

How

ANDY BEAL

Runs His
BANK

Like a
**HEDGE
FUND**

THE INVESTOR MADE A FORTUNE GATHERING FEDERALLY INSURED DEPOSITS AND USING THEM TO BUY DISTRESSED LOANS. NOW, HE SAYS THE MARKETS ARE IN A BUBBLE AND MAY CRASH AGAIN.

By ANTHONY EFFINGER

Photograph by JEFF WILSON





A

NDY BEAL'S ROAD to becoming a billionaire, doing deals with the likes of Carl Icahn and Donald Trump, runs straight through the slums of Newark, New Jersey.

It was 1981, and Beal, then a 29-year-old vulture investor, was scoping out two 16-story apartment buildings owned by the U.S. Department of Housing and Urban Development. The bricks were chipped and bulging off the exterior of the buildings. Tenants had pried open the elevator doors and thrown furniture down the shafts. Beal liked what he saw.

He and a partner bought the towers for \$25,000 and a promise, backed by a \$2.5 million letter of credit, to fix the bricks. They did the repairs—employing armed guards for protection when visiting the apartments—and never tapped the credit line before selling the buildings two years later to a New York doctor for \$3.2 million.

In the past three decades, Beal has made a fortune buying distressed assets. He snapped up bonds of power companies during the California blackouts in 2001, debt backed by jetliners following the 9/11 terrorist attacks and billions worth of commercial and real-estate loans after global credit markets froze in 2008. In between, the investor with a restless mind started a company to build rockets and beat a rotating team of pros at Texas Hold 'em in the world's richest poker game.

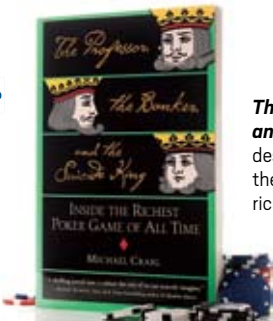
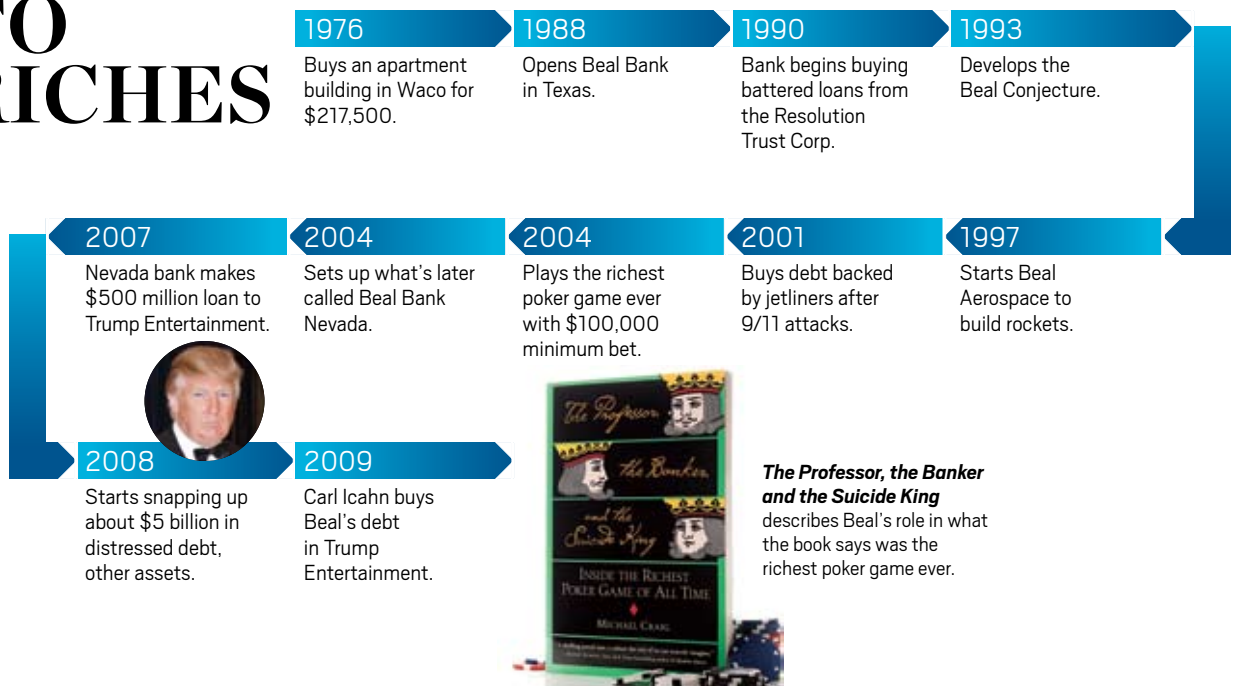
Beal's focus on beaten-down loans makes him look like a hedge-fund manager. He's not; he's a banker. His Plano, Texas-based company, Beal Financial Corp., owns three banks. Deposits are insured by the Federal Deposit Insurance Corp. That means Beal raises money for his investments by promising, these days, to pay depositors just

1 percent a year. A small bank in New Mexico he bought in 2010 offers checking accounts. Otherwise, his 34 branches sell just savings accounts and certificates of deposit, which are less expensive to manage. "It's an FDIC-insured hedge fund," says Sherrill Shaffer, who worked for the U.S. Federal Reserve for 17 years until 1997 and is now the John A. Guthrie Distinguished Professor of Banking and Financial Services at the University of Wyoming in Laramie.

Unlike a hedge-fund manager, Beal doesn't have to divvy up profits with investors. The banks controlled by Beal Financial have shareholder equity of \$3.2 billion, according to the FDIC, and he owns the entire company.

A native of the manufacturing city of Lansing, Michigan, Beal has collected an A-list of partners and friends. He's pals with Trump, the loudmouthed developer. He talks history with Gabe Kaplan, creator and star of the 1970s sitcom *Welcome Back, Kotter*. He's done business with Icahn, the corporate raider. Former President George W. Bush visited Beal's offices after leaving the White House. This year, Beal attended the Las Vegas wedding of his friend Steve Wynn, the casino developer. Clint Eastwood was the best man.

BEAL'S ROUTE TO RICHES



The Professor, the Banker and the Suicide King describes Beal's role in what the book says was the richest poker game ever.

JOSHUA ROBERTS/BLOOMBERG; TED MORRISON (BOOK)



BEAL FINANCIAL in Plano, Texas, controls banks with \$3.2 billion in shareholder equity, making Beal a billionaire.

Beal, who flies commercial and drives a Ford Excursion sport utility vehicle around Dallas, says he still reviews every deal his company does to make sure he's not spending too much. These days, Beal is hitting the brakes because he sees a bubble inflating. Stocks and corporate bonds have rallied during the past two years because the U.S. government dumped money into the economy in the form of rock-bottom interest rates and imprudent deficit spending, Beal says. "Today's markets are being supported by a flood of money," he says. "There are so many lenders in a race to the bottom when things are good. We don't participate in that."

Trump, who borrowed at least \$600 million from Beal's banks during multiple bankruptcies by his casinos, says investors should heed the banker's warning. "He has 20/20 vision into what is going to happen in the future," says Trump, 65, who briefly flirted with running for the U.S. presidency this year. "I know lots of smart bankers. Andy is right at the top of the list."

At dinner in April with Kaplan in the back room of a Dallas steakhouse, Beal is upbeat. He's dressed in dark slacks and a crisp white shirt, looking a decade

younger than his 58 years. His wavy brown hair, blue eyes and chiseled features make the banker appear more like a West Texas rancher. Ordering lobster, he addresses the waitress by name and thanks her repeatedly for the service. When she brings a bottle of California cabernet sauvignon, he un-snobbishly has her pour it into his glass with the remainder of a Spanish tempranillo. He spars with Kaplan about Trump, saying the developer would make a good president simply because he's not a politician.



BEAL'S POLITICS—HE'S A SELF-declared libertarian—seem an odd fit for a banker who relies on federal guarantees to attract deposits. He loathes big government and gives money to politicians who vow to dismantle it. Until they do, he plans to avail himself of federal programs to make money just like the next guy. "I hate big government," Beal says in an e-mail between a series of interviews granted, he says, only to ensure that the facts about his banks are correct. "I don't like the government-issued paper currency rules or the laws that

require its use. But those are the rules, and I live by them."

In buying loans, Beal takes heftier risks with FDIC-insured money than do many bankers. Delinquent loans accounted for 21 percent of all loans at Las Vegas-based Beal Bank Nevada, the largest of his three banks, compared with an average of 5 percent for all U.S. banks as of March 31. Taking bigger risks is legal as long as Beal abides by rules that prohibit banks from owning equity in nonfinancial companies or buying most debt rated as junk without dispensation from regulators, Shaffer says.

Beal's banks also must hold extra capital because they make riskier loans, says George Burns, commissioner of the Financial Institutions Division of the Nevada Department of Business and Industry, a regulator. "If you're dealing with distressed assets that have a high potential for loss, you need higher reserves," Burns says.

Beal Bank Nevada is stockpiled for Armageddon. It had \$2.2 billion of equity capital at the end of 2010. Equity for a bank is the amount of assets—its

outstanding loans—minus liabilities, or deposits. Beal Bank Nevada's equity capital accounts for 35 percent of total assets, according to FDIC data. The average U.S. bank had an equity-to-asset ratio of just 11 percent at the end of 2010.

IN ADDITION TO DEPOSITS, BEAL collects Nascar race cars. He owns six of them, each with 800 horsepower. He and his friends drive the cars at the Texas Motor Speedway in Fort Worth, tearing around the track at 125 miles (200 kilometers) per hour.

A numbers nut, Beal once sat down to solve Fermat's Last Theorem, the ne plus ultra of math geekery. In 1993, he came up with his own mind-bending problem, called the Beal Conjecture: If $A^x + B^y = C^z$, where A, B, C, x, y and z are positive integers and x, y and z are all greater than 2, then A, B and C must have a common prime factor. He still offers a \$100,000 prize, through the American Mathematical Society, for proving or disproving it.

BEAL IS PALS WITH TRUMP AND HAS DONE BUSINESS WITH ICAHN. HE WENT TO STEVE WYNN'S WEDDING AND HAS BEEN VISITED BY GEORGE W. BUSH.

Beal's profitable trades have produced almost off-the-charts results compared with other banks. Beal Bank Nevada had a return on equity of 27.4 percent in 2010 versus an average of 5.9 percent for all U.S. banks, according to the FDIC. Beal says he succeeds because he does his homework and always buys loans that have collateral that he can get if the borrower defaults.

Beal gets most of his deposits not from moms and pops who walk into his branches to open accounts, but from Wall Street firms. They raise money from investors who want FDIC protection, and then sell to banks, like Beal's, that offer the best rates. Banks insure individual accounts to \$250,000 each, and depositors can have accounts at as many banks as they like.

The so-called brokered deposits are

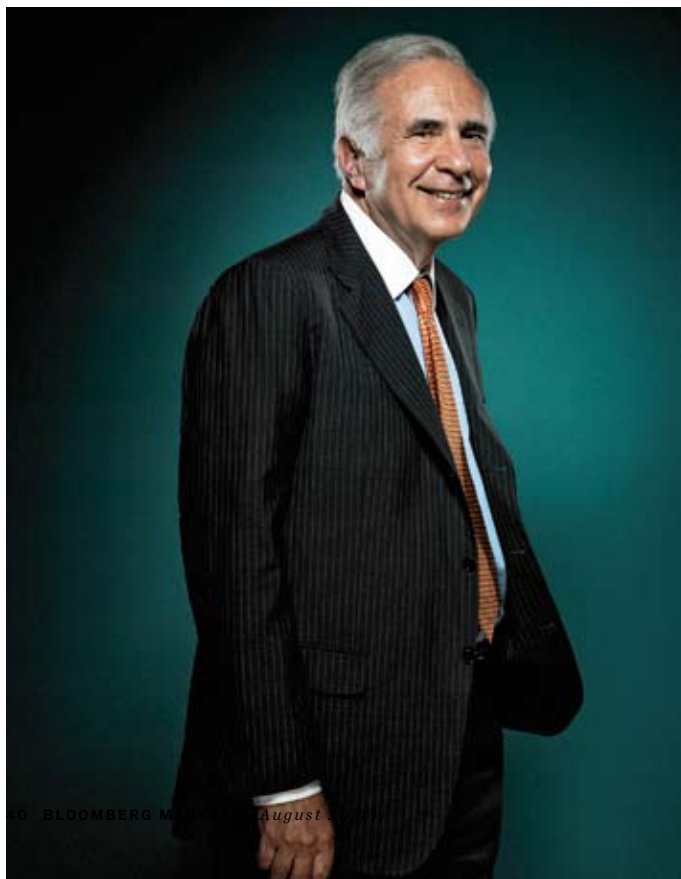
regulated by the FDIC because they worsened the savings-and-loan crisis in the mid-1980s. Many S&Ls offered high interest rates to get the deposits quickly, then invested them in risky assets to pay the promised rates and make a return. After many of the investments failed, the industry required a \$124 billion taxpayer bailout, mostly by the Resolution Trust Corp. To try to curb such reckless lending, Congress in 1991 passed a law requiring banks using brokered deposits to hold more capital relative to their assets or outstanding loans.

The requirements are worth it right now for bankers, says Paul Clark, a partner at law firm Seward & Kissel LLP in Washington who specializes in law related to the deposits. Banks aren't lending very aggressively, so there is less demand for assets, and banks pay less for them, he says. "Brokered deposits are the best deal around," Clark says.

Beal is building out his branch network to wean his reliance on brokers. In mid-June, Beal was paying 1.01 percent for a 12-month CD, compared with 0.5 percent for Bank of America Corp. Beal says he expects rates to increase, and by gathering more deposits directly from customers at branches he'll be able to better manage his costs of acquiring capital.

Beal also mines cheap money from the Federal Home Loan Bank of Dallas. It's one of the 12 private cooperatives set up in 1932 to encourage lending for housing and development. The FHLBs have the implicit backing of the U.S. government, meaning that investors expect that the Feds won't let them fail, just as the government took over mortgage lenders Fannie Mae and Freddie Mac in 2008 rather than let them collapse.

FHLB members, such as Beal's banks,



Financier **CARL ICAHN** bought the loan Beal made to Trump Entertainment.

buy stock in the FHLBs and get the right to borrow against their own loans and other assets. As of Dec. 31, Beal Bank Nevada had advances of \$1.4 billion from the Dallas FHLB, making it the third-largest borrower, after Wells Fargo & Co. and Comerica Inc., according to a 2010 government filing from the Dallas FHLB.



BEAL'S BANKS PAY MILLIONS IN dividends each year to his holding company. They shelled out \$244 million in 2010 and \$220 million in 2009, according to records submitted to the FDIC. In 2004, Beal Bank SSB in Texas alone paid out \$1.3 billion to start Beal Bank Nevada, Beal says. The other dividends were used mostly to pay taxes.

Beal could get richer if he got out of banking with its costly regulations and formed a hedge fund, says Tim Yeager, associate professor at the Sam M. Walton College of Business at the University of Arkansas in Fayetteville. "He's paying nothing on deposits and making extremely high returns on assets," Yeager says. "But he could make more money, I promise you, by not being a bank."

Beal actually toyed with the idea, starting an affiliate called CLG Hedge Fund LLC. Beal says he put *Hedge Fund* in the name because he wanted its employees to think like hedge-fund managers, buying and making higher-yielding loans. He even put them in separate offices in Frisco, 18 miles (29 kilometers) from his bankers in Plano. CLG never operated as a hedge fund, partly because Beal didn't want to share his returns. "Interfacing with regulators is one thing," Beal says in an e-mail. "Taking calls constantly from various investors is intolerable. Also, why split profits?"

Several former Beal employees criticize his management style, saying he treats people just like assets, moving them quickly in and out of the company to keep costs down. They say he hires when he needs help with his buying sprees, such as in 2008, and fires

them when he slows down his asset purchases. Total employment at Beal Bank and Beal Bank Nevada fell 29 percent to 511 in 2010 from 722 at the end of 2009. Most of the decline, Beal says, came from closing his loan-servicing operation.

Former employees also gripe that Beal pays less than other financial companies in Dallas. One former employee who spoke on the condition that he not be named says he took a

20 percent pay cut when he went to work for Beal after leaving a job in finance. Beal doesn't share profits, except through haphazard bonuses, the former employee says.

Beal says he pays plenty. "Jobs paying \$200,000 just don't grow on trees, except in New York," he says.

As a kid, Beal learned the value of money early on. His father was a mechanical engineer and his mother worked as a secretary at a state agency.

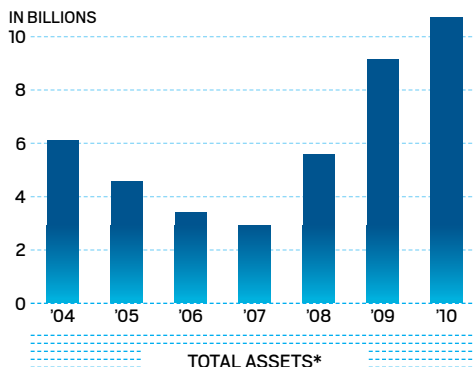
Beal repaired televisions with an uncle and installed home alarm systems.

He attended Michigan State University in East Lansing, where he says he got straight A's. Other temptations pulled him away from the university before getting a degree. He made frequent trips to Las Vegas to play blackjack and kept getting kicked out of casinos for counting cards.

In 1976, Beal says, he bought his first HUD apartment building, sight unseen, for \$217,500 in Waco, Texas. The city wanted him to put up a \$300,000 bond guaranteeing that he would keep renting only to low-income tenants. Clifton Robinson owned an insurance company in town and agreed to put up the bond. Beal and Robinson partnered five years later to buy the two Newark apartment buildings and then trolled blighted parts of New York looking at properties that HUD wanted to give away to people who would maintain them, Robinson says. They paid a cabbie \$500 a day to take them around the South Bronx. Usually, they just drove by the buildings because the driver, scared, wouldn't stop. The duo didn't buy a thing. "It looked like Berlin in 1945," Robinson says.

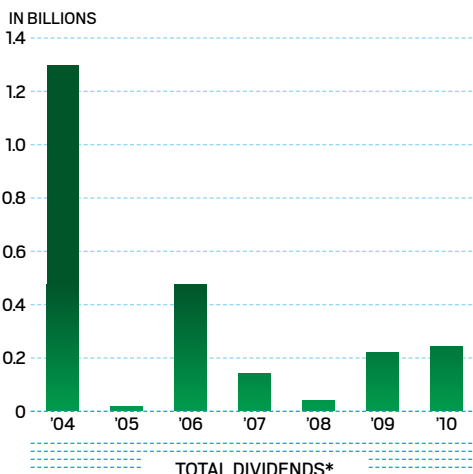
BEAL'S ASSETS...

The banker stopped purchasing loans just before the credit crisis and then went on a buying spree.



... AND HIS DIVIDENDS

Beal Financial has taken more than \$2.4 billion in payouts since 2004.



*Beal Bank Nevada and Beal Bank SSB. Source: FDIC



BEAL drives his Nascar racers at 125 miles per hour.

Beal owns six Nascar racers, each packing a 800-horsepower engine, that he and friends drive at the Texas Motor Speedway.

amid concern that the airlines wouldn't make the payments.

With everything from airplane to apartment investments, Beal has been fanatical about having collateral to back up his assets. Beal hired aircraft brokers to inspect the jets and bought certificates only if the planes were worth enough to cover a default, according to a Beal Bank employee who handled the transactions and wishes to remain anonymous. Sometimes, Beal had three brokers look at a plane.

The banker started buying the airplane paper on Sept. 24, 2001, making one trade at 38 cents on the dollar. Most were done at 60 cents to 80 cents. He never had a loss. The trusts had to take 17 aircraft from airlines that missed payments. Those sold for more than Beal expected, the employee says.

Earlier that year, Beal had begun playing Texas Hold 'em in Las Vegas against a group of professionals who pooled their resources so they could match the banker's purse. He honed his skills by competing against the pros, often losing millions, according to a book about Beal's playing called *The Professor, the Banker and the Suicide King: Inside the Richest Poker Game of All Time*, by Michael Craig (Warner Books, 2006). In May 2004, he played what Craig—and Beal—say was the richest game of poker ever, at the Bellagio casino. The minimum bet was \$100,000.

Beal showed up in sunglasses to hide his eyes and earphones to eliminate distraction. The banker played five pros—Chip Reese, Jennifer Harman, Hamid Dastmalchi, Gus Hansen and Todd

Beal used his profits on the Newark towers to open Beal Bank in 1988. It was the middle of the S&L crisis, and the investor started buying loans at a discount from RTC, which was disposing of the debt recovered from failed thrifts. Beal bought and sold beat-up loans until the RTC closed in 1995, according to Beal Bank filings with the government.

While running his bank, Beal followed a passion and opened a company to make rockets to blast satellites into space. NASA, Beal says, was encouraging private companies to develop rockets and he decided to go for it. Beal Aerospace Technologies Inc. started in 1997 and soon had 200 employees working in Frisco. Beal planned to exploit an unusual fuel for his spaceships: hydrogen peroxide. The chemical, used to clean wounds, becomes a powerful, clean-burning propellant when combined with kerosene.

"He's one of the brightest folks I've ever worked with," says Michael Carden, a developer of the peroxide fuel.

Beal closed the company after three

years of work, in October 2000. He blamed NASA for backtracking by announcing plans to build its own rockets. "When Congress and NASA targeted \$10 billion to fund competing launch systems, we threw in the towel," Beal said in a 2001 letter posted on bealaerospace.com. "We simply could not compete with such government-funded boondoggles."

BEAL WENT BACK TO BANKING

full time. One of his boldest forays into battered assets came just weeks after the 2001 terrorist attacks in New York and Washington. Shares of airlines tumbled. The six largest carriers made plans to cut 92,500 workers in three weeks as travelers stayed off planes.

The banker saw an opportunity. Aircraft are often financed by trusts, which sell interest-bearing certificates to investors and use the proceeds to buy an airplane. The trust then leases the plane to an airline, using the lease payments to pay the certificate holders. After 9/11, the certificates fell in value

Brunson—during two days, winning \$10.6 million. “He was playing on a level I had never seen,” says Kaplan, who watched the game.

Six months later, Beal made a much bigger wager on gambling. Trump Hotels & Casino Resorts Inc., then the owner of the Trump Taj Mahal in Atlantic City, New Jersey, and three other casinos,

that the company still owed, giving it more time to pay.

In November 2009, Trump stopped working with Beal and joined Lasry's bid. Lasry had agreed to let him take as much as a 10 percent stake in the post-bankruptcy company in exchange for use of the Trump name, according to regulatory filings by Trump

other employees—many of them straight out of college—to sift through mortgage bonds and other debt that had plunged in value.

Beal says he spent \$5 billion on these loans and other assets in a 12-month span that started in 2008. “I wish we'd done twice as much,” Beal says. “The sky was falling. We thought it would get cheaper.”

Instead, the U.S. government stepped in and stopped the panic, shoveling taxpayer dollars into the markets via the Fed and the Treasury. Asset prices rose, and Beal stopped his spending spree and cut workers. Another boom at Beal Financial was over. He had bought enough to make another fortune, though. Net income at Beal's banks soared to \$559 million in 2009 from \$281 million in 2008. Citigroup Inc., by contrast, lost \$1.6 billion in 2009.

Less busy at the office these days, Beal says he's spending time driving his Nascar racers with his son and with friends. He's done with poker, he says. He'll be back for more bottom-fishing, though, when asset prices fall and banking is less risky than ripping around a track in an 800-horsepower car.

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BEAL PLAYED THE RICHEST GAME OF POKER EVER, AT THE BELLAGIO. THE MINIMUM BET WAS \$100,000. HE WON \$10.6 MILLION.

went bankrupt in November 2004. Beal stumped up \$100 million in a debtor-in-possession loan shortly after, becoming first in line for any repayment when the company reorganized, as is the case for DIP lenders. Beal says he made money on the loan.

BEAL TOOK AN EVEN LARGER risk on Trump in December 2007, with his Nevada bank loaning the new company, Trump Entertainment Resorts Inc., \$500 million. The company had lost money in three of the previous four quarters. Just 14 months later in February 2009, Trump Entertainment sought protection from creditors. As usual, Beal was first in line to get paid or claim collateral.

Trump and Beal then teamed up on a plan to reorganize the company, competing with a group of bondholders led by Avenue Capital Group and its CEO, Marc Lasry. They filed their plan that August, proposing to invest \$100 million in the casinos. Beal said he would restructure the \$486 million

Entertainment. Beal later sold the loan to Icahn for 92.5 cents on the dollar. Beal says he made money at that price because he had collected enough interest on the loan to more than cover the discount he gave Icahn, who was repaid in cash and new bonds, according to regulatory filings. Icahn didn't return calls seeking comment.

For a bargain hunter like Beal, 2008 and 2009 were bumper years. While hedge funds dumped assets—any assets—to raise money for panicked investors, and banks stopped lending to stanch losses, Beal went shopping. He brought in hundreds of analysts and

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ANALYZING BEAL'S BANKS



FDICBRAT) and click on it to view the information. Click on a data item, such as Equity Capital to Assets, to graph it. Type **NI FDIC <Go>** for news on the FDIC. **BETH WILLIAMS**

You can use the Financial Analysis (FA) function to tap into FDIC data on Andy Beal's banks. Type **550628Z US <Equity> FA <Go>** to view a snapshot of key financial information on Beal Bank Nevada. For more data, click on the double arrows on the left-hand side of the screen to display the template column, if not already shown, and then on the box to the left of FDIC Data. Scroll to find a template such as FDIC-Bank Analysis (FA