

CULLEN FROST BANKERS INC
Form 10-Q
October 25, 2006

United States Securities and Exchange Commission
Washington, D.C. 20549

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Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: September 30, 2006

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number: 0-7275

Cullen/Frost Bankers, Inc.

(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of
incorporation or organization)

74-1751768
(I.R.S. Employer
Identification No.)

100 W. Houston Street, San Antonio, Texas
(Address of principal executive offices)

78205
(Zip code)

(210) 220-4011

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [] No []

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer []

Accelerated filer []

Non-accelerated filer []

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes [] No []

As of October 19, 2006, there were 55,915,888 shares of the registrant's Common Stock, \$.01 par value, outstanding.

Cullen/Frost Bankers, Inc.
Quarterly Report on Form 10-Q
September 30, 2006

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Part I. Financial Information

Item 1. Financial Statements (Unaudited)

Cullen/Frost Bankers, Inc.

Consolidated Statements of Income

(Dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Interest income:				
Loans, including fees	\$ 131,006	93,071 370,304	254,103	
Securities:				
Taxable	32,404	30,137	99,159	91,965
Tax-exempt	2,822	2,710	8,342	7,833
Interest-bearing deposits	61	49	153	100
Federal funds sold and resell agreements	10,114	4,231	24,027	9,380
Total interest income	176,407	130,198	501,985	363,381

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Interest expense:

Deposits	42,277	20,502	109,959	52,659
Federal funds purchased and repurchase agreements	8,353	4,557	23,008	10,825
Junior subordinated deferrable interest debentures	4,439	3,796	12,845	10,938
Subordinated notes payable and other borrowings	2,812	2,058	8,239	5,493
Total interest expense	57,881	30,913	154,051	79,915

Net interest income	118,526	99,285	347,934	283,466
Provision for possible loan losses	1,711	2,725	10,750	7,300
Net interest income after provision for possible loan losses	116,815	96,560	337,184	276,166

Non-interest income:

Trust fees	15,962	14,463	47,460	43,294
Service charges on deposit accounts	19,301	20,173	57,974	59,002
Insurance commissions and fees	7,204	7,389	22,323	22,192
Other charges, commissions and fees	6,558	6,135	20,668	17,008
Net gain (loss) on securities transactions	-	-	(1)	-
Other	10,871	9,894	32,495	32,330
Total non-interest income	59,896	58,054	180,919	173,826

Non-interest expense:

Salaries and wages	48,743	41,818	142,312	122,272
Employee benefits	10,882	9,973	35,492	32,325
Net occupancy	8,964	8,111	25,909	22,863
Furniture and equipment	6,553	6,202	19,212	17,929
Intangible amortization	1,293	1,050	3,957	3,699
Other	26,505	24,838	76,448	72,841
Total non-interest expense	102,940	91,992	303,330	271,929

Income before income taxes	73,771	62,622	214,773	178,063
Income taxes	23,769	20,167	69,544	57,557

Net income	\$ 50,002	42,455	145,229	120,506
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Earnings per common share:

Basic	\$ 0.90	\$ 0.81	\$ 2.64	\$ 2.32
Diluted	0.88	0.79	2.58	2.26

See Notes to Consolidated Financial Statements.

Cullen/Frost Bankers, Inc.

Consolidated Balance Sheets

(Dollars in thousands, except per share amounts)

	September 30, 2006	December 31, 2005	September 30, 2005
Assets:			
Cash and due from banks	\$ 558,997	\$ 873,015	\$ 562,107
Interest-bearing deposits	2,279	6,438	2,773
Federal funds sold and resell agreements	1,016,650	1,033,975	785,625
Total cash and cash equivalents	1,577,926	1,913,428	1,350,505
Securities held to maturity, at amortized cost	10,625	12,701	13,685
Securities available for sale, at estimated fair value	2,770,409	3,059,111	2,667,684
Trading account securities	8,024	6,217	5,937
Loans, net of unearned discounts	6,516,256	6,085,055	5,709,519
Less: Allowance for possible loan losses	(85,667)	(80,325)	(77,117)
Net loans	6,430,589	6,004,730	5,632,402
Premises and equipment, net	202,717	182,356	175,012
Goodwill	246,957	168,983	100,404
Other intangible assets, net	21,117	14,903	10,302
Cash surrender value of life insurance policies	110,673	102,604	101,655
Accrued interest receivable and other assets	268,377	276,404	222,643
	\$ 11,647,414	\$ 11,741,437	\$ 10,280,229
Total assets			

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Liabilities:

Deposits:

Non-interest-bearing demand deposits	\$ 3,380,986	\$ 3,484,932	\$ 3,201,929
Interest-bearing deposits	5,889,462	5,661,462	5,080,871
Total deposits	9,270,448	9,146,394	8,282,800
Federal funds purchased and repurchase agreements	725,779	740,529	608,174
Subordinated notes payable and other borrowings	171,427	188,617	150,678
Junior subordinated deferrable interest debentures	229,898	226,805	226,805
Accrued interest payable and other liabilities	128,441	456,856	115,019
	10,525,993	10,759,201	9,383,476

Total liabilities

Shareholders' Equity:

Preferred stock, par value \$0.01 per share; 10,000,000 shares authorized; none issued	-	-	-
Junior participating preferred stock, par value \$0.01 per share; 250,000 shares authorized; none issued	-	-	-
Common stock, par value \$0.01 per share; 210,000,000 shares authorized; 55,820,763 shares, 54,961,616 shares and 53,561,616 shares issued	558	550	536
Additional paid-in capital	324,534	279,627	216,966
Retained earnings	853,738	776,193	754,798
Accumulated other comprehensive income (loss), net of tax	(57,409)	(50,442)	(31,715)
Treasury stock, no shares, 478,881 shares and 905,097 shares, at cost	-	(23,692)	(43,832)
	1,121,421	982,236	896,753
Total shareholders' equity	\$ 11,647,414	\$ 11,741,437	\$ 10,280,229

Total liabilities and shareholders' equity

See Notes to Consolidated Financial Statements.

Cullen/Frost Bankers, Inc.

Consolidated Statements of Changes in Shareholders' Equity

(Dollars in thousands, except per share amounts)

	Nine Months Ended September 30,	
	2006	2005
Total shareholders' equity at beginning of period	\$ 982,236	\$ 822,395
Comprehensive income:		
Net income	145,229	120,506
Other comprehensive income:		
Change in unrealized gain/loss on securities available for sale of \$(9,758) in 2006 and \$(32,202) in 2005, net of reclassification adjustment of \$1 in 2006 and tax effect of \$(3,415) in 2006 and \$(11,271) in 2005	(6,342)	(20,931)
Change in accumulated gain/loss on effective cash flow hedging derivatives of \$(963) in 2006 net of tax effect of \$(338)	(625)	-
Total other comprehensive income	<u>(6,967)</u>	<u>(20,931)</u>
Total comprehensive income	138,262	99,575
Stock option exercises (1,404,780 shares in 2006 and 1,044,595 shares in 2005)	37,270	25,286
Stock compensation expense recognized in earnings	7,030	1,333
Excess tax benefits related to stock compensation	14,563	8,279
Purchase of treasury stock (66,752 shares in 2006 and 311,928 shares in 2005)	(3,580)	(14,946)
Cash dividends (\$0.98 per share in 2006 and \$0.865 per share in 2005)	<u>(54,360)</u>	<u>(45,169)</u>
Total shareholders' equity at end of period	<u>\$ 1,121,421</u>	<u>\$ 896,753</u>

See Notes to Consolidated Financial Statements.

Cullen/Frost Bankers, Inc.
Consolidated Statements of Cash Flows
(Dollars in thousands)

	Nine Months Ended	
	September 30,	
	2006	2005
Operating Activities:		
Net income	\$ 145,229	\$ 120,506
Adjustments to reconcile net income to net cash from operating activities:		
Provision for possible loan losses	10,750	7,300
Deferred tax expense (benefit)	(1,779)	1,227
Accretion of loan discounts	(7,593)	(4,827)
Securities premium amortization (discount accretion), net	(1,366)	(92)
Net (gain) loss on securities transactions	1	-
Depreciation and amortization	18,323	18,461
Origination of loans held for sale	(58,954)	(55,173)
Proceeds from sales of loans held for sale	59,171	57,183
Net gain on sale of loans held for sale and other assets	(1,633)	(2,375)
Stock-based compensation expense	7,030	1,333
Tax benefit from stock-based compensation arrangements	-	8,279
Excess tax benefits from stock-based compensation arrangements	(14,563)	-
Net proceeds from settlement of legal claims	-	(2,389)
Earnings on life insurance policies	(3,054)	(2,985)
Net change in:		
Trading account securities	(1,807)	(1,266)
Accrued interest receivable and other assets	9,902	(15,187)
Accrued interest payable and other liabilities	(320,790)	(25,676)
Net cash from operating activities	(161,133)	104,319
Investing Activities:		
Securities held to maturity:		
Maturities, calls and principal repayments	2,069	3,020
Securities available for sale:		
Purchases	(13,028,949)	(10,548,635)

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Sales	25,689	2,289
Maturities, calls and principal repayments	13,351,918	10,803,857
Net change in loans	(141,303)	(545,756)
Net cash paid in acquisitions	(61,016)	-
Proceeds from sales of premises and equipment	202	36
Purchases of premises and equipment	(21,055)	(15,711)
Benefits received on life insurance policies	-	6,553
Proceeds from sales of repossessed properties	1,571	2,813
Net cash from investing activities	129,126	(291,534)
Financing Activities:		
Net change in deposits	(257,529)	177,122
Net change in short-term borrowings	(20,669)	101,832
Principal payments on notes payable and other borrowings	(19,190)	(194)
Proceeds from stock option exercises	37,270	25,286
Excess tax benefits from stock-based compensation arrangements	14,563	-
Purchase of treasury stock	(3,580)	(14,946)
Cash dividends paid	(54,360)	(45,169)
Net cash from financing activities	(303,495)	243,931
Net change in cash and cash equivalents	(335,502)	56,716
Cash and equivalents at beginning of period	1,913,428	1,293,789
Cash and equivalents at end of period	\$ 1,577,926	\$ 1,350,505
Supplemental disclosures:		
Cash paid for interest	\$ 157,237	\$ 81,529
Cash paid for income taxes	54,099	41,945

See Notes to Consolidated Financial Statements.

Cullen/Frost Bankers, Inc.
Notes to Consolidated Financial Statements

(Table amounts are stated in thousands, except for share and per share amounts)

Note 1 - Significant Accounting Policies

Nature of Operations. Cullen/Frost Bankers, Inc. (Cullen/Frost) is a financial holding company and a bank holding company headquartered in San Antonio, Texas that provides, through its subsidiaries, a broad array of products and services throughout 12 Texas markets, including commercial and consumer banking services, as well as trust and investment management, investment banking, insurance, brokerage, leasing, asset-based lending, treasury management and item processing services.

Basis of Presentation. The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of Cullen/Frost and all other entities in which Cullen/Frost has a controlling financial interest (collectively referred to as the "Corporation"). All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies the Corporation follows conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry.

The consolidated financial statements in this Quarterly Report on Form 10-Q have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the Corporation's financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (SEC). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with the Corporation's consolidated financial statements, and notes thereto, for the year ended December 31, 2005, included in the Corporation's Annual Report on Form 10-K filed with the SEC on February 3, 2006 (the "2005 Form 10-K"). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for possible loan losses, the fair value of stock-based compensation awards, the fair values of financial instruments and the status of contingencies are particularly susceptible to significant change in the near term.

Stock-Based Compensation. On January 1, 2006, the Corporation changed its accounting policy related to stock-compensation in connection with the adoption of Statement of Financial Accounting Standards (SFAS) No. 123, "Share-Based Payment (Revised 2004)." See Note 12 - Stock-Based Compensation for additional information.

Comprehensive Income. Comprehensive income includes all changes in shareholders' equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of the Corporation's comprehensive income include the after tax effect of changes in the net unrealized gain/loss on securities available for sale, changes in the additional minimum pension liability and changes in the accumulated gain/loss on effective cash flow hedging instruments. Comprehensive income for the nine months ended September 30, 2006 and 2005 is reported in the accompanying consolidated statements of changes in shareholders' equity. The Corporation had comprehensive income of \$99.1 million and \$21.5 million for the three months ended September 30, 2006 and 2005. Comprehensive income during the three months ended September 30, 2006 included a \$48.8 million net after-tax gain due to a decrease in the net unrealized loss on securities available for sale and a

\$344 thousand net after-tax decrease in the accumulated loss on effective cash flow hedging derivatives. Comprehensive income during the three months ended September 30, 2005 included a \$20.9 million net after-tax loss due to an increase in the net unrealized loss on securities available for sale.

Reclassifications. Certain items in prior financial statements have been reclassified to conform to the current presentation.

Note 2 - Mergers and Acquisitions

The acquisitions described below were accounted for as purchase transactions with all cash consideration funded through internal sources. The purchase price has been allocated to the underlying assets and liabilities based on estimated fair values at the date of acquisition. The operating results of the acquired companies are included with the Corporation's results of operations since their respective dates of acquisition. Neither of the acquisitions had a significant impact on the Corporation's financial statements.

Texas Community Bancshares, Inc.

On February 9, 2006, the Corporation acquired Texas Community Bancshares, Inc. including its subsidiary, Texas Community Bank and Trust, N.A. ("TCB"), a privately-held bank holding company and bank located in Dallas, Texas. The Corporation purchased all of the outstanding shares of TCB for approximately \$32.1 million. The purchase price includes \$31.1 million in cash and approximately \$1.0 million in acquisition-related costs. Upon completion of the acquisition, TCB was fully integrated into Cullen/Frost and Frost Bank. As of September 30, 2006, the Corporation had a liability totaling \$2.3 million related to TCB shares that have not yet been tendered for payment.

Alamo Corporation of Texas. On February 28, 2006, the Corporation acquired Alamo Corporation of Texas ("Alamo") including its subsidiary, Alamo Bank of Texas, a privately-held bank holding company and bank located in the Rio Grande Valley of Texas. The Corporation purchased all of the outstanding shares of Alamo for approximately \$87.8 million. The purchase price includes \$87.0 million in cash and \$834 thousand in acquisition-related costs. Alamo was fully integrated into Frost Bank during the second quarter of 2006.

The total purchase prices paid for the acquisitions of TCB and Alamo were allocated based on the estimated fair values of the assets acquired and liabilities assumed as set forth below. The purchase price allocations are preliminary and are subject to final determination and valuation of the fair value of assets acquired and liabilities assumed.

	TCB	Alamo
Cash and cash equivalents	\$ 27,595	\$ 27,282
Securities available for sale	15,842	52,499
Loans, net	64,376	222,887
Premises and equipment, net	427	10,805
Core deposit intangible asset	3,762	6,410

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Goodwill	19,864	58,943
Other assets	3,661	5,494
Deposits	(101,298)	(280,285)
Other borrowings	-	(11,012)
Other liabilities	(2,134)	(5,191)
	<u>\$ 32,095</u>	<u>\$ 87,832</u>

The core deposit intangible assets acquired in these transactions are expected to be amortized over a period of 8 years. Additional information related to intangible assets and goodwill is included in Note 6 - Goodwill and Other Intangible Assets. Pro forma condensed consolidated results of operations assuming TCB and Alamo had been acquired at the beginning of the reported periods are not presented because the combined effect of these acquisitions was not considered significant.

Horizon Capital Bank. The Corporation previously reported the acquisition of Horizon Capital Bank ("Horizon"), a privately-held bank located in Houston, Texas in the 2005 Form 10-K. During 2006, the purchase price allocation was revised based on additional information related to the valuation of certain assets acquired and liabilities assumed. The revised total purchase price of \$109.2 million includes \$61.4 million of the Corporation's common stock (1.4 million shares), \$46.9 million in cash and \$996 thousand in acquisition-related costs primarily for professional fees. The purchase price paid for the acquisition was allocated based on the estimated fair values of the assets acquired and liabilities assumed. The purchase price allocation is still preliminary and subject to final determination and valuation of the fair value of assets acquired and liabilities assumed.

Summit Bancshares, Inc. On July 2, 2006, the Corporation and Summit Bancshares, Inc. ("Summit") entered into an Agreement and Plan of Merger (the "Merger Agreement") that provides for the merger of Summit with and into Cullen/Frost (the "Merger") and the subsequent merger of Summit Bank, a wholly-owned subsidiary of Summit, with and into The Frost National Bank, a wholly-owned subsidiary of Cullen/Frost.

Under the terms of the Merger Agreement, the consideration for the Merger will consist of approximately 3.8 million shares (assuming the treasury stock method of accounting for options before giving effect to any exercises in outstanding options) of Cullen/Frost's common stock, par value \$0.01 per share ("Cullen/Frost Common Stock"), and approximately \$143.4 million in cash. The Merger is intended to constitute a "reorganization" for United States federal income tax purposes. Consummation of the Merger is subject to receipt of requisite regulatory approvals. The Corporation expects to consummate the Merger in the fourth quarter of 2006.

Note 3 - Securities Held to Maturity and Securities Available for Sale

A summary of the amortized cost and estimated fair value of securities, excluding trading securities, is presented below.

September 30, 2006				December 31, 2005			
Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value

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Securities
Held to
Maturity:

U.S. government agencies and corporations	\$ 9,625	\$ 100	\$ 11	\$ 9,714	\$ 11,701	\$ 126	\$ 25	\$1,802
Other	1,000	-	14	986	1,000	-	12	988
Total	\$10,625	\$ 100	\$ 25	\$ 10,700	\$ 12,701	\$ 126	\$ 37	\$2,790

Securities
Available
for Sale:

U.S. Treasury	\$94,925	\$ -	\$ 494	\$ 94,431	\$ 84,897	\$ -	\$588	\$4,309
U.S. government agencies and corporations	2,412,945	3,354	48,922	2,367,377	2,710,445	6,632	40,974	2,676,103
States and political subdivisions	279,097	4,313	620	282,790	268,975	3,741	1,423	271,293
Other	25,811	-	-	25,811	27,406	-	-	27,406
Total	2,812,778	\$7,667	50,036	\$,770,409	\$3,091,723	\$ 10,373	42,985	3,059,111

Securities with a carrying value totaling \$1.8 billion at September 30, 2006 and \$2.1 billion at December 31, 2005 were pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law.

Sales of securities available for sale were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Proceeds from sales	\$ -	\$ -	\$ 25,689	\$2,289
Gross realized gains	-	-	117	-
Gross realized losses	-	-	(118)	-

As of September 30, 2006, securities, with unrealized losses segregated by length of impairment, were as follows:

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	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Held to Maturity						
U.S. government agencies and corporations	\$ 2,548	\$ 6	\$ 479	\$ 5	\$ 3,027	\$ 11
Other	-	-	986	14	986	14
Total	\$ 2,548	\$ 6	\$ 1,465	\$ 19	\$ 4,013	\$ 25
Available for Sale						
U.S. Treasury	\$ 9,966	\$ 1	\$ 84,465	\$ 493	\$ 94,431	\$ 494
U.S. government agencies and corporations	956,691	7,190	1,224,606	41,732	2,181,297	48,922
States and political subdivisions	2,122	4	33,612	616	35,734	620
Total	\$968,779	\$ 7,195	\$ 1,342,683	\$ 42,841	\$ 2,311,462	\$ 50,036

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Management has the ability and intent to hold the securities classified as held to maturity until they mature, at which time the Corporation will receive full value for the securities. Furthermore, management also has the ability and intent to hold the securities classified as available for sale for a period of time sufficient for a recovery of cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2006, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Corporation's consolidated income statement.

Note 4 - Loans

Loans were as follows:

	September 30, 2006	Percentage of Total	December 31, 2005	Percentage of Total	September 30, 2005	Percentage of Total
Commercial and industrial:						
Commercial	\$ 2,852,027	43.8 %	\$ 2,610,178	42.9 %	\$ 2,549,846	44.7 %
Leases	165,465	2.5	148,750	2.4	134,119	2.3
Asset-based	46,387	0.7	41,288	0.7	45,618	0.8
Total commercial and industrial	3,063,879	47.0	2,800,216	46.0	2,729,583	47.8
Real estate:						
Construction:						
Commercial	607,749	9.4	590,635	9.7	498,762	8.7
Consumer	104,781	1.6	87,746	1.4	54,595	1.0
Land:						
Commercial	352,775	5.4	301,907	5.0	242,490	4.2
Consumer	4,323	0.1	10,369	0.2	5,560	0.1
Commercial mortgages	1,494,114	22.9	1,409,811	23.2	1,334,096	23.4
1-4 family residential mortgages	97,453	1.5	95,032	1.5	72,002	1.3
Home equity and other consumer	470,088	7.2	460,941	7.6	439,367	7.7
Total real estate	3,131,283	48.1	2,956,441	48.6	2,646,872	46.4
Consumer:						
Indirect	2,150	-	2,418	-	2,665	-
Student loans held for sale	53,428	0.8	51,189	0.8	63,966	1.1
Other	276,219	4.2	265,038	4.4	256,358	4.5
Other	19,188	0.3	27,201	0.5	26,344	0.5
Unearned discounts	(29,891)	(0.4)	(17,448)	(0.3)	(16,269)	(0.3)
Total loans	\$ 6,516,256	100.0 %	\$ 6,085,055	100.0 %	\$ 5,709,519	100.0 %

Concentrations of Credit. Most of the Corporation's lending activity occurs within the State of Texas, including the four largest metropolitan areas of Austin, Dallas/Ft. Worth, Houston and San Antonio as well as eight other markets.

The majority of the Corporation's loan portfolio consists of commercial and industrial and commercial real estate loans. As of September 30, 2006, there were no concentrations of loans related to any single industry in excess of 10% of total loans.

Student Loans Held for Sale. Student loans are primarily originated for resale on the secondary market. These loans, which are generally sold on a non-recourse basis, are carried at the lower of cost or market on an aggregate basis.

Foreign Loans. The Corporation has U.S. dollar denominated loans and commitments to borrowers in Mexico. The outstanding balance of these loans and the unfunded amounts available under these commitments were not significant at September 30, 2006 or December 31, 2005.

Non-Performing/Past Due Loans. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations, which typically occurs when principal or interest payments are more than 90 days past due. Non-accrual loans totaled \$30.0 million at September 30, 2006 and \$33.2 million at December 31, 2005. Accruing loans past due more than 90 days totaled \$7.9 million at September 30, 2006 and \$7.9 million at December 31, 2005.

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Corporation will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectibility of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Impaired loans were as follows:

	September 30, 2006	December 31, 2005	September 30, 2005
Balance of impaired loans with no allocated allowance	\$ 8,204	\$ 8,491	\$ 9,058
Balance of impaired loans with an allocated allowance	15,518	17,520	19,462
Total recorded investment in impaired loans	\$ 23,722	\$ 26,011	\$ 28,520
Amount of the allowance allocated to impaired loans	\$ 6,672	\$ 8,811	\$ 9,881

The impaired loans included in the table above were primarily comprised of collateral dependent commercial loans. The average recorded investment in impaired loans was \$23.9 million and \$25.4 million during the three and nine months ended September 30, 2006 and \$28.8 million and \$27.8 million for the three and nine months ended September 30, 2005. No interest income was recognized on these loans subsequent to their classification as impaired.

Note 5 - Allowance for Possible Loan Losses

The allowance for possible loan losses is a reserve established through a provision for possible loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio, as well as trends in the foregoing. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Corporation's control, including the performance of the Corporation's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

Activity in the allowance for possible loan losses was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Balance at the beginning of the period	\$ 85,552	\$77,103	\$ 80,325	75,810
Provision for possible loan losses	1,711	2,725	10,750	7,300
Allowance for possible loan losses acquired	-	-	2,373	-
Net charge-offs:				
Losses charged to the allowance	(3,437)	(4,106)	(13,798)	(10,361)
Recoveries of loans previously charged off	1,841	1,395	6,017	4,368
Net charge-offs	(1,596)	(2,711)	(7,781)	(5,993)
Balance at the end of the period	\$ 85,667	\$77,117	\$ 85,667	77,117

Note 6 - Goodwill and Other Intangible Assets

Goodwill. Goodwill totaled \$247.0 million at September 30, 2006 and \$169.0 million at December 31, 2005. During the first nine months of 2006, the Corporation recorded goodwill totaling \$78.8 million in connection with the acquisitions of TCB and Alamo. Additionally, goodwill recorded in connection with the acquisition of Horizon during the fourth quarter of 2005 was reduced \$833 thousand as a result of a reallocation of the purchase price based on additional information related to the valuation of certain assets acquired and liabilities assumed. See Note 2 - Mergers and Acquisitions.

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Other Intangible Assets. Other intangible assets totaled \$21.1 million at September 30, 2006 including \$18.2 million related to core deposits, \$2.0 million related to customer relationships and \$903 thousand related to non-compete agreements. Other intangible assets totaled \$14.9 million at December 31, 2005 including \$11.1 million related to core deposits, \$2.4 million related to non-compete agreements and \$1.4 million related to customer relationships. During the nine months ended September 30, 2006, the Corporation recorded core deposit intangibles totaling \$10.2 million in connection with the acquisitions of TCB and Alamo. See Note 2 - Mergers and Acquisitions.

Amortization expense related to intangible assets totaled \$1.3 million and \$4.0 million during the three and nine months ended September 30, 2006 and totaled \$1.1 million and \$3.7 million during the three and nine months ended September 30, 2005. The estimated aggregate future amortization expense for intangible assets remaining as of September 30, 2006 is as follows:

Remainder of 2006	\$ 1,261
2007	4,658
2008	3,733
2009	2,847
2010	2,242
Thereafter	6,376
	<u>\$ 21,117</u>

Note 7 - Deposits

Deposits were as follows:

	September 30, 2006	Percentage of Total	December 31, 2005	Percentage of Total	September 30, 2005	Percentage of Total
Non-interest-bearing demand deposits:						
Commercial and individual	\$ 3,092,177	33.4 %	2,945,366	32.2 %	\$ 2,721,812	32.9 %
Correspondent banks	208,469	2.2	458,821	5.0	365,853	4.4
Public funds	80,340	0.9	80,745	0.9	114,264	1.4
Total non-interest-bearing demand deposits	<u>3,380,986</u>	36.5	<u>3,484,932</u>	38.1	<u>3,201,929</u>	38.7

Interest-bearing deposits:

Private accounts:

Savings and interest checking	1,255,776	13.5	1,320,781	14.4	1,190,342	14.4
Money market accounts	3,116,532	33.6	2,761,944	30.2	2,676,641	32.3
Time accounts under \$100,000	513,573	5.5	431,741	4.7	390,625	4.7
Time accounts of \$100,000 or more	627,159	6.8	534,151	5.9	504,822	6.1
Public funds	376,422	4.1	612,845	6.7	318,441	3.8
Total interest-bearing deposits	5,889,462	63.5	5,661,462	61.9	5,080,871	61.3

Total deposits	\$ 9,270,448	100.0 %	\$ 9,146,394	100.0 %	\$ 8,282,800	100.0 %
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At September 30, 2006 and December 31, 2005, interest-bearing public funds deposits included \$97.8 million and \$314.3 million in savings and interest checking accounts, \$90.1 million and \$84.4 million in money market accounts, \$6.6 million and \$6.1 million in time accounts under \$100 thousand, and \$181.9 million and \$208.0 million in time accounts of \$100 thousand or more.

Deposits from foreign sources, primarily Mexico, totaled \$677.0 million at September 30, 2006 and \$641.2 million at December 31, 2005.

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Note 8 - Commitments and Contingencies

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, the Corporation enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in its consolidated balance sheets. The Corporation enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Corporation minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

Commitments to Extend Credit. The Corporation enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Corporation's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Commitments to extend credit totaled \$3.6 billion and \$3.3 billion at September 30, 2006 and December 31, 2005.

Standby Letters of Credit. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Corporation would be required to fund the commitment. The

maximum potential amount of future payments the Corporation could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Corporation would be entitled to seek recovery from the customer. The Corporation's policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements. Standby letters of credit totaled \$221.7 million at September 30, 2006 and \$241.6 million at December 31, 2005. The Corporation had an accrued liability totaling \$1.1 million at September 30, 2006 and \$1.3 million at December 31, 2005 related to potential obligations under these guarantees.

Lease Commitments. The Corporation leases certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled \$3.8 million and \$11.3 million for the three and nine months ended September 30, 2006 and \$3.3 million and \$9.7 million for the three and nine months ended September 30, 2005. There has been no significant change in the future minimum lease payments payable by the Corporation since December 31, 2005. See the 2005 Form 10-K for information regarding these commitments.

Litigation. The Corporation and its subsidiaries are subject to various claims and legal actions that have arisen in the normal course of conducting business. Management does not expect the ultimate disposition of these matters to have a material adverse impact on the Corporation's financial statements.

Note 9 - Regulatory Matters

Regulatory Capital Requirements. Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

Quantitative measures established by regulations to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

Cullen/Frost's and Frost Bank's Tier 1 capital consists of shareholders' equity excluding unrealized gains and losses on securities available for sale, goodwill and other intangible assets. Tier 1 capital for Cullen/Frost also includes \$223 million of trust preferred securities issued by unconsolidated subsidiary trusts. Cullen/Frost's and Frost Bank's total capital is comprised of Tier 1 capital plus \$150 million of subordinated notes payable and a permissible portion of the allowance for possible loan losses.

The Tier 1 and total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, excluding goodwill and other intangible assets, allocated by risk weight category and certain off-balance-sheet items (primarily loan commitments). The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets.

Actual and required capital ratios for Cullen/Frost and Frost Bank were as follows:

Minimum	Required to be Well Capitalized Under
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	Actual		Required for Capital Adequacy Purposes		Prompt Corrective Action Regulations	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
September 30, 2006						
Total Capital to Risk-Weighted Assets	1,316,782	14.68 %	717,410	8.00 %	N/A	N/A
Cullen/Frost	1,083,690	12.09	716,791	8.00	\$ 895,989	10.00 %
Frost Bank						
Tier 1 Capital to Risk-Weighted Assets	1,111,115	12.39	358,704	4.00	N/A	N/A
Cullen/Frost	878,021	9.80	358,395	4.00	537,593	6.00
Frost Bank						
Leverage Ratio	1,111,115	9.76	455,404	4.00	N/A	N/A
Cullen/Frost	878,021	7.72	454,908	4.00	568,634	5.00
Frost Bank						

	Actual		Minimum Required for Capital Adequacy Purposes		Required to be Well Capitalized Under Prompt Corrective Action Regulations	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
December 31, 2005						
Total Capital to Risk-Weighted Assets	1,273,702	14.94 %	682,154	8.00 %	N/A	N/A
Cullen/Frost	991,846	11.64	681,703	8.00	\$ 852,129	10.00 %
Frost Bank						

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Tier 1 Capital to Risk-Weighted Assets

	1,043,377	12.24	341,077	4.00	N/A	N/A
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Cullen/Frost

	761,521	8.94	340,852	4.00	511,277	6.00
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Frost Bank

Leverage Ratio

	1,043,377	9.62	433,819	4.00	N/A	N/A
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Cullen/Frost

	761,521	7.03	433,269	4.00	541,586	5.00
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Frost Bank

Frost Bank has been notified by its regulator that, as of its most recent regulatory examination, it is regarded as well capitalized under the regulatory framework for prompt corrective action. Such determination has been made based on Frost Bank's Tier 1, total capital, and leverage ratios. There have been no conditions or events since this notification that management believes would change Frost Bank's categorization as well capitalized under the aforementioned ratios.

Cullen/Frost is subject to the regulatory capital requirements administered by the Federal Reserve, while Frost Bank is subject to the regulatory capital requirements administered by the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. Regulatory authorities can initiate certain mandatory actions if Cullen/Frost or Frost Bank fail to meet the minimum capital requirements, which could have a direct material effect on the Corporation's financial statements. Management believes, as of September 30, 2006, that Cullen/Frost and Frost Bank meet all capital adequacy requirements to which they are subject.

Trust Preferred Securities. In accordance with the applicable accounting standard related to variable interest entities, the accounts of the Corporation's wholly owned subsidiary trusts, Cullen/Frost Capital Trust I, Cullen/Frost Capital Trust II and Alamo Corporation of Texas Trust I have not been included in the Corporation's consolidated financial statements. However, the \$223 million in trust preferred securities issued by these subsidiary trusts have been included in the Tier 1 capital of Cullen/Frost for regulatory capital purposes pursuant to guidance from the Federal Reserve Board. In February 2005, the Federal Reserve Board issued a final rule that allows the continued inclusion of trust preferred securities in the Tier 1 capital of bank holding companies. The Board's final rule limits the aggregate amount of restricted core capital elements (which includes trust preferred securities, among other things) that may be included in the Tier 1 capital of most bank holding companies to 25% of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. Large, internationally active bank holding companies (as defined) are subject to a 15% limitation. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. The final rule provides a five-year transition period, ending March 31, 2009, for application of the quantitative limits. The Corporation does not expect that the quantitative limits will preclude it from including the \$223 million in trust preferred securities in Tier 1 capital.

Note 10 - Derivative Financial Instruments

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The fair value of derivative positions outstanding is included in accrued interest receivable and other assets and accrued interest payable and other liabilities in the accompanying consolidated balance sheets and in the net change in each of these financial statement line items in the accompanying consolidated statements of cash flows.

Interest Rate Derivatives. The notional amounts and estimated fair values of interest rate derivative positions outstanding at September 30, 2006 and December 31, 2005 are presented in the following table. The estimated fair value of the subordinated debt interest rate swap and the interest rate floors on variable-rate loans are based on a quoted market price. Internal present value models are used to estimate the fair values of the other interest rate swaps and caps.

	September 30, 2006		December 31, 2005	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Interest rate derivatives designated as hedges of fair value:				
Commercial loan/lease interest rate swaps	\$ 15,662	\$ 175	\$ 163,068	\$ 1,513
Commercial loan/lease interest rate caps	-	-	4,810	41
Interest rate swaps related to subordinated notes	-	-	300,000	450
Interest rate derivatives designated as hedges of cash flows:				
Interest rate floors on variable-rate loans	1,300,000	737	1,300,000	1,702
Non-hedging interest rate derivatives:				
Commercial loan/lease interest rate swaps	176,708	3,335	138,546	2,409
Commercial loan/lease interest rate swaps	176,708	(3,335)	138,546	(2,409)
Commercial loan/lease interest rate caps	17,500	9	19,375	24
Commercial loan/lease interest rate caps	17,500	(9)	19,375	(24)
Commercial loan/lease interest rate floors	17,500	19	19,375	53
Commercial loan/lease interest rate floors	17,500	(19)	19,375	(53)

The weighted-average receive and pay interest rates for interest rate swaps and the weighted-average strike rates for interest rate caps and floors outstanding at September 30, 2006 were as follows:

	Weighted-Average		
	Interest Rate Paid	Interest Rate Received	Strike Rate

Interest rate swaps:

Commercial loan/lease interest rate swaps	4.67 %	5.33 %	-
Non-hedging interest rate swaps	5.61	5.61	-

Interest rate caps and floors:

Interest rate floors on variable-rate loans	-	-	6.00 %
Non-hedging commercial loan/lease interest rate caps	-	-	6.00
Non-hedging commercial loan/lease interest rate floors	-	-	4.17

Interest rate contracts involve the risk of dealing with counterparties and their ability to meet contractual terms. These counterparties must have an investment grade credit rating and be approved by the Corporation's Asset/Liability Management Committee.

The Corporation's credit exposure on interest rate swaps is limited to the net favorable value and interest payments of all swaps by each counterparty. In such cases collateral is required from the counterparties involved if the net value of the swaps exceeds a nominal amount considered to be immaterial. The Corporation's credit exposure, net of any collateral pledged, relating to interest rate swaps was approximately \$2.4 million at September 30, 2006. This credit exposure was primarily related to bank customers. Collateral levels are monitored and adjusted on a monthly basis for changes in interest rate swap values.

For fair value hedges, the changes in the fair value of both the derivative hedging instrument and the hedged item are recorded in current earnings as other income or other expense. The extent that such changes in fair value do not offset represents hedge ineffectiveness. For cash flow hedges, the effective portion of the gain or loss on the derivative hedging instrument is reported in other comprehensive income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is recorded in current earnings as other income or other expense. The amount of hedge ineffectiveness reported in earnings was not significant during any of the reported periods. The accumulated net after-tax loss on the floor contracts included in accumulated other comprehensive income totaled \$905 thousand at September 30, 2006.

During the first quarter of 2006, the Corporation terminated certain interest rate swaps with a total notional amount of \$334.6 million. The swaps were designated as hedging instruments in fair value hedges of certain fixed-rate commercial loans. The cumulative basis adjustment to fair value resulting from the designation of these loans as hedged items totaled \$4.4 million upon termination of the swaps. This cumulative basis adjustment will be treated similar to a premium and amortized as an offset to interest income over the expected remaining life of the underlying loans using the effective yield method.

Commodity Derivatives. The Corporation enters into commodity swaps and option contracts to accommodate the business needs of its customers. Upon the origination of a commodity swap or option contract with a customer, the

Corporation simultaneously enters into an offsetting contract with a third party to mitigate the exposure to fluctuations in commodity prices.

The notional amounts and estimated fair values of commodity derivative positions outstanding are presented in the following table. The estimated fair values are based on quoted market prices.

	Notional Units	September 30, 2006		December 31, 2005	
		Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Commodity swaps:					
Oil	Barrels	30	\$ 87	-	\$ -
Oil	Barrels	30	(79)	-	-
Natural gas	MMBTUs	760	1,180	130	267
Natural gas	MMBTUs	760	(1,166)	130	(261)
Commodity options:					
Oil	Barrels	581	1,829	117	155
Oil	Barrels	581	(1,826)	117	(155)
Natural gas	MMBTUs	1,440	1,085	500	594
Natural gas	MMBTUs	1,440	(1,085)	500	(594)

Foreign Currency Derivatives. The Corporation enters into foreign currency forward and option contracts to accommodate the business needs of its customers. Upon the origination of a foreign currency forward or option contract with a customer, the Corporation simultaneously enters into an offsetting contract with a third party to negate the exposure to fluctuations in foreign currency exchange rates. The notional amounts and fair values of open foreign currency forward and option contracts were not significant at September 30, 2006 and December 31, 2005.

Note 11 - Earnings Per Common Share

Basic earnings per share is computed by dividing net income by the weighted-average number of shares outstanding during the applicable period. Diluted earnings per share is computed using the weighted-average number of shares determined for the basic computation plus the dilutive effect of stock options and non-vested stock granted using the treasury stock method.

The following table presents a reconciliation of the number of shares used in the calculation of basic and diluted earnings per common share.

Three Months Ended September 30,		Nine Months Ended September 30,	
2006	2005	2006	2005

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Weighted-average shares outstanding for basic earnings per share	55,440	52,345	55,043	51,963
Dilutive effect of stock options and non-vested stock awards	1,147	1,285	1,233	1,315
Weighted-average shares outstanding for diluted earnings per share	56,587	53,630	56,276	53,278

Note 12 - Stock-Based Compensation

Prior to January 1, 2006, employee compensation expense under stock option plans was reported only if options were granted below market price at grant date in accordance with the intrinsic value method of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Because the exercise price of the Corporation's employee stock options always equaled the market price of the underlying stock on the date of grant, no compensation expense was recognized on options granted. As stated in Note 1 - Significant Accounting Policies, the Corporation adopted the provisions of SFAS 123R on January 1, 2006. SFAS 123R eliminates the ability to account for stock-based compensation using APB 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the measurement date, which, for the Corporation, is the date of the grant. The Corporation transitioned to fair-value based accounting for stock-based compensation using a modified version of prospective application ("modified prospective application"). Under modified prospective application, as it is applicable to the Corporation, SFAS 123R applies to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered (generally referring to non-vested awards) that were outstanding as of January 1, 2006 will be recognized as the remaining requisite service is rendered during the period of and/or the periods after the adoption of SFAS 123R. The attribution of compensation cost for those earlier awards is based on the same method and on the same grant-date fair values previously determined for the pro forma disclosures required for companies that did not previously adopt the fair value accounting method for stock-based employee compensation.

The fair value of the Corporation's employee stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of highly subjective assumptions, changes to which can materially affect the fair value estimate. Additionally, there may be other factors that would otherwise have a significant effect on the value of employee stock options granted but are not considered by the model. Accordingly, while management believes that the Black-Scholes option-pricing model provides a reasonable estimate of fair value, the model does not necessarily provide the best single measure of fair value for the Corporation's employee stock options.

As a result of applying the provisions of SFAS 123R during the three and nine months ended September 30, 2006, the Corporation recognized additional stock-based compensation expense related to stock options of \$1.7 million, or \$1.1 million net of tax, and \$5.1 million, or \$3.3 million net of tax. The increase in stock-based compensation expense related to stock options, resulted in a \$0.02 decrease in both basic and diluted earnings per share during the three months ended September 30, 2006 and a \$0.06 decrease in both basic and diluted earnings per share during the nine months ended September 30, 2006. Cash flows from financing activities for the nine months ended September 30, 2006 included \$14.6 million in cash inflows from excess tax benefits related to stock compensation. Such cash flows were previously reported as operating activities.

A combined summary of activity in the Corporation's active stock plans for the nine months ended September 30, 2006 is presented in the following table.

	Shares Available for Grant	Non-vested Stock Awards Outstanding	Stock Options Outstanding	
			Number of Shares	Weighted-Average Exercise Price
Balance, January 1, 2006	3,206,400	246,552	5,394,750	\$34.61
Granted	(21,000)	-	21,000	56.83
Stock options exercised	-	-	(1,404,780)	26.53
Stock awards vested	-	(2,796)	-	-
Forfeited	67,806	(1,306)	(66,500)	46.45
Cancelled	(38,906)	-	-	-
Balance, September 30, 2006	3,214,300	242,450	3,944,470	37.49

The weighted-average fair value of options granted during the nine months ended September 30, 2006 was \$12.80. The following weighted-average assumptions were used to estimate the fair value of options granted during the nine months ended September 30, 2006:

Risk-free interest rate	4.93 %
Dividend yield	2.49
Market price volatility factor	0.23
Weighted-average expected life of options	5.1 Years

Stock-based compensation expense totaled \$2.3 million and \$7.0 million during the three and nine months ended September 30, 2006 and \$491 thousand and \$1.3 million during the three and nine months ended September 30, 2005. Stock-based compensation expense is recognized ratably over the requisite service period for all awards. Unrecognized stock-based compensation expense related to stock options totaled \$8.9 million at September 30, 2006. At such date, the weighted-average period over which this unrecognized expense is expected to be recognized was 1.5 years. Unrecognized stock-based compensation expense related to non-vested, non-option stock awards was \$4.2 million at September 30, 2006. At such date, the weighted-average period over which this unrecognized expense was expected to be recognized was 1.5 years.

The following pro forma information presents net income and earnings per share for the three and nine months ended September 30, 2005 as if the fair value method of SFAS 123R had been used to measure compensation cost for stock-based compensation plans. For purposes of these pro forma disclosures, the estimated fair value of stock options and non-vested, non-option stock awards is amortized to expense over the related vesting periods.

Three Months	Nine Months
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	Ended September 30, 2005	Ended September 30, 2005
Net income, as reported	\$ 42,455	\$ 120,506
Add: Stock-based employee compensation expense included	319	866
in reported net income, net of related tax effects		
Less: Total stock-based employee compensation expense	(1,250)	(3,779)
determined under fair value method for all awards, net of related tax effects		
Pro forma net income	<u>\$ 41,524</u>	<u>\$ 117,593</u>
Earnings per share:		
Basic - as reported	\$ 0.81	\$ 2.32
Basic - pro forma	0.79	2.26
Diluted - as reported	0.79	2.26
Diluted - pro forma	0.77	2.21

During the nine months ended September 30, 2006 and 2005, proceeds from stock option exercises totaled \$37.3 million and \$25.3 million. During the nine months ended September 30, 2006 and 2005, 1,404,780 shares and 1,044,595 shares, respectively, were issued in connection with stock option exercises. During the nine months ended September 30, 2006, 859,147 shares issued in connection with stock option exercises were new shares issued from available authorized shares, while 545,633 shares were issued from available treasury stock. During the nine months ended September 30, 2005, all shares issued in connection with stock option exercises and non-vested, non-option stock awards were issued from available treasury stock.

Note 13 - Defined Benefit Plans

The components of the combined net periodic benefit cost for the Corporation's qualified and non-qualified defined benefit pension plans were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Expected return on plan assets, net of expenses	\$ (1,863)	\$ (1,752)	\$ (5,589)	\$ (5,256)
Interest cost on projected benefit obligation	1,795	1,692	5,385	5,076
Net amortization and deferral	749	536	2,247	1,608

Net periodic benefit cost	\$ 681	\$ 476	\$ 2,043	\$ 1,428
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The Corporation's non-qualified defined benefit pension plan is not funded. Contributions to the qualified defined benefit pension plan totaled \$4.0 million through September 30, 2006. The Corporation does not expect to make any additional contributions during the remainder of 2006.

The net periodic benefit cost related to post-retirement healthcare benefits offered by the Corporation to certain former employees was not significant during either of the reported periods.

Note 14 - Income Taxes

Income tax expense was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Current income tax expense	\$23,816	\$17,452	\$ 71,323	\$ 56,330
Deferred income tax expense (benefit)	(47)	2,715	(1,779)	1,227
Income tax expense as reported	\$23,769	\$20,167	\$ 69,544	\$ 57,557
Effective tax rate	32.2 %	32.2 %	32.4 %	32.3 %

Net deferred tax assets totaled \$59.5 million at September 30, 2006 and \$57.4 million at December 31, 2005. No valuation allowance was recorded against these deferred tax assets, as the amounts are recoverable through taxes paid in prior years.

Note 15 - Operating Segments

The Corporation has two reportable operating segments, Banking and the Financial Management Group (FMG), that are delineated by the products and services that each segment offers. Banking includes both commercial and consumer banking services, Frost Insurance Agency and Frost Securities, Inc. Commercial banking services are provided to corporations and other business clients and include a wide array of lending and cash management products. Consumer banking services include direct lending and depository services. FMG includes fee-based services within private trust, retirement services, and financial management services, including personal wealth management and brokerage services.

The accounting policies of each reportable segment are the same as those of the Corporation except for the following items, which impact the Banking and FMG segments: (i) expenses for consolidated back-office operations are allocated to operating segments based on estimated uses of those services, (ii) general overhead-type expenses such as executive administration, accounting and internal audit are allocated based on the direct expense level of the

operating segment, (iii) income tax expense for the individual segments is calculated essentially at the statutory rate, and (iv) the parent company records the tax expense or benefit necessary to reconcile to the consolidated total.

The Corporation uses a match-funded transfer pricing process to assess operating segment performance. The process helps the Corporation to (i) identify the cost or opportunity value of funds within each business segment, (ii) measure the profitability of a particular business segment by relating appropriate costs to revenues, (iii) evaluate each business segment in a manner consistent with its economic impact on consolidated earnings, and (iv) enhance asset and liability pricing decisions.

Summarized operating results by segment were as follows:

	Banking	FMG	Non-Banks	Consolidated
Revenues from (expenses to) external customers:				
Three months ended:				
September 30, 2006	\$56,582	\$ 26,044	\$ (4,204)	\$ 178,422
September 30, 2005	139,224	21,720	(3,605)	157,339
Nine months ended:				
September 30, 2006	\$66,086	\$ 74,937	\$12,170)	\$ 528,853
September 30, 2005	405,164	62,291	(10,163)	457,292
Net income (loss):				
Three months ended:				
September 30, 2006	\$ 47,109	\$ 6,089	\$ (3,196)	\$ 50,002
September 30, 2005	40,836	4,592	(2,973)	42,455
Nine months ended:				
September 30, 2006	\$38,557	\$ 16,447	\$ (9,775)	\$ 145,229
September 30, 2005	116,485	12,079	(8,058)	120,506

Note 16 - New Accounting Standards

Statements of Financial Accounting Standards

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140."

SFAS 155 amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS 155 (i)

permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133, (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (v) amends SFAS 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 is effective for the Corporation on January 1, 2007 and is not expected to have a significant impact on the Corporation's financial statements.

SFAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140."

SFAS 156 amends SFAS 140. "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a replacement of FASB Statement No. 125," by requiring, in certain situations, an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract. All separately recognized servicing assets and servicing liabilities are required to be initially measured at fair value. Subsequent measurement methods include the amortization method, whereby servicing assets or servicing liabilities are amortized in proportion to and over the period of estimated net servicing income or net servicing loss or the fair value method, whereby servicing assets or servicing liabilities are measured at fair value at each reporting date and changes in fair value are reported in earnings in the period in which they occur. If the amortization method is used, an entity must assess servicing assets or servicing liabilities for impairment or increased obligation based on the fair value at each reporting date. SFAS 156 is effective for the Corporation on January 1, 2007 and is not expected to have a significant impact on the Corporation's financial statements.

SFAS No. 157, "Fair Value Measurements."

SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for the Corporation on January 1, 2008 and is not expected to have a significant impact on the Corporation's financial statements.

SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88 106, and 132(R)."

SFAS 158 requires an employer to recognize the overfunded or underfunded status of defined benefit postretirement plans as an asset or a liability in its statement of financial position. The funded status is measured as the difference between plan assets at fair value and the benefit obligation (the projected benefit obligation for pension plans or the accumulated benefit obligation for other postretirement benefit plans). An employer is also required to measure the funded status of a plan as of the date of its year-end statement of financial position with changes in the funded status recognized through comprehensive income. SFAS 158 also requires certain disclosures regarding the effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of gains or losses, prior service costs or credits, and the transition asset or obligation. The Corporation will be required to recognize the funded status of its defined benefit postretirement benefit plans in its financial statements for the year ended December 31, 2006. The requirement to measure plan assets and benefit obligations as of the date of the year-end statement of financial position is effective for the Corporation's financial statements beginning with the year ended after December 31, 2008. SFAS 158 is not expected to have a significant impact on the Corporation's financial statements.

Financial Accounting Standards Board Interpretations

FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109." Interpretation 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. Interpretation 48 also provides guidance on the accounting for and disclosure of unrecognized tax benefits, interest and penalties. Interpretation 48 is effective for the Corporation on January 1, 2007 and is not expected to have a significant impact on the Corporation's financial statements.

SEC Staff Accounting Bulletins

Staff Accounting Bulletin (SAB) No. 108, "Considering the Effects of a Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements." SAB 108 addresses how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. The effects of prior year uncorrected errors include the potential accumulation of improper amounts that may result in a material misstatement on the balance sheet or the reversal of prior period errors in the current period that result in a material misstatement of the current period income statement amounts. Adjustments to current or prior period financial statements would be required in the event that after application of various approaches for assessing materiality of a misstatement in current period financial statements and consideration of all relevant quantitative and qualitative factors, a misstatement is determined to be material. SAB 108 will be applicable to all financial statements issued by the Corporation after November 15, 2006.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Financial Review

Cullen/Frost Bankers, Inc.

The following discussion should be read in conjunction with the Corporation's consolidated financial statements, and notes thereto, for the year ended December 31, 2005, included in the 2005 Form 10-K. Operating results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results for the year ending December 31, 2006 or any future period.

Dollar amounts in tables are stated in thousands, except for per share amounts.

Forward-Looking Statements and Factors that Could Affect Future Results

Certain statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in the Corporation's future filings with the SEC, in press releases, and in oral and written statements made by or with the approval of the Corporation that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of Cullen/Frost or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", "intends", "targeted", "continue", "remain", "will", "should", "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

Local, regional, national and international economic conditions and the impact they may have on the Corporation and its customers and the Corporation's assessment of that impact.

Changes in the level of non-performing assets and charge-offs.

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Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.

The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board.

Inflation, interest rate, securities market and monetary fluctuations.

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Political instability.

w

Acts of war or terrorism.

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The timely development and acceptance of new products and services and perceived overall value of these products and services by users.

Changes in consumer spending, borrowings and savings habits.

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Changes in the financial performance and/or condition of the Corporation's borrowers.

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Technological changes.

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Acquisitions and integration of acquired businesses. See the Corporation's Current Reports on Form 8-K filed with the SEC on July 3, 2006 and July 7, 2006 and the registration statements on Form S-4 and Form S-4/A filed with the SEC on August 15, 2006 and September 14, 2006.

The ability to increase market share and control expenses.

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Changes in the competitive environment among financial holding companies and other financial service providers.

The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Corporation and its subsidiaries must comply.

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.

Changes in the Corporation's organization, compensation and benefit plans.

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The costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews.

Greater than expected costs or difficulties related to the integration of new products and lines of business.

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The Corporation's success at managing the risks involved in the foregoing items.

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Forward-looking statements speak only as of the date on which such statements are made. The Corporation undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

Application of Critical Accounting Policies and Accounting Estimates

The accounting and reporting policies followed by the Corporation conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Corporation bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The Corporation considers accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on the Corporation's financial statements. Accounting policies related to the allowance for possible loan losses and stock-based compensation are considered to be critical, as these policies involve considerable subjective judgment and estimation by management.

For additional information regarding critical accounting policies, refer to Note 1 - Summary of Significant Accounting Policies in the notes to consolidated financial statements and the sections captioned "Application of Critical Accounting Policies" and "Allowance for Possible Loan Losses" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2005 Form 10-K. There have been no significant changes in the Corporation's application of critical accounting policies related to the allowance for possible loan losses since December 31, 2005. As more fully discussed in Note 12 - Stock-Based Compensation in the accompanying notes to consolidated financial statements included elsewhere in this report, the Corporation changed its method of accounting for stock options in connection with the adoption of a new accounting standard which eliminated the ability to account for stock-based compensation using the intrinsic value method of APB 25 and requires such transactions to be recognized ratably over the service period in the income statement based on their fair

values at the date of grant.

Overview

A discussion of the Corporation's results of operations is presented below. Certain reclassifications have been made to make prior periods comparable. Taxable-equivalent adjustments are the result of increasing income from tax-free loans and securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a 35% federal income tax rate, thus making tax-exempt asset yields comparable to taxable asset yields. As more fully discussed in Note 2 - Mergers and Acquisitions in the notes to consolidated financial statements, the Corporation acquired Texas Community Bancshares, Inc. and Alamo Corporation of Texas during the first quarter of 2006. The operating results of the acquired companies are included with the Corporation's results of operations since their respective dates of acquisition.

Results of Operations

Selected income statement data and other selected data for the comparable periods was as follows:

	Three Months Ended			Nine Months Ended	
	September 30, 2006	June 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Taxable-equivalent net interest income	\$ 121,093	\$ 119,309	\$101,255	\$ 355,119	\$ 288,971
Taxable-equivalent adjustment	2,567	2,341	1,970	7,185	5,505
Net interest income, as reported	118,526	116,968	99,285	347,934	283,466
Provision for possible loan losses	1,711	5,105	2,725	10,750	7,300
Net interest income after provision for possible loan losses	116,815	111,863	96,560	337,184	276,166
Non-interest income	59,896	60,265	58,054	180,919	173,826
Non-interest expense	102,940	100,194	91,992	303,330	271,929
Income before income taxes	73,771	71,934	62,622	214,773	178,063
Income taxes	23,769	23,384	20,167	69,544	57,557
Net income	\$ 50,002	\$ 48,550	\$ 42,455	\$ 145,229	\$ 120,506
Net income per share - basic	\$ 0.90	\$ 0.88	\$ 0.81	\$ 2.64	\$ 2.32
	0.88	0.86	0.79	2.58	2.26

Net income per share -
diluted

Dividends per share	0.34	0.34	0.30	0.98	0.865
Return on average assets	1.72 %	1.70 %	1.68 %	1.70 %	1.63 %
Return on average equity	18.56	19.02	18.98	18.81	18.88

Net income for the three and nine months ended September 30, 2006 increased \$7.5 million, or 17.8%, and \$24.7 million, or 20.5%, compared to the same periods in 2005. The increase during the three months ended September 30, 2006 was primarily the result of a \$19.2 million increase in net interest income, a \$1.8 million increase in non-interest income and a \$1.0 million decrease in the provision for possible loan losses partly offset by an \$10.9 million increase in non-interest expense and a \$3.6 million increase in income tax expense. The increase during the nine months ended September 30, 2006 was primarily the result of a \$64.5 million increase in net interest income and a \$7.1 million increase in non-interest income partly offset by a \$31.4 million increase in non-interest expense, a \$3.5 million increase in the provision for possible loan losses and a \$12.0 million increase in income tax expense.

Net income for the third quarter of 2006 increased \$1.5 million, or 3.0%, from the second quarter of 2006. The increase was primarily the result of a \$1.6 million increase in net interest income and a \$3.4 million decrease in the provision for possible loan losses offset by a \$2.7 million increase in non-interest expense, a \$369 thousand decrease in non-interest income and a \$385 thousand increase in income tax expense.

Details of the changes in the various components of net income are further discussed below.

Net Interest Income

Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is the Corporation's largest source of revenue, representing 65.8% of total revenue during the first nine months of 2006. Net interest margin is the ratio of taxable-equivalent net interest income to average earning assets for the period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin.

The Federal Reserve Board influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Corporation's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, began 2005 at 5.25% and increased 50 basis points in each of the four quarters to end the year at 7.25%. During the first nine months of 2006, the prime interest rate increased 50 basis points in the first quarter and 50 basis points in the second quarter to end the period at 8.25%. The federal funds rate, which is the cost of immediately available overnight funds, has moved in a similar manner, beginning 2005 at 2.25%. During 2005, the federal funds rate increased 50 basis points in each of the four quarters to end the year at 4.25%. During the first nine months of 2006, the federal funds rate increased 50 basis points in the first quarter and 50 basis points in the second quarter to end the period at 5.25%.

The Corporation's balance sheet is asset sensitive, meaning that earning assets generally reprice more quickly than interest-bearing liabilities. Therefore, the Corporation's net interest margin is likely to increase in sustained periods of rising interest rates and decrease in sustained periods of declining interest rates. The Corporation is primarily funded

by core deposits, with non-interest-bearing demand deposits historically being a significant source of funds. This lower-cost funding base is expected to have a positive impact on the Corporation's net interest income and net interest margin in a rising interest rate environment. Since 2004, there has been an upward trend in the prime interest rate and the federal funds rate. The Corporation does not currently expect this upward trend to continue in the foreseeable future; however, there can be no assurance to that effect as changes in market interest rates are dependent upon a variety of factors that are beyond the Corporation's control. Further analysis of the components of the Corporation's net interest margin is presented below.

The following table presents the changes in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities. The changes in net interest income due to changes in both average volume and average interest rate have been allocated to average volume or average interest rate change in proportion to the absolute amounts of the change in each. The comparisons between the quarters include an additional change factor that shows the effect of the difference in the number of days in each period, as further discussed below.

	Third Quarter 2006 vs. Third Quarter 2005	Third Quarter 2006 vs. Second Quarter 2006	First Nine Months 2006 vs. First Nine Months 2005
Due to changes in average volumes	\$ 15,895	\$ 790	\$ 47,594
Due to changes in average interest rates	3,943	(322)	18,554
Due to difference in the number days in each of the comparable periods	-	1,316	-
Total change	\$ 19,838	\$ 1,784	\$ 66,148

Taxable-equivalent net interest income for the three and nine months ended September 30, 2006 increased \$19.8 million, or 19.6%, and \$66.1 million, or 22.9%, compared to the same periods in 2005. The increases primarily resulted from increases in the average volume of earning assets combined with increases in the net interest margin. The average volume of earning assets for the third quarter of 2006 increased \$1.3 billion compared to the third quarter of 2005. Over the same time frame, the net interest margin increased 17 basis points from 4.52% in 2005 to 4.69% in 2006. The average volume of earning assets for the nine months ended September 30, 2006 increased \$1.3 billion compared to the same period in 2005. Over the same time frame, the net interest margin increased 27 basis points from 4.41% in 2005 to 4.68% in 2006. The increases in the average volume of earning assets were due in part to recent acquisitions (see Note 2 - Mergers and Acquisitions). The increases in the net interest margin were partly due to the increases in market interest rates discussed above. Additionally, the relative proportion of loans, which generally carry higher yields compared to other types of earning assets, increased from 62.3% of total average earning assets during the first nine months of 2005 to 64.3% of total average earning assets during the first nine months of 2006.

Taxable-equivalent net interest income for the third quarter of 2006 increased \$1.8 million, or 1.5%, from the second quarter of 2006. The increase primarily resulted from an increase in the average volume of earning assets combined with an increase in the number of days in the third quarter. The average volume of earning assets for the third quarter of 2006 increased \$90.5 million compared to the second quarter of 2006. Taxable-equivalent net interest income for the third quarter of 2006 included 92 days of interest accrual compared to 91 days for the second quarter of 2006. The additional day added approximately \$1.3 million to taxable-equivalent net interest income during the third quarter of 2006. Excluding the impact of the additional day during the third quarter of 2006 results in an effective increase in taxable-equivalent net interest income of approximately \$468 thousand compared to the second quarter of 2006. This effective increase was the result of the aforementioned increase in average earning assets partly offset by the impact of a decrease in the net interest margin. The net interest margin decreased one basis point from 4.70% in the second quarter of 2006 to 4.69% in the third quarter of 2006.

The average volume of loans, the Corporation's primary category of earning assets, increased \$1.0 billion during the first nine months of 2006 compared to the same period in 2005. The average yield on loans was 7.70% during the first nine months of 2006 compared to 6.25% during the same period in 2005. As stated above, the Corporation had a larger proportion of average earning assets invested in loans during the first nine months of 2006 compared to the first nine months of 2005. Such investments have significantly higher yields compared to securities and federal funds sold and resell agreements and, as such, have a more positive effect on the net interest margin. The average volume of securities increased \$48.7 million during the first nine months of 2006 compared to the same period in 2005. The average yield on securities was 4.97% during the first nine months of 2006 compared to 4.82% during the first nine months of 2005. Average federal funds sold and resell agreements during the first nine months of 2006 increased \$235.5 million compared to the same period in 2005. The average yield on federal funds sold and resell agreements was 4.98% during the first nine months of 2006 compared to 3.02% during the first nine months of 2005.

Average deposits increased \$1.1 billion during the first nine months of 2006 compared to the same period in 2005. The increase in the average volume of deposits was due in part to recent acquisitions (see Note 2 - Mergers and Acquisitions). Average interest-bearing deposits for the first nine months of 2006 increased \$725.1 million compared to the same period in 2005. The ratio of average interest-bearing deposits to total average deposits was 63.6% for the first nine months of 2006 compared to 63.4% during the first nine months of 2005. The average cost of interest-bearing deposits and total deposits was 2.55% and 1.62% during the first nine months of 2006 compared to 1.40% and 0.89% during the first nine months of 2005. The increase in the average cost of interest-bearing deposits was primarily the result of increases in interest rates offered on deposit products due to increases in market interest rates.

The Corporation's net interest spread, which represents the difference between the average rate earned on earning assets and the average rate paid on interest-bearing liabilities, was 3.75% during the first nine months of 2006 compared to 3.85% during the first nine months of 2005. The net interest spread, as well as the net interest margin, will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment. A discussion of the effects of changing interest rates on net interest income is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

The Corporation's hedging policies permit the use of various derivative financial instruments, including interest rate swaps, swaptions, caps and floors, to manage exposure to changes in interest rates. Details of the Corporation's derivatives and hedging activities are set forth in Note 10 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements included elsewhere in this report. Information regarding the impact of fluctuations in interest rates on the Corporation's derivative financial instruments is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

Provision for Possible Loan Losses

The provision for possible loan losses is determined by management as the amount to be added to the allowance for possible loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for possible loan losses totaled \$1.7 million and \$10.8 million for the three and nine months ended September 30, 2006 compared to \$2.7 million and \$7.3 million for the three and nine months ended September 30, 2005. See the section captioned "Allowance for Possible Loan Losses" elsewhere in this discussion for further analysis of the provision for possible loan losses.

Non-Interest Income

The components of non-interest income were as follows:

	Three Months Ended			Nine Months Ended	
	September 30, 2006	June 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Trust fees	\$ 15,962	\$ 15,744	\$ 14,463	\$ 47,460	\$ 43,294
Service charges on deposit accounts	19,301	19,566	20,173	57,974	59,002
Insurance commissions and fees	7,204	6,144	7,389	22,323	22,192
Other charges, commissions and fees	6,558	8,196	6,135	20,668	17,008
Net loss on securities transactions	-	-	-	(1)	-
Other	10,871	10,615	9,894	32,495	32,330
Total	\$ 59,896	\$ 60,265	\$ 58,054	\$ 180,919	\$ 173,826

Total non-interest income for the three and nine months ended September 30, 2006 increased \$1.8 million, or 3.2%, and \$7.1 million, or 4.1%, compared to the same periods in 2005. Total non-interest income for the third quarter of 2006 decreased \$369 thousand, or 0.6%, compared to the second quarter of 2006. Changes in the components of non-interest income are discussed below.

Trust Fees. Trust fee income for the three and nine months ended September 30, 2006 increased \$1.5 million, or 10.4%, and \$4.2 million, or 9.6%, compared to the same periods in 2005. Investment fees are the most significant component of trust fees, making up approximately 69% and 70% of total trust fees for the first nine months of 2006 and 2005, respectively. Investment and other custodial account fees are generally based on the market value of assets within a trust account. Volatility in the equity and bond markets impacts the market value of trust assets and the related investment fees.

The \$1.5 million increase in trust fee income during the three months ended September 30, 2006 compared to the same period in 2005 was primarily the result of increases in investment fees (up \$769 thousand), oil and gas trust management fees (up \$344 thousand) and real estate fees (up \$260 thousand). The \$4.2 million increase in trust fee income during the nine months ended September 30, 2006 compared to the same period in 2005 was primarily the result of increases in investment fees (up \$2.3 million), oil and gas trust management fees (up \$1.1 million), estate fees (up \$356 thousand) and custody fees (up \$317 thousand). The increases in investment fees were primarily due to higher equity valuations during first nine months of 2006 compared to the same period in 2005 and growth in overall trust assets and the number of trust accounts. The increases in oil and gas trust management fees were partly due to increased market prices, new production and new lease bonuses.

Trust fee income for the third quarter of 2006 increased \$218 thousand, or 1.4% compared to the second quarter of 2006. Increases in investment fees (up \$645 thousand), real estate fees (up \$249 thousand), financial consulting fees (up \$128 thousand) and oil and gas trust management fees (up \$125 thousand) were partially offset by decreases in tax fees (down \$815 thousand) which are seasonally higher during the second quarter.

At September 30, 2006, trust assets, including both managed assets and custody assets, were primarily composed of fixed income securities (43.8% of trust assets), equity securities (38.5% of trust assets) and cash equivalents (11.2% of trust assets). The estimated fair value of trust assets was \$22.6 billion (including managed assets of \$8.9 billion and custody assets of \$13.7 billion) at September 30, 2006, compared to \$18.1 billion (including managed assets of \$8.3 billion and custody assets of \$9.8 billion) at December 31, 2005 and \$18.2 billion (including managed assets of \$8.3 billion and custody assets of \$9.9 billion) at September 30, 2005.

Service Charges on Deposit Accounts. Service charges on deposit accounts for the three and nine months ended September 30, 2006 decreased \$872 thousand, or 4.3%, and \$1.0 million, or 1.7%, compared to the same periods in 2005. The decrease during the three months ended September 30, 2006 compared to the same period in 2005 was primarily related to service charges on commercial accounts (down \$1.0 million) and consumer accounts (down \$117 thousand) partly offset by increases in overdraft/insufficient funds charges on commercial accounts (up \$146 thousand). The decrease during the nine months ended September 30, 2006 compared to the same period in 2005 was primarily related to service charges on commercial accounts (down \$2.9 million) and consumer accounts (down \$452 thousand) partly offset by increases in overdraft/insufficient funds charges on consumer accounts (up \$1.6 million) and commercial accounts (up \$481 thousand). The decreases in service charges on commercial accounts were primarily related to decreased treasury management fees. The decreased treasury management fees resulted primarily from a higher earnings credit rate. The earnings credit rate is the value given to deposits maintained by treasury management customers. Because interest rates have trended upwards since the first quarter of 2005, deposit balances have become more valuable and are yielding a higher earnings credit rate relative to 2005. As a result, customers are able to pay for more of their services with earning credits applied to their deposit balances rather than through fees. The decrease in treasury management fees resulting from the higher earnings credit rate was partly offset by the additional fees from an increase in billable services. The increases in overdraft/insufficient funds charges on both commercial and consumer accounts was partly the result of growth in deposit accounts.

Service charges on deposit accounts for the third quarter of 2006 decreased \$265 thousand, or 1.4%, compared to the second quarter of 2006. The decrease was primarily due to a decrease in service charges on commercial accounts (down \$256 thousand) related to a higher earnings credit rate and overdraft/insufficient funds charges on consumer accounts (down \$213 thousand) partly offset by an increase in overdraft/insufficient funds charges on commercial accounts (up \$197 thousand).

Insurance Commissions and Fees. Insurance commissions and fees for the three and nine months ended September 30, 2006 decreased \$185 thousand, or 2.5%, and increased \$131 thousand, or 0.6%, compared to the same periods in 2005. The decrease for the three months ended September 30, 2006 was primarily related to lower commission income (down \$155 thousand). The increase for the nine months ended September 30, 2006 was primarily related to higher commission income (up \$355 thousand) partly offset by a decrease in contingent commissions (down \$223 thousand).

Insurance commissions and fees include contingent commissions totaling \$3.1 million during the nine months ended September 30, 2006 and \$3.3 million during the nine months ended September 30, 2005. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers related to the loss performance of insurance policies previously placed. Such commissions are seasonal in nature and are generally received during the first quarter of each year. These commissions totaled \$2.7 million and \$2.8 million during the nine months ended September 30, 2006 and 2005. Contingent commissions also include amounts received from various benefit plan insurance companies related to the volume of business generated and/or the subsequent retention of such business. These commissions totaled \$348 thousand and \$530 thousand during the nine months ended September 30, 2006 and 2005.

Insurance commissions and fees for the third quarter of 2006 increased \$1.1 million, or 17.3%, compared to the second quarter of 2006. The increase was primarily related to higher commission income (up \$1.6 million) due to normal variation in the timing of renewals and in the market demand for insurance products. The increase in commission income was partly offset by a decrease in contingent commissions (down \$493 thousand).

Other Charges, Commissions and Fees. Other charges, commissions and fees for the three and nine months ended September 30, 2006 increased \$423 million, or 6.9%, and \$3.7 million, or 21.5%, compared to the same periods in 2005. The increase during the three months ended September 30, 2006 was primarily related to an increase in investment banking fees related to corporate advisory services (up \$1.1 million) and commission income related to the sale of money market accounts (up \$289 thousand). These increases were partially offset by decreases in the realization of deferred loan commitment fees (down \$686 thousand), letter of credit fees (down \$278 thousand) and commission income related to the sale of annuities (down \$259 thousand). The increase during the nine months ended September 30, 2006 was primarily related to an increase in investment banking fees related to corporate advisory services (up \$3.6 million) and increases in commission income related to the sale of money market accounts (up \$531 thousand) and mutual funds (up \$416 thousand). These increases were partially offset by decreases in the realization of deferred loan commitment fees (down \$1.3 million) and letter of credit fees (down \$439 thousand). During the second quarter of 2006, the Corporation recognized investment banking fees related to corporate advisory services totaling \$2.8 million, which was primarily related to a single transaction. During the third quarter of 2006, the Corporation recognized investment banking fees related to corporate advisory services totaling \$1.3 million, which was primarily related to two transactions. Investment banking fees related to corporate advisory services are transaction based and can vary significantly from quarter to quarter.

Other charges, commissions and fees for the third quarter of 2006 decreased \$1.6 million, or 20%, compared to the second quarter of 2006. The decrease was primarily due to the aforementioned investment banking fees related to corporate advisory services recognized in the second quarter.

Net Gain/Loss on Securities Transactions. The Corporation sold available-for-sale securities with an amortized cost totaling \$25.7 million and \$2.3 million during the nine months ended September 30, 2006 and 2005. The Corporation realized a net loss of \$1 thousand on the 2006 sales. No gain or loss was realized on the 2005 sales.

Other Non-Interest Income. Other non-interest income increased \$977 thousand, or 9.9%, during the three months ended September 30, 2006 compared to the same period in 2005. Contributing to the increase during the three months ended September 30, 2006 were increases in income from check card usage (up \$759 thousand) and earnings on cashier's check balances (up \$386 thousand), among other things. The impact of these increases was partly offset by a decrease in income from securities trading activities (down \$249 thousand) as well as decreases in various other categories of non-interest income.

Other non-interest income increased \$165 thousand, or 0.5%, during the nine months ended September 30, 2006 compared to the same period in 2005. During the second quarter of 2005, the Corporation realized \$2.4 million in income from the net proceeds from the settlement of legal claims against certain former employees who were employed within the employee benefits line of business in the Austin region of Frost Insurance Agency. Also during 2005, the Corporation recognized \$2.0 million (\$1.7 million in the first quarter and \$294 thousand in the second quarter) in income related to a distribution received from the sale of the PULSE EFT Association whereby the Corporation and other members of the Association received distributions based in part upon each member's volume of transactions through the PULSE network. Excluding the income related to these items during the nine months ended September 30, 2005, other non-interest income for the nine months ended September 30, 2006 increased \$4.5 million, or 16.3%, compared to the same period in 2005. Contributing to the effective increase during the nine months ended September 30, 2006 were increases in income from check card usage (up \$2.1 million), earnings on cashier's check balances (up \$1.3 million), mineral interest income (up \$295 thousand) and income from securities trading activities (up \$255 thousand).

Other non-interest income for the third quarter of 2006 increased \$256 thousand, or 2.4%, compared to the second quarter of 2006. Contributing to the increase were increases in income from check card usage (up \$118 thousand) and mineral interest income (up \$115 thousand), as well as increases in various other categories of non-interest income. Other non-interest income during the third quarter of 2006 also included approximately \$165 thousand in income related to a settlement. The impact of these increases was partly offset by a decrease in income from securities trading activities (down \$302 thousand) as well as decreases in various other categories of non-interest income.

Non-Interest Expense

The components of non-interest expense were as follows:

	Three Months Ended			Nine Months Ended	
	September 30, 2006	June 30, 2006	September 30, 2005	September 30, 2006	September 30, 2005
Salaries and wages	\$ 48,743	\$ 47,463	\$ 41,818	\$ 142,312	\$ 122,272
Employee benefits	10,882	11,434	9,973	35,492	32,325
Net occupancy	8,964	8,512	8,111	25,909	22,863
Furniture and equipment	6,553	6,357	6,202	19,212	17,929
Intangible amortization	1,293	1,358	1,050	3,957	3,699
Other	26,505	25,070	24,838	76,448	72,841
Total	\$ 102,940	\$ 100,194	\$ 91,992	\$ 303,330	\$ 271,929

Total non-interest expense for the three and nine months ended September 30, 2006 increased \$10.9 million, or 11.9%, and \$31.4 million, or 11.5%, compared to the same periods in 2005. Total non-interest expense for the third quarter of 2006 increased \$2.7 million, or 2.7%, compared to the second quarter of 2006. Changes in the components of non-interest expense are discussed below.

Salaries and Wages. Salaries and wages for the three and nine months ended September 30, 2006 increased \$6.9 million, or 16.6%, and \$20.0 million, or 16.4%, compared to the same periods in 2005. The increases were primarily related to normal, annual merit increases and increases in headcount. The increases in headcount were primarily related to the acquisition of Horizon Capital Bank during the fourth quarter of 2005 and the acquisitions of Texas Community Bancshares and Alamo Corporation of Texas during the first quarter of 2006. Also, effective January 1, 2006, the Corporation began recognizing compensation expense related to stock options in connection with the adoption of a new accounting standard, as further discussed in Note 12 - Stock-Based Compensation. Stock-based compensation expense related to stock options and non-vested stock awards totaled \$2.3 million and \$7.0 million during the three and nine months ended September 30, 2006 compared to \$491 thousand and \$1.3 million during the three and nine months ended September 30, 2005.

Salaries and wages expense for the third quarter of 2006 increased \$1.3 million, or 2.7%, compared to the second quarter of 2006. The increase was partly related to normal, annual merit increases, an increase in headcount and an increase in the incentive compensation accrual. The increase was also partly due to increased commissions related to higher insurance revenues.

Employee Benefits. Employee benefits expense for the three and nine months ended September 30, 2006 increased \$909 thousand, or 9.1%, and \$3.2 million, or 9.8%, compared to the same periods in 2005. The increase during the three months ended September 30, 2006 was primarily related to increases in medical insurance expense (up \$259 thousand), payroll taxes (up \$256 thousand), expenses related to the Corporation's 401(k) and profit sharing plans (up \$231 thousand) and expenses related to the Corporation's defined benefit retirement and restoration plans (up \$205 thousand). The increase during the nine months ended September 30, 2006 was primarily related to increases in payroll taxes (up \$1.2 million), medical insurance expense (up \$719 thousand), expenses related to the Corporation's defined benefit retirement and restoration plans (up \$613 thousand) and expenses related to the Corporation's 401(k) and profit sharing plans (up \$522 thousand). The increases in employee benefits expense for both the three and nine months ended September 30, 2006 compared to the same periods in 2005 were also partly the result of increases in headcount related to the acquisition of Horizon Capital Bank during the fourth quarter of 2005 and the acquisitions of Texas Community Bancshares and Alamo Corporation of Texas during the first quarter of 2006.

Employee benefits expense for the third quarter of 2006 decreased \$552 thousand, or 4.8%, compared to the second quarter of 2006. The decrease is primarily due to decreases in payroll taxes (down \$350 thousand) and expenses related to the Corporation's 401(k) and profit sharing plans (down \$124 thousand).

The Corporation's defined benefit retirement and restoration plans were frozen effective as of December 31, 2001 and were replaced by the profit sharing plan. Management believes these actions reduce the volatility in retirement plan expense. However, the Corporation still has funding obligations related to the defined benefit and restoration plans and could recognize retirement expense related to these plans in future years, which would be dependent on the return earned on plan assets, the level of interest rates and employee turnover.

Net Occupancy. Net occupancy expense for the three and nine months ended September 30, 2006 increased \$853 thousand, or 10.5%, and \$3.0 million, or 13.3%, compared to the same periods in 2005. The increase during the three months ended September 30, 2006 was primarily due to increases in depreciation expense related to buildings

(up \$173 thousand), property taxes (up \$135 thousand), utilities expense (up \$125 thousand) and a decrease in rental income (down \$102 thousand) as well as increases in various other categories of occupancy expense. The increase during the nine months ended September 30, 2006 was primarily due to increases in utilities expense (up \$726 thousand), lease expense (up \$466 thousand), property taxes (up \$434 thousand), depreciation expense related to buildings (up \$418 thousand) and a decrease in rental income (down \$293 thousand) as well as increases in various other categories of occupancy expense. These increases are partly related to the additional facilities added in connection with recent acquisitions during the fourth quarter of 2005 and the first quarter of 2006 (see Note 2 - Mergers and Acquisitions).

Net occupancy expense for the third quarter of 2006 increased \$452 thousand, or 5.3%, compared to the second quarter of 2006. The increase is primarily due to increases in lease expense (up \$258 thousand), utilities expense (up \$196 thousand) and service contracts (up \$102 thousand) partly offset by an increase in rental income (up \$192 thousand).

Furniture and Equipment. Furniture and equipment expense for the three and nine months ended September 30, 2006 increased \$351 thousand, or 5.7%, and \$1.3 million, or 7.2%, compared to the same periods in 2005. The increase during the three months ended September 30, 2006 was primarily related to increases in software maintenance expense (up \$478 thousand), service contracts expense (up \$327 thousand) and depreciation expense related to furniture and fixtures (up \$173 thousand). The impact of these items was partially offset by a decrease in software amortization expense (down \$641 thousand). The increase during the nine months ended September 30, 2006 was primarily related to increases in software maintenance expense (up \$1.3 million), depreciation expense related to furniture and fixtures (up \$824 thousand) and service contracts expense (up \$628 thousand). The impact of these items was partially offset by a decrease in software amortization expense (down \$1.7 million).

Furniture and equipment expense for the third quarter of 2006 increased \$196 thousand, or 3.1%, compared to the second quarter of 2006. The increase is primarily related to increases in service contracts expense (up \$206 thousand) and software maintenance expense (up \$183 thousand) partly offset by a decrease in depreciation expense related to furniture and fixtures (down \$93 thousand).

Intangible Amortization. Intangible amortization is primarily related to core deposit intangibles and, to a lesser extent, intangibles related to non-compete agreements and customer relationships. Intangible amortization totaled \$1.3 million and \$4.0 million for the three and nine months ended September 30, 2006 compared to \$1.1 million and \$3.7 million during the same periods in 2005 and \$1.4 million during the second quarter of 2006. The increase in intangible amortization during 2006 compared to 2005 was primarily due to the amortization of new intangible assets acquired in connection with recent acquisitions during the fourth quarter of 2005 and the first quarter of 2006 (see Note 2 - Mergers and Acquisitions and Note 6 - Goodwill and Other Intangible Assets).

Other Non-Interest Expense. Other non-interest expense for the three and nine months ended September 30, 2006 increased \$1.7 million, or 6.7%, and \$3.6 million, or 5.0%, compared to the same periods in 2005. Components of the increase during the three months ended September 30, 2006 included professional service expense (up \$1.2 million) and other non-interest expense (up \$0.5 million). (7) the amount of Indebtedness issued at a price that is less than the principal amount thereof will be equal to the amount of the liability in respect thereof determined in accordance with GAAP.

Accrual of interest, accrual of dividends, the accretion of accreted value or original issue discount, the amortization of debt discount, the payment of interest in the form of additional Indebtedness and the payment of dividends in the form of additional shares of Preferred Stock or Disqualified Stock will not be deemed to be an Incurrence of Indebtedness for purposes of this covenant. The amount of any Indebtedness outstanding as of any date shall be (i) the accreted value thereof in the case of any Indebtedness issued with original issue discount or the aggregate principal amount outstanding in the case of Indebtedness issued with interest payable in kind and (ii) the principal amount or liquidation preference thereof in the case of any other Indebtedness.

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In addition, the Company will not permit any of its Unrestricted Subsidiaries, for so long as it is an Unrestricted Subsidiary, to Incur any Indebtedness (including the issuance any shares of Disqualified Stock), other than Non-Recourse Debt. If at any time an Unrestricted Subsidiary becomes a Restricted Subsidiary, any Indebtedness of such Subsidiary shall be deemed to be Incurred by a Restricted Subsidiary as of such date (and, if such Indebtedness is not permitted to be Incurred as of such date under this Limitation on indebtedness covenant, the Company shall be in Default of this covenant).

For purposes of determining compliance with any U.S. dollar-denominated restriction on the Incurrence of Indebtedness, the U.S. dollar-equivalent principal amount of Indebtedness denominated in a foreign currency shall be calculated based on the relevant currency exchange rate in effect on the date such Indebtedness was Incurred, in the case of term Indebtedness, or first committed, in the case of revolving credit Indebtedness; *provided* that if such Indebtedness is Incurred to refinance other Indebtedness denominated in a foreign currency, and such refinancing would cause the applicable U.S. dollar-denominated restriction to be exceeded if calculated at the relevant currency exchange rate in effect on the date of such refinancing, such U.S. dollar-denominated restriction shall be deemed not to have been exceeded so long as the principal amount of such Refinancing Indebtedness does not exceed the principal amount of such Indebtedness being refinanced. Notwithstanding any other provision of this covenant, the maximum amount of Indebtedness that the Company may Incur pursuant to

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this covenant shall not be deemed to be exceeded solely as a result of fluctuations in the exchange rate of currencies. The principal amount of any Indebtedness Incurred to refinance other Indebtedness, if Incurred in a different currency from the Indebtedness being refinanced, shall be calculated based on the currency exchange rate applicable to the currencies in which such Refinancing Indebtedness is denominated that is in effect on the date of such refinancing.

Limitation on restricted payments

The Company will not, and will not permit any of its Restricted Subsidiaries, directly or indirectly, to:

(1) declare or pay any dividend or make any distribution (whether made in cash, securities or other assets or property) on or in respect of its or any of its Restricted Subsidiaries' Capital Stock (including any payment in connection with any merger or consolidation involving the Company or any of its Restricted Subsidiaries) other than:

(a) dividends or distributions payable solely in Capital Stock of the Company (other than Disqualified Stock); and

(b) dividends or distributions by a Restricted Subsidiary payable to the Company or another Restricted Subsidiary (and if such Restricted Subsidiary is not a Wholly Owned Subsidiary, to its other holders of common Capital Stock; *provided* that the Company or a Restricted Subsidiary receives at least its pro rata share of such dividend or distribution);

(2) purchase, redeem, retire or otherwise acquire for value any Capital Stock of the Company or any direct or indirect parent of the Company held by Persons other than the Company or a Restricted Subsidiary (other than in exchange for Capital Stock of the Company (other than Disqualified Stock));

(3) make any principal payment on, or purchase, repurchase, redeem, defease or otherwise acquire or retire for value, prior to any scheduled maturity, scheduled repayment or scheduled sinking fund payment, any Subordinated Obligations or Guarantor Subordinated Obligations, other than:

(a) Indebtedness of the Company owing to and held by any Restricted Subsidiary or Indebtedness of a Subsidiary Guarantor owing to and held by the Company or any Restricted Subsidiary; or

(b) the purchase, repurchase, redemption, defeasance or other acquisition or retirement of Subordinated Obligations or Guarantor Subordinated Obligations purchased in anticipation of satisfying a sinking fund obligation, principal installment or final maturity, in each case due within one year of the date of purchase, repurchase, redemption, defeasance or other acquisition or retirement); or

(4) make any Restricted Investment;

(all such payments and other actions referred to in clauses (1) through (4) (other than any exception thereto) shall be referred to as a *Restricted Payment*), unless, at the time of and after giving effect to such Restricted Payment:

(a) no Default shall have occurred and be continuing (or would result therefrom);

(b) immediately after giving effect to such Restricted Payment on a *pro forma* basis, the Company is able to Incur \$1.00 of additional Indebtedness under the provisions of the first paragraph of the *Limitation on indebtedness* covenant; and

(c) the aggregate amount of such Restricted Payment and all other Restricted Payments declared or made subsequent to the Issue Date (excluding Restricted Payments made pursuant to clauses (1), (2), (3), (7), (8), (9), (10), (12), (13) and (14) of the next succeeding paragraph) would not exceed the sum of (without duplication):

(i) 50% of the Company's Consolidated Net Income for the period (treated as one accounting period) from October 3, 2009 to the end of the Company's most recent fiscal quarter ending prior to the date of such Restricted Payment for which financial statements prepared on a consolidated basis in accordance with GAAP are available;

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(ii) 100% of the aggregate Net Cash Proceeds and the fair market value, as determined in good faith by an Officer of the Company (if in excess of \$25.0 million, as evidenced by an Officers Certificate) or if in excess of \$50.0 million by the Board of Directors of the Company, of marketable securities or other property received by the Company since October 22, 2009 from the issue or sale of its Capital Stock (other than Disqualified Stock) or as a capital contribution, other than:

(A) Net Cash Proceeds received from an issuance or sale of such Capital Stock to a Subsidiary of the Company or to an employee stock ownership plan, option plan or similar trust (to the extent such sale to an employee stock ownership plan or similar trust is financed by loans from or Guaranteed by the Company or any Restricted Subsidiary unless such loans have been repaid with cash on or prior to the date of determination); and

(B) Net Cash Proceeds received by the Company from the issue and sale of its Capital Stock or capital contributions to the extent applied to redeem Notes in compliance with the provisions set forth under the second paragraph of the caption Optional redemption ;

(iii) 100% of any cash dividends or cash distributions received directly or indirectly by the Company or a Restricted Subsidiary after the Issue Date from an Unrestricted Subsidiary, to the extent that such dividends or distributions were not otherwise included in Consolidated Net Income;

(iv) the amount by which Indebtedness of the Company or its Restricted Subsidiaries is reduced on the Company s consolidated balance sheet upon the conversion or exchange subsequent to the Issue Date of any Indebtedness of the Company or its Restricted Subsidiaries (other than debt owing to and held by a Subsidiary of the Company) convertible or exchangeable for Capital Stock (other than Disqualified Stock) of the Company (less the amount of any cash, or the fair market value of any other property, distributed by the Company upon such conversion or exchange); and

(v) the amount equal to the net reduction in Restricted Investments made by the Company or any of its Restricted Subsidiaries in any Person resulting from:

(A) repurchases or redemptions of such Restricted Investments by such Person, proceeds realized upon the sale of such Restricted Investment to an unaffiliated purchaser, or repayments of loans or advances or other transfers of property or assets (including by way of dividend or distribution) by such Person to the Company or any Restricted Subsidiary (other than for reimbursement of tax payments);

(B) the release of any Guarantee (except to the extent any amounts are paid under such Guarantee); or

(C) the redesignation of Unrestricted Subsidiaries as Restricted Subsidiaries or the merger or consolidation of an Unrestricted Subsidiary with and into the Company or any of its Restricted Subsidiaries (valued in each case as provided in the definition of Investment) not to exceed the amount of Investments previously made by the Company or any Restricted Subsidiary in such Unrestricted Subsidiary,

which amount in each case under this clause (v) was included in the calculation of the amount of Restricted Payments; *provided, however*, that no amount will be included under this clause (v) to the extent it is already included in Consolidated Net Income.

The provisions of the preceding paragraph will not prohibit:

(1) a Restricted Payment made by exchange for, or out of the proceeds of, a substantially concurrent sale of, Capital Stock of the Company (other than Disqualified Stock and other than Capital Stock issued or sold to a Subsidiary or an employee stock ownership plan or similar trust to the extent such sale to an employee stock ownership plan or similar trust is financed by loans from or Guaranteed by the Company or any Restricted Subsidiary unless such loans have been repaid with cash on or prior to the date of determination)

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or any cash capital contribution to the Company; *provided, however*, that the amount of Net Cash Proceeds from such sale of Capital Stock that is utilized for such Restricted Payment will be excluded from clause (c)(ii) of the preceding paragraph;

(2) any purchase, repurchase, redemption, defeasance or other acquisition or retirement of Subordinated Obligations of the Company or Guarantor Subordinated Obligations of any Subsidiary Guarantor made by exchange for, or out of the proceeds of, the substantially concurrent sale of, Subordinated Obligations of the Company or any purchase, repurchase, redemption, defeasance or other acquisition or retirement of Guarantor Subordinated Obligations made by exchange for, or out of the proceeds of, the substantially concurrent sale of Guarantor Subordinated Obligations so long as such refinancing Subordinated Obligations or Guarantor Subordinated Obligations are permitted to be Incurred pursuant to the covenant described under Limitation on indebtedness and constitute Refinancing Indebtedness;

(3) any purchase, repurchase, redemption, defeasance or other acquisition or retirement of Disqualified Stock of the Company or a Restricted Subsidiary made by exchange for, or out of the proceeds of, the substantially concurrent sale of Disqualified Stock of the Company or such Restricted Subsidiary, as the case may be, so long as such refinancing Disqualified Stock is permitted to be Incurred pursuant to the covenant described under Limitation on indebtedness and constitutes Refinancing Indebtedness;

(4) the purchase, repurchase, redemption, defeasance or other acquisition or retirement for value of any Subordinated Obligation (a) at a purchase price not greater than 101% of the principal amount of such Subordinated Obligation in the event of a Change of Control in accordance with provisions similar to the Repurchase at the option of holders Change of control covenant or (b) at a purchase price not greater than 100% of the principal amount thereof in accordance with provisions similar to the Repurchase at the option of holders Sales of assets and subsidiary stock covenant; *provided* that, prior to or simultaneously with such purchase, repurchase, redemption, defeasance or other acquisition or retirement, the Company has made the Change of Control Offer or Asset Sale Offer, as applicable, as provided in such covenant with respect to the Notes and has completed the repurchase or redemption of all Notes validly tendered for payment in connection with such Change of Control Offer or Asset Sale Offer;

(5) any purchase or redemption of Subordinated Obligations or Guarantor Subordinated Obligations of a Subsidiary Guarantor from Net Available Cash to the extent permitted under Repurchase at the option of holders Sales of assets and subsidiary stock below;

(6) the payment of any dividend or distribution, or the consummation of any irrevocable redemption, within 60 days after the date of declaration of the dividend or distribution or giving of the redemption notice, as the case may be, if at such date of declaration or redemption notice such dividend, distribution or redemption, as the case may be, would have complied with this provision;

(7) the purchase, redemption or other acquisition, cancellation or retirement for value of Capital Stock or equity appreciation rights of the Company or any direct or indirect parent of the Company held by any existing or former employees, officers, directors, management or consultants of the Company or any Subsidiary of the Company or their assigns, estates or heirs, in each case in connection with the repurchase provisions under employee stock option or stock purchase agreements or other agreements to compensate employees, officers, directors, management or consultants entered into in the ordinary course of business or approved by the Board of Directors of the Company; *provided* that such Capital Stock or equity appreciation rights were received for services related to, or for the benefit of, the Company and its Restricted Subsidiaries; and *provided further* that such redemptions or repurchases pursuant to this clause will not exceed \$15.0 million in the aggregate during any fiscal year (with unused amounts in any fiscal year being carried over to the next succeeding fiscal year), subject to a maximum payment in any fiscal year of \$25.0 million, although such amount in any fiscal year may be increased by an amount not to exceed:

(a) the Net Cash Proceeds from the sale of Capital Stock (other than Disqualified Stock) of the Company and, to the extent contributed to the Company, Capital Stock of any of the Company's direct or indirect parent companies, in each case to existing or former employees, officers, directors, management or consultants of the Company, any Subsidiary of the Company or any of its direct or

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indirect parent companies that occurs after the Issue Date, to the extent the cash proceeds from the sale of such Capital Stock have not otherwise been applied to the payment of Restricted Payments (provided that the amount of Net Cash Proceeds from such sales or contributions that is utilized for redemptions or repurchases pursuant to this clause (7) will be excluded from clause (c)(ii) of the preceding paragraph); *plus*

(b) the cash proceeds of key man life insurance policies received by the Company or its Restricted Subsidiaries after the Issue Date; *less*

(c) the amount of any Restricted Payments previously made with the cash proceeds described in the clauses (a) and (b) of this clause (7);

provided, further, that the aggregate amount of Restricted Payments made pursuant to this clause (7) shall not exceed \$50.0 million in the aggregate;

(8) the declaration and payment of dividends or distributions to holders of any class or series of Disqualified Stock of the Company or any of its Restricted Subsidiaries Incurred in accordance with the covenant described under Limitation on indebtedness ;

(9) the purchase, redemption or other acquisition, cancellation or retirement of Capital Stock: (a) deemed to occur upon the exercise or exchange of options, warrants, other rights to purchase or acquire Capital Stock or other securities convertible into or exchangeable for Capital Stock if such Capital Stock represents a portion of the exercise or exchange price thereof, or (b) made in lieu of withholding taxes resulting from the exercise or exchange of options, warrants, other rights to purchase or acquire Capital Stock or other securities convertible into or exchangeable for Capital Stock;

(10) the distribution, by dividend or otherwise, of shares of Capital Stock of Unrestricted Subsidiaries (other than Unrestricted Subsidiaries the primary assets of which are cash and/or cash equivalents);

(11) other Restricted Payments in an aggregate amount, which, when taken together with all other Restricted Payments made pursuant to this clause (11) (as reduced by the amount of capital repaid or otherwise returned from any such Restricted Payments that constituted Restricted Investments in the form of cash and Cash Equivalents (exclusive of items reflected in Consolidated Net Income) not to exceed \$75.0 million;

(12) payments in lieu of the issuance of fractional shares in connection with the exercise or exchange of options, warrants or other rights to purchase or acquire Capital Stock or other securities convertible into or exchangeable for Capital Stock;

(13) the purchase, redemption, acquisition, cancellation or other retirement of any Capital Stock of the Company or a Restricted Subsidiary to the extent necessary, in the good faith judgment of the Company, to prevent the loss or secure the renewal or reinstatement of any license, permit or other authorization held by the Company or any of its Subsidiaries issued by any governmental or regulatory authority or to comply with government contracting regulations;

(14) the repurchase, from any future, present or former employee, consultant, director or officer of the Company or its Subsidiaries, of Capital Stock or other securities convertible into or exchangeable for Capital Stock deemed to occur upon the exercise or exchange of options, warrants or other rights to purchase or acquire Capital Stock where such repurchase represents (a) all or a portion of the exercise price therefor or (b) payments in connection with a withholding to pay for taxes payable by the holder thereof; and

(15) any payment of cash by the Company or any Subsidiary issuer to a holder of Convertible Notes upon conversion or exchange of such Convertible Notes, and entry into or any payment in connection with any termination of any Permitted Bond Hedge or any Permitted Warrant;

provided, however, that at the time of and after giving effect to, any Restricted Payment permitted under clauses (5), (7), (8), (10) and (11), no Default shall have occurred and be continuing or would occur as a consequence thereof.

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The amount of all Restricted Payments (other than cash) will be the fair market value on the date such Restricted Payment is made of the assets, securities or other property proposed to be declared, paid, made, purchased, redeemed, retired, defeased or acquired pursuant to such Restricted Payment. The fair market value of any cash Restricted Payment shall be its face amount. With respect to any non-cash Restricted Payment, such fair market value shall be determined, if the fair market value of such non-cash Restricted Payment (a) exceeds \$25.0 million by an Officer of the Company (as evidenced by an Officers Certificate) or (b) exceeds \$50.0 million by the Board of Directors of the Company, in each case acting in good faith. Not later than the date of making any Restricted Payment under the first paragraph or clause (11) of the paragraph above, the Company shall deliver to the Trustee an Officers Certificate stating that such Restricted Payment is permitted and setting forth the basis upon which the calculations required by the covenant Limitation on restricted payments were computed.

As of the Issue Date, all of the Company's Subsidiaries other than TrellisWare will be Restricted Subsidiaries. The Company will not permit any Unrestricted Subsidiary to become a Restricted Subsidiary except pursuant to the last sentence of the definition of Unrestricted Subsidiary. For purposes of designating any Restricted Subsidiary as an Unrestricted Subsidiary, all outstanding Investments by the Company and its Restricted Subsidiaries (except to the extent repaid) in the Subsidiary so designated will be deemed to be Restricted Payments and/or Permitted Investments in an amount determined as set forth in the definition of Investment. Such designation will be permitted only if a Restricted Payment and/or Permitted Investment in such amount would be permitted at such time and if such Subsidiary otherwise meets the definition of an Unrestricted Subsidiary. Unrestricted Subsidiaries will not be subject to any of the restrictive covenants set forth in the Indenture.

Limitation on liens

The Company will not, and will not permit any of its Restricted Subsidiaries to, directly or indirectly, create or incur any Lien securing Indebtedness (other than Permitted Liens) upon any of its property or assets (including Capital Stock of Subsidiaries), or income or profits therefrom, or assign or convey any right to receive income therefrom, whether owned on the Issue Date or acquired after that date, which Lien is securing any Indebtedness, unless contemporaneously with the Incurrence of such Liens:

(1) in the case of Liens securing Subordinated Obligations or Guarantor Subordinated Obligations, the Notes and related Subsidiary Guarantees are secured by a Lien on such property, assets or proceeds that is senior to such Liens; or

(2) in all other cases, the Notes and related Subsidiary Guarantees are equally and ratably secured or are secured by a Lien on such property, assets or proceeds that is senior in priority to such Liens.

Any Lien created for the benefit of holders of the Notes pursuant to this covenant shall be automatically and unconditionally released and discharged upon the release and discharge of each of the Liens described in clauses (1) and (2) above.

Limitation on restrictions on distributions from restricted subsidiaries

The Company will not, and will not permit any Restricted Subsidiary to, directly or indirectly, create or otherwise cause or permit to exist or become effective any consensual encumbrance or consensual restriction on the ability of any Restricted Subsidiary to:

(1) pay dividends or make any other distributions on its Capital Stock to the Company or any of its Restricted Subsidiaries, or with respect to any other interest or participation in, or measured by, its profits, or pay any Indebtedness or other obligations owed to the Company or any Restricted Subsidiary (it being understood that the priority of any Preferred Stock in receiving dividends or liquidating distributions prior to dividends or liquidating distributions being paid on Common Stock shall not be deemed a restriction on the ability to make distributions on Capital Stock);

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(2) make any loans or advances to the Company or any Restricted Subsidiary (it being understood that the subordination of loans or advances made to the Company or any Restricted Subsidiary to other Indebtedness Incurred by the Company or any Restricted Subsidiary shall not be deemed a restriction on the ability to make loans or advances); or

(3) sell, lease or transfer any of its property or assets to the Company or any Restricted Subsidiary (it being understood that such transfers shall not include any type of transfer described in clause (1) or (2) above).

The preceding provisions will not prohibit encumbrances or restrictions existing under or by reason of:

(a) the Senior Credit Facility or any other agreement or instrument in effect at or entered into on the Issue Date;

(b) the Indenture, the Notes, the Exchange Notes and the Subsidiary Guarantees;

(c) any agreement or other instrument of a Person acquired by or merged or consolidated with or into the Company or any of its Restricted Subsidiaries in existence at the time of such acquisition, merger or consolidation (but not created in contemplation thereof), which encumbrance or restriction is not applicable to any Person, or the property or assets of any Person, other than the Person and its Subsidiaries, or the property or assets of the Person and its Subsidiaries, so acquired (including after-acquired property and assets);

(d) any amendment, restatement, modification, renewal, supplement, extension, refunding, replacement or refinancing of an agreement referred to in clauses (a), (b), (c) or this clause (d); *provided, however*, that the encumbrances or restrictions contained in such amendment, restatement, modification, renewal, supplement, extension, refunding, replacement or refinancing is, in the good faith judgment of the Company, not materially more restrictive, when taken as a whole, than the encumbrances and restrictions contained in any of the agreements or instruments referred to in clauses (a), (b) or (c) of this paragraph on the Issue Date or the date such Restricted Subsidiary became a Restricted Subsidiary or was merged or consolidated with or into the Company or a Restricted Subsidiary, whichever is applicable;

(e) in the case of clause (3) of the first paragraph of this covenant, Permitted Liens or Liens otherwise permitted to be Incurred under the provisions of the covenant described under *Limitation on liens* that limit the right of the debtor to dispose of property or assets subject to such Liens;

(f) purchase money obligations, mortgage financings, Capitalized Lease Obligations and similar obligations or agreements permitted under the Indenture, in each case, that impose encumbrances or restrictions of the nature described in clause (3) of the first paragraph of this covenant with respect to the property or assets acquired, financed, designed, leased, constructed, repaired, maintained, installed or improved in connection therewith or thereby (including any proceeds thereof, accessions thereto and any upgrades or improvements thereto);

(g) agreements for the sale, transfer or other disposition of property or assets, including without limitation customary restrictions with respect to a Subsidiary of the Company pursuant to an agreement that has been entered into for the sale, transfer or other disposition of all or a portion of the Capital Stock, property or assets of such Subsidiary;

(h) restrictions on cash, Cash Equivalents or other deposits or net worth imposed by customers, suppliers or landlords under contracts entered into in the ordinary course of business or as required by insurance surety or bonding companies;

(i) any provisions in joint venture agreements, partnership agreements, LLC agreements and other similar agreements, which (x) are customary or (y) do not adversely affect the Company's ability to make payments of principal or interest payments on the Notes when due, as determined in good faith by an Officer of the Company (if the consideration thereunder is in excess of \$25.0 million, as evidenced by an Officers' Certificate) or if the consideration thereunder is in excess of \$50.0 million by the Board of Directors of the Company;

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(j) any provisions in leases, subleases, licenses, asset sale agreements, sale/leaseback agreements or stock sale agreements and other agreements entered into by the Company or any Restricted Subsidiary that (x) are customary and entered into in the ordinary course of business or (y) do not adversely affect the Company's ability to make payments of principal or interest payments on the Notes when due, as determined in good faith by an Officer of the Company (if the consideration thereunder is in excess of \$25.0 million, as evidenced by an Officer's Certificate) or if the consideration thereunder is in excess of \$50.0 million by the Board of Directors of the Company;

(k) applicable law or any applicable rule, regulation or order, or any license, permit or other authorization issued by any governmental or regulatory authority; or

(l) Debt Facilities or other debt arrangements Incurred by the Company or any Restricted Subsidiary, or Preferred Stock issued by any Restricted Subsidiary, in accordance with Limitation on indebtedness, that are not materially more restrictive, when taken as a whole, than those applicable in either the Indenture or the Senior Credit Facility on the Issue Date, which, as determined in good faith by the Company, do not adversely affect the Company's ability to make payments of principal or interest payments on the Notes when due.

Limitation on affiliate transactions

The Company will not, and will not permit any of its Restricted Subsidiaries to, directly or indirectly, enter into or conduct any transaction (including the purchase, sale, lease or exchange of any property or the rendering of any service) with any Affiliate of the Company (an *Affiliate Transaction*) unless:

(1) the terms of such Affiliate Transaction are not materially less favorable to the Company or such Restricted Subsidiary, as the case may be, when taken as a whole, than those that would have been obtained by the Company or such Restricted Subsidiary in a comparable transaction at the time of such transaction on an arm's-length basis with a Person who is not an Affiliate;

(2) in the event such Affiliate Transaction involves an aggregate consideration in excess of \$50.0 million, the terms of such transaction have been approved by a majority of the disinterested members of the Board of Directors of the Company and the Board of the Directors of the Company shall have determined in good faith that such Affiliate Transaction satisfies the criteria in clause (1) above); and

(3) in the event such Affiliate Transaction involves an aggregate consideration in excess of \$75.0 million, the Company has received a written opinion from an Independent Financial Advisor (a) that such Affiliate Transaction is not materially less favorable, when taken as a whole, than those that might reasonably have been obtained in a comparable transaction at the time of such transaction on an arm's-length basis with a Person who is not an Affiliate, or (b) as to the fairness to the Company or such Restricted Subsidiary of such Affiliate Transaction from a financial point of view.

The preceding paragraph will not apply to:

(1) any transaction between or among the Company and one or more Restricted Subsidiaries or between or among any Restricted Subsidiaries and any Guarantees issued by the Company or a Restricted Subsidiary for the benefit of the Company or a Restricted Subsidiary, as the case may be, in accordance with Limitation on indebtedness;

(2) any Restricted Payment permitted to be made pursuant to the covenant described under Limitation on restricted payments or any Permitted Investments ;

(3) any employment, consulting, service or termination agreement, or indemnification arrangement, entered into by the Company or a Restricted Subsidiary with a current or former director, officer or employee of the Company or a Restricted Subsidiary; the payment of compensation or expense reimbursement to any current or former director, officer or employee of the Company or a Restricted Subsidiary (including amounts paid pursuant to employee benefit, employee stock option or similar plans); or any issuance of securities, or other

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payments, awards or grants in cash, securities or otherwise pursuant to, or the funding of, employment agreements and other compensation arrangements, options to purchase Capital Stock of the Company, restricted stock plans, restricted stock unit plans, long-term incentive plans, stock appreciation rights plans, participation plans or similar employee benefits plans and/or indemnity provided on behalf of directors, officers and employees of the Company or a Restricted Subsidiary approved by the Board of Directors of the Company;

(4) the payment of reasonable fees and expense reimbursements to current or former directors of the Company or any Restricted Subsidiary;

(5) loans or advances to employees, officers or directors of the Company or any Restricted Subsidiary in the ordinary course of business consistent with past practices, in an aggregate amount not in excess of \$15.0 million outstanding at any time;

(6) any agreement as in effect as of the Issue Date, as such agreement may be amended, modified, supplemented, extended or renewed from time to time, so long as any such amendment, modification, supplement, extension or renewal, when taken as a whole, is not materially more disadvantageous to the holders, in the reasonable determination of the Company, than the terms of any such agreements in effect on the Issue Date;

(7) any agreement between any Person and an Affiliate of such Person existing at the time such Person is acquired by or merged or consolidated with or into the Company or a Restricted Subsidiary, as such agreement may be amended, modified, supplemented, extended or renewed from time to time; *provided* that such agreement was not entered into contemplation of such acquisition, merger or consolidation, and so long as any such amendment, modification, supplement, extension or renewal, when taken as a whole, is not materially more disadvantageous to the holders, in the reasonable determination of the Company, than the applicable agreement as in effect on the date of such acquisition, merger or consolidation;

(8) transactions with customers, clients, suppliers, joint venture partners or purchasers or sellers of goods or services, in each case in the ordinary course of the business of the Company and its Restricted Subsidiaries and otherwise in compliance with the terms of the Indenture; *provided* that, in the reasonable determination of the Company, such transactions are on terms that are not materially less favorable, when taken as a whole, to the Company or the relevant Restricted Subsidiary than those that would have been obtained in a comparable transaction by the Company or such Restricted Subsidiary with an unrelated Person;

(9) transactions with a Permitted Joint Venture pursuant to which the Company or any of its Restricted Subsidiaries provides, leases or receives any of the following: managerial, operational, technical, administrative or other services; property, plant, equipment or other goods (including without limitation gateways, hubs and ground equipment); satellite capacity; intellectual property or other tangible or intangible assets, property or rights; *provided* that, as determined in good faith by the Company, such transaction (i) is in the best interests of the Company and its Restricted Subsidiaries and (ii) does not affect the Company's ability to make payments of principal or interest payments on the Notes when due;

(10) any issuance or sale of Capital Stock (other than Disqualified Stock) to Affiliates of the Company and the granting of registration and other customary rights with respect thereto;

(11) any transaction, or series of related transactions, involving aggregate consideration not exceeding \$5.0 million; and

(12) transactions in which the Company or any Restricted Subsidiary delivers to the Trustee a letter or opinion from an Independent Financial Advisor stating that such transaction is fair to the Company or such Restricted Subsidiary from a financial point of view or stating that the terms are not materially less favorable, when taken as a whole, than those that might reasonably have been obtained by the Company or such Restricted Subsidiary in a comparable transaction at such time on an arms-length basis from a Person that is not an Affiliate.

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Maintenance of insurance

The Company will deliver an Officers Certificate to the Trustee within 120 days after the end of each fiscal year certifying that the Company and each of its Restricted Subsidiaries has obtained and has in full force and effect:

(1) with respect to each Covered Satellite for which the risk of loss passes to the Company or such Restricted Subsidiary at or before launch, launch insurance with respect to each such Covered Satellite covering the launch of such Covered Satellite and a period of time thereafter in an amount not less than the aggregate of the purchase price of such Covered Satellite, the purchase price of launch services therefor (other than for risks borne by the relevant satellite manufacturer or by the relevant launch services provider pursuant to any launch risk guarantee) and the premium payable for such insurance; *provided* that such launch insurance is available for a price, in an amount and on other terms and conditions that are, in the reasonable determination of the Company, commercially reasonable; and

(2) at all times subsequent to the later of (x) initial completion of in-orbit testing and (y) the coverage period of launch insurance described in clause (1) above, In-Orbit Insurance with respect to Covered Satellites other than Excluded Satellites in an amount not less than the Aggregate In-Orbit Insurance Amount (with the allocation of such insurance among such Covered Satellites being in the Company's discretion).

Insurance policies required by the foregoing paragraph, shall:

(1) contain no exclusions other than:

(A) Acceptable Exclusions, and

(B) such specific exclusions applicable to the performance of the Covered Satellite being insured as are reasonably acceptable to the Company in order to obtain insurance for a price that is, and on other terms and conditions that are, commercially reasonable; and

(2) provide coverage on an all-risks basis for loss of and damage to the Covered Satellite, subject to the exclusions specified above.

The insurance required by this covenant shall name the Company and/or one or more Restricted Subsidiaries as named insureds.

For any Covered Satellite, in lieu of In-Orbit Insurance, the Company may, at its option, maintain In-Orbit Spare Capacity in which event such Covered Satellite (or portion, as applicable) shall be deemed to be insured for the percentage of the Covered Satellite's (or applicable portion's) net book value for which In-Orbit Spare Capacity is available. In the event of any loss, damage or failure affecting a Covered Satellite or the expiration and non-renewal of an insurance policy for a Covered Satellite resulting from a claim of loss under such policy that causes a failure to comply with clause (2) of the immediately preceding paragraph, the Company and its Restricted Subsidiaries shall be deemed to be in compliance with clause (2) of the immediately preceding paragraph for the 120 days immediately following such loss, damage or failure or policy expiration or non-renewal, provided that the Company or a Restricted Subsidiary, as the case may be, procures such In-Orbit Insurance or provides such In-Orbit Spare Capacity as necessary to comply with clause (2) within such 120 day period.

SEC reports

Notwithstanding that the Company is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act or otherwise report on an annual and quarterly basis on forms provided for such annual and quarterly reporting pursuant to rules and regulations promulgated by the SEC, the Company will (a) file with the SEC (unless the SEC will not accept such filing), and (b) make available to the Trustee and, upon written request, the registered holders of the Notes, without cost to any holder, from and after the Issue Date:

(1) within the time periods specified by the Exchange Act (including all applicable extension periods), an annual report on Form 10-K (or any successor or comparable form) containing the information required to be contained therein in all material respects (or required in such successor or comparable form);

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(2) within the time periods specified by the Exchange Act (including all applicable extension periods), a quarterly report on Form 10-Q (or any successor or comparable form); and

(3) all current reports that would be required to be filed with the SEC on Form 8-K (or any successor or comparable form).

In the event that the Company is not permitted to file such reports with the SEC pursuant to the Exchange Act, the Company will nevertheless make available such Exchange Act reports to the Trustee and the holders of the Notes as if the Company were subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act within the time periods specified by the Exchange Act (including all applicable extension periods), which requirement may be satisfied by posting such reports on its website within the time periods specified by this covenant. Notwithstanding the foregoing, the availability of the reports referred to in paragraphs (1) through (3) above on the SEC's Electronic Data Gathering, Analysis and Retrieval system (or any successor system) and the Company's website within the time periods specified above will be deemed to satisfy this delivery obligation.

If the Company has designated any of its Subsidiaries as Unrestricted Subsidiaries and such Unrestricted Subsidiaries, either individually or collectively, would otherwise have been a Significant Subsidiary, then the quarterly and annual financial information required by this covenant shall include a reasonably detailed presentation, either on the face of the financial statements or in the footnotes to the financial statements, and in management's discussion and analysis of financial condition and results of operations, of the financial condition and results of operations of the Company and its Restricted Subsidiaries separate from the financial condition and results of operations of the Unrestricted Subsidiaries.

In addition, the Company and the Subsidiary Guarantors have agreed that they will make available to the holders and to prospective investors, upon the request of such holders, the information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act so long as the Notes are not freely transferable under the Securities Act. For purposes of this covenant, the Company and the Subsidiary Guarantors will be deemed to have furnished the reports to the Trustee and the holders of Notes as required by this covenant if it has filed such reports with the SEC via the EDGAR filing system and such reports are publicly available.

Merger and consolidation

The Company will not consolidate with or merge with or into or wind up into (whether or not the Company is the surviving corporation), or sell, assign, convey, transfer or otherwise dispose of all or substantially all of the properties and assets of the Company and its Restricted Subsidiaries, taken as a whole, in one or more related transactions, to any Person *unless*:

(1) the resulting, surviving or transferee Person (the *Successor Company*) is the Company or will be a corporation, limited liability company or partnership organized and existing under the laws of the United States of America, any State of the United States, the District of Columbia or any territory of the United States; *provided* that if such Person is not a corporation, such Person will immediately cause a Subsidiary that is a corporation to be added as a co-issuer of the Notes under the Indenture;

(2) the Successor Company (if other than the Company) assumes all of the obligations of the Company under the Notes and the Indenture pursuant to a supplemental indenture or other documentation or instruments and assumes by written agreement all of the obligations of the Company, if applicable, under the Registration Rights Agreement;

(3) immediately after giving effect to such transaction, no Default or Event of Default shall have occurred and be continuing;

(4) immediately after giving *pro forma* effect to such transaction and any related financing transactions, as if such transactions had occurred at the beginning of the applicable four-fiscal-quarter period,

(a) the Successor Company would be able to Incur at least \$1.00 of additional Indebtedness pursuant to the first paragraph of the Limitation on indebtedness covenant, or

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(b) the Consolidated Coverage Ratio for the Successor Company would be equal to or greater than such ratio for the Company immediately prior to such transaction; and

(5) each Subsidiary Guarantor (unless it is the other party to the transactions above, in which case clause (1) shall apply) shall have confirmed in writing to the Trustee that its Subsidiary Guarantee shall apply to such Person's obligations in respect of the Indenture and the Notes and, if applicable, that its obligations under the Registration Rights Agreement shall continue to be in effect.

Notwithstanding the preceding clauses (3) and (4),

(1) any Restricted Subsidiary may consolidate with, merge with or into or transfer all or part of its properties and assets to the Company so long as no Capital Stock of the Restricted Subsidiary is distributed to any Person other than the Company, and

(2) the Company may merge with an Affiliate of the Company solely for the purpose of reincorporating the Company in another jurisdiction.

In addition, the Company will not permit any Subsidiary Guarantor to consolidate with or merge with or into or wind up into (whether or not the Subsidiary Guarantor is the surviving corporation), or sell, assign, convey, transfer or otherwise dispose of all or substantially all of its properties and assets to, any Person (other than to the Company or another Subsidiary Guarantor) *unless*:

(1)(a) if such entity remains a Subsidiary Guarantor, the resulting, surviving or transferee Person (the *Successor Guarantor*) will be a corporation, partnership, trust or limited liability company organized and existing under the laws of the United States of America, any State of the United States, the District of Columbia or any other territory thereof and, if applicable, shall assume by written agreement all the obligations of the Subsidiary Guarantor under the Registration Rights Agreement; (b) the Successor Guarantor, if other than such Subsidiary Guarantor or another Subsidiary Guarantor, expressly assumes all the obligations of such Subsidiary Guarantor under the Notes and the Indenture pursuant to a supplemental indenture or other documents or instruments; (c) immediately after giving effect to such transaction, no Default or Event of Default shall have occurred and be continuing; and (d) if the Successor Guarantor is other than such Subsidiary Guarantor or another Subsidiary Guarantor, the Company will have delivered to the Trustee an Officers' Certificate and an Opinion of Counsel, each stating that such consolidation, merger or transfer and such supplemental indenture comply with the Indenture; and

(2) the transaction is made in compliance with the covenant described under Repurchase at the option of holders Sales of assets and subsidiary stock (it being understood that only such portion of the Net Available Cash as is required to be applied on the date of such transaction in accordance with the terms of the Indenture needs to be applied in accordance therewith at such time) and this Merger and consolidation covenant.

In addition, the Company will not, directly or indirectly, lease, or permit any Subsidiary Guarantor to lease, all or substantially all of the properties of it and its Restricted Subsidiaries, taken as a whole, in one or more related transactions, to any other Person.

Subject to certain limitations described in the Indenture, the Successor Guarantor will succeed to, and be substituted for, such Subsidiary Guarantor under the Indenture and the Subsidiary Guarantee of such Subsidiary Guarantor. Notwithstanding the foregoing, any Subsidiary Guarantor may (x) merge with or into or transfer all or part of its properties and assets to another Subsidiary Guarantor or the Company, or (y) merge with a Restricted Subsidiary of the Company solely for the purpose of reincorporating the Subsidiary Guarantor in a State of the United States or the District of Columbia, as long as the amount of Indebtedness of such Subsidiary Guarantor and its Restricted Subsidiaries is not increased thereby, and the resulting entity remains or becomes a Subsidiary Guarantor.

For purposes of this covenant, the sale, assignment, conveyance, transfer, lease or other disposition of all or substantially all of the properties and assets of one or more Subsidiaries of the Company, which properties and

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assets, if held by the Company instead of such Subsidiaries, would constitute all or substantially all of the properties and assets of the Company on a consolidated basis, shall be deemed to be the disposition of all or substantially all of the properties and assets of the Company.

Although there is a limited body of case law interpreting the phrase substantially all, there is no precise established definition of the phrase under applicable law. Accordingly, in certain circumstances there may be a degree of uncertainty as to whether a particular transaction would involve all or substantially all of the property or assets of a Person.

The Company and a Subsidiary Guarantor, as the case may be, will be released from its obligations under the Indenture and its Subsidiary Guarantee, as the case may be, and the Successor Company and the Successor Guarantor, as the case may be, will succeed to, and be substituted for, and may exercise every right and power of, the Company or a Subsidiary Guarantor, as the case may be, under the Indenture, the Notes, the Registration Rights Agreement and such Subsidiary Guarantee; *provided* that, in the case of a lease of all or substantially all its properties and assets, the predecessor Company will not be released from the obligation to pay the principal of and interest on the Notes.

Future subsidiary guarantors

The Company will cause any domestic Restricted Subsidiary that borrows under or Guarantees the Senior Credit Facility in the future, to execute and deliver to the Trustee a supplemental indenture to the Indenture pursuant to which such Restricted Subsidiary will irrevocably and unconditionally Guarantee, on a joint and several basis, the full and prompt payment of the principal of, premium, if any, and interest in respect of the Notes on a senior basis and all other obligations under the Indenture. Notwithstanding the foregoing, in the event (a) a Subsidiary Guarantor is released and discharged in full from all of its obligations under its Guarantees of the Senior Credit Facility, and (b) such Subsidiary Guarantor has not Incurred any Indebtedness in reliance on its status as a Subsidiary Guarantor under the covenant Limitation on indebtedness or such Subsidiary Guarantor's obligations under such Indebtedness are satisfied in full and discharged or are otherwise permitted to be Incurred by a Restricted Subsidiary (other than a Subsidiary Guarantor) under the covenant Limitation on indebtedness, then the Subsidiary Guarantee of such Subsidiary Guarantor shall be automatically and unconditionally released or discharged.

The obligations of each Subsidiary Guarantor under its Subsidiary Guarantee are limited to the maximum amount as will, after giving effect to all other contingent and fixed liabilities of such Subsidiary Guarantor (including, without limitation, any Guarantees under the Senior Credit Facility) and after giving effect to any collections from or payments made by or on behalf of any other Subsidiary Guarantor in respect of the obligations of such other Subsidiary Guarantor under its Subsidiary Guarantee or pursuant to its contribution obligations under the Indenture, result in the obligations of such Subsidiary Guarantor under its Subsidiary Guarantee not constituting a fraudulent conveyance or fraudulent transfer under applicable law.

Each Subsidiary Guarantee shall also be released in accordance with the provisions of the Indenture described under Subsidiary guarantees.

Events of default

Each of the following is an Event of Default:

- (1) default in any payment of interest on any Note when due, continued for 30 days;
- (2) default in the payment of principal of or premium, if any, on any Note when due at its Stated Maturity, upon optional redemption, upon required repurchase, upon declaration of acceleration or otherwise;
- (3) failure by the Company to comply with its obligations under Certain covenants Merger and consolidation (other than its obligations under clause (5) of the first paragraph) or the failure by any Subsidiary Guarantor to comply with its obligations under clauses (1)(b), (1)(c), (1)(d) and (2) of the third paragraph of Certain covenants Merger and consolidation, in each case continued for 30 days;

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(4) failure by the Company or any Subsidiary Guarantor to comply for 30 days after notice as provided below with any of its obligations under the covenants described under Repurchase at the option of holders Change of control above or under the covenants described under Certain covenants above (in each case, other than (a) a failure to purchase Notes which constitutes an Event of Default under clause (2) above, (b) a failure to comply with Certain covenants Merger and consolidation which constitutes an Event of Default under clause (3) above or (c) a failure to comply with Certain covenants SEC reports which constitutes an Event of Default under clause (5) below);

(5) subject to the second and third paragraphs below, failure by the Company to comply for 60 days after notice as provided below with Certain covenants SEC reports ;

(6) failure by the Company or any Subsidiary Guarantor to comply for 60 days after notice as provided below with its other covenants and agreements contained in the Indenture;

(7) default by the Company or any Restricted Subsidiary under any mortgage, indenture or instrument under which there may be issued or by which there may be secured or evidenced any Indebtedness for money borrowed by the Company or any of its Restricted Subsidiaries (or the payment of which is Guaranteed by the Company or any of its Restricted Subsidiaries), other than Indebtedness owed to the Company or a Restricted Subsidiary, whether such Indebtedness or Guarantee now exists or is created after the Issue Date, which default:

(a) is caused by a failure, after the expiration of the grace period provided in such Indebtedness, to pay principal of, or interest or premium, if any, on such Indebtedness (*payment default*); or

(b) results in the acceleration of such Indebtedness prior to its maturity (the *cross acceleration provision*);

and, in each case, the principal amount of any such Indebtedness, together with the principal amount of any other such Indebtedness under which there has been a payment default or the maturity of which has been so accelerated, aggregates \$50.0 million or more;

(8) certain events of bankruptcy, insolvency or reorganization of the Company or a Significant Subsidiary or group of Restricted Subsidiaries that, taken together (as of the latest audited consolidated financial statements for the Company and its Restricted Subsidiaries), would constitute a Significant Subsidiary (the *bankruptcy provisions*);

(9) failure by the Company or any Restricted Subsidiary or any group of Restricted Subsidiaries that, taken together (as of the date of the latest audited consolidated financial statements for the Company and its Restricted Subsidiaries), would constitute a Significant Subsidiary to pay final judgments aggregating in excess of \$50.0 million (net of any amounts that are covered by insurance provided by a reputable and creditworthy insurance company), which judgments are not paid, discharged or stayed for a period of 60 days (the *judgment default provision*); or

(10) any Subsidiary Guarantee of a Significant Subsidiary or any group of Restricted Subsidiaries that taken together as of the latest audited consolidated financial statements for the Company and its Restricted Subsidiaries would constitute a Significant Subsidiary ceases to be in full force and effect (except as contemplated by the terms of the Indenture) or is declared null and void in a judicial proceeding or any Subsidiary Guarantor that is a Significant Subsidiary or group of Subsidiary Guarantors that taken together as of the latest audited consolidated financial statements of the Company and its Restricted Subsidiaries would constitute a Significant Subsidiary denies or disaffirms its obligations under the Indenture or its Subsidiary Guarantee.

However, a default under clauses (4), (5) and (6) of this paragraph will not constitute an Event of Default until (a) the Trustee provides written notice to the Company of the default or the holders of 25% in aggregate principal amount of the then outstanding Notes provide written notice to the Company of the default, with a copy to the Trustee, and (b) the Company does not cure such default within the time specified in clauses (4), (5) and (6) of this paragraph after receipt of such notice.

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Notwithstanding the foregoing, the Indenture will provide that, to the extent elected by us, the sole remedy for an Event of Default relating to the failure to comply with the reporting obligations in the Indenture, which are described above under Certain covenants SEC reports, will, for the first 60 days after the occurrence of such an Event of Default, consist exclusively of the right to receive additional interest on the Notes at an annual rate equal to 0.25% of the principal amount of the Notes. If we so elect, such additional interest will accrue on all outstanding Notes from and including the date on which the Event of Default relating to the failure to comply with the reporting obligations in the Indenture first occurs to but not including the earlier of (a) the 120th day thereafter or (b) date on which such Event of Default is cured or waived by the holders of a majority in principal amount of the outstanding Notes. On such 120th day (or earlier, if the Event of Default relating to the reporting obligations under the Indenture is cured or waived by the holders of a majority in principal amount of the outstanding Notes prior to such 120th day), such additional interest will cease to accrue and, if the Event of Default relating to reporting obligations has not been cured or waived prior to such 120th day, the Notes will be subject to acceleration as provided above. The provisions of the Indenture described in this paragraph will not affect the rights of holders of Notes in the event of the occurrence of any other Event of Default. In the event we do not elect to pay the additional interest upon an Event of Default in accordance with this paragraph, the Notes will be subject to acceleration as provided above.

In order to elect to pay the additional interest on the Notes as the sole remedy during the first 120 days after the occurrence of an Event of Default relating to the failure to comply with the reporting obligations in the Indenture in accordance with the immediately preceding paragraph, we must notify all holders of Notes and the trustee and paying agent of such election on or before the close of business on the date on which such Event of Default first occurs. We may make such an election with respect to the Notes.

If an Event of Default (other than an Event of Default described in clause (8) above) occurs and is continuing, the Trustee by notice in writing specifying the Event of Default and that it is a notice to the Company, or the holders of at least 25% in aggregate principal amount of the then outstanding Notes by notice to the Company and the Trustee, may, declare the principal of, premium, if any, and accrued and unpaid interest, if any, on all the Notes to be due and payable. Upon such a declaration, such principal, premium, if any, and accrued and unpaid interest, if any, will be due and payable immediately. In the event of a declaration of acceleration of the Notes because an Event of Default described in clause (7) under Events of default has occurred and is continuing, the declaration of acceleration of the Notes shall be automatically annulled if the default triggering such Event of Default pursuant to clause (7) shall be remedied or cured by the Company or a Restricted Subsidiary or waived by the holders of the relevant Indebtedness within 20 days after the declaration of acceleration with respect thereto and if (1) the annulment of the acceleration of the Notes would not conflict with any judgment or decree of a court of competent jurisdiction and (2) all existing Events of Default, except nonpayment of principal, premium, if any, or interest on the Notes that became due solely because of the acceleration of the Notes, have been cured or waived. If an Event of Default described in clause (8) above occurs and is continuing, the principal of, premium, if any, and accrued and unpaid interest on all the Notes will become and be immediately due and payable without any declaration or other act on the part of the Trustee or any holders. The holders of a majority in aggregate principal amount of the then outstanding Notes may waive all past defaults (except with respect to a continuing Default or Event of Default with respect to nonpayment of principal, premium or interest on the Notes) and rescind any such acceleration with respect to the Notes and its consequences if (1) rescission would not conflict with any judgment or decree of a court of competent jurisdiction and (2) all existing Events of Default, other than the nonpayment of the principal of, premium, if any, and interest on the Notes that have become due solely by such declaration of acceleration, have been cured or waived.

If an Event of Default occurs and is continuing, the Trustee will be under no obligation to exercise any of the rights or powers under the Indenture at the request or direction of any of the holders unless such holders have offered to the Trustee an indemnity or security reasonably satisfactory to the Trustee against any loss, liability or expense. Except to enforce the right to receive payment of principal, premium, if any, or interest when due, no holder may pursue any remedy with respect to the Indenture or the Notes *unless*:

(1) such holder has previously given the Trustee written notice that an Event of Default is continuing;

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(2) holders of at least 25% in aggregate principal amount of the then outstanding Notes have requested the Trustee, by notice in writing, to pursue the remedy;

(3) such holders have offered the Trustee reasonably satisfactory security or indemnity against any loss, liability or expense;

(4) the Trustee has not complied with such request within 60 days after the receipt of the request and the offer of security or indemnity; and

(5) the holders of a majority in aggregate principal amount of the then outstanding Notes have not given the Trustee a direction that, in the opinion of the Trustee, is inconsistent with such request within such 60-day period.

Subject to certain restrictions, the holders of a majority in aggregate principal amount of the then outstanding Notes are given the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or of exercising any trust or power conferred on the Trustee. The Indenture provides that in the event an Event of Default has occurred and is continuing, the Trustee will be required in the exercise of its powers to use the degree of care and skill that a prudent person would use, under the circumstances, in the conduct of its own affairs. The Trustee, however, may refuse to follow any direction that conflicts with law or the Indenture or that the Trustee determines in good faith is unduly prejudicial to the rights of any other holder or that would involve the Trustee in personal liability. Prior to taking any action under the Indenture, the Trustee will be entitled to indemnification from the holders satisfactory to it in its sole discretion against all losses and expenses caused by taking or not taking such action.

The Indenture provides that if a Default occurs and is continuing and is known to the Trustee, the Trustee must mail to each holder notice of the Default within 90 days after it occurs. Except in the case of a Default in the payment of principal of, premium, if any, or interest on any Note, the Trustee may withhold notice if and so long as a committee of trust officers of the Trustee in good faith determines that withholding notice is in the interests of the holders. In addition, the Company is required to deliver to the Trustee, within 120 days after the end of each fiscal year ending after the Issue Date, a certificate indicating whether the signers thereof know of any Default that occurred during the previous year. The Company also is required to deliver to the Trustee, within 30 days after the occurrence thereof, written notice of any events which constitute certain Defaults, their status and what action the Company is taking or proposing to take in respect thereof.

Amendments and waivers

Except as provided in the next two succeeding paragraphs, the Indenture, any Subsidiary Guarantee and the Notes issued thereunder may be amended or supplemented with the consent of the holders of a majority in aggregate principal amount of the then outstanding Notes (including without limitation, consents obtained in connection with a purchase of, or tender offer or exchange offer for, Notes) and, subject to certain exceptions, any past default or compliance with any provisions may be waived with the consent of the holders of a majority in aggregate principal amount of the then outstanding Notes (including, without limitation, consents obtained in connection with a purchase of, or tender offer or exchange offer for, Notes). However, without the consent of each holder of an outstanding Note affected, no amendment, supplement or waiver may, among other things:

(1) reduce the principal amount of Notes whose holders must consent to an amendment;

(2) reduce the stated rate of interest or extend the stated time for payment of interest on any Note;

(3) reduce the principal of or extend the Stated Maturity of any Note;

(4) waive a Default or Event of Default in the payment of principal of, or interest or premium, if any, on the Notes issued thereunder (except a rescission of acceleration of the Notes issued thereunder by the holders of at least a majority in aggregate principal amount of the then outstanding Notes with respect to a nonpayment default and a waiver of the payment default that resulted from such acceleration);

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(5) reduce the premium payable upon the redemption or repurchase of any Note or change the time at which any Note may be redeemed or repurchased as described above under Optional redemption, Repurchase at the option of holders Change of control or Repurchase at the option of holders Sales of assets and subsidiary stock whether through an amendment or waiver of provisions in the covenants, definitions or otherwise (except amendments to the definition of Change of Control);

(6) make any Note payable in money other than that stated in the Note;

(7) otherwise impair the right of any holder to receive payment of principal, premium, if any, and interest on such holder's Notes on or after the due dates therefor or to institute suit for the enforcement of any payment on or with respect to such holder's Notes;

(8) make any change in the amendment provisions which require each holder's consent or in the waiver provisions; or

(9) modify the Subsidiary Guarantees in any manner materially adverse to the holders of the Notes.

Notwithstanding the foregoing, without the consent of any holder, the Company, the Subsidiary Guarantors and the Trustee may amend the Indenture, the Notes and the Subsidiary Guarantees to:

(1) cure any ambiguity, omission, defect or inconsistency;

(2) provide for the assumption by a successor entity (or co-issuer) of the obligations of the Company or any Subsidiary Guarantor under the Indenture (whether through merger, consolidation, sale of all or substantially all of assets, properties or otherwise);

(3) provide for or facilitate the issuance of uncertificated Notes in addition to or in place of certificated Notes (*provided* that the uncertificated Notes are issued in registered form for purposes of Section 163(f) of the Code);

(4) comply with the rules of any applicable depository;

(5) add Guarantees with respect to the Notes or release a Subsidiary Guarantor from its obligations under its Subsidiary Guarantee or the Indenture in accordance with the applicable provisions of the Indenture;

(6) secure the Notes and the Subsidiary Guarantees;

(7) add to the covenants of the Company and its Restricted Subsidiaries or Events of Default for the benefit of the holders or to make changes that would provide additional rights to holders or to surrender any right or power conferred upon the Company;

(8) make any change that does not materially adversely affect the rights of any holder under the Indenture;

(9) comply with any requirement of the SEC in connection with the qualification of the Indenture under the Trust Indenture Act;

(10) evidence or provide for the appointment under the Indenture of a successor trustee; provided that the successor trustee is otherwise qualified and eligible to act as such under the terms of the Indenture;

(11) provide for the issuance of Additional Notes under the Indenture;

(12) comply with the provisions described under Subsidiary guarantees or Certain covenants Future subsidiary guarantors ;

(13) provide for the issuance of exchange securities which shall have terms substantially identical in all respects to the Notes (except that the transfer restrictions and additional interest provisions contained in the Notes shall be modified or eliminated as appropriate) and which shall be treated, together with any outstanding Notes, as a single class of securities;

(14) conform the text of the Indenture, the Notes or the Subsidiary Guarantees to any provision of this Description of notes to the extent that such provision in this Description of notes is intended to be a verbatim recitation of a provision of the Indenture, the Notes or the Subsidiary Guarantees (as certified in an Officers Certificate delivered to the Trustee); or

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(15) make any amendment to the provisions of the Indenture relating to the transfer and legending of Notes as permitted by the Indenture, including, without limitation to facilitate the issuance and administration of the Notes, exchange notes issued in a registered exchange offer or, if Incurred in compliance with the Indenture, Additional Notes; *provided, however*, that (A) compliance with the Indenture as so amended would not result in Notes being transferred in violation of the Securities Act or any applicable securities law and (B) such amendment does not materially and adversely affect the rights of holders to transfer Notes.

The consent of the holders is not necessary under the Indenture to approve the particular form of any proposed amendment, supplement or waiver. It is sufficient if such consent approves the substance of the proposed amendment, supplement or waiver. A consent to any amendment, supplement or waiver under the Indenture by any holder of Notes given in connection with a tender of such holder's Notes will not be rendered invalid by such tender. After an amendment, supplement or waiver under the Indenture becomes effective, the Company is required to give to the holders a notice briefly describing such amendment, supplement or waiver. However, the failure to give such notice to all the holders, or any defect in the notice will not impair or affect the validity of the amendment, supplement or waiver.

Defeasance

The Company may, at its option and at any time, elect to have all of its obligations and the obligations of the Subsidiary Guarantors discharged with respect to the outstanding Notes issued under the Indenture (*legal defeasance*) except for:

- (1) the rights of holders of outstanding Notes issued thereunder to receive payments in respect of the principal of, or interest or premium, if any, on such Notes when such payments are due from the trust referred to below;
- (2) the Company's obligations with respect to the Notes issued thereunder concerning issuing temporary Notes, registration of Notes, mutilated, destroyed, lost or stolen Notes and the maintenance of an office or agency for payment and money for security payments held in trust;
- (3) the rights, powers, trusts, duties and immunities of the Trustee, and the Company's obligations in connection therewith; and
- (4) the legal defeasance provisions of the Indenture.

If the Company exercises the legal defeasance option, the Subsidiary Guarantees in effect at such time will terminate.

The Company at any time may terminate its obligations described under Repurchase at the option of holders and under the covenants described under Certain covenants (other than Merger and consolidation), the operation of the cross-default upon a payment default, cross acceleration provisions, the bankruptcy provisions with respect to Significant Subsidiaries or any group of Restricted Subsidiaries that taken together would constitute a Significant Subsidiary and the judgment default provision described under Events of default above and the limitations contained in clause (3) under Certain covenants Merger and consolidation above (*covenant defeasance*).

If the Company exercises the covenant defeasance option, the Subsidiary Guarantees in effect at such time will terminate.

The Company may exercise its legal defeasance option notwithstanding its prior exercise of its covenant defeasance option. If the Company exercises its legal defeasance option, payment of the Notes may not be accelerated because of an Event of Default with respect to the Notes. If the Company exercises its covenant defeasance option, payment of the Notes may not be accelerated because of an Event of Default specified in clause (4), (5), (6), (7), (8) (with respect only to Significant Subsidiaries or any group of Restricted Subsidiaries

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that, taken together (as of the date of the latest audited consolidated financial statements of the Company and its Restricted Subsidiaries) would constitute a Significant Subsidiary) or (9) under Events of default above or because of the failure of the Company to comply with clause (4) under Certain covenants Merger and consolidation above.

In order to exercise either legal defeasance or covenant defeasance under the Indenture:

(1) the Company must irrevocably deposit with the Trustee, in trust, for the benefit of the holders of the Notes issued thereunder, cash in U.S. dollars, non-callable U.S. Government Obligations, or a combination of cash in U.S. dollars and non-callable U.S. Government Obligations, in amounts as will be sufficient, in the opinion of a nationally recognized firm of independent public accountants, to pay the principal of, or interest and premium, if any, on the outstanding Notes issued thereunder on the Stated Maturity or on the applicable redemption date, as the case may be, and the Company must specify whether the Notes are being defeased to maturity or to a particular redemption date;

(2) in the case of legal defeasance, the Company has delivered to the Trustee an Opinion of Counsel confirming that (a) the Company has received from, or there has been published by, the Internal Revenue Service a ruling or (b) since the Issue Date, there has been a change in the applicable U.S. federal income tax law, in either case to the effect that, and based thereon such Opinion of Counsel will confirm that, the holders of the respective outstanding Notes will not recognize income, gain or loss for U.S. federal income tax purposes as a result of such legal defeasance and will be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such legal defeasance had not occurred;

(3) in the case of covenant defeasance, the Company has delivered to the Trustee an Opinion of Counsel confirming that the holders of the respective outstanding Notes will not recognize income, gain or loss for U.S. federal income tax purposes as a result of such covenant defeasance and will be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such covenant defeasance had not occurred;

(4) such legal defeasance or covenant defeasance will not result in a breach or violation of, or constitute a default under any material agreement or instrument (other than the Indenture) to which the Company or any of its Restricted Subsidiaries is a party or by which the Company or any of its Restricted Subsidiaries is bound;

(5) no Default or Event of Default has occurred and is continuing on the date of such deposit (other than a Default or Event of Default resulting from the borrowing of funds to be applied to such deposit and the grant of any Lien securing such borrowings) or insofar as Events of Default resulting from the borrowing of funds or insolvency events are concerned, at any time in the period ending on the 91st day after the date of deposit;

(6) the Company must deliver to the Trustee an Opinion of Counsel to the effect that, assuming, among other things, no intervening bankruptcy of the Company between the date of deposit and the 91st day following the deposit and assuming that no holder is an insider of the Company under applicable bankruptcy law, after the 91st day following the deposit, the trust funds will not be subject to the effect of any applicable bankruptcy, insolvency, reorganization of similar laws affecting creditors rights generally;

(7) the Company must deliver to the Trustee an Officers Certificate stating that the deposit was not made by the Company with the intent of defeating, hindering, delaying or defrauding creditors of the Company or others; and

(8) the Company must deliver to the Trustee an Officers Certificate and an Opinion of Counsel (which Opinion of Counsel may be subject to customary assumptions and exclusions), each stating that all conditions precedent relating to the legal defeasance or the covenant defeasance, as the case may be, have been complied with.

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Satisfaction and discharge

The Indenture will be discharged and will cease to be of further effect as to all Notes issued thereunder, when:

(1) either:

(a) all Notes that have been authenticated, except lost, stolen or destroyed Notes that have been replaced or paid and Notes for whose payment money has been deposited in trust and thereafter repaid to the Company, have been delivered to the Trustee for cancellation; or

(b) all Notes not theretofore delivered to the Trustee for cancellation have become due and payable by reason of the making of a notice of redemption or otherwise, will become due and payable within one year or may be called for redemption within one year under arrangements satisfactory to the Trustee for the giving of notice of redemption by the Trustee in the name, and at the expense, of the Company, and the Company or any Subsidiary Guarantor has irrevocably deposited or caused to be deposited with the Trustee, as trust funds in trust solely for the benefit of the holders of the Notes, cash in U.S. dollars, U.S. Government Obligations, or a combination thereof, in such amounts as will be sufficient without consideration of any reinvestment of interest to pay and discharge the entire Indebtedness on the Notes not theretofore delivered to the Trustee for cancellation for principal, premium, if any, and accrued interest to the date of maturity or redemption;

(2) the deposit will not result in a breach or violation of, or constitute a default under, any other material instrument to which the Company is a party or by which the Company is bound;

(3) the Company has paid or caused to be paid all sums payable by it under the Indenture; and

(4) the Company has delivered irrevocable instructions to the Trustee under the Indenture to apply the deposited money toward the payment of the Notes issued thereunder at maturity or the redemption date, as the case may be.

In addition, the Company must deliver an Officers' Certificate and an Opinion of Counsel to the Trustee stating that all conditions precedent to satisfaction and discharge have been satisfied.

No personal liability of directors, officers, employees and stockholders

No past, present or future director, officer, employee, incorporator, member, partner or stockholder of the Company or the Subsidiary Guarantors, as such, shall have any liability for any obligations of the Company or the Subsidiary Guarantors under the Notes, the Indenture or the Subsidiary Guarantees or for any claim based on, in respect of, or by reason of, such obligations or their creation. Each holder by accepting a Note waives and releases all such liability. The waiver and release are part of the consideration for issuance of the Notes. The waiver may not be effective to waive liabilities under the federal securities law.

Notices

Notices given by publication will be deemed given on the first date on which publication is made; notices delivered by hand will be deemed given at the time of delivery; notices sent by overnight air courier guaranteeing next-day delivery will be deemed given the next Business Day after timely delivery to the courier; and notices given by first-class mail, postage prepaid, will be deemed given three Business Days after mailing. Notwithstanding any other provision of the Indenture or any Note, where the Indenture or any Note provides for notice of any event (including any notice of redemption) to any holder of an interest in a global Note (whether by mail or otherwise), such notice shall be sufficiently given if given to DTC or any other applicable depository for such Note (or its designee) according to the applicable procedures of DTC or such depository.

Concerning the trustee

Wilmington Trust, National Association, is the Trustee under the Indenture and has been appointed by the Company as Registrar and Paying Agent with regard to the Notes.

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The holders of a majority in aggregate principal amount of the then outstanding Notes issued under the Indenture have the right to direct the time, method and place of conducting any proceeding for exercising any remedy available to the Trustee, subject to certain exceptions. The Indenture provides that in case an Event of Default occurs and is continuing, the Trustee will be required, in the exercise of its power, to use the degree of care and skill of a prudent person would under the circumstances in the conduct of its own affairs. Subject to such provisions, the Trustee will be under no obligation to exercise any of its rights or powers under the Indenture at the request of any holder of Notes, unless such holder has offered to the Trustee indemnity reasonably satisfactory to it against any loss, liability or expense.

Governing law

The Indenture provides that it, the Notes and any Subsidiary Guarantee will be governed by, and construed in accordance with, the laws of the State of New York.

Certain definitions

Acceptable Exclusions means:

- (1) war, invasion or hostile or warlike action in time of peace or war, including action in hindering, combating or defending against an actual, impending or expected attack by:
 - (a) any government or sovereign power (de jure or de facto),
 - (b) any authority maintaining or using a military, naval or air force,
 - (c) a military, naval or air force, or
 - (d) any agent of any such government, power, authority or force;
- (2) any anti-satellite device, or device employing atomic or nuclear fission and/or fusion, or device employing laser or directed energy beams;
- (3) insurrection, strikes, labor disturbances, riots, civil commotion, rebellion, revolution, civil war, usurpation, or action taken by a government authority in hindering, combating or defending against such an occurrence, whether there be declaration of war or not;
- (4) confiscation, nationalization, seizure, restraint, detention, appropriation, requisition for title or use by or under the order of any government or governmental authority or agent (whether secret or otherwise or whether civil, military or de facto) or public or local authority or agency (whether secret or otherwise);
- (5) nuclear reaction, nuclear radiation, or radioactive contamination of any nature, whether such loss or damage be direct or indirect, except for radiation naturally occurring in the space environment;
- (6) electromagnetic or radio frequency interference, except for physical damage to the Covered Satellite directly resulting from such interference;
- (7) willful or intentional acts of the named insured designed to cause loss or failure of the Covered Satellite;
- (8) any act of one or more Persons, whether or not agents of a sovereign power, for political or terrorist purposes and whether the loss, damage or failure resulting therefrom is accidental or intentional;
- (9) any unlawful seizure or wrongful exercise of control of the Covered Satellite and/or launch vehicle made by any Person or Persons acting for political or terrorist purposes;
- (10) loss of income or revenue, incidental damages or indirect and/or consequential loss;
- (11) extra expenses, except to the extent this exclusion conflicts with the insuring agreements provisions for corrective measures;

(12) third party liability;

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(13) loss of a redundant component(s) that does not cause a transponder or beam failure; and

(14) such other similar exclusions or modifications to the foregoing exclusions as either may be customary for policies of such type as of the date of issuance or renewal of such coverage or may be otherwise reasonably acceptable to the Company.

Acquired Indebtedness means, with respect to any specified Person,

(a) Indebtedness of any Person or any of its Subsidiaries existing at the time such Person becomes a Restricted Subsidiary or merges with or into the Company or a Restricted Subsidiary or

(b) assumed in connection with the acquisition of property or assets from such Person,

in each case whether or not Incurred by such Person in connection with, or in anticipation or contemplation of, such Person becoming a Restricted Subsidiary or such merger or acquisition, and Indebtedness secured by a Lien encumbering any property or asset acquired by such specified Person. Acquired Indebtedness shall be deemed to have been Incurred, with respect to clause (a) of the preceding sentence, on the date such Person becomes a Restricted Subsidiary or merges with or into the Company or a Restricted Subsidiary and, with respect to clause (b) of the preceding sentence, on the date of consummation of such acquisition of property or assets. The term *Acquired Indebtedness* does not include Indebtedness of a Person which is redeemed, defeased, retired or otherwise repaid at the time of or immediately upon consummation of the transactions by which such Person becomes a Restricted Subsidiary or merges with or into the Company or a Restricted Subsidiary or such property or assets are acquired, which Indebtedness of such Person will not be deemed to be Indebtedness of the Company or any Restricted Subsidiary.

Additional Assets means:

(1) any property, plant, equipment or other asset (excluding any asset classified as a current asset under GAAP), including improvements thereto through capital expenditures or otherwise, to be used, or that is useful, in a Similar Business;

(2) all or substantially all of the assets of a Similar Business;

(3) the Capital Stock of a Person that becomes a Restricted Subsidiary as a result of the acquisition of such Capital Stock by the Company or a Restricted Subsidiary; or

(4) Capital Stock in any Person that at such time is a Restricted Subsidiary;

provided, however, that, in the case of clauses (3) and (4), such Restricted Subsidiary is primarily engaged in a Similar Business.

Affiliate of any specified Person means any other Person, directly or indirectly, controlling or controlled by or under direct or indirect common control with such specified Person. For the purposes of this definition, *control* (including, with correlative meanings, the terms *controlling*, *controlled by* and *under common control with*) when used with respect to any Person means possession, directly or indirectly, of the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise; and the terms *controlling* and *controlled* have meanings correlative to the foregoing.

Aggregate In-Orbit Insurance Amount means 75% of the aggregate net book value of all in-orbit Covered Satellites other than Excluded Satellites. For the purposes of this definition, aggregate net book value with respect to a Covered Satellite shall exclude any liability of a satellite purchaser to pay the satellite manufacturer any satellite performance incentive payments and any liability of a satellite manufacturer to pay the satellite purchaser any satellite performance warranty paybacks.

Applicable Premium means, with respect to a Note on any date of redemption, the greater of:

(1) 1.0% of the principal amount of such Note and

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(2) the excess, if any, of (a) the present value as of such date of redemption of (i) the redemption price of such Note on June 15, 2016, (each such redemption price being described under *Optional Redemption*) plus (ii) all required interest payments due on such Note through June 15, 2016 (excluding accrued but unpaid interest to the date of redemption), computed using a discount rate equal to the Treasury Rate as of such date of redemption plus 50 basis points, over (b) the then-outstanding principal of such Note, as such amount is calculated by the Company.

Asset Sale means any direct or indirect sale, lease (other than an operating lease entered into in the ordinary course of business), transfer, issuance or other disposition, or a series of related sales, leases, transfers, issuances or dispositions that are part of a common plan, of shares of Capital Stock of a Subsidiary of the Company (other than directors qualifying shares and shares issued to foreign nationals to the extent required by applicable law), property or other assets (each referred to for the purposes of this definition as a *disposition*) by the Company or any of its Restricted Subsidiaries, including any disposition by means of a merger, consolidation or similar transaction.

Notwithstanding the preceding, the following items shall not be deemed to be Asset Sales:

- (1) a disposition of Capital Stock, property or other assets by a Restricted Subsidiary to the Company or by the Company or a Restricted Subsidiary to a Restricted Subsidiary;
- (2) the disposition of Cash Equivalents in the ordinary course of business;
- (3) a disposition of equipment, inventory, receivables or other tangible or intangible assets or property (x) in the ordinary course of business or (y) to any Permitted Joint Venture in compliance with the covenant *Certain covenants Limitation on affiliate transactions* ;
- (4) a disposition of obsolete, damaged or worn out property or equipment or property or equipment that is no longer useful in the conduct of the business of the Company and its Restricted Subsidiaries;
- (5) a disposition pursuant to a Sale/Leaseback Transaction;
- (6) the disposition of all or substantially all of the assets of the Company in a manner permitted pursuant to *Certain covenants Merger and consolidation* or any disposition that constitutes a Change of Control pursuant to the Indenture;
- (7) an issuance of Capital Stock by a Restricted Subsidiary to the Company or to a Wholly Owned Subsidiary;
- (8) for purposes of *Repurchase at the option of holders Sales of assets and subsidiary stock* only, the making of a Permitted Investment (other than a Permitted Investment to the extent such transaction results in the receipt of cash or Cash Equivalents by the Company or its Restricted Subsidiaries) or a disposition subject to *Certain covenants Limitation on restricted payments* ;
- (9) dispositions of property or assets in a single transaction or series of related transactions with an aggregate fair market value of less than \$20.0 million;
- (10) the creation or incurrence of a Permitted Lien or any other Lien created or incurred in compliance with the covenant described under the caption *Certain covenants Limitation on liens, and dispositions in connection therewith*;
- (11) dispositions of receivables in connection with the compromise, settlement or collection thereof in the ordinary course of business or in bankruptcy or similar proceedings and exclusive of factoring or similar arrangements;
- (12) the issuance by a Restricted Subsidiary of Preferred Stock or Disqualified Stock that is permitted by the covenant described under the caption *Certain covenants Limitation on indebtedness* ;
- (13) the licensing or sublicensing of intellectual property or other general intangibles and licenses, leases or subleases of other property in the ordinary course of business;

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(14) the licensing or sublicensing of intellectual property related to the ViaSat-1 satellite and any subsequent high-capacity satellite and/or related ground infrastructure and equipment;

(15) a disposition of satellite capacity in a single transaction or series of related transactions of up to 50% of the total capacity of a satellite;

(16) a surrender or waiver of contract rights or a settlement, release or surrender of contract, tort or other claims in the ordinary course of business;

(17) foreclosure, condemnations or similar actions on assets or property;

(18) any sale or other disposition of Capital Stock in, or Indebtedness or other securities of, an Unrestricted Subsidiary;

(19) an Asset Swap effected in compliance with Certain covenants Sales of assets and subsidiary stock; and

(20) dispositions of accounts receivable and related assets (including, without limitation, collateral securing accounts receivable, contracts and guarantees or other obligations in respect of accounts receivable, proceeds of accounts receivable and other assets which are customarily transferred in connection with asset securitization transactions involving accounts receivable) in connection with the Incurrence of Indebtedness permitted by clause (15) of the second paragraph under the caption Certain covenants Limitation on indebtedness.

Asset Swap means a concurrent purchase and sale or exchange of assets related to a Similar Business (or a combination of such assets and cash or Cash Equivalents) between the Company or any of its Restricted Subsidiaries and another Person; *provided* that any cash or Cash Equivalents received must be applied in accordance with Certain covenants Limitation on sales of assets and subsidiary stock.

Attributable Indebtedness in respect of a Sale/Leaseback Transaction means, as at the time of determination, the present value (discounted at the interest rate implicit in the transaction) of the total obligations of the lessee for rental payments during the remaining term of the lease included in such Sale/Leaseback Transaction (including any period for which such lease has been extended), determined in accordance with GAAP; *provided, however*, that if such Sale/Leaseback Transaction results in a Capitalized Lease Obligation, the amount of Indebtedness represented thereby will be determined in accordance with the definition of Capitalized Lease Obligations.

Average Life means, as of the date of determination, with respect to any Indebtedness or Preferred Stock, the quotient obtained by dividing (1) the sum of the products of the numbers of years from the date of determination to the dates of each successive scheduled principal payment of such Indebtedness or redemption or similar payment with respect to such Preferred Stock multiplied by the amount of such payment by (2) the sum of all such payments.

Board of Directors means:

(1) with respect to a corporation, the board of directors of the corporation or (other than for purposes of determining Change of Control) a duly authorized committee of the board of directors;

(2) with respect to a partnership, the board of directors of the general partner of the partnership;

(3) with respect to a limited liability company, the managing member or members or any controlling committee or board of managers of such company or the Board of Directors of the sole member or the managing member thereof; and

(4) with respect to any other Person, the board or committee of such Person serving a similar function.

Business Day means each day that is not a Saturday, Sunday or other day on which banking institutions in New York, New York or the place of payment are authorized or required by law to close. If a payment date at a place of payment is not on a Business Day, payment shall be made at that place on the next succeeding Business Day, and no interest shall accrue on such interest payment for the intervening period.

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Capital Stock of any Person means any and all shares, interests, rights to purchase, participations (including rights to receive a share of profits or losses), equity appreciation rights or other equivalents (however designated) of or in equity of such Person, including any Preferred Stock or any limited liability company, membership or partnership interests (whether general or limited), together with any and all warrants, options or other rights to purchase or acquire any of the foregoing, but excluding any debt securities convertible into or exchangeable for any of the foregoing.

Capitalized Lease Obligations means an obligation that is required to be classified and accounted for as a capitalized lease for financial reporting purposes in accordance with GAAP, and the amount of Indebtedness represented by such obligation will be the capitalized amount of such obligation at the time any determination thereof is to be made as determined in accordance with GAAP, and the Stated Maturity thereof will be the date of the last payment of rent or any other amount due under such lease prior to the first date such lease may be terminated without penalty.

Cash Equivalents means:

- (1) U.S. dollars, or in the case of any Foreign Subsidiary, such local currencies held by it from time to time in the ordinary course of business;
- (2) securities issued or directly and fully guaranteed or insured by the United States government or any agency or instrumentality of the United States (*provided* that the full faith and credit of the United States is pledged in support thereof), having maturities of not more than one year from the date of acquisition;
- (3) marketable general obligations issued by any state of the United States of America or any political subdivision of any such state or any public instrumentality thereof maturing within one year from the date of acquisition and, at the time of acquisition, having a credit rating of A or better from either Standard & Poor's Ratings Group, Inc. or Moody's Investors Service, Inc., or carrying an equivalent rating by a nationally recognized Rating Agency, if both of the two Rating Agencies cease publishing ratings of investments;
- (4) certificates of deposit, demand deposits, time deposits, eurodollar time deposits, overnight bank deposits or bankers' acceptances having maturities of not more than one year from the date of acquisition thereof issued by any commercial bank the long-term debt of which is rated at the time of acquisition thereof at least A or the equivalent thereof by Standard & Poor's Ratings Group, Inc., or A or the equivalent thereof by Moody's Investors Service, Inc., or carrying an equivalent rating by a nationally recognized Rating Agency, if both of the two Rating Agencies cease publishing ratings of investments, and having combined capital and surplus in excess of \$500.0 million;
- (5) repurchase obligations with a term of not more than seven days for underlying securities of the types described in clauses (2), (3) and (4) entered into with any bank meeting the qualifications specified in clause (4) above;
- (6) commercial paper rated at the time of acquisition thereof at least A-2 or the equivalent thereof by Standard & Poor's Ratings Group, Inc. or P-2 or the equivalent thereof by Moody's Investors Service, Inc., or carrying an equivalent rating by a nationally recognized Rating Agency, if both of the two named Rating Agencies cease publishing ratings of investments, and in any case maturing within one year after the date of acquisition thereof; and
- (7) interests in any investment company or money market fund which invests 95% or more of its assets in instruments of the type specified in clauses (1) through (6) above.

Change of Control means:

- (1) the Company becomes aware (by way of a report or any other filing pursuant to Section 13(d) of the Exchange Act, proxy, vote, written notice or otherwise) of the acquisition by any person or group of related persons (as such terms are used in Sections 13(d) and 14(d) of the Exchange Act) of the beneficial ownership (as defined in Rules 13d-3 and 13d-5 under the Exchange Act, except that such person or group

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shall be deemed to have beneficial ownership of all shares that any such person or group has the right to acquire, whether such right is exercisable immediately or only after the passage of time), directly or indirectly, of more than 50% of the total voting power of the Voting Stock of the Company or any of its direct or indirect parent entities (or their successors by merger, consolidation or purchase of all or substantially all of their assets); or

(2) for so long as any Existing Senior Notes remain outstanding, the first day on which a majority of the members of the Board of Directors of the Company are not Continuing Directors; or

(3) the sale, assignment, conveyance, transfer, lease or other disposition (other than by way of merger or consolidation), in one or a series of related transactions, of all or substantially all of the assets of the Company and its Subsidiaries taken as a whole to any person (as such term is used in Sections 13(d) and 14(d) of the Exchange Act); or

(4) the adoption by the stockholders of the Company of a plan or proposal for the liquidation or dissolution of the Company.

Code means the Internal Revenue Code of 1986, as amended.

Commodity Agreement means any commodity futures contract, commodity swap, commodity option or other similar agreement or arrangement entered into by the Company or any Restricted Subsidiary designed or intended to protect the Company or any of its Restricted Subsidiaries against fluctuations in the price of commodities actually used in the ordinary course of business of the Company and its Restricted Subsidiaries.

Common Stock means with respect to any Person, any and all shares of, interest or other participations in, and other equivalents (however designated and whether voting or nonvoting) of such Person's common stock whether or not outstanding on the Issue Date, and includes, without limitation, all series and classes of such common stock.

Consolidated Coverage Ratio means as of any date of determination, with respect to any Person, the ratio of (x) the aggregate amount of Consolidated EBITDA of such Person for the period of the most recent four consecutive fiscal quarters ending prior to the date of such determination for which financial statements prepared on a consolidated basis in accordance with GAAP are available to (y) Consolidated Interest Expense for such four fiscal quarters, *provided, however*, that:

(1) if the Company or any Restricted Subsidiary:

(a) has Incurred any Indebtedness since the beginning of such period that remains outstanding on such date of determination or if the transaction giving rise to the need to calculate the Consolidated Coverage Ratio includes an Incurrence of Indebtedness, Consolidated EBITDA and Consolidated Interest Expense for such period will be calculated after giving effect on a pro forma basis to such Indebtedness as if such Indebtedness had been Incurred on the first day of such period (except that in making such computation, the amount of Indebtedness under any revolving Debt Facility outstanding on the date of such calculation will be deemed to be (i) the average daily balance of such Indebtedness during such four fiscal quarters or such shorter period for which such facility was outstanding or (ii) if such facility was created after the end of such four fiscal quarters, the average daily balance of such Indebtedness during the period from the date of creation of such facility to the date of such calculation) and the discharge of any other Indebtedness repaid, repurchased, defeased or otherwise discharged with the proceeds of such new Indebtedness as if such discharge had occurred on the first day of such period; or

(b) has repaid, repurchased, redeemed, retired, defeased or otherwise discharged any Indebtedness since the beginning of the period that is no longer outstanding on such date of determination or if the transaction giving rise to the need to calculate the Consolidated Coverage Ratio includes a discharge of Indebtedness (in each case, other than Indebtedness Incurred under any revolving Debt Facility unless such Indebtedness has been permanently repaid and the related commitment terminated), Consolidated

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EBITDA and Consolidated Interest Expense for such period will be calculated after giving effect on a *pro forma* basis to such discharge of such Indebtedness, including with the proceeds of such new Indebtedness, as if such discharge had occurred on the first day of such period;

(2) if since the beginning of such period the Company or any Restricted Subsidiary will have made any Asset Sale or disposed of or discontinued (as defined under GAAP) any company, division, operating unit, segment, business, group of related assets or properties or line of business or if the transaction giving rise to the need to calculate the Consolidated Coverage Ratio includes such a transaction:

(a) the Consolidated EBITDA for such period will be reduced by an amount equal to the Consolidated EBITDA (if positive) directly attributable to the assets or properties that are the subject of such disposition or discontinuation for such period or increased by an amount equal to the Consolidated EBITDA (if negative) directly attributable thereto for such period; and

(b) Consolidated Interest Expense for such period will be reduced by an amount equal to the Consolidated Interest Expense directly attributable to any Indebtedness of the Company or any Restricted Subsidiary repaid, repurchased, redeemed, retired, defeased or otherwise discharged with respect to the Company and its continuing Restricted Subsidiaries in connection with such transaction for such period (or, if the Capital Stock of any Restricted Subsidiary is sold, the Consolidated Interest Expense for such period directly attributable to the Indebtedness of such Restricted Subsidiary to the extent the Company and its continuing Restricted Subsidiaries are no longer liable for such Indebtedness after such sale);

(3) if since the beginning of such period the Company or any Restricted Subsidiary (by merger or otherwise) will have made an Investment in any Restricted Subsidiary (or any Person that becomes a Restricted Subsidiary or is merged or consolidated with or into the Company or a Restricted Subsidiary) or an acquisition of assets or property, including any acquisition of assets or property occurring in connection with a transaction causing a calculation to be made hereunder, which constitutes all or substantially all of a company, division, operating unit, segment, business, group of related assets or properties or line of business, Consolidated EBITDA and Consolidated Interest Expense for such period will be calculated after giving *pro forma* effect thereto (including the Incurrence of any Indebtedness) as if such Investment or acquisition occurred on the first day of such period; and

(4) if since the beginning of such period any Person (that subsequently became a Restricted Subsidiary or was merged or consolidated with or into the Company or any Restricted Subsidiary since the beginning of such period) will have Incurred any Indebtedness or discharged any Indebtedness, made any disposition or any Investment or acquisition of assets or property that would have required an adjustment pursuant to clause (1), (2) or (3) above if made by the Company or a Restricted Subsidiary during such period, Consolidated EBITDA and Consolidated Interest Expense for such period will be calculated after giving *pro forma* effect thereto as if such transaction occurred on the first day of such period.

For purposes of this definition, whenever *pro forma* effect is to be given to any calculation under this definition, the *pro forma* calculations will be determined in good faith by a responsible financial or accounting Officer of the Company. If any Indebtedness bears a floating rate of interest and is being given *pro forma* effect, the interest expense on such Indebtedness will be calculated as if the rate in effect on the date of determination had been the applicable rate for the entire period (taking into account any Interest Rate Agreement applicable to such Indebtedness if such Interest Rate Agreement has a remaining term in excess of 12 months). If any Indebtedness that is being given *pro forma* effect bears an interest rate at the option of the Company, the interest rate shall be calculated by applying such optional rate chosen by the Company. Interest on a Capitalized Lease Obligation shall be deemed to accrue at an interest rate determined in good faith by a responsible financial or accounting Officer of the Company to be the rate of interest implicit in such Capitalized Lease Obligation in accordance with GAAP. *Pro forma* calculations may include, with respect to clause (2) or (3) of this definition, adjustments calculated to give effect to any Pro Forma Cost Savings in an aggregate amount not to exceed \$25.0 million for any such period.

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Consolidated EBITDA means, with respect to any Person for any period, the Consolidated Net Income of such Person for such period:

(1) increased (without duplication) by the following items to the extent deducted in calculating such Consolidated Net Income:

(a) Consolidated Interest Expense; *plus*

(b) Consolidated Income Taxes; *plus*

(c) consolidated depreciation expense; *plus*

(d) consolidated amortization expense or impairment charges; *plus*

(e) other non-cash charges reducing Consolidated Net Income, including any write-offs or write-downs (excluding (i) any such non-cash charge to the extent it represents an accrual of or reserve for cash charges that the Company reasonably expects will be settled prior to the final maturity date of the Notes, or (ii) amortization of a prepaid cash expense that was paid in a prior period not included in the calculation); *plus*

(f) the amount of any Restructuring Charges or reasonable expenses or charges related to any proposed or consummated Equity Offering, Investment, acquisition, Incurrence of Indebtedness or recapitalization; *provided* that any amounts added to Consolidated Net Income pursuant to this clause will not exceed \$15.0 million in the aggregate during any fiscal year;

(2) decreased (without duplication) by non-cash items increasing Consolidated Net Income of such Person for such period (excluding any items which represent the reversal of any accrual of, or reserve for, anticipated cash charges that reduced Consolidated EBITDA in any prior period), and

(3) increased or decreased by (without duplication) the following items reflected in Consolidated Net Income:

(a) any net gain or loss resulting in such period from Hedging Obligations and the application of Accounting Standards Codification Topic 815, *Derivatives and Hedging*;

(b) any net gain or loss resulting in such period from currency translation gains or losses related to currency remeasurements of Indebtedness (including any net loss or gain resulting from Hedging Obligations for currency exchange risk); and

(c) effects of adjustments (including the effects of such adjustments pushed down to the Company and its Restricted Subsidiaries) in any line item in such Person's consolidated financial statements pursuant to GAAP resulting from the application of purchase accounting in relation to any completed acquisition.

Notwithstanding the foregoing, clauses (1)(b) through (f) relating to amounts of a Restricted Subsidiary of a Person will be added to Consolidated Net Income to compute Consolidated EBITDA of such Person only to the extent (and in the same proportion) that the net income (loss) of such Restricted Subsidiary was included in calculating the Consolidated Net Income of such Person and, to the extent the amounts set forth in clauses (1)(b) through (f) are in excess of those necessary to offset a net loss of such Restricted Subsidiary or if such Restricted Subsidiary has net income for such period included in Consolidated Net Income, only if a corresponding amount would be permitted at the date of determination to be dividended to the Company by such Restricted Subsidiary without prior approval (that has not been obtained), pursuant to the terms of its charter and all agreements, instruments, judgments, decrees, orders, statutes, rules and governmental regulations applicable to that Restricted Subsidiary or its stockholders.

Consolidated Income Taxes means, with respect to any Person for any period, taxes imposed upon such Person or other payments required to be made by such Person by any governmental authority which taxes or other payments are calculated by reference to the income or profits or capital of such Person or such Person and its Restricted Subsidiaries (to the extent such income or profits were included in computing Consolidated Net

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Income for such period), including, without limitation, state, franchise and similar taxes and foreign withholding taxes regardless of whether such taxes or payments are required to be remitted to any governmental authority.

Consolidated Interest Expense means, for any period, the total interest expense of the Company and its consolidated Restricted Subsidiaries, whether paid or accrued, plus, to the extent not included in such interest expense (without duplication):

- (1) interest expense attributable to Capitalized Lease Obligations and the interest portion of rent expense associated with Attributable Indebtedness in respect of the relevant lease giving rise thereto, determined as if such lease were a capitalized lease in accordance with GAAP and the interest component of any deferred payment obligations;
- (2) amortization of debt discount (including the amortization of original issue discount resulting from the issuance of Indebtedness at less than par) and debt issuance cost; *provided, however*, that any amortization of bond premium will be credited to reduce Consolidated Interest Expense unless, pursuant to GAAP, such amortization of bond premium has otherwise reduced Consolidated Interest Expense;
- (3) non-cash interest expense, but excluding any non-cash interest expense attributable to the movement in the mark to market valuation of Hedging Obligations or other derivative instruments pursuant to GAAP;
- (4) commissions, discounts and other fees and charges owed with respect to letters of credit and bankers' acceptance financing;
- (5) interest actually paid by the Company or any such Restricted Subsidiary under any Guarantee of Indebtedness or other obligation of any other Person;
- (6) costs associated with Hedging Obligations (including amortization of fees) *provided, however*, that if Hedging Obligations result in net benefits rather than costs, such benefits shall be credited to reduce Consolidated Interest Expense unless, pursuant to GAAP, such net benefits are otherwise reflected in Consolidated Net Income;
- (7) the Consolidated Interest Expense of such Person and its Restricted Subsidiaries that was capitalized during such period;
- (8) the product of (a) all dividends paid or payable, in cash, Cash Equivalents or Indebtedness or accrued during such period on any series of Disqualified Stock of such Person or on Preferred Stock of its Restricted Subsidiaries that are not Subsidiary Guarantors payable to a party other than the Company or a Wholly Owned Subsidiary, times (b) a fraction, the numerator of which is one and the denominator of which is one minus the then current combined federal, state, provincial and local statutory tax rate of such Person, expressed as a decimal, in each case, on a consolidated basis and in accordance with GAAP;
- (9) Receivables Fees; and
- (10) the cash contributions to any employee stock ownership plan or similar trust to the extent such contributions are used by such plan or trust to pay interest or fees to any Person (other than the Company and its Restricted Subsidiaries) in connection with Indebtedness Incurred by such plan or trust.

For the purpose of calculating the Consolidated Coverage Ratio, the calculation of Consolidated Interest Expense shall include all interest expense (including any amounts described in clauses (1) through (10) above) relating to any Indebtedness of the Company or any Restricted Subsidiary described in the final paragraph of the definition of Indebtedness.

For purposes of the foregoing, total interest expense will be determined (i) after giving effect to any net payments made or received by the Company and its Subsidiaries with respect to Interest Rate Agreements and (ii) exclusive of amounts classified as other comprehensive income in the balance sheet of the Company.

Consolidated Leverage Ratio, as of any date of determination, means the ratio of:

- (1) the sum of the aggregate outstanding Indebtedness of the Company and its Restricted Subsidiaries as of the date of calculation on a consolidated basis in accordance with GAAP; to

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(2) Consolidated EBITDA of the Company and its Restricted Subsidiaries for the period of the most recent four consecutive fiscal quarters ending prior to the date of such determination for which financial statements prepared on a consolidated basis in accordance with GAAP are available; *provided, however*, that:

(3) if the Company or any Restricted Subsidiary:

(a) has Incurred any Indebtedness since the beginning of such period that remains outstanding on such date of determination or if the transaction giving rise to the need to calculate the Consolidated Leverage Ratio is an Incurrence of Indebtedness, Indebtedness at the end of such period, Consolidated EBITDA and Consolidated Interest Expense for such period will be calculated after giving effect on a pro forma basis to such Indebtedness as if such Indebtedness had been Incurred on the first day of such period (except that in making such computation, the amount of Indebtedness under any revolving Debt Facility outstanding on the date of such calculation will be deemed to be:

(i) the average daily balance of such Indebtedness during such four fiscal quarters or such shorter period for which such facility was outstanding or

(ii) if such facility was created after the end of such four fiscal quarters, the average daily balance of such Indebtedness during the period from the date of creation of such facility to the date of such calculation) and the discharge of any other Indebtedness repaid, repurchased, defeased or otherwise discharged with the proceeds of such new Indebtedness as if such discharge had occurred on the first day of such period; or

(b) has repaid, repurchased, defeased or otherwise discharged any Indebtedness since the beginning of the period that is no longer outstanding on such date of determination or if the transaction giving rise to the need to calculate the Consolidated Leverage Ratio involves a discharge of Indebtedness (in each case other than Indebtedness Incurred under any revolving Debt Facility unless such Indebtedness has been permanently repaid and the related commitment terminated), Indebtedness, Consolidated EBITDA and Consolidated Interest Expense for such period will be calculated after giving effect on a pro forma basis to such discharge of such Indebtedness, including with the proceeds of such new Indebtedness, as if such discharge had occurred on the first day of such period;

(4) if since the beginning of such period the Company or any Restricted Subsidiary will have made any Asset Sale or disposed of any company, division, operating unit, segment, business, group of related assets or line of business or if the transaction giving rise to the need to calculate the Consolidated Leverage Ratio is such an Asset Sale:

(a) Indebtedness at the end of such period will be reduced by an amount equal to the Indebtedness discharged, defeased or retired with the Net Available Cash of such Asset Sale and the assumption of Indebtedness by the transferee;

(b) the Consolidated EBITDA for such period will be reduced by an amount equal to the Consolidated EBITDA (if positive) directly attributable to the assets which are the subject of such disposition for such period or increased by an amount equal to the Consolidated EBITDA (if negative) directly attributable thereto for such period; and

(c) Consolidated Interest Expense for such period will be reduced by an amount equal to the Consolidated Interest Expense directly attributable to any Indebtedness of the Company or any Restricted Subsidiary repaid, repurchased, defeased or otherwise discharged with respect to the Company and its continuing Restricted Subsidiaries in connection with such disposition for such period (or, if the Capital Stock of any Restricted Subsidiary is sold, the Consolidated Interest Expense for such period directly attributable to the Indebtedness of such Restricted Subsidiary to the extent the Company and its continuing Restricted Subsidiaries are no longer liable for such Indebtedness after such sale);

(5) if since the beginning of such period the Company or any Restricted Subsidiary (by merger or otherwise) will have made an Investment in any Restricted Subsidiary (or any Person which becomes a Restricted Subsidiary or is merged with or into the Company) or an acquisition of assets, including any acquisition of

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assets occurring in connection with a transaction causing a calculation to be made hereunder, which constitutes all or substantially all of a company, division, operating unit, segment, business or group of related assets or line of business, Indebtedness, Consolidated EBITDA and Consolidated Interest Expense for such period will be calculated after giving pro forma effect thereto (including the Incurrence of any Indebtedness) as if such Investment or acquisition occurred on the first day of such period; and

(6) if since the beginning of such period any Person (that subsequently became a Restricted Subsidiary or was merged with or into the Company or any Restricted Subsidiary since the beginning of such period) will have Incurred any Indebtedness or discharged any Indebtedness or made any disposition or any Investment or acquisition of assets that would have required an adjustment pursuant to clause (3), (4) or (5) above if made by the Company or a Restricted Subsidiary during such period, Indebtedness, Consolidated EBITDA and Consolidated Interest Expense for such period will be calculated after giving pro forma effect thereto as if such transaction occurred on the first day of such period.

The *pro forma* calculations will be determined in good faith by a responsible financial or accounting officer of the Company. If any Indebtedness bears a floating rate of interest and is being given pro forma effect, the interest expense on such Indebtedness will be calculated as if the rate in effect on the date of determination had been the applicable rate for the entire period (taking into account any Interest Rate Agreement applicable to such Indebtedness if such Interest Rate Agreement has a remaining term in excess of 12 months). If any Indebtedness that is being given *pro forma* effect bears an interest rate at the option of the Company, the interest rate shall be calculated by applying such optional rate chosen by the Company. Interest on a Capitalized Lease Obligation shall be deemed to accrue at an interest rate determined in good faith by a responsible financial or accounting Officer of the Company to be the rate of interest implicit in such Capitalized Lease Obligation in accordance with GAAP. *Pro forma* calculations may include adjustments calculated to give effect to any Pro Forma Cost Savings in an aggregate amount not to exceed \$25.0 million for any such period.

Consolidated Net Income means, for any period, the net income (loss) of the Company and its consolidated Restricted Subsidiaries determined on a consolidated basis in accordance with GAAP; *provided, however*, that there will not be included in such Consolidated Net Income on an after-tax basis (without duplication):

(1) any net income (loss) of any Person if such Person is not a Restricted Subsidiary or that is accounted for by the equity method of accounting, except that:

(a) subject to the limitations contained in clauses (3) through (7) below, the Company's equity in the net income of any such Person for such period will be included in such Consolidated Net Income up to the aggregate amount of cash actually distributed by such Person during such period to the Company or a Restricted Subsidiary as a dividend or other distribution (subject, in the case of a dividend or other distribution to a Restricted Subsidiary, to the limitations contained in clause (2) below); and

(b) the Company's equity in a net loss of any such Person (other than an Unrestricted Subsidiary) for such period will be included in determining such Consolidated Net Income to the extent such loss has been funded with cash from the Company or a Restricted Subsidiary;

(2) solely for the purpose of determining the amount available for Restricted Payments under clause 4(c)(i) of Certain covenants Limitation on restricted payments, any net income (but not loss) of any Restricted Subsidiary (other than a Subsidiary Guarantor) if such Subsidiary is subject to prior government approval or other restrictions due to the operation of its charter or any agreement, instrument, judgment, decree, order statute, rule or government regulation (which have not been waived), directly or indirectly, on the payment of dividends or the making of distributions by such Restricted Subsidiary, directly or indirectly, to the Company, except that:

(a) subject to the limitations contained in clauses (3) through (7) below, the Company's equity in the net income of any such Restricted Subsidiary for such period will be included in such Consolidated Net Income up to the aggregate amount of cash that could have been distributed by such Restricted Subsidiary during such period to the Company or another Restricted Subsidiary as a dividend (subject, in the case of a dividend to another Restricted Subsidiary, to the limitation contained in this clause); and

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(b) the Company's equity in a net loss of any such Restricted Subsidiary for such period will be included in determining such Consolidated Net Income;

(3) any gain or loss (less all fees and expenses relating thereto) realized upon sales or other dispositions of any assets of the Company or such Restricted Subsidiary, other than in the ordinary course of business;

(4) any after-tax effect of income (loss) from the early extinguishment of Indebtedness or Hedging Obligations or other derivative instruments;

(5) any net income or loss included in the consolidated statement of operations with respect to noncontrolling interests due to the application of Accounting Standards Codification Topic 810, *Consolidation*;

(6) any net after-tax extraordinary gain or loss; and

(7) the cumulative effect of a change in accounting principles.

Continuing Directors means, as of any date of determination, any member of the Board of Directors of the Company who: (1) was a member of such Board of Directors on the Issue Date; or (2) was nominated for election or elected to such Board of Directors with the approval of a majority of the Continuing Directors who were members of such Board at the time of such nomination or election.

Convertible Notes means Indebtedness of the Company that is optionally convertible into Common Stock of the Company (and/or cash based on the value of such Common Stock) and/or Indebtedness of a Subsidiary of the Company that is optionally exchangeable for Common Stock of the Company (and/or cash based on the value of such Common Stock).

Covered Satellite means any Satellite or a portion of a Satellite, as applicable, with respect to which the Company or any of its Restricted Subsidiaries owns or retains risk of loss.

Currency Agreement means in respect of a Person any foreign exchange contract, currency swap agreement, futures contract or option contract with respect to foreign exchange rates or currency values, or other similar agreement as to which such Person is a party or a beneficiary.

Debt Facility means, with respect to the Company or any Subsidiary Guarantor or any Restricted Subsidiary that is a Foreign Subsidiary, one or more debt facilities (including, without limitation, the Senior Credit Facility) or commercial paper facilities or indentures with banks or other institutional lenders or trustees providing for revolving credit loans, term loans, receivables financing (including through the sale of receivables to such lenders or to special purpose entities formed to borrow from such lenders against such receivables) or letters of credit or issuances of debt securities evidenced by notes, debentures, bonds or similar instruments, in each case, as amended, restated, modified, renewed, refunded, replaced or refinanced (including by means of sales of debt securities to institutional investors) in whole or in part from time to time (and whether or not with the original administrative agent, lenders or trustee or another administrative agent or agents, other lenders or trustee and whether provided under the original Senior Credit Facility or any other credit or other agreement or indenture).

Default means any event that is, or after notice or passage of time or both would be, an Event of Default.

Designated Noncash Consideration means the fair market value of noncash consideration received by the Company or one of its Restricted Subsidiaries in connection with an Asset Sale that is so designated as Designated Noncash Consideration pursuant to an Officers' Certificate setting forth the basis of such valuation, less the amount of cash or Cash Equivalents received in connection with a subsequent sale or other disposition, redemption or payment of, on or with respect to such Designated Noncash Consideration.

Disqualified Stock means, with respect to any Person, any Capital Stock of such Person that by its terms (or by the terms of any security into which it is convertible or for which it is exchangeable, in each case at the option of the holder thereof) or upon the happening of any event:

(1) matures or is mandatorily redeemable pursuant to a sinking fund obligation or otherwise;

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(2) is convertible into or exchangeable for Indebtedness or Disqualified Stock (excluding Capital Stock which is convertible or exchangeable solely at the option of the Company or a Restricted Subsidiary (it being understood that upon such conversion or exchange it shall be an Incurrence of such Indebtedness or Disqualified Stock)); or

(3) is redeemable at the option of the holder of the Capital Stock in whole or in part,

in each case on or prior to the date 91 days after the earlier of the final maturity date of the Notes or the date the Notes are no longer outstanding; *provided, however*, that only the portion of Capital Stock which so matures or is mandatorily redeemable, is so convertible or exchangeable or is so redeemable at the option of the holder thereof prior to such date will be deemed to be Disqualified Stock; *provided, further* that any Capital Stock that would constitute Disqualified Stock solely because the holders thereof have the right to require the Company to repurchase such Capital Stock upon the occurrence of a change of control or asset sale shall not constitute Disqualified Stock if the terms of such Capital Stock (and all such securities into which it is convertible or for which it is ratable or exchangeable) provide that the Company may not repurchase or redeem any such Capital Stock pursuant to such provision prior to compliance by the Company with the provisions of the Indenture described under the captions Repurchase at the option of holders Change of control and Repurchase at the option of holders Sales of assets and subsidiary stock unless such repurchase or redemption complies with Certain covenants Limitation on restricted payments.

Equity Offering means a public offering or private placement for cash by the Company of Capital Stock (other than Disqualified Stock), other than (x) public offerings with respect to the Company's Capital Stock, registered on Form S-4 or S-8, (y) an issuance to any Subsidiary of the Company or (z) any offering of the Company's Common Stock issued in connection with a transaction that constitutes a Change of Control.

Exchange Act means the Securities Exchange Act of 1934, as amended, and the rules and regulations of the SEC promulgated thereunder.

Excluded Satellite means any (a) Covered Satellite that has a book value of less than \$50.0 million, (b) Covered Satellite that is not expected or intended, in the good faith determination of the Company, to earn revenue from the operation of such Covered Satellite in excess of \$75.0 million for the immediately succeeding 12-month calendar period, (c) Covered Satellite with one year or less of in-orbit life remaining (it being understood and agreed that such Covered Satellite shall be deemed to have in-orbit life only for so long as it is maintained in station kept orbit in a manner consistent with applicable governmental and ITU requirements), (d) Covered Satellite for which the procurement of In-Orbit Insurance in the amounts and on the terms required herein would not be available at a premium amount that is, and on other terms and conditions that are, commercially reasonable despite commercially reasonable efforts to obtain such coverage (including efforts to minimize the exclusions and insurance deductibles, subject to usual and customary exclusions consistent with the operating status of the Covered Satellite) and (e) Covered Satellite designated as an Excluded Satellite by the Company if the Company determines in good faith that (i)(A) such Covered Satellite's performance and/or operating status has been adversely affected by anomalies or component exclusions and the Company and its Restricted Subsidiaries are unlikely to receive insurance proceeds from a future failure thereof or (B) there are systemic failures or anomalies applicable to satellites of the same model or using the same components and (ii) the Company and its Restricted Subsidiaries are unlikely to obtain usual and customary coverage in the satellite insurance market for the Covered Satellite at a premium amount that is, and on other terms and conditions that are, commercially reasonable despite commercially reasonable efforts to obtain such coverage (including efforts to minimize the exclusions and insurance deductibles, subject to usual and customary exclusions consistent with the anomalies and/or operating status of the Covered Satellite).

Existing Senior Notes means the \$275.0 million aggregate principal amount of 8.875% Senior Notes due 2016 issued by the Company.

Foreign Subsidiary means any Restricted Subsidiary that is not organized under the laws of the United States of America or any state thereof or the District of Columbia and any Subsidiary of such Restricted Subsidiary.

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GAAP means generally accepted accounting principles in the United States of America as in effect as of the Issue Date, including those set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other entity as approved by a significant segment of the accounting profession. All ratios and computations based on GAAP contained in the Indenture will be computed in conformity with GAAP, except that in the event the Company is acquired in a transaction that is accounted for using purchase accounting, the effects of the application of purchase accounting shall be disregarded in the calculation of such ratios and other computations contained in the Indenture.

Guarantee means any obligation, contingent or otherwise, of any Person directly or indirectly guaranteeing any Indebtedness of any other Person and any obligation, direct or indirect, contingent or otherwise, of such Person:

(1) to purchase or pay (or advance or supply funds for the purchase or payment of) such Indebtedness of such other Person (whether arising by virtue of partnership arrangements, or by agreement to keep-well, to purchase assets, properties, goods, securities or services, to take-or-pay, or to maintain financial statement conditions or otherwise); or

(2) entered into for purposes of assuring in any other manner the obligee of such Indebtedness of the payment thereof or to protect such obligee against loss in respect thereof (in whole or in part); *provided, however*, that the term *Guarantee* will not include endorsements for collection or deposit in the ordinary course of business. The term *Guarantee* used as a verb has a corresponding meaning.

Guarantor Pari Passu Indebtedness means Indebtedness that ranks equally in right of payment to its Subsidiary Guarantee.

Guarantor Subordinated Obligation means, with respect to a Subsidiary Guarantor, any Indebtedness of such Subsidiary Guarantor (whether outstanding on the Issue Date or thereafter Incurred) that is expressly subordinated in right of payment to the obligations of such Subsidiary Guarantor under its Subsidiary Guarantee pursuant to a written agreement.

Hedging Obligations of any Person means the obligations of such Person pursuant to any Interest Rate Agreement, Currency Agreement or Commodity Agreement.

holder means a Person in whose name a Note is registered on the Registrar's books.

In-Orbit Insurance means, with respect to any Covered Satellite, insurance or other contractual arrangement providing for coverage against the risk of loss of or damage to such Covered Satellite attaching upon the expiration of the launch insurance therefor (or, if launch insurance is not procured, upon the initial completion of in-orbit testing) and attaching, during the commercial in-orbit service of such Covered Satellite, upon the expiration of the immediately preceding corresponding policy or other contractual arrangement, as the case may be, subject to the terms and conditions set forth in the Indenture.

In-Orbit Spare Capacity means a satellite or the payload of a satellite that:

(a) is available in the event of a Covered Satellite loss or failure in order to restore service on the Covered Satellite;

(b) meets or exceeds the contractual performance specifications for the payload being protected; and

(c) may be provided directly by the Company or a Restricted Subsidiary or by another satellite operator pursuant to a contractual arrangement.

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Incur means issue, create, assume, Guarantee, incur or otherwise become liable for; *provided, however*, that any Indebtedness or Capital Stock of a Person existing at the time such Person becomes a Restricted Subsidiary (whether by merger, consolidation, acquisition or otherwise) will be deemed to be Incurred by such Restricted Subsidiary at the time it becomes a Restricted Subsidiary; and the terms Incurred and Incurrence have meanings correlative to the foregoing.

Indebtedness means, with respect to any Person on any date of determination (without duplication):

- (1) the principal of and premium (if any) in respect of indebtedness of such Person for borrowed money;
- (2) the principal of and premium (if any) in respect of obligations of such Person evidenced by bonds, debentures, notes or other similar instruments;
- (3) the principal component of all obligations of such Person in respect of letters of credit, bankers' acceptances or other similar instruments (including reimbursement obligations with respect thereto except to the extent such reimbursement obligation relates to a trade payable and such obligation is satisfied within 30 days of Incurrence);
- (4) the principal component of all obligations of such Person to pay the deferred and unpaid purchase price of property, which purchase price is due more than six months after the date of placing such property in service or taking delivery and title thereto, except (i) any such balance that constitutes a trade payable or similar obligation to a trade creditor, in each case accrued in the ordinary course of business, and (ii) any earn-out obligation until the amount of such obligation becomes a liability on the balance sheet of such Person in accordance with GAAP;
- (5) Capitalized Lease Obligations and all Attributable Indebtedness of such Person (whether or not such items would appear on the balance sheet of the guarantor or obligor);
- (6) the principal component or liquidation preference of all obligations of such Person with respect to the redemption, repayment or other repurchase of any Disqualified Stock or, with respect to any Non-Guarantor Subsidiary, any Preferred Stock (but excluding, in each case, any accrued dividends);
- (7) the principal component of all Indebtedness of other Persons secured by a Lien on any asset or property of such Person, whether or not such Indebtedness is assumed by such Person; *provided, however*, that the amount of such Indebtedness will be the lesser of (a) the fair market value of such asset or property at such date of determination and (b) the amount of such Indebtedness of such other Persons;
- (8) the principal component of Indebtedness of other Persons to the extent Guaranteed by such Person (whether or not such items would appear on the balance sheet of the guarantor or obligor);
- (9) to the extent not otherwise included in this definition, net obligations of such Person under Hedging Obligations (the amount of any such obligations to be equal at any time to the termination value of such agreement or arrangement giving rise to such Obligation that would be payable by such Person at such time); and
- (10) to the extent not otherwise included in this definition, the amount of obligations outstanding under the legal documents entered into as part of a securitization transaction or series of securitization transactions that would be characterized as principal if such transaction were structured as a secured lending transaction rather than as a purchase outstanding relating to a securitization transaction or series of securitization transactions.

The amount of Indebtedness of any Person at any date will be the outstanding balance at such date of all unconditional obligations as described above and the maximum liability, upon the occurrence of the contingency giving rise to the obligation, of any contingent obligations at such date. Notwithstanding the foregoing, the following shall not be deemed to be *Indebtedness*: (1) money borrowed and set aside at the time of the Incurrence of any Indebtedness in order to pre-fund the payment of interest on such Indebtedness; *provided* that such money is held to secure the payment of such interest; (2) obligations to make payments to one or more insurers under satellite insurance policies in respect of premiums or the requirement to remit to such insurer(s) a

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portion of the future revenues generated by a satellite which has been declared a constructive total loss, in each case in accordance with the terms of the insurance policies relating thereto; (3) any obligations to make progress or incentive payments under any satellite manufacturing contract or to make payments under satellite launch contracts in respect of launch services provided thereunder, in each case, to the extent not overdue by more than 90 days; *provided, however*, that in the case of clauses (2) and (3), such amounts are not required by GAAP to be treated as indebtedness on the balance sheet of such Person.

In addition, Indebtedness of any Person shall include Indebtedness described in the preceding paragraph that would not appear as a liability on the balance sheet of such Person if:

- (1) such Indebtedness is the obligation of a partnership or joint venture that is not a Restricted Subsidiary (a *Joint Venture*);
- (2) such Person or a Restricted Subsidiary of such Person is a general partner of the Joint Venture (a *General Partner*); and
- (3) there is recourse, by contract or operation of law, with respect to the payment of such Indebtedness to property or assets of such Person or a Restricted Subsidiary of such Person; and then such Indebtedness shall be included in an amount not to exceed:
 - (a) the lesser of (i) the net assets of the General Partner and (ii) the amount of such obligations to the extent that there is recourse, by contract or operation of law, to the property or assets of such Person or a Restricted Subsidiary of such Person; or
 - (b) if less than the amount determined pursuant to clause (a) immediately above, the actual amount of such Indebtedness that is recourse to such Person or a Restricted Subsidiary of such Person, if the Indebtedness is evidenced by a writing and is for a determinable amount.

Independent Financial Advisor means an accounting, appraisal, investment banking firm or consultant to Persons engaged in Similar Businesses of nationally recognized standing that is, in the good faith judgment of the Company, qualified to perform the task for which it has been engaged.

Interest Rate Agreement means, with respect to any Person any interest rate protection agreement, interest rate future agreement, interest rate option agreement, interest rate swap agreement, interest rate cap agreement, interest rate collar agreement, interest rate hedge agreement or other similar agreement or arrangement as to which such Person is party or a beneficiary.

Investment means, with respect to any Person, all investments by such Person in other Persons (including Affiliates) in the form of any direct or indirect advance, loan (other than advances or extensions of credit to customers in the ordinary course of business) or other extensions of credit (including by way of Guarantee or similar arrangement, but excluding any debt or extension of credit represented by a bank deposit other than a time deposit) or capital contribution to (by means of any transfer of cash or other property to others or any payment for property or services for the account or use of others), or any purchase or acquisition of Capital Stock, Indebtedness or other similar instruments issued by, such Person and all other items that are or would be classified as investments on a balance sheet prepared in accordance with GAAP; *provided* that none of the following will be deemed to be an Investment:

- (1) Hedging Obligations entered into in the ordinary course of business and in compliance with the Indenture;
- (2) endorsements of negotiable instruments and documents in the ordinary course of business; and
- (3) an acquisition of property, assets, Capital Stock or other securities by the Company or a Subsidiary for consideration to the extent such consideration consists of Common Stock of the Company.

For purposes of Certain covenants Limitation on restricted payments,

- (1) Investment will include the portion (proportionate to the Company's equity interest in a Restricted Subsidiary to be designated as an Unrestricted Subsidiary) of the fair market value of the net assets of such

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Restricted Subsidiary at the time that such Restricted Subsidiary is designated an Unrestricted Subsidiary; provided, however, that upon a redesignation of such Subsidiary as a Restricted Subsidiary, the Company will be deemed to continue to have a permanent Investment in an Unrestricted Subsidiary in an amount (if positive) equal to (a) the Company's aggregate Investment in such Subsidiary as of the time of such redesignation less (b) the portion (proportionate to the Company's equity interest in such Subsidiary) of the fair market value of the net assets (as determined in good faith by an Officer of the Company (if in excess of \$25.0 million, as evidenced by an Officer's Certificate) or if in excess of \$50.0 million by the Board of Directors of the Company) of such Subsidiary at the time that such Subsidiary is so re-designated a Restricted Subsidiary; and

(2) any property transferred to or from an Unrestricted Subsidiary will be valued at its fair market value at the time of such transfer (in each case, as determined in good faith by an Officer of the Company (as determined in good faith by an Officer of the Company (if in excess of \$25.0 million, as evidenced by an Officer's Certificate) or if in excess of \$50.0 million by the Board of Directors of the Company).

Investment Grade Rating means a rating equal to or higher than Baa3 (or the equivalent) by Moody's Investors Service, Inc. and BBB- (or the equivalent) by Standard & Poor's Ratings Group, Inc., or any equivalent rating by any Rating Agency, in each case, with a stable or better outlook.

Issue Date means February 27, 2012.

Lien means, with respect to any asset or property, any mortgage, lien (statutory or otherwise), pledge, hypothecation, charge, security interest, preference, priority or encumbrance of any kind in respect of such asset or property, whether or not filed, recorded or otherwise perfected under applicable law, including any conditional sale or other title retention agreement, any lease in the nature thereof, any option or other agreement to sell or give a security interest in any asset or property and any filing of or agreement to give any financing statement under the Uniform Commercial Code (or equivalent statutes) of any jurisdiction; *provided* that in no event shall an operating lease be deemed to constitute a Lien.

Net Available Cash from an Asset Sale means the aggregate cash payments received (including any cash payments received by way of deferred payment of principal pursuant to a note or installment receivable or otherwise and net proceeds from the sale or other disposition of any securities or other assets or property received as consideration, but only as and when received, but excluding any other consideration received in the form of assumption by the acquiring Person of Indebtedness or other obligations relating to the properties or assets that are the subject of such Asset Sale or received in any other non-cash form) therefrom, in each case net of:

(1) all legal, accounting, brokerage and investment banking fees and expenses, title and recording tax expenses, commissions and other fees, expenses and direct costs (including, without limitation, employee severance and relocation costs and expenses) Incurred, and all Federal, state, provincial, foreign and local taxes required to be paid or accrued as a liability under GAAP (after taking into account any available tax credits or deductions and any tax sharing agreements), as a consequence of such Asset Sale;

(2) all payments made on any Indebtedness that is secured by any assets or property subject to such Asset Sale, in accordance with the terms of any Lien upon such assets or property, or which must by its terms, or in order to obtain a necessary consent to such Asset Sale, or by applicable law be repaid out of the proceeds from such Asset Sale;

(3) all distributions and other payments required to be made to minority interest holders in Subsidiaries or joint ventures as a result of such Asset Sale;

(4) the deduction of appropriate amounts to be provided by the seller as a reserve, in accordance with GAAP, against any liabilities associated with the assets or property disposed of in such Asset Sale and retained by the Company or any Restricted Subsidiary after such Asset Sale; and

(5) until received by the selling person, any portion of the purchase price from an Asset Sale placed in escrow or withheld by the purchaser, whether as a reserve for adjustment of the purchase price, for satisfaction of indemnities in respect of such Asset Sale or otherwise in connection with such Asset Sale.

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Net Cash Proceeds, with respect to any issuance or sale of Capital Stock, means the cash proceeds of such issuance or sale net of attorneys' fees, accountants' fees, underwriters' or placement agents' fees, listing fees, discounts or commissions and brokerage, consultant and other fees and charges actually incurred in connection with such issuance or sale and net of taxes paid or payable as a result of such issuance or sale (after taking into account any available tax credit or deductions and any tax sharing arrangements).

Non-Guarantor Subsidiary means any Restricted Subsidiary that is not a Subsidiary Guarantor.

Non-Recourse Debt means Indebtedness of a Person:

(1) as to which neither the Company nor any Restricted Subsidiary (a) provides any Guarantee or credit support of any kind (including any undertaking, Guarantee, indemnity, agreement or instrument that would constitute Indebtedness) or (b) is directly or indirectly liable (as a guarantor or otherwise); and

(2) no default with respect to which (including any rights that the holders thereof may have to take enforcement action against an Unrestricted Subsidiary) would permit (upon notice, lapse of time or both) any holder of any other Indebtedness of the Company or any Restricted Subsidiary to declare a default under such other Indebtedness or cause the payment thereof to be accelerated or payable prior to its Stated Maturity.

Obligations means any principal, interest (including any interest accruing subsequent to the filing of a petition in bankruptcy, reorganization or similar proceeding at the rate provided for in the documentation with respect thereto, whether or not such interest is an allowed claim under applicable state, federal or foreign law), other monetary obligations, penalties, fees, indemnifications, reimbursements (including reimbursement obligations with respect to letters of credit and banker's acceptances), damages and other liabilities, and Guarantees of payment of such principal, interest, penalties, fees, indemnifications, reimbursements, damages and other liabilities, payable under the documentation governing any Indebtedness.

Officer means the Chairman of the Board, the Chief Executive Officer, the President, the Chief Operating Officer, Chief Financial Officer, any Executive Vice President, Senior Vice President or Vice President, the Controller, the Treasurer or the Secretary of the Company. Officer of any Subsidiary Guarantor has a correlative meaning.

Officers' Certificate means a certificate signed by two Officers or by an Officer and either an Assistant Treasurer or an Assistant Secretary of the Company.

Opinion of Counsel means a written opinion from legal counsel who is acceptable to the Trustee. The counsel may be an employee of or counsel to the Company.

Pari Passu Indebtedness means Indebtedness that ranks equally in right of payment to the Notes.

Permitted Bond Hedge means any call options or capped call options referencing the Company's Common Stock purchased by the Company concurrently with the issuance of Convertible Notes to hedge the Company's or any Subsidiary issuer's obligations under such Indebtedness.

Permitted Investment means an Investment by the Company or any Restricted Subsidiary in:

(1) the Company or a Restricted Subsidiary;

(2) any Investment by the Company or any of its Restricted Subsidiaries in a Person that is engaged in a Similar Business if as a result of such Investment:

(a) such Person becomes a Restricted Subsidiary; or

(b) such Person, in one transaction or a series of related transactions, is merged or consolidated with or into, or transfers or conveys all or substantially all of its assets to, or is liquidated into, the Company or a Restricted Subsidiary,

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and, in each case, any Investment held by such Person; *provided* that such Investment was not acquired by such Person in contemplation of such acquisition, merger, consolidation or transfer;

(3) cash and Cash Equivalents;

(4) receivables owing to the Company or any Restricted Subsidiary created or acquired in the ordinary course of business and payable or dischargeable in accordance with customary trade terms; *provided, however*, that such trade terms may include such concessionary trade terms as the Company or any such Restricted Subsidiary deems reasonable under the circumstances;

(5) commission, payroll, travel and similar advances to cover matters that are expected at the time of such advances ultimately to be treated as expenses for accounting purposes and that are made in the ordinary course of business;

(6) loans or advances to employees, officers or directors of the Company or any Restricted Subsidiary in the ordinary course of business consistent with past practices in an aggregate amount not in excess of \$10.0 million at any one time outstanding;

(7) any Investment acquired by the Company or any of its Restricted Subsidiaries:

(a) in exchange for any other Investment or accounts receivable held by the Company or any such Restricted Subsidiary in connection with or as a result of a bankruptcy, workout, reorganization or recapitalization of the issuer of such other Investment or accounts receivable;

(b) in satisfaction of judgments or in compromise, settlement or resolution of any litigation, arbitration or other dispute; or

(c) as a result of a foreclosure by the Company or any of its Restricted Subsidiaries with respect to any secured Investment or other transfer of title with respect to any secured Investment in default;

(8) Investments made as a result of the receipt of non-cash consideration from an Asset Sale that was made pursuant to and in compliance with Repurchase at the option of holders Sales of assets and subsidiary stock or any other disposition of assets or property not constituting an Asset Sale;

(9) Investments in existence on the Issue Date;

(10) Currency Agreements, Interest Rate Agreements, Commodity Agreements and related Hedging Obligations, which transactions or obligations are Incurred in compliance with Certain covenants Limitation on indebtedness ;

(11) Guarantees issued in accordance with Certain covenants Limitation on indebtedness ;

(12) Investments made in connection with the funding of contributions under any non-qualified retirement plan or similar employee compensation plan in an amount not to exceed the amount of compensation expense recognized by the Company and its Restricted Subsidiaries in connection with such plans;

(13) Investments made with respect to any Satellite Joint Venture (or any Person which upon the making of such Investment becomes a Satellite Joint Venture) in an aggregate amount not in excess of (a) \$100.0 million in any fiscal year (with unused amounts in any fiscal year being carried over to the next succeeding fiscal year subject to a maximum of \$150.0 million in such next succeeding fiscal year); *provided* that on the date of such Investment the Consolidated Leverage Ratio is less than 3.50 to 1.00; or (b) \$50.0 million in any fiscal year in the event that on the date of such Investment the Consolidated Leverage Ratio is greater than or equal to 3.50 to 1.00;

(14) Investments by the Company or any of its Restricted Subsidiaries, when taken together with all other Investments made pursuant to this clause (14) since the Issue Date that are at that time outstanding, having an aggregate fair market value (with the fair market value of each Investment being measured at the time made and without giving effect to subsequent changes in value) at the time of such Investment not to exceed the greater of \$50.0 million and 5.0% of Total Assets;

(15) Investments in TrellisWare made after the Issue Date in an aggregate amount not in excess of \$40.0 million at any one time outstanding;

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(16) Investments to the extent made in exchange for the issuance of Capital Stock (other than Disqualified Stock) of the Company;

(17) any repurchase of the Notes; and

(18) any Asset Swap made in accordance with Certain covenants Sales of assets and subsidiary stock.

Permitted Joint Venture means: (a) TrellisWare, (b) any Satellite Joint Venture or (c) any other Person (other than a Restricted Subsidiary) in which the Company or any of its Restricted Subsidiaries has made a Permitted Investment or any Investment permitted to be made pursuant to the covenant described under Limitation on restricted payments (or Subsidiary of such Person), which Person is engaged in a Similar Business and in respect of which the Company or any of its Restricted Subsidiaries beneficially owns at least 10.0% of the Capital Stock of such Person.

Permitted Liens means, with respect to any Person:

(1) Liens securing Indebtedness and other obligations under a Debt Facility and any related Hedging Obligations and related banking services or cash management obligations and Liens securing Guarantees of Indebtedness and other obligations under a Debt Facility permitted to be Incurred under the Indenture under the provisions described in clause (1) of the second paragraph under Certain covenants Limitation on indebtedness);

(2) Liens by such Person under workers compensation laws, unemployment insurance laws or similar legislation, in connection with satellite construction agreements (including the satellite construction agreement in existence on the Issue Date) or in connection with launch services agreements, or good faith pledges or deposits in connection with bids, tenders, contracts (other than for the payment of Indebtedness) or leases, or Liens to secure public or statutory obligations of such Person or deposits of cash or United States government bonds to secure surety or appeal bonds, or deposits as security for contested taxes or import or customs duties or for the payment of rent, in each case Incurred in the ordinary course of business;

(3) Liens imposed by law, including carriers, warehousemen, mechanics, suppliers, vendors, materialmen and repairmen Liens or similar Liens, Incurred in the ordinary course of business;

(4) Liens for taxes, assessments or other governmental charges not yet subject to penalties for non-payment or that are being contested in good faith provided appropriate reserves to the extent required pursuant to GAAP have been made in respect thereof;

(5) Liens to secure surety, stay, appeal, indemnification, performance or similar bonds or letters of credit or bankers acceptances or similar obligations; *provided, however*, that such letters of credit do not constitute Indebtedness, or Liens with respect to insurance premium financing;

(6) survey exceptions, encumbrances, ground leases, easements or reservations of, or rights of others for, licenses, rights of way, sewers, electric lines, telegraph and telephone lines and other similar purposes, or zoning, building codes or other restrictions (including, without limitation, minor defects or irregularities in title and similar encumbrances) as to the use of real properties or Liens incidental to the conduct of the business of such Person or to the ownership of its properties that do not in the aggregate materially adversely affect the value of said properties or materially impair their use in the operation of the business of such Person;

(7) Liens securing Hedging Obligations so long as any related Indebtedness is permitted to be Incurred under the Indenture;

(8) leases, licenses, subleases and sublicenses of assets or property (including, without limitation, real property and intellectual property rights) that do not materially interfere with the ordinary conduct of the business of the Company or any of its Restricted Subsidiaries;

(9) judgment and attachment Liens and Liens arising by reason of a court order or decree and notices of *lis pendens* and associated rights related to litigation being contested in good faith, in each case not giving rise to an Event of Default;

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(10) Liens securing Indebtedness (including Capitalized Lease Obligations, Attributable Indebtedness, mortgage financings and purchase money obligations) permitted under clause (8) of the second paragraph under Certain covenants Limitation on indebtedness, which Liens cover only assets or property acquired, financed, designed, leased, constructed, repaired, maintained, installed or improved with or by such Indebtedness (including any proceeds thereof, accessions thereto and any upgrades, replacements or improvements thereto); *provided* that the aggregate principal amount of Indebtedness secured by such Liens is otherwise permitted to be Incurred under the Indenture and does not

exceed the cost of the assets or property so financed, designed, leased, constructed, repaired, maintained, installed or improved.

(11) Liens arising solely by virtue of any statutory or common law provisions relating to banker's Liens, rights of set-off, revocation, refund or chargeback or similar rights and remedies as to deposit or securities accounts or other funds or instruments maintained with a depository institution; *provided* that:

(a) such deposit or securities account is not a dedicated cash collateral account and is not subject to restrictions against access by the Company in excess of those set forth by regulations promulgated by the Federal Reserve Board; and

(b) such deposit or securities account is not intended by the Company or any Restricted Subsidiary to provide collateral to the depository institution;

(12) Liens arising from Uniform Commercial Code financing statement filings regarding operating leases entered into by the Company and its Restricted Subsidiaries in the ordinary course of business;

(13) Liens existing on the Issue Date (other than Liens permitted under clause (1));

(14) Liens on property or Capital Stock of a Person at the time such Person becomes a Restricted Subsidiary or is merged or consolidated with or into the Company or a Restricted Subsidiary; *provided, however*, that such Liens were in existence prior to such Person became a Restricted Subsidiary or merged or consolidated with or into the Company or a Restricted Subsidiary and were not Incurred in connection with, or in contemplation of, such event; *provided further, however*, that any such Lien may not extend to any other property owned by the Company or any other Restricted Subsidiary;

(15) Liens on property (including Capital Stock) at the time the Company or a Restricted Subsidiary acquired the property, including any acquisition by means of a merger or consolidation with or into the Company or any Restricted Subsidiary; *provided, however*, that such Liens were in existence prior to such acquisition and were not Incurred in connection with, or in contemplation of, such acquisition; *provided further, however*, that such Liens do not extend to any other property owned by the Company or any other Restricted Subsidiary;

(16) Liens securing Indebtedness or other obligations of the Company owing to a Restricted Subsidiary, or of a Restricted Subsidiary owing to the Company or another Restricted Subsidiary (other than a receivables entity);

(17) Liens securing the Notes and Subsidiary Guarantees;

(18) Liens securing Refinancing Indebtedness Incurred to refinance, refund, replace, defease, amend, extend or modify, as a whole or in part, Indebtedness that was previously so secured pursuant to clauses (13), (14), (15), (17) and (18) of this definition, *provided* that any such Lien is limited to all or part of the same property or assets (plus improvements, accessions, replacements, proceeds or dividends or distributions in respect thereof) that secured (or, under the written arrangements under which the original Lien arose, could secure) the Indebtedness being refinanced or is in respect of property that is the security for a Permitted Lien hereunder;

(19) any interest or title of a lessor under any Capitalized Lease Obligation or operating lease;

(20) Liens in favor of the Company or any Restricted Subsidiary;

(21) Liens securing Indebtedness in an aggregate principal amount outstanding at any one time not to exceed \$50.0 million;

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(22) Liens securing Replacement Satellite Vendor Indebtedness permitted under clause (13) of the second paragraph under Certain covenants Limitation on indebtedness or securing Indebtedness permitted under clause (14) of the second paragraph under Certain covenants Limitation on indebtedness, which Liens cover only assets or property acquired with or financed by such Indebtedness;

(23) Liens on cash collateral not to exceed \$25.0 million in the aggregate at any time securing letters of credit;

(24) Liens securing Indebtedness permitted under clauses (15) or (16) of the second paragraph under Certain covenants Limitation on indebtedness ;

(25) other non-consensual Liens incurred in the ordinary course of business that do not materially interfere with the ordinary conduct of the business of the Company and its Restricted Subsidiaries;

(26) Liens that may be deemed to exist by virtue of contractual provisions that restrict the ability of the Company or any of its Restricted Subsidiaries from incurring or creating Liens on their assets or property;

(27) Liens on deposits made in the ordinary course of business with respect to premiums in favor of insurance carriers and Liens on insurance policies and the proceeds thereof securing the financing of the premiums with respect thereto; and

(28) Liens on the Capital Stock of Unrestricted Subsidiaries.

Permitted Warrant means any call option in respect of the Company's Common Stock sold by the Company concurrently with the issuance of Convertible Notes.

Person means any individual, corporation, limited liability company, partnership, joint venture, association, joint-stock company, trust, unincorporated organization, government or any agency or political subdivision hereof or any other entity.

Preferred Stock, as applied to the Capital Stock of any corporation, means Capital Stock of any class or classes (however designated) that is preferred as to the payment of dividends upon liquidation, dissolution or winding up.

Pro Forma Cost Savings means, without duplication, with respect to any period, the net reduction in costs and other operating improvements or synergies that have been realized or are reasonably anticipated to be realized in good faith with respect to a *pro forma* event within twelve months of the date of such pro forma event and that are reasonable and factually supportable, as if all such reductions in costs had been effected as of the beginning of such period, decreased by any incremental expenses incurred or to be incurred during such four quarter period in order to achieve such reduction in costs. Pro Forma Cost Savings described in the preceding sentence shall be accompanied by a certificate delivered to the Trustee from the Company's Chief Financial Officer that outlines the specific actions taken or to be taken and the net cost reductions and other operating improvements or synergies achieved or to be achieved from each such action and certifies that such cost reductions and other operating improvements or synergies meet the criteria set forth in the preceding sentence.

Rating Agency means each of Standard & Poor's Ratings Group, Inc. and Moody's Investors Service, Inc. or if Standard & Poor's Ratings Group, Inc. or Moody's Investors Service, Inc. or both shall not make a rating on the Notes publicly available, a nationally recognized statistical rating agency or agencies, as the case may be, selected by the Company (as certified by a resolution of the Board of Directors) which shall be substituted for Standard & Poor's Ratings Group, Inc. or Moody's Investors Service, Inc. or both, as the case may be.

Receivable means a right to receive payment arising from a sale or lease of goods or the performance of services by a Person pursuant to an arrangement with another Person pursuant to which such other Person is obligated to pay for goods or services under terms that permit the purchase of such goods and services on credit and shall include, in any event, any items of property that would be classified as an account, chattel paper, payment intangible or instrument under the Uniform Commercial Code as in effect in the State of New York and any supporting obligations as so defined.

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Receivables Fees means any fees or interest paid to purchasers or lenders providing the financing in connection with a factoring agreement or other similar agreement, including any such amounts paid by discounting the face amount of Receivables or participations therein transferred in connection with a factoring agreement or other similar arrangement, regardless of whether any such transaction is structured as on-balance sheet or off-balance sheet or through a Restricted Subsidiary or an Unrestricted Subsidiary.

Refinancing Indebtedness means Indebtedness that is Incurred to refund, refinance, replace, exchange, renew, repay or extend (including pursuant to any defeasance or discharge mechanism) (collectively, refinance, refinances and refinanced shall each have a correlative meaning) any Indebtedness existing on the Issue Date or Incurred in compliance with the Indenture (including Indebtedness of the Company that refinances Indebtedness of any Restricted Subsidiary, Indebtedness of any Restricted Subsidiary that refinances Indebtedness of another Restricted Subsidiary or Indebtedness of any Subsidiary Guarantor that refinances Indebtedness of the Company or any Subsidiary Guarantor) including Indebtedness that refinances Refinancing Indebtedness, *provided, however*, that:

(1)(a) if the Stated Maturity of the Indebtedness being refinanced is earlier than the Stated Maturity of the Notes, the Refinancing Indebtedness has a Stated Maturity no earlier than the Stated Maturity of the Indebtedness being refinanced or (b) if the Stated Maturity of the Indebtedness being refinanced is later than the Stated Maturity of the Notes, the Refinancing Indebtedness has a Stated Maturity at least 91 days later than the Stated Maturity of the Notes;

(2) the Refinancing Indebtedness has an Average Life at the time such Refinancing Indebtedness is Incurred that is equal to or greater than the Average Life of the Indebtedness being refinanced;

(3) such Refinancing Indebtedness is Incurred in an aggregate principal amount (or if issued with original issue discount, an aggregate issue price) that is equal to or less than the sum of the aggregate principal amount (or if issued with original issue discount, the aggregate accreted value) then outstanding of the Indebtedness being refinanced (plus, without duplication, any additional Indebtedness Incurred to pay interest or premiums required by the instruments governing such existing Indebtedness and fees Incurred in connection therewith);

(4) if the Indebtedness being refinanced is subordinated in right of payment to the Notes or the Subsidiary Guarantee, such Refinancing Indebtedness is subordinated in right of payment to the Notes or the Subsidiary Guarantee on terms not materially less favorable, when taken as a whole, to the holders as those contained in the documentation governing the Indebtedness being refinanced; and

(5) Refinancing Indebtedness shall not include Indebtedness of a Non-Guarantor Subsidiary that refinances Indebtedness of the Company or a Subsidiary Guarantor.

Registration Rights Agreement means that certain registration rights agreement dated as of the Issue Date by and among the Company, the Subsidiary Guarantors and the initial purchasers set forth therein and, with respect to any Additional Notes, one or more substantially similar registration rights agreements among the Company and the other parties thereto, as such agreements may be amended from time to time.

Replacement Satellite Vendor Indebtedness means Indebtedness of the Company or a Restricted Subsidiary provided by a satellite or satellite launch vendor, insurer or insurance agent or Affiliate thereof for (i) the construction, launch or insurance of all or part of one or more replacement satellites or satellite launches for such satellites, where replacement satellite means a satellite that is to be used: (x) as a replacement for the ViaSat-1 satellite, or (y) for continuation or expansion of the Company's satellite service as a replacement for, or supplement to, a satellite that is retired or relocated (due to a deterioration in operating useful life) within the existing service area or reasonably determined by the Company to no longer meet the requirements for such service or as a supplement to one or more existing satellites to provide additional capacity or (ii) the replacement of a spare satellite that has been launched or that is no longer capable of being launched or suitable for launch. Replacement Satellite Vendor Indebtedness includes any Refinancing Indebtedness thereof.

Restricted Investment means any Investment other than a Permitted Investment.

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Restricted Subsidiary means any Subsidiary of the Company other than an Unrestricted Subsidiary.

Restructuring Charges means all charges and expenses caused by or attributable to any restructuring, severance, relocation, consolidation, closing, integration, business optimization or transition, signing, retention or completion bonus or curtailments or modifications to pension and post-retirement employee benefit plans.

Sale/Leaseback Transaction means an arrangement relating to property now owned or hereafter acquired whereby the Company or a Restricted Subsidiary transfers such property to a Person (other than the Company or any of its Subsidiaries) and the Company or a Restricted Subsidiary leases it from such Person.

Satellite means any satellite owned by the Company or any of its Restricted Subsidiaries and any satellite purchased by the Company or any of its Restricted Subsidiaries pursuant to the terms of a satellite purchase agreement with the prime contractor and manufacturer of such Satellite relating to the manufacture, testing and delivery of such satellite, whether such satellite is in the process of manufacture, has been delivered for launch or is in orbit (whether or not in operational service).

Satellite Joint Venture means (a) a Person in which the Company or any Restricted Subsidiary has made an Investment, which Person is engaged in a business relating to the financing, development, construction, launch, operation or improvement of one or more satellites, satellite-related infrastructure or satellite-related equipment and/or the provision of satellite-based services, or (b) any Subsidiary of such Person; *provided* that such Satellite Joint Venture is not in respect of the development, construction, launch, operation or ownership of the ViaSat-1 satellite.

SEC means the United States Securities and Exchange Commission.

Secured Indebtedness means any Indebtedness of the Company or any of its Restricted Subsidiaries secured by a Lien.

Securities Act means the Securities Act of 1933, as amended, and the rules and regulations of the SEC promulgated thereunder.

Senior Credit Facility means the Fourth Amended and Restated Revolving Loan Agreement dated as of July 1, 2009, among the Company, Union Bank, N.A., as Administrative Agent, Bank of America, N.A., as Syndication Agent, JPMorgan Chase Bank, N.A., as Documentation Agent, Banc of America Securities LLC and Union Bank, N.A., as Joint Lead Arrangers and Joint Book Runners and Union Bank, N.A., as Collateral Agent, and the lenders parties thereto from time to time, as amended as of September 30, 2009, October 6, 2009, July 1, 2009, March 15, 2010, March 31, 2010, October 12, 2010, January 25, 2011, October 31, 2011 and February 21, 2012 and as the same may be further amended, restated, modified, renewed, refunded, replaced or refinanced in whole or in part from time to time (including increasing the amount loaned thereunder, *provided* that such additional Indebtedness is Incurred in accordance with the covenant described under "Certain covenants - Limitation on indebtedness"); *provided* that a Senior Credit Facility shall not relate to Indebtedness that does not consist exclusively of Pari Passu Indebtedness or Guarantor Pari Passu Indebtedness.

Significant Subsidiary means any Restricted Subsidiary that would be a Significant Subsidiary of the Company within the meaning of Rule 1-02 under Regulation S-X promulgated by the SEC, as in effect on the Issue Date.

Similar Business means any business conducted or proposed to be conducted by the Company and its Restricted Subsidiaries on the Issue Date or any business that is similar, reasonably related, incidental, complementary or ancillary thereto, or that constitutes a reasonable extension or expansion thereof.

Stated Maturity means, with respect to any security, the date specified in the agreement governing or certificate relating to such Indebtedness as the fixed date on which the final payment of principal of such security is due and

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payable, including pursuant to any mandatory redemption provision, but shall not include any contingent obligations to repay, redeem or repurchase any such principal prior to the date originally scheduled for the payment thereof.

Subordinated Obligation means any Indebtedness of the Company (whether outstanding on the Issue Date or thereafter Incurred) that is subordinated or junior in right of payment to the Notes pursuant to a written agreement.

Subsidiary of any Person means (a) any corporation, association or other business entity (other than a partnership, joint venture, limited liability company or similar entity) of which more than 50% of the total ordinary voting power of shares of Capital Stock entitled (without regard to the occurrence of any contingency) to vote in the election of directors, managers or trustees thereof (or Persons performing similar functions) or (b) any partnership, joint venture limited liability company or similar entity of which more than 50% of the capital accounts, distribution rights, total equity and voting interests or general or limited partnership interests, as applicable, is, in the case of clauses (a) and (b), at the time owned or controlled, directly or indirectly, by (1) such Person, (2) such Person and one or more Subsidiaries of such Person or (3) one or more Subsidiaries of such Person. Unless otherwise specified herein, each reference to a Subsidiary will refer to a Subsidiary of the Company.

Subsidiary Guarantee means, individually, any Guarantee of payment of the Notes and exchange notes issued in a registered exchange offer pursuant to the Registration Rights Agreement by a Subsidiary Guarantor pursuant to the terms of the Indenture and any supplemental indenture thereto, and, collectively, all such Guarantees. Each such Subsidiary Guarantee will be in the form prescribed by the Indenture.

Subsidiary Guarantor means each Restricted Subsidiary in existence on the Issue Date that provides a Subsidiary Guarantee on the Issue Date (and any other Restricted Subsidiary that provides a Subsidiary Guarantee in accordance with the Indenture); *provided* that upon release or discharge of such Restricted Subsidiary from its Subsidiary Guarantee in accordance with the Indenture, such Restricted Subsidiary ceases to be a Subsidiary Guarantor.

Total Assets means the total assets of the Company and its Restricted Subsidiaries on a consolidated basis determined in accordance with GAAP, as shown on the most recent balance sheet of the Company (and determined on a *pro forma* basis in a manner consistent with the *pro forma* basis contained in the definition of Consolidated Coverage Ratio).

Treasury Rate means as of any date of redemption of Notes the yield to maturity at the time of computation of United States Treasury securities with a constant maturity (as compiled and published in the most recent Federal Reserve Statistical Release H.15 (519) that has become publicly available at least two Business Days prior to the redemption date (or, if such Statistical Release is no longer published, any publicly available source or similar market data)) most nearly equal to the period from the redemption date to June 15, 2016; *provided, however*, that if the period from the redemption date to June 15, 2016 is not equal to the constant maturity of a United States Treasury security for which a weekly average yield is given, the Treasury Rate shall be obtained by linear interpolation (calculated to the nearest one-twelfth of a year) from the weekly average yields of United States Treasury securities for which such yields are given, except that if the period from the redemption date to June 15, 2016 is less than one year, the weekly average yield on actually traded United States Treasury securities adjusted to a constant maturity of one year will be used.

TrellisWare means TrellisWare Technologies, Inc., a Delaware corporation.

Unrestricted Subsidiary means:

- (1) any Subsidiary of the Company that at the time of determination shall be designated an Unrestricted Subsidiary by the Board of Directors of the Company in the manner provided below;
- (2) any Subsidiary of an Unrestricted Subsidiary; and
- (3) as of the date of the Indenture, TrellisWare.

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The Board of Directors of the Company may designate any Subsidiary of the Company (including any newly acquired or newly formed Subsidiary or a Person becoming a Subsidiary through merger or consolidation or Investment therein) to be an Unrestricted Subsidiary only if:

- (1) such Subsidiary or any of its Subsidiaries has not Guaranteed any Capital Stock or Indebtedness of or have any Investment in, the Company or any Restricted Subsidiary and does not hold any Liens on any property or assets of the Company or any Restricted Subsidiary;
- (2) all the Indebtedness of such Subsidiary and its Subsidiaries shall, at the date of designation, and will for so long as it is an Unrestricted Subsidiary, consist of Non-Recourse Debt;
- (3) the aggregate fair market value of all outstanding Investments of the Company and its Restricted Subsidiaries in such Subsidiary complies with Certain covenants Limitation on restricted payments or constitutes a Permitted Investment;
- (4) such Subsidiary is a Person with respect to which neither the Company nor any of its Restricted Subsidiaries has any direct or indirect obligation to maintain or preserve such Person's financial condition or to cause such Person to achieve any specified levels of operating results; and
- (5) except as permitted by the covenant above under the caption Certain covenants Limitation on affiliate transactions, on the date such Subsidiary is designated an Unrestricted Subsidiary, such Subsidiary is not a party to any agreement, contract, arrangement or understanding with the Company or any Restricted Subsidiary with terms substantially less favorable to the Company or such Restricted Subsidiary, when taken as a whole, than those that would have been obtained from Persons who are not Affiliates of the Company.

Any such designation by the Board of Directors of the Company after the Issue Date shall be evidenced to the Trustee by filing with the Trustee a resolution of the Board of Directors of the Company giving effect to such designation and an Officers Certificate certifying that such designation complies with the foregoing conditions. If, at any time, any Unrestricted Subsidiary would fail to meet the foregoing requirements as an Unrestricted Subsidiary, it shall thereafter cease to be an Unrestricted Subsidiary for purposes of the Indenture and any Indebtedness of such Subsidiary shall be deemed to be Incurred as of such date.

The Board of Directors of the Company may designate any Unrestricted Subsidiary to be a Restricted Subsidiary; *provided* that immediately after giving effect to such designation, no Event of Default shall have occurred and be continuing or would occur as a consequence thereof and the Company could Incur at least \$1.00 of additional Indebtedness pursuant to the first paragraph of the Certain covenants Limitation on indebtedness covenant on a *pro forma* basis taking into account such designation.

U.S. Government Obligations means securities that are (a) direct obligations of the United States of America for the timely payment of which its full faith and credit is pledged or (b) obligations of a Person controlled or supervised by and acting as an agency or instrumentality of the United States of America the timely payment of that is unconditionally guaranteed as a full faith and credit obligation of the United States of America, which, in either case, are not callable or redeemable at the option of the issuer thereof, and shall also include a depository receipt issued by a bank (as defined in Section 3(a)(2) of the Securities Act), as custodian with respect to any such U.S. Government Obligations or a specific payment of principal of or interest on any such U.S. Government Obligations held by such custodian for the account of the holder of such depository receipt; *provided* that (except as required by law) such custodian is not authorized to make any deduction from the amount payable to the holder of such depository receipt from any amount received by the custodian in respect of the U.S. Government Obligations or the specific payment of principal of or interest on the U.S. Government Obligations evidenced by such depository receipt.

Voting Stock of a Person means all classes of Capital Stock of such Person then outstanding and normally entitled to vote in the election of directors, managers or trustees, as applicable, of such Person.

Wholly Owned Subsidiary means a Restricted Subsidiary, all of the Capital Stock of which (other than directors qualifying shares) is owned by the Company or another Wholly Owned Subsidiary.

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DESCRIPTION OF OLD NOTES

The terms of the old notes are substantially identical to those of the new notes, except that (1) the old notes have not been registered under the Securities Act, are subject to certain restrictions on transfer and are entitled to certain rights under the registration rights agreement (which rights will terminate upon consummation of the exchange offer, except under limited circumstances); and (2) the new notes will not provide for any additional interest as a result of our failure to fulfill certain registration obligations.

The old notes provide that, in the event that we and the guarantors determine that a registered exchange offer is not available or may not be completed because it would violate any applicable law or applicable interpretations of the staff of the SEC, or, if for any reason, the exchange offer is not completed on or before February 27, 2013 (or, if required, a shelf registration statement is not declared effective by the SEC on or prior to on or before February 27, 2013), the annual interest rate borne by the old notes will be increased by 0.25% per annum (which rate will be increased by an additional 0.25% per annum for each subsequent 90-day period that such additional interest continues to accrue, provided that the rate at which such additional interest accrues may in no event exceed 1.00% per annum) until the exchange offer is completed, the shelf registration statement is declared effective or the old notes become freely tradable under the Securities Act. The new notes are not, and upon consummation of the exchange offer with respect to the old notes will not be, entitled to any such additional interest. Accordingly, holders of old notes should review the information set forth under **Risk Factors** and **Description of New Notes**.

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BOOK-ENTRY SETTLEMENT AND CLEARANCE

The Global Notes

The new notes will be issued in the form of one or more registered notes in global form, without interest coupons (the global notes).

Upon issuance, each of the global notes will be deposited with the Trustee as custodian for DTC and registered in the name of Cede & Co., as nominee of DTC.

Ownership of beneficial interests in each global note will be limited to persons who have accounts with DTC (DTC participants) or persons who hold interests through DTC participants. We expect that under procedures established by DTC:

upon deposit of each global note with DTC's custodian, DTC will credit portions of the principal amount of the global note to the accounts of the DTC participants designated by the initial purchasers; and

ownership of beneficial interests in each global note will be shown on, and transfer of ownership of those interests will be effected only through, records maintained by DTC (with respect to interests of DTC participants) and the records of DTC participants (with respect to other owners of beneficial interests in the global note).

Beneficial interests in the global notes may not be exchanged for notes in physical, certificated form except in the limited circumstances described below.

Exchanges Among the Global Notes

Beneficial interests in one global note may generally be exchanged for interests in another global note. Depending on to which global note the transfer is being made, the Trustee may require the seller to provide certain written certifications in the form provided in the indenture governing the notes. In addition, in the case of a transfer of interests to the Institutional Accredited Investor global note, the Trustee may require the buyer to deliver a representation letter in the form provided in the indenture governing the notes that states, among other things, that the buyer is not acquiring notes with a view to distributing them in violation of the Securities Act.

A beneficial interest in a global note that is transferred to a person who takes delivery through another global note will, upon transfer, become subject to any transfer restrictions and other procedures applicable to beneficial interests in the other global note.

Book-Entry Procedures for the Global Notes

All interests in the global notes will be subject to the operations and procedures of DTC. We provide the following summaries of those operations and procedures solely for the convenience of investors. The operations and procedures of each settlement system are controlled by that settlement system and may be changed at any time. Neither we nor the initial purchasers are responsible for those operations or procedures.

DTC has advised us that it is:

a limited purpose trust company organized under the laws of the State of New York;

a banking organization within the meaning of the New York State Banking Law;

a member of the Federal Reserve System;

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a clearing corporation within the meaning of the New York Uniform Commercial Code; and

a clearing agency registered under Section 17A of the Exchange Act.

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between its participants through electronic book-entry changes to the accounts of its participants. DTC's participants include securities brokers and dealers, including the initial purchasers; banks and trust companies; clearing corporations and other organizations. Indirect access to DTC's system is also available to others such as banks, brokers, dealers and trust companies; these indirect participants clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly. Investors who are not DTC participants may beneficially own securities held by or on behalf of DTC only through DTC participants or indirect participants in DTC.

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So long as DTC's nominee is the registered owner of a global note, that nominee will be considered the sole owner or holder of the notes represented by that global note for all purposes under the indenture governing the notes. Except as provided below, owners of beneficial interests in a global note:

will not be entitled to have notes represented by the global note registered in their names;

will not receive or be entitled to receive physical, certificated notes; and

will not be considered the owners or holders of the notes under the indenture governing the notes for any purpose, including with respect to the giving of any direction, instruction or approval to the Trustee under the indenture governing the notes.

As a result, each investor who owns a beneficial interest in a global note must rely on the procedures of DTC to exercise any rights of a holder of notes under the indenture governing the notes (and, if the investor is not a participant or an indirect participant in DTC, on the procedures of the DTC participant through which the investor owns its interest).

Payments of principal, premium (if any) and interest with respect to the notes represented by a global note will be made by the Trustee to DTC's nominee as the registered holder of the global note. Neither we nor the Trustee will have any responsibility or liability for the payment of amounts to owners of beneficial interests in a global note, for any aspect of the records relating to or payments made on account of those interests by DTC, or for maintaining, supervising or reviewing any records of DTC relating to those interests.

Payments by participants and indirect participants in DTC to the owners of beneficial interests in a global note will be governed by standing instructions and customary industry practice and will be the responsibility of those participants or indirect participants and DTC.

Transfers between participants in DTC will be effected under DTC's procedures and will be settled in same-day funds.

Certificated Notes

Notes in physical, certificated form will be issued and delivered to each person that DTC identifies as a beneficial owner of the related notes only if:

DTC notifies us at any time that it is unwilling or unable to continue as depository for the global notes and a successor depository is not appointed within 90 days;

DTC ceases to be registered as a clearing agency under the Exchange Act and a successor depository is not appointed within 90 days;

we, at our option, notify the Trustee that we elect to cause the issuance of certificated notes and any participant requests a certificated note in accordance with DTC procedures; or

certain other events provided in the indenture governing the notes should occur.

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CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion is a summary of certain U.S. federal income tax consequences relevant to the exchange of old notes for new notes in the exchange offer, but does not purport to be a complete analysis of all potential tax effects. This discussion is based upon the U.S. Internal Revenue Code of 1986, as amended (the Code), U.S. Treasury Regulations issued thereunder, Internal Revenue Service (IRS) rulings and pronouncements, and judicial decisions now in effect, all of which are subject to change at any time. Any such change may be applied retroactively in a manner that could adversely affect a holder of the notes. We have not sought and will not seek any rulings from the IRS with respect to the statements made and the conclusions reached in the following discussion, and there can be no assurance that the IRS will agree with such statements and conclusions.

This discussion is limited to holders who exchange old notes for new notes in the exchange offer. This discussion does not address all of the U.S. federal income tax consequences that may be relevant to a holder in light of such holder's particular circumstances or to holders subject to special rules, such as banks and certain other financial institutions, partnerships and other pass-through entities, regulated investment companies, real estate investment trusts, U.S. expatriates, insurance companies, dealers in securities or currencies, traders in securities, U.S. holders whose functional currency is not the U.S. dollar, holders subject to alternative minimum tax, tax-exempt organizations, tax deferred or other retirement accounts and persons holding the notes as part of a straddle, hedge, conversion transaction or other integrated transaction. In addition, this discussion is limited to persons that hold the notes as capital assets (generally, property held for investment) within the meaning of Section 1221 of the Code. This discussion does not address the Medicare tax on net investment income or the effect of any applicable state, local, foreign or other tax laws, including gift and estate tax laws.

If a partnership or other entity treated as a partnership for U.S. federal income tax purposes holds notes, the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. If you are a partner of a partnership holding the notes, you should consult your tax advisor regarding the tax consequences of the exchange of old notes for new notes in the exchange offer.

THIS SUMMARY OF CERTAIN U.S. FEDERAL INCOME TAX CONSEQUENCES IS FOR GENERAL INFORMATION ONLY AND IS NOT TAX ADVICE. HOLDERS SHOULD CONSULT THEIR TAX ADVISORS REGARDING THE APPLICATION OF THE TAX CONSEQUENCES DISCUSSED BELOW TO THEIR PARTICULAR SITUATIONS AS WELL AS POTENTIAL CHANGES IN APPLICABLE TAX LAWS AND THE APPLICATION OF ANY STATE, LOCAL, FOREIGN OR OTHER TAX LAWS, INCLUDING GIFT AND ESTATE TAX LAWS, AND ANY TAX TREATIES.

The exchange of old notes for new notes in the exchange offer will not constitute a taxable exchange for U.S. federal income tax purposes. As a result, (1) a holder will not recognize taxable gain or loss as a result of exchanging such holder's old notes; (2) the holding period of the new notes will include the holding period of the old notes exchanged therefor; and (3) the adjusted basis of the new notes received will be the same as the adjusted basis of the old notes exchanged therefor immediately before such exchange.

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PLAN OF DISTRIBUTION

Each broker-dealer that receives new notes for its own account in connection with the exchange offer must acknowledge that it will deliver a prospectus in connection with any resale of such new notes. This prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of new notes received in exchange for old notes where such notes were acquired as a result of market-making activities or other trading activities. We have agreed that, beginning on the date of consummation of the exchange offer and ending on the close of business one year after the consummation of the exchange offer, we will make this prospectus, as amended or supplemented, available to any broker-dealer for use in connection with any such resale. In addition, all dealers effecting transactions in the new notes may be required to deliver a prospectus during the time periods prescribed by applicable securities laws.

We will not receive any proceeds from the issuance of new notes in the exchange offer or from any sale of new notes by broker-dealers. New notes received by broker-dealers for their own accounts pursuant to the exchange offer may be sold from time to time in one or more transactions in the over-the-counter market, in negotiated transactions, through the writing of options on the new notes or a combination of such methods of resale, at market prices prevailing at the time of resale, at prices related to such prevailing market prices or at negotiated prices. Any such resale may be made directly to purchasers or to or through brokers or dealers who may receive compensation in the form of commissions or concessions from any such broker-dealer and/or the purchasers of any such new notes. Any broker-dealer that resells new notes that were received by it for its own account pursuant to the exchange offer and any broker or dealer that participates in a distribution of such new notes may be deemed to be an underwriter within the meaning of the Securities Act, and any profit on any such resale of new notes and any commissions or concessions received by any such persons may be deemed to be underwriting compensation under the Securities Act. The letter of transmittal states that by acknowledging that it will deliver and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act.

For a period of one year after the consummation of the exchange offer, we will promptly send a reasonable number of additional copies of the prospectus and any amendment or supplement to this prospectus to any broker-dealer that requests such documents in the letter of transmittal. We have agreed to pay all expenses incident to the exchange offer (including the expenses of one counsel for the holder of the notes) other than commissions or concessions of any brokers or dealers and will indemnify the holders of the new notes, including any broker-dealers, against certain liabilities, including liabilities under the Securities Act.

CERTAIN ERISA CONSIDERATIONS

Our notes may be acquired and held by an employee benefit plan subject to Title I of the U.S. Employee Retirement Income Security Act of 1974, as amended (ERISA), or by an individual retirement account or other plan subject to Section 4975 of the Code. A fiduciary of an employee benefit plan subject to ERISA must determine that the purchase and holding of the notes is consistent with its fiduciary duties under ERISA. The fiduciary of an ERISA plan, as well as any other prospective investor subject to Section 4975 of the Code or any other federal, state, local, non-U.S. or other laws or requirements that are similar to such provisions of ERISA or the Code (collectively, Similar Laws), must also determine that its purchase and holding of the notes does not result in a non-exempt prohibited transaction as defined in Section 406 of ERISA or Section 4975 of the Code or any applicable Similar Law. Each holder of our notes who is subject to Section 406 of ERISA, Section 4975 of the Code or any Similar Law (Plan Investor) will be deemed to have represented by its acquisition and holding of the notes that its acquisition and holding of the notes does not constitute or give rise to a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or a violation of any applicable Similar Law. The sale of any notes to any Plan Investor is in no respect a representation by us, our subsidiary guarantors, or any of our or their affiliates or representatives that such an investment meets all relevant legal requirements with respect to investments by Plan Investors generally or any particular Plan Investor, or that such an investment is appropriate for Plan Investors generally or any particular Plan Investor.

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LEGAL MATTERS

The validity of the new notes and guarantees offered hereby has been passed upon for us by Latham & Watkins LLP, San Diego, California and Snell & Wilmer LLP, Denver, Colorado.

EXPERTS

The consolidated financial statements, the financial statement schedule and management's assessment of the effectiveness of internal control over financial reporting (which is included in Management's Report on Internal Control Over Financial Reporting) incorporated in this prospectus by reference to the Annual Report on Form 10-K of ViaSat, Inc. for the year ended March 30, 2012 have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

LIMITATION ON LIABILITY AND DISCLOSURE OF COMMISSION POSITION ON INDEMNIFICATION FOR SECURITIES ACT LIABILITIES

Our certificate of incorporation and bylaws provide that we will indemnify our directors and officers, and may indemnify our employees and other agents, to the fullest extent permitted by the Delaware General Corporation Law. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers or persons controlling us pursuant to the foregoing provisions, we have been informed that in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is therefore unenforceable.

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