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Q1 2021 Northeast Bank Earnings Call

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PRESENTATION

Operator

Good day everyone and welcome to the Northeast Bank Fiscal Year 2021 First Quarter Earnings Results Conference Call. This call is being recorded and with us today from the Bank is Rick Wayne, President and Chief Executive Officer; JP Lapointe, Chief Financial Officer; Pat Dignan, Executive Vice President and Chief Credit Officer.

Last night, an investor presentation was uploaded to the Bank's website, which we will reference in this morning's call. The presentation can be accessed at the Investor Relations section of northeastbank.com under Events and Presentations. You may find it helpful to download this investor presentation and follow along during the call. Also at this call will be available for rebroadcast on the website for future use. The question and answer session for this call will be conducted electronically following the presentation.

Please note that the presentation contains forward-looking statements about Northeast Bank. Forward-looking statements are based upon the current expectations of Northeast Bank's management and are subject to risks and uncertainties. Actual results may differ materially from those discussed in the forward-looking statements. Northeast Bank does not undertake any obligation to update any forward-looking statements.

At this time, I would like to turn the call over to Rick Wayne. Please go ahead, sir.

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

Thank you. Good morning and thank you all for joining us today. I am Rick Wayne, the Chief Executive Officer of Northeast Bank, and with me on the call are JP Lapointe our Chief Financial Officer and Pat Dignan our Chief Credit Officer and Executive Vice President. After my comments JP, Pat and I will be happy to answer your questions. First, just making a general comment about how we're doing at the Bank. We get calls somewhat regularly from different investors and others and asking, like many businesses, we're still working at home, except for the 9 branches that we have open. Everyone is healthy and our business is doing remarkably well while we're working at home. This is now going on since the beginning of March.

Now, let me proceed with some of the conversation around our quarterly results and I'm going to reference the slides that were loaded up yesterday, which you have. Starting first on the financial highlights slide on page number 3, I think the headline is really great earnings, $7.8 million or $0.94 per diluted earnings per share, for return on equity of 18.5% and a return on assets of 2.49%. Let me just say that again, return on equity of 18.5%, quite a number. During the quarter, our loan volume was a little bit under $76 million, which includes $23 million of PPP loans, which were originated. We also originated $40.9 million of loans in our national lending group and we purchased $4.6 million or invested $4.6 million on $5.8 million of UPB. I am going to talk about both of those in more detail in a little bit. Our net interest margin was 4.95% and excluding PPP was 5.00%.

If we turn to Page 4, I want to comment and provide some detail on our correspondent fee income and so there is a slide on Page 4, that the first part of the slide on the top, designated correspondent fee summary, takes a look at what has happened on the purchase side by loan source through September 30th initially. You can see that in the quarter that ended June 30, our fourth fiscal quarter, Loan Source purchased, and I'll do some rounding for this, the numbers are there, $1.3 billion and then in our first fiscal quarter ending September 30th, they purchased $2.1 billion for a total of $3.4 billion. We derive on the purchase side income in a few different ways. First, when they're purchased, we get a share of the discount when they buy the loans and dividing that by that discount and our share on that aggregate of $3.4 billion was $8.2 million.

Secondly, when they buy the loans similar to buying any securities, they have to pay for accrued interest and our share of that was $3.5 million roughly, so the total of all of that, the total of all of that is $11.7 million. I would add and this was after the quarter-end, but you can see it on the slide that they purchased in October another $614 million, the correspondent fee on that was $353,000 and the purchased accrued interest was $1.5 million for a total of $1.85 million. You may wonder why the correspondent fee was so low and that is because at the time they buy the loans they need to refinance with the Federal Reserve, who is providing the financing for the interest so it tends to reduce the correspondent fee, but ultimately it comes out to be the same because they owe less money so they pay the interest expenses to say accurately.

If you look at the bottom of this slide we break out the components of the $4.7 million of correspondent fee that we recorded in the quarter, it was $822,000 of correspondent fee, which represents the amortization of the $8.2 million correspondent fee in the above table, it is roughly over 2 years. It is also the amortization of the purchased accrued interest you recall I just said that when they buy the PPP loans, they have to pay accrued interest and that $279,000 is the amortization of the $3.4 million above and then we also get a share of the servicing income, which is the spread between the rate the borrower pays which is 1%, that is the PPP borrowers, and the cost of borrowing from the Fed, which is 35 basis points. So there is 65 basis points on $3.4 billion through September, now $4 billion starting in October, less the cost of servicing that, so you can see that it has been quite a profitable transaction for us and I hope this level of detail makes it easier for you to understand the components.

Moving on to the next slide, we wanted to provide some details on our deferment program, which I know is of great interest to all of you. And so the slide on Page 5 is a slide that shows where every month March through August in which we provided a full deferment for 3 months and you can see that we did over that time period a total of $136.2 million of deferments to borrowers, and we are of course pleased to help them out. These were total, not forgiveness, but just forbearance of their loans for 3 months. And at the end of September, we only had $26.8 million of those that were still being deferred and the biggest chunk of those are some of the ones we granted in April for 3 months. We provided them with an additional 3 months, so its $26.8 that is still on deferment, $109.1 million off deferment and of those only $300,000 were more than 30 days delinquent as of September 30th. I am very, very pleased with that result.

On the next slide on Page 6 is a breakout of deferments in which we gave interest only and this ran from March through July, the same kind of analysis we gave out $44.7 million, some of those have come off, there were only $35.9 million at the end of September and none of those are more than 30 days past due, which we're very pleased with of course.

Moving on to slide 7 is a slide that shows our lending activity both originated loans and purchased loans for the 5-trailing quarters and you can see in here that on the originated basis I'm looking at it even pre-COVID of course, originated going back to Q1 of '20 was $40.6 million, a very large quarter in Q2 of '20 that was the end of our, I mean that was not the end, that was the second-quarter fiscal '20 of $98.6 million and $48.8 million and then $33.6 million at June 30 and this quarter of $40.9 million. So, we saw a fair amount of activity. I think as we mentioned on the other call we're always careful, always conservative, even more so now, just a little color on the originated loans roughly half of that $40.9 million were portfolio finance loans and we've talked about this in the past where we lend money to non-bank lenders to leverage their lending activities. But if you look at that, roughly half of that is portfolio finance. If you look at our loan amount to the underlying value of the real estate that secures the loan of our borrower you know it is still 40%, sometimes less than that and the other half of it were loans directly to borrowers where the LTVs were sub 60%. Virtually all of those set up with interest reserves giving us protection for all or most of our loan, that was the story on the originated portfolio.

On the purchased portfolio it was only $4.6 million invested for the quarter. Few comments on that, one is we looked at a lot in the quarter but we couldn't find, even though we looked at a lot, we couldn't find a lot that we were able to buy, a lot of it were asset classes that we weren't interested in taking now hotels, restaurants, big box retail, etc. and then there is a whole big chunk of that where we just couldn't get there on the pricing. As we say, almost on every call if not on every call, purchase business is lumpy. We have great expectations that over the next a couple of years we're going to see our fair share of loans to purchase and we will. We want to be careful and with all those caveats it is an important point, want to listen up? In October, we have already put $80 million of purchased loans under contract. I'll repeat that number, it's a big one, about $80 million of loans under contract, which we will close in November. So, we're obviously quite happy with that. It is a great transaction for us and subject to remind you, as a forward-looking statement, we think we're going to have meaningful opportunity to do that.

Moving on to Slide 8 - on Slide 8 you can see the roll forward of our loan portfolio, it did go down by about - this is now our national lending portfolio, which is the way we would refer to that now rather than LASG, same group but you can see that the portfolio from June to September went down by about $33 million. Interestingly, if you look at the originated part of that it's mostly flat, we originated as I mentioned earlier about $41 million and we had $45 million of pay-downs. The reason that the portfolio went down by about $30 million mostly was that on the purchase side we purchased $4.6 million and we had $33 million of pay-downs. You can imagine what the borrow will look like at least this portion of the purchase part next quarter you know if not $4.6 million but at least $80 million and I remind we are only at the end of October. Now we have a couple of more months of that.

Going on to Slide 9 and the next group of slides, we thought it would be helpful to continue to put in here, although I'm not going to go through them line by line, you may recall that in the quarter ending March 31, we provided a lot of detail on our loan book and some investors suggested to us that we continue to keep this data in there. So we put it back, so you can see that, as I mentioned our loan book balance in loan portfolio has gone down a little bit, some of the headlines of this you can see that on a weighted average basis, the LTV is 53% and as you recall for the purposes of this calculation we're using the appraisal at that time that the loan was originated, this hasn't been reappraised other than in the ordinary course when we look at loans and we're getting valuations, generally speaking, these are the values at the time of origination.

On Slide 10 is a pie chart, you've seen these before, let's take a look at our national lending business starting at the pie chart on the upper right hand corner that shows purchased loans that our net investment basis is 91% of purchased loans. Below that, in terms of geography, our largest is in New York, and then California and then spread out among a lot of states, moving to the upper left hand corner, you can see that the average investment size is $692,000. It is a lot of loans a lot of that is purchased and below the breakdown, you can see the breakdown of the collateral types.

On Page 11 you can see we again, by different collateral types, we break out the national lending LTVs on a weighted average basis, it is at 50% it was a little bit higher on the first slide I showed you because of some of our loan balance, it was 53% for the whole portfolio, because of the lending in our Community Banking division, but national lending is 50%. Of course averages can be misleading because you need to take a look at them and they're not all 50% but the slide on page 12 I think is really helpful, which makes the point only 2% of the book is more than 80% and only 10% more than 70%. So 88% of it is under 70% and only 20% between 60% and 90% so good LTVs.

On Slide number 13, we have some further analysis of the purchased portfolio in terms of how some of the loans originated and what has happened to them, I think it is really interesting. We've broken out the purchase book between the loans that were originated before 2009 and after 2009 you can see that 62% of it is before 2009. So a lot of, lot of seasoning and a lot of pay-down on those loans. And then you can see on Slide 14, we take a look at loans that we have where we have interest reserves, you can see that in our portfolio finance, 83% of those loans have interest reserves with weighted average duration of 6.2 months and then on the direct originated loans of 40% of the portfolio is a weighted average duration of 7.2 months.

There is some more break out of the portfolio in the Community Banking division on Page 15 and then on Page 16 is a breakdown of the weighted average portfolio LTVs in our SBA portfolio and you can see that of the $50 million on our books, just under $7 million is guaranteed, $43 million is un-guaranteed and you can see the breakout by the different collateral types.

I'll just remind you that while loans that are un-guaranteed to the extent that we split, we share any loss with the SBA pro rata. So we share 25% of it, the collateral value and as JP will talk about in a second, so we have a large allowance associated with that.

And on that note, I will ask JP to takeover. Thank you, JP.

Jean-Pierre L. Lapointe ***Northeast Bank - CFO & Treasurer***

Thank you, Rick and good morning everyone. Continuing on Slide 17, we provide a breakout of our allowance for loan losses by loan segment. As you can see, our allowance has increased from $5.3 million, or 57 basis points of total loans, as of September 30, 2019 to $9.5 million, or 1.02% of total loans, as of September 30, 2020. Excluding purchase loans and the related allowance, our allowance to covered loans is 1.5% at September 30, 2020, an increase from 80 basis points at September 30 2019.

As you may recall from our Q3 fiscal 2020 earnings call, we significantly increased our allowance for loan losses as of March 31, 2020 as a result of the COVID-19 pandemic and its effect on our loan portfolio. The increase was largely concentrated in the SBA and USDA loan segment inherent risk of loss is significantly higher given the nature of the borrowers and their typically higher LTVs as Rick indicated. Through September 30, 2020, the allowance for SBA and USDA loans has increased $3 million since September 30, 2019 despite loan balances in this segment, declining approximately $9.5 million over the past year, which we feel appropriately addresses the risk inherent in the portfolio as the pandemic continues. Moving to Slide 18, our asset quality metrics for our nonperforming assets and nonperforming loans have remained fairly consistent over the past 3 quarters even with a declining loan portfolio. Classified assets have also remained consistent and have not increased significantly over the past 3 quarters. Net charge-offs were very low during the quarter ended September 30, 2020 with 1 basis point of average loans being charged off, which is lower than the previous periods shown.

Moving to Slide 24, you can see the declining cost of our deposits over the trailing 5-quarter period. The average cost of deposits has decreased from 1.84% in the September 30 2019 quarter to 1.19% during the current quarter. Additionally, the cost of deposits of September 30, 2020 was only 1.05%. We also have $188 million of able and bulletin board CDs at a weighted average rate of 2.21% maturing over the next 2 quarters, which includes $84 million at 2.22% maturing in the quarter ending December 31, 2020.

The annual interest expense for the able and bulletin board CDs running off over the next 6 months is $4.2 million, which if we were to replace all of the maturing CDs with the same products, the annual interest expense on those CDs would only cost us $900,000. Given our current funding position we have let maturing CDs run off and are not bringing new CDs on. As a result, the cost of funds as a percentage of deposits may remain elevated until we bring lower-cost funds on the balance sheet to fund loan growth as needed.

However, interest expense by dollars is expected to continue to decrease as a higher cost funds and excess deposits continue to roll off. Switching to slide 25 as you can see here total revenue excluding PPP gains has continuously increased over the past 5 quarters from $16.9 million in the prior comparable quarter to $20.3 million in the current quarter, a 20% increase year-over-year. This significant increase during the current quarter is primarily due to the correspondent fee income of $4.7 million as Rick mentioned in his earlier remarks. In contrast to increase in revenues, noninterest expense has remained flat even declining slightly over this 5-quarter period demonstrating the bank's ability to control operating expenses as we continue to grow our revenue streams.

That concludes our prepared remarks. At this time, we would like to open up the line to Q&A.

QUESTIONS AND ANSWERS

Operator

We have a question in from Jeffrey Kitsis of Piper Sandler.

Jeffrey Scott Kitsis ***Piper Sandler, Research Division - Assistant Vice President***

Congrats on a strong quarter. I was hoping you could please give us some more clarification around the accounting on Loan Source fees. I appreciate the color that you did give. But I was hoping you could help us understand some of the drivers for forward- looking modeling purposes so it seems like there are different things that will cause these items fluctuate, for example, gain on sale of PPP loans would depend on you guys selling more PPP loans, but other items like the correspondent fees and amortization of purchase of accrued interest are going to depend on other factors. So I was hoping you could run through that, please.

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

JP, you want to do that?

Jean-Pierre L. Lapointe ***Northeast Bank - CFO & Treasurer***

Sure. So we have the 3 different aspects that we broke out in the table on slide 4, Jeff. We have the correspondent fee of $8.2 million and the purchased accrued interest of about $3.5 million. Right now, that's being recognized over an approximate life of 2 years. However, we have to monitor the underlying loans that are associated with that. So, if the loans payoff quicker than the recognition of that, deferred income would speed up. If all the loans remain for 2 years, it will take that straight line over the 2-year period. So, it kind of depends on when the loans are forgiven and how all of that reacts to how we recognize that over that period. The other aspect to see is earned net servicing interest, which fluctuates based on the average balance of the loans that Loan Source as Rick indicated, whether or not repay the PPP all of the funds that they receive from the Fed Reserve at any given period and what we earn in each month on those loan balances.

So if Loan Source continues to purchased loans in the balance of their portfolio that they're servicing gets bigger and those loan sales defer for a longer period of time, then that number could grow and continue to stay large for a period of time, whereas if the loans are forgiven in a shorter period of time, then that number will run down a little quicker. It is tough to estimate not knowing exactly how many borrowers are going to apply for forgiveness and when they're going to apply and receive forgiveness if they do. So I hope that answered your question on how you can model it and you know if you want to build into assumptions on loan forgiveness in the upcoming quarters. Rick, do you want to provide any more color on that?

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

No, unless Jeff has another question around the accounting part.

Jeffrey Scott Kitsis ***Piper Sandler, Research Division - Assistant Vice President***

That was very helpful. I appreciate it. So it sounds like the correspondent and purchased accrued interest that kind of depend on loan forgiveness speeds and the earned net servicing interest that is going to fluctuate more based on just the balance of loans that the Loan Source has so their volume of course.

Okay. And then on deferrals. It looks like deferrals have ended sooner for full payment deferrals, those are almost done now but the interest only deferrals are sticking around a little longer. I was wondering if you could please talk about the factors that cause the interest only deferrals to last longer. Is that by design or those typically...

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

Well. It's simple because they were for 6 months and will come out. I have no doubt that when we talk again after the end of the next quarter, those will all be off deferral, they're coming off deferral mostly in October, if not in September. It's just that they were longer. The other one for 3 months. These are 6 months.

Jeffrey Scott Kitsis ***Piper Sandler, Research Division - Assistant Vice President***

Got it. Thank You. And then last question, I was hoping you could give an update on the, on the purchased loan market. I appreciate the color that you guys have already put of $80 million of purchased loans under contract so far in October. I am just wondering where you see that trending over time and if you're seeing any more competition for these loans or competition remains low with buyers entering market.

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

No. When we started there has been based on a lot that comes to market, I mentioned that in my comments but what we saw in the quarter that ended September 30, we didn't see a lot that we want to do even though there is a lot of volume. I think there's going to be a lot coming. I might be wrong on this just to be clear, but my view is that there is going to be a lot of loans coming to market and yes, there will be competition, the $80 million that I referred to, there were lot of bidders but for the right kind of assets we can be very competitive. So I expect that, I can't say quarter to quarter but I would say that over the next couple of years, we will see the percentage of purchased loans on our balance sheet Increase from where it is now. Jeff the $80 million is obviously significant, it is a big month of October for us.

Jeffrey Scott Kitsis ***Piper Sandler, Research Division - Assistant Vice President***

Yes, definitely that's a really strong production. Thanks for taking my questions.

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

Thank you, Jeff.

Operator

And your next question in queue comes from David Minkoff with DCM Asset Management.

David Minkoff ***Dcm Assets Management, LLC - President***

Congratulations on another nice quarter.

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

Thank you.

David Minkoff ***Dcm Assets Management, LLC - President***

I have also a question on those PPP loan chart you may have actually answered it, but I guess it wasn't clear on it. So, you show the fourth quarter fiscal year 2020 and the first quarter of fiscal year 2021 and you had the correspondent fees and accrued interest in total. And I think you said it's going to be realized over 2 years. Does it end at the end of the first quarter, first quarter 2021 or next quarter might we see a line that says Second Quarter fiscal '21 and third quarter or is the program over?

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

No, the program under current rules to buy loans was run through December 31 because that's how long the Fed has made available financing to the banks and non-banks at 35 basis points. So excuse me, that was supposed to end September 30, I think and they extended it until December the 31, so they extended that, if the Fed does not extend the borrowing window, there won't be any more loans, 1% loans to purchase. If they extend that and the regulators still say that you don't count that in your capital calculations, then the PPP purchasing could extend beyond December 31. You can see on the chart, there is already some activity in the quarter we're in now because Loan Source purchased $614 million in October.

David Minkoff ***Dcm Assets Management, LLC - President***

Right, right, right.

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

And it's possible we can purchase more in November-December.

David Minkoff ***Dcm Assets Management, LLC - President***

Okay. In the prior question the gentleman asked, I think you said it's not necessarily realized over the next 2 years it depends on how there are payoffs. I would assume, correct me if I'm wrong, that it will be recognized largely in the earlier quarters waning down as you get to the latter part of the years is that that your anticipation at this time?

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

We would think that a lot of the loans will be forgiven and therefore the balances will come down, so I think what you're saying is generally correct. There is a small number of loans in the portfolio that are 5-year loans and so to the extent that they not forgiven, some of them even longer. So I think as a starting point, thinking about 2 years for amortization seems to make sense, but I would agree with your point.

David Minkoff ***Dcm Assets Management, LLC - President***

Okay. And the second thing I didn't see a comment as to buyback. So I assume that you completed the 900,000 share buyback. Also the number of shares outstanding last December was roughly 9 million and now it's a little over 8 million. So that almost shows that you bought back the 900,000, am I my correct in that assumption?

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

Well, you're mostly correct. At the end of the June, we had out of the 900,000 we had 46,000 remaining.

David Minkoff ***Dcm Assets Management, LLC - President***

Yes.

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

And then we did not buy any stock back in the quarter that just ended September 30. So our capacity to buy back stock is 646,000 which consists of 46,000 remaining from the 900,000 plan, plus the 600,000 that we recently, in the last 3 or 4 months, announced. So you are mostly correct.

David Minkoff ***Dcm Assets Management, LLC - President***

No, I didn't see that, you announced another 600,000 add on buyback of shares, what month was that in?

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

JP, when did we do that?

Jean-Pierre L. Lapointe ***Northeast Bank - CFO & Treasurer***

July, I think it was July 21 was the announcement, so that would have been in - we did a press release when that was approved.

David Minkoff ***Dcm Assets Management, LLC - President***

Very Good. I would have suggested you -- your original 900,000 share buyback was what I would call a standby buyback. I didn't really plan for you to act on that at the price the stock was selling when you announced it unless there was some kind of dislocation, which you have an amazing crystal ball because that disastrous events with the coronavirus took place a few months after you announced that standby buyback. I was going to suggest that you authorized that standby because we're in crazy times still. Of course, we've got election coming up next week and that could be because the volatility plus in many states the Coronavirus is picking back up again and we're going to get another lockdown or go-backs. We could have the same situation we had early this year in March. I mean there's just no way of telling we are in crazy times, but I'm glad to see you have another standby buyback. Hopefully we don't have to use it, but you never know.

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

Yes, exactly.

Operator

And I see no questions at this time, I would like to turn the call back over to Rick Wayne for closing remarks.

Richard N. Wayne ***Northeast Bank - President, CEO & Director***

Thank you, Erin. Well, thank you all for listening, participating, supporting us. I hope you are all safe and stay healthy and I look forward to talking to you at the end of next quarter. Thank you all. Bye.

Operator

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