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Q4 2018 Great Southern Bancorp Inc Earnings Call

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CORPORATE PARTICIPANTS

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Kelly A. Polonus *Great Southern Bancorp, Inc. - Director of Communications & Marketing for Great Southern Bank*
Rex A. Copeland *Great Southern Bank - Senior VP & CFO*

CONFERENCE CALL PARTICIPANTS

Andrew Brian Liesch *Sandler O'Neill + Partners, L.P., Research Division - MD*
Michael Perito *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Great Southern Bancorp, Inc. Fourth Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call may be recorded for replay purposes.

It is now my pleasure to hand the conference to Ms. Kelly Polonus, Investor Relations. Ma'am, you may begin.

Kelly A. Polonus ***Great Southern Bancorp, Inc. - Director of Communications & Marketing for Great Southern Bank***

Thank you, Brian. 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 December 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 fourth quarter 2018 earnings release.

President and CEO, Joe Turner; and Chief Financial Officer, Rex Copeland, are here with me.

I'll turn the call over to Joe Turner.

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

Thanks, Kelly. Good afternoon, everybody. And I also want to thank you for joining our earnings call this afternoon. As usual, I'll provide some preliminary remarks, and then Rex will go into the release in a little more detail. Hopefully, you've had a chance to review the release. If you have, you've seen that we had a very solid quarter in year for that matter.

During the fourth quarter, we earned $17.3 million or $1.21 per share. For the fourth quarter, our return on average common equity was 13.34%. Our annualized return on assets was 1.5%, and our margin was 4.07%.

We did earn about almost $700,000 during the quarter from income on an interest rate swap that was entered into in October. Net -- fees associated with -- onetime fees associated with entering into that swap that added about $0.015 to our earnings. We continue to feel very positive about the loan portfolio, both in terms of production and in terms of quality.

Our loans grew $46 million during the quarter, $263 million during the year, that's in spite of $42 million of paydowns in the acquired loan portfolio and I think like $106 million of paydowns in the consumer portfolio, as we continue to see that portfolio pay down. So really good healthy loan growth, great commercial loan origination volume, $1.35 billion of new originations across our footprint.

Atlanta and Denver offices were opened during the quarter, and they're, of course, staffed by industry veterans, and we're excited to see what they'll do in 2019.

Our loan pipeline continues to be good, up about $140 million from the end of the year. Importantly, closed construction loans were up $204 million from the end of the year and up about $78 million from the end of the third quarter.

Asset quality continues to improve as well, coming off very good numbers in the third quarter. Nonperformers actually reduced by about $4 million to $11.8 million.

So I think, at this point, we're something less than 0.25% nonperformer ratio to assets. So we feel very good about where that is.

Common stockholders' equity grew $60 million during the year. Of course, almost 10 -- not quite $10 million of that relates to mark-to-market gain on the swap that I mentioned earlier, but even without that, our common stockholders' equity grew $50 million. Our book value per share increased from $33.48 to $37.59.

Our ratio of tangible common equity to tangible assets was 11.2%, and we were calculating earlier today, even if you were to net the $9 million of mark-to-market gain off and approximate $10.5 million that we're going to pay with -- for the special dividend that we announced earlier today, would still be 10.7% or 10.8% tangible common equity ratio. So a very strong capital position. We did repurchase 17,542 shares of stock during the quarter at an average price of $51.52. And as I mentioned, we probably, more importantly, just announced our anticipated special dividend of $0.75 a share. I think that underscores our commitment to return value to shareholders. That concludes my prepared remarks.

I'll turn the call over to Rex Copeland at this time.

Rex A. Copeland ***Great Southern Bank - Senior VP & CFO***

Thank you, Joe. I'm going to talk first a little bit about net interest margin. We mentioned some things earlier about this that our core margin, which excludes the FDIC-acquired loan portfolio accretion for the fourth quarter was 3.93%, which is the 25 basis points higher than a year-ago quarter and 5 basis points higher than the third quarter of 2018.

Primary driver for the expansion versus the year-ago quarter is just some growth in the loan portfolio and also increasing interest rates. What kind of drove the expansion between the third quarter and fourth quarter of '18, a lot of that had to do with the interest income on the swap that was mentioned earlier.

So just a couple of things to clarify on the swap interest income. We will receive on this swap roughly 3.02% as a fixed rate that we will receive on it and will pay 1-month LIBOR rate. So as of today, 1-month LIBOR is around 2.51. So we are still in a position -- and it resets every month. So we're still in the position where we'd receive net payments. Now if the 1-month LIBOR rate moves higher, we'll receive less or we could even end up having to pay net settlements on that.

So as Joe said, the first -- in the fourth quarter, we did record $673,000 of interest income related to the swap.

We've indicated kind of along those same lines. We've indicated in our past filings that, that rising interest rates may have a positive -- modest positive effect on our net interest income and margin, and that's been borne out so far as rates have moved higher, but as competition is significant for deposits, we would anticipate that we may have a little bit of headwinds to margin improvement just because of higher funding cost from deposits and, of course, our borrowings outside of deposits that we utilized to fund our assets are really going to be counter-effected by changes in short-term LIBOR rates primarily.

Noninterest income for the quarter decreased by about $154,000 compared to the fourth quarter a year ago. We did have the largest decrease in that and really most significant item was in gain on loan sales. We do -- historically, we've sold fixed rate loans that we've originated one- to four-family loans in the secondary market booked a gain on those at that time. And then, more recently in 2018, we primarily have originated more hybrid arm-type loans. And so we've been holding those in our portfolio primarily, and so we have not originated and sold as much of the longer-term fixed rate loans in 2018.

Noninterest expense, our noninterest expenses were lower compared to the fourth quarter last year and a little bit higher compared to the third quarter of 2018.

We continue to focus on efficiency and cost containment. Our core operating expenses, I think, are staying relatively stable even as we've been able to grow our assets over the last year. The efficiency ratio in the fourth quarter was 55.6% and was 56.4% for the full year. We'll see some additional -- the full cost of the newest LPOs in Denver and Atlanta and will start in the first quarter of 2019, but we expect that they'll begin covering those operating costs relatively soon.

Kind of going along with the efficiency a bit, and this is not a large item, but we did mention that we are going to be consolidating an office in Arkansas -- in Fayetteville, Arkansas into our Rogers, Arkansas office, that will be occurring here fairly soon. So we will have one office in Arkansas, once that's completed, the one in Rogers.

That was all the things that I had to cover. At this time, we will entertain questions, and let me ask our operator to once again remind the attendees on how to queue in for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first 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***

Just some questions here on expenses. If I just maybe take out the charge or the fee for entering into the swap as well as OREO cost get right around $28 million, I guess, there may be a step-up here in the first quarter for payroll taxes and bonus accruals. But beyond that is like, is $28 million a decent run rate for the expense base going forward?

Rex A. Copeland ***Great Southern Bank - Senior VP & CFO***

We're probably reasonable in that. If you're going to exclude the ORE, I mean, that can be kind of choppy. So if you're going to exclude that from it, I mean there'll be some expenses there, we still do have some, and there are some expenses associated with it. So there would be some component of that.

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

Yes, we have -- Andrew, I mean, a number of our folks get re --, that have employment reviews annually, and so -- raises probably kick in at that point. So there may be some increase there as well, but I mean, you're -- we are trying to highlight anything that we see as unusual or -- out of pattern and we haven't -- we didn't highlight anything really other than the swap fee.

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

Okay. And then just on the margin, the swap certainly was beneficial this quarter, but it seems like maybe the margin would have been fairly stable. Is that kind of your outlook going forward? And are you cautioned for rising deposit costs, but you also have -- doing a good job at getting stronger loan yield as well. So I mean, if we kind of assume that -- for now anyway that the swap is accretive versus where you might have been previously forecasting, so the margin may be -- your margin outlook may be better now than what it was, say, 4 months ago?

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

Yes. Well, I mean, I would say this, Andrew. I mean, we didn't put the swap on to be -- I mean, it's a benefit and it's initially accretive, but the purpose of the swap from our perspective is, we told you we're slightly asset-sensitive, which means as rates -- if and when rates come down, we would be hurt modestly. And so we put that swap on the books to benefit us when rates begin to fall. So that's number one. I mean, that was not a -- it was not really that -- we didn't put the swap on -- a $400 million swap on the book to try to pick up $500,000 or $600,000 a quarter of additional interest income. But as far as margin goes, we haven't highlighted anything really different. The one thing I would say is that, really most of the benefit from rising interest rates because our loans are generally tied to LIBOR, most of the benefit happens prior to the Fed rate increase. As LIBOR is going to increase in anticipation of a rate increase, I would say most of the paying, the increase in deposit costs happen subsequently. Would you say that's correct, Rex?

Rex A. Copeland ***Great Southern Bank - Senior VP & CFO***

Yes, and I think you can kind of think of it like this a lot of -- probably like $1.4 billion or something like that of our loans are tied to 1-month LIBOR. So you can kind of see a large portion of our loan portfolio is going to be reflected by however 1-month LIBOR is moving around. Likewise, with the swap, you can kind of figure out what our spread is going to be on that swap based on 1-month LIBOR. The part that may be not as clear is if we're generating some fixed rate loans that maybe they have a 3- to 5-year maturity or something like that, depends on what the fixed rate is, you know, that we're able to generate on that. On the liability side, the borrowings and things that we have are going to be a lot tied primarily to 1-month LIBOR rates, generally speaking. And deposits, like Joe said, we do have a bit of a lag on some of our deposits, especially CDs, in particular, because maybe we have a CD that was originated a year ago that's getting ready to move up the maturity to 1-year CD. And so a year ago, the rates were probably lower than what they are going to be today. So there still may be yet some additional cost associated with deposits repricing up a little bit as they mature and replace.

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

So I mean, I guess, long-winded answer is same. We're not promising there couldn't be some contraction. There could possibly be some contraction, but we're trying to -- we're pulling every level we can negotiating for higher yields on loans, trying to pay as low rate as we can on deposits, we're doing everything we can.

Operator

(Operator Instructions) Our next question will come from the line of Michael Perito with KBW.

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

I was -- I've been looking kind of at the loan growth production, it seems like the last couple of years, specifically the construction portfolio has seen fairly accelerated growth, and I'm curious, I guess, where -- I guess, I have a handful of questions related to that. I guess, one, as you think about the percentage of portfolio that's now in construction which, to me, seems like if I'm looking in your filings from last quarter, it seems like it's north of 20%. I guess, how do you guys think about that number in terms of managing the concentration there? What do you think is a number where you -- the range, I guess, where you feel comfortable bringing that construction exposure to as you continue to try and grow moving forward?

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

Mike, I'm looking at our portfolio report that we file every quarter, and we filed, I think, yesterday or today, and it's showing our construction land development at 17% of the portfolio. And I think based on where we are, based on the way we underwrite those loans, the quality that we believe those loans are, we would believe we've got more a lot -- quite a lot more runway there. We really like the quality of the business. It's diversified geographically. It's diversified across property type, and we really think we have very high-quality borrowers there. So I think we have a fair amount of runway there.

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

What's the difference between -- I'm looking -- sorry -- looking at the filing though when I see that -- if I sum up the 4 lines in the 10-Q of the one- to four-family residential construction and subdivision construction land development and commercial construction, it's like almost $1.4 billion, but that would seem to be a different number than the construction in the 8-K that you guys filed last night. You know what the -- I guess, what the different segmenting is that makes up that difference?

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

That listing that you had may be -- I'll look back and see, that may be gross -- the gross...

Rex A. Copeland ***Great Southern Bank - Senior VP & CFO***

This did include unfunded.

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

Yes, unfunded perhaps.

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

Okay. That makes sense. And then, I guess, can you remind us -- I guess, it's a little bit -- give us a little bit more rather about the construction portfolio just from a metric perspective like average credit size and what -- which typical yield is on that portfolio today?

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

I don't know that we've filed any of that. Mike, I can tell you that we do -- that we'll typically do loans from $3 million to $15 million. Those are going to be variable rate loans, and I would say, from -- at the very low end 250 over LIBOR, I would say, more typically, 275, 300, 325 over LIBOR, and I can't remember what else did you say besides pricing and...

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

No, that does...

Rex A. Copeland ***Great Southern Bank - Senior VP & CFO***

Well, you asked about the yield.

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

Yes.

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

Yes. And then, I guess, my last question on the topic is just -- and the reason I'm asking really overall is I'm trying to get a better sense. Obviously, you're going to do special dividend, which helps on the capital front. And relative to peers, your capital levels still seem pretty healthy. I guess, what I'm trying to understand is, what's the right kind of number to be thinking about is as in terms of capital that would be [deemed to] access. And I mean, as I try to think about the regulatory guidelines, I think it's, with the risk weightings relative to the construction exposure and -- which, I think, is supposed to be less than 100%. I'm just trying to think about how you guys are thinking about that capital position and how much of it is we should really be considering as potentially dry powder for additional action, whether that be M&A, share repurchases, organic growth, dividends or capital that needs to be held as you guys continue to grow that construction portfolio?

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

Right, right. That's good question. I mean, we're probably not going to get down to a number, but I would say this, Mike, you hit the nail on the head with our loan portfolio, heavy commercial real estate, construction, multifamily, that's a portfolio that regulators do expect to see some higher level of capital. So given that, you are probably going to see a little higher capital levels out of Great Southern than you might see other banks our size. But having said that, we think based on our capital levels, where they are post payment of the special dividend, based on what we believe are our operating prospects, based on what we believe are -- what we believe about the quality of our loan portfolio, we still believe we have a very strong capital position and are in a -- continue to be in a position to grow the company organically to consider acquisition to consider or buy additional shares as we see shares priced at a level that we like and to consider more special dividends. So we -- I guess, what I'm saying is, we don't believe we fired our last bullet here. That's not the perception that we have.

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

Okay. That was very helpful, Joe. And I guess, just to wrap it up, just on that incremental capital deployment. I mean, it sounds like you guys are fairly agnostic, I mean, it's just really obviously see at the end of next year comes around, you'll see where capital levels are at. During the course of the year, you'll use share [purchases] modestly as the market permits and then kind of consider any dividends on top of your regular dividend at that point. Is that kind of a fair way to think about how you guys are approaching it? Or should we think about something else?

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

No, I think that's fair.

Operator

And I'm showing no further questions at this time. So now it is my pleasure to hand the conference back over to Mr. Joe Turner for any closing comments or remarks.

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

All right. Well, we appreciate everybody attending the conference today, and we look forward to talking with you in 3 months. Thank you.

Operator

Ladies and gentlemen, thank you for your participation on today's conference. This does conclude our program, and you may all disconnect. Everybody, have a wonderful day.