

# CARROLLTON BANK

March 2, 2011

*A look at some developments  
in the banking industry  
that could affect your business.*

As a business owner, I thought you might appreciate a quick update about our bank and the banking industry, plus I'll answer several recurring questions I've heard from a number of business owners recently.

## ***Do you have money to lend?***

Yes. Our deposits grew \$108 million (16%) last year, so we continue to have a stable flow of new funds to lend.

## ***Are you making loans?***

Yes. Last year, our loans increased \$79 million (14%). The St. Louis Post-Dispatch article below lists us as one of the five banks, out of 75 banks, that are "showing fast loan growth."

## ***Carrollton Bank grew a lot in 2010, adding 11 top bankers and opening 3 new branches. Will that pace of growth continue?***

No. Prudent, long-term companies always pause to digest growth. That's what we've done after each of our last three growth spurts, and that's what we will do again for the next few years. Our goal, as always, is to be a successful, safe, strong bank.

## ***What's next for the banking industry?***

We may be seeing three distinct and significant eras of banking end and begin within a few short years. The *Old Normal* of prosperous growth and the emergence of several start-up banks that began in the early 1990s and ended abruptly in 2008. The *Great Recession* that started in late 2008 and continues today, when all banks were severely tested and some did not survive. And now, the *New Normal*, that will be characterized by greater permanent expenses and tighter operating parameters (both due to new regulations), and significant industry consolidation as the pace of mergers and acquisitions is expected to accelerate (e.g., Bank of Montreal's recent purchase of M&I Bank, formerly Southwest Bank).

## ***Is that why many banks are increasing checking fees now?***

Yes. Recent federal legislation added several new costs to banks and the banks are trying to pass them through to their customers. The largest new expense for most banks is higher FDIC insurance premiums.

## ***Will Carrollton Bank start passing these higher FDIC costs on to customers?***

No. Our growth has created efficiencies of scale that have helped to produce annual operating expense savings of more than 30% compared to our peers.

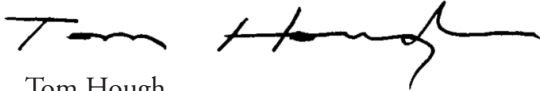
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***What's next for Carrollton Bank?***

Due to these higher fees, we are being introduced to a lot of business owners who would like us to serve their deposit needs. We have added several top Treasury Management Officers to serve this growing need. If you know a business owner like this, we would appreciate an introduction to see if we can give them a better deal and a better banking experience.

All of us at Carrollton Bank would like to wish you and your family all the best in 2011, and express how much we enjoy having the opportunity to serve you.

Best regards,

A handwritten signature in black ink, appearing to read "Tom Hough". The signature is fluid and cursive, with a long horizontal stroke at the end.

Tom Hough  
Chairman & CEO

P.S. Please feel free to share this letter with other business leaders if you believe it could help them.



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# ST. LOUIS POST-DISPATCH

November 14, 2010

## St. Louis banks are stuck in a rut

*Banking in St. Louis seems frozen in time, and a bad time at that.*

By Jim Gallagher  
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The latest figures from the Federal Reserve indicate that community banks based in St. Louis boosted lending a tiny 1 percent from early July to late September, but money on loan was still 3 percent below September of 2009.

The good news is that St. Louis banks in general remain profitable. Only 11 of 75 locally based commercial banks are losing money this year, compared with 23 in 2009. Two small money-losing banks failed this year.

The bad news is that profits are slim. The typical bank here was earning 46 cents on every \$100 in loans and securities as of September. In good times, most banks earn double that and more.

Meanwhile, local banks' pile of delinquent loans and foreclosed properties is holding steady. It made up 4.53 percent of bank loans here, up 4.29 percent in June and 3 percent in September of 2009. In normal times, that figure is less than 2 percent.

The banking business here has hit a "plateau," says Julie Stackhouse, senior vice president for banking supervision at the Federal Reserve Bank of St. Louis. "We're not seeing a lot of progress," she said.

The high problem-loan count means that "we still have a lot of risk," Stackhouse said.

The Fed's latest national survey for banks shows a slight loosening in standards for commercial and industrial loans — loans to businesses not involved in real estate and development.

Bankers here say they're seeing that too. Having been burned on real estate loans, banks here are trying to shift their lending toward

other kinds of businesses, and that's producing stiff competition among banks for such loans.

Until now, banks were competing by lowering interest rates and fees. Now some are just beginning to lower credit standards for certain business loans, says Jim Watson, president of Midwest BankCentre. In some cases, banks are no longer insisting that business owners sign a personal guarantee to get a loan.

Bankers complain that profitable commercial and industrial firms don't want to borrow much. With sales slow, they're paying down debt instead.

"Organic loan demand has been very tepid. It's just not there," said Tom Hough, CEO at Carrollton Bank.

Meanwhile some banks are still pushing good business borrowers out the door, bankers say. Sometimes, the bank itself is weak and can't renew loans. Sometimes banks are trying to reduce their exposure to real estate, so even good landlords are frozen out.

As a result, some banks are growing while others shrink. Banks such as UMB, Carrollton, Citizens, Eagle and Lindell are showing fast loan growth.

Commercial real estate loans are the biggest remaining headache for area bankers. Loans on offices, warehouses, shopping centers and the like make up 27 percent of loans at the average St. Louis bank.

Rising vacancies mean trouble for landlords, and that means trouble for their bankers. The last real estate slump in the 1980s showed that such problems can linger long. "It typically takes years," Stackhouse said.

Still, bankers say they've prepared in advance for the pain.

"I think most banks have figured out their bad loans. There are fewer surprises," Hough said. "I don't think there will be a second shoe drop."

Capital is the prime measure of bank safety. It's a cushion of money invested in the bank that can absorb losses and prevent failure.

Two tiny banks — Peoples Bank & Trust of Troy and Superior Bank — are below the level regulators consider "well-capitalized." One small bank, 1st Advantage of St. Peters, is below the "adequate" capital standard — a danger sign.

Greg Smith, CEO at 1st Advantage, said the company would raise capital through a stock offering within the next few weeks. "We're still in the banking business. I'm still looking for good loans," he said.

First Bank, the largest locally based bank, is ranked as well-capitalized, although its holding company is below the "adequately" capitalized level. Bank regulators care less about capital at the holding company level when dealing with mid-sized operations such as First Bank.

First Bank officials say their problem isn't a lack of capital, just the wrong kind. Regulators limit the portion of capital that can be held as "trust-preferred securities," a form of long-term debt. First Bank is asking holders of those securities for permission to swap them for securities that count more heavily in capital measures.

When the economic slum finally ends, bankers are expecting a new wave of bank-eat-bank buyouts. For now, healthy banks in a mood to expand are waiting to see which competitors fail, knowing they

can buy them from the FDIC on the cheap.

But once the economy improves, bankers expect that many small banks will put themselves up for sale to larger competitors. Some of that will be driven by tougher bank safety regulations, as well as restrictions on fees banks collect for overdrafts and for charges merchants pay when consumers use debit cards.

Those are cash cows for banks. In response, some banks have ended free checking accounts, although plenty of banks still offer them. "I think you'll see more fees and less free," Hough said.

But the profit pressure will force small banks into the arms of larger ones in order to achieve economies of scale, he said.

The Fed's figures cover banks based in St. Louis. That excludes some of the biggest players in the market, such as U.S. Bank, Bank of America and PNC. Those banks don't break out numbers for St. Louis. The figures also exclude Commerce Bank, which is legally based in Kansas City, although its senior executives are in St. Louis.

All 75 locally based banks are showing a loss of \$42 million for the first nine months of the year. That figure includes a \$131 million loss at First Bank. First Bank lost heavily on California real estate loans, and most of its business is outside St. Louis. Excluding First Bank, other St. Louis banks turned an \$89 million profit.