

Young bank finds pathway to profit

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by [Justin Matlick](#)

Staff Writer

Puget Sound Bank has turned its first quarterly profit, four quarters ahead of schedule and ahead of the two-year profitability goal that analysts use to define a strong startup.

The Bellevue-based bank logged \$40,000 profit in last year's fourth quarter, according to President and Chief Executive Officer Jim Mitchell. While the number might seem small, hitting profitability is a key benchmark for new banks, and Puget's early success highlights how its business-banking strategy has enabled it to flourish in an interest-rate environment that is dragging down other local banks, according to James Bradshaw, senior research analyst in D.A. Davidson & Co.'s Portland office.

Puget's "margins are great for a bank that's not even two years old," Bradshaw said.

Puget opened its doors in April 2005 on the leading edge of the region's startup-bank boom. In the past two years, nine banks have either opened or announced they were forming in the Puget Sound region, according to the state Department of Financial Institutions.

The bank's core strategy is to deliver loans and services to businesses with sales of between \$5 million and \$60 million, Mitchell said. Roughly 60 percent of Puget's loan portfolio consists of commercial and industrial loans, with a heavy emphasis on business lines of credit and equipment loans, Mitchell said.

This distinguishes Puget from many of its community-bank brethren, which have logged heavy concentrations of commercial real estate loans in recent years.

At Bremerton-based West Sound Bank, for instance, commercial real estate loans make up more than 90 percent of the loan portfolio, according to the Federal Deposit Insurance Corp.

Because real estate loans often carry fixed interest rates, they can put downward pressure on bank margins at a time when the gap between short- and long-term interest rates is narrow.

When the rates are close together, fixed-rate loans can lock banks into narrow margins on those loans, dragging down their overall net interest margins.

Many of the Pacific Northwest's community banks are "feeling some pain," Bradshaw said. "In some cases, the cost of funds is higher than the loan yields."

One reason Puget has managed to escape is that only about 30 percent of its loans are real estate loans. Roughly 90 percent of the bank's loans carry floating interest rates, which fluctuate along with the prime rate, according to Mitchell.

Thanks to this high concentration of variable-rate loans, which help keep interest margins wide, "the flat yield curve ... doesn't affect us at all," Mitchell said.

Mitchell said Puget's net interest margin hovers around 4.6 percent. Bradshaw said Puget's margins were strong considering the bank's age, and that many older banks are struggling to reach similar margins.

Mitchell's approach has met with praise from business customers like Seattle Chocolate Co., which moved its accounts to Puget Sound Bank in 2005.

Seattle Chocolate Chief Executive Officer Jean Thompson said the line of credit she keeps through Puget has been critical to her company's success, especially since her company is a seasonal business with a cash flow that fluctuates dramatically. Roughly 70 percent of Seattle Chocolate's sales come in the fourth quarter, Thompson said.

"We use (the credit line) to bridge the gap between cash flow-challenged months and other, more cash-intensive months," Thompson said.

Looking ahead, Puget's strategy revolves around continuing to pluck companies like Seattle Chocolate away from bigger banks, and Mitchell expects Puget to continue growing at a rapid clip.

To feed that growth, Mitchell said he is mulling the possibility of raising more capital, following in the footsteps of Seattle-based First Sound Bank, which launched about nine months before Puget Sound Bank and raised an additional \$11 million at the end of last year.

While Mitchell acknowledged it might be smart to strike at a time when investors seem hungry to fund banks, he said Puget could continue growing without more capital, and is still considering how a new round of funding might affect his current shareholders.

"I see the benefits" of raising money now," Mitchell said, "but I have to balance that with shareholder dilution."

Contact: jmatlick@bizjournals.com • 206-447-8505x158