# Sterling Bancorp

## First Quarter 2018 Earnings Call

## Monday, April 30, 2018, 5:00 PM Eastern

**CORPORATE PARTICIPANTS**

**Gary Judd** - *Chairman and Chief Executive Officer*

**Tom Lopp** - *President, Chief Operating Officer, Chief Financial Officer*

**Michael Montemayor** - *Chief Lending Officer*

**Allyson Pooley** - *Financial Profiles*

**PRESENTATION**

**Operator**
Good day, and welcome to the Sterling Bancorp First Quarter 2018 Earnings Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your telephone keypad, to withdraw the question, please press star then two. Please note this event is being recorded.

I would now like to turn the conference over to Allyson Pooley with Financial Profiles. Please go ahead.

**Allyson Pooley**
Thank you, Bryan and good afternoon, everyone. Thanks for joining us today to discuss Sterling Bancorp financial results for the first quarter ended March 31st, 2018. Joining us today from Sterling's management team are Gary Judd, Chairman and CEO, Tom Lopp, President, Chief Operating Officer and Chief Financial Officer and then Michael Montemayor who will be participating in the Q&A portion, is also with us. Gary and Tom will discuss the first quarter results and then we will open the call to your questions.

Before we begin, I'd like to remind you that this conference call contains forward-looking statements with respect to the future performance and financial conditions of Sterling Bancorp that involve risks and uncertainties. Various factors could cause actual results to be materially different from any future results expressed or implied by such forward-looking statements. These factors are discussed in the company's SEC filings which are available on the company's website. The company disclaims any obligation to update any forward-looking statements made during the call.

Additionally, management may refer to non-GAAP measures which are intended to supplement, but not substitute for the most directly comparable GAAP measures. The press release available on the website contains the financial and other qualitative information to be discussed today as well as a reconciliation of the GAAP to non GAAP measures.

And with that, I'd like to turn the call over to Gary.

**Gary Judd**
Thank you, Allyson and good afternoon, everyone, and again thank you for joining us today. I am going to begin with a brief overview of our first quarter and then Tom will continue the discussion in more detail.

We are very pleased with our strong start to 2018. We delivered excellent revenue growth combined with well controlled expenses. We generated income of $15.7 million or $0.30 per diluted share, a year-over-year increase of 51% and 30% respectively. Despite the first quarter being a seasonally slower period for home buying, we continued to see strong demand for our residential mortgage loans, both our advantage loans and our TIC or Tenants-In-Common loans. We generated $349 million of residential loan production in the first quarter which is an increase of 67% over the first quarter of last year.

Total loan production was $408 million in the quarter, which is an increase of 59% compared to the first quarter of 2017. Given the strong loan production, we increased the volume of loan sold to the secondary market as part of our balance sheet management strategy.

Our loan sales programs enables us to fully capitalize on the demand in our markets and the productivity of the loan production platform we've built, without putting excessive pressure on our liquidity or net interest margin. We worked hard to build the secondary market for our loans and we believe there is sufficient market capacity to absorb any sales we might choose to make.

We will continue to use loan sales to balance our strong loan origination platform with the growth in deposits. Meeting the borrowing needs of our customers and our markets, will remain a priority. We continue to build deeper customer relationships as most of our borrowers also used our depository products.

Our total loan portfolio including loan sales for investment and loan sales for sale increased by an annualized rate of 11% on a linked quarter basis, and importantly, was up 39% from the first quarter of 2017. Had we not sold any loans during the first quarter of 2018, the annualized growth rate would have been in the neighborhood of 30%, which gives you a better sense of loan trends in the quarter.

Moving to the other side of the balance sheet, the cost of deposits increased with the rise in short term interest rates as reflected in our net interest margin. We've been more than able to mitigate this pressure and still drive strong earnings growth due to the total revenue we generated from our loan production in terms of both interest income and gain on sale.

The other key element of our earnings growth is our high level of efficiency; tight expense control and strong productivity are a daily focus of the company. Our efficiency ratio for the first quarter was 33.6% lower than our 2017 full year average of 35.8%.

Looking ahead, we remain optimistic about 2018. The healthy markets remain healthy in the regions where we operate and there continues to be good demand for our loan products. We entered the second quarter with robust loan pipelines. We are also moving forward with our plans to expand our franchise through De Novo branch and loan production office openings.

Last week, we expanded our presence in Southern California with the new branch in Chino Hills. We now have five branches in the LA market, an area that represents tremendous opportunity for Sterling Bank.

We also recently opened our second full service branch in the New York City market and in the near future, we plan to open a branch in the Seattle market and another in Southern California. These branches should be particularly helpful in generating core deposits that will support our planned loan growth.

In summary, based on our first quarter performance and the positive trends we are seeing in many areas, we believe that 2018 will be another year of successfully executing on our strategy of expanding our franchise, creating high-touch customer relationships that result in strong loan production and a high concentration of core deposits. This combined with our strong credit culture and very efficient back office operations should continue to drive profitable growth and exceptional returns for our shareholders.

With that as an overview, let me turn the call over to Tom to provide additional details on our financial performance for the first quarter. Tom…

**Tom Lopp**
Thank you, Gary. As I walk through the income statement and balance sheet, I am going to focus just on those items where some additional discussion is warranted. As a general comment on the quarter, we were very pleased that the significant loan revenue we generated, the largest components of which were net interest income and gain on sale income enabled us to offset the impact of rising deposit costs.

One of the key performance metrics that we track internally is certain components of our total revenue as a percentage of average loans. We believe that this measurement provides a more complete picture of all the revenue sources from our loan portfolio, including loans held for investment and the loans that we sell.

Since we began selling a portion of our residential mortgage loans back in 2014, we've consistently generated net interest income and non-interest income as a percentage of average loans at 5% or better on an annual basis, although there can be some significant variance in this metric from quarter-to-quarter due to timing of loan sales.

In the first quarter of 2018, our annualized net interest income and non-interest income represented 5.01% of our average loans. The high-level revenue that we generate is one of the key drivers of our superior returns.

Now looking at the net interest margin; for the first quarter of 2018, our margin was 3.89%, down 8 basis points from fourth quarter of 2017. The decline was attributable to a 10 basis point increase in the average cost of our interest bearing deposits and a 5 basis point decrease and the average yield on earning assets.

The environment for deposit gathering remains highly competitive, so we expect that we will continue to see increases in our deposit costs. The average yield on our loans was down 7 basis points during the quarter. This was due to a number of factors including a lower level of loan recoveries, reversal of interest related to one large loan placed on non-accrual this quarter, two fewer days in the quarter for interest accrual, and we sold some loans with longer resets that have higher yields.

As I discussed on last quarter's call, approximately 85% of our loans are either tied to one-year LIBOR or the prime work rate. And we continue to expect that approximately $930 million of the LIBOR-based loans will adjust in 2018.

We are currently seeing between $35 million and $45 million of our LIBOR-based loans reprising on a monthly basis. In an average, they are increasing by 30 basis points to 40 basis points. So we expect to see a positive impact on our average loan yields in the upcoming quarters. In addition, at the beginning of the year, we increased some of our loan offering rates, so that will also contribute to increase loan yields as these new loans close and are funded. However, due to the impact of higher deposit costs, we expect our NIM to slightly decline again during the second quarter.

Our total non-interest income increased by $3.2 million from the fourth quarter, the increase was driven by a $3.1 million increase and the gain on sale of portfolio loans due to the higher amount of residential mortgages we sold in the secondary market during the quarter. The amount of gain on sale income, we generated from quarter-to-quarter will likely vary based on a number of factors, including our loan production levels, our success in gathering deposits, and our short-term liquidity needs. That being said, given our healthy loan pipeline and the higher level of mortgage loans held for sale at the end of the first quarter, we anticipate that gain on sale income will increase in the second quarter.

Our total non-interest expense decreased by approximately $400,000 from the prior quarter, as we focused on expense control and the fourth quarter results included $200,000 of expenses related to the initial public offering. We are continuing to add personnel to drive and support or loan, deposit and revenue growth.

We expect that our operating expenses will increase in the coming quarters as we open the new branches and hire additional loan officers and business development professionals. We will also increase our corporate back office operations team to support our ongoing growth initiatives and deliver on our outstanding service commitments.

However, even with the increase in expenses, we anticipate maintaining our efficiency ratio within our targeted range of the mid to high-thirties, but there could be some quarters where it is lower than that depending on our volume of loan sales.

Turning to the balance sheet, Gary already discussed our loan trends, so I will start with our deposits. Our total deposits increased by $46 million from the end of the prior quarter. We had an increase in retail deposits of approximately $123 million during the quarter, offset in part by a reduction in our balances of brokered CDs of approximately $77 million.

Moving to our asset quality, we continue to experience low delinquencies and generally positive trends in the portfolio. While our non-performing assets totaled $8.1 million or 27 basis points of total assets at the end of the quarter, an increase from $3.8 million or 13 basis points of total assets at December 31st; the increase was primarily due to one large residential real estate loan in southern California that became non-performing while the estate of a deceased [indiscernible] was being settled.

The estate owns multiple properties and is in the process of putting several of them up for sale including the properties supporting the loan it has with us. We received a current appraisal on the property that shows a loan to value of approximately 60%, so we believe there is no impairment and actually as of today, this account has been brought fully current. We do not see any meaningful losses in any of our past due loans. We had recoveries and no charge offs during the quarter.

With a lack of charge offs and no specific reserve required for the large loan placed on nonaccrual, our provision for loan expense was $641,000 for the quarter. Our allowance for loan losses was relatively steady at 74 basis points of total loans, up 3 basis points from the end of the prior quarter. This was primarily due to changes in our quarterly model related to past rates and qualitative factors.

With that, let's open up the call to answer any questions you may have. Operator, we are ready for questions.

**QUESTION AND ANSWER**

**Operator**
We will now begin the question and answer session. If you would like ask a question, please press star then one on your telephone keypad. If you are using a speakerphone, please pick up the handset before pressing the keys, to withdraw the question, please press star then two. Once again, if you would like to ask a question, please press star then one.

And our first question today comes from Aaron Deer with Sandler O'Neill & Partners. Please go ahead.

**Aaron Deer**
Hi, good afternoon, guys.

**Gary Judd**
Good afternoon.

**Aaron Deer**
Just one question I guess prompted by the uptick in the NPLs in the quarter. I believe the average loan size on the residential mortgage is below $500,000 or at least somewhere around there. This obviously is well above that amount. How many loans do you have on the books…what percentage of the loans on the books are, say of this size…say, $2 million or larger?

**Michael Montemayor**
Aaron, this is Michael Montemayor, while I don't have the exact number, we could follow-up with you is the percentage of our overall loans; it's a fairly small number. But, obviously, we do do loans 2, 3, 4 million, but they are very small percentage of overall production in terms of the numbers. We can do a follow-up and get you some specifics?

**Aaron Deer**
Okay. I mean obviously California is a pretty large real estate market. But, I just curious to know how many are in the larger category?

**Michael Montemayor**
And as Tom mentioned, we did a current appraisal on it and it's listed in a price for 6.2, the loan balance is 3.7, so about a 60% loan to value. We don't anticipate any loss and then Tom also mentioned the account was brought completely current this month, we anticipate the estate to continue to maintain the account while they liquidate the asset.

**Aaron Deer**
Okay. And then, relatively how much was the interest reversal and since it's been brought current now before the 10Q is published, do you expect interest reversal to be reflected in the 10Q or in the recovery in the second quarter or how might we expect that to play out?

**Tom Lopp**
Yes, Aaron this is Tom. I believe that is how it will play out. We reversed approximately $100,000 from that loan. It's been on non-accrual for a little bit, so, will pick up more than that likely in the second quarter here.

**Aaron Deer**
Okay. I guess beyond that, just trying to better understand that the pressures, if any other on the loan yields in the quarter, it sounds like, as you get the repricing on the existing portfolio and renew, new yields are coming up, we should expect some material improvement in the loan yields in the quarter's ahead? Is that right?

**Tom Lopp**
We expect that Aaron, both on the new production yields which we have already seen an increase in, as well as the LIBOR-based loans in particular, that are scheduled to reprice obviously with LIBOR increasing that helps us, I will add to that probably even at least as important. Q1 of 2018 for the full year has the lowest number of dollar amount or LIBOR loans repricing. And it increases dramatically from quarter-to-quarter where Q4 is almost three times what Q1 was and its kind of an even step up ladder if you will for the four quarters.

**Aaron Deer**
Okay. That's good color. And then on the deposit side, where are incremental deposits coming on the books at this point. I would guess that the, the remix of greater retail and away from wholesale indicates that you are getting better pricing on the retail side, just wondering kind of where this incremental dollar deposit costs are today?

**Tom Lopp**
Well, in the first quarter we had…we are raising money with a 12-month CD that was at 1.75.

**Aaron Deer**
Yes.

**Tom Lopp**
And ballpark on the money market because we have different clout based on relationship there. It was probably in the 120$^{th}$ range 130, so for Q1, somewhere between 1.30 and 1.75.

**Aaron Deer**
Okay. And has that already moved higher yet today or did you guys kind of front run, market a little bit there, so you get a little bit relief at this point or you are still seeing the pressure?

**Tom Lopp**
We are still seeing the pressure, there is definitely more rate competition out there both on money market and CDs.

**Aaron Deer**
Okay. Good stuff. Thank you for taking my questions this afternoon.

**Michael Montemayor**
Thanks, Aaron.

**Tom Lopp**
Thank you.

**Operator**
Again, if you would like ask a question, please press star then one. Our next question comes from Anthony Polini with American Capital Partners. Please go ahead.

**Anthony Polini**
Thanks.  Hi guys, great quarter.

**Michael Montemayor**
Thank you, Anthony.

**Tom Lopp**
Thanks, Anthony.

**Anthony Polini**
I love when you make me look bad by beating me by a nickel.

**Company Representative**
So do we.

**Anthony Polini**
We really did it two ways; I guess the provision is the interesting thing.  I am assuming you as well as me we would have liked to have been able to throw a little bit more into that reserve. But, credit quality is just too darn good.  Is it likely that the provision remains at a million or less until we have some substantial deterioration in credit quality, because you had good loan growth and we are looking for that to continue, but I guess I was hoping you could get a little more bump up in that provision level, even though the stellar credit quality played out.

**Tom Lopp**
Yes, I know I think the one key point there Anthony is the amount of loans that we had designated as held for sale at quarter end, which don't require any provision there.  Due to timing of loan sales and classification of loans as held for sale, I think you will see some noise there if you will.  But overall, we are right in the range that we think is appropriate and that we are comfortable with.  But I'm sorry, but if you look at just consistent loan growth quarter-to-quarter, that type of thing, I would expect a relative percentage to be applied against those loans from what you've been seeing.

**Anthony Polini**
Okay.  And when we take your guidance about gain on sale income going up, I assume the gain on sale on margins are going to be relatively stable.  But your production will increase?

**Gary Judd**
Yes, we expect production to continue to accelerate as we open new branches; add new staff in all the various markets.  And then, if you just take a look at what we had scheduled in the loan held for sale in the end of the fourth quarter versus what we had at the end of the first quarter, you will see an uptick there.  As Tom mentioned, we expect that to increase but hopefully as we increase the other side of the balance sheet, the liabilities, deposit side, we will as the year go down retain more.

**Anthony Polini**
Yes, I'm assuming like most people you don't think if that's going to move this week, but will likely move in June.  Is that how you are planning right now?

**Tom Lopp**

Yes, that is correct.

**Anthony Polini**
Okay, and just for my own information, how much does a new branch in Chino Hills cost?

**Gary Judd**
I don't have the figures in front of me but, I think compared to some of the other markets we are in fairly reasonable, if you look New York or Seattle, which we are also expanding in.

**Tom Lopp**
Yes, one thing just to be clear on, Anthony, in Chino Hill, that's actually going to be branch with full service lending both residential and commercial and backroom process, there is underwriters that type of thing. The actual portion of the branch is relatively modest as most if not all of our branches are. The actual branch expense is relative low and one thing that we do when we open up new branches in new markets is, we lead with loans and get a revenue stream created, so that the breakeven period is very, very quick.

**Anthony Polini**
And I just have one more question, a little bit of color on the loan growth, if we had to pick one or two markets that were accelerating in growth and one or two that perhaps were flattening out or decelerating in growth, what would you say?

**Gary Judd**
Well, I would say that I don't see any markets that are decelerating. But certainly, the higher potential for loan growth for us has been in the L.A. and New York marketplaces. The Seattle marketplace I think is a function of getting that branch and more space and accelerating the hiring efforts up there, but I think it's an excellent market also and certainly San Francisco is a more mature market for us.

**Anthony Polini**
Okay. Well, thanks again for a great quarter. That's all I have for now.

**Gary Judd**
Thank you.

**Tom Lopp**
Thank you.

**Operator**
At this time, this will conclude the question and answer session. So with that, I'd like to turn the conference back over to Garry Judd for any closing remarks.

**CONCLUSION**

**Gary Judd**
Thank you all again and we do appreciate you joining us today. And we'll look forward to speaking with you next quarter and then we'll follow-up there Aaron with you on the question you had on loan side. Michael will get that back to you. But thanks a lot for participating.

**Operator**

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.