How to Improve Your Net Interest Margin
Brad Dahlman

Brad has 25 years of experience with financial institutions. He has held senior roles in audit, finance, operations, and technology. Over the past 10 years, he has focused on Profitability and Pricing.

Brad was a co-founder of the RPM product, which was sold to Jack Henry in 2005. He now manages Profitability (Branch/Product/Member); Pricing and Dashboarding solutions.
Webinar Series

**Phase I** – How to Improve Your Net Interest Margin

**Phase II** – How to Understand and Drive Out Expenses

**Phase III** – How to Effectively Manage Client
Agenda

• Understanding your Balance Sheet/Income Statement
• Review of industry trends (how do you compare?)
• Key Tools for Effective Margin Management
  – Relationship Profitability
  – Pricing
• Strategies for Margin Improvement
Understanding your Balance Sheet & Income Statement
## Balance Sheet - Basic

### Asset
- Cash
- Due to/from Accts
- Investments
- Loans
- Fixed Assets
- Other Assets

### Liabilities and Equity
- DDA
- Savings
- CD
- Purchased Funds
- Other Liabilities
- Equity

What you own and what you owe. Must be balanced (equal)
Income Statement - Basic

Interest Income
- Interest Expense
  Net Interest Margin (NIM)

- Loan Loss Provision
+ Fee Income
- Expenses
= Net Income

Revenues, expenses and net income for a specific time period
Review of industry trends (how do you compare?)
Industry Consolidation

Annualized

2007 2008 2009 2010 2011 2012 2013 2014

Assets and Loans (in 000’s)

2.6% annual growth in loans (2010 – 2014)
Deposits and Equity (in 000’s)

3.4% annual growth in deposits (2010 – 2014)
Net Income (in 000's)

ROA = 1.01%; ROE = 8.95%
Margin vs Fees (in 000’s)

Margin = 65%; Fee Income 35%
Non Interest Expenses (in 000’s)

Efficiency Ratio = 65%
Loan Rates and Deposit Rates

- **Loan Interest Rate**
  - 2007: 7.074%
  - 2014: 4.705%

- **Deposit Cost**
  - 2007: 4.295%
  - 2014: 0.410%
### Benchmarks for Comparison

<table>
<thead>
<tr>
<th>Category</th>
<th>2014 Annualized - Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>1.01%</td>
</tr>
<tr>
<td>ROE</td>
<td>8.95%</td>
</tr>
<tr>
<td>Client Margin</td>
<td></td>
</tr>
<tr>
<td>– Loan</td>
<td>4.705%</td>
</tr>
<tr>
<td>– Deposits</td>
<td>0.41%</td>
</tr>
<tr>
<td>– Client Margin</td>
<td>4.295%</td>
</tr>
<tr>
<td>Efficiency ratio</td>
<td>65%</td>
</tr>
<tr>
<td>Growth in loans (2010 – 2014)</td>
<td>2.6%</td>
</tr>
<tr>
<td>Growth in deposits (2010 – 2014)</td>
<td>3.4%</td>
</tr>
</tbody>
</table>

How do you compare to industry? To local competitors?
Key Tools for Effective Margin Management
Relationship Profitability – What is it…

• The ability to determine the contribution to profit that comes from each account/client.

• Based on…
  – Balance
  – Rates
  – Terms
  – Credit Risk
  – Fee Income
  – Costs (origination/servicing and transactional)

• Provides an accurate historical view of who your most profitability (valuable) clients are
Decile Profit

<table>
<thead>
<tr>
<th>Decile</th>
<th>90-100</th>
<th>80-90</th>
<th>70-80</th>
<th>60-70</th>
<th>50-60</th>
<th>40-50</th>
<th>30-40</th>
<th>20-30</th>
<th>10-20</th>
<th>0-10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Profit</td>
<td>$12,606,960</td>
<td>$720,461</td>
<td>($2,636)</td>
<td>($294,663)</td>
<td>($420,957)</td>
<td>($565,610)</td>
<td>($829,480)</td>
<td>($1,006,724)</td>
<td>($1,247,660)</td>
<td>($3,124,221)</td>
</tr>
<tr>
<td>% of Total Profit</td>
<td>216%</td>
<td>12%</td>
<td>0%</td>
<td>-5%</td>
<td>-7%</td>
<td>-10%</td>
<td>-14%</td>
<td>-17%</td>
<td>-21%</td>
<td>-54%</td>
</tr>
<tr>
<td>Ave Profit/Cust.</td>
<td>$4,623</td>
<td>$264</td>
<td>($1)</td>
<td>($108)</td>
<td>($154)</td>
<td>($207)</td>
<td>($304)</td>
<td>($369)</td>
<td>($457)</td>
<td>($1,146)</td>
</tr>
</tbody>
</table>
Loan & Deposit Balance by Decile

- Assets
- Deposits

<table>
<thead>
<tr>
<th>Decile</th>
<th>0-10</th>
<th>10-20</th>
<th>20-30</th>
<th>30-40</th>
<th>40-50</th>
<th>50-60</th>
<th>60-70</th>
<th>70-80</th>
<th>80-90</th>
<th>90-100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>50,000,000</td>
<td>50,000,000</td>
<td>50,000,000</td>
<td>50,000,000</td>
<td>50,000,000</td>
<td>50,000,000</td>
<td>50,000,000</td>
<td>50,000,000</td>
<td>50,000,000</td>
<td>450,000,000</td>
</tr>
</tbody>
</table>

Adjust Margin by Decile

- Interest Inc
- Interest Exp
- Interest w Fee & CC

90-100 80-90 70-80 60-70 50-60 40-50 30-40 20-30 10-20 0-10
Monthly Fee Income by Decile

- Loan Fees
- Deposit Fees
What does RPM look like?
What does RPM look like?
What does RPM look like?

<table>
<thead>
<tr>
<th>Profitability</th>
<th>Balance</th>
<th>Rate</th>
<th>Income/Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Income</td>
<td>$366,500.94</td>
<td>7.25%</td>
<td>$2,396.21</td>
</tr>
<tr>
<td>Funding Costs</td>
<td></td>
<td>7.25%</td>
<td>$1,557.76</td>
</tr>
<tr>
<td>Gross Margin</td>
<td></td>
<td>2.41%</td>
<td>$720.45</td>
</tr>
<tr>
<td>Less Credit Costs</td>
<td></td>
<td>0.00%</td>
<td>$30.33</td>
</tr>
<tr>
<td>Plus Loan Fees</td>
<td></td>
<td></td>
<td>$50.69</td>
</tr>
<tr>
<td>Gross Profit</td>
<td></td>
<td></td>
<td>$570.81</td>
</tr>
<tr>
<td>Less Direct Expenses</td>
<td></td>
<td></td>
<td>$229.60</td>
</tr>
<tr>
<td>Contribution</td>
<td></td>
<td></td>
<td>$545.81</td>
</tr>
<tr>
<td>Less Allocations</td>
<td></td>
<td></td>
<td>$20.00</td>
</tr>
<tr>
<td>Loss Taxes</td>
<td></td>
<td>35.00%</td>
<td>$184.03</td>
</tr>
<tr>
<td>After-Tax Profit</td>
<td></td>
<td></td>
<td>$341.78</td>
</tr>
<tr>
<td>Less Capital Costs</td>
<td>$28,002.94</td>
<td>0.00%</td>
<td>$190.39</td>
</tr>
<tr>
<td>Value Added</td>
<td></td>
<td></td>
<td>$151.39</td>
</tr>
</tbody>
</table>
Pricing – what is it...

• The ability to determine who to price the next transaction to achieve the desired return. (Commercial and Consumer)

• Based on...
  – Product
  – Balance
  – Rates
  – Terms
  – Credit Risk
  – Fee Income
  – Costs (origination/servicing)

• Provides the ability to see value of additional account and impact on relationship.
Strategies for Margin Improvement
Strategies for Margin Improvement

• Relationship Profitability
  – Decile Profitability – Segmenting clients
    • Protect clients
    • Grow clients
    • Up or Out clients
• Pricing – Effectively pricing “next transaction”
  – Commercial
    • Price for size
    • Price for risk
    • Price based on terms
    • Provide clients options
  – Consumer
    • Build standard rates for products
    • Compare to competition
    • Always have CD special but only for price sensitive clients
Summary
Summary

- First step is understanding…
  - How does your bank compare to industry/peers?
  - Have you identified your best clients?
  - Do you know the margin of your products?

- Finding the right tools…
  - Understanding of profitability
  - Effective Pricing

- Building processes to support…
  - CRM Strategies
    - Protect clients – assign officer/calls/fee waivers/bump rate on CD…
    - Grow clients – find additional products that can improve profit/cross sale
    - Up or Out clients – Find ways to adjust pricing (or improve credit)
    - Use information in fee waiver decisions
  - Commercial pricing guidelines (include in credit displays)
  - Consumer pricing sheet
The Key Formula

Tools + Knowledge + Discipline = Results
Clients that have profitability and pricing solutions have greater margins. Our clients have consistently had higher NIM and ROE than the industry. Historically between 6 – 10 bp greater margin than the industry.

<table>
<thead>
<tr>
<th>Asset Size</th>
<th>Added bp</th>
<th>Annual Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100 MM</td>
<td>10 bp</td>
<td>$100,000</td>
</tr>
<tr>
<td>$250 MM</td>
<td>10 bp</td>
<td>$250,000</td>
</tr>
<tr>
<td>$500 MM</td>
<td>10 bp</td>
<td>$500,000</td>
</tr>
<tr>
<td>$1B</td>
<td>10 bp</td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>
Our Product Set…

- Long Range Outlook
- Asset Liability Management
- Budgeting Process
- Organizational Profitability
- Product Profitability
- Customer/Member Profitability
- Loan/Deposit Pricing

PROFITstar

Budget Manager

PROFITability-Org

PROFITability-Prod

RPM

Margin Maximizer
Questions?
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