August 13, 2012

Capital raise critical to Capitol Bancorp's future

The success of Lansing, Mich.-based Capitol Bancorp Ltd.'s prepackaged Chapter 11 reorganization plan hinges on the company's ability to raise capital—a move that observers believe could be a daunting task.

Capitol's plan contemplates an equity infusion of at least $70 million and up to $115 million, pursuant to a separate equity commitment agreement to be entered into with certain third-party investors.

In a Form 8-K filed on Aug. 9, Capitol said it has been "actively seeking" external capital sources to help restore all affiliate institutions to "well-capitalized" status in exchange for approximately 47% of the restructured company. This capital can be immediately deployed into the reorganized company's subsidiary banks, "thus avoiding the disastrous consequences that would result from the seizure of any subsidiary bank," the filing stated.

The company's Form 10-Q, also filed Aug. 9, called the anticipated equity infusion from outside investors "a critical component" of the likelihood of the reorganization plan succeeding, but suggested that Capitol has not lined up any investors yet.

"[C]apitol has not secured written commitments for the equity infusion as of the date of this quarterly report," the filing stated. "If Capitol is unable to raise capital from new investors, or raise less than the amount currently anticipated, it may be forced to operate in the Chapter 11 Cases for an extended period while trying to develop a different reorganization plan that can be confirmed."

A spokeswoman for Capitol declined to comment on the anticipated timeline for the capital raise.

"We get the sense that if they had anything firmed up, they probably wouldn't be keeping it from us right now. They'd probably be telling everybody about it," said Michael Nichol, a portfolio manager at Hildene Capital Management LLC. Hildene holds multiple CDOs in which Capitol is an asset.

Capitol Bancorp Ltd.'s banking subsidiaries

Subsidiary	City, state	Tier 1 leverage ratio (%)	Significantly under capitalized?
Indiana Community Bank	Goshen, IN	7.54	No
Capitol National Bank	Lansing, MI	6.60	No
High Desert Bank	Bend, OR	5.66	No
Bank of Maumee	Maumee, OH	4.55	No
Michigan Commerce Bank	Ann Arbor, MI	2.44	Yes
1st Commerce Bank	North Las Vegas, NV	2.27	Yes
Sunrise Bank of Albuquerque	Albuquerque, NM	2.10	Yes
Sunrise Bank	Valdosta, GA	2.05	Yes
Sunrise Bank of Arizona	Phoenix, AZ	2.04	Yes
Central Arizona Bank	Scottsdale, AZ	2.03	Yes
Pisgah Community Bank	Asheville, NC	2.03	Yes
Bank of Las Vegas	Henderson, NV	2.01	Yes

As of Aug. 10, 2012
Includes all those subsidiaries for which capital adequacy ratios were listed in Capitol Bancorp Ltd's Form 10-Q for the quarter ended June 30, 2012.
Significantly undercapitalized is defined as not meeting the criteria for undercapitalized, which in turn is defined as having a total risk-based capital ratio of 6% or more and Tier 1 leverage and Tier 1 risk-based ratios of 3% or more. However, the institution does have a Tier 1 leverage ratio of 2% or more.
Source: SNL Financial, Capitol Bancorp Ltd. Form 10-Q for the quarter ended June 30, 2012

Steven Kent of River Branch Capital LLC is the financial adviser to Capitol in the execution of its plan. Kent said the company has made progress in executing the capital component of its plan. He said the fact that Capitol has not reported any written commitments should not be seen as a red flag.

"The plan has just been initiated, so the fact that we don't have any commitments at this stage is anticipated. We're in the marketing process," Kent told SNL.

Kent said that elements of Capitol's plan, like the debt exchange and the planned bulk sale of nonperforming loans, should make the company attractive to potential investors.

The company's plan contemplates the conversion of all current trust preferred security holders, unsecured senior note holders, current preferred equity shareholders and current common equity shareholders into new classes of common stock that will retain approximately 53% of the voting control and value of the restructured company.

Capitol also continues to seek a bulk sale of its nonperforming assets and nonperforming loans to third parties.

"Those two actions provide for enhanced risk-return characteristics for the investment," Kent said.

John Donnelly, a managing director of Donnelly Penman & Partners, agreed that the debt exchange should attract investors. "There were four or five people ahead of the equity investor — the trust preferred holders, the preferred holders, the senior note holders," Donnelly said. "There's a much clearer path for the equity

Capitol Bancorp's future *continued*

investor now that some of this debt has been extinguished."

Nichol also believes that Capitol made the right move. "The bankruptcy process is a necessary means to facilitate this type of a money raise. There is certainly a negative stigma typically attached to bankruptcies, but Capitol is going about it the right way with the [plan] that they've put forward," he said.

Nichol said Capitol's ability to raise capital will depend largely on its ability to preserve its deferred tax assets, which are valuable to potential investors. There is no guarantee that Capitol will be able to do so, but Nichol was optimistic about the company's chances.

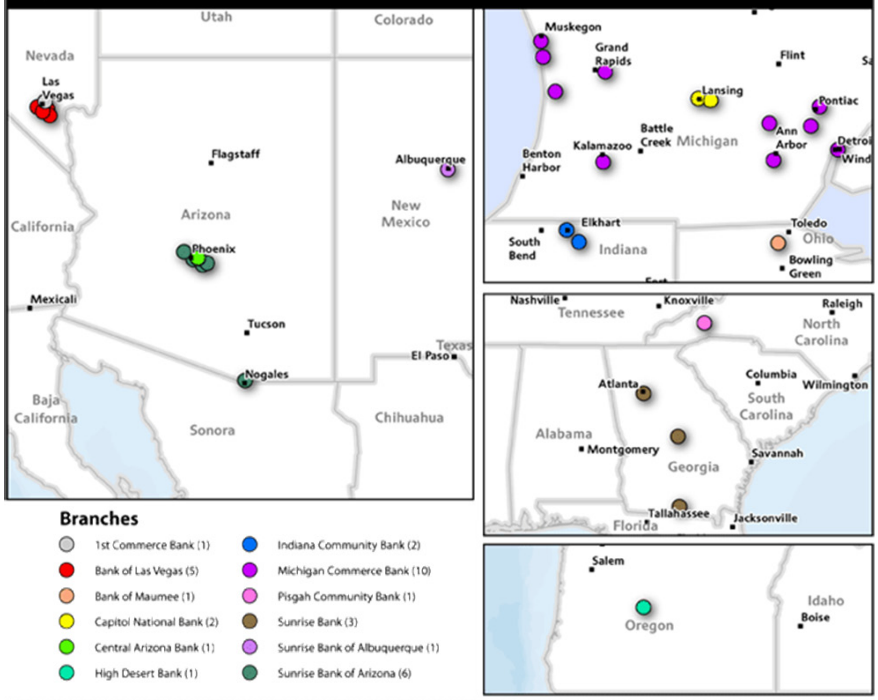
Others highlighted the potential headwinds facing Capitol. Ken Kohler, senior of counsel at Morrison & Foerster LLP, said raising the funds could be a "daunting proposition" for Capitol, which has already spent years trying to boost its capital levels.

"It's always a daunting challenge for a company in bankruptcy to raise capital. Obviously while it's in bankruptcy there's a lot of uncertainty about what the outcome of the bankruptcy is going to be," Kohler said. "Also, the company is by definition a distressed company, so you're already talking about a tough sell to investors."

Industry observers that SNL spoke to could think of few instances of bank holding companies filing for bankruptcy and then successfully raising capital. One company that tried and failed at this approach was Nexity Financial Corp., which filed for bankruptcy protection with a proposed Chapter 11 plan that contemplated raising substantial new capital. That plan fell through and unit Nexity Bank failed in April 2011.

Several sources did point to AmericanWest Bancorp. as an example of a bank holding company using the bankruptcy process to save its subsidiaries. In December 2010, Spokane, Wash.-based AmericanWest Bancorp. sold unit AmericanWest Bank to an investor group led by SKBHC Holdings LLC under Section 363 of the bankruptcy code.

Capitol Bancorp Ltd. branches



Capitol Bancorp Ltd. branches are pro forma for openings/closings and completed mergers and acquisitions since June 30, 2011.
Includes all those subsidiaries for which capital adequacy ratios were listed in Capitol Bancorp Ltd.'s Form 10-Q for the quarter ended June 30, 2012.
As of Aug. 10, 2012
Source: SNL Financial

SNLFinancial

The AmericanWest and Capitol situations do differ in some key ways. AmericanWest lined up a buyer before entering bankruptcy, making the process much easier, said Kohler, who represented AmericanWest in its sale to SKBHC Holdings.

AmericanWest also took a different approach to TruPS. "[Capitol's plan is] very different from the AmericanWest plan that went forward, where the TruPS were shut out," said Hildene's Nichol. "In this case the way it's being structured the TruPS will get a stake in some meaningful recovery if they're able to raise money."

While the structure of AmericanWest's bankruptcy differs from Capitol's approach, Kohler believes the two may have had the same underlying motivation. In both cases, the companies faced impediments due to their debt structure.

"It certainly addresses a similar problem that bank holding companies are having, which is how to deal with the drag on their balance sheet created by legacy debt and trust preferreds," said Kohler.

Observers that SNL spoke to tended to agree: While the structure of Capitol's plan could attract investors, the company has its work cut out for it to raise the necessary funds.

As Donnelly said, "It doesn't guarantee success, but it at least sets the table."

By Lindsey White, Andrew Wolcott and Tahir Ali