HTH 10-K 12/31/2009

Section 1: 10-K (10-K)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2009

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 1-31987

Hilltop Holdings Inc.
(Exact name of registrant as specified in its charter)

MARYLAND	**84-1477939**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
200 Crescent Court, Suite 1330 Dallas, Texas	**75201**
(Address of principal executive offices)	(zip code)

(214) 855-2177
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**

Common Stock, par value $0.01 per share	New York Stock Exchange
8.25% Series A Cumulative Redeemable Preferred Stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐	Accelerated filer ☒	Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☐

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

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant, computed by reference to the price at which the common stock was last sold on the New York Stock Exchange on June 30, 2009, was approximately $471 million. For purposes of this computation, all officers, directors and 10% stockholders were deemed to be affiliates. This determination should not be construed as an admission that such officers, directors and 10% stockholders are affiliates. The number of shares of the registrant's common stock outstanding at March 11, 2010 was 56,488,488.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant's definitive Proxy Statement pertaining to the 2010 Annual Meeting of Stockholders, filed or to be filed not later than 120 days after the end of the fiscal year pursuant to Regulation 14A, is incorporated herein by reference into Part III.

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MARKET AND INDUSTRY DATA AND FORECASTS

Market and industry data and other statistical information and forecasts used throughout this Annual Report on Form 10-K are based on independent industry publications, government publications and reports by market research firms or other published independent sources. We have not sought or obtained the approval or endorsement of the use of this third-party information. Some data also is based on our good faith estimates, which are derived from our review of internal surveys, as well as independent sources. Forecasts are particularly likely to be inaccurate, especially over long periods of time.

Unless the context otherwise indicates, all references in this Annual Report on Form 10-K to the "Company," "Hilltop," "HTH," "we," "us," "our" or "ours" or similar words are to Hilltop Holdings Inc.(formerly known as Affordable Residential Communities Inc.) and its direct and indirect wholly-owned subsidiaries.

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K and the documents incorporated by reference into this report include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, or Exchange Act, as amended by the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, included in this Annual Report on Form 10-K that address results or developments that we expect or anticipate will or may occur in the future, where statements are preceded by, followed by or include the words "believes," "expects," "may," "will," "would," "could," "should," "seeks," "approximately," "intends," "plans," "projects," "estimates" or "anticipates" or the negative of these words and phrases or similar words or phrases, including such things as our business strategy, our financial condition, our litigation, our efforts to make strategic acquisitions, our liquidity and sources of funding, our capital expenditures, our products, market trends, operations and business, are forward-looking statements.

These forward-looking statements are based on our beliefs, assumptions and expectations of our future performance taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If an event occurs or further changes, our business, business plan, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. Certain factors that could cause actual results to differ include, among others:

- changes in the acquisition market;
- our ability to find and complete strategic acquisitions with suitable merger or acquisition candidates or find other suitable ways in which to invest our capital;
- the adverse impact of external factors, such as changes in interest rates, inflation and consumer confidence;
- the condition of capital markets;
- actual outcome of the resolution of any conflict;
- our ability to use net operating loss carryforwards to reduce future tax payments;
- the impact of the tax code and rules on our financial statements;
- failure of NLASCO, Inc.'s insurance subsidiaries to maintain their respective A.M. Best ratings;
- failure to maintain NLASCO, Inc.'s current agents;
- lack of demand for insurance products;
- cost or availability of adequate reinsurance;
- changes in key management;
- severe catastrophic events in our geographic area;
- failure of NLASCO, Inc.'s reinsurers to pay obligations under reinsurance contracts;
- failure of NLASCO, Inc. to maintain sufficient reserves for losses on insurance policies;

- failure to successfully implement NLASCO, Inc.'s new information technology system; and
- failure of NLASCO, Inc. to maintain appropriate insurance licenses.

For a further discussion of these and other risks and uncertainties that could cause actual results to differ materially from those contained in our forward-looking statements, please refer to "Risk Factors" in this report. Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements, and there can be no assurance that the actual results or developments anticipated by us will be realized, or even substantially realized, and that they will have the expected consequences to, or effects on, us and our business or operations. Forward-looking statements made in this report speak as of the date of this report or as of the date specifically referenced in any such statement set forth in this report. We undertake no obligation to update or revise any forward-looking statements in this report.

PART I

ITEM 1. BUSINESS

General Information

We are a holding company that is endeavoring to make opportunistic acquisitions or effect a business combination. In connection with that strategy, we are identifying and evaluating potential targets on an ongoing basis. With respect to financial institution opportunities, we have received preliminary approval from the Comptroller of Currency, The Office of Thrift Supervision and the Federal Deposit Insurance Corporation to on government-assisted financial institution transactions. The approvals from the Comptroller of Currency and The Office of Thrift Supervision expire on May 17, 2010 and November 30, 2010, respectively, and are subject to the satisfaction of certain conditions should we be the successful bidder. At December 31, 2009, we had approximately $737 million aggregate available cash and cash equivalents that may be used for this purpose. No assurances, however, can be given that we will be able to identify suitable targets, consummate acquisitions or effect a combination or, if consummated, successfully integrate or operate the acquired business.

We also provide fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States through our wholly-owned property and casualty insurance holding company, NLASCO, Inc., or NLASCO. We acquired NLASCO in January 2007. NLASCO operates through its wholly-owned subsidiaries, National Lloyds Insurance Company, or NLIC, and American Summit Insurance Company, or ASIC.

NLASCO targets underserved markets that require underwriting expertise that many larger carriers have been unwilling to develop given the relatively small volume of premiums produced by local agents. Within these markets, NLASCO attempts to capitalize on its superior local knowledge to identify profitable underwriting opportunities. NLASCO believes that it distinguishes itself from competitors by delivering products that are not provided by many larger carriers, providing a high level of customer service and responding quickly to the needs of its agents and policyholders. NLASCO applies a high level of selectivity in the risks it underwrites and uses a risk-adjusted return approach to capital allocation, which NLASCO believes allows it to consistently generate underwriting profits.

A.M. Best assigned NLIC a financial strength rating of "A" (Excellent) and ASIC a rating of "A-" (Excellent) in 2007. These ratings were affirmed in May 2009. An "A" rating is the third highest of 16 rating categories used by A.M. Best, and an "A-" rating is the fourth highest of 16 rating categories. Many insurance buyers, agents and brokers use the ratings assigned by A.M. Best and other rating agencies to assist them in assessing the financial strength and overall quality of the companies from which they purchase insurance. This rating is intended to provide an independent opinion of an insurer's ability to meet its obligations to policyholders and is not an evaluation directed at investors. This rating assignment is subject to the ability to meet A.M. Best's expectations as to performance and

capitalization on an ongoing basis, including with respect to management of liabilities for losses and loss adjustment expenses, and is subject to revocation or revision at any time at the sole discretion of A.M. Best.

Our common stock is listed on the New York Stock Exchange, or NYSE, under the symbol "HTH." Our 8.25% Series A Cumulative Redeemable Preferred Stock is listed on the NYSE under the symbol "HTHPRA."

Our principal office is located at 200 Crescent Court, Suite 1330, Dallas, Texas 75201, and our telephone number at that location is (214) 855-2177. Our internet address is www.hilltop-holdings.com.

We currently are subject to the reporting requirements of the Exchange Act and, therefore, file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission, or the SEC. These filings, and amendments to these filings, may be accessed, free of charge, on the investor relations page of our website as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC. Additionally, any materials that we file with, or furnish to, the SEC may be read and copied at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for more information regarding the operations of the SEC Public Reference Room. The SEC also maintains a website, www.sec.gov, which contains reports, proxy and information statements and other information regarding issuers, such as ourselves, that file electronically with the SEC. Our codes of conduct and ethics, including amendments to, and waivers of, those codes, our corporate governance guidelines, director independence criteria and board committee charters can be accessed, free of charge, on our website, as well. We will provide, at no cost, a copy of these documents upon request by telephone or in writing at the above phone number or address, attention: Investor Relations. The references to our website address do not constitute incorporation by reference of the information contained on our website into, and should not be considered a part of, this Annual Report on Form 10-K.

In 2009, our Chief Executive Officer certified to the NYSE, pursuant to Section 303A.12 of the NYSE's listing standards, that he is unaware of any violation by us of the NYSE's corporate governance listing standards.

Company Background

We were formed in 1998 under the name "Affordable Residential Communities Inc." as a Maryland corporation that elected to be taxed as a real estate investment trust, or REIT. Until July 2007, we primarily engaged in the acquisition, renovation, repositioning and operation of all-age manufactured home communities, the retail sale and financing of manufactured homes, the rental of manufactured homes and other related businesses, including acting as agent in the sale of homeowners' insurance and related products, to residents and prospective residents of those communities. Our primary operations previously were conducted through an operating partnership, in which we owned a general partnership interest.

On February 18, 2004, we completed our initial public offering, or IPO. Through the year ended December 31, 2005, we operated as a fully integrated, self-administered and self-managed equity REIT for U.S. federal income tax purposes. In 2006, we revoked our election as a REIT for U.S. federal income tax purposes.

In January 2007, we acquired NLASCO. NLASCO was incorporated in Delaware in 2000, but its origins trace back to 1948 through one of its subsidiaries, NLIC. In 1964, C. Clifton Robinson, who is currently the Chairman of NLASCO and a member of our board of directors, along with other investors, purchased NLIC and moved its headquarters from San Antonio, Texas to Waco, Texas. Following various acquisitions and dispositions of equity in NLIC by Mr. Robinson and others, including the re-acquisition of NLIC in conjunction with the acquisition of ASIC in 2000, Mr. Robinson

held 100% of NLASCO and its subsidiaries, NLIC and ASIC, from 2001 until we acquired NLASCO in 2007.

On July 31, 2007, we sold substantially all of the operating assets used in our manufactured home communities business and our retail sales and financing business to American Residential Communities LLC. We received gross proceeds of approximately $890 million in cash, which represents the aggregate purchase price of $1.794 billion less the indebtedness assumed by the buyer. After giving effect to expenses and taxes and our continued outstanding preferred stock and senior notes, our net cash balance was approximately $550 million. We used a portion of the proceeds from this transaction for general working capital, liquidation of our operating partnership units, and to repay certain outstanding obligations. We intend to make opportunistic acquisitions with certain of the remaining proceeds from this transaction and, if necessary or appropriate, from additional equity or debt financing sources. In conjunction with this transaction, we transferred to the buyer the rights to the "Affordable Residential Communities" name, changed our name to Hilltop Holdings Inc., and moved our headquarters to Dallas, Texas.

Following the completion of the sale of our manufactured home communities businesses, our current operations have consisted solely of those of NLASCO and its subsidiaries. Therefore, the remainder of our discussion focuses on the property and casualty insurance operations of NLASCO and its subsidiaries and the results of operations and financial position of the manufactured home communities businesses are now reflected as discontinued operations for all periods presented in this Annual Report on Form 10-K. Although we present information on NLASCO for prior years, they are only included in operations since the acquisition at January 31, 2007.

Insurance Operations

NLASCO specializes in providing fire and limited homeowners insurance for low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States. NLASCO targets underserved markets that require underwriting expertise that many larger carriers have been unwilling to develop given the relatively small volume of premiums produced by local agents. Within these markets, NLASCO attempts to capitalize on its superior local knowledge to identify profitable underwriting opportunities. NLASCO believes that it distinguishes itself from competitors by delivering products that are not provided by many larger carriers, providing a high level of customer service and responding quickly to the needs of its agents and policyholders. NLASCO applies a high level of selectivity in the risks it underwrites and uses a risk-adjusted return approach to capital allocation, which NLASCO believes allows it to consistently generate underwriting profits.

Many insurance buyers, agents and brokers use the ratings assigned by A.M. Best and other rating agencies to assist them in assessing the financial strength and overall quality of the companies from which they purchase insurance. A.M. Best assigned NLIC a financial strength rating of "A" (Excellent) in 2007 and ASIC a rating of "A-" (Excellent) in 2007. A.M. Best confirmed these ratings in May 2009. An "A" rating is the third highest of 16 rating categories used by A.M. Best, and an "A-" rating is the fourth highest of 16 rating categories.

The Insurance Industry

The property and casualty insurance industry provides protection from pre-specified loss events, such as damage to property or liability claims by third parties. Property and casualty insurance can be broadly classified into two lines; personal lines, in which insurance is provided to individuals, and commercial lines, in which insurance is provided to business enterprises. In the U.S., personal and commercial insurance products are written in admitted and non-admitted markets, also known as the

excess and surplus lines market. NLASCO provides insurance products in the personal line and the commercial line markets.

In the admitted market, insurers are authorized by state insurance departments to do business, insurance rates and forms are generally highly regulated and coverage tends to be standardized. Within the admitted market, NLASCO focuses on underserved segments that do not fit into the standard underwriting criteria of national insurance companies due to several factors, such as type of business, location and the amount of premium per policy. This portion of the market tends to have limited competition. Therefore, NLASCO believes it has greater flexibility in pricing and product design relative to most admitted market risks.

The non-admitted market focuses on harder-to-place risks that admitted insurers typically do not write. In this market, risks are underwritten with more flexible policy forms and rates, resulting in more restrictive and expensive coverage. NLASCO writes in this market for its dwelling fire, homeowner, and mobile home business in Louisiana.

The property and casualty insurance industry, historically, has been subject to cyclical fluctuations in pricing and availability of insurance coverage. "Soft" markets are often characterized by excess underwriting capital and involve intense price competition, expanded policy terms and conditions, erosion of underwriting discipline and poor operating performance. These market conditions usually lead to a period of diminished underwriting capacity after insurance companies exit unprofitable lines and exhibit greater underwriting discipline, increase premium rates and implement more restrictive policy terms and conditions. This latter market condition is called a "hard" market. The insurance market may not always be hard or soft; rather, it could be hard for one line of business and soft for another. The market at the start of 2010 is likely to be characterized as soft for property risks in NLASCO's operating area; however, in coastal areas, due to the hurricane activity in recent years, those markets are considered hard.

Product Lines

Personal and Commercial Lines

The NLASCO companies specialize in writing fire and homeowners insurance coverage for low value dwellings and manufactured homes. The vast majority of NLASCO's property coverage is written on policies that provide actual cash value payments, as opposed to replacement cost. Under actual cash value policies, the insured is entitled to receive only the cost of replacing or repairing damaged or destroyed property with comparable new property, less depreciation. Additionally, most of NLASCO's property policies exclude coverage for water and mold damage.

NLASCO's business is conducted with two product lines, its personal lines and its commercial lines. The personal lines include homeowners, dwelling fire, manufactured home, flood and vacant policies. The commercial lines include commercial, builders risk, builders risk renovation, sports liability

and inland marine policies. Set forth below is certain financial data broken down by line of business (in millions):

	For The Year Ended December 31,		
	2009	2008	2007
Gross Premiums Written			
Personal lines	$ 129.5	$ 131.8	$ 131.1
Commerical lines	6.7	6.2	6.1
Total	$ 136.2	$ 138.0	$ 137.2
Net Operating income			
Personal lines	$ 5.9	$ (3.1)	$ 14.4
Commerical lines	0.8	0.5	1.3
Total	$ 6.7	$ (2.6)	$ 15.7
Total Assets			
Personal lines	$ 256.3	$ 247.6	$ 253.2
Commerical lines	23.6	22.8	23.3
Total	$ 279.9	$ 270.4	$ 276.5

Geographic Markets

The following table sets forth NLASCO's total gross written premiums by state for the periods shown (in millions):

	For The Year Ended December 31,		
	2009	2008	2007
Gross Written Premiums			
Texas—Flood	$ 5.9	$ 5.3	$ 4.1
Texas—North	20.7	21.2	24.1
Texas—South	34.4	34.9	34.6
Texas—Central	9.4	9.4	9.1
Texas—West	13.0	13.5	11.1
Texas—Panhandle	6.8	7.3	7.4
Texas—East	13.4	13.2	11.9
Texas—Total	103.7	104.8	102.3
Arizona	11.3	11.8	12.8
Tennessee	7.8	8.0	8.7
Oklahoma	5.1	5.2	5.5
Louisiana	3.0	3.0	2.8
Missouri	1.4	1.6	1.5
Nevada	1.1	1.2	1.4
Mississippi	—	—	0.1
All other states	2.8	2.4	2.1
TOTAL	$ 136.2	$ 138.0	$ 137.2

NLASCO underwrites insurance coverage primarily in Texas, as well as other states in the south and southwest regions.

Distribution

NLASCO distributes its insurance products through a broad network of independent agents in 27 states and a select number of managing general agents, referred to as MGAs. NLASCO has a preference for doing business with agents that desire a long-term relationship that will result in mutual profitability and value for both parties. NLASCO believes that "relationship" agents are more oriented to the long-term and desire a meaningful relationship with their customers and the insurers they represent. NLASCO's top ten agents accounted for only 9.9%, 10.1% and 12.1% of direct premiums written in 2009, 2008 and 2007, respectively, and as of December 31, 2009, the average tenure of the top 25 agencies was over 12 years.

Underwriting and Pricing

NLASCO applies its regional expertise, underwriting discipline and a risk-adjusted, return-on-equity based approach to capital allocation to primarily offer short-tail insurance products in its target markets. NLASCO's underwriting process involves securing an adequate level of underwriting information from its independent agents, identifying and evaluating risk exposures and then pricing the risks it chooses to accept.

NLASCO employs a disciplined underwriting approach that incorporates the continuously refined stratification of its target markets to permit it to tailor its policies to individual risks and adopt pricing structures that will be supported in the applicable market. NLASCO utilizes underwriting principles and processes that reflect the knowledge and experience it has acquired during its 40-plus year history of underwriting risks. NLASCO has started to use advanced modeling software on an individual risk basis that will allow it to underwrite risks at the time of quotation in high risk areas, such as the seacoast. NLASCO believes that this comprehensive process capitalizes on its knowledge and expertise and results in better underwriting decisions.

Pricing levels are established by NLASCO's senior management with the assistance of a consulting actuary. Pricing balances NLASCO's return requirements along with the legal/regulatory environment in each particular geographic region. Management reviews pricing on a quarterly basis to monitor any emerging issues, such as the mold crisis that hit Texas in 2003. NLASCO's statistical database allows this analysis to be performed on a specific coverage or geographic territory.

Catastrophe Exposure

NLASCO maintains a comprehensive risk management strategy, which includes actively monitoring its catastrophe prone territories by zip code to ensure a diversified book of risks. NLASCO utilizes software and risk support from its reinsurance brokers to analyze its portfolio and catastrophe exposure. Biannually, NLASCO has its entire portfolio analyzed by its reinsurance broker who utilizes hurricane models to predict risk. Based on this information and management's active role in risk management, NLASCO makes decisions on what geographic areas to write risks. Over the years, NLASCO has adjusted its business based on its perceived risk of catastrophe losses. For example, in 2005, ASIC withdrew from the Mississippi market to mitigate its catastrophe exposure in that area, and in 2006, it stopped writing new policies that cover wind damage along the seacoast of Louisiana. In 2009, NLASCO decided not to renew wind policies for properties within the Texas seacoast. All policies will exclude wind by the end of February 2011.

In recent years, NLASCO's catastrophe exposure primarily resulted from property policies in Cameron, Harris, Jefferson and Nueces Counties in Texas, which include the densely populated Houston metropolitan area and the cities extending from the northern tip to the southern point on the

Texas Gulf Coast. All of this territory is exposed to potential wind storm activity from the Gulf of Mexico. By not renewing wind policies on the Texas seacoast, which is exposed to the majority of potential wind storm activity, NLASCO's primary catastrophe exposure will be limited to property policies in Harris County. NLASCO also is exposed to hail and other catastrophic events in the Texas panhandle and plains states.

In 2009, the coastal area represented 16% of Texas state-wide premiums; however, only 8% of these coastal policies included full wind coverage. The panhandle represents 7% of Texas state-wide premiums.

Terrorism Risk Insurance Act of 2002, Terrorism Risk Insurance Extension Act of 2005 and Terrorism Risk Insurance Program Reauthorization Act of 2007

On November 26, 2002, the Terrorism Risk Insurance Act of 2002 was enacted into Federal law and established the Terrorism Risk Insurance Program, or the Program. The Program is a Federal program that provides for a system of shared public and private compensation for insured losses resulting from acts of terrorism or war. The Program was scheduled to terminate on December 31, 2005. On December 22, 2005, the Terrorism Risk Insurance Extension Act of 2005 was enacted into Federal law, reauthorizing the Program through December 31, 2007, while reducing the Federal role under the Program. On December 26, 2007, the Terrorism Risk Insurance Program Reauthorization Act, or the Reauthorization Act, was enacted into Federal law, reauthorizing the Program through December 31, 2014 and implementing several changes to the Program.

In order for a loss to be covered under the Program, as presently constituted, aggregate industry losses of $100 million must be satisfied. Further, the losses must be the result of an event that is certified as an act of terrorism by the U.S. Secretary of the Treasury, Secretary of State and Attorney General. The original Program excluded from participation certain of the following types of insurance: Federal crop insurance, private mortgage insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance and reinsurance. The 2005 Act exempted from coverage certain additional types of insurance, including commercial automobile, professional liability (other than directors and officers), surety, burglary and theft and farm-owners multi-peril. In the case of a war declared by Congress, only workers' compensation losses are covered by the Program. The Program generally requires that all commercial property and casualty insurers licensed in the United States participate in the Program. Under the Program, a participating insurer is entitled to be reimbursed by the Federal government for a percentage of subject losses, after an insurer deductible, subject to an annual cap. The Federal reimbursement percentage was fixed by the Reauthorization Act at 85%. The deductible is calculated by applying the deductible percentage to the insurer's direct earned premiums for covered lines. The deductible under the Program is fixed at 20%. NLASCO's deductible under the Program was $1.2 million for 2009 and is estimated to be $1.2 million in 2010. The annual cap limits the amount of aggregate subject losses for all participating insurers to $100 billion. Once subject losses have reached $100 billion aggregate amount during a Program year, there is no additional reimbursement from the U.S. Treasury and an insurer that has met its deductible for the program year is not liable for any losses that exceed the $100 billion cap. When insured losses under the Program exceed the $100 billion cap, the insured losses are subject to pro-rata sharing based upon regulations promulgated by the U.S. Treasury. Additionally, under the Reauthorization Act, the timing of mandatory recoupment of the Federal reimbursement through policyholder surcharges was accelerated.

On December 14, 2009, two final rules with respect to the Program were published in the Federal Register. The first rule describes how the Treasury will calculate the amounts to be recouped from insurers and establishes procedures for insurers to use in collecting Federal Terrorism Policy Surcharges and remitting them to the Treasury. The second rule describes how the Treasury intends to determine

the pro rata share of insurance losses under the Program when losses otherwise would exceed the annual monetary cap. NLASCO had no terrorism-related losses in 2009.

Reinsurance

NLASCO purchases reinsurance to reduce its exposure to liability on individual risks and claims and to protect against catastrophe losses. NLASCO's management believes that less volatile, yet reasonable returns are in the long-term interest of NLASCO and, as a result, maintains a conservative reinsurance program. NLASCO generated direct premiums written totaling $125.7 million, net of flood policies, in 2009 and paid approximately $14.5 million in catastrophe reinsurance premiums prior to any reinstatement premiums.

Reinsurance involves an insurance company transferring, or ceding, a portion of its risk to another insurer, the reinsurer. The reinsurer assumes the exposure in return for a portion of the premium. The ceding of risk to a reinsurer does not legally discharge the primary insurer from its liability for the full amount of the policies on which it obtains reinsurance. Accordingly, the primary insurer remains liable for the entire loss if the reinsurer fails to meet its obligations under the reinsurance agreement, and as a result, the primary insurer is exposed to the risk of non-payment by its reinsurers.

We believe that NLASCO's financial stability is substantially protected from catastrophic events through several excess of loss reinsurance contracts that combine to provide a mix of coverage against various types and combinations of catastrophe losses. As noted in the section titled "Risk Factors," NLASCO is exposed to catastrophic losses that could exceed the limits of reinsurance and negatively impact its financial position and results of operations. The Company purchases catastrophe excess of loss reinsurance to a limit that exceeds the Hurricane 500-year return time, as modeled by RMS Risk Link v. 9.0 and AIR v 11.0.

In formulating its reinsurance programs, NLASCO believes that it is selective in its choice of reinsurers and considers numerous factors, the most important of which are the financial stability of the reinsurer, its history of responding to claims and its overall reputation. In an effort to minimize exposure to the insolvency of reinsurers, NLASCO evaluates the acceptability, and continuously monitors the financial condition, of each reinsurer. NLASCO enters into reinsurance agreements only with reinsurers that have an A.M. Best financial strength rating of "A- (Excellent)" (fourth highest of 16 categories) or better, or at least an "A" rating by Standard & Poors. If a reinsurer rating subsequently drops below "A- (Excellent)," NLASCO can cancel or replace the reinsurer. As of December 31, 2009, 100% of NLASCO's paid loss recoverables were from reinsurers rated "A- (Excellent)" or better by A.M. Best. To further minimize exposure to reinsurer insolvency, NLASCO spreads reinsurance treaties among many reinsurers. NLASCO reviews retention levels each year to maintain a balance between the growth in surplus and the cost of reinsurance. NLASCO's losses from unrecoverable reinsurance in 2009 were nominal.

NLASCO's ten largest net receivable balances from reinsurers as of, and for the year ended, December 31, 2009 were as follows (in millions):

	Year Ended December 31, 2009				
	A.M. Best Financial Strength Rating	Ceded Premiums	Balances Due from Reinsurance Companies	Prepaid Reinsurance Premiums	Net Receivable Balance(1)
Federal Emergency Management Agency	N/A	$ 5.6	$ 1.1	$ 4.7	$ 5.8
Endurance Specialty Insurance Ltd	A	0.7	2.9	—	2.9
Ariel Reinsurance Company Limited	A-	1.7	2.3	—	2.3
Platinum Underwriters Reinsurance, Inc.	A	1.7	1.9	—	1.9
Munich Reinsurance America, Inc.	A+	1.4	1.4	—	1.4
MS Frontier Reinsurance Limited	A	0.6	1.4	—	1.4
Arch Reinsurance Company	A	1.1	1.2	—	1.2
Validus Reinsurance Ltd	A-	0.2	1.0	—	1.0
Amlin Bermuda Limited	A	0.6	0.9	—	0.9
Transatlantic Reinsurance Company	A	0.3	0.8	—	0.8

(1) The net receivable balance includes balances due from reinsurance companies, contingent commissions, prepaid reinsurance premiums and ceded contingent commissions, less balances due to reinsurance companies.

As of December 31, 2009, NLIC had reinsurance for up to $164 million of losses per event in excess of $6 million retention by NLIC. This reinsurance is comprised of four layers of protection: $19 million in excess of $6 million retention; $25 million in excess of a $25 million loss; $50 million in excess of a $50 million loss; and $70 million in excess of a $100 million loss, and $120 million in excess of $50 million loss. NLIC retains no participation in any of the layers, other than the first $6 million retention. The projected premiums on these treaties are $12.7 million in 2010.

As of December 31, 2009, ASIC had reinsurance for up to $169 million of losses per event in excess of a $1 million retention by ASIC. This reinsurance is comprised of five layers of protection: $5 million in excess of $1 million retention; $19 million in excess of $6 million retention; $25 million in excess of a $25 million loss; $50 million in excess of a $50 million loss; and $70 million in excess of a $100 million loss, and $120M in excess of $50 million loss. The projected premiums on these treaties are $1.2 million in 2010.

As of December 31, 2009, total retention for any one catastrophe that affects both NLIC and ASIC is limited to $6 million in the aggregate.

In addition to the catastrophe reinsurance noted above, both NLIC and ASIC participate in an excess of loss program with General Reinsurance Corporation. The General Reinsurance Corporation program is limited to each risk with respect to property and liability in the amount of $800,000 for each of NLIC and ASIC. Each of NLIC and ASIC retain $200,000 in this program.

In 2009, ASIC increased premium rates in Louisiana and NLIC increased rates in Texas and Missouri. NLIC also implemented in May 2009 a catastrophe fee on all policies that cover the peril of wind within tiers one and two in Texas.

Liabilities for Unpaid Losses and Loss Adjustment Expenses

NLASCO's liabilities for losses and loss adjustment expenses include liabilities for reported losses, liabilities for incurred but not reported, or IBNR, losses and liabilities for loss adjustment expenses, or LAE, less a reduction for reinsurance recoverables related to those liabilities. The amount of liabilities for reported claims is based primarily on a claim-by-claim evaluation of coverage, liability, injury severity or scope of property damage, and any other information considered relevant to estimating exposure presented by the claim. The amounts of liabilities for IBNR losses and LAE are estimated on the basis of historical trends, adjusted for changes in loss costs, underwriting standards, policy provisions, product mix and other factors. Estimating the liability for unpaid losses and LAE is inherently judgmental and is influenced by factors that are subject to significant variation. Liabilities for LAE are intended to cover the ultimate cost of settling claims, including investigation and defense of lawsuits resulting from such claims. Based upon the contractual terms of the reinsurance agreements, reinsurance recoverables offset, in part, NLASCO's gross liabilities.

Significant periods of time can elapse between the occurrence of an insured loss, the reporting of the loss to the insurer and the insurer's payment of that loss. NLASCO's liabilities for unpaid losses represent the best estimate at a given point in time of what it expects to pay claimants, based on facts, circumstances and historical trends then known. During the loss settlement period, additional facts regarding individual claims may become known and, consequently, it often becomes necessary to refine and adjust the estimates of liability.

The table below presents one-year development information on changes in the liability for losses and LAE and a reconciliation of liabilities on a direct premiums written and net premiums written basis for the twelve months ended December 31, 2009 and 2008 (in thousands):

	2009	2008
Balance at January 1,	$ 34,023	$ 18,091
Less reinsurance recoverables	(14,613)	(2,692)
Net balance at January 1,	19,410	15,399
Incurred related to:		
Current Year	71,509	80,726
Prior Period	(1,214)	(291)
Total incurred	70,295	80,435
Payments related to:		
Current Year	(61,372)	(66,522)
Prior Year	(15,655)	(9,902)
Total payments	(77,027)	(76,424)
Net balance at December 31,	12,678	19,410
Plus reinsurance recoverables	21,102	14,613
Balance at December 31,	$ 33,780	$ 34,023

NLASCO's claim reserving practices are designed to set liabilities for losses and LAE that, in the aggregate, are adequate to pay all claims at their ultimate loss cost, net of anticipated salvage and subrogation. Thus, NLASCO's estimates are not discounted for inflation or other factors.

Loss Development

NLASCO estimates the aggregate amount of losses and LAE ultimately required to settle all claims for a given period. The following tables present the development of estimated liability for losses and LAE, net of reinsurance, for the years 2000 through 2009 of NLIC and ASIC. These tables present accident or policy year development data. The first line of the table shows, for the years indicated, net liability, including IBNR, as originally estimated. For example, as of December 31, 2000, NLIC estimated that $12.9 million would be a sufficient net liability to settle all unsettled claims retained by it that had occurred prior to December 31, 2000, whether reported or unreported. The next section of the table sets forth the re-estimates in later years of incurred losses, including payments, for the years indicated. For example, as indicated in that section of the table, the original net liability of $12.9 million was re-estimated to be $14.0 million at December 31, 2004 (four years later). The increase in the original estimate is caused by a combination of factors, including: (1) claims being settled for amounts different than originally estimated; (2) the net liability being increased or decreased for claims remaining open as more information becomes known about those individual claims; and (3) more or fewer claims being reported after December 31, 2000 than had occurred prior to that date. The bottom section of the table shows, by year, the cumulative amounts of net losses and LAE paid as of the end of each succeeding year. For example, with respect to the liability for net losses and LAE of $12.9 million as of December 31, 2000, by the end of 2004 (four years later), $13.2 million had actually been paid in settlement of the claims.

The "net cumulative redundancy (deficiency)" represents, as of December 31, 2009, the difference between the latest re-estimated net liability and the net liability as originally estimated for losses and LAE retained by us. A redundancy means the original estimate was higher than the current estimate; and a deficiency means that the original estimate was lower than the current estimate. For example, as of December 31, 2009 and based upon updated information, NLIC re-estimated that the net liability that was established as of December 31, 2000 was $0.3 million deficient.

The following tables are presented net of reinsurance recoverable.

National Lloyds Insurance Company
Analysis of Loss Reserve Development
(Dollars in Thousands)

	Year Ended December 31,									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Original Reserve*	12,926	12,231	18,141	35,061	33,951	41,282	47,684	44,613	65,592	60,392
1 year later	13,381	12,077	17,852	32,887	28,106	36,332	43,640	44,064	64,864	
2 years later	13,208	12,871	17,281	32,559	27,593	40,391	43,465	44,134		
3 years later	13,840	12,822	17,357	31,614	25,747	41,231	43,394			
4 years later	14,021	12,671	17,340	31,030	25,712	39,735				
5 years later	14,016	12,669	17,312	31,088	25,579					
6 years later	13,240	12,695	17,332	31,072						
7 years later	13,244	12,696	17,321							
8 years later	13,244	12,677								
9 years later	13,244									
Net cumulativ redundan (deficienc	(318)	(446)	820	3,989	8,372	1,547	4,290	479	728	
Cumulative amount of net liability paid as of:										
1 year later	12,894	11,333	16,836	30,867	24,747	32,871	42,301	42,478	63,761	
2 years later	13,049	12,310	17,160	30,818	25,149	34,625	42,668	43,245		
3 years later	13,094	12,612	17,209	30,875	25,388	36,157	43,140			
4 years later	13,211	12,647	17,231	30,989	25,462	39,533				
5 years later	13,192	12,650	17,287	31,026	25,521					
6 years later	13,207	12,676	17,300	31,030						
7 years later	13,226	12,677	17,301							
8 years later	13,126	12,677								
9 years later	13,226									

* Including amounts paid in respective year.

American Summit Insurance Company
Analysis of Loss Reserve Development
(Dollars in Thousands)

	Year Ended December 31,									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Original Reserve*	—	6,621	11,873	6,235	8,297	11,041	13,003	9,351	12,769	9,773
1 year later	(894)	6,928	11,983	5,322	7,388	9,932	13,014	9,154	12,009	
2 years later	(719)	6,742	11,963	5,512	6,999	9,918	12,998	9,335		
3 years later	(671)	6,813	11,554	5,563	6,859	9,918	13,435			
4 years later	(723)	7,106	11,749	5,401	6,772	9,797				
5 years later	(689)	6,732	11,775	5,396	6,714					
6 years later	(726)	6,737	11,799	5,394						
7 years later	(726)	6,735	11,804							
8 years later	(747)	6,735								
9 years later	(747)									
Net cumulative redundancy (deficiency)	747	(114)	69	841	1,583	1,244	(432)	16	760	
Cumulative amount of net liability paid as of:										
1 year later	(1,149)	6,000	10,909	4,987	6,566	9,341	12,429	8,732	11,560	
2 years later	(914)	6,281	11,284	5,612	6,610	9,578	12,639	9,095		
3 years later	(748)	6,450	11,647	5,756	6,682	9,679	13,326			
4 years later	(739)	6,760	11,727	5,393	6,699	9,740				
5 years later	(711)	6,727	11,747	5,393	6,714					
6 years later	(748)	6,730	11,759	5,394						
7 years later	(748)	6,735	11,764							
8 years later	(747)	6,735								
9 years later	(747)									

* Including amounts paid in respective year.

Please refer to Note 9 in the notes to consolidated financial statements for a reconciliation of the reserves presented in the tables above to the reserves for losses and loss adjustment expenses set forth in the balance sheet at December 31, 2009 and 2008. Because NLASCO did not own ASIC prior to January 1, 2001, the information in the table above prior to that date with respect to ASIC was developed by a different management group. Since NLASCO's acquisition of ASIC in 2001, NLASCO has modified the development of estimated liability for losses and LAE for ASIC, and the numbers for the years prior to 2001 may not be comparable to 2001 and subsequent years.

Current loss reserve development has been favorable. In the years 2006, 2007 and 2008, the developed reserves as of December 31, 2009 were $3.9 million, $0.5 million, and $1.5 million, respectively, less than the initial carried reserve for each year. For the years 2000 through 2005, the reserves were $18.3 million favorable. Starting in 2002, IBNR loss reserves were strengthened, contributing to the favorable development in years 2002, 2003 and 2004. This strengthening of reserves was due to increases in direct written premium and increased net written premium from reductions in quota share, a form of pro rata insurance, reinsurance.

The following table is a reconciliation of the gross liability to net liability for losses and loss adjustment expenses (dollars in thousands).

	Year Ended December 31,*										
	1999	2000	2001	2002	2003	2004	2005	2006	2007**	2008	2009
Gross unpaid losses											
Consolidated balance sheet	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	$ 18,091	$ 34,023	$ 33,780
Reinsurance recoverable	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	(2,692)	(14,613)	(21,102)
Net unpaid losses	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	$ 15,399	$ 19,410	$ 12,678

* Information is not presented for periods prior to January 31, 2007, as that is the date Hilltop Holdings Inc. acquired the insurance operations.

** Only includes eleven months, as the insurance operations were acquired on January 31, 2007.

Ratings

Many insurance buyers, agents and brokers use the ratings assigned by A.M. Best and other rating agencies to assist them in assessing the financial strength and overall quality of the companies from which they purchase insurance. A.M. Best assigned NLIC a financial strength rating of "A" (Excellent) and ASIC a rating of "A-" (Excellent) in 2007. These ratings were confirmed in May 2009. An "A" rating is the third highest of 16 rating categories used by A.M. Best, and an "A-" rating is the fourth highest of 16 rating categories. In evaluating a company's financial and operating performance, A.M. Best reviews a company's profitability, leverage and liquidity, as well as its book of business, the adequacy and soundness of its reinsurance, the quality and estimated market value of its assets, the adequacy of its liabilities for losses and LAE, the adequacy of its surplus, its capital structure, the experience and competence of its management and its market presence. This rating is intended to provide an independent opinion of an insurer's ability to meet its obligations to policyholders and is not an evaluation directed at investors. This rating assignment is subject to the ability to meet A.M. Best's expectations as to performance and capitalization on an ongoing basis, including with respect to management of liabilities for losses and LAE, and is subject to revocation or revision at any time at the sole discretion of A.M. Best. NLASCO cannot ensure that NLIC and ASIC will maintain their present ratings.

Investments

HTH's primary investment objectives, as a holding company, are to preserve capital and possess available cash resources to utilize in making opportunistic acquisitions. Accordingly, HTH has $790.0 million in short-term cash equivalent investments as of December 31, 2009. HTH's management regularly monitors investment performance.

Our insurance operating subsidiary, NLASCO, has primary investment objectives to preserve capital and manage for a total rate of return in excess of a specified benchmark portfolio. The investment strategy of NLASCO's insurance subsidiaries is to purchase securities in sectors that represent what is expected to possess the most attractive relative value. Bonds, cash and short-term investments constituted $182.7 million, or 99.9%, of NLASCO's investments at December 31, 2009. NLASCO insurance subsidiaries have custodial agreements with A.G. Edwards and Wells Fargo Bank and investment management agreement with DTF Holdings, LLC.

NLASCO's investment guidelines reflect the desire and intent to assure the prudent investment of capital and surplus, keeping in mind the long-term nature of some insurance reserves, while recognizing the uncertainty of expected cash flows, the shorter term characteristics of and the desire to supplement

insurance underwriting gains and offset losses with portfolio income and realized gains in order to maintain adequate capital and surplus. All investments are made in compliance with all state and Federal laws and regulations applicable to such investments and the company involved. State insurance laws and regulations limit the amount of investments in asset classes below certain "quality" levels. NLASCO currently maintains a quality structure exceeding the minimum requirements imposed on the portfolio by state insurance laws and regulations, which is known as the Investment of Insurer's Model Act, or National Association of Insurance Commissioners Act. Currently, NLASCO has no investments in subprime mortgages.

Liquidity and preservation of policyholder surplus can be limiting factors in achieving a favorable return on invested assets, as sufficient funds need to be maintained to meet ongoing near term financial obligations. Funds not immediately needed to offset withdrawals may be invested in short-term securities on a continuous basis. A maturity structure must be maintained to invest cash flows from operations and reinvest investment income, as well as to provide a source of liquidity and flexibility to meet changing market, tax and other operating considerations.

Notwithstanding the above, the underlying objective of NLASCO's investment policy is to obtain a favorable total return on invested assets to augment the growth of surplus from operations. Total return comes both from income and capital growth, so a portion of the funds are invested in assets other than fixed income securities, including common stocks and growth oriented preferred stocks. In managing these investment choices, market volatility, the absolute level of NLASCO's capital and surplus relative both to existing liabilities and the level of premium revenue, as well as to total assets, are the limiting factors that influence the portion of assets invested in assets other than fixed income investments.

Performance is measured by comparing the total return, for each period, of each major sector of NLASCO's investment portfolio to an appropriate market index, as well as comparing the total return of NLASCO's investment portfolio to an average of the market indices, weighted by the portfolio's average exposure to each other particular sector during the period. The assets are managed with the goal of exceeding these market indices, with volatility of return similar to or less than the indices.

NLASCO's investment committee meets regularly to review the portfolio performance and investment markets in general. NLASCO's management generally meets monthly to review the performance of investments and monitor market conditions for investments that would warrant any revision to investment guidelines.

The following table sets forth information concerning the composition of NLASCO's investment portfolio at December 31, 2009 (in thousands):

	December 31, 2009			
	Cost and Amortized Cost	Fair Value	Carrying Value	Percent of Carrying Value
Available-for-sale securities:				
Fixed maturities:				
Government securities	$ 23,217	$ 24,519	$ 24,519	18.9%
Commercial mortgage-backed securities	10,533	11,217	11,217	8.6%
Corporate debt securities	73,988	77,421	77,421	59.6%
	107,738	113,157	113,157	
Equity securities	234	272	272	0.2%
	107,972	113,429	113,429	
Held-to-maturity securities:				
Fixed maturities:				
Government securities	16,539	17,244	16,539	12.7%
	$ 124,511	$ 130,673	$ 129,968	100.0%

At December 31, 2009, NLASCO's fixed maturity portfolio had a fair value of approximately $130.4 million. All of the fixed maturity investments are rated as investment grade. As a result, the market value of these investments may fluctuate in response to changes in interest rates. In addition, we may experience investment losses to the extent our liquidity needs require disposition of fixed maturity securities in unfavorable interest rate environments.

The amortized cost (original cost for equity securities), gross unrealized holding gains and losses, and fair value of available-for-sale and held-to-maturity securities by major security type and class of security at December 31, 2009 for NLASCO's investment portfolio were as follows (in thousands).

	December 31, 2009			
	Cost and Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Available-for-sale securities:				
Fixed maturities:				
Government securities	$ 23,217	$ 1,493	$ (191)	$ 24,519
Commercial mortgage-backed securities	10,533	683	—	11,216
Corporate debt securities	73,988	3,645	(211)	77,422
	107,738	5,821	(402)	113,157
Equity securities	234	40	(2)	272
	107,972	5,861	(404)	113,429
Held-to-maturity securities:				
Fixed maturities:				
Government securities	16,539	706	(1)	17,244
	$ 124,511	$ 6,567	$ (405)	$ 130,673

During 2009, the Company took other-than-temporary impairment on one corporate bond and recognized a loss of $0.8 million.

While all of these investments are monitored for potential impairment, our experience indicated that they generally do not present a great risk of impairment, as fair value recovers over time. Management believes that the analysis of each of these investments supports the view that these investments were not other-than-temporarily impaired. Evidence considered in this analysis includes the reasons for the impairment, the severity and duration of the unrealized loss position, changes in value subsequent to year-end, credit worthiness, and forecasted performance of the investee. While some of the securities held in the investment portfolio have decreased in value since the date of acquisition, the severity of loss and the duration of the loss position are not significant enough to warrant other-than-temporary impairment of the securities. The Company does not intend to sell these securities and it is not likely that the Company will be required to sell these securities before the recovery of the cost basis, other than specifically identified securities; and, therefore, does not believe any other-than-temporary impairments exist as of December 31, 2009.

The following table presents the maturity profile of NLASCO's fixed maturity investments as of December 31, 2009. Actual maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The schedule of fixed maturities available-for-sale and held-to-maturity at December 31, 2009 by contractual maturity is as follows (in thousands).

	December 31, 2009	
	Amortized Cost	Fair Value
Available-for-sale fixed maturities:		
Due within one year	$ 3,416	$ 3,455
Due after one year through five years	46,945	49,623
Due after six years through ten years	38,736	40,546
Due after ten years	8,113	8,322
Mortgage-backed securities	10,528	11,211
	$ 107,738	$ 113,157
Held-to-maturity debt securities:		
Due within one year	$ 3,364	$ 3,408
Due after one year through five years	7,873	8,317
Due after six years through ten years	5,302	5,519
Due after ten years	—	—
	$ 16,539	$ 17,244

We are subject to various market risk exposures, including interest rate risk and equity price risk. Our primary risk exposure is to changes in interest rates. We manage market risk through our investment committee and through the use of an outside professional investment management firm. We are vulnerable to interest rate changes, like other insurance companies, because we invest primarily in fixed maturity securities, which are interest-sensitive assets. Mortgage-backed securities, which make up approximately 10% of our investment portfolio, are particularly susceptible to interest rate changes.

The value of our equity investments is dependent upon general conditions in the securities markets and the business and financial performance of the individual companies in the portfolio. Values are typically based on future economic prospects that are perceived by investors in the equity market.

Competition

NLASCO competes with a large number of other companies in its selected lines of business, including major U.S. and non-U.S. insurers, regional companies, mutual companies, specialty insurance companies, underwriting agencies and diversified financial services companies. The personal lines market in Texas is dominated by a few large carriers and their subsidiaries and affiliates, including State Farm, Zurich Insurance Group, Allstate and USAA. According to the Texas Department of Insurance, the top ten insurers writing homeowners insurance accounted for approximately 83.4% of the market for the trailing twelve months at September 30, 2009. NLASCO competes for business on the basis of a number of factors, including price, coverages offered, customer service, relationships with agents (including ease of doing business, service provided and commission rates paid), size and financial strength ratings. In its personal lines business, NLASCO's competitors include Republic Companies Group, Inc., Columbia Lloyds, Foremost, American Modern Home Group and American Reliable. In its commercial lines business, NLASCO's competitors include Travelers, Safeco and Republic. NLASCO seeks to distinguish itself from its competitors by targeting underserved market segments that provide NLASCO with the best opportunity to obtain favorable policy terms, conditions and pricing.

Regulation of Insurance Activities

NLASCO's insurance subsidiaries, NLIC and ASIC, are subject to regulation and supervision in each state where they are licensed to do business. This regulation and supervision is vested in state agencies having broad administrative power over the various aspects of the business of NLIC and ASIC.

State insurance holding company regulation

NLASCO controls two operating insurance companies, NLIC and ASIC, and is subject to the insurance holding company laws of Texas, the state in which those insurance companies are domiciled. These laws generally require NLASCO to register with the Texas Department of Insurance and periodically to furnish financial and other information about the operations of companies within its holding company structure. Generally under these laws, all transactions between an insurer and an affiliated company in its holding company structure, including sales, loans, reinsurance agreements and service agreements, must be fair and reasonable and, if satisfying a specified threshold amount or of a specified category, require prior notice and approval or non-disapproval by the Texas Department of Insurance.

Changes of control

Before a person can acquire control of an insurance company domiciled in Texas, prior written approval must be obtained from the Texas Department of Insurance. Prior to granting approval of an application to acquire control of an insurer, the Texas Department of Insurance will consider the following factors, among others:

- the financial strength of the applicant;
- the integrity and management experience of the applicant's board of directors and executive officers;
- the acquirer's plans for the management of the domestic insurer;
- the acquirer's plans to declare dividends, sell assets or incur debt;
- the acquirer's plans for the future operations of the domestic insurer;
- the impact of the acquisition on continued licensure of the domestic insurer;

- the impact on the interests of Texas policyholders; and
- any anti-competitive results that may arise from the consummation of the acquisition of control.

Pursuant to the Texas insurance holding company statutes, "control" means the possession, direct or indirect, of the power to direct, or cause the direction of, the management and policies of the company, whether through the ownership of voting securities, by contract (except a commercial contract for goods or non-management services) or otherwise. Control is presumed to exist if any person directly or indirectly owns, controls or holds with the power to vote 10% or more of the voting securities of the company; however, the state's insurance department, after notice and a hearing, may determine that a person or entity that directly or indirectly owns, controls or holds with the power to vote less than 10% of the voting securities of the company nonetheless "controls" the company. Because a person acquiring 10% or more of HTH's common stock would indirectly control the same percentage of the stock of ASIC and two affiliated corporations controlling NLIC, the change of control laws of the State of Texas would apply to such a transaction.

These laws may discourage potential acquisition proposals and may delay, deter or prevent change of control transactions, including those that some or all of the Company's stockholders might consider to be desirable.

National Association of Insurance Commissioners

The National Association of Insurance Commissioners, or NAIC, is a group consisting of state insurance commissioners that discuss issues and formulates policy with respect to regulation, reporting and accounting for insurance companies. Although the NAIC has no legislative authority and insurance companies are at all times subject to the laws of their respective domiciliary states and, to a lesser extent, other states in which they conduct business, the NAIC is influential in determining the form in which such laws are enacted. Certain Model Insurance Laws, Regulations and Guidelines, or Model Laws, have been promulgated by the NAIC as a minimum standard by which state regulatory systems and regulations are measured. Adoption of state laws that provide for substantially similar regulations to those described in the Model Laws is a requirement for accreditation by the NAIC.

The NAIC provides authoritative guidance to insurance regulators on current statutory accounting issues by promulgating and updating a codified set of statutory accounting practices in its Accounting Practices and Procedures Manual. The Texas Department of Insurance has generally adopted these codified statutory accounting practices.

Texas also has adopted laws substantially similar to the NAIC's risk based capital, or RBC laws, which require insurers to maintain minimum levels of capital based on their investments and operations. Domestic property and casualty insurers are required to report their RBC based on a formula that attempts to measure statutory capital and surplus needs based on the risks in the insurer's mix of products and investment portfolio. The formula is designed to allow the Texas Department of Insurance to identify potential inadequately capitalized companies. Under the formula, a company determines its RBC by taking into account certain risks related to its assets (including risks related to its investment portfolio and ceded reinsurance) and its liabilities (including underwriting risks related to the nature and experience of its insurance business). Among other requirements, an insurance company must maintain capital and surplus of at least 200% of the RBC computed by the NAIC's RBC model (known as the "Authorized Control Level" of RBC). At December 31, 2009, NLIC and ASIC capital and surplus levels exceeded the minimum RBC requirements that would trigger regulatory attention. In their 2009 statutory financial statements, both NLIC and ASIC complied with the NAIC's RBC reporting requirements.

The NAIC's Insurance Regulatory Information System, or IRIS, was developed to assist state insurance departments in executing their statutory mandates to oversee the financial condition of

insurance companies. IRIS identifies twelve industry ratios and specifies a range of "usual values" for each ratio. Departure from the usual values on four or more of these ratios can lead to inquiries from state insurance commissioners as to certain aspects of an insurer's business. For 2009, all ratios for both NLIC and ASIC were within the usual values.

The NAIC adopted an amendment to its "Model Audit Rule" in response to the passage of the Sarbanes-Oxley Act of 2002, or SOX. The amendment is effective for financial statements for accounting periods after January 1, 2010. This amendment addresses auditor independence, corporate governance and, most notably, the application of certain provisions of Section 404 of SOX regarding internal control reporting. The rules relating to internal controls apply to insurers with gross direct and assumed written premiums of $500 million or more, measured at the legal entity level (rather than at the insurance holding company level), and to insurers that the domiciliary commissioner selects from among those identified as in hazardous condition, but exempts SOX compliant entities. Neither NLIC nor ASIC currently has direct and assumed written premiums of at least $500 million, but it is conceivable that this may change in the future; however, NLASCO must still be SOX compliant because it is wholly-owned by HTH, a public company subject to SOX.

Legislative changes

From time to time, various regulatory and legislative changes have been, or are, proposed that would adversely affect the insurance industry. Among the proposals that have been, or are being, considered are the possible introduction of Federal regulation in addition to, or in lieu of, the current system of state regulation of insurers and proposals in various state legislatures (some of which proposals have been enacted) to conform portions of their insurance laws and regulations to various Model Laws adopted by the NAIC. NLASCO is unable to predict whether any of these laws and regulations will be adopted, the form in which any such laws and regulations would be adopted, or the effect, if any, these developments would have on its financial condition or results of operations.

In 2002, in response to the tightening supply in certain insurance and reinsurance markets resulting from, among other things, the September 11, 2001 terrorist attacks, the Terrorism Risk Insurance Act, or TRIA, was enacted. TRIA was modified and extended by the Terrorism Risk Insurance Extension Act of 2005 and extended again by the Terrorism Risk Insurance Program Reauthorization Act of 2007. These Acts created a Federal Program designed to ensure the availability of commercial insurance coverage for terrorist acts in the United States. This Program helped the commercial property and casualty insurance industry cover claims related to terrorism-related losses and requires such companies to offer coverage for certain acts of terrorism. As a result, NLASCO is prohibited from adding certain terrorism exclusions to the policies written by its insurance company subsidiaries. The 2005 Act extended the Program through 2007, but eliminated commercial auto, farm-owners and certain other commercial coverages from its scope. The Reauthorization Act further extended the Program through December 31, 2014 and fixed the reimbursement percentage at 85% and the deductible at 20%. Although NLASCO is protected by federally funded terrorism reinsurance as provided for in the TRIA, there is a substantial deductible that must be met, the payment of which could have an adverse effect on its financial condition and results of operations. NLASCO's deductible for 2009 was $1.2 million. Potential future changes to the TRIA could also adversely affect NLASCO by causing its reinsurers to increase prices or withdraw from certain markets where terrorism coverage is required.

In 2003, legislation was passed in Texas that significantly changed the regulation of homeowners insurance, and, to a lesser extent, automobile insurance. Prior to 2003, certain types of insurers, including insurance companies that participate in Lloyd's, reciprocals, county mutuals and farm mutuals that wrote these lines of insurance were generally exempt from rate regulation. The 2003 legislation eliminated, or severely reduced, these exemptions, and imposed a new rate regulation regime for all insurers writing these lines of insurance. This legislation also included limitations on the use of credit scoring and territorial distinctions in underwriting and rating risks. Further, the Texas Commissioner of

Insurance has been given broader authority under the law to order refunds to policyholders when rates charged have been deemed excessive or unfairly discriminatory.

The Texas Sunset Act provides that the Sunset Commission, composed of legislators and public members, periodically evaluate a state agency to determine if the agency is still needed, and what improvements are needed to ensure that state funds are well spent. Based on the recommendations of the Sunset Commission, the Texas Legislature ultimately decides whether an agency continues to operate into the future. The Sunset Commission reviewed the Texas Department of Insurance in 2008 and made recommendations on the agency to the 81st Texas legislative session, which occurred in 2009. The legislation containing the Sunset Commission's recommendations, however, failed to pass. The Texas Legislature, instead, passed legislation that continues the agency until 2011 and limits the Sunset Commission's review of the Texas Department of Insurance to the appropriateness of the recommendations made during the 81st legislative session. The Sunset Commission staff is currently reviewing those recommendations and is scheduled to issue an updated report in April 2010. Based on public input and the Sunset Commission staff report, the Sunset Commission will adopt recommendations for the legislature to consider when it convenes in January 2011 for the 82nd Texas legislative session. Accordingly, it is likely that changes will occur as a result of this review, which may have an adverse effect on us.

State insurance regulations

State insurance authorities have broad powers to regulate U.S. insurance companies. The primary purposes of these powers are to promote insurer solvency and to protect individual policyholders. The extent of regulation varies, but generally has its source in statutes that delegate regulatory, supervisory and administrative power to state insurance departments. These powers relate to, among other things, licensing to transact business, accreditation of reinsurers, admittance of assets to statutory surplus, regulating unfair trade and claims practices, establishing actuarial requirements and solvency standards, regulating investments and dividends, and regulating policy forms, related materials and premium rates. State insurance laws and regulations require insurance companies to file financial statements prepared in accordance with accounting principles prescribed by insurance departments in states in which they conduct insurance business, and their operations are subject to examination by those departments.

As part of the broad authority that state insurance commissioners hold, they may impose periodic rules or regulations related to local issues or events. An example is the State of Louisiana's prohibition on the cancellation of policies for nonpayment of premium in the wake of Hurricane Katrina. Due to the extent of damage and displacement of people, inability of mail to reach policyholders and inaccessibility of entire neighborhoods, the State of Louisiana prohibited insurance companies from canceling policies for a period of time following that named storm.

Periodic financial and market conduct examinations

The insurance departments in every state in which NLASCO's insurance companies do business may conduct on-site visits and examinations of its insurance companies at any time to review the insurance companies' financial condition, market conduct and relationships and transactions with affiliates. In addition, the Texas Department of Insurance will conduct comprehensive examinations of insurance companies domiciled in Texas every three to five years. Examinations are generally carried out in cooperation with the insurance departments of other licensing states under guidelines promulgated by the NAIC.

The Texas Department of Insurance completed their examination of NLIC from January 31, 2002 through December 31, 2006, and ASIC from January 1, 2004 through December 31, 2006. The final NLIC and ASIC examination reports dated June 13, 2008 and June 1, 2008, respectively, contained no information of any significant compliance issues.

State dividend limitations

The Texas Department of Insurance must approve any dividend declared or paid by an insurance company domiciled in the state if the dividend, together with all dividends declared or distributed by that insurance company during the preceding twelve months, exceeds the greater of (1) 10% of its policyholders' surplus as of December 31 of the preceding year or (2) 100% of its net income for the preceding calendar year. The greater number is known as the insurer's extraordinary dividend limit. As of December 31, 2009, the extraordinary dividend limit for NLIC and ASIC is $9.0 million and $3.3 million, respectively. In addition, NLASCO's insurance companies may only pay dividends out of their earned surplus.

Statutory accounting principles

Statutory accounting principles, or SAP, are a comprehensive basis of accounting developed to assist insurance regulators in monitoring and regulating the solvency of insurance companies. SAP rules are different from generally accepted accounting principles in the United States of America, or GAAP, and are intended to reflect a more conservative view of the insurer. SAP is primarily concerned with measuring an insurer's surplus to policyholders. Accordingly, SAP focuses on valuing assets and liabilities of insurers at financial reporting dates in accordance with insurance laws and regulatory provisions applicable in each insurer's domiciliary state.

While GAAP is concerned with a company's solvency, it also stresses other financial measurements, such as income and cash flows. Accordingly, GAAP gives more consideration to appropriate matching of revenues and expenses and accounting for management's stewardship of assets than does SAP. As a direct result, different assets and liabilities and different amounts of assets and liabilities will be reflected in financial statements prepared in accordance with GAAP as opposed to SAP. SAP, as established by the NAIC and adopted by Texas regulators, determines the statutory surplus and statutory net income of the NLASCO insurance companies and, thus, determines the amount they have available to pay dividends.

Guaranty associations

In Texas, and in all of the jurisdictions in which NLIC and ASIC are, or in the future may be, licensed to transact business, there is a requirement that property and casualty insurers doing business within the jurisdiction must participate in guaranty associations, which are organized to pay limited covered benefits owed pursuant to insurance policies issued by impaired, insolvent or failed insurers. These associations levy assessments, up to prescribed limits, on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the lines of business in which the impaired, insolvent or failed insurer was engaged. States generally permit member insurers to recover assessments paid through full or partial premium tax offsets.

NLASCO incurred no levies in 2009, 2008 or 2007. Property and casualty insurance company insolvencies or failures may, however, result in additional guaranty fund assessments at some future date. At this time NLASCO is unable to determine the impact, if any, that these assessments may have on its financial condition or results of operations. NLASCO has established liabilities for guaranty fund assessments with respect to insurers that are currently subject to insolvency proceedings.

National Flood Insurance Program

NLASCO voluntarily participates as a Write Your Own carrier in the National Flood Insurance Program, or NFIP. The NFIP is administered and regulated by the Federal Emergency Management Agency. NLASCO operates as a fiscal agent of the Federal government in the selling and administering of the Standard Flood Insurance Policy. This involves the collection of premiums belonging to the Federal government and the paying of covered claims by directly drawing on funds of the United States

Treasury. NLASCO receives allowances from NFIP for underwriting administration, claims management, commission and adjuster fees.

Participation in involuntary risk plans

NLASCO's insurance companies are required to participate in residual market or involuntary risk plans in various states where they are licensed that provide insurance to individuals or entities that otherwise would be unable to purchase coverage from private insurers. If these plans experience losses in excess of their capitalization, they may assess participating insurers for proportionate shares of their financial deficit. These plans include the Georgia Underwriting Association, Texas FAIR Plan Association, Texas Windstorm Insurance Agency, or TWIA, the Louisiana Citizens Property Insurance Corporation, the Mississippi Residential Property Insurance Underwriting Association and the Mississippi Windstorm Underwriting Association. For example in 2005, following Hurricanes Katrina and Rita, the above plans levied collective assessments totaling $10.4 million on NLASCO's insurance subsidiaries. Additional assessments, including emergency assessments, may follow. In some of these instances, NLASCO's insurance companies should be able to recover these assessments through policyholder surcharges, higher rates or reinsurance. The ultimate impact hurricanes have on the Texas and Louisiana facilities is currently uncertain and future assessments can occur whenever the involuntary facilities experience financial deficits.

Other

Insurance activities are subject to state insurance laws and regulations as determined by the particular insurance commissioner for each state in accordance with the McCarran-Ferguson Act, as well as subject to the Gramm-Leach-Bliley Act and the privacy regulations promulgated by the Federal Trade Commission.

Changes in any of the laws governing our conduct could have an adverse impact on our ability to conduct our business or could materially affect our financial position, operating income, expense or cash flow.

Employees

As of December 31, 2009, we had 134 full-time equivalent employees. Of these 134 employees, 4 work for HTH, and the remaining 130 work for NLASCO. The NLASCO employees perform underwriting, claims, marketing, and administrative functions for the insurance business. We consider our employee relations to be good.

ITEM 1A. RISK FACTORS

The following risk factors identify important factors, including material risks and uncertainties, which could cause actual results to differ materially from those reflected in forward-looking statements or in our historical results. Each of the following risk factors, among others, could adversely affect our ability to meet the current expectations of our management.

Risks Related to Our Substantial Cash Position and Related Strategies for its Use

We intend to use a substantial portion of our available cash to make acquisitions or effect a business combination.

We are endeavoring to make opportunistic acquisitions or effect a business combination with a substantial portion of our available cash. No assurances, however, can be given that we will be able to identify suitable targets, consummate acquisitions or effect a combination or, if consummated, successfully integrate personnel and operations. Even if we identify suitable targets, we may not be able to make acquisitions or effect a combination on commercially acceptable terms, if at all. The success of any acquisition or combination will depend upon, among other things, the ability of management and our employees to integrate personnel, operations, products and technologies effectively, to retain and motivate key personnel and to retain customers and clients of targets. In addition, any acquisition or combination we undertake may involve certain other risks, including consumption of available cash resources, potentially dilutive issuances of equity securities and the diversion of management's attention from other business concerns. We also may need to make further investments to support the acquired or combined company and may have difficulty identifying and acquiring the appropriate resources. There can be no assurance that any acquisition or combination we undertake will perform as expected. We may enter, on our own and through acquisitions or a combination, into new lines of business or initiate new service offerings, whether related or unrelated to our insurance business. Our success in any such endeavor will depend upon, among other things, the ability of management to identify suitable opportunities, successfully implement sound business strategies and avoid the legal and business risks of any new line of business or service offering and/or an acquisition related thereto. There can be no assurance that we will be able to do any of the foregoing. In addition, any such undertakings may result in additional costs without an immediate increase in revenues and may divert management's attention from the operation and growth of our current lines of business.

Since we have not definitively selected a particular target business to acquire or combine with, you will be unable to ascertain the merits or risks of the industry or business in which we may ultimately primarily operate.

We may consummate an acquisition of, or effect a business combination with, a company in any industry and are not limited to any particular type of business. Accordingly, there is no current basis for you to evaluate the possible merits or risks of the particular industry in which we may ultimately conduct our primary ongoing operations or the target business that we may ultimately acquire. To the extent we complete an acquisition of, or business combination with, a financially unstable company or an entity in its development stage, we may be affected by numerous risks inherent in the business operations of those entities. If we complete an acquisition of, or effect a business combination with, an entity in an industry characterized by a high level of risk, we may be affected by the currently unascertainable risks of that industry. Although our management will endeavor to evaluate the risks inherent in a particular industry or target business, we cannot assure you that we will properly ascertain or assess all of the significant risk factors. Even if we properly assess those risks, some of them may be outside of our control or ability to affect.

We may change our primary lines of business without stockholder approval, which may result in riskier lines of business than our current lines of business.

Depending on the structure of an acquisition or business combination, it may result in us conducting our primary operations in lines of business that are different from, and possibly more risky than, our current business without stockholder approval.

Resources could be expended in researching acquisitions that are not consummated, which could materially adversely affect subsequent attempts to locate and acquire or merge with another business.

It is anticipated that the investigation of each specific target business and the negotiation, drafting and execution of relevant agreements, disclosure documents and other instruments will require substantial management time and attention and substantial costs for accountants, attorneys and others. If a decision is made not to complete a specific acquisition or business combination, the costs incurred up to that point for the proposed transaction likely would not be recoverable. Furthermore, even if an agreement is reached relating to a specific target business, we may fail to consummate our acquisition or combination for any number of reasons, including those beyond our control, such as if the target's or our stockholders do not approve the transaction. Any such event will result in a loss to us of the related costs incurred, which could materially adversely affect subsequent attempts to locate and acquire or merge with another business.

Existing circumstances may result in several of our directors having interests that may conflict with our interests.

A director who has a conflict of interest with respect to an issue presented to our board will have no inherent legal obligation to abstain from voting upon that issue. We do not have provisions in our bylaws or charter that require an interested director to abstain from voting upon an issue, and we do not expect to add provisions in our charter and bylaws to this effect. Although each director has a duty to act in good faith and in a manner he or she reasonably believes to be in our best interests, there is a risk that, should interested directors vote upon an issue in which they or one of their affiliates has an interest, their vote may reflect a bias that could be contrary to our best interests. In addition, even if an interested director abstains from voting, the director's participation in the meeting and discussion of an issue in which they have, or companies with which they are associated have, an interest could influence the votes of other directors regarding the issue.

Difficult market conditions have adversely affected the yield on our available cash.

Our primary objective is to preserve and maintain the liquidity of our available cash, while at the same time maximizing yields without significantly increasing risk. The capital and credit markets have been experiencing volatility and disruption for more than eighteen months. This volatility and disruption reached unprecedented levels, resulting in dramatic declines in interest rates and other yields relative to risk. This downward pressure has negatively affected the yields we receive on our available cash to effectively zero. If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will receive any significant yield on our available cash. Further, given current market conditions, no assurance can be given that we will be able to preserve our available cash.

Competition from other motivated purchasers may hinder our ability to consummate an acquisition in the near term.

We expect to encounter intense competition from entities having a business objective similar to ours, including venture capital funds, special purpose acquisition companies, private equity funds, leveraged buyout funds, opportunity funds and other operating businesses competing for acquisitions.

Many of these entities are well established and have extensive experience in identifying and effecting acquisitions or business combinations directly or through affiliates. Many of these competitors possess greater technical, human and other resources than we do and our financial resources may be relatively limited when contrasted with those of many of these competitors. While we believe that there are numerous potential target businesses that we could acquire with our available cash, our ability to compete in acquiring certain sizable target businesses may be limited by our available financial resources. This inherent competitive limitation gives others an advantage in pursuing the acquisition of certain target businesses. For these reasons, we cannot assure you that we will be able to effectuate an acquisition or business combination in the near term.

Following the consummation of an acquisition or business combination, we may be required to take write-downs or write-offs or restructuring, impairment or other charges that could have a significant negative effect on our financial condition, results of operations and our stock price.

Even if we conduct extensive due diligence on a target business that we acquire or with which we merge, we cannot assure you that this diligence will surface all material issues that may be present inside a particular target business, that it would be possible to uncover all material issues through a customary amount of due diligence, or that factors outside of the target business and outside of our control will not later arise. As a result of these factors, we may be forced to later write-down or write-off assets, restructure our operations or incur impairment or other charges that could result in us reporting losses. Even if our due diligence successfully identifies certain risks, unexpected risks may arise and previously known risks may materialize in a manner inconsistent with our preliminary risk analysis. Even though these charges may be non-cash items and not have an immediate impact on our liquidity, the fact that we report charges of this nature could contribute to negative market perceptions about us or our securities. In addition, charges of this nature may cause us to violate net worth or other covenants to which we may become subject as a result of assuming pre-existing debt held by a target business or by virtue of our obtaining post-acquisition debt financing.

We may issue additional shares of common or preferred stock to complete an acquisition or effect a combination or under an employee incentive plan after consummation of an acquisition or combination, which would dilute the interests of our stockholders and likely present other risks.

The issuance of additional shares of common or preferred stock:

- may significantly dilute the equity interest of our stockholders;
- may subordinate the rights of holders of common stock if preferred stock is issued with rights senior to those afforded our common stock;
- could cause a change in control if a substantial number of shares of common stock are issued, which may affect, among other things, our ability to use our net operating loss carry forwards; and
- may adversely affect prevailing market prices for our common stock.

We may be unable to obtain additional financing to complete an acquisition or business combination or to fund the operations and growth of a target business, which could compel us to restructure or abandon a particular acquisition or business combination.

Although we believe that our available cash will be sufficient to allow us to consummate an acquisition or effect a business combination, we cannot ascertain the exact capital requirements for any particular transaction because we have not yet definitively selected a target business. If our available cash is insufficient, either because of the size of the acquisition or business combination or the depletion of available funds in search of a target business, we may be required to seek additional

financing. We cannot assure you that such financing will be available on acceptable terms, if at all. To the extent that additional financing proves to be unavailable, if and when needed, to consummate an acquisition or effect a business combination, we would be compelled to either restructure the transaction or abandon that particular acquisition or business combination and seek an alternative target business candidate. Even if we do not need additional financing to consummate an acquisition or effect a business combination, we may require such financing to fund the operations or growth of the target business. The failure to secure additional financing could have a material adverse effect on the continued development or growth of the target.

There may be tax consequences with respect to an acquisition or business combination that adversely affect us.

While we expect to undertake any merger or acquisition so as to minimize taxes, both to the acquired business and/or asset and us, such acquisition or business combination might not meet the statutory requirements of a tax-free reorganization, or the parties might not obtain the intended tax-free treatment upon a transfer of shares or assets. A non-qualifying reorganization could result in the imposition of substantial taxes.

Our net operating loss and other carryovers may be limited if we undergo an ownership change. Generally, an ownership change occurs if certain persons or groups increase their aggregate ownership in us by more than 50 percentage points looking back over the prior three-year period. If an ownership change occurs, our ability to use our net operating losses, or NOLs, to reduce income taxes is limited to an annual amount, or a Section 382 limitation, equal to the fair market value of our common stock immediately prior to the ownership change multiplied by the long term tax-exempt interest rate, which is published monthly by the Internal Revenue Service, or IRS. In the event of an ownership change, NOLs that exceed the Section 382 limitation in any year will continue to be allowed as carryforwards for the remainder of the carryforward period and such excess NOLs can be used to offset taxable income for years within the carryforward period subject to the Section 382 limitation in each year. Whether or not an ownership change occurs, the carryforward period for NOLs is either 15 or 20 years from the year in which the losses giving rise to the NOLs were incurred. If the carryforward period for any NOL were to expire before that NOL had been fully utilized, the unused portion of that NOL would be lost. Our use of NOLs arising after the date of an ownership change would not be affected by the Section 382 limitation (unless there were another ownership change after those NOLs arose).

Based on our knowledge of stockholder ownership of Hilltop, we do not believe that an ownership change has occurred since our initial public offering, or IPO, that would limit our post-IPO NOLs. Accordingly, we believe that there is no annual limitation under Section 382 of the Internal Revenue Code, or the Code, imposed on our use of post-IPO NOLs to reduce future taxable income. Our pre-IPO NOLs are subject to an annual limitation of approximately $17.0 million.

The determination of whether an ownership change has occurred, or will occur, is complicated, and therefore, no assurance can be provided as to whether an ownership change has occurred or will occur. We have not obtained, and currently do not plan to obtain, an IRS ruling or opinion of counsel regarding our conclusions as to whether the pre-IPO NOLs or post-IPO NOLs are subject to any such limitations. In addition, limitations imposed by Section 382 may prevent us from issuing additional shares of common stock to raise capital or to acquire businesses or properties. To the extent not prohibited by our charter, we may decide in the future that it is necessary or in our best interest to take certain actions that could result in an ownership change.

If we are deemed to be an investment company, we may be required to institute burdensome compliance requirements and our activities may be restricted, which may make it difficult for us to complete strategic acquisitions or effect combinations.

We do not plan to operate as an investment fund or investment company, or to be engaged in the business of investing, reinvesting or trading in securities. Our plan is to acquire, hold, operate and grow for the long-term one or more operating businesses in an industry that will strategically align with or complement our current operations. We do not plan to operate as a passive investor or as a merchant bank seeking dividends or gains from purchases and sales of securities.

If we were deemed to be an investment company under the Investment Company Act of 1940, or the 1940 Act, we would be required to become registered under the 1940 Act (or liquidate) and our activities would be subject to a number of restrictions, including, among others:

- corporate governance requirements and requirements regarding mergers and share exchanges;
- restrictions on the nature of our investments;
- restrictions on our capital structure and use of multiple classes of securities; and
- restrictions on our use of leverage and collateral,

each of which may make it difficult for us to consummate strategic acquisitions or effect a combination.

In addition, we may have imposed upon us burdensome requirements, including:

- registration as an investment company;
- adoption of a specific form of corporate structure; and
- reporting, record keeping, voting, proxy and disclosure requirements and other rules and regulations,

compliance with which would reduce the funds that we have available to consummate strategic acquisitions or a combination.

In order not to be regulated as an investment company under the 1940 Act, unless we can qualify for an exclusion, we must ensure that we are engaged primarily in an initial business other than investing, reinvesting or trading of securities and that our activities do not include investing, reinvesting, owning, holding or trading "investment securities." Our business, in addition to our insurance operations, will be to identify and consummate an acquisition or business combination and, thereafter, to operate the acquired business or businesses for the long term. We do not plan to buy businesses to be a passive investor. We do not believe that our anticipated principal activities will subject us to the 1940 Act. If we were deemed to be subject to the 1940 Act, compliance with these additional regulatory burdens would require additional expense for which we have not accounted.

Risks Related to NLASCO's Business and NLASCO's Industry

The occurrence of severe catastrophic events may have a material adverse effect on NLASCO, particularly because NLASCO conducts business in a concentrated geographic area.

NLASCO expects to have large aggregate exposures to natural and man-made disasters, such as hurricanes, hail, tornados, windstorms, floods, wildfires and acts of terrorism. NLASCO expects that its loss experience, generally, will include infrequent events of great severity. Hurricanes Dolly, Gustav and Ike, which occurred in 2008, are examples, as well as Hurricanes Katrina and Rita that occurred in 2005. The risks associated with natural and man-made disasters are inherently unpredictable, and it is difficult to predict the timing of these events with statistical certainty or estimate the amount of loss any given occurrence will generate. Although NLASCO may attempt to exclude certain losses, such as

terrorism and other similar risks, from some coverage that NLASCO writes, it may be prohibited from, or may not be successful in, doing so. The extent of losses from a catastrophe is a function of both the total amount of policyholder exposure in the geographic area affected by the event and the severity of the event. The occurrence of losses from catastrophic events may have a material adverse effect on NLASCO's ability to write new business and on its financial condition and results of operations. Increases in the values and geographic concentrations of policyholder property and the effects of inflation have resulted in increased severity of industry losses in recent years, and NLASCO expects that these factors will increase the severity of losses in the future. Factors that may influence NLASCO's exposure to losses from these types of events, in addition to the routine adjustment of losses, include, among others:

- exhaustion of reinsurance coverage;
- increases in reinsurance rates;
- unanticipated litigation expenses;
- unrecoverability of ceded losses;
- impact on independent agent operations and future premium income in areas affected by catastrophic events;
- unanticipated expansion of policy coverage or reduction of premium due to regulatory, legislative and/or judicial action following a catastrophic event; and
- unanticipated demand surge related to other recent catastrophic events.

NLASCO's insurance subsidiaries write insurance primarily in the States of Texas, Arizona, Tennessee, Oklahoma and Louisiana. In 2009, Texas accounted for 74.5%, Arizona accounted for 8.7%, Tennessee accounted for 6.1%, Oklahoma accounted for 4.0%, Louisiana accounted for 2.3% and the other states we do business in accounted for the other 4.4% of our premiums. As a result, a single catastrophe, destructive weather pattern, wildfire, terrorist attack, regulatory development or other condition or general economic trend affecting this region or significant portions of this region could adversely affect NLASCO's financial condition and results of operations more significantly than other insurance companies that conduct business across a broader geographic area. Although NLASCO purchases catastrophe reinsurance to limit its exposure to these types of catastrophes, in the event of one or more major catastrophes resulting in losses to it in excess of $170.0 million, NLASCO's losses would exceed the limits of its reinsurance coverage.

NLASCO is exposed to claims related to severe weather and the occurrence of severe weather may result in an increase in claims frequency and exposure amount that could materially adversely affect its financial condition.

NLASCO is subject to claims arising out of severe weather, such as hurricanes, tornados, rainstorms, snowstorms, hailstorms, windstorms and ice storms, which may have a significant effect on its financial condition and results of operations. The majority of its business is written in Texas, Arizona and Oklahoma, and Texas experienced two major hurricanes in 2008. The incidence and severity of weather conditions are inherently unpredictable. Some forecasters predict that the world is currently in a cycle of more numerous and more severe hurricanes.

Generally, NLASCO's insured risks exhibit higher losses in the second and third quarters of the year due to a seasonal concentration of weather-related events in its primary geographic markets. Although weather-related losses (including hail, high winds, tornadoes and hurricanes) can occur in any calendar quarter, the second quarter, historically, has experienced the highest frequency of losses associated with these events. For example, for the last five years, the contribution of weather-related catastrophes to the consolidated second quarter net loss ratio was on average approximately 19.0 points

greater than the average contribution of such catastrophes in the other three quarters. Hurricanes, however, are more likely to occur in the third quarter of the year.

NLASCO incurred $17.9 million (including loss adjustment expenses) in gross catastrophic related losses for the year ended December 31, 2009. During 2009, NLASCO's net catastrophic loss experience was $0.9 million after reinsurance and decreases in net premiums earned due to reinsurance reinstatement premiums. A substantial portion of the expense in 2009 relates to claims being paid or reserved on hail and windstorms occurring in Texas. NLASCO incurred $83.1 million (including loss adjustment expenses) in gross catastrophic related losses for the year ended December 31, 2008. During 2008, NLASCO's net catastrophic loss experience was $13.0 million after reinsurance and decreases in net premiums earned due to reinsurance reinstatement premiums. A substantial portion of the expense in 2008 relates to claims being paid or reserved on Hurricanes Dolly, Gustav and Ike.

Due to the inherent inability to accurately predict the severity and frequency of catastrophic losses, higher than expected catastrophic losses could materially adversely affect NLASCO's financial condition.

NLASCO utilizes catastrophe modeling to assess its probable maximum insurance losses from hurricane and other wind/hail perils and to structure its catastrophe reinsurance program to minimize its exposure to high severity/high frequency types of losses. Hurricanes Katrina and Rita highlighted the challenges inherent in predicting the impact of catastrophic events. The catastrophe models, generally, failed to adequately project the financial impact of Hurricanes Katrina and Rita. This experience highlights the limitations inherent in the use of modeling as a means of risk assessment/abatement. If the exposure amount and frequency of catastrophe losses are higher than predicted under NLASCO's modeling, NLASCO's financial condition may be materially adversely affected.

NLASCO's investment performance has suffered, and may further suffer, as a result of adverse capital market developments and other factors, which affect its financial results.

NLASCO invests the premiums it receives from policyholders until they are needed to pay policyholder claims or other expenses. At December 31, 2009, NLASCO's invested assets consisted of $130.4 million in fixed maturity securities and $0.3 million in equity securities. During the year ended December 31, 2009, NLASCO had $6.2 million of net investment income, representing 4.8% of NLASCO's total revenues. Although NLASCO's investment policies stress diversification of risks, conservation of principal and liquidity, its investments are subject to a variety of investment risks, including those relating to general economic conditions, market volatility, interest rate fluctuations, liquidity risk and credit and default risk. In particular, the volatility of NLASCO's claims may force it to liquidate securities, which may cause it to incur capital losses. If NLASCO's investment portfolio is not appropriately matched with its insurance liabilities, it may be forced to liquidate investments prior to maturity at a significant loss to cover these liabilities. Investment losses could significantly decrease its asset base and statutory surplus, thereby adversely affecting its ability to conduct business and potentially its A.M. Best financial strength rating. Further, developments in the world's financial and capital markets have adversely impacted the performance of NLASCO's investments. Additionally, inflation could increase beyond investment income.

The capital and credit markets have been experiencing volatility and disruption for more than eighteen months. This volatility and disruption has reached unprecedented levels, resulting in dramatic declines in prices. This downward pressure has negatively affected the performance of NLASCO's investments, which has resulted in the write down of several of those investments. These write-downs, when determined to be other-than-temporary, reduce NLASCO's earnings for that period. If current levels of market disruption and volatility continue or worsen, there can be no assurances that we will not experience additional losses on our investments and reductions in our earnings.

NLASCO's investment results may be adversely affected by interest rate changes.

NLASCO's operating results are affected, in part, by the performance of its investment portfolio. NLASCO's investment portfolio contains instruments, such as bonds, that may be adversely affected by increases in interest rates. Because bond trading prices decrease as interest rates rise, a significant increase in interest rates could have a material adverse effect on NLASCO's financial condition and results of operations. On the other hand, decreases in interest rates could have an adverse effect on NLASCO's investment income and results of operations. For example, if interest rates decline, investment of new premiums received and funds reinvested will earn less. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond NLASCO's control.

With respect to fixed-income investments, the fair market value of these securities fluctuates depending on market and other general economic conditions and the interest rate environment. Changes in interest rates can expose NLASCO to prepayment risks on these investments. When interest rates fall, mortgage-backed securities typically are prepaid more quickly and the holder must reinvest the proceeds at lower interest rates. NLASCO's mortgage-backed securities currently consist of securities with features that reduce the risk of prepayment, but NLASCO can make no assurances that it will invest in other mortgage-backed securities that contain this protection. In periods of increasing interest rates, mortgage-backed securities typically are prepaid more slowly, which may require NLASCO to receive interest payments that are below the then prevailing interest rates for longer time periods than expected.

If NLASCO cannot price its business accurately, its profitability and the profitability of its insurance companies could be materially adversely affected.

NLASCO's results of operations and financial condition depend on its ability to underwrite and set premium rates accurately for a wide variety of risks. Adequate rates are necessary to generate premiums sufficient to pay losses, loss adjustment expenses and underwriting expenses and to earn a profit. To price its products accurately, NLASCO must:

- collect and properly analyze a substantial amount of data;
- develop, test and apply appropriate pricing techniques;
- closely monitor and recognize changes in trends in a timely manner; and
- project both severity and frequency of losses with reasonable accuracy.

NLASCO's ability to undertake these efforts successfully, and price its products accurately, is subject to a number of risks and uncertainties, some of which are outside its control, including:

- the availability of sufficient reliable data and NLASCO's ability to properly analyze available data;
- changes in applicable legal liability standards and in the civil litigation system generally;
- NLASCO's selection and application of appropriate pricing techniques;
- NLASCO's ability to obtain regulatory approval, where necessary;
- the uncertainties that inherently characterize estimates and assumptions; and
- NLASCO's ability to obtain adequate premium rates to offset higher reinsurance costs.

Consequently, NLASCO could under-price risks, which would adversely affect its profit margins, or it could overprice risks, which could reduce its competitiveness and sales volume. In either case, its profitability and the profitability of its insurance companies could be materially adversely affected.

If NLASCO's actual losses and loss adjustment expenses exceed its loss and expense estimates, its financial condition and results of operations could be materially adversely affected.

NLASCO's financial condition and results of operations depend upon its ability to assess accurately the potential losses associated with the risks that it insures. NLASCO establishes reserve liabilities to cover the payment of all losses and loss adjustment expenses incurred under the policies that it writes. These liability estimates include case estimates, which are established for specific claims that have been reported to NLASCO, and liabilities for claims that have been incurred but not reported, or IBNR. Loss adjustment expenses represent expenses incurred to investigate and settle claims. To the extent that losses and loss adjustment expenses exceed estimates, NLIC and ASIC will be required to increase their reserve liabilities and reduce their income before income taxes in the period in which the deficiency is identified. In addition, increasing reserves causes a reduction in policyholders' surplus and could cause a downgrade in the ratings of NLIC and ASIC. This, in turn, could diminish its ability to sell insurance policies.

The liability estimation process for NLASCO's casualty insurance coverage possesses characteristics that make case and IBNR reserving inherently less susceptible to accurate actuarial estimation than is the case with property coverages. Unlike property losses, casualty losses are claims made by third-parties of which the policyholder may not be aware and, therefore, may be reported a significant time after the occurrence, including sometimes years later. As casualty claims most often involve claims of bodily injury, assessment of the proper case estimates is a far more subjective process than claims involving property damage. In addition, in determining the case estimate for a casualty claim, information develops slowly over the life of the claim and can subject the case estimation to substantial modification well after the claim was first reported. Numerous factors impact the casualty case reserving process, such as venue, the amount of monetary damage, legislative activity, the permanence of the injury and the age of the claimant.

The effects of inflation could cause the severity of claims from catastrophes or other events to rise in the future. Increases in the values and geographic concentrations of policyholder property and the effects of inflation have resulted in increased severity of industry losses in recent years, and NLASCO expects that these factors will increase the severity of losses in the future. As NLASCO observed in 2008, the severity of some catastrophic weather events, including the scope and extent of damage and the inability to gain access to damaged properties, and the ensuing shortages of labor and materials and resulting demand surge, provide additional challenges to estimating ultimate losses. NLASCO's liabilities for losses and loss adjustment expenses include assumptions about future payments for settlement of claims and claims handling expenses, such as medical treatments and litigation costs. To the extent inflation causes these costs to increase above liabilities established for these costs, NLASCO expects to be required to increase its liabilities, together with a corresponding reduction in its net income in the period in which the deficiency is identified.

Estimating an appropriate level of liabilities for losses and loss adjustment expense is an inherently uncertain process. Accordingly, actual loss and loss adjustment expenses paid will likely deviate, perhaps substantially, from the liability estimates reflected in NLASCO's consolidated financial statements. Claims could exceed NLASCO's estimate for liabilities for losses and loss adjustment expenses, which could have a material adverse effect on its financial condition and results of operations.

If NLASCO cannot obtain adequate reinsurance protection for the risks it underwrites, NLASCO may be exposed to greater losses from these risks or may reduce the amount of business it underwrites, which may materially adversely affect its financial condition and results of operations.

NLASCO uses reinsurance to protect itself from certain risks and to share certain risks it underwrites. During 2009 and 2008, NLASCO's personal lines ceded 16% and 17%, respectively, of its

direct premiums written (primarily through excess of loss, quota share and catastrophe reinsurance treaties) and its commercial lines ceded 16% and 17%, respectively, of its direct premiums written (primarily through excess of loss and catastrophe reinsurance treaties). The total cost of reinsurance, inclusive of per risk excess and catastrophe, increased 16.9% in the year ended December 31, 2009, which is primarily attributable to two major catastrophes occurring in 2008. This includes additional catastrophe limits purchased. Reinsurance cost will likely materially increase, in part due to the frequency and severity of hurricanes and the lack of capacity in the reinsurance market.

From time to time, market conditions have limited, and in some cases have prevented, insurers from obtaining the types and amounts of reinsurance that they have considered adequate for their business needs. Accordingly, NLASCO may not be able to obtain desired amounts of reinsurance. Even if NLASCO is able to obtain adequate reinsurance, it may not be able to obtain it from entities with satisfactory creditworthiness or negotiate terms that it deems appropriate or acceptable. Although the cost of reinsurance is, in some cases, reflected in NLASCO's premium rates, NLASCO may have guaranteed certain premium rates to its policyholders. Under these circumstances, if the cost of reinsurance were to increase with respect to policies for which NLASCO guaranteed the rates, NLASCO would be adversely affected. In addition, if NLASCO cannot obtain adequate reinsurance protection for the risks it underwrites, it may be exposed to greater losses from these risks or it may be forced to reduce the amount of business that it underwrites for such risks, which will reduce NLASCO's revenue and may have a material adverse effect on its results of operations and financial condition.

NLASCO could face unanticipated losses from war, terrorism and political unrest, and these or other unanticipated losses could have a material adverse effect on NLASCO's financial condition and results of operations.

NLASCO has exposure to unexpected losses resulting from future man-made catastrophic events, such as acts of terrorism and political instability. These risks are inherently unpredictable. It is difficult to predict the timing of such events with statistical certainty or to estimate the amount of loss that any given occurrence will generate. In certain instances, NLASCO specifically insures risks resulting from acts of terrorism. Even in cases where NLASCO attempts to exclude losses from terrorism and certain other similar risks from some coverage it writes, NLASCO may be prohibited from, or may not be successful in, doing so. Irrespective of the clarity and inclusiveness of policy language, a court or arbitration panel may limit the enforceability of policy language or otherwise issue a ruling adverse to NLASCO. Accordingly, while NLASCO believes that its reinsurance programs, together with the coverage provided under the Terrorism Risk Insurance Act of 2002, the Terrorism Risk Insurance Extension Act of 2005 and the Terrorism Risk Insurance Program Reauthorization Act of 2007, or, collectively, the Terrorism Act, are sufficient to reasonably limit its net losses relating to potential future terrorist attacks, its reserves may not be adequate to cover losses when they materialize. Under the Terrorism Act, after an act of terrorism is certified by the Secretary of the Treasury, NLASCO may be entitled to be reimbursed by the Federal government for a percentage of subject losses, after an insurer deductible and subject to an annual cap. The Terrorism Act covers an insurance company's operations for up to 85% of its losses, subject to certain mandatory deductibles. The deductible is calculated by applying the deductible percentage to the insurer's direct earned premiums for covered lines from the calendar year immediately prior to the applicable year. Although the Terrorism Act provides benefits in the event of certain acts of terrorism for losses in 2005 through 2014, the Terrorism Act may not be extended beyond 2014 or its benefits may be reduced. It is not possible to completely eliminate NLASCO's exposure to unforecasted or unpredictable events, and to the extent that losses from such risks occur, NLASCO's financial condition and results of operations could be materially adversely affected.

If NLASCO's reinsurers do not pay losses in a timely fashion, or at all, NLASCO may incur substantial losses that could materially adversely affect its financial condition and results of operations.

At December 31, 2009, NLASCO had $21.8 million in reinsurance recoverables, including ceded paid loss recoverables, ceded losses and loss adjustment expense recoverables and ceded unearned premiums. NLASCO expects to continue to purchase substantial reinsurance coverage in the foreseeable future. Since NLASCO remains primarily liable to its policyholders for the payment of their claims, regardless of the reinsurance it has purchased relating to those claims, in the event that one of its reinsurers becomes insolvent or otherwise refuses to reimburse NLASCO for losses paid, or delays in reimbursing NLASCO for losses paid, its liability for these claims could materially and adversely affect its financial condition and results of operations. As an example, if one of NLASCO's catastrophe reinsurers experienced financial difficulties following one of the major hurricanes in 2005 and had been unable to meet its obligations to NLASCO, NLASCO could have experienced difficulty in meeting its obligations to its policyholders.

NLASCO relies on independent insurance agents to distribute its products, and if the agents do not promote NLASCO's products successfully, NLASCO's results of operations and financial condition could be adversely affected.

NLASCO's business depends, in large part, on the efforts of independent insurance agents to market its insurance products and on its ability to offer insurance products and services that meet the requirements of their customers. While NLASCO strives to offer products that its agents require, NLASCO competes for business with other carriers based on the scope of coverage provided in its products, services, commissions and rates. NLASCO's competitors may offer coverage that is more attractive to particular customers than it offers for a specific product, may price their insurance products more aggressively, may offer higher agent commissions and may devote additional resources to improve their services. Accordingly, NLASCO's agents may find it easier to promote the programs of NLASCO's competitors rather than NLASCO's. If NLASCO's agents fail to, or choose not to, market NLASCO's insurance products successfully, NLASCO's growth may be limited and its financial condition and results of operations may be adversely affected. Additionally, rather than utilizing an independent agent to buy their insurance, consumers may elect to deal with direct-writers or mass marketers who utilize the Internet to advertise and/or underwrite their business. Industry developments that centralize and commoditize insurance products could be detrimental to NLASCO's agency distribution model of doing business.

Because NLASCO relies on managing general agents to underwrite some of its products and to administer claims, such managing general agents could expose NLASCO to liability or allocate business away from NLASCO, which could cause NLASCO's financial condition and results of operations to be adversely affected.

NLASCO has developed programs with managing general agents, or MGAs, whereby the MGA will, within the guidelines established by NLASCO, underwrite insurance policies on NLASCO's insurance subsidiaries' behalf with oversight by NLASCO. A MGA is a person, firm or corporation that has supervisory responsibility for the local agency and field operations of an insurer in the state where it is organized or that is authorized by an insurer to accept or process, on the insurer's behalf, insurance policies produced and sold by other agents. While NLASCO exercises care in the selection of its MGA relationships and regularly audits the performance of its MGAs, NLASCO is at risk for their conduct as a result of the authority it has delegated to them. If one of NLASCO's MGAs binds NLASCO's insurance subsidiaries to policies that expose it to unexpected losses or fails to appropriately report claims, NLASCO's financial condition and results of operations could be adversely affected. For example, if a terminated MGA fails to continue to appropriately report claims during the runoff period, then liabilities for losses and loss adjustment expenses could be deficient, which would

impact NLASCO's results of operations in future periods. Furthermore, subject to contractual limitations, MGAs have the ability to change carriers or increase or decrease the allocation to a particular carrier. A MGA might choose to change carriers or allocations for many reasons, such as pricing, service, conditions in the reinsurance market or a change in ownership of an MGA.

A decline in NLIC's or ASIC's financial strength ratings by A.M. Best could cause either of their sales or earnings, or both, to decrease.

Ratings have become an increasingly important factor in establishing the competitive position of insurance companies. A.M. Best maintains a letter scale rating system ranging from "A++ (Superior)" to "F (In Liquidation)" to rate the financial strength of insurance enterprises. NLIC has been rated "A (Excellent)" by A.M. Best, which is the third highest of sixteen rating levels. ASIC has been rated "A- (Excellent)" by A.M. Best, which is the fourth highest.

Each of NLIC's and ASIC's financial strength rating is subject to periodic review by, and may remain the same, be revised downward or upward or be revoked at the sole discretion of, A.M. Best. A decline in either NLIC's or ASIC's rating or an announced negative outlook on the rating can cause concern about their viability among agents, brokers and policyholders, resulting in a movement of business away from NLASCO and its insurance company subsidiaries to more highly-rated carriers. In addition, the errors and omissions insurance coverage of many of NLASCO's independent agents does not provide coverage if the covered agents sell policies from insurers with an A.M. Best financial strength rating of "B+ (Very Good)" or below. As a result, the loss of NLIC's or ASIC's A.M. Best financial strength rating, or a reduction to "B+ (Very Good)" or worse, may adversely impact NLASCO's ability to retain or expand its policyholder base. Periodically, A.M. Best changes its rating methodology and practices. Any change to the methodologies and practices could result in a reduction of NLIC's or ASIC's A.M. Best rating.

The failure of any of the loss limitation methods NLASCO employs could have a material adverse effect on its financial condition and results of operations.

At the present time, NLASCO employs a variety of endorsements to its policies that limit its exposure to known risks, such as exclusions for mold losses and water damage. NLASCO's policies also are not designed to provide coverage for claims related to exposure to potentially harmful products or substances, including, among others, lead paint and silica. NLASCO's homeowners' policies, other than policies specifically written for flood coverage, specifically exclude coverage for losses caused by flood, but generally provide coverage for damage caused by wind. In addition, NLASCO's policies contain conditions requiring the prompt reporting of claims and its right to decline coverage due to late claim reporting. NLASCO's policies also include limitations restricting the period during which a policyholder may bring a breach of contract or other claim against it, which in many cases is shorter than the applicable statutory limitations for such claims. It is possible that a court or regulatory authority could nullify or void, or legislation could be enacted modifying or barring, the use of endorsements and limitations in a way that would adversely affect NLASCO's loss experience, which could have a material adverse effect on its financial condition and results of operations.

The effects of emerging claim and coverage issues on NLASCO's business are uncertain.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect NLASCO's business by either extending coverage beyond its underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until long after NLASCO has issued insurance policies that are affected by the changes. As a result, the full extent of liability under NLASCO's insurance policies may not be known until after a contract is issued. Changes in other legal theories of liability under NLASCO's insurance policies or the failure of

any loss limitation it applies also could adversely impact NLASCO's financial condition and results of operations.

Because NLASCO's main source of premiums written is in Texas, unfavorable changes in the economic or regulatory environment in that state may have a material adverse effect on its financial condition and results of operations.

Texas accounted for approximately 75% and 74% of NLASCO's direct premiums written in 2009 and 2008, respectively. The Texas legislature, in its 2011 legislative session, is reviewing insurance regulation, which will likely result in changes to those regulations. The loss of a significant amount of NLASCO's premiums written in Texas, whether due to an economic downturn, competitive changes, regulatory or legislative developments or other reasons, could have a material adverse effect on its financial condition and results of operations.

If NLASCO is unsuccessful in competing against other competitors in the insurance industry, its financial condition and results of operations could be adversely affected.

The insurance industry is highly competitive and has, historically, been characterized by periods of significant price competition, alternating with periods of greater pricing discipline during which competitors focus on other factors. In the current market environment, competition in NLASCO's industry is based primarily on the following:

- products offered;
- service;
- experience;
- the strength of agent and policyholder relationships;
- reputation;
- speed and accuracy of claims payment;
- perceived financial strength;
- ratings;
- scope of business;
- commissions paid; and
- policy and contract terms and conditions.

NLASCO competes with many other insurers, including large national companies who have greater financial, marketing and management resources than NLASCO. Many of these competitors also have better ratings and market recognition than NLASCO. NLASCO seeks to distinguish itself from its competitors by providing a broad product line and targeting those market segments that provide the best opportunity to earn an underwriting profit.

NLASCO also faces competition from entities that self-insure, primarily in the commercial insurance market. From time to time, established and potential customers may examine the benefits and risks of self-insurance and other alternatives to traditional insurance.

In addition, a number of new, proposed or potential industry developments also could increase competition in NLASCO's industry. These developments include, but are not necessarily limited to, changes in practices and other effects caused by the Internet (including direct marketing campaigns by NLASCO's competitors in established and new geographic markets), which have led to greater

competition in the insurance business and increased expectations for customer service. These developments could prevent NLASCO from expanding its book of business.

NLASCO also faces competition from new entrants into the insurance market. New entrants do not have historic claims or losses to address and, therefore, may be able to price policies on a basis that is not favorable to NLASCO. New competition could reduce the demand for NLASCO's insurance products, which could have a material adverse effect on its financial condition and results of operations.

The debt agreements of NLASCO and its controlled affiliates contain financial covenants and impose restrictions on its business.

The indenture governing NLASCO's LIBOR plus 3.40% notes due 2035 contains restrictions on its ability to, among other things, declare and pay dividends and merge or consolidate. In addition, this indenture contains a change of control provision, which provides that (i) if a person or group becomes the beneficial owner, directly or indirectly, of 50% or more of NLASCO's equity securities and (ii) if NLASCO's ratings are downgraded by a nationally recognized statistical rating organization (as defined in the Securities Exchange Act of 1934), then each holder of the notes governed by such indenture has the right to require that NLASCO purchase such holder's notes, in whole or in part, at a price equal to 107.5% of the outstanding principal amount at any time prior to March 10, 2010, and at 100% of the outstanding principal amount thereafter.

NLIC's surplus indentures governing its LIBOR plus 4.10% notes due 2033 and ASIC's surplus indenture governing its LIBOR plus 4.05% notes due 2034 contain restrictions on dividends and mergers and consolidations. In addition, NLASCO has other credit arrangements with its affiliates and other third-parties.

NLASCO's ability to comply with these covenants may be affected by events beyond its control, including prevailing economic, financial and industry conditions. The breach of any of these restrictions could result in a default under the loan agreements or indentures governing the notes or under its other debt agreements. An event of default under its debt agreements would permit some of its lenders to declare all amounts borrowed from them to be due and payable, together with accrued and unpaid interest. If NLASCO were unable to repay debt to its secured lenders, these lenders could proceed against the collateral securing that debt. In addition, acceleration of its other indebtedness may cause NLASCO to be unable to make interest payments on the notes.

Other agreements that NLASCO or its insurance company subsidiaries may enter into in the future may contain covenants imposing significant restrictions on their respective businesses that are similar to, or in addition to, the covenants under their respective existing agreements. These restrictions may affect NLASCO's ability to operate its business and may limit its ability to take advantage of potential business opportunities as they arise.

The regulatory system under which NLIC and ASIC operate, and potential changes to that system, could have a material adverse effect on their respective business activities.

NLIC and ASIC are subject to comprehensive regulation and supervision in those states in which they are domiciled and write insurance policies. Though NLIC and ASIC currently write most of their policies in Texas, Arizona, Tennessee, Oklahoma and Louisiana, NLIC is licensed in 21 states and ASIC is licensed in 34 states. Laws and regulations pertaining to NLIC and ASIC are generally administered by state insurance departments and relate to, among other things:

- standards of solvency, including risk-based capital measurements;
- restrictions on the nature, quality and concentration of investments;
- required methods of accounting;

- rate and policy form regulation and other market conduct; and
- potential assessments for the provision of funds necessary for covered claims under certain policies provided by impaired, insolvent or failed insurance companies.

These state insurance departments also conduct periodic examinations of insurance companies and require the filing of annual and other reports relating to financial condition, holding company issues and other matters. Current or future regulatory requirements may adversely affect or inhibit each of the insurance company's ability to achieve some or all of its business objectives.

NLIC and ASIC may not be able to obtain or maintain necessary licenses, permits, authorizations or accreditations in states where they are currently licensed or in new states they intend to enter, or they may be able to do so only at a significant cost. In addition, they may not be able to comply fully with, or obtain appropriate exemptions from, the wide variety of laws and regulations applicable to insurance companies and insurance holding companies, which could result in restrictions on their operating flexibility and could subject them to fines and other sanctions that may have a material adverse effect on their business.

Significant changes in the political and regulatory climate could result in changes in applicable laws and regulations and could make it more expensive or less profitable to manage their business. In recent years, the United States insurance regulatory framework has come under increased federal scrutiny, and some state legislators have considered, or enacted, laws that may alter or increase state regulation of insurance and reinsurance companies and holding companies. Moreover, the National Association of Insurance Commissioners, or NAIC, and state insurance regulators regularly reexamine existing laws and regulations and develop new laws. For instance, the Texas legislature, in its 2011 legislative session, is reviewing insurance regulation, which will likely result in changes to those regulations. Changes in laws and regulations, or their interpretation, could have a material adverse effect on the insurance companies' financial condition and results of operations.

The activities of the insurance companies' MGAs are subject to licensing requirements and regulation under the laws of the states in which they operate. The insurance companies' MGAs' businesses depend on the validity of, and continued good standing under, the licenses and approvals pursuant to which they operate, as well as compliance with pertinent laws and regulations.

Company licensing laws and regulations vary from jurisdiction to jurisdiction. In all jurisdictions, the applicable company licensing laws and regulations are subject to amendment or interpretation by regulatory authorities. Generally, these authorities are vested with relatively broad discretion to grant, renew and revoke licenses and approvals for various reasons, including the violation of law and conviction of crimes. Other sanctions may include the suspension of individual employees, limitations on engaging in a particular business for specified periods of time, revocation of licenses, censures, redress to policyholders and fines. Although NLASCO and its insurance subsidiaries endeavor to follow practices based on good faith interpretations of laws and regulations, or those generally followed by the industry, these practices may prove to be different from those that the regulatory authorities require.

If the states in which NLIC and ASIC write insurance drastically increase the assessments that insurance companies are required to pay, NLASCO's and their financial condition and results of operations will suffer.

NLIC and ASIC are subject to a variety of taxes, fines, levies, license fees, tariffs and other assessments that may, from time to time, be material. These assessments are made by the states in which NLIC and ASIC operate and include participation in residual market or involuntary risk plans in various states that provide insurance coverage to individuals or entities that otherwise are unable to purchase such coverage from private insurers. Due to this participation, NLIC and ASIC may be exposed to material losses. They also are subject to assessments in the states in which they write insurance for various purposes, including the provision of funds necessary to fund the operations of

various insurance guaranty associations, which pay covered claims under certain policies issued by impaired, insolvent or failed insurance companies. These assessments are generally set based on an insurer's percentage of the total premiums written in the relevant state within a particular line of business for the relevant time period. For the year ended December 31, 2009, NLASCO paid no assessments. For the year ended December 31, 2008, NLIC and ASIC, collectively, paid $1.3 million in assessments related to Hurricanes Dolly and Ike. If NLIC's and ASIC's total premiums written grow, NLASCO's share of any assessments may increase. NLASCO, however, cannot predict with certainty the amount of future assessments, because these assessments depend on factors outside NLASCO's control, such as the insolvencies of other insurance companies, the market shares of other insurance companies writing in a particular state and the degree to which other companies write in coastal areas.

NLASCO is subject to assessments from the Georgia Underwriting Association, Louisiana Citizens Property Insurance Corporation, or LCPIC, Mississippi Windstorm Underwriting Association, or MWUA, the Texas FAIR Plan Association and the Texas Windstorm Insurance Association, or TWIA.

LCPIC, MWUA and TWIA have estimated plan losses due to losses incurred from the hurricanes that struck Louisiana and Texas in the third quarter of 2005, and are thereby able to levy regular and emergency assessments to participating companies and policyholders, respectively. NLASCO does not expect that these assessments will have a net financial statement impact, as all these assessments are recoverable (subject to treaty limits) under its reinsurance treaties. Further, NLASCO may be able to recoup a regular assessment through a surcharge to policyholders. These recoupments will be refunded to reinsurers as the related premiums are written and collected. NLASCO is required to collect emergency assessments directly from residential property policyholders and remit them to LCPIC as they are collected.

NLASCO continues to monitor developments with respect to various state facilities, such as the Georgia Underwriting Association, LCPIC, MWUA, the Texas FAIR Plan Association and the TWIA. The ultimate impact of Hurricanes Katrina, Rita, Dolly and Ike on these facilities is currently uncertain, but could result in the facilities recognizing a financial deficit different than the level currently estimated. They may, in turn, have the ability to assess participating insurers when financial deficits occur. NLASCO will not, however, incur any net expense or loss from any of these assessments due to reinsurance recoveries.

NLASCO may be subject to high retaliatory taxes in several states as a result of its multistate operations, which could have a material adverse impact on its financial condition and results of operations.

Nearly all states impose a retaliatory tax on insurers operating in their state that are domiciled in another state. Retaliatory taxes are based on the principle that if the aggregate taxes, fees and obligations imposed by an insurer's domiciliary state are greater than the aggregate taxes, fees and obligations imposed by the taxing state, then the difference is payable to the taxing state as a retaliatory tax. For example, the State of Texas imposes various premium-based taxes that, in the aggregate, total approximately 2.0% of gross written premiums in Texas. The State of Illinois imposes various premium-based taxes that, in the aggregate, total approximately 0.5% of gross written premiums in Illinois. The Illinois retaliatory tax provisions would require a Texas-domiciled insurer operating in Illinois to pay the 0.5% aggregate Illinois taxes plus a 1.5% incremental amount, which represents the difference between the Texas effective rate and the Illinois effective rate. Thus, a Texas-domiciled insurer would pay a 2.0% effective tax in Illinois, while an Illinois-domiciled insurer would only pay a 0.5% effective tax. Insurance companies with multistate operations, like NLASCO, may find themselves subject to high retaliatory taxes in several states, which could have a material adverse impact on NLASCO's financial condition and results of operations.

NLASCO's ability to meet ongoing cash requirements and pay dividends may be limited by its holding company structure and regulatory constraints.

NLASCO operates as a holding company. Dividends and other permitted payments from its operating subsidiaries are expected to be its primary source of funds to meet ongoing cash requirements, including any future debt service payments and other expenses, and to pay dividends, if any, to Hilltop. NLIC and ASIC are subject to significant regulatory restrictions and limitations under debt agreements limiting their ability to declare and pay dividends, which could, in turn, limit NLASCO's ability to meet its ongoing cash requirements, including any future debt service payments and other expenses, or to pay dividends.

Current legal and regulatory activities, investigations, litigation proceedings or other activities relating to the insurance industry could affect NLASCO's business, financial condition and results of operations.

The insurance industry has experienced share price volatility as a result of litigation, investigations and regulatory activity by various insurance, governmental and enforcement authorities concerning certain practices within the insurance industry. NLASCO is unable to predict the potential effects, if any, that these investigations may have upon the insurance markets and industry business practices in general or what, if any, changes may be made to laws and regulations regarding the industry and financial reporting. Any of the foregoing could materially and adversely affect its business, financial condition and results of operations.

NLIC and ASIC are subject to periodic financial and market conduct examinations by state insurance departments. If these examinations identify significant findings or recommend significant changes to its operations, either insurance company could lose its licenses or its financial condition and results of operations could be affected.

The insurance departments in every state in which NLASCO's insurance companies do business may conduct on-site visits and examinations at any time and generally for any purpose, including the review of NLASCO's insurance companies' financial condition, market conduct and relationships and transactions with affiliates. In addition, the Texas Department of Insurance will conduct comprehensive examinations of NLASCO's insurance companies every three to five years. NLIC's last regulatory exam was a full scope financial examination by the Texas Department of Insurance covering the period from January 1, 2002 through December 31, 2006, including material transactions and/or events occurring after December 31, 2006. ASIC's last regulatory exam was a full scope financial examination by the Texas Department of Insurance covering the period from January 1, 2004 through December 31, 2006, including certain material transactions and/or events occurring after December 31, 2006. Neither examination resulted in any significant regulatory compliance issues being raised by the Texas Department of Insurance. NLASCO and its insurance subsidiaries, however, have paid fines related to market conduct examinations by various states. Fines incurred in the last three years did not have a material impact on its financial condition or results of operations.

While there were no material adverse findings or recommended changes to NLASCO's or its insurance company subsidiaries' operations identified in the recently completed financial examinations conducted by the departments of insurance, there can be no assurance that there will not be adverse findings or recommended changes identified by these or other state insurance departments in the future. In addition, significant adverse findings could lead to a revocation of NLASCO's or its insurance company subsidiaries' licenses. Any adverse findings or recommended changes resulting from such financial examinations, or from any future examinations, could have a material adverse effect on NLASCO's or its insurance company subsidiaries' financial condition and results of operations.

Departure of key personnel would deprive us of the institutional knowledge, expertise and leadership they provide.

Operating an insurance company is complex. The insurance industry is highly competitive and has historically been characterized by periods of significant price competition, alternating with periods of greater pricing discipline during which competitors focus on other factors. In addition, insurance companies are subject to comprehensive regulation and supervision in those states in which they write insurance policies and in which they are domiciled. Significant changes in the political and regulatory climate could result in changes in these laws and regulations and could make it more expensive or less profitable for us to manage an insurance company. The loss of key personnel may result in us encountering difficulties in operating an insurance company and complying with regulatory requirements applicable to insurance companies.

NLASCO is in the process of implementing a new information technology system that could cause substantial business interruption.

We are in the process of designing and implementing a new information technology system and are investing significant financial and personnel resources into this project. There is no assurance, however, that the design will meet our current and future business needs or that it will operate as designed. We are heavily dependent on computer systems, and any significant failure or delay in the system implementation, if encountered, would cause a substantial interruption to our business and additional expense that could result in an adverse impact on our operating results, cash flows and financial condition.

Failures in NLASCO's current electronic underwriting system could adversely affect its financial condition and results of operations.

NLASCO's Internet-based Policy Agency Claim System, or PACS, was primarily developed in-house. PACS is fully integrated and is able to process quotes, policy issuance, billings, payments and claims. The system is designed for ease of use by agents and employees. PACS has been an integral part of NLASCO's success. Almost all applications are submitted online. Problems or errors of which NLASCO is not currently aware may have occurred in connection with the installation, upgrading or maintenance of this system or any of its other systems or may result from a major physical disaster or other calamity that causes damage to NLASCO's systems generally. A loss of PACS or any of NLASCO's other systems for a sustained period of time could have an adverse impact on its financial condition and results of operations.

Failure to develop an adequate knowledge transfer or a succession plan for NLASCO's information technology personnel could adversely affect its financial condition and results of operations.

The success of PACS and NLASCO's new and other systems depend heavily on the incumbent information technology team that developed or implemented the system. A loss of key members of this team without adequate knowledge transfer or a succession plan could disrupt NLASCO's operations and adversely affect its results of operations.

Claims by third-parties that NLASCO infringes their proprietary technology could adversely affect NLASCO's financial condition and results of operations.

If NLASCO discovers that any of its products or technology that it licenses from third-parties violates third-party proprietary rights, NLASCO may not be able to reengineer its products or obtain a license on commercially reasonable terms to continue using the products or technology without substantial reengineering, or to otherwise modify programs. In addition, product and technology development is inherently uncertain in a rapidly evolving technology environment in which there may

be numerous patent applications pending for similar technologies, many of which are confidential when filed. In addition, much of the software used by NLASCO may be used subject to a licensing agreement, and NLASCO's failure to comply with the terms for usage under any such licensing agreement could subject it to claims that could adversely impact its business. Although NLASCO sometimes may be indemnified by third-parties against claims that licensed third-party technology infringes proprietary rights of others, this indemnity may be limited, unavailable or, where the third party lacks sufficient assets or insurance, ineffective. NLASCO currently does not have liability insurance to protect against the risk that its technology or future licensed third-party technology infringes the proprietary rights of others. Any claim of infringement, even if invalid, could cause NLASCO to incur substantial costs defending against the claim and could distract its management from the business. Furthermore, a party making such a claim could secure a judgment that requires NLASCO to pay substantial damages. A judgment also could include an injunction or other court order that could prevent NLASCO from using the products and technologies. Any of these events could have a material adverse effect on NLASCO's business, operating results and financial condition.

Acquisitions could result in operating difficulties and other harmful consequences.

From time to time, NLASCO may engage in discussions regarding potential acquisitions, including potential acquisitions that could be material to its financial condition and results of operations. NLASCO may acquire whole businesses or books of business that fit its underwriting competencies from insurance companies, MGAs and other agents. In addition, NLASCO may expand its business, product offerings and policyholder base by acquiring businesses in areas in which NLASCO has limited operating experience. The process of integrating an acquired company or book of business may create unforeseen operating difficulties and expenditures. In particular:

- NLASCO has achieved its prior success by applying a disciplined approach to underwriting and pricing in select markets that are not well served by its competitors. NLASCO may not be able to successfully implement its underwriting, claims management, pricing and product strategies in companies or books of business it acquires;
- NLASCO may not be able to retain the agents associated with acquired businesses and, as a result, may fail to realize the anticipated potential benefits of the acquisition;
- NLASCO could be required to implement or remediate controls, procedures and policies for an acquired privately-held company that prior to acquisition may not have been required;
- An acquisition could present cultural challenges associated with integrating employees from the acquired company into the organization, which could result in a loss of employees from the businesses NLASCO acquires and other adverse consequences;
- NLASCO's management may have to divert its time and energy from operating the business to integration challenges;
- NLASCO could have no prior experience operating the type of business that it acquires, which could create difficulties and result in NLASCO failing to realize many of the anticipated potential benefits of the acquisition; and
- An acquisition could dilute NLASCO's book value per share or after-tax return on average equity.

The anticipated benefits of any acquisition may not materialize. Future acquisitions could result in the incurrence of debt or an assumption of inadequate liabilities for losses and loss adjusted expenses or claims management structures, any of which could harm NLASCO's financial condition. Future acquisitions may require NLASCO to obtain additional financing, which may not be available on favorable terms or at all.

Risks Related to the Securities Markets and Ownership of Our Common Stock

Our charter and insurance laws contain provisions that could discourage acquisition bids or merger proposals, which may adversely affect the market price of our common stock.

Ownership Limit. In order to reduce the risk of an ownership change in the future, our charter restricts certain acquisitions of our securities in order to preserve the benefit of our NOLs. The charter generally prohibits any direct or indirect sale, transfer, assignment, conveyance, pledge or other disposition of our shares of stock or warrants, rights or options to purchase our stock or any other interests that would be treated as our stock under the income tax regulations promulgated under the Internal Revenue Code of 1986, as amended, if as a result of such sale, transfer, assignment, conveyance, pledge or other disposition any person or group would beneficially own five percent or more of the market value of the total outstanding shares of our common stock or the percentage of our common stock owned by a five percent or greater stockholder would be increased. Beneficial ownership is determined utilizing Treasury Regulation Section 1.382-2T(g). The transfer restrictions were implemented in January 2007, and we expect that the restrictions will remain in force as long as the NOLs are available. We cannot assure you, however, that these restrictions will prevent an ownership change. If any of our stockholders increase their beneficial ownership percentage in our common stock through future acquisitions, there is an increased possibility that the provisions under the charter may be triggered. Any attempted transfer of shares in violation of the charter prohibitions will be void, and the intended transferee will not acquire any right in those shares. We have the right to take any lawful action that we believe is necessary or advisable to ensure compliance with these ownership and transfer restrictions and to preserve our NOLs, including refusing to recognize any transfer of stock in violation of our charter. These ownership and transfer restrictions of our charter may have the effect of discouraging or preventing a third party from attempting to gain control of us without the approval of our board of directors. Accordingly, it is less likely that a change in control, even if beneficial to stockholders, could be effected without the approval of our board of directors.

Authority to Issue Additional Shares. Under our charter, our board of directors may issue up to an aggregate of ten million shares of preferred stock without stockholder action. The preferred stock may be issued, in one or more series, with the preferences and other terms designated by our board of directors that may delay or prevent a change in control of us, even if the change is in the best interests of stockholders. As of December 31, 2009, we had outstanding five million shares of our 8.25% Series A cumulative redeemable preferred stock.

Insurance Laws. NLIC and ASIC are domiciled in the State of Texas. Before a person can acquire control of an insurance company domiciled in Texas, prior written approval must be obtained from the Texas Department of Insurance. Acquisition of control would be presumed on the acquisition, directly or indirectly, of ten percent or more of Hilltop's outstanding voting stock, unless the regulators determine otherwise. Prior to granting approval of an application to acquire control of a domestic insurer, the Texas Department of Insurance will consider several factors, such as:

- the financial strength of the acquirer;
- the integrity and management experience of the acquirer's board of directors and executive officers;
- the acquirer's plans for the management of the insurer;
- the acquirer's plans to declare dividends, sell assets or incur debt;
- the acquirer's plans for the future operations of the domestic insurer;
- the impact of the acquisition on continued licensure of the domestic insurer;
- the impact on the interests of Texas policyholders; and

- any anti-competitive results that may arise from the consummation of the acquisition of control.

These laws may discourage potential acquisition proposals of Hilltop and may delay, deter or prevent a change of control of Hilltop, including transactions that some or all of our stockholders might consider desirable.

Future issuances of shares of common stock may adversely affect the price of our common stock.

The future issuance of a substantial number of shares of common stock into the public market, or the perception that such issuance could occur, could adversely affect the prevailing market price of our common stock. A decline in the price of our common stock could make it more difficult to raise funds through future offerings of our common stock or securities convertible into common stock.

Our common stock price may experience substantial volatility, which may affect your ability to sell our common stock at an advantageous price.

Price volatility of our common stock may affect your ability to sell our common stock at an advantageous price. Market price fluctuations in our common stock may be due to acquisitions, dispositions or other material public announcements, including those regarding dividends or changes in management, along with a variety of additional factors, including, without limitation, other risks identified in "Forward-looking Statements" and these "Risk Factors." In addition, the stock markets in general, including the NYSE, have experienced extreme price and trading fluctuations. These fluctuations have resulted in volatility in the market prices of securities that often have been unrelated or disproportionate to changes in operating performance. These broad market fluctuations may adversely affect the market price of our common stock.

Our rights and the rights of our stockholders to take action against our directors and officers are limited.

We are organized under Maryland law, which provides that a director or officer has no liability in that capacity if he or she performs his or her duties in good faith, in a manner he or she reasonably believes to be in our best interests and with the care that an ordinarily prudent person in a like position would use under similar circumstances. In addition, our charter eliminates our directors' and officers' liability to us and our stockholders for money damages, except for liability resulting from actual receipt of an improper benefit or profit in money, property or services or active and deliberate dishonesty established by a final judgment and that is material to the cause of action. Our bylaws require us to indemnify our directors and officers for liability resulting from actions taken by them in those capacities to the maximum extent permitted by Maryland law. As a result, our stockholders and we may have more limited rights against our directors and officers than might otherwise exist under common law. In addition, we may be obligated to fund the defense costs incurred by our directors and officers.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Not applicable.

ITEM 3. LEGAL PROCEEDINGS

We are a party to various legal actions resulting from our operating activities. These actions consist of litigation and administrative proceedings arising in the ordinary course of business, some of which are covered by liability insurance, and none of which is expected to have a material adverse effect on our consolidated financial condition, results of operations or cash flows taken as a whole.

ITEM 4. RESERVED

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Securities, Stockholder and Dividend Information

Our common stock is listed on the New York Stock Exchange under the symbol "HTH". Our common stock has no public trading history prior to February 12, 2004. The initial public offering price of our common stock on February 12, 2004 was $19.00 per share. Our common stock closed at $12.28 on March 10, 2010. As of March 10, 2010, there were 56,488,488 shares of our common stock outstanding with approximately 188 stockholders of record.

Our 8.25% Series A Cumulative Redeemable Preferred Stock is listed on the New York Stock Exchange under the symbol "HTHPRA". Our Series A preferred stock has no public trading history prior to February 12, 2004. Our Series A preferred stock closed at $25.20 on March 10, 2010. At our IPO, the Company issued 5,000,000 shares of Series A preferred stock at an initial public offering price of $25.00 per share. The Series A Preferred Stock has a liquidation preference of $25.00 per share, plus all accumulated, accrued and unpaid dividends. As of March 10, 2010, there were 5,000,000 shares of our Series A preferred stock outstanding with one stockholder of record.

We have not paid, and do not intend to pay in the foreseeable future, cash dividends on our common stock. Any declaration of dividends on our common stock will be at the discretion of our Board of Directors and will depend on the earnings, financial condition, capital requirements, contractual restrictions with respect to payment of dividends and other factors. The payment of dividends from our insurance subsidiaries is subject to significant regulatory restrictions and limitations under debt agreements limiting their ability to declare and pay dividends. See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Restrictions on Dividends and Distributions."

The following table sets forth the cash dividends declared and paid in 2009 and 2008 with respect to our Series A Preferred Stock:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Series A Preferred Stock				
2009				
Date of declaration	March 16, 2009	July 6, 2009	September 15, 2009	December 10, 2009
Date of record	April 15, 2009	July 15, 2009	October 15, 2009	January 15, 2010
Date paid	April 30, 2009	July 30, 2009	October 30, 2009	January 29, 2010
Distribution per unit	$ 0.5156	$ 0.5156	$ 0.5156	$ 0.5156
Total dollars (in thousands)	$ 2,578	$ 2,578	$ 2,578	$ 2,579
2008				
Date of declaration	April 9, 2008	June 12, 2008	September 30, 2008	December 22, 2008
Date of record	April 15, 2008	July 15, 2008	October 15, 2008	January 15, 2009
Date paid	April 30, 2008	July 30, 2008	October 30, 2008	January 30, 2009
Distribution per unit	$ 0.5156	$ 0.5156	$ 0.5156	$ 0.5156
Total dollars (in thousands)	$ 2,578	$ 2,578	$ 2,578	$ 2,579

As of December 31, 2009, we had accrued $1.7 million of the preferred stock dividend, representing the portion of the dividend earned by preferred shareholders but unpaid through that date.

The following table discloses the high and low sales prices per quarter for our common and preferred stock during 2009 and 2008:

	Common Stock		Series A Preferred Stock	
	High	Low	High	Low
December 31, 2009				
First Quarter	$ 11.95	$ 8.93	$ 21.25	$ 16.20
Second Quarter	$ 12.53	$ 10.87	$ 23.59	$ 17.39
Third Quarter	$ 12.98	$ 11.20	$ 24.46	$ 22.50
Fourth Quarter	$ 12.95	$ 11.25	$ 25.84	$ 23.25
	High	Low	High	Low
December 31, 2008				
First Quarter	$ 11.09	$ 9.97	$ 23.02	$ 19.21
Second Quarter	$ 11.10	$ 9.57	$ 21.25	$ 18.70
Third Quarter	$ 11.63	$ 9.80	$ 21.08	$ 16.10
Fourth Quarter	$ 11.25	$ 7.74	$ 19.43	$ 12.86

As of December 31, 2009, we had 515 warrants outstanding with an exercise price of $15.60 per share.

Issuances of Unregistered Securities

All issuances of unregistered securities have previously been reported.

Equity Compensation Plan Information

The following table sets forth as of December 31, 2009, information concerning our equity compensation plans, including the number of shares issuable and available for issuances under our plans, options, warrants and rights; weighted average exercise price of outstanding options, warrants and rights; and the number of securities remaining available for future issuance.

	Equity Compensation Plan Information		
Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column)
Equity compensation plans approved by security holders*	100,000	$ 12.06	1,039,412
Equity compensation plans not approved by security holders	—	—	—
Total	100,000	$ 12.06	1,039,412

* Excludes shares of restricted stock granted, as all of these shares are vested. No exercise price is required to be paid upon the vesting of the restricted shared of common stock granted. These shares are issuable under our 2003 equity incentive plan, which provides for the grant of equity-based incentives, including restricted shares of our common stock, stock options, grants of shares and other equity-based awards, to our directors, officers and other employees and those of our subsidiaries selected by our Compensation Committee for participation in the plan. At inception, 1,992,387 shares were authorized for grant pursuant to this plan. All shares outstanding, whether vested or unvested, are entitled to receive dividends and to vote, unless forfeited. No participant in our 2003 equity incentive plan may be granted awards in any fiscal year covering more than 500,000 shares of our common stock.

ITEM 6. SELECTED FINANCIAL AND OPERATING DATA

Our historical consolidated balance sheet data as of December 31, 2009 and 2008 and our consolidated statement of operations data for the years ended December 31, 2009, 2008 and 2007 have been derived from our audited historical financial statements included elsewhere in this Form 10-K. The following table shows our selected historical financial data for the periods indicated (in thousands, except per share data). You should read our selected historical financial data, together with the notes thereto, in conjunction with the more detailed information contained in our financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this Form 10-K.

	Year Ended December 31,					
	2009	2008	2007	2006	2005	2004
Income Statement Data:						
Direct premium written	$ 131,309	$ 132,642	$ 122,708	$ —	$ —	$ —
Net premium written	114,743	113,285	118,357	—	—	—
Net premium earned	115,153	115,247	96,804	—	—	—
Net investment income	6,458	27,143	24,829	2,133	2,266	1,611
Net realized (loss) gain	307	(45,992)	3,205	—	—	—
Other income, net	6,917	6,147	6,445	—	—	—
Total revenue	128,835	102,545	131,283	2,133	2,266	1,611
Net loss and loss adjustment expense	70,295	80,435	52,074	—	—	—
Policy acquisition and other expense	52,333	53,726	42,397	7,477	10,996	16,105
Interest expense	9,668	10,528	11,539	7,436	2,814	—
Total expenses	132,296	144,689	106,010	14,913	13,810	16,105
(Loss) Income from continuing operations before federal income tax expense	(3,461)	(42,144)	25,273	(12,780)	(11,544)	(14,494)
Federal income taxes benefit (expense) for continuing operations	1,349	19,559	(10,635)	—	—	—
Net (loss) income from continuing operations before allocation of non-controlling interest	$ (2,112)	$ (22,585)	$ 14,638	$ (12,780)	$ (11,544)	$ (14,494)
Selected Balance Sheet Data:						
Total investments	129,968	138,568	191,024	—	—	—
Total assets	1,040,752	1,048,770	1,085,491	1,542,701	1,728,481	1,813,002
Total liabilities	256,975	257,315	261,306	1,095,323	1,252,484	1,097,296
Stockholders' equity	783,777	791,455	824,185	419,236	444,095	659,047
Other Data:						
Net loss and LAE ratio	61.0%	69.8%	53.8%	n/a	n/a	n/a
Expense ratio	35.7%	35.6%	29.2%	n/a	n/a	n/a
GAAP Combined ratio	96.8%	105.4%	83.0%	n/a	n/a	n/a
Statutory surplus	$ 117,063	$ 108,478	$ 124,892	n/a	n/a	n/a
Statutory premiums to surplus ratio	98.0%	104.4%	94.8%	n/a	n/a	n/a
Per Share Data:						
Basic (loss) earnings per share attributable to common stockholders	$ (0.22)	$ (0.58)	$ 5.10	$ (0.63)	$ (4.50)	$ (2.49)
Diluted (loss) earnings per share attributable to common stockholders	$ (0.22)	$ (0.58)	$ 5.02	$ (0.63)	$ (4.50)	$ (2.49)
Weighted average share information						
Basic shares outstanding	56,474	56,453	55,421	43,681	43,277	37,967
Diluted shares outstanding	56,474	56,453	56,326	43,681	43,277	41,354
Cash dividends declared per share of unit:						
Series A preferred stock dividends	$ 2.06	$ 2.06	$ 2.06	$ 2.06	$ 2.06	$ 1.97
Series B preferred unit distributions	$ —	$ —	$ —	$ —	$ 0.78	$ 0.78
Series C preferred unit distributions	$ —	$ —	$ —	$ 1.56	$ 1.56	$ 0.78
Common stock and OP unit dividends	$ —	$ —	$ —	$ 0.50	$ 0.50	$ 1.09

(1) Series B and Series C preferred unit distributions were redeemed in 2007.

(2) All years have been adjusted to reflect the disposal of our manufactured home community properties and related business, except for NLASCO.

(3) Commencing with the third quarter 2005, we suspended declaration of dividends on our common stock. We have, however, continued to pay the full accrued dividends on our outstanding preferred stock.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated historical financial statements and notes appearing elsewhere in this Form 10-K and the financial information set forth in the tables below. All dollar amounts in the following discussion are in thousands, except per share amounts.

Unless the context otherwise indicates, all references in this Management's Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, to the "Company,""Hilltop," "HTH," "we," "us," "our" or "ours" or similar words are to Hilltop Holdings Inc.(formerly known as Affordable Residential Communities Inc.) and its direct and indirect wholly-owned subsidiaries.

OUR GENERAL STRUCTURE

At December 31, 2009, HTH is a holding company that owns all of the outstanding shares of NLASCO, Inc., or NLASCO. NLASCO, in turn, owns National Lloyds Insurance Company, or NLIC, and American Summit Insurance Company, or ASIC, both of which are licensed property and casualty insurers operating in multiple states. In addition, NLASCO also owns the NALICO GA, a general agency that operates in Texas. NLIC commenced business in 1949 and currently operates in 15 states, with its largest market being the state of Texas. NLIC carries a financial strength rating of "A" (Excellent) by A.M. Best. ASIC was formed in 1955 and currently operates in 12 states, its largest market being the state of Arizona. ASIC carries a financial strength rating of "A-"(Excellent) by A.M. Best. Both of these companies are regulated by the Texas Department of Insurance.

Beginning in 1995, we were founded as several companies under the name "Affordable Residential Communities" or "ARC," now known as Hilltop Holdings Inc., for the purpose of engaging in the business of acquiring, renovating, repositioning and operating manufactured home communities, as well as certain related businesses. In 1998 we formed a Maryland corporation for the purpose of acting as the investment vehicle for, and a co-general partner of, our operating partnership, Affordable Residential Communities LP. In May 2002, we completed a reorganization in which we acquired substantially all the other real property partnerships and other related businesses we had previously organized and operated.

Through the year ended December 31, 2005, we were organized as a fully-integrated, self-administered and self-managed equity real estate investment trust, or REIT, for U.S. Federal income tax purposes. In 2006, we revoked our election as a REIT for U. S. Federal income tax purposes.

In January 2007, we acquired NLASCO. NLASCO was incorporated in Delaware in 2000 but its origins trace back to 1948 through one of its subsidiaries, NLIC. In 1964, C. Clifton Robinson, who is currently the Chairman of NLASCO and a member of our Board of Directors, along with other investors, purchased NLIC and moved its headquarters from San Antonio, Texas to Waco, Texas. Following various acquisitions and dispositions of equity in NLIC by Mr. Robinson and others, including the re-acquisition of NLIC along with the acquisition of ASIC in 2000, Mr. Robinson held 100% of NLASCO and its subsidiaries, NLIC and ASIC, from 2001 until we acquired NLASCO in 2007.

On July 31, 2007, we sold substantially all of the operating assets used in our manufactured home communities business and our retail sales and financing business to American Residential Communities LLC. We received gross proceeds of approximately $890 million in cash, which represents the aggregate purchase price of $1.794 billion, less the indebtedness assumed by the buyer. After giving effect to expenses, taxes and our continued outstanding preferred stock and senior notes, our net cash balance was approximately $550 million. We used a portion of the proceeds from this transaction for general working capital, liquidation of our operating partnership units and to repay certain outstanding

obligations. We intend to make opportunistic acquisitions with certain of the remaining proceeds from this transaction, and, if necessary or appropriate, from additional equity or debt financing sources.

DEVELOPMENTS DURING 2009

We appointed a new President and Chief Executive Officer.

On November 30, 2009, Larry D. Willard, a director and the President and Chief Executive Officer of Hilltop Holdings, Inc., or the Company, announced his retirement effective as of December 31, 2009, to the Board of Directors of the Company. In connection with Mr. Willard's retirement, the Board of Directors of the Company appointed Gerald J. Ford, the Company's Chairman of the Board, as President and Chief Executive Officer effective as of December 31, 2009.

We had an extension to our loan agreement.

On October 27, 2009, NLASCO renewed its line of credit with a financial institution. The line allows for borrowings by NLASCO up to $5.0 million and is secured by substantially all of NLASCO's assets. The line of credit bears interest equal to a base rate, less 0.5% (5.0% at December 31, 2009), which is due quarterly. This line of credit will expire in October 2010. During the year ended December 31, 2009, the principal balance on this note was reduced to zero. As of December 31, 2009, there was no credit balance on the note.

Approvals from financial regulatory authorities.

During 2008 and 2009, in regards to financial institution opportunities, we have received preliminary approval from the Comptroller of Currency, The Office of Thrift Supervision and the Federal Deposit Insurance Corporations to bid on government-assisted financial institution transactions. The approvals from the Comptroller of Currency and The Office of Thrift Supervision expire on May 17, 2010 and November 30, 2010, respectively, and are subject to the satisfaction of certain conditions should we be the successful bidder.

OVERVIEW OF RESULTS

For the year ended December 31, 2009, net loss attributable to common stockholders was $12.4 million, or $0.22 per share, as compared to a net loss attributable to common stockholders of $32.9 million, or $0.58 per share, for the year ended December 31, 2008, and a net income attributable to common stockholders of $282.9 million, or $5.10 per share, for the year ended December 31, 2007.

Our results for 2007 include gains on sales of discontinued operations of $366.9 million. This gain comes from the sale of substantially all of our assets used in the manufactured home communities business and its manufactured home retail sales and financing business. In 2007, we also incurred an $11.1 million loss from discontinued operations. In addition, we have recast the operations of this line of business as discontinued operations in the accompanying consolidated statements of operations for the twelve months ended December 31, 2007, and recorded gains of $366.9 million for the year ended 2007.

Segments

On July 31, 2007, the Company sold the manufactured home communities, retail sales and financing of manufactured home businesses to American Residential Communities LLC and retained ownership of NLASCO. NLASCO operates through its wholly-owned subsidiaries, NLIC and ASIC. Given the homogenous nature of our products, the regulatory environments in which we operate, the nature of our customers and our distribution channels, we now monitor, control and manage our business lines as an integrated entity offering fire and homeowners insurance to low value dwellings

and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States. Accordingly, the segment information previously provided is no longer used by us to monitor our business, as we only have insurance company segment information to disclose.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We have prepared our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, or GAAP, which requires us to make certain estimates and assumptions that affect the recorded amount of assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results may differ from these estimates. We have provided a summary of our significant accounting policies in Note 1 to the accompanying consolidated financial statements as of, and for the year ended, December 31, 2009. We have summarized below those accounting policies that require our most difficult, subjective or complex judgments and that have the most significant impact on our financial condition and results of operations. Our management evaluates these estimates on an ongoing basis. These estimates are based on information currently available to management and on various other assumptions management believes are reasonable.

Discontinued Operations. In accordance with guidance provided in ASC 360, *Plant, Property and Equipment*, we measure our assets of discontinued operations held for sale at the lower of its carrying amount or fair value, less cost to sell at the balance sheet date and re-cast any applicable balances and corresponding liabilities related to the discontinued operations in all comparable periods presented. Depreciation of the assets held for sale, if applicable, is suspended at the date of the determination of discontinuance. Interest and other expenses attributable to the liabilities of the assets of discontinued operations as held for sale continue to be accrued. The results of operations and cash flows of the assets sold and those classified as held for sale are reported as discontinued operations for all periods presented. We recognize any estimated losses on the sales of assets of discontinued operations in the period in which the operations are discontinued and recognize any resulting gains on the sales of assets when realized. A description of the facts and circumstances leading to the expected disposal, the expected manner and timing of that disposal, and, if not separately presented on the face of the balance sheet, the carrying amounts of the major classes of assets and liabilities included as part of the disposal group is disclosed in the notes to the financial statements. We disclose in the ASC 360 and, if applicable, the amounts of revenue and pretax profit or loss reported in discontinued operations.

Losses and Loss Adjustment Expenses. The liability for losses and loss adjustment expenses represents estimates of the ultimate unpaid cost of all losses incurred, including losses for claims that have not yet been reported. Separately for each of NLIC and ASIC and each line of business, our actuaries estimate the liability for unpaid losses and loss adjustment expenses, or LAE, by first estimating ultimate losses and LAE amounts for each year, prior to recognizing the impact of reinsurance. There are several methods that our actuaries utilize to estimate ultimate loss and LAE amounts, including:

- Paid Loss Development Method;
- Reported Loss Development Method;
- Paid Bornhuetter-Ferguson Method; and
- Reported Bornhuetter-Ferguson Method.

Paid and Reported Loss Development Methods. Insured losses for a given year change in value over time as additional information on claims are received, as claim conditions change and as new claims are reported. This process is commonly referred to as "loss development." To project ultimate

losses and LAE, our actuaries examine the paid and reported (paid, plus case) losses and LAE and multiply these values by a loss development factor. The selected loss development factors are based upon a review of the loss development patterns indicated in the companies' historical loss triangles and applicable insurance industry loss development factors.

Paid and Reported Bornhuetter-Ferguson Methods. The Bornhuetter-Ferguson, or BF, Method is a procedure that weights an expected ultimate loss and LAE amount, and the result of the loss development method. This method is useful when loss data is immature or sparse because it is not as sensitive as the loss development method to unusual variations in the paid or reported amounts. The BF method requires an initial estimate of expected ultimate losses and LAE. For each year, the expected ultimate losses and LAE is based on a review of the ultimate loss ratios indicated in the companies' historical data and applicable insurance industry ultimate loss ratios. Each loss development factor, paid or reported, implies a certain percent of the ultimate losses and LAE is still unpaid or unreported. The amounts of unpaid or unreported losses and LAE by year are estimated as the percentage unpaid or unreported, times the expected ultimate loss and LAE amounts. To project ultimate losses and LAE, the actual paid or reported losses and LAE to date are added to the estimated unpaid or unreported amounts.

The results of each actuarial method performed by year are reviewed to select an ultimate loss and LAE amount for each year. In general, more weight is given to the loss development projections for more mature accident periods and more weight is given to the BF methods for less mature accident periods.

The combination of the methodologies described above is used for all lines of business, regardless of whether the line is a short-tailed or long-tailed line of business, though specific parameter selections within the methods vary to reflect the nature of the underlying line of business. ASIC and NLIC specialize in writing fire and extended coverage for low-value dwellings, mobile homes and homeowners, which generally are considered short-tailed coverages. In addition, ASIC and NLIC write a small amount of commercial risks, which are still predominantly property coverages, along with some low-limit liability coverages.

The methodology used by our actuaries is directly dependent upon the unique development characteristics of each line of business. For those lines of business with significant volume (homeowners, special property and commercial multiple peril), the selected loss development factors are derived from the historical development data for that line. For lines of business where the loss volume is small, insurance industry statistics regarding loss development for that line also are considered in selecting the loss development factors.

The estimated unpaid losses and LAE equal the estimated ultimate loss and LAE amounts, described above, less the cumulative paid amounts on known claims for each year. This estimate of unpaid losses and LAE is further segmented into case reserves on known claims and incurred-but-not-reported, or IBNR, reserves. IBNR reserves are calculated by reducing the estimate of unpaid losses and LAE by the case reserve amounts. In the normal course of operations, each case reserve is initially set at a standard amount determined from past payments for that type of loss. Individual case reserves may be adjusted based on information indicating that the loss amount is actually over, or under, the standard amount. Most case reserves are not adjusted until the receipt of documentation concerning the amount to be paid on the loss. This usually occurs within seven days of the reporting of the claim, longer in the case of large scale catastrophic events.

The reserve analysis performed by our actuaries provides preliminary central estimates of the unpaid losses and LAE. At each quarter-end, the results of the reserve analysis are summarized and discussed with our senior management. The senior management group considers many factors in determining the amount of reserves to record for financial statement purposes. These factors include the extent and timing of any recent catastrophic events, historical pattern and volatility of the actuarial

indications, the sensitivity of the actuarial indications to changes in paid and reported loss patterns, the consistency of claims handling processes, the consistency of case reserving practices, changes in our pricing and underwriting, and overall pricing and underwriting trends in the insurance market.

Our recorded reserves reflect our best estimate as of a particular point in time based upon known facts, current law and our judgment. The carried reserve may differ from the actuarial central estimate as the result of our consideration of the factors noted above, as well as other factors impacting claims costs that may not be quantifiable through actuarial analysis. This process results in management's best estimate, which is then recorded as the reserve for unpaid losses and LAE.

The level of loss and LAE reserves we maintain represents our best estimate, as of a particular point in time, of the ultimate cost to settle and administer all claims based on our assessment of facts and circumstances known at that time. Reserves are not an exact calculation of liability, but instead are complex estimates that we derive, generally utilizing a variety of actuarial reserve estimation techniques, with numerous underlying assumptions and expectations about future events, both internal and external, many of which are highly uncertain.

The key assumptions fundamental to the reserving process are often different for various reserve categories and accident years. Some of these assumptions are explicit assumptions that are required of a particular method, but many assumptions are implicit and cannot be precisely quantified. An example of an explicit assumption is the pattern employed in the paid loss development method. However, the assumed pattern is itself based on several implicit assumptions, such as the impact of inflation on medical costs and the rate at which claim professionals close claims. Loss frequency is a measure of the number of claims per unit of insured exposure, and loss severity is a measure of the average size of claims. Each reserve segment has an implicit frequency and severity for each accident year as a result of the various assumptions made. As a result, the effect on reserve estimates of a particular change in assumptions usually cannot be specifically quantified, and changes in these assumptions cannot generally be tracked over time.

In light of the many uncertainties associated with establishing the estimates of ultimate losses and LAE, and making the assumptions necessary to establish recorded reserve levels, we review our reserve estimates on a regular basis and make adjustments in the period that the need for such adjustments is identified. The anticipated future emergence underlying our current estimates continues to reflect the historical patterns, and the selected development patterns have not changed significantly over the past few years.

Reserve estimates are subject to uncertainty from various sources, including, among others, changes in claim reporting patterns, claim settlement patterns, judicial decisions, legislation, economic conditions. In estimating the reserves for unpaid losses and LAE, it is necessary to project future loss and LAE payments. Actual future losses and LAE will not develop exactly as projected and may, in fact, vary significantly from the actuarially indicated projections. Further, these projections make no provision for extraordinary future emergence of new classes of losses or types of losses, which are not sufficiently represented in the companies' historical data or that are not yet quantifiable. Extraordinary future emergence can arise from an unforeseen broadening of coverage instigated by regulatory actions, judicial decisions or similar developments.

The underlying processes of establishing our best estimate of the liability for unpaid losses and LAE require the use of estimates, actuarial judgment and management considerations and, therefore, is an inherently uncertain process. The recorded reserves for the companies' liability for unpaid losses and LAE are estimates based on long term averages. Actual loss experience in any given year may differ from what is suggested by these averages. For some lines of business, the written premium volume is small and actual results are therefore subject to an exceptionally high degree of variability. While the recorded reserves are our best estimate as of a particular point in time, these reserves should be considered central estimates within a wide range of possible outcomes.

In arriving at our best estimate of the unpaid losses and LAE, and based on management discussion with our actuaries, we would consider reasonably likely changes in the key assumptions, such as the underlying loss development pattern or the expected loss ratio, to have an impact on our best estimate by +/- 10%. As of December 31, 2009, this equates to approximately +/- $1.2 million, which represents approximately 0.2% of equity and 9.7% of calendar year 2009 losses.

The following table presents our gross loss and LAE reserve amounts at December 31, 2009 and 2008 for each of NLIC and ASIC by line of business (dollars in thousands):

	For the year ended December 31, 2009					
Company	Homeowners	Special Property	Commercial Multiple Peril	Other Liability	Fidelity & Surety	All Lines
ASIC	$ 1,167	$ 390	$ 87	$ 923	$ —	$ 2,567
NLIC	20,693	8,654	801	1,032	33	31,213
Consolidated	$ 21,860	$ 9,044	$ 888	$ 1,955	$ 33	$ 33,780

	For the year ended December 31, 2008					
Company	Homeowners	Special Property	Commercial Multiple Peril	Other Liability	Fidelity & Surety	All Lines
ASIC	$ 2,043	$ 900	$ 426	$ 744	$ —	$ 4,113
NLIC	14,847	13,465	816	730	52	29,910
Consolidated	$ 16,890	$ 14,365	$ 1,242	$ 1,474	$ 52	$ 34,023

Investment Securities. At December 31, 2009, investment securities consist of U.S. Government, mortgage-backed, corporate debt and equity securities. We classify our fixed maturities in one of three categories: trading, available-for-sale or held-to-maturity. Our equity securities are classified as trading or available-for-sale. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity debt securities are those securities in which we have the ability, and intent, to hold the security until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity debt securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income until realized. Realized gains and losses from the sale of trading and available-for-sale securities are determined on a specific-identification basis.

We regularly review our investment securities to assess whether the security is impaired and if impairment is other-than-temporary. A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether impairment is other-than-temporary, we consider whether we are more likely than not to hold an investment until a market price recovery and consider whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to period end, and forecasted performance of the investee.

Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective-interest method. Dividend and interest income are recognized when earned.

Deferred Acquisition Costs. Costs of acquiring insurance vary with, and are related to, the production of new and renewal business, primarily consisting of commissions, premium taxes and underwriting expenses. These costs are deferred and amortized over the terms of the policies or reinsurance treaties to which they relate. Proceeds from reinsurance transactions that represent recovery of acquisition costs reduce applicable unamortized acquisition costs in a manner that net acquisition costs are capitalized and charged to expense in proportion to net revenue recognized. Future investment income is considered in determining the recoverability of deferred acquisition costs. The Company regularly reviews the categories of acquisition costs that are deferred and assesses the recoverability of this asset. A premium deficiency, and a corresponding charge to income, is recognized if the sum of the expected loss and loss adjustment expenses, unamortized acquisition costs, and maintenance costs exceed related unearned premiums and anticipated investment income. At December 31, 2009, there was no premium deficiency.

Revenue Recognition. Property and liability premiums are recognized as revenue on a pro rata basis over the policy term. The portion of premiums that will be earned in the future are deferred and reported as unearned premiums. The Company routinely evaluates the premium receivable balance to determine if an allowance for uncollectible accounts is necessary.

Other income consists of premium installment charges, which are recognized when earned, and other miscellaneous income.

Reinsurance. In the normal course of business, NLASCO seeks to reduce losses that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Net premiums earned, losses and LAE and policy acquisition and other underwriting expenses are reported net of the amounts related to reinsurance ceded to other companies. Amounts recoverable from reinsurers related to the portions of the liability for losses and LAE are reported as assets. Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsured policy.

The Company accounts for reinsurance contracts under the provisions of GAAP in accounting and reporting for reinsurance. Reinsurance assumed from other companies, including assumed premiums written and earned and losses and LAE, is accounted for in the same manner as direct insurance written.

Income Taxes. We have been in a taxable loss position since our inception and, as a result, we have substantial net operating loss carry-forwards to offset taxable income and capital gains from the sale of discontinued operations. We have established a tax provision beginning on January 1, 2006. We allocate income taxes between continuing and discontinued operations.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recorded for the estimated future tax effects related to the temporary difference between the tax basis and book basis of assets and liabilities reported in the accompanying consolidated balance sheets. The provision for income tax expense or benefit differs from the amounts of income taxes currently payable because certain items of income and expense included in the consolidated financial statements are recognized in different time periods by taxing authorities.

Effective January 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* or FIN 48, which is now part of ASC 740, specifically 740-10-25, *Recognition*. ASC 740 clarifies the accounting for uncertainty in income taxes recognized in financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 requires that we determine whether the benefits of our tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, we recognize the largest amount of the benefit that is more likely

than not of being sustained in our consolidated financial statements. For tax positions that are not more likely than not of being sustained upon audit, we do not recognize any portion of the benefits in our consolidated financial statements.

The cumulative effect of the adoption of the recognition and measurement provisions resulted in no change to the January 1, 2007 balance of accumulated deficit. Our policy for interest and penalties related to income tax exposures is to recognize interest and penalties as incurred within the provision for income taxes in the consolidated statements of operations.

Deferred tax assets, including net operating loss and tax credit carry forwards, are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that any portion of these tax attributes will not be realized. At December 31, 2007, a valuation allowance of $4.6 million was recorded to reduce deferred tax assets to the amount expected to be recoverable. However, as a result of the allocation of the purchase price for the real estate assets we sold in 2007 by the purchaser, we reallocated $34.1 million of gain recognized to those asset in the quarter ended September 30, 2008, the period in which the purchase price allocation was finalized. This reallocation resulted in a deferred tax benefit of $4.6 million as of December 31, 2008. There is no valuation allowance as of December 31, 2009.

From time to time, management must assess the need to accrue or disclose a possible loss contingency for proposed adjustments from various Federal, state and foreign tax authorities that regularly audit the company in the normal course of business. In making these assessments, management often must analyze complex tax laws of multiple jurisdictions.

Goodwill and Other Indefinite Lived Intangible Assets. Goodwill for HTH represents the excess of the cost over the fair value of the assets of NLASCO. Goodwill is tested annually for impairment and is tested more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value.

The goodwill impairment analysis is a two-step test. The first step (Step #1), used to identify potential impairment involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. The Company has estimated fair values of reporting units based on a market approach using historic, normalized actual and forecast results. Management determined that HTH has two reporting units, which are the Parent (the holding company) and NLASCO (the insurance company).

The second step (Step #2) involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted.

At December 31, 2009, we determined that the estimated fair value of our reporting units exceeded their carrying values and, therefore, we did not perform the second step as described above. Consequently, we determined that no impairment existed with respect to goodwill and intangible assets at December 31, 2009.

RESULTS OF OPERATIONS

Comparison of the Year Ended December 31, 2009 to the Year Ended December 31, 2008

Results of insurance operations. The following table shows the underwriting gain or loss, as well as other revenue and expense items included in the financial results of NLASCO for the year ended December 31, 2009 and 2008 (in thousands). NLASCO's underwriting gain or loss consists of net premiums earned, less loss and LAE and policy acquisition and other underwriting expenses. NLASCO's underwriting performance is one of the most important factors in evaluating the overall results of operations given the fluctuations that can occur in loss and LAE due to weather related events, as well as the uncertainties involved in the process of estimating reserves for losses and LAE. The underwriting results and fluctuations in other revenue and expense items of NLASCO are discussed in greater detail below.

NLASCO Summary of Insurance Operations

	Year Ended December 31,			
	2009	2008	Dollar	Percentage
Underwriting gain (loss)				
Homeowners	$ (4,227)	$ (7,596)	$ 3,369	44.4%
Fire	3,556	(2,324)	5,880	253.0%
Mobile Home	1,155	844	311	36.8%
Commercial	967	220	747	339.5%
Other	209	216	(7)	-3.2%
Total underwriting gain (loss)	$ 1,660	$ (8,640)	$ 10,300	119.2%
Other revenue (expense items)				
Net investment income	6,165	8,255	(2,090)	-25.3%
Net realized gains (losses) on investments	83	(4,035)	4,118	102.1%
Other income	6,917	6,147	770	12.5%
Depreciation and amortization	(1,981)	(2,159)	178	-8.2%
Interest expense	(2,601)	(3,644)	1,043	-28.6%
Total other revenue (expense) items	8,583	4,564	4,019	88.1%
Operating income (loss) before federal income taxes	10,243	(4,076)	14,319	351.3%
Federal income tax expense (benefit) on operating income	3,578	(1,434)	5,012	349.5%
Net income (loss) from continuing operations of NLASCO	$ 6,665	$ (2,642)	$ 9,307	352.3%

Revenue. Revenue for the year ended December 31, 2009 was $128.8 million, compared to $102.5 million in 2008. This increase is due to the realized gains on investments of $0.3 million for year ended 2009, compared to realized investment losses of $46.0 million for the year ended 2008 and $6.5 million of net investment income for the year ended 2009 compared to $27.1 million in 2008 due to having the cash at HTH (parent only) earning no interest. The Investment Committee elected to deposit the cash at HTH (parent only) in non-interest bearing accounts, taking advantage of the Temporary Liquidity Guarantee Program to preserve principal. The $128.8 million in revenue in 2009 is comprised of net premiums earned of $115.2 million, net investment income of $6.5 million, other income of $6.9 million and net realized gains on investments of $0.3 million. The $102.5 million in revenue in 2008 is comprised of net premiums earned of $115.2 million, net investment income of $27.1 million, other income of $6.1 million and net realized losses on investments of $46.0 million.

Underwriting Results. The following table shows the components of NLASCO's underwriting gain for the year ended December 31, 2009 and 2008. NLASCO's underwriting gain or loss consists of net premiums earned, less loss and LAE and policy acquisition and other underwriting expenses. The underwriting results are discussed below (in thousands).

	Year Ended December 31,			
	2009	2008	Dollar	Percentage
Direct premiums written	$ 131,309	$ 132,642	$ (1,333)	-1.0%
Net premiums written	$ 114,743	$ 113,285	$ 1,458	1.3%
Net premiums earned	$ 115,153	$ 115,247	$ (94)	-0.1%
Loss and LAE	70,295	80,435	(10,140)	-12.6%
Policy acquisition and other underwriting expenses	43,198	43,452	(254)	-0.6%
Underwriting gain (loss)	$ 1,660	$ (8,640)	$ 10,300	-119.2%
Agency expenses	$ (2,051)	$ (2,375)	$ 324	-13.6%
Loss and LAE ratio	61.0%	69.8%	8.7%	
Policy acquisition and other underwriting less agency expense ratio	35.7%	35.6%	-0.1%	
Combined ratio	96.8%	105.4%	8.6%	

NLASCO seeks to operate at a combined ratio of no greater than 85.0%. Loss ratios are ratios that express the relationship of losses to premiums. Loss and LAE ratio is loss and LAE expenses divided by net premiums earned for the same period. Policy acquisition and other underwriting expense ratio is policy acquisition and other underwriting expense divided by net premiums earned for the same period. Combined ratio gives you the sum of both previous ratios. Agency expenses are related to our general agent, NALICO GA, and are removed from Total policy acquisition and other underwriting expenses because they have no effect on the expense ratios of the insurance companies. The decrease in loss and LAE ratio in 2009 is due to less severe weather and lower overall loss experience due to no catastrophic events occurring in 2009. The loss and LAE ratio in 2008 is due to the incurred losses related to Hurricane Dolly, Gustav, and Ike of $83.1 million (including loss adjustment expenses and gross incurred but not reported reserves) in catastrophic related losses for the year ended December 31, 2008. For the year ended December 31, 2008, NLASCO's net catastrophic loss experience was $13.0 million after reinsurance.

The industry aggregate for combined ratio for 2008, was 104.7%, which is slightly below the combined ratio for NLIC and ASIC of 105.4% for the same period.

Premiums. The property and casualty insurance industry is affected by soft and hard market business cycles. During a soft market, price competition tends to increase as insurers are willing to reduce premium rates in order to maintain growth in premium volume. The soft market makes it more difficult to attract new business, as well as retain exposures that are adequately priced. Although we recognize the need to remain competitive in the marketplace, the Company remains committed to its disciplined underwriting philosophy, accepting only risks that are appropriately priced, while declining risks which are under priced for the level of coverage provided.

Direct premiums written by major product line for the year ended December 31, 2009 and 2008 are presented in the table below (in thousands):

	Year Ended December 31,			
	2009	2008	Dollar	Percentage
Direct Premiums Written:				
Homeowners	$ 57,356	$ 58,942	$ (1,586)	-2.7%
Fire	46,815	48,014	(1,199)	-2.5%
Mobile Home	20,439	19,483	956	4.9%
Commercial	6,318	5,804	514	8.9%
Other	381	399	(18)	-4.5%
	$ 131,309	$ 132,642	$ (1,333)	-1.0%

Total direct premiums written decreased for the year ended December 31, 2009 for all insurance products except for mobile home and commercial as a result of stronger competition and more challenging economic times.

Net premiums written by major product line for the year ended December 31, 2009 and 2008 are presented in the table below (in thousands):

	Year Ended December 31,			
	2009	2008	Dollar	Percentage
Net Premiums Written				
Homeowners	$ 50,119	$ 50,340	$ (221)	-0.4%
Fire	40,909	41,007	(98)	-0.2%
Mobile Home	17,861	16,640	1,221	7.3%
Commercial	5,521	4,957	564	11.4%
Other	333	341	(8)	-2.3%
	$ 114,743	$ 113,285	$ 1,458	1.3%

Total net premiums written increased for the year ended December 31, 2009 in the mobile home and commercial lines of business. Reinstatement premiums related to hurricanes Dolly, Gustav and Ike of $8.2 million decreased net premiums written in 2008, partially offset by higher reinsurance costs and lower direct premiums in 2009.

Net premiums earned by major product line for the year ended December 31, 2009 and 2008 are presented in the table below (in thousands):

	Year Ended December 31,			
	2009	2008	Dollar	Percentage
Net Premiums Earned:				
Homeowners	$ 50,299	$ 51,212	$ (913)	-1.8%
Fire	41,055	41,717	(662)	-1.6%
Mobile Home	17,924	16,928	996	5.9%
Commercial	5,540	5,043	497	9.9%
Other	335	347	(12)	-3.5%
	$ 115,153	$ 115,247	$ (94)	-0.1%

Net premiums earned for the year ended December 31, 2009 decreased as compared to 2008 due to gross earned premiums decreasing $3.3 million, which was partially offset by lower ceded premiums of $3.2 million in 2009. Direct premiums written decreased 1% in 2009, which also contributed to the decrease in net premiums earned.

Policy Acquisition and Other Underwriting Expenses. Policy acquisition and other underwriting expenses for the year ended December 31, 2009 and 2008 were as follows (in thousands):

	Twelve Months Ended December 31,			
	2009	2008	Dollar	Percentage
Amortization of deferred policy acquisition costs	$ 30,354	$ 29,469	$ 885	2.9%
Other underwriting expenses	12,844	13,983	(1,139)	-8.9%
Total policy acquisition and other underwriting expenses	43,198	43,452	(254)	-0.6%
Agency expenses	(2,051)	(2,375)	324	-15.8%
Total policy acquisition and other underwriting expenses less agency expenses	$ 41,147	$ 41,077	$ 70	0.2%
Net premiums earned	$ 115,153	$ 115,247	$ (94)	0.1%
Expense ratio	35.7%	35.6%	0.1%	

Total policy acquisition and other underwriting expenses, less agency expenses, are up only $0.1 million from 2008 due to higher amortization of deferred policy acquisition costs, offset by lower other underwriting expenses and lower agency expenses. Agency expenses are related to our general agent, NALICO GA, and are removed from total policy acquisition and other underwriting expenses because they have no effect on the expense ratios of the insurance companies.

Loss and Loss Adjustment Expenses. Loss and LAE are recognized based on formula and case basis estimates for losses reported with respect to direct business, estimates of unreported losses based on past experience and deduction of amounts for reinsurance placed with reinsurers. The loss and LAE ratio is calculated by taking the ratio of incurred losses and LAE to net premiums earned. The loss and LAE ratio for the year ended December 31, 2009 and 2008 of 61.0% and 69.8%, respectively, has been adjusted to remove the effect of losses attributable to the prior owner. The decrease in the loss and LAE ratio is due to several catastrophic hurricanes that occurred in July and September 2008. The actual loss related to Hurricane Dolly, Gustav, and Ike, excluding reinstatement premium, was $13.0 million after reinsurance.

The Company's net loss and LAE and the gross loss and LAE ratios for the year ended December 31, 2009 and 2008 are shown in the tables below:

	Year Ended December 31, 2009	Year Ended December 31, 2008
Loss and LAE (in thousands):		
Homeowners	$ 35,657	$ 39,499
Fire	22,098	28,312
Mobile Home	10,045	9,702
Commercial	2,495	2,922
	$ 70,295	$ 80,435
Incurred Claim Count:		
Homeowners	10,417	13,024
Fire	7,775	11,062
Mobile Home	4,083	3,882
Commercial	387	618
	22,662	28,586
Average Loss and LAE per Claim:		
Homeowners	$ 3,423	$ 3,033
Fire	2,842	2,559
Mobile Home	2,460	2,499
Commercial	6,447	4,728
Loss and LAE Ratio:		
Homeowners	70.9%	77.1%
Fire	53.8%	67.9%
Mobile Home	56.0%	57.3%
Commercial	45.0%	57.9%

General and Administrative Expense. General and administrative expense for 2009 was $7.2 million, as compared to $8.1 million for 2008, a decrease of $0.9 million, or 12%. This decrease is primarily due to a decrease in professional fees, which consisted of acquisition costs of $1.2 million in 2008 versus $0.2 million in 2009. The acquisition costs related to expenses incurred in connection with a possible transaction, that, at the end of the second quarter of 2008, we determined no longer to pursue.

Depreciation and Amortization Expense. Depreciation and amortization expense was $2.0 million for the year ended December 31, 2009, as compared to $2.1 million in 2008.

Interest Expense. Interest expense was $9.7 million for 2009, as compared to $10.5 million for 2008, a decrease of $0.8 million, or 8%. The decrease in interest expense is due to lower libor rates on variable rate debt in 2009.

Income Taxes. The Company had a $1.3 million income tax benefit for the year ended December 31, 2009, compared to $19.6 million for 2008. The benefit decreased in 2009 due to realized investment losses of $41.9 million in 2008 at HTH (parent only) and net income before taxes of $10.2 million in 2009, versus a net loss before taxes of $4.1 million in 2008 at NLASCO. We allocate income taxes in accordance with ASC 740, specifically 740-10-20.

Preferred Stock Dividend. In each of the years ended December 31, 2009 and 2008, we recorded four quarterly preferred stock dividends declared at the annual rate of 8.25%, or $2.0625 per share on the 5.0 million shares of Series A Preferred Stock outstanding.

Net Loss Attributable to Common Stockholders. As a result of the foregoing, our net loss attributable to common stockholders was $12.4 million for 2009, as compared to $32.9 million for 2008, a decrease of $20.5 million. The majority of this difference is due to losses on investments in 2008 of $46.0 million, partially offset by higher net investment income in 2008 of $27.1 million.

Comparison of the Year Ended December 31, 2008 to the Year Ended December 31, 2007

Results of insurance operations. The following table shows the underwriting gain or loss, as well as other revenue and expense items included in the financial results of NLASCO for the year ended December 31, 2008 and 2007 (in thousands). NLASCO's underwriting gain or loss consists of net premiums earned less loss and LAE and policy acquisition and other underwriting expenses. NLASCO's underwriting performance is one of the most important factors in evaluating the overall results of operations given the fluctuations that can occur in loss and LAE due to weather related events, as well as the uncertainties involved in the process of estimating reserves for losses and LAE. The underwriting results and fluctuations in other revenue and expense items of NLASCO are discussed in greater detail below.

NLASCO Summary of Insurance Operations

	Year Ended December 31,			
	2008	2007	Dollar	Percentage
Underwriting (loss) gain				
Homeowners	$ (7,596)	$ 5,680	$ (13,276)	-233.7%
Fire	(2,324)	4,993	(7,317)	-146.5%
Mobile Home	844	2,076	(1,232)	-59.3%
Commercial	220	868	(648)	-74.7%
Other	216	199	17	8.5%
Total underwriting (loss) gain	$ (8,640)	$ 13,816	$ (22,456)	-162.5%
Other revenue (expense items)				
Net investment income	8,255	8,107	148	1.8%
Net realized (losses) gains on investments	(4,035)	32	(4,067)	-12709.4%
Other income	6,147	6,487	(340)	-5.2%
Depreciation and amortization	(2,159)	(2,069)	(90)	4.3%
Interest expense	(3,644)	(4,655)	1,011	-21.7%
Total other revenue (expense) items	4,564	7,902	(3,338)	-42.2%
Operating (loss) income before federal income taxes	(4,076)	21,718	(25,794)	-118.8%
Federal income tax (benefit) expense on operating income	(1,434)	7,577	(9,011)	-118.9%
Net (loss) income from continuing operations of NLASCO	$ (2,642)	$ 14,141	$ (16,783)	-118.7%

Revenue. Revenue for the year ended December 31, 2008 was $102.5 million, compared to $131.3 million from continuing operations in 2007. This decrease is due to the loss on investment of $41.9 million recorded for equity securities held at HTH, offset by an increase in premiums earned of $18.4 million. The $102.5 million in revenue in 2008 is comprised of net premiums earned of $115.2 million, net investment income of $27.1 million, other income of $6.1 million and net realized losses on investments of $46.0 million. The $131.3 million in revenue in 2007 is comprised of net premiums earned of $96.8 million, net investment income of $24.8 million, other income of $6.4 million and net realized gains on investments of $3.2 million.

Underwriting Results. The following table shows the components of NLASCO's underwriting gain for the year ended December 31, 2008 and 2007. NLASCO's underwriting gain or loss consists of net premiums earned, less loss and LAE and policy acquisition and other underwriting expenses. The underwriting results are discussed below (in thousands).

	Year Ended December 31,			
	2008	2007	Dollar	Percentage
Direct premiums written	$ 132,642	$ 122,708	$ 9,934	8.1%
Net premiums written	$ 113,285	$ 118,357	$ (5,072)	-4.3%
Net premiums earned	$ 115,247	$ 96,804	$ 18,443	19.1%
Loss and LAE	80,435	52,074	28,361	54.5%
Policy acquisition and other underwriting expenses	43,452	30,914	12,538	40.6%
Underwriting (loss) gain	$ (8,640)	$ 13,816	$ (22,456)	-162.5%
Agency expenses	$ (2,375)	$ (2,634)	$ 259	-9.8%
Loss and LAE ratio	69.8%	53.8%	-16.0%	
Policy acquisition and other underwriting less agency expense ratio	35.6%	29.2%	-6.4%	
Combined ratio	105.4%	83.0%	-22.4%	

NLASCO seeks to operate at a combined ratio of no greater than 85.0%. Loss ratios are ratios that express the relationship of losses to premiums. Loss and LAE ratio is loss and LAE expenses divided by net premiums earned for the same period. Policy acquisition and other underwriting expense ratio is policy acquisition and other underwriting expense divided by net premiums earned for the same period. Combined ratio gives you the sum of both previous ratios. The increase in loss and LAE ratio is due to the incurred losses related to Hurricane Dolly, Gustav, and Ike of $83.1 million (including loss adjustment expenses and gross incurred but not reported reserves) for the year ended December 31, 2008. For the year ended December 31, 2008, NLASCO's net catastrophic loss experience was $13.0 million after reinsurance; there were no catastrophic events that occurred in the year ended December 31, 2007. Additionally, the increase in policy acquisition and other underwriting expenses is due to the benefit received in 2007 related to purchase accounting of $14.5 million, offset by one month of purchase accounting of $1.4 million in 2008.

The industry aggregate for combined ratio for 2008, was 104.7%, which is slightly below the combined ratio for NLIC and ASIC of 105.4% for the same period.

Premiums. The property and casualty insurance industry is affected by soft and hard market business cycles. During a soft market, price competition tends to increase as insurers are willing to reduce premium rates in order to maintain growth in premium volume. The soft market makes it more difficult to attract new business, as well as retain exposures that are adequately priced. Although we recognize the need to remain competitive in the marketplace, the Company remains committed to its disciplined underwriting philosophy, accepting only risks that are appropriately priced, while declining risks which are under priced for the level of coverage provided.

Direct premiums written by major product line for the year ended December 31, 2008 and 2007 are presented in the table below (in thousands):

	Year Ended December 31,			
	2008	2007	Dollar	Percentage
Direct Premiums Written:				
Homeowners	$ 58,942	$ 54,378	$ 4,564	8.4%
Fire	48,014	46,554	1,460	3.1%
Mobile Home	19,483	15,714	3,769	24.0%
Commercial	5,804	5,685	119	2.1%
Other	399	377	22	5.8%
	$ 132,642	$ 122,708	$ 9,934	8.1%

Total direct premiums written increased for the year ended December 31, 2008 for all insurance products due to the fact that 2007 only includes eleven months. Otherwise, direct premiums are down slightly from the prior year due to the overall soft insurance market.

Net premiums written by major product line for the year ended December 31, 2008 and 2007 are presented in the table below (in thousands):

	Year Ended December 31,			
	2008	2007	Dollar	Percentage
Net Premiums Written				
Homeowners	$ 50,340	$ 52,456	$ (2,116)	-4.0%
Fire	41,007	44,897	(3,890)	-8.7%
Mobile Home	16,640	15,156	1,484	9.8%
Commercial	4,957	5,484	(527)	-9.6%
Other	341	364	(23)	-6.3%
	$ 113,285	$ 118,357	$ (5,072)	-4.3%

Total net premiums written decreased for the year ended December 31, 2008 for all lines of business, except for mobile home, due to reinstatement premiums related to Hurricane Dolly, Gustav, and Ike of $7.0. Considering that 2007 includes only eleven months of production, net written premiums are down slightly over the same period last year, due to overall soft insurance market.

Net premiums earned by major product line for the year ended December 31, 2008 and 2007 are presented in the table below (in thousands):

	Year Ended December 31,			
	2008	2007	Dollar	Percentage
Net Premiums Earned:				
Homeowners	$ 51,212	$ 42,746	$ 8,466	19.8%
Fire	41,717	36,900	4,817	13.1%
Mobile Home	16,928	12,396	4,532	36.6%
Commercial	5,043	4,470	573	12.8%
Other	347	292	55	18.8%
	$ 115,247	$ 96,804	$ 18,443	19.1%

Net premiums earned for the year ended December 31, 2008 were up as compared to 2007 due to the fact that 2007 only included eleven months of income from NLASCO, compared to twelve months of income in 2008. The premium revenue is earned over the life of the policies, generally twelve months. On the date NLASCO was acquired by Hilltop, the unearned premium balance was adjusted to fair market value as required under GAAP, which reduced net premiums earned $1.5 million and $16.6 million for the year ended December 31, 2008 and 2007, respectively.

Policy Acquisition and Other Underwriting Expenses. Policy acquisition and other underwriting expenses for the year ended December 31, 2008 and 2007 were as follows (in thousands):

	Twelve Months Ended December 31,			
	2008	2007	Dollar	Percentage
Amortization of deferred policy acquisition costs	$ 29,469	$ 14,762	$ 14,707	99.6%
Other underwriting expenses	13,983	16,152	(2,169)	-13.4%
Total policy acquisition and other underwriting expenses	43,452	30,914	12,538	40.6%
Agency expenses	(2,375)	(2,634)	259	9.8%
Total policy acquisition and other underwriting expenses			—	
less agency expenses	$ 41,077	$ 28,280	$ 12,797	45.3%
Net premiums earned	$ 115,247	$ 96,804	$ 18,443	19.1%
Expense ratio	35.6%	29.2%	69.4%	

Amortization of deferred policy acquisition costs was $29.5 million for the year ended December 31, 2008, compared to $14.8 million for the year ended December 31, 2007. The increase is due to the additional amortization of $14.7 million of deferred policy acquisition costs in 2008. Since insurance company was purchased January 31, 2007; no previous deferred policy acquisition costs were established at the date of the purchase.

Loss and Loss Adjustment Expenses. Loss and LAE are recognized based on formula and case basis estimates for losses reported with respect to direct business, estimates of unreported losses based on past experience and deduction of amounts for reinsurance placed with reinsurers. The loss and LAE ratio is calculated by taking the ratio of incurred losses and LAE to net premiums earned. The loss and LAE ratio for the year ended December 31, 2008 and 2007 of 69.8% and 53.8%, respectively, has been adjusted to remove the effect of losses attributable to the prior owner. The increase in the loss and LAE ratio is due to several catastrophic hurricanes that occurred in July and September 2008. The actual loss related to Hurricane Dolly, Gustav, and Ike, excluding reinstatement premium, was $13.0 million after reinsurance.

The Company's net loss and LAE and the gross loss and LAE ratios for the year ended December 31, 2008 and 2007 are shown in the tables below (in thousands, except claim count figures):

	Year Ended December 31, 2008	Year Ended December 31, 2007
Loss and LAE (in thousands):		
Homeowners	$ 39,499	$ 23,415
Fire	28,312	20,123
Mobile Home	9,702	6,361
Commercial	2,922	2,175
	$ 80,435	$ 52,074
Incurred Claim Count:		
Homeowners	13,024	7,970
Fire	11,062	5,552
Mobile Home	3,882	2,270
Commercial	618	307
	28,586	16,099
Average Loss and LAE per Claim:		
Homeowners	$ 3,033	$ 2,938
Fire	2,559	3,624
Mobile Home	2,499	2,802
Commercial	4,728	7,085
Loss and LAE Ratio:		
Homeowners	77.1%	54.8%
Fire	67.9%	54.5%
Mobile Home	57.3%	51.3%
Commercial	57.9%	48.7%

General and Administrative Expense. General and administrative expense for 2008 was $8.1 million, as compared to $9.4 million for 2007, a decrease of $1.3 million, or 14%. This decrease is primarily due to a decrease in salaries, benefits, and professional fees, which were offset by $1.2 million in acquisition costs expensed in 2008. The acquisition costs related to expenses incurred in connection with a possible transaction, that, at the end of the second quarter of 2008, we determined no longer to pursue.

Depreciation and Amortization Expense. Depreciation and amortization expense was $2.2 million for the year ended December 31, 2008, as compared to $2.1 million in 2007.

Interest Expense. Interest expense was $10.5 million for 2008, as compared to $11.5 million for 2007, a decrease of $1.0 million, or 9%. The decrease in interest expense is due to the pay down of debt in the first quarter of 2008 and lower libor rates on variable rate debt, partially offset by only eleven months of interest expense on the debt of NLASCO.

Non-Controlling Interest. Non-controlling interest for the year ended December 31, 2007 was $0.1 million. Minority interest only affected 2007, as all minority interest holders were eliminated in conjunction with the closing of the asset sale on July 31, 2007.

Income Taxes. The Company had a $19.6 million income tax benefit for the year ended December 31, 2008, compared to $10.6 million expense for 2007. The benefit in 2008 is primarily due to the tax benefit recorded of $15.0 million as a result of recognizing losses on an impairment on securities and operating losses of NLASCO. The expense in 2007 is primarily due to the tax expense

related to the gain on sale of discontinued operations of $77.7 million. We allocate income taxes between continuing and discontinued operations in accordance with ASC 740, *Income Taxes.*

Discontinued Operations. On July 31, 2007, the Company sold certain of its assets, including the operating assets of the Company's manufactured home businesses, to American Residential Communities LLC. The Company received gross proceeds of $889.3 million in cash, which represents the amount of the excess of the purchase price of $1.794 billion over the indebtedness assumed by American Residential Communities LLC. The Company recorded a gain on the sale of the manufactured home business of $366.9 million in 2007. In July 2007, when this transaction occurred, the Company accrued for expenses related to the sale. As of December 31, 2007, all expenses related to the sale had been paid and the accrual was reduced, resulting in an additional $2.6 million gain on sale in the fourth quarter of 2007.

In accordance with the provisions of ASC 360, *Accounting for the Impairment or Disposal of Long-lived Assets*, all of the operating assets of the Company's manufactured home line of business have been classified as discontinued operations and those not sold prior to December 31, 2006 have been classified as assets held for sale. We have recast the operations for these assets as discontinued operations in the accompanying consolidated statements of operations for the year ended December 31, 2007.

Operations of the discontinued manufactured home line of business for the twelve months ended December 31, 2007 recorded losses of $11.1 million and gains were recorded on the sale of discontinued operations of $366.9 million.

For discontinued operations, we considered a manufactured home community to be discontinued when: (i) management commits to a plan to sell the asset, supported by a Board resolution granting approval to proceed with the sale; (ii) the asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets; (iii) an active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated; (iv) the sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, within one year; (v) the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and (vi) actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. In accordance with the guidance provided by ASC 360, we measure each of our assets held for sale at the lower of its carrying amount or fair value, less cost to sell at the balance sheet date and re-cast any applicable balances and corresponding liabilities related to the asset identified in all comparable periods presented. Depreciation of the assets held for sale, if applicable, is suspended at the date of the determination of discontinuance. Interest and other expenses attributable to the liabilities of the asset classified as held for sale continues to be accrued. The results of operations and cash flows of the assets sold and those classified as held for sale are reported as discontinued operations for all periods presented. We recognize any estimated losses on the sales of assets in the period in which the properties are discontinued and recognize any resulting gains on the sales of assets when realized. A description of the facts and circumstances leading to the expected disposal, the expected manner and timing of that disposal, and, if not separately presented on the face of the balance sheet, the carrying amounts of the major classes of assets and liabilities included as part of the disposal group is disclosed in the notes to the financial statements. We disclose in the notes to our financial statements (and on the face of the income statement) the gain or loss recognized in accordance with ASC 360 and, if applicable, the amounts of revenue and pretax profit or loss reported in discontinued operations. If circumstances arise that previously were considered unlikely and, as a result, we decide not to sell assets previously classified as held for sale, the assets will be reclassified as held and used. An asset that is reclassified shall be measured at the lower of its (a) carrying amount before the asset was classified as held for sale, adjusted for any depreciation expense that would have been recognized had

the asset been continuously classified as held and used, or (b) fair value at the date of the subsequent decision not to sell.

Preferred Stock Dividend. In each of the years ended December 31, 2008 and 2007, we recorded four quarterly preferred stock dividends declared at the annual rate of 8.25%, or $2.0625 per share on the 5.0 million shares of Series A Preferred Stock outstanding.

Net (Loss) Income Attributable to Common Stockholders. As a result of the foregoing, our net loss attributable to common stockholders was $32.9 million for 2008, as compared to a net income of $282.9 million for 2007, a decrease of $315.8 million. The majority of this difference is due to the sale of the manufactured housing communities' line of business and its manufactured housing retail sales and finance line of business in 2007 and the net realized loss on investments of $27.2, net of tax, due to the write down and subsequent sale of securities owned by HTH in 2008.

LIQUIDITY AND CAPITAL RESOURCES

HTH is a holding company whose assets primarily consist of the stock of its subsidiaries and invested assets with a combined value of $1.04 billion at December 31, 2009. HTH's primary investment objectives as a holding company are to preserve capital and have available cash resources to utilize in making opportunistic acquisitions, and, if necessary or appropriate, from additional equity or debt financing sources.

On July 31, 2007, we sold substantially all of our operating assets used in our manufactured home community business and our manufactured home retail sales and financing businesses. We received gross proceeds of $889.3 million in cash and the buyer also assumed all of our approximately $943 million in debt related to this line of business.

As of December 31, 2009, we had approximately $790.0 million in cash and cash equivalents, consisting of approximately $737.0 million owned by the parent company and $53.0 million owned by NLASCO and its subsidiaries. At December 31, 2009, we had total investments of approximately $130.0 million, consisting of investments in available-for-sale equities with a fair value of $0.3 million and $129.7 million in carrying value of fixed maturities securities owned by NLASCO and its subsidiaries.

As of December 31, 2009, we had $138.4 million of debt, consisting of $90.9 million of senior exchangeable notes and $47.5 million of debt owed by NLASCO and its subsidiaries.

Our short-term liquidity needs as of December 31, 2009 include (a) funds for dividend payments on the $125 million Series A cumulative redeemable preferred stock bearing a dividend rate of 8.25% per annum ($10.3 million annually), (b) funds to pay our insurance claims of NLASCO and subsidiaries, and (c) funds to service the $90.9 million of senior exchangeable notes.

Our insurance operating subsidiary, NLASCO, has primary investment objectives to preserve capital and manage for a total rate of return in excess of a specified benchmark portfolio. NLASCO's strategy is to purchase securities in sectors that represent the most attractive relative value. Bonds, cash and short-term investments constituted $182.7 million, or 99.9%, of NLASCO's $183.0 million in investments at December 31, 2009. NLASCO had $0.3 million, or 0.2% of its investments, in equity investments as of December 31, 2009. We currently do not have any significant concentration in both direct and indirect guarantor exposure. NLASCO has no investments in subprime mortgages. NLASCO has custodial agreements with A.G. Edwards and Wells Fargo Bank and an investment management agreement with DTF Holdings, LLC.

NLASCO's liquidity requirements are met primarily by positive cash flow from operations and investment activity. Primary sources of cash from insurance operations are premiums and other considerations, net investment income and investment sales and maturities. Primary uses of cash

include payments of claims, operating expenses and income taxes, funds to service $47.5 million of debt and purchases of investments. NLASCO's insurance subsidiaries have regulatory restrictions on the amount of dividends they can declare.

The investment committee meets regularly to review the portfolio performance and investment markets in general. Our management generally meets monthly to review the performance of investments and monitor market conditions for investments that would warrant any revision to investment guidelines.

We believe that existing cash and investment balances, when combined with anticipated cash flows from operations and dividends from our insurance companies, will be adequate to meet our expected liquidity needs for the reasonably foreseeable future. We will continue to pursue and investigate possible strategic investments. In that regard, we may need to secure external financing. We cannot assure you that we will be successful in obtaining any such financing or in the implementation of our business plan. See "Item 1A. Risk Factors" starting on page 25.

Restrictions on Dividends and Distributions

Aside from available cash and investment income on our invested assets, as a holding company we rely on dividends and other permitted distributions from our subsidiaries. The payment of dividends from our insurance subsidiaries, NLIC and ASIC, is subject to significant regulatory restrictions and limitations under debt agreements limiting their ability to declare and pay dividends.

Under Texas State Insurance Law for property and casualty companies, all dividends must be distributed out of earned surplus only. Furthermore, without the prior approval of the Commissioner, dividends cannot be declared or distributed that exceed the greater of ten percent of the company's surplus, as shown by its last statement on file with the Commissioner, or one hundred percent of net income for such period. The subsidiaries paid $14.0 million in dividends to NLASCO in March 2008. There were no dividends paid as of December 31, 2009. At December 31, 2009, the maximum dividend that may be paid to NLASCO in 2010 without regulatory approval is approximately $12.3 million.

Regulations of the Texas Department of Insurance require insurance companies to maintain minimum levels of statutory surplus to ensure their ability to meet their obligations to policyholders. At December 31, 2009, NLASCO's insurance subsidiaries had statutory surplus in excess of the minimum required.

Also, the National Association of Insurance Commissioners, or NAIC, has adopted risk-based capital, or RBC, requirements for insurance companies that establish minimum capital requirements relating to insurance risk, credit risk, interest rate risk and business risk. The formula is used by the NAIC and certain state insurance regulators as an early warning tool to identify companies that require additional scrutiny or regulatory action. At December 31, 2009, the Company's insurance subsidiaries' RBC ratio exceeded the level at which regulatory action would be required.

We believe that restrictions on liquidity resulting from restrictions on the payments of dividends by our subsidiary companies will not have a material impact on our ability to carry out our normal business activities, including dividend payments on our Series A cumulative redeemable preferred stock and debt payments on our senior exchangeable notes.

CASH FLOWS

Comparison of the Year Ended December 31, 2009 to the Year Ended December 31, 2008

Cash provided by operations was $18.9 million in 2009, as compared to $7.2 million used by operations in 2008. Cash provided by operations increased primarily due to a decrease in income taxes receivable of $22.4 million, offset by operating losses of $2.1 million.

Cash provided by investing activities was $32.1 million in 2009, as compared to cash used in investing activities of $12.1 million in 2008. The increase in cash provided by investing activities primarily was due to proceeds from sales of available-for-sale securities of $23.6 million and the release of restricted cash of $18.5 million, which was offset by purchases and maturities of available-for-sale securities of $8.4 million.

Cash used by financing activities was $10.3 million in 2009, as compared with $14.3 million in 2008. The decrease in cash used in financing activities primarily was due to the repayment of debt in 2008 of $4.0 million.

Comparison of the Year Ended December 31, 2008 to the Year Ended December 31, 2007

Cash used by operations was $7.2 million in 2008, as compared to $46.9 million used by operations in 2007. Cash used in operations decreased primarily due to a $69.6 million payment of taxes related to the sale of the manufactured housing business and subsequent reclass to discontinued operations, offset by $7.0 million of reinstatement premiums paid and losses paid related to catastrophes in 2008.

Cash used by investing activities was $12.1 million in 2008, as compared to cash provided by investing activities of $742.0 million in 2007. The decrease in cash from investing activities primarily was due to proceeds from discontinued operations of $881.1 million, cash acquired in the NLASCO purchase of $45.5 million, proceeds of securities sold and matured of $50.1 million, partially offset by $115.4 million in cash used in the NLASCO acquisition and $117.8 million used to purchase securities.

Cash used by financing activities was $14.3 million in 2008, as compared with cash provided by financing activities of $58.6 million in 2007. The decrease in cash from financing activities primarily was due the common stocks rights offering in 2007 of $80.0 million and the issuance of $20.0 million in common stock. This was partially offset by the $17.9 million paid to liquidate OP unit holders, the $10.3 million payment of preferred dividends, the $5.8 million reduction in debt, and $6.2 million used to pay debt related to discontinued operations in 2007.

INFLATION

Inflation in the U.S. has been relatively low in recent years and did not have a material impact on our results of operations for the years ended December 31, 2009, 2008 and 2007. Although the impact of inflation has been relatively insignificant in recent years, it remains a factor in the U.S. economy and may increase the cost of labor and utilities.

COMMITMENTS

At December 31, 2009, we had $138.4 million of outstanding indebtedness. It consists of the following: $90.9 million, or 66%, of our total indebtedness is fixed rate and $47.5 million, or 34%, is variable rate. At December 31, 2009, we had the following indebtedness outstanding with the following repayment obligations (in thousands):

	Principal Commitments			Interest Commitments			Total Debt Commitments		
	Fixed	Variable	Total	Fixed	Variable(1)	Total	Fixed	Variable	Total
2010	$ —	$ —	$ —	$ 6,814	$ 4,341	$ 11,155	$ 6,814	$ 4,341	$ 11,155
2011	—	—	—	6,814	4,341	11,155	6,814	4,341	11,155
2012	—	—	—	6,814	4,341	11,155	6,814	4,341	11,155
2013	—	—	—	6,814	4,341	11,155	6,814	4,341	11,155
2014	—	—	—	6,814	4,341	11,155	6,814	4,341	11,155
Thereafter	90,850	47,500	138,350	79,516	88,788	168,304	170,366	136,288	306,654
Commitments	$ 90,850	$ 47,500	$ 138,350	$ 113,586	$ 110,493	$ 224,079	$ 204,436	$ 157,993	$ 362,429

(1) For variable rate debt, interest commitments were calculated as expected interest payments based on the weighted average interest rate.

At December 31, 2009 the following table shows our outstanding commitments for leases (in thousands).

	Payments Due by Period		
Lease Obligations	Less than 1 year	1-3 years	Total
Total lease obligations	$ 528	$ 1,455	$ 1,983

NLASCO's loss reserves do not have contractual maturity dates. Based on historical payment patterns, however, the following table estimates when management expects the loss reserves to be paid. The timing of payments is subject to significant uncertainty. NLASCO maintains a portfolio of investments with varying maturities to provide adequate cash flows for the payment of claims.

	Reserves in thousands
2010	$ 21,382
2011	6,486
2012	2,905
2013	1,284
2014	777
Thereafter	946
	$ 33,780

The following table sets forth certain information with respect to our indebtedness outstanding as of December 31, 2009 and 2008 excluding indebtedness related to assets held for sale (in thousands):

	Year Ended December 31,	
	2009	2008
Senior exchangeable notes due 2025, 7.50% per annum	$ 90,850	$ 90,850
Insurance company line of credit due October 2010, base rate less 0.5% per annum	—	18
NLIC note payable due May 2033, three-month LIBOR plus 4.10% (4.35% at December 31, 2009)	10,000	10,000
NLIC note payable due September 2033, three-month LIBOR plus 4.05% (4.30% at December 31, 2009)	10,000	10,000
ASIC note payable due April 2034, three-month LIBOR plus 4.05% (4.30% at December 31, 2009)	7,500	7,500
Insurance company note payable due March 2035, three-month LIBOR plus 3.40% (3.65% at December 31, 2009)	20,000	20,000
	$ 138,350	$ 138,368

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, FASB issued new guidance on the accounting for the transfers of financial assets. The new guidance, which was issued as ASC 860, *Transfers and Servicing*, requires additional disclosures for transfers of financial assets, including securitization transactions, and any continuing exposure to the risks related to transferred financial assets. There is no longer a concept of a qualifying special-purpose entity, and the requirements for derecognizing financial assets have changed. The new guidance is effective on a prospective basis for the annual period beginning after November 15, 2009, and interim and annual periods thereafter. The Company does not expect that the provisions of the new guidance will have a material effect on its results of operations, financial position or liquidity.

In June 2009, FASB issued revised guidance on the accounting for variable interest entities. The revised guidance, which was issued as ASC 810, *Consolidation*, reflects the elimination of the concept of a qualifying special-purpose entity and replaces the quantitative-based risks and rewards calculation of the previous guidance for determining which company, if any, has a controlling financial interest in a variable interest entity. The revised guidance requires an analysis of whether a company has: (1) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (2) the obligation to absorb the losses that could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity. An entity is required to be re-evaluated as a variable interest entity when the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights to direct the activities that most significantly impact the entity's economic performance. Additional disclosures are required about a company's involvement in variable interest entities and an ongoing assessment of whether a company is the primary beneficiary. ASC 810 is effective for interim and annual periods that begin after November 15, 2009. The Company does not expect that the adoption of this guidance will impact the Company's results of operations, financial position or liquidity.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our future income, cash flows and fair values relevant to financial instruments are dependent upon prevalent market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. We currently do not use derivative financial instruments to manage, or hedge, interest rate risks related to our borrowings. We do not use derivatives for trading or speculative

purposes and only enter into contracts with major financial institutions based on their credit rating and other factors.

As of December 31, 2009 our total debt outstanding was $138.4 million, comprised of approximately $90.9 million of indebtedness subject to fixed interest rates. Approximately $47.5 million, or 34%, of our total consolidated debt is variable rate debt.

If LIBOR and the prime rate were to increase by one eighth of one percent (0.125%), the increase in interest expense on the variable rate debt would decrease future earnings and cash flows by approximately $59,000 annually.

Interest risk amounts were determined by considering the impact of hypothetical interest rates on our financial instruments. These analyses do not consider the effect of any change in overall economic activity that could occur in that environment. Further, in the event of a change of that magnitude, we may take actions to further mitigate our exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, these analyses assume no changes in our financial structure.

The fair value of debt outstanding as of December 31, 2009 was approximately $138.2 million.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our financial statements required by this item are submitted as a separate section of this Annual Report on Form 10-K. *See* "Financial Statements," commencing on page F-1 hereof.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

CONCLUSION REGARDING THE EFFECTIVENESS OF DISCLOSURE CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by Form 10-K. Based on such evaluation, our Chief Executive Officer and principal financial officer have concluded that, as of the end of such period, our disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act and are effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the

preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorization of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*. Based on our assessment, management concluded that, as of December 31, 2009, our internal control over financial reporting is effective.

The effectiveness of our internal control over financial reporting as of December 31, 2009, has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm as stated in their report, which appears on Page F-2 of this Annual Report on Form 10-K.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have not been any changes in our internal controls over financial reporting during the year ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information called for by this Item is contained in our definitive Proxy Statement for our 2010 Annual Meeting of Stockholders, and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information called for by this Item is contained in our definitive Proxy Statement for our 2010 Annual Meeting of Stockholders, and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information called for by this Item is contained in our definitive Proxy Statement for our 2010 Annual Meeting of Stockholders, or in Item 5 of this Annual Report on Form 10-K for the year ended December 31, 2009, and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information called for by this Item is contained in our definitive Proxy Statement for our 2010 Annual Meeting of Stockholders, and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

The information called for by this Item is contained in our definitive Proxy Statement for our 2010 Annual Meeting of Stockholders, and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed herewith as part of this Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HILLTOP HOLDINGS INC.

By: /s/ GERALD J. FORD

Gerald J. Ford
Chief Executive Officer
(Principal Executive Officer and duly authorized officer)

MARCH 11, 2010

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated:

Signature	Title	Date
/s/ GERALD J. FORD Gerald J. Ford	President, Chief Executive Officer and Director (Principal Executive Officer)	March 11, 2010
/s/ DARREN PARMENTER Darren Parmenter	Senior Vice President (Principal Financial and Accounting Officer)	March 11, 2010
/s/ RHODES BOBBITT Rhodes Bobbitt	Director and Audit Committee Member	March 11, 2010
/s/ W. JORIS BRINKERHOFF W. Joris Brinkerhoff	Director	March 11, 2010
/s/ CHARLES R. CUMMINGS Charles R. Cummings	Director and Chairman of Audit Committee	March 11, 2010
/s/ J. MARKHAM GREEN J. Markham Green	Director and Audit Committee Member	March 11, 2010
/s/ JESS T. HAY Jess T. Hay	Director	March 11, 2010

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Signature	Title	Date
/s/ WILLIAM T. HILL, JR. William T. Hill, Jr.	Director	March 11, 2010
/s/ W. ROBERT NICHOLS, III W. Robert Nichols, III	Director	March 11, 2010
/s/ C. CLIFTON ROBINSON C. Clifton Robinson	Director	March 11, 2010
/s/ JAMES R. "RANDY" STAFF James R. "Randy" Staff	Director	March 11, 2010
/s/ CARL B. WEBB Carl B. Webb	Director	March 11, 2010

Exhibit Number	Description of Exhibit
2.1	Transaction Agreement, dated April 17, 2007, by and among Affordable Residential Communities Inc., Affordable Residential Communities LP, ARC Dealership, Inc., ARC Management Services, Inc., ARCIV GV, Inc., ARCMS, Inc., ARC TRS, Inc., Salmaho Irrigation Co., Windstar Aviation Corp., ARC/DAM Management, Inc., Colonial Gardens Water, Inc., and American Riverside Communities LLC (filed as Exhibit 2.1 to Hilltop Holding Inc.'s (formerly known as Affordable Residential Communities Inc.) (the "Registrant") Current Report on Form 8-K filed on April 17, 2007, and incorporated herein by reference).
3.1	Articles of Amendment and Restatement of Affordable Residential Communities Inc., dated February 16, 2004, as amended or supplemented by Articles Supplementary, dated February 16, 2004, Corporate Charter Certificate of Notice, dated June 6, 2005, Articles of Amendment, dated January 23, 2007, Articles of Amendment, dated July 31, 2007, and Corporate Charter Certificate of Notice, dated September 23, 2008 (filed as Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2008, and incorporated herein by reference).
3.2	Second Amended and Restated Bylaws of Hilltop Holdings Inc. (filed as Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on March 16, 2009, and incorporated herein by reference).
4.1	Form of Certificate of Common Stock of Hilltop Holdings Inc. (filed as Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007, and incorporated herein by reference).
4.2	Form of Certificate of 8.25% Series A Cumulative Redeemable Preferred Stock of Hilltop Holdings Inc. (filed as Exhibit 4.2 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 and incorporated herein by reference).
4.3	Articles Supplementary of Affordable Residential Communities Inc. Designating a Series of Preferred Stock, dated February 16, 2004 (filed as Exhibit 4.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 and incorporated herein by reference).
4.4	Form of Warrant, dated August 9, 2000, that expires July 23, 2010 (filed as Exhibit 4.3 to the Registrant's Registration Statement on Form S-3 (File No. 333-124073) and incorporated herein by reference).
4.5	First Amended and Restated Pairing Agreement, dated February 12, 2004, by and between Affordable Residential Communities Inc. and Affordable Residential Communities LP (filed as Exhibit 4.5 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 and incorporated herein by reference).
4.6	Corporate Charter Certificate of Notice, dated June 6, 2005 (filed as Exhibit 3.2 to the Registrant's Registration Statement on Form S-3 (File No. 333-12585) and incorporated herein by reference).
4.7.1*	Indenture, dated August 9, 2005, by and between Affordable Residential Communities LP and U.S. Bank National Association, as Trustee, regarding the $7^{1}/_{2}$% Senior Exchangeable Notes Due 2025 of Affordable Residential Communities LP.

Exhibit Number	Description of Exhibit
4.7.2	Form of Waiver to the Indenture, dated August 9, 2005, by and between Affordable Residential Communities LP and U.S. Bank National Association, as Trustee, with respect to the 7 1/2% Senior Exchangeable Notes Due 2025 (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on July 17, 2007, and incorporated herein by reference).
4.8.1	Rights Agreement, dated July 11, 2006, by and between Affordable Residential Communities Inc. and American Stock Transfer & Trust Company (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on July 11, 2006, and incorporated herein by reference).
4.8.2	Amendment No. 1 to Rights Agreement, dated January 23, 2007, by and between Affordable Residential Communities Inc. and American Stock Transfer & Trust Company (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on January 23, 2007, and incorporated herein by reference).
10.1.1	First Amended and Restated Agreement of Limited Partnership of Affordable Residential Communities LP, dated February 11, 2004 (filed as Exhibit 10.1.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 and incorporated herein by reference).
10.1.2	Amendment to the First Amended and Restated Agreement of Limited Partnership of Affordable Residential Communities LP, dated July 3, 2007 (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on July 6, 2007, and incorporated herein by reference).
10.2.1†	Affordable Residential Communities Inc. 2003 Equity Incentive Plan (filed as Exhibit 10.5 to the Registrant's Registration Statement on Form S-11 (File No. 333-109816) and incorporated herein by reference).
10.2.2*†	Form of Restricted Stock Grant Agreement for use under the Affordable Residential Communities Inc. 2003 Equity Incentive Plan.
10.2.3†	Form of Affordable Residential Communities Inc. 2003 Equity Incentive Plan Non-Qualified Stock Option Agreement (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on July 31, 2006, and incorporated by reference).
10.3†	Affordable Residential Communities Inc. Management Incentive Plan (filed as Exhibit 10.6 to the Registrant's Registration Statement on Form S-11 (File No. 333-109816) and incorporated herein by reference).
10.4	Third Amended and Restated Registration Rights Agreement, dated February 18, 2004, by and among Affordable Residential Communities Inc. and the parties listed on the exhibits thereto (filed as Exhibit 10.5 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 and incorporated herein by reference).
10.5*	Registration Rights Agreement, dated August 9, 2005, among Affordable Residential Communities LP, Affordable Residential Communities Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated.
10.6*	Common Stock Delivery Agreement, dated August 9, 2005, by and between Affordable Residential Communities LP and Affordable Residential Communities Inc.

Exhibit Number	Description of Exhibit
10.7	Stock Purchase Agreement, dated October 6, 2006, by and among Affordable Residential Communities Inc., ARC Insurance Holdings Inc., C. Clifton Robinson, C.C. Robinson Property, Ltd. and the Robinson Charitable Remainder Unitrust (filed as Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on October 10, 2006, and incorporated herein by reference).
10.8	Registration Rights Agreement, dated January 31, 2007, by and between Affordable Residential Communities Inc. and C. Clifton Robinson. (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on February 5, 2007, and incorporated herein by reference).
10.9	Stock Purchase Agreement, dated October 6, 2006, by and between Affordable Residential Communities Inc. and Flexpoint Fund, L.P. (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on October 10, 2006, and incorporated herein by reference).
10.10	Registration Rights Agreement, dated January 31, 2007, by and between Affordable Residential Communities Inc. and Flexpoint Fund, L.P. (filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on February 5, 2007, and incorporated herein by reference).
10.11	Investment Agreement, dated October 13, 2006, by and among Affordable Residential Communities Inc., Gerald J. Ford, ARC Diamond, LP and Hunter's Glen/Ford, Ltd. (filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on October 16, 2006, and incorporated herein by reference).
10.12†	Employment Agreement, dated January 31, 2007, by and between NLASCO, Inc. and C. Clifton Robinson (filed as Exhibit 10.17 to the Registrant's Annual Report on Form 10-K/A (Amendment No. 1) for the fiscal year ended December 31, 2007, and incorporated herein by reference).
10.13†	Employment Agreement, dated August 15, 2007, by and between Hilltop Holdings Inc. and Darren Parmenter (filed as Exhibit 10.18 to the Registrant's Annual Report on Form 10-K/A (Amendment No. 1) for the fiscal year ended December 31, 2007, and incorporated herein by reference).
10.14	Management Services Agreement, dated April 28, 2008, but effective as of January 1, 2008, by and between Hilltop Holdings Inc. and Diamond A Administration Company LLC (filed as Exhibit 10.17 to the Registrant's Current Report on Form 8-K filed on April 30, 2008 and incorporated herein by reference).
10.15*†	Employment Agreement, dated January 31, 2007, by and between NLASCO, Inc. and Greg Vanek.
10.16*†	Retirement and Release Agreement, dated December 1, 2009, by and between Hilltop Holdings Inc. and Larry D. Willard.
14.1	Hilltop Holdings, Inc. Code of Business Conduct and Ethics (filed as Exhibit 14.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2008, and incorporated herein by reference).
21.1*	List of subsidiaries of the Registrant.
23.1*	Consent of PricewaterhouseCoopers LLP.
31.1*	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended.

Exhibit Number	Description of Exhibit
31.2*	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended.
32.1*	Certification of Chief Executive Officer of Affordable Residential Communities Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer of Affordable Residential Communities Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

† Exhibit is a management contract or compensatory plan.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

Report of Independent Registered Public Accounting Firm

To The Board of Directors and Stockholders of Hilltop Holdings Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Hilltop Holdings Inc. and its subsidiaries (the "Company") at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a)(2) present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PRICEWATERHOUSECOOPERS LLP
Dallas, Texas
March 11, 2010

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HILLTOP HOLDINGS INC.

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2009 and 2008

(in thousands except share and per share data)

	December 31, 2009	December 31, 2008
Assets		
Investments		
Fixed maturities		
Available for sale securities, at fair value (amortized cost of $107,738 and $116,207, respectively)	$ 113,157	$ 115,336
Held-to-maturity securities, at amortized cost (fair value of $17,244 and $17,738, respectively)	16,539	16,406
Equity securities		
Available for sale securities, at fair value (cost of $234 and $7,470, respectively)	272	6,826
Total investments	129,968	138,568
Cash and cash equivalents	790,013	749,376
Restricted cash	—	18,500
Accrued interest and dividends	1,494	1,551
Premiums receivable	20,955	20,462
Deferred acquisition costs	15,745	15,935
Reinsurance receivable, net of uncollectible amounts	21,769	16,944
Prepaid reinsurance premiums	4,728	4,782
Income tax receivable	2,187	24,598
Deferred income taxes	11,531	14,966
Goodwill	23,988	23,988
Intangible assets, definite life	9,241	11,002
Intangible assets, indefinite life	3,000	3,000
Property and equipment, net	1,845	350
Loan origination costs, net	3,068	3,265
Other assets	1,220	1,483
Total Assets	$ 1,040,752	$ 1,048,770
Liabilities and Stockholders' Equity		
Liabilities		
Reserve for losses and loss adjustment expenses	$ 33,780	$ 34,023
Unearned premiums	68,145	68,451
Reinsurance payable	1,100	781
Accounts payable and accrued expenses	8,381	9,306
Notes payable	138,350	138,368
Dividends payable	1,719	1,719
Other liabilities	5,500	4,667
Total liabilities	256,975	257,315
Commitments and Contingencies (see Note 17)		
Stockholders' Equity		
Preferred stock, no par value, 5,750,000 shares authorized, 5,000,000 shares issued and outstanding at December 31, 2009 and 2008, respectively; liquidation preference of $25 per share plus accrued but unpaid dividends	119,108	119,108
Common stock, $.01 par value, 100,000,000 shares authorized, 56,485,405 and 56,455,515 shares issued and outstanding at December 31, 2009 and 2008 respectively	565	564
Additional paid-in capital	917,896	917,682
Accumulated other comprehensive gain (loss)	3,547	(985)
Accumulated deficit	(257,339)	(244,914)
Total stockholders' equity	783,777	791,455
Total liabilities and stockholders' equity	$ 1,040,752	$ 1,048,770

The accompanying notes are an integral part of these consolidated financial statements.

HILLTOP HOLDINGS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 and 2007

(in thousands except per share data)

	2009	2008	2007
Revenue:			
Net premiums earned	$ 115,153	$ 115,247	$ 96,804
Net investment income	6,458	27,143	24,829
Other income	6,917	6,147	6,445
Net realized (losses) gains on investments			
Other-than-temporary impairments on fixed maturity securities	(841)	(4,267)	261
Other realized investment gains (losses), net	1,148	(41,725)	2,944
Total realized investment gains (losses), net	307	(45,992)	3,205
Total revenue	128,835	102,545	131,283
Expenses:			
Loss and loss adjustment expenses	70,295	80,435	52,074
Policy acquisition and other underwriting expenses	43,198	43,452	30,914
General and administrative expenses	7,154	8,115	9,414
Depreciation and amortization	1,981	2,159	2,069
Interest expense	9,668	10,528	11,539
Total expenses	132,296	144,689	106,010
(Loss) Income from continuing operations before income tax benefit and allocation to non-controlling interest	(3,461)	(42,144)	25,273
Income tax benefit (expense) from continuing operations	1,349	19,559	(10,635)
(Loss) Income from continuing operations before allocation to non-controlling interest	(2,112)	(22,585)	14,638
Non-controlling interest	—	—	112
(Loss) Income from continuing operations	(2,112)	(22,585)	14,750
Loss from discontinued operations	—	—	(11,124)
Gain on sale of discontinued operations	—	—	366,859
Income tax expense from discontinued operations	—	—	(77,744)
Non-controlling interest in discontinued operations	—	—	494
Net (loss) income	(2,112)	(22,585)	293,235
Preferred stock dividend	(10,313)	(10,313)	(10,313)
Net (loss) income attributable to common stockholders	$ (12,425)	$ (32,898)	$ 282,922
(Loss) Income per share from continuing operations less preferred dividends			
Basic (loss) income per share	$ (0.22)	$ (0.58)	$ 0.08
Diluted (loss) income per share	$ (0.22)	$ (0.58)	$ 0.08
Income (Loss) per share from discontinued operations			
Basic income (loss) per share	$ —	$ —	$ 5.02
Diluted income (loss) per share	$ —	$ —	$ 4.94
(Loss) Income per share attributable to common stockholders			
Basic (loss) income per share	$ (0.22)	$ (0.58)	$ 5.10
Diluted (loss) income per share	$ (0.22)	$ (0.58)	$ 5.02
Weighted average share information			
Basic shares outstanding	56,474	56,453	55,421
Diluted shares outstanding	56,474	56,453	56,326

The accompanying notes are an integral part of these consolidated financial statements.

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HILLTOP HOLDINGS INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 and 2007

(in thousands)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance, December 31, 2006	5,000	$ 119,108	41,346	$ 413	$ 794,653	$ —	$ (494,938)	$ 419,236
Net income							293,235	293,235
Preferred stock dividends declared							(10,313)	(10,313)
Other comprehensi income, net of tax						(1,053)		(1,053)
Total comprehens income								281,869
Common stock issued to board members			9		111			111
Rights offering shares			10,000	100	78,349			78,449
Preferred partnership unit redemption			1,628	16	17,626			17,642
Share issuances			3,394	34	33,324			33,358
Stock compensatio expense					1,428			1,428
Amortization of unearned compensatio					121			121
Transfer of minority interest ownership in operating partnership					(1,373)			(1,373)
Premium paid to operating partnership unit holders					(7,656)			(7,656)
Redemption of operating partnership units for common stock			84	1	999			1,000
Balance, December 31, 2007	5,000	$ 119,108	56,461	$ 564	$ 917,582	$ (1,053)	$ (212,016)	$ 824,185
Net loss							(22,585)	(22,585)
Preferred stock dividends declared							(10,313)	(10,313)
Other comprehensi income, net of tax						68		68
Total comprehens loss								(32,830)
Common stock issued to board members			16		167			167
Shares								

redeemed			(21)		(215)			(215)
Stock compensation expense					148			148
Balance, December 31, 2008	5,000	$ 119,108	56,456	$ 564	$ 917,682	$ (985)	$ (244,914)	$ 791,455
Net loss							(2,112)	(2,112)
Preferred stock dividends declared							(10,313)	(10,313)
Other comprehensive income, net of tax						4,532		4,532
Total comprehensive loss								(7,893)
Common stock issued to board members			12	1	136			137
Options exercised			17					—
Stock compensation expense					78			78
Balance, December 31, 2009	5,000	$ 119,108	56,485	$ 565	$ 917,896	$ 3,547	$ (257,339)	$ 783,777

The accompanying notes are an integral part of these consolidated financial statements

HILLTOP HOLDINGS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 and 2007

(in thousands)

	For the Twelve Months Ended December 31		
	2009	2008	2007
Cash flow from operating activities:			
Net (loss) income	$ (2,112)	$ (22,585)	$ 293,235
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,981	2,159	2,037
(Increase) decrease in deferred income taxes	995	7,216	2,837
(Decrease) increase in unearned premiums	(306)	41	18,839
Decrease (increase) in deferred acquisition costs	190	(1,414)	(14,521)
Realized (gains) losses on investments	(307)	45,992	(3,205)
Purchases of trading securities	—	—	(419)
Proceeds from sales of trading securities	—	—	1,046
Amortization of loan origination costs	197	197	201
Stock grant compensation expense	214	100	1,660
Decrease (increase) in income tax receivable	22,411	(24,598)	—
Decrease (increase) in income tax payable	—	(12,238)	12,238
Partnership preferred unit distributions declared	—	—	67
Non-controlling interest	—	—	(179)
Adjustments related to discontinued operations	—	—	(494)
Gain on sale of discontinued operations	—	—	(366,326)
Payment of income taxes related to sale of assets	—	—	9,599
Increase (decrease) in payable to related party	761	(613)	3,766
Changes in operating assets and liabilities	(5,124)	(1,447)	(7,247)
Net cash provided by (used in) operating activities	$ 18,900	$ (7,190)	$ (46,866)
Cash flow from investing activities:			
Purchases of available-for-sale securities	(1,094,906)	(42,864)	(117,842)
Purchases of held-to-maturity securities	(331)	(9,761)	(1,062)
Proceeds from sales of available-for-sale securities	23,647	39,829	30,541
Proceeds from maturities of available-for-sale securities	1,086,227	12,777	17,249
Proceeds from maturities of held-to-maturity securities	646	6,863	2,350
Purchases of fixed assets	(1,715)	(98)	(401)
Decrease (increase) in restricted cash	18,500	(18,500)	—
Purchase of NALICO GA	—	(375)	—
Proceeds from sale of assets related to discontinued operations	—	—	881,149
NLASCO acquisition	—	—	(115,407)
Cash acquired from NLASCO	—	—	45,457
Net cash provided by (used in) investing activities	$ 32,068	$ (12,129)	$ 742,034

The accompanying notes are an integral part of these consolidated financial statements

HILLTOP HOLDINGS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 and 2006

(in thousands)

	For the Twelve Months Ended December 31		
	2009	2008	2007
Cash flow from financing activities:			
Repayment of debt	(18)	(4,000)	(5,750)
Payment of preferred dividends	(10,313)	(10,313)	(10,313)
Cash flow from rights offering and stock issuances			
Common stock rights offering	—	—	80,000
Common stock offering expenses	—	—	(1,551)
Proceeds from issuances of common stock	—	—	20,000
Proceeds from issuance of debt	—	—	438
Payment of partnership preferred distributions	—	—	(251)
Proceeds from or payments on debt related to discontinued operations	—	—	(6,169)
Liquidation of OP Unit holders	—	—	(17,852)
Loan origination costs	—	—	7
Net cash (used in) provided by financing activities	(10,331)	(14,313)	58,559
Net increase (decrease) in cash and cash equivalents	40,637	(33,632)	753,727
Cash and cash equivalents, beginning of period	749,376	783,008	29,281
Cash and cash equivalents, end of period	$ 790,013	$ 749,376	$ 783,008
Non-cash financing and investing transactions:			
Debt and other liabilities assumed in the NLASCO acquisition	$ —	$ —	$ 136,288
Redemption of OP units for common stock	$ —	$ —	$ 18,873
Fair value of common stock issued in the NLASCO acquisition	$ —	$ —	$ 13,359
Notes receivable issued for manufactured home sales	$ —	$ —	$ 2,829
Dividends declared but unpaid	$ 1,719	$ 1,719	$ 1,719
Supplemental cash flow information:			
Cash paid for interest	$ 9,209	$ 10,350	$ 13,375
Cash paid for income taxes	$ (23,890)	$ 10,634	$ 69,600

The accompanying notes are an integral part of these consolidated financial statements

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies

Business

Hilltop Holdings Inc., formerly known as Affordable Residential Communities Inc. ("Hilltop","HTH", or the "Company"), was organized in July 1998 as a Maryland corporation that was engaged in the acquisition, renovation, repositioning and operation of primarily all-age manufactured home communities, the retail sale and financing of manufactured homes, the rental of manufactured homes and other related businesses, all exclusively to residents in its communities.

On January 31, 2007, we acquired all of the stock of NLASCO, Inc. ("NLASCO"), a privately held property and casualty insurance holding company. NLASCO is a Delaware corporation that specializes in providing fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States. NLASCO operates through its wholly-owned subsidiaries, National Lloyds Insurance Company ("NLIC") and American Summit Insurance Company ("ASIC"). Texas comprises approximately 75% of our business, with Arizona 9%, Tennessee 6%, Oklahoma 4%, Louisiana 2%, and the remaining states in which we do business makes up the other 4%.

On July 31, 2007, the Company sold the manufactured home communities, retail sales and financing of manufactured home businesses to American Residential Communities LLC, as discussed in Note 15, and retained ownership of NLASCO. In conjunction with this sale, the Company transferred the rights to the "Affordable Residential Communities" name, changed its name to Hilltop Holdings Inc., and moved its headquarters to Dallas, Texas. Our insurance operations are headquartered in Waco, Texas.

Our common stock is listed on the New York Stock Exchange under the symbol "HTH". Our Series A Cumulative Redeemable Preferred Stock is listed on the New York Stock Exchange under the symbol "HTHPRA". We have no public trading history prior to February 12, 2004.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America ("GAAP"), and in conformity with the rules and regulations of the Securities and Exchange Commission. The consolidated financial statements include the accounts of all wholly-owned subsidiaries of the Company. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

Operating results and cash flows of NLASCO are for the eleven months from the date of acquisition, January 31, 2007, through December 31, 2007, as compared to twelve months for 2008 and 2009.

We are required by GAAP to make estimates and assumptions that affect our reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our financial statements and our reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. These estimates and assumptions are particularly important in determining revenue recognition, reserves for losses and loss adjustment expenses, deferred policy acquisition costs, reinsurance receivables and potential impairment of assets.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Summary of Significant Accounting Policies

Investment Securities

Investment securities at December 31, 2009 consisted of U.S. Government, mortgage-backed, corporate debt and equity securities. We classify our fixed maturities in one of three categories: trading, available-for-sale or held-to-maturity. Our equity securities are classified as trading or available-for-sale. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity debt securities are those securities in which we have the ability and intent to hold the security until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity debt securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income until realized. Realized gains and losses from the sale of trading and available-for-sale securities are determined on a specific-identification basis.

We regularly review our investment securities to assess whether the security is impaired and if impairment is other-than-temporary. A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether impairment is other-than-temporary, we consider whether we are more likely than not to hold an investment until a market price recovery and consider whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to period end, and forecasted performance of the investee.

Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective-interest method. Dividend and interest income are recognized when earned.

Cash and Cash Equivalents

Cash and cash equivalents include all cash and liquid investments with maturities less than 90 days from the date of purchase.

Restricted Cash

On January 5, 2009, the third party loan for which we provided a guaranty and designated as restricted cash of $18.5 million was repaid in full, thus relieving us of any further obligation. At December 31, 2009, we had no cash and cash equivalents designated as restricted.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Premiums Receivable

Premiums receivable include premiums written and not yet collected. The company routinely evaluates the receivable balance to determine if an allowance for uncollectible amounts is necessary. At December 31, 2009 and 2008, the Company determined no valuation allowance was necessary.

Deferred Acquisition Costs

Costs of acquiring insurance vary with and are primarily related to the production of new and renewal business, primarily consisting of commissions, premium taxes and underwriting expenses, and are deferred and amortized over the terms of the policies or reinsurance treaties to which they relate. Proceeds from reinsurance transactions that represent recovery of acquisition costs reduce applicable unamortized acquisition costs in such a manner that net acquisition costs are capitalized and charged to expense in proportion to net revenue recognized. Future investment income is considered in determining the recoverability of deferred acquisition costs. The Company regularly reviews the categories of acquisition costs that are deferred and assesses the recoverability of this asset. A premium deficiency and a corresponding charge to income is recognized if the sum of the expected loss and loss adjustment expenses, unamortized acquisition costs, and maintenance costs exceed related unearned premiums and anticipated investment income. At December 31, 2009 and 2008, there was no premium deficiency.

Reinsurance

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsured policy.

Net premiums earned, losses and LAE and policy acquisition and other underwriting expenses are reported net of the amounts related to reinsurance ceded to other companies. Amounts recoverable from reinsurers related to the portions of the liability for losses and LAE and unearned premiums ceded to them are reported as assets. Reinsurance assumed from other companies, including assumed premiums written and earned and losses and LAE, is accounted for in the same manner as direct insurance written.

Goodwill and Other Intangible Assets

Goodwill is the excess of cost over fair value of net assets acquired. Goodwill is tested annually for impairment and is tested more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. For goodwill, the impairment determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Management determined that HTH has two reporting units, which are the Parent (the holding company) and NLASCO (the insurance company).

Other indefinite lived intangible assets consist of $3.0 million of estimated fair value of state licenses acquired in the NLASCO purchase.

Finite Lived Intangible Assets

We record finite lived intangible assets at the estimated fair value of the assets acquired and amortize the assets over their estimated useful lives. The following finite lived intangible assets were acquired when the Company purchased NLASCO (in thousands).

	Estimated Fair Value	Estimated Useful Life
Customer relationships	$ 6,100	12 years
Agent relationships	3,600	13 years
Trade name	3,500	15 years
Software	1,500	5 years
Total	$ 14,700	
Less accumulated amortization	(5,459)	
Balance at December 31, 2009	$ 9,241	

Customer and agent relationships are amortized using the sum of the years digits method to approximate the non-renewal rate of customers and attrition of agents. The trade name and software are amortized using the straight-line method.

Property and Equipment

We carry property and equipment at cost, less accumulated depreciation. We expense maintenance and repairs as incurred. Depreciation is computed primarily using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of the various classes of furniture and equipment assets are as follows:

Asset Class	Estimated Useful Lives (Years)
Furniture and other equipment	5
Computer software and hardware	3

Loan Origination Costs

We capitalize loan origination costs associated with financing of debt. These costs are amortized on a straight-line basis, which approximates the effective interest method, over the repayment term of the loans. We amortized $0.2 million of loan origination costs for the years ended December 31, 2009,

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

2008, and 2007, which is included in interest expense. Accumulated amortization was $0.9 million, $0.7 million and $0.5 million as of December 31, 2009, 2008 and 2007, respectively.

Other Assets

Included in other assets are prepaid insurance of $0.6 million and $0.8 million for the years ended December 31, 2009 and 2008, respectively. Other prepaid expenses include $0.3 million and $0.5 million held by the state as guaranty assessments for the years ended December 31, 2009 and 2008, respectively, and other miscellaneous prepaid expenses.

Reserve for Losses and Loss Adjustment Expenses

The liability for losses and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount, based on past experience, for losses incurred but not reported. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in earnings currently. The liability for losses and loss adjustment expenses has not been reduced for reinsurance recoverable.

Income Taxes

We have been in a cumulative taxable loss position since our inception and as a result we have net operating loss carry-forwards to offset operating profits and capital gains from profits from asset sales. We allocate income taxes between continuing and discontinued operations.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recorded for the estimated future tax effects of the temporary difference between the tax basis and book basis of assets and liabilities reported in the accompanying consolidated balance sheets. The provision for income tax expense or benefit differs from the amounts of income taxes currently payable because certain items of income and expense included in the consolidated financial statements are recognized in different time periods by taxing authorities.

Effective January 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, or FIN 48, which is now part of ASC 740, specifically 740-10-25, *Recognition*, which clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with GAAP. ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We determine whether the benefits of our tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, we recognize the largest amount of the benefit that is more likely than not of being sustained in our consolidated financial statements. For tax positions that are not more than likely than not of being sustained upon audit, we do not recognize any portion of the benefits in our consolidated financial statements.

The cumulative effect of the adoption of the recognition and measurement provisions of ASC 740 resulted in no change to the January 1, 2007 balance of accumulated deficit. Our policy for interest and

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

penalties related to income tax exposures is to recognize interest and penalties as incurred within the provision for income taxes in the consolidated statements of operations. We are not aware of any pending changes within the next twelve months to the tax law that could change our perspective of our loss position.

Deferred tax assets, including net operating loss and tax credit carry forwards, are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that any portion of these tax attributes will not be realized. At December 31, 2007, a valuation allowance of $4.6 million was recorded to reduce deferred tax assets to the amount expected to be recoverable. However, there was no valuation allowance recorded as of December 31, 2009 or 2008.

From time to time, management must assess the need to accrue or disclose a possible loss contingency for proposed adjustments from various Federal, state and foreign tax authorities that regularly audit the company in the normal course of business. In making these assessments, management must often analyze complex tax laws of multiple jurisdictions.

Convertible Debt

In August 2005, our Operating Partnership, or OP issued $96.6 million aggregate principal amount of senior notes which are exchangeable at an initial rate of 69.8812 shares of common stock per $1,000 principal amount of the notes and callable under certain circumstances. The notes are treated as a combined instrument and not bifurcated to separately account for any embedded derivative instruments principally because in accordance with ASC 815, *Derivatives and Hedging,* (i) the conversion feature is indexed to HTH's common stock and would be classified in stockholders' equity if it were a freestanding derivative and (ii) the put and call option features are clearly and closely related to the notes at fixed conversion amounts. As a result of our rights offering in January 2007, at which we offered shares of our common stock for sale at a below-market price of $8 per share, the exchangeable rate of our convertible debt was adjusted to 73.95 shares of common stock per $1,000 principal amount of the notes equal to an initial exchange rate of $13.52 per share.

Stock Based Compensation

Stock-based compensation expense for all share-based payment awards granted after December 31, 2005 is based on the grant date fair value estimated in accordance with the provisions of ASC 718. We recognize these compensation costs for only those awards expected to vest over the service period of the award. Prior to the adoption of ASC 718 we recognized stock-based compensation expense in accordance with Accounting Principles Board, or APB Opinion No. 25, *Accounting for Stock Issued to Employees,* APB 25. In March 2005, the SEC issued Staff Accounting Bulletin No. 107, *Share-Based Payment, or* SAB 107, regarding their interpretation of ASC 718 and the valuation of share-based payment awards for public companies. We have applied the provisions of SAB 107 in our adoption of ASC 718.

We consider the number of vested shares issued under our 2003 equity incentive plan as common stock outstanding and include them in the denominator of our calculation of basic earnings per share. We also consider the total number of unvested restricted shares granted under our 2003 equity incentive plan in the denominator of our calculation of diluted earnings per share if they are dilutive.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

We return shares forfeited to the 2003 equity incentive plan as shares eligible for future grant and adjust any compensation expense previously recorded on such shares in the period the forfeiture occurs.

Warrants

On August 9, 2000, while the Company was privately held, 1,250,000 warrants were issued to all existing shareholders at the time of entering into a significant cash equity contribution agreement with a new shareholder. The warrants give each holder the right to purchase one share of our common stock at an original exercise price of $11.70 per share. The Company received no cash or other consideration from the existing shareholders for the warrants. Because the warrants were issued in conjunction with an equity contribution, they are considered a cost of equity issuance and there is no impact on the financial statements from the issuance of the warrants because all transactions are recorded within additional paid-in capital. Because the Company received no consideration for the warrants and because there was no active market for our common stock or warrants at the time of issuance in 2000, we determined that the fair value of the warrants was immaterial. The warrants outstanding expire if not exercised prior to 5:00 PM, New York City time, on July 23, 2010.

The warrants, which represent a written call option on our common shares, originally allowed for the purchase of the Company's shares at a fixed price per share of $11.70. On January 23, 2004, in preparation for the IPO, we affected a 0.519-for-1 reverse split of our common stock. Subsequent to this, we have declared cash dividends, issued common stock, paid stock compensation to our non-management directors and redeemed 936,744 warrants in 2008 at $0.23. As a result, the exercise price per share under the outstanding warrants has been adjusted to $15.60 and the total number of shares of our common stock issuable upon exercise of all warrants was adjusted to 515 as of December 31, 2009. The closing price of our common stock was $11.64 as of December 31, 2009, significantly below the warrant exercise price of $15.60.

We can settle our warrants only through physical settlement or net share settlement and therefore the initial classification and measurement was in equity at fair value. Subsequently, the warrants have continued to be classified in equity with no changes in fair value being recorded after the initial measurement. The Company believes equity classification for its warrants continues to be appropriate and will prospectively continue to re-evaluate the appropriateness of the warrants' treatment at each balance sheet date.

Accumulated Other Comprehensive Income

Amounts recorded in accumulated other comprehensive income as of December 31, 2009 and 2008 represent unrecognized gains or losses on our investment portfolio. Total accumulated other comprehensive gain or loss as of December 31, 2009 and 2008 is $3.5 million gain and $1.5 million loss net of income taxes, respectively.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Revenue Recognition

Property and liability premiums are recognized as revenue on a pro rata basis over the policy term. The portion of premiums that will be earned in the future are deferred and reported as unearned premiums. Other income consists of premium installment charges, which are recognized when earned, and other miscellaneous income. The Company routinely evaluates the premium receivable balance to determine if an allowance for uncollectible accounts is necessary.

Discontinued Operations

In accordance with guidance provided by ASC 360—*Plant, Property and Equipment,* we measure our assets in discontinued operations as held for sale at the lower of its carrying amount or fair value, less cost to sell at the balance sheet date and re-cast any applicable balances and corresponding liabilities related to the discontinued operations in all comparable periods presented. Depreciation of the assets held for sale, if applicable, is suspended at the date of the determination of discontinuance. Interest and other expenses attributable to the liabilities of the assets in discontinued operations classified as held for sale continues to be accrued. The results of operations of the assets sold and those classified as held for sale are reported as discontinued operations for all periods presented. We recognize any estimated losses on the sales of assets in the period in which the properties are discontinued and recognize any resulting gains on the sales of assets when realized. A description of the facts and circumstances leading to the expected disposal, the expected manner and timing of that disposal, and, if not separately presented on the face of the balance sheet, the carrying amounts of the major classes of assets and liabilities included as part of the disposal group is disclosed in the notes to the financial statements. We disclose in the notes to our financial statements (and on the face of the income statement) the gain or loss recognized in accordance with ASC 360 and, if applicable, the amounts of revenue and pretax profit or loss reported in discontinued operations.

Statutory Accounting Practices

NLASCO is required to report its results of operations and financial position to insurance regulatory authorities based upon statutory accounting practices, or SAP. The significant differences between SAP and GAAP include: 1) NLASCO is required to expense all sales and other policy acquisition costs as they are incurred rather than capitalizing and amortizing them over the expected life of the policy as required by GAAP. The immediate charge off of sales and acquisition expenses and other conservative valuations under SAP generally causes a lag between the sale of a policy and the emergence of reported earnings. Because this lag can reduce the Company's gain from operations on a SAP basis, it can have the effect of reducing the amount of funds available for dividends from insurance companies; 2) under SAP certain assets are designated as "non admitted" and are charged directly to unassigned surplus, whereas under GAAP, such assets are included in the balance sheet net of an appropriate valuation reserve; 3) under SAP investments are carried at amortized book value and under GAAP, certain investments are carried at fair value; 4) surplus notes are classified as capital and surplus under SAP but classified as notes payable under GAAP; 5) ceded reinsurance receivables are netted against reserves under SAP, but are classified as assets under GAAP; 6) under SAP, while statutory deferred incomes taxes are provided on temporary differences between the statutory and tax basis of assets and liabilities, statutory deferred tax assets are limited based on admissibility tests and

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

allowed deferred income taxes are recorded in unassigned statutory surplus rather than the income statement; and 7) the statutory statement of cash flows follows a prescribed method included in the annual statement instructions issued by the National Association of Insurance Commissioners to present changes in amounts in balance sheet accounts which may not reflect actual cash flows from transactions or operations; whereas the cash flows presented in these financial statements are presented in accordance with GAAP.

Use of estimates

We are required by GAAP to make estimates and assumptions that affect our reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our financial statements and our reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. These estimates and assumptions are particularly important in determining revenue recognition, reserves for losses and loss adjustment expenses, deferred policy acquisition costs, reinsurance receivables and potential impairment of assets.

Recently Adopted Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board (FASB) issued guidance on the disclosure of derivative and hedging activities. The new guidance, which is now part of ASC 815, *Derivatives and Hedging*, requires enhanced disclosures about an entity's derivative and hedging activities and strives to improve the transparency of financial reporting. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company currently holds no derivative instruments and has no hedging activities; therefore, there is no impact of adopting ASC 815 on its financial statements.

In April 2008, FASB issued revised guidance on the determination of the useful life of intangible assets, which is now a part of ASC 350, *Intangibles—Goodwill and Other*. The new guidance amends the factors that an entity should consider in determining the useful life of a recognized intangible asset to include the entity's historical experience in renewing or extending similar arrangements, whether or not the arrangements have explicit renewal or extension provisions. Previously, an entity was precluded from using its own assumptions about renewal or extension of an arrangement where there was likely to be substantial cost or modifications. Entities without their own historical experience should consider the assumptions market participants would use about renewal or extension. The revised guidance may result in the useful life of an entity's intangible asset differing from the period of expected cash flows that was used to measure the fair value of the underlying asset using the market participant's perceived value. Disclosure to provide information on an entity's intent and/or ability to renew or extend the arrangement is also required. The revised guidance was effective for financial statements issued for fiscal years beginning after December 15, 2008 and for interim periods within those fiscal years. The adoption of the revised guidance on January 1, 2009 did not have a material effect on the Company's

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

results of operations, financial position or liquidity and did not require additional disclosures related to existing intangible assets.

In December 2007, FASB issued revised guidance for the accounting for business combinations. The revised guidance, which is now part of ASC 805, *Business Combinations*, significantly changes the financial accounting and reporting of business combination transactions. ASC 805 establishes principles for how an acquirer recognizes and measures the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The guidance is effective for acquisition dates on or after the beginning of an entity's first fiscal year that begins after December 15, 2008. The Company has not had any business combination transactions since the effective date; therefore, there is no impact of adopting on its current financial statements.

In January 2009, FASB issued revised guidance for measuring and recognizing pre-acquisition contingencies in a business combination. The revised guidance, which is now part of ASC 805, *Business Combinations*, requires that an asset or a liability arising from a contingency in a business combination be recognized at fair value if fair value can be reasonably determined and provides guidance on how to make that determination. If the fair value of an asset or liability cannot be reasonably determined, the guidance requires that an asset or liability be recognized at the amount that would be recognized in accordance with ASC 450, *Contingencies*, and ASC 450, *Loss Contingencies*, for liabilities and an amount using a similar criteria for assets. The ASC 805 revision also amends the subsequent measurement and accounting guidance and the disclosure requirements for assets and liabilities arising from contingencies in a business combination. The guidance is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company does not have any assets or liabilities arising from a contingency in a business combination; therefore, there is no impact of adopting ASC 805 on its financial statements.

In December 2007, FASB issued new guidance for the accounting for noncontrolling interests. The new guidance, which is now part of ASC 810, *Consolidation*, significantly changes the financial accounting and reporting of noncontrolling (or minority) interests in consolidated financial statements. The new guidance is effective as of the beginning of an entity's first fiscal year that begins after December 15, 2008, with early adoption permitted. The Company does not have any noncontrolling interests in its consolidated financial statements as of December 31, 2009; therefore, there is no impact of adopting ASC 810 on its financial statements.

In April 2009, FASB issued new guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly. The new guidance, which is now part of ASC 820, *Fair Value Measurements and Disclosures*, affirms that the objective of fair value when the market for an asset is not active is the price that would be received to sell the asset in an orderly transaction, and clarifies and includes additional factors for determining whether there has been a significant decrease in market activity for an asset when the market for that asset is not active. The guidance requires an entity to base its conclusion about whether a transaction was not orderly on the weight of the evidence. It also requires disclosures of the inputs

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

and valuation techniques used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, for both interim and annual periods. This standard is effective for interim and annual periods ending after June 15, 2009. There was no material impact on our financial statements as a result of adopting the standard effective second quarter of 2009.

In April 2009, FASB issued new guidance for the recognition and presentation of other-than-temporary impairments. This new guidance, which is now part of ASC 320, *Investments-Debt and Equity Securities*, (i) changes existing guidance for determining whether an impairment is other than temporary to debt securities and (ii) replaces the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. According to this new guidance, 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 to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. This standard is effective for interim periods ending after June 15, 2009. There was no material impact of adopting ASC 320 effective June 30, 2009.

In May 2009, FASB issued new guidance on subsequent events, which is now part of ASC 855, *Subsequent Events.* This established standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The standard is based on the same principles that currently exist but has included a required disclosure of the date though which the entity has evaluated subsequent events. The standard was effective for interim and annual filings ending after June 15, 2009 and has been adopted by the Company as of June 30, 2009. The required disclosures have been included in these notes to the consolidated financial statements.

In June 2009, FASB issued new guidance on accounting standards and codification, which is now part of ASC 105, *Generally Accepted Accounting Principles*. This will serve as the single source of authoritative non-governmental GAAP. Accordingly, all other accounting literature not included is considered non-authoritative. There was no material impact of adopting this guidance effective September 15, 2009.

In August 2009, FASB issued new guidance for the accounting for the fair value measurement of liabilities. The new guidance, which is now part of ASC 820-10, provides clarification that in certain circumstances in which a quoted price in an active market for the identical liability is not available, a company is required to measure fair value using one or more of the following valuation techniques: the quoted price of the identical liability when traded as an asset, the quoted prices for similar liabilities or similar liabilities when traded as assets, and/or another valuation technique that is consistent with the principles of fair value measurements. The new guidance clarifies that a company is not required to include an adjustment for restrictions that prevent the transfer of the liability and if an adjustment is applied to the quoted price used in a valuation technique, the result is a Level 2 or 3 fair value measurement. The new guidance is effective for interim and annual periods beginning after August 27, 2009. There was no material impact as a result of adopting ASC 820-10 effective third quarter 2009.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

1. Business, Basis of Presentation and Summary of Significant Accounting Policies (Continued)

Recently Issued Accounting Pronouncements

In June 2009, FASB issued new guidance on the accounting for the transfers of financial assets. The new guidance, which was issued as ASC 860, *Transfers and Servicing*, requires additional disclosures for transfers of financial assets, including securitization transactions, and any continuing exposure to the risks related to transferred financial assets. There is no longer a concept of a qualifying special-purpose entity, and the requirements for derecognizing financial assets have changed. The new guidance is effective on a prospective basis for the annual period beginning after November 15, 2009, and interim and annual periods thereafter. The Company does not expect that the provisions of the new guidance will have a material effect on its results of operations, financial position or liquidity.

In June 2009, FASB issued revised guidance on the accounting for variable interest entities. The revised guidance, which was issued as ASC 810, *Consolidation*, reflects the elimination of the concept of a qualifying special-purpose entity and replaces the quantitative-based risks and rewards calculation of the previous guidance for determining which company, if any, has a controlling financial interest in a variable interest entity. The revised guidance requires an analysis of whether a company has: (1) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (2) the obligation to absorb the losses that could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity. An entity is required to be re-evaluated as a variable interest entity when the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights to direct the activities that most significantly impact the entity's economic performance. Additional disclosures are required about a company's involvement in variable interest entities and an ongoing assessment of whether a company is the primary beneficiary. ASC 810 is effective for interim and annual periods that begin after November 15, 2009. The Company does not expect that the adoption of ASC 810 will impact the Company's results of operations, financial position or liquidity.

2. NLASCO Acquisition and Associated Equity Issuances

On January 31, 2007, we acquired all of the stock of NLASCO, a privately held property and casualty insurance holding company. In exchange for the stock, NLASCO's shareholders, consisting of C. Clifton Robinson and affiliates, received $105.75 million in cash and 1,218,880 shares of HTH common stock for a total consideration of $122.0 million. In addition, Flexpoint Fund, L.P., a fund managed by Flexpoint Partners, LLC of Chicago, Illinois, invested $20 million to purchase 2,154,763 shares of common stock of the Company at the leading ten-day average market price of our common stock on the date the agreement was signed, subject to certain anti-dilution provisions.

In order to raise $80 million to provide a source of funding for a portion of the acquisition of NLASCO, we conducted a rights offering to our stockholders. In the rights offering, all holders of HTH common stock as of the record date of December 19, 2006 received one non-transferable right to purchase 0.242 shares of common stock of the Company for each share held. The price at which the additional shares were purchased was $8.00 per share. The rights offering expired on January 23, 2007, and the company issued approximately 7.8 million shares of common stock to existing shareholders upon completion of the rights offering. In addition, Gerald J. Ford and certain affiliates controlled by him purchased approximately 1.8 million shares that they would have been entitled to in the rights offering in a separate private placement transaction. Gerald J. Ford, one of the Company's directors

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

2. NLASCO Acquisition and Associated Equity Issuances (Continued)

and the beneficial owner of approximately 16.0% of HTH's common stock as of the record date, and certain of his affiliates also backstopped the rights offering and purchased another approximately 400,000 shares that were not purchased in the rights offering by the stockholders of record on the record date, at the rights offering price per share of $8.00.

The results of NLASCO's operations for the eleven months ended December 31, 2007 and twelve months ended December 31, 2008 and 2009 are included in these consolidated financial statements.

The total cash and equity consideration paid for the acquisition of NLASCO is as follows (in thousands):

Purchase price paid in cash	$ 105,750
Fair value of HTH shares issued to shareholder of NLASCO	13,359
Other consideration	2,945
Total consideration received by seller	122,054
Other acquisition expenditures	10,044
Total cash, equity and other consideration	$ 132,098

The source of funds for the above cash and equity consideration is as follows (in thousands):

Cash received from Flexpoint Partners for common stock	$ 20,000
Cash raised in the rights offering	80,000
Fair value of HTH shares issued to shareholder of NLASCO	13,359
Liability for future payment	2,945
Consideration paid by HTH from existing lines of credit	15,794
	$ 132,098

The total purchase price of NLASCO including liabilities assumed in the acquisition consists of the following (in thousands).*

Total cash and equity consideration	$ 129,153
Other consideration	2,945
Notes payable assumed at fair value (including $5.6 million paid by HTH)	56,680
Loss and loss adjustment expense liability assumed	18,664
Unearned premiums assumed	49,571
Accounts payable and other liabilities assumed	8,428
Total purchase price including transaction costs and assumed liabilities	$ 265,441

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

2. NLASCO Acquisition and Associated Equity Issuances (Continued)

Our purchase price allocation is as follows (in thousands).*

Tangible assets at fair value	$ 32,780
Investments, cash and cash equivalents at fair value	166,471
Deferred income tax asset at fair value	24,782
Finite lived intangible assets	14,700
Goodwill	23,708
Other indefinite lived intangibles	3,000
	$ 265,441

* The total purchase price of NLASCO has been adjusted, pursuant to requirements of the Stock Purchase Agreement, dated October 6, 2006, Section 2(e)(i), to reflect the Closing Stockholders' Equity Adjustment.

We have prepared the following unaudited pro forma income statement information as if the NLASCO acquisition had occurred on January 1, 2007. The pro forma data is not necessarily indicative of the results that actually would have occurred if we had consummated the acquisition on January 1, 2007 (in thousands).

	Twelve Months Ended December 31, 2007
Revenue	$ 126,642
Total expenses	(115,777)
Interest income	17,100
Income from continuing operations before income taxes and allocation to minority interest	27,965
Income tax expense from continuing operations	(13,169)
Income from continuing operations before allocation to minority interest	14,796
Minority interest	112
Income continuing operations	14,908
Discontinued operations	279,527
Net income	$ 294,435
Net income (loss) attributable to common stockholders	$ 284,122
Basic income (loss) per share attributable to common stockholders	$ 5.13
Diluted income(loss) per share attributable to common stockholders	$ 5.04
Weighted average shares	55,421
Diluted shares outstanding	56,326

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

3. Investments

The amortized cost (original cost for equity securities), gross unrealized holding gains and losses, and fair value of available-for-sale and held-to-maturity securities by major security type and class of security at December 31, 2009 and 2008 were as follows (in thousands).

	December 31, 2009			
	Cost and Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Available-for-sale securities:				
Fixed maturities:				
Government securities	$ 23,217	$ 1,493	$ (191)	$ 24,519
Commercial mortgage-backed securities	10,533	683	—	11,216
Corporate debt securities	73,988	3,645	(211)	77,422
	107,738	5,821	(402)	113,157
Equity securities	234	40	(2)	272
	107,972	5,861	(404)	113,429
Held-to-maturity securities:				
Fixed maturities:				
Government securities	16,539	706	(1)	17,244
	$ 124,511	$ 6,567	$ (405)	$ 130,673

	December 31, 2008			
	Cost and Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Available-for-sale securities:				
Fixed maturities:				
Government securities	$ 31,707	$ 1,835	$ (738)	$ 32,804
Commercial mortgage-backed securities	12,917	540	(37)	13,420
Corporate debt securities	71,583	868	(3,339)	69,112
	116,207	3,243	(4,114)	115,336
Equity securities	7,470	—	(644)	6,826
	123,677	3,243	(4,758)	122,162
Held-to-maturity securities:				
Fixed maturities:				
Government securities	16,406	1,332	—	17,738
	$ 140,083	$ 4,575	$ (4,758)	$ 139,900

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

3. Investments (Continued)

The following table summarizes the length of time securities with unrealized losses at December 31, 2009 have been in an unrealized loss position (in thousands).

	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Available-for-sale securities:						
Fixed maturities:						
Government securities	$ 373	$ (52)	$ 362	$ (139)	$ 735	$ (191)
Commercial mortgage-backed securities	—	—	—	—	—	—
Corporate debt securities	9,868	(138)	2,741	(73)	12,609	(211)
	10,241	(190)	3,103	(212)	13,344	(402)
Equity securities	—	—	151	(2)	151	(2)
	$ 10,241	$ (190)	$ 3,254	$ (214)	$ 13,495	$ (404)
Fixed maturities:						
Government securities	—	—	—	(1)	—	(1)
	$ 10,241	$ (190)	$ 3,254	$ (215)	$ 13,495	$ (405)

For the year ended December 31, 2009, the Company took an other-than-temporary impairment on one corporate bond and recognized a loss in earnings of $0.8 million.

While all of the investments are monitored for potential other-than-temporary impairment, our experience indicates that they generally do not present a great risk of other-than-temporary impairment, as fair value recovers over time. Management believes that the analysis of each of these investments supports the view that these investments were not other-than-temporarily impaired. Evidence considered in this analysis includes the reasons for the unrealized loss position, the severity and duration of the unrealized loss position, credit worthiness, and forecasted performance of the investee. While some of the securities held in the investment portfolio have decreased in value since the date of acquisition, the severity of loss and the duration of the loss position are not significant enough to warrant other-than-temporary impairment of the securities. The Company does not intend to sell these securities and it is not likely that the Company will be required to sell these securities before the recovery of the cost basis, other than specifically identified securities; and, therefore, does not believe any other-than-temporary impairments exist as of December 31, 2009.

Upon the adoption of ASC 320, there were no adjustments to previously taken other-than-temporary impairment as a result of credit losses, as the Company determined it is more likely than not that it will sell these impaired securities before recovery of its cost basis.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

3. Investments (Continued)

Gross realized investment gains and losses for the year ended December 31, 2009, 2008 and 2007 are summarized as follows (in thousands).

	Twelve Months Ended December 31,								
	2009			2008			2007		
	Gross Gains	Gross Losses	Total	Gross Gains	Gross Losses	Total	Gross Gains	Gross Losses	Total
Fixed maturiti	$ 503	$ (1,226)	$ (723)	$ 433	$ (1,669)	$ (1,236)	$ 199	$ (347)	$ (148)
Equity securiti	1,032	(2)	1,030	—	(44,756)	(44,756)	3,361	(8)	3,353
	$ 1,535	$ (1,228)	$ 307	$ 433	$ (46,425)	$ (45,992)	$ 3,560	$ (355)	$ 3,205

Sales of available-for-sale investment securities resulted in the following during the year ended December 31, 2009, 2008 and 2007 (in thousands):

	2009	2008	2007
Proceeds	$ 23,647	$ 39,829	$ 30,541
Gross gains	$ 1,535	$ 433	$ 3,560
Gross losses	$ (1,228)	$ (46,425)	$ (355)

Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The schedule of fixed maturities available-for-sale and held-to-maturity at December 31, 2009 and 2008 by contractual maturity is as follows (in thousands).

	December 31, 2009	
	Amortized Cost	Fair Value
Available-for-sale fixed maturities:		
Due within one year	$ 3,416	$ 3,455
Due after one year through five years	46,945	49,623
Due after six years through ten years	38,736	40,546
Due after ten years	8,113	8,322
Mortgage-backed securities	10,528	11,211
	$ 107,738	$ 113,157
Held-to-maturity debt securities:		
Due within one year	$ 3,364	$ 3,408
Due after one year through five years	7,873	8,317
Due after six years through ten years	5,302	5,519
Due after ten years	—	—
	$ 16,539	$ 17,244

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

3. Investments (Continued)

	December 31, 2008	
	Amortized Cost	Fair Value
Available-for-sale fixed maturities:		
Due within one year	$ 6,998	$ 6,831
Due after one year through five years	46,584	46,647
Due after six years through ten years	38,259	37,457
Due after ten years	11,449	10,981
Mortgage-backed securities	12,917	13,420
	$ 116,207	$ 115,336
Held-to-maturity debt securities:		
Due within one year	$ 165	$ 167
Due after one year through five years	10,874	11,738
Due after six years through ten years	5,367	5,833
Due after ten years	—	—
	$ 16,406	$ 17,738

Net investment income for the year ended December 31, 2009, 2008, and 2007 is as follows (in thousands).

	Twelve Months Ended December 31,		
	2009	2008	2007
Cash equivalents	$ 457	$ 19,609	$ 18,504
Fixed maturities	6,157	7,178	5,781
Equity securities	252	766	748
	6,866	27,553	25,033
Investment expenses	408	410	204
Net investment income	$ 6,458	$ 27,143	$ 24,829

At December 31, 2009 and 2008, the Company had on deposit in custody for various State Insurance Departments investments with carrying values of approximately $16.5 million and $16.4 million, respectively.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

4. Fair Value Measurements

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in ASC 820, *Fair Value Measurements and Disclosures*. The framework is based on the inputs used in valuation and gives the highest priority to quoted prices in active markets and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The three levels of the hierarchy are as follows:

- Level 1—Unadjusted quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access.
- Level 2—Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.
- Level 3—Valuations based on models where significant inputs are not observable. The unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use.

The capital and credit markets have been experiencing volatility and disruption for more than 24 months. If the market were to worsen, there can be no assurance that we will not experience additional losses on our investments and reductions to earnings.

The following table presents the hierarchy used by the Company by asset and liability type to determine their value at December 31, 2009 and 2008 (in thousands).

	Twelve months ended December 31, 2009			
	Total	Level 1	Level 2	Level 3
Financial assets:				
Cash and cash equivalents	$ 790,013	$ 790,013	$ —	$ —
Available-for-sale fixed maturities	113,157	—	113,042	115
Available-for-sale equity securities	272	272	—	—
Total	$ 903,442	$ 790,285	$ 113,042	$ 115

	Twelve months ended December 31, 2008			
	Total	Level 1	Level 2	Level 3
Financial assets:				
Cash and cash equivalents	$ 749,376	$ 749,376	$ —	$ —
Available-for-sale fixed maturities	115,336	—	115,021	315
Available-for-sale equity securities	6,826	6,826	—	—
Total	$ 871,538	$ 756,202	$ 115,021	$ 315

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

4. Fair Value Measurements (Continued)

Level 1 financial assets

The Company's Level 1 investments are limited to cash and cash equivalent balances and actively-traded equity securities. Cash and cash equivalents are carried at amortized cost, which approximates fair value. Fair value of actively traded equity securities are based on unadjusted quoted market prices.

Level 2 financial assets

Most of the Company's fixed maturity securities are classified in Level 2, including private and corporate debt securities, federal agency and municipal bonds, non-government mortgage and asset-backed securities, and collateralized mortgage obligations. Fair values of inactively traded fixed maturity securities are based on quoted market prices of identical or similar securities or based on observable inputs, such as interest rates, using either a market or income valuation approach and are generally classified as Level 2.

Level 3 financial assets

The Company's Level 3 fixed maturity securities include collateralized mortgage obligations. Fair values are based on inputs that are unobservable and significant to the overall fair value measurement, and involve management judgment. Inputs used to determine fair market value include market conditions, spread, volatility, structure and cash flows.

The following table includes a rollforward of the amounts at December 31, 2009 and 2008 for financial instruments classified within level 3. The classification of a financial instrument within level 3 is based upon the significance of the unobservable inputs to the overall fair value measurement.

	Twelve Months Ended December 31,	
	2009	2008
Balance at January 1,	$ 315	$ —
Net transfers in	1,888	1,246
Sales	(1,284)	—
Realized Gains	—	(273)
Change in unrealized losses	(804)	(658)
Balance at December 31,	115	315

During the year ended December 31, 2009, the Company had net transfers in of $4.3 million, which were commercial mortgage-backed and corporate securities that were previously classified within Level 2 and transferred to Level 3. The Company sold two Level 3 securities for $1.3 million. Net unrealized losses relate to those financial instruments held by the Company at December 31, 2009.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

4. Fair Value Measurements (Continued)

The following table presents the fair value and carrying value of financial instruments not measured at fair value at December 31, 2009 and 2008 (in thousands):

	December 31, 2009		December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets				
Held to maturity fixed maturities	$ 16,539	$ 17,244	$ 16,406	$ 17,738
Financial liabilities				
Notes payable	$ 138,350	$ 138,208	$ 138,368	$ 126,426

The fair value of notes payable is determined by market value and discounted cash flows.

5. Property and Equipment

The following summarizes property and other fixed assets as of December 31, 2009 and 2008 (in thousands).

	December 31,	
	2009	2008
Other equipment	$ 824	$ 824
Software	1,771	56
Less accumulated depreciation	(750)	(530)
	$ 1,845	$ 350

6. Deferred Acquisition Costs

Policy acquisition expenses, primarily commissions, premium taxes and underwriting expenses related to issuing a policy incurred by NLASCO are deferred and charged against income ratably over the terms of the related policies The activity in deferred acquisition costs for the twelve months ended December 31, 2009 and 2008 is as follows (in thousands).

	Year Ended December 31,	
	2009	2008
Beginning of period deferred acquisition cost	$ 15,935	$ 14,521
Acquisition expenses capitalized	30,164	30,883
Amortization charged to income	(30,354)	(29,469)
End of period deferred acquisition costs	$ 15,745	$ 15,935

Amortization is included in policy acquisition and other underwriting expenses on the face of the income statement.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

7. Goodwill and Intangible Assets

Goodwill and intangible assets for HTH represents the excess of the cost over the fair value of the assets of NLASCO. There were no impairments to goodwill for the years ended December 31 2009 and 2008. The changes in the carrying amount of goodwill and indefinite lived intangible assets for the year ended December 31, 2009 and 2008 are as follows (in thousands):

	For the year ended December 31,			
	2009		2008	
	Goodwill	Indefinite Lived Intangibles	Goodwill	Indefinite Lived Intangibles
Balance at beginning of period	$ 23,988	$ 3,000	$ 23,613	$ 3,000
Contingent acquisition payments	—	—	375	—
Balance at end of period	$ 23,988	$ 3,000	$ 23,988	$ 3,000

At December 31, 2009, we determined that no impairment existed with respect to goodwill and intangible assets. The Company tests goodwill and other intangible assets having an indefinite useful life for impairment on an annual basis on December 31, or more often if events or circumstances indicate there may be impairment. Goodwill impairment testing is performed at the reporting unit level, which is one level below an operating segment. Goodwill is assigned to reporting units at the date the goodwill is initially recorded. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or internally generated, are available to support the value of the goodwill. Management determined that HTH has two reporting units, which are the Parent (the holding company) and NLASCO (the insurance company).

The goodwill impairment analysis is a two-step test. The first step ("Step1"), used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. The Company has estimated fair values of reporting units based on a market approach using historic, normalized actual and forecast results.

The second step ("Step 2") involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

7. Goodwill and Intangible Assets (Continued)

At December 31, 2009, we determined that the estimated fair value of our reporting units exceeded their carrying values and therefore we did not perform the second step as described above. Consequently, we determined that no impairment existed with respect to goodwill and intangible assets at December 31, 2009.

The following table reflects the balances of our definite lived intangible assets at December 31, 2009 and 2008 (in thousands):

	For the year ended December 31,			
	2009		2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Customer relationships	$ 6,100	$ (2,524)	$ 6,100	$ (1,727)
Agent relationships	3,600	(1,390)	3,600	(949)
Trade name	3,500	(670)	3,500	(447)
Software	1,500	(875)	1,500	(575)
Total	$ 14,700	$ (5,459)	$ 14,700	$ (3,698)

Future amortization of intangible assets for the next five years is as follows (in thousands):

2010	1,643
2011	1,525
2012	1,132
2013	989
2014	872
	6,161

Amortization for the year ended December 31, 2009 was $1.8 million.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

8. Notes Payable

The following table sets forth certain information regarding our debt in thousands:

	Year Ended December 31,	
	2009	2008
Senior exchangeable notes due 2025, 7.50% per annum	$ 90,850	$ 90,850
Insurance company line of credit due October 2010, base rate less 0.5% per annum	—	18
NLIC note payable due May 2033, three-month LIBOR plus 4.10% (4.37% at December 31, 2009)	10,000	10,000
NLIC note payable due September 2033, three-month LIBOR plus 4.05% (4.30% at December 31, 2009)	10,000	10,000
ASIC note payable due April 2034, three-month LIBOR plus 4.05% (4.32% at December 31, 2009)	7,500	7,500
Insurance company note payable due March 2035, three-month LIBOR plus 3.40% (3.65% at December 31, 2009)	20,000	20,000
	$ 138,350	$ 138,368

Senior Exchangeable Notes Due 2025

In August 2005, our OP issued $96.6 million aggregate principal amount of 7.50% senior exchangeable notes due 2025 to qualified institutional buyers in a private transaction. The notes are senior unsecured obligations of the OP and are exchangeable, at the option of the holders, into shares of HTH common stock at an initial exchange rate of 69.8812 shares per $1,000 principal amount of the notes (equal to an initial exchange price of approximately $14.31 per share), subject to adjustment and, in the event of specified corporate transactions involving HTH or the OP, an additional make-whole premium. Upon exchange, the OP has the option to deliver, in lieu of shares of HTH common stock, cash or a combination of cash and shares of HTH common stock.

According to the terms of the notes, their initial exchange rate is adjusted for certain events, including the issuance to all holders of HTH common stock of rights entitling them to purchase HTH common stock at less than their current market price. Accordingly, as a result of our rights offering in January 2007, in which we offered all holders of HTH common stock the right to purchase shares at $8.00 per share, the initial exchange rate of the notes was adjusted to 73.95 shares per $1,000 principal amount of the notes (equal to an initial exchange rate of $13.52 per share).

Prior to August 20, 2010, the notes are not redeemable at the option of the OP. After August 20, 2010, the OP may redeem all or a portion of the notes at a redemption price equal to the principal amount plus accrued and unpaid interest, if any, on the notes, if the closing price of HTH common stock has exceeded 130% of the exchange price for at least 20 trading days in any consecutive 30-trading day period.

Holders of the notes may require the OP to repurchase all or a portion of the notes at a purchase price equal to the principal amount plus accrued and unpaid interest, if any, on the notes on each of

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

8. Notes Payable (Continued)

August 15, 2010, August 15, 2015, and August 15, 2020, or after the occurrence of certain corporate transactions involving HTH or the OP.

In conjunction with the closing of the asset sale on July 31, 2007, certain holders of the Company's Senior Exchangeable Notes redeemed their holdings for cash resulting in a $5.75 million reduction in notes outstanding.

Insurance Company Line of Credit

Our insurance subsidiary has a line of credit with a financial institution. The line allows for borrowings by NLASCO of up to $5.0 million and is secured by substantially all of NLASCO's assets. The line of credit bears interest equal to a base rate less 0.5% (5.0% at December 31, 2009), which is due quarterly. This line is scheduled to mature in October 2010. During the twelve months ended December 31, 2009, the principal balance on this note was reduced to zero. There was no credit balance payable as of December 31, 2009.

NLIC Notes Payable

NLIC has two unsecured $10 million notes payable to unaffiliated companies. The notes payable bear interest at three-month LIBOR plus 4.05% and three-month LIBOR plus 4.10% (4.30% and 4.37% at December 31, 2009). Interest is due quarterly and principal is due at maturity in September 2033 and May 2033, respectively. The notes are subordinated in right of payment to all policy claims and other indebtedness of NLIC. Further, all payments of principal and interest require the prior approval of the Insurance Commissioner of the State of Texas and are only payable to the extent that the statutory surplus of NLIC exceeds $30 million.

ASIC Note Payable

ASIC has an unsecured $7.5 million note payable to an unaffiliated company. The note payable bears interest at three-month LIBOR plus 4.05% (4.32% at December 31, 2009). Interest is due quarterly and principal is due at maturity in April 2034. The note is subordinated in right of payment to all policy claims and other indebtedness of ASIC. Further, all payments of principal and interest require the prior approval of the Insurance Commissioner of the State of Texas and are only payable to the extent that the statutory surplus of ASIC exceeds $15 million.

Insurance Company Notes Payable

NLASCO has an unsecured $20 million note payable to an unaffiliated company which bears interest equal to the three-month LIBOR plus 3.40% (3.65% at December 31, 2009). Interest is due quarterly and the principal is due at maturity in March 2035.

NLASCO's loan agreements relating to the notes payable contain various covenants pertaining to limitations on additional debt, dividends, and officer and director compensation, and minimum capital requirements. The Company was in compliance with the covenants as of December 31, 2009.

NLASCO has entered into an indenture relating to the notes payable which provides that (i) if a person or group becomes the beneficial owner directly or indirectly of 50% or more of its equity

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

8. Notes Payable (Continued)

securities and (ii) if NLASCO's ratings are downgraded by a nationally recognized statistical rating organization (as defined in the Securities Exchange Act of 1934, as amended, or the Exchange Act), then each holder of the notes governed by such indenture has the right to require that NLASCO purchase such holder's notes in whole or in part at a price equal to 107.5% of the outstanding principal amount prior to March 11, 2010, or 100.0% thereafter.

Note Payable Principal Maturities

The aggregate amount of annual principal maturities subsequent to December 31, 2009 is as follows (in thousands):

	Principal Commitments		
	Fixed	Variable	Total
2010	$ —	$ —	$ —
2014 and Thereafter	90,850	47,500	138,350
Commitments	$ 90,850	$ 47,500	$ 138,350

9. Reserve for Unpaid Losses and Loss Adjustment Expenses

A roll-forward of the reserve for unpaid losses and loss adjustment expenses for the twelve months ended December 31, 2009 and 2008 is as follows (in thousands).

	Year Ended December 31,	
	2009	2008
Balance at January 1,	$ 34,023	$ 18,091
Less reinsurance recoverables	(14,613)	(2,692)
Net balance at January 1,	19,410	15,399
Incurred related to:		
Current Year	71,509	80,726
Prior Period	(1,214)	(291)
Total incurred	70,295	80,435
Payments related to:		
Current Year	(61,372)	(66,522)
Prior Year	(15,655)	(9,902)
Total payments	(77,027)	(76,424)
Net balance at December 31,	12,678	19,410
Plus reinsurance recoverables	21,102	14,613
Balance at December 31,	$ 33,780	$ 34,023

The reserve for losses and loss adjustment expenses includes amounts that may be due to or from the sellers of NLASCO by January 2010 based on actual losses incurred applicable to the reserve as of the acquisition date. Prior year losses and payments include amounts back to the purchase of NLASCO

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

9. Reserve for Unpaid Losses and Loss Adjustment Expenses (Continued)

on January 31, 2007 only, as all other prior losses and payments are the responsibility of the sellers. Incurred amounts related to prior year indicate that we were redundant in incurred but not reported as of December 31, 2008, resulting in a benefit in the year ending December 31, 2009.

10. Reinsurance Activity

NLASCO limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risk. Substantial amounts of business are ceded, and these reinsurance contracts do not relieve NLASCO from its obligations to policyholders. Such reinsurance includes quota share, excess of loss, catastrophe, and other forms of reinsurance on essentially all property and casualty lines of insurance. Net premiums earned, losses and LAE and policy acquisition and other underwriting expenses are reported net of the amounts related to reinsurance ceded to other companies. Amounts recoverable from reinsurers related to the portions of the liability for losses and LAE and unearned premiums ceded to them are reported as assets. Amounts recoverable from reinsurers related to the portions of the liability for losses and LAE are reported as assets. Failure of reinsurers to honor their obligations could result in losses to NLASCO; consequently, allowances are established for amounts deemed uncollectible as NLASCO evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. At December 31, 2009, reinsurance receivables have a carrying value of approximately $22.9 million. There was no allowance for uncollectible accounts as of December 31, 2009.

Reinsurers with a balance in excess of 5% of our outstanding receivables at December 31, 2009 are listed below (in thousands):

	Balances due from Reinsurance Companies
Federal Emergency Management Agency	$ 5,800
Endurance Specialty Insurance Ltd	2,891
Ariel Reinsurance Company Limited	2,349
Platinum Underwriters Reinsurance, Inc.	1,864
Munich Reinsurance America, Inc	1,433
MS Frontier Reinsurance Limited	1,431
Arch Reinsurance Company	1,177
	$ 16,945

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

10. Reinsurance Activity (Continued)

The effect of reinsurance on premiums written and earned for the year ended December 31, 2009 and 2008 is as follows (in thousands):

	Year Ended December 31, 2009		Year Ended December 31, 2008	
	Written	Earned	Written	Earned
Premiums from direct business	$ 131,309	$ 131,451	$ 132,642	$ 132,017
Reinsurance assumed	4,898	5,061	5,352	5,936
Reinsurance ceded	(21,464)	(21,359)	(24,709)	(22,706)
Net premiums	$ 114,743	$ 115,153	$ 113,285	$ 115,247

The effect of reinsurance on incurred losses was as follows:

	Year Ended December 31, 2009	Year Ended December 31, 2008
Loss and Loss Adjustment (LAE) expense incurred	$ 91,108	$ 148,398
Reinsurance recoverables	(20,813)	(67,963)
Net loss and LAE incurred	$ 70,295	$ 80,435

Multi-line excess of loss coverage

For all lines of business, retention on any one risk for 2009 is $200,000.

Catastrophic coverage

As of September 30, 2009, NLASCO had five levels of catastrophic excess of loss reinsurance providing for coverage up to $170.0 million through June 30, 2010 above $1.0 million in retention for ASIC and $6.0 million for NLIC. Total retention for any one catastrophe that affects both NLIC and ASIC is limited to $6 million in the aggregate. NLASCO has an automatic reinstatement provision after the first loss for each layer to provide coverage in the event of subsequent catastrophes during the year. Coverage will lapse after the second or third event depending on the coverage layer, in which case NLASCO will evaluate the need for a new contract for the remainder of the year. During 2009, the first three layers can be reinstated once for 100%, 115% and 120% respectively, of the original premium each time and the next two layers can be reinstated one time for 100% of the original premium.

For the year ended December 31, 2008, the Company experienced three significant catastrophes that resulted in losses in excess of retention. As of December 31, 2008, the total loss and loss adjustment expenses incurred associated with Hurricane Dolly was $6.5 million; however, since the losses exceeded retention, net exposure to the Company was $6.0 million in retention and $71,000 in reinstatement premiums. Total loss and loss adjustment expenses incurred associated with Hurricane Gustav was $3.5 million; however, since the losses exceeded retention, net exposure to the Company was $1.0 million in retention and $459,000 in reinstatement premiums. Total loss and loss adjustment expenses incurred associated with Hurricane Ike was $72.9 million; however, since the losses exceeded

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

10. Reinsurance Activity (Continued)

retention, net exposure to the Company was $6.0 million in retention and $6.4 million in reinstatement premiums.

For the year ended December 31, 2009, the ultimate reserves for incurred but not reported losses related to Hurricane Ike increased $22.0 million, resulting in additional reinstatement premiums of $0.9 million.

11. Income Taxes

At December 31, 2009, the Company had net operating loss carry-forwards for Federal income tax purposes, subject to certain limitations, of approximately $45.3 million and $49.0 million for regular income tax and alternative minimum tax, respectively. These net operating loss carry-forwards expire in 2018 through 2024. The net operating loss carry-forwards for alternative minimum Federal income taxes generally are limited to offsetting 90% of the alternative minimum taxable earnings for a given period.

In conjunction with the sale of the Company's manufactured housing business lines that closed on July 31, 2007, approximately $282.6 million of the Company's net operating loss carry forwards were utilized and $175.2 million of temporary taxable differences were recognized.

As of December 31, 2009, we had a net deferred tax asset, net of liabilities, of $11.5 million. Our 35% statutory rate reflects a change from the 40% in 2007 due to the expectation that future taxable income of our insurance business will primarily be subject to Federal but not state income taxes. Insurance companies are generally not taxed in most states on income taxes as they pay premium taxes in states where they generate premium revenue.

As a result of the allocation of the purchase price for the real estate assets we sold in 2007 by the purchaser, we reallocated $34.1 million of gain recognized to those assets in the quarter ended September 30, 2008, the period in which the purchase price allocation was finalized. This reallocation allowed us to utilize $34.1 million of our net operating loss carry forwards, which reduced our deferred tax asset by $11.9 million and increased our income tax receivable by the same amount. In addition, we were able to utilize $13.2 million of net operating losses that previously were limited under special IRS rules (the "Section 382 Limitations"), resulting in a deferred tax benefit of $4.6 million.

GAAP requires the measurement of uncertain tax positions. Uncertain tax positions are the difference between a tax position taken, or expected to be taken in a tax return, and the benefit recognized for accounting purposes. For the period ending December 31, 2009 we had the following uncertain tax benefit. Prior to 2009 there were no uncertain tax positions.

	December 31, 2009
Balance at beginning of year	$ —
Tax positions of prior years	1,167
Balance at end of year	$ 1,167

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

11. Income Taxes (Continued)

We file tax returns as prescribed by the tax laws of the jurisdictions in which we operate. We are subject to tax audits in numerous jurisdictions in the U.S. until the applicable statute of limitation expire. The following is a summary of the tax years open to examination:

U.S. Federal—2006 through 2008
U.S. States—2005 through 2008

As of December 31, 2009, the Company was not under audit for Federal income taxes, whereas there are two state income tax audits in process. The Company expects no material impact on its financials as a result of these state income tax audits.

Under special IRS rules (the "Section 382 Limitation"), cumulative stock purchases by 5% shareholders exceeding 50% during a three year period can limit a company's future use of net operating losses (NOL's). We had a Section 382 ownership change in February 2004 at the time of the IPO.

The significant components of the provision for income taxes are as follows (in thousands):

	For the Year Ended December 31,	
	2009	2008
Current tax benefit (expense)	$ 2,325	$ 26,800
Deferred tax benefit (expense)	(976)	(11,844)
Allowance	—	4,603
Income tax expense benefit (expense)	$ 1,349	$ 19,559

The provision for income taxes differs from the amount that would be computed by applying the statutory Federal income tax rate of 35% to income before income taxes as a result of the following (in thousands):

	For the Year Ended December 31,	
	2009	2008
Tax at statutory rate	$ 1,211	$ 14,751
Permanent differences	(1)	205
State taxes	139	—
(Increase)decrease in valuation allowance	—	4,603
Income tax benefit (expense)	$ 1,349	$ 19,559

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of the assets and liabilities for financial reporting purposes and the amounts used for income

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

11. Income Taxes (Continued)

tax purposes. The tax effects of significant temporary differences that give rise to the net deferred tax assets and liabilities are as follows (in thousands):

	December 31, 2009	December 31, 2008
Deferred Tax Assets		
Net operating loss carryforwards	$ 15,850	$ 16,092
Accrued liabilities and other	2,269	1,890
Loss and loss adjustment expense discounting	304	477
Securities available for sale	—	530
Unearned premiums	4,439	4,566
Investments	—	934
Loan origination costs	371	404
Rental and other property, net	36	—
AMT credit carryforward	769	787
Total gross deferred tax assets	$ 24,038	$ 25,680
Deferred Tax Liabilities		
Rental and other property, net	$ —	$ 29
Intangible assets	4,284	4,901
Goodwill	307	207
Investments	495	—
Securities available for sale	1,910	—
Deferred policy acquisition costs	5,511	5,577
Total gross deferred tax liabilities	$ 12,507	$ 10,714
Net Deferred Tax Asset	$ 11,531	$ 14,966

12. Common Stock, Preferred Stock, Dividends and Minority Interest Related Transactions

Common Stock

In accordance with ASC 718, *Compensation—Stock Compensation*, total compensation expense recorded in general and administrative expenses for the years ended December 31, 2009, 2008 and 2007 related to stock-based compensation was $0.1million, $0.2 million and $1.4 million, respectively. Stock compensation expense is included as part of additional paid-in capital on the consolidated balance sheets.

The Company issued approximately 7.8 million shares for $80.0 million in a rights offering that expired on January 23, 2007, see Note 2 for more details.

At December 31, 2009, there were no outstanding OP Units that were owned by non-affiliated limited partners. OP Units are convertible into common stock at an initial exchange ratio of one share for each OP Unit. According to the terms of the partnership agreement, the initial exchange rate of the OP Units is adjusted for certain events, including the issuance to all holders of HTH common stock of rights entitling them to purchase HTH common stock at less than their current market price.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

12. Common Stock, Preferred Stock, Dividends and Minority Interest Related Transactions (Continued)

Accordingly, as a result of our rights offering in January 2007, in which we offered all holders of HTH common stock the right to purchase shares at $8.00 per share, the initial exchange rate of the OP Units was adjusted to approximately 1.06 shares for each OP Unit. During 2007, we issued approximately 104,000 shares of our common stock to redeem OP units.

As of December 31, 2009, there were no outstanding restricted stock grants. In 2007, as a result of the sale of the manufactured housing business it triggered the change in control provision fully vested the remaining 7,000 shares of restricted stock. Also during 2007, 2,000 shares of restricted stock were forfeited, bringing the number of outstanding restricted stock grants to 0.

As of December 31, 2009, the Company has outstanding warrants to certain shareholders authorizing the purchase of up to 515 shares of common stock at $15.60 per share, as adjusted for common stock issued and dividends paid. The warrants expire on July 23, 2010. To date, no warrants have been exercised.

On October 25, 2007, the Compensation Committee of our Board of Directors approved the grant of an aggregate 100,000 non-qualified stock option awards to two senior executive officers of the Company pursuant to our 2003 Equity Incentive Plan at an exercise price of $12.06 per share, the closing price of HTH's common stock on the New York Stock Exchange on the date of grant. The options have a term of five years from the date of the award. Under the terms of the grants, 20% of the options vested on the grant date, and the balance of the options vest ratably over a four-year period with 20% of the award amount vesting on the first anniversary of the award and 20% each anniversary thereafter. Vesting is accelerated in certain circumstances, including in the event of the death of the award recipient or in the event of a change of control of the Company. The fair value for the stock options granted during the year ended December 31, 2007 were estimated using the Black-Scholes option pricing model with an expected volatility of 25%, a risk-free interest rate of 4.0%, a dividend yield rate of zero, a five-year expected life of the options, and a forfeiture rate of fifteen percent. Based on calculations using the Black-Scholes option pricing model, the grant date fair value of the options granted during the quarter approximated $3.10 per share. The expected volatility is based on the historical volatility in the price of our common stock since our IPO. The risk-free interest rate is the five-year Treasury rate, based on the term of the options. The dividend yield assumption is based on our history and expectation of dividend payments on common stock. The expected life of the stock options represents the period in which the stock options are expected to remain outstanding.

In March 2007, four senior executives of HTH were granted options to acquire a total of 25,000 shares of common stock at $11.28 per share to compensate for dilution from the rights offering. The options have a term of ten years from the date of the award. Under the terms of the grants, the options vest ratably over a three-year period with the first third of the award amount vesting on the first anniversary of the award with one-third vesting each anniversary thereafter. Vesting is accelerated in certain circumstances, including in the event of the death of the award recipient or in the event of a change of control of the Company. The fair values for the stock options granted during the year ended December 31, 2007 were estimated using the Black-Scholes option pricing model with an expected volatility of 30%, a risk-free interest rate of 5.1%, a dividend yield rate of zero, a six-year expected life of the options, and a forfeiture rate of ten percent. Based on calculations using the Black-Scholes option pricing model, the grant date fair value of the options granted during the quarter approximated

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

12. Common Stock, Preferred Stock, Dividends and Minority Interest Related Transactions (Continued)

$4.04 per share. The expected volatility is based on the historical volatility in the price of our common stock since our IPO. The risk-free interest rate is the ten-year Treasury rate, based on the term of the options. The dividend yield assumption is based on our history and expectation of dividend payments on common stock. The expected life of the stock options represents the period in which the stock options are expected to remain outstanding.

In July 2006, the Compensation Committee of our Board of Directors approved the grant of 500,000 non-qualified stock option awards to four senior executive officers of the Company pursuant to our 2003 Equity Incentive Plan at an exercise price of $10.74 per share, the closing price of HTH's common stock on the New York Stock Exchange on the date of grant. The options have a term of ten years from the date of the award. Under the terms of the grants, the options vest ratably over a three-year period with the first third of the award amount vesting on the first anniversary of the award with one-third vesting on the date of grant and each anniversary thereafter. Vesting is accelerated in certain circumstances, including in the event of the death of the award recipient or in the event of a change of control of the Company. The fair values for the stock options granted during the year ended December 31, 2006 were estimated using the Black-Scholes option pricing model with an expected volatility of 30%, a risk-free interest rate of 5.1%, a dividend yield rate of zero, a six-year expected life of the options, and a forfeiture rate of ten percent. Based on calculations using the Black-Scholes option pricing model, the grant date fair value of the options granted during the quarter approximated $4.38 per share. The expected volatility is based on the historical volatility in the price of our common stock since our IPO. The risk-free interest rate is the ten-year Treasury rate, based on the term of the options. The dividend yield assumption is based on our history and expectation of dividend payments on common stock. The expected life of the stock options represents the period in which the stock options are expected to remain outstanding.

During 2009, 2008 and 2007, we granted 12,359, 15,282 and 9,432 common shares, respectively, to independent members of our board of directors for service rendered to the Company during the periods.

Preferred Stock

In 2004, the Company issued 5,000,000 shares of Series A preferred stock at an initial public offering price of $25.00 per share that have no stated par value and a liquidation preference of $25.00 per share, plus all accumulated, accrued and unpaid dividends. The holders of our Series A preferred stock are entitled to receive cash dividends at a rate of 8.25% per annum on the $25.00 liquidation preference. The Series A preferred stock has no voting rights and no stated maturity. On and after February 18, 2009, we have the option to redeem our Series A preferred stock, in whole or from time to time in part, at a cash redemption price equal to $25.00 per share, plus all accumulated, accrued and unpaid dividends, if any, to and including the redemption date. Our Series A preferred stock is not convertible into or exchangeable for any of our other properties or securities.

Stockholder Rights Plan

On July 11, 2006, we entered into a Stockholder Rights Plan (the "Rights Plan") under which one right was distributed as a dividend for each share of our common stock held by stockholders of record

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

12. Common Stock, Preferred Stock, Dividends and Minority Interest Related Transactions (Continued)

as of the close of business on July 17, 2006. The Rights Plan was adopted as a means to preserve the use of previously accumulated net operating losses. Effective with the revocation of our REIT election in March 2006, we have been taxed as a corporation for U.S. Federal income tax purposes and our net income has been subject to taxation at regular (or alternative minimum) corporate rates without the benefit of a dividends paid deduction. We have net operating losses, or NOLs from prior years that are expected to substantially offset our taxable income, if any. Therefore, the preservation of such NOLs is the key to minimizing our U.S. Federal income tax liability. U.S. Federal income tax law imposes significant limitations on the ability of a corporation to use its NOLs to offset income in circumstances where such corporation has experienced a "change in ownership." Generally, there is a change in ownership if, at any time, one or more 5% shareholders have aggregate increases in their ownership in the corporation of more than 50 percentage points looking back over the prior three year period. One of the principal reasons for adopting the Rights Plan was to preserve the use of the NOLs by dissuading investors from aggregating ownership in HTH and triggering such a change in ownership. The Rights Plan was designed to reduce the likelihood of a change in ownership by, among other things, discouraging any person or group from acquiring additional shares such that they would beneficially own 5% or more of the outstanding shares of our common stock. The Rights Plan was not adopted in response to any effort to acquire control of the Company. Under the Rights Plan, each right initially entitled stockholders to purchase a fraction of a share of preferred stock at a purchase price of $50.00, subject to adjustment as provided in the Rights Plan. Subject to the exceptions and limitations contained in the Rights Plan, the rights generally were exercisable only if a person or group acquired beneficial ownership of 5% or more of our common stock or commenced a tender or exchange offer upon consummation of which such person or group would have beneficially owned 5% or more of our common stock.

To help preserve the benefit of the NOLs, we submitted for stockholder approval an amendment to our charter to restrict certain acquisitions of our common stock so as to reduce the likelihood of triggering a change in ownership. Upon shareholder approval of the charter amendment in January 2007 the Rights Plan was terminated.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

12. Common Stock, Preferred Stock, Dividends and Minority Interest Related Transactions (Continued)

Dividends

The following table sets forth the cash dividends declared and paid in 2009 and 2008:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Series A Preferred Stock				
2009				
Date of declaratio	March 16, 2009	July 6, 2009	September 15, 2009	December 10, 2009
Date of record	April 15, 2009	July 15, 2009	October 15, 2009	January 15, 2010
Date paid	April 30, 2009	July 30, 2009	October 30, 2009	January 29, 2010
Distribution per unit	$ 0.5156	$ 0.5156	$ 0.5156	$ 0.5156
Total dollars (in thousands	$ 2,578	$ 2,578	$ 2,578	$ 2,579
2008				
Date of declaratio	April 9, 2008	June 12, 2008	September 30, 2008	December 22, 2008
Date of record	April 15, 2008	July 15, 2008	October 15, 2008	January 15, 2009
Date paid	April 30, 2008	July 30, 2008	October 30, 2008	January 30, 2009
Distribution per unit	$ 0.5156	$ 0.5156	$ 0.5156	$ 0.5156
Total dollars (in thousands	$ 2,578	$ 2,578	$ 2,578	$ 2,579

Non-Controlling Interest

As of December 31, 2009 and 2008, there were no non-controlling interests outstanding in the OP.

During 2007, all 1,455,615 OP units outstanding were redeemed. During the first quarter of 2007, 44,265 units were redeemed for common stock valued at approximately $0.6 million in cash. During the third quarter of 2007, 55,621 OP Units were redeemed for common stock valued at approximately $.7 million and 1,355,729 OP Units were redeemed for $17.6 million in cash, including a premium paid of $7.7 million.

In January 2007, all 705,688 units of our Series "C" PPUs were redeemed according to their terms for 1,628,410 shares of HTH common stock.

We recorded an equity transfer adjustment between additional paid-in capital and the non-controlling interest in our consolidated balance sheet as of September 30, 2007 to account for changes in the respective ownership in the underlying equity of the OP.

All retained earnings of our insurance subsidiary are unappropriated.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

13. General and Administrative Expense

During the years ended December 31, 2009, 2008 and 2007, we incurred general and administrative expense as follows (in thousands):

	Year Ended December 31,		
	2009	2008	2007
Salaries and benefits	$ 2,269	$ 2,009	$ 4,693
Travel	46	76	145
Professional services	2,753	3,983	3,483
Management fees	1,224	1,200	—
Insurance	566	568	740
Rent	47	51	235
Other administrative expense	249	228	118
	$ 7,154	$ 8,115	$ 9,414

14. Discontinued Operations

On July 31, 2007, the Company closed the sale of certain of its assets, including the operating assets of the Company's manufactured home businesses, to American Residential Communities LLC, an affiliate of Farallon Capital Management, L.L.C., Helix Funds LLC and GEM Realty Capital, Inx. The Company received gross proceeds of $889.3 million in cash, which represents the amount of the excess of the purchase price of $1.794 billion over the indebtedness assumed by American Residential Communities LLC. The Company recorded a gain on the sale of the manufactured home business of $366.9 million in 2007. In July, when this transaction occurred, the Company accrued for expenses related to the sale. As of December 31, 2007, all expenses related to the sale have been paid and the accrual was reduced, resulting in an additional $2.9 million gain on sale in the fourth quarter of 2007.

In accordance with the provisions of ASC 360, *Plant, Property and Equipment*, all of the operating assets of the Company's manufactured home line of business have been classified as discontinued operations. In addition, we have recast the operations for these assets as discontinued operations in the accompanying consolidated statements of operations for the years ended December 31, 2007.

Operations of the discontinued manufactured home line of business for the twelve months ended December 31, 2007 recorded losses of $11.1 million and gains were recorded on the sale of discontinued operations of $366.9 million for the year 2007.

For the discontinued operations, we considered a manufactured home community to be discontinued when: (i) management commits to a plan to sell the asset, supported by a Board resolution granting approval to proceed with the sale; (ii) the asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets; (iii) an active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated; (iv) the sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, within one year; (v) the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and (vi) actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. In accordance with the guidance provided by ASC 360 we measure each of our assets held

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

14. Discontinued Operations (Continued)

for sale at the lower of its carrying amount or fair value, less cost to sell at the balance sheet date and re-cast any applicable balances and corresponding liabilities related to the asset identified in all comparable periods presented. Depreciation of the assets held for sale, if applicable, is suspended at the date of the determination of discontinuance. Interest and other expenses attributable to the liabilities of the asset classified as held for sale continues to be accrued. The results of operations and cash flows of the assets sold and those classified as held for sale are reported as discontinued operations for all periods presented. We recognize any estimated losses on the sales of assets in the period in which the properties are discontinued and recognize any resulting gains on the sales of assets when realized. We disclose the gain or loss recognized in accordance with ASC 360 and, if applicable, the amounts of revenue and pretax profit or loss reported in discontinued operations. If circumstances arise that previously were considered unlikely and, as a result, we decide not to sell assets previously classified as held for sale, the assets will be reclassified as held and used. An asset that is reclassified shall be measured at the lower of its (a) carrying amount before the asset was classified as held for sale, adjusted for any depreciation expense that would have been recognized had the asset been continuously classified as held and used, or (b) fair value at the date of the subsequent decision not to sell.

The following table summarizes the income statement information for the discontinued operations noted above (in thousands):

	Year Ended December 31,		
Statement of Operations	2009	2008	2007
Revenue	$ —	$ —	$ 151,626
Operating expenses	—	—	(162,750)
Loss from discontinued operations	$ —	$ —	$ (11,124)

15. Employee Savings Plan

We provide our employees a qualified retirement savings plan, or Plan designed to qualify under Section 401 of the Internal Revenue Code. The Plan allows our employees and employees of our subsidiaries to defer a portion of their compensation on a pre-tax basis subject to certain maximum amounts. The Plan provides for matching contributions to be made by us to employee accounts at the rate of 100% of the first 3% of compensation and 50% of the next 2% of compensation. For the years ended December 31, 2009, 2008 and 2007, the Company match was $ 0.1 million, $0.1 million and $0.1 million.

16. Related Party Transactions

On April 28, 2008, but effective as of January 1, 2008, Hilltop entered into a Management Services Agreement with Diamond A Administration Company LLC, or Diamond A, an affiliate of Gerald J. Ford, the current Chairman of the Board of the Company and the beneficial owner of 26.6% of Company common stock as of December 31, 2009. Effective January 1, 2010, Gerald J. Ford assumed the role of Chief Executive Officer of HTH. Pursuant to this Management Services Agreement, Diamond A provides certain management services to Hilltop and its subsidiaries, including, among

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

16. Related Party Transactions (Continued)

others, financial and acquisition evaluation. These services are provided to Hilltop at a cost of $100,000 per month, plus reasonable out-of-pocket expenses. This agreement continues in effect until December 31, 2009; provided, however, either party may terminate the agreement upon thirty days' prior notice to the other. Hilltop also agreed to indemnify and hold harmless Diamond A for its performance or provision of these services, except for gross negligence and willful misconduct. Further, Diamond A's maximum aggregate liability for damages under this agreement is limited to the amounts paid to Diamond A under this agreement during twelve months prior to that cause of action.

On December 12, 2007, the Compensation Committee of our Board of Directors approved the grant of 40,000 cash-settled stock appreciation rights, or SARS to a related party consultant of the Company at an exercise price of $10.96 per share, the closing price of HTH's common stock on the New York Stock Exchange on the date of grant. Under the terms of the grant, 20% of the SARS vested on grant date, and the balance of the SARS vest ratably over a four-year period with 20% of the award amount vesting on the first anniversary of the award and 20% each anniversary thereafter. The SARS have a term of five years from the date of the award. Upon exercise, the consultant is entitled to receive in cash, the difference between the current market price and the exercise price. Vesting is accelerated in certain circumstances, including in the event of the death of the award recipient or in the event of a change of control of the Company. The fair values for the SARS granted during the year ended December 31, 2007 were estimated using the Black-Scholes option pricing model with an expected volatility of 25%, a risk-free interest rate of 3.5%, a dividend yield rate of zero, a five-year expected life of the options, and a forfeiture rate of fifteen percent. Based on calculations using the Black-Scholes option pricing model, the grant date fair value of the SARS granted during the quarter approximated $2.73 per share. The expected volatility is based on the historical volatility in the price of our common stock since our IPO. The risk-free interest rate is the five-year Treasury rate, based on the term of the SARS. The dividend yield assumption is based on our history and expectation of dividend payments on common stock. The expected life of the SARS represents the period in which the stock options are expected to remain outstanding. In 2009, we negotiated a consulting agreement with the consultant whereby the SARS were cancelled and the consultant is being paid $80,000 per year instead.

On March 8, 2007, the Company's board of directors appointed C. Clifton Robinson as a director of the Company. Mr. Robinson is the former chief executive officer of NLASCO. At the closing of the NLASCO acquisition, C. Clifton Robinson and his son, Gordon Robinson, the former vice chairman and deputy chief executive officer of NLASCO, entered into employment agreements with NLASCO. C. Clifton Robinson's employment agreement provides that he will serve as chairman of NLASCO and will be paid $100,000 per year. Gordon Robinson's employment agreement provides that he will serve as a senior advisor to NLASCO and will be paid $100,000 per year. Both employment agreements are for a one-year term with automatic one-year extensions by agreement of the parties. Both employee agreements were extended for the year ending December 31, 2009.

As part of the NLASCO acquisition, there will be a settlement of the reserves for losses and loss adjustment expense based on the runoff of the actual NLASCO loss reserves that were in existence and recorded on the NLASCO books and records as of the transaction closing date—January 31, 2007. This settlement is to occur at a date estimated to be June 30, 2010. Depending on actual experience in disposition of these claims, additional payment would be due Mr. Robinson and related selling parties if claim settlement experience is favorable relative to the original amount reserved; or if claim

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

16. Related Party Transactions (Continued)

settlement experience is unfavorable relative to the original reserves, Mr. Robinson and related selling parties would be required to reimburse the Company for any inadequate reserve. The additional payment to Mr. Robinson and related selling parties, or refund from Mr. Robinson and related selling parties, would be 65% of the variance of actual losses versus loss reserves in existence at the transaction closing date, plus 8% interest on this balance due, accruing from the date 18 months after the transaction closing date, July 31, 2008. At December 31, 2009, the Company estimates this is currently a payable to Mr. Robinson of $3.9 million, and is reflected in our "Other Liabilities" on the consolidated Balance Sheet.

The Company also leases office space for NLASCO and its affiliates in Waco Texas from affiliates of Mr. Robinson. There are 2 separate leases. The first lease is a month to month lease at an annual rental rate of $4,400. The second lease requires payments of $40,408 per month and expires on December 31, 2014, but does have renewal options at the discretion of the lessee.

17. Commitments and Contingencies

At December 31, 2009 the following table shows our outstanding commitments for leases (in thousands).

	Payments Due by Period		
Lease Obligations	Less than 1 year	1-3 years	Total
Total lease obligations	$ 528	$ 1,455	$ 1,983

Liabilities for loss contingencies arising from claims, assessments, litigation, fines and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated.

We are a party to various legal actions resulting from our operating activities. These actions consist of litigation and administrative proceedings arising in the ordinary course of business, some of which are covered by liability insurance, and none of which is expected to have a material adverse effect on our consolidated financial condition, results of operations or cash flows taken as a whole.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

18. Quarterly Financial Information (Unaudited)

The following is quarterly financial information for the years ended December 31, 2009 and 2008 (in thousands except per share data):

	Quarter ended			
For the quarters ended 2009:	**Mar 31**	**Jun 30**	**Sep 30**	**Dec 31**
Total revenue	$ 31,704	$ 31,287	$ 32,681	$ 33,163
Total expenses	$ 29,638	$ 44,110	$ 30,062	$ 28,486
Net income (loss)	$ (1,222)	$ (10,909)	$ (896)	$ 602
Basic income (loss) per share	$ (0.02)	$ (0.19)	$ (0.02)	$ 0.01
Diluted income (loss) per share	$ (0.02)	$ (0.19)	$ (0.02)	$ 0.01

For the quarters ended 2008:	**Mar 31**	**Jun 30**	**Sep 30**	**Dec 31**
Total revenue	$ 19,229	$ 17,691	$ 29,751	$ 35,874
Total expenses	$ 29,914	$ 42,844	$ 45,581	$ 26,350
Net income (loss)	$ (9,460)	$ (19,008)	$ (8,241)	$ 3,811
Basic income (loss) per share	$ (0.17)	$ (0.34)	$ (0.15)	$ 0.07
Diluted income (loss) per share	$ (0.17)	$ (0.34)	$ (0.15)	$ 0.07

Total revenue for the quarter ended March 31, 2009 was $31.7 million as compared to $19.2 million for the quarter ended March 31, 2008. The increase is due to a net realized loss on investments of $20.2 million in the quarter ending March 31, 2008.

Total revenue for the quarter ended June 30, 2009 was $31.2 million as compared to $17.7 million for the quarter ended June 20, 2008. The increase is due to the net realized loss on investments of $21.6 million in the second quarter of 2008 and partially offset by an increase of $4.9 million on net investment income due to proceeds received from the sale of our manufactured housing businesses and $4.5 increase in net earned premiums due to the effect of purchase accounting in 2007 not included in 2008.

Total expenses for the quarter ended September 30, 2009 was $30.1 million as compared to $45.6 million for the quarter ended 2008. The decrease is due to several hurricanes that occurred in July and September 2008. The actual loss related to Hurricane Dolly, Ike and Gustav excluding reinstatement premium is $13.0 million.

Net loss for the quarter ended September 30, 2009 was $0.9 million as compared to $8.2 million for the quarter ended 2008. The increase in net income is due to hurricane losses that occurred in the third quarter of 2008.

Total revenue for the quarter ended December 31, 2009 was $33.2 million as compared to $35.8 million for the quarter ended December 31, 2008.

19. Statutory Net Income and Capital and Surplus

The Company's insurance subsidiaries, which are domiciled in the State of Texas, prepare their statutory financial statements in accordance with accounting principles and practices prescribed or permitted by the Texas Department of Insurance, which Texas recognizes for determining solvency

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

19. Statutory Net Income and Capital and Surplus (Continued)

under Texas State Insurance Law. The Commissioner of the Texas Department of Insurance has the right to permit other practices that may deviate from prescribed practices. Prescribed statutory accounting practices are those practices that are incorporated directly or by reference in state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in Texas. Permitted statutory accounting practices encompass all accounting practices that are not prescribed; such practices differ from state to state, may differ from company to company within a state, and may change in the future. The Company's insurance subsidiaries have no such permitted statutory accounting practices.

The Company's insurance subsidiaries' statutory financial statements are presented on the basis of accounting practices prescribed or permitted by the Texas Department of Insurance. Texas had adopted the National Association of Insurance Commissioners' statutory accounting practices as the basis of its statutory accounting practices with certain differences which are not significant to the company's statutory equity.

Following is a summary of statutory capital and surplus and statutory net income of each insurance subsidiary for the year ended December 31, 2009, 2008 and 2007 (in thousands).

	Year Ended December 31,		
	2009	2008	2007
National Lloyds Insurance Company			
Surplus	$ 89,767	$ 84,343	$ 99,229
Statutory net (loss) income	$ 6,119	$ (4,214)	$ 17,092
American Summit Insurance Company			
Capital and surplus	$ 27,296	$ 24,135	$ 25,663
Statutory net income	$ 3,308	$ 1,126	$ 4,207

20. Capital and Dividend Restrictions

The funding of the cash requirements (including debt service) of NLASCO is primarily provided by cash dividends from NLASCO's wholly-owned insurance subsidiaries. Dividends paid by the insurance subsidiaries are restricted by regulatory requirements of the Texas Department of Insurance. Under Texas State Insurance Law for property and casualty companies, all dividends must be distributed out of earned surplus only. Furthermore, without the prior approval of the Commissioner, dividends cannot be declared or distributed which exceed the greater of ten percent of NLASCO's surplus, as shown by its last statement on file with the Commissioner, or one hundred percent of net income for such period. The subsidiaries paid $14.0 million in dividends to NLASCO in March 2008. At December 31, 2009, the maximum dividend that may be paid to NLASCO in 2010 without regulatory approval is approximately $12.3 million.

Regulations of the Texas Department of Insurance require insurance companies to maintain minimum levels of statutory surplus to ensure their ability to meet their obligations to policyholders. At December 31, 2009, the Company's insurance subsidiaries had statutory surplus in excess of the minimum required.

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

20. Capital and Dividend Restrictions (Continued)

Also, the NAIC has adopted the RBC formula for insurance companies that establishes minimum capital requirements relating to insurance risk, asset credit risk, interest rate risk and business risk. The formula is used by the NAIC and certain state insurance regulators as an early warning tool to identify companies that require additional scrutiny or regulatory action. At December 31, 2009, the Company's insurance subsidiaries' RBC ratio exceeded the level at which regulatory action would be required.

21. (Loss) Income per Share

The following reflects the calculation of (loss) income per share on a basic and diluted basis (in thousands, except per share information):

	Year Ended December 31,		
	2009	2008	2007
(Loss) Income per share from continuing operations:			
(Loss) Income from continuing operations	$ (2,112)	$ (22,585)	$ 14,750
Preferred stock dividends	(10,313)	(10,313)	(10,313)
Net (loss) income from continuing operations	$ (12,425)	$ (32,898)	$ 4,437
Basic (loss) income per share from continuing operations	$ (0.22)	$ (0.58)	$ 0.08
Diluted (loss) income per share from continuing operations	$ (0.22)	$ (0.58)	$ 0.08
Income (Loss) per share from discontinued operations:			
Loss from discontinued operations	$ —	$ —	$ (11,124)
Gain on sale of discontinued operations	—	—	366,859
Income expense on discontinued operations	—	—	(77,744)
Minority interest in discontinued operations	—	—	494
Net income (loss) from discontinued operations	$ —	$ —	$ 278,485
Basic income (loss) per share from discontinued operations	$ —	$ —	$ 5.02
Diluted income (loss) per share from discontinued operations	$ —	$ —	$ 4.94
(Loss) Income per share per common stockholders:			
Net (loss) income per common stockholders	$ (12,425)	$ (32,898)	$ 282,922
Basic (loss) income per share to common stockholders	$ (0.22)	$ (0.58)	$ 5.10
Diluted (loss) income per share to common stockholders	$ (0.22)	$ (0.58)	$ 5.02
Weighted average share information:			
Basic shares outstanding	56,474	56,453	55,421
Diluted shares outstanding	56,474	56,453	56,326
Weighted average equivalent shares excluded from diluted loss per share because they would be anti-dilutive:			
Stock warrants	1	1	937
Senior exchangeable Notes	6,718	6,718	6,718
Stock options	516	541	—
Total	7,235	7,260	7,655

HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

DECEMBER 31, 2009, 2008 and 2007

22. Segments

On July 31, 2007, the Company closed the sale of the manufactured home communities, retail sales and financing of manufactured home businesses to American Residential Communities LLC and retained ownership of NLASCO. NLASCO operates through its wholly-owned subsidiaries, NLIC and ASIC. Given the homogenous nature of our products, the regulatory environments in which we operate, the nature of our customers and our distribution channels, we now monitor, control and manage our business lines as an integrated entity providing fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States. Accordingly, the segment information previously provided is no longer used to monitor the company and we only disclose insurance company segment information.

23. Subsequent Events

On February 5, 2009, we paid C. Clifton Robinson, C.C. Robinson Property Company, Ltd. and The Robinson Charitable Remainder Unitrust, or the Robinsons, an aggregate of $4.3 million. This payment was made pursuant to the post-closing reserve adjustment provisions set forth in the Stock Purchase Agreement, dated as of October 6, 2006, by and among the Robinsons and us. The reserve provisions set forth the mechanics of settling reserve amounts for claims that occurred prior to our purchase of NLASCO, Inc., but were resolved subsequently. A small number of claims remain unresolved. Accordingly, we are in the process of negotiating an amendment to the Stock Purchase Agreement to provide for an extension of time to allow for the resolution of all remaining claims for which reserves were established prior to our purchase.

We also are currently in the process of negotiating an amendment to the Management Services Agreement with Diamond A Administration Company, LLC to extend the term of that agreement and to provide for additional matters.

Schedule I—Schedule of Investments—Other than Investments in Related Parties

(in thousands)

Type of Investment	December 31, 2009 Cost	Market Value	Balance Sheet
Fixed maturities:			
Bonds:			
Unites States Government and government agencies and authorities	$ 19,030	$ 19,905	$ 19,201
States, municipalities and political subdivisions	38,317	40,432	40,432
All other	66,931	70,064	70,063
Total fixed maturities	$ 124,278	$ 130,401	$ 129,696
Equity securities:			
Industrial, miscellaneous, and all other	$ 81	$ 121	$ 121
Preferred Stock	152	151	151
Total equity securities	233	272	272
Total investments	$ 124,511	$ 130,673	$ 129,968

Schedule IV—Reinsurance

(in thousands)

Premiums	For the Year Ended December 31, 2009
Gross premiums	$ 131,451
Ceded to other companies	(21,359)
Assumed from other companies	5,061
Net Premiums	$ 115,153
Percentage of amount assumed to net	4.40%

Premiums	For the Year Ended December 31, 2008
Gross premiums	$ 132,017
Ceded to other companies	(22,706)
Assumed from other companies	5,936
Net Premiums	$ 115,247
Percentage of amount assumed to net	5.15%

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Section 2: EX-4.7.1 (EX-4.7.1)

Exhibit 4.7.1

AFFORDABLE RESIDENTIAL COMMUNITIES LP

7 1/2% SENIOR EXCHANGEABLE NOTES DUE 2025

INDENTURE

DATED AS OF AUGUST 9, 2005

U.S. BANK NATIONAL ASSOCIATION

AS TRUSTEE

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* This Cross-Reference Table shall not, for any purpose, be deemed a part of this Indenture.

THIS INDENTURE dated as of August 9, 2005 is between Affordable Residential Communities LP, a Delaware limited partnership (the "*Company*"), and U.S. Bank National Association, a national banking association organized and existing under the laws of the United States, as Trustee (the "*Trustee*").

In consideration of the premises herein and the purchase of the Securities by the Holders thereof, the parties agree as follows for their mutual benefit and for the equal and ratable benefit of the registered Holders of the Company's 7 1/2% Senior Exchangeable Securities due 2025.

ARTICLE 1
DEFINITIONS AND INCORPORATION BY REFERENCE

Section 1.1. Definitions.

"Affiliate" means, with respect to any specified person, 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" when used with respect to any person means 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.

"Agent" means any Registrar, Paying Agent or Exchange Agent.

"Applicable Procedures" means, with respect to any transfer or exchange of beneficial ownership interests in a Global Security, the rules and procedures of the Depositary, in each case to the extent applicable to such transfer or exchange.

"Board of Directors" means either the board of directors of Parent or any committee of the Board of Directors authorized to act for it with respect to this Indenture.

"Business Day" means each day on which the New York Stock Exchange is open for trading.

"Capital Stock" of any Person means any and all shares, interests, rights to purchase, warrants, options, participations or other equivalents of or interests in (however designated) equity of such Person, but excluding any debt securities convertible into such equity.

"Certificated Security" means a Security that is in substantially the form attached hereto as Exhibit A and that does not include the information or the schedule called for by footnotes 1, 3 and 4 thereof.

"Change of Control" means the occurrence of any of the following events:

(i) any "person" or "group" (as such terms are used in Sections 13(d) and 14(d)(2) of the Exchange Act or any successor provision to either of the foregoing), including any group acting for the purpose of acquiring, holding or disposing of securities within the meaning of Rule 13d-5(b)(1) under the Exchange Act, becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act directly or indirectly) through a purchase, merger or other acquisition transaction, of 50% or more of the total voting power of all classes of Parent's Voting Stock, other than an acquisition by the Company, Parent, any of their Subsidiaries or any of the Company's or Parent's benefit plans;

(ii) the Company or Parent consolidates with, or merges with or into, another person or conveys, transfers, leases or otherwise disposes of all or substantially all of its assets to any person, or any person consolidates with or merges with or into the Company or Parent, other than (x) any transaction (A) that does not result in any reclassification, exchange, or cancellation of outstanding shares of Parent's Capital Stock or the Company's partnership interests, as the case may be, and (B) pursuant to which holders of Parent's Capital Stock or the Company's partnership interests, as applicable, immediately prior to the transaction have the entitlement to exercise, directly or indirectly, 50% or more of the total Voting Power of all shares of Parent's Capital Stock or 50% of the Voting Power of the Company's partnership interests, as the case may be, in each case, with

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respect to the continuing or surviving entity of such transaction; or (y) any merger solely for the purpose of changing jurisdiction of formation of the Company or Parent and resulting in a reclassification, conversion or exchange of outstanding shares of common stock or partnership units, as the case may be, solely into shares of common stock or partnership units, as the case may be, of the surviving entity;

(iii) from and after the Issuance Date, during any consecutive two-year period, individuals who at the beginning of that two-year period constituted the Board of Directors (together with any new directors whose election to such Board of Directors, or whose nomination for election by stockholders of Parent, was approved by a vote of a majority of the directors then still in office who were either directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of the Board of Directors then in office; or

(iv) the Company or Parent is liquidated or dissolved or approves a plan of liquidation or dissolution.

"Closing Price" means the price of a share of Common Stock on the relevant date, determined (a) on the basis of the closing per share sale price (or if no closing sale price is reported, the average of the bid and ask prices or, if more than one in either case, the average of the average bid and average ask prices) on such date on the principal national securities exchange on which the Common Stock is listed; or (b) if the Common Stock is not listed on a national securities exchange, as reported by the National Association of Securities Dealers Automated Quotation System; or (c) if not so quoted, as reported by National Quotation Bureau, Incorporated or similar organization. In the absence of such a quotation or report, the Closing Price shall be such price as the Board of Directors shall reasonably determine on the basis of such quotations as most accurately reflecting the price that a fully informed buyer, acting on his own accord, would pay to a fully informed seller, acting on his own accord in an arms-length transaction, for a share of such Common Stock.

"Common Stock" means the common stock of Parent, par value $0.01 per share, as it exists on the date of this Indenture and any shares of any class or classes of capital stock of Parent resulting from any reclassification or reclassifications thereof and which have no preference in respect of dividends or of amounts payable in the event of any voluntary or involuntary liquidation, dissolution or winding-up of Parent and which are not subject to redemption by Parent; *provided, however*, that if at any time there shall be more than one such resulting class, the shares of each such class then so issuable on exchange of Securities shall be substantially in the proportion which the total number of shares of such class resulting from all such reclassifications bears to the total number of shares of all such classes resulting from all such reclassifications.

"Company" means the party named as such in the first paragraph of this Indenture until a successor replaces it pursuant to the applicable provisions of this Indenture, and thereafter "Company" shall mean such successor Company.

"Corporate Trust Office" means the office of the Trustee at which at any particular time the trust created by this Indenture shall be administered which office at the date of the execution of this Indenture is located at U.S. Bank National Association, 60 Livingston Avenue, EP-MN-WS3C, St. Paul, MN 55107-2292, Attention: Rick Prokosch, or at any other time at such other address as the Trustee may designate from time to time by notice to the Company.

"Default" or "default" means, when used with respect to the Securities, any event which is or, after notice or passage of time or both, would be an Event of Default.

"Exchange Act" means the Securities and Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder, as in effect from time to time.

"Exchange Date" means, with respect to any Holder, the date on which such Holder has satisfied all the requirements to exchange its Securities as described in Section 4.2 hereof.

"Ex-Dividend Date" means, with respect to any distribution on shares of Common Stock, the first date on which the shares of Common Stock trade regular way on the principal securities market on which the shares of Common Stock are then traded without the right to receive such distribution.

"Exchange Price" means, at any time, $1,000 divided by the Exchange Rate in effect at such time, rounded to two decimal places (rounded up if the third decimal place thereof is 5 or more and otherwise rounded down).

"Exchange Rate" means initially 69.8812 shares per $1,000 principal amount of Securities, subject to adjustment as set forth herein.

"Exchange Value" means, on any Trading Day, the amount equal to the product of the Sale Price at such time multiplied by the then current Exchange Rate.

"Final Maturity Date" means August 15, 2025.

"Fundamental Change" means the occurrence of either a "Change in Control" or a "Termination of Trading."

"Fundamental Change Effective Date" means the date on which a Fundamental Change becomes effective.

"GAAP" means generally accepted accounting principles in the United States of America as in effect from time to time, including those set forth in (1) the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants, (2) the statements and pronouncements of the Financial Accounting Standards Board, (3) such other statements by such other entity as approved by a significant segment of the accounting profession and (4) the rules and regulations of the SEC governing the inclusion of financial statements (including pro forma financial statements) in registration statements filed under the Securities Act and periodic reports required to be filed pursuant to Section 13 of the Exchange Act, including opinions and pronouncements in staff accounting bulletins and similar written statements from the accounting staff of the SEC.

"Global Security" means a permanent Global Security that is in substantially the form attached hereto as Exhibit A and that includes the information and schedule called for by footnotes 1, 3 and 4 thereof and which is deposited with the Depositary or its custodian and registered in the name of the Depositary or its nominee.

"Holder" means the person in whose name a Security is registered on the Primary Registrar's books.

"Indenture" means this Indenture as amended or supplemented from time to time pursuant to the terms of this Indenture.

"Initial Purchaser" means Merrill Lynch, Pierce, Fenner & Smith Incorporated.

"Issuance Date" means the date on which the Securities are first authenticated and issued.

"Liquidated Damages" has the meaning specified in paragraph 3 of the Security.

"Officer" means the Chairman or any Co-Chairman of the Board, any Vice Chairman of the Board, the Chief Executive Officer, the President, any Vice President, the Chief Financial Officer, the Controller, the Secretary or any Assistant Controller or Assistant Secretary of the Company.

"Officers' Certificate" means a certificate signed by the principal executive officer, principal financial officer or principal accounting officer of the Company and by one other Officer.

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

"Parent" means Affordable Residential Communities Inc., a Maryland corporation, and its successors.

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

"Principal" or "principal" of a debt security, including the Securities, means the principal of the security plus, when appropriate, the premium, if any, on the security.

"Redemption Date" when used with respect to any Security to be redeemed, means the date fixed for such redemption pursuant to this Indenture.

"Registration Rights Agreement" means the Registration Rights Agreement dated, as of August 9, 2005, among the Company, Parent and the Initial Purchaser.

"Rule 144" means Rule 144 under the Securities Act or any successor to such Rule.

"Rule 144A" means Rule 144A under the Securities Act or any successor to such Rule.

"SEC" means the United States Securities and Exchange Commission.

"Securities" means the 7$^{1}/_{2}$% Senior Exchangeable Notes due 2025 or any of them (each, a "*Security*"), as amended or supplemented from time to time, that are issued under this Indenture.

"Securities Act" means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder, as in effect from time to time.

"Securities Custodian" means the Trustee, as custodian with respect to the Securities in global form, or any successor thereto.

"Significant Subsidiary" means, in respect of any Person, a Subsidiary of such Person that would constitute a "significant subsidiary" as such term is defined under Rule 1-02 of Regulation S-X under the Securities Act and the Exchange Act.

"Subsidiary" means, in respect of any Person, any corporation, association, partnership or other business entity of which more than 50% of the total Voting Power thereof is at the time owned or controlled, directly or indirectly, by (i) such Person; (ii) such Person and one or more Subsidiaries of such Person; or (iii) one or more Subsidiaries of such Person.

"Termination of Trading" means the occurrence after the date hereof, of the following event: the Common Stock (or other common stock for which the Securities are then exchangeable) is not listed for trading on a United States national securities exchange or approved for trading on an established automated over-the-counter trading market in the United States.

"TIA" means the Trust Indenture Act of 1939, as amended, and the rules and regulations thereunder as in effect on the date of this Indenture, except as provided in Section 11.3, and except to the extent any amendment to the Trust Indenture Act expressly provides for application of the Trust Indenture Act as in effect on another date.

"Trading Day" means, with respect to any security, each day, other than Saturday, Sunday or any other day on which securities are not generally traded on the principal exchange or market in which such security is traded.

"Transfer Restricted Security" means a Security required to bear the restricted legend set forth in the form of Security set forth in Exhibit A of this Indenture.

"Trust Officer" means, with respect to the Trustee, any officer assigned to the Corporate Trust Office, and also, with respect to a particular matter, any other officer to whom such matter is referred because of such officer's knowledge of and familiarity with the particular subject.

"Trustee" means the party named as such in the first paragraph of this Indenture until a successor replaces it in accordance with the provisions of this Indenture, and thereafter means the successor.

"Vice President" when used with respect to the Company or the Trustee, means any vice president, whether or not designated by a number or a word or words added before or after the title "vice president."

"Voting Stock" of a Person means all classes of Capital Stock or other interests (including partnership interests) of such Person then outstanding and normally entitled (without regard to the occurrence of any contingency) to vote in the election of directors, managers or trustees thereof.

Section 1.2. Other Definitions.

Term	Defined in Section
"Agent Members"	2.1(b)
"Bankruptcy Law"	8.1
"Company Order"	2.2
"Exchange Agent"	2.3
"Exchange Notice"	4.2(a)
"Current Market Price"	4.5(i)
"Custodian"	7.1
"Depositary"	2.1(a)
"Distributed Assets or Securities"	4.5(d)
"Dividend Threshold Amount"	4.5(e)
"DTC"	2.1(a)
"Event of Default"	7.1
"Expiration Time"	4.5(f)
"Fair Market Value"	4.5(i)

“Fundamental Change Purchase Date”	3.8(a)
“Fundamental Change Company Notice”	3.8(b)
“Fundamental Change Purchase Notice”	3.8(b)
“Fundamental Change Purchase Price”	3.8(a)
“indenture securities”	1.3
“indenture securityholder”	1.3
“indenture to be qualified”	1.3
“indenture trustee”	1.3
“institutional trustee”	1.3
“Legal Holiday”	11.7
“Legend”	2.12(a)
“Make-Whole Premium”	4.14
“Maximum Exchange Rate”	4.5(g)
“Notice of Default”	7.1
“obligor”	1.3
“Optional Redemption”	3.1(a)
“Paying Agent”	2.3
“Primary Registrar”	2.3
“Purchase Agreement”	2.1
“Purchased Shares”	4.5(f)

“Put Right Purchase Date”	3.7(a)
“Put Right Purchase Notice”	3.7(b)
“Put Right Purchase Offer”	3.7(b)
“Put Right Purchase Price”	3.7(a)
“QIB”	2.1(a)
“Record Date”	4.5(i)
“Redemption Price”	3.1(a)
“Registrar”	2.3
“Regular Record Date”	3.1(a)
“successor corporation”	6.1(a)
“Trigger Event”	4.5(d)

Section 1.3. Trust Indenture Act Provisions.

Whenever this Indenture refers to a provision of the TIA, that provision is incorporated by reference in and made a part of this Indenture. The Indenture shall also include those provisions of the TIA required to be included herein by the provisions of the Trust Indenture Reform Act of 1990. The following TIA terms used in this Indenture have the following meanings:

“indenture securities” means the Securities;

“indenture security holder” means a Holder;

“indenture to be qualified” means this Indenture;

“indenture trustee” or “institutional trustee” means the Trustee; and “obligor” on the indenture securities means the Company or any other obligor on the Securities.

All other terms used in this Indenture that are defined in the TIA, defined by TIA reference to another statute or defined by any SEC rule and not otherwise defined herein have the meanings assigned to them therein.

Section 1.4. Rules of Construction.

Unless the context otherwise requires:

(a) a term has the meaning assigned to it;

(b) an accounting term not otherwise defined has the meaning assigned to it in accordance with GAAP;

(c) words in the singular include the plural, and words in the plural include the singular;

(d) provisions apply to successive events and transactions;

(e) the term “merger” includes a statutory share exchange and the term “merged” has a correlative meaning;

(f) the masculine gender includes the feminine and the neuter;

(g) references to agreements and other instruments include subsequent amendments thereto; and

(h) "herein," "hereof" and other words of similar import refer to this Indenture as a whole and not to any particular Article, Section or other subdivision.

ARTICLE 2
THE SECURITIES

Section 2.1. Form and Dating.

The Securities and the Trustee's certificate of authentication shall be substantially in the respective forms set forth in Exhibit A, which Exhibit is incorporated in and made part of this Indenture. The Securities may have notations, legends or endorsements required by law, stock exchange rule or usage. The Company shall provide any such notations, legends or endorsements to the Trustee in writing. Each Security shall be dated the date of its authentication. The Securities are being offered and sold by the Company pursuant to a Purchase Agreement, dated August 3, 2005 (the "*Purchase Agreement*"), among the Company, Parent and the Initial Purchaser, in transactions exempt from, or not subject to, the registration requirements of the Securities Act.

(a) *Restricted Global Securities*. All of the Securities are initially being offered and sold to qualified institutional buyers as defined in Rule 144A (collectively, "*QIBs*" or individually, each a "*QIB*") in reliance on Rule 144A under the Securities Act and shall be issued initially in the form of one or more Restricted Global Securities, which shall be deposited on behalf of the purchasers of the Securities represented thereby with the Trustee, at its Corporate Trust Office, as custodian for the depositary, The Depository Trust Company ("*DTC*") (such depositary, or any successor thereto, being hereinafter referred to as the "*Depositary*"), and registered in the name of its nominee, Cede & Co., duly executed by the Company and authenticated by the Trustee as hereinafter provided. The aggregate principal amount of the Restricted Global Securities may from time to time be increased or decreased by adjustments made on the records of the Securities Custodian as hereinafter provided, subject in each case to compliance with the Applicable Procedures.

(b) *Global Securities In General*. Each Global Security shall represent such of the outstanding Securities as shall be specified therein and each shall provide that it shall represent the aggregate amount of outstanding Securities from time to time endorsed thereon and that the aggregate amount of outstanding Securities represented thereby may from time to time be reduced or increased, as appropriate, to reflect exchanges, redemptions or purchases of such Securities. Any adjustment of the aggregate principal amount of a Global Security to reflect the amount of any increase or decrease in the amount of outstanding Securities represented thereby shall be made by the Trustee in accordance with instructions given by the Holder thereof as required by Section 2.12 and shall be made on the records of the Trustee and the Depositary.

Members of, or participants in, the Depositary ("*Agent Members*") shall have no rights under this Indenture with respect to any Global Security held on their behalf by the Depositary or under the Global Security, and the Depositary (including, for this purpose, its nominee) may be treated by the Company, the Trustee and any agent of the Company or the Trustee as the absolute owner and Holder of such Global Security for all purposes whatsoever. Notwithstanding the foregoing, nothing herein shall (A) prevent the Company, the Trustee or any agent of the Company or the Trustee from giving effect to any written certification, proxy or other authorization furnished by the Depositary or (B) impair, as between the Depositary and its Agent Members, the operation of customary practices governing the exercise of the rights of a Holder of any Security.

(c) *Book Entry Provisions*. The Company shall execute and the Trustee shall, in accordance with this Section 2.1(c), authenticate and deliver initially one or more Global Securities that (i) shall be registered in the name of the Depositary, (ii) shall be delivered by the Trustee to the Depositary or pursuant to the Depositary's instructions and (iii) shall bear legends substantially to the following effect:

"UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY TO THE COMPANY OR ITS AGENT FOR

REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY (AND ANY PAYMENT HEREON IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL SINCE THE REGISTERED OWNER HEREOF, CEDE & CO., HAS AN INTEREST HEREIN. THIS SECURITY IS A GLOBAL SECURITY WITHIN THE MEANING OF THE INDENTURE HEREINAFTER REFERRED TO AND IS REGISTERED IN THE NAME OF A DEPOSITARY OR A NOMINEE THEREOF. THIS SECURITY IS EXCHANGEABLE FOR SECURITIES REGISTERED IN THE NAME OF A PERSON OTHER THAN THE DEPOSITARY OR ITS NOMINEE ONLY IN THE LIMITED CIRCUMSTANCES DESCRIBED IN THE INDENTURE AND, UNLESS AND UNTIL IT IS EXCHANGED IN WHOLE OR IN PART FOR SECURITIES IN DEFINITIVE FORM, THIS SECURITY MAY NOT BE TRANSFERRED EXCEPT AS A WHOLE BY THE DEPOSITARY TO A NOMINEE OF THE DEPOSITARY OR BY A NOMINEE OF THE DEPOSITARY TO THE DEPOSITARY OR ANOTHER NOMINEE OF THE DEPOSITARY OR BY THE DEPOSITARY OR ANY SUCH NOMINEE TO A SUCCESSOR DEPOSITARY OR A NOMINEE OF SUCH SUCCESSOR DEPOSITARY."

Section 2.2. Execution and Authentication.

An Officer shall sign the Securities for the Company by manual or facsimile signature attested by the manual or facsimile signature of the

Secretary or an Assistant Secretary of the Company. Typographic and other minor errors or defects in any such facsimile signature shall not affect the validity or enforceability of any Security which has been authenticated and delivered by the Trustee.

If an Officer whose signature is on a Security no longer holds that office at the time the Trustee authenticates the Security, the Security shall be valid nevertheless.

A Security shall not be valid until an authorized signatory of the Trustee manually signs the certificate of authentication on the Security. The signature shall be conclusive evidence that the Security has been authenticated under this Indenture.

The Trustee shall authenticate and make available for delivery Securities for original issue in the aggregate principal amount of up to $87,000,000 ($100,000,000 if the option set forth in Section 2(b) of the Purchase Agreement is exercised in full) upon receipt of a written order or orders of the Company signed by an Officer of the Company (a "*Company Order*"). The Company Order shall specify the amount of Securities to be authenticated, shall provide that all such Securities will be represented by a Restricted Global Security and the date on which each original issue of Securities is to be authenticated. The aggregate principal amount of Securities outstanding at any time may not exceed $87,000,000 ($100,000,000 if the option set forth in Section 2(b) of the Purchase Agreement is exercised in full) except as provided in Section 2.7.

The Trustee shall act as the initial authenticating agent. Thereafter, the Trustee may appoint an authenticating agent acceptable to the Company to authenticate Securities. An authenticating agent may authenticate Securities whenever the Trustee may do so. Each reference in this Indenture to authentication by the Trustee includes authentication by such agent. An authenticating agent shall have the same rights as an Agent to deal with the Company or an Affiliate of the Company.

The Securities shall be issuable only in registered form without coupons and only in denominations of $1,000 principal amount and any integral multiple thereof.

Section 2.3. Registrar, Paying Agent and Exchange Agent.

The Company shall maintain one or more offices or agencies where Securities may be presented for registration of transfer or for exchange (each, a "*Registrar*"), one or more offices or agencies where Securities may be presented for payment (each, a "*Paying Agent*"), one or more offices or agencies where Securities may be presented for exchange (each, an "*Exchange Agent*") and one or more offices or agencies where notices and demands to or upon the Company in respect of the Securities and this Indenture may be served. The Company will at all times maintain a Paying Agent, Exchange Agent, Registrar and an office or agency where notices and demands to or upon the Company in respect of the Securities and this Indenture may be served in the Borough of Manhattan, The City of New York. One of the Registrars (the "*Primary Registrar*") shall keep a register of the Securities and of their transfer and exchange.

The Company shall enter into an appropriate agency agreement with any Agent not a party to this Indenture. The agreement shall implement the provisions of this Indenture that relate to such Agent. The Company shall notify the Trustee of the name and address of any Agent not a party to this Indenture. If the Company fails to maintain a Registrar, Paying Agent, Exchange Agent or agent for service of notices and demands in any place required by this Indenture, or fails to give the foregoing notice, the Trustee shall act as such. The Company or any Affiliate of the Company may act as Paying Agent (except for the purposes of Section 5.1 and Article 9).

The Company hereby initially designates the Trustee as Paying Agent, Registrar, Custodian and Exchange Agent, and each of the Corporate Trust Office of the Trustee and the office or agency of the Trustee (which shall initially be 100 Wall Street, Suite 1600, New York, NY 10005, Attention: Rick Prokosch), shall be one such office or agency of the Company for each of the aforesaid purposes.

Section 2.4. Paying Agent to Hold Money in Trust.

Prior to 10:00 a.m., New York City time, on each due date of the principal of or interest, if any, on any Securities, the Company shall deposit with a Paying Agent a sum sufficient to pay such principal or interest, if any, so becoming due. The Paying Agent shall hold in trust for the benefit of Holders or the Trustee all money held by the Paying Agent for the payment of principal of or interest, if any, on the Securities, and shall notify the Trustee of any default by the Company (or any other obligor on the Securities) in making any such payment. If the Company or an Affiliate of the Company acts as Paying Agent, it shall, before 10:00 a.m., New York City time, on each due date of the principal of or interest on any Securities, segregate the money and hold it as a separate trust fund. The Company at any time may require a Paying Agent to pay all money held by it to the Trustee, and the Trustee may at any time during the continuance of any default, upon written request to a Paying Agent, require such Paying Agent to pay forthwith to the Trustee all sums so held in trust by such Paying Agent. Upon doing so, the Paying Agent (other than the Company) shall have no further liability for the money.

Section 2.5. Holder Lists.

The Trustee shall preserve in as current a form as is reasonably practicable the most recent list available to it of the names and addresses of Holders. If the Trustee is not the Primary Registrar, the Company shall furnish to the Trustee on or before each semiannual interest payment date, and at such other times as the Trustee may request in writing, a list in such form and as of such date as the Trustee may reasonably require of the names and addresses of Holders.

Section 2.6. Transfer and Exchange.

Subject to compliance with any applicable additional requirements contained in Section 2.12, when a Security is presented to a Registrar with a request to register a transfer thereof or to exchange such Security for an equal principal amount of Securities of other authorized

denominations, the Registrar

shall register the transfer or make the exchange as requested; *provided, however*, that every Security presented or surrendered for registration of transfer or exchange shall be duly endorsed or accompanied by an assignment form and, if applicable, a transfer certificate each in the form included in Exhibit B, and in form satisfactory to the Registrar duly executed by the Holder thereof or its attorney duly authorized in writing. To permit registration of transfers and exchanges, upon surrender of any Security for registration of transfer or exchange at an office or agency maintained pursuant to Section 2.3, the Company shall execute and the Trustee shall authenticate Securities of a like aggregate principal amount at the Registrar's request. Any exchange or transfer shall be without charge, except that the Company or the Registrar may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto.

Neither the Company, any Registrar nor the Trustee shall be required to exchange or register a transfer of (i) any Securities for a period of 15 days next preceding any mailing of a notice of Securities to be redeemed, (ii) any Securities or portions thereof selected or called for redemption (except, in the case of redemption of a Security in part, the portion thereof not to be redeemed) or (iii) any Securities or portions thereof in respect of which a Fundamental Change Company Notice has been delivered and not withdrawn by the Holder thereof (except, in the case of the purchase of a Security in part, the portion thereof not to be purchased). All Securities issued upon any transfer or exchange of Securities shall be valid obligations of the Company, evidencing the same debt and entitled to the same benefits under this Indenture, as the Securities surrendered upon such transfer or exchange.

Any Registrar appointed pursuant to Section 2.3 shall provide to the Trustee such information as the Trustee may reasonably require in connection with the delivery by such Registrar of Securities upon transfer or exchange of Securities.

Each Holder of a Security agrees to indemnify the Company and the Trustee against any liability that may result from the transfer, exchange or assignment of such Holder's Security in violation of any provision of this Indenture and/or applicable United States federal or state securities law.

The Trustee shall have no obligation or duty to monitor, determine or inquire as to compliance with any restrictions on transfer imposed under this Indenture or under applicable law with respect to any transfer of any interest in any Security (including any transfers between or among Agent Members or other beneficial owners of interests in any Global Security) other than to require delivery of such certificates and other documentation or evidence as are expressly required by, and to do so if and when expressly required by the terms of, this Indenture, and to examine the same to determine substantial compliance as to form with the express requirements hereof.

Section 2.7. Replacement Securities.

If any mutilated Security is surrendered to the Company, a Registrar or the Trustee, or the Company, a Registrar and the Trustee receive evidence to their satisfaction of the destruction, loss or theft of any Security, and there is delivered to the Company, the applicable Registrar and the Trustee such security or indemnity as may be required by them to save each of them harmless, then, in the absence of notice to the Company, such Registrar or the Trustee that such Security has been acquired by a bona fide purchaser, the Company shall execute, and upon its written request the Trustee shall authenticate and deliver, in exchange for any such mutilated Security or in lieu of any such destroyed, lost or stolen Security, a new Security of like tenor and principal amount, bearing a number not contemporaneously outstanding.

In case any such mutilated, destroyed, lost or stolen Security has become or is about to become due and payable, or is about to be redeemed or purchased by the Company pursuant to Article 3, the Company in its discretion may, instead of issuing a new Security, pay, redeem or purchase such Security, as the case may be.

Upon the issuance of any new Securities under this Section 2.7, the Company may require the payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto and any other reasonable expenses (including the reasonable fees and expenses of the Trustee or the Registrar) in connection therewith.

Every new Security issued pursuant to this Section 2.7 in lieu of any mutilated, destroyed, lost or stolen Security shall constitute an original additional contractual obligation of the Company, whether or not the mutilated, destroyed, lost or stolen Security shall be at any time enforceable by anyone, and shall be entitled to all benefits of this Indenture equally and proportionately with any and all other Securities duly issued hereunder.

The provisions of this Section 2.7 are (to the extent lawful) exclusive and shall preclude (to the extent lawful) all other rights and remedies with respect to the replacement or payment of mutilated, destroyed, lost or stolen Securities.

Section 2.8. Outstanding Securities.

Securities outstanding at any time are all Securities authenticated by the Trustee, except for those canceled by it, those exchanged pursuant to Article 4, those delivered to it for cancellation or surrendered for transfer or exchange and those described in this Section 2.8 as not outstanding.

If a Security is replaced pursuant to Section 2.7, it ceases to be outstanding unless the Company receives proof satisfactory to it that the

replaced Security is held by a bona fide purchaser.

If a Paying Agent (other than the Company or an Affiliate of the Company) holds on a Redemption Date, a Put Right Purchase Date, a Fundamental Change Purchase Date or the Final Maturity Date money sufficient to pay the principal of (including premium, if any) and accrued interest on Securities (or portions thereof) payable on that date, then on and after such Redemption Date, Put Right Purchase Date, Fundamental Change Purchase Date or the Final Maturity Date, as the case may be, such Securities (or portions thereof, as the case may be) shall cease to be outstanding and interest on them shall cease to accrue; *provided*, that if such Securities are to be redeemed, notice of such redemption has been duly given pursuant to this Indenture or provision therefore satisfactory to the Trustee has been made.

A Security does not cease to be outstanding because the Company or an Affiliate of the Company holds the Security.

Section 2.9. Treasury Securities.

In determining whether the Holders of the required principal amount of Securities have concurred in any notice, direction, waiver or consent, Securities owned by the Company or any other obligor on the Securities or by any Affiliate of the Company or of such other obligor shall be disregarded, except that, for purposes of determining whether the Trustee shall be protected in relying on any such notice, direction, waiver or consent, only Securities which a Trust Officer of the Trustee actually knows are so owned shall be so disregarded. Securities so owned which have been pledged in good faith shall not be disregarded if the pledgee establishes to the satisfaction of the Trustee the pledgee's right so to act with respect to the Securities and that the pledgee is not the Company or any other obligor on the Securities or any Affiliate of the Company or of such other obligor.

Section 2.10. Temporary Securities.

Until definitive Securities are ready for delivery, the Company may prepare and execute, and, upon receipt of a Company Order, the Trustee shall authenticate and deliver, temporary Securities. Temporary Securities shall be substantially in the form of definitive Securities but may have variations that the Company with the consent of the Trustee considers appropriate for temporary Securities.

Without unreasonable delay, the Company shall prepare and the Trustee shall authenticate and deliver definitive Securities in exchange for temporary Securities.

Section 2.11. Cancellation.

The Company at any time may deliver Securities to the Trustee for cancellation. The Registrar, the Paying Agent and the Exchange Agent shall forward to the Trustee or its agent any Securities surrendered to them for transfer, exchange, redemption or payment. The Trustee and no one else shall cancel, in accordance with its standard procedures, all Securities surrendered for transfer, exchange, redemption or payment or cancellation and shall deliver the canceled Securities to the Company. All Securities which are redeemed, purchased or otherwise acquired by the Company or any of its Subsidiaries prior to the Final Maturity Date shall be delivered to the Trustee for cancellation, and the Company may not hold or resell such securities or issue any new Securities to replace any such Securities or any Securities that any Holder has exchanged pursuant to Article 4.

Section 2.12. Legend; Additional Transfer and Exchange Requirements.

(a) If Securities are issued upon the transfer, exchange or replacement of Securities subject to restrictions on transfer and bearing the legends set forth on the forms of Securities attached hereto as Exhibit A (collectively, the "*Legend*"), or if a request is made to remove the Legend on a Security, the Securities so issued shall bear the Legend, or the Legend shall not be removed, as the case may be, unless there is delivered to the Company and the Registrar such satisfactory evidence, which shall include an opinion of counsel if requested by the Company or such Registrar, as may be reasonably required by the Company and the Registrar, that neither the Legend nor the restrictions on transfer set forth therein are required to ensure that transfers thereof comply with the provisions of Rule 144A or Rule 144 under the Securities Act or that such Securities are not "restricted" within the meaning of Rule 144 under the Securities Act; *provided*, that no such evidence need be supplied in connection with the sale of such Security pursuant to a registration statement that is effective at the time of such sale. Upon (i) provision of such satisfactory evidence if requested, or (ii) notification by the Company to the Trustee and Registrar of the sale of such Security pursuant to a registration statement that is effective at the time of such sale, the Trustee, at the written direction of the Company, shall authenticate and deliver a Security that does not bear the Legend. If the Legend is removed from the face of a Security and the Security is subsequently held by an Affiliate of the Company, the Legend shall be reinstated.

(b) A Global Security may not be transferred, in whole or in part, to any Person other than the Depositary or a nominee or any successor thereof, and no such transfer to any such other Person may be registered; *provided*, that the foregoing shall not prohibit any transfer of a Security that is issued in exchange for a Global Security but is not itself a Global Security. No transfer of a Security to any Person shall be effective under this Indenture or the Securities unless and until such Security has been registered in the name of such Person. Notwithstanding any other provisions of this Indenture or the Securities, transfers of a Global Security, in whole or in part, shall be made only in accordance with this Section 2.12.

(c) Subject to the succeeding paragraph, every Security shall be subject to the restrictions on transfer provided in the Legend other than a Restricted Global Security. Whenever any Transfer Restricted Security other than a Restricted Global Security is presented or surrendered for registration of transfer or for exchange for a Security registered in a name other than that of the Holder, such Security must be accompanied by a certificate in substantially the form set forth in Exhibit B, dated the date of such surrender and signed by the Holder of such Security, as to compliance with such restrictions on transfer. The Registrar shall not be required to accept for such registration of transfer or exchange any

Security not so accompanied by a properly completed certificate.

(d) The restrictions imposed by the Legend upon the transferability of any Security shall cease and terminate when such Security has been sold pursuant to an effective registration statement under the Securities Act or transferred in compliance with Rule 144 under the Securities Act (or any successor provision thereto) or, if earlier, upon the expiration of the holding period applicable to sales thereof under Rule 144 (k) under the Securities Act (or any successor provision). Any Security as to which such restrictions on transfer shall have expired in accordance with their terms or shall have terminated may, upon a surrender of such Security for exchange to the Registrar in accordance with the provisions of this Section 2.12 (accompanied, in the event that such restrictions on transfer have terminated by reason of a transfer in compliance with Rule 144 or any successor provision, by, if requested, an opinion of counsel reasonably acceptable to the Company, addressed to the Company and in form acceptable to the Company, to the effect that the transfer of such Security has been made in compliance with Rule 144 or such successor provision), be exchanged for a new Security, of like tenor and aggregate principal amount, which shall not bear the restrictive Legend. The Company shall inform the Trustee of the effective date of any registration statement registering the Securities under the Securities Act. The Trustee shall not be liable for any action taken or omitted to be taken by it in good faith in accordance with the aforementioned opinion of counsel or registration statement.

(e) As used in the preceding two paragraphs of this Section 2.12, the term "transfer" encompasses any sale, pledge, transfer, hypothecation or other disposition of any Security.

(f) The provisions of clauses (1), (2), (3), (4) and (5) below shall apply only to Global Securities:

(1) Notwithstanding any other provisions of this Indenture or the Securities, a Global Security shall not be exchanged in whole or in part for a Security registered in the name of any Person other than the Depositary or one or more nominees thereof, *provided*, that a Global Security may be exchanged for Securities registered in the names of any person designated by the Depositary in the event that (A) the Depositary has notified the Company that it is unwilling or unable to continue as Depositary for such Global Security or such Depositary has ceased to be a "clearing agency" registered under the Exchange Act, and a successor Depositary is not appointed by the Company within 90 days, or (B) an Event of Default has occurred and is continuing with respect to the Securities. Any Global Security exchanged pursuant to clause (A) above shall be so exchanged in whole and not in part, and any Global Security exchanged pursuant to clause (B) above may be exchanged in whole or from time to time in part as directed by the Depositary. Any Security issued in exchange for a Global Security or any portion thereof shall be a Global Security; *provided*, that any such Security so issued that is registered in the name of a Person other than the Depositary or a nominee thereof shall not be a Global Security.

(2) Securities issued in exchange for a Global Security or any portion thereof shall be issued in definitive, fully-registered book entry form, without interest coupons, shall have an aggregate principal amount equal to that of such Global Security or portion thereof to be so exchanged, shall be registered in such names and be in such authorized denominations as the Depositary shall designate and shall bear the applicable legends provided for herein. Any Global Security to be exchanged in whole shall be surrendered by the Depositary to the Trustee, as Registrar. With regard to any Global Security to be exchanged in part, either such Global Security shall be so surrendered for exchange or, if the Trustee is acting as custodian for the Depositary or its nominee with respect to such Global Security, the principal amount thereof shall be reduced, by an amount equal to the portion thereof to be so exchanged, by means of an appropriate adjustment made on the records of the Trustee. Upon any such surrender or adjustment, the Trustee shall authenticate and deliver the Security issuable on such exchange to or upon the order of the Depositary or an authorized representative thereof.

(3) Subject to the provisions of clause (5) below, the registered Holder may grant proxies and otherwise authorize any Person, including Agent Members and persons that may hold interests

through Agent Members, to take any action which a Holder is entitled to take under this Indenture or the Securities.

(4) In the event of the occurrence of any of the events specified in clause (1) above, the Company will promptly make available to the Trustee a reasonable supply of Certificated Securities in definitive, fully registered form, without interest coupons.

(5) Neither Agent Members nor any other Persons on whose behalf Agent Members may act shall have any rights under this Indenture with respect to any Global Security registered in the name of the Depositary or any nominee thereof, or under any such Global Security, and the Depositary or such nominee, as the case may be, may be treated by the Company, the Trustee and any agent of the Company or the Trustee as the absolute owner and holder of such Global Security for all purposes whatsoever. Notwithstanding the foregoing, nothing herein shall prevent the Company, the Trustee or any agent of the Company or the Trustee from giving effect to any written certification, proxy or other authorization furnished by the Depositary or such nominee, as the case may be, or impair, as between the Depositary, its Agent Members and any other person on whose behalf an Agent Member may act, the operation of customary practices of such Persons governing the exercise of the rights of a holder of any Security.

Section 2.13. CUSIP Numbers.

The Company in issuing the Securities may use one or more "CUSIP" numbers (if then generally in use), and, if so, the Trustee shall use "CUSIP" numbers in notices of redemption or purchase as a convenience to Holders; *provided*, that any such notice may state that no representation is made as to the correctness of such numbers either as printed on the Securities or as contained in any notice of a redemption or purchase and that reliance may be placed only on the other identification numbers printed on the Securities, and any such redemption or purchase

shall not be affected by any defect in or omission of such numbers. The Company will promptly notify the Trustee of any change in the "CUSIP" numbers.

Section 2.14. Senior Unsecured Obligations.

The Securities are senior unsecured obligations of the Company and rank equally in right of payment with all existing and future unsecured and unsubordinated indebtedness of the Company senior to existing and future subordinated indebtedness of the Company.

Section 2.15. Calculations Regarding the Securities.

The Company and its agents shall be responsible for making all calculations as contemplated under this Indenture and the Securities. The Company and its agents shall make such calculations in good faith, and absent manifest error, such calculations shall be final and binding upon all Holders of the Securities. The Company shall provide a copy of these calculations to the Trustee, and, absent manifest error, the Trustee shall be entitled to rely on the accuracy of such calculations without conducting an independent verification as to the accuracy thereof.

ARTICLE 3
REDEMPTION AND REPURCHASES

Section 3.1. Company's Rights to Redeem; Notice to Trustee.

(a) Prior to August 20, 2010, the Securities shall not be redeemable at the Company's option. The Securities may be redeemed at the election of the Company (the "*Optional Redemption*"), as a whole or from time to time in part, at any time on or after August 20, 2010, at a redemption price equal to 100% of the principal amount of those Securities plus accrued and unpaid interest (including Liquidated Damages, if any) to, but not including, such Redemption Date (the "*Redemption Price*"), if the Closing Price of the Common Stock has exceeded 130% of the Exchange Price for at least 20 Trading Days in any consecutive 30 Trading Day Period ending on or after the earliest date on which the Company may mail the notice of redemption (and the Trustee shall be entitled to assume that such condition has been satisfied based upon its receipt of the notice set forth in Section 3.1(b)); *provided*, that if the Redemption Date falls after an interest payment record date (the "*Regular Record Date*") and on or before an interest payment date, then the interest (including Liquidated Damages, if any) will be payable to the Holders in whose name the Securities are registered at the close of business on the Regular Record Date and the Redemption Price shall not include such interest payment. The Company will make an additional payment with respect to all Securities called for redemption, including any Securities exchanged after the date the notice of redemption is mailed to Holders, equal to the total value of the aggregate amount of the interest otherwise payable on the Securities from the last day through which interest was paid on the Securities through the Redemption Date.

(b) If the Company elects to redeem Securities pursuant to Section 3.1(a), it shall notify the Trustee at least 45 but not more than 60 days prior to the Redemption Date, as fixed by the Company, (unless a shorter notice shall be satisfactory to the Trustee) of the Redemption Date and the principal amount of Securities to be redeemed. If fewer than all of the Securities are to be redeemed, the record date relating to such redemption shall be selected by the Company and given to the Trustee, which record date shall not be less than ten days after the date of notice to the Trustee.

Section 3.2. Selection of Securities to be Redeemed.

(a) If less than all of the Securities are to be redeemed, unless the Applicable Procedures provide otherwise, the Trustee shall, at least 30 days but not more than 60 days prior to the Redemption Date, select the Securities to be redeemed. The Trustee shall make the selection from the Securities outstanding and not previously called for redemption, by lot, or in its discretion, on a pro rata basis. Securities in denominations of $1,000 may only be redeemed in whole. The Trustee may select for redemption portions (equal to $1,000 or any integral multiple thereof) of the principal of Securities that have denominations larger than $1,000. Provisions of this Indenture that apply to Securities called for redemption also apply to portions of Securities called for partial redemption.

(b) If any Security selected for partial redemption is exchanged in part before termination of the exchange right with respect to the portion of the Security so selected, the exchanged portion of such Security shall be deemed to be the portion selected for redemption. Securities which have been exchanged during a selection of Securities to be redeemed shall be treated by the Trustee as outstanding for the purpose of such selection.

Section 3.3. Notice of Redemption.

(a) At least 30 days but not more than 60 days before a Redemption Date, the Company shall mail or cause to be mailed a notice of redemption to each Holder of Securities to be redeemed at such Holder's address as it appears on the register of Securities maintained by the Primary Registrar.

(b) The notice shall identify the Securities (including CUSIP numbers) to be redeemed and shall state:

(1) the Redemption Date;

(2) the Redemption Price;

(3) the then current Exchange Price;

(4) the name and address of each Paying Agent and Exchange Agent;

(5) that Securities called for redemption must be presented and surrendered to an Exchange Agent to collect the Redemption Price;

(6) that Holders who wish to exchange Securities must surrender such Securities for exchange no later than the close of business on the Business Day immediately preceding the Redemption Date and must satisfy the other requirements set forth in Section 11 of the Securities;

(7) that, unless the Company defaults in making the payment of the Redemption Price, interest on Securities called for redemption shall cease accruing on and after the Redemption Date and the only remaining right of the Holder shall be to receive payment of the Redemption Price plus any accrued but unpaid interest (including Liquidated Damages, if any) upon presentation and surrender to a Paying Agent of the Securities; and

(8) if any Security is being redeemed in part, the portion of the principal amount of such Security to be redeemed and that, after the Redemption Date, upon presentation and surrender of such Security, a new Security or Securities in aggregate principal amount equal to the unredeemed portion thereof will be issued.

If any of the Securities to be redeemed is in the form of a Global Security, then the Company shall modify such notice to the extent necessary to accord with the Applicable Procedures. At the Company's written request, which request shall (i) be irrevocable once given and (ii) set forth all relevant information required by clauses (1) through (8) of the preceding paragraph, the Trustee shall give the notice of redemption in the Company's name and at the Company's expense; *provided* that the text of such notice shall be prepared by the Company.

Section 3.4. Effect of Notice of Redemption.

Once notice of redemption is mailed, Securities called for redemption become due and payable on the Redemption Date and at the Redemption Price stated in the notice, together with accrued and unpaid interest (including Liquidated Damages, if any) except for Securities that are exchanged in accordance with the provisions of Article 4. Upon presentation and surrender to a Paying Agent, Securities called for redemption shall be paid at the Redemption Price, plus accrued and unpaid interest (including Liquidated Damages, if any) up to, but not including, the Redemption Date; *provided*, that if the Redemption Date falls after an interest payment record date and on or before an interest payment date, then the interest (including Liquidated Damages, if any) will be payable to the Holders in whose name the Securities are registered at the Regular Record Date.

Section 3.5. Deposit of Redemption Price.

Prior to noon, New York City time, on the Redemption Date, the Company shall deposit with the Paying Agent (or if the Company or a Subsidiary or an Affiliate of any of them is acting as the Paying Agent, shall segregate and hold in trust as provided in Section 2.4) an amount of cash (in immediately available funds if deposited on such Redemption Date) sufficient to pay the Redemption Price of and accrued and unpaid interest (including Liquidated Damages, if any) on all Securities to be redeemed on that date, other than Securities or portions thereof called for redemption on that date which have

been delivered by the Company to the Trustee for cancellation or have been exchanged. The Paying Agent shall as promptly as practicable return to the Company any money not required for that purpose because of the exchange of Securities pursuant to Article 4 or, if such money is then held by the Company in trust and is not required for such purpose, it shall be discharged from the trust.

If the Paying Agent holds, in accordance with the terms hereof, at noon, New York City time, on the Redemption Date, cash sufficient to pay the Redemption Price and accrued and unpaid interest (including Liquidated Damages, if any) for all Securities to be redeemed on such date, then, immediately after such Redemption Date, such Securities shall cease to be outstanding and interest on such Securities will cease to accrue, whether or not such Securities are delivered to the Paying Agent, and the rights of the Holders in respect thereof shall terminate (other than the right to receive the Redemption Price upon delivery of such Securities).

Section 3.6. Securities Redeemed in Part.

Upon presentation and surrender of a Security that is redeemed in part, the Company shall execute and the Trustee shall authenticate and deliver to the Holder a new Security equal in principal amount to the unredeemed portion of the Security surrendered.

Section 3.7. Repurchase of Securities at the Option of Holders on Specific Dates.

(a) Securities shall be purchased by the Company, at the option of the Holder thereof, on August 15, 2010, August 15, 2015 and August 15, 2020 (each, a "*Put Right Purchase Date*"), at a purchase price equal to 100% of the principal amount of those Securities plus accrued and unpaid interest (including Liquidated Damages, if any) to, but not including, such Put Right Purchase Date (the "*Put Right Purchase Price*"), subject to satisfaction by or on behalf of the Holder of the requirements set forth in this Section 3.7.

(b) No later than 20 days prior to each Put Right Purchase Date, the Company shall mail a written notice of the repurchase right under Section 3.7(a) (a "*Put Right Purchase Offer*") by first class mail to the Paying Agent, which initially is the Trustee, and to each Holder (and to beneficial owners as required by applicable law). The Company shall disseminate a press release through Dow Jones & Company, Inc. or Bloomberg Business News containing the information specified in such notice, or publish the notice in a newspaper of general circulation in New York City, or post the notice on Parent's website, or disseminate the information through some other public means that the Company, in its reasonable discretion, deems appropriate. The Put Right Purchase Offer shall include a form of notice to be completed by the Holder and returned to the Company in the event that the Holder elects to exercise its repurchase rights under Section 3.7(a) (the "*Put Right Purchase Notice*"). The Put Right Purchase Offer shall briefly state, as applicable:

(1) the amount of Put Right Purchase Price;

(2) that any Securities with respect to which the Holder has delivered a Put Right Purchase Notice may be exchanged in accordance with the terms of this Indenture only if such Holder withdraws such Put Right Purchase Notice in accordance with Section 3.7 (f); and

(3) the procedures the Holder must follow in order to exercise its rights under this Section 3.7.

If any of the Securities subject to the Put Right Purchase Offer is in the form of a Global Security, then the Company shall modify such Put Right Purchase Offer to the extent necessary to accord with the Applicable Procedures. At the Company's written request, which request shall (i) be irrevocable once given and (ii) set forth all relevant information required by clauses (1) through (3) of the preceding paragraph, the Trustee shall give the Put Right Purchase Offer in the Company's name and

at the Company's expense; *provided* that the text of the Put Right Purchase Offer shall be prepared by the Company.

(c) A Holder may exercise its repurchase rights under Section 3.7(a) upon delivery of a properly completed Put Right Purchase Notice to the Paying Agent at any time during the period beginning at 9:00 a.m., New York City time, on the date that is 20 days immediately preceding the relevant Put Right Purchase Date until 5:00 p.m., New York City time, on the second Business Day immediately preceding such Put Right Purchase Date, stating:

(1) the certificate number, if any, of the Security in respect of which such Put Right Purchase Notice is being submitted or, if the Security is not then issued as a Certificated Security, that the Put Right Purchase Notice complies with the Applicable Procedures of the Depositary in effect at that time;

(2) the portion of the principal amount of the Security which the Holder will deliver to be repurchased, which portion must be in principal amounts of $1,000 or an integral multiple of $1,000; and

(3) that such Security shall be repurchased by the Company as of the Put Right Purchase Date pursuant to the terms and conditions specified in the Securities and in this Indenture.

(d) The delivery of a Security to the Paying Agent with, or at any time after delivery of, the Purchase Notice (together with all necessary endorsements) at the offices of the Paying Agent shall be a condition to the receipt by the Holder of the Put Right Purchase Price therefor; *provided, however*, that such Put Right Purchase Price shall be so paid pursuant to this Section 3.7 only if the Security so delivered to the Paying Agent shall conform in all respects to the description thereof set forth in the related Put Right Purchase Notice.

The Company shall repurchase from the Holder thereof, pursuant to this Section 3.7, a portion of a Security, so long as the principal amount of such portion is $1,000 or an integral multiple of $1,000. Provisions of this Indenture that apply to the repurchase of all of a Security also apply to the repurchase of such portion of such Security.

Notwithstanding anything contained herein to the contrary, any Holder delivering to the Paying Agent the Put Right Purchase Notice contemplated by Section 3.7(b) shall have the right to withdraw such Put Right Purchase Notice at any applicable time prior to 5:00 p.m., New York City time, on the second Business Day immediately preceding the Put Right Purchase Date by delivery of a written notice of withdrawal to the Paying Agent in accordance with Section 3.7(f).

The Paying Agent shall promptly notify the Company of the receipt by it of any Put Right Purchase Notice or written notice of withdrawal thereof.

(e) Upon receipt by the Paying Agent of the Put Right Purchase Notice specified in Section 3.7(b), the Holder of the Security in respect of which such Put Right Purchase Notice was given shall (unless such Put Right Purchase Notice is withdrawn as specified in Section 3.7 (f)) thereafter be entitled to receive solely the Put Right Purchase Price with respect to such Security. Such Put Right Purchase Price shall be paid to such Holder, subject to receipt of cash, by the Paying Agent, promptly (but within two Business Days) following the later of (a) the Put Right Purchase Date with respect to such Security (provided the conditions in Section 3.7(c) have been satisfied) and (b) the time of delivery of such Security to the Paying Agent by the Holder thereof in the manner required by Section 3.7(c). Securities in respect of which a Put Right Purchase Notice has been given by the Holder thereof may not be exchanged pursuant to Article 4 on or after the date of the delivery of such Put Right Purchase Notice unless such Put Right Purchase Notice has first been validly withdrawn as specified in Section 3.7(f).

(f) A Put Right Purchase Notice may be withdrawn by means of a written notice of withdrawal delivered to the office of the Paying Agent in accordance with the Put Right Purchase Notice at any time prior to 5:00 p.m., New York City time, on the second Business Day immediately preceding the Put Right Purchase Date, specifying:

(1) the name of the Holder;

(2) a statement that the Holder is withdrawing its election to require the Company to repurchase its Securities;

(3) the certificate number, if any, of the Security in respect of which such notice of withdrawal is being submitted or, if the Security is not then issued as a Certificated Security, that the notice of withdrawal complies with the Applicable Procedures of the Depositary in effect at that time;

(4) the principal amount of the Security with respect to which such notice of withdrawal is being submitted; and

(5) the principal amount, if any, of such Security which remains subject to the original Put Right Purchase Notice and which has been or will be delivered for repurchase by the Company, which must be an integral multiple of $1,000.

(g) Prior to noon, New York City time, on the Business Day following the applicable Put Right Purchase Date, the Company shall deposit with the Paying Agent (or if the Company or a Subsidiary or an Affiliate of any of them is acting as the Paying Agent, shall segregate and hold in trust as provided in Section 2.4) an amount of cash (in immediately available funds if deposited on such Put Right Purchase Date) sufficient to pay the aggregate Put Right Purchase Price of all the Securities or portions thereof which are to be purchased on such Put Right Purchase Date.

If the Paying Agent holds, in accordance with the terms hereof, at noon, New York City time, on the Business Day following the applicable Put Right Purchase Date, cash sufficient to pay the Put Right Purchase Price of any Securities for which a Put Right Purchase Notice has been tendered and not withdrawn pursuant to Section 3.7(f), then, immediately after such Put Right Purchase Date, such Securities will cease to be outstanding and interest on such Securities will cease to accrue, whether or not such Securities are delivered to the Paying Agent, and the rights of the Holders in respect thereof shall terminate (other than the right to receive the Put Right Purchase Price upon delivery of such Securities).

(h) Any Certificated Security which is to be repurchased only in part shall be surrendered at the office of the Paying Agent (with, if the Company or the Trustee so requires, due endorsement by, or a written instrument of transfer in form satisfactory to the Company and the Trustee duly executed by, the Holder thereof or such Holder's attorney duly authorized in writing) and the Company shall execute and the Trustee shall authenticate and deliver to the Holder of such Security, without charge, a new Security or Securities, of any authorized denomination as requested by such Holder in aggregate principal amount equal to, and in exchange for, the portion of the principal amount of the Security so surrendered which is not repurchased.

Section 3.8. Repurchase of Securities at Option of the Holder Upon a Fundamental Change.

(a) If a Fundamental Change occurs at any time prior to the Final Maturity Date, each Holder will have the right to require the Company to repurchase all of its Securities not previously called for redemption, or any portion of such Securities, at a purchase price equal to 100% of the principal amount of all such Securities, plus accrued and unpaid interest (including Liquidated Damages, if any) on such Securities to, but not including, the Fundamental Change Purchase Date (the "*Fundamental Change Purchase Price*"), subject to satisfaction by or on behalf of any Holder of the requirements set

forth in this Section 3.8; provided that the Company may not repurchase any Securities at the option of Holders upon the occurrence of a Fundamental Change if there has occurred and is continuing an Event of Default with respect to the Securities, other than a default in the payment of the Fundamental Change Purchase Price. The date the Company shall repurchase the Securities pursuant to this Section 3.8(a) (the "*Fundamental Change Purchase Date*") shall be no earlier than 15 days and no later than 30 days after the date of the mailing of the Fundamental Change Company Notice under Section 3.8(b).

(b) No later than 20 days after the occurrence of a Fundamental Change, the Company shall mail a written notice of such Fundamental Change (the "*Fundamental Change Company Notice*") by first class mail to the Trustee and to each Holder (and to beneficial owners as required by applicable law). The Company shall disseminate a press release through Dow Jones & Company, Inc. or Bloomberg Business News containing the information specified in such notice, or publish the notice in a newspaper of general circulation in New York City, or post the notice on Parent's website, or disseminate the information through some other public means that the Company, in its reasonable discretion, deems appropriate. The Fundamental Change Company Notice shall include a form of notice to be completed by the Holder in the event the Holder elects to exercise its repurchase right under Section 3.8(a) (the "*Fundamental Change Purchase Notice*"). The Fundamental Change Company Notice shall briefly state, as applicable:

(1) the events causing the Fundamental Change;

(2) the date of such Fundamental Change;

(3) the Fundamental Change Purchase Date;

(4) the date by which the Fundamental Change Purchase Notice must be delivered to the Paying Agent in order for a Holder

to exercise the Fundamental Change repurchase right;

(5) the amount of the Fundamental Change Purchase Price;

(6) the name and address of the Paying Agent and the Exchange Agent;

(7) the procedures for withdrawing a Fundamental Change Repurchase Notice;

(8) the Exchange Rate applicable on the date of the Fundamental Change Company Notice and any adjustments to the Exchange Rate that will result from the Fundamental Change (including any Make-Whole Premium);

(9) that the Securities with respect to which the Holder has delivered a Fundamental Change Purchase Notice may be exchanged in accordance with the terms of this Indenture, only if such Holder withdraws such Fundamental Change Purchase Notice in accordance with Section 3.8(f); and

(10) the procedures the Holder must follow in order to exercise its rights under this Section 3.8.

If any of the Securities subject to the Fundamental Change Company Notice is in the form of a Global Security, then the Company shall modify such Fundamental Change Company Notice to the extent necessary to accord with the Applicable Procedures. At the Company's written request, which request shall (i) be irrevocable once given and (ii) set forth all relevant information required by clauses (1) through (10) of the preceding paragraph, the Trustee shall give the Fundamental Change Company Notice in the Company's name and at the Company's expense; *provided* that the text of the Fundamental Change Company Notice shall be prepared by the Company.

(c) A Holder may exercise its repurchase rights under Section 3.8(a) upon delivery of a properly completed Fundamental Change Purchase Notice to the Paying Agent at any time from the opening of

business on the date of the Fundamental Change Company Notice until 5:00 p.m., New York City time, on the fifth Business Day immediately preceding the Fundamental Change Purchase Date, stating:

(1) the certificate number, if any, of the Security in respect of which such Fundamental Change Purchase Notice is being submitted or, if the Security is not then issued as a Certificated Security, that the Fundamental Change Purchase Notice complies with the Applicable Procedures of the Depositary in effect at that time;

(2) the portion of the principal amount of the Security that the Holder will deliver to be repurchased, which portion must be $1,000 or an integral multiple of $1,000; and

(3) that such Security shall be repurchased on the Fundamental Change Repurchase Date pursuant to the terms and conditions specified in the Securities and in this Indenture.

(d) The delivery of a Security to the Paying Agent with, or at any time after delivery of, the Fundamental Change Purchase Notice (together with all necessary endorsements) at the offices of the Paying Agent shall be a condition to the receipt by the Holder of the Fundamental Change Purchase Price therefor; *provided, however*, that such Fundamental Change Purchase Price shall be so paid pursuant to this Section 3.8 only if the Security so delivered to the Paying Agent shall conform in all respects to the description thereof set forth in the related Fundamental Change Purchase Notice.

The Company shall repurchase from the Holder thereof, pursuant to this Section 3.8, a portion of a Security, so long as the principal amount of such portion is $1,000 or an integral multiple of $1,000. Provisions of this Indenture that apply to the repurchase of all of a Security also apply to the repurchase of such portion of such Security.

Notwithstanding anything contained herein to the contrary, any Holder delivering to the Paying Agent the Fundamental Change Purchase Notice contemplated by this Section 3.8 shall have the right to withdraw such Fundamental Change Purchase Notice at any time prior to 5:00 p.m., New York City time, on the Business Day immediately preceding the Fundamental Change Purchase Date by delivery of a written notice of withdrawal to the Paying Agent in accordance with Section 3.8(f).

The Paying Agent shall promptly notify the Company of the receipt by it of any Fundamental Change Purchase Notice or written notice of withdrawal thereof.

(e) Upon receipt by the Paying Agent of the Fundamental Change Purchase Notice specified in Section 3.8(b), the Holder of the Security in respect of which such Fundamental Change Purchase Notice was given shall (unless such Fundamental Change Purchase Notice is withdrawn as specified in Section 3.8(f)) thereafter be entitled to receive solely the Fundamental Change Purchase Price with respect to such Security. Such Fundamental Change Purchase Price shall be paid to such Holder, subject to receipt of cash, by the Paying Agent, promptly (but within two Business Days) following the later of (a) the Fundamental Change Purchase Date with respect to such Security (provided that the conditions set forth in Section 3.8(c) have been satisfied) and (b) the time of delivery of such Security to the Paying Agent by the Holder thereof in the manner required by Section 3.8(c). Securities in respect of which a Fundamental Change Purchase Notice has been given by the Holder thereof may not be exchanged pursuant to Article 4 on or after the date of the delivery of such Fundamental Change Purchase Notice unless such Fundamental Change Purchase Notice has first been validly withdrawn as specified in Section 3.8(f).

(f) A Fundamental Change Purchase Notice may be withdrawn by means of a written notice of withdrawal delivered to the office of the Paying Agent in accordance with the Fundamental Change Purchase Notice at any time prior to 5:00 p.m., New York City time, on the fifth Business Day immediately preceding the Fundamental Change Purchase Date, specifying:

(1) the name of the Holder;

(2) a statement that the Holder is withdrawing its election to require the Company to repurchase its Securities;

(3) the certificate number, if any, of the Security in respect of which such notice of withdrawal is being submitted or, if the Security is not then issued as a Certificated Security, that the notice of withdrawal complies with the Applicable Procedures of the Depositary in effect at that time;

(4) the principal amount of the Security with respect to which such notice of withdrawal is being submitted; and

(5) the principal amount, if any, of such Security which remains subject to the original Fundamental Change Purchase Notice and which has been or will be delivered for repurchase by the Company, which must be an integral multiple of $1,000.

(g) Prior to noon, New York City time, on the applicable Fundamental Change Purchase Date, the Company shall deposit with the Paying Agent (or if the Company or a Subsidiary or an Affiliate of any of them is acting as the Paying Agent, shall segregate and hold in trust as provided in Section 2.4) an amount of cash (in immediately available funds if deposited on such Fundamental Change Purchase Date) sufficient to pay the aggregate Fundamental Change Purchase Price of all the Securities or portions thereof which are to be repurchased on such Fundamental Change Purchase Date.

If the Paying Agent holds, in accordance with the terms hereof, at noon, New York City time, on the applicable Fundamental Change Purchase Date, cash sufficient to pay the Fundamental Change Purchase Price of any Securities for which a Fundamental Change Fundamental Change Purchase Notice has been tendered and not withdrawn pursuant to Section 3.8(f), then, immediately after such Fundamental Change Purchase Date, such Securities will cease to be outstanding and interest on such Securities will cease to accrue, whether or not such Securities are delivered to the Paying Agent, and the rights of the Holders in respect thereof shall terminate (other than the right to receive the Fundamental Change Purchase Price upon delivery of such Securities).

(h) Any Certificated Security which is to be repurchased only in part shall be surrendered at the office of the Paying Agent (with, if the Company or the Trustee so requires, due endorsement by, or a written instrument of transfer in form satisfactory to the Company and the Trustee duly executed by, the Holder thereof or such Holder's attorney duly authorized in writing) and the Company shall execute and the Trustee shall authenticate and deliver to the Holder of such Security, without charge, a new Security or Securities, of any authorized denomination as requested by such Holder in aggregate principal amount equal to, and in exchange for, the portion of the principal amount of the Security so surrendered which is not repurchased.

Section 3.9. Company Purchases of Securities.

The Company may from time to time, to the extent permitted by applicable law, purchase any or a certain amount of the Securities in the market on which such Securities trade, or by commencing a tender offer under the rules and regulations promulgated under the Securities Act and the Exchange Act, or by entering into a private agreement with a third party. Upon the occurrence of such an event, (a) after the date that is two years from the latest issuance of the Securities, the Company may, at its option and to the extent permitted by applicable law, reissue, resell or surrender to the Trustee for cancellation any such Securities purchased and (b) on or prior to the date that is two years from the latest issuance of the Securities, the Company will surrender to the Trustee for cancellation any such Securities purchased. Any such Securities surrendered to the Trustee for cancellation shall be cancelled and shall not be reissued or resold.

Section 3.10. Repayment to the Company.

To the extent that the aggregate amount of cash deposited by the Company pursuant to this Article 3 exceeds the aggregate payment, thereon of the Securities or portions thereof that the Company is obligated to purchase, then the Trustee or a Paying Agent, as the case may be, shall promptly return any such excess cash to the Company.

Section 3.11. Compliance with Securities Laws.

(a) When complying with the provisions of this Article 3 in respect of any redemption, purchase or repurchase of the Securities, and subject to any exemptions available under applicable law, the Company shall:

(1) comply with Rule 13e-4 and Rule 14e-1 (or any successor provision) under the Exchange Act, as applicable;

(2) file the related Schedule TO (or any successor schedule, form or report) under the Exchange Act, as applicable; and

(3) otherwise comply with all federal and state securities laws so as to permit the rights and obligations under this Article 3 to be exercised in the time and in the manner specified therein.

(b) To the extent that the provisions of any securities laws or regulations conflict with the provisions of Article 3, the Company's compliance with such laws and regulations shall not in and of itself cause a breach of its obligations under this Article 3.

ARTICLE 4
EXCHANGE

Section 4.1. Exchange Right.

(a) Subject to the provisions of this Article 4, a Holder of a Security shall have the right, at such Holder's option, to exchange all or any portion (if the portion to be exchanged is $1,000 or an integral multiple of $1,000) of such Security into shares of Common Stock at the Exchange Rate in effect on the date of exchange at any time at any time prior to the earlier of (1) the close of business on the Business Day prior to the Redemption Date and (2) the close of business on the second Business Day immediately preceding the Final Maturity Date.

(b) The Company agrees that it shall deliver cash, shares of Common Stock or a combination of cash and shares of Common Stock to an exchanging Holder in accordance with the provisions of this Article 4.

Section 4.2. Exercise of Exchange Right.

(a) To exercise the exchange right, the Holder of any Security to be exchanged shall in the case of Global Securities, comply with the Applicable Procedures, and, in the case of Certificated Securities, surrender such Security duly endorsed or assigned to the Company or in blank, at the office of any Exchange Agent, accompanied by a duly signed exchange notice (an "*Exchange Notice*") substantially in the form attached to the Security to the Company stating that the Holder elects to exchange such Security or, if less than the entire principal amount thereof is to be exchanged, the portion thereof to be exchanged.

(b) In the case of any Certificated Security which is exchanged in part only, upon such exchange the Company shall execute and the Trustee shall authenticate and deliver to the Holder thereof, at the expense of the Company, a new Security or Securities of authorized denominations in an aggregate principal amount equal to the unexchanged portion of the principal amount of such Securities.

Section 4.3. Company's Right to Elect to Pay Cash or Common Stock.

In lieu of delivery of Common Stock upon notice of exchange of any Securities (for all or any portion of the Securities), the Company may elect to pay Holders surrendering Securities an amount in cash per Security (or a portion of a Security) equal to the Closing Price of Common Stock for the five consecutive trading days commencing on and including the third Business Day following the Exchange Date multiplied by the Exchange Rate in effect on the Exchange Date. The Company will inform the Holders through the Trustee no later than two business days following the Exchange Date of its election to pay cash in lieu of delivery of Common Stock or to deliver a combination of cash and Common Stock. If the Company elects to deliver all of such payment in Common Stock, the Common Stock will be delivered by the Company through the Exchange Agent no later than the third Business Day following the Exchange Date. If the Company elects to pay all or a portion of such payment in cash, the payment, including any delivery of Common Stock, will be made to Holders surrendering Securities no later than the tenth Business Day following the applicable Exchange Date.

Section 4.4. Fractions of Shares.

No fractional shares of Common Stock shall be issued upon exchange of any Security or Securities. If more than one Security shall be surrendered for exchange at one time by the same Holder, the number of full shares which shall be issued upon exchange thereof shall be computed on the basis of the aggregate principal amount of the Securities (or specified portions thereof) so surrendered. Instead of any fractional shares of Common Stock which would otherwise be issued upon exchange of any Security or Securities (or specified portions thereof), the Company shall pay a cash adjustment in respect of such fraction (calculated to the nearest one-100th of a share) in an amount equal to the same fraction of the Closing Price per share of Common Stock as of the Trading Day preceding the Exchange Date.

Section 4.5. Adjustment of Exchange Rate.

(a) In case Parent shall hereafter pay a dividend or make a distribution to all holders of the outstanding Common Stock in shares of Common Stock, the Exchange Rate shall be increased so that the same shall equal the rate determined by multiplying the Exchange Rate in effect at the opening of business on the date following the date fixed for the determination of stockholders of Parent entitled to receive such dividend or other distribution by a fraction,

(1) the numerator of which shall be the sum of the number of shares of Common Stock outstanding at the close of business on the date fixed for the determination of stockholders of Parent entitled to receive such dividend or other distribution plus the total number of shares of Common Stock constituting such dividend or other distribution; and

(2) the denominator of which shall be the number of shares of Common Stock outstanding at the close of business on the date fixed for such determination,

such increase to become effective immediately after the opening of business on the day following the date fixed for such determination. If any dividend or distribution of the type described in this Section 4.5(a) is declared but not so paid or made, the Exchange Rate shall again be adjusted to

the Exchange Rate that would then be in effect if such dividend or distribution had not been declared.

(b) In case outstanding shares of Common Stock shall be subdivided into a greater number of shares of Common Stock, the Exchange Rate in effect at the opening of business on the day following the day upon which such subdivision becomes effective shall be proportionately increased, and conversely, in case outstanding shares of Common Stock shall be combined into a smaller number of shares of Common Stock, the Exchange Rate in effect at the opening of business on the day following the day upon which such combination becomes effective shall be proportionately reduced, such increase

or reduction, as the case may be, to become effective immediately after the opening of business on the day following the day upon which such subdivision or combination becomes effective.

(c) In case Parent shall issue rights or warrants to all holders of its outstanding shares of Common Stock entitling them to subscribe for or purchase shares of Common Stock at a price per share less than the Current Market Price as of the record date fixed for determination of stockholders of Parent entitled to receive such rights or warrants, the Exchange Rate shall be increased so that the same shall equal the rate determined by multiplying the Exchange Rate in effect immediately prior to the date fixed for determination of stockholders of Parent entitled to receive such rights or warrants by a fraction,

(1) the numerator of which shall be the number of shares of Common Stock outstanding on the record date fixed for determination of stockholders of Parent entitled to receive such rights or warrants plus the total number of additional shares of Common Stock offered for subscription or purchase, and

(2) the denominator of which shall be the sum of the number of shares of Common Stock outstanding at the close of business on the record date fixed for determination of stockholders of Parent entitled to receive such rights or warrants plus the number of shares that the aggregate offering price of the total number of shares so offered would purchase at a price equal to the Current Market Price as of the date immediately preceding the record date fixed for determination of stockholders of Parent entitled to receive such rights or warrants.

Such adjustment shall be successively made whenever any such rights or warrants are issued, and shall become effective immediately after the opening of business on the day following the date fixed for determination of stockholders of Parent entitled to receive such rights or warrants. To the extent that shares of Common Stock are not delivered after the expiration of such rights or warrants, the Exchange Rate shall be readjusted to the Exchange Rate that would then be in effect had the adjustments made upon the issuance of such rights or warrants been made on the basis of delivery of only the number of shares of Common Stock actually delivered. If such rights or warrants are not so issued, the Exchange Rate shall again be adjusted to be the Exchange Rate that would then be in effect if such date fixed for the determination of stockholders of Parent entitled to receive such rights or warrants had not been fixed. In determining whether any rights or warrants entitle the holders to subscribe for or purchase shares of Common Stock at a price less than the Current Market Price as of the record date fixed for determination of stockholders of Parent entitled to receive such rights or warrants, and in determining the aggregate offering price of such shares of Common Stock, there shall be taken into account any consideration received by the Company for such rights or warrants and any amount payable on exercise or conversion thereof, the value of such consideration, if other than cash, to be determined by the Board of Directors.

(d) In case Parent shall, by dividend or otherwise, distribute to all holders of its Common Stock assets, debt securities, shares of any class of Capital Stock of Parent or rights or warrants to purchase any securities of Parent excluding (x) any dividend or distribution or issuance referred to in Section 4.5(c), (y) any dividends or distributions in connection with a reclassification, change, consolidation, merger, sale or conveyance for which the consideration payable upon exchange of the Securities shall be changed in accordance with Section 4.7 and (z) any dividend or distribution paid exclusively in cash (any of the foregoing hereinafter in this Section 4.5(d) referred to as "*Distributed Assets or Securities*"), then, in each such case, the Exchange Rate shall be increased so that the same shall be equal to the rate determined by multiplying the Exchange Rate in effect on the Record Date with respect to such distribution by a fraction,

(1) the numerator of which shall be the Current Market Price on such Record Date plus the Fair Market Value (as determined by the Board of Directors, whose determination shall be conclusive, and described in a resolution of the Board of Directors) on the Record Date of the

portion of the Distributed Assets or Securities so distributed applicable to one share of Common Stock; and

(2) the denominator of which shall be the Current Market Price on such Record Date,

such adjustment to become effective immediately prior to the opening of business on the day following such Record Date. If such dividend or distribution is not so paid or made, the Exchange Rate shall again be adjusted to be the Exchange Rate that would then be in effect if such dividend or distribution had not been declared. If the Board of Directors determines the Fair Market Value of any distribution for purposes of this Section 4.5 (d) by reference to the actual or when issued trading market for any securities, it must in doing so consider the prices in such market over the same period used in computing the Current Market Price on the applicable Record Date.

Rights or warrants distributed by the Company to all holders of Common Stock (including, without limitation, rights issued pursuant to any rights agreement) entitling the holders thereof to subscribe for or purchase shares of the Company's capital stock (either initially or under

certain circumstances), which rights or warrants, until the occurrence of a specified event or events ("*Trigger Event*"): (i) are deemed to be transferred with such shares of Common Stock; (ii) are not exercisable; and (iii) are also issued in respect of future issuances of Common Stock, shall be deemed not to have been distributed for purposes of this Section 4.5 (and no adjustment to the Exchange Rate will be required) until the occurrence of the earliest Trigger Event, whereupon such rights and warrants shall be deemed to have been distributed and an appropriate adjustment (if any is required) to the Exchange Rate shall be made under this Section 4.5(d). If any such right or warrant, including any such existing rights or warrants distributed prior to the date of this Indenture, are subject to events, upon the occurrence of which such rights or warrants become exercisable to purchase different securities, evidences of indebtedness or other assets, then the date of the occurrence of any and each such event shall be deemed to be the date of distribution and record date with respect to new rights or warrants with such rights (and a termination or expiration of the existing rights or warrants without exercise by any of the holders thereof). In addition, in the event of any distribution (or deemed distribution) of rights or warrants, or any Trigger Event or other event (of the type described in the preceding sentence) with respect thereto that was counted for purposes of calculating a distribution amount for which an adjustment to the Exchange Rate under this Section 4.5 was made, (1) in the case of any such rights or warrants that shall all have been redeemed or repurchased without exercise by any holders thereof, the Exchange Rate shall be readjusted upon such final redemption or repurchase to give effect to such distribution or Trigger Event, as the case may be, as though it were a cash distribution, equal to the per share redemption or repurchase price received by a holder or holders of Common Stock with respect to such rights or warrants (assuming such holder had retained such rights or warrants), made to all holders of Common Stock as of the date of such redemption or repurchase, and (2) in the case of such rights or warrants that shall have expired or been terminated without exercise thereof, the Exchange Rate shall be readjusted as if such expired or terminated rights and warrants had not been issued.

For purposes of this Section 4.5(d) and Sections 4.5(a) and (c), any dividend or distribution to which this Section 4.5(d) is applicable that also includes shares of Common Stock, or rights or warrants to subscribe for or purchase shares of Common Stock described in Sections 4.5(a) or 4.5(c) (or both), shall be deemed instead to be (1) a dividend or distribution of the evidences of assets, debt securities or shares of capital stock other than such shares of Common Stock or rights or warrants (and any Exchange Rate adjustment required by this Section 4.5(d) with respect to such dividend or distribution shall then be made) immediately followed by (2) a dividend or distribution of such shares of Common Stock or such rights or warrants (and any further Exchange Rate adjustment required by Sections 4.5(a) and 4.5(c) with respect to such dividend or distribution shall then be made), except (A) the Record Date of such dividend or distribution shall be substituted as "the date fixed for the determination of stockholders of Parent entitled to receive such dividend or other distribution", "the date fixed for the determination of stockholders of Parent entitled to receive such rights or warrants"

and "the date fixed for such determination" within the meaning of Sections 4.5(a) and 4.5(c) and (B) any shares of Common Stock included in such dividend or distribution shall not be deemed "outstanding at the close of business on the date fixed for such determination" within the meaning of Section 4.5(a).

(e) In case Parent shall, by dividend or otherwise, make distributions consisting exclusively of cash to all holders of its Common Stock, excluding any cash dividend on the Common Stock to the extent that the aggregate cash dividends per share of Common Stock in any quarter does not exceed $0.1875 (the "*Dividend Threshold Amount*") then, in such case, the Exchange Rate shall be increased so that the same shall equal the rate determined by multiplying the Exchange Rate in effect immediately prior to the close of business on such record date by a fraction,

(1) the numerator of which shall be the Current Market Price on such record date; and

(2) the denominator of which shall be the Current Market Price minus the amount of cash in excess of the Dividend Threshold Amount applicable to one share of Common Stock on such record date,

such adjustment to be effective immediately prior to the opening of business on the day following the record date. If such dividend or distribution is not so paid or made, the Exchange Rate shall again be adjusted to be the Exchange Rate that would then be in effect if such dividend or distribution had not been declared. If an adjustment is required to be made as set forth in this Section 4.5(e) above as a result of a distribution that is not a cash dividend, such adjustment shall be based upon the full amount of the distribution.

(f) In case a tender or exchange offer made by Parent or any of its Subsidiaries (including the Company) for all or any portion of the Common Stock shall expire and such tender or exchange offer (as amended upon the expiration thereof) shall require the payment to stockholders of Parent of consideration per share of Common Stock having a Fair Market Value (as determined by the Board of Directors, whose determination shall be conclusive and described in a resolution of the Board of Directors) that as of the last time (the "*Expiration Time*") tenders or exchanges may be made pursuant to such tender or exchange offer (as it may be amended) exceeds the Closing Price of a share of Common Stock on the Trading Day next succeeding the Expiration Time, the Exchange Rate shall be increased so that the same shall equal the rate determined by multiplying the Exchange Rate in effect immediately prior to the Expiration Time by a fraction,

(1) the numerator of which shall be the sum of (x) the Fair Market Value (determined as aforesaid) of the aggregate consideration payable to stockholders of Parent based on the acceptance (up to any maximum specified in the terms of the tender or exchange offer) of all shares validly tendered or exchanged and not withdrawn as of the Expiration Time (the shares deemed so accepted up to any such maximum, being referred to as the "*Purchased Shares*") and (y) the product of the number of shares of Common Stock outstanding (less any Purchased Shares) at the Expiration Time and the Closing Price of a share of Common Stock on the Trading Day next succeeding the Expiration Time, and

(2) the denominator of which shall be the number of shares of Common Stock outstanding (including any Purchased Shares) at the Expiration Time multiplied by the Closing Price of a share of Common Stock on the Trading Day next succeeding the Expiration Time,

such adjustment to become effective immediately prior to the opening of business on the day following the Expiration Time. If the Company is

obligated to purchase shares pursuant to any such tender or exchange offer, but the Company is permanently prevented by applicable law from effecting any such purchases or all such purchases are rescinded, the Exchange Rate shall again be adjusted to be the Exchange Rate that would then be in effect if such tender or exchange offer had not been made.

(g) Notwithstanding anything to the contrary, in the event of an adjustment to the Exchange Rate pursuant to Section 4.5(e) or (f), in no event will the Exchange Rate for any series of Securities exceed 82.1018 (the "*Maximum Exchange Rate*"). The Maximum Exchange Rate is subject to the same proportional adjustments made to the Exchange Rate pursuant to Sections 4.5(a), (b), (c) or (d).

(h) If any adjustment or readjustment is made to the Exchange Rate pursuant to this Section 4.5 (other than any adjustment pursuant to Section 4.5(e)), the same proportional adjustment shall be made to the Dividend Threshold Amount; *provided that*, (x) in the event the Exchange Rate is increased (other than pursuant to Section 4.5(e)), the Dividend Threshold Amount shall be proportionally decreased, and (y) in the event the Exchange Rate is decreased (other than pursuant to Section 4.5(e)), the Dividend Threshold Amount shall be proportionally increased.

(i) For purposes of this Section 4.5, the following terms shall have the meaning indicated:

(1) "*Current Market Price*" shall mean, for purposes of any dividend or distribution requiring adjustment under Section 4.5 (d) or Section 4.5(e), the average of the daily Closing Prices per share of Common Stock for the 5 consecutive Trading Days beginning on the Ex-Dividend Date for such dividend or distribution.

If another dividend or distribution to which Section 4.5 applies occurs during the period applicable for calculating "*Current Market Price*" pursuant to the definition in the preceding paragraph, "*Current Market Price*" shall be calculated for such period in a manner determined by the Board of Directors to reflect the impact of such issuance, distribution, subdivision or combination on the Closing Price of the Common Stock during such period.

(2) "*Fair Market Value*" shall mean the amount which a willing buyer would pay a willing seller in an arm's-length transaction.

(3) "*Record Date*" shall mean, with respect to any dividend, distribution or other transaction or event in which the holders of Common Stock have the right to receive any cash, securities or other property or in which the Common Stock (or other applicable security) is exchanged for or converted into any combination of cash, securities or other property, the date fixed for determination of stockholders of Parent entitled to receive such cash, securities or other property (whether such date is fixed by the Board of Directors or by statute, contract or otherwise).

(j) The Company may make such reductions in the Exchange Rate in addition to those otherwise required by this Section 4.5 as the Board of Directors considers to be advisable to avoid or diminish any income tax to holders of Common Stock or rights to purchase Common Stock resulting from any dividend or distribution of stock (or rights to acquire stock) or from any event treated as such for income tax purposes.

To the extent permitted by applicable law, the Company from time to time may increase the Exchange Rate for any series of Securities by any amount for any period of time if the period is at least 20 days, the increase is irrevocable during the period and the Board of Directors shall have made a determination that such increase would be in the best interests of the Company, which determination shall be conclusive. Whenever the Exchange Rate is increased pursuant to the preceding sentence, the Company shall mail to Holders a notice of the increase at least 15 days prior to the date the increased Exchange Rate takes effect, and such notice shall state the increased Exchange Rate and the period during which it will be in effect.

(k) No adjustment in the Exchange Rate for any series of Securities shall be required unless such adjustment would require an increase or decrease of at least one percent (1%) in such rate; *provided* that any adjustments that by reason of this Section 4.5(k) are not required to be made shall be carried forward and taken into account in any subsequent adjustment. All calculations under this Article 4 shall

be made by the Company and shall be made to the nearest cent or to the nearest one-ten thousandth (1/10,000) of a share, as the case may be.

(l) No adjustment to the Exchange Rate need be made for a transaction referred to in this Article 4 if Holders are to participate in the transaction without exchange on a basis and with notice that the Board of Directors determines in good faith to be fair and appropriate in light of the basis and notice on which holders of Common Stock participate in the transaction (which determination shall be described in a Board Resolution).

(m) For purposes of this Section 4.5, the number of shares of Common Stock at any time outstanding shall not include shares held in the treasury of Parent, unless such treasury shares participate in any distribution or dividend that requires an adjustment pursuant to this Section 4.5, but shall include shares issuable in respect of scrip certificates issued in lieu of fractions of shares of Common Stock.

Section 4.6. Notice of Adjustment.

(a) Whenever an adjustment in the Exchange Rate with respect to the Securities is required:

(1) the Company shall forthwith place on file with the Trustee and any Exchange Agent for such securities a certificate of the Treasurer of the Company, stating the adjusted Exchange Rate determined as provided herein and setting forth in reasonable detail such facts as shall be necessary to show the reason for and the manner of computing such adjustment; and

(2) a notice stating that the Exchange Rate has been adjusted and setting forth the adjusted Exchange Rate shall forthwith be given by the Company or, at the Company's request, by the Trustee in the name and at the expense of the Company, to each Holder. Any notice so given shall be conclusively presumed to have been duly given, whether or not the Holder receives such notice.

(b) If the Company takes any action, or becomes aware of an event, that would require an adjustment to the Exchange Rate as described in Section 4.5(a), (b), (c), (d), (e) and (f), the Company shall mail to Holders a written notice of such action or event at least 20 days prior to the record, effective or expiration date, as the case may be, of the transaction.

Section 4.7. Consolidation or Merger of Parent.

If any of the following events occurs, namely:

(a) any reclassification or change of the outstanding Common Stock into another class of Capital Stock (other than a change in par value, or from par value to no par value, or from no par value to par value, or as a result of a subdivision or combination);

(b) any merger, consolidation, statutory share exchange or combination of Parent with another corporation as a result of which all of the holders of Common Stock shall be entitled to receive stock, securities or other property or assets (including cash or any combination thereof) with respect to or in exchange for all of their Common Stock; or

(c) any sale or conveyance of all or substantially all the properties and assets of Parent to any other person as a result of which all of the holders of Common Stock shall be entitled to receive stock, securities or other property or assets (including cash or any combination thereof) with respect to or in exchange for all of their Common Stock;

in each case as a result of which holders of Common Stock are entitled to receive stock, other securities, other property or assets (including cash or any combination thereof) with respect to or in exchange for Common Stock, the Company shall execute with the Trustee a supplemental indenture (which shall comply with the TIA as in force at the date of execution of such supplemental indenture,

if such supplemental indenture is then required to so comply) providing that the Holder's right to exchange a Security into Common Stock shall be changed to a right to exchange a Security into the kind and amount of shares of stock and other securities or property or assets (including cash) which such Holder would have been entitled to receive upon such reclassification, change, merger, consolidation, statutory share exchange, combination, sale or conveyance had such Securities been exchanged into Common Stock immediately prior to such reclassification, change, merger, consolidation, statutory share exchange, combination, sale or conveyance. In the event holders of Common Stock have the opportunity to elect the form of consideration to be received in a reclassification, change, consolidation, merger combination, sale or conveyance, the Company shall make adequate provision whereby the Holders of the Securities shall have the opportunity, on a timely basis, to determine the form of consideration into which all of the Securities, treated as a single class, shall be exchangeable. Such determination shall be based on the blended, weighted average of elections made by Holders of the Securities who participate in such determination and shall be subject to any limitations to which all of the holders of Common Stock are subject to, such as pro-rata reductions applicable to any portion of the consideration payable.

The Company shall cause notice of the execution of such supplemental indenture to be mailed to each Holder, at the address of such Holder as it appears on the register of the Securities maintained by the Primary Registrar, within 20 days after execution thereof. Failure to deliver such notice shall not affect the legality or validity of such supplemental indenture.

The above provisions of this Section 4.7 shall similarly apply to successive reclassifications, changes, mergers, consolidations, statutory share exchanges, combinations, sales and conveyances.

If this Section 4.7 applies to any event or occurrence, Section 4.5 shall not apply.

Section 4.8. Taxes on Exchange.

The issue of stock certificates on exchange of Securities shall be made without charge to the exchanging Holder for any documentary, stamp or similar issue or transfer taxes in respect of the issue thereof, and the Company shall pay any and all documentary, stamp or similar issue or transfer taxes that may be payable in respect of the issue or delivery of shares of Common Stock on exchange of Securities pursuant hereto. The Company shall not, however, be required to pay any such tax which may be payable in respect of any transfer involved in the issue or delivery of shares of Common Stock or the portion, if any, of the Securities which are not so exchanged in a name other than that in which the Securities so exchanged were registered, and no such issue or delivery shall be made unless and until the Person requesting such issue has paid to the Company the amount of such tax or has established to the satisfaction of the Company that such tax has been paid.

Nothing contained herein shall preclude any income tax withholding required by law or regulation upon exchange of the Securities. Upon surrender of a Security for exchange, the Holder shall deliver to the Company cash in an amount equal to the applicable income tax withholding in connection with such exchange; *provided, however,* that if the Holder does not deliver such cash, the Company may deduct and withhold from the consideration otherwise deliverable to such Holder the amount required to be so withheld.

Section 4.9. Exchange after Record Date.

Except as provided in this Section 4.9, an exchanging Holder of Securities shall not be entitled to receive any accrued and unpaid interest (including Liquidated Damages, if any) on any such Securities being exchanged. By delivery to the Holder of the number of shares of Common Stock or other consideration issuable or payable upon exchange in accordance with this Article 4, any accrued and unpaid interest (including Liquidated Damages, if any), on such Securities will be deemed to have been paid in full. If any Securities are surrendered for exchange subsequent to the Record Date preceding

an Interest Payment Date but prior to such Interest Payment Date, the Holder of such Securities at the close of business on such Record Date shall receive the interest payable on such Security on such Interest Payment Date notwithstanding the exchange thereof. Securities surrendered for exchange during the period from the close of business on any Record Date preceding any Interest Payment Date to the opening of business on such Interest Payment Date shall (except in the case of Securities which have been called for redemption on a Redemption Date within such period) be accompanied by payment from exchanging Holders, for the account of the Company, in New York Clearing House funds, or other funds of an amount equal to the interest payable on such Interest Payment Date (excluding any overdue interest, if applicable) on the Securities being surrendered for exchange; *provided, however*, if the Company elects to redeem Securities on a date that is after the Regular Record Date but prior to the corresponding Interest Payment Date, and such Holder elects to exchange those Securities, the Holder will not be required to pay the Company, at the time that Holder surrenders those Securities for exchange, the amount of interest such Holder will have received on the Interest Payment Date.

Section 4.10. Company Determination Final.

Any determination that the Company or the Board of Directors must make pursuant to this Article 4 shall be conclusive if made in good faith and in accordance with the provisions of this Article, absent manifest error, and set forth in a Board Resolution.

Section 4.11. Responsibility of Trustee for Exchange Provisions.

The Trustee has no duty to determine when an adjustment under this Article 4 should be made, how it should be made or what it should be. Unless and until a Trust Officer of the Trustee receives a certificate delivered pursuant to Section 4.6 setting forth an adjustment of the Exchange Rate, the Trustee may assume without inquiry that no such adjustment has been made and that the last Exchange Rate of which the Trustee has knowledge remains in effect. The Trustee makes no representation as to the validity or value of any securities or assets issued upon exchange of Securities. The Trustee shall not be responsible for any failure of the Company to comply with this Article 4. Each Exchange Agent other than the Company shall have the same protection under this Section 4.11 as the Trustee.

The rights, privileges, protections, immunities and benefits given to the Trustee under this Indenture including, without limitation, its rights to be indemnified, are extended to, and shall be enforceable by, the Trustee in each of its capacities hereunder, and each Paying Agent or Exchange Agent acting hereunder.

Section 4.12. Unconditional Right of Holders to Exchange.

Notwithstanding any other provision in this Indenture, the Holder of any Security shall have the right, which is absolute and unconditional, to exchange its Security in accordance with this Article 4 and to bring an action for the enforcement of any such right to exchange, and such rights shall not be impaired or affected without the consent of such Holder.

Section 4.13. Repayment to the Company.

To the extent that the aggregate amount of cash deposited by the Company pursuant to this Article 4, if applicable, exceeds the aggregate payment thereon of the Securities or portions thereof that the Company is obligated to purchase, then the Trustee or a Paying Agent, as the case may be, shall promptly return any such excess cash to the Company.

Section 4.14. Make-Whole Premium.

(a) If a Fundamental Change described in clauses (1), (2) or (4) of the definition of "Change of Control" occurs prior to August 20, 2015, Holders who exchange Securities in accordance with the provisions of this Article 4 in connection with such Fundamental Change shall be entitled to receive a "*Make-Whole Premium*" consisting of an increase in the Exchange Rate. The Make-Whole Premium shall be calculated by the Company and paid for in shares of Common Stock or, at the election of the Company under Section 4.3, cash or a combination of cash and shares of Common Stock. The number of additional shares of Common Stock by which the Exchange Rate shall increase shall be determined by reference to the table below and shall equal the number of shares of Common Stock for the applicable Fundamental Change Effective Date and Stock Price (as set forth in such table) of such Fundamental Change. If the applicable Fundamental Change Effective Date and/or Stock Price is not set forth in the table then:

(1) if the applicable Fundamental Change Effective Date and/or Stock Price is between two Fundamental Change Effective Dates or Stock Prices, as the case may be, set forth in the table, the Make-Whole Premium shall be determined by a straight-line interpolation between the Make-Whole Premiums set forth for the two Fundamental Change Effective Dates and/or Stock Prices, as the case may be, set forth in the table based on a 365-day year;

(2) if the Stock Price on the Fundamental Change Effective Date exceeds $50.00 a share, subject to adjustment as set forth herein, no Make-Whole Premium shall be paid; and

(3) if the Stock Price on the Fundamental Change Effective Date is less than $12.18 a share, subject to adjustment as set forth herein, no Make-Whole Premium shall be paid.

Effective Time

Stock Price	8/9/2005	8/20/2006	8/20/2007	8/20/2008	8/20/2009	8/20/2010	8/20/2011	8/20/2012	8/20/2013	8/20/2014	8/20/2015
$ 12.18	12.2206	12.2206	12.2206	12.2206	12.2206	12.2206	12.2206	12.2206	12.2206	12.2206	0.0000
13.00	10.2161	9.8807	9.5000	9.1194	8.6301	7.9468	7.4436	7.0419	7.0419	7.0419	0.0000
14.00	8.3749	8.0136	7.6469	7.2499	6.7830	6.2169	5.5323	4.6956	3.7746	2.7440	0.0000
15.00	6.9156	6.4409	6.0190	5.6616	5.2984	4.9353	4.4068	3.6785	2.7276	1.4954	0.0000
16.00	5.9083	5.2726	4.6812	4.1705	3.7891	3.3968	3.0046	2.6123	2.2201	1.2536	0.0000
17.00	5.2941	4.5418	3.7839	3.0444	2.3763	2.0309	1.9261	1.6038	1.2814	0.9591	0.0000
18.00	5.0000	4.1667	3.2881	2.4091	1.4853	0.4825	0.4647	0.4137	0.3656	0.2372	0.0000
20.00	4.5000	3.7500	2.8500	2.0000	1.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
25.00	3.6000	3.0000	2.2800	1.6000	0.8000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
30.00	3.0000	2.5000	1.9000	1.3333	0.6667	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
40.00	2.2500	1.8750	1.4250	1.0000	0.5000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
50.00	1.8000	1.5000	1.1400	0.8000	0.4000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000

The Stock Prices set forth in the table above shall be adjusted as of any date on which the Exchange Rate of the Securities is adjusted by multiplying each such Stock Price in effect immediately prior to such adjustment by a fraction, the numerator of which shall be the Exchange Rate in effect immediately prior to the adjustment giving rise to the Stock Price adjustment and the denominator of which shall be the Exchange Rate as so adjusted. The number of additional shares set forth in the table above shall be adjusted in the same manner as the Exchange Rate as set forth in Section 4.5.

Delivery of the payment of the Make-Whole Premium shall be upon the later of (x) the settlement date of the exchange of Securities by the Holder and (y) promptly following the Fundamental Change Effective Date.

(b) An exchange of Securities by a Holder will be deemed for the purposes of this Section 4.14 to be "in connection with" a Fundamental Change if the Exchange Notice delivered by the Holder pursuant to Section 4.2(a) hereof is received by a Exchange Agent (i) on or subsequent to the date that is 15 Business Days prior to the date announced by the Company as the anticipated Fundamental Change Effective Date but (ii) prior to the close of business on the Business Day immediately preceding the related Fundamental Change Purchase Date. The Company shall notify the Holders of an anticipated Fundamental Change Effective Date at least 20 Business Days prior to such Fundamental Change Effective Date.

(c) Notwithstanding any of the provisions of this Section 4.14, in no event shall the Exchange Rate exceed 82.1018 shares per $1,000 principal amount of Securities (subject to adjustment as provided herein).

ARTICLE 5
COVENANTS

Section 5.1. Payment of Securities.

The Company shall promptly make all payments in respect of the Securities on the dates and in the manner provided in the Securities and this Indenture. An installment of principal or interest or Liquidated Damages, if any, shall be considered paid on the date it is due if the Paying Agent (other than the Company) holds by noon, New York City time, on that date money, deposited by the Company or an Affiliate thereof, sufficient to pay the installment. The Company shall, (in immediately available funds) to the fullest extent permitted by law, pay interest on overdue principal (including premium, if any) and overdue installments of interest at the rate borne by the Securities per annum.

Payment of the principal of (and premium, if any) and any interest on the Securities shall be made at the office or agency of the Company maintained for that purpose in the Borough of Manhattan, The City of New York (which shall initially be U.S. Bank Trust National Association, an Affiliate of the Trustee, as agent of the Trustee) or at the Corporate Trust Office of the Trustee in such coin or currency of the United States of America as at the time of payment is legal tender for payment of public and private debts; *provided, however,* that at the option of the Company payment of interest may be made by check mailed to the address of the Person entitled thereto as such address appears in the register of Securities maintained by the Primary Registrar; *provided, further,* that a Holder with an aggregate principal amount in excess of $5,000,000 will be paid by wire transfer in immediately available funds at the election of such Holder if such Holder has provided wire transfer instructions to the Company at least 10 Business Days prior to the payment date.

Section 5.2. SEC Reports.

The Company shall file all reports and other information and documents which it is required to file with the SEC pursuant to Section 13 or 15(d) of the Exchange Act, and shall make such reports and other information and documents available on its website to the extent required by law.

The Company shall annually provide the Trustee with copies of Parent's most-recent annual report to stockholders, promptly after such annual report is mailed to Parent's holders of its Common Stock. Delivery of such reports, information and documents to the Trustee is for informational purposes only and the Trustee's receipt of such shall not constitute constructive notice of any information contained therein or

determinable from information contained therein, including the Company's compliance with any of its covenants hereunder (as to which the Trustee is entitled to rely exclusively on Officers' Certificates).

Section 5.3. Compliance Certificates.

The Company shall deliver to the Trustee, within 90 days after the end of each fiscal year of the Company (beginning with the fiscal year ending December 31, 2005), an Officers' Certificate as to the signer's knowledge of the Company's compliance with all conditions and covenants on its part contained in this Indenture and stating whether or not the signer knows of any default or Event of Default. If such signer knows of such a default or Event of Default, the Officers' Certificate shall describe the default or Event of Default and the efforts to remedy the same. For the purposes of this Section 5.3, compliance shall be determined without regard to any grace period or requirement of notice provided pursuant to the terms of this Indenture.

Section 5.4. Further Instruments and Acts.

Upon request of the Trustee, the Company will execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes of this Indenture.

Section 5.5. Maintenance of Corporate Existence.

Subject to Article 6, the Company will do or cause to be done all things necessary to preserve and keep in full force and effect its existence as a limited partnership.

Section 5.6. Rule 144A Information Requirement.

Within the period prior to the expiration of the holding period applicable to sales thereof under Rule 144(k) under the Securities Act (or any successor provision), the Company covenants and agrees that it shall, during any period in which it is not subject to Section 13 or 15(d) under the Exchange Act, upon the request of any Holder or beneficial holder of the Securities make available to such Holder or beneficial holder of Securities or any Common Stock issued upon exchange thereof which continue to be Transfer Restricted Securities in connection with any sale thereof and any prospective purchaser of Securities or such Common Stock designated by such Holder or beneficial holder, the information required pursuant to Rule 144A(d)(4) under the Securities Act or such Common Stock and it will take such further action as any Holder or beneficial holder of such Securities or such Common Stock may reasonably request, all to the extent required from time to time to enable such Holder or beneficial holder to sell its Securities or Common Stock without registration under the Securities Act within the limitation of the exemption provided by Rule 144A, as such Rule may be amended from time to time. Upon the request of any Holder or any beneficial holder of the Securities or such Common Stock, the Company will deliver to such Holder a written statement as to whether it has complied with such requirements.

Section 5.7. Stay, Extension and Usury Laws.

The Company covenants (to the extent that it may lawfully do so) that it shall not at any time insist upon, plead, or in any manner whatsoever claim or take the benefit or advantage of, any stay, extension or usury law or other law which would prohibit or forgive the Company from paying all or any portion of the principal of, premium, if any, or interest (including Liquidated Damages, if any) on the Securities as contemplated herein, wherever enacted, now or at any time hereafter in force, or which may affect the covenants or the performance of this Indenture, and the Company (to the extent it may lawfully do so) hereby expressly waives all benefit or advantage of any such law and covenants that it will not, by resort to any such law, hinder, delay or impede the execution of any power herein granted to the Trustee, but will suffer and permit the execution of every such power as though no such law had been enacted.

Section 5.8. Payment of Liquidated Damages.

If Liquidated Damages are payable by the Company pursuant to the Registration Rights Agreement, the Company shall deliver to the Trustee a certificate to that effect stating (i) the amount of such Liquidated Damages that are payable (ii) the reason why such Liquidated Damages are payable and (iii) the date on which such Liquidated Damages are payable. Unless and until a Trust Officer of the Trustee receives such a certificate, the Trustee may assume without inquiry that no such Liquidated Damages are payable. If the Company has paid Liquidated Damages directly to the Persons entitled to it, the Company shall deliver to the Trustee a certificate setting forth the particulars of such payment.

ARTICLE 6
CONSOLIDATION, MERGER, CONVEYANCE, TRANSFER OR LEASE

Section 6.1. Company May Consolidate, Etc, Only On Certain Terms.

The Company shall not consolidate with or merge into any other Person (in a transaction in which the Company is not the surviving corporation) or convey, transfer, lease or otherwise dispose of all or substantially all of its properties and assets to any Person, whether in a single transaction or series of related transactions, unless:

(a) either (i) the Company is the surviving entity or (ii) the successor or transferee (the "*successor corporation*") is a corporation

organized and existing under the laws of the United States, any State thereof, or the District of Columbia and shall expressly assume, by an indenture supplemental hereto, executed and delivered to the Trustee, all of the obligations of the Company under the Securities and the Indenture;

(b) if as a result of such transaction the Securities become convertible or exchangeable into common stock or other securities issued by a third party, such third party fully and unconditionally guarantees all obligations under the Securities and the Indenture;

(c) immediately after giving effect to such transaction, no Default or Event of Default shall exist; and

(d) the Company shall have delivered to the Trustee an Officers' Certificate and, if requested by the Trustee, an Opinion of Counsel, each stating that such consolidation, merger, conveyance, transfer, sale, lease or other disposition and, if a supplemental indenture is required in connection with such transaction, such supplemental indenture, comply with this Article 6 and that all conditions precedent herein provided for relating to such transaction have been satisfied.

Section 6.2. Successor Substituted.

Upon any consolidation of the Company with, or merger of the Company into, any other Person or any conveyance, transfer or lease of all or substantially all of the properties and assets of the Company in accordance with Section 6.1, the successor Person formed by such consolidation or into which the Company is merged or to which such conveyance, transfer or lease is made shall succeed to, and be substituted for, and may exercise every right and power of, the Company under this Indenture with the same effect as if such successor Person had been named as the Company herein, and thereafter, except in the case of a lease, the predecessor Person shall be relieved of all obligations and covenants under this Indenture and the Securities.

ARTICLE 7
DEFAULT AND REMEDIES

Section 7.1. Events of Default.

An "*Event of Default*" shall occur if:

(a) the Company defaults in the payment of the principal amount (or premium, if any), with respect to the Securities, when the same become due and payable, whether at maturity, upon redemption, on the Put Right Purchase Date or Fundamental Change Purchase Date;

(b) the Company defaults in the payment of any accrued and unpaid interest (including Liquidated Damages, if any), in each case, when due and payable, and continuance of such default for a period of 30 days;

(c) the Company fails to satisfy its exchange obligation with respect to any portion of the principal amount of any Security following the exercise by a Holder of the right to exchange such Security into shares of Common Stock (or cash or a combination of shares of Common Stock and cash, if the Company so elects) pursuant to and in accordance with Article 4, which is not cured within 15 days;

(d) the Company defaults in its obligation to pay the Put Right Purchase Price or the Fundamental Change Purchase Price, as applicable, with respect to any Security, or any portion thereof, upon the exercise by a Holder of such Holder's right to require the Company to purchase or repurchase such Securities pursuant to and in accordance with Section 3.7 or 3.8, as applicable;

(e) the Company fails to comply with any of its agreements or covenants in the Securities or this Indenture (other than those referred to in clauses (a) through (e) above) and such failure continues for 30 days after receipt by the Company of a Notice of Default (defined below);

(f) the Company fails or any Significant Subsidiary of the Company fails to make any payment at maturity on any indebtedness for money borrowed, including any applicable grace periods, in an amount in excess of $5.0 million in the aggregate for all such indebtedness for money borrowed and such amount has not been paid or discharged within 30 days after receipt by the Company of a Notice of Default;

(g) a default by the Company or any Significant Subsidiary of the Company that results in the acceleration of maturity of any indebtedness for money borrowed of the Company or any Significant Subsidiary, at any one time, in an amount in excess of $5.0 million unless the acceleration is cured, waived or rescinded within 30 days after receipt by the Company of a Notice of Default;

(h) the Company or any Significant Subsidiary of the Company fails to pay final judgments, the uninsured portion of which aggregates in excess of $5.0 million, if such judgments are not paid or otherwise discharged within 30 days;

(i) the Company, pursuant to or under or within the meaning of any Bankruptcy Law:

(1) commences a voluntary case or proceeding;

(2) consents to the entry of any order for relief against it in an involuntary case or proceeding or the commencement of any case against it;

(3) consents to the appointment of a Custodian of it or for any substantial part of its property;

(4) makes a general assignment for the benefit of its creditors;

(5) files a petition in bankruptcy or answer or consent seeking reorganization or relief; or

(6) consents to the filing of such petition or the appointment of or taking possession by a Custodian;

(j) a court of competent jurisdiction enters an order or decree under any Bankruptcy Law that:

(1) is for relief against the Company, in an involuntary case or proceeding;

(2) appoints a Custodian of the Company, or for any substantial part of its property; or

(3) orders the winding up or liquidation of the Company,

and in each case the order or decree remains unstayed and in effect for 60 consecutive days;

The term "*Bankruptcy Law*" means Title 11 of the United States Code (or any successor thereto) or any similar federal or state law for the relief of debtors. The term "*Custodian*" means any receiver, trustee, assignee, liquidator, sequestrator or similar official under any Bankruptcy Law.

A default under clause (e) above is not an Event of Default until the Trustee notifies the Company, or the Holders of at least 25% in aggregate principal amount of the Securities then outstanding notify the Company and the Trustee, in writing of the default, and the Company does not cure the default within 30 days after receipt of such notice. The notice given pursuant to this Section 7.1 must specify the default, demand that it be remedied and state that the notice is a "*Notice of Default*." When any default under this Section 7.1 is cured, it ceases.

The Trustee shall not be charged with knowledge of any Event of Default unless written notice thereof shall have been given to a Trust Officer at the Corporate Trust Office of the Trustee by the Company, a Paying Agent, any Holder or any agent of any Holder.

Section 7.2. Acceleration.

If an Event of Default (other than an Event of Default specified in clause (i) or (j) of Section 7.1 occurs and is continuing, the Trustee may, by notice to the Company, or the Holders of at least 25% in aggregate principal amount of the Securities then outstanding may, by notice to the Company and the Trustee, declare all unpaid principal to the date of acceleration on the Securities then outstanding (if not then due and payable) to be due and payable upon any such declaration, and the same shall become and be immediately due and payable. If an Event of Default specified in clause (i) or (j) of Section 7.1 occurs, all unpaid principal of the Securities then outstanding shall ipso facto become and be immediately due and payable without any declaration or other act on the part of the Trustee or any Holder. The Holders of a majority in aggregate principal amount of the Securities then outstanding by notice to the Trustee may rescind or annul such acceleration and its consequences if (a) all existing Events of Default, other than the nonpayment of the principal of the Securities which has become due solely by such declaration of acceleration, have been cured or waived; (b) to the extent the payment of such interest is lawful, interest (calculated at the rate per annum borne by the Securities) on overdue installments of interest and overdue principal, which has become due otherwise than by such declaration of acceleration, has been paid; (c) the rescission would not conflict with any judgment, order or decree of a court of competent jurisdiction; and (d) all payments due to the Trustee and any predecessor Trustee under Section 8.7 have been made. No such rescission shall affect any subsequent default or impair any right consequent thereto.

Section 7.3. Other Remedies.

If an Event of Default occurs and is continuing, the Trustee may, but shall not be obligated to, pursue any available remedy by proceeding at law or in equity to collect the payment of the principal of or interest on the Securities or to enforce the performance of any provision of the Securities or this Indenture.

The Trustee may maintain a proceeding even if it does not possess any of the Securities or does not produce any of them in the proceeding. A delay or omission by the Trustee or any Holder in exercising any right or remedy accruing upon an Event of Default shall not impair the right or remedy or constitute a waiver of or acquiescence in the Event of Default. No remedy is exclusive of any other remedy. All available remedies are cumulative to the extent permitted by law.

Section 7.4. Waiver of Defaults and Events of Default.

Subject to Sections 7.7 and 10.2, the Holders of a majority in aggregate principal amount of the Securities then outstanding by notice to the Trustee may waive an existing default or Event of Default and its consequences, except a default or Event of Default (i) in the payment of the principal of, premium, if any, or interest (including Liquidated Damages, if any) on any Security, or the payment of the Redemption Price, the Put Right Purchase Price, or the Fundamental Change Purchase Price, (ii) arising from the Company's failure to comply with the exchange procedures provided in Article 4 of this Indenture, or (iii) in respect of any provision of this Indenture which, under Section 10.2, cannot be modified or amended without the consent of the Holder of each Security affected. When a default or Event of Default is waived, it is cured and ceases.

Section 7.5. Waiver of Compliance.

Except as otherwise provided in this Indenture, the Holders of a majority in aggregate principal amount of the Securities then outstanding, by notice to the Trustee, may waive compliance with any provision of this Indenture, or of the Securities (as described in this Indenture).

Section 7.6. Control by Majority.

The Holders of a majority in aggregate principal amount of the Securities then outstanding may direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or exercising any trust or power conferred on it. However, the Trustee may refuse to follow any direction that conflicts with law or this Indenture, that the Trustee determines may be unduly prejudicial to the rights of another Holder or the Trustee, or that may involve the Trustee in personal liability unless the Trustee is offered indemnity, reasonably satisfactory to it, against the costs, expenses and liabilities the Trustee may incur to comply with such request or demand; *provided*, *however*, that the Trustee may take any other action deemed proper by the Trustee which is not inconsistent with such direction.

Section 7.7. Limitations on Suits.

A Holder may not pursue any remedy with respect to this Indenture or the Securities (except actions for payment of overdue principal or interest or for the exchange of the Securities pursuant to Article 4) unless:

(a) the Holder gives to the Trustee written notice of a continuing Event of Default;

(b) the Holders of at least 25% in aggregate principal amount of the then outstanding Securities make a written request to the Trustee to pursue the remedy;

(c) the Holder or Holders offer to the Trustee indemnity reasonably satisfactory to it against any loss, liability or expense; and

(d) the Trustee does not comply with the request within 60 days after receipt of the request and the offer of indemnity and no direction inconsistent with such written request has been given to the Trustee during such 60-day period by the Holders of a majority in aggregate principal amount of the Securities then outstanding.

A Holder may not use this Indenture to prejudice the rights of another Holder or to obtain a preference or priority over such other Holder.

Section 7.8. Rights of Holders to Receive Payment and to Exchange.

Notwithstanding any other provision of this Indenture, the right of any Holder of a Security to receive payment of the principal of and interest on the Security, on or after the respective due dates expressed in the Security and this Indenture, to exchange such Security in accordance with Article 4 and to bring suit for the enforcement of any such payment on or after such respective dates or the right to exchange, is absolute and unconditional and shall not be impaired or affected without the consent of the Holder.

Section 7.9. Collection Suit by Trustee.

If an Event of Default in the payment of principal or interest specified in clause (a) or (b) of Section 7.1 occurs and is continuing, the Trustee may recover judgment in its own name and as trustee of an express trust against the Company or another obligor on the Securities for the whole amount of principal and accrued interest remaining unpaid, together with, to the extent that payment of such interest is lawful, interest on overdue principal and on overdue installments of interest, in each case at the rate per annum borne by the Securities and such further amount as shall be sufficient to cover the costs and expenses of collection, including the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel.

Section 7.10. Trustee May File Proofs of Claim.

The Trustee may file such proofs of claim and other papers or documents as may be necessary or advisable in order to have the claims of the Trustee (including any claim for the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel) and the Holders allowed in any judicial proceedings relative to the Company (or any other obligor on the Securities), its creditors or its property and shall be entitled and empowered to collect and receive any money or other property payable or deliverable on any such claims and to distribute the same, and any Custodian in any such judicial proceeding is hereby authorized by each Holder to make such payments to the Trustee and, in the event that the Trustee shall consent to the making of such payments directly to the Holders, to pay to the Trustee any amount due to it for the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel, and any other amounts due the Trustee under Section 8.7, and to the extent that such payment of the reasonable compensation, expenses, disbursements and advances in any such proceedings shall be denied for any reason, payment of the same shall be secured by a lien on, and shall be paid out of, any and all distributions, dividends, money, securities and other property which the Holders may be entitled to receive in such proceedings, whether in liquidation or under any plan of reorganization or arrangement or otherwise. Nothing herein contained shall be deemed to authorize the Trustee to authorize or consent to, or, on behalf of any Holder, to authorize, accept or adopt any plan of reorganization, arrangement, adjustment or composition affecting the Securities or the rights of any Holder thereof, or to authorize the Trustee to vote in respect of the claim of any Holder in any such proceeding.

Section 7.11. Priorities.

If the Trustee collects any money pursuant to this Article 7, it shall pay out the money in the following order:

(a) First, to the Trustee for amounts due under Section 8.7;

(b) Second, to Holders for amounts due and unpaid on the Securities for principal and interest (including Liquidated Damages, if any), ratably, without preference or priority of any kind, according to

the amounts due and payable on the Securities for principal and interest (including Liquidated, if any), respectively; and

(c) Third, the balance, if any, to the Company.

The Trustee may fix a record date and payment date for any payment to Holders pursuant to this Section 7.11.

Section 7.12. Undertaking for Costs.

In any suit for the enforcement of any right or remedy under this Indenture or in any suit against the Trustee for any action taken or omitted by it as Trustee, a court in its discretion may require the filing by any party litigant in the suit of an undertaking to pay the costs of the suit, and the court in its discretion may assess reasonable costs, including reasonable attorneys' fees and expenses, against any party litigant in the suit, having due regard to the merits and good faith of the claims or defenses made by the party litigant. This Section 7.12 does not apply to a suit made by the Trustee, a suit by a Holder pursuant to Section 7.7, or a suit by Holders of more than 10% in aggregate principal amount of the Securities then outstanding.

ARTICLE 8
TRUSTEE

Section 8.1. Duties of Trustee.

(a) If an Event of Default has occurred and is continuing, the Trustee shall exercise such of the rights and powers vested in it by this Indenture and use the same degree of care and skill in its exercise as a prudent person would exercise or use under the circumstances in the conduct of his or her own affairs.

(b) Except during the continuance of an Event of Default:

(1) the Trustee need perform only those duties as are specifically set forth in this Indenture and no others; and

(2) in the absence of bad faith on its part, the Trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon certificates or opinions furnished to the Trustee and conforming to the requirements of this Indenture. The Trustee, however, shall examine any certificates and opinions, which by any provision hereof are specifically required to be delivered to the Trustee to determine whether or not they conform to the requirements of this Indenture.

(c) The Trustee may not be relieved from liability for its own negligent action, its own negligent failure to act, or its own willful misconduct, except that:

(1) this paragraph does not limit the effect of subsection (b) of this Section 8.1;

(2) the Trustee shall not be liable for any error of judgment made in good faith by a Trust Officer, unless it is proved that the Trustee was negligent in ascertaining the pertinent facts; and

(3) the Trustee shall not be liable with respect to any action it takes or omits to take in good faith in accordance with a direction received by it pursuant to Section 7.6.

(d) No provision of this Indenture shall require the Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder or in the exercise of any of its rights or powers unless the Trustee shall have received adequate indemnity in its opinion against potential costs and liabilities incurred by it relating thereto.

(e) Every provision of this Indenture that in any way relates to the Trustee is subject to subsections (a), (b), (c) and (d) of Section 8.1.

(f) The Trustee shall not be liable for interest on any money received by it except as the Trustee may agree in writing with the Company. Money held in trust by the Trustee need not be segregated from other funds except to the extent required by law.

Section 8.2. Rights of Trustee.

Subject to Section 8.1:

(a) The Trustee may rely conclusively, and shall be protected in acting or refraining from acting, upon any document believed by it to be genuine and to have been signed or presented by the proper person. The Trustee need not investigate any fact or matter stated in the document.

(b) Before the Trustee acts or refrains from acting, it may require an Officers' Certificate or an Opinion of Counsel, which shall conform to Section 11.4(b). The Trustee shall not be liable for any action it takes or omits to take in good faith in reliance on such Officers' Certificate or Opinion.

(c) The Trustee may act through its agents and shall not be responsible for the misconduct or negligence of any agent appointed with due care.

(d) The Trustee shall not be liable for any action it takes or omits to take in good faith which it believes to be authorized or within its rights or powers.

(e) The Trustee may consult with counsel of its selection, and the advice or opinion of such counsel as to matters of law shall be full and complete authorization and protection in respect of any such action taken, omitted or suffered by it hereunder in good faith and in accordance with the advice or opinion of such counsel.

(f) The Trustee shall be under no obligation to exercise any of the rights or powers vested in it by this Indenture at the request or direction of any of the Holders pursuant to this Indenture, unless such Holders shall have offered to the Trustee security or indemnity satisfactory to the Trustee against the costs, expenses and liabilities which might be incurred by it in compliance with such request or direction.

(g) The Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, security, other evidence of indebtedness or other paper or document, but the Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit, and, if the Trustee shall determine to make such further inquiry or investigation, it shall be entitled to examine the books, records and premises of the Company, personally or by agent or attorney at the sole cost of the Company and shall incur no liability or additional liability of any kind by reason of such inquiry or investigation. Except with respect to Sections 5.1 and 5.3, the Trustee shall have no duty to inquire as to the performance of the Company's covenants set forth in Sections 3.7, 3.9, 3.10 and 3.11 and in Articles 4, 5 and 6.

(h) The Trustee shall not be deemed to have notice of any Default or Event of Default unless a Trust Officer of the Trustee has actual knowledge thereof or unless written notice of any event which is in fact such a default is received by the Trustee at the Corporate Trust Office, and such notice references the Securities and this Indenture.

(i) The rights, privileges, protections, immunities and benefits given to the Trustee, including, without limitation, its right to be indemnified, are extended to, and shall be enforceable by, the Trustee in each of its capacities hereunder, and to each agent, custodian and other Person employed to act hereunder.

Section 8.3. Individual Rights of Trustee.

The Trustee in its individual or any other capacity may become the owner or pledgee of Securities and may otherwise deal with the Company or an Affiliate of the Company with the same rights it would have if it were not Trustee. Any Agent may do the same with like rights. However, the Trustee is subject to Sections 8.10 and 8.11.

Section 8.4. Trustee's Disclaimer.

The Trustee makes no representation as to the validity or adequacy of this Indenture or the Securities, it shall not be accountable for the Company's use of the proceeds from the Securities, and it shall not be responsible for any statement in the Securities other than its certificate of authentication.

Section 8.5. Notice of Default or Events of Default.

If a default or an Event of Default occurs and is continuing and if the Trustee has received notice thereof in accordance with this Indenture, the Trustee shall mail to each Holder notice of the default or Event of Default within 30 days after it occurs. However, the Trustee may withhold the notice if and so long as a committee of its Trust Officers in good faith determines that withholding notice is in the interests of Holders, except in the case of a default or an Event of Default in payment of the principal of or interest on any Security.

Section 8.6. Reports by Trustee to Holders.

If such report is required by TIA Section 313, within 60 days after each May 15, beginning with the May 15 following the date of this Indenture, the Trustee shall mail to each Holder a brief report dated as of such May 15 that complies with TIA Section 313(a). The Trustee also shall comply with TIA Section 313(b)(2) and (c).

A copy of each report at the time of its mailing to Holders shall be mailed to the Company and filed with the SEC and each stock exchange, if any, on which the Securities are listed. The Company shall notify the Trustee whenever the Securities become listed on any stock exchange or listed or admitted to trading on any quotation system and any changes in the stock exchanges or quotation systems on which the Securities are

listed or admitted to trading and of any delisting thereof.

Section 8.7. Compensation and Indemnity.

The Company shall pay to the Trustee from time to time such compensation (as agreed to from time to time by the Company and the Trustee in writing) for its services (which compensation shall not be limited by any provision of law in regard to the compensation of a trustee of an express trust). The Company shall reimburse the Trustee upon request for all reasonable disbursements, expenses and advances incurred or made by it. Such expenses may include the reasonable compensation, disbursements and expenses of the Trustee's agents and counsel.

The Company shall indemnify the Trustee or any predecessor Trustee (which for purposes of this Section 8.7 shall include its officers, directors, employees and agents) for, and hold it harmless against, any and all loss, liability or expense including taxes (other than taxes based upon, measured by or determined by the income of the Trustee), (including reasonable legal fees and expenses) incurred by it in connection with the acceptance or administration of its duties under this Indenture or any action or failure to act as authorized or within the discretion or rights or powers conferred upon the Trustee hereunder including the reasonable costs and expenses of the Trustee and its counsel in defending itself against any claim or liability in connection with the exercise or performance of any of its powers or duties hereunder. The Trustee shall notify the Company promptly of any claim asserted against the

Trustee for which it may seek indemnity. The Company need not pay for any settlement without its written consent, which shall not be unreasonably withheld.

The Company need not reimburse the Trustee for any expense or indemnify it against any loss or liability incurred by it resulting from its gross negligence or bad faith.

To secure the Company's payment obligations in this Section 8.7, the Trustee shall have a senior claim to which the Securities are hereby made subordinate on all money or property held or collected by the Trustee, except such money or property held in trust to pay the principal of and interest on the Securities. The obligations of the Company under this Section 8.7 shall survive the satisfaction and discharge of this Indenture or the resignation or removal of the Trustee.

When the Trustee incurs expenses or renders services after an Event of Default specified in clause (j) or (k) of Section 7.1 occurs, the expenses and the compensation for the services are intended to constitute expenses of administration under any Bankruptcy Law. The provisions of this Section shall survive the termination of this Indenture.

Section 8.8. Replacement of Trustee.

The Trustee may resign by so notifying the Company. The Holders of a majority in aggregate principal amount of the Securities then outstanding may remove the Trustee by so notifying the Trustee and may, with the Company's written consent, appoint a successor Trustee. The Company may remove the Trustee if:

(a) the Trustee fails to comply with Section 8.10;

(b) the Trustee is adjudged a bankrupt or an insolvent;

(c) a receiver or other public officer takes charge of the Trustee or its property; or

(d) the Trustee becomes incapable of acting.

If the Trustee resigns or is removed or if a vacancy exists in the office of Trustee for any reason, the Company shall promptly appoint a successor Trustee. The resignation or removal of a Trustee shall not be effective until a successor Trustee shall have delivered the written acceptance of its appointment as described below.

If a successor Trustee does not take office within 45 days after the retiring Trustee resigns or is removed, the retiring Trustee, the Company or the Holders of 10% in principal amount of the Securities then outstanding may petition any court of competent jurisdiction for the appointment of a successor Trustee at the expense of the Company.

If the Trustee fails to comply with Section 8.10, any Holder may petition any court of competent jurisdiction for the removal of the Trustee and the appointment of a successor Trustee.

A successor Trustee shall deliver a written acceptance of its appointment to the retiring Trustee and to the Company. Immediately after that, the retiring Trustee shall transfer all property held by it as Trustee to the successor Trustee and be released from its obligations (exclusive of any liabilities that the retiring Trustee may have incurred while acting as Trustee) hereunder, the resignation or removal of the retiring Trustee shall become effective, and the successor Trustee shall have all the rights, powers and duties of the Trustee under this Indenture. A successor Trustee shall mail notice of its succession to each Holder.

A retiring Trustee shall not be liable for the acts or omissions of any successor Trustee after its succession.

Notwithstanding replacement of the Trustee pursuant to this Section 8.8, the Company's obligations under Section 8.7 shall continue for the benefit of the retiring Trustee.

Section 8.9. Successor Trustee by Merger, Etc.

If the Trustee consolidates with, merges or converts into, or transfers all or substantially all of its corporate trust assets (including the administration of this Indenture) to, another corporation, the resulting, surviving or transferee corporation, without any further act, shall be the successor Trustee, provided such transferee corporation shall qualify and be eligible under Section 8.10. Such successor Trustee shall promptly mail notice of its succession to the Company and each Holder.

Section 8.10. Eligibility; Disqualification.

The Trustee shall always satisfy the requirements of paragraphs (1), (2) and (5) of TIA Section 310(a). The Trustee (or its parent holding company) shall have a combined capital and surplus of at least $50,000,000. If at any time the Trustee shall cease to satisfy any such requirements, it shall resign immediately in the manner and with the effect specified in this Article 9. The Trustee shall be subject to the provisions of TIA Section 310(b). Nothing herein shall prevent the Trustee from filing with the SEC the application referred to in the penultimate paragraph of TIA Section 310(b).

Section 8.11. Preferential Collection of Claims Against Company.

The Trustee shall comply with TIA Section 311(a), excluding any creditor relationship listed in TIA Section 311(b). A Trustee who has resigned or been removed shall be subject to TIA Section 311(a) to the extent indicated therein.

ARTICLE 9
SATISFACTION AND DISCHARGE OF INDENTURE

Section 9.1. Satisfaction and Discharge of Indenture.

This Indenture shall cease to be of further effect (except as to any surviving rights of exchange, registration of transfer or exchange of Securities herein expressly provided for and except as further provided below), and the Trustee, on demand of and at the expense of the Company, shall execute proper instruments acknowledging satisfaction and discharge of this Indenture, when

(a) either:

(1) all Securities theretofore authenticated and delivered (other than (i) Securities which have been destroyed, lost or stolen and which have been replaced or paid as provided in Section 2.7 and (ii) Securities for whose payment money has theretofore been deposited in trust and thereafter repaid to the Company as provided in Section 9.3) have been delivered to the Trustee for cancellation; or

(2) all such Securities not theretofore delivered to the Trustee for cancellation

(i) have become due and payable, or

(ii) will become due and payable at the Final Maturity Date, Put Right Purchase Date or Fundamental Change Purchase Date, or

(iii) are to be called for redemption 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, in the case of clause (i), (ii) or (iii) above, has irrevocably deposited or caused to be irrevocably deposited with the Trustee or a Paying Agent (other than the Company or any of its Affiliates) as trust funds in trust for the purpose cash and/or shares of Common Stock (as permitted under the Indenture) in an amount sufficient to pay and discharge the entire indebtedness on such Securities not theretofore delivered to the Trustee

for cancellation, for principal and interest (including Liquidated Damages, if any) to the date of such deposit (in the case of Securities which have become due and payable) or to the Final Maturity Date, Redemption Date, Put Right Purchase Date or Fundamental Change Purchase Date, as the case may be; *provided, however*, that there shall not exist, on the date of such deposit, a Default or Event of Default; *provided, further*, that such deposit shall not result in a breach or violation of, or constitute a default under, this Indenture or any other agreement or instrument to which the Company is a party or to which the Company is bound;

(b) the Company has paid or caused to be paid all other sums payable hereunder by the Company; and

(c) the Company has delivered to the Trustee an Officers' Certificate and an Opinion of Counsel, each stating that all conditions precedent herein provided for relating to the satisfaction and discharge of this Indenture have been complied with.

Notwithstanding the satisfaction and discharge of this Indenture, the obligations of the Company to the Trustee under Section 8.7 shall survive and, if money shall have been deposited with the Trustee pursuant to subclause (2) of clause (a) of this Section, the provisions of Sections 2.3, 2.4, 2.5, 2.6, 2.7, 2.12, 3.7, 3.8, Article 4 and this Article 9, shall survive until the Securities have been paid in full.

Section 9.2. Application of Trust Money.

Subject to the provisions of Section 9.3, the Trustee or a Paying Agent shall hold in trust, for the benefit of the Holders, all money deposited with it pursuant to Section 9.1 and shall apply the deposited money in accordance with this Indenture and the Securities to the payment of the principal of and interest on the Securities.

Section 9.3. Repayment to Company.

The Trustee and each Paying Agent shall promptly pay to the Company upon request any excess money (i) deposited with them pursuant to Section 9.1 and (ii) held by them at any time.

The Trustee and each Paying Agent shall pay to the Company upon request any money held by them for the payment of principal or interest that remains unclaimed for two years after a right to such money has matured; *provided, however*, that the Trustee or such Paying Agent, before being required to make any such payment, may, at the expense of the Company, either publish in a newspaper of general circulation in the City of New York, or cause to be mailed to each Holder entitled to such money, notice that such money remains unclaimed and that after a date specified therein, which shall be at least 30 days from the date of such mailing, any unclaimed balance of such money then remaining will be repaid to the Company. After payment to the Company, Holders entitled to money must look to the Company for payment as general creditors unless an applicable abandoned property law designates another person, and the Trustee and each Paying Agent shall be relieved of all liability with respect to such money.

Section 9.4. Reinstatement.

If the Trustee or any Paying Agent is unable to apply any money in accordance with Section 9.2 by reason of any legal proceeding or by reason of any order or judgment of any court or governmental authority enjoining, restraining or otherwise prohibiting such application, then the Company's obligations under this Indenture and the Securities shall be revived and reinstated as though no deposit had occurred pursuant to Section 9.1 until such time as the Trustee or such Paying Agent is permitted to apply all such money in accordance with Section 9.2; *provided, however*, that if the Company has made any payment of the principal of or interest on any Securities because of the reinstatement of its

obligations, the Company shall be subrogated to the rights of the Holders of such Securities to receive any such payment from the money held by the Trustee or such Paying Agent.

ARTICLE 10
AMENDMENTS, SUPPLEMENTS AND WAIVERS

Section 10.1. Without Consent of Holders.

The Company, with the Trustee's consent, may amend or supplement this Indenture or the Securities without notice to or consent of any Holder to:

(a) add to the covenants of the Company for the benefit of the Holders of Securities;

(b) surrender any right or power herein conferred upon the Company by this Indenture;

(c) provide for the assumption of the Company's obligations to the Holders of Securities in the case of a merger, consolidation, conveyance, transfer, sale, lease or other disposition of all or substantially all of the Company's property or assets pursuant to Article 6;

(d) increase the Exchange Rate or make other adjustments to the Exchange Rate, in accordance with this Indenture;

(e) comply with the requirements of the SEC in order to effect or maintain the qualification of this Indenture under the TIA;

(f) secure the Securities;

(g) supplement any of the provisions of the Indenture to such extent as shall be necessary to permit or facilitate the discharge of the Securities, *provided*, that such change or modification does not adversely affect the interests of the Holders of the Securities in any material respect;

(h) make any changes or modifications to this Indenture necessary in connection with the registration of the Securities under the Securities Act as contemplated in the Registration Rights Agreement; and

(i) cure any ambiguity, correct or supplement any provision herein which may be inconsistent with any other provision herein or which is otherwise defective, or to make any other provisions with respect to matters or questions arising under this Indenture which the Company may deem necessary or desirable and which shall not be inconsistent with the provisions of this Indenture; *provided, however*, that such action does not adversely affect the interests of the Holders of Securities.

Section 10.2. With Consent of Holders.

The Company and the Trustee may amend or supplement this Indenture or the Securities with the written consent of the Holders of at least a majority in aggregate principal amount of the Securities then outstanding. The Holders of at least a majority in aggregate principal amount of the Securities then outstanding may waive compliance in a particular instance by the Company with any provision of this Indenture or the Securities without notice to any Holder. However, notwithstanding the foregoing but subject to Section 10.4, without the written consent of each Holder affected, an amendment, supplement or waiver, including a waiver pursuant to Section 7.4, may not:

(a) change the stated maturity of the principal of, any premium due on or interest on (including Liquidated Damages) any Security;

(b) reduce the principal amount of, Redemption Price, Put Right Purchase Price or Fundamental Change Purchase Price or any premium (including any Make-Whole Premium) or interest on (including Liquidated Damages) on, any Security;

(c) alter the manner of calculation or rate of accrual of interest (including Liquidated Damages) on any Security;

(d) change the place or currency of payment of principal of, or any premium or interest on (including Liquidated Damages), any Security;

(e) impair the right of any Holder to institute suit for the enforcement of any repurchase of, payment on or with respect to, or exchange of, any Security on or after the stated maturity of the Securities, in the case of redemption, on or after the Redemption Date, or in the case of repayment at the option of the Holder, on or after the Put Right Purchase Date or Fundamental Change Purchase Date;

(f) adversely affect the right of Holders to exchange Securities other than as provided in or under Article 4 of this Indenture;

(g) adversely affect the right of Holders to require the Company to purchase or repurchase the Securities as provided in Article 3 of this Indenture;

(h) reduce the percentage of the aggregate principal amount of the outstanding Securities whose Holders must consent to a modification or amendment of this Indenture or the Securities;

(i) reduce the percentage of the aggregate principal amount of the outstanding Securities necessary for the waiver of compliance with any provision of this Indenture or of the Securities or the waiver of any default or Event of Default; and

(j) modify any of the provisions of this Section 10.2 or Section 7.4, except to increase any such percentage or to provide that certain provisions of this Indenture cannot be modified or waived without the consent of the Holder of each outstanding Security affected thereby.

It shall not be necessary for the consent of the Holders under this Section 10.2 to approve the particular form of any proposed amendment, supplement or waiver, but it shall be sufficient if such consent approves the substance thereof.

After an amendment, supplement or waiver under this Section 10.2 becomes effective, the Company shall mail to the Holders affected thereby a notice briefly describing the amendment, supplement or waiver. Any failure of the Company to mail such notice, or any defect therein, shall not, however, in any way impair or affect the validity of any such amendment, supplement or waiver.

To the extent that the Company or any of the Subsidiaries hold any Securities, such Securities shall be disregarded for purposes of voting in connection with any notice, waiver, consent or direction requiring the vote or concurrence of Holders.

Section 10.3. Compliance with Trust Indenture Act.

Every amendment to or supplement of this Indenture or the Securities shall comply with the TIA as in effect at the date of such amendment or supplement.

Section 10.4. Revocation and Effect of Consents.

Until an amendment, supplement or waiver becomes effective, a consent to it by a Holder is a continuing consent by the Holder and every subsequent Holder of a Security or portion of a Security that evidences the same debt as the consenting Holder's Security, even if notation of the consent is not made on any Security. However, any such Holder or subsequent Holder may revoke the consent as to its Security or portion of a Security if the Trustee receives the notice of revocation before the date the amendment, supplement or waiver becomes effective.

After an amendment, supplement or waiver becomes effective, it shall bind every Holder, unless it makes a change described in any of clauses (a) through (j) of Section 10.2. In that case the amendment, supplement or waiver shall bind each Holder of a Security who has consented to it and every subsequent Holder of a Security or portion of a Security that evidences the same debt as the consenting Holder's Security.

Section 10.5. Notation on or Exchange of Securities.

If an amendment, supplement or waiver changes the terms of a Security, the Trustee may require the Holder of the Security to deliver it to the Trustee. The Trustee may place an appropriate notation on the Security about the changed terms and return it to the Holder. Alternatively, if the Company or the Trustee so determines, the Company in exchange for the Security shall issue and the Trustee shall authenticate a new Security that reflects the changed terms.

Section 10.6. Trustee to Sign Amendments, Etc.

The Trustee shall sign any amendment or supplemental indenture authorized pursuant to this Article 11 if the amendment or supplemental indenture does not adversely affect the rights, duties, liabilities or immunities of the Trustee. If it does, the Trustee may, in its sole discretion, but need not sign it. In signing or refusing to sign such amendment or supplemental indenture, the Trustee shall be entitled to receive and, subject to Section 8.1, shall be fully protected in relying upon, an Opinion of Counsel stating that such amendment or supplemental indenture is authorized or permitted by this Indenture. The Company may not sign an amendment or supplement indenture until the Board of Directors approves it.

Section 10.7. Effect of Supplemental Indentures.

Upon the execution of any supplemental indenture under this Article, this Indenture shall be modified in accordance therewith, and such supplemental indenture shall form a part of this Indenture for all purposes; and every Holder of Securities theretofore or thereafter authenticated and delivered hereunder shall be bound thereby.

ARTICLE 11
MISCELLANEOUS

Section 11.1. Trust Indenture Act Controls.

If any provision of this Indenture limits, qualifies or conflicts with the duties imposed by any of Sections 310 to 317, inclusive, of the TIA through operation of Section 318(c) thereof, such imposed duties shall control.

Section 11.2. Notices.

Any demand, authorization notice, request, consent or communication shall be given in writing and delivered in person or mailed by first-class mail, postage prepaid, addressed as follows or transmitted by facsimile transmission (confirmed by delivery in person or mail by first-class mail, postage prepaid, or by guaranteed overnight courier) to the following facsimile numbers:

If to the Company, to:

600 Grant Street
Denver, Colorado
Attn: General Counsel
Facsimile No.: 303-749-2073

with a copy (for informational purposes only) to:

Brownstein Hyatt & Farber, P.C.
410 Seventeenth Street
Twenty-Second Floor
Denver, Colorado 80202-4437
Attention: Jeff Knetsch
Facsimile No.: 303-223-0954

if to the Trustee, to:

U.S. Bank National Association
60 Livingston Avenue
St. Paul, Minnesota 55107-2292
Attention: Corporate Trust Services
Internal mail EP-MN-WS3C
(Affordable Residential Communities LP 7.50%
Senior Exchangeable Notes due 2025)
Facsimile No.: (651) 495-8097

Such notices or communications shall be effective when received.

The Company or the Trustee by notice to the other may designate additional or different addresses for subsequent notices or communications.

Any notice or communication mailed to a Holder shall be mailed by first-class mail or delivered by an overnight delivery service to it at its address shown on the register kept by the Primary Registrar.

Failure to mail a notice or communication to a Holder or any defect in it shall not affect its sufficiency with respect to other Holders. If a notice or communication to a Holder is mailed in the manner provided above, it is duly given, whether or not the addressee receives it.

Section 11.3. Communications by Holders with Other Holders.

Holders may communicate pursuant to TIA Section 312(b) with other Holders with respect to their rights under this Indenture or the Securities. The Company, the Trustee, the Registrar and any other Person shall have the protection of TIA Section 312(c).

Section 11.4. Certificate and Opinion as to Conditions Precedent.

(a) Upon any request or application by the Company to the Trustee to take any action under this Indenture, the Company shall furnish to the Trustee at the request of the Trustee:

(1) an Officers' Certificate stating that, in the opinion of the signers, all conditions precedent (including any covenants, compliance with which constitutes a condition precedent), if any, provided for in this Indenture relating to the proposed action have been complied with; and

(2) an Opinion of Counsel stating that, in the opinion of such counsel, all such conditions precedent (including any covenants, compliance with which constitutes a condition precedent) have been complied with.

(b) Each Officers' Certificate and Opinion of Counsel with respect to compliance with a condition or covenant provided for in this Indenture shall include:

(1) a statement that the person making such certificate or opinion has read such covenant or condition;

(2) a brief statement as to the nature and scope of the examination or investigation upon which the statements or opinions contained in such certificate or opinion are based;

(3) a statement that, in the opinion of such person, he or she has made such examination or investigation as is necessary to enable him or her to express an informed opinion as to whether or not such covenant or condition has been complied with; and

(4) a statement as to whether or not, in the opinion of such person, such condition or covenant has been complied with;

provided, however, that with respect to matters of fact an Opinion of Counsel may rely on an Officers' Certificate or certificates of public officials.

Section 11.5. Record Date for Vote or Consent of Holders.

The Company (or, in the event deposits have been made pursuant to Section 9.1, the Trustee) may set a record date for purposes of determining the identity of Holders entitled to vote or consent to any action by vote or consent authorized or permitted under this Indenture, which record date shall not be more than 30 days prior to the date of the commencement of solicitation of such action. Notwithstanding the provisions of Section 10.4, if a record date is fixed, those persons who were Holders of Securities at the close of business on such record date (or their duly designated proxies), and only those persons, shall be entitled to take such action by vote or consent or to revoke any vote or consent previously given, whether or not such persons continue to be Holders after such record date.

Section 11.6. Rules by Trustee, Paying Agent, Registrar and Exchange Agent.

The Trustee may make reasonable rules (not inconsistent with the terms of this Indenture) for action by or at a meeting of Holders. Any Registrar, Paying Agent or Exchange Agent may make reasonable rules for its functions.

Section 11.7. Legal Holidays.

A "*Legal Holiday*" is a Saturday, Sunday or a day on which state or federally chartered banking institutions in New York, New York and the state in which the Corporate Trust Office is located are not required to be open. If a payment date is a Legal Holiday, payment shall be made on the next succeeding day that is not a Legal Holiday, and no interest shall accrue for the intervening period. If a Regular Record Date is a Legal Holiday, the record date shall not be affected.

Section 11.8. Governing Law.

This Indenture and the Securities shall be governed by, and construed in accordance with, the laws of the State of New York, without regard to principles of conflicts of laws.

Section 11.9. No Adverse Interpretation of Other Agreements.

This Indenture may not be used to interpret another indenture, loan or debt agreement of the Company or a Subsidiary of the Company.

Any such indenture, loan or debt agreement may not be used to interpret this Indenture.

Section 11.10. No Recourse Against Others.

All liability described in paragraph 23 of the Securities of any director, officer, employee or shareholder, as such, of the Company is waived and released.

Section 11.11. Successors.

All agreements of the Company in this Indenture and the Securities shall bind its successor. All agreements of the Trustee in this Indenture shall bind its successor.

Section 11.12. Multiple Counterparts.

The parties may sign multiple counterparts of this Indenture. Each signed counterpart shall be deemed an original, but all of them together represent the same agreement.

Section 11.13. Separability.

In case any provisions in this Indenture or in the Securities shall be invalid, illegal or unenforceable, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

Section 11.14. Table of Contents, Headings, Etc.

The table of contents, cross-reference sheet and headings of the Articles and Sections of this Indenture have been inserted for convenience of reference only, are not to be considered a part hereof, and shall in no way modify or restrict any of the terms or provisions hereof.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands as of the date and year first above written.

AFFORDABLE RESIDENTIAL COMMUNITIES LP

By: Affordable Residential Communities Inc., its general partner

By: _____
Scott Gesell
Executive Vice President

U.S. BANK NATIONAL ASSOCIATION, AS TRUSTEE

By: _____
Name:
Title:

EXHIBIT A

[FORM OF FACE OF SECURITY]

UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY TO THE COMPANY OR ITS AGENT FOR REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY (AND ANY PAYMENT HEREON IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL SINCE THE REGISTERED OWNER HEREOF, CEDE & CO., HAS AN INTEREST HEREIN. THIS SECURITY IS A GLOBAL SECURITY WITHIN THE MEANING OF THE INDENTURE HEREINAFTER REFERRED TO AND IS REGISTERED IN THE NAME OF A DEPOSITARY OR A NOMINEE THEREOF. THIS SECURITY IS EXCHANGEABLE FOR SECURITIES REGISTERED IN THE NAME OF A PERSON OTHER THAN THE DEPOSITARY OR ITS NOMINEE ONLY IN THE LIMITED CIRCUMSTANCES DESCRIBED IN THE INDENTURE AND, UNLESS AND UNTIL IT IS EXCHANGED IN WHOLE OR IN PART FOR

SECURITIES IN DEFINITIVE FORM, THIS SECURITY MAY NOT BE TRANSFERRED EXCEPT AS A WHOLE BY THE DEPOSITARY TO A NOMINEE OF THE DEPOSITARY OR BY A NOMINEE OF THE DEPOSITARY TO THE DEPOSITARY OR ANOTHER NOMINEE OF THE DEPOSITARY OR BY THE DEPOSITARY OR ANY SUCH NOMINEE TO A SUCCESSOR DEPOSITARY OR A NOMINEE OF SUCH SUCCESSOR DEPOSITARY.

THE NOTES AND THE SHARES OF COMMON STOCK OF AFFORDABLE RESIDENTIAL COMMUNITIES INC. ISSUABLE UPON EXCHANGE OF THIS NOTE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE SECURITIES ACT), OR ANY STATE SECURITIES LAWS. NEITHER THIS NOTE, THE SHARES OF COMMON STOCK ISSUABLE UPON EXCHANGE OF THIS NOTE NOR ANY INTEREST OR PARTICIPATION HEREIN OR THEREIN MAY BE REOFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE ABSENCE OF SUCH REGISTRATION OR UNLESS SUCH TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, REGISTRATION. BY ITS ACQUISITION HEREOF, THE HOLDER (1) AGREES TO OFFER, SELL OR OTHERWISE TRANSFER SUCH NOTE PRIOR TO THE DATE WHICH IS TWO YEARS AFTER THE LATER OF THE ORIGINAL ISSUE DATE HEREOF AND THE LAST DATE ON WHICH AFFORDABLE RESIDENTIAL COMMUNITIES LP (THE "COMPANY") OR ANY AFFILIATE OF THE COMPANY WAS THE OWNER OF THIS NOTE (OR ANY PREDECESSOR OF THIS NOTE) ONLY (A) TO THE COMPANY OR ANY SUBSIDIARY THEREOF, (B) PURSUANT TO A REGISTRATION STATEMENT WHICH HAS BEEN DECLARED EFFECTIVE UNDER THE SECURITIES ACT, (C) FOR SO LONG AS THE NOTES ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, TO A PERSON IT REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER AS DEFINED IN RULE 144A THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHOM NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (D) PURSUANT TO ANOTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT, SUBJECT TO THE COMPANY'S AND THE TRUSTEE'S RIGHT PRIOR TO ANY SUCH OFFER, SALE OR TRANSFER PURSUANT TO CLAUSE (D) TO REQUIRE THE DELIVERY OF AN OPINION OF COUNSEL, CERTIFICATION AND/OR OTHER INFORMATION SATISFACTORY TO EACH OF THEM, AND IN EACH OF THE FOREGOING CASES, TO REQUIRE THAT A CERTIFICATE OF TRANSFER IN THE FORM APPEARING ON THE OTHER SIDE OF THIS NOTE IS COMPLETED AND DELIVERED BY THE TRANSFEROR TO THE TRUSTEE. THIS LEGEND WILL BE REMOVED UPON THE REQUEST OF THE HOLDER AFTER THE RESALE RESTRICTION TERMINATION DATE.

AFFORDABLE RESIDENTIAL COMMUNITIES LP

CUSIP No.: 00828U AA1

7 1/2% SENIOR EXCHANGEABLE NOTES DUE 2025

Affordable Residential Communities LP, a Delaware limited partnership (the "Company," which term shall include any successor corporation under the Indenture referred to on the reverse hereof), promises to pay to Cede & Co., or registered assigns, the principal sum of Eighty-Seven Million Dollars ($87,000,000) on August 15, 2025, or such greater or lesser amount as is indicated on the Schedule of Exchanges of Securities on the other side of this Security to reflect exchanges, redemptions, purchases and repurchases.

Interest Payment Dates: February 15 and August 15, commencing February 15, 2006

Record Dates: February 1 and August 1

This Security is exchangeable as specified on the other side of this Security. Additional provisions of this Security are set forth on the other side of this Security.

SIGNATURE PAGE FOLLOWS

IN WITNESS WHEREOF, the Company has caused this instrument to be duly executed.

AFFORDABLE RESIDENTIAL COMMUNITIES LP

By: _____
Name:
Title:

Attest: _____
Name:
Title:

Dated:

TRUSTEE'S CERTIFICATE OF AUTHENTICATION

This is one of the Securities referred to
in the within-mentioned Indenture.

U.S. Bank National Association,
as Trustee

Authorized Signatory

[FORM OF REVERSE SIDE OF SECURITY]
AFFORDABLE RESIDENTIAL COMMUNITIES LP
7 1/2% SENIOR EXCHANGEABLE NOTES DUE 2025

1. Interest

Affordable Residential Communities LP, a Delaware limited partnership (the "*Company*," which term shall include any successor corporation under the Indenture hereinafter referred to), promises to pay interest on the principal amount of this Security at the rate of 7 1/2% per annum. The Company shall pay interest semiannually on February 15 and August 15 of each year (each, an "*Interest Payment Date*"), commencing on February 15, 2006. Interest on the Securities shall accrue from the most recent date to which interest has been paid to, but excluding, the next Interest Payment Date, or the Final Maturity Date, as the case may be. Interest will be computed on the basis of a 360-day year of twelve 30-day months.

If this Security is redeemed pursuant to Section 7 of this Security or the Holder elects to require the Company to repurchase this Security pursuant to Section 9 or 10 of this Security, on a date that is after the Regular Record Date and prior to the corresponding Interest Payment Date, interest (including Liquidated Damages, if any) accrued and unpaid hereon to, but not including, the applicable Redemption Date, Put Right Purchase Date or Fundamental Change Purchase Date will be paid to the same Holder to whom the Company pays the principal of such Security regardless of whether such Holder was the registered Holder on the Regular Record Date immediately preceding the applicable Redemption Date, Put Right Purchase Date or Fundamental Change Purchase Date.

Interest (including Liquidated Damages, if any) on Securities exchanged after the close of business on a Regular Record Date but prior to the opening of business on the corresponding Interest Payment Date will be paid to the Holder of the Securities on February 1 or August 1 (whether or not a Business Day), as the case may be, next preceding the corresponding Interest Payment Date (a "*Regular Record Date*") but, upon exchange, the Holder must pay the Company the interest (including Liquidated Damages, if any, but not including any overdue interest) which has accrued and will be paid on such Interest Payment Date.

Any reference herein to interest accrued or payable as of any date shall include Liquidated Damages accrued or payable on such date as provided in Section 3 hereof.

2. Maturity

The Securities will mature on August 15, 2025.

3. Registration Rights Agreement

The holder of this Security is entitled to the benefits of a Registration Rights Agreement, dated as of August 9, 2005, among the Company, Parent and the Initial Purchaser (the "*Registration Rights Agreement*"). Pursuant to the Registration Rights Agreement the Company and Parent agree for the benefit of the Holders of the Securities, that (i) they will, at their cost, within 90 days after the closing of the sale of the Securities (the "*Closing*"), file a shelf registration statement (the "*Shelf Registration Statement*") with the Securities and Exchange Commission (the "*Commission*") with respect to resales of the Securities and will use their best efforts to cause such Shelf Registration Statement to be declared effective within 180 days after the Closing, and (iii) their will use their best efforts to keep such Shelf Registration Statement continuously effective under the Securities Act of 1933, as amended (the "*Securities Act*"), subject to certain exceptions specified in, and in accordance with, the Registration Rights Agreement. In the event that (a) a Shelf Registration Statement is not filed with the SEC on or before the 90th calendar day following the Closing Date, (b) a Shelf Registration Statement is not declared effective on or prior to the 180th calendar day following the Closing Date,

(c) after effectiveness, subject to Section 2.5, the Shelf Registration Statement fails to be effective or usable by the Holders without being succeeded within five Business Days by a post-effective amendment or a report filed with the SEC pursuant to the 1934 Act that cures the failure to be effective or usable, or (d) the Prospectus has ceased to be effective or useable as described in clause (c) for a period of 30 consecutive days (each such event being a "Registration Default"), additional interest, as liquidated damages ("Liquidated Damages"), will accrue at a rate per annum of 0.25% of the principal amount of the Securities for the first 90-day period from day following the Registration Default, and thereafter at a rate per annum of 0.50% of the principal amount of the Securities, provided that in no event shall Liquidated Damages accrue at a rate per annum exceeding 0.50% of the issue price of the Securities, provided further that no Liquidated Damages shall accrue after the Effectiveness Period. Upon the cure of all Registration Defaults then continuing, the accrual of Liquidated Damages will automatically cease and the interest rate borne by the Securities will revert to the original interest rate at such time. Holders who have exchanged Securities into Common Stock will not be entitled to receive any Liquidated Damages with respect to such Common Stock or the issue price of the Securities exchanged.

4. Method of Payment

Except as provided in the Indenture (as defined below), the Company will pay interest (including Liquidated Damages, if any) on the Securities to the persons who are Holders of record of Securities at the close of business on the Regular Record Date set forth on the face of this Security next preceding the applicable Interest Payment Date. Holders must surrender Securities to a Paying Agent to collect the principal amount, Redemption Price, Put Right Purchase Price or Fundamental Change Purchase Price of the Securities, plus, if applicable, accrued and unpaid interest (including Liquidated Damages), if any. The Company will pay, in money of the United States that at the time of payment is legal tender for payment of public and private debts, all amounts due in cash with respect to the Securities, which amounts shall be paid (A) in the case this Security is in global form, by wire transfer of immediately available funds to the account specified by the Holder hereof and (B) in the case this Security is held in other than global form, by wire transfer of immediately available funds to the account specified by the Holder hereof or, if no such account is specified, by mailing a check to such Holder's address shown in the register of the Registrar. Any payments to be made in shares of Common Stock shall be made in accordance with the terms of the Indenture.

5. Paying Agent, Registrar, Bid Solicitation Agent and Exchange Agent

Initially, U.S. Bank National Association (the "*Trustee*," which term shall include any successor trustee under the Indenture hereinafter referred to) will act as Paying Agent, Registrar, and Exchange Agent. The Company may change any Paying Agent, Registrar, or Exchange Agent without notice to the Holder. The Company or any of its Subsidiaries may, subject to certain limitations set forth in the Indenture, act as Paying Agent or Registrar.

6. Indenture, Limitations

This Security is one of a duly authorized issue of Securities of the Company designated as its $7^1/_2$% Senior Exchangeable Notes due 2025 (the "*Securities*"), issued under an Indenture dated as of August 9, 2005 (together with any supplemental indentures thereto, the "*Indenture*"), between the Company, the Subsidiary Guarantor and the Trustee. The terms of this Security include those stated in the Indenture and those required by or made part of the Indenture by reference to the Trust Indenture Act of 1939, as amended, as in effect on the date of the Indenture. This Security is subject to all such terms, and the Holder of this Security is referred to the Indenture and said Act for a statement of them. The Securities are senior unsecured obligations of the Company limited to $87,000,000 aggregate principal amount (or $100,000,000 if the option to purchase additional Securities is exercised in full by the Initial Purchaser). The Indenture does not limit other debt of the Company, secured or unsecured.

7. Company's Right to Redeem

Prior to August 20, 2010, the Securities shall not be redeemable at the Company's option. The Securities may be redeemed at the election of the Company, as a whole or from time to time in part, at any time on or after August 20, 2010, at a redemption price equal to 100% of the principal amount of those Securities plus accrued and unpaid interest (including Liquidated Damages, if any) to, but not including, such Redemption Date (the "*Redemption Price*"), if the Closing Price of the Common Stock has exceeded 130% of the Exchange Price for at least 20 Trading Days in any consecutive 30 Trading Day Period; provided, that if the Redemption Date falls after an interest payment record date (the "*Regular Record Date*") and on or before an interest payment date, then the interest (including Liquidated Damages, if any) will be payable to the Holders in whose name the Securities are registered at the close of business on the Regular Record Date and the Redemption Price shall not include such interest payment.

The Company will make an additional payment with respect to all Securities called for redemption, including any Securities exchanged after the date the notice of redemption is mailed to Holders, equal to the total value of the aggregate amount of the interest otherwise payable on the Securities from the last day through which interest was paid on the Securities through the Redemption Date.

No sinking fund is provided for the Securities.

8. Notice of Redemption

At least 30 days but not more than 60 days before a Redemption Date, the Company shall mail or cause to be mailed a notice of redemption to each Holder of Securities to be redeemed at such Holder's address as it appears on the register of Securities maintained by the Primary Registrar. Once notice of redemption is mailed, Securities called for redemption become due and payable on the Redemption Date and at the Redemption Price stated in the notice, together with accrued and unpaid interest (including Liquidated Damages, if any), except for Securities that are exchanged in accordance with the provisions of Section 11 of this Security. On and after the Redemption Date, subject to the deposit with the Paying Agent of funds sufficient to pay the Redemption Price plus accrued interest (including Liquidated Damages, if any), accrued to, but not including, the Redemption Date, interest shall cease to accrue on Securities or portions of them called for redemption.

9. Repurchase of Securities at the Option of Holders on Specific Dates.

Securities shall be purchased by the Company, at the option of the Holder thereof, on August 15, 2010, August 15, 2015 and August 15, 2020 (each, a "*Put Right Purchase Date*"), at a purchase price equal to 100% of the principal amount of those Securities plus accrued and unpaid interest (including Liquidated Damages, if any) to, but not including, such Put Right Purchase Date (the "*Put Right Purchase Price*"), subject to satisfaction by or on behalf of the Holder of the requirements set forth in the Indenture.

To exercise such right, a Holder shall deliver to the Paying Agent a Put Right Purchase Notice containing the information set forth in the Indenture, at any time from 9:00 a.m., New York City time, on the date that is 20 days immediately preceding such Put Right Purchase Date until,

5:00 p.m., New York City time, on the second Business Day immediately preceding such Put Right Purchase Date, and shall deliver the Securities to the Paying Agent as set forth in the Indenture.

Holders have the right to withdraw any Put Right Purchase Notice by delivering to the Paying Agent a written notice of withdrawal in accordance with the provisions of the Indenture. The Paying Agent shall promptly notify the Company of the receipt by it of any Purchase Notice or written notice of withdrawal thereof.

If cash, sufficient to pay the Put Right Purchase Price of all Securities or portions thereof to be repurchased with respect to a Purchase Date, have been deposited with the Paying Agent, at noon,

New York City time, on the Business Day immediately following the Put Right Purchase Date, then, immediately after the Put Right Purchase Date, such Securities will cease to be outstanding and interest (including Liquidated Damages, if any and Special Interest, if any), on such Securities will cease to accrue, whether or not such Securities are delivered to the Paying Agent, and the Holder thereof shall have no other rights as such other than the right to receive the Purchase Price upon surrender of such Security.

10. Repurchase of Securities Upon a Fundamental Change

If a Fundamental Change occurs at any time prior to the Final Maturity Date, each Holder will have the right to require the Company to repurchase all of its Securities not previously called for redemption, or any portion of such Securities, at a purchase price equal to 100% of the principal amount of all such Securities, plus accrued and unpaid interest (including Liquidated Damages, if any) on such Securities to, but not including, the Fundamental Change Purchase Date (*the "Fundamental Change Purchase Price*"), subject to satisfaction by or on behalf of any Holder of the requirements set forth in the Indenture; provided that the Company may not repurchase any Securities at the option of Holders upon the occurrence of a Fundamental Change if there has occurred and is continuing an Event of Default with respect to the Securities, other than a default in the payment of the Fundamental Change Purchase Price. The date the Company shall repurchase the Securities pursuant to this Section 3.8(a) (the "*Fundamental Change Purchase Date*") shall be no earlier than 15 days and no later than 30 days after the date of the mailing of the Fundamental Change Company Notice.

A "Fundamental Change" shall be deemed to have occurred upon the occurrence of either a "Change in Control" or a "Termination of Trading."

A "Change of Control" shall be deemed to have occurred if any of the following occurs after the date hereof:

(i) any "person" or "group" (as such terms are used in Sections 13(d) and 14(d)(2) of the Exchange Act or any successor provision to either of the foregoing), including any group acting for the purpose of acquiring, holding or disposing of securities within the meaning of Rule 13d-5(b)(1) under the Exchange Act, becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act directly or indirectly) through a purchase, merger or other acquisition transaction, of 50% or more of the total voting power of all classes of Parent's Voting Stock, other than an acquisition by the Company, Parent, any of their Subsidiaries or any of the Company's or Parent's benefit plans;

(ii) the Company or Parent consolidates with, or merges with or into, another person or conveys, transfers, leases or otherwise disposes of all or substantially all of its assets to any person, or any person consolidates with or merges with or into the Company or Parent, other than (x) any transaction (A) that does not result in any reclassification, exchange, or cancellation of outstanding shares of Parent's Capital Stock or the Company's partnership interests, as the case may be, and (B) pursuant to which holders of Parent's Capital Stock or the Company's partnership interests, as applicable, immediately prior to the transaction have the entitlement to exercise, directly or indirectly, 50% or more of the total Voting Power of all shares of Parent's Capital Stock or 50% of the Voting Power of the Company's partnership interests, as the case may be, in each case, with respect to the continuing or surviving entity of such transaction; or (y) any merger solely for the purpose of changing jurisdiction of formation of the Company or Parent and resulting in a reclassification, exchange or exchange of outstanding shares of common stock or partnership units, as the case may be, solely into shares of common stock or partnership units, as the case may be, of the surviving entity;

(iii) From and after the Issuance, Date, during any consecutive two-year period, individuals who at the beginning of that two-year period constituted the Board of Directors (together with any new directors whose election to such Board of Directors, or whose nomination for election by

stockholders of Parent, was approved by a vote of a majority of the directors then still in office who were either directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of the Board of Directors then in office; or

(iv) the Company or Parent is liquidated or dissolved or approves a plan of liquidation or dissolution.

A "Termination of Trading" shall be deemed to have occurred if, after the date hereof, the Common Stock (or other common stock into which the Securities are then exchangeable) is not listed for trading on a United States national securities exchange or approved for trading on an established automated over-the-counter trading market in the United States.

To exercise such right, a Holder shall deliver to the Paying Agent a Fundamental Change Purchase Notice containing the information set forth in the Indenture, at any time from the opening of business on the date of the Fundamental Change Company Notice until 5:00 p.m., New York City time, on the fifth Business Day immediately preceding such Repurchase Date, and shall deliver the Securities to the Paying Agent as set forth in the Indenture.

Holders have the right to withdraw any Fundamental Change Company Notice by delivering to the Paying Agent a written notice of withdrawal in accordance with the provisions of the Indenture. The Paying Agent shall promptly notify the Company of the receipt by it of any Fundamental Change Company Notice or written notice of withdrawal thereof.

If cash sufficient to pay the Fundamental Change Purchase Price of all Securities or portions thereof to be repurchased with respect to a Fundamental Change Repurchase Notice, has been deposited with the Paying Agent, at noon, New York City time, on the Fundamental Change Purchase Date, then, immediately after Fundamental Change Purchase Date, such Securities will cease to be outstanding and interest (including Liquidated Damages, if any), on such Securities will cease to accrue, whether or not such Securities are delivered to the Paying Agent, and the Holder thereof shall have no other rights as such other than the right to receive the Repurchase Price upon surrender of such Security.

11. Exchange Privilege

Subject to the provisions of set forth in the Indenture, a Holder of a Security shall have the right, at such Holder's option, to exchange all or any portion (if the portion to be exchanged is $1,000 or an integral multiple of $1,000) of such Security into shares of Common Stock at the Exchange Price in effect on the date of exchange at any time at any time prior to the earlier of (1) the close of business on the Business Day prior to the Redemption Date and (2) the close of business on the second Business Day immediately preceding the Final Maturity Date.

A Security in respect of which a Holder has delivered a Put Right Purchase Notice or Fundamental Change Purchase Notice, as the case may be, exercising the right of such Holder to require the Company to repurchase such Security may be exchanged only if such Purchase Notice or Fundamental Change Purchase Notice is withdrawn in accordance with the terms of the Indenture, unless the Company defaults in the payment of the Put Right Purchase Price or the Fundamental Change Purchase Price.

The initial Exchange Rate is 69.8812 shares per $1,000 principal amount of Securities, subject to adjustment in certain events described in the Indenture.

To surrender a Security for exchange, a Holder must, in the case of Global Securities, comply with the Applicable Procedures of the Depositary in effect at that time, and in the case of Certificated Securities, (1) surrender the Security duly endorsed to the Company or in blank, at the office of the Exchange Agent, (2) complete and manually sign the exchange notice below (or complete and manually

sign a facsimile of such notice) and deliver such notice to the Exchange Agent, (3) furnish appropriate endorsements and transfer documents and (4) pay all funds required, if any, relating to interest (including Liquidated Damages, if any), and any withholding, transfer or similar tax, if required.

If a Fundamental Change described in clauses (1), (2) or (4) of the definition of "Change of Control" occurs prior to August 20, 2015, Holders who exchange Securities in accordance with the provisions of Section 11 in connection with such Fundamental Change shall be entitled to receive a "Make-Whole Premium" consisting of an increase in the Exchange Rate as more fully described in the Indenture.

No fractional share of Common Stock shall be issued upon exchange of any Security. Instead, the Company shall pay a cash adjustment as provided in the Indenture.

If more than one Security shall be surrendered for exchange at one time by the same Holder, the number of full shares of Common Stock which shall be deliverable upon exchange shall be computed on the basis of the aggregate principal amount of the Security (or specified portions thereof to the extent permitted thereby) so surrendered. Subject to the next succeeding sentence, the Company will, as soon as practicable thereafter, issue and deliver at said office or place to such Holder of a Security, or to such Holder's nominee or nominees, certificates (other than in the case of Holders of Securities in book-entry form with the Depositary, which shares shall be delivered in accordance with the Depositary customary practices) for the number of full shares of Common Stock to which such Holder shall be entitled as aforesaid, together with cash in lieu of any fraction of a share to which such Holder would otherwise be entitled.

If shares of Common Stock to be issued upon exchange of a Transfer Restricted Security are to be issued in the name of a Person other than the Holder of such Transfer Restricted Security, such Holder must deliver to the Exchange Agent a certification in substantially the form set forth in a Transfer Certificate dated the date of surrender of such Transfer Restricted Security and signed by such Holder, as to compliance with the restrictions on transfer applicable to such Transfer Restricted Security. The Company shall not be required to issue Common Stock upon exchange of any such Transfer Restricted Security to a Person other than the Holder if such Transfer Restricted Security is not so accompanied by a properly completed certification, and the Registrar shall not be required to register Common Stock upon exchange of any such Transfer Restricted Security in the name of a Person other than the Holder if such Transfer Restricted Security is not so accompanied by a properly completed certification.

If any of the following events occurs:

(i) any reclassification or change of the outstanding Common Stock into another class of Capital Stock (other than a change in par value, or from par value to no par value, or from no par value to par value, or as a result of a subdivision or combination);

(ii) any merger, consolidation, statutory share exchange or combination of Parent with another corporation as a result of

which all of the holders of Common Stock shall be entitled to receive stock, securities or other property or assets (including cash or any combination thereof) with respect to or in exchange for all of their Common Stock; or

(iii) any sale or conveyance of all or substantially all the properties and assets of Parent to any other person as a result of which all of the holders of Common Stock shall be entitled to receive stock, securities or other property or assets (including cash or any combination thereof) with respect to or in exchange for all of their Common Stock;

in each case as a result of which holders of Common Stock are entitled to receive stock, other securities, other property or assets (including cash or any combination thereof) with respect to or in exchange for Common Stock, the Company shall execute with the Trustee a supplemental indenture (which shall comply with the TIA as in force at the date of execution of such supplemental indenture, if such supplemental indenture is then required to so comply) providing that the Holder's right to

exchange a Security into Common Stock shall be changed to a right to exchange a Security into the kind and amount of shares of stock and other securities or property or assets (including cash) which such Holder would have been entitled to receive upon such reclassification, change, merger, consolidation, statutory share exchange, combination, sale or conveyance had such Securities been exchanged into Common Stock immediately prior to such reclassification, change, merger, consolidation, statutory share exchange, combination, sale or conveyance. In the event holders of Common Stock have the opportunity to elect the form of consideration to be received in a reclassification, change, consolidation, merger combination, sale or conveyance, the Company shall make adequate provision whereby the Holders of the Securities shall have the opportunity, on a timely basis, to determine the form of consideration into which all of the Securities, treated as a single class, shall be exchangeable. Such determination shall be based on the blended, weighted average of elections made by Holders of the Securities who participate in such determination and shall be subject to any limitations to which all of the holders of Common Stock are subject to, such as pro-rata reductions applicable to any portion of the consideration payable.

In case any Certificated Security shall be surrendered for partial exchange, the Company shall execute and the Trustee shall, upon the written order of the Company, authenticate and deliver to the Holder of the Security so surrendered, without charge to such Holder (subject to the provisions of the Indenture), a new Security or Securities in authorized denominations in an aggregate principal amount equal to the unexchanged portion of the surrendered Certificated Securities.

12. Merger

The Company shall not consolidate with or merge into any other Person (in a transaction in which the Company is not the surviving corporation) or convey, transfer, lease or otherwise dispose of all or substantially all of its properties and assets to any Person, whether in a single transaction or series of related transactions, unless:

(i) either (i) the Company is the surviving entity or (ii) the successor or transferee (the "*successor corporation*") is a corporation organized and existing under the laws of the United States, any State thereof, or the District of Columbia and shall expressly assume, by an indenture supplemental hereto, executed and delivered to the Trustee, all of the obligations of the Company under the Securities and the Indenture;

(ii) if as a result of such transaction the Securities become convertible or exchangeable into common stock or other securities issued by a third party, such third party fully and unconditionally guarantees all obligations under the Securities and the Indenture;

(iii) immediately after giving effect to such transaction, no Default or Event of Default shall exist; and

(iv) the Company shall have delivered to the Trustee an Officers' Certificate and, if requested by the Trustee, an Opinion of Counsel, each stating that such consolidation, merger, conveyance, transfer, sale, lease or other disposition and, if a supplemental indenture is required in connection with such transaction, such supplemental indenture, comply with this Article 6 and that all conditions precedent herein provided for relating to such transaction have been satisfied.

13. Denominations, Transfer, Exchange

The Securities are in registered form, without coupons, in denominations of $1,000 and integral multiples of $1,000. A Holder may register the transfer of or exchange Securities in accordance with the Indenture. The Registrar may require a Holder, among other things, to furnish appropriate endorsements and transfer documents and to pay any taxes or other governmental charges that may be imposed in relation thereto by law or permitted by the Indenture.

14. Persons Deemed Owners

The Holder of a Security may be treated as the owner of it for all purposes.

15. Unclaimed Money

If money for the payment of principal or interest (including Liquidated Damages if any), remains unclaimed for two years, the Trustee or Paying Agent will pay the money back to the Company at its written request, subject to applicable unclaimed property law. After that, Holders entitled to money must look to the Company for payment as general creditors unless an applicable abandoned property law designates another person.

16. Amendment, Supplement and Waiver

Subject to certain exceptions, the Indenture or the Securities may be amended or supplemented with the consent of the Holders of at least a majority in aggregate principal amount of the Securities then outstanding, and certain existing defaults or Events of Default and their consequence or compliance with any provision of the Indenture or the Securities may be waived in a particular instance with the consent of the Holders of a majority in aggregate principal amount of the Securities then outstanding. Without the consent of or notice to any Holder, the Company and the Trustee may amend or supplement the Indenture or the Securities to, among other things, cure any ambiguity, defect or inconsistency or make any other change that does not adversely affect the rights of any Holder.

17. Successor Entity

When a successor corporation assumes all the obligations of its predecessor under the Securities and the Indenture in accordance with the terms and conditions of the Indenture, the predecessor corporation (except in certain circumstances specified in the Indenture) shall be released from those obligations.

18. Defaults and Remedies

Under the Indenture, an Event of Default includes: (i) default for 30 days in payment of any accrued and unpaid interest (including Liquidated Damages, if any) on any Securities; (ii) default in payment of any principal (including, without limitation, any premium, if any) on the Securities when due; (iii) failure by the Company for 30 days after notice to it to comply with any of its other agreements contained in the Indenture or the Securities; (iv) default in the payment of certain indebtedness of the Company or a Significant Subsidiary; and (v) certain events of bankruptcy, insolvency or reorganization of the Company or any Significant Subsidiary.

If an Event of Default (other than as a result of certain events of bankruptcy, insolvency or reorganization of the Company) occurs and is continuing, the Trustee or the Holders of at least 25% in aggregate principal amount of the Securities then outstanding may, declare all unpaid principal to the date of acceleration on the Securities then outstanding to be due and payable immediately, all as and to the extent provided in the Indenture. If an Event of Default occurs as a result of certain events of bankruptcy, insolvency or reorganization of the Company, unpaid principal of the Securities then outstanding shall become due and payable immediately without any declaration or other act on the part of the Trustee or any Holder, all as and to the extent provided in the Indenture. Holders may not enforce the Indenture or the Securities except as provided in the Indenture. The Trustee may require indemnity reasonably satisfactory to it before it enforces the Indenture or the Securities. Subject to certain limitations, Holders of a majority in aggregate principal amount of the Securities then outstanding may direct the Trustee in its exercise of any trust or power. The Trustee may withhold from Holders notice of any continuing default (except a default in payment of principal or interest) if it determines that withholding notice is in their interests. The Company is required to file periodic reports with the Trustee as to the absence of default.

19. Trustee Dealings with the Company

U.S. Bank National Association, the Trustee under the Indenture, in its individual or any other capacity, may make loans to, accept deposits from and perform services for the Company or an Affiliate of the Company, and may otherwise deal with the Company or an Affiliate of the Company, as if it were not the Trustee.

20. No Recourse Against Others

A director, officer, employee or shareholder, as such, of the Company shall not have any liability for any obligations of the Company under the Securities or the Indenture nor for any claim based on, in respect of or by reason of such obligations or their creation. The Holder of this Security by accepting this Security waives and releases all such liability. The waiver and release are part of the consideration for the issuance of this Security.

21. Calculations in Respect of Securities

The Company and its agents shall be responsible for making all calculations as contemplated under this Indenture and the Securities. Any calculations made in good faith and without manifest error shall be final and binding upon all Holders of the Securities. The Company shall provide a copy of its calculations to the Trustee, and, absent manifest error, the Trustee shall be entitled to rely on the accuracy of such calculations without conducting an independent verification as to their accuracy.

22. Authentication

This Security shall not be valid until the Trustee or an authenticating agent manually signs the certificate of authentication on the other side of this Security.

23. Abbreviations and Definitions

Customary abbreviations may be used in the name of the Holder or an assignee, such as: TEN COM (= tenants in common), TEN ENT (= tenants by the entireties), JT TEN (= joint tenants with right of survivorship and not as tenants in common), CUST (= Custodian) and UGMA (= Uniform Gifts to Minors Act).

All terms defined in the Indenture and used in this Security but not specifically defined herein are defined in the Indenture and are used herein as so defined.

24. Indenture to Control; Governing Law

In the case of any conflict between the provisions of this Security and the Indenture, the provisions of the Indenture shall control.

THIS SECURITY SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK, WITHOUT REGARD TO PRINCIPALS OF CONFLICTS OF LAW.

The Company will furnish to any Holder, upon written request and without charge, a copy of the Indenture. Requests may be made to: Affordable Residential Communities LP, 600 Grant Street, Suite 900, Denver Colorado, 80203, Attention: General Counsel.

ASSIGNMENT FORM

To assign this Security, fill in the form below:

I or we assign and transfer this Security to _____

(Insert assignee's soc. sec. or tax I.D. no.)

_____

_____

_____

(Print or type assignee's name, address and zip code)

and irrevocably appoint

_____

agent to transfer this Security on the books of the Company. The agent may substitute another to act for him or her.

Your Signature:

Date: _____

(Sign exactly as your name appears on the other side of this Security)

* Signature guaranteed by:

By: _____

_____

* The signature must be guaranteed by an institution which is a member of one of the following recognized signature guaranty programs: (i) the Securities Transfer Agent Medallion Program (STAMP); (ii) the New York Stock Exchange Medallion Program (MSP); (iii) the Stock Exchange Medallion Program (SEMP); or (iv) such other guaranty program acceptable to the Trustee.

EXCHANGE NOTICE

To exchange this Security into Common Stock of the Company, check the box: ☐

To exchange only part of this Security, state the principal amount to be exchanged (must be $1,000 or a integral multiple of $1,000): $.

If you want the stock certificate made out in another person's name, fill in the form below:

_____

(Insert assignee's soc. sec. or tax I.D. no.)

_____

(Print or type assignee's name, address and zip code)

Your Signature:

Date:

(Sign exactly as your name appears on the other side of this Security)

* Signature guaranteed by:

By:

* The signature must be guaranteed by an institution which is a member of one of the following recognized signature guaranty programs: (i) the Securities Transfer Agent Medallion Program (STAMP); (ii) the New York Stock Exchange Medallion Program (MSP); (iii) the Stock Exchange Medallion Program (SEMP); or (iv) such other guaranty program acceptable to the Trustee.

SCHEDULE OF EXCHANGES OF SECURITIES

The following exchanges, redemptions, repurchases or purchases of a part of this global Note have been made:

Principal Amount of this Global Security Following Such Decrease Date of Exchange (or Increase)	Authorized Signatory of Securities Custodian	Amount of Decrease in Principal Amount of this Global Security	Amount of Increase in Principal Amount of this Global Security

EXHIBIT B

CERTIFICATE TO BE DELIVERED UPON EXCHANGE OR REGISTRATION OF TRANSFER OF TRANSFER RESTRICTED SECURITIES

Re: $7^1/_2$% Senior Exchangeable Notes due 2025 (the "*Securities*") of Affordable Residential Communities LP

This certificate relates to $ principal amount of Securities owned in (check applicable box)

☐ book-entry or ☐ definitive form by (the "*Transferor*").

The Transferor has requested a Registrar or the Trustee to exchange or register the transfer of such Securities.

In connection with such request and in respect of each such Security, the Transferor does hereby certify that the Transferor is familiar with transfer restrictions relating to the Securities as provided in Section 2.12 of the Indenture dated as of August 9, 2005 between Affordable Residential Communities LP and U.S. Bank National Association, as trustee (the "*Indenture*"), and the transfer of such Security is being made pursuant to an effective registration statement under the Securities Act of 1933, as amended (the "*Securities Act*") (check applicable box) or the transfer or exchange, as the case may be, of such Security does not require registration under the Securities Act because (check applicable box):

☐ Such Security is being transferred pursuant to an effective registration statement under the Securities Act.

☐ Such Security is being acquired for the Transferor's own account, without transfer.

☐ Such Security is being transferred to the Company or a Subsidiary (as defined in the Indenture) of the Company.

☐ Such Security is being transferred to a person the Transferor reasonably believes is a "qualified institutional buyer" (as defined in Rule 144A or any successor provision thereto ("*Rule 144A*") under the Securities Act) that is purchasing for its own account or for the account of a "qualified institutional buyer," in each case to whom notice has been given that the transfer is being made in reliance on such Rule 144A, and in each case in reliance on Rule 144A.

☐ Such Security is being transferred pursuant to and in compliance with an exemption from the registration requirements under the Securities Act in accordance with Rule 144 (or any successor thereto) ("*Rule 144*") under the Securities Act.

The Transferor acknowledges and agrees that, if the transferee will hold any such Securities in the form of beneficial interests in a global Security

which is a "restricted security" within the meaning of Rule 144 under the Securities Act, then such transfer can only be made pursuant to Rule 144A under the Securities Act and such transferee must be a "qualified institutional buyer" (as defined in Rule 144A).

Date: _____
(Insert Name of Transferor)

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Section 3: EX-10.2.2 (EX-10.2.2)

Exhibit 10.2.2

AFFORDABLE RESIDENTIAL COMMUNITIES INC.
2003 EQUITY INCENTIVE PLAN

RESTRICTED STOCK AGREEMENT

RESTRICTED STOCK AGREEMENT, made as of the date set forth on the Notice of Grant of Restricted Stock, by and between Affordable Residential Communities Inc., a Maryland corporation (the "Company"), pursuant to the Affordable Residential Communities Inc. 2003 Equity Incentive Plan (the "Plan") and the employee or director of the Company or an Affiliate named on the Notice of Grant of Restricted Stock (the "Participant"). Except as otherwise expressly set forth herein, this Agreement shall be construed in accordance with the provisions of the Plan and any capitalized terms not otherwise defined in this Agreement shall have the definitions set forth in the Plan.

WHEREAS, the Plan administrator has authorized the grant to the Participant of the shares of Restricted Stock as set forth in the Notice of Grant of Restricted Stock.

NOW, THEREFORE, in consideration of the mutual covenants hereinafter set forth and for other good and valuable consideration, the parties hereto have agreed and do hereby agree as follows:

1. Grant of Award. Pursuant to Section 7 of the Plan, the Company grants to the Participant, as of the effective date of grant specified in the Notice of Grant of Restricted Stock and subject to the terms and conditions of the Plan and subject further to the terms and conditions set forth herein, the number of shares of Restricted Stock as shown on the Notice of Grant of Restricted Stock. The Participant's grant and record of Restricted Stock share ownership shall be kept on the books of the Company until the restrictions on transfer have lapsed. At the Participant's request, vested shares may be evidenced by stock certificates.

2. Vesting. The shares of Restricted Stock granted to the Participant shall vest in accordance with the vesting schedule set forth in the Notice of Grant of Restricted Stock. Such vesting schedule indicates each date upon which the Participant shall be entitled to receive shares of freely transferable Common Stock equal to the number of vested shares of Restricted Stock, provided that, as of the vesting date, the Participant has not incurred a termination of service with the Company and all of its Affiliates. No vesting shall occur after the termination of a Participant's employment or service with the Company and its Affiliates for any reason.

3. Rights as a Stockholder. The Participant shall have all of the rights of a stockholder with respect to the shares of Restricted Stock, including the right to vote on all matters with respect to which the stockholders of the Company have the right to vote and the right to receive dividends thereon.

4. Restrictions on Transfer. Shares of Restricted Stock may not be transferred or otherwise disposed of by the Participant, including by way of sale, assignment, transfer, pledge, hypothecation or otherwise, except as permitted by the Committee, or by will or the laws of descent and distribution.

5. Approvals. No shares of Common Stock shall be issued under this Restricted Stock Agreement unless and until all legal requirements applicable to the issuance of such

shares have been complied with to the satisfaction of the Committee. The Committee shall have the right to condition any issuance of shares to the Participant on the Participant's undertaking in writing to comply with such restrictions on the subsequent disposition of such shares as the Committee shall deem necessary or advisable as a result of any applicable law or regulation.

6. Invalid Transfers. No purported sale, assignment, mortgage, hypothecation, transfer, pledge, encumbrance, gift, transfer in trust (voting or other) or other disposition of, or creation of a security interest in or lien on, any of the shares of Restricted Stock by any holder thereof in violation of the provisions of this Restricted Stock Agreement shall be valid, and the Company will not transfer any of said shares of Restricted Stock on its books nor will any of said shares of Restricted Stock be entitled to vote, nor will any dividends be paid thereon, unless and until there has been full compliance with said provisions to the satisfaction of the Company. The foregoing restrictions are in

addition to and not in lieu of any other remedies, legal or equitable, available to enforce said provisions.

7. Effect of Termination of Employment or Service for Death, Disability, Retirement or Without Cause. Unless otherwise provided in an individual employment, severance or other agreement entered into between the Participant and the Company, in which case the provisions of such agreement shall apply, in the event that the Participant's employment or service with the Company terminates for any reason prior to the vesting of all of the shares of Restricted Stock subject hereto, any shares subject to this Agreement as of the effective date of such termination shall be immediately forfeited and cancelled.

8. Taxes. The Participant shall pay to the Company promptly upon request, and in any event at the time the Participant recognizes taxable income in respect to the shares of Restricted Stock (or, if the Participant makes an election under Section 83(b) of the Code in connection with such grant, on or about the date of grant), an amount equal to the federal, state and/or local taxes the Company determines it is required to withhold under applicable tax laws with respect to the shares of Restricted Stock. The Participant may satisfy the foregoing requirement by making a payment to the Company in cash or, with the consent of the Company, by authorizing the Company to withhold cash otherwise due to the Participant (e.g., by filing a revised form W-4 to increase payroll tax withholdings). The Participant shall promptly notify the Company of any election made pursuant to Section 83(b) of the Code. The Participant understands that the Participant (and not the Company) shall be responsible for any tax liability that may arise as a result of the transactions contemplated by this Restricted Stock Agreement.

THE PARTICIPANT ACKNOWLEDGES THAT IT IS THE PARTICIPANT'S SOLE RESPONSIBILITY AND NOT THE COMPANY'S TO FILE TIMELY THE ELECTION UNDER SECTION 83(b) OF THE CODE, IN THE EVENT THAT THE PARTICIPANT DESIRES TO MAKE THE ELECTION.

9. Compliance with Law and Regulations; Legend. The award and any obligation of the Company hereunder shall be subject to all applicable federal, state and local laws, rules and regulations and to such approvals by any government or regulatory agency as may be required. The Company may require, as a condition of the issuance and delivery of certificates evidencing Restricted Stock pursuant to the terms hereof, that

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the certificates bear the legend set forth immediately below, in addition to any other legends required under federal and state securities laws or as otherwise determined by the Committee.

> The transferability of this certificate and the shares of stock represented hereby are subject to the restrictions, terms and conditions (including forfeiture provisions and restrictions against transfer) contained in the Affordable Residential Communities Inc. 2003 Equity Incentive Plan and an Agreement entered into between the registered owner of such shares and the Company. A copy of the Plan and Agreement is on file in the office of the Secretary of the Company, 600 Grant Street, Suite 900, Denver, CO 80203.

Such legend shall not be removed until such shares vest pursuant to the terms hereof.

10. Incorporation of Plan. This Agreement is made under the provisions of the Plan (which is incorporated herein by reference) and shall be interpreted in a manner consistent with it. To the extent that this Agreement is silent with respect to, or in any way inconsistent with, the terms of the Plan, the provisions of the Plan shall govern and this Restricted Stock Agreement shall be deemed to be modified accordingly.

11. Notices. Any notices required or permitted hereunder shall be addressed to the Company, at 600 Grant Street, Suite 900, Denver, CO 80203, or to the Participant at the address then on record with the Company, as the case may be, and deposited, postage prepaid, in the United States mail. Either party may, by notice to the other given in the manner aforesaid, change his/her or its address for future notices.

12. Binding Agreement; Successors. This Agreement shall bind and inure to the benefit of the Company, its successors and assigns, and the Participant and the Participant's personal representatives and beneficiaries.

13. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Maryland. The Committee shall have final authority to interpret and construe the Plan and this Agreement and to make any and all determinations under them, and its decision shall be binding and conclusive upon all Persons.

14. Amendment. This Agreement may be amended or modified by the Company at any time; *provided* that notice is provided to the Participant in accordance with Section 11; and *provided, further,* that no amendment or modification that is adverse to the rights of the Participant as provided by this Agreement shall be effective unless set forth in a writing signed by the parties hereto.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its officer thereunder duly authorized and the Participant has hereunto set his hand, all as of the day and year set forth below.

AFFORDABLE RESIDENTIAL
COMMUNITIES INC.

By: _____
Its: _____

The undersigned hereby acknowledges having read this Agreement and the Plan and hereby agrees to be bound by all provisions set forth herein and in the Plan.

_____

_____

Date: _____

AFFORDABLE RESIDENTIAL COMMUNITIES INC.
2003 EQUITY INCENTIVE PLAN

NOTICE OF GRANT OF RESTRICTED STOCK

This Notice is to certify that the Participant named below has been granted the number of shares of Restricted Common Stock set forth below under the terms and conditions set forth in this Notice. This Notice is subject to and incorporates by reference the terms and conditions of the Restricted Stock Agreement ((the "Agreement"), a copy of which is enclosed). Please refer to the Restricted Stock Agreement and the 2003 Equity Incentive Plan document for an explanation of the terms and conditions of this grant and a full description of your rights and obligations. You must sign the Agreement in order for this Notice and grant to be effective. Please sign and date the Agreement on the last page and return it promptly in the enclosed envelope.

Name of Participant: _____

Number of Restricted Shares: _____

Per Share Value on Grant Date: $ _____

Grant Date: _____

Vesting Schedule: _____ Shares vest on Grant Date _____
(Date(s) on which Restricted
Stock Restrictions Lapse) _____ Shares vest on _____

Additional Terms: See the Restricted Stock Agreement.

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Section 4: EX-10.5 (EX-10.5)

Exhibit 10.5

REGISTRATION RIGHTS AGREEMENT

dated as of August 9, 2005

among

Affordable Residential Communities LP,
Affordable Residential Communities Inc.

and

Merrill Lynch, Pierce, Fenner & Smith Incorporated

REGISTRATION RIGHTS AGREEMENT

This Registration Rights Agreement (the "*Agreement*") is made and entered into this 9th day of August, 2005, among Affordable Residential Communities LP, a Delaware limited partnership (the "*Company*"), Affordable Residential Communities Inc., a Maryland corporation (the "Parent") and Merrill Lynch, Pierce, Fenner & Smith Incorporated (the "*Initial Purchaser*").

This Agreement is made pursuant to the Purchase Agreement, dated as of August 3, 2005, among the Company, Parent and the Initial Purchaser (the "*Purchase Agreement*"), which provides for the sale by the Company to the Initial Purchaser of an aggregate of $87,000,000 principal amount at maturity ($100,000,000 principal amount at maturity if the Initial Purchaser exercises their option in full) of the Company's 7 1/2% Senior Exchangeable Notes due 2025 (the "*Securities*"). In order to induce the Initial Purchaser to enter into the Purchase Agreement, the Company has agreed to provide to the Initial Purchaser and its direct and indirect transferees the registration rights set forth in this Agreement. The execution of this Agreement is a condition to the closing under the Purchase Agreement.

In consideration of the foregoing, the parties hereto agree as follows:

1. Definitions.

As used in this Agreement, the following capitalized defined terms shall have the following meanings:

"*1933 Act*" shall mean the Securities Act of 1933, as amended from time to time.

"*1934 Act*" shall mean the Securities Exchange Act of l934, as amended from time to time.

"*1939 Act*" shall mean the Trust Indenture Act of 1939, as amended from time to time.

"*Closing Date*" shall mean the Closing Time as defined in the Purchase Agreement.

"*Common Stock*" shall mean any shares of common stock, $.01 par value, of Parent and any other shares of common stock as may constitute "Common Stock" for purposes of the Indenture.

"*Company*" shall have the meaning set forth in the preamble and shall also include the Company's successors.

"*Depositary*" shall mean The Depository Trust Company, or any other depositary appointed by the Company, *provided, however*, that such depositary must have an address in the Borough of Manhattan, in the City of New York.

"*Holder*" shall mean an Initial Purchaser, for so long as it owns any Registrable Securities, and each of its successors, assigns and direct and indirect transferees who become registered owners of Registrable Securities under the Indenture.

"*Indenture*" shall mean the Indenture relating to the Securities, dated as of August 9, 2005, between the Company and US Bank National Association, as trustee, as the same may be amended, supplemented, waived or otherwise modified from time to time in accordance with the terms thereof.

"*Initial Purchaser*" shall have the meaning set forth in the preamble.

"*Majority Holders*" shall mean the Holders of a majority of the outstanding Registrable Securities (assuming conversion of all Securities into Common Stock); *provided* that whenever the consent or approval of Holders of a specified percentage of Registrable Securities is required hereunder, Registrable Securities held by the Company, Parent or any of their Affiliates (as defined in the Indenture) shall be disregarded in determining whether such consent or approval was given by the Holders of such required percentage amount.

"*Person*" shall mean an individual, partnership (general or limited), corporation, limited liability company, trust or unincorporated organization, or a government or agency or political subdivision thereof.

"*Prospectus*" shall mean the prospectus included in a Shelf Registration Statement, including any preliminary prospectus, and any such prospectus as amended or supplemented by any prospectus supplement, including any such prospectus supplement with respect to the terms of the offering of any portion of the Registrable Securities covered by a Shelf Registration Statement, and by all other amendments and supplements to a prospectus, including post-effective amendments, and in each case including all material incorporated by reference therein.

"*Purchase Agreement*" shall have the meaning set forth in the preamble.

"*Registrable Securities*" shall mean all or any of the Securities issued from time to time under the Indenture in registered form, and the shares of Common Stock issuable upon conversion of such Securities; *provided, however*, that any such Securities shall cease to be Registrable Securities when (i) a Shelf Registration Statement with respect to such Securities shall have been declared effective under the 1933 Act and such Securities shall have been disposed of pursuant to such Shelf Registration Statement, (ii) such Securities have been or may be sold to the public pursuant to Rule l44 (or any similar provision then in force, but not Rule 144A) under the 1933 Act, (iii) such Securities shall have ceased to be outstanding or (iv) such Securities may be sold or transferred, other than by the Company, Parent or any of their Affiliates, pursuant to Rule 144 (k) under the 1933 Act.

"*Registration Expenses*" shall mean any and all expenses incident to performance of or compliance by the Company and Parent with this

Agreement, including without limitation: (i) all SEC, stock exchange or National Association of Securities Dealers, Inc. (the "*NASD*") registration and filing fees, including, if applicable, the fees and expenses of any "qualified independent underwriter" (and its counsel) that is required to be retained by any holder of Registrable Securities in accordance with the rules and regulations of the NASD, (ii) all fees and expenses incurred in connection with compliance with state securities or blue sky laws and compliance with the rules of the NASD (including reasonable fees and disbursements of counsel for any underwriters or Holders in connection with blue sky qualification of any of the Registrable Securities and any filings with the NASD), (iii) all expenses of the Company or Parent in preparing or assisting in preparing, word processing, printing and distributing any Shelf Registration Statement, any Prospectus or any amendments or supplements thereto, (iv) all fees and expenses incurred in connection with the listing, if any, of any of the Registrable Securities on any securities exchange or exchanges, (v) the fees and disbursements of counsel for the Company and Parent and of the independent public accountants of the Company and Parent, including the expenses of any special audits or "comfort" letters required by or incident to such performance and compliance, (vi) the reasonable fees and expenses of the Trustee, and any escrow agent or custodian, (vii) the reasonable fees and expenses of a single counsel to the Holders in connection with the Shelf Registration, which counsel shall be selected by the Majority Holders, and (viii) any fees and expenses of any special experts retained by the Company or Parent in connection with any Shelf Registration Statement, but excluding any underwriting discounts and commissions and transfer taxes, if any, relating to the sale or disposition of Registrable Securities by a Holder.

"*SEC*" shall mean the Securities and Exchange Commission or any successor agency or government body performing the functions currently performed by the United States Securities and Exchange Commission.

"*Shelf Registration*" shall mean a registration effected pursuant to Section 2.1 hereof.

"*Shelf Registration Statement*" shall mean a "shelf" registration statement of the Company and Parent pursuant to the provisions of Section 2.1 of this Agreement which covers all of the Registrable Securities on an appropriate form under Rule 415 under the 1933 Act, or any similar rule that may be adopted by the SEC, and all amendments and supplements to such registration statement, including post-effective amendments, in each case including the Prospectus contained therein, all exhibits thereto and all material incorporated by reference therein.

"*Trustee*" shall mean the trustee with respect to the Securities under the Indenture.

2. Registration Under the 1933 Act.

2.1. *Shelf Registration*.

(a) The Company and Parent shall, at their cost, no later than 90 days after the Closing Date, file with the SEC, and thereafter shall use their best efforts to cause to be declared effective as promptly as practicable but no later than 180 days after the Closing Date, a Shelf Registration Statement relating to the offer and sale of the Registrable Securities by the Holders that have provided the information pursuant to Section 2.1(d).

(b) The Company and Parent shall, at their cost, use their best efforts, subject to Section 2.5, to keep the Shelf Registration Statement continuously effective in order to permit the Prospectus forming part thereof to be usable by Holders for a period that will terminate when all Registrable Securities covered by the Shelf Registration Statement have been sold pursuant to the Shelf Registration Statement or cease to be outstanding or otherwise to be Registrable Securities (the "*Effectiveness Period*").

(c) Notwithstanding any other provisions hereof, the Company and Parent shall use their best efforts to ensure that (i) any Shelf Registration Statement and any amendment thereto and any Prospectus forming part thereof and any supplement thereto complies in all material respects with the 1933 Act and the rules and regulations thereunder, (ii) any Shelf Registration Statement and any amendment thereto does not, when it becomes effective, contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading and (iii) any Prospectus forming part of any Shelf Registration Statement, and any supplement to such Prospectus (as amended or supplemented from time to time), does not include an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading.

(d) Notwithstanding any other provision hereof, no Holder of Registrable Securities may include any of its Registrable Securities in the Shelf Registration Statement pursuant to this Agreement unless the Holder furnishes to the Company and Parent a fully completed notice and questionnaire in the form attached as Annex A to the Offering Memorandum (the "*Questionnaire*") and such other information in writing as the Company and Parent may reasonably request in writing for use in connection with the Shelf Registration Statement or Prospectus included therein and in any application to be filed with or under state securities laws. In order to be named as a selling securityholder in the Prospectus at the time of effectiveness of the Shelf Registration Statement, each Holder must, before the effectiveness of the Shelf Registration Statement and no later than the 20th day after the issuance of a press release by the Company and Parent announcing the initial filing of the Registration Statement (or the filing of the first amendment to the Shelf Registration Statement in the event the Company and Parent promptly file the Shelf Registration Statement following the date of this Agreement), furnish the completed Questionnaire and such other information that the Company and Parent may reasonably request in writing, if any, to the Company and Parent in writing and the Company and Parent will include the information from the completed Questionnaire and such other information, if any, in the Shelf Registration Statement and the Prospectus in a manner so that upon effectiveness of the Shelf Registration Statement the Holder will be permitted to deliver the Prospectus to purchasers of the Holder's Registrable Securities. From and after the date that the Registration Statement is first declared effective by the SEC, upon receipt of a completed Questionnaire and such other information that the Company and Parent may reasonably request in writing, if any, the Company and Parent will use their best efforts to file within 20 Business Days any amendments or supplements to the Shelf Registration Statement necessary for such Holder to be named as a selling securityholder in the Prospectus contained therein to permit such Holder to deliver the Prospectus to purchasers of

the Holder's Securities (subject to the Company's and Parent's right to suspend the Shelf Registration Statement as described in Section 2.5 below); *provided* that the Company and Parent shall not be required to file more than one such amendment to the Shelf Registration Statement in any calendar quarter for all such Holders. Holders that do not deliver a completed written Questionnaire and such other information, as provided for in this Section 2.1(d), will not be named as selling securityholders in the Prospectus. Each Holder named as a selling securityholder in the Prospectus agrees to promptly furnish to the Company and Parent all information required to be disclosed in order to make information previously furnished to the Company and Parent by the Holder not materially misleading and any other information regarding such Holder and the distribution of such Holder's Registrable Securities as the Company and Parent may from time to time reasonably request in writing.

(e) Each Holder agrees not to sell any Registrable Securities pursuant to the Shelf Registration Statement without delivering, or causing to be delivered, a Prospectus to the purchaser thereof and to notify the Company and Parent not later than three Business Days prior to any proposed sale by such Holder pursuant to the Shelf Registration Statement of the amount of Registrable Securities intended to be sold pursuant to the Shelf Registration Statement which notice shall be effective for five Business Days; if the Holder has not sold the Registrable Securities at the end of the five Business Days period, it may submit another notice to the Company and Parent. Absent any further notices, the Company and Parent may assume that all of the amount of such Holder's Registrable Securities set forth in the notice have been sold; provided that the Company and Parent shall use their best efforts to confirm that such Registrable Securities have been so sold prior to making such assumption.

The Company and Parent shall not permit any securities other than Registrable Securities to be included in the Shelf Registration Statement. The Company and Parent further agree, if necessary, to supplement or amend the Shelf Registration Statement, as required by Section 2.3(b) below, and to furnish to the Holders of Registrable Securities copies of any such supplement or amendment promptly after its being used or filed with the SEC.

2.2. *Expenses*. The Company and Parent shall pay all Registration Expenses in connection with the registration pursuant to Section 2.1. Each Holder shall pay all underwriting discounts and commissions and transfer taxes, if any, relating to the sale or disposition of such Holder's Registrable Securities pursuant to the Shelf Registration Statement.

2.3. *Effectiveness*. (a) The Company and Parent will be deemed not to have used their best efforts to cause the Shelf Registration Statement to become, or to remain, effective during the requisite period if the Company or Parent voluntarily takes any action that would, or fails to take any action which failure would result in any such Shelf Registration Statement not being declared effective or the Holders of Registrable Securities covered thereby not being able to offer and sell such Registrable Securities during that period as and to the extent contemplated hereby, unless such action is required by applicable law.

(b) A Shelf Registration Statement pursuant to Section 2.1 hereof will not be deemed to have become effective unless it has been declared effective by the SEC; provided, however, that if, after it has been declared effective, the offering of Registrable Securities pursuant to a Shelf Registration Statement is interfered with by any stop order, injunction or other order or requirement of the SEC or any other governmental agency or court, such Shelf Registration Statement will be deemed not to have been effective during the period of such interference, until the offering of Registrable Securities pursuant to such Shelf Registration Statement may legally resume.

2.4. *Interest*. In the event that (a) a Shelf Registration Statement is not filed with the SEC on or before the 90th calendar day following the Closing Date, (b) a Shelf Registration Statement is not declared effective on or prior to the 180th calendar day following the Closing Date, (c) after effectiveness, subject to Section 2.5, the Shelf Registration Statement fails to be effective or usable by the Holders without being succeeded within five Business Days by a post-effective amendment or a

report filed with the SEC pursuant to the 1934 Act that cures the failure to be effective or usable, or (d) the Prospectus has ceased to be effective or useable as described in clause (c) for a period of 30 consecutive days (each such event being a "*Registration Default*"), additional interest, as liquidated damages ("*Liquidated Damages*"), will accrue at a rate per annum of 0.25% of the principal amount of the Securities for the first 90-day period from day following the Registration Default, and thereafter at a rate per annum of 0.50% of the principal amount of the Securities, provided that in no event shall Liquidated Damages accrue at a rate per annum exceeding 0.50% of the issue price of the Securities, provided further that no Liquidated Damages shall accrue after the Effectiveness Period. Upon the cure of all Registration Defaults then continuing, the accrual of Liquidated Damages will automatically cease and the interest rate borne by the Securities will revert to the original interest rate at such time. Holders who have exchanged Securities into Common Stock will not be entitled to receive any Liquidated Damages with respect to such Common Stock or the issue price of the Securities exchanged.

The Company shall notify the Trustee within ten Business Days after each and every date on which an event occurs in respect of which Liquidated Damages are required to be paid. Liquidated Damages shall be paid by depositing with the Trustee, in trust, for the benefit of the Holders of Registrable Securities, on or before the applicable semiannual interest payment date, immediately available funds in sums sufficient to pay the Liquidated Damages then due. The Liquidated Damages due shall be payable on each interest payment date to the record Holder of Registrable Securities entitled to receive the interest payment to be paid on such date as set forth in the Indenture. Each obligation to pay Liquidated Damages shall be deemed to accrue from and including the day following the Registration Default to but excluding the day on which the Registration Default is cured.

A Registration Default under clause (a) above shall be cured on the date that the Registration Statement is filed with the SEC. A Registration Default under clause (b) above shall be cured on the date that the Registration Statement is declared effective by the SEC. A Registration Default under clauses (c) or (d) above shall be cured on the date an amended Registration Statement is declared effective by the SEC or the Company and Parent otherwise declare the Registration Statement and the Prospectus useable, as applicable.

2.5. *Suspension*. The Company and Parent may suspend the use of any Prospectus, without incurring or accruing any obligation to pay Liquidated Damages pursuant to Section 2.4 hereof, for a period not to exceed 30 calendar days in any three-month period, or an aggregate of 90 calendar days in any 12-month period (each, a "*Suspension Period*"), if the Board of Directors of Parent shall have determined in good faith that because of valid business reasons (not including avoidance of the Company's and Parent's obligations hereunder), including without limitation proposed or pending corporate developments and similar events or because of filings with the SEC, it is in the best interests of the Company and Parent to suspend such use, and prior to suspending such use the Company and Parent provide the Holders with written notice of such suspension, which notice need not specify the nature of the event giving rise to such suspension. Each Holder shall keep confidential any communications received by it from the Company or Parent regarding the suspension of the use of the Prospectus, except as required by applicable law.

3. Registration Procedures.

In connection with the obligations of the Company and Parent with respect to the Shelf Registration, the Company and Parent shall:

(a) prepare and file with the SEC a Shelf Registration Statement, within the relevant time period specified in Section 2, on the appropriate form under the 1933 Act, which form (i) shall be selected by the Company and Parent, (ii) shall be available for the sale of the Registrable Securities by the selling Holders thereof, (iii) shall comply as to form in all material respects with the requirements of the

applicable form and include or incorporate by reference all financial statements required by the SEC to be filed therewith or incorporated by reference therein, and (iv) shall comply in all material respects with the applicable requirements of Regulation S-T under the 1933 Act, if any, and use their best efforts to cause such Shelf Registration Statement to become effective and remain effective in accordance with Section 2 hereof;

(b) prepare and file with the SEC such amendments and post-effective amendments to the Shelf Registration Statement as may be necessary under applicable law to keep the Shelf Registration Statement effective for the Effectiveness Period, subject to Section 2.5; and cause each Prospectus to be supplemented by any required prospectus supplement, and as so supplemented to be filed pursuant to Rule 424 (or any similar provision then in force) under the 1933 Act and comply during the Effectiveness Period with the provisions of the 1933 Act, the 1934 Act and the rules and regulations thereunder required to enable the disposition of all Registrable Securities covered by the Shelf Registration Statement in accordance with the intended method or methods of distribution by the selling Holders thereof;

(c) (i) notify each Holder of Registrable Securities of the filing, by issuing a press release, of a Shelf Registration Statement with respect to the Registrable Securities; (ii) furnish to each Holder of Registrable Securities that has provided the information required by Section 2.1(d), counsel to such Holder and to each underwriter of an underwritten offering of Registrable Securities, if any, without charge, as many copies of each Prospectus, including each preliminary Prospectus, and any amendment or supplement thereto and such other documents as such Holder or underwriter may reasonably request, including financial statements and schedules and, if the Holder so requests, all exhibits in order to facilitate the unrestricted sale or other disposition of the Registrable Securities; and (iii) subject to Section 2.5 hereof and to any notice by the Company and Parent in accordance with Section 3(e) hereof of the existence of any fact of the kind described in Sections 3(e)(ii), (iii), (iv), (v) and (vi) hereof, hereby consent to the use of the Prospectus or any amendment or supplement thereto by each of the selling Holders of Registrable Securities that has provided the information required by Section 2.1(d) in connection with the offering and sale of the Registrable Securities;

(d) use their best efforts to register or qualify the Registrable Securities under all applicable state securities or "blue sky" laws of such jurisdictions as any Holder of Registrable Securities covered by a Shelf Registration Statement and each underwriter of an underwritten offering of Registrable Securities shall reasonably request, and do any and all other acts and things which may be reasonably necessary or advisable to enable each such Holder and underwriter to consummate the disposition in each such jurisdiction of such Registrable Securities owned by such Holder; *provided, however*, that neither the Company nor Parent shall be required to (i) qualify as a foreign corporation or as a dealer in securities in any jurisdiction where it would not otherwise be required to qualify but for this Section 3(d), or (ii) take any action which would subject it to general service of process or taxation in any such jurisdiction where it is not then so subject;

(e) notify promptly each Holder of Registrable Securities under a Shelf Registration that has provided the information required by Section 2.1(d) and, if requested by such Holder, confirm such advice in writing promptly (i) when a Shelf Registration Statement has become effective and when any post-effective amendments thereto become effective, (ii) of any request by the SEC or any state securities authority for post-effective amendments and supplements to a Shelf Registration Statement and Prospectus or for additional information after the Shelf Registration Statement has become effective, (iii) of the issuance by the SEC or any state securities authority of any stop order suspending the effectiveness of a Shelf Registration Statement or the initiation of any proceedings for that purpose, (iv) of the happening of any event or the discovery of any facts during the period a Shelf Registration Statement is effective which makes any statement of a material fact made in such Shelf Registration Statement or the related Prospectus untrue or which requires the making of any changes in such Shelf Registration Statement or Prospectus in order to make the statements therein not misleading, (v) of the

receipt by the Company or Parent of any notification with respect to the suspension of the qualification of the Registrable Securities for sale in any jurisdiction or the initiation or threatening of any proceeding for such purpose and (vi) of any determination by the Company and Parent that a post-effective amendment to such Shelf Registration Statement would be appropriate;

(f) furnish special counsel for the Holders of Registrable Securities copies of any comment letters received from the SEC or any other request by the SEC or any state securities authority for amendments or supplements to a Shelf Registration Statement and Prospectus or for

additional information;

(g) use their best efforts to obtain the withdrawal of any order suspending the effectiveness of a Shelf Registration Statement at the earliest possible moment;

(h) cooperate with the selling Holders of Registrable Securities to facilitate the timely preparation and delivery of certificates representing Registrable Securities to be sold and not bearing any restrictive legends (other than as required by the Company's organizational documents or Parent's certificate of incorporation or bylaws or applicable law); and enable such Registrable Securities to be in such denominations (consistent with the provisions of the Indenture) and registered in such names as the selling Holders or the underwriters, if any, may reasonably request at least three Business Days prior to the closing of any sale of Registrable Securities;

(i) upon the occurrence of any event or the discovery of any facts, each as contemplated by Sections 3(e)(ii), (iii), (iv), (v) and (vi) hereof, as promptly as practicable after the occurrence of such an event, use their best efforts to prepare a supplement or post-effective amendment to the Shelf Registration Statement or the related Prospectus or any document incorporated therein by reference or file any other required document so that, as thereafter delivered to the purchasers of the Registrable Securities, such Prospectus will not contain at the time of such delivery any untrue statement of a material fact or omit to state a material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading or will remain so qualified. The Company and Parent agree promptly to notify each Holder that has provided the information required by Section 2.1(d) of such determination and to furnish each Holder such number of copies of the Prospectus as amended or supplemented, as such Holder may reasonably request;

(j) no less than three Business Days prior to the filing of any Shelf Registration Statement, any Prospectus, any amendment to a Shelf Registration Statement or amendment or supplement to a Prospectus (other than amendments and supplements that do nothing more than name Holders and provide information with respect thereto), provide copies of such document to the Initial Purchaser on behalf of such Holders;

(k) provide the Trustee with printed certificates for the Registrable Securities in a form eligible for deposit with the Depositary;

(l) (i) cause the Indenture to be qualified under the 1939 Act in connection with the registration of the Registrable Securities, (ii) cooperate with the Trustee and the Holders to effect such changes to the Indenture as may be required for the Indenture to be so qualified in accordance with the terms of the 1939 Act, and (iii) execute, and use their best efforts to cause the Trustee to execute, all documents as may be required to effect such changes, and all other forms and documents required to be filed with the SEC to enable the Indenture to be so qualified in a timely manner;

(m) enter into such customary agreements and take all other customary and appropriate actions in order to expedite or facilitate the disposition of such Registrable Securities including but not limited to:

(i) obtain opinions of counsel to the Company and Parent and updates thereof addressed to each selling Holder and the underwriters, if any, covering the matters set forth in the opinion of such counsel delivered on the Closing Date;

(ii) obtain "comfort" letters and updates thereof from the Company's and Parent's independent certified public accountants (and, if necessary, any other independent certified public accountants of any subsidiary of the Company or Parent or of any business acquired by the Company or Parent for which financial statements are, or are required to be, included in the Shelf Registration Statement) addressed to the underwriters, if any, and use their best efforts to have such letter addressed to the selling Holders of Registrable Securities (to the extent consistent with Statement on Auditing Standards No. 72 of the American Institute of Certified Public Accounts), such letters substantially in the form and covering the matters covered in the comfort letter delivered on the Closing Date; and

(iii) if an underwriting agreement is entered into, cause the same to set forth indemnification provisions and procedures substantially equivalent to the indemnification provisions and procedures set forth in Section 4 hereof with respect to the underwriters and all other parties to be indemnified pursuant to said Section or, at the request of any underwriters, in the form customarily provided to such underwriters in similar types of transactions;

(n) if reasonably requested in connection with a disposition of Registrable Securities, make available for inspection during business hours by representatives of the Holders of the Registrable Securities, any underwriters participating in any disposition pursuant to a Shelf Registration Statement, and any counsel or accountant retained by any of the foregoing, all financial and other records, pertinent corporate documents and properties of the Company and Parent reasonably requested by any such persons, and cause the respective officers, directors, employees, and any other agents of the Company and Parent to supply all information reasonably requested by any such representative, underwriter, special counsel or accountant in connection with a Shelf Registration Statement, and make such representatives of the Company and Parent available for discussion of such documents as shall be reasonably requested by the Initial Purchaser, in each case as is customary for "due diligence" investigations; *provided*that, to the extent the Company and Parent, in their reasonable discretion, agree to disclose non-public information, such persons shall first agree in writing with the Company and Parent that any such non-public information shall be kept confidential by such persons and shall be used solely for the purposes of exercising rights under this Agreement and such person shall not engage in trading any securities of the Company and Parent until such material non-public information becomes properly publicly available, unless (i) disclosure of such information is required by court or administrative order or is necessary to respond to inquiries of regulatory authorities, (ii) disclosure of such information is required by law (including any disclosure requirements pursuant to federal securities laws in connection with the filing of any Registration Statement or the use of any Prospectus referred to in this Agreement), (iii) such information becomes generally available to the public other than as a result of a disclosure or failure to safeguard by any such person or (iv) such information becomes available to any such person from a source other than the Company or Parent and such source is not bound by a confidentiality agreement, and *provided further*, that the foregoing inspection and information gathering shall, to the greatest extent possible, be coordinated on behalf of all the Holders and the other parties entitled

thereto by special counsel to the Holders;

(o) a reasonable time prior to filing the Shelf Registration Statement, any Prospectus forming a part thereof, any amendment to the Shelf Registration Statement or amendment or supplement to such Prospectus (other than amendments and supplements that do nothing more than name Holders and provide information with respect thereto), provide copies of such document to the Holders of Registrable Securities that have provided the information required by Section 2.1(d), to the Initial Purchaser, to special counsel for the Holders and to the underwriter or underwriters of an underwritten offering of Registrable Securities, if any, make such changes in any such document prior to the filing thereof as the Initial Purchaser, the counsel to the Holders or the underwriter or underwriters reasonably request within three Business Days of delivery of such copies and not file any such document in a form to which the Majority Holders, the Initial Purchaser on behalf of the Holders of

Registrable Securities, counsel for the Holders of Registrable Securities or any underwriter shall not have previously been advised and furnished a copy of or to which the Majority Holders, the Initial Purchaser on behalf of the Holders of Registrable Securities, counsel to the Holders of Registrable Securities or any underwriter shall reasonably object within three Business Days of delivery of such copies, and make the representatives of the Company and Parent available for discussion of such document as shall be reasonably requested by the Holders of Registrable Securities, the Initial Purchaser on behalf of such Holders, counsel for the Holders of Registrable Securities or any underwriter;

(p) use their best efforts to cause all Registrable Securities to be listed on any securities exchange or inter-dealer quotation system on which similar securities issued by the Company and Parent are then listed if requested by the Majority Holders, or if requested by the underwriter or underwriters of an underwritten offering of Registrable Securities, if any;

(q) otherwise comply with all applicable rules and regulations of the SEC and make available to its security holders, as soon as reasonably practicable, an earnings statement covering at least 12 months which shall satisfy the provisions of Section 11(a) of the 1933 Act and Rule 158 thereunder; and

(r) cooperate and assist in any filings required to be made with the NASD and in the performance of any due diligence investigation by any underwriter and its counsel (including any "qualified independent underwriter" that is required to be retained in accordance with the rules and regulations of the NASD).

Without limiting Section 2.1(d), the Company and Parent may (as a condition to such Holder's participation in the Shelf Registration) require each Holder of Registrable Securities to furnish to the Company and Parent such information regarding the Holder and the proposed distribution by such Holder of such Registrable Securities as the Company and Parent may from time to time reasonably request in writing.

Each Holder agrees that, upon receipt of any notice from the Company and Parent of the happening of any event or the discovery of any facts, each of the kind described in Section 3(e)(ii), (iii), (iv), (v) and (vi) hereof, such Holder will forthwith discontinue disposition of Registrable Securities pursuant to the Prospectus included in the Shelf Registration Statement until such Holder's receipt of the copies of the supplemented or amended Prospectus contemplated by Section 3(j) hereof or written notice from the Company and Parent that the Shelf Registration Statement is again effective and no amendment or supplement is needed, and, if so directed by the Company and Parent, such Holder will deliver to the Company and Parent (at their expense) all copies in such Holder's possession, other than permanent file copies then in such Holder's possession, of the Prospectus covering such Registrable Securities current at the time of receipt of such notice.

In the event that a Registration Default has occurred and is continuing, the Company and Parent shall not file any Registration Statement with respect to any securities (within the meaning of Section 2(1) of the 1933 Act) of the Company or Parent other than Registrable Securities.

If any of the Registrable Securities covered by any Shelf Registration Statement are to be sold in an underwritten offering, the underwriter or underwriters and manager or managers that will manage such offering will be selected by the Majority Holders of such Registrable Securities included in such offering and shall be acceptable to the Company and Parent. No Holder of Registrable Securities may participate in any underwritten registration hereunder unless such Holder (a) agrees to sell such Holder's Registrable Securities on the basis provided in any underwriting arrangements approved by the persons entitled hereunder to approve such arrangements and (b) completes and executes all questionnaires, powers of attorney, indemnities, underwriting agreements and other documents required under the terms of such underwriting arrangements.

4. Indemnification; Contribution.

(a) The Company agrees to indemnify and hold harmless the Initial Purchaser, each Holder who has provided information to the Company and Parent in accordance with Section 2.1(d) hereof, each Person who participates as an underwriter (any such Person being an "*Underwriter*") and each Person, if any, who controls any Holder or Underwriter within the meaning of Section 15 of the 1933 Act or Section 20 of the 1934 Act as follows:

(i) against any and all loss, liability, claim, damage and expense whatsoever, as incurred, arising out of any untrue statement or alleged untrue statement of a material fact contained in any Shelf Registration Statement (or any amendment or supplement thereto) pursuant to which Registrable Securities were registered under the 1933 Act, including all documents incorporated therein by reference, or the omission or alleged omission therefrom of a material fact required to be stated therein or necessary to make the statements therein not misleading, or arising out of any untrue statement or alleged untrue statement of a material fact contained in any Prospectus (or any

amendment or supplement thereto) or the omission or alleged omission therefrom of a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading;

(ii) against any and all loss, liability, claim, damage and expense whatsoever, as incurred, to the extent of the aggregate amount paid in settlement of any litigation, or any investigation or proceeding by any governmental agency or body, commenced or threatened, or of any claim whatsoever based upon any such untrue statement or omission, or any such alleged untrue statement or omission; *provided* that (subject to Section 4(d) below) any such settlement is effected with the written consent of the Company and Parent; and

(iii) against any and all out-of-pocket expense whatsoever, as incurred (including the reasonable fees and disbursements of counsel chosen by any indemnified party), reasonably incurred in investigating, preparing or defending against any litigation, or any investigation or proceeding by any governmental agency or body, commenced or threatened, or any claim whatsoever based upon any such untrue statement or omission, or any such alleged untrue statement or omission, to the extent that any such expense is not paid under subparagraph (i) or (ii) above;

provided, however, that this indemnity agreement shall not apply to any loss, liability, claim, damage or expense to the extent arising out of any untrue statement or omission or alleged untrue statement or omission made in reliance upon and in conformity with written information furnished to the Company or Parent by or on behalf of any Holder or Underwriter expressly for use in a Shelf Registration Statement (or any amendment thereto) or any Prospectus (or any amendment or supplement thereto); *provided, further*, that this indemnity provision shall not apply to any loss, liability, claim, damage or expense if the Holder fails to deliver at or prior to the written confirmation of sale the most recent Prospectus furnished to such Holder by the Company or Parent and such Prospectus, as amended or supplemented as of the time of such confirmation of sale, including any amendment or supplement filed with the SEC that is incorporated by reference in the Prospectus), corrects such untrue statement or omission or alleged untrue statement or omission of a material fact and delivery thereof was required by law.

(b) Each Holder who has provided information to the Company and Parent in accordance with Section 2.1(d) hereof, severally, but not jointly, agrees to indemnify and hold harmless the Company, Parent the Initial Purchaser, each Underwriter and the other selling Holders who have provided information to the Company and Parent in accordance with Section 2.1(d) hereof, and each of their respective directors and officers, and each Person, if any, who controls the Company, Parent, the Initial Purchaser, any Underwriter or any other selling Holder within the meaning of Section 15 of the 1933 Act or Section 20 of the 1934 Act, against any and all loss, liability, claim, damage and expense

described in the indemnity contained in Section 4(a) hereof, as incurred, but only with respect to untrue statements or omissions, or alleged untrue statements or omissions, made in the Shelf Registration Statement (or any amendment thereto) or any Prospectus included therein (or any amendment or supplement thereto) in reliance upon and in conformity with written information with respect to such Holder furnished to the Company and Parent by or on behalf of such Holder expressly for use in the Shelf Registration Statement (or any amendment thereto) or such Prospectus (or any amendment or supplement thereto); *provided, however*, that no such Holder shall be liable for any claims hereunder in excess of the amount of net proceeds received by such Holder from the sale of Registrable Securities pursuant to such Shelf Registration Statement.

(c) Each indemnified party shall give notice as promptly as reasonably practicable to each indemnifying party of any action commenced against it in respect of which indemnity may be sought hereunder, but failure to so notify an indemnifying party shall not relieve such indemnifying party from any liability hereunder to the extent it is not materially prejudiced as a result thereof and in any event shall not relieve it from any liability which it may have otherwise than on account of this indemnity agreement. Counsel to defend such action shall be selected by the indemnifying party. An indemnified party may participate at its own expense in the defense of any such action; *provided, however*, that counsel to the indemnified party shall not (except with the consent of the indemnifying party) also be counsel to the indemnifying party. Except as set forth below, the indemnifying parties shall not be liable for fees and expenses of more than one counsel (in addition to any local counsel) separate from their own counsel for all indemnified parties in connection with any one action or separate but similar or related actions in the same jurisdiction arising out of the same general allegations or circumstances. Notwithstanding the indemnifying party's election to appoint counsel to represent an indemnified party in an action, the indemnified party shall have the right to employ separate counsel (including local counsel), and the indemnifying party shall bear the reasonable fees, costs and expenses of such separate counsel if (i) the use of counsel chosen by the indemnifying party to represent the indemnified party would present such counsel with a conflict of interest, (ii) the actual or potential defendants in, or targets of, any such action include both the indemnified party and the indemnifying party and the indemnified party shall have reasonably concluded that there may be legal defenses available to other indemnified parties which are different from or additional to those available to the indemnifying party, (iii) the indemnifying party shall not have employed counsel satisfactory to the indemnified party to represent the indemnified party within a reasonable time after notice of the institution of such action or (iv) the indemnifying party shall authorize the indemnified party to employ separate counsel at the expense of the indemnifying party. No indemnifying party shall, without the prior written consent of the indemnified parties, settle or compromise or consent to the entry of any judgment with respect to any litigation, or any investigation or proceeding by any governmental agency or body, commenced or threatened, or any claim whatsoever in respect of which indemnification or contribution could be sought under this Section or Section 8 hereof (whether or not the indemnified parties are actual or potential parties thereto), unless such settlement, compromise or consent (i) includes an unconditional release of each indemnified party from all liability arising out of such litigation, investigation, proceeding or claim and (ii) does not include a statement as to or an admission of fault, culpability or a failure to act by or on behalf of any indemnified party.

(d) If the indemnification provided for in this Section 4 is for any reason unavailable to or insufficient to hold harmless an indemnified party in respect of any losses, liabilities, claims, damages or expenses referred to therein, then each indemnifying party shall contribute to the aggregate amount of such losses, liabilities, claims, damages and expenses incurred by such indemnified party, as incurred, in such proportion as is appropriate to reflect the relative fault of the indemnifying party or parties on one hand and the indemnified party or party on the other hand in connection with the statements or omissions which resulted in such losses, liabilities, claims, damages or expenses, as well as any other relevant equitable considerations.

The relative fault of Company and Parent, on the one hand and the Holders and the Initial Purchaser on the other hand shall be determined by reference to, among other things, whether any such untrue or alleged untrue statement of a material fact or omission or alleged omission to state a material fact relates to information supplied by the Company and Parent, or by the Holder or the Initial Purchaser and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission.

The Company, Parent, the Holders and the Initial Purchaser agree that it would not be just and equitable if contribution pursuant to this Section 4 were determined by pro rata allocation or by any other method of allocation which does not take account of the equitable considerations referred to above in this Section 4. The aggregate amount of losses, liabilities, claims, damages and expenses incurred by an indemnified party and referred to above in this Section 4 shall be deemed to include any out-of-pocket legal or other expenses reasonably incurred by such indemnified party in investigating, preparing or defending against any litigation, or any investigation or proceeding by any governmental agency or body, commenced or threatened, or any claim whatsoever based upon any such untrue or alleged untrue statement or omission or alleged omission.

Notwithstanding the provisions of this Section 4, the Initial Purchaser shall not be required to contribute any amount in excess of the amount by which the total price at which the Securities sold by it were offered exceeds the amount of any damages which such Initial Purchaser has otherwise been required to pay by reason of such untrue or alleged untrue statement or omission or alleged omission.

No Person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the 1933 Act) shall be entitled to contribution from any Person who was not guilty of such fraudulent misrepresentation.

For purposes of this Section 4, each Person, if any, who controls the Initial Purchaser or a Holder within the meaning of Section 15 of the 1933 Act or Section 20 of the 1934 Act shall have the same rights to contribution as the Initial Purchaser or such Holder, and each director of Parent, and each Person, if any, who controls the Company or Parent within the meaning of Section 15 of the 1933 Act or Section 20 of the 1934 Act shall have the same rights to contribution as the Company and Parent.

5. Miscellaneous.

5.1. *Rule 144 and Rule 144A*. For so long as the Company or Parent is subject to the reporting requirements of Section 13 or 15(d) of the 1934 Act, the Company and Parent covenant that they will file the reports required to be filed by them under Section 13(a) or 15(d) of the 1934 Act and the rules and regulations adopted by the SEC thereunder. If the Company or Parent ceases to be so required to file such reports, the Company and Parent covenant that they will upon the request of any Holder of Registrable Securities (a) make publicly available such information as is necessary to permit sales pursuant to Rule 144 under the 1933 Act, (b) deliver such information to a prospective purchaser as is necessary to permit sales pursuant to Rule 144A under the 1933 Act and take such further action as any Holder of Registrable Securities may reasonably request for such purpose, and (c) take such further action that is reasonable in the circumstances, in each case, to the extent required from time to time to enable such Holder to sell its Registrable Securities without registration under the 1933 Act within the limitation of the exemptions provided by (i) Rule 144 under the 1933 Act, as such Rule may be amended from time to time, (ii) Rule 144A under the 1933 Act, as such Rule may be amended from time to time, or (iii) any similar rules or regulations hereafter adopted by the SEC. Upon the request of any Holder of Registrable Securities, the Company or Parent, as the case may be, will deliver to such Holder a written statement as to whether it has complied with such requirements. Notwithstanding the foregoing, nothing in this Section 5.1 shall be deemed to require the Company or Parent to register any of its securities (other than the Common Stock) under the 1934 Act.

5.2. *No Inconsistent Agreements*. Neither the Company nor Parent has entered into and neither the Company nor Parent will after the date of this Agreement enter into any agreement which is inconsistent with the rights granted to the Holders of Registrable Securities in this Agreement or otherwise conflicts with the provisions hereof. The rights granted to the Holders hereunder do not and will not for the term of this Agreement in any way conflict with the rights granted to the holders of any of the Company's or Parent's other issued and outstanding securities under any such agreements.

5.3. *Amendments and Waivers*. The provisions of this Agreement, including the provisions of this sentence, may not be amended, modified or supplemented, and waivers or consents to departures from the provisions hereof may not be given unless the Company and Parent have obtained the written consent of Holders of at least a majority of the outstanding Registrable Securities (with Holders of Securities deemed to be the Holders, for purposes of this Section 5.3, of the number of outstanding shares of Common Stock into which such Registrable Securities are or could be exchangeable on the date that consent would be required) affected by such amendment, modification, supplement, waiver or departure. Notwithstanding the foregoing, this Agreement may be amended by a written agreement among the Company, Parent and the Initial Purchaser, without the consent of the Holders of the Registrable Securities, in order to cure any ambiguity or to correct or supplement any provision contained herein, *provided* that no such amendment shall adversely affect the interest of the Holders of Registrable Securities. Each Holder of Registrable Securities outstanding at the time of any amendment, modification, waiver or consent pursuant to this Section 5.3, shall be bound by such amendment, modification, waiver or consent, whether or not any notice or writing indicating such amendment, modification, waiver or consent is delivered to such Holder.

5.4. *Notices*. All notices and other communications provided for or permitted hereunder shall be made in writing by hand delivery, registered first-class mail, facsimile, or any courier guaranteeing overnight delivery (a) if to a Holder, at the most current address given by such Holder to the Company and Parent in a Questionnaire or by means of a notice given in accordance with the provisions of this Section 5.4, which address initially is the address set forth in the Purchase Agreement with respect to the Initial Purchaser; and (b) if to the Company or Parent, initially at the Company's address set forth in the Purchase Agreement, and thereafter at such other address of which notice is given in accordance with the provisions of this Section 5.4.

All such notices and communications shall be deemed to have been duly given: at the time delivered by hand, if personally delivered; two Business Days after being deposited in the mail, postage prepaid, if mailed; when receipt is acknowledged, if sent by facsimile; and on the next Business Day if timely delivered to an overnight courier.

Copies of all such notices, demands, or other communications shall be concurrently delivered by the person giving the same to the Trustee under the Indenture, at the address specified in the Indenture.

5.5. *Successor and Assigns*. This Agreement shall inure to the benefit of and be binding upon the successors, assigns and transferees of each of the parties, including, without limitation and without the need for an express assignment, subsequent Holders; *provided* that nothing herein shall be deemed to permit any assignment, transfer or other disposition of Registrable Securities in violation of the terms of the Purchase Agreement or the Indenture. If any transferee of any Holder shall acquire Registrable Securities, in any manner, whether by operation of law or otherwise, such Registrable Securities shall be held subject to all of the terms of this Agreement, and by taking and holding such Registrable Securities such person shall be conclusively deemed to have agreed to be bound by and to perform all of the terms and provisions of this Agreement, including the restrictions on resale set forth in this Agreement and, if applicable, the Purchase Agreement, and such person shall be entitled to receive the benefits hereof.

5.6. *Third Party Beneficiaries*. The Initial Purchaser (even if the Initial Purchaser is not a Holder of Registrable Securities) shall be a third party beneficiary to the agreements made hereunder between the Company and Parent, on the one hand, and the Holders, on the other hand, and shall have the right to enforce such agreements directly to the extent they deem such enforcement necessary or advisable to protect their rights or the rights of Holders hereunder. Each Holder of Registrable Securities shall be a third party beneficiary to the agreements made hereunder between the Company and Parent, on the one hand, and the Initial Purchaser, on the other hand, and shall have the right to enforce such agreements directly to the extent it deems such enforcement necessary or advisable to protect its rights hereunder.

5.7. *Specific Enforcement.* Without limiting the remedies available to the Initial Purchaser and the Holders, the Company and Parent acknowledges that any failure by the Company and Parent to comply with its obligations under Section 2.1 hereof may result in material irreparable injury to the Initial Purchaser or the Holders for which there is no adequate remedy at law, that it may not be possible to measure damages for such injuries precisely and that, in the event of any such failure, the Initial Purchaser or any Holder may seek such relief as may be required to specifically enforce the Company's and Parent's obligations under Section 2.1 hereof.

5.8. *Restriction on Resales*. Until the expiration of two years after the original issuance of the Securities, neither Company nor Parent will, and will cause its Affiliates not to, resell any Securities which are "restricted securities" (as such term is defined under Rule 144(a)(3) under the 1933 Act) that have been reacquired by any of them.

5.9. *Counterparts*. This Agreement may be executed in any number of counterparts and by the parties hereto in separate counterparts, each of which when so executed shall be deemed to be an original and all of which taken together shall constitute one and the same agreement.

5.10. *Headings*. The headings in this Agreement are for convenience of reference only and shall not limit or otherwise affect the meaning hereof.

5.11. *GOVERNING LAW*. THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAW OF THE STATE OF NEW YORK WITHOUT REGARD TO THE PRINCIPLES OF CONFLICT OF LAWS THEREOF.

5.12. *Severability*. In the event that any one or more of the provisions contained herein, or the application thereof in any circumstance, is held invalid, illegal or unenforceable, the validity, legality and enforceability of any such provision in every other respect and of the remaining provisions contained herein shall not be affected or impaired thereby.

5.13. *Entire Agreement*. This Agreement is intended by the parties as a final expression of their agreement and intended to be a complete and exclusive statement of the agreement and understanding of the parties hereto in respect of the subject matter contained herein. There are no restrictions, promises, warranties or undertakings, other than those set forth or referred to herein with respect to the registration rights granted by the Company or Parent with respect to the Registrable Securities. This Agreement supersedes all prior agreements and understandings between the parties with respect to such subject matter.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

AFFORDABLE RESIDENTIAL COMMUNITIES LP

By: Affordable Residential Communities Inc.,
its general partner

By: _____
Scott Gesell
Executive Vice President

AFFORDABLE RESIDENTIAL COMMUNITIES INC.

By: _____
Scott Gesell
Executive Vice President

Confirmed and accepted as
of the date first above written:

MERRILL LYNCH, PIERCE, FENNER & SMITH
INCORPORATED

By: _____
Name:
Title:

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Section 5: EX-10.6 (EX-10.6)

Exhibit 10.6

COMMON STOCK DELIVERY AGREEMENT

This agreement ("Agreement") is being made this 9th day of August, 2005 by and between Affordable Residential Communities LP, a Delaware limited partnership (the "Operating Partnership"), and Affordable Residential Communities Inc., a Maryland corporation (the "Corporation").

Recitals

WHEREAS, the Corporation is the general partner of the Operating Partnership; and

WHEREAS, the Operating Partnership and the Corporation have entered into a purchase agreement of even date herewith with Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated (the "Initial Purchaser"), providing for the issuance and sale by the Operating Partnership in a private offering under Rule 144A promulgated under the Securities Act of 1933, as amended (the "Act"), of one or more series of unsecured and unsubordinated debt securities to be titled "Senior Exchangeable Notes Due 2025" (the "Notes"), which Notes shall be exchangeable into cash and shares of common stock, par value $.01 per share of the Corporation ("Common Stock") under certain circumstances.

NOW, THEREFORE, in consideration of the foregoing and in consideration of the mutual covenants contained herein, the parties agree as follows:

Agreement

1. The Operating Partnership hereby acknowledges that it is the sole obligor of the Notes and is responsible for the payment of the obligations (including the obligation to deliver, under certain circumstances, Common Stock) in accordance with the terms of the indenture, dated August 9, 2005 between the Operating Partnership and U.S. Bank National Association, as trustee (the "Indenture").

2. If the Operating Partnership is obligated to deliver Common Stock to the holders of the Notes upon exchange, redemption or maturity in accordance with the terms of the Indenture, the Corporation agrees to issue the number of shares of Common Stock so required to the Operating Partnership, and the Operating Partnership hereby directs the Corporation to deliver such Common Stock to the holders of the Notes on behalf of the Operating Partnership in accordance with the Indenture.

3. The Operating Partnership agrees to issue to the Corporation on a concurrent basis a number of "Partnership Units" (as defined in the Amended and Restated Limited Partnership Agreement of the Operating Partnership) equal in number to the shares of Common Stock issued by the Corporation pursuant to this Agreement.

4. The Operating Partnership hereby agrees to indemnify the Corporation and each of its directors and officers (each, an "Indemnified Party") against, and agrees to hold, save and defend each Indemnified Party, harmless from, any loss, expense or damage (including without limitation, reasonable attorneys' fees and expenses and court costs actually incurred) suffered or incurred by an Indemnified Party by reason of anything such Indemnified Party may in good faith do or refrain from doing for or on behalf of the Operating Partnership pursuant to this Agreement; provided however, that the Operating Partnership shall not be required to indemnify an Indemnified Party for any loss, expense or damage that such Indemnified Party may suffer or incur as a result of its willful misconduct or gross negligence.

5. The Corporation agrees that it will not consolidate with or merge into another business entity or transfer or lease all or substantially all of its assets, unless:

- either (1) the Corporation is the continuing entity in the case of a merger or (2) the resulting, surviving or acquiring entity, if other than the Corporation, is a U.S. entity and it expressly

assumes the Corporation's obligations under this Agreement and the Indenture, including but not limited to the obligations under Section 4.7 thereto;

- immediately after giving effect to the transaction, no event of default under the Indenture and no circumstances which, after notice or lapse of time or both, would become an event of default under the Indenture, shall have happened and be continuing; and

- the Corporation has delivered to the trustee an officers' certificate and a legal opinion confirming that the Corporation has complied with the Indenture.

6. Miscellaneous.

(a) **THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK, WITHOUT GIVING EFFECT TO CONFLICT LAWS, RULES OR PRINCIPLES.**

(b) No provision of this agreement may be amended, modified, or waived, except in writing signed by both parties and with the consent of a majority in principal amount of Notes then outstanding; provided, however, that the unanimous consent of the holders of all outstanding Notes will be required in order to amend, modify, or waive the provisions of paragraph 2 hereof or to otherwise adversely affect the right of holders of Notes to exchange the Notes for Common Stock as provided in the Indenture. Any consent of the holders of the Notes shall be obtained in accordance with the applicable provisions of the Indenture.

(c) In the event that any claim of inconsistency between this Agreement and the terms of the Indenture arise, as they may from time to time be amended, the terms of the Indenture shall control.

(d) If any provision of this Agreement shall be held illegal, invalid, or unenforceable by any court, this Agreement shall be construed and enforced as if such provision had not been contained herein and shall be deemed an Agreement among us to the full extent permitted by applicable law.

(e) The terms and provisions of this Agreement are intended solely for the benefit of each party hereto and their respective successors or permitted assigns, and it is not the intention of the parties to confer third-party beneficiary rights to any other person, except that the holders of the Notes shall be deemed third-party beneficiaries of this Agreement and shall be entitled to enforce the provisions of this agreement as if they were parties hereto.

(f) This Agreement may not be assigned by either party without prior written consent of both parties.

[The remainder of the page has been left blank intentionally.]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement by their duly authorized officers as of the day and year above written.

AFFORDABLE RESIDENTIAL COMMUNITIES LP

By Affordable Residential Communities Inc.,
as sole general partner

By _____
Title

AFFORDABLE RESIDENTIAL COMMUNITIES INC.

By _____
Title

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Section 6: EX-10.15 (EX-10.15)

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Exhibit 10.15

EMPLOYMENT AGREEMENT

by and among

NLASCO, Inc.

and

Gregory Vanek

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT (this "*Agreement*") is made as of this 31st day of January, 2007 (the "*Effective Date*"), by and among NLASCO, Inc., a Delaware corporation ("*NLASCO*") and Gregory Vanek (the "*Executive*").

R E C I T A L S

A. Affordable Residential Communities Inc., a Maryland corporation ("*ARC*"), and ARC Insurance Holdings Inc., a Delaware corporation ("*Buyer*"), on the one hand, and C. Clifton Robinson, an individual, C.C. Robinson Property Company, Ltd., a Texas limited partnership, and the Robinson Charitable Remainder Unitrust (each a "*Seller*" and collectively, "*Sellers*"), on the other hand, entered into a Stock Purchase Agreement (the "*Stock Purchase Agreement*"), dated as of October 6, 2006, pursuant to which Buyer will acquire the outstanding capital stock of NLASCO, and acquire the business of writing consumer property and casualty insurance (the "*Business*") conducted by NLASCO and its Subsidiaries (defined below).

B. Buyer is a wholly-owned subsidiary of ARC.

C. Pursuant to Section 7(a)(xii) of the Stock Purchase Agreement, NLASCO and the Executive desire to enter into an agreement relating to the employment of the Executive by NLASCO, which employment shall commence on the Closing Date under the Stock Purchase Agreement.

D. The Board of Directors of NLASCO (the "*Board*") recognizes that the Executive has and can continue to contribute significantly to the growth and success of NLASCO and its Subsidiaries and desires to provide for the employment of the Executive and to encourage the attention and dedication to NLASCO and its Subsidiaries of the Executive as a member of management, in the best interests of NLASCO and its shareholders.

E. The Executive is willing to commit himself to serve NLASCO on the terms and conditions herein provided.

F. NLASCO desires to employ the Executive upon the terms hereinafter set forth.

G. Initially capitalized terms used but not defined in this Agreement have the meanings ascribed to them in the Stock Purchase Agreement.

A G R E E M E N T

NOW, THEREFORE, in consideration of the premises and the mutual covenants and agreements herein contained, NLASCO and the Executive agree as follows:

1. *Employment.* NLASCO shall employ the Executive, and the Executive shall accept such employment, on the terms and conditions hereinafter set forth. This Agreement shall become effective on the Effective Date.

2. *Term.* The period of employment of the Executive by NLASCO hereunder shall commence on the Effective Date, and shall continue in effect through the third anniversary of such date unless further extended as provided in this *Section 2* or sooner terminated as provided in *Section 7*. Commencing on the first anniversary of the Effective Date, and on each successive anniversary thereafter, the contract term of the Executive's employment shall be automatically extended for one (1) additional year unless, not later than the date which is sixty (60) days prior to such anniversary, NLASCO shall have delivered to the Executive or the Executive shall have delivered to NLASCO a written notice that the term of the Executive's employment hereunder will not be extended (the initial term, as it may be so extended, the "*Employment Period*").

3. *Position and Duties.* During the Employment Period, the Executive shall serve as the Chief Executive Officer of NLASCO. The Executive's responsibilities and authority shall include such responsibilities and authority as may from time to time be assigned to the Executive by the Board and shall be consistent with the Executive's title, position and stature with NLASCO. The Executive agrees to devote substantially all of his business time and efforts to the performance of his duties for NLASCO.

4. *Place of Performance.* In connection with the Executive's employment by NLASCO, the Executive shall be based in Waco, Texas, except for required travel on NLASCO's business.

5. *Compensation and Related Matters.*

(a) *Base Salary.* As compensation for the performance by the Executive of his obligations hereunder, during the Employment Period, NLASCO shall pay the Executive a base salary at the rate of $225,000 per annum, which amount may be increased from time to time during the Employment Period by the Board in its sole discretion ("*Base Salary*"). Base Salary shall be paid in approximately equal installments in accordance with NLASCO's customary payroll practices.

(b) *Bonuses.* During the Employment Period, the Executive shall be eligible to participate in NLASCO's management incentive bonus plan (or any successor or substitute bonus or incentive plan) and to receive such annual performance bonus (the "*Bonus*") pursuant to such plan as may be awarded to him by the compensation committee of the Board in its sole discretion.

(c) *Expenses.* NLASCO shall promptly reimburse the Executive for all reasonable business expenses incurred during the Employment Period by the Executive in performing services hereunder, including all travel expenses and all living expenses while traveling on business or at the request of and in the service of NLASCO (or any Subsidiary of NLASCO as contemplated by *Section 6* below), provided that such expenses are incurred and accounted for in accordance with the policies and procedures established by NLASCO.

(d) *Other Benefits.* The Executive shall be entitled to participate in all of the employee compensation, welfare and benefit plans and arrangements (including any vacation policy or program) made available by NLASCO to its similarly situated executive officers, subject to and on a basis consistent with the terms, conditions and overall administration of such plans and arrangements. In addition, NLASCO shall promptly reimburse the Executive for his monthly dues to Ridgewood Country Club, grossed up to pay the taxes associated therewith, and a monthly automobile allowance of $ 1200.00 per month for the Employment Period, which amount may be changed from time to time at the discretion of the compensation committee of the Board.

6. *Offices.* Subject to *Sections 3* and *4* hereof, the Executive agrees to serve without additional compensation, if elected or appointed thereto, as a director of NLASCO and/or any Subsidiary of NLASCO, as a member of any committee of the board of directors of any of such companies, and/or in one or more executive management positions with any of NLASCO's Subsidiaries or affiliates, provided that the Executive shall be indemnified for serving in any and all such capacities on a basis no less favorable than is currently provided to any other director of NLASCO or any of its Subsidiaries or any such executive management position, as the case may be.

7. *Termination.* The Executive's employment hereunder (and the Employment Period) may be terminated as follows:

(a) *Death.* The Executive's employment hereunder (and the Employment Period) shall terminate upon his death.

(b) *Disability.* If, as a result of the Executive's incapacity due to physical or mental illness, the Executive shall have been absent from the full-time performance of his duties hereunder for the entire period of six (6) consecutive months, and within thirty (30) days after written Notice of

Termination (as defined in *Section 8* hereof) is given shall not have returned to the performance of his duties hereunder on a full-time basis, NLASCO may terminate the Executive's employment hereunder (and the Employment Period) for "*Disability*." In the event of any dispute under this paragraph, the Executive agrees to submit to a physical or mental examination by a licensed physician selected by NLASCO and to be bound by NLASCO's decision based on the results thereof.

(c) *Cause.* NLASCO may terminate the Executive's employment hereunder (and the Employment Period) for Cause. For purposes of this Agreement, NLASCO shall have "*Cause*" to terminate the Executive's employment arrangement hereunder upon (i) the willful and continued failure by the Executive to substantially perform the Executive's duties with NLASCO (other than any such failure resulting from the Executive's incapacity due to physical or mental illness or any such actual or anticipated failure after the issuance of a Notice of Termination for Good Reason by the Executive pursuant to *Section 7(d)* hereof) that has not been cured within thirty (30) days after a written demand for substantial performance is delivered to the Executive by the Board, which demand specifically identifies the manner in which the Board believes that the Executive has not substantially performed the Executive's duties, (ii) the willful engaging by the Executive in conduct which is demonstrably and materially injurious to NLASCO or its Subsidiaries or affiliates, monetarily or otherwise or (iii) the Executive's conviction of, or entry by the Executive of a guilty or no contest plea to, a felon under any laws of the U.S. or any state thereof. For purposes of clauses (i) and (ii) of this definition, no act, or failure to act, on the Executive's part shall be deemed "willful" unless done, or omitted to be done, by the Executive not in good faith and without reasonable belief that the Executive's act, or failure to act, was in the best interest of NLASCO.

(d) *Good Reason.* The Executive may terminate his employment hereunder (and the Employment Period) for "Good Reason." "*Good Reason*" for termination by the Executive of the Executive's employment shall mean:

(i) any purported termination of the Executive's employment which is not effected pursuant to a Notice of Termination satisfying the requirements of *Section 8* hereof; for purposes of this Agreement, no such purported termination shall be effective; or

(ii) a substantial reduction in Base Salary or in the aggregate opportunity of the Executive to participate in NLASCO's incentive compensation and other employee welfare and benefit plans from that provided to the Executive as of the Effective Date.

The Executive's continued employment shall not constitute consent to, or a waiver of rights with respect to, any act or failure to act constituting Good Reason hereunder; *provided, however,* that the Executive shall be required to provide a Notice of Termination within ninety (90) days following the occurrence of any event alleged by the Executive to constitute Good Reason for the termination of his employment hereunder. The Executive's right to terminate the Executive's employment for Good Reason shall not be affected by the Executive's incapacity due to physical or mental illness.

(e) *Without Cause by NLASCO; Without Good Reason by the Executive.* NLASCO may terminate the Executive's employment hereunder (and the Employment Period) at any time without Cause upon thirty (30) days prior written notice to the Executive. The Executive may terminate the Executive's employment (and the Employment Period) voluntarily for any reason or no reason at any time by giving thirty (30) days prior written notice to NLASCO.

8. Termination Procedure.

(a) *Notice of Termination.* Any termination of the Executive's employment by NLASCO or by the Executive (other than termination pursuant to *Section 7(a)* hereof) shall be communicated

by written Notice of Termination to the other party hereto in accordance with *Section 12*. For purposes of this Agreement, a "*Notice of Termination*" shall mean a notice which shall indicate the specific termination provision in this Agreement relied upon and shall, if applicable, set forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated. Further, a Notice of Termination for Cause is required to include a copy of a resolution duly adopted by the affirmative vote of not less than two-thirds ($^2/_3$) of the entire membership of the Board (excluding the Executive) at a meeting of the Board which was called and held for the purpose of considering such termination (after reasonable notice to the Executive and an opportunity for the Executive, together with the Executive's counsel, to be heard before the Board) finding that, in the good faith opinion of the Board, the Executive was engaged in the conduct set forth in clause (i) or (ii) of the definition of Cause herein, and specifying the particulars thereof in detail.

(b) *Date of Termination.* "*Date of Termination*" shall mean (i) if the Executive's employment is terminated by his death, the date of his death, (ii) if the Executive's employment is terminated for Disability pursuant to *Section 7(b)*, thirty (30) days after the date of delivery of Notice of Termination (provided that the Executive shall not have returned to the performance of his duties on a full-time basis during such thirty (30) day period), (iii) if the Executive's employment is terminated for Cause pursuant to Section 7(c), the date specified in the Notice of Termination, which shall not be earlier than thirty (30) days after the date of delivery of the Notice of Termination and (iv) if the Executive's employment is terminated for any other reason, the date on which a Notice of Termination is given or any later date (within thirty (30) days following the date on which such Notice of Termination is delivered) set forth in such Notice of Termination.

9. *Compensation upon Termination or During Disability.* The Executive hereby agrees that no severance compensation of any kind, nature or amount shall be payable to the Executive except as expressly set forth in this Section 9, and except for such payments, the Executive hereby irrevocably waives any claim for severance compensation.

(a) *Disability; Death.* During any period that the Executive fails to perform his duties hereunder as a result of his Disability, the Executive shall continue to receive his full Base Salary at the rate in effect at the beginning of such period and continue as a participant in all compensation and benefit plans in which the Executive was participating pursuant to Sections 5(b) and 5(d) until his employment is terminated pursuant to Section 7(a) or Section 7(b). Following the termination of the Executive's employment due to Disability or death, NLASCO shall:

(i) pay to the Executive any accrued but unused vacation pay (the "*Unpaid Vacation Amounts*");

(ii) pay to the Executive an amount equal to the sum of (I) the Executive's then current Base Salary and (II) the Executive's pro rata portion to the Date of Termination of the value of the Executive's bonus for the fiscal year in which the Date of Termination occurs (such sum of (I) and (II), the "*Severance Payment*"), paid in installments at such times as Executive would normally receive payroll checks as though employed by NLASCO through the severance payment period;

(iii) provide for the full vesting of any equity incentive awards then held by the Executive to the extent unvested as of the Date of Termination;

(iv) pay to the Executive a pro rata portion to the Date of Termination of the value of the Executive's bonus for the fiscal year in which the Date of Termination occurs under an annual incentive bonus plan adopted by NLASCO (or any successor or substitute bonus plan thereto), calculated by multiplying the award that the Executive would have earned on the last day of such fiscal year, assuming achievement at target level of all performance goals

established with respect to such bonus, by a fraction, the numerator of which is the number of days elapsed from the commencement of the fiscal year in which occurs the Date of Termination and the denominator of which is 365 (the "*Pro Rata Bonus*"); and

(v) for a period of one (1) year (the "*Benefit Coverage Period*") in the case of the Executive's death or Disability, provide the Executive with COBRA benefits for the equivalent medical and dental benefit coverage received by the Executive at the Date of Termination, and NLASCO shall bear the cost of such coverage; *provided, however*, that, in the case of Disability, benefits otherwise due to the Executive pursuant to this Section 9(a)(v) shall be reduced to the extent benefits of the same type are received by or made available to the Executive during the Benefit Coverage Period by a subsequent employer ("*Health Benefit Coverage*").

(b) *By NLASCO without Cause or by the Executive for Good Reason.* If during the Employment Period the Executive's employment is terminated (x) by NLASCO other than for Cause or Disability or (y) by the Executive for Good Reason, NLASCO shall:

(i) Continue to pay and otherwise provide to the Executive, during any notice period (not to exceed thirty (30) days), all compensation, Base Salary and previously accrued but unpaid Bonuses (if any) and shall continue to allow the Executive to participate in any welfare benefit plans in accordance with the terms of such plans;

(ii) pay to the Executive the Unpaid Vacation Amounts;

(iii) pay to the Executive an amount equal to the greater of (x) the Executive's then current Base Salary for the remainder of the Employment Period then in effect, or (y) the Executive's then current Base Salary for one year;

(iv) pay to the Executive the Pro Rata Bonus; and

(v) provide the Health Benefit Coverage for the Benefit Coverage Period following the Date of Termination.

Notwithstanding the foregoing, NLASCO's obligation to provide the Executive the payments and benefits described in this Section 9(b) shall cease as of the date the Executive breaches any of the provisions of Section 11 hereof.

(c) *Tax Gross-Up.* If any of the payments or benefits received or to be received by the Executive (including any payment or benefits received in connection with the Executive's termination of employment whether pursuant to the terms of this Agreement or any other plan, arrangement or agreement (all such payments and benefits, excluding the Gross-Up Payment, being hereinafter referred to as the "*Total Payments*")) will be subject to any excise tax imposed under Section 4999 of the Internal Revenue Code of 1986, as amended (the "*Excise Tax*"), NLASCO shall pay to the Executive an additional amount (the "*Gross Up Payment*") such that the net amount retained by the Executive, after deduction of any Excise Tax on the Total Payments and any federal, state and local income and employment taxes and Excise Tax upon the Gross-Up Payment, and after taking into account the phase out of itemized deductions and personal exemptions attributable to the Gross Up Payment, shall be equal to the Total Payments. The Gross-Up Payment is intended to place the Executive in the same economic position that he would have been in if the Excise Tax did not apply.

(d) *By NLASCO for Cause or by the Executive other than for Good Reason.* If the Executive's employment shall be terminated by NLASCO for Cause or by the Executive other than for Good Reason, then NLASCO shall pay the Executive his Base Salary (at the rate in effect at the time Notice of Termination is given) through the Date of Termination, and NLASCO shall

have no additional obligations to the Executive under this Agreement except as set forth in subsection (e) of this *Section 9*.

(e) *Compensation Plans.* Following any termination of the Executive's employment, NLASCO shall pay the Executive all accrued but unpaid amounts, if any, to which the Executive is entitled as of the Date of Termination under any compensation plan or benefit plan or program of NLASCO, at the time such payments are due, in any event, in accordance with the terms of such plans or programs.

(f) *Return of Company Property.* Executive agrees that following the termination of his employment for any reason, he shall return all property of NLASCO, its Subsidiaries, affiliates and any divisions thereof he may have managed which is then in or thereafter comes into his possession, including, but not limited to, documents, contracts, agreements, plans, photographs, books, notes, electronically stored data and all copies of the foregoing as well as any automobile or other materials or equipment supplied by NLASCO to Executive, if any.

10. *Mitigation* The Executive shall not be required to mitigate the amount of any payment provided for the Executive by seeking other employment or otherwise. However, the amount of any payment or benefit provided for the Executive hereunder shall be reduced by any compensation earned by the Executive as the result of employment by another employer, by retirement benefits, by offset against any amount claimed to be owed by the Executive to NLASCO or otherwise.

11. Confidential Information; Noncompetition; etc.

(a) Confidential Information.

(i) *Acknowledgment.* NLASCO shall provide the Executive with confidential proprietary information of NLASCO and/or ARC ("*Confidential Information*"), including, without limitation, information regarding: (i) any and all trade secrets concerning NLASCO, ARC, their respective Subsidiaries or any of their respective Businesses, data, know-how, past, current and planned market research, policy forms, policy renewal retention analyses, master data files, agency agreements, customer lists, current and planned marketing and sales methods and processes, current or prior policy applicants, current or prior agents, current and anticipated customer requirements, underwriting guidelines, claims reports, claims management strategies, price lists, market studies, business plans, proprietary computer software and programs (including object code and source code), proprietary computer software and database technologies, systems, structures and architectures (and related processes, formulae, compositions, improvements, devices, know-how, discoveries, concepts, ideas, designs, methods and information) and any other information, whether or not documented in any manner, relating to NLASCO, ARC, their respective Subsidiaries or any of their respective Businesses that is a trade secret within the meaning of applicable trade secret law; (ii) any and all information concerning NLASCO, ARC, their respective Subsidiaries or any of their respective the Businesses (which includes historical financial statements, financial projections and budgets, historical and projected sales, capital spending budgets and plans, the names and backgrounds of key personnel, personnel training, and sales or marketing techniques and materials), however documented; and (iii) any and all notes, analyses, compilations, studies, summaries, and other material prepared by or for any Seller containing or based, in whole or in part, on any information included in the foregoing.

(ii) *Agreement Regarding Confidential Information.* The Executive acknowledges and agrees that all Confidential Information known or obtained by him, whether before or after the date hereof, is the property of NLASCO, ARC or Buyer (as applicable). Therefore, the Executive agrees that he shall not, at any time, directly or indirectly, disclose to any unauthorized individual, corporation (including any non-profit corporation), general or limited

partnership, limited liability company, joint venture, estate, trust, association, organization, labor union, governmental or quasi-governmental authority of any nature, or other entity or use for its own account in violation of this Section 11(a)(ii) or for the benefit of any third party any Confidential Information, whether or not such information is embodied in writing or other physical form, without NLASCO's, ARC's or Buyer's (as applicable) prior written consent, unless and to the extent that the Confidential Information is or becomes generally known to and available for use by the public other than as a result of the Executive's fault or the fault of any other Person bound by a duty of confidentiality to NLASCO, ARC or the Buyer. If the Executive becomes legally compelled by deposition, subpoena or other court or governmental action to disclose any of the Confidential Information, then the Executive will give NLASCO, ARC or Buyer (as applicable) prompt notice to that effect, and will cooperate with such party if such party seeks to obtain a protective order concerning the Confidential Information. The Executive will disclose only such Confidential Information as its counsel shall advise is legally required. The Executive shall deliver to NLASCO, ARC or Buyer, at any time as such parties may request, all documents, memoranda, notes, plans, records, reports, and other documentation, models, components, devices, or computer software, whether embodied in a disk or in other form (and all copies), relating to NLASCO, ARC, their respective its Subsidiaries or any of their respective Businesses and any other Confidential Information that the Executive may then possess or have under its control.

(b) *Non-Competition.* In exchange for NLASCO's, ARC's and Buyer's agreement to provide Confidential Information to the Executive, during the Employment Period and for a period of two years after the Executive's termination, the Executive shall not:

(i) directly or indirectly, engage or invest in, own, manage, operate, finance, control, or participate in the ownership, management, operation, financing, or control of, be employed by, lend such Seller's credit to, or render services or advice to, any business whose products, services or activities compete with the products, services or activities of the Businesses of NLASCO, ARC or any of their respective Subsidiaries, within any state in the United States, at the time of the Executive's termination, and the Executive agrees that this covenant is reasonable with respect to its duration, geographical area, and scope; or

(ii) directly or indirectly, either for himself or itself or any other Person, (A) induce or attempt to induce any employee of NLASCO, ARC or Buyer or any of their respective Subsidiaries to leave the employ of NLASCO, ARC or Buyer or any of their respective Subsidiaries, (B) in any way interfere with the relationship between NLASCO, ARC or Buyer or any of their respective Subsidiaries and any of their respective employees, (C) employ, or otherwise engage as an employee, independent contractor, or otherwise, any employee of NLASCO, ARC or Buyer or any of their respective Subsidiaries other than former employees of NLASCO whose employment was terminated by Buyer, or (D) induce or attempt to induce any customer, supplier, licensee, producer, independent agent or business relation of NLASCO, ARC or Buyer or any of their respective Subsidiaries to cease doing business with NLASCO, ARC or Buyer or any of their respective Subsidiaries, or in any way interfere with the relationship between any customer, supplier, licensee, producer, independent agent or business relation of NLASCO, ARC or Buyer or any of their respective Subsidiaries.

(c) *Nondisparagement.* The Executive shall not, directly or indirectly, at any time during the Employment Period and for a period of two years after the Executive's termination, publicly disparage the respective shareholders, directors, officers, employees, producers or agents of NLASCO, ARC or Buyer or any of their respective Subsidiaries with the intent to harm any of the foregoing.

(d) *Injunctive Relief.* The Executive agrees that any breach or threatened breach of subsections (a), (b) and (c) of this Section 11 would result in irreparable injury and damage to ARC, NLASCO and their respective Subsidiaries and affiliates for which ARC, NLASCO and their respective Subsidiaries and affiliates would have no adequate remedy at law. Executive therefore also agrees that in the event of said breach or any reasonable threat of breach, NLASCO and/or ARC (as applicable) shall be entitled to seek an immediate injunction and restraining order to prevent such breach and/or threatened breach and/or continued breach by the Executive and/or any and all persons and/or entities acting for and/or with the Executive. The terms of this paragraph shall not prevent NLASCO or ARC (as applicable) from pursuing any other available remedies for any breach or threatened breach hereof, including, but not limited to, remedies available under this Agreement and the recovery of damages. The parties hereto further agree that the provisions of the covenant not to compete are reasonable. Should a court or arbitrator determine, however, that any provision of the covenant not to compete is unreasonable, either in period of time, geographical area, or otherwise, the parties hereto agree that the covenant shall be interpreted and enforced to the maximum extent which such court or arbitrator deems reasonable.

12. Successors; Notice.

(a) *Company's Successors.* NLASCO will require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of NLASCO to expressly assume and agree to perform this Agreement in the same manner and to the same extent that NLASCO would be required to perform it if no such succession had taken place. Failure of NLASCO to obtain such assumption and agreement prior to the effectiveness of any such succession shall be a breach of this Agreement and shall entitle the Executive to compensation from NLASCO in the same amount and on the same terms as he would be entitled to hereunder if NLASCO had terminated his employment other than for Cause, except that for purposes of implementing the foregoing, the date on which any such succession becomes effective shall be deemed the Date of Termination.

(b) *Executive's Successors.* This Agreement and all rights of the Executive hereunder shall inure to the benefit of and be enforceable by the Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. If the Executive should die while any amounts would still be payable to him hereunder if he had continued to live, all such amounts unless otherwise provided herein shall be paid in accordance with the terms of this Agreement to the Executive's devisee, legatee, or other designee or, if there be no such designee, to the Executive's estate. The services to be performed by the Executive hereunder are specific to the Executive and may not be assigned by the Executive.

(c) *Notice.* For the purposes of this Agreement, notices, demands and all other communications provided for in this Agreement shall be in writing and shall be deemed to have been duly given when delivered or (unless otherwise specified) mailed by United States certified or registered mail, return receipt requested, postage prepaid, addressed as follows:

If to NLASCO:

Affordable Residential Communities
7887 East Belleview Avenue, Suite 200
Englewood, CO 80111
Attn: Scott L. Gesell
T: (303) 383-7506
E: scottg@aboutarc.com

Copy to (which shall not constitute notice):

Haynes and Boone, LLP
901 Main Street, Suite 3100
Dallas, Texas 75202
Attn: Michael M. Boone
T: (214) 651-5552
E: michael.boone@haynesboone.com

If to ARC:

Affordable Residential Communities
7887 East Belleview Avenue, Suite 200
Englewood, CO 80111
Attn: Larry D. Willard
T: (303) 383-7547
E: larry.willard@aboutarc.com

Copy to (which shall not constitute notice):

Affordable Residential Communities
7887 East Belleview Avenue, Suite 200
Englewood, CO 80111
Attn: Scott L. Gesell
T: (303) 383-7506
E: scottg@aboutarc.com

Copy to (which shall not constitute notice):

Haynes and Boone, LLP
901 Main Street, Suite 3100
Dallas, Texas 75202
Attn: Michael M. Boone
T: (214) 651-5552
E: michael.boone@haynesboone.com

If to the Executive:

Gregory Vanek
3030 Bosque Ridge
Crawford, Texas 76638
T: (254) 756-5531 ext. 201
F: (254) 399-0765

or to such other address as any party may have furnished to the others in writing in accordance herewith, except that notices of change of address shall be effective only upon receipt.

13. *Miscellaneous.* No provisions of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing signed by the Executive and such officer of NLASCO as may be specifically designated by its Board. No waiver by either party hereto at any time of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not set forth expressly in this Agreement. This Agreement shall be binding on all successors to NLASCO. The validity, interpretation, construction and performance of this Agreement shall be governed by the laws of the State of Texas without regard to its conflicts of law

principles. All references to sections of the Exchange Act shall be deemed also to refer to any successor provisions to such sections. The obligations of NLASCO and the Executive under this Section 13 and Sections 8, 9, 10, 11 and 12 hereof shall survive the expiration of the term of this Agreement. The compensation and benefits payable to the Executive under this Agreement shall be in lieu of any other severance benefits to which the Executive may otherwise be entitled upon his termination of employment under any severance plan, program, policy or arrangement of NLASCO.

14. *Withholding.* Any amounts payable or property transferred pursuant to this Agreement shall be subject to applicable tax withholding, and NLASCO may require a cash payment with respect to such obligations as a condition of any such payment or transfer of property.

15. *Validity.* The invalidity or unenforceability of any provision or provisions of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement, which shall remain in full force and effect.

16. *Counterparts.* This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original but all of which together will constitute one and the same instrument.

17. *Entire Agreement.* This Agreement sets forth the entire agreement of the parties hereto in respect of the subject matter contained herein and supersedes all prior agreements, promises, covenants, arrangements, communications, representations or warranties, whether oral or written, by any officer, employee or representative of any party hereto; and any prior agreement of the parties hereto in respect of the subject matter contained herein is hereby terminated and cancelled.

* * * * *

IN WITNESS WHEREOF, the parties have executed this Agreement the date first above written.

NLASCO, Inc.

By: /s/ C. CLIFTON ROBINSON

C. Clifton Robinson
Chief Executive Officer

/s/ GREGORY VANEK

Gregory Vanek

QuickLinks

Exhibit 10.15

EMPLOYMENT AGREEMENT by and among NLASCO, Inc. and Gregory Vanek
EMPLOYMENT AGREEMENT
R E C I T A L S
A G R E E M E N T
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Section 7: EX-10.16 (EX-10.16)

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Exhibit 10.16

RETIREMENT AND RELEASE AGREEMENT

This Retirement and Release Agreement (this "*Agreement*") is made and entered into effective as of December 1, 2009, by and between Hilltop Holdings Inc., a Maryland corporation (the "*Company*"), and Larry D. Willard, an individual resident of Dallas County, Texas ("*Willard*").

RECITALS

WHEREAS, Willard has been a director and the President and Chief Executive Officer of the Company since June 2005 and September 2005, respectively;

WHEREAS, Willard has expressed his desire to retire from all positions held with the Company and its subsidiaries effective as of December 31, 2009; and

WHEREAS, in connection with said retirement, the Company and Willard desire to provide certain releases to each other and the Company desires to compensate Willard.

AGREEMENT

In consideration of the mutual benefits to be derived from this Agreement and the covenants and agreements set forth herein, the receipt and sufficiency of which are hereby acknowledged and confessed by the execution and delivery hereof, the parties, agreeing to be legally bound hereby, agree as follows:

1. *Resignations.* Willard hereby resigns as an officer, director and employee of the Company and from all positions he holds with the Company (except as a stockholder) effective as of December 31, 2009 (the "*Effective Date*"), and the Company hereby accepts such resignations effective as of the Effective Date. For purposes of this Agreement, the term "*Company*" refers to Hilltop Holdings Inc. and its subsidiaries and their respective successors and assigns.

2. *Non-disclosure and Confidentiality.* Willard understands that he has developed and been exposed to highly confidential information and trade secrets of the Company ("*Confidential Information*"), and that maintenance by the Company of its proprietary Confidential Information to the fullest extent possible is extremely important to the Company. Willard acknowledges and agrees that, except with the prior written consent of the Company, he shall at all times keep confidential and not divulge, furnish or make accessible to anyone (except the Company's authorized representatives), any Confidential Information to which Willard has been privy relating to the business of the Company. The provisions of this *Section 2* shall not apply to any information to the extent that (i) it is, or shall become, generally known to the public other than as a result of a disclosure by Willard, his affiliates or anyone controlled by Willard, (ii) it is, or shall become, available to Willard on a non-confidential basis from a person other than the Company or its attorneys, officers, directors, employees, agents or strategic partners, provided that Willard does not believe such person is bound by a confidentiality agreement with the Company or prohibited in any manner from transmitting information to Willard or (iii) Willard is required by law to disclose such information to any person. In the event that Willard is requested pursuant to, or required by, applicable law or regulation or legal process to disclose any Confidential Information or any other information concerning the Company, Willard agrees to provide the Company, to the extent legally permissible, with prompt notice of such request(s) or the receipt of legal process to enable the Company to seek an appropriate protective order and to consult with the Company with respect to taking steps to resist or narrow the scope of such request or process.

3. *Releases.*

3.1 *Releases by Willard.* Effective as of the Effective Date, Willard, for and on behalf of himself, individually, and his heirs, executors, trustees, administrators, representatives and assigns, if any, hereby fully, finally, completely and forever releases, discharges, acquits and relinquishes, the Company, its predecessors, successors, parent entities, subsidiaries, attorneys, officers, directors, employees, stockholders, agents and assigns, jointly and/or severally, from any and all claims,

actions, demands, liabilities, promises, obligations, damages and/or causes of action of whatever kind or character, joint or several, whether known or unknown, suspected or unsuspected, asserted or unasserted, under any federal or state statute and common law, including, but not limited to, Title VII of the Civil Rights Act of 1964; the Civil Rights Act of 1991; the Texas Commission on Human Rights Act; the Employee Retirement Income Security Act; the Fair Labor Standards Act; **THE AGE DISCRIMINATION IN EMPLOYMENT ACT OF 1967 (29 U.S.C. Section 621, et seq.)**; the Texas Payday law, Tex. Lab. Code section 61.001; claims based on alleged breach of an obligation or duty arising in contract or tort, including, but not limited to, any and all claims relating to any alleged breach of any oral or written promise or employment contract, any and all claims for unpaid or withheld wages, bonuses, benefits, stock or stock options, deferred compensation, commissions or profit-sharing, any claims for wrongful discharge, retaliation or termination, breach of contract, promissory estoppel, fraud, breach of any implied covenants, assault, battery, negligent hiring, negligent retention, defamation, invasion of privacy, slander or intentional infliction of emotional distress, harassment, negligence, gross negligence and strict liability; any alleged unlawful act; any and all claims by Willard, directly or derivatively, in his capacity as a stockholder against the Company or its officers or directors for breach of any duty owed to the stockholders of the Company; or any other claim regardless of the forum in which it might be brought, if any, that he has, might have or might claim to have against the Company, for any and all injuries, harm, damages, penalties, costs, losses, expenses, attorneys' fees and/or liability or other detriment, if any, whatsoever and whenever incurred, suffered or claimed by Willard as a result of any and all alleged acts, omissions or events, up to the Effective Date but not thereafter. It is expressly agreed and understood by Willard that this release includes, but is not limited to, any and all claims, actions, demands and causes of action, if any, arising from or in any way connected with any and all, if any, communications, negotiations, dealings, compensation, employment relationships and separations of employment between Willard and the Company, including any claim of discrimination, wrongful termination, breach of contract and/or tortious conduct. For avoidance of doubt, this *Section 3.1* does not constitute a release or waiver of any rights of Willard arising under this Agreement.

3.2 *Releases by the Company.* Effective as of the Effective Date, the Company, for and on behalf of itself and its current and past officers, directors, attorneys, employees, agents, parent companies, subsidiaries and their respective heirs, successors and assigns, in their individual capacity or corporate capacities, hereby fully, finally, completely and forever releases, discharges, acquits and relinquishes Willard, and his heirs, executors, trustees, administrators, representatives and assigns, in their individual or corporate capacity, from any and all claims, actions, demands, liabilities, promises, obligations, damages and/or causes of action of whatever kind or character, joint or several, whether known or unknown, suspected or unsuspected, asserted or unasserted, arising prior to or existing at the time of the Effective Date that they may have, or might claim to have, against Willard in any form, including, but not limited, for violation of any federal or state law or common law claim, whether in tort, contract or otherwise, including, but not limited to, for discrimination, retaliation, harassment, breach of contract, breach of fiduciary duty, promissory estoppel, fraud, breach of any implied covenants, assault, battery, negligent hiring, retention and supervision, defamation, invasion of privacy, slander or intentional infliction of emotional distress, harassment, negligence, gross negligence, and strict liability; any alleged unlawful act, including for any act or omission of Willard during the term of his employment. For avoidance of doubt, this *Section 3.2* shall not release or waive any claim or cause of action that the Company or they might have or that may arise against Willard, in his official or individual capacity, (i) under the terms of this Agreement, (ii) after the Effective Date or (iii) in any stockholder derivative litigation.

4. *Compensation of Willard.* As compensation for his prior service and in consideration for other promises and covenants of Willard hereunder, the Company shall pay to Willard the following amounts (with appropriate amounts withheld for taxes as required):

(a) On or before the Effective Date, $500,000 in cash;

(b) In exchange for Willard's agreement not to exercise any stock options issued to him by the Company, and Willard hereby agrees not to exercise any stock options issued to him by the Company, an aggregate dollar amount equal to the difference between (a) the closing price of Company common stock on November 30, 2009 as reported by the New York Stock Exchange and (b) the strike price of each share acquirable as of the Effective Date under a stock option issued to Willard by the Company (e.g. closing price minus strike price, and such difference multiplied by the number of shares acquirable under the stock option at that strike price); and

(c) Continued payment to Willard of the monthly base rent for the apartment leased by Willard in Dallas, Texas, on a tax grossed-up basis, until the earlier of the termination of said lease and July 31, 2010.

5. *Indemnification.* The Company agrees that it will indemnify Willard against claims, lawsuits and investigations (collectively, "*Claims*") that have been, or may be asserted, against him by third parties or governmental agencies, including, but not limited to, any class actions or stockholders derivative suits relating to the Company or successor or assigns arising out of the conduct of the business of the Company by Willard, and will pay the reasonable expenses of defense of such Claims incurred by Willard, in his capacity as an officer or director of the Company prior to the Effective Date, to the extent permitted by the Maryland General Corporation Law and consistent with the scope of indemnification and procedures provided under the Company's Charter and Bylaws applicable to officers or directors of the Company in existence as of the date of demand for indemnification. Willard agrees to permit the Company's counsel to handle the defense of such Claims (and Willard agrees to sign such agreements and/or consents of such counsel to provide joint representation as may be required under any Code of Professional Responsibility), except in such situations where the Company's counsel reasonably determines that Willard's interests and defenses in such Claims are so divergent from those of the Company so as to warrant separate representation by independent counsel, in which case Willard may retain separate counsel at the Company's expense. Willard agrees to cooperate with the Company in the defense of the Claims, including, but not limited to, claims arising from litigation filed or threatened against the Company as of the date hereof and other matters. Such cooperation shall include, but not be limited to, Willard making himself available in the preparation of the Company's defense, as a witness for depositions and trial of such Claims at no charge to the Company (except for reasonable travel expenses, if necessary, incurred at the request and with the prior approval of the Company). In the event the Company claims that the Company is not required to indemnify Willard pursuant hereto, the Company shall provide Willard, within ten (10) days of Willard making such claim for indemnification, with written notice to such effect, and setting forth in reasonable detail the grounds therefor.

6. *Assignment.* Willard shall not assign, without the Company's prior written consent, this Agreement or any right or obligation hereunder, and any and all assignments without such prior written consent shall be null and void. The Company may assign the entirety of this Agreement to any person, firm, corporation or other business organization with the consent of Willard, which consent shall not be unreasonably withheld, at any time.

7. *Return of Property.* Willard acknowledges that all computers, credit cards, telephones, pagers, PDA's, equipment, memoranda, notes, records, reports, manuals, handbooks, drawings, blueprints, books, papers, letters, client and customer lists, contracts, products, product samples, software programs, instruction books, catalogs, information and records, lines of code, technical manuals and documentation, drafts of instructions, guides and manuals, maintenance manuals, sales information and

aids relating to the Company's business, and any and all other documents containing Confidential Information furnished to Willard by any representative of the Company or otherwise acquired or developed by Willard in connection with his employment with the Company (collectively, "*Recipient Materials*"), shall at all times be the property of the Company. If the Company so requests, within seven (7) days of such request, Willard shall make available to the Company any Recipient Materials that are in his possession, custody or control, including Recipient Materials retained by Willard in his office, automobile or home. If any such information, documentation or material is stored on Willard's personal computer or disk drive, this fact should be disclosed to the Company within seven (7) days of the request by the Company for the Recipient Materials so that an appropriate course of action may be taken.

8. *Miscellaneous.*

8.1 *Notices.* Any notice to be given hereunder is to be given in writing by either party to the other and delivered or sent by prepaid airmail post, any courier guaranteeing overnight delivery or facsimile transmission addressed to the address set forth opposite each party's name below or such other address as may be notified by one party to the other for such purposes and shall be deemed to be served, in the case of airmail post, three days after posting; in the case of courier guaranteeing overnight delivery, the next business day if timely delivered to such courier; and in the case of facsimile transmission, immediately upon successful transmission.

8.2 *Headings; Pronouns.* The headings of the paragraphs of this Agreement are for convenience of reference only and are not to be considered and construed in this Agreement. When the context so requires in this Agreement, the masculine gender includes the feminine and neuter, and the singular number includes the plural, and vice versa.

8.3 *Severability.* Whenever possible, each provision of this Agreement will be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Agreement is held to be invalid, illegal or unenforceable in any respect under any applicable law or rule in any jurisdiction, such invalidity, illegality or unenforceability will not affect any other provision or any other jurisdiction, but this Agreement will be reformed, construed and enforced in such jurisdiction as if such invalid, illegal or unenforceable provisions had never been contained herein.

8.4 *Governing Law; Venue.* THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF TEXAS, EXCEPT TO THE EXTENT THEY ARE PREEMPTED OR SUPERCEDED BY THE LAWS OF THE UNITED STATES, AND THE PARTIES AGREE TO SUBMIT THEMSELVES TO THE JURISDICTION OF TEXAS WITH VENUE FOR ANY DISPUTE IN DALLAS, TEXAS.

8.5 *Counterparts.* This Agreement may be executed in multiple counterparts, all of which shall be deemed originals, but which counterparts shall constitute one and the same instrument.

8.6 *Binding Agreement.* This Agreement shall inure to the benefit of, and be binding upon, the parties and their respective heirs, representatives, successors and permitted assigns. Whenever a reference to any party is made herein, such reference shall be deemed to include a reference to the heirs, executors, representatives, successors and permitted assigns of such party, and in the case of the Company, specifically including any parent, subsidiary or successor entities.

8.7 *Entire Agreement.* This Agreement, including any documents otherwise executed in connection herewith, contains the entire agreement between the parties hereto with respect to the subject matter hereof and supersedes any prior agreement with respect to the subject matter hereof, whether written or oral. No variations, modifications or changes herein or hereof shall be binding upon any party unless set forth in a document duly executed by or on behalf of such party.

8.8 *Mediation.* If it is not possible to resolve matters informally and a party has a legal claim against the other, the Company and Willard will be required to engage in a one (1) day external mediation before they can commence litigation. The mediation will occur under the auspices of JAMS/Endispute, a for-profit organization established in 1981 ("*JAMS*"), unless the parties agree otherwise. The parties hereto agree to participate in the mediation in good faith. The Company will pay the cost of the one (1) day mediation. If either party chooses to be represented by counsel, each party will be responsible for his or its own attorneys' fees; provided, however, a mediated settlement may include reasonable attorneys' fees as agreed upon by the parties.

8.9 *Free Will.* The Company and Willard acknowledge that each has had an opportunity to consult with his or its respective attorneys or advisors concerning the meaning, import and legal significance of this Agreement, and each has read this Agreement, as signified by their signatures hereto, and are voluntarily executing same after advice of counsel or advisors for the purposes and consideration herein expressed.

8.10 *Good Faith Performance.* The Company and Willard hereby agree to perform all their obligations under this Agreement in good faith.

*** * * ***

SIGNATURE PAGE FOLLOWS

IN WITNESS WHEREOF, the parties have executed this Agreement on the day and year above first written.

THE COMPANY:

Hilltop Holdings Inc.,
a Maryland corporation

By: /s/ COREY G. PRESTIDGE

Name: Corey G. Prestidge
Title: General Counsel & Secretary

ADDRESS:

200 Crescent Court, Suite 1350
Dallas, Texas 75201
Attn: General Counsel
Fax: (214) 855-2173

WILLARD:

/s/ LARRY D. WILLARD

Larry D. Willard

ADDRESS:

Fax:

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AGREEMENT
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Section 8: EX-21.1 (EX-21.1)

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EXHIBIT 21.1

List of Subsidiaries of Hilltop Holdings Inc.

Name	State or Other Jurisdiction of Incorporation or Formation
Affordable Residential Communities LP	Delaware
American Summit Insurance Company	Texas
ARC Arlington Lakeside LP	Texas
ARC DAM Carsons LLC	Delaware
ARC DAM Chelsea LLC	Delaware
ARC DAM Crest LLC	Delaware
ARC DAM Danboro LLC	Delaware
ARC DAM Ephrata LLC	Delaware
ARC DAM GA LLC	Delaware
ARC DAM Gregory LLC	Delaware
ARC DAM HB LLC	Delaware
ARC DAM Maple LLC	Delaware
ARC DAM Monroe LLC	Delaware
ARC DAM Moosic LLC	Delaware
ARC DAM Mountain LLC	Delaware
ARC DAM SA LLC	Delaware
ARC DAM SS LLC	Delaware
ARC DAM Suburban LLC	Delaware
ARC Insurance Holdings, Inc.	Delaware
ARC TRS, Inc.	Delaware
ARC4UT, L.L.C.	Delaware
Colonial Water Gardens, Inc.	Kansas
Enspire Insurance Services, Inc.	Delaware
Excalibur Financial Corporation	Delaware
Hilltop Investments I LLC	Delaware
JE Murphy Company, Inc.	Arizona
JE Murhpy Company of Florida, Inc.	Florida
NALICO General Agency, Inc.	Texas
NAGRUPCO, Ltd.	Texas
National Group Corporation	Delaware
National Lloyds Insurance Corporation	Texas
NLASCO National Lloyds, Inc.	Texas
NLASCO Underwriter Partner 1 LLC	Delaware
NLASCO Underwriter Partner 2 LLC	Delaware
NLASCO Underwriter Partnership	Delaware
NLASCO, Inc.	Delaware
NLASCO Services, Inc.	Texas

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EXHIBIT 21.1

List of Subsidiaries of Hilltop Holdings Inc.
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Section 9: EX-23.1 (EX-23.1)

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Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statement on Forms S-3 (Nos. 333-129254 and 333-160047) and Form S-8 (333-112874) of Hilltop Holdings Inc. of our report dated March 11, 2010 relating to the financial statements, financial statement schedules and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PRICEWATERHOUSECOOPERS LLP
Dallas, Texas
March 11, 2010

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Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
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Section 10: EX-31.1 (EX-31.1)

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Exhibit 31.1

Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002

I, Gerald J. Ford, certify that:

1. I have reviewed this Annual Report on Form 10-K of Hilltop Holding Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 11, 2010

/s/ GERALD J. FORD

Gerald J. Ford

Chief Executive Officer
(principal executive officer)

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Exhibit 31.1

Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002
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Section 11: EX-31.2 (EX-31.2)

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Exhibit 31.2

Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002

I, Darren Parmenter, certify that:

1. I have reviewed this Annual Report on Form 10-K of Hilltop Holding Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 11, 2010

/s/ DARREN PARMENTER

Darren Parmenter

Senior Vice President—Finance
(principal financial officer)

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Exhibit 31.2

Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002
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Section 12: EX-32.1 (EX-32.1)

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Exhibit 32.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
Required by 18 U.S.C. Section 1350
(as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)

In connection with the Annual Report of Hilltop Holdings Inc. (the "Company") on Form 10-K for the period ended December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Gerald J. Ford, as principal executive officer of the Company, hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 11, 2010

/s/ GERALD J. FORD

Gerald J. Ford
Chief Executive Officer

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Exhibit 32.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER Required by 18 U.S.C. Section 1350 (as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)
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Section 13: EX-32.2 (EX-32.2)

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Exhibit 32.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
Required by 18 U.S.C. Section 1350
(as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)

In connection with the Annual Report of Hilltop Holdings Inc. (the "Company") on Form 10-K for the period ended December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Darren Parmenter, as principal financial officer of the Company, hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to his knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 11, 2010

/s/ DARREN PARMENTER

Darren Parmenter
Senior Vice President—Finance

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