Bank Holding
Company Association

First Quarter, 2011

Newsletter

Volume 26, No. 1

By Alan Smith

Get Disciplined: Maximize Loan Yields

Many factors are out of a bank's control, but loan pricing is one area that an institution can command. A strategic, disciplined approach can help your bank maximize loan yields. It is time to revisit your credit pricing procedures to see if your bank is being adequately compensated for loan risk and higher costs of funding. It takes examining all facets of your pricing policies and implementing best practices.

Ask the right questions to understand your loan production practices:

Does the current process give the loan officer the final authority and the prerogative to price loans and credit lines, or does that reside elsewhere? At what levels of exposure does that authority extend ($10K, $100K), and what pricing committee structure is in place after those levels of exposure?

What is your negotiating strategy when rates are objected to and has the loan officer been trained on that strategy?

Is there a process in place to evaluate returns on each loan based on the recommended pricing? Do you calculate an estimated return on assets and return on equity on larger commercial credit lines, and does that evaluation incorporate a value for deposits? Does the recommended pricing achieve your bank's financial goals?

Do you differentiate pricing strategy and processes for consumer loans and lines of credit and commercial lines of credit?

How does the bank's loan yield performance compare to other institutions with similar loans and portfolios?

Apply best practices

Armed with an understanding of how you are making commercial and consumer loans today, you'll be able to identify opportunities to improve your pricing practices and profitability. Take a page from the playbook of the high performers. They have the following practices and processes in place to maximize return on both consumer and commercial loans.

Price the relationship—Consider the value of the borrower to your institution by remembering that a relationship encompasses much more than money. However, be willing to say no when the risk is too high.

Treat consumer and commercial credits differently—Use distinct pricing tools because there is a significant difference in the revenue and profitability generated from consumer loans and commercial loans. For commercial credit lines, use 360-day accruals instead of 365 days and periodically check your commercial portfolio to ensure that commercial accruals are set correctly.

Deploy fractional pricing—If you determine that the majority of loans in your portfolio are priced at standard intervals of 25/50/75 basis points you should consider other rate structures. Charging non-standard basis points that are five to 10 points higher may not compromise your ability to book business and can significantly add to the profitability of your institution.

Structure loan agreements to protect profit-

Maximizing Loan Yields, *Continued on page 4*

Alan Smith, Senior Bank Strategist for Fiserv Bank Intelligence, is scheduled to speak at the BHCA Spring Seminar, May 2-3, in Bloomington, Minn. He can be reached at alan.smith@fiserv.com. Fiserv is a BHCA Associate Member.

President's Column

Douglas L. Jilek
Prairie Bancshares, Inc.
Lester Prairie, Minn.

There's no better time to become a BHCA member

I have always enjoyed being a member of the Bank Holding Company Association because of its great seminars. Plus, it is the only group that specifically offers education designed for bank owners. BHCA dues are modest, so the value is extraordinary. I always feel that I get more than my money's worth from the seminars and the networking that goes with them.

I want to share with you some of the comments that my board colleagues have about BHCA membership:

"We chose to join BHCA in about 1990, shortly after we formed a new holding company… We were new at the process and thought that joining BHCA would be a great educational experience. Since that time, several of us have managed to attend nearly every seminar," said Gary Paulson of First Holding Company in Park River, N.D.

"Ideas we implemented from the seminars include mandatory retirement of both bank and holding company directors, general director responsibilities, audit and compliance committee ideas, and excellent presentations by economists over the years to assist us in funds management. And, of course, there is always the exchange of ideas with fellow bankers."

Here is what Steve Wilcox said: "The Bank Holding Company is an association of like-minded community bank ownership professionals which presents a forum for discussion of similar interests as well as providing a venue for industry sensitive information, education, and dialogue." Wilcox, who was BHCA president for the last two years, is chairman of Wilcox Bancshares in Grand Rapids, Minn.

Charles Robasse of Wabasso Bancshares, in Wabasso, Minn., said: "The semi-annual seminars conducted by the BHCA have consistently provided me with thoughtful advice on timely topics. It's also a great place to visit with old friends and make new ones. Definitely a 'must attend' event!"

I invite you to go to our web site and read what other BHCA members are saying about the association. The address for our new web site is www.theBHCA.org. You probably have your own reasons for belonging to the BHCA. Thank you very much for your membership.

Now let me make a request. I want to encourage you to invite someone from another bank holding company to join our association. There are many holding companies in the Upper Midwest that are not members. We can make our association even better by building up our membership. It is easier than ever, now that you can refer potential members to our web site which lists the benefits of membership. Please make it a point to invite someone from another bank holding company to join within the next few months.

Thank you very much for your support. I look forward to seeing you at the Spring Seminar. ■

BHCA website offers new services

The Bank Holding Company Association now has its own website. Take a look at: www.theBHCA.org.

The website offers seminar details and the opportunity to register online. From the new website, you can choose to download our standard registration form, fill it out and mail it by traditional mail, or you can register electronically and pay with a credit card.

The website has a "members only" section. Once logged on, members can access the BHCA directory. You will still receive a printed directory once a year, but now, you can go to the website anytime for the most up-to-date list of BHCA members and associate members. Our online directory even gives you the opportunity to edit your own profile.

The members only section also includes an archive of previously published editions of this newsletter. Want to reread an article that appeared in one of our issues last year? Just log in and select the edition you want to read. ■

Welcome New Members

The Bank Holding Company Association is pleased and honored to welcome the following new members who have joined our Association during 2011:

Reid Everson, President/CEO
Tradition Bancshares, Inc.

Julie Causey, Chairman
John T. Gill, Senior Vice President, CFO
Western Bancshares, Inc., Saint. Paul, Minn.

The BHCA Newsletter is published quarterly by the Bank Holding Company Association for its members. To submit an article, please contact BHCA Managing Director Tom Bengtson at 952-835-2248 or 1-800-813-4754. FAX: 952-835-2295, e-mail: info@thebhca.org.

Director's Column

By Tom Bengtson
Managing Director

Supercharge your bank with Spring Seminar

I consider it a privilege to serve you, the members of the Bank Holding Company Association, in the wake of Dennie Emman's retirement. I look forward to planning compelling seminars, producing useful newsletters, growing membership and otherwise working to promote the BHCA on your behalf for years to come.

This is a particularly opportune time to grow the BHCA; given the significant changes on the horizon for the industry, there has never been a more important time to bring bank owners together from across the Upper Midwest. If we preserve the best of the BHCA's historical offerings and add a few new features, the association will thrive well into the future.

Planning already is underway for the Spring Seminar, themed "Supercharge Your Bank." Mark your calendars for Monday and Tuesday, May 2-3 for the seminar, which takes place at the Minneapolis Airport Marriott Hotel in Bloomington, Minn. The format resembles past seminars, although we have added a feature on Tuesday evening.

Bryan Dodge, a highly sought-after speaker will inform, motivate and entertain with his presentations on getting the most out of life and "The Power of Coaching Up." Dodge will address our group after dinner on Monday, and he will open our day on Tuesday. Alan Smith, a former banker and now senior strategist for Bank Intelligence Solutions, will present "Strategic Ideas for Growth – Revenue and Assets" on Tuesday morning. He will offer concrete ideas, based on his firm's interaction with hundreds of bank clients all over the country.

The luncheon program on Tuesday features former Minnesota House of Representatives Speaker, Steve Sviggum, who will offer his thoughts on state government. He will comment on the budget battles taking place across the country, particularly in Minnesota and Wisconsin. As a former legislator, Sviggum is in unique position to comment on the current state of affairs.

Then we will go to Washington, D.C., via satellite hookup for a Capitol Hill report from Steve Verdier, executive vice president of congressional relations for the Independent Community Bankers of America. Community bankers from all over the country will be in Washington, D.C., visiting with their lawmakers the first week of May, and Verdier will give us a first-hand account of the industry issues and priorities.

Our program concludes with a presentation from economist Chris Kuehl, managing director of Armada Corporate Intelligence of Kansas City, Kan. He will provide an analysis of the current economic conditions and offer insight as to what we might expect in the months to come.

The seminar also offers breakout sessions on topics such as the merger and acquisition environment, commercial real estate loan recovery, a regulatory update, and a look at insurance trends affecting bank officers and directors.

***Director's Column**, Continued on page 4*

Maximize Loan Yields

Continued from page 1

ability—Loan agreement covenants — for example, minimum net worth or profitability — can allow you to change pricing if borrower performance declines.

Utilize rate floors wisely—Whether at inception and/or at renewal, consider how the percentage of credit lines with floors will increase over time and how that will impact your bottom line as interest rates change.

Establish a policy for prepayment penalties—As rates decrease, borrowers frequently refinance with other institutions and pay off their loans before the end of the term; this leaves your institution with the obligation to repay your own borrowed funds at a higher-than-market rate without a matched asset generating revenue to offset your cost. To mitigate potential loss due to prepayment, implement penalties that will cover your costs. However, when commercial borrowers want to prepay their fixed-rate debt with cash flows from their businesses and not refinance loans from your competitors, consider waiving prepayment fees to strengthen the relationships.

Monitor late charge amounts and waivers—Many commercial late charge policies were established several years ago and minimum penalty amounts need to be revised upward. Further, waiver rates need to be monitored to insure that the bank is being compensated for the additional risk and administrative burden that is associated with the late payment.

Track profitability by loan officer—Monitor and report on loan spreads (performance) by loan officer and establish specific incentives that will ensure that the loan officer is working primarily for the bank and not the borrower.

Compare your bank to your peers—It's absolutely crucial that you know how your loan yield performance stacks up against banks with similar loan products and portfolios.

In building your bank's business, few processes are more important than the procedures and tactics deployed to manage loan pricing. Take a more calculated approach—with greater discipline, and your institution can progress towards maximizing returns on its loan portfolio. ■

Director's Column

Continued from page 3

I am particularly pleased to announce three new seminar features.

The first is a discounted registration rate for directors of member institutions. Your outside directors can attend the Monday evening program and/or the Tuesday program at a significant discount. So don't come to the seminar alone. Bring your directors; they will absolutely benefit from the education and networking that only a BHCA seminar can offer.

Second, the BHCA now offers online seminar registration. Simply go to the association's new web site at www.theBHCA.org. You may choose to pay with a credit card, or to receive an invoice whereby you can pay with a check. Either way, online registration is easy and efficient. Or if you prefer, you may register by mail as in the past.

And third, we have added an optional social event on Tuesday evening. The BHCA is sponsoring a night at the Guthrie Theater to view a performance of the hilarious classic play, Arsenic and Old Lace. The outing includes roundtrip coach transportation from the Minneapolis Airport Marriott Hotel to the Guthrie Theatre in downtown Minneapolis, a private back-stage tour, dinner and the show. If you are coming to the seminar from out of town, I highly encourage you to bring your spouse, stay an extra night and enjoy this evening out with your peers in the BHCA.

At the BHCA, we are doing everything we can to make the Spring seminar your best two days in banking! I look forward to seeing you there.

I have had the opportunity to visit with Dennie Emmans on the phone frequently since the first of the year, and he asked that I pass along his gratitude for the outpouring of support he has received. He says "thanks" for the many cards and notes that you have sent, and he appreciates the thoughts and prayers. He said that he is regaining his strength and feeling better. If you would like to send Dennie a note, use his email at wdebhca@aol.com. ■

***BHC News**,*

Continued from page 8

Fidelity Holding Company, Minnetonka, Minn., and thereby gain control of Fidelity Bank, Edina.

✓ Gregory R. Raymo, Worthington, Minn., individually and as a proposed co-trustee of the First State Bank Southwest 2010 Amended and Restated KSOP Plan and trust, filed to acquire 25 percent or more of First Rushmore Bancorporation, Inc., Worthington, and thereby gain control of First State Bank Southwest, Pipestone, Minn.

✓ Karl J. Breyer, Minneapolis, filed to acquire 10 percent or more of First Advantage Bancshares, Inc., Coon Rapids, Minn., and thereby gain control of First Advantage Bank, Coon Rapids. In addition, notice filed by Richard M. Ihrig, and Colleen J. Cooper, both of Minneapolis, to jointly acquire 10 percent or more of First Advantage Bancshares, Inc., Coon Rapids, and thereby gain control of First Advantage Bank. ■

Supercharge your bank!

The Bank Holding Company Association Spring Seminar is set for Monday and Tuesday, May 2-3, 2011 at the Minneapolis Airport Marriott Hotel in Bloomington, Minn.

Supercharge your bank at the BHCA Spring Seminar…It's THE industry event of the season.

Bring:
YOUR DIRECTORS. Directors of member institutions get a special discounted rate on seminar registration

BUSINESS CARDS. BHCA seminars are known for the best industry networking available. Meet other bank owners throughout the Upper Midwest.

YOUR SPOUSE. The Seminar hotel is located across the street from the world famous Mall of America. Plus, a special Tuesday evening event is planned for dinner and a show at the Guthrie Theater.

Register online at

www.theBHCA.org

or call 1-800-813-4754

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LINDQUIST & VENNUM

McGladrey

New in 2011!

SPECIAL EVENT

Arsenic and Old Lace…Stay for a special á la carte event on Tuesday, May 3. Join your colleagues in the BHCA for a backstage tour, dinner and a show at the Guthrie Theater in downtown Minneapolis. If you are coming in from out of town, bring your spouse, stay an extra night, and make the most of your seminar trip with this unique social outing.

REGISTRATION FEES:

Members and guests:
Monday evening…$75
Tuesday seminar…$225

Directors from member institutions:
Monday evening…$50
Tuesday seminar..$125

Non-members:
Monday evening…$125
Tuesday seminar…$325

Tuesday evening at the Guthrie
(includes transportation, backstage tour, dinner and show ticket)…$125

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Call to reserve your hotel room before April 11 to get your discounted room rate.

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952-835-2248 or 800-813-4754

Let our educational line-up supercharge your bank!

You will hear from:

▷ **Bryan Dodge**, one of the nation's most sought-after speakers, will share time-proven leadership principles. His energetic presentations May 2 and May 3 will inform, challenge and entertain.

▷ **Alan Smith** of Bank Intelligence Solutions will offer strategic ideas for growing both revenues and assets.

▷ **Steve Sviggum**, former Speaker of the House of Representatives in the Minnesota legislature, will offer insight into state government.

▷ **Steve Verdier,** executive vice president of Congressional relations for the Independent Community Bankers of America, will report live via satellite hookup from the ICBA Spring meetings in Washington, D.C.

▷ **Chris Kuehl,** managing director of Armada Corporate Intelligence, will provide an economist's assessment of the business landscape.

▷ Plus much more, including breakout sessions on mergers and acquisitions, regulatory trends and more.

BHCA

A strong 2010, sort of...

Earnings continue to improve, but community banks still face challenges

By Ben Crabtree

For a year that certainly was a challenge for the banking industry, 2010 did show some encouraging trends, scoring substantial year-over-year gains in a host of performance measures.

The fourth quarter of 2010 was no exception; as the FDIC's recently-released Quarterly Banking Profile noted, the industry reported its sixth consecutive quarter of year-over-year earnings increases. Specifically, industry profits were $21.7 billion in the fourth quarter, a very positive comparison with the $1.8 billion loss of the previous year's final quarter. The headlines from the FDIC report were indeed pretty positive.

So we are pretty clearly out of the woods as regards to the recent bad times for bank earnings, and except for the unlikely occurrence of a double dip in the economy, we should see further improvements in the industry's health in 2011 and beyond. Nevertheless, the positive picture is a bit muted. For one thing, there was minimal upward momentum after mid-year; if this relative flatness continues, the year-over-year earnings gains will soon become much more modest. In addition, there is a high likelihood of a double dip in residential real estate values for 2011, which could impact a wide variety of community banks.

Secondly, the earnings gains are not being driven by growth in loans or net interest income, but by lower credit costs. While lower credit costs are certainly a welcome development, we would argue that this trend is probably not sustainable for too many more quarters; we note that the reduced loan loss provisions are not being accompanied by equivalent reductions in nonperforming loans and assets, and this should put some sort of limit on how much lower loan loss provisions can be taken. And a relatively flat trend in loan loss provisions would mean that earnings gains would be largely dependent upon revenue growth, which will be very hard to achieve unless we see renewed vigor in the recent sluggish trends in loan growth.

And finally, the FDIC noted that the number of problem banks continued to climb in the quarter, from 860 to 884. Note that this represents 11.5 percent of the population of U.S. banks, up from 11.2 percent at the end of September. So in sum, while the fourth quarter results were certainly not bad news, the underlying momentum wasn't as encouraging as might have first appeared.

A tale of two segments

Unfortunately, the industry's improved results were not evenly shared within industry segments. Even though we continue to argue that community banking is in many ways a better business model than that of the super-large, money center-type banks, this has not been evident in the recent results of the industry.

Large banks have shown greater (and continuing) improvement in their nonperforming asset ratios, allowing them to show ongoing reductions in charge-offs and the loan loss provision burden, while the smaller bank segments have essentially shown no gains in charge-off or NPA ratios since the middle of last year. This, plus the fact that the big banks generate significantly more noninterest income on a relative basis and have substantially lower efficiency ratios, goes a long way toward explaining their superior profitability as measured by return on assets. Unfortunately for the smaller banks, their substantially higher weightings of commercial real estate loans suggests that further reductions in credit costs are likely to come fairly slowly, and their laggard profitability may persist for a while. In other words, the bank industry as a whole may have a hard time generating vigorous earnings growth, and smaller banks may be even more challenged.

Such expectations may explain why bank stocks, and especially smaller bank stocks, have lagged behind the broad market for the past several months.

Bank valuations

Given the previous discussion about the relative prospects for big banks and smaller banks, it is not too surprising that the equity valuations of the big banks are higher than those of the smaller banks.

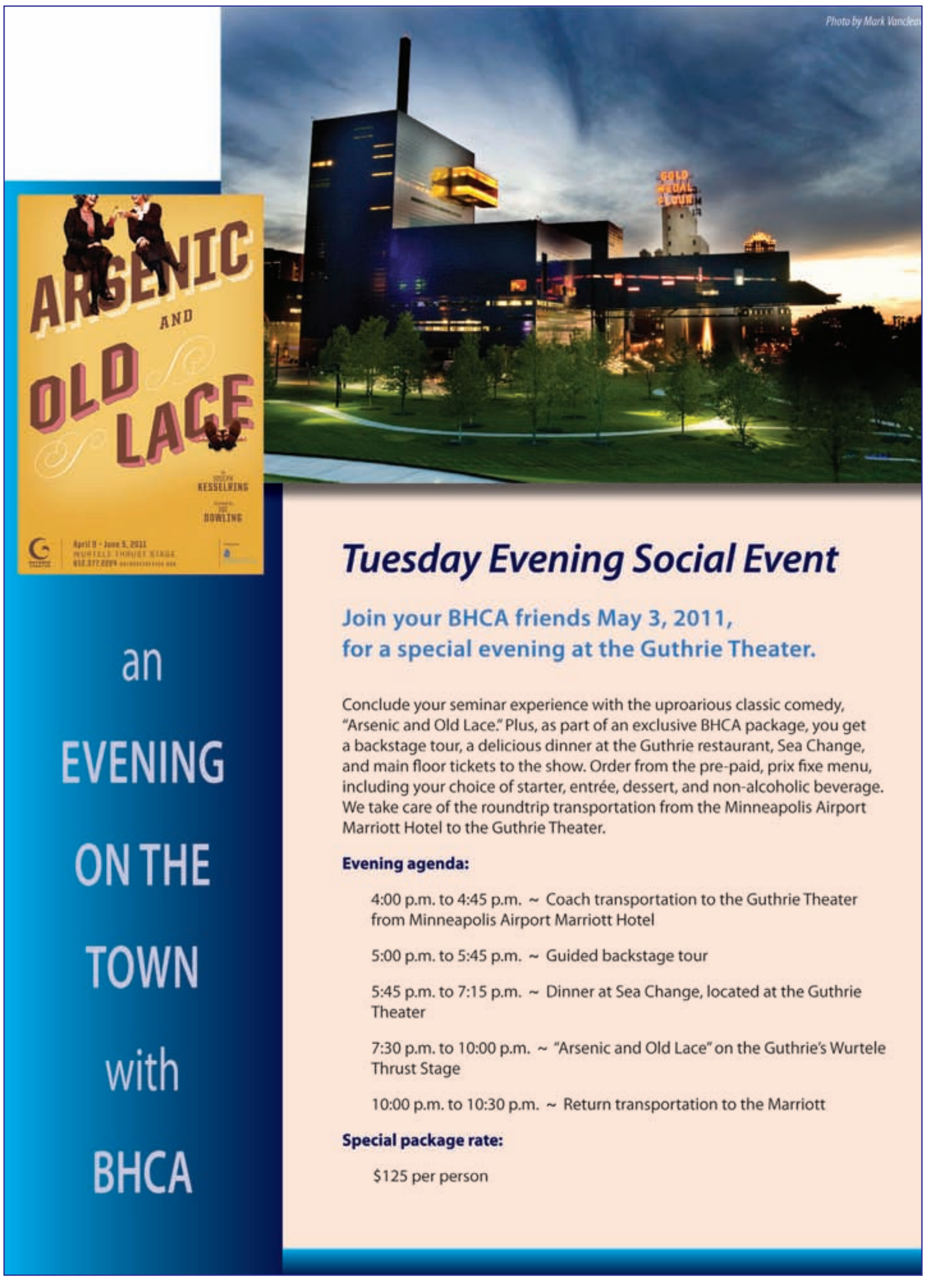
In fact, there is a quite linear relationship between asset size and the valuation (as measured by price/book) that the market is placing on bank stocks. For example, banks with assets between $500 million and $5 billion are trading at about 95 percent of tangible book value; publicly-held banks between $250 million and $500 million of assets are trading at about 73 percent of tangible book value per share; and banks with assets under $250 million are trading at about 65 percent of tangible book value per share.

We suspect that the market's preference for bigger rather than smaller banks reflects more than relative profitability. In our experience, a significant percentage of investors see the primary investment appeal of banks as being their acquisition potential, and it seems as though there might not be a lot of acquirer interest in the small end of the banking spectrum at the present time. The large banks tend to view small acquisitions as being too much work for limited benefit, and (unlike previous decades) there is a relative paucity of mid-sized banks (say, $5 billion to $20 billion in assets) that are positioned with the capital and experience necessary to play the role of consolidators.

But as the old cliché says, there is probably an opportunity hidden within every problem, and extreme movements of investor psychology usually create attractive investment opportunities. In this case, the fact that the smaller banks are, as a class, clearly unloved and ignored should suggest that many of them are significantly undervalued on a longer-term basis. With the median smaller bank trading at a discount to tangible book value, and that book value having typically been scrubbed down by a series of asset write-downs driven by tough regulatory exams and more pessimistic (realistic) attitudes on the part of bank managements, it is hard not to conclude that the category of small banks (for example, the group between $500 million and $5 billion of assets referenced above) contains a significant number of very undervalued franchises.

Of course, it would take time, effort and thought to pick out those with good managements, attractive franchises, and healthy business models (focused strategies, solid deposit bases, high quality and balanced loan portfolios), and a full pay-off would probably not occur until the economy moves onto firmer ground and a new group of mid-sized consolidators emerges, but we suspect that it is most likely a pretty good time for investors to sift through this smaller-bank group in search of exceptionally attractive long-term investments. ■

Ben Crabtree is senior advisor at Oak Ridge Financial, Golden Valley, Minn. This essay was adapted from the Oak Ridge Financial February newsletter. Oak Ridge Financial is an Associate Member of the BHCA.



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Bank Holding Company News

Following is a partial report of recent bank holding company filings with the Federal Reserve Bank of Minneapolis:

✓ Robert Karl Kamp, Manhattan, Mont., has filed a change in control notice to retain control of Inter-Mountain Bancorp, Inc., Bozeman, Mont.., and thereby retain control of First Security Bank, Bozeman.

✓ Cara Mulder, Prinsburg, Minn., filed notice to join a group acting in concert with Myron Mulder, Prinsburg, to acquire and retain control of PSB Financial Shares, Inc., Prinsburg, and thereby acquire and retain control of Prinsbank, Prinsburg.

Western State Agency, Inc., ESOP and Trust, Devils Lake, N.D, filed to become a bank holding company by acquiring more than 25 percent of Western State Agency, Devils Lake, and thereby indirectly acquire Western State Bank, Devils Lake.

✓ John D. Connolly, Danvers, Minn., filed a change in control notice to acquire and retain 25 percent or more of West 12 Bancorporation, Inc., Danvers, and thereby acquire and retain control of State Bank of Danvers.

✓ Noah W. Wilcox, Grand Rapids, Minn., filed notice as an individual and as trustee of the Noah W. Wilcox Trust, Grand Rapids, to acquire 25 percent or more of Wilcox Bancshares, Grand Rapids, and thereby control Grand Rapids State Bank. Additionally, the Noah W. Wilcox Trust, trustees Noah W. Wilcox and Dorsey & Whitney Trust Company LLC, Sioux Falls, S.D., will acquire 10 percent or more of Wilcox Bancshares, and thus join the Wilcox Family Group, and thereby control Grand Rapids State Bank.

✓ Jorgenson Williston Holding Company, Kenmare, N.D., filed to become a bank holding company by acquiring First National Bank & Trust Company of Williston, N.D.

✓ Retroactive notice filed by Russell James Gesell, Saint Paul, Minn., individually, and as co-trustee of the Charles R. Gesell Irrevocable Trust, Saint Paul, and the Peter J. Gesell Irrevocable Trust, Saint Paul, to retain 25 percent or more of Cherokee Bancshares, Inc., Saint Paul, and thereby retain control of BankCherokee, Saint Paul.

✓ Russell Craig Flom, Edina, Minn., filed a change in control notice to gain control of

***BHC News**, Continued on page 4*