HIGH PERFORMANCE

by Steve Brown

As with other industries, banks constantly seek out ways to be high performing. Like motorcycle racers constantly seeking the tiniest edge to improve performance, community bankers also need to streamline their operations.

For some, increasing net interest margin is a favored way to improve performance, while others choose to expand a specialty lending niche and still others choose balance sheet growth. Before twisting the throttle all the way back, however, a better question to ask is how outsiders might perceive the bank. Maybe the best question to ask is what critical factors are required to have ongoing access to capital. What attributes do investors think are critical in order to crown banks "top performing?"

From an investor point of view, bankers would be well served to focus on earnings. Consistent, measurable earnings streams are critical to bank success. That is often why bank stocks that remain strong year after year are also the very same ones that tend to have consistent earnings.

Next, bankers know intuitively that simply growing the balance sheet does not in and of itself increase earnings. Sure, earning assets increase, but the deposit side is just as important. We have seen too many banks over the years sharply increase their number of branches, without achieving deposit targets. Branch growth without deposit growth subtracts from performance as much as jumping into new loans to hit arbitrary growth targets also increases risk. In order to protect the stability of earnings in this time of significant uncertainty, bankers have to be smart about how and where they choose to grow. Maybe it is time to revisit the growth formula, throttle down expectations and manage credit risk more tightly by sector.

Another area bankers can capture performance is also one community bankers do not like to talk about very much. Just as a race team only lets its fastest racers take the track, banks may need to look inward for areas of improvement. No one wants to say this openly, but in times of stress, sometimes the best move to make is to turn over underperforming employees and work to replace them with stronger ones that are more driven to succeed.

You have heard us say this before as well, but it bears repeating. One of the fastest ways to affect earnings is to focus additional energies on programs designed to maintain lower cost core deposits. Such deposits deliver more value to a community bank than boosting loan totals. Most community banks are excellent asset generators, but those that can find the jet fuel for their gas tank that increases core deposits, will significantly boost performance.

Times have been good for so long, bankers may need to rethink how precious capital really is. As efforts focus in 2008 on managing asset quality issues, capital is expended and performance drops off. For those banks where credit issues are not projected to be an issue, excess capital levels can also provide opportunity. Top performing banks have developed a plan to support performance and actively seek ways to maximize the use of their capital.

When times are tough, opportunities will surface, so maybe it is time to have another strategic planning session. Community banks with a well-developed (and updated) plan will not only have peace of mind, but also stand a better chance of being able to capture and exploit future performance opportunities. Now is the time to prepare to take immediate action, because times like these will be difficult and some won't make the next curve.

BANK NEWS

M&A

Jacksonville Bancorp ($384mm, FL) will buy Heritage Bancshares ($161mm, FL) for $32mm or about 1.75x book.

Capital

Banks that raised capital in 2007 did so through a variety of methods including TRUPs (50%), Common Stock (33%), Debt/Bank Holding Company (9%) and Pfd Stock (7%).

Dividends

The majority of community banks announced dividends of 5% (51% of banks) last year, followed by 10% (27% of banks), 20% (8% of banks) and 3% (5% of banks).

Nastier SFR

The sum of 60 day delinquent, foreclosure and repossessed rates on SFR loans to Alt-A borrowers (one step up from subprime) climbed to 6.6% in November (a 54% jump from August). The scary thing about this data is that Alt-A and subprime mortgages made up about 40% of all loans originated in 2006 and many adjustable rate loans have not yet started to reset.

FIN 48

FASB has agreed to defer the implementation of FIN 48 for qualifying non-public banks until this year. FIN 48 requires companies to analyze any unrecognized tax liability (such as tax returns not filed in other states).

ATM Fees

JP Morgan Chase has increased the fees it charges non-customers to use its ATM machines to $3, following Bank of America, US Bank and Wachovia