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SBCF - Q4 2015 Seacoast Banking Corporation of Florida Earnings Call

EVENT DATE/TIME: JANUARY 29, 2016 / 3:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Denny Hudson *Seacoast Banking Corporation of Florida - CEO*

Steve Fowle *Seacoast Banking Corporation of Florida - CFO*

CONFERENCE CALL PARTICIPANTS

Bob Ramsey *FBR Capital Markets - Analyst*

PRESENTATION

Operator

Welcome to the Seacoast fourth-quarter and year-end earnings conference call. My name is Christine and I will be your operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded. I will now turn the call over to Denny Hudson, CEO. You may begin.

Denny Hudson - *Seacoast Banking Corporation of Florida - CEO*

Thank you very much for joining us today for Seacoast's fourth-quarter earnings conference call. Our press release, released yesterday after the market closed, and slides with supplementary information are posted on our web site at seacoastbanking.com.

Before we begin, I'll direction your attention, as we always do, to the statement contained at the end of the press release regarding forward-looking statements that we will be making during our call. We'll be discussing issues that constitute forward-looking statements within the meaning of the Securities and Exchange Act and as a result, our comments are intended to be covered within the meaning of that act.

With me today is Steve Fowle, our Chief Financial Officer, who will be discussing our financial and operating results. Also joining us in the room are Chuck Cross, who leads our Commercial Banking teams; Chuck Shaffer, who heads Community Banking; David Houdeshell, our Chief Credit Officer; and Jeff Lee, our Chief Marketing Officer. We'll all be available to answer questions following the conclusion of our prepared remarks.

We are very pleased with Seacoast's fourth-quarter results, which cap a year of strategic development and operational progress in which we grew core earnings per share on a diluted basis by 46%. Our balanced growth strategy, comprising digital and other investments, that expand our franchise combined with selective strategic transactions that deepen our market presence and enable us to market to our acquired banks customers, continue to produce results for shareholders in the fourth quarter and for the year as a whole.

Fourth-quarter revenue rose to $36.9 million, an increase of 16% year on year. We pulled this growth to the bottom line as well, with adjusted fourth-quarter net income rising 56% to $6.5 million compared with the year-ago period. Note that the increase in adjusted income excludes the $416,000 bargain purchase gain resulting from post-acquisition recoveries related to our acquisition of Grand Bankshares in Palm Beach earlier this year.

While our successful integration of recent acquisitions made a meaningful contribution to our fourth-quarter performance, our operating results show the impact of our investments in organic growth. Total loans, excluding acquisitions, increased 12%, or $218 million, compared to the same quarter last year and the households we serve increased 5% organically compared with year-ago levels during the quarter. When we include our acquisitions, our households grew this year by about 8%.

As our customers rely less on high-cost branch and paper-based transactions and more on lower-cost digital operations we provide them, Seacoast has reaped substantial operating efficiency. We are enormously pleased with some of the other results during the fourth quarter. More than 10%

of deposit accounts were opened outside the branch, up from virtually none in 2014. Nearly 30% of deposits were made outside of our branch network, compared with around 20% in late 2014. Consumer loans originated outside of our branch average -- branches averaged 24% of total consumer loans compared to zero in 2014.

Turning to acquisitions, the integration of recently acquired BankFIRST in Orlando and Grand Bankshares in Palm Beach made meaningful contributions to the quarter's results. Both acquisitions grew households served by the 90-day mark following the close of those transactions. Growth in our Orlando franchise in the first year following the integration has exceeded our expectations, with households rising 7%. So not only have these acquisitions scaled up our level of households, they're also now contributing to higher organic growth. The acquisition of BankFIRST in Orlando, which occurred just over a year ago, has served as a corner stone for our expansion in central Florida and set the stage for the acquisition of BMO Harris Orlando banking operations, which we announced in October, and Floridian bank shares, which we announced in November.

These transactions will make us a top-ten Orlando bank and a top-five Florida based bank based on deposits. We have received regulatory approval for both of these transactions and we expect to close the Floridian acquisition late in the first quarter and the BMO Harris branch purchase late in the second quarter. We look forward to welcoming more than 14,000 new households to the Seacoast family once these transactions are completed.

The tremendous flexibility of our technology platform enables us to more quickly optimize locations without diminishing customer service and product delivery. We consolidated three branches during 2015 with very minimal customer impact and anticipate that we will consolidate an additional four legacy locations in the first half of 2016. Again, as our customers discover greater convenience, we can adjust the pace of consolidation.

We closed out 2015 well positioned to drive further increases in shareholder value. As we consider our business today and our vision for continued execution of our balanced growth strategy, we expect to produce earnings per share of $1 in 2016 and a substantially increase in our earnings run rate as we exit the year. We continue to commit to maintaining a disciplined approach to growing our balance sheet with a focus on organic growth and we believe we will continue to drive long-term shareholder value.

With that I'd like to turn the call over to Steve Fowle, our Chief Financial Officer, to discuss some results for the quarter and afterwards, we look forward to your questions. Steve?

Steve Fowle - *Seacoast Banking Corporation of Florida - CFO*

Thank you, Denny, and thanks to all of you for taking the time to join us this morning.

Our fourth-quarter results improved both year on year and sequentially, showing the operating leverage inherent in Seacoast's commercial loan origination and out-of-branch consumer transaction convenience. Fourth-quarter diluted EPS rose to $0.18 per share compared with a $0.5 loss in the year-ago period. Net income was $6 million compared to a fourth quarter loss of $1.5 million last year. Adjusted earnings, factoring out merger-related and other non-core items, was $6.5 million, or $0.19 per diluted share, up 46% from $0.13 in the fourth quarter last year and nearly flat link quarter.

For the year as a whole, earnings per share more than tripled to $0.66 per share in 2015 as strong prudent loan growth combined with successful acquisitions to grow margin and operating leverage. As with past quarters, we continue to drive growth by leveraging our investment in digital analytics as well as our commercial banking service offering. As Denny mentioned, customer acquisition remains strong. Households grew at 5% analyzed quarterly rate, matching organic household growth rate of 5% for all of 2015.

Loans increased $57 million, or 3% sequentially, and 18% over last year,12% after adjusting for the Grand acquisition. Much of this quarter's growth came late in the quarter and again, this growth was attained while maintaining a diverse, granular, self-originated loan portfolio with an average Q4 loan size of $139,000. Deposit growth accelerated with seasonal public fund inflows. Deposits increased $102 million, or 4% not annualized, from third-quarter levels. Year over year, deposits grew $428 million, or 18%,10% when adjusted for acquisitions. Of note, non-interest demand deposits represent a strong 30% of deposits. Including interest checking, demand deposits represent 56% of total deposits, and our overall cost of deposit stands at just 12 basis points.

Turning to our income statement, our net income was impacted by two notable items this quarter. First, during the fourth quarter we had recoveries from loans and REO acquired from Grand Bank. These recovers exceeded the provisional mark we had made of the assets at the time of the transaction. When the revised value associated with the assets was recorded in accordance with GAAP, we eliminated Grand's goodwill and recorded approximately $416,000 of bargain purchase gain. This was a $1.6 million swing in valuation from previous estimates.

Second, we've made progress in our pending acquisition of Floridian and our BMO Harris Orlando branch purchase. Costs related to these acquisitions and other adjusting entries are noted in our press release. As Denny, stated we recently received regulatory approval for both acquisitions.

With these adjustments, we recorded an adjusted EPS of $0.19 as follows. During the quarter we recorded $29.1 million net interest income, or a NIM of 3.67%. Net interest income improved a strong $4.4 million, or 18% from prior-year levels, and was up slightly link quarter.

The link-quarter improvement's notable as Q3 included about $700,000 to $800,000, or 10 basis points, in excess purchase loan accretion, largely due to modifications of current relationships during that third quarter. We recorded essentially no excess purchase loan accretion in Q4. Net interest margin included 11 basis points from Q4 2014 and was down 8 points sequentially. Remember though, Q3 had about 10 basis points of NIM from excess loan [acretiation], so directionally margin continues to see up side.

We have been successful in driving fundamental margin and net interest improvement as we have enhanced our balance sheet mix and as we have actively managed asset yields. For next quarter, we expect a slight increase in net interest income as growth is offset by a shorter quarter and relatively flat to slightly decrease that interest margin as benefit of loan growth is offset by $100 million security purchases made at the end of 2015 in December, in anticipation of liquidity from the upcoming BMO Harris branch purchase. As we progress through 2016, organic growth and acquisitions will add substantially to net interest income but margin will be diluted as we initially deploy liquidity from our branch purchase into securities.

Adjusted fee income was up a strong 9% from 2014 levels, reflecting household growth. Notably, interchange income, a good measure of customer growth and engagement, increased 24% from prior-year levels. Debit card transaction values hit a record for Seacoast in the fourth quarter. Link quarter fee income decreased $300,000 to $7.8 million as holiday-driven slow downs in mortgage banking, brokerage and marine fees outweighed activity-related fee increased in areas like interchange. In 2015 overall, our fee growth out paced customer acquisition rates. We see additional opportunity for outsized growth in 2016 as we further penetrate our new markets for Seacoast with fee-based businesses like mortgage and wealth.

Fourth-quarter expenses showed decreases from both fourth quarter 2014 and sequential-quarter comparisons. Both prior periods contained significant adjusting entries related to merger and non-core activity. Adjusted expenses were up $200,000, well less than 1% sequentially, and rose $1.6 million, or 6%, from prior-year levels.

The link quarter increase includes small increases in areas like occupancy data processing, somewhat offset by decreases in salary and benefits. Such volatility quarter to quarter can be expected. Compared to the year-ago period, increases reflect investments we have made in our franchise including acquisitions, talent acquisition, and other investment in our business strategy and variable costs associated with growth of the franchise.

I want to remind you that first quarter typically faces decreased revenues from lower number of days in the quarter and noticeably higher expenses, particularly in payroll tax and benefit costs. This dynamic will run against the positive impact of our continued growth. For the remainder of the year, we expect organic growth combined with our in-market acquisitions should drive efficiency down to the low 60%s.

With that said, I wanted to turn back to a comment Denny made about our goals for this year. We are providing an adjusted EPS target of $1 per share for 2016. This reinforces our continuing progress on earnings performance. More importantly, this kind of performance sign posts the results we believe our strategy can continue to provide. We're positioned to benefit from investments we have made, and continue to make, in our business strategy and franchise that will produce margin and operating leverage organically.

We also have built a strong core funding franchise. More than half our deposits are solid core checking accounts and our cost of deposits as a result is a low 12 basis points. We anticipate that a rising rate environment in 2016 will illuminate the value of this customer base through improved net interest income and margin. Finally, we're scheduled to close two acquisitions in the first half of the year, the Floridian acquisition scheduled late this quarter and the BMO Harris branch purchase late in the second quarter. These acquisitions both have strong IRRs and will be accretive to earnings per share, excluding merger costs and other short-term transaction related expense.

To put numbers to our outlook, we're heading into 2016 with a $0.19 per-quarter run rate that translates to $0.76 per share annualized. The forward rate curve, and we use this rate curve as a best guess to what will happen in 2016, will add about $0.06 or more to our results. While this factors out of our control, the first rate hike did happen already and represents a sizable portion of the $0.06. 2016 M&A activity, again excluding nonrecurring costs, will add $0.04 to $0.06 plus or minus to our earnings as we successfully integrate operations. This benefit will be an annuity as we have had great success in cross selling into and further growing in our acquired markets at a rate often in excess of our core franchise.

Finally, organic growth and core operating performance, definitely in our control, led an additional $0.12 to $0.14 to our bottom line. This operating leverage improvement is anticipated despite past and continued significant investment in our business model. So as you look at these forward thoughts, you'll note coming into the year with a flattish first quarter and our performance will accelerate as we go through the year. We look forward to executing on 2016 as the next step in our business plan.

With that said, now I'll turn the call back to Denny.

Denny Hudson - *Seacoast Banking Corporation of Florida - CEO*

Thank you very much, Steve. We're happy to take a few questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question is from Bob Ramsey of FBR. Please go ahead.

Denny Hudson - *Seacoast Banking Corporation of Florida - CEO*

Morning.

Bob Ramsey - *FBR Capital Markets - Analyst*

Sorry about that. I had my mute button on. Good morning. I guess I was hoping maybe you could talk a little bit about the efficiency assumption that sort of underlies your 2016 guidance. I'm curious not only where you see things overall but maybe where you end the year once you've got both of these acquisitions folded in.

Denny Hudson - *Seacoast Banking Corporation of Florida - CEO*

Steve, you want to take that?

Steve Fowle - *Seacoast Banking Corporation of Florida - CFO*

Yes, so we anticipate with organic growth that we'll have some nice operating leverage, probably about 4% to 5% operating leverage as we go through the year, on some really strong organic loan growth. That operating leverage will start to drive our efficiency ratio down, but as we pick up the acquisitions and integrate them and realize the efficiencies through those acquisitions, we think we can get our efficiency ratio down in the low 60%s by the end of the year.

Denny Hudson - *Seacoast Banking Corporation of Florida - CEO*

I think the key thought behind the acquisitions, we had a franchise in Orlando going into those negotiations, and adding these two franchises on top of our existing investment there creates tremendous improvement in our operating leverage in that market, so lots of consolidation work will occur as a result of that, the combination, putting all three together. And so we have some pretty nice upside coming out of that, as Steve described earlier, in the path to $1 a share. I think it's just a continued good execution of our strategic plan really gets us there, and feel pretty confident about it.

Bob Ramsey - *FBR Capital Markets - Analyst*

Okay. You may have given this detail, and I might have missed it, but the BMO branch deal, I think the release said late 2Q is when you anticipate that close in. Is it fair to model it at June 30 or do you have a better sense of what the timing might look like?

Steve Fowle - *Seacoast Banking Corporation of Florida - CFO*

I think by June 30 we'll have the transaction closed. Again, we're expecting a late Q2, probably June-ish, type of an integration.

Bob Ramsey - *FBR Capital Markets - Analyst*

Okay. Can you remind me, is there much seasonality in the expense number in the first quarter for, I don't know, annual increases or FICO or 401-k match or anything else?

Steve Fowle - *Seacoast Banking Corporation of Florida - CFO*

Yes, there definitely is. So first quarter, fee income's hurt because there's a shorter number of days. Expenses are hurt because we now have people in the Company that haven't capped on social security. We have payroll taxes as a result that are higher. We have 401-k bonus payments and 401-k matches accelerate at that time of the year, so typically Q1 for us and for most companies is a tough quarter. As I was concluding my remarks, that's why I gave some insight into the fact that Q1 is probably pretty flattish to where we are.

Bob Ramsey - *FBR Capital Markets - Analyst*

Okay, great. Thank you very much.

Denny Hudson - *Seacoast Banking Corporation of Florida - CEO*

I think, Bob, the other thing to keep in mind is, as Steve said earlier, as we see steady improvement as we go through the year but we have the added boost of the additional size as we get into the second half of the year. And so again, we kind of start out flattish, have some nice growth, and then it really begins to accelerate as we hit the back-end of the year, and feel the impacts, positive impacts of the M&A that we do. So continued organic growth, the M&A impacts and also the cost opportunity that we laid out in our remarks, really effect fully the back half of the year.

Bob Ramsey - *FBR Capital Markets - Analyst*

Great. Thank you very much.

Operator

Thank you.

(Operator Instructions)

I'm showing no further questions so I'll turn the call back over to Denny Hudson.

Denny Hudson - *Seacoast Banking Corporation of Florida - CEO*

Okay. Well, thank you very much for attending today and we look forward to updating everybody following the conclusion of Q1. Thank you.

Operator

Thank you, and thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.
