



Century National Bank

Freshman Case - Week 1

**Subject Area:
Improving Market Capitalization**

Case Leader: Graham Thompson

2014 Session

Background

Century Corporation (Century) is a multibank holding company comprised of three banks located in central Texas. Century National Bank (CNB) is the largest of the three banks and is located in the Dallas/Fort Worth market. Century was formed in 2004 with CNB being the only bank in the holding company. In 2007, Sagebrush National Bank and Oil City National Bank were acquired by Century. Century's stock is listed on the NASDAQ Stock Exchange and recent trading volume has been moderate. Morgan Keegan of Memphis, Tennessee makes a market in the stock. Prior to 2004, Frank Williams was Chairman/CEO of CNB and also became Chairman/CEO of Century when Century was formed in 2007. He continues in both roles today. The Presidents/CEOs of Sagebrush National Bank and Oil City National Bank remained after the acquisitions and today serve in their premerger positions.

Currently Century and CNB have a strained relationship with their regulators. In 2008 the OCC issued a Matters Requiring Attention Memorandum to CNB and the Federal Reserve issued a Board resolution to the Board of Century. In 2010 CNB was rated a composite CAMELS 2 and was issued a Memorandum of Understanding. At the same time the Board of Century signed a Written Agreement. In 2012 CNB was rated a composite CAMELS 3.

Under Frank William's management, CNB's primary business objective has been growth in deposits and loans. Preparation of annual budgets has focused on assignment of responsibility for loan and deposit growth. All commercial loan officers and retail officers are paid incentive pay based on achievement of personal and management unit loan and deposit budgets. Branch managers as well as commercial lenders are expected to make outside calls on commercial customers. Staff members are encouraged to sell deposit and loan products through the use of contests, prizes, personal recognition, and cash payments as incentives. Aggressive advertising campaigns also have been used regularly. Members of Executive and Senior Management are paid annual bonuses based on the bank's achievement of loan and deposit budgets.

CNB is a sales focused organization and has achieved a considerably greater percentage increase in loans and deposits than the average of banks in central Texas. In fact, on a national basis, CNB's percentage increase in deposits and loans has been nearly three times greater than those banks holding of similar size.

Since December 31, 2008, Century's stock prices have trended downward. This decline in stock prices is a concern to the Board of Directors of Century, and they have begun to question Frank Williams more frequently and intensely as to what he is doing to correct this negative trend. Mr. Williams has been required by the board to find the answers to correct the trend of declining stock price. Of greater concern to the Board are the regulatory CAMELS ratings, the Memorandum of Understanding and the Board Written Agreement. The working relationship between Frank Williams and the Century Board of Directors has deteriorated.

Financials

The following selected data is provided for CNB:

As of December 31

<i>Key Ratios:</i>	<i>2012</i>	<i>2011</i>	<i>2010</i>	<i>2009</i>	<i>2008</i>
Return on Assets (%)	.35	.40	.45	.10	.05
Return on Equity (%)	2.30	3.00	3.06	2.95	2.85
Loans to Available Deposits (%)	90	92	75	70	75
Net Interest Margin (%)	2.45	2.55	2.65	2.60	2.70
Efficiency Ratio (%)	80	79	77	82	71
Loan Loss Reserve Ratio (%)	2.87	2.46	2.30	2.05	1.95
Non Performing Asset Ratio (%)	4.30	4.23	3.70	3.36	2.85
Non Current Loans to Total Loans (%)	6.75	6.48	6.14	6.00	4.55
Net Charge off Ratio (%)	2.75	2.37	2.26	2.70	1.75
Core Capital (Leverage) Ratio (%)	5.06	5.66	6.00	6.47	7.03
<i>Common Shares Data:</i>					
Primary Earnings per share (\$)	2.35	2.40	2.60	2.75	2.85
Cash Dividends Per Share (\$)	0	0	0	.75	1.20
<i>Trading Data:</i>					
Low Closing Price (\$)	11.75	14.40	18.20	24.75	28.50
High Closing Price (\$)	14.40	18.20	24.75	28.50	35.40
End of Period Closing Price (\$)	11.75	14.40	18.20	24.75	28.50

(See Glossary of Terms used in bank financial statements)

January, 2013

After reviewing 2012 financial results, Frank Williams asked all banks in the holding company to examine their operating costs and identify opportunities for reduction. Williams identified personnel costs as an opportunity for improvement. Since CNB had the largest percentage increase in payroll costs, Williams asked all management personnel at CNB to recommend courses of action to improve payroll costs. Ted Chandler, officer in charge of Management Development (See Exhibit 1) recommended employing an outside consulting firm to set up a work measurement program in order to define work standards and to recommend branch staffing levels. Williams approved the idea and gave Chandler the responsibility of conducting a search for the appropriate consulting firm. Eight nationally known consulting firms were contacted to submit proposals. All eight submitted proposals, and one was selected in early February, 2013

based on an estimated potential annual payroll savings (salary, plus benefits) of \$1,352,000 at CNB. The start date for the selected consultant was February 15, 2013.

March, 2013

The work measurement program was named the Profit Improvement Program and was put under the direction of Executive Vice-President John Porter. Ted Chandler was designated as the bank officer in charge of the program. He felt that the PIP group should be a staff group whose function would be to aid the branch managers. This went along with the bank's concept of centralized organization, where such things as accounting, purchasing and personnel matters were controlled from the main office.

The consulting firm assigned Frank Parkinson to the job on a full-time basis. Mr. Parkinson was very skilled quantitatively and enjoyed his technical work very much. CNB assigned three young men from the management training program to work under Mr. Parkinson. One of these three "analysts" was designated head analyst. He had an MBA from the University of Texas and had been with CNB for a little over a year. The other two analysts were also new with the bank, one having been there for three months and the other for two weeks. The three analysts were trained in the techniques of the PIP methodology by Mr. Parkinson. Progress was reported by Mr. Parkinson weekly at a meeting of the bank's Profit Improvement Committee composed of Mr. Porter, who was the chairman of the committee, two bank officers from the Commercial Lending Department, the corporate secretary, and Mr. Chandler. Exhibit 2 is the memorandum that introduced the PIP to CNB branch officers and managers.

To assist the analysts in the branch studies, Mr. Parkinson recommended that branch operations officers should be the direct contacts for the analysts. An operations officer was equivalent to an assistant branch manager and was responsible for the day-to-day operation of the office as well as being a loan officer. He/she reported to both the branch manager and to the area operations officer. All operations officers attended eight two-hour training sessions on the various aspects of PIP.

PIP was separated into two areas: (1) a work measurement program designed to set standards for the various tasks and jobs performed in a branch and to measure performance against staffing budgets based on those standards and (2) a waiting-line analysis to schedule tellers.

PIP Methodology

The work measurement program consisted of four elements. The jobs to be studied were first determined; tellers, new account clerks, loan interviewers, assistant branch manager and branch manager. The tasks performed within each job were next identified and these tasks were assigned standard times to complete. Total standard times for each job were calculated using the actual volume of each task assigned to the job and the standard time assigned to each task. Total standard times for all jobs in the branch were used to determine branch staffing levels.

The second area of PIP was for the analysts to develop a means of determining the optimal teller staff assignments for various customer loads. The Marion Branch, CNB's largest, was chosen for this study. The method used was based on the relationship between customers served per unit of time and customer line length experienced at different levels of customer demand. Teller log sheets were kept by each teller for three weeks. During these same three weeks, a person was assigned the task of recording total customers at the teller windows at ten random times per hour. It was determined by the analysts that, if a criterion of a maximum of two persons in any teller line 95 percent of the time were desired, this service level would result in low teller utilization. If a criterion of a maximum of four persons in the line 95 percent of the time were used, teller utilization would be very high but customers might object to the resulting waiting time. Thus, Mr. Parkinson adopted the criterion of a maximum of three persons in any line 95 percent of the time, which would result in a teller utilization that was workable and a line length that would be competitive with other banks' service levels.

Using this criterion, the consultant developed a rule that called for a teller window to be opened for every 14 additional customers (assuming a random arrival pattern of customers). The analysts found that a teller could service an average of 16 customers per half-hour. The surveys also showed that the number of customers coming into a branch would vary depending on the time of day (busy at lunchtime), the day of the week (busy on Mondays and Fridays), and other special days (busy on payday or the day before a holiday). From this information, an open window schedule was developed for each day of the week.

Mr. Chandler was concerned about the validity of the staffing schedule. He had thought about testing the schedule out at several branches. But he was not certain about the design or even the feasibility of such a test.

June, 2013

After four months of work, the PIP group had completed studies and presented their recommendations for three of the largest branches of the bank. Performance was being reported by these three branches, but top management had not as yet taken any action to improve branch performance. Potential savings had been identified at the rate projected by the consulting firm, but actions to achieve these savings had not yet been initiated.

Top management of the bank was considering offering Mr. Parkinson the position of Planning Officer of the bank. He would head up the PIP group and report directly to Porter. In trying to determine what he thought the future of PIP should be at CNB. Mr. Chandler talked to some of the people who were involved with the program. The following are some of the comments he received:

Executive Vice-President, John Porter: "The Profit Improvement Program is good for the bank because it will make the branch managers better managers by giving them a means to measure the efficiency of their people as the bank grows. It will give us (top

management) a quantitative means of controlling payroll costs and comparing the performance of the branches.”

Personnel Officer, Mr. Randall: “I think the program will be useful to my department, but I do not think that it was introduced correctly; the central office operations people were not involved and they should have been. Instead the program went directly into the field. There is a close informal relationship, you know, between central office operations people and branch operations people.”

Area Branch Manager: “This program is good because it will get our people to be more concerned with costs; until now we have had no way of quantifying a need for additional personnel.”

Marion Branch Manager: “I was not really aware of what these people (PIP group) were doing. I mean I knew they were working in my branch, mostly with my operations officer. I was surprised when I found out how much savings potential they identified in my branch.”

Marion Branch Operations Officer: “The branch personnel were a little nervous when they (PIP group) came around; however, I think they have done a pretty good job in getting along with the branch personnel. Personally, I think they are nice guys and all their figures and recommendations look fine on paper, but I just don’t think they will work. You just cannot predict, at least the way they say you can, when customers will come in and what they will want.”

Branch Manager 2: “I don’t really understand all their figures. That consultant is really smart, but I don’t understand what he says. The analyst working in my branch is only 23 years old; I’ve been in banking for 33 years and am a vice-president. How can he help me run my branch? We’ve always done all right in the past, and I just don’t think we need PIP.”

PIP Analyst: “I think this program is very important for the bank; it can really save money if handled in the proper way. It’s very frustrating, though, to know you’re right and not be able to convince the people you’re trying to help. Political problems seem to get in the way.”

Head Teller: “Those boys (PIP analysts) don’t really know what it’s like to handle customers all day. You have to go out of your way and take some extra time to please customers or to sell them a new service.”

July, 2013

You are in your office at CNB on Friday afternoon and three members of the Board of Directors of Century (the Executive Committee) enter your office and inform you that

today, Frank Williams was fired by the Board and that you have been elected the new CEO of both Century and CNB. The Board does not intend to search for a CEO to replace you unless you fail in your role as CEO. They set a meeting for 4 p.m. on the following Monday for you to meet with the full Board and discuss the following questions/issues:

1. What is the problem(s) at Century Corporation and Century National Bank?
2. What are the causes of the problem(s) at Century and CNB?
3. What decisions were made and what actions were taken by the previous CEO in an attempt to solve the problem(s)?
4. What have been the results of the decisions made/actions taken by the previous CEO?
5. What actions do you intend to take and what plans do you have to solve the problem(s)?

You have the weekend to get ready for your Monday meeting with your board.

GLOSSARY FOR CAMELS RATINGS

Regulatory agencies use six components to rate the safety and soundness of a financial institution. These six are:

1. CAPITAL ADEQUACY

A financial institution is expected to maintain capital commensurate with its existing and potential risk exposures and the ability of management to identify, measure, monitor and control these exposures.

2. ASSET QUALITY

This component reflects the quantity and severity of existing and potential credit risks associated with the loan and investment portfolios, other real estate owned, and off-balance sheet transactions. The adequacy of the allowance for loan and lease loss, and the exposure to counter-party, issuer or borrower default under actual or implied contractual agreements are considered. The ability of management to identify, measure, monitor and control these risks is a factor.

3. MANAGEMENT

The capability of the Board of Directors and management to identify, measure, monitor and control the risks of an institution's activities and to ensure a financial institution's safe, sound and efficient operation in compliance with applicable laws and regulations is evaluated.

4. EARNINGS

The quality and quantity of earnings as well as factors that may affect the sustainability of the quality and quantity of earnings is reflected in this component.

5. LIQUIDITY

Current and prospective sources of liquidity compared to funding needs as well as adequacy of funds management practices to manage unplanned changes in funding sources are evaluated. The ability to meet its financial obligations in a timely manner and to fulfill the legitimate credit needs of its community are also considered.

6. SENSITIVITY TO MARKET RISKS

This component reflects the degree to which changes in interest rates, foreign exchange rates or commodity or equity prices can affect a financial institutions assets, earnings, liabilities and capital values. This vulnerability is measured by potential changes in earnings or economic value of capital under an appropriate range of economic scenarios.

Each one of these six components is given a rating of 1–strong, 2–satisfactory, 3–needs improvement, 4–deficient, or 5–critically deficient.

These six ratings are summarized into a single composite rating known as the CAMELS rating. Composite ratings are:

1. Sound in every respect. All components are rated 1 or 2.
2. Fundamentally sound. No component rating should be more severe than 3.
3. Some degree of supervisory concern. No component rating should be more severe than 4.
4. Unsafe and unsound. Failure is a distinct possibility if the problems and weaknesses identified are not satisfactorily addressed and resolved.
5. Extremely unsafe and unsound. Failure is highly probable and the least cost resolution alternatives are being considered by the appropriate agencies.

**Glossary
of Selected Terms**

Used in Century's Financial Statements

Term	Definition	Calculation
Return on Assets	The earnings percent on each dollar of assets	Net Income divided by Average Total Assets
Return on Equity	The earnings percent on each dollar of Total Equity	Net Income divided by Average Total Equity
Net Interest Margin	The Net Interest Income rate on each dollar of Earning Assets	Net Interest Income (FTE) divided by Average Earning Assets
Loan to Available Deposit Ratio	The percent of loans funded by unsecured deposits	Actual loans and leases net of unearned income divided by actual total deposits minus municipal deposits requiring pledging of securities
Efficiency Ratio	The Net Non-Interest Expense rate on each dollar of revenue	Operating Expense (Non-Interest Expense) divided by Net Interest Income (FTE) plus Non-Interest Income
Loan Loss Reserve Ratio	The percent of loans reserved for possible loss	Actual loans and leases net of unearned income divided by reserves for loan and lease losses
Non-Performing Asset Ratio	The percent of Non-Performing Assets compared to Loans and Foreclosed Assets	Non-Accrual Loans plus Foreclosed Assets divided by Actual Loans and Leases, Net of Unearned Income plus Foreclosed Assets
Net Charge Off Ratio	The percent of net loans charged off compared to total loans	Actual loans and leases charged off minus recoveries divided by actual loans and leases minus unearned income
Primary Earnings Per Share	The earnings generated during the current period for each common share	Net Income divided by the weighted average number of common shares outstanding.
Non Current Loan to Total Loans	The percent of loans Delinquent compared to Total loans	Loans and leases net of unearned income Delinquent one day or more divided by actual Loan and leases minus unearned income.
Core Capital (leverage)	The percent of tangible net Worth compared to total liabilities	Tangible net worth divided by total Liabilities

Exhibit 1

CENTURY NATIONAL BANK

Partial Organization Chart

(Numbers in parentheses represent the number of managers/officers)

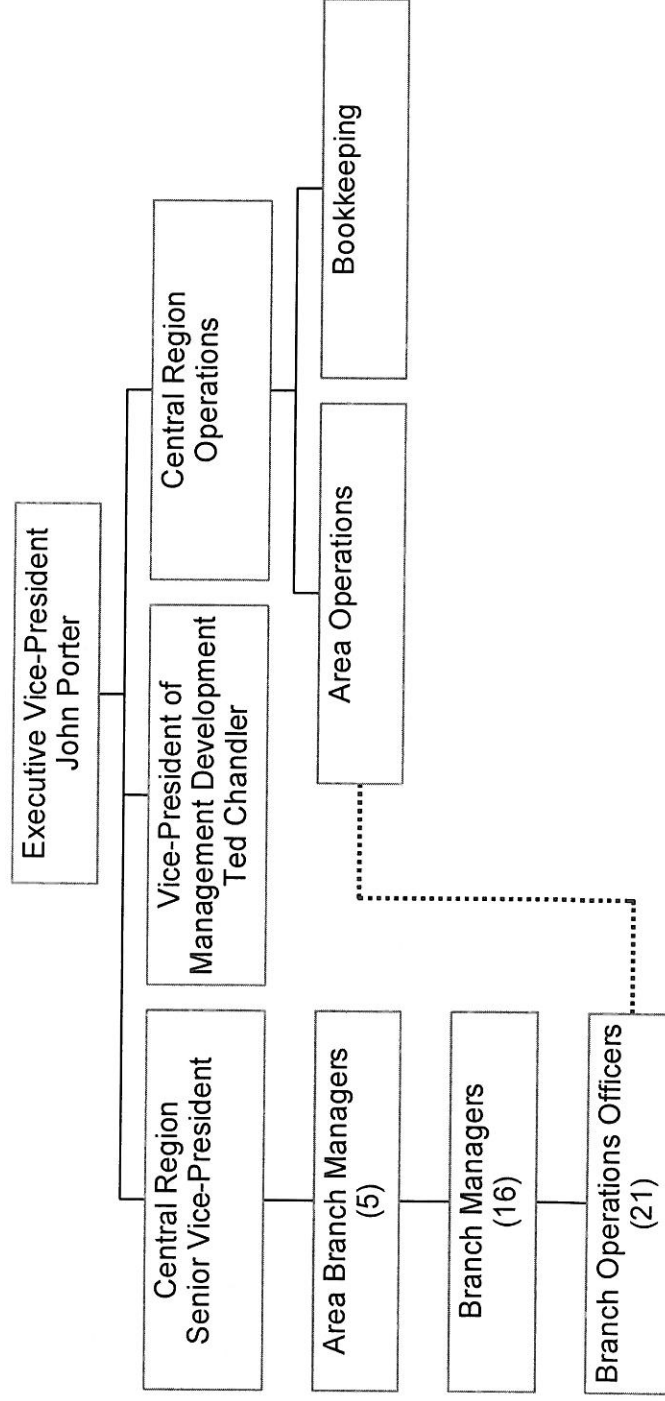


Exhibit 2

CENTURY NATIONAL BANK

Memorandum

To: All Branch Officers and Managers
From: Frank Williams
Date: February 15, 2013
Subject: Profit Improvement Program

Our Profit Improvement Program will soon be well under way in several branches of the bank. As you realize, this is an ambitious undertaking, and we are sure you know how anxious we are to show real improvement in payroll costs as soon as possible.

We are assured by our consultant that actual accomplishment of reduced payroll costs lies entirely in your hands, both now and in the future. It is recognized that until studies are completed in your areas, the full complement of work standards and other control techniques will not be available to you. At the same time, we are confident that you are willing and able to take appropriate improvement action based on your own knowledge of your operations in anticipation of the new performance standards and resulting staffing levels.

Each time you contemplate requesting a newly authorized position for your staff, the filling of a vacancy or replacement for a terminated employee, there is an opportunity for profit improvement. Perhaps there are other ways in which the problem can be solved. Consider all the possibilities you can think of and ask the PIP staff for their assistance before taking final action. For example, some of the following alternatives may forestall the need for adding staff:

- Reapportionment of routine duty assignments among several employees.
- Identification and postponement of selected low-priority work to low-volume periods.
- Cross-training of employees to handle non-recurring special work.
- Reasonable use of overtime to handle short-term spurts in workload.
- Borrowing and lending available employee time between sections for routine work.

In addition, review whatever interim arrangements you would make assuming a delay in filling the vacancy. If such arrangements will work during a short period, they may well become part of the permanent routine.

In order to assure that every effort is made to maintain economical staffing levels, we are asking Dave Durrill and our consultant, Frank Parkinson, to review all current personnel requisitions with you as they are received to provide you with every possible assistance.

As you know, a good portion of the money we save will revert back to you through increased salaries and profit sharing.

TABLE I-A. Selected Indicators, All FDIC-Insured Institutions*

	2012**	2011**	2011	2010	2009	2008	2007
Return on assets (%)	1.02	0.92	0.88	0.65	-0.08	0.03	0.81
Return on equity (%)	9.02	8.18	7.80	5.85	-0.73	0.35	7.75
Core capital (leverage) ratio (%)	9.28	9.17	9.07	8.89	8.60	7.47	7.97
Noncurrent assets plus other real estate owned to assets (%)	2.36	2.66	2.60	3.11	3.37	1.91	0.95
Net charge-offs to loans (%)	1.15	1.61	1.55	2.55	2.52	1.29	0.59
Asset growth rate (%)	2.98	3.28	4.30	1.77	-5.45	6.19	9.88
Net interest margin (%)	3.46	3.61	3.60	3.76	3.49	3.16	3.29
Net operating income growth (%)	13.57	51.34	43.64	1594.96	-155.98	-90.71	-27.59
Number of institutions reporting	7,181	7,437	7,357	7,658	8,012	8,305	8,534
Commercial banks	6,168	6,352	6,291	6,530	6,840	7,087	7,284
Savings institutions	1,013	1,085	1,066	1,128	1,172	1,218	1,250
Percentage of unprofitable institutions (%)	10.68	15.85	16.16	22.11	30.84	24.89	12.10
Number of problem institutions	694	844	813	884	702	252	76
Assets of problem institutions (in billions)	\$262	\$339	\$319	\$390	\$403	\$159	\$22
Number of failed institutions	43	74	92	157	140	25	3
Number of assisted institutions	0	0	0	0	8	5	0

* Excludes insured branches of foreign banks (IBAs).

** Through September 30, ratios annualized where appropriate. Asset growth rates are for 12 months ending September 30.

TABLE II-A. Aggregate Condition and Income Data, All FDIC-Insured Institutions

(dollar figures in millions)	3rd Quarter 2012	2nd Quarter 2012	3rd Quarter 2011	%Change 11Q3-12Q3
Number of institutions reporting	7,181	7,245	7,437	-3.4
Total employees (full-time equivalent)	2,105,833	2,108,185	2,109,352	-0.2
CONDITION DATA				
Total assets	\$14,222,941	\$14,030,857	\$13,811,902	3.0
Loans secured by real estate	4,087,407	4,086,590	4,119,282	-0.8
1-4 Family residential mortgages	1,889,898	1,875,389	1,856,675	1.8
Nonfarm nonresidential	1,057,994	1,058,384	1,056,246	0.2
Construction and development	210,431	217,372	254,720	-17.4
Home equity lines	567,297	580,218	608,268	-6.7
Commercial & industrial loans	1,454,913	1,423,081	1,281,309	13.5
Loans to individuals	1,295,124	1,282,033	1,284,574	0.8
Credit cards	667,864	664,287	666,476	0.2
Farm loans	65,448	64,006	59,834	9.4
Other loans & leases	676,646	659,188	596,923	13.4
Less: Unearned income	1,925	2,039	1,723	11.7
Total loans & leases	7,577,612	7,512,860	7,340,198	3.2
Less: Reserve for losses	166,972	176,571	197,319	-15.4
Net loans and leases	7,410,640	7,336,289	7,142,879	3.7
Securities	2,986,465	2,937,408	2,788,234	7.1
Other real estate owned	41,044	41,761	50,494	-18.7
Goodwill and other intangibles	364,170	366,741	372,713	-2.3
All other assets	3,420,622	3,348,659	3,457,582	-1.1
Total liabilities and capital	14,222,941	14,030,857	13,811,902	3.0
Deposits	10,504,235	10,322,533	10,000,254	5.0
Domestic office deposits	9,060,210	8,913,728	8,505,305	6.5
Foreign office deposits	1,444,025	1,408,805	1,494,949	-3.4
Other borrowed funds	1,355,870	1,389,997	1,479,822	-8.4
Subordinated debt	112,096	116,634	136,524	-17.9
All other liabilities	613,003	594,560	616,884	-0.6
Total equity capital (includes minority interests)	1,637,737	1,607,133	1,578,416	3.8
Bank equity capital	1,619,341	1,588,810	1,560,178	3.8
Loans and leases 30-89 days past due	86,995	83,759	100,140	-13.1
Noncurrent loans and leases	292,098	292,198	314,285	-7.1
Restructured loans and leases	104,734	106,715	127,251	-17.5
Mortgage-backed securities	1,732,870	1,713,754	1,600,471	8.3
Earning assets	12,469,465	12,271,987	11,921,919	4.6
FHLB Advances	318,113	325,850	323,421	-1.6
Unused loan commitments	5,812,208	5,857,132	5,793,121	0.3
Trust assets	17,338,788	16,899,742	15,361,533	12.9
Assets securitized and sold***	990,670	986,180	965,273	2.6
Notional amount of derivatives***	229,317,269	225,007,648	250,633,580	-8.5
INCOME DATA				
Total interest income	\$368,769	\$381,668	\$122,068	-2.9
Total interest expense	50,876	65,678	16,092	-21.6
Net interest income	317,893	315,989	105,976	0.7
Provision for loan and lease losses	43,260	57,660	14,766	-20.6
Total noninterest income	185,866	175,575	63,662	7.0
Total noninterest expense	313,939	304,681	104,452	4.0
Securities gains (losses)	7,034	3,767	2,716	-12.2
Applicable income taxes	46,174	40,273	15,370	11.2
Extraordinary gains, net	-54	765	-44	N/M
Total net income (includes minority interests)	107,366	93,483	37,722	6.3
Bank net income	106,853	92,916	37,589	6.7
Net charge-offs	64,404	87,861	22,330	-16.5
Cash dividends	60,843	55,245	20,421	3.0
Retained earnings	46,010	37,671	17,168	11.3
Net operating income	102,177	89,969	35,708	9.4

*** Prior to 2012, does not include data for insured savings institutions that file Thrift Financial Reports. Beginning in 2012, all insured institutions file Call Reports. N/M - Not Meaningful