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Earnings Call

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Call Participants

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Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the MidWestOne Financial Group, Inc. Fourth Quarter 2024 Earnings Call.

[Operator Instructions] As a reminder, this call is being recorded. I would now like to turn the call over to Barry Ray, Chief Financial Officer of MidWestOne Financial Group.

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Thank you, everyone, for joining us today. We appreciate your participation in our earnings conference call this morning. With me here on the call are Chip Reeves, our Chief Executive Officer; Len Devaisher, our President and Chief Operating Officer; and Gary Sims, our Chief Credit Officer.

Following the conclusion of today's conference, a replay of this call will be available on our website. Additionally, a slide deck to complement today's presentation is available on the Investor Relations section of our website.

Before we begin, let me remind everyone on the call that this presentation contains forward-looking statements relating to the financial condition, results of operations and business of MidWestOne Financial Group, Inc. Forward-looking statements generally include words such as believes, expects, anticipates and other similar expressions. Actual results could differ materially from those indicated. Among the important factors that could cause actual results to differ materially are interest rates, changes in the mix of the company's business, competitive pressures, general economic conditions and the risk factors detailed in the company's periodic reports and registration statements filed with the Securities and Exchange Commission.

MidWestOne Financial Group, Inc. undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances after the date of this presentation.

I would now like to turn the call over to Chip.

Charles N. Reeves
CEO & Director

Thank you, Barry. Good morning, and we truly appreciate everyone joining for this quarter's call. Today, I'll provide a high-level overview of our fourth quarter results. As well as highlights regarding the continued execution of our strategic initiatives. Len will provide an update on our lines of business and Barry will conclude with a more detailed review of the fourth quarter and the impact of October's balance sheet repositioning.

We're very pleased with our fourth quarter results, which exhibited the dramatic impact of the bond portfolio repositioning and the paydown of higher cost borrowings. Those actions, combined with lower deposit costs drove a 92 basis point improvement in our net interest margin, leading to a 30% quarter-over-quarter increase in net interest income. This, along with continued focus on our strategic initiatives, led to net income of $16.3 million and a return on average assets of 1.03%.

Turning to the continued execution of our strategic initiatives. Our premium deposit franchise showed its strength with total deposits increasing 2% compared to the linked quarter. And importantly, noninterest-bearing deposits grew 4% on a linked quarter basis, aided by our year-long investments in treasury management. In April of 2023, we laid out a strategic plan with emphasis on driving wealth management and establishing an SBA vertical. The results of these initiatives are seen in our fourth quarter and full year financial results. Which Len will discuss further in his comments.

For the quarter, loan growth was flat, primarily due to elevated payoffs, many of which were loan resolutions, and you see that classified assets decreased substantially. We're pleased with our 2024 asset

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quality metrics and remain focused on problem loan resolutions while we continue with our disciplined growth strategy. Thank you to our team members who have been resolute in the transformation of MidWestOne and in their commitment to our customers. Together, we've positioned the bank to become a consistent, high-performing company, and we look forward to the opportunities in 2025 and beyond.

Now I'll turn the call over to Len.

Len D. Devaisher
President & COO

Thank you, Chip. We are pleased with the 2% increase in total deposits from the linked quarter. The true power of our deposit franchise was on display with an improving mix, continued strength in our commercial and consumer deposit segments has allowed us to assume a more conservative pricing posture on public funds. For the year, public funds in total were down 14%, while public fund CDs were down 40%. Meanwhile, consumer balances were up 2% and commercial balances were up 6%. This mix improvement reflects an intentional strategy to optimize our funding base.

As Chip pointed out, noninterest-bearing deposits increased 4% in the quarter. This is the second consecutive quarter of increase in this important category and the increase was across all customer segments. For the year, commercial noninterest-bearing deposits increased 7%. The growth in commercial noninterest-bearing reflects our treasury management focus, where fees were up 12% in 2024 from the prior year. While reported loan balances were flat from September 30, we were pleased that pass-rated loan balances grew at a 4% linked quarter annualized rate. And that our fourth quarter commercial originations exceeded third quarter originations by 8%. Favorable borrower sentiment and growing pipeline activity position us well for 2025. We anticipate mid-single-digit loan growth in the first quarter.

As Chip pointed out, the 54 basis point decline in our classified loan ratio, a 150 basis point improvement from a year ago, a decline in past due loans and a modest CRE ratio at 224% of capital reflect our vigilant focus on asset quality. [Congruent] with our strategic plan initiatives. Our SBA team generated more than $1.6 million of SBA gain on sale revenue in 2024, with $630,000 acquiring in the fourth quarter. The momentum in this business remains strong as we enter 2025. Another strategic plan initiative is a focus on wealth management. The 11% increase over the linked quarter and the 18% increase over the same period last year demonstrate continued momentum from our private wealth and investment services teams.

Our team-based planning-driven approach is working. And we see runway in that business, particularly in our growth markets. Deposit growth with an improving mix. Green shoots and loan demand with plenty of capacity momentum in our fee businesses, including wealth, SBA and treasury management. Indeed, MidWestOne's business lines are well positioned as we launch into 2025.

So with that, I'm pleased to turn the call over to Barry.

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Thank you, Len. Starting with the balance sheet on Slide 11. Total assets declined $316 million from September 30, 2024, due primarily to the deleveraging of our balance sheet from the repositioning executed early in the fourth quarter. As a reminder, that repositioning included the sale of $1 billion of securities, primarily corporates, munis, and CMOs that had a book yield of 1.58%. Proceeds from the sales were used to pay in full for $418.7 million of Federal Reserve Bank term funding program borrowings that were costing 4.77% and to purchase $590 million of Agency CMO and pass-through securities yielding 4.65%.

Len covered the loan and deposit changes, so I'll touch on shareholders' equity, which decreased $2.5 million from September 30, 2024, to $560 million. As unfavorable $14 million adjustment to accumulated other comprehensive loss was only partially offset by an $11 million increase in retained earnings. The company's consolidated CET1 ratio was 10.73% at year-end 2024, up 82 basis points from September 30, 2024, reflecting in part benefits from the balance sheet repositioning. Turning to the income statement on Slide 13. We reported net income of $16.3 million or $0.78 per diluted common share. Net interest

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income increased $11.4 million in the fourth quarter to $48.9 million as compared to the linked quarter due primarily to higher earning asset yields and lower funding volumes and costs, partially offset by lower earning asset volumes.

Loan interest income in the fourth quarter of 2024 included $2.5 million of loan purchase discount accretion, compared to $1.4 million in the linked quarter. We expect quarterly loan purchase discount accretion in 2025 to be closer to $1 million. Our tax equivalent net interest margin increased 92 basis points to 3.43% in the fourth quarter compared to 2.51% in the linked quarter as earning asset yields increased 60 basis points and the cost of interest-bearing liabilities declined 35 basis points. The average loan portfolio yield for the fourth quarter was 5.86%, flat from the linked quarter, while the average yield on loan originations during the fourth quarter was 7.10%.

On the liability side, the cost of interest-bearing deposits decreased 17 basis points from the linked quarter to 2.41%. We expected the balance sheet repositioning would add about 70 basis points to our net interest margin, and we were pleased to exceed that expectation as our core interest margin, which excludes loan purchase discount accretion, expanded to 3.26% for the fourth quarter, 85 basis points greater than the linked quarter.

Noninterest income in the fourth quarter of 2024 was $10.8 million compared to a loss of $130.4 million in the linked quarter. Adjusting for securities gains and losses and mortgage servicing right evaluations noninterest income was down $300,000 as outperformance from our Wealth Management business was more than offset by declines in other BOLI loan and card revenue.

Finishing with expenses. Total noninterest expense of $37.4 million in the fourth quarter was up $1.6 million from the linked quarter. Driving the unfavorable variance was a $575,000 increase in medical claims paid a $400,000 increase in non-merger-related legal costs and a $300,000 increase in property tax accruals. We do not believe such costs will continue at those levels in 2025 and thus, expect our 2025 annual expenses will be in the range of $145 million to $147 million.
And with that, I'll turn it back to the operator to open the line for questions.

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Question and Answer

Operator

[Operator Instructions] Our first question today will be from the line of Brendan Nosal with Hovde Group.

Brendan Jeffrey Nosal
Hovde Group, LLC, Research Division

Maybe to start off here on capital. Now that the balance sheet restructuring is behind you, you're back to building capital at a pretty decent clip here. So just wondering how you're thinking about deployment options over the course of the year.

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Yes, I'll start with that, Brendan. This is Barry. I'd like to talk about the use of capital waterfall. So starting with supporting loan growth, supporting balance sheet growth the cash dividend to shareholders, share repurchase and then finally, M&A. We are approaching -- we're at or kind of approaching that target of 11% CET1.

We think that's a good ratio for the risk profile of our organization. And I expect that waterfall that I just walked through is how we're thinking about it. Obviously, we kept the -- for example, we kept the dividend flat this quarter as we move forward throughout the year and build capital we'll see where we land with respect to opportunities, but -- and what we want to do with capital deployment as we go through the year.

Brendan Jeffrey Nosal
Hovde Group, LLC, Research Division

Got it. Okay. Maybe moving to the margin. I mean, as you noted in your prepared remarks, quite a bit more expansion than you or we were expecting, which was great to see. Just kind of curious about the path from here, especially as rate cut expectations have eased off a little bit. And more or less wondering if this quarter was a pull-through of margin expansion you had expected to persist throughout 2025 or if there's more left in the tank as we move through the year?

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Yes. I think there's a little bit more left in the tank, Brendan and the kind of the data points I can give you is we highlighted that our core margin in the fourth quarter was 3.26%, if you look at the month of December, the core margin was 3.29%. So I think we got a little bit more gas in the tank with respect to margin expansion, particularly we're getting some benefit from the shape of the yield curve, which is really, I'd say, mostly flat here. But yes, I think we still have some benefit here.

Charles N. Reeves
CEO & Director

And Brendan, this is Chip. I think the back book loan repricing, frankly, continues as well. Our loan yields are 5.86% that includes some accretion in that 5.86%, but we're originating in the fourth quarter in the low 7s. So we believe that will continue. And so we have a fair amount of maturities still coming at us in '25, '26. So we believe there's still some, you call it, gas in the tank margin expansion to come.

Operator

The next question today will be from the line of Terry McEvoy with Stephens.

Terence James McEvoy
Stephens Inc., Research Division

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In 2024, commercial loan growth was 5%, wealth management revenue, 16% year-over-year. I know you said 5% loan growth for the first quarter, but is that a good run rate to use for full year loan growth? And what are your thoughts on the outlook for fee income and specifically that wealth management line?

Len D. Devaisher
President & COO

Terry, this is Len. Thanks for the question. As we look at 2025, I think the mid-single-digit number is how we're modeling the year just based on what we're seeing overall. And with respect to wealth, in particular, we are targeting the double-digit growth to continue in that line of business. So -- and the key strategy there for us is the talent story and where we're adding and particularly in the growth markets.

Charles N. Reeves
CEO & Director

And Terry, this is Chip. And on the loan growth side, Yes. So mid-single digits and that belly of the curve with where it is today and obviously increased in the fourth quarter, slight pullbacks here in January, but still relatively high. We're just not seeing really commercial real estate projects penciling out at this juncture. So where I could see that potentially moving higher is if the belly of the curve comes down a little bit. But right now, that's negating some of the potential growth that's out in the system.

Terence James McEvoy
Stephens Inc., Research Division

Thanks Chip. And then as a follow-up, just given the tariff talk and some of the volatility in commodity prices, could you share with us your thoughts on how your ag customers and portfolio is holding up?

Gary L. Sims
Senior VP & Chief Credit Officer

Yes. Terry, this is Gary Sims. Thanks for the question. We are thinking through that as well as you relative to our ag producers. And as a reminder, not an overwhelming part of our portfolio, but certainly something that we monitor. As we look into -- well, first of all, 2024, pretty solid year for our producers. Prices were somewhat moderated, but very good yields. And as we go into 2025, we see pressure as a result of some of these issues. But one thing that we really gained confidence in is that over the course of the past 5 or 6 years, the portfolio of our producers that we do business with is a pretty resilient bunch. So we feel pretty confident that we can help our customers manage through this if, in fact, there are negative results from it.

Operator

The next question today will be from the line of Damon DelMonte with KBW.

Damon Paul DelMonte
Keefe, Bruyette, & Woods, Inc., Research Division

Hello, everybody. I hope you're all doing well today. Just wanted to start off with a little bit on credit and kind of -- I know Gary was just kind of touching on the ag sector there. But just kind of your thoughts on where the portfolio sits today, if there's any areas of concern. And kind of how you think about the reserve level at this point. I think the reserve was up a few basis points quarter-over-quarter. So -- do you feel like you're at an adequate level? Or do you feel you need to maybe add a little bit more going forward?

Gary L. Sims
Senior VP & Chief Credit Officer

Thanks for the question, Damon. And what I'm seeing from the portfolio today in terms of pressure points really hasn't shifted much over the course of 2024 and going into 2025. Office still has deterioration that we haven't identified in it. Our senior living portfolio has deterioration, but we're actually seeing improvement -- operational improvement in those borrowers that have struggled. And realistically, our largest senior living troubled asset, we were able to liquidate over the course of third and fourth quarters.

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So not a lot of shift in terms of what I'm seeing with pressure points. As we move into 2025, as we saw in 2024, as we identified the credits, we worked through them, we created resolutions, and you saw the results that we got for the fourth quarter. First quarter and beyond, we're going to continue to see resolutions of those assets that we have identified. You mentioned the reserve. We did move that up a little bit. And we feel like what we have on tap for first quarter and beyond for resolutions, we are adequately reserved to be able to execute those resolutions. So I think what you saw in 2024, you're going to continue to see in 2025.

Damon Paul DelMonte
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. Okay. That's helpful. And then I guess just kind of a broader-based question on your approach for driving sustainable organic growth. You guys have made a lot of investments in commercial bankers and kind of ventured into some other business lines. Chip, can you just give us an update as to the plans for '25? Are you guys still actively looking to add new bankers and potentially physical locations and other parts of your footprint?

Charles N. Reeves
CEO & Director

So Damon, the answer to that one is -- would be yes, and I'll quantify the yes, probably more from geographic areas or areas of focus for you. Twin Cities in Denver and then Iowa Metro are high focus areas for us. And I think you'll continue to see us invest in those geographies. You'll also see us continue to invest, frankly, in what I call our infrastructure and our acquisition readiness and there from technology, from platform to talent, risk management, platform, talent, operational talent, as we prepare ourselves for '25 being a year of execution, but between our capital levels, our newfound earnings profile, organic growth that we're expecting, I believe we're positioning ourselves to become a little bit bigger when the time is right.

Operator

Our next question will be from the line of Nathan Race with Piper Sandler.

Nathan James Race
Piper Sandler & Co., Research Division

Going back to the margin discussion. Chip, you mentioned some of the back book repricing. I was wondering if you could kind of frame up just in terms of how much of loans you guys have kind of repricing over the course of this year?

Charles N. Reeves
CEO & Director

Nate, I'm going to swing that one to Barry. He has the detailed statistics.

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Yes, Nate, we've got $386 million of fixed rate loans that we expect to reprice over the course of the next 12 months. The coupon on those is 4.57%. So $386 million at 4.57% is what we expect to reprice.

Nathan James Race
Piper Sandler & Co., Research Division

Okay. And then just generally, what are new loans coming on the portfolio at today on a blended basis.

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Yes. Fourth quarter, we put them on at 7.1% to low 7s.

Nathan James Race

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Piper Sandler & Co., Research Division

Got you. Yes. And if the Fed remains on pause this year, can you kind of just talk us through kind of the CD repricing gaps that you have that could aid in deposit costs continue to come down? And if there's any opportunities to lower pricing on non-CD products as well, at least over the next quarter or 2?

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Yes. Most of our CD book, Nate, is less than 1 year. And so yes, we see opportunity even if the Fed remains on pause to lower the cost of that book as that comes due. And then to the second part of your question, we continue to look at our other non-maturity interest-bearing deposits and where we have opportunity to lower there. And so we're still actively looking at those costs and looking for pockets where we could perhaps lower cost even if the Fed remains on pause.

Nathan James Race
Piper Sandler & Co., Research Division

Okay. And just one last one, Barry, can you just update us in terms of kind of the balance sheet sensitivity and margin impact from each -- if the Fed does cut this year?

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Well, right now, our balance sheet models as asset sensitive with the shock scenarios made. And so -- and again, that's plus or minus 100 parallel shock. And so we model as asset sensitive. So if the -- if the rates cut, that suggests that our net interest income would go down in that shock scenario. However, as I talked about earlier, what we're observing is actual the yield curve flattening out. And so I think there's still opportunity for margin expansion. But the balance sheet models as asset sensitive on a shock scenario.

Operator

[Operator Instructions] And the next question will be from the line of Brian Martin with Janney Montgomery Scott.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Barry, if you covered this, I apologize. Did you give us some thoughts on kind of the -- I know you talked about the fourth quarter expenses, but just how to think about the expense run rate as we kind of head into '25 here and just puts and takes there?

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Yes. In my prepared remarks for the script, Brian, I did talk about what we expect for 2025 expenses to be in the $145 million to $147 million range for the year, which would suggest $36 million to $37 million per quarter for the expense run rate.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Got you. Okay. I apologize for that. And then just in terms of fee income, Chip, I don't know, can you give -- it sounds like the SBA really had a nice year here, kind of embedded in the mortgage line or the loan line there. I mean it also kind of seems like that the mortgage side, the traditional mortgage maybe has kind of been flattish. So I guess just trying to understand if I'm thinking about that right. And the other real question is just kind of the areas you talked about in terms of initiatives on the fee side as far as expanding fee income going forward.

Can you just talk about outside of -- you've talked about the wealth and the SBA kind of the other business lines you've added this year, kind of what they've contributed or just kind of where the

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opportunity is as we think about fee income next year outside of wealth, which you've already covered, but just in SBA, but the other line items or potential that we have that get some pickup here.

Len D. Devaisher
President & COO

Brian, this is Len. I'll take a stab at that. So if you look at SBA as an example, so that number was [1.6] for us in '24, about 4x what it was in '23 -- over 4x what it was in '23. And if you look back, 2/3 of that number came in the last 2 quarters. So I see good momentum there. So that's a key point on the loan line item, as you point out. The other thing is, obviously, the mortgage -- residential mortgage business has headwinds with the rate environment where it's been.

But what I would tell you is one of the strategies tactically is to focus on leveraging our secondary market product offerings to make sure we're optimizing that as best we can. When I look at drivers, wealth, obviously, was a huge story for us in '24, and I've talked about that. We see more runway there. And then treasury management, the 12% number, which flows through the service charge line is 12% in '24 over '23. And I see more runway for us in the treasury management line as well. Then lastly, what I would tell you is, as Chip talked about, as borrowers get a little more confidence and a little more stability relative to CRE, I think our CRE business, we've got room to go there, right, when you just look at our CRE powder.

And I think that can help drive our swap line because that's frankly been a modest line for us these last couple of years. And I think as the CRE business picks up, I think that can help drive the swap line too from a fee perspective. So those would be the drivers I would see.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Got you. And Len, can you talk about -- I mean, I guess, just give some color in terms of the outlook for growth in fee income, I guess, in terms of how you guys are thinking about that, given some items you just went through in terms of where the momentum may be?

Len D. Devaisher
President & COO

Yes. So I'm going to say mid- high single digits is what we would be on a total for the fee income line is what we'd be looking at for '25.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Got you. Okay. That is helpful. I appreciate that. And Barry, just last thing back to just the margin for one moment. The trajectory on the margin given the steepening of the curve here and just kind of a little bit of tailwind you have. If we don't see -- if we see a pretty -- not much activity from the Fed, the general outlook should be that given what you've outlined maybe a gradual trajectory in the margin kind of throughout the year? Is that how to kind of frame that up?

Barry S. Ray
Senior Executive VP, CFO & Treasurer

That's how I would frame it up, Brian, exactly like that. Yes, gradual over the course of the year.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Okay. And maybe a bit of a step down in 1Q if the accretion -- I think you said the accretion goes back to around $1 million a quarter. Is that -- I think I heard that right. So that give back starts first quarter?

Barry S. Ray
Senior Executive VP, CFO & Treasurer

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Yes. That's kind of how I would -- if I start thinking about the first quarter, that's kind of where we talked about the -- that's why I was focusing on the core net interest margin, Brian, of [3.26%] and so the layer in that kind of $1 million plus of discount accretion or about $1 million of discount accretion per quarter, and that should get you to kind of a launch point.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Got you. Perfect. And I don't know, just a big picture comment in terms of profitability. I think, obviously, you guys were above 1% on the ROA in the quarter. As we think about kind of an exit to 2025, Chip can you kind of talk about where you think that exit is on ROA or just kind of how we should be thinking about that as we proceed through the year?

Charles N. Reeves
CEO & Director

Yes. We're extremely focused, Brian, in terms of obviously building that throughout the year. And what we anticipate is that, that has potential with execution to be in the [$110 million] to [$115 million] range as we exit 2025.

Operator

The next question will be from the line of Nathan Race with Piper Sandler.

Nathan James Race
Piper Sandler & Co., Research Division

Yes. follow-up. I'm just curious if you can kind of frame up your deposit growth expectations for this year. I know you guys are focused on adding bold relationships, but just curious if you're expecting deposit growth to follow that kind of mid-single-digit pace in loans.

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Yes. Nate, this is Barry. I'll take that kind of as we have been looking at deposit growth expectations for the year 2025, we're thinking around 3% is probably what we're looking at for deposit growth.

Nathan James Race
Piper Sandler & Co., Research Division

Okay. Great. That's helpful. And then, Barry, can you just update us in terms of the amount of cash flow coming off the bond book this year following the restructuring?

Barry S. Ray
Senior Executive VP, CFO & Treasurer

Yes. Next, we expect to get around $200 million of cash flows off of the portfolio in 2025, Nate.

Operator

We have no further questions in the queue at this time. So I would now like to hand the call back to CEO, Chip Reeves, for closing remarks.

Charles N. Reeves
CEO & Director

All right. Thanks, everyone, for joining us today, and we truly look forward to our April call to share our continued progress in becoming that consistent, high-performing company that we've spoken about over the last few years and began to demonstrate even further with our fourth quarter results. Thanks, everyone.

Operator

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This concludes today's conference call. Thank you all for joining. You may now disconnect your lines.

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