AN X-RAY LOOK AT EARLY BANK PERFORMANCE

by Steve Brown

A North Carolina banker had the quote of the day yesterday, when we inquired about 1Q numbers. He said things were getting better, but he "felt like he had just gotten over a 2Y case of appendicitis." We can relate, but have to admit that we barely know where the appendix is and really have no idea of its purpose. For that matter, we have no idea why

it gets inflamed, but we will just thank our lucky stars that while many things hurt, our appendix is not currently one of them.

Yesterday, we finally achieved a representative sample of strong banks from 1Q and can further validate our appendix- challenged banker's thoughts - things are getting slightly better for more banks. For starters, when banks have issues, they tend to file their call report late. Last quarter at this time we had 1,540 banks that had filed, which was about average for most of 2009. For 2010, we already have 2,126 banks that have filed, which happens to be a representative sample to capture how the strongest quartile of banks is doing. As a cohort, these banks tend to be smaller (under $400mm in assets on average), retail - oriented and based either in the Midwest or Northeast. Similar to the last 5 quarters, geography remains one of the largest determinants of performance. It also should be noted that this cohort has outperformed the average of the industry by about 512bp in ROE for 2009 and now outperforms by almost 600bp.

Speaking of ROE, this ratio doubled from 4% to 8% for these banks quarter over quarter. The increase was driven by a slight improvement in net interest margin, which in turn was the result of some of the lowest cost of funds on interest bearing deposits since 1951. This gain was partially offset by lower leverage, as the loan-to-deposit ratio dropped from 78% to 76%. The largest driver of higher earnings came from a reduction of overhead costs, as expenses were cut by this group, which reduced the efficiency ratio from 68% to 65%. Tax loss carry forwards also helped improve net income.

In terms of asset quality, charge-offs to earning assets dropped from 60bp to 40bp which helped; but not all was an improving trend, as ALLL to loans increased from 1.6% to 1.7% for this group. More disturbing is that noncurrent loans to total loans went from 1.9% in 4Q to 2.4% in 1Q, underscoring the fact that we have still not turned the asset quality corner. Meanwhile, Texas ratio (excluding 30 to 89 day delinquencies) at these banks ticked up slightly as it went from 28% to 29%. It should be noted that acquisition, development, construction and CRE loans as a percent of capital decreased, while securities investments increased. The net result was a more diversified balance sheet and a lower risk profile.

In terms of liquidity, the decrease in loan balances eased liquidity pressure and banks continued to grow both interest bearing and non-interest bearing deposits (money market accounts grew the most). Higher liquidity balances and probably regulatory pressure pushed these banks to replace wholesale funding with more expensive (but probably local) deposits.

Finally, capital remained stable, with a slight improvement to risk-based holdings (because of greater securities holdings), but a slight deterioration in leverage capital.

Overall, the takeaway is that for banks in the top quartile reporting so far, performance is improving, but not markedly so. Until loan growth returns and asset quality improves, banks will continue to struggle with profitability. However, given the large reduction in risk over the past 5 quarters, the increase in earnings has been impressive.

If you are interested in learning more about how banks with reduced intestinal problems are faring, go here and click the interactive "Early Look" at the bottom right. We will be getting final 1Q numbers on Fri, so watch for final 1Q numbers next week.

Related Links:
BIG Metrics

BANK NEWS

TAG Opt Out

A reminder to banks currently participating in Transaction Account Guarantee Program (TAG) that the opt-out deadline is this Friday. Banks already in that don't opt out will automatically be rolled into the 2nd 6-month extension that runs from 7/1 to 12/31/2010. Those who wish to opt out need to send an e-mail to optout@fdic.gov and use the subject line "TLGP Election Form Opt Out Requested -- Cert No. #####." Please note that PCBB will be staying in the program.

Reform

The Senate came 3 votes short of passing enough votes to bring the financial regulatory reform bill to the floor. The next attempt could come as early as today.

Underwater

AZ, FL and MI are proposing to use funds from the $1.5B reallocated from TARP to pay down loan balances for underwater borrowers and/or up to 9 months of mortgage bills for unemployed owners.

JD Power Finding

A recent retail banking study showed that only 60% of bank customers noted experiencing basic customer service acts, like a simple hello/welcome, thank you and offers of assistance.

Earnings

With 48% of major publicly traded financial firms reporting earnings, 45% have surprised to the upside.

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