First PacTrust Bancorp, Inc

Moderator: Gregory Mitchell
February 9, 2011
12:00 p.m. EST

Operator: Welcome to the First PacTrust Bancorp, Inc.' s, February 9, 2011, fourth-quarter 2010 earnings investor conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session.

I'd now like to turn the conference over to Mr. James Sheehy, Executive Vice President, Secretary and Treasurer for First PacTrust Bancorp. Mr. Sheehy, you may begin.

James Sheehy: Thank you. Hello, everyone, and thanks for joining us for today's fourth-quarter 2010 earnings investor conference call. With me on the call today are First PacTrust Bancorp's President and Chief Executive Officer, Gregory A Mitchell. Also here to assist Mr. Mitchell in answering your questions later during this teleconference, is the Company's Principal Accounting Officer, Senior Vice President – Controller, Regan Lauer; the President and Chief Executive Officer of the Company's wholly-owned Pacific Trust Bank subsidiary, Hans Ganz; and the Bank's Executive Vice President and Chief Administrative Officer, Richard Herrin.

Today's conference call is being recorded for replay via phone, and a copy of the recording and a transcript of the meeting will be available later on the Company's Investor Relations website.

Before I turn it over to Greg, I want to remind everyone that, as always, elements of this presentation are forward-looking, and are based on our best

views of the world and our business as we see them today. Those elements can change as the world changes. Please interpret them in that light.

The forward-looking statements in our February 8 fourth-quarter earnings release and 8K filing also apply to our comments today. Those documents are available on our firstpactrustbancorp.com investor relations website, as are other 8Ks filed regarding investor presentation materials and other matters. A PDF file of the investor presentation February 2011 slide show for this earnings conference call can be found on the Company's Investor Relations website under the link entitled, annual reports and presentations. We will have time for questions and answers at the end of the presentation.

I'll now turn it over to our President and CEO, Greg Mitchell.

Gregory Mitchell: Thank you very much, Jim, and thank all of you for joining us on this fourth-quarter earnings call, and really the beginning of a new day for First PacTrust Bancorp and Pacific Trust Bank. As many of you know, I've been on board officially since November 1, 2010, and I'm extremely excited by what I've seen thus far, and what I project to happen on a go-forward basis. And before jumping into the fourth-quarter results for 2010, I'd like to revisit where we have been, and talk a little bit about where we're going. And then I'm hoping to spend a fair amount of time with you to respond to questions.

I'm joined today, as Jim mentioned, by Hans Ganz, who was really the founder of First PacTrust Bancorp, the guy that took this company public many years ago. Richard Herrin, who is one of our new Executive Vice Presidents, and Chief Administrative Officer. As many of you know, Richard was formerly with the FDIC here in California, as well as having been a very skilled community banker. Regan, as our Chief Accounting Officer, has been here doing yeoman's work on providing greater transparency and clarity in the financial statements, and hopefully each of you are acknowledging that as you review our most recent results. And Jim has continued to be here holding down the fort, dealing with treasury issues, and a number of other tasks at the Bancorp.

We're also joined on this call remotely by Matt Bonaccorso. Matt is our new Chief Credit Officer. He worked with me at California National Bank, and most recently served as a senior officer for US Bank running special assets in the western United States. Also with us on the call is Chang Liu. Chang is our new Chief Lending Officer. Also coming recently from US Bank and having been a Senior Vice President at California National Bank, and a very prolific generator of commercial real estate loans.

Joseph Abraham, Director of Credit Services, is really somewhat of a rocket scientist on loan servicing, risk analytics, credit management, and able to build and maintain platforms that are very strong from a risk-management perspective. And last but not least, our Director of Retail Banking, Gaylin Anderson, who worked with me at California National Bank, and most recently held a senior position with US Bank, where he was responsible for some sales and service initiatives, and some expansion plans for US Bank.

These are a team of professionals who have grown an institution from a small community bank to a mid-sized, $7.7 billion regional bank, have taken the Company from a small platform to a large one, and have done it with a great deal of regulatory success, and earnings success in the future. And I point that out because I'll be counting on this team, as well as each of you to assist me, to assist the Board, and to assist our employees in transforming Pacific Trust Bank and First PacTrust Bancorp into an organization that we can all be extremely proud of.

So where we've been. As many of you know, I viewed the transformation process of the financial institution as a measured journey. From a defined point today, to a much brighter point in the future. And it's a journey that requires a fair amount of work, a lot of effort, a lot of victory, some setbacks, but takes us to a destination that should provide great results for our shareholders, our customers, our employees, and the communities that we serve. We are moving to a community-bank model that should be beneficial to all.

As many of you also know, the strategy here at First PacTrust Bancorp is to take advantage of three distinct opportunities in our market. One is to

leverage our very strong capital base and that strong management team to achieve solid returns for our shareholders through the execution of an organic growth strategy. By that we mean we take advantage of opportunities that exist in the market to grow the organization's loan portfolio, and to transform the organization's liability portfolio into that of a community bank with high levels of core deposits, low funding costs, and a great deal of rate stability in a rising rate environment.

Our view is that if we focus on qualitative growth at this institution, we should provide strong earnings for our shareholders, stability for our regulators, and expansion in price earnings multiples as the market looks at PacTrust's income stream as something that is stable and predictable. Under our organic growth strategy, we see the bank growing to about $2 billion over the next five years, and we also have positioned ourself to take advantage of opportunities in the market from an acquisition perspective. And as I've shared with others in the past, we see an opportunity to grow our bank from $900 million to $5 billion over the next five years.

So, we are taking steps through the acquisition of capital, the acquisition of management, and a prudent execution of the business plan to achieve those objectives. A lot has been done in the last three months to begin to get us there. First and foremost, we closed on the capital transaction on November 1, raising $60 million gross, a little over $56 million net, in new Tier 1 common equity. We promised to the market that we would repay TARP, and completed and executed on that promise. And not only that, but in January of 2011, we were successful in repurchasing the warrants from the Department of the Treasury at a price level that was accretive to the book value of First PacTrust Bancorp. It was accretive then, and now that the market has begun to take notice of our stock, it has caused that accretion to improve even more. So those are a couple of the notable achievements, and I'll talk about some more as we go along.

So, where are we now? The bank remains strong, sound, and positioned for organic growth. As I mentioned earlier, we have hired the strong management team, and I've introduced those individuals earlier, and many of you have met

them here at the Bank. We've established a strong capital base, we've repaid the TARP, and we've begun to execute this new business plan.

Part of what we shared with many of you was that we intended to acquire opportunistic branch locations throughout southern California, and populate those branches with managers and community bankers who are able to take advantage of the high level of dissatisfaction that exists in the community banking arena. Last year, we acquired a branch in the village of La Jolla, a very attractive 10,000 square foot building, which we acquired from the FDIC for $2.1 million. So, that is roughly $210 a square foot. So those of you who know southern California, I think can understand the value of that transaction from a real estate perspective.

More importantly, that branch previously held as much as $140 million in deposits from the very attractive and affluent La Jolla community. We will soon populate that branch with a number of community bankers, and more importantly, populate that branch with a number of customers, expanding our footprint from nine offices today to 10.

Earlier this quarter, we announced a transaction with the FDIC for the acquisition of a branch in the community of San Marcos, California. Attractive location, solid market; that branch held in excess of $90 million in deposits. So between those two offices, roughly $230 million in potential deposits. We don't expect to populate those branches at that level in the near term, but we certainly see an opportunity to gain some share in those markets, particularly when recent polls suggest that more than 70 percent of the customers that have been dislocated as a result of mergers and acquisitions, rate their experience and their like of their new bank as unacceptable, and that they are highly dissatisfied with where they are at now. So again, we'll populate those offices with great managers, take advantage of some of that growth that exists within our markets.

We have continued to work our loan portfolio, improving credit quality trends, and we'll spend more time on that as we go through the specific numbers. But you've seen a continued reduction in non-performing assets, a stabilization in our REO, continued reduction in our delinquencies, and

overall improvement in the credit portfolio. And we'll give a little more color there.

So, we've begun to execute the capital plan. We've built on – begun to execute the business plan, continue to build on capital, continue to build on management, and are now positioned, I think well, to move forward with the full execution of our business plan.

I talked a moment ago about three legs of the stool; organic growth, acquisitions, and potential FDIC -assisted transactions. We are not focusing principally on FDIC -assisted transactions in this market. We see, today, a significant level of opportunity in organic growth, and a significant level of opportunity in acquisitions. As you might imagine, having a community bank in southern California with more than $136 million in tangible equity, and the ability to attract more equity through other channels, makes us somewhat of a darling among community banks in southern California. And your imagination probably wouldn't have to work too hard to think about the number of reverse inquiries the organization may have received as a result of our capital position, and the belief on the part of some banks that they may benefit from a combination with FPTB.

So that's a little bit about where we've been, where we are today, and why I am quite excited about where we're going in 2011 and beyond. So with that I'm going to flip to the earnings results for the fourth quarter and the year. As noted in our 8K filed yesterday, Bancorp generated $1.4 million prior to the payment of dividends, and $1.2 million or $0.15 a share available for common shareholders. There was, as has been pointed out by many of you, a fair amount of noise, most of which was predictable, in the earnings stream for the fourth quarter. We incurred relatively significant costs in connection with completion of the recapitalization effort. A significant portions of that were partial payouts under change of control agreements, partial – excuse me, redemption of some of the existing options that existed at the institution, certain legal expenses and other transactional expenses.

In addition, as part of our asset-quality initiatives, we took some additional charges on our OREO portfolio, most notably on one asset, which was a

construction project as part of a participation. We previously disclosed that as an asset that was carried at 36 percent of the original loan balance. That asset is now carried at less than 25 percent of the original loan balance. I think as many of you know in the market, there is somewhat of a disconnect between appraised values received by financial institutions on assets, and what it might take to clear assets in the open market. We feel pretty good about where that asset is valued now.

In addition to that, from a credit perspective, we moved off a number of OREOs that were coming into the bank, quite clearly and are now sitting on an OREO portfolio that consists of that one construction project, which is a legacy, one high-end home in Rancho Santa Fe, which we're making good progress on, and four additional small single-family homes. I'm hopeful that the trends from an OREO perspective will continue to improve.

Back to earnings, for the full year, the Bank generated positive net income for the quarter. The bank generated $3.1 million or $0.39 per share. That excludes elimination of a lot of the noise related to the transaction expense, OREO charges, and certain provisions.

What was also notable in the fourth quarter was that the Bank was fortunate enough – Bank and Bancorp, were fortunate enough to realize meaningful gains on the disposition of some Z-tranche securities Bancorp acquired in connection with First PacTrust's acquisition of certain super-senior Re-REMICs in 2008 and 2009. By way of history, Bancorp acquired those assets at roughly $0.05 on the $1, wrote those down to zero, and held them at Bancorp. We were approached by a third party in December, and were able to sell those securities at greater than [$0.50]. So, it was a very nice gain. It also spoke well to the strength and quality of our super-senior piece that came from that Re-REMIC portfolio. Because arguably if the market was willing to buy the junior-most piece of a security at a meaningful premium, it must speak to the strength of the capital structure and the stack as it relates to the larger component.

So, other expenses, the $3.1 million that I discussed as it related to salary and related expenses, the $1.6 million in charge-offs and other expenses related to

the portfolio of OREO, and a handful of miscellaneous expenses. We obviously, as I mentioned earlier, increased the private placement, raising $60 million, substantially increasing the share count, repaid the TARP, and as I discussed in January, were successful in retiring the warrants.

So, earnings positive, the core levels were positive, base earnings were positive, and we showed some nice trends as it related to our funding costs and other elements. And we've discussed those previously, and would be happy to provide additional color later as we go along.

Asset quality; 9.4 percent reduction in NPAs. In our conversations with analysts and other market participants, as well as our regulators, we began to understand that we were being inappropriately criticized for the way we were reporting our non-performing assets. So we've provided in this 8K, and in the 10-K that you should receive sometime next week, and in the investor presentation, a great deal of transparency on what our non-performing asset portfolio looks like, and how we are accounting for that now and on a go-forward basis. We think you will like what you see, both from a trends perspective, and certainly from a detailed reporting perspective. Notwithstanding that increased transparency, yes, we're very pleased with the general direction of credit risk.

You saw the ALLL decline from $17.6 to $14.6 million, taking us now down to 2.12 percent reserves to loans. That was largely attributable to a charge-off on two long-term non-performing assets. Under GAAP, if an asset is delinquent for more than 180 days, you have to take the specific charge-off. So that was completed. It was not an intent or an exercise to have negative provisioning. None of that occurred in the fourth quarter. To the contrary, we slightly increased the GDA or ALLL during Q4. Again, as I mentioned a moment ago, the levels of delinquencies and other classified assets continued to decline.

So from an earnings perspective, from a margin perspective, from an asset quality perspective, from a management perspective, I am encouraged and pleased. I have to tell you that one of the nicest comments that I've received while chatting with investors, current and prospective, was during a meeting

in Chicago a few weeks ago, where I met for the second time with a group of investors that we had spoken with in August of 2010.

And in August of 2010, they said they really liked the story and would continue to look at it. When I met with them in January, they said – we meet with dozens and dozens of investors who come through our doors saying that we're going to do certain things, that we're going to complete a recap, that we're going to transform an organization, and you can't believe how many people fail to perform; we are delighted to see that everything you told us you would do in the summer and fall of 2010, you have done in 2011. And our hope and expectation is to continue to do that for our shareholders, for our customers, for our employees and the communities we serve. We have a great deal of responsibility, we also have a great deal of opportunity, and we're very, very excited about the future that stands before us.

So with that, I'm going to give – Hans, any comments that you would like to make as it relates to fourth quarter earnings or other trends?

Hans Ganz: No, all I would add to it is that the statement that I made in the announcement, that the team is now on board. I am very excited about the possibilities down the road. We are going to restructure some of our lending and deposit products as we promised the market we would do. And I am sure that at the end of this first quarter here, most of the stuff will start getting into gear. And I think the market can look forward to see some results out of that by the middle of the year.

Gregory Mitchell: Yes.

Hans Ganz: So I think that's an exciting approach, because it's part of the expertise needed to transform the Bank into more community bank approach. And having the right people there with the right leadership is clearly essential, and I am excited for the guys to be on board and moving forward. So that to me is the most exciting part in the first quarter.

Gregory Mitchell: Thank you. And as always and you know this, how much I appreciate your leadership and the way we've worked together between Bancorp and Bank on a go-forward basis. I couldn't be happier.

Hans Ganz: Neither could I.

Gregory Mitchell: So with that, I am going to open it up for questions, and hopefully I can provide a lot more detail on earnings, asset-quality trends, liability trends, and others, as we respond to questions. I was intentionally being high level in my comments, and hopefully we can provide a little more detail in response to specific questions that you may have.

So with that, I'd invite the operator to open the lines.

Operator: Your first question comes from Ed Timmons with Sterne Agee.

Ed Timmons: How are you today?

Gregory Mitchell: Not too bad. I hope you guys are doing well. We're doing well.

Ed Timmons: Just a couple quick questions. I guess the first one on the margin. You know, you got some pressure this quarter from the excess liquidity and the cash position. Do you have any plans to deploy that invested into the portfolio, or are you going to try to remain fairly liquid given the advances coming due this year?

Gregory Mitchell: Well, we have $55 million of advances coming through in 2011, and interestingly those advances have about a 3.47 percent coupon, so we expect some nice pickup as we replace those with money market demand accounts or core relationships, or even potentially CDs. There is some pretty good lift there. We had substantial capacity to attract deposits. We also have access to some other funding vehicles in this market that are very attractive. For example, we have zero exposure to the state of California, and we can borrow at an all in cost of about 34 basis points from the state. So, we have numerous means of attracting deposits and don't intend to maintain huge levels of liquidity.

You will see us continue in 2011, to Hans's point, to increase the production of loans. You may see some purchased asset activity in 2011, and you'll see increased growth in the Bank's securities portfolio. So the levels of cash that

we have sitting around should be somewhat limited. We intend to be more fully invested and not hopefully suffer much more margin depression. Is that in response to your question, Ed?

Ed Timmons: Yes, it was good. What kind of securities you think you might be looking at?

Gregory Mitchell: Well, you know, we're – because we're a bank and working at a new regulatory environment, we'll have a decent portion of liquid agency securities which are required to meet the new liquidity standard. We continue to see some opportunities in the Re-REMIC portfolio with attractive credit terms and attractive yields. As you know, that product that if properly understood and properly underwritten can be quite attractive and the Bank has done a very good job in that in the past. We're also continuing to look at other security classes that tend to have short durations and low credit risk.

Ed Timmons: All right. And then on M&A, you guys touched on it briefly. I'm just wondering. Is there increased interest from sellers versus say six months ago? And, you know, at this point, what is your view on fair value marks and goodwill creation, and is that an impediment to kind of near-term deal activity?

Gregory Mitchell: Great questions, Ed. Thank you. Yes, there is a – there is – despite some of the high premiums that have been paid in Texas with the co-America Sterling deal, there is increasing awareness on the parts of boards and management here in California at least, that for many of the institutions they have become either zombies and are now among the walking dead. Some of them know it, some of them don't. Those that do, are now beginning to understand FAS 141R and the mark issues and capital issues that relate to that. So they tend to be receptive to discussions on financial terms that are beneficial to the resulting institution. It is unlike cash purchasers that, you know, they get the check and they go away forever.

When investors participate with First PacTrust, they need to recognize that they're buying into a long term opportunity and that the stock of the resulting institution needs to remain strong. And that when they run the present value analysis with their financial advisors or others, they see the benefit of being

realistic from pricing perspective. So I guess the bottom line is we see an opportunity to complete transactions that remain capital-efficient after considering FAS 141R issues and others, and as we've noted previously, we expect to complete transactions that would be accretive to our tangible book value and accretive to earnings. Is that in response to your question, Ed?

Ed Timmons: Yes, good answer. Thanks for taking my calls, guys.

Operator: Next question is Kevin Reynolds with Wunderlich Securities.

Kevin Reynolds: Thanks for having the call and good disclosures and discussion as well. Sort of along the same lines as a consolidator, it is one thing to have the potential sellers out there who are starting to come to your way of thinking, but in your commentary where you talk about San Diego seem to be getting a little bit better, does that change at all your views as to how you deploy your current capital, i.e., is it more beneficial to create your own paper rather than buying someone else's that's marked down if we have in fact made the turn and we consistently get better from here?

Gregory Mitchell: Well, much of the paper that we'll be originating, Kevin, will be our own. And one of the elements that's particularly attractive for us in California, at least, and I'm not as familiar with the balance sheet challenges of institutions outside of this state, is many of the smaller institutions in California were sort of one-trick ponies who focused their efforts and energies on the origination of commercial real estate assets.

So, they have books that are heavily concentrated in CRE, and now facing increased pressure and increasing pressure from the regulators to delever their balance sheets to reduce their concentrations in CRE. So, some of their best relationships are being pushed out and there is now a very limited universe of banks that are originating in that space. So, we continue to see an opportunity and it's actually strengthened by the improving economy to originate smaller ticket, commercial real estate loans in San Diego, Orange and LA counties.

It's important to note that Chang and Matt and Joseph are all domiciled out of a loan production office and centered in Los Angeles. So, the bank that they used to work with had a very substantial portfolio in the LA and Orange

County market. They have pretty deep relationships in that market from their own book and many other community bankers from smaller institutions that are now facing capital constraints and where the lenders at those institutions want to feed their families, are certainly having conversations with us saying that they would like to join with Pacific Trust Bank. Notably, while those banks are constrained by concentration risk, we have $450 million in immediate capacity for CRE out of this institution. So, the pain that exists in the market as a result of low levels of supply, meaning lenders able to lend in that arena, gives us some unique opportunities, because the demand, resulting from refinancing or repositioning of existing commercial real estate assets, or banks having to push off their relationships, fits well into our strength of scalable balance sheet, strong capital, and sufficient balance sheet capacity to board those types of credits.

Kevin Reynolds: OK. OK.

Gregory Mitchell: Is that responsive, Kevin?

Kevin Reynolds: Very good, very good. The other question I had was I guess more of a detailed question in the quarter. It looks like after you exclude the salaries or the payments related to the change of control, you're looking at about $2.1 million or so, $2 million in salaries expense. What do you think the run rate is as you go forward there? I apologize if I missed it, if you already addressed that.

Gregory Mitchell: No, we didn't already address it. We think that as a result of the addition some of our lenders and some branch staff coming into the organization, that the salary component for the Bank and Bancorp on a consolidated basis, should rise by about $4 million in 2011.

So we've discussed our expectation that the efficiency ratio would rise from its historically low level and you would expect that as part of a transformation. But if and when we get to the point where we're originating the levels of volume of new production that we believe that we will originate, and matching that off with funding costs that are sub 1 percent, you know, we see an opportunity to get sort of high fours, very low five NIMs.

And just hypothetically if you got – and I'll just make up a number here – if you had $150 million in production and a five NIM, you've got sort of 7.5 percent in net interest income, plus some additional fee income to help support $4 million in gross expense. And that as the portfolio continues to grow, or we perhaps pursue some wholesale activities that are done – that give us that margin with lower production costs, you will see the efficiency ratio coming more in line. Is that in response to your question?

Kevin Reynolds: Yes, it does, thanks.

Hans Ganz: And, by the way, those are projections that we had previously talked about. This is pretty much in line with what we expected at the completion of the transaction.

Operator: Your next question comes from Andrew Liesch with Sandler O'Neill & Partners.

Andrew Liesch: Nice work producing the non-performers there.

Gregory Mitchell: Thank you.

Andrew Liesch: Two questions. First one is, it looked like that the commercial real estate and multi-family portfolio is up just slightly. So, maybe there's been a bit of organic growth there, which is good to see. But I'm curious if that is the case, like who are you running into, as far as competition is concerned? Is there a lot of big guys out there that can price someone like you out of the market by just going really low?

Gregory Mitchell: No, we're not – I think what volume you did see may have been a green commercial real estate asset. As you recall, in the past, the Bank originated green mortgages for residential, which is where substantially all of the production is and a little bit in commercial. We are not seeing, and I'm going to sort of quote my friend Chang Liu here. We're not seeing significant competition from the big players in the small ticket CRE arena. Doing a $3 million or a $5 million commercial real estate loan, isn't very exciting for an institution that's got hundreds of billions of dollars on the balance sheet. They

tend to be focusing on slightly larger credits where there is much more price sensitivity.

We continue to see opportunities in our space for nice yields with strong credit metrics, and are not, yet, at least, seeing significant competition from a price perspective, or people reaching for credit. And quite frankly, I don't think that will happen for some time. We believe over the five-year period, that competition will increase in that CRE space, and actually believe that during the five-year period some of the conduits and people who are particularly irrational during this last cycle will come back in the market and will attach to many of our commercial real estate loans meaningful prepayment penalties, to give us a little bit of a good-bye kiss, if and when the markets get crazy again and some of our borrowers say, you know, we want to go to somebody who is going to give us 4 percent money, or whatever it is, at that point in time. But we're not seeing in the CRE space crazy pricing yet or crazy terms. Again, the level of competition is somewhat limited, and continues to be constrained by the concentration issues in capital issues that I discussed earlier.

Andrew Liesch: Great.

Gregory Mitchell: Is that responsive, Andrew?

Andrew Liesch: Absolutely. Thank you. And then my last question, just on the occupancy and equipment expense line item. Looked like that was up quite a bit from the – to the highest level in a while, but with the new branches that you're planning on adding, and maybe this infrastructure upgrade or IT infrastructure upgrade, is there like any sort of like run rate or maybe lumpiness that might have in 2011?

Gregory Mitchell: A limited amount. We've done a capital budget as we acquire these locations. You're seeing an increase in sort of fixed assets and equipment. There is some computer upgrades that we'll be doing. There is some systems upgrades that we will be doing, to support the deeper community banking and bit of small-business model. The bank already had a lot of that infrastructure in place. You know, there's – routine with really any bank, you need to upgrade ATMs

to deal with changes in ADA. So you will see some rises, but nothing particularly notable. The biggest expense lift that you'll see relates to building out the first two locations and any additional offices that we may open for the balance of 2011.

Andrew Liesch: All right. Thank you very much. I'll step back.

Gregory Mitchell: Thank you, Andrew.

Operator: Your next question comes from Dan Nicholas with Robert W. Baird.

Dan Nicholas: A couple of questions. In the presentation you talk about the possibility to access small-business, the SBLF funding, capital. I guess just trying to get a sense of how you all view that from an attractiveness standpoint or appeals standpoint, relative to your balance sheet and growth prospects.

Gregory Mitchell: Well, we view it pretty positively. We've had some conversations with Treasury. We certainly had conversations with our regulator over the topic. You know, our initial concern on I'm looking at SBLF was the market reacts poorly because we're in bed with the government, or, worse yet, the government imposes some strings or conditions that make the real cost of that capital far greater than 1 percent. In chatting with people within our community, and other market participants, we think there is less, much less of a negative stigma, regarding small-business loan guarantee program, than TARP, or any other, you know, historic government support.

Quite frankly, I think there is a positive spin to the market that says, you know, PacTrust intends to leverage its capital position to continue to help small businesses grow in LA, Orange and San Diego counties, as well as our other markets. And from a capital structure perspective or cost perspective, since we are starting with an extremely low level of commercial exposure, our CNI book is $547,000. We would need to show very de minimis asset growth in that class, in order to qualify for the 1 percent capital rate. So if we can acquire, in our case, $43 million in debt, effectively 10-year debt with a coupon at 1 percent, that should provide meaningful benefits to our common shareholders, and other investors, as we leverage that capital through organic growth, or use it to help support some of our acquisition initiatives.

Dan Nicholas: OK. Yes, that makes sense. And then I guess if I understood you all correctly, you kind of said you won't be as focused as much on the FDIC front going forward here as you will on the organic and the more traditional M&A front. Is that a function of less deals to be had, or less attractive deals, or the terms of the deals?

Gregory Mitchell: Yes, it's a good question. We think – and I'm glad you asked that because it gives me a chance to add a little more color there. In Southern California, there are a fewer number of available FDIC institutions that we think will fail. Richard, obviously, has a lot of familiarization with the process, the people, and probably a bit of the pipelines that exist out there. And I'm going to give him a chance to speak to that – that topic more specifically. So we don't see – we're not centering our business plan around success and completing FDIC - assisted transactions.

We found that some of our competitors that have gone out and raised capital and think that is nirvana, and everything centers around FDIC deals. That is sort of silly and if we focused on that, we would lose opportunities to grow organically and lose opportunities to acquire some of these other institutions that we think can be had that are attractive to their shareholders and certainly attractive to our shareholders. We also see opportunities in the market and expect to continue to see opportunities to purchase things from the FDIC of assets that may be repackaged with a little more seasoning and some pricing that makes it attractive; either loans or securities. So we'll be looking to the FDIC process for that. We're on their list. You know, we're seeing some product from the FDIC, and hope to build on that. Richard, you want to speak briefly about the universe that's out there?

Richard Herrin: Well, we are already approved from the FDIC perspective, so we can begin looking at portfolios, assets, ORE, that fall within our purview from the descriptive locations that we've provided to the FDIC at the time of our application. As it pertains to bank failures, Greg is absolutely right. There are a number of firms out there that have attempted to raise capital, raised capital, brought money in, but are forced to jump regions on failed bank acquisitions

in locations that are not attractive to us or are not markets that we are looking to participate in at this time.

Gregory Mitchell: I mean, the other part is for strategic perspective, Dan, is we look at where some of those failed institutions are. They're in markets that are really not contiguous to where we are at today. We think that folks like many of you on the call would sort of scratch your head if you saw us suddenly pick up a FDIC -assisted institution in Walla Walla, Washington, which would be sort of way out of our market. Being now the largest federally charted institution in San Diego, which is a vibrant economy, you know strong defense spending, significant improvements in technology spending in this market and significant improvements in the life sciences and healthcare spending, as well as being in part, part of the eighth largest economy in the world, we think we've got a lot of opportunity organically and through unassisted acquisitions in our primary markets.

I know it might have been your firm, Dan, that did a population showing somewhere around 127 institutions sub $500 million in assets, that have concentration risk issues. So if you think about the number of assets that those institutions hold, the limited number of buyers that exist out there, I think you can see ample opportunity for PacTrust to be successful in picking up some of those institutions. And I think that's much more controllable than a possible win on an FDIC -assisted transaction. Maybe more – I may have given you more than what you wanted.

Dan Nicholas: No, no, that's really helpful. That makes sense. I think that's all I got. I'll hop back into queue.

Gregory Mitchell: Thank you.

Operator: Your next question comes from Brett Villaume with FIG partners.

Brett Villaume: I know you touched on the SBLF and on your slide there in your presentation, but I don't know if someone specifically asked what the dollar amount of the SBA loan pipeline is, if you have a number you can give me?

Gregory Mitchell: Well, we think, because our small-business, sort of CNI ambitions are modest, at least, we think, some one asked earlier about price competition, and in markets. We think that where there's a little bit of craziness today is in the CNI arena as some of those institutions that were heavily concentrated in CRE are now trying to go into a new market to get little bit of traction and growth. So we see goals of getting to perhaps on a $2 billion balance sheet, say, $90 million, less than 5 percent of the total asset portfolio, in pure CNI by the end of 2015. So it is pretty small as it relates to totals. The play for us is more dealing with professional small businesses within our primary markets that are pretty well established, having large – much large focus on the deposit relationship and then bank at work programs with those small businesses where once we formed a trusting relationship with the business, our local branch managers will go into those businesses, provide some training on financial literacy, provide a suite of products and services that would be very attractive to the employees of those institutions and theoretically branching out to vendors of others.

It's sort of a wedge strategy of get the small-business relationship, overwhelm them with a quality of products suite and sort of a community banking model, where they are all treated with dignity and respect and can count on their community banker to be there for them, and then build on that relationship to sort of branch out to employees, customers, and friends. We had a fair amount of success with that at one of my former banks, and we think we'll have pretty of high level of success here.

So you'll see growth, if we're at – if we're successful in execution of that, and I believe we will. You'll see an inordinate amount of growth in liabilities versus assets on that side. But you'll still see meaningful growth to more than exceed the expectations of SBLF. Because, again, if you're starting with sort of $600,000 in pure CNI, which is where we are at today, and need to do a 10 percent year-over-year increase, it doesn't – you know, it doesn't take a whole lot of work to get and maintain that attractive yield over the term of the debt. Is that responsive, Brett?

Brett Villaume: Yeah, that's great. Thanks. You had some good growth in core deposits this quarter and I was wondering if that was specifically related to growth in the

green mortgage product, maybe? And whether we should continue to see the mix improve with deposits like in the first quarter?

Gregory Mitchell: Well our expectation is that you should continue to see improvement in mix. Gaylin, who's our new head of retail banking, is really doing a bang-up job in continuing to build upon the strength that already existed within the network, focusing on increased sales of products and services through the branch. He has introduced a building excellence program. There are now daily sales goals that are reporting on daily deposit growth. The branches in the coming weeks and months, as well as all employees in the organization, will fully understand how Pacific Trust Bank makes money and how their actions contribute to that.

So they will be delivering the great level of service that they've always done, but will be doing it armed with a lot of knowledge that makes them easier to ask for the business and to keep the relationship that we've already had. We also have a few other initiatives that we're working on to bring in increasing levels of non-interest bearing or non-CD accounts the first half of 2011. You know, we noted the improvement in the mix and in the cost of deposits, and cost of funds in the first quarter. We've also provided in the 10-K, which you'll see shortly, some increased guidance on maturities for the CDs, and some of the increased guidance on maturities for the federal home loan bank advances, so that should help you sort of anticipate what might happen to the Bank's cost of deposits and overall cost of funds for the balance of 2011.

Brett Villaume: Great. Thank you.

Gregory Mitchell: Thank you.

Brett Villaume: And then, finally, just a quick question on TDRs, and I loved the slide in your presentation. Thanks for that. I wanted to see if you could give me some color on whether or not we might see some of your performing TDRs run off soon?

Gregory Mitchell: Regan, you want to speak to that? Regan has laryngitis, so I'll jump in. One of the good things that happens to PacTrust is in July of this year, we'll go under the governance of the OCC. OTS tends to believe that once a TDR,

forever a TDR, and they really frown on reclassifying a TDR to pass, until the loan is paid off. So what we're trying to do now is include that enhanced reporting for you all, to show what effectively we're reconciling GAAP and traditional SEC reporting with our reporting requirements to the OTS. So you'll see in the bucket – I would expect that you'll see in the bucket where we show month by month breakdown in TDRs, you'll say that weighting heavily towards 12 months plus. But I think until that charter change occurs, we'll need to continue to report it as TDR.

Brett Villaume: Great. Great info. Thank you very much.

Operator: Your next question comes from Don Worthington with Howe Barnes Hoefer & Arnett.

Don Worthington: I just have one other question. You mentioned as part of these recap costs some partial payments. So do you have more recap costs that are coming in 2011?

Gregory Mitchell: Well, here's where that's at. The employees had change control agreements that provided for the receipt of from one year to – I don't even recall the numbers–

Hans Ganz: The max was 2.99 years.

Gregory Mitchell: The max was 2.99 years. So upon a change of control as classically defined that's more than 25 percent of the ownership changed hands and as part of this transaction that happened. What management allowed to occur as part of this transactions is that they – they agreed to accept just half in connection with the initial change in control. But they remain protected in the event that they leave or they are separated as a result of summary organization. The corporation has an obligation to pay them on an ongoing basis. Right now they're all here. And there's no need to provide for that eventuality at this stage.

Don Worthington: OK, great. Thank you.

Gregory Mitchell: But, a direct response to your question, if they all said Greg, we love you or don't love you and we're leaving tomorrow, I think our obligation would be $1.4 million or $1.6 million.

Hans Ganz: Probably $1.8 million, I think, $1.78 million.

Gregory Mitchell: So that hangs out there. And we specifically pointed out that 50 percent of that was paid because we wanted to disclose to the market that that liability remains out there.

Don Worthington: OK. Thank you.

Operator: Next question comes from Gary Tenner with D.A. Davidson.

Gary Tenner: Actually Don just took one of my questions, but just in terms of the (inaudible) reserve, went down quite a bit this quarter, obviously, you know, due the that one large charge-off, I guess, primarily, but as that – as we progress into 2011, what level do you think that could get down to? What's your sense of kind of where regulators may force you to keep that number over a longer period of time?

Gregory Mitchell: Well, that is sort of hard to predict. They are – they have certainly been comfortable with where they are at and I can't really speak to the levels of cushion that we may have in there today. My bias is to try to keep as much as possible in that provision. Part of what we've sort of forecasted is that I think in the new world banks are generally going to be required to have, regardless of the quality or composition of their portfolio a minimum of sort of 1.8 percent to 2 percent of loans.

So, I would never see it, quite frankly, dropping below 1.8 percent level and probably not likely to drop much below 2 percent level, forever. And I think that in the new world FAS 5 and FAS 114, notwithstanding, I think the accountants will support that, unless and until there's substantial improvement and sustained improvement in the US and global economy. There is just too much risk out there to allow for banks to go back to the traditional A Triple L levels. Is that responsive?

Gary Tenner: Yes, thank you. And just a follow-up on the question earlier about personnel expenses. I think you had mentioned you expect it to be $4 million higher in 2011 than in 2010. I assume that that's ex the $3.1 million of special costs in the fourth quarter.

Gregory Mitchell: Correct.

Gary Tenner: Great. Thank you very much.

Operator: At this time there are no further questions. You may continue with your presentation or closing remarks.

Gregory Mitchell: Well, once again, hopefully you've sort of heard from me in my opening remarks, and in my response, to some of these questions, my level, personal level of excitement, about what we have here today at First PacTrust Bancorp and the Bank and the promise that stands before us in the future. I think we've got a lot of building yet to do and we're working hard to do that. I'm particularly appreciative of management and the Board and some of our advisors who helped us immensely in achieving a great deal of work in over the past three to four months. And, you know, as I often sign off on communication to staff, now, as a firm believer in the promise of the future, I believe the best is yet to come.

So I thank all of you for joining us on this journey. For the analysts that are on the call, I thank you all for helping us improve transparency. Some of the comments that you've seen in the 8K and in the investor presentation, came from advice and counsel that you have given us, and we look forward to having an even more enhanced level of transparency, and relationship with our shareholders in the capital markets. Because we work together and, you know, we work to create something great. So thank you all again, and we look forward to seeing you in the months to come.

Operator: This concludes today's conference call.

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