



What the Bear Stearns Bailout Means for Bank of America's Acquisition of Countrywide

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I am surprised the market is betting on B of A increasing its bid for Countrywide. To the contrary, I believe the implications of the JPMorgan acquisition of Bear Stearns (even at the higher "bargain price") are not positive for Countrywide shareholders. The structure and terms of the JP Morgan acquisition of Bear Stearns should clearly elevate speculation that the Bank of America acquisition of Countrywide will never be consummated –certainly not on the terms originally announced.

Jamie Dimon and Kenneth Lewis are among the most highly regarded CEOs in financial services today. However, the contrast between these two transactions may prove defining in the reputation of each of these business leaders going forward.

The similarities in the dire circumstances preceding each of the transactions have much in common, yet the outcomes are vastly different. In each case, the acquirer had a longstanding relationship with the company to be acquired.

In the case of Countrywide, imminent failure or a bankruptcy filing would have posed considerable risks of further panic in the marketplace and rippling effects well beyond mortgages and housing. Recall, at the critical moment in time, Countrywide was the single largest borrower of the Federal Home Loan Bank of Atlanta – to the tune of \$51 billion. These advances were secured by collateral of dubious value. A filing by Countrywide would have presented the Federal Reserve and the Federal Home Loan Bank System with circumstances it had never before faced, and would have had an immediate adverse impact on every other member/shareholders of the Atlanta FHLB.

Additionally, Countrywide is the loan servicer on 1 out every 5 home loans across the nation, not to mention the issuer of hundreds of billions in mortgage backed



securities that contain representations and warranties regarding the underlying mortgage loans. It is virtually impossible to assess the mayhem that would follow should the administration of those loans be disturbed in bankruptcy as a result of the claims of creditors and the immediate need to shed overhead.

Similarly, the collapse of Bear Stearns also presented widespread panic throughout the credit markets, virtually elevating concerns about counterparty risk between all institutions and posing the threat of further freezing up of capital market transactions and liquidity.

Now let us look at the transactions as they stand at this point in time. The acquisition price for Countrywide at \$4 billion (\$7 dollars a share) represents approximately 20% of Countrywide's book value. At the time, this huge discount was a hedge against the myriad of contingent liabilities and distressed assets that came along with the "bargain price". Yet the contingencies are considerable and virtually incapable of estimation. There are multiple private class action suits, SEC investigations, and off balance obligations relating to the hundreds of billions of dollars in loans sold over recent years.

On the other hand, the \$ 1.2 billion (\$10 dollars per share) deal virtually mandated by the Federal Reserve represents less than 11% of book value. More significantly, JP Morgan managed to negotiate for the Federal Reserve to guarantee the exposure presented by \$29 billion of the most illiquid and toxic assets on Bear Stearns' balance sheet.

Under these circumstances, how can the Countrywide acquisition move forward as announced? In fact, the most recent stock prices for Bear Stearns and Countrywide are a clear indication of the validity of this assessment. Countrywide continues to trade at a considerable discount to the acquisition price, whereas Bear Stearns continues to trade at a considerable premium over the \$10 acquisition price.

No doubt the discount in the case of Countrywide reflects the risks of intervening calamities that could arise prior to the announced August closing. On the other hand, the premium associated with the Bear Stearns acquisition reflects a level of confidence that there is enough shareholder leverage that the Fed may cajole JP Morgan into increasing its acquisition price to insure shareholder approval.

Mr. Lewis is under considerable pressure, both externally and by the need to demonstrate he deserves to share the same esteem as Mr. Dimon in terms of business acumen and the value that he brings to shareholders. With this in mind, it is hard to imagine the Countrywide acquisition closing consistent with the announced terms, without similar assurances from the Federal Reserve or a renegotiation of terms. In the absence of direct support from the Fed, the



transaction will no doubt be renegotiated at a reduced price and will be limited to an asset purchase of the Bank subsidiary and the technology platform. The mortgage banking business that has been the core of Countrywide's legacy will be abandoned.

Of course, as the market has demonstrated over the last year, anything can happen in four months.

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