Bank OZK

Transcript of the First Quarter 2023 Conference Call

April 21, 2023, 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 Jay Staley, Director of Investor Relations & Corporate Development 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;
- Tim Hicks, Chief Financial Officer; and
- Cindy Wolfe, Chief Operating Officer.

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

Timur Braziler – ***Wells Fargo Securities***

Starting on the land loan that was moved into OREO, I guess what's the price at which that loan could be sold at today? And I'm wondering, putting it in OREO with the appraised value of $100 million, why not use the sale value today as kind of the basis for that loan?

Brannon Hamblen

We talked about the credit last quarter and described the credit for you. In specific answer to your question, we obviously had the appraisal originally at $139 million in June of 2021 and we had another one more recently at $100.4 million. As to where we booked it, look, at the end of the day, the basis is known, our basis is out there. So in terms of where we come in there, that's going to be affected by that. It's a great site. We feel very good about our ability to market that site over the next year or two. And as we said, we feel good that we'll have little, if any, loss associated with that.

Timur Braziler

Looking at the continued strength on the lending side, I would love to hear your thoughts on the plan for funding in the rest of the year. And then maybe just talk through what the incremental spread on the loan production in 2023 looks like?

George Gleason

The prospects for continued loan growth look pretty good to us. Obviously, we reiterated our guidance for our RESG originations that we gave in the first quarter. Our first quarter results were very consistent with that January guidance, and we think that continues to be good. We continue to enjoy a diversification in the growth. All of our units contributed, to some degree, to our positive loan growth in the quarter just ended. I'm not sure they'll all be positive every quarter. But over the course of the year, I would expect all of them to be positive contributors to loan growth. And we're continuing with our underwriting and application process, origination process, totally business as usual. There have been no adjustments because of the economy and we continue to do business as we did in the Great Recession and the COVID pandemic and other times of economic stress. We just continue to do business with quality sponsors on quality projects on terms and structures that make sense, and we're always there for our customers.

So we expect good origination volume throughout the year, certainly off the record pace of RESG originations last year, but consistent with that 2021 level of RESG origination with good contributions from other groups.

On the deposit side, as you saw in the quarter just ended, we had good deposit growth, 3.6% growth in deposits, not annualized. That was organically through our branch networks. Most of our deposit growth comes from our 229 branches in Arkansas, Texas, Georgia, Florida and North Carolina. We expect those branches will continue to fund that growth going forward in the remainder of the year. We've not had any changes in our deposit gathering strategies or adjustment. We've not become more reliant on wholesale deposit sources. We don't expect to do so. So we're driving that with organic branch deposit growth, and we feel very good about the prospects for that.

Now, as you saw, our deposit costs were up because we're generating a lot of growth through those branches. And you've seen most banks that have reported, that I've seen at least, have had negative deposit growth numbers. We had nicely positive deposit growth numbers because we've got growth in our business that we need growth in deposits to fund it, so we are paying for that. Our deposit costs probably rose in the upper half of banks in the quarter, but our net interest margin increased nicely, and we've got a nicely balanced balance sheet between variable rate loans and our cost of deposits that's letting us offset that and still generate very nice returns.

And of course, we already have an industry-leading net interest margin by a wide distance from our competitors, and that's a very nice thing to have.

Stephen Scouten
I'm curious, as you think about your new loan production, you just spoke to having to pay up for deposits because you guys are in the enviable position of having some good growth. But how do you think about the spread you manage to on that with your marginal cost of deposits and your new loan growth? How you think about that marginal spread versus your current NIM?

George Gleason
It's a constant debate on every transaction. I've got an opportunity that landed in my inbox late last night or early this morning that I was looking at before I came to work this morning. That certainly is one of those questions. It's a piece of business you'd love to do, and the quality is great, but you're looking at it and the spread is just not what you would want to see versus our marginal cost of deposits. So I'm going to sit down with Brannon and the lenders involved in that transaction after this meeting, and we're going to parse that out; looking at the other opportunities that relationship will generate; the deposits that will come with it; if there's any cost on those deposits; the magnitude of that and just go through and do that

gut wrenching thing you do 1,000 times a quarter making a value judgment. Is there enough return and long-term relationship building value to that relationship to do it. So we do that all the time.

And I think we parse that out pretty well for our shareholders and our customers as well, because we have a lot of customers that want to do business with us, as evidenced by the fact that our loans are growing and our deposits are growing. We generate a really good return for our shareholders, as shown by our industry-leading net interest margin, return on average assets and efficiency ratio. So I think we're parsing those decisions well. But it's very much a case-by-case basis on every credit. We've got some guidelines and some principles. We won't go below this or beyond that. But there are nuances in every situation. What's the historical relationship with the customer, what's the prospects for additional business, what's the deposits? What's the other ancillary fees, treasury and other services you get with it? We try to factor all those together and make good decisions. And I think our wonderful team of bankers have a good track record of doing that, which is reflected in our numbers.

Stephen Scouten

You guys are transparent, as always, which I appreciate in your management commentary here. And if I'm looking at that Figure 22, you show the deposit composition and kind of where you are from a brokered deposit perspective. How high could that 9.5% go within your internal guidance or any regulatory guidelines? Because I'm assuming that the duration of the RESG book is extended in this environment. Maybe I'm wrong, but I would presume that some of these loans would stay on your books a little bit longer than they would have 2 years ago, which should be a positive to your earnings and capital build, but might put some pressure on deposit gathering and the size of the balance sheet. I'm just kind of curious how big that could get, and what other ways you might fund that unfunded book as it moves over.

George Gleason

I'll sort of take that backwards and say, yes, RESG is having loans stay on the books longer. Part of that is just there continue to be shortages of certain laborers out there and some materials, particularly HVAC and electronic components for building seem to have a lot of delays on those sort of things. It's just an environment where everything seems to move a little slower than it did pre-COVID. Projects are taking longer. And because of the turbulence in the interest rate markets, they're staying on the books longer, and that's good.

And it is a positive in that it gives us additional earning assets -- we're not objecting to that at all. It's easy to overstate that. I mean, we've already had several loans pay off this quarter. So the flow has not stopped. It's just slower.

On your question about brokered deposits -- number one, we have no regulatory limit on how much brokered deposits we could have. Our internal limit is broken down into target, tolerance, buffer and capacity limitations. And the capacity limitation is way beyond where we are now. We're sort of in the lower half of the tolerance range for that. So we could increase that if we needed to. As I said on the last call, our working premise is we'll keep that under 10%. But if we needed that to go higher, it could. But our working premise is that we'll keep that under 10%.

We've got a lot of room to move around on deposits, and on the following Figure 23 of the Management Comments, we give you the fact that we've got right at $10 billion of cash, unpledged investment securities, FHLB, Fed funds borrowing capacity and lines of credit. The lines of credit are not tapped. The Fed funds or the Fed discount window is not tapped, and that borrowing capacity that we've given you there doesn't include anything for this new Bank Term Funding Program, which we don't have any expectation of using, but it's available out there. But we didn't even include in the calculation because we don't expect to use that.

As I said earlier, we believe we will fund the growth in our balance sheet this year through our traditional means of organic growth through our 229 branch network and feel pretty good about the prospects of doing that.

Manan Gosalia – *Morgan Stanley*
Just given the general concerns around credit and CRE, I was hoping you could give some more color on the special mention loan you discussed in the release if you can. What drove the potential buyer to withdraw, and why did the sponsor choose to surrender rather than look for another buyer? And I guess the question for you is, if the recent appraised value is above your loan basis, why not sell now? Why wait for macro conditions to change?

George Gleason
Well, Manan, let me answer that part of that -- and why not sell now? You're talking about selling a piece of land. It's a great site, but people who buy pieces of land are a little bit different than people who buy office buildings or apartments or hotels or condo buildings. They've got to conceive a project, go out and

design, build that project, and do all the development work for that. And you don't typically buy a piece of land until you're ready to start that process and have some visibility going forward.

So the comment was made in one of our research reports that was issued overnight that land builds tend to be more variable in value and tend to be more variable in the marketability than other types of properties, and that was a very good observation. The time to sell this and to get our maximum value out of it, is probably when conditions stabilize and people are coming back to the market to start incubating new deals and really looking forward to the opportunity to develop it. Buying a piece of land to hold in an environment that has as much economic turbulences environment today is not something a lot of people will do just because there's uncertainty. And there's holding cost, carry costs, interest costs and so forth with acquiring a tract of land.

We think the best strategy is to wait to actively market this property until the Fed's kind of stopped raising rates and the dust is settling on current economic conditions. And people sort of have a view of the future where they have enough certainty they want to go out and incubate a new project on this piece of land. It is a great site, and I will tell you without marketing it, we are having some unsolicited inquiries and interest in the site. But again, our intent to not actively go out and market the site until economic conditions stabilize at some level.

Manan Gosalia
Maybe if I can push you a little bit on that, just given all the concerns around credit. If the appraised value is dated from December, at what point would you need to reappraise this or mark this down? What would you need to see for that to happen?

George Gleason
Well, we're certainly getting it reappraised at least annually. And we would reappraise it otherwise if we thought there was a material likelihood in the change of the value on it. Our policy on OREO properties is to reappraise those annually. I will tell you when this appraisal was done, our guys in appraisal services pushed pretty hard on the appraiser, challenging him on the value, and the appraiser was adamant that he could not get to a more conservative value. So it is a reflection of the fact that what we've got in OREO, I think, is a reflection of the LOI the sponsor had an agreement to sell it. And when the Signature and Silicon Valley Bank deals unraveled the buyer backed out of the transaction based on that. So I think if we hadn't had the economic turbulence we had this asset would already be gone.

Manan Gosalia

And then if I can just follow up with some -- I was hoping for some general comments on credit. As you know, investor concerns have ramped up since the bank failures. So my question for you is how much do you share these concerns given your unique vantage point in the CRE market? And maybe if you can talk about how you're managing ahead of it.

George Gleason

Well, we feel very good about our credit position. Our RESG portfolio is weighted average 54% loan-to-cost, 43% loan-to-value. That gives us tremendous cushion for values to contract far beyond anything that I think anybody is talking about in commercial real estate, at least that I've seen. We feel very good about that. We reiterated our guidance that Tim gave in the January call that we expect our net charge-offs this year to range from 6 to 16 basis points for the full year. Our 14 basis points in Q1 was in that range. I think that guidance is still good. We feel pretty solid about it or we wouldn't have reiterated that guidance.

There is a lot of chatter out there about commercial real estate. I would make two points in regards to that. One point is that our portfolio is new construction, and we referenced this in the management comments. These are properties that have the newest state-of-the-art features, the newest amenities and attributes that sponsors are building brand new because it's what renters or purchasers of those buildings or units are wanting. And as a result, our properties tend to be the best, most highly marketable properties in the market.

We're still doing office buildings, and I know there's a lot of noise around office buildings, but we're still seeing good leasing activity on the office parts of our portfolio. And it's not because the world is out there running to buy office space and there's a giant competition to rent office space. But it's because we've got the best properties in markets or submarkets and the transactions that we've done make sense, and there's demand for those. Now is leasing slower than it was four years ago, or five years ago, or three years ago before COVID? Yes, it is. We'll give you that. But we're seeing decent leasing velocity and loans on office buildings paid off because the office buildings are leasing up and moving on. It is slower, but they are getting there.

The second thing I would tell you is there's a lot of conversation about CMBS and the wave of maturities in all property types. Office gets talked about a lot, coming from CMBS, and that's not our market, and those are not our type of properties. I understand that there's going to be some challenges in commercial real estate from CMBS loans that have a 3% or 4% interest rate that are maturing and now are going to refinance at a 7% or 8% interest rate, or maybe even higher. That's going to put a lot of those projects in the ditch. A lot of those projects will still work, though because over the ensuing five years or seven years or ten since that loan was originated and put into CMBS there's been substantial amortization on that loan and substantial increases in rents. But those are older properties. They're not new state-of-the-art properties. They're not going to, by and large, benefit from the flight to quality attributes that our developers of new properties enjoy. So they're going to be harder to lease up if they're not already leased than a new state-of-the-art property that has all the desirable amenities that people want to be in.

And the current employment environment where, employers are trying to get employees to come back to work, they desperately want them to come back to work for the most part, they're trying to get them to come back to work. The quality of the office environment is critically important in that regard. If you've got really nice offices that people like, and they have the amenities and the attributes that people want, and going to the office is a pleasant experience because you like where you work, that's a valuable tool in recruiting people. Our sponsors who are building these new state-of-the-art office buildings understand that. And if you've got an old B-grade building you're probably looking to get out of that. That's not our customer. You're probably looking to get out of that building and get in a place where you can recruit better talent, even though your cost per square foot is going to go up a lot to be in that nicer building. So we think we're very well positioned in this market.

Brody Preston – *UBS*
I did just want to follow up, maybe with Brannon, on the loan that's been repossessed. I wanted to ask if you could give us any color as to geographically where it's located? And then secondarily, is it a straight land loan? Or has it been developed to any extent where a potential buyer might have to think about repurposing anything that's been done to suit their needs for a new project?

Brannon Hamblen
This loan is on the West Coast, it's in L.A. And it's, as George said, is a phenomenal site. I mean it's right in the heart of the entertainment culture there. I think we all fully expect that one day, there's going to be a phenomenal vertical development on that piece of dirt.

As to your question around repurposing, or I think the heart of your question, work to undo, not so much. I mean, look, the prior sponsor purchased that site in 2012 and spent a decade on entitlements and just sort of predevelopment. But late in the game, they put a ton of equity in it. I think their cost basis was around $105 million. And so they spent a lot of time on it, but then got to a point where we've talked about rising costs, we talked about rising interest rates and things of that nature, and they decided not to take that step forward to go vertical.

There will be a plan for a great vertical development on that side. There's not a lot of work that has to be done, to specifically answer your question. As we said, we feel good about marketing that thing. It's just, as George said, picking the right time when things are a little bit more certain, a little bit more stable under a new owner's feet.

Brody Preston
Do all the permits and all the stuff that the previous owner has done, does that stay in place? And does that help make it more attractive for a potential buyer?

Brannon Hamblen
I think so. And of course, you can't make promises about what ultimately they put there and whether they have to do some things. But as George said, we've had some unsolicited interest in the site. There's no question in our mind about its viability for great development going forward.

Brody Preston
This is just a ticky tack -- on this loan, though, could you just help me like ring-fence what the loan yield is? I'm just trying to think about the slight loss to earnings here as it relates to this loan.

Brannon Hamblen
I don't know the exact rate that we had on that one. It was an older loan and it's floating rate. So it's been up there but so are all the loans that we're replacing it with today.

George Gleason
Yes. I would probably assume an 8% rate on it. That's kind of the norm. So that would be a $4.8 million a year, $1.2 million a quarter in interest income.

Brody Preston
I did want to ask just on the updated appraisals that you had for the 15 properties or so. Just a couple of questions on that. One, what kind of drove the reappraisals if there was any kind of one thing, if you could help us understand that. And then two, should we expect more appraisals going forward? And I

think a lot of us are maybe focused on maybe the office. So it was just one office reappraisal there, but should we expect more of that just given the tougher office environment?

Brannon Hamblen

In terms of what drives these appraisals, as we've talked about before, we really stay on top of our risk migration in the portfolio, and it's sort of a natural evolution. Nothing was really driving these appraisals more than the natural place in the life cycle. We have, as we said, typically a three-year loan would be standard, and then we'll have renewal options that typically have some sort of economic hurdle to get over to allow the borrower to extend the loan. And that always -- I think virtually every deal has an appraisal requirement.

These were typically at the point of maturity and extension. I don't know for sure there may have been some other reasons in here, but that's generally what you will see, and this was normal course appraisals.

In answering your second question around future appraisals, you'll see more of those normal course appraisals as loans hit their initial maturity and look for extension. And then I would assume that there'll probably be a similar velocity -- that velocity is going to follow historic origination from roughly three years ago. But if there was any reason, sometimes we have a reason to upsize a loan, and if we were going to do that, we of course, get another appraisal then to understand the LTV at that point in time. But that's generally the background for the appraisals you see here in this figure and then what you'll see or hear about in the future.

Brody Preston

And that's just -- that's extension just because they're still in the construction phase, correct?

Brannon Hamblen

They may be in construction. They may have just completed construction and entering the lease-up phase. It varies depending on the situation.

Brody Preston

George, obviously, for the last few years, I think RESG has been, I guess, a point of debate amongst the investment community. And so I'm asking, you never want to see a loan go bad, but just given that this loan is relatively small in size or some of the other RESG loans, do you kind of look at this as like an opportunity to kind of maybe prove to some of the folks that have been more negative on the RESG strategy like we can take a land loan, underwrite it really well, and come out with potentially no loss on it in a pretty stressed environment? Do you think that, that would be -- do you think perversely, this credit could wind up being beneficial to the story going forward?

George Gleason

Brody, perhaps, I don't know -- I find it an amazing thing that people debate the merits of the RESG strategy and the quality of that portfolio. We've been doing this 20 years now. We've averaged an 8 basis point annualized loss ratio over 20 years. We've had tens and tens and tens of billions of dollars of projects that have paid off. People in the industry know that we've probably got the best risk-adjusted real estate credit model in the whole industry. We are always a senior secured lender. We're always low loan-to-value, low loan to cost on these things.

And the track record through all sorts of economic environments just proves that we're only going to have occasional incidental challenges in that portfolio and the life of the portfolio losses are just indisputably favorable at 8 basis points over 20 years. So people who want to be negative and want to be argumentative and want to be hardheaded and continue to argue that something that has demonstrated good quality is not a good quality and is some sort of systemic risk to our balance sheet, I don't know that you can prove to them that it's not.

We've got a great business model. It drives great quality assets. It drives great yields, which give us an industry-leading net interest margin and an industry-leading ROA, and if people want to argue about it, they can argue about it. We're just going to execute our business plan well and consistently, time and time again. And I think however long it takes, the naysayers will get over it.

Matt Olney – *Stephens Inc.*

I want to follow up on the OREO property. Just curious, if you hold back the property into 2024 and wait until conditions stabilize and improve, I would assume you need to take or get another appraisal by December of '23, if not earlier. Is that fair?

George Gleason

Yes. As I said earlier, we will reappraise it at least annually since it's in OREO.

Matt Olney

On that note, I guess, what we typically see from other banks is once a property is taken into OREO, I think that action typically requires they get an appraisal at that time, but that wasn't the case here. Any more clarity for us as far as why there wasn't a new appraisal when it did come into the foreclosed assets for the bank?

George Gleason

It was essentially within 90 days. So a new appraisal by regulatory standards is anything that's a year or less old. So it was a new appraisal at that time.

Matt Olney

Thinking more about capital ratios, the unfunded balance at RESG was relatively flat, I think, in the first quarter. Do you think we've seen a peak in that unfunded balance, at least for the near term? Just looking for any kind of commentary on kind of where you think that could go over the next few quarters.

Tim Hicks

Yes. Matt, I would agree with you that it is certainly at its peak or near its peak and is likely to trend down as we go throughout the year. Obviously, we had $14 billion of originations last year. We're not going to have that much this year.

George Gleason

$13.82 billion.

Tim Hicks

We’re not expecting to have that much this year, at this point. So yes, to your point, I do think that will trend down as we go throughout the year.

Matt Olney

And then, Tim, just to follow up on that as far as capital ratios. Any commentary on kind of where you expect capital ratios to go? I mean the bank has done a good job of deploying some of the excess capital, but now you're sitting on a pretty sizable slug of the unfunded balance. Just curious kind of where you expect to see this go.

Tim Hicks

This is probably a good opportunity to talk about capital ratios, as they obviously came into light pretty considerably over the last quarter. Certainly, our tangible common equity ratio is among the top of the top 100 banks in the U.S. And if you adjust that for fair value of HTM or other things -- remains in the top 100. We, of course, don't have any HTM securities.

Looking at tangible common equity, we have maintained a very high level of that over the years. I would expect to continue to do that. Obviously, our risk-weighted asset grew considerably last year. We don't expect risk-weighted assets to grow certainly at that level this year and possibly are relatively flat. So with our earnings, in a somewhat flat risk-weighted asset scenario, our capital ratios as we go throughout the year could be flat to up on a risk-weighted basis, and certainly maintaining really strong tangible common and Tier 1 Leverage Ratio throughout the year.

Brian Martin – *Janney Montgomery Scott*

A lot of it has been answered on the real estate stuff, but just a couple of things. Just on the payoffs this quarter for RESG, are you beginning to see those? It sounds like you had a couple this quarter already, but are you starting to see that pick up. I mean, given how low it's been here, is that still where you're trending, but are you beginning to see some acceleration there in the payoffs or still a lot of caution from the sponsors as they kind of gauge the market?

George Gleason

Brian, I don't know that I would say it's accelerating, but we are seeing a continued level of payoffs. It's not slowing or stopping. We'll see where that goes. I think we reiterated our guidance for payoffs this year to be back in that same range as we had in 2021 and 2022, which was kind of \$5.6 million to \$6.2 million, plus or minus \$1 billion.

I think we're going to see somewhat of a repeat of the last couple of years of payoffs that has some nice implications given the substantial origination volume last year. For us to continue to have good growth in our funded balance of loans over the course of this year and next year, and that plays back into Tim's response to the capital question. We expect to continue to have industry-leading total tangible common equity and CET 1 capital ratios, but those ratios are going to support the expected growth that we expect this year and next year.

Brian Martin

Could you just touch a little bit -- there's a lot of good momentum on the lending groups outside of RESG. Where do you think the momentum, and given kind of the recessionary outlook here, just how much momentum do you think can continue there on some of those areas. From a high level, if you could give a little perspective, it would be helpful.

George Gleason

I would say we're cautiously optimistic about those guys in the other business units and their ability to maintain momentum. Part of that is a result of the fact, Brian, that we think we're going to see some other banks that are pulling back. There are banks that don't have the robust capital level that we do and banks that don't have the more diverse, stable organically originated deposit base that we do. And you've already read some banks commenting that they've shut down loan growth and expect to shrink their balance sheet and so forth, or curtail new originations or limit and restrict new originations going forward.

It's business as usual at Bank OZK, and we're looking for good customers, good relationships, good business. I think even though there may be some macroeconomic headwinds that will tend to constrain volume in some respects, I think we may get some opportunities and bigger pieces of the pie that we wouldn't have gotten before. That will tend to offset that. We'll just have to see how that plays out. But we're pretty cautiously positive about that as we look at the remainder of the year.

Brian Martin

Yes. I agree, the positioning looks really good there. And maybe just last one for Tim. Tim, can you just give any color on -- just I know you gave some comments in the prepared remarks about the margin, but just given how quickly it's gone up with the benefits over the last twelve months, just how quickly you expect that to maybe come down as the funding costs kind of catch up here. And just directionally how to think about, or maybe where we end up, whether it be in margin percentage or margin dollars, whatever you can offer on that front.

Tim Hicks

Certainly, what the Fed does throughout the year is going to impact my answer. But assuming the Fed increases once more in May and holds for the rest of the year, then certainly, our loan yields will go up slightly more based on that May increase, but our deposit costs are going to go up more than that. We've got good growth opportunities in RESG and our other business lines. We will fund that, as George said previously, through our retail branch network primarily, and that's primarily going to be CDs. We obviously are always working on grabbing core deposits, and we'll continue to do that and ramp up those efforts. And we're supporting those efforts with enhanced marketing and advertising that will help all of the deposit raising efforts that we've got. We are adding additional staff in our retail network, which we've talked about for the last few quarters. That will help with gathering core deposits and opening time deposits as well.

But it's likely that our margin will continue to decrease each quarter this year. But as we said in our comments, we think the average balance of earning assets will help offset any decline we see in margin. And as we look at net interest income for the year, obviously, we had a great quarter, record quarter of net interest income in the first quarter. I think we'll have other great quarters as we go throughout this year on net interest income. And if you certainly look at our net interest income year-over-year, really strong growth there as well.

Hopefully, that provides you some commentary, Brian, and certainly willing to answer any more questions you may have.

Brian Martin
It sounds like directionally the NII will just be down sequentially in the next three quarters or so, just as that plays out.

Tim Hicks
Not necessarily. I don't know that NII will be down, NIM will be down but NII has the opportunity to increase in one or more quarters this year based on our average balance.

Catherine Mealor – *Keefe, Bruyette, & Woods, Inc.*
I wanted to start back on the deposit conversation. Can you give us an idea of where new deposit rates are coming on and maybe where you where your spot rate on average deposit costs were coming out of the quarter?

Cindy Wolfe
I think this will give you an idea, Catherine. So the quarter cost of interest-bearing deposits was 220. March was 237. Does that give you an indication of what you're going to get?

Catherine Mealor

I was looking at some of your offerings online. It looked like you've got a 13-month special CD at 5% and 7 months at 440, does that feel like kind of on average range of where you're seeing new CDs coming on?

George Gleason

Yes, those rates went into effect on March 10 and continue to be in effect. We have one exception to that, which for competitive reasons, I'll not talk about. But yes, that's the general rate out there today.

Catherine Mealor

It seems like you still feel like you have capacity in your branch network to grow to grow your funding through core CDs, not having to really tap the brokered market yet, even if your loan growth kind of continues at this $1 billion, $1.5 billion per quarter pace, is that a fair conclusion from what you were saying earlier?

Cindy Wolfe

It is there. If you look at our branches in the aggregate, now we're in a lot of small markets as well as metro markets. So the nature of our branch network we have a slightly lower total deposits per branch than our peers. That gives you that proof that there is capacity. In any given market, we do have room to grow and do better competing against our competition, and we work on that all the time in our core deposits. So we know there's capacity there to continue to grow.

Catherine Mealor

Were there any specific markets where you found more success in growing these core CDs?

Cindy Wolfe

To me, it's a function of talent primarily, and our culture is a culture of being the best, and winning in every market. So we focus a lot on our talent as a way to win. And another huge focus is service quality. Consumers really do care about service quality in any retail business. So we're extremely focused on that. I know the story is mostly about pricing, but I spend most of my time on talent and service.

Catherine Mealor

And was there a market that you felt like there was more dislocation just given all the drama of March that you felt like it was -- you had better traction in ex steady or ex market?

Cindy Wolfe
We know which markets are doing well, and we talk on a very granular level to each individual leader in those markets. So we have the same products. We have the same nice buildings, and we have the same general competitors. I mean we have a good diversity in our competitor set, which I consider a strength. You don't want to line up 100% in every market against just big banks or just community banks. So the factors that go into it are pretty complex as to why you might be winning in one market versus another, and it's not just price driven. So I would take way too much time in this meeting to go through why one market might be doing better than another. I'll just say it's not necessarily price. And we work on all aspects of the equation all the time, not just pricing.

Catherine Mealor
Then back to the credit conversation. As your construction loans continue to reprice up and they're now at about an 8% yield, can you talk about your ability for your borrowers to continue to afford that rate? And any impact you're seeing that it has on interest reserves and any stress you're seeing in your borrowers just with the higher rates on the construction loans today?

George Gleason
Our sponsors, the equity in these transactions, are the guys that are most impacted by those higher rates. And the continued increases in interest rates are cutting into their profit margins on projects that they're pursuing, which is frankly why you're seeing fewer new originations, new projects being created this year than you did last year. The significant ramp up in interest rates over the last 14, 15 months has impacted the profitability and hence, desirability of a lot of those projects.

Our sponsors and the quality of our sponsorship and the structure of our transactions is very protective of us in those situations. Almost all of our RESG loans would require sponsors to buy an interest rate hedge, an interest rate cap, and those are beneficial to protecting our sponsors and those who are assigned to us as additional collateral for our loan. In addition, we're very diligent and continuously monitoring in our asset management department every loan, evaluating the adequacy of reserves and adequacy of the cap stack. Our completion guarantees require as part of the guarantee structure that if a deficiency in the cap stack or any of the reserves develops, that the sponsors have to rectify that by putting in more equity.

So that's a fairly common occurrence, and goes without a hitch in the normal course of managing these credits, that as interest rates have risen additional reserves are sometimes required and our sponsors have to put that up. And that's a discussion that they would rather not have, but they honor that obligation and do that almost without exception. So yes, it's a legitimate issue. It's an issue for the sponsor of the equity as opposed to an issue for us if we manage and administer it right.

Catherine Mealor

And then my last question on credit is just I think pay downs have slowed, obviously, for the reasons we've talked about for the past hour. But you have seen some of your projects obviously pay down. So for those that you are seeing success in moving the project to the permanent financing market, can you just give us a flavor for what that looks like, what the pricing looks like, how active the market is, what type of buyer you're seeing just to kind of give us a sense as to what that process and market looks like today?

George Gleason

That's all over the place. I'm going to throw that to Brannon and see if we can harmonize an answer for you on that.

Brannon Hamblen

There are sales that are occurring as well as refinances. And I would say what's paying off is fairly even across the board. I mean you've got -- I think in terms of number of loans this past quarter, actually, condo was the biggest in terms of actual number of loans that's fully paid off, and that's not counting all the condo loans that you actually had pay downs on.

In this environment, you might think with rates where they are, you wouldn't see that. But of course, a lot of our condo loans are secured by collateral in the southern Miami market. And those are typically presold with very high buyer deposits and those guys tend to follow through on those transactions versus other markets that might not have such a big buyer deposit and a little slower there. But behind that, I'd say multifamily tends to still be the most liquid. Of course, their cap rates are up, but they're still on a historical basis, pretty reasonable. And I've seen some refinances and heard some sizing around some agency type lenders that was pretty compelling.

So overall, again, it's lower -- but we're still seeing some stuff pay off. We had a big life science loan that was a refi, we had some in industrial, we had a hotel refi as well. So the sensitivity of our assets is one thing that if our buyer or our borrowers can improve on that, that rate they're paying us at all, it's a consideration. So not an ideal market but still seeing transactions come off.

Brody Preston – *UBS*

I just had one follow-up on the RESG projects that are office. They're obviously Class A in nature. And I know that some of those buildings when they're under construction, or at least I've read that they can have a pre-leasing that occurs. I wanted to ask if any of your office buildings that are under construction have pre-leasing in place. And if you could give us a sense for how much or how often that occurs?

Brannon Hamblen

Good question, and the answer in short is yes. We do some that are spec and we do some that have pre-leasing, and of late more of it has material pre-leasing in place, or a requirement that it'd be in place, before we fund.

And the other thing to point out, I mean, well, you're starting at, on average, I think our office projects are at a 53% loan to cost, right? And -- and in addition to that, you've got typically sequential funding, which means we're asked by our borrowers before we start funding. And then on top of that, you've got the fact that as leasing does occur, it has leasing commissions and tenant improvement dollars that are funded only at that point in time.

I would tell you that probably, call it, 1/3 of our commitments are actually funded on office. So that, in combination with, in certain cases, a pre-leasing requirement, and in other cases, leasing taking place, we feel good about the ultimate loan to cost and loan to value and the way that, that actually happens with future deliveries and TILC, or good news money as we call it. So we feel good about our office portfolio, as George alluded to in detail earlier.

Brody Preston

And then just my last quick one was the 8% rate for that loan, and I think Catherine referenced it, but is that a good rate to assume for what funding currently, like what funded this quarter? And just remind us that those come on at floors, right? So that interest rate should be relatively sticky if we were to get a Fed cut at any point over the next 3 to 9 months?

Brannon Hamblen

I don't know exactly, as I said, what that rate was, but it's a good proxy. And I want to say our non-purchased yield was 8 and change. And the floors, we've talked about the fact that we are as we're closing loans today and as we did, and obviously, we closed a lot of loans last year. Those floors are typically going in on the day of closing.

Now SOFR has moved a lot, quickly, as we all know. So those floors have moved up quickly as well. You really -- we have a good loan vintage chart, I forget what -- I think that was Figure 11, that sort of gives you the vintage of our loans. But even maybe more so and more granular basis, on Figure 9 where you see the quarterly originations. And so you sort of follow the movement of SOFR through those quarters that I'll sort of tell you where the floors are being set.

But not only on the origination side, but George mentioned the asset management group being busy with interest reserves and allocations and things of that nature. They're also busy as we're extending loans. I mentioned before, sort of natural around on average 3 years, there will be a maturity and a possible extension at that point in time or any other point in time that they have asked for any sort of modification that we feel like we can do and be in the same sort of safe place we were, we'll be looking at that rate. We'll be looking at that floor rate and attempting to move that up to increase the stickiness that you alluded to in the legacy portfolio as well.

So it's an important part of what we do. We work hard at it every day. But again, a lot of it has to do with the speed and magnitude of the SOFR changes over the last, especially 6 to 9 months.

Timur Braziler – *Wells Fargo Securities*
First, on the allowance ratio, it looks like over the last two quarters, the incremental build to the allowance ratio has all been from the unfunded commitments. We started to see some incremental charge-off activity happening outside of RESG. I'm just wondering, as we enter into this period of incremental uncertainty, how you're feeling about the overall 1.01% allowance ratio and what that could trend like in the back end of the year?

Tim Hicks
Obviously, we feel really good about that ratio and the overall ratio. And you've seen us build the overall ratio the last couple of quarters. Clearly, our provision has been impacted the last couple of quarters by growth in our funded balance. It all depends on the Moody's macro scenarios and how we view those compared to our own view. There continues to be a lot of uncertainties in the current environment, and that's reflected in our viewpoint on our scenario selections, our scenario weightings.

But Timur, we've got a really low net charge-off ratio, historically, a range that we've given is still on the low end. If you look at our nonperforming loans, they're on the low end of our historical norm. Our past due ratio is low. So our asset quality is really good. If you looked at our substandard loans and our special mention loans, outside of the one transfer to OREO, those are relatively stable to actually down a little bit this quarter over last quarter.

So our asset quality is very, very good, and we feel really good about where our ACL is and expect the variables on that to be our funded growth and our view on the forward-looking economic scenarios.

George Gleason
I would just reiterate what Tim said that the last couple of quarters, we've had really good loan growth and the majority of our ACL and growth has been attributable to the growth in the portfolio, either funded or unfunded. And that we did reiterate our prior guidance on net charge-off ratios for this year.

Timur Braziler
Great. And then just lastly, on the buyback, you guys were pretty aggressive in the first quarter. I'm just wondering how much of that $85 million was bought back post Silicon Valley? And then just how should we be thinking about the buyback for the rest of the year?

Tim Hicks
Timur, we were very active in March. So I'll leave it at that. And certainly, we expect to be active this quarter and in future quarters. We've got $200 million left in our current authorization. So that gives us an opportunity to remain active and certainly at the valuation that we're seeing now, we feel like it's compelling to continue to be active in the current market. And obviously, a lot of things go into our consideration of when we buy and how much we buy, but certainly feel like we'll remain active this quarter and potentially in future quarters.

Timur Braziler
Great. And then just remind us when that $200 million authorization is through?

Tim Hicks
It's November 9.

George Gleason
Thank you, guys, for joining the call today. We appreciate it. Appreciate all the questions. Have a great day. We'll see you in about 3 months. Thank you. That concludes our call.