

Origin Bancorp, Inc. Third Quarter 2024 Earnings Call - Transcript

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Evercall Moderator

Ladies and gentlemen, good morning and welcome to the Origin Bancorp Inc. Q3 Earnings Conference Call. My name is David, and I will be your Evercall coordinator. The format of today's call includes prepared remarks from the company, followed by a question and answer session. Please note that all attendees will be on the listen only mode until the Q&A portion of today's call. Also, please note that this event is being recorded. I would now like to turn the call over to Chris Reigelman, Director of Investor Relations. Please go ahead.

Chris Reigelman

Good morning and thank you for joining us today. We issued our earnings press release yesterday afternoon, a copy of which is available on our website along with the slide presentation that we were referred to during this call.

Please refer to page 2 of our slide presentation, which includes our safe harbor

statements regarding forward looking statements and use of non-GAAP financial measures. For those joining by phone, please note the slide presentation is available on our website at www.ir.origin.bank. Please also note that our safe harbor statements are available on page 5 of our earnings release filed with the SEC yesterday. All comments made during today's call are subject to the safe harbor statements in our slide presentation and earnings release.

I'm joined this morning by Origin Bancorp's Chairman, President & CEO, Drake Mills; President and CEO of Origin Bank, Lance Hall; our Chief Financial Officer, Wally Wallace; Chief Risk Officer, Jim Crotwell; our Chief Accounting Officer, Steve Brolly; and our Chief Credit and Banking Officer, Preston Moore. After the presentation, we will be happy to address any questions you may have. Drake, the call is yours.

Drake Mills

I like to believe that I've developed a reputation of being transparent and direct. We have accomplished a great deal since we went public in 2018 when we were \$4.2B in assets. We've expanded our presence in Texas, grown market share in Louisiana and Mississippi, entered new markets in South Alabama and the Florida Panhandle, built an award-winning culture that attracts talented bankers, and we have diligently prepared to cross \$10B in assets. Even with these successes, we clearly understand the work in front of us to create upper quartile profitability.

We have been very strategic in how we have prepared for crossing \$10B in assets. We've made significant investments in people and processes that we knew would impact short-term profitability but would prepare us to drive long-term value. While this preparation, and the rate environment, have pressured our profitability, I am confident we've made the right decisions to lay the foundation to build long-term value. We have strengthened our management team, we have enhanced our ability to gather and analyze data to drive strategic decision making, and we have improved our risk management capabilities, to name a few. Now it is time to sharpen our focus on near-term profitability. We are laser focused on a strategic initiative to return to acceptable profitability levels by the end of next year.

We will provide detailed metrics around this initiative when we report our full year results in January. We are well into this process and are actively working with a third party to benchmark us at a granular level to our peers. We have also begun outlining

specific revenue and expense opportunities to achieve our profitability goals. In the near term, we need to operate at levels in line with our peers, with a defined path to outperform them.

Now, I'll turn it over to Lance and the team to talk through this quarter's results.

Lance Hall

Thanks and good morning.

Over the past several quarters I've talked about our banker's consistent focus on driving core deposit growth and expanding relationships. While the rate environment has put pressure on deposits across the banking industry, I'm pleased with the balance sheet trends we showed in the third quarter. I'm confident these trends will continue, and our bankers will capitalize on opportunities, particularly in our metro Texas markets and our new Southeast market.

Total deposits, excluding brokered, were up 2.3% quarter over quarter, which is the strongest growth we've seen in two years. Non-interest bearing deposits were also up, growing 1.5% for the quarter. Also, our NIB mix as a percent to total deposits remained stable at 22%.

I want to speak directly to the success we are having in our Texas markets. Our teams throughout the state continue to drive meaningful growth. Year to date, our Texas bankers have grown deposits \$241M and grown loans \$154M. We see tremendous opportunity in Texas, and we have the infrastructure in place to continue to grow that business.

While we look forward to detailing the profitability initiative that Drake mentioned next quarter, improving operating efficiencies is always a focus. As an example, one area we have had success in building efficiencies is in our Robotics Process Automation Platform. Our RPA team continues to add value at the bank by saving approximately 3,356 hours of manual work in the third quarter. Year to date this team has saved more than 9,600 hours of manual work, equivalent to just over 7 FTEs.

I'm optimistic about the momentum we are seeing within our markets and how our bankers are focused on growing profitable relationships.

Now, I'll turn it over to Jim.

Jim Crotwell

Thanks Lance. As we discussed over the past several quarters, we continue to experience normalization within our loan portfolio. With that said, we are pleased to report decreases in past dues, classified loans, as well as non-performing loans for the quarter, while we did experience an increase in net charge offs for the quarter, year to date, net charge offs continued to be in line with expectations.

Past Due Loans Held for investment came in at .49% as of September 30th, decreasing from .83% as of June 30th, and in line with past due levels of .42% as of the end of the 1st quarter. As you will recall, the increase in past dues as of June 30th was attributed to relationships identified as part of the questioned activity of a former banker in our East Texas Market. We continue to work through this issue with our customers, including those relationships subject to the ongoing dispute.

Classified Loans decreased \$10.8M to 1.35% of loans as of September 30th, down from 1.49% as of June 30th while non-performing loans decreased \$12M to .81% as of quarter end, down from .95% as of the prior quarter end. The decrease in both classified and non-performing loans was primarily driven by the \$10.4M write-down in three acquired loans as well as the settlement payment of \$3.3M on one of these loans. As to classified loans, these reductions were partially offset by downgrades of 4 relationships totaling \$7M, 3 of which were acquired loans.

Net Charge-offs for the quarter totaled \$9.5M, up from \$2.9M from the prior quarter. While net charge offs for Q3 were .48%, year-to-date net charges offs were .26%, and are in line with expectations. Our credit provision expense was \$4.6M for the quarter compared to \$5.4M for the prior quarter, and, after considering net charge-offs, resulted in a \$4.9M decrease in the allowance to \$96M. The reduction in the reserve was primarily driven by the utilization of previously established reserves. On a percentage basis, our allowance decreased from 1.27% to 1.21% as a percentage of total Loans Held for Investments and from 1.34% to 1.28%, net of Mortgage Warehouse.

During the quarter, we completed our external loan review, which covered

approximately 55% of loans net of consumer and 1-4 family residential loans. The results of the review were positive, resulting in no recommended downgrades to criticized or classified loans.

As discussed last quarter, we continue to focus on client selection and during Q3, we saw an additional \$42M in desired reductions. We will continue to closely monitor and manage our portfolio.

With the markets continued focus on non-owner occupied CRE Office, we continue to provide added detail on slide 13, which shows the resiliency and performance of this sector within our portfolio. As of quarter end, this segment totaled \$364.7M, average loan size of only \$2.4M, a weighted average debt service coverage of 1.34% and a weighted average loan to value of 59.01%. We had no past dues, minimal classifieds, and no non-performing loans, and no charge-offs with this segment.

As to total ADC and CRE, we continue to closely monitor our overall exposure and reflected total funded ADC and CRE of total risk based capital at quarter end of 72% and 239%, which positions Origin with the flexibility to support our customers and provide strategic growth.

Wally Wallace

Thanks Jim and good morning everyone. Turning to the financial highlights, in Q3 we reported diluted earnings per share of \$0.60. As you can see on slide 24, the combined financial impact of notable items during the quarter equated to a net expense of \$627,000, equivalent to \$0.02 in EPS pressure.

On the balance sheet side, I will start with a discussion on deposits, which were down 0.3% during the quarter. Excluding brokered though, deposits grew 2.3% linked quarter, a strong quarter, as Lance mentioned. Furthermore, non-interest bearing deposits grew 1.5% linked quarter, the first quarter of growth in NIBs since 2022. We continue to see mix-stabilization in our deposits, with non-interest bearing deposits remaining flat at 22% of total deposits.

On the loan side, growth in gross loans held for investment and growth excluding mortgage warehouse were both essentially flat during the quarter as our strategic focus on client selection continues to result in some planned reductions as Jim

discussed. As a result, our loan to deposit ratio, ex mortgage warehouse, remains below our 90% target, at 87.9%. We anticipate our client selection process could add some continued pressure to growth in Q4, but continue to expect loan growth in the low-single digits for the year with deposit growth essentially matching.

Moving to the Income Statement, Net Interest Margin expanded one basis point during the quarter to 3.18%; below our guidance which was for mid-single digit expansion from an adjusted base of 3.22% in 2Q. The primary driver of this shortfall relative to our expectations was deposit costs that were higher than we anticipated, as pricing pressures for new deposits did not ease as much as forecasted across our markets. While we anticipated margin expansion despite potential pressures from Fed rate cuts, our prior models considered a measured cadence of 25-BPS cuts, versus our current model which now includes the already announced 50-BPS cut in September and additional 25-BPS cuts in November and December of this year. This scenario results in a brief period of NIM compression of roughly 10-BPS, as the benefits from asset repricing lag the pressures from our floating rate loan portfolio. Assuming the Fed slows or stops easing, we still anticipate asset repricing benefits to drive NIM expansion in line with our previous expectations.

Shifting to noninterest income, we reported \$16.0M in Q3. The quarter included a \$221,000 gain on sale of securities. Excluding this notable item and the \$6.1M net benefit of notable items in Q2, noninterest income declined to \$15.8M from \$16.4M in Q2, due primarily to normal seasonality in our mortgage business. In Q4, we expect normal seasonal pressures in both our mortgage and insurance businesses to drive Q4 fee income to levels similar to Q4 '23.

Our noninterest expense declined to \$62.5M in Q3 from \$64.4M in Q2. Excluding \$848,000 of notable items in Q3 and \$1.5M in Q2, noninterest expense declined to \$61.7M from \$62.9M. While Q3 levels were better than anticipated, we still expect Q4 expense will remain at levels similar to Q2 which includes an expectation of legal and accounting related professional services expense associated with the activity Jim discussed earlier. As such, our 2024 full year expense growth, when excluding the notable items mentioned previously, is still expected to be in the mid-single digits.

Lastly, turning to capital we note that our TCE ratio ended Q3 at 10.0%, up from 9.5% in Q2. Also, due to continued easing of AOCI pressures and the contribution from earnings, we were pleased to report growth in our tangible book value per share of 5% quarter over quarter and 17% year over year. Furthermore, as shown on slide 23 of

our investor presentation, all of our regulatory capital levels, at both the bank and holding company levels, remain above levels considered well-capitalized. As such, we remain confident that we have the capital flexibility to take advantage of any potential future capital deployment opportunities to drive value for our shareholders.

With that, I will now turn it back to Drake.

Drake Mills

Thanks Wally. As I mentioned earlier, while I'm not satisfied with where we are from a performance standpoint, I'm extremely confident in our ability to take the necessary steps to be an elite financial performer. Origin has a strong history of delivering for our shareholders, employees, customers, and communities. I have spent my career building this organization and I have every intention to see us be successful.

Origin has a strong culture that has attracted best-in-class bankers, a geographic footprint that serves some of the most dynamic growth markets in the country, and our management team is deeply committed to doing what it takes to increase value for this company. Thank you for being on the call. We'll open it up for questions.

Evercall Moderator

Thank you, team. Ladies and gentlemen, at this time, we will conduct the question and answer session. If you would like to ask a question, please press *1 on your telephone keypad to enter the queue. Or if you've joined via web, please press the raise hand icon on the right side of your Deal Roadshow screen. Again, that'll be *1 on the telephone keypad, or the raise hand icon on the right side of your DRS screen. We will pause here briefly to allow any questions to generate. Our first question comes from Matt at Stephens Inc, your line is open, Matt.

Matt Olney. (Stephens Inc)

Hey, thanks. Good morning, everybody. Want to start on the net interest margin. It sounds like the loan repricing story is in tax. No real change there, but it's the deposit costs that were stubbornly high in the Q3. Just want to drill down more into that. Did

you get more pushback than you expected on exception pricing? Or was there other pushback with specific deposit categories? Just trying to appreciate the drivers there and then part two, kind of moving forward. Does it give you pause for your assumptions around deposit betas with down rates? Thanks.

Wally Wallace

Hey, Matt, thanks. So on the deposit beta question, there were no real surprises, as far as negative surprises. If you look at our deposit balances, our deposit growth was actually higher than we anticipated, and that growth was concentrated in interest bearing accounts, so that adds pressure to our overall deposit costs. What we've seen, as far as the trends in pricing, they remain in line with what we had been seeing. We anticipate, well, prior to Fed moves, we would have anticipated continued stabilization and potentially even declines in the overall cost. We're not going to slow down our deposit gathering efforts, so we will take a quarter of deposit growth being higher than we anticipated, because, as we've said pretty consistently now, that deposit growth is what governs our ability to grow loans, and we want to get back into the business of growing our loan portfolio. So we view this pressure as temporary. And then with the Fed rate cuts, we had been modeling that there would be a zero beta to be conservative in our models. So far, with what we saw in the September 50 basis point cut, our deposit betas on our non-maturity interest bearing deposits are around 40%, which is in line with historical, so better than our models. So that gives us confidence that we'll be able to keep up on the deposit side if the Fed continues to cut.

Matt Olney (Stephens Inc)

Okay. Thanks for that, Wally. And just to clarify the margin outlook from here, I think you said margin compression about 10 bits in Q4, and that assumes, besides what we got into September, another 25 basis point cut in November, Fed, and then also in December. And then, I guess there was some commentary about the margin expanding mid single digits. Do you need a Fed pause to see that? Or do you think you could start to see some of that mid single digit margin expansion early next year?

Wally Wallace

We do not need a Fed pause, Matt. We've modeled this from anywhere from no more rate cuts to seven more rate cuts. And in all scenarios, our margin expands to levels above where we have been so far year to date. What we need is a measured cadence of cuts, 25 basis cuts, preferably. 49% of our loan portfolio floats. When the Fed cuts 50 basis points in one meeting, that 49% prices down essentially immediately. Our loans that are maturing, they're maturing throughout the quarter, so it takes time for the benefits of those repricing to offset what the pressure that we see on day one of a 50 basis point cut. So if we continue to get 50 basis point cuts, then you would expect to see the following quarter continued pressure on our loan yields. But as soon as the Fed pauses or slows the cadence of cuts, then those asset repricing benefits kick in, and we end up at the same end point. It's just a matter of the short term effect offsets because of the lagging of the repricing.

Matt Olney (Stephens Inc)

Okay, all right, understood. Thanks for the commentary, Wally. And if I could just sneak one more question in for Drake. Drake, your prepared remarks were interesting, helpful. I think you mentioned achieving peer profitability in the near term. And then there's also mention of achieving upper quartile peer profitability at some point. It sounds like you're still working on the details, and you'll have more for us next quarter. What specific metrics are you focused on, and is the board focused on? Is this an ROA or efficiency? And within the peer levels, what do you consider peer and then upper quartile within those metrics?

Drake Mills

Yeah, currently, you know what we're looking at, and then we're anxious to get on with communicating, as we said in the prepared remarks, at the next in January, we'll do that, but we are looking at every aspect of expense and revenue across all lines using internal metrics to drive what we think is pure, like, profitability. And for that, right now, that's 105, 106 or whatever that number is, but we want to get back to profitability as we were sitting in at the end of '22 going into '23; and to do that, what we plan to accomplish in the next several quarters, not only puts us in a position to be peer-like, but it also puts us in a position once our planned growth returns, and as we've always talked about, we've built this company to grow 8% to 10% a year. We

are adjusting that, but once we get back to that growth, then that'll be the accelerator for us to get back to that upper quartile profitability.

Matt Olney (Stephens Inc)

Okay, thanks for the color, Drake. Appreciate you taking my questions. I'll step back.

Drake Mills

Thank you.

Evercall Moderator

Thank you, Matt. Our next question comes from Tim at Raymond James. Your line is open.

Tim Mitchell (Raymond James)

Hey guys. This is Tim in for Michael. Good morning, everyone. Just want to follow up on Matt's question around deposits and betas. Just understanding you want to grow the portfolio as much as possible, but just want to get a sense of where the release could come from with down rates. Is there a certain mix of the portfolio that's indexed? Are there CDs repricing in the next few quarters? Is there kind of a big relief from the roll off rate to what you're putting CDs on now at? Any color there would be appreciated.

Wally Wallace

So yes, we would anticipate relief across all of our deposit products. You know, there's no, there's no magic bullet in the time deposit portfolio where it's going to be a really lumpy repricing benefit in any given quarter. It's really kind of measured throughout the pace of the year. We've seen our non-interest bearing deposits pretty stable in that 22% range of total deposits. Right now, I think what we would do is use any

continued deposit inflows to continue to allow our broker deposits to roll off the balance sheet. That's our highest cost segment in the deposit portfolio, but I would really just kind of think about it as a measured cadence of deposit price improvements throughout the course of the year.

Tim Mitchell (Raymond James)

Understood.

Lance Hall

Maybe if I could, hey, this is Lance. Sorry to kind of go back to you and Matt's question. I do want to kind of make it clear that from a deposit pricing perspective across all markets, that is being actively, actively managed. This is something that we've worked with our treasury management partners, retail partners, presidents, and we have ongoing plans for interest bearing accounts. We're touching every single one of them in regard to profitability of clients and understanding the competition in the marketplace. So it's not a one size fits all solution, but actively managed throughout each of our markets, and which is going to, I think, do a very effective job for us and getting our deposit costs where they need to be.

Tim Mitchell (Raymond James)

Yeah, that's great. Appreciate it. And then back to the kind of strategic action you might lay out here in January, when I get a sense on the expense side, you hired a team earlier this year down in South Alabama. As you get over \$10B in assets, you want to look move past that number meaningfully. Might be some more team lift outs, you know, maybe some more technology spend on the horizons. But again, since, you know, where do you think those opportunities lie, just as you look at the expense space right now?

Drake Mills

Yeah, you know, for us, we, as we go through this process, it's been amazing for me to look back and recognize the impact of our technology investments on the process of

strategic planning in the directions we go, so we are what I think using data today, and more accurately looking at profitability and revenue streams across, like I said, all aspects of the institution. It gives us much better feel that we can create efficiency in the organization and still have the opportunity to expand in areas that are meaningful. I am extremely pleased with our Southeast expansion and Nate and his team and what's going on. They are, you know, slightly above our plan, continue to do good things, but we're positioning ourselves at this point to really be able to take off in '25. From a credit standpoint, a number of areas that we are working in to make sure that as we launch next year, we have everything behind us from a planning standpoint.

Lance Hall

Yeah, and this is Lance again, maybe, to kind of add on to that, to your question. I think part of the evolution of this company is the impact that Wally and his team have brought in, the ability to use data in a much more meaningful way. So as we launch our plan, I think the optimization of everything is on the table, as we have looked deeply into banker profitability, product profitability, branch profitability, business lines. All of that is consistently and deeply being analyzed at this point, as we understand, once we cross over the 10B threshold and we kind of need to turn the jets on, what that looks like from both a growth and a profitability perspective.

Tim Mitchell (Raymond James)

Okay, great. If I could piggyback one more off that, you talked about returning to at 8% growth range over time, and not as convert '25 or 2026 guidance or anything, but just conceptually, what's it going to take? Is it just a matter of the macro environment improving at lower rates, or is it more specific to you guys? Just want to get a, appreciate kind of, yeah, how you return to that posture?

Lance Hall

Yeah, this is Lance, and Drake- Drake may have a different answer. Expand on this a little bit, for me, it's really been two things as I work with our president. It's been about our loan to deposit ratio and driving core liquidity. That's we have said pretty consistently that that's been the governor that we've sort of pulled back on. We've

had really strict client selection through this process. So it's really been about liquidity in 10B for me. You know, if we could stay under 10B for one more quarter. What that does to pushing Durbin into, you know, 18 months out, and then what we've been able to do to strengthen our balance sheet. I mean, just this quarter, very proud of the deposit growth, the ability to reduce broker deposits. So, you know, we have, we're sitting here with increasing liquidity, good loan to deposit ratio, really positive trends on CRE and ADC. So we are positioning ourselves, if we cross over 10B early next year, with strong liquidity. And I think that sort of takes the shackles off a little bit and allows us to do what we do, which is really grow specifically with our footprint in Texas and the Southeast.

Tim Mitchell (Raymond James)

Great appreciate you taking my questions.

Evercall Moderator

Thank you, Tim. Once again, ladies and gentlemen, if you would like to ask a question, please press either *1 on your telephone keypad to enter the queue or the raise hand icon on the right side of your Deal Roadshow screen. And, once again, that'll be *1 on your telephone keypad to join the queue and ask a question, or the raise hand icon on the right side of your Deal Roadshow screen. Ladies and gentlemen, this concludes the question and answer session. Handing it back to Drake Mills for any additional remarks.

Drake Mills

Yeah, thank each one of us being on it. Two points; One, there was a comment about credit deterioration, and I take exception to that, and certainly I can do that. It gets personal, but it's to look back on this past quarter. We were, we've reduced past dues. We reduced non-performers. Classifieds declined. Charge offs driven, were basically driven by a credit that was fully reserved. In our classifieds and non-performers, most a lot of that's been driven by a non-credit event through the questionable activity. So I am extremely pleased with where our credit positioning is, the process that we've gone through, client selection being a push out another \$41M of credits this quarter

that quite, that really don't fit us, not necessarily non-performing credits. It's really been a true indication of our commitment to go into '25 with a very strong credit profile. The last point, we have worked diligently this year to position ourselves for deposit growth. We saw a reduction in broker deposits. Our 10B efforts through this past year has really been like Lance said, almost have shackles on us. But the reality of it is, we're trying to push Durbin in '26 so we've worked diligently to ensure that we stay under 10B this year. Our capacity to grow is well intact. Our ADC CRE is in very strong position. Liquidity continues to increase. We've had strict client selection, which I said, puts us in a much cleaner credit profile going into '25. And our footprint, I would put it up against any footprint in the country. On top of that, our team, the experience, cohesiveness, and what we've been able to accomplish very quickly in the Southeast, sets us up for a very strong '25. And that's the work that is really starting to pay off, that we've gone through for this past year. So again, thank each one of you for being on the call, and I look forward to seeing most of you soon.

Evercall Moderator

Ladies and gentlemen, this concludes today's Evercall. Thank you and have a great day.