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THE WALL STREET TRANSCRIPT**

## **ANALYST INTERVIEW**

# JACQUELYNNE CHIMERA BOHLEN

## Keefe, Bruyette & Woods, Inc.

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# Positive Environment Supports Valuation Levels for Pacific Northwest Banks

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**JACQUELYNNE CHIMERA BOHLEN, CFA**, is a Managing Director based in Keefe Bruyette & Woods, Inc.'s Portland office where she covers community and regional banks headquartered in the Western United States. Prior to joining the firm in September 2003, she was an Assistant Branch Manager for Wells Fargo Financial where she spent the majority of her days tailoring loan products to meet borrowers' individual needs and working through collection issues with delinquent borrowers. Ms.

Bohlen received a Bachelor of Arts from the University of California, Santa Barbara, with a double major in business economics and communication, and she is a CFA charterholder.

## SECTOR — BANKING

**(AGV800) TWST: Let's start with a look back at 2016. Were there many surprises? Did the year evolve the way you expected?**

**Ms. Bohlen:** From an economic standpoint, it certainly did. The Pacific Northwest economy, and particularly the two main economies, Portland and Seattle, have done very, very well over the past year. And that's enabled the banks to have, for the most part, pretty solid loan growth, clean credit metrics and just good profitability metrics in general. The one thing that has been somewhat of a surprise to me has been the huge run-up in valuations toward the end of the year as a reflection of the recent election. And yet this is not surprising when taking into account what that likely means to the operating environment for the banks.

**TWST: How sustainable is that recent uptrend; what's your overall outlook going forward?**

**Mrs. Bohlen:** It's difficult to predict the sustainability of the increase in valuations. I do think that the operating environment, to the extent that it unfolds in the way the market expects it to, means that valuations will hold and perhaps increase further from here. What can be difficult to predict is if, and to what extent, valuations could potentially increase from here.

I think there are a couple of different factors at play, the first being that we are now in what I see as a higher likelihood of a higher rate environment. KBW changed its economic baseline to

include rate increases that were not previously there. As a result, we saw an increase in our earnings estimates across the board. And higher earnings estimates do, in my view, warrant higher valuations. It's also potentially a more favorable regulatory environment, which would also support higher valuations.

And then something that I don't have at all in my estimates is the potential that we could see a reduction in tax rates, which could also have a favorable impact on earnings estimates. Some of that I think may already be priced into valuations, but it certainly is not in my estimates. That's something we could see if that policy for lower tax rates does come into play.

The one thing that I think is a bit harder to predict is the continued inflow into financials. We've seen a lot of people who had been underweight the sector look to get involved now that we have a more favorable rate environment. For a very long time now, it's been challenging for most banks to find earnings growth just from spread income alone, because the rate environment has generally been a disadvantage for most banks. Rates have remained low for a very, very long time. And so now that the market indicates that we are seeing going to see rising interest rates

— and we saw a second rate increase in December 2016, which was the first increase in the targeted fed funds rate since the increase in December of 2015 — we could continue to see inflows into financials. And that could continue to drive momentum and valuations higher.

**TWST: So right now you sort of like valuation levels?**

### Highlights

*Jacquelynne Chimera Bohlen discusses the environment of Pacific Northwest banking. She says the two main economies there, Portland and Seattle, have done very well over the past year. That's enabled banks to have solid loan growth, clean credit metrics and good profitability metrics. Ms. Bohlen says a surprise to her has been the huge run-up in valuations toward the end of the year. She says the current operating environment means that valuations will hold and perhaps increase further from here. Companies discussed: [First Interstate Bancsystem](#) (NASDAQ:FIBK); [Cascade Bancorp](#) (NASDAQ:CACB) and [Umpqua Holdings Corp](#) (NASDAQ:UMPQ).*

**They are still reasonable in your view?**

**Ms. Bohlen:** Yes. I think that they are because the environment overall is more positive. And going forward, the environment we're heading into looks increasingly positive, and so that supports higher valuations. Similar to my view last year, I think that you still want the differentiated stories and asset sensitivity. But to the extent that we think that earnings increases are more likely, we see that valuations will be supported.

***“Similar to my view last year, I think that you still want the differentiated stories and asset sensitivity. But to the extent that we think that earnings increases are more likely, we see that valuations will be supported.”***

**TWST: Can you give some examples of the types of differentiated stories that look poised to do well in the coming year?**

**Ms. Bohlen:** I think that companies who are in a niche space have a higher likelihood of doing well, just because they have an area of lending and perhaps deposit gathering where they tend to excel and have a competitive advantage to peers. And that kind of gives them a leg up in a positive growth market, which is what's going on throughout the Pacific Northwest right now. I also like companies that have a strong level of underwriting and a history of strong credit performance. We obviously have the background of the recent recession to look to in terms of tracking who was a strong performer throughout that. I think that can give investors a level of comfort with the sustainable growth that these banks have, and so that also helps to support valuation levels as well.

**TWST: Give us closer look at some of the local economies in the region that you focus on.**

**Ms. Bohlen:** The strongest economy is the Seattle area. Portland is also doing well. When I look at the strength of an economy, there are several different metrics that I take into account, and those metrics have been doing very well recently. I look to job growth and how strong it is. In both Portland and Seattle, it's exceeding the national average, particularly in Seattle. I also look to median household income and is that increasing, is it decreasing, what are the movements within that. And I look at whether economic activity will support future job growth; how are home prices behaving? Portland and Seattle have been interchangeably the number one and number two regions in the United States according to the Case-Shiller Index.

I think that all of those metrics in combination support very strong local economies. Microeconomies that surround those two main cities have also been doing well. There are still pockets here there that are not at the high levels of growth that you see in the metro areas, but the region overall is doing very, very well.

**TWST: Are there any particular types of businesses in Portland and Seattle that drive and perhaps dominate banking demand for loan growth or other services?**

**Ms. Bohlen:** I would say it's fairly well-diversified. The two markets have seen an increase in technology-related jobs, particularly in Seattle, and so that has helped the overall economy itself. I wouldn't say that it's necessarily been the main driver of growth at the banks, but I would say that because of the positive benefit to the local economies, the banks themselves have done a good job with lending.

**TWST: So are these mostly small businesses that require additional capital? What drives the loan market in these local economies?**

**Ms. Bohlen:** You have a wide array of businesses that are looking to expand. There are some small companies, there are some larger companies. Most of the banks that I cover are not lending to huge conglomerates just because of constraints with their capacity and their risk appetite. Many of the banks that I follow, if not all of them, don't even come close to having loans as large as their overall lending limit could be. They have in-house limits that tend to be lower than what they could be. And

so there is a mixture of small businesses and middle market businesses that are seeing positive benefits from the local economies and are utilizing their local banks in order to grow their businesses.

**TWST: What are some of the key metrics you focus on when evaluating a bank in this region, and what are some of the commonalities that occur most often in your highest-rated stocks?**

**Ms. Bohlen:** I look to their net interest margins and the movements within those. Most margins have been under pressure given the rate environment, but I think we could see some actual expansion, core expansion, happening for some of the banks as rates increase, and given some of the movements we've seen in the yield curve. I also look to loan growth, and I look at credit metrics. Are the banks provisioning to support the loan growth that they have? Is their credit profile clean? Is it something where if we were to have an economic downturn — which I don't foresee, but I do always think about — how are the reserve levels? How is the bank's historical underwriting profile? And do I think that they can survive the next wave, should it come to pass?

**1-Year Daily Chart of Umpqua Holdings Corporation**



Chart provided by [www.BigCharts.com](http://www.BigCharts.com)

I also look at just the makeup of the loan portfolio: Is it diversified? How is it funded? Is it through deposits? Many of the banks that I think will do very well over the next several months and years are those that have a strong core deposit base with sticky customers, especially as we head into a rising environment. I think

that that's going to serve the banks very well and perhaps make them a little more asset-sensitive than some of their indicators show.

**TWST: Do you like to see an acquisitive growth strategy in this environment?**

**Ms. Bohlen:** It depends on the bank. If the bank has a strong currency or if it's proven that it can do strategic M&A that's accretive to earnings, then I very much like an acquisitive strategy.

**TWST: What is the level of the M&A that you're seeing now? Do you expect to see a pickup in M&A as we move into 2017?**

**Ms. Bohlen:** I think that we could see a pickup in 2017. M&A in the region has been fairly sluggish over the past two to three years. Larger deals have been very few and far between. We did recently see a larger one, with **First Interstate's** (NASDAQ:FIBK) purchase of **Cascade Bancorp** (NASDAQ:CACB). **FIBK** isn't necessarily in the region, but **Cascade** is. So we saw that deal, and it was one of the bigger ones for 2016.

And I think that there are a couple of factors at play here. A year ago, I thought that M&A was going to pick up because earnings could be challenging for some institutions given the difficulty of regulatory oversight and not as many assets to spread those expenses across, coupled with net-interest margin pressures and the resulting income pressure given the low rate environment. Fast-forward to today, and we find ourselves in a better rate environment and potentially a better regulatory environment. And so some of the banks that might otherwise have been inclined to sell may now wish to remain independent because things are looking a little bit more positive for them.

That said, a lot of banks have a stronger currency. And so if you had some banks that were on the sidelines because they had a certain price in mind they weren't willing to sell below, now they may be at that price, and somebody who would be interested in acquiring them may have a higher currency with which to purchase them. And so I think that that could cause some more transactions to take place.

**TWST: Last time we spoke in January of 2016, you highlighted Umpqua Bank as a top pick. You've liked it for its depressed valuation and good ROE. Now it's at, or near to, a yearly high. What is your current view of Umpqua?**

**Ms. Bohlen:** I think that for the most part it will likely trade in line with the group. The bank itself is not overly asset-sensitive, but it has shown good metrics throughout the past year. And it should, like the others, benefit over time from a higher rate environment and from the positive economic backdrop in the Pacific Northwest.

**TWST: What could upset the rosy outlook? Do you see any below-the-radar trends on the horizon that could pose risk?**

**Ms. Bohlen:** There are a couple of things. One of them would be difficulty with trade. If we were to see tariffs put into place, that could potentially hurt the export operations within the Pacific Northwest. And so that could potentially cause jobs to be lost, which of course would hurt the region. There is strong growth within the region, but I think that significant changes to tariff policy could potentially have a negative impact there.

This isn't specific to the Pacific Northwest. I would think that this could affect the broader United States as a whole. That could potentially change my outlook. And I don't think it's something that is really on the radar right now.

**TWST: Have you seen any notable technological**

**advancements or any banks that have been impacted to a large degree by the shift to digitization?**

**Ms. Bohlen:** I think they're all taking a look at it, and they're all implementing positive changes where they can. **Umpqua** (NASDAQ:UMPQ) does stand out as a strong competitor within the technological space from a banking perspective just because they tend to be on the forefront of that for a regional player. But overall, I think that the majority of the banks have done a very good job of implementing technology into their platforms. And over time I expect that to produce efficiency improvements.

**TWST: Can you summarize key factors that are most important for potential investors to focus on when evaluating a bank in the region?**

**Ms. Bohlen:** I think there are a couple of main items. Number one is management. I think it's very important to know the management team. You want to invest in strong executive teams, because if things go badly, these are the people who are going to be working it out.

I think it's also important to take a look at profitability metrics: How those have fluctuated over time, and what the drivers of those fluctuations are? For instance, if you look at a bank where ROE has been a little bit stagnant, is that a reflection of lower income, or is it a reflection of higher equity, because those are two very different things. And so I think that overall, assessing the strength of the management team, the strength of the balance sheet and profitability trends are the main items I would look at.

**TWST: How do you evaluate the strength of the management team? What are the key determinants?**

**Ms. Bohlen:** There are quantitative and qualitative measures that I use. A lot of them are just face-to-face meetings, also seeing what management has said in the past and has that guidance come to be. Are they more of an overpromise, underdeliver, or an underpromise and overdeliver type of management team? But in my mind, there's not a cut-and-dry method for evaluating a management team. Part of it is your gut. And for those of us that have been doing this for a long time, you gain years of experience with various management teams. And so come to know who tells it like it is and who tends to put a rosy glow on it, and who tends to under-promise and over-deliver.

And also through time and through meetings, you can better establish your view on a management team. In the end, it's a very personal view, and I don't think there is a checklist to be had that says whether a team is strong. It's a compilation of many, many things, and many of them are personal.

**TWST: Thank you. (VSB)**

*Note: Opinions and recommendations are as of 1/4/17.*

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