Origin Bancorp, Inc.

Q1 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

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

Chris Reigelman -- *Investor Relations*

Stephen Brolly -- *Chief Financial Officer*

Lance Hall -- *President of Origin Bank*

PRESENTATION

Operator
Good morning and welcome to the Origin Bancorp, Inc. First Quarter 2019 Earnings Conference Call.

At this time, I'd like to turn the call over to Drake Mills, Chairman, President, and Chief Executive Officer, of Origin Bancorp. Please go ahead, sir.

Drake Mills
This is Drake Mills, and I just want to take a short break from my normal course of reporting this morning to acknowledge that our hometown community of Ruston, Louisiana, was struck by a significant tornado last night. To the best of our knowledge, all our people are accounted for, and none of our facilities were damaged, but our community suffered some severe damage at certain places, and we simply want to say that our thoughts and prayers go out to those friends and families who are affected, and the Origin Bank family will be looking for opportunities to help repair and restore our hometown to normal just as soon as we can. And I apologize for maybe the sound quality, because we've had to move facilities to a temporary facility for this call. So I'll turn it back over to the Operator for the normal call. Thank you.

Operator
At this time, 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 on your telephone keypad. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then 1 on your telephone keypad. To withdraw your question, please press star, then 2. Please note this event is being recorded.

I would now like to turn the conference over to Chris Reigelman of Investor Relations. Please go ahead.

Chris Reigelman
Good morning and 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 today's call.

Before we begin, I'd like to remind you that this presentation may include our management's views of future performance, business, and growth strategy, projected plans and objectives, and various other matters that constitute forward-looking statements under federal securities laws.

Due to the various risks and uncertainties, actual results may differ materially from historical results or any results implied by forward-looking statements. For a discussion of these risks and uncertainties, please refer to the forward-looking statements section of our earnings release and the risk factors included in our Prospectus filed with the SEC on May 9, 2018, pursuant to Section 424(b) of the Securities Act, as well as other documents we periodically file with the SEC. Forward-looking statements speak as of the date they are made, and Origin undertakes no obligation to publicly update or revise any forward-looking statement.

If you are logged onto our webcast, please also refer to Slide 2 of the presentation, which includes our forward-looking statement 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 in our slide presentation and earnings release.

Finally, in this presentation, we may discuss certain financial measures that are not calculated in accordance with U.S. GAAP. Please refer to the reconciliations of these non-GAAP financial measures to their closest comparable GAAP metrics in our slide presentation, which is also 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 supplemented 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 will be happy to address any questions you may have.

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

Drake Mills
Thanks, Chris, and thanks for being on the call today. We marked a strong start to 2019, and I believe we have the right team of bankers in place to continue to execute on our strategy for this year and beyond to drive loan deposit growth, developing deep and trusted relationships, and leverage operational efficiencies. While we, along with many in our industry, are experiencing pricing pressures, I'm proud of our results this quarter and feel we can continue to achieve strong growth and earnings throughout the remainder of the year.

In the first quarter, we reported record net income of $14.2 million and diluted earnings per share of $0.60, an increase of $0.05 from the previous quarter. We ended the quarter with over $3.8 billion in loans held for investment, an improvement over our position at the beginning of the year. We also showed deposit growth during the quarter of $115 million, ending the quarter with approximately $3.9 billion in total deposits.

Now, I will let Steve discuss more details around financial results for the quarter.

Stephen Brolly
Thanks, Drake. I'll start with Slide #4. While we had a modest growth in earning assets for the quarter, our net interest income was relatively flat at $42 million. Net interest margin for the quarter was 3.80% on a fully tax-equivalent basis, which was 2 basis points down from the fourth quarter of 2018. Our interest income on loans held for investment increased by $1.4 million due to volume and $1.1 million due to rate. However, this was offset by rate paid on deposits by $1.2 million and $820,000 net, due to two fewer days in the quarter. On a daily basis, our average net interest income increased by 2.1% in quarter one compared to Q4 of 2018. Compared to the first quarter of 2018, our net interest income increased 21%.

Our provision for credit losses was approximately $1 million, which was a decline from the linked quarter and is a result of stabilized credit quality metrics, which you will see later in the presentation.

Non-interest income improved by nearly 10% from the linked quarter, driven primarily by a $1 million increase from our insurance division, which reflects the added activity of our insurance agency that we acquired last year. The overall increase in non-interest income outpaced the slight growth in non-interest expense for the quarter, which helped improve our efficiency ratio to 65.97%.

Lance will now give an overview of our loans, deposits, and credit quality.

Lance Hall
Thanks, Steve. We continue to be rewarded for our strong growth, driven by the execution of our lift-out strategies. Over the past four quarters, we have captured 18.2% loan growth, 8.9% deposit growth, a 55-basis point increase in loan yields, 12 basis points in margin expansion, and an 18.4% improvement in non-interest income. For the quarter, we experienced some seasonality in our deposit mix that contributed to our slight margin compression as tax dollars and public fund dollars in our core markets rolled out, and we expect a return later in the year.

The primary driver of deposit growth in Q1 was in our Texas markets. The pricing of these markets is higher than in Louisiana and Mississippi but is a direct function of delivering deposits associated with our new banking teams' relationships. We continue to be hyper focused on core deposit growth and pricing discipline. We have updated our retail and commercial bankers' incentive plans to more strongly promote core deposit growth and to maintain NIB growth as our primary focus.

To continue to strategically support core deposit growth, we have opened a new full-service branch in Dallas, expanded our Frisco, Texas location, and rolled out two new exciting deposit products. Our loan pipeline and credit quality remain strong. Q1 was a slower-than-expected start to loan growth with a seasonal $40 million reduction in our mortgage warehouse lines and a delay in the closing time of a few loan pipeline projects. That being said, we are confident in our pipelines and still expect to deliver double-digit loan growth in 2019.

Our credit quality indicators and metrics for Q1 stabilized and returned to historical levels. Credit quality has been and will continue to be a strategic focus of our company as we develop relationships and make loans in 2019.

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

Drake Mills
Thanks, Lance. As we moved into the first quarter of the new year, one of our goals was for deposit growth to outpace loan growth. We previously mentioned on our last call, that deposit growth was a top priority and a throttle for loan growth, and we were able to grow deposits in the first quarter in a meaningful way. We believe our success in growing deposits will continue throughout 2019 but are mindful of the discipline needed in pricing and our bankers' understanding of the importance of customer relationships in the current environment.

During the first quarter, we hosted our Annual Cultural Celebration and kick-off events in each of our markets. This is our time to come together as a company and celebrate our successes as well as roll out our agenda for strategy for the year. The focus and excitement that I see from our teams gives me great optimism. As Lance mentioned, we presented new deposit products and initiatives that fit our strategy of growing relationships and driving value for our company.

I am very pleased with where we are as a company. The first quarter saw record profit for Origin, deposits increased, credit quality remained strong, our infrastructure and team of bankers are in place to capitalize on growth opportunities within our markets, and we are following our strategy to increase franchise value for our stakeholders. We will continue to stay focused on our plan.

Thank you and we'll now open up the line for questions.

QUESTION AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star, then 1 on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time, your question has been addressed and you would like to withdraw your question, please press star, then 2. At this time, we will pause momentarily to assemble our roster.

The first question comes from Matt Olney with Stephens. Please go ahead.

Matt Olney
Hi, thanks, guys. Good morning.

Drake Mills
Good morning, Matt.

Chris Reigelman
Good morning, Matt.

Matt Olney
I've got a few questions for you guys, but, first, thanks for the update on the tornado. It sounds like it was a direct hit on Ruston. Our thoughts and prayers are with you guys.

Drake Mills
Thanks, Matt.

Lance Hall
Thanks.

Matt Olney
I'll start on the deposit side. It looks like you had some outflows on the non-interest bearing. You made great progress there last year, but obviously a little slippage in 1Q. Can you try to quantify how much of that slippage is seasonal in nature and how much you expect to rebound and what are your expectations for that more on a full-year basis in 2019?

Drake Mills
Yes, Matt, you know, this is our first Q1 to report as a public company, and we do have a tremendous amount of seasonality, especially in the core, as public funds flow out. We actually each year have a decline in balances, so the majority of our deposit growth came from Texas, and, as you well know, the pricing on those Texas deposits are significant, and when I say significant, they're higher than they are in our core markets. We expect, as we've seen historical trends, that in the next three quarters, we'll rebound with non-interest-bearing deposit growth as we historically do and also stronger growth in the core. So, again, the first time we've reported Q1, and this is seasonality that we've experienced in the past.

Stephen Brolly
Matt, this is Steve. Just to add to that, at March 31st, our non-interest bearing were larger than they were at the beginning of March since the beginning of January, so although the average is a little bit lower, we're trending up so far at the end of the quarter.

Lance Hall
And this is Lance. I might also would add, if you look back from Q1 '18 to Q1 '19, non-interest bearings were up $92 million, which is about 10% growth, and I think we're projected to be able to do the same thing in the next 12 months.

Matt Olney
Okay, that's great color. And then it sounds like you continue to expect some good, strong loan growth this year. I think you mentioned double digits. Can you just talk about the challenges of trying to maintain that core margin? I think we're around 380 at this point. Can you hold this margin throughout the year if you do get that loan growth, or could there be some softness there?

Drake Mills
Well, at this point, Matt, with this loan growth through the first quarter, we still have significant pipelines, and there's some timing issues there. For instance, if you look in our Dallas market, we had a 13% annualized growth rate in the first quarter; Fort Worth, 9%; Houston, 26% annualized, so the core market in Mississippi was a little bit soft, we'll just see some return.

We expect that margin to see some increase in the second quarter, and I'm being extremely diligent from a fractional pricing prospect. We're passing on some loans that historically we might would have put on the books that are cheaply priced. So we're kind of picking our poison as we see what goes up or as we see deposit growth, you know, come through the chute. So we still feel at this point, we're going to see somewhere in the range of 10% annualized loan growth for 2019, and we think that we can continue to manage and battle the pricing strategies that we have in place on the lending side, so, hopefully, that will allow us to come in and understand what our margin's going to look like. For instance, if you look at the decline in LIBOR, we have $1.3 billion of loans tied to LIBOR. That's moved from 279 and 259, so we're feeling a little bit of pressure on that, so we're being, you know, creative in our pricing strategies and how we tie in those indexes as we move forward.

So a lot of things going on, and we're battling the margin side, but I still think that we're going to see the loan growth and deposit growth as we saw. You know, at this point, when I look into the third and fourth quarter, maybe I see some flatness in the margin at this point, but we're still determining what that will look like as we get aggressive with our pricing strategies.

Matt Olney
Okay, thanks for that, Drake. And, I guess, I also want to hear Lance's view. Hey, Lance, you've talked about being disciplined on the loan pricing side, and you've got some new programs and tools that you've implemented over the last year or so. Can you just kind of talk more about how much progress you've made so far on that and how much more upside there is especially on the loan renewal side?

Lance Hall
Yes, I think that is the daily battle, Matt, and we've talked about it in the past. We implemented PrecisionLender, which really kind of got going in the fourth quarter of last year, and so we're

still kind of working through some of the hurdles on the rates and assumptions inside of it. So I wouldn't say that it's not fully functional for us, but we're getting it there quickly, and I think that's going to be nothing but a lift for us on the pricing side as we analyze the ROA and the ROEs of total relationships.

We're actually having a Presidents' Meeting today. We met with them all day yesterday, getting them hyper focused on rate discipline, fighting for that extra 10 basis points on the loan side and the deposit side, so, you know, I would say, for us, priority one is core deposit growth and NIB growth and options. And then the second-most highly emphasized is our loan yields right now, so it is very much top of mind.

Matt Olney
And, I guess, on that same topic, Steve, I don't know if you have any numbers in front of you that you can share as far as some of the new and renewed loan yields that you saw more recently in the first quarter compared to the overall loan book.

Stephen Brolly
We look at that on a weekly basis, actually, and our new loans are probably going on an average of about 540 right now, and so we think loans will continue to go up about the same as they have in the past couple quarters, maybe not as much, but, then, the pressure will be on the deposits also. So we still think there's some overall improvement in loan yields going forward.

Matt Olney
Okay, guys, that's helpful. I'll hop back in the queue.

Drake Mills
Thank you, Matt.

Operator
The next question comes from William Wallace with Raymond James. Please go ahead.

William Wallace
Thanks, good morning, guys.

Drake Mills
Hello, Wally, how are you doing this morning?

William Wallace
I'm very good, thank you. Maybe to kind of push on the NIM topic, Drake, it sounds like you said you're expecting margin expansion in the second quarter, correct me if I'm wrong, but, you know, I can understand seeing the loan pricing improve when you've got a Fed hike in September and December. How are you guys going to continue to raise loan pricing with the Fed pausing?

Drake Mills
We have a percentage of our portfolio that is renewing on fixed rate two- and three-year fixed rates that we're going to be able to continue to price up. On the deposit side, with some of the public funds and some of the indexes that we're using with no further moves, those betas will cease, and then I believe that we're going to continue.

You know, we've run through these markets on the pricing strategies, and we have a pretty good feel of what it's going to look like in the second quarter. It gets foggy going into the third quarter, and that's what we're working to get a better feel for. Again, with the increase in some of the deposit rates we've seen, it's been because of the 100% beta type situation we have, which that's over. But pricing disciplines, like I said, we've passed on a couple of deals here just this past couple of weeks that were fixed rate low, for instance, seven-year, 499 fixed-rate-type stuff that we're just looking at. And our pipelines are strong enough to where we can still hit our 10% growth, pick those that make more sense from a pricing standpoint and can help us fight off this compression.

William Wallace
Okay. And then you mentioned the $1.3 billion in loans tied to LIBOR, and you hinted at some changing of pricing strategy around those. Are you changing? I know there's some question in the industry as to what's going to be the new benchmark rate, are you guys going to switch to whatever the new benchmark rate is, or are you going to go to prime? Can you talk a little bit about what some of the strategies are around those loans?

Drake Mills
Yes, you know, unfortunately, that's a factor of that relationship and the way that they, the client, drives that to a degree, but we are definitely going to look at the benchmark rate and start pushing what we feel is going to be best for us from a pricing standpoint.

William Wallace
Okay, and then on the deposit pricing, you mentioned the Texas markets are driving the deposit growth, and those are higher cost markets. Are you seeing, with the Fed pausing, are you seeing any change in the competitive environment around how other banks are pricing deposits, and do you anticipate that the pricing pressures will ease?

Drake Mills
You know, Wally, I'm anticipating that they should ease. We're not seeing that at this point. We're continuing to see some unreasonable pricing in our markets from some competitors, but overall I believe that we're going to be able to kind of hold that beta where it sits today, with maybe some slight pressure upward. We've launched, and Lance is going to probably talk a little bit about this, but we've launched and worked diligently on launching new account types and focusing on niche plays that we think are going to be significant impactors to our overall cost of funds.

William Wallace
Okay. And one last question before I hop off, just on the operating expense base, can you tell us what the new branch in Dallas will add, kind of your thoughts on the run rate and expenses for the rest of the year?

Drake Mills
Well, you're touching on a subject that is top of mind internally. We are taking a completely different focus on expense management as we try to understand margin. You think about how quick this margin depression came at us from the standpoint of the rates environment. For instance, we have 45 open positions. I've asked him to hold those open positions. You know, when you have 800 and some odd employees, you've got a percentage of those positions always open.

The new Dallas office and we have the new Jackson office, which both are CRA offices, that we have open that are going to be productive on the deposit side. You know, I believe that we're going to be able to offset that with some of the cost efforts or expense management efforts that we have in place that will impact us through the next three quarters. So I am looking and pushing this organization hard to see extreme expense management through the next three quarters.

William Wallace
So am I hearing that you are trying to hold the line from the first quarter, kind of keep it flat this year?

Drake Mills
We're not going to be able to keep it flat, but it's not going to be as we had projected, and we're still trying to get a handle on that. We think we can knuckle this thing under to lower the middle single-digit increase in expenses, and those expense increases are going to be around these two new offices that we have coming online.

William Wallace
Okay.

William Wallace
I'll hop out. Thank you.

Drake Mills
So it's not going to be significant, is what I'm saying.

William Wallace
Okay. Thanks, Drake, appreciate it. I'll hop off.

Operator
The next question comes from Brad Milsaps with Sandler O'Neil. Please go ahead.

Brad Milsaps
Hi, good morning, guys.

Drake Mills
Hello, Brad.

Brad Milsaps
Maybe you wanted to touch on fees. We haven't hit that topic yet. I think last quarter you mentioned you thought you could kind of grow fee income sort of in line with what you did in 2018, which were sort of low double digits. The insurance was seasonally strong this quarter. Obviously, that will maybe back up a little bit in the second quarter, but you'll probably have a better mortgage quarter, so just curious, it seems like your fees are maybe tracking better than you originally thought. Just any update around insurance and mortgage would be greatly appreciated.

Drake Mills
Yes, and I'm going to let Lance visit a little bit about this. We're doing a tremendous amount around mortgage are getting very close. We talked in the past about breakeven. We had a really good first quarter, which you would expect that to be somewhat down because of the seasonality of it, but we have done some extensive work around expenses and managing mortgage processes to where we had, I think, a net contribution loss of $96,000 for the quarter, I mean, excuse me, for the month, which, if you compare that to a year ago, it was over $600,000, so that's been a strong move for us.

Now, treasury management fees are really driving a big percentage. They're up 27%, and that has continued, as you can imagine, on the non-interest-bearing side and the clients that we're bringing in. We're not bringing in larger relationships from the loan side unless we have some significant treasury management opportunities with those clients. So the swap fees are up. Insurance, we really have some strong momentum on the insurance side, and I think the efforts we see internally and the way we're incenting fees, I believe that we can end up with stronger fee production for the year. Lance, you want to comment on anything else?

Lance Hall
No, you've covered it good. I think that's right. We are focused as a strategy on doing more back-to-back swaps with our customers than we have in the past, and I think that really benefit us in the first quarter. I think we had almost a quarter of a million dollars in swap fees. In this flat yield-curve environment, it's a strategy that we're looking at hard.

Drake Mills
Brad, I would also point out that in the swaps and what we're trying to do from a hedge standpoint. As potentially we start to position ourselves more neutral from an asset-sensitivity position, we're getting very aggressive with our customers on hedging the larger relationships to where we can and put ourselves in what we think is a better position if potentially in '20, we see rates move down.

Brad Milsaps
That's helpful, so good bottom line, though. It sounds like you've got enough positives going on to where you feel like you could do better than that low double-digit growth rate that you kind of talked about last quarter.

Drake Mills
I do, and, again, we're just we're waiting. We expect the core markets to take out the first quarter seasonality and see some continued growth in those markets, which will be much lower cost.

Brad Milsaps
That's helpful, and then I wanted just to follow up on deposits. My timing might be slightly off, but I think I noticed you guys unveiled a 4% checking product up to like $40,000. You've got to jump through a number of hurdles, I think, with debit card transactions, et cetera, to get the 4%, but just curious how much success you have with that product, and what's sort of the all-in cost if everybody, if you do in fact hit the everything you've got to do in terms of point-of-sale, debits, et cetera? What does that bring the cost of that money down to?

Lance Hall
Yes, this is Lance, so we launched that mid-March, spent a lot of time through the last quarter of last year really analyzing how much cannibalization we think we're going to have in that product and what we think the total weighted-average rate is going to be. We had a similar product previously, called TrustPlus. We fine-tuned it with a service charge, paying zero if the debit card swipes and the ACH performance isn't there. All in, our projection is it's going to be about 35 to 40 basis points of the stated rate, I'm sorry, a percent of the stated rate, so we've projected about a 160 rate on that. Our goal is to be able to raise over $100 million in that product. The real win for us, though, is the amount of households that it drives into the branches, especially, you know, in our Mississippi and Louisiana markets. It's been huge in Dallas so far. We've opened up over 250 accounts already, just in the Dallas market in the last few weeks, and as many dollars that we're getting into this performance checking account, we're getting an equal amount of dollars into other accounts, because when people come in and realize, "Well, that's not for me. I don't swipe my debit card quite to that level," we're really right now almost dollar for dollar in other accounts as well. So when you look at the weighted rate, I think it's going to be very advantageous for us at the end of the year.

Brad Milsaps
Great. Thank you very much.

Operator
The next question comes from Brady Gailey with KBW. Please go ahead.

Brady Gailey
Hi, good morning, guys.

Drake Mills
Hi, Brady, how are you doing?

Brady Gailey
Good. I didn't know about the tornado last night. I hate to hear that and hope everything ends up okay.

Lance Hall
Thank you, my friend.

Brady Gailey
Hi, I wanted to ask a little bit more about the mortgage side. I know last quarter you all were going through some riffs there and maybe looking at doing the servicing side a little differently. As we go forward, are there any major changes left on the cost side of your mortgage group?

Drake Mills
Yes Brady, we are in the process of continuing to assess servicing and how we address that, and there's some decisions to be made, but I will tell you that we are going to continue to reduce the overall operating expense of mortgage. Our resale production continues to strengthen, the number of our mortgage lenders continues. We've had two big wins this past month on some great hires, as I've been saying for the last two quarters, a little bit behind my schedule. I think you'll see breakeven in the next month or so, and, you know, from that point, I do think there are some opportunities for us to reduce our overhead, but I'd like to hold that until we make the decisions.

Brady Gailey
All right. And then I know you all entered into the leveraged transaction, I think it was third quarter of last year, where you took on the 250 of advances. Can you just give us an update on the profit? I know the yield curve has changed pretty dramatically, but can you just give us an update on the profitability of that transaction and any updated thoughts there?

Stephen Brolly
Hi, Brady, it's Steve. Right now, looking at the home loan bank, if we were to replace that today, not if it's called later on, it's about 10 basis points higher when a similar structure. If we go out and borrow overnight, which isn't something that we would do for that, it's about 100 basis points higher. And so it was 165, you could see that we've taken almost the entire amount and put it into loans. And our loans are in the 5% area, so it was very good profitability for us.

In the beginning, it took a little while to take that money and to use it, but we do have some securities that were sitting on the side and they will mature if we want to pay it down, and we have some cash flow from securities also, but we're looking at all of our options, and we had a really good finance committee board meeting yesterday, and there was a lot of give and take about what are some of the options; what should we do; strategically, what's the best for us? So it was very profitable. We just have to see where the market is and where our liquidity is as the first call date is in August.

Brady Gailey
All right. Thanks, Steve. And then, lastly, for Drake, just an update on M&A. I know when we spoke 90 days ago, you were having, I don't know, three to four conversations. Most of them were more on the funding side, and I think in the State of Mississippi. Just an update on kind of how you're feeling on M&A.

Drake Mills
Yes, have what I would consider four opportunities in the pipeline, one that we're really laser focused on. We actually have walked away from two that heated up that were not very good fits for us. And I would think, you as an analyst and our investors, this first one out of the chute needs to make a tremendous amount of sense, and it needs to be really 100% based on funding opportunities. And so the one that's heating up pretty good hits all those marks, and I am hoping that we can get something. I'm being very aggressive with this and hopefully from our standpoint, if you take $150 million, $200 million of low-cost funding and throw it in our mix

at this point, and that's significantly accretive very quickly. So I'm very active in it. This is a priority of mine at this point.

Brady Gailey
All right. Great. Thanks, guys.

Drake Mills
Thank you.

Operator
Again, if you have a question, please press star, then 1.

The next question is a follow-up from Matt Olney with Stephens. Please go ahead.

Matt Olney
Hi, guys, just a follow-up. You've been pretty active hiring commercial lending teams within your footprint over the last few years. I didn't know if there were any updates you want to share with us for this year, and, I guess, related, it sounds like you're being pretty careful on the expense side at this point. So I'm curious if this initiative is going to slow down the team lift-out strategy this year.

Drake Mills
Matt, our focus on any type of lift-out right now is going to be deposit-driven, and we have had a little success there. We have culled some lower producers, and we're going to be replacing them with what we think are high-quality producers in the DFW market at this point. So those are going to be not adds, but I think significant increases in production, but we're looking at continuing to increase our production through making sure that we're taking out those that aren't producing and replacing them with stronger producers. I think we have two to three in the DFW market that are going to be significant for us. Those are all replacements, and I think they're going to be upsized for us. But on the positive side, we're going to continue. If we have opportunities for some lift-out and some adds there that are positive focused, we're going to make those moves.

Matt Olney
Okay, thanks for that, Drake. And then just a general update on credit quality. I think last quarter there were a few loans that were more problematic and went through an impairment process, and I think you were expecting some resolution at some point this year. Just an update on those handful of loans and just some overall commentary on credit. Thanks.

Drake Mills
I really feel good about overall credit quality and the direction. We've had a slight decrease in NPLs in the first quarter. We have if you look at our substandards are down 19% since Q1 of '18. We still see that trend moving in a favorable direction, and we've looked at other areas that we've recently seen some stress in, like franchise restaurants. We have $66 million of exposure there, 1.7% of our loan portfolio. And those are all really backed well in good brands. Assisted living, which has been a problem, $96 million, 2.5% of the loan portfolio, is performing well. Multi-family is continuing to perform well. And overall offices, we feel pretty good. ADC, we're at 77 basis points and CRE is 266, so we still have some room in those areas. But overall our credit metrics look really good at this point. We just had yesterday with our risk committee and also audit, we went through a real deep dive in the portfolio. Jim Crotwell, our Chief Risk Officer, has done an excellent job of staying on top of those metrics, and at this point, there's not

anything on the horizon that bothers me, but we're staying close as we potentially see some recessionary pressures.

Matt Olney
And so it sounds like the classified loans continue to come down, especially year-over-year. Is it your expectation, Drake, that there's additional healing, additional improvement you guys could see, especially with the energy portfolio, or is this now kind of where classified loans could level off?

Drake Mills
No, Matt, we will see some additional reduction in classified loans. Even though it's decent, it's not where we historically are, and we want to continue to see some deals working on a couple of those credits that have been historical low performers. We should see some reduction in those in the second and third quarter, hopefully, because we're working diligently and just don't feel like our numbers need to represent our overall credit quality. So you'll see some decline in those.

Matt Olney
Okay, great. Thank you, guys.

Drake Mills
Thank you, Matt.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Drake Mills for any closing remarks.

CONCLUSION

Drake Mills
Well, we appreciate everyone's participation, and I would say this, historically, we receive some calls to the office. We do not have power or a phone at this point. For those that know me, I give my cell phone out generously, and if there's any questions, if you could please try to call my cell phone, (318) 243-2525. Appreciate your participation, and we'll keep everybody up to date on the damage and what's going on for the tornado, thank you very much.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.