CEOCFO Interviews & News!

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First State Bancorporation's focus on bottom-line profitability should enable EPS to grow by 15 to 20% over the next couple of years, according to FTN Midwest Securities

Financial
Regional Banks

Analyst Interview Covering:
First State Bancorporation
(FSNM-NASDAQ)
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BIO:

Mr. Green began his career in the brokerage industry in 1993 and has been a research analyst since 1996. As an equity analyst he has focused on the banking industry since 1998.

Mr. Green joined FTN Midwest Securities Corp.'s Nashville, Tennessee, office on August 27, 2001. Since, he has been responsible for building the firm's coverage of small and mid cap financial institutions, which covers approximately 150 banks and thrifts across the U.S. His current coverage universe includes 24 banks and thrifts with market capitalizations of $400 million to $4.2 billion in the Southeast, Midwest, Inter-Mountain West, and Northeast. He has been routinely quoted in newspapers, business journals, and banking industry publications, both nationally and throughout the Southeast, about both general industry and specific company issues.

For his stock picking in 2002, Mr. Green was recognized as a Top 10 Stock Picker in the United States by NASDAQ-STARMINE 2002 Analyst Award Winner survey. Also, he was listed as a Top 5 analyst for Stock Picking Among Under-Covered Stocks in the NASDAQ-STARMINE survey. In May 2003, Mr. Green was listed as the third best among 97 analysts that covered Banks and S&Ls in *The Wall Street Journal's* Best on the Street survey for his stock picks in 2002.

About FTN Midwest Securities Corp:
FTN Midwest Securities Corp (MWRE) is a wholly owned subsidiary of First Tennessee Bank National Association which offers securities and investment products and services, including investment banking services, through its subsidiaries and affiliates. Additional information is available upon request. MWRE is a member of the NASD and SIPC www.sipc.org.

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Interview conducted by:
Lynn Fosse, Senior Editor
CEOCFOinterviews.com

CEOCFO: Mr. Green, please tell us a bit about what you follow in general and your interest in First State Bank Corp.
Mr. Green: "Our firm covers approximately 150 banks and savings and loans across the US. First State Bancorporation (FSNM-Nasdaq) is just one of 24 companies that I cover. My coverage list goes from the intermountain west into the Midwest primarily between Green Bay, Chicago and Kansas City, down into the southeast into Louisiana and Mississippi, and then into Florida and the northeast into New York, New Jersey and Massachusetts as well. Basically, we have multiple analysts across each geographical section of the nation, which is unusual compared to the regional approach that most firms take."

CEOCFO: What makes you choose a bank to cover, in general, and why have you chosen First State Bancorporation in particular?
Mr. Green: "We have tried to cover banks that are currently or will be institutionally significant. Our research focus is toward providing institutional investors with high quality research on financial institutions. First State has been a bank that we thought, over the years, would post very strong balance sheet and earnings growth, which would make it attractive to institutional investors. That is why we added the Company our coverage about five years ago."

CEOCFO: What do you like about First State Bancorporation today?
Mr. Green: "Our outlook for the company reflects that management should be able to grow the balance sheet by 12 to 15% over the next 3 to 4 years, which seems likely to be a far more challenging banking environment compared to the strong economic environment that has existed over the past 4 or 5 years. We feel 10% balance sheet growth will look pretty good over the next couple of years, maybe even 3 years. We believe that First State will do better than that given its concentration in the inter-mountain West. Separately, management's focus on improving bottom-line profitability, should enable earnings per share ("EPS") to grow 15 to 20% over the next couple of

years; coupled with the pullback in the valuation over the past six months, the opportunity for above average top-line and bottom-line revenue and EPS growth makes the shares particularly interesting in our opinion. Again, we believe top line balance sheet growth should be 10%-plus and bottom line growth should approach 15 to 20%."

CEOCFO: How is First State handling recent acquisitions; do you see that as a challenge?

Mr. Green: "Acquisitions are always challenging for even the best acquirers. First State historically has not been very acquisitive. In the last eighteen months they have done three acquisitions. To some degree, the two acquisitions that they completed last year were in New Mexico and represented more in-footprint type acquisitions. The acquisition of Front Range Capital in Colorado is in-footprint in the context that they did have a Colorado operation, but will take a fair amount of reengineering to benefit the bottom line. Importantly, the purchase gives First State a more coherent focus and market share in the attractive Boulder County area, which represented about 65% of Front Range's overall Colorado franchise. The two acquisitions First State completed last year should prepare management to deal with the integration of Front Range in more efficient manner. All integrations have their own challenges, but results were in line to actually slightly better than we expected in 1Q07, which included one month of Front Range's results. The real bottom-line benefit will come once management gets the back office consolidated and the technology platforms converted all onto First State's system, which should happen in early July. We will see the first signs of true and full progress in the third quarter rather than the second quarter, however."

CEOCFO: What are they doing to drive the bottom line growth?

Mr. Green: "I think the bottom line will benefit from the solid economic environment across its footprint in New Mexico, Colorado, and Arizona and in management's focus on eliminating inefficiencies throughout the company. Historically, the Company has been very capable at banking commercial deposit and loan relationships. With over 50 branches, to the extent that they can get some retail deposit growth, which has never been much of a focus, balance sheet growth could positively surprise. Over the past nine months or so, their commercial customers have been using more of their liquidity to support their own growth, making it more difficult for First State to grow deposits. For the past 18 months, CEO Mike Stanford has focused on looking at the entire company and saying, 'Okay, we are a $3 billion asset commercial bank and we are now operating in New Mexico, which is our strongest market position, Colorado secondarily, which is a developing market, and our start-up position in Arizona. What should we look like as a $3 billion regional bank?' As a result, they have gone through their entire organization and benchmarked themselves against peers and tried to look at industry best practices and say, 'These are the ones that will work for us, let's go back to implementing those into our management process.' In some respects they will actually manage the head count lower by utilizing technology to streamline the back office; however, with respect to the front line, management is in the process of moving all of their commercial bankers to a quarterly incentive plan. In our opinion, the quarterly incentive will result in a more focused front line corps of bankers and management team. Although we can't quantify it, we believe it is a great strategy to energize its existing workforce and, potentially, a great tool to recruit additional bankers with. We believe the new program will enable First State grow deposit and loan volumes at an above average rate. Also, it represents a more thoughtful and intensive management process. They will definitely have a conversation every ninety days with their bankers about what they are doing very well and what needs work. It gives you four opportunities to have a heart-to-heart conversation in contrast to the typical annual chat under the more common salary and annual bonus structure that a good portion of the industry operates. We are excited about that. From a two or three year perspective of keeping an above average growth rate for the balance sheet and improving profitability, we believe it is the correct strategy."

CEOCFO: Please tell us about the management team.

Mr. Green: "The CEO, Michael R. Stanford, along with COO, H. Patrick Dee, have been with the company since the early days. What is most impressive is that they took a community bank with a strong position in Taos, which is not a growth market, and have created the largest local bank in Albuquerque, after starting basically from scratch. Back in 1994 when they moved into Albuquerque, they had maybe 1% market share, which has blossomed into 14%, positioning First State as the third largest bank in the MSA and the largest local bank. Over

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CEOCFO: What should potential investors be looking at about First State?
Mr. Green: "A concern right now and one that has caused some pressure on the stock is the fact that credit quality has deteriorated. A large portion of the credit quality slip has resulted from the acquisition of Front Range Capital. The slip was not unexpected, but perhaps the magnitude was. However, we would note that management reclassifies all of an acquired bank's loans in-line with First State's, which has been more rigorous. This happened after the purchase of First Community Industrial Bank in 2002, too. At the time, a very pronounced spike in past dues and NPLs was seen; however, First State's management actively managed credit and reduced NPLs and past dues significantly over the following 12 months, with minimal charge-offs. We think that is going to happen in the case of Front Range Capital, too. Still, it bears watching and represents a material potential risk to our notion that management will be able to improve the profitability of First State's legacy operation and Front Range at the same time. The greatest opportunity stems from management's focus on small-to-middle market commercial segment of the economy, which is the strongest segment currently. Given its focus on high touch service and community involvement, First State should be very well positioned to siphon market share from the Super-Regional banks that dominate the landscape in New Mexico, Colorado, and Arizona. Their focus, along with their capital base, gives them the ability to bank just about any commercial relationship that they want to bank, usually in a higher quality fashion than the smaller community or larger mega banks can."

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CEOCFO: They are in a good spot?
Mr. Green: "Should be."

CEOCFO: What is your current rating?
Mr. Green: "We have a 'buy' rating on First State Bancorporation, which means we think the stock can outperform other bank stocks over the next twelve months."

CEOCFO: What are your final thoughts on First State?
Mr. Green: "Our impression is that if they do not get the integration of Front Range Capital done as expected and do not get to a solid operating level with respect to their own operations, that the management team would be open to maximizing value through the sale of the company. That is not something that they have ever managed the company for, but because they have managed to grow a very good banking franchise, we think the result would be a premium to the common price if they decided to go down that road. In the inter-mountain West there are very few multi-billion dollar bank franchises—placing a fair amount of scarcity value on First State. We do not think that much of the scarcity value is reflected in the current share price."

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