

## E-Memo

**TO:** INVESTORS/MEMBERS AND FRIENDS  
**FROM:** Jon Bruss and Bob Ollech  
**Date:** January 17, 2007  
**Subject:** What is Your Time Horizon?

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Recently, one of our friends in the brokerage community provided us with an example demonstrating the long term benefits of owning well-run banks—not just the near term or the short term but the long term. He cited a \$1.7 billion asset southeastern bank located in Myrtle Beach, SC, which had just announced that it was being acquired by BB&T, a \$100+ billion asset regional bank located in Winston-Salem, NC. Our friend pointed out that if you had owned that bank since it became publicly traded in 1992, your annual return would have been around 31% (our data source, Bloomberg, on this bank goes back to January of 1995 where we find the annual return to be 21.9% vs. the S & P at 12.20%)! Sure, we know, everyone has a story like this, right? Do you?

This gave us the opportunity to think a bit about our ownership of bank stocks in the southeast that were acquired this year by larger institutions. We had two—both in Atlanta, Summit Bank of Georgia (SBGA) and Flag Financial (FLAG). We should state outright that we don't pick banks because we think they will be taken out—acquired at a fat premium to the current price. We do pick banks with great business models in high growth areas of the country that have management teams that understand the importance of acquiring the best possible staff members and incenting them to generate high quality loans and a high level of core deposits.

But back to the two banks, SBGA and FLAG. We began acquiring shares of SBGA soon after discovering the bank in a screen we had set as we were searching for stocks and meeting the Chairman and CEO, Pin Pin Chau. It was clear to us that she had shaped the business model of the bank and knew it inside and out. Moreover, she was able to articulate it and the bank's long range plans for expansion. We liked both the strategy and the executives charged with executing it and decided that we should invest. Here in Table 1 are the results of our initial investment in SBGA:

TABLE 1

Period Held	Total Return SBGA	Total Annual Return SBGA	Total Return S&P 500	Total Annual Return S&P 500	Total Return NASDAQ Bank Index	Total Annual Return NASDAQ Bank Index
Since IPO (10/94)	1,335.92%	24.47%	200.26%	11.38%	365.85%*	13.44%*
Our Buy Date (7/03)	148.65%	30.55%	52.36%	13.12%	45.50%	11.60%

\*In earlier years the NASDAQ Bank Index Total Returns did not include the reinvestment of dividends.

We believe there are several important lessons to be learned from TABLE 1:

- The power of compounding is incredible—the 8<sup>th</sup> Wonder of the World—some have said. Compare the Total Returns of SBGA with the S&P 500 and the NASDAQ Bank Index, either from its IPO date or from our initial purchase date. Improving one's annual return by just a few percentage points works wonders for your investment dollars.
- Both indices had lots of mergers and acquisitions during the periods covered. SBGA still outperformed them handily.
- One never knows which company will be acquired, but we feel assured that buying the right business model in the right location with the right management can, *over time*, provide the kind of results reflected in Table 1.

On the other hand you can get lucky with timing and we were lucky this past year. We started buying FLAG in May of 2006 after visiting with management and liked what they had to say. They took the reigns of an underperforming bank and were in the process of turning it around. We were not able to get in on the ground floor, but we thought we'd gotten on to something in time to take advantage of a two-to-three year run before the bank was completely fixed and ready for "prime time"—prime time meaning the sale of the bank. Roughly 90 days later, the bank announced that it was being acquired for cash by Royal Bank of Canada (RBC Centura). TABLE 2 tells a different but nonetheless great story:

TABLE 2

Period Held	Total Return FLAG	Total Annual Return FLAG	Total Return S&P 500	Total Annual Return S&P 500	Total Return NASDAQ Bank Index	Total Annual Return NASDAQ Bank Index
Since IPO (3/87)	1,212.12%	13.97%	654.76%	10.82%	561.87%*	10.08%*
Our Buy Date (5/06) <sup>1</sup>	25.27%	51.41%	12.46%	23.51%	6.70%	12.37%

<sup>1</sup> 203 days annualized.

\*In earlier years the NASDAQ Bank Index Total Returns did not include the reinvestment of dividends.

Clearly, we were fortunate in our timing. We believed that management would eventually sell the bank. They said as much. It was also clear to us that the bank was being molded around a very good business model—a model that would appear on the radar screen of larger bank seeking to acquire the skills and relationships developed from that skill-set. What did we learn from this experience?

- Timing, as it turns out, means a lot. Those *poor* shareholders who were in since 1987 didn't do as well as we did in 203 days, or did they?
- Time means a lot, too. In the nearly 20 years they owned the stock, they beat the S & P 500's annualized results by over 3 percentage points and the NASDAQ Bank Index's annualized return (without dividends) by nearly 4 percentage points. Look how that modest difference in returns impacted the total return. FLAG, with over 3 percentage points or incremental annual returns, created a total return of 1,212% vs. the S&P's 655%, a 185% difference! Such is the power of compounded returns.
- Were we any more pleased than the shareholders who got in 20 years ago? Our guess is that the 20-year shareholder has no regrets. They are probably ecstatic if they invested \$100,000 twenty years ago and now have \$1,212,000.00.

Sure there are other stories out there about the big splash made by this tech stock or that energy play but there are **hundreds** like these two, FLAG and SBGA, which patient investors have found over the past 15 to 20 years and longer. And here's another example that we like and we've held since 2000. We are not predicting that it will be sold any time soon, but it does have two of what we consider to be the most important earmarks of a great long term bank investment: an economically vibrant and growing market area and a seasoned management team that is focused on building shareholder value.

We are talking about **TIB Financial Corp.** (TIBB) in Naples, Florida. Naples, you say. Isn't residential housing sliding and aren't condo prices crashing? We have all heard the recent stories, mostly one-off kinds of tales of homes being purchased for \$850,000 last year only to be sold for \$600,000 recently—or even less. Condo prices have been subjected to the same kind of correction—if that's what it can be called. Real estate prices were "crazy" in Florida last year and wise investors were sitting on the sidelines waiting, waiting for this adjustment to come—and indeed it has. But Southwest Florida is more than high priced housing and condos. It has, in fact, a well developed service and light manufacturing infrastructure that is growing and growing rapidly. We understand that Florida's population is growing at a rate of 1,000 persons per day. That's 360,000 per year. These are not all retirees but many others from all walks of life and all

ages moving south for lifestyle reasons aside from retirement, moving to Florida to fill positions in services, manufacturing, commercial construction, healthcare and on and the list goes on and on. We continue to like Florida despite the bad press it has been getting and the ugly stories we've read in some of the local Florida newspapers. As usual, we seek banks in fast growing markets that are managed by a team of indigenous bankers with proven track records. TIBB is one of those banks.

We've owned TIBB since June of 2000. We paid a split adjusted \$5.06 for our first shares and an average of \$7.29 for our entire holdings. Our annual return on our initial purchase, through the end of 2006, is 23.7%. Our total return on those shares is 298.4%. We are not new to fast growing banks in fast growing markets, we've really been investing in those kinds markets from our inception. TIBB is one of those investments:

- TIBB has been around for 32 years and has **long history of management delivering on its promises to shareholders** especially in the 6½ years of our ownership. It was founded in the Florida Keys. Shortly after Ed Lett, the current president and CEO, came on board, it became apparent to him that the Keys were not growing as rapidly as other parts of Florida, including Southwest Florida, and the Naples area, in particular. The Keys residents and Naples residents have long had close ties.
- **Fortress Partners spoke publicly about this stock in November 2003**—"Analyst goes fishing for tiny Keys bank", *Milwaukee Journal-Sentinel*, November 29, 2003, and we said ". . . we began buying TIB shares in the second quarter of 2000 and [have] an average cost of [split adjusted \$6.3125] . . . [We] would buy these shares up to [a split adjusted \$11] and [we said] this stock could go as high as [a split adjusted \$15] a share in the next two to three years." Three years later, **on November 29, 2006 the stock closed at \$17.01.**
- It has **strong name recognition** in Southwest Florida and in the Keys.
- **It has succeeded at cross selling where many other banks have failed.** For example, it achieved a 35% penetration with Internet banking 4 years ago—well before the behemoths got on the Internet bandwagon. How did they do it? They simply incented their staff to sell it as part of the checking package.
- It was clear when attending early shareholder meetings that **community involvement was deeply rooted at the bank.** This commitment continues.
- The hiring of Millard Younkens, who like Ed Lett, is a seasoned banker, but with roots in the Naples area, kept us and other shareholders interested and involved as the bank played out its Southwest Florida strategy.
- **Shareholders remained patient and informed because of easy access to management, its focus on shareholder value and the payment of a modest dividend.**
- The Growth Pay-off:
  - **Assets grew** 13.1% annually from 1999-2002 and **25.8% from year end 2002 through Q306.** This growth, foretold of good things to come.
  - **Loans grew** 15% annually from 1999-2002 and **26.9% from year end 2002 through Q306.** Loan growth was a very positive indicator of the outstanding results to come.
    - The loan mix includes a highly diversified commercial real estate portfolio representing 50% of total loans
    - Rigorous credit discipline has resulted in a history of nominal non-performing assets and negligible loan losses
  - **Deposits grew** 11.6% annually from 1999-2002 and **22.7% from year end 2002 through Q306.** The bank's continued focus on core deposits, the keystone of franchise value, gave us great confidence.
    - Today, **demand deposits** represent 28% of total deposits which we believe, along with **transaction accounts** (savings and money market accounts are 22% of total deposits), **are the key franchise value driver.**
  - **Revenue grew** by 8.9% annually in those earlier years and, since 2003, revenue compounded annually at **19.4%** (through Q306).

- Earnings were a different story. Management focused on keeping the earnings stream steady while making huge investments in technology infrastructure, operations centralization in southeast Florida and building branches in Southwest Florida. All along, 2005 and beyond were targeted to be the years when the bottom-line payoff would begin to be realized—and indeed it was.
  - A successful public offering in 2004 added approximately 33% more shares outstanding resulting in some dilution in 2004
  - **2005 earnings increased by over 22% vs. 2004** and
  - **year to date through Q306, earnings are up 27.2%**

We think that the TIBB management team is unique—one of a kind, as is their market niche and style of doing business. The Florida Keys market is very profitable but also very mature. The Florida Southwest market is fast growing and TIBB's expansion into that market has been enabled by its dominant position in the Keys, which still accounts for over 48% of the bank's loans and over 55% of its deposits. From the beginning of 2003 through 3Q06, loans and deposits in TIBB's Keys market grew at a 12.6% and 10.2%, annually, respectively, while annualized loan and deposit growth rates in TIBB's Southwest Florida franchise were 64.3% and 84.5%, respectively. With growth figures like those, it is clear to us that this new market will soon overtake the Keys as the predominant driver of TIBB's results. And we believe that there is ample shareholder value yet to be harvested as the bank carefully and cautiously makes small but key acquisitions and stakes out territory for new branch locations.

Management credibility drives much of our decision making process. Clearly making a public statement as we did on November 29, 2003 is not something we take lightly. We could have been wrong, but management credibility gave us the confidence to hazard a forecast. **On November 29, 2005**, 2 years after we made our prediction that the stock could be at a split adjusted \$15 per share, **it was**, in fact, **\$15.76 per share**. **On November 29, 2006**—three years after our prediction, **the stock closed at 17.01 per share**. We haven't looked back until now for a brief moment or two to document our ownership.

Just as with location in real estate investing, there are three things critical to success in bank investing—management, management and management. In all three banks we cited, meeting with management cemented our investment decision. In each case it was management that cinched our interest in owning the stock and in continuing to hold the stock—in the case of TIBB for 6 ½ years and for SBGA, 3 ½ years and FLAG—we were lucky, remember? We owned FLAG for three months. Our investment time horizon? As long as we can continue to generate annualized returns on shares like those of TIBB we'll continue to hold.

We hope your time horizon matches ours.

# FORTRESS

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