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In Q2 earnings, focus is on loan growth, deposit costs and M&A

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By Kevin Dobbs

As the second quarter closes this week and community banks prepare for earnings reports in July, analysts say they are eager for details on loan growth and deposit costs amid a heating economy and rising interest rates. Bankers' M&A appetites also remain top of mind.

Following deregulation and federal tax cuts that took effect this year — the top levy rate for corporations declined to 21% from 35% — analysts anticipated that the U.S. economy would gain steam during the spring months. The Atlanta Federal Reserve this week forecast that second-quarter gross domestic product would advance by 4.5%, more than double the rate of the previous quarter.

By extension, analysts have looked for business owners to borrow and invest more in their own growth to capitalize on an expanding economy. That would bolster community banks, many of which focus on commercial lending, and help them post stronger loan growth in the second quarter. Total loans at U.S. commercial banks grew just 0.5% during the first quarter, according to an S&P Global Market Intelligence analysis.

"Many of the community banks are gaining some momentum" in the second quarter, bank analyst Mark Fitzgibbon of Sandler O'Neill & Partners said in an interview. Noting feedback from the community banks that he covers, he said: "I do think we are seeing more commercial growth now."

Loan growth is important in 2018, analysts say, because greater lending volumes will enable banks to capitalize on the benefits of higher interest rates, even as they wrestle with the downsides. New loans made at higher rates will help banks boost interest income and offset the greater interest levels that depositors have begun to demand following several Federal Reserve rate hikes. Maintaining a healthy spread between those two is a vital earnings ingredient for most community banks that rely on bread-and-butter deposit gathering and lending.

The U.S. banking industry's cost of funds increased 6 basis points to 63 basis points during the first quarter, an S&P Global report showed. Those costs climbed 20 basis points from a year earlier. Analysts are hungry for updated details for this quarter to gauge the pace of additional increases on deposit costs.

"We started to see that deposit pick up last quarter and I think we will see that continue for this quarter," Keefe Bruyette & Woods bank analyst Damon DelMonte said in an interview. "It's a matter of how much."

The upward shift in deposit costs is motivating more banks to ramp up their pursuits of core deposits — those deposits from customers who often have longstanding relationships with banks that are not based primarily on rates. That, in turn, is driving acquisitive banks to hunt in earnest for targets that boast strong core deposit bases, analysts say.

Many are paying more for acquisitions this year than last, giving potential sellers added reason to pull up chairs to deal tables and galvanizing analysts to seek commentary from bank buyers on their M&A inclinations during earnings season.

As of June 15, an S&P Global tally found that there were 124 bank and thrift deals announced in 2017 with a median deal value-to-tangible common equity ratio of 169.7%. Those figures were up from the same period a year earlier, when there were 111 announced deals with a median ratio of 158.6%.

"Right now, buyers are motivated and the conditions are quite good" for sellers, Rick Weiss, chief banking strategist at Ambassador Financial Group, said in an interview. "If you want to sell" and have a strong deposit base, "you could command a nice premium."