**Community Banks Fourth Quarter 2016 (4Q2016) Quarterly Review by Jamie Sumner**

Hello everyone, I am Jamie Sumner, chief analyst at Seifried&Brew. For this week's webcast I wanted to review some of the fourth quarter 2016 (4Q2016) financial data that came out a little bit ago on the community bank benchmark.

So let's look at the top number here [Slide 2], with ***Return on Average Assets (ROAA).*** As you can see on Slide 2, over the past year the ROAA really hasn't changed, as it was 86 basis points (bps) back in 4Q2015, and ended this year at 86 bps as well. If we were to look at this on a last 12-month basis, we see very little change over the course of the year. So, overall banks have been maintaining their earnings streams as a percentage of assets. But of course the interchange with inside the makeup of that ROAA has changed a little bit.

We look at the ***Net Interest Margin (NIM)*** over the past year [Slide 3]. What we see here is that we have come up pretty much from 3.77 back in 4Q2015, reached a high of 3.98 in 2Q16, and ended the year (4Q2016) at 3.93. So overall throughout the year we've seen an increase in the NIM which we view as positive with the increase primarily in the latter half of the year.

Looking at the components of NIM [Slide 4] we can see that the overall yield on earning assets ticked up just 5 bps year-over-year from 4.14 back in 2015 to 4.19 in 4Q2016. So we had a little bit of upward momentum with the ***Yield on Earning Assets***. We had some volatility throughout the year and this is what we anticipate as we go through 2017, as rates continue to move a little higher we should anticipate this ratio of 4.19 to start to increase a little bit. Another result of the increase here is as banks move more (assets) into the loan portfolio and away from the investment portfolio and we'll look at that statistic in just a minute.

On the other side of the net interest margin equation is [Slide 5] ***Cost of Funds***. We survived at 47 bps for some time. Beginning in 3Q2016 we saw a 1 bps increase to 48 bps and that's where we've stayed. Historically still very, very low for the overall Cost of Funds. As we move into 2017, (and this is something that we have been talking about) is the need for banks to begin to increase their deposit rates, and our big question here is, *when will that happen?* As I said before, I think we are fine for another fed rate hike of 25 bps. The questions is once you get to two or three fed rate hikes*, is that going to be the time when we start to see the need to increase the overall rates paid on deposits?* So **this could be detrimental as we move throughout 2017, that is, if we see the imbalance with costs of funds going up faster than the yield on earning assets.**

We flip over now to ***Net Overhead*** [Slide 6]. If you recall, Net Overhead is the difference between non-interest expense and non-interest income. So it is sort of an efficiency ratio. Over the course of a year you see we came from 2.23 back in the 4Q2015 down to 2.14 in the 4Q2016. So it has made some headway here on Slide 6 as you can see how the volatility happened. In the fourth quarter we saw a pick up. So this is a positive number going into 2017.

When we combine the Net Interest Margin and the Net Overhead you get the ***Efficiency Ratio*** [Slide 7]. This is kind of similar in what we saw in the Net Overhead. We go from 70.47 in 4Q2015 down to 68.61 year over year. So we have some improvements in this efficiency ratio throughout the year so that is a positive. Remember, the lower the efficiency ratio the better. It is basically telling you how much you are paying (in cents) per dollar of revenue. So here we are paying $0.68 per $1.00 of revenue. So we are still pretty efficient. We would like to see this number get down below the $0.65 mark. That's kind of a historical number, so we like to see banks at or below the $0.65 mark. If you are in the $0.50s you're a highly efficient institution.

Now moving on from here let's look at the balance sheet [Slide 8]. We continue to see loans grow throughout 2016. And you can see here on Slide 8 for the last 12 months (all of 2016 ***LTM Growth Rates***), loans were up a little more than 9.57% and that's a pretty good growth rate on average for the community bank benchmark. Assets were up 7.39% and since loan growth was greater than asset growth we'll see an increase in the loan to asset ratio. Overall deposits were up 7.75% so we've had good growth across the board here with inside the community bank benchmark.

Looking at the ***Loans to Assets*** ratio [Slide 9] we started the year or ended 2015 at 65.86%. And throughout the year we continued to increase as we have over the past several years and now we are up at 67.06%. So we are continuing to add to that loan portfolio, driving the increase in the overall NIM. Loans typically pay a higher level of yield compared to investments.

When we look at the overall ***Noncurrent Loans*** [Slide 10], which demonstrates our credit risk, here we continue to see this come down. And now for the first time in many years, we are at the benchmark level, below that 1% mark (at 98 bps). And that's a positive for the credit environment, in that we have come such a long way.

The ***Equity Asset ratios*** [Slide 11], you can see that we are at 11.16% at the end of 2015, reached a high in 2Q2016 of 11.38%, 11.37% in 3Q2016, and then we saw this tremendous drop off to 11.12%. A lot of this drop off is due to the increase in rates and therefore a lot of banks saw their unrealized gains in their portfolios became either neutral or into a loss. So we saw this big drop off here.

We can mute that out by looking at regulatory capital ratios [Slide 12]. We look here at the ***Tier 1 Risk-Based Capital Ratio*****.** You can see we were at 15.97 back in 4Q2015, and then we made our way all the way down to a 15.9 in the 4Q2016. We see this decline here primarily because of the overall higher weighted assets, risk weighted assets ratio. Moving from the investment portfolio to a loan portfolio we have more of a risk on the balance sheet and therefore the risk weighted asset ratio is higher and causing this little bit of a trail off within inside of the ratios, the capital ratios here.

Well, that's what we have for you this week. Please join us next week as we look over some of the economic numbers and we'll touch on a little bit of the risk with inside the community bank benchmark as well. Have a great week everyone!

**Materials set forth above are based on transcripts/slides presented from the Seifried & Brew Briefing transmitted on Tuesday, Feb. 14, 2017. For further reference please click on *http://seifriedbrew.com/briefings.html***