Winning the Uphill Battle:

Capital Raising Alternatives for Community Banks

February 20, 2012

American Bankers Association®

StoneCastle Partners LLC

Introduction

- StoneCastle Partners, LLC ("SCP" or "StoneCastle") was founded in 2003 and is one of the largest managers of investment funds and provider of advisory services dedicated to the U.S. community banking sector

- Institutional asset management, investment advisory, and asset-liability management advisory to regional and community banks, corporations and institutional investors comprise its core competencies
  - 30+ professionals with deep community banking expertise
  - Over $3.5 billion of managed assets, over $2 billion of direct bank capital investments

- StoneCastle has privately executed 220+ capital transactions as principal, expanding the capital base and lending capacity of community banks in 43 states

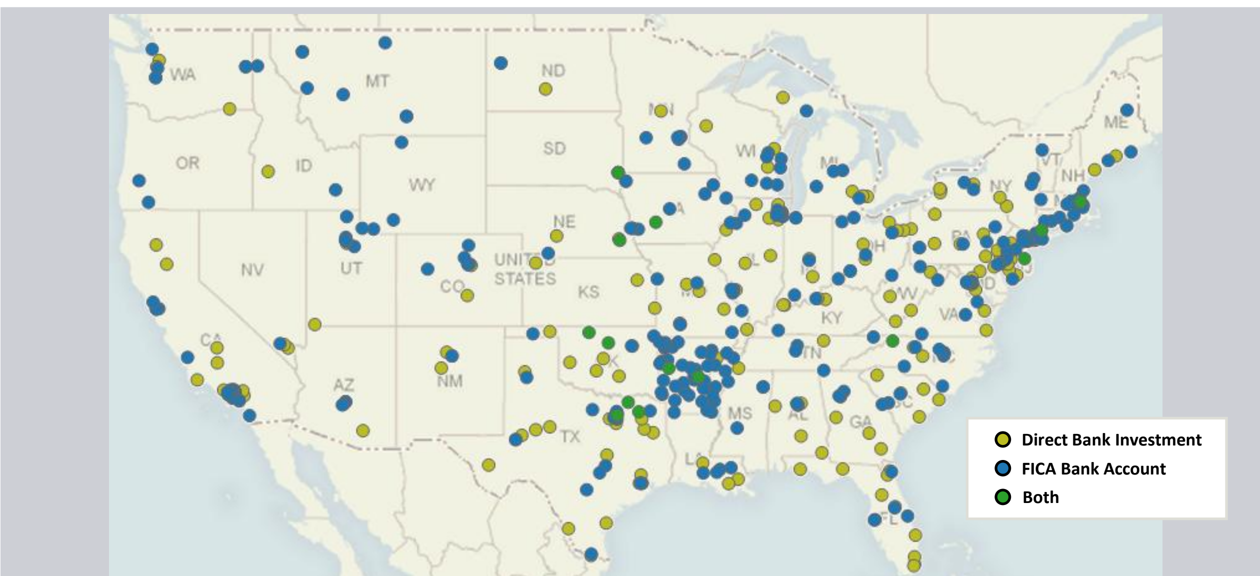
- SCP is wholly owned by its principals and by funds controlled by Charlesbank Capital Partners (former private equity division of the Harvard Endowment)

StoneCastle Has A National Industry Reach

- StoneCastle Cash Management, on behalf its clients, has deposited over $1.7 billion in newly established FICA bank accounts in over 300 banks across the U.S., giving StoneCastle even greater reach into the community banking sector

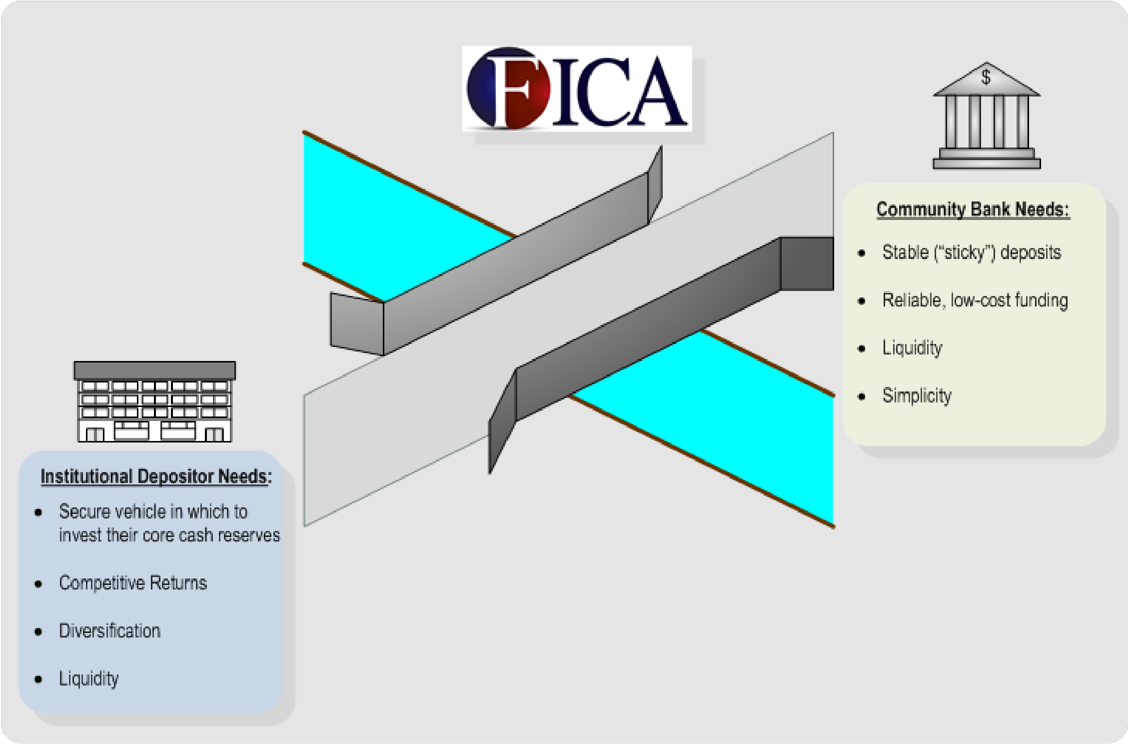
- In addition to the 430+ banks that received capital from the principals of StoneCastle since 1999, FICA has added 260+ new relationships to StoneCastle in 2011 and this number continues to grow at 5 - 7 new banks each week

Nationwide Footprint



FICA – Bringing Corporate Deposits Back To The Banks

- FICA, the Federally Insured Cash Account, bridges the needs of institutional depositors with community banks
- FICA provides stable, low-cost core cash reserves of institutions that would otherwise keep cash in money-center banks and treasury money market funds
- FICA can serve as a key tool to retain large balance deposits once the TAG program ends in Dec 2012



StoneCastle Bank Rating Methodology

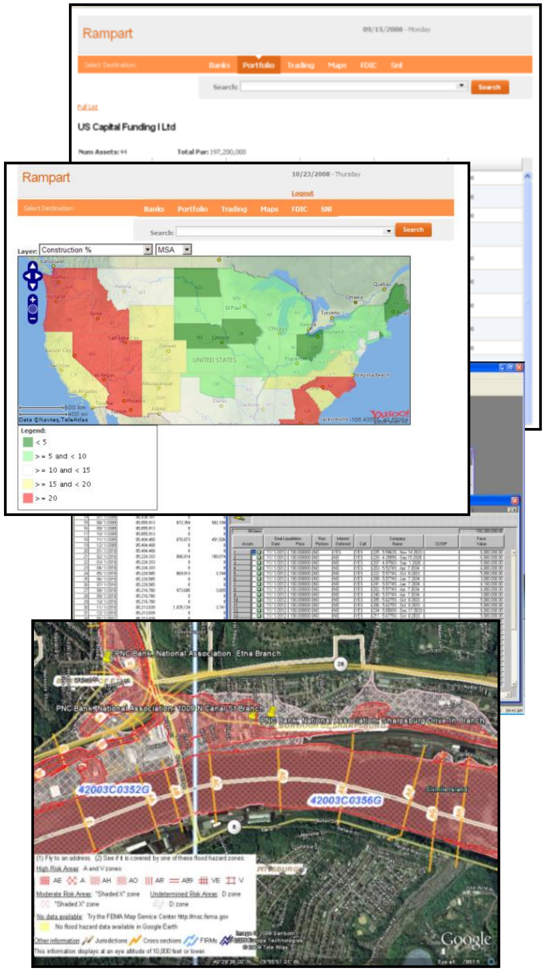
RAMPART is StoneCastle's proprietary bank-rating and credit technology platform which allows it to quickly assess a bank's strength and performance record using both regressive and stress-test analyses

Forward-looking metrics
- Capital relative to asset quality
- Exposures to problem asset classes
- Profitability

Historical metrics
- Growth
- Profitability
- Capital
- Liquidity

Proprietary Algorithm weights metrics based on correlations to bank failure

- **SCP A -** CAMELS 1 – S&P AA+/AA
- **SCP B –** CAMELS 1,2 – S&P AA-/A-
- **SCP C –** CAMELS 2,3 – S&P BBB/BB+
- **SCP D –** CAMELS 3,4 – S&P BB/B
- **SCP E -** Camels 4,5 – S&P B-/CCC-



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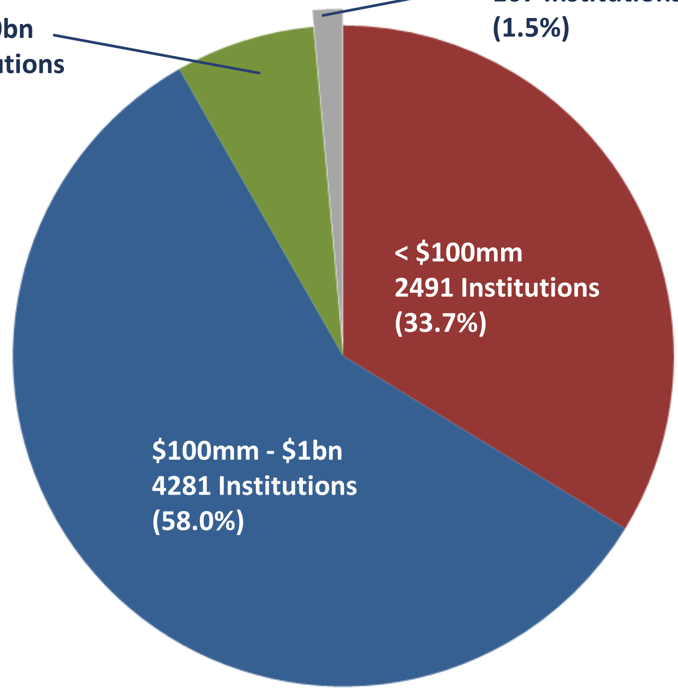
Banking Industry Has Distinct Segments

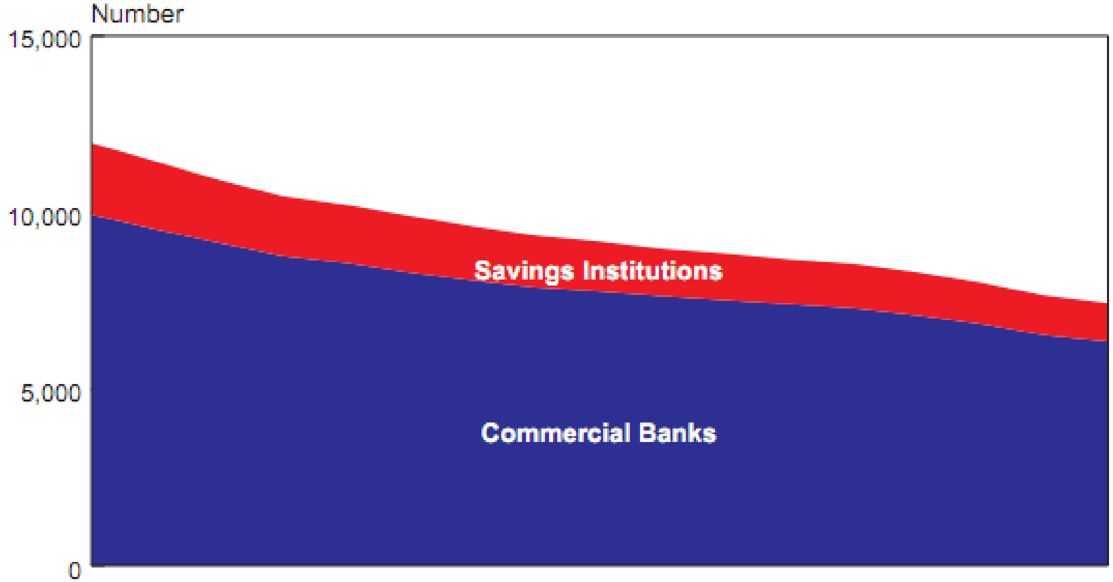


- **Highly fragmented industry – 7,275 banks have less than $10 billion of assets**
  - 98.5% of total U.S. banks
  - $2.8 trillion of combined assets
  - $322 billion of combined equity capital

Number of Commercial Banks Continues to Decline

Number of FDIC-Insured Institutions

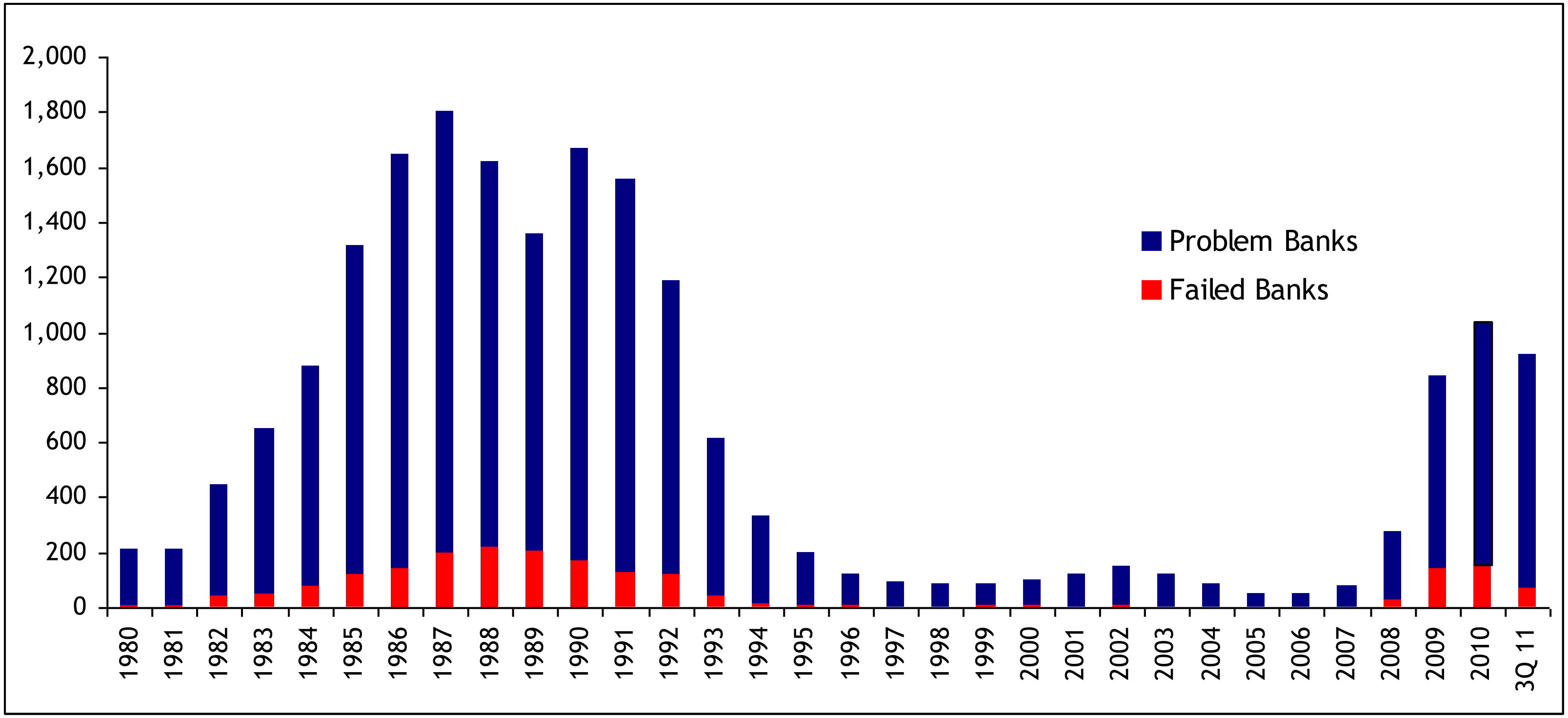
1995 - 2011



	12/95	12/97	12/99	12/01	12/03	12/05	12/07	12/09	9/11
Savings Institutions	2,030	1,780	1,642	1,534	1,411	1,307	1,250	1,172	1,084
Commercial Banks	9,941	9,143	8,580	8,080	7,770	7,526	7,284	6,840	6,352
Total	11,971	10,923	10,222	9,614	9,181	8,833	8,534	8,012	7,436

- **Consolidation has resulted in improved industry credit quality**
- **Weaker banks typically acquired by stronger banks or have failed**

Number of FDIC-Insured “Problem” Institutions



- **Currently 844 FDIC-Insured “Problem” Institutions as of September 2011**
- **1,430 banks were placed on watch at the beginning of 1992**
  - Less than 140 banks have failed between 1992 and 2007

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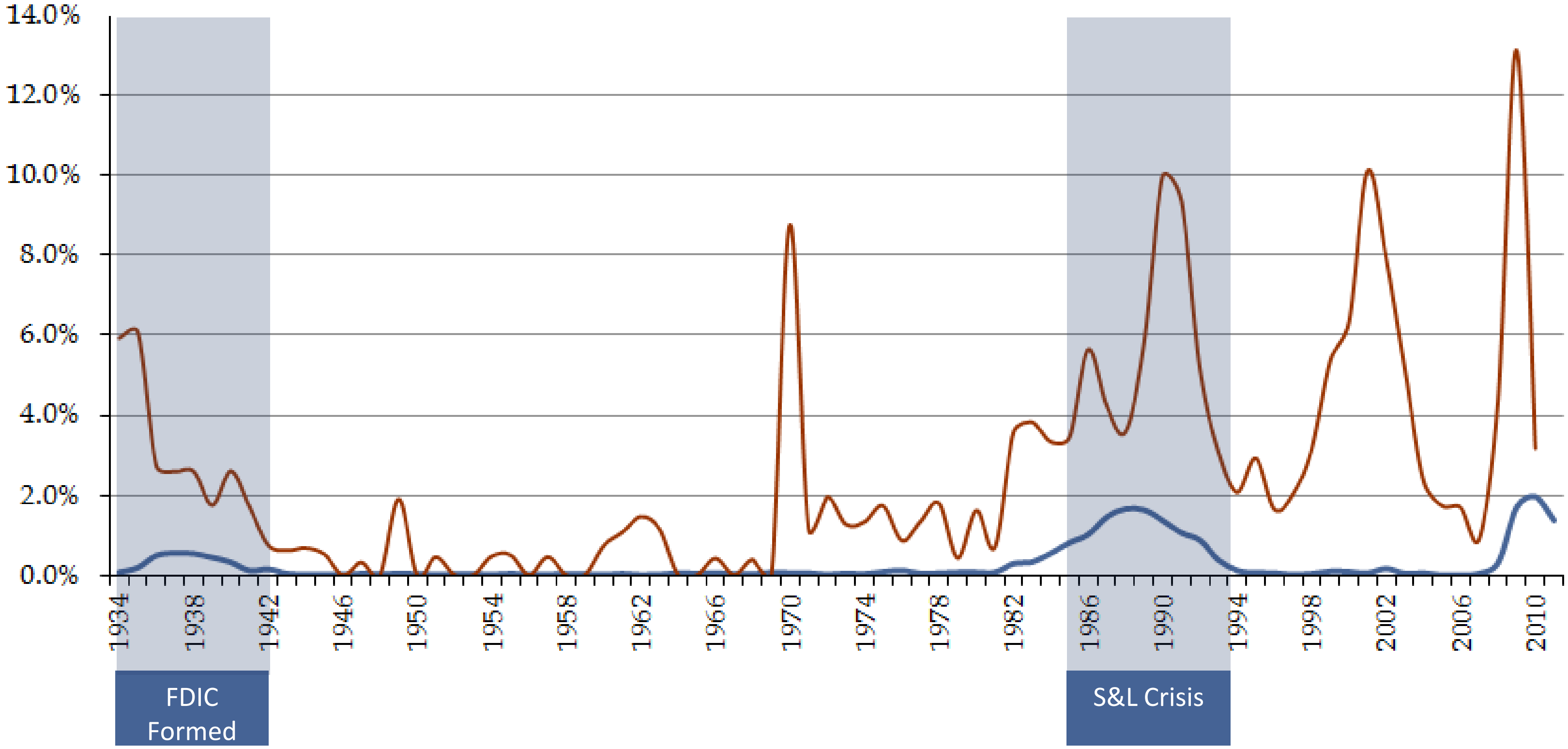
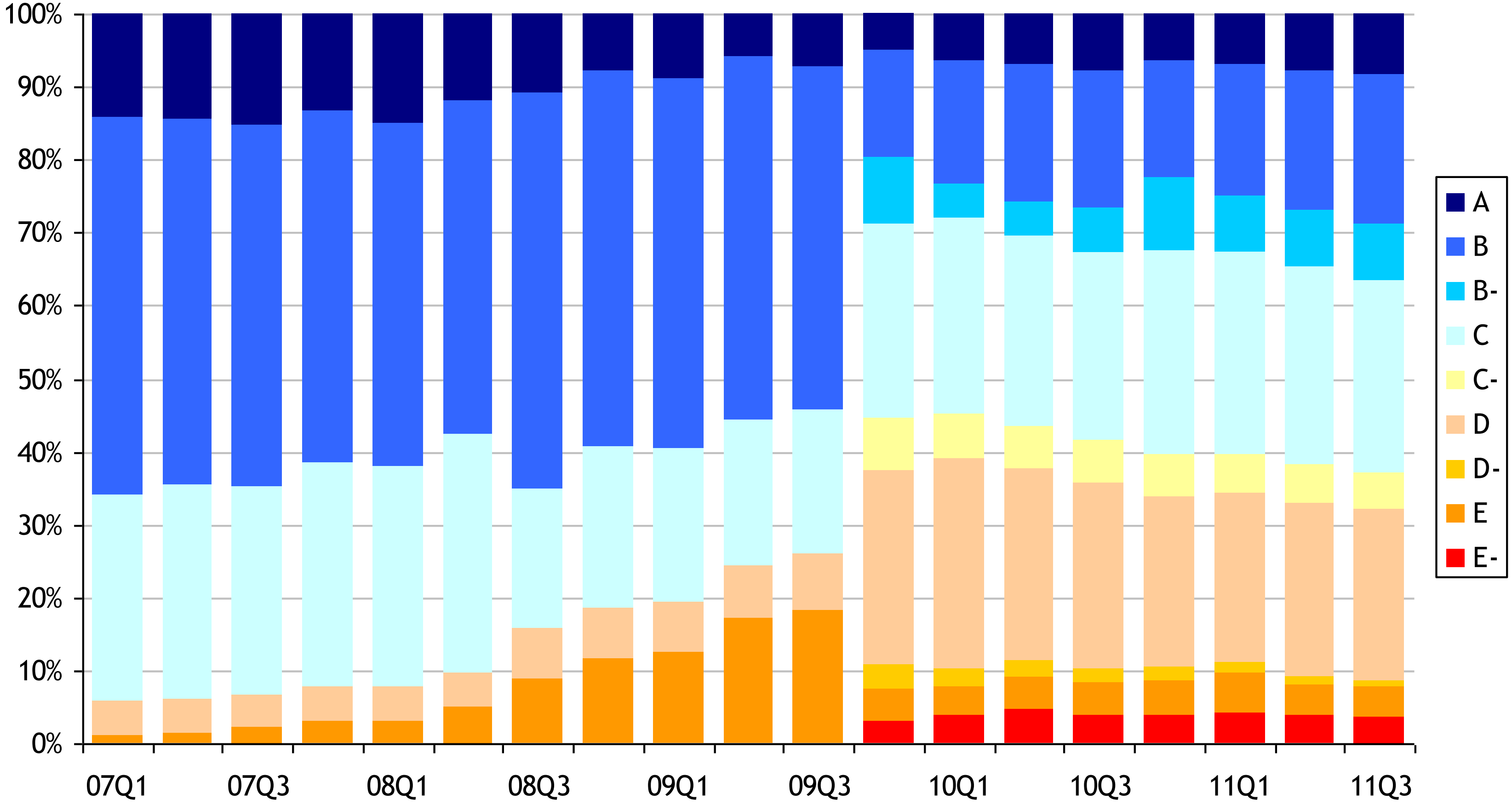
Putting Things in Perspective



- **Banks are generally less risky than other corporations**
- **Historically, banks have performed similar to A/BBB corporate credits**

SCP Industry Rating Migration: 1Q07 – 3Q11…Have we turned the corner?



Community Banks: Stronger Core Earnings & Balance Sheet

YTD Through 3Q11	Assets < $1 billion	$1 billion to $10 billion	Assets > $10 billion
Number of Institutions	6,772	566	107
Total Assets (billion)	$1,417	$1,445	$10,979
ROA	0.60%	0.85%	0.97%
Net Interest Margin	3.82%	3.84%	3.54%
Non-current Loans	3.25%	3.93%	4.41%
Past Due Loans	0.78%	0.66%	0.73%
Net Charge-off Rate	0.81%	1.15%	1.81%
Earnings coverage of NCOs	2.43x	2.37x	2.08x
Leverage Ratio	10.27%	10.53%	8.85%
Tier I Ratio	15.36%	15.52%	12.58%
Total Risk-Based Ratio	16.57%	16.79%	15.22%

Investors and Regulators Do Focus on Similar Items

- Deposit quality and franchise value
- “True” book value of the company
- Asset/liability composition
- Market demographics:
  - Population growth, median household income, local industry, age trends
- Microeconomic factors:
  - Unemployment, house prices, bankruptcy filings
- Topographical considerations:
  - Earthquake, flood, hurricane

StoneCastle's Investment Process – The High Level

Management → **Market** → **Balance Sheet**

Management
- The risk taker
- Bank is vehicle to hold the risk

Market
- Local market factors drive performance

Balance Sheet
- BS is a snap shot in time
- Average loan duration is 5 years

We view the bank as a vehicle to hold risk and ***management*** determines the risks taken. While the local ***market*** drives performance, management remains responsible for the proper risk and return mix in the vehicle.

When analyzing the ***balance sheet***, it is important to remember that it is a snapshot in time and the average loan duration is approximately 5 years. This means that the entire risk and return profile will turnover in a short horizon. Qualified management is critical, as they will determine the "next" balance sheet.

StoneCastle's Bank Stress Model

- **StoneCastle developed a proprietary bank stress model to predict how banks perform in a run-off scenario**
- **Integrates bank financial data and local economic data on a county level by bank branch**
- **Five year projections include expectations of income on performing assets**

Run-off Analysis [1]

Alliance Bank

SCP Rating B

Asset Composition	%	5yr CAGR
Sec	37.8%	15.8%
Constr	2.1%	26.9%
Resi-1st	11.4%	18.5%
Resi-jr lien	0.5%	8.2%
Resi-HE	2.0%	1.6%
CRE	16.2%	17.0%
Cons	1.4%	-1.6%
C&I	12.1%	9.8%
Other	16.4%	2.2%

YTD Asset Growth	
1-yr	19.2%
5-yr	18.4%

TCE / TA	
Ratio	9.6%

		Projected Tangible Equity Cap / Tangible Assets				
Unemployment	House Price Decline [2]	Year 1	Year 2	Year 3	Year 4	Year 5
7.0%	-10.0%	10.7%	11.6%	12.5%	13.3%	14.2%
9.0%	-20.0%	10.4%	11.0%	11.1%	11.6%	12.3%
12.0%	-30.0%	9.9%	9.8%	9.2%	9.4%	9.8%
18.0%	-40.0%	5.3%	0.8%	-3.8%	-4.6%	-4.6%
W.A. of Bank by Deposit Geography						
12.9%	-17.6%	7.9%	7.3%	6.9%	7.5%	8.3%

County, St	Deposits (000's)	% of Deposits	Unemploy-ment	5-yr Change	House Price Decline [2]	Vacancy Rates
1. Pulaski, IN	72,651	37.1%	14.7%	91.1%	-15.0%	17.5%
2. Jasper, IN	42,781	21.8%	10.4%	68.7%	-29.1%	11.5%
3. White, IN	41,106	21.0%	14.9%	66.2%	-14.9%	29.3%
4. Benton, IN	23,245	11.9%	10.5%	99.4%	-12.6%	15.3%
5. Tippecanoe, IN	16,047	8.2%	10.1%	119.3%	-13.2%	9.2%
	195,830		12.9%	84.3%	-17.6%	17.7%
US	7,896,870,516		9.7%	79.6%	-26.4%	

[1] Excess cashflow goes to cash and delever's the bank

[2] Peak-to-trough Median Sales Price

[3] Assumes a flat interest rate environment and no new loans are orginated at attractive market spreads

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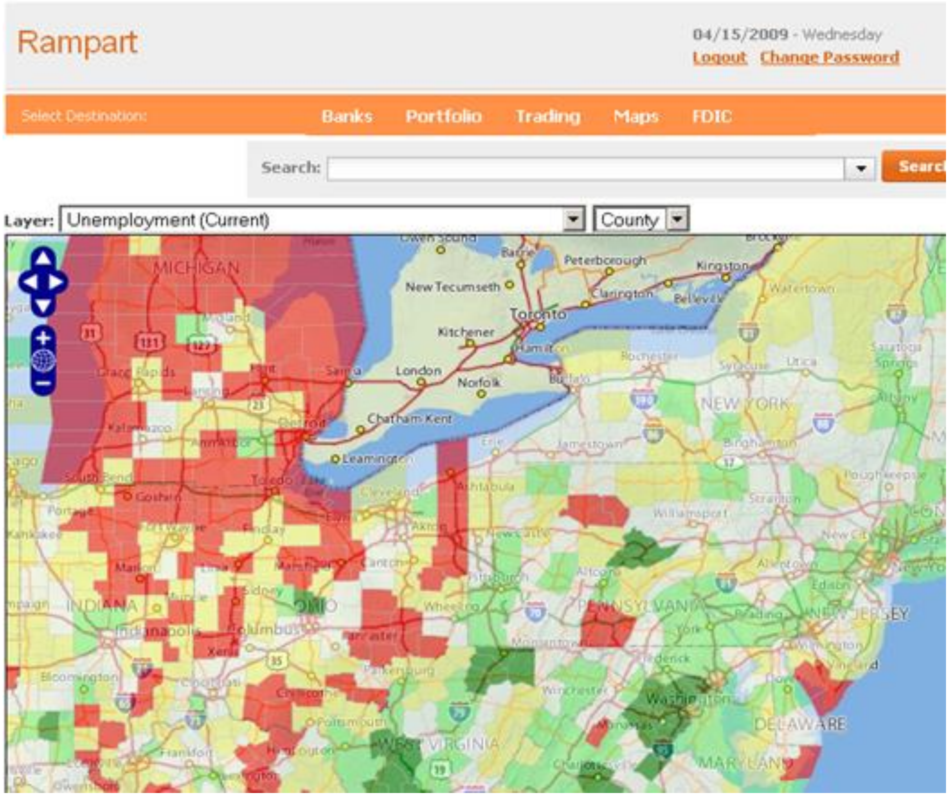
RAMPART – County by County Level Detail

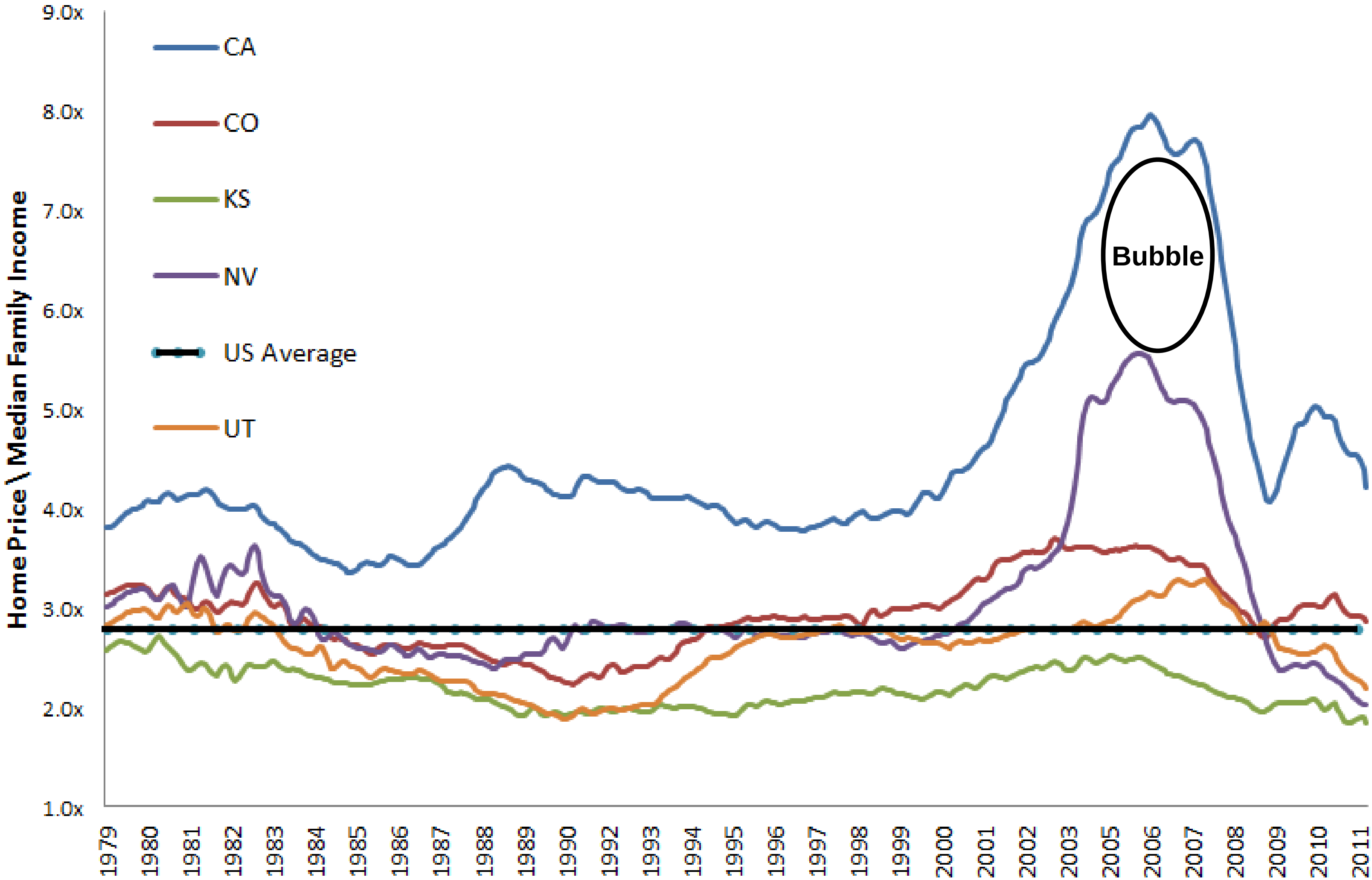
- **StoneCastle considers up to 12 county-level economic metrics to determine the stress level scenario for each bank**
- **Stress levels are deposit weighted by county exposure for each bank**
- **Entire Bank Universe (7,300+) is modeled and updated on a quarterly basis**



Key Economic Statistics – Select States vs. The United States

Select Economic Data *(Q3 2011)*	**California**	**Colorado**	**Utah**	**United States**
Median Home Price to Median Family Income	4.22x	2.87x	2.20x	2.59x
Unemployment Rate	11.9%	8.3%	7.4%	9.0%
5 yr. Change in Unemployment Rate	112.5%	112.8%	164.3%	91.5%
5 yr. Change in Population	4.0%	6.3%	8.1%	3.4%
Population Migration: 35-49 yr. / 25-34 yr. Ratio	1.42x	1.43x	2.39x	1.50x
Vacant Housing Stock	7.9%	10.9%	10.4%	11.4%

Home Price to Median Family Income – California Bubble



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Raising Capital

Banks and Funds are Very Different Types of Investors

- **Hedge Funds and Private Equity**
  - Focused on picking winners and outperforming
  - Invest in fixed income, equities, commodities, currencies, etc… (unlimited universe)
  - Global markets
  - Various investment horizons

- **Community Banks**
  - Focused on avoiding losses through risk management
  - Entirely fixed income
  - Profits generated entirely through risk management
  - Loan book average duration is five years
  - Management must choose from loans in their local markets
  - Illiquid investments

Banks Always Have a Need for Capital

- **Banks need to raise capital in weak markets to:**
  - Acquire weaker performing or failed banks
  - Acquire divested branches
  - Grow loan portfolio and deposits organically in the wake of competitor weakness
  - Absorb current potential and future loan losses

- **Banks also need capital in strong markets to:**
  - Organically grow loan portfolio and deposits while maintaining regulatory capital ratios
  - Acquire strategically aligned banks to gain cost efficiencies and pricing power
  - Expand branch network for control of market share
  - Acquire value-added businesses to increase non-interest income

The Community Banking Sector Requires Approximately $90 Billion Of Capital Over The Next Several Years

- Community banks hold approximately $2.8 trillion in assets and $324 billion in equity capital
- Additional capital will be needed for:
  - Charge-offs
  - Organic growth
  - Reserve building
  - Acquisition of weaker banks

Capital to be Funded	
Additional Loan Charge-offs	$28 Bn
Organic Asset Growth	$ 7 Bn
Permanent Increase to Loan Loss Reserves	$12 Bn
Acquisition of D and E rated banks	$43 Bn
Total New Capital Needed:	**$90 Bn**

- We will not attempt to quantify the trillions of lending that occurred outside the bank market (REITs, Hedge Funds, BDCs, SIVs, CDO, CLO, ABS) – some portion of this lending will return to the traditional bank lending market and capital will be needed for 8-10% of this growth

Difference in Views Between the Regulators Complicates the Capital Raise

- **Each regulator (Fed, FDIC, OCC, State) has differing views regarding the capital raising process…all of which are valid**
- **What is different?**
  - Amount of capital to receive
  - Who should get capital
  - Which forms of capital are feasible
  - What type of investor is acceptable
  - What usage of capital is valid
  - Timing and process to complete a deal

Capital Forms and Structures

Contingent Capital	• Pre-negotiated agreement to receive capital at a specific contingency or threshold • Possible to receive capital injection at time of weakness
Holding Company Debt	• Danger of double leverage • Ability to send cash downstream as common equity
Tier 2 Sub Debt	• Limited to 100% of Tier 1 Capital levels • Large concentrations are considered abusive
Trust Preferred	• Non-dilutive hybrid instrument issued at HC level • Dodd-Frank: Certain restrictions on issuance and Tier I eligibility depending on size
Perpetual Preferred	• No maturity, non-cumulative perpetual dividend payments • Includes redemption privileges
Convertible Preferred	• Similar to perpetual preferred but has stock basis allowing holder to convert to common • Ability to add in a forced conversion provision
Common Equity	• Dilutive to ownership, issuance fees, increase in regulatory and accounting costs

What are the Barriers Holding Back Fresh Capital For The Industry?

- Limited number of capital providers
- Large bid/ask spread remains between investors and banks
- New forms of capital (Contingent Capital)?
- Smaller banks rely on existing shareholders and board members for new capital
  - Difficult to attract investors unless bank is pristine or involved in a FDIC-assisted deal
  - Private placements
- BHC rules remain onerous for traditional private equity firms
- Investors migrating to minority investment models
- Institutional investors are becoming more active

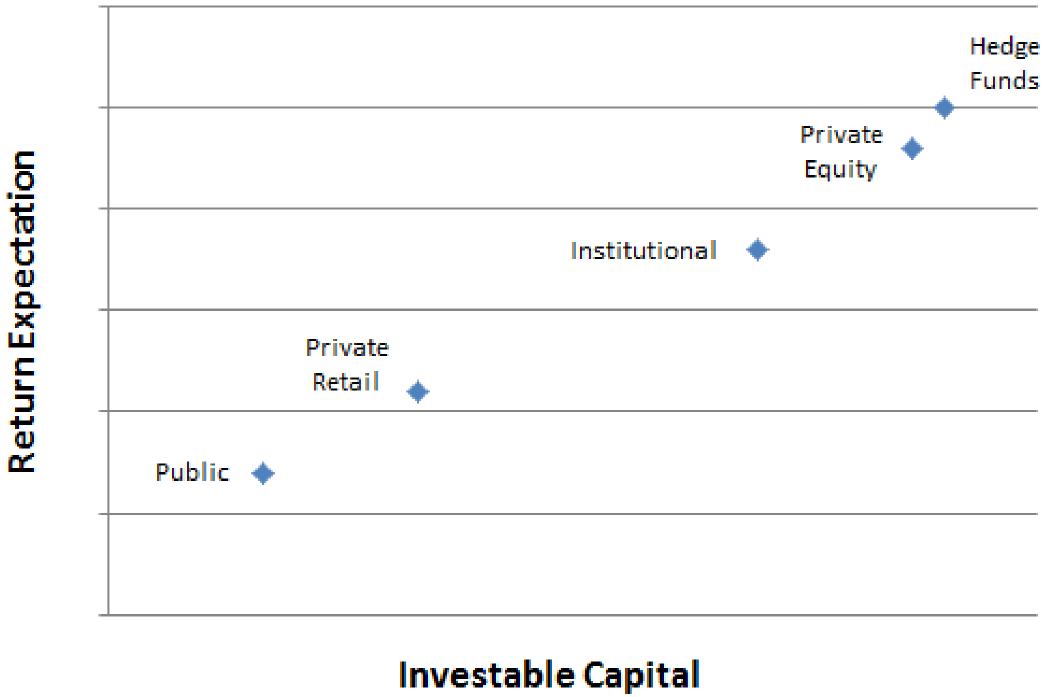
Can You Accommodate Your Potential Investor?

	Main Goal	Time Horizon	Return Expectations	Liquidity
Public	Long term growth or income generation	5 years+	10%	High Need
Private Retail	Long term growth or income generation	5 – 10 years	10-15%	High Need
Institutional	Achieving the risk/return profile set in the IPS or prospectus	5 – 10 years	10-15%	Intermediate Need
Private Equity	Outsized returns combined with exit strategy	5 – 7 years	30%	Low Need, Flexible
Hedge Funds	Picking winners for outsized returns, alpha generation	3 – 5 years	30%+	Low Need, Flexible

Types of Bank Investors

- **Public:** IPO, Exchange Listed Equity
- **Private Retail:** Local HNWI, Doctors, Dentists, Lawyers
- **Institutional:** Pensions, Endowments, Mutual Funds
- **Private Equity**
- **Hedge Funds**

Different Investors Have Different Goals!



Handling Your Potential Investors

- **Be honest**: Your regulatory data is public…qualified and knowledgeable investors know your positioning and results.

- **Know your balance sheet**: Off the cuff, know your top 5 performing and non-performing loans.

- **Have a vision**: Why should you get capital over another bank? What will you do different? How will you innovate and create returns?

- **Understand investors needs**: Does your vision fit with your investors needs? Can you accommodate and manage this type of investor?

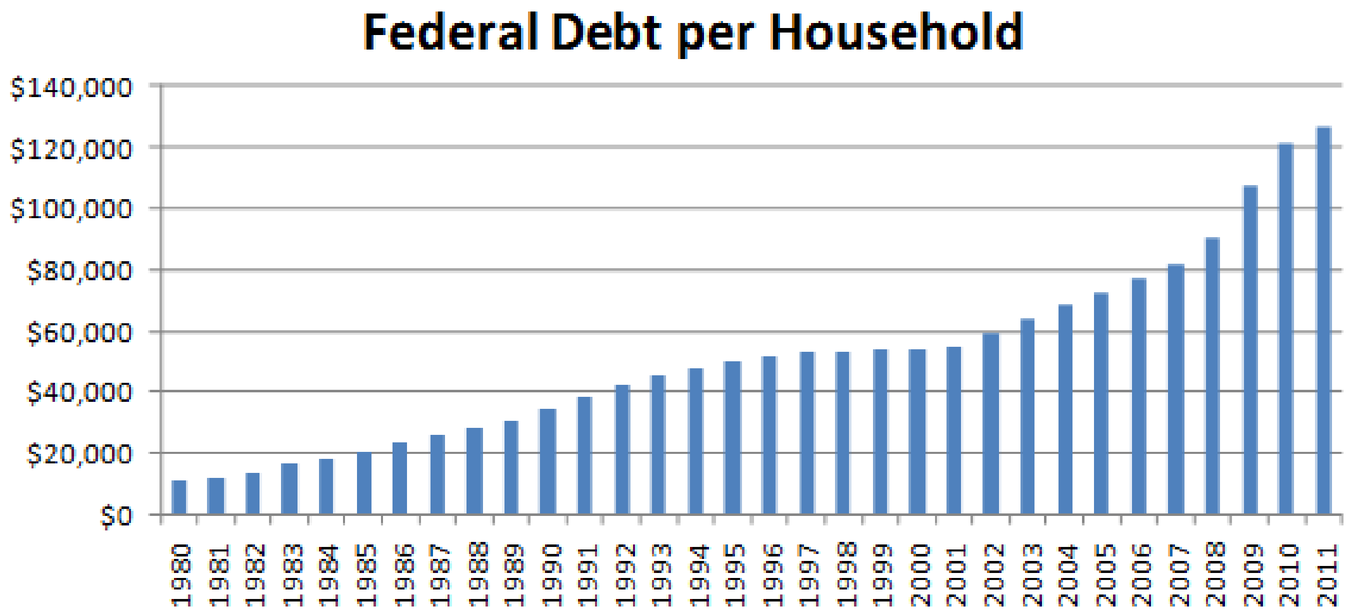
The Alternatives to Raising Capital

- **Shrink the balance sheet**
  - Reducing the overall asset and liability mix releases capital and improves the ratios
- **Free up fixed assets**
  - Divest a branch
- **“Rent the balance sheet”**
  - Innovative leasing structures

The Government Can Not Continue to be a Solution for Capital

Too Much Leverage Remains in the System

Inflation should have increased this number from $10,000 in 1980 to $28,500 by 2011…instead it has increased 450% even after inflation



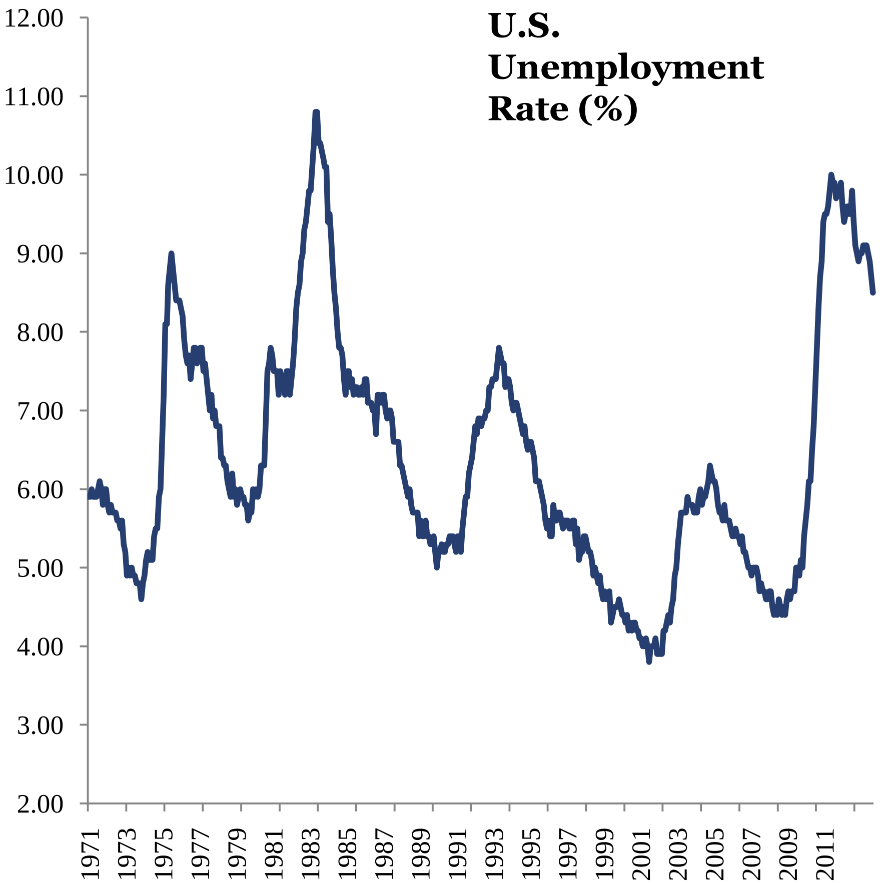
Source: John Burns Real Estate Consulting, U.S. Treasury, Federal Debt includes Intragovernmental Debt. Debt as of March 2011.

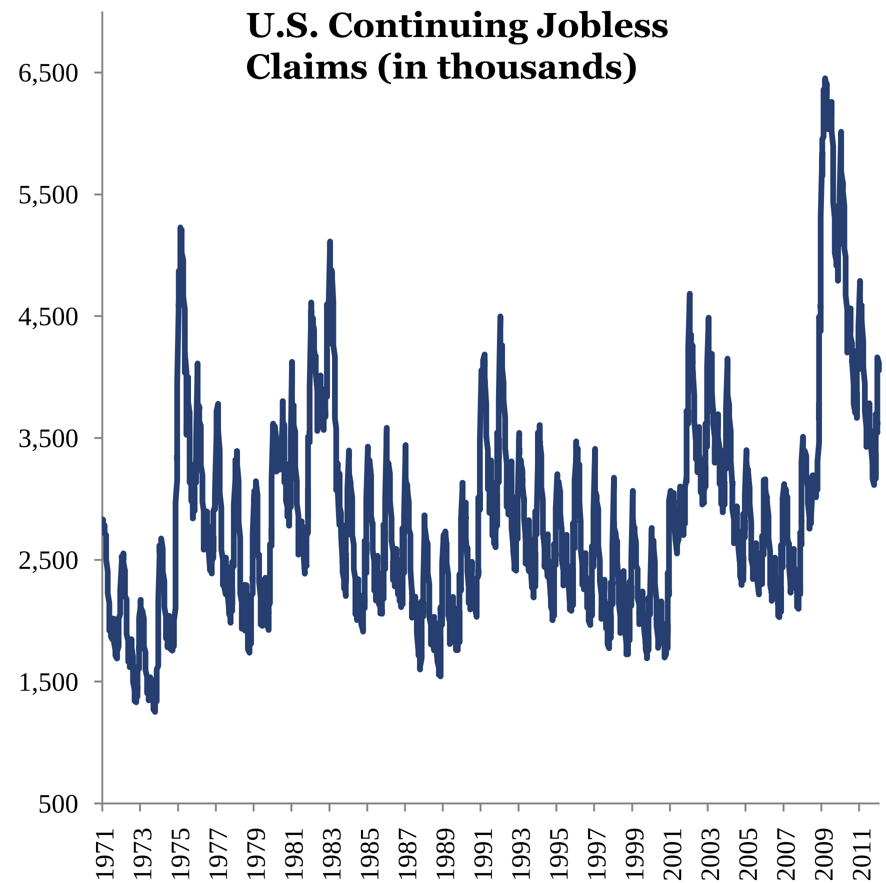
The Size of the Financial Markets Has Grown Dramatically and Has Investors Nervous

- **U.S. cash securitization is a $10 trillion market (unregulated!) vs. the $13 trillion banking market**
- **Global cash securitization is $12.5 trillion**
- **Global stock market is $36 trillion**
- **Global bond market is $82 trillion**
- **Global banking market is $97 trillion**

<u>Global Derivatives market is $790 Trillion, or 11 times the size of the world economy</u>

There Are Signs of Life but We Are Not Yet in the Clear





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Joshua Siegel, Managing Principal – StoneCastle Partners, LLC

In 2003, Joshua Siegel founded StoneCastle Partners, LLC, and has grown its assets to over $3 billion under management. Mr. Siegel is widely regarded as a leading expert in the community banking industry. He is regularly featured at major industry conferences, workshops, seminars and panels. Mr. Siegel, an innovative educator with a passion for teaching, has been invited to better educate government regulators in this specialized field during regular, scheduled sessions, year after year. He has lead robust roundtables where he speaks fervidly about investment options in the community banking sector.

He was appointed Adjunct Professor at the Columbia Business School in New York City and just completed teaching "Financial Services: Inner-workings and Imagineering" in the Spring 2011 semester. His published research studies, namely, Historical Default Rates of FDIC-Insured Commercial Banks, 1934–2001, Regional Bank Diversification, and Analysis of Idealized Cumulative Default Rates Beyond 10 Years established the basis for institutional investments into community bank hybrid capital. His research and financial innovations have brought nearly $40 billion of capital to over 1,600 banks across America over the past ten years.

Today, StoneCastle Partners is one of the largest investment firms dedicated to investing in the banking sector and, as a result of his prominence in the field, Mr. Siegel is a frequent commentator on major business television programs, such as CNBC and Forbes.com, and has been widely quoted in major industry and trade publications, including: The Wall Street Journal, Pension & Investments, Dow Jones Newswire, the ABA Banking Journal, Forbes, the New York Times, the Daily Deal, American Banker and many others.

Prior to co-founding StoneCastle, Mr. Siegel was a co-founder and Vice President of the Global Portfolio Solutions Group within the Fixed Income Division at Salomon Brothers/Citigroup Global Markets, a group organized to finance portfolios of financial assets for corporations and to invest in the sector as a principal. As the group continued to grow, Mr. Siegel assumed responsibility for developing new products, including pooled investment strategies for the community banking sector.

Mr. Siegel originally joined Salomon Brothers/Citigroup in 1996 in the tax and lease division which provided structured financing to government-sponsored enterprises and Fortune 500 corporations. Prior to that, he was with Sumitomo Bank where he served in three capacities: corporate lending officer to large corporate borrowers; banker structuring equipment lease transactions for industrial and financial customers and credit derivative transactions; member of the New York Credit Committee.

Mr. Siegel began his career in private equity and merchant banking, working for Charterhouse Bank in New York and London beginning in 1994 and Sulzer Brothers in its Corporate Market Development (R&D and private capital investments) division in Winterthur, Switzerland beginning in 1992. He holds a B.S. in Management and Accounting from Tulane University.

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