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SBNY - Q2 2018 Signature Bank Earnings Call

EVENT DATE/TIME: JULY 19, 2018 / 2:00PM GMT

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PRESENTATION

Operator

Welcome to Signature Bank's 2018 Second Quarter Results Conference Call. Hosting the call today from Signature Bank are Joseph J. DePaolo, President and Chief Executive Officer; and Eric R. Howell, Executive Vice President, Corporate and Business Development. (Operator Instructions)

It is now my pleasure to turn the floor over to Joseph J. DePaolo, President and Chief Executive Officer. You may now begin.

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Thank you, Lori. Good morning, and thank you for joining us today for the Signature Bank 2018 Second Quarter Results Conference Call. Before I begin my formal remarks, Susan Lewis will read the forward-looking disclaimer. Please go ahead, Susan.

Susan Lewis

Thank you, Joe. This conference call and oral statements made from time to time by our representatives contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties. You should not place undue reliance on those statements because they are subject to numerous risks and uncertainties relating to our operations, business environment, all of which are difficult to predict and may be beyond our control. Forward-looking statements include information concerning our future results, interest rates and the interest rate environment, loan and deposit growth, loan performance, operations, new private client, team hires, new office openings and business strategy. As you consider forward-looking statements, you should understand that these statements are not guarantees of performance or results. They involve risks, uncertainties and assumptions that could cause actual results to differ materially from those in the forward-looking statements.

These factors include those described in our quarterly and annual reports filed with the FDIC, which you should review carefully for further information. You should keep in mind that any forward-looking statements made by Signature Bank speak only as of the date on which they were made.

Now I would like to turn the call back to Joe.

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Thank you, Susan. I will provide some overview into the quarterly results and then Eric Howell, our EVP of Corporate and Business Development, will review the Bank's financial performance in greater detail. Eric and I will address your questions at the end of our remarks.

Signature Bank had a solid quarter of growth and performance, enabling us to deliver record earnings. These record earnings, coupled with both the positive impact of the $50 billion SIFI mark moving higher and tax reform has afforded us the opportunity to declare an inaugural quarterly cash dividend of $0.56 to our common shareholders, representing an annualized dividend of $2.24 per share. Now we will turn our attention to a buyback program, which will require shareholder approval. Moreover, this quarter, we further invested into the future growth of the bank by continuing to hire quality private client banking teams on both coasts.

Now let's take a further look into earnings. Net income for the 2018 second quarter was $154.6 million or $2.83 diluted earnings per share, an increase of $140.6 million, compared with $14 million or $0.26 diluted earnings per share reported in the same period last year. The increase in net income was driven by a decrease in charge-offs and noninterest expense, both related to taxi medallion loans as well as an increase in net interest income, primarily driven by the positive loan growth. These items were partially offset by increased expenses due to the addition of new private client banking teams.

Looking at deposits. Deposits increased $176 million to $35 billion this quarter, affected by a decrease of $918 million in escrow deposits, while average deposits grew $237 million. Since the end of the 2017 second quarter, deposits increased $1.8 billion and average deposits increased $1.5 billion. Noninterest-bearing deposits of $11.8 billion represented 34% of total deposits and grew $22 million this quarter. Our deposit and loan growth, coupled with earnings retention, led to an increase of $4.5 billion or 11% in total assets since the second quarter of last year.

Now let's take a look at our lending businesses. Loans during the 2018 second quarter increased $900 million to $34.1 billion. For the prior 12 months, loans grew $3.8 billion and represents 75.5% of total assets, compared with 74.6% 1 year ago. The increase in loans this quarter was primarily across the board, as commercial investor lending increased by 7.7%, specialty finance increased by 4.3%, and multifamily and commercial real estate loans again increased.

Turning to credit quality. Our core portfolio is performing remarkably well. Nonaccrual loans further decreased this quarter by $11 million to $158 million as we worked down our remaining medallion portfolio. But excluding medallion loans, nonaccrual loans were only $23 million or just 7 basis points. Let me repeat that, excluding medallion loans, nonaccrual loans were only $23 million or just 7 basis points of loans on a $45 billion balance sheet. We saw a decrease in our 30- to 89-day past due loans to $39 million, our 90-day-plus past due loans remained low, at $5 million. The provision for loan losses for the 2018 second quarter was $8 million compared with $141 million for the 2018 first quarter.

Net charge-offs for the 2018 second quarter were $3 million, compared with $128 million for the 2018 first quarter. The allowance for loan losses was 62 basis points of loans, versus 63 basis points in the 2018 first quarter.

And now, on to the team front. During the quarter, we had one team in New York and one team in San Francisco. Thus far, in the third quarter, we have already added 2 additional teams in San Francisco. Now that gives us 3 teams hired for New York and 3 teams hired for San Francisco thus far this year, for a total of 6. Our pipelines in both New York and San Francisco remain active. And we look forward to the ongoing opportunities to attract talented banking professionals to our network.

At this point, I'll turn the call over to Eric, and he will review the quarter's financial results in greater detail.

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

Thank you, Joe, and good morning, everyone. I'll start by reviewing net interest income and margin. Net interest income for the second quarter reached $321 million, up $13.8 million or 4.5% when compared with the 2017 second quarter, an increase of 1% or $2.9 million from the 2018 first quarter. Net interest margin decreased 7 basis points on a linked-quarter basis to 2.94%. Excluding prepayment penalty income, core net interest margin for the linked quarter decreased 6 basis points to 2.89%. The decrease was primarily driven by an increase in borrowings, which come at a greater cost than deposits. Additionally, both borrowings and deposit costs increased.

Let's look at asset yields and funding costs for a moment. Interest-earning asset yields increased 7 basis points from the linked quarter to 3.82%. Yields on the securities portfolio increased 12 basis points linked quarter to 3.17%, given a slight slowdown in premium amortization and better reinvestment yields. The duration of the portfolio remains stable at 3.8 years.

Turning to our loan portfolio, yields on average commercial loans and commercial mortgages increased 5 basis points to 4.03%. Excluding prepayment penalties from both quarters, yields would have increased 6 basis points.

Now looking at liabilities. Our overall deposit costs this quarter increased 11 basis points to 76 basis points, compared to the 2018 first quarter, driven by further fed rate increases leading to heightened competition. Average borrowings, excluding subordinated debt, increased $634 million to $5.4 billion or 12% of our average balance sheet. The average borrowing cost increased 26 basis points from the prior quarter to 2%. Overall, the cost of funds for the quarter increased 14 basis points to 96 basis points.

And on to noninterest income and expense. Noninterest income for the 2018 second quarter was $5.6 million, a decrease of $3.9 million when compared with the 2017 second quarter. The decline was due to an increase of $3.8 million in tax credit investment amortization, which positively impacts our effective tax rate. Noninterest expense for the 2018 second quarter was $112.6 million versus $116.3 million for the same period a year ago. The $3.7 million decrease was primarily a result of write-downs of $11.5 million on repossessed New York City taxi medallion loans in the 2017 second quarter. This decrease was partially offset by increases in salaries and benefits from the addition of new private client banking teams.

The bank's efficiency ratio improved to 34.5% for the 2018 second quarter, versus 36.7% for the comparable period last year. The decrease was due to the aforementioned write-downs on repossessed New York City taxi medallion loans.

And turning to capital. Our capital ratios were all well in excess of regulatory requirements and augment the relatively low-risk profile of the balance sheet. As evidenced by a Tier 1 leverage ratio of 9.64% and a total risk-based ratio of 13.42% as of the 2018 second quarter.

And now, I'll turn the call back to Joe. Thank you.

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Thanks, Eric. We are pleased the House took appropriate measures to pass the Senate bill moving the $50 billion SIFI threshold higher. This will allow the bank to slow down the pace on nonrevenue-related expense growth and to better focus on our growth initiatives.

As we head into the second half of 2018, we are engaged in many exciting undertakings, such as, our expansion on the West Coast; the commencement of our quarterly dividend; the strengthening of our infrastructure, which includes a new credit approval system, a foreign exchange system and an enhanced payments platform; and, the ongoing hiring of new private client teams in New York. As we relate to this quarter, we are happy to have posted a solid and clean quarter. We recognize that NIM is compressing, but it is manageable as evidenced by our ability to grow net interest income this quarter. A provision came in at a normal level of $8 million. Our expense growth normalized at 10%. Our balance sheet growth was solid at $780 million. Normalized earnings growth was nearly 30%. And for the first time, return on equity was over 15%.

With that said, we look forward to the many opportunities ahead of us. And we are happy to answer any questions you might have. So Lori, I'll turn it over to you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Dave Rochester of Deutsche Bank.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

So you mentioned the buyback. Joe, what you guys thinking in terms of timing at this point? Sorry, if I missed that. And any reason why you didn't do it this quarter?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Well, many of our long-term shareholders that are mainly large-fund complexes, prefer we pay a dividend to attract their value funds, and ultimately, this will allow us to broaden our shareholder base. We put it -- and we also put into place more than just a token dividend. A buyback program is not off the table, but we thought it was best to stop on a dividend and see how our growth initiatives pan out. Without giving you any timing, we will have to get shareholder approval for a buyback program, but it's certainly not off the table.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

Okay. It doesn't sound like that's imminent though this quarter?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

It could be.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

Okay. Great. And then just switching to the NIM. As you noted, return was a little bit worse than what you're expecting this quarter. Given your outlook on rates at this point, how are you thinking about that trend from here? And what you guys are assuming for deposit growth for the year at this point that's baked into that?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

The NIM was definitely affected this quarter by significant outflow of escrows that happened mostly in June where we had to put on higher cost borrowings. We anticipate that we will have deposit flows over the course of the next couple of quarters to replace that NIM some. So -- but given that, we're still going to see pressure on the NIM. We're probably looking at 3 to 6 basis points of NIM compression per quarter for the next 2 quarters and then we'll see what the Fed outlook is for next year.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

And so what's the differential between this new guidance and where you guys were before, which is down 1 to 3 bps a quarter?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

Well, the yield curve's flattened a little bit, and we're seeing just even more intense deposit pressures.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

Got you. And in terms of, I guess, what you're expecting for the curve going forward, are you looking for basically a stable tenure from here and then another rate hike in September?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

That's right.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

Okay. I know it's early in the quarter, but where are deposits at this point in the quarter in terms of growth?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Deposits. They're up.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

They're up? On an average basis as well?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Yes. On an average basis, they're much higher than the average for the second quarter.

David Patrick Rochester - *Deutsche Bank AG, Research Division - Equity Research Analyst*

Okay. Great. And then I think you already alluded to this, but given you guys are out of the LCR and CCAR and everything, not that you would have been in CCAR, but more of a -- the heightened of super -- nonsupervisory stress test, if you will, are you guys thinking that the high single-digit expense growth pace can apply to next year as well?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

Absolutely.

Operator

Your next question comes from the line of Casey Haire of Jefferies.

Casey Haire - *Jefferies LLC, Research Division - VP and Equity Analyst*

Eric, just wanted to follow up on the NIM, the guidance. The 3 to 6 basis points, does that contemplate dollar-for-dollar funding of loan growth with deposits? Or is that -- does that bake in some increased borrowings usage going forward?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

We really anticipate that we'll be able to fund loan growth with deposits fully.

Casey Haire - *Jefferies LLC, Research Division - VP and Equity Analyst*

Okay. Great. And so if deposits do fall short of loans, then you would have to use borrowings, which would be downside of the NIM guide?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

That's correct. That gets us to the 6 basis points versus the 3.

Casey Haire - *Jefferies LLC, Research Division - VP and Equity Analyst*

Okay. Got you. All right. And then just switching to capital return. I guess, the 20% payout ratio at this dividend, I guess, we'll wait and see on timing, but any updated thoughts as to how much buyback you would use as a percentage of a payout?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

No. It's very difficult to say, because, as we said, we've hired 6 teams in which 2 have come on over the last -- one actually just joined us yesterday and one joined us within the last 2 weeks, and we have a fairly large pipeline of opportunities on the deposit side. Most of these teams in deposit gathering and C&I on the loan side. So we're going to see what opportunities actually pan out and that's going to depend on how quickly we can get these teams up and running, and that will then dictate what we'll do.

Operator

Your next question comes from the line of Jared Shaw of Wells Fargo Securities.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Just on the buyback. I guess, why do you need to get shareholder approval? I don't remember seeing that at other banks before. Usually, it'd just be board approval. Is that something just to do with your...

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

As a state-chartered bank, we have to obtain -- a New York State-chartered bank, we have to obtain shareholder approval.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Is that just onetime...

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

As a national charter of our holding company.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Okay. And is that just a onetime approval, just to authorize the buyback? Or is it as you would go through a buyback, you'd have to keep coming back to the shareholders to reload?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

I think it's a onetime for the authorization of the buyback, Jared.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Okay. And then looking at the growth on the West Coast and the teams there, are you seeing any differential in deposit pricing in the markets there? Or you're doing fairly standard pricing throughout the franchise?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

No, we see -- not that it's not competitive, it's very competitive, but we see cheaper deposits there.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

And how is the new teams you've hired, have you been happy with the progress in terms of onboarding new clients with them or is it taking a little bit longer to bring the customers over?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Well, out in San Francisco, we just hired. One started yesterday, one started about 2 weeks ago. So it's hard to say, but the reception for the teams, the receptivity of their clients has been positive. We're actually working on a couple of large opportunity -- deposit opportunities for one of the teams that started much sooner. And in New York, we have 1 of the 3 teams that's really knocking the cover off the ball.

Operator

Your next question comes from the line of Chris McGratty of KBW.

Christopher Edward McGratty - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Joe, Eric, could you remind us the comfort on the loan-to-deposit ratio where you're hoping to run it kind of in this interest rate cycle?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

We really want to maintain it around -- between 90% and 95%. We could go up to 100% if we had to, but we prefer to keep it in the mid-90s, Chris.

Christopher Edward McGratty - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. And then Eric, you mentioned, I think, in the release, the escrow volatility, which is around $900 million. What's the total -- what's that based off of? Like, how much of that -- of the escrow -- how much are total escrow deposits at the bank?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

It's probably -- we're around $2 billion to $3 billion in total escrows remaining.

Christopher Edward McGratty - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. Great. And then maybe just last one, if I could, on the tax rate. Assuming the level of fee income amortization, is this the right tax rate to use back on the back of the year?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

Yes, I'd stay with 25% to be safe.

Operator

Your next question comes from the line of Matthew Breese with Piper Jaffray.

Matthew M. Breese - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Joe and Eric, I just wanted to focus on some of the commentary around the teams. One of the teams you hired to start the year, some of them had backgrounds in blockchain and given their prior institution, perhaps cryptocurrency. And so I wanted to get a sense for if that's part of the plan going after some of the larger chunkier, crypto-related deposits? And could you outline for us what the opportunity is there?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

The opportunity is significant if you're dealing with the right clients. And we hired a team, which is in the digital space, and they've been there for a number of years and have a knowledge base at -- in that industry to know who and who not to deal with. We've added on a significant amount of compliance to work with that area and the opportunity is quite significant as time goes on.

Matthew M. Breese - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

What is the ultimate goal in that space as far as gathering deposits? And what portion of the balance sheet you're willing to dedicate to it?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Well, from a risk perspective, you can only dedicate a certain portion, if you're mindful of how you run your balance sheet. You don't want to be overconcentrated in any particular area. So I can tell you that we're on top of this from a risk and compliance standpoint. We don't want to give out what amount, because there are competitors out there, and they'll know -- they'll have an idea of what we are willing or not willing to do. So without giving any real numbers, blockchain technology is the future. And we don't want to be caught short because in 5 years, a number of banks will not be around because of blockchain technology.

Matthew M. Breese - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Understood. Okay. Could you give us some update on your loan growth outlook for the year, any changes to guidance there?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Before Eric gives that answer, I do want to say, one of the things in digital technology, we have turned down billions of deposits, believe it or not, that we could have brought on to the institution because of, as they call them, bad actors, that have digital currencies. And you have to watch out from a due-diligence standpoint of bringing on the wrong clients. So I just want to caution to everyone out there on that.

Matthew M. Breese - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Just following up on that, so your goal would be to play in the institutional money space, not the retail space, correct?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

Exactly. Institutional, no retail, and if you want to deal with us, you have to be a client. If you're not a client, you can't deal with us on any sort of transaction relating to digital currencies.

Matthew M. Breese - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Understood. Okay. Going back to the loan growth question, any changes to guidance in terms of, I think, it was $3 billion to $5 billion in asset growth. Any changes there?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

No, not at all. I mean, we're midway through the year, and we're a little bit past the midway point of the guidance, right? Our growth in assets has been over $2 billion thus far. So there's no need to change that, either up or down.

Matthew M. Breese - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Okay. My last one. Just -- what happened to the escrow deposits? How much of that was expected, where did they go, and how much of that do you expect to recover?

Joseph John DePaolo - *Signature Bank - Co-Founder, President, CEO & Director*

No, it's a daily or weekly flow, like, for instance, some bankruptcy money that were -- that was in escrow left at the very end of the quarter and some bankruptcy money has come back on a different bankruptcy case already in the third quarter. Some 1031 money went out. I mean, we open up 5 or 6 or 7 1031 accounts daily and money flows in, money flows out. It's not as if we lost any clients per se. It's just the flow of money and total timing. That's why we give guidance on an annual basis and not quarter to quarter.

Operator

Your next question comes from the line of David Bishop of FIG Partners.

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David Jason Bishop - *FIG Partners, LLC, Research Division - Senior VP & Research Analyst*

Most of my questions have been answered, but just curious from a -- the variability of repricing the loan portfolio, sounds like it will be more from the C&I and specialty finance portfolio. Just curious if you're getting a little bit more shorter duration? How that compared versus last quarter, maybe the year before?

Eric Raymond Howell - *Signature Bank - EVP of Corporate & Business Development*

Look, I mean, the duration of all of our portfolios are relatively the same. Let's say, the C&I portfolio is predominantly floating rate. There, yields are coming on in the low 5s percent range. If we look at Signature Financial, we're roughly at 2 to 2.1 year-average duration. That also has stayed the same. Yields in that space are coming in the high 4s to low 5s now. And the CRE portfolio is predominantly 5-year fixed, where yields in that space are coming in at 4.375% to really 4.5% now for the best credits. So it's really blended a little bit north of that. We have also begun entering into a swap 3-year term. We've executed on $250 million of the swap thus far. We're look to basically swap about $2 billion in total of our fixed-rate loans into floating-rate loans, so that should be beneficial to our margin in 2019.

Operator

This concludes our allotted time and today's teleconference. If you would like to listen to a replay of today's conference, please dial (800) 585-8367 and refer to conference ID number 6364689. A webcast archive of this call can also be found at www.signatureny.com. Please disconnect your lines at this time, and have a wonderful day.
