

# Athens Lender Lunch

Hosted by SouthState Bank

**Chris Nichols**

Director of Capital Markets

**Ed Kofman**

Director of Loan Hedging

**Steve Olson**

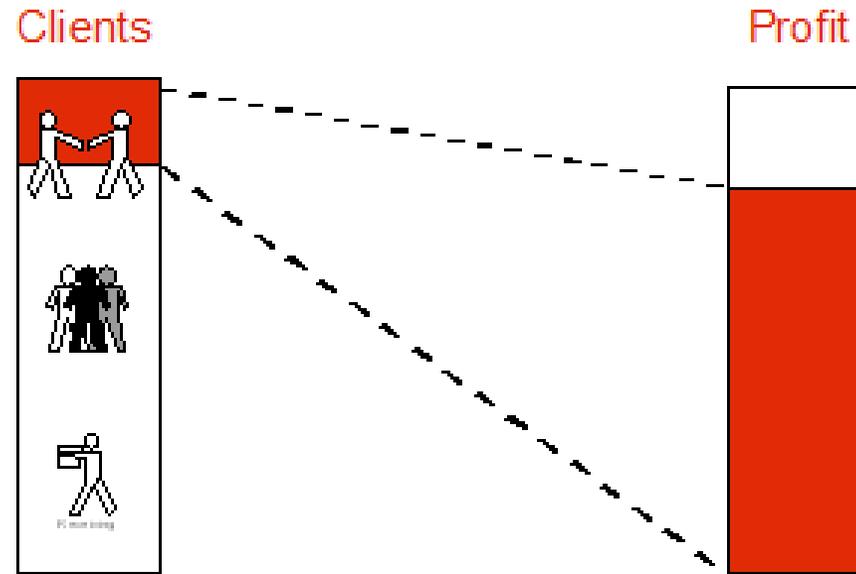
Hedging Specialists



# Customer Profitability



# Dissecting Relationship Profitability



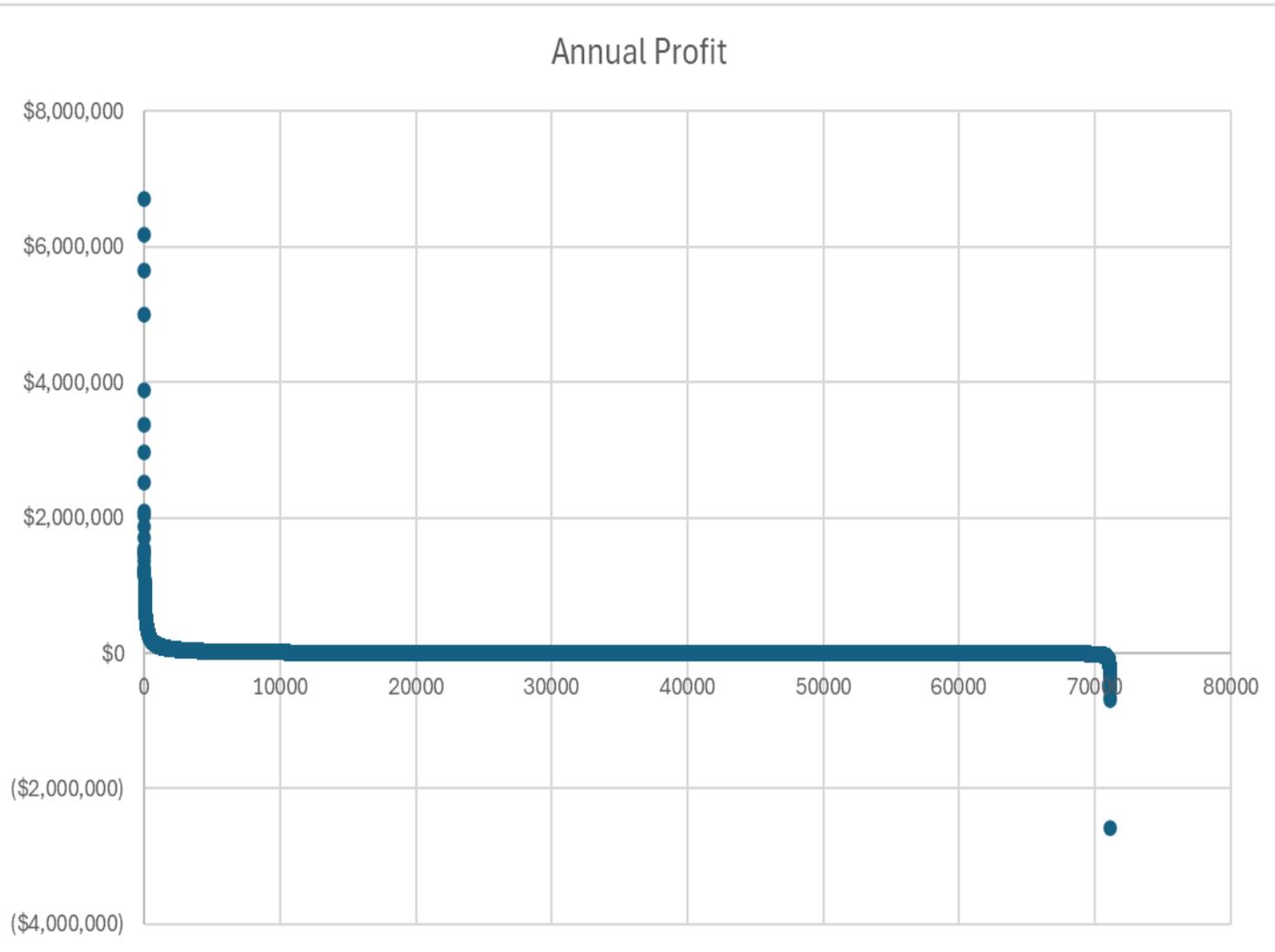
The top 20% of your clients  
Generate 80% of your profit

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

# Dissecting Relationship Profitability

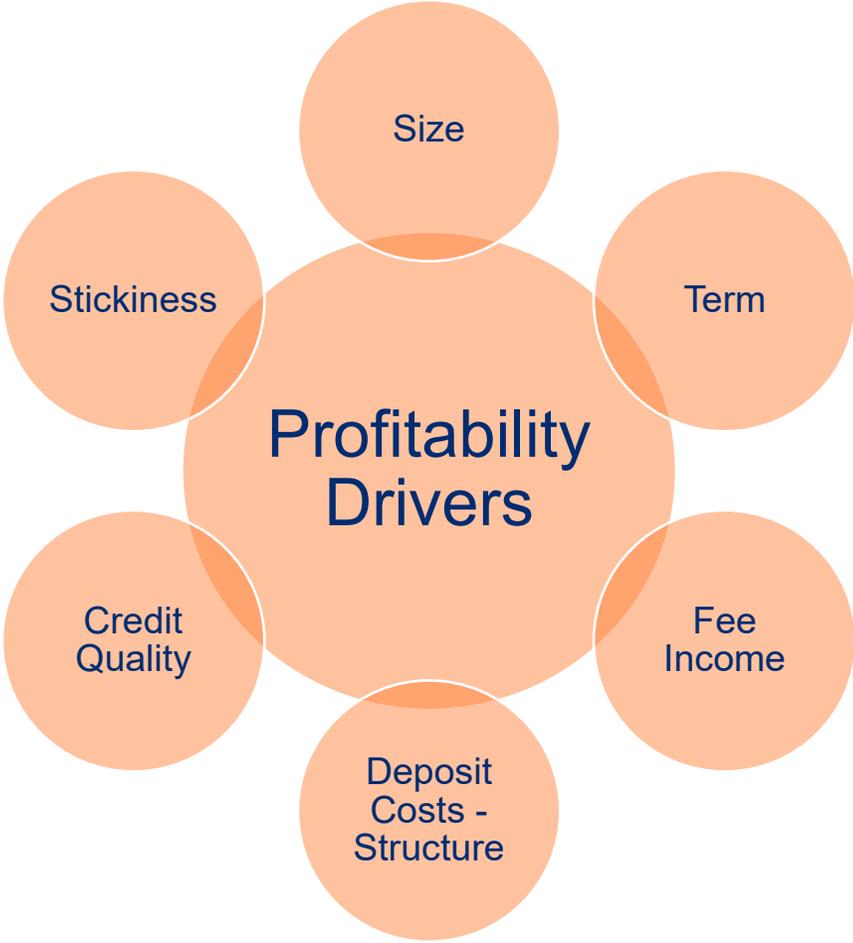


Case Study – over \$40Bn bank, 71k commercial clients



- 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

# Dissecting Banking Profitability



# Community Banking Industry Challenges and Opportunities

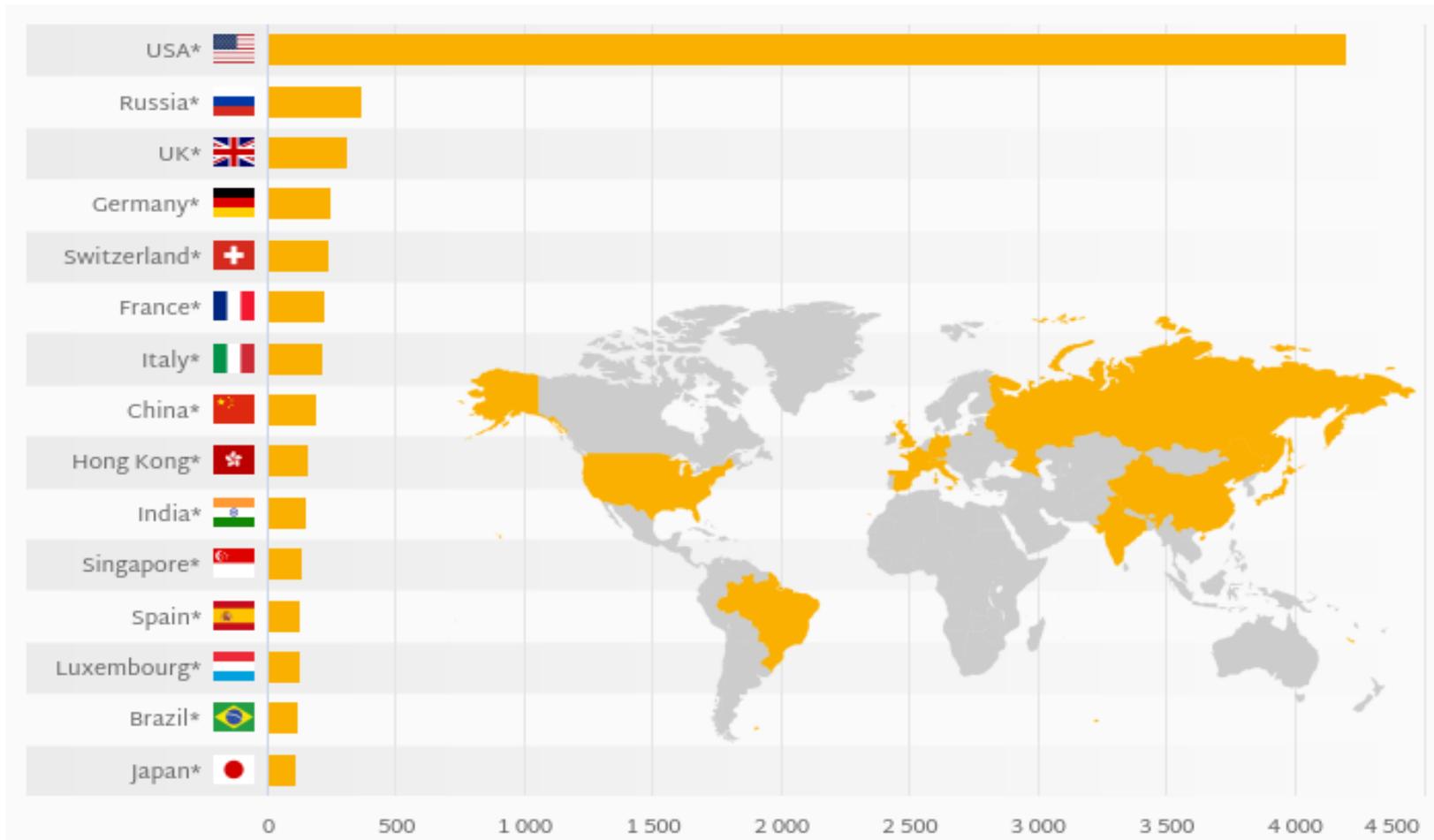


# Why So Many Banks



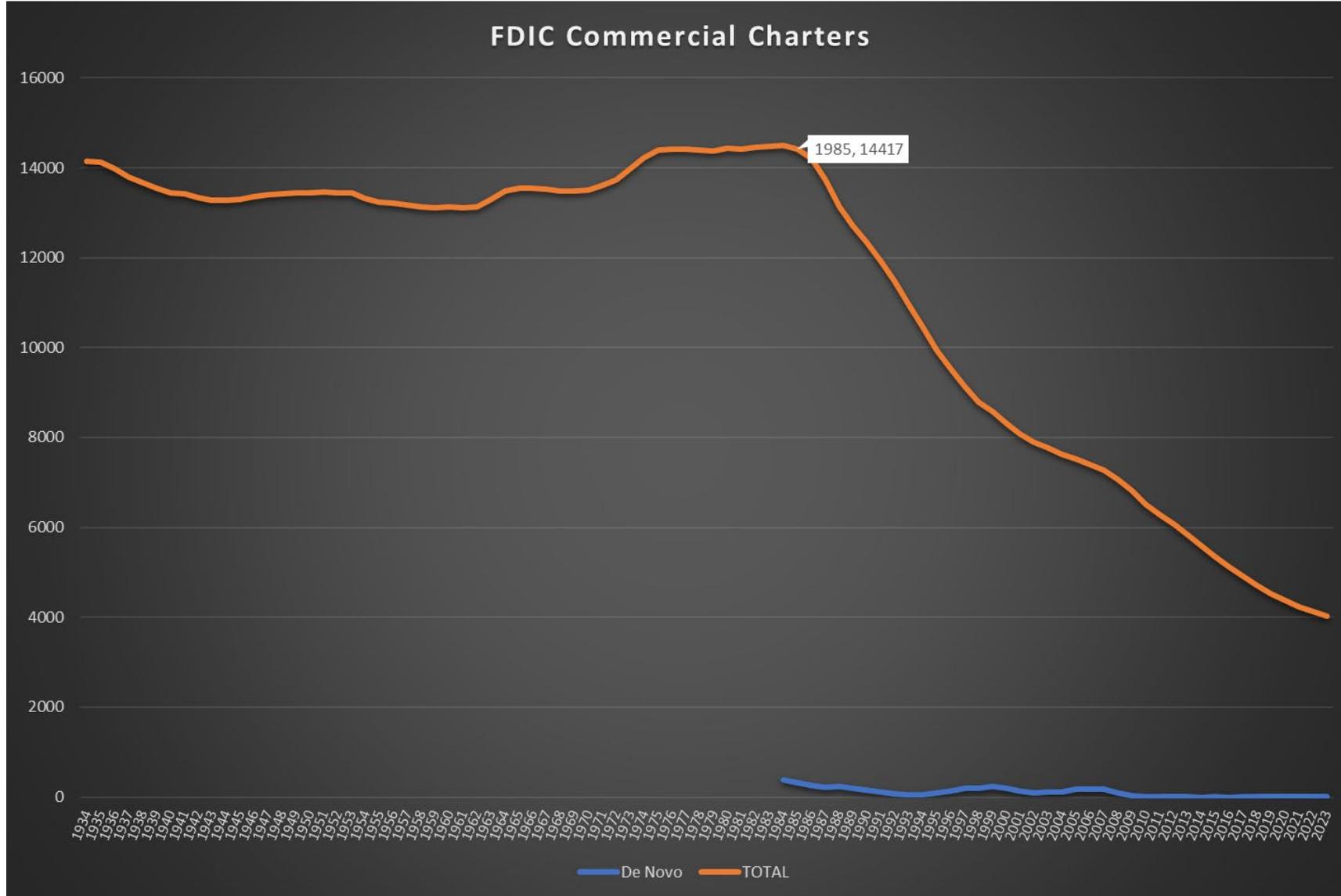
## What Country Has the Most Banks?

Number of Banks (banks), 2022 or latest



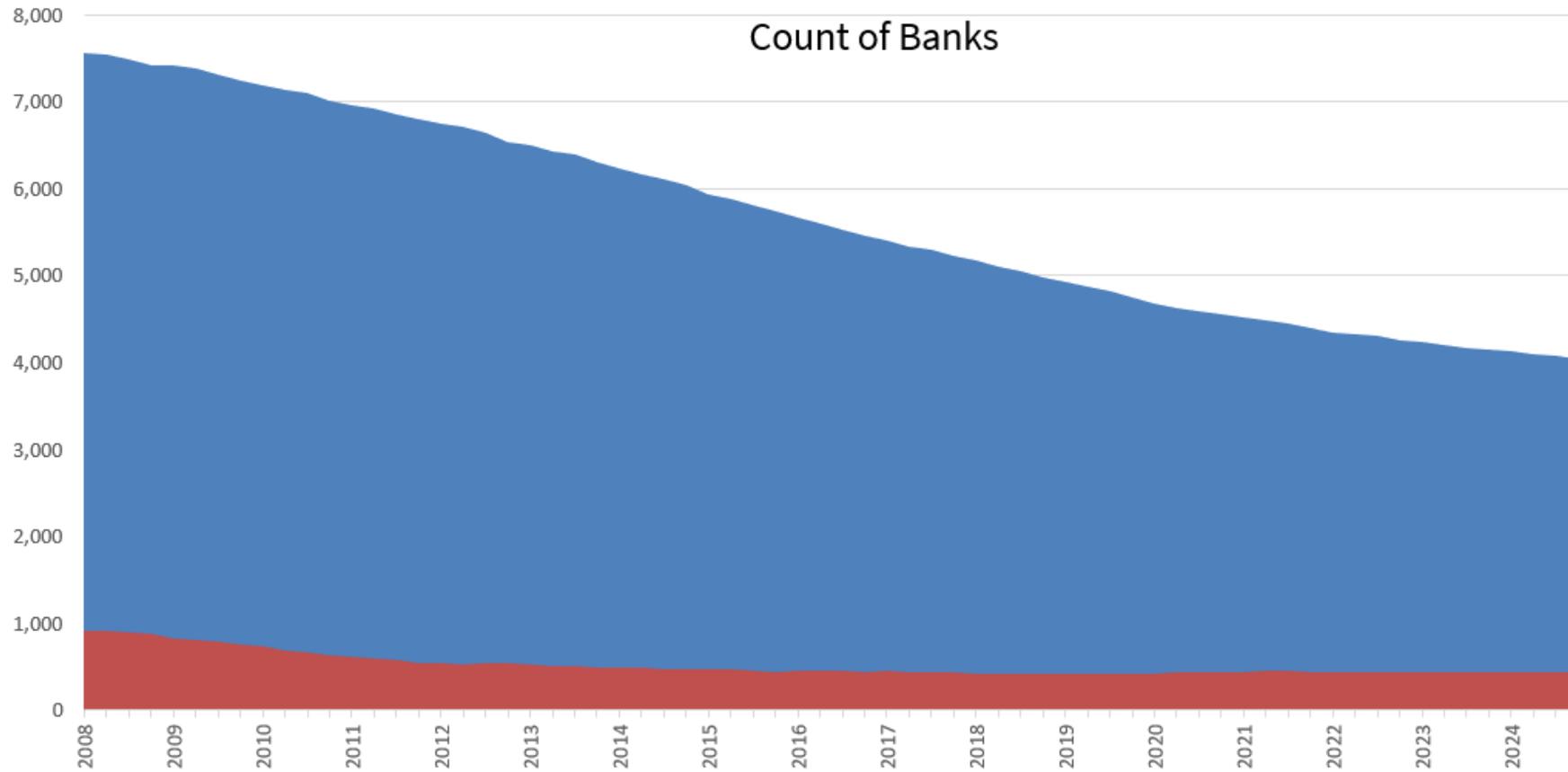
Source: National Statistical Office, \* Data from 2020

# Competitive Landscape



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

# Competitive Landscape



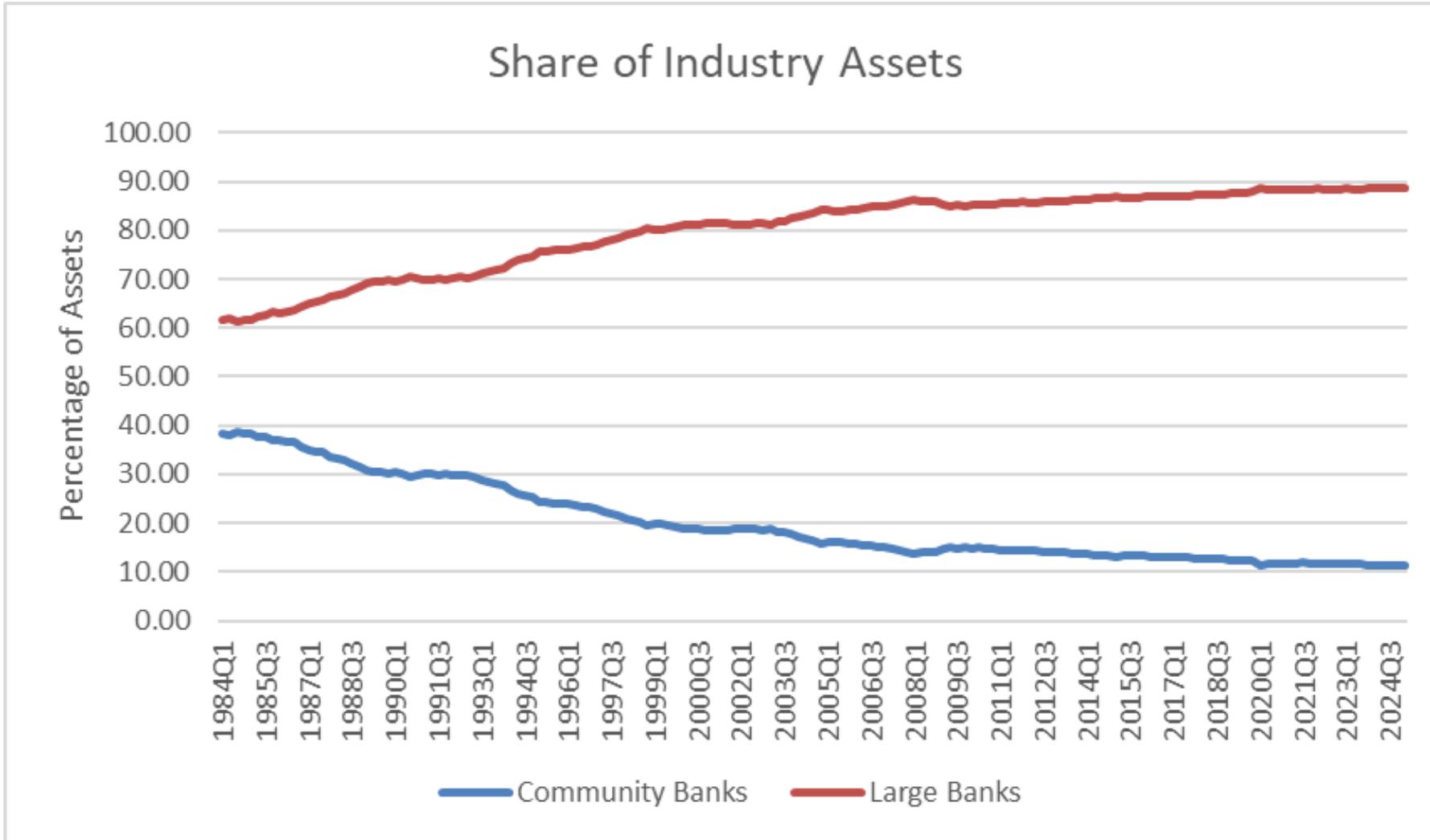
Not all banks are consolidating equally

Source: FDIC.

■ Community Banks

■ Noncommunity Banks

# Competitive Landscape

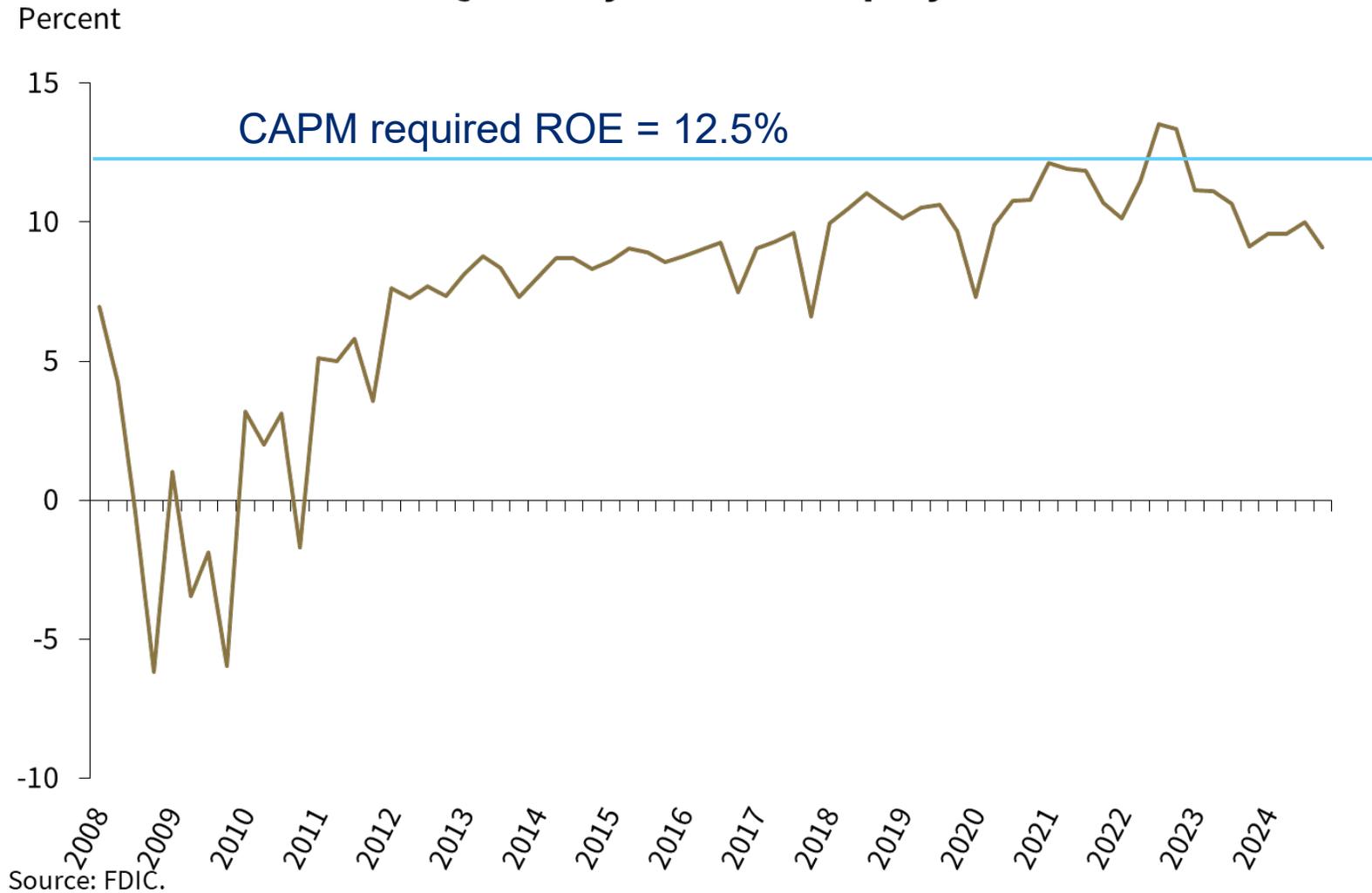


Shrinking market share for community banks (<\$10Bn assets)

# Competitive Landscape



## Community Banks Quarterly Return on Equity

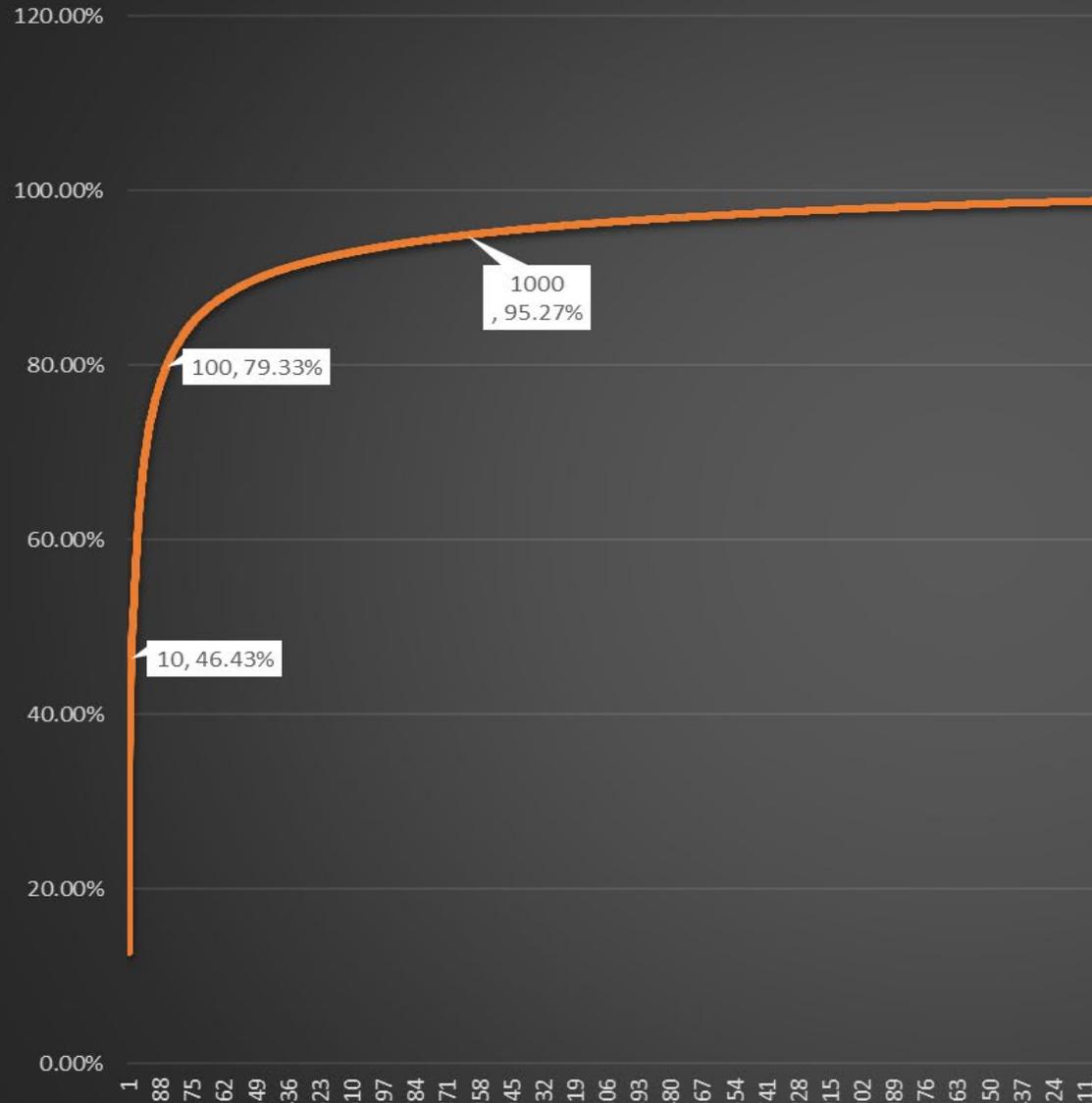


Defunct bank ROE =  
1.66% (~ 12k banks,  
over 40yrs)

# Competitive Landscape



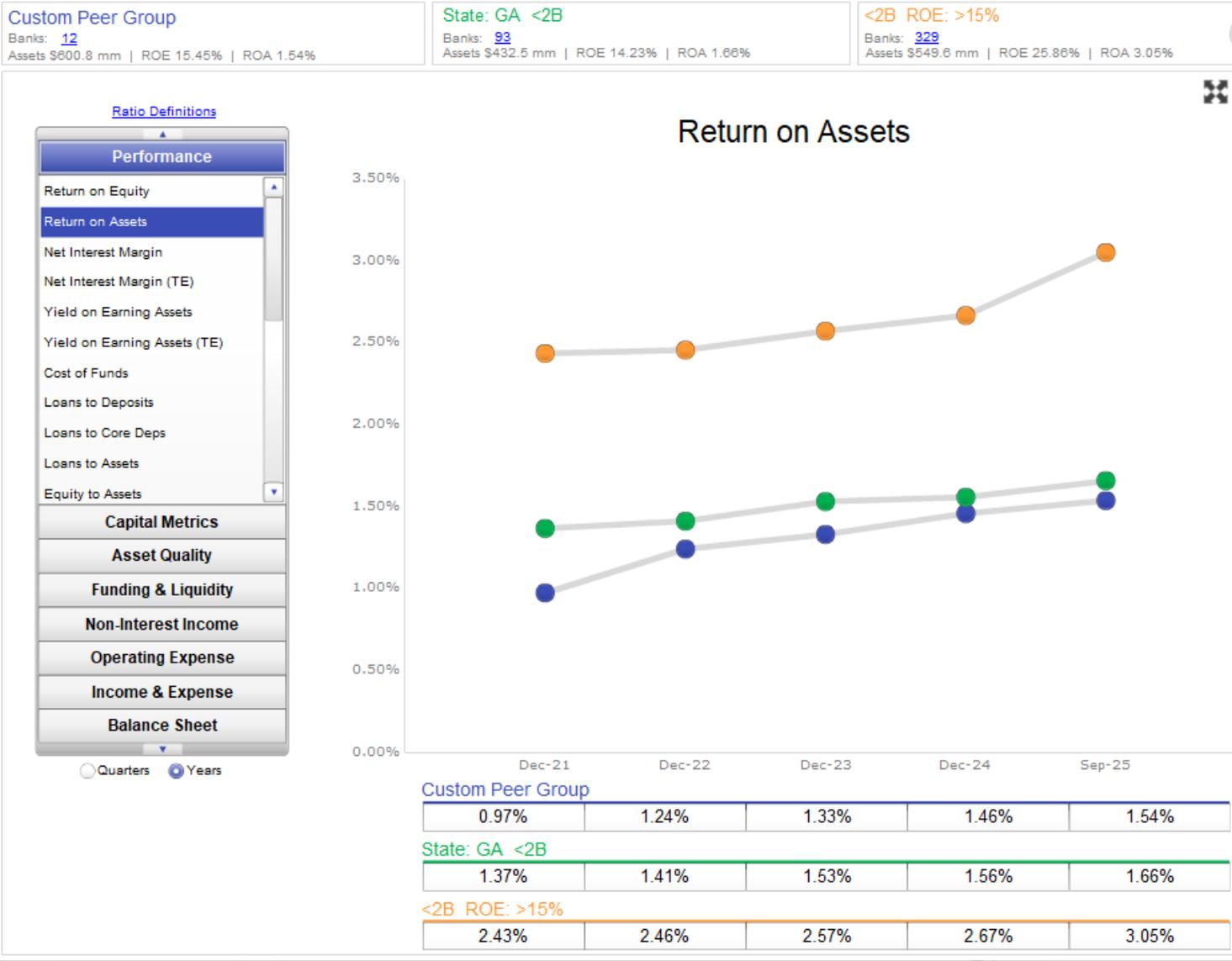
Cumulative % of Assets



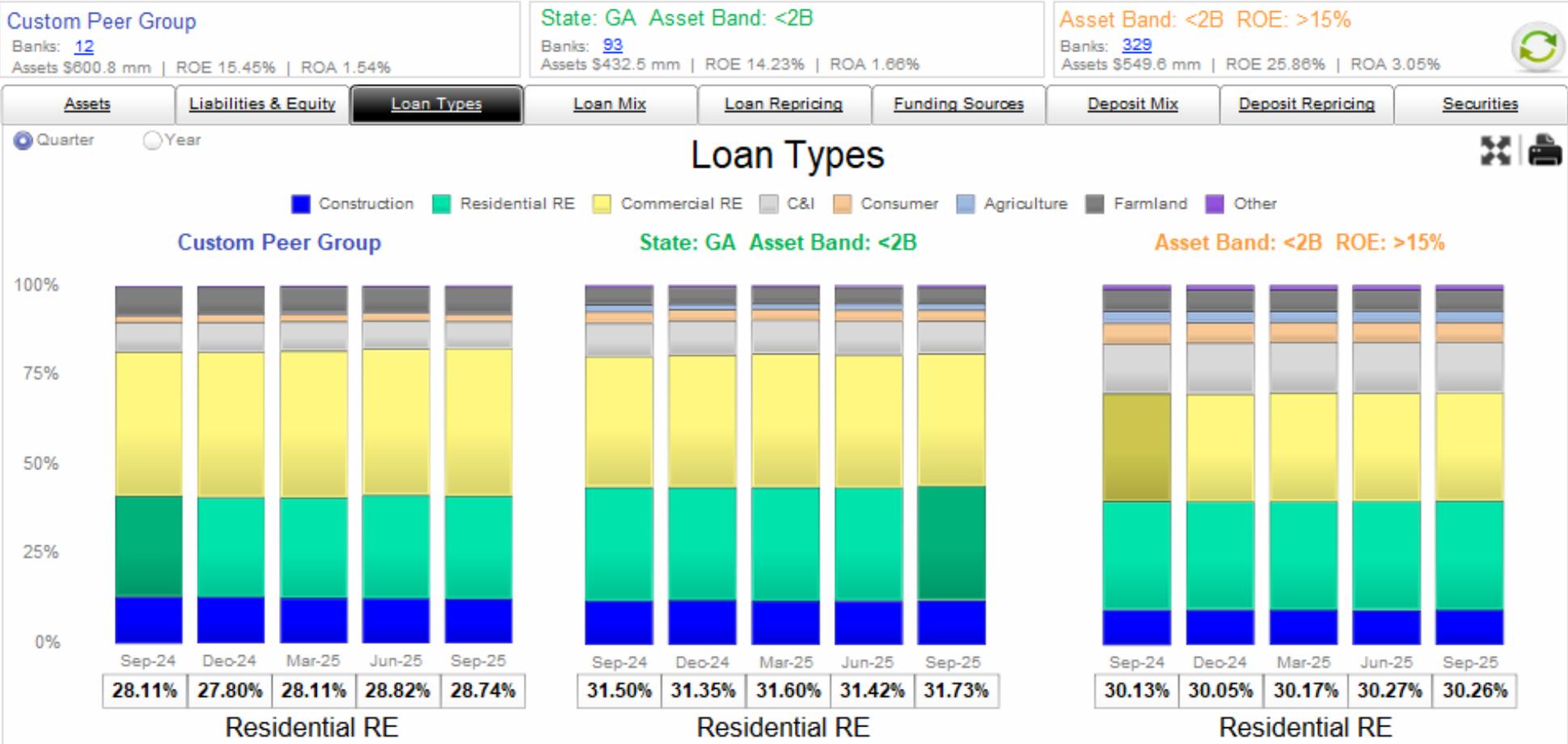
						Values in Thousands
↕ Cert	↕ Institution Name	↕ City	↕ State	↕ Class	↕ Total Assets	↕ Total Assets
873	<a href="#">SYNOVUS BANK</a>	Columbus	GA	SM	60,332,869	
20504	<a href="#">AMERIS BANK</a>	Atlanta	GA	NM	27,013,931	
26342	<a href="#">RBC BANK, (GEORGIA) NATIONAL ASSOCIATION</a>	Atlanta	GA	N	7,422,026	
58181	<a href="#">METRO CITY BANK</a>	Doraville	GA	NM	3,626,177	
22257	<a href="#">COLONY BANK</a>	Fitzgerald	GA	NM	3,139,991	
57071	<a href="#">GEORGIA BANKING COMPANY</a>	Atlanta	GA	NM	2,723,145	
14065	<a href="#">PINNACLE BANK</a>	Elberton	GA	NM	2,232,023	
172	<a href="#">UNITED BANK</a>	Zebulon	GA	NM	2,185,994	
2138	<a href="#">QUEENSBOROUGH NATIONAL BANK &amp; TRUST COMPANY</a>	Louisville	GA	N	2,161,509	
34068	<a href="#">THOMASVILLE NATIONAL BANK</a>	Thomasville	GA	N	1,981,783	
17910	<a href="#">MORRIS BANK</a>	Dublin	GA	NM	1,538,379	
5694	<a href="#">PRIMESOUTH BANK</a>	Blackshear	GA	NM	1,470,491	
16418	<a href="#">BANKSOUTH</a>	Greensboro	GA	SB	1,332,501	
34998	<a href="#">FIRST IC BANK</a>	Doraville	GA	NM	1,243,029	
21292	<a href="#">PEOPLESOUTH BANK</a>	Colquitt	GA	NM	1,170,615	
29510	<a href="#">AFFINITY BANK, NATIONAL ASSOCIATION</a>	Covington	GA	N	924,941	
16858	<a href="#">FIRST AMERICAN BANK AND TRUST COMPANY</a>	Athens	GA	NM	863,947	
58657	<a href="#">PROMISEONE BANK</a>	Duluth	GA	NM	822,611	
8033	<a href="#">CITIZENS TRUST BANK</a>	Atlanta	GA	SM	767,393	
5716	<a href="#">FARMERS AND MERCHANTS BANK</a>	Lakeland	GA	NM	754,493	
57123	<a href="#">FIRST CENTURY BANK, NATIONAL ASSOCIATION</a>	Commerce	GA	N	739,653	

# Challenges/Opportunities for Community Banks

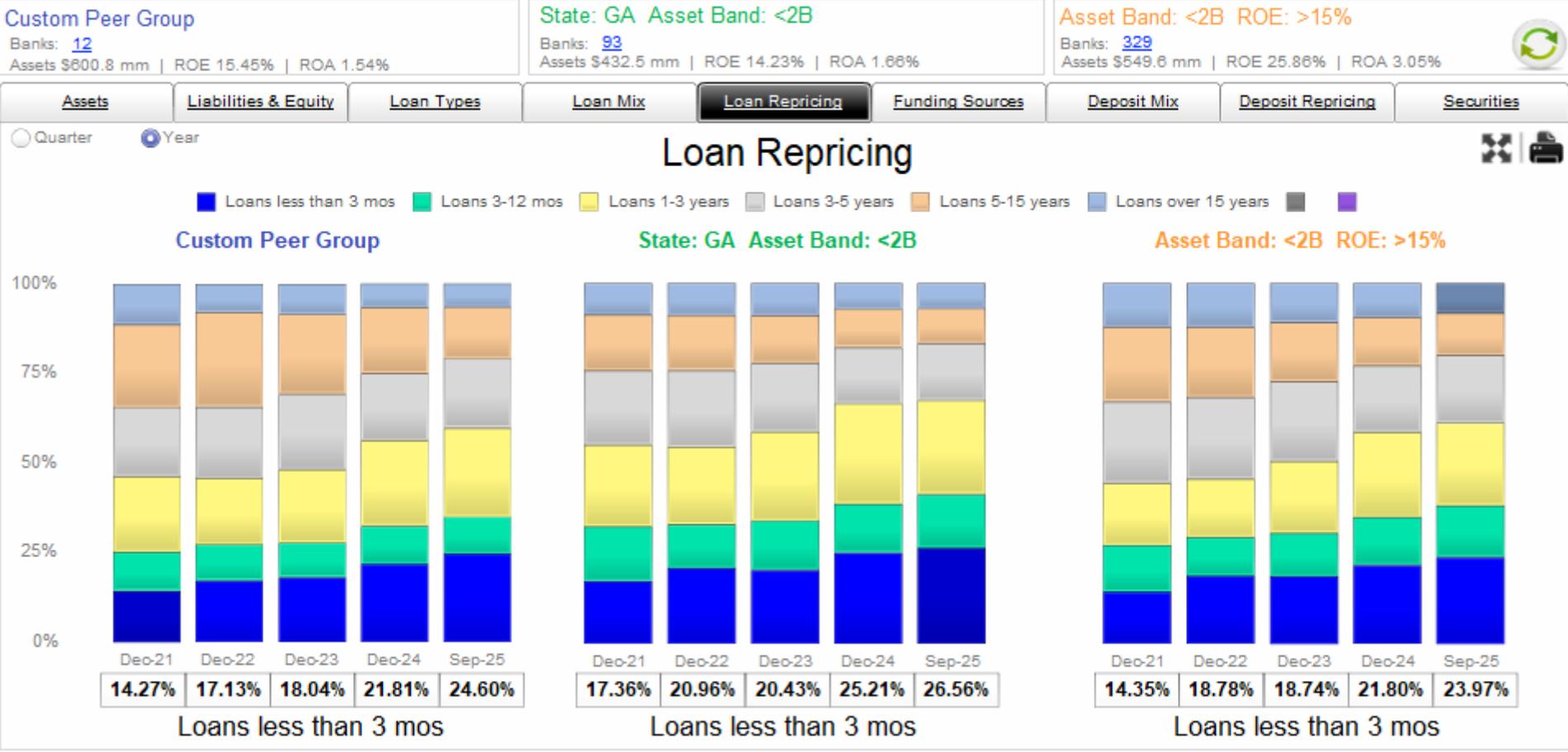




# Peer Group Business Model



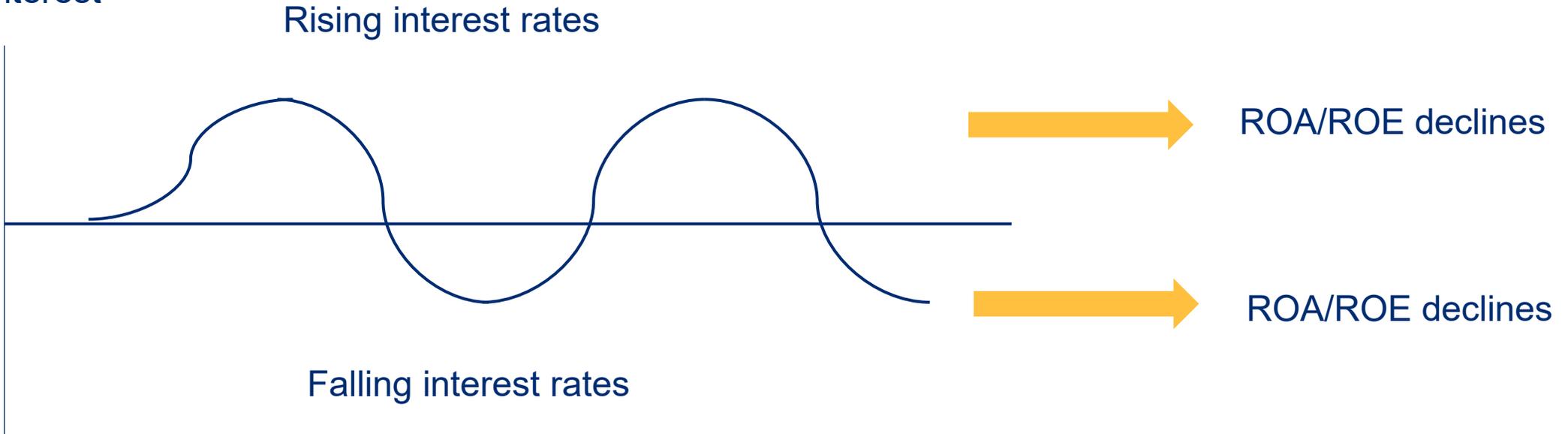
# Peer Group Business Model



# Risk Without Reward – fixed rate loans



COF/Interest Rates



### Custom Peer Group

Banks: [12](#)  
Assets \$600.8 mm | ROE 15.45% | ROA 1.54%

### State: GA <2B

Banks: [93](#)  
Assets \$432.5 mm | ROE 14.23% | ROA 1.66%

### <2B ROE: >15%

Banks: [329](#)  
Assets \$549.6 mm | ROE 25.86% | ROA 3.05%

#### Ratio Definitions

Performance

- Return on Equity
- Return on Assets
- Net Interest Margin
- Net Interest Margin (TE)
- Yield on Earning Assets
- Yield on Earning Assets (TE)
- Cost of Funds
- Loans to Deposits
- Loans to Core Deps
- Loans to Assets
- Equity to Assets

Capital Metrics

Asset Quality

Funding & Liquidity

Non-Interest Income

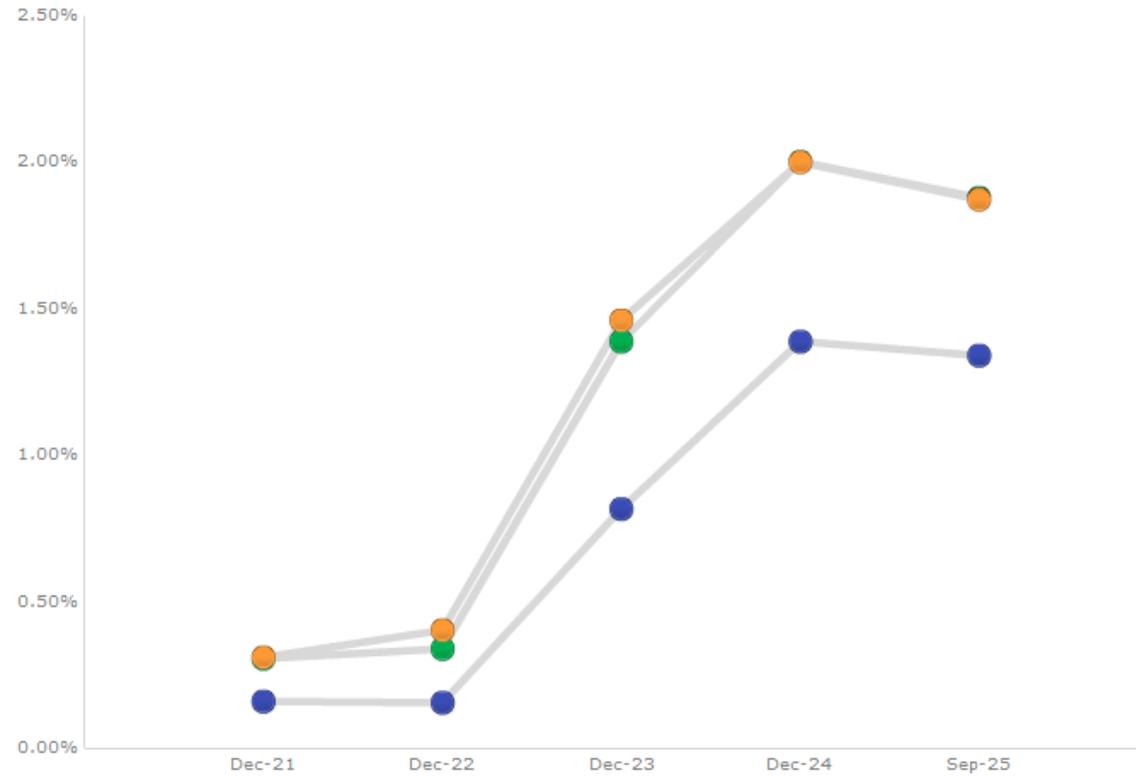
Operating Expense

Income & Expense

Balance Sheet

Quarters  Years

## Cost of Funds



#### Custom Peer Group

0.16%	0.16%	0.82%	1.39%	1.34%
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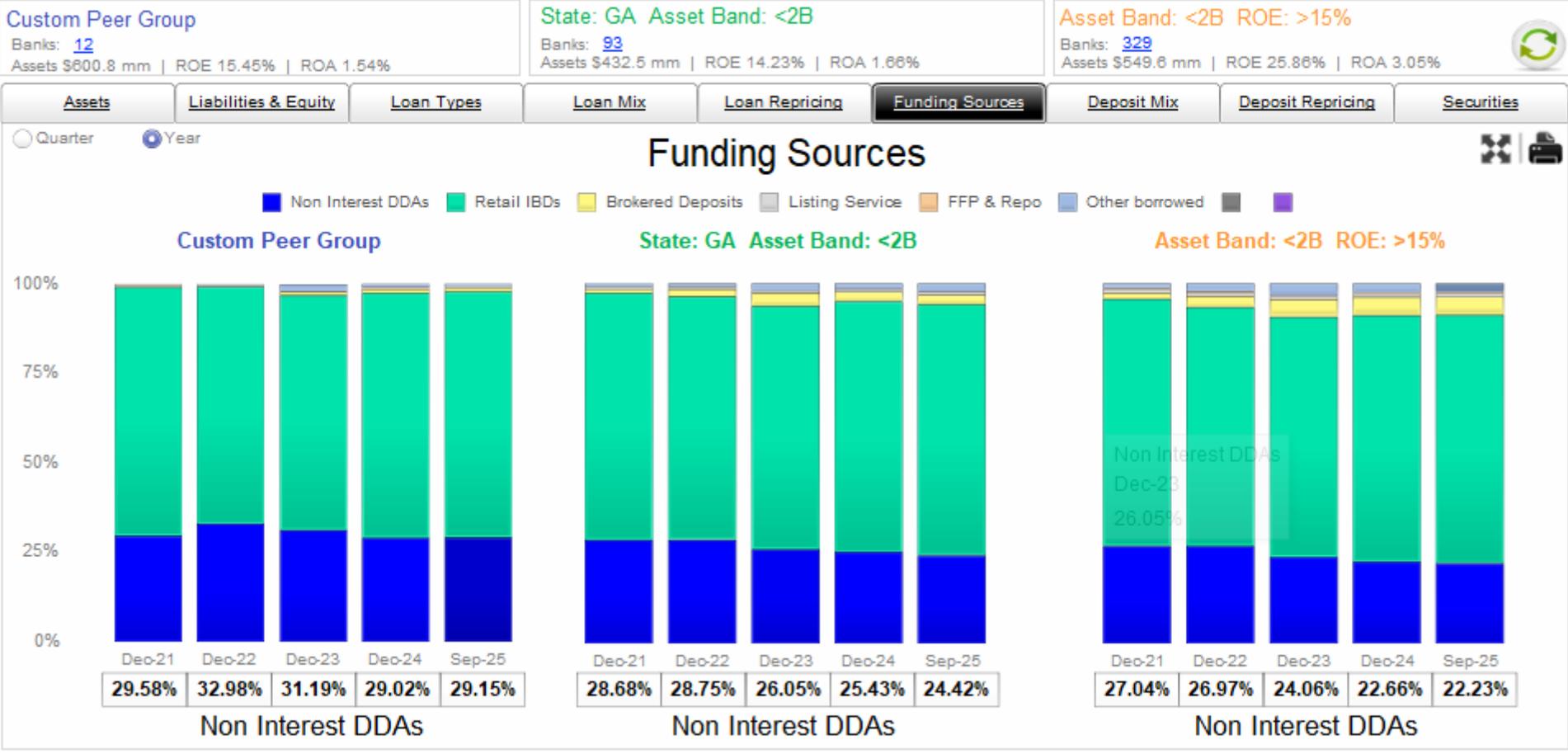
#### State: GA <2B

0.31%	0.34%	1.39%	2.00%	1.88%
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#### <2B ROE: >15%

0.31%	0.40%	1.46%	2.00%	1.87%
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# Funding Sources



# Asset Yield



### Custom Peer Group

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**Capital Metrics**

**Asset Quality**

**Funding & Liquidity**

**Non-Interest Income**

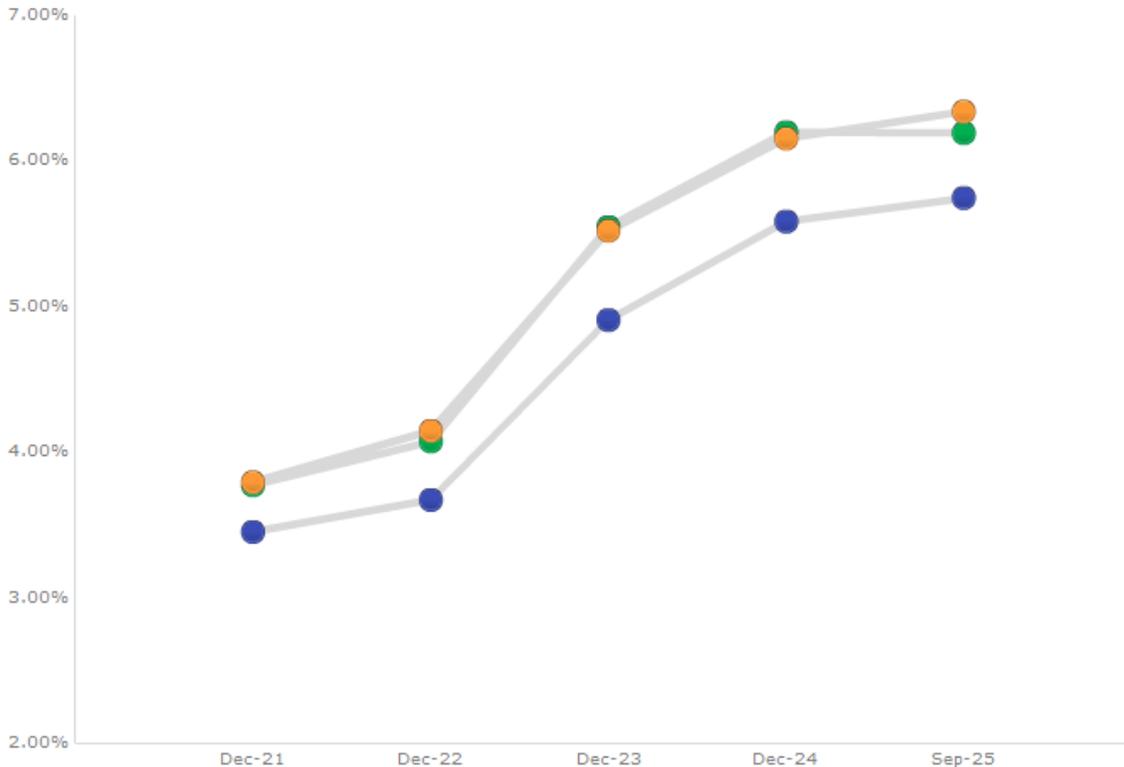
**Operating Expense**

**Income & Expense**

**Balance Sheet**

Quarters  Years

## Yield on Earning Assets



#### Custom Peer Group

3.45%	3.67%	4.91%	5.59%	5.75%
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#### State: GA <2B

3.77%	4.07%	5.55%	6.20%	6.19%
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#### <2B ROE: >15%

3.79%	4.15%	5.52%	6.16%	6.34%
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### Custom Peer Group

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**Capital Metrics**

**Asset Quality**

**Funding & Liquidity**

**Non-Interest Income**

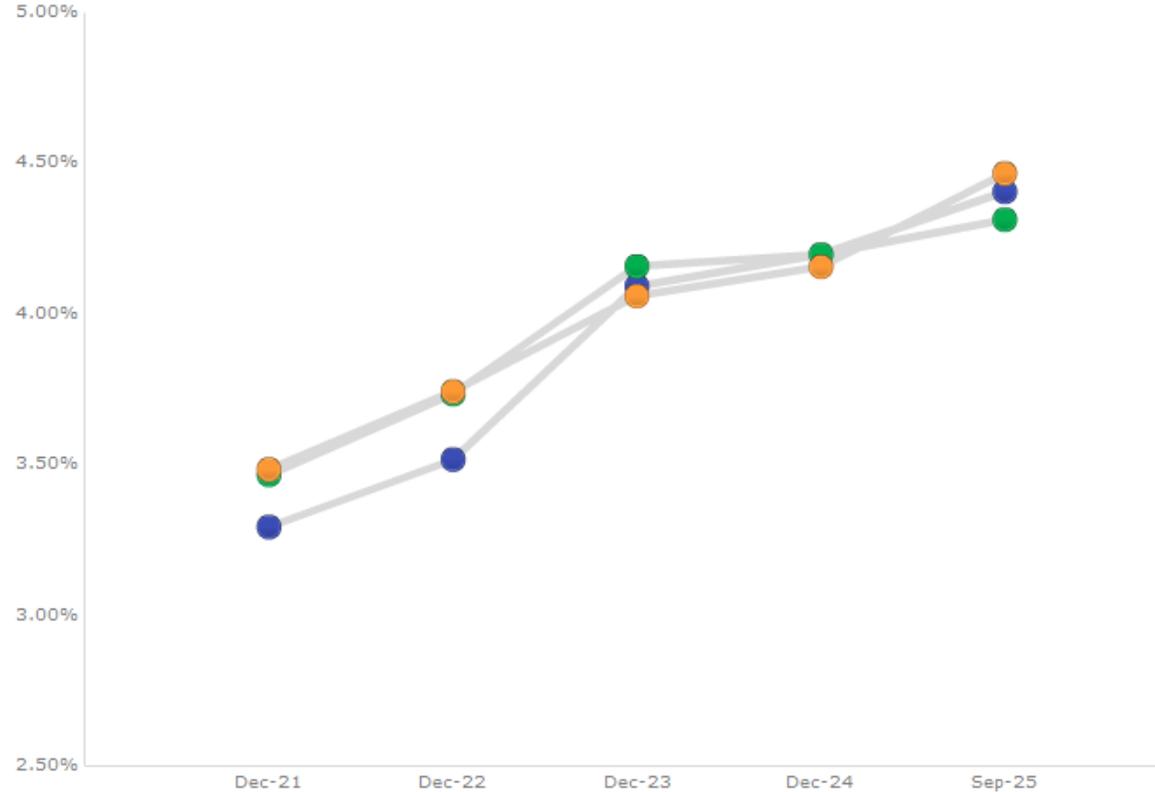
**Operating Expense**

**Income & Expense**

**Balance Sheet**

Quarters  Years

## Net Interest Margin



#### Custom Peer Group

3.29%	3.52%	4.09%	4.20%	4.41%
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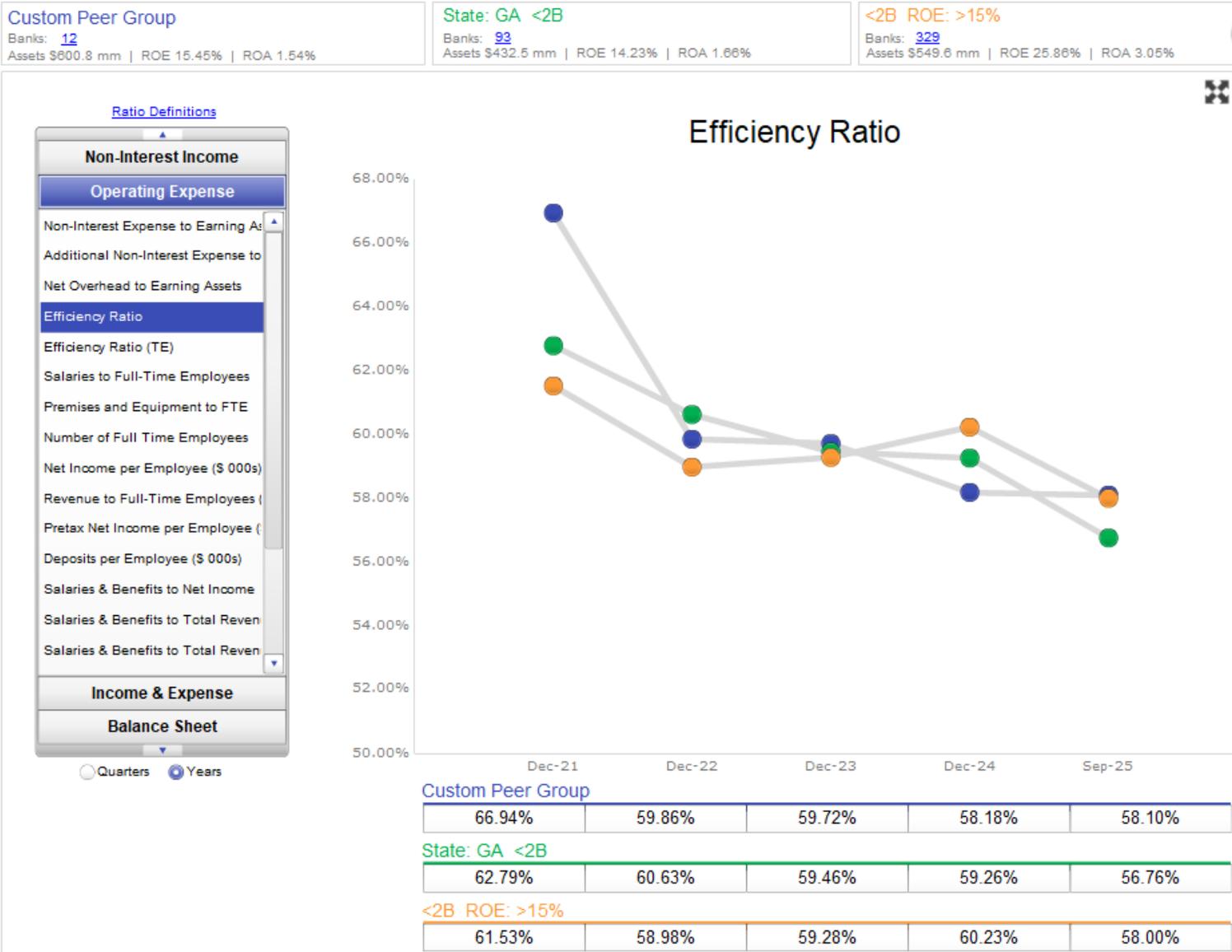
#### State: GA <2B

3.47%	3.73%	4.16%	4.20%	4.31%
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#### <2B ROE: >15%

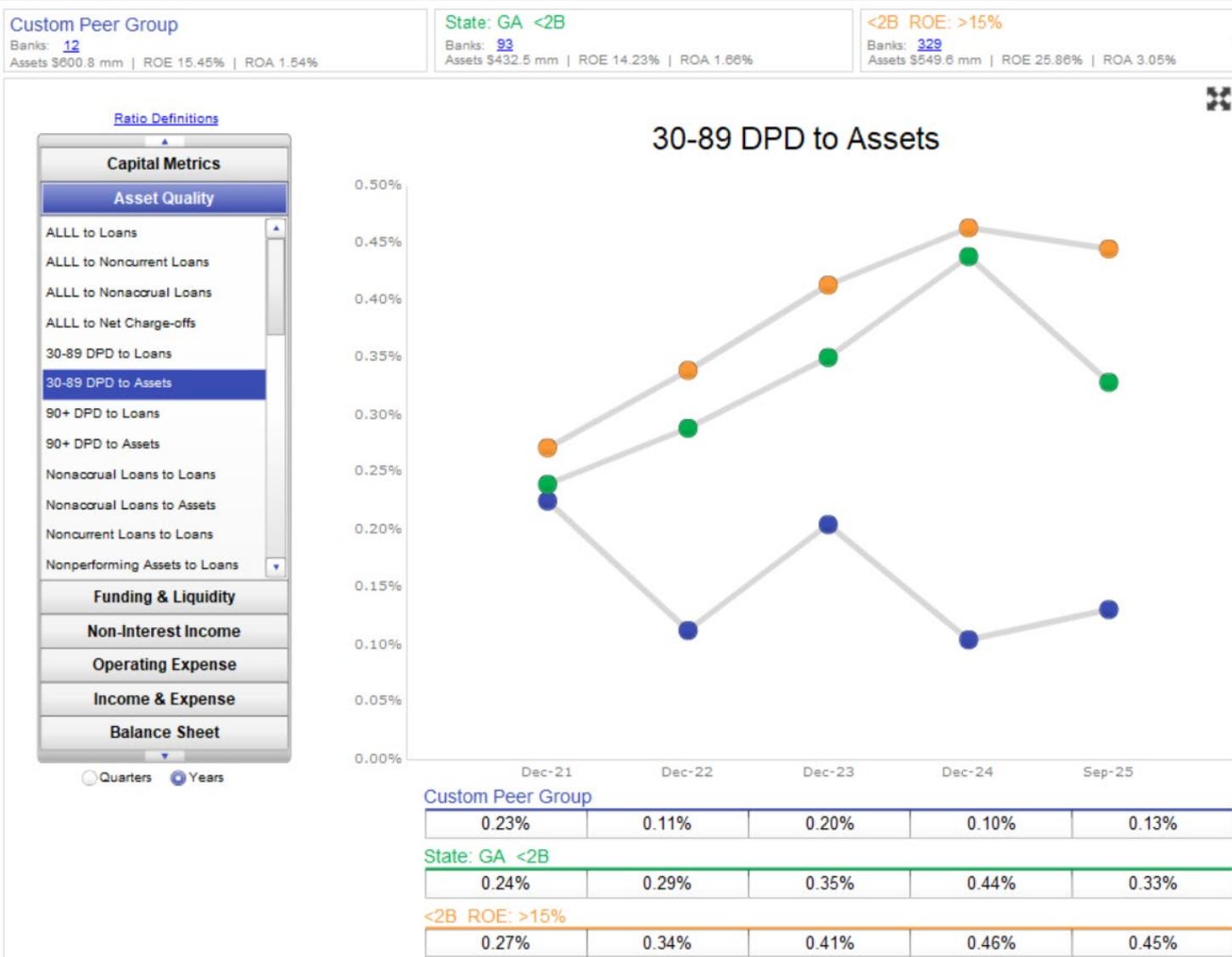
3.48%	3.74%	4.06%	4.16%	4.47%
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# Efficiency Ratio



Efficiency Ratio =  
 Non-Interest  
 Expenses / Total  
 Revenue

# Asset Quality



# Challenges – NII – Big Driver



**Custom Peer Group**  
 Banks: [12](#)  
 Assets \$800.8 mm | ROE 15.45% | ROA 1.54%

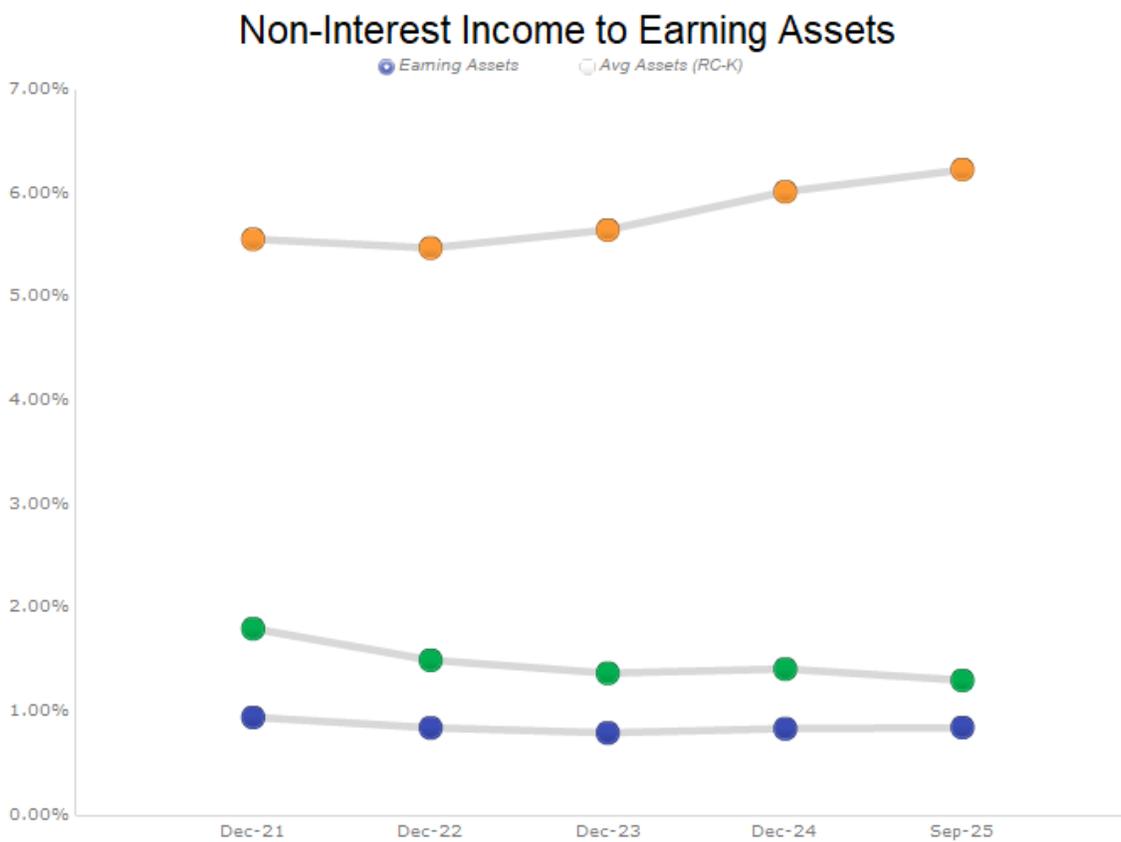
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[Ratio Definitions](#)

- Operating Expense
- Income & Expense**
  - Interest Income to Earning Assets
  - Interest Income to Earning Assets (
  - Net Interest Income to Earning Ass
  - Non-Interest Income to Earning Ass**
  - Additional Non-Interest Income to I
  - Net Income to Earning Assets
  - Income Tax to Earning Assets
  - Interest Expense to Earning Assets
  - Loan Loss Provisions to Earning As
  - Securities Gains (Losses) to
  - Trading Account Gains (Losses) to I
  - Total Non-Interest Expense to Earn
  - Advertising and Marketing Expense
  - ATM and Interchange Expense to
  - Accounting and Auditing Expense
  - Consulting and Advisory Expense t
- Balance Sheet

Quarters  Years



**Custom Peer Group**

0.95%	0.85%	0.80%	0.84%	0.85%
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**State: GA <2B**

1.80%	1.50%	1.37%	1.41%	1.30%
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**<2B ROE: >15%**

5.56%	5.48%	5.65%	6.02%	6.23%
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## 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?

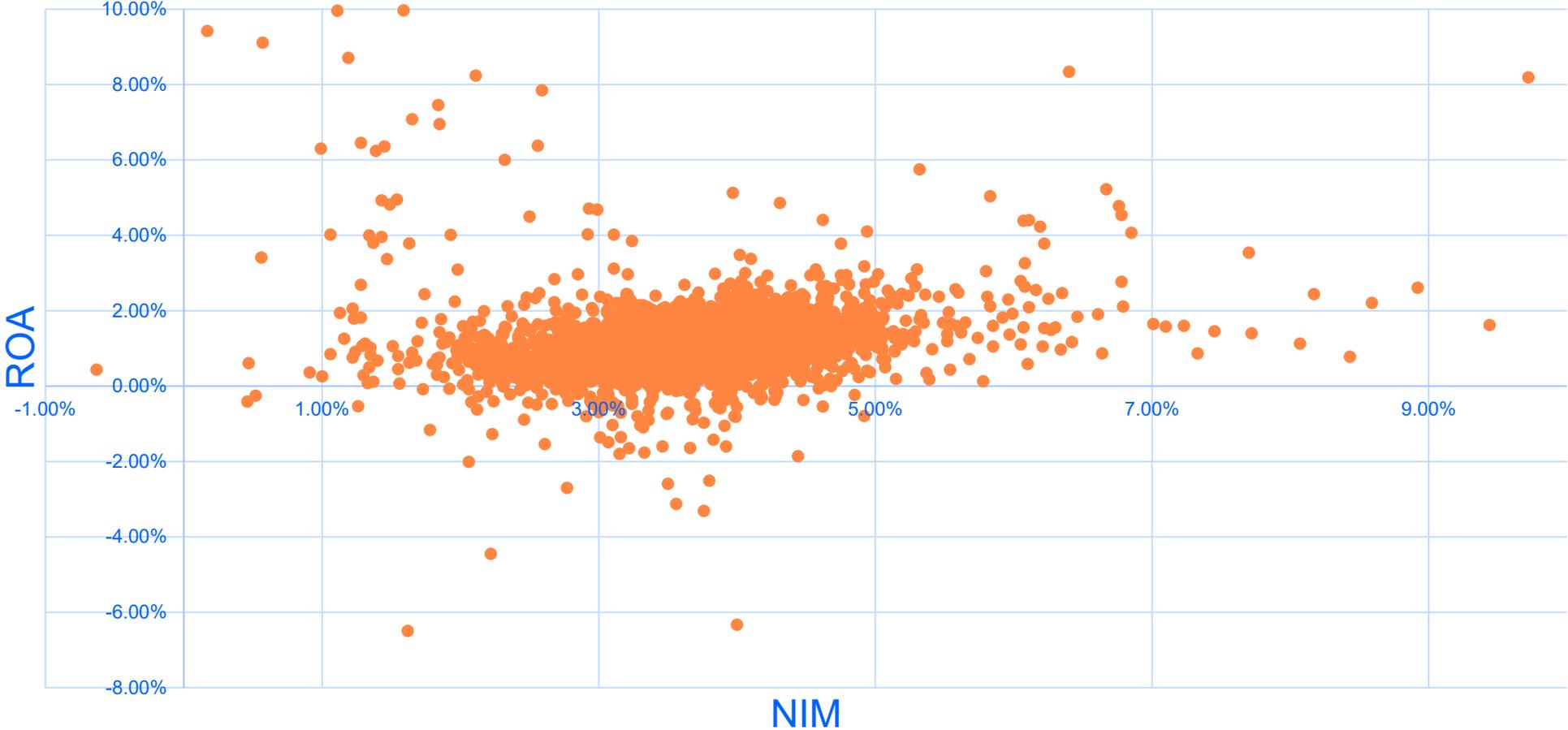
- Direct contribution to income
- Reflects value added
- Self-selecting profitable clients
- Less transparency is key

# NIM – ROA/ROE relationship



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

Correlation (R2) = - 0.02



# Banking is the Business of Keeping not Making Loans



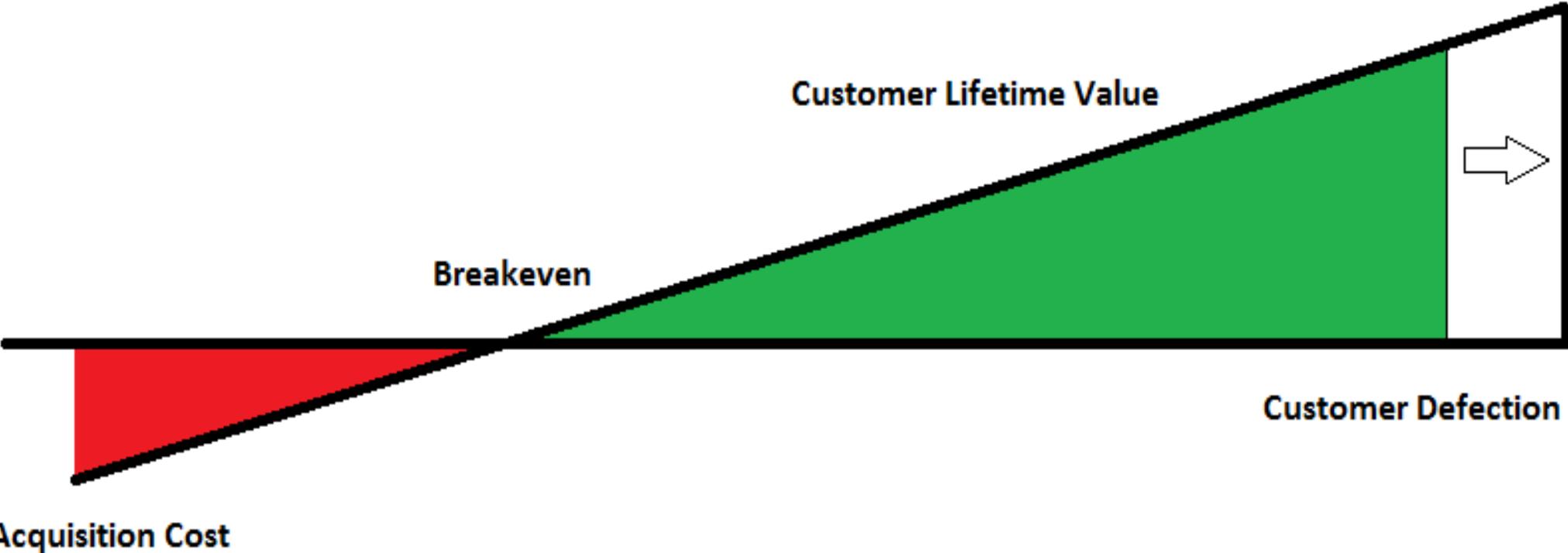
Long-term Relationships, Size, Term, Credit Quality, **Non-interest Income**



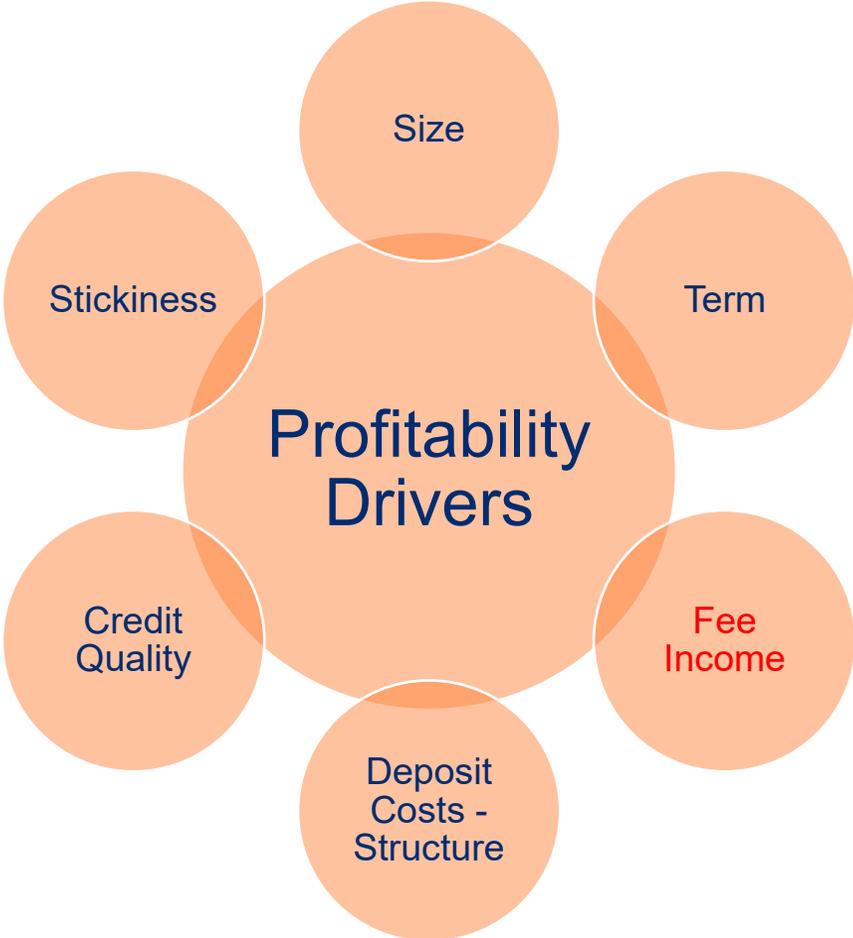
# Long-term relationships



Increasing Retention / Reducing Churn



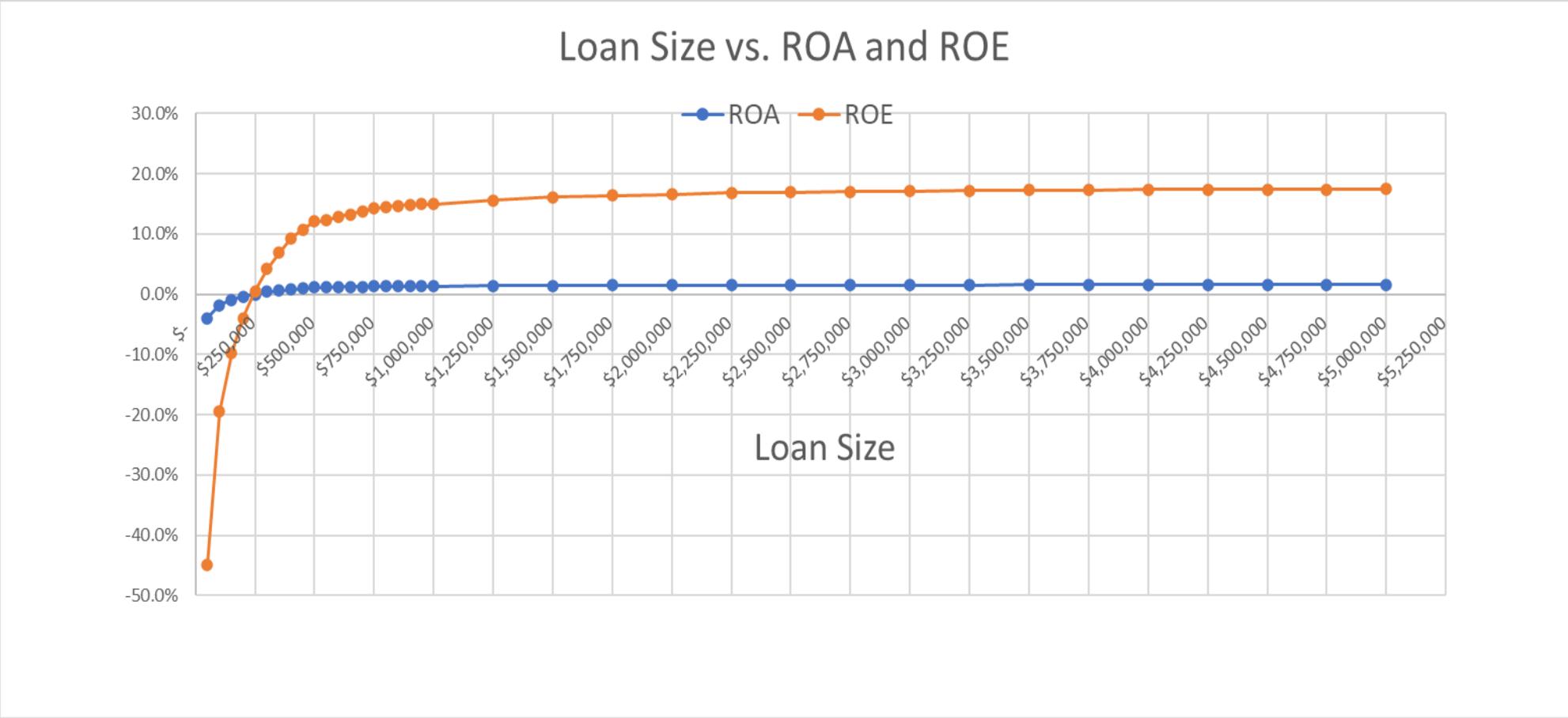
# Dissecting Banking Profitability



# Loan Size – scale matters



5yr CRE loan, S + 2.50%





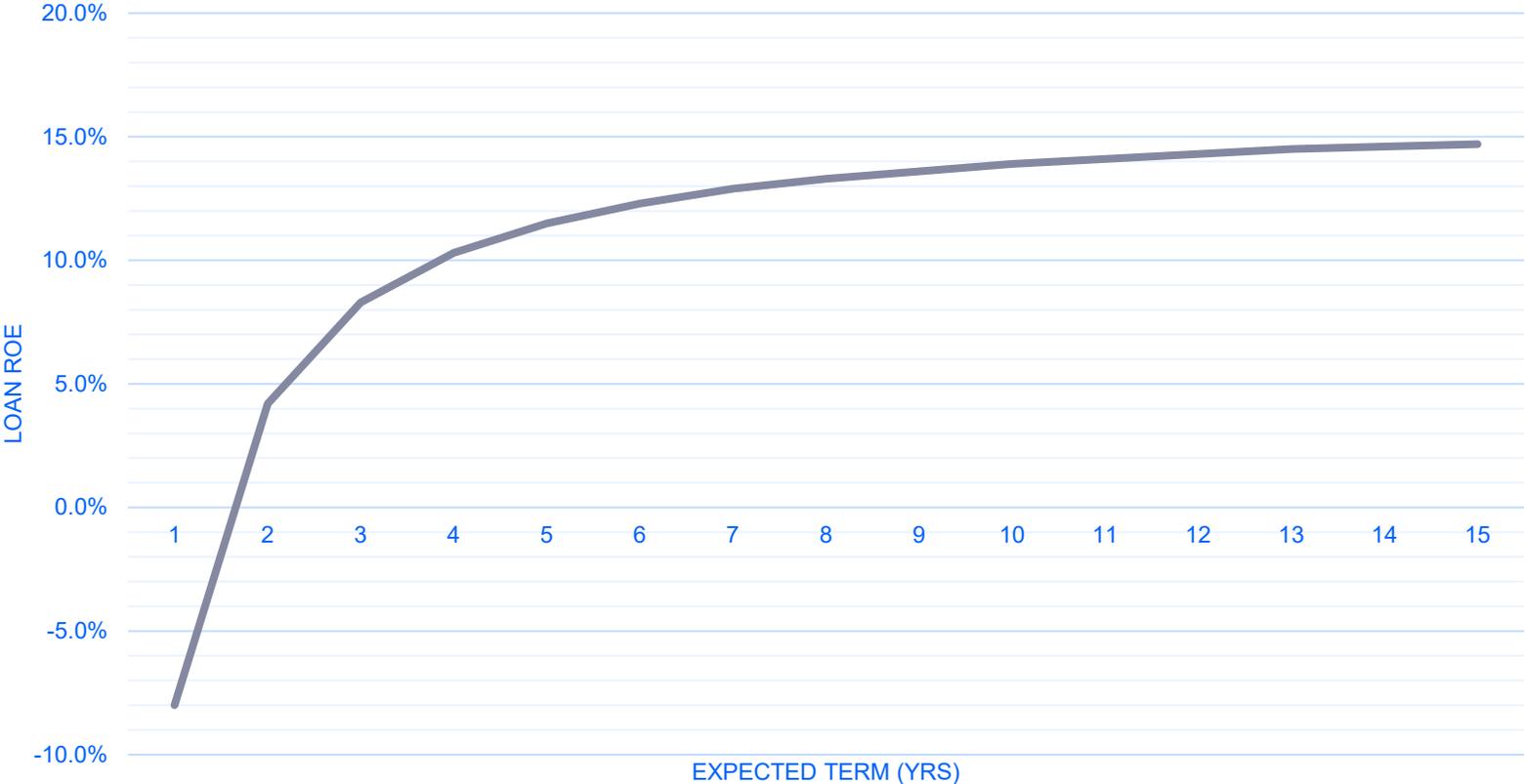
# Loan Size – scale matters

	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



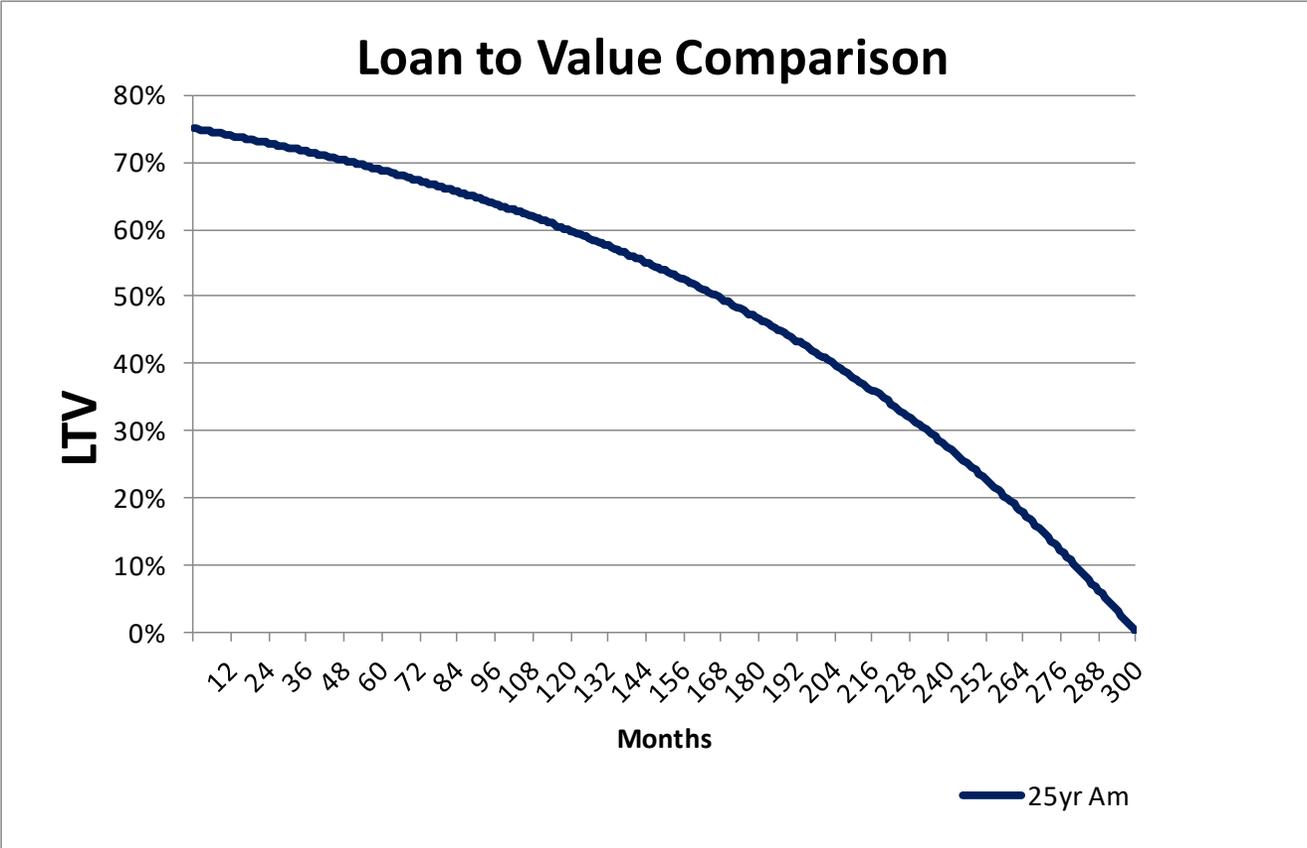
\$500k CRE loan, S + 2.50%

### Loan Term vs. ROE





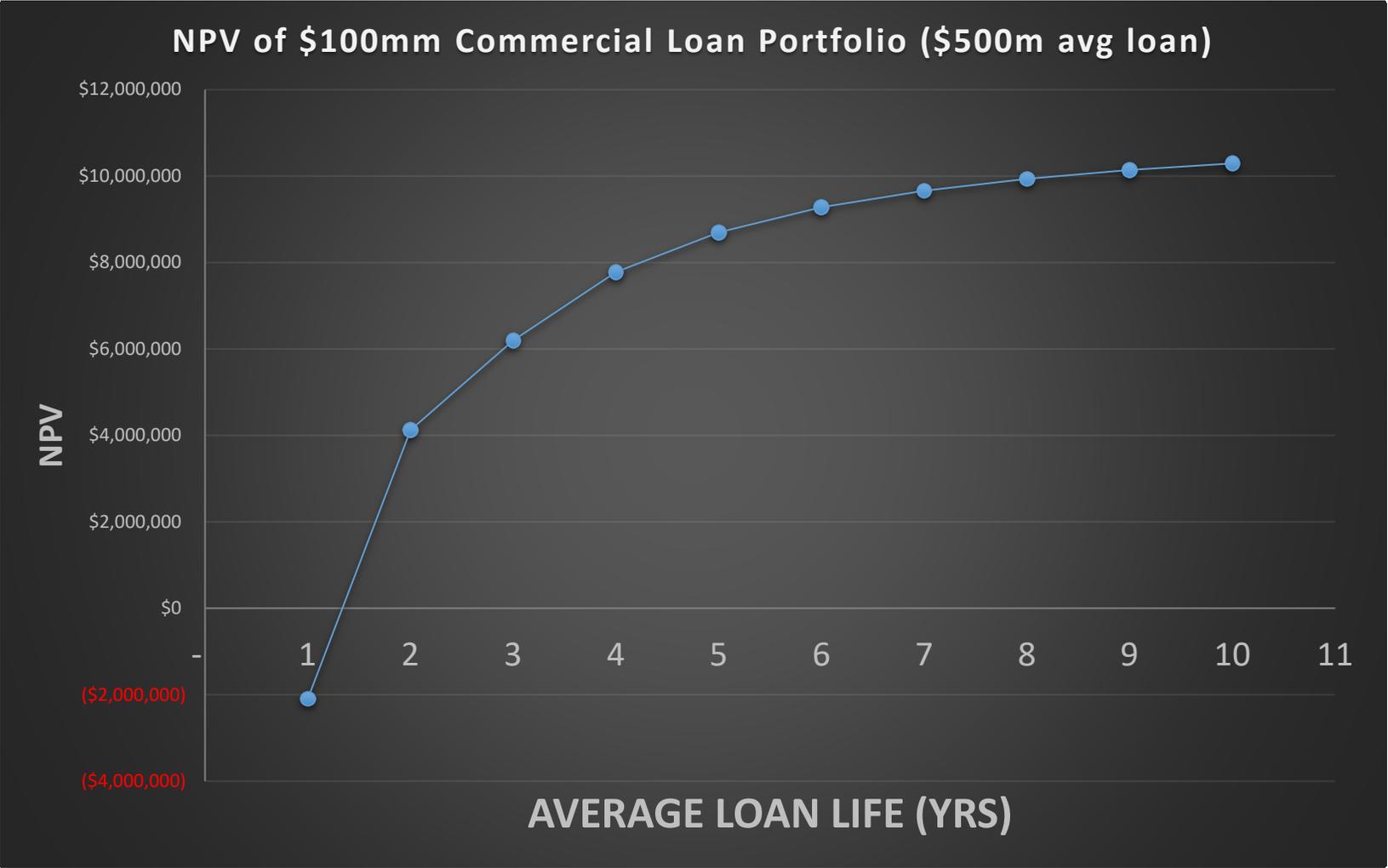
## Equity Buildup



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



- \$1Bn commercial loan portfolio
- 5% growth target (\$50mm)



- 2% GDP



- \$1Bn commercial loan portfolio
- 2% organic growth (\$20mm)
- 3% market acquisition (\$30mm)

- Market acquisition
  - Service, differentiated product, loan category
  - Pricing or credit

- 3% market acquisition



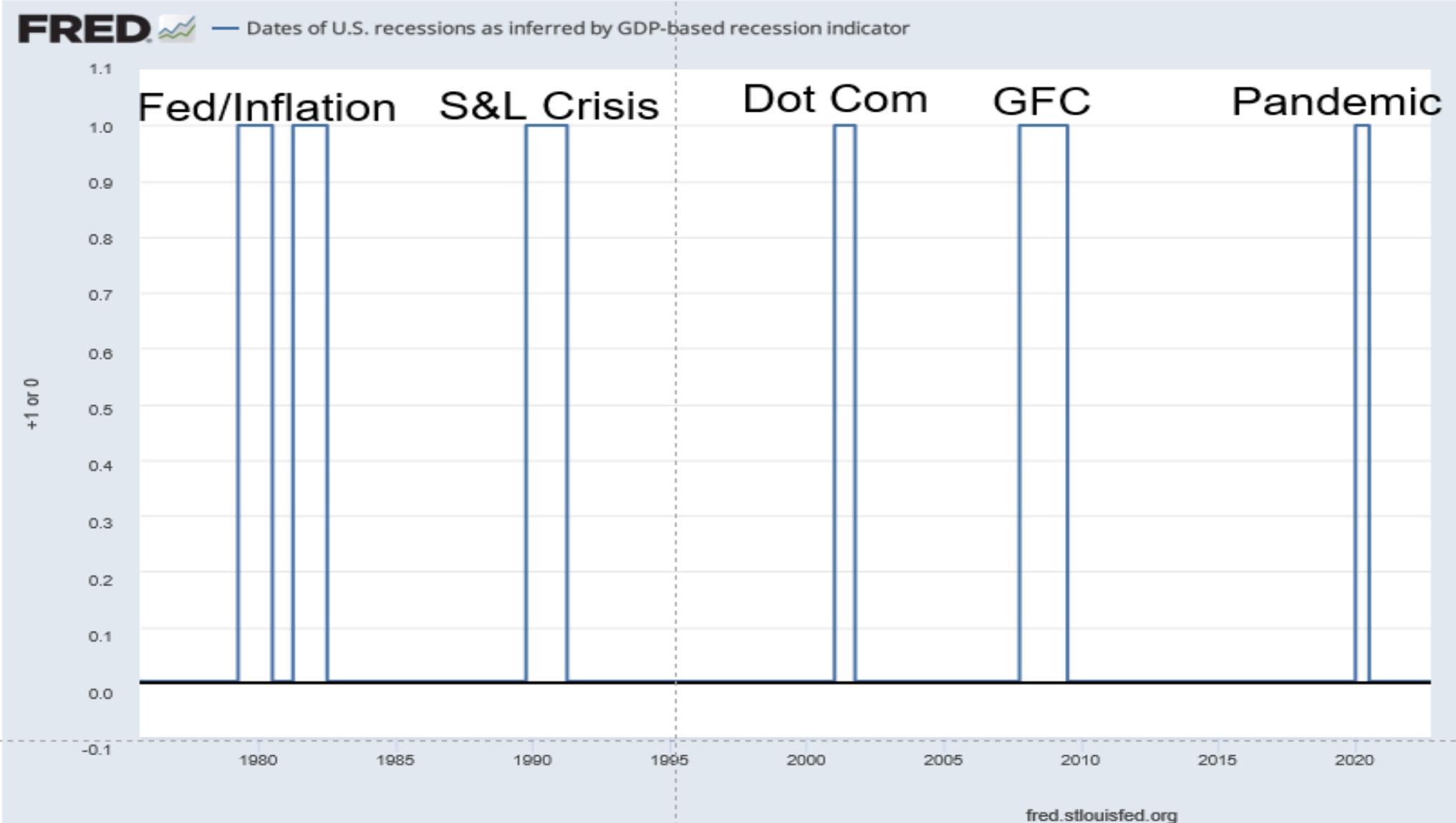
**7yr avg loan life (3% runoff)**

- \$1Bn commercial loan portfolio
- Loan production needs
  - \$30mm runoff
  - \$50mm growth
  - Total new production \$80mm to get to \$1.05Bn in loans

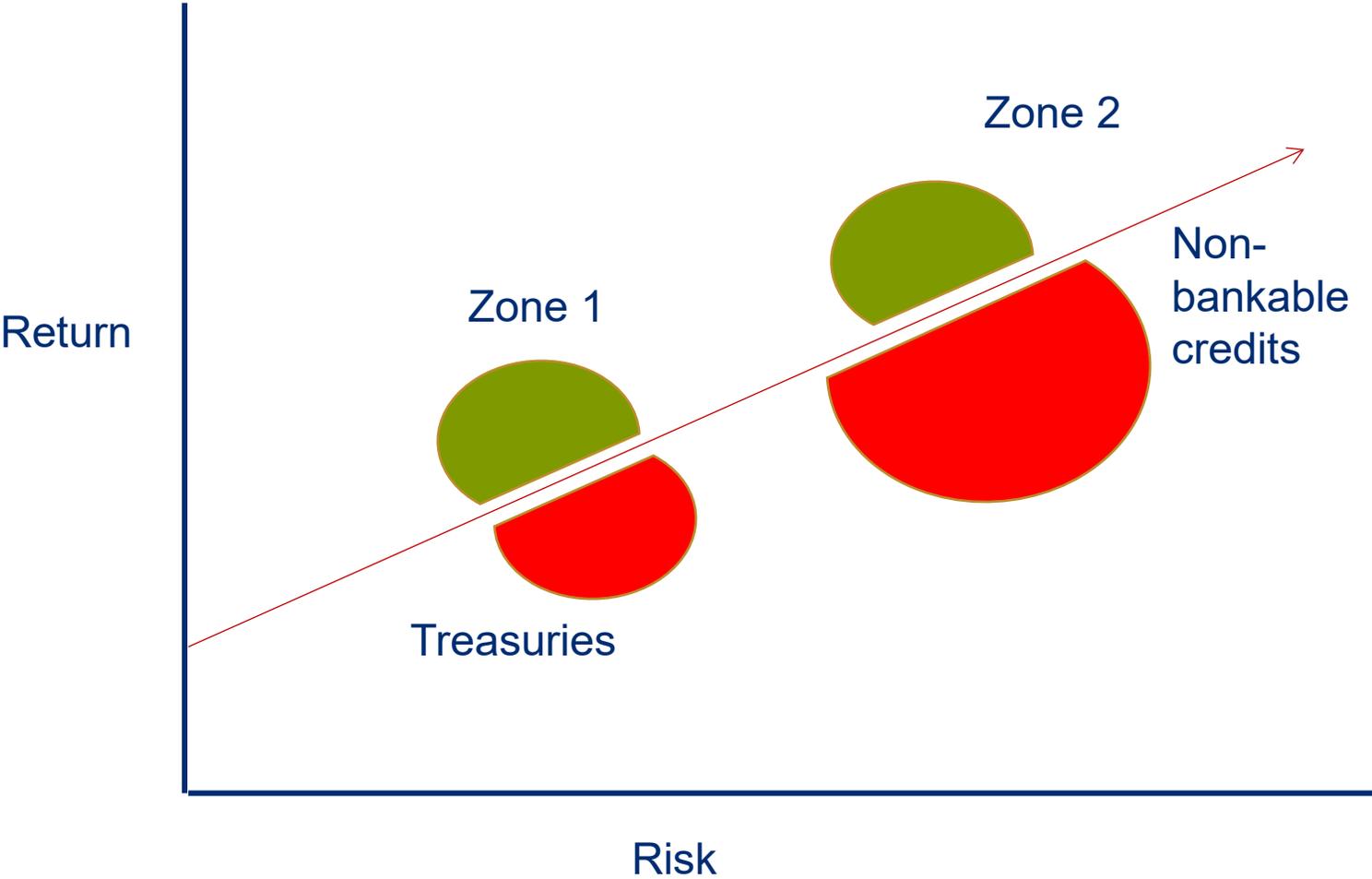
**2.3yr avg loan life (36% runoff)**

- \$1Bn commercial loan portfolio
- Loan production needs
  - \$360mm runoff
  - \$50mm growth
  - Total new production \$410mm to get to \$1.05Bn in loans

# Credit Quality



# Credit Quality



# RAROC Loan Pricing – Best Practices

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- **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**



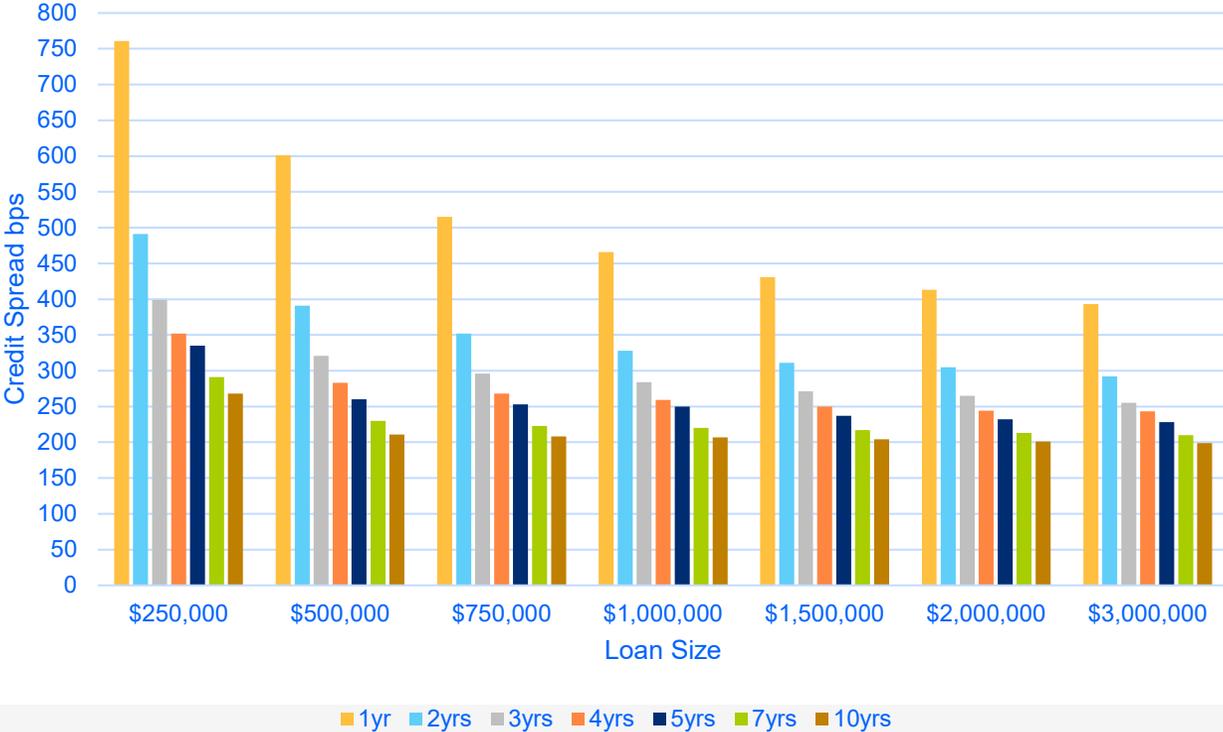
# Credit Quality/Term/Size



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



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





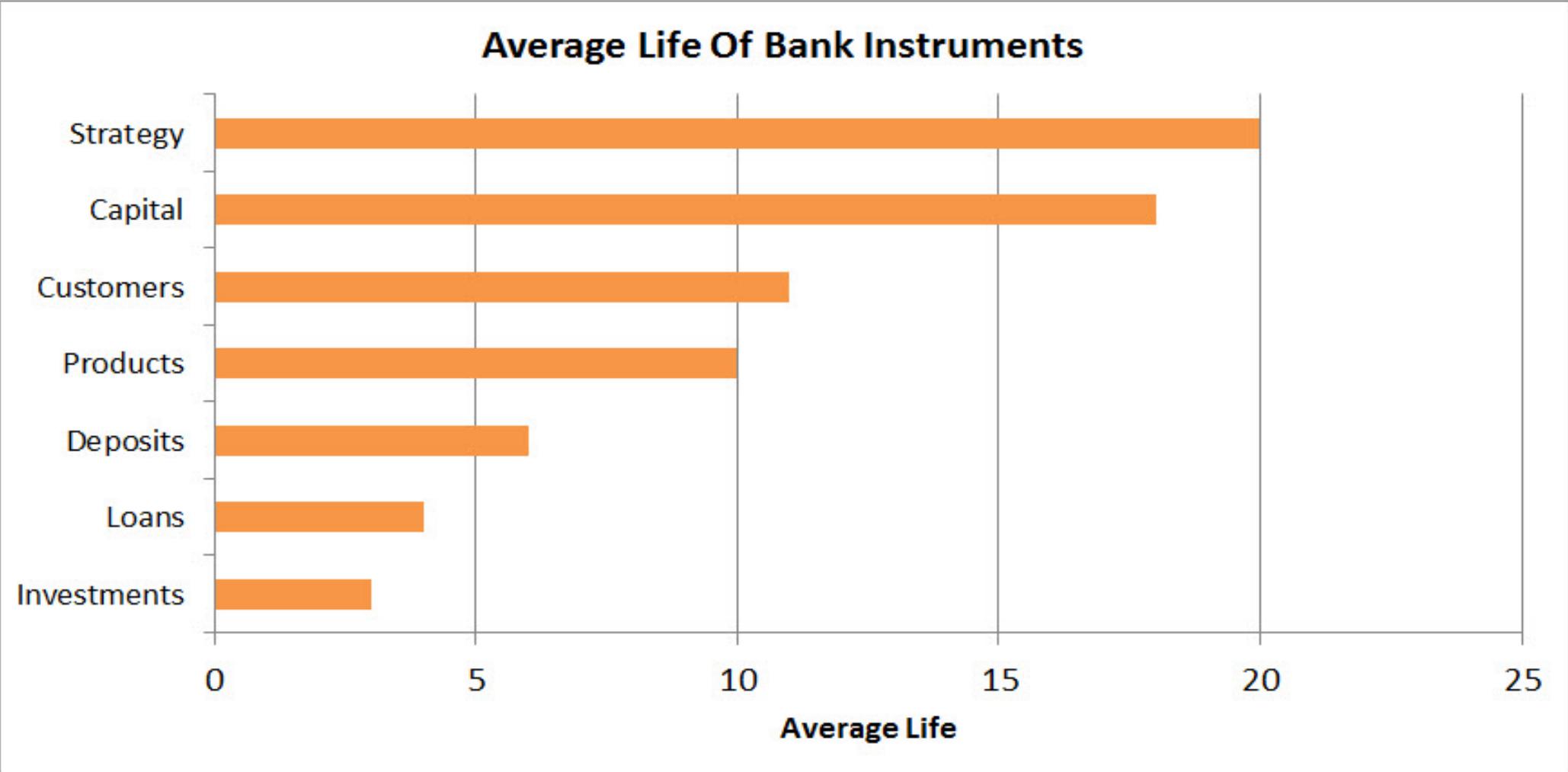
# Relationship vs. Transaction (stickiness)

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





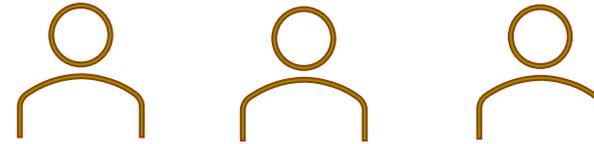
# Long-term Relationship vs. Transaction

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

# Thank you!

Want more ideas and data?

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[SouthStateCorrespondent.com](https://SouthStateCorrespondent.com)



# Disclaimer

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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.

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