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Q4 2019 Southside Bancshares Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Southside Bancshares' Fourth Quarter and Year-end 2019 Earnings Conference 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, ma'am.

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

Thank you, Sydney. Good morning, everyone, and welcome to Southside Bancshares' Fourth Quarter and Year-end 2019 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 risk and uncertainty. 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. First, Julie will give an overview of our financial results, then Lee will share his comments on the quarter and an update on our nonperforming assets.

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 2019 earnings call. We ended 2019 with net income of $74.6 million, an increase of $416,000 or 0.6% from $74.1 million for the year ended December 31, 2018.

Our diluted earnings per share increased by $0.09 per share or 4.3% to $2.20 per share as of December 31, 2019. We reported net income of $17.3 million for the fourth quarter, a decrease of $2.5 million or 12.4% on a linked-quarter basis.

For the quarter ended December 31, 2019, our diluted earnings per share were $0.51, a decrease of $0.07 per share on a linked-quarter basis. We experienced additional loan growth on a linked-quarter basis of $68.3 million, and we're pleased to end the year with $3.57 billion in loans, an increase of $255.4 million or 7.7% compared to December 31, 2018.

We are very pleased to report a significant decrease in our nonperforming assets for the fourth quarter and the year. Total nonperforming assets decreased $12.3 million or 41.3% for the linked quarter and $25.5 million or 59.3% for the year ended December 31, 2019. These decreases resulted in a nonperforming assets to total assets ratio of 0.26% as of December 31, 2019, a decrease from 0.45% at September 30 and 0.70% at December 31, 2018.

The allowance for loan losses decreased $2.2 million or 18.2% to $24.8 million or 0.69% of total loans as of December 31, 2019, as compared to $27 million or 0.82% of total loans as of December 31, 2018, largely driven by the $30.8 million decrease in our nonaccrual loans.

Our securities portfolio increased by $112.1 million or 4.7% for the quarter ended December 31, 2019, due primarily to purchases of municipal securities. At December 31, 2019, we had a net unrealized gain in the securities portfolio of $52.2 million in the duration of 4.4 years, a decrease from 4.7 years at the end of September and a decrease from 5.5 years at December 31, 2018.

Our mix of loans and securities shifted slightly at year-end to 59% loans and 41% securities compared to a mix of 60% loans and 40% securities at the end of the third quarter and 61% and 49% at December 31, 2018. The slight shift on a linked-quarter basis in year-over-year was due to purchases in our securities portfolio outpacing our loan growth.

Our net interest margin for the fourth quarter of 2019 decreased 5 basis points to $2.98 from $3.03 in the previous quarter. The net interest margin continued to be compressed by lower interest rates, resulting in a lower yield on average assets of 16 basis points. The lower interest rate environment in the fourth quarter led to an increase in prepayments on our securities portfolio. And as a result, we recorded an increase in premium amortization of $1 million, which resulted in a decrease to our net interest margin of 6 basis points.

We had a 2 basis point decrease in net interest spread, linked quarter, to $266 million as the decrease in the 16 basis point yield on average assets were significantly offset by the 14 basis point decrease in interest-bearing liabilities. Linked quarter, our net interest income increased to $803,000 due to a decrease in interest expense, a result of the decrease in average yield on interest-bearing liabilities. We recorded $336,000 in loan accretion this quarter, an increase of $46,000 from the prior quarter.

During the fourth quarter, we recorded provision for loan loss expense of $2.5 million, a linked-quarter increase of $1.5 million. Most of the additional provision relates to a partial charge-off of a previously reported nonaccrual loan. Linked quarter, our noninterest income decreased $646,000 or 5.8%, primarily due to decreases in swap fee income of $373,000 and a fair value of written loan commitments of $104,000.

For the 3 months ended December 31, 2019, our noninterest expense increased $1.9 million or 6.6% for the linked quarter, primarily driven by increases in salaries and employee benefits and other noninterest expense. The $1 million in salary and employee benefits was primarily related to benefits with our health insurance increasing $0.6 million in salaries and payroll taxes at $0.2 million. Other noninterest expense included losses on the disposition of certain assets of $0.6 million.

We used additional FDIC credits in the amount of $422,000 in the fourth quarter, and we have $766,000 remaining credits that will carry over into 2020. Our efficiency ratio increased to 53.87% compared to 50.53% on a linked-quarter basis due to the increase in the noninterest expense.

Income tax expense decreased $807,000 on a linked-quarter basis. Our effective tax rate decreased from 15.6% to 14.1% for the fourth quarter, primarily due to an increase in tax-exempt income as a percentage of pretax income in the fourth quarter. The effective tax rate for the 12 months ended December 31, 2019, was 15.1%.

At this time, we're estimating noninterest expense of approximately $30.5 million and an effective tax rate for that same period of 12.6%. During the fourth quarter, we purchased approximately 26,000 shares of our stock at an average price of $33.47. There are approximately 974,000 shares authorized for purchase remaining in our stock repurchase plan.

Thank you for listening today. And I will now turn the call over to Lee.

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

Thank you, Julie, and I would like to thank everyone for joining us on this call this morning. We ended the year with a solid fourth quarter, highlighted by annualized linked quarter loan growth of 7.7%, a 71% decrease in nonaccrual loans, a decrease in nonperforming assets to total assets ratio to 0.26% compared to 0.5% in the previous quarter and the opening of our 60th branch in Kingwood, just north of Houston.

Associated with the decrease in nonaccrual loans during the fourth quarter, our provision for loan loss increased, linked quarter, $1.5

million, primarily due to the partial charge-off of 1 of our 2 largest loans previously classified as nonaccrual and paid off during the quarter. As we discussed last quarter, the second of our 2 largest nonaccrual loans reflected significant improvement during the third quarter as the real estate property damaged by Hurricane Harvey reopened for business. This loan has never missed a payment, and during the fourth quarter, we were able to upgrade this loan to accrual status.

During the fourth quarter, we also wrote off approximately $400,000 in fixed assets associated with rightsizing our branches and experienced elevated health benefit costs.

As Julie explained, we experienced a linked-quarter 5 basis point decrease in our net interest margin and a 2 basis point decrease in the net interest spread. This was largely due to a change in the mix of earning assets as average securities represented a greater percentage of average earning assets.

As we indicated in our last earnings call, fourth quarter funding costs benefited from the third and fourth quarter rate cuts by the Fed. We anticipate additional savings on our funding costs during the first quarter of 2020 as the full impact of those fourth quarter savings are reflected and additional borrowings and deposits reprice into this lower interest rate environment.

Based on January mortgage-backed security prepayment speeds, we anticipate amortization expense should stabilize during the first quarter.

We begin 2020 with near pristine asset quality and a vibrant, growing, healthy Texas economy that is projected to continue to perform at above average levels. Our credit quality is strong, and we do not currently see additional areas of concern.

We are also budgeting 7.5% loan growth for 2020 based on the anticipated continued job and population growth associated with corporate relocations and expansions and the addition of new commercial lenders in Austin and Fort Worth-Dallas and Houston.

During the fourth quarter, we hired a commercial lender to focus on Houston, a market that we have loaned into for several years. We expect to hire additional commercial lenders in Houston during 2020. We plan to file an application to open a loan production office in the Greater Houston area, subject to regulatory approval. The Austin and Dallas-Fort Worth economic growth levels remain among the best in the country. All of this to say, we believe Southside will report solid performance levels during 2020.

We continue to explore opportunities for further growth, either from an acquisition or through organic growth.

This concludes our comments at this point in time, and we will open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Brady Gailey with KBW.

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

I wanted to start with Houston. So you've hired 1 guy already, you're opening up your second location in Metro Houston. How big of an investment, longer term, would you like to make here, Lee? Maybe talk about longer term, the number of branches you'd like to have there? And then you talked about hiring some more people in Houston, is that a couple more people? Is that a dozen more people? Maybe just help frame how big you're going to invest in Houston?

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

Our plan in Houston is to do kind of what we did in Austin, and that is, we'll either start with an LPO or we may start with a full service branch, but it will be in an office location, primarily commercial based. And initially, we're probably going to hire 3 or 4 lenders. Ultimately -- I would guess, somewhere in that range for this year, certainly no more than a handful. And then we'll gradually build it as they build portfolios, and we see continued revenue growth in that area. We do not anticipate adding lots of branches. In Austin, we did add a second location. We may do that at some point in time in Houston, but that would be in -- well into the future. Does that kind of give you some color?

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

That does, yes. And then the tax rate came in lower this quarter. And then it sounds like it's going to come in even lower in the first quarter. I heard the guidance from Julie of 12.6%. Is that 12.6%, is that the way that we should think about the full year 2020? Or is there something kind of onetime in nature impacting that tax rate in 1Q?

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

No. I think at this point -- I mean, I would tell you to use it for the full year. What's truly driving that and what kept it from being at that level last -- well, for '19 was the tax-free municipal securities. We had budgeted more municipal securities in our budget last year and the growth ended up coming more in the mortgage-backed portfolio as opposed to the municipal portfolio. So that was really what had the impact on the tax rate varying from our initial projection. And it happened pretty early on in the year, so we were reporting such. But we are expecting -- and we did have, if you look in the earnings release, in the average balance, you will see that we did pick up some additional tax-free income in the municipal portfolio during the fourth quarter, specifically. So we're expecting that again. That's what we're planning on. So that's really the driver.

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

All right, great. And then finally, for me, is just the level of discount accretion that was realized in the fourth quarter. I think, last quarter, it was around $300,000. What was that number for 4Q?

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

It was $336,000 in the fourth quarter, and it was $290,000 in the third quarter.

Operator

And our next question comes from Brad Milsaps with Piper Sandler.

Bradley Jason Milsaps ***Piper Sandler & Co., Research Division - MD & Senior Research Analyst***

Lee, looks like you had a nice inflow of deposits in the quarter. I think the press release notes impacted by public funds. Just kind of wanted to get a sense of how quickly you thought those might reverse out as you kind of move through the first part of this year and can kind of continue your goal of reducing securities and increasing loans?

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

Okay. Thank you. The public funds, the fourth quarter, typically, we see public funds grow as tax receipts come in, especially in December, and then we'll see some additional tax receipts from the corporate level come in, in January. I would expect we'll see some reversal at least half of that begin to roll out either some time mid-February through the end of March. It just really depends when they distribute the money out to the various entities, and it also depends on -- we bank some of those other entities that they distribute the money to. So -- but we will see a reduction in, I would say, at least half of that growth by the end of the first quarter.

In terms of the securities versus loans, our plan this year is with 7.5% loan growth anticipated or projected, I guess, at this point in time. That loan growth would outpace the securities growth over the year. We're not scheduling $250 million to $300 million in securities growth. We may see $100 million to $150 million in securities growth during the year, but we do expect the loan growth to be the lot -- much larger percentage of the earning asset growth.

Bradley Jason Milsaps ***Piper Sandler & Co., Research Division - MD & Senior Research Analyst***

That's great. Yes, it looks like your loan growth guidance is a little above where you were last quarter, which is encouraging. Could you give me a sense of kind of what the rates are on the new loans that are coming on the books? Just kind of curious if you have more pressure coming on the yield side? Or it sounds like you've got some opportunities on the deposit side that maybe, hopefully, hold the NIM steady, but just wanted to get a sense of what you're thinking on the asset yield side?

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

Okay. On the loans, let's see, Julie was handing me something. It's the fourth quarter.

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

It's the change in the fourth quarter.

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

Okay.

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

Overall, the portfolio, 15 basis points; and 22 in the variable.

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

Okay. You go ahead and -- do you want to? Julie is going to tell you about the loans.

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

I can tell you a little bit about the average yield on the portfolio itself. I can't necessarily speak to the new loans. But over the course of the fourth quarter, overall yield on the portfolio declined about 15 basis points from 9/30 to 12/31. So that includes new loans put on and then, of course, some of that paid off. And then just in the variable group, which is about 53% of our total loans, those rates went down about 22 basis points on that variable portfolio. And that gives you a little bit of...

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

Yes, and that's reflective of the Fed decrease in October. So I don't know the exact percentage, but I'd say it's probably somewhere in the 4.25%, give or take, 10 basis points is probably the average of what we've been putting on here recently.

Bradley Jason Milsaps ***Piper Sandler & Co., Research Division - MD & Senior Research Analyst***

Great. And maybe just one final one for me. Julie, it sounds like in the first quarter, you're going to get some benefits from some of those expense items reversing out. Your expenses will be down just a little bit. Given the investments you're making in Houston, do you still expect you could hold expense growth for the year kind of in that low single-digit pace you guys have been accustomed to?

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

Yes, I think so, Brad. We do have some pending retirements coming up that will help offset some of that. So that will occur in the second quarter. And so we do anticipate that, that's going to help us to some extent. And we -- our investment in Houston will be basically whatever we spend on the commercial lenders and then on office space. And fortunately, office space in Houston is a little less expensive than it is in some of the other metro markets.

Operator

(Operator Instructions) And our next question comes from Michael Young with SunTrust.

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

Just wanted to follow up on the loan growth guide again. It's pretty good loan growth, I think, compared to the rest of the industry, which is expecting a bit of a slowdown. I know there's been higher levels of payoffs and pay-downs at times in the past. I was just curious if you had any foresight into that this year? And then also, if there was any kind of view that you had maybe from just some unfunded commitments or things that were already in pipeline that were giving you sort of the strength in loan growth expectation this year?

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

Sure. We do anticipate some pay-downs this year. There's projects that have completed, stabilized and will likely go up for sale this year. And as we've seen in the past, we'll probably complete the sale without any problems. But we do have a lot of construction loans, that there is a lot of funding going on at this point in time, ones where the equity is finally gone into those, and we're beginning to see some funding. And then we just believe that we are in markets that are exceptionally good compared to some of the other parts of the country.

And we -- there's a lot of opportunities out there. And as long as the job growth and population inflow continues into these markets, which is substantial, we think there's plenty of opportunity. And if we just get our share of it that we've gotten in the past, which is a small sliver in some of those markets, we should be able to see that type of loan growth.

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

And then should -- with that strength, particularly in construction, which I assume is a little higher yielding, should we expect the margin maybe to expand throughout the year with some lower funding costs and good loan growth and higher-yielding categories? Is that the right way to think about it?

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

Yes. I would think so because the Fed's kind of indicated they're on hold, they're looking for 2% inflation. They've been searching for that for almost a decade now. And I don't -- especially in an election year, I don't anticipate they're going to raise rates at this point in time. So -- and there's really no need to. So yes, I think we'll have some lower funding costs. We've seen most of the floating rate decrease associated with LIBOR and prime occur. And if the Fed doesn't change rates lower, then the asset yields should stay where they are. And with the change in the mix with more loans, we should see the NIM and the spread move up.

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

Okay. And then just maybe lastly on capital. Capital levels are still fairly robust. You guys were a little active on the share buyback last quarter and kind of mentioned it again that you had some excess capacity on that potentially this year. Any thoughts or sizing around how we should think about share buyback going forward?

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

We're going to reevaluate levels at which we're willing to buy back stock. We do realize we have, I agree with you, robust capital levels, and if we're not able to deploy that capital into acquisitions or additional organic loan growth at levels above what we're projecting, then we certainly will look at the buybacks at more aggressive levels.

Operator

And I'm not showing any further questions at this time. I will now turn the call to Lee Gibson for any further remarks.

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

All right. Thank you. Our strong balance sheet, recent momentum, combined with the excellent markets we serve make us optimistic about 2020. Thank you for joining us today. We look forward to reporting first quarter results in April. And this concludes this call.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for participating. You may now disconnect.