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GSBC - Q1 2018 Great Southern Bancorp Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Great Southern Bancorp, Inc. First Quarter 2018 Earnings Conference Call. (Operator Instructions) And as a reminder, this conference may be recorded.

I would now like to turn the conference over to Ms. Kelly Polonus with Investor Relations. Ma'am, you may begin.

Kelly Polonus

Thank you, Serena. Good afternoon, and welcome. This is Kelly Polonus, Investor Relations for Great Southern. The purpose of this call is to discuss the company's results for the quarter ending March 31, 2018.

Before we begin, I need to remind you that during the course of this call, we may make forward-looking statements about future events and future financial performance. You should not place undue reliance on any forward-looking statements, which speak only as of the date they are made. These statements are subject to a number of factors that could cause actual results to differ materially from the results anticipated or projected. For a list of some of these factors, please see the forward-looking statements disclosure in our first quarter 2018 earnings release.

President and CEO, Joe Turner; and Chief Financial Officer, Rex Copeland are here with me today. I'll now turn the call over to Joe Turner.

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

All right. Thanks, Kelly. And I want to thank everybody on the call for joining us today for our first quarter earnings call. I'll provide some remarks about our performance during the first quarter. And then I'll turn the call over to Rex Copeland, who will give a little bit more detail on the income statement. And then, of course, we'll open it up for questions.

Hopefully, everybody on the call has had a chance to review our earnings release. If you have, then you saw that we had an extremely good quarter. We earned $0.95 a share, $13.5 million in the first quarter. Our annualized return on common equity was 11.22% and our annualized return on average assets was 1.23%. Our margin -- stated margin was 3.93%, and our core margin during the quarter was 3.81%, which was up like 13 basis points from the end of the year.

As far as the loan portfolio goes, good news all around, I think. Our loan portfolio increased $35 million during the quarter on funded outstandings. Our total gross loans -- and we exclude the FDIC-acquired loans from this number, but our total gross loans, which would include unfunded construction loans, increased $80 million during the quarter. And that increase was primarily in construction and commercial real estate.

And as we've talked about previously, our auto loans did continue to decrease. They decreased $34 million in the quarter, and we would expect that to continue to happen at, kind of, that level, at least through the end of the year.

Asset quality was also very good during the quarter. We started with almost historically low levels of problem assets. And they remain relatively consistent, I think. Our overall level of nonperforming assets decreased by $472,000. The level of potential problem loans was pretty well consistent with the end of 2017. Foreclosed assets did increase by $1.4 million during the first quarter.

Total net charge-offs were $2.1 million during the quarter. $1.3 million of that was consumer net charge-offs, and then the rest was commercial. Of the commercial, there were 3 larger charge-offs that amounted to $626,000, and those were all on older, vintage projects.

Our capital continues to be very strong. Total common equity -- it grew $8 million during the quarter to about $480 million, which is 10.9% of total assets. And book value per share of $34.02 and tangible common to assets is 10.7%. So strong, strong capital ratios.

As far as business initiatives go, I'm sure you all saw that we entered into an agreement to sell our Omaha area deposits to West Gate Bank. We expect that transaction to close in the third quarter of this year. When it does close, we expect to book a gain of $6.5 million to $7 million, which would amount to $0.35 to $0.38 after tax.

After the transaction, on a go-forward basis, we expect that our non- interest income will decrease annually by about $300,000 to $350,000. We expect net interest income, essentially interest expense, to increase $300,000 to $350,000 and noninterest expense to decrease by $1.1 million to $1.2 million. So a positive operating event for us as well.

That concludes my prepared remarks. At this time, I'll turn it over to Rex.

Rex A. Copeland - *Great Southern Bancorp, Inc. - Treasurer*

Thank you, Joe. I want to speak for a moment about net interest margin. Joe touched on that earlier. And so for the first quarter in 2018, our core margin, as he said, which excludes the additional yield accretion from the FDIC-acquired loan pools, expanded to 3.81% in the quarter, which was an increase, I believe, of 22 basis points from a year-ago quarter and 13 basis points from the fourth quarter of 2017. Primarily, driving that expansion is increased yields in most of our loan categories, and also higher yields on the balances that we maintained at the Federal Reserve Bank.

We've indicated in our past filings that rising interest rates would potentially have a modestly positive effect on our net interest income and margin. We saw that here in the first quarter of this year. We would anticipate that as rates move higher, generally speaking, that those trends would continue modestly. And one thing that will offset that a little bit is, if we have a lot of pressure to raise rates on deposits, certainly, our wholesale funds borrowings and things are going to -- rates will move up kind of along with the market rates. But we will continue to do what we can to maintain and monitor raising rates on our deposit products.

Noninterest income. We actually had a decrease in noninterest income this quarter compared to the first quarter of last year of about $763,000. A couple of things happened in the previous year quarter that were kind of some extra items. We did have a couple of large loan payoffs last year that generated about $500,000 in fees to us. We didn't have that level of prepayments and things in this quarter that generated those kinds of fees. Also, other income, last year, we did have some residual income effects related to some federal tax credits, better than in first quarter last year that were larger than kind of normal, and so we did record some additional income last year on that.

One other thing that I would note, in the other income section or noninterest income section, is profit on loan sales. That is down this year compared to the first quarter last year. That's somewhat due to a change in the type of loans we're originating in the mortgage loan area. A lot of what we did a year ago was fixed rate loans, which we sold to secondary market. This year, the kind of customer demand as well as kind of some things we've been looking at, we've originated more kind of hybrid-arm type loans where they're fixed for 3 years or 5 years and then become adjustable, rather than fixed from the beginning and stay fixed for the whole period. And those loans we do generally maintain in our portfolio.

Noninterest expenses. I think we're well contained in this quarter compared to the fourth quarter last year and the first quarter last year. Our total noninterest expense was $28.3 million this quarter. We listed a few items in the earnings release, which kind of played into that a little bit.

The other thing, obviously, that we benefited from in this first quarter this year was the tax reform and the implications of that. This year, our first quarter effective tax rate was decreased quite a bit. It was 16.4% in the first quarter this year compared to 26.1% in the first quarter last year. Our effective tax rate has been below the stated rate in both last year and this year period due to some municipal income or tax-exempt income, and also more so investment tax credits that we utilized. And so our tax rate is below the 21% stated federal rate here in the first quarter. As long as we have those credits available to us and flowing through the process, we would anticipate that our effective tax rate would be less than the statutory rate of 21%, as we move forward.

That concludes our remarks right now. And at this time, we'll entertain questions. And I'd like to ask our operator, once again, remind the attendees of how to queue in for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from the line of Michael Perito with KBW.

Michael Anthony Perito - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

I have a couple, and I did hop on a few minutes late, so I apologize if you covered this. But I wanted to first start, I noticed that the new share of purchase authorization that you guys mentioned in the press release, seems like it's about 3.5% of your outstanding shares. Obviously, it was a pretty good first quarter from a profitability perspective, so the internal capital generation seems to be building. Curious, just from your internal perspective, how aggressive or how much you plan to utilize that, as we, kind of, think about our models going forward.

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

Well, it's, obviously, going to depend on the availability of stock, and we're always with the share repurchase and everything, we're executing it in order to increase long-term shareholder value. So we're really not focused on trying to push the stock price over the near term. Having said that, we think the shares, at their current level, represent a value and represent an opportunity to -- if repurchased, to increase longer-term shareholder value. So we're excited to get going with it.

Michael Anthony Perito - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

As you guys -- can you help us maybe just think about -- as you've discussed with the board, capital, I mean, the TC ratio is almost 11% today. I mean, is the hope that -- the commercial loan growth was, again, pretty good in the quarter. Obviously, there's still some room for the consumer book to move down. But eventually, that will presumably show, which will let the loan portfolio kind of grow at a bit more of a rapid pace. So is there hope that the organic growth, some level of buyback and future dividend increases kind of keep the TC ratio in this 10% to 10.5% range, rather than building? And then, obviously, if you can find some M&A that makes sense, maybe that's what gets you down to the next level?

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

Right. I think that's reasonable assumption.

Michael Anthony Perito - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. And I was just -- overall, the credit metrics still seem fine. I just noticed some of the -- obviously, you guys give really good detail on the asset quality in the release, and I noticed that there was a handful of commercial credits, I think, that went NPL in the quarter. And I was just curious if there was any particular area or line where you're seeing weakness, or were they're pretty widespread? Just curious where the credit update is, maybe, more specifically today.

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

No. Very, very, sort of, specific issues with different customers. Nothing that would create sort of a systemic concern. And the other thing to point out, Mike, is they're all older, vintage credits. I mean, we really haven't had any problems to speak of with commercial credits generated post crisis, really. So all older level or older vintage credits, and they're just happen to be something happened to the customers in each of those cases.

Michael Anthony Perito - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. Helpful. Just one last one for Rex on the margin. The core margin has trended pretty well over the last 3 or 4 quarters. Just curious, competitively, we're hearing from a lot of the larger banks that commercial real estate, consumer auto, the pricing is getting challenging. Just curious of your near-term margin thoughts on the core margin and also, just on asset pricing, what kind of market you're seeing out there today.

Rex A. Copeland - *Great Southern Bancorp, Inc. - Treasurer*

Well, I think, as far as the asset pricing, I think it's really competitive. And Joe, you can probably to that as well as I can. But we do have, in our loan portfolio, about $1.3-or-so billion of our portfolio is tied to LIBOR. And so as LIBOR rates have been moving up, that portfolio has generally been repricing higher. I'd say, generally, most of the newer loans that we've been originating are coming on at higher rates than they were 6 months ago. Joe, I mean...

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

I'd say it is competitive.

I would echo that, Mike, the spreads on construction loans seem to spread to LIBOR, seems -- seem to be 2.50% to 3.25%, those kind of spreads for the most part. Fixed rate spreads for longer-term commercial real estate deals can get much tighter than that. So I would agree that the competition on the asset side does seem to be -- well, on the deposit side for that matter, seems to be heating up on both sides. And so we're -- that's why we like to have a number of offices producing deals, because we feel like we can be more selective, again, as we've told you before, on credit and on pricing and still have reasonable growth rates.

Rex A. Copeland - *Great Southern Bancorp, Inc. - Treasurer*

And we do have a variety of wholesale-type funds that we can draw on if we need to, so we don't have to reprice up all of our deposits. We may, selectively, increase some deposit rates in various types or locations. But we're not completely reliant on raising deposit rates to generate some funding. So we have a variety of sources, and we try to utilize those as efficiently and effectively as we can.

Operator

And the next question will come from the line of Andrew Liesch with Sandler O'Neill.

Andrew Brian Liesch - *Sandler O'Neill + Partners, L.P., Research Division - MD*

Question around the margin, just the earning asset mix here. Securities and Feds funds getting down to pretty well percentage of assets. Is there a level that you target for balance sheet liquidity here?

Rex A. Copeland - *Great Southern Bancorp, Inc. - Treasurer*

Not necessarily that we target. But I think, what your observation is probably accurate that it's gotten down to a fairly low level. Like I said, we do have some off-balance sheet ability to fund some things. But we've got quite a bit of capacity, actually, to do some things off-balance sheet. But we are mindful of where we are with our securities portfolio and on-balance sheet liquidity. So you are correct, it's a fairly low percentage.

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

Yes. I would say, Andrew, if you're trying to put together a model, I wouldn't see it drifting too much lower from where it is now.

Andrew Brian Liesch - *Sandler O'Neill + Partners, L.P., Research Division - MD*

Okay. And then just to clarify, the improvement in the loan yields across most types, is that really been driven by the improvement in LIBOR? Or is there anything else behind that besides that?

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

No, I think it's just market rates increasing, generally.

Rex A. Copeland - *Great Southern Bancorp, Inc. - Treasurer*

LIBOR and prime. We've probably got $400-and-something million that are tied to prime also. So between the two, $1.8 billion, $1.9 billion of our loan portfolio are tied to fairly short-term adjustments in rates.

Operator

(Operator Instructions) And our next question will come from the line of John Rodis with FIG Partners.

John Lawrence Rodis - *FIG Partners, LLC, Research Division - Senior VP & Research Analyst*

Joe, just back to the buybacks. So it is your intention to actively use it this year, is that what I'm hearing?

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

Yes, I think so. I think we like at the price our stock is trading, we like it as a long-term investment for our shareholders. So yes, I would say so. Given where we're trading and given the level of capital we have, I think we'd like that as an opportunity.

John Lawrence Rodis - *FIG Partners, LLC, Research Division - Senior VP & Research Analyst*

And then, Joe, as far as we look, you sort of -- the growth in construction offset the runoff in auto this quarter. Do you, sort of, think we'd probably see a similar level of growth throughout the rest of the year? Or how should we sort of think about that?

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

It's so hard to predict. I mean we just -- the visibility on payoffs and those sorts of things is not that good, John, and that's why we don't give forward guidance, as far as growth goes. I think, I would point you to our comments in this presentation and in the earnings release with respect to the commitments; unfunded commitments are really strong, the strongest they've ever been. So you would think origination, volumes would -- or would continue to be pretty good. I can tell you that we have strong activity in most all our offices. So we feel good about that. I just -- it's hard for me to tell you exactly what our growth will be like because I just don't have great visibility on the payoffs and pay-downs. And I can tell you, we do have a very attractive loan portfolio that's well-structured and our customers do have lots of opportunities.

John Lawrence Rodis - *FIG Partners, LLC, Research Division - Senior VP & Research Analyst*

That make sense. Joe, just one other question. There was a deal announced in Springfield yesterday by -- I'm sure, you saw it. I guess, to the extent you came, what did you think about that deal? Was that something you had a look at, just any color you can add?

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

I have not studied the parameters of that, that much. So I probably wouldn't be comfortable commenting on it or opining on it.

John Lawrence Rodis - *FIG Partners, LLC, Research Division - Senior VP & Research Analyst*

Okay. Do you compete against that bank? I'm not sure.

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

Yes, we do some. They're -- the QCR you mean or?

John Lawrence Rodis - *FIG Partners, LLC, Research Division - Senior VP & Research Analyst*

The Springfield Bank.

Joseph William Turner - *Great Southern Bancorp, Inc. - President, CEO & Director*

The Springfield First. Yes, we do. I mean, we -- they're a good solid local bank, and I think do a good job. Not talking about them specifically, but just about consolidation in general, I think we have found that when our competitors merge, it's not a bad thing for us. It does typically create opportunity, and so we hope this does as well.

Operator

And I'm showing no further questions at this time. I'd like to turn the conference back over to Ms. Kelly Polonus for any further remarks.

Kelly Polonus

Well, thank you for joining us today. If anyone does have any further questions, please feel free to contact me, and I can try to assist you with that. If not, we look forward to meeting again with you next quarter.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude your program. You may all disconnect. Everyone, have a great day.