CEOCFO Interviews & News!

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Exiting The Utah Market Will Allow First State Bancorporation To Focus On Their Credit Quality And Their Core New Mexico, Colorado And Arizona Markets Where The Economy Is Generally Above The National Average

Financial
Regional – Southwest Banks

Analyst Interview Covering
First State Bancorporation
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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.

Important: All disclosures can be located on our website at http://www.ftnmidwest.com/disclosures/index.asp

Company Profile:
First State Bancorporation (NASDAQ: FSNM) is a New Mexico based commercial bank holding company that provides services to customers from a total of 62 branches located in New Mexico, Colorado, Utah and Arizona. Through its wholly owned subsidiary First Community Bank, First State's strategy is to provide a business culture that offers individualized customer service. First State's flexible approach, which combines direct access to decision makers, the latest in technology, a wide menu of product offerings, and increasingly convenient branch locations, has allowed First State to profitably capture market share made available because of customer dissatisfaction caused by consolidation in the banking industry.

First Community Bank, which has been in operation since 1922, is a state chartered, community focused bank providing a full range of commercial banking services to small and medium size commercial businesses in New Mexico, Colorado, Utah and Arizona. They offer a full range of financial services to commercial and individual customers, including checking accounts, short- and medium-term loans, revolving credit facilities, inventory and accounts receivable financing, equipment financing, residential and small commercial construction lending, residential mortgage loans, various savings programs, installment and personal loans, safe deposit services and credit cards.

Interview conducted by:
Lynn Fosse, Senior Editor
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CEOCFO: Mr. Green, how has the universe changed for you over the past year and what are the challenges in covering this particular sector?
Mr. Green: "A year ago we were certainly worried about the state of the economy and the housing market specifically. The housing market has obviously declined over the past year in terms of sales of existing and new homes in most markets. In addition, prices have come down significantly compared to price pull backs that we've seen in the past. For many of the community and regional banks that we cover, a significant portion of their

balance sheet growth over the past five years was because of increased relationships to construction companies and developers of residential property. Commercial property development and construction has increased more recently, which might spell trouble down the road if the economy further softens. So far, residential construction and development has caused almost all of the credit issues. It is a much more difficult world that we live in today compared to a 12 to 18 months ago when conditions were still benign. Going forward, given our outlook that the overall economy will continue to slow, we have more concerns about credit quality and the profitability of the banks and thrifts we cover. As a result, balance sheet growth is out the window for most companies over the next year to eighteen months."

CEOCFO: Tell us about First State Bancorporation today.

Mr. Green: "Looking at First State's credit quality metrics, management is dealing with their fair share of problems. Like many of the banks we cover, their nonperforming loans are related to residential construction and development projects. We believe that management has tried to be aggressive (and early) in their identification process of potential problems and to position the Company to deal with the problems in the portfolio before it is too late. Often times, in managing through a difficult economy, your best loss is your first loss; however, bankers tend to be slow to recognize transitions in the cycle, which magnifies losses in problem loans that are held too long in hopes that the economy will improve sooner rather than later. The good news is that we feel like their local markets, even though they may be slowing down, in New Mexico and Colorado will remain much stronger than the United States as a whole. Certainly, we believe that most of their markets in Colorado and New Mexico will be much better than markets in California, Florida, Nevada or Phoenix, where the conditions are down right nasty. At the end of the day, we believe that the sting from the recognition of weaker credit quality is more than adequately reflected in the stock price. If management can show improvement in credit quality going forward, then the stock could be a strong performer on an absolute basis and compared to other banks."

CEOCFO: Would you tell us about some of the things that they are doing to better their position?

Mr. Green: "On July 7th they announced that they are going to basically run-off their balance sheet in Utah, which represented assets of $310 million, or 10% of FSNM's total assets. The Utah operation provided for strong loan growth over the past few years, but deposit growth was negligible; specifically, loans represented 11% of FSNM's loan balances, but deposits only represented 0.8% of total deposits. Unlike Utah, their banking effort in New Mexico has always provided for more deposit growth than the Company could lend. The attractiveness of the Colorado market historically was that they could use their "excess" deposits from New Mexico to fund "excess" loan growth in Colorado, until deposit growth picked up, too. Historically, the bank has done a great job of growing low-cost and non-interest bearing deposits in New Mexico, due to their strong relationships with their commercial customers. In the last 24 months they have shown fairly significant progress on that front in Colorado, as the loan to deposit ratio improved to approximately 110% versus 150% two years ago. Although loan growth in Arizona has outstripped deposit growth over the past year, Arizona's deposit base funds its loan portfolio. In looking at the franchise from a perspective that the availability of capital will be constrained, FSNM's New Mexico, Colorado, and Arizona banks could all stand on their own. Utah could not, so it becomes the odd man out, given the strategic need to preserve capital, increase capital ratios and returns, and reduce risk."

CEOCFO: What is the management doing that has allowed them to take these forward thinking steps?

Mr. Green: "After going down a growth path for the past decade, which resulted in expansion of the footprint, it is always a very difficult decision for any management team to pare back. However, that is what the situation dictates. With the shares trading hands for approximately 65% of tangible book value ($8.98 per share at June, 30, 2008), the market is not giving FSNM credit for being more clinical about their underperforming situation. We believe this presents risk-tolerant investors with an interesting opportunity to pick-up a solid commercial bank at a bargain basement price. However, in fairness, management needs to execute and the economy needs to hold up relatively well. If both occur, we believe that valuation could improve to 1.5x to 2.0x tangible book value over the next two years."

CEOCFO: What is the financial picture like for First State Bancorporation today?

Mr. Green: "Like many banks, First State Bancorporation was focused on growth for the better part of the 1990's and certainly this decade. Over this time period, banks were able to raise capital easily, either through offerings of common equity or trust preferred securities (a form of debt that can be treated as equity capital from a regulatory perspective). Over the past year, the trust-preferred market has shutdown for all but the largest banks in the country. With FSNM's current valuation, an equity raise represents the least attractive alternative. Therefore, they are going to have to improve earnings and shrink the balance sheet to improve capital. With heightened operational and a tighter geographical focus in their three core markets of New Mexico, Colorado and Arizona, we believe their chances for success have improved."

"First State Bancorporation is buy-rated given a discounted valuation approximating 65% of tangible book value and our belief that the Company will get past its recent credit quality woes and return the franchise to solid profitability and strong EPS growth. Based on our analysis, we believe that the economy in New Mexico will be stronger than most expect. Also, the Colorado economy should outperform the national economy." - Peyton N. Green

CEOCFO: Are their customers supportive?

Mr. Green: "I think so. They are a very relationship oriented bank and it does not seem like they have a customer service problem at all. In New Mexico, being the largest locally owned bank is a very defendable position. With a well built out footprint in New Mexico and an improved one in Colorado, we believe FSNM is better positioned than they have been in the past."

CEOCFO: What is your rating for First State?

Mr. Green: "First State Bancorporation's shares are rated a buy. We feel that the underlying economy in New Mexico is stronger than most people give credit. We think Colorado is certainly better than the national average, too. Although FSNM has had their share of hiccups in Colorado, we believe that the Company is better positioned than it has ever been. Considering that its presence in New Mexico represents about 65% of the franchise, improved performance would be magnified. Colorado, which accounts for about 20% of the franchise, should continue to gradually improve. In the Arizona market (5% of assets), management has taken a cautious stance, focused growing its commercial customer base that would look more like its non-development customers in New Mexico or Colorado. Although overall balance sheet growth will be flat to negative, management will remain focused on improving commercial (non-real estate) loan growth and deposit growth, too. We think that this is the right approach and our basic thought is that the recovery potential based on the current valuation represents a double in the stock price over the next 12 to 18 months."

CEOCFO: In closing, when might we see M&A activity again?

Mr. Green: "Few acquisitions have happened on a year-to-date basis; unfortunately, we are not optimistic over the next year. Buyers remain very apprehensive about the credit quality of others, especially considering that their own credit quality issues are mounting. At some point, probably late in 2009 or 2010, we would expect that M&A activity will pick-up once credit trends stabilize. Until then, the market will remain skeptical about bank stocks, until bankers string together a couple of solid quarters. If the New Mexico economy continues to outperform and the Colorado economy holds up fairly well, FSNM has a relatively solid outlook. No one is talking about this, but what if Arizona starts to stabilize or improves? What would happen to FSNM? We believe FSNM is well positioned to benefit from a vibrant Inter-Mountain West economy. FSNM represents one of only a handful of sizable, publicly-traded bank franchises in the region. If management does not show meaningful progress, we would not be surprised to see FSNM end up in the "cross hairs" of a would-be buyer."

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