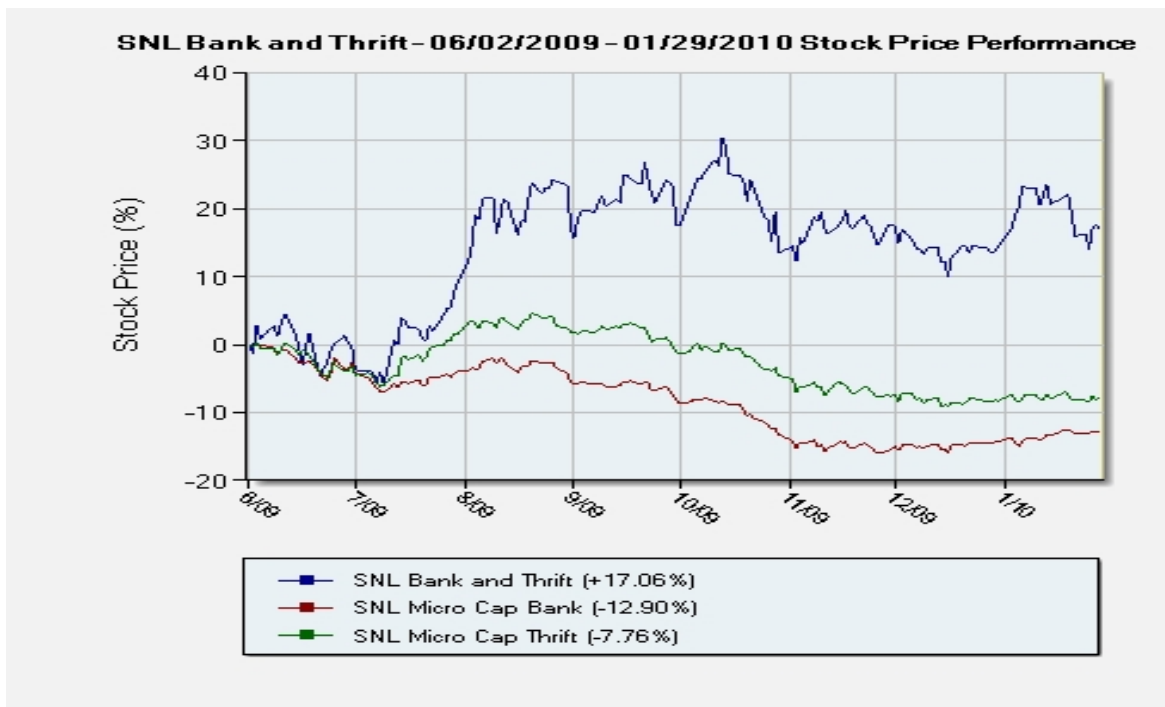


E-Memo

TO: INVESTORS/MEMBERS/PARTNERS AND FRIENDS
FROM: Jon Bruss and James Bruss
DATE: January 29, 2010
SUBJECT: The Market Helps Those That Help Themselves

Since the dust began to settle on the bank panic in May of 2009, it has become increasingly clear that the market for bank stocks will show kindness to those banks that recognize and capitalize on the opportunities for consolidation and growth presented by the financial crisis. We don't suggest the financial crisis is over, but rather that the panic is. Indeed, it is partly the continuation of the crisis that will allow well-positioned banks to thrive over the next several years. The stocks of the largest banks have outshone smaller banks; but aggressive opportunists among smaller banks have also performed quite well.

After the Treasury Department put its qualified stamp of approval on the banking industry with its stress tests last spring, bank stocks as a whole have performed extremely well. However, this is not generally the case with smaller banks.



Source: SNL Financial, LC

As the chart above shows, micro cap banks and thrifts have not benefitted from the market upswing since early summer. While the entire universe of publicly traded U.S. banks and thrifts was up 17% since the beginning of June, micro cap banks were down almost 13% and micro cap thrifts were down almost 8%. The market has pursued the safety of the government's too-big-to-fail ideology.

In fact, the market's attention is preoccupied with failures and regulatory actions, though it does not appear to understand either very well. While it is certainly true the majority of failed banks have been smaller institutions, it is hardly true that the majority of smaller institutions will fail. Regulators have

been far more aggressive in closing smaller banks, but this too presents numerous opportunities for well-positioned community banks in terms of consolidation and growth.

After the Treasury's 2009 spring stress tests, numerous banks felt confident going to the markets to raise capital. Among the micro caps that raised capital in 2009 (79 by our count), their stocks have performed dismally since the beginning of June, falling an average of 16.5%. It is even worse for those banks that raised capital but did not go on the offensive by acquiring another bank (whether assisted by the FDIC or not). Those banks dropped almost 20% in value since the beginning of June. But the micro caps—seven of them—that raised capital and hit the accelerator by buying another institution increased almost 23%.

Price performance for publicly traded micro cap banks and thrifts that raised capital in 2009	January 2, 2009 to January 29, 2010	June 2, 2009 to January 29, 2010
All micro caps that raised capital	-26.73%	-16.50%
Banks that completed deals	6.18%	22.96%
Banks that did not complete deals	-29.63%	-19.88%

Not every deal is a good deal and many banks will find that integrating failed institutions may not be worth the time, effort, and capital. But aside from an appetite for large banks, the market clearly appreciates small banks that recognize the opportunities brought about by the financial crisis. Among those micro caps that have raised capital there are many that have simply "filled the hole", attempting to rebuff the attack on their capital by escalating credit losses. On the other hand, micro caps that have completed deals (FDIC-assisted or otherwise) have told the market their capital positions are safe from further significant deterioration and they are prepared to build value through growth and consolidation. Such deals have become, for the market, the identifying badge of a good bank.

While there are many micro caps in the middle—neither hole-fillers nor aggressive buyers—the stocks of these banks generally haven't performed well. We do expect many of these well-capitalized banks will become more aggressive in 2010 as their own credit stabilizes and we expect the market to respond favorably. We also anticipate the enthusiasm for FDIC deals will taper off as they become more common and as the market begins to appreciate the difficulty of the task involved in buying failed banks.

In the short-term, aggressive buyers will benefit, as they already have. The best long-term investments will continue to be with those banks buttressed by strong capital and served by nimble and experienced management. Whether this describes an aggressive buyer or a bank with steady organic growth may be immaterial. The market has begun to clarify its impatience with banks that continue to struggle with current problems, unmindful of the opportunities the crisis has presented.

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