

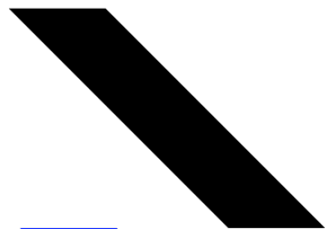


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Q2 2024 SOUTHSIDE BANCSHARES INC EARNINGS CALL

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CORPORATE PARTICIPANTS

- **Suni Davis** *Southside Bancshares Inc - Chief Risk Officer of the Company and Southside Bank*
- **Lee Gibson** *Southside Bancshares Inc - Chief Executive Officer, President*
- **Julie Shamburger** *Southside Bancshares Inc - Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Woody Lay** *KBW - Analyst*
- **Brett Rabatin** *Hovde - Analyst*
- **Matt Olney** *Stephens - Analyst*

PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to Southside Bancshares, Inc. second-quarter 2024 earnings call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Suni Davis, Chief Risk Officer. Please go ahead.

Suni Davis *Southside Bancshares Inc - Chief Risk Officer of the Company and Southside Bank*

Thank you, Justin. Good morning, everyone, and welcome to Southside Bancshares' second-quarter 2024 earnings call. A transcript of today's call will be posted on southside.com under Investor Relations.

During today's call and in other disclosures and presentations, I will remind you that any forward-looking statements are subject to risks and uncertainties. Factors that could materially change our current forward-looking assumptions are described in our earnings release and Form 10-K.

Joining me today are Lee Gibson, CEO; and Julie Shamburger, CFO. First, Lee will share his comments on the quarter, and then Julie will give an overview of our financial results.

I will now turn the call over to Lee.

Lee Gibson *Southside Bancshares Inc - Chief Executive Officer, President*

Thank you, Suni. Good morning, everyone.

This morning, we reported second-quarter net income of \$24.7 million, earnings per share of \$0.81, a return on average tangible common equity of 16.9% and continued strong asset quality metrics.

Linked quarter, our net interest margin increased 1 basis point to 2.87%. During the quarter, we sold approximately \$93 million of lower coupon municipal securities, unwound the related fair value swaps and reinvested most of the proceeds in higher-yielding

agency mortgage-backed securities.

We estimate the payback of the loss on the sale of securities will be less than one year. Linked quarter, loans increased an annualized 1.1% as we experienced a few payoffs. Our loan pipeline remains solid, and we continue to target 5% loan growth for 2024.

Since the last quarter, we have continued implementing initiatives associated with our five-year strategic plan. One of the initiatives is to carefully examine additional revenue as well as cost containment opportunities.

Attrition and a slight reduction in workforce resulted in additional cost savings of approximately \$600,000. Repricing of services in our wealth management and trust department will result in additional revenue of approximately \$500,000.

We are executing on an initiative to expand C&I lending in our metropolitan markets to further diversify our loan portfolio, increase revenue, and grow deposits. We've hired a lead C&I relationship manager in the Houston area and expect to add additional C&I team members in the coming months.

The \$600,000 in cost saves and \$500,000 in added revenue are estimated to more than cover the expense associated with this initial C&I expansion phase in the Houston area. We continue to evaluate expenses as well as revenue opportunities, and we'll update you on any further progress in future quarters. The markets we serve remain healthy and continue to grow and perform well.

I look forward to answering your questions following Julie's remarks. I will now turn the call over to Julie.

Julie Shamburger Southside Bancshares Inc - Chief Financial Officer

Thank you, Lee. Good morning, everyone, and welcome to our second-quarter call. We are pleased to report second quarter net income of \$24.7 million, an increase of \$3.2 million or 14.7% on a linked quarter basis and diluted earnings per share of \$0.81, an increase of 14.1% linked quarter.

We had slight loan growth of \$12 million or 0.3% linked quarter and 1.1% annualized. Our annualized year-to-date loan growth was 2.9%. The growth was driven by increases of \$59.4 million in commercial real estate loans and \$17.5 million of 1-4 family residential loans partially offset by decreases in construction loans of \$53.4 million and municipal loans of \$10.2 million.

The average interest rate of loans funded during the quarter was approximately 8%. As of March 31, our loans with oil and gas industry exposure were \$120.8 million or 2.6% of total loans. Our allowance for credit losses decreased \$762,000 for the linked quarter to \$45.6 million.

Asset quality metrics remained strong. Nonperforming assets decreased to \$6.9 million from \$8 million or 0.08% of total assets on June 30 compared to 0.10% at March 31. On June 30, our allowance for loan losses as a percentage of total loans was 0.92% compared to 0.95% on March 31.

Our securities portfolio was \$2.71 billion at June 30, consistent with March 30. As Lee mentioned, we sold municipal securities and replaced them with higher-yielding agency mortgage-backed securities and to a lesser extent, US treasury bills. In connection with the sale of the municipal securities, we unwound the fair value swaps associated with the hedged items, which resulted in a net loss in the second quarter of \$563,000.

There were no transfers of AFS securities during the second quarter. As of June 30, we had a net unrealized loss in the AFS securities portfolio of \$48.3 million compared to \$48.8 million last quarter. At March 31, the unrealized gain on the fair value hedges on municipal and mortgage-backed securities was approximately \$18.6 million compared to \$20.4 million linked quarter. This unrealized gain partially offset the unrealized losses in the AFS securities portfolio.

Our AOCI on June 30, 2024, was a net loss of \$111 million compared to a net loss of \$110.9 million on March 31, 2024. The net loss was comprised of net losses on our securities and swap derivatives of \$92.5 million and \$18.5 million related to our retirement plans. As of June 30, the duration in the total securities portfolio was 8.9 years, and the duration of the AFS portfolio was 6.7 years, the slight increase from 9.1 years and 6.9 years, respectively, at March 31.

At quarter end, our mix of loans and securities was 63% and 37%, respectively, with no change in the mix from March 31. Deposits decreased \$49.8 million or 0.8% on a linked-quarter basis due to a decrease in public fund deposits of approximately \$71 million and broker deposits of \$100 million.

These decreases were partially offset by an increase of approximately \$121 million in deposits from an account that increases at this time each year for a short time and is expected to exit in the third quarter. This account enables us to reduce our brokered deposits during the same time, saving approximately 190 basis points.

Our capital ratios remain strong with all capital ratios well above the capital adequacy and well-capitalized threshold. Liquidity resources remain solid with \$2.24 billion in liquidity lines available as of June 30.

During the second quarter, we purchased 57,966 shares of our common stock at an average price per share of \$26.22. We have not purchased any shares subsequent to June 30, and we have approximately 583,000 authorized shares remaining for repurchase.

Our tax equivalent net interest margin increased 1 basis point on a linked quarter basis to 2.87% from 2.86%. The tax equivalent net interest spread decreased for the same period by 3 basis points to 2.13% down from 2.16%. For the three months ended June 30, we experienced a slight increase in net interest income of \$260,000 or 0.5% compared to the linked quarter.

Noninterest income, excluding the net loss on the sales of AFS securities increased \$2.4 million or 24.4% for the linked quarter primarily due to the increase in BOLI income of approximately \$1 million due to a death benefit on a former covered officer realized in the second quarter, a loss on sale of loans in the first quarter, an increase in deposit services income and trust fees.

Noninterest expense decreased \$1.1 million on a linked-quarter basis to \$35.8 million driven by decreases in salary and employee benefits, primarily due to approximately \$618,000 recorded in the first quarter associated with future cost reductions.

Based on the estimated cost savings reported last quarter, we are expecting quarterly expense of \$37 million for the remaining two quarters of 2024. Our fully taxable equivalent efficiency ratio decreased to 52.71% as of June 30 from 55.54% as of March 31.

We recorded income tax expense of \$5.2 million, an increase of \$590,000 compared to the first quarter. The increase in tax expense was driven by an increase in pretax income. Our effective tax rate decreased slightly to 17.4% for the second quarter from 17.7% in the previous quarter. We currently estimate an annual effective tax rate of 17.6% for 2024.

Thank you for joining us today. This concludes our comments, and we will open the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Woody Lay, KBW.

Woody Lay KBW - Analyst

Hey. Thanks for taking my question.

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

Good morning, Woody.

Woody Lay KBW - Analyst

Yeah, hi. Good morning. Wanted to start on the NIM, obviously, a couple of different moving pieces there. I think in the opening comments you called out sort of a short term in nature deposit account that benefited the NIM in the quarter. Any way to quantify how much of an impact that was on either the NIM or NII?

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

I can tell you that the account started accumulating money probably in early June and reached that high of around \$120 million at June 30. So I don't know what the exact average was, but I'm going to guess it was \$60 million for that one month.

So one-sixth of the quarter, we experienced a benefit on that \$60 million. I have not quantified it in basis points. But likely, it's probably going to leave sometime in August is what we estimate at this point in time.

It is an account that does this every year, and they build up to a certain level. And then they take the money for the purposes that it was raised for.

Woody Lay KBW - Analyst

Got it. And that account is listed in the interest-bearing bucket?

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

That is correct.

Woody Lay KBW - Analyst

Okay. And then with the securities repositioning, we've seen a pullback in longer-term rates over the past couple of months. Is there an opportunity for further repositionings from here.

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

It's possible. And we're going to continue to look for those opportunities. We've been doing it off and on now for probably the last 18 to 24 months. And as we find opportunities, especially with the fair value swaps that we have in place, and we can get a reasonable payback, and we're going to look for those opportunities.

I don't have anything specific right now. But we're obviously going to -- as rates change, as spreads change on the various securities, we're actively looking at that.

Woody Lay KBW - Analyst

Yes. And then maybe lastly on the loan growth front, any expectations for growth in the back half of the year. You've got the C&I initiative coming on board, but I would imagine that would take some time to contribute to the growth?

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

Yes, I think it will. I -- we may see some growth occur as a result of that in the fourth quarter, but I don't think -- it will be 2025 before we believe that's going to be significant in nature. So likely, most of the growth will be continued funding on our construction portfolio and other full funders on the CRE front.

Woody Lay KBW - Analyst

Yes. All right. Thanks for taking my question.

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

All right. Thank you.

Operator

Brett Rabatin, Hovde.

Brett Rabatin Hovde - Analyst

Hey, good morning, everyone.

Julie Shamburger Southside Bancshares Inc - Chief Financial Officer

Good morning.

Brett Rabatin Hovde - Analyst

I wanted to ask -- just staying on the margin. So it looks to me like the securities portfolio actions you've taken if I look at it, right, it didn't really affect the second quarter that much. Do those actions raise the margin in 3Q? Or does the cost of funds, is that going to be an offset in the back half of the year? Just any thoughts on the tenure of the margin in the back half?

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

Most of those transactions took place in either late May, but the bulk of them took place in June. And so there really wasn't much impact that we saw in the second quarter. Most of that impact will be in the third quarter.

And I agree with you. I think as long as the Fed funds rate stays where it is, that's mainly going to mitigate any potential impact as a result of potential deposit increases. And really, it's just a point -- when we reach that point where the Fed does decrease rates, then I think that pressure will wane, and it will move the other direction.

Brett Rabatin Hovde - Analyst

Okay. And then on the expense guidance, if I heard you correct, Julie, was that \$37 million for the back half of the year?

Julie Shamburger Southside Bancshares Inc - Chief Financial Officer

Yes, that's correct.

Brett Rabatin Hovde - Analyst

Okay. And so looking at 2Q versus the \$37 million, I know you've obviously made some changes and done some things to improve efficiency. Is the growth in the back half because of the initiatives that you've added. Can you maybe give us some color on the growth in the back half of the year?

Julie Shamburger Southside Bancshares Inc - Chief Financial Officer

Well, originally, we started off with a budget of roughly \$37.9 million. And then we did some of the cost containment efforts in the first quarter and kind of projected out that that would have \$800,000 or \$900,000 -- or maybe \$700,000 or \$800,000 impact on the third and fourth quarter.

So we're -- I'm taking that off. Certainly, we continue, and we want to err on the side of caution with respect to software. And software expense continues -- has remained steady. And actually, most of the categories, if you look at them quarter-to-quarter, we're pretty steady with the exception of salaries and employee benefits.

So I really just didn't want to project a lower number. I mean, so far, we have been lower than that anticipated budget that just didn't want to project it any lower than that for the third and fourth quarter if that helps.

Brett Rabatin Hovde - Analyst

Yeah. That's helpful. And then --

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

We are probably being conservative.

Julie Shamburger Southside Bancshares Inc - Chief Financial Officer

Yeah. I mean we are being conservative.

Brett Rabatin Hovde - Analyst

Okay. And then just lastly on credit, the results are really pristine, and you reduced the reserve with the negative provision. Any thoughts on -- are criticized assets lower? Any color on if you guys just are basically just not seeing anything from a credit perspective at this point in terms of any borrower stress?

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

Yeah. Once a month, we have our watch list meeting, and it's basically any credits that are criticized at all. I came away from that meeting not losing sleep over any of them. I think we have one very small credit that we think will have a small loss in, but it looks like now that loss is going to be less than what we've reserved for.

Beyond that, there's just with the equity that we had going into deals, it just doesn't look like we're -- at this point, we're seeing any credits that give us any significant concern. Obviously, we have ones that we watch, and we get reporting on a monthly basis, but many of them are trending in the right direction. So that's encouraging.

Brett Rabatin Hovde - Analyst

Okay, great. Appreciate all the color.

Operator

(Operator Instructions) Matt Olney, Stephens.

Matt Olney Stephens - Analyst

Hey, thanks. Good morning.

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

Good morning.

Julie Shamburger Southside Bancshares Inc - Chief Financial Officer

Good morning.

Matt Olney Stephens - Analyst

Wanted to ask about the fees. Good quarter of fees even after I make a few adjustments that you noted. I would love to hear any commentary about expectations for fees for the back half of the year.

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

I think we mentioned that we did some repricing and we needed to in the wealth management and trust area. So we anticipate those fees are going to go up the last half of the year. Also, our brokerage is doing extremely well, so I think that's going to go up.

And then the deposit services fees have really done probably better than we originally budgeted and anticipated. So those are really the areas. Obviously, then we have the extra BOLI income, but that was a death benefit.

So we are hopeful that doesn't reoccur in the third quarter. But overall fees, it's been encouraging this year to see the fees move in the direction they have.

Matt Olney Stephens - Analyst

Okay. Appreciate that. And then the Houston C&I hiring, appreciate it may take some time to get some traction there. Would love to hear maybe kind of some longer-term plans. I guess it's early as far as the team. You're still looking for new employees, but maybe it's a longer-term strategy that you want to build out there.

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

Yes. I think our plan is, and it's going to occur over many, many quarters, is we're going to build out that Houston area first and then we'll decide whether to move to DFW or Austin next. But those would be the three markets that we would build out some additional C&I lending teams that can focus on small to midsized C&I lending in those areas.

And that will be their primary focus, so that we can further expand our C&I lending in those metro markets. But we're going to start with the Greater Houston area, and then we'll move forward. But we're anticipating -- we're hopeful by year-end, we'll have a large part of the team in place in Houston.

Matt Olney Stephens - Analyst

Okay. And I guess your existing footings in some of those larger metro Texas markets, I assume at this point, those are mostly real estate based. So these new teams would kind of complement those existing teams?

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

That is correct. I mean we do have some C&I lenders in the various markets. But if you were to look at the concentration of the lenders we have, they're much more heavily focused in the CRE arena.

Matt Olney Stephens - Analyst

Right. Okay. Thanks for the commentary.

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

All right. Thank you.

Operator

Thank you. And I'm showing no further questions. I would now like to turn the call back over to Lee Gibson, CEO, for closing remarks.

Lee Gibson Southside Bancshares Inc - Chief Executive Officer, President

Thank you, everyone, for joining us today. We appreciate your interest in Southside Bancshares along with the opportunity to answer your questions.

In closing, we're looking forward to our prospects during the second half of 2024 and reporting third-quarter results to you during our next earnings call in October. This concludes the call.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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