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LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

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JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to the Luther Burbank Corporation's Second Quarter 2018 Earnings Conference Call. (Operator Instructions)

Before we begin, I would like to remind everyone that some of the comments made during this call may be considered forward-looking statements. The company's Form 10-K for the 2017 fiscal year, its quarterly reports on Form 10-Q and current reports on Form 8-K identify certain factors that could cause the company's actual results to differ materially from those projected in any forward-looking statements made this morning.

The company does not undertake to update any forward-looking statements as a result of new information or future events or developments. The company's periodic reports are available from the company or online on the company's website or the SEC's website.

I would like to remind you that while the company's management thinks the company's prospects for continued growth and performance are good, it is the company's policy not to establish with the markets any earnings, margin or balance sheet guidance.

I would now like to turn the conference over to John Biggs, President and CEO. Please go ahead.

John G. Biggs - *Luther Burbank Corporation - President, CEO & Director*

Thank you. Welcome to Luther Burbank's second quarter earnings call. I'd like to start out by reviewing some of the key components of our earnings release that went out last night close of business.

Second quarter net income was \$11.2 million compared to quarter 1 at \$11.1 million. That equates to \$0.20 a share that meets consensus average estimate.

We were able to achieve net interest income growth in the second quarter. Quarter 1 was \$30.465 million. Second quarter was \$31.159 million.

Our efficiency ratio remains relatively steady just under 47%. With NIM compression, it will be more difficult to reduce that efficiency ratio. I also like to look at G&A to average assets at March 31 that was 1.01%. At June 30, it's 0.97%. My expectation with the asset growth we're achieving that we will see further reductions in G&A to average asset ratios.



JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

I will have Laura Tarantino, our CFO, delve into NIM discussion in more detail. One thing I would like to comment, when I look at NIM, I am always looking at year-to-date NIM. So if I look at March 31 NIM comparing it to June 30 NIM, I am looking at the year-to-date numbers as I look at those comparisons.

At March 31, NIM was 2.11%. To remind analysts and those who were looking at it, that number had a couple of unusual items that elevated it by about 2 basis points. So if you do a more normalized NIM at 3/31, it was 2.09%. As of June 30, the year-to-date NIM is 2.05%. That's a 4 basis point reduction as of June 30. I think considering the upward pressure on deposit funding rates that is pretty good as far as NIM compression for Q2.

Moving on to loans. Our markets -- our geography on the West Coast markets is really very strong. We had very strong loan growth in the second quarter. Net loans in the second quarter grew to \$409 million. That's 7.7% compared to the first quarter of \$284 million, which was 6.1%. That gets us to a combined net loan growth of \$693 million or 13.8%.

If you annualize that, will we achieve a 28% loan growth rate in calendar 2018. The numbers show that that's possible. It may abate a bit. But nevertheless, the loan growth is strong and continues strong and the pipelines are strong as well.

If you split that loan growth into our 2 main categories, commercial real estate and single family residential, for those of you who have pulled the slide deck, that's slide 14 and 15 in the deck.

CRE originations in the second quarter were \$383.9 million. They were originated at a weighted average coupon of 4.56%. That compares to the first quarter of \$262.6 million at an origination rate of 4.33%. So we are seeing improved coupon and originations as we move forward in the year.

CRE pipeline is at \$230 million. So that's a very strong pipeline still, even with the growth we have already achieved for the year and that pipeline is at 4.68%.

If you move -- if you look at the slide deck on slide 14, the lower half of that slide deck, the pie charts, we're really trying to show the movement in our objectives of funding less core, lower yielding multi-family loans and having more activity in extended core, noncore and commercial. And the bottom shows 2017, 87% of what we originated was core. For the first 6 months of '18, we're down to 73%.

You can also see the movement in rate in that piece of the origination. It was 3.97% in 2017, and it's moved to 4.40% in 2018.

The top chart will track quarter-by-quarter. I always like to see for myself how we're performing quarter-by-quarter, so I'd like to compare this quarter -- the second quarter to the first quarter. And you can see in the bar chart on the top, again, the same improvement 78% in Q1 was core. It's now down to 70%. So we expect to see that movement continue throughout the -- through the rest of this year and on into 2019.

One piece I'll mention that is still just getting started is construction lending that will be a part of the CRE. And when we have any portfolio balance that's of any significance, we will report on that. But at this point, it is just a few loans that are funded year-to-date.

Moving on to single family. Second quarter \$252.6 million in originations at a weighted average coupon of 4.78%. That compares to the first quarter of \$215.2 million at 4.29%. That's a pretty significant increase in coupon quarter-over-quarter. We also have a pretty strong pipeline in the single family as well at \$114 million and that coupon on the pipeline is 5.1%. So in both of our lending categories, we are seeing improvements in rates as we move forward in time.

As Slide 15 shows, again, the same split we showed for CRE in single family. We split it not by core / extended core, but more by niche and nonniche. The niche product is gaining better yield for us. That would be departing residents who's cross collateralized. Any type of jumbo single family that's not just a standard 5-year fix fully amortizing credit. And you can see in the bottom pie charts, really significant progress between last year and the first 6 months of this year. Last year, niche originations were 42%, through the first 6 months of '18 were at 69%. So we've made some very significant improvements on that. And you can see with the coupons compared single family to CRE, the market is giving better coupons on the jumbo single families than we're getting in totality on our CRE originations.

JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

Again, part of the desire of doing some well, underwritten construction and some commercial to boost that CRE coupon in the future.

Moving over to deposits. For most of this year, loan growth has outpaced deposit growth. We have really worked hard to get deposit growth ramped up. It has been an extremely competitive environment. There are rate ads in the Sunday papers in all of our markets. We see the usual players, but it's surprising. This is the first time I've seen it where I pick up a Sunday paper and see Wells Fargo advertising a CD at 2%. I don't even know in my career if I've ever seen that. So yes, it is a competitive environment for retail deposits.

I'm happy to say though that in the month of June and for the month-to-date of July, we have turned that around and retail deposit growth has exceeded net loan growth for the first time this year. So that has really been ramping up, and I think it is going to continue to catch up to the earlier loan growth.

Deposit growth in the second quarter was \$478.1 million compared to \$162.8 million. That gets us to total growth of \$640.9 million. There's some slides in the deck, 16 and 17, and I will let Robert Armstrong get into that into more detail.

The Bellevue branch is open. It was opened on June 25, and we have about \$21 million in deposits in a month. That goes with our strategy that we've discussed with -- on the roadshow with analysts before, which is we open strategic branches in very dense communities with high deposit balances, and we can grow those deposits pretty quickly. That is at a higher rate. That's at about 2.60%, but that's only on that branch deposit. And our numbers show that as we grow a new branch, the rate floats down over time. Our oldest branches, namely the Santa Rosa home office branch over \$1 billion is our lowest cost of deposit. So that strategy continues to work. We have 2 to 3 other market areas that we are looking at to expand our branches. And my expectation is that we will do at least 1 in the next year or so and then 1 after that. On average, when we were opening branches, we were opening branches at a pace of about 1 per year. Again, we are very particular on where those branches are located and that is sort of part of why it takes about a year to get a branch location selected, get a branch site picked, get a tenant approved and get it to be growing. But I believe very good pickup in deposit growth in the second quarter.

I think I'll pause there and hand it over to Laura Tarantino, our CFO, to get into more of the numerical details.

Laura Tarantino - *Luther Burbank Corporation - Executive VP & CFO*

Thank you, John. Good morning or good afternoon depending on where you're sitting today. My goal here is just to provide a little additional detail to the information that we filed yesterday. And in my comments, I'll primarily be talking about our operations in relation to the linked quarter or the first quarter of 2018.

Our results for the second quarter, unlike the first quarter, really do not include any unusual item that I would consider a nonrecurring item. So a strong set of net income for the second quarter with \$11.2 million, and we were pleased to have met the market consensus of \$0.20 per share. \$11.2 million compares to \$11.1 million of the linked quarter. But again, a reminder that we mentioned in our prior quarter earnings call was that the first quarter results included about \$400,000 in the bottom line that were unusual items. So our improvement over the first quarter in earnings is really a result of our asset growth outpacing our net interest margin compression.

Our net interest income increased 2% or \$694,000 over the linked quarter. As we look at the components more granularly, interest income increased by \$5.4 million or 11%, primarily due to the increase in our loan volume. On average, \$391 million increase in volume quarter-over-quarter and a 9 basis point increase in rate quarter-over-quarter.

As John said, we continue to see improvement on the rate on our loan originations. For the second quarter, our total new loan origination rate was 4.65% as compared to 4.31% in the prior quarter. And happy to report that our month-to-late July loan origination rate is at a weighted average rate of 4.82%.

As a result, this spread between the rate on our originations and our payoff and pay downs over the quarter has grown. 6 months year-to-date, there's differential of 61 basis points between originations and payoffs and pay downs, and that was only 42 basis points at March quarter-end. At June 30, the coupon on our loan portfolio is 3.94% or 18 basis point increase year-to-date.

JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

Interest expense increased \$4.7 million or 25% over the linked quarter, which is both attributed to growth in deposit and borrowing balances.

Our deposits average volume increased \$269 million over the quarter and a 17 basis point increase. And FHLB borrowings increased \$194 million. Average balances were 36 basis point increases. The cost of those funding sources have increased in relation to market interest rate cost. But more specifically, the cost in our deposits reflect the intense competition. Whereas the increase in our FHLB advances have an impact from extending the repricing on the FHLB portfolio. Repricing on a FHLB borrowing of advances at June 30 were 22 months as compared to 15 months at March 31 and as compared to 11 months, 1 year ago. So in 1 year, we have doubled repricing on our FHLB portfolio.

As a reminder, we do use FHLB borrowings as a hedge of our loan portfolio.

At June 30, the ending rate on our deposit portfolio was 1.46% or a 31 basis point increase over year-end. And the ending rate on our FHLB portfolio was 2.23% at the same time. As a result of our interest -- excuse me, as a result of our liability sensitive position and our funding cost outpacing our earnings cost on the loan portfolio, our net interest margin for the second quarter was 2% as compared to 2.11% for the first quarter.

Again, a reminder that, that NIM in the first quarter had some unusual items.

The decrease in our net interest margin is really what we expected with short-term interest rate increases and the continued flattening of the yield curve. Inclusive of investments, our yield and earning assets increased 9 basis points to 3.51% from 3.42% over the linked quarter. Our total funding cost increased 21 basis point to 1.65% from 1.44% in the prior quarter. And note that we all tend to measure deposit beta a little differently. We compare deposit beta as compared to the average LIBOR cost, and we have seen that beta increase over the past 6 months. As we compare our cost of deposits to the average cost of 3 months LIBOR, we have a beta of 30% for the first 6 months of 2018.

At the end of -- at June 30, over the next quarter, we have approximately \$700 million of maturing time deposits over the third quarter. The differential of maturing rate on those deposits is about 53 basis points greater than that of what we brought in most of our funding or renewed our deposits at over the month of June. At 53 basis point differential is roughly the same as it was in the prior quarter or as at March 31.

We recorded provisions -- loan loss provisions of \$1.3 million over the -- during the second quarter and that compares to \$1.5 million for the first quarter of 2018. The provisions are entirely due to growth in our loan portfolio. We have a coverage ratio of 58 basis points, and we expect to maintain our coverage ratio at a similar position.

Our noninterest income was down by about \$200,000 over the first quarter, both as a result of a small decrease in FHLB dividends of \$85,000 and a decrease quarter-over-quarter of about \$140,000 from interest on -- excuse me, servicing income on our loan portfolios. The amortization of mortgage servicing asset increased over the second quarter due to prepayment model revisions in our model for the March servicing rights.

You may have noticed a small portfolio of loans held for sale at June 30. We showed \$21 million of loan held for sale at 6/30. Occasionally, we will get approached from other banks looking for loan volume to do small deals, and we will entertain doing those deals to maintain our relationships with those that we're currently servicing loans for and occasionally to get market feedback on our loans.

Our noninterest expense also increased by about \$200,000 over the linked quarter. Total noninterest expense of \$14.9 million was in line with our projections of a run rate at \$15 million per quarter in net interest income -- net interest expense. Again, more granularly, the components of noninterest expense have changed. Compensation and benefits decreased by \$420,000 over the linked quarter, primarily related to a reduction in payroll taxes. I reminded you last quarter that payroll taxes are impacted by the timing of the calendar year and as well as the payment of incentive comp, which we did during the first quarter of 2018.

We saw increase in marketing expenses of \$348,000, primarily attributed to deposit competition and also had a \$105,000 increase over the prior quarter for professional services, primarily related to public company expenses.

As John noted, our efficiency ratio remained steady, and our noninterest expense to average assets decreased nicely to 95 basis points over 101 basis points to the prior quarter and compared to 111 basis points as of last June '17.



JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

Our effective rate for the quarter was -- for taxes was 29%, in line, again, with our projections that we made last quarter.

Finally, asset growth as you noticed were up to \$6.5 billion, very strong growth over the quarter and over the year. The composition of our loan portfolio by product type really has remained unchanged. In our deposit portfolio, we have a greater proportion of our deposit portfolio in time deposits, approximately 64% at 6/30. And that's in line with our marketing efforts to try to extend terms in our deposit portfolio during a rising interest rate environment.

Finally, our tangible capital per share ended at \$9.88 per share, growth of 1.5% over the linked quarter of \$9.73 per share.

With that, I'll pass it to Robert Armstrong to talk about our deposit performance.

Robert Armstrong

Thank you, Laura. John and Laura covered most of the numbers. So I just want to add a little bit of color to our deposits, our progress in Q2 and a little bit of strategy.

So Q2 happened to be our strongest retail growth month since implementing our strategic growth initiatives in '16. Very strong and with an increasing pipeline of new business. Our consumer deposit franchise with distribution primarily from our branch network came under significant pricing pressure in Q2. This was most noticeable in the 44 basis point increase in consumer time deposits year-over-year for a 3-month period. However, cost of deposits increased -- the increases were tempered by strong business banking activity, which is fast approaching the \$0.5 billion mark, well on its way to the \$1 billion target established for '18. It now comprises almost 10% of total deposits. So our cost of deposits were dramatically reduced based on those -- that activity, which is now 50% of the growth.

Our investment in niche business banking verticals continues to pay dividends, with our commitment to providing specialized products and services to specific industry segments as seen in the pie chart on Page 19. You can see that we continue to diversify and expand and grow in these niche verticals.

I'll remind everyone on the call that this is important because these niche verticals are typically less expensive because we are subject matter experts and we are able to provide a service that has a premium attached to it.

Also important is the increase in noninterest bearing business accounts, which nearly doubled for the quarter. With \$38.6 million, it's now at 1.5% of deposits. And we will continue to expand on operating accounts and noninterest accounts in this segment and others.

I want to point out that the launch of our Washington branch, which John already has touched on, continues our legacy of successful de novo activity. It happens to be the fastest-growing new branch for the first month of operation in our history. So additional growth is anticipated here by working with our lending relationships in the market, which we are just starting to do.

Our deposit franchise has strong brand loyalty. It continues to provide a solid foundation for growth. LBC's large branch strategy was strategic distribution in digital and (inaudible) results in all-in acquisition costs that are comparable to other low-cost distribution including online. When you include personnel occupancy, marketing and data processing related to client acquisition, we are a very efficient model. And while our rates may be higher, the fact that our branches are near double the size of other operators in California is a meaningful metric that translates into our efficiency.

Our branches are centers of high-quality client engagement with high retention augmented by a robust digital (inaudible) platform. I also would note that the success of business banking demonstrates our ability to develop and add accretive business lines outside of our traditional model. I believe Q2 shows that we are uniquely positioned to respond to market challenges and the competitive landscape. Although under tremendous pricing pressure, we should continue to see low cost growth to support our tremendous loan growth.

And now I'll pass it over to John Cardamone.



JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

John A. Cardamone - *Luther Burbank Savings Corp. - Executive VP & Chief Credit Officer*

Thank you, Robert. Many of you in the past have described our credit quality as pristine, and I thank you for that description. I'm here to tell you that quarter-over-quarter, we've marginally improved on that status of our portfolio. For example, our nonperforming assets to total assets dropped from 12 basis points to 7, our nonperforming loans to total loans dropped from 13 basis points to 8. The portfolio LTVs on our commercial real estate are staying flat at about 56.8%.

On the single family side, our FICO scores have moved up slightly from 749 to 751 on average. The LTVs on the portfolio have dropped from just under 65% to just under 64%. Delinquencies are flat in the CRE portfolio at about 6 basis points and our single family delinquencies have dropped from 40 to 29 basis points. In that, typically we have a few 30-day delinquencies at the end of the month that usually clear up by midmonth. We continue to have no REO in our portfolio. And we accomplish these metrics as you've heard today from all of the other presenters, while our portfolio has grown rapidly. We have been able to maintain very strong credit quality on this portfolio.

And with that, I'll turn it back to John.

John G. Biggs - *Luther Burbank Corporation - President, CEO & Director*

Thank you, John. Just on closing, I would like to recap a couple of comments that were made here. We have excellent growth opportunities in our markets. We see no sign of abatement in those markets. Our performance, I'm very proud of, for the second quarter. I think it shows consistency of our franchise, and I don't expect to see any changes in that. It's very steady. It's very solid. I think the growth is very strong. NIM will remain under pressure as long as we're in this rate cycle. But I think also as some of these slides and charts were showing, we are working hard to offset that NIM compression, not just with growth but also with the business online banking, strategic new branches, business online banking bringing deposits at a lower cost of funds plus more niche lending still conservative but to increase that loan coupon over time. And those are the areas that management can control. We can't control the yield curve, but we can control the deposit growth. We can control the loan growth. And again, very pleased with these results. So I will pause there and open up to analyst questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Matthew Clark from Piper Jaffray.

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

Can you, Laura, maybe give us -- I think the rates on the CDs that are maturing? And what they're renewing into? I think you gave us the differential, but I was just looking for the rates to...

Laura Tarantino - *Luther Burbank Corporation - Executive VP & CFO*

Yes. Over the next quarter, the weighted average rate of renewing CDs is 53, so -- excuse me, I had my differential here. So differential is 53 basis points, and we are bringing in most of our deposits at 2.04%. So it's about 150 in maturing CDs over the next 3 quarters -- excuse me, 3 months.



JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

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

Got it. Okay. Great. And then thinking about maybe origination rates 4.65%, 4.82% in the month of July. And you consider incremental cost of funds. It does imply a better spread. I'm just curious as your thoughts on why you think NIM compression will necessarily continue based on those origination rates?

John G. Biggs - Luther Burbank Corporation - President, CEO & Director

I just think that you will continue to see deposit side repricing quicker. And even though we're getting better rates on the new loans, we're not putting as much new dollars each month into that portfolio to move the dial on that. So -- and we don't know how fast the Fed is going to move. We don't know what the shape of the curve is going to be. We don't know where the 10-year will go. So if you watch the 10-year over the last month or so, it's bounced around, but it's slightly under 3 and it's sort of hanging there. So in order to -- we can do some things on continuing to expand some of these other products. But in order to really get some bang for better coupons, we need to see that 10-year surpass the 3 and start steepening. And we're not seeing that yet. So we can't predict that, but my message today is the same as it was at Q1 earnings, which is our perception is that NIM will be under pressure. To how much? I don't know. And you can see we're working very hard to offset that NIM compression with a variety of activities. It's just a question of how that all flows out over the next couple of quarters and into '19.

Laura Tarantino - Luther Burbank Corporation - Executive VP & CFO

We've seen, Matt, that our loan portfolio moving about 3 basis points a month improvements. However, the deposit portfolio is moving at twice that increase.

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

Yes. Got it. Okay. Great. And then just on noninterest expense. I know it was largely in line with your expectations, just under \$15 million. Want to get your updated thoughts on the expense outlook and -- with maybe some investments you might be making. We heard that your comments about the overhead ratio continue to come down, but just also wondering about just the run rate in general.

Laura Tarantino - Luther Burbank Corporation - Executive VP & CFO

I'm still going to consider that a run rate. We do make some cost improvements in some areas and there are places where we need to spend more money. We have opened a new branch and have some additional personnel there, but there are other areas where we maintain control. So I think \$15 million a quarter is a good run rate.

John G. Biggs - Luther Burbank Corporation - President, CEO & Director

Another way to say it, there's not a perception that that's going to increase for any big expenditures that we're aware of.

Operator

And our next question comes from the line of Tim O'Brien Sandler O'Neill and Partners.

Timothy O'Brien - Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research

One question I have on capital. TC ratio came down a little bit this quarter. Can you give some sense of how low -- how leverage -- how much leverage you can handle with your capital and the adds to capital from earnings and stuff before you might need to raise more capital?



JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

John G. Biggs - Luther Burbank Corporation - President, CEO & Director

Sure, Tim. We've looked at that pretty carefully. The plan is to file a shelf registration after the year is up, just so that we have that there. But our current numbers show that -- and it's hard to know whether this growth is going to continue. I mean, this is really pretty -- this is the most we've grown in quite a while. And my philosophy has always been when the market is strong and the growth is there, you should take it. And of course, we have the fresh capital that we just brought in. So we are deploying that capital. But I think with reasonable growth rates sort of -- somewhat like where we're at, maybe a little bit less, we'd be looking towards the end of 2019 needing to actually go-to-market. So it's sort of what we talked about on the roadshow, which was we felt that this capital -- initial public offering would be good for 24 months or so.

Timothy O'Brien - Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research

Great. That's great color. And then could you give a little bit of -- could John talk a little bit -- excuse me, Robert talk a little bit about marketing for business deposits? How that process works? How do you capture that new business? Is it face-to-face contact with folks or do you run campaigns or?

Robert Armstrong

There are several ways to capture that market without giving up any special sauce here. We have...

Timothy O'Brien - Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research

No special sauce?

Robert Armstrong

Yes. Just in case. We're all clamoring for deposits, and we think we have something very unique. And one of the more unique aspects of this is the very strong embedded relationship capital we have in our branches. And we continue to find great relationships that we can leverage where we have not been able to offer in the past. And one of the examples of that would be our recent expansion into our union vertical. That was a gem found at a local branch and we have now put resources behind it. We now market it and it's in person. It's speaking engagements is going to where they are, and where their membership is. Just as an example. So business thinking as a whole does not have a branch location that it primarily works out of it. It works through the distribution that's already existing. So we can be remote. We do not have to have (inaudible), boots on the ground. And we will travel to larger customers.

John G. Biggs - Luther Burbank Corporation - President, CEO & Director

So I think another way to say that, Tim, is that we don't do big giant campaigns when we do this. This is boots on the ground. This is really organic. It's hiring a few key people on the phones. As Robert said, capitalizing on some of the relationships that we already have that we haven't utilized in the past. It's sort of nuts and bolts marketing to attract these deposits and these customers.

Timothy O'Brien - Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research

Understood. And then no change as far as West Coast Metropolitan areas. That's the -- where the next branch might go and that's where you're looking or not? Looking beyond that -- and it's all the markets that you've -- we know and you've talked about probably, correct?



JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

John G. Biggs - Luther Burbank Corporation - President, CEO & Director

Correct. Again, just looking at the whole West Coast, there's a lot of places I wouldn't go. We want to go where there are dense demographics and large deposit totals. And we've got a few places picked out that we're looking at sites now (inaudible) to look at that. And I think that will be successful. The tendency is to -- when you want to grow that is to accept something less than perfect. And I have always been able to sort of be patient with that. And I think the quality of our branch franchise today shows that we've been very patient and not taken anything that isn't exactly perfect. I've looked at a couple of sites in Southern California recently, and we passed on them. They just weren't quite right. So I still believe even though I wish we had 2 more branches open now today that for the value of the franchise, we are better off being patient and making sure that the sites are A class perfect sites for our business.

Timothy O'Brien - Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research

What's the number 1 attribute of a perfect site in your mind, John?

John G. Biggs - Luther Burbank Corporation - President, CEO & Director

Perfect demographic or actual?

Timothy O'Brien - Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research

For you to like feel -- all sites must have -- the one thing that all sites must have as far as being the right place for a Luther Burbank branch, I guess. Demographics or what have you, I don't know. Maybe it's a range of things. And maybe that's the wrong way to -- the wrong approach to kind of get a feel for it. But I don't know what characteristics?

John G. Biggs - Luther Burbank Corporation - President, CEO & Director

I can tell you the process I go through. So I use the FDIC June 30 deposit reports that all of the banks have to file. And we geographically -- to start with, we don't go in areas we don't know. So we're very familiar with the markets from Seattle to San Diego. So we know all those key markets. We have people in them. So we start with, "boy, I think this looks like it would be a good market. It looks like it's dense. It looks like there would be a lot of deposits here" Then I go to the FDIC deposit totals, and I find that how much is there? Is there \$2 billion in deposits? Is there \$7 billion in deposits? How much deposits? And you can run it by ZIP Code. You can run it by county. You can run it by city. So you can slice and dice that with the FDIC reports. Then what I'll do is go and look and say, "who's in there? Is First Republic there? I really target First Republic because our franchises are so similar and their customers are so similar. So I say, "Is First Republic there? How big is their branch? How many deposits have they collected in this market?" We have a few other key players that we look for that. And then if that all looks good, then we start looking for locations. And I guess, I would say for location, it's just like everything else, like real estate, which is it's location, location, location, which is visibility, signage, parking. What's around you? All of those things. So that's the process we go through.

Timothy O'Brien - Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research

I appreciate that. One process question. There is great color on this call. Will the transcript be available?

John G. Biggs - Luther Burbank Corporation - President, CEO & Director

Yes.



JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

Operator

And our next question comes from the line of Jackie Bohlen from KBW.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

I echo Tim's comments on just -- the wonderful color that's been on the call and that's in the presentation. It's very, very helpful. Just 1 quick question for me. Since we've covered so much already. I wondered if you might give a little bit of detail on securities yields. I know it's obviously a much smaller component of earning assets. But just what kind of reinvestment differentials you're seeing in that? And how much cash flow it's providing?

Laura Tarantino - *Luther Burbank Corporation - Executive VP & CFO*

Well, I would say from a general purpose, the cash flow considering the growth in our loan portfolio is that we continue to purposely buy additional securities 1 or 2 a month just to keep our -- on balance sheet liquidity ratio where we would like it. We are seeing the yield on some of the current investment purchases that we're doing increase over prior periods. But we do have a mixture of what we're adding to our books, whether it be adjustable product or something that's maybe fixed for 5 years. Our goal is to not take credit risk or take any interest risk in the investment portfolio. Really want to limit that and just have it there primarily as a contingent source of liquidity.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

Okay. But you are getting a positive differential and what you're adding to it to keep that liquidity?

Laura Tarantino - *Luther Burbank Corporation - Executive VP & CFO*

We are, but I think that's really [just to draw] mostly from the increase in market rates.

Operator

And our last question comes from the line of Gary Tenner from D.A. Davidson.

Gary Peter Tenner - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Just wanted to ask a follow-up question about the kind of yields that you indicated for 1Q and 2Q, and then kind of the month-to-date in July. It looks like month-to-date July is 4.82%. I'm just wondering -- I get the pickup in the second quarter with the 10-year higher than it was over the course of the first quarter. With things sort of stable from that perspective right now, what do you attribute the additional pickup in terms of the new production loan yields to. Is it the mix or is there anything else we should know about?

John G. Biggs - *Luther Burbank Corporation - President, CEO & Director*

You know that's hard to predict. It'd be mostly the mix, right? So if the 10-year sticks around just under 3, there's not going to be much room for any of our competitors to move up the loan rates. So that means any additional pickup in yield is going to be the initiatives we have as far as doing more extended core, noncore construction and commercial. But I'm just not in a position where I can say what I think that rate would be.



JULY 27, 2018 / 5:00PM, LBC.OQ - Q2 2018 Luther Burbank Corp Earnings Call

Gary Peter Tenner - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Okay, but -- okay. That's helpful. And it sounds like where the curve is right now is what you're factoring into your assumption, obviously, on your margin.

John G. Biggs - *Luther Burbank Corporation - President, CEO & Director*

Yes. Yes, I just try not to predict where that's going to go. It's just too hard to do. So yes.

Operator

Ladies and gentlemen, that completes our call today. A recorded copy of the call will be available on the company's website. Thank you for joining us.

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