

FUND FINANCE FRIDAY

Q1 Bank Earnings Takeaways

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By Chris van Heerden
Director

First quarter bank earnings clarified the new operating environment in 2022 in which loan growth will continue to be a key driver of earnings growth and valuation. Fund finance business lines can continue to be a material contributor in the year.

The quarter illustrated that a “higher-rates-good-for-banks” thesis for the year may be oversimplified. Instead, lower mortgage originations and the slump in capital markets activity drove revenue declines for the largest banks, while mid-cap players with less exposure to the two were able to drive top-line growth. The capital markets weakness had been well telegraphed prior to earnings, with Dealogic having reported a 35% year-over-year decline in publicly disclosed investment banking fees for the quarter and Refinitiv data confirming that 2022 was off to the slowest start in capital markets since 2019.

Management teams affirmed a focus on loan growth to deploy larger balance sheets into a higher rate environment and drive net interest income. While this mandate is shared across the industry, results for the quarter varied. Within the large cap group, loan growth was generally in the positive single-digits and accelerating, while some of the mid-cap banks affirmed targets for a more robust year similar to 2021.

We see the loan growth priority carrying through the year. Elevated capital markets volatility should be the base case and may continue to add a drag to non-interest fee income businesses. Capital deployment into securities in a rising rate environment is also less attractive (no negative convexity in fund finance). A material share of the net new originations will need to come from outside of consumer businesses where loan demand is more interest rate sensitive.

Of course, “higher-rates-good-for-banks” is not wrong, and net interest margins posted material improvements with further expected upside in coming quarters. Where granular detail was available, fund finance utilization was slightly down from the recent highs but continued to hold well above the historic average.

On the whole, the quarter illustrated that bank balance sheet and income objectives continue to align with the expanding demand for credit in the fund finance space. On that note, the recent KKR [Investor Day presentation](#) is another perspective on what we see as the same theme (count the number of times the words “scale” or “scaling” show up). Scaling is the name of the game for private capital platforms and, we think, for fund finance lenders in 2022.