Byline Bancorp, Inc.

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First Quarter 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Alberto Paracchini, *President and Chief Executive Officer*

Lindsay Corby, *Chief Financial Officer*

Allyson Pooley, *Financial Profiles*

Tim Hadro, *Chief Credit Officer*

PRESENTATION

Operator

Good morning and welcome to the First Quarter 2018 Byline Bancorp, Inc. Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then 1 on your touchtone phone. To withdraw your question, please press star, then 2. Please note this event is being recorded.

I would now like to turn the conference over to Allyson Pooley, Financial Profiles. Please go ahead.

Allyson Pooley

Thank you, Debbie. Good morning, everyone, and thank you for joining us today for the Byline Bancorp First Quarter 2018 Earnings Call. Joining us from Byline's management team are Alberto Paracchini, [unintelligible] President and Chief Executive Officer, Lindsay Corby, Chief Financial Officer, and Tim Hadro is Byline's Chief Credit Officer — is also here and will participate in the Q&A.

We will be giving a slide presentation as part of our discussion this morning. If you have not done so already, please visit the Events and Presentations page of Byline's Investor Relations website to download a copy of the presentation. Alberto and Lindsay will discuss the first quarter results, and then we'll open up the call for questions.

Before we begin, we'd like to remind you that this conference call contains forward-looking statements with respect to the future performance and financial condition of the Byline Bancorp that involve risks and uncertainties. Various factors could cause actual results to be materially different from any future results expressed or implied by such forward-looking statements. These factors are discussed in the company's SEC filings, which are available on the company's website. The company disclaims any obligation to update any forward-looking statements made during the call. Additionally, management may refer to non-GAAP measures which are intended to supplement, but not substitute for, the most directly comparable GAAP measures. The press release, available on the website, contains the financial and other quantitative information to be discussed today as well as the reconciliation of the GAAP to non-GAAP measures.

And, with that, I'd like to turn the call over to Alberto.

Alberto Paracchini

Thank you, Allyson, and good morning to everyone on the call. As we normally do, I'll start by providing you with the highlights for the quarter and pass the call over to Lindsay for more detail on our financial results.

Now, turning over to Slide 3 on the deck, our first quarter results reflect solid growth in net interest income, with our net interest margin expanding nicely, both including and excluding the effects of accretion income. This was offset by higher credit costs, primarily related to a single isolated commercial relationship that went into non-performing status during the quarter.

Overall, net income for the quarter came in at $6.8 million, or 22 cents per diluted share. This figure includes both approximately $123,000 in merger-related charges and the higher provision expense related to the commercial credit I just mentioned. Pre-tax pre-provision ROA came in at

159 basis points in the quarter, which was a bit lower than Q4 but flat on a year-over-year basis. Loan and lease originations were $87.3 million, which is lower than last quarter but consistent with softer activity levels we typically experience during the early part of the year. Our originated portfolio stood at $1.6 billion at the end of the quarter, which represents an increase of $45 million, or 11½ percent, and was primarily due to strong growth in our C&I and construction portfolios.

Within the C&I portfolio, we had a particularly strong quarter from a sponsor-financed and government-guaranteed lending team. The growth in our originated book was offset by payoffs coming from our acquired portfolio, which declined by $42 million during the quarter. We saw approximately half of the payoffs come from the government-guaranteed portfolio, which reflects both refinancing activity as borrowers take advantage of our lower-rate conventional financing and just simply the outright sale of a business or asset.

Moving on to revenues, spread revenue increased nicely for the quarter, stemming from a 19 basis point increase in our net interest margin, driven by both higher yields and a higher level of earning assets. Deposit funding remained stable overall, and interest bearing funding costs remained in check, rising by 11 basis points for the quarter. Competition for deposits increased from last quarter, and we anticipate that to continue as customers become more sensitive to rate levels and banks manage to their targeted loan-to-deposit ratios. We expect to see deposit betas move higher, depending on the product, along with overall deposit costs consistent with increases in short-term rates.

Non-interest income was down from the prior quarter, primarily due to lower gain on sales loans, reflecting a lower volume of loans sold for the quarter. Loan sale activity and margins fluctuate during the course of the year, with loans sold generally tracking rising origination levels and margins impacted by the mix of loans sold. That said, production levels in our government-guaranteed business were solid during the quarter, showing strong double digit growth on a year-over-year basis. As stated earlier, asset quality for the quarter was impacted by a single commercial loan that we downgraded to non-performing status. We have been closely monitoring the credit and were encouraged by the company's ability to raise capital last fall. Notwithstanding, during the first quarter of 2018, financial performance deteriorated to the point where the business needed to be substantially restructured. Based on these developments, we determined the amount of impairment required, provisioned and charged-off accordingly, in order to write down the value of loan to the level we expect to collect. Due largely to this one credit, we saw an increase in our non-performing loans, charge-offs, and provision expense for the quarter. The remaining increase in NPLs was primarily driven by one government-guaranteed loan.

With respect to branch consolidations, as you may recall, we did a major branch consolidation back in 2015 and 2016, and since that time, we continued to actively evaluate the performance of our branches, given changing consumer behavior and preferences in order to make informed decisions about our footprint. Based on our analysis, we identified six locations and two drive-up facilities that we felt could be consolidated with minimal impact to customer service levels and overall convenience. Consolidation is expected to result in approximately $1.4 million in one-time charges and $2 million in annual cost saves. We anticipate that over time, we will redeploy those savings back into the business in both infrastructure spend and on growth initiatives. We expect the majority of the charges to occur in the second quarter.

Completing the acquisition of First Evanston and ensuring a smooth transition for our customers and colleagues remains a top priority for 2018. To that end, we have received all required regulatory and stockholder approvals and expect the transaction to close by the end of May.

Strategically, this is an important transaction for us, with benefits that we've shared previously, and we're very much looking forward to completing the first part shortly.

With that, I'd like to pass on the call to Lindsay to cover the financials in more detail.

Lindsay Corby
Thanks, Alberto. I will start on Slide 4, with a review of our loan and lease portfolio. Our total loans and leases were $2.3 billion at March 31st, an increase of $2.9 million from the end of the prior quarter. Our originated loan portfolio increased approximately $45 million, with the strongest growth coming in our C&I and construction portfolios. This was partially offset by a $28 million decline in our originated CRE portfolio. On a year-over-year basis, our originated portfolio increased by $303 million, or 23 percent. As Alberto discussed, the overall growth in the loan portfolio was impacted by elevated payoffs. Total payoffs in the quarter were approximately $100 million, up from the $74 million we had last quarter.

Moving on to deposits, on Slide 5, our total deposits increased $81 million from the end of the prior quarter, with most of the increase coming in our money market and time deposits. The increase in money market was primarily due to variability in a public deposit relationship which we rebuilt to fit balances with us at the end of the last quarter. Our overall cost of deposits increased 6 basis points from the prior quarter. This was driven by an 8 basis point increase and the cost of our interest bearing deposits due to higher promotional rates on CDs and an overall increase in core deposit rates.

Moving to Slide 6, I'll discuss our net interest income and the expansion of our margin. Our net interest income increased by $1.5 million, to $33.7 million. The increase was largely driven by higher average loan balances and higher average loan yields. Our net interest margin increased 19 basis points to 4.45 percent, or 18 basis points when you exclude the increase in income. Although we saw an increase in our deposit costs, the impact of re-pricing in our loan portfolio and higher average yields on loans and leases drove the expansion in our margin. Assuming the Fed continues to raise interest rates, we would expect to see a slight continuation of the expansion in loan and lease yields, although, as previously mentioned, we anticipate seeing continued upward pressure on our funding costs.

Turning to Slide 7 and our non-interest income, compared to the prior quarter, our non-interest income decreased by $1.2 million. The decrease was due to a number of factors. We had $1.6 million of a decrease in our net gains on loan sales due to a lower volume of loans sold. The average premium on the loan sales, however, held relatively steady quarter over quarter. We had a decrease of $280,000 in ATM and interchange fees, primarily due to changes in our fee assessments. We also had a decrease of $141,000 in net servicing fees, primarily due to the change in the fair value of the servicing assets as a result of increases in pre-payment fees on government-guaranteed loans. These decreases were partially offset by an increase in other income primarily due to variations and gains on sales of assets from quarter to quarter.

Moving to Slide 8, let's look at our non-interest expense. Our first quarter non-interest expense included $123,000 in merger-related expenses for the First Evanston transaction, down from the $1.3 million expenses from last quarter. Outside of these items, three other significant variations drove our higher expense level during the quarter. Our salaries and employee benefits increased by $1.2 million due to the seasonal increases as a result of higher payroll taxes, benefit costs, merits, and organizational growth. We had $429,000 of a decline in gains on OREO sales and other related expenses due to a decrease in the number of sales during the quarter. And our other non-interest expense increased $387,000, primarily due to an increase of $223,000 in our provision for unfunded commitments.

As Alberto mentioned, we are consolidating eight locations during the second quarter. We recorded approximately $100,000 of the expenses related to these consolidations during the first quarter, and we will record approximately $1.3 million of expenses during the second.

Our efficiency ratio bumped up to 69 percent this quarter, primarily due to the seasonal impact of lower revenue from our gain on sale of SBA loans and higher salaries and benefits expense. Over the longer term, we believe we will continue to see an improvement in our efficiency ratio, particularly after we realize the synergies from the First Evanston transaction.

Turning to Slide 9, we'll take a look at asset quality. Our non-performing loans increased to 1.08 percent of total loans and leases at the end of the first quarter, primarily due to the one commercial credit we discussed earlier. The remaining inflow into NPLs this quarter primarily related to one government-guaranteed loan, where the guaranteed portion is not sold and represents approximately $3.3 million. In general, the workout process for problem loans, problem government-guaranteed loans, where the guaranteed portion has not been sold, can be elongated, which at times will cause the inflows to NPLs to exceed the rate of outflow as the loans are resolved. And while loss rates on the government-guaranteed loans will generally be higher than the rest of our portfolio, they also carry higher yields which makes them attractive on a risk-adjusted basis.

Our net charge-offs were $4.2 million, or 75 basis points of average loans and leases for the quarter. Charge-offs were primarily related to one commercial relationship in the unguaranteed portion of the [inaudible]. Provision expense for the first quarter was $5.1 million. The first quarter provision included allocations of $3.7 million for originated loans and leases, $1 million for acquired non-impaired loans, and $451,000 for acquired impaired loans. The largest component of the allocation for originated loans and leases was the addition to the specific reserve held against the commercial relationship discussed earlier. Our allowance for loan and lease losses to total loans increased to 77 basis points at March 31st. In addition to the traditional allowance as a percent of loan and lease metrics, we also analyzed the allowance in conjunction with the acquisition accounting adjustment impacting the acquired portfolio. At March 31st, the acquisition accounting investment, plus the allowance for loan and lease losses, represented 198 basis points of total loans and leases.

With that, I'd like to pass the call back to Alberto for closing remarks.

Alberto Paracchini
Thank you, Lindsay. In summary, we've had a busy start for the quarter but remain positive on the environment and on our strategy. Pipelines remain solid, and we're looking forward to welcoming new clients and colleagues from the First Evanston transaction. With respect to M&A, we remain constructive on the market and continue to be interested in completing a transaction that fits our criteria.

With that, Operator, I'd like to open the call up for questions.

QUESTIONS AND ANSWERS

Operator

We will now begin the question-and-answer session. As a reminder, to ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2.

The first question comes from Michael Perito with KBW.

Michael Perito
Hey, good morning, everybody.

Alberto Paracchini
Good morning, Mike.

Lindsay Corby
Hi, Mike.

Michael Perito
I have a few questions. I want to start on the expense side. So as — and obviously this is excluding First Evanston, which will now add some to the run rate, but if we think about where you guys are, $31.8 million or so, if we back out the $123,000 merger expenses in the quarter, is it fair, Lindsay, it sounded like in your prepared remarks [unintelligible] maybe like $400,000 or $500,000 of maybe seasonally heavier than normal expenses in that just under $32 million run rate. Is that fair, or is that really encompassing everything that's normalized?

Lindsay Corby
No, I think that's pretty fair. I think that the salaries and benefits was the area that saw some seasonality. I also think you see some seasonality, Mike, in the occupancy line, given the amount of snowfall we've had here in Chicago over the first quarter. So those are the two biggest lines that had some variability in there, and, other than that, I think your assessment is pretty fair.

Michael Perito
Okay. So that brings you down, to $231 and a half million, and then what's the timing? A two-part question. One, what's the timing of the initial cost saves on the branch closures? And then, secondly, what's the timing of perhaps fees reinvested over time? Is this something where $500,000 comes out of the quarterly run rate, and then that slowly flows away over the next one to two years, or is it longer than that? Any help you can give there would be helpful.

Alberto Paracchini
Yeah, I'll start, and I'm sure Lindsay can get much more specific, but I think, Mike, this stuff is usually it's a little hard in the sense that statically, I think you're absolutely right, so obviously you have that charge, and then you have the cost saves, and in the ideal scenario, we can tell you, "Okay, gee, on an annual basis, we're going to utilize X, and maybe the rest will fall into the bottom line."

It's a little hard this year, because obviously with First Evanston going on, we're really, really focused on that, so the question — we may see benefits flow, and then over time, we'll reinvest it, so I'm thinking it more as over time, what we'd like to do with that is be able to flow it back into the business, but we don't have things that immediately we're going to spend on, and so you will see probably a benefit here on the run rate. And then over time, we'd like to utilize that benefit to flow it back into the business. I don't know if you want to add —

Lindsay Corby

Yeah, Mike, it lags a little bit, so as we close them at the end of the quarter, it's not like they're going to start seeing them immediately from July. So there is a little bit of a lag, so I'd say give it about a quarter, and then you'll start seeing it flow through, and then, again, we'll continue to reinvest in our infrastructure and put some of the money back to work, but you'll start seeing some savings come through in the fourth quarter.

Michael Perito
Okay, helpful. Thank you, guys. And then a quick one on the loan side. The pipeline sounds like it's still fairly strong. Was the paydown activity in the first quarter in line with what you were expecting, or should we be thinking that maybe paydowns could perhaps get a little accelerated this year, given what you saw in the first quarter and what you see in the pipeline?

Alberto Paracchini
So they were — I'm trying to think of the same period last year. They were lower than they —

Lindsay Corby
They're right about the same, a little bit higher.

Alberto Paracchini
From last year?

Lindsay Corby
Uh-huh.

Alberto Paracchini
Okay. I think two things, Mike, on that. I think — and we're starting to provide, I think, trying to get you guys to see clarity in terms of where the paydown activity is largely concentrated, and you can see it's coming primarily from the acquired portfolios. Obviously, as those balances come down in dollar terms, paydown activity just simply by math is going to decline as those balances continue to decline. Obviously, we have a portfolio that's growing. At some point, we're going to see higher paydown activity from that portfolio, but I don't know that there's anything in particular at this point of time in terms of visibility that would point to us expecting higher than what we've seen.

If I look to last year, the first two quarters were higher than the rest of the year, but I don't know that I could point to anything right now that would lead us to think that paydowns are going to be — call it materially higher than what we've seen so far.

Michael Perito
Okay. And then, lastly, I just wanted to spend some time on the commercial relationship. I was wondering, first, can you just maybe provide us the overall size of that relationship and what industry it's in?

Alberto Paracchini
Yeah, Mike, one thing — and we'll give you as much detail as we can — one thing that we are sensitive to, it's an active restructuring, and we've written down the credit to a level that reflects the restructuring terms. So we want to be sensitive in terms of names or providing very, very specific information of the credit. What we can share with you, it's, a single loan relationship here in Chicago on our C&I book

In terms of the business segment or the industry, I would categorize it as health and wellness, and this is a situation — it's a loan I think we did early on in 2016, where the company had a growth plan. They were looking to expand the size of their operation, and I think the end result here was the expansion plan was not successful, which necessitated for the company to be restructured. We were encouraged last fall in the sense that the company was able to raise capital, fresh capital, but earlier on this year we and certainly the company concluded that that was not going to be enough, and, therefore, the business itself needed to be restructured.

Tim, I don't know if you want to add to that.

Tim Hadro
I'd only add that a new management team is in place, and we are working constructively with the new management team as we try to implement the revised capital plan and restructure program.

Michael Perito
Okay. And can you give us just the size of the credit or —

Alberto Paracchini
Yeah, the size of the credit, just overall, was $6.7 million.

Michael Perito
And can you remind me, Alberto or Tim, what's the average commercial loan size you've seen in that book, give or take?

Tim Hadro
Well, we look at it two ways. The legacy portfolio consisted of much smaller loans in general. That median loan size was $400,000 to $500,000. In our newly originated portfolio in the business we've done since 2013, it is in the approximately $4 [million] to $6 million range. It varies from line of business, that the SBA loans tend to, the median loan size would be smaller. I'm talking about the conventional commercial loan business.

Alberto Paracchini
Yeah, Mike, and what Tim added there, that's ACE, so that's aggregate credit exposure, not just individual loan size. because you have facilities that have multiple loans through for same borrower.

Michael Perito
Okay, so your average commercial relationship is $4 [million] to $6 million on here [inaudible].

Alberto Paracchini
I'm sorry, Mike, we couldn't hear you very well. Could you repeat?

Michael Perito
I'm sorry. So I said the way that I interpret what you guys just disclosed is the average total commercial relationship in your newly originated commercial book is about $4 [million] to $6 million, but that could include multiple loans, depending on each situation.

Alberto Paracchini
That's correct.

Michel Perito

Okay. Great. Well, I appreciate all the color, guys. Thank you very much.

Alberto Paracchini
Thank you.

Operator
The next question comes from Ebrahim Poonawala from Bank of America Merrill Lynch.

Ebrahim Poonawala
Good morning, guys.

Lindsay Corby
Hi.

Alberto Paracchini
Hi, EB, good morning.

Ebrahim Poonawala
So just a quick question, Alberto, on this loan you mentioned. This was something that was done early 2016. Was the implication there that you've changed how you perceive credits like this today from your underwriting standard, and you may not have made this loan, or I'm just wondering if, to handicap the risk of more one-off instances like this, would love any thoughts around whether your underwriting standards today are a little different with early 2016, or this was such a big anomaly relative to other stuff that you underwrite on the C&I side?

Alberto Paracchini
Yeah, EB I don't know that I would say that our standards were looser back then or different from today. I think our standards have remained consistent. I think this is one of those things where it's a single credit with very much company-specific factors impacting it, so when I look across the board, obviously on C&I, it's company-specific. Every company is unique in some way, so I don't know that I would generalize. To your comment, though, there, EB, that I would generalize that this is not a credit. I think we would have underwritten the credit based on the information and based on the plans and the projections that the company made. And I think in this case, this is just a situation where that growth plan just was not successful and just the business was not able to execute the strategy that they wanted to pursue.

Ebrahim Poonawala
Understood, and, yeah, I just wanted to clarify that in terms of adjusting in terms of the risk of more such one-offs happening. It doesn't sound like that you feel that way right now.

And thanks for the color on the loan payoffs. I think if I go back to my notes, we expected high-single digits to mid-double digit loan growth, low to mid-double digits. Is that still the expectation, or do you expect loan growth to be lower on an annual basis, given what you're seeing on the payoff side?

Lindsay Corby
So, EB, I think we expect it to trend similarly to last year as stronger production comes as we move throughout the year, so I don't think much has changed in terms of that guidance there. But we are obviously focused on the First Evanston transaction, the closing, so that's been a big focus for us, but I do think that the trends that we're seeing are consistent with last year with the stronger part coming in the second half.

Ebrahim Poonawala
Understood, but —

Alberto Paracchini
[Inaudible] —

Ebrahim Poonawala
— but what does that mean in terms of just net loan growth? And I know it could move around, but I'm just trying to understand should we expect 8 to 10 percent, 12 to 14 percent just in terms of conservatively how you would think about net loan growth?

Alberto Paracchini
I think what you said is a reasonable expectation, EB, very high-single digit to low-double digits. I think that's fair.

Ebrahim Poonawala
Understood. And just one last question. If we can talk about in terms of deposit growth environment, we've heard some competition, from the larger banks or foreign banks in the index market, so if you could talk to your ability to organically grow deposits and dovetail that with your outlook for the margin relative to the 445 you reported for the quarter.

Alberto Paracchini
Yeah, so I'll take the first part of the question, and then Lindsay will jump for the second part. I think we're competing effectively, and I feel pretty good about our ability to raise the process. I think as you know, and as we have talked in the past, we had a unique circumstance in that we were coming from having very, very low loan-to-deposit ratios, to now being more within the targeted range that we want to be at. So now we obviously, in order to continue to grow our balance sheet and do it relying on deposits, obviously we need to see deposit growth, consistent deposit growth going forward.

I see no reason why that cannot be the case, and, in fact, what would say is we're competing and we're competing well in the market today. Clearly, obviously, the competitive environment today is very different than it was I would say a year and a half ago. We started seeing the dynamics in terms of the market, changing very much as early as May or June of last year, and certainly that has continued to be, I think, very evident in terms of the amount of marketing, product promotions, et cetera, that we're seeing here in the market from all players, local as well as some of the regional banks that have branches here in Chicago.

So in terms of the margin and the impact that we see there, Lindsey, do you want to —

Lindsay Corby
Sure. I think that with the margin, we are going to see increasing pressure on the cost-of-funds side of the NIM, so I think we've been really happy with what we've seen in terms of the asset yields and the pickup we've been getting with the rising rates. I think we saw some increase this quarter, and I think it's going to continue to put pressure on the NIM going forward here.

Ebrahim Poonawala
And so what would be your expectation if you had to quantify in the margin, assuming that we do get a couple more rate hikes relative to the 445 in 1Q? Is it flat, considering all the factors, or do you expect just 1Q to be the high end of the margin trend [unintelligible] from here?

Lindsay Corby
I think this was a very good margin that we got this quarter. I don't anticipate seeing what we did this quarter, next quarter. I think we had some really nice pickup, but it's hard, EB, on a GAAP NIM basis. Remember, we are closing the Frist Evanston transaction here, and so I don't have complete clarity yet in terms of accretion, so once the purchase accounting marks are completed, then I can give better sense from a GAAP standpoint, but on the core standpoint, I'd say that this last statement is fair.

Ebrahim Poonawala
Understood. Thanks for taking my questions.

Operator
The next question comes from Terry McEvoy with Stephens.

Terry McEvoy
Good morning.

Alberto Paracchini
Good morning, Terry.

Terry McEvoy
I wonder if you could just help me understand the process of getting out of a government-guaranteed NPL, the timing involved with that, and, just optically, as we screen for banks, it impacts your NPLs, but I'm trying to understand the process for those gradually coming down once they're resolved.

Alberto Paracchini
Yeah, so there's two, I would say, two nuances, generally, and we have Tim here, so he can jump in and answer as well, but the vast majority of our loans are loans that we carry the unguaranteed portion, and the guaranteed portion has been sold into the secondary market. So if we have a workout situation, obviously the balance that we're carrying is — let's say 25 percent of the unpaid principal balance from the loan, and the 75 percent has been sold to an investor on the secondary market. So in that case, loan goes bad, the workout happens, the SBA will effectively pay on the guarantee, the investor will get paid, and we basically will wait until the liquidation of the collateral to essentially work out the loan, given that our position on the loan is that of the unguaranteed piece.

When we have loans where the guaranteed portion has not been sold and we own the guaranteed as well as the unguaranteed portion, we have to wait until the liquidation of the collateral and the final resolution with the borrower, and then we can submit the claim to the SBA, which will process the claim and then eventually pay.

Tim Hadro
So we're carrying the balance, even though we have a guaranteed loan, or guaranteed portion of it for the duration of the workout, and then we make, essentially, the claim on the guarantee and get repaid. So then for a period of time, you're showing the elevated NPL as a result of having both the guaranteed and the unguaranteed portion on your NPL.

Terry McEvoy
Great. Thank you.

Tim Hadro
I would just add that the reason we carry a government-guaranteed loan as a non-performing loan is that is the principal that is guaranteed, not the interest, and, therefore, we have to carry it as a non-performing loan.

Terry McEvoy
Okay. Thanks, Tim. And then just shifting gears, could you expand on the changes made last quarter that impacted deposit fee service charges and whether any of those changes as you transition Frist Evanston, will impact any of the pro forma results that were mentioned when you announced the deal?

Alberto Paracchini
Don't think so, Terry. These are just very favorable changes for consumers in terms of the fee changes that we made, but we don't anticipate that that impacts the differences between the way they assess fees and us is not materially different. So we don't anticipate much of a change there.

Terry McEvoy
And just one last question. The areas of reinvestment coming from the branch-related cost savings, would you define them as offensive investments or more on the defensive side just given the competitive landscape?

Alberto Paracchini
I think both. I think I would say generally making sure that, for example, on the branch network, making sure that we're investing in the upkeep of our branches and modernizing branches that need to be refreshed as well as in just capabilities, whether that be feature functionality on existing products or new things that we want to do with a particular customer segment or perhaps even on the marketing front. So I think it's a mix of both, Terry.

Terry McEvoy
Great. Thank you. Have a nice weekend, everyone.

Alberto Paracchini
Thank you very much, Terry.

Operator
The next question is from Nathan Race with Piper Jaffray.

Nathan Race
Hey, everyone, good morning.

Alberto Paracchini
Morning, Nate.

Nathan Race
Just going back to the loan growth discussion from earlier, Alberto, I was just curious to get your updated thoughts on what appetite and pipeline looks like to add additional lenders going forward. Obviously, you guys had an active year last year, and you have the addition of First Evanston coming on here soon, which I imagine would be accretive to your absolute production capabilities, so just curious to get your updated thoughts on where you're seeing opportunities and just the overall level of discussion at this point.

Alberto Paracchini
Yeah, Nate, I think we touched on this last quarter a bit. I think given the fact that we were anticipating the First Evanston transaction, and obviously that we're adding really fantastic talent there, particularly on the commercial banking side, we were not really going to be as active in pursuing, call it hiring, of new lenders. We'd do it much more so on an opportunistic basis. We have seen folks, we have interviewed folks, but we have not — I would say activity for us so far this quarter has been muted. We're always looking for talented folks to join the company, so in terms of your question as it relates to appetite, we always have appetite for talented lenders that have a customer following and are known in the marketplace, but we've been more focused on integrating the folks and making sure that we do a good job integrating customers and the folks, there's a lot of work still to be done in that end. We're just getting to the first step here of being able to legally close, but I hope that gives you some color, but certainly, in the future, as we get past the integration, definitely continue to want to find ways to add talented people to the organization. So as far as the appetite is concerned, that appetite is certainly still there.

Nathan Race
Understood. And then just changing gears a little bit and thinking about the core loan yield expansion in the quarter, obviously you had the December rate hike, which helped, but just curious, Lindsay, if maybe there was a material change in the composition of production this quarter, or if there are perhaps some pre-payment fees included that perhaps helped drive the core loan yield higher this quarter, just due to the sales activity that you guys had.

Lindsay Corby
Yes, that's a great question, Nathan, and, as I alluded in my comments, it was a very good quarter from the loan yields, and there was a little bit of one-time noise in there that I'd say it would probably be muted by about 10 basis points, call it, from the loan yield standpoint, just given some of that one-time noise in there. We did have some acceleration and items going through that weren't normally there.

Nathan Race
Okay.

Alberto Paracchini
But as far the mix, Nate, the mix was pretty consistent, so no big changes in the mix in terms of the lines. I think, as we mentioned earlier, we saw good activity coming in the conventional C&I book from one of our teams and certainly on the government-guaranteed book from that team. So in terms of the other areas, I think those areas are in some ways — maybe that's where the seasonality impacts it a little bit. Rates have backed up here a bit. One thing that we have seen is customers are much more sensitive now to maybe finally realizing that, hey, maybe it's a good opportunity now to lock in long-term financing, so inquiries as it pertains to interest rate swaps and things of that sort, we've seen an uptick in that. But as far as overall the mix of the business, I think it's been pretty consistent.

Nathan Race
Got it. That's helpful. I appreciate that. And if I could just make one last one on [unintelligible], the securities portfolio, obviously you guys were able to get down on an absolute basis through the back half of last year, and obviously you had some seasonality in some of your deposit flows this quarter so just curious, Lindsay, in your expectations in terms of the absolute and relative size of the securities book going forward.

Lindsay Corby
Yeah, Nate, we want to make sure we have enough liquidity, obviously, to run the institution in a safe and sound manner, but I think we have a little bit of room there to continue down a bit more, so we're about 21 percent as the potential total assets. And we'll go dip into this 20 area, high teens, but not much below that.

Alberto Paracchini
I think one thing that has changed in that regard, Nate, and I think it's tied to the question that we got earlier about our ability to, in terms of deposit growth and our ability to grow deposits on a go-forward basis, one thing that has changed is the dynamics are a little different. Eighteen months ago you were raising deposits and essentially — let's say if you had a very, very short-term view of things, it wasn't a really attractive transaction, just because of the carry.

Now that's a bit different with rates being a little higher, so I think I would say we have a willingness, if we have to park money in securities so that we can continue to be consistent in terms of raising deposits in anticipation of growth, I think we certainly will take advantage of that flexibility.

Nathan Race
Understood. I appreciate all the color, guys. Thank you.

Alberto Paracchini
Thank you.

Operator
Again, if you have a question, please press star, then 1.

Our next question comes from Brian Martin of FIG Partners.

Brian Martin
Hey, good morning.

Lindsay Corby
Good morning, Brian.

Alberto Paracchini
Good morning, Brian.

Brian Martin
Hey, maybe, Lindsay, just back to, I think, Nate's question, which was what I was getting at, just the core margin expansion this quarter, it sounds like you're comfortable that, with deposit costs going up, it felt like it was sustainable, but then, which was my real question, but it sounds like maybe that level is not sustainable as there were some one-timers in there, so maybe it's, like you alluded to, it's more than a 10 basis point range if that is not sustainable. And then do you keep a baseline type of level? Is that big picture how to be thinking about it?

Lindsay Corby
It's hard to give you an exact number.

Brian Martin
Right.

Lindsay Corby
I can't really predict in terms of payoffs and recoveries and things that flow in and out of there, perfectly. We always have some noise there, but I would say we were very happy at that level. It was a good level to be at. As I said, going forward with, just assuming we continue to see the Fed raising rates, we do see an uptick in terms of our loan yields, because we do have an asset-sensitive balance sheet. So it's a balancing act, so I think my comments in terms of a flat outlook is pretty consistent, Brian, in terms of modeling. But, again, there is a little bit of noise out there, so you can make your assessment in terms of — I threw out a number, and it ebbs and flows every quarter.

Brian Martin
Yeah, and just one question, Lindsay. The outliers this quarter, if there were some, what are the outliers to think about if we're going to make a decision, better or worse, in a given quarter. The biggest impact that could change on that front is what, that leads to the volatility?

Lindsay Corby
I would say the biggest unknown right now is accretion. So I'd say accretion is something that we don't have visibility into it at this point in time, but —

Brian Martin
Right, but I'm just looking at the core numbers. I'm taking out the accretion. So if we're just talking that 414 number that was up, like I said the core margin was up a fair amount, I'm just trying to understand where the volatility in that number could be. Why it could be down, let's say, the 10 basis points or whatever the number you mentioned earlier, on a range, so —

Alberto Paracchini
Brian, you have, from refinances to payoffs or things of that sort that cause an acceleration in fees that flows through interest income, that fluctuates on a monthly basis, and that's depending on activity, so I think —

Brian Martin
Okay.

Alberto Paracchini
— that primarily is kind of what you'll see.

Brian Martin
Yeah, okay. I got you. All right. And then just the last two things. Alberto, maybe just the SBA's pipeline and where that stands today. Has anything changed recently with that, or how is that tracking today?

Alberto Paracchini
As you see in the deck, if you go to page 7 on the deck, I think the really useful table there at the bottom of that chart, where you can know this is close loan commitments, but I like to look at the year-over-year comparison, and I think that's pretty good. So pipelines there remain good, and I think, in general, obviously the SBA business, as some of the other banks that have really mentioned during their calls. Sometime ago there used to be X number of people that were in the SBA business. Now there seems to be a lot more people, but we like what we have. We're a focused, we're not doing this as an add-on product or as, call it, a tool or a feature that some of our lenders can use. We have a dedicated team of people that manage and run the business on

a soups-to-nuts basis, so we like our chances, and we think that we can compete and compete well there, so remain positive in that regard.

Brian Martin
Okay, perfect. And this is the last two. On the M&A side, any color you can provide on just the level of discussions today? Certainly, we know you're interested if the right opportunity came along, but it seems like there's been dialogue or at least what has actually come to the bottom line has been a little bit less this year than last year. Not that discussions aren't up, but the level of discussions today versus how they've been the last couple quarters, has there been any change on that front?

Alberto Paracchini
I think two things on that front, Brian. I think the factors, as far as M&A, and I think that goes to my comments during the remarks in terms of remaining constructive, I think the factors are definitely present. You have the usual factors in terms of folks that made investments some time ago and are looking potentially to exit those investments, and then the more traditional factors involving succession planning and institutions that are getting to the point where — looking for where growth perhaps is a little bit more challenging on a go-forward basis. So those factors remain, and I think are very much still present.

As far as discussions and activity, I would tell you, I haven't seen discussions and call it chatter, I think, remains alive and well. Discussions certainly remain, and sometimes these things take longer, sometimes they're faster. I can tell you from experience, in First Evanston it was a long, long process. We began talking really to, and had a relationship with, the team there for a long, long time. And over time, we had discussions, we talked, and then finally we were able to reach an agreement last year, but to your question about activity levels and discussions, et cetera, I think those remain, and it's just a matter of continuing to proceed along in those processes.

Brian Martin
Okay. No, I appreciate the color there. And just the last thing too, there was a lot of talk about the loan growth and the payoffs this quarter. When you think about your outlook for the year, Alberto, is it fair to say that your outlook includes some of these payoffs in the numbers? Whatever the number, if it's 8 to 10 or 10 to 12, whatever your number is as far as the loan growth outlook, when you were talking about your expectations, you're assuming that there's going to be some level of payoffs in these numbers. Is how to think about it?

Alberto Paracchini
Yeah.

Brian Martin
It's not like if it's a little bit more, maybe the growth is just a touch less, but is there some element in your forecast regardless?

Alberto Paracchini
Of course.

Brian Martin
Yes. Okay. All right. I appreciate the color, guys. Thanks.

Alberto Paracchini
You bet, Brian.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Byline's management for any closing remarks.

CONCLUSION

Alberto Paracchini
Great. Thank you. Operator, and thanks for everyone for participating in the call today. Thank you for your interest in Byline, and we look forward to speaking to you again next quarter. Thank you.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.