Bank of America to acquire Countrywide

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Bank of America said Friday it will buy Countrywide Financial for $4.1 billion in stock, a deal that rescues the country's biggest mortgage lender and expands the financial services empire of the nation's largest consumer bank.

The acquisition will make Charlotte-based Bank of America Corp. the nation's biggest mortgage lender and loan servicer.

Bank of America said it initially plans to operate Countrywide separately under the Countrywide brand, with integration occurring no sooner than 2009.

The transaction represents a 7.5 percent discount to where Countrywide shares ended Thursday after they soared on news that a rescue plan was in the works. It also effectively leaves Bank of America with a big loss on its $2 billion August investment in Countrywide Financial Corp. during the height of the summer's global credit crisis.

An aggressive dealmaker who has already snapped up behemoths FleetBoston Financial and MBNA, Bank of America chief executive Ken Lewis this time isn't buying a financial winner. Delinquencies and loans in pending foreclosure are rising in Countrywide's loan portfolio, and Lewis said Friday "there are near-term challenges" in the nation's housing market.

But Countrywide's troubles have allowed Lewis to sweep in and add a major business line to his supermarket of financial products on the cheap.

"Countrywide presents a rare opportunity for Bank of America to add what we believe is the best domestic mortgage platform at an attractive price and to affirm our position as the nation's premier lender to consumers," Lewis said in a statement.

It also places Lewis in the position of a market savior. By buying Countrywide, he's keeping the industry and regulators from the messy task of figuring out who would take on the responsibility of collecting payments for the 9 million U.S. home loans serviced by the Calabasas, Calif.-based lender. Lewis said Friday there was no government support for Countrywide's loan portfolio.

"There's still plenty of risk involved," said Bart Narter, senior analyst at Celent, a Boston-based financial research and consulting firm. "He's brave to do it. But I think that it's very likely down the road to be profitable, maybe not immediately, but long-term."

There was no immediate word on job cuts, but analysts said they expect some among the ranks of Countrywide's 15,000 employees. Lewis said he would like Countrywide chairman and chief executive Angelo R. Mozilo to stay with the combined companies until the deal is done.

“Angelo has told me that he will do anything that we want him to do,” Lewis said. “I would guess that he’ll want to go have some fun. I will talk with him next week about his personal desires. Many of the senior people will have big operating roles in this company.”

Shareholders of Countrywide will receive 0.1822 of a share of Bank of America stock in exchange for each share of Countrywide. The deal is expected to close in the third quarter and to be neutral to Bank of America earnings per share in 2008 and lift earnings per share in 2009, excluding buyout and restructuring costs.

Bank of America expects $670 million in after-tax cost savings in the transaction, or 11 percent of the expense base of the two companies’ mortgage operations.

The agreement has been approved by both companies’ boards and is subject to regulatory and Countrywide’s shareholders approval.

Shares in Countrywide hit record lows in recent days on persistent rumors that a bankruptcy was imminent, a condition brought on by the widespread spike in mortgage defaults and foreclosures, especially in subprime loans — those made to borrowers with weak credit.

Countrywide shares plummeted more than 13 percent, or $1.04, to $6.71 at the open of trading Friday. Bank of America shares fell 19 cents to $39.11.

Countrywide shares have fallen 57 percent since Bank of America made its $2 billion deal in August at $18 per share. That purchase of preferred stock was convertible into a common shares of Countrywide at $18 per share, for roughly a 16 percent stake in the company.

Along with the $2 billion investment from Bank of America, Countrywide was forced to draw on an $11.5 billion line of credit to steady itself in August. It also tightened its credit guidelines and stopped selling some types of adjustable rate loans. But analysts said it wasn’t enough, with one noting this week that Countrywide needed an infusion of $4 billion in capital within the next two weeks to save itself.

Lewis’ bank holds $1.5 trillion in assets and is the nation’s largest bank by market capitalization.

“Their balance sheet can take a shock much better than Countrywide,” said CreditSights senior analyst David Hendler. “When you take the shocks at Countrywide, they have a big, busting consequence that’s negative.”

While Lewis downplayed the prospect of a major deal last month, it fits with an established pattern of building Bank of America through acquisition. In the past few years, Lewis has expanded the bank’s retail operation with multibillion purchases of FleetBoston Financial

Corp., bolted on a credit card business by adding MBNA Corp., and grabbed a wealth-management business in U.S. Trust Co.

The result of all the dealmaking is a widely diversified financial services company that does business with nearly one out of every two American households.

In the past year, Bank of America has boosted its market share of prime mortgages, or those offered to borrowers with a solid credit history, and was the top retail mortgage originator in the U.S. during the first nine months of 2007.

“We are aware of the issues within the housing and mortgage industries,” Lewis said. “The transaction reflects those challenges. Mortgages will continue to be an important relationship product, and we now will have an opportunity to better serve our customers and to enhance future profitability.”

In Countrywide, Lewis gets the “best, total mortgage-banking company in the U.S. by far,” Hendler said. Countrywide’s sophisticated back office is a valuable asset that makes Bank of America a much bigger competitor with Wells Fargo & Co., Washington Mutual Inc. and others, he said. In 2007, Countrywide had $408 billion in mortgage originations and has a servicing portfolio of about $1.5 trillion with 9 million loans.

“The technology platform, the people who run it, the hedging, the facilities, the mortgage servicing rights, the origination platform, you know, they are all state of the art,” Hendler said.

While there are some regulator hurdles to close the deal, they are hardly insurmountable. The buyout would require approval from the Federal Reserve, and possibly other agencies, but analysts believe regulators are more concerned about a Countrywide collapse than industry consolidation.

A Countrywide failure would be a huge blow to government-sponsored mortgage finance companies Fannie Mae and Freddie Mac, which are major buyers of Countrywide’s loans.

Federal law also bars banks from acquisitions that would increase market share above 10 percent of U.S. deposits, a limit that Bank of America is nearing. Bank of America chief financial officer Joe Price said because Countrywide Bank us a federally regulated thrift, it “doesn’t play into the deposit cap.”

In addition, banking industry experts say Bank of America could easily lower the total amount of money held in deposits by decreasing interest rates and shedding deposits.