B | S | Profiles

June 23, 2016

Atlantic Capital Bancshares (NASDAQ: ACBI)

Trading Price:	$14.32	**Tangible Book Value**:	$10.61
52-week Range:	$11.55-$17.50	**Price/TBV**:	1.33x
		Market Capitalization:	$352 million
EPS Estimates:	2015A: $0.62		
	2016E: $0.66		
	2017E: $0.88		
	2Q16E: $0.16 (vs. $0.21 2Q15)		

Nancy A. Bush, CFA
NAB Research, LLC
Distributed by: Banks Street Partners, LLC

- **This is not a de novo bank...But it is something of a de novo story...**
- **This Atlanta-centric bank has a distinctive operating model and a very experienced management team...**
- **The dust from the First Security Group deal should clear by year-end 2016, and then the growth potential of this unique franchise should become more clearly visible...**

It has not been often in recent years that we have found a bank with a "story" that is truly distinctive… And we don't think that we have ever seen a merger quite like this one. When we first met Doug Williams, the CEO of **Atlantic Capital Bancshares (ACBI)**, a couple of years ago, it was immediately clear that his bank—at that time a **$1 billion-plus privately held company concentrating on business lending in the Atlanta market**—would eventually go public and go to other places in the Southeast, and that has now happened. **That process, however, has been quite a bit different than we had anticipated, and we must say that the bank's**

solution to becoming a public company and beginning to enter other Southeastern markets was both creative and unusual—and as a result has created a few near-term challenges for investors.

First for the "story". The "old" Atlantic Capital was founded in 2007 by a group of experienced Atlanta-area bankers (there seems to be a heavy representation of **"old Wachovia" veterans** among the senior ranks) who saw the need for small-to-mid-sized businesses in the Atlanta area to receive more attention from their banks than they were getting either from the area giants or from the community banks, many of which were devoted solely at that time to the residential building mania that had enveloped the Southeast. **Mr. Williams and his team received backing from a group of private equity and other investors to capitalize their company, and while the timing may not have initially seemed to be fortuitous—Atlanta's meltdown in the wake of the Financial Crisis followed pretty quickly—in retrospect, it probably was.**

Atlantic Capital was able to take advantage of the crippled state of the local community banking industry and the disruption caused by the near-failure of the "new Wachovia" to attract both customers and bankers, and their double-digit loan growth in the intervening years has been noteworthy. But sooner or later—usually within a 5-10 year time horizon—private equity and other investors start to seek liquidity and an exit strategy, and that was the case with some of Atlantic Capital's large initial contributors. In addition, the consolidation of the Southeastern community banking industry had picked up a full head of steam and it was time for Atlantic Capital to begin to become part of that trend—**admittedly a difficult task without a public currency**—lest it be left behind.

We must admit that we did not foresee how this challenge would be overcome. Our expectation was that the bank would first go public and then would quickly go on the acquisition trail, but Doug Williams and his team instead chose to accomplish everything all at once. **Atlantic Capital elected to merge with a bank that had a public currency, assume that company's charter, and essentially effect a merger and an IPO in one fell swoop.** (We won't go into the fine detail of how that was accomplished here—way too much legal detail for one report—but we would refer readers instead to the S-4 document on ACBI's website.) **Atlantic Capital announced on March 25, 2015, that it would merge with First Security Group (FSGI) of Chattanooga, TN, in a cash and stock deal valued at $160 million.** (As part of the deal financing, Atlantic also did a $25 million private placement of its stock—at $12.60 per share—with **Stone Point Capital LLC**, a respected and long-term bank investment firm that now holds 12.5% of the company's stock.)

First Security Group would not have been our first guess as a partner for Atlantic Capital, but this is one "odd coupling" that seems to be working out. At the time of the deal announcement, FSGI had $1.1 billion in assets, 26 offices in eastern and middle Tennessee and north Georgia, and had had a rocky road through the Southeastern real estate downturn—one that had gained it the designation as a "distressed" bank (as well as an MOU with the OCC.) **The bank had acquired a new management team in 2011 (led by industry veteran Mike Kramer), recapitalized with $96 million in investor funds in 2013,** and began a new operating strategy based on small business and middle market lending, treasury management services, mortgage banking and trust and wealth management. **But the operating environment of low rates and sluggish recovery persisted and FSGI's board decided in 2014 to pursue a merger strategy concurrently with the new operating plan.**

Fast forward to the present day, and there is a different company…
The merger of Atlantic Capital and First Security—completed in 4Q15 but really still underway— has been an unexpectedly fortuitous combination, and we attribute that reality to the new management team. First Security shareholders obviously got a positive outcome from this deal—a graceful exit from their capital and growth challenges and avenues for future growth and enhanced profitability. But we would argue that the

Atlantic Capital holders did equally well—they got an enhanced core deposit gathering franchise (to lessen the company's use of brokered funds) and two businesses that will be very important for the future: trust services and mortgage banking. **In addition, Mike Kramer has joined the ACBI management team as President and Chief Operating Officer, and his knowledge of the Tennessee market and his good relationship with the OCC (now ACBI's chief bank-level regulator) will go a long way toward paving the way for the company's future growth.**

The new Atlantic Capital is going through a period of rationalization. As with any new company, there is a period of "putting things together" that may result in an entity that is not yet quite recognizable, and ACBI faces a few unique challenges in that regard. Since Atlantic Capital was not—and is not—a retail bank, the FSGI branch network has had to be reconfigured into markets that held the potential for greater commercial loan growth. To that end, the bank recently shed seven of its Tennessee branches—mainly those in more rural markets, like Sweetwater—and divested roughly $200 million in deposits and $35 million in loans in the process. The savings from the divestiture—roughly estimated to be $1 million per quarter beginning in 3Q16—will likely not hit the bottom line but will be reinvested into growth strategies in other markets.

Atlantic Capital is not slowing down its growth efforts as the integration with FSGI proceeds. As the economy in Atlanta and the rest of the Southeast continues to build momentum and as the banking scene in the region continues to evolve—which is one way of saying that the community banking consolidation here is producing "churn" in some major markets—ACBI really can't afford to leave the scene for a matter of months. The company added nine revenue producers in the first quarter and will continue to add producers as opportunities arise in new markets. Indeed, CEO Doug Williams has stated publicly that the company is looking at five markets in the Southeast for possible de novo entry this year and will at some point pick one, with the most likely scenario being the establishment of a loan production office staffed by a local market production team.

The bank is also beginning to emphasize another important line of business—trust and asset management. CEO Doug Williams mentioned in the 1Q earnings call that the company is pursuing an expansion of the trust and wealth management business, and they have added a trust officer in the Atlanta market to get the effort started. **The business (an important legacy from FSGI) is at present small—roughly $206 million in assets under management and 450 accounts—with the platform based in the Chattanooga bank.**

In **our view, this business can make a big difference in the long-term fortunes of this company.** For reasons not immediately apparent to us, the local Atlanta banks—both large and small—have historically not done a great job in offering a full suite of services to local business owners, and wealth management is one of the most important and most lucrative of these. Those relationships have instead been ceded to outside companies—like Northern Trust—and we hope that more local banks will use this moment of customer unhappiness with the large wealth management providers (whose results have been mediocre at best) to pick up both disaffected investors and the wealth management teams that may be seeking more stable homes. **Atlantic Capital has the potential to become one of those places of refuge for both investors and managers, and we look forward to their evolution into a more "private bank-like" model.**

There's huge potential here—but first, there's the rest of 2016...
And that brings us to the near-term challenges faced by investors in this stock. For one thing, as an "emerging growth company" (even the S-4 says so), Atlantic Capital's results are not going to be in the straight-line growth path that many bank stock investors (even community bank investors) are accustomed to and desire. This

bank—while well-established and well-known already—is going to be on a path that may be both eclectic and episodic as this growth-oriented management finds new opportunities in new markets and in new product lines as well.

But they first need to get the year 2016 in the rear-view mirror. The conversion of the acquired First Security systems will be completed in 3Q16, and that important event will set the stage for a more robust earnings growth path. There is much to be accomplished in that regard. While the net interest margin (currently in the 3.20%-plus range) will experience the same impacts that are being registered throughout the banking industry and credit quality will continue its exemplary path (due to a rock-solid and conservative credit culture), **expense levels and the high tax rate are the two areas that will give the biggest bang for the bottom-line buck.**

Management is well aware that the 75%-plus overhead ratio is not sustainable, but the path downward will be a gradual one. Obviously, the biggest cost saves will come after the systems are converted and the saves from the branch divestitures (estimated to be roughly $1 million per quarter beginning in 3Q) kick in, but it will still be some time (like the next 2-3 years) before the bank goes from the 78% expense ratio of 1Q16 to the **60% ratio that is the aspirational target.** But we would caution that opportunities for investment (like new people and new markets) may interrupt that progress on expenses from time to time, and investors must be prepared for those possibilities. **As for the 37% tax rate, there will be opportunities for the bank to add municipal holdings should (as?) interest rates gyrate, and they will do so in order to gradually improve their tax position.**

Another word to potential investors—as a growth company, don't look for ACBI to return capital any time soon. This company's capital is presently ample (CET1 ratio of 9.5% at 3/31/16) and will stay that way, and "excess" capital will likely be put to work in hiring lift-out teams of revenue producers and enhancing important platforms (like asset management.) **While it is possible that the company might begin to pay out some nominal dividend in the future to satisfy the requirements of institutional ownership, at this point anything more meaningful in capital returns awaits a greater and more predictable level of profitability.**

Bottom Line: We're really happy to "discover" this company, for a host of reasons…
First and foremost, this bank is NOT the "same old, same old." We don't have to spend time here awaiting the outcome of the DFAST and the CCAR, we don't have to agonize over every basis point of the net interest margin, and we don't have to ask the same old boring questions quarter after quarter about the possibilities for revenue growth—because they are readily apparent in this company's targeted customer base and markets. **We also hope that the success of Atlantic Capital will mark a turning point for the way that investors view the Atlanta banking scene—as one not dominated just by giant banks or by community banks that are real estate-lending disasters waiting to happen—and that moment can't come soon enough.**

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

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016E	2015A	2016E	2017E	Percent Change 16E/15A	17E/16E
Net Interest Income	**$9,043**	**$9,570**	**$9,494**	**$15,978**	**$18,921**	**$20,125**	**$44,085**	**$78,890**	**$88,550**	**79**	**12**
Tax Equivalent Adjustment	11	0	0	30	54	50	41	200	200	384	0
Loan Loss Provision	364	185	(137)	7,623	368	400	8,035	1,300	1,600	(84)	23
Subtotal	**8,668**	**9,385**	**9,631**	**8,325**	**18,499**	**19,675**	**36,009**	**77,390**	**86,750**	**115**	**12**
Noninterest Income											
Service Charges	326	501	521	1,265	1,498	1,600	2,613	6,500	6,800	149	5
Trust Income	0	0	0	192	314	400	192	1,400	1,600	629	14
BOLI Income	231	1,336	227	365	393	400	2,159	1,500	1,600	(31)	7
Mortgage Income	0	0	0	163	339	500	163	1,600	1,800	882	13
SBA Lending Activities	358	903	745	904	880	900	2,910	3,400	3,600	17	6
Securities Gains & Derivatives Income	83	65	77	89	98	100	314	300	400	(4)	33
Gains on Sale	0	0	0	103	431	400	103	1,000	1,000	871	0
Other Noninterest Income	184	223	159	379	467	400	945	1,500	1,550	59	3
Total Noninterest Income	**1,182**	**3,028**	**1,729**	**3,460**	**4,420**	**4,700**	**9,399**	**17,200**	**18,350**	**83**	**7**
Noninterest Expense											
Employment Expenses	4,742	4,836	4,859	9,661	10,555	11,500	24,098	40,000	42,000	66	5
Occupancy & Equipment Exp.	640	648	662	1,515	1,786	1,650	3,465	7,000	7,200	102	3
Professional Services	109	273	208	1,020	748	750	1,610	3,500	3,500	117	0
DP & Office Expenses	355	360	334	670	1,085	750	1,719	3,500	3,600	104	3
Marketing	46	77	90	197	267	300	410	1,000	1,200	144	20
FDIC Premiums	166	189	161	273	398	400	789	1,700	2,000	115	18
Merger & Conversion Costs	508	756	718	7,172	749	500	9,154	2,200	500	(76)	(77)
Amortization of Intangibles	0	0	0	526	762	800	526	3,200	3,200	508	0
Other Expenses	636	682	639	2,205	1,916	2,000	4,162	8,000	8,300	92	4
Total Noninterest Exp.	**7,202**	**7,821**	**7,671**	**23,239**	**18,266**	**18,650**	**45,933**	**70,100**	**71,500**	**53**	**2**
Pretax Income	**2,648**	**4,592**	**3,689**	**(11,454)**	**4,653**	**5,725**	**(525)**	**24,490**	**33,600**	**(4,762)**	**37**
Income Taxes/(Benefit)	934	1,690	1,463	(3,293)	1,722	2,100	794	9,200	12,500	1,059	36
Net Income	**1,714**	**2,902**	**2,226**	**(8,161)**	**2,931**	**3,625**	**(1,319)**	**15,290**	**21,100**	**(1,259)**	**38**
Average Diluted Shares	13,798	13,895	13,904	21,005	24,994	24,750	15,664	24,500	24,250	56	(1)
Net Income per Dil. Share	**0.12**	**0.21**	**0.16**	**(0.39)**	**0.12**	**0.15**	**(0.08)**	**0.62**	**0.87**	**(841)**	**39**
Tax Rate	35.27	36.80	39.66	28.75	37.01	36.68	(151.15)	37.57	37.20	(125)	(1)
Adjusted Tax Rate	35.54	36.80	39.67	28.56	37.73	37.23	(172.59)	38.07	37.57	(122)	(1)
Net Interest Margin	**2.86%**	**2.92%**	**2.93%**	**3.13%**	**3.26%**	**3.22%**	**2.98%**	**3.22%**	**3.22%**	**8**	**0**
Average Earning Assets	1,280,916	1,314,921	1,286,247	2,024,095	2,335,655	2,500,000	1,476,545	2,450,000	2,750,000	66	12
Overhead Ratio %	70.4%	62.1%	68.4%	119.6%	78.3%	75.1%	85.9%	73.0%	66.9%	(15)	(8)
Tangible Book Value	**$10.61**	**$10.72**	**$10.95**	**$10.59**	**$10.61**	**$10.73**	**$10.59**	**$11.21**	**$12.08**	**6**	**8**
Revenues	10,225	12,598	11,223	19,438	23,341	24,825	53,484.0	96,090.0	106,900.0		
Fees as % of Total Revenue	**11.6**	**24.0**	**15.4**	**17.8**	**18.9**	**18.9**	**17.6**	**17.9**	**17.2**		

Table 2
Atlantic Capital Bancshares
Average Balance Sheet Summary and Analysis
($ Thousands)

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	% Change vs. Last Quarter	% Change vs. Last Year
Earning Assets							
Deposits & ST Investments	$100,988	$16,151	$94,862	$152,346	$93,744	(38)	(7)
Taxable Investment Securities	132,276	197,787	131,732	245,475	338,880	38	156
Non-Taxable Investment Securities	2,362	10,318	2,284	9,837	18,848	92	698
Total Investment Securities	**134,638**	**208,105**	**134,016**	**255,312**	**357,728**	**40**	**166**
Loans	**1,040,657**	**775,608**	**1,052,785**	**1,612,854**	**1,881,749**	17	81
FHLB Stock	4,633	0	4,584	3,583	2,434	(32)	(47)
Total Earning Assets	**1,280,916**	**999,864**	**1,286,247**	**2,024,095**	**2,335,655**	**15**	**82**
Non-earning Assets	**65,521**	**85,342**	**63,750**	**224,519**	**285,095**	**27**	**335**
Interest-Bearing Liabilities							
NOW, Money Market & Savings	644,298	380,168	661,265	1,015,427	1,117,316	10	73
Time Deposits	16,000	265,446	15,756	184,257	267,330	45	1,571
Internet & Brokered Deposits	125,542	114,895	98,939	199,748	216,490	8	72
Total Interest-Bearing Deposits	**785,840**	**760,509**	**775,960**	**1,399,432**	**1,601,136**	**14**	**104**
Other Borrowings	108,771	59,498	94,031	24,564	99,357	304	(9)
Long-Term Debt	0	0	0	49,189	49,213	0	NM
Total Interest-Bearing Liabilities	**894,611**	**820,007**	**869,991**	**1,473,185**	**1,749,706**	**19**	**96**
Demand Deposits	**299,909**	**166,278**	**325,474**	**486,860**	**554,547**	**14**	**85**
Net Interest Spread	**2.74%**	**3.22%**	**2.81%**	**2.96%**	**3.10%**		
Net Interest Margin	**2.86%**	**3.33%**	**2.93%**	**3.13%**	**3.26%**		

Note: 2Q15 average balance sheet is as originally reported by First Security.

Nancy A. Bush, CFA
706-438-3098
NBush@BushOnBanks.com

NAB Research, LLC, is a consulting firm specializing in providing independent research on financial stocks and banking industry analysis and commentary ("Reports") to institutional investors, bank managers and other financial industry participants. NAB Research also distributes banking research and commentary on a third-party basis through Banks Street Partners (BSP), an Atlanta-based investment bank. (www.banksstreetpartners.com) BSP and its affiliates may include appropriate disclosures and disclaimers in the Reports that BSP uses as they reasonably determine are required for regulatory compliance purposes. Otherwise, BSP shall distribute NAB Reports in their entirety without alteration.

The information relating to any company mentioned in these Reports is derived from publicly available sources and NAB makes no representation as to the accuracy or completeness of such information. NAB and/or its principal, Nancy A. Bush, may have long/short positions or holdings in the securities or other related investments of companies mentioned herein.

NAB Research LLC, is not a registered investment adviser and does not make markets in any of the securities mentioned in its Reports. Neither Nancy A. Bush nor any related household member is an officer, director, or advisory board member of any company in its Reports, or otherwise affiliated with such companies in these Reports. Neither NAB Research, LLC, nor its principal, Nancy A. Bush, own shares equal to one percent or more of any company mentioned in its Reports.

Opinions expressed in this report are those of the author and may not reflect the opinions of Banks Street Partners, BSP Securities, or any of its employees or officers. Some of the information in this report is from outside sources we deem to be reliable, but no attempt has been made to verify its accuracy.

Over the last 12 months, BSP affiliate BSP Securities LLC has received compensation from the covered company for providing investment banking services. BSP and its affiliates might seek to provide investment banking services to the covered company in the future. For more information about BSP, please visit BanksStreetPartners.com.