Credit Crisis Fallout: A New Paradigm for Bank Relationships?

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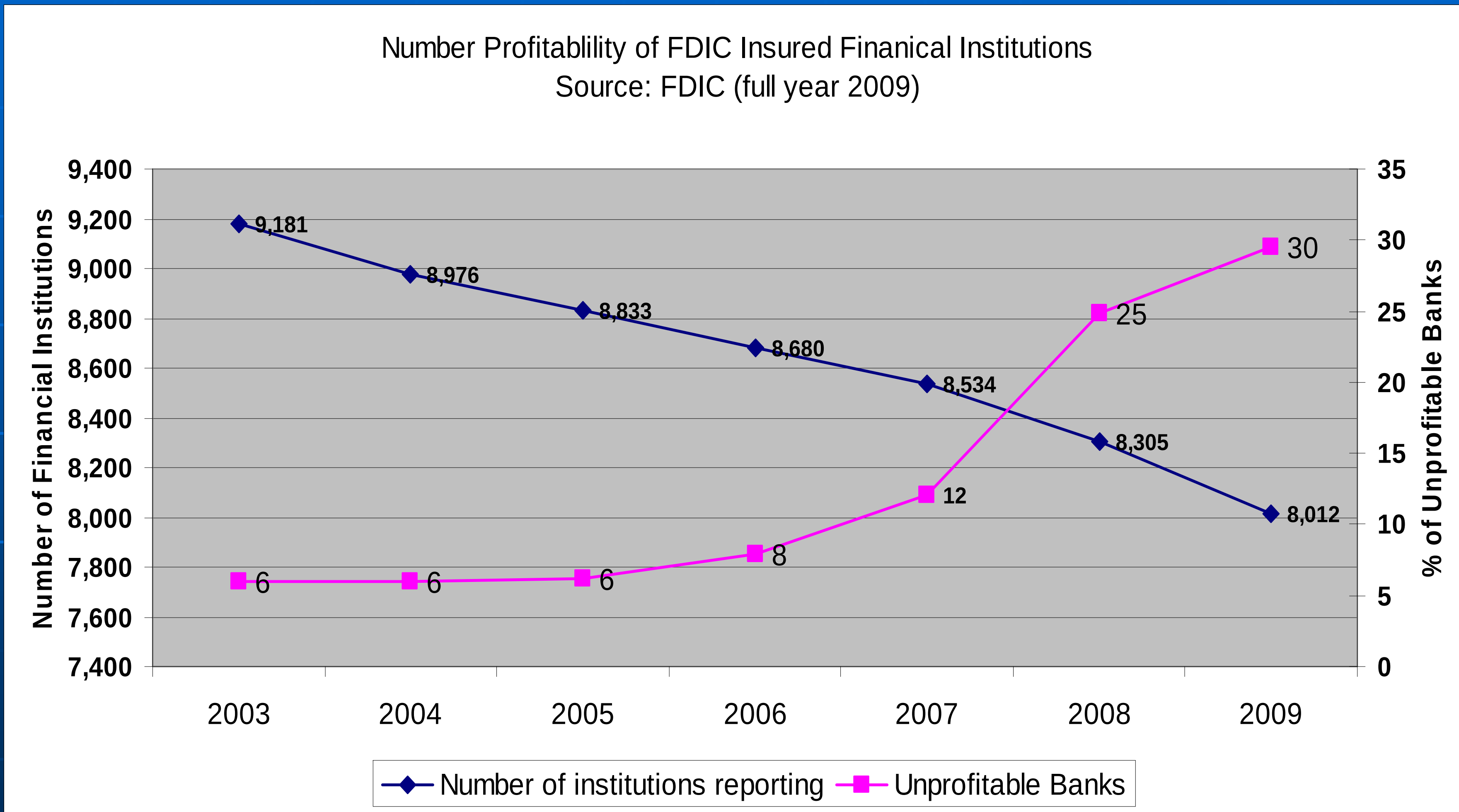
Agenda

- Banking Industry Profile
- Bank Credit Markets
- Bond Credit Markets
- Compliance
- Conclusions

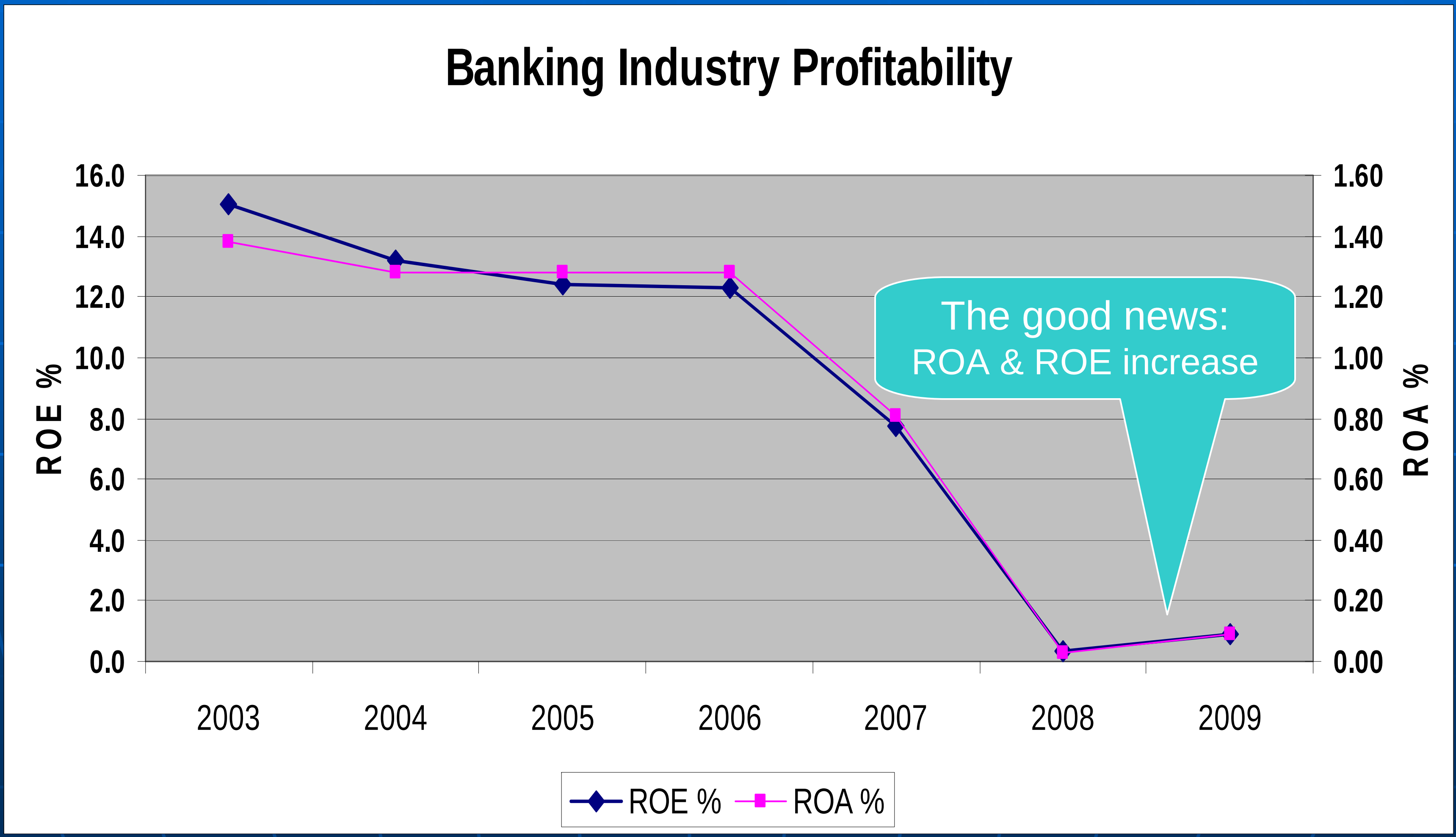
Banking Industry Profile

- Full Year 2009 (Source: FDIC)
  - Total assets since 2008 declined by 5.3% ($732BN) to $13.1Trn, **largest decline since inception of the FDIC**
    - C & I loans outstanding $1.2Trn, 18% decline from 2008
    - Loans secured by R.E. $4.5Trn, 5% “ “ “
  - 30% of the 8,000+ banks insured by the FDIC were unprofitable
  - Total assets at “problem” institutions rose to 402BN, highest level since June, 1993
  - Loan reserves to loans now 3.12%, **highest level since FDIC inception**
  - Net interest margin = 3.47% (2008 = 3.16%)
  - ROA = 9BP (2008 = 3BP. 2005 = 128BP)
- The Good(?) News
  - Earnings in 4qtr09 vs 4qtr08 were “breakeven”
  - Growth in noncurrent loan balances slows
  - ROA and ROE show gains as asset levels fall and profitability returns
  - More banks were profitable

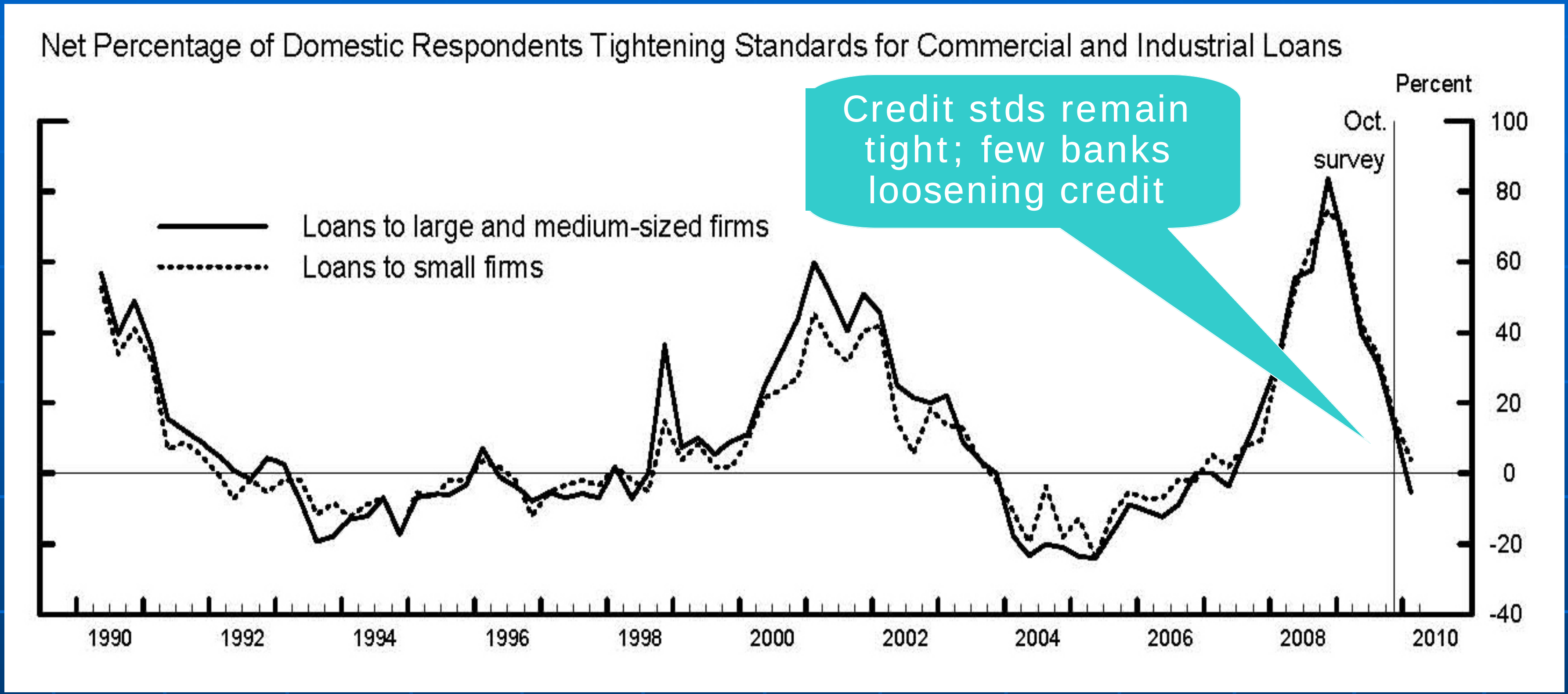
Banking Industry Profile



Banking Industry Profile



Bank Credit Market



"Tightening Standards" implies

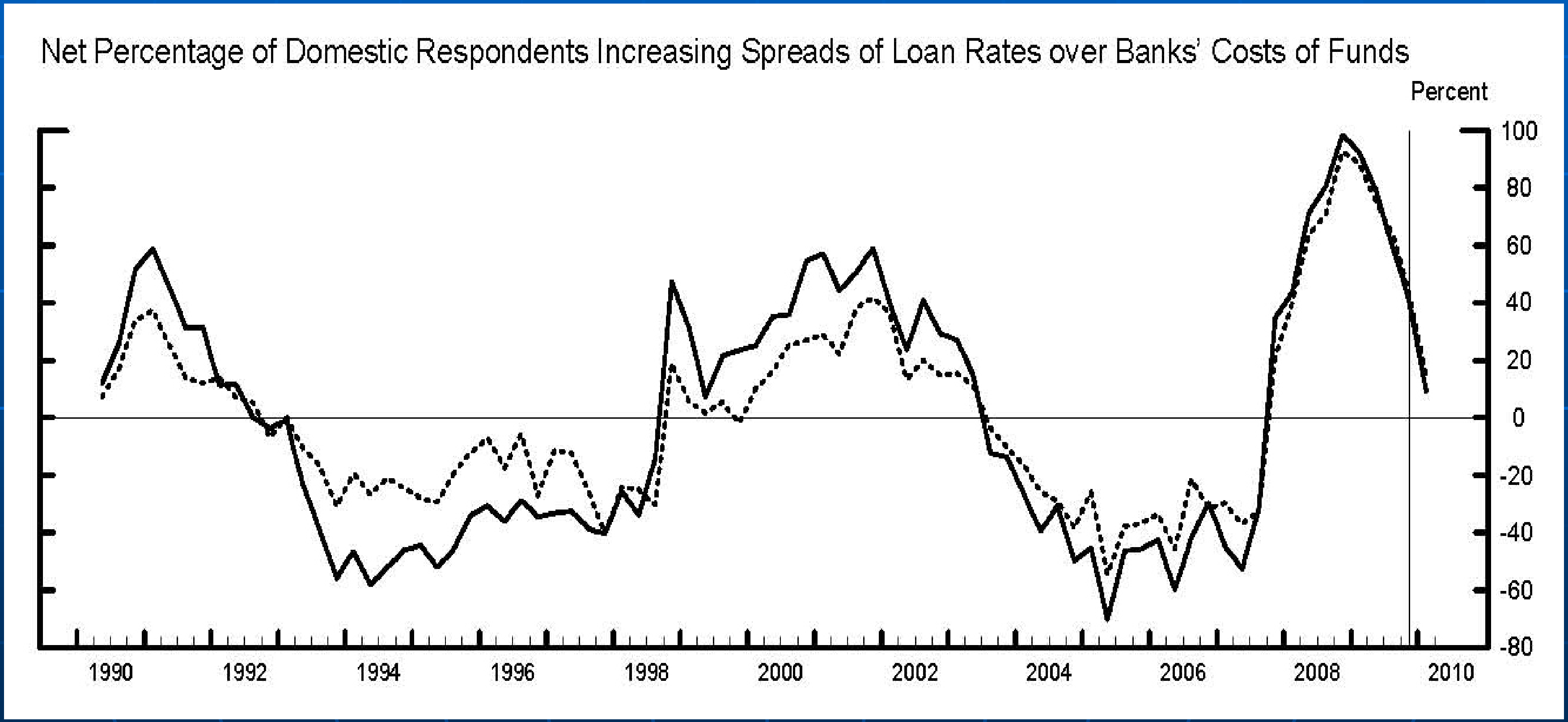
- More restrictive covenants
- Lower loan limits
- Shorter maturities

- Higher loan spreads
- More collateral

Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices – Jan10

Bank Credit Market

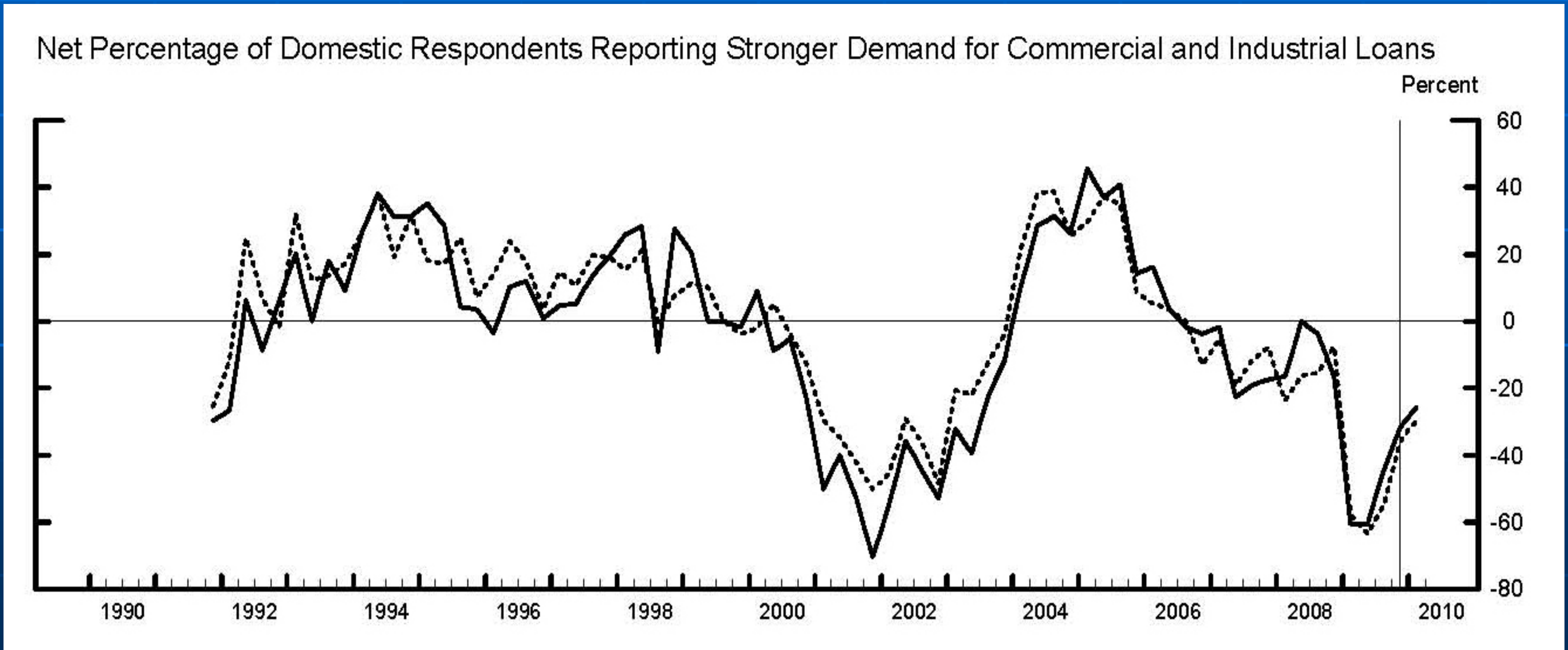
- Fewer banks are increasing loan spreads for C & I loans
- Loan spreads remain high (2 – 3 x “normal”)
- Use of LIBOR “floors” still common



Source: Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices – Jan10

Bank Credit Market

- Loan demand remains low for “big” needs (CAPEX, M & A)
    - Demand low because price & terms too high?
    - Which is cause, which is effect for loan demand?
- Loan losses looming on commercial real estate as asset values decline



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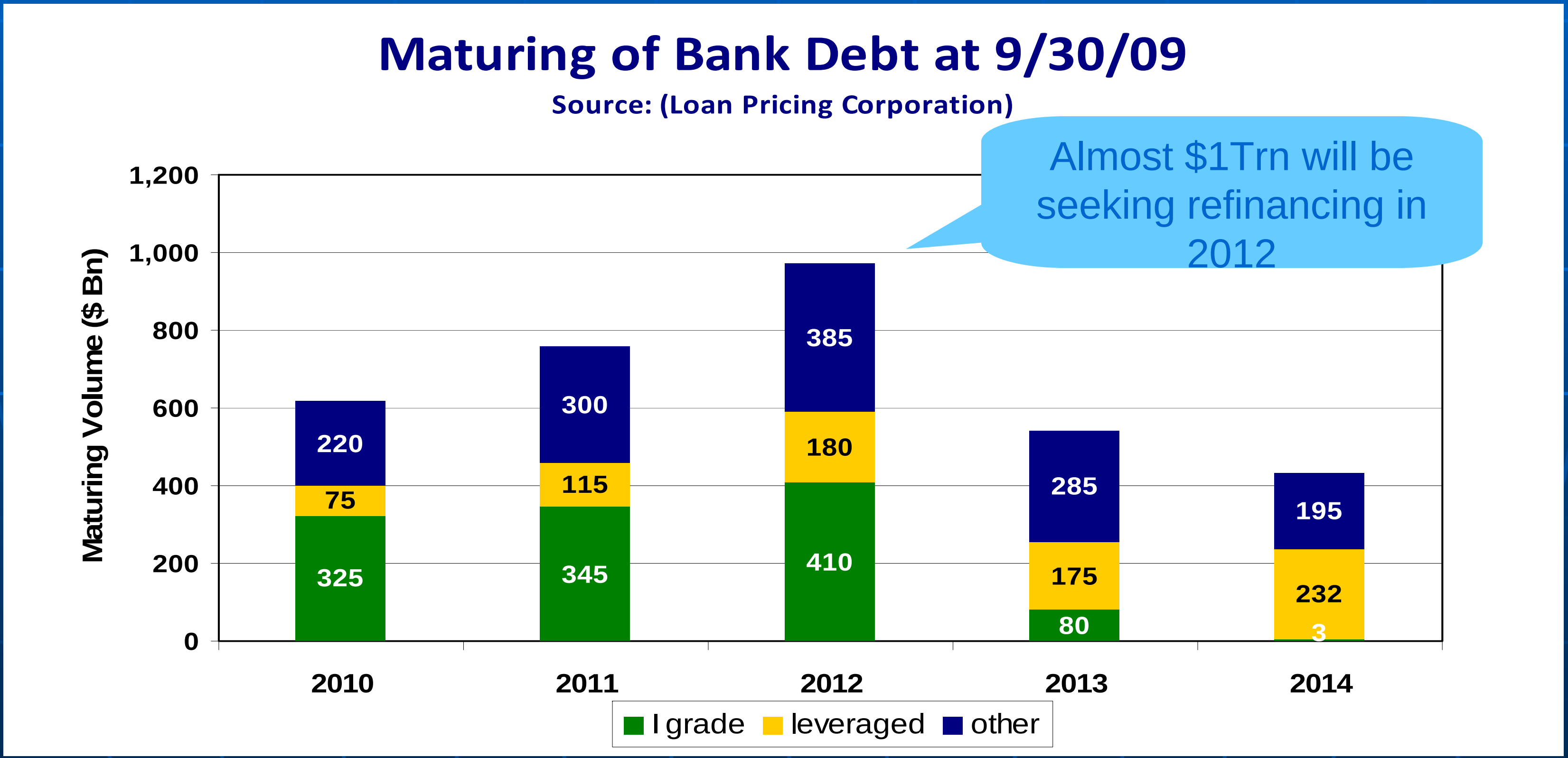
Bank Credit Market

- Large refinance needs due to 2004 – 2008 bank credits maturing
- Last one to "extend & pretend" maybe shut out?



Rate Environment

Good News: Rate volatility declines

FIGURE 5

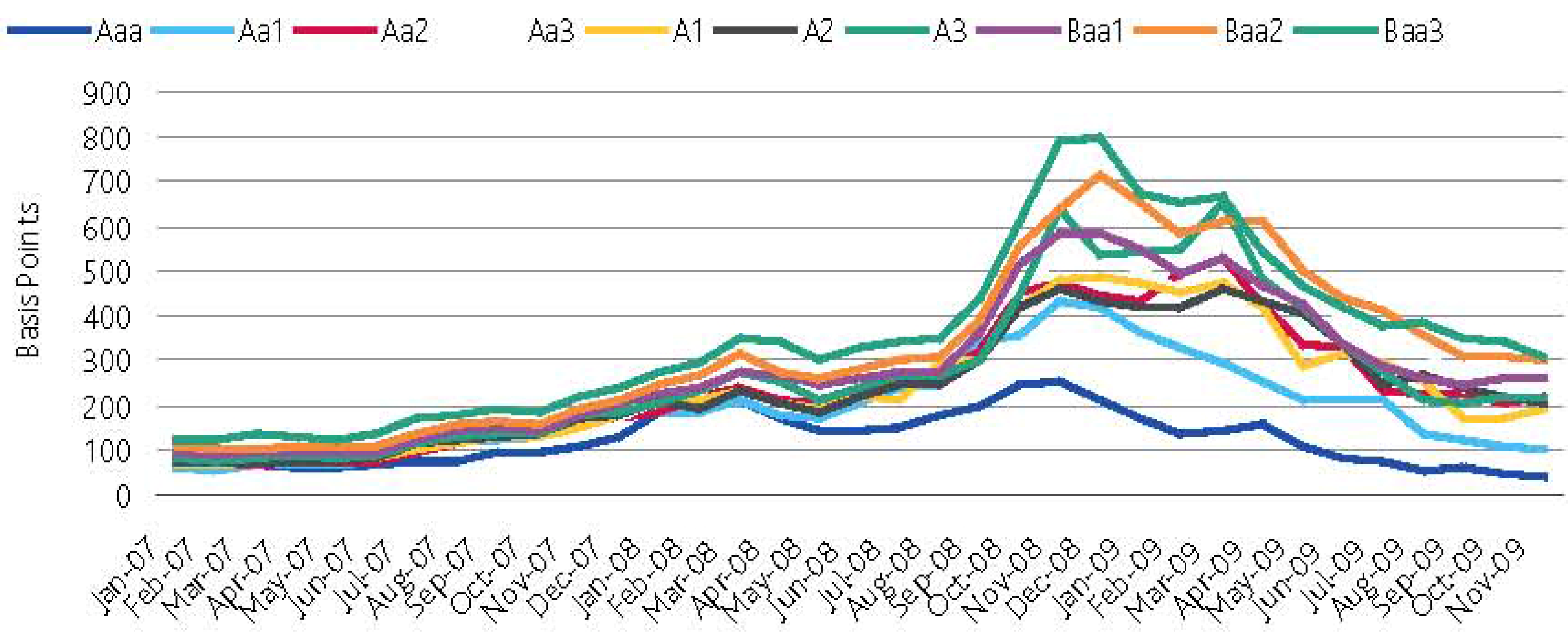
TED Spread: Difference Between the 3 Month Libor Rate and 3 Month Treasury Bill Rate, (Basis Points, NSA) for United States

*Source: Moody's Economy.com

Bond Market - Rates vs. Risk

FIGURE 4

U.S. Intermediate-Term Investment Grade Credit Spreads

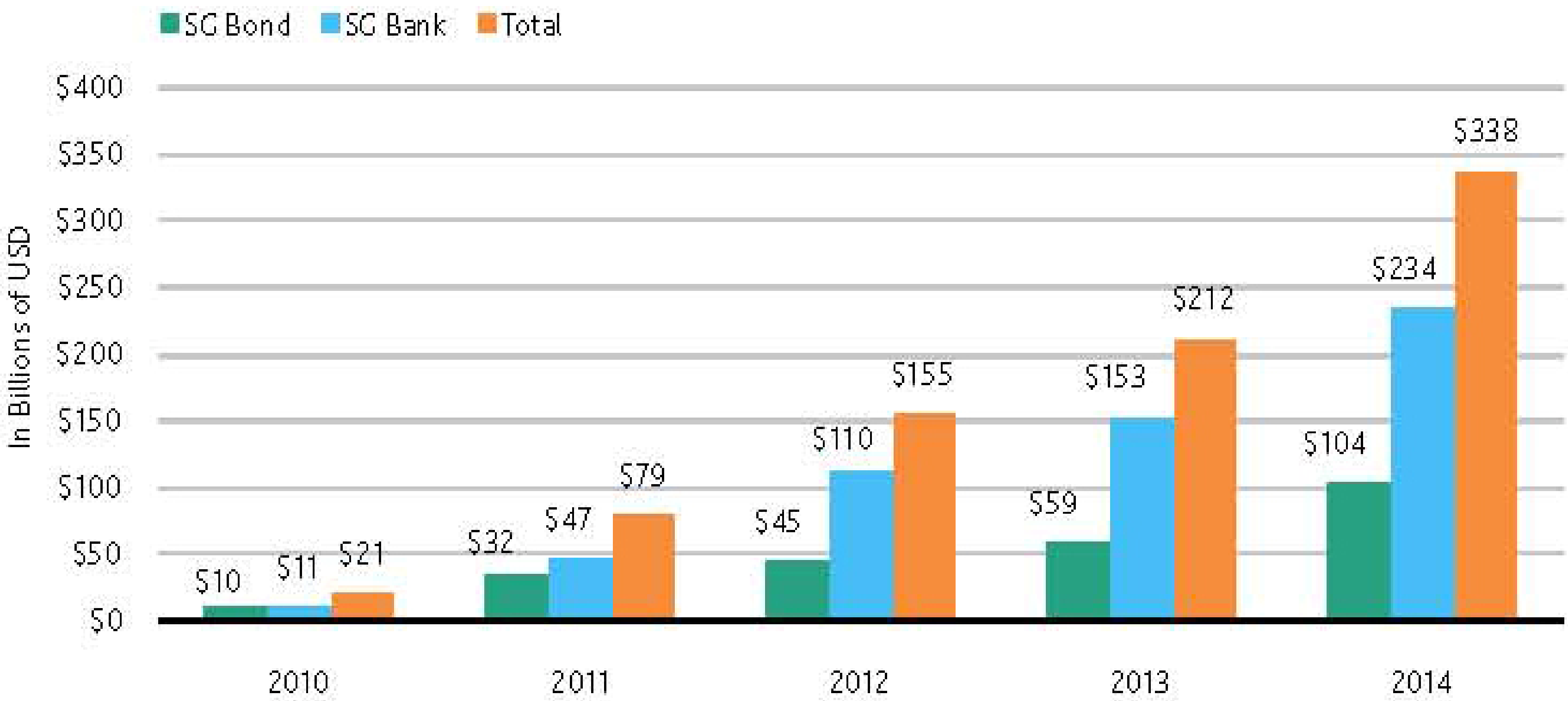


*Source: Moody's Investors Service

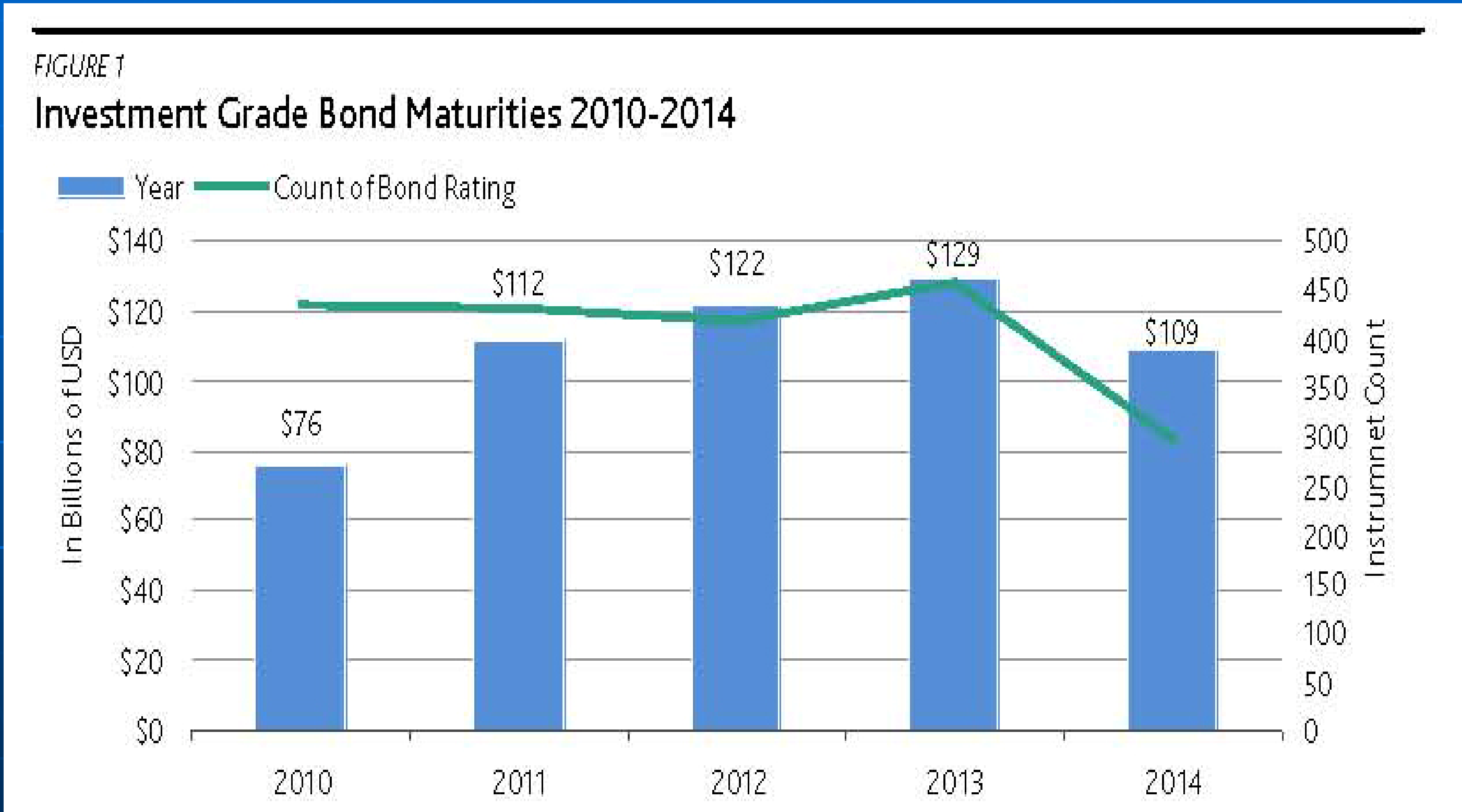
Credit – Speculative Grade

FIGURE 1

Rated Speculative-Grade Bank Credit Facilities and Bonds Maturing 2010-2014*



Credit – Investment Grade



Compliance

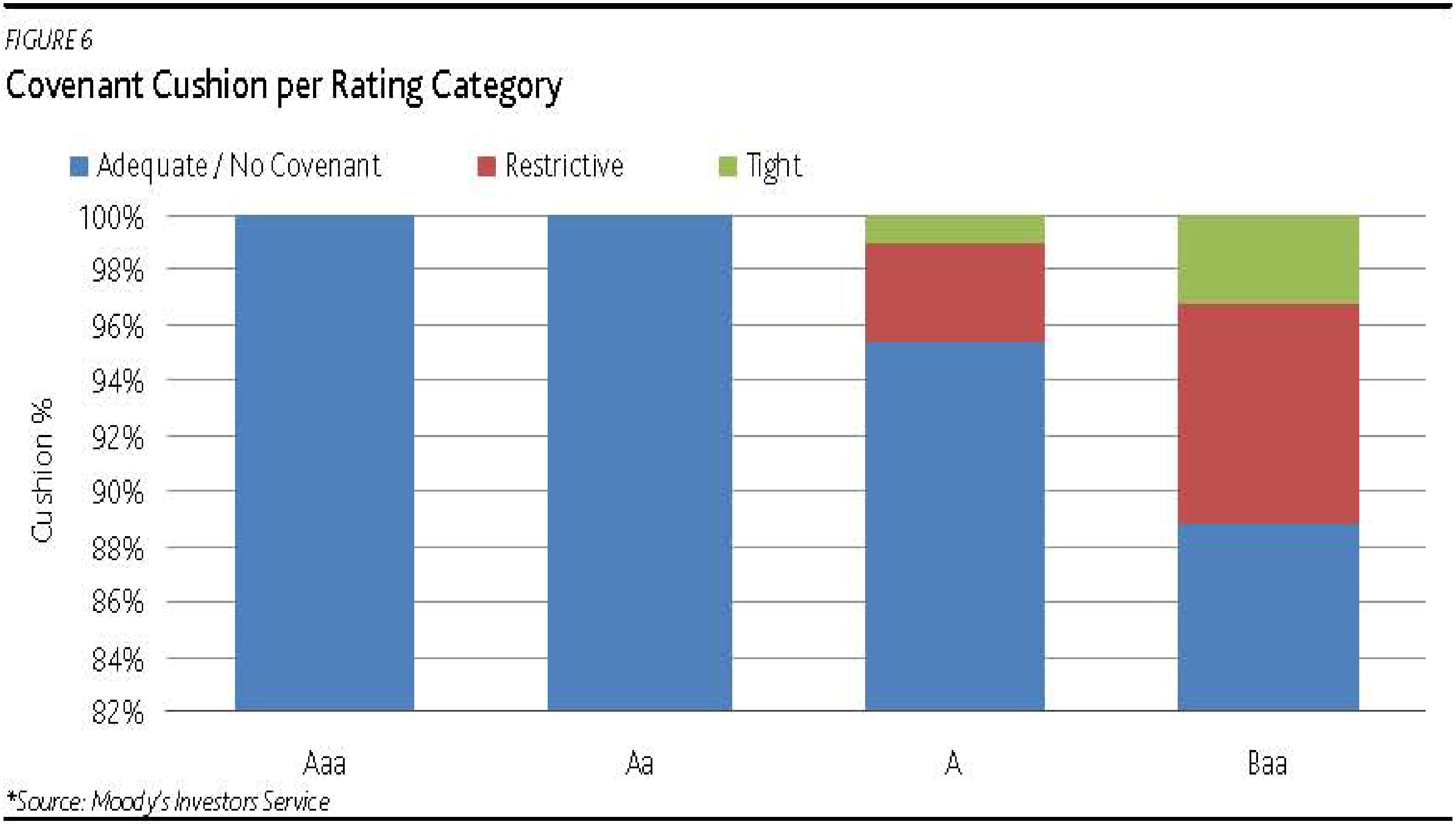


FIGURE 6
Covenant Cushion per Rating Category
Adequate / No Covenant
Restrictive
Tight
100%
98%
96%
94%
92%
90%
88%
86%
84%
82%
Cushion %
Aaa
Aa
A
Baa
*Source: Moody's Investors Service

Conclusion

- Current credit markets remain “difficult”
  - Banks unwilling (unable?) to lend
  - Credit price & terms remain tight
- Future credit markets will be crowded & “pricey”
  - Rates will be rising to meet demand
  - Banks will be seeking to repair their returns (ROA, ROE)
- For liquidity - Look to operating cash flows
  - Reduces exposure to rising rates as internal needs rise
  - Requires setting metrics to reward operating units
- Avoid “foot faults” on credit agreements
  - Opportunity for bank to say “no” and get out
  - Compliance is best defense: costly to amend after
- Review current banking relationships
  - What am I really worth to my bankers?
  - If banks are not lending: What is driving relationship?
    - Fee for services (cash management, trusts, etc)
    - If drivers unknown: Time to change banks?