

# The Findley Reports

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## Editor's Comments

### EXCEPTIONAL PERFORMANCE IN A DIFFICULT TIME

The March Newsletter has been a time where we recognize five exceptional banks who are team players, understand the game and have exemplified exceptional performance. Exceptional performance in 2007 was not easy, based upon the challenges of the economic markets, the sub-prime debacle, the absence of core deposit growth, net interest margin compression and increased regulatory scrutiny.

Over the last several years we've always had several candidates for each of the five exceptional bank categories. This year it was not the case. There were some banks that we looked at very closely and who on paper had exceptional performance numbers for 2007, but when you look at delinquent loans, non-accruals and OREO we suspect that 2008 will be a year of headaches. Our goal in recognizing exceptional banking institutions is to recognize those that don't have picket fence performance where one year they have exceptional performance and another year poor performance. We want to recognize those banking institutions that have been consistent players; that have delivered in good times as well as challenging times. In the past four years we have recog-

nized twenty banking institutions, several of which have now been merged out of existence at exceptional multiples.

The banks recognized in 2004 were Mid-State Bank & Trust, Arroyo Grande, California; Community Bank of Central California, Salinas, California; Butte Community Bank, Chico, California; Bank of Visalia, Visalia, California; and Orange Community Bank, Orange, California.

The banks recognized in 2005 were: Citizens Business Bank, Ontario, California; Bank of the Sierra, Porterville, California; Stockmans Bank, Elk Grove, California; Metropolitan Bank, Oakland, California; and 1<sup>st</sup> Pacific Bank of California, La Jolla, California.

The banks recognized in 2006 were: Cathay Bank, Los Angeles, California; Community National Bank, Escondido, California; Plumas Bank, Quincy, California; Sonoma Valley Bank, Sonoma, California; and Bridge Bank, N.A., San Jose, California.

The banks recognized in 2007 were: East West Bank, Pasadena, California; United Security Bank, Fresno, California; Heritage Oaks Bank, Paso Robles, California; Mission Bank, Bakersfield, Califor-

nia; and Commercial Bank of California, Costa Mesa, California.

For 2007 we are happy that most of the banks identified above that are still in existence had a solid year and is further testament to strong management and a solid banking foundation.

For 2008 we are pleased to identify five banks that fall within these categories: over \$1.2 billion; \$600 million - \$1.2 billion; \$200-\$600 million; less than \$200 million; and de novo banks (less than five years old). Again, this was not a simple choice and some of the banks that look good on paper, when you start digging into the Call Reports and look at where they are currently positioned, you recognize that they have challenges ahead.

In this month's Newsletter, we have a simple profile of each of the five banking institutions recognized for 2008. We encourage our readers to become familiar with not only these five banks recognized for 2008, but also those banking institutions that have been recognized over the last four years. We believe that several of these institutions are the best of the banks and are truly exceptional financial performers and a credit to the banking industry.

#### SPECIAL POINTS OF INTEREST:

- ◆ *De Novo Grading*
- ◆ *Fair Weather Bankers*
- ◆ *CCO Turnovers*
- ◆ *Are CRE Loans the Next Problem?*
- ◆ *Bracing for Failure*

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***Our 40th Year of Banking Publications***



## Editor's Comments

### EXCEPTIONAL PERFORMANCE IN A DIFFICULT TIME *(Continued)*

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The five banks we give special recognition to in 2008 are as follows:

\* Over \$1.2 billion in assets - United Commercial Bank, San Francisco, California

\* \$600 million to \$1.2 billion in as-

sets - American Business Bank, Los Angeles, California

\* \$200 million to \$600 million in assets - The Bank of Hemet, Riverside, California

\* Under \$200 million in assets - Summit Bank, Oakland, California

\* De novo bank less than five years

old - First Community Bank, Santa Rosa, California

Hopefully these five banks can continue to make us proud for 2008 and beyond. We will recognize another five in 2009; hopefully, there will be five that we can recognize in a very difficult and challenging environment.

### DE NOVO GRADING

Included in this month's Newsletter is the fourth quarter assessment of de novo banking institutions as well as the December 31, 2007 financial performance numbers for de novo banks that opened since January 1, 2003. In the past thirty days we've had calls from four bankers of de novos that we have identified as "dogs" in our rants over the last year. We are pleased that each of these four bankers recognize that their banks were worthy of a "dog" rating, recognize that they have a significant challenge ahead, but they also know what they need to do. Identifying the problem is the first step to an acceptable solution and we are pleased that these bankers see the issues. Unfortunately, there are so many bankers, boards and even in some instances regulators that are still in a state of denial; do not see their banking enterprise for what it is -- a problem; have not implemented the right strategies to

address the issues and are only compounding their problems through poor choices and poor management.

As we have stated in the past, we anticipate that the regulatory agencies will take a much more aggressive position with a number of the de novo banks, those that have opened since January 1, 2003. We know there are several that are under enforcement actions in the form of a board resolution, memorandum of understanding or in some instances cease and desist orders. You only have to look at the institutions that have significant changes in management, continue to have significant negative financial performance and little growth to recognize that they are either under an enforcement action or are a quick candidate to be under an enforcement action.

We have been criticized in the past for stating that we believe that 35%

of the bank in California will be under some form of regulatory enforcement action or will have a major CAMELS rating of "3" or "4". That's either **Management** or **Asset Quality**. You only have to look at the banks that have opened since 2003 to see that there are a significant number of candidates for enforcement actions, additional regulatory scrutiny and for a permanent ranking as a "dank". While some have gotten the message - others haven't. Some of the messages will be delivered by the regulatory agencies; some of the messages have been delivered by shareholders not wanting to buy additional capital; and there will be no one to bail out these banks at a price the board of directors thinks their franchise is worth. 2008 much like 2007 will be a year of shareholder emotional depression for a lot of de novo banks. The numbers don't lie - just take a look and open your eyes.

### FAIR WEATHER BANKERS

We are continually amazed by the number of fair weather bankers - those that know how to navigate their bank only in calm waters and light breezes. Many of these bankers have never been in a storm, had significant deterioration in their loan portfolios, significant pressure on earnings, difficult examination processes or disarray in the board room.

While the seas got choppy in 2007 and the winds picked up, we know

there are a number of bankers that still think things will calm down in 2008 and that they have things under control. Unfortunately, they are misreading the weather, and for a lot of these bankers putting their banks in harm's way. For some time we have been emphasizing that 2008 and 2009 are going to be much more difficult than 2007. The environment that bankers now find themselves in may be similar to the perfect storm.

We suspect that several of these fair weather bankers will go down with the ship, and already we've seen a number of executives terminated or retired in just the first two months of 2008. There are a number of boards that want changes at the helm -- moving away from fair weather sailors to experienced hands. We encourage boards and executive managements, if you haven't battened down the hatches, if you haven't placed your bank into a

## Special Edition

### FIVE EXCEPTIONAL BANKS FOR 2008

*The Findley Reports* is pleased to provide special recognition to five exceptional banks. Some of these banks did have a little bit of a downturn in their performance in 2007 as compared to 2006; however, based upon the challenges that were affecting all financial institutions, their performance has to be recognized. These five banks have exemplified community and independent banking and have provided a long term solid return for their shareholders and all of their partners.

In the past five years, we have recognized 20 banks and these five exceptional banks bring the total number to 25. We have to recognize that there are some financial institutions that have flashier performance; however, we are looking for consistency and strength of the organization as well as the integrity of the Board and Management.

For 2008 we are pleased to recognize the following five exceptional banks:

**Over \$1.2 Billion Asset Size Category - United Commercial Bank, San Francisco, California.**

United Commercial Bank, San Francisco, California ("UCB") began business as United Savings Bank, FSB in San Francisco, California in 1974. In January 1998, it converted to a commercial banking charter; in October 2002 it acquired Bank of Canton, San Francisco, California; in July 2003 it acquired First Continental Bank, Rosemead, California; in October 2005 it acquired Pacifica Bank, Bellevue, Washington; in November 2005 it acquired Asian America Bank & Trust, Boston, Massachusetts; and is owned by UCBH Holdings, Inc., San Francisco, California. UCB has also added its presence in Mainland China with the

acquisition of Business Development Bank LTD, Shanghai, China. Only a few large banking companies, such as Citicorp have brought banking interest in China. UCB is the first among its peers to have full service banking platforms in China.

UCB has grown significantly over the last several years; at year-end 2005 it had total assets slightly less than \$8.0 billion and it finished 2007 with assets of approximately \$11.8 billion. While return on beginning equity for UCB dipped to 12.63% in 2007 as compared to 15.09% in 2006, net interest margin compression as well as its aggressive expansion into other markets had an impact on its overall net income.

In 2007, UCB was a "**Premier Performing**" bank and for previous years from 1999 to 2006 was "**Super Premier Performing**." But when you are looking at a entity that is multi-billion in size, regional focused, has an ability to expand in China, this is an entity that has positioned itself over the last ten years to be a significant player in banking throughout the world.

Chairman, President and Chief Executive Officer, Thomas S. Wu, has led UCB since 1999. UCB like a lot of the strong financial performers has seen consistency in its Board of Directors and consistency in its Executive Management Team. It does make sense to pick the right players and give them the tools to build the right organization.

UCB has over 70 banking offices throughout the Western United States, East Coast and in the Asian markets. UCB serves as a premier financial bridge between East and West and it is extremely competitive in the Asian market place. We

suspect that UCB will be in a position to continue its expansion looking for right opportunities to expand its banking platform and to remain at the top of its game as a premier financial banking enterprise. UCB is definitely an exceptional bank that has and will remain at the forefront of the Asian banking market.

**\$600 Million To \$1.2 Billion Asset Size Category - American Business Bank, Los Angeles, California.**

American Business Bank, Los Angeles, California ("American Business") is definitely a role model for other banks since it has a board of directors and an executive management that knows what they want and can definitely execute. They operate from one banking office in Downtown Los Angeles. Since its inception on September 28, 1998, the bank has grown to total assets over \$614 million as of year-end 2007.

American Business has been a consistent "**Premier Performing**" bank that has a wholesale focus. The Executive Management Team has been in place since the inception of the Bank as well as their Board of Directors. These guys took their role model from 1st Business Bank and have an exceptional banking franchise that provides top level wholesale banking services to top end businesses. American Business is not the bank for everyone; however, if you are a customer with this bank, you know what top quality service is all about. American Business has been under the consistent leadership of Robert Schack, Donald Johnson, Wes Schaefer, Leon Blankstein and Robin Paterson.

In looking at their financial numbers it is important to recognize

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## Special Edition

### FIVE EXCEPTIONAL BANKS FOR 2008 *(Continued)*

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that of their total deposits of approximately \$560 million at year-end, approximately \$176 million are non-interest bearing deposits and their loan portfolio was only \$285 million. Non-performing assets at year-end 2007 were zero. This is an entity that had a total of 72 employees at year-end 2007. Payroll per employee was \$128,000; assets per employee were approximately \$8.5 million; and the total operating income per employee was approximately \$466,000. You talk about getting performance from their employees.

It is refreshing to have a bank such as American Business as an exceptional bank since these guys knew what they wanted from day one and have executed on their business plan. It is also important to recognize that this is not first floor banking operation. It is located on the 9<sup>th</sup> floor of a Downtown Los Angeles building. This is where banking is taken to the customer and the needs of the customer are handled in an exceptional way. This is the definition of a business bank; this is a great illustration of a management team and board that are focused on the strategic vision and direction of the bank. Don't expect American Business to grow with tons of offices. While it operates four loan production offices, American Business expects to stay with one deposit office. American Business focuses on the quality of individuals, quality of customers and executing a plan that they know very well.

#### **\$200 Million To \$600 Million Asset Size Category - The Bank of Hemet, Riverside, California.**

The Bank of Hemet, Riverside, California ("TBOH") is an S Corporation that has been around since

June 3, 1974. In 1986 it changed its name from Bank of Hemet to The Bank of Hemet; in 1992 it merged Inland Savings & Loan, Hemet, California; and in 2003, Hemet Bancorp, its parent company converted into an S Corporation; TBOH operates from six banking offices, primarily in the Inland Empire and much like a lot of the institutions that are recognized as exceptional banking entities, has had a management team that has been in place for a number of years. The Chairman of the Board, James Jaqua, has served as its leader for 23 years and the current President/Chief Executive Officer Kevin Farrenkopf, has served in his current capacity since 2003, and as EVP/Chief Operating Officer since 2001. TBOH as an S Corporation focuses on a model where it is not looking to significantly grow its assets but to deliver to Hemet Bancorp's shareholders a significant annual distribution.

In 2007, net income for TBOH was \$10.2 million and the total cash distributions to Hemet Bancorp were approximately \$9.4 million. It has been consistently recognized as either a "Super Premier" or "Premier" performing bank and in 2007 had a return on beginning equity of 29.59% -- recognizing that it is an S Corporation.

TBOH has an exceptional efficiency ratio, its non-interest expense as a percentage of total operating income was 31.1%, significantly below the industry average which is closer to 50%. The total number of employees was 78 at year-end 2007; assets per employee were approximately \$5.2 million; and total operating income per employee was slightly in excess of \$369,000. The loan quality continues to be strong; there was no OREO and total non-performing

loans were \$151,000 at year-end 2007.

TBOH does utilize Federal Home Loan Bank advances as well as repos and short term borrowings as a mechanism to fund its loan growth. The loan totals at year-end 2007 were \$383 million; total deposits were slightly in excess of \$301 million; and Federal Home Loan Bank advances and short term borrowing and repos were slightly in excess of \$67 million. This is a bank that does not have a lot of securities and runs fairly hot from a standpoint of its loan to deposit ratio. However, this is an entity that knows quality credit, knows its market place and knows its customers. While it is headquartered in the Inland Empire, which has been a troubled area for a lot of financial institutions, TBOH has diversified its commercial real estate loans both geographically and by collateral type and limits the quantity of real estate construction or land development loans to borrowers. Day in and day out you know what TBOH is delivering. It stays under the radar screen, does its job, delivers to Hemet Bancorp's shareholders as well as to its customers.

#### **Less Than \$200 Million Asset Size Category - Summit Bank, Oakland, California.**

Summit Bank, Oakland, California ("Summit") opened for business in Oakland, California on July 1, 1982 as a subsidiary of Summit Bancshares; it remains such at this time. Since its inception, Summit has had one leader and that is Shirley W. Nelson who serves as Chairman and Chief Executive Officer. What a classy lady who has really run this bank with strong leadership for so many years and in 2007 was recognized as one of the 25 most powerful women in banking and also received a Lifetime

## Special Edition

### FIVE EXCEPTIONAL BANKS FOR 2008 *(Continued)*

Achievement Award from American Banker.

Summit operates from four banking offices and ended 2007 with total assets slightly less than \$182 million; this is down from \$195 million in 2006. However, part of that had to do with a deposit at year-end 2006 which artificially increased its assets at the time. Summit has been a consistent *"Super Premier"* performing bank. In 2007, return on beginning equity was 22%. Summit is definitely a bank that knows its market and if Shirley doesn't like it, it doesn't happen. Several members of Senior Management have been in place for over 15 years and three of the members of the Board of Directors have been in place since the inception. Consistency in management and the board does matter.

At year-end 2007, its total delinquencies were only at \$1.4 million, which is significantly below the delinquent numbers of a number of other financial institutions. Total assets at the end of 2007 were approximately \$181 million; total loans were approximately \$119 million; and its deposits stand at \$161 million of which \$53 million are DDA. Total employees at the end of 2007 stood at 39; with total assets per employee of approximately \$4.6 million; and total operating income per employee of approximately \$375,000. Summit also continues to run an exceptional efficiency ratio with non interest expense as a percentage of total operating income in the 37% range.

Summit continues to pay significant dividends to its shareholders. While we expect Summit to have a reduction in its net income in 2008 as compared to 2007, as will most financial institutions, we believe the numbers will still stay strong. This is definitely one of those banks that have proven that you do not

have to have a significant amount of mass to have an exceptional financial performance. With quality of service, focusing in on what they want to accomplish, controlling of non-interest expense (non-interest expense as a percentage of total operating income is at 37.3%) and maintaining a quality loan portfolio, you can deliver exceptional financial performance; however, it starts with a banker and Shirley Nelson is quite the banker.

#### De Novo Bank Category - First Community Bank, Santa Rosa, California.

First Community Bank, Santa Rosa, California ("First Community") is definitely on a rocket ship ride! First Community began business on January 28, 2005 with \$18.4 million in capital and at year-end 2007 had total assets of approximately \$460 million. We know that the current asset level is in excess of \$500 million and its total equity capital is currently at about \$40 million in the bank. In 2007 they completed a bank holding company reorganization and are owned by First Community Holdings, Santa Rosa, California which put in \$10 million of additional capital in 2007 to handle growth.

What is fantastic about First Community is that this is an institution that actually has gone black/black within the first three years; something that is desired by all de novos. When looking at de novo banking institutions, most institutions are lucky to achieve monthly profitability by the end of the third year. First Community was able to do it during the second year and have significant financial performance that allows them to have positive retained earnings at year-end 2007, well before the third year anniversary. Our hats are off to this entity. First Community Holdings is an S Corporation owned by

less than fifteen shareholders. First Community has benefited from merger and acquisition activity in its market place and it is anticipated that it will continue to benefit from some instability with other financial institutions for a couple of years. While we do anticipate that this bank will continue to grow, we do not see its size doubling within the next three years but rather staying in a sweet spot in the \$600 - \$800 million size.

Sometimes we have to recognize that there are institutions that need to receive special recognition, First Community is definitely one of those and we recognize them as a "Super Premier" performing bank in 2007 with strong financial numbers.

First Community operates with five banking offices at year-end 2007. We anticipate they will add a couple of additional offices in 2008. First Community is led by its Chairman of the Board William Gallaher and its Management Team of Kathy Pinkard, Debbie Fakalata with Bryan Reed have been together for a couple of years. This Board is focused as to what they want to achieve. Management is focused on how to achieve it and definitely this is a team effort. We believe that First Community will continue to be a strong player in the market place for a number of years. We do not anticipate that this is an entity that's being groomed to sell but in its S Corporation format is in a structure where it will pay significant distributions to its shareholders. Long term value is being created and was the basis upon which this model was established. Definitely an exceptional bank! Definitely one of the few de novo banks that have been able to achieve profitability in such a short period of time! Definitely a bank that has been able to grow its asset size, grow its loans, grow its deposits and make a difference in its market place. A hell of a ride in three years! Just keep it going!