Civista Bancshares, Inc. [CIVB]
2019 Fourth-Quarter and Full-Year 2019Earnings Call
Friday, February 7, 2020, 1:00 PM ET

Company Participants:
Dennis Shaffer; President and Chief Executive Officer
Rich Dutton; Senior Vice President, Civista Bancshares, Inc. and Chief Operating Officer, Civista Bank
Chuck Parcher; Senior Vice President, Civista Bancshares, Inc. and Chief Lending Officer, Civista Bank

Analysts:
Michael Perito; Keefe, Bruyette & Woods Inc.
Nick Cucharale; Piper Sandler Companies
Kevin Swanson; Hovde Group LLC
Scott Beury; Boenning & Scattergood Inc.

Presentation:

Operator: Good day, and welcome to the Civista Bancshares Fourth-Quarter and Full-Year 2019 Earnings Conference Call. [Operator Instructions] Please note today's event is being recorded.

I would now like to turn the conference over to Dennis Shaffer, Civista Bancshares President and Chief Executive Officer. Please go ahead, sir.

Dennis Shaffer: Good afternoon. This is Dennis Shaffer, and I would like to thank you for joining us for our Fourth-Quarter and Full-Year 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 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 the 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 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 you may have.

I am very pleased to announce that this morning we reported record earnings for 2019. Our full-year results resulted in record net income of $33.2 million, or $2.01 per diluted share. Our fourth-quarter results were also very good, with net income of $7.7 million, or $0.47 per diluted share.

I would like to take a minute to discuss some of our accomplishments in 2019. We increased our loan portfolio 9.4%, or $147 million for the year, ending with $1.7 billion in loans. In addition to those loans that were added to the portfolio, we also sold $125.8 million of loans in the secondary market.

While the loan side of the house was very busy with new production, we were also very successful in the deposit area. Our deposits increased $98.9 million, or 6.3%. At the end of October we opened a full-service branch in Beachwood, Ohio, which is on the east side of Cleveland. We have had a loan production office in the area for a few years that has been very successful generating loans. This full-service office will allow us to serve all of the needs of our current customers in the Cleveland area, as well as prospective customers.

Also in October we announced that we would begin the process of redeeming our convertible preferred stock. The convertible preferred stock was in the money, in fact nearly tripling in value, so virtually all of our holders converted their preferred stock to common stock.

Speaking of capital management, during 2019 we had a stock repurchase plan of up to 472,000 shares of stock. We repurchased 188,200 shares at a weighted average price of $20.77. That repurchase plan expired in December and our board approved a new repurchase plan of up to 672,000 shares for 2020.

Getting back to our financial results, our full-year diluted earnings per share increased $0.16 compared to our adjusted 2018 results, which is an 8.6% increase. Our fourth-quarter results compared to adjusted 2018 earnings showed a slight decline. In the fourth quarter of 2019 our diluted earnings per share was $0.47, which is a decline of 3.8%. But that is primarily due to a December 2018 accrual adjustment we made to our wealth management income.

Our return on average assets was 1.37% for the quarter and 1.51% year to date, while our return on average equity was 9.44% for the quarter and 10.64% year to date.

The increase in our core earnings continues to be driven by our strong net interest income in what has been an interesting interest rate environment. Net interest income increased $477,000 for the fourth quarter and $19 million for the year. Interest income increased $814,000 for the fourth quarter and $24.4 million for the year.

Our average earning assets increased $162.2 million for the fourth quarter and $429.7 million for the year. The volatility in the interest rate environment tipped the scale on our average yields. For the fourth quarter our average yield decreased 3.6%, while for the year our average yield increased 5.5%.

Our interest expense increased $337,000 for the fourth quarter and $5.4 million for the year. These increases were due to both increased balances and a higher cost of funding. During the first half of 2019, funding costs rose to catch up with the increases the Fed put in place during 2018. Deposit costs have not decreased as quickly as the Fed moved in the last half of 2019.

Net interest income grew by 3.9% for the linked quarter and 28.7% year over year. Our net interest margin remained strong at 4.18% for the quarter and 4.31% for the year compared to 4.38% and 4.21% in 2018. Included in our 2019 margin are 14 basis points of accretion in the fourth quarter and 15 basis points of accretion for the year, compared to 22 and 6 basis points for the same periods in 2018.

All of the comparisons that I make to 2018 include the adjusted earnings for both the fourth-quarter and year-to-date periods. The non-GAAP tables on our earnings release have the full details of our adjusted earnings.

We were successful increasing our noninterest income in 2019. During the quarter noninterest income increased $762,000, or 15.7%, in comparison to the fourth quarter of 2018, and increased $3.9 million, or 21%, for the year, primarily due to our acquisition of UCB during the third quarter of 2018. For both periods we have seen an uptick in service charges and interchange fees from the addition of UCB.

Gain on sale of loans increased $620,000 for the quarter and $1.1 million for the year on strong mortgage activity. During the quarter Civista originated and sold $45.2 million of mortgage loans compared to $21.4 million in 2018. Year to date our mortgage loans sold totaled $125.8 million compared to $79.5 million in 2018.

The decline in wealth management fees during the quarter is attributable to a $245,000 accrual adjustment made during the fourth quarter of 2018. We continue to view wealth management as an opportunity to grow noninterest income and look forward to expanding these services into our new markets.

Controlling noninterest expense continues to be a priority. After adjusting for $782,000 of acquisition expenses incurred during the fourth quarter of 2018 and $12.7 million incurred during the entirety of 2018, noninterest expense increased $9.7 million for the quarter and 24.1% year over year.

A similar adjustment is necessary to draw a meaningful comparison of compensation expense, which included $172,000 and $5.2 million of acquisition-related expense. Adjusted compensation expense increased $601,000 for the quarter and $7.1 million for the year. This was attributable to an increase in FTEs and normal pay raises. Our FTE count increased by 75 to 445 compared to 2018, and was primarily attributable to the UCB acquisition.

The increase in net occupancy and equipment, again, is primarily due to the addition of 8 branches and a loan production office in the UCB transaction and the opening of our new Beachwood, Ohio branch. Conversely, the decrease in data processing expense was primarily due to conversion-related expenses of $260,000 for the quarter and $5.5 million for the year related to the UCB transaction in 2018. Professional services also decreased due to $139,000 and $1.6 million of expenses associated with the UCB transaction included in the fourth quarter and year to date during 2018.

Our efficiency ratio was 61.4% for the year compared to our adjusted efficiency ratio of 62.9% in 2018. Given our business model of operating as a community bank in rural communities and as a more boutique commercial bank in urban markets, we think of ourselves as a low-60s efficiency ratio.

We continue to be pleased with loan production across our footprint. Our loan portfolio grew $147 million, or 9.4% for the year and 14.5% annualized for the quarter. While the majority of the growth came in both owner- and nonowner-occupied commercial real estate, we had strong growth in virtually every category and across our footprint. We anticipate growing our loan portfolio at a mid-single-digit rate for 2020.

On the funding side, our deposits increased $98.9 million, or 6.3%, during the year, with $90.7 million of that growth coming in core deposit accounts. We are particularly pleased that $73.5 million of this growth was in business and municipal operating accounts. We added 2 treasury bankers to our staff early in 2019 and are beginning to see lift in deposit growth from new and existing business customers across our footprint.

On the wholesale funding side, FHLB advances increased $32.9 million to $226.5 million at year end. I'm sure many of you are wondering what impact CECL will have on our bank. We were fortunate to meet the guidelines for the delayed implementation of CECL and will not be required to adopt it until 2023.

While our asset quality remains strong, the growth in our loan portfolio led us to record an $885,000 provision during the fourth quarter and $1 million for the year. Our asset-quality metrics continue to be solid. Our nonperforming loans were $9.1 million, representing 0.39% of total assets at year end, compared to $9.9 million in 2018. The ratio of our allowance for loan losses to loans was 0.86% at December 31, 2019, compared to 0.88% at December 31, 2018. Our coverage of nonperforming loans increased to 161.95% at December 31, 2019, from 137.87% at the end of 2018.

As we look back on 2019, it was another very busy and extremely successful year for Civista. In a challenging interest rate environment we managed to organically grow our loan portfolio by 9.4%. We were also able to fund a large portion of that loan growth with core deposit funding, which grew at 6.3%. And we were able to do that while maintaining our margin at 4.31%.

We are pleased with a record 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. Looking forward into 2020, 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 will be happy to address any questions you may have.

Questions & Answers:

Operator: Thank you. [Operator Instructions] Today's first question comes from Michael Perito of KBW.

Michael Perito: I wanted to start on the loan growth outlook. A mid-single-digit outlook does seem a little conservative based on kind of the acceleration over the course of the year in loan growth. And I'm curious if that's a function of the setup with the funding of the balance sheet now, with the loan and deposit ratios stepping up towards -- right at 100% or so over the course of the year and now you guys are in a position where you want to fund loans dollar for dollar with deposit growth going forward and that kind of limits you a little bit on some of the net growth you can show. Or are there other facts that kind of lead you to maintaining that mid-single-digit guidance for next year after the strong end to 2019?

Chuck Parcher: Yes, Mike, I would say we're in that mid- to single-digit range just from a projection perspective. We're a little leery where the economy is exactly going to go here in 2020, with it being an election year. I'd say that mid to -- I would call it mid- to high-single-digit assumption is probably the right assumption for us. We did come into the year with a pretty healthy pipeline. We came into the year with a nice construction portfolio that still is available to be drawn. So we feel good about where we're at. We're just a little apprehensive about where the economy is going to go in the back half of the year.

Dennis Shaffer: We can continue, Mike, I think to be selective in the loan segment. We want to make sure we're getting the pricing and the structure of the loans. So I think that's why, given what Chuck said and being a little bit selective, is why we've targeted kind of that mid-single-digit loan growth.

Michael Perito: Okay, that's helpful. And on the deposit side, can you talk a little bit more about the cost of some of the growth that you are seeing and how you expect that to trend into 2020 here? Do you think there's room for funding costs to move down if you're growing it at a mid-single-digit pace? Or do you think it might move a little slower downward if you guys are growing the overall portfolio based on kind of the market pricing dynamics that you're seeing today?

Rich Dutton: Mike, this is Rich. Our funding costs have always been among the lowest in the peer group. There's not a whole lot of room for them to come down. They did come down I think 1 basis point linked quarter. That's where the compression on our margin comes from. I mean, again, I think that the treasury folks that we hired early in the year and their ability to attract business deposits, that's where our deposit growth for the most part is going to come from. I just think, again, we're seeing some pretty good momentum as it built toward the end of the year.

Chuck Parcher: Yes. And we continue to try and build out that treasury platform, Mike. And it's our goal to continue to try and bring in as many low-cost/core deposits as we possibly can.

Dennis Shaffer: Yes. And we had tremendous success in '19. I think we have that momentum that's going to carry over into 2020. I mean, that is a huge emphasis for us because we think we can continue to garner a little bit more of that relationship from some of those commercial clients.

Michael Perito: Helpful. And then one more, just on capital. I'm wondering, Dennis, is the kind of the conservatism on the economic outlook, does that carry into your M&A appetite as well as we think about your capital plans for this year? I guess -- well, we could start there. I have a couple follow-ups. But does that impact your willingness I guess to pursue M&A, given the conservative economic kind of thoughts you guys are having for the back half of 2020?

Dennis Shaffer: No, no. I actually think the interest rate environment is going to put a little bit of pressure on these net interest margins for some of these smaller banks. So if anything, I think that that environment is going to hopefully fuel some activity there. There's not been a ton in Ohio, other than the First Defiance and Home Savings deal. So I think that the outlook for the economy and with the interest rate environment is going to help that per se. And we, I think, being pretty well levered up, we want to try to find a bank that has -- ideally would have a lower loan-to-deposit ratio than us so that we can continue to put those funds to work.

Michael Perito: Okay. And actually I want to pivot a little back to my loan growth question, because you reminded me of a question I wanted to ask and I forgot. Also, is there room -- what kind of assumptions are you making, if any, around the First Defiance/United Community merger? I know it's just closed and conversion hasn't happened yet, so there might still be some time for a bunch of moving pieces to play out. And I know both franchises weren't very overlapped, but do you think in kind of the northern half of the State they'll be opportunities from any disruption? Or how are you guys viewing that and is that factored in at all to your loan growth budgeting for 2020?

Chuck Parcher: Michael, this is Chuck. We really haven't factored really any of that disruption into our loan growth assumptions. We haven't seen a lot of it yet. Quite frankly, I guess I'm looking at it more so from a perspective I think they'll probably be a little bit more competitive than a little bit less perspective just because they're going to have a little bit more sheer size. I don't know yet if there's -- we haven't seen any of it yet, as far as any employees being let go that would be somebody that we would like to target in addition to bring in and help generate loans from their portfolio. That hasn't taken place yet, but we'll probably know more at our next call next quarter.

Michael Perito: Okay. Well, thank you for taking my questions. As always, I appreciate it.

Operator: And our next question today comes from Nick Cucharale of Piper Sandler.

Nick Cucharale: With the tax business coming into focus in the first quarter, can you help us think through your expectations? Is it similar to prior years?

Rich Dutton: Yes, although I'll tell you that it's going to be a little less I think in the [indiscernible] [past]. Several years I think that the total revenue that we earned on that was $2.7 million. This year we expect it to be $2.4 million, with about $1.9 million happening in the first quarter. But it's not materially different and I think in terms of the funds flowing through they'll be pretty similar. But it is going to be a little less than what we've had the last 2 or 3 years.

Nick Cucharale: Okay. That's great. And did you happen to extend your agreement to future years? Or are --

Rich Dutton: We did happen to do that. And think it was around like -- we did that in December.

Dennis Shaffer: We added a year.

Rich Dutton: We added a year so [that will be three seasons].

Nick Cucharale: Okay. That's great. And then just building on the loan growth outlook here, as far as segments are concerned are you expecting similar trends with commercial real estate leading the way? Or is the focus on greater diversification in 2020?

Chuck Parcher: Well I think, Mike -- it's Chuck. I think we'll keep it hopefully at the same kind of trajectory with commercial and commercial real estate. Our goal is to help augment, or I guess keep that at the same growth pace, but maybe grow our C&I a little bit quicker as far as from a trajectory perspective. We did hire a new person to run retail. And I would like to see us do a little more consumer lending, too, here going into 2020 as compared to what we've done in the past. But I would tell you as you're modeling I would think that commercial real estate will still lead the way as far as from a total volume perspective.

Nick Cucharale: That's great color. Thanks for taking my questions.

Operator: And our next question today comes from Kevin Swanson of The Hovde Group.

Kevin Swanson: Most of my questions are answered. Appreciate the color. But maybe just thinking about the expense space, obviously it was up a little bit but not all that surprising, given the strong production in mortgage and loans. But how do we kind of think about the expenses going forward I guess in kind of conjunction with the mid-single-digit loan growth outlook for 2020? Thanks.

Dennis Shaffer: Rich, you want to tackle that?

Rich Dutton: I think you're right on in terms of the growth of the commission expense because of the increased loan demand. I think what we're looking at in the first quarter for next year is -- again, we've got the increase in the payroll taxes, the FICA piece of it. I guess it's the FICA piece, [indiscernible] piece of it. Anyway, that first quarter is always bigger. And then health insurance. And I don't know if you've been on the calls before, but we always kind of -- we're self-insured until we take and expense what the underwriters tell us that we ought to, what we should expect. But I would tell you that more years than not as the year progresses we end up reducing that expense as we see the actual expense coming through. So to say it's front-end loaded is probably not the wrong way to look at it. I think we're looking at a run rate -- run rate's not the right term, but for the first quarter I think -- and I've got the number here in front of me and I can't find it. What did we say it was going to be, Todd, for the first quarter? Let me flip one page. I've got $17.6 million is what we've got for noninterest expense for the first quarter.

Dennis Shaffer: Yes, 17.6.

Kevin Swanson: Okay. And then maybe just one follow-up on the tax business. Was there something specific that drove kind of the difference between '19 and the expectation for '20? I guess now with couple weeks past the [HUD] testing, just curious if there's anything that you're seeing in the market.

Rich Dutton: No, there's nothing that we're seeing in the market. It's just -- again, our partner, [Key PG,] who is owned by Green Dot, they've got their own bank and it was just kind of a load shift. I think part of one of the bigger producers, they shipped a little bit more of that business to them and we got a little bit more of the kind of smaller RT originators. I think it was just kind of a load shift I suppose is the best way to look at it.

Kevin Swanson: Great. Thanks. Appreciate it.

Operator: And our next question today comes from Scott Beury from Boenning & Scattergood.

Scott Beury: I just wanted to kind of touch on a few things. First off, on the loan yield, kind of looking at where new loans are coming on, and I obviously can respect that this is dependent on mix and product type. But looking at the yield in the portfolio today and where new yields are coming on, do you have any thoughts on kind of the directional trend line you expect for the overall loan yields in the portfolio? I think stripping out the accretion my math says that you were down about 15 basis points or so this quarter.

Dennis Shaffer: That's correct.

Chuck Parcher: And loan yields have definitely fallen back in the fourth quarter. And it's stabilized a touch here as we started new originations in 2020. But we still feel that there's going to be some downward pressure looking forward. I don't know that I've got a great number for you today, Scott. But we're definitely probably off a few tics from where we were last year.

Dennis Shaffer: Yes. The fourth quarter would have had the full impact of the 3 interest rate reductions. So even though some of them happened midyear and some of them later in that third quarter, the fourth quarter had the full impact, which I think impacted that 15 basis points that you saw. So that's -- but the loans are definitely going on at a lower rate than what we were putting them on the first quarter of 2019.

Scott Beury: So would it be fair to say that we could expect maybe not quite the same reduction that you experienced this quarter with the flat interest rate environment, but maybe some directional drip downward through the year --

Dennis Shaffer: Yes.

Scott Beury: -- [just based] on new originations?

Rich Dutton: We think that's pretty accurate [indiscernible].

Dennis Shaffer: And we think that will be not as great in the first quarter I think as it might be later in the year, because we've got all the tax program income coming in that first quarter, or the majority of it coming in that first quarter.

Rich Dutton: From a margin perspective.

Dennis Shaffer: From a margin perspective. Right.

Scott Beury: Excellent. That's very helpful. And then, a few other questions from me. First off, on the tax rate I know you have some lumpiness usually kind of through the year. But the tax rate was a bit low for me in the fourth quarter. Is kind of a 14% to 15% range a good rate to use for 2020?

Rich Dutton: 15% would be a -- a 14% or 15%, pick. I'd pick 15% if I were you.

Scott Beury: Okay. Thank you. And then lastly, from a little bit of a broader perspective, I know that you're still actively exploring M&A opportunities. Just wanted to kind of follow up on that. And looking at the earnings power of the Company right now, and your capital ratios, just kind of wanted to get a sense of any thoughts you might have on the buyback and particularly any thoughts you might have on the decision to not be more active with that in the fourth quarter.

Dennis Shaffer: Yes. I think, given that we're growing our capital and we're earning and growing our capital the way we are, we did increase the authorization of the buyback going in here to the first quarter. And without an M&A transaction imminent I think that we'd probably be a little bit more aggressive with the buybacks. We think that's a good way to deploy some of our capital.

Scott Beury: Excellent. No, that was helpful. Well, that answers all my questions and thanks for taking the time.

Operator: And this concludes our question-and-answer session. I'd like to turn the conference back over to Mr. Shaffer for any final remarks.

Dennis Shaffer: Thank you. I do want to thank everyone for listening today and for those that participated on the call. Again, we are extremely pleased with our fourth-quarter and 2019 results and are very proud of the production across all of our business lines and of the strong, low-cost core deposit franchise that we have created through our disciplined relationship pricing approach. We look forward to a prosperous 2020 and to talking to you again in a few months to share our first-quarter results. Thank you for your time today.

Operator: Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.