

# Doral Financial Corp

DRL:NYSE

Valuex Conference

June 15-17, 2011

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# Investment Thesis

- Turnaround story – Doral is at the inflection point of returning to profitability and stability
- At \$1.80 (\$230m market cap), DRL is trading at 45% of TBV. 100% upside if stock trades up to \$3.63 or 90% of 2011 estimated TBV of \$4.03.
- Despite high NPA's, loan portfolio adequately secured, NPA's are decreasing and reserves are adequate
- Security portfolio has been cleaned up and reduced with non-performing CMO's sold/written down.
- Doral has been transformed from a mortgage broker/securities trader to a community bank
- Puerto Rican economy and housing market still depressed but have stabilized. Not getting worse.

# Background

- Prior to 2006, sold mortgages to other PR banks for gain on sale
- Had issues with inaccurate valuation of I/O strips & booking of gain on sale. \$1.0b in earnings from '01 to '05 restated in '07. Treasurer convicted of fraud
- Glen Wakeman and new management brought in from GE in '06-'07.
- Raised \$600m in new equity in '07, paid off \$700m in debt at holding company. Avoided default. Settled shareholder suit and SEC fines. 48 of 50 top managers replaced.

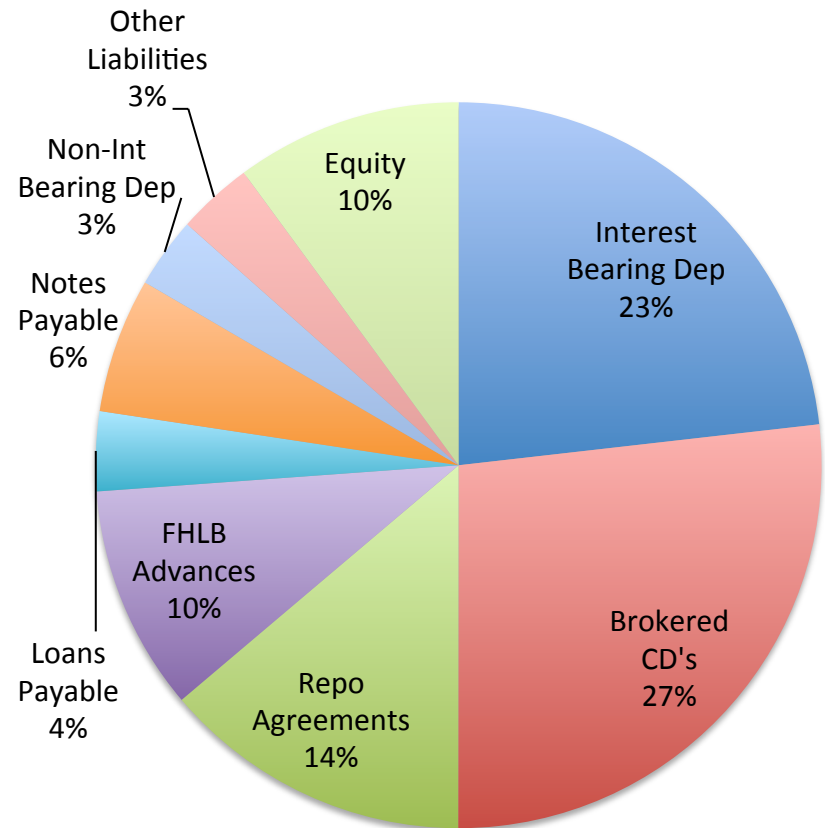
# Current Financial Condition

- Total assets of \$8.5b, Total Equity of \$861m, Tier 1 Capital of \$394m
- Tier 1 leverage of 8.87% vs. 5% for well-capitalized bank
- 1/5 the size of Popular
- Return to profitability. Net income for 1Q11 of \$3.3m or \$0.01 p/c/s. Management believes this will be maintained
- Improving Net Interest Margin of 2.23% in 1Q11, up from 1.87% in 4Q10
  - Increase in C&I loans in US; reduction in lower rate securities
  - Decrease in funding costs
- Steady Non-Interest Income running at \$100m per year, mostly driven by mortgage business
- Declining Non-Interest Expense down 9% from 3/10 to a \$244 annual run rate vs. \$325 for YE2010 due to lower provisions, comp and professional services

# Deposits and Funding

- Loans/Deposits: 1.4x – bank not funding itself with core deposits
- Bank is funded mostly by CD's (50%) and Repo's (14%) plus FHLB advance, notes and loans
- CD costs declining, including brokered. On-Island deposit rates down 25-50bps
- Rate on FHLB loan of \$555m has been significantly reduced to 2.9% from 4.1%
- \$250m of expensive 7% notes in Holding Company that will run off. May be able to repurchase at discount when bank is able to send money to Holding Company. \$30m of 7% coming due in 4/12.

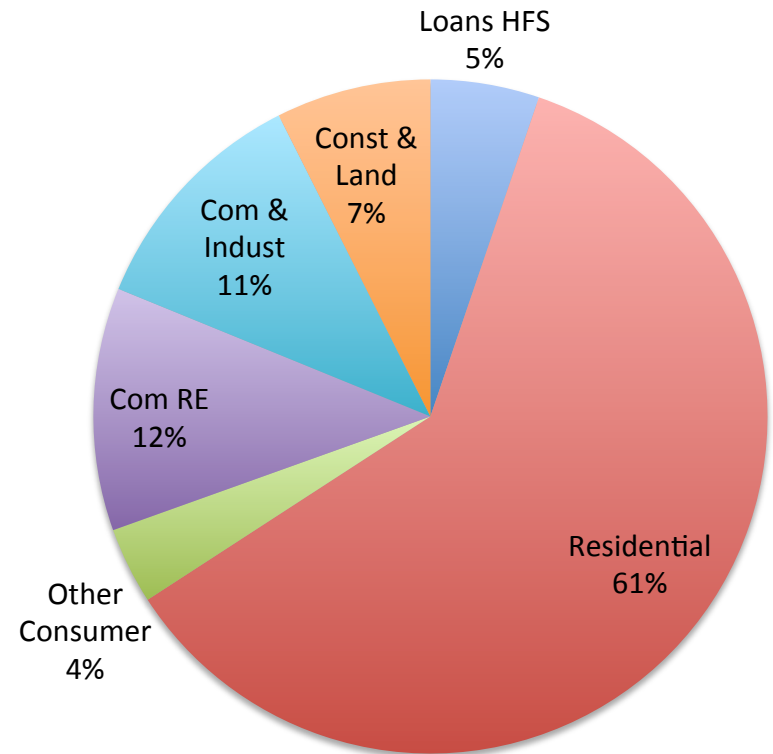
**Funding Profile**



# Loan Portfolio

- NPA's have declined \$293m or 30% in past year
- CRE in PR is being wound down. \$300m in workouts; may have small additional provisions. Discontinued new construction lending in PR in '07, new CRE in '08
- Increasing C&I and CRE loans in US-ML with stronger credits, variable rates and higher yields - shared credits, apartment lending and healthcare receivable financing.
- NPA's defined by Bank only 13% of Loans. Add TDR's of \$775m then NPA's are 28% of Loans
- ALLL is 2.24% of Loans. ALLL/NPL's of 21.11%

## \$5.8b Loan Portfolio 84% of loans in PR



# Why It Is Not So Bad

- Vast majority of mortgages in portfolio were 30 year fixed with 20% down payment. No rate adjustments. Adequate Loan/Value coverage on loans.
- Doral's loans are in lower end housing - more stable market. Price decline has been ~10% since recession started; much greater in higher end of market.
- Only 30% of loans past due 240 days actually go to foreclosure. Borrowers come up with money sporadically. Bank works with them based on their income and debt load after they make up 3 payments
- Bank estimates Loan/Value to be just under 80%. Avg loan balance is \$122k. Avg payment is ~\$800 per month
- Liquid real estate market for lower end homes in PR. Homes being sold for 102% of book value after initial write down.
- Bank believes only 1% of their borrowers are underwater
- No rental alternative in PR
- High touch work-outs. Loss mitigation efforts include door-to-door collectors who get borrowers to come into bank. Bank will restructure loan based on income/debt situation. Borrower has equity in the home.

# Puerto Rican Economy

- PR economy is bad but not getting worse, slow to no growth, retail sales flat (Popular)
- S&P upgrade to PR's GO debt from BBB- to BBB and positive outlook. Fitch: BBB+, Moody's: A3
- 20% of personal income in PR comes from transfer payments (Wikipedia)
- US Government has strong interest in stabilizing economy for security reasons. PR is a gateway to the US
- PR unemployment has stabilized at 15-16% up from 10-12% from '01 to '08. (BLS)
- Expiration of government home support programs at 6/30/11 may hurt RE sales volume but lower end of market has been more stable. Program may be renewed.
  - Did not have much affect on home prices. May have increased volume
  - Market is driven by low monthly payment, not lower costs
  - Guarantee of portion of equity. Property tax abatement. Closing costs paid by government



# Where Doral is Going

- Not a growth story. No deposit engine, no loan engine. Doral is an average bank returning to profitability and selling at a cheap price
- Very good management with a ~4% ownership stake that navigated through a lot of past problems and avoided default
- Stable Loan portfolio in PR residential mortgages and US C&I & CRE loans.
- Declining NPL's, lower loss provision going forward and lower related expenses. Winding down CRE in PR.
- Improving NIM as lower yielding securities are replaced with higher yielding lending on the mainland.
- Continue to generate about \$100m per year in non-interest income
- Improving efficiency ratio with reduced credit and collection expenses related to bad debt
- Ultimately generate ROA of 0.5%, ROE of 6%

# Valuation

- As market realizes Doral has returned to profitability and loan losses stabilized, stock will trade closer to TBV
  - TBV estimate: \$4.03 in '11 and \$4.25 in '12
  - Target Price of \$3.63 to \$3.83 at 90% of TBV
- Popular trades at 93% of TBV. Oriental trades at 84%
- DTA of \$2.72. If bank is profitable for 4Q's in '11, then can begin to defrost this into income.
  - Potential increase in TBV of ~\$0.25 per share if Bank maintains profitability
- Potential for further bank consolidation in PR – sale or acquisition
- TH Lee just announced an investment of \$150m of \$500m equity raise in First Bancorp
- Reasons stock trades at discount to peers:
  - High NPA's to loans
  - Past losses.
  - Bank did not participate in PR bank consolidation

# Risks

- Further deterioration in PR economy and increase in PR unemployment causing a deterioration in credit quality or loan/value coverage
- New, unexpected loan provisions
- Rapidly rising interest rate environment
- Elimination of housing subsidies at June 30
- Further decline in home prices
- Decline in transfer payments
- Increase in funding costs from brokered CD's and repo market
- Sustained high oil prices

# Valuation Comparison

Tangible Book Value	Doral	First Bancorp**	Popular	Oriental Financial
SH Equity	861	1,552	3,755	713
Pfd Stock	352	27	50	68
Intangibles	4	42	703	2
Tangible Equity	505	1,483	3,002	643
Shares O/S	127.3	200.6	1,022.3	45.4
TBV/share	\$3.97	\$7.39	\$2.94	\$14.17
Current Price*	\$1.80	\$4.26	\$2.73	\$11.94
Price/TBV	45%	58%	93%	84%

\* Price 6/13 close

\*\* Assumes conversion of Pfd & new equity issue of \$525m

# Comparison to Other PR Banks

	1Q11	1Q11	1Q11	1Q11
Comparables	Doral	First Bancorp	Popular	Oriental Financial
Assets	8,464	15,104	38,736	7,176
Loans	5,724	11,673	25,976	1,732
Securities	1,539	3,611	5,828	4,488
Deposits	4,486	11,716	27,197	2,501
Equity	861	1,027	3,805	713
Net Int Inc	43.2	106.3	343.3	37.2
Provision	2.6	88.7	75.3	4.3
Net Int Margin	2.23%	2.89%	4.15%	2.30%
Non-Int Income	28.6	40.5	164.4	7.5
% of NII	66.20%	38.10%	47.89%	20.16%
Non-Int Exp	60.8	82.9	275.0	30.8
Efficiency Ratio	84.68%	56.47%	54.17%	68.90%
NPA/Loans	13.6%	12.0%	9.0%	7.8%
ALLL/Loans	2.10%	4.81%	2.80%	1.91%
NCO/Loans	0.11%	0.69%	0.56%	0.14%
Net Income	3.3	(28.4)	10.1	3.1
EPS	\$ 0.01	\$ (1.66)	\$ 0.01	\$ 0.04
ROE	1.5%	-11.1%	1.1%	1.7%
Tier 1 Leverage	8.9%	7.8%	10.2%	9.5%