County Bancorp, Inc.

Earnings Release First Quarter 2019 Conference Call

Thursday, April 18, 2019, 2:30 PM Eastern

CORPORATE PARTICIPANTS

Tim Schneider - *President*

Glen Stiteley - *Chief Financial Officer*

PRESENTATION

Operator
Good afternoon and welcome to the County Bancorp Earnings Release First Quarter 2019 Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question you may press "*" then "1" on your telephone keypad, to withdraw your question, please press "*" then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Tim Schneider, President of County Bancorp. Please go ahead.

Tim Schneider
Thank you. I like to start off by directing you to the second page of our slide deck for the disclosure on our forward-looking statements.

Thank you all for joining us. First of all, I would like to start by announcing two new Director Appointments that we've made in the past quarter. We are happy to announce the addition of two new Directors during 2019, Patrick Roe and Jacob Eisen. Pat recently served as the President, Director of First Community Financial Partners Incorporated a $1.3 billion NASDAQ registrant. Prior to First Community, Pat was the President of Heritage Bank. Pat has over 40 years of experience in all facets of operating our Community Bank including a public registrant.

Jacob brings more than 17 years of diversified financial services experience. The County Bancorp as a formal financial services industry and investment banker he regularly served as trusted adviser to publicly traded entities including commercial banks and thrifts, financial technology payments and specialty finance companies.

Jacob currently serves as Chief Operating Officer and Director of ConnexPay, an innovative business-to-business payments company which is venture capital backed. Earlier in his career Jacob served as Head of the Financial Services practice for a boutique Global Investment Bank with more than 3 billion in assets under management, as a Head of Capital markets for a broker dealers specialized in community and regional banks. We are very excited to be able to attract Directors of Pat and Jacob's experience to our board.

Next I want to touch on the AG and credit update a bit. We saw solid quarter of reduction in classified assets which was driven by a combination of credit classification upgrades in the sub standard category, OREO sales and loan payouts.

From an AG culture perspective, we are about one thirds of the way through our credit review process of our watch and lower classified credits. We expect by the end of second quarter we will have the majority of the reviews complete and we will have a better sense on direction of classified assets.

We continue to manage as aggressively as possible reductions of classifieds with a few liquidations of farm operations occurring at spring and some solid activity on more of our ORE currently. We have seen some gradual improvement in oak prices on the CME Class III futures market over the past month or so. Again, we've mentioned this in the past, but we feel like the trade deal with China and the new NAFTA hopefully benefits to continuing to improve commodity prices for our farmers and increase export opportunities.

And now, I'll turn it over to Glen Stiteley, our CFO.

Glen Stiteley
Thanks Tim. As we noted during our last earnings call, we're still going to be focusing on reducing our overall wholesale funding. We are still targeting our reduction, loan balances were approximately $40 million sometime in Q2 2019 and a flattening growth throughout the remainder of 2019. Through Q1 we totaled $24.3 million of bad loan reduction.

As we talked about last quarter we are targeting a $120 million reduction, and wholesale funding mostly focused on the brokered CDs during 2019. So far this year we are up we reduced our wholesale funding by $41.2 million…sorry $41.2 million. We still believe this will enhance our long term profitability as well as our liquidity risk profile of the bank.

As we talked about in the last earnings call, our current market cap is $114.6 million. We anticipate that our market cap would make us a target for falling out the Russell 2000 Index as it stands today.

As Tim talked about, we are encouraged by positive trends in our classified asset front but we still want to continue to conserve cash and capital, until we see consistent in that trend and we are still not really working at any stock buybacks currently at this time.

The next slide I get up… we touched on this a little bit last quarter, but I just want to walk folks through, what we do from a capital stress testing perspective. So for the last two years we have engaged Invictus Group and outside third-party to conduct capital stress testing. The stress testing is comparable to the Big-Bank's stress test under DFAS and CCAR and have been adapted to our banks market.

This degree of stress testing is now required for our bank, but we think that is a valuable tool to help manage our capital, as well as our dairy concentration. We updated the stress testing as of September 30th, 2018. We utilized [indiscernible] data and assume no growth or dividends as part of the stress testing. There's a severe adverse case which mimics the recent recession on the commercial side and the 1980s crisis on the Ag side. And you will see some of the assumptions on the slide as well.

Under the severe adverse stress scenario, we experience $67.7 million of loan losses in a two-year stress period which results in $31.2 million in lost capital after adding back earnings, this assumes no management actions such as deleveraging the balance sheet to manage our capital ratios. Even with that stress, we show $42.1 million on excess capital to stay in compliance with our internal policy limits. We believe there is sufficient capital at the bank to absorb losses and to continue provide dividend support to the holding company at this time.

Our earning since 9/03/18, when we did the stress testing and recent deleveraging of our balance sheet is only going to continue to strengthen our capital ratios and provides additional cushion.

And now Tim and I open it up for questions.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question, please press "*" then "2."

And our first question will come from Brendan Nosal of Sandler O'Neill and Partners

Brendan Nosal
Hi, good afternoon, guys. How are you?

Tim Schneider
Hi, Brendon. Good, how are you?

Brendan Nosal
Good, thanks. Just want to start off with a question on capital. And I just want to make sure that I'm reading your prepared remarks and the comments in the deck, correct, just given the comments on last quarter. I mean, it sounds like at this point, you no longer think that a capital raise to help in this Ag cycle is necessary. Is that correct?

Tim Schneider
Yes, really, the one caveat to that, Brendan is just how we balance that the adversely classified ratio. We don't think we need it from a pure regulatory capital perspective, which the stress testing shows. It's just a matter of really balancing that ratio. I think once they start the climb towards the 60%, 70%, we start to get a little bit more regulatory pressure from that perspective.

Glen Stiteley
And as I mentioned earlier, we are only a third or maybe closer to 50% somewhere in that range - watching below classified asset review process and till we get through that entire cycle of the reviews, we don't exactly know you know, how things are shaping, although we feel that have a have a pretty good sense on most of our clients, but you know, until you dig into the numbers you don't know for sure of how these are going to look.

Brendan Nosal
Okay. Aright, got it. And then, more of a modeling question here, but it looks like the non-loan average earning assets were down about $30 million quarter-over-quarter, but the period ending was pretty stable and well above where the average was for the quarter. Is it fair to assume that the non-loan earning assets you know, rebound in the second quarter just given where period imbalances were?

Tim Schneider
Brendan, I am not sure I follow what you are asking on that. You talking about…..

Glen Stiteley
Securities?

Brendan Nosal

Securities and then the deposits, interest earning deposits, they were on an average basis down pretty significantly quarter-over-quarter with the period ending level was well above the average. Is that one of the timing discrepancy?

Tim Schneider
Yes, we do have some seasonality in our deposit base. Number one, we have a build-up of balances on the municipal side, as well as on the Ag side, but that tends to flaw out pretty quickly after year end, so that could be part of the discrepancy.

Brendan Nosal
Okay, all right, that's, that's helpful. And then I guess, last one from me, and then I'll step back here. You know, just given the decision to reduce loans by roughly $40 million and then wholesale funding by $120 million. I mean, there is more or less an $80 million gap that you need to fill with core deposits. Just talk about your confidence and your ability to more or less plug that hole throughout the course of the year.

Glen Stiteley
Now, tell me how you are…tell me how the rest of the banks are answering that question. I'll be able to tell you. I mean, it's a challenge deposit environment right now. I mean, Uber competitive, rates in our Wisconsin markets are…they're aggressive. And so, we are having to compete on a lot of different fronts, I can say is we continue to stress everybody from top to bottom that the deposits are key to this franchise moving forward. So we are starting to see some…little bit of traction here in March, but you know, the first couple of months like I said, we just have some seasonality that tends to impact that. I think what concerns me is just on the, the cost of client deposit because of how competitive it is, it's just out of whack with…if you can look at the FHLB curve, right now FHLB advances, it's almost an inverted yield curve once you get past one year. So there's going to be a true disconnect between wholesale funding and trying to get our client deposits probably more so than we've seen in a long time so.

Tim Schneider
I think as Glen mentioned, our strategies that we put into place last year are starting to take hold a little bit this year. And definitely there's a sense of urgency throughout the organization, not just on the front lines to be seeking and finding additional core deposit relationships for our organization, because we know it's that important then it continues to be stressed with our entire staff. So we feel pretty confident we can meet that boggy.

Brendan Nosal
Alright, fantastic. Well, thanks for taking my questions.

Operator
The next question will come from Kevin Reevey of DA Davidson.

Kevin Reevey
Good afternoon, gentlemen. How are you?

Glen Stiteley
Hi, Kevin. How are you?

Tim Schneider
Hi, Kevin.

Kevin Reevey
Good. Thanks. Good day. So a couple of questions on your capital stress testing analysis, which I really appreciate you sharing with us and updating. Firstly, the $42 million that you would have in excess capital after the two-year stress. Is that based on risk-based capital or tangible common equity, and then could you clarify kind of the bank…can you clarify the bank policy limits that you've stated here?

Glen Stiteley
Yes. Kevin. So it is Glen. So the $42.1 million, basically what happens during the stress testing, you find which capital ratio you moved through first, right and the well capitalized perspective. So the leverage ratio is where that falls through first. But from our bank, internal policies we look at 11.5 total risk base and a 9.5 Tier 1 leverage ratio. So that's even above the well capitalized, we just try to build in some cushions just because even though we do the stress testing, we just want to make sure that we've got additional cushion even on top of that, really, really mostly for our Ag. concentration, I would say so.

Kevin Reevey
So in other words, the $42 million, that's above the leverage ratio of 9.5%.

Glen Stiteley
Correct.

Kevin Reevey
Right. And then, I am assuming, based on this analysis, we shouldn't expect assuming everything else holds firm, we shouldn't expect to seeing any additional cuts in your common stock dividend, is that correct?

Glen Stiteley
As of right now, no, I mean, we are providing dividend support from the bank to the holding company still. So we don't anticipate and currently that we are going cut that any further.

Kevin Reevey
And then lastly, how are land prices holding up so far this year?

Glen Stiteley
Land prices from what we are seeing are still holding up very well. And we're paying attention to those transactions that are occurring as matter of fact, two of our ORE properties that we sold in first quarter sold at or above appraised values on per acre value, so in two different markets, one in the western side of the state and one on the eastern side of Wisconsin. So there are obviously pockets maybe where it's not as strong but we have not seen any significant decline in Ag land values in the state yet to this point.

Kevin Reevey
Great, thank you very much.

Operator
The next question comes from Terry McEvoy of Stephens.

Terry McEvoy
Hey guys, good afternoon.

Glen Stiteley
HI, Terry.

Tim Schneider
Hi, Terry.

Terry McEvoy
Just a question on kind of time deposits and how competitive you are on pricing within your market. How are you making sure you're not just getting hot money? If I look at some of the CD [ph] rates, particularly in the first quarter, high relative maybe to some national peers. And so, could you just comment on where you are pricing in the market and why do you think those are sustainable customers?

Tim Schneider
Yes, we have a deposit pricing committee that meets on every other week basis. And we have local market data and information on the various time deposit pricing throughout our footprint here in Northeast Wisconsin and even in Central Wisconsin. And it includes also some credit union pricing and we have needed to stay competitive and stay at or near the top of the market to drive some of these core deposits into the bank. Our franchise has always been sort of a high deposit paying institution and we can do that given our small footprint from a branch location standpoint and our efficiency ratio and still generate a decent return, but we're paying very close attention to that and we're also attempting to with these clients when they do come into the bank and then maybe it's a brand new customer and they're enticed by some of our CD rates to try to solicit additional business from them whether it be their checking accounts or money market funds that might be available as well. So we're trying to make them a little more sticky, and making sure it's a relationship not just the transaction.

Glen Stiteley
Terry, that's Glenn I mean, historically the Bank has always been kind of at the top, now its towards the top of the rate in our markets, so we tend not to lose kind of the hot money clients because they find a competitive rate with us and don't have to leave.

Tim Schneider
But to your other commentary, I think as we've seen it this market here and I know there's other places where it's competitive, but our rates are definitely near the top of I think a lot of areas in the country right now, just very competitive here.

Terry McEvoy
Thanks. Just as a follow-up Glenn, just the fee income there was the unfunded loan commitment impacted non-interest income. What are your thoughts on kind of run rate for non-interest income comment [indiscernible] expenses as well, as you think about the second quarter or maybe full year 2019?

Glen Stiteley
Yes. So, I mean, on the non-interesting income sure there's 2 pieces that were what I consider kind of more one-time, it's what you just mentioned, the allowance for the unfunded commitments and then there's the yes, loan servicing right valuation allowance of $200,000 that was kind of unique events for us, but the $200,000 on the loan servicing rights will be a consistent number you'll see quarter-over-quarter throughout 2019, but that'll go away this year, after the end of this year. So as far as the rest of it goes, we didn't have as much what I'd call

servicing fee income, we didn't have as many loan sales until probably March, January, and February were pretty slow because of the…partially because of the government shutdown. So we may see a little bit pickup there, but I think if you back off those one-timers, the 475, I think that'll be a pretty good run rate for the rest of the year.

On the expense side, it wasn't a ton of noise there, unfortunately we had some additional snow piling [ph] expenses, which we paid in March, but other than that I think the run rate should be fairly consistent, I think so.

Terry McEvoy
Great. Thanks, guys.

Operator
The next question will come from Joe Fenech of Hovde Group.

Joe Fenech
Good afternoon, guys.

Glen Stiteley
Hi, Joe.

Tim Schneider
Hi, Joe.

Joe Fenech
A couple of questions here. Tim, you mentioned that you were one-third of the way through your deal with Ag credits. What was the approach that you took in terms of, which credits you looked at first? Whether credits that you looked at with certain characteristics first or was it more random. Just trying to get a sense for whether you're maybe looking at the more troubled stuff first or last or whatever the case may be?

Tim Schneider
No, we're definitely looking at the more troubled stuff first. We looked at classification, some of the substandard credits and even some of the watch credits that we had some concerns about. We also did a pretty deep analysis of breakeven historically, what breakeven prices were and tried to kind of prioritize some of the reviews based on maybe the ones we felt that had higher breakeven points and just to see if performance was improving. And we're making good progress on that review cycle. But as I mentioned, we have a ways to go, and the third might be a little bit light, I think we might actually be a little bit higher than that from a review percentage standpoint. Our Chief Credit Officer just gave me some notes here, we had about 50% of the dollars, year-to-date this is like through today, and 31% of the number of relationships [indiscernible] within our portfolios today. So the number I mentioned was a little light, we have more progress on that than I mentioned.

Joe Fenech
Okay. Good to hear. And then, guys what are the upcoming events that you kind of look to as mile markers for measuring progress from here, in other words, such and such events happens will be much better and then hey if this particular scenario unfolds whether it would be with low prices [ph] trade policy, interests rates whatever the case maybe that maybe we don’t feel quite as good about the outlook, in other words that’s a big picture question that anything you can give us to look to was measuring sticks [ph] over the next couple of months?

Tim Schneider
Yes, that's difficult to predict. As I mentioned earlier, we are starting to see some uptick over the last two or three weeks probably on the CME Class III futures market for milk, which is when our farmers shift their milk into the Class IIII portion. We don't know if that's because some of the optimism that's being created because of the China deal, that they keep saying is getting closer to being done, that might be a factor in it. We are starting to see as you probably…if you are reading on the dairy industries, we are starting to see some reduction in number of herds throughout the sale Wisconsin and even the cattle numbers were declining a little bit. So, that may be correcting some of the supply demand situation that's out there.

We are also seeing in some of the other countries where dairy is fairly heavy including in Oceana more of a heavier drought type situation which is impacting some of their milk production. So it's maybe opening up some export opportunities for our dairy products as well. So the milk price side is really hard to predict. I mean we are feeling little bit better about where things are trending right now, futures market out into the summer are above $16 and approaching $17 and the base price which is generally a pretty profitable level for most of our operations, but again will it hold is the big question mark and what's impacting us?

Glen Stiteley
So, we keep the class 550 [ph] and see they are continuing going down in a good trend quarter-over-quarter and continue to see some stabilization on milk price. I think that's really just from my perspective, that's kind of where we are going to feel better overall.

Joe Fenech
Got it. Thanks guys. And what's the latest [indiscernible] on the U.S. with the new NAFTA, I guess you call it, it seem like the position that there was [indiscernible] based on historical position that each side has to maybe take and each party, but obviously as the current protocol environment it seems like there is unwillingness to do anything that resembles kind of bipartisan shifts, so where does the…what's the [indiscernible] in terms of where things stand on the stand on the new NAFTA agreement?

Tim Schneider
Yes, I think as you all read and perceived, and then I think the general public perceived this is when, Trump came out and stood side-by-side with the Mexican President and Canadian President back in fall that this deal was a done deal, while it's not, and really haven't heard much about it until of recent. And there has been a few publications that I have got in the Wall Street that there may be some conversations occurring. We even had a Congressman in here from our region not too long ago, and he had a [indiscernible] talked to him about it, because he had heard anything. So it's been kind of quiet, my sense is then that they then focused on the Channel D [ph] then maybe the new NAFTA is secondary, but we haven't heard much.

Joe Fenech
Okay, and then engaging in Invictus Group the stress testing, how did that update, I guess, turnout relative to what you thought going in. I am just trying to get a sense for whether or not you were surprised in anyway by the findings or the finding is more validated the initial thought that you had going in?

Glen Stiteley

Joe it is Glen, so this is the second round we have done. We started this 12/31 of 2017, so that was kind of a first blush of it and continued with this year. Honestly, I would say it was better than we expected. Until you kind of go through that, you really don't know what kind of cushions you really think you have, I mean, historically you know, just like most Community Banks, I think, we kind of [indiscernible] came up with what we thought our policy limits are, but the problem is you are really going blind, you really dive in your loan data which is really, you know where our losses come from. It is really hard to tell. So I mean, we are pleased with the results and it really helps us kind of management capital and also we get through this, once we get through this kind of Ag stress, you know I am hoping that we will be able to use that from an offers perspective and hunt for deals and look into…for things that can help was even more accelerate the change of our funding structure.

Tim Schneider
And as you know, Joe, continued broad use of the FSA guarantee programs throughout our Ag portfolio, we have mentioned it before that, you know 70% to 75% of our relationships have some form of an FSA guarantee. And with the new additional bump of additional 350,000 or so that we can use per operation, that also continues to help us to kind of buffer any significant loss exposure that we might have on direct portfolio.

Joe Fenech
Okay. Great and then last one from me in terms of funding, I thought it was interesting that your overall cost of funds about 8 basis points which is what…well it was up in the fourth quarter. Would you said that fourth quarter for whatever reason was really the inflection point, where that trajectory really flowing itself, why you do think that is, and then looking out from here [indiscernible] hold, do you expect that trajectory, that increase to decline further?

Glen Stiteley
Yes, you know, Joe if had to guess**,** because of our wholesale funding base and how much we have on our board, I mean, which is really subject to rate increases the fact they were not going up again I think helps. But part of it I think it's going to be going forward is, if that's reducing our [indiscernible] and I relying on that as much, you know I am hoping that that's going to start level off what our cost of funds look like, and hopefully will be subjected to these, when rates increase our kind of the short-term pain of rates going up so…

Joe Fenech
Okay. Very helpful. Thanks, guys.

Operator
Again, if you would like a question, please press "*" then "1" at this time. Our next question will come from Feddie Strickland of FIG Partners.

Feddie Strickland
Hey guys, this is Feddie on for Bryan. Just a quick question, great to see Brokered and National Time Deposit balances go down, but notice DDAs went down decently as well. I know they did last year. Is this seasonal or what should we expect in the DDA arena.

Glen Stiteley
Yes, that's…I mean that's a challenge for us every first quarter Feddie, you know we just…we have a…we have quite a bit of municipal deposits from a tax perspective, real estate tax deposits, as well as, again we have a build-up of, you know we have a lot of milk [ph] checks

that come in at the end of the year and then fall [ph] off pretty quickly further thereafter. So we just…we have always got their challenge in Q1, especially on the DDA side.

Tim Schneider
And also I would say the other thing on the Ag front which you know the dollars ebb and flow of milk prices. First quarter milk prices are pretty soft, especially January and February, probably lot lower than our dairy famer's expected, they have rebounded since then but that impacts big chunk of our DDA balances as well.

Feddie Strickland
Got it. Thanks for the color guys.

Operator
And this concludes our question and answer session. I would like to turn the conference back over to Tim Schneider for any closing remarks.

CONCLUSION

Tim Schneider
Well, we feel overall we had a very solid quarter. We had some nice reductions in our classified assets as we mentioned and elaborated on a bit and also drove some of our strategic initiative to move our wholesale funding reliance down a bit and overall feel really solid about the quarter and hopefully you all feel the same. And do you have any follow-up questions, feel free to reach out to Glen or I, and we do appreciate to be on the call today.

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