

FIRST BANCTRUST CORP
Form DEFM14A
September 02, 2008

Table of Contents

SCHEDULE 14A
INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934

Filed by the Registrant

Filed by a party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Section 240.14a-11(c) or Section 240.14a-12

FIRST BANCTRUST CORPORATION

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement,
if other than Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:
Common Stock

(2) Aggregate number of securities to which transaction applies:
27,779

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined): \$11.00, which is the per share price to be paid in the transaction subject to this Schedule 14A filing

(4) Proposed maximum aggregate value of transaction: \$305,569

(5) Total fee paid: \$12.01

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously.

Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement:

(3) Filing Party:

(4) Date Filed:

Table of Contents

FIRST BANCTRUST CORPORATION
101 South Central Avenue
Paris, Illinois 61944

September 8, 2008

Dear Stockholder:

You are cordially invited to attend a special meeting of stockholders, which will be held at 10:00 a.m., on Tuesday, October 21, 2008 at First Bank & Trust's Main Office at 101 South Central Avenue, Paris, Illinois 61944. I hope that you will be able to attend the meeting, and I look forward to seeing you.

At the special meeting, you will be asked to vote on a proposed transaction that will result in termination of the registration of the First BancTrust common stock under federal securities laws and thereby eliminate the significant expense required to comply with reporting requirements under those laws. Our costs associated with the routine SEC filing and reporting requirements are estimated at approximately \$173,700 or approximately 1.8% of our overhead expense for our 2007 reporting year and 2008 annual meeting (the 2007 reporting cycle). We believe that the costs incurred over the 2007 reporting cycle are a conservative estimate for the recurring annual cost savings that should result from the going private transaction and subsequent termination of our SEC registration.

Referred to as going private, the proposed transaction will reduce the number of stockholders to fewer than 300 persons, as required for termination of the registration. The reduction in the number of stockholders is accomplished by a merger of a newly-formed, wholly-owned subsidiary of First BancTrust (FBT Merger Co.), with and into First BancTrust on terms set forth in the merger agreement, a copy of which is attached as Appendix A to the enclosed proxy statement.

Under the terms of the merger, (i) each share of common stock owned of record at the close of business on the date preceding the effective time of the merger, by a holder of fewer than 250 shares will be converted into the right to receive, from First BancTrust, \$11.00 in cash per share, and (ii) each share of common stock owned of record at the close of business on the date preceding the effective time of the merger, by a holder of 250 or more shares will remain as outstanding First BancTrust common stock after the merger. We anticipate that the effect of the purchase from holders of less than 250 shares will be a reduction in the total number of stockholders from approximately 484 to approximately 226 as required for termination of registration, while the number of shares outstanding is expected to be reduced by less than 2% (to 2,158,060 shares outstanding from the current 2,185,839 shares outstanding.)

At the special meeting, stockholders will also consider and vote on a proposed amendment to First BancTrust's certificate of incorporation. The amendment would prohibit certain future transfers of shares of First BancTrust common stock if, as a result of the transfer, any stockholder would own of record fewer than 250 shares of the surviving corporation. This amendment is intended to slow the growth in the number of our stockholders in the future, thus avoiding or delaying the need to again register. Approval of the amendment is contingent on stockholder approval of the merger agreement.

The First BancTrust board of directors has approved the going private transaction and the amendment as in the best interest of all First BancTrust stockholders and recommends that you vote in favor of the proposed transaction and the amendment. The attached notice of special meeting and proxy statement describe the transaction, the amendment, and provide specific information concerning the special meeting. The going private transaction and the amendment are important for First BancTrust and its stockholders but will only be approved upon the affirmative vote of a majority of the number of shares entitled to vote at the special meeting.

The board of directors has established August 29, 2008 as the record date for determining stockholders who are entitled to notice of the special meeting and to vote at the special meeting. Whether or not you plan to attend the special meeting, please complete, sign and date the proxy card and return it in the envelope provided in time for it to be received by October 14, 2008. If you attend the meeting, you may vote in person, even if you have previously returned your proxy card.

Sincerely,

Terry J. Howard
President & CEO

Table of Contents

**FIRST BANCTRUST CORPORATION
101 South Central Avenue
Paris, Illinois 61944**

**NOTICE OF THE SPECIAL MEETING OF STOCKHOLDERS
To Be Held 10:00 a.m. on Tuesday, October 21, 2008**

A special meeting of stockholders of First BancTrust Corporation will be held at 10:00 a.m. on Tuesday, October 21, 2008, at First Bank & Trust's Main Office at 101 South Central Avenue, Paris, Illinois 61944, for the following purposes:

- (1) To consider and act upon a proposal to approve the merger of FBT Merger Co., a wholly-owned subsidiary of First BancTrust, with and into First BancTrust as contemplated by the merger agreement attached as Appendix A to the enclosed proxy statement. Pursuant to the terms of the merger agreement, (a) each share of First BancTrust common stock owned of record at the close of business on the date preceding the effective time of the merger, by a holder of fewer than 250 shares of common stock, will be converted into, and will represent the right to receive from First BancTrust \$11.00 cash per share; and (b) each share of First BancTrust common stock owned of record at the close of business on the date preceding the effective time of the merger, by a holder of 250 or more shares of common stock will continue to represent one share of First BancTrust common stock after the merger.
- (2) To consider and act upon a proposal to approve an amendment to First BancTrust's certificate of incorporation, the text of which can be found in Appendix B to the enclosed proxy statement. This amendment would prohibit certain transfers of the surviving corporation's stock if, as a result of the transfer, any stockholder would own of record fewer than 250 shares of the surviving corporation. The amendment is contingent on stockholder approval of the merger agreement.
- (3) To consider and act upon a proposal to adjourn or postpone the meeting, if necessary, in the event that an insufficient number of shares is present in person or by proxy to approve and adopt the merger agreement and approve the transactions it contemplates.
- (4) To transact any other business as may properly come before the meeting or any adjournments of the meeting.

The board of directors unanimously recommends that you vote FOR the approval of each of the proposals. Under applicable Delaware laws, First BancTrust's stockholders have dissenters' rights in connection with the merger.

The board of directors has set the close of business on August 29, 2008 as the record date for determining the stockholders who are entitled to notice of, and to vote at, the meeting or any adjournment of the meeting.

We hope that you will be able to attend the meeting. We ask, however, whether or not you plan to attend the meeting, that you please mark, date, sign, and return the enclosed form of proxy as soon as possible. Promptly returning your form of proxy will help ensure the greatest number of stockholders are present whether in person or by proxy.

If you attend the meeting in person, you may revoke your proxy at the meeting and vote your shares in person. You may revoke your proxy at any time before the proxy is exercised.

By Order of the Board of Directors,

Joseph R. Schroeder

Secretary

September 8, 2008

Table of Contents

**FIRST BANCTRUST CORPORATION
101 South Central Avenue
Paris, Illinois 61944**

**PROXY STATEMENT
For Special Meeting of Stockholders
To Be Held At 10:00 a.m. on Tuesday, October 21, 2008**

The board of directors of First BancTrust provides this proxy statement to you to solicit your vote on the approval of the Agreement and Plan of Merger, dated as of April 21, 2008, by and between First BancTrust and FBT Merger Co., a newly-formed subsidiary of First BancTrust organized for the sole purpose of facilitating this proposed transaction. Pursuant to the merger agreement, FBT Merger Co., will merge with and into First BancTrust, with First BancTrust continuing as the surviving corporation after the merger. If First BancTrust's stockholders approve the merger agreement, each stockholder:

holding fewer than 250 shares of First BancTrust common stock on the date preceding the effective time of the merger will receive \$11.00 cash, without interest, per share from First BancTrust; or

holding 250 or more shares on the date preceding the effective time of the merger will continue to hold the same number of shares after the merger and will not receive any cash payment from First BancTrust.

After the merger, First BancTrust anticipates it will have approximately 226 stockholders of record. As a result, First BancTrust will no longer be subject to the annual and periodic reporting and related requirements under the federal securities laws that are applicable to public companies.

At the special meeting, stockholders will also consider and vote on a proposed amendment to First BancTrust's certificate of incorporation. The amendment would prohibit certain future transfers of shares of First BancTrust common stock if, as a result of the transfer, any stockholder would own of record fewer than 250 shares of the surviving corporation. This amendment is intended to slow the growth in the number of our stockholders in the future, thus avoiding or delaying the need to again register. Approval of the amendment is contingent on stockholder approval of the merger agreement.

The merger and the amendment cannot occur unless the holders of a majority of the shares of First BancTrust common stock entitled to vote at the special meeting of stockholders approve the merger agreement and the amendment. The board of directors has scheduled a special meeting of stockholders to vote on the merger as follows:

Tuesday, October 21, 2008 at 10:00 a.m.
First Bank & Trust's Main Office
101 South Central Avenue
Paris, Illinois 61944

This document provides you with detailed information about the proposed merger and the amendment. Please see "Where You Can Find More Information" on page 50 for additional information about First BancTrust on file with the Securities and Exchange Commission.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved the proposed transaction or determined if this proxy statement is truthful or complete. The Securities and Exchange Commission has not passed upon the fairness or merits of the proposed transaction

nor upon the accuracy or adequacy of the information contained in this proxy statement. It is a criminal offense for any person to tell you otherwise.

The date of this proxy statement is September 8, 2008. We first mailed this proxy statement to the stockholders of First BancTrust on or about that date.

Table of Contents

IMPORTANT NOTICES

First BancTrust common stock is not a deposit or bank account and is not insured by the Federal Deposit Insurance Corporation or any other governmental agency.

We have not authorized any person to give any information or to make any representations other than the information and statements included in this proxy statement. You should not rely on any other information. The information contained in this proxy statement is correct only as of the date of this proxy statement, regardless of the date it is delivered or when shares of First BancTrust common stock are converted.

We will update this proxy statement to reflect any factors or events arising after its date that individually or together represent a material change in the information included in this document.

First BancTrust makes forward-looking statements in this proxy statement that are subject to risk and uncertainties. Forward-looking statements include information about possible or assumed future results of the operations or the performance of First BancTrust after the merger is effected. When we use words such as believes, anticipates, expects, intends, targeted, and similar expressions, we are making forward-looking statements that are subject to risk and uncertainties. Various future events or factors may cause our results of operations or performance to differ materially from those expressed in our forward-looking statements. These factors include:

- (1) changes in economic conditions, both nationally and in our primary market area;
- (2) changes in governmental monetary and fiscal policies, as well as legislative and regulatory changes;
- (3) the effect of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements;
- (4) the effects of competition from other financial service providers operating in our primary market area and elsewhere; and
- (5) the failure of assumptions underlying the establishment of reserves for possible loan losses and estimations of values of collateral and various financial assets and liabilities.

The words we, our, and us, as used in this proxy statement, refer to First BancTrust and its wholly owned subsidiaries, collectively, unless the context indicates otherwise.

TABLE OF CONTENTS

<u>SUMMARY</u>	1
<u>QUESTIONS AND ANSWERS ABOUT THE SPECIAL MEETING AND THE MERGER</u>	4
<u>SPECIAL FACTORS</u>	6
<u>Background of the Merger Proposal</u>	6
<u>Purposes of and Reasons for the Merger Proposal</u>	9
<u>Structure of the Merger</u>	11
<u>Determination of the Terms of the Merger</u>	11
<u>Financial Fairness</u>	12
<u>Recommendation of our Board of Directors</u>	20
<u>Purposes and Reasons of FBT Merger Co., Inc. for the Merger Proposal</u>	22
<u>Position of FBT Merger Co., Inc. as to the Fairness of the Merger</u>	22
<u>Interests of Certain Persons in the Merger</u>	22
<u>Certain Consequences of the Merger: Benefits and Detriments to Affiliated and Unaffiliated Stockholders</u>	23
<u>Operations of First BancTrust and the Bank Following the Merger</u>	23
<u>Financing of the Merger</u>	23
<u>Source of Funds and Expenses</u>	24
<u>Certain Terms of the Merger</u>	24
<u>Effective Time of the Merger</u>	24
<u>Conversion and Exchange of Stock Certificates</u>	24
<u>Conditions to Consummation of the Merger</u>	25
<u>Amendment or Termination of the Merger Agreement</u>	25
<u>Regulatory Requirements</u>	25
<u>Dissenters' Rights</u>	25
<u>Accounting Treatment</u>	27
<u>Material U.S. Federal Income Tax Consequences of the Merger</u>	27
<u>Pro Forma Effect of the Merger</u>	29
<u>Termination of Securities Exchange Act Registration</u>	29
<u>AMENDMENT PROPOSAL</u>	30
<u>INFORMATION REGARDING THE SPECIAL MEETING OF STOCKHOLDERS</u>	30
<u>Time and Place of Meeting</u>	30
<u>Record Date and Mailing Date</u>	30
<u>Number of Shares Outstanding</u>	30
<u>Purpose of Special Meeting</u>	30
<u>Voting at the Special Meeting</u>	31
<u>Dissenters' Rights</u>	31
<u>Procedures for Voting by Proxy</u>	31
<u>Requirements for Stockholder Approval</u>	31
<u>Solicitation of Proxies</u>	32
<u>Authority to Adjourn Special Meeting to Solicit Additional Proxies</u>	32
<u>INFORMATION ABOUT FIRST BANCTRUST AND ITS AFFILIATES</u>	32
<u>General</u>	32
<u>Directors and Executive Officers of First BancTrust Corporation</u>	33
<u>Voting Securities and Principal Holders Thereof</u>	35
<u>Recent Affiliate Transactions in First BancTrust Stock</u>	37
<u>Stock Repurchases by First BancTrust Corporation</u>	38
<u>Market for Common Stock and Dividend Information</u>	39

<u>Description of Common Stock</u>	40
<u>Dividend Policy</u>	40
<u>FUTURE STOCKHOLDER PROPOSALS</u>	50
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	50
<u>DOCUMENTS INCORPORATED BY REFERENCE</u>	50
<u>APPENDIX A</u>	A-1
<u>APPENDIX B</u>	B-1
<u>APPENDIX C</u>	C-1
<u>APPENDIX D</u>	D-1

Table of Contents

SUMMARY TERM SHEET

This Summary Term Sheet, together with the following Question and Answers section, highlights the material information included in this proxy statement. This Summary Term Sheet may not contain all of the information that is important to you. To understand the merger proposal fully, and for a more complete description of the legal terms of the merger proposal, you should read carefully this entire document and the other documents referenced in this document. The actual terms of the merger are contained in the merger agreement, a copy of which is attached as Appendix A to this proxy statement.

The merger would result in a reduction in the number of First BancTrust stockholders. This reduction is expected to permit First BancTrust to terminate the registration of its securities under the Securities Exchange Act of 1934. *(See page 29.)*

The merger would be effective when the certificate of merger is filed with the Secretary of State of the State of Delaware, or as otherwise specified on the certificate of merger. First BancTrust intends to file the certificate of merger promptly following stockholder approval of the merger proposal. *(See page 24.)*

Each holder of record of 250 or more shares of First BancTrust common stock immediately prior to the effective time of the merger will continue to be a holder of the same number of shares he or she owned prior to the effective time. *(See page 11.)*

Continuing First BancTrust stockholders following the effective time of the merger will not be entitled to any cash payment for their shares of common stock as a result of the merger. *(See page 11.)*

Each holder of record of fewer than 250 shares of common stock immediately prior to the effective time of the merger will be entitled to receive only cash, without interest, in the amount of \$11.00 for each share of common stock held immediately prior to the effective time. *(See page 11.)*

Following the effective time of the merger, stockholders who are entitled to be paid cash for their shares will no longer be stockholders of First BancTrust. *(See page 11.)*

In conjunction with the merger, stockholders are also being asked to consider an amendment to First BancTrust's certificate of incorporation which would prohibit certain transfers of the surviving corporation's stock if, as a result of the transfer, any stockholder would own of record fewer than 250 shares of the surviving corporation. The amendment is contingent on stockholder approval of the merger agreement. *(See page 30.)*

At the special meeting, holders of common stock will be asked to approve the merger transaction and the amendment. Each share of common stock is entitled to one vote. Under Delaware law, the merger must be approved by a majority of the shares of First BancTrust common stock entitled to vote. *(See page 31.)*

On the record date, there were approximately 2,185,839 shares of common stock issued and outstanding. Of those shares, approximately 267,965 shares are owned, directly or indirectly, by directors and executive officers (approximately 12.3% of the outstanding shares). We have been informed that all of First BancTrust's directors and executive officers intend to vote in favor of the merger proposal. Therefore, the affirmative vote of 824,955 shares (approximately 37.7% of the outstanding shares) of unaffiliated stockholders is necessary to ensure the approval of the merger and the amendment. *(See page 31.)*

The applicable Delaware laws entitle stockholders of First BancTrust to elect dissenters' rights in connection with the merger. (See page 25.)

Shares held in street name accounts with brokerage firms, banks and other investment institutions at the effective time of the merger may remain outstanding after the merger. Stockholders who own fewer than 250 shares in a street name account with a broker, bank or other investment institution will not be cashed out as a result of the merger if the investment institution holds of record 250 or more shares immediately prior to the effective time of the merger. If you are a security holder who holds your shares in street name and hold fewer than 250 shares you will be unable to predict whether you will be cashed out in the merger unless you promptly take action to become a record holder on First BancTrust's stockholder list, rather than a holder

Table of Contents

in street name. Re-registration of shares can take a week or more to become effective so please do not delay if you wish to ensure that you are the record holder at the time of the merger. *(See page 6.)*

The merger agreement and the transactions contemplated by the merger agreement are subject to a number of conditions, including approval of the merger by our stockholders. *(See page 25.)*

As a result of the merger, First BancTrust anticipates that it will be able to terminate the registration of its securities under the Securities Exchange Act of 1934. This means First BancTrust would no longer publicly file financial information nor incur the burdens, risks and expense associated with being subject to this act. *(See page 29.)*

Following the completion of the merger, First BancTrust's common stock would no longer be registered with the SEC and, as a result, the public would have access to less information about First BancTrust. For example, while First BancTrust intends to prepare and distribute to remaining stockholders on an annual basis, an annual report containing audited financial statements along with a less detailed proxy statement, First BancTrust will not prepare and make available the following reports which it currently files with the SEC:

Annual Report on Form 10-K;

Quarterly Reports on Form 10-Q;

Current Reports on Form 8-K;

Forms 3, 4, and 5 required of executive officers and directors under Section 16 of the Securities Exchange Act; and

Detailed proxy statement as required by Regulation 14A under the Securities Exchange Act of 1934, as amended.

In addition, the merger will result in there being less liquidity in First BancTrust's common stock and may negatively affect the goodwill of some customers of First BancTrust's subsidiary bank. *(See pages 23 and 29.)*

First BancTrust's directors and officers have, or may appear to have, a conflict of interest in voting for and recommending the approval of the merger. As a result of the merger, directors and officers' beneficial ownership of First BancTrust stock, as a group, are expected to increase from approximately 21.9% to 22.3%. *(See page 36.)*

The merger is expected to be taxable to those stockholders who receive cash in exchange for their securities. These holders are expected to recognize gain or loss for federal, and possibly state and local, income tax purposes when they receive cash for their securities. They will generally recognize gain or loss equal to the difference between the amount of cash received and their tax basis in the securities. **Stockholders should consult their personal tax advisors for a full understanding of the merger's tax consequences.** *(See page 27.)*

First BancTrust's financial advisor, Howe Barnes Hoefler & Arnett, Inc., has given the Board of Directors a written opinion that the cash consideration to be paid in the merger is fair, from a financial point of view, to the stockholders of First BancTrust. *(See page 12.)* A copy of this opinion is attached to this proxy statement as Appendix C.

The proposed amendment is expected to help slow the growth in the number of stockholders, thus avoiding or delaying the need to again register the common stock under the Securities Exchange Act of 1934. The amendment will be effective when First BancTrust files a certificate of amendment with the Delaware Secretary of State. First BancTrust intends to file the certificate of amendment promptly following stockholder approval of the amendment proposal. (*See page 30.*)

The amendment will not take effect unless the stockholders approve the merger.

Table of Contents

The board of directors has determined that the proposed merger is substantively and procedurally fair to all unaffiliated stockholders of First BancTrust, including those being cashed out in the merger, as well as those remaining unaffiliated stockholders. The board has also determined that the price of \$11.00 per share to be paid to those holders receiving cash for their shares is a fair price. Applicable SEC rules require that in addition to First BancTrust itself, FBT Merger Co. must express its belief as to the substantive and procedural fairness of the merger to each group of unaffiliated stockholders. FBT Merger Co. has determined that the merger is substantively and procedurally fair to the unaffiliated stockholders of First BancTrust that are cashed-out in the merger, as well as those remaining unaffiliated stockholders of First BancTrust. (See pages 20 and 22.)

The board recommends that stockholders vote FOR the Agreement and Plan of Merger proposal and FOR the amendment to the certificate of incorporation.

Table of Contents

QUESTIONS AND ANSWERS ABOUT THE SPECIAL MEETING AND THE MERGER

The following questions and answers are intended to briefly address commonly asked questions regarding the special meeting, the merger and the amendment. These questions and answers may not address all questions that may be important to you as a stockholder. Please refer to the more detailed information contained elsewhere in this proxy statement, the appendices to this proxy statement, and the documents referred to or incorporated by reference in this proxy statement.

When and where is the special meeting?

The meeting will be held on Tuesday, October 21, 2008, at 10:00 a.m. local time, at First Bank & Trust's Main Office, located at 101 South Central Avenue, Paris, Illinois 61944.

How many votes do I have?

You will have one vote for every share of common stock you owned on August 29, 2008, the record date.

How many votes can be cast by all stockholders?

As of August 29, 2008 (the record date), 2,185,839 shares of common stock were issued and outstanding and held of record by approximately 484 stockholders.

Can I change my vote?

Yes, just send in a new proxy with a later date, or send a written notice of revocation to the corporate secretary at the address on the cover of this proxy statement. If you attend the special meeting and want to vote in person, you can deliver a written revocation of your proxy to the secretary at the meeting.

What happens if the meeting is postponed or adjourned?

Your proxy will be good and may be voted at the postponed or adjourned meeting. You will still be able to change or revoke your proxy until it is voted.

Why should I vote to approve the plan of merger?

The board of directors believes that the merger is in the best interests of all First BancTrust stockholders. The merger will reduce the number of holders of shares of common stock to below 300 persons, which will then allow termination of the registration of the common stock under the Securities Exchange Act of 1934, as amended (the "1934 Act"). The board believes that the monetary expense and the burden to management incident to continued compliance with the 1934 Act significantly outweigh any material benefits derived from continued registration of the shares.

The merger will also serve as a source of liquidity for those stockholders who receive cash for their shares. The board recognizes that there is no active trading market for the common stock and no market is expected to develop upon consummation of the merger. The board believes that the merger provides a means for those stockholders with a limited number of shares to receive cash for their shares at a fair price and without out-of-pocket costs.

How will the merger affect the day-to-day operations?

The merger will have very little effect on First BancTrust or its subsidiary bank's operations. The bank will continue to conduct its existing operations in the same manner as now conducted. The certificate of incorporation and by-laws of First BancTrust and the bank will remain in effect and unchanged by the merger. The deposits of the bank will continue to be insured by the FDIC. After the merger is completed, the current officers and directors of the bank will continue to hold the positions each now holds with the bank, and the bank will continue to be regulated by the same agencies as before the merger.

Table of Contents

How was the cash price for shares of the common stock determined?

The board of directors retained Howe Barnes Hoefler & Arnett, Inc., an independent financial advisor experienced in the financial analysis and valuation of financial institutions, to assist the board in determining a fair price for the shares of common stock to be purchased by First BancTrust in the merger transaction. Howe Barnes delivered a valuation report to the board valuing a share of the common stock at \$11.00 per share. The board of directors considered the independent valuation and other factors and determined that the cash consideration under the merger agreement should be \$11.00 per share. Subsequently, Howe Barnes issued an opinion to the board of directors that the cash consideration to be paid in the merger is fair, from a financial point of view, to the stockholders of First BancTrust. A copy of the fairness opinion of Howe Barnes is attached as Appendix C to this proxy statement for your review.

May I obtain a copy of Howe Barnes valuation report?

In connection with Howe Barnes fairness opinion, Howe Barnes has prepared and delivered to First BancTrust a valuation report that details the valuation principles and methodologies used to determine the fairness of the proposed transaction. You or your representative (designated in writing) may inspect and copy the valuation report at First BancTrust's main office during regular business hours. You or your representative (designated in writing) may also receive a copy of the report upon written request and at your expense. Please send in your written request to the address set forth on the cover page of this proxy statement. Additional information or documentation may be requested from you if necessary to verify your identity or that of your representative or the authority of your representative.

The SEC also maintains a website that contains reports, proxy statements and other information about issuers, including First BancTrust, who file electronically with the SEC. The address of that site is <http://www.sec.gov>. First BancTrust has filed with the SEC a Rule 13e-3 Transaction Statement on Schedule 13E-3 in connection with the transactions described in this proxy statement. As permitted by the SEC, this proxy statement omits certain information contained in the Schedule 13E-3. A copy of the valuation report is attached as an exhibit to the Company's Schedule 13E-3 and is available for inspection electronically at the SEC's website.

When will the merger be completed?

We plan to complete the transaction during the fourth quarter of 2008 so that registration of the common stock can be terminated in the fourth quarter of 2008.

Should I send in my common stock certificates now?

No. After the merger transaction is completed, those stockholders who receive cash in the merger will receive written instructions for exchange of their common stock certificates for cash.

What is the purpose of the amendment?

The amendment will allow First BancTrust to slow the growth of its stockholder base by limiting transfers which would result in a stockholder holding of record fewer than 250 shares.

Who can help answer my questions?

If you have any questions about the special meeting or any of the items to be considered by the stockholders at the meeting, or if you need additional copies of the enclosed materials or proxy, you should contact: Terry J. Howard,

President and Chief Executive Officer, First BancTrust Corporation, 101 South Central Avenue, Paris, Illinois 61944.
His telephone number is 217-465-0260.

What do I need to do now?

Mail your signed proxy in the enclosed return envelope as soon as possible so that your shares may be represented at the meeting. If you sign and return your proxy but do not include instructions on how to vote,

Table of Contents

your shares will be voted FOR the proposal to approve and adopt the merger and the merger agreement and FOR the amendment.

For a more complete description of voting at the stockholders meeting, see the section entitled Information Regarding the Special Meeting of Stockholders beginning on page 30 of this proxy statement.

SPECIAL FACTORS

Background of the Merger Proposal

Overview. Of First BancTrust's 484 holders of record, approximately 258 hold fewer than 250 shares (not including beneficial owners whose shares may be registered in street name). Collectively, these 258 record holders (who comprise approximately 53% of all record holders) own an aggregate of approximately 27,779 shares, or 1.3% of our outstanding shares.

We have no direct knowledge of the number of shares of our common stock owned beneficially (but not of record) by persons who own fewer than 250 shares of our common stock and hold the shares in street name. The right to retain stock or receive cash as a result of the merger will be determined with reference to the number of shares held as it appears on First BancTrust's list of record stockholders as of the effective time of the merger. Thus, the rights of a beneficial owner of shares held in street name will be determined with reference to the number of shares held in aggregate by that bank, broker, financial institution or its depository or nominee as that holding appears on the stock records of First BancTrust, and not with reference to the number of shares owned by the ultimate beneficial owner of those shares. Therefore, if you are a stockholder who holds your shares in street name and hold fewer than 250 shares, you will be unable to predict whether you will be cashed out in the merger unless you take action to become a record holder on First BancTrust's stockholder list, rather than a holder in street name. Generally, this is accomplished by instructing your nominee in writing to re-register your shares in your name personally (or as you otherwise instruct other than in street name). Your nominee may have specific procedures in order to effect such re-registration so please contact your nominee promptly if you wish to re-register your shares.

If you are a record holder holding 250 or more shares and want to ensure that you are cashed-out in the merger, you must take some action to reduce your holdings below 250 shares prior to the close of business on the day preceding the effective time of the merger (e.g. by selling some of your shares, or re-registering a portion of them in another form jointly, for example, if you currently hold them individually). Correspondingly, if you are a record holder holding fewer than 250 shares but would like to remain a stockholder of First BancTrust, you must take some action to increase your shares up to 250 or more (e.g., by buying additional shares or consolidating your ownership if you hold shares in more than one form, for example, jointly and individually, or by transferring stock into street name with a broker that holds 250 or more shares). First BancTrust has assumed that a substantial portion of the beneficial owners of shares held in nominee with 250 or more shares and will remain stockholders of First BancTrust after the merger.

As a SEC reporting company, First BancTrust is required to prepare and file with the SEC, among other items, the following:

Annual Reports on Form 10-K;

Quarterly Reports on Form 10-Q;

Current Reports on Form 8-K;

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Forms 3, 4, and 5 required of executive officers and directors under Section 16 of the Securities Exchange Act; and

Proxy Statements and related materials as required by Regulation 14A under the Securities Exchange Act of 1934, as amended.

The costs associated with these reports and other filing obligations comprise a significant corporate overhead expense. These costs include securities counsel fees, auditor fees, costs of printing and mailing the SEC documents and the word processing, specialized software filing costs associated with the SEC reports and other filings, and

Table of Contents

considerable management's time and attention devoted to public reporting issues and the SEC's reporting requirements. These SEC registration-related expenses have increased since the adoption of the Sarbanes-Oxley Act in 2002 and comprise a significant portion of First BancTrust's overhead expense. (See Purposes of and Reasons for the Merger Proposal.)

Most of the requirements of the Sarbanes-Oxley Act are now effective and applicable to First BancTrust, and First BancTrust has implemented procedures intended to comply with those requirements. However, one very substantial requirement of the Sarbanes-Oxley Act, Section 404, will first be applicable to First BancTrust in connection with its annual report to be filed in the first quarter of 2010. In general terms, Section 404 of the Sarbanes-Oxley Act requires that management include in each annual report an assessment of the effectiveness of its internal control structure and procedures for financial reporting. Further, for First BancTrust's annual report to be filed in 2010, it will require that First BancTrust's registered public accounting firm attest to, and report on, this assessment. These requirements are expected to result in significant increased annual charges from First BancTrust's registered public accounting firm. The merger proposal is being made at this time, primarily to avoid the costs to be incurred in complying with Section 404 of the Sarbanes-Oxley Act and, secondarily to eliminate those costs that we currently incur as a result of having our securities registered under the Securities Exchange Act. The sooner the proposal can be implemented, the sooner First BancTrust will cease to incur the expenses and burdens associated with having our securities registered under the Securities Exchange Act and the sooner holders who are to receive cash in the merger will receive and be able to reinvest or otherwise make use of such cash payments.

Alternatives Considered. The board considered the following alternatives at its March 20, 2008 and April 21, 2008 board meetings, further details of which meetings are described in detail below. In making its determination, the board of directors considered other means of possibly achieving the same result, but rejected these alternatives for the reasons that follow. These alternatives were:

Tender Offer at a Similar Price. The board of directors was uncertain as to whether this alternative would result in securities being tendered by a sufficient number of record holders so as to accomplish the going private objective and to reduce recurring costs. The board found it unlikely that many holders of small numbers of shares would make the effort to tender their securities.

Reverse Stock Split. This alternative would accomplish the objective of reducing the number of record stockholders, assuming approval of the reverse stock split by First BancTrust's stockholders. In a reverse stock split, First BancTrust would acquire the interests of the cashed-out stockholders pursuant to an amendment to First BancTrust's certificate of incorporation to reduce the number of issued and outstanding shares of common stock such that the cashed-out stockholders would own less than one full share of First BancTrust common stock. First BancTrust would then distribute cash for the resulting fractional share interests. The reverse stock split and the merger would both achieve the same objective of reducing the number of record common stockholders, assuming stockholder approval. However, the reverse stock split had the disadvantage that it would result in an unreasonably high share price, or in the alternative, would require an immediate forward stock split to return the stock to its pre-reverse share price—a procedural step that would not be necessary utilizing a merger. The board viewed the merger alternative as preferable because it did not require this subsequent step.

After consideration of the various alternatives described above, the board determined that the merger proposal was the best choice for First BancTrust and its stockholders. First BancTrust estimates that, following the proposed merger, it should have approximately 226 stockholders of record, which will permit First BancTrust to terminate the registration of its securities under the Securities Exchange Act.

Board of Directors. Since the enactment of the Sarbanes-Oxley Act in 2002, management and the board of directors had become increasingly aware of the alternative of going private, as that alternative has been presented at industry conferences, in business publications and discussed generally among banking industry participants. Management and the board also became aware of going private transactions being effected by other community bank holding companies which are very similar to First BancTrust located in Illinois, Michigan, Ohio, and Indiana. On February 7, 2008, the board of directors held a meeting at which issues relating to going private were discussed. All members of the board of directors were present along with Mrs. Litteral and representatives of Howe Barnes.

Table of Contents

Howe Barnes discussed common reasons for going private, various risks and costs of going private and alternative structures of completing a going private transaction. Mrs. Litteral reviewed with the board the historical costs that would continue if First BancTrust continues as a reporting company. These costs were estimated at approximately \$173,700. In order to be conservative, these estimates reviewed by Mrs. Litteral with the board included the direct internal costs associated with the employment of a dedicated employee responsible for Sarbanes-Oxley Section 404 compliance but did not include any estimate of management time involved in department heads performing periodic testing of their control procedures, or Mr. Howard's or Mrs. Litteral's management time in overseeing these responsibilities. (See Purposes of and Reasons for the Merger Proposal.)

Mrs. Litteral then provided the board with an overview of the Sarbanes-Oxley Act and Section 404 in particular. Mrs. Litteral reviewed with the board current reporting requirements of First BancTrust as well as the additional requirements resulting from the full implementation of Section 404. Based on information received from First BancTrust's independent registered public accounting firm, Mrs. Litteral estimated that costs for the external audit of management's assessment of its internal controls which would begin to be required starting in 2010 would be between \$40,000 and \$80,000 per year. Mrs. Litteral further estimated that total annual employee costs to perform testing and ongoing monitoring of control procedures required under Section 404 including estimates of management time involved in department heads performing periodic testing of their control procedures, and Mr. Howard's and Mrs. Litteral's management time in overseeing these responsibilities was approximately \$177,500.

At that meeting, the board of directors authorized management to further investigate the feasibility of a going private transaction and to report back to the board at its April meeting.

The board of directors held a special meeting on March 20, 2008, which was attended all members of the board of directors, representatives of Howe Barnes, and Theodore L. Eissfeldt of Howard & Howard Attorneys P.C. Mrs. Litteral was also present. Mr. Eissfeldt discussed with the board the board's fiduciary responsibilities in considering a going private. He also discussed the alternative structures of and steps necessary to complete a going private transaction. Additional discussions took place regarding the feasibility and costs associated with a going private transaction. Management reported to the board regarding the number of stockholders who would likely receive cash in a going private transaction in order to achieve a reasonable number of stockholders to assure that the going private transaction would have ongoing success. Mrs. Litteral again reviewed with the board the costs that the company would continue to incur if First BancTrust continues as a reporting company.

At a special board meeting held on March 27, 2008, all members of the board of directors were present. The board discussed the need for the appointment of a financial advisor to perform a stock valuation and to ultimately render a fairness opinion in connection with such a transaction. Following that discussion, the board authorized management to engage the services of Howe Barnes to serve as financial advisor in connection with a possible going private transaction. The board also instructed management to move forward in exploring the going private transaction for consideration at the April, 2008 meeting of the board of directors. The engagement letter with Howe Barnes was executed by Mr. Howard on behalf of First BancTrust on April 14, 2008. Pursuant to the engagement, Howe Barnes agreed to:

meet with the board of directors and management of First BancTrust as necessary, either in person or telephonically;

identify alternative methods of effecting the transaction;

analyze the financial impact of the transaction and provide such written analysis to First BancTrust;

identify and evaluating other similar transactions; and

either (i) render an opinion in such form as it and First BancTrust shall consider appropriate, as to the fairness, from a financial point of view, to First BancTrust's common shareholders of the consideration to be paid by First BancTrust in the transaction or (ii) advise the board of directors that it is unable to render such an opinion due to the excessiveness of the consideration.

At the April 21, 2008 meeting of the board of directors of First BancTrust, which was attended by all First BancTrust directors, Mrs. Litteral, Mr. Eissfeldt and Kenneth Lovik and Andrew Ross of Howe Barnes, Mr. Eissfeldt

Table of Contents

summarized alternative legal structures associated with the proposed transaction, the terms of a proposed agreement and plan of merger by and between First BancTrust and a Delaware corporation to be formed to facilitate the proposed transaction and the steps necessary to complete the transaction.

Mr. Howard then requested Mr. Lovik and Mr. Ross from Howe Barnes to present the results of the valuation:

882,000 1,762,000 1,627,000

License

12,000 559,000 16,000 1,415,000

Total Revenues

4,600,000 5,041,000 8,509,000 10,414,000

Cost of Revenues

Subscription

557,000 1,023,000 1,113,000 2,099,000

Appliance

811,000 779,000 1,236,000 1,337,000

License

4,000 18,000 5,000 50,000

Total Cost of Revenues

1,372,000 1,820,000 2,354,000 3,486,000

Gross Profit

3,228,000 3,221,000 6,155,000 6,928,000

Sales and marketing expenses

2,065,000 3,414,000 3,881,000 7,474,000

Research and development expenses

746,000 1,789,000 1,499,000 3,647,000

General and administrative expenses

1,377,000 2,441,000 2,575,000 4,870,000

Total Operating Expenses

4,188,000 7,644,000 7,955,000 15,991,000

Loss from Operations

(960,000) (4,423,000) (1,800,000) (9,063,000)

Other (Income) Expense

Interest expense - net

157,000 59,000 300,000 72,000

(Gain) loss on sale of assets

- 251,000 (320,000) (3,463,000)

Other income

(180,000) - (444,000) (9,000)

Total Other (Income) Expense

(23,000) 310,000 (464,000) (3,400,000)

Loss Before Income Taxes

(937,000) (4,733,000) (1,336,000) (5,663,000)

Income tax expense

3,000 - 3,000 4,000

Net Loss

\$(940,000) \$(4,733,000) \$(1,339,000) \$(5,667,000)

Net Loss Per Common Share - Basic and Diluted

\$(0.06) \$(0.32) \$(0.09) \$(0.38)

Weighted Average Shares Outstanding - Basic and Diluted

14,772,367 14,764,512 14,772,096 14,779,434

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

St. Bernard Software, Inc.

Unaudited Consolidated Statement of Stockholders' Deficit

	Common Stock		Additional	Accumulated	Total
	Shares	Amount	Paid-in Capital	Deficit	
Balance at December 31, 2007	14,760,052	\$ 148,000	\$ 39,079,000	\$ (47,183,000)	\$ (7,956,000)
Common stock issued under the employee stock purchase plan	12,315	-	6,000	-	6,000
Stock-based compensation expense	-	-	334,000	-	334,000
Value of warrants issued	-	-	209,000	-	209,000
Net loss	-	-	-	(1,339,000)	(1,339,000)
Balance at June 30, 2008	14,772,367	\$ 148,000	\$ 39,628,000	\$ (48,522,000)	\$ (8,746,000)

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

St. Bernard Software, Inc.

Unaudited Consolidated Statements of Cash Flows

	Six months ended June 30,	
	2008	2007
Cash Flows From Operating Activities		
Net loss	\$ (1,339,000)	\$ (5,667,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	321,000	740,000
Allowance for doubtful accounts	11,000	(32,000)
Gain on sale of assets	(320,000)	(3,463,000)
Stock-based compensation expense	334,000	581,000
Noncash interest expense	122,000	2,000
Increase (decrease) in cash resulting from changes in:		
Accounts receivable	(525,000)	(92,000)
Inventories	(187,000)	4,000
Prepaid expenses and other assets	38,000	(24,000)
Accounts payable	(911,000)	(564,000)
Accrued expenses and other current liabilities	(242,000)	72,000
Deferred rent	51,000	-
Deferred revenue	582,000	1,031,000
Net cash used in operating activities	(2,065,000)	(7,412,000)
Cash Flows From Investing Activities		
Additional costs related to purchase of business	-	(83,000)
Purchases of fixed assets	(4,000)	(231,000)
Proceeds from the sale of assets	320,000	1,200,000
Net cash provided by investing activities	316,000	886,000
Cash Flows From Financing Activities		
Proceeds from stock option and warrant exercises	-	30,000
Proceeds from the sales of stock under the employee stock purchase plan	6,000	-
Principal payments on capitalized lease obligations	(74,000)	(51,000)
Net increase in short-term borrowings	896,000	2,042,000
Net cash provided by financing activities	828,000	2,021,000
Net Decrease in Cash and Cash Equivalents	(921,000)	(4,505,000)
Cash and Cash Equivalents at Beginning of Period	1,297,000	4,842,000
Cash and Cash Equivalents at End of Period	\$ 376,000	\$ 337,000
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	\$ 190,000	\$ 125,000
Income taxes	\$ -	\$ 2,000

Non Cash Investing and Financing Activities:

In January 2008, the Company amended its loan agreement with a bank. As a result, the Company issued warrants which allows the bank to purchase up to 140,350 shares of the Company's common stock at an exercise price of \$0.57 a share. Debt issuance costs of \$58,000 were recorded in connection with the issuance of the warrants. See Note 3.

In January 2008, the Company entered into a loan agreement with a lender. As a result, the Company issued a warrant which allows the lender to purchase up to 460,526 shares of the Company's common stock at an exercise price of \$0.57 a share. Debt discount of \$151,000 was recorded in connection with the issuance of the warrants. See Note 3.

During the six months ended June 30, 2007, the Company entered into capitalized lease obligations for the purchase of \$219,000 in fixed assets.

In April 2007, the shares issued in conjunction with the purchase of AgaveOne were reduced by 66,667 shares or \$250,000 as a result of indemnification claims.

In May 2007, the Company issued 100,000 warrants in conjunction with a loan agreement with a bank. See Note 3.

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

St. Bernard Software, Inc.

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

St. Bernard Software, Inc., a Delaware corporation (the “Company” or “St. Bernard”) is a software development company that designs, develops, and markets Secure Content Management, SCM, and policy compliance solutions to small, medium, and enterprise class customers. The Company sells its products through distributors, dealers, and original equipment manufacturers (“OEM”), and directly to network managers and administrators worldwide.

Basis of presentation

The consolidated balance sheet as of June 30, 2008, the consolidated statements of operations for the three and six months ended June 30, 2008 and 2007, the consolidated statement of stockholders’ deficit for the six months ended June 30, 2008, and the consolidated statements of cash flows for the six months ended June 30, 2008 and 2007, are unaudited and reflect all adjustments of a normal recurring nature which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations, stockholders’ deficit, and cash flows for the interim periods presented. The consolidated balance sheet as of December 31, 2007 was derived from the Company’s audited financial statements. Operating results for the interim periods presented are not necessarily indicative of results to be expected for the fiscal year ending December 31, 2008. These consolidated financial statements should be read in conjunction with the Company’s December 31, 2007 consolidated financial statements and notes thereto included in the Company’s Annual Report filed on Form 10-KSB with the Securities and Exchange Commission on March 20, 2008.

The consolidated financial statements include our accounts and those of our subsidiaries which include our operations in the UK and Australia; such entities were dissolved in 2007. All inter-company balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of the consolidated financial statements in conformity with U.S generally accepted accounting principles (“U.S. GAAP”) requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates. Significant estimates used in preparing the consolidated financial statements include those assumed in computing revenue recognition, the allowance for doubtful accounts, warranty liability, the valuation allowance on deferred tax assets, testing goodwill for impairment, and assumptions used to determine the fair value of stock options under Statement of Financial Accounting Standards, or SFAS, No. 123R (revised 2004), “Share-based Payment” (“SFAS 123R”).

Liquidity

As of June 30, 2008, the Company had approximately \$0.4 million of cash and cash equivalents and a working capital deficit of \$11.1 million. Approximately \$9.9 million of our current liability balance at June 30, 2008 consists of deferred revenues, which represents amounts that will be amortized into revenue as they are earned in future periods. The Company also had a stockholders’ deficit of approximately \$8.7 million at June 30, 2008.

The Company has a history of losses and has not been able to achieve profitability. For the three and six months ended June 30, 2008, the Company incurred net losses of \$0.9 million and \$1.3 million, respectively, and through June 30,

2008 has recorded a cumulative net loss of \$48.5 million. During the fourth quarter of 2007 and through the second quarter of 2008, the Company made substantial changes to the cost structure of its business. These changes included the closure of its sales and marketing offices within Europe, reducing headcount to be in line with the current size of its business, renegotiating vendor contracts, and refocusing its marketing strategy around its core business. In addition to the changes described above, the Company entered into a Loan and Security Agreement (the “PFG Loan Agreement”) with Partners for Growth II, L.P. (“PFG”) in July 2008 for the amount of \$1.5 million. See Note 7.

St. Bernard Software, Inc.

Notes to Consolidated Financial Statements

The Company believes that its existing cash resources, combined with projected billings for 2008, cost reductions implemented in the fourth quarter of 2007 and through the second quarter of 2008, and its borrowing availability under existing credit facilities, will provide sufficient liquidity for the Company to meet its continuing obligations for the next twelve months. However, there can be no assurances that projected revenue will be achieved or the improvement in operating results will occur. In the event cash flow from operations is not sufficient, the Company may require additional sources of financing in order to maintain its current operations. These additional sources of financing may include public or private offerings of equity or debt securities. Whereas management believes it will have access to these financing sources, no assurance can be given that additional sources of financing will be available on acceptable terms, on a timely basis, or at all.

Loss per common share

Basic loss per common share is calculated by dividing net loss by the weighted-average number of shares of common stock outstanding. Diluted loss per common share includes the components of basic loss per common share and also gives effect to dilutive common stock equivalents. Potentially dilutive common stock equivalents include stock options and warrants. No dilutive effect was calculated for the three and six months ended June 30, 2008 and 2007, respectively, as the Company reported a net loss in each period and the effect would have been anti-dilutive.

New accounting standards

In May 2008, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principle”. SFAS 162 will provide framework for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. SFAS 162 will be effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board (PCAOB) amendments to AU Section 411. The Company is currently evaluating the impact, if any, this statement will have on its financial position, cash flows, or results of operations.

On February 15, 2007, FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities”. SFAS No. 159 permits all entities to choose, at specified election dates, to measure eligible items at fair value (the “fair value option”). A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. The Company adopted SFAS 159 on January 1, 2008. The adoption of SFAS 159 did not have a material impact on its financial position, cash flows, or results of operations.

In September 2006, FASB issued SFAS No. 157, “Fair Value Measurements.” This Statement defines fair value, establishes a framework for measuring fair value in U.S. GAAP, and expands disclosures about fair value measurements. This statement applies in those instances where other accounting pronouncements require or permit fair value measurements and the board of directors has previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. The Company adopted SFAS 157 on January 1, 2008. The adoption of SFAS 157 did not have a material impact on its financial position, cash flows, or results of operations.

Reclassifications

Certain amounts in the 2007 financial statements have been reclassified to conform to the 2008 classifications. These reclassifications have no effect on previously reported net income.

9

St. Bernard Software, Inc.

Notes to Consolidated Financial Statements

2. Stock-based Compensation Expense

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R using the modified prospective method. Stock-based compensation expense for all stock-based compensation awards granted after January 1, 2006 are based upon the grant date fair value estimated in accordance with SFAS 123R.

The Company has non-qualified and incentive stock option plans (together, the “Plans”) providing for the issuance of options to employees and others as deemed appropriate by the Board of Directors. Terms of options issued under the Plans include an exercise price equal to the estimated fair value (as determined by the Board of Directors) at the date of grant, vesting periods generally between three to five years, and expiration dates not to exceed ten years from date of grant. The determination of fair value of the Company’s stock is derived using the value of the stock price at the grant date.

Calculating stock-based compensation expense requires the input of highly subjective assumptions, including the expected term of the stock-based compensation, expected stock price volatility factor, and the pre-vesting option forfeiture rate. The weighted average fair value of options granted during the six months ended June 30, 2008 and 2007 was calculated using the Black-Scholes option pricing model using the valuation assumptions in the table below. The Company estimates the expected life of stock options granted based upon management’s consideration of the historical life of the options and the vesting and contractual period of the options granted. The Company estimates the expected volatility factor of its common stock based on the weighted average of the historical volatility of three publicly traded surrogates of the Company and the Company’s implied volatility from its common stock price. The Company applies its risk-free interest rate based on the U.S. Treasury yield in effect at the time of the grant. The Company has no history or expectation of paying any cash dividends on its common stock. Forfeitures were estimated based on historical experience.

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Average expected life (years)	6.5	6.5
Average expected volatility factor	73.3%	74.0%
Average risk-free interest rate	3.8%	4.8%
Average expected dividend yield	0	0

Total stock-based compensation expense was approximately \$277,000 and \$321,000 for the three months ended June 30, 2008 and 2007, respectively, and \$334,000 and \$581,000 for the six months ended June 30, 2008 and 2007, respectively. The stock-based compensation expenses were charged to operating expenses. The earnings per share effect as a result of the stock based compensation expense was approximately \$0.02 for the three and six months ended June 30, 2008. The tax effect was immaterial.

The following is a summary of stock option activity under the Plans as of June 30, 2008 and changes during the six months ended June 30, 2008:

	Number of Shares Outstanding	Weighted Average Exercise Price
Options outstanding at December 31, 2007	2,074,861	\$ 1.77
Granted	472,000	\$ 0.58
Exercised	—	\$ —
Forfeited	(509,857)	\$ 1.64
Options outstanding at June 30, 2008	2,037,004	\$ 1.60

St. Bernard Software, Inc.

Notes to Consolidated Financial Statements

Additional information regarding options outstanding as of June 30, 2008 is as follows:

Range of Exercise Prices	Number of Shares Outstanding	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 0.36 to \$0.54	52,500	9.69	\$ 0.52	—	—
\$ 0.57 to \$0.57	375,000	9.41	\$ 0.57	—	—
\$ 0.58 to \$0.58	3,000	9.76	\$ 0.58	—	—
\$ 0.59 to \$0.59	331,977	8.81	\$ 0.59	35,977	\$ 0.59
\$ 0.60 to \$1.80	192,728	6.77	\$ 1.03	133,856	\$ 1.04
\$ 1.90 to \$1.90	275,000	8.47	\$ 1.90	136,812	\$ 1.90
\$ 1.95 to \$1.95	552,347	8.02	\$ 1.95	204,912	\$ 1.95
\$ 3.71 to \$3.71	177,666	6.94	\$ 3.71	114,852	\$ 3.71
\$ 4.75 to \$4.75	60,000	1.54	\$ 4.75	60,000	\$ 4.75
\$ 5.20 to \$5.20	16,786	4.10	\$ 5.20	16,786	\$ 5.20
\$ 0.36 to \$5.20	2,037,004	8.08	\$ 1.60	703,195	\$ 2.30

The aggregate intrinsic value of options outstanding and exercisable at June 30, 2008 was \$0. The aggregate intrinsic value of options outstanding and exercisable at June 30, 2007 was \$39,000. The aggregate intrinsic value represents the total intrinsic value based upon the stock price of \$0.51 at June 30, 2008.

As of June 30, 2008, there was approximately \$1.5 million of total unrecognized compensation expense related to unvested share-based compensation arrangements granted under the option plans. The cost is expected to be recognized over a weighted average period of 1.93 years.

3. Debt

Credit Facility

On May 15, 2007, the Company entered into a Loan and Security Agreement with Silicon Valley Bank, a California corporation (“SVB”). The Loan and Security Agreement with SVB was later amended during the first quarter of 2008 as discussed below.

On January 25, 2008, St. Bernard entered into an Amendment to the Loan and Security Agreement (the “SVB Loan Amendment”) with SVB, amending the Loan and Security Agreement entered into between St. Bernard and SVB on May 15, 2007. Pursuant to the terms of the SVB Loan Amendment, among other things, SVB (i) refinanced the existing term loan with the proceeds of an advance under the revolving line of credit (and terminated the term loan facility), (ii) reduced the revolving line of credit it will provide to St. Bernard to an amount not to exceed \$2,000,000, (iii) increased the interest rate on the revolving line of credit to 3% (from 2%) over the greater of the prime rate or 7.5%, (iv) modified the tangible net worth covenant, and (v) took a security interest in St. Bernard’s intellectual property. At June 30, 2008, the effective interest rate was 10.5%. At June 30, 2008 the Company was in compliance with the above stated covenants and restrictions.

St. Bernard Software, Inc.

Notes to Consolidated Financial Statements

In connection with the execution of the SVB Loan Amendment, St. Bernard issued warrants to SVB on January 25, 2008, which allows SVB to purchase up to 140,350 shares of St. Bernard common stock at an exercise price of \$0.57 per share. The warrants expire on the seventh anniversary of the issue date of the warrants. Accordingly, the Company recorded debt issue costs in the amount of \$58,000, based on the estimated fair value allocated to the warrants using the following assumptions; 75.35% volatility, risk free interest rate of 3.61%, an expected life of seven years and no dividends. Amortization of the debt issuance costs for three and six months ended June 30, 2008, which is being recorded as interest expense, was approximately \$11,000 and \$19,000, respectively. Furthermore, St. Bernard has agreed to grant SVB certain piggyback registration rights with respect to the shares of common stock underlying the warrants. As of June 30, 2008, the balance on the line of credit with SVB was \$1.9 million.

Bridge Loan

On January 25, 2008, St. Bernard Software, Inc. entered into a Loan Agreement (the "Agility Loan Agreement") with Agility Capital, LLC ("Agility"). Pursuant to the terms of the Agility Loan Agreement, Agility provided St. Bernard with a non-revolving term loan in the amount of \$750,000, at a 15% fixed interest rate (the "Agility Loan"). Beginning March 1, 2008, and on the first day of each month thereafter until July 1, 2008, St. Bernard is required to pay to Agility \$25,000 plus accrued but unpaid interest. Beginning July 1, 2008, and on the first day of each month thereafter, St. Bernard is required to pay Agility \$50,000 plus accrued interest. The obligations under the Agility Loan Agreement are secured by substantially all of St. Bernard's assets subordinated by the SVB Loan Amendment.

The Agility Loan Agreement contains customary affirmative and negative covenants and other restrictions. At June 30, 2008, the Company was in compliance with the above stated covenants.

In connection with the execution of the Agility Loan Agreement, St. Bernard issued warrants to Agility (the "Agility Warrants"), which allows Agility to purchase up to 460,526 shares of St. Bernard common stock at an exercise price equal to \$0.57 per share. The Agility Warrants expire on the seventh anniversary of their issue date. The Company estimated the fair value of the warrants to be \$189,000 using the following assumptions; 75.35% volatility, risk free interest rate of 3.61%, an expected life of seven years and no dividends. In accordance with Accounting Principles Board Opinion No. 14, the relative fair value of the warrants, estimated to be approximately \$151,000, was recorded as debt discount. Amortization of the debt discount for three and six months ended June 30, 2008, which is being recorded as interest expense, was approximately \$38,000 and \$63,000, respectively. The Agility Warrants contains anti-dilution protection in the event of a debt or equity financing, with respect to the exercise price and number of shares. Furthermore, St. Bernard granted Agility piggyback registration rights with respect to the shares of common stock underlying the Agility Warrants. As of June 30, 2008, the balance on the Agility loan was approximately \$650,000.

In July 2008, the entire outstanding balance on the Agility Loan was paid using the proceeds from a new loan (See Note 7).

4. Stockholders' Deficit

Warrants

As of June 30, 2008 and December 31, 2007, a total of 9,350,980 and 8,750,104 shares of common stock, respectively, were reserved for issuance for the exercise of warrants at exercise prices of \$0.57, \$1.60, \$1.85, \$2.98,

and \$5.00 per share. During the six months ended June 30, 2008, warrants to purchase an aggregate of 600,876 shares of common stock at an exercise price of \$0.57 per share were granted resulting in \$209,000 in compensation costs. There were no warrants that were exercised or expired during this period.

St. Bernard Software, Inc.

Notes to Consolidated Financial Statements

5. Related Party Transactions

During 2007, a stockholder and former member of the Board of Directors provided legal services to the Company in the ordinary course of business. Billings for such services totaled approximately \$14,000 for the three months ended June 30, 2007 and \$636,000 for the six months ended June 30, 2007. Amounts due at December 31, 2007 were approximately \$400,000. The Company settled the amounts due with this related party for approximately \$179,000 resulting in a gain of \$246,000 during the three months ended March 31, 2008. No such services were rendered in 2008.

The Company previously occupied office space provided by an affiliate of certain officers and directors of the Company. The Company paid this affiliate \$7,500 per month to lease 2,000 square feet of office space in Amsterdam. The lease was terminated on February 15, 2008.

6. Concentrations

Sales and revenue

The Company considers itself to operate within one business segment, Secure Content Management (“SCM”). For the six months ended June 30, 2008 and 2007, approximately 97% and 92%, respectively, of the Company’s revenue was in North America, the remaining 3% and 8%, respectively, were disbursed over the rest of the world.

7. Subsequent Events

On July 21, 2008, the Company entered into a Loan Agreement with Partners for Growth II, LP (“PFG”), which became effective on July 23, 2008. Pursuant to the terms of the PFG Loan Agreement, PFG provided St. Bernard with a revolving line of credit in the amount not to exceed the lesser of (a) \$1,500,000 at any one time outstanding or (b) up to 30% of the amount of St. Bernard’s aggregate Eligible Billings (as defined in the PFG Loan Agreement) over a rolling three month period calculated monthly.

The annual interest rate on the PFG Loan is set at the Prime Rate, quoted by Silicon Valley Bank as its Prime Rate from time to time, plus 3% (the “Applicable Rate”). St. Bernard is required to maintain a minimum borrowing amount of at least \$750,000 (the “Minimum Borrowing Amount”) or pay PFG a minimum interest amount (the “Minimum Interest Amount”) equal to \$750,000, multiplied by the Applicable Rate, and further multiplied by the number of days (based on a 360-day year) from the date of such failure to maintain the Minimum Borrowing Amount to the Maturity Date (as defined in the PFG Loan Agreement). Pursuant to the terms of the PFG Loan Agreement, St. Bernard paid PFG a one-time commitment fee of \$30,000 and agreed to reimburse PFG for PFG’s reasonable attorneys’ fees in connection with the negotiation of the PFG Loan Agreement.

Subject to the requirement to maintain the Minimum Borrowing Amount or pay the Minimum Interest Amount, St. Bernard may borrow, repay and reborrow from time to time until the Maturity Date. Proceeds of the initial loan amount were used to pay all indebtedness owing to Agility, with the remaining amount to be used for working capital.

The PFG Loan Agreement will terminate on July 20, 2010, on which date all principal, interest and other outstanding monetary obligations must be repaid to PFG. The obligations under the PFG Loan Agreement are secured by a security interest in collateral comprised of substantially all of St. Bernard’s assets, subordinated by the SVB Loan

Agreement.

The PFG Loan Agreement contains affirmative, negative and financial covenants customary for credit facilities of this type, including, among other things, limitations on indebtedness, liens, sales of assets, mergers, investments, and dividends. The PFG Loan Agreement also requires that St. Bernard maintain a Modified Net Income (as defined in the PFG Loan Agreement) greater than zero. The PFG Loan Agreement contains events of default customary for credit facilities of this type (with customary grace or cure periods, as applicable) and provides that upon the occurrence and during the continuance of an event of default, among other things, the interest rate on all borrowings will be increased, the payment of all borrowings may be accelerated, PFG's commitments may be terminated and PFG shall be entitled to exercise all of its rights and remedies, including remedies against the collateral.

In connection with the execution of the PFG Loan Agreement, St. Bernard issued a warrant to PFG on July 21, 2008 (the "Warrant"), which allows PFG to purchase up to 450,000 shares of St. Bernard common stock at an exercise price equal to \$0.46 per share. The Warrant expires on July 20, 2013.

PART II – OTHER INFORMATION

Item 6. Exhibits

- 3.1 Amended and Restated Certificate of Incorporation of St. Bernard Software, Inc. (formerly known as Sand Hill IT Security Acquisition Corp.) (incorporated herein by reference to Exhibit 3.1.1 to the Company's Registration Statement on Form S-4 initially filed with the Securities and Exchange Commission on December 16, 2005).
- 3.2 Amended and Restated Bylaws of St. Bernard Software, Inc. (formerly known as Sand Hill IT Security Acquisition Corp.) (incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K initially filed with the Securities and Exchange Commission on April 5, 2007)
- 4.1 Specimen Unit Certificate of St. Bernard Software, Inc. (formerly known as Sand Hill IT Security Acquisition Corp.) (incorporated herein by reference to Exhibit 4.1 to the Company's Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-114861) filed with the Securities and Exchange Commission on June 23, 2004).
- 4.2 Specimen Common Stock Certificate of St. Bernard Software, Inc. (formerly known as Sand Hill IT Security Acquisition Corp.) (incorporated herein by reference to Exhibit 4.2 to the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission on March 20, 2008).
- 4.3 Specimen Warrant Certificate of St. Bernard Software, Inc. (formerly known as Sand Hill IT Security Acquisition Corp.) (incorporated herein by reference to Exhibit 4.3 to the Company's Amendment No. 2 to the Registration Statement on Form S-1 (File No. 333-114861) filed with the Securities and Exchange Commission on June 23, 2004).
- 4.4 Unit Purchase Option No. UPO-2 dated July 30, 2004, granted to Newbridge Securities Corporation (incorporated herein by reference to Exhibit 4.4.1 to the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission on March 31, 2005).
- 4.5 Unit Purchase Option No. UPO-3 dated July 30, 2004, granted to James E. Hosch (incorporated herein by reference to Exhibit 4.4.2 to the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission on March 31, 2005).
- 4.6 Unit Purchase Option No. UPO-4 dated July 30, 2004, granted to Maxim Group, LLC (incorporated herein by reference to Exhibit 4.4.3 to the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission on March 31, 2005).
- 4.7

Unit Purchase Option No. UPO-5 dated July 30, 2004, granted to Broadband Capital Management, LLC (incorporated herein by reference to Exhibit 4.4.4 to the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission on March 31, 2005).

- 4.8 Unit Purchase Option No. UPO-6 dated July 30, 2004, granted to I-Bankers Securities Incorporated (incorporated herein by reference to Exhibit 4.4.5 to the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission on March 31, 2005).
- 4.9 Warrant issued by St. Bernard Software, Inc. on May 16, 2007 to Silicon Valley Bank (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 23, 2007).
- 4.10 Warrant issued by St. Bernard Software, Inc. on January 25, 2008 to Agility Capital, LLC (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 31, 2008).
- 4.11 Warrant issued by St. Bernard Software, Inc. on January 25, 2008 to Silicon Valley Bank (incorporated herein by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on January 31, 2008).

10.1* St. Bernard Software, Inc. 2008 Variable (Bonus) Compensation Plan (incorporated herein by reference to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 28, 2008).

31.1 Certification of Chief Executive Officer and Acting Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer and Acting Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Management contract or compensatory plan or arrangement

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this amended report to be signed on its behalf by the undersigned thereunto duly authorized.

ST. BERNARD SOFTWARE, INC.

Date: August 26, 2008

By: /s/ Vincent Rossi
Vincent Rossi
Chief Executive Officer
Acting Chief Financial Officer