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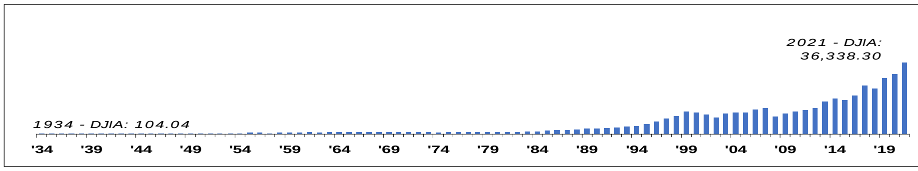

MARCH 13, 2023

SPECIAL REPORT: SVB FINANCIAL GROUP (NGS: SIVB)

HIGHLIGHTS

* In order to shore-up capital levels, SVB Financial Group announced on Thursday, March 9, that it had sold all $21 billion of its Available For Sale (AFS) securities, consisting of U.S. Treasuries and Agency mortgage securities. The sales resulted in a $1.8 billion loss.
* On March 10, California's financial regulator, the Department of Financial Protection and Innovation, took possession of the company's Silicon Valley Bank due to inadequate liquidity and insolvency.
* Silicon Valley Bank had been the go-to bank for emerging companies, especially in the Technology sector. Seed funding received by companies often was deposited in the bank with the expectation of an eventual IPO. But with virtually no IPOs in 2022, companies needed to withdraw funds in order to pay for ongoing operations.
* This is our final report on SVB Financial Group based on the lack of liquidity in the SIVB shares, and we have withdrawn any investment ratings on the stock.

ANALYSIS

INVESTMENT THESIS

In order to shore-up capital levels, SVB Financial Group (NGS: SIVB) announced on Thursday, March 9, that it had sold all $21 billion of its Available For Sale (AFS) securities, consisting of U.S. Treasuries and Agency mortgage securities. The sales resulted in a $1.8 billion loss. SVB also announced a $2.25 billion capital raise. General Atlantic, a private equity firm, agreed to purchase a portion of the deal, but other investors couldn't be lined up and the deal fell through. The SIVB stock closed at $106.04 on Thursday, down from $267.90. Investors and depositors then initiated withdrawals of $42 billion in deposits, causing a run on Silicon Valley Bank and leaving it with a negative cash balance of approximately $1 billion.

On Friday, March 10, pre-market indications had the SIVB stock in the mid-$30s and trading was halted pending news. Around noon ET, it was announced that California's financial regulator, the Department of Financial Protection and Innovation, had taken possession of Silicon Valley Bank due to inadequate liquidity and insolvency. The collapse resulted in a sharp downturn in bank stocks, as investors worried about a contagion effect on the entire banking industry.

Those with deposits in Silicon Valley Bank below the $250,000 Federal Deposit Insurance Corp. (FDIC) insurance limit will be able to withdraw their money from the FDIC-created Deposit Insurance National Bank of Santa Clara (DINB) on Monday, March 13. Uninsured depositors will be paid a dividend in the next week and will be issued a receivership certificate for remaining uninsured funds. Future payments will be made as the FDIC sell assets of Silicon Valley Bank.

It is expected that the FDIC will have to sell the $91 billion of securities (the majority or possibly all of which are low-coupon MBS) that were Held to Maturity (HTM). This will be done over time so as not to disrupt the capital markets. In the current market environment, it is likely that the sales will result in significant losses.

Silicon Valley Bank had been the go-to bank for emerging companies, especially in the Technology sector. Seed funding received often was deposited in the bank with the expectation of an eventual IPO. But with virtually no IPOs in 2022, companies needed to withdraw funds in order to pay for ongoing operations. The bank invested funds primarily into low-coupon agency MBS when interest rates were low. This strategy backfired when the Federal Reserve began its campaign to raise interest rates, causing the duration of the MBS to extend from three-to-four years to 10-12 years at current rates. The result was a classic case of a mismatch between assets and liabilities.

It is our expectation that a sale of the company as a whole will not occur. (SVB has a significant investment-banking business — the result of the combination of Leerink Partners and MoffettMathanson — and asset-management operations from the 2021 acquisition of Boston Private Financial Holdings.)

RECENT DEVELOPMENTS

Prior to the events of last week, approximately 17.6% of the available SIVB shares were held in various ETFs. This. along with concerns about other banks with substantial losses in their investment portfolio, resulted in a 12.8% two-day loss in the iShares U.S. Regional Banks ETF IAT.

By way of an historical look at the company's operations, we note that on January 19, SVB Financial reported 4Q22 EPS of $4.62, down from $6.22 a year earlier and below the consensus estimate of $5.27. Revenue rose 49% from the prior year to $2.25 billion, boosted by higher net interest income. Full-year EPS totaled $25.35. Revenue rose to $7.4 billion from $5.9 billion.

On December 13, 2021, SIVB announced the acquisition of MoffettNathanson, an independent research firm. The acquisition was intended to help the company expand its investment banking business in the Technology and Healthcare sectors.

In July 2021, the company acquired Boston Private Financial Holdings for approximately $1.2 billion. As part of this transaction, it issued 1.89 million shares of SIVB common stock for $1.1 billion. The company also recognized $104 million of intangible assets and goodwill of $201 million as a result of the acquisition.

In 1Q21, SVB reorganized its business into four segments: Silicon Valley Bank, providing global commercial banking services; SVB Securities, integrating MoffettNathanson and Leerink to provide investment-banking services; SVB Private, a provider of wealth management and private banking services; and SVB Capital, a venture capital and credit investing business.

EARNINGS & GROWTH ANALYSIS

The company's loan book totaled $74.2 billion at the end of 4Q, with $68 billion (92%) in variable-rate loans. Some 60% of the variable-rate loans were based on prime-lending rates, 14% are based on LIBOR, and 66% are tied to alternate reference rates. (As of the end of 2021, most LIBOR rates are no longer tracked, and the legacy LIBOR-based contracts are being migrated to other short-term rates.) The 4Q provision for loan losses was $144 million, up from $11 million a year earlier. The allowance for credit losses rose to $557 million in 4Q from $398 million in the prior-year quarter, and represented 0.86% of loans.

The investment portfolio declined to $120 billion in 4Q22 from $128 billion in 4Q21. Approximately $91 billion (76%) of the securities were held-to-maturity (HTM) and $26 billion were available-for-sale (AFS). The portfolio consisted mainly of government and agency-backed mortgage securities, along with smaller amounts of corporate and municipal securities. In 4Q22, the average yield was 1.76%, up from 1.54% in 4Q21.

FINANCIAL STRENGTH & DIVIDEND

Moody's had rated SVB's debt at A3/stable, while S&P had a rating of BBB/stable. Long-term debt was $5.4 billion at the end of 4Q22. Last week, Moody's initially downgraded a "notch" to Baa1/negative and on Friday moved lower to C. Moody's will withdraw and future ratings.

In April 2022, the company issued $350 million of senior notes due 2028 and $450 million of senior notes due 2033. The bank CET 1 ratio was 15.29% as of December 31, 2022, up from 14.89% a year earlier. Book value fell to $208.85 per share from $214.30. At the end of the fourth quarter, stockholders' equity was $16.0 billion.

The company did not pay a dividend

MANAGEMENT & RISKS

SVB is led by President and CEO Gregory Becker. The CFO is Daniel Beck. It has been reported that they both sold SIVB shares several weeks ago.

COMPANY DESCRIPTION

SVB Financial Group provided banking and financial services. The company operated through four segments: Silicon Valley Bank, SVB Private, SVB Securities, and SVB Capital. It was founded in 1983 and is headquartered in Santa Clara, California.

VALUATION

We expect no recoveries for equity holders of the SIVB shares. Depositors will be repaid first, and then the bondholders. As of Friday, the company's debt was trading in the mid-$40s after trading in the $90s on Wednesday. This is our final report on SVB Financial Group based on the lack of liquidity in the SIVB shares, and we have withdrawn any investment ratings on the stock. (Kevin Heal, 3/10/23)