

Q3'18 results could be 'inflection point' for large banks

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By Kiah Lau Haslett and Chris Vanderpool

All eyes will be on deposits costs in a rising rate environment that has analysts concerned about banks' funding.

Analysts expect third-quarter earnings to be flat or down from the linked quarter for more than half of top 20 U.S. banks. While the economic backdrop for banks remains positive with lower corporate tax rates and multiple interest rate increases, the third quarter experienced heightened trade war talk and a flatter yield curve that dragged bank stocks. A variety of factors including deposit costs and slowing loan growth may dampen earnings growth at some banks.

This quarter could be an "inflection point" for banks as interest rates have increased and banks try to hold their cost of funds in check, said Rick Weiss, chief bank strategist at Ambassador Financial Group.

"I don't think it's going to be a bad quarter at all," he said, "I just don't see a lot of catalysts to drive valuations much higher at this point."

Estimated Q3'18 EPS, revenue for the 20 largest public US banks

Company (ticker)	Q2'18 total assets (\$B)	EPS — Q3'18 mean estimate*			Revenue — Q3'18 mean estimate*		
		(\$)	Vs. actual Q2'18	Vs. actual Q3'17	(\$B)	Vs. actual Q2'18	Vs. actual Q3'17
JPMorgan Chase & Co. (JPM)	2,590.05	2.27	▼	▲	27.45	▼	▲
Bank of America Corp. (BAC)	2,291.67	0.62	▼	▲	22.76	▼	▲
Citigroup Inc. (C)	1,912.33	1.67	▲	▲	18.47	▼	▲
Wells Fargo & Co. (WFC)	1,879.70	1.18	▲	▲	21.79	▲	▼
U.S. Bancorp (USB)	461.33	1.04	▲	▲	5.67	▲	▲
PNC Financial Services Group Inc. (PNC)	380.71	2.72	NC	▲	4.33	▲	▲
Capital One Financial Corp. (COF)	363.99	2.84	▼	▲	6.92	▼	▼
Bank of New York Mellon Corp. (BK)	352.93	1.04	▲	▲	4.16	▲	▲
State Street Corp. (STT)	248.31	1.92	▼	▲	3.03	▼	▲
BB&T Corp. (BBT)	222.68	1.00	▼	▲	2.93	▲	▲
SunTrust Banks Inc. (STI)	207.51	1.40	▼	▲	2.36	▲	▲
Citizens Financial Group Inc. (CFG)	155.43	0.90	▲	▲	1.56	▲	▲
Fifth Third Bancorp (FITB)	140.70	0.63	NC	▼	1.63	▲	▲
KeyCorp (KEY)	137.79	0.45	▲	▲	1.64	▼	▲
Northern Trust Corp. (NTRS)	135.11	1.63	▼	▲	1.52	▲	▲
Regions Financial Corp. (RF)	124.56	0.36	▲	▲	1.47	▲	▲
M&T Bank Corp. (MTB)	118.43	3.35	▲	▲	1.50	▲	▲
Huntington Bancshares Inc. (HBAN)	105.36	0.32	▲	▲	1.15	▲	▲
First Republic Bank (FRC)	93.85	1.20	NC	▲	0.79	▲	▲
Comerica Inc. (CMA)	71.99	1.79	▼	▲	0.85	▲	▲

Data compiled Oct. 5, 2018.

Analysis limited to the 20 largest U.S. public banks and thrifts by total assets based on GAAP filings for the period ended June 30, 2018.

* Mean estimate = consensus operating estimate based on the mean calculation, collected from analyst research reports by S&P Global Market Intelligence; the estimates are compared out to two decimal places (in billions for revenue) to the operating version of the actual data from prior periods

NC = no change

Source: S&P Global Market Intelligence

RBC Capital Markets managing director Gerard Cassidy also believes deposit betas, a measure of how much of the Fed's rate increases are passed on to depositors, could be a defining factor of bank earnings.

"We've been saying deposit betas were going to be hockey sticks: start off flat and when they take off, they'll really take off," he said. "And we're just at that point now where they've started to take off, so we expect another quarter of higher numbers."

Most analysts expect net interest margins at large banks to modestly increase. Marty Mosby, director of bank and equity strategy at Vining Sparks, said that is because short-term interest rates and the London Interbank Offered Rate both moved in anticipation of the Federal Reserve's actions during the first half of the year, causing NIMs to expand in those quarters.

"We had an anomaly in that the market anticipated all this," he said. "We still think margins are going to continue to round up as we go forward — we'll just take a little pause this particular quarter."

The normalization of short-term interest rates could also affect net interest income, which Mosby said could also be weaker than it was in the second quarter.

Estimated Q3'18 credit quality, NIM for 20 largest public US banks

Company (ticker)	Loan loss provision — Q3'18 mean estimate*		NCOs to average loans — Q3'18 mean estimate*		Net interest margin — Q3'18 mean estimate*	
	(\$M)	Vs. actual Q2'18	(%)	Vs. actual Q2'18	(%)	Vs. actual Q2'18
JPMorgan Chase & Co. (JPM)	1,536.5	▲	0.57	▲	2.49	▲
Bank of America Corp. (BAC)	1,015.5	▲	0.45	▲	2.41	▲
Citigroup Inc. (C)	1,992.3	▲	1.12	▲	2.72	▼
Wells Fargo & Co. (WFC)	666.8	▲	0.30	▲	2.94	▲
U.S. Bancorp (USB)	347.6	▲	0.49	▲	3.15	▲
PNC Financial Services Group Inc. (PNC)	122.8	▲	0.21	▲	2.99	▲
Capital One Financial Corp. (COF)	1,605.4	▲	2.54	▲	6.75	▲
Bank of New York Mellon Corp. (BK)	4.6	▲	0.02	▲	1.27	▲
State Street Corp. (STT)	0.8	▼	0.00	▼	1.47	▲
BB&T Corp. (BBT)	144.5	▲	0.37	▲	3.46	▲
SunTrust Banks Inc. (STI)	89.0	▲	0.24	▲	3.28	▲
Citizens Financial Group Inc. (CFG)	88.1	▲	0.29	▲	3.19	NC
Fifth Third Bancorp (FITB)	77.5	▲	0.34	▼	3.21	▲
KeyCorp (KEY)	72.2	▲	0.30	▲	3.22	▲
Northern Trust Corp. (NTRS)	2.1	▲	0.02	▲	1.50	▲
Regions Financial Corp. (RF)	76.7	▲	0.37	▲	3.51	▲
M&T Bank Corp. (MTB)	47.5	▲	0.19	▲	3.86	▲
Huntington Bancshares Inc. (HBAN)	54.1	▲	0.23	▲	3.33	▲
First Republic Bank (FRC)	14.7	▼	0.01	▲	2.92	▼
Comerica Inc. (CMA)	12.9	▲	0.16	▲	3.65	▲

Data compiled Oct. 5, 2018.
 Analysis limited to the 20 largest U.S. public banks and thrifts by total assets based on GAAP filings for the period ended June 30, 2018.
 * Mean estimates are collected from analyst research reports by S&P Global Market Intelligence. The estimates are compared out to two decimal places (for loan loss provision, out to one decimal place in millions) to the actual data for the prior quarter, based on GAAP filings.
 NCOs = net charge-offs; NC = no change
 Source: S&P Global Market Intelligence

Earnings per share at the largest banks could also be affected by the share count. Mosby said the share repurchases at the largest banks accelerated in the third quarter compared to previous ones because this will be the first full quarter after the Fed's nonobjections to plans that banks submitted as part of the 2018 Comprehensive Capital Analysis and Review.

Mosby said he expects 1% to 2% revenue growth, relatively flat expenses, stable credit and declining share count, which should all add up to a sequential increase in EPS. However, that may not be enough to impress investors, who might

focus on flat NIM and loan growth activity.

Investors will be interested to see whether broader economic growth has made an impact on bank income statements through higher loan growth, and preliminary data do not look promising, wrote Keefe Bruyette & Woods managing director Brian Kleinhanzl in an Oct. 2 report.

He wrote that the Fed's H.8 data indicated that loan growth at large banks might be "relatively flat" compared to the quarter prior as seasonally weaker commercial loan growth has obscured consumer loan growth led by credit cards and residential mortgage. Kleinhanzl expects average total loan growth to grow an annualized 2.4% from the linked quarter, compared to an annualized increase of 1.2% the quarter prior.

He also wrote that executives at several large banks have talked about de-risking or avoiding growth in certain portfolios due to unattractive risk-adjusted returns, including commercial real estate. Slower loan growth could also translate into compressed net interest margin growth.

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