South Plains Financial, Inc.

Fourth Quarter and Full Year 2021 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, *Keefe, Bruyette & Woods*

Brad Milsaps, *Piper Sandler*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the South Plains Financial, Inc., Fourth Quarter and Full Year 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, and good afternoon, everyone.

We appreciate your participation in our fourth quarter and full year 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 February 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 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 in 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 fourth quarter and full year 2021 results. Cory will provide an update on our efforts to expand our lending team, which is contributing to our strong organic loan growth, as well as discuss how we are managing the expected decline in our mortgage business as we focus on growing the Company through the cycle. Steve will then conclude with a more detailed review of our fourth quarter 2021 results.

Looking back on 2021, we believe our team delivered another year of strong financial results that exceeded our expectations and has firmly positioned South Plains for continued success in the year ahead. The culture that we have fostered is contributing to our results and can be seen in our employees' commitment to our customers. We believe our culture also differentiates South Plains in our local markets and is a key factor in our ability to recruit high quality talent to our team.

Another differentiating factor is the significant employee and insider ownership of the Company, which stood at almost 40% of shares outstanding at year-end. We are all highly incentivized to do what is right for our customers, the Company, and our Shareholders. I would like to thank our employees for their hard work. I continue to be very proud of their efforts.

Turning to our results, there are five key points that I would like you to take away this afternoon. First, we grew our loan portfolio 9.7% year-over-year in 2021, exceeding our goal of mid-single-digit growth. Strength in our local Texas markets combined with the successful execution of our plan to grow our lending team contributed to these results.

Second, we are approximately halfway to our goal of adding 20 new lenders to our 60 lender team and remain pleased with the quality of bankers that we continue to recruit and hire. Third, as expected, we have started to experience a decline in our mortgage banking revenues in the fourth quarter of 2021, which we believe will continue through the upcoming year.

Fourth, we have significant excess liquidity to deploy into attractive yielding organic loans as we continue to benefit from strong economic growth, market share gains and the expansion of our lending team. We believe this latent earnings power will more than offset the decline in our mortgage banking revenues over the next two to three years.

Lastly, we will remain disciplined on credit as we continue to grow City Bank and are very pleased with the performance of our enterprise risk management system, which enabled our team to effectively manage the credit of our loan portfolio through the COVID-19 pandemic.

Turning to our fourth quarter 2021 results on Slide 4, we reported net income of $14.6 million or $0.79 per diluted common share, which compares to net income of $15.2 million or $0.82 per diluted common share in the third quarter of 2021 and $15.9 million or $0.87 per diluted common share in the fourth quarter of 2020.

Turning to our loan portfolio, we typically experienced softer trends during the fourth quarter given seasonal paydowns in our agricultural loan portfolio. That said, we also continued to receive SBA forgiveness and repayments of PPP loans, as well as the early payoff of two hotel loans and a large classified commercial credit in the fourth quarter of 2021. Taken together, this proved to be a $65 million headwind to loan growth, which we were able to overcome with strong organic loan growth during the fourth quarter of 2021.

As Cory will touch on, we believe our loan pipelines remain at healthy levels given strong economic growth in our attractive Texas markets, combined with our newly hired lenders who are beginning to bring new business to City Bank and grow their loan portfolios. This provides confidence in our outlook for achieving mid-to-high single-digit loan growth in the year ahead.

Importantly, we have ample liquidity to fund this growth as our loan to deposit ratio was 73% at the end of the fourth quarter of 2021, which is a decline from the third quarter's level of 76% given the strong deposit growth that we experienced in the quarter. That said, our goal remains the same. We want to deploy our excess liquidity into attractive loans across our markets, and ultimately drive that ratio up into the mid-to-high 80s over time. As we do that, we expect to deliver improved profitability, earnings growth and returns.

It is hard to predict how earnings will evolve as net interest income grows and mortgage banking fee income normalizes. To help frame this for the investment community, we estimate that excess net mortgage income that we are earning equates to approximately $0.35 to $0.50 per share of earnings power, which assumes mortgage banking revenues of 10% to 15% of total revenue going forward as compared to 23% in the fourth quarter of 2021 and 26% in the third quarter of 2021, respectively. We believe this is manageable and see the expansion of our commercial lending team as a critical component to successfully navigating this transition.

Turning to our full year 2021 results, I am very proud of the success that we achieved again this year, as we grew assets 8.4% year-over-year to $3.9 billion, grew diluted earnings per share 28% year-over-year to $3.17 per share, increased tangible book value per share 13% year-over-year to $21.51 and expanded our return on average assets, 25 basis points to 1.56% for 2021.

One of our short-term goals when we went public was to grow the Company while also improving our returns as we pursue our longer-term goal of achieving returns in line or better than our peers. Our results this year once again demonstrate that we are firmly on course. Looking forward, we believe the best way to stay on this course and achieve our goals is to remain focused on organic growth. As a result, our capital allocation strategy will be centered on maintaining and growing our dividend over time, while strategically utilizing our share repurchase program.

Along these lines, our Board of Directors authorized a quarterly dividend of $0.11 per share this past week, which is an increase of $0.02 per share over the last quarterly dividend that we paid in November of 2021. This will be our twelfth consecutive quarterly dividend and will be paid on February 14, 2022 to Shareholders of record on January 31, 2022. We also repurchased approximately 120,000 shares during the fourth quarter of 2021 under our share repurchase programs.

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 fourth quarter of 2021 were $2.44 billion, which is an increase of $8.5 million from the third quarter of 2021. As Curtis touched on, we experienced strong organic loan growth again during the fourth quarter of 2021, which remains relationship-focused and occurred in a majority of loan segments, with the largest volume and growth in commercial land development loans, commercial retail loans and direct energy loans.

This strength however was largely offset by PPP loan forgiveness and repayments, seasonal repayments in our agricultural portfolio, and the early payoff of two hotel loans and one large classified commercial credit. This high level of paydown activity masked the strong underlying loan production that we experienced through the fourth quarter of 2021. Importantly, our lending team has maintained their top lines at healthy levels, while our newly hired lenders are quickly ramping their portfolios.

We previously noted that we strive to have each newly hired lender reach profitability by the six month mark. We believe that we've achieved that with our plan to-date. Looking forward, we remain confident on our goal of adding 20 lenders to our 60 lender team over a two-year timeframe as we focus on delivering sustainable organic growth and remain confident in our goal of delivering mid-to-high single-digit loan growth in 2022.

While we remain focused on growth, we also remain disciplined on credit, and will not compromise our underwriting standards to grow our loan portfolio. We believe our credit culture remains a key differentiator for South Plains as we consistently and aggressively review our loan portfolio for signs of potential issues and seek to remove those loans from our balance sheet before they become a real problem. The significant investment that we have made in our infrastructure, having implemented our rigorous enterprise risk management system, in the aftermath of the financial crisis has also enhanced our ability to manage credit and was instrumental in helping us to navigate the challenges that we experienced as a result of the pandemic.

Overall, our underwriting process and ability to manage our loan portfolio has improved significantly as a result of our ERM system, which provides confidence as we strive to accelerate growth.

Turning to Slide 7, we are beginning to see a normalization in our mortgage banking activity as mortgage loan originations were $314 million in the fourth quarter of 2021 as compared to $374 million of originations in the third quarter of 2021. This led to a $2.4 million decline in mortgage banking activities, revenue in the fourth quarter of 2021 as compared to the third quarter of 2021. As Curtis touched on, we expect our mortgage banking revenues to continue to normalize and believe our plan to expand our lending team will drive an expansion to our net interest income and provide an offset to this expected decline over time. As a part of this transition, we will manage our expenses to maintain profitability in our mortgage business.

As outlined on Slide 8, we generated $22.9 million of non-interest income in the fourth quarter of 2021, compared to $25.8 million in the third quarter of 2021. The decrease from the third quarter of 2021 was primarily due to the decline in mortgage banking activities revenue that I just discussed, as well as the seasonal decline of $1.6 million in income from insurance activities. For the fourth quarter of 2021, fee income represented 42% of total revenues and continues to be a key differentiator of South Plains relative to our peers.

To conclude, we're very fortunate to operate in strong markets with robust economic growth, which is driving strong underlying loan demand. We are also having good success recruiting experienced lenders, which provides visibility to future growth, while our existing team of lenders continue to perform in a very high level. This provides us with confidence that we can successfully manage the decline in our mortgage business.

I'd like to turn the call over to Steve now.

Steve Crockett

Thank you, Cory.

Starting on Slide 10, net interest income was $31.4 million for the fourth quarter of 2021, as compared to $31.2 million for the third quarter of 2021. The expansion since the third quarter of 2021 was primarily due to an increase of $264,000 in loan interest income as a result of the growth of $66.1 million in average loans outstanding, partially offset by a decrease of 9 basis points in the yield on loans, during the fourth quarter of 2021. Looking forward, we believe that we are well-positioned for our net interest income to benefit from a rise in interest rates if the Fed were to begin raising rates through the year, as is currently anticipated.

We recognized $1.0 million in PPP fee income as an adjustment to interest income, which included accelerated income on PPP loans forgiven by the SBA during the fourth quarter of 2021. At December 31, 2021, the Company had $1.9 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 experienced an 8 basis point decrease to 3.50% in the fourth quarter of 2021, as compared to 3.58% in the third quarter of 2021. The contraction in our net interest margin was primarily due to the 9 basis point decline in our average yield on loans. Our average cost of deposits declined 2 basis points to 23 basis points in the fourth quarter of 2021, as compared to 25 basis points in the third quarter of 2021.

Continuing on Slide 11, deposits increased in the fourth quarter of 2021 to $3.34 billion, an increase of $129 million or 4% from September 30, 2021 as deposits continued to flow into the banking system. Majority of this increase was from personal accounts. We ended the fourth quarter of 2021 with total non-interest bearing deposits of $1.07 billion or 32.1% of total deposits.

Turning to Slide 12, our non-performing assets to total assets ratio declined 2 basis points to 30 basis points in the fourth quarter of 2021, as compared to 32 basis points in the third quarter of 2021. At December 31, 2021 active loan modifications attributed to the ongoing COVID-19 pandemic totaled $15.9 million or 70 basis points of our loan portfolio. All of these active modified loans are concentrated in our hotel portfolio and have original modified terms that extend up to 18 months. We expect that these remaining modified loans will return to full payment status at the end of their respective modification periods.

Importantly, the credit metrics of our loan portfolio also continued to improve through the fourth quarter of 2021, which demonstrates our conservative credit culture and focus on credit as we grow our portfolio. Also, as is noted on this slide, we had a decrease of $20.3 million in classified assets during the fourth quarter of 2021. This was largely the result of the payoff of one credit that was downgraded in the third quarter of 2021 along with two hotel loans being upgraded in the fourth quarter of 2021.

Overall, we continue to believe that our loan portfolio remains well reserved as our allowance for loan loss to total loans was 1.73% at December 31, 2021, which is a decline of 3 basis points from September 30, 2021. Looking forward, we continue to believe that the reserves that we have built to help guard against an uncertain outlook are appropriate. We will continue to evaluate our reserve in the coming quarters.

Skipping ahead to Slide 15, our non-interest expense was $36.1 million in the fourth quarter of 2021, as compared to $38.1 million in the third quarter of 2021. The decline was primarily due to decrease in personnel expense, due to the seasonality of lower commissions on insurance activities and lower commissions in mortgage due to reduced production versus the prior quarter. The declines were slightly offset by ongoing technology and professional services investments for growth.

Looking forward, we expect core expenses to modestly rise as we add to our lending team. Our efficiency ratio was 66.1% in the fourth quarter of 2021 as compared to 66.5% in the third quarter of 2021, an improvement despite the slowdown in our mortgage banking activity.

Moving ahead to Slide 17, we remain well capitalized with tangible common equity to tangible assets of 9.85% at the end of the fourth quarter of 2021, a slight decline from 9.94% at the end of the third quarter of 2021.

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

Curtis Griffith

Thank you, Steve.

To conclude, our focus as a Management team is to increase the value of the Company through having steady balance sheet growth, remaining vigilant on credit quality, growing our organic loans, creating operational efficiencies, and returning a steady stream of capital to our Shareholders through our dividend. We believe our 2021 results are a testament to our success, and I'm very proud of our accomplishments again this year, as well as the consistent results that we have delivered since our IPO, which can be seen in our tangible book value growth, as well as our improved returns.

At the end of the fourth quarter of 2021, our tangible book value per share was $21.51, compared to $18.97 at the end of 2020, and $15.46 at the end of 2019. Likewise, our return on average assets for the full year of 2021 was 1.56%, compared to 1.31% for the full year 2020 and 1.04% for the full year 2019. Looking forward, we have the foundation in place, which positions our team for continued success through 2022 and beyond.

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

Operator

Thank you.

Our first question comes from the line of Brady Gailey with KBW. Please proceed with your question.

Brady Gailey

Hey, thanks. Good afternoon, guys.

Curtis Griffith

Hey, Brady.

Steve Crockett

Hi, Brady.

Brady Gailey

You mentioned that mortgage revenue was about 23% in the fourth quarter, longer term, you think that's 10% to 15%. As you look to 2022, did you think mortgage gets down in that 10% to 15% range or do you think you still over earn on mortgage a little bit in 2022 as well?

Cory Newsom

Hi, Brady. This is Cory. I want to clarify. We talked about the 10% to 15% on mortgage. Our goal is to grow the rest of the bank to a point that mortgage only represents about 10% to 15% of where we are. We think we're probably looking closer to 20 this year on mortgage. Our demand is still good and we feel really confident the first half of the year. There's still a lot of demand and we think a lot of people are trying to make sure they get—try to get their stuff locked in before they do see much increase in rates, but we're still seeing good demand.

Here's the thing that we've always got to remember about where we are. We're in Texas and our economy is so good. We're seeing some really good happenings around that.

Curtis Griffith

Yes, let me just pitch in out there real quick. Realize, we're pretty active in the Dallas-Fort Worth market—in the metroplex, I think we are at 120,000 people in this past year and it's not slowing down, it's probably going to accelerate. Austin, gaining nearly 200 people every day moving into that market. Houston is still growing fast. Lubbock is expected to grow roughly 20,000 people in our little town by 2025. So you're just going to see this demand for housing in Texas.

Yes, the refi business is slowing and we expect it to. But we've got a great group in place and we think we're still going to do a lot of good mortgage business on the home purchases. Like Cory said, the long-term goal is let's get down to about 10% to 15% depending of where we are in the cycle and all that, but that's just because the rest of the bank gets bigger not that mortgage income drops that far.

Brady Gailey

All right. That's helpful. Then on the buyback, you all were active again in the fourth quarter. I think if you look at the year, you repurchased about 2% of the Company. The stock is higher now, which isn't a bad thing, but it does make the buyback a little less advantageous. How do you think about the buyback going forward? You're seeing good growth, your stock price is a little higher, should we expect to see you guys continue to be active on the buyback in 2022?

Curtis Griffith

I think you will. We're going to let our Board look and we discuss it every quarter. We're going to make a decision on just how active we think we need to be based on how we feel our stocks being valued in the marketplace, and currently, yes, I think you're going to see us still active in buying some stock.

Brady Gailey

Okay. Then I heard Steve, when he was talking about the expense base, talked about the—your expense base modestly rising. What does that mean? Does that mean, low-to-mid single-digit level increase as we look into '22 versus '21?

Steve Crockett

Yes. I think you are right. Obviously, a lot of it depends on what the mortgage volume does, how much that comes back because so much of the—or a large percentage of our personnel cost is a variable number with mortgage. We would expect to see that moderate some as the overall volume comes back, but excluding that piece of it, yes, your range there is a good range.

Brady Gailey

Then just lastly for me, you guys mentioned the $65 million of headwind you saw from the loan portfolio in the fourth quarter that you guys overcame. Do you expect to see any notable headwind in 2022 from larger loans paying off or CRE paydowns or is there anything expected on that front this year?

Cory Newsom

Well, I think we'd probably be naïve to not think there would be. If you look at, with the anticipation of some rate increases and things like that, we know there's going to be some headwinds. The thing is our demand, our platforms are solid. We're still seeing so much money sit on the sidelines trying to go to work. If you couple that with the talent we already have in this Company and the additional hires that we continue to make, we think that we're prepared for those headwinds, but we definitely think there's going to be some.

Brady Gailey

Okay, great. Thank you, guys.

Cory Newsom

Okay. Appreciate it.

Operator

Your next question comes from the line of Brad Milsaps with Piper Sandler. Please proceed with your question.

Brad Milsaps

Hey, good afternoon, guys.

Cory Newsom

Hey, how are you?

Steve Crockett

Good afternoon, Brad.

Brad Milsaps

Good. Just maybe want to add some questions around the margin? Your loan yields are still relatively high compared to others, up around 4.80% or so. Just curious how you think your loan book would respond to a 25 basis point increase in the Fed fund rate? Can you just remind us what percentage of your loan portfolio would reprice immediately with any change in that index rate?

Steve Crockett

Yes. We're at 20%—about 20%, I believe, or so, would reprice immediately overall, and I think we have this in our 10-Q, normally, but we're just slightly asset sensitive on the whole as far as assets and liability, looking at it altogether. We do think overall we are positioned to benefit from the rising rates. Loan book, while there's not quite as much, maybe as some others that might reprice immediately, we think we're still in good shape on how that will work along with how we would have to reprice any of the deposits.

Cory Newsom

Keep in mind we've got about 30% of our deposits are in demand accounts. We think that will be beneficial. We think that we're going to lag in raising some of the deposit rates as we go.

Curtis Griffith

We've got so much liquidity on the books right now, but we're just not going to be—we're certainly not going to be a market leader out there on deposit rate increases. We think we can lag a good bit and if we lose a few deposits that's not that big a problem, bluntly.

Brad Milsaps

Yes, sure. I wanted to follow-up on the deposits. I know you guys aren't a big CD bank, but those costs are still stubbornly high. I think it was 119 basis points during the fourth quarter. Are those just here to stay and it's just going to be a slow bleed? I assume those are all longer dated type CDs.

Steve Crockett

Yes. Those were some that primarily we had done couple of years back when rates were higher. Some folks got some rates locked in. You should be seeing that number. It is coming down every quarter. Nothing obviously going in at very high rates on anything new coming in, but yes, there's still couple—a year or two left on some of those higher yielding CDs.

Brad Milsaps

Got it. Maybe just one final minor question from me. Steve, I noticed that in fee income, the card interchange fees jumped up $400,000 or $500,000 linked quarter. Just curious, is that just you guys, your markets getting back to normal, anything in there that's—wouldn't be sort of run rate. Just curious, what caused that big leap, or is it just Christmas shopping season something like that, just was curious if that's a good number going forward?

Steve Crockett

Yes. It usually does end up being a little bit higher in Q4, but we did have—and I think it's in the press release if you look in that section, I think I've got the number. I don't have it here in front of us. I'll turn over here, but we had some performance bonuses that we got in our contract that came in, in the fourth quarter. There is a non-recurring item in there.

I think it's $434,000, that's how much it went up. But that's the biggest—the biggest piece of that increase was just a non-recurring item. However, the overall trend is that those numbers are still increasing, but don't expect it to see that level going forward each quarter.

Brad Milsaps

Okay, thanks. I apologize. I must have missed that on my first time through the release, but appreciate the color. Thank you.

Steve Crockett

No, problem.

Curtis Griffith

Thanks, Brad.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session, and I would like to turn the call back to Mr. Curtis Griffith for closing remarks.

Curtis Griffith

Well, we thank everyone for being on the call today, and we're certainly proud of the results that we achieved during 2021. Twenty twenty-two will bring some new challenges, we're sure. We hope and pray that the pandemic subsides and we can start returning to a lot more normalcy across all of our markets and all around the world too.

Right now, we're just proud of our employees and the hard work they put in and we're excited to embrace another year and we think we can achieve some excellent results with everything we've got in our—aligned right now. Just ask everyone to continue to be active out there and to stay involved and reach out to us, if you have any questions on anything regarding our performance here at South Plains Financial.

Operator, thank you.

Operator

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