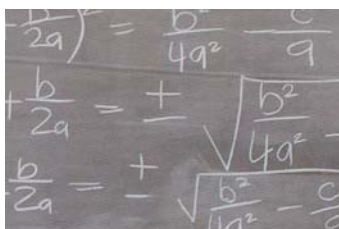


Interpreting CU Ratios

What they mean.
What's a safe and sound range?
How the Ratios Interact and relate.



Being buried in numbers, raw data, may excite some people. This program is based on the general experience that nearly all CU Volunteers and non-financial staff prefer and benefit from a short list of essential ratios. “Essential” means that by knowing them well means when they go in the wrong direction, up or down, your curiosity inspires research that preserves viability.



Directors do not need to calculate ratios. Being diligent means knowing something about where ratios come from and what they mean for the organization.

1. **NET WORTH RATIO**

$$\frac{\text{NET WORTH}}{\text{ASSETS}}$$


Safe and Sound Ratio

Typical account names on the Balance Sheet that represent Net Worth:

- Undivided earnings
- Retained earnings
- Regular reserve
- Reserve for investment losses
- Any number of “special” reserves
- Capital
-
-

- In general _____ is better.
- An upside limit could be _____%
- A ratio that exceeds a reasonable relation to asset risks could mean:
 1. Cons _____
 2. High quality loans, collections, etc.
 3. Operating efficiencies not shared with Members.
- Falling below _____% triggers PCA, Prompt _____ Action. For FCU’s

2. **NET INCOME & ROA**

$$\text{INCOME} - \text{EXPENSES} = \text{NET INCOME}$$

$$\frac{\text{NET INCOME}}{\text{AVERAGE ASSETS}} = \text{ROAA}$$


Performance Ratio

- In general _____ is better.
- _____% has long been a benchmark for deposit institutions.



To aid in comparative analysis, divide each annualized income statement line item by average assets for the same period .

This is called _____
_____ .

Try using a moving average: add actual twelve month’s net income, divide by averages assets those same 12 months.



3.

GROSS MARGIN

$$\begin{aligned} &\text{INTEREST INCOME} \\ &\quad - \text{Cost of Funds} \\ &= \text{GROSS MARGIN} \end{aligned}$$

Divide annualized Gross Margin by
Average Assets for the same year.



Performance
Ratio

- In general _____ is better.
- This is one of the essential ALM report cards; it represents how much you receive for the money you lend versus how much it costs you to acquire that raw material.
- In other businesses, this is “gross revenue” after selling costs and cost of goods sold.

4.

LOANS TO SHARES

$$\frac{\text{TOTAL LOANS}}{\text{TOTAL SHARES}}$$



Performance
Ratio

- In general _____ is better, since loans generate a greater net return than _____.
- How can you have a L:S ratio > 100%?
- A high ratio can have negative consequences:
 1. Liq _____
 2. What risks were taken to get “high”?
 3. Operating efficiencies not shared with Members.



5. **NET LOAN LOSSES**
NET LOAN LOSSES
AVERAGE LOANS



Performance Ratio

- In general _____ is better.
- All loans of all types, and all borrower types.
- Too low and Members may not be getting served — is the L:S ratio high or low; why?

Most recent 12 months for all loans

| | 1 | 2 | 3 | 4 | 5 | 8 | 0 | 10 | 11 | 12 | totals |
|------------------------|---|---|---|---|---|---|---|----|----|----|--------|
| Charge offs | | | | | | | | | | | |
| - Recoveries | | | | | | | | | | | |
| Net loan losses | | | | | | | | | | | |
| Loans | | | | | | | | | | | |

6. **ALLOWANCE TO TOTAL LOANS**
ALL
LOANS



Safe and Sound Ratio

- In general _____ is better.
- Steady is also good: no volatile ups or downs.
- Too low and Members may not be getting served — is the L:S ratio high or low; why?
- Too high, examine trends in the mix of loans.
- Look at delinquent loans and net loan loss ratios.

The *allowance for loan and lease losses* account is an estimate of the aggregate risk in the loan portfolio (including leases if you make them). Using net losses by loan type or by borrower risk categories,

_____ factors are applied to the loan portfolio by types or by letter grade, or both, to result in an Allowance requirement.



7. **DELINQUENT LOANS**

$$\frac{\text{DELINQUENT LOANS}}{\text{TOTAL LOANS}}$$



Safe and Sound Ratio

- In general _____ is better.
- All loans of all types, and all borrower types.
- Too low and Members may not be getting served — is the L:S ratio high or low; why?
- Is there a correlation or lead effect related to the loan loss ratio?

8. **EARNING ASSETS**

$$\frac{\text{EARNING ASSETS}}{\text{ASSETS}}$$



Performance Ratio

- In general _____ is better because it means you're putting assets to work.
- Minimize non-earning assets:
 1. Cash
 2. Fixed Assets
- The need for liquidity puts downward pressure on the ___ : ___ ratio.



9.

$$\frac{\text{NET EXPENSES}}{\text{AVERAGE ASSETS}}$$



Performance
Ratio

- In general _____ is better.
- Practice cost control by examining ways to improve processes and squeeze out inefficiencies.
- The need for liquidity puts downward pressure on interest income.
- Non-interest income, fees for example, “recover” expenses created by members.
- By deducting fee income, your expense to asset ratio is more comparable to a CU with lots of sponsor support.

10.

$$\frac{\text{CURRENT ASSETS}}{\text{CURRENT LIABILITIES}}$$



Liquidity
Ratio

- In general _____ is better because money is working harder.
- This ratio let’s you know if there’s enough cash available in six months to cover an “Oops,” an unexpected call for liquidity, not general day-to-day operations.
- Liquid assets include cash, overnight deposits, mortgage loans pending sale in the secondary market, expected loan payments, some short term investments, available borrowings.
- Liabilities include what come due in 3 months or six months: payrolls, tax payments, estimated share withdrawals, loan commitments ...

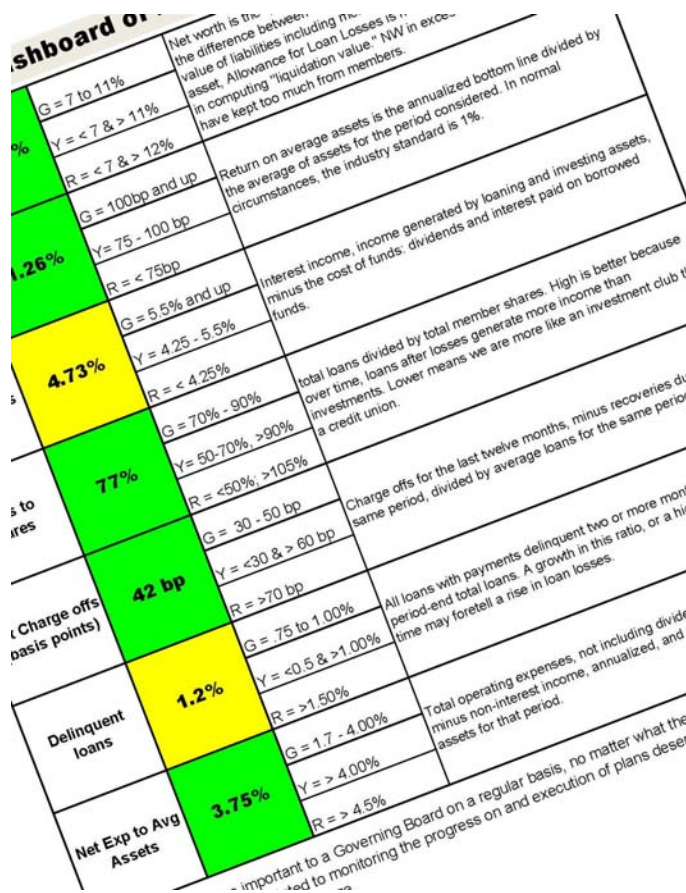
Note . . .

There being so many differences in the needs and behaviors of members from credit union to credit union, there does not now exist a “standard” target or preferred range. Greg Doner (fimacsolutions.com) recommends setting a desired range based on experience.

Calculate the ratio back a couple years and compare the ratio to any time the credit union had a liquidity issue, when the liquidity was too low. Set the range accordingly. Consult your CPA and ALM consultant.



Suggestion:
hold a board/management workshop,
include your CPA, and decide your
desired range for each ratio.



Use a “dashboard” to display essential ratios with your pre-determined ranges, color coded for quick recognition.

Purchase a ready-made Excel file at www.danclark.com
>>Products

Just add your data and you not only get the dashboard, you also produce trend charts for each.

It’s a quick and sure way to comply with fiduciary duties.



Takeaways

Ah Hahs; Questions to ask; Suggestions to display or calculate differently ...
Feedback to the presenter ...

