Q4 2019 RBB Bancorp Earnings Call - Final

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Corporate Participants

* David Richard Morris

RBB Bancorp - Executive VP & CFO

* Larry A. Clark

Financial Profiles, Inc. - SVP

* Larsen Lee

Royal Business Bank - Executive VP & Director of Mortgage Lending

* Yee Phong Thian

RBB Bancorp - Chairman, President & CEO

Conference Call Participants

* Aaron James Deer

Piper Sandler & Co., Research Division - MD & Senior Research Analyst

* Kelly Ann Motta

Keefe, Bruyette, & Woods, Inc., Research Division - Associate

* Tyler Stafford

Stephens Inc., Research Division - MD

Presentation

OPERATOR: Good morning, and welcome to the RBB Bancorp Fourth Quarter and Year-end 2019 Earnings Conference Call. My name is Sydney, and I will be your operator today. (Operator Instructions) This call is being recorded and will be available for replay through February 4, 2020, starting this afternoon, approximately 1 hour after the completion of this call.

I would now like to turn the call over to Mr. Larry Clark, Investor Relations for the company. Please go ahead, Mr. Clark.

LARRY A. CLARK, SVP, FINANCIAL PROFILES, INC.: Thank you, Sydney. Good morning, everyone, and thank you for joining us to discuss RBB Bancorp's financial results for the fourth quarter and year ended December 31, 2019. With me today from management are Chairman and President, CEO, Alan Thian; Executive Vice President, Chief Financial Officer, David Morris; EVP and Chief Credit Officer, Jeffrey Yeh; EVP and Chief Risk Officer, Vincent Liu; and EVP and Director of Mortgage Lending, Larsen Lee. Management will provide a brief summary of the results, and then we'll open up the call to your questions.

During the course of this conference call, statements made by management may include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based upon specific assumptions that may or may not prove correct. Forward-looking statements are also subject to known and unknown risks and uncertainties and other factors relating to RBB Bancorp's operations and business environment, all of which are difficult to predict and many of which are beyond the control of the company.

For detailed discussion of these risks and uncertainties, please refer to the required documents the company has filed with the SEC. If any of these uncertainties materialize or any of these assumptions prove incorrect, RBB Bancorp's results could differ materially from its expectations as set forth in these statements. The company assumes no obligation to update such forward-looking statements unless required by law.

At this time, I'd like to turn the call over to Alan Thian. Alan?

YEE PHONG THIAN, CHAIRMAN, PRESIDENT & CEO, RBB BANCORP: Thank you, Larry. Good morning, everyone, and thank you for joining us today. I will start by discussing our full year accomplishments at a high level, and then David will provide more details on our fourth quarter financial results.

We are very pleased with our financial performance for the year as we generated the highest level of net income in the history of the company. Our positive results were driven by strong revenue growth due to both record net interest and noninterest income, well-managed expenses and disciplined balance sheet management. We also continued to execute well on our strategic goals by growing our franchise organically within our existing markets and by entering the attractive Chicago market through the acquisition of Pacific Global Bank, which we closed earlier this month.

We want to welcome Pacific Global Bank's customer and employees to RBB Bancorp. Pacific Global is an excellent culture fit with RBB as we have similar business models, strong residential mortgage loan productions platforms and a focus on the Chinese-American market. We are excited to be entering the Chicago market and plan to open 2 new branches in that market in the next 2 years. As we began 2019, we viewed it as a rebalancing year, being focused on reducing the size of our portfolio of loans held for sale, completing the integration of First American International and continuing to invest in our business to diversify our revenue mix and provide a foundation for improved returns for our shareholders.

During the year, we successfully completed the integration of First American, and we are now reaping the benefits on both sides of the balance sheet. We realized efficiencies that resulted in reduced expenses, and we will continue to optimize the operational footprint. And we are also making good progress on producing our business deposit and commercial lending products to the New York markets network and expect future growth from that group.

We also have completed the balance sheet repositioning that we began at the beginning of the year. Our loan growth has resumed as we are generating strong production in both residential and commercial real estate. We were also successful in working down the total balance of loans held for sale over the course of the year as we sold over $500 million residential mortgages and decided to retain some on our balance sheet. Finally, our focus on increasing core deposits has helped drive deposit growth and reduce our reliance on wholesale funding.

Our net interest margin was negatively impacted during the year due to a number of factors. First, we have a challenging yield curve early in the year. Second, we also carried excess liquidity on our balance sheet during the second half of the year. Third, we saw pressures on our cost of funds due to a shift in mix from savings and money market accounts to higher-yielding CDs. And finally, the lending environment has remained very competitive, making it challenging to increase our rate, more so as rate came down in the later part of the year. Even with all of the moving parts during the year, 2019 was a solid year for RBB. In addition to our record net income and strong revenue growth, we grew our tangible book value by 11% and generated an attractive return on average tangible common equity of 11.9%.

Our capital levels improved significantly and are at the higher end of banks with assets between $1 billion to $5 billion. Our asset quality remains solid as we continue to maintain our underwriting discipline and strong credit culture despite the competitive lending environment. Since we went public in 2017, we have more than doubled the size of RBB and built a strong business model centered around core community banking. We now have a strong presence in the largest Asian-American markets in 3 of the top major metro areas in the country, which positions us well for future growth and attractive long-term returns for our shareholders.

I will now turn it over to David for more detail on our fourth quarter results. David?

DAVID RICHARD MORRIS, EXECUTIVE VP & CFO, RBB BANCORP: Thank you, Alan. We have provided a great level of detail in our press release. So I'm going to focus on those items where some additional discussion is warranted.

I'll start with our loan activity as there were a lot of moving pieces this quarter. Our total loans were down $80 million during the quarter, but this was primarily driven by a [$151] (corrected by the company after the call) million decline in mortgage loans held for sale as we sold $162 million in the secondary market and transferred approximately $100 million into held for investment portfolio as part of our ongoing balance sheet strategy. Combined with total new production and after netting out payoffs and paydowns, our loans held for investments increased by $71 million for the third quarter.

We experienced healthy new production in both residential and commercial real estate, and our payoffs and paydowns were down quarter-over-quarter. For the quarter, total loan production was $192 million, loan payoffs and paydowns were $123 million. Looking ahead, we expect our total loans held for investments to grow between 8% and 10% for the year with some variability quarter-to-quarter depending on production and payoffs.

Now turning to deposits. While total deposits were relatively flat from the third quarter, our nonmaturity deposits increased $56 million, including a $13 million increase in checking accounts as our deposit gathering efforts have continued to gain traction. Offsetting this increase was a $59 million decrease in CDs, including a $35 million reduction in brokered CDs. Our strong growth in core deposits has set a good foundation for future loan growth. However, typically, we see a runoff in our nonmaturity deposits during the first quarter every year.

Our average cost of interest-bearing deposits was down 9 basis points in the quarter. We experienced lower costs on both our nonmaturity deposits and our CDs given the lower interest rate environment, and we also benefited from a shift in the mix of deposits towards a higher percent of nonmaturity deposits, which pay lower rates than our time deposits. Going forward, we expect the cost of our deposits to be modestly down as the gap between the rates that we pay on new CDs and rates we pay on maturing CDs continues to work in our favor.

Moving on to the net interest margin. On both a reported basis and adjusted for purchase discount accretion, NIM decreased by 12 basis points from the previous quarter. Our NIM was negatively impacted by a 17 basis point decrease in our loan yields, only being partially offset by a 9 basis point decline in total deposit costs as well as temporary excess liquidity we had due to the timing of loan sales and our strong deposit gathering efforts.

Our lower loan yields were due to the fourth quarter drop in short-term rates, but also due to a very competitive lending environment, particularly in the area of commercial real estate. However, commercial loans still come on the books at higher rates than our residential mortgages, so as we grow the book of business, it should help lift the overall average yields. Given that, we are deploying our excess liquidity and we anticipate a modest reduction in cost of funds. However, we are in a very competitive lending environment. We still expect pressure on our commercial loan yields. Therefore, we expect that our net interest margin will be relatively stable.

Turning to noninterest income. As expected, we generated higher gain on sale income due to the resumption of our loan sales during the quarter. As mentioned, we sold $162 million of residential mortgages consisting of $61 million Fannie Mae direct and indirect mortgages and $100 million mortgages to private investors. Going forward, we expect to sell between $125 million and $150 million of residential mortgages per quarter in 2020, again, subject to variability from quarter-to-quarter depending on market conditions and our production levels.

Our total noninterest expense was down modestly from the third quarter. We experienced higher marketing and business expense in addition to higher OREO expenses and slightly higher merger expenses. These increases were mostly offset by lower legal and professional expenses and data processing costs as we realize a full quarter benefit from our New York integration. We expect that our noninterest expense will increase in the first quarter due to higher merger expenses, the addition of Pacific Global and the nonseasonal and the normal seasonal uptick in employee costs.

Controlling our costs remain a key focus, so we expect most other expenses to remain stable for the first quarter. Starting in the second quarter, we expect to begin to see the cost savings associated with PGB. In addition, we have already announced the closure of a branch in the New York region and opening a branch in Edison, New Jersey during the second quarter. The net annual savings to us of the closing of the 1 branch and opening of the other branch is approximately $800,000.

Shifting to income taxes. Our effective tax rate for the quarter was 28%. There was no impact from the exercise of stock options during the quarter. We anticipate an effective tax rate of between 30% and 32% for the full year 2020 and between 29% and 31% for the first quarter, excluding the impact of stock option activity that we may experience from quarter-to-quarter. Our asset quality remains strong. That being said, our nonperforming loans increased by $3.6 million during the quarter as we placed 3 SBA loans and 1 mortgage loan on nonaccrual status at the end of the quarter.

The 3 SBA loans totaled $5.1 million and are secured by $6.5 million in real estate collateral, and $3.9 million of the $5.1 million SBA loans are guaranteed. However, the liquidation value on 1 of the SBA loans is lower than the book value and being conservative resulted in approximately a $450,000 write-off. The $440,000 mortgage loan has more than sufficient collateral value, so we don't believe that any impairment exists. These increases are partially offset by a $1 million commercial real estate loan payoffs and $974,000 decrease in other real estate owned.

During the quarter, we had $1.2 million in net charge-offs related to the hotel loans mentioned last quarter and the $450,000 I just talked about. Our provision for loan losses was $659,000 for the fourth quarter, down from $824,000 for the third quarter. The decrease was mostly due to slightly higher provision in the third quarter due to some specific reserves taken in the SBA portfolio. This brought our allowance for loan losses down slightly to 86 basis points of total loans held for investment from 91 basis points at the end of the third quarter. We are not seeing any system-wide asset quality deterioration, and we continue to maintain a very strong credit quality culture and will remain vigilant on asset quality.

With respect to capital, our capital levels remain strong. Our tangible capital equity to tangible assets increased to 12.59% at the end of the quarter, up from 12.12% at the end of September and 10.61% at the end of last year. We believe that we have ample equity capital to support forecasted growth.

With that, we are happy to take any questions. Operator, please open up the call.

Questions and Answers

OPERATOR: (Operator Instructions) And our first question comes from Aaron Deer with Piper Sandler.

AARON JAMES DEER, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: I guess I'd like to start on the margin because your guidance for stability at this point seems to me anyway fairly conservative given the opportunity to lower deposit costs from what still seems to be a fairly high level as well as get deployed, I'm guessing, somewhere around $100 million of excess liquidity. So can you talk about what -- just how pervasive these pressures are on the asset side? You mentioned commercial real estate that cause you to not be a little bit more optimistic on your margin outlook.

DAVID RICHARD MORRIS: Okay. Let me start with that. On -- we continue to see the 10-year treasury in about the 1.65% level right now. And in the commercial real estate arena, we are seeing our competitors in the low 4s and even in the 3s, okay, high 3s on commercial real estate, including multi-family is all in the high 3s, but including regular old commercial real estate type of loans. We were at the 4.50%. 4.50%, 4.75% to 5% is where we would like to price those, but we're seeing extreme pressure to be closer to 4%, okay? We do have significant amount of CDs that we'll reprice, but we're still -- in our market for large customers, we're still seeing around a 1.70% rate, so -- in all. But we'll see that repricing from probably a 2.40% down to a 1.70-ish over the next quarter. The question is how much of the -- what portion of our loans that we have to do sub 4.5%.

AARON JAMES DEER: Okay. I guess -- and maybe just helping to expand on that. Your cost of deposits was 1.55% all-in in the quarter. Do you have what that number was at year-end? Just trying to gauge what the pace of decline is or maybe...

DAVID RICHARD MORRIS: You mean as of December

AARON JAMES DEER: Yes, yes, exactly.

DAVID RICHARD MORRIS: For the month, I don't have it right here because we have all quarterly data, but I can get up to you.

AARON JAMES DEER: Okay. Yes, we can follow-up on that.

DAVID RICHARD MORRIS: But I definitely have it.

AARON JAMES DEER: Sure. And then just to clarify because the drop in your data processing was pretty sharp in the quarter. It sounds like that was still related to the First American saves, maybe a systems payment that's no longer needed.

DAVID RICHARD MORRIS: Okay. What happened -- yes, that is still First American.

AARON JAMES DEER: Okay. So I was just trying to think about building off of the fourth quarter run rate with the new deal coming in. It looks like you're probably setting up for a run rate starting in the first quarter somewhere a little north of $15 million with the seasonal compensation cost. Does that sound about right, little north of $15 million on a quarterly basis?

DAVID RICHARD MORRIS: Yes. Let me look. Yes, that should be fine. Yes.

AARON JAMES DEER: Okay. Okay. And then, lastly, I might have missed this in your opening comments. Did you give guidance with respect to expected volumes of loan sales through the year?

DAVID RICHARD MORRIS: Yes. On -- I've said in the -- earlier I said between $125 million and $150 million in mortgages, and -- per quarter. Per quarter, okay.

AARON JAMES DEER: And any sense in terms of what the mix would be for Fannie Mae versus to private investors?

DAVID RICHARD MORRIS: I think we will -- yes, it will be similar to this year. Our Fannie Mae -- I would say it's always been approximately 1/3 Fannie Mae, 2/3 other. But it will be around that. But every quarter, it's going to be a little bit different. It fluctuates.

OPERATOR: And our next question comes from Kelly Motta with KBW.

KELLY ANN MOTTA, ASSOCIATE, KEEFE, BRUYETTE, & WOODS, INC., RESEARCH DIVISION: I guess, I would start with kind of the loan sales as well and the move you've had to held for investment. It seems that your loans held this quarter came in a little bit below what you had expected for fourth quarter. I was just kind of wondering about the decision process there and kind of why you did that.

YEE PHONG THIAN: Maybe we should refer to Larsen.

LARSEN LEE, EXECUTIVE VP & DIRECTOR OF MORTGAGE LENDING, ROYAL BUSINESS BANK: Okay. We were scheduled to sell $200 million. We just ran out of time. We closed another $40 million in January. Because of the merger with the Chicago, we just couldn't close another batch in December and got delayed.

KELLY ANN MOTTA: So was there no option to sell in January? Just...

DAVID RICHARD MORRIS: It sold in January, but we can't recognize that income in December. Also, I think when you look at...

KELLY ANN MOTTA: Right, but can you move it from held to sale from -- to held for investment? I'm just curious.

DAVID RICHARD MORRIS: Not those loans that we sold. And just so -- Kelly, just so that everybody on the phone understands this. We will sell out of either bucket, okay? It all comes back down to what the investor wants. But we have a certain criteria. We're guided by FASB, and loans held for sale have to meet a certain criteria, and those get moved after they leave that criteria, okay?

KELLY ANN MOTTA: Okay. That's helpful. I'm wondering is that $125 million to $150 million guidance includes what you expect PGB to produce or if that could be any incremental positive to...

DAVID RICHARD MORRIS: Right now -- we didn't even include that, and we don't even expect to sell any of those right at the moment until we finish the conversion process. And I don't expect anything to really come on our books that is our product until the third quarter or late -- or possibly even the fourth quarter. Also, one thing I do want to point out is that when we look at the staffing of our group and the originations process and so forth, right now, our capacity to sell is probably maxed out at the most, probably $175 million a quarter, okay. So that's a throughput type of item. We only have x number of staff, and that's about all we can get through the pipe, at the same time originating $150 million, $160 million, $170 million in the same quarter.

KELLY ANN MOTTA: Okay. And then just, lastly, and then I'll step back. What is your outlook for SBA sales for next year?

DAVID RICHARD MORRIS: We're hoping to be able to sell between $6 million and $8 million every quarter, okay?

OPERATOR: And our next question comes from Tyler Stafford with Stephens.

TYLER STAFFORD, MD, STEPHENS INC., RESEARCH DIVISION: I wanted to just clarify on the margin outlook, the comment about relatively stable. Does that include the impact from Pacific Global? And then can you just clarify if that is referring to the core margin or the GAAP margin?

DAVID RICHARD MORRIS: I'm referring to the core margin, okay. And I also believe with -- Pacific Global has a slightly lower NIM than we have, and they will put pressure on our NIM. But at the same time, they're going through the same type of scenarios we are that their CDs are going to be repriced lower and so forth. And we probably have 2 more quarters of repricing CDs, so -- the first quarter and the second quarter. So they're going through the same things that we are going through right now, okay?

TYLER STAFFORD: Yes. Okay. And so can you give us a sense of how much of your CDs should mature in the next quarter or 2? I guess I agree with the earlier question that the stable outlook with, I think, a high degree of CDs that are repricing, 50 basis points lower to that 1.70, I would have thought it would give in a little bit more lift to the margin.

DAVID RICHARD MORRIS: Okay. Let me tell you that right now, we believe that there are -- in the Los Angeles region, we have $235 million of CDs repricing. And in New York, we have $85.5 million. I don't have the data for Chicago yet since we're not on the same systems. And they're on our systems right now at -- both of them are on our systems at about a 2.35% rate, and they should be repricing down to the 1.70s-something like that rate, okay.

TYLER STAFFORD: Okay. Very clear. And then just on the -- going back to the mortgage expectations for the sales for 2020. What would you expect from a gain on sale margin that you're kind of factoring in? It's been bouncing around a little bit the last couple of quarters, so just trying to figure out what you're expecting there.

DAVID RICHARD MORRIS: I'm looking at 1.25% net to the bottom line, okay?

TYLER STAFFORD: Okay. And does that compare roughly to a 2.2% margin in the fourth quarter?

DAVID RICHARD MORRIS: That would -- yes, it's 2.2%, to the bottom line is -- after you take all the cost down and everything, it's probably 2.25%. So in the 2.25% to 2.50% after you take all the cost out, okay?

TYLER STAFFORD: Okay. So then not much change to what you've seen in the fourth quarter, for example?

DAVID RICHARD MORRIS: No. We're not seeing much change.

OPERATOR: (Operator Instructions) And our next question comes from Kelly Motta with KBW.

KELLY ANN MOTTA: You may have said this, but I just wanted to clarify. Talking about excess liquidity, what kind of a normal level of cash for you to operate at?

DAVID RICHARD MORRIS: Well, we like to operate only about at $50 million. Our regulators have liked us to operate at $100 million, okay? So we really -- on cash, cash -- cash at the Federal Reserve Bank, we really only need about $50 million to operate this thing. We don't have huge swings typically on a day-to-day basis and so forth, okay? But...

KELLY ANN MOTTA: Compared to that, like $172 million average Fed fund sales that you had this quarter, is that like close to $100 million is normal is what I'm hearing?

DAVID RICHARD MORRIS: Yes, closer to $100 million is normal, okay?

KELLY ANN MOTTA: Great. And lastly, I was hoping you could talk a little bit about resi mortgage and any changes in competition you're seeing there and where you're pricing the products now.

DAVID RICHARD MORRIS: You can talk about that.

LARSEN LEE: No. I didn't get the question. Can you repeat the question, please?

KELLY ANN MOTTA: Just on resi mortgage, wondering any changes on competition, if it's heating up at all? And also where you are in pricing the product now?

LARSEN LEE: Well, there's -- actually, one of the major competition in Southern California exited. So we do expect a boost in our production. We just opened up the Chicago market. I do expect volume to increase steadily. New York has been stabilizing. So just overall, I think we're -- I like where we stand in 2020. I think we're going to be doing probably a lot more than year 2019.

DAVID RICHARD MORRIS: About rate.

LARSEN LEE: Rate is going to be remain -- it changes. Based upon treasury movement, we try to change our rate. The treasury has gone down almost 25 bps in last 10 days. We are not looking to lower our rate. I think our rate is good where it is. But if we continue to downtrend on the TNX we may look down to lower the rate -- base rate to 4.5%.

OPERATOR: And I'm not showing any further questions at this time. I will now turn the call to Mr. Thian for any further remarks.

YEE PHONG THIAN: Once again, thank you all for joining us today. We look forward to speaking with you next quarter. Thank you, again.

OPERATOR: Ladies and gentlemen, this concludes today's conference. Thank you for participating. You may now disconnect.

Load-Date: February 3, 2020