

Butterfield Bank Group

Ticker: NTB - BH

Sector: Financials - Banks

Fiscal Year-End: Dec. 31, 2008

 Web Site: www.butterfieldbank.com

Share Price (03/06/09):	\$7.25
Stock Rating:	Hold
Risk Profile:	Moderate
1-Year Price Target:	Under Review
1-Year Implied ROR:	N/A

Annual Dividend:	\$0.32*
Current Yield:	2.2%*
Payout Ratio:	13%*
Ex-Dividend Date:	03/12/09
Frequency:	Quarterly

Shares O/S:	93.6m
Market Cap:	\$679m
BSX Weight:	45.4%
Book Value:	\$5.54
Price/Book:	1.31x

52-Week High:	\$18.10
52-Week Low:	\$7.25
Avg. Monthly Volume:	393k

Current P/E Ratio:	5.9x
Shareholder's Equity:	\$518m
Total Assets:	\$10,912m
Return on Equity:	18.1%**
Return on Assets:	1.0%**

Earnings Snapshot	2005	2006	2007	2008	2009E
EPS:	\$1.16	\$1.39	\$1.53	\$1.22**	\$1.26**
YoY % Change:	20.8%	19.5%	9.8%	(20.5%)	12.5%
P/E Ratio:	11.0x	12.3x	10.9x	8.6x	9.0x
Fiscal YE Price:	\$12.84	\$17.05	\$16.59	\$10.45	

Notes:

- * Annual dividend was cut as of 03/06/09 to \$0.32 per annum, ½ payable in cash and ½ payable in shares. Current yield and payout ratio are shown on a cash basis.
- ** 2008 reported EPS and 2009 estimated EPS are on a normalized basis, net of one-time items.



2008 Results: Dividend Cut 50%, Government-Backed \$200 Million Share Issue

- Butterfield reported 2008 net income of \$4.8 million, or \$0.05 per share, a year-on-year decline of 97%. Net income included a one-time gain of \$115.5 million relating to the Fulcrum (fund services) merger and \$224.6 million in one-time losses – \$158.2 million related to unrealized losses in the Bank's investment portfolio, \$50.2 million to credit agreements used to support the Butterfield Money Market Fund, and \$5.2 million was due to goodwill impairment.
- Total revenue declined 1.3% year-on-year, from \$470.3 million to \$464.4 million. Net interest income was essentially flat at \$251 million.
- Total assets were \$10.9 billion, down 6.3% from Q3 total assets of \$11.6 billion and down 8.4% from year-end 2007. Assets under management declined 22.9% year-on-year to \$9.1 billion.
- Shareholder's equity fell 17.6% year-on-year, from \$629.3 million to \$518.4 million. Normalized return on equity (i.e. before one-time items) likewise fell, from 25.2% to 18.1%.

- To strengthen its capital base, the Bank announced plans to issue \$200 million in non-convertible preference shares to be guaranteed and/or purchased by the Government of Bermuda. In exchange for Government backing, Butterfield will issue 4 million 10-year share purchase warrants with an exercise price of \$7.01 and pay the Government a 1.0% per annum fee on the preferred shares issued to private investors.
- The issuance of preference shares will raise NTB's tier 1 capital ratio from 7.5% to 10.6% and their total capital ratio from 11.2% to 15.1%. For comparison, the Bank's tier 1 and total capital ratios as of fiscal year-end 2007 were 8.6% and 13.0% respectively.
- In an effort to conserve cash, Butterfield cut its fourth quarter dividend to \$0.08 per share; \$0.04 payable in cash and \$0.04 payable in stock.
- Regarding the Bank's investment book:
 - Total losses and writedowns for the year were \$151.8 million, primarily applied to US residential mortgage-backed securities deemed "other than temporarily impaired".
 - The carrying value of the investment book as a whole fell year-on-year from \$4.7 billion to \$3.8 billion, a decline of 19.4%.
 - Carrying value of CMO's fell by \$302 million, or 36.5%. The mark-to-market discount applied to the remaining CMO balance of \$526.5 million was \$161.7 million, or 30.7%.
 - At year-end, 92% of the Bank's investments were rated 'A' or higher.
- Butterfield's underlying operations remain relatively strong. The consumer loan book continued to grow, rising 16.6% year-on-year, while the commercial loan book was relatively flat. Margins have deteriorated somewhat due to low prevailing interest rates and the deep recessionary environment. However, the quality of the Bank's underlying loan portfolio remains strong, with non-performing loans flat year-on-year at 0.90%.
- Asset management (+8.0%) and foreign exchange operations (+17.5%) were bright spots in 2008, exhibiting strong year-on-year revenue growth. Fund administration revenues (-27.8%) fell significantly due to the ownership stake ceded by the Bank in the Fulcrum transaction.
- From a geographic perspective: Butterfield's operations in Barbados (+8.9%), the UK (+20.8%), and Hong Kong (+238%) showed strong year-on-year revenue growth; Bermuda operations (+3.0%) experienced mild growth, while operations in Cayman (-16.0%), Guernsey (-8.4%), and the Bahamas (-7.6%) exhibited year-on-year revenue declines.

Forecast and Recommendation

- Butterfield's capital base has declined due to a slowing economic environment combined with the significant and protracted impairment of its held-to-maturity CMO investments. The \$200 million capital injection of government-backed preference shares is a welcome and proactive step to strengthen the Bank's balance sheet and capital position.
- Given the preliminary terms announced by the company, we estimate annual servicing costs of this preference share issue of between \$15 million and \$20 million. Also, a future 4% share dilution is possible, should NTB shares rise above the \$7.01 exercise price of the warrants issued to Government.
- NTB common shares have traditionally traded based on 4-6% cash dividend yield. After the announced cut in the cash dividend to \$0.16 per annum (with another \$0.16 paid in stock), the cash yield will fall to 2.2%. Because of this lower yield and the difficulty in earnings growth going forward (due to lower credit spreads, higher cost of capital, and a recessionary environment) we would recommend that investors hold off on buying the stock.
- With unconditional Government of Bermuda backing and terms in-line with recent bank preference share issues, the forthcoming Butterfield preferred stock could prove to be an attractive investment.

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