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Banks – Q1 2021 Earnings Season Themes

Shift from credit concerns to revenue growth: With the economy strengthening and loan deferrals down to very low levels, credit is no longer the primary concern of investors and analysts. Attention is now shifting to identifying which banks are best positioned to drive revenue growth in the current environment. Investors are eager to hear from bankers about where they can boost business – lending lines, geographies, fee-based businesses. Federal Reserve data in March pointed to modest upticks in commercial-and-industrial lending, providing the first glimmers of hope for a pick-up in organic loan growth.

Reserve releases: Banks substantially increased loan-loss reserves in first half 2020, concerned that both businesses and consumers would struggle to make loan payments amid the economic weakness created by the coronavirus pandemic. But government stimulus and loan deferral programs helped to reduce the impact of the pandemic on bank loan books, and now vaccine rollouts have bankers increasingly confident about credit quality. Investors will be looking for color during earnings season around how quickly banks will release reserves as the economy shows signs of a sustainable recovery or if they will elect to grow into their existing allowance for loan losses. U.S. banks had $236.6 billion in total reserves in December, FDIC data show, nearly double the pre-pandemic level.

Economic conditions in specific markets: Given the differences in the rate at which vaccination programs are being ramped up and business restrictions are being rolled back in various states, investors will want to understand the operating environment that banks are seeing in their particular markets. Encouraging signs on these fronts could point to business expansion and the loan growth opportunities that accompany it.

Interest rate sensitivity: Given the recent rise in long-term rates, investors are looking for cues from banks about how they are positioned to benefit from rising rates. Yields tend to rise faster on the asset side of the business – deposit costs follow – providing banks opportunities to expand their net interest margins as rates climb. Investors would welcome such a development after several quarters of heavy pressure on NIMs. That noted, until short-term rates rise, elevated liquidity levels and loan-yield compression are likely to continue weighing on margins. With interest rates presently rising only at the long end of the yield curve, investors will be interested in banks' net interest income sensitivity under a yield curve twist scenario (a change in the slope of the curve), so banks should be prepared to disclose or at least discuss this sensitivity.

Commercial real estate: The pandemic has potentially created long-term fundamental changes in the commercial real estate market, particularly in office and retail properties. To ascertain which banks are most at-risk from these potential changes, investors will want to understand the composition of CRE portfolios, any changes being made to underwriting standards, and how banks plan to diversify into other lending areas to offset lighter CRE loan production.

Paycheck Protection Program: The PPP program continues to have a meaningful impact on earnings, NIM, and loan balances for many banks. Investors will want to understand the moving parts created by the forgiveness trends of the first round of PPP loans and the newly originated loans coming on the balance sheet in the second round. It's recommended that banks provide visibility into inflow/outflow of each round and continue to provide the impact on the net interest run-rate for expenses, as well as how banks are managing the increasing need to invest in technology to meet mounting demand for digital services, products and security.

Capital Deployment: Capital levels are elevated across the sector. Buyback announcements accelerated in 2020 and remain steady. But valuations have increased across the banking sector so far this year. Investors will want to understand how the increase in valuations is impacting buyback activity, how capital deployment priorities are changing, and if more attention is being given to the growth and scale that can be added through M&A. Investors increasingly expect a steady uptick in bank M&A in 2021. There were 30 deals announced in the first quarter – light by the standards of the past decade – but we expect the pace to accelerate as the year goes on.

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About Financial Profiles

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