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Atlantic Capital Bancshares (ACBI)

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NAB Research, LLC
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Price: $17.13
52-week price range: $14.44-$19.85

EPS Estimates: 2018A: $1.04
2019E: $1.18
2020E: $1.28
Q219E: **$0.28** (versus **$0.32 from continuing operations** in 2Q18)

Tangible Book Value: $12.17
Price/TBV: 1.41x
Market Capitalization: $412.9 million

--The "Great Tennessee Experiment" has now finally concluded...
--The bank is highlighting its new role as Atlanta's "only hometown business bank"...
--The next 18-24 months will be a time of sharpened focus and strengthened earnings...And then ACBI may be ready for a phase of revenue diversification….

It seems like it has been years that they have been grappling with issues in Tennessee…
And it has been, actually. We went back in our archives to our first report on **Atlantic Capital Bancshares (ACBI)**, dated June 23, 2016, in which we discussed the unusual aspects of ACBI's 2015 merger with **First Security** of Chattanooga, TN. Atlantic Capital had hoped to accomplish a lot with that deal—its emergence as a public company, a diversification of revenues away from Atlanta (which was still struggling with the overhang from the Financial Crisis at that time), the building of a consumer core deposit base and the gaining of expertise in retail banking, and the exporting of commercial banking expertise into the ranks of First Security's bankers. It was an odd coupling of companies and a challenging integration of cultures—and one which admittedly did not play out as expected.

In retrospect, the greatest impediment to a successful integration of those two cultures likely lay in First Security's history as a "distressed" bank. Ten years on from the damage wrought by the Great Meltdown, it's easy to forget that not all banks found their way back to prosperity, and aside from the most visible failures (**WaMu** and **Wachovia**, notably) there were many community banks that took years to resolve their credit and funding issues. (And indeed, there are a handful that still have not.) First Security was saved from failure by regulatory forbearance and by the installation of a new management, but even that was not enough to overcome the legacy of a damaged deposit franchise and a culture resistant to an evolution to that of a commercial bank. Atlantic Capital's management—after a program of branch sales, installation of new management, etc.—finally bowed to that reality and last November sold the 14 remaining branches in Tennessee and northwest Georgia (as well as the mortgage business), thus marking its return to its founding focus as a high-end business bank serving the metro Atlanta area.

The sale of the Tennessee operations to FB Financial Corp. (FBK) of Nashville was completed in 2Q19 and will result in a reset to results in the second quarter numbers. The company has already been reporting earnings on a "continuing operations" basis for the last two quarters, so there should not be any sticker shock with the finalization of this material restructuring of the bank. (There may be a couple of quarters containing an additional small amount of expenses related to Tennessee, but the impact on results is essentially complete at this point.) On April 8, ACBI transferred roughly $598 million in deposits and $385 million in loans (along with assorted branch-related assets) to FBK, and financed the $166 million in cash needed to complete the branch sale with a combination of excess cash, securities sales, and various borrowings.

All of this is happening at a fortuitous time for ACBI…

Atlantic Capital's management could not have known last November that they would be so lucky in their timing of the Tennessee divestiture. The merger of equals between **BB&T Corp. (BBT)** and **SunTrust Banks Inc. (STI)** (a.k.a. "Truist") announced on February 7 has thrown the banking market in the Southeast into a competitive frenzy, and no market will be more impacted as loyalties and customers realign than that of Atlanta. The location of the new mega-bank's corporate headquarters to Charlotte is seen as a blow to the city's pride and as an abdication of SunTrust's historical position as one of Atlanta's foremost corporate citizens. (And what will happen to SunTrust Park? Truist Park—really?) While SunTrust has made big pledges to charitable causes in Atlanta to cushion the blow of the headquarters move, we believe that it is inevitable that their Atlanta corporate focus and their identification with Atlanta itself will fade with time.

So Atlantic Capital has begun to style itself as Atlanta's "only hometown business bank," and rightly so. While there may be other community banks out there that will compete to gain part of the corporate business that SunTrust will lose, ACBI is the only commercial bank that is Atlanta-owned and Atlanta-focused, and the exit from Tennessee and from the remnants of any retail business lend credence to that claim. ACBI has had that focus since the bank's founding in 2007 and fortuitously did not lose momentum in the commercial market even during the quarters when it was trying to steady the non-Atlanta pieces of the franchise, and it will be able to go into the coming quarters with competitive flags flying. We expect that they will gain not only new business relationships but also new relationship managers as the BBT-STI consolidation progresses and the inevitable large-bank operational snafus ensue.

They bring considerable additional expertise and experience to the table. While we would readily admit that there are several good banks out there that have entered or expanded in the Atlanta market through community bank deals in the past couple of years—**Cadence Bancorp (CADE)**, **CenterState Bank Corp. (CSFL)** and **United Community** Banks **(UCBI)** come most readily to mind—and that there may be others who will swoop in to capitalize on the market turmoil, Atlantic Capital seems to us to enjoy an advantage in both longevity and in expertise. The bank's founding in 2007 and its ability to stay the course during ATL's downturn after the Financial Crisis—and the long and episodic recovery that ensued—should be a tremendous asset in getting and keeping those medium-sized business customers who (rightly) worry about the staying power of their banking relationships as the business cycle lengthens and the likelihood of a slowdown grows ever larger.

The bank's ability to manage its customers' cash is a big asset. In good times and bad, cash has to earn a return, and Atlantic Capital is quietly building an impressive set of skills to make that happen for its depositors. The bank's cash management businesses, bearing the ACE (Atlantic Capital Exchange) for Treasury and ACE for Business names, are state-of-the-art treasury management platforms, and in addition, the bank is also a major ACH processor (44th in the nation.) They aim to use these skills to increasingly tap into the payment stream that flows into ATL through the Federal Reserve and the likes of **First Data** and the myriad of fintech companies that are headquartered in the area.

Indeed, ACBI has also developed an interesting lending "vertical" into the fintech world. The company is banking an increasing number of the 150-or-so fintech companies that are headquartered in Atlanta and has roughly $20+ million in loans and deposits with this segment. Not only does the fintech industry present ACBI with the opportunity for traditional banking relationships, but it may in the future provide the bank with the opportunity for interesting business partnerships as well. In any case, ACBI's payments-oriented and fintech businesses are growing at a 25%-30% clip per year, and we are hopeful that the bank will soon take the opportunity to highlight these growing businesses by beginning to report them on a line-item basis. We think that this aspect of the bank—and the opportunities associated with it—are not well understood or recognized by investors and that a more in-depth discussion of them would go a long way toward refocusing investor attention away from the struggles of the last few years and onto ACBI's very bright opportunities in the still-growing Atlanta market.

Will this bank eventually need more fee-based businesses? We want to emphasize right up front that we do not see acquisition activity—of any kind—in Atlantic Capital's future in either the near or the intermediate term, which we would define as the next 18-24 months. Indeed, this management knows acutely that it needs to demonstrate continued robust organic growth in both loans and deposits, as well as continued strong credit quality, in order to regain the credibility that was lost as its attempts to get Tennessee back on track eventually came to naught. So deals are off the table—at least on the acquiring side—for that long and perhaps longer, dependent upon the course of the Atlanta market and the opportunities that may present themselves locally.

But they will eventually need to add fee-based and other ancillary businesses. We strongly believe that community banks make a mistake in not adding more fee-based activities to their revenue streams, and in ACBI's case, we were particularly disappointed that they chose to sell off their small trust & wealth management business in 2018 as they were trying to get Tennessee to a break-even posture. (It had been a small fiduciary business and needed the addition of investment and experienced personnel, neither of which was available.) But at some point, ACBI will want to be able to deepen its share of wallet with its affluent business owners and we think that private banking and wealth management services are the best way to seal that deal.

And asset-based lending always comes to mind for a business-focused bank. One need only to talk with the management of UCBI to hear the praises sung for their asset-based lending subsidiary, **Navitas**, and what it has done for both net interest margins and loan growth. It is inarguably a value-added product to broaden a banking relationship with a business customer, but like wealth management, it is one that is hard to build and must of necessity be bought, complete with a management team that has long experience through a variety of credit cycles. And as with a good wealth management team, that expertise is often expensive to acquire and to keep happy—thus the traditional (and understandable) reluctance of community banks to jump in with both feet.

These long-range plans are nice to think about—but the here and now still holds some challenges. In spite of the fact that Atlantic Capital is in the right place at the right time in terms of growth, they still must face the same set of challenges that community banks everywhere are now facing. The biggest of these is, of course, this unusual and illogical rate environment and the inversion of the yield curve, which will weigh on the results of the asset-sensitive community banks in the latter half of this year and beyond. CFO Patrick Oakes has affirmed the company's guidance for a 3.50%-3.55% margin in the 2Q19 results, but has also cautioned that any cuts on the part of the Fed will inevitably compress that important metric. In the meantime, this management—like their community brethren everywhere—have begun to have conversations with their customers about deposit rates, but those efforts will take some time to bear any material fruit.

And ACBI management especially need to deliver on expense control, which will be no easy task as they stay positioned for growth. While Atlantic Capital management may enjoy an embarrassment of riches from the BB&T-SunTrust integration, those riches may be—well, rich—in their costs. They have already detailed their new office openings in Cobb County, Buckhead and Athens, and those expenses are already baked into the $13.5 million-in-expenses quarterly run rate that they have projected for late this year. Not baked in are any costs for the hiring of additional experienced relationship managers that may fall out of the Truist combination, and the achievement of the promised expense run rate may be a delicate balancing act as these opportunities are contemplated and acted upon.

And then there is capital management. ACBI will realize a $31 million gain (or so) in 2Q19 results, and tangible book value (TBV) is expected to rise at least $1 per share as intangibles from Tennessee are shed and shares are repurchased. CEO Doug Williams has been emphatic that the bank will be dedicated to a responsible program of capital management—they are well into an $85 million share repurchase authorization that they received last November—and we think that this will be the year that Mr. Williams and his Board will choose to declare a cash dividend (although likely a small one initially) to augment those share repurchases. If that is the case, such a move will mark (for us, anyway) the emergence of ACBI into the "bigger leagues" of community banks and a move into a mature stage of this bank's life cycle. Doug Williams sees the consistent return of capital to shareholders as a way to rebuild management credibility and stock valuation, and we most heartily agree.

Bottom Line: The banking environment may be uncertain, but we do not believe that the prospects for this bank are…

OK, we admit it—we're Atlanta chauvinists—but that doesn't necessarily mean that we're wrong. We had an interesting conversation with Doug Williams recently, and he pointed out that there is a dichotomy presently between the data and the markets and what ACBI is experiencing every day. The bank is seeing strong loan and deposit growth and is seeing in its customers the confidence to invest and to hire. Why is this? We believe (as do they) that because ATL came out of the recovery later than the rest of the nation, the expansion has longer to run there. We'd also say that our own anecdotal experience is that the Northeast continues to shed population and wealth, and many of those people are setting up shop in the greater Atlanta area.

This is not an overly expensive stock...and there is that other thing. We have modeled a tangible book value in line with management's guidance, and based on that number, this stock is presently selling at 1.3X TBV (or thereabouts) versus 1.6X for community banking peers and over 2X TBV for the larger growth community banks. And while the 2020 PE valuation (13.5X roughly) may be a bit rich relative to peers, we do believe that 2020 estimates bear a bit of a "credibility markdown" and that earnings estimates will likely be raised as we go into next year (or maybe sooner.) **And what about that other thing—a nice deal price from a Pinnacle Financial Partners (PNFP) or some other growth community bank? We're not predicting it—but we wouldn't be too surprised, either.**

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Table 1
Atlantic Capital Bank
Earnings Estimates
($ Thousands, Except Per Share Data)

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019E	2018A	2019E	2020E	Percent Change 19E/18A	Percent Change 20E/19E
Net Interest Income	**$21,620**	**$22,112**	**$22,660**	**$21,165**	**$20,524**	**$20,240**	**$87,557**	**$84,480**	**$85,000**	**(4)**	**1**
Tax Equivalent Adjustment	103	98	97	97	100	100	395	420	400	6	(5)
Loan Loss Provision	772	(173)	845	502	814	500	1,946	2,750	3,000	41	9
Subtotal	**20,745**	**22,187**	**21,718**	**20,566**	**19,610**	**19,640**	**85,216**	**81,310**	**81,600**	**(5)**	**0**
Noninterest Income											
Service Charges	1,192	1,308	1,278	876	794	750	4,654	3,200	3,300	(31)	3
Trust Income	518	507	0	0	0	0	1,025	0	0	(100)	NM
BOLI Income	369	378	379	380	360	375	1,506	1,500	1,600	(0)	7
Mortgage Income	304	363	315	0	0	0	982	0	0	(100)	NM
SBA Lending Activities	1,302	997	882	425	1,086	1,200	3,606	5,000	5,500	39	10
Securities Gains & Derivatives Income	114	18	20	(1,699)	(114)	150	(1,547)	300	300	(119)	0
Gains on Sale	(46)	(166)	58	0	0	0	(154)	0	0	(100)	nm
Other Noninterest Income	230	1,926	134	182	210	200	2,472	800	1,000	(68)	25
Total Noninterest Income	**3,983**	**5,331**	**3,066**	**164**	**2,336**	**2,675**	**12,544**	**10,800**	**11,700**	**(14)**	**8**
Noninterest Expense											
Employment Expenses	12,077	10,921	10,152	7,573	9,213	9,150	40,723	36,000	35,500	(12)	(1)
Occupancy & Equipment Exp.	2,142	2,115	2,252	1,438	1,378	1,375	7,947	5,500	5,500	(31)	0
Professional Services	832	960	803	947	775	800	3,542	3,500	3,000	(1)	(14)
DP & Office Expenses	1,101	1,064	1,022	802	723	750	3,989	3,000	3,100	(25)	3
Marketing	190	191	281	224	226	250	886	1,000	1,100	13	10
FDIC Premiums	147	197	208	157	235	250	709	1,000	1,100	41	10
Merger & Conversion Costs	0	0	0	0	0	0	0	0	0	nm	nm
Amortization of Intangibles	343	319	296	0	0	0	958	0	0	(100)	nm
Other Expenses	1,560	1,594	1,581	1,067	1,245	1,000	5,802	5,000	5,000	(14)	0
Total Noninterest Exp.	**18,392**	**17,361**	**16,595**	**12,208**	**13,795**	**13,575**	**64,556**	**55,000**	**54,300**	**(15)**	**(1)**
Pretax Income	**6,336**	**10,157**	**8,189**	**8,522**	**8,151**	**8,740**	**33,204**	**37,110**	**39,000**	**12**	**5**
Income Taxes/(Benefit)	1,298	2,006	1,676	1,039	1,711	1,800	6,019	7,600	7,750	26	2
Net Income	**5,038**	**8,151**	**6,513**	**7,483**	**6,440**	**6,940**	**27,185**	**29,510**	**31,250**	**9**	**6**
Average Diluted Shares	25,946	26,200	26,255	26,044	25,019	25,000	25,821	25,000	24,500	(3)	(2)
Net Income per Dil. Share	**0.19**	**0.31**	**0.25**	**0.29**	**0.26**	**0.28**	**1.05**	**1.18**	**1.28**	**12**	**8**
Tax Rate	20.49	19.75	20.47	12.19	20.99	20.59	18.13	20.48	19.87	13	(3)
Adjusted Tax Rate	21.76	20.52	21.40	13.18	21.95	21.49	19.09	21.37	20.69	12	(3)
Net Interest Margin	**3.51%**	**3.54%**	**3.47%**	**3.66%**	**3.74%**	**3.52%**	**3.55%**	**3.52%**	**3.40%**	**(1)**	**(3)**
Average Earning Assets	2,499,318	2,507,817	2,593,022	2,674,369	2,224,159	2,300,000	2,568,632	2,400,000	2,500,000	(7)	4
Overhead Ratio %	71.8%	63.3%	64.5%	57.2%	60.3%	59.2%	64.5%	57.7%	56.2%	(10)	(3)
Tangible Book Value	**$10.98**	**$11.23**	**$11.37**	**$11.88**	**$12.17**	**$13.46**	**$11.88**	**$13.96**	**$15.24**	**18**	**9**

Results for 4Q18 and 1Q19 are from continuing operations and reflect the divestiture of the TN franchise.

Revenues	25,603	27,443	25,726	21,329	22,860	22,915	100,101.0	95,280.0	96,700.0
Fees as % of Total Revenue	**15.6**	**19.4**	**11.9**	**0.8**	**10.2**	**11.7**	**12.5**	**11.3**	**12.1**

Dated: 7/15/19
NAB Research, LLC

Table 2
Atlantic Capital Bank
Average Balance Sheet Summary
($ Thousands)

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	% Change vs. Last Quarter	% Change vs. Last Year
Earning Assets							
Deposits & ST Investments	$88,553	$106,763	$150,233	$131,066	$103,848	(21)	17
Taxable Investment Securities	375,771	378,291	385,834	376,163	320,089	(15)	(15)
Non-Taxable Investment Securities	78,146	76,343	75,514	74,302	80,012	8	2
Total Investment Securities	**453,917**	**454,634**	**461,348**	**450,465**	**400,101**	**(11)**	**(12)**
Loans	**1,938,953**	**1,927,063**	**1,963,817**	**1,699,801**	**1,707,682**	0	(12)
FHLB & FRB Stock	17,895	19,357	17,624	15,985	12,528	(22)	(30)
Total Earning Assets	**2,499,318**	**2,507,817**	**2,593,022**	**2,297,317**	**2,224,159**	**(3)**	**(11)**
Non-earning Assets	**205,504**	**210,254**	**212,718**	**216,598**	**223,130**	**3**	**9**
Interest-Bearing Liabilities							
NOW, Money Market & Savings	1,257,580	1,254,153	1,333,701	1,079,178	1,124,350	4	(11)
Time Deposits	139,788	148,134	154,507	10,116	12,847	27	(91)
Internet & Brokered Deposits	117,787	100,425	67,937	93,558	81,141	(13)	(31)
Total Interest-Bearing Deposits	**1,515,155**	**1,502,712**	**1,556,145**	**1,182,852**	**1,218,338**	**3**	**(20)**
Other Borrowings	156,822	185,816	143,148	91,155	18,056	(80)	(88)
Long-Term Debt	49,550	49,592	49,634	49,677	49,719	0	NM
Total Interest-Bearing Liabilities	**1,721,527**	**1,738,120**	**1,748,927**	**1,323,684**	**1,286,113**	**(3)**	**(25)**
Demand Deposits	**638,730**	**633,113**	**697,927**	**597,240**	**575,453**	**(4)**	**(10)**
Net Interest Spread	**3.18%**	**3.22%**	**3.03%**	**2.95%**	**2.98%**		
Net Interest Margin	**3.51%**	**3.33%**	**3.47%**	**3.66%**	**3.74%**		

Note: 4Q18 and 1Q19 totals are based on continuing operations.

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