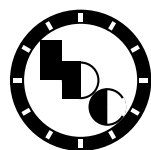


Bank Research Report

Second Quarter 2013 Report

SAMPLE BANK
City, ST



**IDC Financial
Publishing, Inc.**



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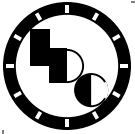
Patrick S. Kowalski

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SAMPLE BANK located in City, ST received an IDC rank which placed it in the "Below Average" group.

Information in this report is based on the bank's June 30, 2013 quarterly statement of Condition & Income as filed to the FDIC.

This institution's rating is:

Superior
Excellent
Average
▶ **Below Average**
Lowest Ratios
Rank of One

IDC ranks are based on the bank's performance of financial ratios. Ranks range from 1 to 300 (the best).

Categories of IDC Ratings

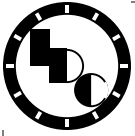
Superior (200-300): Banks rated Superior are simply the best by all measures. In addition to favorable capital ratios, most consistently generate a return on equity (ROE) above cost of equity (COE).

Excellent (165-199): Banks rated Excellent are strong institutions. Their ratios reflect quality management both from a balance sheet and income performance standpoint. Operating expenses and costs of funding are under control, producing a healthy return on equity (ROE).

Average (125-164): Banks rated Average meet industry capital standards. When compared to excellent and superior rated banks, most exhibit lower quality loans and narrower profit margins. The marginal problems of the average bank require shifts in policies and practices to raise asset quality or improve profits.

Below Average (75-124): Banks rated Below Average represent institutions under strain. Average loan delinquency is high. In many, excess nonperforming assets are above the loan loss reserve and threaten equity capital. Return on financial leverage is negligible, on average, due to narrow (or negative) leverage spreads. Banks are also rated Below Average if they are deemed "Adequately Capitalized" per FDIC capital definitions.

Lowest Ratios (2-74): The Lowest Ratios group contains some banks with less than the minimum capital required. In many, increasing loan loss provisions expand net losses on the income statement and, along with the excess of net charge-offs, reduce capital ratios. A high number of failed banks were rated Lowest Ratios prior to failure. Banks are also rated Lowest Ratios if they are deemed "Under Capitalized" or "Significantly Under Capitalized" per FDIC capital definitions. Banks are also rated Lowest Ratios if they are deemed "Adequately Capitalized" and have excess delinquent, nonaccrual, and restructured loans, or repossessed assets significantly greater than loan loss reserve and capital or as a percent of loans.



Rank of One (1): Banks in the Rank of One group have the highest probability of failure. Loans 90-days past due and nonperforming assets, on average, exceed the loan loss reserve and equity capital by a wide margin. Without major balance sheet improvement, these banks will fail. Banks are also rated Rank of One if they are deemed "Critically Under Capitalized" per FDIC capital definitions.

Since 1990, 99 percent of failed financial institutions were ranked below 75 by IDC prior to failure. The remaining 1 percent of financial institutions that failed with a rank of 75 or higher excludes those institutions involved in fraud. The vast majority of these failed banks were ranked one. Any future capital additions or losses or dramatic reductions or increases in nonperforming assets (delinquent loans) can change the bank's rank.

Fundamentals of IDC's Analysis... IDC's CAMEL

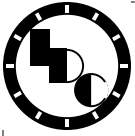
IDC has developed its own version of the commonly cited "CAMEL" approach to choose the financial ratios that have the greatest impact on the quality of an institution. CAMEL is an acronym that defines a number of areas in which the institution has to perform well in order to be profitable: Capital adequacy, Asset quality, Margins, Earning asset returns, and Leverage and Liquidity.

In the following summary, we quantify the performance of SAMPLE BANK in each area and examine those figures in relationship to each other.

"C" - Capital Adequacy

An institution must have enough capital (its own money, invested in the business) so that there is a solid cushion available in hard times -- for instance, if loan defaults increase. That's why we look at the percent of Equity Capital a bank has, relative to its total assets. Equity capital represents the amount that an institution's assets exceed what it owes to depositors and creditors. Other capital ratios include Tier 1 (Equity Capital) and Tier II (Equity Capital plus secondary capital, like long-term debt) as a percent of risk-adjusted assets. Federal regulations define risk-adjusted assets as a measure of potential safety or risk. Federal regulators consider these capital ratios important measurements and have set minimum levels that institutions must stay above.

Capital Adequacy ranges from best to worst as follows: Well Capitalized, Adequately Capitalized, Under Capitalized, and Significantly or Critically Under Capitalized. ***SAMPLE BANK is deemed to be more than "Well Capitalized." It has a strong Tier I equity capital to assets ratio and a total risk-based capital ratio substantially above regulatory requirements. The bank's strong capital position is sufficient to withstand severe economic risks.***



"A" - Adequacy of Capital

Adequacy of Capital measures how effective an institution is at lending money to people who are willing and able to pay it back. To see if it's doing this well, we look at how many delinquent and **nonaccrual loans**, as well as, restructured loans and repossessed assets it has on its books, relative to its capital and to the **loan loss reserve**, which is the fund it has set aside to cover losses from bad loans. This measures the institution's asset quality, and consequently, the risk to its capital, given delinquent, nonaccrual, or restructured loans default or repossessed assets are charged off. Seldom do other rating services, relying only on capital adequacy, scrutinize this factor adequately.

Loans at risk are delinquent, nonaccrual, and restructured loans and leases, and all other real estate owned, including repossessed assets. That is, they are so troubled that the institution does not expect repayment in full. (IDC is not able to determine the underlying collateral value of nonperforming loans based on regulatory information available.)

Problem loans can have a major impact on both the institution's profitability and its capital adequacy. The regulators require that interest payments no longer can be accrued on nonaccrual loans. Because some of these loans don't pay interest, revenues are reduced. If the full amount of principal on these loans cannot be recovered, the institution must reserve for and then charge-off (or expense) these loans in addition to any legal and collection fees. Any time that too many bad loans force an institution to charge-off more money than it has provided for in the expense item called "loan loss provision," its cash net income is reduced by that amount -- what looked like a cash profit can turn into a loss.

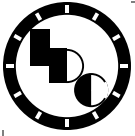
If problem loans are greater than loan loss reserves, the institution may have to make up the difference out of its equity capital. If its capital or collateral value is not adequate for this task, the institution may be in danger of failure.

Asset quality ranges from best to worst as follows: High, Average, Limited, and Poor. ***SAMPLE BANK has "High" asset quality. Nonperforming loans present little or no danger to its capital position.***

"M" - Margins

An institution must price its loans and services in addition to investment yields so that there is an adequate difference between what it earns on assets and what it pays savers in interest on deposits or borrowings. There must also be enough total revenues after interest costs to cover operating expenses. The money left over, after tax, should earn a fair rate of return on equity capital.

All of these differences between revenues and expenses are called **Margins**. And management is measured at the margins. Together, they determine the overall profitability of the institution.



By looking at each of several margin measurements individually, we can learn a great deal about an institution's operating and financial strategies.

Here, we examine three kinds of margins: Operating Profit Margin, Leverage Spread, and Return on Equity as compared to Cost of Equity Capital. Margins range from best to worst as follows: Wide, Average, Narrow, and Negative.

First, we will review the Operating Profit Margin and Leverage Spread of SAMPLE BANK.

Operating Profit Margin is defined as net operating revenue less operating costs (excluding the loan loss provision) divided by net operating revenues (net interest income plus noninterest income). This ratio allows us to focus on how well the institution is controlling its operating costs, which is key to profitability. *SAMPLE BANK has a "Narrow" margin between operating profits and net operating revenues, demonstrating a high cost of operation. SAMPLE BANK has a "High" standard deviation or volatility in the operating margin, indicating a complex or high risk profit structure.*

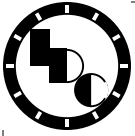
Leverage Spread is the difference between after-tax operating income relative to the cost of funding. *SAMPLE BANK has an "Average" margin between after-tax operating returns and funding costs, indicating effective use of leveraged funds.*

The final kind of margin we examine is **Return on Equity** versus Cost of Equity Capital (ROE vs. COE). Return on equity measures the percent return the institution earns, overall, on its own equity investment -- it is the final measure of profitability. The cost of equity capital is the return a prudent investor would require for investments of comparable risk.

Return on equity can be measured in two ways: First is Book ROE, which simply divides net income by equity capital. The second way, used by IDC, is the net operating profit ROE (NOPAT ROE) which divides the sum of net income plus loan loss provision minus net charge-offs by equity capital plus the loan loss reserve. This method adjusts ROE for the actual loan loss experience to the money the institution has set aside to cover it. If the provision exceeds actual losses, ROE is increased by that amount and vice versa. This method also excludes nonrecurring (one time) income or loss whereas Book ROE ignores these impacts, whether positive or negative.

We compare NOPAT ROE to cost of equity capital. An ROE above COE adds value to a financial institution. In comparison, an institution destroys value with an ROE below the cost of equity capital. *SAMPLE BANK has a net operating profit ROE below estimated cost of equity capital. The ROE is positive and provides only limited profitability for growth in capital funds, while shareholder value is eroding.*

"E" - Earning Asset Returns



An institution must control its operating (noninterest) expenses so that they do not consume a disproportionate part of its revenues. We can determine how well it's doing this by looking at how much money is left from all revenues (from loans, investments, and services) after both operating expenses and taxes have been paid, and a provision set aside for loan losses. This ratio measures the institution's "Return on Earning Assets."

Earning asset returns measure the institution's operating strategy. They measure what the bank's performance would have been if all the money lent or used to pay funding costs were its own (i.e., no interest had to be paid on savers' deposits or borrowings). By temporarily ignoring the role that leverage plays, we get a better picture of how well it's managing its operating business.

To do this, we calculate the bank's after-tax return on earning assets by subtracting operating expenses (excluding loan loss provisions) and taxes from all revenues (including noninterest income and gains or losses on investments). We adjust this after-tax return to reflect the difference between the loan loss provision and the net charge-offs of loans. Return on earning assets consists of operating income less operating expense and income taxes, but excludes the cost of funding liabilities.

Return on earning assets ranges from best to worst as follows: High, Average, and Low. *SAMPLE BANK has an "Average" after-tax return on earning assets (ROEA).*

Now, let's take a look at each of the components of return on earning assets and how the bank performed.

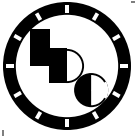
Current yield on loans. This includes interest income from loans divided by the average book value of loans. *SAMPLE BANK earned a "Low" yield on loans.*

Loan to Finance Commercial Real Estate are total real estate loans less 1-4 family real estate loans. A high percentage of earning assets invested in loans to finance commercial real estate indicates risk in the loan portfolio. *> Loans to finance commercial real estate as a percent of earning assets is "Average" for this bank, indicating moderate loan risk.*

Noninterest income. This is revenue and income (or loss) from sources other than loans and investments, such as income from fees. *This bank's ratio of noninterest income as a percent of earning assets is "High." It is an important part of its revenue source and profitability.*

Noninterest expense. The expense ratio equals operating costs divided by average earning assets. This allows us to focus on how well the bank is controlling its operating costs. *This bank's ratio of noninterest expense to earning assets is "High."*

Adjustment to net income. In this measurement, we focus on how much of the loan loss provision was added to net income. *This bank's adjustment provides a modest addition to net income, as the loan loss provision exceeds net loan charge-offs.*



"L" - Leverage and Liquidity

Leverage returns along with liquidity make up the "L" in IDC's CAMEL analysis. First, we will look at the institution's Return on Financial Leverage.

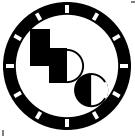
Return on Financial Leverage - A Measure of the Financial Strategy. Return on Financial Leverage measures the efficiency with which the institution uses deposits, borrowings, and other forms of debt to leverage its equity capital and reserves. Return on financial leverage is the product of **leverage spread** and **leverage multiplier**.

Leverage spread compares the after-tax return on earning assets (the measurement of the operating strategy) to the after-tax cost of funding these earning assets. Leverage multiplier is the amount of earning assets (funded by deposits and borrowings) used in relationship to equity capital and loan loss reserves provided by the institution. Financial strategy determines how much to leverage capital and at what cost.

Ratios of Leverage Spread, Leverage Multiplier, and Return on Financial Leverage range from best to worst as follows: High, Average, Low, and Negative. *SAMPLE BANK has an "Average" return on financial leverage. The cost of funding is "High," its leverage spread is "Low," and its leverage multiplier is "Average."*

Liquidity measures (1) balance sheet cash flow as a percent of the Tier I capital and (2) illiquid loans as a percent of stable deposits and borrowings plus excess liquidity. The large potential risk is the transfer of consumer deposits from stable low paying deposits to large deposits or borrowings. This can occur as consumers transfer deposits outside the banking system, requiring banks to attract new funds by increasing deposits over \$250,000 or borrowing funds. The loss of stable low-cost deposits or excessive lending is reflected as a lack of liquidity by an increase to over 100% in the percentage of illiquid loans to stable deposits and borrowings plus excess liquidity. Negative balance sheet cash flow indicates the inability of the change in retained earnings to finance the change in growth producing assets (plant and equipment, investments in unconsolidated subsidiaries, and other long term assets) or the change in liabilities (excluding retained earnings) is larger than the change in investments and loans. A negative balance sheet cash flow ratio of -66% to -100%, coupled with a high percentage of loans to earning assets, illustrates a lack of liquidity. A percentage more negative than -100% is a severe illiquid position, especially if nonperforming loans are in excess of 3% of total loans. *SAMPLE BANK has a percentage of balance sheet cash flow to Tier I capital between a negative 66% and positive 66%, illustrating ample liquidity. The percentage of illiquid loans to stable deposits and borrowings plus excess liquidity is low and illustrates excess liquidity.*

In summary, SAMPLE BANK received an IDC rank which placed it in the Below Average group.



The Federal Deposit Insurance Corporation (FDIC) and US Government insure all deposits up to \$250,000.

This report was prepared by IDC Financial Publishing, Inc., of Hartland, Wisconsin. For more information on this or other institutions, contact IDC at 1-800-525-5457 or by e-mail at info@idcfp.com.

Ranks provide IDC's opinion about the relative value of financial ratios, and are subject to limitations in their use. In IDC's opinion, the selected ratios provide an ample financial picture for rating a bank. However, the quality of individual banks can also be influenced by factors not taken into account in this analysis. The quality of a bank is not fixed over time; ranks may change with changes in management, strategy, or external conditions.

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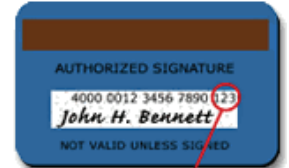
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