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Hovde Gets Back In The FDIC Game: Q&A With Joseph Thomas

Washington-based Hovde Private Equity Advisors LLC focuses exclusively on financial services deals. Over the last couple years, however, when other firms invested in banks in a major way, Hovde sat on the sidelines, seeing valuation getting a bit too high. It recently pulled the trigger, forming a new bank holding company that bought failed Bay National Bank from the Federal Deposit Insurance Corp. We caught up with Managing Director Joseph Thomas.

Q: What is your investment thesis for Bay Bank?

We believe the Baltimore-Washington metropolitan statistical area is a great market in which to operate a community bank because of the recent consolidation of incumbent banks and the robust local economy supported by the expansion of the federal government. Once the bank is stabilized, Bay Bank will primarily pursue organic growth with an expanding banking officer team and over time evaluate additional failed bank acquisitions as well as in-market consolidation opportunities.

Q: Hovde has participated in the FDIC-assisted transactions before via its investment in Sunwest Bank in Orange County, California. Tell us more about that investment.

Sunwest was an investment made by Hovde principals' with partner capital in the mid-1990s. During this economic downturn, Sunwest has acquired three banks from the FDIC, two in California and one in Arizona. All of these were whole bank transactions structured as a purchase and assumption without loss sharing. This investment strategy enables the bank to grow assets at attractive valuations and to build out the core franchise in the target markets.

Q: Where do you see banks' valuation nowadays?

As for failed banks, the pricing on larger transactions has become more competitive as evidenced in the small negative bids offered by the strategic players (existing banks). However, we continue to see more attractive opportunities for smaller failed banks – those with \$500 million or less in assets – where there is less competition and we have a competitive advantage. As for healthy banks seeking to recapitalize, the market has generally been open, but at more depressed valuation levels as compared to a couple years ago. Any bank with legacy credit issues will likely need to raise capital at a discount to book value.

Q: Some firms have said the [FDIC guidelines](#) on failed bank acquisition are too restrictive and aren't conducive to attracting private investment. What do you think?

There are three main aspects of the FDIC statement of policy which are all focused on the health and ownership intent of the assuming entity. First, there is the 10% Tier 1 common equity requirement. We expect regulatory capital levels to gravitate



Joseph Thomas

Hovde

higher under all circumstances and we are able to generate our target returns with that requirement in place. The second aspect is the three-year holding period. We are a long-term investors and we expect that the acquired bank will not have maximized its franchise and valuation attributes any time before three years. Therefore the liquidity constraint is not an issue for our fund. And lastly, there are limitations on related transactions between affiliates, as well as cross-guarantee requirements. All of our activities are focused on the financial services industry and we are comfortable with these requirements. Financial Services Partner Fund I has become a thrift holding company in conjunction with the Bay Bank acquisition.

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