

The Critical Role of Operating Efficiency in Producing Consistently High Performing Community Banks

A sequel to the
Seven Secrets
of Consistently
High Performing
Community Banks
Webinar



May 25, 2016
Webinar



WEBINAR INSTRUCTIONS

April 20, 2016

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- This webinar is being recorded for distribution and will be available on the Austin Associates website shortly after the conclusion of the Webinar at www.austinassociates.com

AUSTIN ASSOCIATES OVERVIEW

Consulting and Investment Bankers to Community Banks

- Community bank advisors for more than 50 years
- Specialized services through multiple practice areas

Investment Banking

Strategic Consulting

Financial Management

Technology Solutions

- Owners are consultants/managers
- Over 200 bank/thrift clients in 2015 from 28 states
- Nationally-ranked leader in community bank M&A for 3 decades

AUSTIN ASSOCIATES, LLC

Financial Management Consultants for Financial Institutions

- Specialized services from the Financial Management Division

Asset / Liability Management

Profitability Measurement & Improvement

Loan & Relationship Pricing Systems

Balance Sheet Structuring

Regulatory Compliance

PRESENTERS

Jeff Morris joined Austin Associates' Financial Management Division in 1998. He is responsible for profitability analysis services and works with clients who utilize the firm's innovative software products, including its proprietary organization/product/customer profitability software and its loan and deposit pricing software. Jeff has over 35 years of experience in various financial management roles.



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AGENDA

The Critical Role of Operating Efficiency in Producing Consistently High Performing Community Banks

May 25, 2016

- Highlights from the Seven Secrets Webinar
- A brief history of the Efficiency Ratio
 - Consistent High Performance Requires Efficiency
- Six Types of Highly Efficient Banks
 - Which type are you? ...or...
 - Which type are you most likely to become?
- A few real life case studies – High Efficiency Banks
- Pathways to Improvement – Recommendations, next steps

Major Findings of the Seven Secrets Webinar

Regarding Consistently High Performing Community Banks

Presented March 22, 2016

The Seven Secrets

1. Limitations on the Economy of Scale rule
2. Not by Low COF'g & PFLL
3. Moderate Yields
4. Moderate Fees
5. Being Fully Invested
6. A Diverse Loan Portfolio
7. **OPERATING EFFICIENCY IS CRITICAL**

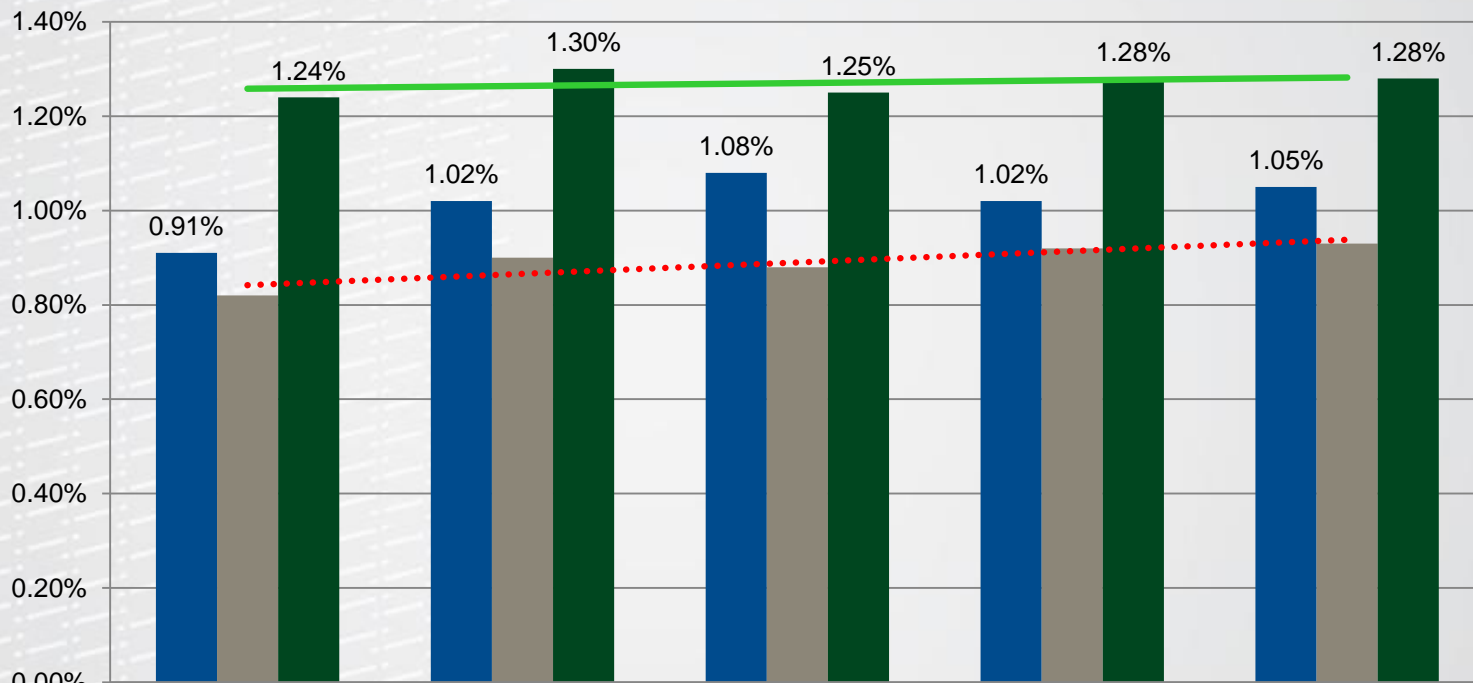
Not High
Priced

To view the webinar go to:

<http://www.austinassociates.com/news/webinars>

Average, Median & Top Q Performance

Commercial Bank (All Sizes) ROA - Average Last Five Years



	2011	2012	2013	2014	2015
■ Avg ROA	0.91%	1.02%	1.08%	1.02%	1.05%
■ Median ROA	0.82%	0.90%	0.88%	0.92%	0.93%
■ Top Quartile ROA	1.24%	1.30%	1.25%	1.28%	1.28%

Austin Webinar – The Seven Secrets of Consistently High Performing Community Banks

Consistent High Performance is Only Achieved by the Efficient



- High performing banks have excellent **Efficiency Ratios** – roughly 30% lower than the average community bank
 - Assets per Employee are 25% greater
 - Each element of NIE are 15 – 30% lower
 - Total Revenue / Employee is 47% higher
 - Median assets / branch is 35% larger

Austin Webinar – The Seven Secrets of Consistently High Performing Community Banks

Efficiency Ratio Definitions

Ratio

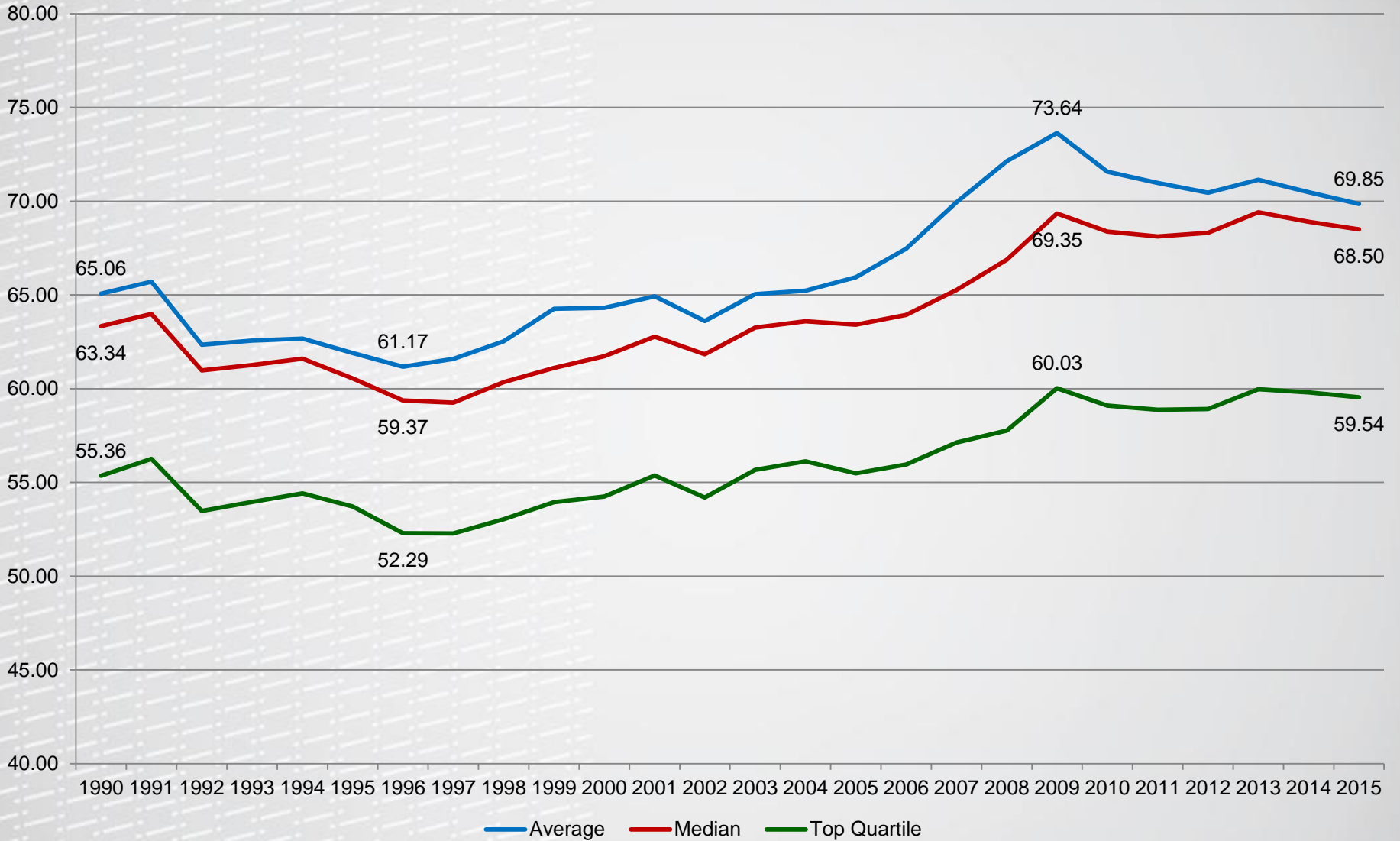
$$\frac{\text{Noninterest Expenses}^*}{\text{Net Interest Income (FTE) + Noninterest Income}}$$

* Less amortization of intangible assets

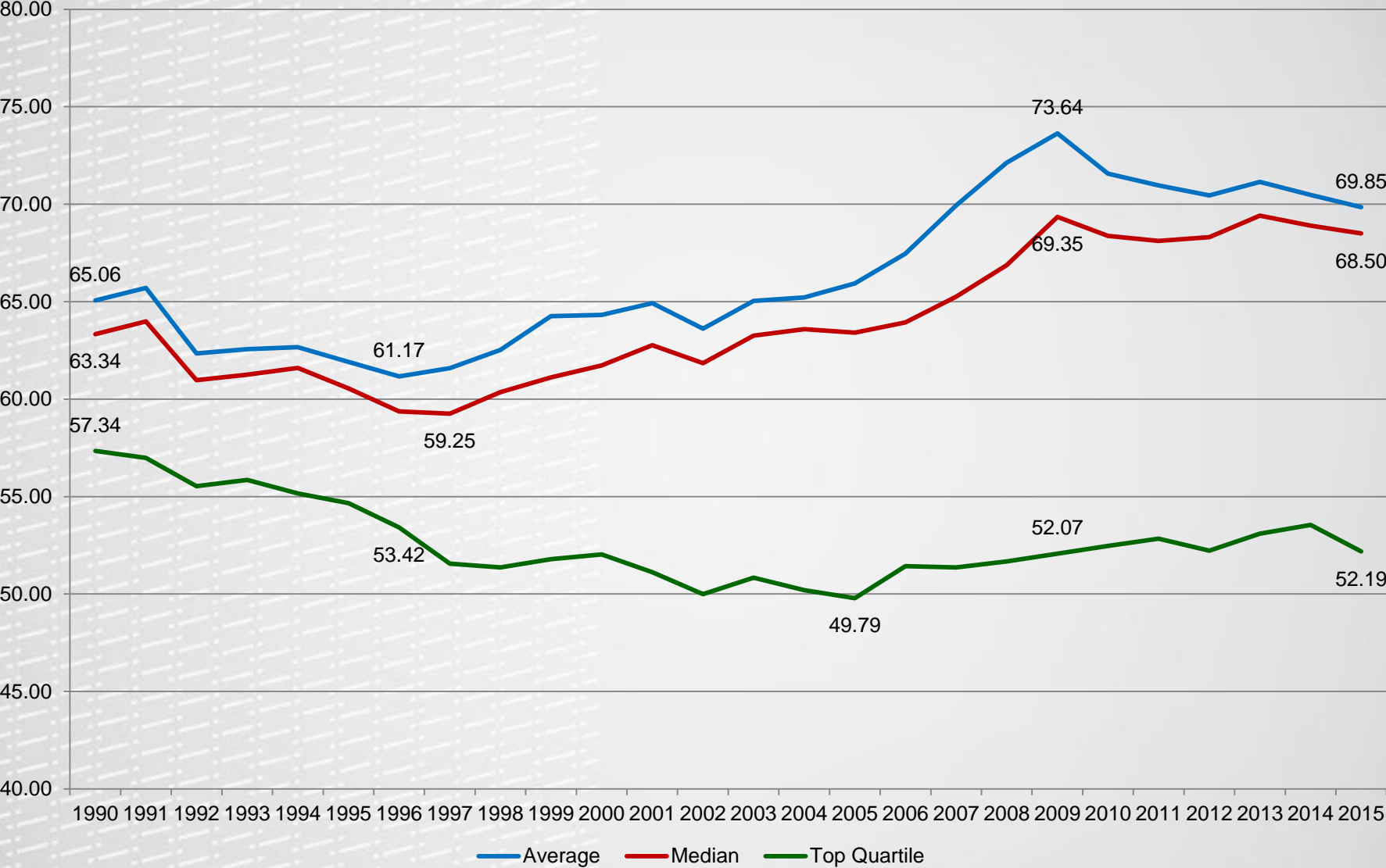
More Simply Stated

What you spend to create a dollar of income

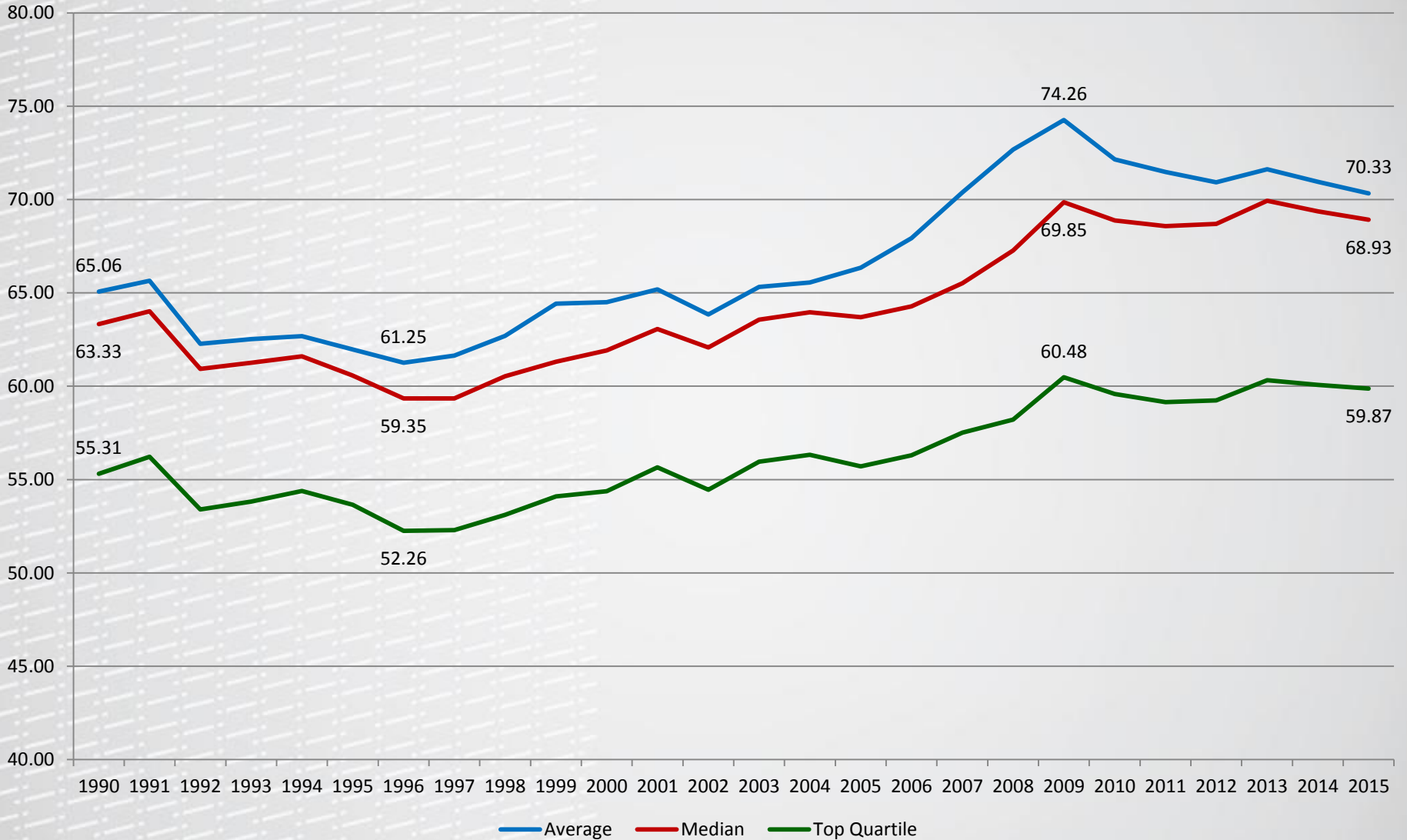
Efficiency Ratio - All Banks



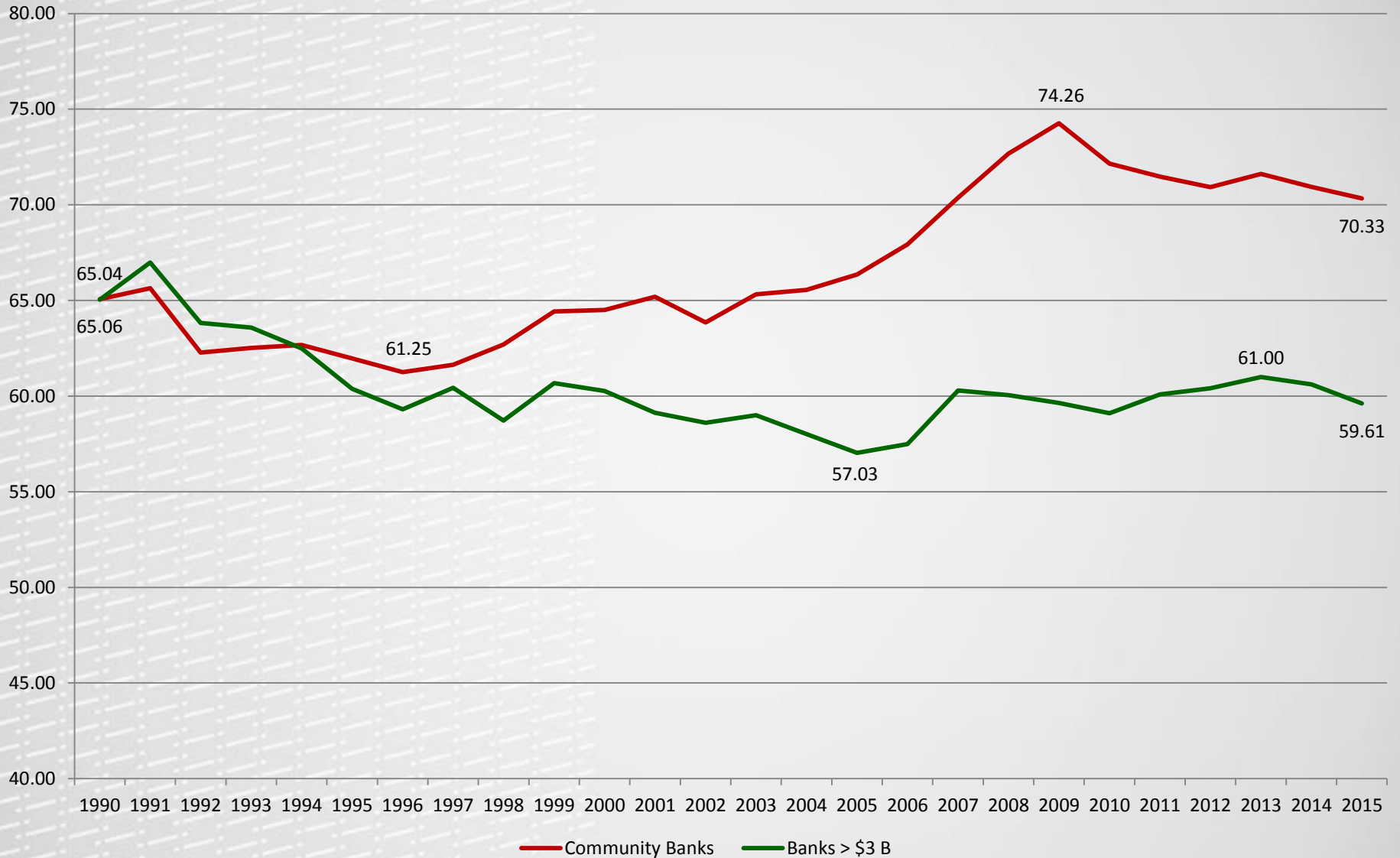
Efficiency Ratio - Large Banks



Efficiency Ratio - Small Banks



Average Efficiency Ratio - Small vs Large Banks



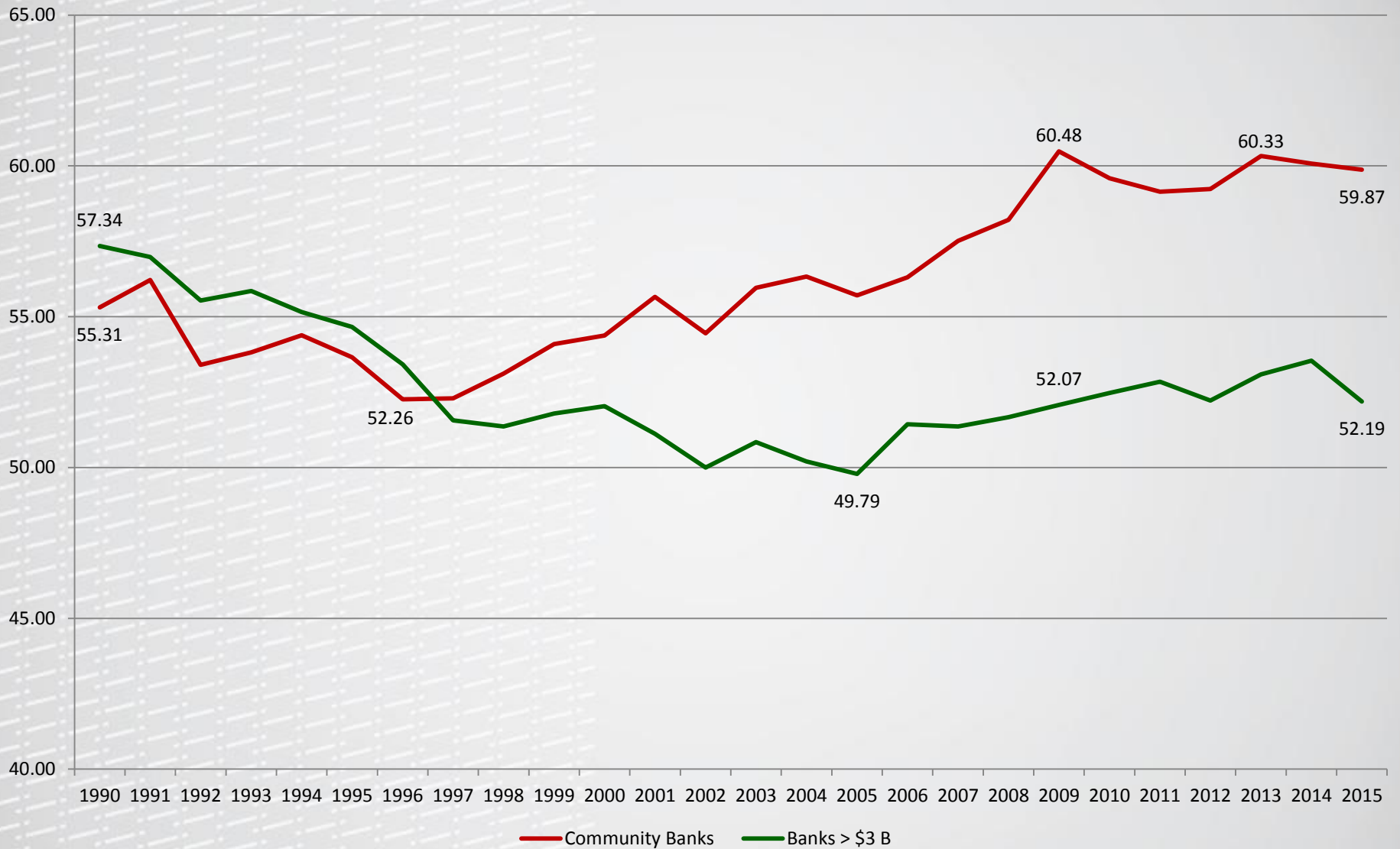


Median Efficiency Ratio - Small vs Large Banks





Top Quartile Efficiency Ratio - Small vs Large Banks



Six Types of High Efficiency Banks

Single Factor Drives Performance

- | | |
|---|------------|
| ✓ High Margin Banks | 12% |
| ✓ High Non-Interest Income (High Fee) Banks | 5% |
| ✓ Low Operating Expense Banks | <u>55%</u> |
| | 72% |

Balanced Performers

- | | |
|---|------------|
| ✓ Balanced High Performance (3/3 Top Quartile) | 1% |
| ✓ Balanced Moderate Performance (3/3 Above Average) | 2% |
| ✓ Partially Balanced Performance (2/3 Top Quartile) | <u>25%</u> |
| | 28% |

Who are the High Efficiency Banks?

824 Institutions (of 5,519 – or the Top 15%)

<u>Size Class – Total Assets</u>	<u>Number</u>	<u>Percent of Total Bank</u>
\$3 – \$10 B	35	22%
\$1 – \$3 B	57	15%
\$750 M – \$1 B	36	16%
\$500 – \$750 M	73	18%
\$250 – 500 M	173	16%
\$100 – 250 M	293	16%
< \$100 M	157	10%

Austin Research / SNL Data

Who are the High Efficiency Banks?

Example Institutions

<u>Total Assets</u>	<u>State</u>	<u>Institution Name</u>
\$3 – \$10 B	WV	United Bank, Inc.
\$1 – \$3 B	KS	KS State Bank
\$750 M – \$1 B	MI	First National Bank of America
\$500 - \$750 M	MT	Independence Bank
\$250 – \$500 M	IL	Gold Coast Bank
\$100 – \$250 M	MN	Ultima Bank Minnesota
< \$100 M	MN	First Security Bank, Canby

What Drives these Banks' High Efficiency?

Example Institutions

<u>Total Assets</u>	<u>Type</u>	<u>Institution Name</u>
\$3 – \$10 B	NIM & NIE	United Bank, Inc.
\$1 – \$3 B	Balanced	KS State Bank
\$750 M – \$1 B	Margin	First National Bank of America
\$500 - \$750 M	NIM & NIE	Independence Bank
\$250 – \$500 M	NIM & NIE	Gold Coast Bank
\$100 – \$250 M	Margin	Ultima Bank Minnesota
< \$100 M	Margin	First Security Bank Canby

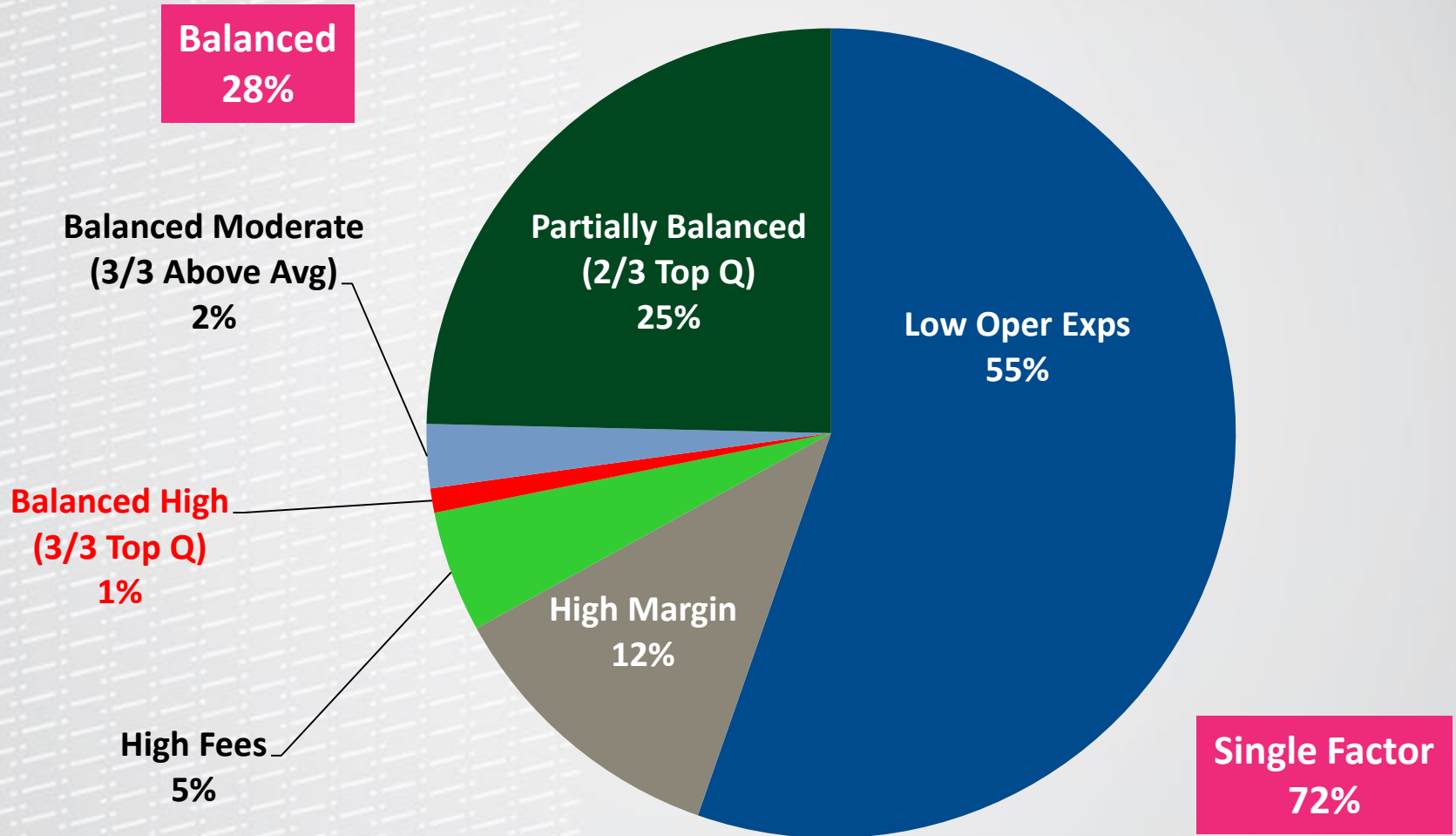
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How do they Achieve High Efficiency?

Component Measures Driving High Efficiency

	Combined "Score"	TOP 3 - HIGH EFFICIENCY DRIVERS		
		Net Interest Income to Average Assets	Non Interest Income to Average Assets	Non Interest Expenses to Average Assets
United Bank, Inc.	2	3.49%	1.08%	2.38%
KS State Bank	3	3.99%	1.09%	2.23%
First National Bank of America	1	6.29%	0.57%	3.54%
Independence Bank	2	4.70%	0.26%	1.83%
Gold Coast Bank	2	4.36%	0.69%	2.28%
Ultima Bank Minnesota	1	4.97%	0.48%	2.91%
First Security Bank Canby	1	4.26%	0.48%	2.41%
Importance Weighting		#2	#3	#1
Top Quartile Entry Point		> = 3.92%	> = 0.86%	< = 2.40%

Types of High Efficiency Banks



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United Bank, Inc.

\$5.5 B

High Efficiency Type

Strengths

Largest Fee Types

Branches

Assets / Branch

Assets per FTE

Revenue / FTE

Parkersburg, WV

Partially Balanced

(NII & NIE)

High Fees, Low Costs

Deposit S/C's, "Other" Fees, Trust, IB-Adv-UW, Security Brokerage, Annuity Sales, Loan Sales, Insurance

62

\$88.2 M

\$5.7 M

\$248,000

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KS StateBank

High Efficiency Type

Strengths

Net Interest Margin – (5 yr avg.)

Largest Fee Types

Branches

Assets / Branch

Assets & Revenue / FTE

Manhattan, KS

\$1.5 B

Balanced High Performer

(NIM, NII & NIE)

They've got it all...

4.92% - 0.93% = 3.99%

NET GAIN ON LOAN SALES,
"Other" NII, Deposit S/C's, Loan
Servicing Fees

7

\$215 M

\$6.5 M

\$329,000

First National Bank of America

\$823 M

East Lansing, MI

High Efficiency Type

Single Factor - NIM

Strengths

High Net Interest Margin

Yield - (5yr Avg.)

8.08%

Cost of Funding

0.85%

Net Interest Margin

6.29%

Risk / Reward

Other Factors:

Business Model – “We make loans no one else will”

5% Non Performing Loans

PFLD Decreasing from \$7M - \$2M over last 5 years

Average Last 5 yr. ROA = 1.78%

(Yes, that's after tax)

Independence Bank

Havre, MT

\$611 M

High Efficiency Type

Partially Balanced

(NIM & NIE)

Strengths

High Margin, Low Costs

Net Interest Margin – (5 yr avg.)

5.22% - 0.52% = 4.70%

Loan Portfolio

50% AG

36% CRE

Branches

6

Assets / Branch

\$81.2 M

Assets per FTE

\$5.2 M

Revenue / FTE

\$316,000

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Gold Coast Bank

Chicago, IL

\$335 M

High Efficiency Type

Partially Balanced

(NIM & NIE)

Strengths

High Margin, Low Costs

Net Interest Margin – (5 yr avg.)

5.362% - 0.90% = 4.36%

Loan Portfolio

50% 1-4 Fam, 30% CRE, 12% C&D

Branches

1

Assets / Branch

\$335 M

Assets per FTE

\$13.4 M

Revenue / FTE

\$729,000

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Ultima Bank Minnesota

Winger, MN

\$160 M

High Efficiency Type

Single Factor - NIM

Strengths

High Net Interest Margin

Yield

5.61%

Cost of Funding

0.64%

Net Interest Margin

Five
Year
Averages

4.97%

Loan Portfolio

58% AG, 15% CRE, 14% C&I

Other Factors:

Subchapter S Bank

< 1% Non Performing Loans (2015)

Average After Tax – ROA, Last 5 yrs. = 1.53%

First Security Bank

Canby, MN

\$68 M

High Efficiency Type

Single Factor / PB

(NIM & NIE)

Strengths

High Margin, Low Costs

Net Interest Margin – (5 yr avg.)

4.51% - 0.25% = 4.26%

Loan Portfolio

47% AG, 25% C&I, 16% CRE

Branches

2

Assets / Branch

\$34.0 M

Assets per FTE

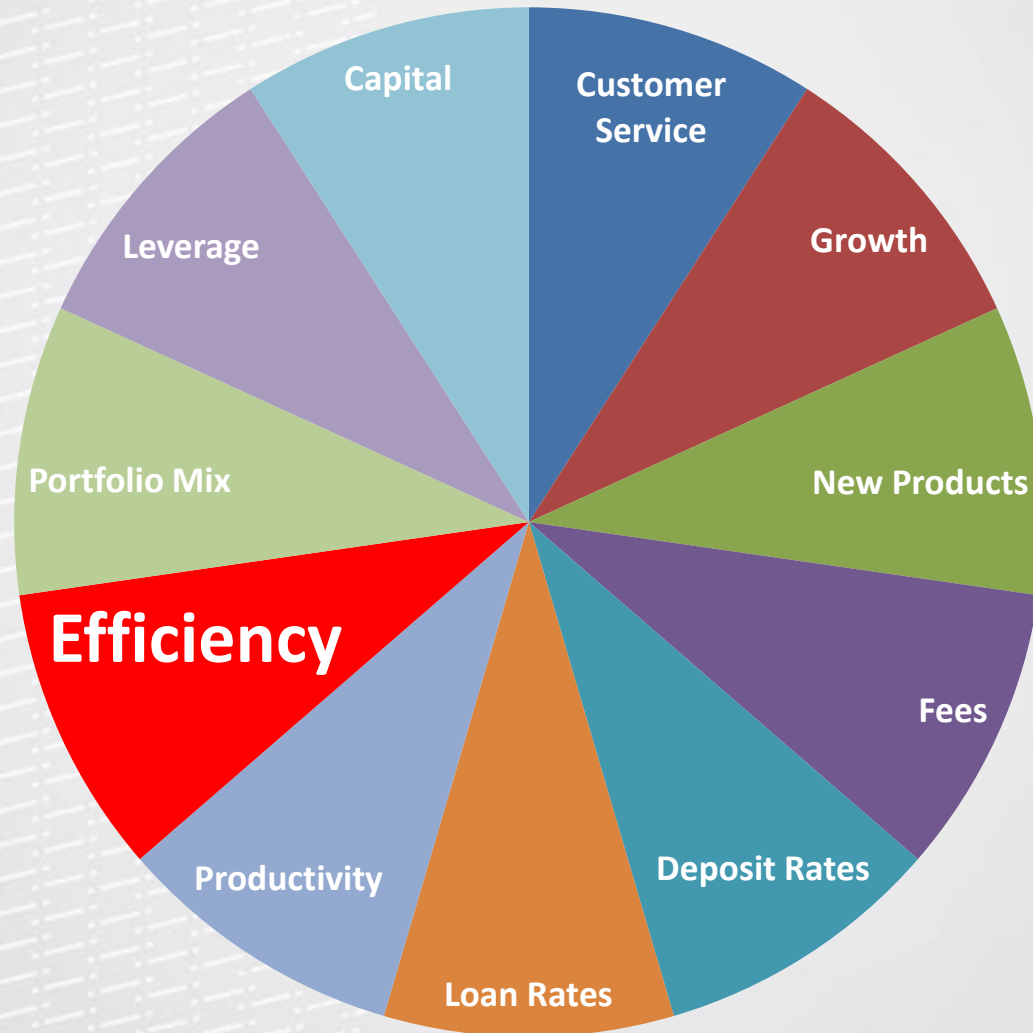
\$5.2 M

Revenue / FTE

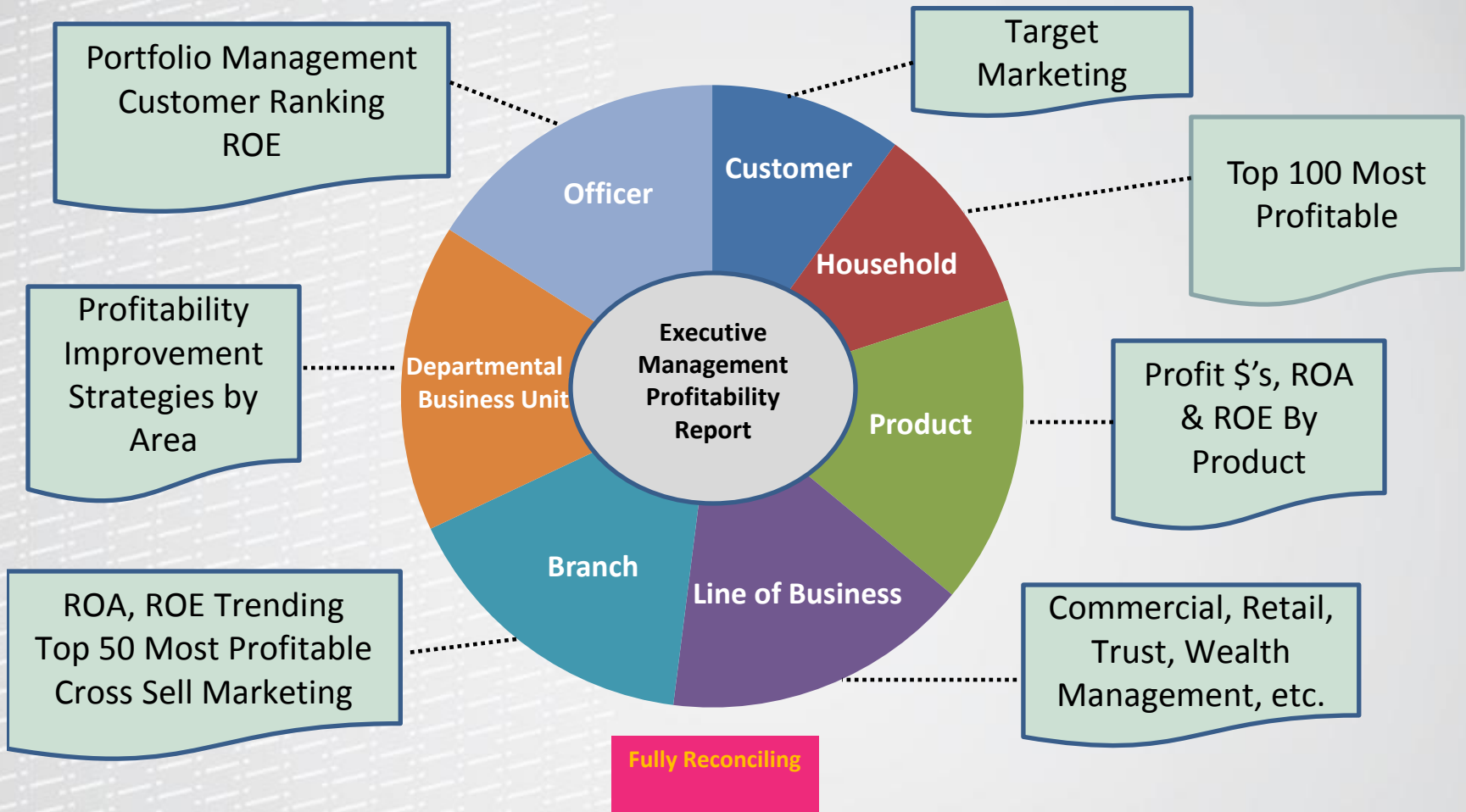
\$219,000

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Strategic Plan for Profitability Improvement



The Austin Profitability System



Core System Data Funds Transfer Pricing Salary Cost Allocation Non Salary Cost Allocation

*****CONSULTING*****

Recommendations

- Run the numbers on your bank – where are you at today? (NIM, NII, NIE / Average Assets)
- Identify which type of highly efficient bank you are or...
- Which type of highly efficient bank might you become? (S.W.O.T. analysis)
- Chart your course – improvement goals & tactics
- Implement

To Do's -

1. Calculate your bank's efficiency ratio and compare to relevant peers
2. Calculate the three essential components of your efficiency ratio:
 - a. $\text{NIM} / \text{Average Assets}$
 - b. $\text{NII} / \text{Average Assets}$
 - c. $\text{NIE} / \text{Average Assets}$
3. Determine which type of high efficiency bank you are or are most capable of becoming
4. Compare your bank to peers on other critical efficiency measures:
 - a. $\text{Assets} / \text{Branch}$
 - b. $\text{Assets} / \text{FTE}$
 - c. $\text{Total Revenue} / \text{FTE}$

Our Next Webinar...

Understanding the Key Drivers of High Efficiency

- Margin Drivers
 - Yield
 - Portfolio Mix
 - Consistent Growth

- Fees (Non-Interest Income)
 - Which fee types most commonly seen at High Efficiency Community Banks

- Non-Interest Expenses
 - How do low operating expense banks achieve their results?

Austin Associates 2016 Webinar Series

Upcoming Webinars

- Key Operating Efficiency Drivers
June 28, 2016
- Interest Rate Risk Management
July, 2016
- Strategic Planning
August, 2016

Stay tuned for more to follow...

CONTACTS

We appreciate hearing from you.

If you have questions or comments, regarding today's Webinar, or if you would like to see any of your bank's current customer relationships modeled, please feel free to contact us at any time.

To receive a personalized demonstration of the Austin Profitability System - simply contact Jeff to arrange a date and time for your demonstration.

To receive a personalized demonstration of LoanPricingPRO® - simply contact Andy to arrange a date and time for your demonstration.

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Questions ?

THANK YOU FOR ATTENDING TODAY'S WEBINAR!