WACHOVIA'S SECRET COWFORCE

by Steve Brown

The understatement of the day yesterday, was one made by Wachovia's CEO Robert Steel who said, "Although this has been a challenging quarter, Wachovia's underlying businesses remain solid and our franchise exceptionally attractive." Please Google it, because that is what he really said.

This statement might have had more meaning if it wasn't accompanied by an earnings release that showed a $24B loss! It is no wonder Citigroup didn't come back with a higher bid. Citi's CEO Vikram Pandit must have blown coffee out of his nostrils when he read the release. We are no earnings history buffs here, but we are pretty sure that $24B is the largest loss by any bank, in any currency, in any country throughout the history of banking. Almost as puzzling was the fact that the median for 16 top analysts had all expected just a 2 cent per share loss only weeks ago. Instead the beleaguered bank turned in a $2.23 per share loss number excluding one-time charges. That is a pretty big miss, so we will have to say "top analysts" loosely.

Later in the day at a House oversight investigation, rating agency officials were asked tough questions about their conduct. It came out that an internal exchange by S&P analysts yielded the money quote of the day - "We rate every deal. It could be structured by cows and we would rate it."

Being the investigative journalists that we are, we did some digging and found out that sure enough - cows were actually structuring financial instruments and loans at Wachovia. How else do losses north of $15B, or half your market value really make sense? Our cow theory also helps explain the bank's historic 50% efficiency ratio. Not only did they hire cows, Wachovia's management didn't even pay them market compensation.

Cow analysts also explain why you never saw a cow during the day in downtown Charlotte, as they were busy crunching numbers over the Golden West acquisition. To prove our point, consider the fine print of the Wachovia 3Q earnings release that talked about how management expects another $26B in losses in their option-ARM portfolio. The due diligence team was clearly composed of a group of lightly quantitative-minded Holsteins. These numbers are even more unfathomable when you remember that Wachovia only paid $25B for all of Golden West.

Most of the other numbers that Wachovia released yesterday, such as a 2.9% interest rate margin and a plunge in fee income (from 40% of revenue to 13%), don't look that good either. To top it off a 23% drop in quarterly revenues, increasing charge offs that are still growing at an increasing rate and a 7.4% Tier 1 capital ratio do not exactly come to mind when you think of an "exceptionally attractive franchise." It would appear that CEO Steel may have been around too much methane.

Finally, Wachovia is still running only 3% in reserves, so we would expect it to take more allowances if the economy continues to go down hill. Luckily, Wachovia's management isn't expected to be around in time for their next 4Q release. However, we sure hope Wells Fargo has a big pasture somewhere and is watching where they walk.

BANK NEWS

Reserves

The FRB has increased the rate paid on excess reserves to the lowest target rate less 0.35% effective today.

Check Processing

In response to declining paper check volumes, the Federal Reserve has accelerated modifications of its check processing platform to be completed by mid-2009. Existing processing sites will be converted to capture/print sites or have operations relocated. Customers in impacted regions will be notified at least 60-days prior to the changes.

Executive Turnover

Through Sept., a record number of CEOs have already left their jobs, according to HR firm Challenger, Gray & Christmas. This is the highest 9 month total since 1999.

Online Banking

Studies find only 20% of banks offer online bill payment for business customers.

IRS Help

While those two words don't normally go together, it is great to see the IRS has temporarily expanded a ruling allowing corporations doing business overseas to bring money home without having to pay a 35% tax. The move is designed to make more cash available to large US corporations.

Credit Cycle

For those keeping score, note that the classic commercial credit cycle usually lasts about 4Ys. Given that, light should appear at the end of the tunnel in 2011.

Pulling Back

A review of S&P 500 companies finds a 650% jump in those who have announced dividend cuts or suspensions in the 3Q. This was the worst level in 50Ys.

Writedowns

Moody's reports home builders have written down the value of land they own by $25.5B from March 2006 through the 2Q of 2008.