



January 2010

BANKERS' BANK OF THE WEST

From the desk of William A. Mitchell, President and CEO

In talking with customers in recent weeks, I heard that 2009 was a year for addressing asset quality issues and establishing a strong foundation for the future. Many of our customers acknowledge more work needs to be done but think community banks have turned the corner. Most bankers expect 2010 to be a better year in spite of lower-than-normal earnings.

At Bankers' Bank of the West, we feel the same way. Last year we managed through some challenging bank stock loan and commercial real estate issues. We entered January feeling we've made considerable progress toward aggressively resolving problem loans.

Since the start of the country's CRE downturn—marked by the secondary market collapse in August 2007—the banking industry is now 2-1/2 years into this downturn. It appears the bulk of CRE level 1 problems have surfaced although bankers will still be keeping an eye on CRE level 2 portfolios. The same holds true for BBW. Any weakness in our CRE portfolio has most likely been identified and addressed. We will, of course, continue to monitor the portfolio proactively.

Probably the bigger challenge for BBW in 2010 will be managing through the bank stock loan portfolio, as several of our customers are dealing with difficult issues. With this in mind, we have aggressively reserved for future problems: The bank's loan loss reserve ended the year at 4.12%, an increase from a reserve of 2.37% as of year-end 2008, and 0.71% as of year-end 2007.

Charge-off for 2009 was high. We incurred gross charge-offs of \$13.8MM. Of this, \$7.9MM was related to bank stock loans, and \$5.9MM to CRE credits. We did recover \$727M during the year.

Despite high charge-off, the bank ended 2009 with strong capital ratios. Risk-based capital, tier one risk-based capital, and leverage capital were 13.78%, 12.50%, and 8.68%, respectively, as of Dec. 31, 2009, versus 12.40%, 11.14%, and 8.28% for Dec. 31, 2008. While our capital ratios are currently strong, I think they will increase throughout 2010 as a consequence of expected lower loan loss provisions—much lower, I hope.

For the first time in my career, I considered earnings in 2009 secondary to the aggressive identification and resolution of loan problems. Earnings suffered for the year because of this aggressive stance on loan loss provisions. Bankers' Bank of the West incurred a loss for net income of \$4.7MM, or (1.01% ROAA), in 2009. The bank also took a very conservative approach from a tax planning perspective, accelerating some highly likely losses. This conservative stance positions us well for the future.

Though widely expected to be a better year, 2010 is sure to present challenges of its own. Accordingly, we have budgeted \$7MM for loan loss provisions. Provisioning at this level should still assure a profit for the year and set us up for near-normal earnings in 2011.

Just as you take pride in your team's accomplishments, I am pleased the staff of BBW has identified, addressed and rectified many of our loan issues. The waters are not yet still, but the sky is starting to clear. We look forward to calmer sailing in the future and wish all our customers a happy and prosperous year ahead.