Origin Bancorp, Inc.

Q2 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Chris Reigelman – *Vice President, Chief of Staff, Investor Relations*

Drake Mills – *Chairman, President and CEO*

Steve Brolly – *Chief Financial Officer*

Lance Hall – *President of Origin Bank*

PRESENTATION

Operator
Good morning, and welcome to the Origin Bancorp's Second Quarter 2018 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 one your telephone keypad. To withdraw your question, please press star then two. Please note this event is being recorded.

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

Chris Reigelman
Good morning, and thank you for being with us.

Before we begin, I'd like to remind you that this presentation may include information about our management's view of our future expectations, plans, and prospects that constitute forward-looking statements. Actual results may differ material from historical results, and those indicated by these forward-looking statements due to risks and uncertainties. For a discussion of these risks and uncertainties, please refer to the forward-looking statement section of our earnings release and the risk factors included in our prospectus filed with the SEC on May 9, 2018, pursuant to Section 424B of the Securities Act and our most recent quarterly reports on Form 10-Q, as well as other documents we periodically file with the SEC. The company undertakes no obligation to publicly revise any forward-looking statement.

If you log into our webcast, please also refer to our slide presentation which includes our safe harbor statement beginning on slide 2. For those joining by phone, please note the safe harbor statement and the presentation are available on our website at www.origin.bank. All comments made during today's call are subject to that safe harbor statement.

Finally, in this presentation we will discuss certain non-GAAP financial metrics. Please note that the reconciliations of these non-GAAP financial metrics to their closest comparable GAAP metrics are contained in our current report filed yesterday with the SEC on Form 8-K. Any references to non-GAAP financial measures are intended to provide meaningful insights. These non-GAAP disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.

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

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

Drake Mills
Thank you, Chris, and good morning. We appreciate you joining us for today's call. This is a special day for us at it marks our first earnings call as a public company. We're extremely grateful to our team and our partners who have worked so hard to help Origin get to this point. We have a proud history and we look forward to continuing our commitment to excellence and are excited about what the future holds for Origin and our partners.

As we begin, I will briefly discuss highlights for the quarter and go through the first part of the slide presentation, and then Steve Brolly will cover financial results. Lance Hall will talk about loans and deposits, as well as credit quality and I will end with closing remarks and open it up for questions.

Origin Bancorp had a strong second quarter with reported net income of $12.7 million or $0.53 diluted earnings per share. Our net interest income was at its highest level ever for our company, increasing by $2.4 million or 7% over the linked quarter. We saw continued improvement in our net interest margin to 3.74% on a tax equivalent basis, 6 basis points higher than the first quarter of 2018. I'm proud of our team throughout our markets who remain focused on relationship development while driving yield in the portfolio.

The yields earned on total loans held for investment during the second quarter was 4.89%, up 16 basis points from the linked quarter. Total loans held for investment increased $126.1 million or 3.9% over the first quarter of 2018. We were successful with the continued lift-out of a seasoned and well-respected team in the Houston market with the addition of eight lenders and we are optimistic about additional opportunities as we move into the second half of 2018.

Deposits grew by $91.4 million or 2.6% over the linked quarter with noninterest-bearing deposits continuing a positive growth trend increasing to 25.9% of total deposits in the second quarter. Our team has been laser focused on strengthening the relationship with our customers and evidenced by the increase in our noninterest-bearing deposits. We are mindful of the competitive rate environment associated with deposits, and we have seen a slight increase in our deposit betas. However, we continue to be pleased with our positive net betas when factoring in loan betas, as yields increase in most loan categories and outpace the increase in rates paid on interest bearing liabilities.

Now, I'm going to turn it over to Steve to provide additional details around financial results for the quarter.

Steve Brolly
Thanks, Drake. I will begin on slide 5, Selected Financial Data for the Quarter. As you heard Drake discuss highlights pertaining to net interest income, net income and diluted earnings per share, I would also like to point out that our loan loss provision for the second quarter was $311,000, which was in line with our expectations and indicative of ongoing health and growth of our loan portfolio. Looking at key ratios, our return on average assets for the current quarter was 1.17% compared to 1.30% for the linked quarter, and return on average equity for the current quarter was 9.94% compared to 11.82% for the linked quarter.

Turning to slide 6, our net interest margin continues to improve as interest rates increase. We ended the quarter with the tax equivalent net interest margin of 3.74%, up from 3.68% for the linked quarter. Our yield on total loans held for investments were 4.89% during the quarter compared to 4.73% for the linked quarter. Our loan portfolio remains mostly variable with a limited number of loans remaining at or below 4.

As you can see on slide 7, these factors should position us to benefit from the anticipated additional increases in interest rates. Noninterest income for the second quarter was $10.6 million, an increase of 8.3% from the linked quarter. The amount of noninterest income continues to be north of 20% of our total net revenue as you can see on the bottom of slide 8. Noninterest expense for the quarter was $32 million, an increase of 7.2% compared to the previous quarter. This change is primarily driven by increases in salary and benefits, which was impacted by the addition of our lift-out teams in Houston and Shreveport, Louisiana.

Our efficiency ratio is 66.99% for the second quarter, showed a slight improvement from the linked quarter of 67.06%. We're pleased with this improvement, particularly given expenses associated with the new teams we hired in the second quarter.

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

Lance Hall
Thanks, Steve. As I start on slide 10, I'm very proud of the fact that we continue to drive noninterest-bearing deposits. As Drake discussed earlier, this has been and continues to be a strategic focus for our bankers in the markets. We pride ourselves on being able to build long-lasting relationships, and these numbers are indicative of that behavior.

Average deposits for the quarter increased by $103.1 million or 2.9% over the linked quarter. The most significant portion of this increase was an average noninterest-bearing deposits which grew $78 million, or 9% over the linked quarter. This is one of the key drivers in increasing our mix of noninterest-bearing deposits to total deposits. Our cost of total deposits increased to 75 basis points during the quarter up from 68 basis points during the linked quarter.

As we look at our loan activity in the second quarter of the year, average loans held for investment increased from the linked quarter by $97.5 million or 3.1% to $3.28 billion. This is attributed to an increase in all significant categories of loans.

We continue to believe there will be increased opportunities with loan growth through our new relationships across our legacy as well as our lift-out teams.

When looking at credit quality, we continue to see improvement with five consecutive quarters of a decrease in net charge-offs. And the second quarter net annualized charge-off rate to average loans held for investment of one basis point.

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

Drake Mills
Thanks, Lance. We believe Origin Bancorp is operating from a position of strength and set up for continued success in 2018. As you can see on slide 13, our capital levels are healthy and position us well for ongoing growth opportunities. Looking forward, we remain focused on our strategic plan and fixated on driving a winning culture and providing value to our stakeholders.

We celebrate a major milestone for our company this quarter. I'm extremely proud of our team and the successful execution of our initial public offering. We issued over 3 million shares with net proceeds before expenses totaling $96.3 million, a portion of which was used to redeem all of the outstanding shares of SBLF. This simplifies our capital structure and lowered our overall cost of equity.

Also during the quarter all of the 901,644 shares of outstanding Series D preferred stock were converted into common stock, on a one-for-one basis. As a result, no shares of Series D preferred stock remain outstanding.

We firmly believe we have opportunity in all of our markets to drive growth through relationship development and increase value based on the long-term proven track record of our company.

QUESTIONS AND ANSWERS

Operator
Thank you, sir. We will now begin the question-and-answer session. To ask a question, you may press

star then one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster.

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

Matt Olney
Hey, great, thanks. Good morning, guys.

Drake Mills
Good morning, Matt.

Matt Olney
I want to start on the deposit side. It's great to see the growth of the noninterest-bearing deposits. Any more details behind this? What was the driver? What markets? I guess the big question is how much more opportunity do you have to grow the noninterest-bearing deposits?

Drake Mills
Matt, Lance is—I'll let Lance answer the question. Lance?

Lance Hall
Good morning, Matt, thanks. Obviously we're incredibly proud of that. As we had talked when we went out on the roadshow, that continues to be a huge emphasis for us as the way we have built our incentive plans. Driving NIB for us is equal to loan growth in our incentive plans for our bankers. So, that combined with some of the teams we've been able to hire, the emphasis in Houston, the bankers in Dallas that have really been focused on calling on specific industries that we felt could drive NIB growth for us, as well as really getting refocused back on our C&I business. Obviously NIBs are a function of operating companies, and so the calling efforts in those operating companies.

We've grown about 14% year-to-date in NIBs. That continues to be something that we're going to continue to drive through the rest of the year.

Drake Mills
Matt, I'd also like to add very quickly that we have a tremendous treasury management team and resources that we continue to focus on and they have been instrumental in developing relationships on the NIB side.

Matt Olney
Okay, very good. On the credit side, from what I could tell, this was more of a mixed bag in 2Q. It looks like classified loans were down but NPAs ticked up a little bit. Any more color as far as the credit migration that you can see and what are your expectations for credit in the back half of the year?

Drake Mills
Yes, we'll continue to see improvement there. We have the pickup in NPAs were just an aggressive stance on some credits that we're looking at. Now, in these, as we talked about on the road, there are three credits, I think, with absolutely no chance of loss. It's just going through managing those credits as our economy continues to improve in north Louisiana. Primarily those credits are north Louisiana.

So we continue to see our credit trends, not only NPAs, non-accruals continue to go down. Our classified assets to total capital is now 17.55 down from 19.99. So, we feel very good, not only about charge-offs but about past dues. Our past dues for the end of Q2, we're at a record low for our company at that 43 basis points. We are seeing very, very good trends on credit quality. So, we will get aggressive with credits as we always do. We don't cover anything up. I think the key going forward in Q3 and Q4 is to look at the past dues. They'll give us a very good clear picture of what it looks like, plus our classifieds continue to move down.

Matt Olney
Okay, thanks, Drake. Last question from me is just about the Houston market. I know Houston is a big focus for you guys, and Lance mentioned this a few minutes ago, seeing some nice deposit growth out of Houston. Just taking a step back in general, how much progress did you see in the Houston market in 2Q and how much more opportunity is there for Origin?

Drake Mills
Well, actually, it's pretty interesting, Matt, because if I break down—and one of the points I made during the IPO is that I would be looking at and measuring our performance pre and post lift-out, especially the Houston lift-out. So, if you look at net interest income pre- lift-out, it's $37.170 million, post lift-out $37.176 million. No impact in Q2 for the lift-out. From an income standpoint, 13.229 pre- lift-out, 12.702 post. So, we saw the impact $527,000 in the second quarter, so we felt that return on average assets 117 versus 122 without the lift-out, efficiency ratio was 66.99 with the lift-out, 65.65 pre.

So, what shows where we are, 1558 of loan growth and with lift-out 1518, so no impact on loan growth, pretty decent impact on deposit growth, which we expect to see deposits first. Houston grew deposits $59 million in Q2. Now, the first couple of weeks of the month in the third quarter starting to see some pretty decent loan growth coming out of the Houston team. So we expect very good strong impact in Q3 and Q4 from our Houston group. That number now is at 11, we think we're going to sign a 12th person on that team and really get us in a good position to see significant impact on loan growth.

Matt Olney
Okay, that's great, guys. Thanks for your help.

Drake Mills
Thank you, Matt.

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

William Wallace
Thank you, good morning, guys.

Drake Mills
Hello, William.

William Wallace
Maybe continuing the conversation on loan growth, Drake, could we talk a little bit about where that growth was concentrated or where it was broken out across your geographies?

Drake Mills
Yes, and really some good moves here. I'm going to let Lance go through those numbers because the loan growth might surprise you where it's coming from at this point without the impact of Houston yet. Lance?

Lance Hall
Thanks a lot. We've actually had real strong growth here in our Louisiana markets. Year-to-date $66 million of our loan growth has come here in Louisiana, $34 million of that was in Q2. We've actually dropped back in Mississippi about $30 million. We had a couple big commercial real estate pay-offs. The pipeline looks really good there, though, and we fully expect that to ramp back up in the third quarter.

Dallas-Fort Worth has been a star for us from a loan growth perspective, $102 million year-to-date in loan growth in the Dallas-Fort Worth market, $29 million of that was in Q2. Again, Houston, $10 million in loan growth, but we are really starting to see those fundings kick in, both from our organic team as well as the new lift-out team that's coming. And then obviously we had a seasonal lift with second quarter in mortgage warehouse that helped drive the loan growth.

William Wallace
So, what you said, what you're saying about Houston and general commentary it sounds like the pipeline is building. So, absent, and some sort of acceleration in pay-downs, should we—it sounds like loan growth could even accelerate from what we saw in the second quarter, in the back half of the year. Is that a fair characterization?

Drake Mills
It's fair. I don't know that I want to state that at this point because we have struggled, Wally, to really get a good handle on pay-downs. For instance, we had a company that sold in our East Texas market that created almost $53 million in deposits that we weren't expecting. So, we'll continue to try to get a handle on that but we think loan growth would be where it is today if not stronger. And the Houston pipeline, I'll tell you, the quality of what we're doing, the approvals we're getting through the pipeline, the first couple weeks in July and going into this last week felt really good with Houston credits.

William Wallace
Okay. Were the pay-downs in the second quarter less than they were in the first quarter? And if so, was it a pretty significant difference?

Drake Mills
No, they were—it's funny you asked that because I almost said take the pay-downs through the first six months and annualize them because it's very similar to the first quarter, but still, somewhat higher than expected. But again, I think we're replacing it with high quality relationships, and these relationships aren't going away in these pay-downs.

William Wallace
Okay. So, turning the conversation then to margin, you were up 6 basis points sequentially in the second quarter. With the June hike, how much expansion might we anticipate in the third quarter?

Drake Mills
Okay, Steve?

Steve Brolly
About the same as this quarter, loans are going to be between the 15 and 20 basis points. When we look at total assets, it'll probably be closer to the 12 basis points. And then deposits we are trying to keep the betas where we are right now which is in the low to mid 40%. So, if the rates go up, I'd say about the same, maybe a little bit higher, one or two basis points higher for the next quarter.

Drake Mills
Wally, I think an interesting add to that, also, is we talked about pricing discipline, we have $1.1 billion of

loans that we'll renew and reprice in the third and fourth quarter, which gives us a really great opportunity to offset deposit betas. And it's a strategy that we are deploying here and getting very serious about pricing disciplines through third and fourth quarter.

William Wallace
Okay, thank you. Maybe one last question, on the expense line you mentioned in the release and in the prepared remarks about the impact from the new hires. Had you continued to hire through the second quarter? Should we anticipate that that base should grow, continue to grow in the second half?

Drake Mills
We do have an opportunity in Dallas that we're working on, Dallas-Fort Worth, that would be significant for us, not to the level necessarily of Houston, but I would say 50% of that potentially, if we're successful. We will continue this strategy as long as we feel comfortable that we're going to get the production ramp up from those investments. So, at this point, that's the only thing that's on the burner.

We also have some slight work going on in Mississippi with some single lift-outs. We have to get loan growth rolling in Mississippi and it's going to be through—continue to build bankers. And we're also getting as aggressive as we can with potential M&A activity in Mississippi.

Steve Brolly
Wally, also, there was only one person in that group that was hired in the first quarter, toward the end of the quarter. The vast majority of the people were hired in the beginning to the middle of the second quarter. So, if you look at the second quarter, you would add just a little bit to catch up to a full quarter's work, and then if we had any other lift-outs. But without any lift-outs, I would say a little bit higher, very little bit to break even on the second and third quarters.

William Wallace
Thank you, guys. I'll step out and let somebody else ask a question.

Operator
Our next question comes from Brad Milsaps with Sandler O'Neill. Please go ahead.

Brad Milsaps
Hi, good morning.

Drake Mills
Hello, Brad.

Brad Milsaps
I just wanted to follow up on Wally's NIM question. I know I think during the IPO you guys talked about maybe 10 or more basis points of margin expansion with each Fed rate hike. I was curious, you still got 6 this quarter, which was great, but kind of how that might have changed. It looks like, too, you have a fair amount of liquidity with the IPO proceeds and I just want to get a sense of how you're thinking about working that down and putting that to use over the next quarter or so.

Steve Brolly
We did have a lot of liquidity. We paid down the SBLF; we also paid down some preferred stock at the end of the quarter. If you saw the average by month, our liquidity is a lot lower at the end of the second quarter. And so we believe the third quarter we won't have as much liquidity. Also with typical mortgage, we'll have a lot more—mortgage production and also the warehouse. So this is usually the third quarter is usually when our loans to deposit ratio is a lot higher. So, we will be less liquid, which means we'll

have less money in the lower yielding instruments.

If you look back at last year, I would say it's about the same level as last year. We were a little high in the first and second quarter, the second quarter was because of the IPO but we put that to use. We waited about a month to put that to use.

Brad Milsaps
Great, that's helpful. And then just switching gears to fees, if you exclude the valuation, deposit valuation just for this quarter, maybe fees were less than I thought. Steve, just kind of curious, are there levers you think you have that you can push that maybe closer to back up to where they were in the first quarter or what are your thoughts around that?

Steve Brolly
If you're talking about other income, the fees are $2.9 million compared to the $1.8 million; that was in other total noninterest income. Most of those items we can't—we'll have a little bit to pull that's income on the bank's own life insurance; that's going to be relatively flat. Credit card exchange will be relatively flat. There's a couple items in here that we do not really control. They are investments in CRAs, LP investment income. One month one quarter may be $800,000 because of an investment may have sold and we have a capital gain. This month it was almost flat—this quarter rather. And so, we typically get about $250,000 to $300,000 a quarter, but it could go as much as $800,000, $900,000, and as low as zero.

Other items that are in there, valuation income, we also have swap fee income. Swap fee income is going to be whenever we get into a swap, and out of the last five quarters, two quarters we had swap fee income and three we didn't.

Brad Milsaps
Got it. So, bigger picture, this is probably a decent run rate, notwithstanding some of the things that you talked about, swap fees, etc.

Steve Brolly
And that would be the large variable. We also have mortgage banking in the total, and mortgage banking in the third quarter is generally a little bit higher than the second quarter. That is seasonal. And we do believe that will be a little bit higher than the second quarter.

Brad Milsaps
Okay, great. Thank you.

Drake Mills
Brad, real quickly, this is Drake. Not to get off that because we were seeing that $10 million and $10.5 million number, it came in at $8.7 million, that was really driven in large part by mortgage banking. That came in about $1.1 million below our expectation. And what drove a tremendous amount of that was the impairment owned run-off. We've been a little bit concerned as we shift to a total retail platform we continue to see production slowly coming up but the lack of production is certainly causing some impairment. But also, the payoffs have been surprising to us to the point to where we did a tremendous amount of work this quarter, not only chasing payoffs but understanding what's driving those payoffs, because they're historically much higher than they should be, especially with an increasing rate environment.

And, thankfully for us it wasn't a service issue, it wasn't a number of things that you could think it was, it was amazing that people selling houses, people moving, it was nuts how much impairment we took on from those payoffs. So, we expect, based on historical in the third quarter to see a reduction in that impairment which should help us get put—because the point is we're trying to restructure and rebuild mortgage to a retail platform where we expect to be at a breakeven run rate at the end of the year. It's something I talked about on the road.

So, if you take that $1.1 million, obviously that's offsetting the gains that we're seeing because of lack of provision and increased credit quality but we do believe we're going to recover that and get back on track by the end of the fourth quarter.

Brad Milsaps
Great, that's helpful. Thank you.

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

Brady Gailey
Hi, good morning, guys.

Drake Mills
Hello, Brady.

Brady Gailey
Just to follow up on what we were just talking about on mortgage, so you did $2.3 million of mortgage fees in 2Q, and I think I heard you right that there's a—not one-time but the impairments were $1.1 million. So, should we expect that mortgage line to go up a little bit in 3Q and then by the end of the year be up closer to a $3.5 million mark, which would be what it would have been this quarter without those impairments?

Drake Mills
That's our expectations this quarter. We made some pretty strong moves. We feel that there's some significant opportunity for efficiency moves in the third quarter. As we downsize the operation and go to true retail, we think there's some significant reductions in expenses that we're going to see. This is all going to be around our ability to understand and control these payoffs that are triggering this impairment. And again, we have to go back to the historical third quarter what it looks like during that period in '17, and fourth quarter which looks much better.

It is our expectation, as I told investors on the road, we're going to fix this by the fourth quarter or we're going to make some hard decisions. But, the retail mortgage business is extremely important to me because of the relationships on the deposit side we're able to build out of it, but also the services that we're able to provide in our markets. But, we're focusing on our footprint, those things, and we do think that by the fourth quarter we'll be back to those numbers and at a breakeven run rate going into '19.

Brady Gailey
Alright. Drake, I know it's only been, what, two or three months since the IPO has closed, but you now have a publicly-traded currency, the stock has done pretty well post-IPO. Are you starting to have some M&A conversations now that your company is in a position to actually execute on something? I know you mentioned the state of Mississippi but give us some color on where you're at on the M&A front now.

Drake Mills
It's been rewarding because of the phone calls, the contacts. We actually are in discussions to some level or another with four different opportunities at this point. And, it's picking up. One of the points I

made is that we're not going to just jump out and do something very quickly. We're going to do something that makes tremendous amount of sense, more on the funding side, which could be a huge add for us in Mississippi if we could reduce our funding costs there with a good acquisition.

So, at this point, they're in all three markets, I mean, states we're in, and we're focused a little more on Mississippi. There is an opportunity in Louisiana. So, we'll continue to push; we think it's a great opportunity for us to maybe have something on the front burner by the end of year, going into '19, hopefully.

Brady Gailey
Great, thanks for the color, guys.

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

CONCLUSION

Operator
And showing no further questions, this concludes our question-and-answer session. This also concludes our conference for today. Ladies and gentlemen, thank you for attending today's presentation. You may now disconnect.