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Q4 2018 Southside Bancshares Inc Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Southside Bancshares Fourth Quarter and Year-End 2018 Earnings Call. (Operator Instructions)

As a reminder, this conference call is being recorded. I would now like to turn the conference over to your host, Ms. Lindsey Bibby, Vice President and Investor Relations officer. Ma'am, you may begin.

Lindsey Bibby ***Southside Bancshares, Inc. - VP & Investor Relations Officer***

Thank you, Bridget. Good morning, everyone, and welcome to Southside Bancshares' Fourth Quarter and Year-End 2018 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 made 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, Senior Executive Vice President and CFO.

Our agenda today is as follows: first, you'll hear Julie discuss an overview of our financial results, including our loan and securities portfolios and an update on our stock repurchase plan. Then Lee will share his comments on the quarter, including financial performance and the loan pipeline.

I will now turn the call over to Julie.

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

Thank you, Lindsey. Good morning, everyone, and welcome to Southside Bancshares' Fourth Quarter and Year-End 2018 Earnings Call. We finished 2018 with net income of $74.1 million for the year ended December 31, 2018, an increase of 36.5% compared to $54.3 million for the same period in 2017.

For the year ended December 31, 2018, our diluted earnings per share increased $0.30 per share or 16.6% to $2.11 per share. For the fourth quarter of 2018, we reported net income of $17.4 million, a decrease of $2.9 million or 14.4% compared to the third quarter ended September 30, 2018.

For the quarter ended December 31, 2018, our diluted earnings per share decreased $0.08 or 13.8% to $0.50 per share compared to $0.58 per share on a linked-quarter basis.

During the fourth quarter, we reported a net interest margin of 3.21% and a net interest spread of 2.86%, increases of 7 basis points and 4 basis points, respectively, on a linked-quarter basis.

We recorded $465,000 of loan accretion this quarter, a slight decrease from last quarter.

Net interest margin for the year ended December 31, 2018, increased 11 basis points to 3.18%, which was primarily the result of the mix in earning assets as a result of the Diboll acquisition.

We recorded loan loss provision expense during the fourth quarter of $2.4 million compared to $975,000 of provision expense in the previous quarter. The increase in provisioning expense was the result of several smaller loans charged off during the quarter, additional reserves on nonaccrual loans and to a lesser extent, additional provision for the growth in loans during the fourth quarter.

On a linked-quarter basis, our noninterest income, excluding net losses on AFS securities, decreased $690,000 or 6.4% from the previous quarter.

During the fourth quarter, we recorded a slight gain on the sale of available-for-sale securities of $61,000, an increase of $802,000 compared to the loss of $741,000 reported for the quarter ended September 30, 2018.

During the quarter ended December 31, 2018, our noninterest expense increased $1.2 million or 4.3% compared to the third quarter of 2018.

On a linked-quarter basis, the efficiency ratio increased to 52.18% compared to 48.91% as a result of the increase in noninterest expense.

For the year ended December 31, 2018, we reported an efficiency ratio of 49.98% compared to 50.3% for the same period in 2017.

Income tax expense did increase in the fourth quarter compared to the prior quarter, partially as a result of the $0.8 million discrete tax benefit recorded last quarter. The effective tax rate for the 3 and 12 months ended December 31, 2018, was 12.7% and 12.1%, respectively.

At this time, we're estimating noninterest expense of approximately $30 million for the first quarter of 2019 and an effective tax rate for that same period of 12.5%.

On a linked-quarter basis, total loans increased $38.3 million for the fourth quarter of 2018. Total loans increased $18.4 million or 0.6% to $3.31 billion for the year ended December 31, 2018, compared to December 31, 2017.

Nonperforming assets totaled $42.9 million or 0.7% of total assets at December 31, 2018, an increase of $3.3 million from September 30, 2018, due primarily to the addition of one commercial real estate loan in the fourth quarter.

Now I'll give an update on our securities portfolio. During the fourth quarter the securities portfolio increased $49.7 million or 2.4%. However, since December 31, 2017, the size of the portfolio has decreased $295.9 million or 12.1%. At December 31, 2018, we had a net unrealized loss in the securities portfolio of $42.5 million. The duration in the securities portfolio at December 31, 2018, was approximately 5.5 years, a slight increase from 5.4 on a linked-quarter basis.

The mix of our loans and securities remained consistent at 61% loans and 39% securities on a linked-quarter basis, an increase compared to a 57-43 mix at December 31, 2017.

On October 25, 2018, the company's Board of Directors approved a stock repurchase plan. The board authorized the repurchase from time-to-time of up to 1.5 million shares of common stock in open market purchases and privately negotiated transactions at prevailing market prices.

During the fourth quarter, we purchased approximately 1.46 million shares of our common stock at an average price of $32.34. The remaining shares authorized for repurchase were repurchased in January 2019.

Thank you very much, and I will turn the call to Lee.

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

Thank you, Julie. I would like to thank everyone for joining us this morning. During the fourth quarter, both our net interest margin and net interest spread increased on a linked-quarter basis and we had an increase in loans of $38.3 million. Our net income of $17.4 million during the quarter was less than we had anticipated, due primarily to an elevated provision expense.

In addition, much of the fourth quarter loan growth occurred late in the quarter. As Julie mentioned, we purchased 1.5 million shares of our common stock during the fourth quarter and the early part of January. As bank stock prices across the country declined significantly, during the second half of 2018, we decided that repurchasing shares of a company, we know well, made sense.

Looking back at 2018, I'm extremely proud of the job that our combined team did in successfully integrating Diboll State Bancshares into Southside. In many ways, this merger has exceeded our original expectations and we look forward to 2019 as our efforts are more focused on expanding market share in this area of the state.

During 2018, our efficiency ratio remained consistent, 49.98% for 2018 compared to 50.3% for 2017. And we reported net income of $74.1 million.

We ended the year on a positive note in the loan portfolio with an annualized linked-quarter increase in loans of 4.6%. During 2018, we also significantly increased our C&I loans, which are generally stickier loans and provide more deposit opportunities.

We anticipate additional growth in C&I loans during 2019. For 2019, we've made additional changes to further incent loan growth without compromising our underwriting standards. The current loan pipeline looks solid. And overall, we're projecting loan growth of 4% during 2019.

During 2018, as the Federal Reserve increased short-term interest rates, we strategically reduced the securities portfolio.

In the latter half of the fourth quarter, the Fed signaled a major shift in its stance towards interest rates. This week, the Fed further clarified their position. As a result, you'll likely see an increase in the investment portfolio on a linked-quarter basis in the first quarter of 2019.

At this time, we will conclude the prepared remarks and open the lines for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Michael Young with SunTrust.

Michael Masters Young ***SunTrust Robinson Humphrey, Inc., Research Division - VP and Analyst***

We wanted to start with your last comment first, actually, on the securities book and just help us think about maybe the pace of the securities increase next year. And so it sounds like balance sheet remix is kind of done to loans, and now you're going to grow the securities book on a net-net basis. So just help us kind of frame that a little bit more?

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

I don't think the loan growth is done. It's just that we're probably instead of shrinking the securities book, we'll stop shrinking it and we'll probably grow it some in this first quarter in order to -- now that we have some certainty as to what the Fed looks like they're going to do on a go-forward basis. It doesn't look like they're going to continue to raise interest rates almost every quarter going forward.

Michael Masters Young ***SunTrust Robinson Humphrey, Inc., Research Division - VP and Analyst***

Okay. And do you expect to do that in a more rapid pace in the first half of the year, maybe as loan growth is softer in the first half of the year and we get kind of the normal dynamic of loan growth ramping in the second half? Or do you think, all in all, we'll kind of see more steady loan growth in '19?

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

I think that you'll see the securities probably in the early part of '19, the loan growth -- we certainly like to see it over the course of the year. That's kind of one of those wild cards that you just never know, but we expect to see pretty consistent loan growth throughout the year, but it's kind of one of those wild cards which you just never know.

Michael Masters Young ***SunTrust Robinson Humphrey, Inc., Research Division - VP and Analyst***

Okay. And then, overall, will the balance sheet growth kind of track deposit growth? Or do you plan to borrow or lever up the balance sheet a little bit in advance at all this year?

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

On the securities growth, it'll probably, initially, will lever up the balance sheet some. On the loan side, it'll follow deposit growth.

Michael Masters Young ***SunTrust Robinson Humphrey, Inc., Research Division - VP and Analyst***

Okay. And then, one last one, if I could, just on the CRE credit that moved to nonaccrual this quarter. Could you just provide any more color around the geography, and maybe the type of loan that it is? What food group it's in, so to speak?

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

It's in the southern part of the state. And it actually had to do with Hurricane Harvey, and it had to do with a lien being filed. And we're in good shape on it, but it's just a situation that we're dealing with right now, trying to figure out exactly how to deal with this situation.

Operator

And our next question is from Brad Milsaps with Sandler O'Neill.

Bradley Jason Milsaps ***Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research***

Just here to see if you guys can maybe just talk a little bit more about the NIM against the backdrop of kind of the balance sheet moves you discussed? And also, Julie, I don't know if I missed it in your comments, I was writing quickly, but do you have the amount of loan discount accretion income that may or may not have helped the NIM during the quarter?

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

Yes, Brad, it was $465,000. It was down about $12,000 from the previous quarter.

Bradley Jason Milsaps ***Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research***

Okay. Great. And Lee, absent -- kind of what you're doing on the bond portfolio, would you -- that notwithstanding, would you expect sort of your NIM to track a bit higher in 2019? It sounds like with the bond purchase that might not be the case, but you're looking to probably drive some NII growth in lieu of that?

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

Right. Absent to bond growth, I would say, we'd see some NIM improvement. With the bond growth, I don't see the NIM improvement but I do see the net interest income improvement.

Bradley Jason Milsaps ***Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research***

Okay. And then just one final to follow up on credit. Any new news on the couple of larger loans that you added in nonaccrual, the -- I think they're both health care kind of senior housing type credits?

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

We continue to see improvements in those 2 credits in terms of occupancy. I guess that's what you referred to and they continue to perform. And so they're getting better. We've actually had some pay downs on the -- one of the other credits. So -- where they've sold some of the assets there, so we are seeing some positive notes on some of those credits, and we're actively working them.

Operator

(Operator Instructions) Our next question comes from the line of Brady Gailey with KBW.

Brady Matthew Gailey ***Keefe, Bruyette, & Woods, Inc., Research Division - MD***

So Lee, I mean, you bought back a significant amount of stock in the quarter. It's about 4% of the company. How do you think about -- I mean the stock is kind of still trading right around the level that you repurchased it in 4Q. How do you think about additional buybacks from here?

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

It's a possibility. If the stock continues to trade around this level or goes lower, we have ample capital to do that. And so our capital levels have increased nicely, and we have dry powder to be able to do that.

Brady Matthew Gailey ***Keefe, Bruyette, & Woods, Inc., Research Division - MD***

Okay. And then, Julie, if you look at the amount of yield accretion last couple of quarters, it's been pretty constant in that $450,000 to $0.5 million range per quarter. Is that -- do you think that level will remain fairly stable in 2019? Or will there be a notable decline there?

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

I think it will be pretty flat, honestly. I mean, obviously, you can't ever predict any payoffs that had significant discounts attached. But I expect it to be pretty flat. I don't see it going above that except in the instance of a large payoff.

Brady Matthew Gailey ***Keefe, Bruyette, & Woods, Inc., Research Division - MD***

Okay. All right. And then, on loan growth, if you look at period in loans, you grew loans about 1% in 2018. You look back, like, 2016 and 2017, and you grew loans organically around that 4% to 5% mark. I mean, it sounds like it's kind of a wild card as far as where you think loan growth will come in, but do you think we should think about loan balances flat from here? Or do you think that we could get back up to that 4% to 5% growth number?

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

We're projecting 4%. We kind of divided the portfolio into 3 different groups. We looked at mortgage, which we think 1-4 family, which we think we can hold flat. We looked at consumer, which we think will continue to decline. And then we looked at commercial real estate and C&I, and that we think we can grow at 5%. And that's where we're getting to the 4% overall. It's actually 3.95% when you work the math.

Brady Matthew Gailey ***Keefe, Bruyette, & Woods, Inc., Research Division - MD***

Okay. And then, finally, from me -- just on the expense base, I got what Julie said about $30 million in this quarter, so 1Q '19. Throughout the rest of the year, should we expect to see some modest growth of that 1Q base? And how do you think that translates into any sort of movement on the efficiency ratio? Do you think we should think about the efficiency ratio flat from here? Or is there a possibility for an improvement?

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

I think the improvement -- well, let's speak first to the noninterest expense. I really think that we are going to be around the $30 million noninterest expense on a quarterly basis. That's pretty much what's budgeted. With that said, if net interest income we can see an increase there, that will contribute to improving the efficiency ratio. Notwithstanding that, it potentially would stay flat. But it's our goal to get that improved even further, and keeping it below 50% (corrected by Company after the call) on a quarterly basis as well.

Operator

I'm not showing any further questions. So I'll now turn the call back over to Lee Gibson for closing remarks.

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

All right. Thank you. We're excited about 2019 and the potential growth opportunities given the outstanding economic conditions in our market areas fueled by company relocations and in-migration from other states.

Thank you for joining us today, and we look forward to hosting our first quarter 2019 call in late April.

Operator

Ladies and gentlemen, this does conclude the program. You may now disconnect. Everyone, have a great weekend.