South Plains Financial, Inc.

Second Quarter 2023
Earnings Call Transcript

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Brady Gailey, *KBW*

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Graham Dick, *Piper Sandler & Co.*

Joseph Yanchunis, *Raymond James*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the South Plains Financial Second 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 second 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 slide deck presentation to complement today's discussion is available on the News & Events section of our website, www.spfi.bank.

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Before we begin, I'd like to 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. 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 at the end of our earnings release and beginning on Slide 23 of the slide deck presentation.

Curtis, let me hand it over to you.

Curtis C. Griffith

Thank you, Steve, and good afternoon.

On today's call, I will briefly review the highlights of our second quarter 2023 results, as well as provide an update on our capital allocation priorities following the sale of Windmark, which closed in April. Cory will discuss our loan portfolio in more detail and how we continue to benefit from competitor mergers in our key markets. Steve will then conclude with a more detailed review of our financial results.

To start, I'm very pleased with our second quarter results, as they highlight the strength of our culture and the commitment that our employees have to our customers and to our Company, especially in such a challenging environment for our industry. We've exited the second quarter in a strong financial position, and I'd like to thank our employees for their hard work, which can clearly be seen in our results once again this quarter.

Turning to today's call, there are six key points that I hope you will take away.

First, our deposits remained stable through the second quarter, further demonstrating the strength of our community-based deposit franchise.

Second, despite the continued rising market interest rate environment, our net interest margin held steady from March's level, as higher loan yields are offsetting the rise in our cost of funds.

Third, our organic loan growth was very strong in the second quarter, as we benefited from a robust loan pipeline combined with lower competition across our markets. That said, we continue to be selective in the new loans that we fund as we maintain our underwriting discipline.

Fourth, the credit profile of our loan portfolio improved through the second quarter, though we did have one non-accrual addition, which I will touch on in more detail in a moment.

Fifth, we further built capital this quarter through our earnings and the sale of Windmark, as our Tier 1 capital to average assets ratio increased to 11.7%.

Lastly, we strategically sold a portion of our investment securities portfolio in the quarter, which we believe to be advantageous given the gain we recorded from the Windmark sale, combined with the yield improvement that we were able to achieve as we reinvested the securities sale proceeds into new loans.

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Turning to our results in more detail on Slide 4 of our earnings presentation, we delivered net income of $29.7 million or $1.71 diluted earnings per share as compared to $9.2 million or $0.53 diluted earnings per share for the first quarter of 2023. This compares to net income of $15.9 million or $0.88 per diluted common share in the year-ago second quarter.

As we discussed on our first quarter call, we completed the sale of Windmark, City Bank's wholly owned insurance subsidiary, for $35.5 million in April in an all-cash transaction. The after-tax sale proceeds, less transaction expenses, the incentive compensation triggered by the transaction, and the realized loss on the sale of our investment securities during the second quarter, resulted in $1.16 per share of one-time net income in the second quarter. Excluding these items, we earned $0.55 per share.

Given the large gain that we recorded, we made the strategic decision to sell $56 million of investment securities from our portfolio, which resulted in a realized loss of $3.4 million. We believe this was a tax-efficient transaction and will boost our earnings in future periods given that the securities we sold were yielding approximately 2.7% and we reinvested the proceeds in loans that are yielding more than 7% in the second quarter. The incremental income will help replace the loss of future net income from the Windmark operations.

Turning to our loan portfolio, we grew loans 6.8% in the second quarter as we continued to experience healthy economic growth, combined with customer dislocation in many of our markets from recent competitor mergers. Additionally, we are seeing larger competitors pull back in some markets, which allowing our team to bring new relationships to the bank, as Cory will touch on in more detail.

We recorded a provision for credit losses of $3.7 million in the second quarter as compared to $1 million in the first quarter of 2023. The provision was primarily for the strong loan growth that we delivered in the quarter, and a $1.3 million increase in specific reserves related to one previously classified credit relationship totaling $13.3 million that was placed on nonaccrual in May of 2023. This credit was for a business that is currently in borrower directed liquidation and from which we expect to see larger repayments starting in the third quarter of 2023. While there continues to be payment performance, we placed the relationship on nonaccrual and recorded the specific reserve given that the business is no longer a going concern.

As Steve will touch on in more detail, the overall credit quality of our portfolio continued to improve through the second quarter. Of note, our budget and consensus estimates were for $1.25 million of provision expense in the second quarter. Our recorded provision expense was approximately $0.14 per share above these expectations. As a result, we believe the run rate earnings of the bank, excluding all one-time items and the increased provision, was $0.69 per share in the second quarter, which bodes well for the second half of the year, as we will fully benefit from the second quarter's loan growth and improved loan yields.

We grew deposits $66.5 million or 1.9% to $3.57 billion at June 30, 2023, as compared to the end of the first quarter 2023. Our deposit growth was primarily due to an $81 million increase in brokered deposits, partially offset by a $67 million reduction in public funds which had grown $118 million during the prior quarter. We are making a concerted effort to manage overall deposit levels and related interest costs. Ultimately, we will continue to build out our deposit-gathering capabilities as we strive to grow core deposits and manage our cost of funds.

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, 81% of our deposits were in our rural markets, with only 19% in our major metropolitan markets of Dallas, Houston, and El Paso. Additionally, our average deposit account balance is approximately $36,000, and only an estimated 16% of our total deposits are uninsured or uncollateralized.

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We believe we also ended the second quarter in a strong liquidity position with $1.82 billion of untapped borrowing capacity. We have $1.01 billion of availability from the Federal Home Loan Bank of Dallas, $612 million of availability from the Federal Reserve's Discount Window, and $200 million of capacity from the Federal Reserve's Bank Term Funding Program. We have ample capital to take advantage of growth opportunities both organic and otherwise as they present themselves.

Given our strong capital and liquidity position, our Board of Directors authorized a $15 million stock repurchase program in May, and we bought back approximately 113,000 shares during the second quarter for $2.6 million. We continue to believe that our shares are trading below intrinsic value and do not reflect our strong results and the opportunities that we see to further grow the bank. That said, we will be cautious with our capital given the uncertain economic environment combined with the dislocation in the banking sector. We will be patient and continue to review a broad range of options to determine the best uses for the capital generated from the Windmark sale.

As part of our capital allocation, returning a steady stream of income to our shareholders through our quarterly dividend has been a focus since going public over four years ago. Our Board of Directors again authorized a $0.13 per share quarterly dividend, as announced last week. This will be our seventeenth consecutive quarterly dividend to be paid on August 14, 2023, for shareholders of record on July 31, 2023.

To conclude, we are successfully navigating what is a challenging environment and remain cautiously optimistic looking into the second half of the year. Economic growth is holding remarkably steady in our markets, while unemployment remains low. We will maintain our capital as we look to take advantage of opportunities in the market and continue to conservatively grow the bank.

Now, let me turn the call over to Cory.

Cory T. Newsom

Thanks, Curtis, and good afternoon, everyone.

Starting on Slide 6, loans held for investment increased during the second quarter by $190.4 million or 6.8% compared to the first quarter of 2023. Demand was broad-based across both our markets and industry sectors, highlighted by organic loan growth in residential mortgage, commercial real estate, and energy. We were fortunate to end the second quarter with a strong loan pipeline, which contributed to this growth. Additionally, the competitive environment continued to ease as we benefited from the customer dislocation created by competitor mergers, as well as from a reduction in credit availability from several competitors through the quarter. We believe this is an opportunity to bring high-quality, long-term customer relationships to South Plains. While the competitive environment has improved, we are maintaining our underwriting standards, as we will not sacrifice credit quality for growth. We remain focused on funding high-quality loans with good risk and return profiles.

Our loan yield was 5.94% in the second quarter, which compares to 5.78% in the first quarter of 2023. We continue to proactively price new loans to account for a higher market interest rate environment, which is contributing to rising funding costs. We continue to believe that loan yields are beginning to peak and remain focused on managing our deposit growth and funding costs to mitigate margin pressure as we look to the second half of the year.

Skipping to Slide 8, we grew our loan portfolio by $65 million or 7.3% in our major metropolitan markets of Dallas, Houston, and El Paso as compared to the first quarter of 2023. The commercial lenders that we have added in these markets continue to grow their loan portfolios by bringing new customer relationships

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to the bank. We are watching the Texas economy closely and will be cautious as we grow, with a focus on expenses.

The Permian Basin is another market we are pleased with this quarter, as we experienced an increase in loan demand. Since completing our acquisition with West Texas State Bank in 2019, we've been investing in our facilities, people, and technology in order to tap into the strong potential that exists in this region from both a lending and deposit-gathering perspective. It has taken time, and the pandemic certainly set us back, but our operations are running well, and we are beginning to take share. We believe that we are in the early stages of our growth in the Permian.

Taken together, we are pleased with our loan growth for the first six months of the year but expect loan growth to moderate given the impact of higher interest rates on loan demand. Therefore, we expect full year loan growth to be in the high single-digit to low double-digit range, which is meaningfully above our prior guidance of low single-digit growth for the full year of 2023.

Skipping ahead to Slide 10, we have approximately $1.1 billion of commercial real estate exposure in our loan portfolio at quarter end, which represented 36.5% of our total loan portfolio. Our office exposure represented 16.8% of our CRE portfolio and 6.1% of our total loan portfolio at the end of the second quarter. Of note, 29% of our office exposure is owner-occupied, and medical offices comprise 11% of our office exposure. Our office portfolio is performing well, and our largest credits have strong guarantors. We continue to stress test the individual credits in our portfolio for challenges. As Steve will discuss, the overall credit quality of our loan portfolio improved through the second quarter, which provides confidence if the economy were to slow.

As I discussed on our first quarter's earnings call, we are strategically enhancing our Treasury Management and Liquidity team as we focus on growing deposits. The focus is on how we deliver, not just adding expense. This includes enhancing the level of education for our team on all aspects of treasury products. If we want to win the business, we have to be better than our competition in providing solutions and identifying needs. We look to further build our core deposit franchise as we focus on relationships for the long term. 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 decreased by $2.4 million to $297.9 million in the second quarter, as compared to the end of the first quarter 2023. Our strategy this year has been to level out or modestly reduce the indirect auto loan portfolio over time, while replacing some of the runoff with higher-yielding loans with strong credit profiles. We are also maintaining a disciplined approach to underwriting, as 62% of the indirect auto loan portfolio was originated with a credit score of 719 or better, which is super prime, and 28% of the portfolio was originated with a credit score of 660 to 719, which is prime. The strong credit profile positions the portfolio for resilience across varying economic cycles.

Turning to Slide 12, we generated $47.1 million of noninterest income in the second quarter, which included $33.5 million gain from the sale of Windmark. Excluding this gain, we generated $13.6 million of noninterest income, which compares to $10.7 million in the first quarter of 2023. The increase was primarily due to $3 million increase in mortgage banking activities revenue, partially offset by a reduction of $1.4 million in income from insurance activities due to the sale of Windmark.

During the second quarter, mortgage loan originations increased $46 million to $132 million, as compared to $86 million in the first quarter of 2023 given the normal pickup from the spring selling season. Additionally, there was a write-up of $400,000 in the fair value of our mortgage servicing rights portfolio in the second quarter, as compared to $2 million write-down in the first quarter of 2023, given the rise in market interest rates. Our secondary mortgage origination division, which excludes mortgage servicing activities, was breakeven in the second quarter. Looking forward, we will remain in the mortgage business

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as long as it is profitable and drives incremental business through cross-selling. For the second quarter, noninterest income, excluding the one-time gain for Windmark, was 28% of bank revenues as compared to 24% in the first quarter of 2023.

To conclude, we delivered strong results through the second quarter, and we believe we remain well-positioned for the current environment. We are strategically taking market share given the customer dislocation that is occurring in our markets and are always looking to add talented lenders where it makes sense. We will continue to focus on driving organic deposit growth while mitigating margin pressure as we strive to grow the earnings power of the bank.

I will now turn the call over to Steve.

Steven B. Crockett

Thanks, Cory.

Starting on Slide 14, net interest income was $34.6 million for the second quarter as compared to $34.3 million for the first quarter of 2023. The modest increase was primarily the result of a $3.4 million increase in the interest income due to higher average loan balances and loan yields, largely offset by a $3.1 million increase in interest expense due to the rise in short-term interest rates.

Our net interest margin, calculated on a tax-equivalent basis, was 3.65% in the second quarter as compared to 3.75% in the first quarter of 2023. Our NIM was impacted by a 33-basis point increase in our cost of deposits in the second quarter as compared to the first quarter of 2023. This was partially offset by our organic loan growth, combined with the corresponding increase in our loan yields of 16-basis points as compared to the first quarter of 2023. Importantly, our NIM dropped 15-basis points in the month of March 2023 to 3.65% and has held steady through the second quarter.

We remain focused on managing our profitability in this more challenging environment. Our average cost of deposits was 169-basis points in the second quarter, an increase from 136-basis points in the first quarter of 2023. Given the rising interest rate environment through the year, we have had to be proactive in maintaining deposit relationships, which has led to the rise in our funding costs. Importantly, we have continued to see organic core deposit growth while not having to rely on time deposits, as outlined on Slide 15. During the second quarter, our deposit mix was relatively stable, as noninterest-bearing deposits decreased slightly to 30.8% of total deposits as compared to 31.7% of total deposits in the first quarter of 2023.

Turning to Slide 16. We continue to believe that our loan portfolio remains appropriately reserved, as our ratio of allowance for credit losses to total loans was 1.45% at June 30, 2023, as compared to 1.42% at March 31, 2023. As Curtis touched on earlier, we recorded a provision for credit losses of $3.7 million in the second quarter. The larger provision was largely due to our organic loan growth in the quarter and $1.3 million in specific reserves attributable to one previously classified credit relationship, totaling $13.3 million that was placed on nonaccrual in May 2023. Due to the relationship being placed on nonaccrual, our nonperforming assets to total assets ratio increased to 51-basis points in the second quarter from 19-basis points in the first quarter of 2023.

That said, classified loans declined approximately $3 million during the second quarter to $68 million from $71 million at March 31, 2023. Further, a classified relationship with $3.2 million in nonperforming loans paid off in full the first week of July 2023. Nevertheless, future economic conditions remain uncertain due to the continued rising market interest 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.

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Skipping ahead to Slide 18. Our noninterest expense was $40.5 million in the second quarter as compared to $32.4 million in the first quarter of 2023. The increase was primarily due to $4.5 million of transaction expenses and related incentive-based compensation from the Windmark transaction and the $3.4 million loss on the sale of securities. As a result, we see our core noninterest expense as $32.6 million for the second quarter and we do not expect additional expenses related to the transaction in future quarters.

Importantly, we continue to manage our personnel expense by implementing efficiencies and closely managing personnel based on the activity in our operations, which has allowed us to manage wage inflation across the bank as we adapt to the current market.

Looking to the third quarter of 2023 and the year ahead, we expect noninterest expense to be flat or slightly increase based on continued rising costs. That said, we will keep looking for offsets to manage noninterest expense as we continue to selectively add talent to our team.

Moving ahead to Slide 20, we remain well-capitalized with tangible common equity to tangible assets of 8.96% at the end of the second quarter, an increase from 8.54% at the end of the first quarter of 2023. The increase was driven by $27.5 million in net income after dividends paid, partially offset by $2.6 million in share repurchases. Tangible book value per share increased by $1.63 to $21.82 during the second quarter.

Let me turn the call back to Curtis for concluding remarks.

Curtis C. Griffith

Thank you, Steve.

To conclude, I am very proud of our results through the second quarter as we continue to successfully navigate a challenging environment and position South Plains for the future. Through the quarter, we grew loans and deposits, while maintaining our profitability, in spite of turmoil in the banking industry in March, which is a testament to the franchise value of South Plains. Additionally, the sale of Windmark added capital to our balance sheet for growth, while also enabling us to strategically sell a portion of our investment securities portfolio in a tax advantaged way, which we believe has further improved the earnings power of the bank. We will continue to look for opportunities to deploy capital to further enhance the earnings power of the bank as we strive to create value for our shareholders.

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

Operator

Your first question comes from Brady Gailey with KBW. Please go ahead.

Brady Gailey

Hey. Thanks. Good afternoon, guys.

Steven B. Crockett

Hi, Brady.

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Cory T. Newsom

Hi, Brady.

Curtis C. Griffith

Hi, Brady.

Brady Gailey

Maybe just a little more color on the $13 million NPA. What type of business is that and what happened there?

Cory T. Newsom

That's a C&I business, a little color and one of the things I kind of hoped you would pick up is when we talked about this in our script about it being a borrower-directed liquidation, you've got a guy that's got a lot of different businesses in a lot of different industries. He expanded into kind of a related type business, which didn't really work out like he wanted it to. He, at his own discretion, made the decision to self liquidate, kind of shut it down, self liquidate. We're always going to account for our stuff appropriately, but this guy's very strong net worth, strong balance sheet, a lot of income from other businesses, and we even have those other businesses that actually guarantee this debt. We kind of got caught in a window that we needed to account for it appropriately but feel pretty good about it.

Brady Gailey

Okay. All right, and then when you talk about expenses being flat to slightly up, are you basing that off of the second quarter core run rate of that $32.6 million? Is that what you're basing that off of?

Steven B. Crockett

Yes, that's correct. That's what we're looking at after we kind of normalize the transaction costs and additional expenses, right around that $32.5 million.

Brady Gailey

All right, and then I mean, loan growth was incredible this quarter. It was 27% linked quarter annualized. Maybe just a little more color on kind of what drove that level of loan growth.

Cory T. Newsom

Yes, I'll pick up and let Brent kind of clean it up on this one. We went into the quarter with a good pipeline. We've talked about this for a long time that with our team in place the way we have it and opportunities to pick up good relationships. If you look at some of the different markets we're in and some of the disruption that's happened, it just really worked. We've been very conservative, and we walked away from a lot of stuff that we could have done, just didn't want to. We really cherry picked it. Brent?

Brent A. Bates

Yes, we pulled a lot through the pipeline the second quarter: Growth centered in industrial storage; you have some multifamily and some single-family; owner-occupied, non-owner-occupied growth there; as well as energy. It was a mix between the South Plains side of the Company and the more metro markets.

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We had a pretty good blend of a mix, and we still have a pipeline of fundings on our construction book that we anticipate to continue. Near term, that's kind of going to be a tailwind to that growth, and added to it, for sure, in the second quarter. I think our pay downs were a little lighter than what we thought they were going to be in the second quarter. That kind of attributed too. I know we talked about that last quarter, but overall, feel really good about it. We pulled a lot through this quarter.

Brady Gailey

All right, and then finally for me, the margin was down about 10-basis points linked-quarter. Maybe your outlook on how the margin should trend in the back half of this year.

Steven B. Crockett

Yes, NIM held steady through the quarter. We kind of looked at, not for the quarter of March, but the month of March, we were right about that same level, 365. We were fortunate and stayed pretty consistent during the second quarter at that level. It's a challenge every day, there's still competitive issues on pricing on deposits. We've got to face that, and some compression in NIM, I think, is out there. We just hope to minimize that as much as we can.

Cory T. Newsom

I think our new pricing on our loans, the funding, the stuff that we're getting, will continue to help hopefully keep that as flat as possible.

Curtis C. Griffith

I agree with what they said, that we are going to get some benefit from the loans that we're putting on the books now. You're going to have a full quarter of a lot of those. We did, as we noted, sell off some of the low-yielding securities, and those are now largely funded back up in some of the loans we're putting on the books. With the other stuff still in the pipeline, still in the stage of construction where we're going to be providing funding now that the customer's basically put in their equity. We're going to continue to push up the yield on loans. It's just a question of can we stay up with the increase in deposit costs because we do know deposit costs are moving up some more. We're going to do all we can to keep it down. We think the deposit mix we have is one that lends itself to maybe not reacting as fast as some types of deposits do. It's going to be a challenge, and I would say that we'll see a little more NIM compression. We're going to hold it as firm as we can, but I'd expect it tightening up a little in both the third and fourth quarter.

Brady Gailey

Okay, got it. Thank you, guys.

Curtis C. Griffith

Thanks, Brady.

Cory T. Newsom

Thanks, Brady.

Operator

Your next question comes from Brett Rabatin with Hovde Group. Please go ahead.

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Brett Rabatin

Hey. Good afternoon, everybody. Wanted to go back just to deposits and the cost of deposits only 1.69% on average in 2Q. Curtis or Cory, is there not any concern that there might be a catch-up quarter in terms of betas, and then could you just give us any color around what rate you added those brokered deposits on during 2Q?

Cory T. Newsom

I really don't, do you see some big movement in rate. I don't see a catch-up quarter coming at all. I do think that we made some moves early in the year into late last year to try to take care of some of our interest-bearing accounts that we felt like that were a little bit below where they should be from market. No, I feel pretty good about the mix and what we're actually doing. I think a lot of it goes back to the type of deposits we have, especially in some of the rural markets, and that's what we're so proud of, so I don't really see a catch-up quarter coming.

Steven B. Crockett

Yes. I'll just add to that just a little bit. As far as brokered, that was added toward the end of the quarter, there wasn't necessarily a full quarter of that in. It is at the upper end of the cost range there tied to Fed funds, and it is a costlier deposit. That will increase our deposit cost during the quarter, but as Curtis said, on the flip side, we've got the loans that were not funded for the entire quarter. We'll have a full quarter's worth of earnings on those new loans that are being put on at 7%-plus, 8% in different cases to help offset that cost.

Cory T. Newsom

Brett, I doubt we're much different than anybody else. We are using the brokered as a way to manage our overall cost.

Curtis C. Griffith

What we've been able to do with that, as was indicated, it's not inexpensive, but we think it's better than trying to run a whole bunch of CD specials out there. In our markets, that's going to take something north of 5% if you're really going after new money to get that in, and we're trying to do all we can to still hold ours more in line at little lower levels. If you see our deposit mix, we just don't have that much in CDs, we're not having to deal with a bunch of CDs, and particularly jumbo CDs maturing that we've got to be really up there with higher rates or they're going to walk out the door. A lot of ours are in transaction accounts and money market accounts, and we're able to adjust those rates and kind of do things competitively and keep the customer relationship there, and also still have that flexibility that when, and it is a when, not an if, rates go back down at some point, we'd be able to quickly pull rates back down on those type counts.

Brett Rabatin

Okay, that's helpful. Then, I know your DDA has been fairly stable the past year, but I was really impressed it was only down in the period $10 million 1Q to 2Q. Are you guys opening up a bunch of new accounts that's helping keep that fairly stable, or are you just not seeing mix shift change away from noninterest bearing to interest-bearing?

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Cory T. Newsom

We've talked about this the last couple of quarters. Deposits are such a focus when we're approving loans of the relationships that are actually coming in, and it's real. Literally, we sit down and have a conversation over loan approvals, and we start out what the deposit relationship looks like, and we're making that much more of a focus when we're doing it, and it's helped us keep those demands pretty stable.

Steven B. Crockett

Yes. We are seeing some move out, but those new ones coming in are helping to mitigate that.

Brett Rabatin

Okay, and then just last quick one for me on the loans, you had talked about a strong loan pipeline, and obviously, the really strong growth in 2Q. Would you attribute the growth in 2Q to any kind of market share movement or just people getting stuff done in front of any additional rate hikes, or any additional color on the strong growth relative to the pipeline?

Brent A. Bates

I'll start off. The majority of our new loan funding that we had during the quarter was expansions of existing relationships. These are long relationships that had an opportunity to either acquire, but most of the time acquire. In some cases, they had a maturing credit they wanted to move from one place to another to raise maybe capital for another venture. The majority of our business we booked as new fundings, outside of the construction fundings, are existing clients that came to us for expansion of their relationship. That was both in metro markets and in the South Plains side of the Company.

Cory T. Newsom

Yes, and Brett, I would probably catch on to that with part of your question of the fundings people trying to beat the rate for a movement. I don't think at all, because so much of what we're doing's going in with a floating rate they're going to catch it anyway. We all saw some of that a year-and-a-half ago with people trying to get some stuff done. We saw that movie. No, most of this stuff coming in is floating, and knowing that they're going to face whatever rate increases come.

Curtis C. Griffith

Yes, we definitely saw that back in the second quarter of '22. It was pretty obvious what was happening then, but that ship's already sailed, I think. Right now, as Cory said, I think we're booking things at rates that look pretty favorable, and a lot of them are floating. Yes, we are picking up some business related to some of the institution sales and consolidations that we've seen, particularly out in our West Texas markets. I think we're going to continue to see that over the next couple of quarters. People are not terribly happy with some of the new ownership in some cases, and they're looking to either move entire relationships, or, as Brent indicated, maybe they've already got a relationship with us and now they're going to take what they had over at the bank X and move that over to us as well, and we've got room. We're glad to bring them on and we already have the underwriting and to look at the credits and it's a fairly easy transition for them. I think that was a key trend in Q2, and I think we'll see more of it in Q3 and Q4. Overall, we are going to see a slowdown. The pipeline has already shrunk some, and I think the rate of increase is definitely going to slow. I don't see us actually going backwards. I think we'll continue to grow loans out through the balance of the year.

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Cory T. Newsom

Brett, I'll just add one more to it. Over time we've spent time making sure that we've really done a good job with some of our metro markets, making sure the right teams, leaderships, everything's in place. We're still just as focused at taking care of that in our rural markets, and we're seeing opportunities to take share in those areas and picking up good leadership in some of the rural markets where some of those good deposits and good loan opportunities are. We want to take care of both sides of our balance sheet, meaning metro and rural, knowing that they're both beneficial.

Brett Rabatin

Okay, great. Appreciate all the color.

Curtis C. Griffith

Thanks, Brett.

Cory T. Newsom

Thanks, Brett.

Operator

Next question, Graham Dick with Piper Sandler. Please go ahead.

Graham Dick

Hey. Good evening, guys.

Cory T. Newsom

Hi, Graham.

Curtis C. Griffith

Hi, Graham.

Graham Dick

I kind of just wanted to stick with, I guess, that last point there about customers maybe being unhappy with their bank and looking to move over to you guys. Banks that have been impacted by M&A, and kind of look at the other side of that and say, are there lenders out there that you guys are looking at right now that, maybe at a bank that has done M&A and they're not happy with it or the bank doesn't have the capital and liquidity to make loans like you guys have in this current environment. I know you guys made a handful of hires or a lot of hires over the last couple of years and it's kind of slowed down a bit, but just wondering, with your all's capital position now and the deposit base you have, if you're looking at all for hires or in organic opportunities?

Cory T. Newsom

Just go with what I was just saying. We just picked a market leader and different ones at a rural market that fit everything you just described, and it's going to bring a lot of opportunity with it. We're excited about

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that, but it'll bring deposits and loans. That's what we like. We said it, we're going to make selective hires, strategic hires. I will tell you that we interview frequently. We don't hire frequently. We're very, very careful about who gets to come on and be a part of the team and make sure that it's going to be a long-term fit that can bring relationships that fit what we're looking for, and that's what we've done. We've been very consistent with this for years, and it's why we've built the caliber team that we truly have, and we're not backing down from it. We're making very selective, strategic hires.

Graham Dick

Okay. I hear you. All right, and then I guess just shifting more to the margin. I just wanted to touch on loan yields a little bit. I think you said you feel as if they're topping out a bit. I guess maybe on new loan yields, if you assume the Fed's pretty much done out there this month or maybe one more hike after that, what sort of loan yield do you have baked into your assumptions that NIM is going to contract a little bit in the back half of the year? What kind of loan yield expansion do you have through the end of the year do you expect?

Steven B. Crockett

As far as loans go, and I'll get Brent to help me out, we're putting loans on when they're fixed, they've been in the upper 7's, mid to upper 7's, I would say, even some maybe slightly higher than that. A good thing is we've got our indirect portfolio that, while that's at some lower rates, that stuff amortizes a lot faster off and so those lower yields are paying off and coming back in. We should show expansion in the overall loan yield. We went up around 15, 16-basis points in the quarter. We should see a decent-sized and hopefully in that range for Q3 especially given the growth that we had in Q2.

Cory Newsom

If you look at those rates, though some of the ones I think what Steve was trying to explain was some of the little fixed stuff that we fill the book. We're putting a lot of prime plus on the books too that's floating that I think will be very beneficial to it as well.

Brent A. Bates

You've got draws on construction loans that for the most part are variable rate, and then what Steve was alluding to, you have a really short duration on indirect portfolio, about a little over $300 million indirect portfolio that those lower rates have rolled off of that portfolio and been replaced by much higher rates. You're seeing lift in that segment, and same with ag. Ag is going to be a variable rate funding for the second half of the year, you should see some lift in that yield.

Cory T. Newsom

Here's the other thing that's kind of interesting. We're not missing opportunities over rate right now because for a while, that was kind of a challenge. I don't believe that you go out there and charge all you can get. I think you still have to stay competitive, but I think our rates are competitive. I think, though, that we're not sitting around losing them over that. It gets down to a credit quality. Do we want it? Is this a relationship that we want to tie on to?

Graham Dick

Okay. I guess that's a perfect segue to what I have last for you guys is just talking about the provision. I know you guys said that you budgeted for $1.25 million this quarter. Obviously, it's a little bit higher with the growth and that specific reserve you talked about, but are you guys looking at the rest of the year

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saying $1.25 million is good for the provision line going forward or is there anything in there that might take that higher or lower?

Steven B. Crockett

I'll start and I'll definitely let Brent pipe in. At this point that would be our hope of where we want to be. Typically, we always have some net charge-offs during the quarter, along with net loan growth. I think we've got a healthy reserve out there currently, and given the view of the economy, I don't think there's any view that that needs to ramp up at this point.

Brent A. Bates

Yes, this is Brent. We feel really good about the reserve level and we're not seeing broad risk trends in the portfolio. I think the provision's going to be largely just like this quarter, most likely going to be driven by growth. What does the total portfolio look like or the mix of the portfolio, and that's likely going to be the driver at least in the near term.

Curtis C. Griffith

We've worked pretty hard on our CECL model, and we are cautious. You know that. You've watched us. We're probably going to run a higher reserve than peers, and it's not because we think we have more credit problems than peers. It's just that we're trying to be cautious and we're taking into account a lot of uncertainty still out there in the overall economy. It looks more and more like if we have a recession, it may be a fairly short-lived and soft one, but today, frankly, we don't know, and we're just going to try to be well-prepared for what comes. There will be some one-offs that happen just like the one we've been describing today, but we think we're pretty well underwritten and don't look for big losses out there even if we do have some credits that do move on to nonperforming status. We just don't see the trends building right now in that direction, but we're still going to be real cautious and be sure that that reserve level stays up where we think we can withstand whatever ills may befall us.

Graham Dick

All right. Appreciate it. Thanks, guys.

Steven B. Crockett

Thank you.

Curtis C. Griffith

Thank you.

Operator

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

Joseph Yanchunis

Good afternoon.

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Cory T. Newsom

Hi, Joe.

Steven B. Crockett

Hey, Joe.

Joseph Yanchunis

You touched on your strategy to modestly reduce the size of the indirect auto portfolio, and I was curious, what is the time horizon of this reduction and how low would you like to take it?

Brent A. Bates

Sorry if I may have caused some confusion. Right now, we're keeping a pretty stable portfolio in that segment. We like it, but the duration there is so short that we're routinely replacing cheap rate. I think that was the point I was trying to make is the production we have in that unit isn't necessarily producing growth or contracting, but it's churning that portfolio into higher rate and into higher rate loans. Yes, the percentage has come down a little bit, but I think that's really just because we're driving the rates in that portfolio up, and frankly, the industry itself has kind of contracted a little bit. I don't see a significant contraction unless the industry continues to contract some, but I think we're still getting our fair share of volume out of that and meanwhile increasing our yield pretty good.

Cory T. Newsom

Yes, we were only down $2.4 million, I think, quarter-over-quarter. Part of that is we're not going to be the cheapest around, and if you look how we stack up on the way we view them as compared to like CFBB, we want top end credit. We want the really good stuff for the majority of our portfolio, and we don't have to be the cheapest to do it. We're strategically placed where we don't have to be.

Joseph Yanchunis

Understood, and moving over to deposits, you previously kind of guided to a cumulative interest-bearing deposit beta of about 50% by year end. Do you still think that holds?

Curtis C. Griffith

I'll let Steve jump in here, but I kind of said that when we started into this, we've managed to stay a little below that up to now. I still think that's probably kind of upper end for us unless we see some real anomaly pop up on something out there. That currently being based as we are with a fairly high percentage of rural market deposits, they're just not as volatile as what we see in some of the larger communities and as long as we can keep those relationships in place, I think we can hold to that 50% or lower level. Steve?

Steven B. Crockett

I agree with what you said. We have been able to maintain it below that level. We said earlier, there's pressure every day on deposit costs and we're monitoring it every day, but as of now, we still feel that we can just come in right at that level or slightly below.

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Joseph Yanchunis

Perfect. I appreciate it, and then kind of the last one for me here is, you talked a lot about the opportunity in the Permian, and I was curious to know what was deposit loan growth like in that market in recent quarter? Maybe you have that handy.

Steven B. Crockett

Let me pull that and see what I can grab real quick.

Curtis C. Griffith

While Steve's looking that up, we definitely are getting some decent loan growth there, and the good news in that market, loans down there quite often do come with strong deposit relationships. That's an area where there's still a lot of liquidity given the nature of the oil and gas business and the ancillary industries. As we're getting opportunities to move those families and those companies in, it doesn't happen real fast, but the whole idea is the relationships that stay with us a long time as well, and we are seeing those opportunities pop up more and more. That's a combination, I think, of having the kind of leadership that we've been looking for in those markets, as well as in that market, as well as we've seen here in Lubbock and some of the others, a little dissatisfaction with some of the changes that they've seen in the banks they've been at. Steve, did you get something?

Steven B. Crockett

Yes. I think about 10% of our loan growth was in the Permian region during the quarter. Deposits were up slightly, but not a significant amount.

Joseph Yanchunis

Understood. Thank you for taking my questions.

Cory T. Newsom

Thanks, Joe.

Steven B. Crockett

Yes, sir. Thank you.

Curtis C. Griffith

Thanks, Joe.

Operator

Thank you. I would like to turn the floor over to Curtis for closing remarks.

Curtis C. Griffith

Thank you, Operator. Thank you to all of you who have participated in today's call, and a very sincere thank you to our outstanding employees who make all this possible.

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As I said at the beginning, we had a very good quarter. We exited in a strong financial position. Our deposits and deposit costs remained stable through the quarter as we worked to maintain profitability in this higher rate environment.

We also delivered excellent loan growth in the quarter, but we do expect it to moderate through the balance of the year. The higher yields from these loans will help mitigate the expected continuing rise in deposit costs. Very importantly, we continue to improve the credit profile of our loan portfolio and are maintaining our strict credit underwriting standards as we conservatively grow the bank.

Finally, we do remain well-capitalized with strong liquidity, and take advantage of opportunities to improve shareholder returns as they present themselves. I'm truly excited about what I see in our future for City Bank and South Plains Financial. Thank you all again. Have a good day.

Operator

This concludes today's teleconference. You may disconnect your lines and thank you for your participation.

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