

# THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

## CapitalSource Inc. (CSE)



**JOHN K. DELANEY** is the co-Founder, Chairman and Chief Executive Officer of CapitalSource Inc., one of the nation's leading commercial lending organizations. He has been the Chief Executive Officer and Chairman of the Board of CapitalSource since the company's inception in 2000. From 1993 until its sale to Heller Financial in 1999, Mr. Delaney was a Founder, Chairman and Chief Executive Officer of HealthCare Financial Partners, Inc., a provider of commercial financing to small and medium-sized healthcare service companies. Mr. Delaney is the Chairman of the Board of Trustees of St Patrick's Episcopal Day School, the largest independent elementary school in Washington, DC, and a member of the Board of Regents of Georgetown University. Mr. Delaney received his undergraduate degree from Columbia University and his Juris Doctor degree from Georgetown University Law Center.

**(ADK602) TWST: We'd like to begin with a brief historical sketch of CapitalSource and a picture of the things you are doing right now.**

**Mr. Delaney:** The company is about five and a half years old. We are a broad-based commercial finance company, which makes loans to borrowers that range in size of about \$5 to \$200 million in terms of borrowing size. We offer these loans to companies or investors that are engaging in all types of situations, whether they are buying businesses, buying real estate assets or financing the growth of their business.

**TWST: What was the inspiration for the founding of the company?**

**Mr. Delaney:** It was our view that there was a secular change occurring in the banking industry, whereby the large commercial banks were increasingly focusing their attention on one of three things: consumer lending, very large corporate borrowers and investment banking. That would create an opportunity to provide financing or middle market borrowers, which are not particularly small borrowers, nor large corporate issuers.

**TWST: What were the principle drivers of your success?**

**Mr. Delaney:** This is an execution-oriented business, and we've been able to attract a talented team of people that are very focused on delivering value to customers and protecting our balance sheet. As a result, during a period of time where some of the traditional participants have pulled back, we've captured very significant market share and built a large and balanced business to cover many sectors of the economy.

**TWST: What are the most important things that you have done within the last year or so? What is your strategic plan as you look out over the next few years?**

**Mr. Delaney:** During the last year or so, we continued to broaden the business. CapitalSource today touches about nine different industries or sectors, ranging from financing leveraged buy-outs, to financing healthcare companies, to financing media companies, to providing a whole range of real estate financial solutions. I would say the most significant thing we've done as a company on the product side is to build out the platform and diversify the business. We have about 550 employees in over 20 offices across the country providing financing through all sorts of borrowers, and that creates a very balanced business plan.

In addition, the company's assets are approaching about 50% real estate in terms of their composition. To better position that part of our portfolio, we elected to have the REIT status effective on January 1, 2006, which gives us significant tax savings on the part of our business that is linked to real estate and should make those businesses much more competitive in the future. So the future of the company shows continued growth and a continued balancing of the business across many different sectors so that CapitalSource, over time, becomes a large diversified financial institution focused on financial solutions to middle market borrowers.

**TWST: What is the competitive landscape like? Are there any other companies that are very similar to you?**

**Mr. Delaney:** There are companies that participate in different parts of our business. So we have competitors in different niches, but we don't see many square competitors that have the breadth of products that we have.

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**TWST: Didn't you make a very large acquisition recently?**

**Mr. Delaney:** Yes, we made a reasonably good-sized acquisition. One of the things that we are doing as part of the REIT status is increasing our exposure to sale leaseback transactions, which is a form of financing where you buy an asset and you actually own the real estate, but you lease it back to the operator for a period of time and it's a form of a financing transaction more than it is traditional ownership of real estate. We've always had a very strong, market leading healthcare business, and with the new status we have as a REIT, we can offer some new products. One of those products is sale leaseback transactions to long-term care operators, meaning nursing homes, assisted living operators, etc. We announced a very large acquisition of over \$200 million of nursing homes that we leased back to one of the finest nursing home operators in the country.

**TWST: Do things look as good for REITs as they did a year or two ago?**

**Mr. Delaney:** To some extent, CapitalSource is a bit of a hybrid REIT or a “super” REIT, in that only about half of our business is real estate and half of it is corporate. So I would say the general trends that affect REITs don't match up quite as neatly with our business because CapitalSource has a more efficient way of holding about 50% of our business, which is real estate lending. So it tends

to have different dynamics from what most REITs are, which is large, long-term owners of investment property.

**TWST: Do you see any problems or challenges emerging for CapitalSource over the next few years?**

**Mr. Delaney:** There are always significant challenges in all businesses, particularly in a business that's credit focused like ours is. The main challenge we have is to continue to stay focused on our business and execute at the highest level we can. I'm very confident we can do that, but that challenge occurs every single day. As I said, it is an execution business and we bring the best team in the business to the market, and our job is to keep them focused on executing at the high level they have done historically. But we are not worried about some of the traditional factors that would affect a company like ours, principally because of our platform. We don't have any significant exposure to any single industry or any single sector — it's a balanced business. We will ensure ourselves better access to capital and should be able to avoid major external events.

**TWST: Would you tell us about your own background and expertise, and the same for a couple of your colleagues.**

**Mr. Delaney:** I was the Founder and the CEO of a company called HealthCare Financial Partners, which was a very similar business in that it was a lending business, but it was just focused on healthcare companies. That business was built up and became public and was sold in 1999, and it was a very successful business. I started this business with Jason Fish, who came from a large, very well regarded private investment firm.

Jason's background is in credit and real estate investing, and my background is in operating lending businesses. We've surrounded ourselves with people, some of whom worked with me in my prior company, and others who came from other leading financial institutions in the country.

**TWST: You have over 500 employees overall?**

**Mr. Delaney:** Yes, about 550.

**TWST: Would you tell us about the recruitment, training and development of these people?**

**Mr. Delaney:** We've had very good retention; we have lost very few people. We hire these people, depending upon their position, from all different places. We hire some experienced people for certain jobs. We hire them from Wall Street and from law firms, and

we teach them the lending business. We think attorneys are a good talent pool for this business, but we also have an active recruiting program out of colleges and business schools where we bring people in and teach them the business.

**TWST: You have offices in a number of different locations?**

**Mr. Delaney:** Yes, about 20 locations.

**TWST: What would you reasonably expect the company to look like in about three years?**

**Mr. Delaney:** I think the company will largely stay on the course it's on, which is to continue to build out our platform. As I tell investors, you shouldn't expect any course change from us. We have a large diverse business; we are constantly trying to drive efficiencies and build scale in these businesses because we think the best value proposition for the shareholders is to run as efficient a business as possible. We stay focused on parts of the economy that we think are underserved compared to other large financial institutions and to have a very balanced business. That way, we can avoid any major external events.

**TWST: What occupies most of your own attention on a day-by-day, week-by-week basis?**

**Mr. Delaney:** I'm clearly focused on operations and credit, which are two critical aspects of the business. As a CEO of a public company, I spend a fair amount of time with the public markets and with other financing strategies. We are a very significant consumer of debt capital, so that takes up a decent amount of my time.

**TWST: Is there anything else that you would like to bring up regarding your strategies for the next few years?**

**Mr. Delaney:** It's fairly straightforward: we will stay focused on doing the things we do well, and just continue to build scale.

**TWST: Do you feel that the investment community understands your proposition pretty well?**

**Mr. Delaney:** I think they are starting to. We are trading at somewhat of a discount relative to what people would put in our peer

group category, and most of the companies in our peer group lack the diversification and the breadth or the underlying returns that our company produces. So we have a year or two of education to the market because we are new to an investment community that's focused on dividends, so that they can better understand the value that we deliver and put us where I think we should be, which is on the top end of the peer group.

**TWST: What would be the two or three best reasons for the long-term investor to take a close look at CapitalSource?**

**Mr. Delaney:** I think we're a very stable, very predictable dividend-paying company that has above average growth prospects.

**TWST: Thank you.**

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