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EXCLUSIVE | BANKING

Banc of California Agrees to Buy PacWest as Regional Lenders Seek Strength Together

Private-equity firms Warburg Pincus and Centerbridge provide only external source of funding for acquisition

By Lauren Thomas, Justin Baer, Ben Eisen, and Gina Heeb

Banc of California agreed to buy PacWest Bancorp in a move by the lenders to further shore themselves up following a regional-banking crisis earlier this year.

While the value of the tie-up isn't huge by M&A standards, at just over $1 billion, it is a major milestone for a banking sector that was in turmoil earlier in the year and still faces questions about its health. The deal didn't require an assist from the federal government, which had stepped in to rescue other banks and broker sales earlier this year.

Instead, Warburg Pincus and Centerbridge plan to invest a total of $400 million in newly issued equity, giving them about a 19% stake in the combined business. The private-equity firms, each with a history of investing in financial companies, will provide the only external source of funding for the acquisition.

The rapid failure of Silicon Valley Bank in March stirred fears about the stability of midsize banks. Many were sitting on deposits that were prone to flight while simultaneously holding long-term debt and loans that lost value as interest rates shot up. PacWest has been at the center of fears about the regional-banking system since the failure of SVB and two other lenders this spring, beset by deposit outflows and a sinking stock price. Shares of Banc of California also dropped significantly.

Both banks have come through the recent turmoil in relatively good health, with both stocks rebounding somewhat.

In the all-stock transaction, PacWest stockholders will receive 0.6569 of a Banc of California share for each share they own, or about $9.60 based on Banc of California's closing price Tuesday. That is a roughly 25% premium to PacWest's $7.69 closing price Tuesday.

Banc of California shares rose by about 11% in regular trading after The Wall Street Journal reported that a deal was imminent, while PacWest, which has a bigger market value, dropped by 27%.

PacWest has around 70 branches, mostly in California, except for one in Colorado and another in North Carolina. Banc of California's branch network is roughly half that size, running from San Diego to Santa Barbara.

Both banks largely focus on commercial customers in California and are based in the Los Angeles area. Banc of California's CEO, Jared Wolff, previously worked at PacWest.

At the end of June, Banc of California had some $9.4 billion in assets and PacWest, $38 billion. The deal will create a bank with $36 billion in assets, $25 billion in loans and $31 billion in total deposits, the companies said.

PacWest was hit harder by the recent banking turmoil, losing 18% of its deposits in the first half of the year, versus a nearly 4% loss for Banc of California. PacWest investors were particularly skittish because of its ties to the type of venture customers who pulled cash en masse at SVB.

PacWest shares have rebounded since hitting a low of $3.17 in May, but they are still down by more than half this year. Customers continued to pull cash this spring, with deposits sliding nearly 10% the week that ended May 5.

In an earlier effort to manage the crisis, PacWest sold a $2.6 billion property-loan portfolio to Kennedy-Wilson Holdings in May and a $3.5 billion package of specialty-finance loans to Ares Management in June. It also sold a real-estate lending unit in May. The bank had separately secured financing from Atlas SP Partners.

But customers are now demanding more interest on deposits, and large and midsize banks are bracing for higher technology costs and new U.S. regulations aimed at insulating the industry from additional failures.

Underscoring the challenges the banks face, PacWest on Tuesday reported a loss of $197 million for the second quarter, while Banc of California's profit fell by a third.

Executives and government officials increasingly expect regional banks to bulk up through mergers to help them weather the tougher operating environment. Mergers offer benefits including an ability to spread out costs across a larger organization.

One major holdup has been the billions of dollars in paper losses that have accumulated on balance sheets as interest rates rose and the value of loans and bonds deteriorated. Banks typically keep most of those assets until they mature without marking down their value. But if the bank is sold, the acquirer has to absorb those losses and take a potential hit to its capital position.

The investments by Warburg and Centerbridge will help Banc of California fill the capital hole created by markdowns from the PacWest deal. The combined company intends to use proceeds from future asset sales to pay down higher-cost borrowings, including loans from the Federal Home Loan Bank system.

-David Benoit contributed to this article.