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Shareholder urges Baltimore bank to sell

By Syed Atif Hussain

A minority shareholder of Baltimore-based BCSB Bancorp Inc. is urging the company's board to seek out a merger partner, saying that "BCSB should be sold as soon as possible" if shareholders are a priority for the board.

In a Jan. 26 letter recently obtained by SNL, David Moore pointed BCSB's board toward the 15 cents per-share loss the company's common shareholders experienced in fiscal 2011. He said shareholders should have higher expectations than the results delivered over the past few years and that the time has come for BCSB to realize that the structural challenges it faces are "simply too daunting."

Moore manages Marathon Financial Ventures I LP, which owns 89,969 BCSB common shares, or approximately 2.8% of the company's outstanding common stock. Marathon Financial has been a BCSB shareholder since November 2008, according to the letter.

The shareholder said the fundamental problem with BCSB is that the combination of its cost structure and spread-generation limitations, resulting from its legacy thrift structure, makes it "nearly impossible" for the company to generate a return on capital above its cost of capital, which Moore estimated to be in the range of 9% to 10%.

Since BCSB's formation via a second-stage conversion in April 2008, the company has grown tangible book value by a cumulative 98 cents per share, representing a cumulative return on equity of around 6.4% over the period, Moore said. "I estimate that a reasonably competent acquirer should be able to generate an ROE of 11% [to] 12% on BCSB's balance sheet … assuming a clean loan portfolio, the elimination of redundant operating expenses, and a modest reduction in deposit costs," he added.

This pro forma ROE suggests that BCSB's value to a potential acquirer is likely modestly above its current tangible book value of $16.26, Moore said. "Moreover, this analysis also suggests that BCSB's shareholders are losing money on an opportunity-cost basis every quarter that passes during which the company is not sold."

Moore pointed toward Philadelphia-based SE Financial Corp. and Columbus, Ind.-based Indiana Community Bancorp as two companies with similar structural characteristics to BCSB who recently decided to sell. He said BCSB's management and board have gone to "considerable lengths" to maximize their own economic benefit should a change in control materialize. He expressed hope that the board would maximize value for shareholders with "similar diligence and determination."

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David B Moore CFA
Managing Partner

26 January 2012

Board of Directors
BCSB Bancorp, Inc.
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Gentlemen:

Marathon Financial Ventures I, LP ("MFV"), a limited partnership I manage, owns 89,969 common shares of BCSB Bancorp, Inc. ("BCSB" or the "Company"). As such, MFV owns approximately 2.8% of the Company's outstanding common shares. MFV has been a BCSB shareholder since November 2008.

I am writing to you regarding the financial performance of our Company, its prospects for material improvement, and a suggested strategic option.

As you are aware, BCSB's common shareholders experienced a loss of $0.15 per share for the 2011 fiscal year. Since BCSB's formation via a second-step conversion in April 2008, the Company has grown tangible book value by a cumulative $0.98 per share, representing a cumulative return on equity (ROE) of approximately 6.4% over the period. Despite an extremely challenging credit environment and an admittedly difficult operating (re: thrift) structure, I am sure you agree that BCSB's shareholders should have higher expectations than the results delivered over the last few years. While I appreciate the time and effort that the management and board have put into the Company since its conversion, there comes a time when one must admit that the structural challenges facing a task are simply too daunting – to paraphrase Clint Eastwood, "A company's got to know its limitations."

The fundamental problem with BCSB is that the combination of its cost structure and spread-generation limitations (resulting from its legacy thrift structure) leaves us with a company for which it is nearly impossible to generate a return on capital above its cost of capital (which I estimate to be in the range of 9%-10%). To wit, even if all of the Company's credit-related costs (provision for loan losses, OTTI charges, OREO expenses, etc.) were eliminated, BCSB would have generated just a 5% (at best) ROE for fiscal 2011. That's the bad news.

The good news is that there is a modestly profitable company hidden beneath BCSB's cost structure. I estimate that a reasonably competent acquirer should be able to generate an ROE of 11%-12% on BCSB's balance sheet (this will vary by acquirer, of course) assuming a clean loan portfolio, the elimination of redundant operating expenses, and a modest reduction in deposit costs. While this pro forma ROE is not going to win any awards, it does suggest that our

Company's value to a potential acquirer is likely modestly above its current tangible book value of $16.26. Moreover, this analysis also suggests that BCSB's shareholders are losing money on an opportunity cost basis every quarter that passes during which the Company is not sold. Consequently, to put it bluntly, BCSB should be sold as soon as possible if shareholders are a priority for the board of directors.

SE Financial Corporation (SEFL) and Indiana Community Bancorp (INCB) are two companies with similar structural characteristics to BCSB whose boards recently decided to sell. SEFL is a $305 million-asset savings bank based in Philadelphia with 3.75% NPAs/Assets that recently announced an agreement to be acquired by Beneficial Mutual Bancorp in an all-cash transaction for approximately 110% of tangible book value. INCB is a $985 million-asset bank (which converted from a thrift charter to a commercial bank charter 10 years ago) based in Columbus, Indiana with 4.35% NPAs/Assets that just days ago announced an agreement to be acquired by Old National Bancorp in an all-stock transaction currently valued at 117% of tangible book value. Following this letter is an interview with John Keach, Indiana Community's CEO, from the January 25 issue of *American Banker* titled, "Why John Keach Became a Bank Seller". I suspect you will empathize with a number of Mr. Keach's observations regarding the difficulties of operating a small bank in the current environment.

Again, I want to express my appreciation for all of the work the management and board have done at BCSB over the last few years. It has been a very difficult credit environment and the (former) thrift structure did not lend itself to high levels of profitability; and converting a thrift into a commercial bank is like turning around a barge – it takes considerable time. I also commend you for welcoming Richard Lashley to the Company's board of directors. Mr. Lashley's history of helping boards create value for shareholders is extensive and varied.

In closing, I will reiterate that the time has clearly come to seek out a merger partner. Our Company's management and board have gone to considerable lengths to maximize their own economic benefit should a change of control come to fruition – with which I have no issues, by the way. I trust, however, that with similar diligence and determination you will pursue the optimal course of action for shareholders and seek out a suitable merger partner for our Company sooner rather than later.

Regards,

David B. Moore

David B. Moore

AMERICAN BANKER

Why John Keach Became a Bank Seller

By Dean Anason
JAN 25, 2012 5:08pm ET

The pause spoke volumes.

When asked if he had a lot of sleepless nights before the early morning announcement that his bank would be sold, John Keach Jr. took a deep breath, laughed nervously and answered politely: "It's been a process. Yes, sir."

The momentary gap in conversation betrayed feelings that cut deep, and could have swallowed up the hundreds, perhaps thousands, of small bankers around the country who still have to make the tough call whether to sell.

The day Keach had hoped to avoid came Wednesday when his lifelong employer — Indiana Community Bancorp, the holding company of Indiana Bank and Trust Co. — said it would be sold to Old National Bancorp of Evansville for $79.2 million.

Keach, 59, has a classic story. He started working at the bank 37 years ago, as a teller. His grandfather, Glenn, joined the bank in 1941 and rose to chief executive officer like his son, John Sr. and grandson, John Jr.

But the ending of the story is a familiar one these days. The bank's board and its officers decided they couldn't make it and had to sell.

"That's obviously one of the most difficult decisions I have ever made professionally," he said.

Keach clearly fought back some emotion during a tedious question-and-answer session about the particulars of the bank's decision. But he spoke forcefully and frankly about the reasons why.

"It's about scale. It's about size. It's about the ability to absorb the increase in operating costs in an environment that is difficult to grow your earnings," he said, again seeming to channel the every-banker. "Revenue growth was becoming a challenge. As we forecast it out over the next couple of years, we feel that it is going to continue to be a challenge while costs are going to continue to increase."

He ticked off a long list, including regulatory demands, credit challenges and the likelihood of a prolonged period of low interest rates.

"In this environment, it's very difficult to forecast meaningful revenue growth," he said.

Indiana Community took some heavy medicine in the third quarter, charging off $13.3 million of loans. On Wednesday it reported a fourth-quarter profit of $1.8 million — but a loss of $1.7 million for the year.

He had to inform employees in personal and phone meetings of the decision to sell. Their reaction was one of understanding, Keach said. "It's not anger, no. Sadness, yes. A number of our good folks have been here for many years — 20, 30, 40 years."

Some of the 230 employees will lose their jobs — Old National has "to get some cost saves," Keach said. But the majority will stay, and shareholders are getting a good price, Keach said. Old National Bancorp Chief Executive Bob Jones and he had become friends in recent years, and Keach said that Indiana Community found a community-minded buyer with a similar culture that he could feel confident in.

Old National will pay off Indiana Community's Troubled Asset Relief Program aid as part of the deal, the two companies announced Wednesday.

"We wanted to control our own destiny," Keach said, in summing up why the bank decided to sell now instead of waiting it out and risk getting worse terms.

"We are honored to partner with such a highly regarded institution with a focus on basic banking and a well-earned reputation for community involvement," Jones said in a release.

Keach acknowledged that his story channeled the experiences of many other bankers. "It is certainly affecting a lot of us ... that's for sure."
