Zacks Small-Cap Research

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The First Marblehead Corporation (FMD-NYSE)

FMD: First Quarter Beats Our Estimate, Reverse 1-for-10 Stock Split, and Two New Clients!

Current Recommendation	**Neutral**
Prior Recommendation	N/A
Date of Last Change	06/10/2010
Current Price (01/20/14)	$6.26
Six- Month Target Price	**$8.00**

OUTLOOK

FMD reported its fiscal 2014 first quarter results for the period ended September 30, 2013, posting a net loss of $11.6 million, or a loss per share of $1.03 (all EPS data have been adjusted for the 1-for-10 reverse stock split in early December). This compares to our first quarter loss estimate of $12.1 million, or a loss of $1.08 per diluted share. The primary reason for the better performance vis-à-vis our estimate is due to revenue coming in $0.5 million higher than our projection, as both TMS tuition payment fees and Monogram-based fee income beat expectations. FMD's net operating cash usage improved significantly, falling to $6.4 million from $10.8 million in the year-ago quarter, primarily reflecting higher cash revenues and lower cash expenses. FMD expects net operating cash usage to be in the $26-$30 million range for the 2014 fiscal year, a substantial improvement over fiscal 2013's $42.5 million. New business initiatives included an agreement with Thrivent Federal Credit Union to provide origination services (through Cology) and sales support and data analysis (through Monogram) and an agreement with Vermont Student Assistance Corporation to perform credit and data analytics services and consulting services. FMD's Board of Directors approved a 1-for-10 reverse stock split, which finally resolved the problem FMD had in maintaining compliance with the $1.00 per share minimum listing standard of the New York Stock Exchange.

SUMMARY DATA

52-Week High	**$18.80**
52-Week Low	**$6.02**
One-Year Return (%)	**-30.82**
Beta	**2.18**
Average Daily Volume (sh)	**56,508**
Shares Outstanding (mil)	**11**
Market Capitalization ($mil)	**$71**
Short Interest Ratio (days)	**10.31**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**14**
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 2013 Estimate	**N/A**
P/E using 2014 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High**
Type of Stock	**Small-Value**
Industry	**Fin-Cons Loans**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Net Revenue*
(in millions of $)

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2012	10.9A	6.6A	13.5A	8.8A	39.8A
2013	12.6A	11.2A	12.8A	8.0A	44.6A
2014	14.1A	12.6E	14.2E	9.3E	50.2E
2015					54.8E

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

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2012	$(1.97)A	$(1.67)A	$(0.49)A	$(1.40)A	$(5.52)A
2013	$(1.37)A	$(1.20)A	$(0.83)A	$(1.27)A	$(4.64)A
2014	$(1.03)A	$(0.95)E	$(0.66)E	$(1.16)E	$(3.80)E
2015					$(3.40)E

*Excludes securitization trusts segment, reported as a discontinued operation.
Quarterly EPS may not add to total dues to changes in shares outstanding.
EPS has been adjusted for reverse 1-for-10 stock split in December 2013.

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FIRST QUARTER UPDATE

FMD reported its fiscal 2014 first quarter results for the period ended September 30, 2013, posting a net loss of $11.6 million, or a loss per share of $1.03 (all EPS data have been adjusted for the 1-for-10 reverse stock split in early December). This compares to our first quarter loss estimate of $12.1 million, or a loss of $1.08 per diluted share.The primary reason for the better performance vis-a-vis our estimate is due to revenue coming in $0.5 million higher than our projection, as both TMS tuition payment fees and Monogram-based fee income beat expectations.

In last year's first quarter, FMD reported a net loss of $13.9 million, or a loss per share of $1.37. The $2.3 million improvement reflected a $1.2 million, or 10%, growth in revenues after the loan loss provision and a $1.1 million, or 4%, cut in operating expenses.

Relative to the first quarter a year ago, net revenue increased $1.5 million, or 12%, to $14.1 million, the cyclically highest-growth period in FMD's fiscal year.

Net interest income jumped 37% to $1.3 million on a higher net interest margin (1.66% versus 1.09%) as lower yield cash and short-term investments were partially liquidated and replaced by higher yield education and mortgage loans and mortgage securities in the available-for-sale investment portfolio.

This was aided by a gain in noninterest revenues of $1.1 million, or 10%, as growth in fees from TMS, Cology, and Monogram more than offset the loss of $1.5 million in special servicing revenues (sold last fiscal year) and a drop of $0.4 million in fair value changes to service revenue receivables.

Specifically, TMS fees rose $0.5 million, or 7%, due to a $383,000, or 25%, jump in credit card convenience fees to $1.9 million, as credit card volume improved 26%, as well as a $198,000, or 16%, advance in merchant services fee income as volumes rose 11%. Cology contributed $1.9 million in revenues for the first time in the first quarter (it was acquired in last year's fiscal second quarter) and Monogram-based fees posted a $618,000, or roughly one-third, increase to $2.5 million.

Operating expenses tumbled $1.1 million, or 4%, year over year to $25.1 million, due to declines of $2 million in loan acquisition costs and of $1.3 million in special servicing costs that were partly offset by increases of $1.6 million in compensation expense, of $389,000 from larger interchange fees related to the higher TMS fee revenues, and of $300,000 in higher depreciation expense as a capitalized costs for the student account center investment at TMS started to amortize.

In addition, operating expenses also include approximately $820,000 in professional fees related to developments in the IRS matter during the quarter, as well as the initial review performed by the additional tax counsel engaged by the Company. FMD believes that this expense will most likely be in the $200,000-$500,000 range going forward.

FMD's net operating cash usage improved significantly during the quarter, falling to $6.4 million from $10.8 million in the year-ago quarter, primarily reflecting higher cash revenues and lower cash expenses. FMD expects net operating cash usage to be in the $26-$30 million range for the 2014 fiscal year, a substantial improvement over fiscal 2013's $42.5 million.

Excluding UFSB, FMD had $93 million in cash and cash equivalents at the end of September, down about $17 million from the $110 million at the end of the June quarter. This decline largely reflected cash operating usage during the quarter, a $5.6 million increase in participation account deposits, and a $450,000 capital contribution to Union Federal.

New business initiatives included an agreement with Thrivent Federal Credit Union to provide origination services (through Cology) and sales support and data analysis (through Monogram) and an agreement

with Vermont Student Assistance Corporation to perform credit and data analytics services and consulting services.These were announced in 2014's fiscal second quarter.

As previously disclosed, on September 10, 2013 FMD received two NOPAs from the IRS in which the IRS asserted that FMD's sale of the Trust Certificate should not be recognized for federal income tax purposes. The IRS further concluded that the transaction should be characterized as a financing instead of a sale.

As a result, the NOPAs propose to disallow the loss that generated the tax refunds that FMD previously received as well as require FMD to include income from the Trust Certificate from the March 31, 2009 sale date through June 30, 2011 in taxable income for such years. If the IRS's positions are successful, the disallowance of the loss, coupled with the additional taxable income after the sale date through June 30, 2011, would create federal income tax adjustments that FMD estimates to be approximately $300.0 million plus interest, with the interest continuing to accrue until the matter is resolved. The NOPAs do not address tax years beyond June 30, 2011. The NOPAs are only initial IRS positions and not final determinations and, as a result, do not require any current tax payment. FMD did not record an accrual for this matter in its consolidated financial statements at September 30, 2013. FMD plans to vigorously contest the proposed adjustments and believes it has a strong position as it relates to these matters.

In its quarterly conference call, FMD clarified certain timing issues related to the NOPAs. There are three phases to the process, beginning with the exam phase, which FMD is currently undergoing. After that, the decision goes through the appeal phase, and finally the litigation phase, with the results from litigation also subject to appeal.

This NOPA disclosure caused First Marblehead shares to decline 36% on August 16, 2013. As a result, a class action lawsuit was filed in United States District Court, District of Massachusetts. The lawsuit alleges that throughout the Class Period (November 4, 2010 through August 15, 2013), FMD made false and/or misleading statements, as well as failed to disclose material adverse facts about the Company's business, operations, and financial performance.

An additional lawsuit was filed on October 23, 2013 by a different plaintiff who alleges, among other things, that the defendants breached their fiduciary duties to FMD by making, or not preventing, purported false and misleading statements concerning FMD's corporate income tax filings. The complaint seeks, among other relief, a return of all damages purportedly sustained by FMD as well as changes to corporate governance policies and procedures.

It will probably be several years before the NOPAs and related lawsuits are resolved. We believe these uncertainties will likely keep a lid on FMD's share price until some significant positive news is announced, such as a major new partnered lending program or an asset securitization.

FMD's Board of Directors approved an amendment to the Corporation's restated certificate of incorporation to (1) effect a 1-for-10 reverse stock split and (2) decrease the number of authorized shares of common stock on a basis proportional to the reverse stock split ratio. This was accomplished on December 3, 2013 and finally resolved the problem FMD had in maintaining compliance with the $1.00 per share minimum listing standard of the New York Stock Exchange.

We are raising our fiscal 2014 EPS estimate by $0.20 to a loss of $3.80 per share from a loss of $4.00 per share, largely due to increased estimates for revenue contributions from TMS, Cology and Monogram. Our initial loss per share estimate for fiscal 2015 is $3.40, a $0.40 improvement from our $3.80 loss per share estimate for fiscal 2014. We expect higher lending volumes at UFSB, growing revenues from Cology and Monogram, initial contributions from Thrivent Federal Credit Union and Vermont Student Assistance Corporation, and continued strong expense control to be the primary drivers behind this gain.

Below we discuss first quarter results in more depth. Projections are shown at the back of the report.

Business Review

The following table shows lending statistics broken down by segment for the first quarter of fiscal 2014 and fiscal 2013. As shown, facilitated loan volume for the quarter totaled $433.2 million, which includes $357.1 million from Cology and $76.1 million of Monogram-based loan originations. Facilitated Monogram-based loan originations were down $8.4 million, or 10%, when compared to the same quarter a year ago, largely driven by reduced marketing spending. Disbursed loan volumes for the first quarter totaled $236.9 million, of which, $194.5 million was from Cology, $8.7 million from Union Federal, and $33.7 million from partnered lending.

	Quarter Ended September 30, 2013				Quarter Ended September 30, 2012			
	Partnered Lending	Union Federal	Cology	Total	Partnered Lending	Union Federal	Cology	Total
Facilitated Loans ($ Mil)	$61.9	$14.2	$357.1	$433.2	$63.1	$21.4	$0.0	$84.5
Disbursed Loans ($ Mil)	$33.7	$8.7	$194.5	$236.9	$33.1	$12.9	$0.0	$46.0

Credit quality statistics of the Monogram loans that have been approved remain strong: a weighted-average credit score of 758; 88% are cosigned, 62% are in some form of immediate repayment; and 73% have repayment terms of 10 years or less.

At September 30, 2013, 1.1% of the Union Federal loans were delinquent and $17,000 of loans were in default. Nonaccrual loans plus past due loans greater than 90 days and still accruing interest were $234,000, or 0.3%, of outstanding education loans of $72.1 million at Union Federal. About $894,000, or 1.2%, of education loans were in alternate repayment plans, whereby the borrower makes partial payments for a limited period, typically 6-24 months.

The high credit quality of the education loan portfolio reflects both the Monogram program, as well as the fact that there are no loans made to for-profit colleges, which tend to display higher default rates than four-year private and public colleges and universities. 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 most loans are about one year old or less. 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 credit characteristics to the Monogram loan portfolio. The general loss reserve for education loans was $1.7 million or 2.36% of outstanding education loans at September 30, 2013, 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 70-100 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 annual net charge-offs on the UFSB loans at 75-100 basis points and annual 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 when FMD contributed $4 million of capital to UFSB, in fiscal 2013 when FMD contributed $5.8 million of equity, and again in fiscal 2014's first quarter when FMD contributed $450,000 of equity.

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 ($72.1 million of education loans were outstanding at UFSB at September 30, 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 20% of FMD's available-for-sale securities portfolio, 24% of UFSB's mortgage loans, and all of its education loans had variable interest rates at September 30, 2013. 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 is somewhat liability sensitive, meaning that FMD's net interest income and net interest margin should be hurt in a rising interest-rate environment.

Future growth prospects for the Monogram loan program appear bright. FMD currently has over 1,100 approved lender list positions, reflecting 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 69% 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 ½ million, with roughly $8 million generated in the first through third fiscal quarters and $4-5 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 and payment plan terms reach their end.

A new product that TMS began offering in 2012's second quarter is refund management, now having 30 clients in total. Through refund management, which is expected to be a key driver of growth going forward, schools transfer credit balances in excess of tuition and fees to a TMS-provided debit card for students to pay for other expenses, relieving colleges of the administrative burden of issuing checks for these credit balances. 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 to be 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 along with other potential merchant services utilized by educational institutions, now having 20 clients, 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 was profitable for the seventh straight quarter, posting net income of $536,000 in 2014's fiscal first quarter, compared to $139,000 in the year-ago quarter. A couple of factors contributed to this better performance. First, average interest-earning assets rose by $43 million, or 29%, year over year to $189 million, largely funded by growth in low-cost core deposits. Second, these funds were primarily invested in higher interest-earning loans and mortgage-backed securities (as compared to the much lower returns earned on cash and other short-term investments). Thus, the net interest margin increased significantly, rising by about 44 basis points year over year to 2.37%.

UFSB's expanding balance sheet has required capital contributions from Parent FMD so that UFSB continues to be well capitalized. These amounted to $4 million in 2012, $5.8 million in fiscal 2013, and $450,000 in 2014's fiscal first quarter. At September 30, 2013, UFSB's Tier 1 capital ratio was 24.2%, its Total capital ratio was 25.0%, and its Tier 1 core ratio was 12.0%, 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.

The Cology acquisition adds another revenue stream to FMD's line-up. As a loan processor, Cology earns fees based primarily on the number of loan applications, disbursements, and loan certifications it processes on behalf of its clients, consisting of about 270 credit union institutions. In the first quarter, Cology contributed $1.9 million in revenue on $194.5 million of loan disbursals. From its date of acquisition on October 19, 2012, Cology disbursed loan volumes of $311 million through the fiscal year ended on June 30, 2013 (about $527 million assuming Cology had been owned for the entire 2013 fiscal year). We estimate this added about $3 million in revenues.

New business initiatives with Thrivent Federal Credit Union and Vermont Student Assistance Corporation should also begin adding to both Cology fee and Monogram-based fee income in fiscal 2014.

Other News

On January 16, 2014, FMD confirmed that it has regained compliance with the New York Stock Exchange, Inc.'s continued listing standards following implementation of a one-for-ten reverse stock split on December 3, 2013.

On December 18, 2013, FMD announced the signing of an agreement to perform credit and data analytics services and consulting services to the Vermont Student AssistanceCorporation (VSAC).

On December 3, 2013, FMD completed a 1-for-10 reverse stock split of its outstanding common stock as was previously approved by the Board of Directors on November 12, 2013.

On August 14, 2013, FMD announced that Seth Gelber had been appointed President and Chief Operating Officer, succeeding Daniel Meyers in the position. Mr. Gelber, 34, has served as a Managing Director of the Company since September 2008 and as Chief Operating Officer since August 2012. He served as the Corporation's Chief Administrative Officer from March 2010 to August 2012 and originally joined the capital markets group at First Marblehead in 2001. Notably, Mr. Meyers will continue to serve as the FMD's Chairman of the Board and Chief Executive Officer.

On May 2, 2013, FMD confirmed that it had regained compliance with the continued listing standards of the New York Stock Exchange. As previously disclosed on November 7, 2012, 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 March 5, 2013, FMD announced that in order to avoid suspension and NYSE delisting procedures (its shares have traded below the NYSE's continued listing standard of $1.00 per share since the beginning of October 2012) and should the cure require stockholder approval, FMD may seek such approval at its annual meeting of stockholders for the fiscal year ending June 30, 2013, which is expected to be held in November 2013. Until such time, FMD’s common stock will continue to be listed and traded on the NYSE during the cure period (with a “.BC” indicator affixed to the ticker symbol), subject to the Company’s compliance with the other NYSE continued listing requirements.

On November 27, 2012, TERI and FMD filed a joint notice of dismissal of their lawsuit with the First Circuit. In relation to this matter, TERI destroyed all of its copies and reproductions of the loan database, and granted FMD an exclusive and perpetual license to use the loan database to the maximum extent permitted by applicable law.

On November 7, 2012, FMD was notified by the New York Stock Exchange (NYSE) that the average closing price of the Company's common stock over a consecutive 30-trading-day period had fallen below the NYSE's continued listing standard of $1.00 per share. As of November 6, 2012, the average closing price of the Company's common stock over a consecutive 30-trading-day period was $0.99 per share. The Company generally has a period of six months from the date of notice to satisfy the average share price requirement, and expects the deficiency to be cured within the prescribed timeframe. Until then, the Company's common stock will continue to be listed and traded on the NYSE, subject to the Company's compliance with other NYSE continued listing requirements.

On October 19, 2012, FMD completed the $4.7 million 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. The transaction is expected to be accretive in fiscal 2014. 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).

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 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 by the portfolio of program loans for which they provide credit enhancement

Currently, FMD has three 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; Kinecta Federal Credit Union, a California-based federal credit union with over $3.5 billion in assets; and Higher Education Servicing Corporation, a Texas-based loan servicing agency for federal and private student loans, currently servicing more than $1.6 billion in education loans. Program capacity is $500 million for SunTrust and $75 million for Kinecta, with a maturity of early 2015 for SunTrust (the Kinecta program, which originally had a mid-2013 maturity date, remains a client).

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 700 school clients, including such prestigious institutions as Duke University, Boston College,

University of Chicago, MIT, and Carnegie Mellon. TMS added $26.7 million of total revenues in fiscal 2013.

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, and had $76.9 million of total loans outstanding at June 30, 2013, including $ 63.6 million of education loans and $13.3 million of mortgage loans primarily first mortgage loans on 1-4 family residential properties.

On October 19, 2012, FMD completed the $4.7 million cash acquisition of certain assets and liabilities of Cology, Inc., a provider of processing, disbursement, and life-of-loan servicing to about 270 credit unions and lending institutions nationally. For the 12 months ended June 30, 2012, Cology processed over 65,000 applications and disbursed more than $451 million in private student loans. In fiscal 2013, FMD estimates that Cology disbursed loan volumes of $311 million from the date of acquisition through the fiscal year ending on June 30, 2013 (about $527 million assuming Cology had been owned for the entire 2013 fiscal year).

VALUATION

FMD's stock valuation metrics remain 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 loss per share estimate at $3.80 in fiscal 2014 and $3.40 in fiscal 2015. This compares to fiscal 2013's operating loss per share from continuing operations of $4.64 (all data have been adjusted for the 1-for-10 reverse stock split in early December).

That said, we believe uncertainties stemming from the NOPAs and related class action lawsuit will likely keep a lid on FMD's share price until some significant positive news is announced, such as a major new partnered lending program or an asset securitization.

Using Price/Book Value as a valuation metric, we note that FMD is valued at 0.42X, below FMD's average Price/Book Value of roughly 0.6 X for the past four years.

Applying the 0.6X ratio to our estimated book value for FMD six months out results in a price target of approximately $8.00. 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	2013E	2014E	5-Yr Avg	Price/ Book	TTM*	5-Yr Avg	TTM*	5-Yr Avg	Div Yld
First Marblehead	**(15.3)**					**0.42**	**Neg**	**Neg**	**Neg**	**Neg**	**-----**
S&P 500	**(0.5)**	**18.5**	**15.7**	**15.0**	**16.7**	**5.3**	**18.2**		**6.60**		**2.1**
Median	**(4.3)**	**12.1**	**11.3**	**9.0**	**10.2**	**1.33**	**15.1**	**13.80**	**3.64**	**4.8**	**-----**
Average	(5.2)	15.2	12.8	9.9	11.8	2.8	3.3	(3.82)	2.82	(3.0)	1.4
High	7.0	36.1	20.0	19.3	22.4	20.0	74.3	47.82	23.19	32.5	10.7
Low	(30.0)	6.3	8.6	6.7	5.5	0.4	(154.2)	(236.46)	(17.55)	(142.2)	-----

*Trailing twelve months

The First Marblehead Corporation

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	06/09	06/10	06/11	06/12	06/13	06/14 E	06/15 E
Net interest income	25.1	9.9	0.7	2.4	4.3	5.8	7.5
Non-interest revenue	(315.1)	6.4	6.8	37.4	40.3	44.4	47.3
Total net revenue	(290.0)	16.3	7.5	39.8	44.6	50.2	54.8
Loan loss provision (credit)	0.0	0.0	0.3	(0.6)	0.1	0.7	0.7
Non-interest expense	260.8	232.1	93.5	102.0	93.0	91.2	92.5
Income tax expense (credit)	(187.8)	(70.3)	1.1	(5.5)	1.3	1.5	1.5
Net income before NRI	**(363.0)**	**(145.5)**	**(87.4)**	**(56.1)**	**(49.8)**	**(43.2)**	**(39.9)**
Discontinued operations	0.0	0.0	(140.2)	1,135.8	0.0	0.0	0.0
GAAP net income	(363.0)	(145.5)	(221.6)	1,102.2	(50.2)	(43.2)	(39.9)
EPS before NRI	**(36.64)**	**(14.62)**	**(8.67)**	**(5.52)**	**(4.64)**	**(3.80)**	**(3.40)**
Reported EPS	(36.64)	(14.62)	(21.97)	99.60	(4.68)	(3.80)	(3.40)
Dividends per share	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Cash & short-term investments	173.1	381.0	267.4	208.5	137.1	96.9	68.9
Restricted cash & GICs	0.0	1.0	124.7	65.4	87.3	115.0	115.0
Loans	360.5	113.6	6.4	40.9	75.6	110.0	145.0
Receivables	233.9	73.3	2.9	16.3	14.8	14.0	14.0
Other assets	53.8	64.5	106.1	126.7	157.5	161.8	159.4
Subtotal	821.3	633.4	507.5	457.8	472.3	497.7	502.3
Discontinued operations	0.0	0.0	7,144.4	0.0	0.0	0.0	0.0
Total assets	**821.3**	**633.4**	**7,651.9**	**457.8**	**472.3**	**497.7**	**502.3**
Deposits	154.5	108.7	60.5	83.4	164.0	190.8	225.8
Restricted funds due to clients	0.0	0.0	121.9	105.0	87.0	115.0	115.0
Short-term borrowings	230.1	218.1	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
Other liabilities	31.2	36.8	67.8	42.4	42.0	54.5	64.0
Shareholders' equity	405.5	269.8	257.3	227.0	179.3	137.4	97.5
Subtotal	821.3	633.4	507.5	457.8	472.3	497.7	502.3
Discontinued operations	0.0	0.0	7144.4	0.0	0.0	0.0	0.0
Total liabilities and equity	**821.3**	**633.4**	**7,651.9**	**457.8**	**472.3**	**497.7**	**502.3**

N.B.: 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.

The First Marblehead Corporation

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	2013				2014			
	Q1 A	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**	**Q2 E**	**Q3 E**	**Q4 E**
Net interest income	0.9	1.0	1.1	1.2	1.7	1.8	1.9	2.0
Non-interest revenue	11.7	10.2	11.8	6.8	13.8	11.9	13.4	8.3
Total net revenue	12.6	11.2	12.9	8.0	15.5	13.7	15.3	10.3
Loan loss provision (credit)	(0.1)	(0.0)	0.1	0.2	0.2	0.2	0.2	0.2
Non-interest expense	26.2	23.4	21.6	21.8	25.4	23.0	21.5	22.4
Income tax expense (credit)	0.4	0.4	0.4	0.1	0.4	0.4	0.4	0.4
Net income before NRI	**(13.9)**	**(12.6)**	**(9.2)**	**(14.1)**	**(10.5)**	**(9.9)**	**(6.8)**	**(12.7)**
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GAAP net income	(13.9)	(12.3)	(8.8)	(15.2)	(10.5)	(9.9)	(6.8)	(12.7)
EPS before NRI	**(1.37)**	**(1.20)**	**(0.83)**	**(1.27)**	**(0.90)**	**(0.85)**	**(0.57)**	**(1.07)**
Reported EPS	(1.37)	(1.17)	(0.79)	(1.36)	(0.90)	(0.85)	(0.57)	(1.07)
Dividends per share	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Cash & short-term investments	186.9	182.5	191.7	137.1	89.9	82.9	75.9	68.9
Restricted cash & GICs	83.5	127.8	36.6	87.3	115.0	115.0	115.0	115.0
Loans	54.5	61.0	73.6	75.6	125.0	135.0	140.0	145.0
Receivables	16.1	16.0	15.7	14.8	14.0	14.0	14.0	14.0
Other assets	139.4	150.9	155.7	157.5	161.2	160.6	160.0	159.4
Subtotal	480.4	538.2	473.3	472.3	505.1	507.5	504.9	502.3
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total assets	**480.4**	**538.2**	**473.3**	**472.3**	**505.1**	**507.5**	**504.9**	**502.3**
Deposits	100.6	126.7	164.2	164.0	205.8	215.8	220.8	225.8
Restricted funds due to clients	123.7	167.4	76.3	87.0	115.0	115.0	115.0	115.0
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	41.6	40.3	37.6	42.0	57.3	59.7	58.8	64.0
Shareholders' equity	214.5	203.8	195.2	179.3	127.0	117.0	110.3	97.5
Subtotal	480.4	538.2	473.3	472.3	505.1	507.5	504.9	502.3
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total liabilities and equity	**480.4**	**538.2**	**473.3**	**472.3**	**505.1**	**507.5**	**504.9**	**502.3**

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