ANOTHER BOLT AND JOLT

by Steve Brown

Now that there are just 23 days to go until the 1Q goes into the record books, we thought we would take a quick look back at where we ended the 4Q of 2007 to see if we could project where community banks might end up when the current quarter closes.

The 4Q ended with a thunderous clap. Particularly worrisome credit deterioration permeated the community banking landscape (and banking in general for that matter).

In all, banks set new records with loan loss provisions and many community banks also wrote down goodwill due to significant impairment (mostly related to previous merger activity). The result was predictable, as banks reported sharply lower earnings. Given that the markets have been even more volatile as of late, we look for even larger write downs and bigger loan loss reserves, as bankers respond to a deepening credit crisis. For most community banks, things got worse in the last quarter of the year and will likely do so again. Adaptability is critical at this point not only to keeping one's sanity, but also to survival given ongoing credit deterioration.

On the performance front, big loan loss reserves hammered ROA for the quarter, pushing it down to 0.18%. ROA in the 4Q was the lowest since 1990, when it was a negative 0.19 percent. As for loan loss reserves, banks set aside a record $31B in provisions, more than 300% higher than they did in the same quarter in 2006. Our expectation for the 1Q of 2008 is that banks will again need to set aside even larger loan loss reserves, which might even push ROA for the quarter into negative territory. As things stand now, pressure is building and banks are reacting by tightening credit and ratcheting up reserves. Don't look for the trend to reverse this quarter.

Margins will also probably feel more pain. While the FRB has cut rates and reduced overall risk in the market, large banks such as Countrywide and IndyMac have been nearly insatiable in their need for funding. These large banks have kept deposit costs from falling very much despite action from the FRB. Despite lower interest rates, asset yields likely continued the trend of the 4Q and fell more than funding costs. As a result, look for NIM to compress even further from its 3.30% level in the 4Q (to probably 3.25%) as community bankers scrambled to make money.

Finally, look for net loan charge-offs to rise again in the 1Q. At the end of last year, the spike to $16B was the highest in 5Ys. Unfortunately, credit continues to deteriorate and regulators continue to make the rounds. In addition, look for higher delinquency levels in the credit cards, single family and home equity sectors. In addition to the charge off situation, noncurrent loans will also probably gain momentum as well. Total noncurrent loans 90 days or more past due climbed 33% in the 4Q to $27B and a similar situation is likely in the 1Q of 2008. Overall, the 1Q will likely serve up a noncurrent loan percentage of around 1.38% to 1.40% (the highest level in 5Ys).

The two bits of good news that carry over from 4Q are the facts that large banks are having greater problems than community banks and the fact that this market presents various opportunities. Increased marketing around financial stability and financial advisory continues to serve community banks well. Those banks with excess capital will find some opportunity in the next 6 months, as acquisition value will be plentiful (if you retain the currency to purchase). The trick for the next quarter will be to play up your strengths, reduce financial risks and move quickly between the lightening bolts.

BANK NEWS

AMBAC

Amid speculation that the credit rating firm would lose its "AAA" rating, the Company put out a release that its claims paying ability is strong to the tune of $15B.

Stimulus Usage

According to a recent Scottrade survey, only 3% of Americans will go shopping with their financial stimulus windfall. 47% said they will save their money and 48% plan to pay down debts.

Small Biz Sentiment

The Wells Fargo/Gallup Small Business Index fell 16 points to 83, the largest ever drop and the 2nd lowest score in its 8 year history.

Top Green Banks

The environmental group, Ceres, ranked the top 40 banks as to their "green practices" and placed HSBC as the most resources sensitive bank followed by AMN-AMRO and Barclays. Citigroup and BofA, the highest ranking US banks, placed 7th and 8th, respectively.

Small Biz Focus

In an effort to help small businesses ride out the credit crunch, Bank of the West ($59B, CA) is offering reduced rates on CRE loans, no-fee lines of credit, free checking and other discounts on small business products.

Auto Lending

A new study by R.L. Polk finds the median age of cars on the road was 9.2Ys in 2007, matching the record set in 2006. Meanwhile, the median age for trucks and SUVs climbed to 7.1Ys. Last year, new car sales fell 3%, as higher gas prices and a weak economy slowed consumer spending.