Five Star Bancorp

Third Quarter 2024 Earnings Webcast

Tuesday, October 29, 2024, 1:00 PM ET

CORPORATE PARTICIPANTS

James Beckwith – *President and CEO*

Heather Luck – *SVP and Chief Financial Officer*

PRESENTATION

Operator
Good day, everyone, and welcome to the Five Star Bancorp Third Quarter 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 "*" and then "1" using a telephone keypad. To withdraw your question, you may press "*" and "2".

Before we get started, we would like to 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, 2023, quarterly reports on Form 10-Q for the three months ended March 31, 2024, and June 30, 2024, 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, unaudited financial 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.

At this time, I'd like to turn the presentation 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 third quarter of 2024. 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.

Our organic growth story continued in the third quarter with the successful opening of our whole service office in San Francisco's Financial District on September 3, 2024, allowing us to continue our momentum in the San Francisco Bay Area. We added five more seasoned professionals to support this expansion and also continue to add new core deposit accounts and relationships, as seen in the increase of non-wholesale deposits of $92.9 million, during the three months ended September 30, 2024.

In the third quarter, we maintained our ability to conservatively underwrite, as evidenced by a 50% loan-to-value on commercial real estate, managed expenses with our 43.37% efficiency ratio and deliver value to our shareholders with our $0.20 per share dividend for the first, second, and third quarter of 2024.

Additionally, we were able to maintain our net interest margin, which decreased by only 2 basis points and loans. Total assets and deposits have grown since prior periods.

Our pipeline continues to remain solid at the end of the third quarter of 2024 within verticals we have historically operated in, as presented in the loan portfolio diversification slide.

Loans held for investments decreased--excuse me, increased during the quarter by $194.3 million, or 5.95% from the prior quarter, primarily related to the purchase of loans within the consumer concentration of the loan portfolio, representing $129.4 million of the increase. Loan originations during the quarter were $333.8 million, while payoffs and pay-downs were $40.7 million and $98.8 million, respectively.

Asset quality continues to remain strong. Nonperforming loans decreased to 0.05% of loans held for investment at period end, compared to 0.06% at the end of the prior quarter.

At the end of the third quarter, the allowance for credit losses was $37.6 million. We recorded a $2.8 million provision for credit losses during the quarter, reflecting loan growth and continued risk associated with general economic trends and forecast.

The ratio of the allowance for credit losses to loans held for investment was 1.09% at quarter end. Loans designated as substandard or doubtful approximately--totaled approximately $1.9 million at the end of the quarter, which is unchanged from the end of the previous quarter.

During the third quarter, deposits increased by $250.3 million, or 7.95% as compared to the previous quarter. Non-interest-bearing deposits as a percent of total deposits at the end of the third quarter increased slightly to 26.67% from 26.22% at the end of the previous quarter.

As noted earlier, we are pleased we had net non-wholesale deposit inflows for the three months ended September 30, 2024. Our ability to grow deposit accounts support 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.

To offer more detail on our deposit composition, I want to highlight that deposit relationships totaling at least $5 million constitutes 60.58% of total deposits. And the average age on these accounts was approximately nine years, as of September 30, 2024. Local agency deposits accounted for 18.77% of deposits as of September 30, 2024.

Overall, deposit balances have increased when compared to the prior quarter. Wholesale deposits, which we defined as broker deposits and public time deposits, increased by $157.4 million. Non-wholesale deposits increased by $92.9 million, driven by an $11.7 million increase in non-wholesale interest-bearing deposits and an $81.2 million increase in non-interest-bearing deposits. Cost of total deposits was 263 basis points during the quarter, an increase of 16 basis points from the previous quarter.

We continue to be well capitalized with all capital ratios well above regulatory thresholds for the quarter. Our common equity Tier 1 ratio decreased from 11.27% to 10.93% between June 30, ‘24 and September 30, 2024.

On October 17, our Board declared a cash dividend of $0.20 per share on the company's voting common stock, expected to be paid on November 12, 2024, to shareholders of record, as of November 4, 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 $10.9 million. Return on average assets was 1.18%, and return on average equity was 11.31%. Average loan yield for the quarter was 5.98%, representing an increase of 15 basis points over the prior quarter.

Our net interest margin was 3.37% for the quarter, while net interest margin for the prior quarter was 3.39%. As a result of changes in interest rates and other factors, our other comprehensive income was $2.5 million during the three months ended September 30th, 2024, as unrealized losses, net of tax effect, decreased on available-for-sale debt securities from $12.2 million as of June 30, 2024, to $9.7 million, as of September 30, 2024.

Non-interest income decreased to $1.4 million in the third quarter from $1.6 million in the previous quarter. This is due primarily to a reduction in gains from loans sold during the three months ended September 30, compared to June 30, 2024. Non-interest expense grew by $0.3 million in the three months ended September 30 compared to three months ended June 30, primarily due to increases in salaries and employee benefits, during the quarter.

Now that we've discussed the overall results of operations, I will 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 third quarter results. Five Star Bank has a reputation built on trust, speed to serve and certainty of execution, which support 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 are very proud to have earned the trust of those we serve, including our shareholders.

As we move into the fourth quarter of 2024, 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 on our organic growth and disciplined business practices, which we believe will benefit our customers, employees, community and shareholders.

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

QUESTION AND ANSWER

Operator
Ladies and gentlemen, at this time, once again, we will begin that question-and-answer session. If you would like to ask a question, press "*" and then "1". To withdraw your questions, you may press "*" and "2".

And our first question, today, comes from Woody Lay from KBW. Please go ahead with your question.

Woody Lay
Hey, thanks for taking my questions. I wanted to start on the non-interest-bearing deposit growth. As you mentioned in your opening comments, it was really impressive to see in the quarter. I was just curious, was that pretty granular across your customer base? And do you think those balances can continue to move higher from here?

James Beckwith
Let's see. We had one relationship that we've had for many years, probably five years, that grew their balances decently, probably accounts for--well, I'm going to say 20% of that increase and everything else has been pretty granular.

Woody Lay
Now, got it. Does it feel like that--go ahead?

James Beckwith
We sense that we're hitting our stride somewhat with respect to growing our non-interest-bearing deposits pre-DDA, as we call them here. And I think that is just a function of the number of accounts we've been opening as those balances build. And so, we expect fourth quarter to see some increases there, maybe not to the extent that we saw in the third quarter but certainly noticeable.

Woody Lay
Got it. Maybe shifting over to the loan side, I was just curious on what the purchase strategy is from here? Do you expect that to continue in the fourth quarter and into '25? And outside of the purchase strategy, just how does the pipeline look heading into the fourth quarter?

James Beckwith
Sure. The purchase strategy was centered around loans that we purchased from Bankers Health Group, BHG. And so, we've capped the number of loans that we're going to carry on our balance sheet with BHG to $300 million. And so, I think as of today, we're there. I think we had a maybe $5 million, $8 million in October that we bought.

Heather Luck
Yeah. At September 30, we were at $274 million.

James Beckwith
Yeah, so it's a little bit more than that. So, we've capped that at $300 million. And so, what you're going to see from here on out, there'll be some increase in Q4, but after that, it's just going to be maintained at a steady balance of $300 million. Now in terms of our pipeline, we've seen some nice increases here in the last couple of weeks.

So, we expect loan growth in the fourth quarter, Woody, to probably be in the mid-single-digit level. And so, we'll see. We've got some big deals that we're looking at. But we like where our pipeline is, our loan pipeline is right now, across all of our verticals and geographies.

Woody Lay
That's helpful color. Just last turning to the NIM, just any near-term expectations with the recent 50 basis point cut and just how that could impact the NIM in the fourth quarter?

James Beckwith
Sure. So, we fundamentally financed our increase in our purchased loans or our wholesale loan strategy with BHG with broker deposits and state of California deposits. Now the broker deposits and the state of California deposits, we've kept them very short, so they're on 3-month repricing intervals.

So, over the next three to six months, we expect those yields that we have to pay, those rates to come down very consistently with any Fed moves. So, we kind of like that in terms of what it looks like, in terms of what the cost of those deposits are. Probably won't see too much of an impact in Q4, but certainly in Q1 and Q2, you will, of 2025.

Woody Lay
Got it. Alright. Thanks for taking my questions.

James Beckwith
Sure.

Operator
Our next question comes from Andrew Terrell from Stephens. Please go ahead with your questions.

Andrew Terrell
Hey, good morning.

James Beckwith
Good morning.

Heather Luck
Good morning.

Andrew Terrell
If I could just follow up a little bit on the margin line of questioning. On the CD portfolio, specifically, it was like $326 million on average in the quarter at 5.08% cost. We obviously saw a pretty big build into the period end up at $490 million or so, if I remember correctly. Do you have the CDs you're putting on during the quarter, do you have the weighted average costs you're putting those on at? Understanding that some of the broker and everything kind of reprices on a 3-month term.

James Beckwith
Yeah, we don't have much CDs, outside of our wholesale strategy. So, we put on one large one with the state, and that was at about, well shy of 4.60.

Heather Luck
Yeah, 4.60.

James Beckwith
And so--but as those CDs reprice, we'll see all the brokers reprice in Q4, but mostly in December.

Heather Luck

Yeah, so we've got $275 million of brokers that will roll off in December; that's at a weighted average rate of 5.01%.

James Beckwith
Yeah. So, depending upon what Fed does in November and December, you could see an appreciable decline. At this point, we're planning to kind of re-up those CDs, Andrew. So, we expect a pretty significant rate move on those.

Andrew Terrell
Yeah, okay. And then maybe to help us on the asset side as well, just to understand the purchase strategy. If the wholesale funding kind of put on during the third quarter was 4.6% territory, what was the marginal loan yield for the loan purchases, just so we can think about kind of the net margin of the more kind of wholesaler purchase strategy?

James Beckwith
Sure. They were done at about 8.11%.

Heather Luck
Weighted.

James Beckwith
Weighted average, 8.11%.

Andrew Terrell
Okay, great. I appreciate it. And then you said--

James Beckwith
--Yeah, that was at a fixed rate, so we expect that margin to widen when our CDs reprice.

Andrew Terrell
Got it. Okay. That makes sense. And then just for the purchases overall, I think a lot--you mentioned about Bankers Healthcare Group. Can you just discuss maybe the liquidity profile for these purchase pools? Are they liquid enough that you can kind of trade in and out of this portfolio similar to how you would a bond book.

And the reason for kind of that specific question, just thinking about the next couple of years, if loan growth ramps in kind of the core business, to the extent we saw back a couple of years ago. Just trying to think through the kind of liquidity dynamics there to contemplate outside of deposit growth that your source of funds.

James Beckwith
Well, we've been told that they are readily salable to other folks in their network, and they've got a pretty broad network. So, we believe that we would be able to execute any type of exit strategy should we need to be, if we have to. But we don't expect that. I mean, these are pretty quick amortizing loans.

So, the balances, if we didn't maintain our outstandings with where--they would pay off fairly quickly. They probably have an average life, I am going to say, four years, four years to five years, so. But they are--we can move them off our balance sheet to the folks that are in the BHG network, as we've been told. Now, Andrew, never done that, but we feel confident that we would be able to do that if we have to.

Andrew Terrell
Yeah. Understood. Okay. Yeah, I just want to--I know deposit growth is obviously fantastic this quarter, but I just wanted to throw that in. The last--

Heather Luck
--I just want to reiterate, though, that the program for the BHG are capped at $300 million, and so we are pretty close to that, already. I just kind of want to make sure that you guys for your models know that that's a cap on that side.

James Beckwith
Yeah, we're not going to do any more of it.

Andrew Terrell
For sure. Okay. And I appreciate that. And then the last one for me, just you're up to, I think the release said 24 employees in the Bay Area. It's obviously a huge increase in lift when you think about starting this expansion out kind of mid of last year. Just talk about maybe, James, big picture, what the framework in the market looks like today from a talent standpoint. Do you feel like most of the dislocated talent has found a new home at this point? And then just specifically about kind of your pipeline and hire expectations for the year ahead.

James Beckwith
Sure. I think that the dynamics of the hiring opportunities have certainly changed from a general market perspective, but we have also changed, too. Now, we're a recognizable entity down in the Bay Area and people are seeking us out, whereas maybe that wasn't the case a year ago. And so, we've made a big splash. We 've jumped in with both feet, so people are beginning to know who we are.

We're getting involved in the communities, various communities, but in San Francisco, in particular. And so, what our hiring pipeline looks like right now, we've got three people that we are eyeing that are all biz dev and then maybe one other--two other support folks. So, the pipeline, hiring pipeline remains very good.

Again, we're attracting some really high-quality folks and not necessarily from the old First Republic, but other banks, whether it would be Wells Fargo, and some major banks and some also, some community banks. So, we're--we like where we are. We like our profile. And I think that we've done a good job at telling our story down there. And the folks that we've hired are very recognizable. And so, that carries some cachet with respect to future hires. So, we're excited about what we see there.

Andrew Terrell
Yeah, very good. Okay. Thank you all for taking my questions, I appreciate it.

James Beckwith
Thank you.

Heather Luck
Thank you.

Operator

Our next question comes from Gary Tenner from D.A. Davidson. Please go ahead with your question.

Gary Tenner
Thanks. Good morning.

James Beckwith
Good morning.

Gary Tenner
I wanted to ask about the deposit growth in the quarter. If you look at the non-wholesale and public funds balances in the quarter, I think 75% or 80% of that growth would have been non-interest bearing DDA. And it's a high-class problem, so a fantastic job. But I'm just curious about it just seems to be sort of a disconnect of having such a sizable amount of that--of the non-wholesale growth in non-interest bearing. So, could you talk to that a little bit? Obviously, a lot of success in the San Francisco market, etc., but just wondering about the mix of what's coming in the door on a core deposit basis.

James Beckwith
Sure. A lot of accounts that we've opened this year, they're very relationship based. And as I mentioned previously, Gary, those balances are beginning to build. The typical cycle of onboarding a new relationship, you open the accounts and then they start to populate and fund. And that could take up to six months to nine months, sometimes. And so, what we are seeing right now is the evidence of that.

So, to the extent that we continue to bring on new relationships, and we have a very robust deposit pipeline, we expect those balances to continue to grow. Now, I'm not sure if they are going to grow to the same extent they did in Q3, as we're looking out past Q4 and then into 2025, but we certainly expect them to continue to grow.

Gary Tenner
I appreciate that, James. Are you seeing any--within the, again, non-wholesale interest-bearing book, any sort of churn or customers using those balances to pay down lines or just kind of what the trend is there?

James Beckwith
Not noticeably. I think that we have our normal amount of payoffs in our CRE book, especially in our mobile home park book of business and RV Park, as folks take deals to agency. But that pipeline, the origination pipeline remains pretty robust. So, if any use of liquidity to pay down loans, we're not seeing too much evidence of that.

Gary Tenner
Great. And one, just one last question for me if, Heather, you have the September 30th cost of deposit spot rate.

Heather Luck
Two sixty-six.

Gary Tenner
Two sixty-six. Yeah, thank you.

CONCLUSION

Operator
Once again if you would like to ask a question, please press “*”, then “1”. To withdraw your question, please press “*”, then “2”. And I am showing no additional questions. We will conclude today’s question-and-answer session. I would like to turn the conference call 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 strategic initiatives, which include 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 successes we share with our employees and shareholders.

These successes include numerous ratings and awards. In addition to the numerous awards received in the first half of 2024, Five Star Bancorp was included among Piper Sandler, Sm-All Stars Class of 2024 and was also ranked number five by Bank Director Magazine’s RankingBanking study of the 2024 Best U.S. banks with assets less than $5 billion.

Bank Director Magazine’s RankingBanking study also ranked Five Star Bancorp as the number 18 among the 2024 top 25 U.S. banks. Our company leadership was recognized with the Sacramento Business Journal’s 40 Under 40 Award. Five Star Bank continues to be a driving force for economic development, a trusted resource for our customers and a committed advocate for our communities.

We look forward to speaking with you again in January to discuss earnings for the fourth quarter of 2024. Have a great day and thank you for listening.

Operator
Ladies and gentlemen, with that, we’ll conclude today’s conference call. We thank you for attending today’s presentation. You may now disconnect your lines.