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PRESENTATION

Operator

Hello. Thank you for standing by, and welcome to the Simmons First National Corporation Second Quarter Earnings Call and Webcast. (Operator Instructions) Please be advised that today's conference may be recorded. (Operator Instructions) I would now like to hand the conference over to your speaker today. Ed Bilek, please go ahead.

Edward J. Bilek - *Simmons First National Corporation - Executive VP & Director of IR*

Good morning, and thank you for joining our second quarter earnings call. My name is Ed Bilek, and I serve as Director of Investor Relations at Simmons First National Corporation. Joining me today are George Makris, Chairman and Chief Executive Officer; Bob Fehlman, President and Chief Operating Officer; Jay Brogdon, Chief Financial Officer and Treasurer; Steve Massanelli, Chief Administrative Officer; Matt Reddin, Chief Banking Officer; and David Garner, Chief Accounting Officer.

The purpose of our call is to discuss the information and data provided by the company and its quarterly earnings release issued this morning and to discuss the company's outlook for the remainder of 2021. We will begin with prepared comments, followed by a Q&A session. We have invited institutional investors and analysts from the equity firms that provide research on the company to participate in the Q&A session. (Operator Instructions). Recording of today's call, including our prepared remarks and the Q&A session, will be posted on our website, simmonsbank.com, under the Investor Relations page for at least 60 days.

During today's call, we will make forward-looking statements about our future plans, goals, expectations, estimates, projections and outlook. I remind you that you should not place undue reliance on any forward-looking statement as actual results could differ materially from those projected in or implied by the forward-looking statements due to a variety of factors. Additional information concerning some of these factors is contained in the company's SEC filings, including, without limitation, the description of certain risk factors contained in the company's Form 10-K for the year ended December 31, 2020, and the forward-looking information section of the company's earnings release issued this morning. The company assumes no obligation to update or revise any forward-looking statements or other information.

Finally, in this presentation, we will discuss certain non-GAAP financial metrics we believe provide useful information to investors. Please note that the additional disclosures regarding non-GAAP metrics, including the reconciliations of these non-GAAP metrics to GAAP, are contained in the company's earnings press release and second quarter investor presentation, which are included as exhibits to the company's current report filed this morning with the SEC on Form 8-K and available on the Investor Relations page of the company's website, simmonsbank.com. I will now turn the call over to George Makris.

George A. Makris - *Simmons First National Corporation - Chairman & CEO*

Thanks, Ed, and welcome once again to our second quarter 2021 earnings call. Overall, we're very pleased with our results for the quarter as we delivered solid performance in multiple areas while continuing to navigate the challenging environment.

Net income for the quarter was $74.9 million, up $16.1 million or 27% compared to the second quarter a year ago. Diluted earnings per share were $0.69, up 28% from the year ago quarter. Core earnings for the quarter, which excludes certain noncore items were $75.4 million or $0.69 on a per share basis. In terms of key performance metrics, return on average assets was 1.3%, return on average common equity was 10.1%, and return on tangible common equity was 17.3%.

Net interest income for the quarter totaled $146.5 million, flat versus first quarter 2021 levels as we were able to offset a 10 basis point decrease in our percent net interest margin by holding loan yields steady, continuing to actively manage deposit costs and reinvesting excess cash into variable rate short-term securities. As a result of these actions, core net interest income, which excludes accretion, increased 1% on a linked-quarter basis. Noninterest income totaled $47.9 million for the second quarter. Core noninterest income was $47.5 million, up 6% on a linked quarter basis.

Expenses were well contained as total interest -- noninterest expense, both on a reported basis and on a core basis, were up 1% from first quarter 2021 levels. Our efficiency ratio was 56.9%, an improvement of 50 basis points on a linked quarter basis.

Credit quality trends over the past 3 quarters continued to show marked improvement as certain concerns during the pandemic failed to materialize. Nonperforming loans totaled $80.9 million, down $34.6 million from first quarter 2021. In addition, during the quarter, we reported net recoveries of 7 basis points. These positive trends, combined with improved economic modeling scenarios, resulted in a recapture of provision expense in the quarter totaling $13 million. At the same time, our allowance-to-loan ratio ended the quarter at 2%, up 7 basis points on a linked quarter basis, and our nonperforming loan coverage ratio stood at 281%.

With respect to the balance sheet, total assets ended the quarter at $23.4 billion. Total loans were $11.4 billion and total deposits were $18.3 billion. While the extensive stimulus programs provided to support those in need of assistance, high levels of liquidity also creates a challenge to the financial services industry in terms of loan growth, and we have not been immune. Total loan production during the first half of 2021 totaled $1.8 billion, putting us on place to significantly exceed loan origination volume reported for the full year of 2020. While we would normally expect higher loan production volume to translate into an increase in total loans, that has not occurred as we continue to experience a higher-than-normal level of paydowns.

On a positive note, our commercial loan pipeline rose for the third consecutive quarter to $1.3 billion, and deposit generation continues to be strong as total deposits increased $1.3 billion during the first half of 2021.

Our capital remains very strong. Total risk-based capital was 17.5%, CET1 was 14.2%, and the leverage ratio was 9%. Given this strong position, our Board of Directors increased the authorization of, and extended the time line for our stock repurchase program, thus increasing our remaining capacity under the program to approximately $150 million. On our website at simmonsbank.com, we shared an extensive presentation, along with the press release and financial data, which gives much more detail regarding our quarterly results and other important information about our company.

Finally, the second quarter also marked a return of M&A activity as we announced agreements to acquire 2 Tennessee-based financial institutions, Landmark Community Bank and Triumph Bancshares, Inc. Both of these organizations are successful local community banking groups who share our philosophy of a strong credit culture, significant community involvement and a passion for delivering excellent customer service.

In addition to the cultural synergies, these acquisitions highly complement our existing footprint in Tennessee and enhance our scale in 2 of our key growth markets, Memphis and Nashville, while creating the ninth largest bank in Tennessee. We're on target to complete these acquisitions during the fourth quarter, subject, of course, to satisfaction of closing conditions, including receipt of regulatory approval, and we look forward to welcoming these associates and customers to Simmons.

While we're encouraged by our performance during the first half of 2021, we also recognize the backdrop of economic uncertainty as we navigate the second half of the year. As such, our focus remains on executing basic blocking and tackling fundamentals, taking care of our clients and meeting the needs of the communities we serve. Our strategic plan has a number of initiatives designed to help us finish the year on a high note while placing us in a position to continue to grow our bank in the future.

Given the investments we have made to transform our company, coupled with the discipline and strong culture we have in place, we're confident in our ability to implement these initiatives while adapting to the ever-changing landscape. This concludes our prepared comments. I will now turn the line over to our operator and invite questions from our analysts and institutional investors.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Stephen Scouten with Piper Sandler.

Stephen Kendall Scouten - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

So if I could start maybe with loan growth. Obviously, that continues to be under pressure. And I'm wondering if you could give us -- kind of frame that up a little bit in terms of paydowns quarter-over-quarter. I know you show in the one waterfall chart, the year-to-date paydowns. But I'm wondering what that was quarter-over-quarter and what sort of visibility you have in the paydown levels moving forward?

Matthew Steven Reddin - *Simmons First National Corporation - Executive VP & Chief Banking Officer*

Steve, this is Matt. Really good question. We saw a slightly higher amount of payoffs in the second quarter versus the first quarter. And so as we think about what that looks like moving forward, we do feel that is slowing, and we're already starting to see that in the first month of the year. But our challenge is some of the still planned exits. I mean we're still planning to exit energy. That's another $150 million that we think we'll exit, especially in the current environment. So we have those headwinds that we see coming.

But the planned payoffs in CRE that we have talked about many times seems to be slowing, but there are still some headwinds that -- and honestly, with this uncertain environment and stimulus, there's -- it continues to happen. I mean we thought it would slow in the second quarter, but we're still seeing it. I think it's going to slow in the third and fourth, but it's still out there.

Stephen Kendall Scouten - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Okay. And Matt, do you happen to have a number of, like a ballpark of the amount of loans that are renewing over the next year?

Matthew Steven Reddin - *Simmons First National Corporation - Executive VP & Chief Banking Officer*

Well, I don't have that exact number, Stephen. But our duration now is at 3.8 years overall. And so that can give you an idea of the velocity of the overall churn in the portfolio.

Stephen Kendall Scouten - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Yes, definitely. Okay, great. And then if I could think about the share repurchase for a minute, when are you guys able to repurchase loans with the pending deals? Could you remind me of that? And how aggressive would you anticipate being with that between kind of now and October?

Matthew Steven Reddin - *Simmons First National Corporation - Executive VP & Chief Banking Officer*

Stephen, yes, we -- this last quarter, we were locked out of share repurchase due to the pending acquisitions coming in. So we're 3 days out from when we can start buying back. And we think it's a good opportunity, and we really want to look for good opportunities over the next balance of the year. We believe we'll be pretty active in it going forward as our plan right now.

Stephen Kendall Scouten - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Okay, great. And maybe last thing for me. I wanted to get some incremental detail on your coin checking product and just kind of how long that's, I guess, been in play for your customer base, what you're seeing so far, kind of what the feedback has been. Because I feel like that's a little bit ahead of the curve for a bank of your size, so I think that's a pretty interesting pursuit.

George A. Makris - *Simmons First National Corporation - Chairman & CEO*

Stephen, this is George. So I'll tackle that. As you know, our Chief Digital Officer, Alex Carriles, is top-notch and well-known in the community, and I think you have seen him on American Banker and other opportunities to talk about our coin checking product. It has taken us almost a year to develop that product, with the layers of fraud protection that we felt like we needed. There are actually 3 different fraud protection systems that go into that product to make it so easy for a consumer to use that. .

We piloted the program in Arkansas, and we have rolled it out in all the states where we do business in the last 60 days. And I will tell you, the acceptance has been extraordinary. The ultimate result of all of that will be that all of our customers, whether they're online or whether they come into a branch, are going to have a much better account-opening experience than they have ever had before.

As you know, it only takes a couple of pieces of information in 5 minutes to open an account. And I can still remember, when I used to open my accounts, it was a half a day process. So we believe that we really have a state-of-the-art product. We think it's going to attract new consumers to Simmons Bank. And when you take a look at how we have built our brand and with the consumer groups that we've got relationships with today and some that we're working on. So we have PGA sponsorship. We're associated with Fort Worth Stock Show in rodeo. We've got tremendous access to several colleges in our footprint. So we really are focused on the new consumer group coming to Simmons Bank, and we believe that our coin checking product is a basis for that success.

Operator

Your next question comes from Brady Gailey with KBW.

Brady Matthew Gailey - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

So I just want to start on the bond book. I know you guys have been talking about growing that, and that's exactly what we saw this quarter. Maybe talk about any thoughts on continuing to grow the bond book from here. I think if you look at it on an average point of view, you'll still see some bond growth in the third quarter just as kind of a catch-up. But you're at about $7.5 billion at the end of the quarter. So maybe just talk about your appetite to continue to grow that bond book, especially as we've seen the long end of the curve pull back.

Robert A. Fehlman - *Simmons First National Corporation - President & COO*

Yes. And Brady, first thing I'd point out is if you look at the bond book, we have about $1.3 billion that is in floaters, variable rates. That really is our money we've moved from cash that we are making 10 basis points and picked up to about a 35 basis point yield. So that is really variable. We can move it back if we need it for liquidity. It could move into the bond portfolio permanent when we need to. So we'll continue to look at that piece.

So the way we are looking, and if you look at Slide 23 in our deck, that $1.3 billion is very fluid on the bond side, but it's also fluid on the cash side. That's where we're managing both of those pieces. .

I would say, going forward, we'll continue to look for opportunities. I don't think you'll have this dramatic effect, obviously, going into Q3 and Q4, but we could have some pickup that would be more on opportunistic buys. We continue to manage our bond portfolio, just like we have the last couple of years, and look for opportunities to sell. As you saw, we had an opportunity to sell another $40 million worth of securities, pick up $5 million in gains, and it's just hard to pass up 3 to 4 years of earnings on that. And it does hurt your bond yield a little bit, but it's just tough to pass that up. We will continue to do that each quarter as we go through just looking for good opportunities as we have dips in the 10-year or pickups, either way, to reinvest.

So again, I would say we're at $7.3 million, I would look for that number to increase even into Q3. Some of that will be in the floaters and a little bit will be into select other buckets.

Brady Matthew Gailey - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. All right. That's helpful. And then the $17.2 million of remaining PPP fees, any idea as far as the timing of when those will be realized? Do you think that most of those will be realized in the back half of this year, or does some slip into 2022?

Robert A. Fehlman - *Simmons First National Corporation - President & COO*

Well, I would say it's hard to tell when you're dealing with anything with the government on repayments, and the rules always change. But we would expect Q3 to be a pretty heavy quarter, I believe, and some will go into Q4. There will be some stragglers into next year, and it's just really timing should be small volume -- dollars. We might have a lot of volume that we're dealing with, but on the dollar side, it would be pretty small. I would just tell you, look at that Phase 2, $319 million, and we're down to about $300 million. So that's -- that is -- you're starting to see those payoffs and that really just happened in June. So we believe that will hit more into Q3.

George A. Makris - *Simmons First National Corporation - Chairman & CEO*

We have just started seeing government for giving us on loans in excess of $2 million. So they have been sitting on the books waiting for the government to do something about that since we made them last year. So as those start rolling off, you're going to see large volume decreases in our PPP portfolio.

Brady Matthew Gailey - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. And then just to revisit the loan growth or loan shrinkage topic, I mean it has been pretty surprising. I mean I think your non-PPP loans are down about $3.5 billion today versus the end of '19. When do you believe that you'll be at the inflection point of starting to see loan growth again?

Matthew Steven Reddin - *Simmons First National Corporation - Executive VP & Chief Banking Officer*

Brady, this is Matt. I would say what we're encouraged by is our production trends. If you just look at -- we stated, we did $1.8 billion in production in the first half of the year. But if you dig a little deeper, over 60% to 70% came in the second quarter. So if you look at that plus the trend in the pipeline, I really like where we're heading, trending on a production standpoint.

We hope the inflection point will happen this year if we can just understand the velocity of the continued liquidity in the market. And I feel good about where the known headwinds are. I mean we're now talking -- I'm now speaking to energy at an additional $150 million. It wasn't -- 18 months ago, that was $400 million. So the planned CRE exits, they're at the tail end of that. So I feel that we're there. The unknown was this additional liquidity and stimulus in the market on repayment. But back to production, like the trend, like where we're taking that pipeline. So I think that will continue to grow throughout the back half of the year.

Operator

Your next question comes from Matt Olney with Stephens.

Matthew Covington Olney - *Stephens Inc., Research Division - MD*

I want to ask about the bank's interest rate sensitivity and how you're managing this. It seems like there's lots of moving parts we're seeing with the securities bill this quarter, but also 2 pending acquisitions. And as we get into 2022 and 2023, with hopefully an eventual Fed funds increase, what's the bank's sensitivity to higher rates?

Robert A. Fehlman - *Simmons First National Corporation - President & COO*

Well, I think first off, if you look at the loan book, it's about roughly 50-50, maybe 55-45 on variable versus fixed. A lot of the fixed is shorter term. I think, Matt, on the duration, we're probably 3, 3.5 years or so overall. I would say, on the book bond portfolio, there's obviously some extension in there on some of the munis. But a lot of those munis have decent prices. We do have the $1.3 billion in floaters that we can either reinvest or will move up when the market moves up. And on the -- even with the potential on rates moving at some point, we do believe on the deposit side, we have another 4 to 5 basis points in the next quarter or 2 that will pick up there before we bottom out.

So I would say, right now, we're pretty evenly matched when you look at all the different components that get down underneath. So we're preparing as much as we can at this point. But again, I would tell you, on interest rates, it's still unknown out there. This week, all of a sudden, today, they're talking maybe they'll go back up, but the 10 years down. About 2 weeks ago, rates were going back down, where 10-year might be going to 1%. It just seems like every week, we have a different narrative on where rates are going and a different narrative on where inflation is going. So it's kind of hard to judge right now. All we can try and do is manage the best portfolio we can and manage net interest income in this artificial environment we're in.

Matthew Covington Olney - *Stephens Inc., Research Division - MD*

Okay. That's helpful, Bob. And then I guess kind of a similar topic as far as core loan yields, if I back out some of the PPP and the accretion, I'm showing not much of a move versus the first quarter. Any color you can provide as far as directionally where you expect these core loan yields to move from here?

Robert A. Fehlman - *Simmons First National Corporation - President & COO*

Yes. I would say, yes, we're pretty pleased this quarter to have our core yield actually pick up a basis point or 2. No question, that's a challenge in this environment, as the book -- as loans we're putting on are averaging right at that 4% to 4.25%, so a little bit below what we're on. Now keep in mind, some of the loans that are paying off that Matt talked about earlier on the early payoffs were some of our acquired loans that were at pretty low rates. So you're actually -- that's where you're picking up some of that accretion on the volume there. But we're -- again, it's a constant process on trying to manage that, and it's going to be a challenge to maintain at those levels continue to go forward. But our goal is to keep it in that line or drop just slightly.

Matthew Covington Olney - *Stephens Inc., Research Division - MD*

Okay. Got it. And then lastly for me, provision expense for loan losses was negative this quarter. You're still carrying an ACL ratio around 2%. Would love to hear kind of your view of the incremental provision expense from here?

George A. Makris - *Simmons First National Corporation - Chairman & CEO*

Well, Matt, this is George. So our -- the credit quality today is better than it has been in a long time. And I think we have some charts in our presentation that show that. And you scratch your head and go, then, why do you need 2% allowance against the loan portfolio. And we gave a little additional color on hotels, office and retail. And while we feel very good about our hotel portfolio and where it stands with regard to coming back, we see in our office portfolio and our retail portfolio, some potential delayed deterioration, if you will. And the reason is that 73% of the leases in our office portfolio don't renew until 2023 or after. A higher percentage, 78% of the retail lease expirations occur in 2023 or after.

So right now, they're performing really, really well. And quite honestly, I feel good about that because we're going to have time to analyze what's happening in those 2 sectors over the next couple of years before it really affects our portfolio. So there's still some unknown risk out there. And I don't need to really remind everyone about the uptick in COVID today and whether or not we're going to get back to in-person school, whether we're going to be able to fill those supply chains that have caused artificial inflation because of the supply and demand factor. If we can get those things back to normal, we'll be in pretty good shape.

Operator

(Operator Instructions) Our next question comes from Gary Tenner with D.A. Davidson.

Gary Peter Tenner - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

I think you sort of addressed this question in answering one of Matt's. But in terms of the time deposits, could you kind of talk about the scheduled maturities for the back half of the year and what the prevailing rates are and your renewal rate on those time deposits?

Robert A. Fehlman - *Simmons First National Corporation - President & COO*

Yes, I would say we've got roughly about $800 million. I think the balance of the year, the rate is over -- right over 1%. Those are going on anywhere from 20 to 40 basis points, depending on the relationship, somewhere in that ballpark. So I would tell you, Gary, if you look at that plus the transaction deposits that we've continued to look at individual markets and price down, I think overall, there is a good 4 to 5 basis point pickup from third, maybe a little bit into the fourth quarter, but really over the next quarter or so.

Gary Peter Tenner - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

My other questions were answered.

Robert A. Fehlman - *Simmons First National Corporation - President & COO*

All right. Thank you.

Operator

And I'm not showing any further questions at this time. I would now like to turn the call back over to George Makris for any further remarks.

George A. Makris - *Simmons First National Corporation - Chairman & CEO*

Great. Thank you. Well, notwithstanding the pressure on our loan portfolio and some unexpected paydowns, I will remind everyone that much of what's happened with regard to that loan portfolio shrinkage was intentional with regard to the sale of our Colorado, South Texas locations, intentional elimination of concentrations of credit in St. Louis and DFW and a reduction in our energy portfolio. .

But on a positive note, our asset quality has improved tremendously during that period of time. We've been able to manage a significant securities portfolio. We've been able our mortgage and wealth business, and that continues to expand. We're going to add Triumph and Landmark to our portfolio in Memphis and Nashville before the end of the year. We've just hired a new leader of business and consumer banking that held that position at Regions Bank out of Birmingham.

And once again, if we can manage through the COVID surge, get schools back in person, get the health care system back to taking care of the deferred medical care, if we can get supply chains filled and stem the inflationary pressure, and if we can encourage folks to get vaccinated to protect themselves or families and others, I think we're on the back side of what we experienced in 2020. I think the diversity of the way we operate our bank has shown to be a real plus for Simmons. We made $75 million this quarter. That's nothing to sneeze at.

So we're very encouraged by the outlook. We see our loan pipeline increasing, meaning that we have some very good customers, who see some potential out in the marketplace today, and we're going to be there to help them. So thank you very much for joining us today. And if we don't talk before then, we'll do this again 3 months from now. Have a great day.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.