

04 - 25 - 2024

Alerus Financial Corporation

2024 Q1 Earnings Conference Call

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CORPORATE SPEAKERS:

Katie Lorenson

Alerus Financial Corporation; President and Chief Executive Officer

Alan Villalon

Alerus Financial Corporation; Chief Financial Officer

Forrest Wilson

Alerus Financial Corporation; Chief Retirement Services Officer

James Collins

Alerus Financial Corporation; Chief Banking and Revenue Officer

Karin Taylor

Alerus Financial Corporation; Chief Operating and Risk Officer

PARTICIPANTS:

Brendan Nosal

Hovde; Analyst

Jeff Rulis

D.A Davidson; Analyst

David Feaster

Raymond James; Analyst

Nathan Race

Piper Sandler; Analyst

Damon Del Monte

KBW; Analyst

PRESENTATION:

Operator^ Good afternoon. Welcome to the Alerus Financial Corporation Earnings Conference Call. (Operator Instructions) Please note, this event is being recorded. This call may include forward-looking statements. The company's actual results may differ materially from those indicated in any forward-looking statements.

Important factors that could cause actual results to differ materially from those indicated in the forward-looking statements are listed in the earnings release and the company's SEC filings. I would now like to turn the conference over to Alerus Financial Corporation President and CEO, Katie Lorenson. Please go ahead.

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Katie Lorenson^ All right. Thank you, (Angela). I appreciate it. Greetings, all. Welcome to the Q1 2024 Alerus earnings call. We appreciate you all taking the time to join us today. Joining me here today in Minneapolis is Alerus' CFO, Al Villalon; our Chief Operating and Risk Officer, Karin Taylor; our Chief Banking and Revenue Officer, Jim Collins. And making his debut earnings call with us today is our Chief Retirement Services Officer, Forrest Wilson.

I am incredibly proud to be surrounded by these talented professionals here in this room, and as well as widely and deeply across the Alerus franchise.

Earnings for the first quarter of 2024 matched expectations as our team members delivered again in executing our organic growth of One Alerus strategy. Client wins came across -- came through in all parts of the business and most notably resulted in strong deposit and wealth management growth and inflows.

We saw new client wins in C&I, which came with lending opportunities and full treasury management relationships.

Our One Alerus business model and holistic approach to serving clients continue to differentiate our company with an impressive quarter of net inflows in wealth management and strong production was driven by business owner liquidity events as well as robust rollover business sourced from our retirement division.

The synergies between private banking, wealth, mortgage and commercial banking continue to emerge even faster than expected. The results of these efforts by our team members and support services were evident with deposit balances increasing over 6% in the quarter and commercial loans growing over 2% during the quarter. Highlights for the quarter included an improving core net interest margin as we saw the benefits from the balance sheet repositioning as well as the impact of organic growth.

Fee income, which accounts for over 50% of total revenues delivered ongoing positive momentum showing growth across each of the fee-based businesses.

Alerus remains in a uniquely strong position to grow with a highly-diversified loan portfolio and robust liquidity. Loan balances grew for the ninth consecutive quarter, while deposit balances increased for the fourth consecutive quarter, displaying our proven ability to grow and attract new clients.

While deposit growth for the industry remains very challenged, we continue to see strong client flows within our banking markets as well as nationally through synergies with our retirement and benefits businesses.

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We remain consistently disciplined in our risk management and infrastructure investments while selectively taking market share and supporting our clients and our communities.

Our commitment to our shareholders and our fortress balance sheet is unwavering with an allowance to total loans of 1.31% and a CET1 capital ratio at 11.85%. With our quarterly dividend 5.6% higher than the same period in the prior year, we maintained our history as a dividend aristocrat, and we continued our streak of 40 years of paying a dividend and consistently increasing our dividend.

Asset quality remains strong with less than 1 basis point of net charge-offs and consistently low levels of nonperforming loans.

We remain confident in our strategic initiatives including our focus on building efficiencies, and we will continue to get better at managing expenses, proceeding on our path to returning the company to top shareholder returns and earnings per share growth. With that, I will turn it over to CFO, Al Villalon.

Alan Villalon^ Thanks, Katie. I'll start my commentary on Page 11 of our investor deck that is posted in the Investor Relations part of our website. Let's start on our key revenue drivers.

On a reported basis, net interest income increased 3.1% on a linked quarter basis. The increase was driven primarily by organic loan growth, strong deposit growth and an arbitrage opportunity using the bank term funding program. Net interest income represented 46.7% of revenues.

Switching to fee income. Noninterest income decreased 0.4% on a linked-quarter basis, primarily driven by client swap income of approximately \$1.3 million that was recognized in the prior quarter and other noninterest income. Despite not having any swap income in current quarter, we did see fee income increase across all of our fee-side income segments.

I will go into detail about each of our income segments in later slides. Turning to Page 12. Net interest income increased to \$22.2 million in the first quarter. The BTFP arbitrage was accretive to net interest income by \$349,000.

We can pay back the BTFP any time or its due date in 2025 with no penalty. Adjusted core net interest margin, which excludes the impact of the BTFP arbitrage was 2.44%, an increase of 7 basis points from the prior quarter.

During the quarter, higher loan balances and rates along with lower volumes helped drive margin expansion.

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We expect our reported net interest margin to continue to improve in 2024. After 2024, or when we repay BTFFP, our reported net interest margin will revert to the core margin we show, primarily due to reduction in average earning assets.

Should the Fed remain on pause, we continue to expect our net interest margin to improve. While the Fed outlook is uncertain, our (AUA) modeling shows that with a static balance sheet and at current spreads, our net interest margin will exceed 3% for the full year in 2026.

Should the Fed cut interest rates sooner, we expect to get to 3% net interest margin sooner depending on the timing and magnitude of rate cuts. (Expectation) is our net interest margin returns to being liability-sensitive with \$400 million of swaps maturing in July of this year and another \$200 million of swaps in January of 2025. Let's turn to Page 13 to talk about our earning assets. Total loans grew 1.4% from the prior quarter, driven by organic growth in C&I and commercial real estate.

Our investment portfolio declined 2.2% as we continue to remix low-yielding securities into higher-yielding loans. For 2024, we continue to expect -- we expect to see modest loan growth.

While 7% to 8% of loans are expected to (contractly) payoff during the remainder of the year, we do expect loan production to offset this runoff and expect our earning assets to continue to grow. Turning to Page 14.

On a period ending basis, our deposits increased 6.1% from the prior quarter. The momentum and deposit growth we saw in the prior quarter continued into this quarter.

While overall deposits grew, noninterest-bearing deposits balances decreased 4.9% and now represent 21% of total deposits.

Overall synergistic deposits, so those (stores) from our retirement and wealth businesses, increased 3.7% from the prior quarter. Given the strong deposit growth, we saw our loan-to-deposit ratio decreased to 85.2%.

For the second and third quarters of 2024, we do expect a seasonal outflow of approximately \$200 million, mainly from our public funds.

While these outflows will pressure deposit balances in upcoming quarters, we do expect deposit levels at the end of the year to rebound to the end of the year higher than where we ended in 2023.

Turning to Page 14. I'll now talk about our banking segment which also includes our mortgage business.

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Our focus on the fee income components now since I've already covered net interest income.

Overall noninterest income for banking was down \$627,000 or 15% from the prior quarter. Most of the decline was attributed to \$1.3 million decline swap income that was recognized in the prior quarter.

This swap income does not relate to our balance sheet swaps. Rather, these swaps are done at the client level when a banking relationship would like to lock in a fixed rate by swapping out floating rate loan. This type of swap income tends to be lumpy and unpredictable.

For the second quarter, we do expect the overall level of noninterest income to increase from the first quarter level as we expect mortgage income to improve with a typical seasonal pickup in the second and third quarters.

The current level of other noninterest income of \$1.5 million is a better run rate on a go-forward basis, and we expect that level to be stable as we do not expect any client swap income in the upcoming quarter at this moment.

On Page 16, I'll provide some highlights on our retirement business. Total noninterest income increased 2.2% from the prior quarter.

In the quarter, assets under management increased 4.9%, mainly due to improved equity in bond markets. Participants within retirement grew 1.5% during the quarter.

As we did in our 10-K, we broke out the noninterest expense that is allocated to the retirement segment.

The table on the top left does not include any credit for our synergistic deposits since those earning assets (of) those deposits are within the banking segment. These synergistic deposits are highly valuable when compared to borrowing at FHLB, which are currently in the low 5% range.

While almost 53% of retirement synergistic deposits are indexed, 16% are noninterest-bearing and 31% consists of HSA deposits, which only carry cost of funds around 10 to 15 basis points.

For the second quarter, we expect fee income from retirement business to be stable at \$15.7 million despite the recent downturn in the markets. Turning to Page 17, you can see highlights for our wealth management business.

On a linked quarter basis, net revenues increased 9.3%, while end-of-quarter assets under management increased 5.5% due to improved equity and bond markets.

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Over 85% of revenues in this segment are asset-based fees.

Similar to the prior slide, we show on the top left the noninterest expenses allocated to the wealth segment, but we have also excluded any credit for -- of our synergistic deposits.

As you can see here, 88.6% of our synergistic deposits in wealth are indexed while the remainder for noninterest-bearing.

For the second quarter, excluding any market impact, we expect fee income from the wealth business to be stable given recent market volatility. Page 18 provides an overview of our noninterest expense. During the quarter, noninterest expense increased 0.9%, mainly due to higher seasonal compensation and benefits.

As we continue to deal with inflationary pressures, we continue to expect expenses to grow for 2024 -- to grow low single digits when compared to 2023 on a reported basis. Turning to Page 19. Credit continues to remain very strong.

We had net charge-offs to total loans of 1 basis point in the quarter. A nonperforming assets percentage was 17 basis points compared to 22 basis points in the prior quarter.

Our allowance for credit losses on loans to total loans was 1.31% or 498% over nonperforming loans. I will discuss our capital liquidity on Page 20.

Our common equity Tier one capital to risk-weighted assets is 11.9%, which is almost 200 basis points above the 9.9% stress minimum required by the largest financial institution subjected to the (inaudible) stress test.

On the bottom right, you'll see a breakdown in the sources of over \$2 billion of potential liquidity. Overall, we continue to remain well positioned from both liquidity and a capital standpoint for future growth or weather any economic uncertainty.

While we did not repurchase any shares in the quarter, we have an active 10b5-1 share repurchase plan out there that is very disciplined in our share repurchase approach. The recent sharp run-up in our share price ended up being above the repurchase levels we set in our 10b5-1 plan.

Our 10b5-1 plan currently remains in place today. So to summarize on Page 21, the momentum we had in the fourth quarter of 2023 continued into 2024.

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We continue to see organic loan growth and strong deposit growth. Our net interest margin continued to improve in the quarter. Even if the Fed remains on pause, we continue to see a path of the margin to improve to over 3%.

Our fee businesses, which are nonspread-based represented over 53% of revenue in the quarter and continue to be a differentiator for us. Our capital levels remain strong and we remain committed to returning capital prudently. With that now I'll open it up for Q&A.

Operator^ (Operator Instructions) The first question comes from Brendan Nosal with Hovde.

Brendan Nosal^ Maybe just to start off here on the BTFP trade. At this point, the intention to keep it on for the full 12 months. Then is it (inaudible) business and that is match funded for 12 months?

Alan Villalon^ That is correct, Brendan. That's a safe assumption. The only time we probably repay the BTFP, if we see that arbitrage opportunity, not (be worth) our time.

Brendan Nosal^ Yes. Yes. That makes sense. Then I guess following up on that, in terms of the margin more specifically, I appreciate the longer-term guide for (30%) and you see the continued core margin expansion this quarter.

Can you give us a finer point on the NIM outlook for the rest of this year, kind of assuming that the Fed doesn't do a whole lot here?

Alan Villalon^ Yes. So right now we're a little bit asset sensitive given our swap position.

So it'll be a little bit -- if the Feds remain on pause, we still will see continued NIM improvement and a liability sensitivity will return as our swaps roll off in July and in January of next year.

So right now the biggest wildcard for us would have to say is this the deposit environment, Brendan. So we do expect gradual improvement through the year.

But what I'm trying to give you too is like even if the Fed is on pause between now and 2026, you could see our NIM where we are today on a core basis of 2.44%. You can just kind of map out gradually getting to an average NIM 3% in 2026. That's how I would think about it.

Brendan Nosal^ Yes. Yes. Okay. Then one more follow-up. Can you just remind us how much of a drag on the margin in each of those two swap (inaudible) that are rolling up later this year or early next year?

Alan Villalon^ Yes.

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So the drag right now I would say I mean it's really the way to think about it is in terms of -- the way we look at it in terms of our (ALM) modeling is that when we look at our disclosures right now when we look at a down 100 scenario. Right now our NII is going to be down probably, let's say 1% okay.

On a down 100 scenario. But then if you think about where we disclosed this back in 2022, when we didn't have the swaps in, our net interest income in a down 100 scenario was going to be up around roughly 6% or more.

So that's the way I kind of think about it, of how this impacts those swaps is that (inaudible) from liability sensitive to asset sensitive.

Then we eventually will return in the down 100 scenarios to being NII being up around 100 basis -- sorry, up around 6%.

Operator^ The next question comes from Jeff Rulis with D.A Davidson.

Jeff Rulis^ Just a follow up on the BTFP. The timing that you brought that on in the quarter and more specifically in -- does that represent a full quarter of impact, both NII and margin in Q1?

Alan Villalon^ No. Jeff, I think there's a little bit more we could pick up there because we picked that up late January.

Jeff Rulis^ Okay.

Could that be then now a little more accretive to NII and a little more dilutive to margin?

Alan Villalon^ Correct. That's the way to think about it, Jeff.

Jeff Rulis^ Then...

Alan Villalon^ (inaudible) diluted to the reported net margin, net core margin.

Jeff Rulis^ Right. Right. To that point, as long as you have that out there, again we can kind of track reported and adjusted and just assume that gap closes once retired, we -- is that how to sort of think about those two items?

Alan Villalon^ Correct. That's the way to think about it because there's a denominator effect on our average earning assets.

So we have approximately around \$300 million to \$350 million range of average earning assets that's impacting that.

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So then if you take that off the denominator, that's going to have a great impact.

Jeff Rulis^ Okay. Maybe I'll talk to the retirement and benefits and Forrest being on the line. I wanted to get a sense for any -- I may know the answer to this already, but just any tweak to the strategy.

I think one of the big parts of bringing ahead on here was also on the M&A or strategic end of things.

So just anything to add while we got Forrest on the line?

Forrest Wilson^ Yes. Well thanks, Jeff. Forrest Wilson here, and glad to be here.

But yes. I mean really quick observations would be that this is a very solid business. It's not (broke). There is an opportunity for improvement, which I can address in just a second.

But been very impressed with the team, a lot of tenured folks that are smart, experienced, dedicated, but there is a lot of opportunity here as well.

Organic growth and I think we can see some nice pickup here over time.

It's going to be -- have to be paced out, if you will, but there's an opportunity for more partnerships like one we have with MassMutual, that market, which we have a nice foothold in.

As you just kind of alluded to, Jeff, there's definitely some opportunities for acquisitions as the space continues to consolidate.

I think we have to be really thoughtful with this. It's something that I have some experience with throughout the years. And as excited as we can get about acquisitions, and I do believe we'll likely do 1, 2, 3, a few of them over time.

We need to be very thoughtful as they can push you in the wrong direction as well. In line with that, Katie and I looked at one already that was going to look good at first, but when we dug in, it really wasn't going to be accretive to driving shareholder value, and we step out of that.

But the kind of the third and final thing that I'm seeing is that there's an opportunity for efficiencies gained through -- just through structured, which we're working on. There's a lot of process improvement that can be done.

Then although we have a good technology platform, AI is coming in quick to this business, and there's a lot of opportunity there to leverage that. We're looking at that as well.

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So hopefully, that kind of gives you a little bit to answer your question, Jeff.

Jeff Rulis^ Yes. Appreciate it. Great overview. And maybe last one just on the loan growth outlook coming out of the gates, pretty strong this year, and I think you sort of tamped that down.

Could you just remind me why that sort of is it conservatively thinking for the balance of the year?

Or were there payoffs or anything that kind of moderates that growth outlook from a pretty strong first quarter?

James Collins^ Jeff, this is Jim Collins. I'll take that one. I think it's a little conservative, but I think we've been a little conservative because rates are staying higher.

We did a lot of some growth in investor CRE and multi-housing in both of our largest markets.

We really need to make sure those stabilize and we don't go into those markets and put too many on the books right now until we see how those markets are going to develop.

That was a lot of the growth we had at the back end of last year, which floated into the first quarter. We've had some solid C&I growth, a lot of new relationships, full TM loans, deposit relationships flowing in the first quarter.

I'm bullish on that, but those relationships take a little while to develop.

So we're just kind of harnessing that loan growth. I expect we'll definitely hit budget may be exceed it, but we don't want to throw out some numbers that we (can't) achieve.

Operator^ The next question is from David Feaster with Raymond James.

David Feaster^ Maybe just following up on some of this commentary around the balance sheet managing (it). You guys have been very active, right? We've got the balance sheet restructuring, put on the swaps and liability sensitivity is going to resume in the back half of the year, like you alluded to, Al.

I know you talked about NIM expansion exclusive of cuts and getting back to plus 3%. But I'm curious, how do you think about managing the balance sheet at this point?

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And anything that you're considering or looking at and whether the prospects of a higher-for-longer environment impacts that at all? It doesn't sound like you're looking to put more swaps out. But I'm just kind of curious how you think about managing the balance sheet.

Alan Villalon^ Thanks for the question, David. So as we think about the balance sheet right now I'd say first, let's just start with the investment side.

I don't think there's much more to do there because our investment portfolio is in our targeted range of like 15% to 20% of total assets. And even though you saw yields come down there in the investment portfolio just a tiny bit there, that's because a lot of our munis are low yielding and the (HTM) sites, which we're not going to sell.

When it comes to the loan side out right now there's just not much of a mark out there to really sell some of our loans.

So right now it's just remixing the balance sheet, especially as Jim and his team kind of comes in with more commercial relationships and kind of just which is coming with higher yielding loans for us.

So it's kind of definitely mixing that's going to happen there.

So if there's an opportunity for us to maybe offload especially if some (inaudible) for family, we'll look into it, but that's going to take some severe rate movement to happen.

So -- and then the last part of it in terms of the swaps, I mean I think the only thing you'll see us probably do as the liability (inaudible) returns is that we're probably going to do something a swap in a sense that just making sure that we're still managing our interest rate risk from an (ALM) modeling standpoint because we do have -- as I alluded to, that on a down 100 scenario, our net interest income will improve high single digits, we just want to make sure on the tail risk that we don't have any sort of tail risk we need to worry about.

So we might just employ some swaps on the tail end, just fight collars of some sort to maybe just manage that risk.

David Feaster^ Okay.

Then maybe kind of two just kind of following up on that. I guess do you have any details on the repricing side for your fixed loans or fixed rate earning assets in general that are going to be maturing in the next two months or so and the pickup that you'd expect on those?

Then how do you think about funding the public fund outflows that you're expecting this quarter and next?

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Alan Villalon^ Yes.

So on the first part of it, in terms of the -- what's coming on the book and what's going out, I mean we're probably going to get a little bit of a pickup here of a couple of hundred basis points of what's rolling off to the stuff we're putting back on.

So that's the way to think about it.

Then like I said, we are about 7% to 8% of our book -- our loan book is going to roll off this year in terms of just gross loans.

Then...

James Collins^ On the deposit side, David, I would say those -- we picked up two fairly significant C&I relationships in just the first quarter in just the Twin Cities. Clearly, we have public funds that come in for six months and then they slowly drain out and then they come back towards the end of the year. A lot of the prospect that the C&I teams are doing in all markets are going to help fund some of that public funds deposits that are leaving. They won't be able to fund all of them right away but those relationships grow deposits over time.

Also all those deposits (don't come in) right away.

So we will see some good deposit growth, core deposit growth of existing and new relationships to help temper down the public funds leaving, but there will be a differential that we'll have to fund.

Alan Villalon^ And David, this is Al.

One more. Just to build on what Jim said there, too. While we see seasonal outflows in our public funds in the second and third quarter, we do see that building back up both in the fourth quarter and in the first quarter of the next year.

So we're doing a temporary seasonal outflow right now that should pick back up in the back half of this year.

David Feaster^ Okay.

The gap between the deposit growth, would you just plan on using cash or -- just kind of curious how you think about funding that gap if there is any?

Alan Villalon^ Yes. By cash or if we need to do some short-term borrowings.

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David Feaster^ Perfect.

Then just touching on the credit front. I mean credit remains pristine, right?

You guys have a great reputation as a really conservative underwriter.

I'm curious, as you said -- I mean obviously there's a hyper focus in the market on CRE, right?

As you step back and look and you look at your portfolio, you stress things and you look in the market.

I'm curious, how do you -- what are you watching closely?

What are you seeing?

Is there anything that's causing you any concern at this point?

Then just maybe from a competitive standpoint, is the competitive landscape may be a bit more rational today?

Curious kind of what you're seeing on that front.

Karin Taylor^ Sure, David. This is Karin, I'll take that one.

We obviously take a look at our refinance risk.

We're fortunate in when we started growing our CRE book, rates started to increase.

So our refinance risk, we feel is limited and very manageable.

We do have some construction deals on the books and like others, we're just watching stabilization period.

Our deals are performing well but we're certainly cognizant that we could see some (strongness) in stabilization. Generally speaking, of the fundamentals in our market for the asset classes we're in are very strong.

So we're not overly concerned, but certainly watching it.

In terms of competition, yes, I would say it is more rational. I mean there certainly are players who have concentrations. We've seen growth, but we're not overly concentrated.

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Those that (are) have pulled back and aren't lending to the same degree they were.

Operator^ The next question comes from Nathan Race with Piper Sandler.

Nathan Race^ Just thinking about the wealth management revenue growth outlook going forward. Curious to get an update just in terms of the success you guys are having in terms of transitioning clients from the (inaudible) platform onto the (wealth).

What added tailwinds we can expect in terms of organic AUM growth with some of the private bankers that (you have added) over the last two quarters?

James Collins^ Yes, Dave, this is Jim. I'll take that one. So the terminated participant plans, so the plans that are rolling off of our 401(k) group into our wealth, we've implemented some new tactics and some new tracking mechanisms, and that is actually increasing and going extremely well.

We anticipate that, that will only increase over time as we learn from how we're building this out a little bit better.

So I suspect that, that will continue. We are also a little bit more active in recruiting some additional wealth advisers in that space because we need more capacity.

So we're actively recruiting, and I think we're finding some pretty good success in recruiting some of those individuals in that space. So that will help as well.

As far as the private banking team, they really launched the end of last year, early this year. We're having a lot of success with the private banking team and the mortgage department as well as the wealth team.

We've also had some pretty good success with commercial businesses that are selling with the wealth group and the private banking group getting in early before that announcement of the business sale and that liquidity event and capturing a big chunk of that liquidity.

We have one specific large event this quarter. That's that example, and we'll probably harness about two-thirds of that liquidity event in our wealth department.

So as that continues to build in all markets, really, we're focused on the private banking and the Twin Cities. Now we should be launching Arizona later on second quarter, early third quarter and continued traction. I only see positives out of that.

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Nathan Race^ Okay. Great. Very helpful. Then just curious to kind of think about kind of the trajectory of deposit costs over the course of the quarter. And (you gave) a spot rate on deposit costs at the end of March.

Alan Villalon^ Yes. So Nate, the way I think about it right now is we continue to see migration from noninterest-bearing to interest-bearing.

So right now I mean we continue to see that pressure, which is going to be pushing up our deposit cost slightly.

But I'd say that our overall deposit beta is probably -- it's slowed down dramatically. So I'd say right now that we probably see just marginal increases in our overall deposit costs from these levels.

But there's still big pressure and the bigger pressure will just continue. The question is now going forward is how much pressure comes in the noninterest-bearing side that people move into interest-bearing.

Nathan Race^ Yes. I guess as the competitive environment stands today and based on your pricing, I mean is it fair to expect at least that the magnitude or piece of deposit cost increases flows from here?

Alan Villalon^ Yes. I think that's fair. I mean we're seeing -- we've seen CD rates, especially from our competitors. They rolled back some and so do we.

So we've seen the least (build), especially in -- like anything beyond 12 months have come down, especially with (inversion of the curve).

But overall, I'd say that our call to deposits today are still somewhere in the Fed funds minus (50) to 100 basis points.

Nathan Race^ Okay. Got it.

Then just lastly, I got on late, so I apologize if you already touched on this, but I think you guys had modest loan growth at least near term. You guys have exceeded that based on the similar guidance here for the first quarter.

So just curious, is it just elevated payoff expectations potentially that's weighing on that outlook coming into 2Q? Or is there any other thoughts on how we should think about loan growth over the remainder of 2024?

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Alan Villalon^ No problem, Nate, I'll turn it off to Jim here in a second. Just so you know that we are expecting about payoff of around the 7% to 8% of total loans for the remainder of the year. Then Jim can comment on the color of what's going on.

James Collins^ Yes. So some of the growth we had in the tail end of last year and this year was really centered around investor CRE. There's a heightened focus on C&I growth in all markets.

That tends to be larger lines of credit, but that aren't funding automatically, and those relationships take a little bit more time versus a transactional CRE deal that funds right away.

So that's what's tapering that in our forecast. But we're still very bullish on bringing in new relationships for the rest of the year.

Operator^ Sorry, if I could ask (inaudible) on the tax rate for the quarter.

Alan Villalon^ Yes. I would expect our tax rate. We did see a little bit of gravitating up in other states, some taxes, (inaudible) some recent changes. So I would say somewhere around 24% possibly is a good tax rate to use on a go-forward basis.

Operator^ The next question is from Damon DelMonte with KBW.

Damon Del Monte^ Hope you're all doing well today. Just curious on the mortgage banking outlook with rates remaining kind of stubbornly high here. Is there any concern that the typical seasonal increase here in the second and third quarter might not be as favorable as it has been in the past or that you may be expecting?

James Collins^ We're still tracking pretty close for the second quarter, but we won't be surprised given that the (rate) hire and the inventory is a little lower in our largest markets that we're going to follow a little light on that for the second quarter.

Then we'll see what third and fourth quarter look like. The second quarter and third quarter are really where we're going to see some -- we should see that growth.

So our budgeted number, we're still keeping that number because we can -- I'm pretty confident we can come close to that. The second quarter might be a little light based on the rates and demand.

Damon Del Monte^ Got it.

Okay. That's helpful.

Then with regards to the loan growth and the opportunities, how does Arizona factor into your

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outlook?

Is that a meaningful contributor to the overall growth?

Or is it still being driven primarily by the Twin Cities?

James Collins^ As of right now it's driven more by the Twin Cities than Arizona, but we added a fair number of bankers last year that are getting through their learning curve.

Then we have our existing team down there. Certainly there -- the expectations this year and what seems to be in the pipeline is very advantageous.

So they're going to be a more -- a larger contributor over time, but I think this year, we'll see a significant contribution from them versus what we've seen in years past.

Damon Del Monte^ Okay. Great.

Then just last question, all my other ones were asked and answered. With regards to the expected fair value accretion, I think it was a little bit lighter this quarter out. What would be a decent level we could incorporate into the margin for that?

James Collins^ I'm sorry, I missed the question there, Damon, one more time?

Damon Del Monte^ Fair value accretion expectations, I believe it came in later this quarter than we had seen in the last couple of quarters, but is there kind of a scheduled level that you would expect going forward?

Alan Villalon^ No. I'd say just using this level going forward, I mean that's probably the way to think about it.

Operator^ The next question is from Brendan Nosal with Hovde Group.

Brendan Nosal^ Just wanted to circle back on the swaps, I realize, but I probably didn't raise my question in the best way.

We haven't had -- you haven't had the pay and receive rate on both those chunks -- there is benefit on the margin now but would not be so if the Fed cut (rates)...

Alan Villalon^ Yes.

So Brandon, the one thing I could point you to in our latest K or Q, K and Qs, you can see there where the disclosures are for our swaps, and you could see what we put on the books there.

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So -- but basically, what we've done is we swapped out some fixed and put on some floating, which has made us a little bit more asset sensitive hence why we've moved there.

But we haven't really disclosed really the pickup there.

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

Katie Lorenson^ All right. Thank you. Thank you, to everyone joining our call today. Thank you for the questions.

We appreciate it. At the end of 2023, we turned a pivotal quarter in our company's transformation to return to our long history of delivering top shareholder returns.

During the first quarter, the momentum grew and has put Alerus on a strong path for 2024 and beyond.

We continue to see organic opportunities and improvements in our net interest margin, which will positively impact our earnings going forward.

Our highly valuable fee income businesses, driven mostly by stable annuitized recurring revenues with minimal risk and capital allocation continue to bolster our performance and will be a key differentiator as we emerge from this rate and economic cycle to outperforming the industry.

Our continued focus on core deposits and serving clients holistically with our talented team members across our unique business lines is growing our franchise and growing our brand.

I'm completely confident in our ongoing success and our team's ability to execute on our strategic plans to create value for our clients, our communities and our shareholders.

I will end by thanking our talented team members again for your hard work, your dedication and for making Alerus a great company to do business with and a great place to work. Thank you, everyone. Have a great day.

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