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Banks' oil-based reserves fail to calm the Street's fears

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Banks in oil-rich states took a barrage of questions during fourth-quarter 2014 earnings season and provided new details on their energy exposures, but failed to quell the Street's concerns.

Most banks with operations in Texas, Oklahoma and Louisiana recognized that the Street was hungry for details on their energy lending businesses given the sharp decline in oil prices over the last six months. Bank managers hoped to stave off selling pressure on their stocks with new disclosures on their energy portfolios. And most of the publicly traded banks in Texas, in particular, set aside specific reserves to account for the decline in oil prices, even if they currently do not see any adverse trends in their portfolios.

Still, the Street seems to have taken the new information in its stride. Stocks of previously hit banks have rallied modestly on the back end of earnings season, but the short-term pop has come virtually in tandem with oil prices rebounding off recent lows in late January. Banks seem to have failed to fully win back investors, who are largely expected to stay on the sidelines from banks with exposure to the energy sector at least through the first half of 2015.

The investment community has adopted a wait-and-see approach for now. And the banking industry's acknowledgement that the future remains unknown has only solidified investors' trepidation.

RBC Capital Markets analyst Jon Arfstrom summed up the mixed outlook that banks delivered during fourth-quarter earnings calls. The analyst said that earnings season left him a bit more cautious on the "Texas & Gulf names" that might see continued volatility due to uncertainty over energy prices. He also noted that some banks increased energy-specific reserve allocations in the fourth quarter.

"While the updated outlook for energy-related losses is rather consistent, management hedged this view somewhat, suggesting that risk-rating downgrades could occur as soon as 1Q15, which may trigger higher provisions," Arfstrom noted in a Feb. 9 report.

A number of Texas-based banks, including Cullen/Frost Bankers Inc., LegacyTexas Financial Group Inc., Texas Capital Bancshares Inc., Comerica Inc. and Green Bancorp Inc., set aside energy-specific reserves in the fourth quarter. Some banks also offered far greater detail on their energy operations, with IBERIABANK Corp. allocating four slides to discuss the recent volatility in oil prices and the breakdown of its energy portfolio by concentration and risk profile. Green Bancorp took a similar approach, devoting two slides to its energy business in just its third earnings season as a public company.

Virtually every bank in Texas, Louisiana and Oklahoma commented on their energy businesses, even if they did not create specific slides on the issue. The comments were nearly uniform, with management teams predicting minimal near-term losses while noting that the full impact of falling oil prices is currently unknown and yet to materialize.

The plunge in prices to date seems to have had a modest impact on the Texas economy thus far. Sterne Agee analyst Brett Rabatin noted that jobs grew at a 3.7% annualized pace in Texas in December, compared to a 2.2% growth rate for the U.S. He further noted that the Texas Leading Index also only declined 1.1 to 131.4 from September to November, the most recent period for which data is available. Still, the analyst said construction contracts declined 8% in November and the manufacturing outlook moved to 2.5 in January, down significantly from the mid-20s and low-30s in the past year.

"The bottom line is it looks like Texas GDP growth will slow from a 4%-5% pace the past few years to a ~2% level. Not bad, and probably not much different than the overall outlook for the U.S.," Rabatin wrote in a Feb. 3 report.

Some bankers even suggested that lower oil prices could offer a boost for their local economies. Hancock Holding Co. President and CEO John Hairston noted that the Louisiana economy is far more diversified today than during the oil-led recession in the 1980s and said declining prices could have a positive impact on some industries. The chemical industry, for instance, which is large in Baton Rouge, tends to improve when energy prices are low, he said.

"So I'd guess in Louisiana, presuming the duration is relatively light, generally I would say probably it's a net positive in Louisiana. Other people may think that's going to be a little bit more bearish, but our experience would indicate that Louisiana will generally, across the board, benefit," Hairston said during the company's fourth-quarter 2014 earnings call, according to the transcript.

Cullen/Frost, meanwhile, predicted that business activity would slow down in the first half of 2015, even if it has not yet witnessed a decline in growth. Cullen/Frost Chairman and CEO Richard Evans Jr. said the company had contacted and visited 90% of its energy-related customers based on committed dollars, and decided not to make energy-related additions to problem loans since the third quarter of 2014.

"I would tell you that things are going to slow, particularly in the first 90 days to six months of this year. Because what's going to happen, I told you that our service companies expect their revenues to be down 30% to 50%. That's a pretty good drop," Evans said during the company's fourth-quarter 2014 earnings call, according to the transcript. "So what's going to happen, people that were running four rigs are going to two or one. You've seen the rig counts, they're coming off pretty fast."

The executive still described the process as healthy since companies are looking to become more efficient. He also said there is "tremendous money and capital" standing on the sidelines waiting to acquire distressed products.

"I can't tell you how many calls I get from funds and individuals wanting to buy some problems. I don't have any problems to sell them. That's the good news," Evans said.

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For now, the Street seems to expect that problems, in some form, will eventually arise. Investors are also struggling to estimate what indirect impact falling prices will have on the economies of states like Texas and Louisiana, which outperformed in the years following the credit crisis, in part due to the strength of the energy business. RBC's Arfstrom noted that measuring the indirect impact that weaker oil prices have on the economy is difficult to assess.

"Overall, we remain cautious on the region and will continue to closely monitor economic trends while the situation continues to unfold," Arfstrom wrote in a report.

Caution seems prudent since even those analysts that believe the sell-off in some banks is overdone recognize that the depressed price of black gold could cast a cloud over many bank stocks for the time being.

"Indeed, while we continue to view the sell-off in energy-exposed banks over the past few months as overdone, oil price-driven sentiment will continue to drive nearer-term stock performance for these banks, in our view," Raymond James bank analysts wrote in a Feb. 5 report. "Fundamentally, however, we continue to believe well-positioned banks with expertise/long tenure in the energy space will benefit from the drop in oil prices through increased lending to long-established clients, market share gains from the pullback of recent entrants and foreign banks, and acquisition of new clients."

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