**Civista Bancshares, Inc. Q1 2022 Earnings Call**
**Thursday, April 28, 2022 1:00 PM Eastern Time**

Executives
Dennis Shaffer; President and CEO
Richard Dutton; SVP and COO
Charles Parcher; SVP and Chief Lending Officer

Analysts
Terry McEvoy; Stephens
Ben Gerlinger; Hovde Group
Michael Perito; Keefe, Bruyette & Woods
Nick Cucharale; Piper Sandler
Russell Gunther; D.A. Davidson

## Presentation

Operator: Before we begin, I would like to remind you that this conference call may contain forward-looking statements with respect to the future performance and financial condition of Civista Bancshares, Inc. that involve 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 also available on the company's Web site contains the financial and other quantitative information to be discussed today as well as the reconciliation of the GAAP to non-GAAP measures.

This call will be recorded and made available on the Civista Bancshares Web site at www.civb.com. [Operator Instructions] At the conclusion of Mr. Shaffer's remarks, he and his Civista management team will take any questions you may have.

Now, I will turn the call over to Mr. Shaffer.

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 First Quarter 2022 Earnings Call.

I am 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.

This morning, we reported net income of $8.5 million, or $0.57 per diluted share for the first quarter of 2022. These results include approximately $0.03 per share of expense related to our

Comunibanc acquisition. While these deal costs contributed to the 16.2% decrease in our earnings per share when compared to the first quarter of 2021, the primary reason for the decline was lower mortgage production.

During the first quarter of 2022, our net loans, exclusive of PPP, grew by $48 million, or at an annualized growth rate of 10%. We continue to be on track with the Comunibanc transaction that was announced earlier this quarter. We view this as a low-risk transaction with significant upside that will expand our footprint into Northwest Ohio and the Toledo MSA, and look forward to welcoming our new shareholders, employees and customers into the Civista family. We expect this transaction to close at the end of the second quarter.

We continue to be active in repurchasing common shares. During the quarter, we repurchased 183,357 shares at an average price of $24.17 per share. We continue to view share repurchases as an integral part of our capital management strategy. At March 31, 2022, we had $4.9 million remaining in our current repurchase authorization plan. Our return on average assets was 1.07% for the quarter compared to 1.47% for the linked quarter. And our return on average equity was 9.89% for the quarter compared to 12.49% for the linked quarter.

Now let's turn our attention to our performance for the quarter and for the year. As I stated, we were extremely pleased with our loan growth for the quarter. Excluding the impact of PPP loans, our loan portfolio grew by an annualized rate of 10%, this despite having $42.5 million in loan payoffs during the quarter.

At the end of the quarter, we had $15.5 million in PPP loans remaining. Our strategy of originating PPP loans to only our customers and those referred to us by known referral sources resulted in no fraud to date in the PPP loans that we originated. We have just $583,000 in PPP fees remaining at quarter end and anticipate the forgiveness process to be essentially complete by the end of the second quarter.

Despite solid loan growth, our net interest income declined $391,000, or 1.7% from the linked quarter, primarily due to the increased interest expense related to our subordinated debt issuance in November and declined $896,000, or 3.8% year-over-year for the same reason. Our net interest margin for the quarter was 3.38% compared to 3.42% for the linked quarter.

While accretion of PPP fees boosted our first quarter margin by 16 basis points, excess cash generated by our income tax processing program negatively impacted our first quarter margin by 23 basis points. We expect our margin to expand as the PPP loan process concludes and the liquidity generated by our tax programs subsides. Assuming interest rates continue to increase, our asset sensitive balance sheet should yield further expansion of our margins.

During the quarter, noninterest income increased $832,000, or 12.2% in comparison to the fourth quarter of 2021, and declined $1.5 million, or 16.8% year-over-year. The primary driver of the increase over our linked quarter was our income tax refund processing program, which continues to be an important contributor to our noninterest income during our first and second quarters each year. Income from that program during the first quarter was consistent with the prior year at $1.9 million.

Service charge revenue declined by $234,000, or 12.9% compared to our linked quarter, and showed an increase of $323,000, or 25.7% over our first quarter of last year. The decline in service charges for the linked quarter is due to the timing of when service charges were earned on tax program-related accounts. These charges are related to services we provide to the tax software providers. The service charges associated with this business were around $270,000 in the fourth quarter of 2021 and were $156,000 during the first quarter of 2022. These fees are charged annually and are typically charged late in the year. Interchange fees at $1.1 million were consistent with our linked quarter and that of the prior year.

Mortgage banking continues to be a significant contributor to our noninterest income. However, like much of the industry, Civista experienced a decline in mortgage loan originations as interest rates increased in inventory of homes available, where the purchase continued to be tight.

First quarter gains on the sale of mortgage loans were $936,000, a decline of 36.2% from our linked quarter, which was $1.5 million, and a 66% decline from the prior year, which was $2.7 million. We sold $38.2 million in mortgage loans during the first quarter of 2022 compared to $54.8 million during the linked quarter. The average premium recognized on the sale of loans declined 23 basis points from 2.68% to 2.45% compared to the linked quarter.

Wealth management revenue of $1.3 million was consistent with that of the linked quarter and an increase of $131,000 or 11.4% over the prior year as gains in new accounts were offset by declines in the overall market. We continue to view the expansion of these services across our entire footprint as an opportunity to diversify and grow noninterest income.

Noninterest expense increased $1.1 million, or 5.6% year-over-year, which was primarily attributable to annual compensation increases that go into effect each April. Additionally, noninterest expense increased $3.1 million, or 18% compared to the linked quarter as a result of increases in compensation expense, data processing, marketing and professional fees related to our Comunibanc transaction.

Compensation expense, which increased $2.1 million, accounted for the largest portion of the linked quarter increase in non-interest expense. Payroll taxes are typically higher in the first quarter and increased 411,000 from the linked quarter. Similarly, contributions to our employees' 401(k) are higher in the first quarter and increased $104,000.

Health insurance and incentive expense also increased over the linked quarter by $604,000 and $647,000 respectively as we trued up accruals at year end and then resumed our normal accrual levels in the first quarter of this year.

Data processing expense increased $257,000 over the linked quarter due to $215,000 in conversion fees associated with the pending Comunibanc acquisition. Professional fees increased $589,000 over the linked quarter due to $268,000 in legal and investment banking fees associated with our pending Comunibanc acquisition. In addition to acquisition-related professional fees, $91,000 of the linked quarter increase in professional fees was the result of reversing accruals at the end of the prior year to bring them in line with our actual expense.

With the legal close of our Comunibanc transaction planned for the end of the second quarter and the system conversion scheduled for October, we anticipate recording most of the additional deal costs during the second and third quarters.

Marketing expense increased $214,000 over the linked quarter, which was directly attributable to reversing our accrual by 214,000 in the fourth quarter to bring our budget and marketing expense in line with our actual marketing expense.

Our efficiency ratio was 65.2%, compared to 56.2% for the linked quarter and 57.4% year-over-year. If we had adjusted for one-time deal costs, our first quarter efficiency ratio would have been 63.7%.

Turning our focus to the balance sheet. During the first quarter, our total loans grew by $20.3 million. Backing out $27.7 million of PPP loans forgiven during the first quarter, our loan portfolio grew organically by $48 million, or at an annualized rate of 10%. While nonowner occupied CRE loans led the way, we had good demand in owner-occupied CRE, residential real estate and residential construction loans in every market across our footprint.

Along with strong first quarter loan production, our undrawn construction lines ended the quarter at $120.2 million, giving us confidence that we will grow our own portfolio at a mid single digit rate for 2022. As I stated earlier, mortgage loan production is down. However, we are optimistic that our pipeline is solid with very few refinances. We are seeing a lot of preapprovals, but unfortunately not enough inventory to keep up with the demand.

On the funding side, total deposits increased $198.4 million, or 8.2% since the beginning of the year. Increases in balances related to our income tax processing program of $199 million made up virtually all of this increase, although we did see some movement from time deposits into money market and interest-bearing demand accounts. Noninterest bearing demand accounts continue to be a focus, making up 37.6% of our total deposits at March 31 as we continue to attract the operating accounts of our business customers.

Turning to asset quality. The segment with the largest number of criticized loans remains hotels and lodging. At the end of the quarter, total criticized hotel and lodging loans were $48.6 million. Most of these operators have experienced increased occupancy from leisure travel during the last four quarters. Despite the lingering effects of COVID on business travel, we anticipate continued leisure demand going forward, resulting in further reduction in our criticized portfolio.

While there continue to be uncertainties associated with the economy, we continue to see improvement throughout our footprint in our customers' financial positions. As a result, we did make a $300,000 provision during the quarter, primarily attributable to growth in our loan portfolio rather than economic stress. In addition, we realized $92,000 in net recoveries during the quarter.

The ratio of our allowance for loan losses to loans was 1.34% at quarter end compared to 1.33% at year end 2021. Our allowance for loan losses to nonperforming loans also improved to 501.5%

at the end of the quarter, up from 496.1% at the end of 2021. As a reminder, Civista met the guidelines for the delayed implementation of CECL and are on track to adopt the new allowance methodology beginning in 2023.

The anticipation of a higher interest rate environment and the pressure it has had on the bond market resulted in a $29.5 million decline from December 31, 2021 to the end of the quarter in other comprehensive income related to our investment portfolio. As a result, we ended the quarter with tangible common equity of 7.85%, compared to 9.25% at December 31, 2021. We continue to be comfortable with the credit quality and duration of our security portfolio at the end of the quarter.

We continue to create capital through earnings. Our overall goal is to have adequate capital to support our organic growth and potential acquisitions. Two important parts of our capital management strategy continue to be the payment of dividends and share repurchases. We continue to believe our stock is a value and, as previously discussed, have taken advantage of the recent market conditions to remain active in repurchasing shares.

As I indicated earlier, we continue to be on track to close our transaction with Comunibanc and their subsidiary, The Henry County Bank. Members of both companies have been meeting in anticipation of legally closing the transaction at the end of June and successfully integrating our systems in October. We look forward to welcoming their shareholders and customers to our Civista family as we grow into Northwestern Ohio and the Greater Toledo MSA.

In summary, despite some of the noise in our numbers, we are pleased with another quarter of solid earnings, continued loan growth and solid credit quality. Despite economic and geopolitical uncertainties we are all facing and their impact on our local and larger economies, we remain optimistic. Businesses across our footprint continue to have strong balance sheets, our loan pipelines are solid and we are well on our way to the successful integration of The Henry County Bank into the Civista family.

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

**Questions and Answers**

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

Terry McEvoy: Maybe first question. If we kind of exclude PPP and then the tax refund deposits, could you just talk about the core net interest margin trend as short-term interest rates go higher? And what percentage of the portfolio is variable rate? It will help us understand the impact on a core basis of rising rates.

Richard Dutton: Terry, this is Rich and I'll go through the analysis that we had the last couple of quarters. So we reported 3.38% margin. About 16 basis points of that was attributable to PPP. So

if you back that out, that would have reduced the margin, right? And then we had another 23 basis points that was attributable to the liquidity generated from the tax program.

When you run all that through, I would say a normalized margin for Civista for Q1 was 3.45%. That's not too different from, I think, the number that we shared at the end of last quarter, maybe a fair amount of expansion actually. But the way we -- they're telling me it's not very clear. Is that better, Terry?

Terry McEvoy: Yes, that's better.

Richard Dutton: Okay. I didn't say any important number there anyway.

Terry McEvoy: No, I can hear you. You were just quiet.

Richard Dutton: Okay. So our model indicates that for every quarter basis point increase in short-term rates, our margin will expand by about 5.5 basis points. And I'm not sure what the rest of your question was.

Dennis Shaffer: And the portfolio -- about 1/3 of the portfolio, 33% of the portfolio, Terry, will adjust every 30 days or less.

Terry McEvoy: Perfect.

Dennis Shaffer: And then it's 39%. If you add another 6%, adjusts in a year or less.

Terry McEvoy: Okay. Okay, thank you for that. And then maybe as my follow up, are there parts of the portfolio you're just watching a bit closer given inflation and supply chain issues? And maybe how have you thought about the impact of higher rates on your nonowner occupied CRE customers?

Dennis Shaffer: Well, we're watching it, Terry. The first question, are we watching at any certain part of the portfolio, we're still watching the hotel portfolio relatively closely. We feel good about the numbers we're seeing from that as we're mostly leisure travel and not business travel. So we're watching that probably closer than any other piece.

We are doing -- I guess the right way to say this, we're looking at our portfolio closely as far as from an interest rate increase, but we don't really see any specific area that I would say is at risk. I've been watching our lines of credit pretty closely to see if they are beginning to be drawn on. And to be honest with you, we have not seen any significant draws on our operating lines of credit year-to-date. In fact, they've actually diminished a little bit. We're running about, give or take, 33% utilization on those lines of credit.

Richard Dutton: And we do -- part of our underwriting, Terry, does include -- we stress the interest rate. So we'll underwrite it at the actual rate. And then we do have a stress analysis in there as well.

Operator: The next question comes from Ben Gerlinger with Hovde Group.

Ben Gerlinger: If you just take a 10,000 foot view from a macro perspective here relative to your clients that you're working with, it seems like global economics are slowing a little bit, inflation is increasing. But when you think from boots on the ground perspective, what are your clients -- what are the kind of things that they're worried about or what are they trying to tackle in front of them? How could that juxtapose against loan demand?

Charles Parcher: Ben, this is Chuck. I mean, I think everybody is worried about, I guess, #1, supply chain, #2, labor as far as getting and retaining labor. It's a tough labor market right now. And then, obviously, the inflation effects that are taking place right now.

The interesting part is we've got some people that are distributors, and the retailers are dying for products. So from that perspective, as long as they can get the product here, they can sell it almost at whatever price they want to do it. So there's a lot of -- I guess there's concern, but at the same time, I think most of our clients are doing really well right now and feel like that they'll weather this relatively well.

Ben Gerlinger: Got you. That's helpful. And then when you think about the expense, I know the closing is set 2Q. When you think about a core, do you have anything in mind for the latter half of the year, or any investments that might increase it over time that we're not necessarily seeing in today's numbers?

Dennis Shaffer: I'll let Rich answer that. If you remember in that expense number, the increase was -- a lot of was related to accruals and some of the acquisition stuff. But Rich, do you want to give maybe a better number there?

Richard Dutton: Yes. So Ben, I think a good run rate for you guys to use going forward is probably $20.5 million on the noninterest expense. Remember, we've got annual increases that go into effect April 1 for our folks. That's probably the big thing that you haven't seen yet. But other than that, I don't know if we've got any significant investments other than the lumpiness that we've generated from The Henry County acquisition. But I think what we've got in terms of the run rate, what you see is what you get, I guess, is what I'm saying.

Operator: The next question comes from Michael Perito with KBW.

Michael Perito: I wanted to start -- I apologize if I missed it, but just on the noninterest income side, there were a couple of moving parts. I heard you guys addressed some of them in your remarks. But just are we fair to be in the mid $6 million-ish range? And then layering in the deal on top of that once it's closed, or would you frame it differently, Rich?

Richard Dutton: I think that's probably a good place to be. If you back up, there's the tax program fees, that's the stuff that will -- we had $1.9 million of that this quarter. We'll have another $0.5 million in the second quarter. I think all-in, we'll be at $2.9 million. So we reckon maybe another $1 million in the second quarter. But other than that, I think the crystal ball is -- ours is as good

as anybody else's of what goes on with mortgage fees. But the rest of the stuff is probably where you said, $6 million or $6.5 million is probably a pretty good place to model.

Michael Perito: And how do you guys -- you talked about the state of mind of the customer. But it sounds like the near-term loan outlook you guys have decent line of sight on. As we move into like the back half of the year, like how do you guys think about the degree of confidence around the loan growth, budgeting, and particularly as rates -- right now, the forward curve's doing like 100 basis points by the midpoint of the year. So just curious how you guys are thinking about the back half of the year from a growth perspective as it stands today, and given what we know just from the consensus outlook?

Charles Parcher: Mike, this is Chuck. We shot for -- or I guess I told you guys that would be mid single digits for the year. I still think that outlook is pretty good. Obviously, we exceeded that in the first quarter and our pipeline is really strong right now. And to be honest with you, the pipeline of deals that we're actually looking at is probably at all-time highs.

The rates are affecting it a little bit as far as maybe the amount of money that some people can extract out of some projects going forward just from a cash flow perspective, but we haven't seen demand diminish a lot. In talking to our customers, I think it's really just what -- Columbus right now is really hot. We're getting great growth out of Cleveland. And we're getting great growth out of the Cincinnati area. And we really don't see any one of those three cities slowing down that much. We're hoping to start to get a little bit more demand out of Toledo with our acquisition. So I feel good about demand right now. I'll let you know in 90 days I guess whether as rates go up that that does diminish. But as we're looking at right now, it's pretty strong.

Dennis Shaffer: And we're hoping to add another lender too. We had budgeted just ourselves in Columbus because we are expanding with another office in Gahanna, Ohio, and New Albany area, which is really close to where Intel's starting to make their investment. And also in the Toledo market, we already had that budget. We're still moving forward with that because we think The Henry County Bank acquisition will be a platform for us to do some lending there. And with Chuck's background, having spent almost his entire banking career in Toledo, we just think there's opportunity there as well.

So we still feel pretty bullish on hitting that mid-single digit number and continuing to do that over the next couple of quarters just with that and the things that Chuck mentioned.

Richard Dutton: Mike, before I let you go [indiscernible]. The tax income in the second quarter will be $0.5 million. So it is exactly the same as it was last year.

Operator: The next question comes from Nick Cucharale with Piper Sandler.

Nick Cucharale: Just to follow up on your commentary with respect to the buyback. In light of the reduction to tangible book value, given the FCI mark this quarter, do you see any change to your anticipated level of repurchase or capital deployment more broadly?

Dennis Shaffer: No, I think we'll just continue to be active with the buyback. As the market is down, obviously, we're buying it cheaper. So we have a certain level that we set that target at. And I think we continue -- that will pretty much stay the same. So we think it's a great way to deploy our capital. And I think we'll continue to be active there.

Nick Cucharale: Can you share with us where new loan yields are coming on relative to the portfolio, Rich?

Richard Dutton: That's a great question. From that perspective, Nick, I think that's the hardest thing in banking right now is trying to price these loans as the rates are bouncing around. But I would say they're coming out a little bit higher, probably in the -- averaging in that I'd say 4.75 range of new stuff, give or take, on a five-year. We're starting to obviously quote some rates over 5 now, and we've got some still to close that are in the pipeline that are probably in the mid to lower 4s. But I would tell you, probably a good number is 4.75 right now, and then we'll continue to push that up as the back end of the five and 10-year yields get pressed up.

Nick Cucharale: And then lastly, I just wanted to dig into the loan growth guidance a little bit. You guys are guiding to mid-single digits. Typically, the first quarter is a little bit softer for you guys, but a 10% annualized pace, as you mentioned. Is the mid-single digit guidance just exhibiting a little bit of caution in the back half of the year just without knowledge of --

Charles Parcher: Yes. Sure. The nice part is, Nick, as I looked at the numbers, it grew $48 million this year. In the first quarter last year, we went backwards $26.5 million. And you're right. Usually the first quarter is relatively soft. So we're really excited about that growth box.

And I would tell you we may press it up a little bit. I'd like to get through another quarter to make sure demand stays where it's at. But where we're at right now, the trajectory we're on is pretty good.

Dennis Shaffer: Yes, we just -- I think we are being a little bit cautious just because we hear people talking seven, eight, nine rate hikes. I think that'll eventually does slow things down a little bit. So I think we are a little bit cautious, but we're off to just a fantastic start in our loan portfolio and the loan growth that we had in that first quarter. Because typically, we -- Chuck mentioned we went backwards last year. Well, historically, we always go backwards in that first quarter. So we were really pleased with our loan growth for the quarter.

Operator: [Operator Instructions] The next question comes from Russell Gunther with D.A. Davidson.

Russell Gunther: Circling back to the margin discussion, I appreciate your thoughts on what every 25-basis point move means. Could you let us know what you're expecting from a deposit data assumption in that 5.5 basis points, and maybe what you're thinking about first 100 versus next 100?

Richard Dutton: I think it's pretty ratable whether it's the first -- well, that's probably not true. Let me back up. I mean, we're lagers for sure. I mean, our nonmaturing deposit betas are just shy of 13 basis points. And that's what we've modeled.

But, I mean, you've seen over the years, Russell, you've been covering us for a while, I mean, we're pretty aggressive when rates are coming down. And at least on the last cycle, we were among the last going up. And we never did get back up. And that's something that I think over time -- again, don't forget we got a big portion 30 --

Dennis Shaffer: 37% in noninterest DDA, so that definitely helps.

Richard Dutton: And those are primarily operating accounts of our commercial customers, and they're not really rate sensitive at all. And they're not going anywhere. We've gotten tied up with treasury services and whatnot.

So I don't know if I'm answering your question. But I think that's a good deposit beta for us. And again, I think it just depends on how quickly and how big the rate increases are. But we'll be among -- we'll be in the back of the bus as rates are going back up on the deposit side.

Dennis Shaffer: As Rich said, we're less rate sensitive because we don't have a lot of CDs and we're picking up some additional deposits with The Henry County Bank acquisition. And they're not very rate sensitive as well. So I think that first 100 basis points, we will be -- we'll definitely be a lagger.

Russell Gunther: I appreciate it, guys. Thank you both. Another question I had was just on the tax processing program and related revenue. I appreciate the look into next quarter. Just remind us what type of line of sight you have into future revenue there as we look out a year, maybe even two?

Richard Dutton: So our deal, if you will, hasn't changed. It's a three-year rolling contract at the end of each tax season, usually in the latter half of the year. Once our partners have all done their marketing, we set what the revenues will be for next year and add a year. So we've been -- I think at least the last two years, the revenue has been identical. I don't know what it will be next year. I'll be able to tell you I guess later in the year, but we'll be in the business for at least two more years and probably three.

Russell Gunther: That's a helpful reminder. Thank you. And then last one for me, guys. You've described the pending transaction as a low risk deal. Just curious as to continued appetite for M&A here and just any general color on pace of conversations and what you'd be interested in?

Dennis Shaffer: Yes. So much of it depends on our stock price. And as we know, we're a little bit undervalued there. But we remain really active in our calling efforts. We think we've developed some pretty good relationships. That target for us is a bank with $300 million to $1 billion, probably, in asset size or something. But that's probably the ideal range for us. We think maybe there's a little bit less competition for that $0.5 million bank because it becomes less significant

for some of those larger players that are $7 million, $8 million, $9 million, $1 billion in asset size.

But we would like to continue to grow. I think that helps level out our expenses a little bit. It makes us more efficient as a company. And we've proven that we can integrate these deals really nicely from a cultural standpoint and that they work. They work really well.

I keep pointing back to the last acquisition prior to this deal we just announced, the deal we did late in 2018. We have 45% of the market share, deposit market share, in Ripley and Dearborn Counties in Southeastern Indiana, which is 3.5 hours from our headquarters here. And we've expanded that market presence. We haven't gone backwards. We've increased that deposit market share. So I think we can integrate these deals really well. We can decentralize a few functions and stuff. So we remain -- we would like to continue to grow, and we remain diligent in our calling efforts and in developing relationships.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Dennis Shaffer for any closing remarks.

Dennis Shaffer: Well, in closing, I just want to thank everyone for joining us today and for those that also participated on today's call and again look forward to updating you again in a few months to share our second quarter 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.