



Luther Burbank Corp (LBC) | BUY

Upcoming IPO Priced Right for a Throwback Thrift

December 2nd, 2017

OVERVIEW

We are initiating coverage on Luther Burbank Corporation with a BUY rating and \$13.29 per share Base Case target price. Luther Burbank is an upcoming IPO of a \$5.3 billion in assets thrift based in Santa Rosa, California. The IPO is expected to price on December 7th, 2017. The pricing looks attractive at 121% of proforma tangible book at the mid-point of the IPO range (\$11.50). The next cheapest CA bank is Opus Bank (OPB) at 162%, and OPB has credit and management issues. At the midpoint there is upside of over 30% with limited long-term downside. After the IPO, the founding family will still control over 50% of the stock, so buybacks are unlikely. Risks: Low net interest margin, weak fee income. LBC is a pure spread bank with a very high multi-family loan concentration and a liability sensitive balance sheet.

FOCUS POINTS

- ❖ Upcoming IPO of Luther Burbank, a \$5.3 billion in assets, Santa Rosa, CA based savings and loan.
- ❖ Midpoint price of \$11.50 equates to 121% of Tangible Book Value and \$614 million market cap.
- ❖ Balance sheet is a throwback to 1990s: high CD balances, MMDAs funding mortgages/multi loans.
- ❖ Very low NIM offset by low credit and operating expenses. ROA, ROE in-line with peers.
- ❖ Attractive California markets. Strong local economies help loan and deposit growth.
- ❖ Large insider ownership: Founding Trione family owns more than 50% of shares.
- ❖ Management pay is high, should be lower. Management owns 2.5% of stock post-offering.

Market Data		Company Data	
Price	\$11.50	ROA	0.90%
Market Cap (mil)	614	ROTCE	11.9%
Price/Book	117%	TCE/Assets	9.6%
Price/Tangible Book	121%	Reserve/Loans	0.63%
Dividend Yield	2.0%	NCOs %	0.01%
3 mo. Avg. Volume	n/a	Net Interest Margin	1.81%
Shares O/S (mil)	50.9	Efficiency Ratio	45.5%
Insider Ownership	19%	TBV/Share	\$9.49

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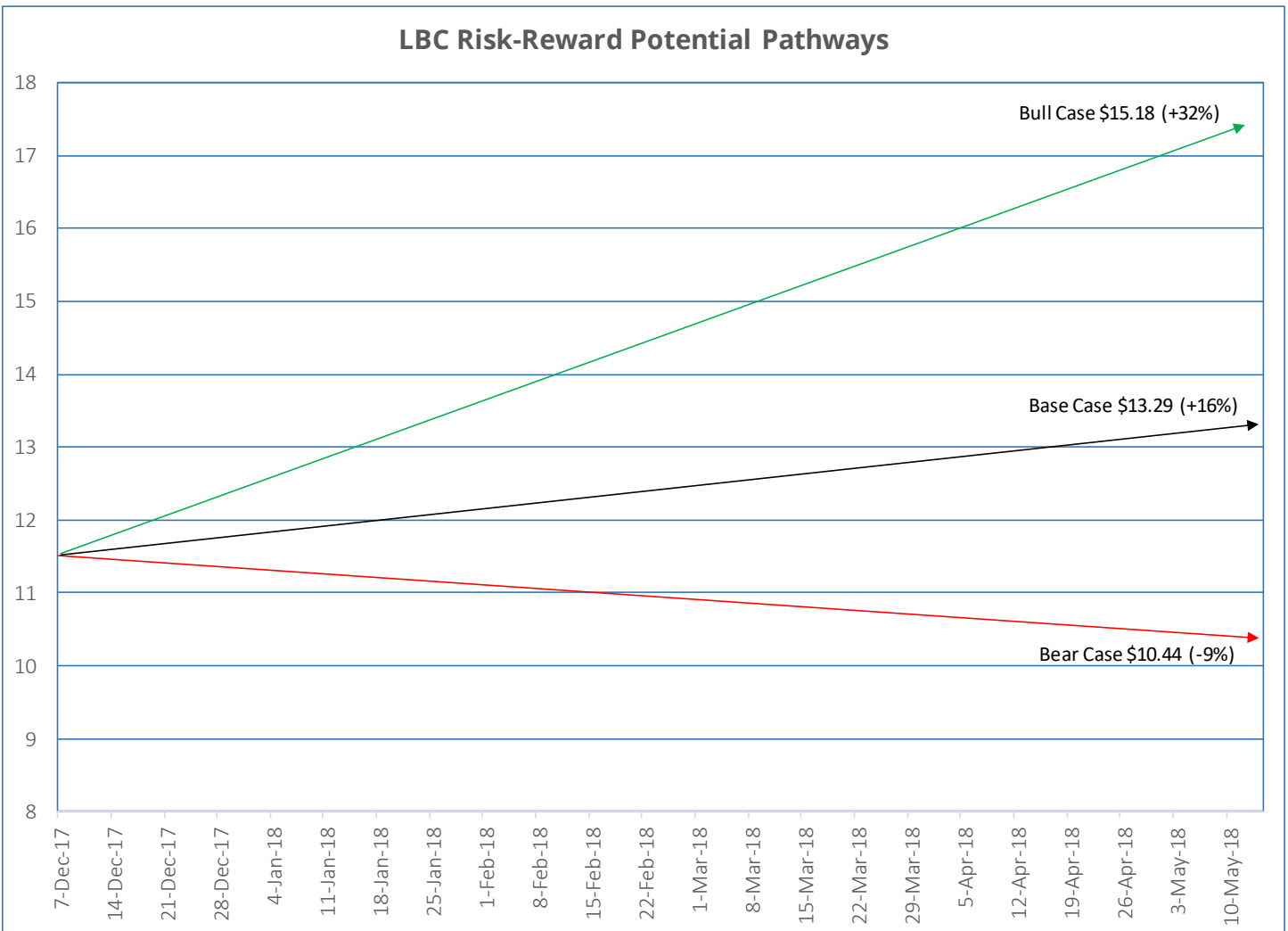
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Next 6-12 Month Trading Range		Key Facts		Franchise Information	
Buy	<12.00	Asset Sensitivity:	Very Negative	Headquarters:	Santa Rosa
Hold	13.00	Buybacks Left:	0%	States of Operation:	California
Sell Half	14.00	Takeout Candidate:	No		Oregon
Exit	15.00	Activist Shareholders:	No		Washington

Target Price Matrix				
Scenario	Target	Return	Price/TBV	18 P/E
Bull	\$15.18	32%	160%	15.5
Base	\$13.29	16%	140%	13.6
Current	\$11.50	0%	121%	11.8
Bear	\$10.44	-9%	110%	10.7



SUMMARY

LUTHER BURBANK IPO – BUY UP TO \$12.00/SHARE.

Luther Burbank (LBC) is a throwback thrift in California with small operations in Oregon and Washington. Management appears to be solid, with a strong credit culture and controlled expenses. Profitability metrics are average due to a strong efficiency ratio and clean credit, which are needed to offset a very low net interest margin of about 2.00%. With the midpoint of the deal range coming at just 121% of tangible book value for a clean balance sheet, we recommend buying shares in the IPO. KBW and Sandler O’Neill are the bookrunners.

BULL CASE: \$15.18

LBC eventually trades in-line with Opus Bank, (OPB), another California bank with a poor franchise, but which also has credit and management credibility issues. OPB trades at 162% of tangible book value, the lowest for a bank in California with a significant market cap. LBC trades up to this valuation.

BASE CASE: \$13.29

Large controlling stake held by founding family limits any outside shareholder ability to influence management or the direction of the company, so LBC trades at a discount to all other public banks in California at 140% of tangible book value. Assumes management doesn’t transition deposit base away from CDs in the near future. Even at this lower valuation, the midpoint of the IPO provides 16% upside.

BEAR CASE: \$16.56

LBC trades at 110% of tangible book value. Scenario possible if management fails to make the deposit franchise more valuable, the U.S. enters a recession, or the overall bank stock market falls 25%. Any credit issues would have an outsized impact on LBC’s valuation, as the weak NIM affords little cushion for NII to offset credit costs. Large exposure to extremely competitive multi-family loan sector.

FOCUS POINTS

- ❖ Old-school California thrift with a housing-oriented loan portfolio and CD-heavy funding base.
 - ❖ Unattractive balance sheet. Multi-family loan exposure is extremely high at 57% of loans, while the loan portfolio yields just 3.40%. CDs make up 57% of the deposit base. NIM about 2.00%.

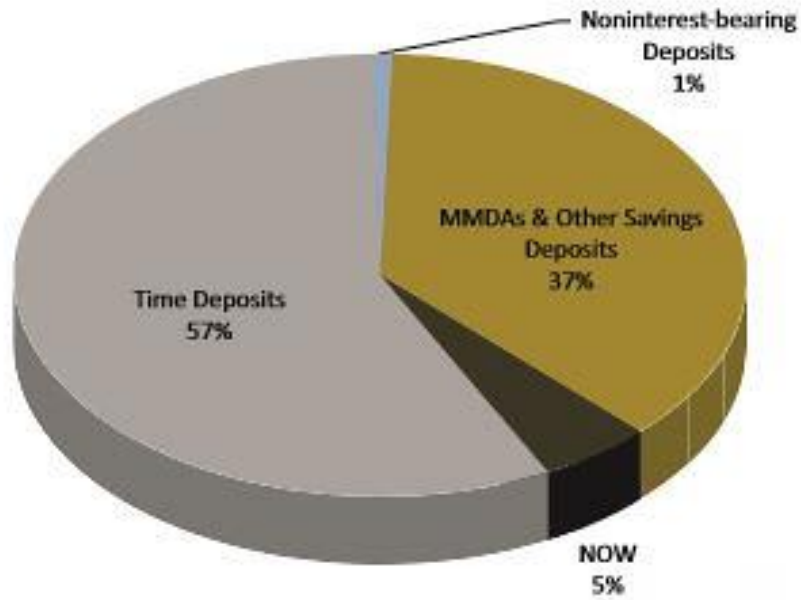
- ❖ Low downside risk. Favorable Risk-Reward. Trading in-line with its weakest comp yields a 32% return.
 - ❖ Simple thesis: Deal midpoint of \$11.50 per share is cheap. Buy up to \$12.00.

- ❖ Tailwind to earnings from balance sheet remixing, focus on deposit growth.
 - ❖ Management says it is focused on growing its core deposit base, which if successful would lower its funding costs and create more franchise value, but this will take a few years.
 - ❖ Large average branch size and average account size (over \$100,000 per account) drives efficient expense management and average ROA and ROE metrics.

- ❖ Attractive markets. Strong economies provide opportunity for above average loan and deposit growth.
 - ❖ LBC operates in all the major metro areas of California, and recently expanded into the Portland, OR and Seattle, WA markets. LBC plans to open 2 more branches in the near-term in Seattle and San Diego. If management wanted to sell, buyers are very interested in LBC's market area.

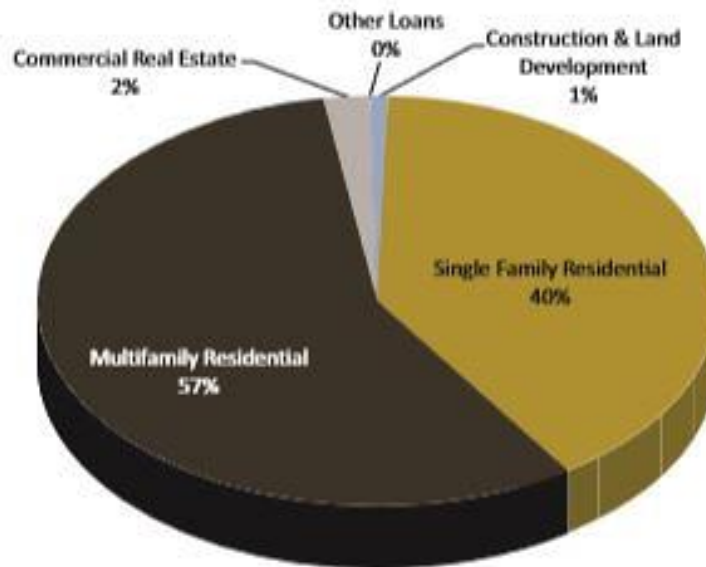
- ❖ Note: Earnings estimates are hard to model as the company has not released detailed quarterly financial results. Expect the earnings estimate range to be wide until more information is released in early 2018.

Total Deposits Composition as of September 30, 2017



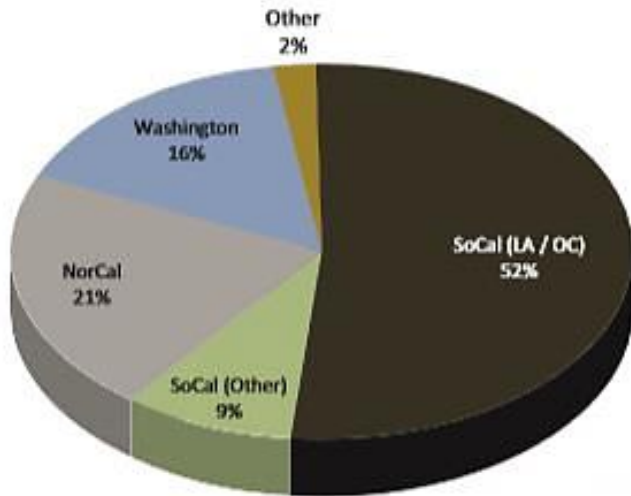
Source: Company Data, SEC Filing

Loan Portfolio Composition
September 30, 2017

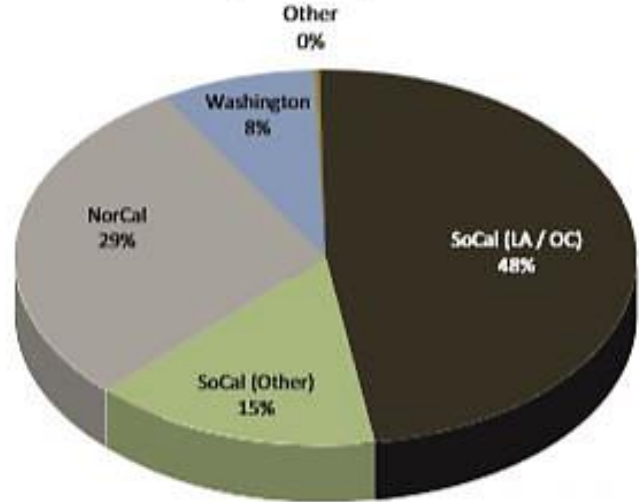


Source: Company Data, SEC Filing

**Multifamily Residential Loans by Lending Area
September 30, 2017**



**Single Family Residential Loans by Lending Area
September 30, 2017**

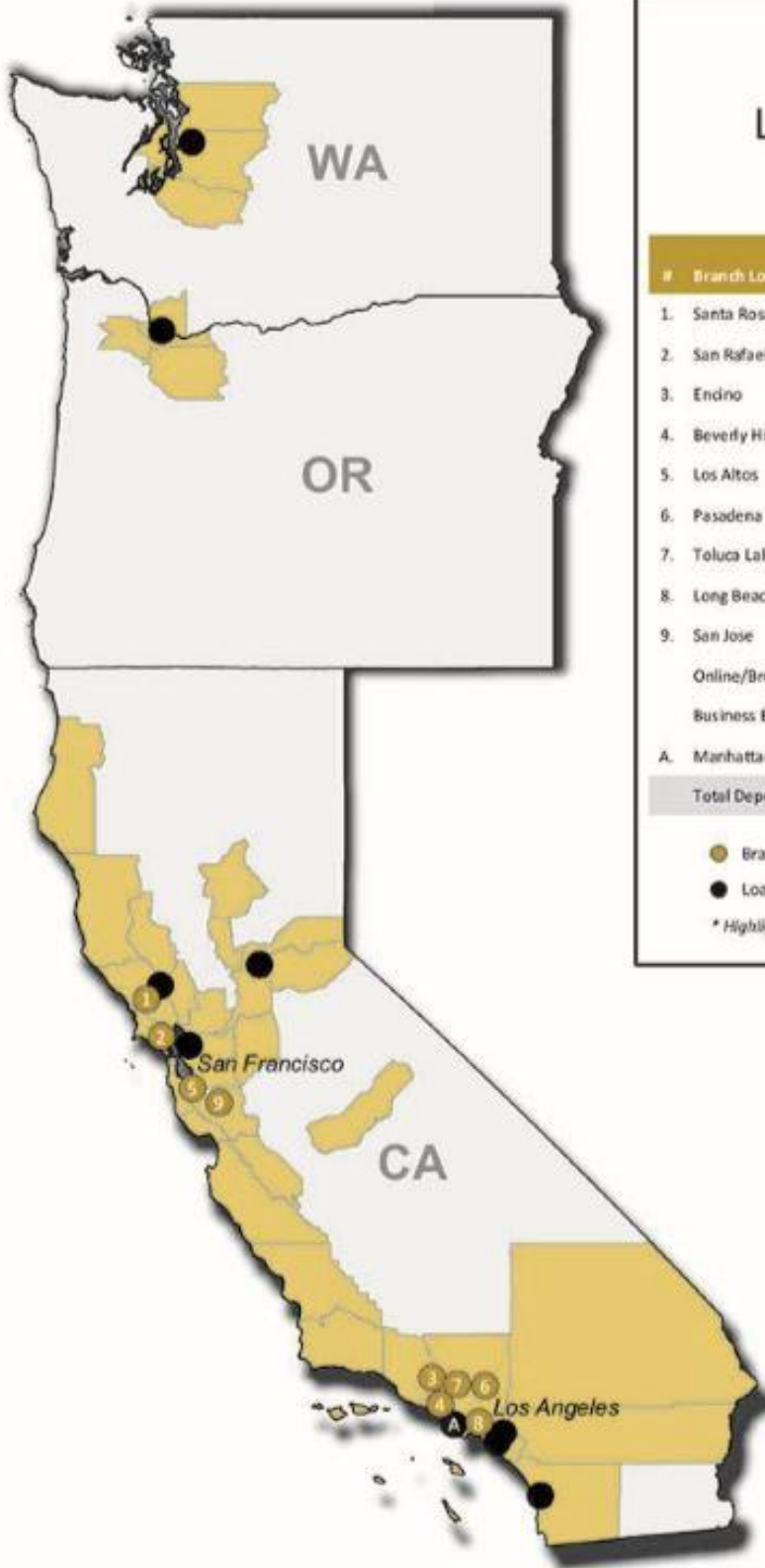


Source: Company Data, SEC Filing

	As of December 31,											
	September 30, 2017		2016		2015		2014		2013		2012	
	Amount	% of total loans	Amount	% of total loans	Amount	% of total loans	Amount	% of total loans	Amount	% of total loans	Amount	% of total loans
<i>(Dollars in thousands)</i>												
Real estate loans held for investment												
Multifamily residential	\$2,628,691	56.8%	\$2,600,262	58.6%	\$2,295,697	59.8%	\$2,132,367	61.8%	\$2,255,068	66.8%	\$2,201,309	66.1%
Single family residential	1,818,914	39.3%	1,711,818	38.6%	1,449,993	37.8%	1,210,146	35.1%	963,336	28.5%	814,724	24.5%
Other:												
Commercial	95,668	2.1%	59,611	1.3%	55,217	1.4%	102,701	3.0%	156,643	4.6%	275,228	8.3%
Construction and land	48,004	1.0%	29,465	0.7%	21,421	0.6%	46	0.0%	-	0.0%	4,937	0.1%
Non-mortgage	50	0.0%	50	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%
Total loans held for investment	\$4,591,327	99.2%	\$4,401,206	99.2%	\$3,822,328	99.5%	\$3,445,260	99.9%	\$3,375,047	100.0%	\$3,296,198	99.0%
Real estate loans held-for-sale												
Single family residential	38,127	0.8%	34,330	0.8%	17,952	0.5%	4,858	0.1%	-	0.0%	32,356	1.0%
Total loans held-for-sale	\$ 38,127	0.8%	\$ 34,330	0.8%	\$ 17,952	0.5%	\$ 4,858	0.1%	\$ -	0.0%	\$ 32,356	1.0%
Total loans before deferred items and fair value adjustments	\$4,629,454	100.0%	\$4,435,536	100.0%	\$3,840,280	100.0%	\$3,450,118	100.0%	\$3,375,047	100.0%	\$3,328,554	100.0%
Unamortized Deferred Loan Costs	40,483		39,240		33,442		27,234		22,364		19,817	
Fair Value Adjustment - (Loss)Gain	-		(36)		(133)		50		-		489	
Total Loans	\$4,669,937		\$4,474,740		\$3,873,589		\$3,477,402		\$3,397,411		\$3,348,860	

Source: Company Data, SEC Filing

Luther Burbank Branch Map





**Luther Burbank[®]
Corporation**

#	Branch Location	Date Established	September 30, 2017 Deposits (\$mm)
1.	Santa Rosa	Oct. 1983	1,044.2
2.	San Rafael	Sep. 1996	559.0
3.	Encino	Aug. 2007	380.9
4.	Beverly Hills	Jul. 2010	347.3
5.	Los Altos	Aug. 2000	291.2
6.	Pasadena	May 2009	241.9
7.	Toluca Lake	Jan. 2008	228.3
8.	Long Beach	Jun. 2015	128.0
9.	San Jose	Jun. 2012	112.3
Online/Brokered Deposits			373.9
Business Banking			156.4
A.	Manhattan Beach		530.3
Total Deposits			3,863.4

● Branch (9)
● Loan Production Office (9)

** Highlighted counties indicate current lending markets*

Average Balance Sheet and Net Interest Analysis
(Dollars in thousands)

For the Nine Months Ended September 30,

	2017			2016		
	Average Balance	Interest Inc / Exp	Average Yield/Rate (7)	Average Balance	Interest Inc / Exp	Average Yield/Rate (7)
Interest-Earning Assets						
Loans (1)	\$ 4,860,423	\$ 124,096	3.40%	\$ 4,074,951	\$ 103,332	3.38%
Securities available-for-sale	474,358	4,781	1.34%	395,846	3,071	1.03%
Securities held-to-maturity (2)	7,248	178	3.27%	8,844	188	2.83%
Cash and cash equivalents	87,183	652	1.00%	74,987	269	0.48%
Total interest-earning assets	\$ 5,429,212	\$ 129,707	3.19%	\$ 4,554,628	\$ 106,860	3.13%
Noninterest-earning assets (3)	65,839			40,878		
Total assets	\$ 5,495,051			\$ 4,595,506		
Interest-Bearing Liabilities						
Transaction accounts (4)	\$ 212,791	\$ 1,423	0.89%	\$ 107,938	\$ 257	0.32%
Money market demand accounts	1,520,009	9,019	0.79%	1,422,264	7,690	0.72%
Time deposits	1,877,951	17,384	1.23%	1,631,921	15,466	1.26%
Total deposits	3,610,751	27,826	1.03%	3,162,123	23,413	0.99%
FHLB advances	1,257,392	12,497	1.33%	840,870	7,253	1.15%
Senior debt	95,000	4,732	6.64%	95,000	4,732	6.64%
Junior subordinated debentures	61,857	1,218	2.63%	61,857	979	2.11%
Total interest-bearing liabilities	\$ 5,025,000	\$ 46,273	1.23%	\$ 4,159,850	\$ 36,377	1.17%
Noninterest-bearing liabilities	54,106			49,937		
Total stockholders' equity	415,945			385,719		
Total liabilities and stockholders' equity	\$ 5,495,051			\$ 4,595,506		
Net interest spread (5)			1.96%			1.96%
Net interest income/margin (6)		\$ 83,434	2.05%		\$ 70,483	2.06%

Tangible Book Value per share will be diluted for purchasers in the offering.

The following table illustrates this dilution on a per share basis:

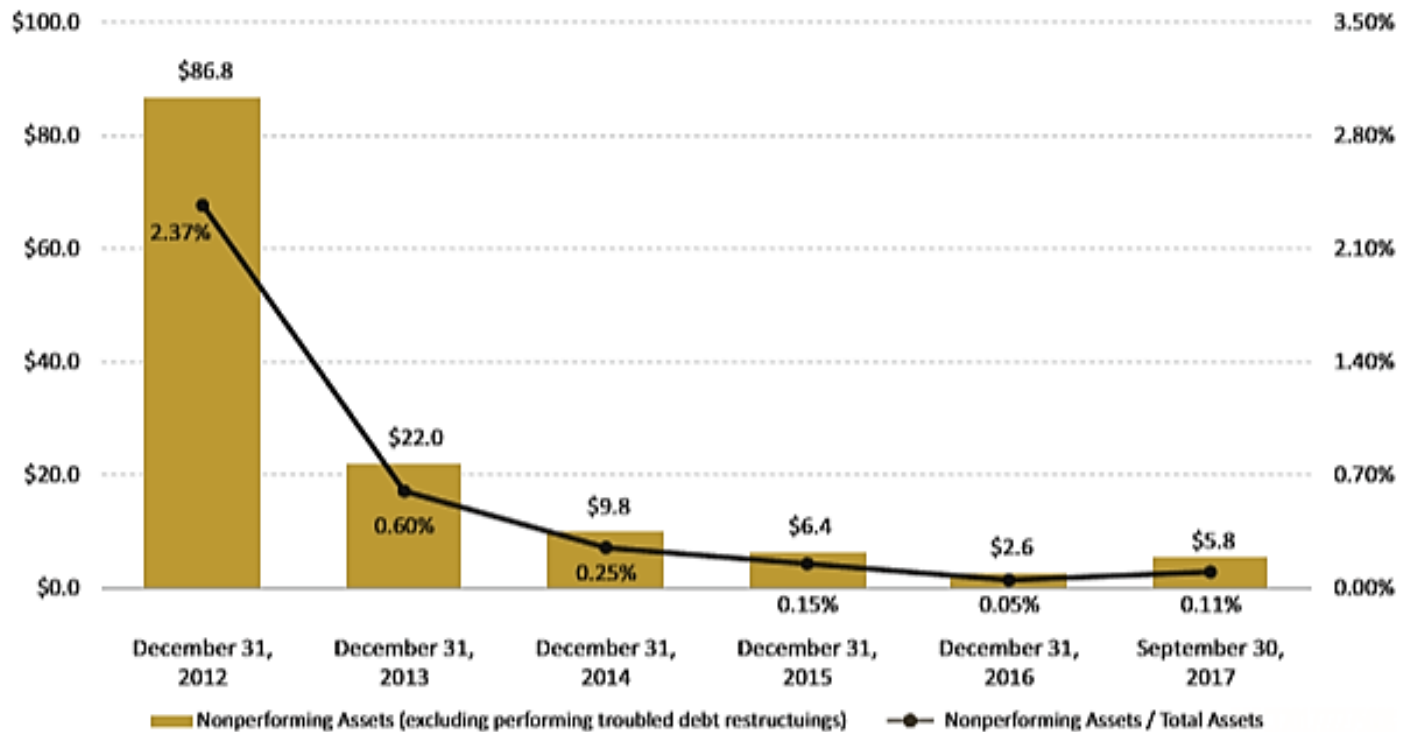
	Per Share
Initial public offering price per share of common stock	\$ 11.50
Net tangible book value per share as of September 30, 2017	\$ 10.14
Decrease in net tangible book value per share of our common stock	\$ 0.66
Pro forma net tangible book value per share of common stock after this offering	\$ 9.49
Dilution per share to new investors in this offering	\$ 2.01

Source: Company Data, SEC Filing

Capital and Asset Quality

Source: Company Data, SEC Filing

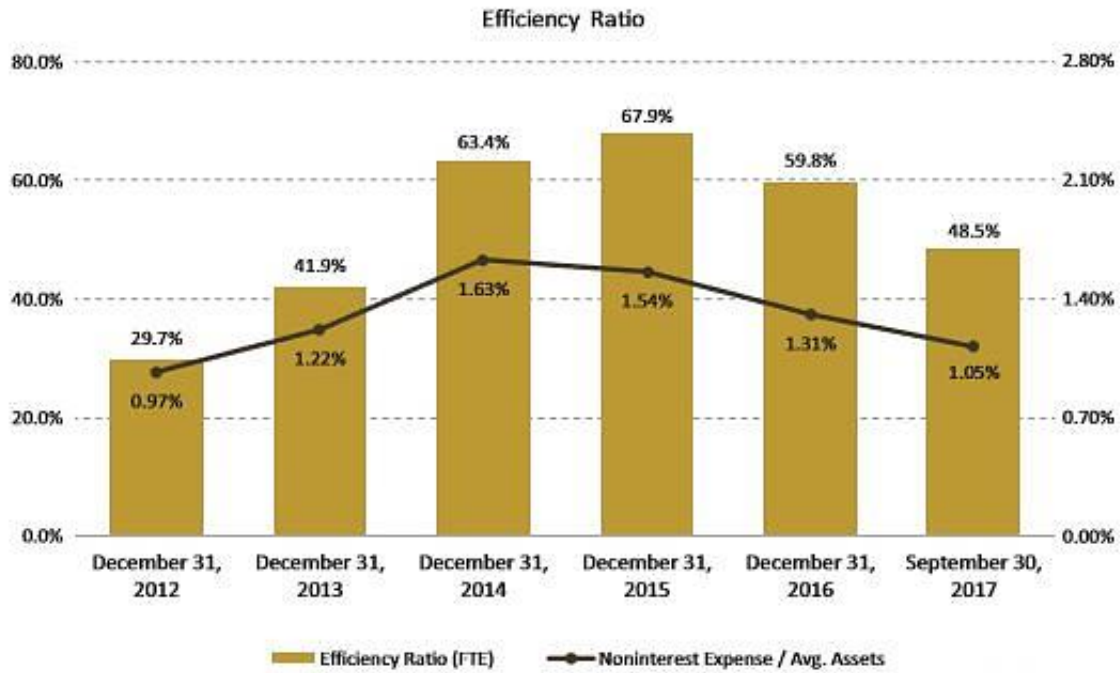
Asset Quality - Nonperforming Assets (Dollars in millions)



<i>(Dollars in thousands, except per share data)</i>	As of or for the nine months ended September 30,			As of or for the years ended December 31,			
	2017 (pro forma)	2017 (actual)	2016	2016 (pro forma)	2016 (actual)	2015	2014
Nonperforming assets to total assets	0.11%	0.11%	0.05%	0.05%	0.05%	0.15%	0.25%
Net (charge-offs) recoveries to average loans (6)	0.01%	0.01%	0.02%	0.01%	0.01%	0.00%	(0.08%)
Allowance for loan losses to loans held-for-investment (2)	0.63%	0.63%	0.86%	0.75%	0.75%	1.18%	1.51%
Capital Ratios							
Leverage capital ratio (9)	10.00%	8.58%	9.57%	9.47%	9.47%	10.22%	10.27%
Common equity tier 1 capital ratio	16.26%	13.68%	15.68%	15.10%	15.10%	16.35%	N/A
Tier 1 risk-based capital ratio	18.21%	15.63%	18.05%	17.33%	17.33%	19.00%	19.18%
Total risk-based capital ratio	19.20%	16.62%	19.30%	18.58%	18.58%	20.26%	20.45%

Efficient Operations offset weak Net Interest Margin

Source: Company Data, SEC Filing



Deal Information

Luther Burbank Corp “LBC” has launched a \$130.5 million IPO expected to price Thursday Dec 7th. KBW is the Lead Left Bookrunner. Sandler O’Neill co-bookrunner. Source: KBW

Issuer: Luther Burbank Corporation

Ticker / Exchange: LBC / NASDAQ

Deal Type: IPO

Pricing Date: Thursday Dec 7th (post close)

Filing Range: \$10.50 – \$12.50

Base Shares Offered: 11,350,000 shares (100% primary)

Overallotment Option: 1,702,500 shares (100% primary)

Base Deal Value: \$130.5 million (midpoint)

Pro Forma Market Cap: \$613.5 Million (pre shoe at midpoint)

Expected Quarterly Dividend: \$0.0575 per share (2.0% annual yield at midpoint)

Use of Proceeds: \$40.0 million non-taxable distribution to shareholders; balance for continued organic growth

Lock-up: 180 days for officers, directors and holders of +95% of the stock

Directed Share Program: 7% (employees, officers, directors, friends & family)

Joint Bookrunners: Keefe, Bruyette & Woods, Sandler O’Neill

Lead Manager: Piper Jaffray Co-Manager: D.A. Davidson

Roadshow Schedule: Wednesday Nov 29th: NYC, Thursday Nov 30th: Boston, Friday Dec 1st: Chicago, Monday Dec 4th: NYC + Lunch, Tuesday Dec 5th: Mid-Atlantic, Wednesday Dec 6th: West Coast
Thursday Dec 7th: Swing + Pricing

New York Group Lunch Date: Monday December 4th, Time: 12:30pm

Location: KBW Office, 787 7th Ave, 4th Floor Executive Board Room, NY, NY 10019

IPO Roadshow Team

Victor S. Trione Chairman and Majority Shareholder

John G. Biggs President & Chief Executive Officer

Laura Tarantino EVP & Chief Financial Officer

John A. Cardamone EVP & Chief Credit Officer

Robert Armstrong, III SVP, Director of Business & Online Banking

Link to SEC Filed Preliminary Prospectus:

<https://www.sec.gov/Archives/edgar/data/1475348/000104746917007304/a2233919zs-1a.htm>

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