Origin Bancorp, Inc.

Fourth Quarter 2021 Earnings Call

January 27, 2022 at 9:00 a.m. Eastern

CORPORATE PARTICIPANTS

Chris Reigelman – *Head of Investor Relations*

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

Steve Brolly – *Chief Financial Officer*

Lance Hall – *President and Chief Executive Officer, Origin Bank*

Jim Crotwell – *Chief Risk Officer*

Preston Moore – *Chief Credit & Banking Officer*

PRESENTATION

Operator
Good morning, everyone. Welcome to the Origin Bancorp, Inc. Fourth Quarter 2021 Earnings Conference call. All participants will be in a listen-only mode. Should you need assistance please signal conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. Please also note today's event is being recorded.

At this time, I'd like to turn the conference call over to Chris Reigelman, Head of Investor Relations. Sir, please go ahead.

Chris Reigelman
Good morning and thank you for joining us today. 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.

Please refer to Slide 2 of our slide presentation which includes our Safe Harbor statements regarding forward-looking statements and the use of non-GAAP financial measures. For those of you joining by phone, please note the slide presentation is available on our website at www.origin.bank. Please also note our Safe Harbor statements are available on Page 6 of our earnings press release that we filed with the SEC yesterday. All comments made during today's call are subject to the Safe Harbor statements in our slide presentation and earnings release.

I'm joined this morning by Origin Bank Corp. Chairman, President and CEO, Drake Mills; Chief Financial Officer, Steve Brolly; President and CEO of Origin Bank, Lance Hall; our Chief Risk Officer, Jim Crotwell; and our Chief Credit and Banking Officer, Preston Moore. After the presentation, we'll be happy to address any questions you may have. Now I'll turn the call over to you, Drake.

Drake Mills
Thank you, Chris, and good morning. Looking back on the past quarter and the full year, I am pleased with our results and what we have accomplished as a company. Moving into 2022, we are deliberate and purposeful in how we execute through our planning process that is focused on creating sustainable, long-term value. Our success places us in a position of strength as we take advantage of positive operating leverage.

You can see that we had an impressive fourth quarter and a full year 2021. We ended December with $7.9 billion in total assets, $5.2 billion in loans and $6.6 billion in deposits. Lance will provide more detail regarding our loan deposit growth, but I want to steal a little thunder of his and mention that we showed 5.7% growth in loans excluding PPP and mortgage warehouse quarter-over-quarter, which is 23% annualized.

At the beginning of 2021, we felt confident in our ability to deliver high single-digit loan growth, and that's exactly what our bank has delivered. Again, backing out PPP and mortgage warehouse, we saw an increase of $404 million, or 9.9% year-over-year. I'll save the deposit growth for Lance, but I'm pleased with how our bank has continued to deliver strong growth through core organic relationships.

Looking at our income statement, I'm proud of our results for the quarter and the year. We finished the quarter with record net income of $28.3 million or $1.20 diluted earnings per share. Our net interest margin was 3.06% on a tax equivalent basis and our efficiency ratio was 56.92%.

For the full year, we had record net income of $108.5 million or $4.60 diluted earnings per share. Our

pre-tax, pre-provision earnings was $122 million for 2021, up 17% year-over-year. Our efficiency ratio improved in 2021 even with slight increases in non-interest expense, which Steve will go through later in the presentation.

A primary strategy that continues to be front and center for our management team is the efficiency of this company. As we focus on expense management, we will always be mindful of the investments in people and infrastructure that produce stronger revenue streams. This has been evident in our investment in the Texas market, which you can see on Slide 9. Our Texas bankers grew loans $373 million and grew deposits $558 million in 2021.

When you look at the last five years, we've grown loans and deposits at a compound annual growth rate of over 21% and 28% respectively. We have had incredible success in DFW and Houston with the way our teams produce. This applies to our legacy bankers as well as our lift out [ph] teams. We will continue to leverage our infrastructure and aggressively pursue the most talented bankers in our market.

Now, I'll turn it over to Lance.

Lance Hall
Thanks, Drake. We had another strong quarter of growth and I'm proud of the meaningful results our bankers have produced. Origin has always had the philosophy that our success comes directly from having the right people. We certainly have high quality bankers who have attracted high quality relationships throughout all of our markets. We've been purposeful and strategic with client selection. This has been and will continue to pay off for us as we continue to focus on the client experience and being trusted advisors.

On Slide 10, you can see that dynamic organic loan growth of over 50% and a compound annual growth rate of 10.8% and our loan portfolio, excluding PPP and mortgage warehouse, over the last five years. As you dissect the core of our loan business, excluding PPP, and look specifically at C&I, owner occupied CRE and owner occupied C&D, we show five year growth of 37% with a compound annual growth rate of 8.2%.

Drake appropriately bragged on our bankers production in the fourth quarter, as loans held for investment, excluding PPP and warehouse, grew $241.5 million, or 5.7% compared to the link quarter, which is 23% on an annualized basis. I'm also pleased that we delivered 9.9% loan growth for the year.

In prior quarters, we've spoken in detail as to how we were able to use the PPP program to deliver for our clients in a time of need during the initial impact of the pandemic. At the end of 2021, we have $105.8 million of PPP loans outstanding with $3 million of net deferred fees remaining. We expect to recognize the balance of those fees in the first half of 2022.

On Slide 12, you can see an overview of our deposit trends. We have and will continue to place a high level of focus on growing non-interest bearing deposits. In the fourth quarter, average non-interest bearing deposits increased $145 million dollars compared to the link quarter and now represent over 33% of total average deposits. Year-over-year, we saw an increase of average non-interest bearing deposits of $425 million or 25.2%.

Core deposits remain at the center of how we truly value a loyal relationship. Regardless of the environment, Origin clearly understands the significance of a core deposit relationship and will continue to emphasize that philosophy with our bankers. In 2021, our bankers responded by growing average core deposits by $1.37 billion, or 30.3%. This growth took place while our cost of total deposits decreased 12 basis points year-over-year.

At Origin, we place a high level of focus on leveraging technology to drive value for our company. During the past year, along with other initiatives, we launched a new website, increased our partnerships with fintechs, and integrated robotics into many of our processes. This focus on technology is a major component of our vision statement, and what we believe is critical to enhancing the client experience and creating long-term sustainability.

Now, I'll turn it over to Jim to go through our credit quality metrics.

Jim Crotwell
Thanks, Lance. As you can see on Slide 14, our overall credit quality continues to improve as evidenced by our continued reduction in classified loans. Classified loans held for investment as a percentage of total loan sale for investment, net of PPP loans, reduced to 1.35% as of yearend, reflecting a 35% reduction from the level a year ago. Past due loan sale for investment to total sale for investment net of PPP loans into the quarter at .50%, which is consistent with the levels reported throughout the year. Non-performing loans held for investment to loans held for investments net of PPP also remained stable at .49%.

Lastly, annualized net charge offs for the quarter to average loans held for investment came in at .22%, down two basis points from Q3, and has also been stable throughout 2021. Based on these metrics as well as our ongoing review of our portfolio, we continue to be extremely pleased with the stability and resiliency of our portfolio, which continues to be driven by our focus on relationship banking.

We decreased our allowance for credit losses to $64.6 million, a $5.4 million reduction from quarter end Q3. As of yearend 2021, our reserve represented 1.23% of loan sales for investment, and 1.43% of loan sales for investment net of PPP and mortgage warehouse loans. The decrease in the reserve was driven by the improving credit quality as well as continued improving economic forecast.

With that said, we continue to keep a close eye on the Omicron variant and its potential impact on economic conditions, as well as inflationary pressures, continued supply chain disruptions, and labor shortages and their potential impact. All in all, we are very pleased with the overall performance and stability of our portfolio.

I'll now turn it over to Steve.

Steve Brolly
Thanks, Jim. I'll start on Slide 15.

Our total yields on loans held for investment increased six basis points in Q4, which includes the impact of PPP loan forgiveness. Excluding the impact of PPP loans, our yield on loans held for investment decreased four basis points in the quarter.

The top right graph shows a continued decrease in our cost of funds as our total cost of deposits was 19 basis points for the quarter, representing a 39% decrease from the fourth quarter 2020.

On the bottom right graph, you'll see our fixed and variable loan composition. As an asset sensitive bank, with approximately 60% of our loans floating, increased interest rates will be beneficial for Origin. We expect to generate an approximate incremental $20 million or 9.1% in net interest income from 100 basis point parallel shift in interest rates.

At December 31, 2021, 51% of our prime and one month LIBOR index loans have a note interest rate

below their floor interest rate. With an increase of 50 basis points, only 20% of our prime and one month LIBOR index loans will have a note interest rate below the floor interest rate. With a total of 100 basis point increase that percentage decreased to 7.2%.

Slide 16 shows a recent net interest income and NIM trends. The graph on the left shows our five quarter trends of income and NIM. Our net interest income increased $1.6 million, representing a 3% quarter-over-quarter increase. Excluding PPP and mortgage warehouse, our net interest income increased from $42.9 million to $45 million or 5% quarter-over-quarter. We believe that our net interest income will continue to improve in 2022.

The graph on the top right shows the change in net interest income excluding PPP and mortgage warehouse loans of $2.2 million from the third to the fourth quarter. Every Balance Sheet component improved compared to the prior quarter, with interest from investment securities increasing $1.2 million, and real estate and C&I loan income contributing $673,000.

The bottom graph shows our NIM quarterly changes with lower yielding securities contributing to the largest negative impact due to the fourth quarter having a full quarter impact on the investment securities purchased that was made in the latter part of the third quarter.

Slide 17 is our net revenue distribution. The top left shows our net revenue growth since our IPO and of 4Q21 over 3Q21 increase of $2.4 million.

The bottom left graph details our non-interest income lines. Mortgage banking revenues increased 5% from the third quarter to the fourth quarter.

Insurance Commission and fee income, which is a seasonal revenue producer, increased 3.5% compared to the fourth quarter of 2020.

We added a new table this quarter to give clarity to the components of other non-interest income, which is on the top right. During the fourth quarter, we completed the acquisition of the remaining 62% of the Lincoln Insurance Agency. The accounting rules require us to fair value our original 38% investment, and that produced a $5.2 million fair value gain.

Slide 18, our non-interest expense analysis, we reported total non-interest expense of $40.4 million, an increase of $1.2 million compared to the third quarter. The main driver of this increase was an additional $900,000 incentive approval primarily due to the growth in loan production.

We continue to focus on efficiencies to support our growth, and the bottom graph represents our quarterly operating leverage and efficiency ratio trends.

Now I'll turn it over to Drake.

Drake Mills
Thanks, Steve. Our capital position has supported our strong organic growth while allowing us to continue building valuable partnerships. I mentioned on our last call that we would close two in-market insurance acquisitions in the fourth quarter. Those partnerships were successfully finalized in December having a slight impact on capital. We were in a strong position. And, as I have consistently stated, we will continue to take an opportunistic and disciplined approach in deploying our capital in ways that we believe will be beneficial to our shareholders and drive long-term value.

2021 was a great year for our company. We executed on our strategic plan and delivered on what we

told the market we would do. We produced strong organic growth, took advantage of dislocation in the market, attracted highly talented bankers, effectively managed our expense structure, maintained strong credit quality, and significantly grew our Texas franchise.

I am proud of the employees of Origin and what they accomplished in 2021. They remain committed to our culture, which is unique and separates us from others in our markets, and continues to be a competitive advantage. This was reinforced this year by being recognized by *American Banker Magazine* as the third best bank to work for in America.

The Origin vision is to combine the power of trusted advisors with innovative technology to build unwavering loyalty by connecting people to their dreams. Our vision is clearly in focus. We are strategic and intentional about following the vision to drive us to attract highly talented bankers who want to be a part of an award-winning culture and continue to build a best-in-class growth story.

Thank you for being on the call today, and we'll open it up for questions.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time we'll begin the question and answer session. To ask a question, you may press star and then one using a touch tone telephone. To withdraw your question, you may press star and two. At this time, we will pause momentarily to assemble the roster.

Our first question today comes from Matt Olney from Stephens. Please go ahead with your question.

Matt Olney
Thanks. Good morning, everybody.

Drake Mills
Good morning, Matt.

Matt Olney
I want to start with the loan growth. It's great to see the robust loan growth when I take out PPP and mortgage warehouse. Any more colors on the driver of the loan growth in the fourth quarter? And if you could speak to utilization rates or pay downs or anything else that you think is more notable as far as the driver. And then as you look into 2022, what type of growth do you expect ex-PPP and mortgage warehouse?

Lance Hall
Hey, Matt. Good morning. This is Lance. We started last year, I was very confident that we were going to get high single-digit loan growth, so I was really pleased in the third and fourth quarter to see that come to fruition. We felt very confident all year in our pipelines and the conversations with our presidents. We kind of walked into Q4 with about a $300 million pipeline at the time, and then that came out great.

Texas continues to be the huge driver for us. Almost 100% of the loan growth came in the Texas markets as those investments in Dallas and Fort Worth and Houston continued to pay off.

On a going forward basis, we just feel like we're an organization that's built to grow. From our geographic management model to the way that we incent, to the culture that we've built that allows us to lift out teams. So if you look at Slides 9 and 10 of the slide deck, we're traditionally growing about 20% in Texas, which is equating to double-digit loan growth for the company and we think that's going to continue and

continue next year.

Matt Olney
So, Lance, if I layer in that 20% plus growth in Texas, along with the other markets, do we get back to the high single-digit level on a combined basis? Is that a fair way to look at it?

Lance Hall
Yes, Matt. I'll tell you, from a budget perspective, we're budgeting 10% loan growth. We think we can drive double-digit loan growth. It was also great to see in Q4 our line utilization get back to historic levels. We went from 42% to 48% in utilization, which equated to about $113 million in C&I growth from that area. The fact that the vast majority of this was C&I, which is where we like to drive this business, it was overall just a really, really good quarter for us and we see that continuing in the next year.

Matt Olney
Okay, that's great, Lance. And then on the deposit side, also some really strong growth in the fourth quarter. Would love to hear your thoughts on how sticky that deposit growth is. Just trying to appreciate if anything seasonal could be in the fourth quarter numbers. And then same thing, expectations for deposit growth as you roll into 2022.

Lance Hall
We have continued to incent bankers on core deposit growth, specifically NIB's. You've seen, we've got our NIB and that was a stated goal over the last few years. We've had to get over 30% NIB in our portfolio, and I think we've gotten up to 33% now.

From a seasonal perspective, we do have public funds here in our core markets in North Louisiana. Through some of the tax dollars, you see $100 million to $150 million ramp up there at the end of the quarter that'll work itself back out through the year as those dollars get distributed. But then we also chart that year-over-year and we always continue to see slight growth in that portfolio book of business. So, it's something that we're continuing to strive to do, and we're now at this point down to 79% loan to deposit ratio and we feel like we've got a great opportunity to put that liquidity to work in our loan portfolio.

Matt Olney
Okay. Thanks, Lance. And then just lastly, on the fee side, there are a few moving pieces in the fourth quarter. I think you called out the fair value gain. But I'm guessing as we look into the first quarter, we should get some more benefit from insurance income from the closing of those two deals in December. Can you point us to a range or a landing spot for us to think about for the first quarter as you integrate all these different items? Thanks.

Drake Mills
And you're talking about total fees, you're not just talking about insurance?

Matt Olney
Correct.

Steve Brolly
So I'm going to start with a subset for insurance, just so you can see, because that's going to be a little bit larger than everything else. Insurance is about $13 million this year. We expect that to be about $20 million in 2022. Other than that, we expect mortgage to increase about 6% and all the other fees to increase low single-digit numbers.

Now, swap fees, we really don't think if rates increase, swap fees probably won't increase. And then the

last piece, really, limited partnership income, we normally budget that kind of flat but thinking maybe a million dollars a year, but that is very volatile.

Matt Olney
Got it. Okay. Thank you, guys.

Drake Mills
Thank you, Matt.

Operator
Ladies and gentlemen, this is the conference operator. Are you able to hear me?

Drake Mills
We can hear you loud and clear now. How about us?

Operator
I can hear you loud and clear. I apologize for that, we were having a technical issue. I do have control of the Q&A. So our next question today comes from Brian Millsaps [ph] from Piper Sandler. Sir, please go ahead.

Brian Millsaps
Hey, good morning, guys.

Drake Mills
Morning, Brian.

Brian Millsaps
Thanks for taking my questions. Maybe wanting to start with expenses. You guys have done a really nice job last couple of years keeping a pretty tight lid on costs. There's a lot of discussion about expense inflation. You guys are a growth company. I know you've got expenses coming in from the consolidation of those insurance companies as well. So Steve, just curious, could you give us a good kind of jumping off point for expenses in 2022 and maybe kind of how that relates to your hiring plans as well?

Steve Brolly
Brad, to make this simple, let's just use a starting point coming out of the fourth quarter of $40.3 million a quarter. I'm very pleased with the fact, let's say that $161.2 million run rate and pleased with the fact that we're looking at about a 3.1% increase in expense for the core bank. And we've spent a tremendous amount of time, there is wage inflation and wage pressure and a number of things that we're dealing with, but after we got through with our budget, came back in as a team, looked at what our opportunities were as a growth company and paying for production, and the majority of that is production, we're going to see about a 3.1% increase in the core bank. If you add on the increase for the insurance agency, that's another 3.4%. About $1.35 million a quarter.

So, we feel pretty good that even though you might look at that as a 6.76% increase that the core bank's at 3.1% going into highly productive year, and I would say a good bit of that 3.1% expense was put on with the nine producers in the third and fourth quarter that's just starting to come into effect. So we're getting that production. We're seeing some good things. We're being able to hold down operating expenses, and very pleased with where we're going to come in.

Brian Millsaps
Thanks. So if I understand it, if I kind of annualize it fourth quarter, maybe add another 3% to that, plus

the insurance companies, that should get me pretty close?

Steve Brolly
Yes, and I will help out a little bit. In my math it's probably, I'm going to say a $43 million run rate with everything baked in.

Brian Millsaps
Got it. Very helpful. And, Steve, I think you said last quarter that your interest rate sensitivity table assumed about a 60% deposit data, but you thought you could do better. Do you still have that 60% assumption in that table or have you guys altered that at all?

Steve Brolly
Brad, we did alter that a little bit. That 60% is really after 100 basis point increase. With all the liquidity in the system right now, the first 25 we really have zero, and we did it by 25 basis points increment. So under 100 basis points, it is averaging about 20%, and that's on an average. Then over 100 basis points is to our normal 60%. So there's going to be a little bit of a lag in the first 100 basis point increase.

Brian Millsaps
Okay, thank you. That's very helpful.

Drake Mills
Brad, I want to add to that. That really the way I'm modeling it, and my model is a little different from their model, is about 50% with zero beta, 50 basis points. I'm sorry.

Brian Millsaps
Okay. Okay. Great. And then, Drake, maybe final question, just kind of a bigger picture one. I think it was on this call about a year ago, you talked about your Mississippi and Louisiana regions kind of being double the profitability of Texas and your goal over time was to get kind of that sub 1 ROA Texas bank up closer to where your other regions are, closer to two. Just kind of curious, can you update us on the progress there you made in 2021. And kind of where you might be able to be a year from now, in terms of bringing the profitability of Texas up in line with the rest of the organization?

Drake Mills
Yes. I was thinking about this a minute ago, when we were preparing for this call. Thirteen years ago, we went into Texas, de novo into Dallas, a year later Fort Worth in 2012, actually 2013 midpoint in Houston. We've been in Texas for 13 years. And today, we're significantly larger in Texas than we are in Louisiana and Mississippi. So that ROA is ramping up very nicely. We're starting to see, as I've talked about many times, and we're extremely focused on positive operating leverage.

I'm sorry to spend a little time here, but going back to the IPO, I told this institution that we'd be able to overlay $2 billion of additional assets on top of the infrastructure. Well, we basically laid $4 billion over the top of that infrastructure, very little investment. And so what we're starting to see is a pretty strong ramp up in ROA in the DFW and Houston market.

So I'll give you a little bit, and I probably shouldn't do this, but if you look at Houston, we're kind of looking at that 150 to 170 range by the end of the year. And then if you look at Dallas, I expect them to be approaching 2% at the end of this year, if not there.

Brian Millsaps
Okay, great. Thank you very much.

Operator
Ladies and gentlemen, our next question comes from Brady Gailey from KBW. Please go ahead with your question.

Brady Gailey
Hey, thanks. Good morning, guys.

Drake Mills
Good morning, Brady.

Brady Gailey
When I look at period end balances linked quarter, the bond book kind of was flat at $1.5 billion. I know average balances kind of caught up in the quarter. But how are you thinking about any potential bond book growth in '22, kind of as the long end of the curve gets a little higher?

Jim Crotwell
So Brady, we have modeled less than 10%, with the loan growth modeled at 10%. Deposits, if they come in a little bit less than 10%, we should be able to just grow the investments maybe 5%, but it really has to do with the timing. We did have a little bit excess cash at the end of December, but that, as Lance had mentioned, is public funds and we know that comes out.

Now that the rates are a little bit higher, the end of the fourth quarter we were seeing about a 140, 150 yield. And right now we're looking at about 175, 180. So we will start to add a little bit more. Our normal run off is between $15 million and $18 million a month, so we need to at least add that on each month, and then we may add more. It just depends on the flow of the cash and where we project loan growth.

Brady Gailey
All right, and then.

Drake Mills
Brady, this is Drake. I want to add to that. I think we're in a very good position from a liquidity standpoint to be able to truly manage expense on the deposit side and look at our relationships and continue to grow core deposits at what I think is a slower clip as far as any kind of rate increases. So as we look at the portfolio, we're going to be mindful that we might run down deposits slightly that are higher costs that we don't see as long-term relationships while we have this luxury.

We also have changed our model somewhat to run a lower loan deposit ratio overall compared to what we've done in the past. So these are all factors I think that we're going to be able to deploy to maybe put some liquidity to work in the right way and make sure that we are very focused on margin as we do that.

Brady Gailey
Okay. All right, and then moving to the mortgage warehouse that continued to normalize lower in the fourth quarter now at about $580 million. How are you thinking about the warehouse into 2022? Is that $580 million kind of a good washed out base to grow from? Or do you think we continue to possibly see some shrinkage? I know 4Q is a seasonally weak quarter, but how do you think about it next year?

Drake Mills
Well, I want to remind everyone on the call and our investors that it's our strategy to run, and it was two years ago to grow mortgage warehouse to 10% to 12% of outstanding's. So if you looked at average balance year-over-year growth that was 31% between 2020 and 2021. And so we think that that number is close to 600. And that, that will run that 10% to 12%, and that we're going to be able to have slight

increases in that. We're still onboarding clients, and we'll continue to do that, but we're going to manage this in that 10% to 12% range. So I'm pleased with where we are, pleased where we've ended up. And even looking overall, we've hit the plan exactly on target. So we're going to probably see that $600 million slight increase, potentially, but I'd say flat at that.

Brady Gailey
Okay, and the 10% to 12%, Drake, that's as a percent of loans or assets?

Drake Mills
Loans.

Brady Gailey
All right. And then finally, it's great to see the couple of insurance acquisitions. Are there any other fee income based businesses that you think you would be interested in? Are you where you want to be with insurance or would you like to add to insurance? It feels like with the growth you're putting on bank M&A, it could be less likely. So I'm just wondering if fee income based M&A is still in the cards for y'all?

Drake Mills
Absolutely. There's some opportunity. I like this insurance business. We are creating some relationships as we speak that I think fill in our footprint. And I think that's an important aspect, because as we look at Texas and some of the relationships that we're growing there, it is, I think, prime opportunity for us to continue [indiscernible] income. We're going to drive this thing to where it's a 70/30 split between spread income and fee income, and feel like that's going to create the valuation that we need.

Brady Gailey
All right, great. Thanks, guys.

Operator
Next question comes from Kevin Fitzsimmons from DA Davidson. Please go ahead with your question.

Kevin Fitzsimmons
Hey, good morning, everyone.

Drake Mills
Morning, Kevin.

Kevin Fitzsimmons
Hey, Drake, just to follow on Brady's last question. So I was going to ask something similar in terms of with the organic growth you have sitting in front of you, why even look for traditional bank deals? But I believe in the past you've mentioned the prospect of getting into a new market in Texas as possibly being something you might be interested in. So I didn't want to jump so fast to rule that out or to give you the chance to rule it out and how you feel about traditional bank M&A?

Drake Mills
Well, first off, I wouldn't rule that out. But, our organic growth is allowing us to be in a position of luxury, let's say. It allows us to stay disciplined and focused on creating partnerships that I think fill in gaps in our markets, but staying within the same footprint that we're in. This is all for me. And after 38 years of building this institution, culture and everything else, truly hopefully we could find partnerships that allow us to continue doing what we're doing, bring in very good markets and production and that's what we're looking for. So, I wouldn't rule that out, but it's going to be a disciplined approach and it's going to be something that's truly going to benefit our shareholders when if we pull the trigger on something.

Kevin Fitzsimmons
Okay, great, thank you. And then just one follow on the margin, I appreciate all the asset sensitivity position, but as we look at all the moving parts between PPP fees running off and then positive tailwinds from mix shift and then rising rates, is it fair to say that maybe the margin might actually bottom in first quarter if that's going to be a heavier quarter for PPP fees running off and then the mix shift and then the effective rates start to more than offset in second quarter and then over the balance of the year? Is that a way to think of a percentage margin trajectory?

Drake Mills
I think that's fair. And I think the important point here is that we feel that we bought them from a margin standpoint and there's upside. I love our asset sensitive position we're in. The fact that our own board with our new production people are bringing on relationships that aren't as price sensitive as if you were out there just combing fresh territory. So I'm pretty bullish that we've bought them and we'll see somewhat of a flat environment without –

Kevin Fitzsimmons
And one thing you mentioned earlier about deposits, because we don't hear a lot about that because the industry is so flush with cash and your focus on keeping that as a priority I find interesting, because do you think from an industry standpoint we're so used to these big increases in deposits and having this excess cash, but could we wake up a few quarters from now and have deposits for the industry actually declining? And so then, maybe we pivot and NII has been driven by earning asset growth from liquid assets, but the percentage margin is getting killed where it pivots to the opposite, where maybe we're getting lift in the percentage margin, but some banks that don't have the loan growth that you have might be pressured on an average earning asset basis. So I'm just curious about your thoughts about industry.

Drake Mills
Yes, and for me, been here 38 years and, again, and in my opening comments I mentioned twice long term value, never have I led up off of building long-term deposit relationships in core deposits. And that is something that I preach, something that we incent here, we are going to build value through core deposits. I don't care how much liquidity we have, because liquidity will flush and then all of a sudden we'll have the same loan growth, positive loan growth and we'll have to get that engine going. This engine is going all the time. And I think it's really what creates long term value for organizations like us.

Kevin Fitzsimmons
That's great to hear. Thanks, Drake.

Operator
And ladies and gentlemen, once again, if you would like to ask a question, please press star and then one. To withdraw your question, you may press star and two.

Our next question comes from William Wallace from Raymond James. Please go ahead with your question.

William Wallace
Thanks, Morning, guys.

Drake Mills
Morning, Wallace.

William Wallace

Maybe just following up on Kevin's questions. I believe, so it was 9% expected NII increase in an up 100 environment. And I think what I heard Steve saying was you're modeling loan growth to be matched by deposit growth. So is that to assume that there's no assumption of liquidity deployment of – it looks like you still have some access liquidity even with the funds that are running off. So if you have excess cash and you decide to deploy it, I'm assuming that would be upside to the 9% NII in an up 100 environment. Am I saying that correctly? Am I hearing that correctly?

Drake Mills
For the most part other than we're going to take a little bit of a stance on deposit growth. We don't see deposit growth matching loan growth this year, because we're in a position that we think we can maximize margin and yield and focus solely owned – because if you go back several years ago, you remember that we had broker deposits, we had a number of different things. We're at a position where you have focused on, and hats off to our Houston team and our DFW team for funding themselves, basically, and that's a position we haven't been in before with DFW. So now we can truly focus on creating the deposit franchise that has, like I said earlier with Kevin, a tremendous amount of value. We don't have to depend on broker deposit like we did before. So we can pare that down and you might see 3% to 5% growth in deposits this year, versus a double-digit loan growth.

William Wallace
Okay, all right. That's very helpful. So the 9% assumes you're having less deposit growth and deploying all liquidity into the loan portfolio.

Drake Mills
Yes, absolutely.

William Wallace
Okay. Okay. Lance, you mentioned a pretty significant increase in line utilization in the fourth quarter, from 42% to 48%. To hit your 10% budgeted target in 2022, do you need continued increase in line utilization? And if so, where do you need to go and where were we pre COVID?

Lance Hall
I don't think that we do. So we're at 48%, our historic number is like 49%, we were 49% pre COVID. So this quarter got back to historic levels. If we got continued lift, that would be a benefit, but we feel like we could do 10% based on producers and production levels.

I mean, just kind of going back and looking year-over-year, we had new loan in line production up 36% year-over-year, fee income up 23%, treasury management up 11%, so we feel like the growth engine can do that without additional line utilization, but that would be a nice benefit.

William Wallace
Okay, great. And then maybe just along the lines on the lending side, I know you guys are always going to be opportunistic as it relates to new hires. Are you actively and aggressively continuing to try to build the production side? Or are you now at a point where you feel like opportunistic is truly the best word?

Lance Hall
No, think that you're always going to see us looking for good talent. Now, at the same time, we feel like we have a lot of capacity in the group that we have now from the lift outs we've done in the previous years to the producers we added last year. From the seven producers last year, we produced about $122 million in loans, which turned into $112 million in growth and $636,000 in fees. I mean, we have much higher expectations as that begins to normalize. So we're going to be able to get the benefit of those producers versus our existing teams.

Now at the same time, we're closely watching dislocation, we're closely monitoring talented people, we're close into these communities. And as we've built the bank, we've done it through lift outs and so that strategy is not going to stop.

Drake Mills
And, Wally, I want to throw something in here. The talent that we attract is in line with our portfolio mix, and our desire to grow C&I institutions, so we've passed on a number of opportunities for lift outs and additional teams that are, let's say, real estate focused or have relationships that just don't fit. So who we're lifting out and who we're bringing on we think are long term producers that produce the portfolio mix that we desire moving forward.

William Wallace
Great. Thank you for that color. And then I believe I heard, Steve, that you said that you guys think you can do a 6% increase in mortgage. There's a lot of headwinds expected, I think we're talking 25% to 30% expected declines in volumes and probably pressures on gain on sale margins. Can you remind us, I know we talked in a couple of quarters past about production hires in the mortgage side, can you talk a little bit about how you ramped up that team that would give you confidence in a 6% growth?

Drake Mills
And especially in Texas, we’re continuing to ramp up to hire NMLO's. And we expect at this time, based on what we know in our pipelines that mortgage volume will increase by 6%. But we understand that competition in markets is going to impact that gain on sale margin, but we intend to use our MSR hedge much more efficiently than in the past to manage that impact. And I the normalization in the markets and the traditional flows are going to allow that MSR hedge to work more effectively than it has in the past. So we see a big upside this year in mortgage.

William Wallace
Okay, great. And last question, just kind of more philosophical. Lance, we've talked about technology and how important technology is to the organization for over a year now, and I know you guys have invested in some systems that help on the lending side and the efficiency side. Are you also, when you're talking about how important technology and partnerships are, are you guys also looking to partner with fintech companies, kind of in a baking as a service type relationship? Or is it all just how can you better utilize offerings from fintech companies to help you all bank more efficiently and operate more efficiently?

Lance Hall
Hey, thanks. I think it's a little bit of both. I mean, if you look at kind of the budget for the year and the investments that we continue to make, it’s continuing to invest in Encino [ph]. We’ve been in Encino commercial bank for a while. We're adding on the consumer piece this year, which creates more automation, more efficiency inside of our operations groups, more of a streamlined view for the client experience. We continue to invest in their robotics process automation. Saw some interesting data around that the other day where from going through and working through the departments and manual processes, we've reduced 4000 man hours on an annual basis so far that have been put over to the process automation group. That’s a savings of 2.25 FTE. So we continue to work through that through our mortgage groups, through our operations.

Doing some things this year with some fraud detection software, some data management, some real time text based client surveys. If we're going to drive our company based on delivery and service that we want to be able to measure that. And so we've partnered with a group called Podium that's going to provide instantaneous feedback and net promoter scores.

We've also invested now into fintech equity funds. And we're trying to have a seat at the table to understand what can benefit us the most as we continue to push this company, both from a client experience and an automation perspective. So we're taking a holistic look at ways that we can improve our company. And as we've talked about in the past, it's about driving efficiency, driving automation , so, therefore, that we can focus on production.

William Wallace
Thank you, Lance. I appreciate it. That's all I had, I'll step out.

Drake Mills
Hey, Wally, thank you for allowing us some of your time this quarter. We appreciate it.

Operator
And our next question is a follow up from Brad Millsaps from Piper Sandler.

Brian Millsaps
Thank you. Drake, just wanted to maybe touch quickly on credit. Obviously, MPAs are at low levels. But the last couple of years, I guess your charge offs have kind of run mid to high 20 basis points, which I think through a cycle I think that's a pretty good level. But, at a time when many banks are having maybe zero or even net recoveries, just kind of curious is that related to some of the cleanup you've don e over the last couple of years in some areas you wanted to push out of the bank? Anything else going on there? Just kind of want to think about kind of charge offs and how you might treat kind of the remainder of your excess reserves going forward.

Drake Mills
No, and I'm a little bit reluctant to cite necessarily clean up. As I've said before, COVID allowed us to do a lot of things to really focus on what we wanted this institution and portfolio to look like moving forward and understood some of the stresses. So we did take the opportunity to do some things and push some credits out. And that's why I'm so proud about on the 9.9% growth we had because we had almost $60 million in credits that we pushed out that did not fit the profile. And there were some cleanups in some areas, especially when you look at the assisted living arena and some of those type of deals. But there were just some legacy deals that we cleaned up.

But I want Jim Crotwell to talk about for just a second, if you don't mind, credit, because I couldn't be prouder of Jim and Preston and their teams and the position they put this institution in, because you're going to see charge off levels that are going to continue to be lower. And I think these are two great trends, our classified assets are down 41%, pass watch credits are down 38%, so we've had some significant changes. So Jim, have at it.

Jim Crotwell
Thank you, Drake. The one metric that I've just been extremely pleased in is the movement that we've had in overall classified assets coming in at 1.35%. At the end of the year, you look back to where we were a year ago at 2.08%, so that's a dramatic improvement and decline in that metric. While all the other credit metrics have been very, very stable, very proud of our bankers an d what they do on ongoing basis. Our past dues have been very stable throughout the year at .50. Our nonperformance have been very stable as well. And, compared to peers, that's a very, very positive metric for us.

So, as I see it from a reserve standpoint, we've done the heavy lifting, if you will, as we brought that reserve down. As we continue to see the resiliency and the stability in our portfolio, I think we will see some continued decline over this year. But depending upon the economic forecast, it will not be at the rate that we've seen this last year, but I think we do have a little bit of room to go there. And I see the

same decline throughout toward the end of 2022, as we get back to the more historical levels from a charge off perspective. So all in all, I can't say enough about how I'm pleased with how our portfolio has performed over the last two years. And again, as I mentioned in our comments earlier, I think it's a direct result of being focused on relationship banking.

Drake Mills
And, Brian, I'm going to add just another note to that. This client selection process that we've talked about has been a very serious matter within this organization. And if you look back at our issues in the past, it's always been surrounded by poor client selection and it even goes a little deeper into poor relationship manager selection, something that we changed four years ago. And if you look at the credits that we are charging off today in this cleanup process, it relates back to that client selection process, and also that relationship manager process, so I'm very pleased with where we are.

Brian Millsaps
That's helpful. Thanks, Drake. And just to follow up on your comments around Houston and Dallas, pushing towards a 1.5% to 2% ROA by the end of this year, if I look at the consensus expectations, folks are kind of looking for you to do a 1% ROA in both years. It would seem if you've got all three states, pushing north of 1.5%, that will need to come up. But there may be other aspects of the organization, thinking about whether the holding company, etc., that's dragging that down, just kind of wanted to square those comments on those two regions achieving those levels of returns kind of vis-à-vis the consolidated ROA for the entire company.

Drake Mills
Yes, and for us, this is about – if you look at our metrics, if you look at our incredible growth in EPS, if you look at our incredible revenue growth and all the things that matter from a metrics perspective, there's one area that we have to continue to focus on and that's pre-ROA, and that's what we're doing. We understand where we have to be. So we have done the things, mortgage was a drag for us, it certainly was to a degree this year. We have ourselves in a very good position there not to be less [indiscernible] drag us down. We have what I think has done an unbelievable job in the last three years of reducing overhead from executive management standpoint.

Now, we just recently hired Derek McGee on the legal side that's going to do an incredible job for us as we get ready to cross 10B, and some other things, but we have what I think is an efficient holding company, an efficient executive team, and so those markets pushing those numbers are going to equate to higher ROA's as we go through 2023/24.

Brian Millsaps
Okay, great. Thanks for taking my questions.

Drake Mills
Okay, Brad. Thank you.

CONCLUSION

Operator
And ladies and gentlemen, with that we'll conclude today's question and answer session. I would like turn the floor back over to Drake Mills for any closing remarks.

Drake Mills
Well, we've finished up what I think is an incredible year, a tremendous amount of obstacles that we had to deal with, but on the same side, our teams, our people, our cultures intact, and we are in a position I

think an undervalued company that's creating a tremendous amount of value. I hope investors recognize that. I appreciate our investors, I appreciate our stakeholders and thank you for the involvement in your company to support and all the things that you do for us. But on the other end, we're producing at a high level, creating a tremendous amount of value and we're doing it in a laser focused way that does things that I think are going to long-term put this company in a very strong position. So thank you for your support and we hope to see you in the future pretty quickly.

Operator
Ladies and gentlemen, with that we'll conclude today's conference call. We do thank you for attending today's presentation. You may now disconnect your lines.