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SBSI - Q1 2017 Southside Bancshares Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Southside Bancshares, Inc. first-quarter 2017 earnings call. (Operator Instructions). As a reminder, this conference is being recorded. I would like to introduce your host for today's conference, Deborah Wilkinson, Executive Vice President Investor Relations. You may begin.

Deborah Wilkinson - *Southside Bancshares, Inc. - EVP & IR Officer*

Thank you, Glinda. Good morning, everyone. Thank you for joining Southside Bancshares first-quarter 2017 earnings call. The purpose for this call is to discuss the Company's results for the quarter and our outlook for upcoming quarters. 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 made are subject to risk and uncertainty. Factors that could materially change our current forward-looking assumptions are described in our earnings release and in our Form 10-K.

Joining me today to review Southside Bancshares' first-quarter 2017 results are: Lee Gibson, our President and CEO, and Julie Shamburger, EVP and CFO. Our agenda today is as follows. First you will hear Julie discuss an overview of financial results for the first quarter of 2017, including loan activity, asset quality, oil and gas exposure in our loan portfolio, cost containment and an update on our securities portfolio. Then Lee will share his comments on the quarter. I'll now turn the call over to Julie.

Julie Shamburger - *Southside Bancshares, Inc. - EVP & CFO*

Thank you, Deborah. Good morning, everyone. Welcome to Southside Bancshares' 2017 first-quarter earnings call. We reported first-quarter net income of $15 million compared to first-quarter 2016 net income of $13.5 million, a 10.9% increase (technical difficulty) on sales of securities from both quarters, net income during the first quarter 2017 increased $2.9 million or 23.9% compared to the same period in 2016.

Our diluted earnings per share for the first quarter ended March 31, 2017 were $0.52 per share, an increase of $0.01 or 2%, compared to $0.51 per share for the same period last year. During the first quarter, our level of pay offs outpaced our new loans resulting in a decrease in total loans of $17.6 million on a linked-quarter basis. For the quarter ended March 31, 2017 total loans increased by $95.7 million or 3.9% when compared to March 31 of 2016. The growth primarily resulted from an increase in our commercial real estate loan portfolio and, to a lesser extent, we increased the municipal loan portfolio.

We continue to see roll-off in the indirect consumer portfolio, approximately $8 million during the first quarter of 2017. The indirect portfolio decreased to $27.8 million at the end of the current quarter. As we stated in our earnings release today, our loan pipeline remains healthy and we expect consistent loan growth throughout 2017.

At March 31, 2017, our loans with oil and gas industry exposure remained minimal at 1.1% of our total loan portfolio. We recorded loan-loss provision expense during the first quarter of 2017 of $1.1 million, a decrease from $2.1 million in the fourth quarter. The higher fourth-quarter provision expense was related to loan growth and additional reserve on a few classified loans.

Nonperforming assets decreased further during the quarter ended March 31, 2017 by $1 million or 6.8% to $14.1 million, or 0.25% of total assets compared to 0.27% of total assets at December 31, 2016 and 0.68% at March 31, 2016.

Next, I'll give an update on our securities portfolio. At March 31, 2017, we had a net unrealized loss in the securities portfolio of $20.8 million. The duration of the securities portfolio at March 31, 2017 increased slightly to 5.2 years compared to 5.1 years at December 31, 2016. On a linked-quarter basis, the size of the securities portfolio decreased $43.3 million during the first quarter.

As we experience growth in the loan portfolio we will gradually adjust the securities portfolio. We expect to continue with the barbell approach for our security purchases as market conditions dictate using US agency CMOs for the short end and treasury notes, agencies, commercial mortgage-backed and municipal securities for the longer end.

During the first quarter, we reported our net interest margin at 3.08% and our net interest spread at 2.93%, increases of 5 and 3 basis points, respectively, on a linked-quarter basis. The increase in both the net interest margin and yield were a direct result of the increase in our average loan balance and yield as well as the increase in the average yield on our securities portfolio.

During the three months ended March 31, 2017, our noninterest expense decreased $3.5 million or 12.1% when compared to first quarter of 2016, primarily due to cost containment in almost all of our noninterest expense categories. We are also pleased to report that our noninterest expense decreased slightly from the fourth quarter of 2016 and our efficiency ratio decreased to 51.60% for the first quarter of 2017.

We expect our noninterest expense to remain consistent and to further reduce our efficiency ratio in the upcoming quarters of 2017. Thank you and I will now turn the call to Lee.

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

Thank you, Julie. The exceptional financial results for the first quarter provide Southside a tremendous start for 2017. Record first-quarter net income, increases in our net interest margin and net interest income on a linked-quarter basis, a decrease in the efficiency ratio and solid credit quality are but some of the highlights.

We have started our project to resize and further automate our branches, commensurate with the delivery channels our customers utilize with seven branches slated for completion by the end of the summer. Cost containment efforts to automate and streamline processes are continuing. We expect to introduce 20 ITMs over the next 12 months providing further cost containment opportunities in that area.

All three of the markets we serve remain healthy. The DFW and Austin economies continue to perform exceptionally well, fueled primarily by job growth and company relocations. The Tyler economy reflects a slower but steady growth pattern. While loan payoffs in the first quarter outpaced fundings, our pipeline is healthy and we anticipate loan growth will occur during the balance of 2017.

Given our solid capital position, balance sheet, credit quality and currency value, we remain open to attractive opportunities to expand our franchise in selected areas. At this time we will conclude our prepared remarks and open the lines for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Michael Young, SunTrust.

Michael Young - *SunTrust Robinson Humphrey - Analyst*

Hey, good morning. I wanted to start on the loan growth and maybe taking this from a different perspective, but where -- you called out the categories where you're getting payoffs and pay downs versus growth. But I'm curious just geographically, is there a pivot that's going on behind the scenes that maybe we're not seeing from one market to another?

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

I don't know that there is really a pivot in one market to another. We're just seeing certain projects where they are being sold and people are getting really attractive prices. And they'll sell the project and they'll pay at off and. And like all bankers, we agonize whether the loan is going to pay off when we make it and then we're upset when it does pay off, so -- (laughter).

Michael Young - *SunTrust Robinson Humphrey - Analyst*

Fair enough. And maybe switching gears to the expense side, obviously good control this quarter. There's -- keeping expenses around $26 million. As you move forward with the rebranding efforts, can you maybe just talk about your expectation for expenses as you execute that and where we should come out maybe on the backend of all that?

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

Sure, on the rebranding, I think most of the major expenses on the rebranding are going to be in signage and a lot of that is going to be -- capital. It will be depreciated over a number of years, so we really don't expect the expenses to move up dramatically in that that will all be capitalized.

So while there will be some expense associated with that, we just don't see that that's going to be a major drag on expenses. And with some of the other initiatives we have going on, we feel like that that's going to probably offset that.

Michael Young - *SunTrust Robinson Humphrey - Analyst*

Okay, and similarly, with the branches and revamping some of those --?

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

Correct, and revamping those branches the way we're revamping those, we're actually, in a lot of cases, reducing the size, providing more automation and through attrition we're going to be able to run those branches with less people.

Michael Young - *SunTrust Robinson Humphrey - Analyst*

Okay. So not a lot of one-time costs necessarily associated with that?

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

Correct. I mean ongoing, it -- we should -- costs should be flat to down associated with that. And then with the rollout of all these ITMs, ultimately, that's going to have a nice reduction in expense there.

Michael Young - *SunTrust Robinson Humphrey - Analyst*

Okay, perfect. Thanks, guys.

Operator

Brady Gailey, KBW.

Mike Thomas - *Keefe Bruyette & Woods - Analyst*

Good morning. This is [Mike Thomas] on for Brady. I had a question. What was the accretion number this quarter?

Julie Shamburger - *Southside Bancshares, Inc. - EVP & CFO*

The accretion on loans was $480,000 this month -- I mean this quarter, excuse me.

Mike Thomas - *Keefe Bruyette & Woods - Analyst*

And then kind of revisiting loan growth again, is [7% to 9%] kind of a good number for the year still?

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

I think we're still budgeting for that, the -- that 7; 9 would be a stretch number. I think we've talked about that being our stretch number. 7 is a number we're continuing to budget towards.

Mike Thomas - *Keefe Bruyette & Woods - Analyst*

Got you. Okay, and then just one last one for me. Investors have been kind of focused on deposit costs. Are you guys seeing anything -- a lot of pressure there? Have things been heating up, or people have been very -- how should I say -- competing correctly and not overpricing deposits?

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

We're not -- in terms of retail deposits, we're just -- we're not seeing a lot of pressure on the retail side, CDs, you always have some pressure, but on the non-maturity deposits, we're just not really seeing much pressure at all there.

Mike Thomas - *Keefe Bruyette & Woods - Analyst*

Perfect, great. Thanks for your time.

Operator

Brad Milsaps, Sandler O'Neill.

Brad Milsaps - *Sandler O'Neill & Partners - Analyst*

Hey, good morning, Lee. Hey, just wanted to follow-up on the deposit cost question. It did look like some of your interest-bearing demand categories were up about 10 basis points linked quarter. I assume some of that is attributable to public funds, also the short-term borrowing costs. Can you kind of give a sense, was all of that related stuff that is tied to prime or to Fed funds, rather? And what's the sensitivity of that going forward as it relates to your outlook for the NIM?

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

Yes, a lot of that was related to the public funds and it -- the public funds are much more interest rate sensitive than the retail deposits. And, I'm sorry, what was the last (multiple speakers) what was the last part of your question?

Brad Milsaps - *Sandler O'Neill & Partners - Analyst*

Yes, more the outlook for your NIM. I know you mentioned -- obviously you feel like the loan growth is going to pick up for you. You plan to fund that out of the bond portfolio. I know we've talked about that a lot over the years and the mix change. You guys continue to grow on the liquidity side, so the bond portfolio can kind of continue to grow as well with the loan. So I'm just kind of curious how that's going to play out this year.

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

Well, as the loans grow, we'll gradually decrease the securities portfolio and probably what we'll look for are some of the lower yielding securities. Potentially we may let some of these higher cost public funds roll off and look for different, different sources of funding. And if we don't have the bonds, obviously, we don't need those public funds. So, we'll -- the NIM with the loans should go up.

Brad Milsaps - *Sandler O'Neill & Partners - Analyst*

Okay, and then just by (multiple speakers) question -- go ahead.

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

Yes, and I mean with our models, as the interest rates -- as the Fed moves up -- moves the Fed funds rate up and prime goes up, with the way our loans are priced right now, most of our loans that go on right now are floating-rate loans and most of those are tied to LIBOR at this point in time. Every time the Fed talks about it, LIBOR tends to move long before the Fed actually moves, so we get the benefit of that.

Brad Milsaps - *Sandler O'Neill & Partners - Analyst*

Sure, yes, I guess I was just kind of thinking bigger picture, looking at your NIM year-over-year you are obviously down a fair amount. Funding costs are up. I know a year ago you benefited from an interest recovery and higher levels of purchase accounting, but is it your sense you can start to track back towards that number depending on what the Fed does and end with loan growth, or some -- maybe halfway back to that point. Is that more what you are thinking?

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

Yes, and in our securities portfolio, we're seeing -- with the higher rates, we are seeing the premium amortization decline quite a bit. And so we're seeing a pretty nice increase in the yields on the mortgage-backed securities portfolio. And that's what caused that slight increase in the duration was some of the shorter-term CMOs. The yield moved up very nicely on those, and so income moved up significantly on those and that is occurring. So, all in all, our models show that as rates move up, we do very nicely.

Brad Milsaps - *Sandler O'Neill & Partners - Analyst*

Sure, and I guess I was under the impression you were buying as many premium CMOs relative to maybe 12 to 24 months ago. Is that still, in fact, the case?

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

Yes, that is still the case.

Brad Milsaps - *Sandler O'Neill & Partners - Analyst*

Okay, and then just finally, you guys always do a great job on the tax rate. Are you still thinking high teens or is it closer to where -- below 17% where we were this quarter?

Julie Shamburger - *Southside Bancshares, Inc. - EVP & CFO*

We have -- we're actually estimating a 17.4%, but we have the new accounting standard and we realized about $126,000 in a discreet reduction. So that drove our rate down about 0.07. So notwithstanding those discrete items, and there's no way to predict how those are going to roll in throughout the year, I would expect about a 17.5%. But again, it reduced it this quarter a little bit, so that's kind of where we are at the moment.

Brad Milsaps - *Sandler O'Neill & Partners - Analyst*

Great, thank you.

Operator

(Operator Instructions). Kevin Fitzsimmons, Hovde.

Kevin Fitzsimmons - *Hovde Group, LLC - Analyst*

Hey, it's Hovde Group. How are you doing, Lee?

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

Good, Kevin. How are you doing?

Kevin Fitzsimmons - *Hovde Group, LLC - Analyst*

I'm good, I'm good. Just one more follow-up on loan growth. Just your expectation going forward. Is it more that you see the pay downs dissipating or do you see it being more like -- I guess the last few years it's been more backend loaded, the loan growth. Do you see it just sort of ramping up that way and transpiring that way this year as well?

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

We've not been able to explain why the loan growth has occurred in the last half of the year, the last two years, so I'm not expecting that to occur this year, but it may occur again. We have a lot of construction loans that are starting to fund and we have a lot of things that we have approved that we're expecting to fund. We have some full funders that we're expecting to fund.

You just never know when some of those pay downs are going to come to fruition; they just come out of the blue. So we do expect some to occur. We just don't know when they are going to occur and what the dollar amounts are going to be.

So, we do -- we are able to kind of gauge what the construction dollars are going to be that are going to go on the books and we're able to gauge what those full funders are going to be. The pay downs are what are difficult to gauge. We know we're going to have some, we just don't know how much they're going to be and who they are going to be. So, that's the difficulty.

Kevin Fitzsimmons - *Hovde Group, LLC - Analyst*

Got it. Okay. And one quick follow-up (multiple speakers).

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

And, I mean (multiple speakers) and the good thing is that's a sign of a very healthy economy in the areas we're in in that these people are -- they do something, they put it on the ground, and then they are able to sell it at a very nice profit.

Kevin Fitzsimmons - *Hovde Group, LLC - Analyst*

Right, good point. One just follow-up. You ended the prepared comments just talking about expansion opportunities. Can you give us a sense for what the state is of those conversations or those potential opportunities? Is it getting better or more constructive or is it very quiet? Just any color you could give on that.

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

I think -- we're seeing more opportunities there in the target area we're interested in. There is -- and our target area is East Texas over to Austin up to Fort Worth and back over to East Texas. And so, there are just more opportunities that are coming to our attention. So I would say that the likelihood of something potentially coming to fruition in 2017 is much greater than it was in the last couple of years.

Kevin Fitzsimmons - *Hovde Group, LLC - Analyst*

And do you think -- just it seems like the stabilization of oil prices, we're just hearing less about problems on that front. Do you think that has something to do with it, that there is less of a -- just less concern on that area from the buyer and the seller perspective?

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

I think so, and I think the rest of the country has been able to see that Texas is -- while oil and gas is very important to Texas, Texas is no longer a one trick pony and the economy is tied to a lot of different things now in Texas. And even with oil half of what it was three or four years ago, the economy is going very well and is extremely healthy right now. So I think a lot of the concerns have dissipated for a number of reasons.

Kevin Fitzsimmons - *Hovde Group, LLC - Analyst*

Great. Thanks, Lee.

Operator

Thank you. And I'm showing no further questions at this time. I would like to turn the call back over to Lee Gibson for closing remarks.

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

All right. Thank you. As you've heard this morning, Southside's first-quarter results were outstanding by virtually every measure. We look forward to building on these first-quarter results and reporting those results to you at future calls. Thank you for joining us on this call this morning. At this time we will conclude this call.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program and you may now disconnect. Everyone have a great day.
