TURKEY SANDWICHES AND 3Q BANK PERFORMANCE

by Steve Brown

A survey of Thanksgiving holiday cooking finds 88% of people roasted their turkey in the oven, 8% grilled it and 4% used a deep fryer. Since most of us will be eating turkey sandwiches for lunch, we thought readers might like to know that as a way to kick off a lunch conversation today. Speaking of leftovers, we thought we would serve up the 3Q FDIC bank data released earlier this week in case you missed it.

On a year-to-date basis through the 3Q, commercial banks as a group posted an industry-wide ROA of 0.44% and ROE of 4.40%. Strains were evident throughout the industry, as 19% of banks were unprofitable, more than double the YTD level of 2007.

When it came to industry growth, commercial banks did ok despite the economic turmoil, increasing asset size by 11.7% compared to the 3Q of 2007. Most of the growth in assets came from CRE lending (up 8.7%), C&I lending (up 9.0%) and increased securities purchases (up 6.6%). Banks were also prudent with the loan loss reserve, boosting it from 1.77% of loans in 2007 to 1.98% in the most recent quarter.

Unfortunately for all commercial banks, the credit crisis also continued to tax loan and earnings performance. Noncurrent loans soared 137% compared to the first 3 quarters of 2007, loans 30-89 days past due climbed 40% and net charge-offs jumped 151%. Such sharp loan deterioration and increased loan loss reserves were also significant catalysts that helped push net income down 58%, slam net operating income by 54% and led banks to cut cash dividends by 48% (when compared to the same period in 2007).

For community banks (defined as institutions with assets of $1B or less), the story was slightly different than the industry as a whole. At the end of the 3Q of 2008, there were 6,637 community banks, which represented 93% of all reporting institutions. Assets for the group were 10% of the overall industry, while deposits came in at 13%. As for performance, weighted average ROA for this group was 0.53, while ROE was 5.02% and the efficiency ratio was 69.7%. On the loan side of the ledger, the loan loss reserve was 1.37% and was enough to cover just over 68% of noncurrent loans. As for capital, community banks averaged 13.03% of Tier 1 risk-based, 10.39% of equity and 9.99% of leverage capital. All were well above minimums to remain well-capitalized. As a group, community banks had a loan-to-deposit ratio of 87%. Finally, when it came to structural changes this year, community banks represented 89% of all mergers and 60% of banks that have failed so far this year.

Finally, we close with a quick update on loan portfolio mix. Community banks at 3Q 2008 held a portfolio that was 74% real estate based. By sub sector, the biggest pieces of the loan pie were held by nonfarm nonresidential (28%), other 1-4 residential (20%), construction (17%) and commercial & industrial (15%). Compared to the industry at large, community banks originated 27% of all nonfarm nonresidential loans, 24% of construction, 16% of multifamily, 12% other 1-4 residential and 9% of commercial & industrial.

There is no mistaking that the 3Q was a rough one for all banks and the 4Q will probably be even more difficult. Hopefully on this quiet day after Thanksgiving, we can all give thanks that it isn't any worse. Now, where did we leave that bottle of mustard lying around?

BANK NEWS

Quick Charter

The OCC created a new, national bank "shelf charter" that will make it easier for private equity to acquire troubled banks. This allows companies to set up a charter and keep it inactive until an acquisition can be identified and completed. In essence, it acts as preliminary approval while investors can pick through the growing FDIC list of troubled banks. One such charter has already been granted.

Problem Banks

The FDIC's list of "Problem Banks" grew from 117 to 171 from 2Q to 3Q. This is the first time since 1994 the combined assets on the list topped $100B. While a stark increase over 2Q, it is still just 2% of banks that made the list.

Good For Housing

FNMA and FHLMC said they will suspend foreclosures from Nov. 26 thru Jan 9, as they give servicers more time to implement an updated loan modification program. The latest data shows 765k properties received foreclosure notices in the 3Q, the most on record.

Retail Sector

Store vacancies at regional malls have increased nearly 7% in October, marking the largest rise in 6Ys, according to research firm Reis.

Consumer Debt

Revolving consumer debt, excluding real estate secured loans, has steadily increased since 2003 (from less than $775B to over $950B this year).

Holiday Spending

Black Friday isn't really "black" as most retailers will still not turn a profit until mid-December (if at all). A recent Gallup Poll shows that the average consumer will spend $616 on gifts this year, down 29%.

Liquidity Guarantee

Bank of America and Citigroup will both issue 3Y FDIC guaranteed notes next week. Price talk is around a 3.20% yield or an 80bp spread. Interested? Let us know and we can try to get an allocation.