Bank OZK

Transcript of the Fourth Quarter 2021 Conference Call

January 21, 2022, 10:00 am

Note: Administrative communications of the operator and other greetings and social exchanges of no substantial import have been omitted from this transcript.

Good morning, I am Tim Hicks, Chief Credit & Administrative Officer for Bank OZK. Thank you for joining our call this morning and participating in our question and answer session. In today's Q&A session, we may make forward-looking statements about our expectations, estimates, and outlook for the future. Please refer to our earnings release, management comments and other public filings for more information on the various factors and risks that may cause actual results or outcomes to vary from those projected in, or implied by, such forward-looking statements.

Joining me on the call to take your questions are:

- George Gleason, Chairman and CEO;
- Brannon Hamblen, President;
- Greg McKinney, Chief Financial Officer; and
- Cindy Wolfe, Chief Banking Officer.

We will now open up the lines for your questions. Let me now ask our operator to remind our listeners how to cue in for questions.

Catherine Mealor - *Keefe, Bruyette, & Woods, Inc*

I just thought we'd start with the margin and the level of minimum interest and other fees that we saw this quarter. I appreciate all the detail you gave about it in the management comments, but just trying to think about how we think about this next year. If you're saying that paydowns are going to be elevated until next year, is this a level of accelerated fees that we could still see into next year? Or is there really anything kind of one-time or temporary in the nature of what we saw this quarter?

George Gleason

Good question. And the answer is yes, no and all of the above. I think we had an exceptionally high level of minimum interest and fees on short-term renewals and extensions this quarter, that in the previous 3 quarters had been about $6 million a quarter, which is a pretty healthy rate itself, and jumped up to $22 million in the current quarter. So clearly, that was even $16 million over what has been a healthy level in the earlier quarters of the year. We expect good income from that sort of source in 2022 because we will have another strong repayment year. But more of those repayments are loans that are going more to their full natural term and getting back on a normal cycle. So it's very unlikely that we'll have a quarter that would approach the quarter just ended. And if we had the $6 million per quarter run rate for all of 2022, we would consider that a positive. So I think when you're trying to calculate your run rate as a starting run rate for our net interest income, you definitely need to take out that $16 million.

And then we mentioned in the management comments, Catherine, that we also had a really healthy level of PPP loan income, another $1 million-plus, in the quarter just ended. That's going to go away in another couple of quarters because we're just about through that PPP resolution collection process. And then our special assets guys did a fabulous job in the quarter, collecting a bunch of purchased loans, including some loans that have been charged off at or prior to those acquisitions and so forth, and fully collecting those. So we had a lot of interest income, another $1 million or so there. So really, I think probably our net interest income for the quarter just ended was $18 million or $19 million above what would be a more typical normal run rate for the quarter. Kudos to our staff, our special assets guys, for the great job they did in collecting a lot of those assets. We have a really gifted, talented special assets team and they deserve credit for that. Kudos to our government-guaranteed lending guys for the work they did on the PPP program and kudos to our RESG guys for their real expertise and very thoughtful and intentional structuring of loans so we can achieve those kind of minimum interest and payoff numbers. Those things are always nice to get. But we had an exceptionally good quarter of those in Q4, and it would not be prudent to bake those in any sort of run rate.

Catherine Mealor

And then maybe a follow-up on that is just on core loan yields outside of that. If we back out PPP and the minimum interest, I'm getting a loan yield of about 5.28%. And you also mentioned in the management comment that new loan yields are coming in lower than where the portfolio is yielding today. And so any guidance you can give us on how big that gap is today and where kind of core loan yields may bottom before we start to benefit from a rising rate environment?

George Gleason

We're seeing new loans originated probably everywhere from, on an extreme low side, 2.5%, to 6% on the high side. If you look at that range, the new loans we're originating are at lower rates than the loans that are paying off. Now there's a flip side to that and that is that, as you can see on Page 15, I think it is, of our management comments document, a lot of our current loan portfolio will not reprice instantly when the Fed starts raising rates because the loans are at floor rates that are substantially above the formula rates now. And you can see we give you a very detailed table that shows how many loans are at their floors at every quarter point increase in rates, and that table is getting better and better. Those bars to the right are getting lower every quarter as we've replaced new loans with a formula that's very near their current floor with old loans that had floor rates that were much higher.

So the new loan portfolio that is being originated that's replacing the old higher rate stuff is more rate sensitive, and hence, we'll adjust more quickly when rates rise. So depending on how much and how fast the Fed raises rates, the fact that we're originating loans that today have a lower rate than the loans that are paying off, the Fed may help mitigate that by raising the rates on those variable rate loans, and the new ones are pretty much all right at their floor rate on the formula right now, so they'll adjust quickly. It's hard to know the timing of Fed rate increases. It's hard to know the magnitude of Fed rate increases. I'm hearing guys talk from 2 to 7 rate increases this year, but who knows. It’s hard to know that.

But if we do get more Fed rate increases, that will help us mitigate the impact of the fact that newly originated loans have formula rates lower than the loans that are paying off with those floors. The other thing I would tell you is we're keenly aware that we've got to have more volume to generate more net interest income going forward, and our guys are doing a really good job on working their pipelines and creating good opportunities for us there.

Timur Braziler - *Wells Fargo Securities*

It's nice to see the momentum building in RESG. Maybe talk a little bit about some of the broader trends you're seeing, which vertical that growth is coming from, kind of some of the larger metro cities starting to reengage and what the typical size of the product you're putting on today is?

George Gleason

All right. Timur, I'm going to let Brannon Hamblen take that question since he's on the front lines of that every day.

Brannon Hamblen

We've got some really positive trends, obviously noted in the results from Q4. And in terms of the "what" and the "where," it continues to be coming from all directions. In each of our LPOs, the guys are just doing a phenomenal job of getting out there and quoting and winning loans and some with sponsors that we've done a lot of business with and some we've never done business with. We've talked many times about the advantage our capital position gives us in terms of doing a lot with those we really like and reaching into other opportunities on different and even larger loans. And the guys are doing that. They're continuing to originate across the spectrum of size in terms of the "what." Multifamily is still probably the dominant property type, and life science, as we talked about a lot, was probably behind that in Q4.

After that, it's pretty evenly distributed across various property types. And in terms of the "where," we are seeing opportunities around, not necessarily in the middle of San Francisco, but in different directions from there as we're seeing a continual move of the "FAANG," big employment drivers moving out of the core, but near, and so we're benefiting a lot. A lot of opportunities in the Bay Area. We did some good business in New York in Q4 as well. We've commented on the New York portfolio and how it's been drifting down over time, but it's a very active market as evidenced both by payoffs we see there and new originations as well. Really, across the country, we're continuing to see really diverse opportunity and increasing volume of it as evidenced by our Q4 results.

George Gleason

Brannon, let me add and correct me if I'm wrong on this, but we're probably also seeing the broadest range of opportunities on larger mixed use projects that we've seen in quite some time and maybe ever. And we're looking at some loan opportunities that would be our largest loan opportunities ever, that we think we've got a good shot at getting in and getting closed. And that volume of really large complex mixed use projects that we're looking at could have some fairly significant implications for our volume later in 2022 and 2023.

Brannon Hamblen

Absolutely the case. And as I've alluded to our continual and consistent strategy of keeping our capital levels where we are, I think that's going to come into play in a big way in the foreseeable future. And of course, those mixed use deals are the ones that tend to be the large ones that give us great quality, great diversity, great leverage levels and, of course, great sponsorship.

George Gleason

And I would also add to that, Brannon mentioned that the Bay Area has been a significant source of growth. We're also seeing some really excellent opportunities in Southern California, the L.A. and San Diego area, and, of course, continue to have a lot of opportunities in Florida. The portfolio is just getting more diverse. With New York coming down in volume, and I think you'll see New York at some point in this next year possibly begin to turn back north in volume, you're going to see us do some nice originations there for sure in New York. We've got a lot of paydowns coming in New York. So it's going to be a horse race between the originations and the paydowns to flip that one. But we're doing much more business in all sorts of other markets across the country. And there's a table that we put in a few quarters ago in our management comments just to kind of highlight the number of MSAs in which we operate and the growing diversification of the portfolio. We think that's a real positive thing as well.

Timur Braziler

And then maybe just adding to that, I noticed in the management comments that the expectation for originations in 2022 is to outpace 2021, but noticed that you stopped short of expecting a record there versus the expectation for record payoffs. Is that conservative just given the timing of some of these transactions? I guess maybe if you could put any kind of parameters on that, that would be great.

Brannon Hamblen

Timur, yes, what I would say about that is that as we sit here today, we definitely expect a strong origination year for 2022. But there are a lot of factors that would cause us to not want to get out over our skis in terms of what could happen 6, 9, 12 months away. But as we sit here today, and I'll just stick with the script, it's going to be strong origination volume. And we really saw a build last year that's continued. It's not weakened. We have the payoffs that we project are a natural maturation of the portfolio and those things would probably happen. So I'm going to stop short of saying any records in originations next year, but I like where the year shapes up for us right now based on especially some of the things we talked about in terms of new opportunities and markets that are really opening up, sponsors that we've not done business with before that the guys are signing up, and loans of size. Between the velocity and the size, new opportunities, new originations in 2022, we're feeling very positive.

Timur Braziler

And then last for me, just kind of rounding out the topic. Can you remind us what the typical time frame is from a loan being originated to the borrowers starting to draw on that line? And then what's finally the loan being refinanced or purchased out?

Brannon Hamblen

That's a great question; like so many others, it's a complex question. I would say the mean that you could think about would be anywhere from 12, 18, on larger loans maybe 24 months. If you've got a large project that's going to take longer, it's going to take longer for the equity to get in. But I would also tell you that a lot of our loans, we originate with an initial funding that's of meaningful size, but based on a low leverage on the land value type sizing. So while our full funding does take a number of months to get to where we can appropriately structure some funding initially, we do that, and that is a common occurrence in the portfolio as well.

Timur Braziler

Okay. And then the time for a refi or purchase out?

Brannon Hamblen

I believe our latest average was around 34 months. I don't have that number right off the top of my head, but it has stayed historically. It lengthened out a bit in COVID, but it's going to start coming back in as the various economic factors influence that, of course, with rates moving, but in combination with already a lot of our portfolio being matured or not in terms of its loan term, just its evolution. You're going to see that's one reason that we're expecting perhaps another record year of payoffs. But again, I would say in the 33 to 36 month time frame is what we've seen historically.

Stephen Scouten - *Piper Sandler & Co*

I appreciate the color, Brannon. I want to dig a little deeper on some of what you just noted, and I know you said you don't want to get too far off script, given who knows what happens 6, 9 months from now, but if I think about $13.5 billion in unfunded commitments, let's call it, $9 billion in new originations that seem possible next year versus maybe $7 billion to $8 billion in repayments, if they're going to be higher than this year, it seems like the potential, even over the time line of funding that you just laid out, is $22 billion, $23 billion of funding versus maybe $7 billion or $8 billion of repayments. So even if I kind of do a weighted average over that unfunded book and the new origination, it seems like the growth potential here in 2022, just in RESG, let alone indirect and community banking, that seems to be turning the tide. It's pretty attractive. I wanted to know if I'm missing something or I'm thinking about that the wrong way.

George Gleason

Stephen, let me jump in there on that. The $13 billion in unfunded commitments, those loans will fund over 3 years for the most part. And a little tail of that may drag out even into year 4. So you can't assume that $13 billion is going to fund next year. And you can't assume that much of what we originate in 2022 is going to fund in 2022. When you think about our origination volume for 2022 and our unfunded commitments, yes, all things that 90% or plus or minus of those things we'll fund over time. That's going to fund over several years. So we do expect a significant level of originations in 2022. We expect a record level of payout most likely in 2022. We think that is a net positive number, but your assumption that a lot of our originations from this year are going to fund this year and all or most of our unfunded commitments are going of fund this year is way too optimistic. We expect positive net loan growth next year, but those uncommitted and to be originated amounts in RESG will fund over several years. Does that help?

Stephen Scouten

Yes. And I wasn't trying to suggest that entire amount. I was thinking 40% of that $23 billion funded and you're talking $9 billion versus maybe $7.5 billion in repayment. So it still seems like a kind of attractive mathematics scenario.

George Gleason

Yes. That's a plausible scenario. I'm not saying that's our guidance, but that's a plausible scenario, yes. I thought you were suggesting we were going to fund all of that next year.

Stephen Scouten

No, I wish. That would be great. But no, I know that's not how it works. And then I just wanted to dig back. I know, George, you referenced Figure 15 earlier, I did notice that there was a pretty meaningful improvement there as you guys originate more new loans, and there's less at the floors. But I'm curious if you could give some more color about what that does to your overall asset sensitivity in the up 100 and 200 scenarios. It seems like that would have made a decent dent there. And just kind of as you guys lay out those assumptions, what you're looking at from a deposit beta perspective? Especially given that you guys don't have quite as much liquidity build as probably some of your peers have seen.

George Gleason

Yes. Well, every month as we originate new loans and have old loans pay off, and there's a lot of velocity on both sides there, that graph on Page 15 gets better. And there are really two graphs. One is total commitments and one is the actual funded balances. And since the older loans tend to be more funded and the newly originated loans

tend to be more in the commitment phase, you can see the delta between those 2 graphs and that kind of gives you a visual image of how new originations are moving those bars to the right down, which is what we want; payoffs of old originations are moving those bars to the right down.

So that is positive for the asset sensitivity of the portfolio. And that is getting better literally every month. We're pleased with the direction of that. And if we can get those numbers more favorable before the Fed starts raising rates, that just makes the portfolio benefit more right at the outset from those first rate increases. So we would hope to see further improvement between now and March, which seems to be the predominant expectation on when the Fed's going to start raising rates. So that's helpful. The deposit beta question is a great question and on Page 33 of our management comments document, we give you a little more detail than we've given in the past on breaking down the deposit book here. And you can see the really excellent work that Cindy Wolfe and Carmen McClennon and Ottie Kerley and Drew Harper and the other folks on the deposit and retail banking teams are doing, growing noninterest-bearing accounts and non-time accounts, both consumer and commercial, and at the same time, working down some of the CD categories from higher levels and working down public funds, brokered and reciprocal deposits that tend to be more expensive deposits.

So I think the guys have been doing some really good blocking and tackling and improving the quality and hence, the rate sensitivity of our deposit base. Certainly, when the Fed starts raising rates, our deposit cost will go up, everybody's in the banking industry will go up pretty much. There will be a few exceptions, I guess. We think that we've done a good job laying the groundwork to have much lower deposit betas over a full interest rate increase cycle, early, mid and late cycle after the increases, than we experienced in the last interest rate cycle. So how that plays out is going to depend on competition and how the Fed postures, how quickly they move and what else they do to withdraw liquidity from the financial system. As far as they've already announced and are rapidly along the way with tapering their rate of asset purchases and the shrinkage of their balance sheet, I think will have a significant impact on availability of funds, liquidity in the system; that will affect deposit rates. None of us really know. I don't think the Fed even knows how they're going to do that yet or if they are, they're not telling. There are a lot of variables there, but we feel like we're much better positioned than we've been in the past to deal with that rising rate environment.

Stephen Scouten
Yes, definitely. Thanks for pointing that chart out. That does show an impressive kind of multiyear improvement. I appreciate that. I'll let some other people jump in, but congrats on a great year and look forward to another one in 2022.

Michael Rose - ***Raymond James & Associates***

Just wanted to touch on the commentary in the management comments on Page 17, just around expenses. You kind of cited what everyone else is citing, wage inflation, etc., and also some offsets, and I know you're selling the Magnolia branch this quarter. But if you could just help us quantify what that could mean to the expense run rate as we move forward, just given some of the puts and takes that you guys have. Clearly, expense control has been really strong here and that's been one of the hallmarks of the company, but just looking for some color on kind of what the magnitude could be on a run rate basis?

George Gleason

Michael, let me make a comment or two, and then I'm going to let Greg comment on that. But we accelerated our annual salary review process. It's a very detailed process where we go through every single employee in the company with their supervisors and set their rate of pay. We accelerated that to the July-October time frame from what would have normally been a September-December time frame. And a lot of those raises were given early, and you can see that in $1 million and then $2 million sort of increase quarter-over-quarter in our salary and benefits line item. The raises were much more significant in percentage terms than what's reflected in those line items, because as we did that, we were closing and selling some branches or closing some branches. We were reengineering some workflows. We were identifying some unproductive activities and personnel and we were eliminating those positions.

So we gave really good raises to a lot of people in that July through October time frame, and accelerated those but avoided really having a big hit to our noninterest expense, kept that pretty manageable by really working hard to offset a chunk of those costs. So I'm really proud of the work that our guys did in that, and it was an extremely laborious and difficult process to really dig down and understand everything in a super granular level there. And the guys just rolled up their sleeves and worked hard on it and I think we did some really good work. We will, as it says in the comments, continue to see higher costs because we've got a bunch of unfilled positions that we are filling. We have some raises, a smaller number, that didn't take effect until January 1. And we're going to add some new positions in some areas where we have growth opportunities. Greg has done some work on that, so I'll let Greg provide some additional color on that.

Greg McKinney

As George said, we've really been focused on the talent, the staffing, the competition; how do we make sure we've got the right people in the right places across the entirety of our company. A lot of what we did in Q3 and Q4, we feel puts us in a really good position today with respect to those guys. Clearly, as George indicated and as we said in our comments, we hope to fill positions and continue to add new team members to support future growth. I

think, Michael, if you take the Q4 noninterest expense, I think if you assume that growth probably on average $2 million to $3 million a quarter over each quarter during 2022, that's probably a pretty good assumption of where we would expect our noninterest expense to end up for the full year of 2022. Obviously, it may not be a linear increase. It may be a little bit choppy, but most of that's going to be in the salary and benefits line item. And the actual amount that that ends up is really going to be dependent upon our ability to find team members to fill open positions and to continue to grow our staff to support future growth. So I think the $2 million to $3 million range is a pretty good on average assumption for overhead growth.

Michael Rose

So is that like a gross number or like a net number? Because I assume there's some offsets. Are you just talking about total expenses?

Greg McKinney

Total noninterest expenses.

Michael Rose

Okay. But what would some of the offsets be? Because it sounds like the number actually might be higher, but you have some savings that you can bring out elsewhere, whether it be further branch cuts, et cetera?

George Gleason

Michael, I think we're there on most of the savings. I mean, there are some smaller items we're still working on. But we pretty much accomplished what we needed to do as far as rationalization of branch network and those sorts of things in that second half of 2021. So yes, we'll sell the Magnolia branch. I don't think we have another branch slated to close at this point. We think everything that we've got in that regard contributing. We actually have a few branches we're going to open. We will, over the next couple of years, have a few branches that we relocate that we'll have some benefits of improving the quality of our location and market at the same time that we're in at least 1 or 2 of those situations ought to get some cost saves out of that. So there are some things we're doing there, but those things are small potatoes, and Greg's $2 million to $3 million a quarter increase in noninterest expense is kind of a net number, I think. Is that right, Greg?

Greg McKinney

Yes, that's correct, George.

Michael Rose

Okay. Great. And maybe just as my follow-up. The share repurchases were a little bit higher this quarter than I was expecting to increase the size of the program. The stock is around 1.50 times tangible book. Just remind us, George, how we should think about the tenor and pace of share repurchases and how you think about intrinsic value?

Tim Hicks

Yes, we were certainly very active in Q4 on the share repurchases. Obviously, we raised some preferred stock and increased our authorization in the beginning of November and became really active in November and December. Our stock price when we started that program was certainly less than where it is today. We do try to be somewhat opportunistic in how we utilize that. So if our stock price is increasing, we're going to be less active comparative if it's being pulled back. So if we see a pullback, we'll be more active. But on the whole, I would expect this to be slightly less active in Q1 than we were just because we're starting at a little bit higher place than where we started the repurchases in Q4.

Jennifer Demba - Truist Securities

George, you guys have about $4.3 million of NSF and overdraft charges in '21. A lot of banks have revamped their programs again. What do you see for OZK in the next few quarters on that front?

George Gleason

Yes. Well, let me say we've broken out the service charge data into 2 lines in the management comments, and you'll see that in our Qs and Ks going forward. And the real reason for that is you've got other service charges, you got your NSF/ ODs, and really, that NSF/OD line could be broken out because insufficient charge and overdraft charges are really two different things. So I'm going to let Cindy Wolfe, our Chief Banking Officer, who is over all of that domain, all of our retail banking operations and so forth report up to her, and deposits and deposit strategies are all her. So Cindy, do you want to take that?

Cindy Wolfe

Like other banks, our NSF and OD fees remain below pre-pandemic levels. And our focus for quite some time has been on the fees we charge in association with value-add products and services where you have a client that receives something of value and is happy to pay a fee for what we're providing. So that said, we have taken 2 steps that appear to be similar to some of the things other banks have announced recently. In November of 2021, we eliminated the transaction fee we had historically charged for automatic transfers from one account to another to cover an overdraft. And then back in February of 2021, we rolled out a new checking product that has no

overdraft or NSF fees. It is a bank on certified checking account aimed at the unbanked and underbanked called freedom advantage checking.

We have really made emergency savings the focus of our retail bank. And since we've done that, we've seen a nice increase in savings account sales. We believe that the focus should be on helping people develop healthy savings and spending habits and that will also help our clients avoid NSFs and overdrafts. So while we have not eliminated all the fees associated with NSF and OD, we have made some similar moves to other banks and of course, we have not ruled out taking other steps in the future.

George Gleason

Jennifer, let me point out on Page 16, consistent with what Cindy said, our NSF/OD fees, if you compare Q4 '21 to pre-pandemic Q4 of '19, that number is down $1 million a quarter. Our other service charge fees are up over that period of time, $1.5 million a quarter from Q4 of '19 to Q4 of '21. And that's all part of Cindy's strategy that she and her team are implementing to create more service charge revenue from really value-add things to our customers and do more things that eliminate and reduce customers' incurring NSF and OD fees. I think that trend will continue on both sides is our strategy to continue to grow these other higher-value things, as Cindy was talking about. I do think market and regulatory efforts over a longer period of time will result in a continued reduction in NSF fee income and then probably overdraft fee income as well.

Jennifer Demba

So do you see a material amount of pressure on that line item for '22 given the recent changes? Or do you think you're at a pretty good run rate?

George Gleason

I think it is premature to judge the timing of that. It's a fluid situation on the competitive front and a fluid situation on the regulatory front. But I do think you will see the other service charge line item increase because they're doing a good job of selling products and services that our customers seem to be very willing and enthusiastic about even though it means paying the fee for it. And I think you'll see further reductions over time in that NSF fee. The timing of that is hard to know. I think the OD fees will also go down over time.

Matt Olney - Stephens Inc.

I wanted to ask more about the impact of higher interest rates and what the bank is doing today to better prepare for this? And the loan floor is obviously going to be a challenge in the near term as the Fed moves higher. But I'm just curious what else the bank is doing to better prepare for higher rates.

George Gleason

Well, obviously, Matt, we've been keeping our securities portfolio pretty short. We've got about $150 million a month in cash flow off that securities portfolio. And the investments we're buying now we're keeping in that short, to short-medium sort of term duration. So considerable efforts to keep that where we're not pinned down to a bunch of long-term investments and so forth. And then a strong propensity as we've always had to make the vast majority of our loans variable rate, and we give you statistics on that in the management comment documents about what percentage of those are variable rate and to put floors in them. And as we recycle older loans and replace them with newer loans, we're certainly getting floors that are much more conducive to having a high level of asset sensitivity in the portfolio. So that's really the way we're preparing, trying to do things on the deposit front that will lower our deposit beta and do things on the asset side, both investments and loans that will enhance asset sensitivity there.

Matt Olney

Yes, that makes sense. And I was also hoping, George, you could put some more commentary around loan growth expectations in 2022. I know you expect to be positive, but I think the consensus forecast is coming for around a mid-single digit loan growth for '22. And just trying to appreciate if those expectations are still reasonable or if we're a little bit too optimistic, given your commentary today.

George Gleason

Matt, I don't think those expectations that you describe are unrealistic. I mean there are probably more variables in the world today economically, politically, regulatory-wise and geopolitically wise than there have ever been in my 42-year career. I mean, gosh, you just listen to the news every day and read the stuff that's going on in the world. It's a complicated world. We've got a great pipeline going into the year. We seem to have a lot of our business units that have positive momentum. We know we've got a big, almost certainly record level of payoffs coming in this next year, but we feel like we can outrun that. But trying to get more precise on what percentage actual growth we're going to have this year, it's impossible to know that because you've got to originate a lot of loans. You know you're going to deal with a lot of payoffs. Some of those payoffs might push as they did last year. If there's supply chain problems, as in '20 if there's supply chain problems, some of those payoffs may accelerate. If customers can lock in permanent financing and they're concerned rates are going up, they're going to try to get to a permanent financing solution faster if they believe rates are going to go up and their permanent financing is going to cost more. So there are just a lot of variables that could push or accelerate payoffs. There are a lot of variables economically that could cause folks to push project a few months or accelerate a project based on what they consider the opportunities to be, and you're playing all that out against an extremely dynamic macroeconomic environment, political, fiscal, monetary policy, geopolitical environment, COVID health

environment. So I think the assumptions that you articulated there are not unreasonable, but it could be more or less than that depending on how those things play out.

Matt Olney

Okay. That's helpful. And definitely, we appreciate there's lots of moving parts this year, more so than most. And just lastly, I guess circling back on expenses with Greg. If I plug in that $2 million to $3 million per quarter growth off the fourth quarter starting point, I'm at about 9% growth in 4Q '22 versus 4Q '21. Am I thinking about that right, Greg?

Greg McKinney

Yes. I believe so, Matt. Yes.

Brock Vandervliet - *UBS*

I guess we've boiled the ocean on RESG questions, so I won't go there. It's kind of a two-parter. One, if we could get an update on the auto business. I know that was impacted last year by kind of a return to that business as well as if you can't get product, you can't finance it, that sort of thing with the pipeline issues affecting the auto business. And more broadly, do you think you've got all the product set that you really need there? Or are there other initiatives you may be working on behind the curtain?

George Gleason

Yes, Brock. Our indirect business is indirect RV & marine, and we don't do indirect auto.

Brock Vandervliet

Yes, I'm sorry. I'm sorry. That's right.

George Gleason

I understand. It's easy to think of all indirect as being auto, but we don't do the auto because we just don't think you can get the return on investment at our scale that we can get out of the marine, RV business and the same quality issues. So we like what we're originating both from a quality and a yield perspective. The guys have rejiggered that business model over the last couple of years, we've been ramping it up since early last year. So they're now, I guess, probably in their third or fourth kind of quarter of ramping that up. We did gain a little bit of momentum on that in Q4 and we expect positive net growth in that portfolio in 2022. And I'm reluctant to quantify what that is, but we do expect originations and funding’s to exceed payoffs on that portfolio in 2022, and it to become a small but noticeable contributor to growth in 2022. The consumer book that you mentioned, we are

continuing to do work to make our consumer facing product set more competitive and doing things to enhance the sales of consumer loans through our branches. I think we'll see some positive trends in that in 2022 as well. Again, that's not going to be a huge line of business, but if that contributes $50 million or $100 million or $200 million in growth, that would be a real plus for us. So I do think we'll see some positive direction there. Volume of it is hard to know at this point in time. But we are focused on growing those as part of our plan to diversify our business more broadly.

Brock Vandervliet
And just as a follow-up, not much to talk about with respect to credit, which is great. How are you feeling about just the size of the reserve at this point?

George Gleason
I think we feel it's appropriate. We gave disclosure in our management comments that stated that the greatest weight in our model selection, as of December 31, was on the Moody's moderate recession scenario and then the Moody's sustained downturn was the second greatest weight in the Moody's baseline scenario, we gave the third highest weight in our model selection allocation. The reason for that is the Moody's baseline scenario by year-end had gotten to be a pretty optimistic, almost an upside scenario in our view. And that was quite a shift from where the Moody's baseline scenario was a quarter before.

So as we looked at the litany of open items on fiscal policy, monetary policy and all the things that I've talked about with Matt Olney a few minutes ago, we just felt like there were a lot of uncertainties and risk. Things that could possibly lead to a Fed miscalculation or a fiscal policy miscalculation that could throw the economy in a more difficult setting. So we adopted a pretty conservative and slightly negative bias to scenario selections for our ACL, as of December 31. I think that's appropriate. I mean, there's just a lot of things out there that could cause our economy to get in a more difficult situation. And we think we appropriately took those things into account in our scenario selections and qualitative adjustments to the model scenarios at 12/31. Tim and Greg may want to weigh in on that too, but that's my take on it.

Greg McKinney
George, I don't know that I've got anything else to add on that. I mean, obviously, there are a lot of unknowns that we were cautiously conservative about as far as our ACL goes. If we have more clarity on those over the next few months or few quarters, certainly, that could impact our level of ACL, but there's just a lot of unknowns today, and I think we were appropriate in where we set our scenarios and where our resulting ACL ended up at December 31.

George Gleason

Brock, over the last 2 years, there have been a lot of negative assessments of economic prospects in the U.S. and those over 2021 got progressively better, and that was reflective in our ACL. But we don't want to get too optimistic too fast, while there's still a lot of variables at play and release a lot of our ACL and then have to come back later because while we got too optimistic and released too much and then you have to build it back. We want to actually see these economic cards play out and adjust our reserve based on real economics instead of hope economics.

Brock Vandervliet

Yes, I think that's an interesting point. You can see a lot of other banks that have nailed themselves to the baseline scenario have to tack pretty rapidly at some point.

George Gleason

They could be right, but we're kind of in the mindset of we want to see all this play out before we release and know that we're really back to a very positive economic situation with a lot of variables resolved before we get too aggressive in releasing that ACL.

Brian Martin - *Janney Montgomery Scott*

Just a couple for me. Most of it have been answered, but just going back to the capital, you talked about the buyback. Tim, maybe on just general commentary on the M&A outlook, given what sounds like fabulous opportunities on the organic side and the buyback being utilized, but just the level of opportunities maybe you're looking at today or seeing? Can you just give a little comment on that?

Tim Hicks

We do think there will be continued consolidation in the industry over the next many years. We hope to be able to participate in that at some point. We are spending more time looking at opportunities. I personally am spending more time looking at opportunities, but the timing of those obviously are hard to predict. And as you pointed out, we've got a lot of good traction organically through RESG and community banking and our asset-based lending groups and equipment finance lending group and indirect lending. So a lot of good momentum that we feel very positive about organically. So we don't have to do M&A. But if we can find something that's accretive to our franchise one way or the other, then we'll certainly be interested in looking at it. And we certainly have a lot of capital where we can do multiple things at the same time. So it's not one strategy that is going to utilize all of our capital. We can do multiple items at the same time. So we're looking. We have appetite, but certainly can't predict when that might occur.

Brian Martin

I think last quarter, George, maybe you talked about the securities portfolio maybe getting a little bit bigger depending on where the yield curve was at. I guess, any change in your outlook there?

George Gleason

Brian, no. I mean, that's very much a day-to-day, moment-to-moment situation and opportunity. As I mentioned, we've got about $150 million a month in cash flow from that portfolio. So knowing that rates are going up, trying to find things and moments to put that money to work as it rolls off, but not taking too much interest rate risk on it. So there will come a day when we want to be much more aggressive in loading up that portfolio than we are now. But we're not anxious to see that portfolio grow a ton right now because I think whatever you buy is going to get devalued going forward. But we still have to keep some of that money at work as well. So it's a delicate balance. We're working every day. And Luke King and Kristi Harper and Rush Harding and the rest of the team who are running that portfolio for us are doing a great job on it. And I think they'll figure it out as we go. But it's a tricky time to be putting money to work there.

Brian Martin

It looked like a nice start to the ABL group. Just kind of wondering that and the CBSG, if you can give any commentary on how you're thinking about that and the momentum there, going forward.

George Gleason

Yes. The ABL group has closed the deal and had several more transactions in the pipeline that they're looking at and working on, and some of those transactions they're looking at look very positive. So we're optimistic about that. Our corporate and business specialties group is primarily subscription finance. We had a lot of pay downs on that. I think their average balance for the quarter was probably much higher than their quarter end balance because right at the end of the year, a lot of those borrowers did capital calls for year-end and cleaned up their subscription lines. But the unfunded part of that business is growing. We're doing more business there, not less, even though the funding's were down with the payoffs right at the end of the year. But that's doing well, and they, of course, manage a small shared national credit portfolio, I think, is down to about $50 million, plus or minus, and continuing to shrink. I don't see us, unless there's a real buying opportunity, reloading that portfolio. But if market conditions make it very advantageous to do so, we might. But the mindset right now is that portfolio, $50 million or so, continues to just run off as it pays off sort of way. And those guys are looking at some other non-subscription line, non-real estate structured finance opportunities where our expertise applies in our equipment finance guys and structured finance guys on the equipment finance side are also getting some pretty good opportunities they're looking at, and we would think they're going to have some volume this year.

So real pleased about the way all of the units in our lending world are working and some are going to contribute a lot more growth than others. But I think we've got almost every unit moving in a positive direction. Of course, we will have PPP payoff headwinds remaining. I think we have about $80 million or so of PPP loans at the end of the year. The last piece of that, probably pays off mostly in Q1 and Q2, and should almost all be gone, if not all gone by the end of this year. So that's a little bit of a headwind on growth in community banking. But the guys had a lot of PPP payoffs last year and still absorb that and offset that with new originations for the most part. So we're feeling pretty good about all units being able to contribute to growth this year.

George Gleason

All right. Thank you. We appreciate you guys joining the call. There being no further questions that concludes our call. We look forward to talking with you in about 90 days. Have a great quarter.