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Q4 2023 Southside Bancshares Inc Earnings Call

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PRESENTATION

Operator

Thank you for standing by, and welcome to Southside Bancshares' Fourth Quarter and Year-end 2023 Earnings Conference Call. (Operator Instructions) I would now like to hand the call over to VP, Investor Relations, Lindsey Bailes. Please go ahead.

Lindsey Bailes ***Southside Bancshares, Inc. - VP & IR Officer***

Thank you, Latif. Good morning, everyone, and welcome to Southside Bancshares' Fourth Quarter and Year-end 2023 Earnings Call. A transcript of today's call will be posted on southside.com under Investor Relations. During today's call and in other disclosures and presentations, I will remind you that any forward-looking statements are subject to risks and uncertainties. Factors that could materially change our current forward-looking assumptions are described in our earnings release and our Form 10-K.

Joining me today are Lee Gibson, President and CEO; and Julie Shamburger, CFO. First, Lee will share his comments on the quarter, and then Julie will give an overview of our financial results. I will now turn the call over to Lee.

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

Thank you, Lindsay. Good morning, everyone, and welcome to Southside Bancshares' Fourth Quarter and Year-end Earnings Call. This morning, we reported fourth quarter net income of $17.3 million, earnings per share of $0.57 and a return on average tangible common equity of 13.10% and continued strong asset quality metrics.

During the fourth quarter, net income was impacted by a loss of $10.4 million or $0.27 per share due to a restructuring of a portion of the securities portfolio by selling approximately $388 million of lower-yielding AFS securities. The proceeds were largely reinvested in premium U.S. Agency mortgage-backed securities with approximately 20% reinvested in loans.

The restructuring is estimated to increase net interest income, resulting in a 2-year payback of the loss. Linked quarter, our net interest income increased $1.2 million and the net interest margin declined only 3 basis points less than originally estimated. Given the restructuring of the securities portfolio, we believe the net interest margin is at -- or near the bottom and should begin to slowly move higher during 2024.

Linked quarter, we continued to experience excellent loan growth with loans increasing $103.9 million or 2.3%. We ended the year with 9.1% loan growth, slightly exceeding our estimate. For 2024, we are currently budgeting for 5% loan growth. The markets we serve remain healthy and continue to grow and perform well.

I look forward to answering your questions following Julie's remarks. I will now turn the call over to Julie.

Julie N. Shamburger ***Southside Bancshares, Inc. - CFO***

Thank you, Lee. Good morning, everyone, and welcome to our fourth quarter and year-end call. We ended the year with net income of $86.7 million and diluted earnings per share of $2.82. For the fourth quarter, we reported net income of $17.3 million, a decrease of $1.1 million on a linked-quarter basis and diluted earnings per common share of $0.57, a decrease of $0.03 compared to September 30.

For 2023, we had loan growth of $376.8 million or 9.1%. The growth was driven primarily by increases of $230.1 million in construction loans and $180.7 million in commercial real estate loans. For the fourth quarter, we had loan growth of $103.9 million or 2.3% linked quarter driven by increases in construction loans of $69.2 million and commercial real estate loans of $51.1 million. The interest rate of loans funded during the quarter was on average approximately 8%.

As of December 31, our loans with oil and gas industry exposure were $94.5 million or 2.1% of total loans. Our allowance for credit losses increased by $1 million for the linked quarter to $46.6 million. The increase was driven by a loan loss provision of $2.2 million and a provision for off-balance sheet credit exposures of $79,000 for the fourth quarter. The provision on loan loss was primarily driven by the increase in loans during the fourth quarter.

Asset quality metrics remained strong with nonperforming assets of $4 million or 0.05% of total assets on December 31. On December 31, our allowance for loan losses as a percentage of total loans was 0.94% consistent on a linked-quarter basis. Our securities portfolio decreased $40.1 million or 1.5% on a linked-quarter basis, driven by sales of AFS securities in late December due to strategic opportunities related to a drop in treasury rates and reinvestment of proceeds primarily into higher-yielding securities and to a lesser extent, into loans.

The sales resulted in a net realized loss of $10.4 million. There were no transfers of AFS securities during the fourth quarter or for the year ended December 31. As of December 31, we had a net unrealized loss in the AFS securities portfolio of $36.2 million compared to $137 million last quarter, a decrease of $100.8 million, primarily in the municipal securities portfolio due to lower interest rates and to a lesser extent, the sale of securities.

As of December 31, the unrealized gain on the fair value hedges on municipal securities was approximately $13.6 million compared to $42.2 million linked quarter also driven by the lower interest rates. This unrealized gain partially offset the unrealized losses in the AFS securities portfolio. Our AOCI on December 31, 2023, was a net loss of $113.5 million compared to a net loss of $155 million on September 30, 2023.

The net loss was comprised of net losses on our securities and swap derivatives of $94.7 million and $18.8 million related to our retirement plans. As of December 31, the duration in the total securities portfolio was 8.4 years and the duration of the AFS portfolio was 5.8 years. A decrease from 9.7 years and 8 years, respectively, at September 30. At quarter end, our mix of loans and securities increased slightly to 64% and 36%, respectively, compared to 63% and 37% on September 30.

Deposits increased $200.1 million or 3.2% on a linked-quarter basis, driven primarily by an increase in public fund deposits of $145.4 million in brokered deposits of $38.4 million. Our capital ratios remained strong with all capital ratios well above the capital adequacy and well-capitalized threshold. Liquidity resources remained solid with $2.2 billion in liquidity lines available as of December 31.

During the fourth quarter, we purchased 146,580 shares of common stock at an average price of $28.54 pursuant to our stock repurchase plan. We have not repurchased any shares since the end of the year. Our tax equivalent net interest margin decreased 3 basis points on a linked-quarter basis to 2.99% from 3.02%. The tax equivalent net interest spread decreased for the same period by 5 basis points to 2.26%, down from 2.31%.

For the 3 months ended December 31, net interest income increased $1.2 million or 2.3% compared to the linked quarter. The purchase loan accretion recorded this quarter was $63,000. Noninterest income, excluding the net loss on the sales of AFS securities increased $2.1 million or 19% for the linked quarter primarily due to the increase in BOLI income of $1.8 million in the fourth quarter.

Noninterest expense decreased $370,000 on a linked-quarter basis to $35.2 million, for 2024, we have budgeted approximately $37.9 million in noninterest expense for each quarter.

Our fully taxable equivalent efficiency ratio decreased to 50.86% as of December 31 from 52.29% as of September 30. Income tax expense decreased $914,000 from $3.1 million during the third quarter, and our effective tax rate decreased to 11.3% for the fourth quarter down from 14.5% in the previous quarter. We currently estimate an annual effective tax rate of 18% for 2024.

Thank you for joining us today. This concludes our comments, and we will open the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Graham Dick of Piper Sandler.

Graham Conrad Dick ***Piper Sandler & Co., Research Division - VP & Research Analyst***

I just wanted to start on loan growth. Another solid quarter for you guys. Relative to what we've seen from some peers. How are you thinking about growth into 2024 as it relates to what your markets are offering right now versus maybe the potential for also new hires. Just generally, can you give an idea for the trajectory you're expecting, you think it would be less or more about in line with what we've seen over the last -- maybe the back half of 2023.

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

Right now, Graham, we're projecting 5% loan growth throughout 2024. Some of that's going to be dependent on interest rates. If interest rates do decrease quite a bit. Then some of these loans we may be able to make. But right now, with the interest rates where they are, even with the healthy markets we have, we feel like 5%, say, a good place for us to budget right now. Obviously, if we see things change during the year, we'll update that estimate.

Graham Conrad Dick ***Piper Sandler & Co., Research Division - VP & Research Analyst***

Got it. And then, I guess, Lee, on the securities transaction this quarter, can you just run through some of your thoughts on it, how you view -- I guess, how you viewed it as appealing or attractive when you initially did it?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

Yes. When the rates came down during the fourth quarter, we took a look at some of our interest rate swaps on our municipal and basically, we were able to come out of about $200 million of long-term lower rate municipals at -- pretty much a push. And then we sold as mortgage-backed securities increased in value. We sold another $188 million of mortgage-backed securities and that's really where the loss ended up being because we ended up with about a $6.4 million gain on our swaps that we unwound and that gave us the net $10,400,000 loss on the security sales.

So basically, we were able to come out of things even with the rate that we were making on the swaps and increase the overall yield on the $388 million about 175 basis points.

Graham Conrad Dick ***Piper Sandler & Co., Research Division - VP & Research Analyst***

Yes, it seems like a good trade. Is there anything else like this that you're looking right now? Or do you think that you kind of have to wait to get some more clarity on rates are going? Or do you have a certain call on where rates might be going, I guess?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

I think at this point, in terms of any additional movement in the securities portfolio, we really aren't looking at anything should interest rates change further long-term rates move down further from here. We certainly would take a look at that. But right now, we don't. In terms of forecast on interest rates, I guess, pretty much anybody's guess. The biggest guess is on when and if the Fed is going to begin to lower rates.

Our thought is that it's probably closer to summer than it is March if they make that first move. Long-term rates -- they've already come down in anticipation of some of that decline.

Graham Conrad Dick ***Piper Sandler & Co., Research Division - VP & Research Analyst***

Yes. Okay. Good to hear. And then I guess just lastly on the margin, just may be a more point of clarification, but it's only down 3 basis points this quarter, a lot better than I think I was expecting and the rest of the analyst industry. I just wanted to hear if there's something there that surprised you I guess, to allow for basically a flattish margin? Or if there's more pressure to come, I remember you referenced, I think, 2.75% number last quarter.

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

Yes. I think when -- the question last quarter was could it get down to 2.75%. And I didn't mean in one quarter, at that time, we weren't sure what kind of loan growth we were going to have, and we were continuing to see the deposit pressure with the -- the deposit pressure remained during the quarter, but the loan growth ended up being probably a little stronger than we anticipated.

And then with the restructuring, primarily occurring in December, that gave us a little lift in the back half of December. So it did surprise me that we only dropped 3 basis points. But with the restructuring and the loan growth that we had, that's why I feel like we're either at or near the bottom at this point and we should be able to see the NIM move up during 2024.

Graham Conrad Dick ***Piper Sandler & Co., Research Division - VP & Research Analyst***

Okay. And I assume that increase in the NIM in 2024 does include some rate cuts, maybe not as many as the markets predicting right now, but some starting at some point this year, right?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

Yes. Right now, we're budgeting for 3. It's anybody's guess. And the first one we're budgeting for is in June, last one in December. So really only 2 rate cuts would help the NIM, the one in December. I don't -- it certainly won't hurt, but it's not going to lift it dramatically.

Operator

(Operator Instructions) Our next question comes from the line of [Mark Setley] of KBW.

Unidentified Analyst

So I guess on expenses, just to clarify that I heard you correctly. So looking at like $37 million quarterly run rate in '24 and with sort of a lot of the technology implementation stuff sort of baked into 2023. I'm wondering what's really going to drive that growth in '24?

Julie N. Shamburger ***Southside Bancshares, Inc. - CFO***

Yes, Mark. The biggest thing driving that is our salaries and employee benefits. And then there is additional -- a little bit over $3 million for additional software technologies that is built into that number as well. And then we did -- we have budgeted for 2024 about $1 million we're going to be combining 2 locations in one of our smaller markets and probably be disposing off one of the buildings. And so we budgeted for some loss there. So those are the 3 largest items. But still, I guess one of the bigger -- the software and technology, we still can -- are looking at more spend there.

Unidentified Analyst

Got it. That's helpful. And then the securities restructuring and sort of the shifting of the balance sheet, I was just wondering more what's your goal for that mix of assets maybe by year-end and possibly longer term, currently sitting at, I think you said like a 64%, 36%. But just kind of wondering how you anticipate the balance sheet playing out from here?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

As with the shift in the -- with the restructuring of the securities portfolio, right now, we have the securities that we purchased are all -- well, they're at least all of them in total or at least at par, and I think they're probably all a gain net -- so that gives us a lot of flexibility without impacting the P&L to sell those securities if we want to put them into loans.

And if the loan growth is greater than what we're anticipating and a lot of that depends on what deposit growth is. If deposit growth can keep up with loan growth, then we likely will keep those securities. If not, we'll be able to sell some of those securities with little -- little or no loss and put that into higher margin loans.

So ideally, with the loan growth we're going to see -- we expect to see in 2024, we'll move that mix to less securities and more loans -- how much that moves I don't really know, but it would probably be a few basis points in either -- up in loans and down in securities.

Unidentified Analyst

Got it. And maybe just one more. Do you still see yourself sort of not slowing down on the buybacks until the current authorization is used up? And I guess sort of what's your outlook for that as far as your capital for 2024?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

I think what we're going to look for there is if there are opportunistic times to buy, we'll be in the market buying. If the stock is at certain levels, we'll probably pull back from that. I think our average buy price in the fourth quarter was somewhere in the $28 range.

Julie N. Shamburger ***Southside Bancshares, Inc. - CFO***

Most of the -- that all happened early. Well, in October, it went through late October.

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

So we'll be looking for -- hopefully, there aren't any opportunistic times to buy stock. But if there are we have that buyback available for us.

Unidentified Analyst

Got it. That makes sense.

Operator

Our next question comes from the line of Matt Olney of Stephens Inc.

Matthew Covington Olney ***Stephens Inc., Research Division - MD & Analyst***

Just a few follow-ups here from some previous questions. On the loan growth front, it looks like the construction loans continue to build a pretty healthy clip. Any more color here? Has construction peaked or you still see some more growth in '24 in that book?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

I think we'll see some more growth in that and they're primarily loans that we originated in late '21 during '22 and then in early '23. We're not seeing as many new construction loans at this point in time. But these are just advances where that 40% to 50% equity has gone in and now they're looking for draws. And that's what's really creating that at this point.

Matthew Covington Olney ***Stephens Inc., Research Division - MD & Analyst***

And remind me on this construction book, kind of any concentrations by market? And is it lean more residential or commercial?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

It's primarily multifamily, homebuilding and warehouse would be the 3 largest concentrations. And I don't really think there's a huge concentration by market. The they're pretty well split between DFW, Austin and maybe to a little lesser extent, the Houston market.

Matthew Covington Olney ***Stephens Inc., Research Division - MD & Analyst***

Okay. Appreciate those details. And then any color on the recent loan growth as far as what some of those yields are -- the new loan yields?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

The -- go ahead Julie...

Julie N. Shamburger ***Southside Bancshares, Inc. - CFO***

The average for the quarter was 8%. I mean, on all loans.

Matthew Covington Olney ***Stephens Inc., Research Division - MD & Analyst***

And that's a -- I assume some kind of new and renewed yield. Is that right?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

That is correct.

Matthew Covington Olney ***Stephens Inc., Research Division - MD & Analyst***

I'm sorry, I missed that.

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

Yes, That is correct.

Matthew Covington Olney ***Stephens Inc., Research Division - MD & Analyst***

Okay. Perfect. And then going back to the securities restructure, you gave us lots of good details there a few minutes ago, as far as what was sold. I think I missed maybe some details about what was purchased in that restructure. Do you have anything from that point of view?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

Sure. About 80% of the proceeds from the sale went into premium U.S. Agency mortgage-backed securities, Fannie and Freddie and about 20% of those proceeds went into loans. We just wanted to go ahead and get with the rates doing, what they're doing and potential anticipation of Fed doing something, we wanted to go ahead and get that money working. But right now, the mortgage-backed securities overall are at a gain and if we need to move out of those and into loans, higher-yielding loans, and we feel like we're in a good position to do that without impacting the P&L on the sale of those securities at this point.

Matthew Covington Olney ***Stephens Inc., Research Division - MD & Analyst***

Okay. And what were the yields on some of the securities that you purchased?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

They were Fannie and Freddie and the average yield was a little over 6%.

Matthew Covington Olney ***Stephens Inc., Research Division - MD & Analyst***

Okay. That's all helpful. And then earlier in your comments around the margin. You mentioned that you're feeling better about the deposit cost pressure. Just wanted to kind of focus on that comment. Any more color you can provide as far as what you're seeing more recently and kind of how much conviction you have that deposit costs are flying out and we'll peak here shortly?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

I don't expect -- well, until the Fed starts cutting, I don't expect them to flatten out. I expect to continue to increase, but I don't think they're going to increase at the pace they've been increasing. And then with the loan growth and with the restructuring and securities portfolio, we feel like that the benefit associated with that is going to help offset the -- any further deposit pressure at this point in time.

But we do expect deposit pressure to continue, but most of the heavy lifting is behind us, that there's still going to be some going forward even after the first rate cut, 25 basis points isn't likely to take pressure off of some of the non-maturity interest-bearing deposits.

Operator

Thank you. I would now like to turn the conference back over to Lee Gibson for closing remarks. Sir?

Lee R. Gibson ***Southside Bancshares, Inc. - President, CEO & Director***

All right. Thank you, everyone, for joining us today. We appreciate the opportunity to answer your questions along with your interest in Southside Bancshares. In closing, we're looking forward to our prospects during 2024 and reporting first quarter results to you during our next earnings call in April. Thank you again.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.