CPG wire
Capital Performance Group's Bi-Monthly Newsletter
CAPITAL PERFORMANCE GROUP
volume 14/issue 6
December 2015

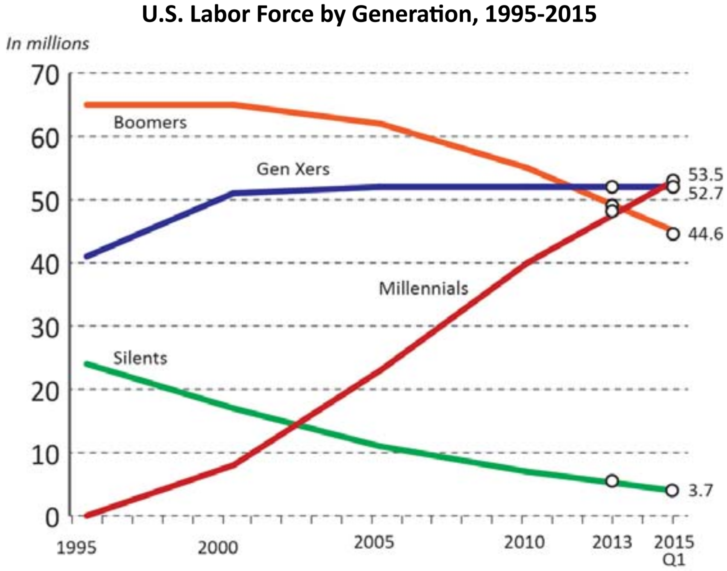
It's that time again, when we dust off our crystal ball to prognosticate about the future and take a look at 2015

2015 Year in Review

Gnarled Apple. Apple Pay failed to gain significant penetration in consumer mobile payments following its ballyhooed launch last year. According to an October 2015 Accenture survey, only 8% of smartphone owners use Apple Pay weekly, compared to 67% using cash, 59% using debit cards, and 50% using credit cards. Long transaction times, poor knowledge of the service by cashiers, and dysfunctional terminals were cited as the biggest obstacles, according to a survey of Apple Pay users by Phoenix Marketing International.

Millennials Ascendant. From 1995 to 2011, Baby Boomers made up the largest part of the U.S. labor force. In 2012, they were eclipsed by Gen Xers. As of first quarter 2015, Millennials now comprise the largest percentage of the U.S. labor force, with 53.5 million workers, compared to 44.6 million Baby Boomers and 52.7 million Gen Xers. Economist Mark Zandi has cited an increased rate of household formations among Millennials as one reason for his bullish outlook on U.S. economic growth.

U.S. Labor Force by Generation, 1995-2015



Source: Pew Research Center tabulations of monthly 1995-2015 Current Population Surveys, Integrated Public Use Microdata Series (IPUMS).

Bearish on FinTech. Much ink was spilled in the financial services press about the competitive strengths of fintech companies, but investors in 2015 proved to be much more skeptical of the model. The stock price of LendingClub Corp. and On Deck Capital, Inc. have declined by an eye-popping 50 percent this year. loanDepot, Inc. cancelled its IPO in mid-November, citing unfavorable market conditions and Square, Inc. priced its initial public offering below the expected range. Investors are especially wary about the competi-

Continued on back

Predictions for 2016

CPG and industry friends gazed into a crystal ball to predict that the following events will occur in 2016:

1. In the latest version of the strategy "If you can't beat 'em, buy 'em", **a bank will acquire a leading non-bank on-line lender** in order to capture the growth potential and the technological savvy of those companies. ~ Claude Hanley, Capital Performance Group

2. As interest rates rise, competition for core small business deposits among community banks will increase and more **community banks will begin to pay interest on small business demand deposits.** ~ John Barrickman, New Horizons Financial Group

3. A greater number of **banks will adopt more formal commercial on-boarding practices.** This follows from a wider appreciation among executives that a regular, organized process of coordinated contacts in the first year between the new customer and various bank personnel (and potentially board members) lowers buyer's remorse and deepens partnerships with new bank customers. ~ Jack Hubbard, St. Meyer & Hubbard, Inc.

4. **Banks will increase their efforts to automate low-value (i.e. predictable, repetitive) elements of client sales interactions** that, to this point, banks have thought only branch staff or small business bankers could provide. Bank management will pursue this automation in order to increase efficiency, ensure greater consistency in the customer experience, and to improve their information on customer interactions. ~ Nick Miller, Clarity Advantage Corp.

5. **Loan problems will begin to appear among community banks**, especially among banks that are located in agricultural markets, oil and gas regions, and coal mining areas. ~ Christine Corso, New Horizons Financial Group

6. The Fed will begin to **raise rates in 2016** but do so very modestly as world economic challenges dampen expectations for the U.S. economy and the presidential election whirlwind dampens moods. Even so, midsize and community banks should continue to outperform larger banks who are more reliant on consumer banking – which the CFPB and other regulators have made significantly more costly for bigger institutions. ~ Mary Beth Sullivan, Capital Performance Group

7. **Senator Elizabeth Warren will find only a chunk of coal in her stocking** on Christmas morning due to her naughty bank bashing this year. ~ Santa Claus

2015 Year in Review (continued)

tive nature of online lending and the low barrier to entry into these businesses.

M&A Premiums Rise. The number of whole bank and thrift deals in 2015 is expected to approximate the level from last year. Since 2012, premiums paid over tangible book value have steadily increased. The median price to earnings multiple paid by acquirers was a hefty 22.6 in 2015. The increase in multiples paid reflects the increased financial wherewithal of buyers and their limited organic growth opportunities.

Metric	2012	2013	2014	2015 (1)
Number of Deals (#)	221	225	284	262
Median Price/Tangible Book (%)	117.0	124.6	136.6	140.6
Median Price/EPS (x)	20.7	19.4	23.9	22.6
Median Assets of Target ($000)	127,305	166,298	159,830	150,354

(1) Transactions announced through November 27, 2015.
Source: CPG analysis of data from SNL Financial, LC 2015.

External Risk Events Monitor

Over the past year, the regulators have emphasized the need for proactive risk management frameworks at institutions of all sizes. Large institutions – those at or near $50B – are expected to have more rigorous risk management programs in place. Smaller institutions have found that they, too, can benefit from more formal processes.

Capital Performance Group has created the RISK EVENTS MONITOR, a new product that allows you to review and respond to outside events in a more efficient and proactive manner. Each report includes:

- A monthly summary of events – including events that could have implications for reputational and strategic risk
- Information on the relative impact of events
- Tools to help you identify priority events for your bank

With the MONITOR, institutions can manage a part of the risk measurement process efficiently and effectively. While institutions already have systems in place to monitor internal risk, external risk can be harder to track – for instance, there are many different sources of information on external events that could pose a risk to an institution. Many banks do not have the resources to devote to this effort.

The MONITOR supports better, faster, and more proactive decision-making around risk management and leads to better allocation of scarce – and expensive – compliance resources.

Subscription Options: Monthly - $3,000 per month; Quarterly - $7,500 per quarter

For more information, please contact Mary Beth Sullivan at msullivan@capitalperform.com or 202-337-7872.

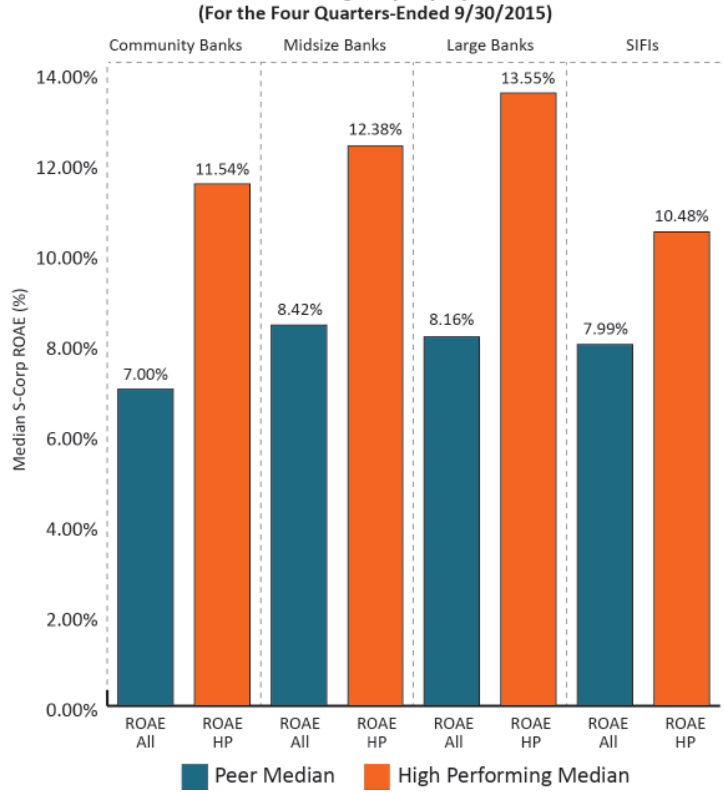
Happy Holidays and Best Wishes for Success in 2016!

Drivers of High Performance

CPG analyzed and compared key financial performance metrics within the banking industry for the twelve months-ended September 30, 2015. Banks were categorized into four asset tiers: SIFIs, defined as those institutions with assets of greater than $50 billion; Large Banks with total assets of $10 billion to $50 billion; Midsize Banks with total assets of $1 billion to $10 billion; and Community Banks with total assets of less than $1 billion. High-performing institutions were defined as those institutions in each asset tier that rank in the top 25th percentile in terms of return on average equity ("ROAE"). High-performing institutions in all asset tiers were able to achieve double-digit median ROAE for the twelve months-ended September 30, 2015.

- High-performing institutions achieved higher profitability than peers through superior execution of the traditional spread-based business model. High-performers in every asset tier generated higher net interest income, net interest margins, core deposit growth, and loan growth. The latter factor was particularly pronounced among high-performing Large and Community Banks. They achieved significantly higher loan growth while simultaneously maintaining better asset quality compared to their respective peers.
- High-performers in all asset tiers were more **efficient** than their peers. High-performing Midsize and Community Banks had a significantly lower ratio of noninterest expense to average assets.
- High-performers recorded **revenue growth** rates that far exceeded their rate of expense growth. Interestingly, high performers did grow expenses more than peers. They simply grew revenue even more. SIFIs were the exception to this observation.
- Among SIFIs, the most important driver of high performance was the ability to generate above average levels of noninterest income. High-performing SIFIs were also more efficient than peers.

Return on Average Equity by Asset Tier
(For the Four Quarters-Ended 9/30/2015)



Source: CPG analysis of data from SNL Financial, LC 2015.