Southside Bancshares(Q1 2025 Earnings)

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Corporate Speakers:

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

Participants:

- Brett Rabatin; Hovde; Analyst
- Wood Lay; KBW; Analyst
- Tim Mitchell; Raymond James; Analyst
- Matt Olney; Stephens; Analyst

PRESENTATION

Operator^ Good day and thank you for standing by. Welcome to Southside Bancshares Inc. First Quarter 2025 Earnings Call. (Operator Instructions).

I would now like to turn the conference over to Lindsey Bailes, Vice President, Investor Relations. Please go ahead.

Lindsey Bailes^ Thank you, Lisa. Good morning everyone and welcome to Southside Bancshares First Quarter 2025 Earnings Call. A transcript of today's call will be posted 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 CEO, Lee Gibson; President, Keith Donahoe and CFO, Julie Shamburger. First, Lee will start us off with his comments on the quarter, then Keith will discuss loans and credit, 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. Overall, we had a solid first quarter with net income of $21.5 million, resulting in diluted earnings per share of $0.71 and an annualized return on average assets of 1.03% and an annualized return on average tangible common equity of 14.14%.

Linked quarter, we experienced a $94.4 million or 2% reduction in loans due to payoff activity, primarily in our CRE portfolio that exceeded our original expectations. We do

not believe the first quarter is indicative of where we will end 2025 as we still anticipate mid-single-digit loan growth this year. Keith will provide additional details related to the first quarter loan activity, our current loan pipeline and non-performing assets.

Linked-quarter declines in loans and securities, a restructuring of $120 million in securities early in the first quarter, combined with an increase in deposits of $91.9 million net of brokered and public fund deposits resulted in a 3 basis point increase in our net interest margin to 2.86% and an increase in our net interest income of $145,000.

Our ability to lower our overall funding costs more than offset the impact of the $160 million in cash flow swaps that matured in the first quarter that had an average weighted rate of 78 basis points. Based on discussions with our customers related to the recent uncertainty in the markets surrounding tariff announcements and the ongoing related negotiations, overall, we are optimistic. While it is too early to discern the likely outcome of these negotiations, we will remain vigilant. Currently, the markets we serve remain healthy, and the Texas economy is anticipated to grow at a faster pace than the overall projected US growth rate.

I look forward to answering your questions, and will now turn the call over to Keith.

Keith Donahoe^ Thank you, Lee. Our first quarter commercial loan production totaled approximately $142 million, representing a 46% increase over first quarter of 2024. Of the new loan production, only $52 million funded during the quarter. We expect the remaining portion of fund over the next nine quarters. First quarter payoffs exceeded our original expectations, mostly related to our CRE portfolio and included 25 loans secured by a variety of commercial properties, including retail, multifamily, skilled nursing and one hotel.

Other than the skilled nursing facilities, which were sold, most of the remaining properties were refinanced by traditional long-term lenders, including agencies, conduit lenders and life insurance companies with lower spreads and leverage above our typical thresholds. Despite first quarter payoffs, we remain positive about loan growth. Currently, our loan pipeline exceeds $1.9 billion and represents our largest pipeline in the last 24 to 36 months.

Pipeline is well balanced with approximately 45% term loans and 55% construction loans. Historically, we've closed between 25% and 30% of our pipeline. Based on loans in the pipeline identified as won but not yet closed, fewer projected payoffs and fundings on existing construction loans, we expect loan growth to exceed payoffs in the second quarter.

Additionally, we're making progress on our C&I initiative, which now represents approximately 25% of our total pipeline. The expansion of our C&I efforts in Houston has contributed to the increase and is gaining momentum. The Houston C&I team expanded by 2 individuals during the first quarter with a budgeted expansion of 2 additional team members in the second half of 2025.

Overall, credit quality remains strong despite a first quarter increase in nonperforming assets and classified loans. The increase in nonperforming assets was specifically related to a negotiated extension of one large construction loan triggering and modified loan status. The loan is secured by a newly built multifamily project with positive leasing activity and a sponsor that has demonstrated awareness and financial capability to support, while a meaningful increase, our nonperforming assets remain low at 0.39%.

Our classified loans totaled $67 million on March 31 compared to $48 million on December 31, primarily due to a downgrade of a $17.9 million CRE loan in the first quarter. That loan subsequently paid off on April 4, 2025.

I look forward to answering questions and will now turn the call over to Julie.

Julie Shamburger^ Thank you, Keith. Good morning, everyone, and welcome to our first quarter call. We started the year with first quarter net income of $21.5 million, a decrease of $279,000 or 1.3% compared to the fourth quarter, and diluted earnings per share of $0.71 for the first quarter of 2025, the same as the linked quarter.

As of March 31, loans were $4.57 billion, a linked quarter decrease of $94.4 million or 2%. The linked quarter decrease was primarily driven by a decrease of $79.7 million in construction loans and $19.7 million in municipal loans, partially offset by an increase of $8.5 million in commercial loans.

The average rate of loans funded during the first quarter was approximately 7.3%. As of March 31, our loans with oil and gas industry exposure were $111 million or 2.4% of total loans. Non-performing assets remained low at 0.39% of total assets as of March 31. Our allowance for credit losses increased to $48.5 million for the linked quarter from $48 million on December 31, and our allowance for loan losses as a percentage of total loans increased to 0.98% compared to 0.96% at December 31.

Our securities portfolio was $2.74 billion at March 31, a decrease of $76.9 million or 2.7% from $2.81 billion last quarter. The decrease was driven primarily by maturities and principal payments. Also, in an effort to reduce prepayment risk, we sold $120 million of mortgage-backed securities with 7% coupon and recorded a net realized loss of $554,000. We replaced the mortgage-backed securities sold with $121 million of low premium 6% coupon mortgage-backed securities with less prepayment risk should rates decrease.

As of March 31, we had a net unrealized loss in the AFS securities portfolio of $51.2 million, a decrease of $2.3 million compared to $53.5 million last quarter. There were no transfers of AFS securities during the first quarter. On March 31, the unrealized gain on the fair value hedges on municipal and mortgage-backed securities was approximately $8.6 million compared to $16.6 million linked quarter. This unrealized gain partially offset the unrealized losses in the AFS securities portfolio.

As of March 31, the duration of the total securities portfolio was 9 years and the duration of the AFS portfolio was 7 years, an increase from 8.2 and 5.7 years, respectively, as of December 31. At quarter end, our mix of loans and securities was 63% and 37%, respectively, a slight shift from 62% and 38% last quarter.

Deposits decreased $63.4 million or 1% on a linked-quarter basis, primarily due to a decrease in broker deposits of $196.7 million or 26.5%, partially offset by an increase in public funds, commercial and retail deposits.

Our capital ratios remained strong with all capital ratios well above the threshold for capital adequacy and well capitalized. Liquidity resources remained solid with $2.29 billion in liquidity lines available as of March 31.

We did not purchase any shares of our common stock during the first quarter. After quarter end and through April 25, we have repurchased 196,419 shares at an average price of $26.82 per share. We have approximately 387,000 shares remaining in the current repurchase authorization.

Our tax equivalent net interest margin increased 3 basis points on a linked-quarter basis to 2.86% from 2.83%. The tax equivalent net interest spread increased for the same period by 8 basis points to 2.20, up from 2.12.

For the three months ended March 31, we had a slight increase in net interest income of $145,000 or 0.3% compared to the linked quarter.

Non-interest income, excluding net loss on the sales of AFS securities, decreased $1.5 million or 12.2% for the linked quarter, primarily due to a decrease in swap fee income and mortgage servicing fee income.

Non-interest expense decreased $1.1 million or 2.8% on a linked-quarter basis to $37.1 million, driven primarily by a decrease in salaries and employee benefits, net occupancy, professional fees and other non-interest expense.

During the call last quarter, I reported that we had budgeted a 5.7% increase in non-interest 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 demolition of a currently occupied branch after completion of the new branch. This increase in terms of an expected run rate was approximately $38.4 million for the first quarter and approximately $39 million for the remaining quarters.

We came in lower than our budget during the first quarter, primarily due to lower salary and employee benefits, net occupancy and software expenses. At this time, we are expecting to recognize the $1 million charge on the old branch in the second quarter. This will likely result in noninterest expense of approximately $39 million in the second quarter. Also, as certain items in our budget materialize later in the year, we expect to move closer to $39 million for the remaining quarters as well.

Our fully taxable equivalent efficiency ratio increased to 55% as of March 31 from 54% as of December 31 due to a decrease in total revenue. We recorded income tax expense of $4.7 million, a slight increase of $62,000 compared to the fourth quarter. Our effective tax rate was 18% for the first quarter, an increase compared to 17.6% last quarter. We are currently estimating an annual effective tax rate of 18% 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^ Thank you. (Operator Instructions) The first question today will be coming from the line of Brett Rabatin of Hovde. Your line is open.

Brett Rabatin^ It's Brett with Hovde Group.

Lee Gibson^ Good morning, Brett.

Brett Rabatin^ I wanted to start on the loans. And if I heard correct, the $1.9 billion pipeline, sounded like that's the biggest it's been in two years. Can you guys just talk about the pull-through from that pipeline? And then does the guidance for mid-single-digit loan growth, does that encapsulate any portion of the longer end of the curve being as low as it is and maybe impacting the CRE book further from here?

Lee Gibson^ Yeah. So on the pipeline itself, it is the largest we've seen in a while. Part of that, we've seen a tremendous amount of activity. A lot of it in the CRE space, but we are picking up some new opportunities in the C&I space, which we're really excited about.

As far as what to expect, I think historically, in these things ebb and flow, the 25% to 30% is what we've historically seen coming out of our pipeline. As far as the -- how it affects the CRE portfolio, we're hopeful that we continue to see some momentum in the C&I business, so that we can moderate the heavy weight in our CRE portfolio, but a lot of the term stuff are investment real estate opportunities at this point in time.

Brett Rabatin^ Okay. And Keith, the two lenders that you added in Houston on the C&I side, any color on their books that they might be able to bring over with their background?

Keith Donahoe^ Yes. They're predominantly what we refer to as business bankers. They're in the small end and middle market focus right now. Those are fairly green fields for us. They're based in the Woodlands. And we're anticipating that they do have books that they managed at other organizations that will take a little bit of time to move that, but we do anticipate that to happen. And then the two that we have budgeted in the future are really replacing two former lenders that we had that left right at the end of last year.

So we're going to backfill those. And then in the future, we're going to be looking at other metro markets to expand C&I presence there or hiring or lifting teams out of other markets or other organizations. That's a long-term strategy.

Brett Rabatin^ Okay. Great. And then just maybe one last one on the margin. I'm looking at the CD portfolio, $1.3 billion that cost 4.37%. Would seem like is that reprice as the margin could move higher? Any thoughts on the margin from here and how you guys see it playing out in the near term in particular?

Lee Gibson^ Yes. In that CD book, we have a little less than $300 million that matures over the next three months, and it has an average rate of 4.84%. So we anticipate that, that will reprice down at least 40 basis points, if not 45 basis points. So that should have a positive impact on the margin. There'll be little pull-through residual of the swaps that rolled off in the first quarter, but we did put some new swaps on early in the second quarter about $125 million that should also have a positive impact.

That combined with the anticipated loan growth that we're expecting to see in the second quarter, should have an overall positive impact on the margin. So overall, we're optimistic. I think we said we felt like we've reached a trough. And most definitely, we would have reached the trough in the first quarter. We feel good about the margin moving forward.

Brett Rabatin^ Okay. Great. Appreciate all the color.

Operator^ Thank you. One moment for the next question. And our next question will come from the line of Woody Lay of KBW. Your line is open.

Woody Lay^ Hi. Good morning guys.

Lee Gibson^ Good morning, Woody.

Woody Lay^ Maybe just a follow-up on margin real quick. And with some of the swaps that you've recently added, how do you view your current -- how do you view your profile of sensitivity to rates right now.

Lee Gibson^ A lot of it depends on what the Fed does, but let's say the Fed stays on hold. I think overall, we're going to see funding costs drift a little lower. And on the asset side, I think we can see the overall asset overall yield increase some. Obviously, if the Fed cuts rates, which right now, it appears there's a possibility they might do it in June, that we'll see some shifting on both sides of the balance sheet. But overall, I think we're in a position where it will be positive. with rates going down. We continue to put some swaps on to protect us should short-term rates, especially move the other direction.

Wood Lay^ Got it. That's helpful. Maybe, next I wanted to follow up on expenses and expenses came in better this quarter. Were there any targeted reductions? Or can you just help provide some context on what allowed you to come under budget.

Julie Shamburger^ No, I would not say there were any targeted reductions. I mean it was obviously first quarter following all the budget preparations. So we didn't have anything specifically targeted -- hold on, Woody, we did see the decrease in salaries and employee benefits. That was about $578,000, and we had booked some additional expense in the fourth quarter for incentives that did not repeat itself this quarter.

And then, also some of our share-based equity expense for equity awards that actually we had a decrease in that for the first linked quarter, a little bit over $100,000. So those are some of the main things that drove it down this quarter. And again, net occupancy, that was a function of a decrease in our depreciation expense, which that's going to what's going to change here and there based on assets rolling off.

And I think our budget for depreciation this year is a little bit -- is slightly higher just anticipating putting on the new branch in Cleveland that we're going to be putting on later in the year and things of that nature. But that is the primary reason for those decreases.

Wood Lay^ Got it. And then maybe last for me, just following up on credit. Just any color you could give on the restructured CRE credit. I'm assuming, is it a multifamily loan? And any color you can give on the geographic location of the credit?

Keith Donahoe^ Yes. It's located in Austin, Texas. And again, it was a negotiated extension that we picked up some credit enhancements, but the nature in which we extended it resulted in us needing to move it into a non-performing asset. The borrower has not missed any payments. We don't anticipate them to miss any payments. And the lease-up activity is positive. It's just slower than originally budgeted.

And so we're -- just like with all of our real estate assets, we're monitoring on a very quick basis. We're constantly looking at these and getting updates and we still feel good about the performance of that asset in spite of having to put it into a non-performing category.

Wood Lay^ All right. Thanks for taking my questions.

Operator^ Thank you. (Operator Instructions) And our next question will be coming from the line of Tim Mitchell of Raymond James. Your line is open.

Tim Mitchell^ Hi, good morning, everyone. Thanks for taking my question.

Julie Shamburger^ Good morning.

Tim Mitchell^ Julie, I heard you just giving any color. I know last quarter, you talked about lower swap income this quarter, and you have still solid growth in wealth. And I

understand, obviously, the market has given a little pressure there, but just any outlook for fee revenue for the rest of the year?

Julie Shamburger^ Yes. I don't know if you recall, and I'm pretty sure we said it, but we had like $1.4 million in swap fee income in the fourth quarter, which was a little extraordinary at the time, it was higher than some of the previous quarters. And we did have some swap fee income this quarter, I think, around $98,000.

And we typically don't budget for swap fee income, but we actually did budget some this year, I think, around $600,000, just because at the time of doing the budget, we had some loans in the pipeline that there were discussions around a few of those loans that we felt like we could reasonably expect swap fee income on those. And I believe that is still the case that we are expecting some upcoming swap fee income, although first quarter was only about $100,000 in the $90,000s.

So we are expecting that. We did see an increase in our brokerage services income for the quarter. And also, I think our trust fees were pretty level with fourth quarter but they were up quite a bit over first quarter last year, and I point that out because we did do some fee adjustments in our trust fee area in the later part of last year.

So with the new team that we have there and those increases in fees, I think we'll continue to see growth in the trust fee area throughout the year. At some point in third or fourth quarter, we may not see as big of an increase year-over-year, but we are budgeting around $7 million for trust fees this year. So that would be about a 16% increase over our trust fees in 2024. So that is the main color with respect to brokerage and trust.

Lee Gibson^ And as Julie mentioned, we have loans in the process of closing getting the final legal docs together and things of that nature. And the projected -- we're projecting that the swap fee income will be much greater. It's not going to be at $1.4 million, but it will be at least a few times the amount of swapping come that we had in the first quarter. So we are anticipating additional swap income in the second quarter.

Tim Mitchell^ Okay. Thanks for all the color there. And then just last for me on the buyback. It looks like you guys leaned in a little bit earlier this month just with the sell-off and everything. You still have, I think, around 400,000 shares left under the program. Just any color on your appetite to continue leaning into that?

Lee Gibson^ We had put a plan in place before we went into our quiet period and it reached the targeted level where we repurchase those shares. We're going to be looking at that, in the next few days to determine what, if any, repurchasing we're going to do at head current prices. But it's something we're closely looking at with the movement really in all bank stocks as a result of the uncertainty that's out there.

Tim Mitchell^ Okay. Sounds good. Thanks for taking my questions.

Operator^ Thank you. One moment for the next question. Our next question will be coming from the line of Matt Olney of Stephens. Your line is open.

Matt Olney^ Hi. Thanks. Good morning, guys. Just kind of on that last question around capital and the buyback. Just curious how you weigh stock repurchase activity, along with that sub debt security that becomes callable and reprice is higher in the fourth quarter. Just any updated thoughts around that.

Lee Gibson^ We definitely are considering both of those things. We want to maintain -- we want to have enough to at least pay down the call, probably half of what's out there. I think there's $92 million left. So we'd like to be able to pay off at least $45 million to $46 million without impacting capital too much. We believe we'll be able to do that. And so we're going to look at that in line with what we have available to purchase stock, around the levels that we purchased it previously without impacting our capital and our ability to grow.

Matt Olney^ Okay. Great. Thanks for that. And then going back to loan growth. You gave some really good color around the paydowns in the first quarter. I'm just trying to appreciate, were those paydowns that were generally expected later in the year and they were pulled forward a few months, and this is a timing issue. And that's why kind of the guidance is maintained? Or is there something more than just timing as far as the paydowns?

Keith Donahoe^ The answer is yes and no. There were some that paid off earlier than we had anticipated. We had them in our payoff forecast coming into the year that they occurred. We thought they may occur in the second, third quarter and they happened in the first. The skilled nursing facilities I mentioned, those were a little bit of a surprise. There were two separate operators that actually sold their operating business that had collateral of skilled nursing facilities. So those operators sold that we weren't anticipating that. So it's a mixed bag.

We do continue to expect some payoffs throughout the rest of the year. Second quarter is going to be lighter than at least what we're expecting is going to be lighter than what occurred in the first quarter, which will help us, kind of, claw back some of the loan reduction that happened in the first quarter.

Matt Olney^ Okay. Appreciate that, Keith. And just I guess, kind of, going back to the full year guidance, kind of, maintain that mid single-digit. Are there any offsets we should think about if some of these loan paydowns were a surprise and obviously, not all of them more, but some of them were surprise you keep the kind of mid single-digit guidance.

Did the pipeline build more than expected? Or was the original guidance in January, was it overly conservative? Just trying to appreciate, kind of, the bank maintaining that same full year guidance for the year.

Keith Donahoe^ I think the quick answer is just for comparison, and coming into December, our pipeline was somewhere around $1.2 billion, $1.3 billion. So we've seen a pretty significant increase just in the first quarter to get us up to about $1.9 billion. So we are anticipating to see continued activity. It's a dynamic pipeline. So this is not stale date information, it's pretty dynamic. So we're encouraged by that.

We also knowing that there are a number of loans that we have already run through our credit process, have approval on and the customer has accepted them, and they are in the process of being documented. So with that, combined with the fundings on our existing construction loans, we feel pretty good about showing positive loan growth in the second quarter.

If we'll recapture everything is yet to be seen, some of it's timing. And we do anticipate a large portion of this to close in the second quarter. Again, sometimes loan negotiations can stretch out a couple of weeks and that may make or break whether you close it on or before June 30 or the second week of July. So yet to see, but we're pretty confident.

Matt Olney^ Okay. Thank you, guys.

Operator^ Thank you. That does conclude today's Q&A session. I would like to turn the call over to Lee Gibson, Chief Executive Officer for closing remarks. Please go ahead.

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 are optimistic about 2025 and look forward to reporting second quarter results to you during our next earnings call in July. This concludes the call. Thank you again.

Operator^ Thank you all for participating in today's conference call. You may now disconnect.