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Core NIM Upside in FY14, Growth
Normalizing But Still Strong

Reiterate Buy: TP +\$4 to \$52, Core EPS to \$2.56/\$2.70/\$3.15 for FY13/14/15
We continue to view the stock as one of our top growth picks in the mid cap bank space. We raised our core EPS estimates by \$0.03/\$0.10 in FY14/FY15 to account for stronger earning asset growth and lower than expected expenses and tax rate, which more than offset a lower expected core NIM and mortgage banking. While FRC expects asset growth to slow to a rate more in line with recent levels prior to 2Q13, given the lower loan pipeline heading into 4Q13, we note this implied ~20% annualized gr. rate remains strong and well above the industry, and should continue to be a solid driver of core NII gr. with the backdrop of a generally stable-to-expanding core NIM in FY14. With the variability of mortgage banking largely removed from core EPS trends going forward, we expect solid fee income growth in 4Q13/FY14 to further support strong core EPS trends.

Key Takeaways (see our 3Q13 First Read Alert for quarterly trends)
Core NIM likely to expand in FY14 with stable interest rates. Following a modest decline in 4Q13 NIM, we expect 6-7 bps of core NIM expansion through FY14. We expect some unwind in FY14 of the -14 bps NIM impact from excess deposit gr. in 3Q13 (following what may also be a solid deposit growth quarter in 4Q13), as FRC funds loan gr. with cash over time, supporting

earning asset yields. While loan production yields are below book yields, they are only modestly so (3.44% book yield ex. prepayment penalty income vs. a ~3.30% loan production yield), which should mean only modest loan yield pressure in FY14. Given the pull-back in deposit rates at the end of 3Q13, core deposit costs should actually decline modestly in 4Q13.

Mortgage banking likely remains weak, at least near-term. FRC guided to continued thin gain on sale spreads and modest loan sales in 4Q13, with lower volumes reflecting stronger demand for ARM product vs. longer-term fixed

rate product (most of which FRC sells). We note that while shifting customer demand favoring resi ARMs is a negative for loan sale volume, it is a positive

for loan growth. We have reduced our gain on sale income ests. to \$3.7M/\$3.6M for FY14/15, levels which may prove conservative over time.

Capital thinner, but still solid.

While solid asset growth pushed the Tier 1

leverage ratio -65 bps to 9.18%, we note this is well above FRC's 8% minimum, and given the expected pace of asset growth, we expect the Tier 1 leverage ratio to remain above 9% through FY15.

Valuation

Our \$52 target is based on a P/E of 16.5x our FY15E core EPS and a P/TBV of 2.1x our 3Q14 TBV/share estimate, versus the current mid cap bank medians of 15.1x FY14E/1.9x, respectively, reflecting a premium on a P/E basis, which we deem appropriate given the stronger relative core EPS growth through FY15, the higher quality nature of the franchise, and the potential increase in

take-out premium over time as the bank approaches \$50B in assets.

Date

15 October 2013

Results

Price at 15 Oct 2013 (USD)

Price Target (USD)

52-week range (USD)

Dave Rochester

Research Analyst

(+ [REDACTED])

Timur Braziler

Research Associate

(+ [REDACTED])

Key changes

Target Price

Source: Deutsche Bank

Stock & option liquidity data

Market Cap (USD)

Shares outstanding (m)

Avg. daily volume ('000)

Source: Deutsche Bank

Key data

FYE 12/31

47.38

52.00

47.68 - 32.00

48.00 to 52.00 †

8.3%

6,219.8

131.3

411,456

1Q 0.67 0.85A

2Q 0.60 0.77A
3Q 0.72 0.75A
4Q 0.77 0.75
2.76
11.8
FY (USD)
P/E
3.11
15.3
2012A 2013E 2014E
0.75
0.76
0.81
0.83
3.16
15.0

Source: Deutsche Bank

* Includes the impact of FAS123R requiring the expensing of stock options.

Risks

Downside risks: (1) economic weakness in California, (2) lower longer-term interest rates (pressuring NIM), (3) the adoption of unfavorable tax policies that adversely impact higher net worth individuals (i.e. the lowering of the mortgage interest deduction threshold).

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