Origin Bancorp, Inc.

Second Quarter 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Drake Mills, *Chairman, President and CEO of Origin Bancorp*

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. Second Quarter 2019 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 star, then 1 on your touchtone phone. 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, 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 information about our management's views of our 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 various risks and uncertainties, actual results may differ materially from historical results or any results implied or indicated 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 most recent Annual Report on Form 10-K, filed with the SEC, as well as any updates set forth in 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 into our webcast, please also refer to Slide #2 of the slide 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 forward-looking statements and safe harbors 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 earnings release and slide presentation, 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 will be happy to address any questions you may have.

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

Drake Mills
Thanks, Chris, and thanks for being on the call today. As we move into the second half of 2019, Origin Bancorp has much to be proud of. Second quarter growth in our loan portfolio was strong as well as overall growth in core deposits, particularly non-interest bearing deposits. We also saw net interest income reach a historical quarterly high. We remained committed to creating long-term value in our franchise by opening two full-service branches in Dallas, Texas, and Jackson, Mississippi. These new locations were a proactive step to better serve our communities and drive opportunity for new core deposit relationships. To support our asset growth, our bankers have continued to focus on building strong core relationships and growing core deposits.

Given the competitive landscape in many of our markets, maintaining our historically low cost to deposits has been challenging. Here in the second quarter, while our yield on loans held for investment remained stable, our rate on interest bearing deposits increased 13 basis points. We continue to evaluate our deposit product offerings and balance sheet funding mix alternatives to minimize our cost of funds while supporting our asset growth. Deposit growth was a main priority for us during the first half of the year, and we will work with our bankers to effectively manage costs associated with building long-term relationships within the markets we serve.

Higher deposit costs in 2019 reflect competition in our geographic markets of Texas, Louisiana, and Mississippi, and our need to fund loan growth. Despite our rate challenges within the second quarter, we believe that the remainder of 2019 provides opportunity to stabilize our funding costs, while being mindful of adding the right customer relationships as we move forward.

Now, Steve will discuss more details around the financial results of the quarter.

Stephen Brolly
Thanks, Drake. I'll start with Slide #4. The end of the quarter was just over $5.1 billion in total assets, up 5.1 percent from the linked quarter. This growth was primarily attributed to loans held for investment, which Lance will touch on later. Total deposits ended the quarter at $3.9 billion, down 1.1 percent from the linked quarter. During the quarter, we made a strategic decision to replace approximately $187 million of brokered deposits with short-term advances from the Federal Home Loan Bank. We expect this change in funding costs to increase net interest income by approximately $450,000 annually.

Net income for the quarter was $12.3 million, and diluted EPS was 52 cents per share. These results were lower than the prior quarter and the same prior-year quarter. The primary drivers were increased provision expense associated with our loan growth during the second quarter and increased non-interest expense during the quarter. The increased non-interest expense was a primary contributor to our increased efficiency ratio during the quarter, which was 68.51 percent compared to 65.97 percent in the linked quarter.

Net interest income for the quarter was $43 million, up over $900,000 from the linked quarter, primarily due to loan growth. As Drake mentioned earlier, our deposit costs increased during the quarter, contributing to a 10-basis point decline in net interest margin for the linked quarter.

During the second quarter, we also increased our short-term liquid asset position to support current loan growth and our near-term loan pipeline, which had a downward effect of 3 basis

points on our margin during the quarter. Net interest income continues to be our primary source of net revenue, accounting for 79 percent of net revenue during the quarter.

Lance will now go into further detail about our loan growth, deposit trends, and credit quality.

Lance Hall
Thanks, Steve. In the first six months of 2019, loans held for investment have grown $196 million, or just over 5 percent, with $146 million in growth during the second quarter alone. Of the year-to-date growth, over $95 million is attributed to construction and development and $69.1 million to commercial and industrial loans. We expect to see continued strong growth in our Texas markets, with ongoing benefit from our lift-out payments.

As we continue to experience strong loan growth, we are maintaining sound credit quality in our loan portfolio. During the quarter, our percentage of non-performing loans to total loans improved 2 basis points from the prior quarter. Our annualized net charge-off rate was 7 basis points, and our past-due percentage decreased from 99 basis points to 80 basis points from the linked quarter.

Not only have we been successful in growing loans and maintaining a strong credit profile, we've also seen success on the deposit side. Steve mentioned earlier about our strategic decision to replace certain brokered deposits with short-term advances to lower our cost of funding. While our total deposits decreased $43 million during the quarter, when adjusted for the brokered deposits we replaced, our total deposits would have increased approximately $143.8 million, or 3.7 percent, for the quarter. We've been successful in increasing non-interest bearing deposits this year by $52 million, or 5.5 percent, which is a testament to the relationships our bankers continue to build.

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

Drake Mills
Thanks, Lance. As we have discussed over the past year, we believe it's in the best interest of all our stakeholders to have a mortgage business that is fully integrated into our bank in a community-based retail mortgage banking model. We have taken a number of steps to achieve this goal, including our decision in the second quarter to outsource our mortgage servicing function to one of the nation's largest independent mortgage services. The transfer of our servicing should be complete in the fourth quarter of 2019, and we believe that it will result in additional ongoing efficiencies for Origin Bank as well as a positive experience for our mortgage customers.

We have always been committed to the long-term vision of Origin Bancorp. As we continue to strive to increase our capital levels over time, we are committed to deploying capital through quality asset growth. We also believe in having other strategic tools to manage our capital levels for the benefit of our shareholders. Over the past several quarters, through periods of record earnings, our management team and Board have discussed those strategic tools, and through those discussions, we have decided to increase our quarterly cash dividend as well as put in place a share buyback program. These actions will not change the fact that we are focused on growing organically and will continue working to do so by deploying internally generated capital. However, we believe these tools show our commitment to our shareholders.

While we acknowledge the challenges we face in the second quarter in relation to deposit pricing, margin pressures, and the ever-evolving competitive landscape within our markets, we

are committed to continue to develop high quality, multi-faceted relationships. I remain optimistic about our ability to execute our strategic plan and look forward to what we will accomplish in the future.

Thank you, and we'll now open the call for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. 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
Hey, thanks, good morning, guys.

Drake Mills
Hello, Matt.

Matt Olney
I want to start on operating expenses. –They seem pretty heavy this quarter versus at least expectations. Can you just walk us through some of these lines and help us appreciate where these lines are headed as we move into 3Q? I'm just trying to get a good run rate to know how to forecast operating expenses. Thanks.

Drake Mills
Yeah, Matt, this is Drake. Yeah, as we look at — as I mentioned earlier about continuing to build what we think is a franchise that will promote strong core deposit growth, we had — and I'll go through this — I think the biggest addition to or the biggest expense item was really a swing in income. If you look at our LP investment income, that typically would have been $400,000. We had an impairment on LP income, so, really, that swing represented about 3 cents of an increase in, let's say, an expense item or lack of income.

We also, as we've talked about in earlier quarters, we created a performance-checking product that we promoted heavily, which represents, I would say, a penny of additional cost that we will cut after basically going into this quarter, but what that created for us was about $60 million of additional deposits that we think the weighted average rate on that is somewhere around the 180 to 190 range. So we believe that investment or that expense item has been very good for us in the creation of not only $60 million in deposits but the acquisition of customer relationships that we've been able to cross-sell and create other fee income opportunities.

We also had about a 1 cent increase in data processing, and it has to do with a conversion of communication lines. –One of the vendors involved in that conversion overcharged us, and it was something that we caught down the road. That overcharge, which will be refunded, represents about a penny.

So if you look at those increases, that represents 5 cents basically, of the increase that we saw in the quarter. We think that the quarter for us is a high quarter from the expense standpoint, probably the highest quarter we'll see. Certainly working to, because of the mortgage process we're going through, and the RIF we're going through, we think we can continue to see, somewhere, let's say, similar to what we were maybe the first quarter, with a little increase from the first quarter.

Matt Olney
And, Drake, that's great color. And I want to drill down on the mortgage piece some more. The mortgage revenue was around $3.2 million in 2Q. How much of that was production versus servicing? And then once we move to the MSR outsourcing in the fourth quarter, can you walk through what the impact, or where we're going to see that in the financials?

Drake Mills
Okay. Matt, if I could, just for a second, let me do a year-over-year comparison, because as I've talked a lot in each quarter, we've worked hard to get mortgage integrated into the community bank model. For instance, in Q2 '18, $2.3 million of revenue; Q2 '19, $3.3 [million], basically. And that was originations. And of that originations, 70 percent was new originations; 30 percent was refinanced. So even though we are getting a bump in refinance, it's not driving the increase in production. We've done an excellent job of cutting mortgage loan officers that weren't producing and adding back, so we actually are working with fewer mortgage loan officers than we did but getting better production.

Non-interest expense for the mortgage side, Q2 '18, $4.2 million; this quarter it was $3.5 million, a 14 percent decrease. So contribution income, and this is what we've been working on to get this thing to break even and we see some profitability coming, we had mortgage contribution income of a loss of $1.7 million last; this quarter we're basically going to break even, so we've made a lot of progress there.

MSR value, through that, we've seen significant change in our hedging. A year ago, we lost $300,000. This quarter we had a positive $207,000 in impact. So we continue to see improvement, but we've reduced the amount of our servicing from our MSR asset value from $26 million to $21 million during that process. So to take that into the next couple of quarters, we think once we get the conversion, which will be in October, November, to our mortgage servicer, we will see about a million-dollar reduction in expense, an annual reduction in expense, because of that program. That does not include the reduction in the people, the RIF, that we'll have in October once we let those people go. And then we'll have a slight spike, because we will pay severance, but we see a $1.5 million total reduction in expense just to move it from the services side.

Matt Olney
Okay. Got it. That's helpful, Drake. And then my last question is going to be on capital. I noted the dividend increase, the share buyback authorization. You've talked about M&A now for a while. I'm just curious as far as the update, does this signal anything as far as M&A? Just any more color on the buyback authorization?

Drake Mills
It doesn't signal anything on M&A. We still are active and certainly have some opportunities that are in tow that we're working on that I think can be good for us. I do think that — and, Matt, I'll go back to our third quarter '18 conference call, when I think you asked the question, and I said that the Board and management was working on the buyback program just to have the tool

available. At that point, we felt it was too quick off the IPO to really have that program in place, but certainly it was something that we thought we had. Well, as the rate environment's changed and a number of different things, we want to have the opportunity to take advantage, and, as we see potential, private equity continue to exit, we just want to be in place to take advantage of it if, indeed, it's there.

But from a capital impact standpoint, we are running models for both the $40 million buyback, and, of course, that's a three-year program, so we want to have that in place. And the dividend, we feel at this point that that's something — we've had retail shareholders that's been with us for a number of years. That dividend of 3¼ cents has been in place now for probably the last 20 years. When we ran our capital model, we saw that we could increase that to 9½ cents and not have any impact, to any degree on, really, the leverage, the ratio we are concerned most about, and that's our total risk-based capital ratio, because we can increase that dividend and, with earnings, continue to see an increase in total risk-based capital.

So we don't think at this point this is signaling that we're not in the M&A business or anything else. — That's job One for me, and it's a priority, and I think that's probably one of the best steps we can take to solve some of the increase in funding costs and also get us positioned to continue that process of M&A.

Matt Olney
Okay. Thanks for the color, and I'll hop back in the queue.

Drake Mills
Okay. Thank you, Matt.

Operator
The next question comes from Woody Lay with KBW. Please go ahead.

Woody Lay
Good morning, guys.

Drake Mills
Hello, Woody.

Woody Lay
So looking at loan growth, it was strong this quarter at 14 percent linked quarter annualized, and this came after a quarter you all lowered guidance down to 10 percent. Going forward, does that 10 percent guidance still feel right to you all?

Drake Mills
Yeah, the 10 percent guidance at this point, the pipeline supports that, Woody. What we are concentrating on, and we'll talk a little bit about this, I'm sure, during the call, is asset yield. We were fortunate, if you look at asset yield for the quarter, that asset yield, not including mortgages held for sale, increased 1 basis point, so we are very, very focused on asset yields and the pricing. So we believe that if we continue to focus on quality, asset yield, and increasing asset yield, at least holding that stable, that we could see a slight decrease in growth in loans, let's say, to 8 percent. So we're modeling both ways.

Our pipelines are full, and it currently supports that 10 percent, but we're going to be aggressive with the pricing, and in our last forecast meeting, we felt that that could bump that down to 8

percent, but with deposit growth still remaining strong and core deposit growth really, getting a good ratchet up right now, we think that that could be 8 to 10 percent, but we're going to be aggressive with this pricing.

Woody Lay
That makes sense. And then looking on the other side of that, it's clear that one of you all's biggest focuses is on maintaining the deposit costs. Do you believe that going forward, we could reach an inflection point where deposit costs could actually compress from here, or do you think it will sort of still see some deposit pricing competition, which we'll see some small increases to it?

Lance Hall
Yeah, hey, Woody, this is Lance. ~~-~~Thanks. ~~-~~That's obviously been the primary focus for us inside the bank. We've spent a lot of time in the past couple weeks with our presidents on creating a plan, because you're right, driving our investment in our core deposit franchise is our number one factor. ~~–~~And you look at that both from a margin perspective and from an expense ~~perspective,~~perspective and we have hired three ~~to five~~ deposit gatherer professionals in Dallas-Fort Worth. ~~–~~We hired a new treasury management professional in Mississippi. Obviously, the branches, it's all about driving this core deposit franchise.

That being said, we've really sort of dissected [~~unintelligible]~~ and tiered our interest-bearing portfolio, met with all the presidents, have met with bankers, we feel we have a real opportunity to smartly drive down some deposit costs in those areas while, at the same time, be able to drive double digit ~~–some of the~~ deposit growth. So, yes, we feel like~~ — ~~obviously, our incremental costs are still high. ~~-~~I feel like our deposit pricing has peaked, and we feel like we have a really smart plan on being able to manage that effectively.

Woody Lay
Okay. And then, last for me, it sounds like loans and deposits should grow pretty evenly, but looking at ~~once~~ the loans to deposit ratio, excluding the warehouse, was up to around 98 percent for the quarter, is there sort of a ceiling level you all feel comfortable growing that up to?

Drake Mills
Yeah, ~~we~~ this is Drake [~~unintelligible],~~ we're at that level and really feel that that's going to continue. That's actually going to head back to the other direction, because there's a couple factors involved in that, and we'll let Lance talk about deposit growth and markets, and we are still waiting to see when Louisiana deposits kick in.~~-~~ I want Lance to visit on that, but we have what we run a daily liquidity model. We feel very comfortable with the liquidity where it is and continue to feel that with the efforts that Lance mentioned about deposit gatherers in the process and the progress we're making there, that we'll see that loan deposit ratio start heading back in the other direction. Lance, do you want to talk real quickly about what we're doing in Louisiana and what we feel the impact will be?

Lance Hall
Yeah. So Steve will talk about the strategic decision to replace the Raymond James money market with Federal Home Loan Bank borrowings, but if you normalize the Raymond James deposit reduction, Woody, basically we're on track to do about 16 percent deposit growth for the year and 10 percent ~~[inaudible~~]in loan growth so you see where are focus is driving the deposits at a faster rate than loans, so that we build a little cushion in that loan-to-deposit ratio.

As Drake said, all of the ~~growth in our deposits in the first six months have~~growth in our deposits in the first six months has really been in Texas and Mississippi, not a normal run for us. Louisiana is always our most stable deposit driver. ~~-~~I have no concerns ~~that~~ that's not going to kick in and continue to be the same. We still project 5%~~profits in~~ deposit growth in Louisiana like we traditionally do, and obviously we do it in Louisiana in a cheaper way, so one of the effects on ~~them~~ NIM for this quarter is that in Mississippi, you've had 14 percent deposit growth year to date; Dallas-Fort Worth, 16; Houston, 16. Those are coming in at a higher cost blended than our projected because of the lack of Louisiana. We had about $65 million in public fund run-off in our Louisiana, but obviously we'll swing back in. It's a little higher number than we're used to, and then we've had about $50 million in reductions in some of our commercial portfolios, and talking to the bankers, absolutely not customer loss, just in timing around some of those commercial accounts. ~~-~~So I still project Louisiana to do 5 or 6 percent deposit growth as we budgeted. And then, obviously, that will significantly draw down the blended expense for the group, and we figure at the end of the year, that's going to be normalized and healthy for us.

Woody Lay
Thanks. That's all for me, guys.

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

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

William Wallace
Thank you. Good morning, guys.

Drake Mills
Good morning, Wally

William Wallace
Drake, if I could back up to some of the commentary you had around ~~expense,~~expense; first, you mentioned the LPL impairment. That's booked in fee income, right?

Drake Mills
Correct.

William Wallace
So how much was that impairment?

Drake Mills
It was basically a penny.

William Wallace
Okay.

Drake Mills
Excuse me, excuse me...

William Wallace
~~[Inaudible] about —~~

Drake Mills
…about 3 cents, I'm sorry, Wally.

Stephen Brolly
Hey, Wally, this is Steve. The swing quarter to quarter was $819,000 pre-tax.

William Wallace
Okay. Okay, thank you. All right. And then, Drake, you said that your targeting expense run rate you think will be closer to the first quarter or slightly higher than the first quarter, I believe is what you said. ~~–~~Does that include the $1½ million of annual savings once the servicing agreement is transferred to the third-party, or is that [~~inaudible]?~~

Drake Mills
No, Wally, that's not going to kick in until the first quarter, really, of 2020, ~~because that isn't — and~~ I want to back up on that, because I'm sitting here running a little bit. I do think it's going to be higher than the first quarter. There is not a doubt that the second quarter is going to be a — and even in our internal budgets, it was — the second quarter was the highest quarter because of the branches that we made decisions. I want to highlight the fact that we made those decisions on those branches, which I still think from a long-term perspective, is the right decision. During the period of time where two quarters ago, three quarters ago, we were looking at increasing interest rates, but for our expansion and what we're doing there, I believe that the second quarter is certainly a high quarter, with probably a reduction around —

Stephen Brolly
Hey, Wally, this is Steve.

William Wallace
Yeah?

Stephen Brolly
I know there's a lot of numbers going back and forth, so if you look at total, we had $35 million in the first quarter, and we had $37 million in the second quarter. Thirty-seven million is going to be a high point for us, but if you look at both them, I would say it's ~~s~~lower than the second but not as low as the first. If I was going to model conservatively, I would say $37 [million] straight across the next two quarters and just slightly lower for some of those items that we talked about.

We don't plan any expansions, we don't plan any other large one-time items, we don't have any large items in the budget whatsoever. If anything happens that comes out of that, that would be something that we don't have expectations for today.

William Wallace
Okay, but $37 million is basically where you were in the second quarter.

Stephen Brolly
Yes, so it's going to be slightly less than that, but not as low as $35 [million].

William Wallace
Okay. Okay.

Drake Mills
And I guess what, Wally, I'm looking at it is loan growth where we are from a provision standpoint and, you know, from a credit quality perspective, what potentially could be there. So I'm going to back up from what I said a little bit — that's what I was looking at right at this point — and say that we're probably going to have a run rate that's slightly less than that, and I would say 1 to 2 cents lower.

William Wallace
Okay. And with the servicing agreement, with that going into a third-party, what kind of revenue comes out once that's completed?

Stephen Brolly
No revenue comes out whatsoever. As a matter of fact, we may have a little bit more revenue, because we hope that the third-party does a better job on delinquencies and foreclosures and recoveries, but we will give them a little bit of revenue, but we think net net is going to be about the same. The real savings is going to be on the cost to service the loans. It's also going to be great for the customer, because they're going to have a better platform, they're going to have better communications, so if you're looking at purely on a cost basis, the cost to service loans is going to be much lower.

William Wallace
Okay. That's great. Okay, and then, if I could, maybe just ask a direct question on ~~that~~ net interest margin. You've made some changes on the deposit side by replacing some brokered deposits, et cetera. If the Fed cuts next week, with the changes that you've made, what is the impact to net interest margin if it goes 25 basis points in your opinion?~~—~~

Drake Mills
Well, Wally —

William Wallace
~~— opinion?~~

Drake Mills
Yeah, at this point, we see 4-to-6 basis points reduction in asset ~~. And past that~~ yield, we have — we know exactly the amount we have to reduce non-interest bearing deposits to offset that. Those plans are in place and ready to pull the trigger, and we feel that we have a very good opportunity to neutralize that 4-to-6 basis point reduction in asset yield.

William Wallace
Four to 6 basis point in asset yield? Are you saying the decline in asset yields would drive NIM down 4 to 6 basis points, and you've got a direct plan to offset that pressure on the funding side, or are you saying the yields go down 4 to 6, but the net interest margin would go down accordingly?

Drake Mills
Yes, and we know, like I said, I know exactly what the cost reduction is we have to have, and that's what we've been working on in the last few days with our presidents to put that in place in the markets. And it's actually very achievable without fear of running off the deposit costs, primarily coming from the money market side as some of the variable costs we have in our interest bearing deposits. So those plans are in place, ready for the trigger to be pulled if they do make the quarter reduction, we think we can offset that 4 to 6 basis points.

William Wallace
Okay. So you think that you can flip a switch on the deposit side?

Drake Mills
Yes.

Stephen Brolly
We have a plan in place ready, everything from the back office operations. As Lance has mentioned before, all the presidents went through the various deposit programs, and on August 31st, if the rates drop, then on July 31st when the rates drop, August 1st, we will put that plan in place, and we're all ready to go.

William Wallace
Okay.

Drake Mills
Now, Wally I want to make sure that we're saying the same thing. You said what would the impact of a quarter decrease — have an effect on us, right?

William Wallace
On NIM.

Drake Mills
On NIM, right, because I'm not representing to you that at this point, NIM's going to be flat. I'm just going to say we think we can offset the impact of the reduction in asset yield on the quarter-point decrease.

William Wallace
Okay.

Drake Mills
I want to make sure we're talking the same.

William Wallace
So, yeah, I'm confused now. So I'm sorry, but you can offset it, but you're not saying NIM will be flat. If you can offset it, I mean, NIM would be flat, right?

Drake Mills
If I offset the quarter decrease, the impact of a —

William Wallace
Yeah.

Drake Mills
— quarter decrease, if I can neutralize the impact of that quarter decrease, we still feel that we'll have some NIM pressure if we do —

William Wallace
Oh, oh, okay.

Drake Mills
We do feel that we have a topping out of our deposit costs, but the plans that we have in place is to really offset the decrease in a quarter point of interest rate decrease.

William Wallace
Okay. I see what you're saying. So what is the continued pressure that you anticipate in the third quarter, just from what you saw in the second quarter?

Stephen Brolly ~~Drake Mills~~
Wally, the range would probably be somewhere ~~— the rate of~~ 3 to 6 basis points, and that's depending on a lot of factors.

William Wallace
Okay. ~~[Inaudible] —~~

Drake Mills
~~[Inaudible] —~~

William Wallace
Yes, I understand.

Drake Mills
~~[Inaudible]~~

William Wallace
Yeah.

Drake Mills
Yeah, we're super, super aggressive, Wally, trying to minimize this, but what we've focused on this past week is a plan to neutralize the decrease in interest rates.

William Wallace
Okay. And I —

Drake Mills
And I will say that, Wally, when I think about where we are with everything, obviously, we're focused on running this business the best way, and I look at it near-term headwinds for a company built to long-term value, but the reality of it is we know that the deposit cost battle is going to be an influence on us being able to be successful for the balance of the year, so, like I said, every aspect of this organization is focused on that.

William Wallace
Okay, understood. Appreciate that. And I'm really sorry to monopolize time, but I've actually gotten several emails while we were talking to go back to expenses. It seems like there's just some confusion around whether or not the run rate is going to be flattish to where it was in the second quarter or going down to where it was in the first quarter. So I'm sorry to back up here, but could you just —

Drake Mills
Okay, let's — I mean, let me make this point, then —

William Wallace
Okay.

Drake Mills
— because I have a tendency to get aggressive with where I think the expense rate is going to be. The CFO is sitting here saying, "You ~~all [unintelligible] go out and~~ should take a $37 million run rate." We're certainly going to work to do better than that, so to break the confusion, I think it's going to be slightly less than what we saw in the second quarter.

William Wallace
Okay. And —

Drake Mills
And I don't mean to —

William Wallace
— your —

Drake Mills
— confuse anyone, because, again, where everyone's focused on deposit costs, I'm focused on expenses.

William Wallace
Right. So I guess where the confusion is coming from is you highlighted the vendor overcharging you and some other one-time-ish type costs in the second quarter that presumably were going away. Are those being partially replaced with continued investment in the franchise? Is that what we're seeing?

Drake Mills
No, we have some severance costs on our RIF~~s~~ that we're going to be dealing with this one time, so what I think they're concerned about around the table is that as we continue to do things to reduce the expense of the organization, we're going to have some one-time costs the next quarter or two.

William Wallace
Okay. So let's talk about it from that perspective, because I think most investors and analysts will look at severance costs as one time, and we're trying to figure out what's a core go-forward expense run rate basis that we should be thinking about in our models to think of as a baseline, absent of the noise that's coming from things like severance and whatever, lease terminations or whatever you might have. So could we approach it from a basis of what might this expense base look like once we get past all the noise associated with things around the servicing contracts going to a third-party, RIFs, et cetera?

Stephen Brolly ~~Drake Mills~~
I'm going to give you a range of very close to $36 million even, give or take things here. So it's not as high as the $37 [million]; it's not as low as the $35.3 [million], but I would be surprised if it's not very, very low $36 [million].

William Wallace
Okay. And this is after you've got the saves and everything around the servicing [~~inaudible~~]?

Stephen Brolly ~~Drake Mills~~
No, that is with the —

William Wallace
That's before —

Stephen Brolly ~~Drake Mills~~
That's two quarters.

William Wallace
And then you've got another --

Stephen Brolly ~~Drake Mills~~
That's another two quarters.

William Wallace
-- 400 or so coming in the first quarter of '20?

Stephen Brolly ~~Drake Mills~~
That would come in the first quarter of '20 —

William Wallace
More so in the fourth quarter ~~[inaudible~~] —

Stephen Brolly ~~Drake Mills~~
However, the first quarter of '20, if you just look at it and say a normal non-interest expense run rate would be 3 to 5 percent --

William Wallace
Yeah. Yeah. Gotcha – will have inflationary pressures.

Stephen Brolly ~~Drake Mills~~
Yeah. Yeah.

William Wallace
~~[Inaudible]~~Risks, et cetera. Okay. Thank you. That helps me. I think I have more clarity on that, and hopefully the investors do too, and I thank you for so much time. I 'll step out and let somebody else have —

Drake Mills
Wally, I apologize for the confusion. Like I said, I'm focused on doing what we say we are, and when you look at the second quarter, a lot of things just fell in between interest rate pressures and our opening of our offices and severance and a number of different things.

William Wallace
Yeah.

Drake Mills
So we'll get on track.

William Wallace

Yeah, thank you. Thanks for all the time and the clarity. I appreciate it. I'll hop out.

Drake Mills
Thank you, Wally.

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

Matt Olney
Yeah, circling on back to the question around the margin and the impact from the Fed, can you just disclose to us what's in your loan book, what percent of those loans are variable, and then, within that, what percent is going to be LIBOR versus another index like Prime?

Drake Mills
Yeah, 58 percent of our loans are variables, and about 52 percent, 53 percent of those are LIBOR-based. And, Matt, we've been feeling that pressure now for quite some time.

Matt Olney
Right.

~~Stephen Brolly~~ Lance Hall
So, Matt, in dollars, I think it's about $995 million that are Prime-based and about $1.2 billion that are LIBOR-based.

Matt Olney
Okay, that's helpful. And then on the other side, the liability side, can you give us an idea of what portion of your liabilities are going to be indexed to something that will also be a very high beta that could help offset some of the headwinds on the loan side?

Stephen Brolly
Sure. The brokered deposits that we have. They are tied to an index, and our public funds are tied to index. The public funds are about $300 million, and the brokered deposits are also somewhere around $l30 [million].

Drake Mills
I think the last — Matt, the last time I looked at that, it was about $500 million total.

Matt Olney
Okay. So $500 million on the liability side. On the earning asset side, we're closer to $2 billion on that, when I add in the Prime and the LIBOR loans. And what about on the CD side? I'm showing the average cost was $213 in the second quarter. Can you talk around what your newer rates are that you're posting right now and how much more pressure are we going to see in that $213 average time deposit cost?

Drake Mills
Yeah, Matt, and before I turn it over to Lance, because Lance is doing a lot of work in this area, I will say if there is any benefit to us as an asset-sensitive institution of rates going down, is to reset the customer mindset that rates are doing down. So, again, that's why we looked at exactly what it was going to take in the reduction of costs on the interest bearing side to offset that quarter, so Lance ~~[unintelligible]~~.

Lance Hall
Yeah, Matt, and as I mentioned, I do think that the rates that we drove in the second quarter would peak out and start to reduce, and, obviously, we are really really ~~have a year-to-date~~ focused on our money market accounts and how we're going to reduce that. At the same time, though, we've got to plan on CDs to starti~~ng~~, incrementaly ~~to be~~ pulling those ~~and~~ pricing back on new offerings, but, at the same time, making sure that we're growing core deposits.

Matt Olney
Okay, so saying it another way, it sounds like you expect the average deposit cost to move down in the third quarter, even if you do grow the dollar amount of deposits. Am I interpreting that correctly?

Operator
Pardon me. This is the conference operator. The presenter's line appears to have disconnected. I'm going to put you back on hold until we get them reconnected. One moment, please.

[Music playing during pause.]

Operator
Pardon me. This is the conference operator. The speaker's line has reconnected. Mr. Olney, let me reopen your line again too, please. And go ahead. Please continue.

Matt Olney
Guys, this is Matt. Can you hear me?

Drake Mills
Hi, Matt. Yes.

Matt Olney
Did you want me to repeat the question, or did you get all that?

Lance Hall
Yeah, I got it. I think I was saying that I'm sorry; I'm not sure what happened there. Yeah, we definitely feel like the deposit rates will peak in the second quarter, and we'll begin to start pulling those back down based on the money market perspective and then from new time deposits. So we do feel confident in our ability to do that.

Drake Mills
And, Matt, to get a little more specific, I know you've asked for what does the rate forward look like. We're going to have to manage this from the standpoint of customer expectations and what length of time they — this is going to change what they look for from a maturity standpoint, and we'll be reducing those rates, I think, accordingly, based on what the Fed does.

Matt Olney
Okay. Got it. That's all for me. Thank you, guys.

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
Okay, we appreciate everyone's attendance on this call. I do want to reinforce the fact that there are many positive things going on with this organization right now, and we do feel comfortable that our growth projections will continue. The acquisition of these teams that we have in place has certainly allowed us to focus on deposit growth and deposit acquisitions, but we will continue to build this organization with customer acquisitions that do create profitability across all lines of the bank. What I mean by that, is we're not out doing loan transactions just for the sake of a loan. It's full relationships that we're working on, and we're having a lot of success around that ~~there~~, but, as I mentioned, this is near-term headwinds for a company that's built on long-term value.

I certainly appreciate your time and the confidence that you have in the company, and I look forward to seeing each of you as we continue to be on the road. So thank you very much for your opportunity.

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