

Butterfield Bank (BSX: NTB)

Research Update

Rating: Hold
 Target: \$1.40

Key Data:	
Industry:	Financial Services
Price:	\$1.47
52 Week Range:	\$1.09 - \$2.99
Market Cap:	\$811 mil.
Shares O/S:	552 mil.
Book Value/Share:	\$1.16
Price/Book:	1.3x
Dividend Yield :	N/A
Trailing P/E Ratio:	N/A
2009 normalised EPS*:	\$0.14
2010 normalised EPS est:	\$0.03
* non-diluted basis (pre-2009 capital raise)	

Third Quarter Loss of \$18.6 million due to Bad Hotel Loans; Bank Focusing on Risk Reduction and Return to Profitability

3Q10 Results: Butterfield ("NTB") reported a third quarter net loss of \$18.6 million, or \$0.03 per fully diluted share. After adjusting for preferred share dividends, the bank lost \$23.1 million, or \$0.04 per share. The quarterly loss was primarily due to a loan loss provision of \$14.2 million relating to as-yet unnamed delinquent hotel/resort loans in Bermuda. The bank also realized a \$7.4 million loss on the sale of its subsidiaries in Malta and Hong Kong.

On a normalized basis (i.e. before taxes and other one-time items), net income was \$4.9 million, compared to \$2.2 million for 2Q10 and \$5.5 million in 3Q09. Our 2010 normalized earnings estimate for NTB is \$16.0 million, or \$0.03 per share.



Net interest income before credit-related provisions rose by 8.2% quarter-on-quarter, from \$42.7 million to \$46.2 million and was essentially flat year-on-year, despite a lower asset base. Total deposits were \$8.1 billion and have declined by \$300 million in each of the past two quarters – although this was largely due to the one-time effects of Cayman-based hedge fund redemptions.

Non-interest income for the quarter was \$34.0 million, down 9.7% from 2Q10 due to modest sequential declines in foreign exchange, community banking, and asset management revenues. Total non-interest expense stood at \$75.4 million – relatively flat from the prior quarter and up by 3.0% year-on-year. Management appears to be shifting a variety of smaller, less-tangible expenses into employee and technology-related expenditures – a positive step towards improving efficiencies.

From a jurisdictional perspective – Bermuda numbers were encouraging ex-loan loss provisions, Cayman results were down marginally, Guernsey showed impressive growth, and the UK operations suffered from exchange rate difficulties, in addition to a \$1.5 million loan loss provision. The Barbados, Bahamas, and Swiss offices showed insignificant contributions, though NTB management maintains their commitment towards improving future returns in these jurisdictions.

Following the massive write-offs of the last two years, the bank's investment portfolio has stabilized. The fair value of NTB's investment portfolio appreciated by 12.3% during the quarter, from \$2.4 billion to \$2.7 billion. New investments were made in investment grade U.S. government agency mortgage-backed securities and non-U.S. sovereign-guaranteed corporate bonds.

The bank's capital base held firm during the quarter, with a total capital ratio of 21.6%, tier 1 capital ratio of 15.7%, and tangible common equity of 6.3%. These capital ratios remain well in excess of applicable regulatory minimums. Book value per share fell by a penny to \$1.16 during the three-month period.

Forecast and Recommendation: Now that NTB management has cleaned up the disaster that was the bank's investment book, they face a host of operational challenges – including a low interest rate environment, a potentially troublesome loan book, and a fluctuating deposit base. Given the size and duration of the recently-announced QE2 plan, the United States may well extend the epoch of artificially low short-term rates into the next several quarters – hence, interest rate spreads will remain slim. On the positive side, we expect improved contributions from asset management following the recent strength in worldwide capital markets. Furthermore, a declining U.S. dollar will help the bank via the currency translation of the bank's foreign revenues. We remain wary of further deterioration in the loan book, as the latest write-downs of hospitality industry loans came as somewhat of a surprise.

Although we have faith in the new management regime and welcome both their focus and transparency, we find it difficult to recommend the purchase of NTB shares until the bank has shown successive quarters of clean profitability. LOM continues to rate NTB shares as a Hold with a price target of \$1.40.

Financial Summary:

BMD\$ (in millions)	2006	2007	2008	2009	2010E	2011E
Revenue, operating	\$415.1	\$470.0	\$464.4	\$233.7	\$270.00	\$285.00
Net Income, reported	134.1	146.0	4.8	(213.4)	(205.0)	15.0
Net Income, normalized*	84.4	93.9	59.2	14.1	16.0	25.0
Reported EPS (diluted)**	\$1.35	\$1.48	\$0.05	(\$2.34)	(\$0.37)	\$0.03
Normalized EPS* (diluted)**	\$0.86	\$0.96	\$0.60	\$0.14	\$0.03	\$0.05
Total Assets	11,133	11,911	10,912	9,595	9,200	9,500

Notes: * Normalized Earnings = Net Income before Gains and Losses plus Provision for Credit Losses less Dividends Paid (both common and preferred.)

** Historical EPS numbers are calculated on former O/S share base of 98.4 million; future estimates use a pro forma O/S share base of 552m.

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