South Plains Financial, Inc.

First Quarter 2022 Earnings Call Transcript

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CORPORATE PARTICIPANTS

Steve Crockett, *Chief Financial Officer and Treasurer*

Curtis Griffith, *Chairman and Chief Executive Officer*

Cory Newsom, *President*

CONFERENCE CALL PARTICIPANTS

Brady Gailey, *KBW*

Brad Milsaps, *Piper Sandler*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen and welcome to the South Plains Financial, Inc. First Quarter 2022 Earnings Conference Call.

As a reminder, this conference 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 and good afternoon, everyone. We appreciate your participation in our first quarter 2022 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 May 10, 2022. Additionally, a slide deck presentation to complement today's discussion is available on the News and Events section of our website.

Before we begin, let me remind everyone that this call may contain forward-looking statements that are subject to a variety of risk, 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 deck 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 first quarter 2022 results. Cory will provide an update on our efforts to accelerate loan growth as well as the successes that we're beginning to achieve in many of our markets. Steve will then conclude with a more detailed review of our Q1 results.

Turning to Slide 4, we reported net income of $14.3 million or $0.78 per diluted common share, which compares to net income of $14.6 million or $0.79 per diluted common share in the fourth quarter of 2021, and $15.2 million or $0.82 per diluted common share in the first quarter of 2021.

It's important to note that our first quarter results included a positive fair value adjustment on our mortgage servicing rights portfolio that added $0.19 per share and a reserve release equating to $0.09 per share, both net of tax. Excluding the impact of these two items, we see core earnings for the first quarter of 2022 of $0.50 per share, which we believe provides a better baseline for the run rate earnings of the Company.

During the first quarter, we grew loans 2.6% annualized compared to the fourth quarter of 2021. As Cory will discuss, we experienced the typical softer trends through the fourth and first quarters, which suppressed loan growth. However, underlying loan demand remains strong as we continue to experience solid momentum across all of our markets.

In Lubbock, we're benefiting from recent acquisitions by out of State banks, which are creating customer disruption and opening up opportunities to bring new relationships to South Plains. In our MSAs at Dallas, Houston, and El Paso, economic growth is strong, and our recently hired lenders continue to build their portfolios, which we expect to accelerate loan growth as we move through the year. We are excited with the progress that we've achieved in the Permian Basin as we have invested in our employees, infrastructure, and operations to position City Bank to gain market share in this very dynamic region.

We also believe that we have an attractive deposit franchise, which continues to demonstrate robust growth, having increased $109 million or 13% annualized from the fourth quarter of 2021. Our cost of deposits remained stable at 23 basis points in the first quarter of 2022, which was consistent with the fourth quarter's level, while noninterest-bearing deposits represented 33% of total deposits.

Our deposit franchise will provide the liquidity to fund loan growth in our MSAs as we continue to work to improve our loan-to-deposit ratio, which was 71% at the end of the first quarter of 2022. As we put this excess liquidity to work in higher-yielding loans, we expect to see increased net interest earnings that will help offset the decline in our mortgage business in this rising interest rate environment.

During the first quarter, mortgage banking income, excluding the MSR fair value adjustment, was approximately 19% of total revenue, which compares to 23% in the fourth quarter of 2021 and 34% in the first quarter of 2021. We continue to expect mortgage banking income to normalize at approximately 10% to 15% of revenues.

As we continue to grow the bank, we will remain disciplined on credit, which is central to our culture. During the first quarter of 2022, we continued to experience improving credit metrics in our loan portfolio, driven by improvements in our hotel and direct energy segments. As a result, we recorded a negative provision for loan losses of $2.1 million in the first quarter of 2022, compared to no provision for loan losses in the fourth quarter of 2021.

Turning to capital, we remain focused on our capital allocation through our dividend, which has grown over time, and strategically utilizing our share repurchase program. As a result, our Board of Directors authorized a quarterly dividend of $0.11 per share this past week. This will be our 13 consecutive quarterly dividend and will be paid as of May 16, 2022 to Shareholders of record on May 2, 2022. We also repurchased approximately 106,000 shares during the first quarter of 2022 under our share repurchase program.

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 first quarter of 2022 were $2.45 billion, which is an increase of $16.1 million from the fourth quarter of 2021. This increase was primarily the result of organic net loan growth of $27.9 million, partially offset by a decrease due to SBA forgiveness and repayments of $11.8 million in PPP loans through the first quarter of 2022.

Our organic loan growth remained relationship-focused and occurred primarily in land development and construction loans, commercial retail loans, and consumer loans. As Curtis noted, loan growth is typically soft in the first quarter, given seasonality from our Ag portfolio, which experiences repayments. During the first quarter, we had net repayments of $35.5 million.

Looking to the second quarter, we also expect to see a large relationship in the energy sector of approximately $46 million pay off as it moves to a non-bank structure. This has been expected and will be a headwind to second quarter loan growth. That said underlying loan demand remains robust, and we remain confident in our goal of delivering mid- to high-single-digit loan growth for the full year of 2022.

We expect to see an acceleration in organic loan growth in the second half of the year as we continue to benefit from strong economic growth, combined with our newly added lenders continue to bring new relationships to South Plains.

As we've discussed on our prior calls, we are adding experienced bankers who share our lending philosophy, credit philosophy, and culture across our MSA markets with a focus on Dallas, Houston, and El Paso. Our strategy is to redeploy our excess low-cost deposits from our smaller non-metropolitan markets into our larger, more dynamic lending markets where we have had strong success. This can clearly be seen in Houston where we recruited a new market head and have experienced 67% loan growth over the last year. Likewise, we've experienced 13% loan growth in Dallas over the last year as we continue adding to our lending team.

As a result of our success, we are also expanding our commercial office space in some of our key metro locations, given the significant potential that we see to increase our presence in these large and growing markets.

Importantly, we believe we have a competitive advantage given that we can close deals more quickly than our larger competitors while not sacrificing on underwriting. We can make rapid decisions, our processes are less onerous, and we are not cutting corners or taking unwarranted credit risks. This provides the foundation to move profitable relationships from our larger competitors as we continue to add to our lending team.

Another market that holds real potential is the Permian Basin. The Permian is unique, given that it is an approximately $12 billion deposit market with no dominant bank in the region. It is a relationship-focused market with a significant private banking opportunity combined with C&I and real estate lending.

Since we entered the market over two years ago, we have worked to establish our culture, demonstrate how we service our customers, as well as upgrade our facilities and technology. We also took the time necessary to install the right market leaders in Midland and Odessa. We are beginning to see the benefits of these actions and expect to see many more in the months and years ahead.

Over the medium term, we believe we see an opportunity to more than double our loan portfolio in this region as we focus on developing private banking relationships, while also growing our C&I loan portfolio. The Permian Basin is a dynamic market for the South Plains and not just because oil has risen sharply in recent months. There is generational wealth in the region that wants to do business with a local bank. Given that there are only four community banks in Midland and Odessa, we see an opportunity to gain significant share of the market.

Turning to Slide 7, mortgage loan originations decreased 25% to $235 million in the first quarter of 2022 as compared to the fourth quarter of 2021. This slowdown has been expected given the rapid rise in interest rates pressuring refinance volumes combined with the record volumes that we have experienced over the last two years.

We continue to manage this business for profitability and are making the best long-term decisions for South Plains and our Shareholders. As a result, we made the decision in the first quarter to not counter aggressive employment offers for several large mortgage producers in our Dallas area, given our view of the cycle. Looking forward, we expect originations to begin to stabilize in the second quarter with the seasonal pickup in mortgage demand that we typically experience in the spring.

While mortgage originations were lower, we did experience a $4.5 million positive fair value adjustment to the Company's mortgage servicing rights portfolio. This was due to the rising interest rates experienced in Q1, which is slowing the prepayment rate and causing a longer estimated life of the portfolio. Overall, we continue to expect our mortgage banking revenues to decline to approximately 10% to 15% of the total revenues and believe that this will likely occur more quickly than originally expected, given the rapid rise in interest rates and the staffing reductions that we had during the first quarter.

Turning to Slide 8, we generated $23.7 million of noninterest income in the first quarter of 2022, compared to $22.9 million in the fourth quarter of 2021. The increase was primarily due to an increase of $1.2 million in mortgage banking activities revenue as just discussed and an $869,000 increase in income from an investment in a small business investment company, which was partially offset by the seasonal decrease of $598,000 in income from insurance activities.

To conclude, we believe we've made good progress through the first quarter positioning South Plains for sustained organic loan growth, improved profitability, and accelerating earnings growth. We continue to add to our lending teams in our MSA markets, which positions us for share gain. We have made necessary investments in our facilities, infrastructure, and people in the Permian Basin to achieve sustainable long-term growth there for South Plains and not growth just attributable to the rise in oil prices.

Lastly, our home market of Lubbock continues to see strong population growth as well as disruption from recent bank acquisitions, which we believe will present further market share gain opportunities. Taken together, we remain confident in our outlook for mid- to high-single-digit loan growth in 2022.

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

Steve Crockett

Thank you, Cory.

Starting on Slide 10, net interest income was $29.9 million for the first quarter of 2022 as compared to $31.4 million for the fourth quarter of 2021. The decrease since the fourth quarter of 2021 was due primarily to a decline of $1.7 million in loan interest income as a result of a decrease of 4 basis points of yield, recognized in the fourth quarter of 2021 on several large loan payoffs; a decline of $388,000 in interest and fees on PPP loans as the amount of PPP loan forgiveness payments received fell 47%; and having two fewer days in the quarter.

Looking forward, we believe that we are well-positioned for our net interest income to benefit as we grow our loan portfolio and benefit from the anticipated rise in interest rates through the year. We recognized $667,000 in PPP fee income as an adjustment to interest income, which included accelerated income on PPP loans forgiven by the SBA during the first quarter of 2022. At March 31, 2022, the Company had $1.3 million in deferred PPP 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.

Our net interest margin was 3.33% in the first quarter of 2022 as compared to 3.5% in the fourth quarter of 2021. The contraction in our net interest margin was primarily due to the 10-basis point decline in our average yield on loans, which included the payoff fees and higher PPP fees in the prior quarter. Additionally, our $86 million rise in average deposits in the first quarter of 2022 pressured our NIM by a further 8 basis points. As Curtis mentioned, our average cost of deposits remained consistent at 23 basis points in Q1. As the Fed is expected to continue to raise interest rates, we plan to lag our increase in deposit rates.

Continuing to Slide 11. Deposits increased $108.9 million in Q1 to $3.45 billion from December 31, 2021. This increase was primarily a result of organic growth as well as existing customers generally maintaining higher liquidity due to perceived uncertainty in the economy. We ended the first quarter of 2022 with total noninterest-bearing deposits of $1.13 billion or 33% of total deposits.

Turning to Slide 12, we continue to believe that our loan portfolio remains appropriately reserved as our allowance to total loans was 1.62% at March 31, 2022 as compared to 1.73% at December 31, 2021, and Curtis touched on our reserve release during Q1 earlier. Looking forward, we will continue to monitor our reserve for future provisions or releases.

Skipping ahead to Slide 15, our noninterest expense was $37.9 million in the first quarter of 2022 as compared to $36.1 million in the fourth quarter of 2021. The increase was primarily due to an increase of $1.2 million in personnel expense due to higher costs for new hires in commercial lending and as part of our data analytics and cloud projects, stock-based compensation and annual salary adjustments, partially offset by a decrease in commissions related to our decline in mortgage loan originations.

Additionally, there was a $480,000 increase in legal expense and a $362,000 loss on fixed asset disposals during the first quarter of 2022. Our efficiency ratio was 70.3% in the first quarter of 2022 as compared to 66.1% in the fourth quarter of 2021. This was expected and largely attributable to the slowdown in our mortgage banking activity and increased personnel cost.

Moving ahead to Slide 17, we remain well-capitalized with tangible common equity to tangible assets of 9.11% at the end of the first quarter of 2022, a decline from 9.85% at the end of the fourth quarter of 2021. The decline was mainly driven by a $30 million change in the fair value of our available for sale securities and cash flow hedges, net of tax. The change was caused by the large increase in interest rates experienced in Q1, which reduced our tangible book value per share by $1.70.

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

Curtis Griffith

Thank you, Steve.

To conclude, I am pleased with our first quarter results as we continue to position the Company for steady growth and improved profitability. We are recruiting experienced lenders to our MSA markets, have transformed our operations in the Permian Basin, and are benefiting from strong economic growth in our home market of Lubbock and all across Texas. We are benefiting from strong underlying loan demand and have confidence we will achieve our goal of mid- to high-single-digit loan growth in 2022.

Additionally, as the Fed raises interest rates, we believe our deposit costs will lag the rise in rates, which will further contribute to margin expansion. Lastly, the credit quality of our loan portfolio has continued to improve through the first quarter and positioned our team to release a portion of our reserves. Our results and the accomplishments of our outstanding employees provide us with optimism for the future.

Thank you again for your time today. Operator, please open the line for any questions.

Operator

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

Brady Gailey

Hey, thanks. Good afternoon, guys.

Curtis Griffith

Hi, Brady.

Brady Gailey

Why don't we start with an update on where we are on the lender hiring front? I think last quarter, you guys said you were about halfway through hiring the planned 20 lenders, maybe I think last quarter, you're about 10 through. But as you said, there's a lot of dislocation there locally in Lubbock from some M&A. Maybe just an update on how that's going and how the disruption may change those plans if they would potentially increase the plans beyond the 20?

Cory Newsom

Hey Brady, this is Cory.

I don't know that we're necessarily trying to increase the plans, although we're consistently going to be looking for good hires that meet our credit culture and the philosophy of the way we do it, but here's the good thing. We think we're approaching about 75% success on where we've come on the lenders.

If you recall back in the last time we had a conversation, stuff really slows down at the end of the year as people are waiting for bonuses and things to kind of settle back out. That's kind of opened back up for us. A lot of the ones that we've been cultivating during that time frame are starting to come to fruition right now.

Brady Gailey

All right. Then I know we talked about the expense base growing at kind of a low- to mid-single-digit level this year, but I know inflation continues to pick up. So, any update on how you think expense growth will pan out this year?

Steve Crockett

Yes Brady, this is Steve.

Yes, we did see a little bit, probably a little bit larger increases on the salary side than we would have hoped initially, but with inflation in wages, with mortgage being a big part of that with somewhat of a slowdown in the mortgage area, we should see some benefit back to us on the expense side with commission expenses and then just some of the other line items there that would lower that number. So, we're still on track. Q1 was maybe just a little bit higher with still some of the higher mortgage numbers in there.

Curtis Griffith

This is Curtis, Brady.

Yes, I don't want to say Q1 was a total anomaly, but we certainly did have a few things in there that probably won't be repeated at those levels. We did have kind of some stacked up legal expenses that all got paid during that quarter related to various projects. As Steve indicated, we did have kind of a tail on a good bit of mortgage activity. Those commissions did get paid out. As the mortgage activity slowed, that won't be repeated at those levels certainly in Q2. So, I think you'll see us kind of get back on track for that.

Inflation is very real, though and everybody is going to have to be competitive out there with what they're going to do with their personnel. We do see inflationary pressures on our suppliers as well. Nearly everything anybody buys out there, as we all know, is getting pushed up a little bit. We hope that we are seeing the peak on that in the next few weeks. Some people seem to think we are. Maybe this can at least moderate and not continue to see these 5% and 7% levels of increases just across the board.

Brady Gailey

All right. Lastly for me is just on the reserve level. It’s been coming down, but you’re still north of 160 basis points in your allowance, which is still a pretty healthy level. Do you think we continue to see that come down over the course of the year as things improve, or do you start to bake in more of a recessionary scenario and hold that stable?

Curtis Griffith

Well, we had some really detailed discussion about that at our last Board meeting. In fact, there's a lot of uncertainty out there in the world. Of course, we continue to see new variants on COVID, and even though fortunately it doesn't seem to be as serious as some of the earlier versions, it's still happening. I don't think anybody knows the full effect of what's going on over in Ukraine and how that affects macro levels across the whole world economy. And we've got the Fed is pushing rates up, quite clearly, and that will have some impact on borrowers as it tightens up cash flow for them as those rates start moving up.

So, all those uncertainties in there, we still want to be cautious. As we've said all along, we're going to follow the math. Mr. Crockett is very good at running the numbers on it, and we're going to try to abide by what our models tell us and with some good qualitative adjustments thrown in there as well. Are we probably still a little on the high side? Well, we might be, but I think we're going very slow and very cautiously on pulling money out, and I think you'll see that trend continue.

Cory Newsom

Brady, this is Cory.

We're always going to be conservative, and we're always going to use that lens in everything we do. The one good thing that's coming on the other side of it is, if you look at our pipelines and where we're going in the future, our pipelines are strong, and you may see some reduction in the percentage just as an effect of that I think, and as long as asset quality continues to improve like it is.

Brady Gailey

Okay. Great. Thanks guys.

Curtis Griffith

Thanks, Brady.

Operator

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

Brad Milsaps

Hey, good afternoon.

Curtis Griffith

Hi, Brad.

Brad Milsaps

Appreciate you guys taking my questions.

Just kind of curious if you could maybe talk about the NIM a little bit. I know there are a lot of moving parts with the liquidity and then some payoffs that you expect in the second quarter, but do you think you're getting close to a bottom in the NIM this quarter and it can start to move higher maybe with what the Fed is doing? I know that historically you guys are maybe a little bit more neutral maybe than some. Anyway, just any color you could provide there, I would really appreciate.

Steve Crockett

Yes, sure, Brad. This is Steve.

I would say we're hopeful that that has gotten toward the bottom. We do continue to grow loans but there's still a lot of competition on loans and primarily on rate, so we're having to be competitive on that a little bit. We're still seeing pressure on that side. We have redeployed some of the liquidity into securities as well that are at higher rates, so that should help us offset some of the pressure we would see on the loan side.

But yes, I mean, generally, in a rates up environment, we are slightly asset sensitive. So that should be helpful to us overall. We are hopeful that we'll see kind of that bottoming out of that deposit growth. We want to still see deposit growth, but that may not be at the same rate that we've seen that growth over the last year, two years.

Cory Newsom

Brad, this is Cory.

If you look at the amount of liquidity that we've got, we've never hidden from the fact that we're going to lag rates up. We just are. We think by the time we kind of work through the transition with some of this movement—and unfortunately there's a lot of competitive pressures out there of people still trying to get stuff priced on what it was like before the rate increases. We're just having to adjust out of that. We don't necessarily agree. I don't know that we're at the very bottom, but I don't think we're far off of it. I think it'll start to turn around the right way.

Curtis Griffith

I do too. I think we'll start seeing, probably during Q2 maybe, and then we'll start easing back up a bit for the reasons Cory and Steve are mentioning, but there's also a factor in there. As we've worked through some of these larger, pretty complex real estate transactions that we've been putting on the books in Q1, many of those were at rates that were negotiated even weeks earlier than when the loan actually gets funded. So, we are going to live to what we've told the customer, and now we are getting to make some of those adjustments in the deals we're looking at today. As you see some of those come on the books later on in Q2, some of those are going to be at some improved levels.

The competitive pressures are still real strong and we're going to pass on a few things. Some people are just still making some awfully cheap pricing out there, and we're beginning to work ours up a bit. I think you will begin to see the NIM start creeping up during Q2 and hopefully upward track on through the rest of the year. We'd love to get it back up to our more historic levels.

Brad Milsaps

Great. That's helpful. Just on that topic, where are you seeing new loan yields come on the books? I think the core yield was 4.74% in the quarter. I assume it's competitive, it's somewhere south of there, but just trying to get a sense of how much more pressure you could see. Can you remind me the percentage of the loans that reprice in fairly short order with any move in Fed funds or LIBOR?

Steve Crockett

Yes, so I'll start first.

I should have mentioned it earlier. In the deck we did add a graph on Slide 6 that's got some information on fixed versus variable rate. That 49%, almost 50%, of our loans are fixed but we've got 17% that would reprice immediately, with another 9% or so that will mature or reprice in the next 12 months.

Cory Newsom

Brad, a lot of what we're trying to do is we're trying to avoid as much of the fixed rates as we can and try to get back more to a floating version because this is where you want to be, floating, when things are headed back up. While we're probably a little bit more competitive in pricing, which our spread's not quite as good as we'd like to have, it's kind of like the devil you know through the whole thing. That's what we're focused on right now is making sure that we can maintain whatever spread that we agreed to throughout the life of the loan and not wake up in a few quarters and start regretting some decisions.

Brad Milsaps

Got it. Sorry, Steve. I see that now. I apologize for that.

Then maybe just final two questions for me. Would you guys anticipate sort of being active in a similar manner in the buyback to the extent the stock stays here? Then Curtis in your initial comments, you kind of mentioned run rate earnings at $0.50. It sounds like you are excluding the MSR and then the SIBC gain. Was there anything else in there that you guys are sort of taking out to get to that $0.50 number?

Curtis Griffith

No, that's really what we've thrown out because there are one timers right there.

Brad Milsaps

Got it.

Cory Newsom

A lot of the things that we're trying to do as we look at that is we know we might spend a little bit of money right now, but everything we're trying to spend monies on is things going to help us to make money in the near term.

Brad Milsaps

That's great. Any thoughts on the buyback?

Curtis Griffith

Well, as far as I know, we'll likely continue. As we've said all along, we think at these levels the stock is a good investment, so we'll continue to spend some money doing that. If you see the track on it, you can probably tell that some days we buy more than others. We still think there's good value right there and would expect, unless we see a significant upturn in the broader market, that we'll probably still be in the market and buying back some of our own stock.

Brad Milsaps

Great. Thank you, guys. I appreciate it.

Cory Newsom

Thanks, Brad.

Operator

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

Curtis Griffith

Thanks, Operator.

We appreciate everybody being on the call today and appreciate the questions. We do have some interesting challenges ahead in a very interesting environment, but we do think that we're positioning the Company well for additional growth and additional profitability. We're very thankful for all of you that continue to invest in our stock and those that do have some consideration for it. If you have any questions, please give us a call. We'd love to talk about it. Thanks.

Operator

This concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.