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OPB - Q3 2018 Opus Bank Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Opus Bank Third Quarter Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to introduce your host for today's conference, Brett Villaume, Director of Investor Relations. Sir, please proceed.

Brett Gerard Villaume - Opus Bank - Senior VP & Director of IR

Thank you. Good morning, and welcome to Opus Bank's investor webcast and conference call. Today, I'm joined by Stephen Gordon, Opus Bank's Chief Executive Officer and President; Brian Fitzmaurice, Senior Executive Vice President and Senior Chief Credit Officer; and Kevin Thompson, Executive Vice President and Chief Financial Officer.

Our discussion today will cover the company's performance during the third quarter of 2018 and information contained in the earnings press release issued earlier this morning. A slide show presentation that accompanies today's call is available on the Opus Bank investor web page at investor.opusbank.com.

Today's discussion may entail forward-looking statements, which are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You'll find a discussion of these forward-looking statements in our recent FDIC filings and on pages 7 and 8 of this morning's release.

Today's call will include a question-and-answer session following the discussion. (Operator Instructions) Now I will turn the call over to Stephen Gordon, CEO and President.

Stephen H. Gordon - Opus Bank - President, CEO & Director

Thank you, Brett. I will now provide an overview of our results for the third quarter, and then Kevin Thompson, Chief Financial Officer; and Brian Fitzmaurice, Senior Chief Credit Officer, will go into more detail on our financial performance and credit metrics. We will address questions at the end of our prepared remarks.

For the third quarter of 2018, Opus recorded net income of \$9.4 million, or \$0.25 per diluted share, compared to \$15.5 million or \$0.40 per diluted share in the prior quarter.



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Net income for the 9 months ended September 30, 2018, was \$37.8 million or \$0.99 per diluted share compared to \$46.4 million or \$1.23 per diluted share for the first 9 months of 2017. Included in net income in the third quarter of 2018 were \$0.07 retention costs and strategic initiative-related expenses totaling \$525,000 or approximately \$0.01 of earnings per share, which were related to the build-out of our Commercial Banking team and the further optimization of our banking office locations. Also, we had an income tax benefit item of \$2.3 million in the third quarter, which resulted in negative income tax expense of \$972,000. Kevin will explain this in greater detail later in the call.

Our reported earnings per share for the third quarter was also impacted by a provision for loan losses of \$8.2 million, which was primarily driven by charge-offs related to 2 enterprise value loans as part of our workout strategies for these previously identified lending relationships.

Enterprise value loans had decreased 80% since the fourth quarter of 2016 to \$184.5 million as of September 30, 2018, of which 66% is pass rated. Enterprise value loans have been further reduced to \$168.5 million as of October 19, 2018.

Unlike in prior quarters, enterprise value loan charge-offs were not equally offset by reserve releases and, therefore, resulted in elevated provision expense for the quarter. So while our provision expense was primarily driven by our positive efforts to reduce our exposure to these types of loans, this quarter's provision reduced our net income.

Notwithstanding these items, Opus' performance during the third quarter of 2018 included solid growth in both loans and deposits, increasing loan and securities yields, a reduction in criticized loans, robust capital ratios and strong liquidity to lend out at higher interest rates.

While we continue to battle through the industry-wide headwinds of elevated loan prepayments and rising costs of deposits, which negatively impacted our net interest margin during the third quarter, loans increased at a 7% annualized rate during the third quarter or, if you exclude the approximately \$61 million of planned loan exits we achieved during this quarter, annualized loan growth was 12%. This is especially important to note now that our balance of loans targeted for planned exit has reached such a reduced level and given that the magnitude of the planned exit is unmasking our growth potential in loan yield expansion.

Additionally, our loan yield increased 3 basis points to 4.24%, and our securities yield increased 12 basis points to 2.04%. Our new loan fundings for the third quarter increased 47% from the second quarter to \$435 million while pay-downs were \$258 million, which includes the planned exits I just mentioned.

Our deposits increased \$208.1 million or 3.5% from the prior quarter and included growth from multiple divisions across Opus, including retail banking, Commercial and Specialty Banking division, Commercial Real Estate Banking and PENSCO. Importantly, it was the contribution to deposit growth from our core transaction account-centric division that helped offset the pressure on deposit costs within retail banking during the third quarter.

While we experienced deposit growth during the quarter, we also experienced continued high amortization and prepayment activity on our loan portfolio, which resulted in an increased low-yielding cash position during the quarter. While contributing increased interest income, this increased cash position was dilutive to our net interest margin. We are seeing early contributions from the Commercial Banking team build-out we initiated earlier this year and expect the team will gain strong traction in 2019, complementing our existing high-performing Income Property Banking division. We anticipate the Commercial Banking team will contribute positively to C&I loan and deposit-related growth as well as enhanced Treasury management fee income, higher net interest margin and improved efficiency.

It should be pointed out that the associated comp and benefits expense of the Commercial Banking team investment will increasingly be deferred and amortized as the bankers contribute and become more productive in future periods.

We remain focused on building Opus into one of the premier commercial banks in the Western region, thereby creating long-term shareholder value and benefiting all of our constituents, including Opus' shareholders, our clients, our team members and the communities we serve.

Based on our quarterly earnings and strong capital ratios, the Board of Directors has approved the payment of a quarterly cash dividend of \$0.11 per common share.



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I will now turn the discussion over to Kevin Thompson to go into more detail on our financial performance.

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Thank you, Stephen. Turning to Slide 4, average loans decreased \$65 million or 1.3% during the third quarter, while period-end balances increased \$88 million or 1.7%. New loan fundings in the third quarter measured \$436 million, a 47% increase from the prior quarter, compared to total payoffs of \$258 million, which included \$61 million in planned loan exits.

Originated loans increased \$98 million or 8% annualized growth rate. 26% of new loan fundings in the third quarter were C&I loans, and the remaining were primarily real estate-related loans.

Total loan yield increased 3 basis points in the third quarter to 4.24%, primarily driven by the net benefit from prepayments and the positive impact of loan repricing and interest rate increases during the quarter.

On Slide 5, we show the balance of cash and investment securities, which increased 9% from the prior quarter due to a \$132 million increase in cash and cash equivalents, slightly offset by a decrease in investment securities of \$5 million.

Principal pay-downs were partially offset by purchases of \$87 million of investment-grade securities during the quarter. The increase in cash and cash equivalents was primarily driven by deposit growth as well as pay-downs and amortization within our loan and securities portfolio.

The yield on investment securities increased 12 basis points to 2.04%, and the average duration of our securities portfolio was 3.3 years.

Turning to Slide 6. Total deposits increased \$208 million in the third quarter or 3.5%, driven by growth from multiple divisions across Opus, including retail banking, Commercial and Specialty Banking division, Commercial Real Estate Banking and PENSCO. Our cost of deposits rose 14 basis points to 0.71% as we responded to increasingly competitive rates being offered by our peers. The increase in our cost of deposits this quarter was primarily driven by rate increases in our retail banking division, while deposit growth from our other specialty deposit divisions resulted in less of an impact as they largely contribute lower-cost core deposits.

Our loan-to-deposit ratio decreased to 84% at the end of the quarter from 85.5% previously.

Turning to Slide 7. Net interest income decreased 1.3% during the third quarter to \$48.9 million, primarily driven by higher interest expense on deposits. This was partially offset by higher interest income from loans, securities and cash, which, in total, increased 2.2% from the prior quarter, as well as a reduction of interest expense on FHLB borrowings, which were reduced to 0 at the beginning of the third quarter.

Planned loan exits, which had a weighted average rate of 7.28% in the third quarter, continued to negatively affect our NIM as well as the growth of our loan balances but do serve to decrease our potential future credit volatility.

Net interest margin decreased 9 basis points from the prior quarter to 2.98%. The change was primarily driven by the 14 basis point increase in the cost of deposits as well as the impact of planned loan exits and interest reversals due to loans placed on nonaccrual during the quarter. These were partially offset by a higher yield on loans due to the net benefit from prepayments and repricing in rate increases on loans during the quarter as well as a higher yield on cash and securities.

Proceeding to Slide 8. Noninterest income decreased from the prior quarter, down 11% to \$11.5 million. This was due to a change in other noninterest income, including a net decrease in equity warrant valuations of \$746,000 compared to a net increase of \$91,000 in the second quarter and a decrease in Merchant Banking division fee income from \$774,000 to \$118,000.

Other sources of noninterest income saw consistent contributions during the quarter, and noninterest income made up 19% of total revenues.



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Turning to Slide 9. Our noninterest expense increased 1.2% to \$43.7 million for the third quarter. There were \$525,000 of severance and strategic initiative-related expenses that we incurred in the third quarter, including expenses related to our Commercial Banking build-out and branch optimization efforts. Excluding these items, noninterest expense was flat compared to the prior quarter.

Our efficiency ratio increased to 72.4% for the third quarter compared to 69.1% for the second quarter, primarily due to a decrease in total revenues. Excluding severance and strategic initiative-related expenses, our efficiency ratio would have been 71.5% for the quarter.

On Slide 10, we show our regulatory capital ratios at the quarter end, including Tier 1 leverage, which increased to 9.89%, and our total risk-based capital ratio, which decreased slightly to 15.75%. Tangible book value per as-converted common share increased \$0.15 to \$17.68.

As illustrated on Slide 11, our balance sheet continues to be asset-sensitive in terms of the potential for rising rates to positively affect our net interest income.

Looking at the table in the bottom right, you can see that 29% of our loans have reset for maturities within the next 12 months and another 28% within 1 to 3 years. Also, our assets have an average duration of 1.9 years compared to an average duration of our liabilities of 2.9 years.

With careful management of pricing, we have been able to drive a cumulative cycle-to-date deposit beta of only 12%. However, during the third quarter, with increasing competitive pressures from our peers, our cost of deposits experienced a 56% beta. Our loan beta for the quarter was only 12% and was impacted by planned exits, lost interest on new nonaccrual loans and elevated loan prepayment activity. We are closely monitoring our deposits in our markets, and our asset liability committee continually assesses our position to determine the appropriate strategy.

Finally, during the third quarter, we recorded a negative impact -- income tax expense of \$972,000, which was primarily driven by \$2.3 million of net discrete income tax items relating to the remeasurement of our initial estimate of deferred tax assets in the fourth quarter of 2017 related to the Tax Cuts and Jobs Act. As a result of these discrete tax items and other adjustments, our estimated full year 2018 effective tax rate is approximately 18%.

I will now turn the discussion over to Brian Fitzmaurice to go into more detail on our loan portfolio and credit metrics.

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

Thank you, Kevin. Our credit quality performance for the quarter was mixed. On the positive side, enterprise value loans decreased by 29% or \$75.5 million to \$184 million. Substandard assets declined by \$22.8 million, total criticized loans declined \$14 million and planned exits totaled \$61 million. Negative developments included \$8.4 million in net charge-offs, an \$8.8 million increase in special mention loans and a \$5.1 million increase in nonaccruals. The combination of all the activities resulted in \$8.2 million in loan loss provisions. 97% of the charge-offs were related to enterprise value loans.

As you will remember, on the second quarter earnings conference call, I informed the participants that as a result of our significant enterprise value exposure, we could have a spike in loan provisions if we have loan defaults that weren't offset by simultaneous improvements in our loan portfolio in an amount that offsets the required provisions. This scenario occurred in the third quarter and continues to be an ongoing risk. Our enterprise value loan portfolio continues to be the source of nearly all of our loan charge-offs. Therefore, I'll provide some observations about the portfolio.

As of September 30, the EV portfolio consisted of 31 relationships with \$184 million in funded loans, of which 21% were deemed eligible for retention. EV loans had been further reduced to \$168.5 million as of October 19, 2018. 66% of the remaining portfolio is pass rated.

The fees and costs to refinance our debt for our borrower are significant. The borrower generally has to have some strategic reason to incur these costs to refinance the debt. Therefore, we don't draw the conclusion that the current EV portfolio consists entirely of loans that are only left because they can't be refinanced. Rather we draw the conclusion that for many loans, there is simply not a reason to refinance.

\$62.6 million of the EV portfolio was criticized, with \$38 million rated substandard and \$27 million of the substandard loans are in nonaccrual.

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Regarding the \$27 million of nonaccrual EV loans, notwithstanding the fact that we have either taken significant charge-offs or established significant specific reserves for each EV loan with the book value of \$1 million or higher, we remind everyone that these loans continue to have -- generally have binary outcomes, meaning we either collect significant principal repayment or there is a very high severity of loss. We expect the rate of repayment for enterprise value loans to slow.

As I previously mentioned, we recorded a provision for loan losses of \$8.2 million compared to a minor negative provision expense last quarter of \$213,000 and a negative provision in the third quarter of 2017 of \$10.6 million. The material factors driving the provision this quarter were net charge-offs of \$8.4 million, additions to specific reserves of \$2.6 million, higher loss factors of \$2.5 million and risk-weighting migration of \$1.9 million. These were partially offset by a decline in reserves due to changes in portfolio mix, fundings and planned exits of loan relationships, which totaled \$7 million.

As of September 30, 2018, our allowance for loan losses totaled \$59 million or 1.14% of total loans, a reduction of \$168,000 or 3 basis points from the prior quarter. And we have \$8.8 million of specific reserves or 20% of nonaccrual loans compared to \$6.3 million or 16% in the second quarter of 2018. Along this general reserves on C&I loans of \$30.1 million, the reserve coverage ratio was 3.76% on our total C&I portfolio at quarter end.

For additional detail on credit information, I'll refer you to slides 12 through 15 of the third quarter earnings deck.

I'll now hand the discussion back to Kevin.

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Thank you, Brian. On Slide 16, we present a summary of our outlook for the future. We revised our outlook for loan fundings from \$2 billion down to \$1.7 billion for the full year 2018. We expect gradually increasing loan fundings from our Commercial Banking divisions as our Commercial Banking strategy gains momentum in 2019 and 2020. Deposit rates are expected to continue to increase as short-term rates increase, although we anticipate this will be at a moderating pace.

With the headwinds of elevated prepayments, planned exits, a flattening yield curve and competitive deposit and loan pricing, we are revising our net interest margin estimate to a range of 3.05% to 3.10% in the fourth quarter. We are continuing to focus on disciplined expense management and revenue growth initiatives to increase our operating leverage. Furthermore, we are investing in our Commercial Banking strategy. And while that is an expense in the short term, we believe it will gain momentum in 2019 and 2020. We expect that our efficiency ratio will gradually improve with these efforts. But with the decrease in total revenues this quarter, we've revised our efficiency ratio estimate for the fourth quarter to 70%.

We anticipate that our outstanding balances of legacy-targeted portfolios and problem loans will continue to decrease, and we remain focused on maintaining a strong risk management infrastructure, including preparing for the implementation of CECL. We anticipate that our effective tax rate will be approximately 18% for the full year 2018.

Finally, as stated previously, our Board of Directors approved the payment of a quarterly cash dividend of \$0.11 per common share, unchanged from the prior quarter. We do not target a specific payout ratio but evaluate our dividend based on quarterly earnings, overall profitability, our risk profile and capital levels and market conditions.

I'll now hand the discussion back over to Stephen for closing remarks.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Thank you, Kevin. Thank you again for joining our conference call today. I look forward to sharing with you our future quarterly results and speaking with you all again soon. Operator, would you please open the call for questions?



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Matthew Clark of Piper Jaffray.

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

Can you -- for the enterprise value loans, I think, were down to \$168.5 million in October, how much of that decline from quarter end came by way of charge-offs?

Brian Fitzmaurice - Opus Bank - Senior EVP & Senior Chief Credit Officer

None.

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

None. Okay, great. And then, can you talk about kind of your expectations for the commercial bankers you've hired? Whether or not you continue -- you feel the need to continue to hire and kind of how you see them progressing next year in terms of production or growth?

Stephen H. Gordon - Opus Bank - President, CEO & Director

So we do not anticipate hiring more at this time. We have rounded out our markets and have created very good coverage across our markets, both in terms of some of the legacy bankers that we had in those markets as well as now rounding them out with really good, talented, opportunistic hires. And so our attention at this point is now to get productivity out of each of those bankers and contribution to pipeline and then contribution into both funding of loans, deposits, fee income, et cetera, going forward. 2019 is really when we see the full ramp occurring, meaning that if you look at the press releases that we put out then on the hires that we've announced, you'll see that on average, they've been with us for roughly about 3 months weighted average. And we generally anticipate somewhere between 4 and 6 months for that gestation to occur that results in funding activity, and that would take them into contribution in this fourth quarter here as well as obviously on into 2019.

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

Okay. And then, can you speak to where the pipeline stood at the end of the third quarter?

Stephen H. Gordon - Opus Bank - President, CEO & Director

The overall pipeline for the company was pretty flat.

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

Okay. And then last one for me, I guess, somewhat related. Brian, maybe you can speak to the \$44 million of downgrades. What's in there? And then, is there any way to quantify how much more in planned exits you might have on a dollar basis at this point?



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Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

So the downgrades are relatively mixed. It was on -- for the fourth quarter, there was one larger EV that was in special mention at approximately \$13 million. And the rest were just kind of across various divisions, [kind of off by space], and some just generally positioning of the multifamily. But could you repeat your second portion of your question, please? I'm not sure I got it.

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

Yes, you have \$61 million of planned exits this quarter. Just trying to get a sense of -- if you can cast a net and quantify how much more in planned exits, at least as of today, you anticipate out of the portfolio on a dollar basis.

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

Yes. So in my comments, I was trying to -- a little bit of message that on the pass rated versus -- because this coming out of EV, obviously, and there's not a reason for them to refinance, so hence, my kind of comments that I think it slows. So I really don't have a good answer for you. We're obviously -- if it's not retention and it's a problem credit, we're going to try to, obviously, exit out of the bank, but I think it's a slowing dollar amount, but I don't have a firm number of it. I'm sorry about that.

Operator

Our next question comes from Jacquie Bohlen of KBW.

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

Just touching base on deposits. I know that last quarter, according to my notes, we had talked about an expected increase in core deposit funds flowing and due in the quarter. And I know we've [got] some of that. Is that an event you expect to repeat in the fourth quarter? And did the third quarter have the level you were anticipating?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

You're talking about compared to second quarter, when we had some of the deposits from core relationship decrease during the quarter versus what we anticipated to occur in the latter part of the year?

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

Yes.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Yes. All right. So we got a very small amount of that contribution in during the third quarter. We anticipate it really coming back in during this fourth quarter here. And so the growth that we had during the quarter, the over \$200 million of deposit growth during the quarter, was almost entirely unrelated to that cyclical relationship that we referenced in the second quarter call.

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

Okay, that's helpful. Does that -- expectations for that relationship to return in the fourth quarter, does that play into your margin expectations?



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Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Yes, it does play into that because it's a lower-margin -- excuse me, higher-margin impact. It's lower cost deposits that we temporarily replaced, and we did so on a seasonal basis.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

And I also -- Jacque, I want to add that the largest of those, I believe, those 2 relationships, the largest of the 2, when you said do we expect the relationship to come back, the relationship is still here, they still have balances with us. We just anticipate a meaningful growth to that balance during this quarter.

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

Okay. Okay, makes sense. And then, the -- when you're thinking about the forward guided range for the margin, what are your expectations for cash balances?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

The cash balances obviously grew this quarter. It's a phenomenon of both prepayment activity as well as our increasing deposits. And so we expect to deploy those cash balances -- and we prefer, obviously, loan growth, the loan growth and looking at the securities markets. We're being patient in this rising rate environment to deploy that liquidity in the proper place, but we are holding high liquidity now.

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

Okay. So does the fourth quarter also continue to include high liquidity?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

I believe that we'll be able to deploy that to loan growth as well as to some securities growth.

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

Okay. And then, just lastly, if I'm understanding correctly what was messaged in prepared remarks and the press release as well, the comments towards compensation and deferrals regeneration, does that imply that compensation could actually come down a little bit as generation ramps up in 2019?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

It's meant to imply that the -- right now we're mostly experiencing the G&A components with the comp and benefits, with the hires that we made, the investment that we've made into expanding our Commercial Banking and deepening our Commercial Banking presence. And we anticipate that consistent with GAAP, that as those bankers become more productive and contribute more, that we would be conferring more to their comp as it relates to their business activity.



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

Okay, yes -- no, that was my understanding of the GAAP accounting treatment of it. So that would be, I would assume, could potentially be an offset to salary increases and everything else going forward?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Right, because built into the comp and benefits line item is their comp.

Operator

Our next question comes from Tim Coffey of FIG Partners.

Timothy Norton Coffey - *FIG Partners, LLC, Research Division - VP & Research Analyst*

With the decrease in cash balances, hopefully to loans, and potentially slower growing deposits, that would imply the loan-to-deposit ratio would go back up. Do you have an ideal target that you'd like to get it to?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

So we generally talked about getting back towards that 90% loan-to-deposit ratio, and we're currently at 84%, and we would like to get back to that.

Timothy Norton Coffey - *FIG Partners, LLC, Research Division - VP & Research Analyst*

Okay. All right. And then, just looking at the, I guess, kind of unexpected pay-downs this quarter, they've come down quite a bit over the last -- since the last 5 quarters. Is there something going on there? Is it the higher rates are causing the drop in prepayments? Or you gamed out and marketing more aggressively to clients who have loans that are coming up for renewal? Is there some kind of trend there? Or is this just a one-off quarter thing?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Well, we are making an effort to capture more of those refi-ed and prepayment opportunities, and we're having some success on that front. I think we're seeing a little bit of slope to the upward slope. For example, our income property loans, multifamily loans, yes, we're still seeing rent increase and NOI increase but not at the same pace of increase than was occurring before. So that may be contributing to a little bit of slowdown. And there's, I think, been -- we've noticed a little bit of slowdown in activity waiting for this election coming up in Prop 10. And now that it's only a couple of weeks away, we'll see how that plays out. But we've been seeing a little bit of a slowdown to that prepayment activity, and hopefully, that continues.

Timothy Norton Coffey - *FIG Partners, LLC, Research Division - VP & Research Analyst*

Okay. And as it relates to Prop 10, what will be the impact on your business if it passed?



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Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

It's a difficult question to answer because we already -- L.A. already has rent control, sort of San Francisco, and they've had it for a long time. And so those are obviously very robust markets. So I think it just depends on how, if it were passed, what the implementation is. And there's proponents on it hurts and there's proponents that it doesn't. So it's a real difficult one to answer. We will just have to see how it plays out.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

I think you probably know that we do a lot of lending on rent-controlled properties. And we lend on cash flow in place, NOI in place, rents in place, not on projected rents. So if rent control is put in place everywhere, that's the same as what we do anyway. And a lot of Los Angeles is rent controlled, almost all of San Francisco is rent controlled, so we don't see this really impacting our activities.

Operator

Our next question comes from Tim O'Brien of Sandler O'Neill.

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

I appreciate the comments on the Prop 10 impact with regard to how you assess cash flows on a current basis as opposed to forward basis. So I appreciate that. That's helpful. One just nit that I have or a point of further details. \$1.5 million decline in other fee income. \$750,000 approximately was due to lower warrant-related income. What was the other component there?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

The other component was our Merchant Banking income that tends to be cyclical. And so that came in, compared to last quarter where we were \$774,000, this quarter we were \$118,000.

Operator

At this time, there are no further questions. I would like to turn the call back over to Stephen Gordon for closing remarks.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

So thank you, and we look forward to the fourth quarter call. We appreciate everybody's participation.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Everyone, have a great day.



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