

# JPM Financial Analysis

Integration of WAMU & Bear Sterns Analysis

**ANONYMOUS INVESTOR**

March 20, 2010

Authored by: Anonymous WAMU Investor

# JPM Financial Analysis

## Integration of WAMU & Bear Sterns Analysis

### 1 Introduction

The year 2008 was a historic year in the United States in terms of the financial crisis that created havoc in the financial markets and World economies as a whole. Like many, I watched on the sidelines as things unfolded in the media, with little appreciation for what was happening behind the scenes and the true drivers of the crisis. In the aftermath of the crisis there were winners and there were losers. One of the biggest losers was Washington Mutual Inc, a publicly traded company with over \$300B in assets, along with their shareholders and bondholders who were essentially wiped out overnight by the mighty hand of the Federal Deposit Insurance Corporation (FDIC). At the top of the list of winners that rose through the ashes was JP Morgan Chase which acquired Bear Sterns at a steep discount in Q2 of 2008 and nearly \$300B of Washington Mutual Bank (WMB) assets for a paltry price of \$1.9 Billion dollars in Q3 of 2008.

I became interested in the Washington Mutual Inc situation in late 2008 and began reading message boards and researching the facts in the case. By early 2009 I had made an initial investment in Washington Mutual Inc which traded on the pink sheets as a result of filing for Chapter 11 bankruptcy immediately after the seizure of its primary banking subsidiary Washington Mutual Bank (WMB). My initial investment in WMI was driven by a sense of a gross injustice imparted on WMI Shareholders and Bondholders due to what I perceived as self-serving actions of the FDIC and JP Morgan Chase.

As I followed the case I became a little frustrated by the complete lack of any kind of fact based analysis. I had no interest in media spin and was looking for analysis based on public facts of the case. All we ever got through the media was that Washington Mutual Bank was a “Failed Bank”, but absolutely no fact based analysis to substantiate that claim. Therefore, for my own benefit and the benefit of WMI shareholders I have undertaken this task as my way of contributing to the resilient community of post and pre-seizure WMI shareholders.

The focus of this document will be the Financials of JP Morgan Chase and the benefits derived by JP Morgan Chase through the acquisition of Washington Mutual Bank. This effort is complicated by the fact that JP Morgan Chase acquired Bear Sterns in roughly the same time frame.

#### 1.1 Disclosure & Disclaimer

First and foremost the reader should understand that I am not a financial analyst. My area of expertise is the Information Technology (IT) field and not Finance or Banking sectors. I do however have a good understanding of financial statements and accounting principles and am very analytical by nature.

With my IT skills I was able to develop a spreadsheet that allowed me to use the power of Excel to present data in graphical form for easy analysis. The excel sheet required considerable VBA coding to extract data from public filings into a form that allowed for the use of Excel Pivot tables. While I have made every effort to verify the data presented, I hereby warn the reader to verify the numbers presented.

The data presented here is from public 10Q and 10K filings. Reader is reminded to make sure that they read the public filings and associated financial notes to put the data in the proper context. Reader is also warned that they should verify the information as it is possible there are errors in the spreadsheet used to analyze the data. *The data*

and analysis presented is for discussion purposes only and should not be construed as investment advice in anyway, shape, or form.

## 2 JP Morgan Chase – Balance Sheet Analysis

The starting point for this analysis is JP Morgan Chase’s balance sheet from the period of Q1 of 2007 to Q3 of 2009. Note that the fiscal year for JP Morgan Chase aligns with the calendar year.

### 2.1 Assets Analysis

Figure 1 below is a graph of total assets between Q1 2007 and Q3 of 2009. As can be seen in the graph below, JPMs asset base grew significantly in Q2 and Q3 of 2008. JPM acquired Bear Sterns in 2008 Q2 and purchased WMB assets in 2008 Q3 from the FDIC which accounts for the significant increase in assets.

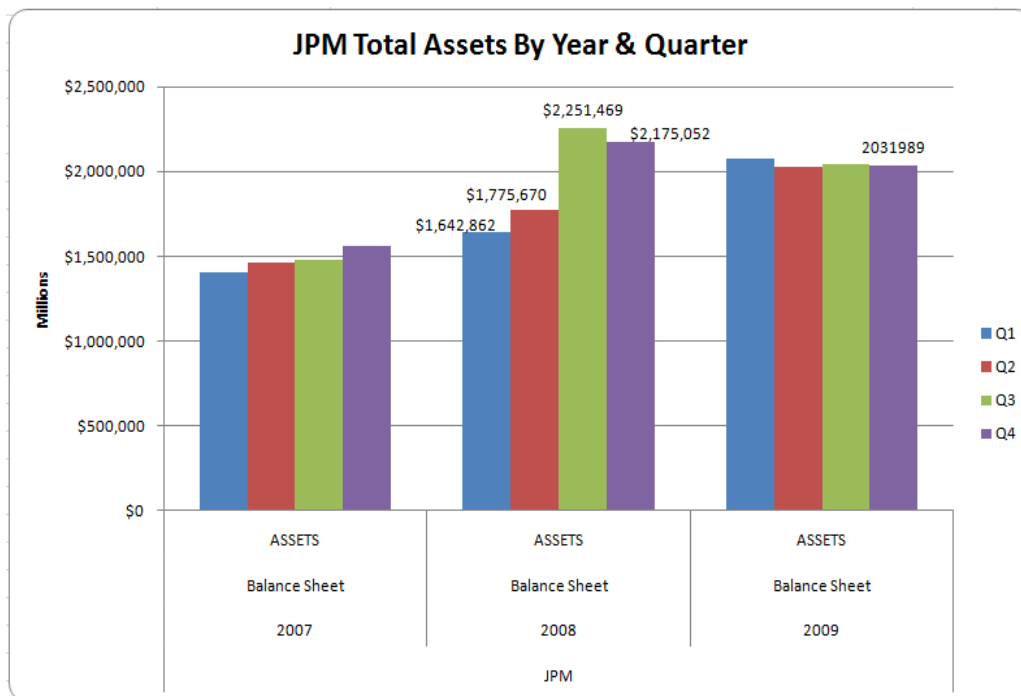


FIGURE 1 - JPM TOTAL ASSETS SINCE Q1 OF 2007

By looking at the graph in Figure 1, there are a couple of questions that come to mind and need to be answered. First, Bear Sterns, according to their 2008 Q1 filing ([Bear Sterns 10Q Filing](#)), had total assets of \$399B just prior to being purchased by JPM. WMB had nearly \$300B in total assets when its assets were acquired by JPM in Q3 of 2008. Combined that represents a total of nearly \$700B in assets; but yet the graph in Figure 1 shows a growth of only \$608.6B between Q1 and Q3 of 2008. The second item that becomes clear is that JPM assimilated the assets of Bear Sterns over the course of multiple quarters (Q2 and Q3) and not fully in Q2, while JPM assimilated the assets of WMB in Q3 alone. Keep in mind that WMB was seized on September 25 of 2008 and JPMs 3Q ended on Sept 31<sup>st</sup>, 2008. This begs the question how JPM was able to assimilate the assets of WMB into their own financials in only 7 days.

The answer to some of the above questions can be found in the JPM 2008 Q3 filing ([JPM 2008 Q3 Filing](#)) and requires reading the notes attached to the financial statements. Much of the information of interest is on page 94 of

the JPM filing. Exhibit 1 below is an excerpt from page 94 that shows what WMB assets JPM recorded on their books. Exhibit 1 below shows that JPM recorded \$262.2B of assets and \$259.7B of total liabilities from the WMB purchase. Exhibit 1 also shows that of the \$262B in total assets, roughly \$7.2B was in cash and another \$24.6B appears to be assets that are readily convertible to cash. Take note of Exhibit 1 as it will be referenced many times throughout this analysis.

**Condensed statement of Washington Mutual net assets acquired**

The following condensed statement of net assets acquired reflects the value assigned to the Washington Mutual net assets as of September 25, 2008.

(in millions)	September 25, 2008
<b>Assets</b>	
Cash and due from banks	\$ 3,680
Deposits with banks	3,517
Federal funds sold and securities purchased under resale agreements	1,700
Trading assets	5,691
Securities	17,240
Loans (net of allowance for loan losses)	206,189
Accrued interest and accounts receivable	3,332
Mortgage servicing rights	5,845
All other assets	15,044
<b>Total assets</b>	<b>\$ 262,238</b>
<b>Liabilities</b>	
Deposits	\$ 159,824
Federal funds purchased and securities loaned or sold under repurchase agreements	4,549
Other borrowed funds	81,759
Trading liabilities	585
Accounts payable, accrued expense and other liabilities	6,092
Long-term debt	6,910
<b>Total liabilities</b>	<b>259,719</b>
<b>Washington Mutual net assets</b>	<b>\$ 2,519</b>

EXHIBIT 1 – WMB ASSETS FROM PAGE 94 OF Q3 2008 JPM FILING

To see the Bear Stearns assets that were acquired, the reader is referred to page 82 of the JPM Q2 2008 Filing ([JPM Q2 2008](#)). The Bear Stearns assets added to JPM in Q2 of 2008 are illustrated in Exhibit 2 below. The total Bear Stearns assets identified is \$288.7B per Exhibit 2. Combined, Bear Stearns and WMB added \$550B in assets to JPM which is within \$58 Billion of the difference shown in Figure 1 between Q1 and Q3.

**Condensed statement of net assets acquired**

The following condensed statement of net assets reflects the value assigned to Bear Stearns net assets as of the merger date.

(in millions)	May 30, 2008
<b>Assets</b>	
Cash and due from banks	\$ 534
Federal funds sold and securities purchased under resale agreements	21,204
Securities borrowed	55,195
Trading assets	136,848
Loans	4,407
Accrued interest and accounts receivable	34,677
Goodwill	99
All other assets	35,738
<b>Total assets</b>	<b>\$ 288,702</b>
<b>Liabilities</b>	
Federal funds purchased and securities loaned or sold under repurchase agreements	\$ 54,643
Other borrowings	16,166
Trading liabilities	24,267
Beneficial interests issued by consolidated VIEs	47,042
Long-term debt	66,954
Accounts payable, accrued expense and other liabilities	78,535
<b>Total liabilities</b>	<b>287,607</b>
<b>Bear Stearns net assets<sup>(a)</sup></b>	<b>\$ 1,095</b>

(a) Reflects the fair value assigned to 49.4% of the Bear Stearns net assets acquired on April 8, 2008 (net of related amortization) and the fair value assigned to the remaining 50.6% of the Bear Stearns net assets acquired on May 30, 2008. The difference between the Bear Stearns net assets acquired as presented above and the fair value of the net assets acquired (including goodwill) presented in the table on page 81 represents JPMorgan Chase's net losses recorded under the equity method of accounting.

EXHIBIT 2 - BEAR STERNS ASSETS PER PAGE 82 OF Q2 2008 JPM FILING

Next we examine the asset section of JPMs balance sheet a little deeper and break down the assets by category as presented in JPMs financials. Here we want to focus on any anomalies that appear between the 2008 Q2 and Q3

quarters when JPM purchased WMB from the FDIC. The first thing that jumps out is the significant increase in loans in Q3 at roughly \$223B, \$206B of which was from WMB per Exhibit 1.

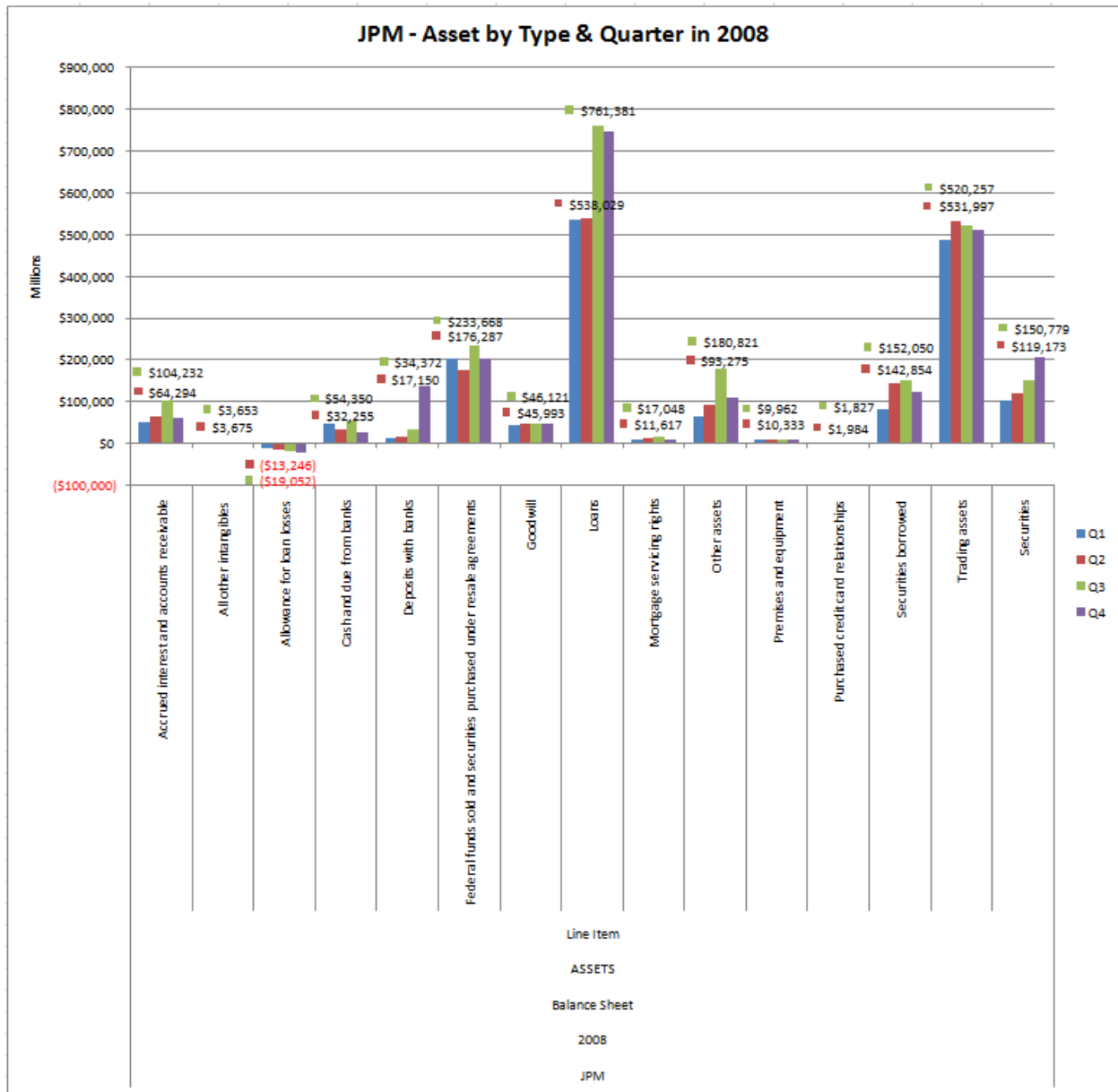


FIGURE 2- JPM 2008 ASSETS BY QUARTER AND ASSET CATEGORY

The chart in Figure 2 brings up an interesting question. How can the “*Premises & Equipment*” category decline in Q3 of 2008 when WMB owned a great deal of property and equipment and was purchased in Q3? Why did the “*Other Assets*” category jump so much in Q3 and was it from WMB or Bear Sterns? What does the category “*Securities Borrowed*” mean and why did it jump so much? Why did the deposits with banks category jump so much in Q4 of 2008? Why is there no big jump in Loan Loss allowance after the WMB asset purchase?

## 2.1.1 Why No Increase in Premises & Equipment?

The answer to this question is again provided on page 94 of the Q3 2008 JPM 10Q filing. The table of interest from the filing is provided in Exhibit 3. The excerpt below from Note 2 on page 94 explains how JPM handled WMBs assets from an accounting standpoint<sup>1</sup>.

### “Washington Mutual purchase price allocation and negative goodwill

The \$1.9 billion purchase price was allocated to the Washington Mutual assets acquired and liabilities assumed using their allocated values as of September 25, 2008. This resulted in negative goodwill. In accordance with SFAS 141, nonfinancial assets that are not held-for-sale, such as the premises and equipment and other intangibles, acquired in the Washington Mutual transaction were written down against the negative goodwill. The negative goodwill that remained after writing down the nonfinancial assets was recognized as an extraordinary gain. The computation of the purchase price and the allocation of the purchase price to the net assets acquired in the Washington Mutual transaction — based upon their respective values as of September 25, 2008, and the resulting negative goodwill — are presented below. The allocation of the purchase price may be modified through September 25, 2009, as more information is obtained about the fair value of assets acquired and liabilities assumed.”

(in millions)	
Purchase price	
Total purchase price	\$ 1,938
Net assets acquired	
Washington Mutual's net assets before fair value adjustments	\$ 38,482
Washington Mutual's goodwill and other intangible assets	(7,566)
Subtotal	30,916
Adjustments to reflect assets acquired at fair value:	
Trading assets	(591)
Loans	(31,265)
Allowance for loan losses	8,216
Premises and equipment	680
Accrued interest and accounts receivable	(164)
Other assets	2,972
Amounts to reflect liabilities assumed at fair value:	
Deposits	(638)
Other borrowed funds	(69)
Accounts payable, accrued expense and other liabilities	(507)
Long-term debt	1,023
Fair value of net assets acquired	10,573
Negative goodwill before allocation to nonfinancial assets	(8,635)
Negative goodwill allocated to nonfinancial assets <sup>(a)</sup>	8,054
Negative goodwill resulting from the acquisition <sup>(b)</sup>	\$ (581)

(a) The acquisition was accounted for as a purchase business combination in accordance with SFAS 141. SFAS 141 requires the assets (including identifiable intangible assets) and liabilities (including executory contracts and other commitments) of an acquired business as of the effective date of the acquisition to be recorded at their respective fair values and consolidated with those of JPMorgan Chase. The fair value of the net assets of Washington Mutual's banking operations exceeded the \$1.9 billion purchase price, resulting in negative goodwill. In accordance with SFAS 141, noncurrent, nonfinancial assets not held-for-sale, such as premises and equipment and other intangibles, were written down against the negative goodwill. The negative goodwill that remained after writing down transaction related core deposit intangibles of approximately \$4.0 billion and premises and equipment of approximately \$3.2 billion was recognized as an extraordinary gain of \$581 million.

(b) The extraordinary gain was recorded net of tax expense in Corporate/Private Equity.

### EXHIBIT 3 - PAGE 94 OF JPM Q3 2008 FILING

In simple terms, JPM took advantage of purchase accounting rules to write off the book value of \$8 billion in WMB premises and equipment against the negative good will they incurred by paying so little for WMB to the FDIC. This gave JPM two benefits: a) It allowed JPM to publish a much lower number for Goodwill (as a one-time gain) in public press releases (see [JPM Press Release](#)), and b) It allowed JPM to record WMB's premises and equipment assets at 0 book value and hence reduce depreciation expense on an ongoing basis and thereby improve profitability over time. The math JPM used is all explained in Exhibit 3.

Exhibit 3 shows a couple of other things that are worthy of note. First, it shows that JPM wrote down \$31B worth of WMB loans to 0, and it shows that \$8.2B of WMB loan loss reserves were added back against the \$31B write down. This in itself explains why Figure 2 does not show a marked increase in loan loss reserves since WMBs loan loss

<sup>1</sup> In subsequent Quarters, JPM modified the calculations in Exhibit 3. The final version of the calculations can be found on page 144 of the [JPM 2009 10K](#) filed on 2/24/10. In the final calculations, the Negative Goodwill increases to (\$1982).

reserves were already factored into the \$31B loan portfolio write-off. But this then brings up the question whether a \$31B loan loss write-off is appropriate and justified.

### 2.1.2 Is a \$31B loan write-off by JPM justified?

WMB had a loan portfolio that consisted of consumer loans and commercial loans. As of the last 10Q filing by WMI prior to seizure, WMI had a total loan portfolio valued at \$239.6B dollars. To understand the breakdown of loans between commercial Loans and consumer loans, all that is required is a review of the [JPM 10K filed on 3/2/2009](#). On page 54 of this filing there is a discussion of the Commercial Banking Group and the first paragraph states:

“On September 25, 2008, JPMorgan Chase acquired the banking operations of Washington Mutual from the FDIC, adding approximately \$44.5 billion in loans to the Commercial Term Lending, Real Estate Banking and Other businesses in Commercial Banking.” .....and further on the same page....

.....”The allowance for loan losses increased \$1.1 billion, which primarily reflected the impact of the Washington Mutual transaction. Nonperforming assets were \$1.1 billion, an increase of \$1.0 billion compared with the prior year, predominantly reflecting the Washington Mutual transaction and higher real estate-related balances.”

So what this appears to say is that JPM got \$44.5B in commercial loans and of the \$44.5 of this total \$1.0B were non-performing loans. So if we conclude that JPM only wrote off \$1B for commercial loans, then that means, from Exhibit 3, that the \$31.26B write-off was composed of \$1B in commercial loans and \$30.26B in consumer loans. If the total consumer loan portfolio at time of seizure was  $(\$206.19B + \$31.26B) - \$44.5B = \$192.5$  Billion, a \$30.26B write-off from a total \$192.5 consumer loan portfolio is 15.7% of the entire consumer loan portfolio.

On Tuesday Feb 9<sup>th</sup>, 2010 an article appeared in the Wall Street Journal titled “*Fannie, Freddie Stagger On, No U.S. Exit in Sight*”. This article had a graph (on page A16) that showed the percentage of mortgages 90 days or more past due. An image of this article and graph is provided in Exhibit 4. The Graph in the image shows the 90 days past due percentage for Fannie Mae at approx 5%, Freddie Mac at 4%, and all loans 90 days past due at almost 9%. So if we assume this data is true, how can JPM possibly write off 15.7% of WMBs consumer loan portfolio?



EXHIBIT 4 - WALL STREET JOURNAL ARTICLE

And even if we assume that the 15.7% 90 day past due rate was true for WMB, past due loans that are first mortgages are secured by the value of the homeowners home and to write them off completely makes no logical sense. Granted that the value of real estate has dropped off considerably in the last few years, but even if we assumed the value of real estate dropped off by 50% the write-off of bad loans should still be half of the \$30.2 Billion, or roughly \$15B. *This may be an accounting thing I don't understand, but I think the WMI Equity Committee needs to hire professionals to take a very close look at this loan portfolio write-off.*

And if one were to believe that the hockey stick shape of the default rate in Exhibit 4 will continue into the near future, then consider this [article \(Report: Fewer people falling behind on home loans\)](#). This latest article has the following paragraph:

“However, more than 15 percent of homeowners with a mortgage have missed at least one payment or are in foreclosure, a record. Worse, nearly half of all delinquent borrowers were at least three months behind on their payments, up from a typical level of less than 20 percent.”

Hey, that 15% number looks familiar, doesn't it? **Is it possible that JPM wrote off any WMB loan that had missed a single payment?**

### 2.1.3 Why the Significant Increase in Borrowed Securities?

Between Q1 and Q2 2008, Securities Borrowed increased by \$61.8B and then increased by another \$9.2B between Q2 and Q3. From Exhibit 2, \$55B came from the acquisition of Bear Sterns. That leaves approximately \$16B rise that can't be directly attributed to the Bear Sterns or WMB acquisitions. The “Borrowed Securities” asset category is graphed over time between Q1 of 2007 and Q3 of 2009 in Figure 3. Figure 3 clearly illustrates the jump in Q2 with the acquisition of Bear Sterns and again in Q3. But before we can understand where the increase came from, we really need to know what the “Borrowed Securities” category represents.

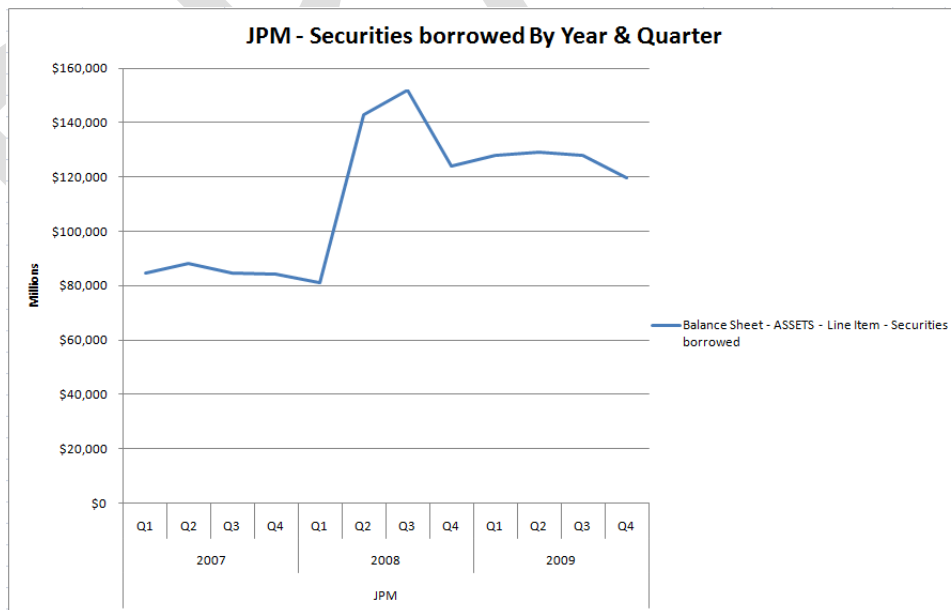


FIGURE 3 - BORROWED SECURITIES BY YEAR

On Page 163 of the JPM 10K filed on 3/2/2009, the following description is given for Securities Borrowed:

“Securities borrowed and securities lent are recorded at the amount of cash collateral advanced or received. Securities borrowed consist primarily of government and equity securities. JPMorgan Chase monitors the market value of the securities borrowed and lent on a daily basis and calls for additional collateral when appropriate. Fees received or paid in connection with securities borrowed and lent are recorded in interest income or interest expense.”

Unless I am reading this wrong, this description seems to be saying that Securities Borrowed represents short positions where securities are borrowed from an institution and collateral of equivalent value is advanced to the institution.

There has been a lot of speculation that JPM was engaged in Naked Short Selling of WMB in an effort to eliminate financing options and bring the bank down. While it is impossible to come to that conclusion from Figure 3, the rise in Borrowed Securities in Q3 of 2008 is interesting and probably merits further investigation and research. If nothing else, the graph shows that short selling is a huge line of business for JPM clients and possibly JPM themselves.

### 2.1.4 Loan Portfolio

Figure 4 below is a graph that shows JPM's loan portfolio stacked by WAMU's loan portfolio. What is very obvious in this graph is that starting with Q3 of 2008, the value of JPM's loan portfolio has declined quarter over quarter from \$761B in Q3 of 2008 to \$633B in Q4 of 2009. Keep in mind that the graph in Figure 4 represents the value of the portfolio before any adjustments for Loan Loss allowances on the balance sheet. So what is driving the value of the loan portfolio to decline quarter after quarter?

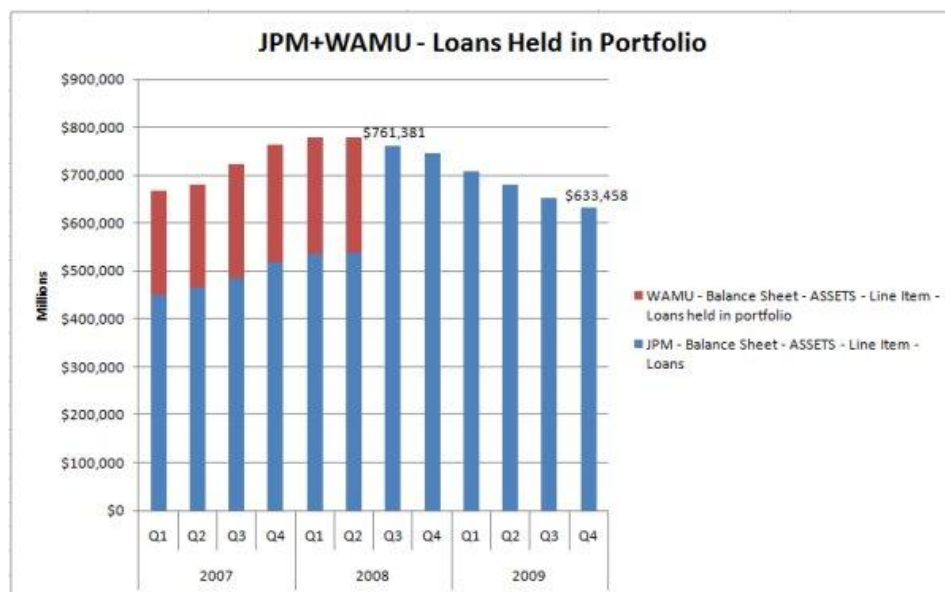


FIGURE 4 - JPM+WMB LOANS IN PORTFOLIO

Figure 5 below is a graph of JPM's Loan Loss allowance stacked by WAMU's Loan Loss allowance. This graph shows a couple of things. First, the Loan Loss Allowance is a running value quarter over quarter and year over year. This

value is added to Loans Held in Portfolio to arrive at a net value for the loans on the balance sheet. It is a value that represents expected losses and when those expected losses materialize they are reflected on the Income Statement.???

Second, WAMU appeared to have a more accelerated Loan Loss allowance than did JPM. And the third thing of note here in Q3 of 2008 when WAMU assets were purchased, WAMU's Loan Loss allowance was not simply added to JPM's Loan Loss allowance. So the question is where did it go?

The answer to what was done here can again be explained by Exhibit 3. When JPM wrote down \$31B in WAMU loans, they added back in WAMU's 2Q Loan Loss allowance of \$8.2B (which I think is appropriate as it would otherwise be a form of double-dipping). But that then begs the question why JPM's Allowance for Loan Losses jumped so much (\$5.8B)? After all, they had just written down \$31B loans with WAMU's Loan Loss baked in. In Q2 of 2008, the percentage of WAMU's Loan Loss allowance was  $\$8.46B / \$239.6B = 3.5\%$ . If we look at JPM's Loan Loss allowance for Q3 of 2008 using only JPM's Loan portfolio, then  $\$19.2B / (\$761.4B - \$206B) = 3.45\%$ . This implies that JPM's Loan portfolio was just as bad as WAMUs.

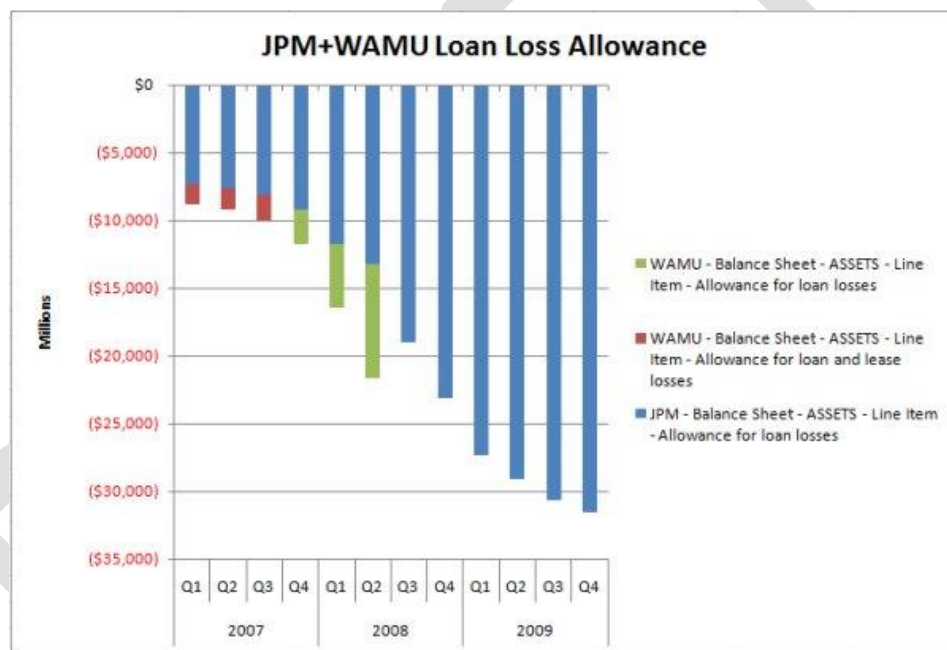


FIGURE 5 - JPM+WAMU LOAN LOSS ALLOWANCE

Figure 4 shows that in Q3 of 2008 JPM had a loan portfolio of \$761B and by 4Q of 2009 it had dropped to \$633B for a difference of \$128B. As Loan Losses are incurred it is expected that the value of the loans is adjusted accordingly. But the Loan Losses cannot by themselves explain the \$128B drop in Loan portfolio value. Here we really need to look at the Statement of Cash flows to determine what is happening.

Figure 6 is a graph that shows JPM's origination of loans and sales of loans by year and quarter. Note in Figure 6 JPM used different labels for the proceeds from sales category in 2007 and therefore you have different colors for categories that essentially mean the same thing. The takeaway from this graph is that JPM, starting in Q1 of 2008, was selling considerably more loans than it was originating. In all of 2008, JPM Originated \$34.9 in loans and sold

\$65.5B of loans for a net decrease of \$30.6B. In 2009 JPM Originated \$22.4 in loan originations and sold \$64.3 in loans for a net decrease of \$41.9. Together that is a net decrease of \$106.2B in the loan portfolio.

One odd thing is that even in 2007, there should have been a small net decline in loan value since selling of loans was slightly greater than purchasing and origination of new loans, but Figure 4 shows a steady increase in loan portfolio value in 2007 ????

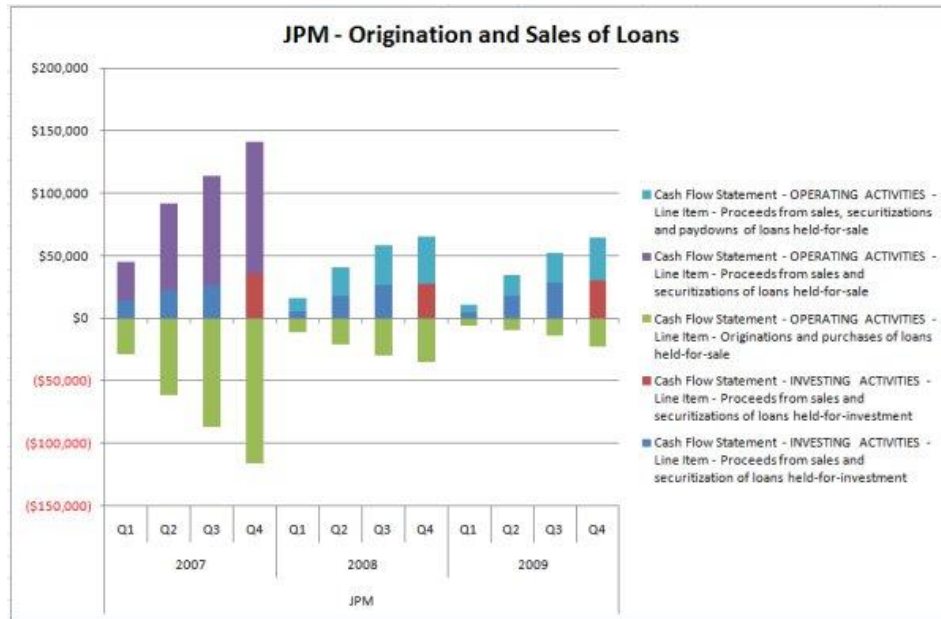


FIGURE 6 - JPM ORIGINATION & SALES OF LOANS

### 2.1.5 JPM Cash & Cash Equivalents

We know from WAMUs 2Q 2008 filing that WAMU has \$7.2B in cash and cash equivalents, and this number is also reaffirmed in Exhibit 1 which shows what JPM acquired from the FDIC. Figure 7 below shows JPM's Cash balance stacked by WAMUs cash balance.

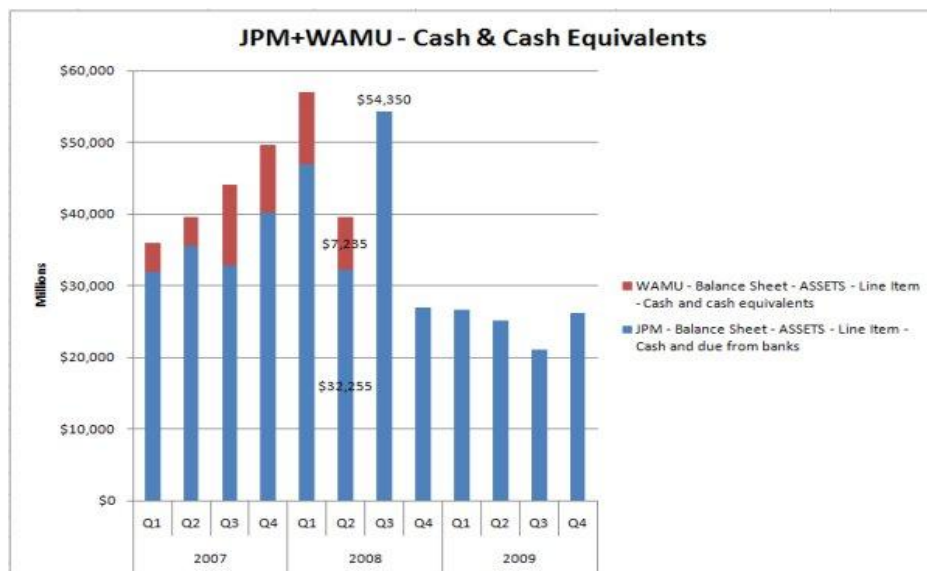


FIGURE 7 – JPM+WAMU CASH, DUE FROM BANKS

What immediately stands out in Figure 7 is how JPMs cash balance jumped in Q3 of 2008 right after the WAMU asset purchase from the FDIC. Given that the FDIC seized WAMU on Sept 25 and there was less than a week left in the quarter, it would be difficult for JPM to convert the cash into other asset forms and therefore the cash jump is expected. JPMs cash balance in Q3 of 2008 jumped even more than can be attributed to WAMU’s cash. Therefore it is possible that JPM converted some of WAMU’s current assets into cash.

Figure 8 below is a graph that stacks all of WAMUs current assets on top of JPMs cash. The sources of JPMs cash in Q3 of 2008 will be explored in more detail in the Statement of Cash flows section of this document.

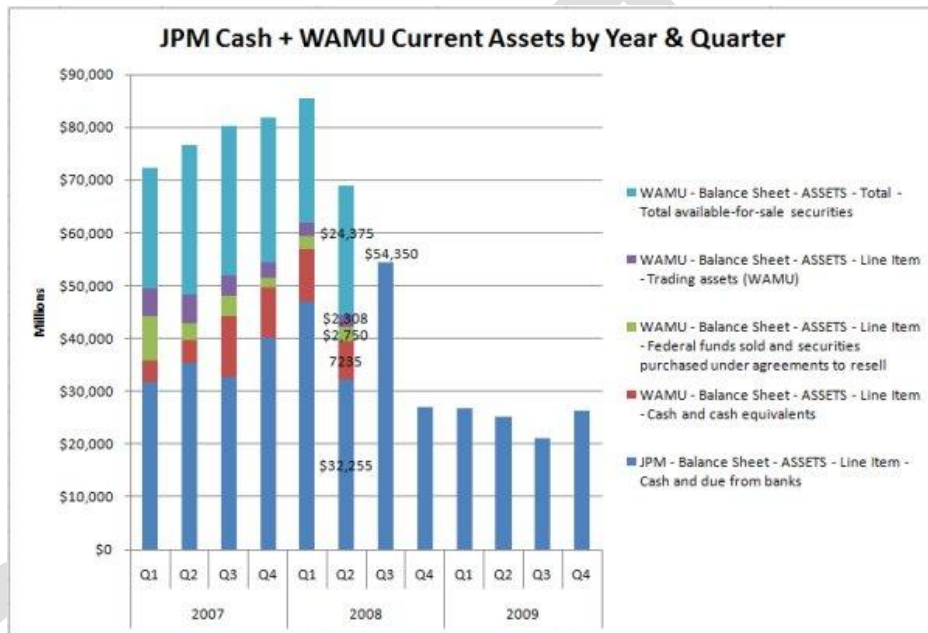


FIGURE 8 - JPM CASH + WAMU CURRENT ASSETS

## 2.2 Balance Sheet Liabilities

Figure 9 below illustrates the balance sheet liabilities for JPM from 2007 through 3Q 2009. Between Q1 and Q3 of 2008, JPM assets increased by approx \$609B per Figure 1, while Liabilities over the same period increased by \$588.4B which means that the Bear Sterns and WMB acquisitions added approximately \$21B to JPMs shareholder equity.

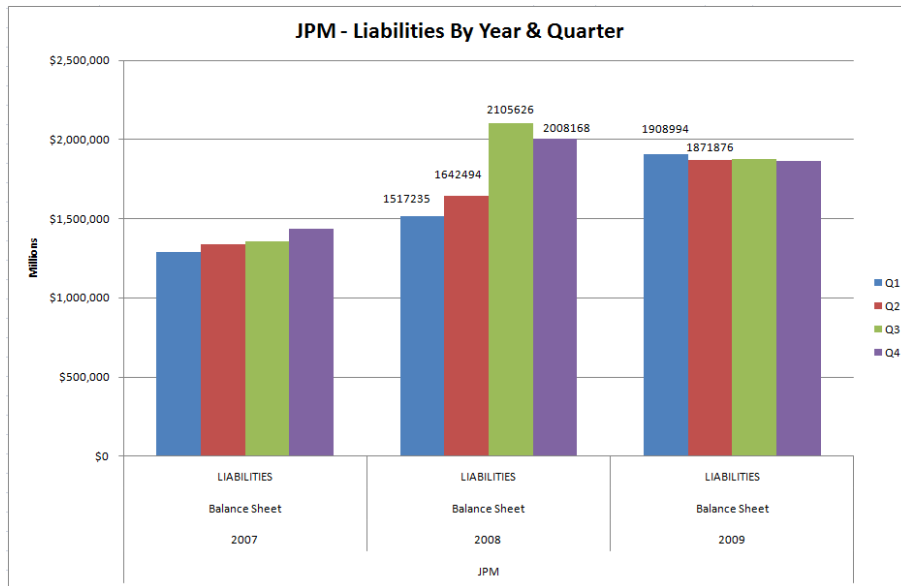


FIGURE 9 - JPM LIABILITIES

One thing that is interesting about Figure 9 is that if you compare it to Assets graph (Figure 1) they both follow each other pretty closely. The decline in assets in 2009 shown in Figure 1 is also shown in Figure 9 with a proportionate and corresponding decline in liabilities. The reason for this becomes clearer in the following paragraphs.

Figure 10 below breaks down the liabilities by category. It should be noted that in Figure 10 there are cases where from quarter to quarter the name of a category changed slightly and therefore there are a few instances where not all 4 quarters appear under a given category label. One such instance is the **“Federal Funds Purchased”** category where Q1 appears by itself and Q2, Q3, & Q4 appear together.

From Figure 10, the notable item is the big increase in Deposits from Q2 to Q3 where deposits increased by \$246.9B. We know from Exhibit 1 that the WMB purchase accounted for \$159.8B of the \$246.9B increase. This leaves \$87B in deposits unaccounted for and may be either due to organic growth or reclassification of other liabilities from the Bear Sterns and WMB purchases.

The other interesting item in Figure 10 is the huge jump in Q3 in the **“Other Borrowed Funds”** category. Between Q2 and Q3 2008, other borrowed funds jumped by massive \$145.2B. From Exhibit 1 & 2, we know that \$81.7B and \$16.2B in **“Other Borrowed Funds”** can be attributed to the WMB asset purchase and Bear Sterns acquisition respectively, but together that only adds up to \$97.9B. Where did the other \$47.3B come from?

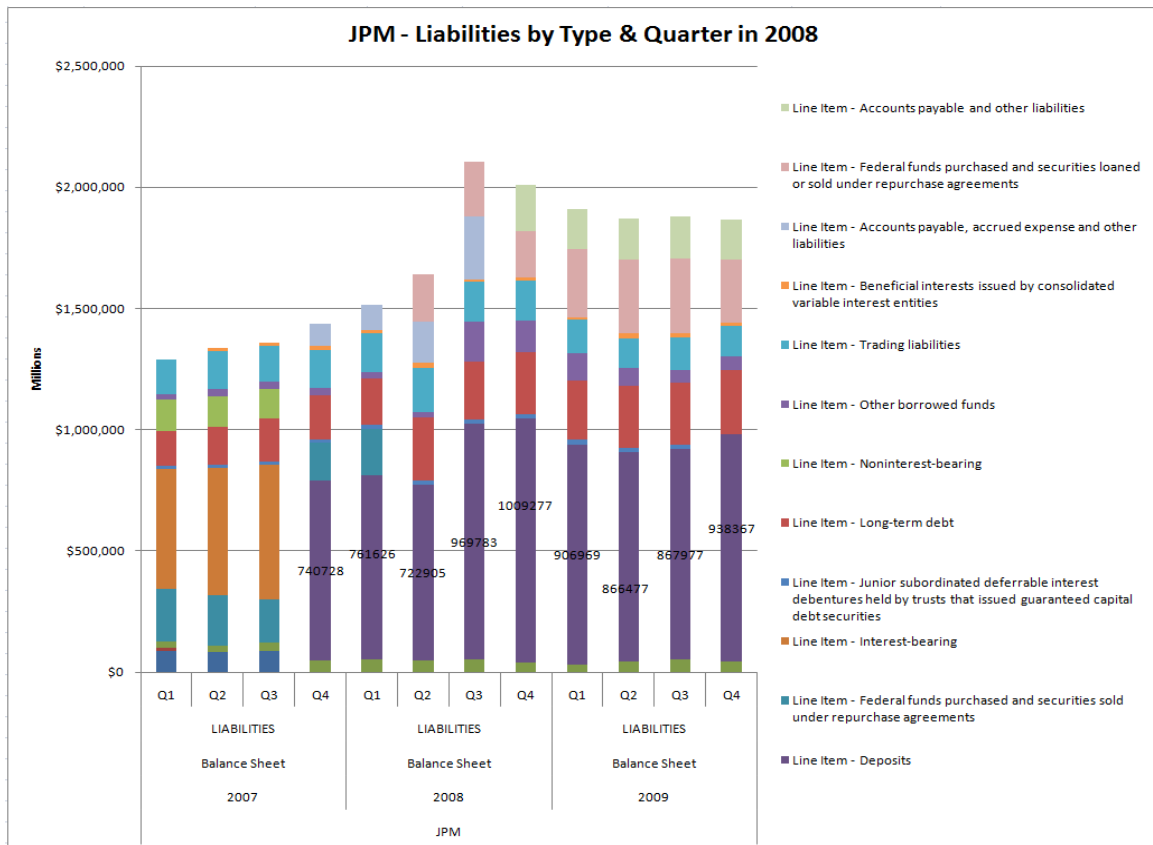


FIGURE 10 - JPM LIABILITIES BY TYPE

The reader should note that in 2007 JPM broke out deposits as “*Interest-Bearing Deposits*” and “*Non-Interest Bearing*” deposits, and starting in 4Q of 2007 they lumped everything into the “*Deposits*” category. That is why prior to Q4 2007 there is no purple bar in Figure 10. Prior to Q4 of 2007 deposits consist of the orange bar and the light green bar which together represent deposits. The “*Accounts Payable*” category is another example where JPM changed something in the category title and multiple instances of that category appears.

### 2.2.1 Deposits

From Figure 10, the most interesting item is the significant decline in Deposits in Q1 and Q2 of 2009. In Q1 deposits declined from \$1009.3B to \$907B for a total of \$102.3B decline. Then in Q2 of 2009 deposits declined from \$907B to \$866.5B. This represents a total decline in deposits of \$142.8B in a 6 month period. If you consider that the WMB asset purchase added \$159B in deposits to JPM, the decline in deposits for the first 2 quarters of 2009 is nearly 90% of what they added with the WMB asset purchase. In the latest 2009 4Q quarter, JPM increased the deposit base by \$70.4B to a total of \$938.4B.

In Figure 11 the deposits of JPM+WMB are stacked together on the same graph. This graph more clearly shows the decline in deposits and the contribution of WMB to JPMs deposit base.

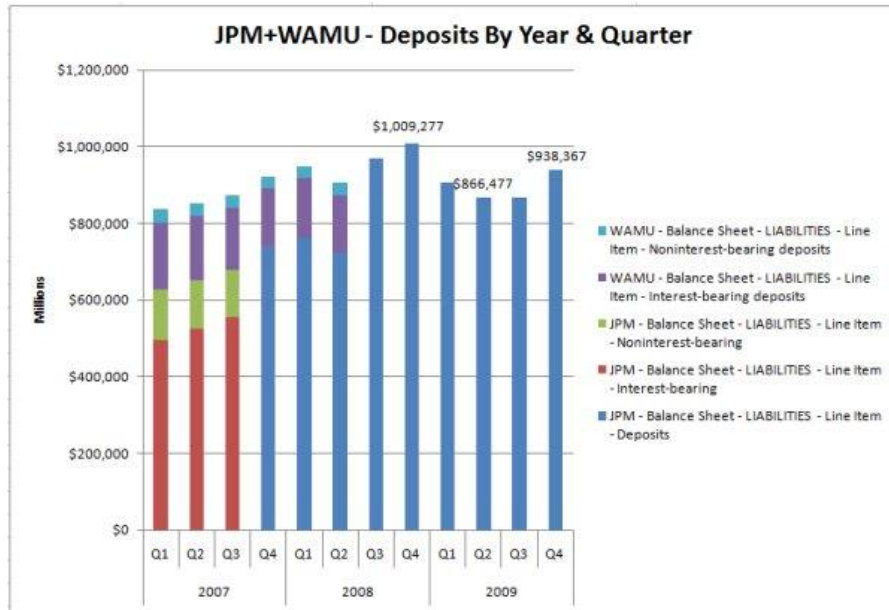


FIGURE 11 - JPM+WMB DEPOSITS BY YEAR & QUARTER

So what drove the decline in deposits? Was it the bad press and “negative goodwill” because JPM did not pay a fair price for WMB? Was it a negative consumer reaction to the greed of the Big Banks after details of the bailouts were made public? Was it a movement advocated by Ariana Huffington for people to move money into local banks and credit unions and away from big banks?

The \$102B decline in deposits in the first quarter was massive by any standard and represented 10% of JPMs entire deposit base. It is my opinion that JPM would have been much better off buying Washington Mutual at a fair price and could have avoided a lot of negative backlash. Even the significant increase in Q4 of 2009 must have come at the expense of increased marketing costs which will be explored in the next section.

### 2.3 Shareholder Equity

Figure 12 is an image of JPM’s Shareholder Equity stacked by WAMU’s shareholder equity by year and quarter. At the end of Q2 of 2008, WAMU had a Shareholder Equity of \$26B dollars. If we remove goodwill (\$7.2B) from assets, then WAMU had assets in excess of liabilities of \$18.8B. This number in itself exemplifies the absurdity of Rosen’s comments in court about WMI being hopelessly insolvent after stating that there was in excess of \$100B in claims. *How does a company with tangible assets in excess of liabilities by \$18.8B magically have over \$100B in claims after a chapter 11 filing? The only plausible explanation is that many of the claims are bogus and wildly inflated.*

It should be noted again that JPM also purchased Bear Sterns in Q2 of 2008 and Bear Sterns had approximately \$11.9B in shareholder equity as of their last filing in Q1 of 2008. Clearly JPM benefited from the purchase of WAMU assets and Bear Sterns as illustrated from the jump of JPMs shareholder equity from \$133B in Q2 of 2008 to \$166.9B in Q4 of 2008. The reader can decide for themselves if this is unjust enrichment or not.

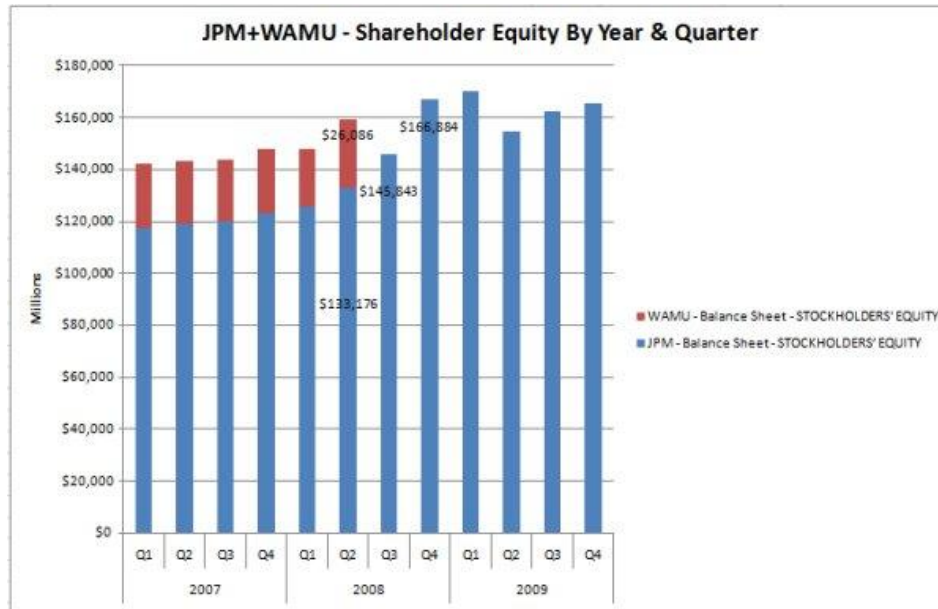


FIGURE 12 - JPM+WAMU SHAREHOLDER EQUITY BY YEAR & QUARTER

### 3 Income Statement Analysis

Figure 13 below graphs JPMs Net Income by quarter and year. As can be seen in the graph, JPMs net income was declining on a quarterly basis up until the purchase of Washington Mutual in Q3 of 2008. Then the tide turned and JPMs net income improved each subsequent quarter with the exception of Q4 of 2009.

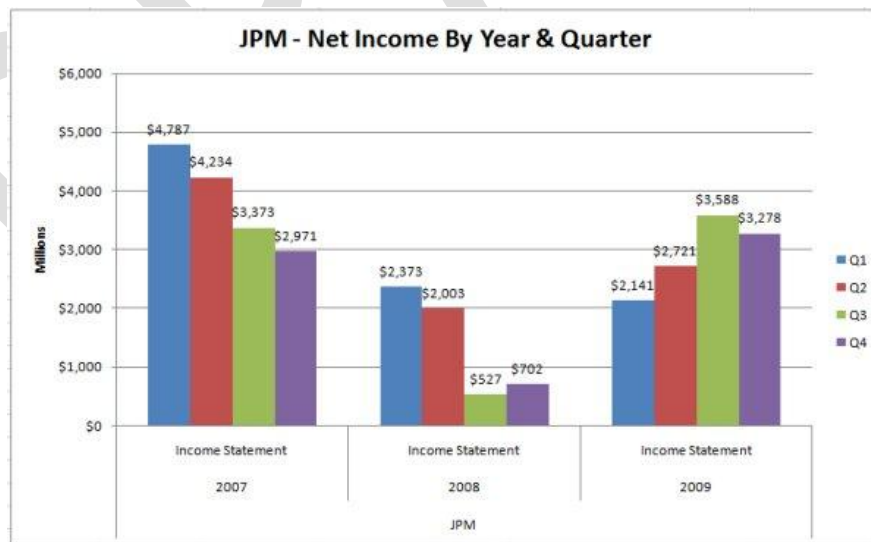


FIGURE 13 - JPM NET INCOME BY QUARTER

If we further break down JPMs income and expense by quarter and year we can examine the trends in income and expenses. Figure 14 below breaks down revenue by interest income and non-interest income, and expenses by

interest expense and non-interest expenses, in addition to extraordinary gains. In Figure 14 we see the impact of the WMB purchase in Q4 of 2009 with a peak in interest income. But then after the peak in interest income there is a gradual decline in interest income. We also see a big dip in Non-Interest income in Q4 and subsequent improvement in 2009.

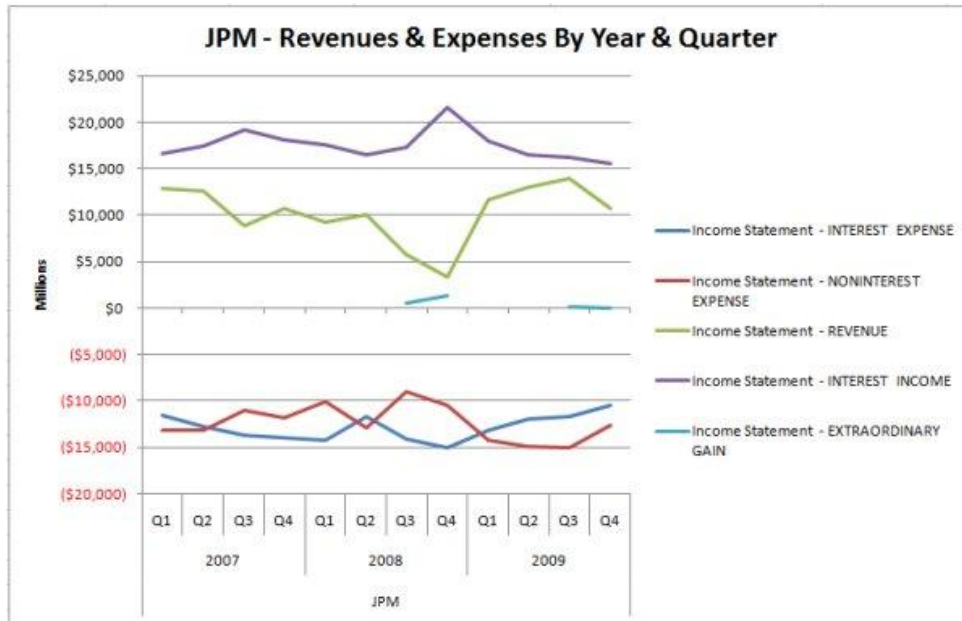


FIGURE 14 - JPM REVENUES & EXPENSES BY QUARTER

On the expense side, the interesting thing is the continual improvement in interest expense from each quarter since the purchase of WMB and the increase in non-interest expense. The causes of some of these observations can be explained by digging into the components that make up income and expenses. It should be noted that the extraordinary gains identified in the graph in Figure 14 relate to the negative goodwill of \$581 associated with the WMB purchase, and subsequent adjustments.

### 3.1 Revenue

The graph in Figure 15 shows JPMs total revenue by year and breaks down the revenue and type. JPMs total revenue in 2007, 2008, & 2009 was \$116.3B, \$103.4B, and \$115.7B respectively. The most notable thing in Figure 15 is the large decline in Non-Interest Revenue in 2008.

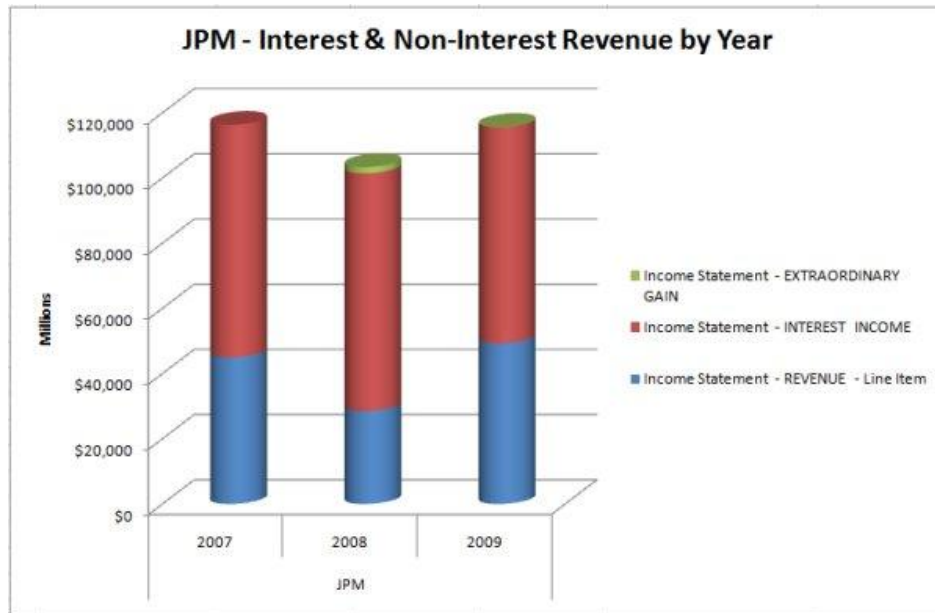


FIGURE 15 - JPM TOTAL REVENUE BY YEAR AND TYPE

Figure 16 breaks out JPMs non-interest revenue by component, quarter and year. Most notable in Figure 16 is the huge losses in Q3 and Q4 of 2009 due to *“Principle Transactions”*. Principle Transactions is the most volatile component of non-interest revenue and is the biggest driver of non-interest revenue. It is the under-performance of the Principle Transactions component that led to a decline in the revenue category in Figure 16 for Q4 of 2009. This brings up the question what are Principal Transactions<sup>2</sup>? What caused the losses in Q3 and Q4 of 2008 and the poor performance of Principal Transactions in Q4 of 2009? The answer to this question can be found on page 33 of the [JPM 2008 10K](#). Given below is an excerpt from the 10K:

“In 2008, principal transactions revenue, which consists of revenue from the Firm’s trading and private equity investing activities, declined by \$19.7 billion from the prior year. Trading revenue decreased \$14.5 billion to a negative \$9.8 billion compared with a positive \$4.7 billion in 2007. The decline in trading revenue was largely driven by higher net markdowns of \$5.9 billion on mortgage-related exposures compared with \$1.4 billion in the prior year; higher net markdowns of \$4.7 billion on leveraged lending funded and unfunded commitments compared with \$1.3 billion in the prior year; losses of \$1.1 billion on preferred securities of Fannie Mae and Freddie Mac; and weaker equity trading results compared with a record level in 2007”.....”For a further discussion of principal transactions revenue, see IB and Corporate/Private Equity segment results on pages 42–44 and 61–63, respectively, and Note 6 on pages 146–148 of this Annual Report”

Given the definition of Principal Transactions, it would appear that JPM took a major hit in their Market Making and Market investing activities in 2008.

Another interesting observation from Figure 16 is JPMs increase in the category *“Lending & Deposit-related Fees”* since the Q3 purchase of WMB. What drove the increase in Lending & Deposit related fees; the increase in loan portfolio, the increase in Deposits, an increase in fee structure, or a combination of items?

<sup>2</sup> A Principal Transaction is a transaction in which a broker/dealer buys or sells a security from his/her own account. See: [Metric:Principal Transactions](#)

The increase in Lending & Deposit related fees can explain in part the graph in Figure 11 which shows a declining deposit base after Q3 of 2008. It appears that JPM raised deposit fees which caused customers to move money out of JPM accounts.

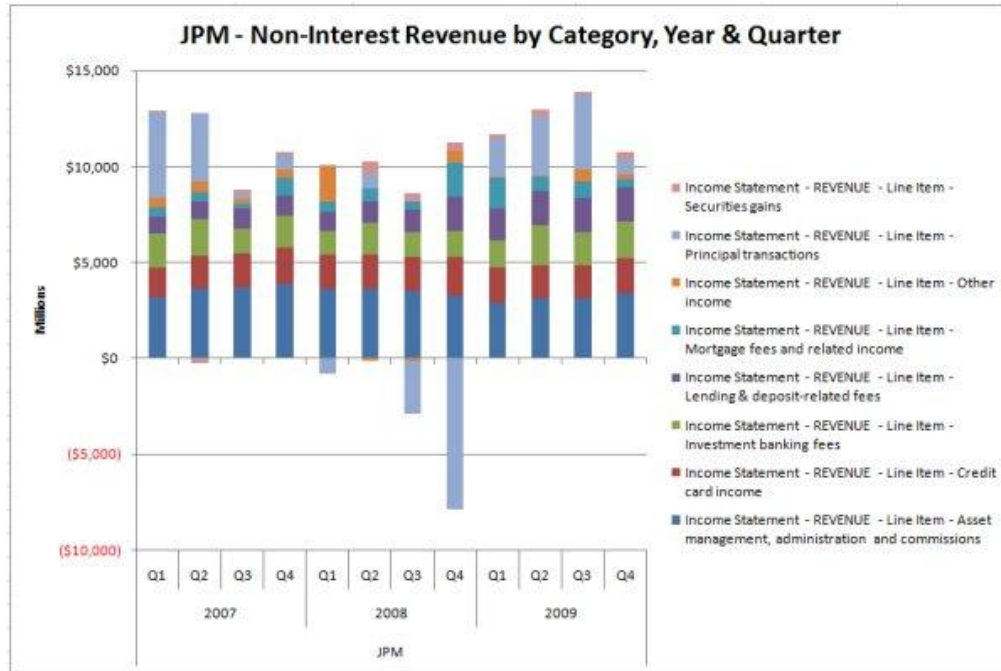


FIGURE 16 - JPM NON-INTEREST REVENUE

### 3.2 Expenses

JPM's total expense by year is illustrated by the graph in Figure 17. JPM's total expenses for 2007, 2008, and 2009 were \$101B, \$97.8B, and \$103.9B respectively. One observation that can be made is that in 2009 JPM's Non-Interest expenses category expanded considerably in 2009 versus prior years. Therefore we will break down the components of Non-Interest expense further.

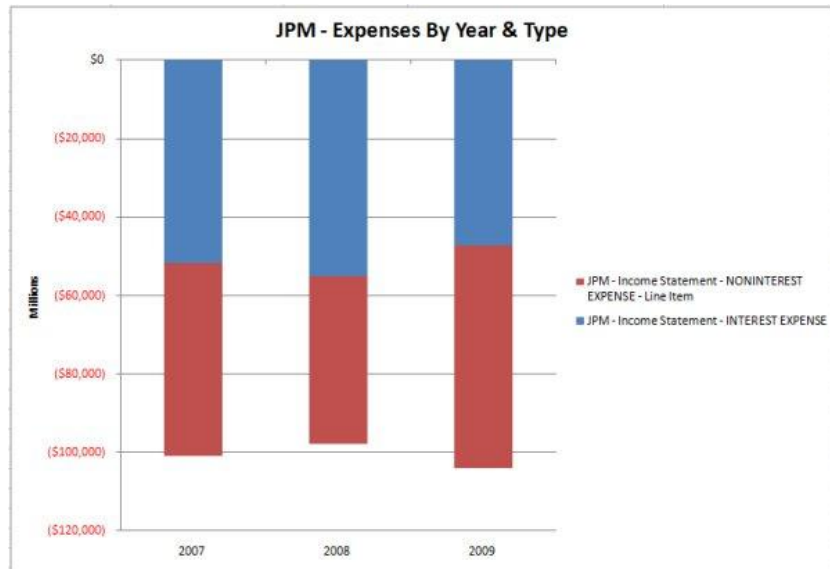


FIGURE 17 - JPM EXPENSES BY YEAR

### 3.2.1 Non Interest Expense

Figure 18 is a breakdown of non-interest expenses by category, year, and quarter. What is clear from Figure 18 is that the dominant expense category is “*Compensation Expense*”. The other notable item is the tax refunds in Q3 and Q4 of 2008. This brings up questions like why so much variability in Compensation Expense?

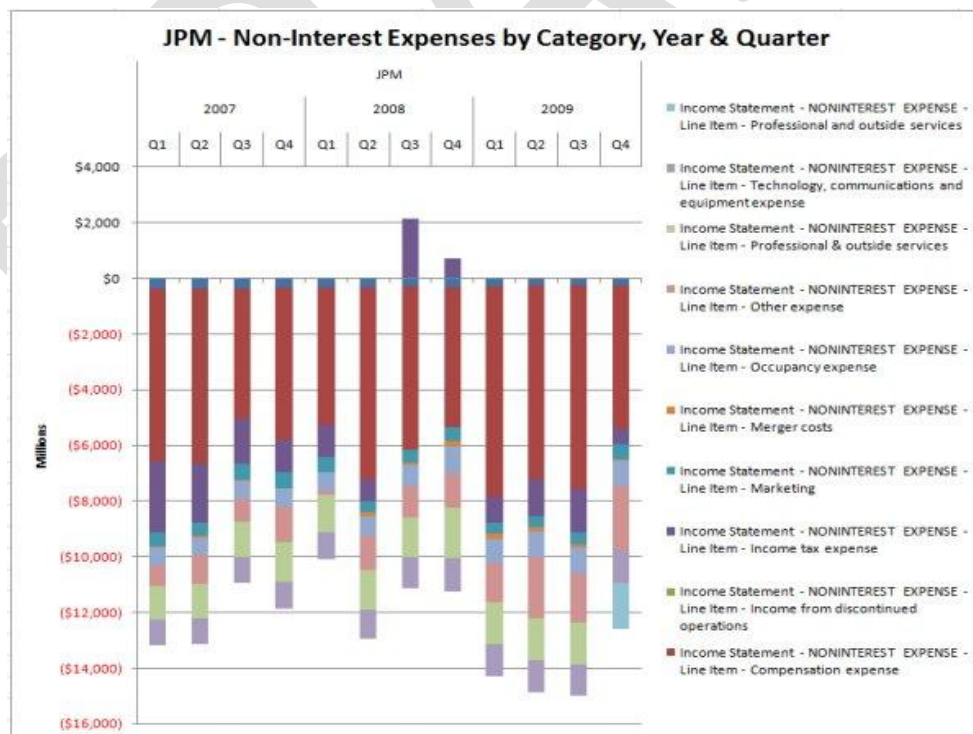


FIGURE 18 - JPM NON-INTEREST EXPENSES

If you compare Figure 17 and Figure 18 you can see that the decline in non-interest expense in Q3 and Q4 of 2008 was mostly a result of income tax refunds and declines in compensation expense resulting from poor performance in Principal Transactions.

### 3.2.2 JPM & WAMU Compensation Expense

Figure 19 is a graph that stacks WMBs compensation expense on top of JPMs compensation expense. On a quarter over quarter basis, WNBMs varies very little over time while JPMs compensation expense varies considerably. This can be explained by the fact that JPM is an active participant in the markets and pays bonuses based on market results, while WMB is more a pure banking institution.

When I first looked at this graph, I questioned if JPM or the FDIC was paying the compensation expense for WMB employees in Q4 of 2008. WMB had compensation expense of \$939M on a quarterly basis and Bear Sterns had \$754M of compensation expense in their last 10Q as an independent company which combined should had added \$1.69B in quarterly compensation expense. But this is not reflected by the graph in Figure 19 and the Compensation Expense in Q4 of 2008 looks exceptionally low compared to other quarters. The decline in the Q4 compensation expense may be explained by the following link: <http://www.businessinsider.com/2008/10/bonus-watch-jp-morgan-slashes-bonuses-30-to-50->

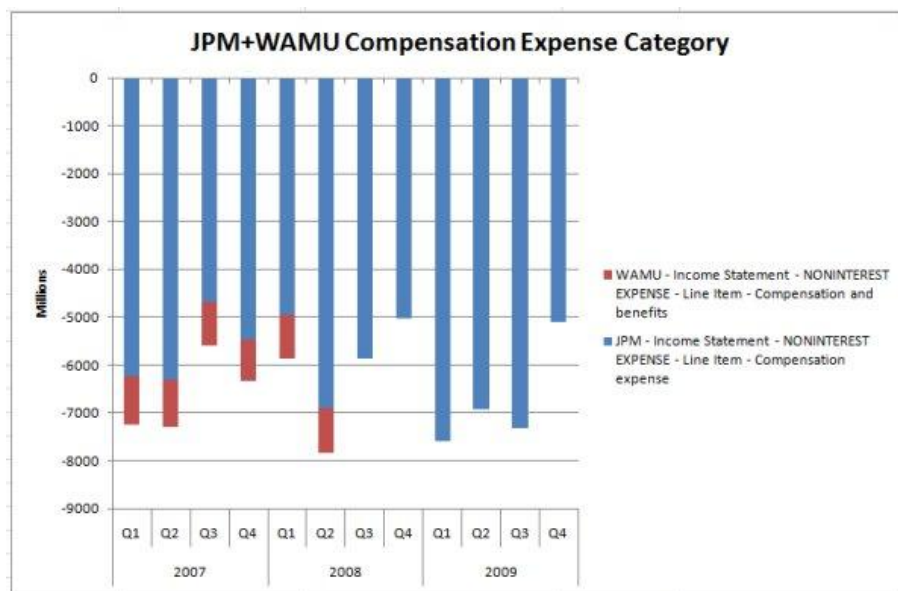


FIGURE 19 - JPM+WAMU COMPENSATION EXPENSE BY QUARTER

While compensation expense on quarter over quarter basis shows a lot of variability, on a year over year basis the results look different as illustrated in Figure 20. In Figure 20, JPMs compensation expense looks surprisingly identical between 2007 & 2008 despite purchasing WMB and Bear Sterns in 2008. And in 2009, the compensation expense jumps considerably and looks close to what it should be with the addition of WMB.

Given the macro level evidence in graph 20, there is a possibility that the FDIC paid WMBs compensation expense in Q4 of 2008 rather than JPM. If this were the case, then that would be a further insult to injury as JPM would have gained a benefit of nearly \$900M in avoided compensation expense on a purchase that only cost them \$1.9B. While it is possible that JPM reduced their compensation expense considerably in 2008, this is something that WMI Equity committee should verify.

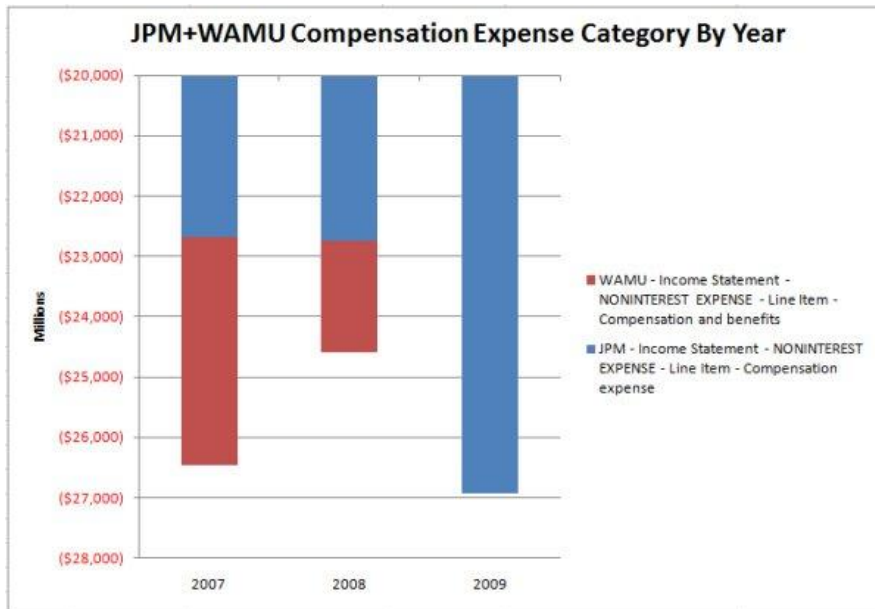


FIGURE 20 - JPM+WAMU COMPENSATION EXPENSE BY YEAR

JPMs compensation expense as a percentage of total revenue between 2007, 2008, and 2009 was 19.5%, 22%, and 23.3%. By contrast, WMB had total revenue of \$25.53B and compensation expense of \$3.77B for a compensation percentage of 14.8%.

### 3.2.3 Marketing Expense

When one a company buys another (or significant assets of another as in the WAMU case), one of the primary places that the benefits of the acquisition show up is in Sales & Marketing expenses. Figure 21 is a graph that stacks WAMU’s marketing expense on top of JPM’s marketing expense by year and quarter.



FIGURE 21 - JPM+WAMU MARKETING EXPENSE BY YEAR & QUARTER

Figure 21 illustrates two items of interest. First, the combined marketing expense of the WAMU+JPM stacked bars appears to be greater than the marketing expense of JPM in 2009 as a combined company. The second thing that stands out is that in Q4 of 2009, JPM increased their marketing expense considerably. One explanation for this increase in marketing expense can be derived from Figure 11. JPM had been losing deposits at a significant rate and they had to increase their marketing expense to increase their deposit base.

If we examine marketing expense by year per Figure 22, we see a better picture of JPM's marketing expense savings as a consolidated entity.

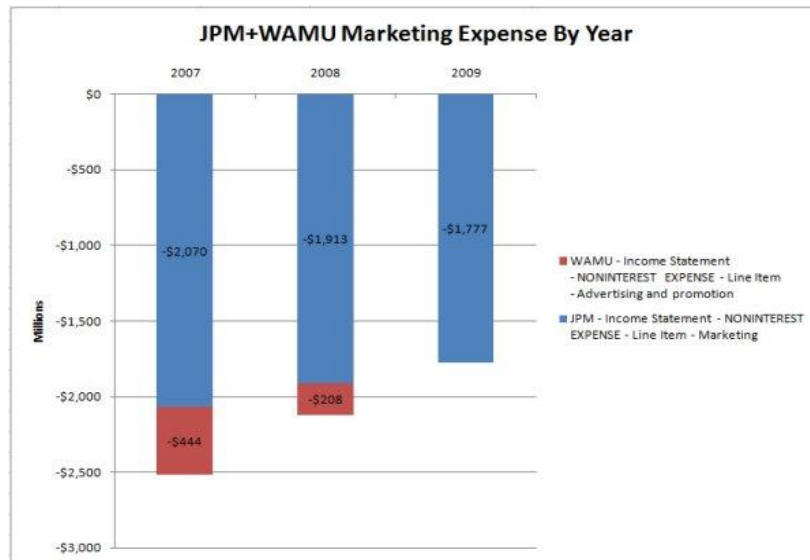


FIGURE 22 - JPM MARKETING EXPENSE BY YEAR

Figure 22 shows that in 2009, JPM spent \$1.78B on marketing expenses, while in 2007 JPM+WAMU as independent companies spent \$2.51B on marketing expenses. If we assume that JPM will save \$500M a year on marketing expenses to sustain the asset base that they have as it exists in 2009, then we can place a value on that savings by using a Present Value (PV) calculation on a series of cash flows. Over a 10 year period, a \$500M savings a year discounted by a 3.25% prime rate<sup>3</sup> is:

$$PV = (t=10, \text{flow}=500M, r= 3.25\%) = \$4.21B$$

Therefore, from savings in marketing expenses alone, JPM can expect to derive a benefit of \$4.21 Billion dollars.

### 3.2.4 Technology, Communication & Equipment Expense

Another area of expense that companies often get savings due to economies of scale and synergies is Technology, Communications, & Equipment. However, the savings in this area usually do not show up right away and in many instances there is an initial increase in spend to assimilate the acquired entity into the operations of the acquiring entity.

<sup>3</sup> As of 3/17/2010, Prime Rate is 3.25% per this link: <http://www.bankrate.com/rates/interest-rates/prime-rate.aspx>

Figure 23 below is a graph that stacks WAMU's Technology & Information Services expenses on top of JPM's Technology, Communications, and Equipment expense. Unlike Marketing expense, the expected saving in this area are harder to determine without detailed information.

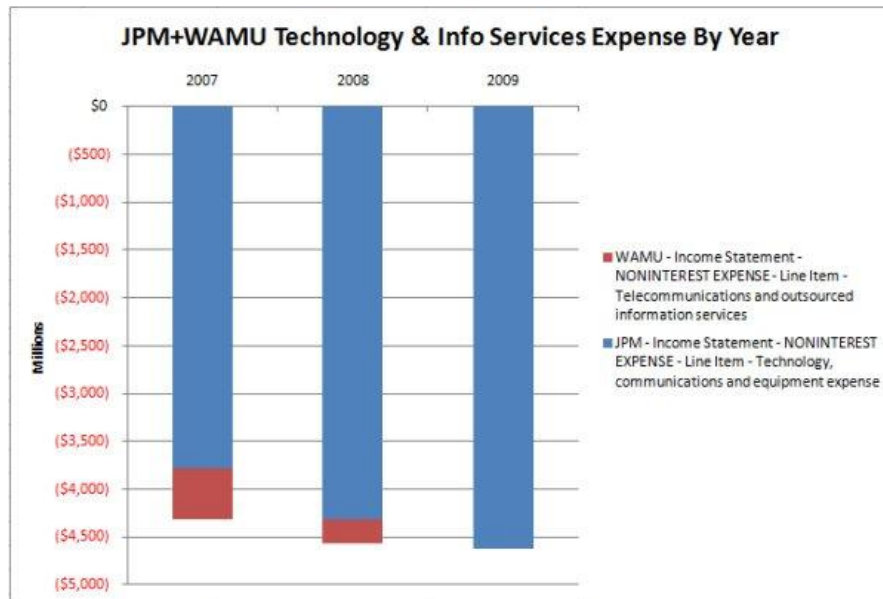


FIGURE 23- JPM+WAMU TECHNOLOGY & INFO SERVICES EXPENSE BY YEAR

The increase in technology and communications expenses is expected given that JPM had to integrate Bear Sterns and WAMU into their operations in 2008. Given the number of WAMU branches acquired, integration activity certainly extended into 2009.

#### 4 JP Morgan Chase - Cash Flow Analysis

JPM's Cash Flows from Financing Activities, Investing Activities, and Operating Activities is graphed in Figure 24. The interesting thing about Figure 24 is that Cash Flows from Financing Activities and Investing Activities are almost mirror images of each other. What this shows is that JPM has been raising capital and then rolling the raised capital straight into investments. This is especially true in Q3 and Q4 of 2008 per Figure 24. In 2009 it looks like JPM started paying off short or long term loans and cashing out on investments.

The other observation from Figure 23 is that JPM was a consumer of cash from operating activities in 2007 and relied on financing for its cash needs. Then starting 2Q of 2008 and going forward JPM steadily improved cash flows from Operating activities. The interesting thing is that the improvement from Operating Activities started after the acquisition of Bear Sterns and WAMU assets.

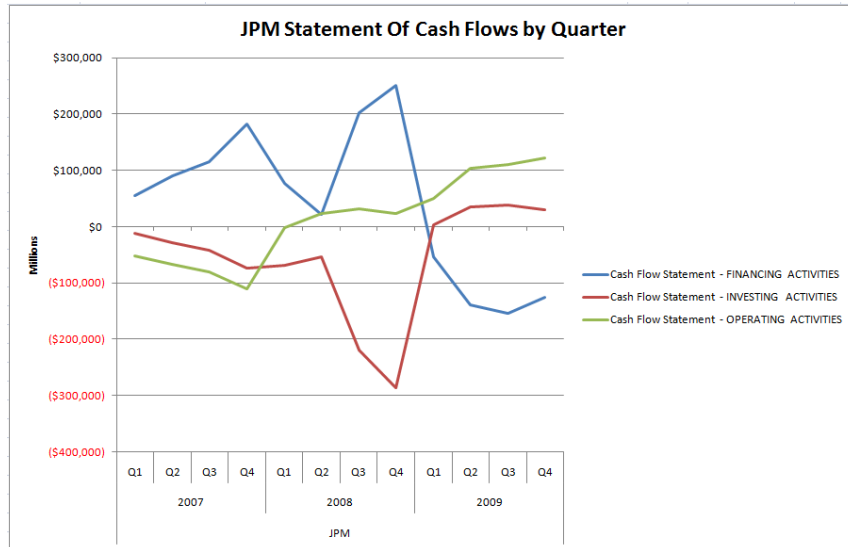


FIGURE 24 - JPM OPERATING, INVESTING, & FINANCING ACTIVITIES

Figure 25 below shows JPMs cash balance by Quarter. Figure 25 shows a sharp increase in cash in 3Q of 2008 of roughly \$23B and is most likely due to the sweetheart deal with the FDIC to buy WAMU assets. WMB, per Exhibit 1, had roughly \$7B in cash and another \$24B in current assets that if sold could explain the large influx of cash in Q3 of 2008.

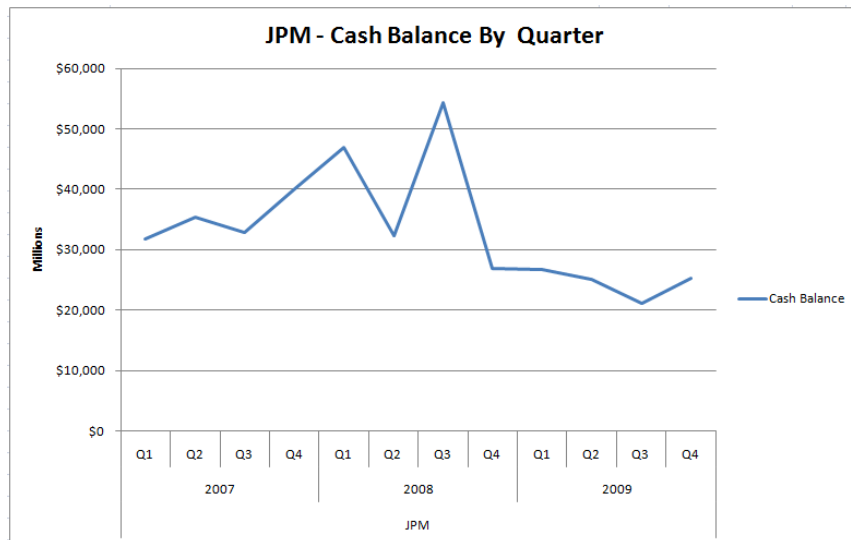


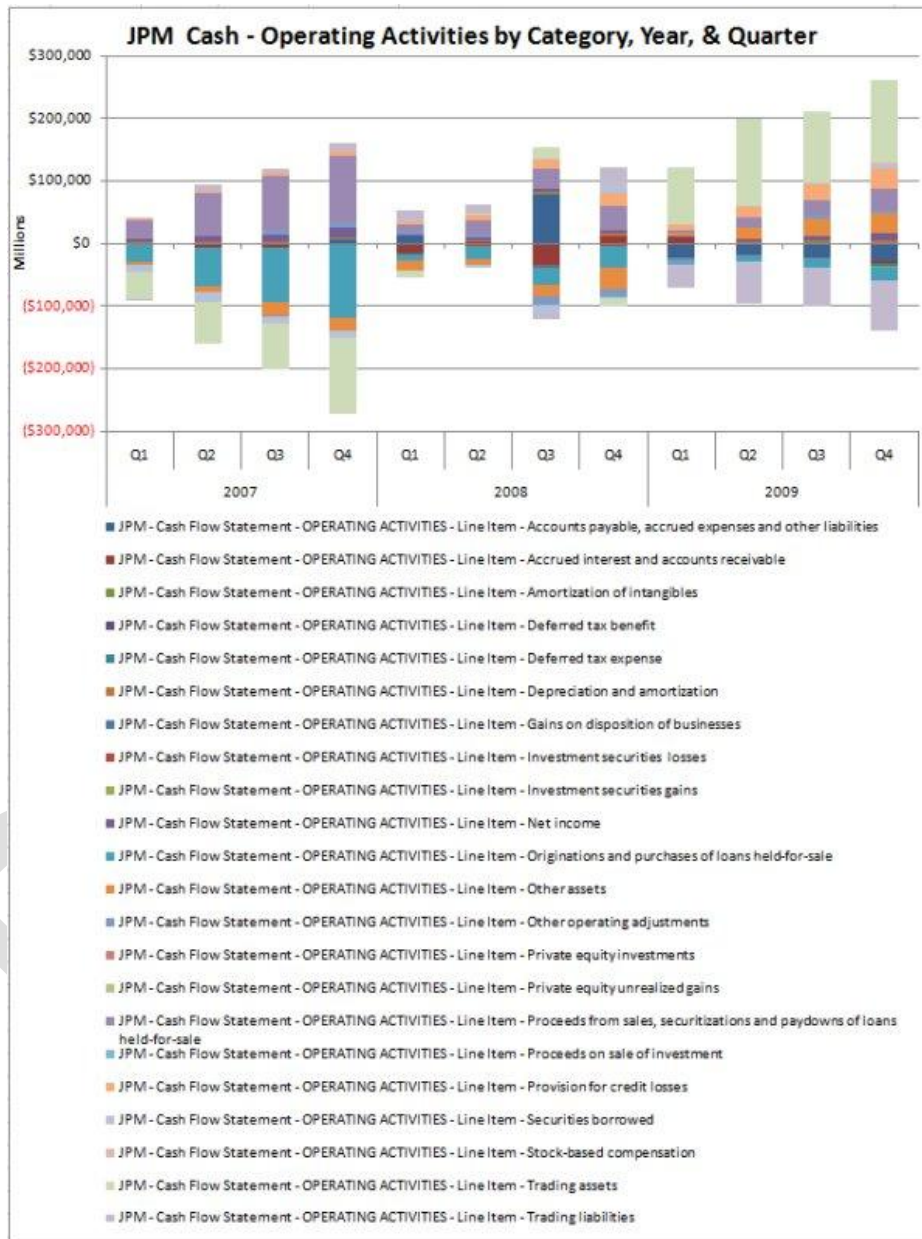
FIGURE 25 – JPM CASH BALANCE BY QUARTER

From Figure 24 above it appears that JPM likes to maintain cash at between \$20B to \$30B dollars. At end of Q3 in 2009 cash holdings were roughly 1% of total assets.

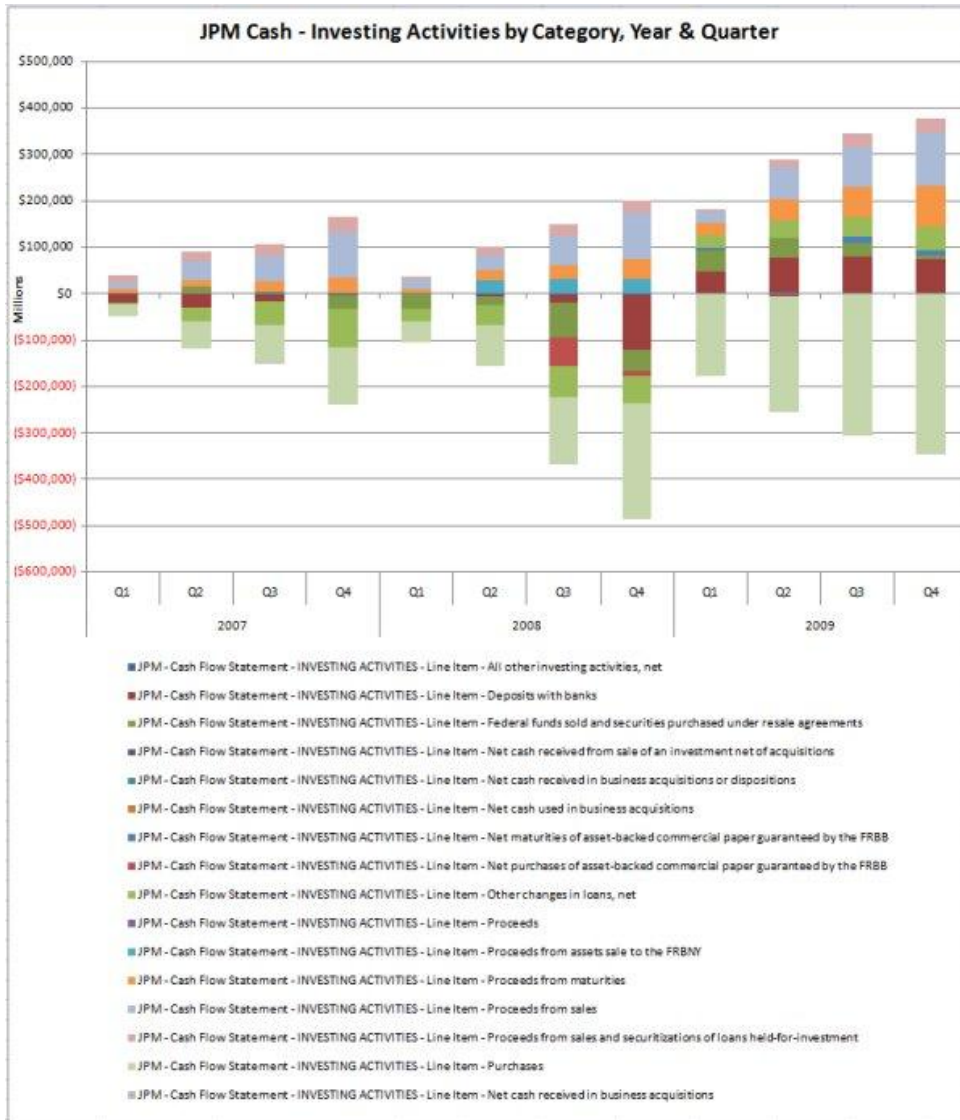
If we further break down the statement of cash flows by categories for Operating, Financing, and Investing activities we can get further insights into JPMs sources and uses of cash. These will be examined using two sets of charts,

stacked charts and bar charts. Because the graphs are so big and require a full page each, the Bar chart graphs for Operating, Financing, and Investing activities are provided in Appendix A-C.

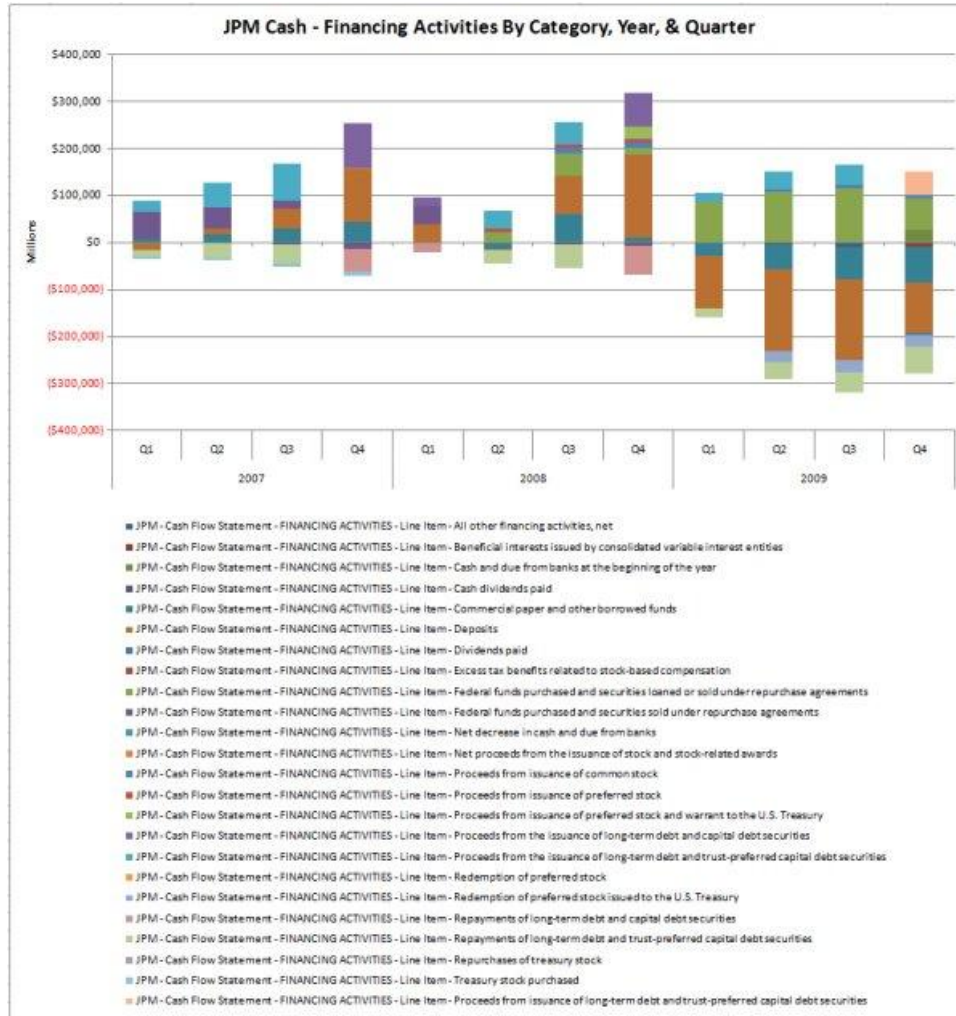
#### 4.1 Cash From Operating Activities



#### 4.2 Cash From Investing Activities

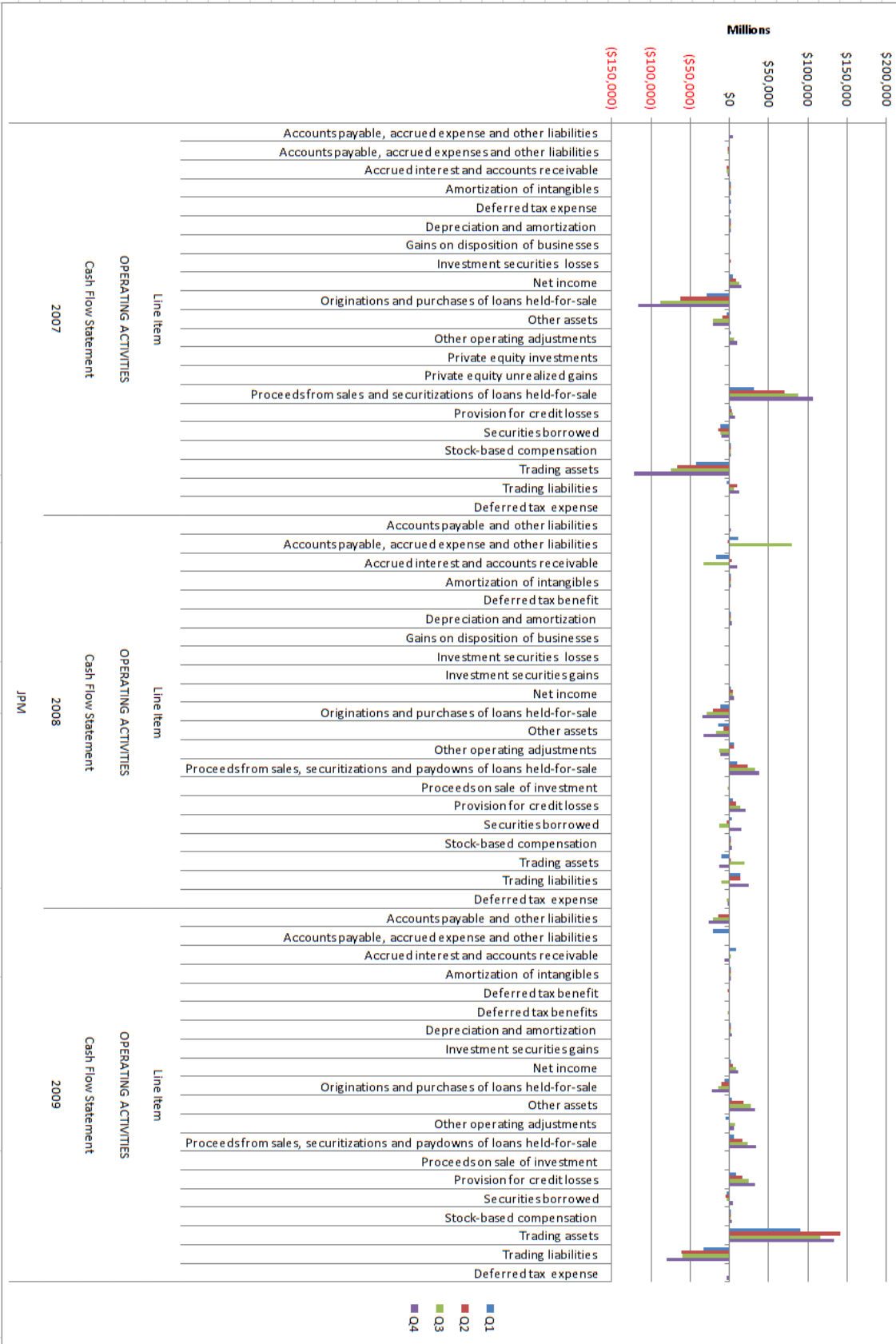


### 4.3 Cash From Financing Activities

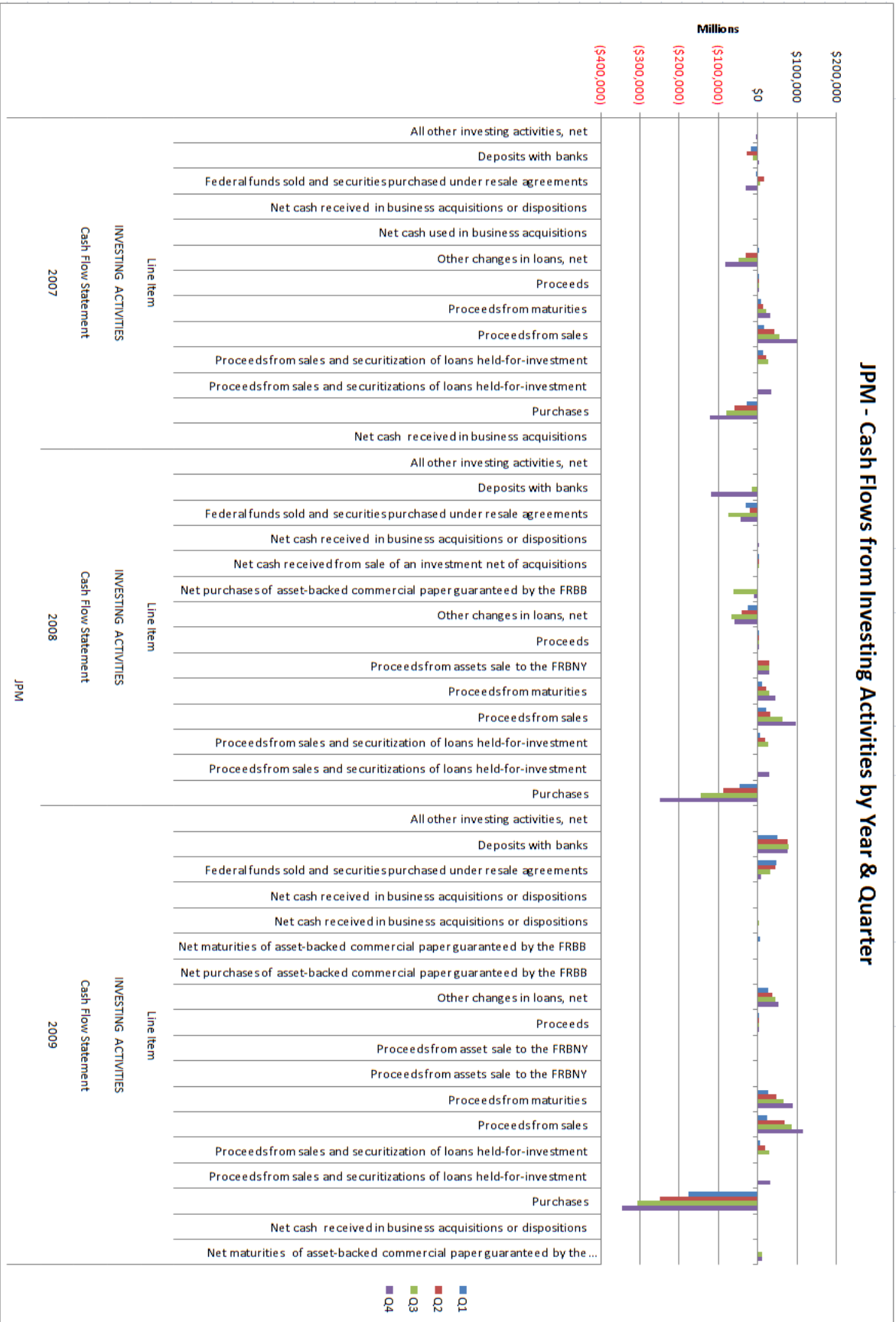


## 5 Conclusions

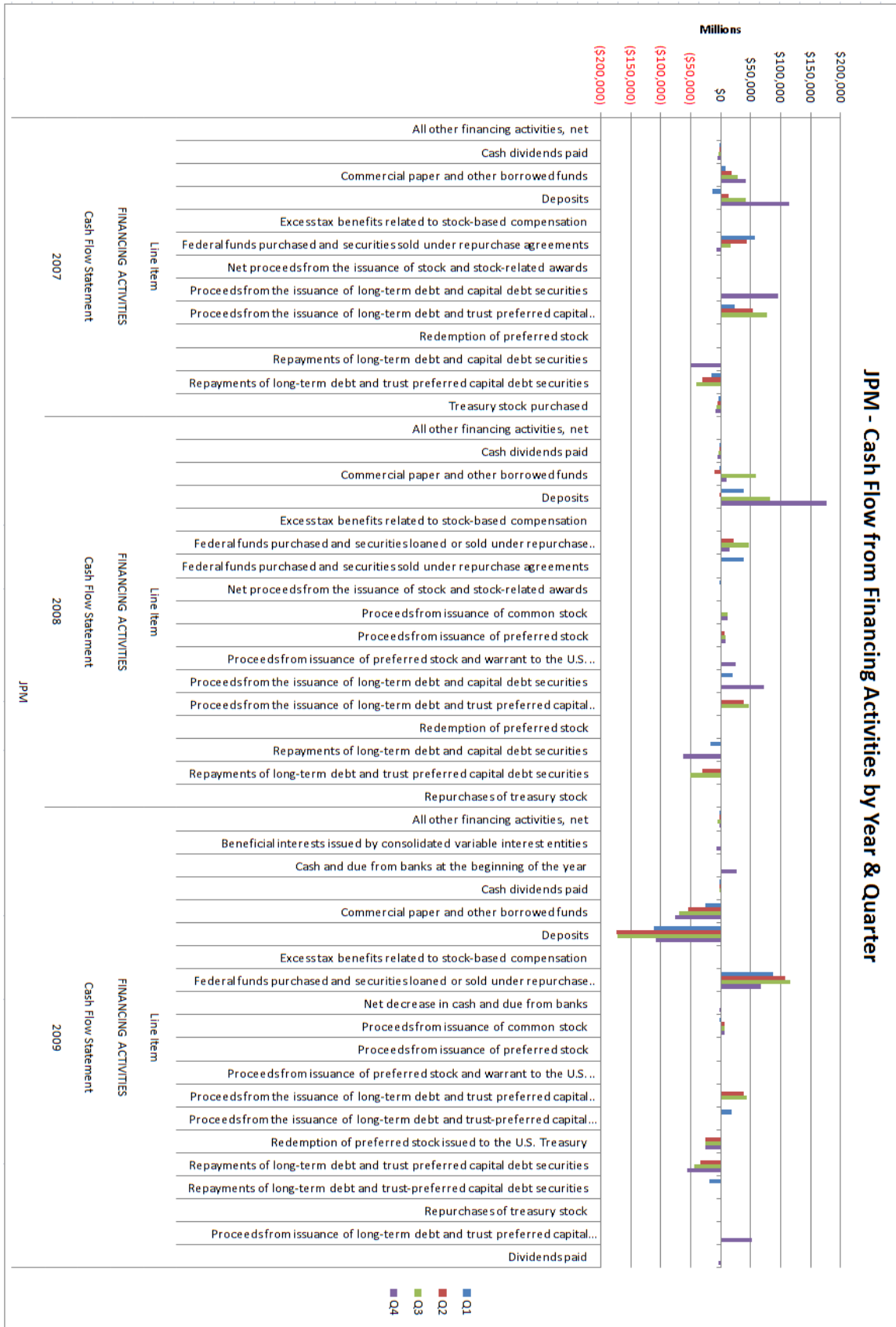
# JPM - Cash Flows From Operating Activities by Year & Quarter



### JPM - Cash Flows from Investing Activities by Year & Quarter



### JPM - Cash Flow from Financing Activities by Year & Quarter



DRAFT