# YOGI AND THE GROWTH FORK

by Steve Brown

"When you come to the fork in the road, take it" Ã¢Â€Â¦Yogi Berra

Baseball Hall of Famer Yogi Berra was brilliant on the baseball diamond (21 World Series appearances), but often went a-foul when it came to the English language. Having only an 8th grade education, Yogi butchered English at almost every at bat, as he often was unable to articulate his complicated, yet deep thoughts. His famous quote "It ain't over until it's over" is a classic example.

Unfortunately, when it comes to choosing a path from a fork in the road, Yogi, while confused, had it right (when describing the current banking environment). The fork in the road that is coming up is what your bank is going to do regarding growth in 2012 and thereafter. At present, there are hundreds of investment bankers, trade associations and even regulators running around telling banks that they need to be at least a $500mm bank to survive. The logic is that the extra regulatory burden, risk management and competitive environment are going to force banks to be larger. To this, we quote Yogi - the notion of growth as a savior is "another wrong mistake."

While we don't argue that banks face additional operating costs, we see any number of ways to make up these costs and asset size shouldn't be the default answer. If asset size was the answer, you would see a much higher correlation to bank multiples and asset size than you do. In fact, ROE is many times more important when determining bank value than asset size. Asset quality and cost of funds, for instance, play a larger role when setting a price on a banking franchise. Fundamentally, would you pay a higher price for a $1B bank that had a high cost of funds and was saddled with a costly branch network, or would you rather have a $500mm bank with a good deposit base and quality assets? If you are like the market, it is by far the latter.

For 2012, that means bankers may have to face some tough decisions given the low rates, flat yield curve and lack of loan growth. While building a stable deposit base was once the most important thing in banking to drive value, now, bankers have to question their liability structure more than ever. Given that the average bank is paying about 13bp in FDIC fees, banks that have a 1% cost of funds and a 75% or higher efficiency ratio are finding that the all-in costs on a majority of their deposits are likely above their risk-adjusted return on their loan portfolio. That means many bankers are expending resources and taking on more risk, just so they can have lower profitability.

In this market, banks need to get aggressive on reducing their liability costs. Currently, there is little reason to be paying any premium for deposits. If deposits aren't rolling in right now, chances are you are not spending enough on marketing (or have the right tactics). Now is the time to increase marketing if you need deposits, as a strong investment in marketing buys banks a much more valuable customer than a strong investment in deposit premiums. Further, if you do need cheaper deposits, then you are prime candidate to consider shrinking the balance sheet, as that may be the best path to profitability. Getting rid (either through sales or attrition) of your lowest risk-adjusted returning loans not only helps on the asset side, but relieves funding pressure. If you are awash in deposits, then you also might have to think about shrinking, as many of these dollars are likely costing you more than you can return.

The takeaway for today is that growth, as a path forward, should be questioned now more than ever. If you can manage risk-adjusted profitability of your customers, then growth can be a home run. However, if you don't have these tools, then growth may do more harm than good. Not wanting growth and pushing away deposits are signs that the current banking model is turned on its head. As Yogi said, "The future ain't what it used to be."

## BANK NEWS

**2 Failures (73 YTD)**

Regulators closed: 1) Citizens Bank of Northern California ($289mm, CA) and sold it to Tri Counties Bank ($2.2B, CA). Tri Counties captures 7 branches, all deposits and essentially all of the assets under a loss share. 2) Bank of the Commonwealth ($985mm, VA) and sold it to Southern Bank and Trust ($1.4B, NC). Southern gets 21 branches, all deposits and 93.8% of the assets (86% under a loss share).

**No Free Checking**

A study by Bankrate.com finds only 45% of non-interest bank checking accounts are free, down from 65% in 2010 and 76% two years ago. The average monthly fee for a checking account has now reached $4.37, up 75% from 2010 and the average minimum balance required for a free checking account that pays interest is $5,587, up 44% from last year.

**Downgrade This**

The SEC is reportedly considering recommending civil legal action against Standard & Poor's for its rating of a 2007 collateralized debt offering.

**Biggest Muni Default**

A housing development for retirees in Chicago has become the largest muni bond default of the year at $229mm, after missing a payment Sep 1. The 53 story apartment development has failed to meet occupancy expectations and the developer, Franciscan Sisters of Chicago Service Corp has now defaulted. The development is a high-rise retirement community with 248 apartments, common dining rooms, three chapels and fitness and aquatic centers.

**Lawsuit**

BB&T, Bank of New York Mellon, Sovereign and Wells Fargo are suing the US Gov't over more than $1B in tax credits that the IRS has disallowed over the past decade.