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Small-Cap Banks

Industry Overview

SC Spotlight: De novo or Acquisition?

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Sector View:

New: 2-Neutral

Old: 2-Neutral

Investment conclusion

- In this week's Spotlight, we examine the addition of new branches in our bank coverage universe and attempt to determine the breakdown of de novo versus acquisition branch growth.

Summary

- The banks in our current coverage universe have increased their combined deposit total by 71% or 13.4% CAGR since 2000, with the median bank growing deposits 57% or 11.2% CAGR.
- At the same time commercial bank deposits have become concentrated among fewer banks, the total number of bank branches have increased due to de novo branch openings.
- By our calculation, the 49 banks in our coverage universe have approximately 33,000 active branches with a minimum \$1 million in deposits. Reviewing specific branch data from the SNL database, we determined that approximately 12,500 or 38% of these branches has either been acquired since 2000 or been organically opened since 2000.
- Our calculations show that approximately 80% of the new branches for the tickers in our universe are a result of acquisitions that occurred since 2000. The majority of these additional branches are a result of several acquisitions that occurred in 2004.

In this week's Spotlight, we examine the addition of new branches in our bank coverage universe and attempt to determine the breakdown of de novo versus acquisition branch growth.

Bank Deposits Becoming More Concentrated

The banks in our current coverage universe have increased their combined deposits total by 71% or 13.4% CAGR since 2000 with the median bank growing deposits 57% or 11.2% CAGR. Some deposit growth has come organically, but the majority has come through industry consolidation. Indeed at the end of 1Q05, the 49 banks in our current coverage universe held 63% of all commercial deposits compared to 50% at the end of 2000. Large-cap mega deals like BAC/Fleet and JPM/Bank One make up a large portion of the pickup in deposit consolidation of our current universe.

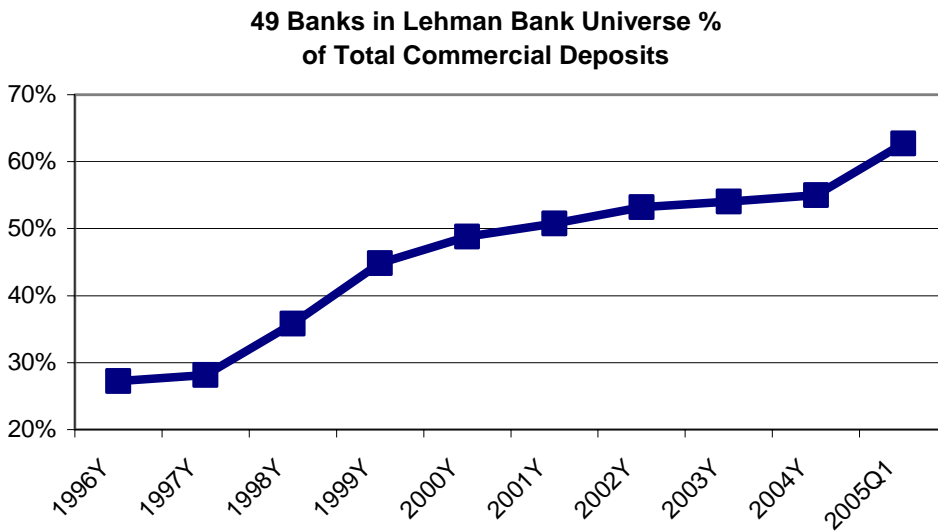
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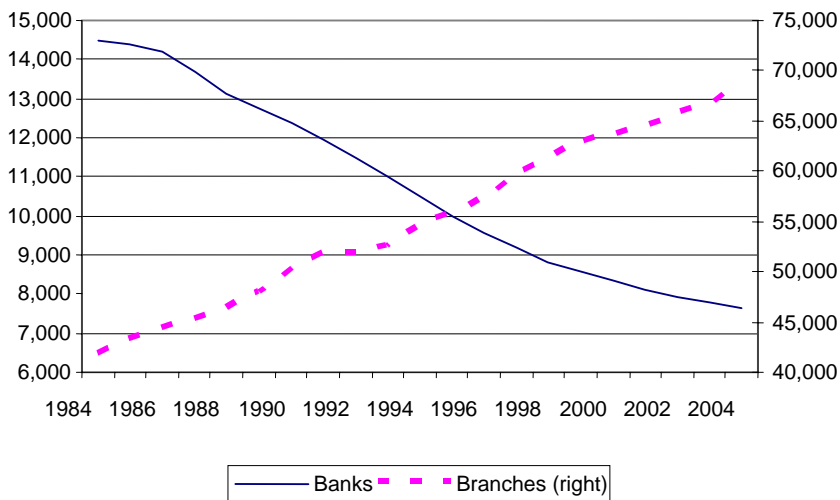
Figure 1: Lehman Bank Universe as % of total Commercial Deposits



Source: SNL Database, FDIC and Lehman Brothers

At the same time commercial bank deposits have become concentrated among fewer banks, the total number of bank branches has increased due in part to de novo branch openings.

Figure 2: Number of Commercial Banks and Branches



Source: Lehman Brothers and FDIC

On a related side-note, the FDIC/OTS released a summary of the change in offices by banks service type from 2003 to 2004. Figure 3 below shows a 2.4% increase in the number of total full-service offices while limited service offices decreased 9.2%.

Figure 3: FDIC/OTS 2004 Summary of Deposits Change in Offices by Bank Service Type

Bank Service Type	Number of Offices 2004	Number of Offices 2003	Change in Number of Offices	Change in Number of Offices (%)
Full - Brick and Mortar Office	80,960	79,489	1,471	1.9
Full - Home Banking	156	150	6	4
Full - Retail Office	4,728	4,211	517	12.3
Limited - Drive-Through/Facility	3,109	3,161	-52	-1.6
Limited - Military Facility	26	29	-3	-10.3
Limited - Mobile/Seasonal Office	405	310	95	30.6
Other	430	870	-440	-50.6
Total	89,814	88,220	1,594	1.8

Source: FDIC/OTS Summary of Deposits

Branch Growth in the Lehman Bank Universe

By our calculation, the 49 banks in our coverage universe have approximately 33,000 active branches with a minimum \$1 million in deposits. Reviewing specific branch data from the SNL database, we determined that approximately 12,500 or 38% of these branches have either been acquired since 2000 or have been organically opened since 2000.

Our calculations show that approximately 80% of the new branches for the companies under coverage are a result of acquisitions that occurred since 2000. The majority of these additional branches are a result of several acquisitions that occurred in 2004. The remaining 20% of the branches are from organic de novo openings in the last five years. This means that it is the existing company which opened the branch. However, we calculate that another 5% of the acquired branches were opened in the last five years by the acquired banks, which means that 25% of the 12,500 new branches in our current coverage universe opened for business in the last five years. In the last 12 months, the banks in our coverage universe have opened approximately 625 de novo branches.

Large-Cap

The 17 large-cap banks under coverage currently make up approximately 75% of the total branches of all banks in the Lehman bank universe, with integrated providers having 27%, super regionals having 47% and fiduciary making up less than 2% of the total branches.

Integrated Providers

Since 2000, Citigroup, Bank of America and JPMorgan have increased their total branch count by approximately 4,200 branches or 47% of the current integrated branches and 13% of the total existing Lehman bank universe branches. Approximately 88% of the new integrated providers' new branches came from acquisition, while approximately 12% or over 500 branches were organically grown.

From in 2004 and 2005, the integrated providers increased their branch count by approximately 3,300, or 26% of the total new branches added to the bank universe since 2000. The integrated providers account for such a large portion of the total universe branch growth primarily as a result of the mega mergers between BAC and Fleet and JPM and Bank One. Indeed, 3,100 legacy Fleet and Bank One branches are open today, accounting for over 10% of the total Lehman bank universe branches.

Super Regionals

The super regional banks increased their total branch count by approximately 5,000 branches or 32% of the current super regional branches and 15% of the total existing universe branches. Approximately 78% of the new super regionals new branches came from acquisitions, while approximately 22% or 1,100 branches were organically grown.

From in 2004 and 2005, the super regionals increased their branch count by approximately 1,900, or 15% of the total new branches added to the bank universe since 2000. The super regionals account for a large portion of the total universe branch growth, primarily as a result of the several recent mergers including Wachovia's acquisition of SouthTrust, SunTrust's acquisition of National Commerce which accounted for 3.5% of the total Lehman bank universe branches.

Fiduciary

The fiduciary banks have only had added a few new branches, all of which have been de novo. NTRS and MEL added about a dozen or so branches, but Bank of New York is the only fiduciary bank with a significant branch presence with about 350 total branches.

Mid-Cap Banks

The mid-cap banks increased their total branch count by approximately 2,400 branches or 43% of the current mid-cap branches and 7% of the total existing universe branches. Approximately 75% of the mid-caps' new branches came from acquisition, while approximately 25% or 600 branches were organically grown.

The mid-cap banks saw a significant portion of this growth in 2004 and 2005 as branches increased by approximately 900, or 7% of the total new branches added to the bank universe since 2000. Large branch impact deals include Regions's acquisition of Union Planters and North Fork's acquisition of GreenPoint.

Small-Cap Banks

The small-cap banks increased their total branch count by approximately 650 branches or 41% of the current small-cap branches and 2% of the total existing bank universe branches. Approximately 54% of the small-caps' new branches came from acquisition, while approximately 46% or 300 branches were organically grown. About 2/3 of the de novo branch openings came from CBH's recent expansion. The small-cap banks saw a large portion of this growth in 2004 and 2005.

West Coast Banks

The West Coast banks increased their total branch count by approximately 160 branches or 22% of the current West Coast branches and less than 1% of the total existing bank universe branches. Approximately 70% of the West Coasts' new branches came from acquisition, while approximately 30% or 300 branches were organically grown. The West Coast banks saw a large portion of this growth in 2004 and 2005.

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Texas Capital Bancshares	TCBI	19.40	1-Overweight
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Wilmington Trust	WL	35.40	2-Equal weight

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