South Plains Financial, Inc.

First Quarter 2023
Earnings Call Transcript

April 27, 2023

CORPORATE PARTICIPANTS

Steven B. Crockett, *Chief Financial Officer and Treasurer*

Curtis C. Griffith, *Chairman and Chief Executive Officer*

Cory T. Newsom, *President*

CONFERENCE CALL PARTICIPANTS

Bradley Milsaps, *Piper Sandler & Co.*

Joseph Yanchunis, *Raymond James*

Brady Gailey, *KBW*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the South Plains Financial, Inc. First Quarter 2023 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.

Steven B. Crockett

Thank you, Operator, and good afternoon, everyone.

We appreciate your participation in our first quarter 2023 earnings conference call. With me here today are Curtis Griffith, our Chairman and Chief Executive Officer; Cory Newsom, our President; and Brent Bates, our Chief Credit Officer.

A replay of this call will be available on our website within two hours of the conclusion of the call until May 11, 2023. Additionally, a slide deck presentation to complement today's discussion is available on the News & Events section of our website, www.spfi.bank.

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.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

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 2 of the slide deck presentation.

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

Curtis C. Griffith

Thank you, Steve, and good afternoon.

On today's call, I'll briefly review the highlights of our first quarter 2023 results, as well as the previously announced sale of our Windmark business, which we believe was a very good transaction for the bank and our shareholders. Cory will discuss our loan portfolio and the investments that we are making in our deposit gathering franchise, which builds upon the success that we have achieved expanding our lending platform. Steve will then conclude with a more detailed review of our quarter one results.

To start, there are six key points that I hope you will take away from our results and today's call. First, the failures of Silicon Valley Bank and Signature Bank created widespread concern across the banking industry in the days following their collapse. Our results this quarter speak directly to the strength and financial soundness of the bank, as well as the customer relationships that we have developed over many years, which can also be seen in our first quarter deposit growth.

Second, we ended the quarter with 17% of our deposits uninsured or uncollateralized, which is an improvement from 26% at year-end 2022.

Third, we are in a very strong liquidity position with $1.75 billion of available borrowing capacity at quarter end from the Federal Home Loan Bank and the Federal Reserve's discount window and Bank Term Funding Program, none of which we are currently utilizing.

Fourth, we further built capital this quarter through our earnings, as our Tier 1 capital to average assets ratio was 11.2%.

Fifth, the credit profile of our loan portfolio remained strong and stable from the fourth quarter of 2022.

And lastly, our markets remained healthy, though slowing, as we posted 5.9% annualized loan growth in the first quarter.

Turning to our results in more detail on Slide 4 of our earnings presentation, we delivered net income of $9.2 million or $0.53 per share, as compared to $12.6 million or $0.71 per diluted common share for the fourth quarter of 2022. This compares to net income of $14.3 million or $0.78 per diluted common share in the year-ago first quarter.

We recorded a provision for loan losses of $1 million in the first quarter of 2023, as compared to a provision of $248,000 in the fourth quarter of 2022. The provision was mainly due to our organic loan growth in the quarter.

Looking forward, we believe we are well reserved for an uncertain economic environment. While the Texas economy continues to grow, given strong in-migration and low unemployment, that growth is slowing, and

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

the availability of credit throughout the U.S. is broadly contracting, which could negatively impact the Texas economy in the quarters ahead.

As a result, additional provisions for loan losses may be necessary in future periods. While economic activity is moderating, we did experience healthy loan growth of 5.9% annualized as compared to the fourth quarter of 2022. Our loan growth was driven by gains in both our community markets as well as our major metropolitan markets. Cory will touch on this in more detail as well as our outlook for the rest of the year in a moment.

We grew deposits $102 million or 12% annualized, to $3.51 billion at March 31, 2023, as compared to the fourth quarter of 2022. Our deposit growth was largely from public funds as we focused on liquidity through the first quarter, and which remains a high priority for our team. While we did get more competitive with deposit interest rates to maintain relationships, we did not utilize time deposits outside of the normal course of business.

Additionally, while our cost of funds did rise through the quarter, especially around the failures of SVB and Signature Bank, we believe the pressure on deposit rates is now beginning to flatten out through April, which is an encouraging sign. We believe we can remain below our original estimate of a 50% beta on interest-bearing deposits through the year.

The stability of our deposit franchise and strong liquidity position can further be seen on Slide 5, which also highlights the competitive position that South Plains holds. At quarter end, 82% of our deposits were in our rural markets with only 18% in our major metropolitan markets. Additionally, our average deposit account balance is approximately $35,000, and only an estimated 17% of our deposits are uninsured or uncollateralized.

We also ended the first quarter in a strong liquidity position with $1.75 billion of untapped borrowing capacity. We have $988 million of availability from the Federal Home Loan Bank of Dallas, $586 million of availability from the Federal Reserve's discount window, and $179 million of capacity from the Federal Reserve's Bank Term Funding Program. We are in a strong position with ample capital to take advantage of growth opportunities as they present themselves.

Turning to Windmark. We completed the sale of City Bank's wholly owned subsidiary to Alliant Insurance Services for $35.5 million in an all-cash transaction with no earnouts. Windmark offers a variety of crop insurance products through offices in Texas, Nebraska and Colorado, as well as by acting as the general agency for independent agents in 17 states. Windmark was a terrific business for us since its inception in 1997. That said, we knew that we were at the point where we either had to commit significant additional capital and resources to sustain and grow the business or look to divest it.

Ultimately, we began exploring potential strategies with Windmark last year, given that crop insurance is not core to South Plains. We believe Alliant was a good fit for Windmark, given their ability to invest in the business combined with their commitment to retain our people and customers.

Looking forward, our Board of Directors is reviewing the optimal uses for this capital as the transaction provides the flexibility to further invest in our core business while augmenting our capital base. Given the uncertain economic environment, combined with the dislocation in the banking sector, we will be patient and review a broad range of options to determine the best uses for this capital.

Returning a steady stream of capital to our shareholders through our quarterly dividend and share repurchases has been a focus since going public almost four years ago. Along those lines, our Board of Directors authorized a $0.13 per share quarterly dividend as announced last week. This will be our 18th consecutive quarterly dividend to be paid on May 15, 2023, for shareholders of record on May 1, 2023.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

In regards to our share buyback, we utilized the remaining capacity on our share repurchase authorization in the fourth quarter of 2022. Our Board of Directors is currently weighing the merits of another share repurchase program in light of the current economic environment. Our Management team and Board both believe that our shares are currently trading well below their intrinsic value.

To conclude, we are successfully navigating what is a challenging environment and believe we are well positioned for an uncertain economy. We believe that we have a strong core deposit franchise, ample liquidity and remain confident in the credit quality of our portfolio. Importantly, we are positioned to take advantage of opportunities in the market that may come our way in the year ahead, but we believe that now is not a good time to pursue any acquisitions.

Now let me turn the call over to Cory.

Cory T. Newsom

Thank you, Curtis, and good afternoon, everyone.

Starting on Slide 6. Loans held for investment increased during the first quarter of 2023 by $40.6 million or 5.9% annualized compared to the fourth quarter of 2022. Demand remained healthy despite the first quarter being seasonally slower combined with higher market interest rates that are beginning to slow the economic activity. Overall, our loan growth continued to be primarily in the commercial real estate and residential mortgage sectors.

Our loan yield was 5.78% in the first quarter, which compares to 5.59% in the fourth quarter of 2022. The rise in our loan yields continues to reflect our efforts to proactively price new loans to account for the higher market interest rate environment, which is contributing to rising funding costs. We believe that loan yields are beginning to peak and are focused on managing our deposit growth and funding costs to mitigate margin pressure, which I will touch on in a moment.

Skipping to Slide 8. We grew our loan portfolio by $11 million or 5% annualized in our major metropolitan markets of Dallas, Houston and El Paso as compared to the fourth quarter of 2022. The commercial lenders that we have added in these markets continue to grow their loan portfolios by bringing new customer relationships to the bank. We are also beginning to see competitors pull back across our markets given the dislocation that has occurred.

That said, we are focused on funding high-quality loans with a good risk and return profile, as we focus on the structure of new loans and are requiring more equity.

We will never sacrifice credit quality for growth, more so now than ever. Given this backdrop and our more cautious approach to growth, we will continue to look for experienced lenders to recruit to our MSA markets, but we will be more strategic and selective as we add to our team. We are also watching the Texas economy closely given the slowing trend that we are beginning to experience, and we'll manage our expense base accordingly. Overall, we believe that low single-digit loan growth is achievable for the full year, if the Texas economy avoids recession.

Skipping ahead to Slide 10. We have $926 million of commercial real estate exposure in our loan portfolio at quarter end, which represented 33% of our total portfolio. Our office exposure represented 16.7% of our CRE portfolio and 5.8% of our total loan portfolio at the end of the first quarter of 2023. Thirty-two percent of our office exposure is owner-occupied and medical offices comprised 13% of office.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

As Steve will discuss, the credit quality of our loan portfolio remains stable through the first quarter. Given our success expanding our commercial lending platform over the last two years, we are undertaking a similar initiative to expand our treasury management and liquidity team as we focus on growing deposits.

We began this initiative last year and have solid success growing our team, having recently hired an experienced liquidity management professional, from a $50 billion institution, who will focus on enhancing our retail and commercial funding strategy. While we have many of the products today, we need to ensure that we have the right go-to-market strategy. I understand the verticals that we are selling into and ensure that the products are working correctly.

We also need to improve how we sell our products to Corporate Treasurers and CFOs. We've had success in this area, but we know we can do much better. We are hiring experienced professionals across our markets and believe this initiative will further build our core deposit franchise as we focus on relationships for the long-term.

We will also be identifying industries where we can specialize as well as under bank sectors where we can take share. I would note that this initiative will be smaller in scope than our commercial lending expansion and do not expect a meaningful impact to our core expense run rate.

That said, we believe this initiative can have a meaningful impact on our deposit base and to a lesser degree, our fee income over the medium term.

Turning to Slide 11. Our indirect auto loan portfolio increased by approximately $3 million to $300 million in the first quarter of 2023 as compared to the fourth quarter of 2022. While there was modest growth in this sector, we're maintaining a disciplined approach to underwriting a 61% of the indirect auto loan portfolio was originated with a credit score of 719 or better, which is super prime. Twenty-eight percent of the portfolio was originated with a credit score of 660 to 719, which is prime.

This strong credit profile positions the portfolio for resilience across varying economic cycles, which can also be seen at our delinquencies as our loans past due 30-plus days percentage improved from 26-basis points of the portfolio in the fourth quarter of '22 to 14-basis points in the first quarter. Additionally, less than 3% of this portfolio is comprised of recreational vehicles, an area where we believe challenges could occur if the economy does experience a more severe recessionary environment.

Turning to Slide 12. We generated $10.7 million of non-interest income in the first quarter of 2023, compared to $12.7 million in the fourth quarter of 2022. This decrease was primarily due to seasonal decline of $1.4 million in income from insurance activities and a decline of $491,000 in mortgage banking revenues. During the first quarter, mortgage loan originations declined to $86 million as compared to $125 million in the fourth quarter of 2022, given the impact of seasonality and higher interest rates.

Additionally, there was a write-down of $2 million in the fair value of our mortgage servicing rights portfolio during the first quarter. This was primarily due to some easing and mortgage rates noted at March 31. Our secondary mortgage origination division, which excludes mortgage servicing activities, lost less than $100,000 in quarter one.

Looking forward, we will remain in the mortgage business as long as it makes sense and drives incremental business through cross-selling. For the first quarter of 2023, non-interest income was 24% of bank revenues as compared to 26% in the fourth quarter of 2022.

To conclude, I am very proud of our first quarter results as they demonstrate the strength and resiliency of City Bank. We are well positioned for the current environment in successfully executing our initiatives designed to grow both our commercial loan portfolio and our deposit franchise.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

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

Steven B. Crockett

Thank you, Cory.

Starting on Slide 14. Net interest income was $34.3 million for the first quarter of 2023, as compared to $36.3 million for the fourth quarter of 2022. The decrease was primarily a result of a $3.2 million increase in interest expense due to the rise in short-term interest rates, partially offset by $1.2 million of increased interest income due to higher average loan balances and interest income on securities and other interest-earning assets.

Our net interest margin, calculated on a tax equivalent basis, was 3.75% in the first quarter of 2023, as compared to 3.88% in the fourth quarter of 2022. Our net interest margin was impacted by a 39-basis point increase in our cost of deposits in the first quarter of 2023, as compared to the fourth quarter of 2022. This was partially offset by our organic loan growth, combined with the corresponding increase in our loan yields of 19-basis points, as compared to the fourth quarter of 2022.

Our average cost of deposits was 136-basis points in the first quarter of 2023, an increase from 97-basis points in the fourth quarter of 2022. As Cory discussed, we have raised certain of our deposit interest rates through the first quarter to maintain deposit relationships in an increasingly competitive environment. While deposit costs did rise, given the uncertainty created by the failures of SVB and Signature Bank, they have flattened out in the weeks since, and we believe are beginning to normalize through the second quarter.

Turning to Slide 15. Total deposits increased $101.6 million in the first quarter to $3.51 billion as compared to the fourth quarter of 2022. Majority of the growth in deposits was a result of our increased focus on liquidity and which occurred predominantly in our public fund deposits.

Overall, we are pleased with our deposit growth through the first quarter and the opportunities that we see to further build our core deposit franchise through our treasury management and liquidity initiatives, which Cory outlined.

Given the competitive landscape, we did see a modest mix shift as noninterest-bearing deposits decreased to 31.7% of total deposits in the first quarter of 2023, as compared to 33.8% of total deposits in the fourth quarter of 2022.

Turning to Slide 16. We continue to believe that our loan portfolio remains appropriately reserved as our allowance for credit losses to total loans was 1.42% at March 31, 2023, as compared to 1.43% at December 31, 2022. As Curtis touched on, we recorded a provision for credit losses of $1.0 million in the first quarter of 2023, which compares to a provision for credit losses of $248,000 in the fourth quarter of 2022. This increase was largely due to our organic loan growth in the quarter.

Overall, we continue to experience stable credit metrics in our loan portfolio as can be seen in our non-performing assets to total assets ratio, which improved to 19-basis points in the first quarter of 2023 from 20-basis points in the fourth quarter of 2022. Nevertheless, future economic conditions remain uncertain due to the rising rate environment, persistent inflation levels that are impacting consumers and businesses in the United States, and the recent dislocations in the banking sector, which may make additional provision for credit losses necessary in future periods.

Skipping ahead to Slide 18. Our non-interest expense was $32.4 million in the first quarter of 2023, as compared to $32.7 million in the fourth quarter of 2022. The decrease was primarily due to a decline of

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

$837,000 in professional services, marketing and occupancy expenses, partially offset by an increase of $551,000 in personnel expense. There was approximately $500,000 in expenses related to the sale of Windmark in the first quarter, and we will record additional expenses related to the transaction in the second quarter.

Importantly, we continue to manage our personnel expense by implementing efficiencies and closely managing personnel to reduce mortgage overhead, which taken together, has allowed us to manage wage inflation across the bank as we adapt to the current market.

Looking at the second quarter of 2023 and the year ahead, we expect core non-interest expense to modestly decline from the first quarter's level, while looking to also replace lost Windmark earnings.

Moving ahead to Slide 20. We remain well capitalized with tangible common equity to tangible assets of 8.54% at the end of the first quarter of 2023, an increase from 8.50% at the end of the fourth quarter of 2022. The increase was driven by $7.0 million of net income after dividends paid and by a $4.7 million increase in accumulated other comprehensive income, which was attributable to the rise in the fair value of our available-for-sale securities and related fair value hedges, net of tax. Tangible book value per share increased by $0.62 to $20.19 during the first quarter of 2023.

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

Curtis C. Griffith

Thank you, Steve.

To conclude, I'm very proud of our results through the first quarter of the year. We are successfully navigating a challenging industry environment, as can be seen by our strong deposit growth, ample liquidity and stable credit profile of our loan portfolio. Additionally, the sale of Windmark will be beneficial with the incremental capital that it provides, which we will use to create value for our shareholders in the year ahead. I would like to thank our employees for their hard work and commitment to our customers and communities once again through the first quarter.

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

Operator

Our first question comes from Brad Milsaps with Piper Sandler. Please go ahead.

Bradley Milsaps

Hey, good afternoon.

Cory T. Newsom

Good afternoon, Brad.

Curtis C. Griffith

Hey, Brad.

Bradley Milsaps

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

I appreciate you taking my questions.

Steve, I wanted to make sure I understood the kind of the moving parts with expenses. I mean, it's pretty straightforward that the insurance revenue will drop to zero. But I think you said that operating expenses would kind of hang around the first quarter level. I was thinking maybe you might see more expenses sort of fall out of the run rate. But maybe those are being reinvested. I just wanted to make sure that if you could just give me a little color on kind of what you're looking for in terms of trajectory on expenses, maybe excluding any further charges related to the disposition?

Steven B. Crockett

Sure, yes. We definitely had some of the expenses that were in there for Q1. Q2, we will see additional transaction expenses that will show up in non-interest expense. Once we work through that piece for a full year, our last three years average of non-interest expense has been about $6.1 million, $6.2 million related to Windmark. That fluctuates throughout each quarter, but that's kind of what the annual run rate has been. Yes, we'll see—that part will go away, there will be some additional items that I think will come back, but we should see that number moderate on the core non-interest expense side.

Bradley Milsaps

Okay. Great. Then just maybe back to your loan growth guidance, I think you said low single-digits, you're off to maybe a better start than you would typically be in 1Q. I know that can be kind of seasonally soft just with ag. I guess your guide would imply pretty modest growth from here. I guess, Cory, is that just you guys being conservative? I mean, are there a lot of payoffs you see coming? Or is it just more a function of if you've got a really high bar for putting any loan on the books at this point in time?

Cory T. Newsom

You're going to see some payoffs, and I mean, yes, we do have a high bar, but we've got really good customers that they're working with. I'll give you an example, though. If you look at our pipeline, if you take 12-31 to 3-31, that's 10% higher than it was at the end of the year. We've still got good opportunities. But I'm telling you, we are so focused on dealing with relationships and that type of a clientele, we have no problem turning some stuff down, but we're gaining a lot of ground with some really good stuff that we're comfortable putting on our books.

That's the thing that we're not afraid to ask for liquidity, we're not afraid to ask for more money coming into it. But hitting the single digits is realistic. We think we can do it. Brent is here with us.

Brent Bates

I agree. I think we will see some payoffs through the probably first half, second half of the year. But we've also got some unfunded commitments that we're anticipating funding through the second half of the year, that'll be a bit of a tailwind to that. We feel good about our low to maybe mid-single-digits.

Cory T. Newsom

There's a little of the payoff that you're going to see that's a little bit by design that we've worked towards. We're kind of proud of how it's come about. That's, like I said, that's much more about design than by default.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Bradley Milsaps

Yes, sure. No, I just felt like the low single seemed fairly conservative just kind of based on kind of what you guys have done historically. But no, I appreciate the color. I'll hop back in the queue and let some other folks ask some questions. Thank you.

Cory T. Newsom

Thanks, Brad.

Operator

Our next question comes from Joe Yanchunis with Raymond James. Please go ahead.

Joseph Yanchunis

Good afternoon. How y'all doing?

Cory T. Newsom

Good. How are you, Joe?

Curtis C. Griffith

Joe, good to hear from you.

Joseph Yanchunis

Great. Good to hear from you as well. I was hoping to stick with kind of loan growth. I know that you just kind of discussed payoffs. What were pay offs in the first quarter? Do you have that number handy? For the magnitude in the back half of the year or for the remainder of the year.

Brent Bates

Our payoff run rate in the first quarter was not abnormal. I think, what I think we're talking about, are some specific larger credits that we see as a strategic payoff, if that makes any sense, that are abnormal maybe payoffs from the normal run rate.

Cory T. Newsom

Yes. Go back to what it is. We've always talked about our approach of trying to identify a problem earlier. Looking into the little bit of a downturn in the economy, we felt like there was a couple there that probably wouldn't be where we wanted to be. We've started way early working to an exit strategy and pretty much think that we're kind of to that point. We don't think there is any true exposure. But we just don't, we don't think we want to be locked arms right there going into a downturn. That's the stuff we're talking about a little bit of a pay down. Other than that, we're not seeing a lot of out of the ordinary payoffs.

Curtis C. Griffith

I think what we're going to see in this interest rate environment is a slowing a little bit of our regular, normal expected paydowns. Because as you know, we do a fair amount of construction. Traditionally, many of those projects would move on into secondary market financing after they reach any initial levels of stability.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Now with where rates are, we think there's a pretty good chance we'll keep some of those on our books longer than we would have in a lower rate environment, I'll say it that way.

We've got those priced we think pretty well. As we've been indicating, some of those have been on our books, and they're all approved, and the projects are moving. But right now, they're using the investor money first, the owner money first and haven't drawn much at all from us, but you will start seeing those draws hit our books as we move on through the year. I think we're going to have some basically built-in increases in there. I don't want to be overly conservative, but yes, I do think that somewhere around low to mid-single-digit increase is very doable for us this year.

Cory T. Newsom

Joe, I'll add just a little bit more color to that, though. If you look at some of the stuff, we've had on the books at a little bit lower rate that may not go away as fast. We think though that we've done a pretty good job with even the stuff that we're pricing out at higher rates today. We've got refi penalties in these and stuff that we think that will help us from that stuff just all going away if rates start moving in any significant amount. We've really tried to look out not so much, taking care of today, but looking at two years from today and exactly where we want to be.

Joseph Yanchunis

Okay. Then just kind of a follow-up there, and then just kind of dig a little deeper into the asset quality. Where are these payoffs coming from that there could be potential problems. Are there any sectors or geographies to call out? Then in addition to that, are you starting to see any potential cracks in the portfolio at this time?

Brent Bates

I can speak to the portfolio quality. We're really seeing good stable trends. It mirrors our ACL and what we're doing there. As far as payoffs, to kind of give a little bit more background on that, you've got a number of different factors. One being credits that as Cory mentioned, were pruning out of the portfolio, but not necessarily in any one industry or geography. They're more specific unrelated credits. When you think about payoffs, you got to think about some of the business we do, one of which is auto, our indirect auto portfolio we have tightened up pricing and a bit on credit. Quarter-over-quarter, we've had flat growth in that area.

That portfolio has a short time frame on it and automatically runs off if it's not replaced. Right now, we're keeping up with that, but we may choose to pull back on that some. Likewise, the homebuilder industry that we have a good business in primarily here in the Lubbock market. Those builders are pulling back on new activity. We see that as that portfolio paying off as those houses sell and maybe that builder doesn't do as much activity as they did last year. That's a little bit of color on kind of how the portfolio we think it will wind up through the year.

We still think we'll get in that growth position; we've got other projects in our unfunded commitments that we expect to fund over the course of the second half of the year that have been thus far funding out of equity if that makes sense.

Cory T. Newsom

Joe, one comment. We talk about some of the payoffs that are coming about a little bit by design, and we mean it by that. But it's more about, we're not satisfied with the direction management is taking that for the reporting that we're getting back. And we're not going to wait. That is kind of the position that we'll take,

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

we're not afraid to try to separate while it's still movable and make sure that we can just move on forward. We do run it conservative from that side.

Joseph Yanchunis

Understood. Pretty thouroughly answered. I appreciate that. Then kind of lastly for me here, and switching gears, what were the loan yields on the NIM for the month of March? Just trying to kind of understand the trajectory from here.

Steven B. Crockett

I do not have it broken out by March. They are increasing, each month, they have gone up. We do have loans that do reprice along with the new loans that are being made that are at a higher yield. Overall, I would say March was probably 15-20-basis points higher than what the average was in January.

Joseph Yanchunis

Got it. That's for loan yields, right?

Steven B. Crockett

That's loan yields, yes.

Joseph Yanchunis

All right. I appreciate it. Thanks for taking my questions.

Operator

Our next question comes from Brady Gailey with KBW. Please go ahead.

Brady Gailey

Hey, thanks. Good afternoon, guys.

Cory T. Newsom

Hey, Brady.

Curtis C. Griffith

Hey, Brady.

Brady Gailey

I think I heard Steve say there were some one-time transaction costs from the sale of Windmark in the first quarter. What was that number?

Steven B. Crockett

It's about $500,000, and would be mostly in the personnel line, but some legal and other cost.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Brady Gailey

All right. And most of the expense reduction from the sale of the insurance, is that also in the personnel line?

Steven B. Crockett

That is where the biggest piece of that will be, yes. The other part will be in just other non-interest expense, but the bulk of it is in personnel.

Brady Gailey

All right. Then the 1Q margin of 3.75%, it feels like given higher deposit costs, there could be some further compression in the margin. Any idea on how to think about how much the margin could go down going forward? Or is that right? Do you think it will compress?

Steven B. Crockett

I believe that it's a good probability that it will compress. Fortunately, we didn't see as much as we might have in the first quarter. We are able to keep putting on the loans we're putting on at higher yields, but the deposits definitely have increased in cost. Hopefully, we can keep that under control and limit the amount of compression. I think we'll see a little bit more compression.

Cory T. Newsom

I think the other thing to keep in mind is, we've not strung ourselves out on deposit costs on long-term. We've kept that stuff very, very short. If and when we start seeing some downward rate movement, we're going to get some immediate response from that.

Curtis C. Griffith

I do agree with Steve, I think we may get a little more compression, but I don't think you're going to see very much. We have intentionally not been leading the market in any categories on interest rates. As Cory said, we're not running CD specials. We're not trying to push out any long-term CDs. We just adjust rates on our transaction accounts to stay competitive.

If the Fed does start moving the other way and we get some rates back down, we can change those very quickly, and hopefully benefit from some of those loan rates that we're putting on the books right now. I would not be surprised to see a slight additional compression, but I don't think it's going to be very much.

Brady Gailey

Okay. All right. Then finally for me, I just wanted to ask about the outlook for deposit growth. I mean, your loan to deposit ratio is 80%, which is still relatively low versus some of your peers. Do you hope to have deposit growth match loan growth? What's the forecast for that?

Cory T. Newsom

I don't think there's any way it's going to match it. We've got good loan demand. When I talk about the things that we've actually done, focused on trying to drive the deposit gathering side of this. I mean, we're focused on relationships. It is hardcore the way that we address, building the deposit side of it. I talked about it in the presentation. While we're not going to go spend the kind of money, we spent adding lenders,

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

we are spending money making sure that we've got representation in all the right markets and in all the right places, chasing the deposits side of this.

Curtis C. Griffith

Brady, one of the things that we've got an advantage on, and of course, you can look at our numbers. By far, the biggest part of our deposits are out here in our Lubbock and more rural markets. With the recent and continuing changes in ownership of some of the banks in those markets, we are getting some great opportunities. We've moved over a very substantial deposit relationship from one of the banks that got acquired. We're talking to some others. While I can't put a hard number on it obviously, at this point, that's a lot of our focus is to go after some of their long-time larger depositors and move those relationships over to us. We're having pretty good success with that.

Brady Gailey

All right. Great. Thanks for the color, guys.

Curtis C. Griffith

Thanks, Brady.

Operator

Our next question is a follow-up from Brad Milsaps with Piper Sandler. Please go ahead.

Bradley Milsaps

Hey, thanks for taking my follow-up. I just wanted to quickly ask about mortgage banking. If I take out the MSR write-down in the quarter, look like you guys had a gain on loan sale margin of close to 5%. I know a lot of banks have had good quarters in that regard. Would you guys expect that to settle down something less than 4% kind of where it's been historically? Do you think the environment is such you can kind of maintain this wider mark? Just curious if anything else work there that we should be aware of?

Steven B. Crockett

I would say, I would expect that to kind of settle back down to the range you're talking about. Part of that is just our mark-to-market at the end of the quarter, and there's still been a lot of volatility in the market and with rates and things. While it may have shown a little bit higher there in Q1, we really expect that to kind of settle back down a little bit more.

Cory T. Newsom

We think we did better in mortgage first quarter, even though we ended up with a slight loss, but we knew it was just going to be, from seasonality side of it, it was going to be lower. We're kind of proud of the fact that we are managing our expenses pretty well. Then anticipating at this point that we probably ought to be up 25%, 30% volume in the second quarter as we compare to the first without a lot of overhead following suit. We still think that mortgage, we're managing the overhead in it pretty well.

Bradley Milsaps

Good. Just a point of clarity on the overhead, Steve. You said $6 million of costs will fall out from the insurance divestiture, but it doesn't sound like you expect sort of $1.5 million to drop out in the second

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

quarter. You've got some other merit raises, things like that, that will eat up some of those savings. Is that how I should think about it?

Steven B. Crockett

For Q2, we'll have, again, just some of the transaction costs.

Brady Gailey

Yes, excluding those. Let's not include those. Exclude those, let's not even think about those.

Steven B. Crockett

Yes. Excluding that, just if we're looking at core expenses, we should be down, we won't be down that full amount, because some other items will take its place. Yes, we should be down on a core run rate basis.

Cory T. Newsom

A lot of the merit raises and stuff are already in there.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Curtis Griffith for any closing remarks.

Curtis C. Griffith

Thank you, Operator.

We appreciate everybody participating in the call today. Obviously, banking is a little more challenging than we thought it might be a few months ago. We're pretty pleased with where we are. All things considered, we feel like we've got strong liquidity. We have very high capital levels. We have an excellent loan portfolio that we are monitoring very closely. We believe that moving forward, we can have decent profitability throughout the balance of the year.

As I mentioned before, we think right now, well, obviously, we can't make an announcement on it, I did mention that we probably were not in the market to do any M&A work. One reason for that is, right now, we'd be hard pressed to find a better buy than our own stock at the levels that we've been at. Clearly, we think we've got some opportunities ahead of us. We're very proud of getting the Windmark sale concluded and look forward to having those numbers roll out in the second quarter and show everybody kind of what we've done. Gives us an opportunity to utilize those for multiple uses as we go forward. We think that you're going to see some real benefits to shareholders.

Again, thanks, everybody, for their participation and for your continued faith in South Plains Financial.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com