

Seeking Alpha^α

Clock is Ticking for Banks With Asset Quality Issues

by: Mindi McClure

posted on: May 27, 2008 | about stocks: [XLF](#)

There are around 8,500 insured financial institutions in the US and while many companies are generally sound and the system is well capitalized, the pain caused by the recent credit crisis is not over yet. Many institutions have evolving and lingering asset quality problems in their loan portfolios and need to consider their options.

The good news for troubled banks is that there is no shortage of capital chasing “problem assets” and no shortage of investors hoping to invest in bank recapitalizations. The bad news is that the bid-ask spreads are incredibly wide, leaving most banks to conclude that the risk premium factored into the bid prices are way too high. It is not uncommon for banks who have received an indicative bid to simply not respond, paralyzing the resolution process while the underlying problems continue to worsen.

The banking system was created following the Great Depression for a reason; specifically, to create financial stability and to mitigate the risk of bank failures due to funding crises and forced sales.

Witness the blinding speed with which non-FDIC insured financial institutions have failed or required government assistance and compare that to the relative stability of insured institutions. American Home Mortgage filed bankruptcy in early August, while FDIC-insured Fremont lingered on until the regulators forced a solution last month despite having a loan portfolio significantly inferior to American Home's. The most obvious example, of course, is the near failure of Bear Stearns over the course of one weekend in March.

But banks do fail, it just takes more time than non-banks. It is up to bank managers and boards to actively seek a solution to their asset quality issues. Investors are trading bank stocks with real or perceived problems at significant discounts. These discounts are magnified when management fails to candidly recognize and address issues, as the investors have imperfect information about just how bad things are. Investors in problem banks are anticipating an erosion in stated book at best and potentially significant dilution or regulatory takeover at worst.

We looked at the 302 publicly traded banks and thrifts with assets between \$1 billion and \$25 billion and scored them on five measures to take into account non-performing assets, reserve coverage, core earnings quality, capital levels and exposure to construction and land development lending (see chart).

It's no surprise that the lower the quality institution (four marks out of possible five) are trading at 36% of tangible book value while the higher quality institutions are trading at 191% of tangible book. What we didn't expect to see was the acceleration in the declines of the three and four ranked banks in the past **month** (down 19% and 25% respectively). Clearly the March earnings season revealed additional problems and the failure of ANB Bancshares indicated that the regulators will take action on problem institutions.

Investors are signaling that they believe fundamentals for these troubled companies are getting worse and not better. Regulators are voting with their feet as well. Clearly, it is time for the managers of these institutions to take action to clean up their balance sheets and shore up capital levels.

click to enlarge image

Median Financial and Trading Data for 302 Publicly Traded Banks and Thrifts

Total Assets Between \$1 Billion and \$25 Billion at March 31, 2008

Source: SNL and The Bear Companies

Number	Score	Tangible Equity/Tangible Assets (%)	NPAs/Reserves Assets (%)	Reserves/NPAs (%)	Net Interest Margin (%)	Const & Land Dev Lns/Tot Lns (%)	Price/Book	Tangible Book	Price/Trailing-four-quarter EPS	Price Change (%) Week	Price Change (%) Month	Price Change (%) Year	Market Capitalization (\$M)
99	0	7.26	0.39	177.80	3.61	8.36	146.04	191.30	14.39	-2.37	-2.03	-9.41	354.25
103	1	6.78	0.73	109.59	3.54	16.51	115.04	167.80	13.49	-1.96	0.02	-17.93	248.77
62	2	6.86	1.63	61.17	3.12	19.19	88.19	114.62	13.32	-1.90	-5.45	-38.20	194.80
34	3	7.35	2.88	40.97	3.31	29.25	67.50	74.47	9.06	-5.06	-19.37	-58.93	138.30
4	4	7.57	4.84	27.39	2.09	43.09	35.63	35.63	3.74	-8.03	-34.86	-68.13	93.52

302

Scoring System	
Non-performing assets > 2% of total assets	1
Reserves/NPAs < 100%	1
Tangible capital/tangible assets < 6%	1
Construction and land development loans/total loans > 20%	1
Net interest margin < 2.5%	1

[notsosmart](#)

May 27 09:02 AM

[My Website](#)

as far as i know the fdic wont give out the names of troubled banks.you have to file "freedom of info act". so along with the phony cpi this govt. is doing all it can to hide the facts.what a sad mess this whole thing is becoming.

[nbdubya](#)

May 27 03:57 PM

[My Website](#)

Amazing that, with asset quality sliding fast, banks just keep on using the same tools that got them into this mess ...

[nik-o-laus.blogspot.co...](#)

[nik-o-laus.blogspot.co...](#)