Beneficial's answer to stiff loan competition: Start alease business

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A quick glance at loan-growth trends is all that's necessary to explain Beneficial Bancorp's decision to build a national small-ticket leasing platform from the ground up.

In 2017, the Philadelphia company's loan portfolio grew by just 0.6% from a year earlier, to $4 billion. Between June 30 and Dec. 31, total loans actually declined by 1%. CEO Gerard Cuddy blames the lackluster growth on the fierce competition for commercial loans in the Mid-Atlantic region.

"It's been very competitive here for the past two or three years," Cuddy, 58, who has led Beneficial since 2006, said in a recent interview. "I've been in this market for 37, 38 years. I can tell you without any hesitation that it's more competitive now than it's ever been."

Cuddy is counting on the new subsidiary, Neumann Finance, to be the difference-maker. If things work according to plan, the startup, which will offer lease financing through hundreds of equipment vendors around the country, could soon begin delivering about $300 million in leasing volume annually. "When you look at what Beneficial looks like on the commercial lending side, they have a book that's $800 million or so," analyst Laurie Havener Hunsicker, who follows the company for Compass Point, said Thursday. "You're talking about making a substantial addition."

Ideally, Hunsicker would prefer to see an Beneficial pursue an initiative closer to home. At the same time, she acknowledged the market forces that are pushing the bank to look further afield. "Do I prefer local lending? Yes. Do I prefer C&I lending that comes with the deposit piece? Always. But I think in this day and age, loan growth is harder and harder to get," Hunsicker said.

While competition in the Mid-Atlantic region has always been fierce, Hunsicker said it has intensified in recent years as number of formerly mutual banks converted to stock-owned companies and began more actively targeting commercial borrowers."You've got so much capital chasing loans that you're almost not getting paid for the credit risk you're necessarily taking," she said.

Neumann Finance President George Pelose said he visualizes the operation he and business partner Dan Dyer are building as kind of conveyer belt.

"You create these relationships with vendors, so when they move their equipment, they're utilizing us to finance it," Pelose said in a recent interview. "It's a constant flow of applications." For now, Neumann, which takes its name from St. John Neumann, a Philadelphia bishop who founded Beneficial Bank in 1863, remains a work in progress

It's not expected to begin writing leases until midyear. In the meantime, it's signed contracts for its key operating systems, filled out its staff, and leased 22,000 square feet of office space in Philadelphia's central business district.

Neumann also approved a tagline for its marketing: Business lending done right.

"It's all going well," Pelose said. "The key components of our platform, the people, the space and technology, have all made good advances."

That progress, of course, comes at a price. Beneficial hasn't disclosed how much it has spent so far, but Hunsicker is forecasting first-quarter earnings of 13 cents per share, which is a penny less than Beneficial earned in the fourth-quarter of 2017.

Neumann's impact on earnings "to begin with will be more of an expense drag," she said. "You don't see production come on immediately. You won't see it substantially materialize until you get to year two." For Cuddy the venture represents a classic case of short-term pain for long-term gain.

"You have to invest up-front," he said. "There's no other way to do it. Something like this requires sophisticated technology, and we very much wanted to be in the center of Philadelphia. So, for a whole host of reasons you're either going to make the proper level of investment or you're not going to do it.

With Neumann, Beneficial joins a long list of banks that have ventured into the equipment-leasing space in recent months. Other recent entrants such as $25.1 billion-asset Investors Bancorp in Short Hills, N.J., and $4.26 billion-asset Peapack Gladstone Financial in Bedminster, N.J., chase deals whose values frequently reach into the tens of millions of dollars. Neumann, by contrast, is content to swim in the shallow end. Its typical lease will be in the $10,000 to $25,000 range.

Neumann's business plan involves leveraging technology to provide quick decisions on lease applications funneled by vendors.

Given the tens of millions of small businesses seeking equipment financing, there is hardly any upper limit on its prospects — so long as it can forge relationships with enough equipment dealers. The company doesn't plan to be picky about what it finances.

"We're almost equipment agnostic," Pelose said. "We'll fund healthcare diagnostic equipment, restaurant equipment, light industrial, et cetera. Every business needs equipment."

Dyer founded Marlin Business Services in 1997 and served as CEO until October 2015. Pelose joined Marlin in 1999, eventually serving as chief operating officer under Dyer. Together, they built Marlin into a leasing heavyweight, with $400 million of originations in 2015.

One big advantage embedded in Neumann's model is that the company can charge a premium for its swift decisioning. According to Cuddy, Neumann's leases will carry interest "in the neighborhood of 10% to 12%."

"That's a competitive rate for the companies that are looking for the type of leasing Neumann is going to provide," he added. "It's an attractive rate for us as a bank, obviously, but it's also a good market rate" for customers. Neumann's national ambitions leave little or no opportunity to seek additional business or deposits from its clients, but Cuddy said he isn't bothered by that fact.

"Honestly, we're not looking at that at all," he said. "If we get anything, it'll be great, but it's not part of our targeting or our plan. The emphasis is for them to remain somewhat autonomous in their space." Neumann's business plan isn't particularly original, but it should yield results if it's executed properly, said Ted Peters, CEO at Bluestone Financial Institutions Fund and the former

CEO at $3.5 billion-asset Bryn Mawr Trust in Pennsylvania.

“This is pretty common stuff, quite frankly, but if they set up good parameters, they stay on top of credit quality and do mission-critical equipment, it might work very well,” Peters said.

The risk lies in chasing volume and losing sight of credit quality, Peters cautioned. “If I was doing this, early on, especially the first six months or so, I’d be looking at these leases very, very closely,” he said. “If you let this business run unbridled and you don’t stay on top of it, you’re going to get hurt.” For her part, Hunsicker said she was confident Beneficial could handle the risk involved in launching Neumann.

“This is a company that is absolutely pristine in credit,” she said. “Right now, nonperforming assets to assets are 36 basis points. They had all of two basis points in chargeoffs in the fourth quarter. They really have a strong handle on credit.”

Hunsicker gave Cuddy credit for avoiding the temptation to chase a potentially dilutive acquisition. “He’s just doing a slow build-out of his franchise and I think this is more of the same,” Hunsicker said. “Sometimes it makes sense to build it out rather than buying someone else’s franchise and wonder what other sorts of issues you’re potentially inheriting.”