

Southside Bancshares (Q4 2024 Earnings)

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Corporate Speakers:

- Lindsey Bailes; Southside Bancshares; Vice President, Investor Relations
- Lee Gibson; Southside Bancshares; Chief Executive Officer
- Julie Shamburger; Southside Bancshares; Chief Financial Officer

Participants:

- Wood Lay; KBW; Analyst
- Jordan Ghent; Stephens; Analyst
- Timothy Mitchell; Raymond James; Analyst

PRESENTATION

Operator^ Good day. And thank you for standing by. Welcome to the Southside Bancshares Fourth Quarter and Year-end 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 speaker today, Lindsey Bailes, Vice President, Investor Relations. Please go ahead.

Lindsey Bailes^ Thank you, Viktor. Good morning, everyone. And welcome to Southside Bancshares' fourth quarter and year end 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'll 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, 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 Gibson^ Thank you, Lindsey. And welcome to today's call. For the year ended December 31, 2024, net income increased \$1.8 million to \$88.5 million and earnings per diluted common share increased \$0.09 to \$2.91 when compared to 2023. Linked quarter, our net income increased \$1.3 million to \$21.8 million, and earnings per share increased \$0.03 to \$0.71.

During the fourth quarter, loans increased \$83.5 million or 7.3% annualized, most of which occurred during December. Linked quarter average loans decreased \$9 million due to early fourth quarter payoffs and late fourth quarter loan growth.

Linked quarter, our net interest margin decreased 12 basis points due to faster prepayments on the premium mortgage-backed securities, resulting from the lower, long-term interest rate environment in the third quarter; hedge-related interest rate adjustments and amortization and the decrease in average loan balances.

As long-term interest rates neared their highs during the last 30 days, we restructured approximately \$120 million of the premium mortgage-backed securities portfolio which should reduce amortization volatility for this portfolio and increase the overall average yield.

Hedge-related net interest income volatility during the fourth quarter should moderate during 2025 due to the restructuring of the mortgage-backed securities portfolio and the anticipated slower pace of Fed interest rate changes.

Our loan pipeline is healthy. And for 2025, we are budgeting mid-single-digit loan growth. These changes, along with the late fourth quarter loan growth and a return to a positively sloped yield curve result in positive net interest margin expectations during 2025.

Loan quality metrics remain solid, the markets we serve remain healthy, and the Texas economy is anticipated to grow at a faster pace than the overall projected U.S. growth rate.

Our wealth management and trust areas are experiencing nice growth resulting from strategic hires during the last 18 months, and we anticipate revenue increases in this area in 2025 of at least 16%.

I look forward to answering your questions, and we'll now turn the call over to Julie Shamburger.

Julie Shamburger^ Thank you, Lee. Good morning, everyone. And welcome to our fourth quarter and year-end call. We're pleased to report net income of \$88.5 million, an increase of \$1.8 million or 2.1% compared to 2023 and diluted earnings per share of \$2.91, an increase of \$0.09 or 3.2% compared to 2023.

We reported fourth quarter net income of \$21.8 million, an increase of \$1.3 million, or 6.1%, on a linked-quarter basis and diluted earnings per share of \$0.71, an increase of \$0.03 or 4.4%.

We ended the year with loans of \$4.66 billion, a linked quarter increase of \$83.5 million, or 1.8%, and an increase of \$137.1 million, or 3%, for the year. The linked quarter increase was driven by an increase of \$157.1 million in commercial real estate loans, partially offset by decreases of \$48 million in construction loans, \$15 million in 1-4 family residential loans and \$11.1 million in municipal loans. The increase in commercial real estate occurred primarily in December.

The average interest rate of loans funded during the fourth quarter was approximately 7.1%. As of December 31, our loans with oil and gas industry exposure were \$117 million, or 2.5%, of total loans.

Our allowance for credit losses increased to \$48 million for the linked quarter from \$47.6 million at September 30.

Asset quality metrics remain solid. Nonperforming assets remained at low levels and decreased on a linked quarter basis by \$4.1 million or 53.1% driven by a commercial real estate loan that paid off in the fourth quarter.

Nonperforming assets were 0.04% of total assets at December 31, a decrease from 0.09% at September 30 and 0.05% at December 31, 2023.

On December 31, our allowance for loan losses as a percentage of total loans decreased slightly, linked quarter to 0.96% compared to 0.97% at September 30 and 0.94% at December 31, 2023.

Our securities portfolio was \$2.81 billion at December 31, an increase of \$116.3 million, or 4.3%, from \$2.70 billion last quarter. The increase was driven by purchases of mortgage-backed securities during the quarter. There were no transfers of AFS securities during the fourth quarter.

And as of December 31, we had a net unrealized loss in the AFS securities portfolio of \$53.5 million, an increase of \$28.9 million compared to \$24.7 million last quarter.

At December 31, the unrealized gain on the fair value hedges on municipal and mortgage-backed securities was approximately \$16.6 million compared to \$3.5 million linked quarter. This unrealized gain partially offset the unrealized losses in the AFS securities portfolio.

Our AOCI on December 31, 2024, was a net loss of \$124.9 million compared to a net loss of \$118.5 million on September 30. The net loss was comprised of net losses on our securities and swap derivatives of \$105.9 million and \$19 million related to our retirement plans.

As of December 31, the duration of the total securities portfolio was 8.2 years and the duration of the AFS portfolio was 5.7 years, a slight decrease from 8.3 years and 5.9 years, respectively, at September 30.

At quarter end, our mix of loans and securities was 62% and 38%, respectively, a slight shift from 63% and 37% last quarter.

Deposits increased \$218.5 million, or 3.4%, on a linked-quarter basis. The increase was primarily driven by an increase in public fund deposits of \$156.8 million, or 14.6%, in December due in large part to seasonality and a couple of new relationships. Customer

deposits increased \$72.5 million, partially offset by a decrease in broker deposits of \$10.7 million.

Our capital ratios remained strong with all capital ratios well above the capital adequacy and well-capitalized threshold. Liquidity resources remained solid with \$2.23 billion in liquidity lines available as of December 31.

We did not purchase any shares of our common stock during the fourth quarter or since December 31. However, we have approximately 583,000 shares remaining in the current repurchase authorization.

Our tax equivalent net interest margin decreased 12 basis points on a linked-quarter basis to 2.83% from 2.95%. The tax equivalent net interest spread decreased for the same period by 11 basis points to 2.12%, down from 2.23%.

For the three months ended December 31, we experienced a decrease in net interest income of \$1.8 million, or 3.2%, compared to the linked quarter.

Noninterest income, excluding net loss on the sales of AFS securities increased \$2.2 million, or 21.6%, for the linked quarter, primarily due to increases in swap fee income and mortgage servicing fee income.

Noninterest expense increased \$1.8 million, or 5%, on a linked quarter basis to \$38.2 million, driven primarily by an increase in salaries and employee benefits, other noninterest expense and professional fees. The increase in other noninterest expense included \$540,000 of losses related to branch closures.

We have budgeted a 5.7% increase in noninterest expense in 2025 over 2024 actual, primarily related to salary and employee benefits, retirement-related expense, software expense and a onetime charge of \$1 million related to the anticipated demolition of a currently occupied branch upon completion of the new branch facility.

Our fully taxable equivalent efficiency ratio increased to 54% as of December 31 from 51.9% as of September 30. We recorded income tax expense of \$4.7 million, an increase of \$269,000 compared to the third quarter.

Our effective tax rate remained consistent at 17.6% on a linked quarter basis, and we're currently estimating an annual effective tax rate of 17.7% for 2025. 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 Wood Lay from KBW.

Wood Lay^ I wanted to start on the loan growth front. It was encouraging to see the growth, especially with a weighted more towards December.

Could you talk about the opportunities you saw in the quarter? And is the pickup in December, is that a reflection of sort of a pickup in client demand? Or was it just a little bit of pull-through?

Lee Gibson^ It was some pull-through, some additional demand from clients. It was just a lot of full funders we've really focused this last six months, and most of it occurred in December that we would work on some full funding loan opportunities. And there were several that closed, and they all just happened to close right near the end of the year.

In fact, I think we had one that closed in the last few days of the year. So it was pretty much across the board, different types of CRE opportunities. And part of the CRE growth is things moving from construction over to CRE. So that was about \$40-something million of that increase.

Wood Lay^ Okay. Got it. That's helpful. And then with the growth weighted towards back end of the quarter, it should be a positive to the NIM going forward. How are you thinking about sort of the magnitude of NIM expansion we could see over the coming couple of quarters?

Lee Gibson^ I think the bulk of the NIM expansion that we're going to see is probably going to be in the second through fourth quarters.

We've got some hedges, cash flow hedges that roll off, a large part of them roll off in February and March that will have some negative impact that will partially offset the overall positive impact of the loan growth and the restructuring of the mortgage-backed securities portfolio.

But we do anticipate some increase in the first quarter, but the real opportunities for margin expansion would be in those latter three quarters of this year.

Wood Lay^ Yes. And then on the deposit side, as you think about that NIM expansion, how are you thinking about the trend of deposit betas through 2025?

Lee Gibson^ Assuming the Fed lowers another 2 times, well even if they don't, we've got a lot of CDs that are going to mature during the year.

We've got some additional funding that we'll be able to reprice during the year. And assuming they lower and we're anticipating maybe two cuts, one kind of midyear and one towards the end of the year, then I would assume that we'll be able to lower overall deposit rates.

Operator^ Our next question comes from the line of Jordan Ghent from Stephens.

Jordan Ghent^ I've just had a question on the securities book. I know you mentioned about the restructure, but it looks like the yield on those were down about kind of 30 bps on a linked quarter. Kind of what are your expectations for the securities book overall as far as growing it? And kind of what yields you expect to put on?

Lee Gibson^ Okay. I would expect us to recoup a lot of that, that basis point decrease and that to go back up closer to where it was. Basically, what we did was we've had some higher-priced, higher coupon mortgages that started to prepay pretty fast when the long-term rates neared their peak in the last 30 days.

We replaced those with some closer to par that had a similar yield to those premiums if they were prepaying at what we would consider to be more normalized prepayment speed.

So one, I'm expecting the overall yield to go up, and it's primarily due to the reduced amortization expense associated with both the hedges and the amortization of the premium mortgage-backed securities since we bought more par-ish type mortgage-backed securities.

So I would anticipate -- in summary, anticipate that it's going to move back up closer to where it was at the end of the third quarter.

Jordan Ghent^ Perfect. And then just one more question about the fees. It looks like it was -- had some good growth and kind of driven by that swap income, I believe. Is -- would you guys consider this a good run rate that you saw in the quarter kind of going forward to be a good run rate?

Lee Gibson^ I wouldn't necessarily consider it a good run rate. Basically, what we've -- we took the swap income that we received in 2024, and we're only budgeting a percentage of that for 2025. The change in the slope of the yield curve makes some of that -- those swap transactions less attractive.

But if somebody wants a fixed rate loan and loans above \$2.5 million, likely, we're going to require a swap on it if it's a maturity beyond a year. So we do anticipate some nice fee income from it, but I wouldn't consider the fourth quarter a run rate. We're anticipating a smaller amount.

Jordan Ghent^ So I just had one more question actually on the buyback. What's your appetite from here? It looks like it's -- kind of activity slowed over the last few quarters. And if you could just give any color on that, that would be great.

Lee Gibson^ Yes. At this point, we're not -- and things could change based on prices, we're not anticipating being active in the share buyback at this point.

We've got some sub debt coming due at the end of the year, and we're basically retaining cash so that we can have our options open as what we do with whether we just keep it in

place and let it float, whether we reissue or whether we pay down and reissue. So we're basically just trying to keep our options open at this point in time.

Operator^ (Operator Instructions) Our next question will come from the line of Tim Mitchell from Raymond James.

Timothy Mitchell^ I wanted to jump back to loan growth and dive deeper into the C&I initiative you guys have been working on.

Could you just discuss kind of any updates to the hires you've made in that group? Any plans for this year and then kind of what you're expecting in terms of the growth of that portfolio for 2025?

Lee Gibson^ Okay. We started that initiative in the third quarter. We hired an individual. I believe he has since hired two individuals associated with that. It went a little slower than we anticipated in terms of the additional hires, but we look to add to that team additionally during 2025.

And we are anticipating some C&I loan growth that we'll begin to see in 2025, hopefully, starting in the first quarter, but for sure, by the second quarter of this year.

Timothy Mitchell^ Understood. That's helpful. And then on the allowance, it looked like you ticked down a basis point this quarter. Credit metrics are pretty pristine. I know you're budgeting for mid-single-digit loan growth.

But if credit kind of remains as is and the economy improves through the year, I mean what should we -- how should we think about the provision expense through the year? Or would you potentially even look to release some reserves?

Lee Gibson^ To release reserves? Is that -- was that the last part of the question?

Timothy Mitchell^ Yes.

Lee Gibson^ Okay. I don't anticipate with our reserve level where it is that we'd be releasing reserves, especially if we meet our expected loan growth target of mid-single digits that would be somewhere in the \$250 million to \$300 million range.

But I would anticipate the percentage would remain somewhat stable. It may move a couple of basis points one way or the other. But we're not looking for a big release of the reserve. We feel like it's appropriate where it is. And someday, you may actually need some of that reserve.

Timothy Mitchell^ Understood. And then lastly, could you just remind us the dollar amount and the rate on the sub debt that you're going to call here?

Lee Gibson^ The overall yield, I think, in the fourth quarter was 4.09%. And so if it begins to float, based on where SOFR is today, it'd be somewhere in the mid-7s. And if we were to reissue, I hate to speculate at this point where that would be in November when that comes due.

Julie Shamburger^ And it's \$92 million.

Lee Gibson^ Yes. It's \$92 million.

Timothy Mitchell^ \$92 million. Got it.

Operator^ Thank you. And I'm not showing any further questions in the queue. I'd like to turn the call back over to Lee Gibson, CEO, for closing remarks.

Lee Gibson^ Thank you everyone, for joining us today. We appreciate your interest in Southside Bancshares along with the opportunity to answer your questions. We enter 2025 optimistic and look forward to reporting first quarter results to you during our next earnings call in April. This concludes the call. Thank you.

Operator^ Thank you for your participation in today's conference. This does conclude the program. You may now disconnect. Everyone have a great day.