Zacks Small-Cap Research

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The First Marblehead Corporation (FMD-NYSE)

UPDATE: Cology Acquisition and Fourth Quarter Update

Current Recommendation	**Neutral**
Prior Recommendation	N/A
Date of Last Change	06/10/2010
Current Price (10/12/12)	$0.96
Six- Month Target Price	**$1.25**

OUTLOOK

Our recommendation on The First Marblehead Corporation (FMD) remains Neutral. FMD is in the middle stage of a turnaround, and has made significant strides in putting together the building blocks for its comeback. This includes the roll-out of its new partnered lending program with two lenders, Sun Trust Bank and Kinecta Federal Credit Union; the acquisition of TMS, a significant factor in tuition payment services; the origination of student loans through its Union Federal Savings Bank (UFSB) subsidiary; the start-up of a new private student loan consolidation program with SunTrust; and the just-announced purchase of certain assets and liabilities of Cology, Inc., a provider of processing, disbursement, and life-of-loan servicing to over 250 credit unions and lending institutions nationally. We view the Cology acquisition positively, noting the potential for cross-selling Monogram and securitization services to Cology's client base. While we have reduced our fiscal 2013 EPS estimate by a couple of pennies to a loss per share of $0.47 from a loss per share of $0.45 due to the Cology acquisition, FMD expects the Cology purchase to be earnings accretive beginning in fiscal 2014. The cost of the Cology acquisition was not disclosed, though we understand that it was substantially lower than the $47 million paid for TMS. Still, with about $179 million of cash on its balance sheet (excluding UFSB) at June 30, 2012 and a cash burn rate of $10-11 million per quarter (pre-Cology), FMD has its work cut out for it.

SUMMARY DATA

52-Week High	**$1.52**
52-Week Low	**$0.85**
One-Year Return (%)	**-4.65**
Beta	**1.89**
Average Daily Volume (sh)	**150,092**
Shares Outstanding (mil)	**102**
Market Capitalization ($mil)	**$98**
Short Interest Ratio (days)	**31.40**
Institutional Ownership (%)	**37**
Insider Ownership (%)	**16**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2012 Actual	**N/A**
P/E using 2013 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**Above Average**
Type of Stock	**Small-Value**
Industry	**Fin-Cons Loans**
Zacks Rank in Industry	**10 of 10**

ZACKS ESTIMATES

Net Revenue*
(in millions of $)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2011					7.5A
2012					39.8A
2013					51.0E

Earnings per Share*
(EPS is operating earnings before nonrecurring items)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2011	$(0.16)A	$(0.10)A	$(0.41)A	$(0.19)A	$(0.87)A
2012	$(0.19)A	$(0.16)A	$(0.06)A	$(0.14)A	$(0.55)A
2013					$(0.47)E

*Excludes securitization trusts segment, reported as a discontinued operation.
Quarterly EPS may not add to total dues to changes in shares outstanding

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RECENT NEWS

On October 3, 2012, FMD announced the cash acquisition of certain assets and liabilities of Cology, Inc., a provider of processing, disbursement, and life-of-loan servicing to over 250 credit unions and lending institutions nationally. First Marblehead Education Loan Services LLC, a wholly owned subsidiary of FMD, expects to complete the acquisition during the second quarter of fiscal 2013, and the transaction is expected to be accretive in fiscal 2014.

Details are slim, but here's what we do know.

- For the 12 months ended June 30, 2012, Cology processed over 65,000 applications and disbursed more than $451 million in private student loans, generating three-year compound annual growth rates of 114% and 106%, respectively. This compares to $57.7 million of disbursed loans in fiscal 2012 for FMD through its partnered lending programs ($23.4 million, or about 41% of the total) and Union Federal Savings Bank ($34.3 million, or 59% of the total). So this acquisition adds significantly to FMD's business volume.

- FMD has not yet disclosed the amount of cash paid for the deal, though we gather that it is substantially less than the $47 million paid for the TMS acquisition. In addition, FMD has agreed to assume certain liabilities of Cology as part of the transaction. We may learn more details about this in the fiscal first quarter (ending September 30) conference call, though this transaction won't be reflected in FMD's financial statements until the second fiscal quarter (ending December 31).

- Cology's fee-for-service business model consists of two lines: (1) full service loan processing, in which Cology underwrites private student loans and performs various other services for its clients, including loan disbursement and customer service and (2) technology hosting, in which Cology only performs loan processing for is clients.

- Revenues per loan are generally lower than that which FMD generates as FMD earns interest income on its first-loss participation accounts, while Cology does not provide such a product to its customer base.

- Unlike FMD which assumes a first-loss position on loans it underwrites, Cology assumes no credit risk for loans it underwrites, as this remains with its credit union clients, or with third-party guarantors selected by the credit unions.

We view this acquisition positively and note that FMD benefits from this acquisition in two ways. First, FMD can cross-sell Monogram services to Cology's clients, particularly with regard to credit scoring and portfolio management, thereby potentially increasing revenues per client. Secondly, in the future, FMD may be able to provide securitization services for private student loans on Cology's client books, which could generate fees for FMD.

In other news, FMD reported its fiscal 2012 fourth quarter results for the period ended June 30, 2012, during which FMD changed its accounting for the securitizations trusts segment to a discontinued operation following complete disposal of all operations related to this segment in the third quarter (prior-period results were restated). For the quarter, FMD recorded a net loss from continuing operations of $14.0 million, or a loss per share of $0.14, including a $0.3 million gain from the TERI settlement. Excluding the TERI gain, the net loss from continuing operations was $14.3 million or an operating loss per share of $0.14.

During the fourth quarter, FMD expanded its Monogram lending program to 850 approved lender list positions, a 21% increase from 704 lender list positions at the end of the previous quarter in March. The timing was propitious as this expansion occurred prior to the peak lending season, which began in June.

Our fourth quarter loss estimate for the education financing segment was $14.5 million, or a loss of $0.14 per diluted share. While our estimate was close to actual operating results, revenues were higher and expenses were lower than we had anticipated.

On the revenue side, the primary reasons for the difference were twofold: (1) administrative and other fees of $2.8 million were $1.0 million less than our $3.8 million estimate following reclassification of the trust administration business, which had previously been included in the education financing segment, to a discontinued operation and (2) TMS revenues of $4.3 million were $1.0 million below our $5.3 million estimate as the year-ago $6.9 million sale of a portfolio of contracts to Nelnet took a bigger bite out of revenues than expected. We note that TMS revenues typically decline by about 25% in the fourth quarter from levels achieved in the first through third quarters due to the seasonal nature of TMS's business as the school year winds down and payment plans reach their conclusion. In total, FMD posted net revenue of $8.8 million, compared to our $10.4 million estimate.

As to expenses, noninterest expense was $23.6 million, $0.9 million better than our $24.5 million estimate, primarily reflecting lower-than-expected general and administrative expenses, largely due to reclassification of the trust administration business, which had previously been included in the education financing segment, to a discontinued operation.

For the 2012 fiscal year, FMD posted a net loss from continuing operations of $33.6 million, or a net loss per share of $0.30. Excluding nonoperating items ($1.7 million gain on TERI, $9.5 million gain from the deconsolidation of the securitization trusts, $12.5 million one-time tax credit, and $1.2 million in one-time severance costs), FMD posted a net operating loss from continuing operations of $56.1 million, or an operating loss per share of $0.55.

FMD has already begun on a significant cost-cutting program, primarily related to legacy operations of the now-sold NCSLT and GATE Trusts. This includes reduced headcount, though no cutbacks are expected in the marketing staff for the Mongram program or at TMS. FMD expects annual compensation expense to be reduced by about $7 million and annual general and administrative expenses to be reduced $6.6 million, stemming from outsourcing operations and TMS's call center, to begin in fiscal 2013's second quarter. In total, annual cash operating usage is expected to be reduced by $13.6 million, or 26%, when all cuts have been implemented by the end of fiscal 2013 (ending June 30, 2013).

We are changing our per share loss per share estimate to $0.47 from $0.45 for fiscal 2013, ending June 30, 2013, due to the Cology acquisition.

Below we discuss 2012 fiscal fourth quarter results in more depth. Details of our projections are shown at the back of the report.

Business Review

Including the Monogram-based loan programs at Sun Trust and Kinecta that began in July and September 2010, respectively, as well as at Union Federal Savings Bank (UFSB), which began on July 1, 2011, as of August 13, 2012, FMD had processed over 122,000 private student loan applications representing $1.3 billion in loans, of which it had approved $380 million, or about 30% of the $1.3 billion total. Booked variable-rate private education loans carried a 6.0% average variable rate, while booked fixed-rate loans had an average interest rate of 8.2%.

The table following shows Monogram lending statistics broken down by segment for fiscal 2012. As can be seen, FMD's bank subsidiary UFSB accounts for about two-thirds of approved loan applications and about 60% of booked and disbursed loans.

12 Months ending 6/30/12	Partnered Lending	Union Federal Savings Bank	Total
Total Applications ($ Mil)	$288.5	$578.4	$866.9
Approved Applications ($ Mil)	$96.7	$119.1	$215.8
Booked Loans ($ Mil)	$26.0	$37.6	$63.6
Disbursed Loans ($ Mil)	$23.4	$34.3	$57.7

These metrics demonstrate that loan demand is quite strong and that FMD is accepting only the cream of the crop, the top 30% of all loans submitted. This is further borne out by the credit quality statistics of the loans that have been approved: a weighted-average credit score of 759; 87% are cosigned, 62% are in some form of immediate repayment; and 69% have repayment terms of 10 years or less.

At June 30, 2012, 0.5% of these loans were delinquent and there were no defaults. Nonaccrual loans plus past due loans greater than 90 days and still accruing interest were $54,000, or 0.2% of outstanding education loans.

The high credit quality of the education loan portfolio reflects both the Monogram program, a well as the fact that here are no loans made to for-profit and two-year colleges, which tend to display higher default rates than four-year private and public colleges and universities do. In addition, the loan portfolio is not yet seasoned, as USFB just began making education loans in the fiscal year beginning on July 1, 2011, meaning that all loans are about one year old. As the loan portfolio matures, we expect asset quality metrics to deteriorate somewhat from current exceptionally strong levels, though still remain solid.

Specific loan loss reserves are established for loans greater than 180 days past due but not yet charged off, while the general loan loss allowance is based upon historical loss experience. Since Monogram's loan history is limited, FMD has used the historical results of the securitization trusts for loans that have similar characteristics to the Monogram loan portfolio. The general loss reserve for education loans was $1.3 million or 3.8% of outstanding education loans at June 30, 2012, and there were no specific loan loss reserves at that date.

While the Sun Trust and Kinecta loan programs contribute 300-400 basis points of revenue per loan, the net interest margin is higher for UFSB. At UFSB, the weighted average yield on the education loan portfolio is an estimated 6.3-6.5%, while funding costs are roughly 90-100 basis points, leaving a net interest margin of about 5.4-5.6%. This is roughly 150 basis points larger than the revenue contribution from the SunTrust and Kinecta loan programs.

On both programs, there are additional costs related to defaults and administrative costs. The Company estimates net charge-offs on the UFSB loans at 75-100 basis points and defaults costs on the SunTrust and Kinecta portfolios at 50-75 basis points. In addition, FMD estimates servicing costs on the UFSB loans at 30-50 basis points. While FMD did not disclose administrative and marketing costs for the SunTrust and Kinecta loan programs, we would assume that they are probably larger than servicing costs at UFSB.

Clearly, the UFSB loans are more profitable for FMD than either the Sun Trust or Kinecta loan programs. However, lending capacity at UFSB is limited given current regulatory capital constraints. At present, we estimate that UFSB could add roughly $100 million in loans and still be well capitalized pursuant to federal regulations, assuming no other changes in its balance sheet. After that, UFSB would have to stop lending or pursue other options, such as obtaining additional capital or pursuit of some form of permanent financing including a securitization or whole loan sale.

In the first option, FMD could downstream cash from the holding company as a capital contribution to UFSB. With a larger capital base, UFSB could lend more. In fact, this occurred in 2012's third quarter when FMD contributed $4 million of capital to UFSB.

In addition, FMD has been exploring various forms of permanent financing, including the establishment of a warehouse line of credit at an investment bank, a securitization, or other financing arrangements that could remove UFSB's education loans from the bank's balance sheet. This would free up capital at UFSB and create further capacity for future loan originations.

While we sense nothing is imminent, once loan volume at UFSB reaches $50-100 million (likely in fiscal 2013), it might make sense financially to go the securitization route, recognizing that FMD has been out of the securitization market since the fall of 2007 and initial terms could be somewhat onerous until FMD regains acceptance in this market.

We note that 46.8% of UFSB's mortgage loans and all of its education loans had variable interest rates at June 30, 2012. Although these variable interest-rate assets generally reprice more frequently and have longer duration than FMD's deposits, interest-rate risk with respect to net interest income is mitigated by similarities in the interest-rate and market risks underlying loan and deposit pricing. That said, the balance sheet remains asset sensitive, meaning that FMD's net interest income and net interest margin should benefit in a rising interest-rate environment.

Future growth prospects for the Monogram loan program appear bright. FMD recently added nine people to its sales staff and now has a 16-member sales team that has visited over 1,700 schools across the country in the last year, including 500 campuses in the fourth quarter. FMD currently has Monogram lending programs approved on 850 lender list positions, a 21% increase from 704 lender list positions at the end of the previous quarter in December (the timing is propitious as this expansion occurred prior to the peak lending season, which began last summer).

This reflects consolidation of all Sun Trust student loan products onto the Monogram platform, the diligent effort of FMD's sales force, and the superiority of the Monogram loan product, which represents a new generation of student loan product. Monogram offers its customers enhanced flexibility in structuring student loans, improved disclosure about terms and costs of the loan for easier comparison with other loan programs, and better pricing. In fact, for the most creditworthy customers, students can borrow money at a cheaper rate than through the major federal student loan programs.

Moreover, FMD's new private student loan consolidation product with SunTrust Bank should also boost lending volumes and related fee revenue.

From a macro standpoint, pressure on the US government's budget could cause a reduction in federal student loan programs, which could benefit private student lenders, including First Marblehead. In addition, as regional banks enter the private student loan sector or expand beyond their lending footprints beyond their territories to enhance diversification, FMD's high-quality Monogram private student education loans could be a good fit.

More importantly, future results will benefit from repeat business, known as serialization. Approximately 65% of Monogram loans were extended either to lower classmen (i.e., freshman, sophomores, and juniors) or to K-12 customers, providing the opportunity to capture increasingly greater share of this market in the years ahead.

At TMS, we have estimated total revenues for the year of about $28 million, with roughly $7-8 million generated in the first though third fiscal quarters and $4-6 million in revenues in the fourth quarter, with the decline the result of the typical seasonal slowdown in payment processing as the school year winds down.

A new product that TMS began offering in 2012's second quarter is refund management, now having nine clients in total. Through refund management, which is expected to be a key driver of growth going forward, TMS provides a debit card to students to pay for living expenses, relieving colleges of the administrative burden of issuing checks periodically for this purpose. Debit cards are initially being issued by a third-party vendor, though at some point in the future could be issued by FMD's UFSB subsidiary. Revenues are generated through fees for subscriptions, transactions, merchant interchange, and ATM usage. The sales pipeline for refund management continues strong, as 70% of schools still process refunds manually.

Two ancillary businesses launched in February 2012 by TMS that will add to revenue growth in the coming years include:

- TMS Campus Advantage, which allows schools to manage 100% of their student receivables though TMS, and

- a marketing agreement with School and Student Services by the National Association of Independent Schools (SSS by NAIS) that will promote TMS to more than 2,100 subscriber schools as the exclusive preferred tuition payment plan provider and the prepGATE Loan Program as the exclusive preferred K-12 education loan provider.

UFSB continued profitable in 2012's fourth quarter posting net income for the quarter of $249,000, following a $134,000 profit in the third quarter and a small loss in the first half. A couple of factors are contributing to this more positive outlook. First, a $40 million deposit related to TMS was transferred from a third party to UFSB in the second quarter. Since it was placed in a noninterest-bearing DDA account, this will reduce UFSB's average cost of funds by about 40 basis points, to 60 basis points from 100 basis points. Just as importantly, the funds were invested in higher interest earning mortgage-backed securities and education loans (as compared to the puny returns earned on cash and other short-term investments). Thus, the net interest margin should benefit from both higher interest income and reduced interest costs.

The $40 million deposit transfer expanded UFSB's balance sheet to about $125 million (now $142 million due to additional loans) from $81 million, requiring a $4 million capital contribution in the third quarter from FMD to beef up UFSB's equity so that it continued to be well capitalized. At June 30, 2012, UFSB's Tier 1 capital ratio was 31.3%, its Total capital ratio was 31.8%, and its Tier 1 core ratio was 11.0%, all well above the required levels of 6%, 10%, and 5%, respectively, to be well-capitalized pursuant to federal regulations. We would expect FMD to make additional capital contributions or take other steps to keep UFSB well capitalized.

Other News

On August 2, 2012, FMD announced the launch of a new private student loan consolidation product with SunTrust Bank that will allow students to refinance their existing private student loans into one new loan at a fixed or variable interest rate with a single payment, and the potential to reduce their current monthly payment and interest rate. The program runs for two years and has a similar structure to those that exist for other SunTrust loan programs based upon the Monogram platform.

On March 30, 2012, the new third party owner of FMDS terminated the agreement with First Marblehead Education Resources, Inc. (FMER) for the special servicing of the GATE Trusts. As a result of the termination of the agreement, FMD deconsolidated the assets and liabilities of the GATE Trusts as of March 31, 2012, and recorded a noncash gain of $10.9 million in its financial statements upon deconsolidation.

On March 2, 2012, FMD announced the sale of First Marblehead Data Services, Inc. (FMDS), its legacy trust administration business, to Route 66 Ventures, Inc., d/b/a Goal Structured Solutions (GS2), for

$13.7 million in cash. The Company recorded a gain of approximately $12.5 million in the quarter ending March 31, 2012 related to this transaction.

On February 9, 2012, FMD announced that its subsidiary Tuition Management Systems LLC (TMS) entered into a marketing agreement with School and Student Services by the National Association of Independent Schools (SSS by NAIS). The agreement creates a joint marketing relationship for the promotion of TMS payment plans, the prepGATE® Loan Program funded by FMD's UFSB bank subsidiary, and SSS By NAIS, a financial aid management service offered to NAIS member and non-member schools. SSS By NAIS will promote TMS to more than 2,100 subscriber schools as its exclusive preferred tuition payment plan provider, and the prepGATE Loan Program as its exclusive preferred K-12 education loan. In turn, TMS will promote SSS By NAIS as its exclusive financial aid management service provider.

On January 6, 2012, FMD confirmed that it had regained compliance with the continued listing standards of the New York Stock Exchange. As previously disclosed on November 2, 2011, the Company ran afoul of this standard when its average closing price fell below the required $1.00 per share over a consecutive 30 trading-day period.

On November 17, 2011, FMD disclosed that the Massachusetts Appellate Tax Board had issued an order (Order) in the cases relating to the Massachusetts tax treatment of GATE Holdings, Inc. In connection with the Order, FMD recognized an income tax benefit during the fiscal second quarter ending December 31, 2011 of approximately $12.5 million. FMD also made net tax payments for GATE's taxable years ended June 30, 2004, 2005 and 2006 of $5.1 million during its fiscal third quarter ending March 31, 2012. FMD could be required to make additional tax payments for GATE's taxable years ended June 30, 2008 and 2009, which could materially adversely affect its liquidity position.

On November 15, 2011, FMD announced it amended its loan program agreement with SunTrust Bank. Key highlights of the new agreement include: (1) increases lending volume through FMD's Monogram platform as all new SunTrust private education lending activity will occur through First Marblehead by the end of the third quarter of fiscal 2012 (previously SunTrust marketed its own private student loan product, in addition to the Monogram product); (2) extends the agreement to January 31, 2015 from April 20, 2012; (3) prohibits SunTrust Bank from marketing non-FMD products through July 1, 2013; (4) increases the Participation Cap and establishes a 54-month waiting period for FMD withdrawals from the Participation Accounts for all loans with applications received on or after July 15, 2012; (5) prohibits FMD from marketing in certain locations exclusive to SunTrust, including the District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, and Tennessee; (6) requires FMD to maintain minimum staffing levels for sales activities in certain states and a minimum amount of sales-related expenditures for each calendar year for the remaining term of the agreement; and (7) gives FMD the option to securitize or otherwise dispose of education loans made by SunTrust.

On November 14, 2011, FMD announced that it sold to VCG Special Opportunities Master Fund Limited (VCG) its variable interests in its National Collegiate Student Loan Trusts (NCSLT Trusts) for $13 million in cash. Notably, this allowed FMD to deconsolidate the NCSLT Trusts from it financial statements, removing assets of $6.7 billion and liabilities of $7.9 billion, while at the same time booking a $1.2 billion gain on the sale, thereby eliminating the deficit in shareholders' equity related to the NCSLT Trusts. Moreover, this sale provides the Company with $13 million in cash immediately for assets that weren't expected to generate cash flow until 2025.

In other news, the Consumer Financial Protection Bureau (CFPB) announced findings on the private student loan (PSL) industry. Significant recommendations that affect PSL lenders include:

- Improved disclosure regarding the availability of federal student loans

- Enhanced cooperation between lenders and higher education institutions to prevent overborrowing by students

- Creating a database for private student loans similar to the National Student Loan Data System (NSLDS) for federal student loans to aid borrowers in understanding their total debt obligations

- Permitting dischargeability of private student loan debt in bankruptcy to borrowers who are experiencing financial distress

Regarding dischargeability, we're not sure if this would have a significant impact on the PSL industry as more than 80% of private student loans currently underwritten are cosigned by high-quality guarantors having strong credit profiles (FICO scores of 750 or better).

OVERVIEW

The First Marblehead Corporation (FMD) provides student loan services to financial and education institutions throughout the United States. These services are comprised of an integrated suite of private student loan design, implementation, and credit risk management services that help these institutions meet their risk, strategic and financial goals while maintaining regulatory compliance.

FMD offers these services under the Monogram® platform (Monogram), a new product for FMD that was developed over the last few years. Monogram utilizes FMD's proprietary credit risk analytics models, which are based upon data gathered by FMD over 20 years and among the most sophisticated in the industry. Through the partnered lending program based upon Monogram, FMD receives service fees, as well as a portion of the net interest income generated portfolio of program loans for which they provide credit enhancement

Currently, FMD has two clients using Monogram though its partnered lending program: SunTrust Bank, headquartered in Atlanta and serving the Southeast and mid-Atlantic regions, with more than $170 billion in assets; and Kinecta Federal Credit Union, a California-based federal credit union with over $3.5 billion in assets. Program capacity is $500 million for SunTrust and $75 million for Kinecta, with maturities of early 2015 for SunTrust and mid 2013 for Kinecta.

With the December 2010 purchase of Tuition Management Systems (TMS) for $47 million, FMD has added a complementary fee-for-service business to its line-up. TMS, one of the nation's largest providers of outsourced tuition planning, billing, counseling, refund management and payment technology services for colleges, universities, and elementary and secondary schools, operates in 47 states and now serves over 760 school clients, including such prestigious institutions as Duke University, Boston College, University of Chicago, MIT, and Carnegie Mellon. TMS added $26.5 million of total revenues in fiscal 2012.

FMD also owns a small federally chartered thrift, Union Federal Savings Bank of North Providence, Rhode Island (acquired in November 2006), that offers residential and commercial mortgage loans, private student loans, and retail savings, money market and time deposit products. Union Federal began originating Monogram-based private education loans in July, 2011.

Financial statements were considerably altered with the beginning of the fiscal 2011 year (ending June 30, 2011), following the adoption of new accounting standards, which required the consolidation of 14 securitizations trusts that had previously been accounted for off balance sheet. Thus, $8.2 billion of securitized loan receivables from the trusts were added to FMD's balance sheet, along with $9.0 billion of nonrecourse debt issued by the trusts. However, with the recent sale of FMD's variable interest in the NCSLT Trusts as well as the sale of FMDS and related transactions, assets and liabilities of these 14 entities were deconsolidated: 11 entities in fiscal 2012's second quarter (ending December 31, 2011) and 3 entities in the 2012 fiscal third quarter (ending March 31, 2012).

FMD's financial statements now include only the operations of the education financing segment as opposed to the two segments reported (education financing and securitization trusts) when the securitization trusts were consolidated. The securitization segment was reported as a discontinued operation in fiscal 2012's fourth quarter, with prior periods restated for this change.

VALUATION

FMD's stock valuation metrics are depressed. Although FMD is in the middle stage of a turnaround and we are encouraged by the progress made to date, the outlook remains somewhat murky. Moreover, FMD continues to lose money, though at a decelerating pace, with our diluted loss per share estimate at $0.47 in fiscal 2013, an improvement over fiscal 2012's operating loss per share from continuing operations of $0.55.

Though FMD's share price has rebounded 13% from a recent low of $0.85 that it hit on November 10, 2011, it is down 17.7% year to date and also down 37% from 2012's high of $1.52 reached on February 22, 2012, and now sells at $0.96 per share.

We note that FMD's stock ran afoul of the continued listing standards of the New York Stock Exchange in early November 2011, when its average closing price fell below the required $1.00 per share over a consecutive 30 trading-day period. Though this was cured in early January, FMD's stock price has again fallen below the requisite $1.00 per share, where it has traded for the last two days.

While the stock remains below its 52-week high of $1.52, it is now trading within the Company's historical norms based upon Price/Book Value. Using Price/Book Value, we note that FMD is valued at 0.52X, though this is below FMD's average Price/Book Value of roughly 0.70X for the past couple of years.

Applying the 0.70X ratio to our estimated book value for FMD six months out results in a price target of approximately $1.25. We continue to recommend a Neutral on FMD shares.

Industry Comparables- Small-Cap Financial Services

		Price / Earnings Ratios					Return on Equity		Return on Assets		
	Pr Chg YTD	TTM* EPS	2012E	2013E	5-Yr Avg	Price/ Book	TTM*	5-Yr Avg	TTM*	5-Yr Avg	Div Yld
First Marblehead	**(17.7)**					**0.52**	**Neg**	**Neg**	**Neg**	**Neg**	**-----**
S&P 500	**13.6**	**14.6**	**14.0**	**13.1**	**16.9**	**3.6**	**29.6**		**8.57**		**2.2**
Median	**5.4**	**10.1**	**9.4**	**8.8**	**10.4**	**1.29**	**12.7**	**13.41**	**5.09**	**4.2**	**-----**
Average	21.5	15.0	11.3	9.7	14.9	2.1	16.2	(13.13)	6.33	(8.4)	1.6
High	128.6	63.8	24.9	19.1	64.1	13.1	54.3	42.47	40.85	32.9	10.7
Low	(50.7)	5.6	3.8	5.7	5.8	0.4	(18.2)	(355.32)	(7.52)	(222.9)	-----

*Trailing twelve months

The First Marblehead Corporation

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	06/07	06/08	06/09	06/10	06/11	06/12	06/13 E
Net interest income	9.4	25.6	25.1	9.9	0.7	2.4	5.4
Non-interest revenue	871.3	(54.0)	(315.1)	6.4	6.8	37.4	45.6
Total net revenue	880.7	(28.4)	(290.0)	16.3	7.5	39.8	51.0
Loan loss provision (credit)	0.0	0.0	0.0	0.0	0.3	(0.6)	0.1
Non-interest expense	253.0	358.5	260.8	232.1	93.5	102.0	98.1
Income tax expense (credit)	256.4	(151.8)	(187.8)	(70.3)	1.1	(5.5)	1.2
Net income before NRI	**371.3**	**(235.1)**	**(363.0)**	**(145.5)**	**(87.4)**	**(56.1)**	**(48.4)**
Discontinued operations	0.0	0.0	0.0	0.0	(140.2)	1,135.8	0.0
GAAP net income	371.3	(235.1)	(363.0)	(145.5)	(221.6)	1,102.2	(48.4)
EPS before NRI	**3.92**	**(2.46)**	**(3.66)**	**(1.46)**	**(0.87)**	**(0.55)**	**(0.47)**
Reported EPS	3.92	(2.46)	(3.66)	(1.46)	(2.20)	9.96	(0.47)
Dividends per share	0.58	0.40	0.00	0.00	0.00	0.00	0.00
Cash & short-term investments	234.9	221.1	173.1	381.0	267.4	208.5	165.5
Restricted cash & GICs	0.0	0.0	0.0	1.0	124.7	65.4	65.0
Loans	37.1	508.1	360.5	113.6	6.4	40.9	95.0
Receivables	809.7	411.2	233.9	73.3	2.9	16.3	0.0
Other assets	132.8	60.5	53.8	64.5	106.1	126.7	122.0
Subtotal	**1,214.5**	**1,200.9**	**821.3**	**633.4**	**507.5**	**457.8**	**447.5**
Discontinued operations	0.0	0.0	0.0	0.0	7,144.4	0.0	0.0
Total assets	1,214.5	1,200.9	821.3	633.4	7,651.9	457.8	447.5
Deposits	53.5	244.1	154.5	108.7	60.5	83.4	137.5
Restricted funds due to clients	0.0	0.0	0.0	0.0	121.9	105.0	105.0
Short-term borrowings	0.0	242.9	230.1	218.1	0.0	0.0	0.0
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	318.4	76.3	31.2	36.8	67.8	42.4	26.4
Shareholders' equity	842.6	637.6	405.5	269.8	257.3	227.0	178.6
Subtotal	**1,214.5**	**1,200.9**	**821.3**	**633.4**	**507.5**	**457.8**	**447.5**
Discontinued operations	0.0	0.0	0.0	0.0	8,281.7	0.0	0.0
Total liabilities and equity	1,214.5	1,200.9	821.3	633.4	7,651.9	457.8	447.5

The First Marblehead Corporation

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	2011				2012			
	Q1 A	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 A**
Net interest income	0.1	0.2	0.4	0.1	0.3	0.5	0.7	0.8
Non-interest revenue	5.0	9.3	(15.0)	7.4	12.0	7.5	14.3	8.0
Total net revenue	5.1	9.5	(14.6)	7.5	12.3	8.0	15.0	8.8
Loan loss provision (credit)	0.1	0.2	0.0	0.0	(0.2)	(0.1)	(0.2)	(0.1)
Non-interest expense	20.0	19.5	27.2	26.9	31.0	24.1	24.3	23.6
Income tax expense (credit)	1.1	(0.0)	(0.1)	0.1	0.8	0.7	(2.9)	(0.4)
Net income before NRI	**(16.1)**	**(10.2)**	**(41.7)**	**(19.5)**	**(19.3)**	**(16.7)**	**(6.2)**	**(14.3)**
Discontinued operations	(48.9)	(29.3)	2.4	(64.3)	(69.8)	1,197.8	8.1	0.0
GAAP net income	(65.0)	(39.5)	(39.3)	(83.8)	(88.0)	1,194.3	9.9	(13.9)
EPS before NRI	**(0.16)**	**(0.10)**	**(0.41)**	**(0.19)**	**(0.19)**	**(0.16)**	**(0.06)**	**(0.14)**
Reported EPS	(0.64)	(0.33)	(0.39)	(0.83)	(0.87)	10.82	0.09	(0.14)
Dividends per share	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Cash & short-term investments	328.6	293.8	278.7	267.4	245.4	217.7	210.5	208.5
Restricted cash & GICs	0.0	147.0	97.4	124.7	142.1	144.5	46.0	65.4
Loans	8.6	8.0	6.9	6.4	14.0	23.7	39.0	40.9
Receivables	21.3	14.6	2.7	2.9	0.0	12.5	16.9	16.3
Other assets	67.1	118.1	105.7	106.2	113.8	99.8	128.9	126.7
Subtotal	**425.6**	**581.5**	**491.4**	**507.6**	**515.3**	**498.2**	**441.3**	**457.8**
Discontinued operations	7,824.8	7,504.1	7,347.8	7,144.3	6,972.9	258.3	0.0	0.0
Total assets	8,250.4	8,085.6	7,839.2	7,651.9	7,488.2	756.5	441.3	457.8
Deposits	79.5	55.9	57.3	60.5	66.4	68.1	73.8	83.4
Restricted funds due to clients	0.0	147.0	94.7	121.9	139.5	143.9	85.4	105.0
Short-term borrowings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	28.6	64.1	65.4	67.8	69.9	49.1	42.1	42.4
Shareholders' equity	317.5	314.5	274.0	257.4	239.5	237.1	240.0	227.0
Subtotal	**425.6**	**581.5**	**491.4**	**507.6**	**515.3**	**498.2**	**441.3**	**457.8**
Discontinued operations	8,869.6	8,578.2	8,419.6	8,281.7	8,178.8	266.4	0.0	0.0
Total liabilities and equity	8,250.4	8,085.6	7,839.2	7,651.9	7,488.2	756.5	441.3	457.8

HISTORICAL ZACKS RECOMMENDATIONS



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