Origin Bancorp

Fourth Quarter 2018 Earnings Call

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CORPORATE PARTICIPANTS

Chris Reigelman – *Investor Relations Officer*

Drake Mills– *Chairman, President and Chief Executive Officer*

Steve Brolly – *Chief Financial Officer*

Lance Hall – *President, Origin Bank*

PRESENTATION

Operator
Good morning and welcome to the Origin Bancorp Inc. Fourth Quarter and 2018 Full Year Earnings Conference call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question you may press * then 1 on your telephone keypad. To withdraw from the question queue, please press * then 2. Please note this event is being recorded.

I would like to turn the conference over to Chris Reigelman, Investor Relations Officer. Please go ahead, sir.

Chris Reigelman
Good morning. Thank you for being with us.

We issued our earnings press release yesterday afternoon, a copy of which is available on our website along with the slide presentation that we will refer to during this presentation.

Before we begin, I would like to remind you that this presentation may include information about our management's view of our future performance, business and growth strategy; projected plans and objectives and various other matters that constitute forward-looking statements under the federal securities laws. Actual results may differ materially from historical results or those implied or indicated by these forward-looking statements due to various risks and uncertainties. For a discussion of these risks and uncertainties, please refer to the forward-looking statement section of our earnings release and the risk factors included in our prospectus filed with the SEC on May 9, 2018, pursuant to Section 4.24B of the Securities Act, our most recent quarterly reports on Form 10-Q as well as other documents we periodically file with the SEC.

Forward-looking statement speak as of the date they are made and Origin undertakes no obligation to publicly update or revise any forward-looking statements. If you are logged into our webcast, please also refer to slide 2 of our slide presentation which includes our forward-looking statements Safe Harbor statement. For those joining by phone, please note the slide presentation is available on our website at www.origin.bank. All comments made during today's call are subject to the Safe Harbor statements on our slide presentation and the earnings release.

Finally, in this presentation we may discuss certain financial measures that are not calculated in accordance with US GAAP. Please refer to these reconciliations of these non-GAAP financial measures to their closest comparable GAAP metrics in our earnings release and slide presentation, also which are available on our website at www.origin.bank.

We believe that certain non-GAAP financial measures can provide meaningful information to investors. However, these non-GAAP financial measures are supplemental and should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP financial measures that may be presented by other companies.

I'm joined this morning by Origin Bancorp's Chairman, President and CEO Drake Mills; our Chief Financial Officer Steve Brolly; and Lance Hall, President of Origin Bank. After the presentation, we'll be happy to address any questions you may have.

At this time, I'd like to turn the call over to Drake.

Drake Mills
Thank you, Chris. Good morning. As we've done in our previous calls, I'll start out with a few highlights, Steve will discuss the financial results, and Lance will report on loans, deposits and credit quality. I will close with a few remarks and then open it up for questions.

I am very excited about today's presentation and what we'll report for the fourth quarter and the full year of 2018, and I'm proud of what our team was able to accomplish this past year. 2018 was a strong year for Origin Bancorp. In the fourth quarter of 2018, we reported net income of $13.2 million and diluted earnings of $0.55 per share. For the year, we reported $51.6 million of net income and $2.20 diluted earnings per share. We ended the year with loans held for investments of $3.8 billion. That was an increase of $188 million for the quarter and $548 million over the previous year.

As we talked about last quarter, our team of bankers is very focused on building relationships throughout our markets and I have been very pleased with the increase in loan volume, particularly over the past two quarters. We ended the year with deposits totaling $3.8 billion, which is an increase of $56 million from the previous quarter and an increase of $271 million for the previous year. Our bank has continued to remain focused on maximizing opportunity with our customers and prospects to drive core deposit growth as we move into the next year. Our growth in noninterest bearing deposits in 2018 speak to this focus, which Lance will elaborate on later in the presentation.

Now I'll turn it over to Steve to provide additional details around the financial results for the quarter and for the year.

Steve Brolly
Thanks, Drake. Let's begin on slide 4, Financial Highlights for the Quarter. Our net interest income of $42.1 million increased 6.5% compared to the linked quarter and almost 23% year-over-year. Our provision for credit losses was higher in the fourth quarter compared to the prior quarter and largely driven by our loan growth.

Noninterest income and noninterest expense had slight increases for the quarter and we improved our efficiency ratio to 66.52% for the fourth quarter.

Net interest margin for the quarter was 3.82% on a fully tax equivalent basis, which was an increase of 6 basis points from the prior quarter. During the fourth quarter we saw yields earned on total loans held for investments increase by 17 basis points while cost of total deposits increased 11 basis points.

Moving to slide 5, our net income was $51.6 million in 2018 compared to $14.7 million in 2017. The primary driver was $35 million or 22% increase net revenue; $23 million increase in net interest income; and a $12 million increase in noninterest income. We continue to benefit from our asset-sensitive balance sheet and benefited from our significant loan growth, as Drake spoke to earlier.

Our fully tax equivalent net interest margin for the year was 3.75% compared to 3.52% for 2017. Our efficiency ratio, return on average assets and return on equity all showed improvement in 2018 as well.

Moving to slide 7, you can see that we remain asset sensitive, which will create value if interest rates increase, but we are mindful of the potential impact of declining interest rates on a net interest income margin.

Lance will now give an overview of our loan and deposit results and credit quality.

Lance Hall
Thanks, Steve. As Drake mentioned in his opening remarks, we continue to see strong loan growth in the fourth quarter. We've consistently emphasized building core relationships throughout our markets and our growth in commercial and industrial loans speak to that emphasis.

C&I loans increased $80 million during the quarter and $283 million overall in 2018. We also saw growth in our commercial real estate balances with an increase of $66 million for the quarter and $145 million for the year.

While we've had a lot of success in building loans during the year, we remain strategically focused on deposit growth and keeping our deposit betas as low as possible. We had $271 million in deposit growth during the year and of that 44% was noninterest bearing deposits. We're extremely proud of our noninterest deposit growth. This was a major emphasis for our team this year and I believe speaks to the core relationships that our bankers are building. As we continue into 2019, we have a strong loan pipeline and driving efficient deposit growth will continue to be a focus for us.

I want to briefly cover credit quality trends on slide 13. As you can see on the bottom of the page, we had an uptick in charge-offs during the fourth quarter. This was driven by a charge-off of one commercial real estate relationship in the healthcare sector that we previously mentioned in our 10-Q for the quarter ended June 30, 2018. You could also see we had an increase in nonperforming loans as a percentage of total loans held for investment during the quarter, which is due to a small number of downgrades in commercial lending relationships. We continue to be very comfortable with our overall credit quality moving into 2019.

From a production standpoint, we're very pleased in how our markets performed in 2018. Our bankers' commitment to relationship development is evident and we are as focused as ever in maximizing our client relationships and opportunities to continue our strong loan growth as well as generating core deposit growth.

Now, I'll turn it back over to Drake.

Drake Mills
Thanks, Lance.

2018 was historic for our company as we completed a successful IPO in May involving hard work from many people within our organization. This year we've added new employees who have embraced our culture and the Origin vision. We've also added new investors whose support we are grateful. We remain committed to the strategies that we've communicated throughout the year and we do not see significant change in that strategy.

There are times when organizations experience growth and add new people, and the identity of the organization can become less defined. In Origin's case, we have become more united and our culture is stronger than ever. For the sixth consecutive year, Origin Bank was named as one of the best banks to work for by American Banker. While some may overlook these types of recognitions, we believe it serves as an indicator that our employees are committed to making Origin a unique and dynamic organization.

Moving into 2019, we celebrate our successes, but we are also aware of our challenges. Growing deposits to fund our loan growth is a top priority. We will also continue to identify areas where we can improve efficiency. Our company has shown that we will be able to meet these challenges. Our management team and our bankers have a clear understanding of what we need to do to continue to provide value to all of our stakeholders.

I am proud of what was accomplished last year and I'm optimistic about what we can achieve as we move forward into 2019.

Thank you and we will now open up the lines for questions.

QUESTIONS AND ANSWERS

Operator
Thank you, Mr. Mills. We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If your question has been addressed, you may remove yourself from the queue by pressing star then two.

Your first question will be from Matt Olney of Stephens. Please go ahead.

Matt Olney
Hey, thanks. Good morning, guys.

Drake Mills
Good morning, Matt.

Matt Olney
I have a few questions here, but first, congrats on 2018. You guys were busy and you guys accomplished a lot, so congrats over last year.

Drake Mills
Thank you.

Matt Olney
On the loan growth front, pretty strong growth that we saw in the fourth quarter. Can you just talk about any trends that are worth nothing, whether it's any change in C&I utilizations or any particular market that was stronger for you? Then talk about that pipeline going into the first quarter.

Drake Mills
I'll turn that over to Lance.

Lance Hall
Hey, Matt. No real difference in the mix of business for us. I would say line utilization was consistent with what it's been over the past few quarters.

I would say our Mississippi business was relatively flat; tremendous continued growth in our North Louisiana franchise, then obviously at Dallas/Ft. Worth really drove a lot of the growth.

Interesting, I would tell you that, while maybe not exactly as high as the fourth quarter, our pipeline right now going into the first quarter is incredibly robust. We continue to see exactly what we thought would happen. When we launched the IPO, we said we thought we could do double-digit loan growth without the [indiscernible] things. That's exactly what we accomplished and we continue to see that going forward with a strong first quarter.

Matt Olney
Okay, great. Thanks for that, Lance. Then on the credit front, what else can you tell us about the three downgrades that were mentioned in the prepared remarks? Did those credits go through an impairment process and were there any charge-offs on those three downgrades?

Drake Mills
Matt, each one of those credits did go through the impairment process. There were no charge-offs related to those three. We are highly confident in those three credits. And I also want to make a point that each one of these situations range from relationships of the shortest of five years, the longest of over ten years; these have been relationships we have had quite some time. As a matter of fact, I went back to see if there had been any downgrades or impairment processes on any credits that we've had on the books less than two years and our credit quality moving forward is stellar and we are extremely aggressive at addressing issues. And we're comfortable to say that I think credit quality will continue to move in the right direction.

For instance, if you look at where we did have, as Lance mentioned, an uptick of about $3 million in Q4, the trend from Q4 '17 to Q4 '18, which was $91.3 million down to $79 million, we see that continuing. That $3 million uptick was one credit. To make sure that we were clean from an audit process, we moved from an income approach valuation to a fair value based on appraisal, because we wanted to be clean in that process. But I will say, even with that charge-off, because of the condition of the credit, the sponsors of that credit, we feel that we potentially will get a full recovery on that. But we are aggressive in how we address those and we want to make sure that we have a clean audit.

So anyway, going back to those three, we are very sure that we do not have any loss and there's not any impairment of those credits.

Matt Olney
So three credit downgrades in a quarter, were there any offsetting upgrades? I'm trying to understand why those three downgrades.

Drake Mills
No, there weren't any, of material there were not. We do feel like our trends from an upgrade standpoint going through the first quarter will continue in a positive way, but those three credits, from the standpoint of justifying that position, still very for us conservative and aggressive in how we address those. And all three of those credits we are pushing out of this institution and starting that process, because we just don't like the trends that we see from a revenue and net income perspective on each one of those three.

Matt Olney
Okay, got it.

The last question from me on the margin, Steve, the margin looked good in the fourth quarter. What can you tell us about the trend of that core margin going into the first quarter in 2019?

Steve Brolly
Hey, Matt. The core margin we think on the loan side, we picked up 17 basis points last quarter. We don't think it's going to be as high as that, maybe two basis points lower. On the cash side, we will have more cash than we had this quarter because of the seasonality, mortgage warehouse, the public funds coming in. If you looked at last year and the year before, we had about $217 [million] to $230 million in cash, but that was that 50 basis points from $164 [million]. The cash that we have now is closer to $250 [million to] $260 [million].

So on the top side we think it's going to expand, but not as much. And then on the deposit side we think we'll still have some pressures on the deposit side. We had 13 basis points increase this quarter. We feel this quarter coming up will be about the same.

Matt Olney
Got it. That's helpful. Thank you, guys. Appreciate it. Nice quarter.

Drake Mills
Thank you, Matt.

Operator
The next question will be from William Wallace or Raymond James. Please go ahead.

William Wallace
Thanks. Good morning, guys.

Drake Mills
Hey, Wally. How are you doing today?

William Wallace
Very good. Thank you. Steve, maybe just following up on the heels of the answer to Matt's question, if you're talking yields and costs, can you just kind of put it together for us so that I don't have to do all the math because I'm not very good at math these days. What's the net interest margin impact that you would anticipate with the help of the December hike and with the deposit pricing pressures that you anticipate?

Steve Brolly
So total last quarter was six, let's say; between four to five this quarter. After that, without any Fed movement, it's going to be relatively flat. That's what we're looking at after this quarter, but we'll update that as each quarter goes on.

Drake Mills
And Wally, I want to address that relatively flat without increases, because we do feel pretty positive that our strategy around pricing discipline, and obviously for us and we can talk about this in more detail, we have put all the incentives in place, the triggers in place to drive significant deposit growth this year. Deposit growth will be what I would say a throttle to our loan growth, even though we're showing strong loan growth for '19. We do think that our selection and ability to pick out the high earners are going to help us achieve some NIM that we haven't seen historically.

William Wallace
Are you finding on the deposit side that in order to be successful you're having to maybe give a little bit more on price to bring deposits over from whatever institutions they are currently, or are you finding that with a loan relationship or some sort of package that you can offer that you're able to pay what you would consider a reasonable cost?

Drake Mills
I'll take a little bit of time quickly, because you're hitting on something that I would like to discuss. Our Houston lift out team has been highly successful. As I interviewed each one of those team members two weeks ago to understand where we were going in 2019, we were surprised at how quickly the asset side of the balance sheet grew from the lift out team. I think they impacted us about $130 million since they arrived.

So in those conversations that team was very focused on covering up their expense; very gracious that we brought them on to the point that they said now they're turning their attention towards deposits. And as I said, we're going to be very pleased with the deposit growth. So as I understood what that meant, this is still relationship driven through these lift out teams. It is extremely competitive in Texas, but we do think that we're going to be able to be in range of what you expect to see. We're not going to go out and pay significantly higher than market to solve our deposit issues that we have today. So I'm comfortable after those calls that now that they are focusing on the relationships, our NIB growth continues to be very strong.

William Wallace
Okay. Then just one additional question around the margin. I had been modeling and anticipating that there would actually be some pressure to NIM related to the follow through effects of the leverage transaction. Was there any pressure or were you able to get fully invested early in the quarter?

Lance Hall
We invested early in the quarter. The first couple days there was some cash, but we had a lot of loan growth in those two quarters. So, it was fully invested.

William Wallace
Okay. Fine. I'll stop there on margin. I wanted to have one follow up on the three credit downgrades. Can you tell us what regions those three credits were in?

Drake Mills
Yes. North Central Louisiana on two of those and Mississippi on the other.

William Wallace
Okay. Great. My last question before I let somebody else ask something. Drake, I just wondered if you could give us an update on your view of the mortgage business and how invested you think you'll be in mortgage moving forward.

Drake Mills
Well, we've made some excellent progress, as I've talked about on the road and during the IPO with the restructure of our mortgage. We see that breakeven for us where I projected it and maybe a quarter off could potentially come at the end of the first quarter.

We are moving towards solving or going through a process of deciding on a solution for mortgage servicing where we feel our major issues are, and we think that at the end of the first quarter we'll be able to announce that solution that will give us significant cost saves there.

From the retail production side, we feel that we're pretty much at a breakeven point going into the spring today. We are projecting adding four additional mortgage lenders to round out that group of mortgage lenders we talked about needing to have to get the levels of production to the point where we were profitable. So, we've done a lot of work. We did go through a riff. We see some opportunities for some additional cost saves, but we do think that's going to be a significant swing for us in 2019 from the standpoint of earnings.

William Wallace
Okay, thank you for the update. I'll let somebody else ask a question. Thanks. Appreciate it, guys.

Operator

The next question will be from Brady Gailey of KBW. Please go ahead.

Brady Gailey
Hey, good morning, guys.

Drake Mills
Good morning, Brady.

Brady Gailey
I think in the past you've talked about loan growth in the low to mid double-digit range for 2019. You did 20% in 2018 and higher than 20%, honestly, in the back half of 2018, so it seems like loan growth is higher than that your previous low to mid double-digit range. How should we think about loan growth in 2019?

Drake Mills
The way we see loan growth, and we spent a lot of time in the markets with the market presidents and I've talked a little bit earlier about pricing disciplines and being able to control the loan growth and ensuring that we're getting the returns that we need through our investments. At this point we see for '19 loan growth in the markets that we've talked about earlier in that low double-digit range. But also we see deposit growth outpacing that. If for some reason our deposit growth does not outpace loan growth, then we'll slow that loan growth down.

We did bring on some lift out teams in the second half. They had some excellent relationships that we picked up through that process. We also, and I want to point this out, were projecting 4% loan growth in North Louisiana and we achieved 11%. Where that was significant and the market is strengthening we probably aren't going to recognize that type of loan growth in 2019 in North Louisiana. So, if you add up the markets and where the markets think they're going to be at the end of 2019, that comes in at really low double-digit loan growth.

Brady Gailey
Alright. Then on the deposit growth side, if you look at 2018 we saw the loan to deposit ratio year-over-year go from 92% up to 100% as of the end of the year. Sounds like you are going to be more deposit-focused, but what's actually going to push deposit growth up from 2018 levels? Are you hoping to keep the loaner deposit ratio flat here? Would you like it down? What's the target there for that ratio?

Drake Mills
I want to mention that in 2018 we made a couple of moves that I think helped strengthen us from a liquidity standpoint. We had a large single customer that had a $60 million deposit that we allowed that to flow out of the bank because we needed to cut that [indiscernible] down. We also reduced our dependency on what we call broker deposits by almost $30 million. So that's let's say $80 [million] to $90 million swing negatively that I think helped enhanced the quality of our overall core deposits.

So as we move into 2019, we have specific plans to continue to focus on relationship managers that have deposit portfolios and we've seen a tremendous amount of success. Also, treasury management, which we've invested heavily in, and that's why we've had 44% growth in noninterest bearing deposits, I think has one of the strongest plans for 2019 that we've seen in quite some time.

So again, our incentive plans have been adjusted heavily towards deposits. Everyone out there, even from directors' perspective, realize that we're going to make and ask on every deposit opportunity we have. And plus, in the second and first quarter we picked up about $55 million of additional deposits from public funds that were supposed to come in at the late part of the fourth quarter but didn't come in until the first quarter. So we see through the first month stronger deposit growth than loan growth.

Brady Gailey
Is M&A an option to help on the funding side? Just some updated thoughts on M&A as we head into 2019.

Drake Mills
I'm very focused on M&A. We have actually four different conversations ongoing as we speak. Each one of these, with the exception of one, would be significant deposit M&A opportunities for us. The one I'm mentioning is a little bit higher than we like to see, but it is a significant franchise that we think could impact us well in the Mississippi market. So, I do think that there's an opportunity. We're certainly not modeling that at this point, but we're aggressive and I'm going to continue to be aggressive because that certainly could be a quick solution for us.

Brady Gailey
Then finally, I know we talked about the efficiency ratio getting down into the low 60% range by the end of this year and then maybe a smidge better next year in 2020. Is that still the right way to think about the expense base and the efficiency ratio?

Drake Mills
Yes. For the most part, and this is something that we'll start to talk about, we have been concerned, I mentioned this in a couple of occasions about redlining opportunities or to solve redlining opportunities and we have two branches, one in South Dallas and one in Mississippi that we'll be opening in the second quarter. We think we're doing that very efficiently, but it will have an impact slightly on our efficiency ratio. So as we look towards where our budget is versus maybe where the consensus is, it could be slightly higher. And when I say slightly, below that 65 but not quite to where we expect, but we do have some opportunities to impact that.

Brady Gailey
Okay. Great. Thanks and congrats on an excellent quarter.

Drake Mills
Thank you.

Operator
Ladies and gentlemen, as a reminder, if you would like to ask a question, please press * then 1.

The next question will be from Brad Milsaps of Sandler O'Neill. Please go ahead.

Brad Milsaps
Good morning.

Drake Mills
Hello, Brad.

Brad Milsaps
You guys have addressed most everything, but I did want to ask maybe around fee revenues. This quarter you had the partnership income gain. I know that can happen from time to time, which helped offset some seasonable weakness in other areas. Drake, you touched on the mortgage bank, but just anything else on fees? Just seem to be running a little bit lower than maybe I thought. I was just curious what your outlook would be there over the next couple of years.

Drake Mills
On our partnership revenue we actually had $500,000 loss in the third quarter; about a $750,000 profit or gain, I would say, in the fourth quarter, so that's pretty much stabilized. We think we feel pretty good about fee generation in 2019. With our pipelines, the type of relationships that we're bringing over, it's heavy fee driven. And also, our incentive plans are weighted heavily towards the fee side of the business.

I think we'll see, we saw a decent increase in fees overall for 2018. I think we can see that type of increase or better in 2019.

Brad Milsaps
Okay, that's helpful. Obviously you got a lot of questions on credit already. I did want to ask about the reserve. Obviously the credits you charged off, you'd already provided for. But you have taken reserve down. If my math is right about 90 basis points of loans. You've had a tremendous amount of loan growth this year. How are you guys approaching the reserve? I know there's a lot of moving parts, some of it you can't control, but is the goal to get that back above 1%? How are you thinking about provisioning as you move through the year?

Drake Mills
Obviously that's a reflection on what we think the quality of the portfolio overall is. We're still slightly ahead of our peer at 90 basis points. We are reserving properly for the additional credit that we're bringing on in new loan growth. But I would have to comment that at this point the outlook for credit overall is very good and feel that this is very representative of where we are at 90 basis points and the quality of that.

Brad Milsaps
Great. Thank you.

Drake Mills
Thank you.

CONCLUSION

Operator
Ladies and gentlemen, this will conclude our question-and-answer session. I would like to hand the conference back to Drake Mills for his closing remarks.

Drake Mills
Thank you to everyone that attended the conference today. For us, 2018 was an outstanding year. I know there's some concerns about credit. We are extremely aggressive on how we deal with our credit, but I am comfortable and very confident about our credit going into 2019.

I also am confident that 2019 can be as successful or better than 2018. We know that our challenges are our deposits, liquidity and mortgage, and we are very focused on meeting those challenges. But I appreciate the support, very grateful for the investor support that we get and also the analysts and conversations. So thank you for attending.

Operator
Thank you, sir. Ladies and gentlemen, the conference has concluded. Thank you for attending today's presentation. At this time you may disconnect your lines.