South Plains Financial, Inc.

Third Quarter 2021 Earnings Call Transcript

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C O R P O R A T E P A R T I C I P A N T S

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Curtis Griffith, *Chairman and Chief Executive Officer*

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P R E S E N T A T I O N

Operator

Good afternoon, ladies and gentlemen, and welcome to the South Plains Financial, Inc. Third Quarter 2021 Earnings Conference Call.

As a reminder, this conference call is being recorded.

I would now like to turn the call over to Mr. Steve Crockett, Chief Financial Officer and Treasurer of South Plains Financial. Please go ahead, sir.

Steve Crockett

Thank you, Operator.

Good afternoon, everyone. We appreciate your participation in our Third Quarter 2021 Earnings Conference Call. With me here today are Curtis Griffith, our Chairman and Chief Executive Officer, and Cory Newsom, our President.

As a reminder, a replay of this call will be available on our website within two hours of the conclusion of the call, until November 9, 2021. Additionally, a slide deck presentation to complement today's discussion is available on the News & Events section of our website.

Before we begin, let me remind everyone that this call may contain forward-looking statements and are subject to a variety of risks, uncertainties and other factors that could cause actual results to differ materially from those anticipated future results.

Please see our Safe Harbor statement in our earnings press release that was issued this afternoon and on Slide 2 of the slide deck presentation available on our website. All comments made during today's call are subject to those Safe Harbor statements. Any forward-looking statements presented herein are made only as of today's date and we do not undertake any duty to update such forward-looking statements, except as required by law.

Additionally, during today's call, we may discuss certain non-GAAP measures, which we believe are useful in evaluating our performance. A reconciliation of these non-GAAP measures to the most comparable GAAP measures can also be found in our earnings release and on Slide 19 of the slide presentation.

At this point, I'll turn the call over to Curtis.

Curtis Griffith

Thank you, Steve, and good afternoon.

On today's call, I will briefly review the highlights of our third quarter 2021 results, Cory will provide an update on our successful efforts to expand our lending team and accelerate organic loan growth, and Steve will then conclude with a more detailed review of our third quarter 2021 financial results.

To start, I'm very pleased with our team's performance again this quarter and would like to thank our employees for their hard work as they continue to deliver outstanding service to our customers, which continues to translate into strong financial results for South Plains. Along those lines, there are six key points that I would like you to take away from today's call.

First, our local Texas markets are seeing strong economic growth and continued population gain from across the country, which is providing a robust backdrop for new business.

Second, our experienced Lending team is benefiting from this strong economic backdrop, as well as our market share gains in our communities, large and small, which we believe are contributing to our strong results.

Third, we have continued to make solid progress adding new lenders to our platform through the quarter as we work to grow our team by 20 lenders, or about 30%, over a two-year timeframe. Importantly, we have been very impressed with our new lenders' ability to bring new clients to City Bank and quickly build their portfolios.

Fourth, we have grown our loan portfolio by more than 9% year-to-date and expect loan growth to continue at a robust pace into 2022. We believe we have ample liquidity to fund this growth, which will drive continued margin expansion, earnings and book value growth, along with improved returns.

Fifth, we expect our mortgage business to decline to about 10% to 15% of total revenues over the next few years as mortgage originations gradually normalize in future periods. I think it is important to reiterate that we are not a mortgage bank; we have simply taken advantage of a strong cycle which has been very lucrative. As mortgage revenues decline, we expect organic loan growth to drive improved net interest income, and we anticipate this growth will more than offset the decline in mortgage income over the next two to three years.

Lastly, we will continue to pursue a thoughtful capital allocation strategy focused on share buybacks, maintaining and growing our dividend over time and tactical M&A. During the quarter, we were aggressive with our share buyback, given the opportunity that we see ahead for South Plains. We do not believe this is fully reflected in our current share price.

Turning to our third quarter 2021 results on Slide 4, we reported net income of $15.2 million, or $0.82 per diluted common share, which compares to net income of $13.7 million, or $0.74 per diluted common share, in the second quarter of 2021.

We did not record a provision for loan loss in the third quarter of 2021 compared to a negative provision for loan loss of $2 million in the second quarter of this year. This decision was made in light of the continued general improvement in the economy as well as a decline in the amount of loans in our portfolio that are actively under a modification. We remain confident in the credit quality of our loan portfolio, as well as the strong reserves that we've built over the last year. Additionally, the credit metrics of our hospitality portfolio continued to improve through the third quarter of 2021.

Turning to loan growth, we delivered 5.5% growth in the third quarter of 2021 as we benefited from our lending team's strong execution, combined with our new lenders who are quickly growing their portfolios as they bring new relationships to City Bank. While recruiting takes time, we are very pleased with the lenders that we have been able to attract. Importantly, we have been deliberate in our growth as we look for lenders who share our culture and values. We will remain laser focused on credit quality, and we will not sacrifice our conservative approach to underwriting to drive growth as we expand our loan portfolio.

Looking to future periods, we have excess liquidity to deploy, as our loan to deposit ratio at the end of the third quarter of 2021 was 76%. Our goal is to ultimately drive that ratio up into the mid-to-high 80s over time, which represents significant earnings power and leverage of the infrastructure we have to support $5 billion or more in assets.

As we execute our strategic plan to profitably grow South Plains, we will also continue to employ a thoughtful capital allocation strategy to create value for our shareholders. During the third quarter of 2021, we continued to see our shares trade below the intrinsic value, and as a result, we repurchased approximately 190,000 common shares under our previously announced $10 million share repurchase program.

Additionally, our Board of Directors authorized a quarterly dividend of $0.09 per share this past week, which is in line with the last quarterly dividend that we paid in August of this year. This will be our eleventh consecutive quarterly dividend and will be paid on November 16, 2021, to shareholders of record on November 1, 2021.

Lastly, we continue to evaluate potential M&A candidates as activity has picked up. As we've said in the past, we are looking at banks with good deposit franchises in rural markets where there could be leadership changes over the next few years. We will be very disciplined and focused on finding the right bank with a similar culture and at an attractive price. Thus far we have not found a target that meets our acquisition criteria and metrics.

Now let me turn the call over to Cory.

Cory Newsom

Thank you, Curtis, and good afternoon, everyone.

Starting with our loan portfolio on Slide 5, loans held for investment at the end of the third quarter of 2021 were $2.43 billion, which is $126 million, or a 5.5%, increase from the second quarter of 2021. This increase was largely driven by organic net loan growth of $178 million, partially offset by a decrease of $52 million from SBA repayments on PPP loans.

Our loan growth in the third quarter of 2021 was broad based and relationship focused as economic activity remains robust in our markets, with particular strength in multifamily properties, agricultural production loans and direct energy loans. In our Ag portfolio, agricultural loans increased to $119 million as compared to $96 million as of the end of the second quarter of 2021 as we experienced typical seasonal fundings. With economic activity picking up, combined with a strong rise in energy prices, we also took advantage of opportunities in the Permian Basin with longstanding customers of the Bank in addition to new relationships generated by recently hired loan officers.

Importantly, our lending team has continued to bring new business and clients to City Bank in the third quarter of 2021, which has kept our loan pipelines at healthy levels. Looking forward, we remain confident in our goal of delivering high single-digit loan growth in 2022 and could even see better results depending upon our ability to hire additional lenders over the next several quarters.

As we discussed on last quarter's earnings call, we have a strong team of bankers in place that have developed longstanding relationships with our customers and continue to drive new business and grow market share, as can be seen in our results this quarter. Our opportunity is to build on this foundation by adding scale across our markets, with a focus on our metropolitan markets of Dallas and Houston, where we can add to our bottom line by continuing to redeploy our low-cost funds into attractive loans.

To accomplish this, we have outlined a goal of adding 20 lenders to our 60-lender team over a two-year timeframe and are actively hiring in all markets. We are focused on veteran bankers who have strong relationships, a history of success, and most importantly, who fit our culture. I am very pleased with our success, as we are almost halfway to our goal, and I have been very impressed with how quickly they've started to bring relationships to City Bank. A good example is the Houston market, where we have hired a new market leader who is attracting both quality lenders as well as attractive new business.

Our focus is on delivering sustainable organic growth, and we are cognizant of the outsized revenues that we have achieved over the last 18 months in our Mortgage business in this low-rate, high-margin environment, as can be seen on Slide 7. For the third quarter of 2021, we generated $373 million in mortgage loan originations as compared to $379 million of originations in the second quarter of 2021. We had a $1.1 million increase in Mortgage Banking activity revenues in the third quarter of 2021 as compared to the second quarter of 2021.

As Curtis touched on, we expect our Mortgage Banking revenues to decline over time as the mortgage market gradually normalizes in future periods while we continue to grow other revenue sources. As a result, we expect mortgage revenues to decline to about 10% to 15% of total revenues, over several years, as compared to about 26% of total revenues today. As we have discussed on prior calls, we've been very focused on managing costs and margins through this cycle and have utilized technology to scale the business as volumes have increased. Looking forward, we expect volumes and revenues related to our Mortgage Banking activities to gradually decline and will continue to manage expenses to maintain profitability. Importantly, we expect net interest income growth to offset the decline in Mortgage income as we grow our Lending platform and put our excess liquidity to work in higher-yielding loans.

As outlined on Slide 8, we generated $25.8 million of noninterest income in the third quarter of 2021 compared to $22.3 million in the second quarter of 2021. The growth from the second quarter of 2021 was primarily due to the seasonal increase of $2.6 million in income from insurance activities and the increase of $1.1 million in Mortgage Banking activities revenue.

To conclude, our local Texas markets are strong and our team has continued to execute very well. We've gotten off to a strong start recruiting experienced lenders to City Bank, which provides visibility to future growth, while our existing team of lenders continues to perform at a very high level. We are proud of our results this quarter and we're optimistic as to what the future holds for South Plains.

I would now like to turn the call over to Steve.

Steve Crockett

Thank you, Cory.

Starting on Slide 10, net interest income was $31.2 million for the third quarter of 2021 as compared to $29.6 million for the second quarter of 2021 and $31.3 million for the third quarter of 2020. The increase since the second quarter of 2021 was due primarily to an increase of $1.4 million in loan interest income as a result of the growth of $83 million in average loans outstanding during the third quarter of 2021.

We recognized $1.7 million in deferred PPP-related SBA fee income as an adjustment to interest income, which included accelerated income on PPP loans forgiven by the SBA during the third quarter of 2021. At September 30, 2021, there was $2.9 million in unrecognized deferred PPP-related SBA fees, the majority of which are expected to be recognized as PPP loans continue to be forgiven by the SBA or repaid over the next several quarters.

We are very pleased that our net interest margin increased to 3.58% in the third quarter of 2021 as compared to 3.42% in the second quarter of 2021. The expansion in our net interest margin was primarily due to the increase of $83 million in average loans outstanding during the third quarter of 2021 as we continued to deploy our excess liquidity.

Our average cost of deposits declined two basis points to 25 basis points in the third quarter of 2021, as compared to 27 basis points in the second quarter of 2021, and declined from 34 basis points in the third quarter of 2020. Continuing on Slide 11, deposits increased in the third quarter of 2021 to $3.21 billion, an increase of $53.8 million from June 30, 2021. The largest increase in deposits for the third quarter was in non-personal demand accounts. We ended the third quarter of 2021 with total noninterest-bearing deposits of $1.05 billion, or 32.8% of total deposits.

Turning to Slide 12, our nonperforming assets to total assets ratio declined five basis points to 32 basis points in the third quarter of 2021 as compared to 37 basis points in the second quarter of 2021. As Curtis touched on, the robust Texas economy has provided a tailwind to our customers and has led to positive credit migrations in several areas of our loan portfolio. At September 30, 2021, active loan modifications attributed to the ongoing COVID-19 pandemic totaled $16.4 million, or 70 basis points of our loan portfolio. Approximately 97% of these active modified loans are in our hotel portfolio, where we continue to experience improving fundamentals. We expect that these remaining modified loans will return to full payment status at the end of their respective modification periods.

Also, as is noted on this slide, we had an increase of $6 million in classified assets during the third quarter of 2021. This was largely the result of one credit being downgraded due to the loss of its underlying cash flow source. Subsequent to the end of the quarter, the borrower repaid this loan in full.

Overall, we continue to believe that our loan portfolio remains well reserved, as our ALLL to total loans was 1.76% at September 30, 2021, which is an 11 basis points decline from the second quarter of 2021. Looking forward, we continue to believe that the reserves that we have built to help guard against an uncertain outlook are appropriate, and we will continue to evaluate our reserve in the coming quarters.

Skipping ahead to Slide 15, our noninterest expense was $38.1 million in the third quarter of 2021 as compared to $36.8 million in the second quarter of 2021. This increase was primarily due to an increase in personnel expense from the payment of higher commissions on insurance activities versus the prior quarter.

Our efficiency ratio was 66.5% in the third quarter of 2021 as compared to 70.5% in the second quarter of 2021. This decrease in the efficiency ratio is primarily a result of the improved net interest margin experienced during the third quarter of 2021, but we remain focused on improving this ratio.

Moving ahead to Slide 17, we remain well capitalized with tangible common equity to tangible assets of 9.94% at the end of the third quarter of 2021, unchanged from the end of the second quarter of 2021, and 9.25% in the third quarter of 2020.

Before turning the call back to Curtis, I would like to highlight that our Audit Committee has completed a competitive process to review the appointment of our independent registered public accounting firm for the fiscal year ending December 31, 2022. Several firms, including our current firm, Weaver & Tidwell, were invited to participate. As a result of this process and following careful deliberation, our Audit Committee has selected BKD, a national CPA and advisory firm, to become our independent registered public accounting firm after the filing of our 10-K for the year ending December 31, 2021.

I will now turn the call back to Curtis for concluding remarks.

Curtis Griffith

Thank you, Steve.

To conclude, our team continued to implement our strategy through the third quarter of 2021 and have delivered impressive results once again. I am proud of the consistent results that we've delivered since our IPO two years ago, which can be seen in our book value growth as well as our improved returns. At the end of the third quarter of 2021, our tangible book value per share was $20.90, which compares to $18.97 at the end of 2020 and $15.46 at the end of 2019. Likewise, our annualized return on average assets for the first nine months of 2021 was 1.57%, which compares to 1.31% for the full year 2020 and 1.04% for the full year 2019. Our consistent book value growth and improved return on assets clearly demonstrate not only our team's execution but also the excellent value we are creating for all of our stakeholders.

Thank you again for your time today.

Operator, please open the line for any questions.

Operator

Thank you. Our first question is from Brady Gailey of KBW. Please proceed with your question.

Brady Gailey

Hi, thanks, good afternoon guys.

Curtis Griffith

Hi, Brady.

Steve Crockett

Hi, Brady.

Brady Gailey

On the lender hiring front, I heard, and last quarter I think you mentioned it too, you want to hire 20 people. I think you're halfway through that hiring process. What do you expect the timeline to be on the remaining 10 lender hires? Is that something that happens in the next quarter or two, or is that longer term?

Cory Newsom

Yes, Brady, this is Cory.

I think we'd love to see it happen in the next quarter or two. I don't think that's really realistic. We'll probably go through the better part of next year getting those exactly the way we want them. You've got to go back and think through our process. I mean, we're not out looking for people that are typically looking to change jobs. We're looking for that much more high-quality seasoned lender that is pretty content where they are. I guess our approach is probably a little bit more methodical on what we go about, looking for that culture fit and making sure that the vetting process is really what we want it to be. I like to say that it's in the next couple of quarters, but I think it's easily the next three.

Brady Gailey

Okay, all right. Then how does that play into growth in your expense base? I know it'll provide operating leverage longer term, which may be good to profitability, but how do you think about expense growth from kind of the 3Q base as we head into 2022?

Curtis Griffith

This is Curtis.

Let me phrase it this way. Of course, we're trying to reduce noninterest expense in some areas, like traditional media advertising, but we know we've got upward pressure out there on personnel cost. We're not immune from the wage inflation that we're seeing occur all across the country. But our goal is to retain the top quality talent that we have, and while we're continuing to add those lenders who will—and they're doing it pretty quickly—generate far more revenue than the cost of adding them to the team.

While we will see some upward movement out there, and specifically personnel cost with the hires that we're making, I think you're going to see a corresponding revenue increase come right along pretty quickly.

Cory Newsom

Brady, this is Cory.

The ones that we've done so far, really kind of trying to stay focused on about a six-month breakeven. I think we're probably, in some cases, beating that, but I mean Curtis is exactly right. We're all seeing a little bit of upward pressure. We're making sure ours is the right kind and just building the quality team that we want to have as we move forward.

Brady Gailey

All right. Then finally for me, I'm just curious, the 190,000 shares that were repurchased, it was about 1% of the Company, do you know what the average repurchase price was for those shares?

Steve Crockett

Yes, Brady, this is Steve.

I've got that right here. It was approximately $23.10, roughly.

Brady Gailey

Oh, and the stock's at $25 now, so it's a little higher. But it's still an inexpensive stock price. How do you think about the buyback going forward?

Curtis Griffith

Well, we continue to have discussions with our Board about that, and I think so far the general consensus is that, as we said in the earnings call we just did, we don't think we're really up to full intrinsic value yet. We'll discuss it. I'm going to have to look at the buyback program, and we will be doing that over the next couple of months. But I think the consensus from the Board is that we've done well with what we've bought so far, and we'll have to just look out in the future and see how far we think we want to go. We still believe that our stock isn't valued at where it really ought to be. I think all of us feel that way.

Brady Gailey

All right, great. Thank you, guys.

Curtis Griffith

Thanks, Brady.

Operator

Our next question is from Brad Milsaps with Piper Sandler. Please proceed with your question.

Brad Milsaps

Oh, hi, good afternoon.

Curtis Griffith

Hi, Brad.

Multiple Speakers

Hi, Brad.

Brad Milsaps

Cory, I appreciate the guidance on high single-digit loan growth in 2022, and I think I heard you mention that, potentially, that could work higher. I mean, you guys have put on $300 million ex-PPP the last two quarters. I mean, I think the growth this quarter was 8% on annualized if I take out PPP. I mean, it seems you're tracking at a much higher rate than that.

Just kind of curious, what sort of maybe has you more anchored in that high single-digit spot? Is that just conservatism on your guys' part, or is there something else there, maybe in terms of payoffs or something else I'm missing, where that number could be a lot higher based on what you're seeing right now?

Cory Newsom

If you look at our pipeline, we still see a lot of optimism out there, but we're backfilling with what we've got out there. The loans that have come through, they're worked at a really good close rate with the things that we've had. I mean, we're definitely being conservative. I mean, we think that with the team that we have and the new lenders that we've brought on, we're pretty optimistic about where we're going to go. But trying to go out there and put out double-digit guidance would be pretty hard for us to do right now.

Curtis Griffith

Hi, Brad, this is Curtis.

The economy's strong here, but it's hard to judge how much of that is just kind of a snap back from COVID. We might see some things slow down a little bit in '22, we don't know. But we do feel pretty confident that we can hit those high single-digit numbers at this point with the people we're bringing in and the activity that we see. But right now, I don't think we'd want to go out and predict we can do a whole lot better than that.

Brad Milsaps

Okay, great. Steve, would the plan be just to continue to fund that with the cash that you have on the balance sheet? I suspect that if the growth continues, you're not really interested in growing the bond portfolio from here, but just kind of curious how to think about sort of the positioning of the balance sheet.

Curtis Griffith

Yes, we really think we're in a great position. We do have a lot of liquidity on the balance sheet right now, and we have plenty of capital. Frankly, we're also seeing some good opportunities from some already completed and some announced acquisitions out here in our West Texas markets, so we think we're getting some great spots to grow loans. We have the ability out there, with the cash on hand to do it. Obviously, there may come a time that we're going to get more aggressive at looking at an acquisition to add it to that liquidity, but we continue to see deposit growth out there at the very time we're still seeing deposit costs decline. It's kind of hard to get excited about trying to go out and make any kind of an M&A play on something as long as we've got plenty of our own money to spend.

Cory Newsom

Yes, and this is Cory.

One other thing that I would probably add to that is we're very pleased with some of the results of the treasury initiatives that we've got out there, working with our commercial customers. I think if you look at all those things coming together, we think with the funding we're in pretty good shape.

Brad Milsaps

Okay, and maybe one last one for me, for Steve maybe, just to kind of go with Brady's expense question another way. It would almost seem that your personnel costs might've been closer to flat without the kind of seasonal insurance commissions, and then maybe some of the occupancy expense was also somewhat seasonal. Do you think that, given some of the investments that you're making, vis-a-vis, declining mortgage commissions in 2022, they kind of offset and you can kind of hold the run rate flattish as those two swap out for one another?

Steve Crockett

Yes, I think we'll definitely have declines on the mortgage side with the variable expenses we've got, as we believe that that revenue will come down as that normalizes on the refinance side. Yes, the things you mention with the new lenders add to the personnel costs, the initiatives we've talked about with the cloud migrations will be some offsets to that. But as Cory mentioned, I think we are continuing to look at other expenses to cut back on, so it's a long way of saying we hope it's going to be flat, but we know that there is, as Curtis mentioned, just that upward pressure on personnel costs not just for us but I think industry-wide and nationwide.

Brad Milsaps

Great, that's helpful. Really appreciate it, thank you guys. Nice quarter.

Steve Crockett

Thank you.

Curtis Griffith

Thanks, Brad.

Operator

We have reached the end of the question-and-answer session. I will now turn the call back over to Mr. Curtis Griffith for closing remarks.

Curtis Griffith

Thank you, Operator.

In summary, we certainly had an excellent quarter. Just to reiterate, compared to second quarter of ’21, our net income is up $1.5 million, but we had a negative provision of $2 million in the second quarter versus no provision at all in Q3. We’ve seen, excluding the PPP balance decrease of $52 million, we achieved net loan growth of $177.6 million. We’re getting good production from our Lending team, including significant and solid business from our new hires, and we are well on the way to hiring 20 great lenders.

The credit quality generally does continue to improve, and economic activity is robust in our markets. Our mortgage volume is slowing, not by much, and over time we expect it’ll only be 10% to 15% of our net income as our other revenue sources increase.

Our deposits continue to increase even as our cost of funds decline. Our tangible book value is increasing; it’s up 16% from third quarter of a year ago, in 2020. We believe that we are on a path to create significant value for all of our stakeholders.

In summary, I want to thank all of our amazing employees that make that possible, and thanks to all of you for joining us on the call today.

Thank you, Operator, and I’ll turn it back to you.

Operator

Thank you. This concludes today’s conference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.