# Third Quarter 2020 Earnings Call Transcript

*October 28, 2020*

## CORPORATE PARTICIPANTS

**Drew LaBenne,** *Senior Executive Vice President, Chief Financial Officer*

**Keith Mestrich,** *President and Chief Executive Officer*

## CONFERENCE CALL PARTICIPANTS

**Janet Lee,** *J.P. Morgan*

**Brian Morton,** *Barclays*

**Chris O'Connell,** *KBW*

## PRESENTATION

**Operator**

Greetings, and welcome to Amalgamated Bank Third Quarter 2020 Earnings Conference Call.

At this time all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference please press star, zero on your telephone keypad. As a reminder this conference is being recorded.

It is now my pleasure to introduce your host, Drew LaBenne, Chief Financial Officer. Please proceed.

**Drew LaBenne**

Thank you, Operator, and good morning, everyone. We appreciate your participation in our third quarter 2020 earnings call.

With me today is Keith Mestrich, President and Chief Executive Officer. As a reminder, a telephonic replay of this call will be available on the Investor section of our website for an extended period of time. Additionally, a slide deck to complement today's discussion is also available on the Investor section of our website.

Before we begin, let me remind everyone that this call may contain certain statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We caution Investors that a number of factors, some of which are beyond our control could cause actual results to differ from the expectations indicated or implied by any such forward-looking information or statements. Investors should refer to Slide 2 of our earnings deck as well as our 2019 10-K filed on March 13, 2020, and our other periodic reports that we file from time to time with the FDIC, typically under cautionary note regarding forward-looking statements and risk factors, for further description or explanation of those items that could cause actual results to differ materially from those indicated or implied by any forward-looking statements that we may make.

Additionally, during today's call, we will discuss certain non-GAAP measures, which we believe are useful in evaluating our performance. The presentation of this additional information should not be considered in isolation or as a substitute for results prepared in accordance with U.S. GAAP. A reconciliation of these non-GAAP measures to the most comparable GAAP measure can be found in our earnings release as well as on our website.

At this point, I'll turn the call over to Keith.

**Keith Mestrich**

Thank you, Drew, and good morning, everyone. We appreciate your time and attention today.

On today's call, I will start by providing an overview of our current operations, and an update to our business given the ongoing COVID-19 pandemic, before turning the call over to Drew to discuss our third quarter results in more detail.

First, as most of you are aware, after eight rewarding and fulfilling years serving this great institution, I announced my plan to step down as President, CEO of the Bank at the end of January 2021. A difficult decision in which I came to the conclusion after much reflection about what I wanted to achieve next. Six years ago, when I assumed my current position, Amalgamated was in a very different place than it is today. It was this time that the Board and I worked closely to establish a number of key objectives to be accomplished. These included resolving the consent order from the regulators, setting a strategic direction for the bank aimed at growth, recruiting a new Management team, returning the Company to profitability and reestablishing the payment of the dividends. Lastly providing an excellent opportunity for our private equity Investors.

Together as an organization, we have achieved these goals. As I look at the bank today, I'm so proud of the fact that Amalgamated is financially and operationally much stronger than it was when I assumed this role back in 2014, as demonstrated by our third quarter results. During the past six years, we have cultivated an exceptional leadership team that first led us out of the precarious position the Bank found itself in following the financial crisis, and then put us on a solid path for growth, highlighted by our acquisition of New Resource Bank and our successful initial public offering in 2018. Together, we also responded to the unprecedented times that we continue to face, instituting protocols that allowed us to seamlessly transition to a remote working environment in the face of the COVID-19 pandemic.

In addition to our financial and operational success, I'm proud that during my tenure, Amalgamated cemented its place as America's socially responsible bank. This has been demonstrated in the growth of our impact lending, exceeding our commitment nearly half the time. The countless positions we took on social issues of the day, such as gun safety, reproductive rights and racial justice, and the launching of the Amalgamated Foundation to enhance the Bank's corporate giving. All of these examples show how the Bank's mission has been deeply ingrained in our culture and our work. I'm confident it will continue after my time.

It was with the aforementioned goals in mind that I felt very much like mission accomplished. There cannot be a better time for me to step back, identify the next challenge for myself, and leave the bank in the very capable hands of my colleagues who have been on this journey with me. I'm deeply grateful to the Board for providing me with the opportunity to lead this great institution. My successor has not been identified, a formal Search Committee has been formed and a leading executive search firm has been engaged. I look forward to assisting the Board and our next CEO with the transition to help ensure we continue to grow, while remaining true to our values.

In order to ensure business as usual is not interrupted, I have agreed to serve as a Special Advisor to the Board till next July. I'm very pleased that Lynne Fox has agreed to step in as Interim President and CEO if our next leader is not identified prior to my departure on January 31, 2020. Lynne knows the organization exceptionally well as a Board member for the last 20 years, Chair for the past four, while also serving as the International President of Workers United, which owns 41% of Amalgamated's common shares.

As we think about the takeaways for the third quarter, I'm most impressed with the Bank's superb operational execution, especially given the ongoing challenging environment. The steps we have taken to improve the Bank's performance can clearly be seen in our third quarter results, which are a testament to our entire leadership team here at Amalgamated.

Turning to our third quarter highlights, our average deposits grew $459 million during the quarter to $5.9 billion compared to the second quarter. Deposits were strong in both political and non-political sectors, and continues to demonstrate the competitive brand recognition Amalgamated holds in this significant market segment. Drew will discuss more on our political deposit outflows as we are on the eve of the November 3, Election Day.

With the close of the third quarter, the Bank continues to be well-positioned as it concerns credit. Our strong capital base and conservatively underwritten loan portfolio is further evidence as our loan deferrals declined $201 million, or 6% of our portfolio. This compares to 13% at the end of the second quarter. Provision for the third quarter declined to $3.4 million compares favorably to $8.2 million provision recorded during second quarter. This low level of remaining deferrals reflects the strong credit underwriting at the bank, and we are excited to see our loan deferral activity largely behind us, though we are cautious to the potential of any impacts of a second wave due to COVID related shutdowns. We continue to monitor our loan portfolio and remain committed to working with our borrowers as problems arise.

As we transition our customers to our online banking platform throughout the pandemic, we will present you with the opportunity to consolidate several of our branch locations. We accelerated this initiative during the third quarter and took the opportunity to permanently close six branches given the backdrop of the pandemic, and the resultant decline in customer traffic. This resulted in a $6.4 million onetime expense this quarter. Importantly, the branches were only closed once we had complete confidence that the high levels of adoption and customer satisfaction in our digital platform would prevent client losses. We expect to realize an annual expense benefit of approximately $4 million over time due to the branch closures. But the impact will gradually be felt as we place almost all employees from the branches in temporary and permanent positions in the bank.

Turning to capital allocation, we continue to like the growth opportunities that we have in front of us and we'll continue to prioritize investments as the strongest avenue as we drive book value growth and Shareholder value. Our share buyback remains under suspension and our dividend is evaluated on a quarterly basis with our Board of Directors. Last night we also received our first bank rating from Kroll, which is BBB+/BBB for senior and sub debt respectively. This is another independent validation of the strength of the franchise we have built.

Before I close, I want to highlight that Amalgamated received some positive press coverage this quarter about our work to track sustainability principles and finances. First, Motley Fool named Amalgamated as one of the few banks actively working to combat climate change. We also received coverage in Politico and several other publications for our leadership, and the Partnership for Carbon Accounting Financials or PCAF and the recent banks that have joined that effort. These examples are more additional proof of our leadership in the ESG investing space, and I am proud to see them highlighted.

To conclude, I would like to take this opportunity to thank our employees for their tireless work and commitment to our important mission as America's socially responsible Bank. Together with a great team and a built-in bank position to weather all economic cycles, and I have every confidence that the bank is in excellent hands. I consider myself extremely fortunate to have had the opportunity to work with a talented group of individuals.

Now I'd like to turn the call over to Drew for a more detailed review of our financial results.

**Drew LaBenne**

Thank you, Keith. I will begin by reviewing our third quarter results before turning the line back to the Operator to open for questions.

Turning to Slide 6, in the third quarter ending deposits increased $151 million, or 10% annualized to $5.9 billion from the second quarter of 2020. While average deposits grew $459 million in the quarter to $5.9 billion. Average non-interest bearing deposits increased $445 million from the prior quarter primarily due to seasonality related to the election cycle. Total non-interest bearing deposits now represent 54% of average deposits at quarter end. Our cost of deposits decreased to 14 basis points, down 6 basis points compared to 20 basis points at the end of the second quarter.

Deposits from politically active customers such as campaigns, PACs, advocacy-based organizations and State and National Party Committees increased $633 million from $578 million at December 31, 2019, ending the third quarter at $1.2 billion as outlined on Slide 7. As of Monday, our political deposits were $805 million. Although we had expected a nadir of $300 million in political deposits, the momentum in the party continues to be exceptional and we now expect these deposits to be above $500 million at the end of the election. We look forward to continuing our support of the Democrats during the presidential race and partnering with the majority of Democratic candidates in office.

Turning to loans, total loans were $3.6 billion, compared to $3.7 billion at the end of the second quarter. For the nine months ended September 30, 2020, total loans increased $115.9 million driven by an increase of $187 million in C&I loans, including $95 million of Government Guaranteed and Paycheck Protection Program loans, and a $16 million increase in consumer loans, primarily consumer residential loans.

Our balance of PACE assessments, which is reported in the held to maturity securities portfolio increased by $44 million in the third quarter to $367 million.

As Keith mentioned earlier, the Bank continues to make progress on reducing loans on deferral. In total, we currently have $201 million, or 6% of our loans on a deferral program, which is shown on Slide 11. This is down approximately $264 million from June 30, 2020. The number of new loans asking for a deferral has pretty much ceased. Commercial loans that reached the end of their deferral have almost all started to pay, and we expect almost all of the remaining commercial loans on deferral to start paying as well; there are a few customers where it isn't clear yet. But in other words, by the end of the fourth quarter, we believe the vast majority of commercial loans on deferral will be paying. Residential deferrals have also decreased to lower levels. Some customers have requested third deferral, which we grant based on legislative guidance. We're moving any loan that goes past 180-days of deferrals to non-accrual for accounting purposes and reversing any accrued interest.

Net interest income for the third quarter of 2020 was $45.2 million, which compares to $44.4 million in the linked quarter, and an approximately $3.5 million increase as compared to $41.8 million in the same quarter of 2019. The year-over-year increase is primarily attributable to a decrease in interest expense, due to a decrease in deposit rates paid and FHLB advances and other borrowings, and an increase in average securities and loans more than offsetting the lower yields earned on such assets.

As shown on Slide 13, our net interest margin was 2.88% for the quarter, a decrease of 22 basis points from the second quarter, and a year-over-year decrease of 62 basis points. The accretion of the loan mark from the loans we acquired in our New Resource Bank acquisition contributed two basis points to our net interest margin in the third quarter of 2020, compared to three and seven basis points in the second quarter of 2020 and the third quarter of 2019 respectively. Prepayment penalties earned through loan income were higher this quarter, and contributed $1.1 million or seven basis points to our net interest margin in the third quarter of 2020 compared to two and zero basis points in the second quarter of 2020 in the third quarter of 2019 respectively.

On a go forward basis, we expect NIM to benefit from the outflow of political deposits but still have pressure from lower rates over the long term, but having said that, the majority of the pressure has already occurred. Given the higher exit point on political deposits, we will likely use cash on hand to fund the outflow, which means minimal impact to earnings as a result.

Now on to non-interest income. Non-interest income for the third quarter of 2020 was $12.8 million increasing from $8.7 million in the second quarter of 2020 and $5.1 million increase compared with the third quarter of 2019. The increase in the third quarter of 2020 compared to the like period in 2019 is primarily due to a $4.3 million tax credit on an equity investment in a solar project, a $0.6 million gain on the sale of securities and a $0.8 million increase in Bank-owned life insurance income due to the receipt of a death benefit payout, and a $0.8 million increase in the gain on sale of residential loans. These increases were partially offset by a $1.3 million decrease in trust department fees, primarily related to the decrease in revenue from a real estate fund that is liquidating assets, the movement of funds to lower yielding but higher margin products and market volatility.

The $4.3 million gain from the tax credit is a timing issue. We will see reversal of that income in the fourth quarter of $2.3 million and in the first quarter of $2.5 million. Then we will have a lower level steady stream of income from the projects. The trends are shown on Slide 14. These future impacts will likely be offset by new tax equity projects coming online in Q4 or Q1 2021, but the timing is uncertain.

As Keith discussed, we've done a great deal of work reducing our noninterest expense on a go-forward basis. We had $6.4 million of onetime expenses which we recognized in the third quarter related to the closing of six branches in New York City and $500,000 in advertising and promotion related to the Democratic National Convention as seen on Slide 15. Excluding these charges from the $37.9 million of expense recorded in the third quarter provides a better run rate of our expense pace and compares to the $31.1 million in expenses in the second quarter and $31.9 million in the year-ago quarter. The fourth quarter tends to be more volatile on expenses and we anticipate some incremental expense related to the bank holding company formation and the CEO transition. On a go-forward basis we will see expense benefits from the branch closures and continue to operate at efficient levels of expense in 2021. We'll have more guidance on the fourth quarter earnings call in January.

Skipping ahead to Slide 17, non-performing assets totaled $80.6 million or 1.22% of period-end total assets at September 30, 2020 which was an increase of $14 million compared to $66.7 million or 1.25% of period-end total assets at December 31, 2019. The change was the result of the addition of one $8 million non-accruing construction loan and one $8.1 million accruing construction loan that was past due at September 30, 2020 and subsequently paid off in full in October. Of the three construction loans that we discussed last quarter, one is paid off, one remains special mention and one has moved to non-accrual. The non-accrual construction loan is well protected and we currently expect no losses on it, but it may be an extended workout given there are legal actions between the developer and the contractor. As a reminder, we are not a construction lender. These are loans remaining from the New Resource acquisition.

The provision for loan losses in the third quarter of 2020 was $3.4 million, which compares to $8.2 million of provision in the linked quarter. The provision expense in the third quarter of 2020 was primarily driven by $5.3 million in charge-offs related to a hotel loan, which was partially reserved for in the previous quarter, and small construction loan. Specific reserves on non-accrual C&I loans increased by $1.1 million.

Moving along to Slide 18, our GAAP and core return on tangible average common equity were 9.6% and 13.4% for the third quarter of 2020, respectively. The core return compares to 9.1% for the second quarter of 2020 and 11.4% for the comparable period in 2019. Lastly, as Keith mentioned, we remain well-capitalized to support future growth.

To conclude, and to reiterate with what Keith touched upon, we are very pleased with our third quarter results and where the bank is today operationally. We have been able to grow our business while supporting our customers and generating ongoing strong returns in what has been a very unusual and unprecedented environment.

Thank you again for your time today. We look forward to updating everyone on the fourth quarter results in January.

With that I'd like to ask the Operator to open up the line for any questions. Operator?

**Operator**

Thank you. Ladies and gentlemen, we will now be conducting a question-and-answer session. If you'd like to ask a question, you may press star, one on your telephone keypad. A confirmation tone will indicate your line is the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment it may be necessary to pick up your handset before pressing the star key.

Our first question comes from the line of Steve Alexopoulos with J.P. Morgan, please proceed with your question.

**Janet Lee**

Good morning. This is Janet Lee on for Steve Alexopoulos. First of all, best of luck, Keith on your next chapter. Maybe for Keith, as you're doing the CEO search, are you looking for someone who's in your market or someone with a specialized background working with the niche sector you're in, such as political organizations and nonprofits?

**Keith Mestrich**

So the Board is leading the search, and I have had a chance to review some of the materials. I know that the search is underway. I think the Board is looking for someone who's really got that set of skills that both have deep experience in banking or financial services along with the ability to connect in our niche market. There are, in my understanding, a number of very, very good candidates who have surfaced.

**Janet Lee**

That's helpful. My follow up is on solar credit. So the modest income you project out beyond 1Q 2021 on Slide 14, is this assuming that the deals are being flat at current levels without new potential deals, you also say on the same slide that you expect to book more deals over the next several quarters that are not included in the projections. So just want to double check to make sure that the run rate should be higher than the $1.8 million forecast for 2022, for example?

**Drew LaBenne**

Correct. Yes. Hi, Janet, it's Drew. Yes, that's correct. The $1.8 million is the total and applied is the total income for the project stream over the life we're showing there. So what we're really doing is just giving you a longitudinal view of one set of projects. So as we add on more projects, which we intend to do, we'll add to those numbers. So that is not a forecast of non-interest income for all projects going forward. Just to be clear.

**Janet Lee**

Is there sort of a magnitude of an income benefit that you get from like an additional deal or the size, or the number or the size of the deals, do you expect to book over the next few quarters?

**Drew LaBenne**

Yes, so this type of investment is constrained by our taxable income. So when we're looking at how many deals we can do in the future, we need to consider how much federal taxable income we're going to have available to us these tax credits. So I would say this is—this one deal I'm referring to is actually four related deals with one project sponsor. So I suspect we could probably do about two of these a year on a normalized basis, as long as taxable income, looks positive in the future.

Then what's really not on the slide, but related to this is, along with the tax equity investment we're making, we're also doing the term loan on the projects as well. So there's other benefits that are related to making these tax equity investments besides just the economics shown on this page.

**Janet Lee**

That's helpful. Thanks for taking my questions.

**Keith Mestrich**

Thanks, Janet.

**Operator**

Our next question comes from the line of Brian Morton with Barclays. Please proceed with your question.

**Brian Morton**

Good morning, guys. How are you doing?

**Keith Mestrich**

Thanks. Good morning, Brian.

**Brian Morton**

I just want to know, you've highlighted that high levels of cash impacted the NIM by about 31 basis points. We've kind of seen pre-penalty payments are headed back 7 basis points. Kind of given the expected decline in political deposits for next quarter, how much of that 31 basis points you think you can get back? And would that imply, you can get a 3% NIM would be achievable even with possibly lower prepayment penalties.

**Drew LaBenne**

It would imply that. I mean, there is still going to be some pressure on—more from the longer end of the curve being lower now on new originations coming in refinances. So we do also have to offset that pressure. That's going to continue as long as low rates exist. But I think we—besides just the cash coming off the balance sheet, I mean, we do have, obviously a large securities portfolio and a lot of lower yielding assets that can be deployed into higher yielding assets in the form of more loans or PACE assessments. So that's what we'll be working on to help counteract some of that longer term pressure on NIM.

**Brian Morton**

Okay, great. Then the other question just on capital. We're seeing capital level continue to creep up. Next quarter, you'll get a lift in the leverage ratio and the political deposits running off. Could you just go through your capital priorities again? If acquisitions and buybacks are on hold, at what point does it become more appropriate to take a closer look at the dividend?

**Keith Mestrich**

Yes, great. So the dividend is a conversation every quarter with the Board, and we'll continue to have that conversation. The first priority for capital is always going to be organic growth. We see a lot of that in our future. I think our growth rate has been very strong over the past several years. We see it continuing to be strong going forward. Obviously, in Q4, we're going to have a little bit of drop from the political deposits. But I think less so than we've been forecasting as the outlook there looks higher. Then we'll continue to grow our core franchise as well. I think we're going to need some capital to continue doing that.

As we plan for next year, or finalize our plans for next year, we'll look at the capital levels and determine what the best course of action is, buybacks, dividends, acquisitions, et cetera. I think the other thing to note here, too, is there's still a lot of dry powder in terms of—Keith mentioned the Kroll rating that's just been established and the bank holding companies coming here. We actually have no sub debt issued, we have no preferred stock, not that we're planning on issuing either of those right now. But those are levels to think about—those are levers available to use as we're thinking about non-organic growth as well.

**Brian Morton**

Okay, great. Well, thanks a lot. Those were all my questions.

**Drew LaBenne**

Thanks, Brian.

**Operator**

Our next question comes from the line of Chris O'Connell with KBW. Please proceed with your question.

**Chris O'Connell**

Good morning, gentlemen. So I'd like to circle back, I guess counter to the margin rate, to capital or to liquidity deployment. Just see how your PACE pipeline or the opportunities that you're seeing for future PACE growth are, and just where you're seeing as well, loan opportunities, given some of the declines this quarter.

**Drew LaBenne**

Yes, great. So I'll take that one, and Keith can jump in. On the PACE assessments, we continue to have—we continue to believe we will originate and put more of those on the balance sheet. So that will be a source of growth. Our partnership with PACE Funding Group has continued to strengthen in other ways as well. I think we see a lot of opportunities for growth in continuing to work with them. We do have some other partners, which are of a similar variety that we're working with to continue to look for loan growth opportunities. We have a pretty strong C&I pipeline for new loan growth as well, more so in the renewable energy space. So I think there's a lot of opportunities for loan growth there.

The two big headwinds for us are going to be the ones that we saw this quarter. The first is multi-family, which for us is primarily in the New York City market. I think what we're seeing in terms of credit deferrals is great. I think we're very happy with where our outcome will be in Q4, with essentially all of those loans, beginning repayment. But at the same time that refinancing activity and purchase activity has really slowed down. So I think originations will be challenged there, but we continue to look for opportunities.

Then in residential, our pipeline originations are the strongest they've ever been. But at the same time, we've made a strategic decision that, at a 2.5% rate or thereabout, we're not looking to put 30 year mortgage on the books at this point, except for relationships. Something we could change that in the future. But in the meantime, that's going to mean a continued stream of higher non-interest income, but some pressure on the loan side of the balance sheet.

**Chris O’Connell**

Got it? That's helpful. Thank you. Then I appreciate, you gave the updated political deposit balance dropping $800 million or so as of October. But do you guys have any view as to where that will bottom out towards the end of the fourth quarter at this point?

**Keith Mestrich**

Well, I think one of the things that we're seeing, Chris, is that we are seeing spending later in a cycle than we normally have. We are seeing some of our clients in the space, recognizing that there could be post-election, let's call it, activity, if there's uncertainty around the outcome, either in the Presidential level, which gets a lot of attention, but you could have that that at the state and local level as well. So I think there's some likelihood that we might see some continued spend of that. Makes it a little hard to project exactly where we will be at the end of the fourth quarter.

It will be a little bit lower than it is today, but I think, the projection that Drew had given in terms of where this is a range. I think it's a probably a pretty good range on what's likely to happen at the end of Q4.

**Chris O’Connell**

Got it. Thank you. Then given just kind of putting all the moving parts together with the political deposits dropping, and the cash balances dropping kind of along with that in the fourth quarter. But then, adding to that, other liquidity deployment opportunities or mix shift opportunities, given the liquidity levels. Do you guys have an idea of where the margin will shake out going forward?

**Drew LaBenne**

I don't think we're ready to give guidance on that. I think we've—I don't want to pat ourselves on the back too much, but I think we've done a pretty good job of holding net interest income pretty steady over the past few quarters while absorbing, obviously a massive decline in the yield curve. We're pretty happy about that.

I think our sources for increasing net interest income in the future are really going to be continued balance sheet growth, excluding the political deposits impact, and then continuing to work on growing the loan portfolio. So there's a lot of factors that go into it. So I don't want to give you a Q4 NIM right now. But we're very focused on holding and then increasing net interest income into the future.

**Chris O’Connell**

Got it-Understood. Then one last quick one, for the bully fees this quarter, were there some elevated? I guess, if they were, where do you think they might drop down to kind of on a normalized level?

**Drew LaBenne**

Yes, I think if you look at where we were and it's actually pretty steady, except for when unfortunate events happen, and it increases up. But if you look back to where we were in Q3, it's in the earnings release in Q3 of 2019, a little over $400,000 per quarter. That's probably a good approximation of where we'll run in the near-term, excluding any one-time event.

**Chris O'Connell**

Great. Thank you. That's helpful. That's all I had.

**Operator**

There are no further questions in the queue. I'd like to hand the call back to Keith Mestrich for closing remarks.

**Keith Mestrich**

Thanks, Operator. I just want to thank everybody for joining us today. We're really pleased with the strong results that we put forward this quarter. It's a testament to the strategy that we've developed, the terrific franchise that we've been able to create and really the strength of so many people on our Management team and all of our staff that works so hard every day. So I just want to thank all of you, stay safe, and we'll talk to you at the end of the year. Thanks.

**Operator**

Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time and have a wonderful day.