# BETTER CONTROL WITH PRE-PRE

by Steve Brown

Long time readers know our marketing love affair with Heinz Ketchup. We worship the perfection of the recipe, we lamented that it took so long for mankind to figure out how to turn the bottle upside down and today we point to the squeeze bottle. One of the biggest sales boosts that Heinz ever received with its ketchup line was when it moved to the squeeze bottle in the early 2000Ã¢Â€Â™s. While helpful for the rest of America, what it really did was give kids everywhere an element of control. When youÃ¢Â€Â™re little, you donÃ¢Â€Â™t get to do too much in this world and when you can control something, even something simple like Ketchup, youÃ¢Â€Â™re pretty happy. Kids loved the new bottle, which prompted them to over-squeeze ketchup all over the place (which is why parents donÃ¢Â€Â™t let them control too much) and, presto, Heinz experienced a 20%+ pop in sales.

That element of control is one reason why the pre-tax, pre-provision earnings (PPE) metric for banks has caught on. This metric, or Ã¢Â€Âœpre-preÃ¢Â€Â as it is often referred to, gives a view into a bankÃ¢Â€Â™s Ã¢Â€ÂœcoreÃ¢Â€Â earnings, not including the volatility of building reserves and the associated impact of taxes (including any net operating loss credits). Bankers like it because it is a whole lot better than talking about negative net income. Analysts like it, as it tends to be a less volatile measure of earnings, absent any unpredictable credit provisions. In almost every earnings call we have listened to recently, management has highlighted PPE.

To be fair, PPE doesnÃ¢Â€Â™t give a complete picture of a bankÃ¢Â€Â™s financial health and it will be interesting to see if it is as widely used when credit improves and reserves are being reduced. For now it is the metric of the day for banks. The industry has even gone one step further and now talks in terms of pre-pre ROE, which gives the earnings over capital. For most banks, this number is around 7.4%, after hitting a low point in 2009. While the number should probably be north of 18.5% (the 10Y average), when you consider all the headwinds of banking (FDIC assessments, record low NIM and a host of other issues), it is not bad just to be positive these days.

The good news is that pre-pre ROE may tick higher in 1Q for the first time since 2008. It is, of course, highly dependent on NIM and that looks like it will improve. Funding costs for banks hit an all-time record low back in Feb, a trend that appears to still be holding for Mar. In addition, loan pricing looks like it will increase slightly, producing higher NIM for 1Q. The 2 wild cards are non-interest expenses (which appear to be stable for the first 2 months of the year) and charge-offs (which get calculated into PPE). Here, the Ã¢Â€Âœ1Q EffectÃ¢Â€Â should play out as it has for almost every year since 1990 (most banks operate on a calendar year and tend to be more aggressive with charge-offs for the 4Q year-end close compared to 1Q the following year). This has held true for every year for the past 25, with 2008 being a notable exception (average improvement is about 30bp from 4Q to 1Q).

Before you figure out whether you want to utilize pre-pre ROE as a metric, we have prepared a supplement that ranks each bank and gives a comparison for the past 5 quarters. To see the specifics on your bank click here and look on the bottom right of the page.

As for Heinz Ketchup, stay tuned, as we understand that they may be coming out with another update to their packaging designed to boost sales.

## BANK NEWS

### FDIC On TAG

Chairman Bair noted the FDIC may extend the TAG program beyond the June 30th expiration as she pressed for a decision within the next month. On another front, the Chair pointed out her opposition to permitting more loan loss reserves to be counted as Tier 2 Capital. This follows remarks by the Comptroller of the CurrencyÃ¢Â€Â™s supporting a change.

### FDIC On Rate Cap

The FDIC clarified its position, as it pertains to interest rate deposit restrictions for less than well-capitalized banks. It said institutions that received a high rate area designation can use the higher of the national rate cap or local market-rate cap to set a ceiling on deposit rates. In addition, the FDIC also said it is reviewing whether its high-rate area determination should apply to every branch at every bank in that market equally, or if it should get more granular and look at rate caps by bank or branch.

### Mobile Ready?

Citibank closed its mobile P2P transfers program at the end of 2009, citing that even those that find phones a valuable means to moving funds are still many years from fully adopting the service. A survey run by IDC Financial Insights found that of customers with a mobile phone, less than 10% use text messaging to check balances, just 6.4% use a phoneÃ¢Â€Â™s internet browser, less than 3% downloaded applications and only 1.2% have used P2P transfers.

### BofA

CEO Moynihan said that the bank is changing to improve customer relations (simplifying fee structures, polices and statements) and alter compensation structures (toward longer-term performance standards).

### Business Continuity

A study by Symantec finds only 53% of businesses has disaster recovery plans in place. What a great area for banks to help provide value for their customers.