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Weekly Trader

A Bank Stock that Stayed Out of Harm's Way

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Hudson City Bancorp, one of the recession's best performing banks, should continue to best rivals in the hyper-competitive New York area.

IN NEW YORK, the city that never sleeps, [Hudson City Bancorp](#) (ticker: HCBK) is one of the few financial institutions that wasn't asleep at the wheel in the last year.

The nation's largest thrift has stayed true to its roots, making conservative mortgage loans in New York City and the surrounding suburbs, even as its rivals were engaged in some risky lending during the last real-estate boom.

Hudson City's strategy paid off, leaving it cash-rich and able to take market share from competitors in a difficult banking environment.

"It's one of the best run banks in the country, and you can see that in their performance metrics, even in the worst of times" says Sandler O'Neill analyst Mark Fitzgibbon. "They're still [turning out] returns on average equity in excess of 10%, and their 19% efficiency ratio is the lowest in the industry."

Still, while Hudson City didn't suffer from the steep losses of its peers in the depths of the recession, its shares haven't been bid up in the latest rally: The stock actually fell 1% in the last three months while the market saw double-digit gains.

Trading at just 11 times 2010 earnings, Hudson City is scraping the bottom of its five-year range. The stock is also paying a hefty 4.5% dividend yield, supported by more than \$600 million in cash.

"We continue to view Hudson City as a solid bank with good capital ratios and a balance sheet that enables it to capitalize on a favorable net-interest-margin environment," says Ragen Steinke, portfolio manager of the WHG SMidCap Fund.

When Hudson City reported better-than-expected earnings last week, profit rose 11%, as net-interest margin widened and deposits grew. The company has continued to make loans to high-quality residential borrowers with at least 20% down.

Although nonperforming assets did rise during the quarter, it was from a very low point. Growing to 90 basis points of total assets, Hudson City's levels are still well below peers.

"It's not a real risk to the story," says FBR Capital Markets analyst Bob Ramsey, who notes the bank's tangible common equity-to-assets ratio of 8.7% gives them plenty of capital for growth, helped by their strong credit quality. "The proof is in the pudding," Ramsey says of their continued earnings power.

"You could call it a one-trick pony, as it's basically a one-product institution on the lending side, but they stick to what they are extremely good at," says Fitzgibbon.

This mentality helped the company avoid all the toxic-financial products that eventually saddled competitors' balance sheets.

"This is a really terrific management team," says Janney Montgomery Scott analyst Richard Weiss. "They knew when to hang up the phone when other banks bought these products that they really didn't understand."

Bill Bartmann, publisher of the weekly financial newsletter, The Bartmann Report, applauds Hudson City for avoiding "the 'siren song' of quick and easy money and stayed true to their business plan."

Still, though the bank still originates the majority of its loans, about 30% are purchased from other institutions, and some investors may fear the company doesn't have as tight of control over these products.

However, Ronald Hermance, the chairman and chief executive of Hudson City, assures Barrons.com that these loans do not dilute Hudson City's quality portfolio.

"We write specifications that are more restrictive than we would take directly: they have to be jumbo, owner-occupied loans with a 25% down payment in the Northeast," he says. "These are prime loans."

And though the bank has maintained its integrity during the downturn, it shouldn't be left behind the pack in the recovery. Making loans and offering attractive rates to depositors (financed by its enviable capital) have allowed Hudson City to gain market share from weaker rivals.

Hermance says he has "no fear" that the company will be able to maintain this lead, because Hudson City's cost efficiency and lean infrastructure is not something competitors can emulate overnight.

Of course with over 70% of their loans in the New York metro area, any steep deterioration in home prices in the region would adversely affect the company, as would sharply rising short-interest rates. Nor is \$30 billion in debt a number to gloss over.

However, the government has indicated that keeping interest rates low is a priority in the near future, and Hudson City's core base doesn't seem in danger of a large housing drop off. Likewise, Hudson City has not been in trouble with its creditors and did not take funds from the Troubled Asset Relief Fund, and has a strong-capital position.

Therefore investors should consider moving into Hudson City.