Balance Sheet Insights

PIPER SANDLER FINANCIAL STRATEGIES

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Earnings Releases: First Quarter 2021 Trends

*Please see this week's **Rate Sheet** and **Yield Curve Opportunities**.*

Often our advice hinges on optimizing internal metrics, from capital ratios, to the investment portfolio, to funding costs. But turning an outward eye allows management teams to see the forces acting for and against them. Knowing what our competitors are doing explains the past, and more importantly, prepares us for the future. As we turn our attention to earnings trends, we continue to see the impact of fiscal and monetary policy, PPP, and other COVID related fallout. Currently, 67% of domestic public banks have reported their metrics, which we have catalogued below. We take a look at the expected or unexpected results so far on an aggregated basis, and what it means for institutions across the country.

Balance Sheet and Liquidity Trends

The trend in elevated liquidity continues in the first quarter hitting recent highs and persisting as a dominant theme. A meaningful portion of liquidity remains in cash - nearing 10% of total assets - with securities still below historic levels. As cash builds with the Fed Effective Rate at a paltry 6bps, this excess liquidity will no doubt squeeze core margins. Loan origination continues to have headwinds as Loans/Deposits have come down yet again this quarter. Lenders were able to make up some shortfall through participation in the PPP program, but non-PPP loans trended down as the portion of PPP loans/loans on balance sheet increased this quarter to 7.5%. This has been a reduction since the peak of the program (8.8% of loans in 3Q) but remains elevated as forgiveness lags and a new round of PPP added to balances.

Recent Trends for U.S. Public Banks						
Balance Sheet & Liquidity	Q2'20	Q3'20	Q4'20	Q1'21	Last 4 Qtrs. (BPS)	QoQ (BPS)
Cash / Assets	8.2%	7.5%	9.1%	9.5%	**136**	**39**
Securities / Assets	13.5%	13.6%	14.2%	14.3%	**82**	**11**
Loans / Deposits	88.4%	87.6%	83.4%	81.7%	**(676)**	**(172)**

S&P Global - Public US Banks, 1Q2021 as of 5/5/2021

Recent Trends for U.S. Public Banks			
COVID - 19	Q3'20	Q4'20	Q1'21
PPP Participation	87.9%	88.2%	78.3%
PPP Loan Ratio	8.8%	6.5%	7.5%

S&P Global - Public US Banks, 1Q2021 as of 5/5/2021

Earnings Trends

Earnings continued an impressive march upward, as fees from a red hot mortgage market and PPP cycled through income. Asset quality will be discussed further down, but the impact of lighter reserves and lighter charge-offs positively bolstered income as losses were less severe than expected. With higher fees and lower provisioning supporting extraordinary ROAs and ROEs, you may miss the fact that margin declined QoQ by nearly 10 bps. Excess liquidity continues its squeeze and profitability may soon face challenges if the fees dry up before loan demand returns.

Recent Trends for U.S. Public Banks						
Profitability	Q2'20	Q3'20	Q4'20	Q1'21	Last 4 Qtrs. (BPS)	QoQ (BPS)
Core ROAA	0.84%	0.96%	1.08%	1.24%	**40**	**16**
Core ROAE	7.96%	9.21%	10.36%	12.11%	**414**	**175**
Net Interest Margin	3.32%	3.24%	3.33%	3.24%	**(8)**	**(9)**

S&P Global - Public US Banks, 1Q2021 as of 5/5/2021

Capital Trends

The build in cash and general risk-off trends have kept Total Capital Ratios high in the most recent quarters, and once again posts above 15% in Q1. Leverage ratios have slowly drifted lower with almost undetectable changes again. With high capital levels and muted asset quality issues, bank balance sheets have capacity for credit, growth, and M&A.

Recent Trends for U.S. Public Banks						
Capital	Q2'20	Q3'20	Q4'20	Q1'21	Last 4 Qtrs. (BPS)	QoQ (BPS)
Total Capital Ratio	14.74%	15.01%	15.14%	15.08%	**35**	**(6)**
Leverage Ratio	9.59%	9.48%	9.44%	9.38%	**(21)**	**(6)**

S&P Global - Public US Banks, 1Q2021 as of 5/5/2021

Asset Quality Trends

NPAs continued to contract in 1Q (now under 50bps) relative to assets. Though this ratio is still clouded by loan modifications that are not included – currently 1.3% of loans for reporting companies – modifications are down from a staggering 14.3% of loans in 2Q2020. With lower NPAs came lower charge-offs and this has led to higher reserve levels among reporting banks. Many banks recorded minimal provisions in 1Q leading to higher earnings while still maintaining a 1.25% reserve level. This higher reserve level is partially attributed to CECL reserves being included in recent quarters, but, if NCOs are light, provisions will be light, and earnings will be strong (unless margin continues its decline).

Recent Trends for U.S. Public Banks						
Asset Quality	Q2'20	Q3'20	Q4'20	Q1'21	Last 4 Qtrs. (BPS)	QoQ (BPS)
NPA+90 Days / Assets	0.60%	0.59%	0.56%	0.49%	**(11)**	**(7)**
LLR / Gross Loans	1.13%	1.19%	1.26%	1.25%	**12**	**(0)**

S&P Global - Public US Banks, 1Q2021 as of 5/5/2021

What Does it All Mean?

Liquidity (more specifically, cash) is still at a record high and will continue to pressure margins. However, non-core fees, mortgage banking income, and light provisions have outweighed this impact, and the industry is reflecting strong earnings. Asset quality may remain solid, but non-core earnings associated with government programs will dry up as the economic impact of COVID continues to diminish. Net Interest Margins will need to improve, and replacing these lost earnings should be a priority. Institutions should consider buying securities or loans with excess cash, or consider interest rate swaps to lower liability costs, increase asset yields, or shore up exposures to rate moves. Lastly, with healthy capital, clarity on asset quality, and increased valuations, be on the lookout for an M&A wave - will your company be a buyer or a seller?

If any of our observations pique your interest, please contact your Piper Sandler representative or email us at PSFS@psc.com. For derivatives, please email our affiliate, Piper Sandler Hedging Services, LLC, at FSG-Derivatives@psc.com.

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