INDUSTRY UPDATE - Q2

by Steve Brown

You can judge a good commercial airline pilot 2 ways: 1) by what he or she does in turbulence, and 2) the landing. In turbulence, a good pilot will immediately climb or go into a bank in an effort to keep everyone in their seats. The last thing a traveler wants to feel is where their Diet Coke is hovering

zero G environment somewhere around eye level. The landing should be silky smooth as well. As they say, you pray for the plane at takeoff, but you pray for the pilot at landing. The other thing that really chafes our seatback is when pilots premature land. This happens when they get on the mic about 10 minutes before you land to say, "Thanks for flying with us...welcome to Chicago." You are not in Chicago - we have barely cleared Iowa, so let's save the welcoming committee for terra firma.

In similar fashion, banks in the second quarter have stabilized, but it is still too early to foresee the future, so no one should be celebrating that they cleared the economic downturn. Looking at about 99.7% of banks (excluding thrifts) for 2Q, as an industry, ROE came in at 5.4%, up from 4.8% last quarter and a vast improvement from negative numbers at the end of 2009. On the now popular, pre-tax, pre-ALLL core earnings number, banking was basically flat coming in at a 19.6% adjusted ROE. Different, from 2009, smaller banks (those under $300mm in assets) continued to underperform larger banks for the 2nd qtr. in a row.

By asset class, bank operations for credit cards continued its streak for 2010 as the most profitable major operating line for community banks producing an 11.9% return. This compares to an 8.1% ROE for consumer operations and an 8.0% ROE for agriculture. After that, mortgage operations produced banks a 5.9% ROE, while commercial operations produced a 1.2% ROE.

In terms of components of earnings, cost of funds for the industry came in at 0.98%, down from 1.00% last qtr. The yield on earning assets fell from 4.83% to 4.75%, which equates to an overall net interest margin for the industry of about 3.78%, down from 3.83% last qtr.

The biggest change remains in asset quality and banks decreased their ALLL to total loans for the first time in 7+ qtrs, to 3.6% from its high of 3.7% in 1Q 2010. ALLL to non-current loans increased slightly to 72.8%, from 72.1% in 1Q. Construction as a percent of capital continued to decrease, while C&I and CRE remained stable. The good news is for the first time in more than a year, the Texas ratio of the industry came down from its high of 40.1% last qtr, to 35.6% for 2Q. Similarly problem loans, as a percentage of capital, also improved.

On the funding front, deposit costs came down and the quality of funding improved. Banks continued to reduce FHLB borrowings in an effort to free up collateral, while brokered CD issuance remained stable. Core deposit performance improved slightly driven by higher transactional account volume and lower interest bearing deposit balances.

Leverage in the form of loans-to-deposits remained stable at 75.8%, as did capital levels. Core, or leverage capital remains at 8.5%, while total risk based capital was at 15.1%.

In summary, 2Q 2010 marks the first significant improvement in bank performance since the downturn. While it is too early to claim that the industry has brought the turbulence under control and that we have landed, it is a step in the right direction and has many bankers starting to breathe easier. If you are a BIG Metrics user, you have access to full 2Q information. If you are not a subscriber, but would like more information on 2Q trends, or would like to see how your bank ranks against the industry in pre- tax, pre-provision ROE, be sure to check out our free information located by clicking here and checking the bottom right.

BANK NEWS

Closed (109)

After 4 consecutive weeks of multiple bank failures, regulators closed just one institution Friday, bringing the total number of bank failures in 2010 to 109. Ravenswood Bank of Chicago ($265mm, IL) was shuttered with most deposits (for a 0.9% premium) and assets ($161mm under loss share) purchased by Northbrook Bank and Trust Company ($905mm, IL), a subsidiary of one of our favorite's, Wintrust Financial ($10B, IL). Look under Failed Banks here for more information.

In Organization

By our count, we know of 36 banks in organization, but we believe only 12 of these will ever open. So far for the year, only 1, Lakeside Bank in LA, 2 weeks ago, has managed to get the green light.

Fair Value Accounting

FDIC Chairman Sheila Bair told Forbes magazine that she would prefer that FASB drop its fair value accounting proposal for all financial instruments.

Consumer Credit

Total outstanding credit dropped for a 5th consecutive month, falling $1.34B to $2.42T following a $5.28B drop in May. Revolvers fell $4.49B for a 21st straight month, while non-revolving loans grew $3.14B.

USTs

For the first time since the start of the financial crisis in 8/07, US investors own more Treasuries than foreign holders.