COMMUNITY BANK SECOND QUARTER 2017 RESULTS; STOCK BANK BENCHMARK GROUP

Good day everyone. Thank you for joining us once again here at Seifried & Brew for our weekly webcast. For this week's webcast we're going to be looking at the results of the second quarter 2017 for our stock bank benchmark group. When we look at our ***performance risk report***, the base benchmark we look at are those banks with assets between $100 million and $5 billion that are stock banks. We exclude the Sub-Chapter S institutions out of that group. So, our base group is this benchmark stock bank here.

And as you can see (Slide 2) the ***return on average assets*** for the second quarter 2017 is up slightly; we're up 6 basis points (bps) going from 83 bps up to 89 bps. When we walk through some of the metrics here we'll find that this increase was led by the net interest margin here. We saw a similar increase in the average ***return on equity*** moving up to that 8.13% in here, beating the past four quarters in here looking back to the second quarter 2016. The prior top was at a 7.92% back here in the third quarter of 2016. So, we're looking good on the earnings side. Seems like we're on the upward swing. The past two quarters we had a decline here but now we're back on that upward swing for this stock benchmark group. Looking at ***net interest margin*** (Slide 3), we saw an increase here up to that 3.78%, increasing 8 bps in that net interest margin. This is a big positive, because as you can see we were on a downward trend for the past 2 quarters. The question is, *is this an anomaly? Or is this quarter going to be reflected in the next couple of quarters and continuing to see this increase in that net interest margin*. That is what we're hoping for with the stabilization of the shorter end of the curve as well as that longer end of the curve. So hopefully we will see this trend continue into the third and fourth quarters of 2017.

Looking at the dynamics between the ***cost of funds and the yield on earning assets,*** you can see here (Slide 4) cost of funds at 0.5%, 50 bps, up just 3 bps from last quarter at 0.47%. Now, this is a total cost of funds, so this includes both the cost of deposits as well as the cost of borrowings in here. When we look at the yield on earning assets we saw an increase of 11 bps. So we're up to that 4.16%; that led a little bit by that increase in the longer end of the yield curve, but also in here this could be a reflection of the increase in the overall loan portfolio as a percent of assets. So, we've see that trend kind of continue throughout the past couple of years and this is being supportive of that higher yielding earning assets.

When we look at the ***cash type deposits to total deposits*** (Slide 5) and if we recall the cash type deposits are those non-maturity deposits, (you're looking at your DDA's, your NOW's, your savings, and your MMDAs). Over the past several years we've seen a continual uptick in this ratio. This is the first quarter where we're starting to see this level off. In fact, it came down just 9 bps from that 70.89 to that 70.80 here. So, we've come down a little bit, but the stabilization we've seen at some banks, the need to do those CD specials in order to retain some of those customers; we're going to keep an eye on this as this is an important ratio. If we continue to see this stabilize or even come down, that's going to be an indication that the tolerance or the appetite of your customers could be leading more toward those longer-term products. Or they're just pushing their monies out of their lower cost or lower interest rate demand deposits and money market and savings into these CDs. So, this potentially could have a reverse effect on that rising net interest margin; that is, if we start to see more and more depositors go out on the yield curve a little bit and start to hit that CD market, increasing your overall cost of deposits and then therefore increasing your cost of funds. So, we're going to keep an eye on this trend; this is a very interesting trend that we're looking at here. (Slide 6)

However, when we look at the ***net overhead*** (if you recall this is the difference between non-interest income and non-interest expense), we're down to 2.08%. We've been on this downward trajectory here. Where we like to see

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banks is around that 2% mark. High performing, our top 15 percentile, are more likely around that 1.75%. But at 2% is basically where we like to see institutions. So, the benchmark is starting to get back down there.

Effective tax burden here (Slide 7); we're at that 30.45%. For that tax rate on average around that 30%, so that's the average. What we like to say, is that if you're real tax efficient you're going to have a tax rate of somewhere between 20% and 25%. So we like to see our banks, the smaller institutions primarily, work in real close to their AMT. But overall, on average, we're at that 30%. We could see banks making up some headway here getting back down to that 25% by the end of the year.

When we look at the balance sheet here (Slide 8) for the second quarter with the last 12 months growth rates, assets up almost 8% at that 7.89% asset growth rate. Loans leading the way at 9.78%. Therefore, with the loans being greater than assets you see that ***loans to assets ratio*** continue to increase in here. Deposits up 8.29% over the last 12 months. When we look at that ***loans of deposit ratio*** again (Slide 9) we continue to see that move up. It came down slightly last quarter, picked back up. We're at that 68% overall for the national benchmark. We continually see this happen when we're getting the loan portfolio building as a percent of assets, supporting that rise in that interest margin and yields on earning assets, but also potentially increasing that future credit risk in the bank overall. ***Non-current loans***, (Slide 10) one of the staple credit risk indicators, on a national basis has continued to come down at that 0.93% in here to total loans. So, we continue to see this come down. That's a big positive that we continue to see that.

Overall, when we look at our risk index, our ***total risk index*** (Slide 11). Recall on a quarterly basis, we look at institutions risk on four categories: the earnings at risk, liquidity risk, capital risk, and credit risk. And this is our index that compiles all those risks together. And overall for the benchmark group here you can see risk came down just a little bit from where we were last year (the second quarter 2016). So, just a slight reduction in that risk overall. We're still in that moderate to low level of risk. We like to see banks in this area kind of down here. This tends to be where we see banks get their biggest bang for their buck in their total return or their risk adjusted return (is when we see them in this area).

That's what we have for you this week. Next week we'll look at a couple of economic statistics that have come out and look at some projections as far as rates, both on the short end with the Fed as well as the long end with the 10-year, going out for the next couple of quarters. Have a great week.

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

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