Bank OZK

Conference Call – January 18, 2019
Transcript

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 Administrative Officer and Executive Director of Investor Relations for Bank OZK. Thank you for joining our call this morning and participating in our question and answer session. In today's Q & A discussion, 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 us on the call from another line is George Gleason, Chairman and CEO. Joining me here in the office are: Greg McKinney, Chief Financial Officer and Chief Accounting Officer; and Tyler Vance, Chief Operating Officer.

We are very pleased to report our fourth quarter results and will begin by opening up the lines for your questions. Let me ask our operator, Sonya, to remind our listeners how to cue in for questions.

<u>Transcript of Q&A:</u>

Ken Zerbe – *Morgan Stanley*

I was, kind of, wondering if we can just least start off with the concept of the repayments or prepayments on some of your larger loans. It sounded like in the prepared remarks that those -- that there was a few of the repayments that were, I guess, technically supposed to be in fourth quarter, that got pushed off to 2019. It did seem that you're a little bit more cautious on the repays that they were going to be higher in '19 than in '18. But can you just elaborate on that a little bit more? How could we be comfortable with, I think it was low to mid-single or double-digit loan growth combined with a high level of repayments. Any clarity would be really helpful.

George Gleason

Ken, first on the timing of those prepays, earlier in the year, when we were giving guidance on our loan growth for the year, and through the middle of the year, the expectation was that most of those loans that slid into '19 would've been in '19. As we got through the third quarter, the likelihood appeared that some of those loans might move into December as prepayments, and accordingly, we gave a fairly cautious guidance on our Q4 growth in the October call in anticipation that those prepays might occur in December. Some moved back into 2019. These are complex transactions with multiple parties involved. If it's a purchase situation sometimes in the capital stack and equity raises, and they're complex transactions. So they will move around a few months to and fro. So we were pleased that some of those prepayments slid into 2019, because they gave us, obviously, another month or two or three of earnings on those loans, which we're very, very glad to have. None of the prepayments that slid are a result of any quality issues or concerns, so it's all upside and that it gives us an opportunity to earn more income. The guidance that we gave on loan growth in the management comments documents for next year, which was non-purchased loan growth in the low to mid-teens takes into account what we described in the management comments as a likelihood of a higher level of prepayments in 2019 than 2018. Both those comments were considered and evaluated in connection with each other.

Ken Zerbe

And then, can you give us any update in terms of your deposit strategies. I saw you just hired someone there. Certainly the deposit costs have been going up less last quarter than they did in the prior couple quarters. What are you doing differently? How should we think about -- or how do you guys think about deposit costs going forward to help fund that mid-teen loan growth.

Tyler Vance

Obviously, we're pleased with our 14 basis points of increase in deposit cost in Q4, which you noted was down from Q2 and Q3. And as our management commentary stated, we had been focused on improving our deposit betas. Over the last couple of quarters, we've been enhancing our data and analytical capabilities around deposits. And those additional deposit analytics have given us improved visibility in various markets and market segments in terms of geography, product and various competitors. We do have some other analytical and modeling enhancements underway and planned for 2019, and we had some good success also in Q4 in lowering our beta on certain large commercial and public fund's customers. For competitive reasons I won't go a lot further there. But as we said in our management commentary, while our results may vary from quarter-to-quarter, we believe that our increase in cost of interest-bearing deposits for the full year 2019 will be less than 2018. Although, we believe those improvements will likely be more evident in the second half of the year. And obviously that level of improvement depends on a number of factors including any Fed actions that may or may not take place, competitor activity and then certainly the volume of deposit growth required to fund our balance sheet growth in 2019. So we feel good about where we are. There's still more work to be done.

And as you noted probably in our recent press release, we did add a new position of Chief Deposit Officer, Ottie Kerley. Another good evolution in our senior management team. He has over a decade of experience in deposit pricing most recently at SunTrust Bank, where he led deposit pricing for around a $110 billion consumer deposit portfolio. As you saw in the press release, he's going to be reporting to Cindy Wolfe, our Chief Banking Officer. They're really doing an outstanding job in our branch banking area. So our strong balance sheet growth requires us to focus on optimizing our funding profile further. And one of the primary ways that we do that is deposit strategy. So we feel like Ottie's expertise will just continue to enhance our existing deposit acquisition capability.

Ken Zerbe

In terms of expenses, looks like the expenses in the fourth quarter were probably a little bit higher than what we were looking for, and certainly, I guess, highest of the year, I guess, technically. Is that sustainable? I mean, is there something unusual in there? And there wasn't a lot of commentary in the management commentary around expenses? How should we expect that to continue into 2019?

Greg McKinney

There's a lot of moving parts that hit those noninterest expenses. We had some, what I'd probably call some unusual debits and unusual credits coming through in the fourth quarter. I think those kind of -- for the most part, generally, offset each other on the impact of the fourth quarter. So I think that the fourth quarter results are, at least, in the aggregate, a clean run rate to start thinking about 2019. I think that when we move into 2019 we may see some movement between categories of noninterest expense. But I think that's, at least, in an aggregate standpoint, Ken, a pretty good starting point to base your 2019 model outlook.

Jennifer Demba – *SunTrust Robinson Humphrey, Inc.*

Got to say the asset quality normalized more in the fourth quarter. A quick question. As you see more angst in the equity markets and what have you seen in terms of sales trends for your higher price point commercial real estate projects or your commercial real estate projects in aggregate?

George Gleason

In general I would say, we've not seen any significant erosion in price or sales velocity on any projects that cause us any concern at all. So we've been watching for that, because obviously, it's been a very turbulent market environment, with a lot of geopolitical and economic and domestic, political themes and things going on, but that it has not seemed to adversely impact our sales, our leasing or anything else at this point. So we continue to be pretty positive about the projects that we've got.

Jennifer Demba

Great. And can you just talk about your net interest margin outlook for 2019 with or without rate hikes?

Tim Hicks

We haven't given any specific margin guidance because of the various factors of how many rate hikes, if any, that we'll get, and the competitive dynamics between loan and deposit pricing. Tyler gave you some good information on our deposit pricing. I will note that on our non-purchased loans, 76% of those are variable rate. A large percentage of those -- actually 77% of those loans -- are variable off of 1-month LIBOR. So they have a high correlation of rising, and we saw the benefit of that in the fourth quarter as the 1-month LIBOR rose throughout the quarter. We'll get the full benefit in the first quarter of 1-month LIBOR being at an elevated level for the full quarter. And non-purchased loan yields will depend on various factors like Fed Funds move and LIBOR move throughout the year. We've talked about our purchased loans. Our purchased loans and non-purchased loans are getting close to converging in their rates. I think non-purchased loans was at 6.34% yield for the fourth quarter and purchased loans was at 6.48% for the quarter. So those are really close. While purchased loans is a higher-yielding portfolio and is declining on a quarter-over-quarter basis, the fact that those two are getting closer and closer in yield makes the impact of that runoff less significant really in 2019 than it was in 2018. So I'll give you those comments around the margin, and we've not given specific guidance on margin, like I said, just given the various factors that really are outside of our control that impact margin.

Stephen Scouten – *Sandler O'Neill + Partners, L.P.*
I know the first question kind of was around some of the pay downs, but obviously pay offs in RESG were slightly higher than originations for the year, but growth kind of came as the unfunded book funded throughout the year. Is that a similar dynamic that we should expect to see here in 2019? Would you estimate that net loan growth largely comes from the shrinking of the unfunded book, but pay downs may still exceed actual new originations?

Tim Hicks
As you pointed out, Stephen, we had, in 2018, in RESG, we had, as you can see on Figure 6 in the management comments, we had $5.7 billion of fundings and that does come out of the unfunded balance and then we had $4.8 million of repayments as well. We've talked about our repayments being elevated in 2019 as well. But we've also given you the guidance of low- to mid-teens non-purchased loan growth. So based on our projections, we feel good about where we are on that. On the unfunded balance, you did see that go down $1.8 billion for 2018, and you can see on Figure 10 in the management comments - $4.7 billion of originations. We've given you comments that we think we will be either at that number or exceed that number in 2019 on originations at RESG. And then the fundings reduces that unfunded balance. So there's a lot of moving parts in both the funded and unfunded balance. All of that was considered in the context of the guidance we gave for non-purchased loan growth.

Stephen Scouten
And maybe on the move up that you saw in loan yields, specifically. Obviously, up 27 basis points this quarter, down 1 basis point last quarter. I know you guys mentioned in the release it was helped by 4 basis points on the fees, but I'm still having a hard time seeing why there is such a big differential on the magnitude, even given some of the movement within the timing of the LIBOR increases? Is there

anything else there besides the timing of LIBOR and those fee differentials that drove such a big delta quarter-over-quarter there?

Tim Hicks

I'll remind you, we listed about five or six bullet points in Q3 of things that moved against us. Each of those were worth one to three basis points and so we had a lot of things moving against us, including minimum interest in -- the level of minimum interest and prepayment penalties. A lot of those moved in our favor in Q4. As you mentioned, we had 4 basis points of yield on non-purchased loans that was in excess of our average from prepayments and minimum interest. LIBOR, which didn't move much at all during Q3, started moving really after the Labor Day, but really that started moving throughout September and really started strong in October and continued throughout the quarter. So we got the benefit of that as well. You may remember that we talked about 1/3 of the loans at RESG actually have a monthly reset as opposed to a daily reset. The other 2/3 of the RESG loans reset daily. And so that -- having that starting in October and then again in November, all of those things worked in our favor. So the things that really worked against us in Q3 turned around and worked in our favor in Q4.

Stephen Scouten

With the 2019 outlook on your core spread, you guys did a really good job of focusing, I've seen on that core spread, and obviously, it was down about, I think, nine basis points for the full year in 2018. So if we were to get no additional rate hikes as the forward as the curve is suggesting today, would that nine basis points of core spread compression theoretically increase in 2019? Or do the deposit initiatives, kind of, minimize that?

George Gleason

I think there are too many moving parts for us to give guidance on that. Our core spread was up two quarters in 2018 and was down two quarters in 2018. We were disappointed that the net number for the year was down and that was a little more adverse than what we would've expected at the beginning of the year. And that's just really a result of all the moving parts there. So we've given cautionary guidance on that, that we could have quarters in 2019 where the core spread is down. I think there are too many moving parts for us to try to give a definitive range of guidance on that. I will tell you, it's a keen focus of ours, and we're going to work hard to minimize deposit cost and maximize loan yields. But there are a lot of variables going into 2019, including one if the Fed moves zero times or four times or in between. So it's hard to know.

Stephen Scouten

But I guess, not comfortable with, kind of, given the range on what your current modeling that says in respect to that for the year?

George Gleason

I think there are too many variables.

Arren Cyganovich – *CitiBank*

Earlier, where you talked about the competitive environment for RESG, are you seeing any intensifying or lessening of the competition there? Originations were on the lower end from the past years but it's kind of consistent with what you've been saying. Has there been any change as credit spreads widened out in the broader markets in your construction lending or CRE business?

George Gleason

We would hope to see that, but we haven't seen that yet. And I think there's a lot of money in the coffers of a lot of debt funds that are real estate centric in their focus that are still maintaining fairly aggressive standards on credit and pricing. Clearly, I think, the important thing for our shareholders is to know that we're very committed first and foremost to maintaining credit quality. And second, we're willing to be competitive, but not to the point it impairs our ability to achieve our minimum target return on equity on transactions. And growth is going to be affected by that positively or negatively as it was negatively last year. Our RESG loan originations last year were $4.74 billion, down about almost $4.4 billion from the previous year. And that was just because we held to our credit discipline. We held to our return on equity discipline. And we let the growth be the variable that moved. And we're optimistic we'll do somewhat better on the origination side in 2019, but we're going to hold to the same principles and standards as we did in 2018.

Arren Cyganovich

Back to the comment in the prepared remarks about the core spread, potential decreases in a couple of quarters in 2019 or some quarters. Do you feel that's coming more-so from the loan yields as you're adding on new loans in the book? Or is that coming more from pressure from deposits? How do you think about that?

George Gleason

Well, of course, it's a combination, since the spread is the difference between those. But again, we are not going to get aggressive enough on loan pricing that it impairs our ability to achieve our ROE. Clearly, we're in a very competitive market, for loans, clearly, we're in a very competitive market for deposits, as we were on both throughout 2018. So we're going to work on both as hard as we can and as I told Stephen and do the best we can. But it's hard to give particular guidance on that given the uncertainty about Fed action and other variables.

Michael Rose – *Raymond James & Associates, Inc.*

I just wanted to start off on the non-RESG side. So you guys have done a really good job working to diversify the portfolio. I know in the past and especially in the marine and RV and some of the other sectors that you've talked about, you've talked about some greater levels of -- clearly of credit risk as we move forward. At this point in the cycle, based on what you see, how willing are you to continue to grow those other portfolios as strongly as you did this past year? And is there anything on the credit front or just on environmental that would make you want to ratchet that level of growth down?

George Gleason

That's a good question, Michael. Clearly, we continue to feel very good about the marine and RV business. That credit quality has held up really well, and we like the profile report we're putting on there really well. And we continue to analyze that pretty keenly, because we're doing a lot of that business, and we want to make sure that what we're doing there is meeting our expectations and going to achieve our goals for credit quality. And we feel good about that, feel like it will. Likewise, I think, we're being very disciplined as we have historically been in recent years in the Community Banking side of things. But we feel pretty good about that.

The Corporate Loan Specialties Group, that's a SNC portfolio, you might have noticed that contracted in the fourth quarter. We looked at that very early in the quarter and thought that the continued repricing to lower spreads on a lot of those deals just was reaching a sort of tipping point from a price perspective. So we made a decision to shrink that portfolio little bit in the quarter, and we pulled about $130 million, $140 million, Tim has the exact number there of those loans and just sold them. And that was a very good decision in retrospect. Obviously, it's been alluded to earlier that debt markets got very turbulent. The markets for those credits dropped a lot as far as the trading prices. So we trimmed that portfolio down. And that was in part, primarily a pricing call. We just thought that the values on those things have gotten so high that we ought to lighten our exposure to it. We don't feel badly about any of the credit we've got in that portfolio, we actually feel pretty good about the credit in that portfolio, but I am glad we lightened it up for pricing. So I think, for us, to get any meaningful growth out of that portfolio in the next year, the pricing would have to come back in a little more toward us for us to feel good about that from a price perspective. And I don't know whether we'll get that or not. The pricing there has actually improved a little bit in the last week or so. But it may determine whether or not that portfolio grows or shrinks this year.

Michael Rose
Okay, that's helpful. And then maybe just one question on the securities book. On the prepared comments, you talked about being opportunistic there. How should we, perhaps, think about that? What would drive you to be more opportunistic versus less, and do you have a targeted size for the securities portfolio?

George Gleason
We're happy with the size of the securities portfolio. Now, if we find a good buying opportunity, we would certainly add to the portfolio. Clearly, now is not a good buying opportunity as flat as the yield curve is and as tight as the spreads are on the high-quality, short-duration stuff, that we're looking at. There's not a compelling reason to buy right now. We do want to increase our liquidity position. And if we don't buy securities, the way to do that is to pledge less of our existing securities. We use a portion of our existing securities portfolio to pledge for public funds and others. One of the objectives that we have this year is to continue to systematically, in a very orderly manner, work down the portion of that portfolio that's pledged so that the portfolio provides more free liquidity to us to improve our liquidity ratios even further than we already did last year. So we will buy securities if it is advantageous to do so, and if it's not, we won't. And today, it's certainly not a good day to buy.

Michael Rose
Just broadly, you've talked about many of the metro markets across the U.S. being much more balanced in terms of supply and demand. So maybe a little bit in your crystal ball, how do you see the real estate markets and supply/demand dynamics playing out over the next year or two, just broadly?

George Gleason

Michael, my view on the fact that conditions there are relatively solid and benign has not changed at all. We continue to be very cautious about the new product we're doing. But we're still finding a lot of things that make a lot of sense. We had a decent closing quarter of RESG originations in Q4, it wasn't great, but it was decent. And we think we'll have a good closing quarter this quarter. And in talking with the guys early on, they're continuing to find things that make sense that we're signing up that would be future quarter closings. So I think there is good business to be done if you're careful and pay close attention.

Matt Olney – *Stephens Inc.*

I wanted to go back to the marine and RV segment. It sounds like you continue to like that business a lot. I think you bought that in 2016. You ramped that up pretty nicely in 2017. Are you going to ramp it again, with 2018 with over billion dollars of growth. Is that business still ramping from here? And can we see something above $1 billion growth? Or will the dollar amount growth slow down in 2019?

George Gleason

Matt, I would expect the dollar growth net-net in 2019 to be more or less in line with 2018. I think there is a slight bias to the upside there. But I don't think it's going to move in a huge way one way or the other from what we saw as the growth in that portfolio in 2018. Tim may want to comment on that, but that's my expectation.

Tim Hicks

I would agree, George. And obviously, you've said earlier that we're very positive about the asset quality that those business lines are bringing, the RV and marine space. We've said in the management comments and other times that we're focused really on super prime and high-prime customers with an average credit score of 790. The guys, they do a great job of daily monitoring of a lot of different metrics that they're able to look at, the asset quality that we're bringing on, on a daily basis and make adjustments as necessary. It's well diversified by loan size, around $90,000 is the average loan size in that book of business. And the delinquency rate, the 30-day plus is eight basis points and actually the net charge-offs for 2018 in that unit were roughly around eight basis points. So we feel great about that opportunity, feel great about the credit quality, what they're able to bring on the books too.

Matthew Olney

And Tim, as a follow-up, as far as the yield on that book, help me out in terms of, kind of, what the newer production yields have been in RV and Marine more recently?

Tim Hicks

They are fixed rates. However, they are -- that's the pressure point that we can continue to push -- and George and I, and John Carter, our Chief Credit Officer, continue to have discussions really on a weekly basis with that team to continue to push that rate as much as they can. And so the new volume -- as the prime rate goes up, we're constantly increasing the rates that we bring on. And we try to lead that when Prime's going to move in late December, then we're going to try to start that process in late November or early December, with the pricing. So George, I don't know if you have any other comments on pricing that you want to add?

George Gleason

It is a competitive business, but we're getting yields in the high-5s that over the life of the loan should, with premiums being paid yield, sort of mid-5s on new origination type business and maybe a little higher. So we feel like we're getting -- given the high-prime, super-prime quality of that, we feel like we're getting a good risk adjusted return on those assets.

Catherine Mealor – *Keefe, Bruyette & Woods, Inc.*

Just back on the loan yields, is there a way for you to dissect within RESG -- just so that we can take out the impact of the marine business -- the average rate of loan that you saw paying off this quarter versus the average rate of loans that you originated? And how that spread has changed or migrated over the course of the year?

George Gleason

Catherine, all the loans in the RESG portfolio are variable rate loans with the exception, I think there is one really small loan and it may have paid off. So they are either all, or all but one little one, variable rate loans in that portfolio. As Tim mentioned, the vast majority of them, if not all of them, were tied to LIBOR. Most of them 1-month LIBOR, a few to 3 or 6-month LIBOR. And the rates -- the coupon rates on the loans being paid off are not materially different than the coupon rates we're putting on today. There may be some modest difference in spread, 25 or 50 basis points, but we've been pretty disciplined about our pricing. We did have a period of time in '16, and we talked about it at the time when we're in early '17, probably the first half of '17, where the market was not as competitive and we were able to get probably 50, 25, 75 basis points higher spread. Some of those loans were just now funding. Some of those loans were shorter duration that are just paying off. So it's the generation of loans. The loans that are paying off from before that, '15, '14 timeframe, were very much probably in line with margins we're getting today. And some of those loans from where we were getting a little higher spreads are paying off, some are just funding. So it's not a material item. If we could extract that information and give it to you, I think it would be pretty ho-hum.

Catherine Mealor

Okay, that's really helpful. And then, you talked a lot about the two credits that you had charge-offs on. I guess, one, any change or update on that and then also, we didn't spend a lot of time last quarter talking about the new larger credit. I think that's about $558 million that you show on Page 29. Can you talk a little bit about this credit? Can you speak if you're able -- how much is funded? The LTV on the project? Just any color on the project? And then your appetite for the other credits this large moving forward?

George Gleason

We continue to do a lot of large credits, and obviously, if you're going to do a really large credit, you want to make sure that it's an exceptionally good quality credit. And we feel, certainly, that way about that credit. That credit is done at, essentially, a 50% loan-to-cost and about a 45% loan-to-value ratio. And you can see that data in the bar in that right-hand -- that far right-hand bar on the Figure 38 in the management comments. It is a Miami condo project that is top-of-the-line and top, top, top level of sponsorship. We had originally -- there're two towers in this project, and we had originally worked for about 13 months putting together the financing on the first tower, which is actually the third building. There're two existing buildings at the project that are highly successful. But we worked for about 13 months putting together, and we were almost to the point of closing the third tower, but their sales velocity on that tower was so good and the amenities and common areas associated with that tower also served the next phase, which would be the fourth building on the project. Then we ended up offering and recommending to the customer that we include both buildings in the loan, which upsized the loan considerably. But the reality is, the first tower is doing so well that it struck us as eminently clear that the sponsor was going to want to continue selling and going to do the second tower. I'm not going to give sales data or price points or sales velocity for the sponsors, that's his business to give. But I would tell you, in the last quarter, the sales velocity has bettered or exceeded our underwriting and the price points it met or had exceeded our underwriting. So that project is, in our view, is going very well. And we're very excited about it. It is the largest credit we've ever done and if he had it to do over again today, I'd do it again. And if another one came along just like it, I would do another one, because it's a great sponsorship, great location, absolutely prime property, low leverage and you've got tremendous market acceptance from a sales velocity and a price point on it. So it's everything we are looking for. So we really like it.

Catherine Mealor

Good. Thank you for that color. May be one last for me. Any updated thoughts on potential buybacks?

Tim Hicks

Catherine, you know this probably. I'm sure that you have read the comments in our management comments around that. I mean, our Board does discuss it on a quarterly basis. We do monitor the adequacy of our capital position at least quarterly, if not more often, and have thorough discussions with our Board. And obviously, they are aware of the competing priorities between having more EPS and more return on equity or having the robust capital position to support our growth and future opportunities. And we just have a tremendous track record of being able to use – in our 21-year-plus history of a public company we have not done a buyback -- and have a tremendous track record of being able to capitalize on opportunities when they present themselves. So the Board will continue to weigh that at each of their meetings and try to weigh those two competing priorities and certainly, they understand our shareholders' view and they understand our strategic planning and management's view as well. So I'll leave it with that and what we have in our management comment document.

George Gleason

Catherine, I'll circle back. I didn't answer your question. I didn't mean to skip it, I just forgot it. I apologize. About the two loans we had charge-offs on last quarter. We're actively in a dialogue with the sponsors on each of those we've been operating this last quarter under a series of short-term forbearance agreements on each one, and we've been working with the sponsors. And looking at other opportunities and strategies to liquidate those in the most cost-effective manner and the most beneficial manner possible. You may note if you looked at that bubble chart in really fine detail that those two loans both were at 80% loan-to-value last quarter were based on us writing them down to 80% of the updated appraisals. You may notice that one of those went down in loan-to-value on the property in South Carolina. That's an operating income-producing shopping mall. We are sweeping the cash flow on that and that loan was not past due at 9/30, but it matured in early October and we didn't renew it. So it is, in this quarter's past due. And for those of you that noticed an uptick in our past due numbers of a modest amount, that was that loan that was nonaccrual at 9/30, which is, of course, nonaccrual at year-end, but it was not past due at 9/30 and went past due because we didn't renew it during Q4. And we are sweeping the cash flow on that. And since they're not making payments we had about a $450,000 principal pay-down on that from free cash flow. Part of that was generated in Q4, part of that had been accumulated previously as we had swept surplus cash flow on that project for a long, long time. So that did result in a pay down. And as long as that's under a forbearance agreement, we would expect it to still be generating positive cash flow.

Matthew Breese – *PiperJaffray & Co.*
I know you didn't want to go too much into the presale activity of the loan down in Miami. But maybe we could focus on the Miami construction portfolio, the condo portfolio as a whole. And I was hoping for some color on how presale activity down there is going in light of growing luxury condo inventory?

George Gleason
Well, our presale activity on our projects is going very well, and we continue to be very positive about all of our projects in the market. And to the point, if we had an identical number of projects to the ones that we've got today, and they came along with all the same metrics and performance track records of the projects we've got today, we would do that many more. Our performance on that portfolio has just been outstanding and continues to be. If you've got the right product with right sponsorship and the right location, we are not seeing a problem with selling the product down there.

Matthew Breese
Maybe, if we could frame it in another way. I think last quarter you said the largest loan presale was about 60% and that was pretty close to getting you out if you had to be repaid on the loan. If you had to size up for the remainder of the Miami construction portfolio, how much is presold? And how much is over or under that 60%? How would that look?

George Gleason
I don't have that data in front of me, and I don't know that Tim has that data in front him. But we did a Miami condo concentration report for our loan committee four or five months ago, and we've originated one loan since then and it's the loan we've talked about at length today and I have spoken very positively about that loan. When we sent that report to committee, we looked at every loan down there and every

project we had, had more than enough sales to fully repay our loan except for one project and on that project we had a very strong personal guarantee from a very strong individual that covered the entire gap between sales that were in place and sales that were required to pay our loan off. So we're in the money on all, but the latest two projects, having enough sales to fully repay the loans. And on those two projects we have very strong guarantees that cover the gap.

So, Tim, I don't remember, I think at that time we had 11 or 12 projects that were still on the books that we had sales fully covered. And I believe, I'm speaking from my memory here, but I believe our average percentage of units sold on those was approaching 80% on average across that portfolio. And it takes 40% or 50% in most cases to pay our loan off. So I mean -- and these are not just sales contracts, they're sales contract with 30% to 50% nonrefundable deposits. So they're -- there are sale contracts that 99.9% of them you would expect to close.

Tim Hicks

I don't have the report in front of me either, but my recollection is exactly as yours is. And I think one or two of those has actually paid off in the second half of the year as well. So I agree with everything you said.

Matthew Breese

Got it, okay. That's great color. Maybe switching to the deposit side of the equation. This year, if I look at what funded the balance sheet, it was really in the CD and time deposit categories? And I know you have some new initiatives underway. But as we think about to 2019, and how you're going to fund the loan growth, is it going to be as heavily weighted towards CDs? Or should we, more closely, consider what you will do on the money market and noninterest-bearing side of things?

Tyler Vance

Obviously, deposit specials are a continuing part of our deposit acquisition strategy. And we expect to continue to offer various CD or other specials from time to time. Now some of those may be money market as you mentioned in certain pricing regions and offices. But our deposit teams' prime focus is on increasing our volume of core deposit customers. So net checking, for instance, in the last year was an excellent 26,756 net new account. But we're going to continue to focus on core deposits, but there is more yield to be had and we will use deposit specials to augment growth from time to time.

Brian Martin – *FIG Partners, LLC*

Just one thing back to the margin. It may sounds like you guys have some initiatives on the deposit side. Just kind of talking, and you've talked a little about this choice of pricing on the loan side, I mean, if we don't get rate increases this year and LIBOR is not really moving, can you just talk about your ability to move up some of the pricing on loans? It sounds like maybe that it is not that much of a lift that comes from the loan yields today? So, just trying to understand the context of the margin. If we don't get the rate increases, it sounds like it may be a little bit more pessimistic on the margin if you're not getting the benefit on the loan side? Am I reading that incorrectly?

George Gleason

Brian, I don't know if that's incorrect at all. There are various things that help our loan yields. One is a high percentage of our loans are variable-rate. So obviously, if the Fed raises the Fed funds target rate and if LIBOR moves in tandem -- that's not always assured -- but you would expect that to happen if there is a high correlation there. Then that variable-rate loan portfolio is going to go up. Going against us, you have the fact that we are getting -- continue to get -- pay downs on our purchased loan portfolio that is somewhat higher-yielding, but as the chart and the management comment shows, it's converging to very close to the non-purchased loan yields. So we are getting to a point where that switching of volume from purchased to non-purchased is less negatively impacting our margin than it has over the last couple of years. And then you have fixed-rate loans that were done a year or two or three years ago, which was four to eight or nine Fed moves back that are rolling off. And those, typically, if you renew them or if they payoff and you replace them, we ought to be getting a better yield along that fixed-rate roll out of the portfolio. So even if the Fed doesn't move, if you just keep Fed funds rate where it is, we would hope that we would have some slight upward bias in loan yields and it would be probably very slight from just the roll-off of previous lower-rate, fixed-rate loans into newer rate loans. And obviously, how much lift, if any, you get there is going to be dependent on how competitive the environment is today.

The flip side, Tyler's talked about it, it's a very aggressive deposit environment out there, and we are working hard to control that cost. Obviously, if the Fed quits raising the Fed funds target rate, we would expect pressure on deposit costs to moderate significantly. And you just have to wait and see how that plays out. So that's kind of the way we're looking at it and there are a lot of variables. I think our chances of having a better margin or less degradation in our margin are better if the Fed continues to raise rates one or two times this year as opposed to if they don't. But there's still a lot of variables any way you cut it and how that plays out.

Brian Martin

Just the pendulum last quarter, Tim, as you have said a lot of things went against you with that non-purchased loan yield dropping and this quarter being up a lot higher. Where would you characterize this quarter as far as where the pendulum was in terms of those handful of items you laid out in last quarter’s management comments?

Tim Hicks

Well, Brian, as you can see in the comments that the one variable that we did point out that was a four basis point help for us that we did have minimum interest and prepayment fees that were in excess of our average. So we will have quarters -- we did mention that we're expecting a lot of payoffs in 2019 – so we'll have quarters where we've got some above-average help there, and we may have a quarter where we have below average. So there's going to be some variability to that component of it. I think the rest of the components were probably more normal and the components in Q3 were more abnormal.

Brian Martin

The last thing I'll jump in was the -- one for Greg, on the expenses you've talked about this quarter being pretty normal. Are there any expense initiatives, Greg, significantly that would affect the run rate going forward? I know you've done a lot of that heavy lifting recently over the last 12 months, but as far as looking forward, any initiatives that we should be aware of?

Greg McKinney

Brian, I'd say that we're going to continue to build our infrastructure as we continue to grow and grow our business. So we'll have to continue to augment what we've done in the technology side and the compliance side and with a whole host of areas that are critical, making sure that we've got a very, very strong, very well-managed top-performing bank. Yes, I do think that a lot of the adds, builds to a lot of infrastructure happened in '17 and '18. That's not to say that there won't still be some incremental costs that continue to move into '19 if we look to augment various areas and continue to add staff as we continue to grow. I think the adds though will be a little more muted versus what you would've seen in '17 and '18. And so I would not expect any significant continuation and ramp-ups in most of those areas as we move through 2019. Obviously, we're continuing to look at our cost structure.

We've given guidance on the fact that Q1 is a challenging quarter from an expense standpoint. A lot of our raises across our staff kick in, increases in insurance, those factors have an impact on Q1 that certainly you'd likely to see some element of that as we move into 2019. But from my earlier comments, we had some debits -- mostly debits and credits in our noninterest expenses. For Q4, I do think that the Q4, though, in the aggregate, is a pretty good run rate on which to start thinking about 2019 expense run rate.

Brian Martin
And the last one, just on the credit quality, it sounds like things are very strong where they are at today. Should we just be thinking about the reserve kind of being in tandem with growth? Is that kind of the best way to think about it today? There's nothing that's overly concerning or are you guys are more cautious on today?

George Gleason
Yes, Brian. I would say, as we've done in recent past years where we've had very good credit quality, you've seen the reserve outpace charge-offs to keep pace with the growth in our balance sheet. I think that is a good, sort of -- if you look at past years-- is a good sort of continuation of that. We're not seeing anything emerging on the credit horizon now that would have significant changes. Of course, we will adopt CECL a year from now, and we are still working on what the impact of that will be. And we won't know those numbers for a while or how they'll affect us there. But apart from the impact of CECL, when it goes effective, I think, the past numbers and kind of pattern is pretty good going forward.

I would echo what Tim and Greg said about run rate of expenses and unusual items. I would caution you and other analyst who are doing your models to remember that we've got 90 days in Q1 and we had 92 days in Q4. And clearly, it's just working out that we're making about a penny EPS per day. So having two less days in Q1 starts us out at a $0.02 EPS hit compared to Q4. And when you factor in cost increases or staff additions and salary additions, increases and health insurance that are all factored into Q1, the first quarter is always a challenging quarter to get any lift in net income. And we think that will be the case of this year, but we're pretty optimistic for the full year of 2019, with that said.

Timur Braziler – *Wells Fargo*
First, looking at the build-out of RV and Marine dealers. It looks like that kind of stabilized in the back end of the year, while balances continued to ramp higher. Two-part question. I guess, what's the capacity

of the existing dealer footprint? And how should we be thinking about dealer growth as we head into 2019?

George Gleason
The dealer growth would have been more robust and would continue to be more robust in 2019 had we not set some limits on how much growth that we wanted from that portfolio for a while. Clearly, we are growing that significantly. And as I mentioned, every metric we're looking at on that portfolio, we're feeling really good about. But we didn't want the $1 billion growth this year to turn into $2 billion of growth -- the $1 billion in '18 to turn into $2 billion in '19. We wanted to take a more measured pace to that growth. So there's been a little bit of a throttling down of our potential growth. We think we can capture that potential later, but we just want to continue to do a lot of analytics and careful monitoring of that portfolio before we let it get to a growth rate that's significantly more than it is now.

Timur Braziler
One final one for me. Just looking at some of the strong growth in unfunded commitments that occurred in '16 and '17 kind of stabilized in '18. I'm assuming that some of that larger growth is now starting to fund up. And just wondering if you're expecting funding to continue to accelerate in 2019? And if that is the case, then kind of what's the outlook for unfunded commitments as we go through the year, where can that shake out?

Tim Hicks
Yes. Timur, we said in our guidance in our management comments that we would expect the 2019 unfunded balance to decrease again as it did in '18. There is a lot of variabilities on the amount of the decrease that would occur. It depends on originations. So if our origination volumes are more than '18 then that's going to help drive up that unfunded balance. But as we said, it's likely to decrease again in '19. And we will -- we are expecting elevated amount of prepayments, but that means we're also expecting an elevated amount of fundings as well.

Blair Brantley – *Brean Capital, LLC*
Just a quick question. What is kind of the view on incremental operating leverage going off of some of your expense commentary and also kind of where we are with the yield curve and an uncertain view of rate increases?

George Gleason

Well, we've talked a lot about -- in the past about the fact that we want to continue to decrease our efficiency ratio. With the big infrastructure build out that we've had over the last couple of years and the cost of that, combined with slower balance sheet growth, particularly in '18, we pretty much have been treading water more and more less on that efficiency ratio. We still have a long term goal of improving that ratio. I think that is possible for us to do. But we need more growth, probably, to accomplish that. So that -- an achievement of a significantly better efficiency ratio may take us to -- may require that we get to a better growth and a better margin environment, or at least one of those, before we can meaningfully improve that ratio.

Blair Brantley

Okay. And then switching gears -- in terms of the non-purchased growth and more on the non-RESG side, I'm curious about your view in terms of the contribution of the community bank side of it? Is it exceeding expectations? Or how is it kind of shaping up? So what where you thought it would be at this point?

George Gleason

I think we've got a ton of potential, and one of the things that I'm doing to just emphasize the importance of our Community Bank, and to try to rally us to achieve more and more of the potential in it, is I have started a program that I'm going to visit and spend time in every one of our 250-plus or minus offices starting December 1 of last year through December 1 of this year. So I've been to 40 of our Community Banking offices so far on that tour and have spent seven days in that process. And it's a process to communicate and coach our Community Banking team, but more importantly, to let our Community Banking team communicate with me and other senior officers that are traveling with me from the Community Banking world there to just to identify things that we can improve and get better so that we can deliver better service to our customers and harness more of that potential from our Community Bank. And it's kind of an exhausting tour, but it is proving to be very profitable and very productive, and we are just 40 offices into the 250-office tour. So I'm very positive about the capacity and the potential that exists within our Community Banking organization. And I think, over the course of this year, we're going to achieve a lot of enhancements in what we're doing there that will let us, just incrementally, hopefully, each quarter, harness more and more of that potential. So pretty positive about it. That's the key of achieving much more significant diversification in our balance sheet going forward, and we are really focused on it in 2019.

Blair Brantley

So is the expectation in terms of the mix of the non-purchased growth to be similar to what we saw in '18? Or do you think the RESG will be a bigger piece of that net growth for the year?

George Gleason

I am hopeful that, as I said, that Indirect RV & Marine will be very similar, plus or minus a little bit to what it was last year. I am hopeful that Community Banking will contribute more to that. And Tim, you want to weigh-in on those specific thoughts on RESG?

Tim Hicks

Yes. I would agree, George. I think the mix, give or take, should be relatively consistent. I would remind you, on Community Banking, our leasing portfolio is in that Community Banking number. And we stopped originating loans out of that leasing portfolio, so Community Banking had about $45 million of headwind from leasing payoffs that occurred in '18. That will be less of a headwind for them, and obviously, George's focus on Community Banking as well as Alan Jessup and Cindy Wolfe, John Carter's focus, renewed focus, on it should help the Community Banking growth for 2019.

Operator

And ladies and gentlemen, this does conclude our question-and-answer session. I would now like to turn the call back over to George Gleason for any closing remarks.

George Gleason

Thank you very much for joining the call today. We greatly appreciate it. We look forward to talking with you in about 90 days, more or less, to report our first quarter results. That concludes our call. Have a great day.