Byline Bancorp, Inc.

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Q3 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Alberto Paracchini – *President and Chief Executive Officer*

Lindsay Corby **–** *Chief Financial Officer*

Allyson Pooley – *Investor Relations, Financial Profiles*

PRESENTATION

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

And with that, I would like to turn the conference over to Ms. Allyson Pooley with Financial Profiles. Please go ahead.

Allyson Pooley
Thank you Brian and good morning to everyone and thank you for joining us today for the Byline Bancorp third quarter of 2018 earnings call. We will be using a slide presentation as part of our discussion this morning. Please visit the Events and Presentations page of Byline's Investor Relations website for access to the presentation. Before we begin, I would like to remind you that this conference call contains forward-looking statements with respect to the future performance and financial condition of Byline Bancorp that involves risks and uncertainties. Various factors could cause actual results to be materially different from 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 website. The Company disclaims any obligation to update any forward-looking statements made during the call. 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, also 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 will turn the call over to Alberto.

Alberto Paracchini
Thank you, Allyson. Good morning and thank you for participating in our third quarter earnings call. Joining me today are Lindsay Corby, our CFO; and Tim Hadro, our Chief Credit Officer. As is our practice, I'll begin by providing you with an overview of our performance and key highlights for the quarter then pass the call over to Lindsay, who will cover our financial results in more detail. Following that, I will discuss our acquisition of Oak Park River Forest Bancshares, and then we'll open the call for questions.

I would like to start the call by thanking our customers for their business and our employees for their hard work. We were certainly busy this quarter and our results would not be possible without the effort put forth by our employees, covering those who originate business and take care of customers on a daily basis to those working hard on our integration project. We're pleased to report that our performance for the third quarter was strong and reflects the continued execution of our strategy, encompassing organic growth, improvements in our operating performance, and executing on M&A transactions that are consistent with our criteria.

Net income came in at $14.5 million or $0.39 per diluted share, which included certain merger-related and core system conversion expenses, impacting our earnings by about $0.01 this quarter. Our earnings for the quarter represent the highest level of earnings since becoming a public company last year and show the progress we've made toward reaching our profitability targets. On an adjusted basis, pre-tax pre-provision ROA was 2.17% in the quarter, an increase from 191 basis points last quarter and 159 basis points from a year ago. ROA came in at 120 basis points and ROTCE was 13.81%. These results reflect the positive impact of the First Evanston transaction despite not having yet realized all of the projected benefits from that opportunity.

The quarter saw a strong increase in total revenue, which came in at $63.7 million, which was 19% higher than last quarter. Growth was largely the result of the full quarter contribution from First Evanston as well as strong organic growth in loan volumes. These factors pushed our net interest income up 34.7% from the prior quarter. This helped offset a decline in non-interest income due to lower gains on sales of government-guaranteed loans. We had a very good quarter with loan originations coming in at $218 million, up 12% from the prior quarter. More importantly, we saw net loan growth of $103.4 million, up 3.1% from the linked quarter and 12.3% annualized. Our strong production levels were truly a team effort and represent the depth of our diversified lending businesses. Our expanded commercial banking teams, CRE, SBA, and Sponsor, all contributed nicely during the quarter. The credit environment remains competitive. Price competition for high-quality credits is intense, and we're seeing non-bank lenders competing aggressively in both price and structure, particularly in our Sponsor and CRE segments. Overall, our pipelines remain healthy, but we expect the credit environment to be choppy as a result of unexpected payoff activity and sell activity on our part when we don't feel we're being compensated for taking credit risk.

Moving over to liabilities. Deposits grew by $96 million for the quarter. We're seeing steady results from our campaigns, and more importantly, our business development efforts with new relationships. Our deposits are solid, with DDAs representing 31.4% of total balances and with core deposits at greater than 82%.

Moving over to expenses, we continue to make steady progress in gaining operating leverage. Revenue for the quarter was up 19% while expenses were up just about 7%. Our adjusted efficiency ratio decreased to 55.8% from 63.5% despite a relatively light quarter of government-guaranteed loan sales. On a year-over-year basis, our efficiency ratio improved by 13%. Lastly, asset quality remained relatively stable with NPLs increasing and OREO decreasing thereby keeping NPAs relatively flat. Charge-offs for the quarter declined, coming in at 25 basis points.

I will come back on in a bit to talk about our recent acquisition regarding Oak Park River Forest Bancshares, but first let me pass the call over to Lindsay who will give you more detail on our third quarter results.

Lindsay Corby
Thank you, Alberto. Good morning, everyone. I will start on slide 4 with a review of our loan and lease portfolio. Our total loans and leases held for investment were $3.46 billion at September 30th, a net increase of $107 million from the end of the prior quarter. Our originated loan portfolio increased approximately $261 million net. This increase was offset by a decline of $154 million in our acquired portfolio. As Alberto mentioned, our payoffs were higher in the third quarter, with approximately $98 million in payoffs compared to $53 million in the prior quarter.

Moving on to deposits. On slide 5, our total deposits increased $96 million to $3.74 billion at September 30th. We saw the strongest growth in our interest-bearing checking, money market, and time deposits. This was offset by an $18 million decline in non-interest-bearing demand deposits which was attributed to our outflows from commercial customers whose balances fluctuated from quarter to quarter. Quarter-to-date average and quarter-end non-interest bearing deposits were steady at $1.2 billion.

Moving to Slide 6, I'll discuss our net interest income and margins. Our net interest income increased by $13.5 million due to the full-quarter impact of First Evanston as well as the organic loan growth generated during the quarter. Yields on earning assets expanded 40 basis points from 509 basis points to 549 basis points, which was moderately muted by a 12 basis-point increase in our cost of deposits, driving the 30 basis-point increase in our net interest margin from 4.43% to 4.73%. The expansion in the yields on earning assets and conversely the increase in the cost of deposits was primarily due to the full-quarter impact of First Evanston. Organic loan growth generated in the quarter also contributed to the expanded earning assets yield. We saw a slight increase in the average yield on time deposits and money market deposits driven by continued promotional campaigns designed to fund the organic loan growth. Excluding accretion income, our net interest margin declined 3 basis points to 3.99.

Moving to Slide 7. Compared to the prior quarter, our noninterest income decreased by $3.4 million. This was primarily due to a $4.7 million decrease in our net gains on government-guaranteed loan sales. This was the result of lower volume of loans sold and the timing of fully funding the loans to sell them into the secondary markets. In addition, the higher interest rate environment is causing increased prepayment speeds that have put downward pressure on premium across the industry. These increased prepayment speeds and the lower premiums in the markets also resulted in a $2.4 million charge during the quarter for the revaluation of our servicing asset, which reduced out net servicing fees this quarter. Most of our other line items increased due to the full quarter impact of the First Evanston transaction, with wealth management and trust business now becoming a more meaningful contributor with $674,000 of revenue in the quarter.

Moving to Slide 8, let's look at our noninterest expense. As you will recall, last quarter our expenses included $10 million related to the significant items from the core conversion and other merger-related expenses. Excluding these significant items, our noninterest expense increased 7%, primarily due to the full-quarter impact of First Evanston. This impact was most pronounced in our salary and benefits line as well as our intangible asset amortization expense. Our core conversion is still planned for the first part of 2019 at which point we will see more of the cost savings projected for the First Evanston transaction in the second half of the year. That being said, we are already seeing the beneficial impacts of the acquisition on our adjusted efficiency ratio, which improved to 55.79% in the third quarter.

Turning to Slide 9, we'll take a look at asset quality. Our nonperforming assets to total assets ratio was stable compared to the end of the prior quarter as an increase in our nonperforming loans was largely offset by a decline in OREO as the result of the sale of properties. Consistent with the trends we have been seeing over this past few quarters, the increase in NPLs is due to inflow from the unguaranteed portion of our government-guaranteed funding business. Our nonperforming loans increased to 87 basis points of total loans at the end of the third quarter or 66 basis points if you exclude the government-guaranteed nonperforming assets. At September 30th, government-guaranteed loans accounted for $7.3 million of our NPLs. Our net charge-offs were $2.1 million or 25 basis points of average loans and leases for the quarter. Charge-offs were primarily related to the unguaranteed portion of SBA loans. Provision expense for the third quarter was $5.8 million. The third quarter provision included allocations of $3.6 million for our originated loans and leases and $2 million for acquired non-impaired loans. Our provision expense this quarter was driven by growth in the portfolio as well as the additional specific impairment and the unguaranteed portion of the government–guaranteed portfolio. This provision increased our allowance for loan and lease losses to $23.4 million. Our coverage of NPLs, excluding government-guaranteed portions, increased to 102% and our allowance for loan and lease losses to total loans increased to 68 basis points at September 30th. In addition to the traditional allowance of the percentage of loan and lease metric, we also analyze the allowance in conjunction with the acquisition accounting adjustments impacting our acquired portfolio. At September 30th, the acquisition accounting adjustments plus the allowance for loan and lease losses represented 188 basis points of total loans and leases.

With that, I would like to pass the call back to Alberto.

Alberto Paracchini
Thank you, Lindsay. We are very excited about the news we shared with you last week regarding the signing of a definitive agreement with Community Bank of Oak Park River Forest Bancshares. Moving to slide 11. Community Bank has $325 million in assets and serves two attractive markets west of the City of Chicago in Oak Park and River Forest. It is the only community bank operating in these markets, which has helped it to build an attractive customer base with a high-quality core deposit franchise. We've not had a presence in Oak Park and River Forest with this level of scale, and we're very excited to enter these markets and partner with the Community Bank team, which we've known and have had a relationship with for a long time. We believe the transaction is an attractive one for our shareholders. We're adding $293 million in high-quality deposits with 29% in DDAs in a market that is complementary to our footprint, we get to partner with a terrific group of people, and are able to execute it at very attractive financial terms.

Moving on to slide 12. Here you have an overview of the bank and how it fits well within the rest of the Byline franchise. If we move over to slide 13, you have additional detail on their deposit base and the performance of those deposits since the start of the current rate cycle. And on slide 14, you have a snapshot of the pro forma impact for their loans and deposits when you combine them with ours.

Wrapping up, on slide 15 the total consideration at the date of announcement was $42 million, which represents 1.6 times Community Bank's tangible common equity and more importantly, a 6.1% core deposit premium. We expect the cost saves to be approximately 40% of Community Bank's expense base with 50% of the cost savings phased in during the first year and 100% in year two. The closing of the transaction is anticipated for the second quarter of 2019.

In summary, we're very excited to continue to execute our M&A strategy and further leverage the capital raise at our IPO. Given the size, location, and quality of the bank we're acquiring, we view this as a low-risk transaction, but it's a bank that fits very well with our culture and one that can add meaningful value to our franchise. We look forward to welcoming the Community Bank customers, colleagues, and new shareholders to Byline.

With that, operator, we can open the call for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. If you would like to ask a question, you may press star then one on your touchtone phone. We do ask if you are using a speakerphone that you do pick up the handset before pressing the keys. To withdraw the question, please press star then two. Once again, if you would like to ask a question today please press star then one. And today's first question will be from Ebrahim Poonawala with Bank of America Merrill Lynch. Please go ahead.

Ebrahim Poonawala
Good morning, guys.

Alberto Paracchini
Good morning, Ebie.

Lindsay Corby
Hey Ebie.

Ebrahim Poonawala
So I guess just first if we could talk about, Lindsay, outlook on the margin, both from a core basis, if you can talk to where deposit costs are relative to the promotions you guys are running and give us some visibility around how to think about accretion income going forward?

Lindsay Corby
Sure, so I'll start, Ebie, in regards to the NIM and then I'll follow-up with deposit costs and then end here with accretion. But on core NIM, I really think it's going to be pretty consistent to what you're seeing. Last quarter we thought it would be about flat and we were pretty close, we were down 3 basis points. Our guidance there is pretty consistent, Ebie, with what we've been stating. In terms of the deposit costs, what we've been seeing, obviously, you saw a 12 basis-point movement in our NIM this quarter and we are seeing the bulk of the pressure on our NIM coming from the CDs, and we are seeing competition out in the market regarding the CD promotions that everybody is advertising and the competition remains fierce within the Chicago market. In terms of accretion and our outlook there, I will say that I do believe this quarter was high. We did see some nice acceleration mainly coming from the First Evanston transaction. This was the first quarter that you really saw the full impact on our margin with that $8 million number. I think that's the peak, and it will be coming down from there. In terms of scheduled accretion is always one thing versus what actually ends up happening, as much as I'd love to say that I'm going to be precise here, Ebie, it tends to move. In terms of scheduled accretion, I'd say for next quarter it'll come down say around somewhere in the $5 million range and then keep stair stepping from there. But again, it moves, Ebie, and it's never perfect, because if we have payoffs or some noise in there it can tend to fluctuate.

Ebrahim Poonawala
Okay, that was helpful. Thank you. And just switching to loan growth. You mentioned, some data scheme of the balance sheet. Can you talk about just the environment either on the C&I and CRE side from one. You've mentioned some of the non-bank competitors, when you think about credit structures, pricing, and within that environment your ability to grow loan balances organically. Like what's the growth rate we should think about?

Alberto Paracchini
Sure. Ebie, I would say our pipelines are healthy. It's just a function of credit, demand for credit, I would say, is generally good but supply is probably even slightly better in the sense that there's active competition for high-quality credits. On the C&I side what we're seeing primarily from other banks is just competition on price. We haven't really seen, there's always something call it around the edges as far as structure is concerned, but bank competition has been pretty disciplined on structure, less disciplined, I would say, or more willing to compete, I would say, on the basis of price.

To my comments earlier regarding non-bank competition, we are seeing more and more, particularly in our Sponsor business and our CRE business, non-bank lenders becoming, coming in and really competing on the basis of terms, and largely, not just covenants but advance rates. Much more aggressive advance rate, particularly on the CRE side and just leverage levels on our Sponsor business. To your question as to how does that impact our outlook going forward, we're going to be selective. We're definitely not going to chase and compete on the basis of trying to do deals that don't make sense or we consider them irrational, from a structure standpoint. We're very willing to pass or let that business go. What I would say there, Ebie, is, I would expect to see some of that and what Lindsay was saying regarding the choppiness of payoff activity over the next quarter and probably heading into 2019. I would say generally speaking mid-single digit, 5% to 8%, 6% to 8% or so in terms of loan growth seems appropriate.

Ebrahim Poonawala
Good. And if I can ask one final, obviously we have announced deals. As you think about, it feels like deposit pricing pressure is picking up for all banks. Is that changing for a sense of urgency when you talk to potential sellers around your ability to do deals and should we expect that the possibility of you doing multiple deals at the same time, if you could talk to that?

Alberto Paracchini
Well, you bring up a good point, and if you look at the example of Community Bank and the transaction that we just announced, obviously a high-quality deposit base. We feel as good about the quality of that franchise in terms of their deposits as we did with First Evanston, first and foremost, that's, the first thing we would look at is, how does that deposit base look like, what's the composition, what's the customer base like, and how does that fit within our franchise? To your second question or to the second point to your question, I think it's fair. Our view is you can never have enough deposits, and certainly we want to have strategies in place to grow our deposits organically. Lindsay talked about the campaigns, Lindsay talked about the other, the competition in the market and we'll certainly continue to play and continue to do business in the environment. That said, the second part of that organic strategy is really more the relationship-based approach and trying to originate high-quality deposits from typically our commercial customers and smaller, small business customers and that continues. With all that said, we obviously compare the cost of raising deposits and doing all of that against the cost of being able to acquire deposits from, as part of an M&A transaction and I would say, Ebie, that's certainly a viable strategy and the transaction that you just saw was probably, is probably representative of that.

Ebrahim Poonawala
Understood. All right. I think that was very helpful. Thank you very much for taking my questions.

Lindsay Corby
Thanks, Ebie.

Operator
The next question will be from Nathan Race with Piper Jaffray. Please go ahead.

Nathan Race
Hey, everyone. Good morning.

Lindsay Corby
Good morning.

Alberto Paracchini

Hi, good morning Nate.

Nathan Race
Lindsay, I just want to start on expenses. Obviously you've got the full quarter impact from some of the branch consolidations that you guys did earlier in the year and the overall number came down relative to what we were thinking last quarter and I understand, it's just tough to predict the back half run ranges given everything that you had going on last quarter and obviously the lower OREO expenses, or the gain in the quarter helped as well. Just curious how you're thinking about the operating expense run rate into 4Q and 1Q as well?

Lindsay Corby
Thanks, Nate. Yeah, that's a great question. In terms of our run rate, I think it was relatively clean for a run rate standpoint. You pointed out the OREO and I would say that's one area that was not a true run rate. We did have some OREO sales; we sold about six properties during the quarter, and that did result in a net gain, you see that coming through. Once you normalize that, it's a pretty fair run rate, in terms of the go forward. We will have some expenses flowing through in relation to the acquisition that we just announced and we will have some conversion related expenses coming through there as well, but on a core run rate that's a pretty fair estimate there.

Nathan Race
Okay, great. And then as we think about the provision from here, can you just help us understand the $2 million that you had for the acquired non-impaired loans in the quarter, is that just a function of the acquired loans renewing and you guys moving those loans into your originated bucket? I'm just trying to think about how we should, expect…

Lindsay Corby
You're spot on. Yep. That's exactly what's going on. As those loans come out they do go into the originated. If they're refinancing, that's where they're going.

Nathan Race
Okay, so fair to expect provision to remain somewhere between $5 million and $6 million going forward?

Lindsay Corby
It's a function of loan growth, at the end of the day. If we're seeing the loan growth like we did, yes, I'd say that would probably, would be a fair estimate. But again, provision is a function of loan growth and credit quality at the end of the day.

Nathan Race
Okay, got it. And then Alberto, I'm thinking about the transaction in Evanston. I'm just curious if you can give us an update in terms of customer retention, both on the commercial and retail side and just how things are tracking in that geography?

Alberto Paracchini
Sure. So far, very good, Nate, on that end, it's been very good. The reception has been very good. We remain, very active and very involved. This goes without saying, it certainly helps when your team, your customer-facing team hasn't changed, lenders and your bankers are focused on serving customers and doing business as opposed to, worrying about converting systems with their customers and all of that. In that regard I think that has been very, very positive.

Nathan Race

Okay, got it. And then if I could just sneak one last one in on fees. Wealth management brokerage, that was a new business for you guys to some extent with the Evanston transaction, so just curious, Alberto, if you have any updated thoughts on just how you're thinking about that business across the broader franchise?

Alberto Paracchini
Well, good question, Nate and it was a capability that we certainly did not have. It was something that if you want to be in, and there's obviously opportunity, particularly when you have a commercial banking business in terms of being able to provide wealth management services to the entrepreneurs and business owners that you do business with on the commercial side, and that certainly was a hole in our toolkit so to speak, that now we have the capability and we have an experienced team there, that's something that would be our intent that we want to capitalize on that and grow that, over time.

Nathan Race
Okay, great. I appreciate you taking the questions. I'll step back. Thank you.

Alberto Paracchini
Thank you.

Operator
And the next question will be from Andrew Liesch with Sandler O'Neill. Please go ahead.

Andrew Liesch
Hi everyone.

Alberto Paracchini
Hi, Andrew.

Lindsay Corby
Hi Andrew.

Andrew Liesch
Just looking at the expense base further out. I mean, when you get the convert over to First Evanston's system early next year, is there a chance for more cost savings ahead?

Lindsay Corby
Some more cost savings ahead of?

Andrew Liesch
I mean, you've already reduced the expense base pretty nicely here this quarter and I appreciate the comment that this is the run rate, but once you convert to their system are there more cost saves that you could generate before, the next deals come on?

Lindsay Corby
Well we're pretty consistent in terms of what we've already disclosed with cost savings. We're always looking for opportunities, Andrew, don't get me wrong. We have a good eye on expenses and we're doing our best to manage those expenses. Like I said, you will have conversion expenses and some merger-related expenses related to training coming through there it's going to be a continued focus for us and we'll continue to work through it but right now what we've previously disclosed is still fair and consistent.

Alberto Paracchini
And if I could add to what Lindsay just said, Andrew, I still think that our guidance regarding our longer-term objectives in terms of where we want to operate the bank from an efficiency standpoint and what our targets are, we remain consistent in that. Some of the savings we talked about, we have discussed in previous calls. For example, when we consolidated some branches we talked about the fact that we wanted to utilize that to reinvest back into the business and that's still our intent. Just keep that in mind in the sense that, our longer-term objectives in terms, of profitability and where we want to run the bank, those have not changed.

Lindsay Corby
Yeah. And just remember in terms of 2019, you do have the seasonality, our largest expense is salaries and benefits so make sure from a tax standpoint you're factoring that in, in terms of how you're looking at things, because you could have an increase in taxes in the beginning of the year.

Andrew Liesch
Okay. And then just on the gain on sale business. I know it can be quite volatile, but where does this business sit this quarter? What have originations been like? What are you seeing as far as premiums so far?

Lindsay Corby
In terms of the gain on sale, it was lower, obviously, and it was just due to timing in our view. The pipeline, as Alberto mentioned, is strong and we do believe that going into the fourth quarter we remain in a good position to have that gain on sale normalize out to what we've seen historically. And then in terms of premiums, I did say in my comments we are seeing some pressure on the premiums, so it's consistent industry-wide and those have come in, I'd say, about 100 basis points or so.

Andrew Liesch
Gotcha. Thank you. I will step back.

Alberto Paracchini
Great.

Operator
The next question will be from Michael Perito of KBW. Please go ahead.

Michael Perito
Hey, good morning.

Alberto Paracchini
Good morning, Mike.

Michael Perito
A few more questions, I mean, most of mine have been asked but a couple of high-level questions here, Alberto. As we look at the quarter, the results were pretty solid but obviously some of the, the accretable yield mainly of 74 basis points, that will come down, but as we look out to '19 and '20, the Oak Park deal will give you a little bit of a refill there, but presumably that number will continue to come down, and I look at the return profile in the third quarter and it was solid, and I'm just curious how you guys are thinking about it over there as to how to maintain that earnings profile while you have to battle the headwind of that accretable yield coming down over the next

couple years?

Alberto Paracchini
Yeah, and I think two things. We're seeing with First Evanston, which was a little different than call it the accretion experience that we have had with, call it, the legacy book of accretable yield, so to speak, in that what you saw was, , there was a question earlier from Nate in the sense that to the degree that we're moving assets that were acquired but not impaired and those assets are refinancing and we're doing more business with those customers, and those assets are moving, clearly we're recognizing accretable yield quicker in that regard than we were will call it our legacy book,. That said, our legacy book is still there, there will still be some degree of accretion, that will be, call it more slower is our expectation. This thing is not, it looks like it's going to go away very, very quickly. I think as Lindsay said in her comments, some of it will go relatively quickly when it means we're moving assets from acquired to more of our, standard cost accounting book. But there will still be some level of accretion there that will be more slower. And as we've said on previous calls, that probably will be there until we implement CECL and, out in the 2020 time frame. Just keep that in mind.

But your point is well taken and this goes back to one of the questions that Andrew was asking regarding expenses and how do we want to run the Company and I would just reiterate what our guidance has been in terms of where we want to run the Company from an efficiency standpoint and what our longer term profitability targets are, we're still very committed and focused on those targets but, just keep that in mind because to the degree that we have declines in revenue coming from lower accretion and obviously there will be some offset of that in terms of the growth in the book and so forth, but we're very, very focused on maintaining that cost-to-revenue ratio at a level that's right at or below the targets that we've set forth. That's how I would give you guidance on that, Mike.

Michael Perito
Helpful, Alberto. Thanks. And in that light, as I think about capital deployment as I'm sure you guys are starting to budget for next year and beyond and, capital levels are still very healthy. Obviously, you guys have demonstrated that there's M&A opportunities to take advantage of, but the reality is, at the size range and with your currency, they're not totally levering your excess capital and with the new growth outlook in the more 6% to 8% range, it seems like that level of growth too will be challenging in terms of levering capital. Are other deployment strategies starting to be thrown around at the board level at this point? Obviously, the bank group as a whole has had a tough month here. I mean, your share of purchases come in, I know you guys are still fairly recent from the IPO, but as those levels continue to build and the ability to lever it through M&A and organic growth alone gets more challenging, are conversations starting to broaden around that subject?

Alberto Paracchini
At the Board level, it's a conversation that is not, I would say, cyclical or seasonal. It's a conversation that we have that's predicated on the basis of where we are, what we think the outlook are, what we think the opportunities are going to be, and the likelihood of us being able to execute those opportunities. I'm very, very confident that with respect to that, Mike, those are things that the Board takes very seriously and I have, as an outlook evolves, those are things that obviously get attention and get discussed regularly.

Michael Perito
But more specifically, do you guys anticipate any near term changes or thoughts around that? I understand there's probably a limit to what you can say, but just trying to get a sense, because

I'm trying to factor in everything we've discussed today, it just seems like capital levels are actually probably going to build and I know there's M&A out there, but just trying to get a sense if this is something that could be discussed and thought of next year or do you still feel there's enough organic and M&A out there where it's a longer term than that?

Alberto Paracchini
Yeah, Mike, unfortunately I can't comment on, and give you that type of guidance, but I will say that capital management and managing our capital is something that the Board takes, our Board takes that responsibility very seriously and those considerations, this is not a discussion that again, it's not something we put off and on and it comes back and goes on; it's an ongoing conversation based on the opportunity set and the growth that we anticipate in the business and I'd just leave it at that.

Michael Perito
Okay, understood. Thank you. And then just one last quick question for Lindsay, just as we look out to next year, any initial thoughts here with your tax rate? It's moved around a little bit this year. I'm just curious if you can provide us any guidance on what you're thinking that could look like in 2019?

Lindsay Corby
Yeah, nothing's changed right now, Mike. We gave the guidance originally at the 27% to 29%, and we still feel comfortable in that range right now.

Michael Perito
Okay. Great. Thank you guys for taking my questions. Appreciate it.

Alberto Paracchini
No problem. Thank you.

Operator
Once again, if you would like to ask a question today, please press star then one. And the next question will be from Brian Martin with FIG Partners. Please go ahead.

Brian Martin
Hey, good morning.

Lindsay Corby
Good morning, Brian.

Alberto Paracchini
Good morning, Brian.

Brian Martin
Hey, just one question going back to the expenses, Lindsay, on the previous question, just the percentage of expense savings already realized on First Evanston, because the conversion's not done yet, can you give us an idea of where you're at as far as what you've realized thus far?

Lindsay Corby
Correct. Yeah, I think we're, it's hard to give you an exact number, but when you look at the run rate we think we're about half way, when you look at the run rate. It's not perfect science and it's hard to really quantify because there's, their numbers are now completely integrated into ours,

it's hard to give you an exact percentage, Brian, but about half is fair.

Brian Martin
Okay. And the full savings should be seen in the second quarter numbers, is that fair to think about with the conversion first quarter?

Lindsay Corby
Hey Brian, can you repeat the question? We, sorry, there's some construction going on below us.

Brian Martin
Yeah, no problem. I was just going to say, does the full run rate of the savings, it should be seen in the second quarter of next year?

Lindsay Corby
I would say the latter half, Brian. I apologize for the background noise. In the latter half of the year, starting third and fourth quarter.

Brian Martin
Okay. Perfect. I appreciate it. The other thing is the accretion, Lindsay. The breakdown between First Evanston and legacy, can you give any parameters around that, you know, where that was? Was the legacy pretty consistent with where it had been running and the differential is First Evanston, or any thought on how to think about that?

Lindsay Corby
So the legacy, Brian, if you look back at Q1, it was about $2 million in terms of net accretion and in legacy it's pretty consistent and you saw that of our first year being public that that legacy piece continued to plod along and slowly come down over time, but is more consistent. But I'd say if you use that as your bogey and back into what First Evanston is, that's a pretty fair way to do it.

Brian Martin
Okay. All right. And then just going back to the capital question, with the Oak Park Deal announced, can you guys just characterize, the opportunities in the market today just, has there been a pickup in deals that's being shown out there, or is it pretty much the same as it's been? I know you guys are interested and would look at doing other deals opportunistically, but just the pace of opportunities in the market today, has there been any change on what you guys are seeing or?

Alberto Paracchini
I'll answer it this way, Brian. Up until the Oak Park transaction, conversations and talk regarding M&A had been pretty consistent, frankly. More recently, and this I would say is probably nothing more than due to the fact that there is the recency of a transaction and an announcement, but usually you do see an uptick in calls, when you announce something because whether it be bankers or whether it be people reaching out and inquiring to see if you have an interest in a particular opportunity or talk about a particular opportunity, but I would not characterize that as unusual, and I would expect that to subside here as time passes. That said, the environment remains, consistent in terms of activity and discussions. I would say about the same.

Brian Martin
Okay. And I guess it seems, Alberto, maybe I'm reading it wrong, that maybe you're, a little bit, maybe I'm wrong and you can clarify, maybe you're just a little bit more conservative on, or

cautious on loan growth. It sounds like in the release you guys talked about the payoffs being up a little bit this quarter and also being selective in what you're looking at, but you put up, a very strong quarter but the guide seems as though it's more mid-single digits, so just kind of trying to reconcile. Is it, am I missing something there? Or just the growth this quarter was maybe it was just a particularly strong quarter and, but you did talk about the payoffs being up, albeit lower than they were a year ago, so just trying to put that together. Any thoughts you have would be helpful.

Alberto Paracchini
Sure. If you look at the last two quarters, those were two very good quarters. The second quarter was a very, very good quarter in terms of loan growth and certainly I would say the third quarter as well. If you look at gross origination activity, it was healthy. As we've discussed in the past, the variable that's hard to predict tends to be unexpected payoff activity. I would just start with that. But the second piece is the last quarter we guided more or less to a range in the, numbers I used was 6% to 8%. That's consistent with our views at this point in time. The comment that we made regarding just the competitive nature of the market and what we're seeing from a pricing standpoint as well as a structure standpoint, that highlights the fact that, we are selective. We're not going to chase transactions, down and take on structures that from a credit standpoint we don't feel comfortable with. And therefore, we may be willing to pass or let some of those transactions go and that may result in payoffs. I don't have anything specific, it's just a view that when the market gets competitive this way from the standpoint of both pricing and credit, it's important for us to remain disciplined and not do transactions that either don't compensate us properly for the risk that we take, or from a structure standpoint we're taking undue risk. That's essentially what we meant with the comments.

Brian Martin
Okay. That's helpful. And just the last one if I sneak in was just the, Lindsay, you talked about the premiums coming down on the government-guaranteed stuff a little bit. I guess, is your expectation, it sounds like volumes in the pipelines are good, that even if the premiums stay a little bit lower that you can still grow that business in '19?

Lindsay Corby
Absolutely. Absolutely, Brian. No doubt. It's a great business. It is higher risk, higher return business, and we have a great team of people there that are continuing to execute on their plans.

Alberto Paracchini
And to add to what Lindsay said, we're committed to the business for the long term. We have a great team. We have a dedicated team that's focused on the government-guaranteed lending business. And there are cycles and, premiums have been exceptionally good for a long period of time. We saw a slight decrease in premiums. That said, it's still a very attractive business. But, and I'm just trying to give you guys some color in terms of how we think about this business. To the degree that premiums were to decline to levels where perhaps it makes more sense for us to use our balance sheet and keep loans and portfolios opposed to selling the guaranteed portion, we will look to do that. I don't think we're at that point yet, particularly for longer term loans, but if at some point premiums get down to levels where it makes economic sense for us to retain them on the balance sheet because we can earn more from the carry of those loans, for the projected period of time that they're going to be on the books for, then that's something that we will do. That gives you some color longer term in terms of how we think about that business.

Brian Martin
Yeah, no – that's really helpful. And thank you guys for taking the questions.

Lindsay Corby
Thanks, Brian.

Alberto Paracchini
You're welcome.

Operator
At this time this will conclude today's question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

CONCLUSION

Alberto Paracchini
I think we've covered it, I would like to thank you once again for participating in the call this morning, and we look forward to talking to you next quarter. Thank you.

Operator
The conference has now concluded. We want to thank you for attending today's presentation. And at this time, you may now disconnect.