

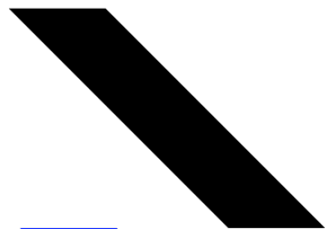


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# EDITED TRANSCRIPT

Q3 2024 SOUTHSIDE BANCSHARES INC EARNINGS CALL

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## CORPORATE PARTICIPANTS

- **Lindsey Bailes** *Southside Bancshares Inc - VP, Investor Relations*
- **Lee Gibson** *Southside Bancshares Inc - President, Chief Executive Officer and Director*
- **Julie Shamburger** *Southside Bancshares Inc - Chief Financial Officer*

## CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Brett Rabatin** *Hovde Group LLC - Analyst*
- **Wood Lay Keefe**, *Bruyette & Woods Inc - Analyst*
- **Matt Olney** *Stephens Inc - Analyst*

## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by. Welcome to Southside Bancshares third-quarter 2024 earnings call. (Operator Instructions). Please be advised that today's conference is being recorded.

I would like now to turn the conference over to your speaker today, Lindsey Bailes, Vice President, Investor Relations. Please go ahead.

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### **Lindsey Bailes** *Southside Bancshares Inc - VP, Investor Relations*

Thank you, Michelle. Good morning, everyone, and welcome to southside Bancshares' third-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 our 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.

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

Thank you, Lindsey. Good morning, everyone. This morning, we reported third quarter net income of \$20.5 million, earnings per share of \$0.68, a return on average tangible common equity of 13.69% and continued strong asset quality metrics.

Linked quarter, our net interest income increased \$1.86 million, and our net interest margin increased 8 basis points to 2.95%. During the quarter, we sold approximately \$28 million of lower-yielding AFS municipal securities, unwound the related fair value swaps and recorded a loss of \$1.9 million. We reinvested the proceeds in higher-yielding agency mortgage-backed securities.

The decrease in other noninterest income was primarily due to recording an impairment charge of \$868,000 on the sale of approximately \$10 million of AFS municipal securities and the unwind of the related fair value swaps on October 1. Recent investments made in our wealth management and trust department are paying dividends as reflected by the steady growth in new clients and quarterly fee income. We anticipate this trend will continue. Linked quarter loans decreased slightly as we experienced a few large payoffs at the end of the quarter. Our loan pipeline remains solid. However, headwinds of anticipated additional loan payoffs have caused us to reduce our target loan growth for 2024 from 5% to 3%. Our initiative to expand C&I lending in our metropolitan markets is progressing as we are hiring additional relationship managers, and we expect to begin seeing results in 2025. 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 third quarter call. We reported third quarter net income of \$20.5 million, a decrease of \$4.1 million or 16.8% on a linked-quarter basis and diluted earnings per share of \$0.68, a decrease of 16% linked quarter. Loans decreased slightly to \$4.58 billion, down from \$4.59 billion at June 30. Our annualized year-to-date loan growth was 1.6%. The linked quarter decrease was driven by decreases of \$50.2 million in commercial real estate loans and \$14.9 million in municipal loans, partially offset by increases of \$39.8 million in construction loans and \$17.4 million in 1-4 family residential loans. The decrease in commercial real estate was primarily a result of a few large payoffs in the third quarter.

The average interest rate of loans funded during the quarter was approximately 8.1%. As of September 30, our loans with oil and gas industry exposure were \$116.1 million or 2.5% of total loans. Our allowance for credit losses increased \$2 million for the linked quarter to \$47.6 million. Asset quality metrics remained strong. Nonperforming assets remained at low levels with nonperforming assets of \$7.7 million or 0.09% of total assets at September 30 and a slight increase from 0.08% at June 30.

On September 30, our allowance for loan losses as a percentage of total loans was 0.97% and compared to 0.92% on June 30. The increase in the allowance as a percentage of total loans was primarily due to the increased economic concerns forecasted in the CECL model specific to office and multifamily markets in metro areas.

Our securities portfolio was \$2.70 billion at September 30, a slight decrease from \$2.71 billion last quarter. As Lee mentioned, during the third quarter, we sold approximately \$28 million of lower coupon AFS municipal securities and replaced them with higher-yielding agency mortgage-backed securities. In connection with the sale of these securities, we unwound their related fair value swaps, which resulted in a net loss in the third quarter of \$1.9 million. In addition, we recorded an impairment loss of \$868,000 in other noninterest income on the sale of AFS municipal securities and the unwind of the related fair value hedges sold subsequent to quarter end.

There were no transfers of AFS securities during the third quarter. As of September 30, we had a net unrealized loss in the AFS securities portfolio of \$24.7 million, a decrease of \$23.6 million compared to \$48.3 million last quarter.

At September 30, the unrealized gain on the fair value hedges on municipal and mortgage-backed securities was approximately \$3.5 million compared to \$18.6 million linked quarter. This unrealized gain partially offset the unrealized losses in the AFS securities portfolio. Our AOCI on September 30, 2024, was a net loss of \$118.5 million compared to a net loss of \$111 million on June 30, 2024.

The net loss was comprised of net losses on our securities and swap derivatives of \$99.3 million and \$19.2 million related to our retirement plans.

As of September 30, the duration in the total securities portfolio was 8.3 years and the duration of the AFS portfolio was 5.9 years, a decrease from 8.9 years and 6.7 years, respectively, at June 30. At quarter end, our mix of loans and securities was 63% and 37%, respectively, with no change in the mix from last quarter.

Deposits decreased \$60.2 million or 0.9% on a linked quarter basis. The decrease was primarily driven by a commercial account that increases during the second quarter each year and exits the third quarter, offset by increases in other funding sources, such as brokered deposits of \$71.9 million.

Our capital ratios remained strong with all capital ratios well above the capital adequacy and well-capitalized threshold. Liquidity resources remained solid with \$2.23 billion in liquidity lines available as of September 30. We did not purchase any shares of our common stock during the third quarter or subsequent to September 30. However, we have approximately 583,000 shares remaining in the current repurchase authorization. Our tax equivalent net interest margin increased 8 basis points on a linked quarter basis to

2.95% from 2.87%. The tax equivalent net interest spread increased from the same period by 10 basis points to 2.23% up from 2.13%.

For the three months ended September 30, we experienced an increase in net interest income of \$1.9 million or 3.5% compared to the linked quarter. Noninterest income, excluding the net loss on the sales of AFS securities decreased \$2 million or 16.7% for the linked quarter. Primarily due to the impairment loss of \$868,000 recorded on AFS securities in the third quarter and the decrease in BOLI income due to debt benefits received in the second quarter.

Noninterest expense increased \$567,000 or 1.6% on a linked-quarter basis to \$36.3 million, driven primarily by an increase in salaries and employee benefits and other noninterest expense. We are expecting noninterest expense of \$37 million for the fourth quarter of 2024.

Our fully taxable equivalent efficiency ratio decreased to 51.90% as of September 30, and from 52.71% as of June 30. We recorded income tax expense of \$4.4 million, a decrease of \$822,000 compared to the second quarter. The decrease in tax expense was driven by the decrease in pretax income. Our effective tax rate increased slightly to 17.6% for the third quarter from 17.4% 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.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Brett Rabatin, Hovde.

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### **Brett Rabatin Hovde Group LLC - Analyst**

I wanted to start with the securities portfolio actions and the hedge. Can you guys like -- I guess, first, can you talk about there were lower-yielding securities? Can you talk about what you what the yield was on what you sold and what you purchased? And then maybe if you've done it, just the net effect to the margin on a go-forward basis would be helpful.

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

The net effect on the margin will be positive. It probably about 1 or 2 basis points. But with the small amount of securities we dealt with it's not going to move the margin materially. But basically, we had some fair value hedges on some of these municipal securities so those are the ones that we unwound, and we primarily bought premium mortgage-backed securities with shorter duration, higher yields, but not at too big of a premium so that if rates then decline, which obviously they haven't over the last two or three weeks, the prepayments wouldn't impact the yield too much. So hopefully, that gives you some color on it.

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### **Brett Rabatin Hovde Group LLC - Analyst**

Yes, that's helpful, Lee. I didn't think it was going to be a big number, but I just want to make sure I know the detail there. I wanted to also ask a lot of banks are struggling with payoffs wanted just to hear payoff activity in the quarter and then just what the loan pipeline looks like and what that might suggest maybe for loan growth going forward?

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

I mean I view loan payoffs two ways: one, I'd like to see the balances; but two, it's a sign of a good economy because these are projects that are being sold out there. But we are beginning to see some of our construction projects that have reached stabilization or close that are beginning to pay off.

We anticipate that a few of them have paid off a little bit earlier than we anticipated. We did have a large loan that we have put on the books in early October that would have offset this, and we would have shown an increase in loans. But the two didn't match up. And so we had these two large payoffs that caused us to have that slight decrease.

Our loan pipeline looks good. It's just we expect some additional payoffs in the fourth quarter. And there's just not enough time to make up the difference to get to 5% loan growth for the year. So that's why we're lowering at 3%. But we have experienced some good loan growth in October, but we also do expect some additional payoffs.

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### **Brett Rabatin Hovde Group LLC - Analyst**

Okay. That's helpful. And then if I could sneak in one last one, just around the margin from here. Any thoughts, Julie, on the margin going forward?

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

I think going forward, it will be a little bumpy, Brett, from the standpoint of during the third quarter. We have this large deposit account that builds up, and it reaches pretty close to maximum by the end of June. But if it's not there, it gets real quick in July. And it's one that we have every year that builds up during June, pretty much reached the peak during July and then pays off usually in early August and it was at a lower rate than the wholesale funding. So that helped our margin some during the third quarter.

We obviously won't have that again in the fourth quarter. So that's why I'm saying it's a little bumpy. And then it really just depends how fast, if at all, the Fed continues to -- or whether they continue to lower short-term rates. What will happen with the margin moving forward. But that's why I'm saying it would be a little bumpy because we won't have that occurring again in the fourth quarter.

And then that balance, I think, got to and Suni you can tell me, I think you got to around \$175 million, yes.

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### **Julie Shamburger Southside Bancshares Inc - Chief Financial Officer**

It was \$122 million at June 30.

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

Yes and it quickly got there during ramped up in early July. So that was a positive for us in terms of our NIM, but -- and we won't have that again. But we also had some other positive things related to the NIM.

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### **Operator**

Wood Lay, KBW.

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### **Wood Lay Keefe, Bruyette & Woods Inc - Analyst**

I wanted to start on the C&I initiative. Just any update on how the build-out is going? And how many hires were made in the quarter?

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

We had two hires during the quarter. We're looking for some additional lenders and are interviewing people right now. So we expect to hire at least a couple of more, and they're hitting the ground running, and it's moving along as we didn't expect to hire everybody at once, because we're looking for certain type of people. And that's why I say that we should begin to see results during 2025 associated with this. And we'll continue to hire during 2025 as well.

**Wood Lay Keefe, Bruyette & Woods Inc - Analyst**

Yes. All right. That's helpful. Maybe shifting over to deposit costs. It was great to see total deposit costs ticked down in the quarter. We got the 50 basis point cut near the end. Could you just walk us through how deposit pricing trends when sort of pre and post cut?

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

Post cut, we were able to -- we have probably close to \$1 billion that we were able to cut the rates pretty close to what the Fed did, maybe not exactly the full amount, but at least probably 80% of what they did. And some of that takes 30 days to take effect, but we were able to do that. We also have a little over \$50 million a month in CDs that are maturing. And those rates, we were able to cut pretty much by the full 50 basis points. And then with the forward outlook at that time, being that they were going to be aggressive rate cuts moving forward, we were able to cut some of the longer ones.

We've since increased those a little bit, but still overall, we're going to be seeing those move down in general, probably 40 basis points every month. So those are the primary things. And then on our wholesale funding, all that unless it's swap will move down as well.

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**Wood Lay Keefe, Bruyette & Woods Inc - Analyst**

Yes. So if I look at the ALCO models you all show up as asset sensitive, but obviously, those are assumption heavy. And it sounds like you're making pretty good progress on the deposit cost side. I mean is asset sensitive still the right way to think about you guys?

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

Yes. I think so because we've got -- we've got about \$1.7 billion, I think, in loans that reprice probably within 2 to 3 months. So it's -- there's more on that side right now. But ultimately, and that's why I say it really just depends what the Fed action is going forward, how much more cut there is. But I would consider us to some extent, asset sensitive at this point in time in terms of a quarterly move and what we're able to do now over a 6- to 9-month period, I think we go back pretty much even.

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**Operator**

(Operator Instructions) Matt Olney, Stephens.

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**Matt Olney Stephens Inc - Analyst**

Just want to ask more about M&A -- just ask more about M&A in your Texas market. Just appreciate your color on kind of the M&A chatter and kind of what you're hearing from other banks in the marketplace.

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

With bank stocks up from probably three to six months ago. The chatter has picked up some. I think a lot of people are looking to see what happens with the election in terms of additional regulation. But I am hearing carry more chatter around M&A right now and really expect in 2025, we'll probably see more activity here in Texas than we've seen this year. I know of a few banks that are for sale, but nothing at this point that we're interested in.

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**Matt Olney Stephens Inc - Analyst**

Maybe just following up there. Just remind us of your target profile bank that at this point you're looking for?

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

With our size, where we are now, Matt, probably no more than \$1.2 billion for a target or we need to target north of \$3 billion in order for it to make sense since we're so close to the \$10 billion. At \$1.2 billion, we'd be able to stand at the \$10 billion and then go look for something in that \$2 billion to \$4 billion range.

But that really would be the target range in terms of dollar amount, in terms of geography, I think we've consistently said that we'd like to stay along I-35 to the East. We'd be willing to go out probably 75 miles or so to the west. But just following that I-35 line down through Fort Worth, Austin and San Antonio and pretty much to the east.

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### **Matt Olney Stephens Inc - Analyst**

Okay. And then I also want to shift gears over to the expenses. I think you gave us some good guidance for the fourth quarter. Just trying to feel out next year and just thinking more about kind of the puts and takes. You've got this C&I initiative that we've talked about seeing some good movements there this past quarter and expect to have some more hires into fourth quarter and into next year. Is it fair to assume that expense growth kind of year-over-year in could be a little bit higher than what we're going to see in '24 as far as the year-over-year growth just from that C&I initiative? Or are there other puts and takes to consider.

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### **Julie Shamburger Southside Bancshares Inc - Chief Financial Officer**

I mean, if you compare to what we've seen in 2024, I think there will be some increase it will happen in salaries more than likely -- we've talked a little bit about 2025 salaries and kind of increases overall. And then the C&I initiative will add some. And then probably the software and data processing will - we did not -- we have not seen it go up as much this year as we had first thought in our budget. But I suspect in 2025, we will get closer to that to a higher level in that category for sure.

So I think it's fair to -- I mean, I know I believe I projected or forecasted around \$37 million or maybe even higher than that very early in the year. And then we brought it down there some cost initiatives that we did in Q1. And -- but I think \$37 million -- I mean, we haven't finished the budgeting process for certain yet. But I think closer to \$37 million or more -- a little more next year, it's probably appropriate at this point. And certainly, in the next quarter, I'll be able to give you something finer tuned.

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### **Operator**

I show no further questions at this time. I would now like to turn the call back over to Lee Gibson, CEO, for the closing remarks.

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

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 for the remainder of the year. and reporting year-end and fourth quarter results to you during our next earnings call in January. This now concludes our call.

Thank you very much.

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### **Operator**

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

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