



2016 KBW Bank Honor Roll: Consistent Growers During Unpredictable Times

Summary

We are publishing our annual KBW Bank Honor Roll acknowledging those banking institutions that achieved positive earnings per share growth trends over the last decade, regardless of the economic environment.

□ **Fifteen banking institutions posted a 10-year record worthy of admission to this year's KBW Bank Honor Roll.**

□ **To be eligible for the KBW Bank Honor Roll, banks with more than \$500 million in total assets must have:**

1. No annual loss reported in net income per share before extraordinary items over the past 10 years;
2. 2016 annual reported net income per share before extraordinary items equal to or greater than peak net income per share over the past 10 years; and
3. Consecutive increases in net income per share before extraordinary items since 2009.

□ **All 15 2016 Honor Roll members were also 2015 KBW Bank Honor Roll members:** AUBN, BANF, CNBKA, EGBN, EBTC, FDEF, FFIN, GABC, GCBC, LKFN, SFBS, SBNY, SYBT, USB, and WASH.

□ **For the five-year period between 2011 and 2016, the KBW Bank Honor Roll members significantly outperformed their banking peers and the market.** With median price appreciation of 21.9% compounded annually, the KBW Honor Roll banks significantly outperformed both BKX's and KRX's 5-year CAGRs of 18.4% and 17.4%, respectively. The KBW Honor Roll banks also meaningfully outperformed the S&P 500 Index's 5-year CAGR of 12.2%.

□ **The KBW Bank Honor Roll members trade at a premium to their banking peers.** At year-end 2016, BKX and KRX banks traded at 13.6x and 17.6x consensus '17 EPS estimates, respectively. The KBW Bank Honor Roll members traded at an even greater premium of 19.5x, on a median basis. Similarly, at year-end 2016, BKX and KRX banks traded at 1.3x and 1.8x book value, respectively. The KBW Bank Honor Roll members traded at 2.4x, on a median basis.

□ **Thus far, 2017 is shaping up to be challenging for bank stock performance, but the KBW Bank Honor Roll members continue to outperform their SMID-cap banking peers.** In 2017 to date (through

3/31), despite declining 2.8% on a median basis, the KBW Bank Honor Roll members outperformed KRX's 4.1% decline. The KBW Bank Honor Roll members as well as KRX underperformed the S&P 500 Index which gained 5.5% and BKX which rose 0.3%.

□ **KBW Bank Honor Roll members have better-than-industry performance ratios and growth rates** when compared to the publicly traded bank universe with total assets over \$500 million, which includes over 380 companies listed on the NYSE and Nasdaq exchanges.

□ **The past decade has been one of the most unpredictable and challenging times in the history of U.S. banking.** All said, the 2016 KBW Bank Honor Roll members have certainly earned their honor as there were many ways to make significant mistakes over the past 10 years, given 532 banks failed during that period.

Melissa A. Roberts
212 887 3820
mroberts@kbw.com

Frederick Cannon, CFA
(212)887-3887
fcannon@kbw.com

Pell Bermingham
212 887 8699
berminghamk@kbw.com

[Glossary of Terms](#)



Constructing the 2016 KBW Bank Honor Roll

To determine the constituents of the 2016 KBW Bank Honor Roll, as shown in Exhibit 1, we analyzed 10 years of fully diluted net income per share before extraordinary items for over 380 publicly traded banking institutions with at least \$500 million in total assets as of year-end 2016.

To qualify for inclusion on the KBW Bank Honor Roll, the following three conditions must be satisfied:

- 1. No annual loss reported in net income per share before extraordinary items over the past 10 years (items are classified as extraordinary per the applicable accounting standard).*
- 2. 2016 annual reported net income per share before extraordinary items equal to or greater than peak net income per share over the past 10 years.*
- 3. Consecutive increases in net income per share before extraordinary items since 2009.*

We believe the past decade has been one of the most challenging in the history of U.S. banking. Over the course of these past ten years, banks faced a horrendous credit environment (2006-2010) overlaid by an extremely flat (and sometimes even inverted) yield curve (2003 and 2016). From 2007-2009, banking institutions were at the epicenter of the major concerns plaguing the market that included increased market volatility, deteriorating economic fundamentals, credit market disturbances, and a tempered economic outlook. In 2010, the economy was faced with stagnant economic growth, labor market weakness, and lackluster consumer spending. Banking institutions continued to address the overhang from nonperforming assets and restructured loans driven by a nearly seven-fold increase in non-performing assets (NPAs) from 2006-2010.

In 2011, the industry was plagued with overcapacity, and the rate, regulatory, and macroeconomic environment made it challenging for banks to achieve meaningful profitability improvement. Low rates in 2011 compressed net interest margins (NIMs) and increased regulation reduced fee income and added expense burdens. In 2012, the low-rate environment continued its course, further pressuring retail banking profitability, as loan spreads continued to compress and securities portfolio repricing weighed further on bank NIMs.

Despite 2012's uneven economic recovery and fiscal uncertainty, banks posted healthier balance sheets through active liability management and benefited from improving fundamentals as credit quality significantly improved. In 2013, banks grappled with slowing annual operating EPS growth as fee income came under significant pressure, and the benefit from improving credit continued to wane. Increased regulatory compliance costs in 2013 resulted in disappointing operating non-interest expense trends, but on the positive side NIMs showed signs of stabilization and loan growth was promising.

In 2014, banks grappled with a "lower-for-longer" rate scenario that most notably impacted profitability and sentiment. Loan growth momentum and continued solid credit trends were positives for banks during the year. SMID-cap banks continued to garner market share from larger competitors and grew at a multiple of GDP. Credit quality remained very strong and while reserve releases did not provide the earnings kicker that they once did a few years ago, losses remained well below historical levels. But, at the same time, banks faced increasing NIM pressure owing to both competitive dynamics and low absolute rates. The resultant impact of the "lower-for-longer" rate scenario on NIMs, the most meaningful input to future bank earnings, remained significant. Expense headwinds from increased financial regulation also remained an area of concern for underlying bank profitability though on the margin showed some signs of abating.



In 2015, banks faced increased economic uncertainty and a “lower-for-longer” rate scenario as the Fed maintained its near-zero interest rate policy until mid-December. Consequently, bank stock performance in 2015 continued to be rate-driven and investors remained focused on asset sensitivity. Macro-driven events dominated investor sentiment. SMID-cap banks, in particular, benefited during the year from continued strong loan growth, relatively benign credit trends and modest NIM degradation. Headwinds came in the back-half of the year from increased market volatility, slowing mortgage activity, renewed concerns about global growth and energy-specific provisioning. As energy prices hit historic lows, energy provisioning came into increased focus for those banks with energy-related lending exposure. Regulations in effect since 2010 for the largest banks continued to drive market share gains for the SMID-cap banks. Banks with differentiating features, including unique avenues of growth and select asset sensitivity tended to be 2015’s best performers. M&A for the banking industry was solid in 2015 with banks beginning to consolidate at an accelerated pace. The prevailing rate environment continued to drive deal activity as banks looked for alternative sources of earnings growth. 2015 marked an important year in the banking industry, in our view, as five M&A transactions with more than \$1 billion in value drove a 42% increase in aggregate deal value relative to 2014, and pricing continued to generally increase.

2016 was yet another unpredictable year for bank stock performance. Banks started off the year under significant pressure as investors remained concerned about slowing global/domestic growth, a re-flattening of the yield curve, falling oil prices and ultimately whether the U.S. was headed into a recession. These concerns drove investors out of bank stocks, particularly many of the growth and asset-sensitive names as well as the energy-focused banks. Banks continued to underperform until mid-February and then rallied through the end of the first quarter. First quarter 2016 earnings results generally exceeded low market expectations as both loan growth and net interest margins performed better and banks continued to accelerate capital deployment through both dividend increases and share repurchases. Investor fears appeared to be mostly over-stated, particularly on growth and credit, and oil prices began to slowly rise from mid-February lows of about \$26/barrel. During the second quarter, falling commodity prices became less of an issue and the trajectory of rates returned to the forefront of investor sentiment. A weaker-than-expected May employment report followed by the unexpected Brexit decision in late June quickly extinguished any investor hope for future rate hikes, and the yield curve flattened to levels not seen since the financial crisis.

However, the sharp correction following the Brexit vote was short-lived for banks as second quarter earnings results were fairly solid with stronger-than-expected loan growth and generally benign credit conditions. Increased market volatility put higher quality/defensive-play banks in focus and a rally in oil prices helped improve investor sentiment toward many energy-focused banks. In the third quarter, investors focused on both growth and regulatory concerns for commercial real estate (CRE) as LIBOR rates increased simultaneously, driven by the change in money fund regulations. Sentiment toward the group peaked in the fourth quarter, shortly after the U.S. Presidential election in early November. The yield curve dramatically steepened after the election and interest rate hikes were once again factored back into forward earnings expectations. Further, the outlook for corporate tax reform gained significant momentum following the election along with the view that regulatory relief could be in the prospects for the banks, buoying both investor sentiment and bank profitability expectations. The improved sentiment towards the group resulted in meaningful inflows into financial-focused exchange traded funds (ETFs), which also helped buoy the outperformance of banking stocks into year-end. We also found that institutional money managers increased their allocations to financial stocks in the fourth quarter, which provided yet another catalyst for banking stocks.


All said, the 2016 KBW Honor Roll banks have certainly earned their honor as there were many ways to make significant mistakes in the past ten years, as the 532 failed banks over the past decade can attest.

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Fifteen banking institutions posted a 10-year record worthy of admission to the 2016 KBW Bank Honor Roll:

Exhibit 1: 2016 KBW Bank Honor Roll

				
		2016 YE Price to Book	2016 YE Price to First Call Consensus 2017 EPS	% CAGR in Stock Price 2011 - 2016
Auburn National Bancorporation, Inc.	AUBN	1.4	14.0	(a) 11.1%
BancFirst Corporation	BANF	2.1	20.1	19.9%
Century Bancorp, Inc.	CNBKA	1.4	13.6	(a) 16.3%
Eagle Bancorp, Inc.	EGBN	2.5	19.7	35.8%
Enterprise Bancorp, Inc.	EBTC	2.0	22.1	(a) 21.3%
First Defiance Financial Corp.	FDEF	1.6	15.1	28.3%
First Financial Bankshares, Inc.	FFIN	3.6	27.1	22.0%
German American Bancorp, Inc.	GABC	2.4	20.5	23.7%
Greene County Bancorp, Inc.	GCBC	2.6	21.6	(a) 21.9%
Lakeland Financial Corporation	LKFN	2.8	21.5	22.4%
ServisFirst Bancshares, Inc.	SFBS	3.8	22.7	* 41.6%
Signature Bank	SBNY	2.3	16.5	20.1%
Stock Yards Bancorp, Inc.	SYBT	3.4	24.6	28.0%
U.S. Bancorp	USB	2.1	14.7	13.7%
Washington Trust Bancorp, Inc.	WASH	2.5	19.1	18.6%
Honor Roll Median Performance		2.4	19.5	21.9%
KBW Nasdaq Bank Index	BKX	1.3	13.6	18.4%
KBW Nasdaq Regional Banking Index	KRX	1.8	17.6	17.4%
S&P 500 Index	SPX	2.8	16.7	12.2%

Note: P/E based on First Call 2017 EPS estimates of March 31, 2017, except for (a) where P/E is based on 2016 year-end EPS.

* indicates that SFBS's CAGR is calculated since its initial public offering date of May 13, 2014.

Source: SNL DataSource, FactSet, Bloomberg, and KBW Research.

All 15 members were also 2015 KBW Bank Honor Roll members:

Auburn National Bancorporation, Inc. (AUBN), BancFirst Corporation (BANF), Century Bancorp, Inc. (CNBKA), Eagle Bancorp, Inc. (EGBN), Enterprise Bancorp, Inc. (EBTC), First Defiance Financial Corp. (FDEF), First Financial Bankshares, Inc. (FFIN), German American Bancorp, Inc. (GABC), Greene County Bancorp, Inc. (GCBC), Lakeland Financial Corporation (LKFN), ServisFirst Bancshares, Inc. (SFBS), Signature Bank (SBNY), Stock Yards Bancorp, Inc. (SYBT), U.S. Bancorp (USB), and Washington Trust Bancorp, Inc. (WASH).

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A Tale of Two Halves for Bank Stock Performance in 2016 Highlighted by Post-Election Optimism

After years of anticipation, the Fed finally raised rates in mid-December 2015. However, the actual hike in rates did not translate into any immediate rate relief for the banks and they started 2016 under significant pressure. Concerns about slowing global/domestic growth, a re-flattening of the yield curve, falling oil prices and ultimately the likelihood of a U.S. recession, weighed on the group. Bank stock price performance continued to track the seemingly constantly changing investor sentiment about interest rates and was temporarily challenged by sharply declining commodity prices and the unexpected Brexit vote results in June.

After the U.S. Presidential election in early November, there was a strong and swift sector rotation into financials and more specifically, banks, due to increased optimism on the forward trajectory of interest rates as well as possible regulatory and corporate tax reform. Inflows into financial-focused ETFs from Election Day through year-end 2016 totaled nearly \$9.4 billion as compared to approximately \$3.4 billion of outflows on a year-to-date basis prior to the election.

Fundamentally, banks posted solid 2016 results as continued strong loan growth and favorable credit conditions helped support earnings despite continued NIM pressure owing to a lack of Fed rate hikes and flattening yield curve for the vast majority of the year. Deal activity slowed a bit in 2016 with 241 transactions announced, as compared to 276 in 2015.

While banks broadly outperformed in 2016, there were differences by capitalization, with large-cap banks, as measured by the KBW Nasdaq Bank Index (BKX), rising 25.6% and SMID-cap banks, as measured by the KBW Nasdaq Regional Banking Index (KRX), rising 35.7%. The S&P 500 Index (SPX) gained 9.5% over the equivalent time period.

KBW Bank Honor Roll Members: A Track of Record Outperformance

In terms of price performance, the KBW Bank Honor Roll members outperformed both BKX and KRX. Over the five-year period between 2011 and 2016, the KBW Bank Honor Roll members posted significantly better-than-industry average price performance, rising 21.9% compounded annually over this time period on a median basis. This represents significant outperformance relative to both BKX and KRX's five-year compound annual growth rates (CAGR) of 18.4% and 17.4%, respectively. In addition to outperforming their banking peers, the KBW Bank Honor Roll members also outperformed the broader market, as represented by SPX, which posted a CAGR of 12.2% over the equivalent time period.

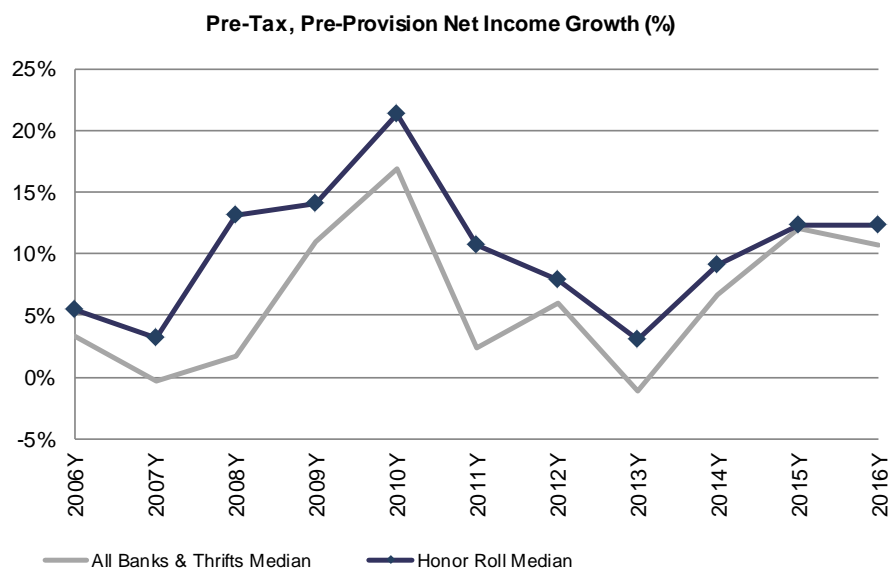
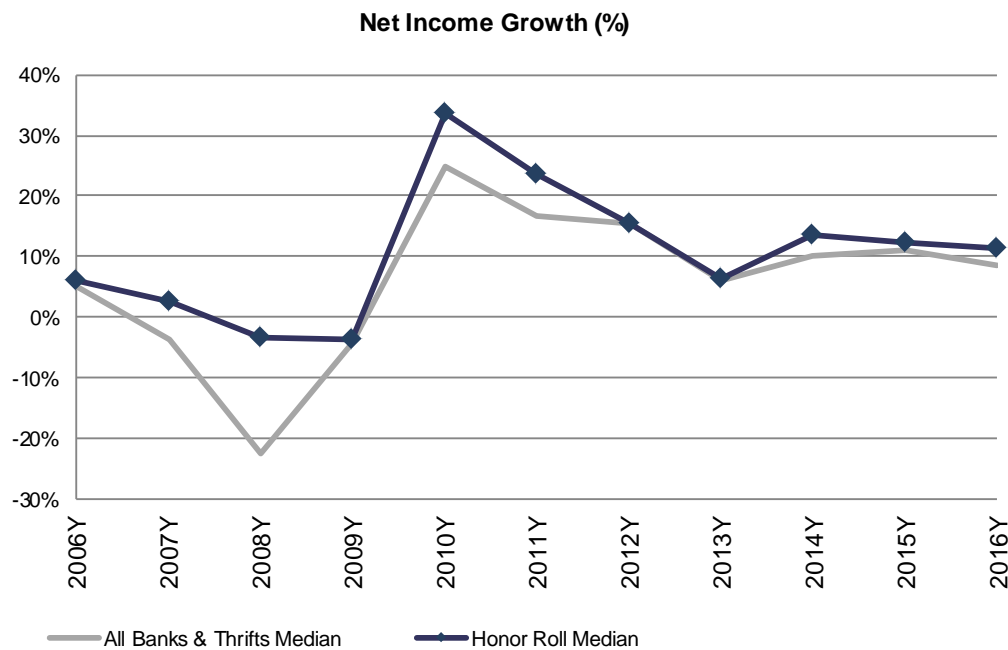
So far 2017 has proved to be challenging for bank stock performance. In 2017 through March 31, despite declining 2.8% on a median basis, the KBW Bank Honor Roll members modestly outperformed their banking peers as KRX fell 4.1%. The KBW Bank Honor Roll members and KRX, along with BKX, which rose 0.3%, all lagged SPX which rose 5.5% in 2017 through March 31.

The KBW Bank Honor Roll members trade at a premium to their banking peers. At year-end 2016, BKX and KRX banks traded at 13.6x and 17.6x consensus '17 EPS estimates, respectively. The KBW Bank Honor Roll members traded at an even greater premium of 19.5x, on a median basis. Similarly, at year-end 2016, BKX and KRX banks traded at 1.3x and 1.8x book value, respectively. The KBW Bank Honor Roll members traded at 2.4x, on a median basis.



KBW Bank Honor Roll members also have better-than-industry performance ratios and growth rates when compared to the publicly traded bank universe with total assets over \$500 million, which includes over 380 companies. We highlight these median ratios and growth rates over the past 10 years for both the KBW Bank Honor Roll members and the banking industry in the following exhibits.

Exhibit 2: Growth Rate Analysis

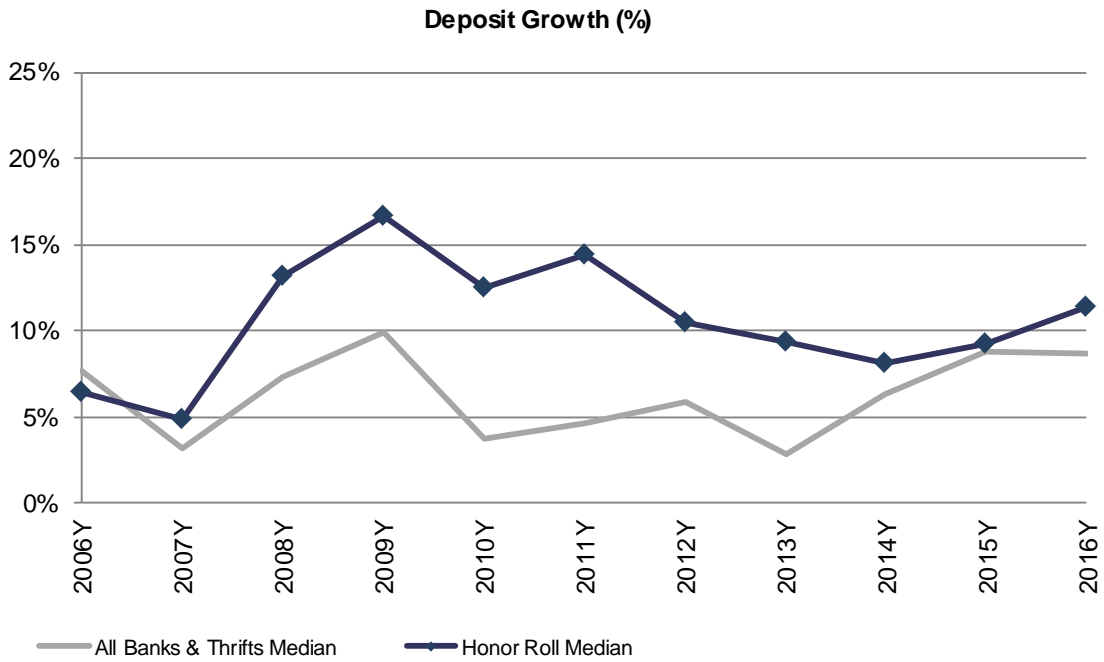
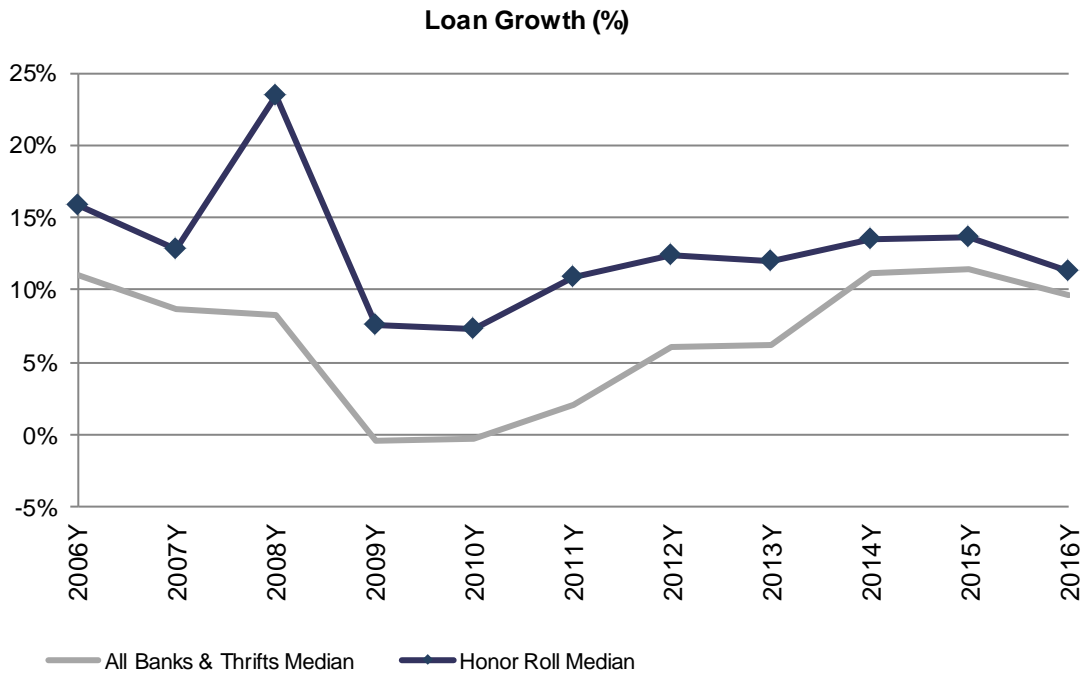


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Exhibit 3: Growth Rate Analysis (Continued)

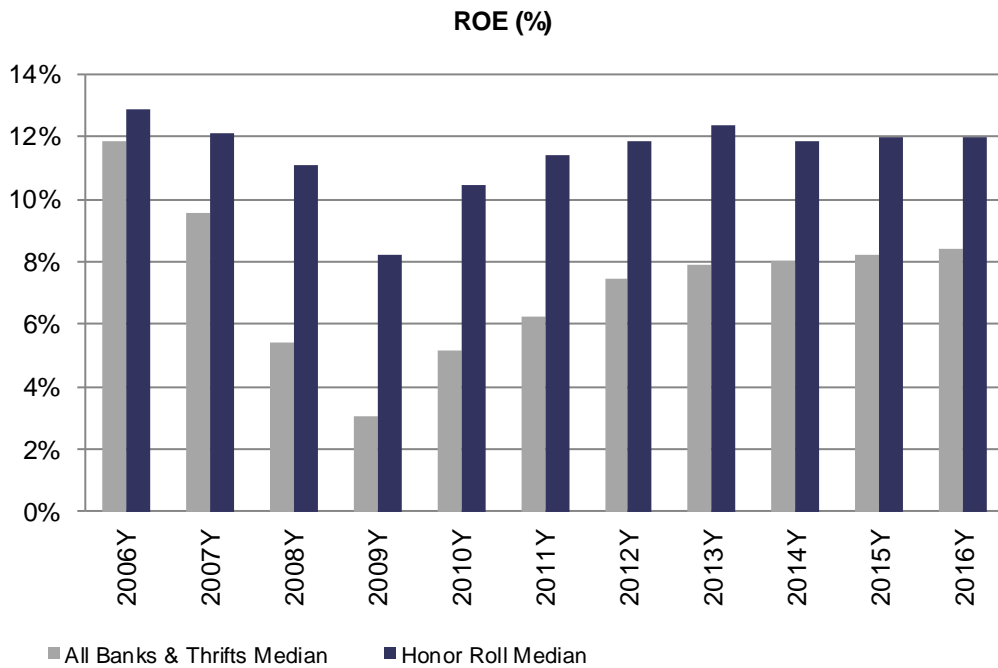
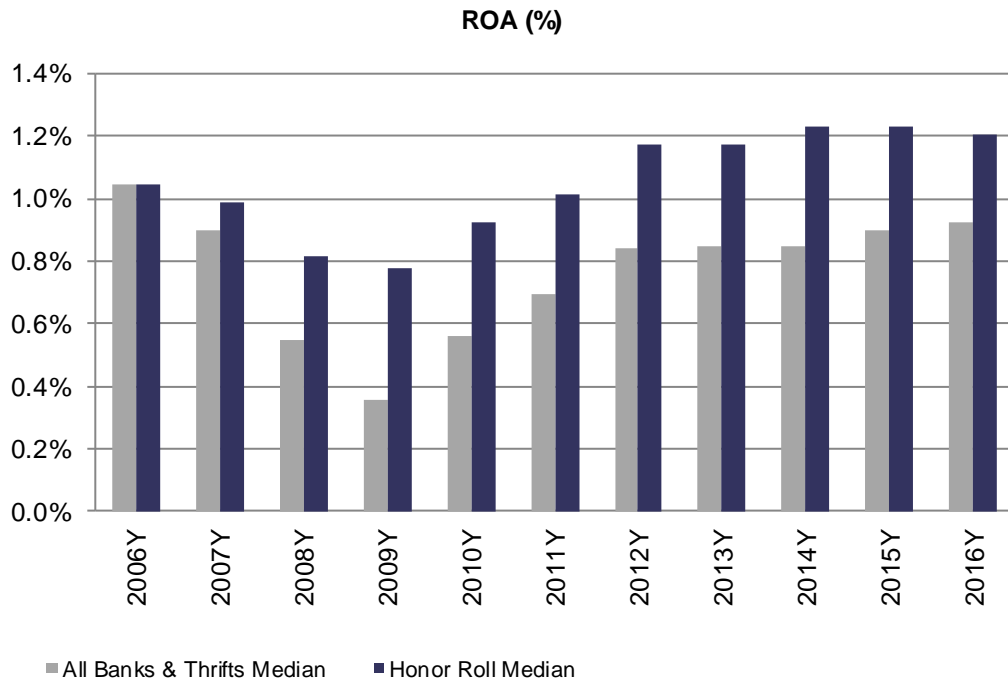


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Exhibit 4: Key Ratio Analysis



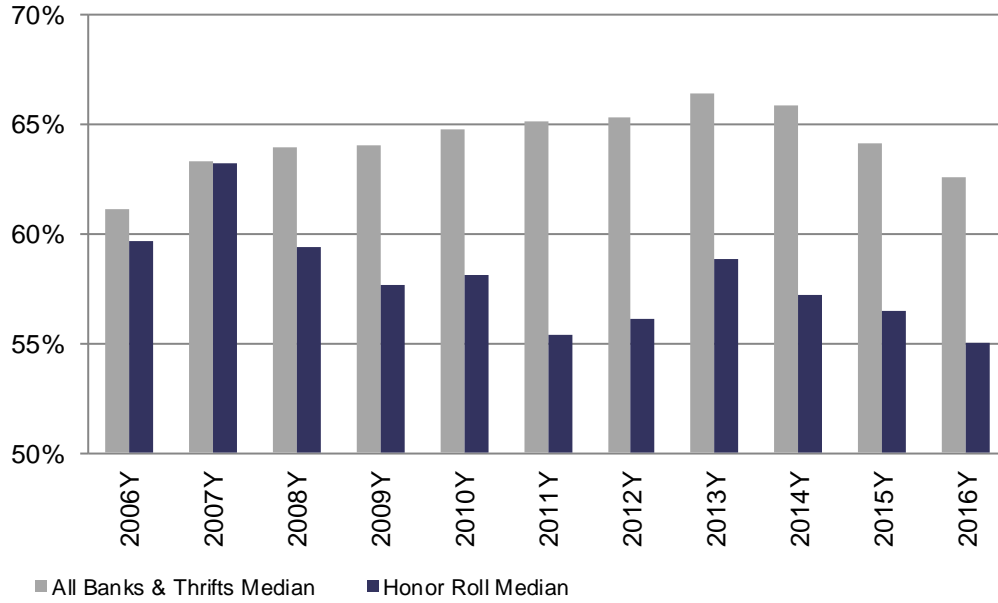
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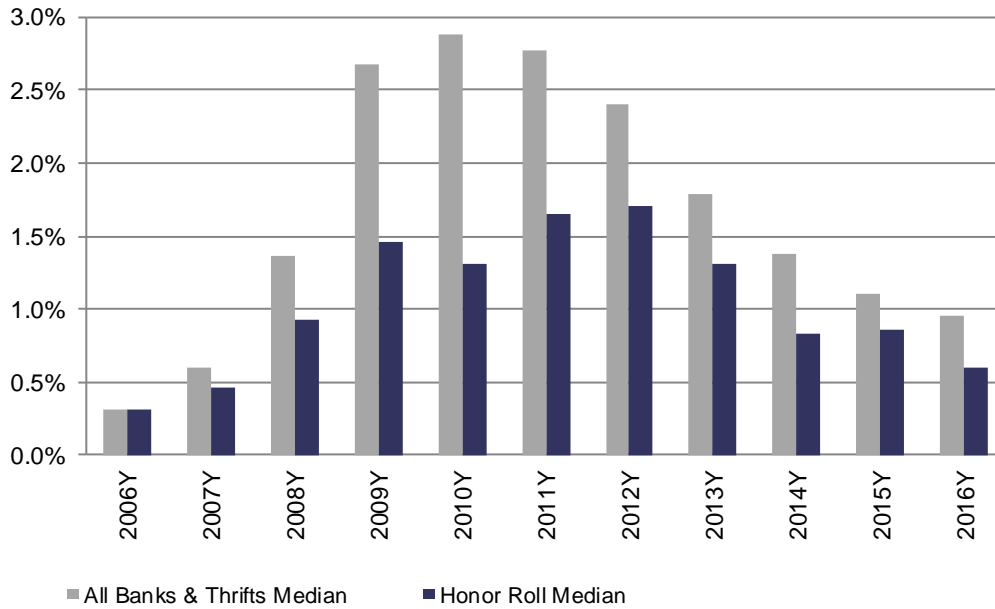


Exhibit 5: Key Ratio Analysis (Continued)

Efficiency Ratio (%)



NPLs / Loans (%)

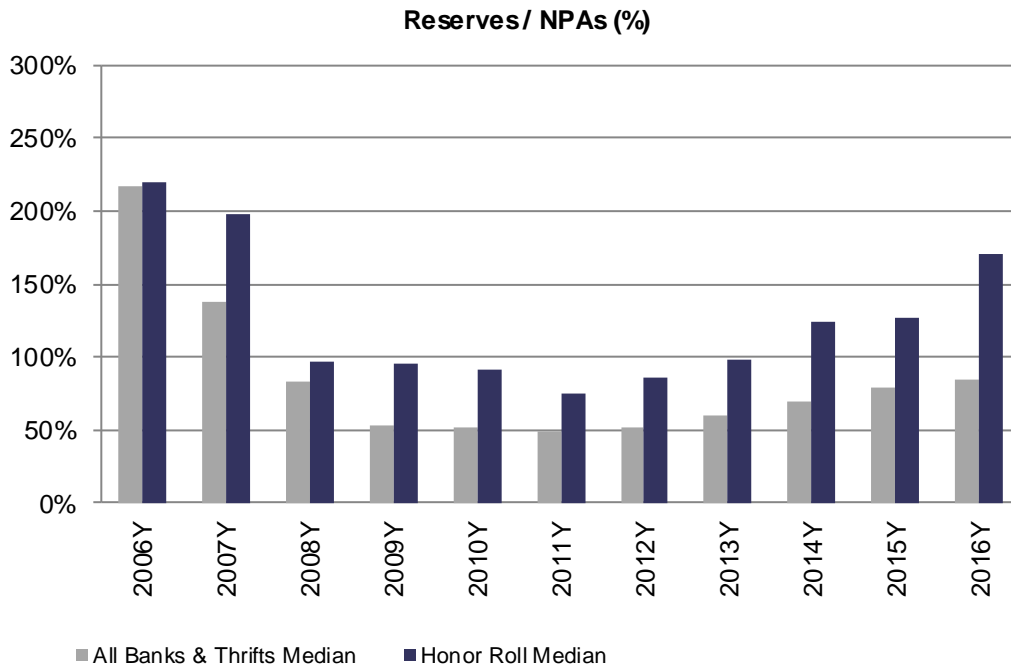


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Exhibit 6: Key Ratio Analysis (Continued)



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KBW

Rating	Count	Percent	*IB Serv./Past 12 Mos.	
			Count	Percent
Outperform [BUY]	193	31.03	74	38.34
Market Perform [HOLD]	361	58.04	114	31.58
Underperform [SELL]	40	6.43	7	17.50
Restricted [RES]	0	0.00	0	0.00
Suspended [SP]	28	4.50	6	21.43
Covered -Not Rated [CNR]	5	0.80	1	20.00

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KBW Model Portfolio: “Model Portfolio Buy” - Companies placed on this list are expected to generate a total rate of return (percentage price change plus dividend yield) of 10% or more over the next 3 to 6 months. “Model Portfolio Sell” - Companies placed on this list are expected to generate a total rate of return (percentage price change plus dividend yield) at or below -10% over the next 3 to 6 months.

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