Five Star Bancorp

2023 Year-End and Fourth Quarter Earnings Results

January 30, 2024, at 1:00 p.m. Eastern

CORPORATE PARTICIPANTS

James Beckwith – *President and Chief Executive Officer*

Heather Luck – *Senior Vice President and Chief Financial Officer*

PRESENTATION

Operator
Welcome to the Five Star Bancorp Fourth Quarter and Year-End Earnings Webcast. Please note, this is a closed conference call, and you are encouraged to listen via the webcast. After today's presentation, there will be an opportunity for those provided with a dial-in number to ask questions. To ask a question, you may press star then one on your telephone key pad. To withdraw your question, please press star then two.

Before we get started, let me remind you that today's meeting will include some forward-looking statements within the meaning of applicable securities laws. These forward-looking statements relate to, among other things, current plans, expectations, events and industry trends that may affect the company's future operating results and financial position. Such statements involve risks and uncertainties, and future activities and results may differ materially from these expectations. For a more complete discussion of the risks and uncertainties that may cause actual results to differ materially from the company's forward-looking statements, please see the company's annual report on Form 10-K for the year ended December 31, 2022, and quarterly report on Form 10-Q for the quarter ended September 30, 2023, and in particular, the information set forth in Item 1A, Risk Factors, in those reports.

Please refer to Slide 2 of the presentation, which includes disclaimers regarding forward-looking statements, industry data and non-GAAP financial information included in this presentation. Reconciliations of non-GAAP financial measures to their most directly comparable GAAP figures are included in the appendix to the presentation. Please note, this event is being recorded.

I would now like to turn the conference over to James Beckwith, Five Star Bancorp President and CEO. Please go ahead.

James Beckwith
Thank you for joining us to review Five Star Bancorp's Financial Results for the Fourth Quarter and the Year Ended December 31, 2023. Joining me today is Heather Luck, Senior Vice President and Chief Financial Officer.

Our comments today will refer to the financial information that was included in the earnings announcement released yesterday. To obtain a copy of the release, please visit our website at fivestarbank.com and click on the Investor Relations tab.

During the 3 months ended December 31, 2023, our return on average assets and return on average equity were 1.26% and 15.45%, respectively, positioning us to remain near the top of our peer group. During the year ended December 31, 2023, our return on average assets and return on average equity were 1.44% and 17.85%, respectively.

Our organic growth story continued during 2023 with the addition of 10 seasoned professionals to support our expansion into the San Francisco Bay Area market. We also continued to add new deposit accounts and relationships as seen in the growth of non-broker deposits of $269.8 million during the year ended December 31, 2023.

Despite expected headwinds on the horizon, our ability to conservatively underwrite and manage expenses with our 44% efficiency ratio and deliver value to our shareholders with our $0.20 per share dividend continue. We believe we are well positioned to continue to endure and succeed as conditions change.

The fourth quarter of 2023 exhibited continued execution of our growth strategy, as evidenced by our earnings, expense management and balance sheet trends during the quarter. Additionally, loans and total assets have consistently grown since prior periods, while deposits have decreased slightly. Our pipeline continues to remain solid at the end of 2023 within verticals we have historically operated in, as presented in the portfolio diversification slide.

Loans held for investment increased during the quarter by $71.8 million or 2.39% from the prior quarter and increased by $290.4 million or 10.40% year-over-year, primarily within the commercial real estate concentration of the loan portfolio. Loan originations during the quarter were approximately $144.1 million and payoffs were $72.3 million. During 2023, loan originations were approximately $668.2 million, and payoffs were $377.8 million.

Asset quality continues to remain strong. Though nonperforming loans have increased over the last several quarters as a result of financial challenges experienced by a small subset of our borrowers, they represent only 0.06% of the portfolio.

As of December 31, 2023, the allowance for credit losses totaled $34.4 million. We recorded a $0.8 million provision for credit losses during the fourth quarter, primarily related to loan growth, for a total provision for credit losses of $4 million for the year ended December 31, 2023. The ratio of the allowance for credit losses to total loans held for investment was 1.12% at year-end. Loans designated as substandard totaled approximately $2 million at the end of 2023, representing an increase of approximately $1.5 million from the previous year-end, while remaining consistent with the prior quarter.

During the fourth quarter, deposits decreased slightly by $5.3 million or 0.18% as compared to the previous quarter. During 2023, deposits increased by $244.9 million or 8.8% since the end of 2022. $208.8 million of this increase related to money market accounts. Noninterest-bearing deposits as a percent of total deposits, at the end of the fourth quarter, remained stable at 27.5% as compared to the end of the previous quarter and decreased from 34.9% at the end of the previous year.

We'll offer more detail on our deposit composition. I want to highlight that deposit relationships totaling at least $5 million constitute approximately 62% of our deposits— of our total deposits. The average age on these accounts was approximately nine years. Local agency depositors accounted for approximately 27% of our deposits as of December 31, 2023.

As noted earlier, we are pleased that we've had net deposit inflows for the year ended December 31, 2023. Our ability to grow deposit accounts supports our differentiated customer centric model that our customers trust and value. As seen through the mix of high dollar accounts and the duration of certain customer relationships, we believe we have a reliable core deposit base.

Overall, deposit balances have decreased slightly when compared to the prior quarter. Noninterest-bearing deposits decreased by $2.3 million, while interest-bearing deposits decreased by $3.0 million quarter-over-quarter. Cost of total deposits was 239 basis points during the fourth quarter and 197 basis points during 2023 overall.

We continue to be well-capitalized, with all capital ratios well above regulatory thresholds for the quarter and the year. Our common equity Tier 1 ratio remained constant at 9.07% between September 30, 2023, and December 31, 2023.

On Friday, January 19th, we announced a declaration by our board of a cash dividend of $0.20 per share on the company's voting common stock, expected to be paid on February 12, 2024, to shareholders of record as of February 5, 2024.

On that note, I will hand it over to Heather to discuss the results of operations. Heather?

Heather Luck
Thank you, James, and hello, everyone. Net income for the quarter was $10.8 million. Return on average assets was 1.26% and return on average equity was 15.45%. Net income for the year was $47.7 million. Return on average assets was 1.44% and return on average equity was 17.85%.

Average loan yield for the quarter was 5.64%, representing an increase of 7 basis points over the prior quarter. Average yield on loans for 2023 was 5.52%, representing an increase of 77 basis points over 2022.

Our net interest margin was 3.19% for the quarter, while net interest margin for the prior quarter was 3.31%. Our net interest margin was 3.42% for the year, while net interest margin for the prior year was 3.75%.

Fed rate increases in 2023 continued to put pressure on deposit costs. As a result of changes in interest rates and other factors, our other comprehensive income was $4.2 million as unrealized losses, net of tax effect, decreased on available-for-sale debt securities from $15.9 million as of September 30, 2023, to $11.8 million as of December 31, 2023.

Noninterest income increased to $1.9 million in the fourth quarter from $1.4 million in the previous quarter, due primarily to gains from distributions on investments and venture-backed funds and the recognition of swap referral fees during the quarter. Noninterest income increased to $7.5 million in 2023 from $7.2 million in 2022, due primarily to gains from distributions on investments in venture-backed funds during the year.

Noninterest expense increased to $12.7 million in the fourth quarter from $12 million in the previous quarter, primarily due to increased salaries, employee benefits, advertising, promotional and other operating expenses related to the company's expansion into the San Francisco Bay area.

Noninterest expense increased from $40.7 million in 2022 to $47.8 million in 2023, driven primarily by a $1.2 million increase in salaries and employee benefits related to the expansion into the Bay, a $2.7 million decline in loan origination costs, a $0.7 million increase in FDIC insurance assessments and an overall increase in expenses incurred to support a larger customer base as the leading drivers of this increase.

Now that we've discussed the overall results of operations, I'll now hand it back to James to provide some closing remarks.

James Beckwith
Thank you, Heather. I want to thank everyone for joining us as we discuss fourth quarter and year-end results. Five Star Bank has a reputation built on trust, speed to serve and certainty of execution, which supports our clients' success. Our financial performance is the result of a truly differentiated customer experience, which continues to power the demand for Five Star Bank's relationship-based services.

We attribute sustained success to our prudent business model and treating customers with an empathetic spirit, understanding and care. We are very proud to have earned the trust of those we serve, including our shareholders.

Looking to 2024, we will be guided by a continued focus on shareholder value. As we monitor market conditions, we are confident in the company's resilience in any environment and remain focused on the future and our long-term strategy. We will continue to execute our organic growth and disciplined business practices, which we believe will benefit our customers, employees, community and shareholders.

We appreciate your time today. That concludes today's presentation. Now, Heather and I will be happy to take any questions that you might have.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster.

Our first question today comes from Woody Lay with KBW. Please go ahead.

Woody Lay
Hey. Good morning, guys.

James Beckwith
Hey, Woody.

Heather Luck
Hi, Woody.

Woody Lay
I wanted to just start out on the margin. I was wondering if you had any expectations for the outlook over the next couple of quarters, just assuming that if rates stayed stable from here.

James Beckwith
Sure. We do have expectations. So, we think that Q1 will probably be the bottom of our margin, if you were going to graph this out. So, we're expecting our margin to be anywhere between 3.15% and 3.20% for the quarter. If rates don't change, Woody, I think we might see an increase in our margin as we continue to execute in our growth strategy and grow more core deposits, but I think that's kind of what we're thinking right now, and we'll see how the first quarter ends up.

Having said that, if we've got any movement, which I think certainly the market expects to have some rate cuts this year. The timing is still up in the air a little bit when the first one is going to occur, but if that happens and we are slightly liability sensitive. So, we expect a decent benefit to happen with the Fed moving in and we will be aggressive on moving rates down. I think sometimes it happens in the industry, is that banks are not aggressive and mindful in a declining rate environment. We do not expect to be that way.

Woody Lay
Got it. That's super helpful color. Maybe shifting over to loan growth. It was another steady quarter of growth. As we look into 2024 and you look at your pipeline, does it feel like the high single-digit range is still the right target for you all?

James Beckwith

Yes, we're expecting an 8% loan growth and a 10% deposit growth as we move into 2024, which has kind of been our mantra for the last four quarters, right? I think we achieved— loan growth was probably a little higher than 8%. I think we went— were over 10% and deposit growth was about 9% in 2023. So, we'd like to see a 10% deposit growth and an 8% loan growth. We think we're fully capable and fully able of doing that given our business development activities.

Woody Lay
Yes. Would you expect the manufactured home community segment would drive a majority of that growth?

James Beckwith
I would expect they'll continue to do what they've done in the past, in 2023. So, I would probably think anywhere between 30% to 40% of our loan growth is going to come from that space— from that particular vertical, which, by the way, we include RV in that— RV parks and also storage. But that's what we're thinking.

Woody Lay
Got it. All right. That's all for me. Thanks for taking my questions.

James Beckwith
Thanks, Woody.

Operator
The next question comes from Andrew Terrell with Stephens. Please go ahead.

Andrew Terrell
Hey, good morning.

James Beckwith
Hey, good morning, Andrew.

Heather Luck
Hi, Andrew.

Andrew Terrell
Maybe if I could start on the deposit base. I mean, it was really good to see the kind of, I'd call them, flat noninterest-bearing deposits this quarter. I know it sounds like a lot of California banks faced some headwinds on the NIBs from tax payments this quarter. So, on a relative basis, the strength is impressive. I'm just curious if you could quantify maybe the seasonal or tax-related headwind that you guys faced during the fourth quarter. Just trying to get a sense of like the underlying kind of new growth that you saw that was able to offset potentially the headwind.

James Beckwith
Yes. There was a couple of factors that happened, especially in the last part of December, frankly. A lot of bonus payments and a lot of our professional service firms were bonusing out their top employees. So, we saw some decline in some balances from that. Also, in California, most of the counties were on the deferral given the atmospheric rain that we had in January. We were declared, I guess, a Disaster County. I know Sacramento was. So that allowed a lot of the counties and the businesses that reside in those counties and the individuals to not have to make their final payments until October 15th. So that did have an impact.

That was offset by, I think, some pretty strong activity that we saw from our San Francisco folks and then also other activity that we saw in our operations out here in the capital region. So, net-net, when you all roll that all together we're ever so slight decline. I think it was— a lot of effort to get to that, too.

Andrew Terrell
Yes. Okay. I appreciate it. Heather, do you have the spot costs on either the interest-bearing or the total deposits as of 12/31?

Heather Luck
Yes. So total— the spot rate was 2.48 at year-end.

Andrew Terrell
Okay. Thank you for that. Then, James, if I could get maybe your thoughts on, you've done a really impressive job on the new hire front, particularly in the back half of 2023. I know it's been your mantra for a long time here. Just as you look into 2024, do you see any incremental talent additions on the horizon? I know there was a deal may be announced in your neck of the woods earlier today. Any opportunities you see coming out of that?

James Beckwith
Well, we certainly know the folks from California Bank of Commerce that operate within the capital region pretty well, actually. Most of them kind of came out of the Wells Fargo operations here. Some good small to medium-sized professionals. I mean, they focus on that C&I. There's some good talent there.

Time will tell. I haven't talked to any of them yet, but plan to do so. Yes. We continue to be opportunistic. I mean, there is some talent there, but there's also talent down in the Bay Area, too, that we're continued excited about in terms of growing out what we're doing down there. So, I would expect some additional business development hires to happen in the first half of the year of 2024. I mean we are planning on that. So, to answer your question, we're going to bring some more firepower to bear in the markets we serve.

Andrew Terrell
Good deal. Do you have a target in mind of what you would kind of target in terms of new hires in the first half or for the year?

James Beckwith
I think we're probably going to add two to four new biz dev people, as we sit here today, end of January. We certainly pivoted in 2023 in terms of being opportunistic about hiring talent. I think as the year goes and transactions happen, we could— we want to continue to be opportunistic, but as we sit here today, I think that's a good number, two to four folks.

Andrew Terrell
Yes. Okay. And then maybe last one for me for Heather. Just I mean, kind of throughout this year, you've done a really good job managing the expense base. Just as you look into 2024, any thoughts on expense run rate into next year and then overall kind of expense growth you'd be looking out for '24?

Heather Luck
Yes. So, we— thank you for that. We definitely pride ourselves on managing expenses and being mindful there. If you look at 2024, really looking at Q1, you could add about $250,000 to what we had rolling in from Q4. I think that's probably a good proxy for where we'll start to shake out. We will see a little bit of a creep the second half of the year once we have rent expense flowing through in the Bay from the new location there, but I think if you add about $250,000 to $500,000 for the first half of the year, you should

be okay.

Andrew Terrell
Okay. Very good. I appreciate it. Thank you, guys, for taking the questions.

James Beckwith
Thank you, Andrew.

Operator
Again, if you have a question, please press star then one.

The next question is from Gary Tenner with D.A. Davidson. Please go ahead.

Gary Tenner
Thanks. Good morning.

James Beckwith
Hey, good morning, Gary.

Gary Tenner
Going back to the Bay Area team. They've been on board for, call it, two quarters and something over $70 million of deposits, I think, in the door. Where does that seem relative to kind of the year one expectations that you had in mind for them? And maybe beyond that, can you talk about just the deposit trends outside that team?

James Beckwith
Sure. It was 2x from what we thought we would be. So, they really performed well. And it was— it's great working with them. We spent a lot of time down there and helping them onboard their customers and their relationships. So, we expect that to continue to grow, maybe at that similar level. So, as we look at 12/31/2024, we hope that we'd be able to double the deposit base down there from where it ended up at 12/31/2023.

In terms of growth outside of the Bay Area, we're excited about what we're doing in all of our verticals, and we're off to a pretty good start. So, I think it's going to be very supportive of our target of 10% deposit growth. So that's kind of where we stand on that. I think we're starting to really execute in our Special District business, which excited about that. And in our professional services nonprofit business, I think, is doing well. And just our basic C&I business and especially in our construction industry business, we're seeing some decent deposit growth there.

So, I think what they're— across the board, in all of our verticals, they're going to execute with respect to deposit growth. We're still— we're working with our health care practice group. We expect to have a decent win here in Q1, but that particular vertical is something that we want to spend more time on in terms of really getting it going.

Gary Tenner
Thanks. I appreciate that, James. And then just a follow-up. I think in your prepared remarks, I don't remember the exact term— phrase you used, if there was a risk on the horizon or storm clouds on the horizon, but can you talk about kind of your broader view that kind of maybe kind of note that in your prepared remarks and kind of your confidence in the underlying economy in your core markets?

James Beckwith

Well, there is still a fair amount of uncertainty associated with the economy and how it's going to— if there's going to be a soft landing or a recession, mild recession. We just don't know. I think hopefully, as every quarter goes by, we continue to have the type of national GDP that we've seen, without any appreciable increase in unemployment.

In our markets here, in California, they remain strong. We've got a few, I'm going to say, issues with respect to commodity prices as it relates to our ag business, but I think we're working through that. And a lot of our farmers are diversified in terms of the crops that they grow, which is really helpful. So, we don't anticipate any problems there, but I'm just being cautious, Gary, I think, with those statements. You can't pick up a business newspaper without having some article that speaks about rates and recession, and it's just a continual bombardment of data points that affect people's opinions and when the Fed is going to move and when they're not going to move. And it's just— I'd like to see things settle down a bit. We've got a national election that is creating some uncertainty, but you also have some geopolitical events that are happening right now in the world that could be problematic to our economy here. So, I think it's kind of a comprehensive cautiousness, I guess, if you will, given all those facts.

Gary Tenner
Great. Appreciate your thoughts, James.

CONCLUSION

Operator
This concludes our question and answer session. I would like to turn the conference back over to management for any closing remarks.

James Beckwith
Great. Thank you. Five Star Bancorp is on a continued path of growth as we execute on our strategic initiatives, which includes growing our verticals and geographies while attracting and retaining talent. Our people, technology, operating efficiencies, conservative underwriting practices and its expense management have also contributed to the success we share with our employees and shareholders.

These successes include numerous ratings and awards. In 2023, we received a Findley Reports Super Premier Performing Rating and IDC Superior Rating, BauerFinancial Superior Rating, 5 stars out 5. We were also awarded the prestigious 2022 Raymond James Community Bankers Cup, and we are among the 2023 Piper Sandler Sm-All Stars.

In 2023, we were recognized as the 2022 S&P Global Market Intelligence Number 1 Best-Performing Community Bank in the nation. That's with banks with asset size between $3 billion and $10 billion. We were also listed on Independent Banker's Top Commercial Banks in 2023, with banks more than $1 billion in assets and ranked number six in the nation. We were listed among American Bankers Top-Performing Banks in 2023, banks with $2 billion to $10 billion in assets and ranked number 12.

In 2023, our executives and senior leaders were awarded a Sacramento Business Journal C-Suite Award, a Sacramento Bee Latino Change Makers Award, a Commercial Real Estate Women Award, a Comstock Magazine's Women in Leadership Award.

Being recognized as community leaders ensures Five Star Bank remains top of mind in the markets we serve as we continue to build out our verticals. We are humbled and proud of our team's accomplishments. We look forward to speaking with you again in April to discuss earnings for the first quarter of 2024. Have a great day, and thank you for listening.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.