

The Current State of the Capital Markets

Breakfast Forum

September 10, 2009

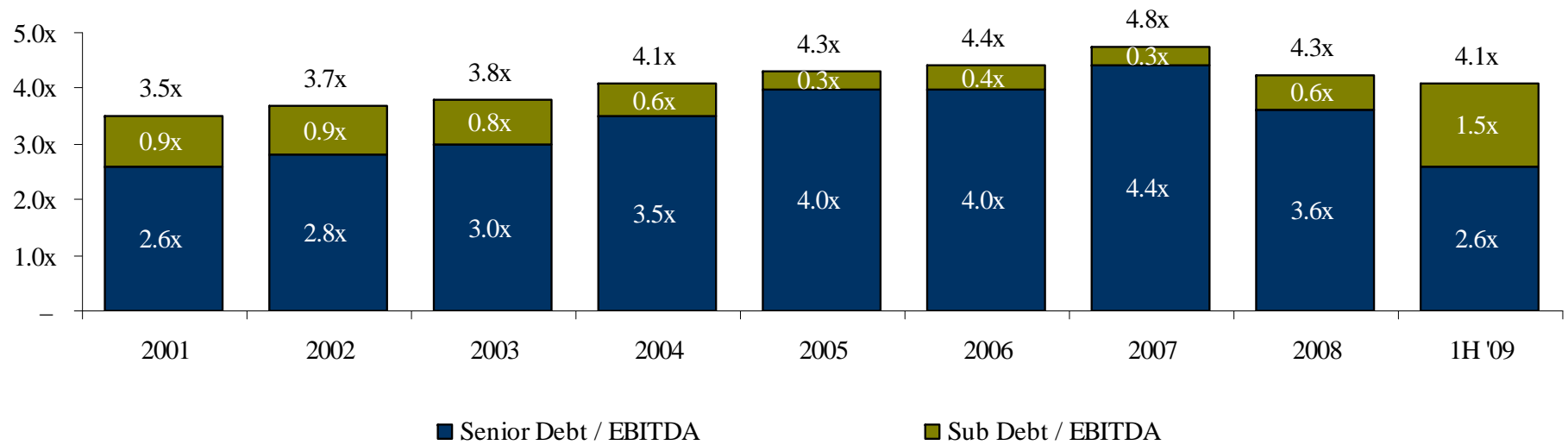
BOYAR  MILLER
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Private Equity and Mergers & Acquisitions

Tom Hargrove – GulfStar Group
Managing Director and Co-Founder



Total Debt Multiples of Middle Market LBO Loans

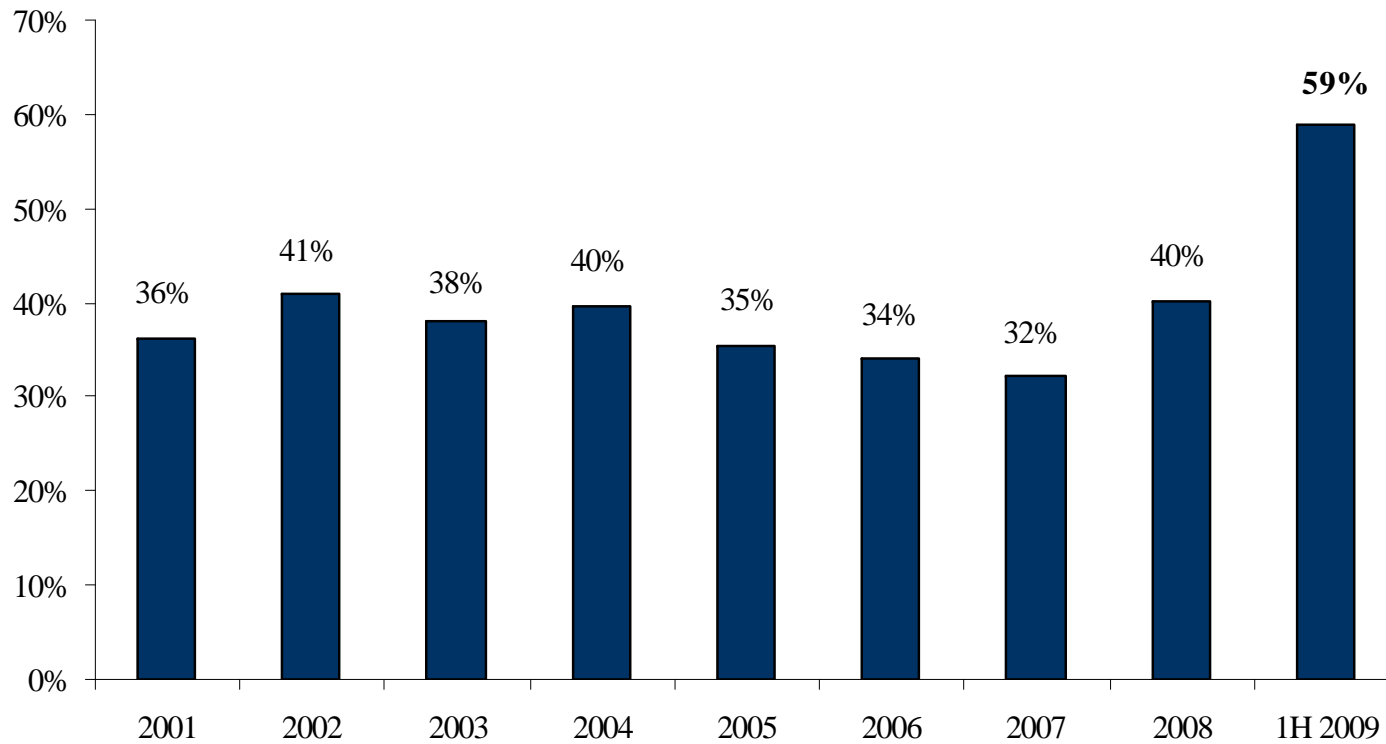


Source: S&P's Leveraged Commentary Data

LENDING ENVIRONMENT'S EFFECT ON EQUITY CONTRIBUTIONS



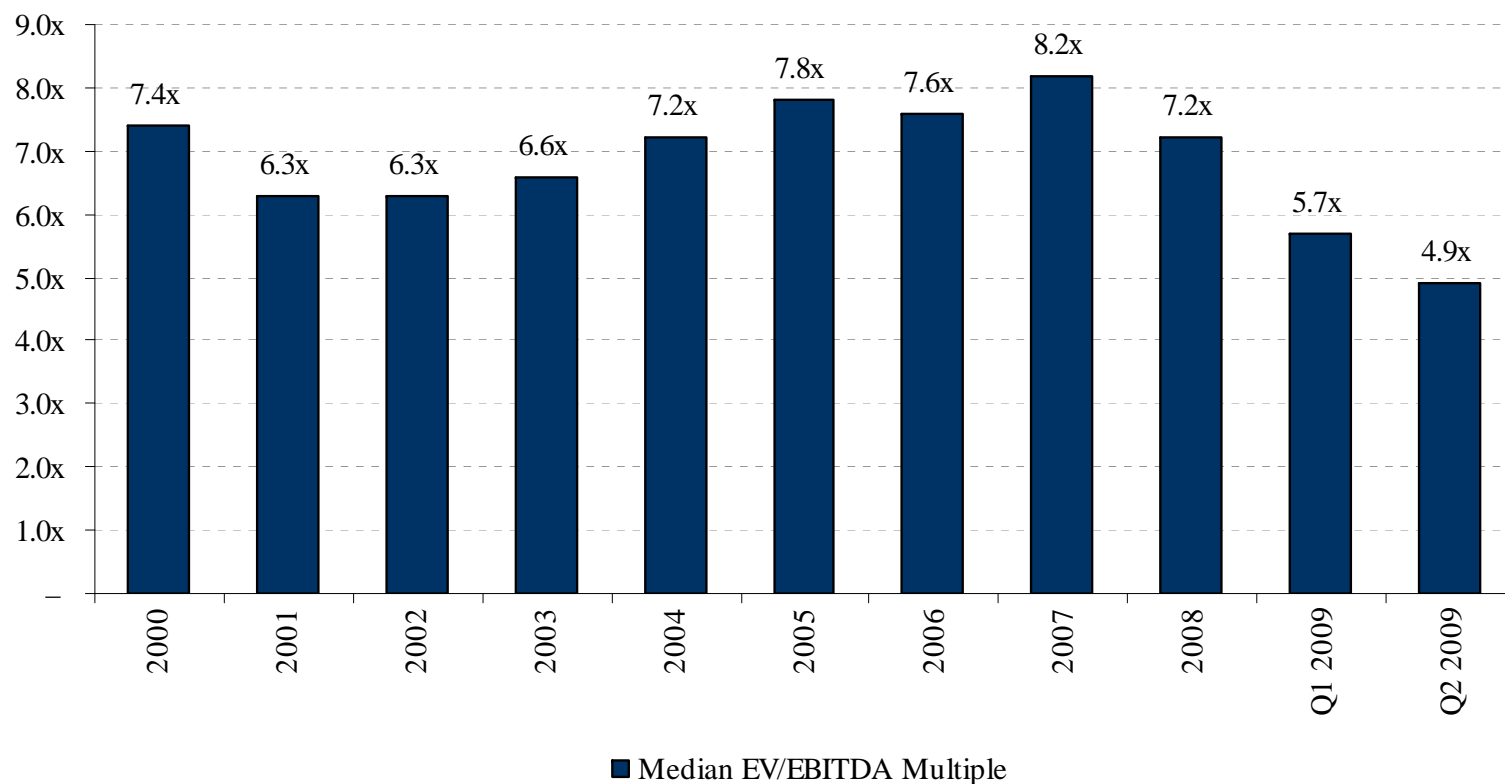
Average Equity Contributions to LBO's



Source: S&P's Leveraged Commentary Data; Capital IQ



Middle Market Transaction Multiples

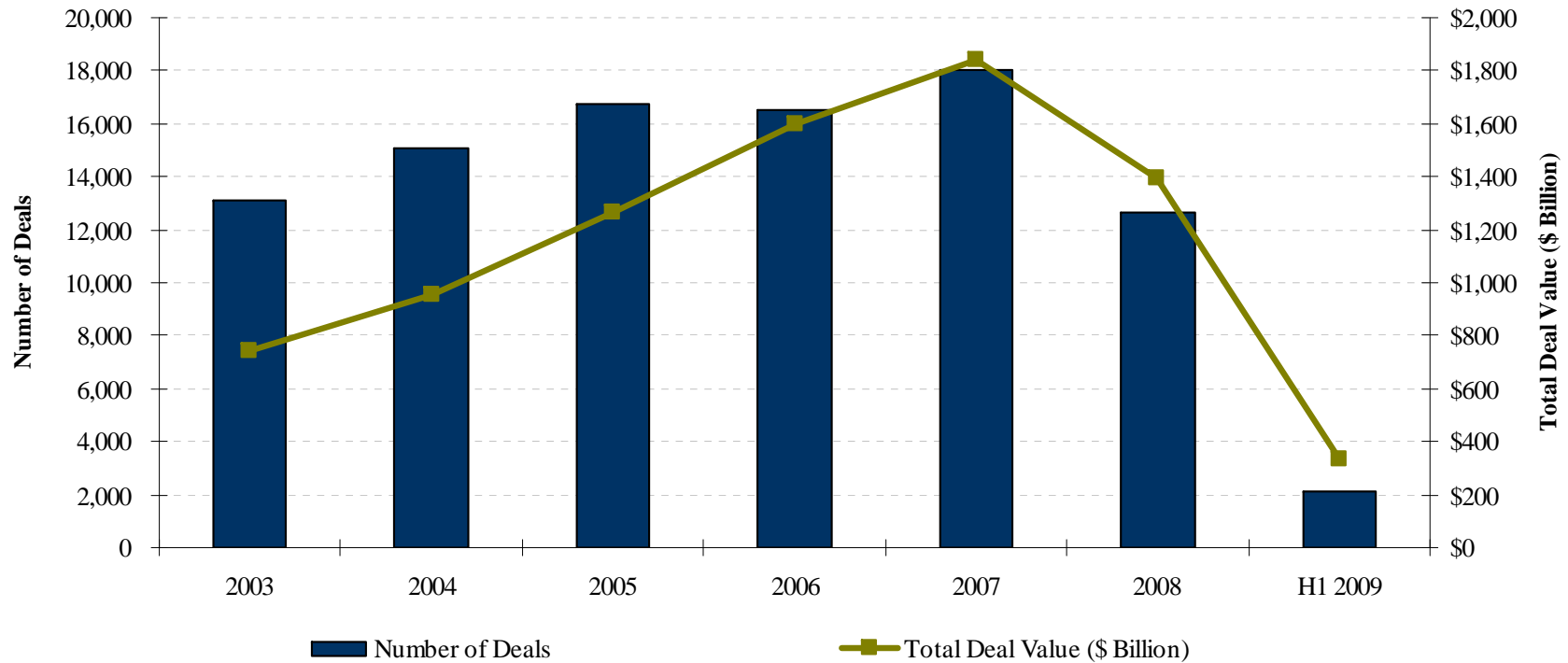


Source: WYCC Market Analysis

Note: Includes transactions valued between \$10 and \$250 million with EV/EBITDA multiples less than 15x; excludes technology, media & telecom



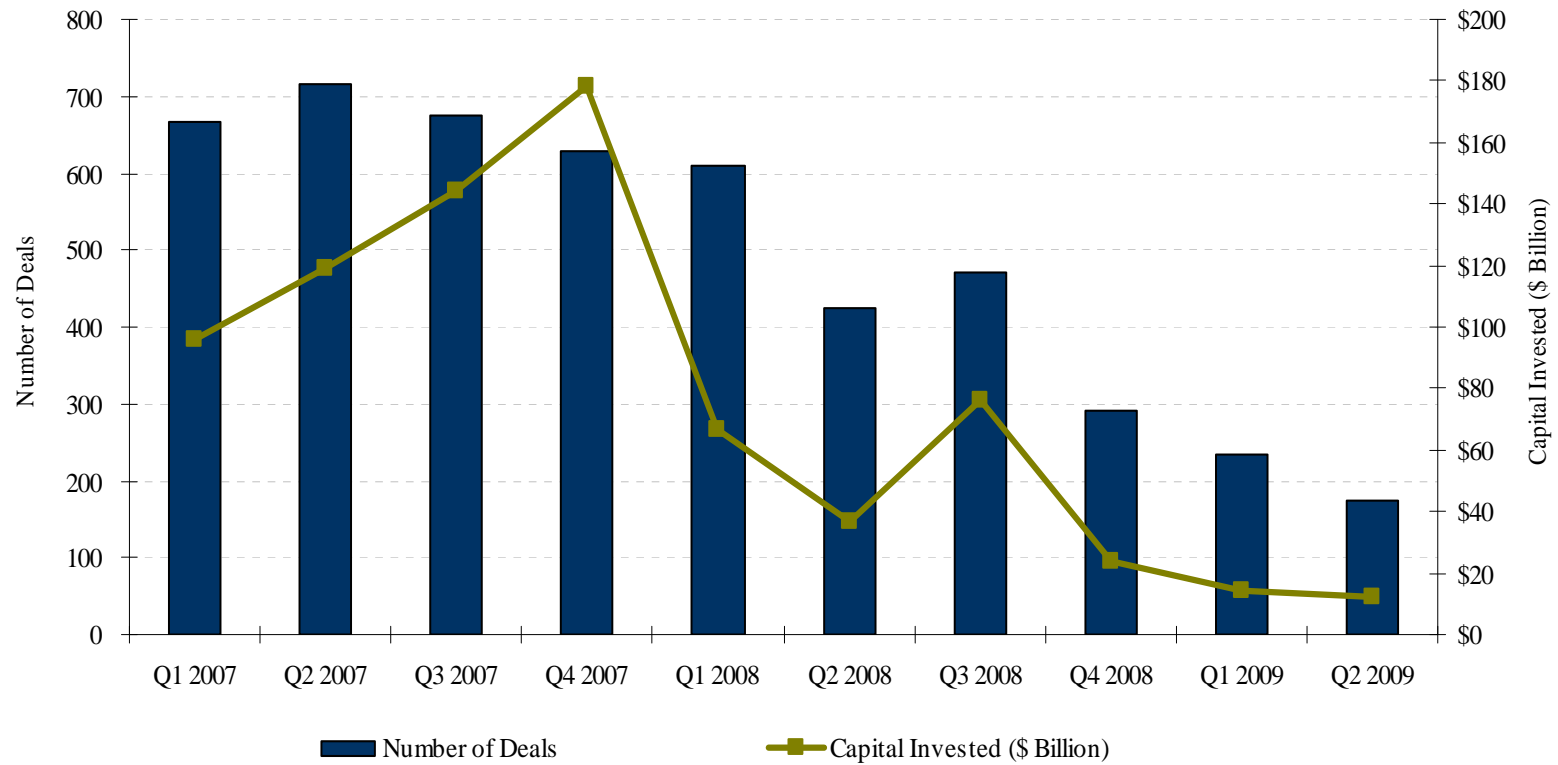
North America M&A Activity



Source: ZEPHYR; Capital IQ



Private Equity Transaction Volume



Source: Pitch Book

ENERGY MARKET UPDATE



- ▶ Domestic Rig Count:
 - August 29, 2008 – 2,031
 - August 21, 2009 – 985

- ▶ Crude Oil Prices:
 - Cushing, OK WTI Spot Price July 14, 2008 – \$145.18 /barrel
 - Cushing, OK WTI Spot Price August 21, 2009 – \$73.19 /barrel

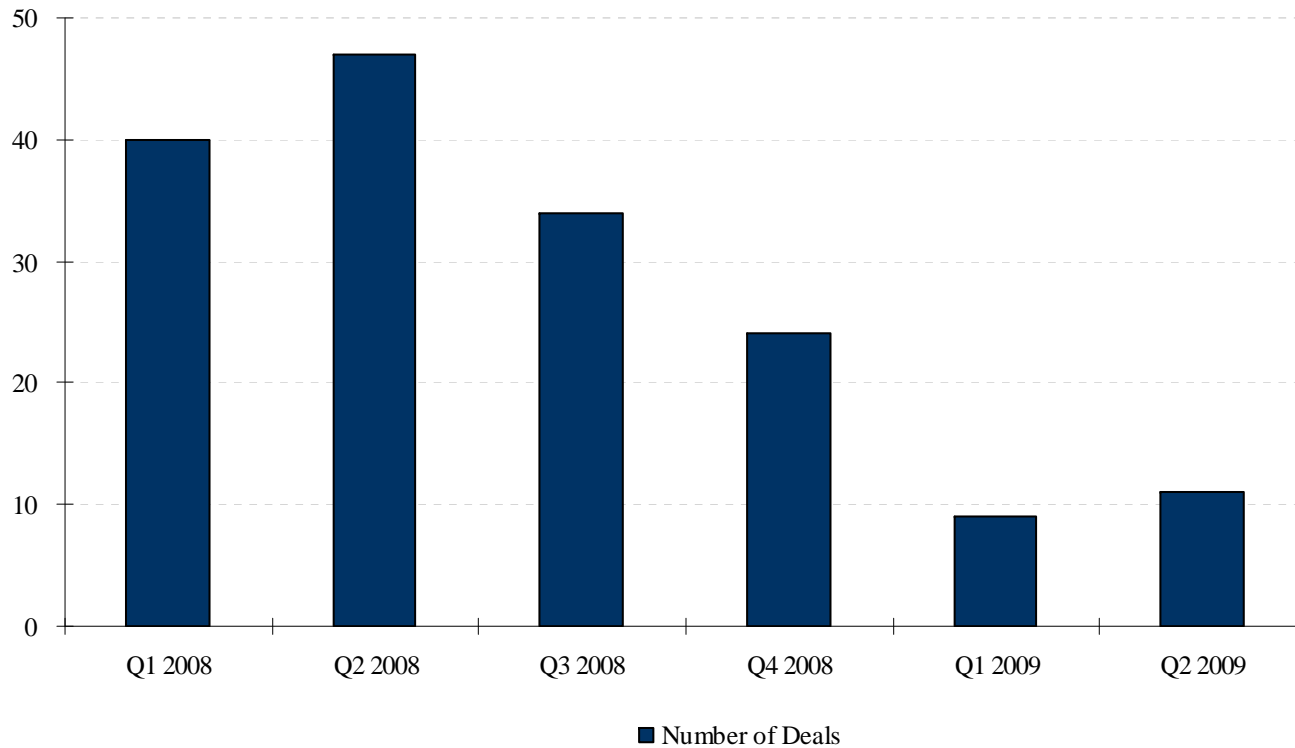
- ▶ Natural Gas Prices:
 - Henry Hub Spot Price July 3, 2008 – \$13.58 /MMbtu
 - Henry Hub Spot Price August 21, 2009 – \$2.81 /MMbtu

- ▶ Refining and petrochemical activity depressed

Source: The Wall Street Journal; Energy Information Agency; Baker Hughes



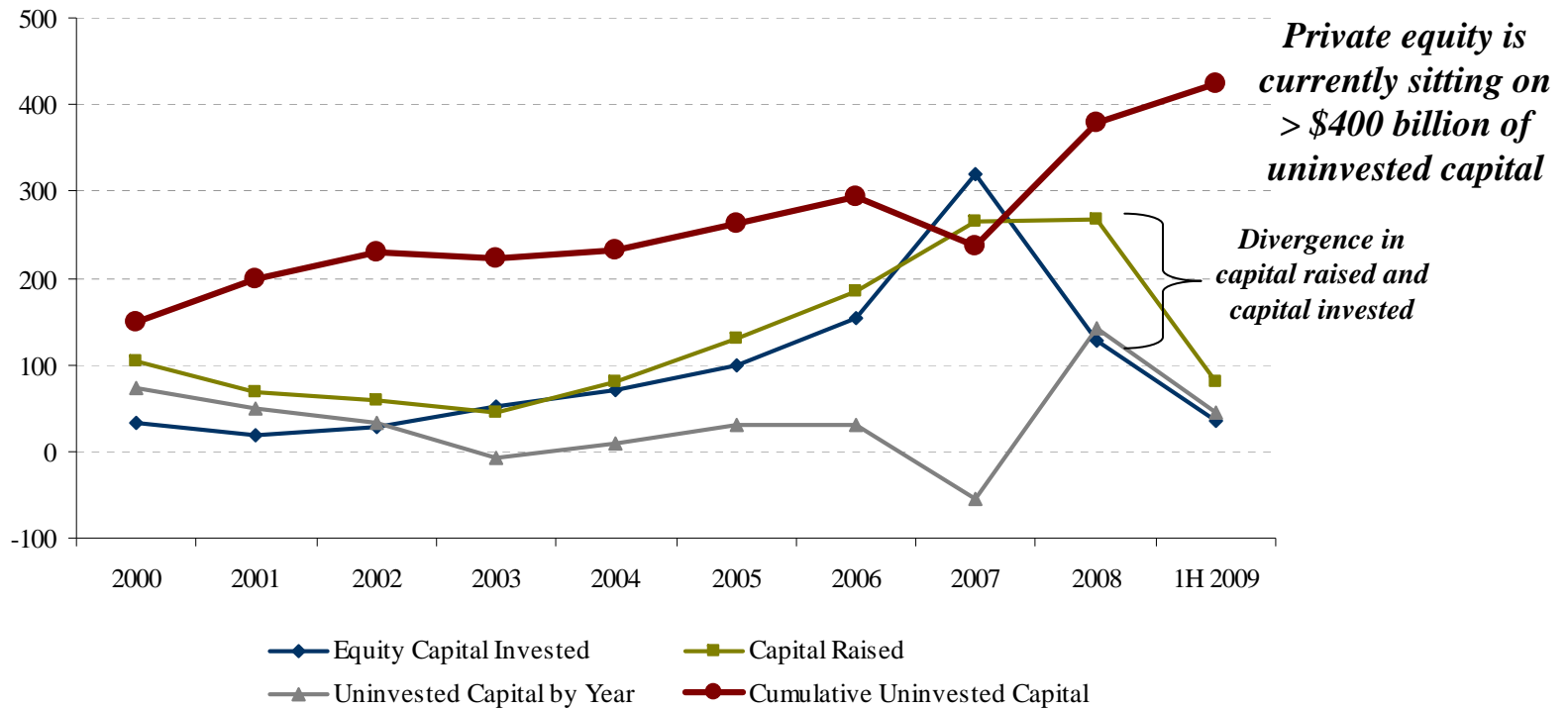
Energy Industry Transaction Volume



Source: Capital IQ



Private Equity Capital Overhang (\$ Billions)

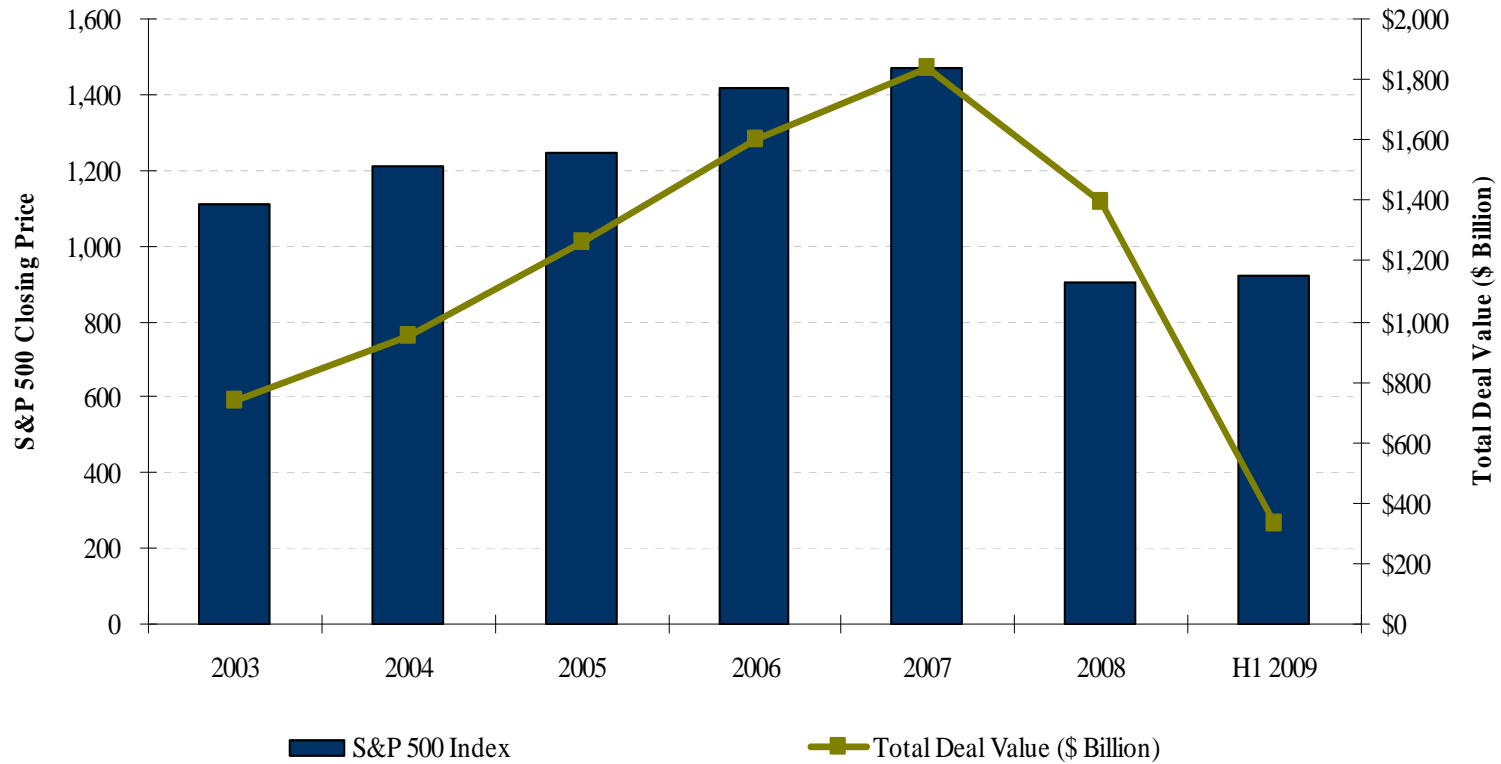


(\$ Billions)	2000	2001	2002	2003	2004	2005	2006	2007	2008	1H 2009
Equity Capital Invested	\$32	\$19	\$28	\$52	\$70	\$98	\$154	\$320	\$127	\$36
Capital Raised	105	68	59	43	79	130	184	265	268	81
Uninvested Capital by Year	73	49	32	(8)	10	31	30	(55)	141	45
Cumulative Uninvested Capital	\$150	\$198	\$230	\$222	\$232	\$263	\$293	\$237	\$379	\$424

Source: Pitch Book



S&P 500 Index vs. M&A Transaction Value



Source: Capital IQ

TALKING POINTS FOR MIDDLE MARKET UPDATE



- ▶ Continuing credit issues – virtually no cash flow senior debt
- ▶ Pricing multiples have decreased
- ▶ Seller financing and contingent consideration
- ▶ Energy industry issues
- ▶ Large amounts of uninvested private capital
- ▶ Increasing tax environment

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Real Estate Finance

Tom Fish – CBRE | Melody
Vice Chairman

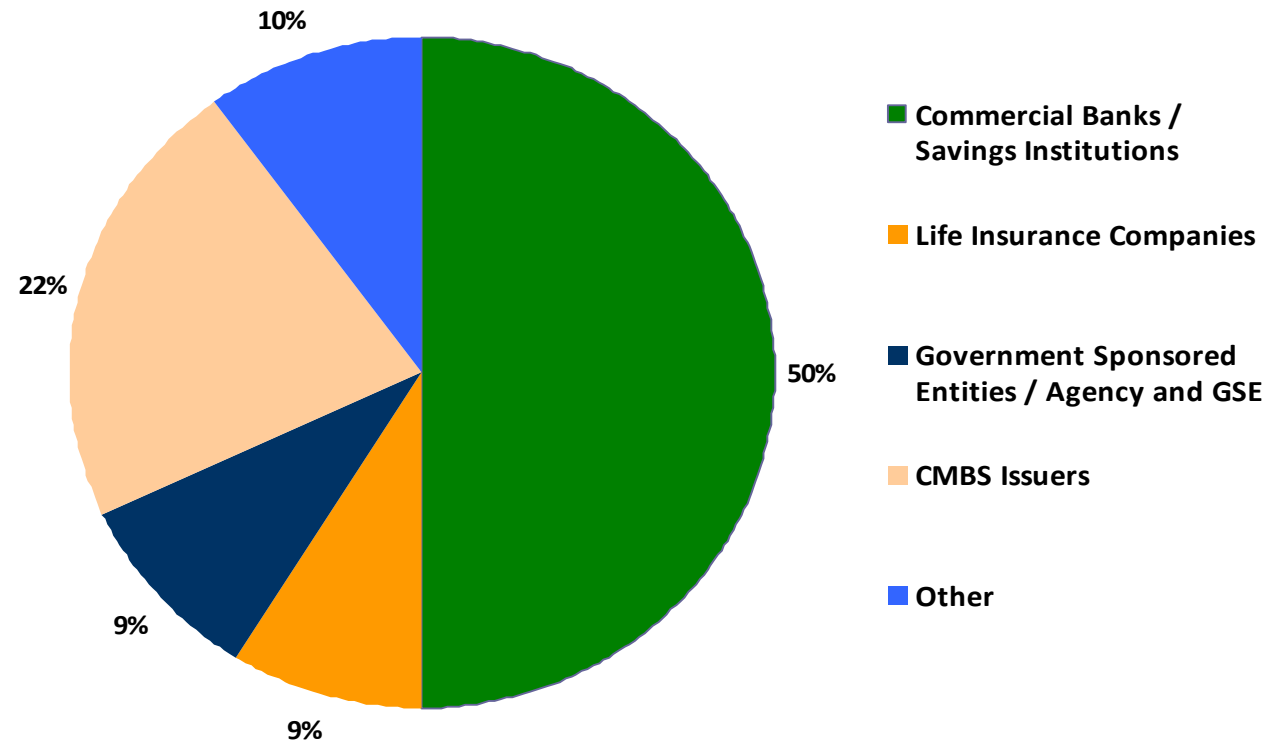
The Tsunami is upon us.

- The vast amount of mortgage debt which matures between 2009 and 2013 cannot be refinanced in the current prevailing market. There will be a colossal refinancing shortfall, both in the number of deals that can get refinanced and the amount that each deal qualifies for in new proceeds.
- The de-leveraging of U.S. real estate during the next five years will create an unprecedented challenge for lenders and borrowers; and an opportunity for astute investors with fresh capital.

Source: Real Capital Analytics and RREEF Research

Outstanding Debt

\$3.4 Trillion Debt Outstanding

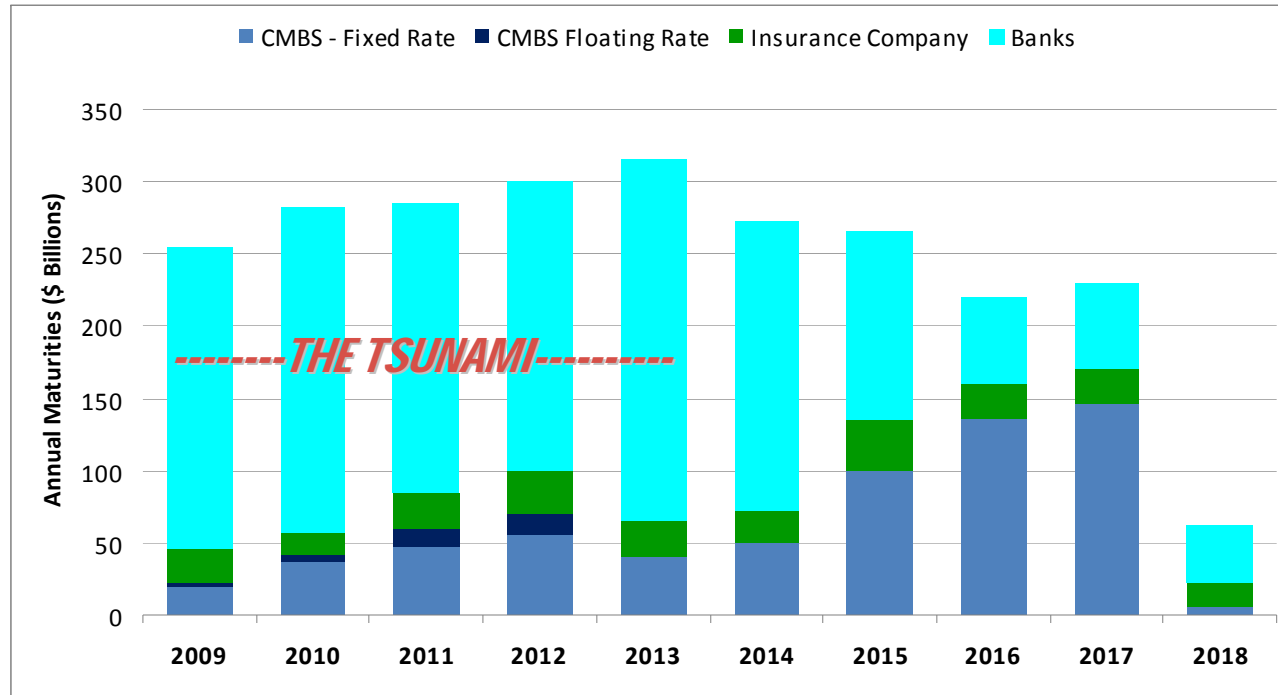


Source: CBRE Torto Wheaton

- The banks account for about 50% of the outstanding real estate debt. CMBS accounts for over 20%, with life companies and government agencies both accounting for less than 10%.
- During the four years of 2004 – 2007, the commercial real estate loan volume exceeded \$1.4 trillion, more than three times the loan volume during the prior four year period of 2000 - 2003.
- McKinsey Research recently estimated the total CRE loss at Commercial Banks over the next 2-3 years to be \$430B, of which less than 10% has already been taken.

Maturity Profile of Banks, CMBS and Life Companies

Estimated maturity profile of commercial mortgages in CMBS, life company and bank portfolios

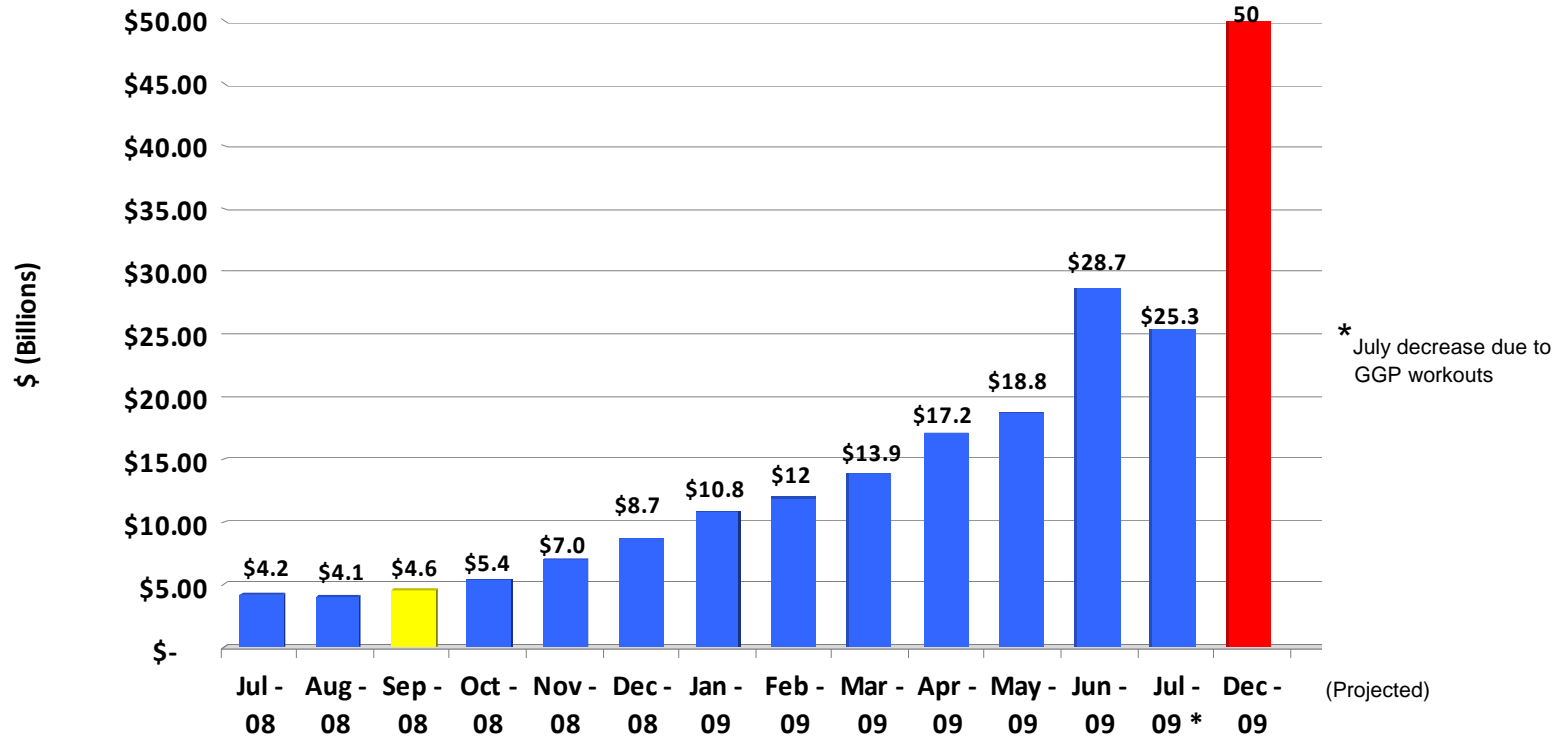


- Loan maturities from CMBS, life companies and banks are expected to total \$1.4 trillion over the next **5** years; the same amount that matured over the last **15** years (1994 – 2008) when capital was abundant.
- Banks have \$1.7 trillion, CMBS has \$700 billion and life insurance companies have \$200 billion in direct loans maturing through 2018.
- The period of 2010-2013 will be one of unprecedented stress and disruption in the U.S. real estate capital markets, a time when lenders could be forced to take massive losses on their commercial real estate portfolios.

Source: Deutsche Bank, Intex, TREPP, Mortgage Bankers Association, Federal Reserve

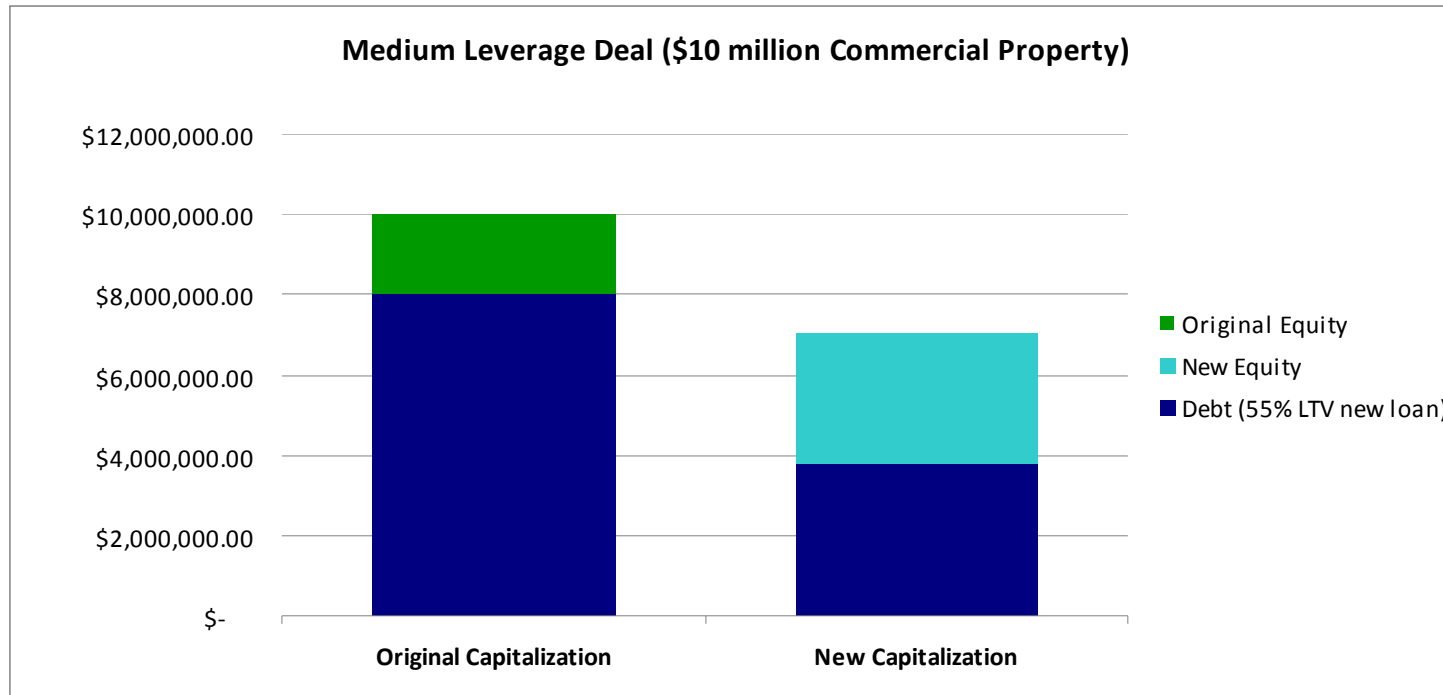
Monthly CMBS Delinquency

Monthly CMBS Delinquency Balance (source: Realpoint)



- CMBS delinquency is about 6.5% of the outstanding debt. This figure is more than 6 times what it was 12 months ago.
- This delinquency figure is expected to exceed \$50 billion, or over 7% of outstanding debt, by end of '09, an increase of about \$40 billion for the year.
- Only 38 percent of June CMBS loan maturities paid off, and most of those were small loans originated 10 years ago.
- Non-maturity loan defaults are increasing.

Refinancing Shortfall



- Two major trends prevail: (1) commercial real estate values have declined, and (2) loan-to-value ratios have declined.
- The de-leveraging problem depends on the extent of leverage which was used in the past...institutional vs. non-institutional product/sponsorship.
- This chart depicts a \$10 million “commercial” property, where the investor borrowed \$8 million (80% LTV) and assumes value of the asset has decreased 30%...a new loan of only about \$4 million is achievable.

We All Know The Cause

- The increase in value of commercial real estate in the years 2004 – 2007 was primarily due to cap rate compression, in part due to high leverage levels.
- The potential refinancing of all these loans will be adversely affected by three diverging trends:
 - A decrease in the value of the property due to cap rate inflation.
 - A decrease in the LTV ratio for a new loan.
 - A decrease in NOI at the property due to market fundamentals / job loss.
- Low transaction volume since mid-2008 has made it difficult to determine “actual” market cap rates...sales volume nationally is down about 80% from a year ago and 90% from 2007.

The Challenge

- The vast majority of CMBS, Life Company and bank loans will suffer a refinancing shortfall at maturity...a significant percentage of the properties will be worth less than their debt amounts at loan maturity.
- Loan maturity and defaults will rise dramatically since existing loans cannot be refinanced with new capital.
- A “shortfall” of at least \$1.2 trillion currently exists between near term demand and new capital supply.
- The Commercial Real Estate Market is in a de-leveraging mode until further notice and will not “stabilize” until after the de-leveraging event.
- Borrowers and lenders face three choices:
 - Foreclosure / Loss
 - Litigation
 - Loan Modification / Restructure

Complicating Dynamics

- Projects which need ongoing capital but are too highly leveraged to justify it...new tenants need new dollars...loans that don't have cash flow or maturity issues.
- Borrowers with capital partners who have no capital....where do I get the other 90% of the equity?

Why Loan Modifications / Restructure Should Prevail

CAVEAT: IF AND ONLY IF THE EXISTING OWNER IS THE “BEST” OWNER FOR THE ASSET.

Lender benefits

- Manage losses over extended period of time to offset with ongoing profits
- Forced liquidation = value diminution
- No disruption of property ownership
- Borrower capital contribution (loan pay down or contribution to an escrow account)

■ Borrower benefits

- Protect tax position
- Protect involvement in property
- Live to fight another day – return on stable capital markets

Core Strategies

- Treat a restructure like a new financing.
- Lenders will be focused on minimizing losses over maintaining relationships.
- Relationships are maintained by borrower working to minimize lender losses.
- Demonstrate that a restructure is a better alternative for the lender than foreclosure.
- Show why the existing sponsorship is the best owner/operator for the property.
- Initiate the process well in advance (12 -18 months) of loan maturity or as soon as the loan is in “imminent default”.

The Cost of Money that is Available

- Construction Debt – 60 – 70% ltv, L + 300 – 400 with 3% Libor floors, points.
- Permanent Debt – 50 – 60% ltv (exc. multifamily), 7%-8%, amortizing.
- CMBS Debt – not originating new debt yet, except big deals for TALF. Spreads are definitely improving!
- Bridge Debt - 60-70% ltv, 8-12%, 1-3 year terms, fees
- Mezzanine Debt – 12 – 20%, primarily stabilized, cash flowing assets.
- Equity – wants 20 – 25% IRRs on existing, cash flowing assets – notes or properties themselves.

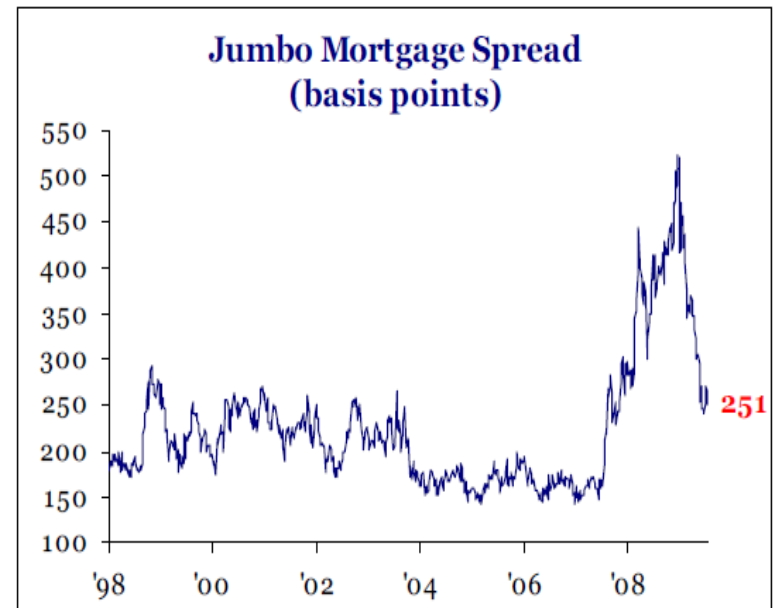
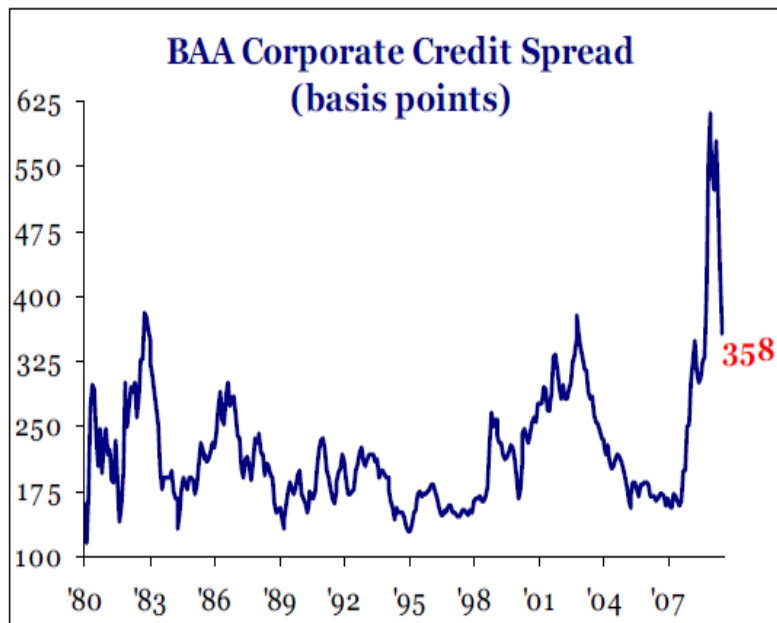
Predictions and Commentary

- There will be billions in both foreclosures and restructures.
- Government is helping and hurting....providing liquidity while forcing writedowns.
- Capital is ready, willing and available to come in at new values with appropriate pricing on best quality assets with best of class borrowers.
- More capital will flow in 2010 as pressure mounts to get yield.
- 2009 will be the low water mark for transaction volume.
- Property Performance will continue declines through 2010.
- TALF will help only the larger transaction / lower leverage situations for probably another year. IT IS HELPING, BUT NOT A PANACEA TO THE "OLD" DAYS.

Equities and the Public Markets

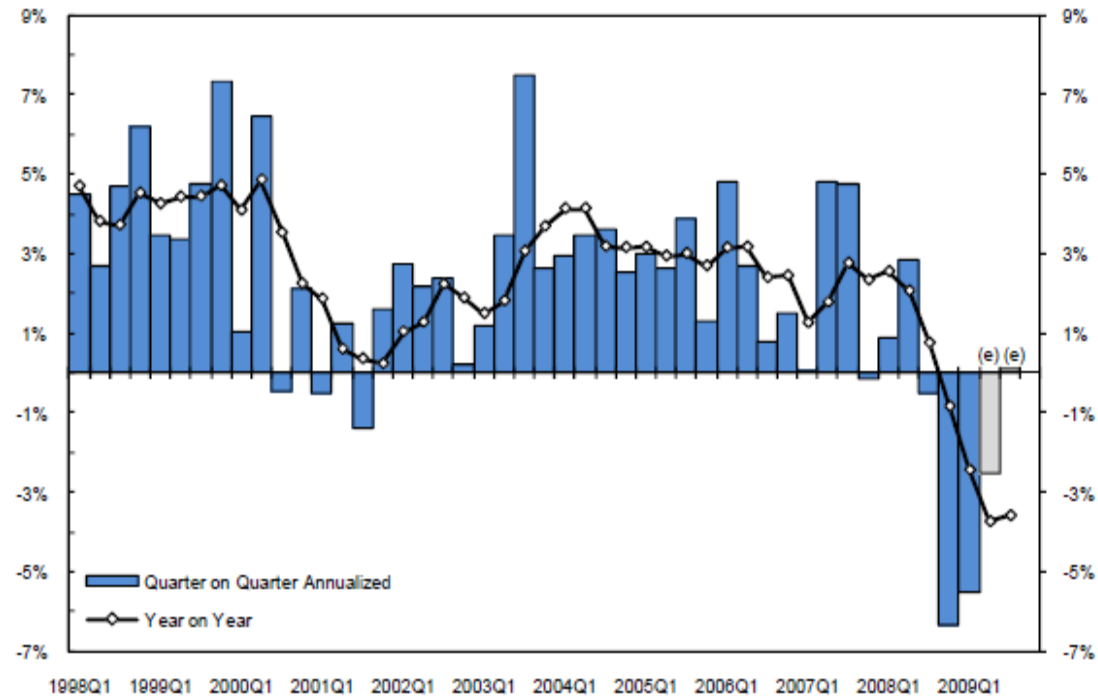
Drew Kanaly – Kanaly Trust
Chairman & CEO

Credit markets have continued to improve since Lehman failure



Recession likely ends this summer

Real GDP Growth: Qtr/qtr Annualized and Yr/yr
(quarterly, actual through Q1-2009, estimated through Q3-2009)



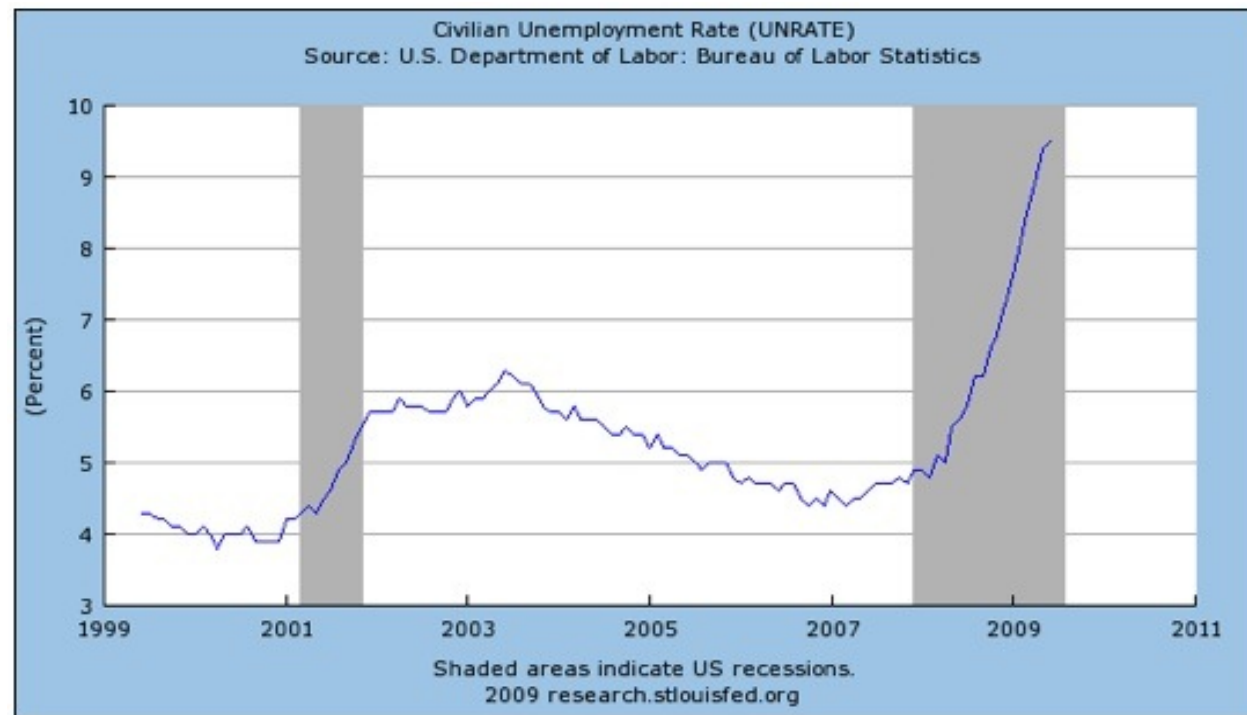
Source: Laffer Associates

Monster rallies in bear markets are not unusual



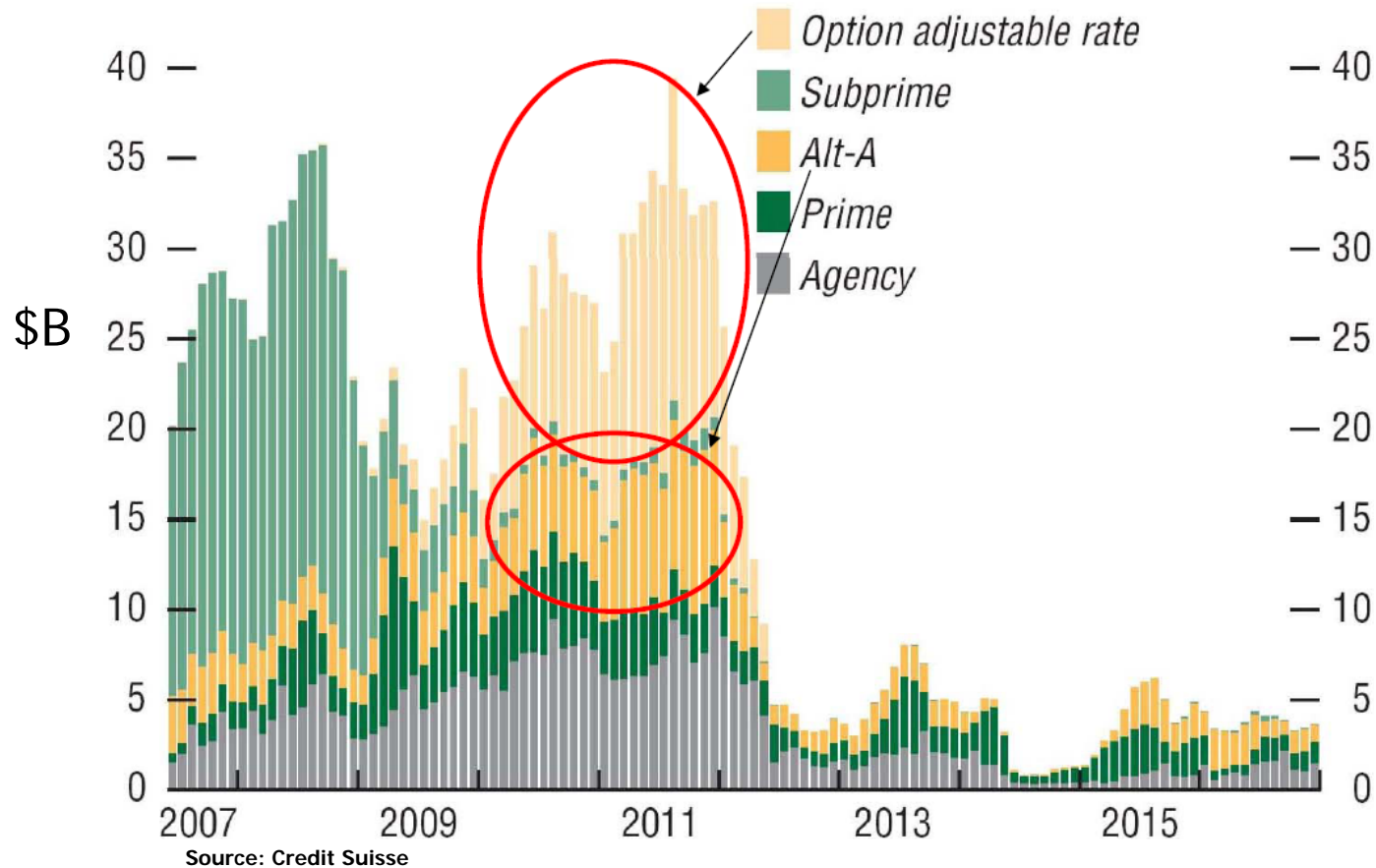
Unemployment is a lagging indicator?

- After 2001 recession, unemployment continued to rise until early 2003
- Stocks did not sustain a recovery employment stabilized in 2003



Housing market not out of the woods

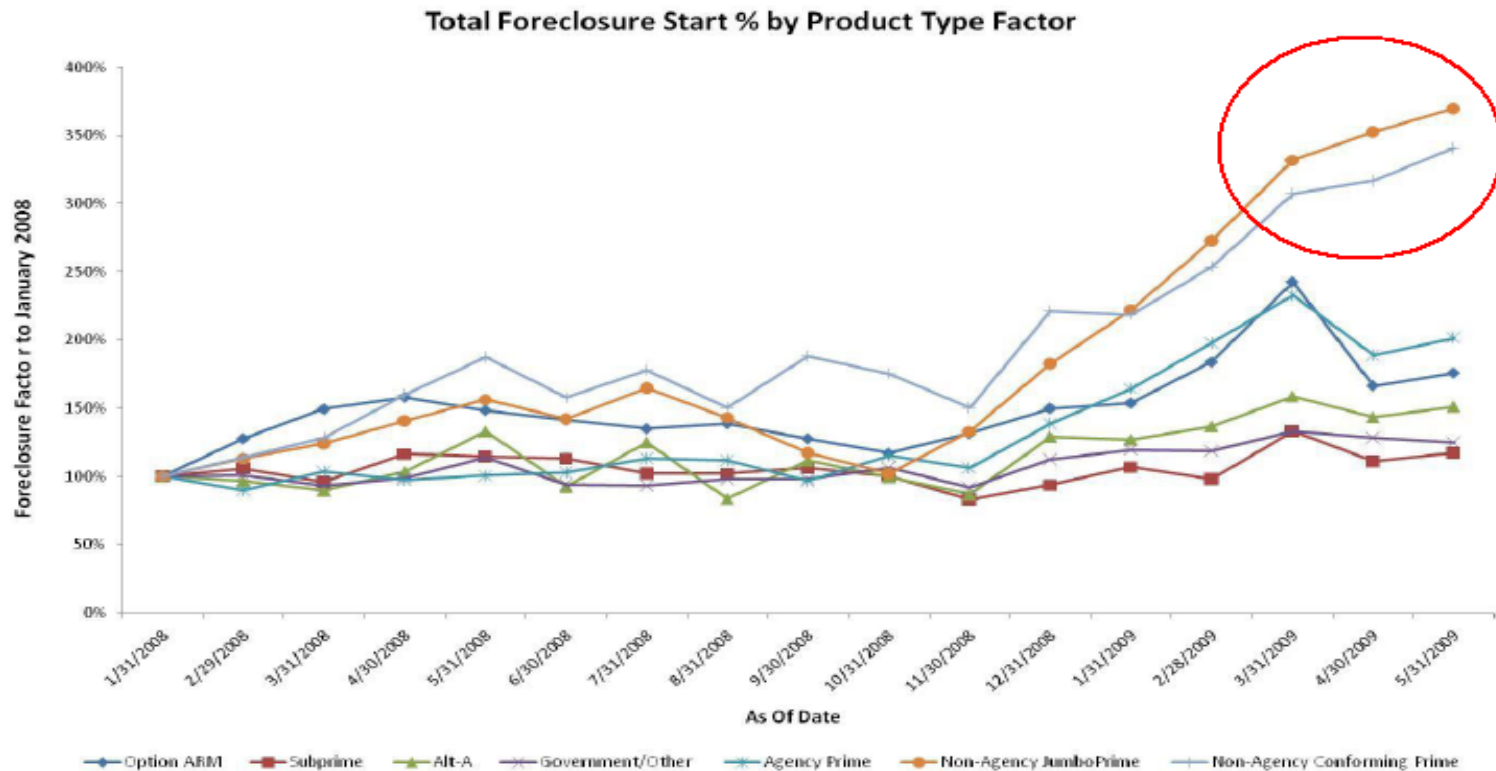
- Monthly Resets on troubled mortgages will pressure housing for two more years



Credit crisis is affecting prime borrowers

Prime products (Non-agency, Jumbo and Agency) have had the highest rates of deterioration since January 2008.

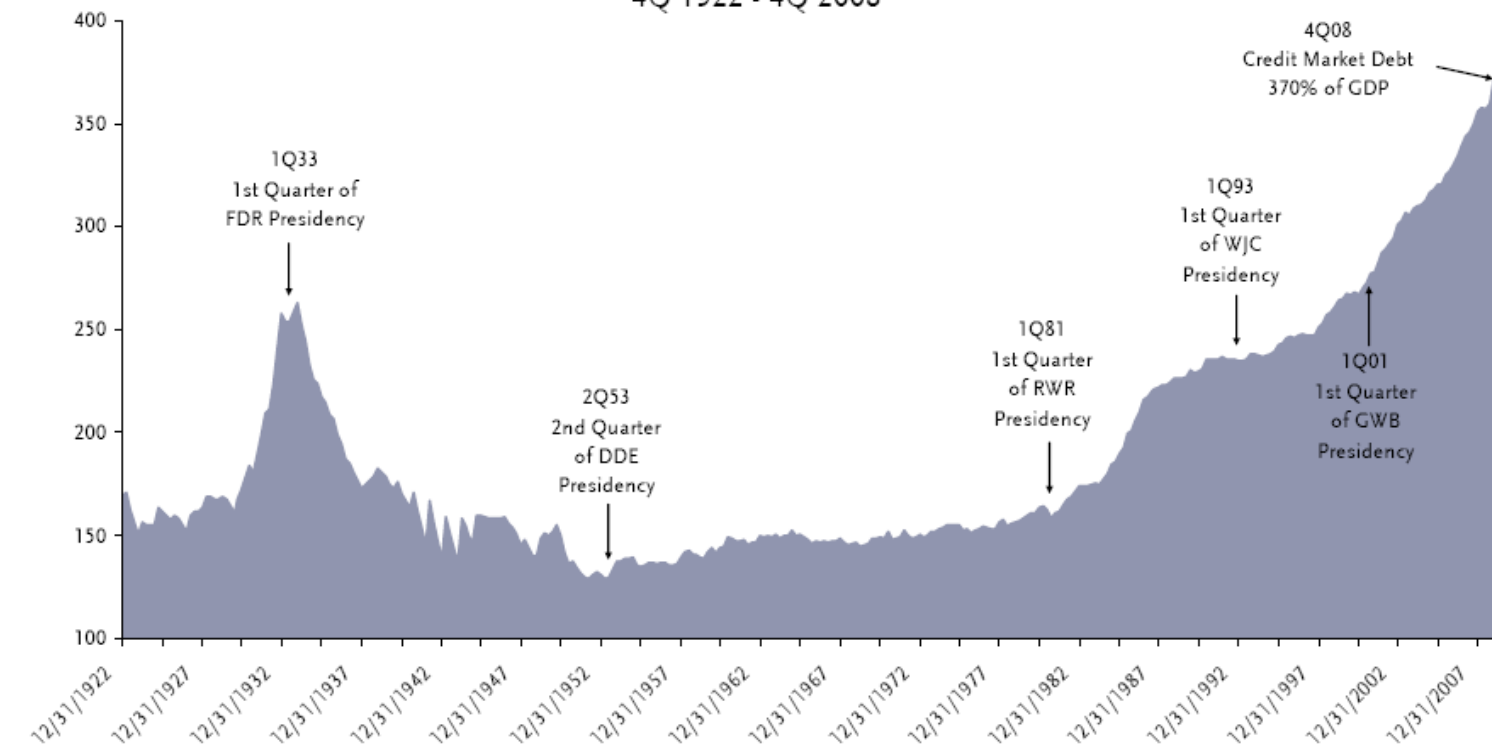
Biggest increase in deterioration has come in the last six months.



Source: Field Check Group

Too much debt is the long term problem

Total Credit Market Debt as a Percentage of U.S. Gross Domestic Product
4Q 1922 - 4Q 2008



Source: Federal Reserve, U.S. Commerce Department, Ned Davis Research

Diminishing Returns from Debt Financing

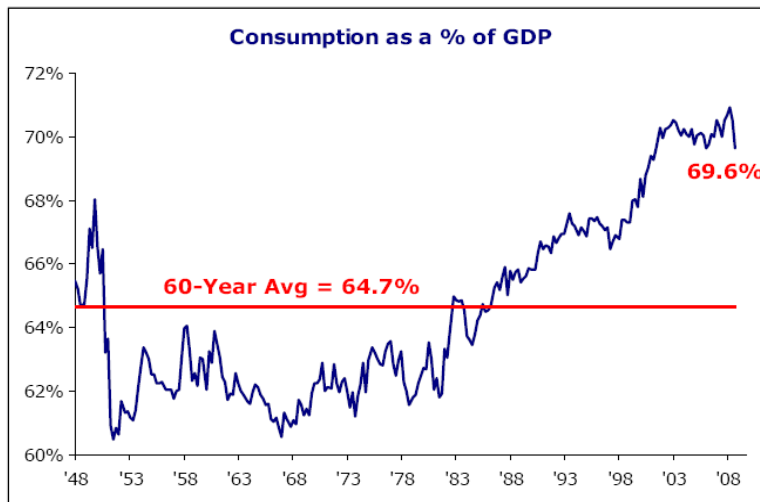
- Table shows how much debt it took each decade to produce one dollar of GDP
- Put another way, \$1 of debt produced only 17 cents of growth this decade
- Too little savings and too much debt...can't borrow our way to prosperity
- If everyone is loaded with debt, then there are few credit worthy borrowers

Date Range	Change in Debt (\$billions)	Change in GDP (\$billions)	Debt/GDP
12/31/1949 - 12/31/1959	337.6	248.0	1.36
12/31/1959 - 12/31/1969	752.1	491.4	1.53
12/31/1969 - 12/31/1979	2,785.2	1,655.9	1.68
12/31/1979 - 12/31/1989	8,563.7	2,923.8	2.93
12/31/1989 - 12/31/1999	12,566.2	3,935.2	3.19
12/31/1999 - 12/31/2008	27,186.5	4,680.8	5.81

Source: Ned Davis Research

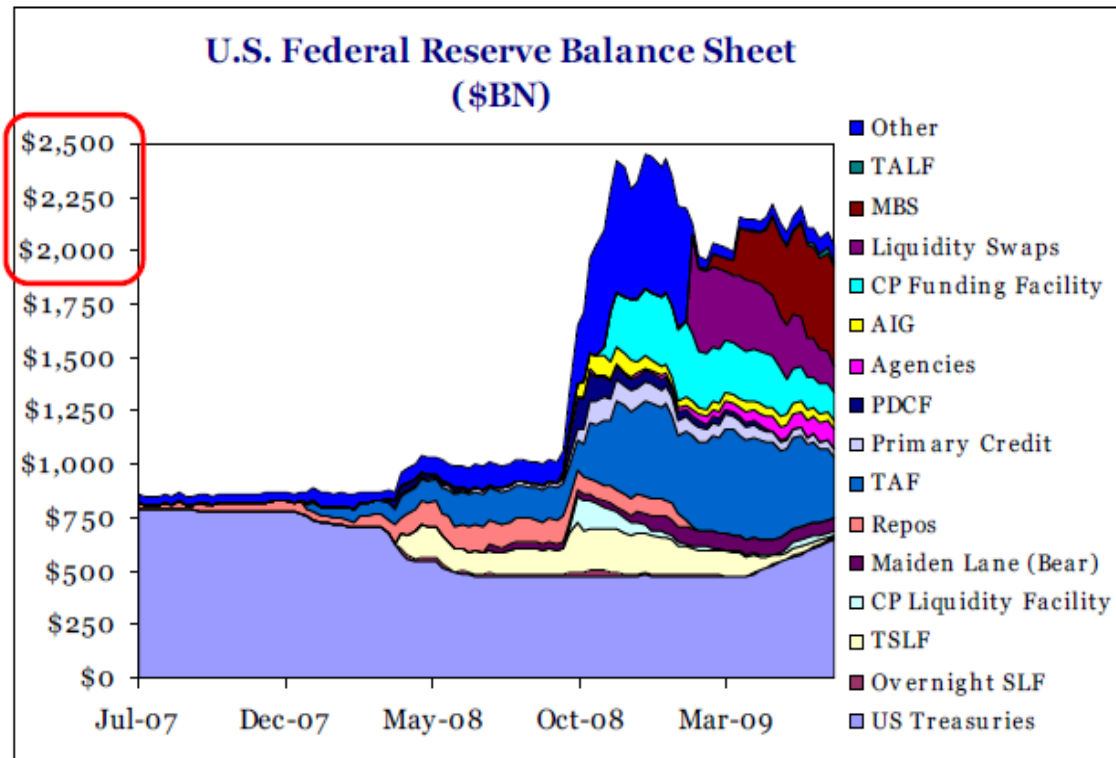
Consumer spending has a long way to fall

- Household balance sheet repair (more savings, paying down debt) likely to drive economic fundamentals over next several years
- In a \$14 trillion economy, reversion to the mean has a huge impact



Source: Strategas Research

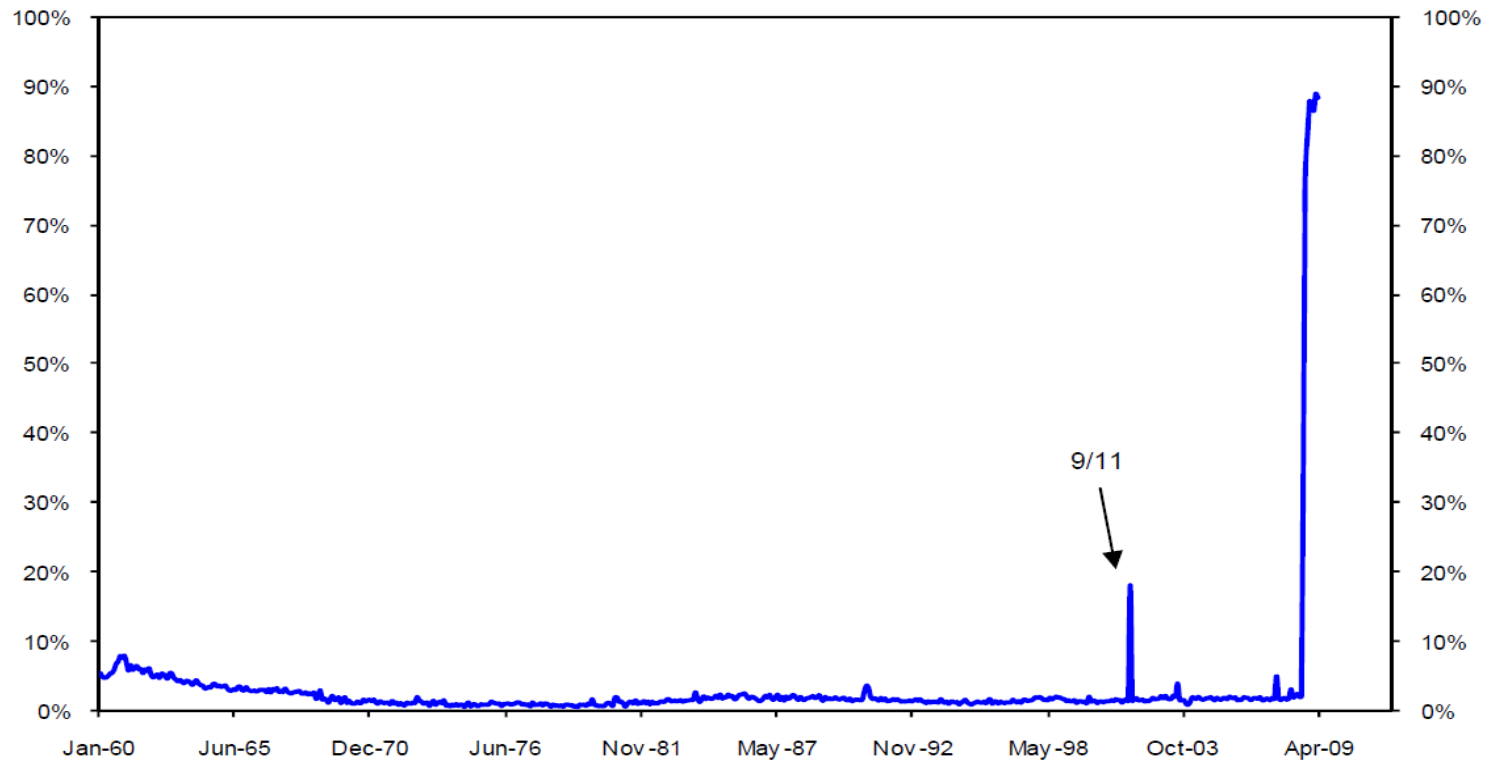
Taxpayers purchased the toxic assets



Unprecedented increase in excess bank reserves

- Expansion of money on this scale should ultimately lead to high inflation

Excess Reserves of Depository Institutions as a Percentage of Total Reserves
(Monthly, Percent, NSA, through Apr-09)



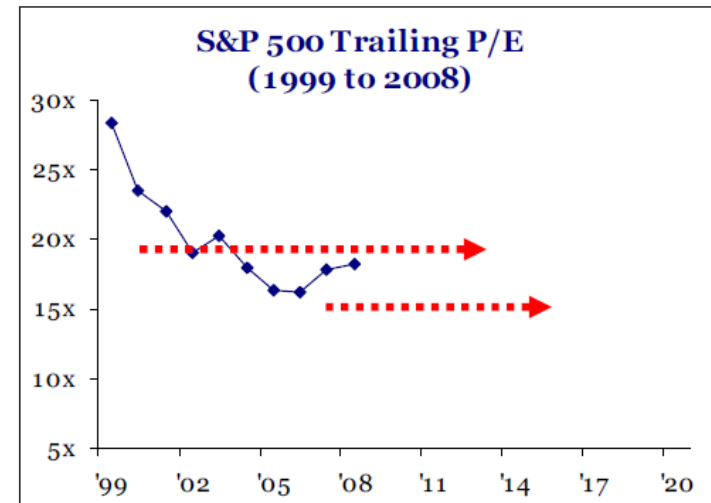
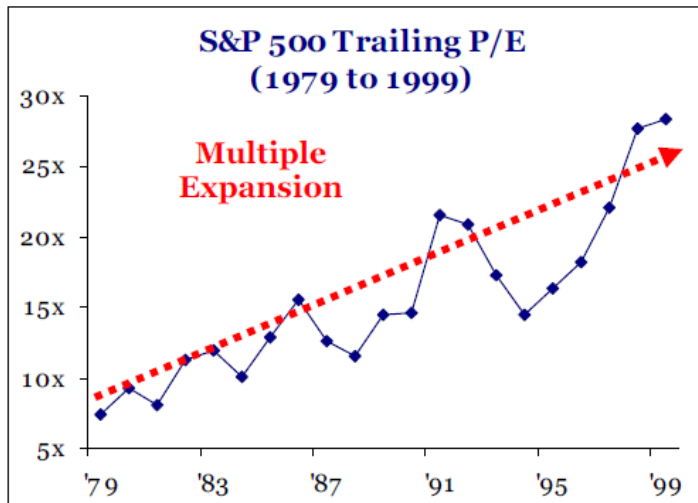
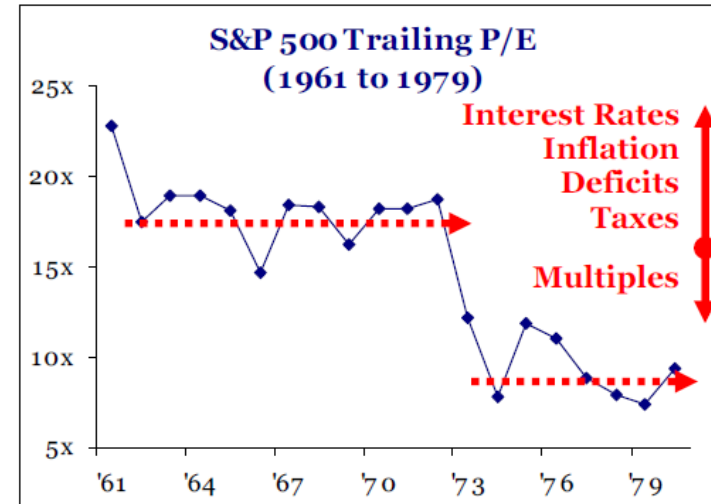
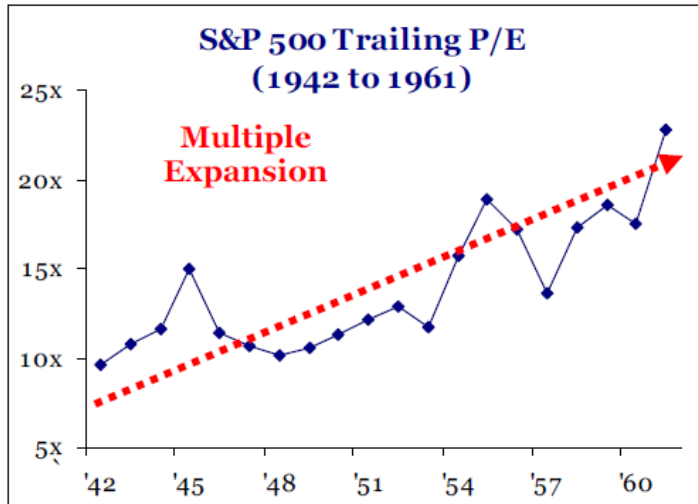
Source: Laffer Associates

This is not 1982 all over again...

Then & Now: August 1982 vs. June 2009

	August '82	Current
Fed Funds Rate	10.25%	0.13%
Prime Rate	14.39%	3.25%
10-Year UST Yield	13.6%	3.7%
Trailing S&P 500 P/E	8.8x	21.8x
Price to Book	1.0x	2.0x
Dividend Yield	6.6%	2.6%
Top Marginal Tax Rate	50%	35%
Capital Gains Tax Rate	20%	15.0%
% of Workforce in Union	20.1%	12.4%

Investors should not count on multiple expansion



Back to the 1970s?

Real Returns Across Asset Class (1975 to 1980)

	Gold	Large-Cap Stocks	Home Prices	T-Bills	Long-Term Corp. Bonds	Long-Term Govt. Bonds
12/31/1974	\$1	\$1	\$1	\$1	\$1	\$1
12/31/1975	\$0.67	\$1.28	\$1.01	\$0.97	\$1.06	\$1.00
12/31/1976	\$0.61	\$1.51	\$1.03	\$0.96	\$1.19	\$1.11
12/31/1977	\$0.70	\$1.31	\$1.09	\$0.95	\$1.13	\$1.03
12/31/1978	\$0.91	\$1.29	\$1.16	\$0.94	\$1.05	\$0.94
12/31/1979	\$1.96	\$1.38	\$1.19	\$0.93	\$0.89	\$0.82
% Return	96%	38%	19%	-7%	-11%	-18%

Real Returns Across Asset Class (1982 to 1989)

	Large-Cap Stocks	Long-Term Corp. Bonds	Long-Term Govt. Bonds	T-Bills	Home Prices	Gold
12/31/1982	\$1	\$1	\$1	\$1	\$1	\$1
12/31/1983	\$1.19	\$1.03	\$0.97	\$1.06	\$1.00	\$0.81
12/31/1984	\$1.22	\$1.16	\$1.08	\$1.11	\$0.99	\$0.62
12/31/1985	\$1.56	\$1.47	\$1.38	\$1.16	\$1.00	\$0.63
12/31/1986	\$1.82	\$1.73	\$1.69	\$1.21	\$1.04	\$0.74
12/31/1987	\$1.85	\$1.66	\$1.59	\$1.23	\$1.08	\$0.89
12/31/1988	\$2.09	\$1.77	\$1.67	\$1.25	\$1.08	\$0.72
12/31/1989	\$2.65	\$1.98	\$1.90	\$1.31	\$1.09	\$0.67
% Return	165%	98%	90%	31%	9%	-33%

Importance of Downside Protection

- Bear market losses often take years to recover
- Lower volatility smoothes the ride, allowing your portfolio to maximize the benefits of compounding

How long will it take my portfolio to recover?

<u>Portfolio Loss</u>	<u>Required Return to Breakeven</u>	<u>Years to Breakeven 9% Annual Return</u>
10.0%	11.1%	1.25
15.0%	17.6%	1.83
20.0%	25.0%	2.50
25.0%	33.3%	3.25
30.0%	42.8%	4.00
40.0%	66.7%	5.75
50.0%	100.0%	7.75

* Assumes monthly compounding of returns

Current Allocations

ASSET CLASS	Traditional 60% Equity 40% Fixed	30% Equity 30% Fixed 40% Alts
Large Cap Equity	30.00%	8.50%
Small Cap Equity	15.00%	6.25%
Micro Cap Equity		3.25%
International Equity	10.00%	8.00%
Emerging Markets	5.00%	4.00%
Fixed Income	40.00%	30.00%
Liquid Alternatives		11.00%
Hedged Equity		6.00%
Commodities		5.00%
MLPs		5.00%
REITs		3.00%
Managed Futures		10.00%
Expected Return	7.60%	8.60%
Standard Deviation	10.74%	8.16%
Sharpe Ratio	0.34%	0.56%

Commerical Banking

Paul Murphy, Jr. – Amegy Bank of Texas
Chief Executive Officer

A look back over the past year



Impact on Commercial Banking

- Funding continues to be available for good businesses, yet demand has significantly declined
- Loans are at higher spreads with more conservative structuring
- Credit quality remains the focus
- Bottom line: spreads have widened; but all-in cost of borrowing is still very attractive

Regulatory Influence on Banking

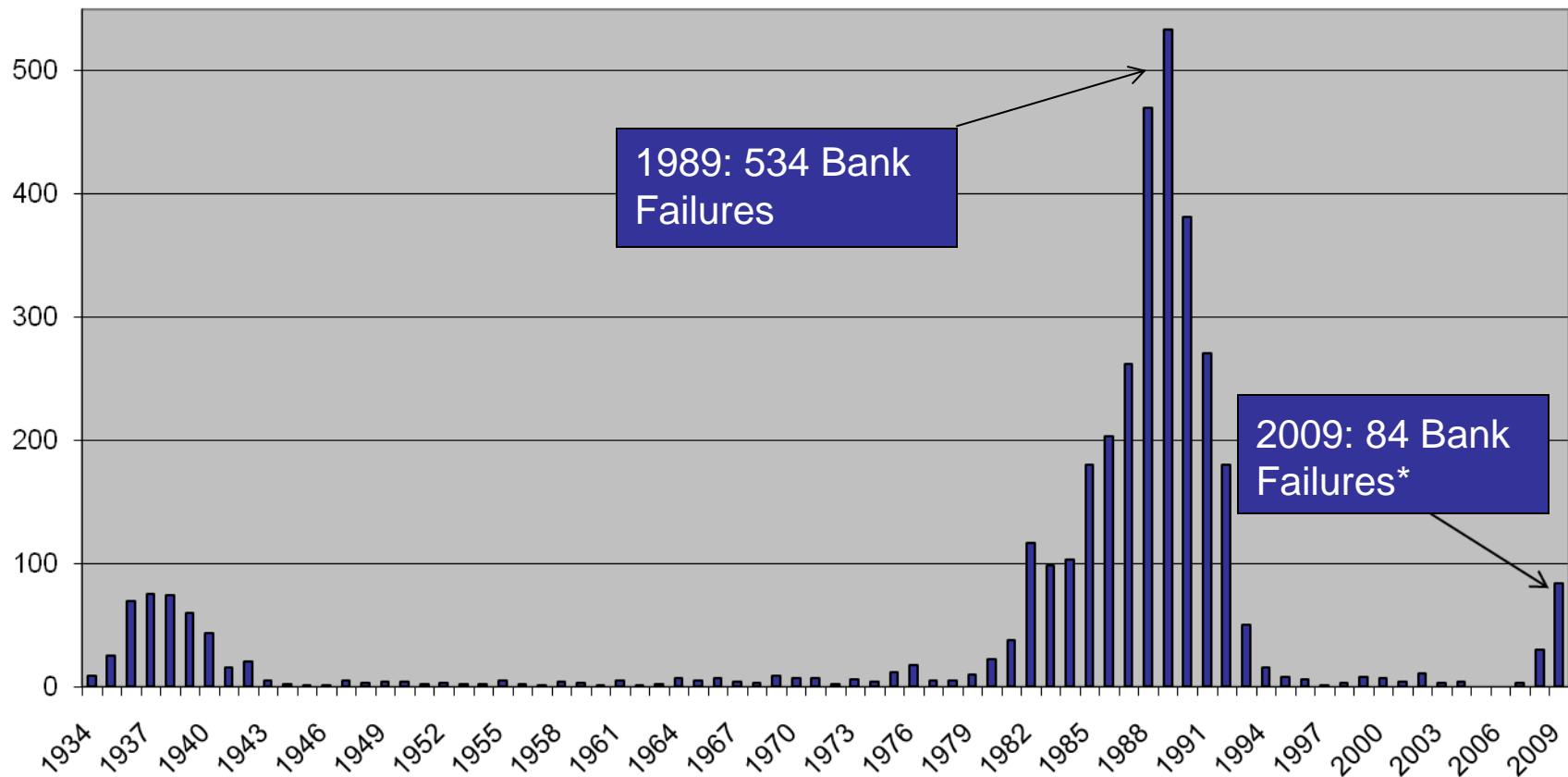
- Regulators continue to tighten policies
- Fed, OCC and FDIC are on track to issue nearly 600 memorandums of understanding 2009, compared to 399 last year
- Reserve requirements are increasing and impacting capital requirements
- FDIC preparing to initiate loan auctions

The Houston Perspective: Oil and Gas

- North American rig count peaked around 2500 in Oct. 08, fell to around 975 in May 09 and has recovered 16% from the bottom (1138 last week)
- Expect to see the larger energy companies get larger (Baker Hughes / BJ Services merger)
- High yield debt is still scarce and expensive for energy companies

How Today Differs from the 80's

Bank Failures & FDIC Assisted Transactions



*As of 9/1/09



Implications of Bank Failures

- Steady supply of troubled real estate loans
- Negative for economic growth
- Negative for rates
- Decline of small banks
 - Banks with less than \$100 million in assets have dropped by more than 5,000 since 1992
 - Small banks' share of the U.S. deposit market plunged to 2% last year from almost 13% in 1992

How the Credit Contraction Impacted Values

- Land
- Privately held companies
- Homes
- Equities

Where are the Opportunities?

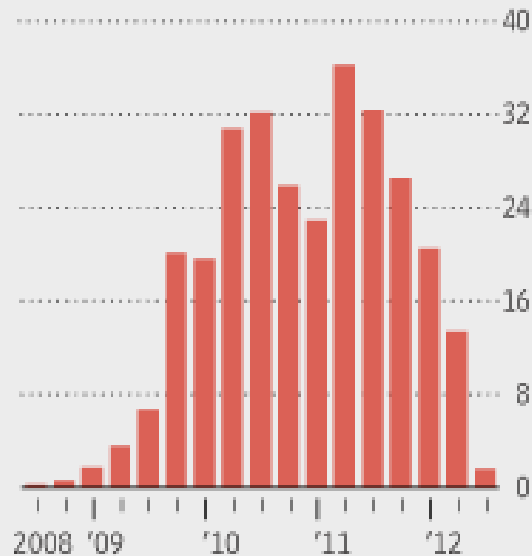
- Buying distressed assets
- Maintaining a fortress balance sheet
- Keeping liquidity strong
- Simply remaining afloat

Looking Forward Through 2010

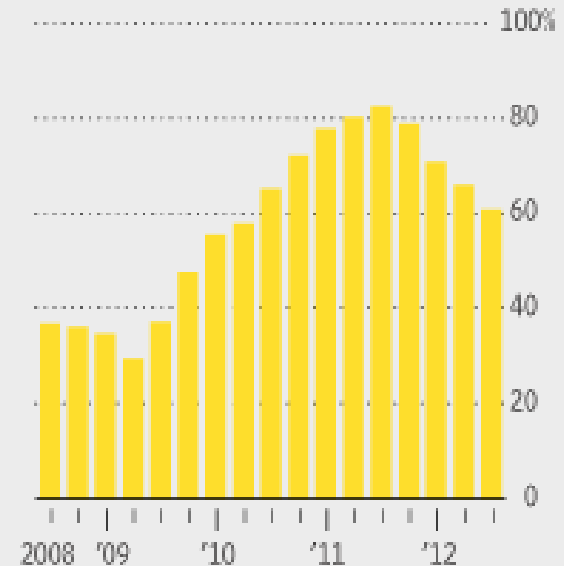
- Very low visibility
- Credit quality remains hard to assess
- Some bright spots in the economy
- Uncertainty around possible legislation and its impact
- More hedge funds will be actively buying distressed assets
- What will be the impact of option ARM's?

What will be the Impact of Option ARMs?

Balance outstanding on option ARMs that are scheduled to be recast* in each quarter; in billions



Relative payment shock, or the average percentage by which borrowers' payments will jump once their mortgages are recast.



*Option ARMs on which payments will be recalculated; estimates exclude loans that are paid off early. Sources: LoanPerformance; Barclays Capital

“Take Aways” for Today’s Environment

- Examine the structure of your accounts
 - FDIC Coverage
 - Are you taking advantage of 100% insurance on non-interest bearing accounts?
 - Rates
 - Safety and soundness of your bank
- Strengthen the security of your finances
 - Fraud increases during times of economic hardship
 - Follow security and password strategies provided to you by your bank
 - Pay attention to dual controls and separation of duties
- 2010 may continue to be turbulent
 - Manage cash flow proactively
 - Communicate frequently with your banker

Questions & Answers

