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BANK DIRECTOR

CHARTING A COURSE FOR AMERICA'S BANKING LEADERS

2008 BANK PERFORMANCE SCORECARD

Highlighting America's Best Banks

THE TOP 150 PERFORMERS

by **PAUL SWEENEY**

There is not much flash and glitz among this year's crop of top-performing U.S. banks and thrifts. But given all that's occurred in the last six months, maybe slow and steady really is the name of the game.

In fact, over a recent 12-month period, as the credit and financial markets came unhinged and some of the country's best-known depository financial institutions teetered on the brink of collapse, "steady at the helm" was the governing mantra for the highest-ranked banks.

That is just one salient feature of this year's class of top performers among banks and thrifts, according to our annual Bank Performance Scorecard. Based on measurement criteria and analysis compiled by Sandler O'Neill & Partners L.P., a New York-based investment banking firm that specializes in the financial services industry, the scorecard features the institutions that maintain top standing in good times and bad—often with recurring high scorers.

The five financial institutions atop this year's scorecard, which ranks the country's largest 150 banks and thrifts with assets of more than $3 billion, are Glacier Bancorp Inc., Kalispell, Montana; First Financial Bankshares, Abilene, Texas; SVB Financial Group, Santa Clara, California; Bank of Hawaii Corp., Honolulu, Hawaii; and Westamerica Bancorp., San Rafeal, California.

More so than in the past, geography appears to matter this year. To place in the forefront, it helped to be located west of the Mississippi, mostly in high-growth areas, but also in regions rich in natural resources where the economy was buoyed by swelling commodity prices. Size also mattered: Interestingly, none of the best banks or thrifts was a megabank. The top five—and seven of the top 10—are mid-sized financial institutions ranging in asset size from $3 billion to $11 billion.

And they are a sober-minded, traditional bunch. Top performers this year have largely eschewed exotic loan products. They tend to have minimal exposure to real estate and construction loans, preferring to lend money to businesses, corporations, and individuals with sound credit histories.

"None are big players in construction lending, which has been a disaster," says Mark Fitzgibbon, Sandler O'Neill's director of research who oversaw the Scorecard's compilation. "Commercial and industrial lending is the bread and butter of these banks," he adds.

Consider the Scorecard's six-point criteria as it pertains to Glacier Bancorp, ranked No. 1 this year. With $5.0 billion in second-quarter 2008 assets, Glacier Bancorp, which is headquartered in scenic Kalispell, Montana, operates as a multibank holding company with 94 branches west of the Rockies (but east of Washington state's Cascade Mountains) in the states of Idaho, Montana, Utah, Washington, and Wyoming.

The first two measurement criteria on the Scorecard—return on average assets (ROAA) and return on average equity (ROAE)—are based on publicly available data calculations for the third and fourth quarters of 2007 and the first two quarters of 2008. Over this period of four linked quarters, Glacier's 1.49% ROAA ranked ninth, while its 13.48% ROAE ranked 21st. (On the theory that profitability is the most important performance criteria for a public company, ROAA and ROAE have been given a greater weight than the other four metrics in the Scorecard's final calculation.)

Next up are two capital adequacy metrics. Capital adequacy includes both the Tier 1 capital ratio and the leverage capital ratio at the close of second quarter 2008. Glacier's Tier 1 capital ratio stood at 12.26%, ranking it 28th; its leverage capital ratio of 10.74% ranked 10th.

THE TOP 150 PERFORMERS

				Profitability				Capital Adequacy				Asset Quality				
Rank	Company Name	State	Total Assets ($000)	Core ROAA (%)	ROA Rank	Core ROAE (%)	ROE Rank	Tier 1 Ratio (%)	Tier 1 Rank	Leverage Ratio (%)	Leverage Rank	NPAs/ Loans & OREO (%)	NPA Rank	Reserves/ Loans (%)	Reserve Rank	Final Score
1	Glacier Bancorp	MT	5,027,868	1.49	9	13.48	21	12.26	28	10.74	10	0.68	38	1.59	43	89.5
2	First Financial Bankshrs	TX	3,084,665	1.72	3	15.35	13	15.25	15	9.55	26	0.71	40	1.23	92	102.5
3	SVB Financial Group	CA	7,309,87	1.68	4	16.25	7	10.43	64	10.72	11	0.22	5	1.14	106	104
4	Bank of Hawaii Corp.	HI	10,371,149	1.67	5	23.24	1	10.91	48	7.04	131	0.10	2	1.57	45	119
5	Westamerica Bancorp.	CA	4,188,868	2.03	1	22.60	2	10.22	67	7.06	130	0.52	24	2.10	22	124.5
6	Capital One Financial Corp.	VA	151,114,271	1.47	11	8.96	62	11.28	38	9.44	28	0.68	38	3.41	6	128
7	Commerce Bancshares	MO	17,018,463	1.27	16	13.31	22	10.65	53	9.03	35	0.32	11	1.27	85	130

Calculating the Scorecard

The *Bank Director* Bank Performance Scorecard is comprised of six performance categories that measure profitability, capitalization, and asset quality. The categories are:

Return on average assets, which measures a bank's profitability relative to its total assets. This metric was given a full weighting in the Scorecard calculation and was based data from four linked quarters—the third and fourth quarters of 2007 and first and second quarters of 2008.

Return on average equity provides a second measurement of profitability—this one focusing on shareholder returns. This metric also received a full weighting and was based on the same four linked quarters of data.

Tier 1 capital ratio, which is defined as shareholders equity, retained earnings and convertible preferred stock divided by risk-adjusted assets. This received a half weighting.

Leverage ratio, which is Tier 1 capital divided by total average equity. This received a half weighting.

Nonperforming asset ratio, or the ratio of nonperforming loans and foreclosed assets to total loans and other real estate owned. This received a half weighting.

Reserve coverage, which is the institution's loan loss reserve divided by total loans. This received a half weighting.

The final four metrics were based on period ending data for the second quarter of 2008.

The 150 banks and thrifts in this year's Scorecard received a numerical rating in each individual category, with the highest-ranked institution in each category receiving a score of one and the lowest ranked institution getting a score of 150. These six category scores were then added across, and the institution with the lowest score received the highest ranking overall.

In the event that two or more institutions received the same final score, ties were broken by awarding the highest finish to the institution with the highest ROAE.

Sandler O'Neill & Partners L.P., a New York-based investment banking firm, helped *Bank Director* devise the Bank Performance Scorecard formula and performed the calculations.

Finally, two metrics measure asset quality at the financial institutions. The first is the ratio of nonperforming assets (NPAs) to total loans and "other real estate owned," or OREO, a category in which Glacier ranked 38th with 0.68%. The second asset-quality metric is the percentage of loan loss reserves to total loans: Glacier ranked 43rd with 1.59%.

Thus, while Glacier does not score higher than ninth in any single category, it ultimately ranks highest overall by keeping on an even keel across several metrics. That makes it "one of the best banking franchises in the country," says Sandler O'Neill research analyst Brad Milsaps. Adds Fitzgibbon, his colleague at Sandler O'Neill: "The moral of the story is that you don't have to shoot the lights out to score well in the survey. You just have to do a good job in every category and be in the upper half of the companies on each list."

Glacier, for its part, has grown both organically and by acquisition, adding 17 banks since 1988. After entering the Glacier Bank fold, however, most acquired banks continue to operate autonomously while retaining their homegrown brand names. In sharp contrast to mass firings endemic to big bank mergers, the same management teams and employees continue on as before.

Changes are subtle, internal ones: loan levels increase and data processing is centralized. In addition, each of Glacier's member banks maintains its own board of directors. The local bank directors, asserts Glacier's president and chief executive Michael Blodnick, constitute "a full-blown board that is not just advisory and focuses on markets, services, and the types of lending they do."

First Financial Bankshares, an Abilene-based bank holding company with $3.1 billion in assets, debuts on the list at No. 2 after crossing the $3 billion eligibility threshold in the second quarter of 2008. While it's not a clone of Glacier, the Texas bank's president and chief executive Scott Dueser admits to adopting a number of Glacier's best practices. "We've compared notes," Dueser says.

Most obviously, the Texas and Montana banks share the community banking model. In addition to maintaining a local identity, First Financial's family of banks hold roughly 40% to 50% of the market share in such West Texas communities as Sweetwater, San Angelo, Stephenville, and Weatherford, notes Bain Slack, an Atlanta-based bank analyst at Keefe, Bruyette & Woods.

Hewing to the community banking model means veteran bankers know their customers and detect problems early on. And their dominant market share in the bank's footprint means loan pricing is advantageous: Slack reports that at the end of third quarter 2008, First Financial sported a net-interest margin of 473 basis points, compared with an average of 395 basis points for Texas banks overall. "They don't have to fight for pricing like bankers in the Dallas and Houston markets," Slack says.

In addition, the West Texas economy is strong. Agricultural prices in wheat and corn have been robust for a few years now; higher oil and natural gas prices, although slipping of late, have meant that drilling rigs continue to be deployed throughout the region, spurring job creation. West Texas is also capitalizing on wind energy and windmill manufacturing. And such staples as military bases and defense spending provide additional ballast to the regional economy.

Ranked third on the Scorecard is SVB Financial Group. Based in Santa Clara, California, it is the holding company for financial services firms that include $7.0 billion Silicon Valley Bank. In addition to operating 27 U.S. branches, SVB has offices in China, India, Israel, and the United Kingdom. While best-known for serving entrepreneurs and working in tandem with venture capitalists in the high-technology and life sciences industries, SVB Financial also lends to private equity financiers and vintners in California's premium wine industry.

Marc Verissimo, chief strategy officer at SVB, is a battle-scarred veteran of California's banking scene, having worked in the trenches at Bank of America and First Interstate Bank (now part of Wells Fargo). He reports that SVB pulled its excess cash—as well as its clients' investments—out of auction rate securities probably four years ago. The bank, meanwhile, has skirted the subprime mortgage crisis and avoided construction loans. "We don't deal with developers," he says.

SVB, which made it through the technology bust earlier in the decade in surprisingly good shape, is actually benefiting from the travails of less-circumspect competitors. "We're seeing a lot of very good opportunities coming our way with so many others in trouble," Verissimo says. "We can afford to be choosy."

One of the bank's strengths, he adds, is a board of directors that is engaged and independent as well as talented and experienced. Among its membership are former CEOs at technology companies, winery owners, audit and consulting professionals, and even international business executives with experience in India and China. "If everyone had a board like ours," insists Verissimo, "no one would be having trouble right now."

Honolulu-based Bank of Hawaii, No. 4 on the Scorecard, has $10.4 billion in assets, making it the largest in asset size of the top five financial institutions. Its impressive 23.24% ROAE is the highest of any large bank or thrift during the four-quarter analysis period. "They are a much more traditional bank with a good mix of commercial and retail customers," says Aaron Deer, a San Francisco-based research analyst at Sandler O'Neill, who follows western banks. "They're well rounded and they've avoided a lot of the pitfalls that many other banks have stepped into."

Deer says that the Hawaiian economy, which prospers from tourism, defense spending, and economic ties to Japan, has been strong. Even so, challenges loom. He cites a 17% decline in tourism so far this year and the bankruptcy of Aloha Airlines, which shut down passenger service in March after falling victim to fare wars and soaring fuel costs.

Westamerica Bancorp., a $4.2 billion financial institution based in San Rafael, California, rounds out the top five. The operator of 86 branches and two trust offices throughout northern and central California, it chalked up a 2.03% ROAA, the best in show. It's also the only bank or thrift on the list to break through the 2% ceiling in ROAA this year. "Westamerica, probably more than any other bank in the country, is extremely risk averse," says Deer. "And that is paying off in spades.

"When a lot of banks were growing their balance sheets like gangbusters, Westamerica's balance sheet was 'steady-as-she goes'," he adds. "They focused on profitability and maintaining efficiency and good core deposit relationships. They were criticized for that at investor meetings, but now they look brilliant."

The two biggest institutions in the top 10 are both specialty banks. Capital One, ranked as the No. 6 bank by the Scorecard, has $151.1 billion in assets. It relies on its credit card business for about 80% of its net income, notes Michael Taiano, a senior analyst at Sandler O'Neill. Capital One has bellied up to the commercial banking bar with acquisitions in recent years of Hibernia Bank in New Orleans and North Fork, a Long Island, New York bank, the deposits of which provide low-cost capital. But with unemployment rates rising and its credit card lending unsecured, "it's facing a challenging 2009," says Taiano.

State Street Corp., a $146.2 billion specialty bank headquartered in Boston, ranks No. 9 and remains in a class by itself. It recorded a nearly negligible .02% in nonperforming asset loans, the top score in that metric. With far-flung offices across the globe from London and Paris to Hong Kong, Seoul, and Tokyo, State Street's focus is providing services to institutional investors and investment managers. "It has deep expertise in those areas, which allows it to grow very effectively," says Charles Wendel, president of Financial Institutions Consulting in New York.

The perilous global economy, however, could whipsaw any bank on the list, no matter how smartly managed. Last year's No. 1 bank, $4.2 billion Frontier Financial Corp., headquartered in Everett, Washington, fell to No. 16 on the Scorecard this year. Jeff Rulis, a Lake Oswego, Oregon-based research analyst at D.A. Davidson, notes that a disproportionate share of Frontier's loan portfolio is centered on construction and land development. On the Scorecard, its NPA ranked 129th and, Rulis notes, the situation was getting more dire by the end of third quarter 2008: NPAs had deteriorated to 4.92%, compared with a 2.36% median at 37 western banks he follows.

Wells Fargo & Co., the $609 billion bank headquartered in San Francisco, ranks No. 35 on the Scorecard, making it the Scorecard's best ranked megabank. Wells Fargo will not only have its hands full, but also its stomach as it prepares to digest $812 billion Wachovia Corp. Ranked No. 147—fourth from the bottom on the Scorecard—poorly performing Wachovia has been operating in negative territory, mustering a -0.91% ROAA and -9.18% ROAE.

What bears watching is whether Wells Fargo can more than double in size, yet somehow maintain the operational strategy that has made it so successful. Despite its big-bank size, says Sandler O'Neill's Deer, "Wells Fargo is the country's best community bank."

Compare that observation with the management philosophy at gargantuan Citigroup, the world's biggest bank with $2.1 trillion, which is smarting after being jilted in its bid for Wachovia. Ranked No. 132 on the Scorecard, Citigroup was positioned well toward the bottom, including dead last at 150th in the leverage ratio metric at 5.04%.

Not coincidentally, Citigroup's operating philosophy—as advanced by the recently departed former chief executive Charles O. Prince III—sounds almost Pied Piperish. "When the music stops, in terms of liquidity," he famously told the *Financial Times* on July 10, 2007, "things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing."

That's a sharp contrast from the logic employed by this year's top-ranked banks. They danced to the beat of a different drummer. **|BD|**

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