Zacks Small-Cap Research

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The First Marblehead Corporation (FMD-NYSE)

FMD: Fourth Quarter Shows Progress, but NOPAs and Class-Action Lawsuit Are Long-Term Hurdles

Current Recommendation	**Neutral**
Prior Recommendation	N/A
Date of Last Change	06/10/2010
Current Price (09/25/13)	$0.87
Six- Month Target Price	**$1.00**

OUTLOOK

For its fiscal 2013 fourth quarter, FMD reported a net loss from continuing operations of $15.2 million, or a loss per share of $0.14. Excluding one-time nonoperating items of $1.1 million, the Company posted a net loss of $14.1 million, or a loss per share of $0.13. This compares to our fourth quarter loss estimate of $12.9 million, or a loss of $0.12 per diluted share, and a year-ago net loss from continuing operations of $14.3 million, or a loss per share of $0.14. FMD also announced that it had received Notices of Proposed Adjustment, or NOPAs, from the IRS in the amount of about $300.0 million plus interest , which FMD plans to vigorously contest believing it has a strong position as it relates to these matters. This disclosure caused First Marblehead shares to decline $0.57 per share, or 36%, to close at $1.00 on August 16, 2013, and the stock is now trading at $0.87 per share. Consequently, a class action lawsuit was filed that alleges 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. It will probably be several years before the NOPAs and related class action lawsuit 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.

SUMMARY DATA

52-Week High	**$1.88**
52-Week Low	**$0.63**
One-Year Return (%)	**-17.92**
Beta	**2.22**
Average Daily Volume (sh)	**1,068,854**
Shares Outstanding (mil)	**113**
Market Capitalization ($mil)	**$98**
Short Interest Ratio (days)	**5.97**
Institutional Ownership (%)	**43**
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 2013 Estimate	**N/A**
P/E using 2014 Estimate	**N/A**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Small-Value**
Industry	**Fin-Cons Loans**
Zacks Rank in Industry	**10 of 12**

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					48.1E

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

	Q1 (Sep)	Q2 (Dec)	Q3 (Mar)	Q4 (Jun)	Year (Jun)
2012	$(0.20)A	$(0.17)A	$(0.05)A	$(0.14)A	$(0.55)A
2013	$(0.14)A	$(0.12)A	$(0.08)A	$(0.13)A	$(0.46)A
2014					$(0.40)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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FOURTH QUARTER UPDATE

FMD reported its fiscal 2013 fourth quarter results for the period ended June 30, 2013, posting a net loss from continuing operations of $15.2 million, or a loss per share of $0.14. Excluding one-time nonoperating items of $1.1 million, consisting of a $946,000 gain on the sale of a stub portfolio, a $1 million tax expense related to the Massachusetts Department of Revenue's completion of its 2008-09 tax exams, and $1 million in severance costs, the Company had a net loss of $14.1 million, or a loss per share of $0.13. This compares to our fourth quarter loss estimate of $12.9 million, or a loss of $0.12 per diluted share.The primary reason for the worse performance stems from a $2.1 million year-over-year decrease in fee income related to the sale of special servicing, an amount that we had estimated would be lower.

In last year's fourth quarter, FMD reported a net loss from continuing operations of $14.3 million, or a loss per share of $0.14, excluding $0.3 million proceeds from the TERI settlement. Last year's fourth quarter also benefitted from a $467,000 income tax credit compared to a $150,000 income tax expense this year, after adjusting for the $1 million tax expense related to the Massachusetts Department of Revenue's completion of its 2008-09 tax exams.

For the 2013 fiscal year, FMD posted a net loss from continuing operations of $50.2 million, or a net loss per share of $0.47. Excluding nonoperating items that totalled $0.4 million ($0.7 million proceeds from the TERI settlement, $0.9 million gain on the sale of a stub portfolio, a $1 million tax expense related to the Massachusetts Department of Revenue's completion of its 2008-09 tax exams, and $1 million in severance costs), FMD posted a net operating loss from continuing operations of $49.8 million, or an operating loss per share of $0.46. Our estimate of the net operating loss for fiscal 2013 was $48.6 million, or a loss of $0.45 per share.

In fiscal 2012, the net loss from continuing operations was $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 severance costs), FMD posted a net operating loss from continuing operations of $56.1 million, or an operating loss per share of $0.55.

Thus, FMD's operating net loss from continuing operations improved by $6.3 million in fiscal 2013, principally due to $4.0 million growth in revenues and a $9.0 million cut in operating expenses, partly offset by a $6.7 million growth in income taxes.

On a pretax operating basis, the fourth quarter loss from operations improved by $0.7 million to a loss of $14.0 million from a loss of $14.7 million in the prior-year period as a $1.8 million drop in expenses was partly offset by a $1.1 million decrease in total revenues after the provision for loan losses.

During the fourth quarter, FMD expanded its Monogram lending program to 1,100 approved lender list positions, a 10% increase from 1,003 lender list positions at the end of the previous quarter in March and a 29% surge from the 850 list positions in the year-ago quarter.

Relative to the fourth quarter a year ago, net revenue decreased $0.8 million, or 9%, to $8.0 million, the cyclically slowest period in FMD's fiscal year. Net interest income jumped 45% to $1.2 million on a higher net interest margin (1.59% versus 1.26%) and a slight 1% increase in average interest-earning assets.

This was partly offset by a fall in noninterest income of $1.2 million, or 8%, largely due to a $0.7 million, or 99%, drop in fair value changes to service revenue receivables plus a $0.5 million, or 17%, decrease in administrative and other fees as $738,000 in Cology processing revenues and an $872,000 in Monogram-based fee income were insufficient to offest the loss of revenues from the special-servicing division, sold early in fiscal 2013. Excluding $2.1 million of fee income from special servicing in last year's fourth quarter, administrative and other fee income actually increased by about $1.6 million.

While TMS fees were flat year over year at $4.4 million, this was due to the timing of revenue recognition from enrollment fees received from the sale of certain K-12 contracts in late fiscal 2011. On a comparable basis, revenues increased $0.2 million, or about 4%.

Operating expenses tumbled $1.9 million, or 8%, year over year to $21.8 million, as a $0.1 million, or 1%, increase in compensation costs to $9.75 million were more than offset by a $2.0 million, or 14%, decrease in general and administrative expenses to $12.0 million, principally the result of a $1.3 million year-over-year decline in third-party services expense as FMD quit servicing the NCSLT and GATE Trusts following their deconsolidation in the prior fiscal year and a $347,000 drop in consulting expenses.

FMD's net operating cash usage improved during the quarter, falling to $10.1 million from $11.5 million in the year-ago quarter, primarily reflecting higher cash revenues and lower cash expenses. Excluding severance costs, the improvement in net operating cash usage would have been about 19%.

Excluding UFSB, FMD had $110 million in cash and cash equivalents at the end of June, down about $11 million from the $121 million at the end of the March quarter. This decline largely reflected cash operating usage during the quarter.

In its fourth quarter report, FMD also announced that, as part of its IRS audit process, FMD expected to receive a Notice of Proposed Adjustment, or NOPA, from the IRS in the amount of approximately $300.0 million plus interest. On September 10, 2013, FMD actually did receive two NOPAs from the IRS that contained the proposed adjustments that had been previously announced on August 15, 2013. In the NOPAs, 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 tax payment at this time. FMD did not record an accrual for this matter in its consolidated financial statements at June 30, 2013 or when it received the NOPAs in September. FMD plans to vigorously contest the proposed adjustments and believes it has a strong position as it relates to these matters.

This disclosure caused First Marblehead shares to decline $0.57 per share, or 36%, to close at $1.00 per share on August 16, 2013, and the stock is now trading at $0.87 per share. Consequently, 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.

It will probably be several years before the NOPAs and related class action lawsuit 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 just-released Proxy Statement contains a couple of noteworthy disclosures: (1) an amendment to effect a 1-for-10 reverse stock split and a decrease the number of authorized shares of common stock on a basis proportional to the reverse stock split ratio, which will address the impending lack of compliance with the continued listing standards of the New York Stock Exchange since the share price has been trading below $1.00 since August 16, 2013 and (2) Mangrove Partners Fund L.P., which had

owned 11 million FMD shares or about 9.75% of outstanding shares at June 30, 2013, sold its entire position in July.

In other news, FMD announced on August 14, 2013 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.

We are maintaing our EPS estimate at a net loss of $0.40 per share in fiscal 2014. We expect higher lending volumes at UFSB, growing contributions from Cology and Monogram, and continued strong expense control (including $3.2 million in annual compensation costs savings related to the fourth quarter's downsizing) to be the primary drivers behind this improvement.That said, we believe that increased legal fees related to the class action lawsuit will partially mitigate operating expense improvement.

Below we discuss 2013 fiscal fourth quarter results in more depth. Details of our projections are shown at the back of the report.

Business Review

The following table shows lending statistics broken down by segment for the fourth quarter of fiscal 2013 and fiscal 2012. As shown, facilitated loan volume for the quarter totaled $79.0 million, which includes $61.8 million from Cology and $16.2 million of Monogram-based loan originations. Facilitated Monogram-based loan originations were up 50% when compared to the same quarter a year ago. Disbursed loan volumes for the fourth quarter totaled $48.2 million, of which, $37.0 million was from Cology, $2.2 million from Union Federal, and $9.0 million from partnered lending.

	Quarter Ended June 30, 2013				Quarter Ended June 30, 2012			
	Partnered Lending	Union Federal	Cology	Total	Partnered Lending	Union Federal	Cology	Total
Facilitated Loans ($ Mil)	$12.9	$3.3	$61.8	$79.0	$6.0	$4.8	$0.0	$10.8
Disbursed Loans ($ Mil)	$9.0	$2.2	$37.0	$48.2	$2.8	$2.6	$0.0	$5.4

Credit quality statistics of the Monogram loans that have been approved remain strong: a weighted-average credit score of 758; 86% are cosigned, 65% are in some form of immediate repayment; and 92% have repayment terms of 15 years or less.

At June 30, 2013, 0.6% of these loans were delinquent and 0.2% of loans were in default. Nonaccrual loans plus past due loans greater than 90 days and still accruing interest were $310,000, or 0.5%, of outstanding education loans of $64.7 million. About $784,000, 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 2.57% of outstanding education loans at June 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's fourth quarter when FMD contributed $4 million of capital to UFSB and again in fiscal 2013's first and fourth quarters when FMD contributed $2.3 million and $3.5 million of equity, respectively.

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 ($64.7 million of education loans were outstanding at UFSB at June 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, 29% of UFSB's mortgage loans, and all of its education loans had variable interest rates at June 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, a 10% increase from 1,003 lender list positions at the end of the previous quarter in March and a 29% surge from the 850 list positions in the year-ago quarter.

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 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 $27 ½ million, with roughly $7-8 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 sixth straight quarter, posting net income of $343,000 in 2013's fiscal fourth quarter, compared to $115,000 in the year-ago quarter. A couple of factors contributed to this better performance. First, average interest-earning assets rose by $72 million, or 57%, year over year to $199 million, largely funded by growth in 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). That said, the net interest margin decreased slightly, falling by about 4 basis points year over year to 2.22%.

UFSB's expanding balance sheet has required capital contributions from Parent FMD so that UFSB would continue to be well capitalized. These amounted to $4 million in 2012's fiscal fourth quarter, $2.3 million in fiscal 2013's second quarter, and $3.5 million in fiscal 2013's third quarter. At June 30, 2013, UFSB's Tier 1 capital ratio was 25.2%, its Total capital ratio was 26.0%, and its Tier 1 core ratio was 11.7%, 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 fourth quarter, Cology contributed $0.7 million in revenue on $37.0 million of loan disbursals. From its date of acquisition on October 19, 2012, Cology disbursed loan volumes of $311 million through the fiscal year ending on June 30, 2013 (about $527 million assuming Cology had been owned for the entire 2013 fiscal year). We estimate that this generated a roughly $2 million of additional revenues.

Other News

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 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 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).

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 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 $0.40 in fiscal 2014. This compares to fiscal 2013's operating loss per share from continuing operations of $0.46.

Moreover, the stock price has been volatile over the past couple of months, reaching a 12-month high of $1.88 on July 25, 2013 before plunging $0.57 from $1.57 on August 15 to $1.00 on August 16 following the disclosure in its fourth quarter earnings release that FMD expected to receive a Notice of Proposed Adjustment, or NOPA, from the IRS in the amount of approximately $300.0 million plus interest and is now trading at $0.87. The stock is again at risk of falling below the required $1.00 share price under the continued listing standards of the New York Stock Exchange, which it did twice before on November 7, 2012 and November 2, 2011 (both times regaining compliance within a few months).

Positively, FMD is recommending in its latest Proxy Statement that shareholders support an amendment to effect a 1-for-10 reverse stock split (and a decrease the number of authorized shares of common stock on a basis proportional to the reverse stock split ratio), which will address the impending lack of compliance with the continued listing standards of the New York Stock Exchange.

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 0.54X, below FMD's average Price/Book Value of roughly 0.7X for the past three years.

Applying the 0.7X ratio to our estimated book value for FMD six months out results in a price target of approximately $1.00. 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	**12.0**					**0.54**	**Neg**	**Neg**	**Neg**	**Neg**	**-----**
S&P 500	**18.7**	**17.2**	**15.6**	**14.7**	**16.6**	**4.5**	**24.2**		**8.47**		**2.0**
Median	**12.0**	**11.1**	**10.8**	**9.6**	**10.1**	**1.38**	**15.6**	**13.05**	**4.30**	**6.2**	**-----**
Average	12.4	14.1	13.6	11.0	11.4	2.6	11.5	(4.86)	4.35	(4.0)	1.4
High	61.0	34.1	26.0	17.7	21.2	18.9	63.4	46.27	25.58	33.0	11.1
Low	(55.8)	6.5	9.4	6.9	5.7	0.5	(34.6)	(261.39)	(10.22)	(158.5)	-----

*Trailing twelve months

The First Marblehead Corporation

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	06/08	06/09	06/10	06/11	06/12	06/13	06/14 E
Net interest income	25.6	25.1	9.9	0.7	2.4	4.3	5.9
Non-interest revenue	(54.0)	(315.1)	6.4	6.8	37.4	40.3	42.2
Total net revenue	(28.4)	(290.0)	16.3	7.5	39.8	44.6	48.1
Loan loss provision (credit)	0.0	0.0	0.0	0.3	(0.6)	0.1	0.2
Non-interest expense	358.5	260.8	232.1	93.5	102.0	93.0	91.1
Income tax expense (credit)	(151.8)	(187.8)	(70.3)	1.1	(5.5)	1.3	1.5
Net income before NRI	**(235.1)**	**(363.0)**	**(145.5)**	**(87.4)**	**(56.1)**	**(49.8)**	**(44.7)**
Discontinued operations	0.0	0.0	0.0	(140.2)	1,135.8	0.0	0.0
GAAP net income	(235.1)	(363.0)	(145.5)	(221.6)	1,102.2	(50.2)	(44.7)
EPS before NRI	**(2.46)**	**(3.66)**	**(1.46)**	**(0.87)**	**(0.55)**	**(0.46)**	**(0.40)**
Reported EPS	(2.46)	(3.66)	(1.46)	(2.20)	9.96	(0.47)	(0.40)
Dividends per share	0.40	0.00	0.00	0.00	0.00	0.00	0.00
Cash & short-term investments	221.1	173.1	381.0	267.4	208.5	137.1	101.1
Restricted cash & GICs	0.0	0.0	1.0	124.7	65.4	87.3	90.0
Loans	508.1	360.5	113.6	6.4	40.9	75.6	135.0
Receivables	411.2	233.9	73.3	2.9	16.3	14.8	15.0
Other assets	60.5	53.8	64.5	106.1	126.7	157.5	156.8
Subtotal	1,200.9	821.3	633.4	507.5	457.8	472.3	497.9
Discontinued operations	0.0	0.0	0.0	7,144.4	0.0	0.0	0.0
Total assets	**1,200.9**	**821.3**	**633.4**	**7,651.9**	**457.8**	**472.3**	**497.9**
Deposits	244.1	154.5	108.7	60.5	83.4	164.0	223.3
Restricted funds due to clients	0.0	0.0	0.0	121.9	105.0	87.0	90.0
Short-term borrowings	242.9	230.1	218.1	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	76.3	31.2	36.8	67.8	42.4	42.0	50.0
Shareholders' equity	637.6	405.5	269.8	257.3	227.0	179.3	134.6
Subtotal	1,200.9	821.3	633.4	507.5	457.8	472.3	497.9
Discontinued operations	0.0	0.0	0.0	7144.4	0.0	0.0	0.0
Total liabilities and equity	**1,200.9**	**821.3**	**633.4**	**7,651.9**	**457.8**	**472.3**	**497.9**

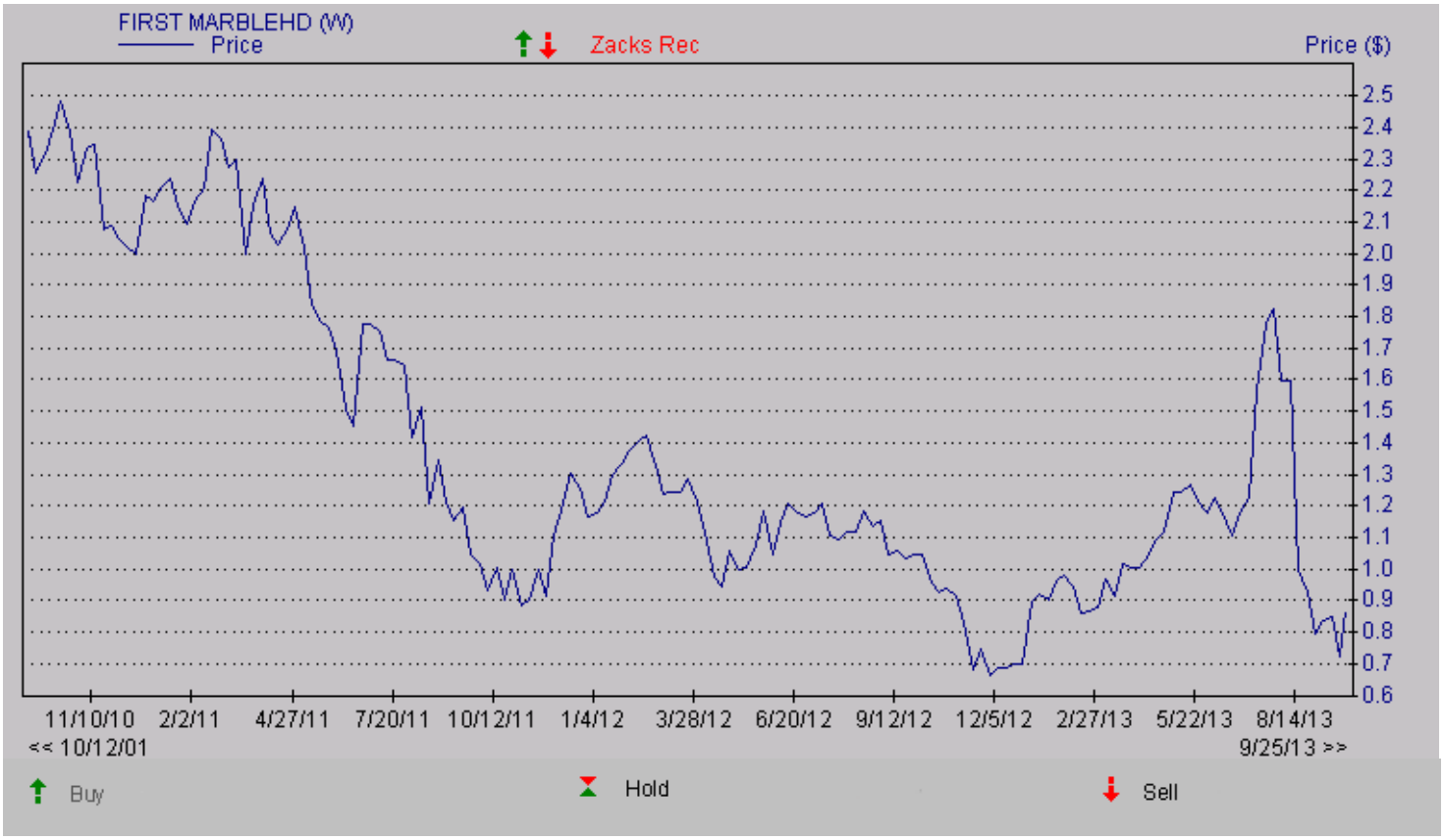
The First Marblehead Corporation

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	2012				2013			
	Q1 A	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 A**
Net interest income	0.3	0.5	0.7	0.8	0.9	1.0	1.1	1.2
Non-interest revenue	10.6	6.1	12.8	8.0	11.7	10.2	11.8	6.8
Total net revenue	10.9	6.6	13.5	8.8	12.6	11.2	12.9	8.0
Loan loss provision (credit)	(0.2)	(0.1)	(0.2)	(0.1)	(0.1)	(0.0)	0.1	0.2
Non-interest expense	30.7	23.7	23.9	23.6	26.2	23.4	21.6	21.8
Income tax expense (credit)	0.3	(0.1)	(5.2)	(0.5)	0.4	0.4	0.4	0.1
Net income before NRI	**(19.9)**	**(16.9)**	**(5.0)**	**(14.3)**	**(13.9)**	**(12.6)**	**(9.2)**	**(14.1)**
Discontinued operations	(69.2)	1,198.0	6.9	0.0	0.0	0.0	0.0	0.0
GAAP net income	(88.0)	1,194.3	9.9	(13.9)	(13.9)	(12.3)	(8.8)	(15.2)
EPS before NRI	**(0.20)**	**(0.17)**	**(0.05)**	**(0.14)**	**(0.14)**	**(0.12)**	**(0.08)**	**(0.13)**
Reported EPS	(0.87)	10.82	0.09	(0.14)	(0.14)	(0.12)	(0.08)	(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	245.4	217.7	210.5	208.5	186.9	182.5	191.7	137.1
Restricted cash & GICs	142.1	144.5	46.0	65.4	83.5	127.8	36.6	87.3
Loans	14.0	23.7	39.0	40.9	54.5	61.0	73.6	75.6
Receivables	0.0	12.5	16.9	16.3	16.1	16.0	15.7	14.8
Other assets	113.8	99.8	128.9	126.7	139.4	150.9	155.7	157.5
Subtotal	515.3	498.2	441.3	457.8	480.4	538.2	473.3	472.3
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total assets	**515.3**	**498.2**	**441.3**	**457.8**	**480.4**	**538.2**	**473.3**	**472.3**
Deposits	66.4	68.1	73.8	83.4	100.6	126.7	164.2	164.0
Restricted funds due to clients	139.5	143.9	85.4	105.0	123.7	167.4	76.3	87.0
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	69.9	49.1	42.1	42.4	41.6	40.3	37.6	42.0
Shareholders' equity	239.5	237.1	240.0	227.0	214.5	203.8	195.2	179.3
Subtotal	515.3	498.2	441.3	457.8	480.4	538.2	473.3	472.3
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total liabilities and equity	**515.3**	**498.2**	**441.3**	**457.8**	**480.4**	**538.2**	**473.3**	**472.3**

HISTORICAL ZACKS RECOMMENDATIONS



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