

# **Director Series: Risk & Capital in Strategic Planning**

*Presented By:*

**Gary J. Young**



**VIRGINIA BANKERS  
ASSOCIATION**

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## Presenter: Gary J. Young



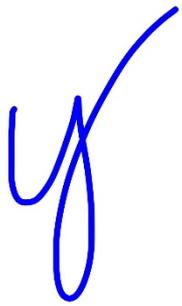
Gary J. Young is founded and was the Chief Executive Officer of Young & Associates, Inc. for over 40 years. He has assisted hundreds of community banks from coast-to-coast with improving shareholder value and profit, establishing effective strategic plans, assisting banks through regulatory concerns, as well as budgeting, asset/liability management, expansion planning, and mergers and acquisitions. He remains a student of the industry and is a popular speaker with bankers for his practical and valuable insight. He has conducted seminars throughout the United States and in Europe.

Gary participated in the purchase of the National Bank of St. Anne, and is a member of that bank's board of directors. In addition, he was the co-founder of Capital Market Securities, Inc., which assists community banks with mergers and acquisitions, and is one of four on the Investment Community for a fund of bank stocks.



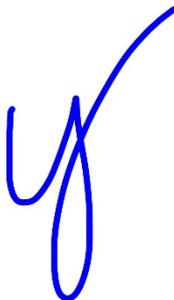
# Overview

- Issues to Discuss
  - Profitability
  - Shareholder Value
  - Capital Adequacy



# Overview

- 2020 – Like no other
  - COVID-19, but not all
  - VIRGINIA BANKS IN 2020
    - Asset growth 18.5% vs. 8.1% average last 4 years
    - Loan growth 12.6% vs. 8.9% average last 4 years
    - Loan/asset ratio 68.1% in 2020; 71.1% in 2019
    - Tier-1 leverage ratio 10.5% in 2020; 11.6% in 2019



# Overview

- 2021 – Return to Normal?
- Hard to know what normal is
  - Deposit surge continues
  - 2<sup>nd</sup> PPP
  - Sale of RE loans strong, but slowing
  - Rapid asset growth pressures tier-1 leverage ratio
  - Some will see net profit fall slightly in 2021
  - Profit falling more in 2022

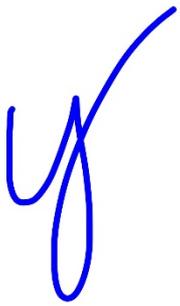


# Profitability

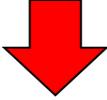
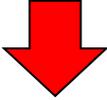
- What to expect in 2021-2022

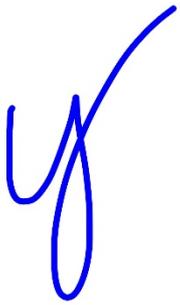
- Net interest margin

- Rates  Margin  (most VA banks)
      - 20 year bond  68 bp. Y-T-D (4.15.21)
      - Short rates no change until mid-2022 at the earliest
    - Liquidity high – Pressure to increase loans – Lower loan rates – Margin 
    - Liquidity high – Less need for deposits – Lower deposit rates, repay high cost funding sources – Margin 



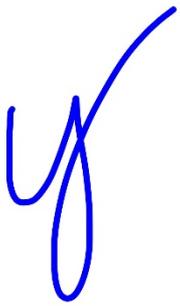
# Profitability (con't)

- Non-interest income 
  - PPP
    - 2<sup>nd</sup> round less than 1<sup>st</sup>?
    - Eliminated in 2022
  - Gain on sale of real estate loans
    - Refinancing  as rates 
    - Most have already refinanced
    - Housing market effected slightly

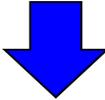


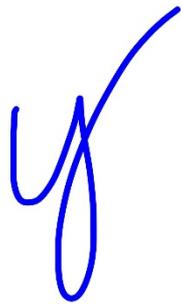
# Profitability (con't)

- Overhead
  - \$ Amount normal increase
  - Non-interest expense/assets
    - 2.85% 2020 vs. 3.09% 2019 (Virginia)
    - Asset growth not expense reduction



# Profitability (con't)

- Loan loss provisions
  - 16 bp. higher in 2020 than 2019
  - Loan growth not deterioration
  - Non-performing loans  2 bp.
  - Higher rates may be negative to borrowers
  - Project provisions higher, but remain historically low

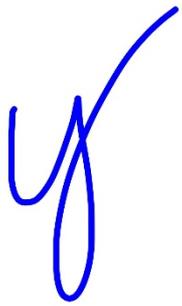


# Profitability (con't)

- Taxes – WILDCARD
- Corporate tax to 28% from 21%

ROA Based on Taxes		
	Taxes	
	21.00%	28.00%
Net Interest Margin	3.50%	3.50%
Non-Interest Income	0.70%	0.70%
Non-Interest Expense	2.70%	2.70%
Loan Loss Provisions	<u>0.15%</u>	<u>0.15%</u>
Gross Profit	1.35%	1.35%
Taxes	<u>0.28%</u>	<u>0.38%</u>
Net Profit	1.07%	0.97%

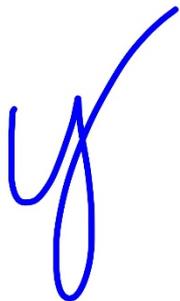
- 9.3%  Net profit



# Profitability (con't)

- Net profit remains strong, but likely falls short of 2020 in Return on Assets (ROA)
- In most cases, measure success by Return on Equity (ROE)
- ROE measures the return to shareholders
- $ROA/EA = ROE$  (EA is equity/assets)

Relationship Between ROA/ROE/PE and Value In Millions						
ROA	Tier-1 Leverage	ROE	PE	Book Multiple	Total Equity	Value
1.00%	8.00%	12.5%	12.0	1.50	\$16	\$24.0
1.00%	9.00%	11.1%	12.0	1.33	\$16	\$21.3
1.00%	10.00%	10.0%	12.0	1.20	\$16	\$19.2
1.00%	12.00%	8.3%	12.0	1.00	\$16	\$16.0



# Profitability (con't)

## Estimate of Stock Value Young National Bank

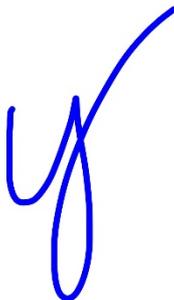
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Net Income	\$1,200	\$1,296	\$1,400	\$1,512	\$1,633	\$1,763	\$1,904	\$2,057	\$2,221	\$2,399
Tier-1 Capital	\$11,300	\$12,078	\$12,917	\$13,824	\$14,804	\$15,862	\$17,004	\$18,238	\$19,571	\$21,010
PE Ratio	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0
Multiple of Book	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
% PE	70.0%	70.0%	70.0%	70.0%	70.0%	70.0%	70.0%	70.0%	70.0%	70.0%
% Book	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Value from PE	\$9,240	\$9,979	\$10,778	\$11,640	\$12,571	\$13,577	\$14,663	\$15,836	\$17,103	\$18,471
Value from Book	\$4,407	\$4,710	\$5,038	\$5,392	\$5,774	\$6,186	\$6,632	\$7,113	\$7,633	\$8,194
Total Value	\$13,647	\$14,689	\$15,815	\$17,031	\$18,344	\$19,763	\$21,294	\$22,949	\$24,735	\$26,665
Shares Outstanding	190,200	190,200	190,200	190,200	190,200	190,200	190,200	190,200	190,200	190,200
Value/Share	\$71.75	\$77.23	\$83.15	\$89.54	\$96.45	\$103.90	\$111.96	\$120.66	\$130.05	\$140.19
Value PE	11.37	11.33	11.30	11.27	11.24	11.21	11.18	11.16	11.14	11.12
Value X Book	1.21	1.22	1.22	1.23	1.24	1.25	1.25	1.26	1.26	1.27

*All numbers are in thousands except for the number of shares.*

*This model is intended to provide a rough estimate of value. This model only uses earnings and capital. There are numerous other factors that effect value including core deposits, perceived future growth in earnings, asset quality, regulatory issues, quality of the market served, branching network, quality of management, etc. This model is not intended to be a definitive determinant of value, and should never be used for that purpose. For a more complete analysis of value, please consult a professional in the field of bank valuations.*

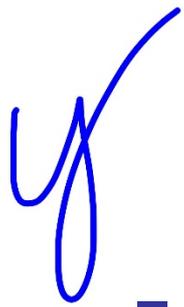
8.00% Income growth  
40.0% Dividend Payout

15.0 Maximum PE  
1.65 Maximum Value X Book

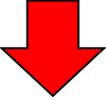


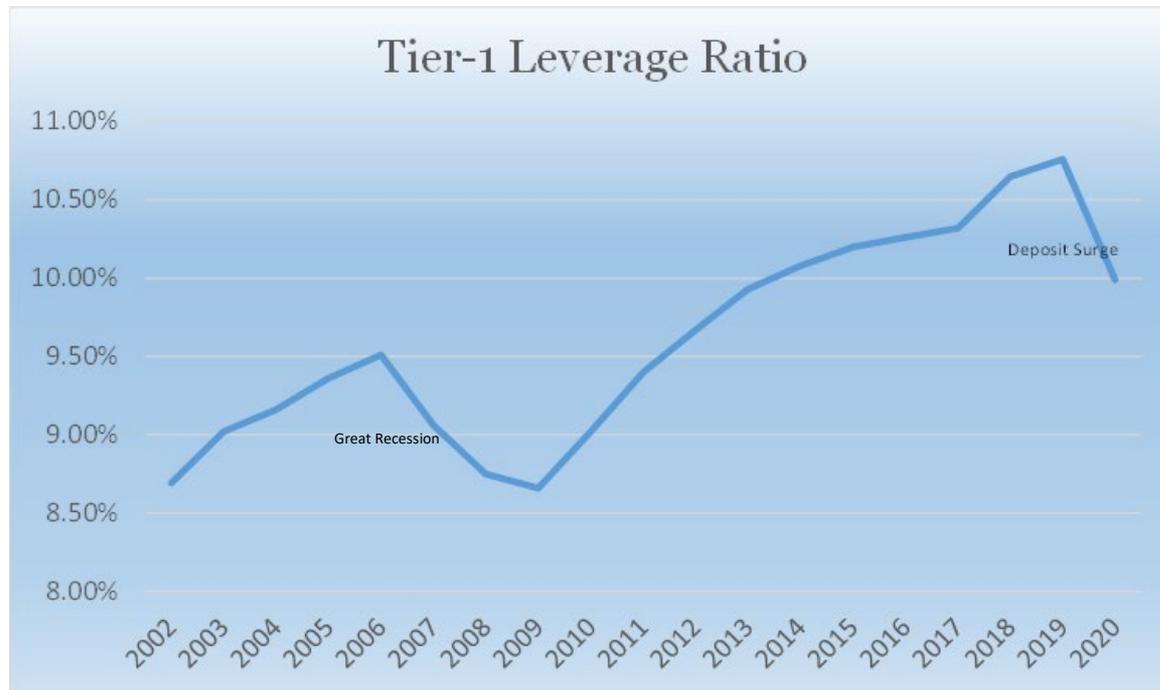
# Stock Value

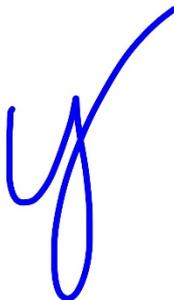
- **Current Bank Values – 4.15.2021**
  - **KBW Bank Index**
    - -13.4% 2020
    - +25.1% 2021 Y-T-D
    - +8.3% Since December 31, 2019
  - **NASDAQ Bank Index**
    - -10.6% 2020
    - +29.1% 2021 Y-T-D
    - +15.4% Since December 31, 2019



# Stock Value con't

- All other things equal
- EA  ROE  Value Multiple of Book 
- Historical EA \$300 Million to \$1 Billion





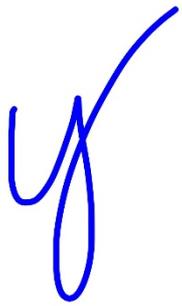
# Capital Adequacy

- Avg. peer tier-1 has nothing to do with Capital Adequacy
  - 10.76% wasn't the definition of capital adequacy in 2019, likewise
  - 9.99% isn't the definition currently
  - Based on your current and planned **RISK**
  - Risk  Need for capital 
  - OCC – must complete Capital Plan & Contingency yearly
  - FDIC or FED – best practices



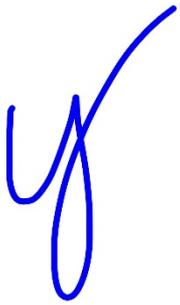
# Capital Adequacy (con't)

- Risk Components
  - Asset quality
  - Interest-rate
  - Liquidity
  - Operational
  - Price (OREO)
  - Compliance
  - Strategic
  - Reputation



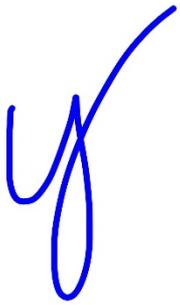
# Capital Adequacy (con't)

- Highest risk
  - Asset quality (loan quality)
- Moderate risk
  - Interest-rate
  - Liquidity
  - Operational (technology)
    - Some regulators *this is or soon will be the greatest risk facing community banks*
    - Don't agree, but it is certainly the fastest growing risk



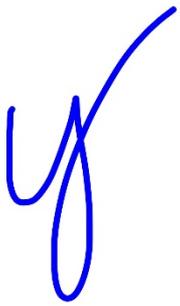
# Capital Adequacy (con't)

- Branch into a new market – *Example*
  - Asset quality
    - Likely increase in risk
      - Often new loan officer
      - Loans to unknown customers
    - Mitigation
      - Heightened emphasis in loan review

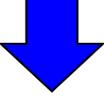
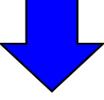


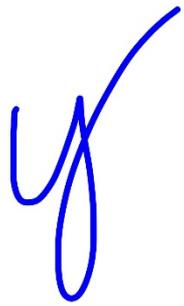
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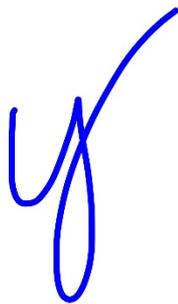
# Capital Adequacy (con't)

- Branch into a new market – *Example*
  - Strategic & Reputation
    - Increase with possible negative impact on net profit (short-term and long-term)
    - Decrease possible from market diversification
  - Actions impact capital adequacy based on specifics of **YOUR BANK**
  - For Director's main point to remember,
    - Risk  Capital Need 
    - Risk  Capital Need 



# Summary

- Future remains bright for community banks
- I remain bullish on the industry
- Key
  - Strong management team
  - Engaged board of directors



# Thank You for Attending!

## Gary J. Young, LLC.

# VIRGINIA BANKERS ASSOCIATION



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