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**Research Update:**

# Carolina First Bank Rating Lowered To 'BB+/B'; Outlook Negative

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## Research Update:

# Carolina First Bank Rating Lowered To 'BB+/B'; Outlook Negative

## Overview

- There is greater banking industry risk and potential for higher credit losses through 2009-2010.
- We are downgrading Carolina First Bank to 'BB+/B' from 'BBB/A-2'.
- The negative outlook reflects the potential for Carolina First's loan portfolio to deteriorate.

## Rating Action

On June 17, 2009, Standard & Poor's Ratings Services lowered its counterparty credit rating on Carolina First Bank to 'BB+/B' from 'BBB/A-2'. The outlook is negative. The ratings were removed from CreditWatch Negative, where it was placed May 4, 2009.

## Rationale

The downgrade reflects our negative view of industry risk and our expectation that Carolina First's asset quality and profitability will remain under pressure at least during the next year, more so than at similar bank peers. In particular, we expect Carolina First's large concentration of Florida construction loans, which led to net losses in 2008, to continue to inhibit the bank's performance through 2009 and into 2010. We also expect to see weakening in Carolina First's South Carolina and North Carolina-based portfolios in 2009, although they are unlikely to develop the same depth of problems that we've seen in Florida.

In addition to its asset-quality issues, the company's earnings tend to underperform those of peers as a result of its below-peer core deposit funding and relatively high expense structure, although both of these measures are improving under the new strategies the company's new management team has put in place. In addition, the company performed relatively worse than its peers in our recent credit stress testing.

Mitigating our asset-quality concerns somewhat are the company's good capital position and its adequate liquidity profile; however, these strengths are outweighed by its high concentration of commercial real estate loans, its elevated and still rising net charge-offs, and its pressured profitability outlook. We also believe that capitalization ratios could come under additional pressure if our expectation for current loan losses materializes.

Management has made a number of positive changes in the past year, including strengthening its credit management team, focusing more on expanding its retail presence within its markets, and reducing its overhead structure. Although these strategic initiatives are still in the early stages of implementation and will take time to bear fruit, we view them as positive

steps that should ultimately strengthen the organization. Carolina First Bank operates a general banking business across South Carolina, North Carolina, and Florida. It is the primary subsidiary of The South Financial Group Inc., a \$13.3 billion financial holding company based in Greenville, S.C.

The ratings downgrade was part of an ongoing industry review and follows our recent criteria on stress testing and U.S. banks.

## Outlook

The outlook is negative. We see Carolina First's exposure to construction loans, particularly in its Florida portfolio, as a source of ongoing stress through 2009 and 2010. If credit quality weakens more than we expect under our base-case stress testing, and profitability and capital levels suffer accordingly, we could lower the rating.

## Related Research

- "Credit Stress Testing For Financial Institutions," published April 29, 2009
- "Stress Testing U.S. Financial Institutions," published April 29, 2009
- "What Stress Tests Reveal about U.S. Banks' Capital Needs," published May 1, 2009

## Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Carolina First Bank		
Counterparty Credit Rating	BB+/Negative/B	BBB/Watch Neg/A-2
South Financial Group Inc. (The)		
Preferred Stock	B-	BB-/Watch Neg

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