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Q1 2019 Great Southern Bancorp Inc Earnings Call

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CORPORATE PARTICIPANTS

Joseph William Turner *Great Southern Bancorp, Inc. - President, CEO & Director*
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*
John Lawrence Rodis *FIG Partners, LLC, Research Division - Senior VP & Research Analyst*
Michael Perito *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Great Southern Bancorp First Quarter 2019 Earnings Call. (Operator Instructions) As a reminder, this conference may be recorded.

I would now like to introduce your host for today's conference, Kelly Polonus of Investor Relations. Please begin.

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

Well, good afternoon, and welcome. This is Kelly Polonus, Investor Relations for Great Southern. The purpose of this call today is to discuss the company's results for the quarter ending March 31, 2019.

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 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 our earnings release dated the first quarter 2019.

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

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

Well, thanks, Kelly, and good afternoon to everybody on the call. Thanks for joining us today. As it's typical, I'll provide some preliminary remarks and then turn the call over to Rex, who will go into a little bit more detail on the financial statements, particularly the income statement, and then we'll open it up for questions.

Hopefully, all of you have had a chance to review our earnings release. We're very excited about the results for the quarter, feel very positive about it. Our earnings were $1.23 a share during the quarter or $17.6 million.

We did highlight a couple of things in the release: one was a -- kind of a noncore, unusual item, and then another was just a highlight. With respect to the noncore nonoperating item, we earned $0.036 as a result of sale of some assets that we acquired in FDIC acquisitions. The assets were difficult to value and probably -- and we concluded were worth 0 when we completed the acquisitions and so that we booked them at 0, and then over time, their value did increase, and we were able to sell them during this quarter for $677,000.

The second item that we highlighted was a $513,000 increase to interest income as a result of this -- the balance sheet swap that we entered into in October 2018. Rex and I have been talking about this. It's a core item. Our loans, in our mind, based on our asset liability analysis, were a little bit shorter than what we would have wanted, and so we used an interest rate swap to synthetically link in the duration on those assets.

So we may quit separately identifying that. That's just a part, we believe, of our core interest income at this point.

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Our annualized return on equity was 13.12%. Annualized return on asset was 1.49%, and our margin -- stated margin was 4.06%. I think our core margin was 3.93% net of the extra accretion.

Loan portfolio. Things continued to be going well there. Our loans grew $61 million. Total growth -- that's our funded loans. Our growth loans, which include unfunded amounts on our construction portfolio, were down slightly. But loan production continues to be good, strong, coming from all parts of the company and from all products as well.

As we notified you earlier, we did completely exit the indirect business. This concluded that the returns weren't satisfactory in that business for us, and so we would expect our $180 million roughly of indirect portfolio to run off over the next 2 to 4 years.

We saw, I think, $24 million in paydown on that portfolio in the first quarter.

Asset quality. You know we've said this the last several quarters we can't imagine it getting much better, but it did actually get just a little bit better in the first quarter with nonperforming assets down by $1.5 million.

Our capital position continued to be strong. We did deploy some capital. In the first quarter, we bought a little bit of stock. We had the special dividend of $0.75 and paid our regular dividend as well. And even after all that, our capital ratios ended the first quarter at the same place that they ended the year.

So we continue to have very strong capital, which gives us a lot of flexibility to consider additional share repurchases or additional dividend should our board deem that advisable.

So at this time, I'll turn the call over to Rex, who will go, as I said, a little more in detail on the income statement. Rex?

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

Thank you, Joe. I'll talk first a little bit about net interest margin. Joe mentioned earlier that our reported margin was 4.06%. The core margin excluding the FDIC accretion was 3.93% as Joe said. That's 12 basis points more than the core margin a year ago and about -- and basically flat from where we were in the fourth quarter of 2018.

So we continue to see our core margin. I think it performed well. We've got probably the growth from a year ago, it's really the growth in our loan and investment portfolios and higher rates on both of those, partially offset by increasing rates on deposits and borrowings. And I'll talk a little more about that in a moment.

Joe talked about the interest rate swap that we entered into late last year and the effect it would have had on our earnings. It's $513,000 of interest income that we recorded in this past quarter.

Just to remind you that the way that's structured is we receive a fixed rate of interest of just over 3%, and we're paying out a rate that's tied to 1-month LIBOR that adjusts monthly. So presuming that the Federal Reserve is sort of sitting tight right now for the foreseeable future, the 1-month LIBOR's been hovering around 2.5%. So that's how we get to that difference in the income that we drive from that right now.

We've talked about in our past filings, and Joe sort of alluded to it already here today, that we think that rising interest rates modestly help us, falling rates probably are somewhat of a detriment. That's why we entered into the interest rate swap. We still think that our core margin, again, totaling in pretty well. I would think though that we'll probably continue to see some pressure on the liability side from the standpoint of deposit cost. We do have a lot of our CDs that mature and repriced at the now-market rates, but we do still have some more -- part of our CD portfolio will probably continue to reprice up a bit. So we may have a little bit of pressure from that perspective. And assuming that the LIBOR rates don't move very much, we have a pretty good portion of our loans that are tied to 1-month LIBOR. So if those rates don't move up much, we probably aren't going to see those loan rates moving up much higher as we move throughout the rest of the year.

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On the noninterest income side. Our noninterest income increased about $515,000 compared to first quarter a year ago. Joe mentioned the majority or -- all of that increase really related to the kind of onetime income that we had on these couple of items that we got through FDIC acquisitions. We did have a little bit of a decrease of $286,000 compared to a year ago in our service charges and ATM fee. That's really mainly in overdraft and debit card fee income between our point of sale. And ATM fees, those were pretty consistent with the year ago quarter.

We also saw a bit of a decrease, $214,000, in gain on sale of single-family mortgage loans. We've originated -- over the last year-plus, 1.5 years, more loans that are fixed-to-variable type loans, and so we keep those primarily in our portfolio.

Noninterest expense area. We're still tracking it well, we think, on expense containment and operational efficiency. The noninterest expense total was $183,000 higher in the first quarter this year compared to the first quarter last year, and pretty consistent with our expense level in the fourth quarter of last year.

Our salary and benefit line did increase a bit this year compared to a year ago. We did open a couple of new loan production offices, late last year. We also had some annual employee compensation increases and some other things related to that. So we did see the salary and benefit line item move up a bit.

Offsetting that quite a bit was foreclosed assets. Expenses were down $521,000 compared to a year ago. We had some lower write-downs -- valuation write-downs on properties that were held in our ORE portfolio. And also, this year, our consumer repossession and other related expenses are lower as we continue to see that portfolio move down.

Also, one other thing - we had some new market tax credit expenses for last several years. Those projects completed, and our flow of credits was up later in the year of 2018. So we wrote off the investment in relation to that, and now that those investments are done, we're not writing off those investments now in 2019.

The efficiency ratio overall has continued to improve. If you look at our trend of our efficiency ratio, it's been migrating down fairly nicely over the last 2 to 3 years. The efficiency ratio this quarter was 54.74%, down from about 61% first quarter last year. So we continue to focus on growing our company, but we -- but as we've said before, we feel like we've got the infrastructure in place to continue to grow without necessarily to commensurate the expense growth along with it.

One other thing. Along the lines of efficiency I mentioned. We did recently this month consolidate our Fayetteville, Arkansas banking center into our Rogers, Arkansas office. They're about 20 miles or so apart geographically and so now we operate the one banking center there in Rogers, Arkansas.

One final thing that I was going to mention today that we haven't really talked a lot about before is kind of what's going on with us and the new accounting standard for loan losses, the CECL loss accounting standard. That will go into effect for us, as you know, the first quarter of 2020.

We've been working hard for some time now in preparation for that. We're utilizing some software from a third-party provider that we are utilizing here in-house.

We've got the historic data in the system. We've been running some parallel testing, and we'll do that throughout this year as we kind of fine-tune that process and that effect. And so we'll probably be able to share some information on that further during our second quarter call and in our second quarter 10-Q.

That concludes our prepared remarks, and at this time, we can entertain some questions. And let me ask our operator to remind the attendees how to queue in for questions.

QUESTIONS AND ANSWERS

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Operator

(Operator Instructions) Our first question comes from Andrew Liesch of Sandler O'Neill.

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

Just sort of -- a question on the loan growth here. Pretty solid mid annualized -- mid-single-digit pace here for the first quarter. Is this kind of like the base rate of loan growth here you're thinking for the year? Or the opportunities to improve upon this?

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

Kind of as your standard caveat, Andrew, we don't project loan growth, but you can do it yourself. You can see that our pipeline is pretty well exactly what it's been. So I think -- there's no big changes. Our consumer loans have been running off here for a couple of years, and we would expect that to continue. Hopefully, our new offices will ramp up. If you've seen our portfolio by region report, that's part of a loan portfolio report we do each quarter, you can see that Chicago is up to about $100 million. So hopefully, we'll see some growth in Atlanta and Denver. We feel positively about the direction, certainly, that the loan portfolios, -- as far as growth and quality, go.

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

Great. And then just on the deposit growth from the quarter. I'm just curious what was driving that? And what's the outlook there? Is there anything unique that drove the growth this quarter?

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

Yes. I can probably answer that for you, Andrew, that the growth has come -- a fair amount of it has come from internet CDs that were out there on a couple of the different internet boards, and we have seen some growth there. Some of the CDARS product is also there. We did have quite a bit of growth in our interest-bearing checking accounts. So those 3 areas are primarily where we're seeing it. What we were able to do in the quarter is we kind of grew in these areas, and we paid down home loan bank advance overnight borrowings from the home loan bank. And so at the end of March, we actually didn't have anything borrowed on the wholesale side from the home loan bank. So it's just kind of a difference in the mix a little bit, but we continue to focus on trying to grow our deposits as best we can. What we're kind of seeing right now is the growth is there more probably in the time deposit categories, but we also have had some growth in the interest-bearing checking-type accounts, too.

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

Got you. And so then to the extent that these inflows continue, looked like you added some of the securities portfolio as well beyond just paying down the borrowings. Should we expect the securities book to rise along with the deposits?

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

I think we'll keep trying to work for options to buy securities that fit sort of our parameters, and there for a while, we had lower rates. The market rates moved down. They kind of ticked back up, again, a little bit here in the last few days. That's part of our interest rate strategy as well as to put on some securities that we feel very comfortable with the quality of -- as far as credit goes there'll be agency-type stuff. And with intermediate-type lives of 5 to 10 years or something like that where -- that helps us from our overall interest rate risk strategy as well. So we'll continue to add some things on, but we don't really have any set amount or target that we're trying to hit.

Operator

Our next question comes from Michael Perito of KBW.

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

I had a couple questions. I want to start, apologies if you mentioned this, but is there any notable cost save related to the auto exit that we should be thinking about?

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

I think there will be, Mike. It sort of rolls in over time, Obviously, the originations staff has now either been found other opportunities elsewhere or has been redeployed the open positions in the bank, but the originations staff was maybe 12-or-so people, 12 or 15. As we -- as the loan portfolio pays down, there should be additional folks in servicing, who we'll have the same opportunity with. Some will decide

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to stay at Great Southern and fill other open positions, and some may choose to seek employment other places. So I think it will be -- I think there have been some cost savings, and there will be down the road as well. I can't really quantify ultimately where that'll be for you the...

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

And really in the first quarter, there weren't cost saves...

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

No, there weren't. That leaves cost saves in the first quarter, yes.

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

Okay. All right. And then a follow-up question. And this question's just -- it looked like the yield on the investment book jumped up a bit. So just curious if you could talk a little bit more about the incremental yield or some of those investments you bought in the quarter.

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

Right. So what we are buying, so I mentioned earlier, and so you know, maybe the yield on those products is 3.40% to 3.60%, 3.70%-type range. We have some -- or we've had more in our portfolio than single-family adjustable arm-type product that -- fixed for 3, 5, 7 years and then floating. So we've had some stuff in there that's been a little lower yielding because it's 1-year adjustable, and some of those things have paid down. We did have a little bit -- I mean, it's not a lot, but we did sell some of those securities in the first quarter and then replaced it with some of these other type of securities. So we probably did, on $25 million or $30 million of our securities portfolio, get out of yields and add new securities to replace, and part of the net difference in that yields may be 50 basis points or something like that.

Operator

Our next question comes from John Rodis of FIG Partners.

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

I guess, Rex maybe just on expenses. Is there any -- I guess, it was up slightly from the -- sort of from the fourth quarter core level. Is there any new initiatives as far as expenses go that we should sort of think about going forward? Or just sort of some low single-digit growth off this level, is that a better way to think about it?

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

Yes. We don't really have any corporate initiative-type things. We have been for some time now really kind of studying different areas of our company and trying to be more efficient and effective. Really, as far as serving the customer and some of the things that have come out of that, have been we've been able to kind of streamline processes a bit. And so sort of a byproduct to that may be where we've been able to kind of be a little more efficient in certain areas. But I wouldn't say, John, that we've got any big initiative to reduce anything. I mean, obviously, we're closing the location in Arkansas, but that was a small location, and there's not a lot of -- in the overall scheme of the company, a lot of cost save there, but there's a little bit. That was a lease facility, so we have a little bit of lease expense that goes away, and then you have got maybe 3 people staffing it or whatever. So -- but that's not a big thing in the overall scope of the company.

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

Yes, John, this is Joe. What Rex described earlier is what we call our Process Matters, and that's something that is an important part of the way we run the business now. We probably have at least one process -- or probably one Process Matters workshop a month. We have a -- we've hired a guy with lean accreditation, and he runs that process for us. And we have identified a lot of opportunities to better serve the customers in a more cost-effective way. So that's just a -- that's an ongoing thing for us. And so hopefully, that will continue to pay dividends. And we're always trying to identify ways to more efficiently do business.

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

Sure. That makes sense. I guess, just one follow-up as far as new LPOs and stuff. Are all the expenses sort of for a full quarter in the first quarter now?

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

Yes.

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

Yes.

Operator

And this concludes our Q&A portion. I'd like to turn the call back over to Mr. Joe Turner for closing remarks.

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

Okay. Well, we appreciate, again, everybody being on the call with us, and we'll look forward to talking to you after the results from our second quarter are published. So thank you, and have a good day.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. You may now disconnect. Everyone, have a wonderful day.

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