

BofA Warrants May Offer Bidders 30% Profit in 30 Days

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The U.S. Treasury Department's auction of bailout warrants tied to Bank of America Corp. may raise about \$1 billion if bidders conclude it's their third chance to earn 30 percent in a matter of weeks.

The sale, planned for sometime in the next month, covers 272.2 million warrants in Bank of America, the biggest U.S. lender. It's the largest auction since December, when 88.4 million warrants for JPMorgan Chase & Co. sold for \$950.3 million. Those jumped 36 percent in the next 29 days. Warrants from an earlier \$148.7 million auction tied to Capital One Financial Corp. soared 34 percent in four weeks.

The prospect of a similar windfall may tempt investors to bid in the Bank of America auction, which the Treasury announced Feb. 18. The department is trying to fulfill a vow by President Barack Obama to recover "every single dime" of bailout money while divesting stakes in U.S. banks as soon as possible.

"You have a motivated seller in the Treasury," said Gary Townsend, president of Hill-Townsend Capital LLC of Chevy Chase, Maryland, which specializes in financial firms. "Everyone knows that they want the cash, so it is going to get sold for less than it is worth."

Chance to Negotiate

The Bank of America auction covers two sets of warrants granted to the Treasury when the Charlotte, North Carolina-based company took bailouts totaling \$45 billion under the Troubled Asset Relief Program.

After paying back TARP money, which Bank of America did in December, banks get a chance to negotiate a price to buy back the warrants. If talks fail, the warrants are auctioned; banks get none of the proceeds.

The securities grant holders the right to buy Bank of America common stock at pre-set prices for 10 years. One block of 121.8 million warrants set the exercise price at \$30.79 a share. A second block of about 150.4 million warrants convert at \$13.30. Bank of America closed at \$16.33 yesterday on the New York Stock Exchange.

"There will be very strong demand for these securities," said Tim Freeman, head of U.S. equity derivatives sales at Capstone Global Markets LLC in New York. The warrants with the \$30.79 target may sell for \$1.50 to \$1.70 each, he said, "and I'd view them to be very attractive at those levels."

Negotiated Deals

Treasury spokesman Andrew Williams declined to comment. The department said Jan. 20 its auctions raised more than JPMorgan and Capital One offered to buy back their warrants. The JPMorgan sale topped the bank's offer by 15 percent, according to Treasury data. The single biggest TARP warrant sale was a \$1.1 billion buyback negotiated with Goldman Sachs Group Inc.

The auctions began after the Congressional Oversight Panel said July 10 that the Treasury sold warrants back to 11 small banks in negotiated deals for about 66 percent of their value. After auctions began, the Treasury's take improved to 92 percent of the estimated value, the panel said in a Feb. 10 report.

Bank of America's warrants could be worth as much as \$2.58 billion and as little as \$578.9 million, with a best estimate of \$965.5 million, the report said. Deutsche Bank Securities is managing the auction. John Gallagher, a spokesman for Frankfurt-based Deutsche Bank AG, and Bank of America's Scott Silvestri declined to comment.

"They've designed a fair game, and the fair game encourages you to play," said Clay Struve of Chicago-based CSS LLC, who bought warrants in the December auctions and plans to bid for Bank of America warrants. "You can't complain that they sold them too cheap if they do it in an auction."

Dividends

Bidding may be restrained because the warrants with the higher exercise price are hard to value accurately, Struve said. The \$30.79 target is almost double Bank of America's current price; the conversion for the JPMorgan warrants was within 3 percent of its stock at the auction.

Paulson & Co., the hedge fund run by billionaire John Paulson that counts Bank of America among its largest holdings, told investors in a quarterly letter that the stock might rise to almost \$30 by December 2011. As of Dec. 31, Paulson's firm owned \$249.6 million of JPMorgan's TARP warrants, according to a filing by the firm. The stake of 18.7 million warrants amounts to 21 percent of the JPMorgan issue. Paulson spokesman Armel Leslie declined to comment.

"The bet is what do you think of the macro economy," said Yu-Dee Chang, who oversees \$140 million in assets as chief executive officer of ACE Investment Strategists LLC in McLean, Virginia. "If we're not going to go through another turmoil, these warrants are good buys," he said.

Sensitive to Dividends

The Bank of America warrants with the \$30.79 exercise price are sensitive to how quickly the bank will restore its quarterly dividend, which was slashed in January 2009 to one penny from 32 cents, Struve said.

Cash distributed to current shareholders hurts the value of warrants, Struve said. While some warrants compensate by lowering the exercise price if dividends are raised, this set of Bank of America warrants adjusts only if the payout exceeds 32 cents, according to company filings. JPMorgan's warrants carried less risk tied to dividends, Struve said.

Investors sitting out this sale include Glenn Tongue, managing partner at T2 Partners Management LP in New York.

"JPMorgan was better merchandise," said Tongue, who bought JPMorgan warrants after the auction. "They are selling something more akin to discount merchandise."

Past performance is not necessarily indicative of future results. The risk of loss exists in futures trading.