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EDITED TRANSCRIPT

Q3 2022 Business First Bancshares, Inc. Earning Call

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CORPORATE PARTICIPANTS

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Matt Olney Stephens - Analyst
Freddie Strickland Janney - Analyst
Kevin Fitzsimmons D.A. Davidson - Analyst
Brett Rabatin Hovde Group - Analyst

PRESENTATION

Operator

Thank you for standing by, and welcome to the Business First Bancshares Q3 2022 Earnings Call.
(Operator Instructions)
It is now my pleasure to turn the call over to Matthew Sealy, SVP, Director of Corporate Strategy and FP&A.

Mr. Sealy, please go ahead.

Matt Sealy Business First Bancshares - SVP, Director of Corporate Strategy

Thank you, [Jack], and thank you all for joining. Yesterday afternoon, we issued our third quarter 2022 earnings press release, a copy of which is available on our website, along with the slide presentation that we will refer to during today's call.

Please refer to Slide 3 of our presentation, which includes our safe harbor statements regarding forward-looking statements, and these are non-GAAP financial measures. Those of you joining by phone, please note the slide presentation is available on our website at www.b1bank.com. Please also note that our Safe Harbor statements are available on Page 8 of our earnings press release that we have 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 afternoon by Business First Bancshares President and CEO, Jude Melville, and Chief Financial Officer, Greg Robertson. After the presentation, we'll be happy to address any questions you may have. I will now turn the call over to you.

David Melville Business First Bancshares - President and CEO

Okay. Thanks, Matt, and welcome, everybody. Excited to be here for our first public call. We're also joined by Philip Jordan, who is our Chief Banking Officer. Just I'll give you a quick overview. Some of you may not be that familiar with our story, and we'll go into a Q&A session, and I look forward to that. b1BANK, a 16-year-old bank in Louisiana, headquartered in Louisiana, but also presence in Texas. We're focused on small businesses as our primary clientele.

We're the number one bank headquartered in Louisiana as measured by Louisiana deposits, and we have about 1/3 of our assets in Dallas and Houston. We also have about $6 billion under management and an RIA called SSW.

A couple of years ago, we started on a five-year plan, our most recent five-year plan, and had three major components. One is growth. We were about $3.7 billion, and at the end of the five years, we wanted to be about $7.5 billion. Second component of the five-year plan was asset diversity. So we were a little under 10% outside of the state of Louisiana. And by the end of the five-year plan, we wanted to be about 50%. And then finally, earnings, we were under one ROA.

And by the end of the five years, want to be probably at 1.25% as an ongoing run rate for ROA. And pleased to report that we're ahead of schedule on all three legs of our five-year plan. Growth-wise, we'll finish the quarter at about -- we finished the quarter at about $5.8 billion in assets. From a diversity standpoint, we're up to about 34% of our assets in Texas, and an earnings standpoint, we're at 1.15 ROA.

So we're pleased with the progress. Specifically, the third quarter really highlighted payoff on a number of investments that we've made over the past few years, including M&A and de novo and organic growth. We finished the third quarter with record profit. It's also our seventh quarter in a row with over 20% annualized growth of the loans. And we're actually at 30% for the second quarter in a row on loan growth. About 60% of that loan growth is in the Dallas and Houston areas. Most importantly, we also finished the quarter with solid asset quality.

What I'm really excited about is that these investments are beginning to pay off, but we feel like there's still lots of capacity to continue on the journey that we embarked upon a couple of years ago, and part of that is that we've hired about 25 bankers over the past six quarters and believe that although their production has certainly kicked in, we'll have room to grow there. And even outside the production officers, we've been able to add quite a bit of talent to our staff, and excited about the people portion of our list of assets. And proud to announce that this year, we won -- Banker Magazine -- American Banker Magazine's one of the best places to work for our institutions. So we're excited about that.

I'm not going to go into great detail on the intro call or the intro portion of the call partly because with our capital raise a couple of weeks ago, we had a chance to talk to many of you and put our information out there and. So I really would be open to turning it over now to Q&A for anybody that has any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Matt Olney with Stephens. Your line is open.

Matt Olney Stephens - Analyst

Yes. Well, thanks for doing this public call. I think this will serve us all well. I appreciate that. Jude, you mentioned the success you've hired -- you've had on the new hires. Recently, I think you quoted 25 bankers over the last six quarters, and we're now seeing this pay off over the last few quarters in terms of the revenue. I'm curious where are we in this recruiting cycle? Are you continuing to recruit at the same level at this point? Or in other words, can we see another 25 bankers over the next six quarters? Or could this pace slow from what we've seen more recently?

David Melville Business First Bancshares - President and CEO

Good question. Yes. No, we don't expect to see the same level of recruitment over the next six quarters. We've hired two bankers this past quarter, and I think two or three bankers a quarter is probably a good run rate for us over the next 1.5 years or so. We feel like we want to let our men and women that we hired have a little room to work, and I want to make sure we're also getting ahead of ourselves in terms of operational capabilities. And of course, with a certain measure of uncertainty in the air for next year. I want to make sure that we're growing prudently. So we'll continue to add when we find good teammates but not at the pace at which we've done over the past 1.5 years or so.

Matt Olney Stephens - Analyst

And then just following up on that, your thinking about geography, I think over the last two years, it's been mostly DFW and New Orleans. Should we expect a similar type of geographic mix in the next two years?

David Melville Business First Bancshares - President and CEO

For hiring, you mean?

Matt Olney Stephens - Analyst

Yes, yes.

David Melville Business First Bancshares - President and CEO

Yes, I don't -- my assumption is it would probably be more Dallas and Houston, but we certainly will fill it when we have good bankers in our Louisiana boot brand as well. Our New Orleans footprint was about 1/3 of the higher than we did over the past 1.5 years.

So we feel really good about the quality of the team there. And most likely, we'll continue to add bankers in the Dallas in these scenarios. As you know, we consummated our M&A of Texas Citizens earlier this year, and then we converted over the summer, and very pleased with their growth in the third quarter. They added about $40 million in loans, which exceeded our expectations. And as we get more selfish there and our brand becomes more well known, we think we'll have other opportunities to add some vendors there.

Matt Olney Stephens - Analyst

Okay. And then I guess on the expense side, we've seen expenses ramp over the last few quarters. You mentioned the Texas Citizens deal. That's now in numbers and some of the new bankers. Any guideposts you'd point us towards for the fourth quarter or as we look towards 2023 for operating expenses?

David Melville Business First Bancshares - President and CEO

Yes. I'll let Greg weigh in on that.

Gregory Robertson Business First Bancshares - Chief Financial Officer

Matt, thanks. Good question. We think the $37 million quarterly run rate is a pretty good rate. And now we think, going forward, in Q4, that there'll probably be about $1.25 million higher just for some seasonal expenses, true up, some accruals and that sort of thing. But the $37 million point from there on out seems to be a good run rate.

Matt Olney Stephens - Analyst

Okay. And then I guess the last topic I want to dig in on is going to be on deposit betas. And I think you guys reported deposit beta -- interest-bearing deposit beta, I'm getting maybe the mid-30s in the third quarter. I think most of your peers are talking about increasing or higher deposit betas as you move into the fourth quarter just from increased competition. I'm curious what the expectations are from you guys as far as deposit betas from here.

David Melville Business First Bancshares - President and CEO

Good question, Matt. We One of the things before we talk about the betas, I think that we're kind of proud of is we started out the year at about 31% noninterest-bearing, and we're almost 36% at the end of the quarter. So when you apply that to the overall beta, it makes that closer to 20%. And so we do think it's going to trend higher up probably to 30% all in as we move forward, maybe slightly higher than that.

Operator

Freddie Strickland with Janney.

Freddie Strickland Janney - Analyst

So just looking at Slide 9 on the footprint of the deck, and it looks like you've been able to raise even more deposits than loans in Houston. Does the contribution on the deposit side start to rise in Dallas over time to something similar to Houston? Or is the strategy in Dallas more to deploy the deposits from some of the Louisiana regions, just given the competition in that market?

David Melville Business First Bancshares - President and CEO

I'll say it a mixture of both. I mean, certainly, a part of our game plan is to take full advantage of the diversified footprint that we have. And we wouldn't have been able to grow where we are in loan lines in Dallas without the contribution of some of our more established deposit-rich areas, including Southwest Louisiana and the -- region.

So we certainly want to continue to focus on growing deposits in Louisiana and the work wherever that makes sense. But I also would say that our Dallas footprint is maturing, and we would expect it that they would contribute to that effort as well. We just opened our fourth spot there. And so we owe have a pretty good established foothold.

I will say that very pleased with our deposit mix that we have grown in balance. Of the $270-ish million cost, a good 60% is noninterest-bearing. So while they're not self-funding, they're certainly making a contribution. And that kind of speaks to the business orientation in the larger markets and our focus on our treasury personnel as well as lenders. So I would say that I'm pleased with the deposit growth in the Dallas area. But certainly, we hope to not only continue. But as we get increasingly -- there, be able to diversify that mix of deposits in balance.

Freddie Strickland Janney - Analyst

Got it. That's helpful. And just one more for me. I was wondering if you could just talk a little bit more about SSW, what opportunity you see to grow that business. And kind of how -- if you could remind us how it interplays with the core bank.

David Melville Business First Bancshares - President and CEO

Sure. So that's what page is that, Greg?

Gregory Robertson Business First Bancshares - Chief Financial Officer

That's on Page 11.

David Melville Business First Bancshares - President and CEO

Page 11 of the deck gives us an overview of SSW. So a couple of things. One is that we have been very successful growing it since they joined our team by about 70% and in assets under management, and that's after taking into account the drop in the market. So they have grown nicely since they became part of the team. So the synergies seems to be working well.

Now the bulk of that is -- as you know, is made up of clients of other financial institutions. So I think we have a couple of opportunities. One is we've been working on developing a network of financial institutions that we serve not only through SSW but also through our big group and our core bank group who sales, loan participations and average deposits for us from other financial institutions, and they are about $300 million in each of those categories. And so SSW provides an additional network for us to tap into, and that works both ways. We're also able to use our big group to recommend financial institutions to SSW, -- so we certainly hope to continue to grow that as a source of deposits end up source of risk mitigation with our loan exposure.

The other opportunity that we have with SSW is to grow the retail presence, and we -- because we've been so busy there, growing the financial institutions group, we really haven't tapped into yet the ability to use that RIA capability across our footprint with our other clients in their businesses and their executive team.

So the next two, three, four years, I think we'll see a more balanced mix between the retail and the financial institution group. And the retail business is higher margin. So we'll look forward to being able to work that into our earnings. But still early in the game just 1.5 years in, but very excited about SSW to contribute not only to noninterest income on the bank side, but we've also continued to grow that network of banks. We're up to about 100 banks that we serve in some way, whether that be revising them on their investment portfolios or through loans or through deposits.

We also -- earlier this year, we did a preferred equity raise. And as you know, we were able to do that in-house, and about half of the participants actually came from our bank network. So there are some other kind of ancillary benefits that we've got -- that we've enjoyed through the affiliation.

Operator

Kevin Fitzsimmons with D.A. Davidson.

Kevin Fitzsimmons D.A. Davidson - Analyst

Just wondering with the substantial loan growth we saw pretty quickly, we got the loan-to-deposit ratio up to almost 97%. Just wondering -- and that's got 2 components, obviously, with loans. I would assume, Jude, that we're not going to be at a 30% clip sustainably going forward. And then it's probably a struggle just industry-wide to keep deposits stable. But just wondering how you're looking at that ratio, what you think is normalized where you want to see it go.

David Melville Business First Bancshares - President and CEO

Sure. I'll start, and I'll let Greg give some detail. But I think you're right that it's unrealistic to assume that we would continue to grow at 30% annualized. We're looking at more kind of 1five-ish kind of mid-teens growth for the rest of the year and then probably into 2023, which ought to give us a little better shot at catching up with deposit growth.

We are kind of seasonal when it comes to our deposit base. So the fourth and first quarters tend to be our best deposit gathering quarters. So we're optimistic about that from end-of-the-year impact to our loan-to-deposit ratio. And we've actually already started the quarter off positively and been able to pay down some of the borrowings and switching to deposits.

So we're pleased with the growth. We think we can be kind of high single digits for growth on the deposit side this quarter and beginning of next year. So still a little bit of gap to make up. But we also have relatively low exposure to wholesale deposits at this point, which we can use to help us fill in the gaps while we continue to work on our deposit gathering capability.

I will say that we've been pleased overall with the growth in noninterest-bearing deposits from our banking centers and from our commercial clients, and some of that's obscured by the fact that we've had such strong loan growth. But we've also put more of an emphasis over the past couple of months, in particular, on revamping some of our deposit incentive programs and just kind of center of our production conversations that we're having. So we have a history of achieving what we set out to achieve and a little more focused on that side of the balance sheet, I'm still confident that we'll be successful.

In terms of your specific question, I think the low 90s, 91, 92 is probably more where we want to -- on a regular basis. Greg, do you want to add detail to that?

Gregory Robertson Business First Bancshares - Chief Financial Officer

Yes, Kevin, it looks like June mentioned, for Q4, we're looking at about 15% annualized, which would be about $170 million seems through this part of the quarter, we're right on pace for that. And also on the deposit front, we're seeing some early signs in the quarter.

We had some successes with deposit gathering so far. So I think you said high single-digit deposit growth in the fourth quarter and then 4-star municipalities should come in, in the fourth quarter -- first part of the first quarter, somewhere in the $200 million to $250 million range. And then we will also have a large part of our ag book in the fourth quarter that pays down about $80 million that should turn to cash and down balance sheet for a while. So between the revamping of the incentive plan and those seasonal things we think have some liquidity options going forward.

Kevin Fitzsimmons D.A. Davidson - Analyst

Okay. Great. Just wondering on the margin front, if you could help us how to think about trajectory going forward. Any help you could provide if you happen to have handy maybe the September margin or a range you might expect for fourth quarter. I think a lot of banks are talking about there being additional expansion but not at the pace seen in the third quarter and then kind of plateauing at some point in 2023 in the first half and fighting to keep it stable thereafter. Just any kind of color or outlook on that front?

David Melville Business First Bancshares - President and CEO

Yes. Good question, Kevin. We -- as you remember from our release, we had about 5 basis points inflows to our margin at quarter end from the nonaccrual that we collected first part of the quarter. So the margin in the fourth quarter, we expect we closed out the quarter with the weighted average yield on new loans at about 6 10.

So we think that that's going to improve somewhere around 50 to 60 basis points in the fourth quarter, which, with our seasonality in the deposit front, which a lot of those municipals that will start coming in will be interest-bearing along with the 5 basis points that we're not going to get, that was a onetime. So we should be full steady on the margin to slightly decline in the fourth quarter. And then looking out from there in 2023, we should start to pick up that 6 to 8 basis points clip per quarter after that.

Matt Sealy Business First Bancshares - SVP, Director of Corporate Strategy

And Kevin, to answer your question about the September month end core NIM, it was around 3.83% core, and that's based on an actual day-count annualization factor for the month..

Kevin Fitzsimmons D.A. Davidson - Analyst

Okay. And just that plus 6 to 8 basis points per quarter in '23, is that just more of the like ongoing repricing of the loan book but then holding the line on the positive pricing from there? Is that how to look at it?

David Melville Business First Bancshares - President and CEO

Yes, that's exactly right. We'll start -- continue repricing the loan book, and that should be the driver of that.

Operator

Brett Rabatin with Hovde Group.

Brett Rabatin Hovde Group - Analyst

Wanted to talk about the loan portfolio from a repricing perspective. And on July 17, you did a great job in sort of laying out the picks versus floating of the portfolio. And of the 65% that are fixed rate, and you've got 13% of those that mature within the next 12 months, what would be the remainder of that fixed rate portfolio? What would be the duration maybe on that portfolio aside from that 13%? And any visibility on when the rest of that fixed rate book reprices?

David Melville Business First Bancshares - President and CEO

Yes, Brett, good question. We have about an average life of our portfolio. It's about 48 months total. So that fixed book is going to track upon that. So we really experience about 1/4 of the fixed rate portfolio that reprices every year is what we traditionally see.

To give you a little more context, you had a quarter-to-date -- on the loan yield to about between 65% and 70%. We think Q4, that's going to be about 75%. And so it should track like that going forward. SP-36

Brett Rabatin Hovde Group - Analyst

Okay. That's a little shorter duration than maybe I would have thought on that fixed piece. Okay. And then I wanted to ask, I think relative to some peers, your growth is going to continue to maybe stay at a higher level than some of the industry.

And I wanted just to hear do you think half of the growth next year might just -- I know you haven't given guidance on that, and maybe this is tough to answer, but when we think about the next year or so, is the growth next year, do you think it will be a majority in Texas? Or can you give us any color on how you think about the loan growth outlook? And if Texas kind of drives that more so than Louisiana?

David Melville Business First Bancshares - President and CEO

Yes. Well, we've been -- in the past two or three quarters, we've been at about 65%, 60% to 70% kind of one in the range or the other. And in terms of loan production in Texas versus Louisiana, even though we believe that our overall growth rate will slow to mid-teens level, I would expect that those percentages would still be about that. So I would assume that 60% to -- 60% to 2/3 of the loan growth would probably continue to come from Houston and Dallas.

And the other thing that's important to note is not just Texas in general. It's those 2 primary and major markets. If we are able to add a bank to quarter and most of those come from those 2 markets, then certainly possible that, that could -- that percentage could go up a little bit. We do think that there is some disruption out there in the market, not -- certainly plenty of Houston and Dallas. But also with the Iberia and First Horizon, TD Bank trading closing, it sounds like sooner rather than later that, that might provide some opportunities for us to pick up a handful of experienced quality commercial bankers in South Louisiana as well.

So -- and regardless of the bankers, I think there will be opportunity for clients in our markets. So I'm not down about the opportunity in Louisiana. But I still think the majority of the growth in the loan book will come from Dallas and Houston. Probably, I think that's 2/3. It's probably a pretty good -- 68% to 70%, it's probably a pretty good estimate.

Brett Rabatin Hovde Group - Analyst

Okay. So that continues. Okay. That's great color, Jude. And then just lastly for me, I just wanted to -- you got on Slide 23. So we got -- I guess, I would call it the time slide with the industries that have been similar question in the past 2 years, hotels, hospitality, retail. Are there any loan segments that maybe you're trying to deemphasize or you're not interested in growing construction? Is there anything that you guys are steering away from this environment?

David Melville Business First Bancshares - President and CEO

Yes. I wouldn't -- we're trying to bank good clients. And so -- and we're pretty balanced in our exposures and have had a good track record even through the pandemic that is not losing a lot of money in those areas. So -- an area per se that we're stepping out of. As you know, over the years, we've worked to decrease our percentage exposure of the portfolio in energy. We've continued to add good clients where we've had the opportunity, but we're down to 4.2%. I would expect that, that would continue to trend down more over the next couple of years into the 2% to 3% range. Again, not turning down business, but I think the other areas of our portfolio will probably grow faster.

I will say for C&D, in the third quarter, even though we had the 30% annualized loan growth, our actual dollars of exposure to C&D actually went down a little bit. So -- and I think that that's not going to be an area of growth for us necessarily. And -- continue to go down in terms of actual dollars. But if you had to pick another sector that we wanted to maybe have a lower percent of the portfolio as a whole and probably being C&D.

I will always do point out, though, with the C&D, A lot of that is in Dallas. And we think that even if recession occurs next year, that the reasons that the market has been strong in Dallas, could continue. As you think about the main driver being in migration. We certainly haven't heard of any slowdown in migration rate from our bankers that are on the ground. And I think you could probably make the argument that the country is in a recession that it might even make balance at a more attractive place for certain people to be.

So we do feel good about where most of our exposure is either in Dallas or some long, long time clients in Louisiana as well. So we feel pretty good about C&D, but we also want to make sure that as we continue to grow, we grow in a balanced way. Greg, do you have anything -- or Phil, do you have anything you want to add to that?

Gregory Robertson Business First Bancshares - Chief Financial Officer

Nothing.

Operator

We have a follow-up from Matt Olney with Stephens. .

Matt Olney Stephens - Analyst

I say the only real pushback I heard from investors following the capital raise a few weeks ago was questioning did the bank raise enough capital, especially given the strong loan growth pipelines that you're seeing. So I just want to give you a chance to respond to that. And how did you arrive at how much capital to raise? And it seems like you're getting closer to accreting capital. Just curious kind of how close you think you are at this point?

David Melville Business First Bancshares - President and CEO

Yes. Thanks. It's a balance when you raise capital, particularly in this environment and the pricing that the market is currently at. So we wanted to make sure that while we enhanced our capital position, we didn't do so in a way that was detrimental to the current shareholders. So we felt like if you, given the $50 million that we raised, added to the $72 million that we registered to preferred equity, about a month before that, we felt like increasing our capital base. But roughly 30% was -- made sense for us.

If you take the additional capital and you take our projected earnings over the next couple of years, we feel like it gets us through our five-year plan. And barring some outsized opportunity here or M&A opportunity and at which point we'll discuss at that time, but we do feel like we are on the verge of being able to accrete capital with our increased earnings and our slightly slower growth rate next year.

So I think in the second quarter right now, we have models to begin accreting capital. So -- plan and like that is an appropriate amount of capital for us to raise at the time given where the market is.

Matt Sealy Business First Bancshares - SVP, Director of Corporate Strategy

Yes, Matt. And one other thing that I'll add to that. When we raised the preferred last quarter, we did not push $20 million of that down in the bank. So this is the discrepancy between bank level capital and holdco consolidated capital. It's important to remember that, we kind of left some dry powder at the holdco to service those holdco obligations over the next 6 to 12 months or so. So that's just something to keep in mind as you think about our capital position going forward.

Operator

I'll now turn the call back over to the management team for final remarks.

David Melville Business First Bancshares - President and CEO

Okay. We appreciate your attention and interest and firmly happy to answer follow-up questions down the road if you want to contact us directly. And since Matt brought up capital raise, we want to be sure to think thank everyone on the line that participated in that, either through their roles as analysts or investment bankers or as equity investors. We look forward to giving you a bit of return on it and excited about what the next few quarters will bring. Thank you all, and have a good afternoon.

Operator

This concludes today's conference call. We thank you for your participation. You may now disconnect.