

Hilltop Holdings Inc.
Form POS AM
March 28, 2008

As filed with the Securities and Exchange Commission on March 28, 2008.

Registration No. 333-129254

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Post-Effective Amendment

to Form S-3 on

FORM S-1

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

HILLTOP HOLDINGS INC.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of incorporation or organization)

6331

(Primary Standard Industrial Classification Code Number)

84-1477939

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(I.R.S. Employer Identification Number)

200 Crescent Court, Suite 1330

Dallas, Texas 75201

(214) 855-2177

(Address, including zip code, and telephone number,
including area code, of registrant's principal executive offices)

Corey G. Prestidge

General Counsel

Hilltop Holdings Inc.

200 Crescent Court, Suite 1330

Dallas, Texas 75201

(214) 855-2177

(Name, address, including zip code, and telephone number,
including area code, of agent for service)

Approximate date of commencement of proposed sale to public: From time to time after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box:

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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 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

Smaller reporting company

This filing constitutes a post-effective amendment to the registration statement on Form S-11/S-3 (File No. 333-129254), which was declared effective on or about May 5, 2006. This post-effective amendment shall hereafter become effective in accordance with Section 8(c) of the Securities Act of 1933.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933, AS AMENDED, OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

EXPLANATORY NOTE

We initially registered on Form S-11/S-3 (File No. 333-129254) the issuance of up to 6,750,524 shares of Hilltop Holdings Inc. (formerly known as Affordable Residential Communities Inc.) common stock upon the exchange of the 7½% Senior Exchangeable Notes due 2025 of Affordable Residential Communities LP. Due to the late filing of our Quarterly Report on Form 10-Q for the period ended September 30, 2007, under applicable rules promulgated by the Securities and Exchange Commission, we no longer qualify for the use of a registration statement on Form S-3. Additionally, since we no longer are a real estate investment trust, as defined in Section 856 of the Internal Revenue Code, and our primary business is no longer that of acquiring and holding for investment real estate or investments in real estate, we cease to qualify for the use of a registration statement on Form S-11. To assure that the shares of Hilltop Holdings Inc. common stock issuable upon the exchange of the 7½% Senior Exchangeable Notes due 2025 of Affordable Residential Communities LP held by the selling stockholders may be sold pursuant to an effective registration statement, we have filed this post-effective amendment on Form S-1 to the registration statement described above. The number of shares of Hilltop Holdings Inc. common stock issuable upon the exchange of the 7½% Senior Exchangeable Notes due 2025 included in this post-effective amendment is higher due to anti-dilution adjustments to the exchange ratio provided for in the notes. This prospectus is a part of that post-effective amendment and registers the sale of Hilltop Holdings Inc. common stock issuable to the selling stockholders upon exchange of the 7½% Senior Exchangeable Notes due 2025 of Affordable Residential Communities LP. We also filed a post-effective amendment to the registration statement on March 17, 2008, deregistering the 7½% Senior Exchangeable Notes due 2025, since the notes are eligible to be sold without restriction pursuant to Rule 144 promulgated under the Securities Act of 1933.

The information in this prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities, and it is not soliciting offers to buy these securities, in any jurisdiction where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MARCH 28, 2008.

PROSPECTUS

6,718,356 Shares

HILLTOP HOLDINGS INC.

Common Stock

(Par Value \$0.01 Per Share)

To Be Offered by Holders of the Common Stock of

Hilltop Holdings Inc.

This prospectus relates to the public offering from time to time of up to 6,718,356 shares of our common stock that may be issued upon the exchange of the 7½% Senior Exchangeable Notes due 2025, or the Senior Notes, of Affordable Residential Communities LP, or ARC LP, held by the selling stockholders. Subject to the conditions described in this prospectus, holders of the Senior Notes may exchange at any time on or prior to maturity or redemption any outstanding Senior Notes, or portions thereof, into shares of our common stock, currently at an exchange rate of 73.94998 shares of our common stock per \$1,000 principal amount of the Senior Notes (equivalent to an exchange price of \$13.52 per share of our common stock). If a holder elects to exchange the Senior Notes in connection with certain specified fundamental changes, as described in this prospectus, that occur prior to August 20, 2015, the holder will be entitled to receive additional shares of our common stock as a make-whole premium upon exchange. In lieu of delivery of shares of our common stock upon exchange of all or any portion of the Senior Notes, we may elect to pay holders surrendering the Senior Notes for exchange an amount in cash per note. In accordance with the Registration Rights Agreement, we are obligated, subject to certain conditions, to register for resale the shares of common stock issuable upon exchange of the Senior Notes.

The distribution of the shares of common stock by the selling stockholders is not subject to any underwriting agreement. We will receive none of the proceeds from the sale of the shares offered by this prospectus. All expenses of registration incurred in connection with this public offering are being borne by us, but all selling and other expenses incurred by the selling stockholders will be borne by the selling stockholder.

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The shares of common stock may be sold by the selling stockholders from time to time on The New York Stock Exchange, or NYSE, or any other national securities exchange or automated inter-dealer quotation system on which shares of our common stock are then listed, through negotiated transactions or otherwise at market prices prevailing at the time of sale or at negotiated prices.

Our common stock is listed on the NYSE under the symbol HTH. The last reported price of our common stock on March 26, 2008, on the NYSE was \$10.25 per share. To preserve our net operating loss carryforwards, or NOLs, our charter limits the amount of common stock that may be owned by any single person or affiliated group to 4.9% of the outstanding shares and restricts the transferability of the shares under certain circumstances.

Investing in shares of our common stock involves risks. See Risk Factors commencing on page 2 of this prospectus for a discussion of certain factors you should consider before buying shares of our common stock being offered by this prospectus.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is _____, 2008.

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This prospectus contains registered trademarks owned or licensed by companies other than us.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission, or SEC. Our SEC filings are available to the public from the SEC's web site at www.sec.gov and also are available from our website at www.hilltop-holdings.com. You also may read and copy any document that we file with the SEC at its public reference facility at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference facility. Our SEC filings are also available at the office of the NYSE, 20 Broad Street, New York, New York 10005. For further information on obtaining copies of our public filings at the NYSE, you should call (212) 656-5060.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

We incorporate by reference into this prospectus the information that we filed with the SEC, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is an important part of this prospectus. We filed our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 with the SEC on March 17, 2008, and it is incorporated herein by reference.

We will provide to each person, including any beneficial owner, to whom this prospectus is delivered, a copy of any or all of the reports or documents that have been incorporated by reference in this prospectus. You may request a copy of these filings (other than an exhibit to a filing, unless that exhibit is specifically incorporated by reference into that filings), at no cost, by writing to us at the following address: Investor Relations, Hilltop Holdings Inc., 200 Crescent Court, Suite 1330, Dallas, Texas 75201 or telephoning us at (214) 855-2177.

SUMMARY

You should read the following summary together with the more detailed information regarding our company, the Senior Notes, our common stock and the financial statements and notes accompanying those financial statements appearing elsewhere in this prospectus or incorporated herein by reference. Unless the context otherwise indicates, the words we, our, ours, us and the Company refer to Hilltop Holdings Inc., or Hilltop, Affordable Residential Communities LP, or ARC LP, and their respective subsidiaries, collectively.

Our Company

We are a holding company that is endeavoring to make opportunistic acquisitions or a business combination. In connection with that strategy, we are identifying and evaluating potential targets on an ongoing basis. At December 31, 2007, Hilltop and ARC LP had approximately \$738 million of 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 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) in 2007 and ASIC a rating of A- (Excellent) in 2007. An A rating is the third highest of 15 rating categories used by A.M. Best, and an A- rating is the fourth highest of 15 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.

On July 31, 2007, we sold our manufactured home communities, retail sales and financing of manufactured home businesses to American Residential Communities LLC, or the Farallon Transaction, and retained ownership of the recently acquired NLASCO. In conjunction with this sale, we transferred the rights to the Affordable Residential Communities name, changed our name to Hilltop Holdings Inc., and moved our headquarters to Dallas, Texas. Our insurance operations are headquartered in Waco, Texas.

Principal Executive Offices

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

RISK FACTORS

You should carefully consider the risks described below before making an investment decision. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that we do not presently know, or that we currently deem immaterial, also may adversely affect our business operations.

If any of the risks actually occur, they could materially adversely affect our business, financial condition or results of operations. In that case, the trading price of our common stock may decline.

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

We intend to use a substantial portion of the proceeds from the Farallon Transaction to make acquisitions or effect a business combination.

We are endeavoring to make opportunistic acquisitions or a business combination with a substantial portion of the proceeds from the Farallon Transaction. No assurances, however, can be given that we will be able to identify suitable targets, consummate acquisitions or 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 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 currently ascertain the merits or risks of the industry or business in which we may ultimately primarily operate.

We may consummate an acquisition or 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 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 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.

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

Since 2003, based upon publicly available information as of March 7, 2008, approximately 156 blank check companies have completed initial public offerings. Of these companies, only 47 companies have consummated a business combination, while 22 companies have announced a business combination but have not consummated such business combination, and 13 companies have failed to complete business combinations and have either dissolved or announced their intention to dissolve and return trust proceeds to their stockholders. Accordingly, as of March 7, 2008, there were approximately 74 blank check companies with approximately \$14.0 billion in trust that are seeking initial business combinations. Furthermore, there are a number of additional offerings for blank check companies that are still in the registration process but have not completed initial public offerings, and there are likely to be more blank check companies filing registration statements for initial public offerings. While some of those companies must complete a business combination in specific industries, a number of them may consummate a business combination in any industry they choose. Therefore, we may be subject to competition from these and other companies with available cash seeking to consummate an acquisition.

We expect to encounter intense competition from entities in addition to blank check companies having a business objective similar to ours, including venture capital funds, private equity funds, leveraged buyout 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 the net proceeds from the Farallon Transaction, 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. Because, as of March 7, 2008, only 69 of the 156 blank check companies that have gone public in the United States since 2003 have either consummated a business combination or announced a business combination and 13 companies have failed to complete business combinations and have either dissolved or announced their intention to dissolve and return trust proceeds to their stockholders, it may indicate that there are fewer attractive target businesses available to such entities like our company or that many privately held target businesses are not inclined to enter into these types of transactions with publicly held companies like ours. For these reasons, we

cannot assure you that we will be able to effectuate an acquisition or business combination in the near term.

Subsequent to our consummation of an acquisition or business combination, we may be required to subsequently take write-downs or write-offs, restructuring and 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 with which we acquire or combine, 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 not consistent 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 be 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 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.

We may issue a substantial number of additional shares of common or preferred stock to complete an acquisition or business combination or under an employee incentive plan after consummation of the transaction. 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 the net proceeds from the Farallon Transaction, including the amounts earned on investment of those proceeds, will be sufficient to allow us to consummate an acquisition or business combination, we cannot ascertain the exact capital requirements for any particular transaction because we have not yet definitively selected any target business. If the net proceeds from the Farallon Transaction, either because of the size of the acquisition or business combination or the depletion of available funds in search of a target business, are insufficient, 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 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 business combination, we may require

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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 combinations that may 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 new 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 new 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. This annual limitation may cause \$13.0 million of our pre-IPO NOLs not to be used before the pre-IPO NOLs expire.

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 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 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 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

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- restrictions on our use of leverage and collateral,

each of which may make it difficult for us to consummate strategic acquisition or 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;
- 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

Our management has limited prior experience operating an insurance company like NLASCO and, therefore, may have difficulty in successfully and profitably operating NLASCO or complying with regulatory requirements applicable to insurance companies.

Our management has limited experience operating an insurance company like NLASCO or complying with regulatory requirements applicable to insurance companies like NLASCO. 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. Because we could encounter difficulties in operating an insurance company and complying with regulatory requirements applicable to insurance companies, you should be especially cautious in drawing conclusions about the ability of our management team to execute its business strategies as they relate to NLASCO.

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 Katrina and Rita, which occurred on August 29, 2005 and September 24, 2005, respectively, are such examples. 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: 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, among others.

NLASCO writes insurance primarily in the States of Texas, Arizona, Tennessee, Oklahoma and Louisiana. In 2007, Texas accounted for 73.8%, Arizona accounted for 9.6%, Tennessee accounted for 6.5%, Oklahoma accounted for 4.1%, Louisiana accounted for 2.1% and the other states we do business in accounted for the other 3.9% 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 \$200 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 and 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, that 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, which have experienced extreme drought conditions, making the risk of loss from wildfires more prevalent. 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.

NLASCO's insured risks, generally, 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 four 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.

NLASCO incurred \$6.0 million (including loss adjustment expenses) in catastrophic related losses for the year ended December 31, 2007. For the year ended December 31, 2007, NLASCO's net catastrophic loss experience was \$5.1 million after reinsurance. Most of the expense in 2007 relates to claims being paid or reserved on Hurricane Rita due to lawsuits filed in 2007. For Hurricane Rita, all related reinsurance treaties are exhausted and we will not recoup any additional reinsurance on those paid claims. NLASCO incurred \$6.0 million (including loss adjustment expenses) in catastrophe related losses for the year ended December 31, 2006. For the year ended December 31, 2006, NLASCO's net catastrophe loss experience was \$4.5 million after reinsurance. In addition, NLASCO is exposed to an increase in claims frequency and exposure amount under the homeowners and dwelling fire insurance it writes because property damage may result from severe weather conditions.

Due to the inherent inability to accurately predict the severity and frequency of catastrophe losses, higher than expected catastrophe 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. Hurricane Katrina highlighted the challenges inherent in predicting the impact of catastrophic events. The catastrophe models, generally, failed to adequately

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project the financial impact of Hurricane Katrina. 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.

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:

- (1) collect and properly analyze a substantial amount of data;
- (2) develop, test and apply appropriate pricing techniques;
- (3) closely monitor and recognize changes in trends in a timely manner; and
- (4) 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 hurt the 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 2005, 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 expenses 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 and combined 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 2007, NLASCO's personal lines ceded eleven percent of its direct premiums written (primarily through excess of loss, quota share and catastrophe reinsurance treaties) and its commercial lines ceded eleven percent 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, decreased two percent in 2007 due to no major catastrophes occurring in 2006. This includes additional catastrophe limits purchased. Reinsurance cost will likely increase, in part due to the frequency and severity of hurricanes and/or 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.

Although NLASCO believes that it does not have exposure to the events of September 11, 2001 because it did not have insurance in-force at that time with respect to exposure to such events, 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

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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 for 2007 and thereafter, in each case 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.

As of December 31, 2007, NLASCO had \$2.7 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. An MGA is a person, firm or

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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 adjusted 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. An 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 fifteen 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 ratings is subject to periodic review by, and may remain the same, be revised downward, upward or 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.

A decline in NLASCO's ratings, coupled with a change of control, could result in a default under one of its debt agreements.

NLASCO is a party to an indenture under which an aggregate of \$20 million in notes are outstanding. That indenture provides that (i) if a person or group becomes the beneficial owner, directly or indirectly, of 50% or more of its 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 that indenture has the right to require that NLASCO purchase that holder's notes, in whole or in part, at a price equal to 107.5% of the outstanding principal amount prior to March 10, 2010, or 100.0% thereafter. A change of control under the indenture occurred as a result of the acquisition of NLASCO by Hilltop. As a result, if a downgrading occurs following the acquisition, the noteholders under the indenture would have the right to require NLASCO to repurchase its notes. This required repayment risk could cause liquidity issues to both NLASCO and Hilltop, could impair NLASCO's ability to obtain additional financing and would likely increase the cost of any financing that it does obtain.

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.

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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 74% and 72% of NLASCO's direct premiums written in 2007 and 2006, respectively. 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.

NLASCO's investment performance may suffer as a result of adverse capital market developments or other factors, which may affect its financial results and ability to conduct business.

NLASCO invests the premiums it receives from policyholders until they are needed to pay policyholder claims or other expenses. As of December 31, 2007, NLASCO's invested assets consisted of \$138.7 million in fixed maturity securities and \$9.4 million in equity securities. For the year ended December 31, 2007, NLASCO had \$8.1 million of net investment income, representing seven percent of NLASCO's total revenues and 37% of its income before taxes. 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, including federal and state legislation related to terrorism insurance and reinsurance, such as the extension of, or replacement for, the Terrorism Risk Insurance Program Reauthorization Act of 2007, could adversely affect the performance of NLASCO's investments. Additionally, inflation could increase beyond investment income.

NLASCO holds \$12.8 million (or 8.7%) of its investment portfolio in mortgage backed securities. All these securities have been issued by either the Federal Home Loan Mortgage Corporation or the Federal National Mortgage Association and, as of March 1, 2008, have not been adversely affected by the sub-prime financing market declines.

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.

As of December 31, 2007, mortgage-backed and asset-backed securities constituted 6.7% of NLASCO's cash and invested assets. As with other 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

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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.

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

The loan agreement governing NLASCO's note due October 2008, with an outstanding principal balance of approximately \$4.0 million at December 31, 2007, contains restrictions on its ability to, among other things:

- create liens;
- sell assets;
- incur additional indebtedness;
- declare or pay dividends;
- consolidate or merge;
- engage in certain businesses;
- make certain loans, advances or investments;
- compensate its owners and executives; and
- enter into transactions with affiliates.

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 businesses that are similar to, or in addition to, the covenants under their 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 18 states and ASIC is licensed in 27 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. 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

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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. From 1999 to 2004, NLASCO's other assessments in any year did not exceed \$1.0 million. For the year ended December 31, 2004, NLASCO paid no other assessments. For the years ended December 31, 2005 and 2006, NLASCO's other assessments were \$10.4 million, with \$4.4 million paid in 2005 and \$6.0 million paid in 2006, principally related to Hurricanes Katrina and Rita in Louisiana, Mississippi and Texas (see next paragraph), and additional or emergency hurricane-related assessments could follow. For the year ended December 31, 2006,

NLASCO paid an assessment of \$0.4 million to cover the claims of an impaired insurer in Texas. For the year ended December 31, 2007, NLASCO paid no assessments. As 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. During the years ended December 31, 2006 and 2007, NLASCO's insurance company subsidiaries paid no assessments based on estimated losses and NLASCO's market shares in Louisiana, Mississippi and Texas. Additional assessments, however, may follow. 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 and Rita 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 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.

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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, including investigations into contingent commission arrangements and insurance quotes regarding NLIC and ASIC, could affect NLASCO's business, financial condition and results of operations.

Recently, the insurance industry has experienced substantial share price volatility as a result of current litigation, investigations and regulatory activity by various insurance, governmental and enforcement authorities concerning certain practices within the insurance industry. These practices include the payment of contingent commissions by insurance companies to insurance brokers and agents and the extent to which such compensation has been disclosed and the solicitation and provision of fictitious inflated or mischaracterized quotes for insurance coverages. NLASCO paid less than 25% of its 2007 gross written premiums to its independent agents pursuant to contingent commission contracts.

NLASCO is unable to predict the potential effects, if any, that these investigations may have upon these arrangements in particular or 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 of its insurance companies at any time and generally for any purpose, including 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, 1997 through December 31, 2001, including material transactions and/or events occurring after December 31, 2001. ASIC's last regulatory exam was a full scope financial examination by the Texas Department of Insurance covering the period from January 1, 2001 through December 31, 2003, including certain material transactions and/or events occurring after December 31, 2003. Neither examination resulted in any significant regulatory compliance issues being raised by the Texas Department of Insurance.

The Texas Department of Insurance is currently conducting an examination of NLIC from January 31, 2002 through December 31, 2006, and ASIC from January 1, 2004 through December 31, 2006. As of March 1, 2008, we have received no information indicating any significant compliance issues.

The March 26, 2002 Market Conduct Examination Report for ASIC issued by Arizona's Department of Insurance contained a recommendation that the Arizona Director of Insurance determine if cause existed to take disciplinary action against ASIC for various apparent law violations cited in the report. Subsequent to the issuance of the report, ASIC entered into a voluntary Consent Order with the Arizona Department of Insurance pursuant to which ASIC agreed to undertake various remedial actions in respect of the apparent law violations cited in the report. ASIC made reports to the Arizona Department required by the Consent Order, and the Arizona Department of Insurance has advised that, while compliance with the Consent Order is subject to further verification upon future examination, the Arizona Department of Insurance is satisfied that ASIC has completed the remedial requirements of the Consent Order. 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 of other states, 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

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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.

NLASCO relies on its information technology and telecommunications systems, and the failure or disruption of these systems could disrupt its operations and adversely affect its results of operations.

NLASCO's business is highly dependent upon the successful and uninterrupted functioning of its information technology and telecommunications systems. NLASCO relies on these systems to process new and renewal business, issue policies, provide customer service, make claims payments and facilitate collections and cancellations, as well as to perform actuarial and other analytical functions necessary for pricing and product development. NLASCO's systems could fail of their own accord or could be disrupted by outside factors, such as natural disasters, power disruptions or surges, failure of third party systems or support, computer hackers, terrorist attacks or other factors beyond its control. Failure or disruption of these systems, or the back-up systems, for any reason could disrupt its operations and adversely affect its results of operations.

Failures in NLASCO's 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 is an integral part of NLASCO's success, and the growth of its business is highly dependent upon it. 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 other systems depend heavily on the incumbent information technology team that developed 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

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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, dilution 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, 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 equity or debt financing, which may not be available on favorable terms or at all.

Risks Related to Ownership of the Senior Exchangeable Notes

The Senior Exchangeable Notes are effectively subordinated to our existing and future secured indebtedness.

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The 7½% Senior Exchangeable Notes due 2025, or the Senior Notes, are unsecured and rank equally with our operating partnership's existing and future unsecured senior debt. The Senior Notes are effectively subordinated to all of our operating partnership's secured debt and to all other debt of Hilltop and its other, direct and indirect, subsidiaries, since the Senior Notes are not guaranteed by Hilltop or its other, direct and indirect, subsidiaries. At December 31, 2007, Hilltop and its consolidated subsidiaries, other than the operating partnership, had approximately \$51.5 million of debt, all of which is effectively senior to the Senior Notes. At December 31, 2007, the operating partnership did not have any indebtedness for borrowed money, except for the Senior Notes. In the event of a bankruptcy, liquidation or dissolution, the assets that serve as collateral for any secured indebtedness and the assets of Hilltop and its subsidiaries, other than the operating partnership, will be available to satisfy the obligations of that indebtedness before any payments are made on the Senior Notes.

There are no restrictive covenants in the indenture governing the Senior Notes relating to our ability to incur future indebtedness or complete other financing transactions.

The indenture governing the Senior Notes does not contain any financial or operating covenants or restrictions on the payment of dividends, the incurrence of indebtedness, transactions with affiliates, incurrence of liens or the issuance or repurchase of securities by us or any of our subsidiaries. Therefore, we may incur additional indebtedness, including secured indebtedness, that would be effectively senior to the Senior Notes to the extent of

the value of the assets securing such indebtedness, or indebtedness at the subsidiary level to which the Senior Notes would be structurally subordinated. We cannot assure that we will be able to generate sufficient cash flow to pay the interest on our indebtedness, including the Senior Notes, or that future working capital, borrowings or equity financing will be available to pay or refinance any such indebtedness.

An adverse rating of the Senior Notes may cause their trading price to fall.

If rating agencies reduce, or indicate that they may reduce, their ratings in the future, the trading price of the Senior Notes could significantly decline. If we elect to satisfy our exchange obligation to holders by paying the cash value of our common stock into which the Senior Notes are exchangeable or by a combination of cash and shares of our common stock, upon exchange of all or a portion of their Senior Notes, holders may not receive any shares of our common stock, or they might receive fewer shares of our common stock relative to the exchange value of the Senior Notes. In addition, there will be a significant delay in settlement, and because the amount of cash and/or common stock that a holder will receive in these circumstances will be based on the sales price of our common stock for an extended period between the exchange date and settlement date, holders will bear the market risk with respect to the market price of the common stock for such extended period. Finally, our liquidity may be reduced to the extent that we choose to deliver cash rather than shares of common stock upon exchange of the Senior Notes.

The failure of our results to meet the estimates of market analysis could adversely affect the trading price of the Senior Notes and our common stock.

We have not in the past provided, and do not intend in the future to provide, estimates of our future financial performance to the investor markets. Certain analysts, however, provide their own estimates of our future financial performance based on their review of our public financial information. In the past, our actual results have been below the expectations of such analysts. In the event our results continue to be less than analyst estimates, the trading price of our common stock could be adversely affected, which could, in turn, adversely affect the trading price of the Senior Notes.

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

The transfer of our securities is restricted through the inclusion of transfer restrictions in our charter.

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

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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.

Applicable insurance laws may make it difficult to effect a change of control of Hilltop.

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.

Additional issuances of equity securities and exchange of the Senior Notes for our common stock will dilute the ownership interest of our existing stockholders, including former Senior Noteholders who had previously exchanged their Senior Notes for common stock.

The exchange of some or all of the Senior Notes will dilute the ownership interests of our existing stockholders, including former Senior Noteholders who had previously exchanged their Senior Notes for common stock. Any sales in the public market of our common stock to be issued upon such exchange could adversely affect prevailing trading price of our common stock. In addition, the existence of the Senior Notes may encourage short selling by market participants because the exchange of the Senior Notes could depress the price of our common stock. We may issue equity in the future in connection with strategic transactions, including acquisitions or combinations, to adjust our ratio of debt-to-equity, including through repayment of outstanding debt, to fund expansion of our operations, upon exchange of the Senior Notes or for other purposes. To the extent we issue additional equity securities, the percentage ownership into which the Senior Notes would exchange could be reduced.

Our common stock price may experience substantial volatility, which may affect your ability to sell our common stock at an advantageous price and could impact the market price, if any, of the Senior Notes.

Price volatility of our common stock may affect your ability to sell our common stock at an advantageous price. In addition, this may result in greater volatility in the market price, if any, of the Senior Notes than would be expected for non-exchangeable debt securities. 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 Risk Factors and Forward-looking Statements. In addition, the stock markets in general, including the NYSE, recently 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, and the market price of the Senior Notes.

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.

FORWARD-LOOKING STATEMENTS

This prospectus and the documents incorporated by reference into this prospectus 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 prospectus 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, 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. These risks, along with the risks disclosed in the section of this prospectus titled Risk Factors beginning on page 2 and the following factors, could cause actual results to vary from our forward-looking statements:

- 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;
- our corporate debt ratings;
- 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's insurance subsidiaries to maintain their respective A.M. Best ratings;
- failure to maintain NLASCO's current agents;
- lack of demand for insurance products;
- cost or availability of adequate reinsurance;
- changes in key management;

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- severe catastrophic events in our geographic area;
- failure of NLASCO's reinsurers to pay obligations under reinsurance contracts;
- failure of NLASCO to maintain sufficient reserves for losses on insurance policies;
- failure of NLASCO to maintain appropriate insurance licenses; and
- failure of Hilltop to realize the benefits from the sale of substantially all of its manufactured home business in July 2007.

Consequently, all of the forward-looking statements made in this prospectus 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 prospectus speak as of the date of this prospectus. We undertake no obligation to update or revise any forward-looking statement in this prospectus.

USE OF PROCEEDS

The selling stockholders will receive all of the proceeds from the sale of shares offered by this prospectus. We will not receive any proceeds from the sale of these shares. We will bear all expenses incident to the registration of the shares of our common stock under the Federal and state securities laws, other than expenses incident to the delivery of the shares to be sold by the selling stockholders. Any transfer taxes payable on these shares and any commissions and discounts payable to underwriters, agents or broker-dealers will be paid by the selling stockholders.

DESCRIPTION OF SECURITIES

The following description, which summarizes the material terms and provisions of our securities, does not purport to be complete and is subject to, and qualified in its entirety by reference to the actual terms and provisions of our charter, bylaws, the Senior Notes and the indenture governing the Senior Notes, which is incorporated herein by reference.

General

Our charter provides that we may issue up to 100,000,000 shares of common stock, \$0.01 par value per share, of which 56,444,059 shares are issued and are outstanding as of March 17, 2008; 10,000,000 shares of preferred stock, \$0.01 par value per share, of which 5,750,000 shares have been classified as 8.25% Series A cumulative redeemable preferred stock, or Series A preferred stock, of which 5,000,000 shares are issued and outstanding as of March 17, 2008; and 10,000,000 shares of special voting stock, par value \$0.01 per share, of which no shares are outstanding as of March 17, 2008. Our board of directors may amend our charter without stockholder approval to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that we have authority to issue. Under Maryland law, our stockholders generally are not liable for our debts or obligations.

Common Stock

General

All shares of our common stock outstanding are duly authorized, fully paid and non-assessable. Holders of our common stock are entitled to receive dividends when authorized by our board of directors out of assets legally available for the payment of dividends and declared by us. They also are entitled to share ratably in our assets legally available for distribution to our stockholders in the event of our liquidation, dissolution or winding up, after payment of, or adequate provision for, all of our known debts and liabilities. These rights are subject to the preferential rights of any other class or series of our stock.

Each outstanding share of our common stock entitles the holder to one vote on all matters submitted to a vote of our stockholders, including the election of directors. Except as provided with respect to any other class or series of stock, including the special voting stock described below, the holders of our common stock possess exclusive voting power with respect to all matters subject to stockholder approval or election or

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otherwise submitted to a vote of our stockholders. There is no cumulative voting in the election of directors.

Holders of our common stock have no preference, conversion, exchange, sinking fund, redemption or appraisal rights and have no preemptive rights to subscribe for any of our securities. All shares of common stock will have equal dividend, liquidation and other rights.

Under Maryland law, a Maryland corporation generally cannot dissolve, amend its charter, merge, sell all or substantially all of its assets, engage in a share exchange or engage in similar transactions outside the ordinary course of business, unless approved by the affirmative vote of holders of shares entitled to cast at least two thirds of the votes entitled to be cast on the matter. A Maryland corporation may, however, provide in its charter for approval

of these matters by a lesser percentage, but not less than a majority of all of the votes entitled to be cast on the matter. Except for the amendment of the provisions of our charter relating to the removal of directors and relating to the amendment of certain provisions of our charter, our charter provides for approval of these matters by a majority of all the votes entitled to be cast. Maryland law permits a corporation to transfer all or substantially all of its assets without the approval of the stockholders of the corporation to one or more persons if all of the equity interests of the person or persons are owned, directly or indirectly, by the corporation. In addition, operating assets may be held by a corporation's subsidiaries, as in our situation, and these subsidiaries may be able to transfer all or substantially all of these assets without a vote of our stockholders.

Restricted Stock Grants

In April 2005, we granted an award of 80,000 shares of common stock to Scott D. Jackson, our then Chief Executive Officer, under our 2003 equity incentive plan. Pursuant to the terms of the grant, 20,000 shares vested immediately and the remainder was forfeited upon Mr. Jackson's resignation from us in December 2005. During 2007, 2006 and 2005, we granted 9,430, 14,400 and 6,250 common shares, respectively, to non-management members of our board of directors for service rendered to us during the periods. The shares granted to our non-management members of our board of directors vested immediately upon grant. All unvested restricted shares granted prior to July 31, 2007 and that had not been forfeited as of that date, vested as a result of the Farallon Transaction, which constituted a change in control under the plan under which those restricted shares were granted.

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 restricted shares granted under our 2003 equity incentive plan in the denominator of our calculation of diluted earnings per share, if they are dilutive. 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, we issued 1,250,000 warrants, each giving its holder the right to purchase one share of our common stock at an exercise price of \$11.70 per share. Subsequently, as the result of a 0.519-for-1 reverse split of our common stock in 2004 in preparation for our IPO, the payment of dividends on our common stock, the issuance from time to time of our common stock as compensation to our non-management directors and the rights offering conducted by us in January 2007, pursuant to the terms of the warrants, the exercise price per share of our common stock under the warrants has been adjusted to \$15.60 and the total number of shares of our common stock issuable upon exercise of all of warrants has been adjusted to 937,440. The warrants expire if not exercised prior to 5:00 PM, New York City time, on July 23, 2010.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is American Stock Transfer & Trust Company.

Special Voting Stock

Pursuant to a pairing agreement between Hilltop and ARC LP, each OP unit in ARC LP that was issued in the reorganization was paired with one share of special voting stock. The pairing agreement provides for the following rights with respect to outstanding special voting stock:

- holders of special voting stock are not entitled to any regular or special dividend payments or other distributions, including any dividends or other distributions declared or paid with respect to shares of our common stock or any of our other stock;
- holders of special voting stock are not entitled to receive any distributions in the event of liquidation or dissolution;
- holders of special voting stock have the right to one vote on all matters submitted to a vote of our stockholders, and the holders of special voting stock vote collectively with the holders of our common stock as one class on all matters submitted to a vote of our stockholders; and

- holders of special voting stock have no class voting rights except as specifically set forth in our charter.

We may not issue any additional shares of special voting stock in the future unless such shares are paired with common partnership units of ARC LP. There currently is no special voting stock issued or outstanding, and we currently do not intend to issue any shares of our special voting stock. Upon the redemption of all of ARC LP's partnership units that were paired with a share of special voting stock in accordance with the redemption provisions of ARC LP's partnership agreement, all shares of special voting stock have been cancelled and were reclassified as authorized but unissued shares of special voting stock.

Preferred Stock

General

Under our charter, our board of directors is authorized without further stockholder action to provide for the issuance of up to 10,000,000 shares of preferred stock, in one or more series, with such terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption in each case, if any, as permitted by Maryland law and as shall be set forth in resolutions providing for the issue of preferred stock adopted by our board of directors.

8.25% Series A Cumulative Redeemable Preferred Stock

The Articles Supplementary adopted by our board of directors creating our Series A preferred stock sets forth the number and fixes the terms, designations, powers, preferences, rights, limitations and restrictions of a series of our preferred stock classified as 8.25% Series A cumulative redeemable preferred stock, or Series A preferred stock. We designated up to 5,750,000 shares of preferred stock as Series A preferred stock, 5,000,000 shares of which were issued in connection with our IPO. Our Series A preferred stock is listed on the NYSE under the symbol HTH-PA. Our Series A preferred stock has the following terms:

- a liquidation preference of \$25.00 per share;
- ranks senior to our common stock with respect to dividends and liquidation;
- subject to the preferential rights of holders of any class or series of senior stock, is entitled to receive, when and as authorized by our board of directors and declared by us, out of funds legally available for payment thereof, cumulative cash dividends at the rate of 8.25% per annum of the \$25.00 liquidation preference (equivalent to a fixed annual rate of \$2.0625 per share);
- source of funds for dividends on our Series A preferred stock is distributions paid on ARC LP's Series A preferred units;
- not redeemable prior to February 18, 2009;
- redeemable in whole or from time to time in part, on and after February 18, 2009, by us, at our option, to the extent permitted by law, at a cash redemption price equal to \$25.00 per share, plus all accumulated dividends;

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- does not have any voting rights, except in limited circumstances, including where we have not been current on payment of dividends for six or more quarterly periods, whether or not consecutive; and
- is not convertible into, or exchangeable for, any of our other property or securities.

Transfer Agent and Registrar

The transfer agent and registrar for our Series A preferred stock is American Stock Transfer & Trust Company.

7½% Senior Exchangeable Notes due 2025 of ARC LP

General

ARC LP issued \$96.6 million aggregate principal amount of Senior Notes, and the Senior Notes are limited to the aggregate principal amount of \$100.0 million. ARC LP issued the Senior Notes pursuant to an indenture, dated as of August 9, 2005, between ARC LP, as issuer, and U.S. Bank National Association, as trustee.

The terms of the Senior Notes include those provisions contained in the Senior Notes and the indenture and those made part of the indenture by reference to the Trust Indenture Act of 1939, or the 1939 Act. The Senior Notes are subject to all such terms, and holders of Senior Notes are referred to the Senior Notes, the indenture and the 1939 Act for a statement thereof. Copies of the indenture and the form of the Senior Notes are available for inspection at the corporate trust office of the trustee, currently located at U.S. Bank National Association, 60 Livingston Avenue, EP-MN-WS3C, St. Paul, MN 55107-2292; Attention: Rick Prokosch.

The Senior Notes will mature on August 15, 2025 and will be paid against presentation and surrender thereof at the corporate trust office of the trustee unless (1) earlier redeemed by ARC LP at its option or repurchased by ARC LP at a holder's option at certain times as described under *Provisional Redemption of the Senior Notes at ARC LP's Option*, *Repurchase at Option of Holders on Certain Dates* or *Repurchase at Option of Holders upon a Fundamental Change* below or (2) exchanged at a holder's option as permitted under *Exchange Rights* below. ARC LP is not required to maintain a sinking fund for the repayment of the Senior Notes.

Exchange Rights

Subject to the restrictions on ownership of Hilltop common stock and the conditions described below, holders may exchange at any time on or prior to maturity or redemption any outstanding Senior Notes (or \$1,000 portions thereof) into shares of Hilltop common stock currently at an exchange rate of 73.95 shares of Hilltop common stock per \$1,000 principal amount of Senior Notes (equivalent to a current exchange price of \$13.52 per Hilltop common share). The exchange rate and the equivalent exchange price in effect at any given time are referred to in this prospectus as the *exchange rate* and the *exchange price*, respectively, and will be subject to adjustment as described in this prospectus. Holders may exchange Senior Notes only in denominations of \$1,000 and whole multiples of \$1,000. If ARC LP calls the Senior Notes for redemption, the Notes may only be exchanged until the close of business on the business day immediately preceding the redemption date unless ARC LP fails to pay the redemption price.

Upon exchange of a Senior Note, a holder will not receive any cash payment of interest, subject to certain exceptions, and we will not adjust the exchange rate to account for accrued and unpaid interest.

Holders of the Senior Notes at the close of business on a record date for an interest payment will receive payment of interest payable on the corresponding interest payment date notwithstanding the exchange of the Senior Notes at any time after the close of business on the applicable regular record date. The Senior Notes tendered for exchange by a holder after the close of business on any record date for an interest payment and on or prior to the corresponding interest payment date must be accompanied by payment of an amount equal to the interest that the holder is to receive on the Senior Notes; provided, however, that no such payment will be made (1) if ARC LP has specified a redemption date that is after such record date and on or prior to such interest payment date or (2) with respect to overdue interest, if any overdue interest exists at the time of exchange with respect to the Senior Notes.

If a holder exchanges the Senior Notes, ARC LP will pay any documentary, stamp or similar issue or transfer tax due on the issuance of shares of Hilltop common stock upon the exchange, if any, unless the tax is due because the holder requests the shares to be issued or delivered to a person other than the holder, in which case the holder will pay that tax prior to receipt of such shares.

A holder wishing to exercise its exchange rights must deliver an irrevocable duly completed exchange notice to the exchange agent. Holders may obtain copies of the required form of the exchange notice from the exchange agent. A certificate, or a book-entry transfer through The Depository Trust Company, or DTC, for the number of shares of Hilltop common stock for which any Senior Notes are exchanged, together with a cash payment for any fractional shares, will be delivered through the exchange agent as soon as practicable, but within the time periods

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specified below, following the exchange date (subject to our ability to elect to deliver cash, or a combination of cash and shares of Hilltop common stock). The trustee initially, and currently, acts as the exchange agent.

In lieu of delivery of shares of Hilltop common stock upon all or any portion of the exchanged Senior Notes, we may elect to pay holders surrendering Senior Notes for exchange an amount in cash per note (or a portion of a note) equal to the average closing price of Hilltop common stock over the five trading day period starting on and

including the third trading day following the exchange date multiplied by the exchange rate in effect on the exchange date (or portion of the exchange rate applicable to a portion of a note if a combination of Hilltop common stock and cash is to be delivered). We will inform such holders through the trustee no later than two business days following the exchange date of our election to deliver shares of Hilltop common stock, to pay cash in lieu of delivery of the shares or to deliver a combination of Hilltop common stock and cash. If we elect to deliver solely shares of Hilltop common stock, these will be delivered through the exchange agent no later than the third business day following the exchange date. If we elect to deliver a combination of shares of Hilltop common stock and cash or to pay all of such payment in cash, such delivery and payment will be made to holders surrendering Senior Notes no later than the tenth business day following the applicable exchange date.

The closing price of Hilltop common stock on any trading day means the reported last sale price per share (or, if no last sale price is reported, the average of the bid and ask prices per share or, if more than one in either case, the average of the average bid and the average ask prices per share) on such date reported by the NYSE or, if Hilltop common stock is not quoted on the NYSE, as reported by the principal national securities exchange or quotation system on which Hilltop common stock is then listed or otherwise as provided in the indenture.

If a holder has already delivered a repurchase notice as described under either *Repurchase at Option of Holders on Certain Dates* or *Repurchase at Option of Holders upon a Fundamental Change*, with respect to a note, that holder may not tender that note for exchange until the holder has properly withdrawn the repurchase notice.

Upon surrender of a note for exchange, the holder shall deliver to us cash equal to the amount that we are required to deduct and withhold under applicable law in connection with such exchange; *provided, however*, that if the holder does not deliver such cash, we may deduct and withhold from the consideration otherwise deliverable to such holder the amount required to be deducted and withheld under applicable law.

Holders may surrender their Senior Notes for exchange of shares of Hilltop common stock at the applicable exchange rate at any time prior to the close of business on the second business day immediately preceding the stated maturity date.

Exchange Rate Adjustments

The exchange rate will be adjusted for certain events, including:

- (1) the issuance of Hilltop common stock as a dividend or distribution on Hilltop common stock;
- (2) subdivisions and combinations of Hilltop common stock;
- (3) the issuance to all holders of Hilltop common stock of rights or warrants entitling them to purchase Hilltop common stock (or securities exchangeable into Hilltop common stock) at less than (or having an exchange price per share less than) the current market price of Hilltop common stock;
- (4) the dividend or other distribution to all holders of Hilltop common stock or shares of Hilltop capital stock (other than common stock) of evidences of indebtedness or assets, including securities, but excluding:
 - (A) the rights and warrants referred to above,

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(B) dividends and distributions in connection with a reclassification, change, consolidation, merger, combination, sale or conveyance resulting in a change in the exchange consideration pursuant to the second succeeding paragraph; or

(C) dividends or distributions paid exclusively in cash;

(5) dividends or other distributions consisting exclusively of cash to all holders of Hilltop common stock in excess of \$0.1875 per share in each fiscal quarter, or the dividend threshold amount; the dividend threshold amount is subject to adjustment as a result of the same events giving rise to an adjustment to the exchange rate, provided that no adjustment will be made to the dividend threshold amount as a result of any event described in this clause (5); and

(6) payments to holders of Hilltop common stock in respect of a tender offer or exchange offer for Hilltop common stock by Hilltop or any of its subsidiaries to the extent that the cash and fair market value of any other consideration included in the payment per share exceeds the closing price of

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Hilltop common stock on the trading day following the last date on which tenders or exchanges may be made pursuant to such tender offer or exchange offer.

Notwithstanding the foregoing, in the event of an adjustment to the exchange rate pursuant to clauses (5) or (6) above, in no event will the exchange rate exceed 86.8821 shares of Hilltop common stock per \$1,000 principal amount of the Senior Notes, subject to adjustment pursuant to clauses (1) through (4) above.

No adjustment in the exchange rate will be required unless the adjustment would require a change of at least one percent in the exchange rate then in effect at that time. Any adjustment that would otherwise be required to be made shall be carried forward and taken into account in any subsequent adjustment. Except as stated above, the exchange rate will not be adjusted for the issuance of Hilltop common stock or any securities exchangeable into or exchangeable for Hilltop common stock or carrying the right to purchase any of the foregoing. We will not make any adjustment if holders of Senior Notes are entitled to participate in the transactions described above.

In the case of:

- any reclassification or change of Hilltop common stock (other than changes resulting from a subdivision or combination); or
- a consolidation, merger or combination involving Hilltop or a sale or conveyance to another corporation of all or substantially all of Hilltop's property and assets,

in each case as a result of which holders of Hilltop 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, Hilltop common stock, holders of the Senior Notes will be entitled thereafter to exchange their Senior Notes into the kind and amount of shares of stock, other securities or other property or assets (including cash or any combination thereof) that they would have owned, or been entitled to receive, upon such reclassification, change, consolidation, merger, combination, sale or conveyance had the Senior Notes been exchanged into Hilltop common stock immediately prior to such reclassification, change, consolidation, merger, combination, sale or conveyance. In the event holders of Hilltop common stock have the opportunity to elect the form of consideration to be received in a reclassification, change, consolidation, merger, combination, sale or conveyance, we will make adequate provision, whereby the holders of the Senior Notes shall have the opportunity, on a timely basis, to determine the form of consideration into which all of the Senior Notes, treated as a single class, shall be exchangeable. This determination shall be based on the blended, weighted average of elections made by holders of the Senior Notes who participate in such determination and shall be subject to any limitations to which all of the holders of Hilltop common stock are subject to, such as pro-rata reductions applicable to any portion of the consideration payable. We may not become a party to any such transaction unless its terms are consistent with the foregoing.

If a taxable distribution to holders of Hilltop common stock or other transaction occurs that results in any adjustment of the exchange price, the holders of Senior Notes may, in certain circumstances, be deemed to have received a distribution subject to United States income tax as a dividend. In certain other circumstances, the absence of an adjustment may result in a taxable dividend to the holders of common stock. We may make these reductions in the exchange price, in addition to those set forth above, as our board of directors deems advisable to avoid or diminish any income tax to holders of Hilltop 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.

We may, from time to time, to the extent permitted by law, reduce the exchange price of the Senior Notes by any amount for any period of at least 20 days. In that case, we will give at least 15 days' notice of the decrease.

Determination of Make Whole Premium

If a transaction described in the first, second or fourth bullet of the definition of change in control (as set forth under *Repurchase at Option of Holders upon a Fundamental Change*) occurs prior to August 20, 2015 and a holder elects to exchange its Senior Notes in connection with the transaction, we will increase the applicable exchange rate for the Senior Notes surrendered for exchange by a number of additional Hilltop common shares, or the additional change in control shares, as described below. An exchange of Senior Notes will be deemed for these purposes to be in connection with the change in control transaction if the notice of exchange of the Senior Notes is

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received by the exchange agent from and including the date that is 15 business days prior to the anticipated effective date of the change in control up to and including the business day prior to the repurchase date as described under *Repurchase at Option of Holders upon a Fundamental Change*.

The number of additional change in control shares will be determined by reference to the table below and is based on the date on which the change in control transaction becomes effective, or the effective date, and the price, or the stock price, paid per Hilltop common share in the transaction. If the holders of Hilltop common shares receive only cash in the change in control transaction, the stock price shall be the cash amount paid per Hilltop common share. Otherwise, the stock price shall be the average of the closing sale prices of Hilltop common shares on the ten consecutive trading days up to but excluding the effective date.

The stock prices set forth in the first row of the table (*i.e.*, the column headers) will be adjusted as of any date on which the exchange rate of the Senior Notes is adjusted. The adjusted stock prices will equal the stock prices applicable immediately prior to such adjustment multiplied by a fraction, the numerator of which is the exchange rate immediately prior to the adjustment giving rise to the stock price adjustment and the denominator of which is the exchange rate as so adjusted. In addition, the number of additional change in control shares will be subject to adjustment in the same manner as the exchange rate as set forth above under *Exchange Rate Adjustments*.

The following table sets forth the stock price and number of additional change in control shares of Hilltop common stock to be received per \$1,000 principal amount of Senior Notes:

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
\$ 11.51	12.9321	12.9321	12.9321	12.9321	12.9321	12.9321	12.9321	12.9321	12.9321	12.9321	12.9321
\$ 12.28	10.8109	10.4560	10.0531	9.6504	9.1326	8.4095	7.8770	7.4519	7.4519	7.4519	7.4519
\$ 13.23	8.8625	8.4802	8.0921	7.6720	7.1779	6.5789	5.8544	4.9690	3.9944	2.9038	
\$ 14.17	7.3183	6.8159	6.3695	5.9912	5.6069	5.2227	4.2824	3.8927	2.8864	1.5825	
\$ 15.12	6.2523	5.5796	4.9538	4.4133	4.0097	3.5946	3.1795	2.7644	2.3494	1.3266	
\$ 16.06	5.6023	4.8062	4.0042	3.2217	2.5147	2.1491	2.0382	1.6972	1.3560	1.0149	
\$ 17.01	5.2911	4.4093	3.4795	2.5494	1.5718	0.5106	0.4918	0.4378	0.3869	0.2510	
\$ 11.51	4.7620	3.9683	3.0159	2.1164	1.0582						
\$ 23.62	3.8096	3.1747	2.4128	1.6932	0.8466						
\$ 28.35	3.1747	2.6456	2.0106	1.4109	0.7055						