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Beyond Business as Usual

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Your Grandfather's Bank And Darn Proud of It

What's old is new again at Sterling National Bank. Continued success in troubled financial times validates the wisdom of this New York City bank's steadfast approach to the business.

Entering the dining room at Sterling National Bank's Fifth Avenue and 52nd Street headquarters in Manhattan, one can't help but feel a wave of nostalgia. The imposing mahogany table, the high-backed wooden chairs, the grandfather clock in the corner that counts the hours with a deep chime. The feel is of a lost time, a more genteel age.

Individual bank clients, small business owners mostly, are invited here every day to enjoy an intimate three-course meal. The menu is monogrammed with the customer's name, and two other people share the meal and talk of events, plans and aspirations: the president of the bank, John Millman, and its chairman, Louis Cappelli.

The two bank executives hope that such intimacy will win over new clients. They want to impress upon them the access they will have to

the bank's top brass. And there is another powerful message they intend to convey with the dark wood and slow-paced lunch: continuity and stability. This is a bank that hasn't missed a dividend payment since the days immediately following World War II; it's been more than 62 years, 250 uninterrupted quarters, since a shareholder of Sterling has gone without a dividend.

Sterling's intense focus on the customer, longevity and consistency make it a rarity. But that is not all that makes it unusual. Sterling also has a very different attitude toward growth. Instead of rapid asset and revenue growth, Sterling is obsessed with earnings and will endure relatively slow revenue growth to keep those earnings per share high. Since 2000, it's increased its assets by 43 percent; compare that to more than 1,000 percent at competitor Signature Bank, which has grown from \$500 million to \$6 billion, in about the same period. "But what's growth without profits?" Cappelli likes to ask.

Two years ago, Sterling's go-slow approach to lunch and revenue growth might have seemed hopelessly outdated and on its way out. But the \$2.1 billion bank's solid results in the face of a serious financial crisis are proving the resilience of its nearly 80-year-old business model.

"Sterling's hands-on, old-school approach to things tends to lead them to be more conservative with every aspect of their business," says Damon DelMonte, an analyst with Keefe, Bruyette & Woods. "That's been seen with their asset quality through this credit cycle so far. They haven't seen a material increase in non-performing loans and that makes it somewhat of an attractive place to put your money because you have some level of comfort because you won't be blown off by a high level of bad credit."

From 1998 through 2007 the bank's average return on tangible common equity was 18.6, "which is very healthy within the industry," says Lana Chan, managing director at BMO Capital Markets. "They also have a very attractive core-deposit base. If you look at the mix of their deposits, almost a third of their deposits

are non-interest bearing demand deposits.”

And that success is holding up. Net income grew to \$4.2 million in the second quarter, up 15 percent from \$3.9 million a year ago. Meanwhile, Sterling’s Tier 1 risk-weighted capital ratio was 9.47 percent in the quarter, in line with the bank’s competitors. Not surprisingly, given the economic environment, Sterling’s provision for loan losses doubled to \$2.2 million in the second quarter from the same period last year.

Steady Eddy

How steady is Sterling Bank? Consider this story from *The New York Times*. “In these perilous days for the banking business, [Sterling] also appears to be one of the steadiest [banks].” That passage could very well have been written today, but was written 17 years ago in May of 1991, during the last major financial meltdown.

Cappelli himself is a living testimony to that stability. Since 1934—nearly 75 years ago—Sterling Bancorp has had only two chairmen:

Cappelli followed after Theodore H. Silbert’s death in 1992. In 1949, fresh out of high school, Cappelli answered an ad in the *New York Times* for an “office boy” position at Standard Factors Corporation, which would later become Sterling Bancorp. In a double-breasted, grey, trunk-stripped suit, which his mom bought him for graduating from William H. Taft High School in the Bronx, Cappelli showed up at Standard. The lady who interviewed him offered Cappelli the job on the spot and when he asked when he could start, she told him that afternoon for the hefty sum of \$28 a week.

The bank’s sweet spot is catering to small businesses such as law firms, accounting firms, advertising firms, public relations firms, architectural firms, software designers and physician groups. And following in the steps of his

mentor, Cappelli believes profits come from great relationships with customers. “What do they do after they come here?” he asks. “Well they go and play golf on Saturday and they boast [to their friends] that they had lunch with the president and chairman of their bank. That doesn’t exist [at other banks]. We want to make them feel good, we want them to feel important, which they don’t get at other institutions.”

That approach worked on Timothy Bryan, who is the chairman and CEO of Galaxy Systems, a company specializing in

something else that we offer that no other community bank offers and that’s the access to senior decision makers,” he says. “Our clients know that they can pick up the phone and call the chairman, the president, our senior loan officers. I’m not saying that they do it every day, but they know they can do it.”

And sometimes they do call. The bank’s CFO, John Tietjen, likes to tell a story about just how much access a customer can have. One day at 5:30 p.m.—after the bank’s branches had closed—a customer called

Cappelli directly and said he had a large check he would like deposited that night. Cappelli himself waited for the customer and took the check personally. “The guy was blown away,” Tietjen says.

This same old-school philosophy extends to the bank’s hiring practices as well. “We have a lot of experience in lending and investing and running companies and as a result, I think you get to be a

better banker as opposed to going to a [business] school and coming to a bank and just looking at numbers,” Cappelli says. “We touch and feel things and know things and have been involved in every aspect of a loan: from making the loan, to foreclosing, to taking over the property, to backing up the truck, to selling the assets.”

Cappelli and Millman expect those people on the Sterling payroll to strive for that same level of detail, too. “Our senior management meets every morning at 11 a.m.,” Millman says, to talk about minutia, such as a change in a client’s bank balance. “We review details in so much greater depth than any other [banks’] management [team] does. Some of our colleagues may say we are a little too hands on.”

Taking a swipe at Bear Stearn’s former



President John Millman (standing) and Chairman Louis Cappelli

building large corporate IT systems for firms that range from \$2 to \$60 billion. Prior to founding Galaxy 18 years ago, Bryan was a customer at a large competitor.

“When you deal with a larger bank, the closest that you can get to a relationship like Sterling may develop with a branch manager,” Bryan says. Galaxy started with a handful of employees in a cramped New York City studio apartment. Today the company has more than 350 employees and offices in New York, New Jersey, Toronto and Bangalore, India. “You get the entire power and support of an entire banking operation, but the intimacy of a branch.”

Millman says this access is the bank’s strongest selling point. “I believe that our loan officers are as good as any community bank officers anywhere, but there is

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CEO Jimmy Cayne, and his penchant for business junkets and bridge tournaments: “We’re not managers that go and play bridge during a crisis,” Cappelli says. “We’re here from eight in the morning until at least six at night, on a normal day, and we watch and we manage the business as close as we possibly can.”

Cappelli says that if he wanted to focus on growth for growth’s sake, he could, and grow rapidly.

But he is absolutely unapologetic that profitability should come first, “Ask that question to [Ken Thompson] at Wachovia, who went and bought [Golden West Financial],” Cappelli says. “He wanted to get bigger,” and now he is out of a job. ... “If we were to reverse [our underwriting standards] we could have 20, 30 branches and instead of having \$2 billion in footings, we could have \$3 billion in footings,” Cappelli says. “But that’s not our game plan.”

The Downside

Not everyone agrees whole-heartedly with the Sterling game plan. For instance, while both Sterling and cross-town rival Commerce Bank (since bought by Toronto Dominion Bank) focus on customer service, they go about that end in vastly divergent ways. Commerce’s founder and retired chairman Vernon Hill says that Commerce and Sterling are at the extreme opposites of the banking spectrum.

Commerce, he says, believes that the true value of a bank is in growing low-cost core deposits. Sterling, on the other hand,

believes the value of a bank is growing their loan book.

“The current problems over the last year has, in my opinion, proven the Commerce model that companies with solid, low-cost funding, have a real advantage,” Hill says. “There’s always room for every model [but] Sterling hasn’t been able to grow with their model and I’m not sure they *can* grow with it.” Cappelli counters that the cost of deposits was too high for Commerce and while their growth was tremendous, ROE was not.

Shareholders have not been rewarded with stock appreciation, despite being an acquisition candidate.

However, investors have not been rewarded with stock appreciation, and Chan and DelMonte, despite their respect for Sterling’s management, rate the stock only a marketperform or neutral. Indeed, its price is down from a high of \$27.09 in January of 2005 to \$15.55 in early August—even though the performance has been stellar and the bank is considered an attractive acquisition target.

“In the New York City marketplace, it is one of the few remaining independent commercial banks left,” Chan says. “Every-

one else of its size has mostly been consolidated. There are very few players focusing on the small business market as focused as Sterling is right now. ... For any of the large banks that want to eventually come into the metropolitan New York market, Sterling would be one of the top choices,” Chan says.

Despite the lackluster stock price, Cappelli is unfazed, and believes that growth on Sterling’s terms is possible and will continue. “When we were at \$400 million in assets in 1992, and we were having these lunches, someone asked me, ‘How are you going to be able to do this when you are a billion-dollar company?’ Now we’re a \$2 billion bank and we still meet with [our clients] for lunch everyday,” he says. “This is what we do. This is what we sell to people. And when we get to \$4 billion, we will still do it.”

Although now 77, Cappelli expects to lead Sterling for some time. When the Bronx native does retire, however, he expects the values he and his predecessor have preached since 1934 will continue.

“We have a cadre of senior executives beyond our immediate level who have been here for 10, 15 years. They believe in our model, in our system, in our way of doing business, because if they didn’t they wouldn’t stay here. We believe that they will take those principles and follow those principles and hopefully do a better and bigger job than we’ve done, just as we’ve done succeeding our predecessors.”

—Anthony Malakian



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STERLING NATIONAL BANK

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COMPANY PROFILE

Sterling National Bank, with offices in New York City and Queens, Nassau and Westchester counties, was founded in 1929. Sterling serves the needs of businesses, professionals and individuals by offering a broad array of products and services combined with a unique high-touch approach to customer service. Sterling National Bank is the principal banking subsidiary of Sterling Bancorp (NYSE: STL), a New York-based banking and financial services company with assets exceeding \$2.0 billion.

Known for its focus on business customers, Sterling offers such services as working capital lines, asset-based financing, factoring and accounts receivable management, payroll funding and processing, equipment leasing and financing, commercial and residential mortgages, international trade financing, cash management, a wide array of deposit products, trust and estate administration, and investment management services.

OFFICE LOCATIONS

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425 Park Avenue (between 55th & 56th)
New York, New York 10022-3506
John Henry, VP & Branch Manager
212-935-1440

Grand Central Plaza

622 Third Avenue (40th Street)
New York, New York 10017-6722
Michael Madeo, VP & Branch Manager
212-490-9813

Seventh Avenue Office

512 Seventh Avenue (38th Street)
New York, New York 10018-4603
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212-354-2265

Broadway Office

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(between Exchange Pl. & Morris St.)
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Great Neck, New York 11021-3006
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516-466-4554

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