

Dallas Lender Lunch

Hosted by SouthState Bank

Chris Nichols

Director of Capital Markets

Ed Kofman

Director of Loan Hedging

Nathan Goodnight & Ben Glidden

Hedging Specialists

Chris Wright

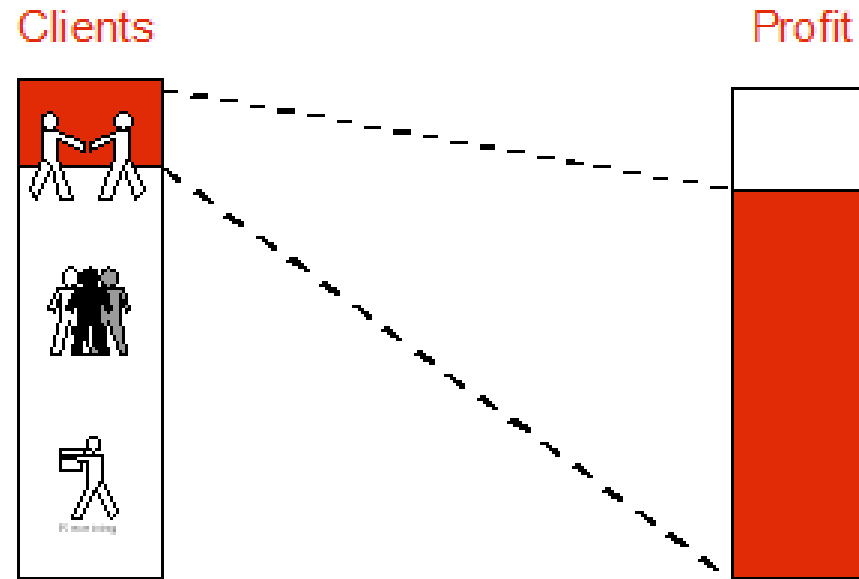
SVP Business Development



Customer Profitability



Dissecting Relationship Profitability



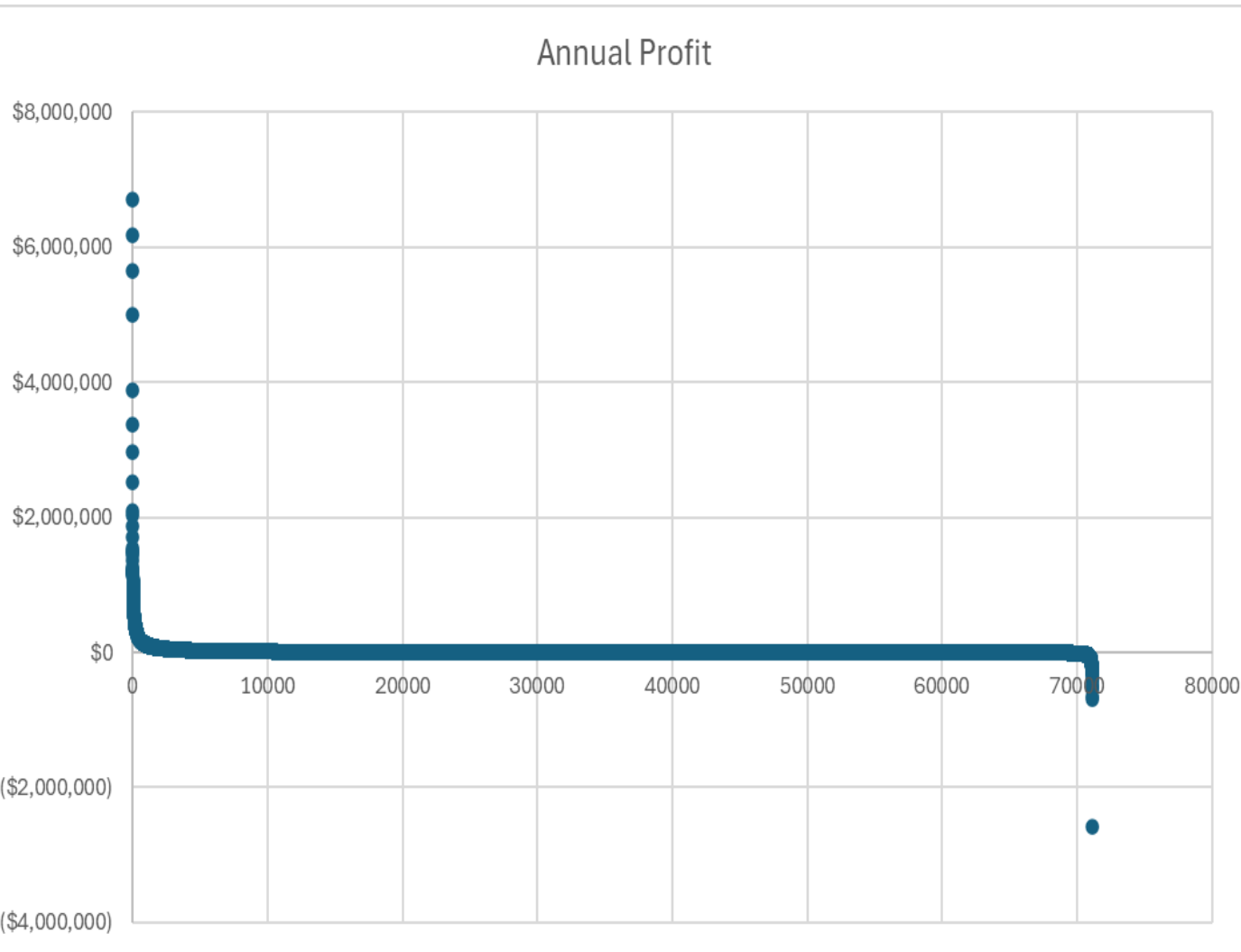
The top 20% of your clients
Generate 80% of your profit

In banking, 10 % of customers generate 120% of your profit

Dissecting Relationship Profitability



Case Study – over \$40Bn bank, 71k commercial clients



- Top 0.04% of clients = 10% of all profits
- Top 1.56% of clients = 50% of all profits
- Top 7.56% of clients = 80% of all profits
- Bottom 48% of clients zero or negative profits
- Bottom 8.6% of clients earn substantial negative profits (subtract 10.3% of total profits)
- 30% of all loan commitments are made to bottom 10% of profitable clients
- Average loan size \$320k
- Average deposit size \$230k

Community Banking Industry Challenges and Opportunities

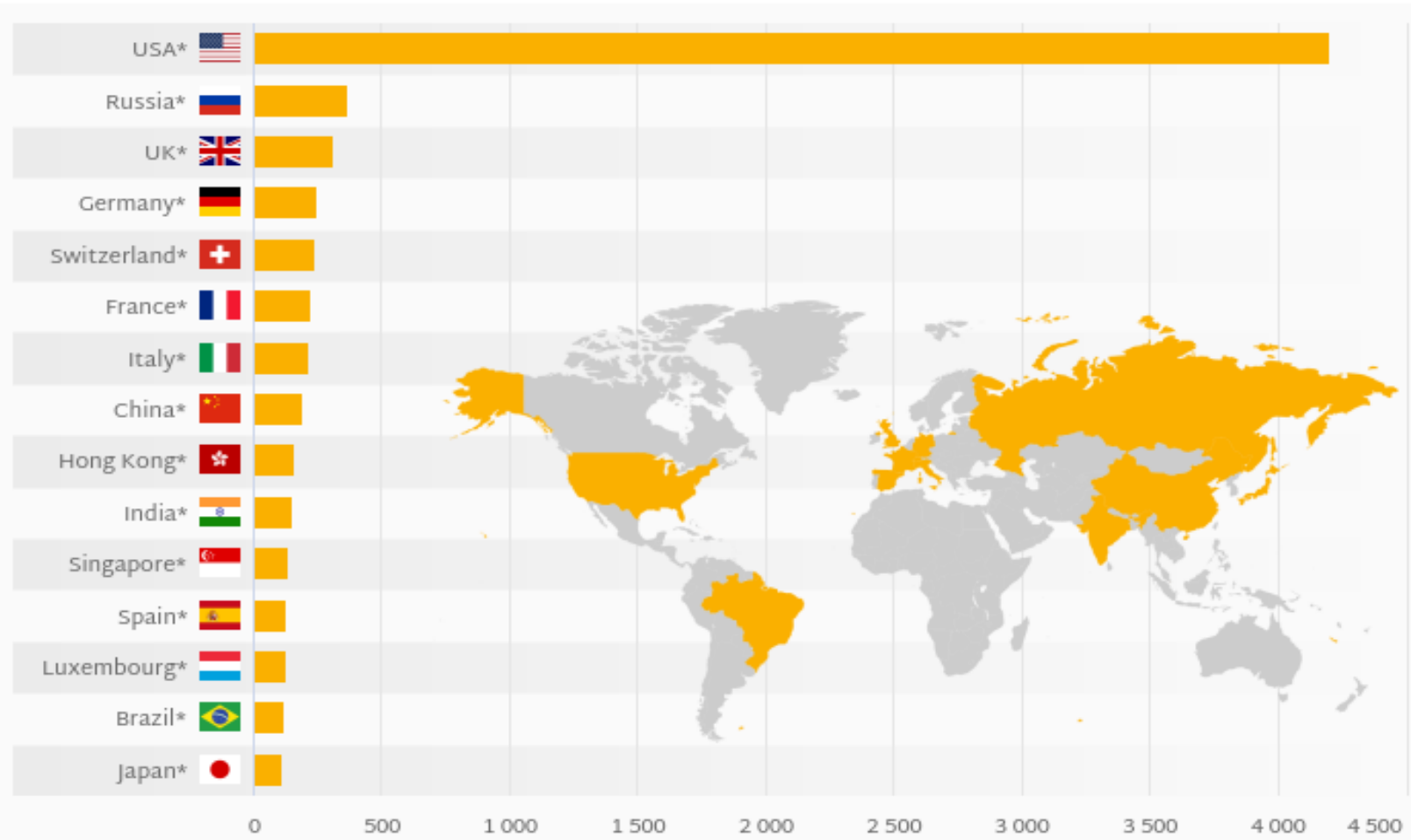


Why So Many Banks



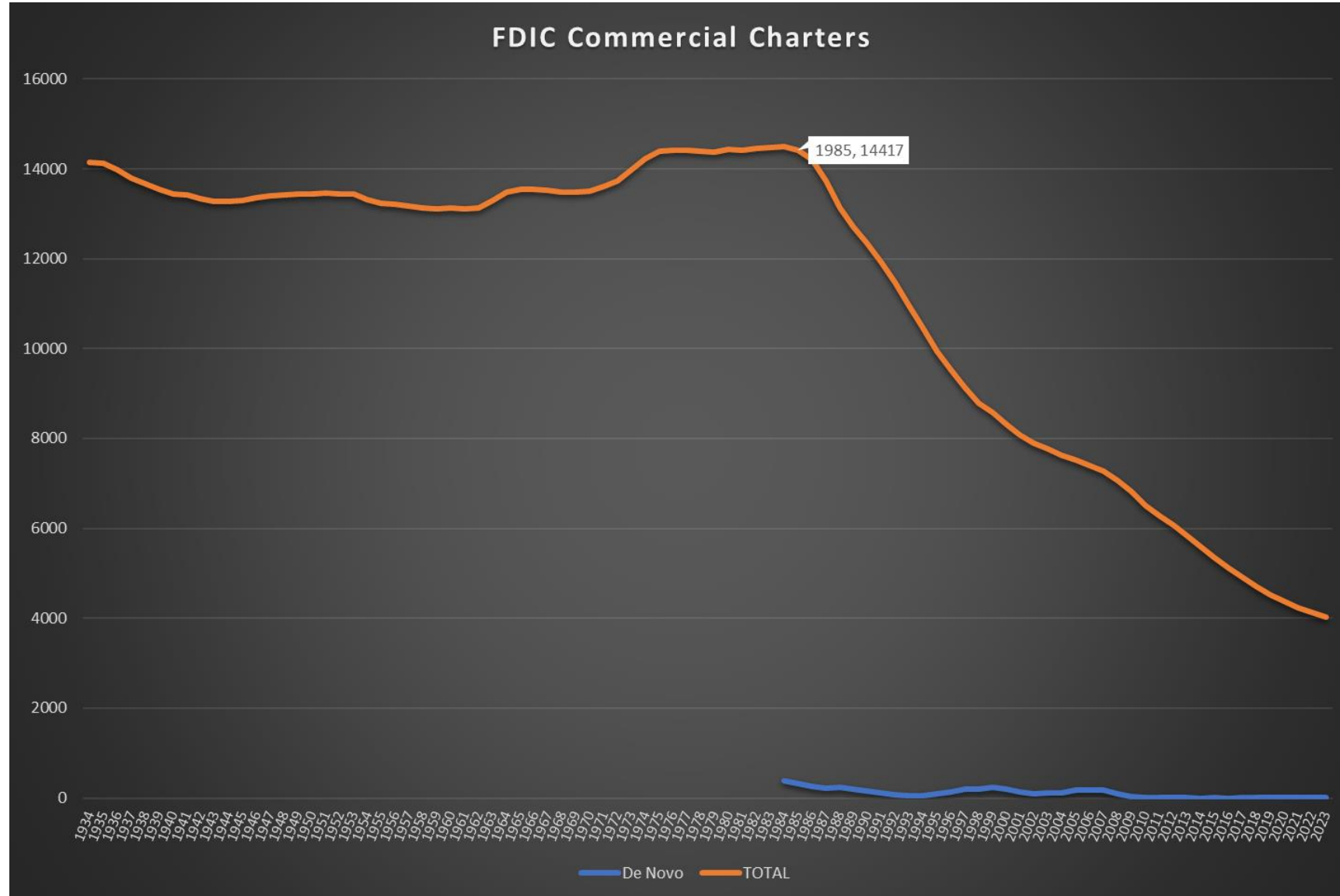
What Country Has the Most Banks?

Number of Banks (banks), 2022 or latest



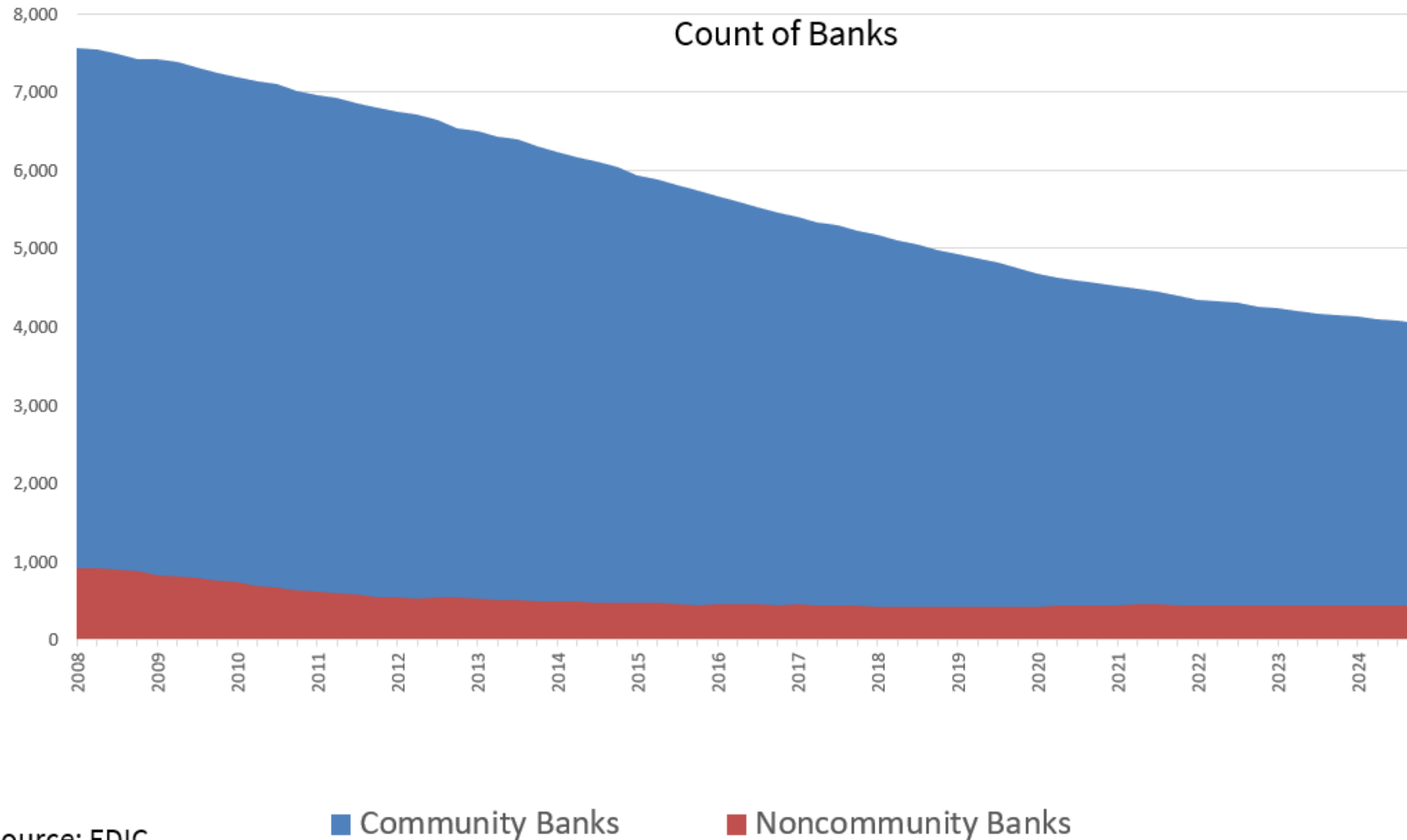
Source: National Statistical Office, * Data from 2020

Competitive Landscape



70% decline in the number of FDIC charters, 350 – 400 banks acquired per year

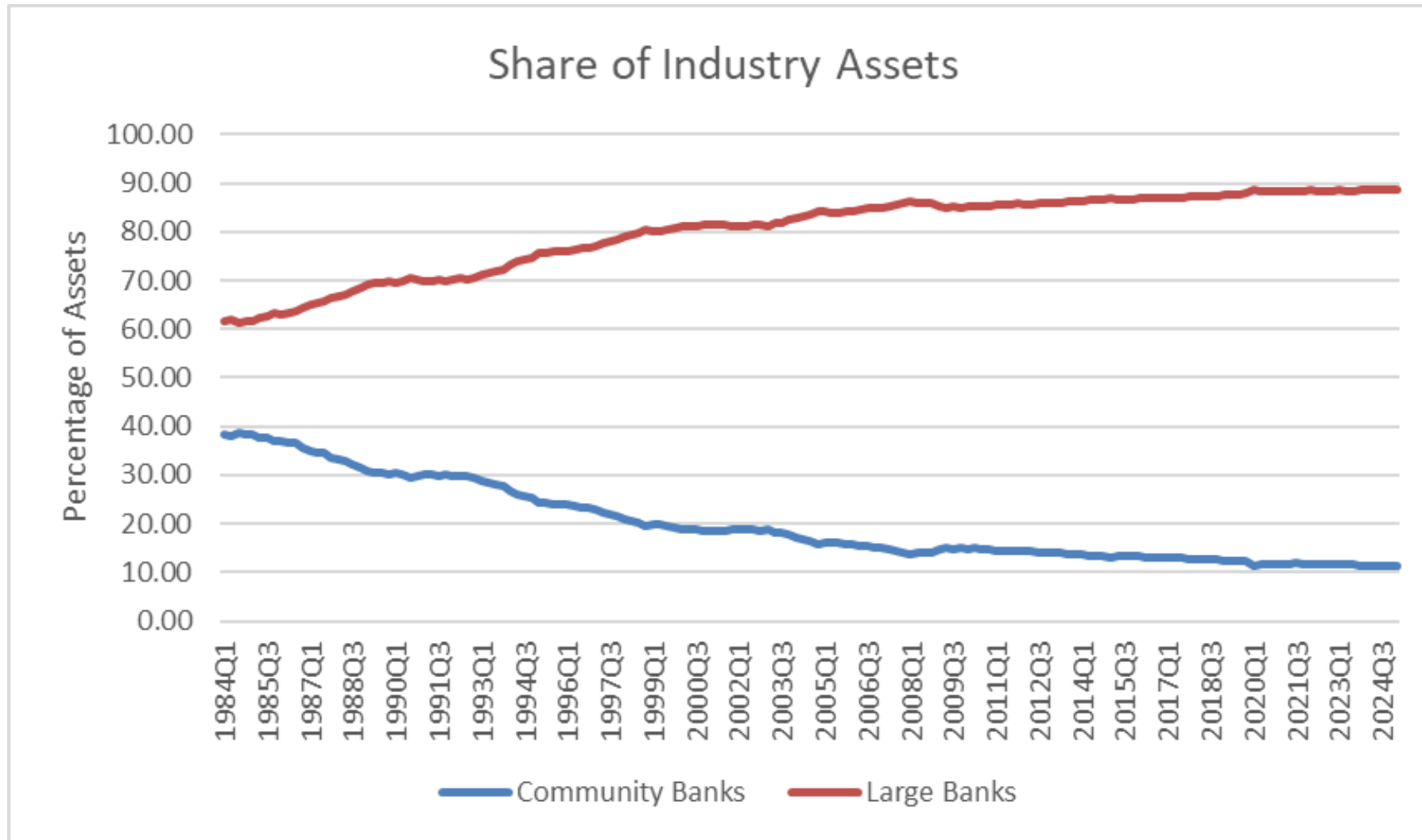
Competitive Landscape



Not all banks are consolidating equally

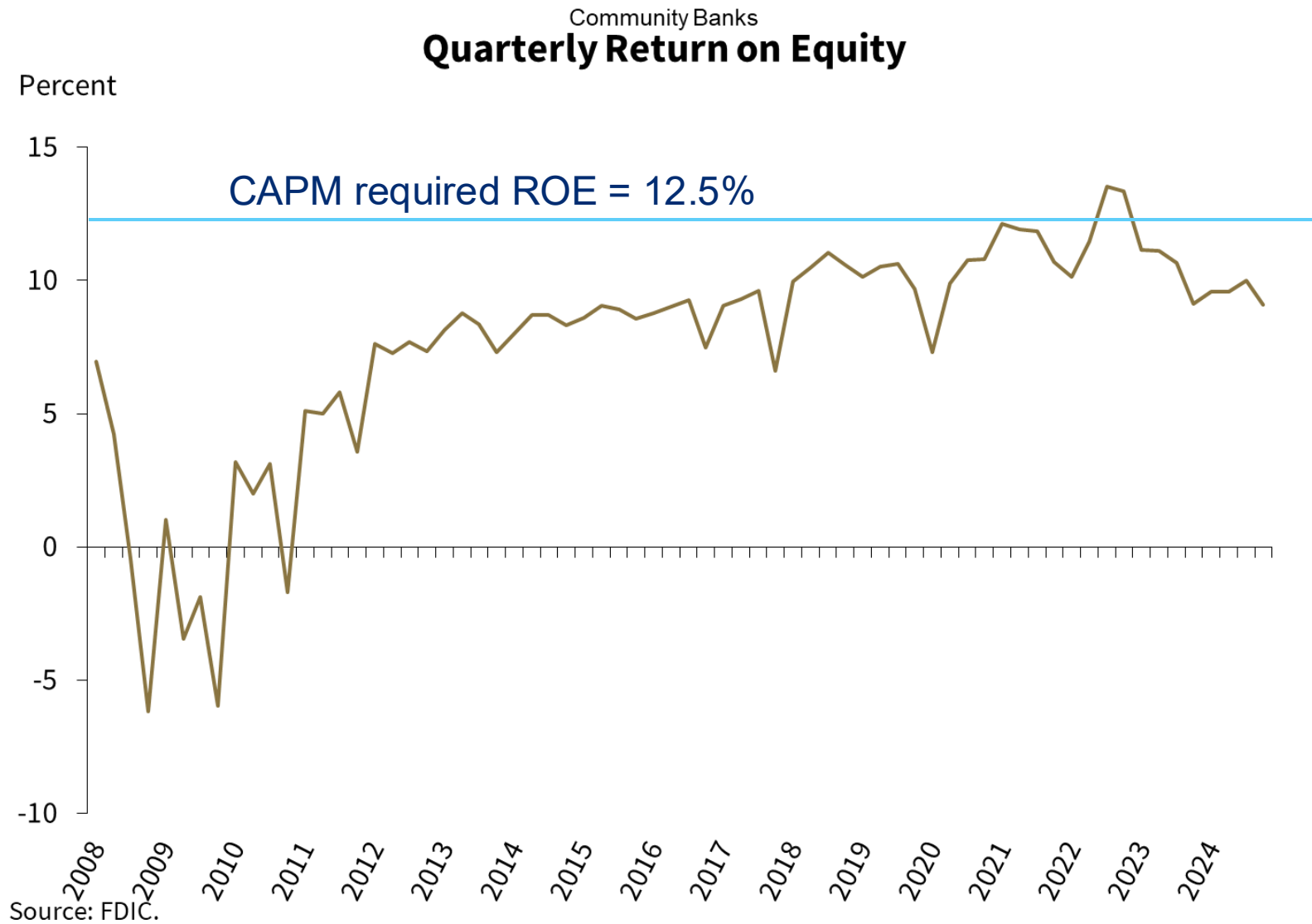
Source: FDIC.

Competitive Landscape



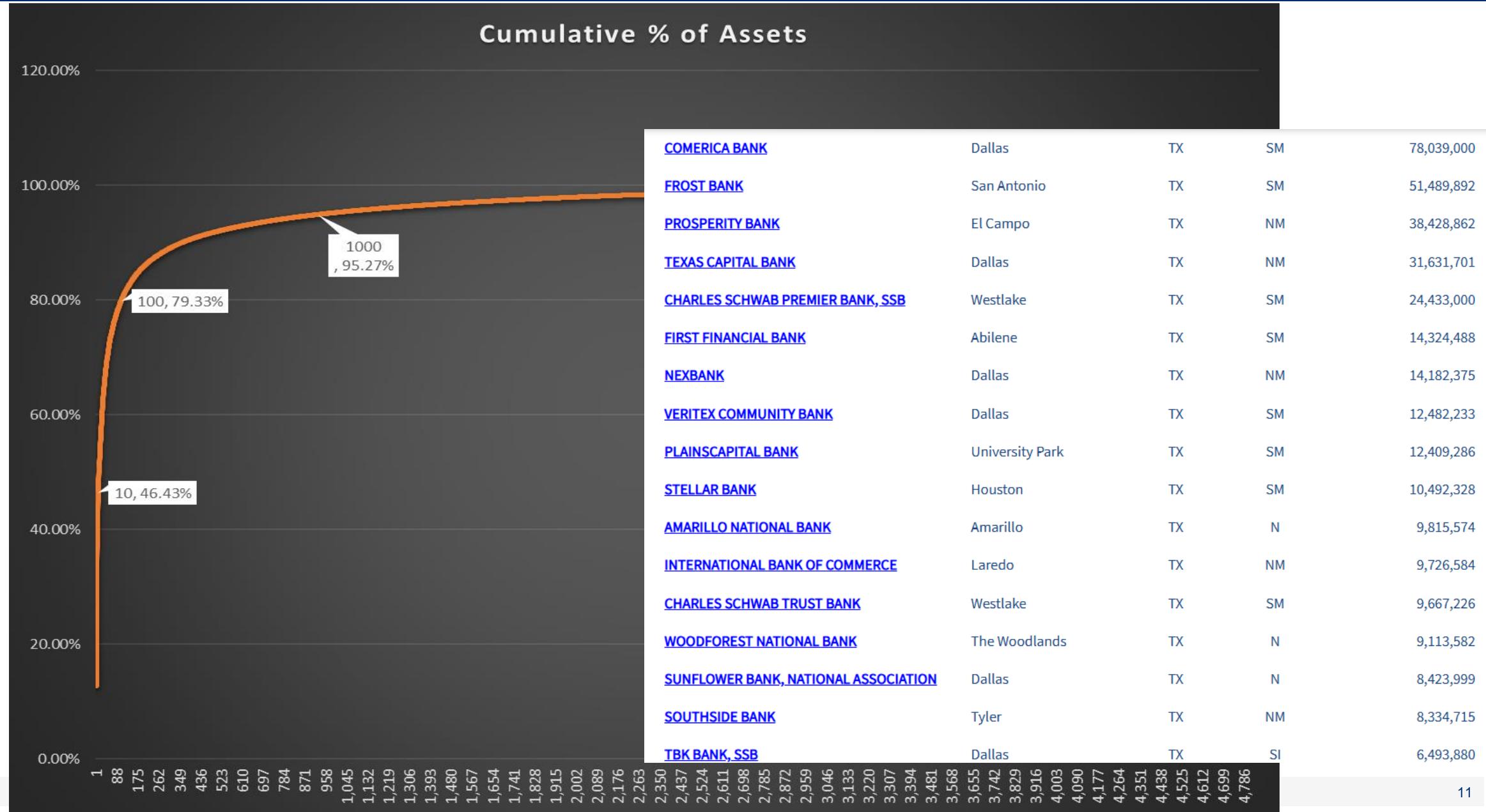
Shrinking market share for community banks (<\$10Bn assets)

Competitive Landscape



Defunct bank ROE =
1.66% (~ 12k banks,
over 40yrs)

Competitive Landscape



Banking is the Business of Keeping Loans Not Making Loans



Long-term Relationships, Size, Term, Credit Quality, Non-interest Income, Risk/Reward



Dissecting Banking Profitability



5yr Avg - Correlation to ROA - all banks \$100mm to \$10Bn assets

1	Nonint Inc/ Avg Assets	0.901
2	Nonint Exp/ Avg Assets	0.424
3	Net Loan Charge-Offs/ Avg Tot Lns & Lses	0.053
4	Average of Interest Exp/ Avg Assets	-0.049
5	Average of Interest Income/ Avg Assets	-0.033
6	Provision Exp/ Avg Assets	0.032
7	Yield on Earning Assets (%)	-0.028
8	Realized Gains/ Avg Assets	-0.026
9	Net Interest Income/ Avg Assets	-0.020
10	Net Interest Margin	-0.014
11	Net Loan Charge-offs	0.013
12	Total Assets	-0.004



Why Fee Income Matters?

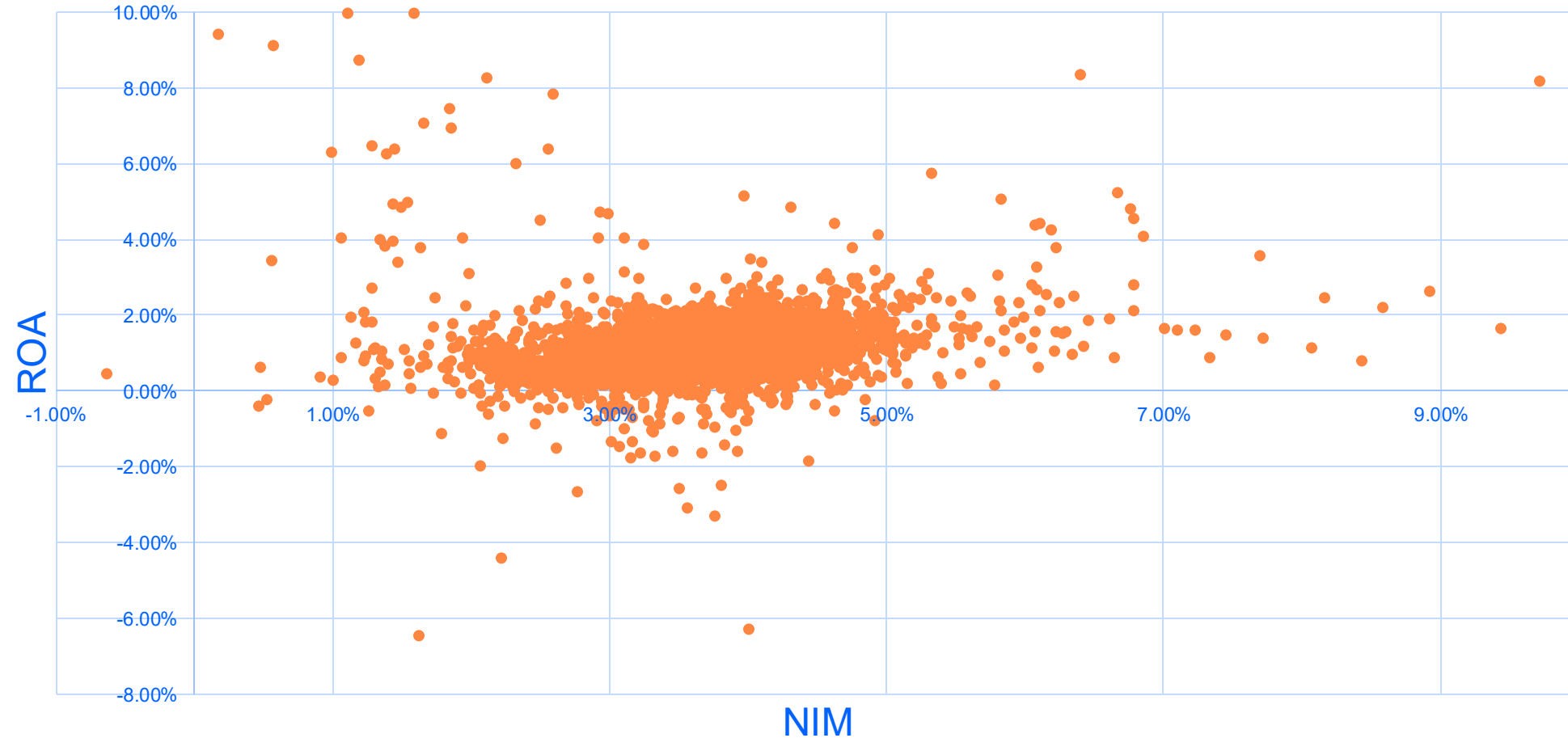
- Direct contribution to income
- Reflects value added
- Self-selecting profitable clients
- Less transparency is key

NIM – ROA/ROE relationship



All Banks - 5YR AVG Net Interest Margin vs. 5YR AVG ROA

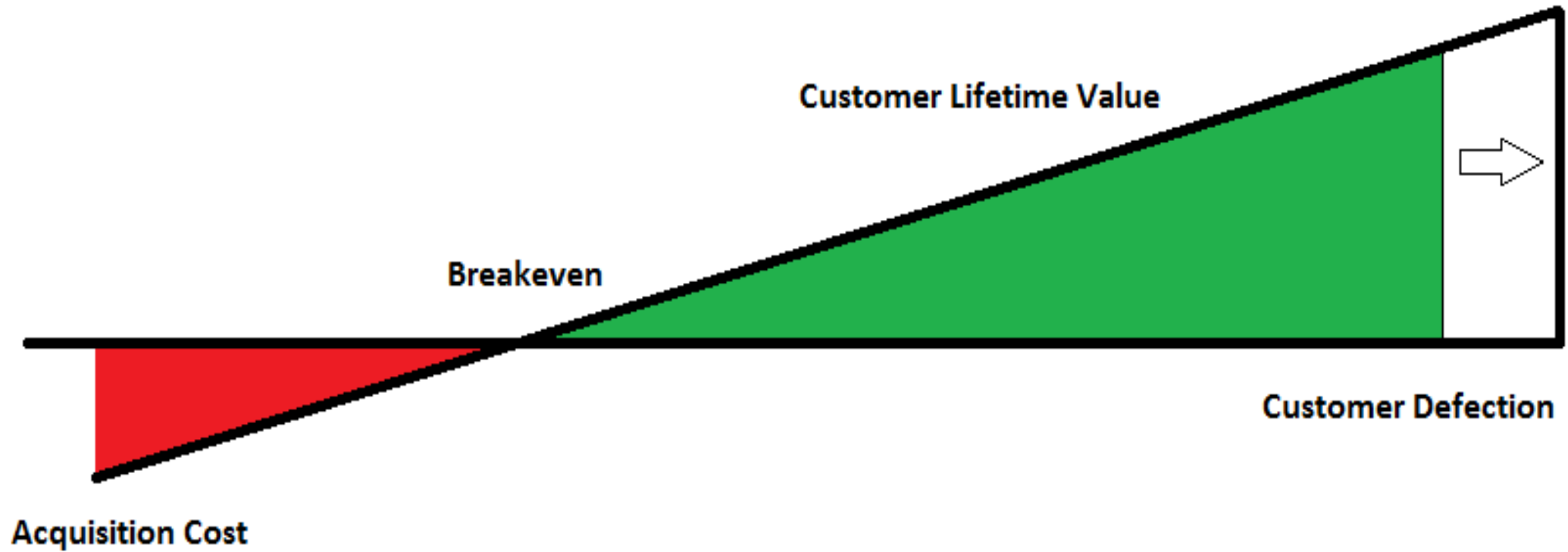
Correlation (R2) = - 0.02



Loan/ROE-ROA relationships



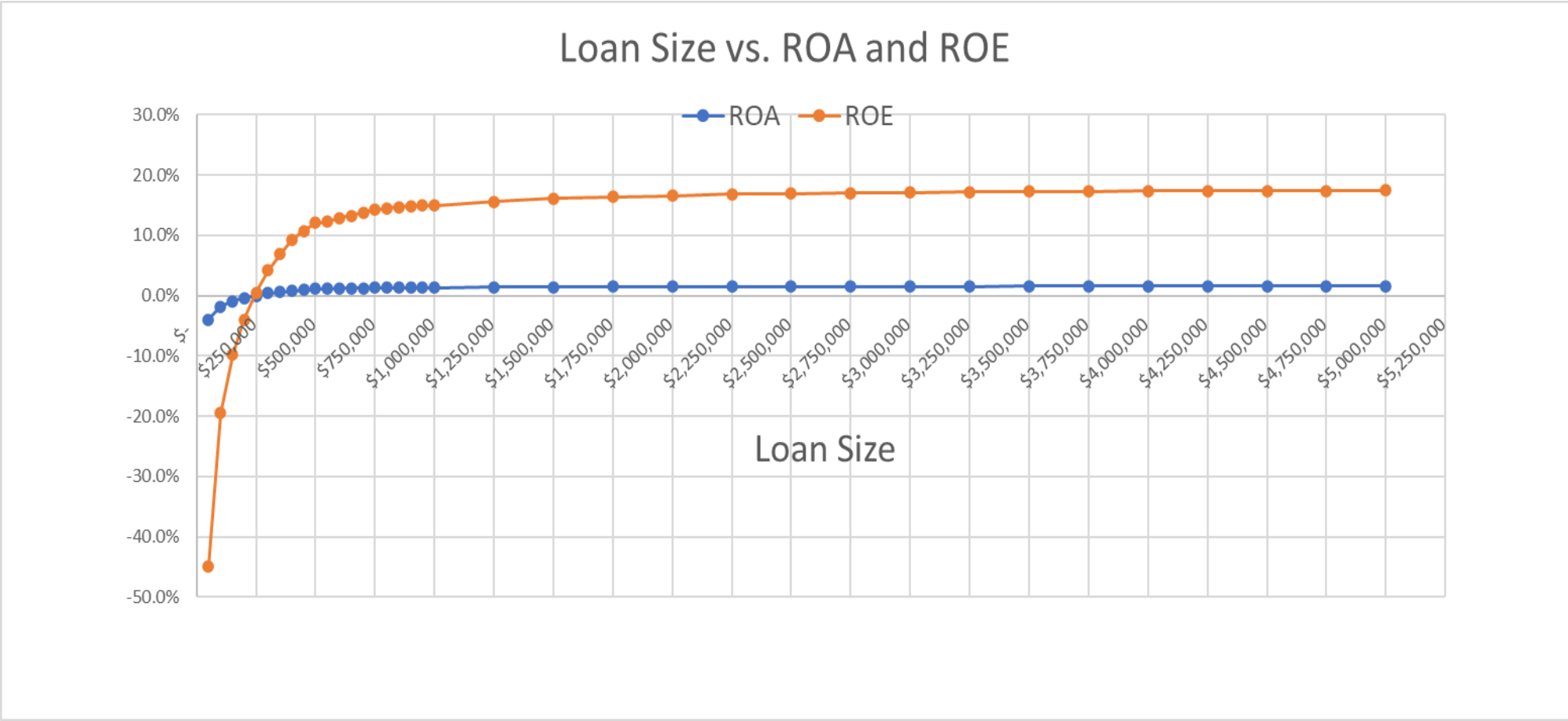
Increasing Retention / Reducing Churn



Loan Size – scale matters



5yr CRE loan, S + 2.50%



Loan Size – scale matters

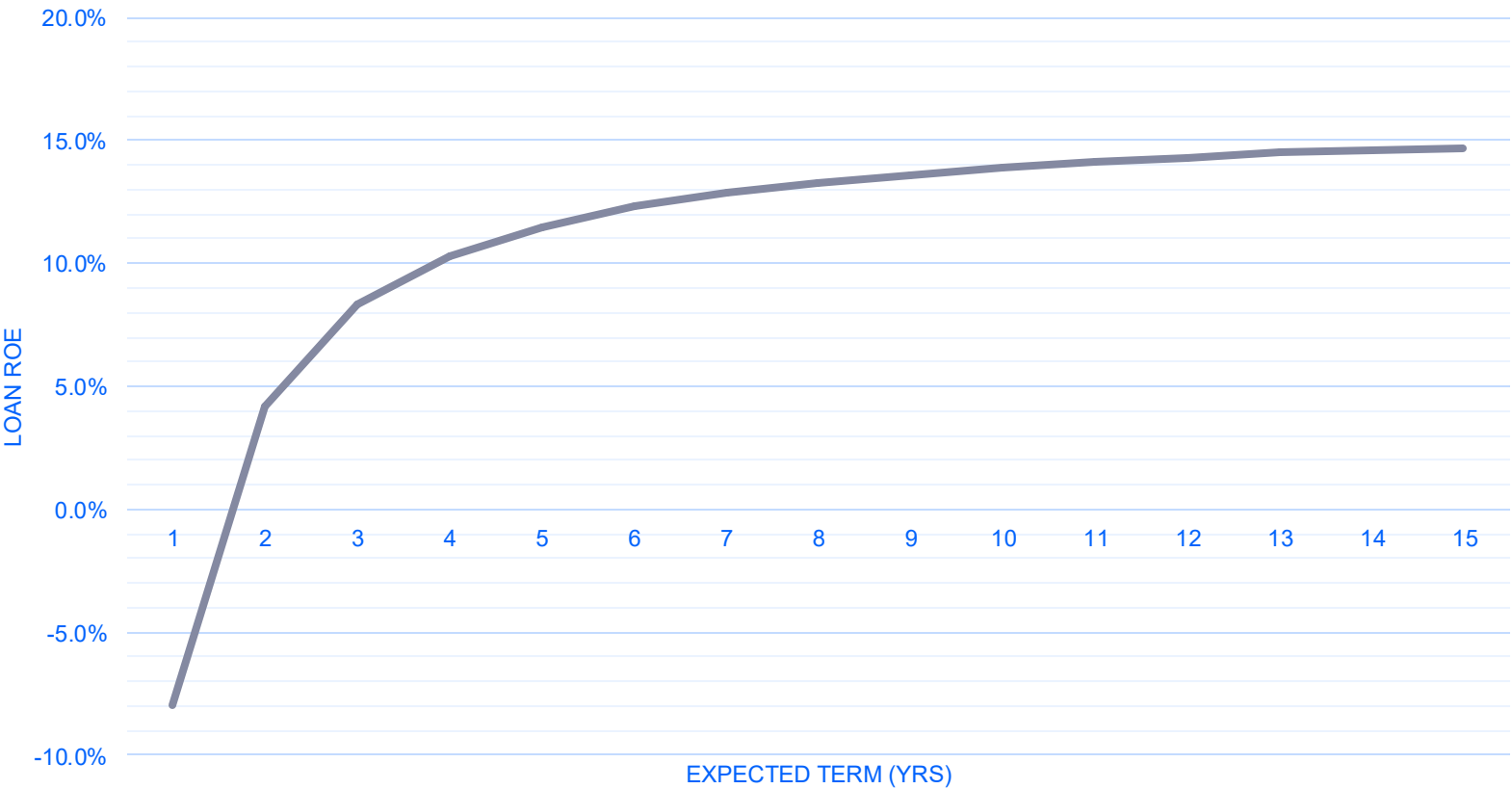


Average Loan Size	
Wells Fargo Bank	\$3,826,157
JPMorgan Chase	\$2,419,298
Bank of America	\$4,616,192
US Bank	\$2,356,782
PNC Financial	\$5,521,871
Regions Bank	\$6,248,154
Key Bank	\$6,982,759
Citi Bank	\$2,705,570
M&T Bank	\$2,713,273
Average	\$4,154,451



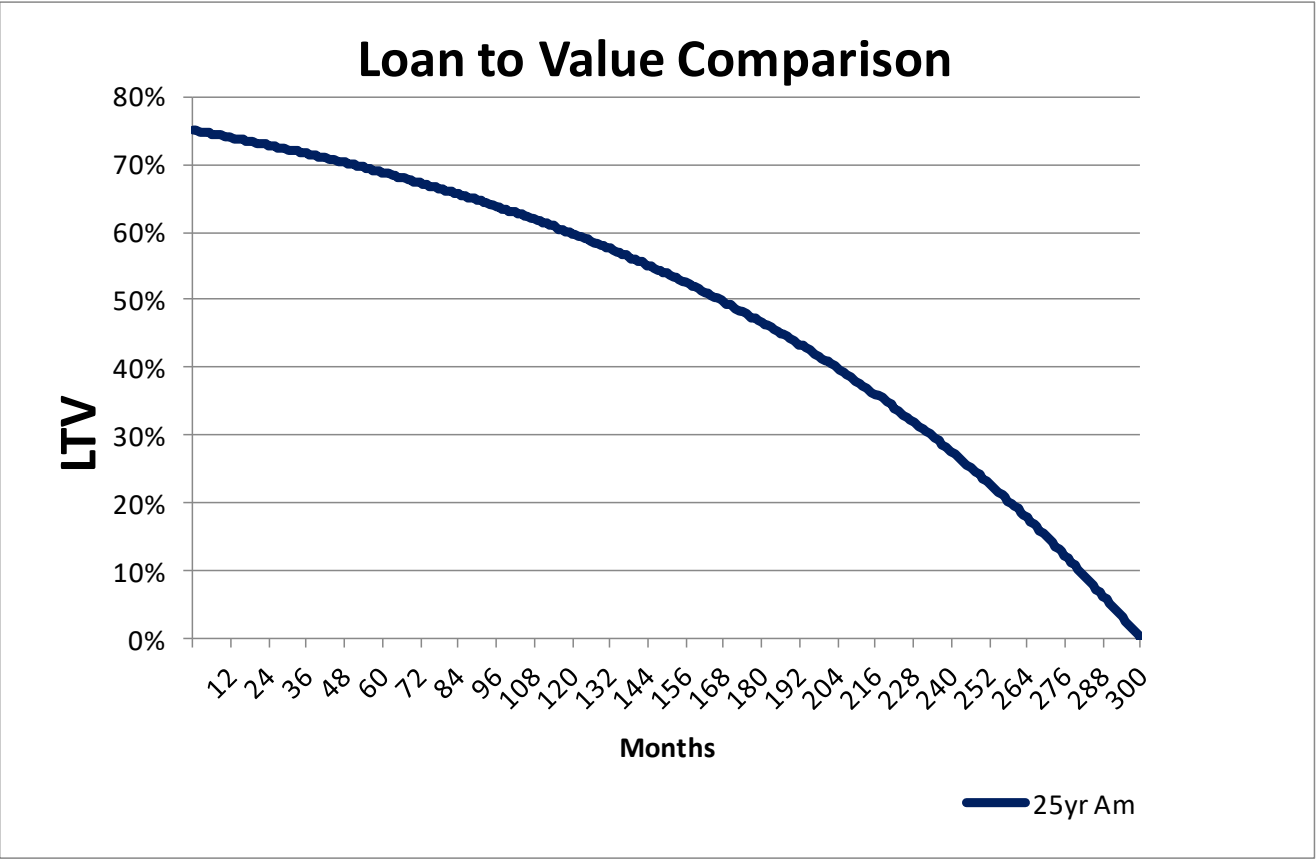
\$500k CRE loan, S + 2.50%

Loan Term vs. ROE





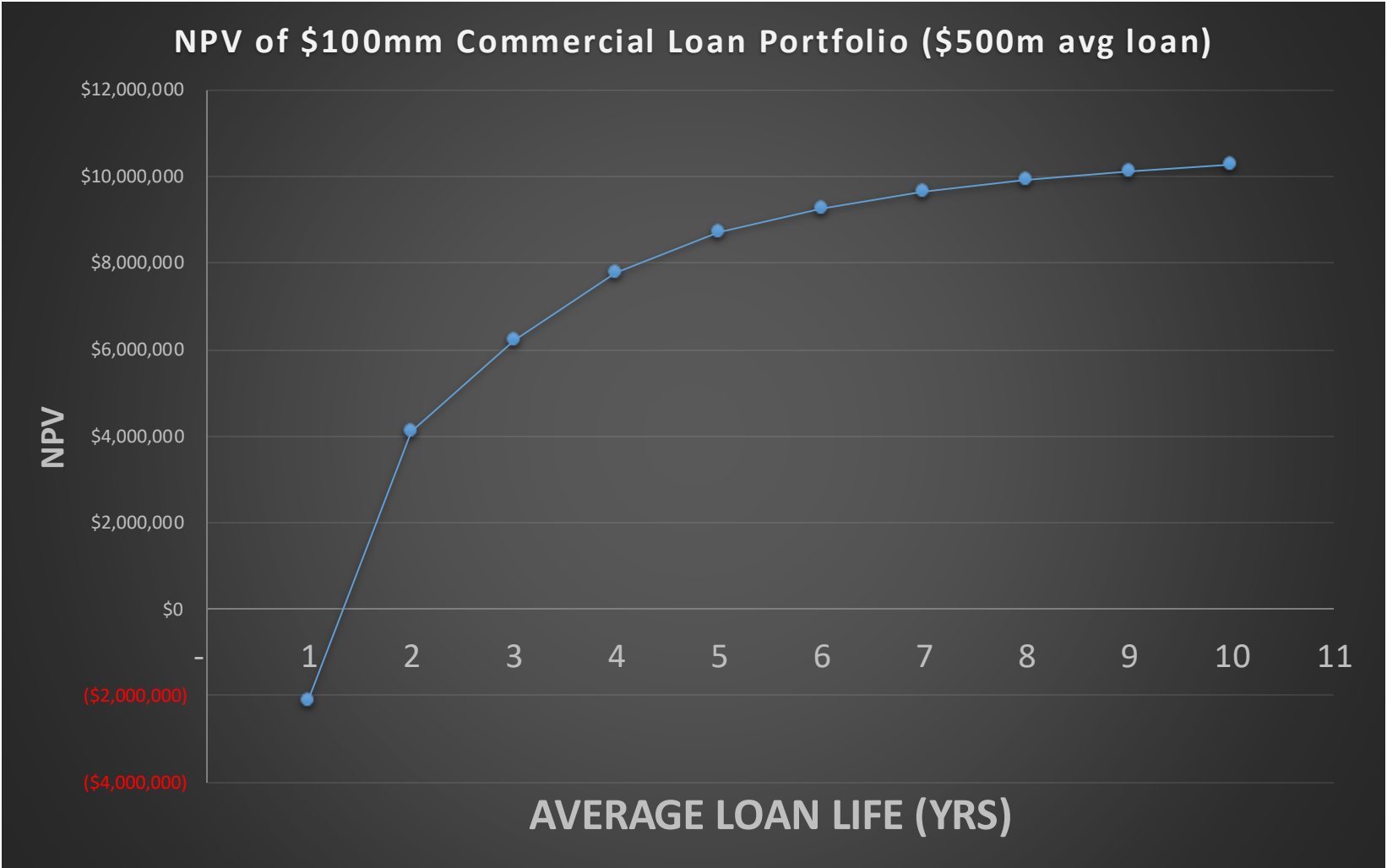
Equity Buildup



Term (yrs)	Principal Reduction
1	0.97%
2	2.11%
3	3.44%
4	4.65%
5	6.08%
7	9.26%
10	15.03%
15	28.05%



Expected average life vs NPV of Income



Long-term Relationship



Two identical \$100mm loan portfolios, only difference is expected average life

Loan Portfolio	\$	100,000,000		\$	100,000,000
Avg Loan Size	\$	500,000		\$	500,000
Avg Am (yrs)		22			22
Expected Avg Life (yrs)		6.99			2.32
Average Yield		6.72%			6.72%
COF		3.00%			3.00%
Credit Charge (per yr)		1.00%			1.00%
Avg Loan Acquisition Cost	\$	6,400		\$	6,400
NPV Income Over 10yrs		?			?

Long-term Relationship



Difference in NPV of income?

Loan Portfolio	\$	100,000,000		\$	100,000,000
Avg Loan Size	\$	500,000		\$	500,000
Avg Am (yrs)		22			22
Expected Avg Life (yrs)		6.99			2.32
Average Yield		6.72%			6.72%
COF		3.00%			3.00%
Credit Charge (per yr)		1.00%			1.00%
Avg Loan Acquisition Cost	\$	6,400		\$	6,400
NPV Income Over 10yrs		\$9,660,645			\$4,995,971

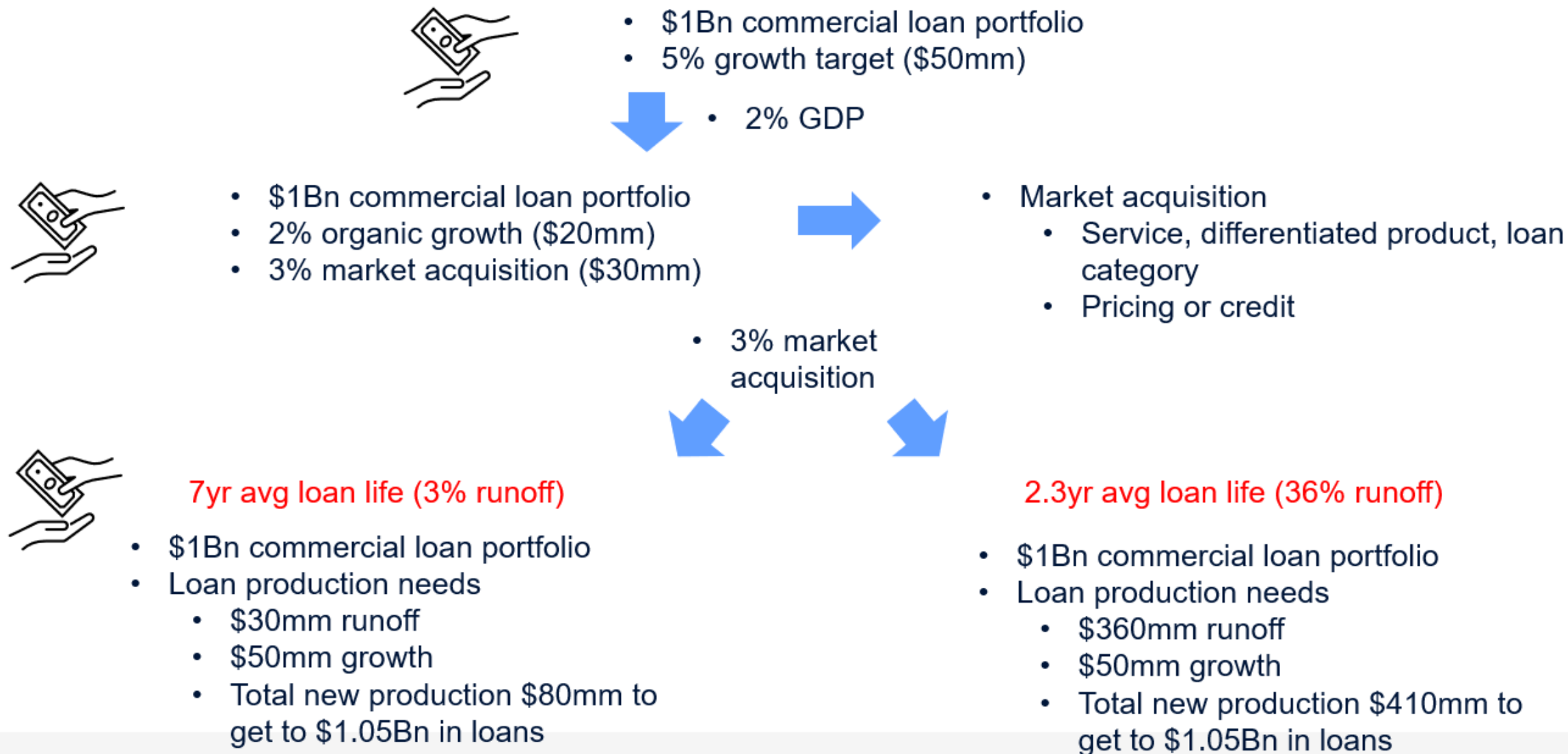
Long-term Relationship



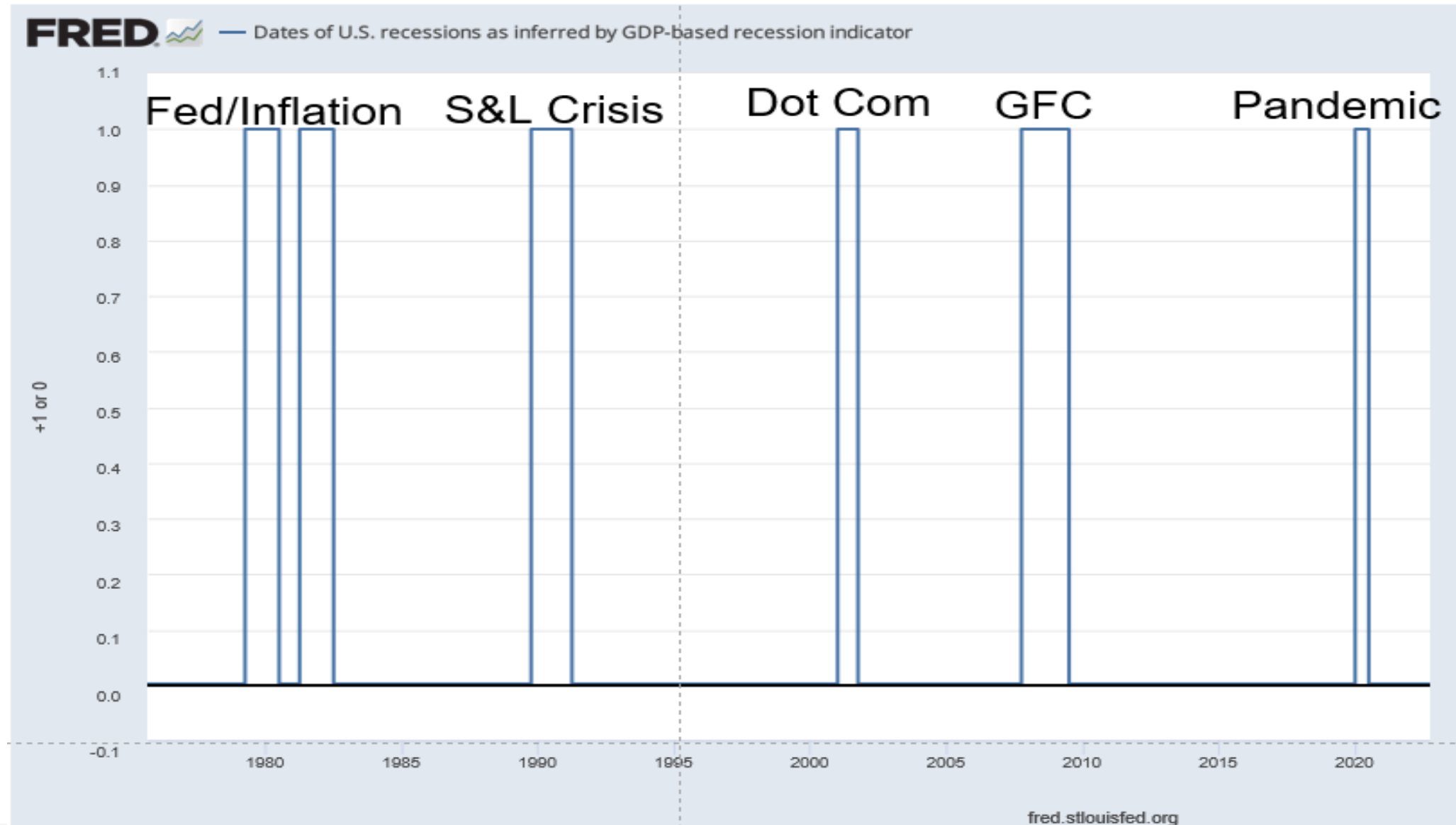
Two identical \$100mm loan portfolios, with smaller average loan size, difference in expected average life

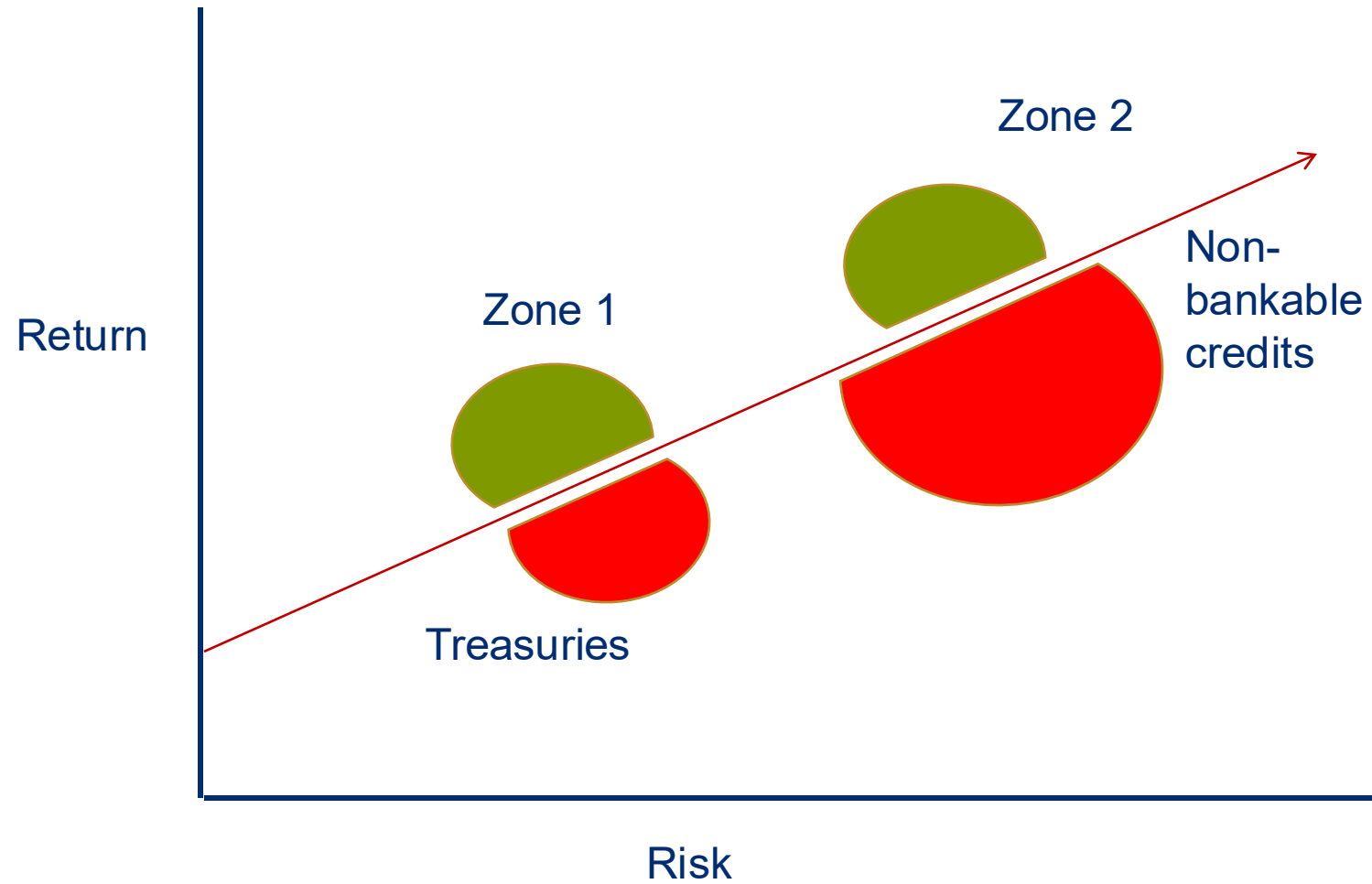
Loan Portfolio	\$ 100,000,000		\$ 100,000,000
Avg Loan Size	\$ 250,000		\$ 250,000
Avg Am (yrs)	22		22
Expected Avg Life (yrs)	6.99		2.32
Average Yield	6.72%		6.72%
COF	3.00%		3.00%
Credit Charge (per yr)	1.00%		1.00%
Avg Loan Acquisition Cost	\$ 3,800		\$ 3,800
NPV Income Over 10yrs	\$7,002,585		(\$2,012,715)

Long-term relationships vs. churn



Credit Quality

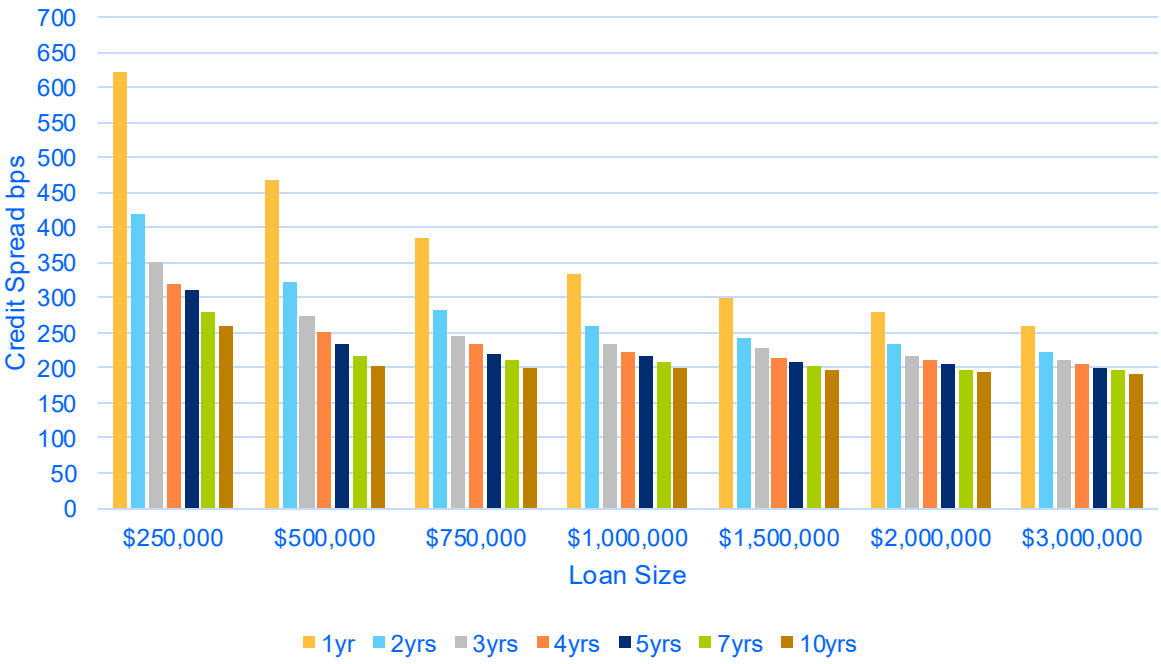




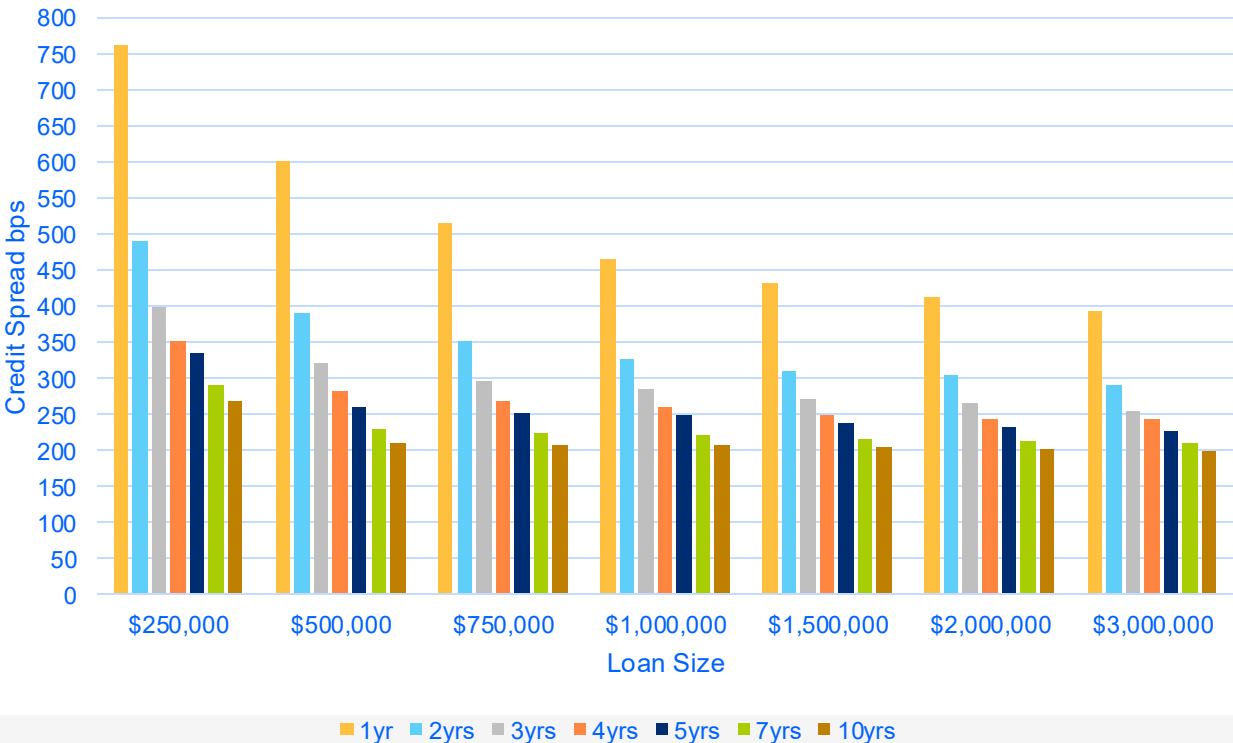
Credit Quality/Term/Size



Credit Spread for 15% ROE (0.5% Expected Loss)



Credit Spread for 15% ROE (1.0% Expected Loss)



Deposits and Profitability



Case Study – over \$40Bn bank, 71k commercial clients

Products	Correlation
Treasury Management Client?	0.1629
Merchant Services Client?	0.0659
Loan Client?	0.0480
Deposit Client?	0.0139
Private Wealth Client?	0.0134
Investment Services Client?	0.0032

Size of Product	Correlation
Deposit Balances	0.721
Loans (Outstanding)	0.320
Treasury Fees (per yr)	0.164

- Product usage and profitability
- Product size and profitability
 - Loan-only ROE – negative 100% to positive 25%
 - Deposit-only ROE – negative 5% to positive 150%

Relationship vs. Transaction (stickiness)

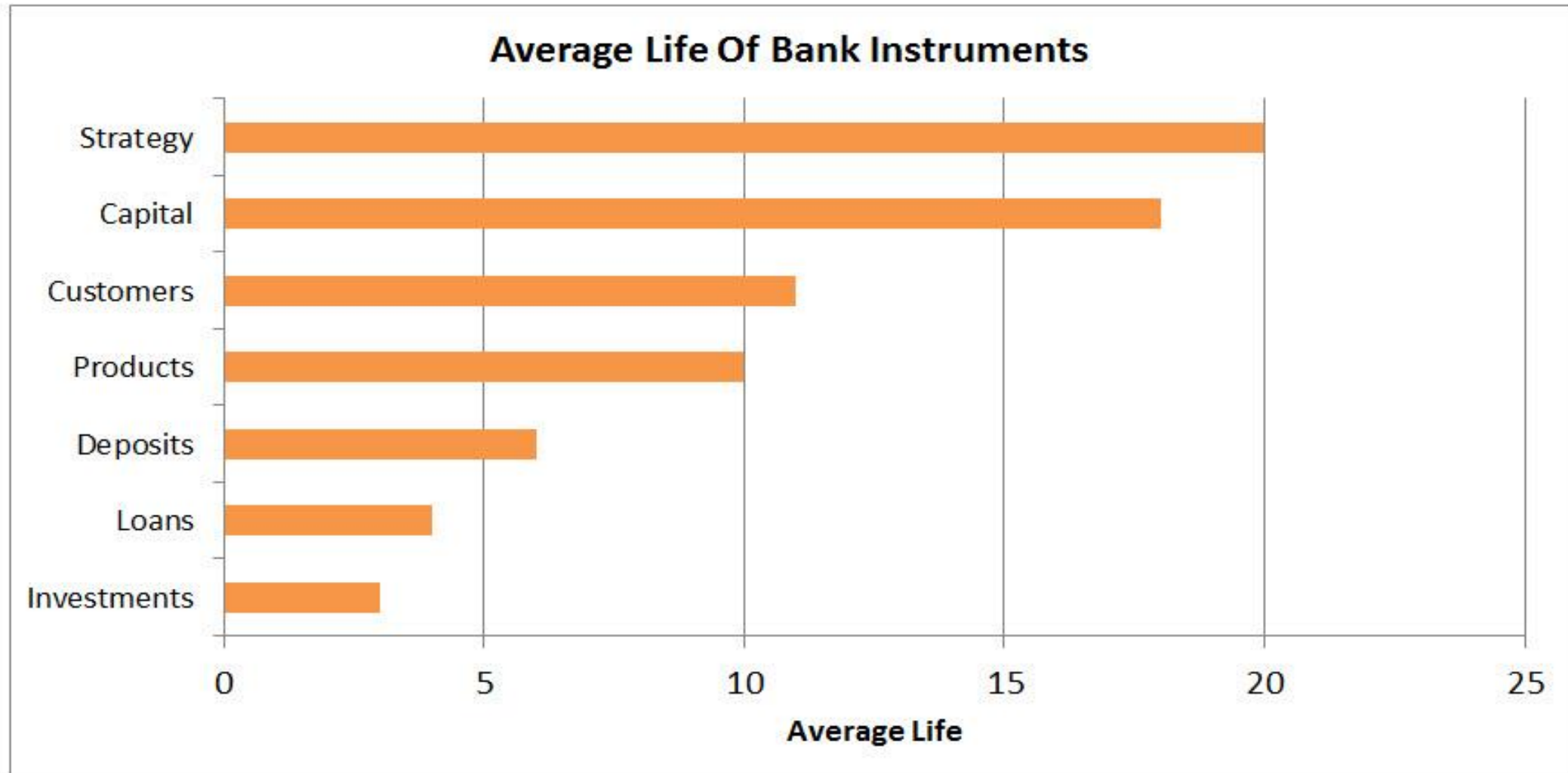


Attributes	Transaction	LT Relationship
Identify fit	Short term parking	Long term growth potential
Existing vs. New Customer	New focus	Existing focus
Commitment (prepay, term, products)	Minimal	Substantial
Equity buildup*	Minimal	Substantial
Value of free cash flow	Motivated to payoff loan	Motivated to deposit at bank
Match liability / assets	Mismatch	Matched
Potential upsell / cross-sell*	Low potential	High potential
Portable vs. planned obsolescence*	Client conditioned to repay	Client conditioned to retain
Balance sheet vs project finance*	Project/collateral focus	Balance sheet focus
Trusted advisor vs. order taker*	Order taker	Trusted Advisor

Long-term Relationship vs. Transaction



Potential upsell and cross-sell



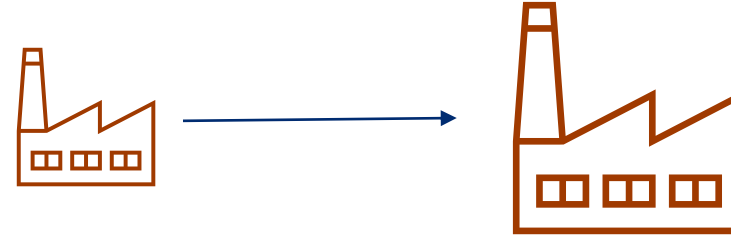
Relationship vs. Transaction (stickiness)



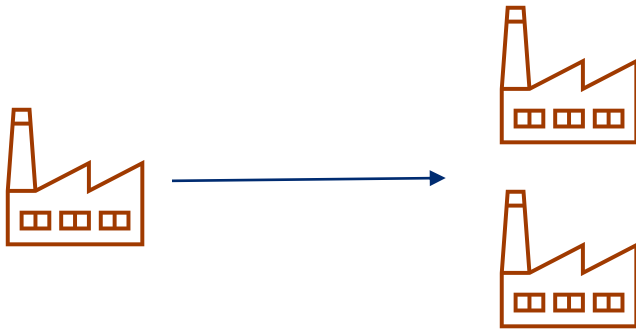
Balance sheet vs. project finance



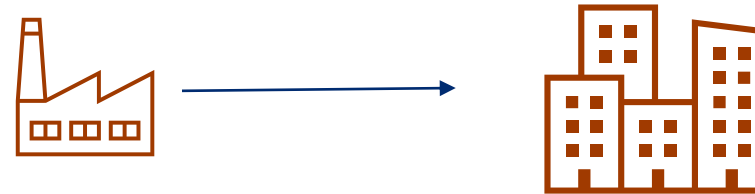
Change in collateral asset



Expansion in collateral asset



Addition in collateral asset



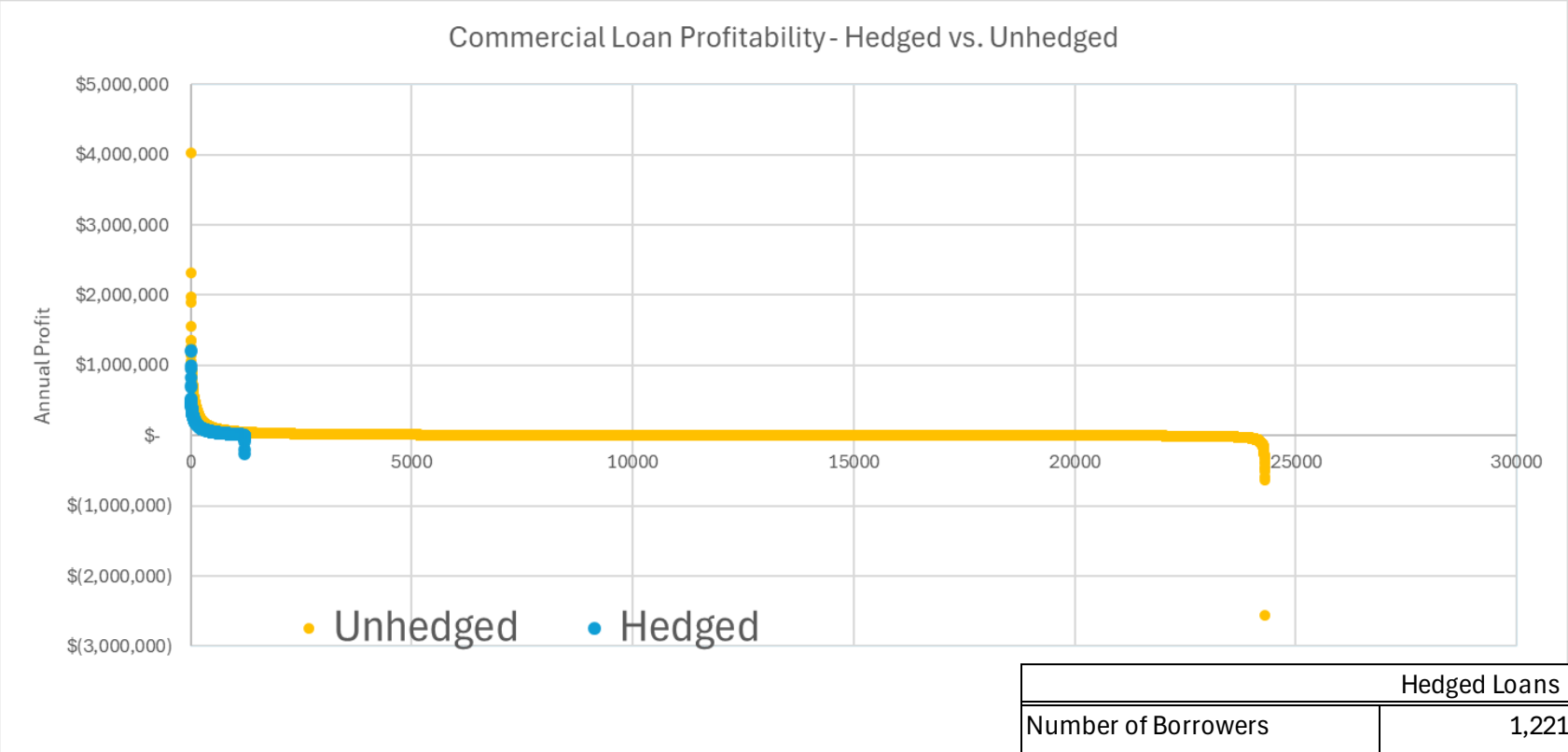
Change in business model

Results



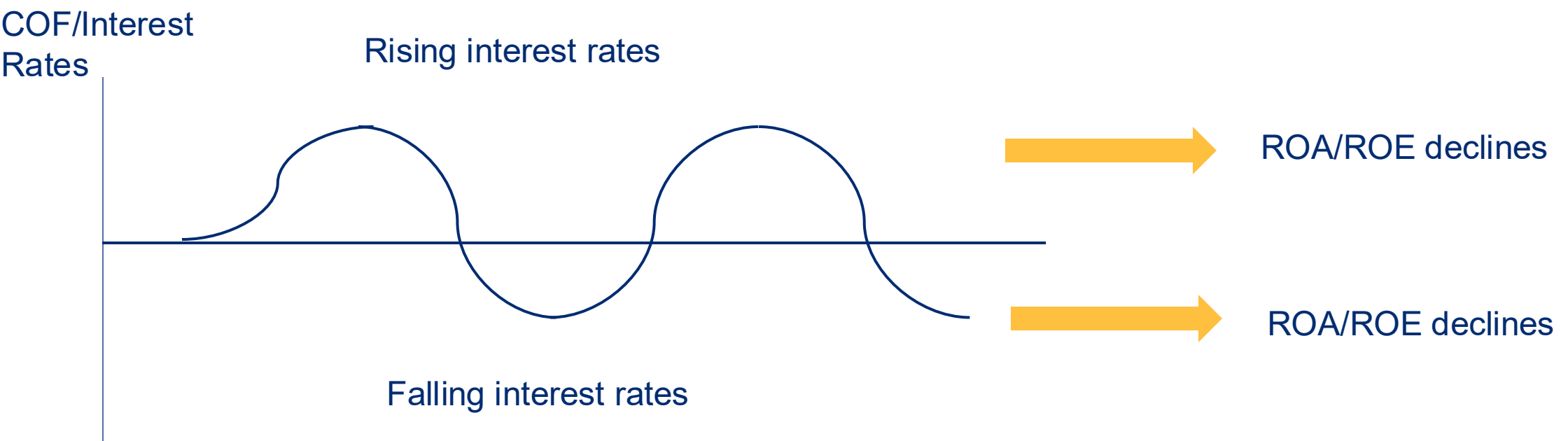
- More deposits
- More loan balances
- Longer relationships
- Less competition
- Less price sensitivity

Hedge Profitability Analysis



	Hedged Loans	Unhedged Loans	All Loans
Number of Borrowers	1,221	24,301	25,522
Percent of Borrowers	4.78%	95.22%	100%
Sum of Loans	\$ 4,154,648,834	\$ 18,994,365,357	\$ 23,149,014,191
Sum of Annual Profit	\$ 89,927,517	\$ 279,050,696	\$ 368,978,213
Percent of Profit	24.37%	75.63%	100%
Average Annual Profit	\$ 73,651	\$ 11,483	\$ 14,457
Average Loan Size	\$ 3,402,661	\$ 781,629	\$ 907,022
# of Unprofitable Borrowers	15	5,653	5,668
Sum of Annual Loss	\$ (751,432)	\$ (61,864,502)	\$ (62,615,934)
Sum of Unprofitable Loans	\$ 84,287,854	\$ 6,569,289,755	\$ 6,653,577,609
% of Unprofitable Loans	2.03%	34.59%	36.61%

Risk Without Reward – fixed rate loans



Long-term Relationship vs. Transaction

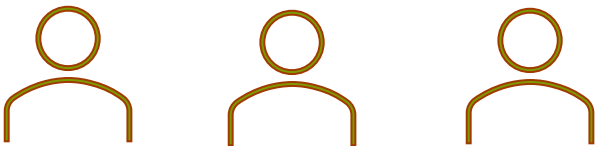


Trusted advisor vs. order taker

Order taker



Trusted advisor



Attributes	Order taker	Trusted advisor
Banking, product, underwriting knowledge	Low	High
Growth potential	Low	High
Upsell and cross-sell potential (banking product needs)	Low	High
NPV income and ROE potential	Low	High
Credit and deposit volume	Low	High
Fee potential	Low	High
Number of prospects	Low	High
Number of clients	High (50 to 200)	Low (20 to 50)
Outbound calling frequency	Low	High

RAROC Loan Pricing – Best Practices

- **Best is the enemy of good**
- **Designate an analyst as checkpoint for uniformity**
- **Use fund transfer pricing to measure product contribution**
- **Use outputs as ordinal ranking not arbiter of lending decisions**



Thank you!

Want more ideas and data?

Sign up at:

SouthStateCorrespondent.com



Disclaimer

This presentation is for general strategic information only and should not be relied upon as a substitute for independent research before making a material management decision. This presentation does not take into account any particular bank's performance objectives, financial situation or needs. All banks should obtain advice based on their unique situation before making any decision based upon this presentation or any information contained within. In addition, any implied projections or views of the bank market provided by the authors may not prove to be accurate. While all the information contained herein is believed to be accurate as of the date of source or publication, the information is subject to change and constant revision.

In addition to any specific risks discussed herein, there are other factors that may influence the performance of an interest rate hedge product.

Counterparty Risk – the risk that the counterparty will not perform pursuant to the contract terms. Borrowers should carefully assess counterparty risk when engaging in such a transaction as described herein.

Basis Risk – the risk that the floating rate interest payments made on the loan and the floating rate interest payments received on the hedge contract could be mismatched, specifically if the floating rate indices, spreads, and other terms are not exact.

Amortization Risk – the risk of the potential mismatch between the outstanding principal amount of the loan and the outstanding notional amount of the hedge. Amortization mismatches could also result in termination of portions of the hedge prior to maturity and under unfavorable conditions.

Termination Risk – the risk that the hedge could be terminated as a result of certain events including payment default or other defined events of default. A termination of a hedge may result in payment received by the borrower or owed to the Bank depending on the market at the time of termination.

Prior to entering into any interest rate hedge transaction, recipients should determine, in consultation with their own legal, tax, regulatory, and accounting advisors, the economic risks and merits, as well as the legal, tax, regulatory and accounting characteristics and consequences of any transaction.

The information herein has been prepared solely for informational purposes and is not an offer to buy or sell or a solicitation of any offer to buy or sell any security or instrument or to participate in any trading strategy. No representation or warranty can be given with respect to the accuracy or completeness of the information herein, or that any future offer of securities, instruments or transactions will conform to the terms hereof. SouthState Bank, N.A. and its affiliates disclaim all liability relating to this information. SouthState Bank, N.A., its affiliates and others associated with it may have positions in, and may effect transactions in, securities and instruments mentioned herein.

The information herein may contain general, summary discussions of certain tax, regulatory, accounting and/or legal issues relevant to the proposed transaction. Any such discussion is necessarily generic and may not be applicable to, or complete for, any particular recipients' specific facts and circumstances. SouthState Bank, N.A. is not offering and does not purport to offer tax, regulatory, accounting or legal advice and this information should not be relied upon as such. Prior to entering into any proposed transaction, recipients should determine, in consultation with their own legal, tax, regulatory and accounting advisors, the economic risks and merits, as well as the legal, tax, regulatory and accounting characteristics and consequences, of the transaction.

The projections or other estimates in these materials (if any), including estimates of returns or performance, are forward-looking statements based upon certain assumptions and are preliminary in nature. Any assumptions used in any such projections or estimates that were provided by a recipient are noted herein. Actual results are difficult to predict and may depend upon events outside the recipient's or SouthState Bank's control. Actual events may differ from those assumed and changes to any assumptions may have a material impact on any projections or estimates. Other events not taken into account may occur and may significantly affect the analysis. Certain assumptions may have been made for modeling purposes only to simplify the presentation and/or calculation of any projections or estimates, and SouthState Bank does not represent that any such assumptions will reflect actual future events. Accordingly, there can be no assurance that estimated returns or projections will be realized or that actual returns or performance results will not be materially different from those estimated herein. Any such estimated returns and projections should be viewed as hypothetical. Recipients should conduct their own analysis, using such assumptions as they deem appropriate, and should fully consider other available information in making a decision regarding these securities, instruments or transactions. Past performance is not necessarily indicative of future results. Price and availability are subject to change without notice.