First Republic Bank
Strategy Report

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Executive Summary

First Republic Bank (NYSE: FRC) is a leading private banking and wealth management company. They specialize in luxury and large home mortgages working with high-net worth individuals providing lending, mortgage, and wealth management services. For the 27 years it has been in business, it has been profitable for 25 and has enjoyed growth in enterprise value of 22% per annum in those 27 years. Their initial IPO in 1986 was done with a market valuation of $23 million. Market of valuation as of the end of FY2012 is at $4.3 billion, showing amazing shareholder value creation[1,2].

First Republic's greatest strength and asset is their great reputation for exceptional client service. Being a customer-oriented firm has been at the core of First Republic's business strategy since their inception. First Republic also prides themselves in the high quality loans they originate, having experienced a cumulative loan loss of 5 basis points in their 27 years of operations – an incredible feat. Their high quality loans have become highly demanded in the secondary market for mortgage backed securities. In Q1of FY2013, First Republic had a record number of loans sold in the secondary market due to the large excess of loan originations which exceeded their expectations[3].

As high-net worth individuals seek greater levels of value added, more of the private banking and wealth management industry is focusing on shifting toward a client-focused business model. However, First Republic has a first mover advantage and has been building their reputation as a client-focused firm for 27 years while maintaining growth. We at Bridges Consulting recommend that, in order to maintain their position as a firm with superior client service, they implement consumer satisfaction metrics such as the Net Promoter Score. Furthermore, we also recommend that First Republic implement a system to gather more detailed information on client levels of satisfaction across various aspects of their business such as Voice of the Customer analysis. Our other recommendations are that: First Republic expands domestically, such as to the Dallas metropolitan area; increase the capabilities of their private wealth management arm and market their service like a luxury service through advocacy marketing.

Company Background

The private bank and personal wealth management company first opened their doors as First Republic Bancorp Inc. in San Francisco in 1985. First Republic Bancorp Inc. was founded by James H. Herbert, CEO of First Republic, and Roger Walther, founding Chairman. The company's main initial banking efforts primarily targeted real estate lending, specifically focusing on larger home loans. Today, residential mortgage loans remain a core business operation, accounting for 66% of total loans[1].

Growth for First Republic

After opening in June 1985, First Republic Bank sustained a steady growth rate throughout the remainder of the decade. In 1986, the company was approved as seller-servicer with both Fannie Mae and Freddie Mac with deposits insured by the FDIC, and completed an initial public offering of common stock, selling 840,000 shares at a market value of $23 million listed on the NASDAQ exchange. In 1991, the company issued 1.7 million shares in 2 offerings with a market value of $100 million. During the 1990's, First Republic Bank continued to develop and open more branches throughout California, as well as in Nevada and New York.

In 1996, First Republic introduced the service mark, "It's a privilege to serve you®," representing the heart of the bank's brand. First Republic states in their corporate values page: "Our business may be about wealth management and banking, but our success is all about service—exceptional customer service." First Republic seeks to both differentiate themselves from competitors as well as generate new business in this way. Commitment to service creates long- term client relationships, and as a testament to the quality of First Republic's commitment and client focus, referrals are the company's number one source of new business. In fact, in 2011 and 2012, Private Asset Management Magazine named First Republic Bank the top rated private bank for client service[4].

In 1999, the company established the First Republic Trust Company, which takes a hands-on and personalized approach to a range of trust services. Closely after, First Republic Securities Company was founded in 2000, offering brokerage and investment solutions. By 2004 First Republic and their subsidiaries offered fully integrated wealth management.

Acquisition and Independence of First Republic

In 2007 the company was taken private as Merrill Lynch acquired First Republic Bank for $1.8 billion in cash and stocks. First Republic Bank's clients have an average net worth of $50 million, and as such Merrill Lynch's goal was to gain new wealthy customers in order to grow their high net-worth, private banking business. After acquisition, First Republic was run as a separate entity and their leadership and management positions remained unchanged. In 2008, Bank of America acquired Merrill Lynch and as a result, also owned First Republic[1].

However, First Republic did not fit into the goals and plans of Bank of America and a deal was struck in 2009 with private equity firms Colony Capital and General Atlantic, which bought just fewer than 50% of First Republic Bank. The remainder of the company was bought by five independent directors who had been previously affiliated with First Republic for quite some time, including Chairman James Herbert and COO Katherine August-DeWilde. Colony Capital's head, Thomas J. Barrack Jr. had been a board member prior to the Merrill and Lynch acquisition and General Atlantic had been an early investor in First Republic, putting up about $5 million in 1987. On July 1, 2010 the buyback had been completed for $1.86 billion and First Republic became independent once again. In 2010, First Republic had another IPO where it sold 11 million shares at $25.50 a piece and listed on NYSE as FRC. In 2011, First Republic was added to the Russell Global, 3000 and 1000, Wilshire 5000, and several Down Jones stock market indices.

First Republic Today

First Republic has come a long way since 1985, at which point it had $64 million in total assets. Today, First Republic Bank provides private business banking services, private wealth management, residential lending products and deposit services. As of December 31, 2012, First Republic had total assets of $34.4 billion, total deposits of $27.1 billion, total equity of $3.4 billion and wealth management assets of $31.7 billion. The company operates 70 offices in metropolitan areas throughout the United States: San Francisco, Palo Alto, Los Angeles, Santa Barbara, Newport Beach, San Diego, New York City, Boston, Portland (Oregon), and Palm Beach. Of these offices, 62 are Preferred Banking licensed deposit-taking offices, and the additional eight offices exclusively offer lending, wealth management, or trust services. Approximately 69% of First Republic's outstanding loans are in California.

In the beginning of 2013 the company acquired Luminous Capital Holdings LLC, a Los Angeles based wealth advisor firm with similar client service standards and complementary wealth management capabilities. The goal of this acquisition was to strengthen First Republic's wealth management component of private banking, and is the first acquisition of this kind for First Republic.

Business Model

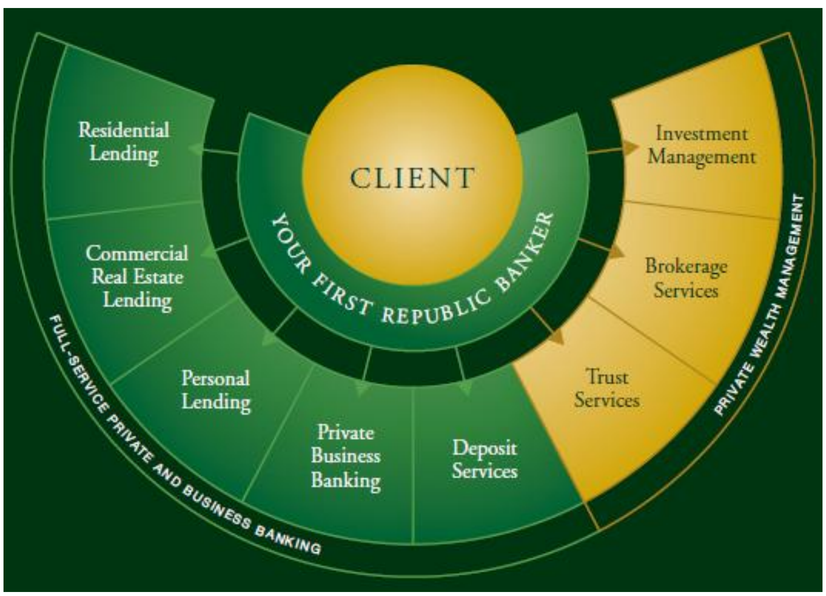
First Republic Bank is a California-chartered commercial bank and trust company headquartered in San Francisco, with deposits insured by the FDIC. What differentiates First Republic from competitors is their commitment to personalized, relationship-based Preferred Banking, preferred business banking, real estate lending, and trust and wealth management services. First Republic does not engage in proprietary trading or investment banking activities, nor does it originate or trade in derivatives.

First Republic's business is operated through two distinct segments, Commercial Banking and Wealth Management. The focus of both segments is a service-based culture, and a commitment to the following principles: originate high quality relationships, deliver superior client service, attract and retain high quality service professionals, cross-sell products and services, grow the wealth management business of First Republic, and grow core deposits.

First Republic has grown their core deposits at a compounded annual growth rate of 20% over the past five years, and was listed as the 39th largest banking organization in the United States measured by total deposits at the end of 2012. This growth has been fostered by the company's strategy to cross-sell deposits to loan clients, businesses, and nonprofits. As of December 31, 2012, First Republic's deposit base consisted of $14.0 billion - 52% in checking deposits, 37% in money market checking, savings and passbook deposits, and 11% in certificates of deposit (CDs).

First Republic offers a broad range of lending products, including residential mortgage loans and lines of credit, commercial real estate loans, residential construction loans and small business loans, secured by single family residences, multifamily buildings and commercial real estate properties. First Republic's lending strategy is to emphasize single-family mortgage loans and to originate on a selective basis multifamily mortgages, commercial real estate mortgages, construction loans and other loans. The strategy also emphasizes lending to borrowers who are successful professionals, business executives or entrepreneurs and who are buying or refinancing homes in metropolitan communities, as this demographic is most amenable to accepting other products and services.

First Republic's Wealth Management activities include investment and brokerage activities, as well as investment advisory services through their subsidiary, First Republic Investment Management. Additionally, First Republic earns fees from transacting foreign exchange on behalf of a client, by executing trades with a customer and offsetting that foreign exchange trade with financial institution counterparty. First Republic Trust Company, another subsidiary, specializes in personal trust activities and operates in California, Oregon, Washington, New York, and Massachusetts. FRTC gathered $5 billion in assets by the end of 2012[1].



Source: First Republic Bank Annual Report 2012

Financial Analysis

Overview

First Republic Bank (NYSE: FRC) is a mid cap stock with a market capitalization of $5 billion, making First Republic much smaller in comparison to the other major competitors in the money center banks industry; in order to compete with their larger competitors, they have focused on building high quality relationships, attracting and retaining high quality service professionals, and growing their core deposits. They operate their business through two business segments, commercial banking and wealth management, with 8% ($2.8 billion) of their assets coming from commercial banking and 92% ($31.7 billion) from wealth management.

As FRC has continuously been headquartered in San Francisco, approximately 69% of their loans outstanding are in California.

Profitability & Growth

As of December 31, 2012, First Republic Bank had total assets of $34.4 billion, total deposits of $27.1 billion, total equity of $3.4 billion and wealth management assets of $31.7 billion. While their banking sector has grown deposits at a compounded annual growth rate of 20% over the past 5 years, their wealth management sector saw a 55% increase in assets during the fiscal year ending in December 31, 2012. The bank is very liquid with $4.1 billion in cash, cash equivalents, and investment and has total assets of $34.4 billion and total liabilities of $31 billion. Their net profit margin for the most recent quarter ending March 31, 2013 was 27.4%[1].

When we break down First Republic Bank's revenues, we see that 88% ($1.287 billion) of their income comes from interest income – income accrued through interest on loans, investments, cash equivalents, and loans to Parent company – with only 12% ($168 million) coming from non-interest income – income mostly from wealth management fees; if we attempt to break down the interest income, we can see that interest on loans comprises 90% of the total income at $1.16 billion. Examining the expense report, we see that only 14% ($114 million) of the expenses come from total interest expense, while the remaining 86% ($698 million) comes from the total non-interest expense, most of which is *salaries and related benefits*; this accounts a 21% increase in non-interest expense from 2011. If FRC can increase the income from interest on investments, as well as non-interest investments such as *investment advisory fees* and *income from investments in life insurance*, First Republic may be able to increase their profitability.

DuPont Analysis

In comparison to the industry average return on equity (ROE) of 8.18%, First Republic Bank is doing well with a ROE of 13.68%. We can break down this number by the profitability, operating efficiency, and financial leverage of FRC:

1) We see that the profit margin for the last year is 31%, calculated by:
   Net Income/Sales=$454 million/ $1,469 million =31%
2) We see that the asset turnover ratio is 0.04, calculated by:
   Sales/Total Assets=$1,469 million/ $34.4 billion = 0.04
3) We see that the equity multiplier is 10.1, calculated by:
   Total Assets/Total Equity=$34.4 billion/ $3.4 billion= 10.1

DuPont Analysis for First Republic and Competitors[5]

	FRC	PBCT	Industry	Sector
Profit Margin (ttm)	31.02	19.74	19.35	22.39
Asset Turnover (ttm)	0.04	0.04	0	0.08
Equity Multiplier (ttm)	10.1	6	-	-
Return on Equity (ttm)	13.68	4.78	8.17	7.68

We see that First Republic has ratios close to the industry averages with high profit margins and financial leverage and a low asset turnover rate; as we would expect from a company in the money center bank industry, FRC has a very low asset turnover rate which indicate that they sell a small multiple of their assets per year. The high return on equity ratio (ROE) is a result of their high profit margin, which is 60% higher than the industry average; this shows that along with their increasing sales they have maintained their high profit margin. Another factor to the high ROE is their high financial leverage, which is 68.3% higher than one of their competitors People's United Financial.

Liquidity & Solvency

The company is highly liquid entering 2013 with $4.1 billion in cash, cash equivalents, and investments; First Republic Bank also has $34.4 billion in total assets and $31 billion in total liability. It is in good shape for 2013 as it has enough cash to make it through the current fiscal year. The most recent cash flow statement shows that in the fiscal year ending on December 31, 2010 they had a positive net change in cash of $1.35 billion; with an increase in customers and assets in the past two years, they have also had a positive net change in cash during the past 24 months.

2012 year highlights[1]:

- Tier 1 leverage ratio 9.32% from 8.81% a year ago showing capital strength
    - Very similar to their competitor PBCT's ratio of 9.81%
- Book value per share up by 13.5% to $22.80
- Net income was a record $402.5 million, up 14% from 2011
    - Net income of $352 million was a 30% increase from 2010
- Loan originations a record $15.5 billion
- Loans outstanding $27.1 billion, up 21%
- Wealth management assets were $31.7 billion, with $5.9 billion from Luminous Capital Holdings LLC, up 55%

Stock Performance

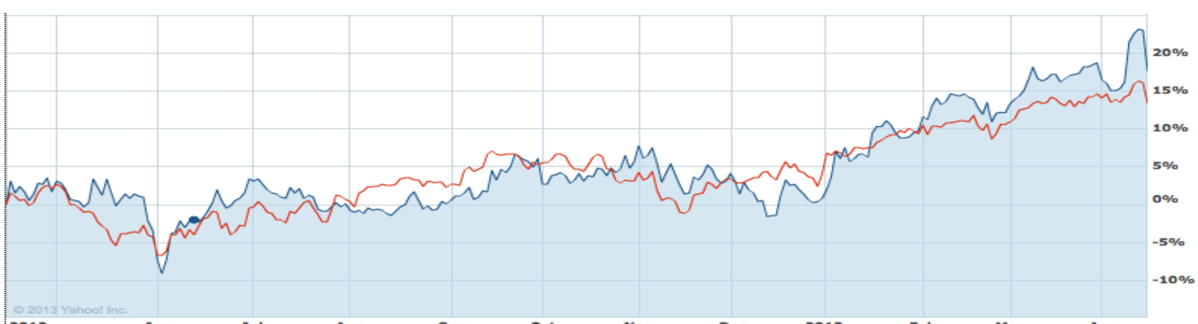


Figure 1: FRC vs. S&P 500 TTM[6]

Direct Competitor Comparison					
	FRC	BPFH	PVT1	PVT2	Industry
Market Cap:	4.99B	746.52M	N/A	N/A	30.40B
Employees:	2,110	827	N/A	N/A	23.26K
Qtrly Rev Growth (yoy):	0.10	0.08	N/A	N/A	0.17
Revenue (ttm):	1.26B	297.49M	N/A	N/A	14.57B
Gross Margin (ttm):	N/A	N/A	N/A	N/A	0.72
EBITDA (ttm):	N/A	N/A	N/A	N/A	-657.00K
Operating Margin (ttm):	0.50	0.28	N/A	N/A	0.34
Net Income (ttm):	370.53M	39.53M	N/A	N/A	N/A
EPS (ttm):	2.76	0.61	N/A	N/A	1.74
P/E (ttm):	13.78	15.42	N/A	N/A	11.14
PEG (5 yr expected):	1.34	1.02	N/A	N/A	1.04
P/S (ttm):	3.97	2.50	N/A	N/A	2.29

Figure 2: FRC vs. Direct Competitors[6]

We see that in the trailing twelve months the stock has faired well against S&P 500 being up just under 20%. As previously stated, we can see that First Republic Bank is a smaller bank than the industry looking at the market capitalization and number of employees. As a smaller bank they have an advantage of having a higher profit margins and price/earnings to growth ratio.

Competitive Analysis

Internal Rivalry - High

First Republic Bank occupies two spaces: private retail banking and private wealth management. In both these areas there exist many different financial players that are all competing for deposits and new clientele. Since the Financial Services Modernization Act of 1999, banks have consolidated and have become much more vertically integrated, providing their customers with a wide array of products and services all neatly gathered at a single institution. Thus, through greater degrees of economies of scope, banks can increase the cost of separation and decrease the attrition rate of their clients by increasing the average number of products per client, especially in a private wealth management capacity.

First Republic occupies space that is already highly saturated with other financial institutions that have considerable clout and brand recognition. For example, New York, Los Angeles and San Francisco are likely to have high levels of competition simply due to the large number of suppliers that are offering financial services in those markets.

First Republic competes with many different entities when it comes to gathering deposits and mortgages. The biggest competitors are the retail and commercial banks such as Bank of America, Chase and Wells Fargo who all offer checking and savings accounts, certificates of deposits (CDs), and loans. This sector mostly competes with the interest rates they offer on their deposits, CDs, and interest rates on loans. There is also high competition when it comes to capturing new clients, whether in the retail or commercial sector. Their client base is usually retained by aggressively cross-selling products and increasing the client's cost of separation.

When it comes to wealth management, competition is also fierce. There are many different alternatives when it comes to wealth management services. The main competitors in this sector are those under the diversified financial service industries with investment banks such as Goldman Sachs, JP Morgan and Merrill Lynch also offering wealth management services. These firms enjoy larger economies of scope and scale compared to First Republic. As a result, First Republic may find themselves subject to predatory pricing. However, First Republic's small size and market share may allow it to price more aggressively and go largely unnoticed[7].

A large reason for high internal rivalry is the fact that financial services are highly undifferentiated (which First Republic tries to change by providing great service). Therefore, a lot of the competition, within private banking and wealth management, occurs with pricing and, increasingly, with customer service. High-net worth individuals are increasingly more responsive to overall "real value added" than simply price for service[8]. As such, much of the differentiation occurs with brand name and reputation for exceptional client service.

Entry & Exit - High

Barriers to entry are high in both the private banking and private wealth management sectors. One of the largest barriers to entry is brand reputation and recognition. A new entrant in the market is unlikely to receive much business due to the fact that they represent larger risks; agents in the market are unable to ascertain the level of solvency of the new entrant and unable to have a reference point for performance or client service. This makes any transaction with the new entrant much riskier than a transaction with a well established firm.

Furthermore, banking requires large levels of capital in order to establish branches, IT systems and security, ATMs, and other infrastructure that is required of a bank to be successful. As a result, new entrants in the market require a large amount of up-front investment in order to even get established. Thus, tight credit lines can prove to be a substantial and immediate barrier to entry.

Stringent capital requirements are also burdensome for smaller banks. Continual assessment of the entrant's assets, liabilities, ownership, and income requires substantial amounts of knowledge to able to comply with. A new entrant must therefore have intimate knowledge of the banking industry. A new entrant will also have a difficult time entering market while meeting the capital requirements. Large sources of capital for banking institutions are deposits and interests on loans. However, as a new entrant, there will be no pre-existing clientele base from which it can gain any deposits and thus cannot originate any loans either.

While there are significant barriers to entry, boutique wealth management firms can, and have, become successful entrants into the market. Usually the boutique wealth management firms are managed by analysts and wealth managers that left a large investment bank along with the clients under their management. These managers have proven their success in the larger firms and have created loyalty with their clients, thus they have reputation, a pre-existing clientele base, and a higher chance of capturing market share.

Overall, however, the barriers to entry in the private banking and private wealth management sectors are high.

Substitutes & Complements - Moderate

There are a number of substitutes for both the private banking and wealth management. In terms of private banking, a major player would be credit unions. Credit unions offer the same sort of client-focused services but may require their customers pay a premium for their services.

In the current low-interest rate climate, assets that offer higher returns than a savings account can also be seen as substitutes to deposits. Clients may prefer to invest in U.S. Treasury securities or mutual funds in order to receive higher returns on their investment while minimizing their exposure to risk. Clients can also choose to invest in the stock market, commodities, or real estate to earn interest on their excess cash.

Substitutes for wealth management services are also abundant. A few of these wealth management services can also be seen as substitutes for a checking and savings account, especially in the low-interest environment we are currently in. However, for high-net worth individuals, there exist other avenues in which they can invest in. They can invest in a variety of different hedge funds, and if they have the required resources, can even go into private equity as alternative means to private wealth management.

Complementarities are often found within the vertical structure of private banking and wealth management. First Republic offers brokerage services, trust services, wealth management services, and loan services which can all serve as complements to one another. The complementarity of products within a bank also increases their ability to cross-sell their products.

Technological progress has also increased the complementarities found in financial services and products. With the rise of smartphones, it is now easier than ever to do online banking. Using smartphones, clients can deposit checks without needing to be at a branch office or even at an ATM. Of course, we cannot forget the ATM debit and credit cards that complement checking and savings accounts.

Supplier Power – Low

Banks have three sources that supply capital: depositors, the credit market, and the central bank/federal reserve (Fed). Of these three sources, individual depositors have the least amount of supplier power. Generally, a depositor decides to deposit at a bank based primarily on the interest rate that bank is willing to pay. Depositors can "shop-around" for the best rate, but due to the large supply of depositors they are price takers and have no supplier power. Corporations and wealthy individuals can have some kind of supplier power but this generally comes in the form of lower restrictions on withdrawal amounts.

The credit market and equity market are also suppliers of funds to banks through the issuance of debt and equity. Most investors in the credit and equity markets readily buy issuances of debt and equity by banks, since these banks generally have good credit ratings and, for the most part, remain solvent. As the economy has recovered, trust in the banks has recovered as well. It is also interesting to note that in the future, with more stringent capital requirements, banks will rely less on the credit market and more on the equity markets to fund their operations. The price of the stock is set by the market, and not any individual investor, meaning that supplier power in the equity market is low.

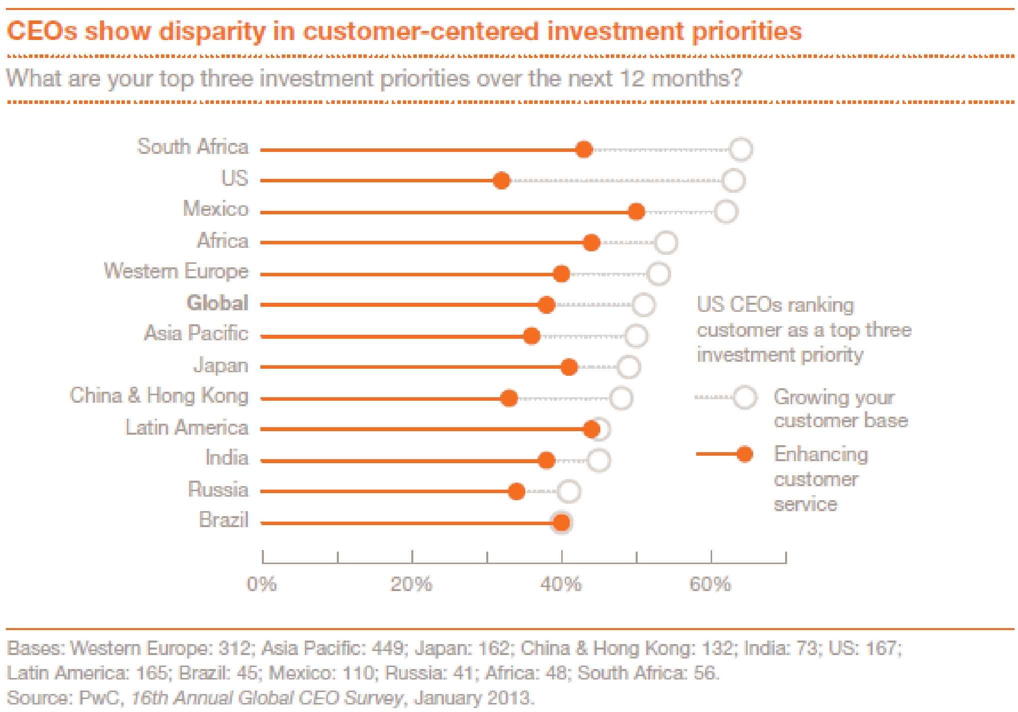
The last source of major funds to banks comes from the Fed and is usually used as a last resort. The Fed will supply the bank with an almost unlimited amount of funds with reasonable interest rates. However, the Fed, in exchange for funds, can intervene in a banks operation if they deem it is necessary. Thus, while the Fed can provide liquidity to the bank, the need to have to use is as a source could send a signal that the bank is not in great financial health. This could potentially limit the amount of funds the bank can raise in the credit market and hurt consumer confidence.

Physical inputs, such as computer, desks, chairs, etc. have a large variety of suppliers and should not have any large amounts of supplier power. Human capital, on the other hand, could potentially have significant supplier power. As the top financial institutions all compete in the same labor market, wages are bid up and the highly skilled may be able to ask for a premium in the market.

Buyer Power – Moderate

The buyers in this market are those that seek the financial services of the banks. With many different individual buyers in the market, and low concentration within the market, each buyer holds relatively low amounts of buyer power. Moreover, there is usually little haggling over interest rates in retail banking. However, very wealthy individuals and large corporations may have buyer power but the extra benefits they receive are usually from lower restrictions, lower fees, and more freedom with their accounts than with increased prices.

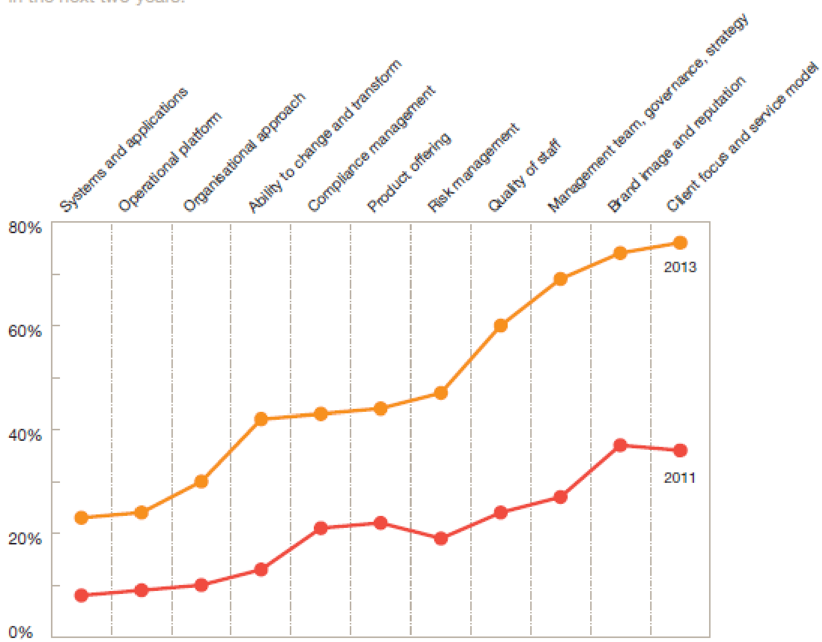
Within private wealth management, clients have shifted from focusing solely on the bottom line to caring more about "real value-added" by the bank performing their wealth management[8]. Since the financial crisis, a key and growing component of "real value-added" has been the quality and breadth of client service. Many of the CEOs and firms in wealth management have begun to respond in-kind, with focusing on becoming a client-focused firm a top three priority[9]. Thus, while those seeking wealth management services are not actively bidding the price down, they are bidding up the level of "real value-added" at each price point.



Source: PwC Global CEO Survey 2013

Figure 4: Organisational self-assessment 2011 and 2013

Please rate your organisation's current state in the following areas, and your desired target state in the next two years.



Based on respondents' answers to the survey, we analysed leading and high-performing aspirations from current to future state across a range of business areas and functions.

Source: PwC Global Private Banking and Wealth Management Survey 2011

SWOT

Strengths

- **Reputation & Exceptional Client Service:** In the world of Finance, a long standing reputation for customer service and performance is very powerful. According to PwC's, "*Anticipating a new age in Wealth Management: Global Private Banking and Wealth Management Survey 2011*", there has been a shift among clients, prioritizing client service over overall performance. This is not to say that performance is less important, but that clients have started to question how much "real value" is being added with client service becoming a larger fraction of "real value added." As such, First Republic Bank's reputation for exceptional client service is a highly valuable asset and essential to their overall business strategy and work culture. Their commitment to be a client-focused firm is evidenced by the fact that a large majority of their new clients are referred by current clients who are satisfied with First Republic Bank's service and performance and has been the driving force of growth the past 27 years. It is also a key point which First Republic Bank rallies behind, with their slogan being "It's a privilege to serve you, ©" putting client testimonials in their annual reports and front-and-center on their webpage. Furthermore, First Republic Bank has been awarded the "Best Private Client Service" in 2012 and 2011 by the "Private Wealth Management Magazine" and "Best Private Bank" in 2012 and 2013[4].

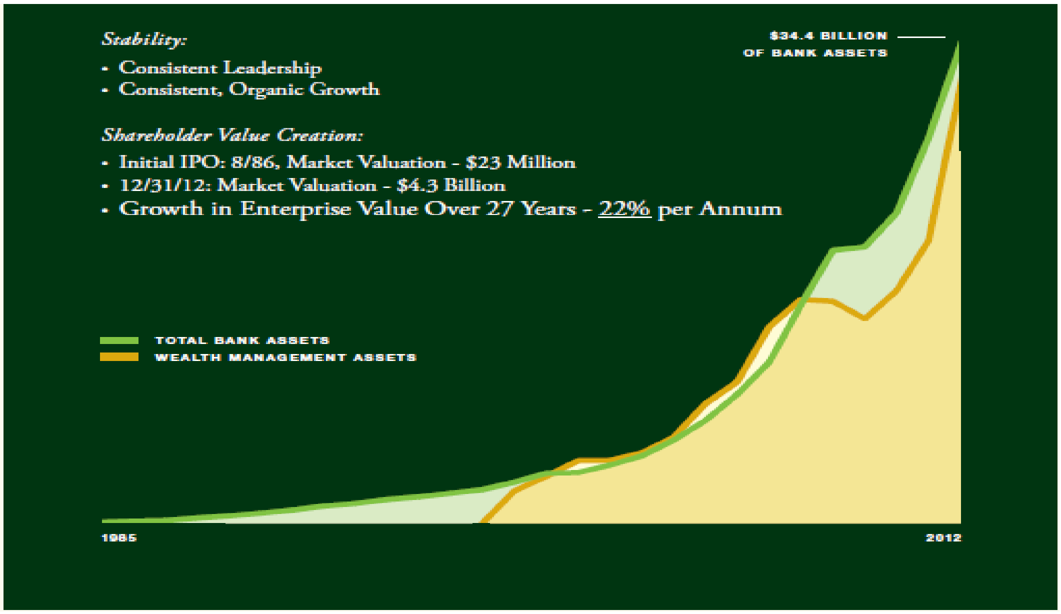
- **High Underwriting Standards:** In light of the subprime mortgage crisis in 2008, underwriting standards have come under closer scrutiny. However, First Republic Bank has managed to largely insulate themselves from the subprime mortgage crisis because they have continually focused on underwriting and originating high quality loans. From their 10k, we see that the average home loan for the past two years has been $933,000 with clients having, on average, a net worth of $14.8 million, liquidity of $4.5 million, and credit score of 764. As a result, they experience very low delinquency rates. Since 1985, of their $59.2 billion in loan originations, they have experienced a cumulative net loan loss of only $30.2 million. In other words, they have only experienced a cumulative loan loss of 5 basis points in the 27 years since First Republic was established[1].

- **Under Same Management Since Their Inception:** Founder and CEO James H. Herbert and President and COO Katherine August De-Wilde, have been with First Republic Bank since their opening in 1985. This has provided First Republic a cohesive and stable strategy for the past 27 years, giving stockholders, employees, and clients a clear indication of where First Republic is heading and how it plans to get there.

- **Well Capitalized:** First Republic Bank has maintained historically high levels of capital. For FY2012, their Tier I leverage and total-risk based capital ratios were 9.32% and 13.86% respectively. The requirements for a "well capitalized" bank, as set by the FDIC, are that a bank maintain a Tier I capital ratio of greater than 6%, and a total capital ratio of greater than 10%. Thus, we can see that First Republic far exceeds the requirements for a "well capitalized" bank. First Republic Bank's Tier I capital is mostly built through the sale of Noncumulative Perpetual Series A, B, C, and D Preferred Stocks. Furthermore, while increased capital requirements have been propose (Basel III), First Republic calculates that if their single family loans were classified as "category 2 residential mortgages", their CET1 ratio would be 8%. If the single family loans were classified as "category 1 residential mortgages", their CET1 ratio would be 11%[1]. The fully phased-in Basel III requirements for CET1 would be 4.5% common equity capital to risk-weighted assets and a 2.5% "conservation buffer", coming out to a total of 7%[1]. An additional 2.5% common equity may also be required in economic booms. As such, in their current state, First Republic Bank is very likely to meet the more stringent Basel III capital requirements[1].

- **Strong Growth and Profitability:** In First Republic's 27 years of operation, they have been profitable 25 years (non-consecutive). Furthermore, within the last couple of years they have exhibited phenomenal growth. From 2007 to 2012, as can be seen on the graph below, total bank assets grew at a compound annual growth rate (CAGR) of +17%, loans at +20%, deposits at +20%, and wealth management assets at +15%[2]. This type of growth continued into FY2012 with loans growing by 21% in the year, bank assets increasing 23% to $34.4 billion up from $27.8 billion, and wealth management assets growing 55% to $31.4 billion, including the Luminous assets, up from $20.4 billion the year before[1].

Source: First Republic Bank Annual Report 2012



Source: First Republic Bank Annual Report 2012

- **Economies of Scope:** When choosing which financial institution to have as a "home," an important factor is often convenience. Having a "one-stop-shop" for deposits, loans, and wealth management can be a very big reason to choose a certain main bank. First Republic fits the "one-stop-shop" role quite nicely, providing fully integrated wealth management and private banking services. Currently, the average number of products per client currently sits at nine. A greater number of products per client could potentially create an anchoring effect – as the number of products per client increases, the client attrition rate decreases. Furthermore, First Republic's free ATM rebate program (with a minimum deposit of $500) allows their clients to access their account from *any* ATM, with any access fee that may be charged refunded in full by First Republic[4]. This allows First Republic to boast a network of 800,000 ATMs worldwide and provides easy, convenient access to checking and savings accounts for their clients.

Weaknesses

- **Highly Concentrated in California (Especially the San Francisco Bay Area):** First Republic Bank is highly concentrated on the west coast, specifically Northern California. In 2012, 61% of their deposits originated from California and 45% of loans outstanding were located in and around the San Francisco Bay. As such, First Republic is very sensitive to

California's economic climate and a general economic downturn, or a downturn in California's housing market, could have an adverse effect on First Republic's ability to generate income on loan interests and reduce overall demand for their products.

- **Interest on Loans is a Large Percentage of Net Income:** A majority of First Republic's income comes from interest income – income accrued through interest on loans, investments, cash equivalents, and loans to Parent company; total interest income in FY2012 was $1.28 billion versus $168 million in total non-interest income, with similar ratios in previous years. Furthermore, a disproportionate percentage of interest income comes from interest on loans. In FY2012 interest on loans represented 90.2% of total interest income – in FY2011 93.3% and in FY2010 98.4%[1]. Thus, a sharp decrease in loan originations due to a weak housing market and decreasing real estate prices could have adverse effects on First Republic's level of net income. It seems the recent housing crisis only reduced the rate of growth close but did not make growth negative. This is most likely due to the fact that their clientele consists of high-net worth individuals and their consistent policy of originating high quality loans.

- **40% of Deposits From 1% of Clients[1]:** First Republic reveals, in their 10k, that significant shares of their deposits originate from a few deposit relationships. These customers generally have no restrictions on withdrawal amounts and are able to close their accounts at any times notice. If First Republic fails to retain these clients, they could be forced to borrow or use more costly sources of funding to meet their business and withdrawal demands.

- **Size:** Larger banks and financial institutions may have an advantage in meeting the more stringent capital requirements as they are able to spread compliance costs due to economies of scale. The lack of sufficient economies of scales may affect First Republic's ability to meet more rigorous capital requirements as well as reduce revenue and income due to increased compliance costs in the future. Currently, however, they run no risk of non-compliance with capital requirements. Furthermore, their small size could put them at risk of predatory pricing.

Opportunities

- **Decreasing Inter-Generational Attrition Rate:** PwC's studies have shown that the attrition rate for inter-generational asset transfers is as high as 50% in many markets[8]; with significantly higher incidences of attrition when the heir is the child of the client, or a charitable organization. As the generation of the baby boomers ages, inter-generational attrition rates could be a significant risk factor to private wealth management firms. As such, strategies to reduce inter-generational attrition rates should be implemented. Creating cross-generational loyalty and understanding their clients' family time horizons are essential in limiting inter-generational attrition rates. It is also an opportunity for First Republic to potentially capture their competitor's clients and increase market penetration.

- **Low-interest Rate Environment:** Strategic acquisitions, like the recent acquisition of Luminous Capital, can be an opportunity to increase market penetration in key market areas. First Republic, if entertaining the thought of acquisitions, should seek out firms that have the same client-focused business model that could act as a complement to their network of private banking and wealth management.

Threats

- **Increasing Regulation and Capital Requirements:** Increasingly more stringent capital requirements, such as Basel III, can create high compliance costs in a small bank such as First Republic. This is mostly because the capital requirements force banks to be funded through equity rather than debt and the stringent capital requirements can also force banks to decrease lending activities in order to conform to the new standards. Increased regulation, such as through the Dodd-Frank Act, can limit the use of products that are deemed too risky or products that "take advantage" of consumers. Currently, Dodd-Frank prohibits "high-cost mortgages" and could make mortgages with pre-payment penalties difficult or impossible to originate. While not currently a large problem, it sets a precedent for the kind of regulations that could be put in place.

- **Government Inaction, "Fiscal Cliff":** With the current trend of congressional inaction and the slow, protracted rate at which budget solutions are resolved, investors in both the domestic U.S market and abroad are faced with uncertainty regarding future economic health. As a result, the uncertainty that is created by the government could lower aggregate consumer confidence, resulting in decreased aggregate demand. While all sectors of the economy would be affected, uncertainty in the financial markets creates a risk-adverse environment. This could result in lower loan originations due to uncertainty in the housing market, a flight to "safe" investments such as U.S. Treasury securities or bonds, decreasing First Republic's interest income and income from service fees.

- **European Crisis:** As the global economy becomes more interconnected, international economic activity becomes increasingly more important to overall domestic economic health. The potential collapse of the European Union could have ripple effects that have negative impacts on the US economy and adversely affect First Republic.

Strategic Recommendations

Expand Domestically

First Republic is highly concentrated on the coasts of the US, especially the San Francisco Bay area in Northern California. Diversifying away from these markets – even though they may be profitable and have growth potential – is key in insulating themselves from regional macroeconomic conditions and maintaining First Republic's growth rate.

First Republic should focus on expanding in growing metropolitan areas with a healthy housing market, labor market, and which resemble the markets where they already have a foot-hold (SF, LA, NY). One of the most attractive places for First Republic's domestic expansion is the city of Dallas and its surrounding suburban areas. Dallas was ranked as a top 10 performer in the luxury homes market, a key area of business for First Republic and their high-net worth clients[10]. Dallas and its surrounding areas also have high expected population growths[11] and high average income[12], with the Dallas-Fort Worth-Arlington metropolitan area experiencing the greatest population growth of all metropolitan areas in 2011 to 2012 according to the U.S. Census. The leading industries in Dallas include "defense, financial services, information technology and data, life sciences, semiconductors, telecommunications, transportation, and processing" [13]. It is also one of the country's top high-technology employers, and for this reason some call it the "Silicon Prairie"[13]. In this regard, we see that Dallas has many similarities with the San Francisco market where First Republic is headquartered. Using a similar strategy in the Dallas area could be very viable and have positive results. Of course, developing a strategy specifically for the Dallas region would be crucial to their long term success in that market.

The nature of this growth is also key to First Republic's growth, with most of it being driven by the migration of young people[11]. A younger demographic provides ample opportunity to grow loan originations and deposits in the market. With proper and aggressive cross-selling of products, First Republic can also experience growth within their private wealth management business division.

By focusing on growing metropolitan areas, First Republic can increase market share, growth, income, and their clientele base. However, it is imperative that First Republic maintain their client-focused business model and continue to deliver exceptional client services even while expanding.

Focus on Expanding Private Wealth Management

While real estate may experience a downturn with adverse economic conditions, wealth management for high-net worth individuals will remain in demand. In a contracting economy, clients will require wealth managers to preserve the value of their wealth, trustees will still be required to carry out fiduciary duties, and brokerage services will still be in high demand. The most likely scenario is that in recessionary periods clients become more risk-adverse, preferring to follow investment strategies that both retain the value of their wealth and minimize their exposure to risk. In this sense, the wealth management side of First Republic can act as a buffer that protects against a falling housing market. Thus, increasing the capabilities and profit margins of their private wealth division can ensure long term growth.

Private wealth capabilities can be increased, as mentioned above, through expansion into growing markets, or as suggested in opportunities, through acquisition of small wealth management firms that would complement First Republic's existing private wealth network and capabilities.

If acquisitions are considered, we recommend that First Republic implement a phase in period. This period should be used to determine how, and if, the new acquisition fits within First Republic. An imperfect match could end up hurting the First Republic name. For this reason, we suggest not incorporating their name until the acquisition shows it is a good fit.

Protect and Enhance Reputation as a Client-Focused Firm

Current trends show that high-net worth individuals are constantly searching for greater levels of value added across all services – they care about the experience as well as the end result. In fact, around 50 percent of recommendations are due to good experiences and not low rates or fees in retail banking[14]. Furthermore, great banking experiences are four times as likely to be a result of positive staff interactions, which in turn are twice as likely to get shared. When coupled with the fact that the most educated and affluent segment of retail banking are also the most vocal, providing an exceptional service and experience can be a great vehicle for continued growth[14].

As mentioned under the "SWOT" section, a reputation for exceptional client services is one of First Republic's greatest strengths and assets. However, we at Bridges Consulting Group believe that given the environment in which First Republic's competitors are shifting towards a more customer oriented business strategy, akin to their own, it is imperative that they stay ahead. While quality of service is qualitative in nature, there are metrics that can give a quantifiable and measurable return to consumer investment or total value added. A very common measure is the Net Promoter Score (NPS) which asks customers, "On a scale of 1 to 10, how likely are you to recommend our product/service". The difference between those who say 9 to10, the promoters, and 1to 6, the detractors, is the NPS. The NPS gives a sense of the total value added a firm provides to their customers but does not tell the firm what causes the detractors to *be* detractors[15]. For this reason, the Bridges Consulting Group also recommends that First Republic supplement the NPS to give a better picture of the strengths and deficiencies in their customer service.

We note that high-net worth individuals want the feeling of "exclusivity and importance"[16]the measure of consumer satisfaction should try to be an instrument of this. These individuals also want a uniquely tailored and personalized experience based around their own needs. When assessing their clients, it is important for First Republic to know not only who is a promoter or detractor, but why – personalized service requires personalized assessment. For this reason, we recommend that First Republic conduct a Voice of the Customer (VoC) analysis to supplement the NPS. VoC consists of surveys, interviews, and focus groups used to inform the firm on how new or current programs of vision, goals, and execution related to customer experience can be formed or altered to augment any deficiencies in customer service[17]. VoC's ultimate goal is finding what makes promoters and detractors "tick" allowing First Republic to leverage this information to their benefit.

We recommend that in addition to VoC analysis, First Republic also analyze the level of client segmentation. By analyzing their clientele segmentation – categorizing their customers by the features they value, social demographics and behavioral profiles – First Republic can implement VoC analyses that can seem very personalized and tailored to a specific individual[14]. Furthermore, looking at each segment group of their customer base and applying VoC separately could give insights into what each segment prioritizes and places more importance on. It could be that First Republic's East coast client base values staff efficiency more than their West coast counterparts. Perhaps their clients from an entertainment background value relationship managers that are both knowledgeable and efficient communicators more than their clients from a finance background. The information gained by segmented VoC not only gives insights of their current client base, it also gives insights into clients in the future who fit into a particular segment. In this way, segmented VoC aids First Republic in having an idea of the general values, needs, and problems potential clients have and allows them to preemptively address them.

Ultimately, VoC analysis should help First Republic increase the number of promoters and decrease the number of detractors, increasing NPS. This, in turn, will lead to an increase in client recommendations and referrals resulting in growth for First Republic. The exact questions that First Republic should ask in VoC we cannot recommend since they have greater knowledge of their own client base. However PwC does have some general guidelines and examples of what kind of questions to ask which we include below. We also include common pitfalls that the PwC has observed among firms that have had difficulties implementing VoC.

Core driver	Insight-gathering question	Sub-driver
Product/service	"What are you looking for from your bank? How does your bank factor into your capital raising and retention strategy?"	• Quality • Meeting expectations • Value for money
Channel delivery	"How responsive is your bank when you need it?"	• Accessibility • Reliability
Expertise	"How well does the bank understand your business? What new and innovative ideas has the bank provided to you and your team?"	• Understanding • Insight/new ideas • Knowledge/skills • Professionalism • Proactivity
Relationships	"What is the strength of the relationship between you and your bank?"	• Flexibility/helpfulness • Reliability/consistency • Integrity • Relationship strength
Communications	"How often do you have meaningful contact with the bank?"	• Communication • Access • Responsiveness • Feedback

Source: PwC[17]

	Common pitfalls	Solutions
VOC strategy	• Unsolicited **data is often overlooked**.	• Listen to a wide variety of client feedback.
	• **Programs become siloed** and non-insightful; a small portion of employees have a partial picture of client feedback.	• Establish and orchestrate multiple listening posts.
	• **VOC is seen as a "quick fix"** rather than a process.	• Treat VOC programs as a long-term investment.
VOC data management	• Unstructured **feedback is not utilized** and not linked to the same database as other data.	• Recognize the value of unstructured feedback, and incorporate it in the same manner as structured feedback.
	• Business owners can tell how key metrics changed but they **do not know why they have changed**.	• Create a set of metrics to provide business owners with actionable information.
	• **Data from multiple sources do not "talk" with each other**, leaving business owners with only a partial view of the problem (such as operations vs. sales).	• Create a unified database to store all customer data from multiple sources.
Implementation and governance	• Data is collected but **not distilled into an actionable plan** to inform training or strategic planning.	• Do not allow data to sit unused, and create a process around how data will be interpreted and incorporated into planning.
	• VOC programs cut across the organization, bringing to light **misalignments within the firm**.	• Align the organization behind VOC programs.
	• VOC programs can be viewed as a local effort and **lose steam** before they yield fruit.	• Help ensure strong executive support.

Source: PwC[17]

Market as a Luxury Service

Bridges Consulting Group wants First Republic to advertise themselves as a luxury experience and service. Their marketing and advertising efforts should focus more on the quality of service provided and how they connect to clients at an emotional level. An important aspect of this will be advocacy marketing, which they already engage in the form of client testimonials on the homepage of their website and annual reports. However, the testimonials that are placed on websites should focus on the tailored experience they receive and the personal level of connection that they have with First Republic relationship managers. The segmented VoC analyses can be used to mention key areas that appeal to a wide portion of their client base. In conjunction with this idea, First Republic can also target specific segments by using well respected, well known members in those segments as their advocates[15].

Endnotes

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