CIVB – Civista Bancshares, Inc.
Civista Bancshares, Inc., Fourth Quarter 2018 Earnings Call
Friday, February 15, 2019 1:00 PM ET

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

Analysts:
Nick Cucharale; Sandler O'Neill & Partners
Michael Perito; Keefe, Bruyette & Woods, Inc.
Scott Beury; Boenning & Scattergood, Inc.

Presentation

Operator: Good day, and welcome to the Civista Bancshares' fourth quarter and full year 2018 earnings call. All participants will be in listen-only mode. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Dennis Shaffer, President and Chief Executive Officer. 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 fourth quarter and full year 2018 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.

Before we begin, I'd 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 risk 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 our website, contains the financial and other quantitative information to be discussed today, as well as the reconciliation of the GAAP to 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' fourth quarter and full year 2018 earnings call. I would like to begin by discussing our results, which were issued this morning.

At the conclusion of my remarks, we will take any questions that you may have.

The integration of our new customers and employees that came to us through our transaction with United Community Bancorp or, as we refer to them, UCB, was the focus throughout the fourth quarter. We closed on the transaction on September 14 and converted and integrated all systems during that weekend. We recognized most of the costs associated with the transaction during the third quarter; however, we incurred some additional integration costs during the fourth quarter, which had an impact on our fourth quarter results.

We are confident we have recognized all significant costs associated with the acquisition and integration of UCB during 2018. As such, our discussion today will refer to both the actual GAAP results, as well as our core results.

In December, our Board of Directors approved a plan to repurchase up to 470,000 shares of our common stock. To date, we have purchased no shares, but we view this as an opportunistic measure and an additional option in managing the company's capital.

In addition to integrating UCB, we finished 2018 with another quarter of strong core earnings. While the reduction in the corporate tax rate provided a welcome boost, it only accounted for $2.9 million, or 30.1% of our increased earnings for the year. The balance of our increased earnings came from growth in a number of our core earning streams that we will discuss during this call.

This morning, we reported net income for the fourth quarter of $7.4 million, or $0.45 per diluted share. This includes $782,000 in non-recurring acquisition and integration expenses. For the quarter, our core adjusted earnings were $8.1 million, or $0.49 diluted earnings per share. For the year ended December 31, 2018, we reported net income of $13.2 million, or $1.02 per diluted share, which included non-recurring acquisition and integration expenses of $12.7 million, as well as a loss on the sale of securities of $413,000. Our core adjusted earnings for the year were $24.7 million, or $1.85 diluted earnings per share.

After adjusting for the integration expenses and the repositioning expense in our securities portfolio, our return on average assets was 1.43% for the quarter and 0.81% for the year, would have been 1.55% for the quarter and 1.47% for the year, and our return on average equity, which was 10.35% for the quarter and 6.5% for the year, would have been 11.25% for the quarter and 11.78% for the year.

The increase in our core earnings continues to be driven by increases in our net interest income. During the past several years, we positioned our balance sheet for rising rates and our results continue to reflect the benefits of that strategy. Net interest income grew by 31.1% for the linked quarter and 21.3% year-over-year. Our net interest margin remained strong at 4.38% for the quarter and 4.21% for the year, compared to 4.24% and 4.01% in 2017.

Our net interest margin for the fourth quarter of 2018 includes 22 basis points of accretion income; that translates into 6 basis points year-to-date. Our net interest margin in the fourth quarter of 2017 included $387,000 of a recovery, which added 10 basis points for the quarter and 2 basis points year-to-date. Our normalized margin expanded by 2 basis points for the quarter and 16 basis points for the year.

Between January 1, 2017 and December 31, 2018, the federal funds rate increased 200 basis points. During that same period, our average cost of interest-bearing liabilities only increased 34 basis points, 8 of which were attributable to deposits we acquired through the UCB acquisition. While we believe our deposit rates will increase, we believe our rural branch network and the relationships we have with our commercial customers will continue to provide us with reasonably priced funding.

Monitoring and modeling our deposit balances [in] funding costs continues to be critical to our ALCO process. We are constantly evaluating the core deposit betas used in our modeling. We also continue to remain disciplined in our approach to loan pricing. We offer our commercial customers adjustable-rate loans that normally reprice within five years, and sell approximately 80% of our mortgage loan production.

For those customers that would rather have a fixed-rate loan, we utilize interest rate swaps. The result has been that from January of 2017 to December of 2018 when the Fed increased the prime rate 200 basis points, the average contractual yield on our loan portfolio increased 59 basis points from 4.41% on December 31, 2016 to 5% at December 31, 2018.

Identifying and growing sources of non-interest income also continues to be a focus. During the quarter, non-interest income increased $1.2 million or 33.3% in comparison to the fourth quarter of 2017, and increased $1.8 million, or 11% year-over-year. Our year-to-date income includes a $413,000 loss on the sale of securities that was almost entirely the result of a repositioning transaction, which increased the yield on these securities by 146 basis points, with no meaningful increase in the portfolio's duration.

Service charge revenue was up $328,000 for the quarter and $431,000 for the year. While we experienced minor increases in service charge revenue throughout 2018, the significant increase occurred in the fourth quarter when we recognized $268,000 in overdraft charges related to new consumer and business customers that came to us through the UCB transaction.

ATM and interchange revenue increased $369,000 for the quarter and $490,000 for the year. These increases were largely the result of our nearly 15,000 new debit card customers in southeastern Indiana, which increased our outstanding debit cards by 70%.

Wealth management revenue increased $273,000 for the quarter and $601,000 for the year. Our average assets under management during 2018 increased by $21.8 million. In addition, adoption of the revenue recognition rules resulted in an additional $245,000 in wealth management revenue during the quarter. We continue to view wealth management as an opportunity to grow non-interest income and look forward to expanding these services into our new markets.

Earlier, I mentioned the swap product that we offer our loan customers. With the rising rate environment, we experienced an increase in swap fees of $279,000 for the quarter and $443,000 dollars for the year. Mortgage business continues to provide reasonably consistent results even in this rising rate environment.

On the expense side, we incurred $782,000 of acquisition expenses during the quarter, and $12.7 million year-to-date. After adjusting for these expenses, non-interest expense increased 26% for the quarter and 11% year-over-year. Adjusted compensation expense increased $1.9 million, or 25.5% for the quarter, and $2.8 million, or 9.6% for the year.

Our FTE count increased by 82 or 24% since 2017, many of which came from the UCB acquisition. We also added eight branches and a loan production office in the acquisition. These additions were mainly the cause for an increase in adjusted occupancy and equipment expense of $419,000, or 36.3% for the quarter, and $764,000, or 18% for the year. Adjusted professional fees increased $95,000, or 16.3% for the quarter, and $291,000, or 12.7% for the year.

We continue to be pleased with our loan production across our footprint. After adjusting for the addition of $299 million in net loans from UCB, our legacy loan portfolio grew $98.4 million, or at a rate of 8.4% for the year, or 12.4% annualized for the quarter. The majority of the growth came in owner-occupied commercial real estate, residential real estate, and real estate construction loan. Our pipeline for 2019 remains strong.

On the funding side, while our deposits increased $375 million since the beginning of the year, $475.9 million in deposits came to us from UCB. Our core deposits in our legacy markets were stable during 2018. We utilized some wholesale funding to supplement our liquidity. During 2018, we migrated from using primarily brokered deposits to overnight borrowings. As a result, our brokered deposits decreased $96.5 million. Each year we manage our wholesale funding in anticipation of the free funding we take in during the tax refund processing season.

While our asset quality remained strong, continued growth in our loan portfolio led us to record a $390,000 provision during the fourth quarter and $780,000 for the year.

Our asset quality metrics continue to be solid. Our non-performing loans were $9.1 million at year-end compared to $9.5 million at the end of 2017, which represents 0.48% of total assets. The ratio of our allowance for loan losses to loans was 0.88% at December 31, 2018 compared to 1.13% at December 31, 2017. Our allowance for loan losses to non-performing loans also increased to 149.67% at December 31, 2018 from 137.73% at the end of 2017.

These changes were primarily the result of adding $299 million in net loans from UCB, which included a credit mark of $4.6 million, or 1.4%. We continue to be disciplined in how we originate loans and believe this is reflected in our continued strong credit metrics.

While the integration of UCB into Civista is going well, we will continue our focus on integrating our new customers and employees from UCB to Civista as we move into 2019.

We remain confident in the benefit Civista shareholders will realize as a result of our UCB transaction. We have already experienced the impact of the efficiencies that come with greater scale.

As we have stated, UCB's low-cost core deposit relationships will provide funding for commercial lending across our entire footprint, and we are already leveraging our commercial lending expertise over what UCB's management had already started.

One of our more significant wins has been our ability to attract and establish wealth management professionals to our new region. Wealth management services are not something UCB was offering prior to the transaction. Since beginning to offer wealth services in November, we were able to book $49 million in assets under management in Lawrenceburg alone. This is just one example of how our combined organizations will create value for our shareholders, as we serve the new market.

While we remain focused on integrating our new customers and employees, our team continues to service customers throughout our footprint, and I believe our results are reflective of those efforts. We are pleased with another strong year, fueled by solid core earnings. We are confident our disciplined approach to managing Civista and our long-term focus on driving shareholder value will continue yielding positive results.

In closing, while the lending environment remains competitive, we are confident that our continued focus on relationships will allow Civista to grow both loans and deposits without relaxing our standards.

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] Nick Cucharale of Sandler O'Neill & Partners.

Nicholas Cucharale: So with one quarter, what might be your biggest quarter for the tax refund processing business, I'd like to start there. From a strategic perspective, what are your expectations for that business line, and how do they compare with years prior?

Richard Dutton: You know what, our -- Nick, this is Rich. Our expectations are right in line with what they've been for the last two years. If you look at that income in quarters 1 and quarters 2 last year, that would be a pretty good indicator of what they're going to be this year.

Nicholas Cucharale: Okay, great.

Dennis Shaffer: We're open to taking on a little bit more of that business, Nick. I think we've always tried to manage that as a percentage of our non-interest income that we generate and now being a larger organization we probably could -- if we could garner a little bit more of that business, it'd be something that we would consider.

Nicholas Cucharale: Okay, great. And then second, I'd like to move over to wealth management. I appreciate your comments there. I saw that AUM was up modestly quarter-to-quarter, even given the soft equity markets. Can you just talk about some of your broader initiatives there, just to expand, especially in light of your new UCB customer base?

Dennis Shaffer: Yes. I think first and foremost still is kind of that expansion into that new region of ours, and we're off to a great start there so I think we want to do that. We also want to kind of expand that into a little bit more presence into some of our more urban markets. Longer term, not in the near short term, but I think longer term our wealth manager would like to expand kind of the brokerage side of the business that we're selling in the retail branches. But we see that as an opportunity for us, particularly with all of the high net worth clients that we deal with on the commercial side. So we think that's an opportunity for us to continue to expand there.

Nicholas Cucharale: Okay, great. And then on the margin, a strong move up here in the quarter with some accretion income impact. Can you share with us how you're thinking about the NIM going forward?

Dennis Shaffer: Yes. I think -- well, if the rates stay flat, I think that the NIM is going to be relatively flat, maybe contract slightly. I think there is ongoing competitive pressure out there. So we see that either -- if we don't get any rate increases, that's staying flat or contracting slightly. I think if we get a rate increase or two maybe a little bit different story.

Nicholas Cucharale: Okay. And your comments are based off of the NIM on a core basis, right? That 416 core basis or are you thinking about it differently?

Dennis Shaffer: Yes. No, correct.

Nicholas Cucharale: Okay, great. And then lastly, what's your projection for the effective tax rate in 2019?

Richard Dutton: Nick, this is Rich. I think we ended the year with an effective rate of 16%, and that's probably a good number going forward for us.

Operator: [Operator Instructions] Michael Perito of KBW.

Michael Perito: Couple of questions from me. I was curious if you guys could give us an update -- apologize, I'm doing it a little off the cuff here, but I think if I remember correctly with the UCB transaction, you had said that -- I think it was about $180 million of invested securities that were coming over that really you guys thought would [indiscernible] [excess] liquidity profile the combined organization would need and that if you could redeploy that, I think it was every $6 million was an additional -- either $6 million or $10 million was an additional $0.01 of earnings accretion for the transaction I guess. I'm just curious if you could kind of update us on where that is and kind of -- because it seems like with the broker deposit runoff, there's a couple moving pieces on the balance sheet. So I was just curious if you guys can give us that update.

Richard Dutton: Yes. Mike, this is Rich. And really, we haven't used any of the security liquidity or liquidity from the security portfolio to fund loan growth. We've been able to do that just with the deposit funding that UCB brought to us. You remember, right when we did the transaction we repositioned the portfolio in a pretty significant transaction that picked up some yield there. But we haven't dipped into or had to dip into the secured liquidity from the security portfolio to fund loan growth, even though we've had some pretty decent loan growth.

Dennis Shaffer: And it was $6 million for every $0.01.

Michael Perito: So at this point, I mean is that still the right magnitude of the potential opportunity that we should be thinking about?

Dennis Shaffer: Yes, I think that's a possibility. We'll just keep evaluating as our loan demand's out there. I think that we should be able to continue to leverage that, but I think we will judge that by the loan growth that we have.

Michael Perito: And then can you maybe just give us -- now with the UCB deal closed -- maybe some of the top strategic priorities are for 2019 for you guys that we should be mindful of as you guys start the year here?

Dennis Shaffer: Well, I think first and foremost we do want to continue to grow. We continue to look for opportunities on the M&A side. There's nothing imminent right now, but it is something that I think we would want to continue to do. We want -- anything we look at, we want to be disciplined in that approach. Even though we closed the UCB transaction, as we've talked before, that integration is ongoing and to me that goes on. It doesn't stop after 4, 5, 6, 12 months. That's ongoing so we'll continue to look to try to grow from an M&A standpoint and organically. Some of the other initiatives that we have really going on for 2019 is really enhancing our customer experience and the way we do business and interact with our customers. I think that's critical for us. So right now we have a -- we're looking at the way we originate all of our commercial loans so we're looking at a way to do that a little bit more efficiently. So we're looking into that. We're looking into the way we open deposit accounts, both in branch and digitally. So we continue to look for things like that. But those are some of our main initiatives, is really continue to grow both through acquisition and organically. We think we have a lot of opportunity, even without an acquisition to grow, given the markets that we're in. So I think that's a top priority. Also, the second priority is really to improve that customer experience. And then finally, it's really investing in our people and investing in technology. We need to continue to do that and keep investing back into the company because we separate ourselves with that customer experience.

Operator: [Operator Instructions] Scott Beury of Boenning and Scattergood.

Scott Beury: So my first question was related to the cost savings. In terms of the overall cost savings from UCB, do you know how much was phased in, in this quarter?

Dennis Shaffer: That was in this quarter?

Scott Beury: Yes.

Dennis Shaffer: About $780,000 or so, about $800,000.

Richard Dutton: Just so I know, Scott, you're talking about cost savings or integration costs?

Scott Beury: I'm talking about cost savings, synergies.

Dennis Shaffer: Oh, cost savings. Okay, sorry about that.

Richard Dutton: I mean I think most of those were recognized over the weekend that we did the deal. We probably had a few more, not what I would call significant in the fourth quarter, Scott, but everything converted and all the change in controls paid out. There's really nothing significant in terms of cost saves left to squeeze out of it. Now we're just ramping up revenue, which is much more fun.

Scott Beury: Yes, exactly. So it kind of leads into my next question actually. In terms of the growth during the quarter, I know it's still early on, but I just wanted to get a sense of -- especially on the commercial side. Do you see any material component of that growth coming in the new UCB markets?

Charles Parcher: Oh we do. Scott, this is Chuck Parcher. We do see that. We're very excited to bring the Southeast Indiana-Cincinnati market in. We had a little bit of growth in that portfolio already in December and feel like we're going to have quite a bit of that going forward. Much like every other year since I've been here, the first quarter is always a little soft on the growth side. But our pipeline's sitting very similar to where we were coming into last year and feels like -- looking forward, we're still anticipating that mid to high single-digit loan growth going into '19.

Scott Beury: And then lastly, I just wanted to clarify. You said that in the quarter, in addition to the accretion income, the margin also benefited 10 bps from a recovery. Is that correct?

Richard Dutton: No, that was a year ago. So when we were trying to compare apples and apples, our fourth quarter '17 margin was inflated, for lack of a better term, by a recovery of a non-performing loan at the end of last year.

Scott Beury: I'm happy I clarified that.

Operator: [Operator Instructions] 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 want to thank everyone for listening in and thank those that participated on the call. Again, I am extremely pleased with our fourth quarter results and our 2018 results as a whole. We grew the size of the company both through acquisition and organically by 40% and increased core earnings, adjusted for acquisition expenses year-over-year by 63%. But what I'm most proud of, is the strong low-cost core deposit franchise that we have created here through our disciplined, relationship-building, pricing approach. We look forward to a prosperous 2019, and to talking to you again in a few months to share our first quarter results. Thank you for your time today.

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