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Q1 2021 Southside Bancshares Inc Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Southside Bancshares, Inc. First Quarter 2021 Earnings Call. (Operator Instructions)

I would now like to hand the conference over to Lindsey Bailes. Please go ahead.

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

Thank you, Ashley. Good morning, everyone, and welcome to Southside Bancshares First Quarter 2021 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 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, CFO. First, Lee will share his comments on the quarter, then Julie will give an overview of our financial results.

I will now turn the call over to Lee.

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

Good morning, and welcome to Southside Bancshares first quarter earnings call for 2021. This morning, we reported that we had an excellent first quarter, highlighted by record net income and earnings per share, beginning the year on a strong note. The first quarter results included a partial reversal of provision for credit losses of $10.1 million.

Our asset quality metrics remained strong as the ratio of non-accruing loans to total loans linked quarter decreased to 0.14% from 0.21% and nonperforming assets to total assets decreased to 0.22% from 0.25%. Linked quarter, we did see a decrease in net interest income. Approximately half of this was due to a decrease in interest and accretion income related to PPP loans, with the rest due to the $200 million decrease in average earning assets.

To give you a little more color about our first quarter average earning assets, there are 3 things I want to point out. First, during the quarter -- during the first quarter, annualized loan growth, net of PPP loans and payoffs, increased 6.2%. A large percentage of the payoffs occurred during the first half of the quarter, and approximately $97 million of the loan growth, net of PPP, occurred during March.

Second, we are actively participating in the second round of PPP. And as of April 21, we've originated a little over 1,000 loans totaling $105 million. Approximately $70 million of these PPP originations occurred after mid-February.

Third, our net interest margin linked quarter was unchanged while our net interest spread increased 1 basis point. As for the rest of 2021, our loan pipeline remains very healthy, a trend we currently anticipate will continue throughout the year given the outlook for the high-growth markets we serve. We continue to anticipate 7% loan growth for 2021, net of PPP loans.

During the first quarter, we added 3 experienced commercial lenders, 2 in the DFW area and 1 in Austin, that have hit the ground running, originating loans and bringing new relationships to Southside. In addition, on April 12, we opened our Houston LPO near The Galleria, and this group of commercial lenders have been active originating loans and introducing new relationships to us as well. We continue to see a very healthy increase in our non-maturity deposits during the first quarter due in part to the stimulus payments received by our customers combined with PPP loan funds being deposited into Southside accounts. These deposits allowed us to further reduce higher-cost wholesale funding and time deposits.

We previously disclosed plans to close 3 branches, 2 in East Texas that were in close proximity to other Southside branches and 1 leased branch in North Texas. These closures were completed in mid-March. During the second quarter, we will realize the full savings associated with these closures.

Economic conditions in our market areas continue to improve, bolstered by company relocations and population growth due to individuals moving to Texas from other states. The DFW and Austin markets continue to be among the highest growth markets in the country.

I look forward to answering your questions following Julie's presentation. And I will now turn the call over to Julie.

Julie N. Shamburger *Southside Bancshares, Inc. - CFO*

Thank you, Lee. Good morning, everyone, and welcome to our call today. We are pleased with the solid start to 2021 with net income of $34.1 million, an increase of $4.5 million or 15.3% on a linked-quarter basis. And our diluted earnings per share increased $0.15 or 16.9% to $1.04 per share on a linked-quarter basis.

Linked quarter, our loan portfolio increased $58.8 million or 1.6% to $3.72 billion, driven primarily by an increase in commercial real estate loans of $52.8 million and construction loans of $23.7 million, partially offset by a decrease in 1-4 family residential loans of $19.5 million. As Lee mentioned in his remarks earlier, we are encouraged by the activity in our loan pipeline at this time.

As of March 31, our PPP loans included in the commercial loan category totaled $220.9 million, including approximately $88 million, net of fees, originated in connection with the second round of the program. New originations, net of forgiveness payments, resulted in a $6 million increase in PPP loans for the linked quarter.

Our credit quality metrics remained strong with nonperforming assets as a percentage of total assets decreasing to 0.22% at March 31 compared to 0.25% at December 31, 2020. On a linked-quarter basis, total nonperforming assets decreased $2.1 million or 12.1% to $15.4 million.

Linked quarter, our allowance for loan loss decreased $7.6 million or 15.4% to $41.5 million at March 31 due to a reversal of provision for credit losses on loans of $7.4 million in the first quarter, the result of an improvement in the economic forecast. In addition, our allowance for off-balance sheet credit exposures at March 31, 2021, was $3.6 million, a decrease from $6.4 million at December 31, 2021, due to a reversal of provision for credit losses on off-balance sheet exposures. Combined, these provision reversals totaled $10.1 million. On March 31, we reported our allowance for loan losses as a percentage of total loans at 1.12% and when excluding PPP loans, 1.19%.

As of April 22, our COVID-19-related deferrals have decreased to $1.4 million, consisting primarily of mortgages. As of March 31, our loans with oil and gas industry exposure were $104.8 million or 2.82% of total loans. There are no COVID-19 modifications in this category.

Our securities portfolio decreased $51.2 million or 1.9% on a linked-quarter basis. We recognized approximately $2 million in net security gains on the sale of AFS securities during the quarter, resulting from sales of municipal securities. At quarter end, we had a net unrealized gain in the securities portfolio of $102.4 million, and the duration in the portfolio was 5.3 years, an increase from 4.7 years at the end of 2020. Our mix of loans and securities at March 31 remained consistent with December 2020 at 58% loans and 42% in securities.

As of March 31, 2021, our treasury stock increased by 301,000 shares. Purchases of 427,000 shares of our stock at an average price of $35.60 were partially offset by 126,000 shares issued from treasury shares in connection with equity award transactions during the quarter. Year-to-date through April 22, we have purchased 518,000 shares at an average price of $36.10. Approximately 420,000 authorized shares remain under our current stock repurchase plan.

Our net interest margin remained consistent at 3.20% on a linked-quarter basis. Approximately 10 basis points of the net interest margin related to interest and fees earned on the PPP loans. The net interest spread increased to 3.03% for the first quarter of 2021 compared to 3.02% in the previous quarter.

For the 3 months ended March 31, net interest income decreased $2.4 million or 4.9%. We recorded $415,000 in purchased loan accretion this quarter, a decrease of $38,000 from the prior period. Additionally, we recorded approximately $2.6 million in net fees related to the PPP loans included in interest income this quarter, of which $2.5 million was related to round 1 of the program.

As of March 31, 2021, we had net deferred fees of approximately $5.25 million remaining, consisting of $1.75 million on round 1 and $3.5 million on round 2 of the PPP loans. As of April 21 and based on approximately $105 million originated on the second round, we expect to recognize approximately $5.1 million in total fees on round 2 as yield adjustment over the terms of the loans.

For the 3 months ended March 31, noninterest income, excluding net gains on the sale of available-for-sale securities, increased $696,000 or 6.4% for the linked quarter, which was primarily driven by an increase in brokerage services and other noninterest income. These increases were partially offset with decreases in deposit services and gain on sale of loans. Our other noninterest income increased primarily due to an increase in swap fee income of $588,000 and increases in the fair value of mortgage servicing rights and mortgage rate locks. A decrease in overdraft income was the primary driver of the decrease in deposit services income, a result of stimulus check deposits during the quarter.

For the 3 months ended March 31, noninterest expense was consistent with the fourth quarter of 2020, with a slight decrease of $81,000. For the second quarter of 2021, we expect noninterest expense to be consistent with this quarter at approximately $31 million.

Our fully taxable equivalent efficiency ratio increased to 50.44% compared to 47.36% on a linked-quarter basis. The increase in the fully taxable equivalent efficiency ratio was due to the decrease in net interest income as well as a decrease in nonrecurring branch closure expense compared to the prior quarter.

Income tax expense increased $485,000 or 11.4% compared to the 3 months ended December 31, driven by the increase in pretax income. Our effective tax rate decreased slightly to 12.2% for the first quarter from 12.6% last quarter due to $134,000 of discrete tax benefit recorded in connection with equity award transactions during the first quarter. At this time, we are estimating an annualized effective tax rate of 12.6%.

Thank you for joining us today. This concludes our comments, and we will open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Brett Rabatin with Hovde Group.

Benjamin Tyson Gerlinger ***Hovde Group, LLC, Research Division - Research Analyst***

This is actually Ben Gerlinger on for Brett. I'm wondering if we can just start with loan growth overall. I guess that a guidance of 7% core loan growth is pretty strong. I know that the banking industry itself is kind of playing that the second half of the year is going to show significantly more growth. I was wondering how you guys are approaching it, being that you're in Texas. There's a lot of people moving there, a lot of businesses moving there. And then you also added those 2 lenders in Dallas and 1 in Austin.

Across the Houston LPO, I was curious on how you guys foresee the rest of this year going? Kind of is it 1 year or is it back half weighted? And then from there, with the additional team members, do you think they will be fully ramped up within 12 months? Or is this something that has much longer legs and would work into '22?

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

Basically, in terms of the new lenders, they're extremely experienced lenders. They, I would say, are pretty much fully ramped up today. Some of them started earlier in the quarter. And we had already anticipated when we forecast the 7% loan growth, that they would be a part of that. So do I expect additional in 2022? Yes, simply because we'll have a full 12 months in 2022. But I do anticipate that they're going to be a nice part of our loan growth this year.

As for the loan growth, I think it's going to be more linear. Right now, we're seeing a very good pipeline. And a lot of that comes down to when loans actually close, especially on the commercial real estate loans when we get appraisals, all sorts of different things. But right now, my guess would be that it would be not perfectly equally weighted between the 3 quarters, but that we would see nice growth in each of the remaining 3 quarters.

And as for the optimism, it just comes from being in the markets we're in. Two of the markets we're in have been among the highest growth markets and continuing to be in the country. And they're having problems finding rooftops for people to live, so it's a good problem to have.

Benjamin Tyson Gerlinger ***Hovde Group, LLC, Research Division - Research Analyst***

Right. That's helpful color. When you think about the different areas within Texas itself, I mean you have multiple MSAs that are experiencing a lot of different kinds of growth, and -- whether that be business or technology or anything of that extent. Are there any areas that you feel like you might want to bolster up in, in terms of potentially doing an M&A or add additional lenders? Or how are you thinking about pockets within the state that you might not have the full capacity that you think you would want?

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

I'll say that Houston, DFW and Austin are massive markets. I don't know that we could hire enough lenders to fully cover those markets. So I think in those 3 markets, we'll continue to explore additional opportunities. And then there's a lot of good smaller markets throughout the state that we're not in that we might, through M&A, explore entering some of those markets.

Benjamin Tyson Gerlinger ***Hovde Group, LLC, Research Division - Research Analyst***

Got you. That's helpful. And then just on the expense guide of approximately $31 million, is it fair to assume that that's somewhat of a new core trend? Or do you think it works higher off of that 2Q level as you work into the second half of the year?

I guess there's a lot of puts and takes like branch closures. Just thinking from that core perspective. Is it fair to assume that $31 million is a new good run rate? Or is it a little bit of a lull before we start ramping higher again?

Julie N. Shamburger ***Southside Bancshares, Inc. - CFO***

I think it is probably a pretty -- I don't expect this to -- at this point, I don't expect us to get to $32 million. So I think somewhere what we've seen these last couple of quarters should be indicative. I mean we may have some few ups and downs. There's a couple of areas, advertising, travel, we think that, that was actually down with fourth quarter.

I think as we get out more because we still haven't gotten out fully like we were accustomed to, so I think as those things happen more, we'll ramp up some in those areas. But I think -- yes, I think $31 million up to $31.5 million should be what we expect to see for the rest of the year. That's my thought at the moment.

Benjamin Tyson Gerlinger ***Hovde Group, LLC, Research Division - Research Analyst***

Okay. Great. That's really helpful color. Appreciate it. Congrats on great start to the year.

Operator

Your next question comes from Brady Gailey with KBW.

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

When you look at the bond portfolio and if you look at it over the last 5 quarters, it has not been dramatic but the bond portfolio just continues to tick down kind of little by little every quarter. When do you make the decision to stabilize, if not kind of grow the size of the bond book? Do you need a higher long end of the curve to do that? Or is this planned and you're really focusing on loan growth so we should continue to expect the bond growth to tick down and loans to tick up?

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

We're expecting loans to tick up. In terms of the decrease in the bond portfolio in the first half, probably 60% of it had to do with the sale of some municipal bonds that we were not anticipating selling and we sold simply because we were of an uncertainty. And they were related to different cities of power -- electric power subsidiaries that they had.

And with the significant event that we had in the power grid crisis in February associated with the weather, we just made the decision that from a credit standpoint, yes, they were down a couple, 3 points, but if things didn't go the way they might have gone -- they could have gone, our upside was maybe 2 or 3 points. Our downside was pretty much unlimited. So that accounts for about 60% of that.

You're correct on rates. As rates ticked up during the quarter and most of that occurred in the second half, we did become more active in purchasing, and we've been more active in April. So it's not a planned thing. It's just kind of where interest rates are and is the risk/reward appropriate for us to make those buys.

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

Yes. All right. That makes sense. And it was good to hear about the 3 lender hires. Lee, how active do you expect to be going forward on hiring lenders? It sounds like you're making more and more of an investment in Houston, which is great to hear, but what should we expect, continued LPOs/branches in Houston and continued lender hires? Or are you going to kind of stick with what you got, let that mature and kind of slow play it at Houston?

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

I would anticipate that we will begin to -- the lenders that we have there we hired the first half of 2020, and obviously, COVID hit. So we kind of slow played it a little bit, and it was really the second half of the year where they got active. I would anticipate that as things open up more, that we're going to begin to look for additional lenders in Houston.

The LPO we opened has additional capacity to house additional people. So I don't anticipate an additional LPO there right now because they're pretty well centrally located, but it is something that in future, '22, '23, may be a real possibility. But if we can find good, solid, experienced lenders that have been successful at other places, then we're going to try to pull them out of those banks and get them to Southside.

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

And sticking with Houston, I know you just started there so it's probably small, but what's your loan base right now in Houston? And then how big do you think you could get that over time? What's the goal as far as the Houston loan portfolio?

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

Let's see. They're handing me some numbers here. Okay.

I know we started, Brady, at probably $250 million to $300 million in loans in Houston. And Julie's searching for the number so we'll get it to you here in just a second, I'm sorry. In terms of what I think we can get it to, I think whatever it is today, I think we can fairly easily over time -- it's certainly not going to happen this year, over time, double in size, if not triple, simply because of the size of the market area.

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

Yes. And then back on M&A. Lee, it feels like things are picking up in Texas and the state is clearly back open for business. And we saw a big transaction with BancorpSouth and Cadence, and it feels like we're going to have more later on this year. But how do you think Southside fits into that? Do you think that realistically, you guys will be active on the M&A front, buying some smaller banks in Texas?

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

Yes. Those discussions have definitely picked up, and I do anticipate that sometime within the next 12 months, I would hope, we're definitely active in that arena. And we're beginning to have additional discussions along those lines.

So I think on the sale side, there are more people interested in talking about that, and so we're definitely interested. And our focus continues to be basically east of I-35 going down through the state with maybe going out 40 or 50 miles to the West of 35.

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

Yes. And Lee, just remind us, from a size point of view -- I mean you guys are $7 billion, so you're getting somewhat close to the $10 billion mark. But from a size point of view, what would the ideal target look like?

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

An ideal target would probably be at least $1 billion up to $2 billion, getting much above $2.5 billion. We could adjust our balance sheet by reducing securities if we wanted to. But if we get much above $2.5 billion, we're right at $10 billion. And while we're preparing to get there, I think it's probably going to be the end of the year before we're fully ready to be able to go over that $10 billion mark.

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

Yes. Great.

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

All right. Thank you. And we'll get you the number on Houston.

Operator

Your next question comes from Brad Milsaps with Piper Sandler.

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

Lee, I just wanted to follow up on the bond portfolio discussion, maybe a different direction than the size. But it looks like the yield has actually stayed fairly stable year-over-year. Just kind of curious if you can kind of talk about that.

Anything sort of out of the ordinary affecting the yield of late? Or is that just your typical working the bond portfolio really hard, like you've done over time? Just I think it's very impressive that that's been able to stay relatively stable. Yet, we've seen obviously rates collapse around us. Just any additional color there would be helpful.

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

Sure. Basically, the stuff that's been rolling off, we really haven't had a lot of municipals roll off other than those that we sold. The stuff that's been rolling off is in the mortgage-backed arena, and typically, they've been paying much faster, up in the 35 to 45 CPR range. And they tend to have some of the lower yields in the portfolio as a result of those higher prepayment speeds, and we own those at premium.

So I think we can largely attribute it to the lower stuff rolling off. And yes, we're not putting on it -- I'd love to say we're putting on everything at 3% or higher, but we're not. But what we are putting on is higher than what's rolling off, so I think that's what you're seeing.

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

Okay. That's helpful. And then just on the other side of the equation, you guys had a lot of runoff in the time deposit category this quarter. I think averages were down almost $300 million. Just kind of curious how much more runoff you think you have to go there. Do you think that's getting close to a pretty steady state?

And then I would ask the same of Federal Home Loan Bank advances. I think most of what you have left is swapped. So that may preclude you from kind of taking that any lower, but just any color on those 2 categories would be helpful.

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

Sure. You're correct on the Home Loan Bank advances. We're pretty close to where everything is swapped. We do have one swap for, I think, $20 million that rolls off in June that likely we won't replace.

On the time deposits, most of the time deposit roll-off has been related to public funds customers and also in the brokered CD arena. And I don't know if we're at 0 on brokered CDs, but we're getting -- we're down to $45 million on those. So those, we anticipate, may continue to run off with the excess funding that we have. And on the public funds side, we're getting down pretty close to what I'd call a core level where we're the depository for the institution. So I would anticipate that that's going to slow quite a bit over the next several quarters.

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

Great. And then just a couple of final ones. Curious where new loan yields are coming on the books. And then, Julie, not sure if you have average PPP loans for the quarter. And then the contribution in dollars from purchase accounting this quarter would also be helpful.

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

Okay. The average yield on loans going on the books without the PPP loans for the first quarter was at 3.32%. We do anticipate with the -- with rates having moved up some that we may see a little higher rate in future quarters. But that was the average rate ex PPP loans. If you put the PPP loans in there, it was right around the 2.90%. And then the...

Julie N. Shamburger ***Southside Bancshares, Inc. - CFO***

The average balance on the PPP loans was $215,061,000.

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

And the purchase?

Julie N. Shamburger ***Southside Bancshares, Inc. - CFO***

The purchase accretion was $415,000. It was down about $38,000 from last quarter.

Operator

There are no further questions at this time. I will now turn the call back to Lee Gibson, CEO and President, for closing remarks.

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

Okay. As for Brady's question on total loans in Houston right now -- in the Houston area, we have right around approximately $400 million in loans in Houston. Our new loan group has provided new loans of about $70 million of that $400 million.

Closing remarks. Thank you for joining us today. Given the positive outlook for our markets, our strong balance sheet, capital position, asset quality and core earnings, we are very encouraged about 2021 and look forward to reporting results to you during our next earnings call in July. Thank you for attending, and this concludes the call.

Operator

This concludes today's conference call. Thank you for joining. You may now disconnect.