Pacific Capital’s Ford infusion

Texas billionaire saves region’s largest bank with $500M

By Stephen Nellis and Marlize van Romburgh  
Staff Writers

Pacific Capital Bancorp’s $500 million rescue by a private equity firm would spread the pain among shareholders, debt holders and the U.S. Treasury. But it also spreads the upside if the bank recovers, and in the meantime it might be the only way to keep the Santa Barbara Bank & Trust name alive in the Tri-Counties.

Pacific Capital is by far the largest banking company in the region, with a $4.9 billion loan portfolio and more than 30 branches spread throughout the Tri-Counties. It has struggled with $500 million in losses, driven by bad real estate loans, since the second quarter of last year. A year ago, Pacific Capital entered a voluntary agreement with the U.S. Treasury and the Federal Deposit Insurance Corp. to boost tier-one capital into the region.

The rise and fall of a regional banking giant

1998: Santa Barbara Bancorp acquires three banks, establishing itself as a regional powerhouse.


2005: Buys First Bank of SLO; assets stand at $8.7 billion.

2008: Takes $188 million in federal government cash under the program later known as TARP.

2010: Announces $41.8 million quarterly loss. Later lays off 300 employees.


April 2009: Agrees to boost tier-one leverage ratios; later misses targets, as stock heads toward low of 99 cents.

April 2009: Ford TARP deal.


April 2010: Ford Fund deal.

Stock price: $10

Jan. 2009: Stock price: $32

April 2009: Stock price: $19

April 2010: Stock price: $7

May 2010: Stock price: $23

Graphic by Marlize van Romburgh

A new deal for a new banking era

Every financial crisis breeds its own solutions.

In the case of Pacific Capital Bancorp, the region’s largest financial institution, that solution is something called a “recapitalization.” As belittles the era of the hybrid, the proposed $500 million cash injection by Dallas-based Ford Financial Group is part sale and part workout, all done with a wink and a nod from regulators who must yet approve it. Maybe this one should be called the Ford infusion.

By any name, the second largest transaction in the region’s banking history provides a way out for a Federal Deposit Insurance Corp. that’s exhausted its coffers taking over and liquidating failed banks.

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Executive summary:

• The Ford fund would end up with between 80 percent and 91 percent of Pacific Capital.

• Current shareholders will be diluted heavily but have a chance to buy up to 20 percent of Pacific Capital at the same 20 cents a share Ford will pay.

• The U.S. Treasury would take common stock at 20 cents a share instead of cash for its $180 million in Troubled Asset Relief Program, or TARP, money.

• Debt holders will take a hit, with cash-out offers for as low as 20 cents to 30 cents on the dollar.

Earnings hint at rebound

By Marlize van Romburgh  
Staff Writer

Even as the region’s largest bank grabs on to a $500 million lifeline, smaller banks in the Tri-Counties reported mixed first quarters and plans to bring much-needed capital into the region.

Many of the region’s banks found their income statements back in the black and saw deposits grow during the first quarter. Many worked to get problem assets off the books — particularly sour real estate loans.

“Bank is a reflection of the local economy, so that tells me the economy is beginning to improve,” said Sung Won Sohn, a CSU Channel Islands professor and former Wells Fargo economist. “More specifically, banks are enjoying very low cost of deposits right now. And asset quality is beginning to improve.”

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Who’s Who in Professional Services

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InTouch raises $10M

Power-One leads earners

GREEN COAST

Ventura’s green biz push

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Ford has a history of buying low, selling high

By Stephen Nellis and Marlize van Romburgh
Staff Writers

Gerald Ford, the 65-year-old Texas billionaire who stands to own as much as 91 percent of the Tri-Counties’ largest bank- ing company, bought his first bank in 1975 for $12 million and, along with partners, sold it for $100 million.

He did the same thing in the mid-1990s, scooping up San Francisco and Los Angeles thrifts from the ashes of savings and loan crisis to assemble Golden State Bancorp, which he sold to Citigroup in 2002 for $6 billion.

“One of our core competencies is dealing with trouble and problems,” Ford told the Business Times. “California was pretty bleak at the time. Banking had some troubles, but we didn’t think [California] was going to fall into the ocean. We’d see Texas recover.”

Ford Financial Fund is controlled by Ford, the former CEO at California Federal Bank, and Carl Webb, that bank’s former president and chief operating officer.

At that stage, Ford would pay 20 cents a share for newly created stock. His fund would own 91 percent of the company’s common stock, the U.S. Treasury would own 7 percent and today’s shareholders would own 2 percent.

“We wouldn’t have entered into an agreement like this we didn’t feel we had a strong chance of closing,” George Leis, CEO of Pacific Capital, told the Business Times.

The proposal would also give shareholders — who have seen prices drop from more than $30 per share in recent years to around the $1 mark — a chance to buy in at the same 20-cent-a-share price as Ford. Current investors would be allowed to buy as much as 20 percent of the company’s total stock, changing the final ownership profile and raising as much as $100 million in capital for the bank.

Montecito investor Herbert Tew, who recently sold Pacific Capital shares at a profit after buying in at around $2, said he was intrigued by the possibility of investing again. Shareholders will be able to exercise a right to buy an additional 13 shares at 20 cents for every share purchased under the deal.

“They have a leadership position in the market and they’ve been able to grow deposits,” despite taking huge losses, Tews said. “There is tremendous wealth in the city of Santa Barbara.”

But today’s investors are hurting. At the company’s annual shareholder meeting April 29, Irwin Pomerantz, a Los Angeles accountant who has held stock in the company since it was first offered 50 years ago, thanked Leis for taking action to save Pacific Capital. But he said he held Leis and the rest of Pacific Capital’s management responsible for the bank’s woes.

“I frankly find it hard to forgive you for what’s happened,” Pomerantz said. “It’s like reaching out to save myself from drowning.”

Ford is aware of the how badly Pacific Capital needs the cash. “[The deal] requires everybody in the capital structure to work together,” he said. “Basically, it boils down to, Can they be better economically advantaged in a transaction such as this, versus the alternative?”

A TALE OF TWO SALES

Without Ford’s cash, one alternative is that Pacific Capital could fail, wiping out shareholders, debt holders and the U.S. Treasury’s stake alike.

“It was evident that the regulators weren’t going to stand much longer without them raising significant amounts of capital,” said Carrol Pruett, the former long-time top executive at Mid-State Bank & Trust.

Ford’s cash could mean the bank need more resources in the future, he’s going to be digging into his pockets and probably coming up with more. “We’d be very involved with the management of the bank,” he said.

At the shareholder meeting, Ed Birch, chairman of Pacific Capital’s board, sought to assure investors that the Ford group is likely to clean up the bank. “The full focus of the company is to get this transaction completed,” he said.

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with federal regulators to boost its capital levels, but it missed the targets laid out for it each step of the way.

That left the company little choice but to find a major investor. At about 3:45 a.m. on April 29, the company signed a $500 million deal to sell up to 91 percent of Pacific Capital to Ford Financial Fund.

The private equity fund is controlled by Texas billionaire Gerald Ford, who made his fortune buying troubled banks and cleaning them up and selling them for huge returns.

“They are willing to put their money where our mouth is.”

Ford has his appetites, but no current bank of his own. That means the Santa Barbara Bank & Trust logo is likely to remain, experts said.

“The fact that it’s not another bank buying them is probably a good thing,” said Janet Garufis, the chief executive of Bank of Santa Barbara.

Ford has his eyes on the Tri-Counties market.

INSIDE THE DEAL

In exchange for putting half a billion dollars at risk, Ford is asking for deep concessions all around.

Pacific Capital is expected to translate the $180 million in Troubled Asset Relief Program funds the bank took on at the height of the financial crisis into common stock at 20 cents a share. It would ask some debt holders to cash out at as little as 20 cents to 30 cents on the dollar — provisions the bank will need to get approved in order to seal the deal.

Leis
CEO, Pacific Capital

“Ford is a very heavy hitter.”

Carrol Pruett
Former CEO, Mid-State Bank & Trust

The Ford group is likely to clean up the back end of the bank with some serious cost-cutting and write-offs, but likely will leave the front end as untouched as possible, experts said.

“He has deep pockets,” said Sohn Won Sohn, an economics professor at CSU Channel Islands and the former chief economist for Wells Fargo. “Should the bank need more resources in the future, he’s going to be digging into his pockets and probably coming up with more.”

Ford got a 22-million-share block of Citi worth more than $1 billion in his Golden State Bancorp deal. Though Citi took a beating, losing more than 90 percent, Ford told Forbes he hedged his shares with $80 million in puts, and lost only 10 percent in selling out his stake.

And his plans for Pacific Capital? Ford said he intends to be hands-on.

“We’d be very involved with the management of the bank,” he said.

Arroyo Grande-based Mid-State — then Pacific Capital’s main regional banking competitor — when Dutch giant Rabobank bought it in 2007. Although Mid-State was much smaller than Pacific Capital is now, the bank sold for $870 million.

Those were different times, Pruett said. Mid-State’s leaders saw a looming housing and market crash and couldn’t pass up Rabobank’s cash offer. “The Mid-State transaction was over 20 times earnings and four times book [value],” he said. “It was somewhat of a historical high.”

WHAT’S NEXT?

Pacific Capital cut hundreds of positions this year but still has more than 1,000 employees. What happens to Santa Barbara Bank & Trust and Pacific Capital’s other brands after the sale? “The boring answer is nothing,” Leis said, adding that bank would see “business as usual and the comfort of knowing that if we complete this transaction, our company is on firm footing.”

At the shareholder meeting, Ed Birch, chairman of Pacific Capital’s board, sought to assure investors that the Ford would help the company with its mission to steer back to its community banking roots.

“This is not an absentee landholder,” Birch said. “They’re not going to do anything to foul up this franchise. They understand what makes it valuable.”

The deal still needs approval from federal regulators and assent from debt holders. Either side can walk away before Oct. 26, but Pacific Capital would face breakup fees of as much as $20 million.

“The full focus of the company is to get this transaction completed,” Leis said.
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And it means that because of its size and market share, the parent of Santa Barbara Bank & Trust was able to hang on long enough to be deemed just a smidge too big to fail.

According to several knowledgeable people I spoke with, the deal that put Gerald Ford’s Ford Financial Fund together with Pacific Capital came together after a number of larger financial institutions — including Wells Fargo, Zions Bancorp and Union Bank — kicked the tires but didn’t get to a deal. Wells Fargo was distracted when it acquired Wachovia in late 2008, and Zions ran into its own problems.

Meanwhile, some people think the FDIC was unwilling to provide guarantees to Union, whose parent company is based in Japan, to backstop Pacific Capital’s bad loans.

Into the void stepped Ford and his Ford Financial Fund. The team that had taken over First Nationwide from Ford Motor Co., and transformed it from a sickly savings and loan into the profitable Cal Fed, had bid unsuccessfully for failed banks in the past.

When it came to Pacific Capital, Ford engineered a bid that on paper looks like a 91 percent takeover, which gives the government about 7 percent of the company and leaves current investors with just 2 percent of the stock.

But the deal also gives the shareholders a chance to play a second round with Ford Financial Group, providing an option to buy roughly 15 new shares at 20 cents for each share they own. And by potentially raising an additional $100 million from shareholders, it lets the FDIC off the hook completely for backstopping any bad loans.

This hybrid sale aligns regulators, shareholders, employees and customers behind a transaction that would leave the branch operations, the brand and the geographic footprint intact.

For the U.S. Treasury, a failure of Pacific Capital would have put the Treasury’s $180 million in TARP funds at risk and reduced its warrants to zero. Instead, the government will trade some debt for stock, get accrued dividends and exercise its warrants at 20 cents per share. If the stock price trades at much over $1 per share, the Treasury could turn a small profit.

Not selling to a bigger institution allows Santa Barbara Bank & Trust and the other brands to live on and, given recently signed employment contracts, management will remain in place. Will Ford Financial sell, the way it sold Cal Fed’s parent to Citigroup? We’ll just have to wait.

For the regional economy, this deal means perhaps the beginning of the end for the commercial real estate lending crunch. Along with capital raises at other local banks, Pacific Capital’s hybrid sale means something like $750 million in capital will be raised by area banks over the next year or two.

After Rabobank’s purchase of Mid-State Bank & Trust for $870 million several years ago, Pacific Capital was the dominant independent bank in much of the region. Having it — and the rest of the emerging “middle class” of $1 billion asset banks — with strong balance sheets likely will be crucial to reviving the tri-county economy.

Meanwhile, across the West, regulators announced a hybrid recapitalization at Sterling Financial of Spokane, Wash.

For the tri-county region and the U.S. financial system, the hybrid recap may be the biggest innovation in banking since the ATM.

INTOUCH
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— we call them our spoke providers — it can provide a source of referrals that can enhance their revenue potential.”

Though it remains to be seen which health care technologies will prove winners after the overhaul bill, investors likely will have an appetite for placing their bets, said Brent Reinke, a partner in the Westlake Village office of Musick, Peeler & Garrett who advises technology companies.

“If they’re going to position themselves as a provider in the middle of [the health-care overhaul], I think there are interesting opportunities,” Reinke said. The recent IPO uptick doesn’t mean the tech boom is back, he said, “but it does indicate that there’s an increased willingness and opportunity for companies to test the public markets.”

Access to these markets doesn’t come free. Though Sarbanes-Oxley compliance costs have come down for smaller companies, InTouch will still have to institute financial controls and become quick at accounting.

“You have a very short timeline on reporting,” said Jeff Hass of Farber Hass Hurley, an accounting firm that handles publicly traded companies. Some companies must report 45 days after the quarter closes, he said.

InTouch’s most recent funding came from the InvestMichigan Growth Capital Fund, which is charged with providing capital to early stage companies with Michigan operations. Adornetto said InTouch has 50 robots and its largest customer in the Wolverine State, with plans to deepen its ties.

“We’re going to take advantage of a highly trained engineering base in Michigan and develop an engineering group there,” Adornetto said. “There’s a definite connection there with robotics in the auto industry, there’s a base in place and a focus at the University of Michigan.”

And while research and prototyping manufacturing will remain at InTouch’s South Coast headquarters, Adornetto said, large-scale manufacturing of InTouch’s robots “could be a good fit for Michigan down the road.”

“We’ve got a bank we can count on, and that counts for a lot.”

Own your own business is all about change. Seizing new opportunities. Adjusting to a shifting marketplace.

To successfully manage that change, it’s important to work with a bank that can support you over time. One that’s financially sound and known for a long-standing commitment to our local business community.

That bank is Montecito Bank & Trust. We provide a full complement of services from cash management to business financing. And many of our clients have been with us for decades.

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