3-SIGMA VALUE

Bank Investing in 2013

This document is for informational purposes only and all information contained herein is subject to revision and completion. This document does not constitute or form part of an offer to issue or sell any securities or other financial instruments, nor does it constitute a financial promotion, investment advice or an inducement or incitement to participate in any product, offering or investment. Any such offer will be made only by means of a confidential private placement memorandum or such other offering documents as may be delivered by 3-Sigma Value to prospective investors and is subject to the terms and conditions contained therein.

The views, analyses and opinions herein reflect the perspective of 3-Sigma Value. No representation, warranty or undertaking, express or implied, is given as to the accuracy or completeness of the information or opinions contained herein. No reliance may be placed for any purpose on the information and opinions contained in this document or their accuracy or completeness and nothing contained herein shall be relied upon as a promise or representation whether as to past or future performance. Certain information in this document has been derived from materials furnished by outside sources. 3-Sigma Value assumes no responsibility for independent verification of such information and has relied on such information being complete and accurate in all material respects. Nothing contained herein should be construed as legal, business or tax advice. Each prospective investor should consult its own attorney, business adviser and tax adviser as to legal, business, tax and related matters concerning the information contained herein.

Bank Investing in 2013[1]

According to the FDIC's *Quarterly Banking Profile* for the Fourth Quarter 2012, FDIC-insured institutions earned $141.3 billion, the second-highest annual earnings ever reported, after the $145.2 billion in 2006. Average return on assets (ROA) for the industry rose to the psychologically-important level of 1.00%, a level last realized in 2006. The number of institutions reporting financial results declined sequentially from 7,357 to 7,083 as 51 banks failed and 223 were merged into other institutions. 2012 is the first year in FDIC history that no new reporting institutions were added.

All FDIC-Insured Institutions (1)								
	2012	2011	2010	2009	2008	2007	2006	2005
Net Interest Margin (NIM)	3.42%	3.60%	3.76%	3.49%	3.16%	3.29%	3.31%	3.47%
Return on Assets (ROA)	1.00%	0.88%	0.65%	-0.07%	0.03%	0.81%	1.28%	1.28%
Return on Equity (ROE)	8.92%	7.86%	5.85%	-0.72%	0.35%	7.75%	12.30%	12.43%
Leverage	8.92x	8.93x	9.00x	10.29x	11.67x	9.57x	9.61x	9.71x
# of Institutions Reporting	7,083	7,357	7,658	8,012	8,305	8,534	8,680	8,833
# of Problem Institutions	651	813	884	702	252	76	50	52
	-19.9%	*-8.0%*						
Assets of Problem Institutions (in billions)	$233	$319	$390	$403	$159	$22	$8	$7
Nonperforming Assets as a % of Total Assets (2)	2.20%	2.60%	3.11%	3.37%	1.91%	0.95%	0.54%	0.50%
# of Failed Institutions	51	92	157	140	25	3	0	0
	-44.6%	*-41.4%*						

(1) Data is taken from the FDIC's Fourth Quarter 2012 Banking Profile.
(2) Includes Other Real Estate Owned (OREO).

Observations:

1. Not one new bank was created in an entire year.

Not a single management team was bestowed a bank charter by the government to profit from the juicy spreads earned between the near zero percent that banks pay to savers and the three to five percent they earn on average loans. The slope of the yield curve as measured by the difference between the 3-month and the 10-year Treasury yields averaged +172 basis points for the year, roughly in line with the 20-year average of +180 basis points. On the surface, banks are nearly as profitable as they were before the financial system collapsed, while the number of banks continues to shrink. A charter to operate a bank is now and becoming more valuable than ever because it is becoming rarer.

[1] Bank Investing in 2012 was included in 3-Sigma Value's *2011 Review / 2012 Outlook*.

Banks are unquestionably better-capitalized now in 2013 than back in 2008, in terms of credit statistics across the system as a whole. Non-performing assets are down. Leverage is down. Yet 651 banks remain on the FDIC's "Problem" List. The singular reason why so many banks are still financially-distressed is the legacy loans trapped on their balance sheets, mismarked and unable to be sold without charging-off so much UPB (unpaid principal balance) that the equity of much of the banking system would be eviscerated. A harbinger of massive consolidation, the banking industry is in the process of bifurcating. Thanks to interest-rate policy, well-capitalized banks are modern-day money machines while under-capitalized banks grind to a halt. The cost of running a bank has increased, requiring scale. The age of the small local community bank serving one MSA is over. Community banks can't compete anymore, so they are merging with each other and morphing into stronger regional institutions.

2. Credit metrics across the banking system continue to improve, i.e. as reflected in nonperforming assets, but if we scratch the surface it doesn't take much to ascertain the reality of widespread insolvency.

Noncurrent assets (as a % of total assets) remain stubbornly high at 2.20% (down from a peak of 3.367% in 2009) while loan loss reserves are down for eleven consecutive quarters. With leverage still high at 9x, the banking system is embedded with ~20% losses, and that ignores loans that are mismarked on the books of nearly all banks across the United States. On April 9, 2009, at the nadir of the financial crisis, FASB[2] issued an official update to FAS 157, the rules governing mark-to-market accounting, suspending the accounting of reality when market conditions are deemed "unsteady or inactive". Since then, it has become impossible to rely on the valuations of loans and other assets as reflected in a bank's audited financial statements.

3. The rich get richer while the poor get consolidated.

The bifurcation of the banking system is enabling one of the great profit opportunities of our time. While under-capitalized banks are frozen, "zombies" in the parlance of our time, well-capitalized banks benefit from the government's hand replacing Adam Smith's. Industry consolidation is governed and the rules are strict. The banking business, like all financial services, is a human capital business, and therefore what matters most is management. Investing in banks is about investing in people. Therefore the quality of the management team is the predominant factor in the analysis of any financial institution.

[2] The Financial Accounting Standards Board (FASB) is the government designated organization responsible for setting accounting standards for public companies in the U.S.

To measure a management's ability to operate a bank wisely and for the long term, we focus on non-interest expense relative to the size of the bank in terms of assets and revenues where revenues consist of net interest income (NIM) and non-interest income (fees). Specifically, we employ a metric called **Efficiency Ratio**[3]. Ironically, a 100% efficiency ratio means a bank is not being efficient. The lower the ratio the better, with most banks striving for a sub-60% ratio. Following is a list of the most efficiently managed banks in the U.S. in 2012.

`	Lowest Efficiency Ratios (%)		
1	BofI Holding (BOFI)	36.7%	San Diego, CA
2	Washington Federal (WAFD)	36.9%	Seattle, WA
3	Oritani Financial (ORIT)	37.1%	New Jersey
4	Signature Bank (SBNY)	37.3%	New York
5	Prosperity Bank (PB)	39.4%	Texas
6	NY Community Bank (NYCB)	40.7%	New York
7	BBCN Bank (BBCN)	41.9%	CA, Korean
8	Capital Federal Financial (CFFN)	42.1%	Kansas
9	East West Bank (EWBC)	42.9%	CA, Korean
10	Dime Community (DCOM)	43.2%	New York
11	BankUnited (BKU)	43.6%	BankUnited
12	Westamerica Bank (WABC)	43.7%	San Fran, CA
13	CapitalSource (CSE)	45.3%	Cali
14	Republic Bank (RBCAA)	45.6%	Louisville, KY
15	Home Bank (HOMB)	45.6%	Conway, AR
16	Investors Bank (ISBC)	45.8%	Short Hills, NJ
17	Bank of the Ozarks (OZRK)	46.3%	Little Rock, AR
18	Cathay General (CATY)	47.5%	CA, Korean
19	Farmers & Merchants of Long Beach (FMBL)	47.9%	Cali
20	First Financial (FFIN)	48.4%	Texas
21	Flushing Financial (FFIC)	49.2%	New York
22	Texas Capital Bancshares (TCBI)	49.4%	Texas
23	Lakeland Financial (LKFN)	49.8%	Warsaw, IN
24	Customers Bank (CUBI)	49.9%	PA/NY/NJ
25	Cardinal Bank (CFNL)	50.4%	Washington DC
26	EagleBank (EGBN)	51.4%	Washington DC

[3] Efficiency ratio equals non-interest expense divided by (net interest income plus non-interest income).

In of itself, efficiency ratio means little if it doesn't translate into a high level of profitability. Not unexpectedly, many of the banks reporting the lowest efficiency ratios are the ones reporting the highest profitability as measured by return on tangible equity (ROTCE). Following is a list of the most profitable banks in the U.S. in 2012.

Highest ROTCE

1	Sterling Financial (STSA)	37.6%	WA - recapitalized
2	Wilshire Bank (WIBC)	31.5%	CA, Korean
3	Hamni Financial (HAFC) *	27.7%	CA, Korean
4	Prosperity Bank (PB)	21.9%	Texas
5	Westamerica Bank (WABC)	21.4%	San Fran, CA
6	M&T Bank (MTB)	17.7%	New York
7	Bank of the Ozarks (OZRK)	17.5%	Little Rock, AR
8	Texas Capital Bancshares (TCBI)	17.5%	Texas
9	F.N.B. Corporation (FNB)	17.2%	Hermitage, PA
10	Bofl Holding (BOFI)	17.1%	San Diego, CA
11	Bank of Hawaii (BOH)	16.8%	Hawaii
12	Cardinal Bank (CFNL)	16.7%	Washington DC
13	Taylor Capital (TAYC)	16.6%	Rosemont, IL
14	NY Community Bank (NYCB)	16.1%	New York
15	First Financial (FFIN)	16.0%	Texas
16	Home Bank (HOMB)	15.9%	Conway, AR
17	Community Bank System (CBU)	15.9%	New York
18	Washington Trust (WASH)	15.6%	Westerly, RI
19	East West Bank (EWBC)	15.4%	CA, Korean
20	City Holding (CHCO)	14.8%	Cross Lanes, WV
21	Western Alliance (WAL)	14.5%	Phoenix, AZ
22	EagleBank (EGBN)	14.4%	Washington DC
23	Valley National (VLY)	14.4%	Wayne, NJ
24	FirstMerit (FRME)	14.2%	Akron, OH
25	United Bancshares (UBSI)	14.0%	Charleston, WV

* Featured in 3-Sigma Value's 2011 Review / 2012 Outlook.

By cross-checking efficiency ratios with ROTCE, we identify the most profitable banks where the high level of profitability is (in part) due to efficient cost management.

2012 Bank Profitability Analysis

	Efficiency	ROTCE	P/TBV*	
Prosperity Bank (PB)	39.4%	21.9%	3.2x	Texas
NY Community Bank (NYCB)	40.7%	16.1%	2.0x	New York
Westamerica Bank (WABC)	43.7%	21.4%	3.0x	San Fran, CA
Home Bank (HOMB)	45.6%	15.9%	2.5x	Conway, AR
Bank of the Ozarks (OZRK)	46.3%	17.5%	3.2x	Little Rock, AR
First Financial (FFIN)	48.4%	16.0%	3.2x	Texas
Texas Capital Bancshares (TCBI)	49.4%	17.5%	2.0x	Texas
Cardinal Bank (CFNL)	50.4%	16.7%	1.6x	Washington DC
EagleBank (EGBN)	51.4%	14.4%	1.7x	Washington DC
Customers Bank (CUBI)	49.9%	12.7%	1.2x	PA/NY/NJ

* As of 3/31/13.

All of the banks in this list trade at richly deserved valuations north of 2x tangible book value (TBV), that is, all except for Customers Bank (CUBI) led by former Sovereign Bank CEO Jay Sidhu, and the two banks operating in Washington DC. Before explaining the situation at Customers Bank, which is our top idea, we briefly describe the attractive opportunities for investing in banks in the Washington DC market.

Like most markets in the U.S., the Washington DC market is dominated by large money center banks such as Capital One (COF), Wells Fargo (WFC), Bank of America (BAC), and Citigroup (C), along with super-regionals including SunTrust (STI), BB&T (BBT), and PNC Financial (PNC). In terms of pure plays (relatively), we identify 4 that are investable:

1. **United Bank (UBSI)** of West Virginia recently entered the DC market via the acquisition of Virginia Commerce Bank (VCBI) for a fair price of 1.8x TBV. With $4.5 billion of in-market deposits, United Bank is now the leading independent bank in Washington DC in terms of deposit share; however, the stock is already fully valued at 2.2x TBV.

2. **Sandy Spring Bank (SASR)** of Olney, MD is a $4.0 billion asset bank that under-earns its peers because of a higher level of non-interest expense and as a result a higher efficiency

ratio (>60%). Nevertheless, Sandy Spring still earned a solid 1.0% ROA and 9.7% ROTCE in 2012, and at only 1.2x is an attractive target for any bank looking to build scale or buy its way into the Washington DC market.

3. **EagleBank (EGBN)** is led by the other Ron Paul, this one a community banking legend who co-founded EagleBank in 1998. Since then, assets have grown to $3.4 billion with a consistent record of profitability through the banking cycle. Credit quality is outstanding with an allowance for credit losses covering 104% of nonperforming assets (NPAs), and non-interest expenses are well-managed as evidenced by a 51.4% efficiency ratio in 2012. In terms of valuation, EagleBank is easily worth 2x TBV (of $12.62) equal to $25.24. On an EPS basis, core EPS is approaching $0.50 on a quarterly basis ($2 of EPS per year), which is again worth at least $25 per share.

4. **Cardinal Bank (CFNL)** is also one of the most consistently profitable banks in the U.S. A huge 1.7% ROA in 2012 (16.7% ROE) is the inflated result of robust mortgage banking fees driven by gain on mortgage sales. With interest rates zero-bound and pre-payments moderating, mortgage securities trade at premiums to par and can be liquidated at a profit at any time. ROA peaked at an amazing 2.07% in the third quarter of 2012 and have been moderating since. As a result Cardinal Bank should report a lower ROA in 2013, however still robust in the 1.20% to 1.40% range (1.44% in Q1[4]). Even at this lower level of profitability, CFNL should continue to generate a mid-teens ROE, warranting a 2x multiple of TBV (2x 2014 TBV = $23.62 per share). On an EPS basis, core EPS is likely to stagnate as a lower level of gain on sale offsets organic revenue growth. Applying 3-Sigma Value's proprietary target price methodology, which is based on a series of operating scenarios driven by key factors including asset and deposit yields, loan production, fee income growth, and efficiency ratio, we derive a probability-weighted target price of $20.13.

Both EagleBank and Cardinal Bank have pristine balance sheets – Cardinal, in particular, has $0 other real estate owned (OREO) and $0 loans receivable past due 90 days or more ($3.0 billion of total assets). With virtually no legacy credit risk, the risk/reward here is extremely attractive. However, Cardinal Bank is missing a crucial element required in 3-Sigma Value's investment process – a clear catalyst that will narrow the gap between CFNL's current market value ($15) and our estimation of its intrinsic value ($20+).

[4] Core ROA, excluding gain on sale, was 1.0%. In 2010/2011, gain on sale was $14 million per annum. 2012 was anomalous. *Base Case* scenarios assume gain on sale in 2013/2014 will be similar to the gain on sale in 2010/2011.

While a take-out of Cardinal Bank is likely, eventually, and theoretically a stock catalyst, as far as we at 3-Sigma Value are concerned a take-out is an exogenous factor that is uncontrollable and therefore only a factor in *Upside Case* scenarios.

In contrast, **Customers Bank (CUBI)** is on the verge of a major catalyst that will unlock value in its shares. Currently, CUBI (formerly CUUU) trades sparingly on the Pink Sheets while its registration statement with the SEC is being reviewed in advance of a move to the Nasdaq. When CUBI lists, volumes will increase dramatically as privately-acquired shares become freely tradeable and the stock becomes eligible for inclusion in a wider range of institutional portfolios.

Buy: Customers Bank (CUBI)

In the middle of 2012, 3-Sigma Value was introduced to Jay Sidhu, the CEO of Customers Bank and formerly the CEO of Sovereign Bank, which he and his team built over the course of twenty years into a major financial institution with over $89 billion in assets at the time of Jay's "retiring" in 2006. Nine out of fourteen senior executives at Customers Bank used to work with Jay at Sovereign.

The rapid demise of Sovereign after the 2006 change in leadership is a morality tale lost in the tragedies of Lehman, Fannie and Freddie, and the overall collapse of the financial system in 2008. Under Jay's leadership, Sovereign was a conservatively run bank that was under-leveraged and under-earning relative to its peers during the credit bubble until activist investor Ralph Whitworth of Relational Investors orchestrated Jay's removal.

To boost return on equity, the new management team, pressed by Whitworth, lowered credit standards and loaded up on an alphabet soup of structured products[5], and sure enough, on October 13, 2008 what remained of Sovereign was acquired by Spain's Banco Santander SA for a measly $2.51 per share. In contrast, two years earlier when Jay was still CEO, Sovereign sold a 19.8% stake to Banco Santander in a strategic transaction for $2.4 billion cash ($27 per share). Included in the deal was an option for Banco Santander to buy the rest of the bank for $40 per share for one year beginning in the middle of 2008. Instead, they were able to pay $2.51.

[5] Buried in "other securities" in the footnotes to the financial statements.

Jay went on record saying about Whitworth, “Every single action taken under his leadership of the risk management committee destroyed value. You need a long-term view with prudent risk-management strategies and not the short-term view of a hedge fund manager."[6]

As far as the notion that Jay was the one responsible for the downfall of Sovereign and by the time Whitworth showed up it was too late, that version of the story is not supported by the data. It wasn’t until 2008 that Sovereign was wrecked. In 2007, a year after Jay was retired, non-performing loans (NPLs) were only 0.53% of total loans, slightly elevated but generally consistent with the 0.38% to 0.44% rate during the prior three years, 2004 to 2006. In 2008, NPLs more than tripled year-over-year to 1.64%.

After watching the disintegration of his work and much of his fortune, in 2009, Jay raised $22 million of equity ($7.5 million from Jay) to acquire New Century Bank, a failed bank in Pennsylvania with $270 million of assets. Jay and his team restructured the operations of the newly rechristened Customers Bank and worked through its non-performing assets (NPAs) before acquiring three banks in 2010/2011, two with FDIC-assistance (total assets = $2.1 billion)[7]. Then in the summer of 2012, Customers Bank announced an $80 million Regulation D Private Placement in a Public Company (PIPE)[8] to fund two ingenious acquisitions structured with an arbitrage that upon closing would increase the total assets of the bank to over $3 billion.

The first acquisition is CMS Bank with $247 million of assets and 5 branches in Westchester New York for $20.8 million stock valued @ 125% of book value (closing expected in 2013). The deal is not only geographically strategic but the terms theoretically establish a floor for CUBI’s valuation. Jay created an arbitrage for his investors – we paid $14 per share, equal to 95% of Q2 2012 book value, while CUBI sells stock at 125% of book value.

The second of the two acquisitions included only the performing assets ($490 million) and one branch of Acacia Federal Savings Bank for $65 million, consisting of $10.3 million cash and common stock valued @ 115% of GAAP book value at the time of closing (expected Q2 2013)[9]. The price paid as a multiple of book value (P/BV) was a very attractive 0.56x, but unfortunately the FDIC deemed it too attractive. On Customers Bank’s April 22, 2013 conference call, management reported that the FDIC would only consider approving one acquisition at a time,

[6] Recently, Whitworth became interim chairman of Hewlett-Packard (HPQ) after joining its board in 2011.

[7] Acquired ISN Bank and USA Bank, both with FDIC-assistance, and then Berkshire Bank in the open market.

[8] 3-Sigma Value, LP participated in the PIPE.

[9] The seller is Ameritus Mutual Holding Company.

and therefore management had to choose. Because CMS Bank represents a franchise, while Acacia is simply a book of business with no intrinsic franchise value, management decided on quality over quantity.

Another important distinguishing characteristic of Customers Bank is the size and productivity of its branches. Average deposits per branch were $174.3 million in December 2012, up from $109 million in December 2011 and $77 million in December 2010. This compares to ~$50 million for community banks. Part of the reason Customers Bank is able to accumulate deposits is the bank doesn’t compete on the basis of cost. While cost of deposits has dropped from 1.76% in December 2010 to 1.19% in December 2011 to 0.79% in the fourth quarter of 2012; that is still well above the cost of deposits at most community banks (<60bps). Management promotes a "high touch supported with high tech" model for gathering deposits based on concierge banking serviced out of sales offices instead of full service branches, a low-cost strategy that depends on experienced bankers who reach out proactively to customers. CUBI operates in key mid-Atlantic markets along the I-95 with attractive demographics in PA (Bucks, Berks, Chester, and Delaware counties), NY (Westchester county), NJ (Mercer county), and Washington DC.

When discussing the Bank’s acquisition strategy, Jay describes "a lot of low hanging fruit." There are 86 “Problem” banks with $33 billion in assets in CUBI’s target markets along the I-95 between New York and Washington DC. Ironically, the competition to acquire these banks is limited given the reality of widespread mark-to-market insolvency and the absence of new entrants.

Problem Institutions Along the I-95

	Texas Ratio > 75% *		Texas Ratio 50-75%	
	# of Banks	Assets ($B)	# of Banks	Assets ($B)
MD	12	6.0	16	4.0
NJ	9	3.5	9	4.8
VA	8	3.2	7	1.8
PA	4	1.3	6	2.0
NY	3	1.3	5	1.6
CT	2	0.5	2	2.1
DE	1	0.4	2	0.9
Total	39	16.2	47	17.2

* Texas Ratio = Non-Performing Assets divided by Tangible Equity plus Loan Loss Reserves.
In normal times, Texas Ratios approach zero. A 50% ratio is considered very sick (~50/50 chance of survival).
A 100% Texas Ratio means the bank is a zombie bank.

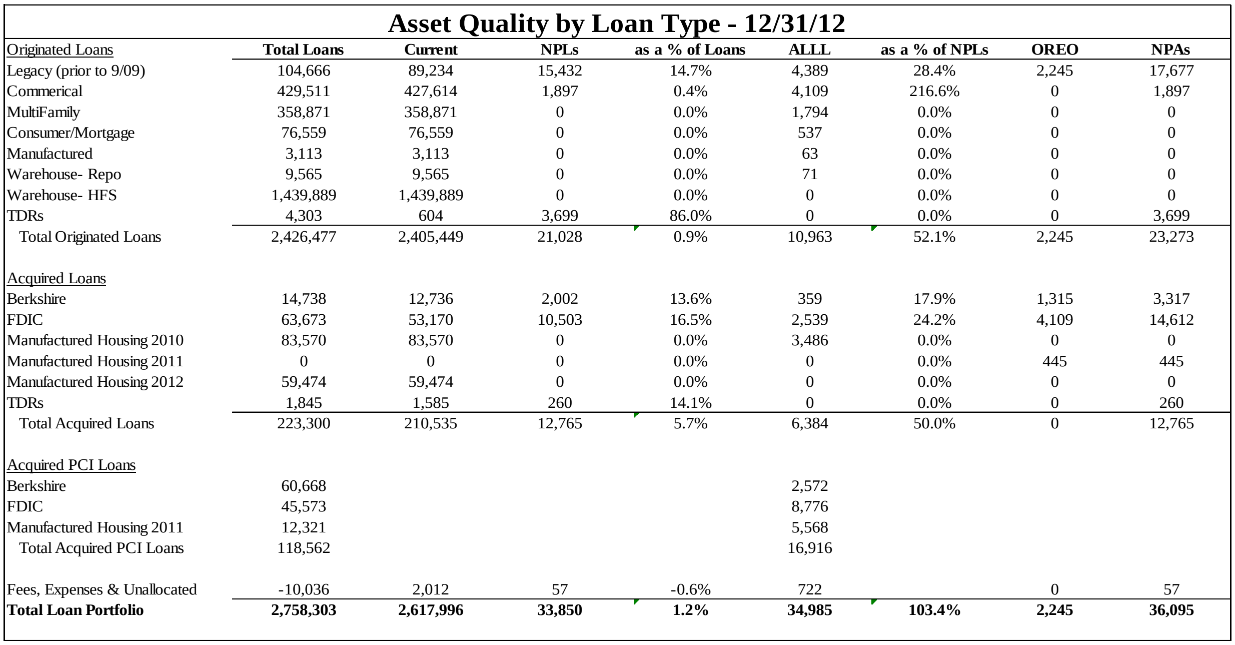
Finally, the Bank’s lending strategy is highly conservative with a focus on “superior” credit quality in the following lending areas:

1. Commercial Lending – divided into three groups: (1) Small business (SBA) loans targeting companies with less than $5 million of annual revenue; (2) Mid-market business loans targeting companies with up to $100 million of annual revenue; (3) Multifamily and commercial real estate (CRE) loans with an average loan size of $7 million.

2. Consumer Lending – real estate secured lending with conservative underwriting standards (>720 FICO). No indirect auto, credit card, student or unsecured loans.

3. Specialty Lending – warehouse lending which provides financing to mortgage bankers for residential mortgage originations from loan closing until sale in the secondary market. Many providers of liquidity in this segment exited the business in 2007-2008 during the period of excessive market turmoil, creating an opportunity to provide liquidity at attractive spreads. For Customers Bank, the warehouse lending business diversifies its revenue streams with a lower credit risk and interest rate line of business. These loans are short-term, usually 16 days, and therefore yield less than commercial bank loans. However, the Bank is paid a portion of the 1% origination fee, which makes up for the lower NIM. Management expects the mix of warehouse loans to constitute 25% of assets over time, down from 52% at December 31, 2012.

As a result of FDIC loss sharing and prudent lending, non-performing assets (NPAs) are 1.2% for the entire loan portfolio[10] and 0% for originated loans since the 2009 acquisition of New Century Bank. In short, this underwriting team is outstanding.



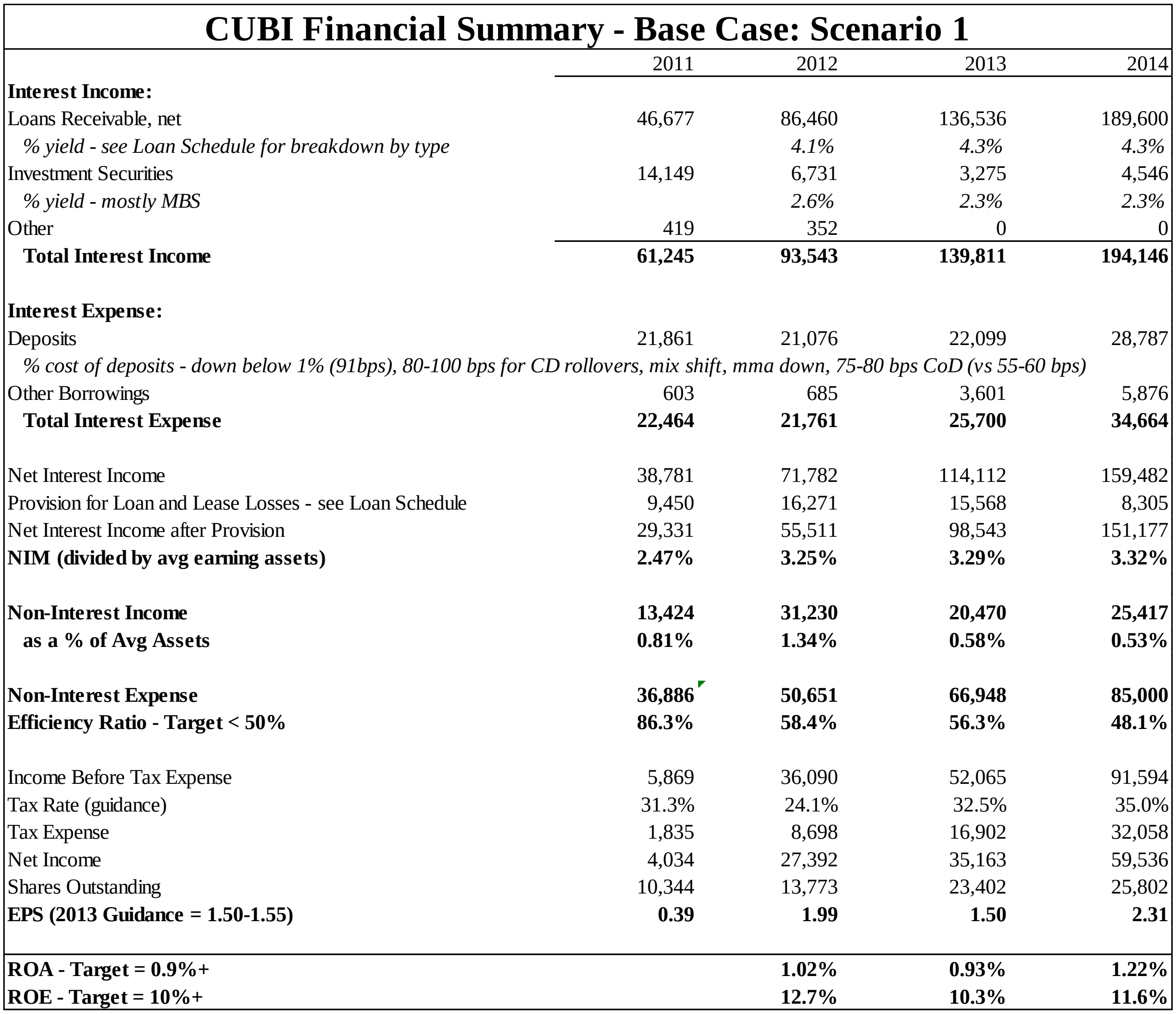
Asset Quality by Loan Type - 12/31/12

Originated Loans	Total Loans	Current	NPLs	as a % of Loans	ALLL	as a % of NPLs	OREO	NPAs
Legacy (prior to 9/09)	104,666	89,234	15,432	14.7%	4,389	28.4%	2,245	17,677
Commerical	429,511	427,614	1,897	0.4%	4,109	216.6%	0	1,897
MultiFamily	358,871	358,871	0	0.0%	1,794	0.0%	0	0
Consumer/Mortgage	76,559	76,559	0	0.0%	537	0.0%	0	0
Manufactured	3,113	3,113	0	0.0%	63	0.0%	0	0
Warehouse- Repo	9,565	9,565	0	0.0%	71	0.0%	0	0
Warehouse- HFS	1,439,889	1,439,889	0	0.0%	0	0.0%	0	0
TDRs	4,303	604	3,699	86.0%	0	0.0%	0	3,699
Total Originated Loans	2,426,477	2,405,449	21,028	0.9%	10,963	52.1%	2,245	23,273
Acquired Loans								
Berkshire	14,738	12,736	2,002	13.6%	359	17.9%	1,315	3,317
FDIC	63,673	53,170	10,503	16.5%	2,539	24.2%	4,109	14,612
Manufactured Housing 2010	83,570	83,570	0	0.0%	3,486	0.0%	0	0
Manufactured Housing 2011	0	0	0	0.0%	0	0.0%	445	445
Manufactured Housing 2012	59,474	59,474	0	0.0%	0	0.0%	0	0
TDRs	1,845	1,585	260	14.1%	0	0.0%	0	260
Total Acquired Loans	223,300	210,535	12,765	5.7%	6,384	50.0%	0	12,765
Acquired PCI Loans								
Berkshire	60,668				2,572			
FDIC	45,573				8,776			
Manufactured Housing 2011	12,321				5,568			
Total Acquired PCI Loans	118,562				16,916			
Fees, Expenses & Unallocated	-10,036	2,012	57	-0.6%	722		0	57
Total Loan Portfolio	**2,758,303**	**2,617,996**	**33,850**	**1.2%**	**34,985**	**103.4%**	**2,245**	**36,095**

[10] Excluding acquired PCI Loans.

In addition, the Bank’s allowance for loan and lease losses (ALLL) is equal to 103.4% of non-performing loans (NPLs). Therefore, even if all of the defaulting loans in the portfolio were written-down to zero, shareholders’ equity would still not be pierced. As far as the potential for additional losses in the portfolio to manifest in the future, the amount is limited. Given the preponderance of short-term warehouse loans, FDIC loss-sharing on legacy loans, and very conservative underwriting standards, Customers Bank stands out as one of the few banks in the United States with little-to-no balance sheet risk.

In summary, Customers Bank has a simple formula for success: (1) superior credit quality, plus (2) revenues = 2x expenses (50% efficiency ratio), equals 1% ROA and double-digit ROE.



CUBI Financial Summary - Base Case: Scenario 1

	2011	2012	2013	2014
Interest Income:				
Loans Receivable, net	46,677	86,460	136,536	189,600
% yield - see Loan Schedule for breakdown by type		*4.1%*	*4.3%*	*4.3%*
Investment Securities	14,149	6,731	3,275	4,546
% yield - mostly MBS		*2.6%*	*2.3%*	*2.3%*
Other	419	352	0	0
Total Interest Income	**61,245**	**93,543**	**139,811**	**194,146**
Interest Expense:				
Deposits	21,861	21,076	22,099	28,787
% cost of deposits - down below 1% (91bps), 80-100 bps for CD rollovers, mix shift, mma down, 75-80 bps CoD (vs 55-60 bps)				
Other Borrowings	603	685	3,601	5,876
Total Interest Expense	**22,464**	**21,761**	**25,700**	**34,664**
Net Interest Income	38,781	71,782	114,112	159,482
Provision for Loan and Lease Losses - see Loan Schedule	9,450	16,271	15,568	8,305
Net Interest Income after Provision	29,331	55,511	98,543	151,177
NIM (divided by avg earning assets)	**2.47%**	**3.25%**	**3.29%**	**3.32%**
Non-Interest Income	**13,424**	**31,230**	**20,470**	**25,417**
as a % of Avg Assets	**0.81%**	**1.34%**	**0.58%**	**0.53%**
Non-Interest Expense	**36,886**	**50,651**	**66,948**	**85,000**
Efficiency Ratio - Target < 50%	**86.3%**	**58.4%**	**56.3%**	**48.1%**
Income Before Tax Expense	5,869	36,090	52,065	91,594
Tax Rate (guidance)	31.3%	24.1%	32.5%	35.0%
Tax Expense	1,835	8,698	16,902	32,058
Net Income	4,034	27,392	35,163	59,536
Shares Outstanding	10,344	13,773	23,402	25,802
EPS (2013 Guidance = 1.50-1.55)	**0.39**	**1.99**	**1.50**	**2.31**
ROA - Target = 0.9%+		**1.02%**	**0.93%**	**1.22%**
ROE - Target = 10%+		**12.7%**	**10.3%**	**11.6%**

Valuation

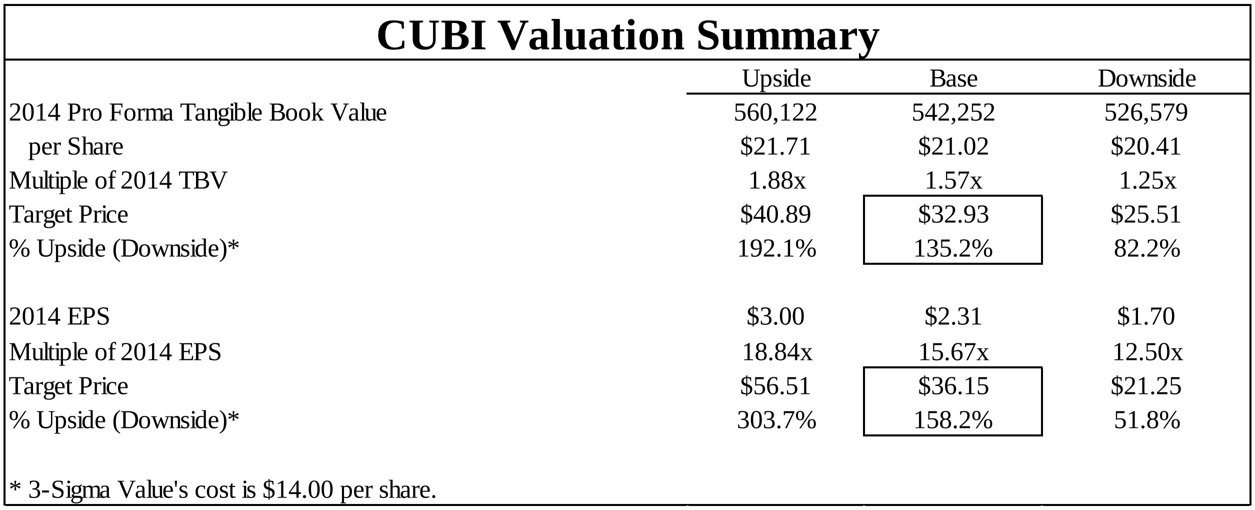
Valuation is not in the eyes of the beholder, it is neither art nor love. It is science. Every input must be validated; every output must be cross-checked. Based on (1) the high correlation between return on equity (ROE) and P/TBV, and (2) comparable bank valuations, we employ a range of Price-to-Tangible Book Value multiples (P/TBV) and Price-to-Earnings (P/E) – to estimate the future value of Customers Bank.

Empirically, the higher the return on equity the higher the multiple of book value. This basic relationship between P/BV and ROE generally holds across all banking (spread) businesses. Based on data from SNL Financial going back to 1990, the median P/TBV of announced M&A transactions is 1.8x. In the early 1990s, banks were sold in the range of 1.3x to 1.8x before launching above 2x in 1997 and remaining there for 10 years except during the brief recession that followed the bursting of the internet bubble. By 2003, M&A multiples were back over 2x, peaking at 2.3x in 2006.

New York / New Jersey / Pennsylvania Community Banks (Assets > $2 Billion)

			Price as of			4Q12				2012	
Bank Name	Ticker	State	3/31/2013	Shares Out	Market Cap	Assets	TBV	TCE / TA	**P/TBV**	**ROA**	**ROTCE**
M&T Bank	MTB	NY	103.16	128.7	13,280	83,009	50.98	7.9%	**2.0x**	**1.40%**	**17.7%**
New York Community Bank	NYCB	NY	14.35	440.4	6,319	44,145	7.31	7.3%	**2.0x**	**1.28%**	**17.5%**
First Niagara Financial Group	FNFG	NY	8.86	349.3	3,094	36,806	5.65	5.4%	**1.6x**	**0.48%**	**9.0%**
People's United Bank	PBCT	CT/NY	13.42	331.3	4,446	30,324	8.71	9.5%	**1.5x**	**0.87%**	**9.1%**
Webster Financial	WBS	CT/NY	24.26	85.3	2,070	20,147	18.20	7.7%	**1.3x**	**0.90%**	**11.7%**
Susquehanna Bank	SUSQ	PA	12.43	186.7	2,320	18,038	6.88	7.1%	**1.8x**	**0.81%**	**11.4%**
Signature Bank	SBNY	NY	78.76	47.3	3,722	17,456	34.92	9.5%	**2.3x**	**1.17%**	**12.4%**
Fulton Financial Corporation	FULT	PA	11.70	198.4	2,322	16,528	7.79	9.4%	**1.5x**	**0.98%**	**10.5%**
Astoria Financial	AF	NY	9.86	96.3	950	16,497	11.51	6.7%	**0.9x**	**0.31%**	**4.6%**
Valley National Bank	VLY	NJ	10.24	199.1	2,038	16,013	5.24	6.5%	**2.0x**	**0.91%**	**14.0%**
Investors Bank	ISBC	NJ	18.78	108.8	2,043	12,723	8.89	7.6%	**2.1x**	**0.77%**	**10.1%**
F.N.B. Corporation d.b.a. First National Bank of Pennsylvania	FNB	PA	12.10	138.0	1,670	12,024	4.99	5.7%	**2.4x**	**0.94%**	**16.4%**
National Penn Bank	NPBC	PA	10.69	145.5	1,556	8,530	6.13	10.5%	**1.7x**	**1.17%**	**11.2%**
Northwest Bancshares d.b.a. Northwest Savings Bank	NWBI	PA	12.68	93.7	1,188	7,943	10.15	12.0%	**1.2x**	**0.79%**	**6.6%**
Community Bank System	CBU	NY	29.63	39.6	1,175	7,497	13.01	6.9%	**2.3x**	**1.08%**	**15.7%**
Provident Financial Services d.b.a. The Provident Bank	PFS	NJ	15.27	56.9	869	7,284	10.96	8.6%	**1.4x**	**0.94%**	**11.0%**
NBT Bank	NBTB	NY	22.15	33.8	749	6,042	12.22	6.8%	**1.8x**	**0.93%**	**13.6%**
First Commonwealth Financial	FCF	PA	7.46	99.3	741	5,995	5.88	9.7%	**1.3x**	**0.71%**	**7.3%**
Beneficial Mutual Savings Bank	BNCL	PA	10.30	77.5	798	5,006	6.48	10.0%	**1.6x**	**0.29%**	**2.9%**
Tompkins Financial Corporation	TMP	NY	42.28	14.4	607	4,925	22.69	6.6%	**1.9x**	**0.32%**	**4.8%**
S&T Bak	STBA	PA	18.54	29.7	551	4,422	11.86	8.0%	**1.6x**	**1.15%**	**14.4%**
Flushing Financial Corp.	FFIC	NY	16.94	30.9	524	4,380	13.74	9.7%	**1.2x**	**0.85%**	**8.8%**
TrustCo Bank Corp NY	TRST	NY	5.58	93.8	523	4,318	3.81	8.3%	**1.5x**	**0.89%**	**10.8%**
Provident New York Bank	PBNY	NY	9.07	44.2	401	4,023	7.30	8.0%	**1.2x**	**0.26%**	**3.3%**
Dime Community Bank	DCOM	NY	14.36	35.6	511	3,954	9.32	8.4%	**1.5x**	**1.21%**	**14.4%**
Sun Bancorp d.b.a. Sun National Bank	SNBC	NJ	3.41	86.0	293	3,180	2.85	7.7%	**1.2x**	**0.16%**	**2.0%**
Hudson Valley Holding Corp.	HVB	NY	14.91	19.6	293	2,929	13.65	9.1%	**1.1x**	**0.44%**	**4.8%**
Kearny Federal Savings Bank	KRNY	NJ	10.20	66.2	675	2,898	5.79	13.2%	**1.8x**	**0.16%**	**1.2%**
Lakeland Bank	LBAI	NJ	9.85	29.7	292	2,860	6.41	6.7%	**1.5x**	**0.78%**	**11.7%**
Northfield Bank	NFBK	NJ	11.36	57.8	656	2,813	6.90	14.2%	**1.6x**	**0.65%**	**4.6%**
Oritani Financial Corp.	ORIT	NJ	15.49	45.2	700	2,771	11.41	18.6%	**1.4x**	**1.37%**	**7.3%**
Sterling Bank	STL	NY	10.16	31.0	315	2,700	6.78	7.8%	**1.5x**	**0.82%**	**10.6%**
Financial Institutions Inc. d.b.a. Five Star Bank	FISI	NY	19.96	13.8	275	2,653	13.31	6.9%	**1.5x**	**0.65%**	**9.5%**
Metro Bank	METR	PA	16.54	14.1	234	2,538	16.34	9.1%	**1.0x**	**0.33%**	**3.6%**
OceanFirst Financial	OCFC	NJ	14.42	18.0	260	2,304	12.19	9.5%	**1.2x**	**0.86%**	**9.0%**
Univest Corp. of Pennsylvania d.b.a. Univest National Bank	UVSP	PA	17.42	16.8	292	2,232	13.29	10.0%	**1.3x**	**1.04%**	**10.4%**
First of Long Island Corp. d.b.a. The First National Bank of Long Island	FLIC	NY	29.65	9.0	266	2,053	22.88	10.0%	**1.3x**	**0.94%**	**9.4%**
						Average:		**8.8%**	**1.6x**	**0.80%**	**9.5%**
Customers Bank	**CUUU**	**PA**	**16.75**	**18.9**	**317**	**3,201**	**14.03**	**8.3%**	**1.2x**	**1.02%**	**12.7%**

Customers Bank is a significantly undervalued bank. It earns a 12% ROE compared to 9.5% for its peers yet trades at 1.2x TBV compared to 1.6x. CUBI should trade at a premium (or at least in line) with its peer group given its superior ROE driven by superior cost management. CUBI is one of the most profitable banks in the U.S. and has minimal credit risk. When CUBI lists on the Nasdaq later this quarter (2Q 2013), the increase in liquidity and trading volume will catalyze the process of elevating the stock price to a level consistent with other similar publicly-traded community banks.



CUBI Valuation Summary

	Upside	Base	Downside
2014 Pro Forma Tangible Book Value	560,122	542,252	526,579
per Share	$21.71	$21.02	$20.41
Multiple of 2014 TBV	1.88x	1.57x	1.25x
Target Price	$40.89	$32.93	$25.51
% Upside (Downside)*	192.1%	135.2%	82.2%
2014 EPS	$3.00	$2.31	$1.70
Multiple of 2014 EPS	18.84x	15.67x	12.50x
Target Price	$56.51	$36.15	$21.25
% Upside (Downside)*	303.7%	158.2%	51.8%

* 3-Sigma Value's cost is $14.00 per share.

Ultimately, an investment in a bank is an investment in people. While I can't say that we at 3-Sigma Value have a spotless record investing in bank management teams, we do have an extensive one, during which time we have conducted due diligence on over 100 past, present, and potential bank management teams.

A fellow investor in Customers Bank warned me not to be "overly-wowed" by Jay's knowledge of banking – a contradiction given knowledge is what we are seeking. Jay is not "shareholder friendly," I am told over and over again – based on a version of the Sovereign tale that history has proven false.

The basic reason Customer Bank is undervalued is the so-called "Jay Sidhu discount" – a discount that we strongly believe is unwarranted and depreciating with each impressive quarter of revenue growth and cost management. Recently, Customers Bank was ranked #1 by Bank Director magazine in terms of organic revenue growth based on data on all U.S. banks, compiled by Bank Intelligence Solutions, a subsidiary of Fiserve (FISV). The data is overwhelming.

http://www.bankdirector.com/index.php/magazine/archives/2nd-quarter-2013/who-says-there-s-no-growth-in-banking/

Final Thoughts

In electrical engineering, there is concept called *losing the signal in the noise*, which when applied to economics describes the failure of forecasting and misuse of statistical probabilities. A signal is something that conveys information, while noise is superfluous, meaningless, or random. Problems arise when the noise is as strong as, or stronger than, the signal. In today's interconnected world, the amount of data we have available to measure and make projections is evergreen yet our ability to extract meaning and truth from it is limited by models that are corrupted by false inputs.

In order to salvage the U.S. banking system, the Federal Reserve perpetuates two policies that distort reality:

1. Pegs short-term interest rates at zero percent, enabling banks to borrow at ~zero and lend at three, four, five percent, it doesn't matter the rate on mortgages because when a bank's cost of capital is zero (or near-zero) all balance sheet activity is accretive.

2. Suspends the rules governing mark-to-market accounting, making it impossible to rely on the valuations of loans and other assets as reflected in a bank's audited financial statements.

Banks collectively continue to earn rising profits as a result of these two controlling policies, posting a healthy ROA (return on assets) of 1.00% in 2012, up from 0.88% in 2011. 2013 should be no different. Bank charters are licenses to make money. And a bank without legacy credit risk is one of the best investments we can think of in this era of financial repression. Within that construct, Customers Bank is statistically the most attractive bank in the United States in terms of the combination of revenue growth, cost management, and valuation. The noise is strong but so is the signal. This bank is undervalued.