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PRESENTATION

Operator

Good day, and welcome to the Simmons First National Corporation Second Quarter 2023 Earnings Conference Call. (Operator Instructions) Please note this event is being recorded. I would now like to turn the conference over to Ed Bilek. Please go ahead.

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

Good morning, and welcome to Simmons First National Corporation Second Quarter 2023 Earnings Call. Joining me today are several members of our executive management team, including our Executive Chairman, George Makris; CEO, Bob Fehlman; and President and CFO, Jay Brogdon.

Before we begin the Q&A, I would like to remind you that our second quarter earnings materials, including the release and presentation deck are available on our website at simmonsbank.com under the Investor Relations tab. During today's call, we will make forward-looking statements about our future plans, goals, expectations, estimates, projections and outlook, including, among others, our outlook regarding future economic conditions, interest rates, lending and deposit activity, credit quality, liquidity and net interest margin. These statements involve risks and uncertainties, and you should, therefore, not place undue reliance on any forward-looking statement as actual results could differ materially from those expressed in or implied by the forward-looking statements due to a variety of factors.

Additional information concerning some of these factors is contained in our earnings release and investor presentation furnished with our Form 8-K today, our most recent Form 10-Q and our Form 10-K for the year ended December 31, 2022, including the risk factors contained in that Form 10-K. These forward-looking statements speak only as of the date they are made, and Simmons 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. Additional disclosures regarding non-GAAP metrics, including the reconciliations of these non-GAAP metrics to GAAP are contained in our earnings release and investor presentation which are included as exhibits to the Form 8-K we filed this morning with the SEC and are also available on the Investor Relations page of our website, simmonsbank.com.

Operator, we are ready to begin the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Brady Gailey with KBW.

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

I wanted to start with the net interest margin, which took a step down here, which is kind of in line with what we're seeing from a lot of your peers. How do you think about the net interest margin as we look towards the back half of this year?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

So Brady, this is Jay. I'll jump in on that with a few initial comments to your question. The biggest driver to margin and kind of the trend there so far has really been more around migration within the deposit portfolio than it has been around rate, if you will. And we've seen in June, in the back half of the quarter here and really kind of holding our head so far into July sort of a slowing down of that migration. And so I think that sort of encourages me from -- as I think about NIM and inflection in NIM looking forward.

I'll tell you this June NIM, the pace of the pressure on NIM was quite a bit lower in June than it has been really in any of the earlier months of the first half of the year this year. So that, too, is kind of holding its head a bit here in July. So I think there's still some near-term pressure in Q3. The significance of that pressure is not nearly as significant as again, as it has been in the first half of the year. That might mean an inflection in the back half of the year more like in Q4. And then keep in mind, too, that in Q4 you also have the benefit of the swap that will kick-in in late September. So I'll have to say, Q3 likely a little bit of pressure from what we see in Q2. Q4, hopefully, we see that inflecting at some point even in the underlying trends. And then you have the benefit of the swap as well on top of that.

Robert A. Fehlman - *Simmons First National Corporation - CEO*

And Brady, I'd just add too, is, obviously, all banks have experienced a pretty big increase in cost of deposits. One of the things we're not afraid of is to defend our market share in a lot of our markets that we have a very good market presence, and we don't want to give up that market share in those deposits. So we're willing to defend those and pay up for some of those. And we did that in this quarter in some select markets that it was really critical.

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

All right. And then you guys have made some good progress in taking some expenses out of your infrastructure. I know you're targeting a reduction of $15 million by the end of the year, which I think you guys will hit. Once you get beyond that, are you happy with the expense base? Or do you think you'll continue to look for opportunities to become more efficient?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Yes. Definitely, we'll continue to look for opportunities there, Brady. I think there are -- in fact, I know there are more opportunities beyond that. The one thing we'll be measured and deliberate just like we were on this initial round, the Better Bank Initiative. We talked about it for a few quarters, really kind of wanted to make sure we had our pencils sharpened around kind of the net cost save number. And we'll do the same thing if there's another round of this.

But as we look into next year, while I do think there are incremental opportunities on the expense side, I think there will also be some opportunities just sort of on the investment side, and we'll be opportunistic in making those investments where we need to and where we feel like there are opportunities. So more to come on that as we kind of round out the analysis to those opportunities and feel good about talking about the numbers.

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

All right. And then finally for me, you repurchased about 1% of the company in the second quarter. Is there any reason to think that, that would slow? Or do you think that you'll continue to consider the buyback in the back half of the year?

Robert A. Fehlman - *Simmons First National Corporation - CEO*

Brady, I'd say, first off, we really took advantage of our pricing for us and all bank stocks in the early part of the quarter when most banks were trending near tangible book values, very accretive to buyback at that point. Bought back $20 million in this quarter. We'll continue to look at it on a quarter-by-quarter basis based on what the market condition is and what our capital needs are. The one constraint, I would say in there is we would stay within -- if we did stock buyback, it would be within our earnings less our cash dividends would be the maximum amount. So we think that's a very prudent way with where our balance sheet and growth is projected.

Operator

Our next question comes from David Feaster with Raymond James.

David Pipkin Feaster - *Raymond James & Associates, Inc., Research Division - VP & Research Analyst*

Maybe just touching on the loan yield side, just the loan growth side. And look, it's nice to see the growth. Obviously, construction fundings have been a key driver of it. When we look at the pipeline slowing as we would expect. But I mean you're really doing a great job pushing new loan yields. I'm just curious, could you touch on from your perspective, what are you hearing from your clients? How is demand trending across your footprint? And maybe just where are you still able to get good risk-adjusted returns at this point? And just what's your appetite for loan growth?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Yes. So David, a lot of questions in there kind of in a roundabout way. So let me try to tackle several different elements of that topic. I do think -- I've said this on past calls and in past meetings, I think it still continues to be true that the rate environment, just the overall environment right now has caused a fair amount of demand destruction. And we continue to see that. I think that, that anywhere where our pricing discipline is showing up, which I think that's pretty well across the board at this point and has been.

And our underwriting continues to be very, very sound as it has been all the way through the cycle. And so when we kind of couple our underwriting standards and our pricing standards together, the volume that we are seeing come into the pipeline, we feel is very, very good relationship-oriented business with very good borrowers and very sound structure. And that's kind of what our appetite is right now.

I will tell you that really in the second quarter, the last month or 2, one kind of positive sign potentially in terms of pipeline trends because the pipeline trends been down and we've been forecasting that, can really continue to expect pipeline trends to kind of be an area where they are right now. But one kind of positive sign is we are seeing some borrowers, some customers that we deal with and have dealt with in the past, very strong relationships, who are it seems more willing to put a little more cash and equity in the deals. And with more equity in the projects that they're looking at and with our underwriting and with strong pricing, I think that's an indicator of kind of the lack of financing opportunities that are out there.

And so we'll continue to look at those and be opportunistic where we can be, again, with very close relationships. But I think that the trend you've seen in a little bit of slowing loan growth but still good growth is a trend overall that I continue to expect. Paydowns are going to be low, and I don't expect that to change. Unfunded commitments, we'll continue to see good fund ups on those over the next few quarters. Pipeline, probably going to level off here in the area that it's in, but hopefully, we can continue to see some good opportunities with good borrowers.

David Pipkin Feaster - *Raymond James & Associates, Inc., Research Division - VP & Research Analyst*

Are there any markets or segments where maybe you're seeing more opportunity and that you think you can gain share just because you are open for business still?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

There's nothing that really jumps out that I think is worth pointing to. You saw growth for us this quarter that was pretty balanced and across the board. And I think that, that still -- there's still the right way to think about it for us going forward. One area I will call out that we continue to have a lot of momentum in and be excited about, it's just the [agri] area. We've seen some really good growth and opportunities. We've got some great talent in our bank in that area, a long history in it. But that's not a huge portfolio for us. That's the one area I'd call out. But I think our focus continues to be diversified and really across the portfolio.

David Pipkin Feaster - *Raymond James & Associates, Inc., Research Division - VP & Research Analyst*

And you mentioned in the presentation that we're expecting fee revenue growth to slow. I know this has been a big push for you all for some time, and it's great to see growth you've generated in part from this Better Bank Initiative. I'm just curious maybe some of the trends you're seeing in the underlying big businesses? Where you see opportunity on the fee side going forward, cross-selling across business lines across the franchise? And just -- any other thoughts on the fee revenue side?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Yes. Well, I will say in the lines of business that we think about out there, whether it's wealth, mortgage, et cetera, I think there's still a lot of opportunity for us. I was pleased to see an uptick this quarter on the revenue side from mortgage with recent rates, that's probably going to be a little more of a challenge in Q3, but I think we'll still continue to do well there. We've got a lot of opportunities to grow in both of those areas, in particular, just by continuing to better penetrate some of the markets that we've acquired into over the past several years. And so that's certainly current and intermediate-term objective and opportunity for us.

I think where we continue to really evaluate the fee side is just overall kind of banking services, deposit charges, et cetera, where the market environment continues to get increasingly competitive in a lot of different ways. And so that's something that we'll continue to evaluate and ensure to Bob's earlier point that we're going to protect and defend in our markets and especially in markets where we have great market share. And so that's the work that we're doing now.

Operator

The next question comes from Matt Olney with Stephens.

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

I want to go back to the funding strategy that was discussed. I appreciate Jay's commentary about deposit migration trends stabilizing in recent weeks. Any more color on just the funding strategy that you executed in the second quarter? It looks like you leaned a little more heavily on the borrowings in the first part of the quarter. Would love to just appreciate the strategy as you move into the back half of the year, and any kind of changes? And then second part of that is, with Bob's comments about just any market share in certain cases. Should we read into that, that the deposit betas are going to be moving higher in the third quarter as compared to 2Q?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Thanks, Matt. Well, I'd say that first and foremost, just on the funding strategy side, really throughout the quarter, I think we were just opportunistic where we needed anything, whether it was anything in the wholesale markets. There were a lot of ebbs and flows, especially coming out of timelines back in March and the things that happened there within our industry, where we were able to just be opportunistic. That meant at times leaning more into borrowings versus brokered CDs. So I think we'll continue to just kind of evaluate those markets as we need to rely on them.

Generally speaking, I think the strategy going forward, as we've talked about, is more along those lines of balance sheet optimization and needing to rely less on that type of funding. And that should bear out as growth slows here a little bit. We went from double-digit loan growth for the last several quarters to still good single-digit growth here. But I think we're getting back to a place where sort of our inherent balance sheet cash flows can hopefully fund the majority of our loan growth and therefore, lean less into any type of wholesale borrowing. So that would be the bigger part of, I think, the strategy going forward.

The one may be nuance or 2 in there this quarter, we coming out of March and the early quarter, we definitely kept a little bit higher cash balances early in the quarter than what was necessary. You might even think back to sort of debt ceiling talks that were going on in the quarter. So there were some things about the macro environment in Q2 that we felt it was just prudent to take a pretty cautious tone around liquidity and what we were keeping on the balance sheet. So those were maybe just again, some nuances for the quarter to think about.

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

And just following up on that, Jay, any comments or thoughts on betas in the third quarter as it relates to what we saw in 2Q?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Yes. I think -- yes. Sorry, I missed that piece of the question. Yes, on the deposit beta front, I think similar to the comments on overall NIM, I think there -- we'll still -- I don't think betas have sort of stopped here. There's still overall pressure really from the competitive environment on deposits that I think will continue and will continue to drive some movement in betas. But again, I hope -- I think the larger part of the beta move has been volume, if you will, more than rate. It's been that migration in and out of lower-cost deposits. I'm hopeful several weeks is not enough to really call the full trend yet, but I am optimistic in what we're seeing there and what I'm hearing from others as well. So if the volume piece or the migration piece does, in fact, slow while there will be some continued pressure, I think, on both NIM and on deposit betas, that's a related pressure there. I do believe that, that -- the significance of that trend seems to be slowing down here.

Robert A. Fehlman - *Simmons First National Corporation - CEO*

And Matt, just one other I would point out on NIM is we did have our sub-debt that repriced from fixed to floating in the quarter. That was a couple of million dollar negative impact to our net interest income. That's a one-time reset there. It may go up a little bit with the next move, but not at the same level it did in this quarter. That's a good call out. Yes.

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

If I remember correctly, I think 2Q got the full impact of that reset.

Robert A. Fehlman - *Simmons First National Corporation - CEO*

That was April 1.

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Yes, every bit of it. .

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

Okay. Perfect. And then, I guess, switching over to the loan repricing opportunities. I think that your debt called out a little over $1 billion of principal maturities over the next year at a lower rate. I would love to know just general thoughts about the repricing opportunities within that? And kind of what the directives are to your production staff about where you're targeting some of those repricing levels?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Yes. I think what you see in terms of trends in our pipeline would be a similar -- that kind of trajectory is where we would expect repricing to be happening on renewals there and even higher because that pipeline is built up over time as rates continue to move. Current-day pricing in that pipeline is higher than sort of the full pipeline itself. So I think our renewal opportunities are pretty significant here on that $1 billion or $1.1 billion that we call out in the deck.

And Matt, the other thing I'd throw in there that we're really focused on is enhancing those relationships at those renewal opportunities. So where we have renewals and opportunity to bring in an operating account or additional deposits or additional fee business back to a question that was asked earlier in the call, we think these are really good opportunities. There's just not a lot of credit availability in the marketplace today for our customers. And so we're trying to take full advantage of that to really enhance and grow our relationship even beyond just the pricing, the loan yield piece of that equation. We think there's a lot of other opportunity at every renewal date.

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

Okay. I appreciate that. And then, I guess, just lastly for me, I think the construction loan balances continue to migrate higher. I think you disclosed you're at 99% on the C&D kind of threshold measurements. We'd love just to appreciate kind of thoughts around those levels, and could that act as a [governor] on the buyback? Or would you be willing to move over that 100% guideline for a quarter or 2? Just any kind of thoughts on that level?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Yes, Matt, I'll jump in on that one, too. It's certainly not our strategy to operate at above 100% for sustained periods of time. At the same time, we've got a lot of expertise in those areas of production and within our business. We're not afraid to go over 100% for a period of time. But I don't think you'd see us just sort of sustained operating above those levels. It's really just going to be a function of time, stabilization rate on those projects, et cetera.

Operator

The next question comes from Gary Tenner with D.A. Davidson.

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

A couple of follow-up questions. I guess on the deposit side, unless I missed it in the deck, and I apologize if I did, but could you give us the June 30 interest-bearing spot rate just as sort of a jumping-off point into the third quarter?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

I don't think we've got that in there. Yes, I don't have that right off hand here, Gary. I'll get back to you with that, Gary.

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

All right. And then in terms of the commentary about the service charges, I don't recall you all making announcements about reductions in service charges or anything along those lines. And I know last quarter, you guided to fee income in the 43 to 45 range, which you were at the top end this quarter. Does that range still hold even with some pressure on service charges? Or is there a larger delta there potentially?

Robert A. Fehlman - *Simmons First National Corporation - CEO*

Well, I'll just start off on the service charges on all of our service charges, whether it's on deposits, whether it's in wealth or investments, we continue to look at that every quarter to see where we are in the market and where we need to adjust for profitability. We talked about our service charges in the Q4 of last year and still have not made any changes. We still evaluate it on a month-by-month basis. So don't have any plans to announce today. But on a go-forward basis, Jay, you may want to comment on the overall because we did have a couple adjustments this quarter.

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Well, I think you're right. We've commented historically that low to mid-40s is kind of where we expect overall fees to be on a quarterly run rate. We've been at the top end of that range, really kind of exceeded that range in my mind for a couple of quarters in a row here. That's consisted in the last couple of quarters of some fair value adjustments and a legal reserve reversal last quarter, et cetera. So I still think that low to mid-40s range is a good range for us here. Depending on actions that we might need to take from a competitive dynamic point of view on the deposit service side, might put me more toward the bottom, the middle of that range, whereas we've been hitting the top end of that range for a couple of quarters here.

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

Okay. I just want to make sure I didn't miss any announcements about reductions in deposit service charge side. So I appreciate the color. And then the discount accretion for the quarter or the purchase accounting adjustments for the quarter, could you give us what that number was?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

I think we have that in here.

George A. Makris - *Simmons First National Corporation - Executive Chairman*

It's on Page 17.

James M. Brogdon - *Simmons First National Corporation - President & CFO*

17 remains. That's what remains. About $3 million for the quarter, a little over $17 million left.

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

Okay. Yes, I know you flagged kind of the delta versus the first quarter. I just want to make sure I have the number accurately. And then last for me. In terms of the fair value hedges on the securities portfolio, we got a hike this week, then they're even more in the money. Just -- you've talked in the past about the potential to unwind part or all, and I think you kind of note that in the slide deck. Just overall thoughts on that. Is the working plan to keep them in place? Or how are you evaluating that?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Well, that's -- we continue to evaluate those hedges as well as any other opportunities, hedging rates candidly in either direction. So that's just a continuous exercise for us. I don't think there's anything in sort of what I would call immediate plans to unwind that hedge right now. But it is absolutely something that will continue to monitor. And to your point, we would expect those to be further in the money even as soon as tomorrow.

Operator

There's one more question here, Stephen Scouten, Piper Sandler.

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

Guys, I was just curious on the progress of the $15 million, how much of that in expense saves -- annualized expense saves was already in the run rate? Or if that $15 million would kind of be incremental to levels today?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

No, Stephen, I still think that we made progress this quarter, very good progress. I feel like -- I don't -- I'm not sure that we had any of our initiatives fully achieved in the quarter from a full kind of 90-day period, if you will. We'll certainly have full benefit of some of those initiatives here in the third quarter. There are other things underway that we'll have partial benefit here and full benefit in Q4. So I think we'll continue to chip away at that. The guidance that we've given is to sort of be able to fully hit that number net in Q4, and have that kind of out of the run rate as we go into next year, still feel very good about our ability to meet that. Hope to even exceed that number by a little bit as we kind of turn the year next year.

And as we mentioned earlier in the call, we hope there's more and expect there are more opportunities beyond that, but we also believe there will be some opportunities for us to make some investments, whether that's talent acquisition or otherwise that will further enhance our business, enhance our growth profile, enhance our scalability. So we'll be balanced as to how we think about that net cost save expectation moving beyond this first $15 million, and we'll continue to inform you all of our progress around that as we move forward.

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

Okay. Great. That's really good. And then just last thing for me. I'm curious how you think about kind of average earning asset growth from here. It sounds like working down some of the borrowings and maybe loan growth in the low mid-single digits. If I heard your answer to Brady's question appropriately, maybe a couple more basis points of NIM compression in the third quarter. So just how do you think about the direction of the balance sheet and average earning assets? And with that compression on the NIM, what do you think the path is for overall NII dollars for the rest of this year?

James M. Brogdon - *Simmons First National Corporation - President & CFO*

Yes. Well, I think that speaking to the growth piece of it, Stephen, as we've said now for several quarters, the strategy more than anything is balance sheet optimization. So it's remixing the earning assets kind of day in and day out, every month, every quarter that we move through. We're having success with that. I think we continue to have success with that as we move forward. Certainly expect to be able to rely less kind of on wholesale funding as that continues as well. And that should be pretty attractive for us from a NIM point of view as we kind of move out from there. Absolute dollars (inaudible), I don't have a great guide for you there that I want to be that specific with. But I think that as we remix the balance sheet, you think about earning asset mix, kind of risk-weighted asset density, I think there's a good opportunity for us to grow NII as we move forward.

Operator

This concludes our question-and-answer session. I would like to turn the conference over to George Makris for any closing remarks.

George A. Makris - *Simmons First National Corporation - Executive Chairman*

Thank you very much, and I appreciate all of you joining us today. I think what you are seeing at Simmons is what you should have expected based on the history of our company, and that is a conservative, diverse markets, product and risk profile, and that's playing out well in today's market. We're certainly committed to our community banking philosophy and relationship banking. And fortunately for us in some of the markets that we entered through acquisition, that customer base is starting to really understand who Simmons is and what our philosophy is and the meaning of relationship banking. I think our pause in M&A in deference to our Better Bank Initiative is certainly timely and will be very beneficial in the long term. We appreciate you joining us today, and we look forward to doing this again 3 months from now. Have a great day.

Operator

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