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Q1 2024 Southside Bancshares Inc Earnings Call

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CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Southside Bancshares' First Quarter 2024 Earnings Call.

(Operator Instructions)

Please be advised that today's conference is being recorded. I would now like to hand the conference over to your first speaker today, Lindsey Bailes, Vice President of Investor Relations. Please go ahead.

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

Thank you, Marvin. Good morning, everyone, and welcome to Southside Bancshares' First Quarter 2024 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, Lindsey. Good morning, everyone, and welcome to Southside Bancshares' First Quarter 2024 Earnings Call.

This morning, we reported first quarter net income of $21.5 million, earnings per share of $0.71, a return on average tangible common equity of 15.07% and continued strong asset quality metrics.

Linked quarter loans increased an annualized 4.7%, just slightly below our projected 5% loan growth for 2024. Our loan pipeline is solid, and the markets we serve remain healthy and continue to grow and perform well. Linked quarter, our net interest margin decreased 13 basis points.

During the quarter, 3 of our lower interest rate cash flow swaps totaling $120 million matured, and the rate for that funding increased over 4%. Our BTFP funding renewed at a higher rate for an additional year, and we continue to experience deposit pricing pressures. We do not have any additional swaps maturing during 2024. While we anticipate ongoing deposit pricing pressure in the absence of the Fed cutting interest rates, we believe anticipated loan growth will help partially mitigate any further NIM compression.

During the quarter, we implemented several initiatives associated with our new 5-year strategic plan. One of the initiatives is to carefully examine additional revenue as well as cost containment opportunities. Through retirements, reduction in workforce and attrition during the first quarter of 2024, we currently anticipate annualized cost savings of approximately $3.5 million, 80% of which should be reflected beginning in the third quarter of this year and 100% in 2025.

During the quarter, we expensed approximately $618,000 associated with these expense reductions. We continue to evaluate expenses as well as revenue opportunities, and we'll update you on any further progress in future quarters. 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 first quarter call. We began the year with first quarter net income of $21.5 million, an increase of $4.2 million or 24.2% and diluted earnings per share of $0.71, an increase of 24.6% linked quarter. For the first quarter, we had loan growth of $52.9 million or 1.2% linked quarter and 4.7% annualized. The growth was driven primarily by increases of $244.9 million in commercial real estate loans, partially offset by decreases in construction loans of $190.3 million. The interest rate of loans funded during the quarter was on average approximately 7.8%. As of March 31, our loans with oil and gas industry exposure were $114 million or 2.5% of total loans.

Our allowance for credit losses decreased by $229,000 for the linked quarter to $46.4 million. Asset quality metrics remained strong, although our nonperforming assets increased to $8 million from $4 million or 0.10% of total assets on March 31 compared to 0.05% at year-end. The increase in nonperforming assets was primarily related to two larger relationships, one commercial real estate and one commercial relationship and not specific to any particular market or industry in our portfolio. Since March 31, 2024, we have received approximately $1.6 million combined of payments on the commercial loan relationship and the payoff of a larger existing residential real estate loan on nonaccrual status.

On March 31, our allowance for loan losses as a percentage of total loans was 0.95%, a slight increase compared to 0.94% on December 31. Our securities portfolio increased $108.8 million or 4.2% on a linked-quarter basis, driven by purchases of mortgage-backed securities during the first quarter.

There were no transfers of AFS securities during the first quarter. And as of March 31, we had a net unrealized loss in the AFS securities portfolio of $48.8 million compared to $36.2 million last quarter. As of March 31, the unrealized gain on the fair value hedges on municipal securities was approximately $20.4 million compared to $13.6 million linked quarter.

This unrealized gain partially offset the unrealized losses in the AFS securities portfolio. Our AOCI on March 31, 2024, was a net loss of $110.9 million compared to a net loss of $113.5 million on December 31, 2023. The net loss was comprised of net losses on our securities and swap derivatives of $92.2 million and $18.7 million related to our retirement plans.

As of March 31, the duration in the securities portfolio was 9.1 years, and the duration of the AFS portfolio was 6.9 years, an increase from 8.4 years and 5.8 years, respectively, on December 31. At quarter end, our mix of loans and securities changed slightly to 63% and 37%, respectively, compared to 64% and 36% on December 31. Deposits decreased slightly by 0.06% or $3.9 million on a linked quarter basis.

Our capital ratios remained strong with all capital ratios well above the capital adequacy and well-capitalized threshold. Liquidity resources remained solid with $2.3 billion in liquidity lines available as of March 31. Our tax equivalent net interest margin decreased 13 basis points on a linked-quarter basis to 2.86% from 2.99%. The tax equivalent net interest spread decreased for the same period by 10 basis points to 2.16% down from 2.26%.

For the 3 months ended March 31, net interest income decreased by $1.1 million or 2.1% compared to the linked quarter. The purchased loan accretion recorded this quarter was $42,000.

Noninterest income, excluding the net loss on the sales of AFS securities decreased $3.1 million or 24.4% for the linked quarter primarily due to the decrease in BOLI income of $1.8 million due to a death benefit realized in the fourth quarter, a loss on sale of loans, a decrease in deposit services income and a loss in fair value of equity securities.

Noninterest expense increased $1.7 million on a linked quarter basis to $36.9 million driven by increases in salaries and employee benefits, which included approximately $618,000 associated with future cost reductions. During last quarter's earnings call, I reported our budget of $37.9 million quarterly for noninterest expense in 2024. As a result of the cost containment initiatives, we expect to realize approximately $400,000 of savings in the second quarter and $700,000 to $800,000 in the third and fourth quarters of the year.

Our fully taxable equivalent efficiency ratio increased to 55.54% as of March 31 from 50.86% as of December 31.

We recorded income tax expense of $4.6 million, an increase of $2.4 million compared to the fourth quarter. The increase in tax expense was driven by a higher effective tax rate and increase in pretax income.

Our effective tax rate increased to 17.7% for the first quarter, up from 11.3% in the previous quarter due to a decrease in tax expense income as a percentage of pretax income. We currently estimate an annual effective tax rate of 17.7% for 2024.

I will now turn the call over for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Brett Rabatin of Hovde Group.

Brett D. Rabatin ***Hovde Group, LLC, Research Division - Head of Research***

Wanted to ask first, Lee or maybe Julie, on the expense reductions. Were those all personnel related? Or are there other things that you made an adjustment to? And then is this kind of the end of taking a look at that in terms of potentially reducing expenses?

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

These were largely, in fact, if not all, personnel-related reductions. We are continuing to evaluate other areas in the expense area. And as we come to further conclusions, we'll report on that in future quarters. But so far, these are the personnel reductions at this point.

Brett D. Rabatin ***Hovde Group, LLC, Research Division - Head of Research***

Okay. And then, Lee, you've always been very good with the bond portfolio. And I'm just curious with the 10-year here at over 4.70% kind of what you're thinking about in terms of additional securities, any restructurings, what do you think about the current level of term structure of interest rates and what you might see from here in your view?

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

I think in terms of the Fed, I think their view of hire for longer is probably correct. We're really not anticipating any more than 1 cut the rest of this year at this point in time. I think initially, we had factored in the 3 cuts, unless the economy changes significantly. In terms of the long-term rates, I feel like they could go even just a little bit higher, but I think cresting 5% on the 10-year would be equivalent to where it got to last year and that might put some additional pressure on the economy that could allow the Fed to begin to decrease rates.

So in terms of the bond portfolio, we'll look for opportunities. We found a few minor ones in the first quarter. But with these higher rates and cheaper bond prices, there may be some additional opportunities as we take a look at those. But right now, we don't have anything that we're planning on doing at this point in time.

Brett D. Rabatin ***Hovde Group, LLC, Research Division - Head of Research***

Okay. That's helpful. And maybe if I could sneak in one last one, just around the margin. Julie, if I heard you correctly, you feel like there's offsets to additional pressure from here, but I didn't quite get the full body language there to comment around the positives for the margin from here? And then if I heard you correctly, maybe a little bit more pressure from year-end and stabilization on the margin. Was that fair?

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

Yes. I think that's fair. The swaps that rolled off in the first quarter were pretty significant. We'll see a little bit of that in the second quarter, but I think it will be pretty much on par with what we saw in the first quarter. The BTFP funding repriced a little bit higher, and that's locked in for a year. So we won't have that pressure, but yes, in terms of the margin going forward, we're thinking that the anticipated loan growth will, at least, partially mitigate any further deposit pressures, a large part of the funding pressures in the first quarter were due to the swap BTF and then to some extent, the deposit pressure.

Operator

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

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

Want to ask about fees. I think the core fees took a step down in the first quarter. Anything to call out there as far as a step down? And then what's the road look like to return to where you were for most of 2023 and that, call it, $10.8 million range for the core fees per quarter.

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

The deposit fees were down $320,000 and around $200,000 of that was due to debit card income. Overdraft fees and service charge fees were down a little - were the difference in that decrease, but most of it was debit card income.

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

And then we did have a loss on a sale of available-for-sale loan of about $500,000. So that caused a decrease there. You see the negative [$436,000] (corrected by company after the call), that loan, we have, like I said, a charge-off around $500,000. We don't anticipate that in the future.

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

Extra $100,000 on that.

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

In fact, yes, we're going to recover another $100,000 in the second quarter on that loan. Trust fees should be back up more in line with what we've seen on a quarterly basis going forward. And as Julie mentioned, the debit card income and the overdraft were down. I would anticipate the debit card income would come back some, but the overdraft fees, we've made some changes along the lines of things that have come out from the CFPB associated with that. And so the overdraft fees probably won't come back significantly.

First quarter, they're typically down because of tax returns so that they should come back maybe $100,000 to $150,000 per quarter. But other than that, those are the major things. So I think we could get back up closer to that $10 million, maybe $10.5 million range moving forward.

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

And on the overdraft fees kind of shift there, any color on just the overall impact we'll see from the change in pricing that you mentioned?

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

Well, you're seeing it. We made these changes last year. I think it was third quarter.

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

Some happened late '22 and then some happened in -- early 2023.

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

Yes. So you're seeing it. And we have -- we did increase the amounts you have to be overdrawn in order to have an overdraft fee pretty significantly. So I think you're seeing the full result of any of that. And then like I say, the first quarter just typically is less because of tax returns with refunds that come in and people aren't overdrawn as much.

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

Sure. Okay. Okay. And then on the credit front, there were some commentary in prepared remarks about some about 2 large relationships during the quarter. I think you mentioned that there were some payoffs or you received partial payments on some of those loans. Can you just go over that again as far as kind of the post -- the movements post March 31.

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

Sure. So one of the relationships, the commercial relationship was about $1.5 million, and it was securing equipment and that particular client is going out of business and has been liquidating at...

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

Better prices.

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

Better prices than the appraisals that we were expecting at the end of the quarter. And to date, that relationship is down to around $880,000. So just in the last few weeks, as late as yesterday, we received some payments on that. And then there was a 1-4 in the nonaccrual status. That was around I believe, $869,000 that paid off during April. So those are 2 of the large things I was referring to in the $1.6 million.

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

Yes. So of the $8 million in nonperforming assets, we've had paydowns of about $1.6 million and the one commercial loan Julie mentioned, we're feeling a lot better about it right now than we did at quarter end based on the sales that have occurred in April.

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

Okay. All right. I appreciate that. And then just lastly, I think you mentioned in prepared remarks, the 5-year strategic plan resulted in some of those cost containment measures. Anything else notable in the 5-year strategic plan that we should appreciate as you think about kind of the longer-term direction of the bank?

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

We're looking at different revenue opportunities, and I hope to report on something in either July or October related to additional revenue that we anticipate receiving in noninterest income. And then there's just a lot of things that we're going to be moving more towards IT-related issues and software in the future and what we need the bank to look like and where -- what markets we want to be in and potentially expand into. And so those are initiatives that are being kicked off and discussed. And at this point, we don't have anything significant to report. We will update on a quarterly basis as we move forward.

Operator

Our next question comes from the line of Woody Lay of KBW.

Wood Neblett Lay ***Keefe, Bruyette, & Woods, Inc., Research Division - VP***

I wanted to hit, just real quick, on that cash flow swap. So when exactly did that mature in the quarter?

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

There were three of them that matured. Two of them were in February and one was in March, on March 11. The overall rate that we had on those swaps was a little below 1%. I think it was like 0.98% or somewhere in that range. So when those rolled off on that $120 million, we had to reprice at today's rate, which is closer to 5.40% and so that's -- that was pretty significant on that $120 million.

Wood Neblett Lay ***Keefe, Bruyette, & Woods, Inc., Research Division - VP***

Yes. All right. That's helpful color. And then last for me. We didn't get any buybacks in the quarter, but if you look at where the stock is trading today, it's below the range on where you bought back in 2023. Is it fair to expect that buyback could pick up again in the second quarter?

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

We're going to be evaluating that and just -- we'll take a look at it and make an appropriate decision in conjunction with the Board.

Operator

This concludes the question-and-answer session. I would now like to turn it back to Lee Gibson, President and CEO, for closing remarks.

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

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

Operator

Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.