



Catching Something

- ◆ Last week's free fall in the equity and credit markets was one for the record books, bringing back unpleasant memories of the 2008 financial crisis. This time around, the immediate issues have nothing to do with concerns about capital levels at U.S. banks. This did not prevent a sharp drop in bank stocks, along with a widening of credit spreads. Even regional banks like **PNC Financial Services Group (PNC)**, which is not a big player in global capital markets or in Asia, was caught up in the general down draft. We don't know how much of the selling is based on fundamentals versus pure panic. But there are valid reasons to worry that earnings across the banking sector will be pressured this year if the Federal Reserve is forced to cut rates in response to the crisis. Net interest margins were already under pressure even before the coronavirus emerged as a threat. *Asset quality remains strong, but credit issues could emerge if economic growth slows in the U.S., which seems increasingly likely given the global spread of the virus (affecting the supply chain), combined with the emergence of new domestic cases.*
- ◆ PNC earned \$1.4 billion in the fourth quarter, up 2% year-over-year. The net interest margin in the fourth quarter was 2.78%, down from 2.96% a year ago. The NIM compression was offset by loan growth and by higher noninterest income. Noninterest income accounted for 46% of total revenues in the fourth quarter. This includes higher earnings from the company's 22% equity investment in BlackRock. The net chargeoff rate was 0.35% in the fourth quarter, up sequentially from 0.26%, reflecting higher losses on credit card and auto loans, but still low by historical standards. On its fourth quarter earnings call, PNC said that CECL, the new accounting standard for credit losses, would boost its reserves by 21% (\$650 million) as of January 1, 2020. The increase primarily reflects the higher reserves required for consumer loans. PNC estimates its first quarter loan loss provision at \$225 million to \$300 million, up from \$221 million in the fourth quarter. In mid-January (prior to the full-blown emergence of the coronavirus threat), PNC said it expected its average loans to grow by about 4% to 5% this year, which would help it to achieve modest revenue growth. Expense control is a focus, and the company has been telling investors it intends to achieve positive operating leverage this year.
- ◆ Given its steady profitability, PNC has been generating enough capital to maintain its capital base, while buying back large amounts of stock. In January 2020, it announced a \$1 billion increase in its share repurchase authorization through the second quarter of 2020. This is in addition to the \$4.3 billion, four-quarter, buyback program it disclosed in June 2019. Last year, PNC returned \$5.4 billion to shareholders, including \$3.5 billion in buybacks and \$1.9 billion of common dividends. The CET1 ratio was 9.5%, down slightly from 9.6% a year ago. This isn't as strong as the level maintained by JPMorgan (12.4% at 12/31/19), but PNC doesn't have the same level of exposure to global market volatility as JPM. *It also has a stronger supplementary leverage ratio: 7.6%, versus 6.3% for JPM.*
- ◆ In mid-January, PNC (holding company) priced \$2.0 billion of senior notes due 2030 at a spread of T+78. Last week, the yield on the 10-year benchmark Treasury dropped by over 30 basis points, to 1.13%, reflecting the flight to safety in global financial markets. *The spread on the new PNC issue widened to T+102 as of February 28.* We have no way of predicting what will happen over the next few weeks in the stock and bond markets, but our credit score for PNC remains stable. Given the company's diversified revenue mix, strong liquidity, and low level of nonperforming assets, we view it as well-positioned relative to its peer group to ride out the current market turmoil. **We maintain a buy opinion on the 2.55% notes due 1/22/30.**

Gimme Credit LLC
Analyst's Data Sheet

Regional Banks
PNC Financial Services Group
Kathleen Shanley, CFA
March 2, 2020

Five Quarter Financial Statistics

\$ millions	4Q19	3Q19	2Q19	1Q19	4Q18
Income Statement:					
Net interest revenue	\$ 2,488	\$ 2,504	\$ 2,498	\$ 2,475	\$ 2,481
Non-interest income	2,121	1,989	1,941	1,811	1,859
Total revenue	4,609	4,493	4,439	4,286	4,340
Operating expenses	2,762	2,623	2,611	2,578	2,577
Pre-provision profit (pretax)	1,847	1,870	1,828	1,708	1,763
Provision for credit losses	221	183	180	189	148
Pretax income	1,626	1,687	1,648	1,519	1,615
Income taxes	245	295	274	248	264
Net Income	\$ 1,381	\$ 1,392	\$ 1,374	\$ 1,271	\$ 1,351
Noninterest income/revenues	46%	44%	44%	42%	43%
Net interest margin (FTE)	2.78%	2.84%	2.91%	2.98%	2.96%
Efficiency ratio	60%	58%	59%	60%	59%
Loan/deposits	83%	83%	87%	86%	84%
Balance Sheet (period end):					
Total assets	\$ 410,295	\$ 408,916	\$ 405,761	\$ 392,837	\$ 382,315
Commercial lending	160,602	160,188	161,603	158,442	152,282
Consumer loans	57,420	56,107	55,520	54,744	55,306
Residential real estate-consumer	21,821	21,082	20,092	19,107	18,657
Total loans and leases	239,843	237,377	237,215	232,293	226,245
Allowance for loan losses	(2,742)	(2,738)	(2,721)	(2,692)	(2,629)
Net Loans	237,101	234,639	234,494	229,601	223,616
Loans held for sale	1,083	1,872	1,144	686	994
Deposits	288,540	285,583	273,260	271,221	267,839
Common equity	45,321	45,428	45,349	44,546	43,742
Total shareholders equity	49,314	49,420	49,340	48,536	47,728
Basel III Capital Ratios:					
Common equity tier 1	9.5%	9.6%	9.7%	9.8%	9.6%
Tier 1 risk-based	10.7%	10.7%	10.9%	10.9%	10.8%
Total capital risk-based	12.8%	12.7%	12.8%	13.0%	13.0%
Leverage ratio	9.1%	9.3%	9.6%	9.6%	9.4%
Supplementary leverage ratio	7.6%	7.8%	8.0%	8.0%	7.8%
Asset Quality:					
Net chargeoffs	\$ 209	\$ 155	\$ 142	\$ 136	\$ 107
Net chargeoff rate	0.35%	0.26%	0.24%	0.24%	0.19%
Nonperforming loans	1,635	1,728	1,724	1,653	1,694
Nonperforming assets	1,752	1,847	1,850	1,785	1,808
NPLs/loans	0.68%	0.73%	0.73%	0.71%	0.75%
NPAs/loans & OREO	0.73%	0.78%	0.78%	0.77%	0.80%
Allowance/loans	1.14%	1.15%	1.15%	1.16%	1.16%
Allowance/NPLs	168%	158%	158%	163%	155%

Source: Company reports