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Buffett's BofA Stakes Net \$1.4B on First Day

By Bradley Keoun, Donal Griffin and Michael J. Moore - Aug 25, 2011

Warren Buffett may have earned \$1.4 billion in one day on his \$5 billion investment in [Bank of America Corp. \(BAC\)](#)

The preferred shares Buffett's [Berkshire Hathaway Inc. \(BRK/A\)](#) bought are worth about \$3.53 billion, Phil Jacoby, chief investment officer at Spectrum Asset Management Inc. in [Stamford, Connecticut](#), estimated. Warrants included in the deal are worth about \$2.87 billion, based on Bank of America's share price of \$7.85 as of 11:53 a.m. in New York trading, said Clay Struve, a partner with Chicago-based CSS LLC.

The 28 percent first-day return -- more than 10,000 percent on an annualized basis -- shows the premium Bank of America Chief Executive Officer [Brian T. Moynihan](#) was willing to pay to attract Buffett as an investor. As Berkshire's CEO, Buffett has garnered a reputation as one of the world's best investors, with shareholder returns over the past decade that are more than double those of the Standard & Poor's 500 Index.

"I'm sure Warren cut a pretty good deal," said Linus Wilson, assistant professor of finance at the University of Louisiana at Lafayette. "For Bank of America, you get the endorsement of [Warren Buffett](#), and it's going to make it a lot easier if Bank of America wants to raise more capital from other investors."

Under the terms of the deal, Omaha, Nebraska-based Berkshire will invest \$5 billion in Bank of America, the Charlotte, North Carolina-based bank said today in a statement.

Preferred Dividend

In exchange, Berkshire will receive 50,000 perpetual preferred shares with a liquidation value of \$100,000 each, according to the statement. The preferred shares pay a dividend of 6 percent per year, and are redeemable at any time by Bank of

America at a 5 percent premium. The dividends are cumulative, meaning Bank of America would have to catch up if it skipped any payments.

Berkshire also will get warrants -- a type of options -- to buy 700 million common shares at a strike price of \$7.14 each. Investors who value warrants weigh a company's stock price, share volatility and the expiration date.

The Bank of America warrants are good for 10 years, according to the statement. The bank's shares, which had declined 48 percent this year through yesterday, surged as much as 26 percent today.

"It's a package deal," said Jacoby, whose firm specializes in preferred shares. For Bank of America, deciding how much to pay Buffett was probably "a process of how much value do you feel you need to give away in order to change the mood of the market."

Bank of America's closing price yesterday was \$6.99 a share.

Goldman Deal

When Buffett bought \$5 billion of preferred stock in Goldman Sachs Group Inc. in 2008, he received a 10 percent dividend and a 10 percent premium when the firm redeemed the stock. He also received warrants that gave him the right to purchase \$5 billion of common stock at a strike price of \$115 at any point within five years.

Those warrants were in the money when the deal was announced. Goldman Sachs disclosed the investment after the market closed on Sept. 23, 2008, with a share price of \$125.05. The stock rallied 6.4 percent the next day to \$133. Goldman redeemed the preferred shares in April, paying the 10 percent premium, or \$500 million.

The warrants are no longer in the money, because the shares have fallen 35 percent this year to \$108.62. Buffett said in May that he plans to hold the Goldman warrants, which expire in 2013, "very close to their expiration."

GE Stock

Berkshire also received a 10 percent dividend and a 10 percent premium when it agreed to buy \$3 billion of perpetual preferred stock in General Electric Co. on Oct. 1,

2008. Buffett got warrants, which expire in 2013, to buy \$3 billion of common shares at \$22.25 per share, lower than the previous day's close of \$25.50.

GE shares plunged 9.6 percent the day after the investment to \$22.15. They have yet to reach a higher closing price in the almost three years since then, ending trading yesterday at \$15.72.

In a 2009 interview, Buffett said the warrants in the GE and Goldman Sachs deals would allow him to profit if the stock surged.

"I wanted a possible kicker," he said, adding that he didn't know if Berkshire would make money by exercising the warrants in either company. "I think the odds are reasonably good we do them. Maybe we'll do it on one and not the other, but in the end I was satisfied with the preferred I was getting."

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