[CIVB] - Civista Bancshares, Inc.
2019 Second Quarter Earnings Call
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Officers
Dennis Shaffer, President, CEO
Chuck Parcher, SVP, Chief Lending Officer
Rich Dutton, SVP, COO
Paul Stark, SVP

Analysts
Nick Cucharale, Sandler O'Neill & Partners
Michael Perito, KBW
Kevin Reevey, D.A. Davidson
Scott Beury, Boenning Scattergood

Presentation

Operator: Good afternoon, and welcome to the Civista Bancshares, Incorporated, 2019 Second Quarter Earnings Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference over to President and CEO, Dennis Shaffer. 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 Second Quarter 2019 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 would like to remind you that during today's call, including the question-and-answer period, you may hear forward-looking statements related to the future financial results and business operations for Civista Bancshares, Inc. Our actual results may differ materially from current management forecasts and projections as a result of factors over which the Company has no control.

Information on these risks and additional information on forward-looking statements are included in our news release and in the Company's reports on file with the Securities and Exchange Commission.

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

Again, welcome to Civista Bancshares second quarter 2019 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.

This morning, I'm very pleased to announce that we reported another quarter of strong core earnings with net income for the second quarter of 2019 of $8.5 million or $0.51 per diluted share and $18 million or $1.08 per diluted share for the 6 months ended June 30, 2019.

If we add back the $3.2 million in pretax, nonrecurring expenses related to our acquisition of United Community Bancorp that were included in the comparable periods for 2018, our diluted earnings per share would have been $0.44 for the quarter and $0.99 for the 6 months ended June 30, 2018, which means our 2019 diluted earnings per share would have increased by 15.9% for the quarter and 9.1% for the year-to-date.

Our return on average assets was 1.58% for the quarter and 1.65% year-to-date, while our return on average equity was 11.01% for the quarter and 11.98% year-to-date.

Our core earnings continue to be driven by our strong net interest income. Net interest income for the quarter was consistent with the linked quarter and increased 47.2% over the prior year. Our net interest margin remains very strong at 4.49% compared to 4.45% for the linked quarter and 4.47% year-to-date.

If we were to eliminate the impact of accretion from purchase accounting adjustments, which accounted for 25 basis points of margin in the second quarter and 23 basis points year-to-date, our margin still would've been a very respectable 4.24% for both the quarter and year-to-date, compared to 4.21% and 4.13% a year ago.

There has been a lot of discussion about the Federal Reserve possibly cutting rates. If the Fed does reduce rates, we do anticipate a slight decline in our margin, but we believe it will be minimal.

We increased noninterest income $714,000 for the quarter and $1.4 million for the first 6 months of 2019 compared to the same period last year. These increases are primarily due to increases in service charges and interchange fees as a result of the UCB merger. Comparing to the linked quarter is a bit more challenging due to the seasonality of our tax refund processing business. Removing the impact of the tax business, we increased noninterest income $470,000, with the largest increase being from gain on sale of loans.

We continue to be disciplined in controlling noninterest expense, which increased only 1.2% for the linked quarter and $8.1 million or 32.4% year-over-year, which we are pleased with, given that the acquisition of UCB increased our size by approximately 36%.

Our loan portfolio increased $25.6 million during the second quarter and $36.8 million year-to-date. That equates to an annualized growth rate of 6.5% for the quarter and 4.8% year-to-date. Our growth came in virtually every category except farm real estate and consumer loans.

Like most of the Midwest, we experienced a very wet spring that delayed construction projects and we had $65.1 million in loan payoffs during the first 6 months of 2019, both of which had a negative impact on our loan growth. That said, we had a very strong loan pipeline of $126.6 million in approved undrawn construction loans. We anticipate growing our portfolio at slightly above a mid-single-digit annual rate for 2019.

On the funding side, our deposits increased $52.8 million since the beginning of the year. This increase was primarily the result of a $28.5 million increase in noninterest-bearing demand, and an increase of $43 million in interest-bearing demand accounts. These increases were partially offset by a $19.3 million decline in broker deposits. We also reduced our wholesale funding by paying off $17.3 million of short-term FHLB advances.

Our asset quality remains strong, which translated into another quarter without the need to make a provision. Our nonperforming loans declined to $8.4 million from $9.9 million at the end of 2018, which represented 0.38% of total assets.

The ratio of allowance for loan losses to loans was 0.86% at June 30, 2019, compared to 0.88% at December 31, 2018. The allowance for loan losses to nonperforming loans increased to 164.69% at June 30, 2019 from 137.87% at the end of 2018.

We continue to be disciplined in how we originate loans and believe this is reflected in our continued strong credit metrics. We have been working diligently to implement the new CECL standard. With the recent FASB proposal to delay CECL, we believe we will qualify for the delay until 2023.

Again, we were pleased with another strong quarter fueled by solid core earnings, and are confident our disciplined approach to managing Civista and our long-term focus on driving shareholder value will continue to yield positive results.

In closing, while the lending and deposit environments remain 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'll 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 with Sandler O'Neill & Partners.

Nick Cucharale: So first, Dennis, I appreciate your commentary on the margin. Can you give us some color on deposit pricing in your markets? Have you seen some easing, or is it still as competitive as ever?

Dennis Shaffer: There has been some easing, I'd say. You still see some outliers. You can pick up the Cleveland Plain Dealer or the Columbus Dispatch, and you'll still see somebody advertising a 3% CD rate or a 2.75% money market rate. So you still see some outliers.

We tend to kind of ignore the outliers, really focus in on deepening relationships and we've stayed pretty disciplined on our pricing. We handle most pricing -- a lot of the public funds things, we're handling that on a one-off basis, but there is still a little bit. It's amazing to me to still see, given the fact there's all this talk about rate reduction, you're picking up the paper, the Sunday paper, and you're seeing rates like that.

Nick Cucharale: Okay, great. And then on expenses, just a modest rise this quarter. Do you expect the $16.6 million to be a good run rate going forward?

Dennis Shaffer: Yes, we do. There are still maybe a couple of open positions; we've always got open positions. But I think $16.6 million, $16.9 million is kind of what we're modeling for the balance of the year, Nick.

Nick Cucharale: Okay. That's helpful. And then lastly, guys, with your capital levels very strong, could you share with us how you're thinking about your priorities for capital deployment?

Dennis Shaffer: Sure. While we continue to position ourselves, we want to be a consolidator of choice. We feel leveraging our capital and acquisitions, similar to our most recent UCB transaction, provides us the best return to our shareholders at this point.

That said, we do have the stock repurchase plan in place and while we currently do that sort of as a defensive tool, should we continue to create capital at the rate we're creating it with our earnings, we might see a scenario where we get a little bit more aggressive in our efforts to repurchase shares. But predominantly right now, we still would like to be in the M&A game and be a consolidator of choice.

Nick Cucharale: Great. Thanks for taking my questions.

Operator: Michael Perito with KBW.

Michael Perito: I wanted to spend a little bit more time on the margin. As I think about your NIM on the way up, it's not like you guys were super-tied to LIBOR or anything. It was more -- at least as I recall -- more the favorable positioning of the balance sheet, the short-duration asset book, long-duration liability book. So when I think about your comments that the NIM should be modestly compressed, that's upfront, right? But as we move into what is potentially a more down rate environment, longer-term, how do you expect your margin to perform?

Rich Dutton: Well, I guess short-term, and I don't know what you're looking at long-term, but short-term I'm looking at the next quarter or maybe potentially the next 2 quarters with a 25 to 50-basis point decrease. I think it's going to contract, still minimally contract, less than 5 basis points. I think there are things that we can do.

We don't have a lot of CDs, so anything that we do, if we get a quarter percent reduction in our rate, we can reduce particularly some of the public fund stuff, some of the private banking stuff that we have out there, we can make reductions to that pretty quickly. We've already lowered kind of our CD forecast going out, but that doesn't -- that's what [new] we're putting on the books, but I think -- and put the quarter to a half percent. There are certain things that we can do. We've run some models and it shows less than a 5% -- I mean a 5-basis point change in the margin.

Rich Dutton: Mike, kind of the way we look at it, and I think it makes sense. If you kind of look at the way our margin behaved going up over the last 18 months or 2 years, I don't see those kind of cuts near term. But I think if we get a 25-basis cut (sic) here next week and maybe one more before the end of the year, I would think that our margin going back down would behave kind of like it did going up.

Really, we don't see huge movements. There will be compression, but again, like Dennis said, we don't see anything -- significant [is] the right word, but they're not going to be big movements in our margin.

Michael Perito: That's kind of what I was getting after; that's consistent with what I was thinking as well.

Dennis Shaffer: Mike, the new loans that we were putting on for April, May and June, our core portfolio on the lending side is 5.05%. We've been putting consistently new loans on above that rate, slightly above that rate, [5-0]. I think June was 5.08% and May was 5.06% and April was 5.20%. So they've been above what the portfolio, the loan portfolio, is so --

Chuck Parcher: Well, the other piece of that too is, Mike, when you look backwards -- this is Chuck -- the next part is a lot of the stuff that's rolling that was -- we put on the books at 3 and 5 years, they were done at rates similar to what they are today. So we're not seeing a decrease in the roll when some of those things roll from -- on a 5.05 or whatever, they're rolling relatively consistent to where they were when they were originally onset.

Michael Perito: Helpful. Thank you, guys. And then on the M&A front, it seems like -- I cover a few of your competitors in the area, and there's a lot of acquirers that -- sellers, unfortunately, seems to be a much shorter list. And obviously, when you see the -- you kind of moved over a little bit into next door. And I'm just curious, as you see your M&A pipeline, where are the majority of the opportunities?

More specifically, do you see yourself maybe broadening the footprint, maybe not jumping in new markets here and there, but just looking maybe less so in the core, or how -- where it seems like some of the sellers have been a bit stubborn to move, and maybe looking at other areas where there are other opportunities.

Dennis Shaffer: Yes, I'd say we've been pretty consistent defining that market in not only Ohio, but southern Michigan, south of Detroit, maybe we have to expand that slightly; Indiana, all up and down that border, there may be more opportunity in those markets. So we continue to have dialogue. We have seen a couple of opportunities, but they've been smaller deals that really didn't meet any of our metrics. So we've just passed on those deals.

Michael Perito: Okay. And then just lastly in the noninterest income side of things, can you just maybe give us a couple of remarks? I think the mortgage gain on sale that's a little better this quarter and the wealth was up year-on-year again. Just maybe some outlook thoughts on both those line items would be helpful.

Dennis Shaffer: Yes, I think the mortgage piece -- Chuck, you can chime in -- but I think that's been fairly consistent for us.

Chuck Parcher: Fairly consistent. We're still predominantly a sale provider, not a refinance provider. We have started to see a little bit of refinance business with this last kind of decrease in rates, but we're still probably -- well, not probably -- in that 78% purchase business, 78% to 80% usually on a monthly basis so --

But we're hoping that if rates do continue to fall a little bit, we might pick up a little bit more repurchase business there. But we've been consistent and we've had nice production across all our markets and actually, the bringing on of UCB has added to our mortgage quite a bit as well.

Dennis Shaffer: Yes, and the wealth side too, Mike, I think we'll continue to see a little bit of slight improvement there. Again, the UCB addition, we were successful in hiring a proven producer out of that market that was with one of the larger competitors. He's already moved over now $75 million in assets, so I think he'll continue to bring in some new business.

Where we really -- or I think I see uplift or where we can bring some penetration there is on the treasury management side. We've added two new treasury reps, both in Cleveland and Columbus. Those were areas we really were trying to cover with one guy. I think we're going to see some nice uptick there just because our lenders now have proven treasury professionals to take out on the calls with them. So I think you'll see a little bit of uptick there and in the private banking realm. As we deepen these relationships, our private bankers continue to bring in some nice deposits for us.

Michael Perito: Great. Helpful color, guys, thanks. Have a good weekend and see you next week.

Operator: (Operator Instructions). Kevin Reevey with D.A. Davidson.

Kevin Reevey: So I just wanted to follow-up on Mike Perito's question earlier. Rich, when you talked about the impact on your margin from a 25 and 50-basis point cut, you said it was a 5-basis point contraction. Is that from the second quarter to the third quarter, or was that from the -- is that a year-over-year comparison? I just wanted to get some clarity there. Thanks.

Rich Dutton: Yes, Kevin. No, and obviously, we need to make a little because what we did, we modeled. We said, okay, we follow the blue chip rate forecast and what they're telling us, the last time they issued one was that we can expect a 25-basis rate cut next week when they meet, and then another rate cut in December. We modeled that and we modeled that the impact through the balance of the year is something less than a 5-basis point contraction in our margin.

Kevin Reevey: So that's first -- second half versus first half of the year?

Rich Dutton: Yes, correct, yes.

Kevin Reevey: Got it. Okay. I just wanted to make sure that that I was hearing you correctly. And then how should we think about the tax rate going forward for the rest of the year?

Rich Dutton: So the effective rate that we had this quarter is probably more indicative of what you'll see the rest of the year. We have so much income in the first quarter, it kind of meets the impact of our tax preference items, if you will. So that kind of drives our effective rate up a little bit, but I think what we had this year -- and I'm trying to find my number in front of me -- but what --

Dennis Shaffer: 15, 15.1 [or so].

Rich Dutton: So 16% is probably a good effective tax rate for us.

Kevin Reevey: That's helpful. And then earlier in your comments, you mentioned a $126.6 million pipeline. Is that just commercial? Is that commercial and everything else? And is that what it is today or what it was going into the second quarter?

Chuck Parcher: Kevin, that $126.6 million is that we refer to is the availability on our construction portfolio at 6-30. So that would include both our commercial and our residential, on-the-books residential, availability on those lines to draw. Our total pipeline -- go ahead.

Kevin Reevey: Yes, and I'm sorry. How does that compare to what it was the comparable -- how does it compare to what it was the prior quarter at the end (inaudible)?

Chuck Parcher: I'll give you two numbers. At June -- at the same period last year, that number was $69.5 million, and at the beginning of the year, it was just roughly over $100 million. And I think that that number has ballooned up a little bit because of two reasons: obviously, one because of we've got some increased production from UCB, from bringing UCB on and the production we're getting down in that southeast Indiana-Cincinnati market.

And then the other reason I think it's so large, as you know, in Ohio, we had a very wet spring, and some of the construction projects are just behind where they would normally be at this time, which has caused that availability to drop. But we feel like we're really positioned well for growth in the second half because we have that excess availability on that portfolio right now.

Kevin Reevey: Excellent. Thank you very much. Have a good weekend.

Operator: (Operator Instructions). Scott Beury with Boenning and Scattergood.

Scott Beury: A couple of questions. So first on the NIM this quarter, you had 25 bps accretion in there from purchase accounting. I was wondering out of that 25 basis points, my back-of-the-envelope math says that's something like $1.2 million, $1.3 million. Out of that, how much of that is kind of scheduled accretion and how much was like prepayments? I'm kind of trying to think about the run rate of what to expect, the accretion impact would be going forward?

Rich Dutton: I'm not sure exactly, Scott. I know the first quarter, it was 23 bps I think, and in the second quarter, it was 25 bps, and something probably between 20 bps and 23 bps is probably a decent number for the rest of the year. I will find that number out and get it to you, I don't know.

Scott Beury: Excellent. And then in terms of the loan growth this quarter, you're really strong in most categories. You may have mentioned this, but was there anything specific driving the reduction in your non-owner occupied book?

Dennis Shaffer: Not really. There's nothing in particular that is driving that, to be honest with you. That's kind of (inaudible) came in this quarter.

Scott Beury: Okay. All right. And in terms of the growth on the positive side, what was the geographic breakdown of kind of where you saw the bulk of the growth?

Dennis Shaffer: I'd tell you it's across the board, but from a purely -- you said point to point. I'd say the two markets we grew the most were Cleveland and that Cincinnati-southeast Indiana marketplace. Columbus, we had a lot of production, but we're doing a lot of development lending down there, so as fast as we're putting it on, we're either -- it's either being taken out to the permanent market or it's being sold. So the two markets where we've got the most stickiness, I guess, from a balance perspective are Cleveland and that greater Cincinnati market.

Scott Beury: Okay, excellent. So yes, period end, more Cleveland and southeast Indiana. But looking at average balances, you're getting a good contribution from Columbus as well. It's a shorter (inaudible) --

Dennis Shaffer: From a production perspective, I don't have that number right front of me. But those three markets are very similar from a production perspective, just a little bit different mix in Columbus.

Scott Beury: Excellent. That's really helpful. And then just one more for me kind of higher level. I know this is a difficult area for you to talk about on a go-forward basis. But just kind of quarter-in, quarter-out with your growth, trying to be conservative on the provision line item, but you've had quite a long trend of coming in with zero provision. So with the stable to improving credit quality metrics in mind, realistically when do you expect a modest provision to kind of come into the P&L here with your growth expectations?

Chuck Parcher: Well, we keep modeling; we keep saying we're going to contribute each quarter. We've had some of our models built it out. It's designed as we grow to continue to put it in. We follow our A-triple-L model and so far, it's not allowed us to put anything in. There are some qualitative adjustments there that we we've tried to look at to see where we can tweak those. But again, I think from a coverage ratio of our nonperforming loans, we cover our nonperforming loans 165%, yes, 165% or so.

So Paul, do you have anything to add?

Paul Stark: Scott, this is Paul Stark. I think really, the biggest shift is improving asset quality kind of offset the growth in this quarter.

Chuck Parcher: Right.

Paul Stark: I think we continue to grow. I don't know how much better, how much stronger, we can get as far as the portfolio. But we've made a good run so far and we continue to work at it. So I don't know, I think the answer to your question is that we will look at it quarter-to-quarter and do what makes sense.

Operator: (Operator Instructions). Okay. If there are no further questions, I'd like to turn the call back over to Mr. Dennis Shaffer for closing remarks.

Dennis Shaffer: Thank you. So in closing, I just want to thank everyone for listening today and for those that participated in the call. Again, we are extremely pleased with our second quarter results and how we're integrating the UCB acquisition.

I'm also very proud of the production that we've had across all of our business lines, and in the strong low-cost core deposit franchise that we've created here with our disciplined relationship pricing approach.

We look forward to continued success for the balance of 2019, and to talking to you guys again in a few months as we share our third 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.