

BANKS MAKING MONEY

BANKMARK'S TURN-KEY APPROACH TO STARTING UP COMMUNITY BANKS IS UNIQUE, AND IT WORKS!

From group formation and charter application preparation through capitalization, they continually bent our vision around the corner, and guided our success every step of the way.

BRYAN HYZDU, SERVICE 1ST BANK, PRESIDENT & C.E.O.

BANKS MAKING MONEY

IN 2008: Q1 - FDIC

Insured Institution Performance

- Industry Earnings Decline 46 Percent from Year-Earlier Level
- Loss Provisions Absorb a Higher Share of Revenue
- Troubled Loans Accumulate in Real Estate Portfolios
- Lending Growth Slows
- Fourth Quarter 2007 Earnings Are Revised Below \$1 Billion

Real Estate Troubles Hold Down Earnings

Deteriorating asset quality concentrated in real estate loan portfolios continued to take a toll on the earnings performance of many insured institutions in first quarter 2008. Higher loss provisions were the primary reason that industry earnings for the quarter totaled only \$19.3 billion, compared to \$35.6 billion a year earlier. FDIC-insured commercial banks and savings institutions set aside \$37.1 billion in loan-loss provisions during the quarter, more than four times the \$9.2 billion set aside in first quarter 2007. Provisions absorbed 24 percent of the industry's net operating revenue (net interest income plus total noninterest income) in the quarter, compared to only 6 percent in the first quarter of 2007.

The average return on assets (ROA) was 0.59 percent, falling from 1.20 percent in first quarter 2007. The first quarter's ROA is the second-lowest since fourth quarter 1991. The downward trend in profitability was relatively broad: slightly more than half of all insured institutions (50.4 percent) reported year-over-year declines in quarterly earnings. However, the brunt of the earnings decline was borne by larger institutions. Almost two out of every three institutions with more than \$10 billion in assets (62.4 percent) reported lower net income in the first quarter, and four large institutions accounted for more than half of the \$16.3-billion decline in industry net income.

Restatements Shrink Fourth Quarter 2007 Profits Substantially

Industry earnings for the fourth quarter of 2007 were previously reported as \$5.8 billion, but sizable restatements by a few institutions caused fourth quarter net income to decline to \$646 million. This is the lowest quarterly net income for the industry since insured institutions posted an aggregate net loss in the fourth quarter of 1990. After the restatements, the fourth quarter 2007 industry ROA was reduced to 0.02 percent. Most of the restatements stemmed from increased charges for goodwill impairment. The writedowns of goodwill reduced the industry's equity capital, based on Generally Accepted Accounting Principles (GAAP), by approximately \$4.7 billion (0.3 percent) from the amount originally reported, but they had no effect on regulatory capital levels, since goodwill is not included in capital for regulatory purposes.

Market-Sensitive Revenues Remain Weak at Large Institutions

In addition to the sharp increase in loan-loss provisions, lower noninterest income also contributed to the decline in industry earnings in the first quarter. Noninterest revenues fell on a year-over-year basis for a second consecutive quarter, declining by \$1.7 billion (2.8 percent). Income from trading was \$4.8 billion (67.8 percent) lower than in first quarter 2007, while sales of loans yielded \$1.7 billion in losses, compared to \$2.0 billion in gains a year earlier. Sales of real estate acquired through foreclosure (OREO), which produced \$3 million in gains a year ago, resulted in losses of \$310 million in the first quarter. Other market-related sources of noninterest income, such as investment banking fees and venture capital revenue, were also lower than a year ago. In contrast, noninterest revenues that were based on transactional activities registered gains. Income from fiduciary activities was up by \$867 million (12.7 percent), while income from service charges on deposit accounts rose by \$862 million (9.4 percent). Revaluations of certain assets and

liabilities under recently adopted fair value accounting¹ reduced first quarter noninterest income by \$1.2 billion. Fewer than one in three institutions reported year-over-year declines in noninterest income because the weakness in market-sensitive revenues primarily affected large institutions. Noninterest expense growth was relatively benign; total noninterest expense rose by \$3.2 billion (3.7 percent) year-over-year. Net interest income was \$8.3 billion (9.6 percent) above the level of a year earlier, as interest-earning asset growth remained relatively strong and net interest margins improved slightly at large institutions.

Interest Rate Environment Squeezes Community Bank Margins

The industry's net interest margin in the first quarter was 3.33 percent, compared to 3.32 percent in both the fourth and first quarters of 2007. However, margins fell at most institutions, with 70 percent reporting declines from fourth-quarter 2007 levels and 61 percent reporting declines compared to first-quarter 2007 levels. The average margin at community banks ~ institutions with less than \$1 billion in total assets ~ fell to 3.70 percent, the lowest level since fourth quarter 1988. Community banks' funding costs did not reprice downward as rapidly as larger institutions' when short-term interest rates declined, owing to the larger share of retail deposits in community banks' liabilities, the low level of interest rates, and the relative sharpness of the rate decline. Retail deposits typically reprice more slowly and their rates generally have a higher floor than other short-term liabilities. Margins improved at larger institutions, because their short-term nondeposit borrowings repriced downward more quickly with the decline in market interest rates.

Charge-Off Rate Climbs to Five-Year High

Insured institutions charged-off \$19.6 billion (net) during the first quarter, an increase of \$11.4 billion (139.1 percent) over the first quarter of 2007. This is the second consecutive quarter of very high net charge-offs ~ fourth-quarter charge-offs totaled \$16.4 billion. The annualized net charge-off rate in the first quarter rose to 0.99 percent, more than double the 0.45 percent rate of a year earlier and the highest quarterly net charge-off rate since the fourth quarter of 2001. Loss rates were higher at larger institutions. The average net charge-off rate at institutions with more than \$1 billion in assets was 1.09 percent, more than three and a half times the 0.29 percent average rate at institutions with assets less than \$1 billion. Industry net charge-offs were higher year-over-year in all major loan categories, but the largest increases were in residential real estate loans and in real estate construction and development loans. Net charge-offs of home equity lines of credit were \$2.0 billion (614.7 percent) higher than in the first quarter of 2007, while charge-offs of closed-end junior lien mortgages increased by \$1.3 billion (1,019.1 percent), and first lien mortgage charge-offs were up by \$2.3 billion (542.5 percent). Chargeoffs of real estate construction and

development loans increased by \$1.6 billion (1,508.2 percent), and commercial and industrial (C&I) loan charge-offs rose by \$1.4 billion (130.7 percent). Charge-offs of credit card loans and other loans to individuals were higher as well (up \$1.1 billion and \$1.2 billion, respectively).

Noncurrent Loan Growth Remains High

Even with the heightened level of charge-offs, the amount of loans and leases that were noncurrent (90 days or more past due or in nonaccrual status) rose by \$26.0 billion (23.6 percent) in the first quarter, following a \$27.0-billion increase in the fourth quarter of 2007. Loans secured by real estate accounted for close to 90 percent of the total increase, but almost all major loan categories registered higher noncurrent levels. The amount of real estate construction and development loans that were noncurrent increased by \$9.5 billion (47.2 percent) during the quarter, while noncurrent loans secured by 1-4 family residential properties other than home equity lines of credit increased by \$9.3 billion (20.2 percent). Noncurrent real estate loans secured by nonfarm nonresidential properties increased by \$2.2 billion (28.5 percent), and noncurrent home equity lines of credit rose by \$1.5 billion (29.5 percent). Noncurrent C&I loans increased by \$2.4 billion (24.9 percent). During the quarter, the percentage of total loans and leases that were noncurrent rose from 1.39 percent to 1.71 percent, the highest noncurrent rate for the industry since the first quarter of 1994. At institutions with assets greater than \$1 billion, the average noncurrent rate at the end of the quarter was 1.74 percent. At smaller institutions, the average rate was 1.52 percent. More than half of all insured institutions ~ 52.2 percent ~ saw their noncurrent rates rise during the first quarter. Restructured loans and leases (which are current under modified terms) increased by \$4.0 billion (57.6 percent) during the quarter, but almost half of the increase was caused by banks including restructured 1-4 family residential real estate loans for the first time. These restructured loans added \$1.8 billion to the total amount of restructured loans at the end of the first quarter.

Reserve Coverage Loses Ground

Insured institutions continued to build their loan-loss reserves in the first quarter. They added \$37.1 billion in loss provisions to their reserves, which was \$17.5 billion more than was subtracted from reserves by charge-offs. The increased loss provisions were the main reason that reserves increased by \$18.5 billion (18.1 percent) during the quarter, to \$120.9 billion. The industry's ratio of loss reserves to total loans and leases increased from 1.30 percent to 1.52 percent, the highest level since the first quarter of 2004. However, the growth in loss reserves was outstripped by the rise in noncurrent loans, and the industry's "coverage ratio" fell for the eighth consecutive quarter, to 89 cents in reserves for every \$1.00 of noncurrent loans from 93 cents at the end of 2007. This is the lowest level for the coverage ratio since the first quarter of 1993.

Institutions Cut Dividends to Preserve Capital

Capital levels benefited from a reduction in dividend payments by many institutions during the quarter. Of the 3,776 insured institutions that paid common stock dividends in the first quarter of 2007, almost half (48 percent) paid lower dividends in the first quarter of 2008, including 666 institutions that paid no dividends. Insured institutions paid \$14.0 billion in total dividends in the first quarter, down \$12.2 billion (46.5 percent) from a year earlier. Retained earnings (net income after dividends) totaled \$5.3 billion, down \$4.1 billion (43.6 percent) from a year earlier despite the lower dividend payments. Slightly more than half of all institutions (51.8 percent) reported year-over-year declines in retained earnings. Total regulatory capital increased by \$25.5 billion (2.0 percent) in the first quarter, as tier 1 capital rose by \$15.0 billion (1.5 percent) and tier 2 capital increased by \$10.5 billion (4.1 percent). All of the increase in tier 2 capital consisted of higher loan-loss reserves. The industry's core capital (leverage) ratio declined from 7.97 percent to 7.87 percent during the quarter, the tier 1 risk-based capital ratio slipped slightly from 10.11 percent to 10.10 percent, while the total risk-based capital ratio increased from 12.78 percent to 12.83 percent. Ninety-nine percent of all insured institutions continued to meet or exceed the highest regulatory capital standards as of the end of the first quarter. Equity capital increased by \$13.5 billion in the quarter. The relatively low level of retained earnings and a sharp increase in unrealized losses on available-for-sale securities were the chief reasons for the modest rise in equity. Other comprehensive income, which includes unrealized losses on securities, reduced equity capital by \$12.1 billion in the first quarter.

Growth in Credit Slows

Total assets increased by \$335.4 billion (2.6 percent) in the first quarter, even as loan growth slowed. Trading assets increased by \$135.2 billion (15.4 percent), with much of the growth occurring in foreign offices of large banks. Total loans and leases increased by just \$61.4 billion (0.8 percent) during the quarter. Loans secured by real estate rose by \$20.5 billion (0.4 percent), the smallest quarterly increase since the first quarter of 2003. Loans secured by 1-4 family residential properties declined for the first time since the fourth quarter of 2003, falling by \$26.5 billion (1.2 percent). Real estate construction and development loans grew by \$2.7 billion (0.4 percent), the smallest quarterly increase since the fourth quarter of 2002. C&I loan growth remained relatively strong; loans to C&I borrowers increased by \$45.5 billion (3.2 percent) in the quarter. Unused loan commitments declined by \$12.3 billion (0.1 percent) during the quarter, with commitments to fund real estate construction and commercial real estate loans declining by \$18.8 billion (6.2 percent), and commitments to extend credit under home equity lines falling by \$10.3 billion (1.4 percent).

Interest-Bearing Retail Deposits Post Strong Growth

Deposits at insured institutions increased by \$150.4 billion (1.8 percent) during the quarter. Deposits in foreign offices declined for the first time in three and a half years, falling by \$5.8 billion (0.4 percent). Domestic interest-bearing deposits other than time deposits (mostly savings deposits and interestbearing checking deposits) accounted for more than three-quarters of the growth in total deposits, increasing by \$116.7 billion (3.7 percent). Nondeposit liabilities increased by \$171.6 billion (5.2 percent), led by securities sold under repurchase agreements (up \$65.0 billion, or 12.6 percent) and trading liabilities (up \$63.2 billion, or 18.5 percent).

“Problem List” Continues to Grow

The number of insured commercial banks and savings institutions reporting financial results declined from 8,534 to 8,494 during the first quarter. Thirty-eight new charters were added, while 77 charters were absorbed by mergers and 2 institutions failed. Eighty-two insured institutions with combined assets of \$13.1 billion converted to Subchapter S corporations during the first quarter. At the end of March, almost 30 percent of all insured institutions were Subchapter S corporations. During the quarter, two mutually owned insured savings institutions with combined assets of \$1.3 billion converted to stock ownership. The number of institutions on the FDIC's “Problem List” increased from 76 to 90 in the first quarter. Total assets of “problem” institutions rose from \$22.2 billion to \$26.3 billion. This is the sixth consecutive quarter that the number of “problem” institutions has increased, from a historic low of 47 institutions at the end of third quarter 2006. The current level represents the largest number of institutions on the list since third quarter 2004, when there were 95 “problem” institutions.

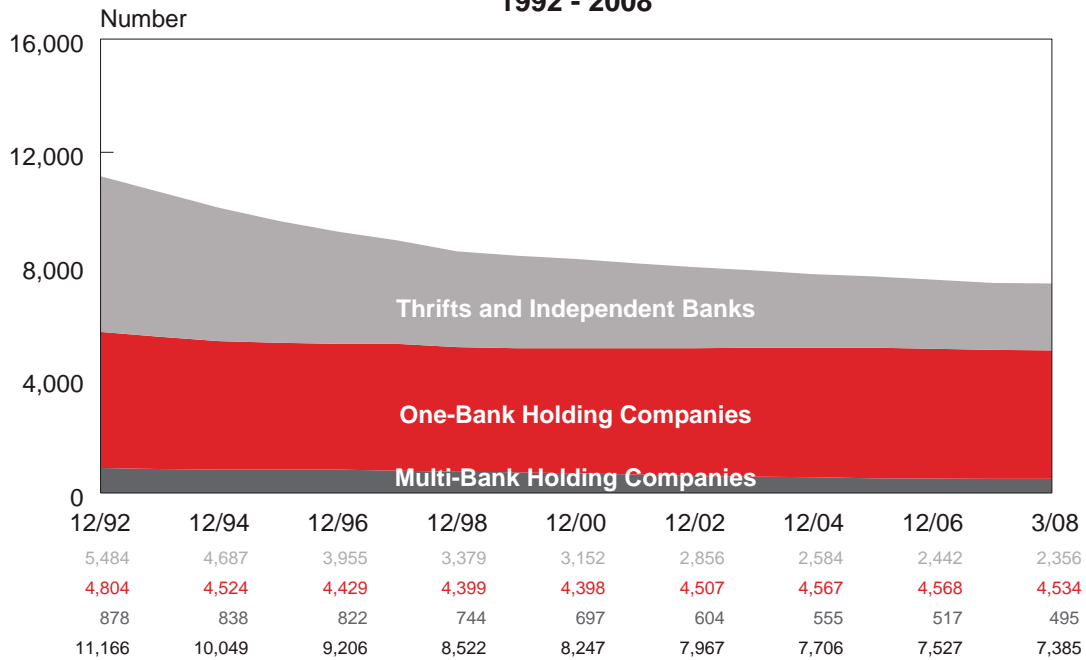
Source: FDIC

Data Compiled by Bankmark Research

Bankmark is the leading consulting firm offering services to the financial industry for over twenty years. Specializing in community banks and the de novo banking market, the Bankmark team has collectively facilitated the opening of over 135 community banks with a completion rate of 100%. Our team is the only professional association providing the expertise needed for every stage of bank development. For more information, please visit us at www.startabank.com.

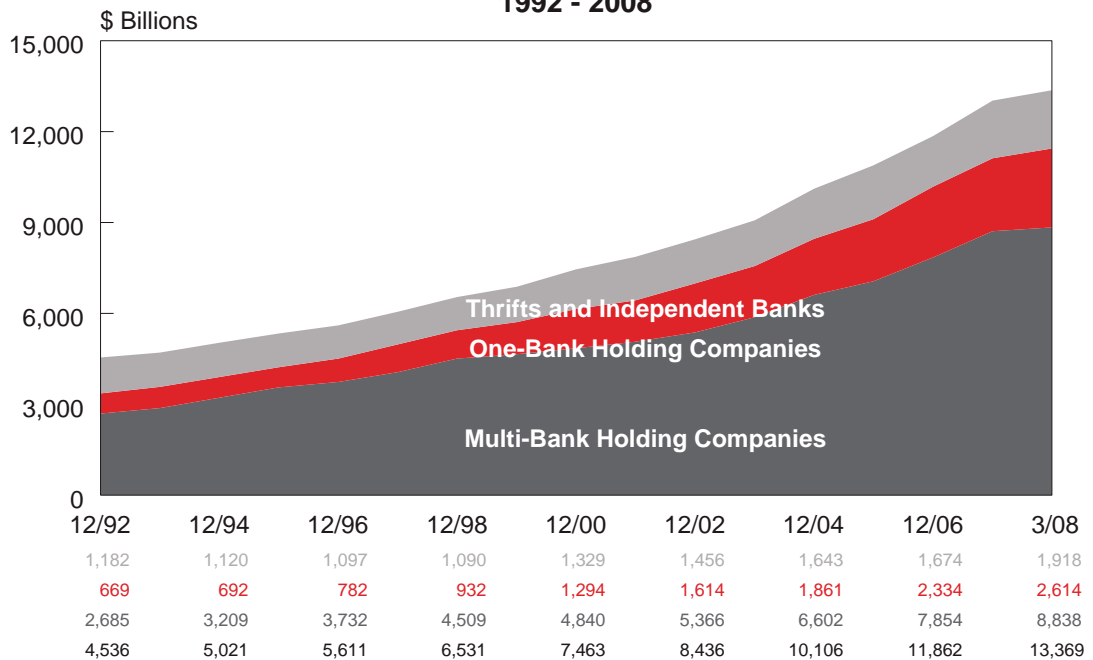
Number of FDIC-Insured Banking Organizations

1992 - 2008



Assets of FDIC-Insured Banking Organizations

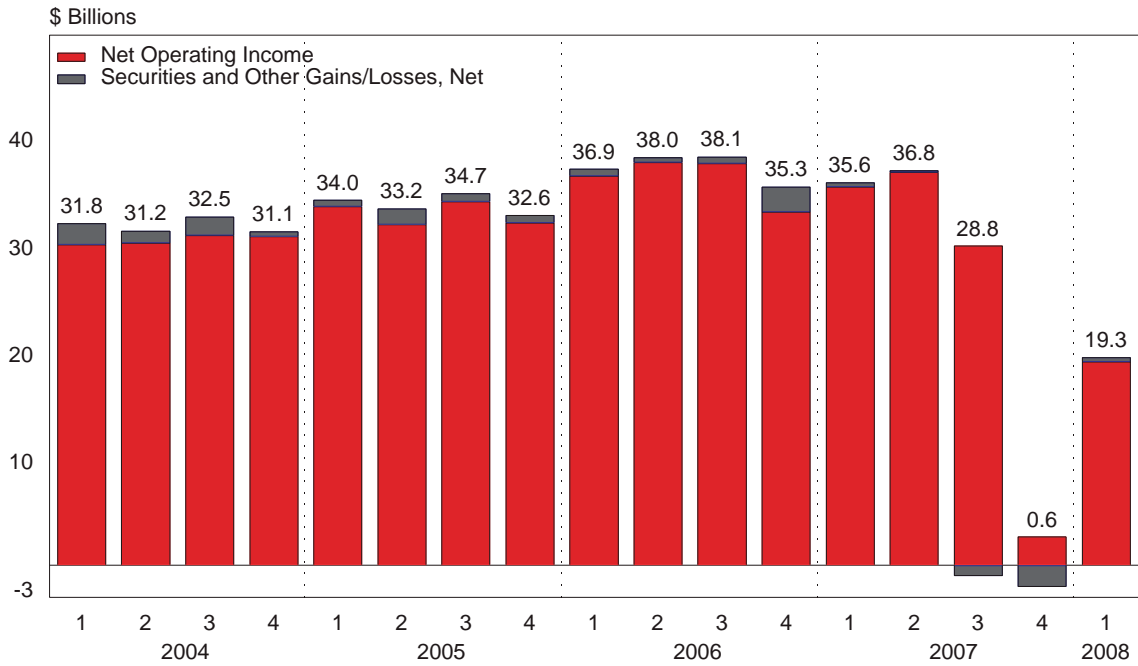
1992 - 2008



* Includes thrifts owned by unitary thrift holding companies or multi-thrift holding companies.

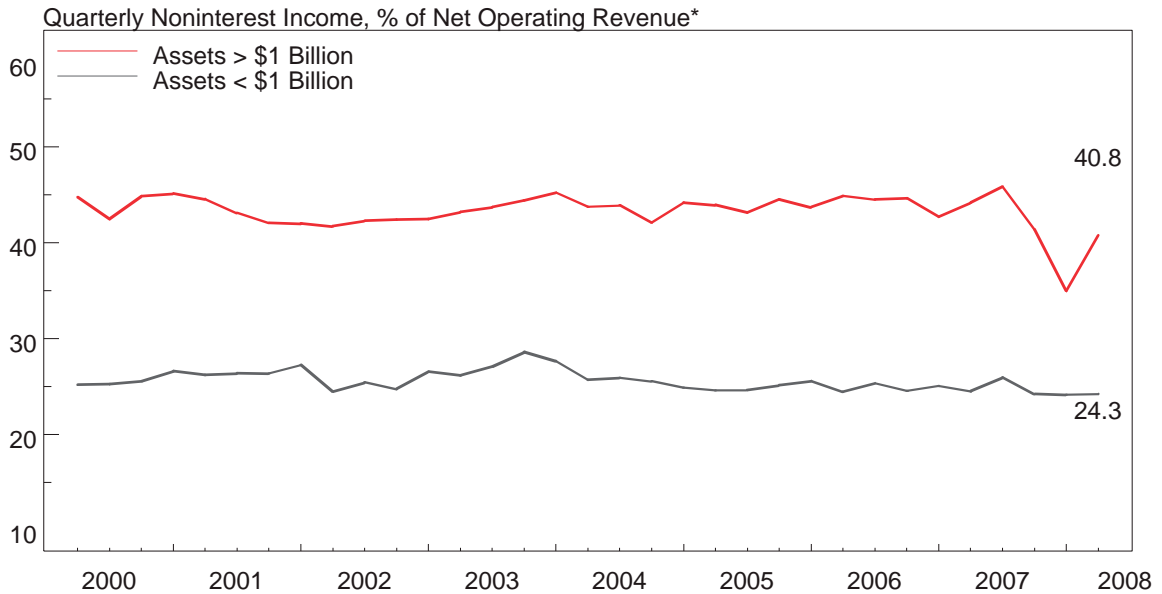
Quarterly Net Income

2004 - 2008

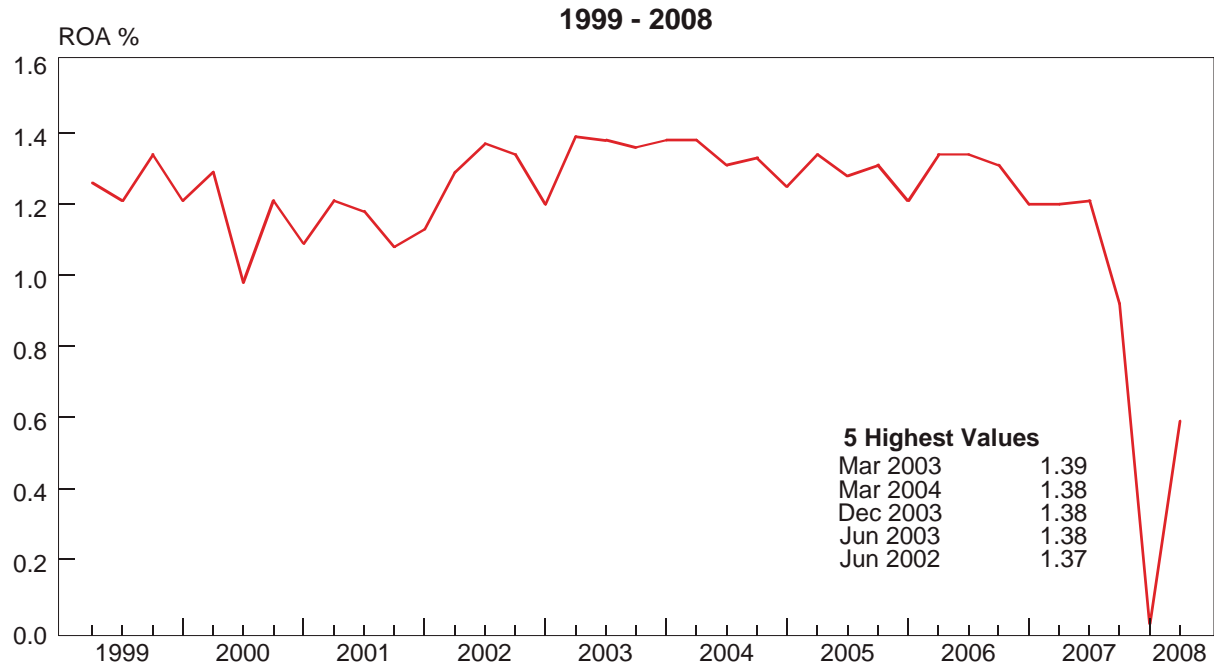


Noninterest Income as a Percentage of Net Operating Revenue*

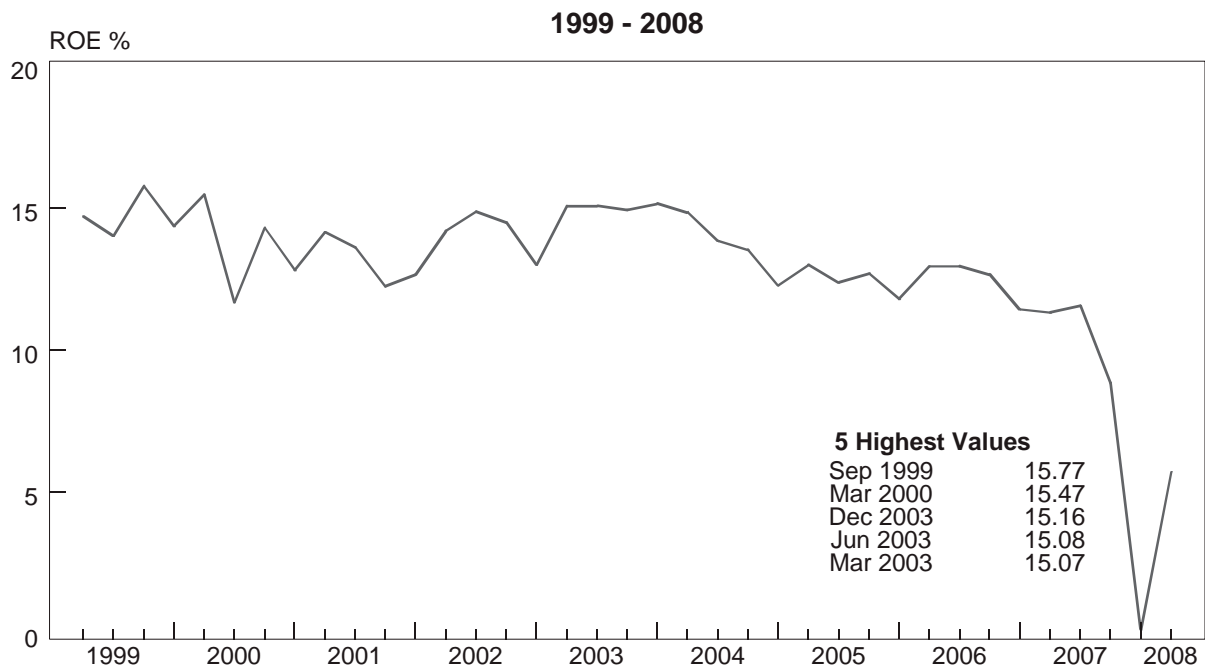
2000 - 2008



Quarterly Return on Assets (ROA), Annualized

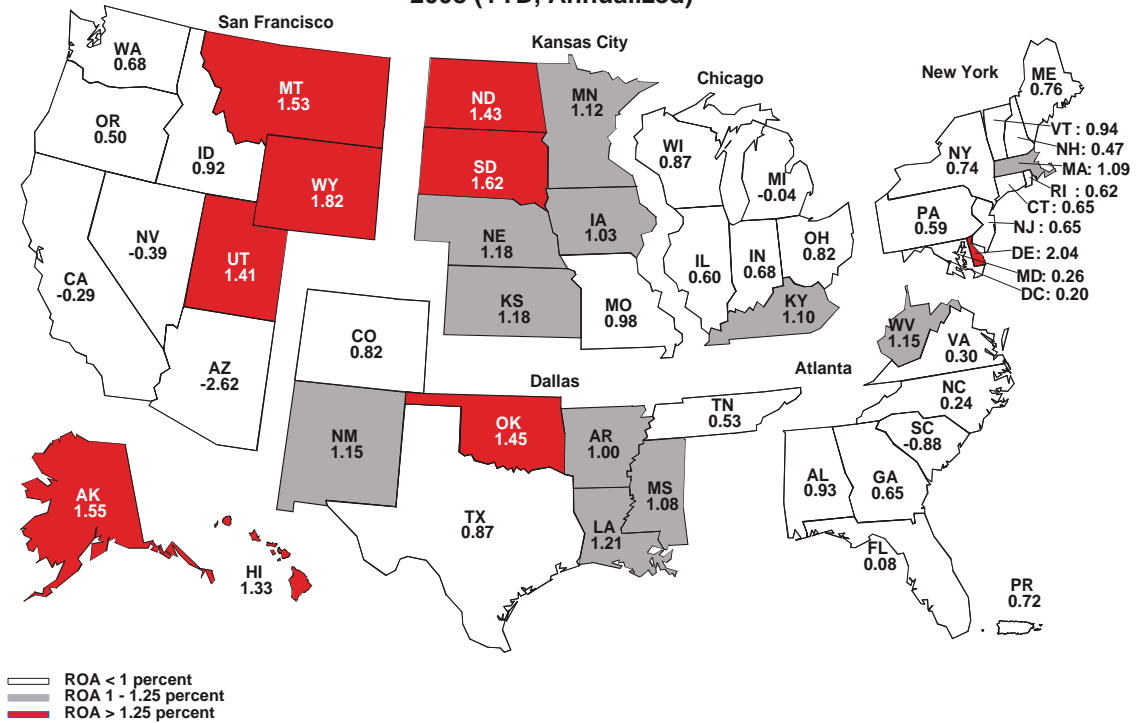


Quarterly Return on Equity (ROE), Annualized



Return on Assets (ROA)

2008 (YTD, Annualized)



Number of Institutions By Asset Size

March 31, 2008

