GOLDEN EGGS AND 3Q PERFORMANCE

by Steve Brown

Bankers know FICO scores range from 300 to 850 and they also have a good idea what they need in this area to make a given loan. What we found interesting is a recent report from FICO on common characteristics of people who have scores of 785 or higher, which from the picture we will call the "golden eggs." It found golden eggs have low revolving balances relative to available credit, they don't max out their credit cards and they consistently make payments on time (96% show no missed payments on their credit report and the rest had one 4Ys ago). On average, 67% also have total balances of less than $8,500 on nonmortgage accounts. In addition, the golden eggs have an account that is 11Ys old on average and they use only 7% of their available revolving credit. As you would expect, golden eggs make it a habit to pay consistently - a key to their success. We took a look at the most recent 3Q FDIC data to see if anything surfaced related to community banks. The headlines are good for the industry, but given about 10 banks skew that so much, the report isn't worth much unless you crack some eggs and make sense of the scramble. We did that and here are some results of our more detailed analysis. The headline screamed that banks had improved quarterly profits in 3Q by 6.6%, as ROA climbed to 1.06% and revenue growth picked up by 3.0%. On a year over year (YOY) basis, revenue growth saw its largest increase in almost 3Ys, as banks sold loans (up 227.5%) and losses on sales of OREO fell by nearly 82%. Meanwhile, NIM declined nearly 4% (by about 13bp), but NII was slightly higher (up 0.7%), as interest earning assets increased. Finally, provisions were reduced by nearly 21% (10th consecutive quarter reserves have declined), driven by lower charge offs (down about 17%). Those were the high level takeaways, but what about community banks? For the 6,522 community banks with assets below $1B, things were a bit different in the 3Q. For this group, yield on earning assets was about 4.50%, the cost of funds was 0.71% and the NIM was 3.79%. That compares to the largest group for each component of 3.81%, 0.48% and 3.33%. Doing some quick math, community banks have an 18% higher asset yield than the biggest banks, but a cost of funds that is 48% more expensive, resulting in a NIM that is about 14% higher. Community banks have slightly more loans on the books in percentage terms, as the loan to deposit ratio is 70% vs. 69% for the largest banks. Next, we looked at ROA, ROE and efficiency ratios. Here, the community bank group had an ROA of 0.85% (vs. 1.10%); an ROE of 7.30% (vs. 9.68%) and an efficiency ratio of 72.6% (vs. 58.9%) for the largest banks. For these metrics, community banks are doing worse by 23%, 25% and 23%, respectively. When it comes to market share, as of the 3Q, community banks in number represented 91% of the industry, but in assets controlled about 10% and in deposits about 11%. Meanwhile, community banks had an average loan loss reserve of 1.80% vs. 2.31% for the largest banks. When it comes to loan mix, 77% of community bank loans are in real estate (vs. 17% for the industry). By sub category, community banks are holding 5% of RE in construction and development (vs. 5% for industry); 39% nonfarm nonresidential (vs. 26%); 5% multifamily (vs. 6%); 5% home equity (vs. 14%) and 37% other 1-4 family (vs. 46%). Finally, a few more interesting golden eggs we throw into the basket include the fact that about 42 new banks per quarter use hedging tools; 98% of all loans sold by banks under $100mm in 3Q were single family residential and deposit balances for all banks above $250,000 sitting in noninterest bearing accounts jumped 8% during 3Q to $1.5T (TAG expires 12/31).

BANK NEWS

Branch Sale Opportunity

Banks looking to sell branches to reduce costs might want to contact Starbucks. They just announced they plan to open at least 1,500 more stores in the U.S. over the next 5Ys.

Worried

A new Wells Fargo/Gallup poll of small business owners finds they are the most pessimistic they have been since 3Q 2010. Uncertainty over the fiscal cliff was the primary catalyst indicated for the pessimism.

Social Media Law

In CA, it is now illegal for a company to require job seekers or employees to provide the username and password to their social media accounts, or for universities from doing the same for students and prospective students.

Slow Growth

Bill Gross of PIMCO said he expects the U.S. will see 1% to 2% growth for some time to come and that investors "should get used to it." He indicated structural challenges such as high debt levels; slower growth in China; and an aging U.S. workforce were all taking a toll on economic growth and would continue to do so for some time to come.

Asset Control

FDIC research finds the difference between the amount of assets held by community banks vs. other banks has widened from about 12x in 1985 to 64x now. The data shows bigger banks continue to swallow up industry assets.

Borrower Risk

Bankers monitoring the quality of loan borrowers should get a handle on the number of employees each customer has and begin to track it going forward. Recall that by 2014, businesses with 50 or more full time employees must offer healthcare coverage based on employee income or face penalties of $2,000 per worker.

Municipal Jobs

Fed research finds federal, state and local government jobs make up about 16.5% of all employment.