

Branch and Deposit Profitability: 2006 Versus Today



New York/New Jersey Chapter

Winter 2016



Performance Measurement



Strategic
Management



Profit & Process
Improvement



Board & Management Advisory
Services



Financial
Advisory

Presenters



Jeff Marsico
Executive Vice President
The Kafafian Group, Inc.
jmarsico@kafafiangroup.com
973.299.0300 x120

20+ Years Industry Experience
Strategic Planning
Process Improvement
Mergers & Acquisitions
Performance Measurement
Microfiche Maker

“How does the economies of scale gang explain Capital Bank of New Jersey?”



Gregg Wagner
Managing Director
The Kafafian Group, Inc.
gwagner@kafafiangroup.com
973.299.0300 x114

25+ Years Industry Experience
Bank CEO
Performance Measurement
Process Improvement
Regulatory Assistance
Accounts Payable “Check Memo” Writer.

“Is deflation just a little illness impacting a few countries, or will it become an epidemic throughout the world?”

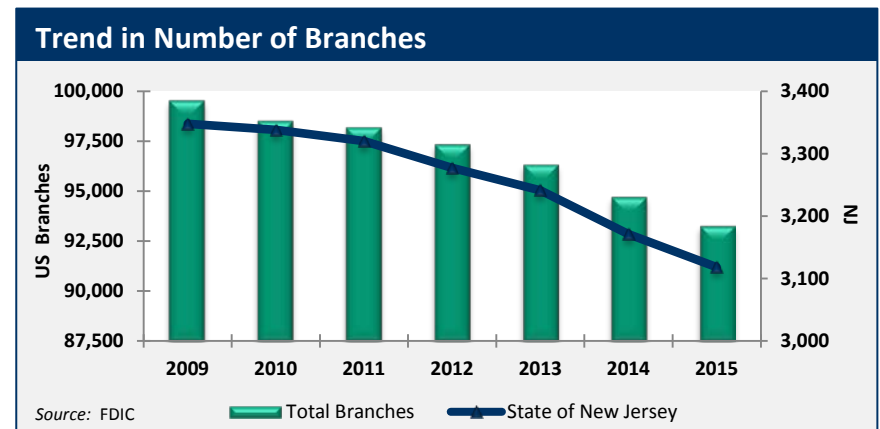
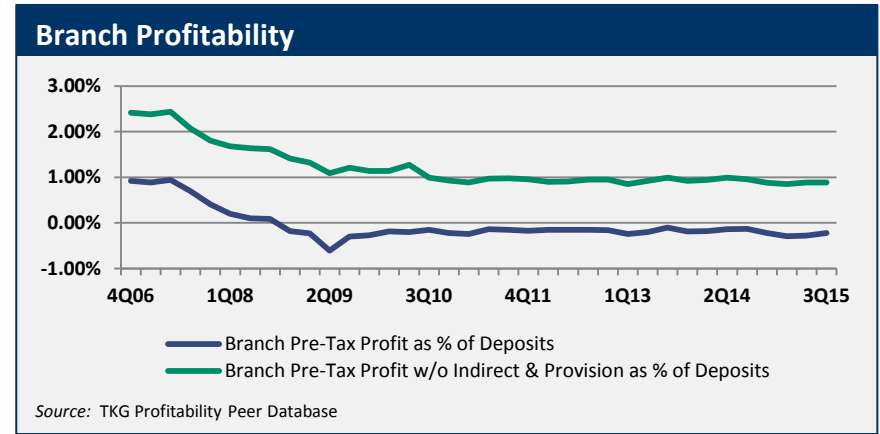
Branch and Deposit Profitability

2006 Versus Today

Branch & Deposit Profitability: 2006 vs. Today

Today's Sorry State of Branch Profitability

- ❖ 123% decline in fully absorbed branch pre-tax profits from 4Q06 to -0.22% during 3Q15
- ❖ 63% decline in direct branch pre-tax profits since 4Q06 to 0.89% during 3Q15
- ❖ 6.3% decline in number of nationwide branches since 2009 to 93,273 branches
- ❖ 6.9% decline in number of NJ branches since 2009 to 3,118 branches.

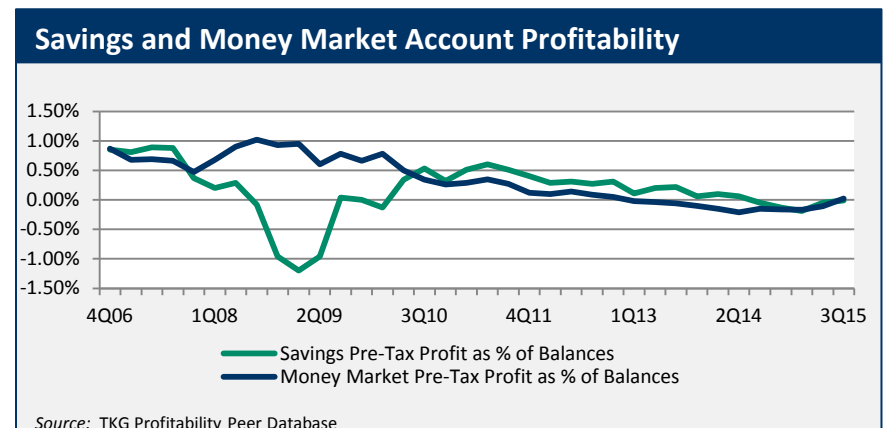
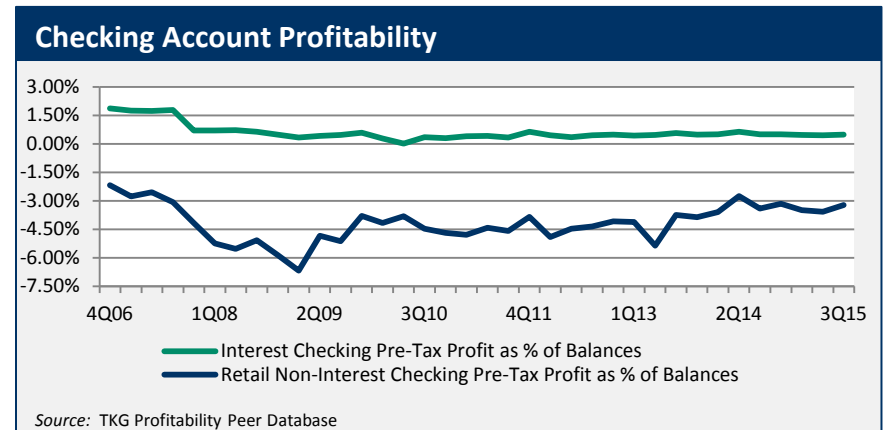


Source: TKG Profitability Peer Group and SNL Financial, LC

Branch & Deposit Profitability: 2006 vs. Today

Today's Sorry State of Deposit Profitability

- ❖ 48% decline in total retail non-interest checking pre-tax profits since 2006 to -3.22% during 3Q15
- ❖ 74% decline in interest checking pre-tax profits since 2006 to 0.49% during 3Q15
- ❖ 101% decline in savings pre-tax profits since 2006 to -0.01% during 3Q15
- ❖ 98% decline in money market pre-tax profits since 2006 to 0.02% during 3Q15

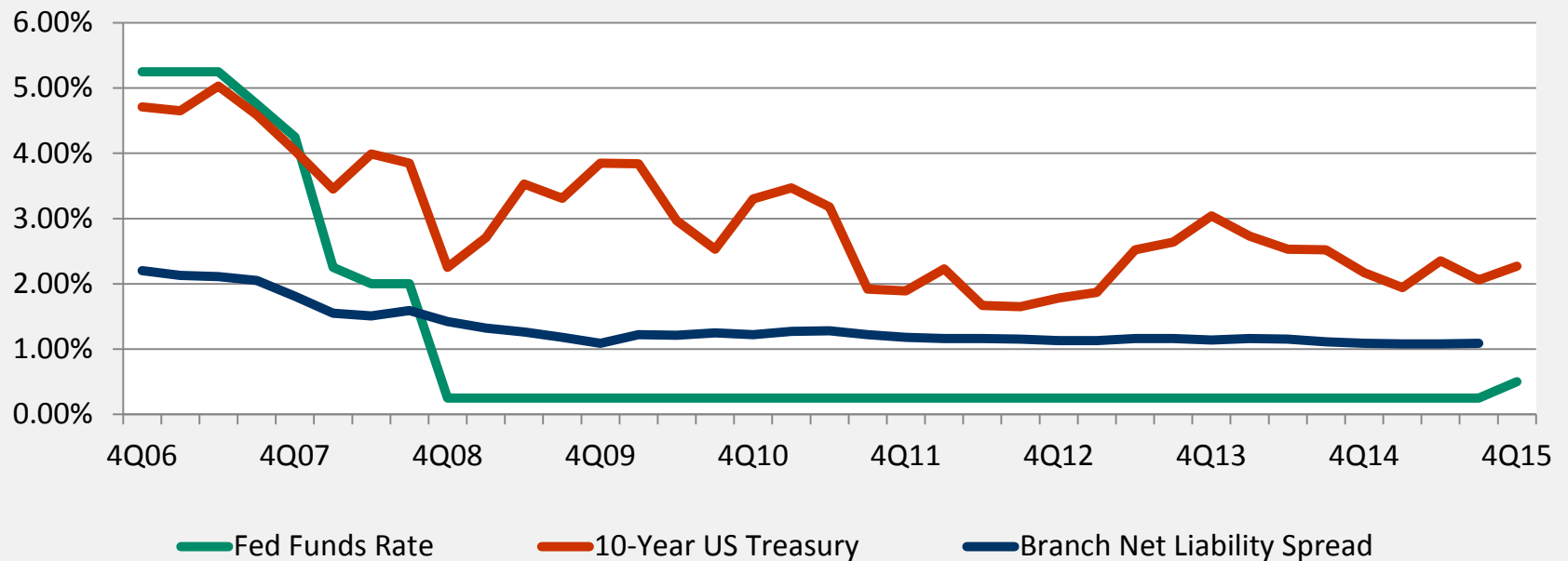


Source: TKG Profitability Peer Group

Branch & Deposit Profitability: 2006 vs. Today

The Culprit: Historically Low Interest Rates

Interest Rate Environment



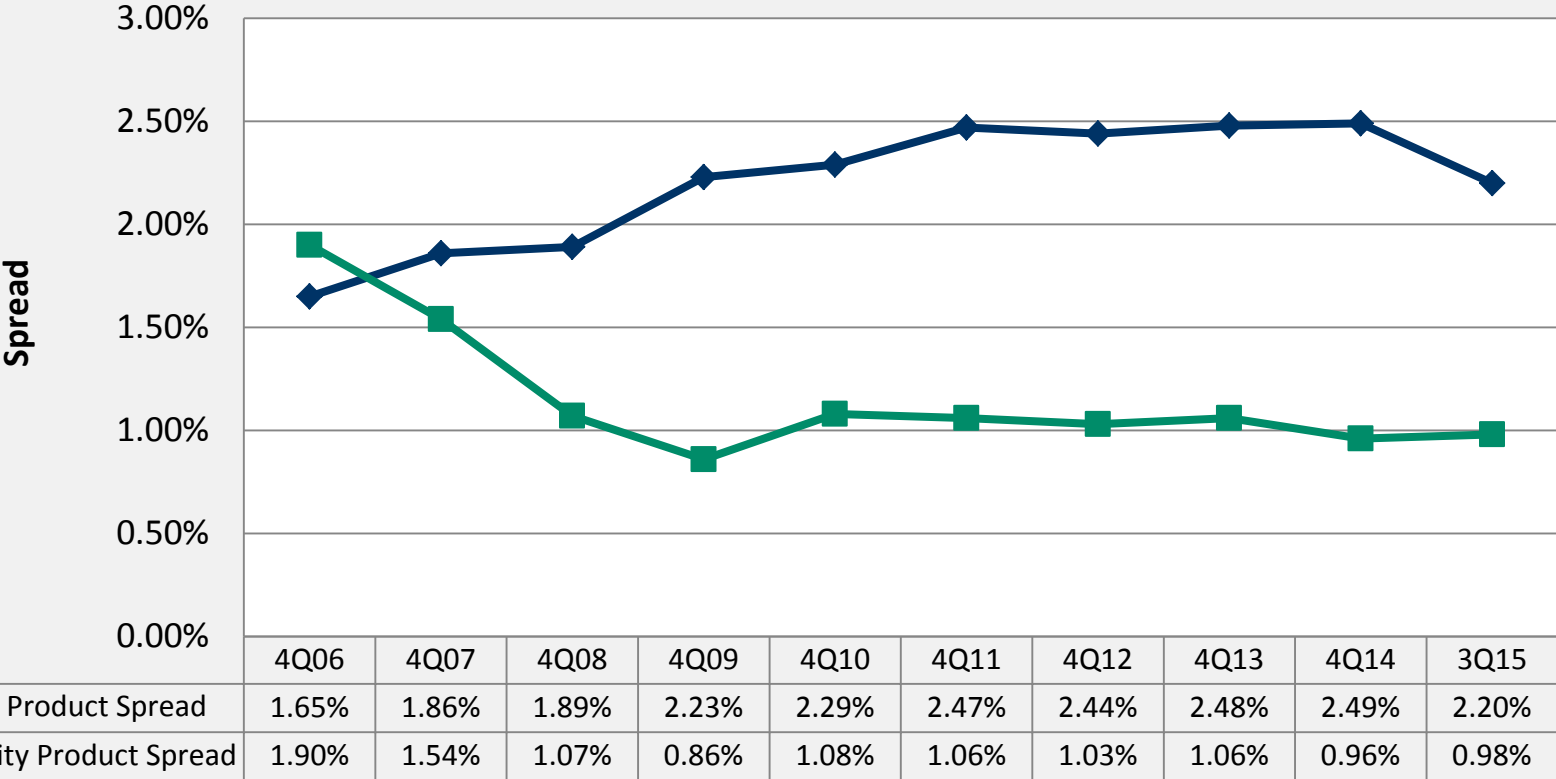
Source: TKG Profitability Peer Group, Federal Reserve, and SNL Financial LP

Source: TKG Profitability Peer Group, Federal Reserve, and SNL Financial LP

Branch & Deposit Profitability: 2006 vs. Today

The Culprit: Impact on Bank Products

Asset & Liability Product Spreads

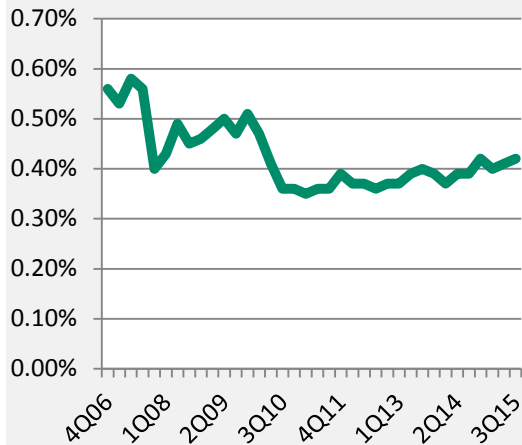


Source: TKG Profitability Peer Group

Branch & Deposit Profitability: 2006 vs. Today

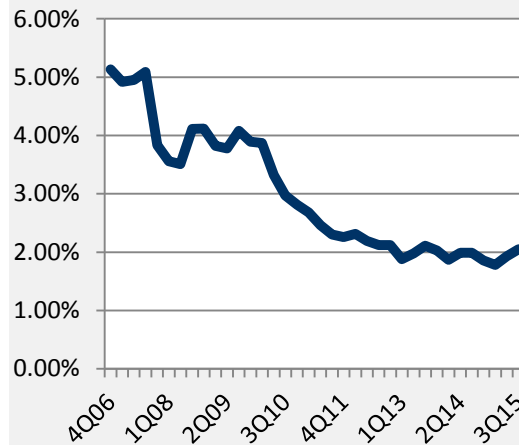
The Culprit: Fee Income

Branch Fee Income as % of Deposits



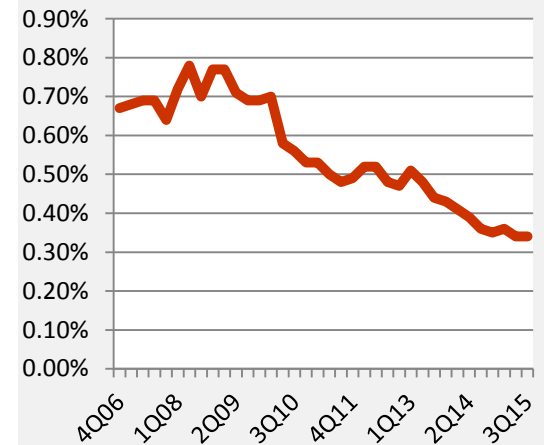
Source: TKG Profitability Peer Database

Retail Non-Interest Checking Fee Income as % of Balances



Source: TKG Profitability Peer Database

Bus. Non-Interest Checking Fee Income as % of Balances



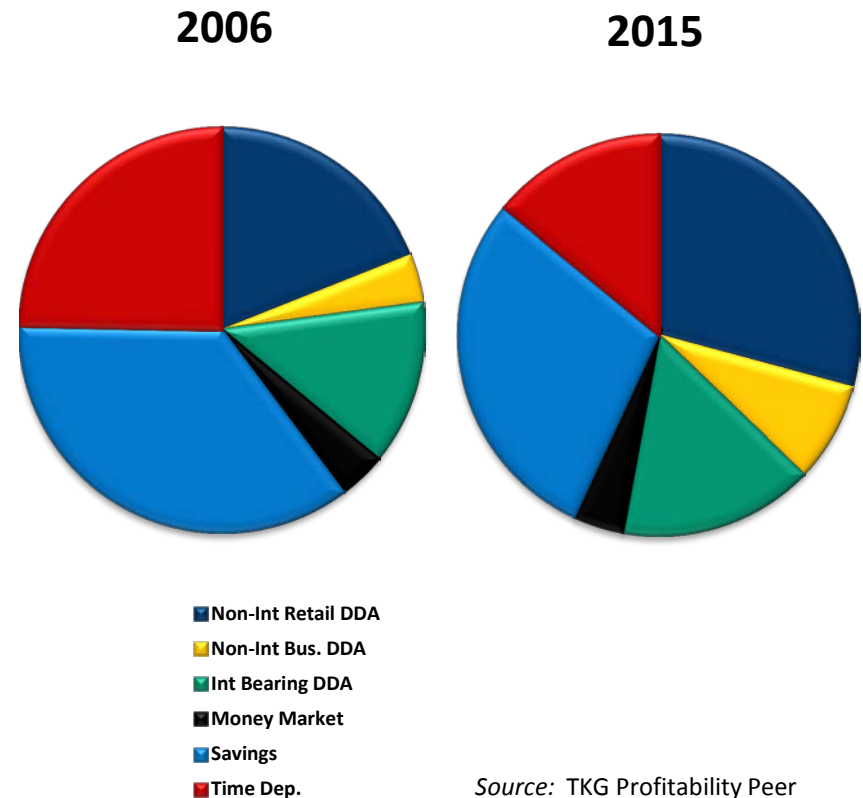
Source: TKG Profitability Peer Database

Source: TKG Profitability Peer Group, Federal Reserve, and SNL Financial LP

Branch & Deposit Profitability: 2006 vs. Today

Banker Reaction 1: Change the Mix

- ❖ In the 10 years prior to 2006, loans grew faster than deposits (108% versus 92%, respectively), leading to price competition for funding.
- ❖ 2006-2015, deposits grew faster than loans (61% versus 19%), leaving banks with greater levels of liquidity.
- ❖ As a result, bankers allowed CD price-shoppers to go elsewhere, and focused deposit gathering on core customers.



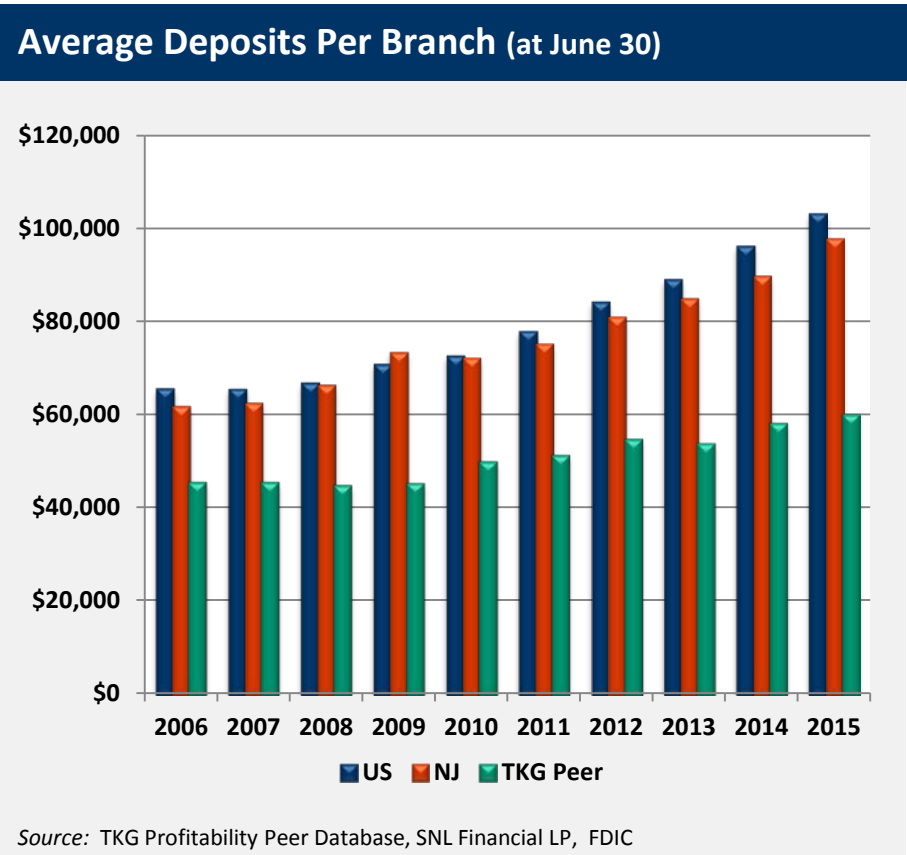
Source: TKG Profitability Peer

Source: FDIC, TKG Profitability Peer Group

Branch & Deposit Profitability: 2006 vs. Today

Banker Reaction 2: Grow Average Branch Deposit Size

- ❖ When total income as a percent of branch deposits was 3.50% in 4Q06, branches could generate acceptable profits with a smaller branch (\$45 million per branch).
- ❖ Shrink total income as a percent of deposits to 2.03% for 3Q15, you need more deposits (\$60 million per branch). Even with greater deposits per branch, revenue per branch is less than 2006.

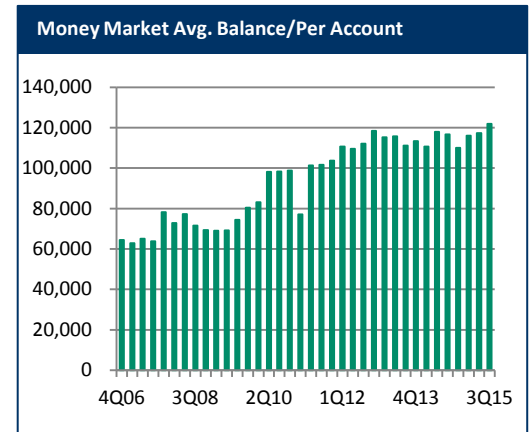
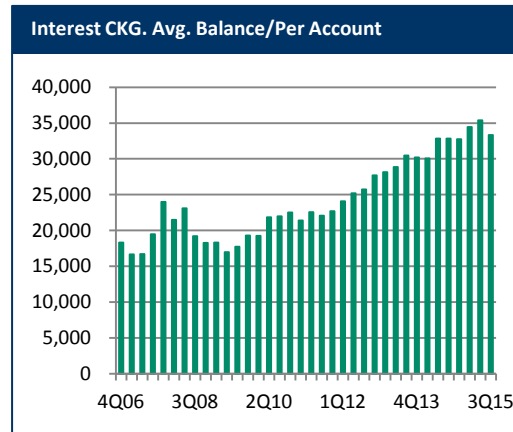
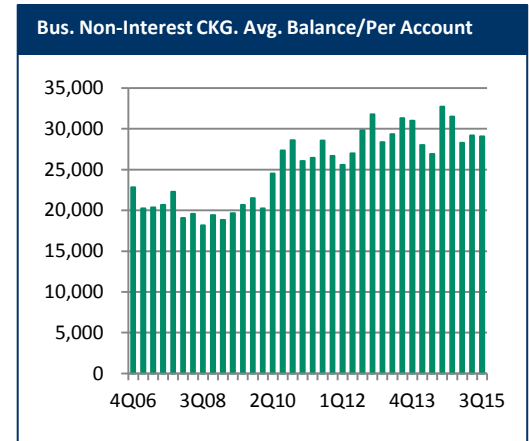
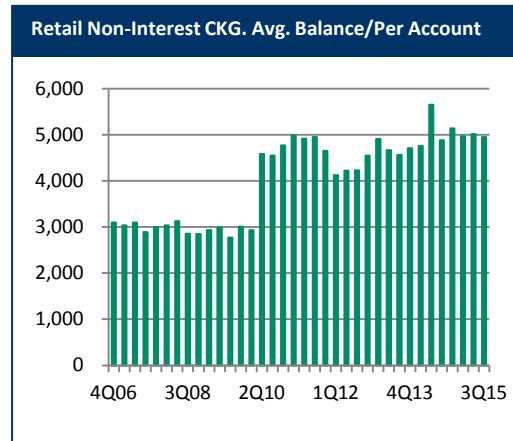


Source: TKG Profitability Peer Group and FDIC

Branch & Deposit Profitability: 2006 vs. Today

Banker Reaction 3: Grow Average Deposit Size Per Account

- ❖ Most deposit and branch revenues are based on account balances, not number of accounts.
- ❖ Given the low interest on deposits, customers allowed core deposit account balances to rise.
- ❖ Also a factor, rising cost of living, elevated retail overdraft fees, and lack of market confidence leading to higher checking balances.



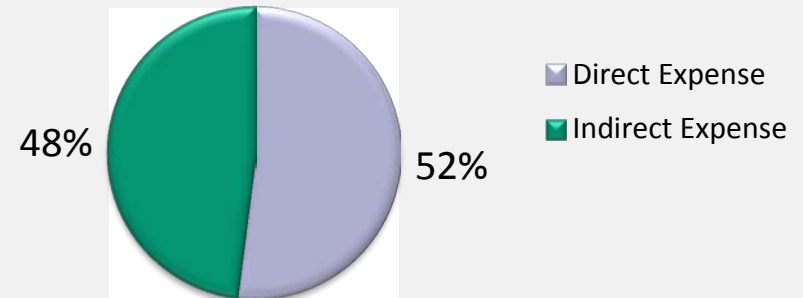
Source: TKG Profitability Peer Group

Branch & Deposit Profitability: 2006 vs. Today

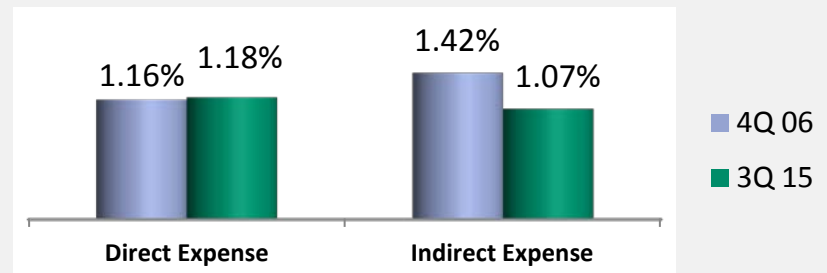
Banker Reaction 4: Reduce Branch Cost

- ❖ Direct expenses are not the only expenses to run a branch.
- ❖ Smaller sq. ft. branches, cutting staff, closing profit laggards, and the prior mentioned increased deposits per branch should be contributing to a relative decline of branch operating expenses.
- ❖ Why is it not?

Branch Non-Interest Expense (3QTR 15)



Average Expense as % of Total Deposits

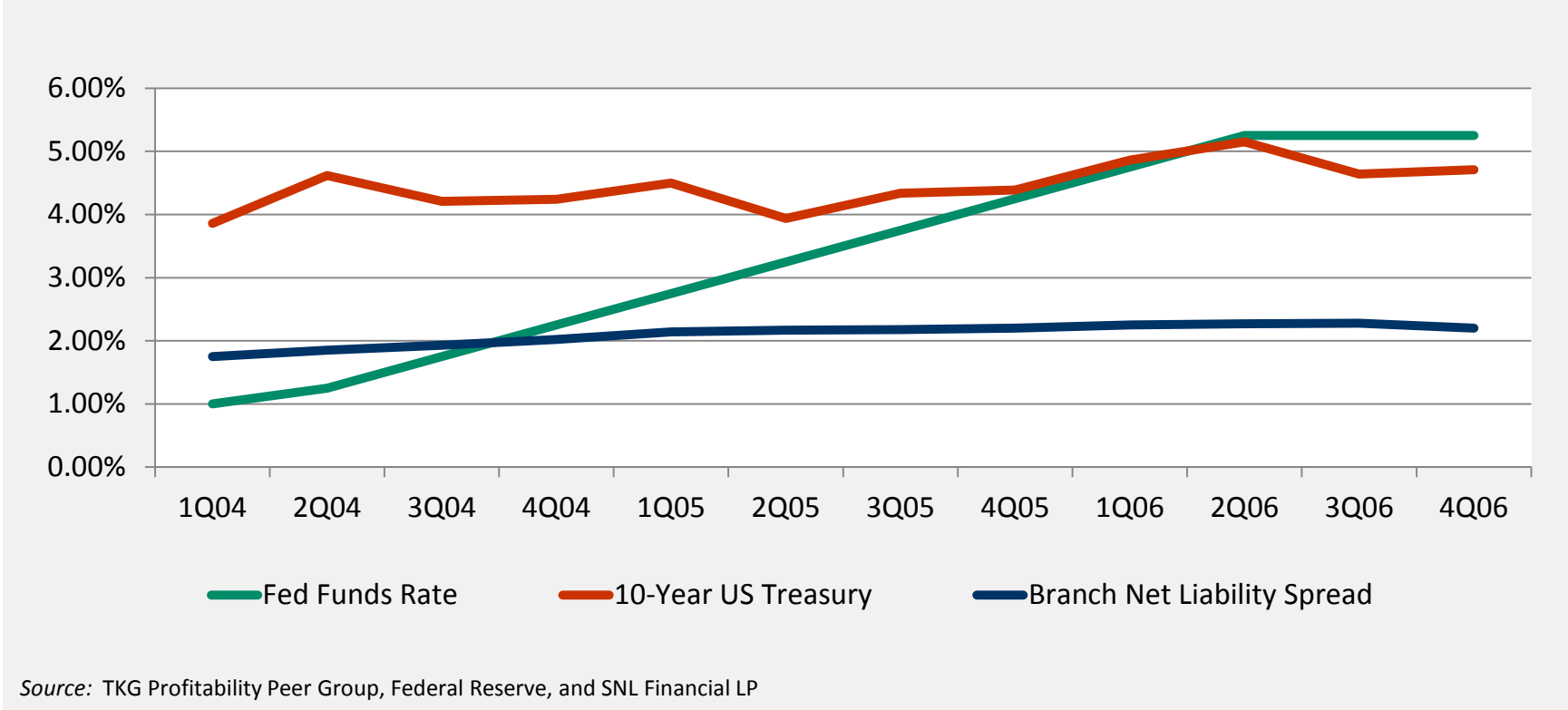


Source: TKG Profitability Peer Group

Branch & Deposit Profitability: 2006 vs. Today

How It Was: 2004-06

Interest Rate Environment

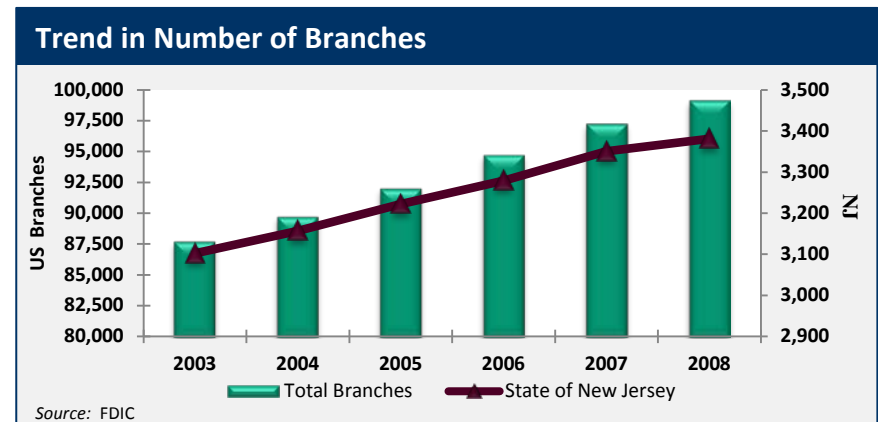
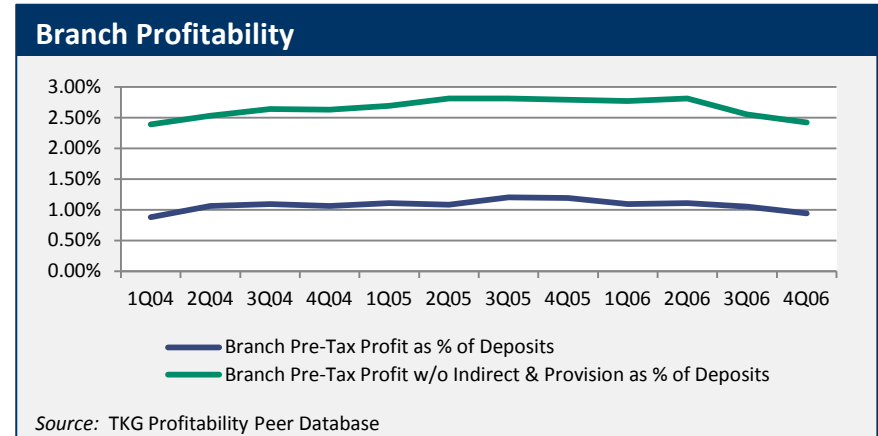


Source: TKG Profitability Peer Group, Federal Reserve, and SNL Financial LP

Branch & Deposit Profitability: 2006 vs. Today

How It Was: 2004-06

- ❖ From 1Q04 to the peak profit period of 3Q05, branch pre-tax profits increased 36%.
- ❖ Profits began to decline as a result of price competition for deposits, increased branching, and inverted yield curve.
- ❖ 13% increase in number of nationwide branches from June 2003 – June 2008
- ❖ Are we in line for a repeat performance?



Source: TKG Profitability Peer Group and SNL Financial, LC

Branch & Deposit Profitability: 2006 vs. Today

Comparison: 2006 to Today

- ❖ Branch net liability spread was greater in 2006 due to higher short term interest rates.
- ❖ Fee income per deposit product was greater due to lower average balances and the newness of automatic overdraft protection.
- ❖ Therefore, total income per branch was greater in 2006. But total income was offset by lower average balances.

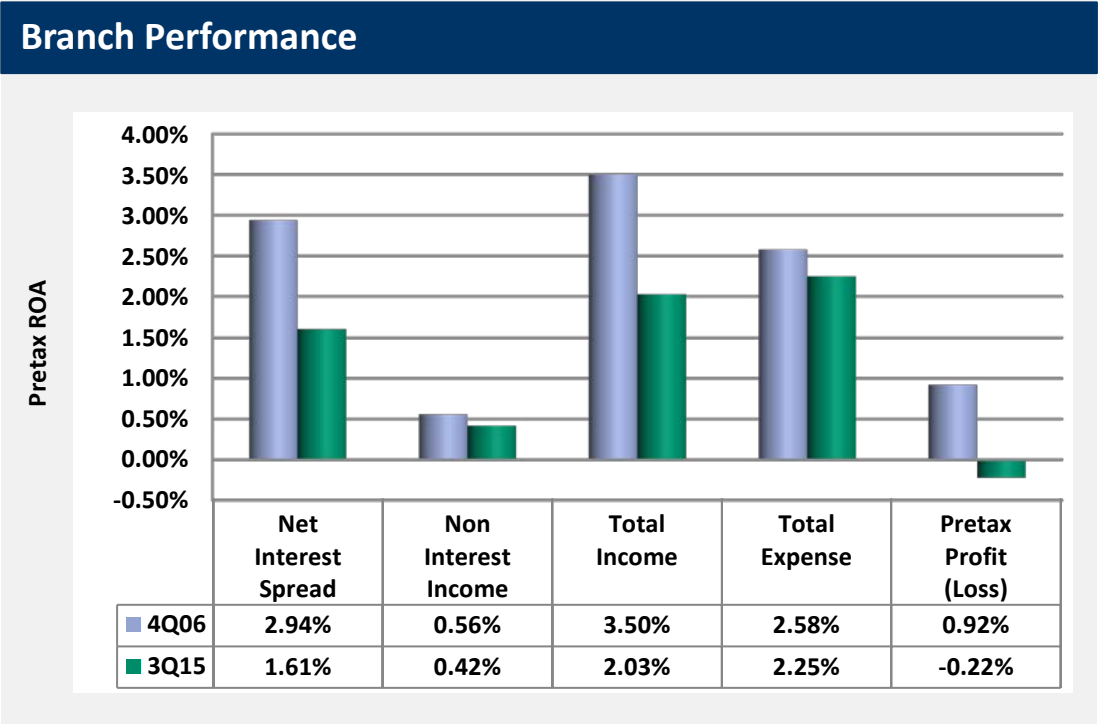
Branch Unit	Proforma		
	4Q06	3Q15	3Q15
Average Branch Deposits (\$000)	\$45,246	\$63,203	\$63,122
Net Interest Spread	2.94%	1.61 %	2.94%
Non-Interest Income	0.56%	0.42 %	0.42%
Total Income	3.50%	2.03 %	3.36%
Direct Expense	1.16%	1.18 %	1.19%
Indirect Expense	1.42%	1.07 %	1.00%
Total Non-Interest Expense	2.58%	2.25 %	2.19%
Pretax Profit (Loss)	0.92%	(0.22)%	1.17%

Source: TKG Profitability Peer Group

Branch & Deposit Profitability: 2006 vs. Today

What Could Be

- ❖ Non-interest income fell 14 basis points but was more than offset by 29 basis point reduction in total expenses.



Source: TKG Profitability Peer Group

Branch & Deposit Profitability: 2006 vs. Today

Deposits Versus Loans

3QTR 2015			
Loan Product	Avg. Balance	Pretax Profit (Loss)	Net Income Per Acct.
C&I	\$289,210	1.69%	\$4,479.60
CRE	\$856,054	2.19%	\$17,674.90
HE Loans	\$47,491	0.03%	\$20.81
HELOC	\$52,431	1.30%	\$699.50
Residential	\$212,274	1.28%	\$2,700.24

3QTR 2015			
Deposit Product	Avg. Balance	Pretax Profit (Loss)	Net Income Per Acct.
Retail Non-Int. Ckg.	\$4,947	(3.23%)	(\$154.95)
Bus Non-Int. Ckg.	\$29,183	(0.52%)	(\$111.83)
Int. Ckg.	\$33,375	0.49%	\$168.12
Savings	\$12,580	(0.10%)	\$0.01
MM	\$122,112	0.03%	\$182.41

Source: TKG Profitability Peer Group

Branch & Deposit Profitability: 2006 vs. Today

Deposits Versus Loans

3QTR 2015						3QTR 2015 Pro forma					
Loan Product	Avg. Balance	Pretax Profit (Loss)	Net Income Per Acct.	Equity Allocated	Pretax ROE	Deposit Product	Avg. Balance	Pretax Profit (Loss)	Net Income Per Acct.	Equity Allocated	Pretax ROE
C&I	\$289,210	1.69%	\$4,479.60	8.50%	20.83%	Retail Non-Int. Ckg.	\$4,947	0.01%	\$0.49	3.00%	0.33%
CRE	\$856,054	2.19%	\$17,674.90	8.00%	27.79%	Bus Non-Int. Ckg.	\$29,183	3.15%	\$919.26	3.00%	105.00%
HE Loans	\$47,491	0.03%	\$20.81	5.00%	0.61%	Int. Ckg.	\$33,375	2.60%	\$867.75	3.00%	86.67%
HELOC	\$52,431	1.30%	\$699.50	5.00%	25.58%	Savings	\$12,580	2.04%	\$256.63	2.00%	102.00%
Residential	\$212,274	1.28%	\$2,700.24	4.00%	30.59%	MM	\$122,112	1.17%	\$1,428.71	2.00%	58.50%

Note: Pro forma pre-tax profits uses 3Q15 actual peer data, plus the difference in product spreads between 4Q06 and 3Q15.

Source: TKG Profitability Peer Group

Branch & Deposit Profitability: 2006 vs. Today

Takeaways

- ❖ Although deposit profitability is at a low water mark, banks should be paying attention to growing deposits and maintaining the deposit mix that they worked so hard to build since 2008.
- ❖ As loan demand challenges banks ability to fund it, competition for deposits will increase.
- ❖ Banks need to continue to evolve the structure of their branches to meet what is demanded by customers... loan and investment assistance and advice, and problem solving.
- ❖ Branch cost structures should decline relative to the branch deposit size.

Branch & Deposit Profitability: 2006 vs. Today

Q&A

Questions?

Branch & Deposit Profitability: 2006 vs. Today

Podcast

We are excited to announce:



A monthly podcast discussing major issues and events throughout the month!

Download at www.kafafiangroup.com/podcasts

Or on iTunes, Stitcher, and Soundcloud and most major podcast apps.

Released every month on the last Wednesday of the month.