Civista Bancshares, Inc.
Third-Quarter 2021 Earnings Call
Wednesday, October 27, 2021, 1:00 PM ET

Company Participants:
Dennis Shaffer; President and Chief Executive Officer
Rich Dutton; Senior Vice President of the Company and Chief Operating Officer of Civista Bank
Chuck Parcher; Senior Vice President of the Company and Chief Lending Officer of Civista Bank

Analysts:
Terry McEvoy; Stephens & Co.
Nick Cucharale; Piper Sandler & Co.
Michael Perito; Keefe Bruyette & Woods Inc.
Russell Gunther; D.A. Davidson & Co.

Presentation:

Operator: Good day and welcome to Civista Bancshares' Third-Quarter 2021 Earnings Call. [Operator Instructions] Please note that this event is being recorded.

Now like to turn the call over to Mr. Dennis Shaffer, President and CEO. Please go ahead.

Dennis Shaffer: Good afternoon. This is Dennis Shaffer, President and CEO of Civista Bancshares, and I would like to thank you for joining us for our third-quarter 2021 earnings call. I'm joined today by Rich Dutton, SVP of the Company and Chief Operating Officer of the Bank; Chuck Parcher, SVP of the Company and Chief Lending Officer of the Bank and other members of our executive team.

Before we begin, I would like to remind you that this conference call contains forward-looking statements with respect to the future performance and financial condition of Civista Bancshares, Inc. that involves risks and uncertainties. Various factors could cause actual results to be materially different from any future results expressed or implied by such forward-looking statements. These factors are discussed in the Company's SEC filings, which are available on the Company's website. The Company disclaims any obligation to update any forward-looking statements made during the call.

Additionally, Management may refer to non-GAAP measures which are intended to supplement but not substitute the most directly comparable GAAP measures. The press release available on the website contains the financial and other quantitative information to be discussed today, as well as the reconciliation of the GAAP and non-GAAP measures.

We will record this call and make it available on Civista Bancshares' website at www.civb.com.

Again, welcome to Civista Bancshares' third-quarter 2021 earnings call. At the conclusion of my remarks, we will take any questions you may have.

Let me start off by noting several significant accomplishments or transactions that occurred during the third quarter. This morning we reported net income of $9.6 million, or $0.64 per diluted share, for the third quarter of 2021 and net income of $29.6 million, or $1.90 per diluted share, for the nine months ending September 30, 2021. Our earnings per share for the quarter increased 33.3% compared to the third

quarter of 2020, as well as 39.7% compared to the first nine months of 2020. This is a direct result of our continued focus on growing and diversifying our revenue stream and the disciplined approach that we take in managing the Company.

Earlier this month we announced a $0.14 quarterly dividend which represents an annualized yield of 2.41% based on our September 30 market close of $23.23 and a dividend payout ratio of 21.88%.

We also continue to look for ways to make our balance sheet more efficient. Late in September we began redeploying $50 million of excess liquidity from cash into investments which we expect to result in $850,000 of additional interest income on an annualized basis.

We continue to be active in our repurchasing common shares. During the quarter we repurchased 404,620 shares. Year to date we have repurchased 909,859 shares, or 5.7% of the outstanding shares at December 31, 2020.

Finally, last Friday we filed a $100 million shelf offering, which was a renewal of our existing shelf that was set to expire at the end of November.

Now let's turn our attention to our quarterly numbers. We were extremely pleased with our loan growth for the quarter. Excluding PPP loans, our loans grew by 3%, or 12% on an annualized basis. The category that we saw the largest increase in was commercial real estate. We originated 3,700 loans for nearly $400 million through the SBA's Paycheck Protection Program. At September 30, we had 772 PPP loans remaining, with balances of $83.3 million. All of our first-round loans have been processed, with all but nine of the first-round loans, totaling $2.7 million, having been forgiven. In addition, 50.2% of our round two loans have initiated the forgiveness process. We anticipate having approximately $20 million of PPP loans remaining at the end of the year and hope to have them all forgiven or in payout by the end of the first quarter of 2022.

We continue our focus on managing COVID-19 loan deferrals, as well as asset quality as a whole. Our deferrals have continued to improve from 3.6% of total loans at December 31, 2020, to less than 1% at September 30. Due to our efforts of working with customers and the strength of our borrowers, we have not experienced any defaults attributable to the pandemic and delinquencies remain at historically low levels.

Net interest income increased $592,000, or 2.5% over the linked quarter, and increased $2.4 million, or 11%, year over year. Net interest income for the first nine months of 2021 increased $5.9 million, or 8.9%, compared to 2020.

Our net interest margin was 3.62% and 3.48% for the quarter and for the first nine months of 2021, respectively. Both measures are lower than the comparable 2020 period, but higher than the linked quarter as the impact of our second-quarter balance sheet restructuring contributed a full quarter of impact. As we shared in our first-quarter earnings release, the increase in liquidity we experienced as a result of the federal government's stimulus program and the excess cash created by our tax processing program both continued to have a negative effect on our year-to-date margin.

We continue to see decreases in our funding costs due to the lower interest rate environment. Funding costs went down by $306,000 compared to the linked quarter and $1.2 million when comparing the third quarter of 2021 to the third quarter of 2020 and $3 million when comparing the first nine months of 2021 to the same period of 2020.

Our yield on earning assets is comparable to the prior-year quarter and increased by 5 basis points over the linked quarter as new loan rates remained stable and the balance sheet restructuring transaction we executed in May took full effect. Our yield on earnings assets for the first nine months of 2021 declined

42 basis points compared to the same period in 2020 as interest rates began to tumble late in the first quarter of 2020.

Backing out the effect of the $1.8 million gain on the sale of our Visa B stock that occurred in the second quarter, noninterest income declined $814,000, or 11.2%, in comparison to the linked quarter and increased $2.3 million, or 11.4%, year over year. The decline in tax program fees from the second to third quarter is typical and the decline in gain on sale of mortgages is reflective of a slowdown in refinancing across our footprint. These declines were partially offset by an increase in service charges. The adjusted year-over-year increase was the result of increases in virtually every category of noninterest income, particularly gains on the sales of mortgage loans, service charges, interchange fees and wealth management fees as we continued to focus on growing our noninterest income stream.

Mortgage banking continues to be the largest driver of our noninterest income, although refinance activity slowed considerably. Third-quarter gains on the sale of mortgage loans were $1.6 million, down from our linked quarter of $2.2 million as refinances began to decline and home inventory continued to be tight across our market. For the first nine months of 2021, we recorded gains of $6.6 million compared to $5.5 million in 2020.

We sold $56.9 million of mortgage loans during the third quarter of 2021 and $204.7 million during the first nine months of 2021. Third-quarter volume was down $12.3 million from the linked quarter as demand for refinancing continued to soften. The average premium recognized on the sale of loans decreased from 3.20% for the linked quarter to 2.83% for the current quarter.

Service charge revenue was a bright spot, increasing $202,000 for the linked quarter and $280,000 for the first nine months of 2021 compared to 2020.

Interchange revenue was consistent with our linked quarter and increased $150,000 for the quarter and $663,000 for the first nine months of 2021, as consumers seemed to maintaining the online and cashless retail buying habits that began during the economic shutdown.

Wealth management revenue continues its strong contribution to our noninterest income, increasing $230,000 for the quarter and $654,000 for the first nine months of 2021. We continue to bring in new accounts as well as benefiting from strong financial markets.

The reduction in swap fees is a result of our decision to book select five- and seven-year fixed rate loans on our balance sheet. Given the current rate environment, we have elected to book the higher fixed rate loan that we might otherwise have swapped to lower variable rate loan.

Adjusting for the $3.8 million Federal Home Loan Bank prepayment penalty we incurred in the second quarter, noninterest expense for the linked quarter would have increased $704,000, or 3.7%, and $3.9 million, or 7.3%, year over year. The year-over-year increase is primarily attributable to a $2.5 million increase in compensation expense, the largest components of which were a $832,000 increase due to normal pay raises, a $984,000 increase in commissions paid to mortgage originators and a $300,000 increase in health insurance claims.

Our efficiency ratio for the quarter was 62.2% compared to our adjusted ratios of 59.5% for the linked quarter and 59.9% year over year.

Turning our focus to the balance sheet, year to date our total loans declined by $52.7 million, which includes a $134 million reduction in PPP loans. Excluding PPP loans, our loan portfolio would have grown by $81.3 million, or 5.9% annually. Third-quarter growth was consistent with that of our second quarter at $55.3 million, or 12% annualized. Demand for commercial real estate loans across our footprint continues. Real estate construction loan demand continued the trend that started during the second quarter. We are encouraged by the loans booked during the second and third quarters, as well as the

strong demand across our footprint in undrawn construction lines totaling $128 million, which are near an all-time high. While we continue to [battle] loan payoffs on completed projects, reduced outstandings on operating lines of credit and increase liquidity of our customers, we continue to expect that we will grow our loan portfolio at a mid-single-digit rate for 2021.

On the funding side, we experienced growth in every category except time deposits, with total deposits increasing $245.4 million, or 11.2%, since the beginning of the year.

Noninterest-bearing demand accounts, which made up 34.2% of our total deposits at September 30, grew by $111.7 million compared to December 31, 2020. While balances related to our income tax processing program made up $31.5 million of the increase, $48.9 million of the growth came from noninterest-bearing business accounts and $28.5 million from public entities. We also experienced a $92.7 million increase in our interest-bearing demand accounts, driven by a $52.1 million increase in public fund accounts.

During the pandemic we automatically downgraded commercial loans that requested concessions beyond the initial 90-day modification period. Our total criticized loan portfolio, which includes all classified and substandard loans, declined from $148.1 million at December 31, 2020, to $106.1 million at September 30, 2021. The segment with the largest number of criticized loans is hotels and lodging, totaling $61.4 million. Many of these operators have experienced increased occupancies from leisure travel during the third quarter of 2021. We anticipate further reduction in our criticized portfolio as hotel revenues stabilize.

While there are still uncertainties associated with the economy, we continue to see improvement in both the economy and our customers' financial positions. In addition, year to date we have realized $710,000 in net recoveries. As a result, it was not necessary to record a provision expense during the quarter.

The ratio of our allowance for loan losses to loans increased from 1.22% at year-end 2020 to 1.33%. Exclusive of the PPP loans, this ratio would have been 1.38%. Our allowance for loan losses to nonperforming loans also increased to 503.5% at the end of the quarter from 343.05% at the end of 2020.

We ended the quarter with a tangible common equity ratio of 9.28% compared to 9.98% at December 31, 2020. The extra $67.5 million of liquidity related to our income tax refund processing business at quarter end, combined with the $83.3 million in PPP loans, had the effect of reducing our tangible common equity ratio by approximately 52 basis points.

We continue to create capital through earnings. Our overall goal is to have adequate capital to support our growth both organically and through acquisitions. Two important parts of our capital management strategy are the payment of dividends and share repurchases. As previously stated, we recently announced our fourth-quarter dividend of $0.14 per share. We also remain active in repurchasing our shares. Even with the recent increase in our stock price, we continue to believe our stock is a value. During the quarter we purchased 404,620 shares of our stock for $9.2 million at an average price of $22.74 per share. Year to date we have repurchased 909,859 shares, or 5.7% of our shares that were outstanding at December 31, 2020. We have approximately $11 million authorized to be repurchased under the current repurchase program.

In summary, we are pleased with another quarter of solid earnings, continued loan growth, net interest margin expansion and improved credit quality. While the economy has opened up during the first nine months of 2021, labor shortages and supply chain issues are affecting many of our customers. In spite of these challenges, we remain optimistic. Our loan pipelines are solid. We expect that most of the remaining PPP Phase 2 loans will be forgiven during the balance of 2021. We will continue leveraging our new digital banking platform and plan to roll out online account opening during the fourth quarter, all of which will allow us to provide a better customer experience.

Thank you for your attention this afternoon. And now we'll be happy to address any questions you may have.

Questions and Answers:

Operator: We'll now begin the question-and-answer session. [Operator Instructions] The first question comes from Terry McEvoy of Stephens.

Terry McEvoy: First question is on the expenses. The software maintenance expenses were up about $300,000 year over year. And I know you mentioned the new digital banking platform. So I guess my question is, is that a good run rate to use going forward? I know you mentioned you're going to roll out the online account opening next quarter. And maybe spend some time, if you could, just talking about how the new digital banking platform is -- how your customers are using it and some early feedback.

Rich Dutton: Terry, this is Rich. We did have about $200,000 worth of kind of one-time nonrecurring expenses related to that that we did expense in the quarter. So the run rate -- I think I told you last quarter we got $200,000 a quarter and that's just about where we expect it to be going forward. I think if you're looking at a run rate for expenses for Q4 and Q1 of next year, $19.2 million is probably a good number.

Dennis Shaffer: And then on the online account opening and stuff, Terry, we'll initially roll that out -- it should roll out here in the fourth quarter. But we'll initially roll that out and we'll market it to existing customers within kind of our footprint and the neighboring bordering states. And then we'll further expand upon that once we see some patterns and analyze some of the usage and stuff like that. But the initial rollout will be marketed and targeted towards existing customers to begin with, so that we can analyze that data.

Rich Dutton: And the only thing I'd add, Terry, is that we don't anticipate any additional expenses attributable to that, to the online account opening.

Terry McEvoy: Great. And then maybe as a follow-up, maybe just talk about new loan yields and just market competition for commercial real estate loans.

Chuck Parcher: Yes. Terry, it's Chuck. I'd love to say that it's softening, but that's not the case. As you know, we've seen a little pickup in the treasuries, but we have not seen the ability to pass that movement upwards to our customers' [indiscernible] loan rates yet. We're hoping that we'll see that here going forward, but that has not been the case. It's been very competitive. We've had some really nice growth across both of our metro -- all of our metro markets, actually -- and Columbus and Cleveland are ultra-competitive right now.

Terry McEvoy: Thanks, Chuck. Appreciate it, guys.

Operator: Next question from Nick Cucharale of Piper Sandler.

Nick Cucharale: Good afternoon. Just on the mortgage side, what was the breakdown in purchase versus refinance in the quarter?

Chuck Parcher: I've got September in front of me. [Indiscernible] the quarter. September was 64% purchase, 36% refi. And we've seen that continue to rotate. If I look across the numbers here, Terry, it's pretty much -- it's pretty close to that for the quarter as well. I can get you an exact number for the quarter as well. I can get you an exact number after the fact, but I know last month it was 64%, 36% because we had been watching it pretty close.

Nick Cucharale: Okay. And then, I appreciate the commentary with respect to the buybacks and the increased dividend recently. Can you talk about another prong of your capital allocation strategy, just your appetite for M&A [in this whole] landscape within your footprint?

Dennis Shaffer: Sure, Nick. We continue to have a number of ongoing talks with many of the smaller banks really across our footprint. I think discussions are probably a little bit more active than they probably -- than normal. And there probably are a few more of those discussions going on. Our view really hasn't changed much. We would like to do a deal. We believe that getting a little larger makes us a little bit more efficient. We continue to be I think opportunistic . But for us it's got to be the right deal, both in terms of creating long-term shareholder value and it needs to call for the aligning for both the buyer and the seller, because those are the deals that are most successful. But I would say that the discussions are probably a little bit more active than they have been in the past.

Nick Cucharale: Thank you for taking my questions.

Chuck Parcher: [Quick] while you're still there -- or, I mean, Nick -- it was 69% purchased for the quarter.

Nick Cucharale: Thanks, Chuck.

Operator: Next question is from Michael Perito with KBW.

Michael Perito: Good afternoon. A few questions. One, just on the size of the balance sheet [indiscernible], is the securities portfolio [indiscernible] in the prepared remarks, but is it likely you'll kind of stay pretty [indiscernible] million and hopefully that excess cash will [indiscernible] the loans [indiscernible] single-digit loan growth expectation over the next handful of quarters? Is that generally how you guys are looking at this total [asset base]?

Rich Dutton: I would say yes.

Chuck Parcher: Yes.

Rich Dutton: That's where we want it to go, is in the loan growth for sure. And, again, we did that transaction -- it kind of bled over the end of the quarter. I think we had $50 million earmarked to be invested and $43 million of it got invested by September 30. The rest of it has been since. But, yes, I think -- again, I think things have kind of stabilized and certainly whenever excess liquidity or any liquidity, we'd love to have to borrow money [indiscernible]. But that's where the dollars will go.

Michael Perito: Helpful, thanks. And then, just on the expenses, I think you said $19.2 million was a better kind of starting point to grow off of for the next couple quarters. Just curious, though. I mean, if we look at overall core expenses of I think, like, 77 -- you know, on pace to do about maybe $77 million, $77.5 million. I mean, how should we think about year-on-year growth? I mean, maybe it's a little too early in the budgeting process to ask, but there's a lot of labor pressures. Kind of an interesting market out there right now. I mean, is it --do you think putting you up in the $79.5 million, $80 million full-year range for next year is too heavy? Or do you think that there's enough kind of headwinds out there where it pays to add a few percent growth in there off of that run rate?

Rich Dutton: So, you're right. We're early in the budgeting process, but I think if you grew expenses in the 2% to 4% range just across the board, that's kind of the way we're looking at it, again, very, very preliminarily. And you alluded to "interesting" on the wages. I don't know if that's the adjective we would use but, yes, it's out there for sure.

Dennis Shaffer: Yes. I mean, I think the wage inflation is real. I mean, in September we did pass on a $1-an-hour increase to all of our hourly nonexempt employees. And in the end it just means that the cost eventually either gets passed on to the consumers or the banks have to figure out a way to operate more

efficiently. And we know that consumer and business behaviors are changing and more customers are banking digitally. So that's why we invested the dollars we did in upgrading our mobile app for consumers and our treasury management platform for our business customers. And it's also why we migrated to this online account opening feature. That's a big step forward for us.

So to combat that inflation, I think banks are just going to have to figure out how to kind of operate more efficiently in some of these areas. And that's what we'll be looking to address and tackle.

Michael Perito: Okay. Helpful. And then just lastly on the NIM, I think you, Rich or Dennis, I think you might have said there's like $850,000 of interest income to come in from some of the liquidity deployment. But I think if you back out the PPP and the accretion, the core NIM was about 3.26, up 4 bps quarter on quarter. And I just -- it seems like with the loan growth and the actions you took over the course of the quarter, that should continue to move higher. I guess my broader question is with the long end where it is and no help on short-term rates, do you guys have any thoughts about where that core NIM could trend to near term with the loan yield pressures you're seeing? And just any insights there would be a helpful starting point.

Rich Dutton: You're right. If it goes up or down it's going to be basis points. I mean, I think we've been and continued to monitor the excess liquidity to see if there's opportunities there. But really, the things that we've put in place, we would expect to push the margin up, again, basis points. I think we said last quarter 12 basis points -- or 17 basis points over a 12-month period.

Chuck Parcher: Seventeen.

Rich Dutton: And that's kind of played out the way we wanted it to. I think Chuck and his team are doing the best they can to hold the line. And I think we're putting [on] assets at a rate pretty comparable to what we did in the prior quarter. So there's less pressure there. But absent any movement in interest rates larger scale, I think where we are and where we'll be -- I think possibly we could trend up, but it would be, again, basis points.

Dennis Shaffer: And when we make all the adjustments, Mike, I think for the year it's been basis points contraction for us as opposed to some of our competitors that I've looked at, they've had that or more in a quarter. So I think our adjustments have been -- I mean, we've been doing a pretty good job of holding the line -- reducing our interest expense and holding the line on our loan pricing.

Michael Perito: Helpful. All right, guys. I appreciate all the insight, as always. Thank you.

Operator: [Operator Instructions] The next question is from Russell Gunther, D.A. Davidson.

Russell Gunther: Good afternoon, guys. I wanted to talk about the growth outlook. So, really strong result over the last couple of quarters. Understand the guide for the year mid-single digits and implies kind of a like amount in the fourth quarter. But as you look out into 2022, I mean, is a high single-digit pace achievable for you guys? Or what would cause you, or the growth results, to take a step back sustainably going forward from where you've been running the past couple quarters?

Chuck Parcher: I think that's that mid -- we've kind of always been that mid-to-high level single-digit growth shop, Russell. You know, I think that's probably a pretty good forecast for us. I mean, a lot of it depends on how fast some of our projects get completed and how fast they go to the [perm] market. We've seen a little bit more aggression out of the perm market lately, taking those projects off our balance sheet a little quicker than they have in the past. That might limit us a little bit from the growth cycle, of keeping them on the books as long. But I think you're probably in the right thought process, mid- to high single-digit price, priced somewhere in the center of that, to be honest with you.

Russell Gunther: Okay. And then is that likely to remain commercial weighted? Or is there any increased appetite to portfolio single-family resi? I know you mentioned the securities book not really expected to build. But does portfolio-ing single family at all incrementally more attractive to you?

Chuck Parcher: It's interesting. The one thing that might help us a little bit is maybe we might not run off as much single family. I think this year last I looked I think we were down $18 million from the beginning of the year in single family as we've taken some of our on-balance-sheet single family product and moved it into [saleable] and sold the market. So maybe we'll get a little bit more single growth just by not doing as much of that as the refinance boom stops.

Dennis Shaffer: Yes. That's kind of somewhat reflective with our slot strategy. I mean, we just have not taken -- you know, we'd rather get the yield right now as opposed to really book those low interest yield deals, the single-family deals. So it is going to almost entirely be -- that growth's going to come from that commercial book.

Russell Gunther: Great. Well, thank you, guys. Appreciate your help.

Operator: This concludes the question-and-answer session. I'd now like to turn the conference back over to Mr. Dennis Shaffer for closing remarks. Please go ahead.

Dennis Shaffer: Well, in closing I just want to thank everyone for listening and thank those that participated on the call. Again, we are pleased with our third quarter and we look forward to talking to you guys again in a few months to share our year-end results. So thank you for your time today.

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