THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

FRC - Q4 2018 First Republic Bank Earnings Call

EVENT DATE/TIME: JANUARY 15, 2019 / 3:00PM GMT

OVERVIEW:

Co. reported 2018 results.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

CORPORATE PARTICIPANTS

Hafize Gaye Erkan *First Republic Bank - President*

James H. Herbert *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Michael J. Roffler *First Republic Bank - Executive Vice President and Chief Financial Officer*

Shannon Houston *First Republic Bank - Senior Vice President, Chief Marketing and Communications Officer*

CONFERENCE CALL PARTICIPANTS

Aaron James Deer *Sandler O'Neill + Partners, L.P., Research Division - MD, Equity Research and Equity Research Analyst*

Brocker Clinton Vandervliet *UBS Investment Bank, Research Division - Executive Director & Senior Banks Analyst of Mid Cap*

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

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

David John Chiaverini *Wedbush Securities Inc., Research Division - Analyst of Equity Research*

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

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

Kenneth Allen Zerbe *Morgan Stanley, Research Division - Executive Director*

Lana Chan *BMO Capital Markets Equity Research - MD & Senior Equity Analyst*

Matthew Timothy Clark *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Samuel Ross *Evercore ISI Institutional Equities, Research Division - Analyst*

Steven A. Alexopoulos *JP Morgan Chase & Co, Research Division - MD and Head of Mid-Cap and Small-Cap Banks*

PRESENTATION

Operator

Greetings, and welcome to the First Republic Bank's Fourth Quarter and Full Year 2018 Earnings Conference Call. (Operator Instructions).

I would now like to turn the call over to Shannon Houston, Senior Vice President and Chief Marketing and Communications Officer. Please go ahead.

Shannon Houston - *First Republic Bank - Senior Vice President, Chief Marketing and Communications Officer*

Thank you, and welcome to First Republic Bank's fourth quarter 2018 conference call. Speaking today will be Jim Herbert, Chairman, and Chief Executive Officer; Gaye Erkan, President; and Mike Roffler, Chief Financial Officer.

Before I hand the call over to Jim, please note that we may make forward-looking statements during today's call that are subject to risks, uncertainties, and assumptions. For a more complete discussion of the risks and uncertainties that could cause actual results to differ materially from any forward-looking statements, see the bank's FDIC filings, including the Form 8-K filed today, all available on the bank's website.

And now I'd like to turn the call over to Jim Herbert.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Thank you, Shannon, and thank you everyone for joining us today. 2018 was an exceptionally strong year across the board. Indeed, it was our best year ever. The year culminated with the addition of First Republic to the S&P 500 Index. This also gave us a one-time opportunity to do a small equity offering, which Mike will speak more about in a moment.

For the benefit of new listers, let me take just a moment to emphasize First Republic's uniquely successful client service model. This differentiated service model is a driver of our ability to consistently deliver safe organic growth.

The unique strength of First Republic is an extraordinary level of client satisfaction, delivered for over 30 years now. This is reflected in our high Net Promoter Score. First Republic's client Net Promoter Score is in the mid-70s, which is more than twice the banking industry's average. This level of stand out service translates directly into a very stable client base with low attrition. Additionally, it translates into high client satisfaction turned into new client referrals on a very strong flow basis.

Fully 75% of First Republic's growth every year comes from these 2 very related sources, satisfied clients who do more with the bank both in size and in complexity and new products, and their proactive direct referrals.

This satisfied client base also expands each year and provides evermore referrals. In turn, creating a compounding network effect leading to safe growth. Put simply, the more happy clients we have who are active promoters of the bank, the more referrals we receive each year, the more new clients we acquire. This sustainable organic growth model is very unusual in banking. I would also note, it works quite well somewhat irrespective of economic and market conditions. First Republic's very strong 2018 results are confirmation of this model's continuing strength.

Let me cover a few key metrics for the year. Total banking assets grew to nearly $100 billion, up 13% during the year.

Net interest income was up 16.3%. Net income was up 12.7%. And earnings per share were up 11.6%. Our growth in net interest income clearly demonstrates the power of consistent earning asset growth. A key driver of this net interest income growth is our largest loan portfolio, single-family home loans. This portfolio grew by 20.5% during the year.

Total business loans outstanding grew very nicely at 33%. Business lending growth was also powered primarily by referrals from existing, satisfied clients.

Student loan refinance and professional loan programs had a breakout year. These younger borrowing households grew by over 50% during the year. Our overall millennial strategy has become quite successful as our younger under 40 households now represent fully 35% of all of our borrowing households. This growth in the millennial group also reflects a strong satisfied client, and is turning into its own compounding network effect.

Importantly, while we have continued to grow our loan portfolio, our credit quality, which has been a hallmark of the bank since we started remains excellent. In our $76 billion loan portfolio, we had only $3 million of charge-offs, and our nonperforming assets at the end of the year were less than 5 basis points.

Total wealth management assets also increased by 18% during the year, despite challenging global market conditions. Wealth management fees grew very nicely and by 22%. Again, a very high level of client satisfaction powered this growth. In short, it was a successful year, our best ever. The growth in 2018 also sets a great foundation for a strong 2019.

Now I'd like to turn the call over to Gaye Erkan, President.

Hafize Gaye Erkan - *First Republic Bank - President*

Thank you, Jim. It was indeed an excellent quarter and a terrific year. We had a record year for loan originations. Total loan originations were $8.4 billion for the quarter. And over $32 billion for the year, up 16% from 2017.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Single-family residential volume was $2.7 billion for the quarter and $10.8 billion for the year.

Home purchase volume accounted for 53% of originations during 2018. Multifamily and commercial real estate lending also had a strong year, up 16% in outstandings.

Importantly, we did not compromise our credit standards at all. For example, our weighted average loan-to-value ratios for all of our real estate loans originated during 2018 remained quite conservative. 59% for single-family residential, 51% for multifamily and commercial real estate.

Conservative credit remains a key pillar of First Republic at all times. Business banking also had a terrific year, and continues to be a strong contributor to both loan and deposit growth. Business loans outstanding grew nicely during the year, driven by increased commitment and a higher line of credit utilization rate. At year-end, utilization was 37% compared to 34% a year ago.

Headed into 2019, our total loan pipeline remains strong and is up from this same time a year ago.

Turning to deposits. We are very pleased with the growth and diversification of our deposit base as well as our ability to lag the Fed Funds rate. Deposit growth was very strong, up over $10 billion in 2018. We grew deposits nearly 15% from a year ago, and our average deposit rate year-over-year increased only 23 basis points, while the Fed Funds rate increased 100 basis points.

Maintaining a diverse deposit franchise provides a strong base of stable, lower rate deposit funding. Checking continues to represent nearly 60% of total deposits at year-end, quite stable. This is a testament to the strength and the value of our relationship-based banking model.

Business deposits continue to represent 56% of our total deposits at year-end. Through business banking, we deepen our existing relationships, acquire new households and diversify our deposit base.

Our more than 70 retail offices also play a key role in client service, gathering deposits and acquiring new households. These offices are highly profitable, averaging more than $400 million in deposits.

In 2018, we opened 5 new offices and will continue to selectively identify new locations in our existing footprint.

As Jim mentioned, Private Wealth Management also continues to perform very well, both in gathering assets and increasing revenues.

Additionally, we are pleased that we continue to attract new wealth managers to our full-service, open architecture platform. We hired 11 new teams during 2018, and 1 already in 2019.

Most importantly, we are very pleased that our clients remain satisfied and continue to provide strong word-of-mouth referrals, which fuels the strong growth rate of the new client household acquisition.

As we enter 2019, our successful business model remains the same. Staying true to our client-centric culture, and keeping First Republic safe and sound at all times. This enables us to maintain our unwavering focus on extraordinary service, one client at a time.

Now I would like to turn the call over to Mike Roffler, Chief Financial Officer.

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Thank you, Gaye. Our capital position remains very strong. In late December, we retired our outstanding 7% Series E perpetual preferred stock, which will reduce our preferred dividend payment by approximately $3.5 million per quarter in 2019. As Jim mentioned at the end of the year, in connection with the addition of our stock to the S&P 500, we completed a modest at-the-market common stock offering selling 2 million shares. We raised just over $170 million in equity, which further strengthens our capital base and supports our continued growth. Including this common stock offering, which settled in early January, we estimate that our diluted share count will be 169.2 million in the first quarter of 2019.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Liquidity also remains strong as high-quality liquid assets were 15.4% of total average assets in the fourth quarter.

During the quarter, earnings asset yields outpaced our funding costs, which led to a modest expansion of our net interest margin. Net interest margin was strong for the quarter at 2.98%, which included a positive impact of 2 basis points from special FHLB dividend. Our net interest margin was quite steady throughout the year, even in the face of rising rates and a flattening yield curve.

For 2019, we continue our guidance for net interest margin in the range of 2.85% to 2.95%. As Jim said, growth in net interest income is a key driver of the franchise. Net interest income was up quite strongly in 2018 and grew fully 16.3% for the year. The growth in net interest income is a direct result of our average earning assets being up a very strong 16%.

For 2019, we expect our loan growth to be in the mid-teens.

Our efficiency ratio was 61.5% for the fourth quarter, and 63% for the full year. For the coming full year 2019, we continue to expect the efficiency ratio to be in the range of 63% to 64%. As a reminder, our first quarter efficiency ratio is typically higher due to the seasonal impact of payroll taxes and benefits.

Our effective tax rate was 19.4% for the fourth quarter, and 18.8% for the full year 2018. We expect the full 2019 tax rate to be between 19% and 20%. Overall, it was a very strong year that speaks to the sustainable power of our model.

Now I'll turn the call back over to Jim.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Thank you, Mike and Gaye. It was a terrific year by every measure. For over 33 years, our simple, straightforward, very client-centric business model has been consistently profitable. We continue to deliver safe, stable, strong organic growth because of our unwavering focus on exceptional client service, very conservative underwriting standards and strong capital levels at all times. We are looking forward to another good year in 2019, and are well positioned to pursue the many opportunities that exist in our markets.

Now we'd be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Steven Alexopoulos of JP Morgan.

Steven A. Alexopoulos - *JP Morgan Chase & Co, Research Division - MD and Head of Mid-Cap and Small-Cap Banks*

I wanted to start with the NIM, maybe follow up of Mike Roffler's, the NIM guidance, 2.85% to 2.95%. Given the very flat curve, Mike, how do you think we're positioned right now within that guidance? What's the most reasonable outcome? Are we at the midpoint of the range, can we push down to the lower end of the range? How are you thinking about that?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

So it is a great question, Steve, because the curve is flattened a lot probably from mid-December till today. Towards the end of the year we were operating at the higher end. And that flatness is probably one of the reasons that we have the lower range of the guidance because you just don't know. And also how competition is going to play out for new both lending and deposit opportunities, which is why the lower end is there.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Steven A. Alexopoulos - *JP Morgan Chase & Co, Research Division - MD and Head of Mid-Cap and Small-Cap Banks*

Okay. And then on the originations, you guys clearly had strong originations really driven by the commercial side. When I look at single-family and HELOC, they were down around 10% year-over-year. Give some color around that decline. Are you seeing the impact of SALT yet?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

It's -- SALT isn't playing into it yet Steve, although it might this year, as it become more self-evident to people the tax impact. But we're not even hearing too much about it, quite frankly. The one thing that's showing it of course, is refinances as rates went up. Although, rates have softened back a little bit. But our purchase finance is pretty strong. And we're not too worried about that. We don't have any indicators why we should be yet. Although, we obviously think about all the time. But it seems to be fairly strong. The other thing is it we had a bit of a slowdown on repayments because -- the refinance has a double edge sword. We do have some new volume but we also get slower repayments.

Hafize Gaye Erkan - *First Republic Bank - President*

And to just add, given the strong pipeline, we remain comfortable with the continued guidance in mid-teens.

Steven A. Alexopoulos - *JP Morgan Chase & Co, Research Division - MD and Head of Mid-Cap and Small-Cap Banks*

So just a final question. So, Jim, we saw another common equity offering in the fourth quarter. Was your thinking that -- I know you have the S&P 500 so there's demand there. But was this more of an offensive raise? You just wanted more capital because this could be a better growth year? Or given all of the macro, was this more defensive? Do you just want to have more years of excess capital to grow? How did you think about that?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Actually a little of both, Steve, to be honest with you. And I would put on top of all that the opportunity. We did have a filing for 4 million shares. But we did 2 million because that was easy to do, 4 million was what the permit was for, that was not necessarily ever a target. We would -- I would say, it was mostly offensive more than anything else. It's not defensive relative to the credit -- the credits, are very strong. But we're in the same conditions that others are. So we like to have more capital. And of course, it was a coincident with the redemption of the $200 million of preferred. And so the 7% payment on the preferred has a nice impact on the dilution of those shares at the same time.

Operator

Our next question comes from the line of Casey Haire with Jefferies.

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

I guess, follow up on the NIM outlook. The -- Mike, you mentioned that the flat yield curve is problematic for the NIM outlook. I was just wondering what was the blended loan yield or the new money yield on loan production in the fourth quarter. And what is it here in the first quarter just to get a better, a finer point on the NIM outlook?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes -- no, I think what I'd say about the NIM outlook, right. We're starting the quarter at a high point. And so we're actually really pleased with where it's been and sort of where it's trending. If I go to the production in the fourth quarter, the real estate portfolio, which is a big part, it was about 4%.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

And the sort of new -- new -- the loan yields in the first quarter have been right around that, not really much different. And so it's holding up pretty well in this environment.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

The comment about problematic is actually incorrect. The flat yield curves are challenging. But they're not really that problematic when we have the amount of growth we have. The point that is missed about us repetitively is that 10% or 12% or 15% growth rate above other banks gives you that much more repriced, each time. And if you add that to the amount of repayments that are made every year, we reprice 25% to 30% of the balance sheet every year.

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

Okay, understood. And I'm just -- so I mean, are you seeing less competitive pressures? Because I'm a little surprised to hear that the production yields hold up given the flattening of the curve we've seen since the third quarter?

Hafize Gaye Erkan - *First Republic Bank - President*

So just to add to Jim's comments, in addition to strong growth in earnings assets, for a third of our lending portfolio and a sizable amount of our investment portfolio, it's also floating rates. And on the business lending side, we do have a fair amount of floating rates. So we are very pleased that our, both the rate locks as well as the originations in the fourth quarter as Mike mentioned, are around 4%. With single-family a little less, and business above that. And the -- in general, the balance sheet growth put together with a great checking mix. Put together with a 1/3 of our earning assets are floating, gives us great leverage in a rising rate environment, even -- despite the curve flattening.

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

Okay, great. And just last one for me. I guess, switching to the efficiency outlook. I know you guys are in the sort of the middle innings of investment (inaudible). And that's keeping the efficiency at 63% to 64%. If you guys are able to make -- to bear -- if these efficiency initiatives bear fruit -- sorry, these franchise investments bear fruit, could we see the efficiency ratio make an improvement as we look towards 2020?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

So I think we feel pretty comfortable operating in this range because we are investing a lot in the different initiatives. And sort of the growth of the franchise that we covered on the call. So there's a lot of good, tangible things we're doing to benefit service. And we feel like we're striking the right mix to be in this range.

Hafize Gaye Erkan - *First Republic Bank - President*

And let me just add at a high level, we're very pleased that our tech-ops initiative that is geared towards supercharging our bankers, increasing employee engagement, and increasing client happiness and scaling our -- continuing to scale our service culture. In 2018, we're very pleased. We launched online and mobile banking. Our clients are seamlessly migrated. And we're one of the first banks that deployed stealth mode for data privacy and external account aggregation just to provide these features to the client. And number two, we have implemented new mortgage loan origination system. Not only it went seamless, but also we're very pleased our average loan closing times are down by 20% already. And we have also implemented robotic process automation to save time from pulling together tax documents, statements, loan documents both on the lending and PWM side. And giving that time back to our people to serve our clients and delight them further. So we're very pleased with the way we've invested and the fruits of those investments.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Operator

And our next question comes from the line of Jared Shaw with Wells Fargo Securities.

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

Maybe with the bigger picture question. How should we compare today to a decade ago, given the higher level of loan growth away from residential recently? And how should we think about normalized credit losses in the next cycle?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Well, let me take a minute. Obviously, it's 2 different questions. The comparison of the bank to a decade ago, or let's say, at the moment we came back from BofA that's a good clean cut point, which was about 8 years ago. Business banking is a larger share of the bank. But not dramatically so. It's about 15% of our lending. And probably back then, it would've been half that. The deposits have landed fairly stably, at around 50% to 55% of our total deposits. The thing to remember is, that our business banking significantly emanates from the fact that we have been personally banking many of the decision-makers. And so our business banking is probably between 60% and 80%, an outgrowth directly of the client satisfaction level that we're able to achieve in our preferred or private banking. And it's the CFO, it's a CEO, it's the influence person, a member of the board our second biggest group of business banking clients are nonprofits, in the bank, for instance, about 30% roughly. And it's a board member of nonprofit school, nonprofit community organization. And so it's directly linked. And so we didn't go into it as a new business, it grew out of the one we're in. And that's important because it also has a feedback loop because as we bank businesses, we then also end up banking more of the principles, which is our core business. Our philosophical base has always been - there are no businesses there are only people. And so we bank them at the personal level. And so it's a circular activity.

In terms of credit losses, I would think that we've been through, this bank since '85 has been through some very difficult ups and downs in the economy generally. And has actually, touch wood here, done quite well. You can look at the '08 experience that's in our deck. We go back, I think, even to the -- through the '01 experience. I think we go back to 2000 in the deck. And see losses, they are both in the dot com meltdown in an '08 or '09, was actually our worst year, where I think we topped out at slightly less than 50 basis points. About 1/5 of banking in general. And I would say that somewhat simultaneously '08 and '09 were very strong lending years. And the reason was that others were out of the market and we were not. Because we went into it well capitalized and strong. So I would -- if you were looking for a range of downturn, I'd look at the '01, '02 and the '08 experiences. We all, obviously, hope '08 doesn't happen again. It's certainly doesn't feel to us like it will at this point. But you never know.

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

That's very helpful color. And then just following up on the capital question. Do you think, I guess, now with this raise, do you have that full capital cushion that you've looked for in the past, that 2 years? Or do you think that you would still be opportunistic going through '19 with potential additional capital raises?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

We have -- we are adequately capitalized for the next couple of years. We're in good shape. And we would expect to be through -- if we needed anything, it would probably be a perpetual preferred round. But we don't, at this point, foresee that at all. And that was another reason for taking the opportunity because it's good to be ahead at all times. If difficult times occur, which they could easily, we generally want to be able to go right through it. And in fact, take advantage of the opportunity because usually the competition diminishes. We like about -- we don't like the bad times obviously, but we want to be ready to take advantage of that. I would point out one other point, which is if you go back 8 or 9 years ago, checking as a percentage of our deposit base was about 30%. Now it's about 60%. And that's, obviously, a very big difference as well. And that's to a large extent driven by the business banking segment.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Operator

And our next question comes from the line of John Pancari with Evercore ISI.

Samuel Ross - *Evercore ISI Institutional Equities, Research Division - Analyst*

This is Sam Ross on for John Pancari. Just had a couple of questions about your -- the loan growth outlook you guys provided. I mean loan growth is coming in pretty strong. I guess stronger than the mid-teens guidance for 2018 that you discussed. For 2019, I know you are still comfortable with that mid-teens. Maybe can you just talk about some of the drivers of that guidance? And what you're seeing particularly maybe within CRE? And also maybe in the private equity/venture capital businesses? That would be really helpful.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Sure. We are guiding the mid-teens because, although, this year was 20%, that was unusually strong. And as Gaye said, to some extent, it was stronger than we somewhat expected, because of the drawdown of the lines of credit that we have outstanding in the business section. But the single-family loan business, which I think maybe Steve pointed out earlier, will be a little slower this year probably because the refinance slowdown. And purchases are slowing down. They are nowhere near stalled or anything of that nature but they are slower. And so we're a little cautious. We don't anticipate, however, any issue with mid-teens.

Samuel Ross - *Evercore ISI Institutional Equities, Research Division - Analyst*

Got it. And then on the other side of balance sheet, deposits have also been running in pretty healthy. I'm just wondering what your thoughts are about, maybe what some of the drivers have been in deposit generation? As well as what your expectations are for 2019?

Hafize Gaye Erkan - *First Republic Bank - President*

Sure. We are very pleased with the 15% growth rate year-over-year at a 23 beta -- 23% beta year-over-year. The drivers have been quite diversified. It was a healthy mix when you look at year-over-year, it was a healthy mix that's seen business deposits and consumer deposits. In terms of product mix, while we grew some money market checking, money market savings, by and large, the barbell strategy we talked about in the prior calls, between checking and certificate of deposits while acquiring new households and deepening relationships, that worked really well. And our funding strategy is going to remain the same, albeit, as markets move and the curve shape changes, we translate that to our CD strategy as well, we're are very flexible and agile in that regard. But we're very pleased with the stability of our checking as well as with the betas. And ability to lag the Fed fund rates, which speaks to our relationship-based, service-based model.

Operator

And our next question comes from the line of Lana Chan with BMO Capital Markets.

Lana Chan - *BMO Capital Markets Equity Research - MD & Senior Equity Analyst*

Just around your deposits, you sort of -- pretty big pickup. It seems like relative to the mid-quarter update that you gave with your common equity raise. Was there anything driving that, that was potentially temporary? Or is that just sort of year-end seasonality?

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Hafize Gaye Erkan - *First Republic Bank - President*

It is the latter, Lana. It's -- the second half of the year historically tends to be a lot stronger than the first half. On the consumer side, the average account sizes are getting larger in the second half compared to the first half. And on the businesses, they are settled, they're gathering their net income. And the first half of the year is mostly tax outflows as we have discussed. So in that regard, it's the seasonality of deposits. And some came in very diversified given the diversification of our businesses.

Lana Chan - *BMO Capital Markets Equity Research - MD & Senior Equity Analyst*

Okay. And I would also pleased to see the incremental deposit beta coming down quarter-over-quarter. Are you starting to see less sort of competition on deposit pricing in your specific markets? I don't know if you gave the spot rate on deposit cost at the end of the year guidance?

Hafize Gaye Erkan - *First Republic Bank - President*

Our spot rate, they'll be around mid-to-high 50s, is around mid-to-high 50s. The competition remains fierce. There are pricing pressures on the deposit side for sure. We have been very pleased, again, our checking deposits 60%, they are stable at 5 basis points. So almost no rate attached to it. That really has been translating nicely into the lower betas, which given our businesses, and sticky stable relationships, we will expect that to become at -- to stay as a tailwind going forward into 2019.

Lana Chan - *BMO Capital Markets Equity Research - MD & Senior Equity Analyst*

Okay. And just one last question for me. Are you baking in further rate hikes on your margin guidance?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes, just one at this point.

Lana Chan - *BMO Capital Markets Equity Research - MD & Senior Equity Analyst*

Sort of midyear or?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes.

Operator

Our next question comes from the line of Chris McGratty with Keefe, Bruyette, & Woods.

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

Mike may be a question for you -- just a quick question on the balance sheet growth targets, the mid-teens. I'm interested if you could speak to kind of earning asset growth, given the remix that's occurring between the reclass in the HQLA this quarter. Should we assume that 2019 earning asset growth might trail loan growth a little bit because of this dynamic?

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Hafize Gaye Erkan - *First Republic Bank - President*

So let me comment on the investment side. We are very pleased that our HQLA ratio including the HQLA munis is at 15.4%, well above the 12% target that we had talked about in the prior calls. In the fourth quarter, we have seen opportunities in HQLA munis. And the purchase that we have made was at above 4.5% TEY. So we will be opportunistic. But we would expect the -- given this strong pipeline and the mid-teens loan growth guidance that we're giving, to grow into the additional HQLA and let it come down to 12% as we have guided before absent an opportunistic trade.

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes, so I think when you sort of put that together, the balance sheet grows a little bit less than what the loan growth guidance we talked to.

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

Got it, okay, that makes sense. Maybe a quick one on the capital call lending business. In the past quarters, I think you've given some updates on utilization rates. Any color that you could provide there would be great.

Hafize Gaye Erkan - *First Republic Bank - President*

It continues to be a strong and mid-to-high 30s. And what we're seeing is that the deal activity is strong. Strong valuations means each investment requires more dollars. Companies are staying private longer, thus, attracting more funds. Again, just to remind, we're pretty short term in those types of capital co-lines, 90 to 180 days. We don't tend to do the longer term ones.

Operator

Our next question comes from the line of Ken Zerbe with Morgan Stanley.

Kenneth Allen Zerbe - *Morgan Stanley, Research Division - Executive Director*

My first question is for Mike. Can you talk about what's the price due with the NIM this quarter? So I think your guidance for last -- as of third quarter conference call is there should be a call to the middle of 2.85% to 2.95% range. And that certainly was well in excess to that even excluding the FHLB dividend.

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes, I think I'd say it, that we're pretty much right at the top of the range. If you take out the FHLB dividend. And -- as I think in one of the question earlier, our deposit beta actually was a little bit less this quarter than it had been. And I think we were plus 9 from Q2 to Q3. And this time, we are plus 6. So I think that was a really good, great job of serving clients and deepening relationships because as Gaye mentioned, our checking mix has stayed on average in the low 60s. And if you think then in the normal rising rate, that does come down, you would expect. And it's been very resilient. And so we're very pleased with that, which led to a little bit better funding cost.

Kenneth Allen Zerbe - *Morgan Stanley, Research Division - Executive Director*

Got it. Okay, that helps. And then if we take out that one rate hike expectation that you have built in. And just simply put in the Fed fund futures curve which I assume is basically flat at this point. How does that change your 2019 NIM guidance?

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

It wouldn't. It wouldn't change. We still think that range is the right range.

Kenneth Allen Zerbe - *Morgan Stanley, Research Division - Executive Director*

Okay and then sorry, just to clarify a little bit more. The 2.85% I've heard in response to a prior question, the 2.85% part of that NIM was in sort of -- I may say the bear case, right? Was that the right way to think about it? Or two, if I say the midpoint of 2.90%, is that the most reasonable normal expectation? Or could you still be at the high-end over the course of the year?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

I think what you said at the end there is about right. I think that's a good reasonable sort of if you put the year together.

Kenneth Allen Zerbe - *Morgan Stanley, Research Division - Executive Director*

That it should be at the high-end?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

The latter part of what you said. The 2.90% part of what you said.

Operator

And our next question comes from the line of Dave Rochester with Deutsche Bank.

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

I'm going to try to ask another one on the NIM if that's possible. Just -- you talked about the rate hike you got in the middle of the year. Was just curious what your thoughts are on longer-term interest rates, what you're baking into that NIM assumption on that front? Are you expecting the flat curve to persist? Did you get any lift later on in the year? How do you think about it?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

I think -- as we all look at the -- I think pretty flat like it is. Don't see a lot of change.

Hafize Gaye Erkan - *First Republic Bank - President*

If I may just chime in. As you know we value stability and consistency a lot as a service organization. And the 2.85%, 2.95%, we feel comfortable with the range. We don't take bets on interest rates and we run slightly asset sensitive to neutral to interest rates. And it's very important that we provide that stability to you, to our clients and to all of our constituents. So given the uncertainty in, if and when the Fed hikes are going to be in 2019, we feel comfortable with the 2.85% to 2.95% range.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

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

Okay, great. And then just on the deposit growth in December. I knew you -- you mentioned you normally see a pickup in the back half of the year and we typically expect that. But I was just curious, did you get the sense at any of that some really strong growth in December might have been somewhat volatility related? Or did you get some transfers from what management's feelings and some of that? Just any color there would be great?

Hafize Gaye Erkan - *First Republic Bank - President*

It is being quite diversified. So consumer accounts -- average account balances are higher on the business side. It was very diversified across different verticals. Obviously, private equity, venture capital was active. But also schools, nonprofits, and RIAs, we have seen increased balances in those categories. And private wealth management, we're very pleased with the deposit referrals from our private wealth management colleagues taking into account the holistic nature of First Republic service. We used to be at 50% of our wealth management -- around 50% of our wealth management households having a banking relationship. Albeit, it's slightly up. But we're about 53%, 54% now of those households trying us on the banking side.

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

Perfect. So it sounds like you are expecting that deposit growth to actually stick as we go into the first quarter then?

Hafize Gaye Erkan - *First Republic Bank - President*

Well, the first half of the year is always the toughest from its deposit seasonality perspective. There's bonuses, then there's taxes. So that's why the spot ending rate is around mid-to-high 50s. But it's usually the second half where the deposits are much stronger.

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

And are you guys -- as you think about the SALT impact or the caps next year. Are you expecting to have any kind of impact on the deposit side?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Not on the deposit side, particularly. I don't think. I think we're not going to -- we all are not going to know the impact of the tax build till after this year's taxes are paid. And people really can tally it properly and think about it. And so -- but I will say, our client base is probably directly impacted rather significantly. And you don't hear much chatter about it.

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

Okay. And maybe just one last one on the efficiency ratio guidance. Can you just give a may be a range of how much in the way of your systems enhancement expenses are you actually expecting to hit in 2019? Just trying to get a ballpark of that component?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes, I mean, our information technology expenses, I think grew about 15%, 16% in the year. That feels like reasonable growth rate for us as we're sort of growing consistent over time. We do -- and I've talked about it, Gaye mentioned some of the initiatives, we've also talked about the core conversion. We're getting started on that. Probably happen early in the year. And we'll start to incur some. But it will grow as we go through the year.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Let me add just to that, that the last question from a slightly different angle. During the last couple of years, '17 and '18, the number of new households, business households, consumer households, millennial households that we have added to the base of the bank have been running about 18% per annum. In the prior 5 years, it ran 10% to 12%. The ramping up of that, obviously, is putting some pressures also on our systems, good ones actually. And we're being able -- we're able to respond to them. A number of the improvements that Gaye had previously referred to are directed exactly at that group of people and at that growth rate and doing it very efficiently. A new account opening system, a new loan system, et cetera. And so the expenditures that we're putting out are actually having very positive, rather immediate effect. And one of the reasons that doesn't show in an efficiency or operating leverage gain is because it's being used to have a growth rate of 15% to 18% on household growth, underneath.

Operator

Our next question comes from the line of Matthew Clark with Piper Jaffray.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Did you have any -- did you reverse any comp accruals in the fourth quarter? And how should we think about overall expense growth this year kind of embedded in that efficiency ratio range? It seems like -- is mid-double-digits the right way to think about it?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes, I think mid-teens is right way to think about dollar of expense growth. I'd seen nothing unusual on the comp line. We pay bonuses or we look at incentives. And it's based on performance and production levels. A year ago in the fourth quarter, there was a spike for a performance fee and comp related. Well, that did not occur this year. So if you look at it that way. And also our headcount has been pretty well contained for the year in growth percentage compared to where it had been in the past.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Okay. And then for the systems upgrade, were there any of those related expenses in the fourth quarter? And is that $30 million to $35 million still the right range to think about for this year?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Still a good number for this year, yes. In the fourth quarter, there's probably a little bit of consulting dollars and a few headcount. But nothing significant in the numbers currently.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Okay. And then just on the insurance line, up nicely linked quarter. Just wondered if there was anything unusual there? Gain or anything?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Nothing unusual in terms of the gain. I will say the insurance business, there is some seasonality to it. And the fourth quarter is typically very strong. And so we just started breaking it out this quarter because it had grown a bit because it's a relatively new business for us given the amount. And

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

so we felt that it was double, I think, over the fourth quarter a year ago. And so we thought that it was right to break it out. And there is some seasonality to it.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Okay. And then just last one just on the source of the increase in nonperformers and net charge-offs this quarter?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

So charge-offs are still very low at $2 million. It's a variety of clients that periodically run into some challenges that we work with. And so it's nothing geography concentrated or anything like that or deterioration. And nonperforming, you know still less than 5 basis points. So no real change there.

Operator

Our next question comes from the line of Brocker Vandervliet with UBS.

Brocker Clinton Vandervliet - *UBS Investment Bank, Research Division - Executive Director & Senior Banks Analyst of Mid Cap*

Just trying to connect the dots a little bit between your current loan growth and what you're guiding for. I understand some of that's just conservatism, and you've called out the lower single-family activity likely next year or 2019. Is there anything more you can say about the private equity venture capital area, that's been such a powerful growth driver? Is there anything you see there going forward that would point to a materially lower loan generation rate?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Not really, although -- And actually, we continue to book new clients in that area. We have a pretty decent backlog of discussions going on right now with some new clients. But one of the things that has interrupted our ability to be quite as accurate as we have been previously on loan growth is the utilization rates on those lines is less predictable. It does have seasonality in it, but it's not as steady, as Gaye indicated, it's swung from 33% to 37%. Well, it doesn't sound like much from a fair number of lines, it is. We're delighted to have the usage, obviously, it's quite profitable. But we can't predict it as a group. We can predict each one relatively well because we hear from them regularly. But predicting the group is really hard surprisingly. So that gives us little more variability than we've had for many years on the growth production.

Brocker Clinton Vandervliet - *UBS Investment Bank, Research Division - Executive Director & Senior Banks Analyst of Mid Cap*

Okay. And as a follow up on the -- within multifamily and the growth, I believe that was 20% year-over-year. Is that a result of adding new teams? And just a similar question, what do you think the kind of go-forward organic growth rate there would be?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

It's not new teams in this year. It's just opportunity in the marketplace and deepening relationships. It's mostly deepening relationships. We've added a number of new relationships over the last 24 months. And we are doing more and more with them. I think the loan-to-value ratio on most of that new business in the year was somewhere between 50% and 52% somewhere right in that line. And the debt service coverage ratio was very positive. So it's very conservative business. But we like the business when it's conservative and when it's solid. And we like it with good borrowers.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Operator

Our next question comes from the line of David Chiaverini with Wedbush Securities.

David John Chiaverini - *Wedbush Securities Inc., Research Division - Analyst of Equity Research*

I have a question on business mix. With the success of the millennial strategy and how it has outpaced growth in other areas of the bank, is it reasonable to assume that business banking could represent a smaller proportion of the overall balance sheet over time?

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Well, I guess, technically, but the outpacing of the millennial strategy is primarily centered in the number of households. I guess, the obvious point is that the younger clients tend to borrow less dollars. And so we're, particularly, delighted to be getting them. We're averaging about 4.5 to 5 products per household. And we're delighted. The Net Promoter Score in that segment is actually even higher than the bank as a whole. So they're quite satisfied. But the dollar growth in the outstanding for them is still -- we grew about $1 billion, $1.2 billion net in that outstanding last year. And so most of that -- one of the reason we like it so much is the vast majority of those clients have not yet purchased their first home. And so we are anticipating, hopefully doing quite a lot of that. We've done a couple of thousand home loans with the cohort already. So it seems to be working quite well. So I don't think it's going to meaningfully tip the percentage of business as a total-- business banking as a total.

Operator

Our next question comes from the line of Aaron Deer with Sandler O'Neill.

Aaron James Deer - *Sandler O'Neill + Partners, L.P., Research Division - MD, Equity Research and Equity Research Analyst*

All my questions were answered, save one. Which is just -- just wondered if you could break out, obviously, the weakness in the capital markets caused your AUM to dip a little lower this quarter. Just wanted it to break out what amount of inflows you had into assets under management in the quarter?

Michael J. Roffler - *First Republic Bank - Executive Vice President and Chief Financial Officer*

Yes, so it's very strong actually. The market decline, I think in the quarter was about $10 billion. So we had over $5 billion of new money come in during the quarter.

Operator

We have reached the end of our question-and-answer session. I would like to turn the call back over to Mr. Jim Herbert for any closing remarks.

James H. Herbert - *First Republic Bank - Chairman, Chief Executive Officer (Founding)*

Thank you very much. Thanks, everybody for taking the call today and joining us. I just would close on focusing on the power of the growth of the model coming off of the satisfied client levels. The engine on First Republic has been and will continue to be satisfying clients. Doing more with us, growing their size of their relationships. And then giving us very strong promotional type referrals. And that has a power through economic conditions actually. So thank you all very much. We appreciate your attention today.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2019, Thomson Reuters. All Rights Reserved.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS