

BLACK ENTERPRISE

Crisis & Opportunity

SMITH ILOANI SAYS BANKS MAY
BECOME RELUCTANT TO FINANCE
PRIVATE EQUITY DEALS.

PHOTOGRAPH BY JULIE BIDWELL

PICTURE A METEOR STRIKING A THRIVING LANDSCAPE and wiping out an entire species. That's how Wall Street veteran Bernard Beal describes the devastation of the credit crisis of 2008.

Calling the event a "seismic change in our marketplace," the CEO of New York-based M.R. Beal & Co. (No. 5 on the **BE INVESTMENT BANKS** list with \$543.7 million in senior managed issues) laments the changing face of the nation's major financial center with J.P. Morgan Chase's takeover of Bear Stearns; Lehman Brothers being forced into bankruptcy; and Goldman Sachs and Morgan Stanley opting to become bank holding companies. "If you would've told me even a year ago that none of the broker

stemming from bad investments in the U.S. housing market, namely mortgage-backed securities," says John Foff, a senior analyst at SNL Financial, a Charlottesville, Virginia-based tracker of data for the financial services industry. "The challenge going forward is for business to restore confidence among American investors and consumers."

Beal's "seismic" analogy is apt. In the natural world, disasters and extreme events force species to adapt, evolve, and find new ways to survive. It's no different on Wall Street. Uncertainty in the credit, real estate, and equity markets, and fears of a recession—despite the bailout plan—are forcing commanders at some of the nation's top black-owned financial service companies to alter strategies and find new sources of revenue.

BE100s financial services firms struggle to find the upside in the credit crunch

Crisis & Opportunity

By Jeffrey McKinney

dealers would exist in their current form a year later, I would've said no way."

Beal is candid about the fact that his firm is feeling the credit crunch. He notes that revenue dropped 30% in September compared to the same month last year. Although overall revenues at M.R. Beal are still up for 2008, income from underwriting bond issues—in both the corporate and municipal finance business—fell. As a result, he says the firm is rethinking its strategy. The firm is bringing back its federal financing area, using employees who have been previously retrained to focus on the equity market. "We're going to ask them to pull out their old uniforms and start going in that direction," Beal says. Beal also says his firm plans to re-enter the asset management business, which it sold off.

For the banks, brokerage houses, and insurers left standing, the challenges in 2009 are many. "The financial service industry has been hit hard over the last year due to liquidity issues

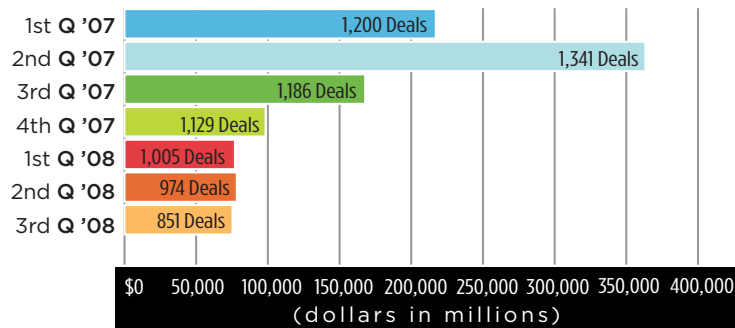
Aggressive marketing, targeting new businesses, and even re-entering businesses vacated or sold are among the tools executives are implementing to boost profitability. Here's how the **BE 100s** are coping:

INVESTMENT BANKS: TARGETING CUSTOMERS, EXPANSION

As part of the \$700 billion rescue package, the U.S. Treasury Department is seeking financial institutions to acquire mortgage-related assets. Included in the legislation is a provision that allows small, minority, and women-owned businesses to take part at a later date. The law says those firms will be designated as sub-managers, but does not spell out required asset sizes of participants. So it's unclear as to how much black participation, if any, there will be.

Avery Byrd, chairman and CEO at New York-based Toussaint Capital Partners L.L.C. (No. 10 on the **BE INVESTMENT BANKS** list

Quarterly Private Equity M&A Volume



SOURCE: THOMSON REUTERS

William Cunningham, senior investment adviser with Creative Investment Research Inc. in Washington, D.C., which specializes in minority banking, says that black-owned banks may be better equipped than their competitors at managing risk in their loan portfolios because they have traditionally dealt with a credit-challenged customer base. Even so, the new landscape will force black banks to venture outside

of their traditional comfort zone. While being conservative has served many banks well, Cunningham says black banking outfits will now have to be more aggressive. That means they will need to do more advertising to go after new customers in a market where a larger bank is financially troubled or no longer exists.

with \$31.6 billion in co-managed issues), insists that it's critical that minority firms are participants in the bailout. "Just as you see the political process working to help the larger firms recapitalize and refund themselves, you're going to need to see that happen in our marketplace or our firms won't survive," he says. Indeed, the shifting landscape in global finance has created a new sense of purpose for Wall Street's black-owned firms. The lessons left behind by the likes of Bear Stearns and Lehman Brothers are clear—evolve or face extinction. Here's how some firms are adjusting.

Louis E. Prezeau, CEO of City National Bank of New Jersey (No. 3 on the **BE BANKS** list with \$449.9 million in assets), says maintaining a strong liquidity position to continue to make loans to small businesses, individuals, and nonprofit organizations such as churches will be among the challenges for his and other banks. "We certainly will not stop lending in our community for viable business, however, we will be using more due diligence to make loans that people and businesses can repay."

It may seem to go against conventional wisdom, but some investment banks are actually expanding, even as they retool operations to tap new markets. Chicago-based Loop Capital Markets L.L.C. (No. 2 on the **BE INVESTMENT BANKS** list with \$3.2 billion in senior managed issues) recently added 16 people, opened new offices in Orlando, Florida; Washington, D.C.; and Charlotte, North Carolina, and expanded its Los Angeles office. The aim is to boost business across all areas of the firm, including in public finance, corporate finance, fixed income, equity sales, and trading. In the end, it will serve institutional clients better, says Kourtney Ratliff, director of global equity and head of firm-wide branding. "While other firms are more focused on just surviving and cleaning up their balance sheets, we're coming up with creative and innovative ways to assist our clients with achieving their goals and objectives."

BANKS: CONSOLIDATION AHEAD?

As a result of the credit crisis, buyout activity has dropped from record levels last year, according to Sandy Anglin, a research analyst at Thomson Reuters. In the first three quarters of this year, there were \$230.6 billion of private equity mergers and acquisitions, down from \$748.2 billion the same period last year. Anglin says a lack of financing is driving down the number of deals. "Until the credit markets stabilize and trust returns to the banking industry, there will be little lending and thus little private equity activity," Anglin says.

For black banks that are struggling, the credit crisis could force them to look for merger or acquisition partners from stronger minority banks, according to Paul C. Hudson, chairman and CEO at Los Angeles-based Broadway Financial Corp., parent of Broadway Federal Bank (No. 4 on the **BE BANKS** list with \$356.8 million in assets). Others may become poised to gain deposits and add income streams by filling in the void left by larger banks who are exiting certain business lines.

The tightened lending conditions could make it tougher for **BE** private equity firms to land future deals and harder to compete for the ones that are available, says Gwendolyn Smith Iloani, president and CEO of Hartford, Connecticut-based Smith Whiley & Co. (No. 9 on the **BE PRIVATE EQUITY FIRMS** list with \$270 million in capital under management). "Private equity firms would probably have to put a lot more money into a deal to entice a bank to come in," she says. "And even with all of that, they're not coming in." But Iloani says her firm has benefited from the credit crisis because of its strategy at the mezzanine

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PRIVATE EQUITY FIRMS: FEWER DEALS

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private equity level. Mezzanine financing is a hybrid of debt and equity financing and used to fill the gap between bank financing and private equity financing. With a bit less reliance on the credit market, the hit to the bottom line is lessened.

Smith Iloani says the firm has committed to do four deals out of some 155 it has looked at from January through September. She says that deal flow is up 20% from the same time a year ago. Yet even with the growth, the firm is being careful given the current environment.

ASSET MANAGERS: EXPLORING NEW OPTIONS

Black-owned asset managers and investment banks now find themselves in a more challenging position, largely due to their exposure to the equity markets. What hurts them most is that they don't have the longevity of black-owned banks. "They're in a very difficult position right now and they will have to do a lot of things differently," Creative Investment Research's Cunningham says.

Access to credit will change for most entities even with the

bailout, says Gerald Smith, chairman and CEO of Houston-based Smith Graham & Co. Investment Advisors L.P. (No. 8 on the BE ASSET MANAGERS list with \$2.7 billion in assets under management). As a result, Smith says the way his firm analyzes a client's portfolio risk will change. "Essentially, the credit crisis will cause us to invest more of our assets in government and agency securities, including mortgage-backed securities, which are now backed by the federal government," he says.

Indeed, those executive teams that keep their companies flexible and resilient will be able to adapt in the face of today's seismic changes. Those that don't will face extinction. Take the S&L crisis of the 1980s that led to the failing of hundreds of savings and loan associations. This too impacted the black financial firms. In 1987 there were 33 Savings & Loans on the BE 100s list. By 1992, there were four that in turn became traditional banks in order to survive. Such modifications aren't done without pain. But what will emerge will be stronger, faster, and more nimble firms, well-positioned for the future. **BE**

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