BANK EARNINGS REPORTS

by Steve Brown

Since we are coming to the end of earnings announcements for the quarter, we thought we would shed light on public bank announcements and earnings. For starters, public banks are required to report performance in the form of an announcement (usually quarterly) with full SEC disclosure fillings to follow. Each public bank has some leeway about the metrics they use in their announcement, but most choose to consistently report at least revenue (more than 90% of reporting banks), earnings (almost 100%), earnings per share (about 80%), margins (about 70% of banks) and usually some form of credit quality indicators (about 40%). Since earnings announcements contain highly market sensitive information, the SEC regulates and restricts the control of information. In concept, the announcement should hit the public market at all at once, thus preventing analysts, vendors and employees from having it prior to release. If you study how equity prices move before and after an announcement, some interesting items come to light. Before an announcement, there can be a mild increase or decrease in price that is foretelling on the direction of earnings as much as 60% of the time. Since insider trading or the leaking of information is illegal, the other explanation is that investors and analyst tend to be accurate with their pre-release forecasts. Also interesting is the fact that even after an earnings announcement, equity prices still move up or down in accordance with the direction of the news. Thus, after a bank releases its earnings, there can be about 3% of movement in the stock price in the direction of the release which runs counter to the efficient market hypothesis. Another interesting aspect of bank performance, particularly for momentum investors, is that studies tend to indicate banks that consistently beat prior period earnings and/or estimates over the last 3 quarters, may deliver higher ROEs in subsequent periods. Earnings announcements by large community and regional banks tend to have a larger impact on stock prices on the announcement date and prices are more likely to drift after the announcement (when compared to large banks, perhaps due to liquidity). To that point, larger banks tend to be covered by more analysts, thus sometimes resulting in more information in the public domain. As a result, large banks may have fewer earnings surprises when compared community or regional banks. The quality of the announcement also plays a role, as there seems to be evidence suggesting the market reaction with management commentary is greater than announcements with only numbers. Finally, there is the question of intrinsic value. There is some evidence to suggest that the market is not a great judge of intrinsic value in banks. Thus, if revenue and earnings are up and are beating expectations, the stock price may follow for 1 to 2 months after the release. However, if core metrics such as margins, asset quality, provisions, organic loan origination and others are down, that means a lower intrinsic value as future cash flow streams are decreased. This is particularly interesting in 2Q, as many banks surprised to the upside, but have declining intrinsic value (or the opposite). In these cases, we surmise we could see equity pricing move in the opposite direction over time, relative to the market. Bank announcements and earnings quality comes in a variety of flavors and factors can be many more than we have discussed here, so make sure you take everything into account prior to investing. Depending on the mood of the market, these factors can also have a different impact at different times. Despite general sentiment, smart bank investors can usually read between the lines for value and trends, while smart managers can perhaps put the odds of positive equity prices in their favor by managing estimates and highlighting positive intrinsic value.

BANK NEWS

Closed (39)

Regulators closed Jasper Banking Co ($217mm, GA) and sold it to Stearns Bank ($1.5B, MN). Stearns gets 3 branches, all deposits (excluding brokered) and entered into a loss share on $106mm of assets.

Clarification

Some astute bankers pointed out our comment on Friday that about 90% of all employment in the country comes from business establishments that employ less than 20 people and 99% comes from those who employ less than 100 refers to the number of businesses and not the number of employees. We should have been clearer.

M&A

Eastern Bank ($7.9B, MA) will acquire The Community Bank ($328mm, MA). Since both are mutual thrifts, no money will exchange hands.

Competition

PNC Bank said it will add 191 branded ATM machines (138 in NC and SC; 53 in FL, FA, VA, MD and DE) to Harris Teeter grocery stores by Labor Day.

TARP Auctions

In an effort to wind down its ownership in community banks, the Treasury sold shares in auctions for 12 banks for roughly 14% less than its original investment. The discount is also higher than the 10% average on positions sold earlier this year by the Treasury. The federal government still owns stakes in 311 banks for over $10B.

Banned

The FDIC has banned four former executives of failed Downey Savings and Loan from the banking industry. The group includes Maurice McAlister (co founder); Cheryl Olson (former vice chairman and McAlister's daughter); Daniel Rosenthal (former CEO and former son-in-law to McAlister); and Thomas Prince (former CFO).