

# 2008 OUTLOOK THE FIRST LOOK Anat Bird

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## 2008 Outlook

- Margin management: the light at the end of the tunnel?
- The credit crunch?
- Credit is beginning to fray
- The deposit story: the next chapter
- The payments business opportunity: still underutilized and expanding
- The acquisition business: hot and heavy
- What's on the regulators' mind?
- Industry trends and The Street

## Margin Management

- Margin pressure persists for many banks, mainly due to stiff pricing competition
- The yield curve is beginning to normalize
- Trends are still unclear (up or down?)
- Checking accounts continue to dry up
- Deposit mix – shift to CDs
- The role of pricing
- Innovation and execution are at a premium

## Margin Behavior - Continued

- Wide range of bank responses to the uncertain rate environment—from heavy margin compression to great expansion; overall, compression is expected to continue
- LIBOR behavior is changing dramatically given European banks' sub-prime credit losses in the US
- Overall, margin continues to experience pressure in many banks
- Larger banks offset margin deterioration through improvements in efficient and non-margin driven revenue sources
- Key lessons:
  - Core funding is always beautiful but its definition is getting murky

## Margin pressure (continued)

- Checking growth strategy needs refreshing
- Margin dependence is risky even if things are going your way
- Market conditions make pricing more challenging than ever

## The Credit Crunch?

- Loan growth continues to outstrip deposit growth nationwide
- Is it real and does it matter?
- C&I loans are growing at a brisk pace (11% annualized in some markets), and even construction loans are holding up surprisingly well
- Certain credit markets are under pressure (e.g. CRE, sub-prime)
- Secondary markets for certain credit products have shut down “on a dime”, causing alarm and a perception (and, sometimes, a reality) of a crunch
- As always, being a contrarian might present an opportunity

## The Deposit Story: The Next Chapter

- Deposit balances are growing, albeit at a slower rate than loans
- Competition still intense but growth comfortable in many markets
- Pricing is challenging
- Checking account growth daunting
- Internet bank flourishing

## The Deposit Story- Continued

- Key lessons:
  - Competition intensifying from internet banks
  - The market for deposit growth is there
  - Innovate, especially the checking product line
  - Focus your marketing on customer segments
  - Retail should include small business deposits



## Credit is Finally Getting Worse

- The predicted credit deterioration has started; liberalized terms, covenants and razor-thin pricing have come home to roost in late 2007
- Non-accrual loans for all banks have risen for each of the last three quarters
- Some sectors (builders, contractors, sub-prime) have been hit hard
- We haven't seen the end yet (the housing inventory is still being digested; 2008 will show the full brunt of the foreclosure flow)
- Loan growth is getting even more robust in most places, especially in C&I
- Real estate has ground to a halt in many markets; builders are keeping the land unimproved, servicing the debt (hopefully) and waiting for the market to turn
- Ensuring “early warning” culture is inculcated within your lender force is key<sup>9</sup>

## Credit (continued)

- Lessons learned:
  - The boy who cried “wolf” is finally right
  - Credit issues are still sporadic both geographically and segment-wise
  - Small business is still under-banked
  - Budgets need to incorporate further credit deterioration in 2008

## The Payments Business Opportunity

- Still underutilized and growing
- Debit card activation
- Credit card portfolio building and usage
- Remote Deposit capture for both commercial and retail customers (USAA)
- Payments strategy gaining acceptance and fee income beginning to show results in some banks
- Opportunity window beginning to close

## The Acquisition Business – Hot and heavy

- The acquisition market is heating up at all bank sizes
- Pricing is better but still not rational, especially in growth markets
- Banks of all sizes are on the block; banks of all sizes are buying
- Deposit franchises and high-growth market banks \$1B+ continue to be extremely pricy

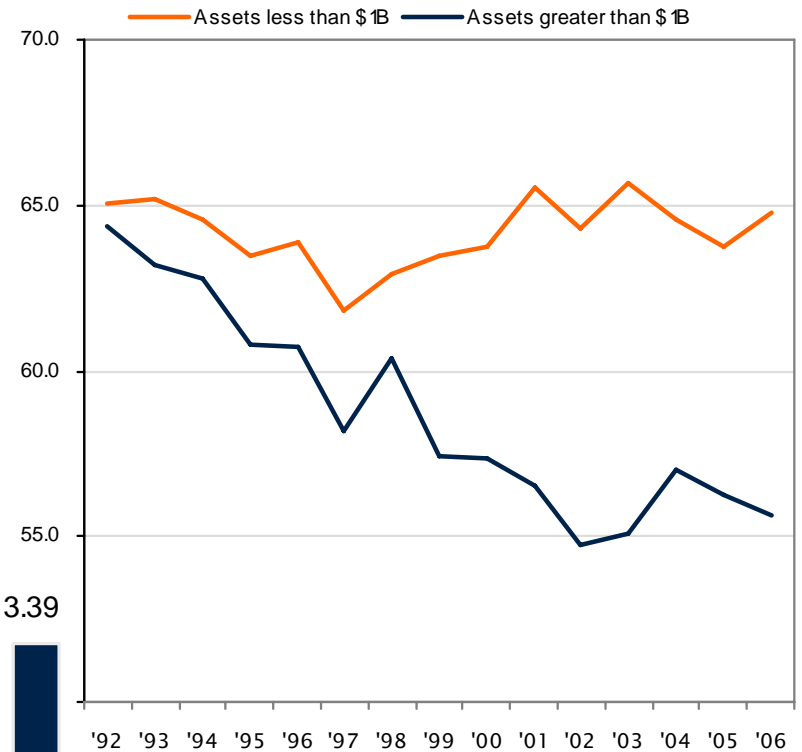
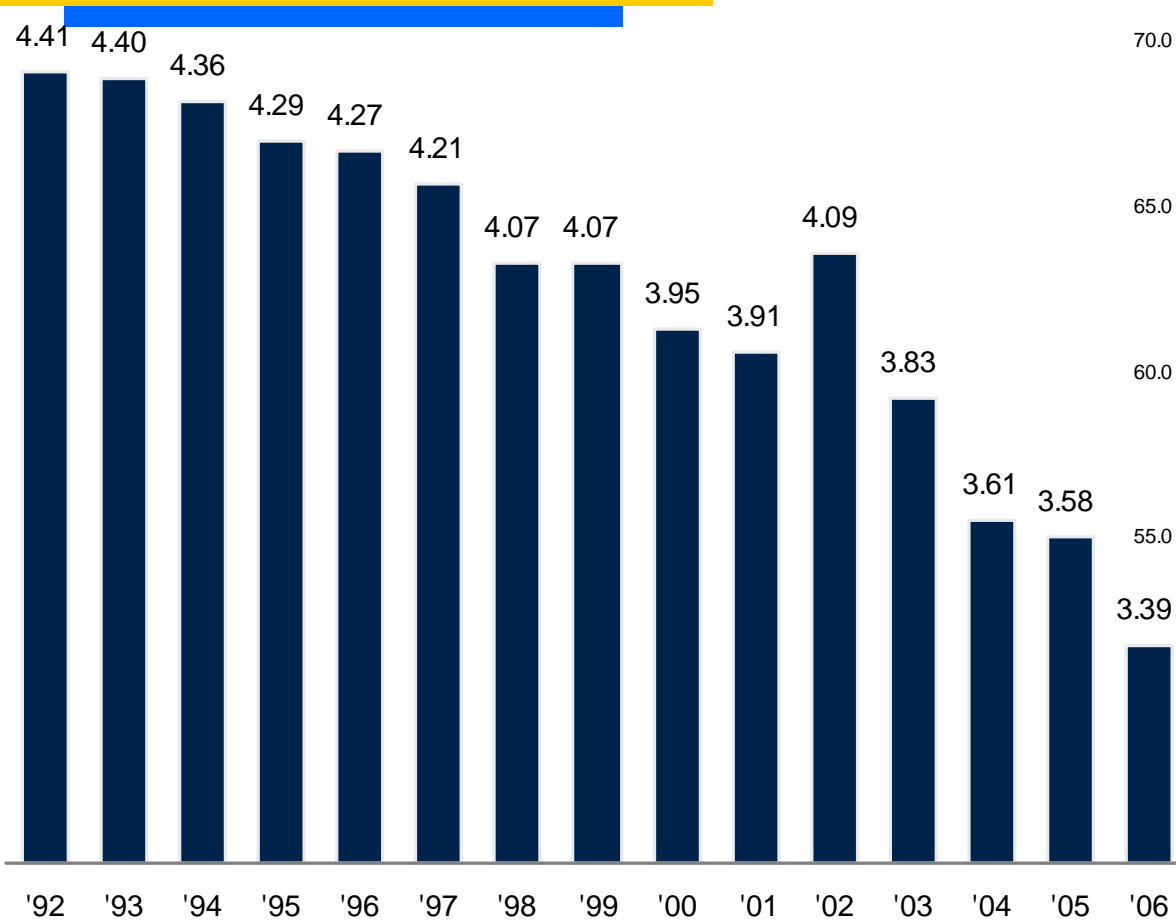
## Acquisitions - Continued

- Lessons learned:
  - 2007 will be a big year for acquisitions but valuations are under pressure
  - Competition will intensify as de novos slow down
  - Big year for aggregators
  - Deposits premiums continue to exceed 30%

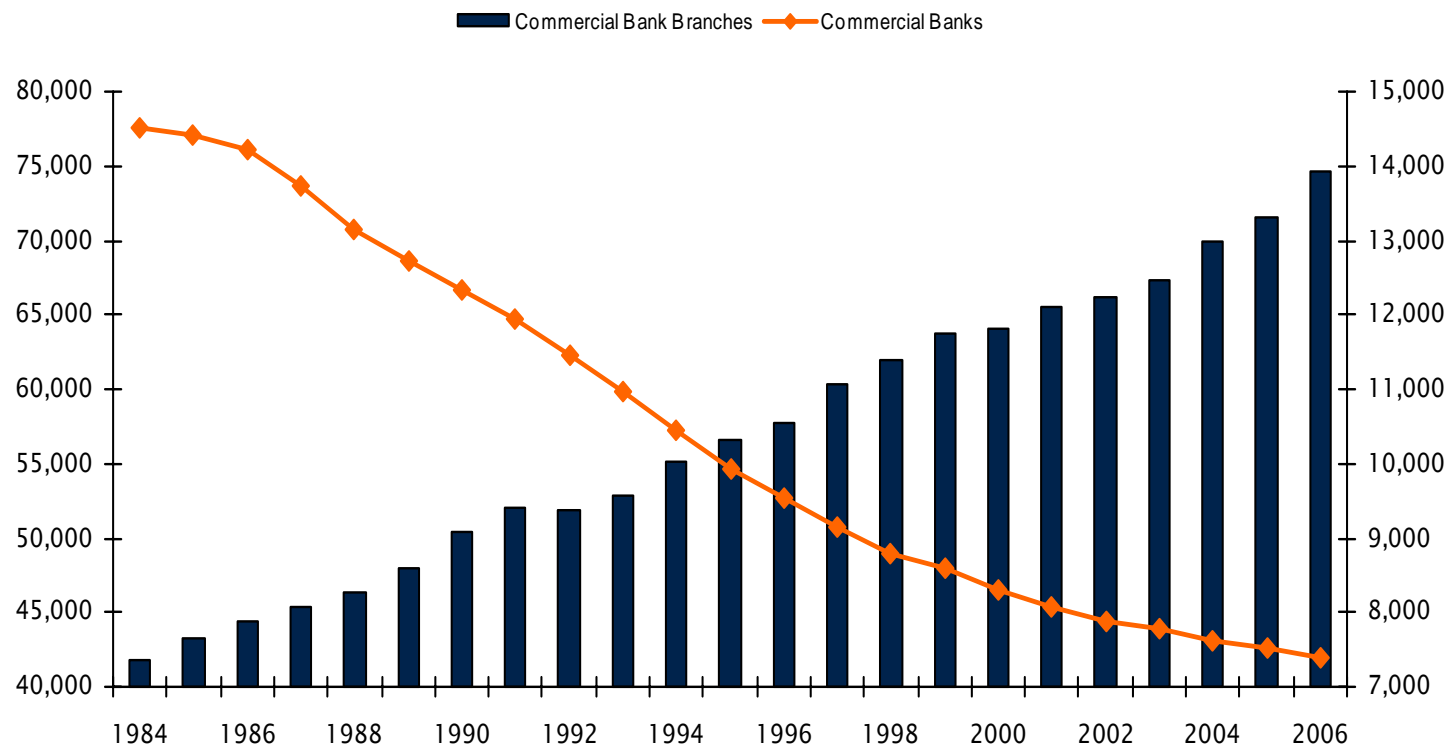
## What's on The Regulators' Mind?

- BSA/AML – civil money penalties continue
- Credit quality back on the map and will significantly intensify in 2008
- Liquidity might follow as a focus of regulatory attention, particularly given anticipated credit issues

## Margin and efficiency

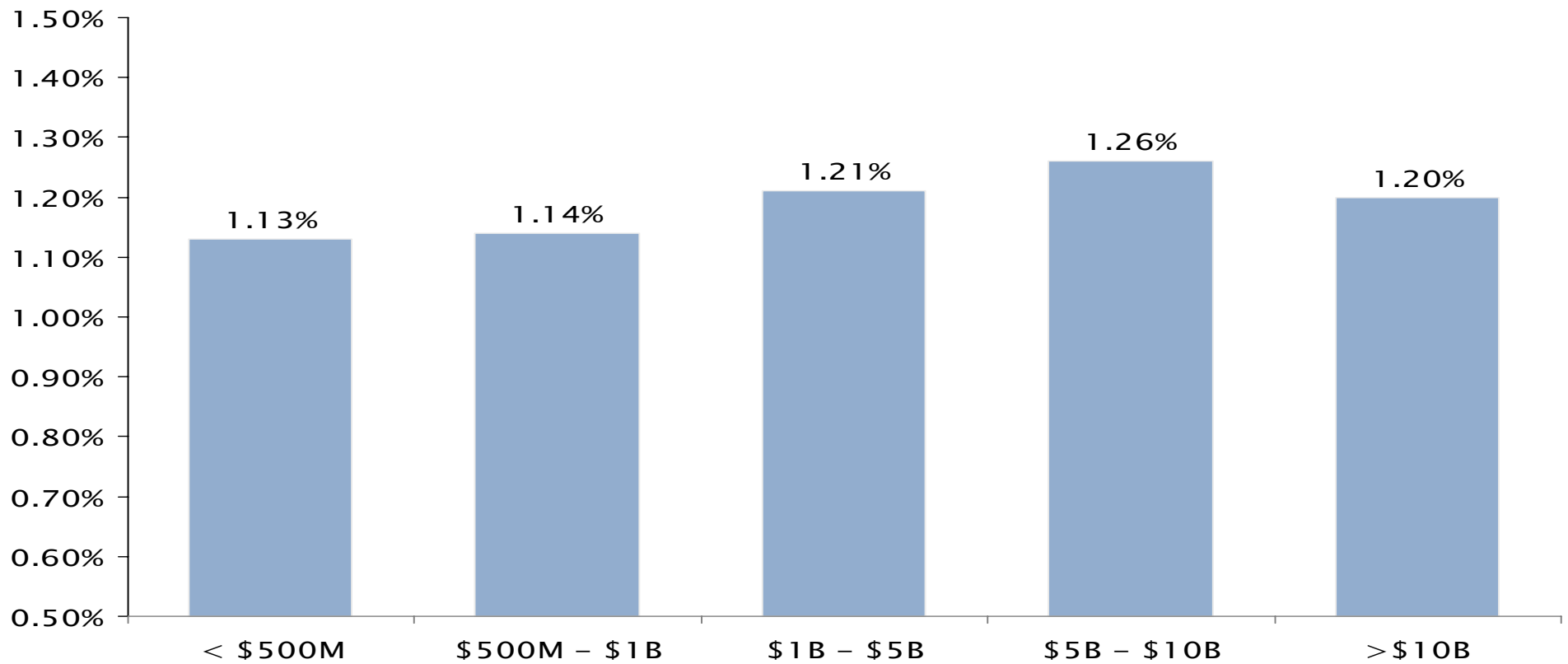


## Banks vs. branches

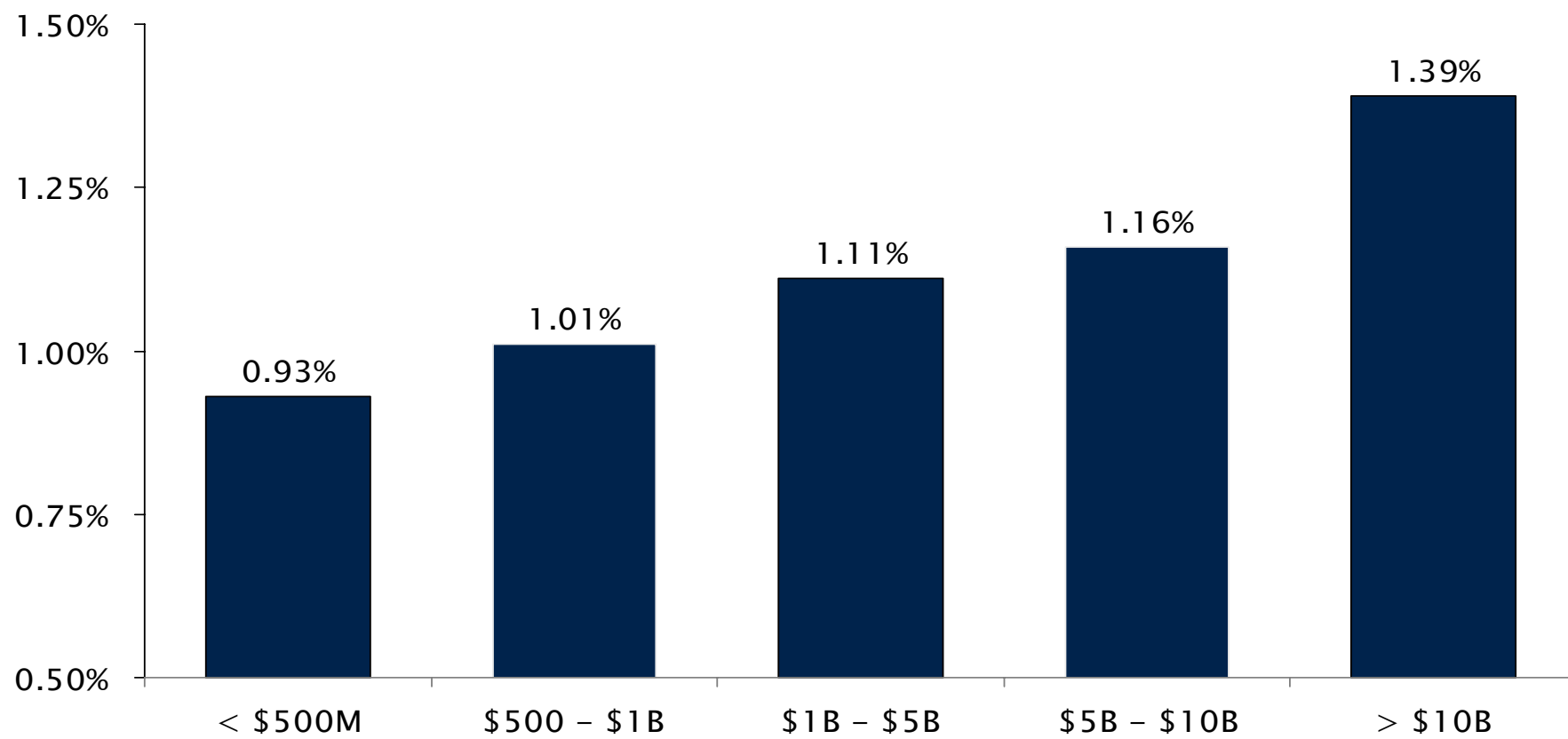




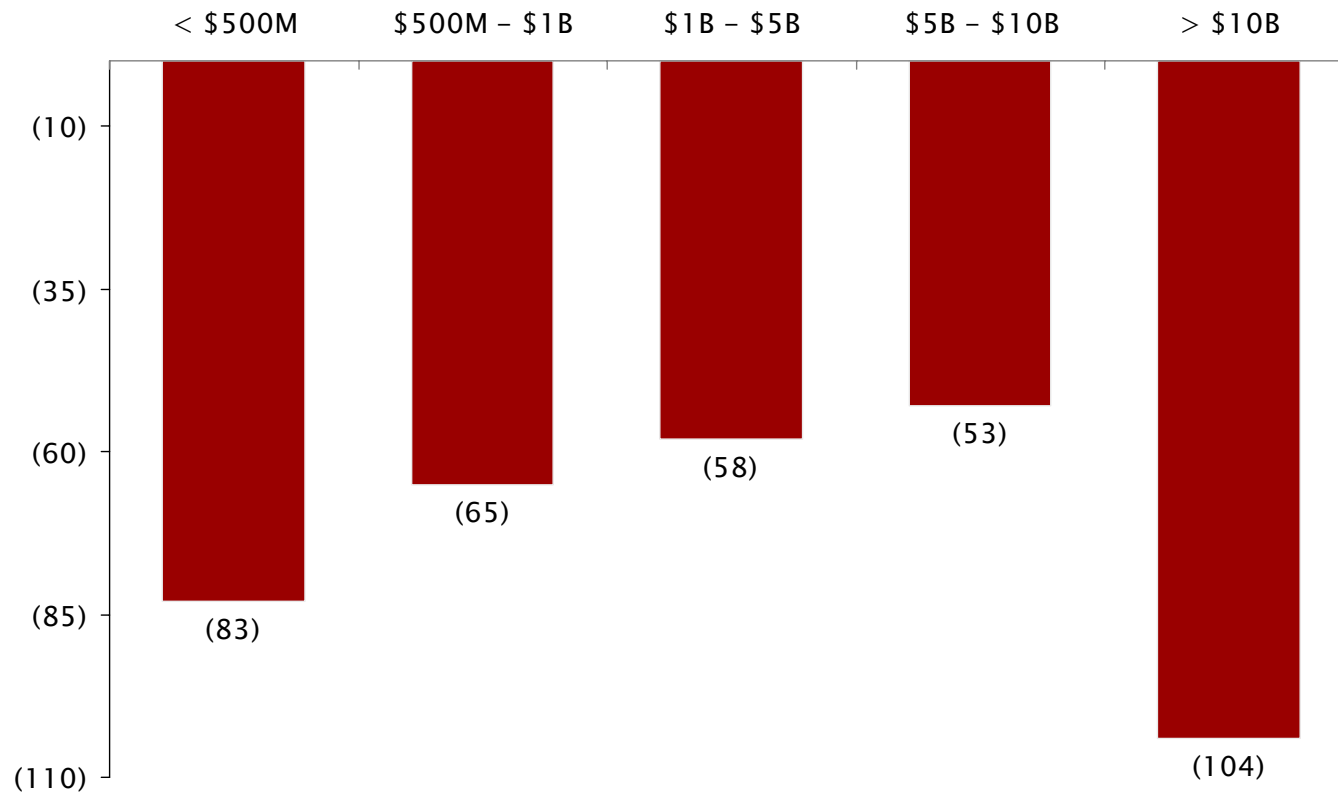
## Profitability 1996



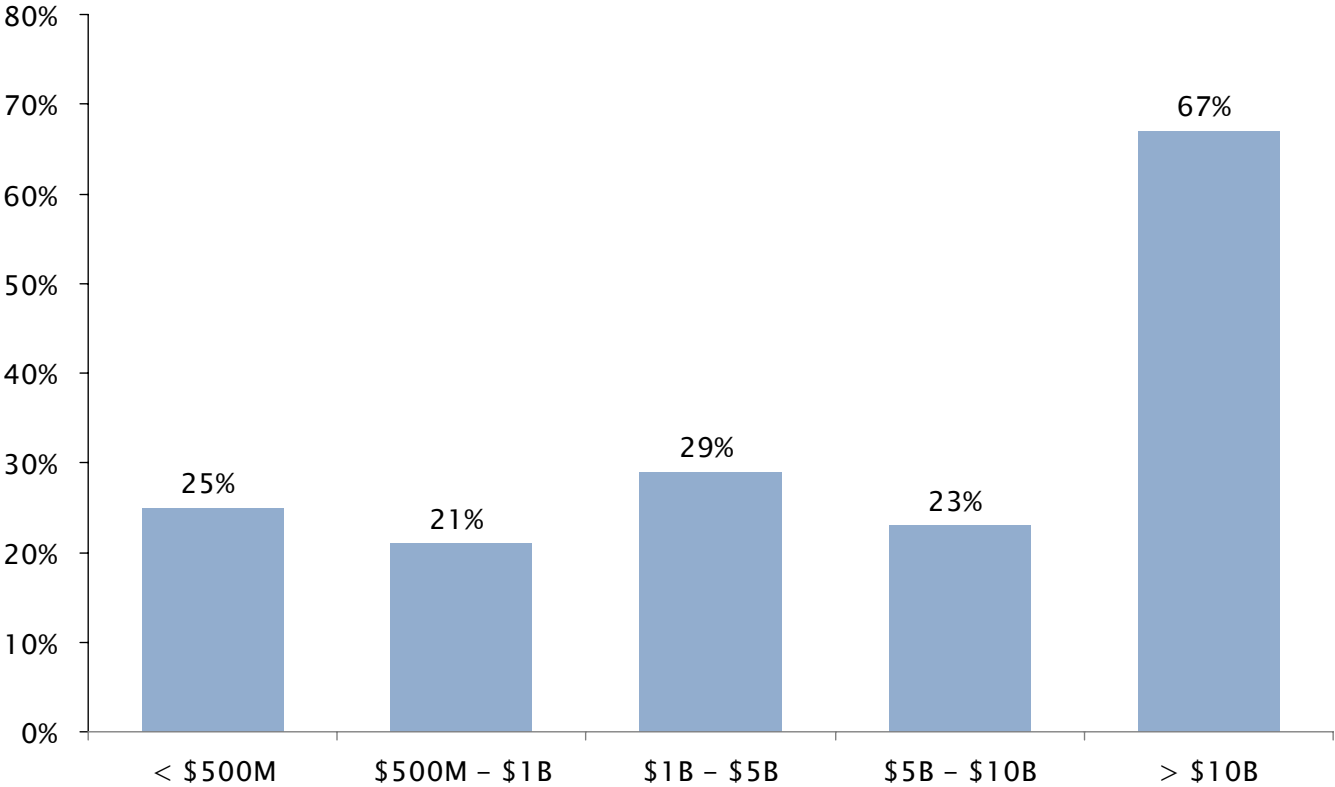
## Profitability 2006



## Margin change



# Efficiency improvement 1996-2006



## Industry Trends and The Street

- Overall, the industry continues to be profitable but growth is decelerating (6.9% for the 12 months ending 3/31/07, the slowest in 4.5 years)
- However, the current picture for banks is turning, with the sputtering housing market (unsold inventory highest since 1993)
- The big banks are doing better than mid and small cap companies, primarily because they have more diversified revenue streams
- 191 de novo banks in 2006, the largest number since 2000
- More banks are experiencing profitability hiccups; median data for 141 community banks show all five major performance measures (margin; efficiency; charge-offs; NPL; provision coverage) weakened 6/30/06-6/30/07
- More volatile earnings are expected in the future due to credit issues and inconsistent margin behavior

