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GSBC - Q4 2017 Great Southern Bancorp Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Great Southern Bank Fourth Quarter and Full Year 2017 Earnings Conference Call. (Operator Instructions) I would now like to introduce your host for today's conference, Ms. Kelly Polonus, with Investor Relations. Ma'am, you may begin.

Kelly Polonus - *Great Southern Bancorp, Inc. - Investor Relations*

Good afternoon, and welcome. This is Kelly Polonus, Investor Relations for Great Southern Bancorp. The purpose of this call today is to discuss the company's results for the quarter ending December 31, 2017.

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 2017 earnings release.

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

I'll now turn the call over to Joe.

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

All right. Thanks, Kelly. And good afternoon to everybody on the call. We appreciate you joining us for our fourth quarter earnings call.

I'll provide some remarks about the company's performance during the fourth quarter, and then I'll turn it over to Rex Copeland, our CFO, who will fill in the details, particularly on the income statement. Then, of course, at the end, we will open it up for questions.

Hopefully, those of you on the call have had a chance to review our earnings release. If you had, you saw that we had a good quarter. We're very pleased with it. As you saw from the earnings release, we earned $0.86 a share or $12.2 million. During the fourth quarter, we earned $3.65 a share for the full year. For the fourth quarter, our return on average assets was 1.1%. Our return on common equity was 10.37%. No doubt, you saw that we did have 2 unusual items that occurred in the fourth quarter. First of all, in response to the tax reform act, which was enacted in the fourth quarter, and as a way of rewarding our associates for the important work they've done for our company, we did give a one time bonus that cost the company $1.1 million or $0.05 after tax. Additionally, in response to the reform act, all companies were -- are obligated to reevaluate their deferred tax items, and that reevaluation process resulted in a $0.02 per share increase in our earnings per share in the fourth quarter.

As far as loans, I'm sure you saw that our outstanding loan balances were down for the quarter and for the year. In spite of that, we feel like there are lots of positive things going on in our loan portfolio, certainly with credit but also with origination. We feel like we're doing the right things to build customer relationships in a way that will support a growing portfolio. And we think when you kind of look behind the numbers, you'll see a lot of positive things going on. First of all, our commitments were up $260 million during the year. Secondly, our gross loan totals, which would include the unfunded portion of construction loans, were actually up. When you look at the whole gross loan portfolio, that was up about $170 million. So there are some factors that lead us to believe that we can have a growing loan portfolio going forward. We did see reduction as a result of declining balances of our FDIC-acquired loans. Those were down $75 million during the year, $73 million, I think. And then our consumer portfolio declined about $144 million during the year.

As I said, asset quality was strong to start the year and I think only improved during the year and during the fourth quarter. Our level of nonperforming assets were down $5.1 million in the fourth quarter and down $11.5 million from the beginning of the year. The level of potential problem loans started the year very low and ended the year at about the same level. Foreclosed assets, excluding those acquired in the FDIC-acquired transactions, reduced by $6.8 million during the fourth quarter.

Our net charge-offs for the fourth quarter were $1.7 million. Of that amount, $1.4 million came from consumer charge-offs, primarily indirect automobile charge-offs. Net charge-offs for the year were $10 million. $6.1 million of that was related to charge-offs, primarily, again, in our indirect automobile portfolio. $3.9 million were not indirect charge-offs, so primarily commercial, maybe some mortgage on there. Of the $3.9 million, $2.9 million of those charge-offs came on 5 relationships, 4 of which were originated prior to '08 and one of which we acquired when we acquired the Fifth Third loans. So we aren't seeing any charge-off activity at all commercially from loans we've originated even in the last 10 years. So we feel very good about the quality of our originations.

As you saw, our capital, again, was strong going into the year and grew by $42 million to $472 million or 10.7%. Total asset -- our tangible common equity to tangible asset ratio is 10.5%. So this gives our board and management team a lot of options going forward.

That concludes my prepared remarks. At this time, I'll turn the call over to our CFO, Rex Copeland. Rex?

Rex A. Copeland - *Great Southern Bancorp, Inc. - Treasurer, CFO of Great Southern Bank and Senior VP of Great Southern Bank*

Thank you, Joe. I'm going to talk for a moment about net interest margin. Our reported margin in the fourth quarter this year was 3.75%. That compares with reported numbers of 3.87% in the fourth quarter last year and 3.77% in the third quarter of 2017. Our core net interest margin was very good, we think, in the fourth quarter of '17. The core margin excludes the impact of additional yield accretion recognized with our updated estimates of the acquired loan pools. That improved about 11 basis points compared to a year ago quarter and was stable compared to the third quarter this year at 3.68%.

And we've indicated in our past filings that rising interest rates may have a modest positive effect on our net interest income and margin. That's been borne out, to some extent so far, in the previews rate increases that have occurred. We expect similar effects as we move forward if we have further rate increases in 2018. Competition does remain significant and increased cost for deposits and other borrowings are anticipated and will likely put some counter pressure on margin expansion. The headwinds to margin improvement also have included, as Joe mentioned earlier, some reduction in our consumer loans and our acquired loan accretion income.

Noninterest income, I'll speak about for a moment. Noninterest income decreased $154,000 to $7.4 million compared to the fourth quarter of 2016, primarily --as a result of a couple of items, the largest of which is the line item for amortization of income related to business acquisitions. Because we terminated our loss sharing agreements in previous periods, that net amortization in the fourth quarter of 2017 was 0 compared to $848,000 for the fourth quarter of 2016. So that 2016 amount reduced noninterest income.

The other income line item in our income statement had a decrease of about $426,000 compared to the prior year quarter. We did have some disposal of some certain fixed assets and some ATM replacements, which we had recorded some losses related to that. The 2016 period also had income that was a little bit higher than normal. The fourth quarter other income item was pretty comparable to the 2017 third quarter other income line.

You'll notice that for the year ended December 31, 2017, our noninterest income increased about $10 million to $38.5 million, comparing it to the year of 2016. We've got several items that we have listed in our earnings release that lead to that. The primary driver of that really was the gain that we recorded when we terminated our Inter Savings Bank loss sharing agreement. That was about $7.7 million of pretax gain that was recorded in 2017. And also, we had a very small amount of amortization on the loss sharing assets in 2017 versus a fairly significant dollar amount in 2016.

As far as our noninterest expenses, I think our expense containment and operational efficiency remained a major focus for our company. Total noninterest expenses were $29.3 million in the 2017 fourth quarter compared to $28 million in the 2017 third quarter and $29.0 million in the fourth quarter of 2016. As Joe mentioned earlier, we did have $1.1 million of additional expense related to the bonuses in the fourth quarter of 2017.

There are a few other items that kind of offset that we list in our earnings release, that played a role in comparing the fourth quarter amounts this year versus last year. The efficiency ratio reported in the fourth quarter this year was 62.78%. If you reduce the expenses by the $1.1 million, that fourth quarter efficiency ratio would be just over 60%, 60.4%.

The last thing I want to touch on is the tax reform implications, and Joe had mentioned that briefly before. We expect to have an increase to our earnings of about $250,000 or $0.02 here in the fourth quarter. That estimate of the impact on the company's net deferred tax items includes, among other things, the timing and recognition of various revenues and expenses. We have reviewed that with the tax advisers for the company, and we expect that to be a fairly good number. But we are still trying to finalize a few items related to it, one of which is what's flowing through accumulated other comprehensive income. There's some accounting items that are being finalized on that right now.

The big thing probably though is our effective tax rate for 2018 and future periods. We think that, typically, in 2018, our effective tax rate is going to be in the range of 15.5% to 17.5% of pretax income, and that's based on our current levels of tax credit usage and tax exempt income, among a few other items. The effective tax rate for the company may fluctuate as it's impacted by the level and timing of our utilization of tax credits and the level of tax-exempt investments and loans that we have. And then, of course, our overall level of pretax income will also affect the tax rate somewhat.

That concludes our prepared remarks today. At this time, we will open it up for 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 + Partners.

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

Just a question on the loan growth outlook here with -- I was kind of surprised to see the multifamily C&I and residential -- or family residential portfolios decline. Is there anything going on there? Just kind of curious what drove that and what your outlook for those types is going forward.

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

I don't think there's anything specific, Andrew, going on in any of those portfolios. I do think it's a challenging environment for banks in that at least at the level -- at the credit level that we originate credits, I think very high-quality credits, borrowers have lots of options. And so loans are getting completed, and they're almost immediately refinanceable. So that's the only issue going on in those. There's nothing other than that, I don't think.

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

Okay. And then just looking at expenses. If you take out the $1.1 million for the bonuses and back out the expenses on foreclosed assets, I get a core expense number of just under $27 million. Is that a good run rate to use going forward or there might be some seasonal costs here in the first quarter?

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

I think we've identified everything that we would include as noncore. Obviously, you have normal kinds of compensation increases for employees, but I think we've done as best we can. We've identified anything that we would assume as nonrecurring in our numbers.

Operator

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

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

A couple questions for me. One on the kind of the economic outlook. Joe, maybe just any thoughts around commercial activity and how you kind of see it changing or maybe improving or after-tax reform. I mean, is there -- are you starting to have better -- more constructive conversations with any of your commercial clients? And have you started to see that translating into any more kind of potential future activity down the line?

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

I would say, it's hard to assess at this point. I do think there's -- kind of both anecdotally and what you're seeing in economic news coverage, there does seem to be a fair amount of optimism out there. So hopefully, that translates into additional economic activity. I think we're seeing very good economic activity throughout our geographic regions. For the second year in a row, we originated over $1 billion of commercial loans, and that goes, Mike, across our offices, $290 million in St. Louis; $190 million in Dallas; $160 million in Minneapolis and Tulsa and Kansas City; $100 million in Springfield; and even our newest LPO, although it wasn't opened that long, Chicago, originated $55 million. So I think it's going to be -- my guess is it's going to be probably more of the same. And maybe with tax reform, you do read a number of articles where businesses are talking about the ways in which that will help them.

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

Very helpful color, Joe. And then just secondly on capital. I'm doing some quick back-of-the-envelope math here. I mean, it seems like with that tax rate that Rex pointed out, I mean, you guys should be doing conservatively about a 120 ROA maybe next year in that ballpark. TCE with that would probably be approaching almost 11% by the end of next year. I mean, I guess, what's holding -- and I know M&A is out there and you guys are being selective and that makes sense, but, I guess, what's the holdup in terms of maybe bumping up the payout ratio a little bit, maybe even doing a share repurchase? You guys are trading at a discount to peers on a book value basis. What are some of the board's thoughts on some of those other non-M&A capital deployment methods at this time?

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

Well, I don't want to get too far out in front of the board, but I do agree with you. I mean, I think with tax reform, with the increased income, we're going to have, as our tax rate -- tax rate has decreased, yes, our payout ratio will be a little low. And so we could certainly look at a dividend increase. I'm sure that's something our board will consider going forward. Buybacks are something we could consider as well. And I haven't done the math lately, Mike, but -- before tax reform. So admittedly, some of the metrics have changed. If you looked at it even at a $52 or $53 purchase price for our stock, the tangible book value earnback still over 6 years. So unless you can get the stock [back] really cheap, it's not that attractive. But I agree with you, our capital levels are getting high, and we certainly have some options and some opportunities as a result of that.

Operator

And the 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 or Rex, I guess, just on the auto portfolio, how much more runoff would you expect there?

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

It's kind of hard to say, John. I would think there's going to be at least another year of runoff kind of at the same -- kind of more or less at the same levels, maybe declining some, but I think we are looking at probably at least another year of it.

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

Okay. So that will end up taking the portfolio down to, what, less than 5% of total loans in theory? Or...

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

Yes, I think so. Roughly, probably that amount.

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

And so are you guys originating any new auto loans today? Or...

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

Yes, we are. We've told you, I think in probably a year ago this time, that in fourth quarter of 2016, we had significantly strengthened our underwriting criteria because of weakness in the used car market. And so during all of 2017, I think we originated about $40 million or something of consumer credit. $34.6 million is still on the books. That's 2,719 loans. And of those, 19 are past due. So I think the underwriting changes we made have worked. And so we will continue to have the consumer portfolio, but it's just going to be at a lower level than what we've had.

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

Okay. And then just one other question on the balance sheet, just deposits. Total deposits were down year-over-year. Would you expect sort of deposit growth to sort of be similar to loan growth in 2018?

Rex A. Copeland - *Great Southern Bancorp, Inc. - Treasurer, CFO of Great Southern Bank and Senior VP of Great Southern Bank*

John, a lot of the decrease in deposits during 2017 was in the CD area, and a lot of that was going to be like more traditional brokered and some of the CDARS one-way buy and products there. So I think our transactional-type accounts were positive for the year. And we'll probably not see --

I wouldn't think we'll see the CD portfolio run down too much more from here. But a lot of what did result in that decrease in 2017 was what you'd call really noncore stuff in the CD side.

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

Okay. But, I guess, my point, Rex, is just trying to -- I know the loan and deposit ratio isn't the only thing you look at, but I wouldn't think you wanted to go a whole lot higher than where it's at right now. Is that fair to assume?

Rex A. Copeland - *Great Southern Bancorp, Inc. - Treasurer, CFO of Great Southern Bank and Senior VP of Great Southern Bank*

Yes, I think that's fair to say. I mean, I think our deposit growth will probably be roughly at least what loan growth is.

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 closing remarks.

Kelly Polonus - *Great Southern Bancorp, Inc. - Investor Relations*

With that, we would like to thank you for joining our conference call, and we look forward to next quarter's call. Thank you.

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

Thanks, everybody.

Operator

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