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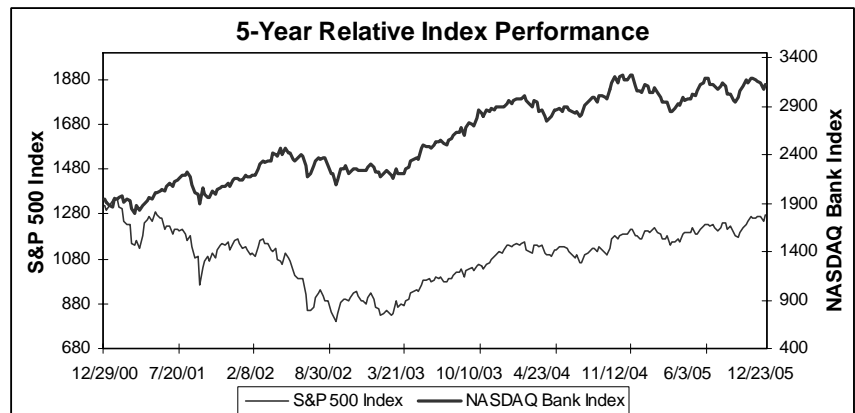
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EQUITY RESEARCH

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2006 Outlook

A challenging operating environment, heady valuation levels, and concerns about the yield curve resulted in the NASDAQ Bank Index underperforming the broader markets during 2005, marking the first time it has done so since 1999. Coming into 2006, we think many of the factors that defined the environment for community bank stocks in 2005 remain in place and 2006 could prove to be another tough year for many community bank stocks. Although several positive factors (good loan growth, expense containment efforts, capital management initiatives, attractive dividend yields, and the potential for the Fed to end its tightening cycle) remain in place and could help support bank stock valuation levels during 2006, we are not broadly bullish on the sector and are projecting a 2-4% total return for the NASDAQ Bank Index for 2006. That being said, we believe buying opportunities exist as certain franchises remain undervalued and others are positioned to weather and overcome current market forces.



12/29/00 – 12/30/05

Performance Statistics

Year	NASDAQ Bank Index	S&P 500 Index	DJIA
2005	(4.3%)	3.0%	(0.6%)
2004	11.0%	9.0%	3.2%
2003	29.9%	26.4%	25.3%
2002	4.4%	(23.4%)	(16.8%)
2001	10.1%	(13.0%)	(7.1%)
2000	14.6%	(10.2%)	(6.2%)
1999	(8.0%)	19.5%	25.2%

2005 - Volatile Year for Community Bank Stocks. Despite stalwart fundamentals, strong profitability, good credit quality, and decent M&A activity, the NASDAQ Bank Index performed in a seesaw manner and posted a loss of 4.3% for 2005. This compared to a gain of 3.0% for the S&P 500 Index and a relatively flat year for the Dow Jones Industrial Average. This marked the first time since 1999 that the NASDAQ Bank Index underperformed the broader markets.

2006 - We are projecting a 2-4% total return for the NASDAQ Bank Index. While the economy continues to show signs of recovery and overall prospects appear good for continued sound fundamental performance at our community banks, current valuation measures continue to signal caution. The P/E for the NASDAQ Bank Index is currently at 17.3X trailing 12-month earnings, roughly in line with its five-year historic average of 17.9X, indicating to us that valuation levels are not exceptionally compelling. While we do see some positives for the sector (good loan growth, continued expense containment and capital management initiatives, attractive dividend yields, and the potential for the Fed to end its tightening cycle), we think headwinds (concerns about the yield curve, intense competition, potentially higher credit costs, and high valuation levels) could continue to curb the performance of community bank stocks. Near-term, we see no catalyst to drive valuation levels higher and we would not be surprised to see a continued pull back in the sector during the first half of the year. Although we think continued M&A activity, stock repurchase activity, and strong industry profitability will help buoy the NASDAQ Bank Index during 2006, we do not view these as key drivers to increased valuation levels. We think selectivity remains key to superior investment returns, more so now than ever, and we continue to be attracted to banks with talented management teams, strong credit quality, good revenue generation capabilities, and product/service differentiation.

2006 - Trend Watch. While the state of the community banking sector appears sound, economic softness continues to exist across some markets, leading us to believe that earnings growth for some community banks and thrifts could be challenging during 2006. Tangible evidence of sustainable revenue growth will be crucial to valuation improvement for community bank stocks in 2006. As the year unfolds, we see several trends emerging for our community banks:

- **NIM – Pressure Should Persist.** Despite a potential end to the Fed's tightening cycle, we think many of our community banks will continue to experience some additional NIM pressure during 2006. We believe impediments to NIM improvements include: 1) our expectations for a flat or inverted yield curve over the near-term; 2) competitive loan and deposit pricing; 3) a negative deposit mix shift from low cost core deposits to higher cost deposits; and 4) an increased reliance on more expensive wholesale borrowings as loan growth outpaces deposit growth.
- **Modest Balance Sheet Growth.** Core deposit growth has been a challenge among our community banks over the past year; driven in part by increased competition as depositors chase higher yielding investment alternatives. We see this trend continuing over the near-term, and we are looking for deposit growth to be in the low single digits for community banks in 2006. Continued economic expansion has resulted in good loan growth through the first nine months of 2005 led by consumer and C&I lending. We believe most of our community banks will grow loan balances as they continue to wrestle away market share from larger competitors and are projecting overall loan growth of 4-8% for our community banks in 2006.
- **Credit Quality Currently Not An Issue, But A Potential Headwind.** Credit losses have been exceptionally low during the past twelve months with community banks posting a median NCO to average loan ratio of 12 b.p. nationally and 15 b.p. for the companies in our coverage universe. We think most banks and thrifts should be commended for maintaining healthy credit quality in the midst of a challenging operating environment. That being said, we think credit quality is about as good as it gets and believe the opportunity for earnings growth based on lower provision expenses could be muted. While we look for credit quality to remain strong in 2006, we would not be surprised to see NCOs begin trending upward (in the 25-40 b.p. range) and loan loss provisions rising commensurately in 2006. Despite this, we think the impact will be minimal for the majority of our covered banks.
- **Expenses Remain In Check.** Banks with the ability to generate cost savings or hold down expense growth, particularly in what could be a moderately improving revenue growth environment in 2006, should be better positioned for bottom line growth than the typical bank.
- **M&A Activity Still A Factor.** We think valuation levels of community bank stocks could continue to be supported by M&A activity. Of the 250 deals announced during 2005, 244 were of financial institutions with total assets under \$5 billion, according to data gathered from SNL Financial. Given current valuation levels and the regulatory burdens faced by many community banks, we would not be surprised to see community banks use their currency to fill in holes in their geographic footprint or enter new markets.
- **Positive Fundamental Outlook With Select Opportunities.** Altogether, we believe that EPS growth will be in the 6-8% range for many community banks in 2006. While we would like to believe that the appreciation potential for the NASDAQ Bank Index over the next 12 months will mimic our EPS outlook for community banks in 2006, we think current valuation levels and the potential for sector rotation could put some pressure on the sector. Given this and our other previously stated concerns, and factoring in a 2% dividend yield, we believe the performance for the NASDAQ Bank Index for 2006 will be flat to up 2% and offer a 2-4% total return potential.

Despite The Headwinds, We Think Opportunities Exist. Our goal remains to identify well-run companies that we think will outperform the sector not only over the coming year, but on a consistent basis, regardless of market conditions. As always, our decision making hinges on a number of factors including, but not limited to, operating fundamentals, growth prospects, valuation, franchise dynamics, and the strength of senior management. Given heady valuation levels, we think selectivity remains paramount. While the economy continues to recover and prospects appear good for continued sound fundamental performance at our community banks, current valuation measures signal caution and make value investing difficult, to say the least. Although our community bank stocks are not inexpensive on a relative basis, we believe there are stocks within our coverage universe whose valuation levels are compelling given their growth prospects and sound fundamental performance. Below is a list of the 16 community bank stocks that we have currently assigned an OUTPERFORM rating.

HBI'S OUTPERFORM LIST

Priced as of 1/06/06		Stock Price/Share (\$)	52-Week		12-Month Projected	
Ticker	Name		High Price (\$)	Low Price (\$)	Target Price (\$)	Total Return (%)
ABVA	Alliance Bankshares Corporation	16.03	17.38	14.20	20.00	24.8
TBNC	Banc Corporation (The)	11.32	12.00	8.00	13.00	14.8
CTBI	Community Trust Bancorp, Inc.	31.79	35.01	27.94	35.00	13.4
COOP	Cooperative Bankshares, Inc.	19.85	21.75	16.58	22.00	11.8
CRFN	Crescent Financial Corporation	15.11	17.47	12.76	17.00	12.5
DCBF	DCB Financial Corp	28.50	29.00	24.16	29.50	5.3
DEAR	Dearborn Bancorp, Inc.	24.69	28.02	22.04	27.62	11.9
EFSC	Enterprise Financial Services Corp	22.73	27.73	18.16	25.00	10.6
BUSE	First Busey Corporation	20.39	21.25	18.03	21.00	6.1
HTLF	Heartland Financial USA, Inc.	21.56	22.25	18.20	22.00	3.7
IBCP	Independent Bank Corporation	27.37	30.10	25.60	31.00	16.0
LKFN	Lakeland Financial Corporation	40.02	45.19	35.00	45.00	14.7
MBFI	MB Financial, Inc.	35.97	42.74	34.02	41.00	15.7
MBWM	Mercantile Bank Corporation	38.63	48.24	36.38	46.00	20.2
PNFP	Pinnacle Financial Partners, Inc.	25.60	26.65	20.50	27.00	5.5
TOFC	Tower Financial Corporation	16.75	17.25	13.00	19.00	13.4

In the upcoming days, we will be releasing our Top Picks for 2006 in which we highlight three names that we think are poised to significantly outperform the NASDAQ Bank Index over the coming year.

RATING SYSTEM

Category	Description
OUTPERFORM	Those equities that we think will likely outperform the NASDAQ Bank Index over the next 12-months. A subset of this category is our Top Picks, which represents our best ideas in the Outperform category.
MARKET PERFORM	Those equities that we think will likely approximate the NASDAQ Bank Index over the next 12-months.
UNDERPERFORM	Those equities that we believe are likely to trail the performance of the NASDAQ Bank Index over the next 12-months.

RATING DISTRIBUTION (as of December 31, 2005)

Coverage Universe	Count	Percent	Investment Banking Relationship*	Count	Percent
OUTPERFORM	15	19.5%	OUTPERFORM	3	18.8%
MARKET PERFORM	58	75.3%	MARKET PERFORM	12	75.0%
UNDERPERFORM	4	5.2%	UNDERPERFORM	1	6.2%

* Companies which Howe Barnes Investments, Inc. has received within the past 12 months or will receive within the next 3 months compensation for services rendered in connection with activities relating to: underwriting an offering for the issuer; acting as a financial advisor in a merger or acquisition; providing valuation services; or serving as placement agent for the issuer.

ADDITIONAL INFORMATION AVAILABLE UPON REQUEST

For a complete list of the companies in which Howe Barnes Investments, Inc. makes a market, go to www.howebarnes.com.

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