

University Bancorp, Inc. (UNIB)



STEPHEN LANGE RANZINI is Chairman and President of University Bank of Ann Arbor, Michigan. He is also Chairman and President of University Islamic Financial, the first Islamic banking subsidiary of a bank in the US. Mr. Ranzini played the leading role in the acquisition of the bank in 1988 when he became the nation's youngest bank holding company President at age 23, and since then has been President and CEO of the bank's holding company, University Bancorp, Inc.. Mr. Ranzini is responsible for formulating and enacting the strategic plan, annual budget and overall management of the bank, which was selected as the "Community Bankers of the Year" in 2006 by U.S. Banker magazine. He is the Portfolio Manager of the bank's investment portfolio and

is a registered investment advisor, managing the bank's clients' funds. Mr. Ranzini has successfully established numerous branch locations and broadened the company's product range to include insurance, mortgage banking, mortgage subservicing, merchant banking, Islamic banking and foreign exchange. The bank currently manages over \$4 billion in assets and through its mortgage subsidiary, Midwest Loan Services, serves as a business process outsourcer for over 2.7% of all of the credit unions in the United States. A magna cum laude graduate of Phillips Exeter Academy, at Exeter, New Hampshire, Mr. Ranzini was the first ever Exeter student to be a Westinghouse (Intel) Science Talent Search Semi-Finalist. He graduated from Yale University on scholarship and earned a double major in East Asian Studies (Japan) and History.

SECTOR – BANKING

(AGE614) TWST: What is University Bancorp?

Mr. Ranzini: We are a bank holding company for a bank that is based in Ann Arbor, Michigan. The bank was founded in 1890, and its main line of business today actually is as a service provider to credit unions through a business that provides mortgage sub-servicing to about 2.7% of all the credit unions in the United States, managing about \$4 billion in mortgage assets. Our other lines of business include a traditional community bank and the nation's first Islamic banking subsidiary of a bank in the United States. That business serves the Muslim community, which has a religious prohibition against the payment or receipt of interest.

TWST: How did all those elements come together?

Mr. Ranzini: We try to innovate by finding profitable niches that have certain characteristics, including high profitability, high return on equity, high return on capital invested, a reasonable risk/reward ratio, and a barrier to entry or little competition. So each of the three businesses that we have, the credit union mortgage sub-servicing business, the community bank here in Ann Arbor, and the Islamic banking subsidiary, has that profile.

TWST: Give us an idea of some of the performance metrics. If we could back up a year, what were your expectations in those business entities, and how well have they performed over the past year?

Mr. Ranzini: In 2005, University Bank had a 66.3% return on equity, and we were the second most profitable bank in the United States on that metric. In 2005, the results were fuelled by some unusual transactions that added about \$1.7 million to the profit net income. In 2006, we expected significantly lower results

based on further investment and through the growth of our Islamic banking subsidiary. The results unfortunately were a little on the disappointing side. Some of the strategic initiatives that we had programmed to be finished in the March time frame didn't happen until the December time frame, and so that is the bad news for 2006. But the good news for 2007 is that those things are in place, and the underlying profitability of the corporation is back exactly where we expected it to be about a year ago. We are really pleased with where we are at right now and are looking forward to a record result in 2007 once again.

TWST: What are some of the fundamentals that you feel allow you to perform and to grow? What are the underlying customer bases and the clients that you have for some of these services? What is it in general that you feel is the driver and supports your strategies and these operations?

Mr. Ranzini: The credit union servicing business is driven by the growth in the credit union industry. The credit union industry has increased its market share of the financial services business in the United States from about 5% in the 1970s to over 10% today. That growth has been fueled by the fact that credit unions pay no federal income tax. So they have a strong competitive advantage versus the banking industry and have been taking market share from the banking industry every year for years now.

A further driver there is that the credit union industry traditionally was not involved in the single-family mortgage business. They were primarily doing unsecured lending, home equity lending and car lending. But as credit unions try to expand into additional products, one of them that they are most interested in expanding into is the mortgage origination business, but it is a complicated product.

Mortgage origination is the most complicated lending process in the financial services industry. So it is something that credit unions typically seek outside help with. Our business helps them even if they have no expertise in the mortgage business to immediately enter the mortgage industry by originating single-family mortgages that are sold off to agencies or put into their own portfolio. We can provide any service that they want from application origination processing, underwriting, packaging and sale to the secondary market, and then servicing that mortgage after the sale to the secondary market. We can do that either in our own name or in their name on a white-label basis. We can do that for any type of mortgage loan from conforming A quality to substandard lower quality or non-confirming such as large jumbo mortgages of any type. We are the only provider in the industry that allows credit unions to do all that.

The dynamics of the Islamic banking business are that you have about 8 million Muslims in the United States who are not really being served by the banking industry. There are only two organizations that are banks that are competing for that business. There is our bank and another bank that is not publicly traded. We are the only bank in the United States that has a deposit product that is FDIC-insured for that community. With the single family lending products that we have, we're competing with the other bank and also a mortgage company that is focused on Islamic mortgage alternatives operating nationwide. So there is very limited competition right now.

The demographic profile of the Muslim community is outstanding from a banking position. About 47% of the Muslims in the United States have college degrees. Their per capita income and education is far superior to the average American and also their credit scores are far superior to the average American. We see no delinquencies in the portfolio and it is also a very rapidly growing community because you have high birth rates as well as high immigration rates.

As to the community bank, Ann Arbor is a university town, hence the name of the bank itself. The University of Michigan is based in Ann Arbor. It is a vibrant community. There are strong underlying dynamics in Ann Arbor and it has been a very good local market for us to grow in.

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TWST: Is the story organic growth at this point or are there M&A opportunities that make sense?

Mr. Ranzini: At this point, we're 100% focused on organic growth and we have been able to do that. The mortgage servicing business grew on average 35% each year for the last seven years. In 2006, the profit growth was a bit disappointing, but finally it has come in. We had a large percentage of our mortgage escrow deposit accounts that we control not on deposit at University Bank, but at another larger financial institution. In December we finally got all of the business processes in line to be able to move all those deposits in-house. We went up from a position where we had only \$12 million of these escrow deposits in the bank to \$30 million of escrow deposits in the bank and it grew in 2007 and recently peaked at \$42 million. That also is organic growth in the sense that we are taking in-house something that we control but we were not getting the benefit of. Each \$1 million of custodial escrow deposits that we add increases our income by \$45,000 annually.

Going forward, there is no reason why the business shouldn't continue to grow at 30%-35% annual rates. We have been doing that for seven years now, and we still only have 2.7% market share in the industry overall. The organic growth there should be outstanding. The business unit generates 55% of our revenues right now. So it's already a very meaningful percentage of the whole. The organic growth opportunities in Islamic banking are tremendous because so far we have only been operating in Michigan in this business. The plan for this year is to build those products on a nationwide basis since they are delivering them nationwide. As a result we will go from serving a 400,000 Muslim community in one state to serving an 8 million Muslim community across the rest of the country. That is a pretty big growth opportunity, and it'll keep us busy for a while.

TWST: What are the key metrics investors should focus on as they track your performance?

Mr. Ranzini: The key things that matter are the number of mortgages sub-serviced by us, which crossed \$4 billion recently. That's really the driver of both the fee income and the custodial escrow deposits for the bank and the mortgage sub-servicing business serving the credit unions. On the Islamic banking side, key metrics to watch would be Islamic deposits, which are currently \$19 million, as well as Islamic financings, both those in the portfolio as well as those that are sold to Freddie Mac under our strategic arrangement with Freddie Mac where they take into their portfolio the Islamic financings that we originate as their agent. Those are the things that investors should keep an eye on that will be indicators of future profitability and trends.

TWST: Introduce us to your top-level management team. Who are two or three of your key individuals?

Mr. Ranzini: I have been the President and CEO of the bank holding company since 1988. I'm also President of the bank and Chairman of the bank.

My CEO at the bank is Nick Fortson, and he has been with us for seven years now. He came to us from South Africa. He had been the Founder and CEO of the Domino's Pizza franchise down in South Africa. Before that, he had been a Controller of a bank in Detroit and a CFO of a group, managing several billion dollars in assets for the US government under the Resolution Trust Corporation (RTC), following the savings and loan debacle. He had been involved in helping clean that up.

Ed Burger is President of Midwest Loan Services, our credit union mortgage sub-servicing company. He has been with us from the founding of the company. In fact, he was the Founder of the company before we bought into it in 1994. He comes out of a multibillion dollar asset bank up in northern Michigan, where he was their Chief Financial Officer. Before that, he was an accounting manager with one of the big nationwide accounting firms.

The President of our insurance agency, Edie Kingsley, has been with us for eight years now. She has been in insurance all her career.

The head of our Islamic operation is John Sickler who has been with us for six years now. He is a highly experienced mortgage guy, and been taking on the challenge of being a pioneer in an industry doing things that no one has ever done before.

Our goal is to hire the best and the most highly experienced people that we can. I don't surround myself with a bunch of yes people. I like to have people who challenge me every day to do a better job. One of the challenges of being in the same position 19 years is that people will say that if you can't accomplish everything you want to accomplish in 10 years, you are not going to accomplish it, but surrounding yourself with good people who are themselves talented and thoughtful people helps keep you fresh and on your toes.

TWST: How strong financially overall is the organization with respect to balance sheet and P&L?

Mr. Ranzini: The bank is rated very highly by independent third-party agencies. For example, IDC, which is the rating agency that Freddie Mac and Fannie Mae use to evaluate banks, rates our bank the 14th strongest in the State of Michigan out of 149 banks. So it's very good and really quite sufficient. Our bank is very financially sound.

TWST: What historically has been the shareholder base with the company? Has that base undergone any changes?

Mr. Ranzini: After we got involved in Islamic banking, we got quite a bit of press. We saw the number of shareholders almost double to over 620. I think it's a wide variety of investors of all types. People like the story and see what we're doing. So I think that the shareholder base is expanding quite nicely. And my take on it, just from the interactions from the shareholders I talk to, is that they are all in this as a long-term investment, recognizing that there is a lot of potential. They understand that the short-term, quarterly results aren't that important and that you have to invest money to make money. It is certainly possible to build a billion dollar financial institution just in Islamic finance. With the potential in the credit union sub-servicing business, I had one party recently call me and say that their analysis is that we would have 5% market share and \$10 billion under management within five years. Honestly, I can't dispute that analysis. I don't know any reason why it couldn't be done. So I'm pretty pleased with what people on the outside are saying and looking at. I'm also very pleased with the long-term and loyal support of the shareholders. This isn't the kind of company that you can day trade in, and we don't see that kind of activity.

TWST: In those discussions, do you believe the University Bancorp story is well understood? Are there any recurring questions or misperceptions?

Mr. Ranzini: I think people who take the time to actually analyze the information on our Website are very well informed. We

have an investor relations Website at www.university-bank.com/bancorp.htm. On that site, there is more than you would ever want to know about the company, including a one-click link to all the SEC filings, all the press releases, annual reports, frequently asked questions list, and historical metrics on the key profit drivers in Excel worksheets that you can download. There is more information than anyone would possibly want to know. But the people who take the time to take a look at that are very well informed. I do occasionally get people who call me up who aren't fully informed. I think it's just because they haven't taken the time to take a look to see what information is available to them.

TWST: When you look at the potential for competition, is there an advantage to being first and to grab market share? Does footprint give you any barriers against additional competition? Are there other barriers?

Mr. Ranzini: On the credit union side of the business, the barrier to entry is quite large. We have spent a significant amount of resources, building the most sophisticated Internet delivered service in the industry. It would be very difficult and very expensive for someone to compete with us now, because our prices are very low relative to the industry. Our quality of service and the technical sophistication of the service is so high that I really don't see anybody coming in to compete with us, or at least coming in to compete successfully. We have taken a kind of the Wal-Mart approach of low prices and customer-centric superior service. So I just don't see anybody competing with us on that.

On the Islamic banking side, there are very severe barriers to entry. It took us four years to get one of our key products to the point where it was 100% Islamically compliant from end to end, from origination through to servicing. It's really not easy. Anybody who takes a look at it would recognize how complex and difficult it is to do correctly. Actually, part of our business plan, not in 2007 but in the intermediate future, will be to offer those products to other financial institutions on a wholesale basis. A lot of financial institutions have taken a look at this business and said, "It is too complicated and too difficult so we're not going to offer products." Frankly, having gone through the process of getting to where we are today, I have to agree with that. If I was the third or fourth fast follower, I'm not sure I would want to get in. It's really a difficult, complicated business.

TWST: What compels investors to include UNIB as part of their current portfolios and as part of their longer-term investment strategies?

Mr. Ranzini: We are the only publicly traded opportunity in the United States for an investor to invest in either the ongoing growth of the credit union industry or the growth of Islamic banking, which worldwide is about a \$276 billion industry, but here in the United States it is just passing \$1 billion.

TWST: Thank you. (DWA)

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