AMERICAN BANKER®
THE FINANCIAL SERVICES DAILY
Thursday, December 2, 2010

COMMUNITY BANKER OF THE YEAR: THE NICHE PLAYER

By Kate Davidson

Spotting Unusual Opportunities

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2010 BEST IN BANKING

When George Gleason took his family to the island of St. Bart's for Thanksgiving in 2007, he told his wife it would be the last vacation they would take for a while.

At **Bank of the Ozarks** in Little Rock, Ark., which Gleason bought in 1979, the chief executive was having similar conversations with his management team, as he worried about what he saw as a potential economic downturn.

"I said that there were going to be challenges and that there were going to be commensurate opportunities, and if we really stayed focused, that we would find enough opportunities to more than offset the challenges and do very well," he said. "And that really has been the way it's played out."

The $2.9 billion-asset company – which has 90 offices in seven states, stretching from Texas to North Carolina – had already begun to go on the defensive in 2006 when Gleason noticed a gradual uptick in problem loans in two high-growth counties in northwest Arkansas. He also saw that Bank of the Ozarks was losing large volumes of "exception bucket" real estate loans to competitors, with terms outside guidelines set by the Federal Financial Institutions Examination Council. In fact, they were taking on more loans than those banks had the capital to make, under regulatory standards.

So Gleason established a policy of unloading Bank of the Ozarks' exception bucket. He also tightened lending standards and pushed for more cash equity in new construction loans.

Those actions, of course, meant that Bank of the Ozarks missed literally thousands of opportunities. But by the time other banks realized that they needed to hunker down to survive, Gleason had already built up the bank's defenses, and was finding innovative and unusual opportunities for growth.

In 2008, Bank of the Ozarks bought $320 million worth of municipal auction-rate securities when those markets seized up. And in 2009, it purchased $350 million of tax-exempt municipal housing authority bonds, many at about 70 cents on the dollar.

Those investments made millions for the company and helped it build up a whopping capital account. And even as Bank of the Ozarks struggled with problems in its construction and development portfolio, there was more than enough to offset those losses.

It also provided Bank of the Ozarks with enough capital to acquire three failed banks, in South Carolina, Florida and Georgia, this year, and plenty of room to do more acquisitions.

For finding opportunities that few others did, and capitalizing on them to generate record profits that positioned Bank of the Ozarks for growth during the downturn, George Gleason is one of *American Banker*'s community bankers of the year for 2010.

He has come a long way since his first day on the job.

When Gleason bought the bank, he was 25 years old. "A hazardously young age," the 57-year-old says now.

Yet Gleason was experienced beyond his years. His parents owned several small businesses, including a hardware store and feed mill, and his father started training him at 5 years old to take over the business someday. By 12 he was running the books, and by 14 he was filing their tax returns.

In the eighth grade, he developed an estate plan to create a family trust. It was four pages long. (The trust exists today, and has grown from $72,000 to more than $35 million.)

His three older sisters were valedictorians of their high school classes, and nothing less was expected of Gleason. After graduating at the top of his high school class, he earned a bachelor's degree in economics from Hendrix College in two years – the only person to do it so quickly – and was the second youngest graduate from the University of Arkansas at Fayetteville Law School.

After not even two years as a securities and transactions lawyer, he decided he wanted to be on the other side of the table. Some colleagues suggested he buy a bank, and agreed to lend him $3.6 million to do so.

Gleason put down just $10,000 in cash, which he had saved from trading cattle as a teenager. The bank – then called Bank of Ozark – had $28 million of assets and three branches. After closing the deal at midnight, he arrived at 7:30 the next morning and delivered a rousing speech to his 28 employees about how he planned to make the little bank one of the best performers in the state.

"Of course, none of them believed me because they all knew I was a kid and all knew that I had never worked at a bank," he said.

But by 8:30, employees were lined up outside his office, asking what they should do about a particular problem credit or loan request.

"It occurred to me as these people would come in the office that each of them probably knew more about banking than I did," he said. "So I would listen to them pose the question and I would then say, 'Well, I want you to tell me what you think we ought to do, and why you think that's the right solution.' "

They would come to a consensus together, Gleason said.

Even today, with 30 years of knowledge and experience in banking, Gleason "still runs the company to a large degree that way," said Mark Ross, Bank of the Ozarks' president and vice chairman, who started there as a loan officer in 1980. "He wants it to be a collaborative effort on decision-making."

For example, Gleason personally manages the company's 30-days-past-due loan list, reviewing each problem credit with its lender once a month. He discovers the root of the problem, what efforts have been taken to resolve it and how the lender plans to proceed.

It's a habit he picked up after Bank of the Ozarks suffered big losses during the banking crisis in the late 1980s.

Today, with the recent failed-bank acquisitions, a job that used to take one or two days a month now consumes about half of Gleason's time. Yet it's one of the last duties he will delegate, he said.

"It lets me know every problem point in the portfolio," Gleason said. "It really is an invaluable, intimate knowledge of the whole credit culture of our company."

Those who know Gleason best say he has an unflinching discipline and an uncanny ability to spot risks. As such, the bank's risk-rating practices have been much more aggressive than its peers, analysts say. "Over the years, he's not made too many mistakes," said Peyton Green, an analyst with Sterne, Agee & Leach. "And if he has, he's not generally repeated them."

In 2004 – well before signs of stress – Gleason decided to expand Bank of the Ozarks' risk classifications beyond regulatory guidelines, and designated certain kinds of loans as substandard. The bank began aggressively building loan-loss reserves, and conducting impairment analysis not just on problem credits, but on performing loans, too.

"I'll be quite honest with you, I thought at the time ... that we were being way too aggressive," said C.E. Dougan, president of the bank's western division. "Obviously that proved not to be the case. And how he knew that, I can't tell you."

That isn't to say Bank of the Ozarks hasn't stumbled during the downturn. It suffered losses in its construction and development portfolio, which makes up nearly one-third of total loans, and analysts still question whether that concentration is too high.

Gleason said Bank of the Ozarks has kept losses to a minimum by having pushed for more cash equity in transactions starting in 2005, when real estate prices started to drop. The average cash equity in those loans is now 35%, and the average appraisal equity is closer to 43%.

Gleason said Bank of the Ozarks' underwriting standards are much higher than its rivals. The key metric: looking for builders with the same commitment to efficiency as the bank, whose efficiency ratio was 39% at Sept. 30.

"You can go to the work sites of a lot of the builders that we finance and you can look at the Dumpsters where the surplus materials are thrown to be carted off," Gleason said. "And you can go to the Dumpsters at another work site, and our guy's Dumpster is a fourth full and the other guy's Dumpster is brimming over."

On the liability side, Bank of the Ozarks started diversifying its de-

posit mix in early 2008, reducing brokered deposits from 16.4% of total deposits to 2.3% at June 30. It also launched a "ground war" for retail deposits, and brought on thousands of new customers. The efforts helped boost its net interest margin to 4.77% at June 30, from 3.61% at the end of 2007.

Yet perhaps the most important opportunities it pursued were investments in the municipal bond sector. In 2008, the auction-rate securities market was frozen, and municipal securities were available for sale at extraordinary rates – the Denver Airport Authority at 18% and the Port Authority of New York at 21%, for instance. "It was fairly clear to us that there was inherent value in those investments, and that they were not going to go bad," Gleason said.

Later that year, Bank of the Ozarks began buying municipal housing authority bonds Gleason said were "horrendously mispriced," some as low as 70 cents on the dollar, when they should have been 90 cents. By late 2009, prices had normalized and the company liquidated the investments, making millions in spread income.

That enabled it to move to the next phase – acquisitions. Bank of the Ozarks received $75 million from the Troubled Asset Relief Program in December 2008, a decision Gleason said was the toughest of his career, and one from which he abstained during the board vote. As public sentiment turned against the program, the company decided to pay back the money without using it to purchase failed banks.

"It was a very expensive source of capital, as it turned out, and in retrospect it was a mistake to take it," Gleason said.

Bank of the Ozarks exited the program in November 2009 without raising additional capital. Within five months, it had won a bid to acquire Unity National Bank in Cartersville, Ga., with assistance from the **Federal Deposit Insurance Corp.** It picked up the failed Woodlands Bank in Bluffton, S.C., on July 16, and Horizon Bank in Bradenton, Fla., on Sept. 10. Before this year, Gleason's bank had made just three acquisitions, and its expansion had been through de novo branching. For much of the past decade, quality franchises were trading at premiums higher than what Gleason thought they were worth.

Yet acquiring a failed bank with a loss-share agreement was too good an opportunity to pass up, he said.

As with his own lenders, Gleason spends the Sunday after an acquisition going through each and every loan at the new bank, said Randy Dennis, the president of DD&F Consulting, who advised Bank of the Ozarks on its failed-bank acquisitions.

"When a bank fails, the people who are in that bank, they like a leader," Dennis said. "They do like somebody who can let them be a banker again, go forward, and that's what George wants to do. He wants to build franchises and grow, and he has a track record of doing it."

While the franchises are fixer-uppers, they've made strategic sense, doubling the number of states in which Bank of the Ozarks has a presence. After taxes and acquisition and conversion costs, the gains from the acquisitions have contributed $14.7 million to net income this year.

"It's kind of like the old Dire Straits song – 'I want my MTV, money for nothing and your chicks for free,' " Gleason joked. "It's kind of like you get paid money to take their problem loans and you get the franchise for free."

The bank has a team of about 20 people conducting due diligence on potential failures, and has bid on more than 30 transactions in the past year. And it hopes to pick up plenty more. Yet it has not set a specific asset-size goal in the past, and won't today.

"Our goal every day – and the goal that runs our company organically – is to make every good-quality, good-yielding loan we can make, consistent with safe, sound and prudent banking practices," Gleason said. "And that's been our stated goal for 20 years."

BANK of the OZARKS®

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