Weathering the Storm:

A Guide to Banking in Uncertain Times

Session 3: Raising Capital In A Challenging Environment

A Jones Walker Webinar Series
February 9, 2010

In conjunction with

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Introduction and Overview

- This is the third of six sessions addressing issues for bankers navigating a difficult banking environment.
- The first and second sessions covered the current regulatory environment and the regulatory enforcement process.
- This session will focus on raising capital, and will:
  - Review the traditional methods of raising capital
  - Survey the approaches taken in recent transactions
  - Discuss alternative approaches to growing your capital base

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Introduction and Overview

- Significant increase in regulatory directives to raise capital:
  - New "standard" Leverage Ratio: 8 to 10%
    - Outliers: 15%
  - New "standard" Total Risk-based Capital Ratio: 12 to 15%
- Usual timeframe for compliance: 60 to 90 days

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Introduction and Overview

- ***Leverage Ratio***, defined:
  - Ratio of total:
    1. Tier 1 Capital to
    2. Total Assets
- ***Total Risk-Based Capital Ratio***, defined:
  - Ratio of:
    1. Tier 1 Capital *plus* Tier 2 Capital to
    2. Total Risk-Weighted Assets

What to Raise?

❖ ***Tier 1 Capital***, defined:

"Core capital" *less* goodwill, intangible assets and certain other items.

"Core capital" generally includes:

1. Qualifying common stockholders' equity;
2. Qualifying non-cumulative perpetual preferred stock (and TARP senior preferred);
3. Minority interest related to qualifying common or non-cumulative perpetual preferred stock directly issued by a consolidated U.S. depository institution or a foreign bank subsidiary; and
4. Restricted core elements (up to 25% of total Tier 1 capital).

What to Raise?

- ***Tier 2 Capital***, defined:

  Supplementary capital elements, including, among others:

  1. Loan- and lease-loss reserves;*
  2. Perpetual preferred stock;
  3. Hybrid capital instruments, perpetual debt and mandatory convertible securities;
  4. Term subordinated debt and intermediate-term preferred stock; and
  5. Unrealized holding gains on equity securities.

  Tier 2 Capital is limited to 100% of Tier 1 Capital for purposes of calculating the Total Risk-based Capital Ratio

* Limited to 1.25% of weighted risk assets

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How to Raise? – General Considerations

❖ **General Rule:**

Most public securities offerings must be registered with the SEC.

Section 5 of the Securities Act of 1933 provides:

Unless a registration statement is in effect as to a security, ***it shall be unlawful*** for any person, directly or indirectly—

1. To make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
2. To carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale

Note: If a security is sold in the absence of registration (or an exemption), the sale can be rescinded by the buyer, among other remedies.

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How to Raise? – General Considerations

❖ **Exemptions:**

The federal registration requirement generally ***does not apply*** to:

1. Private sales to "accredited investors" and other sophisticated parties

   (Rule 506 of Regulation D);

2. Sales totaling $5,000,000 or less to 35 purchasers or less

   (Rule 505 of Regulation D); or

3. Sales within a single state

   (The "intrastate sale" exemption)

How to Raise? – General Considerations

❖ **Disclosure Obligations – Apply to ALL Issuances**

SEC Rule 10b-5 states:

1. It shall be ***unlawful*** for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
2. To employ any device, scheme, or artifice to defraud, ***to make any untrue statement of a material fact <u>or</u> to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading***, or
3. To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Note: A 10b-5 violation can carry both civil and criminal liability

How to Raise? – General Considerations

❖ **Common Private Offerings**

Rule 506 Offering:

- 35 or fewer non-Accredited Investor offerees
- Unlimited number of Accredited Investor offerees
- Unlimited in <u>amount</u> of offering

Note: If there are ***ANY*** non-Accredited Investors, the disclosure obligation – and thus the cost of the offering – increase significantly.

How to Raise? – General Considerations

- "***Accredited Investors***" generally include:
  - Banks, insurance companies and some ERISA plans;
  - Directors, executive officers, or general partners of the issuer;
  - Individuals whose net worth exceeds $1,000,000;
  - Individuals with $200,000 or more in annual income;
  - Any entity in which all of the equity owners are accredited investors.

How to Raise? – General Considerations

- "***Purchaser Representative***" may be any person:
  - Not an affiliate, director, officer or other employee or 10% owner of the issuer:
  - With such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment; and
  - Acknowledged by the purchaser in writing, during the course of the transaction, to be his purchaser representative; *and*
  - *Provided*, that the Purchaser Representative must disclose to the purchaser in writing a reasonable time prior to the sale any direct or indirect material relationship with the issuer and any compensation received or to be received as a result of such relationship.

How To Raise – Stand-Alone Bank Rules

- **Raising Capital by a Stand-Alone Bank**
  - Bank securities are exempt from registration with the SEC

  National Banks
  - Public Offers are registered with the OCC – not the SEC
  - A nonpublic offer for a national bank follows SEC Regulation D (*e.g.*, Rule 506)

  State Banks
  - There are no registration or exemption requirements promulgated by the FDIC or the Fed for state banks. FDIC's policy statement (Statement of Policy Regarding Use of Offering Circulars in Connection with Public Distribution of Bank Securities, September 5, 1996) ***encourages*** state banks to follow SEC disclosure guidelines
  - There is no real distinction between a public and private offer

  State Law
  - For stand-alone banks, most states, like the SEC, exempt "bank" securities from registration. So for stand-alone banks, there is generally no need to make any filing or comply with state securities registration requirements.

Note: Rule 10b-5 (anti-fraud) principles always apply.

How to Raise?

- **Traditional Methods**
  - "Friends and Family" Private Offering
  - Third-Party Private Offering
  - Public Offering
- **Non-Traditional Methods**
  - Private Equity Investors
  - Mezzanine Investors

How to Raise?

- **Traditional Methods**
  - "Friends and Family" Private Offering
    - Accredited Investors or Purchaser's Rep transactions
    - Familiarity with Bank may ease disclosure burden
  - Third Party Private Offering
    - Accredited Investors
    - Private Placement Memorandum is customary
  - Public Offering
  - Federal registration
  - Intrastate registration

Each of these transactions will ultimately be dilutive to current owners

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How to Raise?

- **Non-Traditional Methods**
  - Private Equity Funds
    - Often require 18% or greater IRR
    - Generally structured as preferred participating equity
    - Board observer and step-in rights
    - Disfavored by Regulators
  - Mezzanine Investors
    - Often require 12-18% coupon
    - Generally structured as junior secured debt with warrants
    - Board observer and step-in rights
    - Interest payments will be tax deductible
    - Disfavored by Regulators

Each of these transactions will ultimately be dilutive to current owners

U.S. Depository Environment & Capital Markets Update

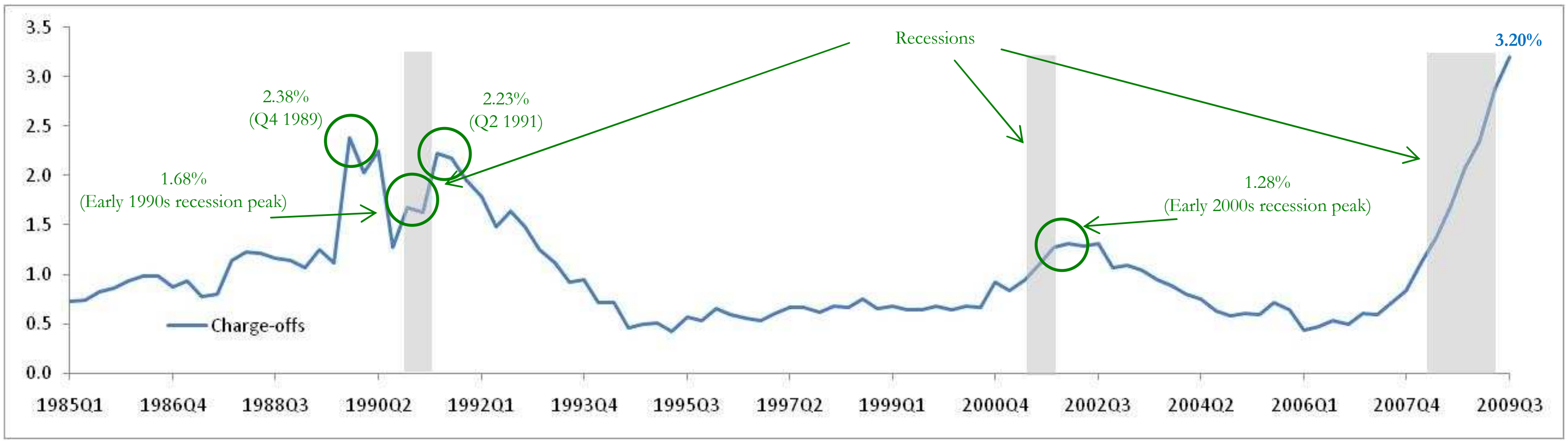
February 9, 2010

U.S. Depository Environment Update

Asset Quality	• NPA levels continue to rise • Charge-offs reached historic recessionary highs since mid 1980s in 2Q 2009 – Certain asset classes including CRE an exception
Capital Strengthening	• Bank balance sheets stronger from recent equity raises • Capital raising likely to continue over the next 6-9 months – Continued credit challenges – TARP repayment a primary focus
Regulatory Oversight	• Regulatory environment will continue to evolve and rule changes are a major concern to banks and investors
Bank Valuation	• Bank valuations improving since 1Q 2009 – Median P/TBV of large-cap banks up over 45% from March 2009 trough – Improving capital position and earnings trend leading to stabilization and investor confidence
M&A	• M&A activity likely to be focused on FDIC assisted transactions over the next 6 months • Traditional M&A likely to return by mid year

Current Charge-off Levels Have Reached Historic Highs

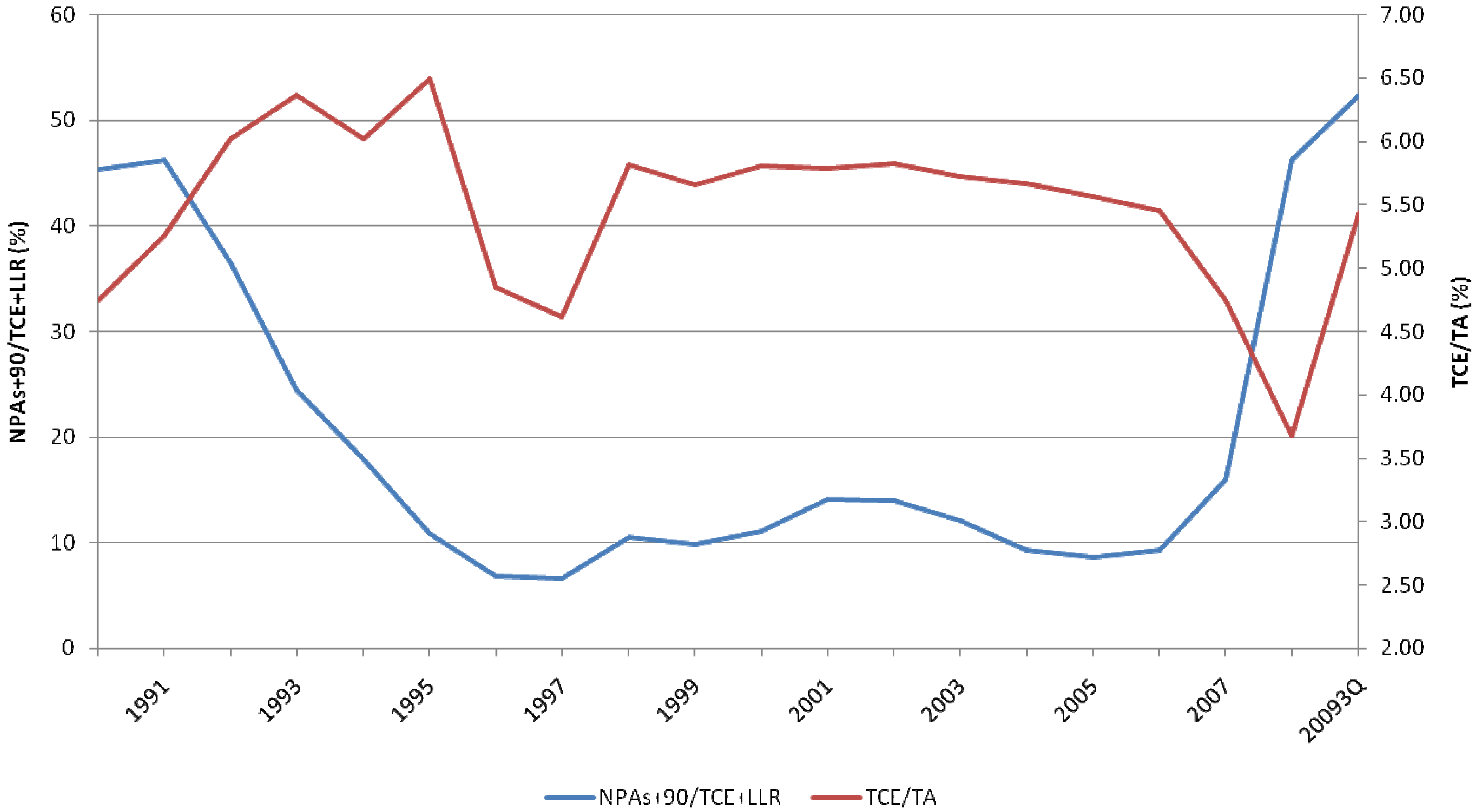
	1Q 1985 - 3Q 2009 Peak (%)	Mean (%)	Median (%)	Early 1990s Recession Peak (%)	Early 2000s Recession Peak (%)	3Q 2009 Current (%)	Absolute Difference From Historic Peak (bps)	Current as Percentage of Historic Peak (%)
Business	2.64	0.87	0.80	1.21	2.29	2.64	0	100%
Leases	1.57	0.49	0.40	0.81	0.77	1.37	(20)	87%
CRE	4.42	0.74	0.14	2.09	0.20	2.65	(177)	60%
Residential Real Estate	2.74	0.33	0.16	0.16	0.60	2.74	0	100%
Consumer	6.21	2.57	2.48	2.65	3.19	6.21	0	100%
Credit Cards	10.43	4.46	4.32	4.48	5.46	10.43	0	100%
Other Consumer	3.51	1.29	1.15	1.55	1.63	3.51	0	100%
All	**3.20**	**1.03**	**0.86**	**1.68**	**1.28**	**3.20**	**0**	**100%**



Source: Federal Reserve Board
Note: Charge-offs for top 100 banks by assets seasonally adjusted

Historical Asset Quality & Capitalization Levels

Equity Capital Raising will Continue Until Capital Levels Relative to Non-Performing Assets Return to More Normalized Levels



Note: Chart values are weighted-averaged by public banks' asset size and include failed and acquired institutions

Bank Common Equity Follow-On Offerings in 2009

Large Cap Banks Led the Common Equity Raising Wave in 2Q09; Mid and Small Cap Banks Are Primary Issuers Today

2009	# of Deals	Gross Amount Offered ($mm)	Average Deal Size ($mm)	Premium/ Discount to Stock Price	Offer Price to TBV (x)	Offering: % of Total Market Capitalization	Deals Withdrawn # of Deals	Deals Withdrawn Median Deal Value ($mm)
1st Quarter	1	$35	$35	(3.00%)	2.36x	4.8%	1	$25
2nd Quarter	26	27,409	1,054	(11.14%)	1.38x	14.4%	2	20
3rd Quarter	31	4,937	159	(9.94%)	1.00x	36.1%	4	89
4th Quarter	26	30,800[1]	1,185[2]	(15.95%)	0.88x	23.1%	7	66
Total	84	$63,182	$752	(11.36%)	1.11x	25.4%	14	$66

Source: SNL Financial

Note: Premiums/Discounts calculated based on stock price and TBV at close prior to announcement date; Dollar amount offered as of announcement

[1] Wells Fargo offering on 12/15/09 accounted for $11bn and Citigroup offering on 12/16/09 accounted for $17bn; Does not include Bank of America's $19bn offering

[2] Average deal size excluding Wells Fargo and Citigroup deals is $131mm

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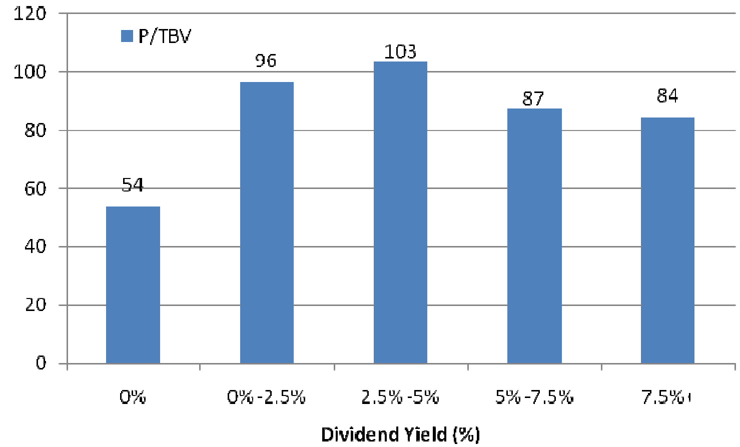
Bank Valuation Metrics: P/TBV over P/E

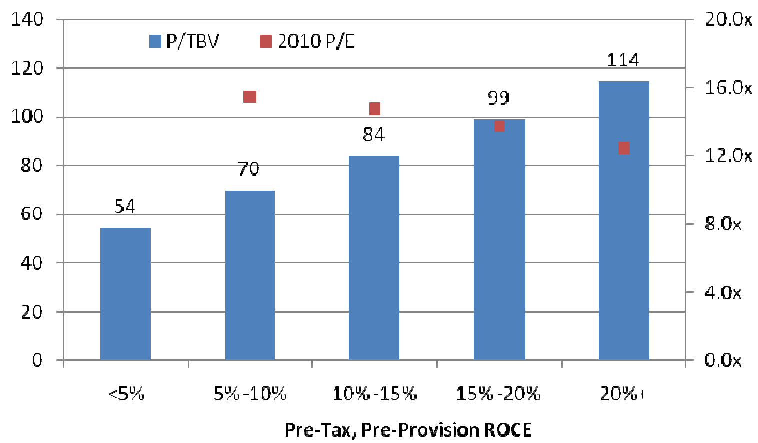
Bank Valuation Metrics

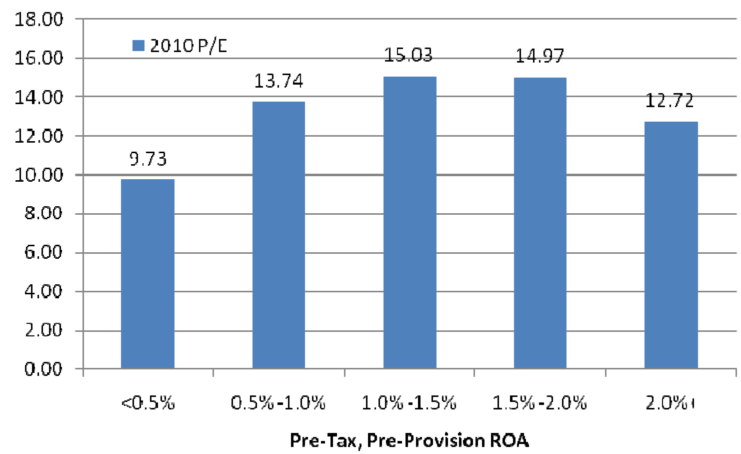
- Tangible book is the primary valuation metric used today
  - Investors focused on banks' capital level and their ability to absorb potential credit losses
  - High provision levels leading to volatility in earnings and in many cases negative earnings
  - Pre-provision earnings (i.e., normalized earnings) still deemed as a meaningful metric
- Limited correlation between dividend yield and valuation

High Dividend not Necessarily Rewarded



P/TBV vs. P/E Valuation: Earnings Valuation is Secondary to Book Value



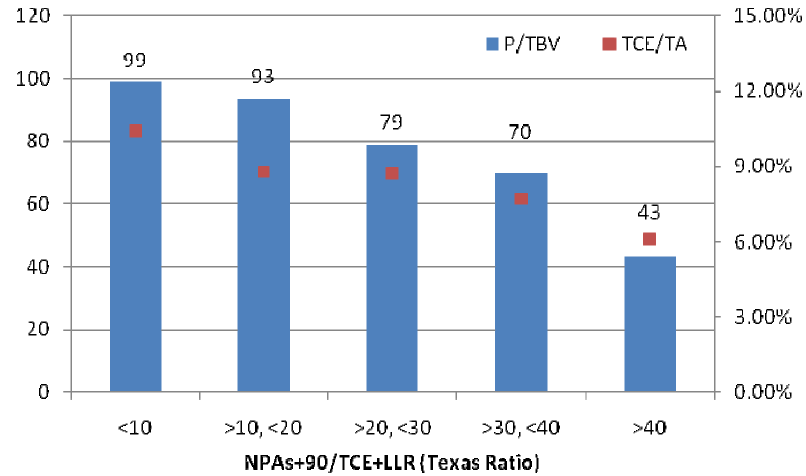


Note: Data set includes all public bank and thrifts; Data as of 1/5/2010

Bank Valuation Drivers: Asset Quality & Franchise Strength

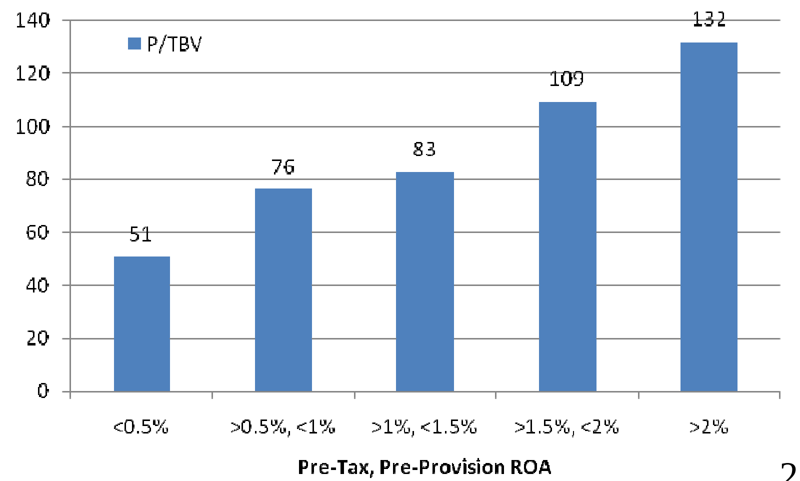
Asset Quality and Capital Support are at Forefront

- Investors seeking assurance that sufficient equity capital is available to support a run-down scenario:
  - Texas Ratio has become a key valuation metric
  - Beyond a 20% Texas ratio, banks are penalized for their relatively high-risk credit profile



Earnings Power Always Commands a Premium

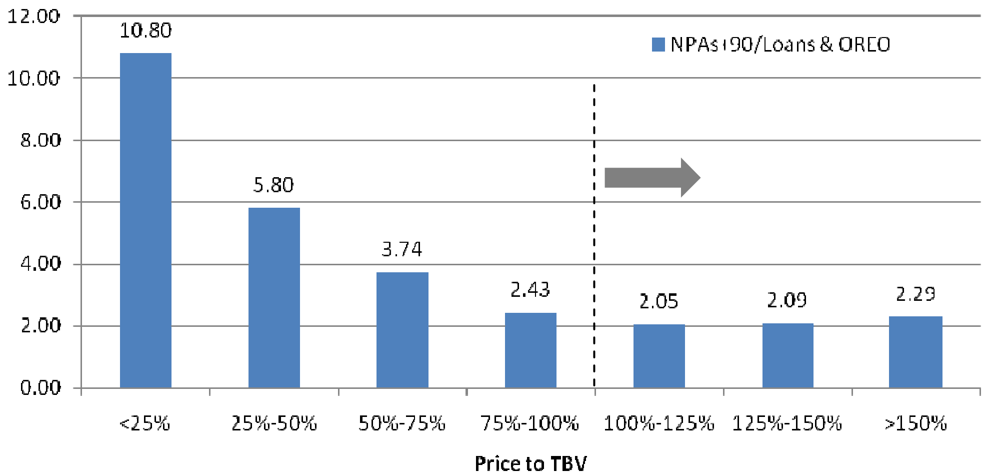
- Among those deemed sufficiently capitalized, banks with franchise value command a premium
- Pre-tax, pre-provision (PTPP) earnings is an indicator for future growth:
  - Capital replenishment for future growth
  - Less risk of dilution from an equity offering



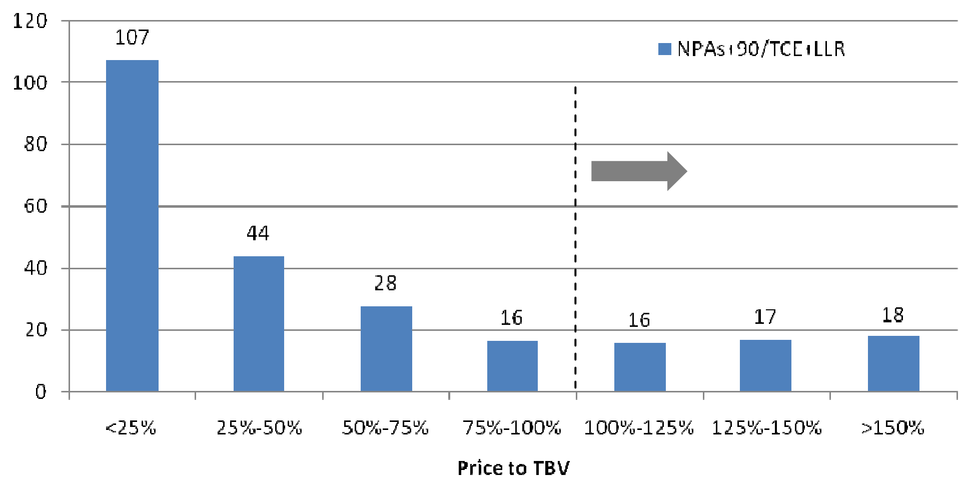
Note: Data set includes all public bank and thrifts; Data as of 1/5/2010

U.S. Depository Universe Segmented by P/TBV

Impact of Asset Quality and Capital Levels in Bank Valuation



- Banks trading at or above tangible book have median NPAs+90/Loans +REO less than 2.25%.
- Bank valuations are penalized when this ratio moves beyond 2.25%.

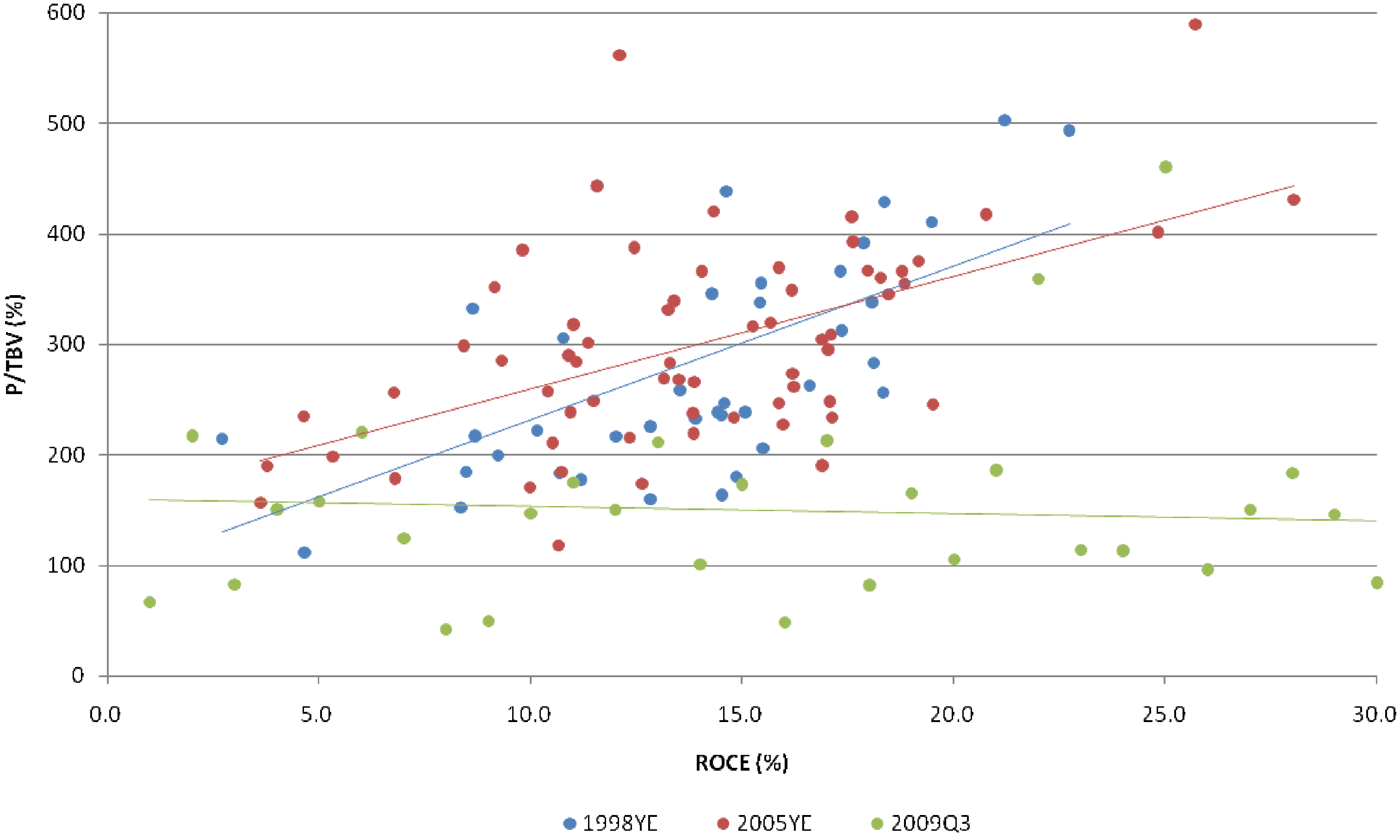


- "Texas" ratios below 20% usually command a valuation premium in this environment.
    - Above 20%, banks begin trading at a meaningful discount to tangible book value.

Note: Data set includes all public bank and thrifts; Data as of 1/5/2010

Historical P/TBV and ROCE Correlation

Earnings are Currently Not a Key Driver of Bank Valuation, as It has been Historically



Source: SNL Financial

Note: Scatter plot represents banks with market cap between $500mm and $5bn

Recent Follow-On Equity Offerings by Southeast Banks

Transactions Detail

Company Name	Market Cap ($mm)	P/TBV	TCE/TA	(NPAs + 90) / Assets	Texas Ratio[1]	% of Market Cap	Discount to Announce	$ Amount Offered ($mm)
BB&T Corporation[2]	$17,603	1.8x	5.1%	2.25%	36.3%	11.0%	-24.0%	$1,500
BB&T Corporation[2]	17,603	1.8x	6.0%	2.49%	34.9%	5.1%	-1.6%	870
Capital One Financial Corporation	17,138	1.4x	5.8%	1.26%	15.8%	7.7%	-11.5%	1,554
SunTrust Banks, Inc.	11,580	1.0x	5.7%	3.51%	50.2%	28.5%	-1.3%	1,404
Regions Financial Corporation	6,867	0.8x	5.4%	2.71%	41.8%	47.1%	-23.7%	1,600
Hancock Holding Company	1,524	2.2x	8.7%	0.78%	8.2%	13.1%	-2.8%	153
Trustmark Corporation	1094	1.5x	7.8%	2.32%	26.9%	10.5	-3.4%	115
Synovus Financial Corp.	921	0.4x	5.9%	5.14%	59.8%	47.8%	5.3%	600
Home BancShares, Inc.	584	1.7x	9.3%	2.05%	19.1%	58.6%	-4.8%	98
Simmons First National Corp.	418	1.5x	8.3%	0.79%	8.8%	16.1%	-14.5%	65
Pinnacle Financial Partners, Inc.	386	1.1x	6.0%	1.16%	17.5%	29.0%	-11.5%	100
United Community Banks, Inc.	365	0.6x	5.2%	4.63%	68.3%	55.2%	-30.3%	194
Cardinal Financial Corporation	254	1.4x	8.4%	0.34%	3.7%	15.2%	-7.0%	31
Centerstate Banks Inc.	228	1.1x	6.9%	2.78%	36.1%	66.8%	-27.8%	75
Union Bankshares Corporation	220	1.0x	6.0%	2.49%	35.7%	31.7%	-18.3%	63
First Financial Holdings	218	0.8x	5.4%	2.20%	32.2%	32.3%	-9.9%	65
First Community Bancshares, Inc.	194	1.1x	4.2%	0.65%	13.7%	30.7%	-28.3%	58
1st United Bancorp, Inc.	154	1.3x	7.6%	1.61%	19.6%	140.4%	-13.0%	70
South Financial Group, Inc.	121	0.2x	6.1%	3.99%	49.6%	64.7%	-37.5%	75
Seacoast Banking Corporation	88	0.7x	4.7%	7.78%	116.2%	132.8%	-13.1%	66
MidSouth Bancorp, Inc.	87	1.2x	7.3%	1.90%	23.4%	45.3%	-8.9%	40
Middleburg Financial Corp.	83	0.9x	7.0%	2.39%	30.6%	36.2%	0.7%	18
Southern National Bancorp of Virgina	70	0.7x	12.2%	1.44%	11.2%	50.4%	-17.7%	25
Median		**1.1x**	**6.0%**	**2.25%**	**32.2%**	**32.3%**	**-13.0%**	

Source: SNL Financial

Note: Financial data as of quarter before completion of deal; Includes all Southeast bank offerings completed in 2009

[1] Texas ratio defined as (NPAs + 90 Days Past Due) / (TCE + Reserves)

[2] First offering completed on 5/12/2009; Second offering completed on 8/17/2009

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Bank Investors' Considerations

Based on Sterne Agee's recent equity-offering executions, investors are focused on issuer's asset quality and capital strength

Asset Quality → **3rd Party Loan Review**

- Loan portfolio quality
- Securities downgrades
- Portfolio concentration

- Independent firm will analyze a majority portion of the company's loan portfolio, applying estimated loss rates and macroeconomic factors
- Investors gain clarity on the company's loan portfolio through an independent expert's customized loss analysis

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Capital Position → **SCAP-like Analysis**

- Current capital position
- Sufficiency of capital raise

- Apply government SCAP stress scenario loss rates to company's current loan portfolio to project capital position post losses
- Investors look to gain comfort that the capital raised is sufficient to keep pro forma capital ratios at adequate levels post stress test losses

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What's Working?

- **Recent Trends**
  - "Friends and Family" raises
  - FDIC-Assisted Acquisitions
  - Mergers

Question and Answer Session

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