

Butterfield Bank Group

Ticker: NTB - BH

Sector: Financials - Banks

Fiscal Year-End: Dec. 31, 2007

 Web Site: www.butterfieldbank.com

Share Price (10/31/08):	\$12.00
Stock Rating:	Hold
Risk Profile:	Moderate
1-Year Price Target:	\$11.00
1-Year Implied ROR:	(3.0%)

Annual Dividend:	\$0.64
Current Yield:	5.3%
Payout Ratio:	42%
Ex-Dividend Date:	11/03/08
Frequency:	Quarterly

Shares O/S:	93.0m
Market Cap:	\$1.1b
BSX Weight:	56.2%
Book Value:	\$6.51
Price/Book:	1.84x

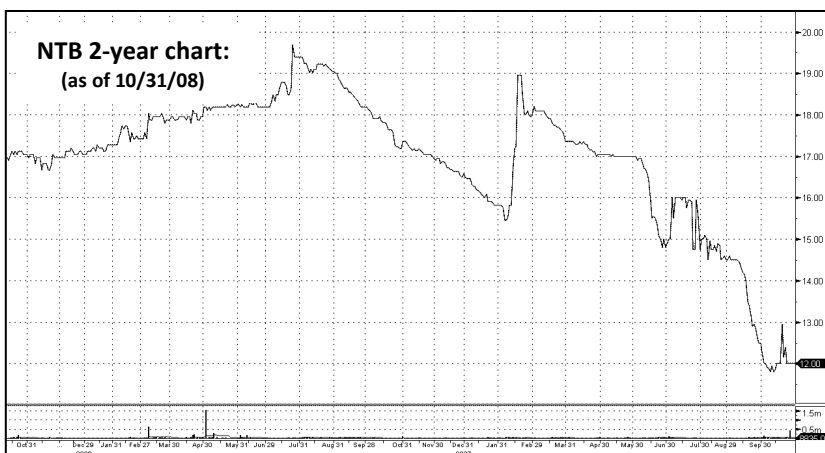
52-Week High:	\$18.95
52-Week Low:	\$11.75
Avg. Monthly Volume:	438.6k

Current P/E Ratio:	7.9x
Shareholder's Equity:	\$664.9m
Total Assets:	\$11,629.5m
Return on Equity:	23.2%
Return on Assets:	1.2%

Earnings Snapshot	2005	2006	2007	2008E	2009E
EPS:	\$1.16	\$1.39	\$1.53	\$1.12*	\$1.26*
YoY Growth:	20.8%	19.5%	9.8%	(26.7%)	12.5%
P/E Ratio:	11.0x	12.3x	10.9x	10.7x	9.0x
Fiscal YE Price:	\$12.84	\$17.05	\$16.59		

Notes:

- *2008 and 2009 EPS estimates are on an operational basis, net of extraordinary items.
- NTB distributed a 1-for-10 stock dividend in Feb. 2008. Per-share figures have been adjusted accordingly.



Company Description

Butterfield Bank Group, now celebrating its 150th year of existence, is a diversified provider of financial services, with headquarters in Bermuda. The Bank operates in nine jurisdictions worldwide, with new offices recently added in Malta, Switzerland, and Hong Kong.

Butterfield's 2007 geographic and operational revenue splits are as follows:

Revenue by Location		Revenue by Segment	
Bermuda	51%	Net Interest Income	53%
Cayman	24%	Investment & Pension Admin.	11%
Guernsey	13%	Banking Services	9%
UK	7%	Asset Management	8%
Other	5%	Trust & Custody	8%
		Foreign Exchange & Other	11%

In their latest financial release (3Q08), Butterfield reported total assets of \$11.6 billion, assets under management of \$11.0 billion, assets under administration of \$54.4 billion, and shareholder's equity of \$665 million. During the past two quarters, the Bank merged its funds services unit with that of Fulcrum Group, and announced an extraordinary gain on the transaction of \$115.5 million.

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2007 Results

Butterfield reported 2007 operating income of \$146 million, or \$1.53 per share (post the Feb. 2008 1-for-10 stock dividend), a year-on-year increase of 8.9%. Top-line growth was 13.2%, as revenues rose from \$415 million to almost \$470 million. Assets Under Administration grew by 17.9% to \$145.7 billion, while Assets Under Management were up by 20% to \$11.9 billion and customer deposits increased 7.1% to \$10.4 billion.

Group operating expenses rose by 14.4%, due primarily to employee headcount additions, information systems upgrades, and the acquisition of the Bentley Reid Group (with private client operations in Hong Kong, London, and Malta.) Return on Equity for the Group was 25.2%, well above management's target threshold of 20%.

The Bank made an unfortunate misstep during 2007 by investing almost \$1 billion in CMO's (collateralized mortgage obligations) and ABS (asset-backed securities). The majority of these new holdings had a term-to-maturity of over 5 years. While these assets were likely seen as "investment grade" or of adequate credit-quality upon purchase, some of them proved to be impaired by year-end due to the deterioration in the U.S. housing market and the subsequent "credit crunch".

Third Quarter 2008 Results

Butterfield reported net income of \$80.5 million (\$0.87 per share), compared to a profit of \$35.9 million (\$0.42 per share) for the same period in 2007. This substantial earnings increase was the direct result of an extraordinary gain of \$115.5 million on the sale and merger of the Bank's fund services unit with Fulcrum Group. The quarter also included a \$29.2 million loss on the write-down of capitalized technology, a \$7.6 million loss from the permanent impairment of a "held-to-maturity" investment, and a \$6.9 million loss relating to credit support on a Butterfield money market fund. Excluding one-time items, 3Q operating profit came in at \$15.6 million, or just \$0.17 per share – a decline of 59% from the \$0.41 reported in 3Q07. The prevailing low interest rate environment during 2008 has served to squeeze Butterfield's operating margins considerably.

There were many positives in the report. Customer deposits in Bermuda increased by \$300 million year-on-year, while Butterfield's loan portfolio increased by 10.4% to \$4.4 billion. The Bank is very liquid, with a loan-to-deposit ratio of 44.0% and a loans-to-asset ratio of 37.9%. The quality of NTB's loan portfolio remains strong, with non-performing loans totaling \$35.2 million (0.8% of total loans.)

Forecast and Recommendation

Like most financial companies, Butterfield faces a difficult operating environment for the remainder of 2008 and into fiscal 2009. Low prevailing interest rates, a weakening economy, adverse lending conditions, and an investment book potentially subject to further write-downs are just four of the myriad challenges facing the Bank going forward.

As expected, Butterfield has used the \$115 million extraordinary gain on the Fulcrum merger as an opportunity to offset some one-time losses, including write-downs to its investment book. Due to these write-downs, as well as principal repayments and maturities, the Bank reports holdings of approximately \$650 million in CMO's and \$500 million in asset-backed securities (at Sept. 30, 2008), down over 20% from year-end 2007. As U.S. mortgage delinquencies have continued to rise and the value of mortgage and asset-backed securities has continued fall throughout 2008, we expect Management to enact further write-downs to their investment book before fiscal year-end.

Despite its recent hardships, the Bank's core operations remain strong and we have confidence in management and their ability to turn things around. We expect profitability and productivity measures to gradually move higher, towards historical levels, as we progress into 2009. We apply a 9.0x multiple to our 2009 operating earnings estimate of \$1.26 per share to arrive at our one-year price target of \$11.00 on NTB shares. We currently rate Butterfield Bank shares with a Hold rating.