened	2005 Assets** (in millions)
1987		
Eagle National, Upper Darby	4/87	$126
Commonwealth State, Newtown	4/87	Sold
First Bank, Philadelphia	7/87	Sold
Berks County Bank, Reading	12/87	Sold
1988		
Republic Bank, Philadelphia (Republic First)	9/88	$780
United Valley Bank, Philadelphia	2/88	Sold
First Sterling Bank, Devon	6/88	Sold
Founders Bank, Bryn Mawr	7/88	Sold
Security First Bank, Media	8/88	Sold
Security National Bank, Pottstown	9/88	Sold
First Capitol Bank, York	11/88	Sold
First Executive Bank, Philadelphia	11/88	Sold
1989		
Pennsylvania State Bank, Camp Hill	4/89	Sold
MetroBank, Philadelphia	8/89	Sold
Regent National Bank, Philadelphia	8/89	Sold
Madison Bank, Blue Bell	8/89	Sold
First Commercial Bank, Philadelphia	10/89	Sold
1990		
Woodlands Bank, Williamsport	10/90	$190
Montour Bank, Danville	5/90	Sold
Valley Community Bank, Kingston	6/90	Sold
Penn Capital Bank, Pittsburgh	9/90	Sold
Ambassador Bank, Allentown	11/90	Sold
1991		
East Penn Bank, Emmaus	11/91	$385

New Bank History – Pennsylvania (Cont'd.)*

	Opened	2005 Assets** (in millions)
1992		
United Bank, Philadelphia	3/92	$72
Premier Bank, Doylestown	4/92	Sold
1994		
First Heritage Bank, Wilkes-Barre	6/94	Sold
1995		
FirstService Bank, Doylestown	7/95	Sold
1996		
Suburban Community Bank, Chalfont	11/96	Sold
First County Bank, Doylestown	12/96	Sold
1997		
American Bank, Allentown	6/97	$509
New Century Bank, Phoenixville	6/97	159
Pocono Community Bank, Stroudsburg	11/97	126
1998		
Enterprise Bank, Allison Park	10/98	$124
Millennium Bank, Malvern	10/98	Sold
1999		
Legacy Bank, Harrisburg	9/99	$369
Stonebridge Bank, Exton	2/99	366
Pennsylvania Business Bank, Philadelphia	3/99	168
Allegiance Bank, Bala Cynwyd	7/99	108
Asian Bank, Philadelphia	6/99	58
Hometown Heritage Bank, Intercourse	7/99	Sold
Northern State Bank, Towanda	7/99	Sold

New Bank History – Pennsylvania (Cont'd.)*

	Opened	2005 Assets** (in millions)
2000		
First Cornerstone, King of Prussia	3/00	$264
2001		
Embassy Bank, Bethlehem	11/01	$178
Earthstar Bank, Upper Southampton	1/01	171
American Home Bank, Lancaster	8/01	159
Landmark Community Bank, Pittston	3/01	111
2002		
York Traditions Bank	10/02	$79
2003		
Integrity Bank, Camp Hill	6/03	$161
Affinity Bank, Wyomissing	4/03	96
Berkshire Bank, Wyomissing	9/03	68
2004		
Penn Liberty Bank, Wayne	9/04	$143
Meridian Bank, Berwyn	7/04	71
Bucks County Bank, Doylestown	8/04	57
Gateway Bank, McMurray	5/04	55
Clarion County Community Bank, Clarion	1/04	35
2005		
First Resource Bank, Exton	5/05	$22

*New bank is defined as a bank opened by an investor group and not an existing bank holding company.
**June 30, 2005.

Source: SNL Financial, Charlottesville, Virginia and various Polk's Bank Directory, Nashville, Tennessee.