2Q BANKING DATA - HANGING ON

by Steve Brown

We have put it off as long as we could, but we now have no choice but to talk about 2Q industry data. No matter how you slice it, the 2Q left banks hanging from the jungle vines in terms of performance. By now, most have read the news releases, so we focus here on providing a summary to give banks a comparison for performance.

To set the baseline, consider that the industry as a whole returned (on an annualized basis), an ROA of 0.15%, ROE of 1.46%, an efficiency ratio of 59.13% and a NIM of 3.37%. Meanwhile, noncurrent loans jumped 140.7% from the 2Q of 2007 to the 2Q of 2008. In short, if your bank hung in there and performed better than that, make sure to make some noise, as these were the average metrics for the industry.

Overall, banks reported earnings declines nearly across the board, as everyone ratcheted up loan loss provisions sharply. In all, loss provisions were more than 4x the average of a year ago and about 1.51% of assets at the end of the quarter.

Meanwhile, 56% of institutions had lower quarterly income compared to last year and 18% actually lost money, as the economy continued to sour. For community banks, if there was any good news in the data, it came in the form of higher net interest income (up 9.3% YOY) and higher service charges collected on deposit accounts (up 8.6%).

Finally, loan performance was tough as well. For the quarter, the total amount of noncurrent loans (90 days+) climbed for the 9th straight quarter, pushing the overall percentage of noncurrent loans to 2.04%. This was the highest level since the 3Q of 1993.

To get to the heart of community banking performance, we also drilled down into the data and zeroed in by asset size grouping. Overall metrics (on an annualized basis) by group were: Group 1 (assets<$100mm) - ROA of 0.59%, ROE of 4.36%, efficiency ratio of 78.31% and a NIM of 3.85%. Group 2 (assets $100mm to $1B) - ROA of 0.56%, ROE of 5.40%, efficiency ratio of 70.07% and a NIM of 3.68%. Group 3 (assets $1B to $10B) - ROA of 0.27%, ROE of 2.41%, efficiency ratio of 59.12% and a NIM of 3.62%. As can be seen by the data, asset size alone was not a help. In addition, while the impact for some banks was larger than others, the data shows that few banks have escaped the credit crisis unscathed.

Focusing on a particular area of interest, the loan data for community banks is also quite interesting. Based on the percent of loans noncurrent, community banks were the most strained in construction and development at 5.29% and 3.76%, for banks less than $100mm and banks $100mm to $1B, respectively. That compares to the industry at large, which came in at 6.08%. Meanwhile, noncurrent real estate loans came in at 1.97% and 1.65%, respectively, for the same categories, compared to 2.70% for the industry. Clearly, stresses have increased in many loan portfolios and are rising in real estate.

As we shift gears and look forward to the 3Q, we expect more banks to report losses, cut back on dividends, sell performing assets to maintain capital ratios and reduce funding pressures.

As for bank failures, the total as of last Friday reached 10. Whether you believe the conservative crowd at 150 bank failures expected before we turn the corner or the aggressive group at 300 banks, there is probably still quite a bit of ground to cover before we return to any semblance of normalcy.

We'll report on the industry in upcoming quarters, but in the mean time, hang on tight and things will eventually turn around.

BANK NEWS

M&A

First Merchants Corp. ($3.8B, IN) has agreed to purchase Lincoln Bancorp ($890MM, IN) for an estimated $74MM to $77MM. Combined, First Merchants will have $1.7B in assets and 82 branches in OH and IN.

Consumer Protection

In response to increasing complaints over reduced or terminated HELOCs, the OTS issued guidance reminding institutions to comply with consumer protection laws and rules when suspending or cutting lines of credit. For instance, the Truth in Lending Act's Regulation Z prohibits lenders from ending a HELOC and then subsequently accelerating repayment on the outstanding balance.

Fear of Failure

The FDIC will hire 230 new employees in Dallas, as it prepares for more bank failures. In addition, nearly 70 retirees will be brought back to assist.

Back-to-School Bust

Low-price retail chains (Wal-Mart & Costco in particular) not withstanding, the back-to-school season is not bringing in big sales. Discretionary items have been skipped, as parents are hit by high gas prices, declining home values and contracting credit. On top of this, the summer job market is the worst in over 20Y.

Bank Activity

The number of bank branches increased 3% in 2007, while the number of ATMs fell 9% over the past 2Ys