Bank OZK

Transcript of the Second Quarter 2021 Conference Call

July 23, 2021, 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.

To make the most efficient use of the time we have for this call, we'd ask that you please limit your questions to one or two at a time, and then re-enter the queue for any follow-up questions, if needed. 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.

Ken Zerbe - ***Morgan Stanley***

I was hoping we can start off, George, I think in your sort of prepared written remarks, you talked about total loan growth and RESG potentially starting to grow again in fourth quarter. I know payoffs have been just such a headwind over the last several years. Are the comments designed to say that, or suggest that, payoffs could actually start to slow in fourth quarter? Could we really be seeing a turnaround that those are starting to end in a big way?

George Gleason

Ken, no, I don't think that's the proper interpretation. I think payoffs will continue to be high. And I think the more appropriate interpretation is to think about origination volumes beginning to increase in a meaningful way. I spent six weeks on the road during the second quarter, visiting the vast majority of our major RESG markets and almost all of our origination team members out there. We had scores of customer meetings and interactions and were looking at projects. So we're pretty optimistic about our ability to begin to achieve higher origination volumes that will offset the elevated repayments that we are experiencing now because we're getting repayments that naturally would have occurred last year, but for delays from the COVID pandemic plus repayments that would naturally have occurred this year.

We originate construction and development loans. So repayments are going to be a common part of the business. Now obviously, we've got a higher level of accumulated repayments this year than normal just because of the COVID related delays in project completion, construction, sales, leasing, refinancing last year. But we're going to continue to have to originate more to offset the fact that all of our loans in that construction and development book pay off.

So we're focused on growth. We've got a great franchise. Our franchise has proven itself now through the Great Recession, proving itself through the pandemic. Our customers know they can count on us and rely on us that we're always going to be there for them. And I think we've got a chance to really grow our business over the next several years. And the six weeks on the road during this last quarter that I spent with our origination teams out there certainly suggest that late 2021, 2022, 2023, we can take our RESG business to a more significant level than we've taken it in the past because the opportunities seem to be there. And of course, Brannon's going to go on the road and do a lot of the same sort of networking that I did in coming quarters. And I think all of that work with our origination team is going to help produce an increasing volume of business, certainly next year, and hopefully, we'll see some of that begin to filter through in Q4.

Ken Zerbe

And then just my one follow-up question, in terms of the net interest margin, obviously, you said you had a very good increase there. And it seems that some of it may have been driven by unusually high minimum interest collections, et cetera, but also lower deposit costs. When you think about the NIM on a go-forward basis from here, should we expect the lower deposit costs to continue to drive the NIM higher? Or how should we think about the trajectory of net interest margin?

George Gleason

I would suggest that we're at or near a peak on the NIM probably in the near term. We commented in our management comments that we're originating loans at lower rates than the rates that were earned on loans last quarter. That is unfortunately a part of this very liquid low rate environment in which we find ourselves. Yields on all sorts of financial instruments and loans are lower than they were and probably lower than they should be, but it is part of the environment. So as loans roll off, we're not able to replace those yields with equal yields.

We are being diligent to not sacrifice our credit standards and structure standards that we've adhered to for a long time that are the hallmark of our great asset quality. But we are having to get more aggressive on price to not only replace assets that are rolling off but also grow assets. So growth is important. Pricing is a bit negotiable in here. So loan yields are probably almost certainly headed lower.

We've got room -- Cindy can talk about this later in detail. We've got room to continue to lower our deposit cost for a while to some extent. And I think there'll be some pressure on core spread and some pressure on NIM.
We did benefit in the quarter just ended from a very good level of minimum interest and loan fees. And I noticed several of the research reports on our results noted that we didn't quantify that. And the reason we didn't quantify that is it's hard to know what's normal. In some quarters that's $9 million or $10 million, some quarters that's $3 million or $4 million, and it bounces around all over the place. We were on the high end of the range this quarter. We could be on the low, the middle or the high end of the range for the next few quarters. It just depends on a lot of things that are hard to know when particular loans pay off and is it this quarter or next quarter and so forth. So we didn't quantify. We were on the high end of that. So that naturally alone will have some pressure on loan yields in Q3. And the key is going to be our ability to continue to offset that pressure with reducing deposit costs and the guys are doing a real nice job there. Long term, Ken, growth is the key.

Timur Braziler - ***Wells Fargo Securities***

George, maybe just following up on your last comment that long-term growth is the key. It seems like RESG, Indirect RV & Marine, ABL, CBSG, all converge in '22. I guess what does the near-term growth rate look like in 2022? And then once RESG is fully normalized with payoffs kind of stabilizing and originations starting to pick up again, what does that growth rate look like?

George Gleason

Timur, I'll let Brannon Hamblen address that because Brannon is our President, but he oversees RESG and our Corporate and Business Specialties Group and our new asset-based lending group. So he's got a pretty good perspective firsthand on most of that. So Brannon, do you want to take that?

Brannon Hamblen

Picking a normalized growth rate is a little bit of a fine point to make. But what I would tell you is from RESG's perspective, and George alluded to this, we're seeing very good pipeline activity. We're very strong there and our conversion, our wins of what's available out there is starting to pick up. So I'm expecting the back half of the year for originations in RESG to be definitely moving in the right direction and back toward and beyond what we'd historically done. You guys know it's a construction loan portfolio and what you close today when you've got 50% average loan-to-cost, it takes a while to get those dollars out the door.

We've included again, the graph on Page 7 of the management comments, it really gives you a sense of what's left from the legacy portfolio that's outstanding and therefore, what's left to pay down. So back to Ken's earlier question, you get a real sense of what that cycle is going to look like. So we'll still have some payoffs, but I'm seeing really good growth opportunities in the -- on the origination side that will start to -- and we've obviously weren't sitting on our hands in 2019 and 2020. So some of those loans starting to hit with funding will help as well to offset at least in part, these payoffs that will keep coming in the velocity that you see on page 7 of management comments, following the originations and the natural life cycle.

In our new asset-based lending group, I'm excited, again, as I mentioned last quarter about the addition of that team and that team is growing or adding incrementally and look forward to having, we think, some really solid players in probably Texas and Georgia markets first is what we think is going to happen there. And Mike Sheff, who leads that group is in addition to building the team and the infrastructure toward originating its first loan is very active in the market as well. And I expect that those guys will start to originate probably the first closings in Q4 or early Q4, possibly get one in Q3, but the opportunities that they're seeing out there in the geography that they're covering, I'm feeling good about those guys really contributing to our growth. They'll start at a moderate

pace, but I think gather steam pretty good towards the back half of 2022 and keep going in 2023. I think there's good potential for originating some really solid credits in that world.

And our CBSG group is, as we noted, going to have some headwinds early on, but they're building a base and getting competitive and originating some new stuff with new borrowers there. So we'll see that accelerate as well. So Timur, it's hard to circle a number, but I can tell you that the outlook is positive across all three of those groups. And I think RESG is the big driver there. We're looking forward to getting back to what we've seen in previous years there. We think that the volume is there, and we're out there trying to haul it in and having some good success now.

George Gleason

Timur, I would add that we are gaining in a very steady and consistent manner of traction with our indirect lending group and the new business model that we rolled out about a year ago now, or almost a year ago there in that unit, and we really like the way that's performing. We're going to, we think, be able to protect our asset quality while paying lower premiums and getting better spreads now given where rates are, we may get better spreads, but that might not translate into better rates right now just because of how low everything is.

And our community bank is also getting some traction, I think. So growth will continue to be a challenge in outstanding, certainly through Q3. I hope that we'll have a positive growth number in Q4. And I think, as Brannon said, there's a lead time between getting these things closed and beginning to get funding on them. But I think we ought to see a steady progression in our total outstanding balances and earning assets from loan side throughout '22 and into the future. And I think we got all these units going in the right direction. The business model has certainly been proven. And I think we've got really good prospects of stepping up to a higher level of origination volume across the company, more diversified also than it's ever been before.

Timur Braziler

And then my follow-up. In the release you had indicated that you're seeing fewer origination opportunities in large urban markets such as New York that are meeting your standards. Is that still a few number of deals that are coming online? Or are you starting to see some deals come online that aren't necessarily checking your credit box or other standards?

George Gleason

Well, we always see a lot of deals that don't fit our credit box. But I would tell you, I was in a lot of our major markets, I was in New York, I was in Boston, I was in Chicago, I was in Miami, I was in the Tampa St. Pete area,

I was in Phoenix, I was in Los Angeles, San Francisco, Denver, I've been in a lot of our markets in this last quarter and larger mixed-use projects that we've missed the origination on those for the last several quarters just because a lot of those projects got put on hold in the pandemic. There are a lot of those opportunities that look really good that make a lot of sense that are coming back to the market now, and we're working on a good portfolio of those. And we're seeing quite a few other opportunities begin to emerge in those more urban markets that were more significantly impacted by the COVID pandemic shutdowns and work-from-home phenomena. So I think things are normalizing and that bodes well for future origination volume.

Brock Vandervliet - ***UBS***

Just on the deposit dynamics, George, it's great to see what seems to be something you've talked about for a couple of quarters now really in motion with a tangible remix declining time deposits in both categories, and as a result, lower funding costs. Could you talk basically top of the house, what inning are we in, in that process and more granularly where you think your total deposit costs or interest costs could settle out by you say, year-end?

George Gleason

Brock, I want to give credit where credit is due on that. Cindy Wolfe, our Chief Banking Officer is on the phone. So I'm going to let Cindy answer that question. But Cindy has built a great team under her that includes Carmen McClennon, our Chief Retail Banking Officer, and Ottie Kerley, our Chief Deposit Officer and a number of other key players. And they are doing really a good job. I'm going to advise Cindy to not try to tell you what inning we're in, but just give you color on where she thinks we are in, or going in, our process of transforming our deposit base. So Cindy, take that one, if you would.

Cindy Wolfe

Yes. And further, I won't guess what our cost of funds will be at year-end. But as you can see on page 14 of management comments, we have runway left in our CD maturities. So I can talk about how that's been going so far, and it will -- there are indications that those trends will continue. And that's when we went into this wave of CD maturities, we expected to retain a certain amount of them based on our historical performance around retention of CDs and the industry. And we actually retained more than this go around and we thought we would, which we're happy about that. And of course, obviously, they're being repriced much lower. So you can see that in Figure 16. And so we'll continue to take advantage of that, not only in lowering cost of funds, but changing our mix of deposits and replacing with core.

Brock Vandervliet

Got it. And just as a follow-up, I noted the comments closing, selling a branch or two here and there, taking out some headcount. What's kind of going on in that process behind the scenes? Is that sort of an interest in kind of stack ranking the profitability of the various branches?

Cindy Wolfe

Well, it is that it's really no different than the way we've always run our branch network planning. We look at a number of different factors. But I will say that a lot of it is client driven. We want to be a client-centric bank. So we have all these various consumer channels where our clients prefer to interact with us, whether it's over the phone, over a mobile device, online and, of course, in branches. So as long as our clients want our branches and they're keeping them busy, then we want them to have that option. So we're really responding to the market with our branch network.

George Gleason

And Brock, I would add a little color there as well. During the COVID pandemic, Cindy and her team responded really aggressively and updated our mobile banking apps a couple of times and accelerated some plans we had to improve the look, feel, functionality, performance of those apps. They worked closely with our technology team to improve the speed and reliability metrics of that as well. And all those things were on the drawing board, but the pandemic, which meant that in our branches we're interacting with customers in a different way, by appointment only or drive-in only or whatever, pushed those mobile channels out much faster and encouraged customers who might have been slow adopters to be more rapid, aggressive adopters of that technology. And that has changed the dynamics of how customers are interacting with these branches.

So that changing customer interaction, increased reliance and utilization of mobile online and other non-face-to-face technologies has accelerated the closure of some of these branches. And most of these are branches -- situations where we had two or three branches in an area, and we concluded that based on changing customer utilization patterns and increased technology utilization, we could serve our customers effectively with two instead of three or one instead of two branches in an area.

So it is helping to offset cost, and you've seen that in a fairly muted noninterest expense growth. Those cost saves are going to be very important because we're in an environment now where a lot of people have changed their working plans and patterns and behaviors following the pandemic and the experience they had for a year or so during the pandemic. So we're experiencing labor cost, as we mentioned in the management comments, and

closing these branches that are no longer needed and eliminating other redundant inefficient cost in our structure are going to be critically important in our effort to maintain or even improve our best-in-class efficiency ratio.

Catherine Mealor - Keefe, Bruyette, & Woods, Inc

I was excited to see the buyback authorization. Just wanted to get your sense as to how active you intend to be? And is it more opportunistic? Or is the plan initially to go ahead and use that whole $300 million?

Tim Hicks

Yes, obviously, this is our first share repurchase authorization that we've done in our company's history. It is an authorization that has a one-year expiration. So it does go to July of next year. I think we'll have a moderate pace there. I mean we will be opportunistic. Obviously, if our stock price were to go down, we're probably going to be more active. When our stock price goes up, we will be less active. So I think we'll look for opportunities to be opportunistic at a moderate pace.

Catherine Mealor

And then my other question is just on the growth outlook. This is more just kind of an industry question. Just to think about how we keep hearing about supply chain issues and construction costs that are impacting new construction projects. How much of that is impacting originations today? And what's your sense as to how that kind of moves along as we move through the back half of the year? And how that kind of impacts your growth outlook?

Brannon Hamblen

I think decreasingly so is the short way to answer that. As we have moved through the year, there have been situations where there are really some impact, but nothing outside of the realm of what we're used to dealing with in our 18-year history on construction projects. And as to affecting originations, as George alluded to in his travels thus far this year, week in, week out over the past quarter, you have seen opportunities increasingly come to market. So it really doesn't feel as though or any data present itself that would say that there is any material impact there. There's a cost impact to projects. And so there's a fine tooth pencil that's there right after the closing projects and there -- from a purely closing loan perspective, it may delay that a bit. But as we've alluded to, the liquidity in the market and some of the lowered expectations on the yield of some of that money is helping those capital stacks to absorb the cost impact and that cost impact seems to be moderating in certain cases.

So in short, deal flow is moving better as we move through the year. So to the extent that it's been an issue, it's not keeping the market from bringing increasing number of deals, and deals that are RESG type deals, that came up

earlier. I think we're definitely looking at more of those larger mixed use projects that had been slow out of the box out of COVID. And so I would expect -- I mean, my expectation would be anything can happen, but that we'll start to see on average larger loan amounts as we close into the back half of this year and into 2022. There are a lot of projects out there. There are a lot of large projects out there yet to come to the market. And of course, our capital puts us in a great position to be able to bid on those large projects. So hopefully, that answers your question.

Catherine Mealor

And then maybe one follow-up, if I could, just to follow up on the loan yield conversation. I know it's hard to pinpoint the fees or the accelerated fees this quarter. But could you maybe give us a sense or maybe anecdotes about where new production is coming on today and the -- particularly in the RESG book?

Brannon Hamblen

It's sort of the same story in terms of the product type. There's been a lot of residential, whether multifamily or condo origination going on. But we continue to have really good diversification across the other product types as well. Our footprint geographically is very well situated to enjoy the benefit of a lot of migration trends into -- in particular, the Southeast but also Southwest, West. Our guys, there was a question earlier on New York, while we haven't seen yet the origination pick back up there, the opportunities that we're looking at definitely are, and I think we'll be doing more business there. But while that's been slow, the guys have done a great job of penetrating the Boston market, good activity there, and the D.C. market.

So we have a lot of ways that we slice and dice our portfolio for you in our comments. And what we're seeing is not all that different from -- in the future origination pipeline from what we said in our comments this quarter. While we haven't been closing the big ones in some of the big markets, they're coming to the market. And in the meantime, we've done a lot of stuff in some of the other smaller markets. So keeping busy closing a lot of loans across a lot of different markets and the same general product types that we've been active in, in the last couple of quarters.

Catherine Mealor

And then pricing on those new loans?

George Gleason

It's all over the board. And we're trying to diversify more into industrial and life sciences because we think that further diversification of that RESG portfolio is helpful. That tends to be things that gets done at a lower margin,

tighter pricing. So it really is all over the board. I think the loans that we've probably had in committee in the last six weeks or so, we probably had a 300 basis point differential between the lowest approved yields and the highest approved yields. And it just reflects the product type, the market, the complexity of the transaction, a variety of things. When we get to start doing more really complex transactions that are not as commodity type transactions that require our expertise and sophistication to execute, we get better pricing on those than we do a plain vanilla apartment deal that pretty much any lender can compete for. So it's hard to nail down pricing. I would tell you, on average, the loan yields we're getting on new originations are less than the yields on the book and that if that is surprising to anybody, they've been under a rock for the last couple of years because the Fed has got the market so liquid that there's just not the yield out there that there was.

So clearly, as we said, a downward pressure on loan yields, we've got to offset that with volume. We've got to offset that with controlling deposit costs and keeping our efficiency ratio really low. So we understand our game plan on how to address an environment where there is pressure on loan pricing, and I like our plan and I like our prospects of being successful with that.

Michael Rose - *Raymond James & Associates*
One area that hasn't been hit on yet, George, is technology. It's becoming a big issue. I know you guys have spent a lot of money over the years moving to new headquarters, systems investments, things like that. But the tech spend continues to move higher for the industry. Just wanted to get an update on maybe some things that you're working on and maybe how you would expect to fund them. You guys have been really good on the expense control fund after some of those larger investments a couple of years ago. So just wanted to get a broad update on the technology efforts and where we stand?

George Gleason
Brannon, do you want to take that? Obviously, data, innovation and technology now reports to Brannon and has been for a couple of quarters. So Brannon, do you want to talk about that?

Brannon Hamblen
I'll say that a lot of the efforts have been, I think we talked about this last quarter around the efficiency of the way we run the operation. And George and Cindy alluded to the outward-facing side as well. So it's a two-front war. It's focused on our efficiency internally. And preparation, everything that we do today is focused on what we want to be tomorrow. And that's bigger, better and faster. So we're working on an initiative that is focused on bringing some application that was developed initially at RESG and bringing that into the rest of the organization and Moody's platform at the same time. And both working together to just give us the opportunity to be more efficient

in the delivery of data from one end of the process to the other, give up our management better insight into what's going on from beginning to end of the process. So there's a lot of -- and then just managing our data in new data marts and new platforms. So efficiency is a big word as it relates to the internal side.

And then Cindy and Carmen have been working with our labs team, as George alluded to on a number of fronts to move with the market as the needs and desires and technology change. We want to stay at the leading edge of that to ensure that we are putting Cindy and her team in the best possible position to move the deposit world where it needs to go. So we have said many times that we're committed to excellence in not just our credit but also our efficiency in the way we serve both customers and provide our employees with the opportunity to do their job. So that will be something we're always focused on. I think everyone on the call understands the speed at which technology is changing and it's our desire to stay up with and ahead of that at all times.

George Gleason
Let me add a little bit to that. And we really are fortunate to have an excellent technology team and that whole group now, technology, data and innovation reports up to Malcolm Hicks, who reports directly to Brannon. And we've been effective in the last year as Brannon said, in delivering quick technology enhancements, upgrades and solutions. Our Labs unit has been very instrumental in that. Those guys, I think, are doing the best work they've ever done. We've gotten a very pragmatic, practical, get things done, accomplish improvements sort of focus throughout that group that makes them really effective in helping our company. And we continue to advance on a lot of fronts.

So I'm pleased with where we are. I think your question probably was aimed at where we're going to see huge increases in expenditures regarding technology. I think we will see increasing spend but at a fairly moderate rate of growth because I think our guys are being very efficient and very pragmatic in how they're approaching this, but we are, at the same time, advancing our technology capabilities consistently and I think pretty materially. I feel real good about the progress we're making and the cost that we're incurring to make that progress seems very efficient to me.

Michael Rose
And maybe just as a quick follow-up. The service charges were up this quarter. There's been some headlines out there, some self-imposed but also some external pressure on NSF fees. I know that's not a big line for you guys, but is this a.) what drove the increase; and then b.) what steps do you plan to take as it relates to NSF for those customers that have in - again, I know it's a small proportion for you - but it has been in the news lately.

George Gleason

Well, we're monitoring what political and regulatory conversations are going on about that subject. It does seem likely that some changes are in the wind ahead. We don't have any significant plans to change anything in the short run, increase or decrease, in that regard. We have seen, particularly the last month or two as economies have more fully reopened and people are out spending and so forth, we have seen an improvement in service charge activity. And part of that is just the philosophical approach that Cindy and her team are taking on deposits and getting more core customers and less interest rate-driven customers. And those core customers tend to engage in activities that create more service charge revenue. So I would tell you, the biggest impact in the improvement in the last quarter was just the normalization of economic activity and reopening. Second to that is improvement that Cindy and her team are making in the quality and value and profitability of our deposit base.

Matt Olney – Stephens Inc.

I'll start on the interest-bearing deposit costs. It sounds like there's more room to bring that down in the near term. But I guess from a strategic standpoint with all the liquidity in the system, I'm just curious if the bank has yet considering locking in longer term funding in anticipation of higher rates in the future?

Cindy Wolfe

We are. So Ottie Kerley, our Chief Deposit Officer, and Drew Harper, our Managing Director of Wholesale Deposits have been working on that and are doing some relatively conservative steps to increase duration in our book. We're not going overboard with it. But yes, we are having those conversations and making some moves to add duration.

George Gleason

And Matt, we're doing that in a cost-effective manner. I think Cindy pointed out that chart at the bottom the page there on deposit costs, Figure 16 I think it was. And if you look at our new and renewed time deposits in Q2, they were a fraction of a basis point -- it actually rounded up instead of down this quarter -- they were a fraction of a basis point higher in Q2 than in Q1. And that differential really reflected their efforts to -- without materially impacting our cost fund begin to ladder in some longer duration deposits.

Matt Olney

I want to circle back on the discussion around loan fees. And as you said, you were just not easy to predict where that's going to land in any given quarter. But it does feel like these fees have been elevated for a few consecutive quarters. Is that fair? And then for the short-term extension fees in particular, I think that was one of the things that was mentioned in the management comments. My working assumption has been that some of those extension

fees are associated with RESG project delays that were driven by the pandemic last year. Is that right? And if so, can we assume that some of those projects are -- that were delayed or not coming back online and getting back to a normal schedule. And so should we assume that those extension fees will be lower next year compared to this year?

George Gleason

That's probably a fair assumption, Matt. And again, these kind of extraordinary extension fees, minimum interest and so forth, I mean, we're talking a range in low quarter of $3 million or $4 million a quarter and a high quarter of $8 million or $9 million and more typically somewhere in between there, but it does just bounce around a lot. So yes, you're correct that a lot of projects that were delayed for three to six months by COVID need another three months or six months or four months to get the project completed and sold, units closed and the loan paid all for to refinance to the permanent market, and that has been a nice source of fee income, particularly the last couple of quarters. We've seen quite a bit of short-term extension fees the last 2 quarters. And I think we'll continue to see some level of that in the last 2 quarters of the year and diminishing somewhat next year.

And the other fees just tend to, even in normal times, tend to, minimum interest and acceleration of deferred loan origination fees from faster-than-expected payoffs, those things tend to just bounce around a lot in good times and bad times. And actually, the acceleration of deferred loan origination fees and minimum interest can have a greater impact in periods where things are going much faster than when refinances and sales are going slow because your project typically tend to earn up those fees and earn out that minimum interest before they pay off when things are going slow. So it's a very dynamic situation, and it's hard to generalize. And that's why we always are hard pressed to give really good guidance on it because it just bounces around a lot from quarter-to-quarter. We're thankful for them, we earn them though. Let me be clear on that.

Brian Martin - *Janney Montgomery Scott*

You talked about just kind of the deployment of capital. I mean, obviously, the growth and the buyback you've mentioned, just kind of any update on just how you're incorporating the M&A commentary, just how that's trending today the opportunities or what you're seeing maybe seems less likely with the growth that's in front of you that you've already articulated?

Tim Hicks

Certainly, as we outlined in the management comments, organic growth is our #1 growth priority. Clearly, we've got a lot of things moving in a positive way there between our RESG, asset-based lending team, and our community banking team. If you exclude the PPP loans, our community banking team actually grew this quarter.

I think there is no surprise, our Florida and Texas markets did really well in community banking. Indirect lending seems to be certainly on a positive trend there as well. So we're focused very heavily on organic growth and the opportunities there.

Obviously, we announced the share repurchase authorization, along with our earnings as well. But our appetite is back for M&A. We are looking at opportunities. It is a secondary growth opportunity for us to add to our organic growth opportunities. We don't want to do anything that would be of a size that would disrupt the momentum that we have organically, but we are actively looking for opportunities.

Clearly, we still believe our stock price is undervalued compared to some of the peers and compared to some of the valuations of some of the acquisitions that have occurred recently. Obviously, the M&A market is very active right now. We would look probably to do something of a size where we could do it for cash or some combination of stock and cash. So a lot of things moving there, but one of our primary focus areas is just how do we deploy our capital in the best interest of our shareholders, and we're looking at all avenues to do that.

Brian Martin

How do we think about the kind of the mix of the balance sheet? I mean I know the securities were up a little bit this quarter. But just given the growth is in front of you, just kind of how that mix may change as you go over the next 12 to 18 months? How should we think about that? I think securities were maybe up to 18% or so of assets. Maybe I'm not sure if I have that exactly right, but just up a little bit relative to the past.

George Gleason

Brian, I would say we've typically maintained our loan-to-deposit ratio in that 89% to 99% range. We've got all sorts of stress testing and secondary source of liquidity and other things that have given us comfort being at that level. We're a little below that right now. I would think that as we get the loan growth going where we want will return back into that 89% to 99% range in the future.

Brian Martin

There is some commentary about the wage inflation, just how that may impact the expenses as we go forward here, just how we should think about that?

Greg McKinney

As we mentioned in our management comments, we have experienced pressure, really broad-based pressure across the U.S. from wages and being able to find workers to fill all the spots here in the bank where we want to

have and we retain our teams and make sure that our teams are getting appropriately compensated. So I think there is going to be pressure from that as we look into the next quarter or two. How long that continues - that's probably still to be determined. But some of the things that Cindy and her comments in response to a question about our branches, some of those things we're trying to make sure that we look at all of our operations when -- and make sure we are eliminating any sort of redundancies or inefficiencies, utilizing technology to really help us to the extent we can offset those wage pressures. Hopefully, we can effectively offset that. But as we mentioned in our prepared comments, that's certainly going to be a challenge and there's going to be probably a driver of increasing our benefit costs for us over the next couple of quarters.

Tim Hicks

We have it in our commentary, but just as a reminder for noninterest expense for Q3 specifically, we do have a couple of one-time type items that are going to impact Q3 noninterest expense -- the $2 million of charges we are going to expect to incur from the closure of a few branches that we have scheduled to close in Q3. And then we did redeem our sub debt on July 1 that had about $800,000 of deferred issuance costs that were not amortized yet, that's going to come in, in Q3 as well. So just a reminder from that perspective, but that will impact Q3, and not future quarters.

Stephen Scouten - Piper Sandler & Co

I wanted to follow up on the capital and just kind of how to think about capital deployment in light of kind of your legal lending limit. And I know the buyback as a part of it, maybe you're able to find a deal that's cash or predominantly cash. And so, is the right inference there that you don't need your legal lending limit theoretically to be as high, and we might not see the bigger commitments, the $400 million, $500 million, $600 million return anytime soon? Or am I reading too much into that?

George Gleason

You're reading too much into that. Our legal loan limit now, which we've grown by accumulating a lot of capital in recent years is a very important part of our strategy to significantly increase our RESG and other portfolios longer term. So I think what you're seeing through our increased dividend rate and the stock repurchase program is not a situation that's going to take our aggregate dollars of capital down. I would expect that our strong earnings to pay for the dividends and the stock repurchase and let us maintain or even increase our aggregate level of capital. Now Tim mentioned that and our management comments mentioned that our $225 million more or less of sub debt we redeemed on July 1, we will probably be back in the market mid-quarter to replace that sub debt with somewhat more or somewhat less, depending on market conditions, we'll replace that we think at a significantly reduced cost, but that sub debt will come back on refilling that part of the capital bucket that

temporarily has gone away from July 1 to whenever we replace that sub debt. But we expect our legal limit to go back up. And as Brannon mentioned in his comments, we are seeing a number of really large complex mixed use projects that have phenomenal top of the universe, best-in-class sponsorship on best-in-class projects. So I hope you're going to see us doing more of those transactions going forward and not less. And I think our legal loan limit even with the stock buyback and the dividend increase history that we've had will continue to grow based on strong earnings.

Stephen Scouten

And then my follow-up question, I guess, is somewhat related. And if I look at Figure 44, it looks like some of those larger commitments have been funding up and then I kind of pair that with the origination levels that have remained strong in Figure 7, where it looks like the headwind of prepayments should normalize as you look at '19 and '20 production. So I'm trying to think about how the prepayments don't slow down more precipitously. I know you said they shouldn't necessarily, but I'm trying to reconcile that with Figure 7 and then think about if growth could really return to like the 7% level we saw in 2020? Or is that too aggressive? But it seems like everything is moving really strongly in the right direction.

George Gleason

Yes. I think everything is moving really strongly in the right direction. Of course, typically, most of our deals are sort of two to four years on the books, three-year average. So we've still got some carryover from '16, '17 and '18, all of the '14 and '15 originations have paid off now and almost everything pre-'14 is paid off. Several more loans paid off in the most recent quarter. So we're down to just a handful of pre-'14 deals. The '16, '17 and '18 stuff is all ripe stuff to pay off over the next several quarters. And we're getting into the point where that 2019 origination volume is going to start seeing some sizable paydowns. Next year, we'll be kind of hitting the 3-year mark on that. And that's kind of the prime time for deals to be moving out.

So we've got to grow origination volume to offset the pay offs. And if you look at our total origination volume, we were doing that from '14 to '15 to '16 to '17. We're hopeful that when you see '22, '23 and '24, you'll see a nice upward trend in total annual originations, and that's what it's going to take to actually grow our outstanding balances is an increasing volume of originations, plus contributions from a variety of other business units. And I'm pretty optimistic about how we're positioned to accomplish that at RESG and elsewhere.

George Gleason

All right. Thank you very much. If there are no other questions, that will conclude our call today. We appreciate all of you being on the call, and we look forward to being with you in about 90 days or so. So thanks. Have a great day. That concludes our call.