Bank OZK

Conference Call – April 18, 2019

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

Good afternoon, I am Tim Hicks, Chief Administrative Officer and Executive Director of Investor Relations for Bank OZK. Thank you for joining our call this afternoon 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 me on the call to take your questions are: George Gleason, Chairman and CEO and Greg McKinney, Chief Financial Officer and Chief Accounting Officer.

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

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

Ken Zerbe – *Morgan Stanley*

I was hoping you guys could provide just a little more color or commentary on the net interest margin outlook. There was some text in the management commentary, which, of course, we appreciate, that seemed a little more negative, and I am just trying to get a sense of where you expect NIM to trend over the course of the year? Is it fair to assume even core spread compression is likely, given the flat yield curve?

George Gleason

Ken - there are a lot of variables there, obviously, in core spread and even more in net interest margin. I think we gave some very detailed commentary regarding deposit costs, in which we reiterated our prior guidance that we expect those to be down for the full year 2019, or not increase as much for the full year of 2019, as in 2018. We also gave guidance that we thought our first quarter increase in deposit costs would be the highest quarter of the year and that the other three quarters should all be down from that. So I do not know that we have a lot more intel to give on the deposit side.

And certainly, you're correct that the slight downturn in LIBOR rates since the last week or two of December put a little pressure on loan yields and deposits. About 78% of our variable rate loans, I think, are tied to 1-month LIBOR, which is down two or three basis points from the end of the year, or from the high near the end of the year. So that's a little bit negative and, certainly, the flat yield curve puts pressure on a lot of our fixed-rate loan offerings. Most of our loans are variable rate but fixed-rate consumer and small-business loan products tend to price, given the duration of the product, off the 2-, 3-, 5-, 7-, 10-year part of the curve, and the flattening of that curve takes a little bit of the juice out of those yields. And we continue to be in a very competitive pricing environment. Notwithstanding that, we are working very hard to maximize the yield on every new loan we originate. So I don't know that we have a precise guidance that we can give you on that, except to tell you that there are forces that challenge our net interest margin. There is a lot of hard work being done to maintain it, or improve it, and we just have to see how those forces play out. There are too many variables to give you precise guidance on that.

Tim Hicks

Yes, Ken, this is Tim. The other thing I would point out is, obviously, as we showed on Figure 11 of our management comments, this was the first quarter in which our non-purchased loan yield was actually higher than our purchased loan yield. So that's been a factor in putting pressure on our margin for many quarters now that -- assuming that continues, that factor is less -- is not a headwind where it has been before. And the other thing I'll point out is we do have an industry-leading net interest margin at 4.53%, so I think that's -- we're very proud of that margin and we are going to work, as George said, work really hard to maintain the industry-leading margin that we've had for many years now.

Ken Zerbe

Understood. It is one of the best, or the best, of any bank that I cover. I guess maybe switching gears just slightly, George, if you can talk just a little bit about the landscape for RESG? I think -- it looks like paydowns were, I believe, it was a little bit less this quarter. But obviously, your commentary that you gave that RESG was going to be a smaller percentage of the total growth as the non-RESG loans grew. Is that more a function that the non-RESG loans are growing? Or is it a function that you still see very competitive payoffs and paydown environment for the RESG loans?

George Gleason

It is a combination of all those factors, Ken. We said in our January conference call that we expected our RESG paydowns to be at an elevated level again in 2019, and those would likely exceed the level of repayments that we had in 2018 for the full year. We reiterated that guidance in the management comments that we issued yesterday. The $1.13 billion in RESG paydowns in Q1 was just fractionally more than the level of paydowns in Q4 of last year. So we are still experiencing strong paydowns. We still think that is going to be a headwind to RESG's growth this year. We did have a really good quarter of originations in RESG, $1.86 billion, which was our best quarter out of the last five. You would have to go back to the fourth quarter of 2017 to have a better quarter of RESG originations. We continue to think that we will beat last year's level of originations for the full year, and hopefully, we will beat it by a nice margin -- time will tell on that.

We have a good pipeline on RESG today for new transactions that we're working on. But, you know what's interesting, the more significant transactions we closed in Q1 have been transactions on which we have been working really more than a year to get those transactions to a successful closing. So the fact that you've got a good pipeline in this day and time doesn't necessarily translate into instant gratification. For example, we had a loan in committee yesterday that we reapproved for closing. It was originally approved for closing in July of last year. When the sponsor got their pricing on it, their pricing cost came in way over the top end of their estimate range, so the sponsor spent the last nine months basically value engineering the project, and has really come up with a much better and more profitable project, which we were thrilled to get reapproved yesterday. But by the time we get that closed in a month or two, that will have been in here 10 or 11 months. So the lead time to get some of these things to fruition sometime is longer than you would expect. But we do have a good pipeline. We did have a good first quarter and we're excited about that.

Ken Zerbe

All right, perfect. In terms of the non-RESG loan growth, obviously, it's a little weaker this quarter. Is there any seasonality that we may have missed or forgotten about? Or -- and I guess the other part of the question is, I guess, what gives you the confidence that, that accelerates towards the later part of the year?

George Gleason

I feel very confident in the job that our teams are doing there. We did have about $70 million of paydowns in the last week or two of the quarter on subscription lines that we had. Several of those credits made their periodic calls on the investors to fund their subscriptions, and that resulted in paydowns in those lines. So our community bank growth was looking better until the last week or two of the quarter when we got a lot of paydowns on that. So I think we are making good progress there, and I feel very good about what we're doing.

I, along with Cindy Wolfe, our Chief Banking Officer, and Alan Jessup, our Director of Community Banking, and John Carter, our Chief Credit Officer, have been making a tour of all of our offices. We're visiting -- my goal is to visit every office in the company, starting December of last year through the end of September this year -- basically a 10-month project. We have been in 115 offices so far, meeting with the teams, looking for ways to improve what we are doing, and we've got about 140-something offices to go. But from that experience being in the field with our teams, I am very, very positive about our prospects to continue to grow and advance our businesses across our footprint.

Tim Hicks

Ken -- yes, this is Tim. You had mentioned seasonality. I will point out that Indirect RV & Marine typically has a pretty strong second quarter, so that's one of our business units that has a little bit of seasonality where second quarter tends to be their strongest quarter.

Catherine Mealor – *Keefe, Bruyette & Woods, Inc.*
One thing you mentioned also in the management comments was that there were other verticals within your community bank that you may bring to a national scale. Any insight there, or are you not ready to disclose that yet?

George Gleason
Well, yes. Our business aviation group certainly falls into that category. We think we've got some good room to grow that. Our GGL, our government guaranteed lending, which is primarily SBA lending platform, I think, has the ability to scale quite a bit. We have some expertise, and it runs small, more regional successful operations, for affordable housing and charter school finance. Our subscription line finance is really a national business, and we are looking to expand the breadth of that into some other, more complex non-real estate lending opportunities. So I think there are a lot of verticals that we have that have quite a bit of room to scale.

Catherine Mealor
Great. And then one follow-up -- any update on the watch credit in your bubble chart that's kind of hovering in the upper left corner -- any update on that credit this quarter?

George Gleason
No. No change. They continue to have good townhome sales. They've got the final phase of lot development in process now and titled, and they've started selling lots in that final phase. And I think they're off to a decent start given the amount of snow that they've had on the ground that has kept people from seeing some of those lots as much as might be desirable. So we're feeling as positive about that certainly as we were three months ago.

Stephen Scouten – *Sandler O'Neill + Partners, L.P.*
I'm curious, guys, on the discussion around floors in your variable rate loan book. Can you talk a little bit about how many of your loans might be near or at their floors or close to being at the floors? Is there any kind of color you can give around that as an impediment to a lower loan yield if LIBOR is to continue to decline a little bit?

George Gleason

Yes, we can give you some color on that. As of March 31, 9.93% of our total variable rate loans were at their floor. If rates dropped 0.25%, that number would go to a little over 14% would be at their floor. If rates dropped 0.50%, about 19% would be at their floor. If rates go down 0.75%, almost 23% would be at their floor. Down 100 basis points, it's 26% of the total variable rate loans would be at their floor. And then moving in quarter increments 29%, 40% -- so down 150 basis points, 40% of them hit their floor. Down 200 basis points, 61% would be at their floors. Down 225 basis points, 88% would be at their floor. So obviously, the floors have been installed on those loans, almost all of our variable rate loans do have floors. The number is 98% of our variable rate loans have floors. Those floors have been installed over the growth and development of that portfolio. So we've had nine Fed funds rate increases, so some of them were floors based on rates nine moves ago, and some were eight moves ago and some seven. So if we stay in a period this year of relatively stable rate, that floor situation ought to improve significantly because we'll be rolling off loans that are older, that were originated when the floors were much lower and replacing them with new loans at higher floors. So as long as we're in a stable rate environment, those percentages should get better every month and every quarter.

Stephen Scouten

That's great color. I'm curious if you guys have expanded your parameters at all around RESG? Obviously, the $1.86 billion was great this quarter. And I know you used to say 6% to 8% of the loans you looked at, you would actually book, and I'm wondering if any of those numbers have changed, or if you had to widen the net at all to deliver that sort of growth in this environment?

George Gleason

I don't know about the pull-through ratio metrics. I don't have those currently, and Tim's nodding, he doesn't either. But I can tell you our credit standards have not changed at all, and we're continuing to follow the very rigorous credit standards that have led us to 18-basis-point historical loss ratio on that portfolio. I think the portfolio quality is good or better today than it's ever been. So we have not weakened our credit standards at all to achieve growth.

Stephen Scouten

Perfect. Can you talk a little bit about how you think about uses for your excess capital? I don't know what your view is there, but I would peg it at like somewhere north of $600 million. And obviously, you noted that the board decided not to do a share buyback. But I'm wondering what the view is for the company on -- if you had to stack rank uses, is it just maintaining this dry powder for opportunistic endeavors, is M&A on the table, share buybacks, is that kind of at the bottom of the stack? Or can you give us a little bit of behind the scenes in the thought process there possibly?

George Gleason

Well, we addressed that to some degree in the management comments. I think probably the only color worth adding to that is that the board and senior management of the company are very optimistic about our medium- and longer-term organic growth abilities. And we believe that we've got a well-demonstrated track record of being able to opportunistically capitalize on opportunities that occur in times of economic dislocation and distress. So I think the best way to characterize the board's decision is – and management's recommendations in that regard, is that we believe we'll have opportunities to use that capital through organic growth, including opportunistic capitalization on opportunities that may arise at various times.

Stephen Scouten

Perfect. That makes a lot of sense and no doubt the opportunistic behavior has been gangbusters for you guys over time. So appreciate all the color.

Timur Braziler – *Wells Fargo*

Maybe starting on the deposits. Nice quarter here. It looks like much of the end-of-period balances came on towards the end of the quarter. I'm just wondering what your thoughts are there on seasonality and how much of that will stick? And what your general thoughts on deposit generation are for the remainder of the year?

Tim Hicks

Yes, obviously, there is a little bit of seasonality when you think about tax refunds coming in in late February and March. Obviously, we had a really good amount of growth for the quarter in deposits. We had a good amount of growth in our noninterest-bearing deposits as well. I think our growth in total deposits was $530-something million compared to growth in our total loan balance of $350 million. So good growth there. We're excited about that. I mean our Chief Banking Officer and Chief Deposit Officer, Cindy Wolfe and Ottie Kerley are very focused on maximizing the value of that portfolio. Obviously, in April, we'll see some tax outflows as people make payments on taxes as well. So we feel really good about our ability to continue to grow our deposits as needed to fund our balance sheet growth, and we'll work really to improve the mix of that as we continue throughout the year.

Timur Braziler

Okay. And then if I can follow up on Stephen's question regarding RESG, maybe ask it a different way. It looks like in the third quarter, you booked your largest credit within that portfolio, and in the first quarter here, it looks like another top five credit was booked. Is there a conscious effort to move upstream with this larger balance sheet? Or is this just the effect of being as successful as you have been in that space and sponsors wanting to do these larger deals with you?

George Gleason

As shown in the management comments document, there is a table there that breaks down the RESG portfolio, figure 32, that really breaks down the RESG portfolio by loan types. So, yes we have, as you correctly observed, originated over the last 3 quarters, our largest and second-largest loans and at least one of the next group of large loans there. But the portfolio continues to be typified by very broad spectrum of loan sizes. We had a loan in committee recently that was a $20 million loan, which is on the smaller side of RESG's business. But it's certainly something we want to do for established customers. The focus of the RESG portfolio has really always been on great properties in great locations with really top-class sponsorship, and we've always said that the larger the credit, the better the quality has got to be. So the large credits that you mentioned, we're extremely proud of, because we believe they are great assets in great locations and have A+ sponsorship involved in them. So we were thrilled to do those. We'd be thrilled to do a bunch more like them because we've got great confidence in those properties' locations and sponsorship.

Timur Braziler

Okay, great. And if I could just ask one more question on the RV & Marine portfolio. This is the third year really running that book. Has that portfolio now normalized where you're starting to see kind of a normal level of payoff and paydowns? And how much of a headwind is that going to be to potentially seeing that similar type of growth rate as you had in the past year to year and a half?

George Gleason

Well, certainly, as the portfolio has gotten bigger, we've seen more prepayments and paydowns in that portfolio. We believe there is considerable upside, over time, to that portfolio's growth, and the portfolio grew net non-purchased growth in that portfolio last year, Tim, was $1.032 billion, is that right?

Tim Hicks

That's right.

George Gleason

Something close to that, if that's not it. So we think we've got potential for another great year of growth this year, very similar to last year's, and probably another great year of growth in 2020, and hopefully for for several years to come at those rates before we reach a point that the payoffs have reached a velocity that it would impede our ability to grow it. So we think we've got several more years of really strong growth in that at this point.

Brody Preston - *Piper Jaffray*

I just wanted to go back to the pricing on your deposits. In your commentary you mentioned some abatement in deposit competition towards the end of year one, and you expect some of that to continue a little bit throughout the rest of the year, given your commentary on deposit costs turning. I just wanted to get a sense of which markets you're seeing that in or if it's across the entire footprint?

George Gleason

Yes, let me clarify the comment, and I'm going to decline to give you specific market details on that, but let me clarify the comment. After the Fed's rate increase in December, there seemed to be a particularly aggressive fervor for rate increases on deposits, and people seemed to be very aggressive on that. And of course, at that time, the sentiment was the Fed was going to be raising three or four more times the Fed funds target rate this year. And -- so you saw deposit prices reset over the course of December and early January, and even as there was a significant shift in sentiment regarding the likelihood of Fed funds rate increases in 2019 we didn't really see any meaningful abatement on anybody's part on deposit rates until probably in the month of March and mostly later in the month of March. So we've made adjustments.

We've seen in the last few weeks, a number of competitors make adjustments downward in deposit rates, which we think is very prudent. Obviously, as we talked about earlier, LIBOR rolled over really at the beginning of the quarter, and you saw a two or three basis point downtick in 1-month LIBOR and 20 or so – 20 to 30 basis points downtick in 3-month and 6-month LIBOR. So your -- and with flattening of the yield curve early in the quarter, pricing on loans tended to adjust early in the quarter, and pricing on deposits didn't seem to abate much until the end of the quarter, which I think was detrimental to some degree to our first quarter results. And hopefully, the deposit pricing adjustments will catch up with the loan pricing adjustments in the current quarter.

Brody Preston

Okay. Great. I guess sticking with deposits, maybe in terms of growth, can you give a breakdown where you show the percent of branches within the cities versus the percent of deposits within the cities? And it seems like there's a little bit of a disparity there. I just wanted to get a sense for growing deposits in the cities as a strategic point of emphasis? And if it is, do you see that maybe negatively impacting overall deposit cost, just given the disparity between the cost of urban deposits versus rural deposits?

George Gleason

Well, the objective that our deposit guys pursue is to take this funding forecast that we mentioned on page 28 of our management comments, we describe a 36-month forward funding forecast. It's a very detailed projection of our needs for deposit growth and liquidity month-by-month for 36 months. We are constantly updating that, at least monthly and often more often than monthly. And the deposit guys are charged with generating those funds at the lowest possible cost of funds, while adhering to a whole bunch of parameters regarding liquidity and concentrations and balance sheet risk and so forth. So it's not a preference for urban deposits or rural deposits, it's a preference for the best, lowest-cost deposits we can get.

Brody Preston

I wanted to go back to the RESG, this watch credit. It looks like it's moved up a bit in LTV since the third quarter, when you guys first addressed it. I wanted to get a sense for what the current LTV was? I know the $57.5 million was the full commitment that you had, but I wanted to get a sense for what the total funded portion was right now?

Tim Hicks

Yes, Brody. I think the funded portion is roughly $50 million. The current LTV is, I think, 102% right now. And again, it's a revolving facility. They're building product, obviously. And then as that product sells, it pays down as well. So the $57.5 million is the total commitment, with about a little over $50 million currently outstanding as well.

Brody Preston

So the value that you guys are pegging on that product then is roughly $49 million?

Tim Hicks

That's correct.

Brody Preston

When was the last appraisal on this property done?

George Gleason

It's been within the last year. What we do is appraise it on an annual basis. And obviously, it's a revolver, so we use the parameters, the holding periods, the discount rates, the -- other parameters from the appraisal and readjust the appraisal on a -- recalculate our loan-to-value using the appraiser's methodology applied to a constantly changing pool of collateral. As Tim mentioned, we're building vertical properties there, our sponsor is, they're selling those, they're developing lots, they're selling those. So the pool of collateral is constantly changing. So you could get an appraisal today, and it would technically be dated tomorrow because you sold a unit, and you just built another unit. So what we do is get an annual appraisal, use the appraiser's precise methodology, applying that methodology to the constantly evolving pool of underlying collateral.

Brody Preston

So you guys are sort of coming up with your own appraised value?

George Gleason

Well, you can say we're coming up with our own appraised value, but we're using the appraiser's methodology and just applying it to the collateral. So if he's saying, "Okay, we're going to assume a two-year holding period on lots and a discount rate of 15%," then we're assuming a two-year holding period and a discount rate at 15%. And if he's assuming that houses are going to sell for this price per square foot, we're making that same assumption as houses sell and new ones come in. Obviously, if the sales prices are not in line or consistent with what's in the appraisal, then we get a new appraisal. But as long as the sale prices are at or consistent with what's in the appraisal or above it, then we're only going to get an appraisal on an annual basis. But if you say that we're making up our own appraisal on it, that's not really accurate. We're very precisely following the appraiser's methodology on it.

Brody Preston

Yes, I guess what I meant is that you guys are sort of reassessing the appraised value on a quarterly basis given the change in the underlying collateral?

George Gleason

Exactly, exactly.

Brody Preston

Okay. Are these primarily secondary homes?

George Gleason

It is a mixture of primary and secondary homes.

Brody Preston

And I guess I wanted to get a sense for when you get paid back on this loan, is it primarily through the sale of the lots or is it through the sale of the developed homes?

George Gleason

Both. There is a lot development feature of the line and a vertical construction feature. So it's a combination. Some parties buy a lot and do their own home construction for cash or with their own financing. There is property, townhomes, that are sort of developed by the sponsor and sold as completed townhomes as part of the structure.

Brody Preston

Okay. And did this loan have an interest reserve account associated with it when you guys originated the loan?

George Gleason

When the loan originated 10 years ago, yes, it did. It does not now.

Brock Vandervliet - *UBS Investment Bank*

Following up on that last question, I was just going to ask generally about interest reserves. Is it general policy within RESG -- or within commercial construction in general -- to set up an interest reserve at the outset of a loan?

George Gleason

That's a general policy in commercial construction lending industry-wide, and our practices are very conservative in that regard because our leverage points are so low. At March 31, our average loan-to-cost was about 49.5%, which meant that the sponsor, the pref equity, the mezz, subordinated piece of the capital stack had over half of the project cost invested, and our average loan-to-value was around 43%. So yes, there are interest reserves built in our loans but it's not like we're financing a high percentage of cost and loaning on the interest. We're financing a very low percentage of cost for the project that includes a reserve for interest during the construction period.

Now you could say, "Oh, gosh, we would prefer that the sponsor pay the interest out of pocket." Well, the sponsor is paying the interest in effect because they are putting a lot equity into the project. We would rather have the sponsor put in all their equity before we fund anything than for us to say, "Well, we'll let the sponsor put in 10% less equity and we'll let them keep that equity and pay the interest over the life of the project as it's incurred. So getting the sponsor to put all their money in first and then including the interest in our loan is actually a more conservative, not a less conservative strategy.

Brock Vandervliet

No, I absolutely understand. On that credit -- so this has been in the bank for a while. What was the issue? Was it the sell-through rate initially was lower than pro forma?

George Gleason

In the aftermath of the Great Recession, this property suffered a great downturn in value on lots and homes and development slowed for a while, as a lot of things did in the Great Recession. That reset of values lower kind of permanently reset the value of the project and as a result, the project has more debt on it than you would want to see. It's our highest loan-to-value loan. But the project has continued to be successfully executed -- they continue to sell townhomes, they continue to sell lots, they continue to improve the amenities of the project and values have a stable-to-positive trend there. So it's a project that, because values went down a lot during the Great Recession, they've never fully come back to where they were at the high before that, it just has too much debt on it. But our projections are that the property will sell out of lots and townhomes with net proceeds sufficient to cover all of our principal, all of our interest and return some equity to the sponsor. So for that reason, it's a performing credit. The most likely scenario in our view is it continues to develop and pay off and that we never lose a penny of principal or interest on it.

Brock Vandervliet

And separately on Figure 11, that chart showing the intersection of purchased and non- purchased loan yields. Does the purchased loan yield continue to drift lower as that portfolio runs off? Or should it hang around here at the 6%-and-change in yield?

George Gleason

I think we made a comment in the management comments document that, that portfolio yield, as that portfolio has seasoned has tended to drift down, even though 40-something percent of the loans in that portfolio are variable rate. So I would expect that it will continue to drift down -- although if you look at that chart, you can see that there is a quarter or two when it's down and then there's a bounce and then another quarter or two where it's down and then another bounce for a quarter or two, so it varies quite a bit from quarter-to-quarter because there are marks on that portfolio and net present value discounts, purchase accounting discounts on that portfolio and depending on the mix and volume of pay downs and which particular loans pay down in various quarters, or pay-off, there tend to be some chunky recognition of those purchase accounting marks on that portfolio. So, it will vary. I think as that chart shows, we were, what, at 6.85%, all the way back at 3Q of '15, we were 6.85% and it's now at 6.29%. So it's tended to go down but not precipitously and certainly not in a linear fashion.

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

I don't know if Tyler is in the room but I just wanted to say congrats on your career choice and I just wanted to see, George, if you guys have thought about a replacement for that role and if you do plan to replace Tyler once he moves on?

Tim Hicks

Obviously Tyler has been a very important part of our organization for over 13 years and we wish him well. He's done a terrific job for us. One of the great things he has done is to help mentor and coach and hire really great folks underneath him -- so we've got a great team underneath him. We have Jeff Starke, Chief Technology Officer and Chad Necessary, our Chief Information Officer, who will report to me going forward. Marcio deOliveira, given the really strategic nature of what he does leading OZK Labs is going to report to George. And then you've seen over the last couple of quarters, Cindy Wolfe taking over the Chief Banking Officer role. She's been with us for over 20 years and is doing a terrific job and is accompanying George on all 254 -- 260 locations on their tour. And of course, we've hired Ottie Kerley as our Chief Deposit Officer in the recent quarter. So again, we've got a great team and have built depth over the years and feel great. So no immediate plans to replace that role. I've taken a couple of positions, direct reports, George has, and then the increased responsibility that Cindy and Ottie have had over the last several quarters, we feel like we're in a terrific position.

George Gleason

I'll add to that, Tyler leaves with our great gratitude for all the contribution he's made to our company. And as I told him yesterday, he and I had a visit, and I told him I had great admiration for his courage and conviction to leave a really great job with a great salary to go full-time into ministry work. I don't know what he's going to be making, but it's probably not what he was making as a banker. And it just -- it's a calling he has and he felt very strongly about it and we have great respect for his conviction and calling there and his courage to go pursue that. And I think he'll be very successful at that. I think Tyler is probably able to be successful at whatever he does.

Michael Rose

He will certainly be missed. Just moving on, the CRE concentration has certainly come down, I think you're around 313% now. Just interplaying that with the decision to maybe not go the buyback route, which it seems like many would like to see you do. Is the goal in keeping the capital growing and elevated here a desire to potentially bring that CRE concentration down below 300%?

George Gleason

Michael, there were a lot of factors in the board's decision. Certainly, our CRE concentration ratio is one of many factors that weighed into that consideration. Given our strong earnings and our capital retention, and given the diversification that's occurring in the portfolio and the pay down of CRE in the purchased loan book and the pay down of so many of our loans in our RESG book, we think there is a decent possibility that both the total CRE and the construction and land development ratios continue to drift lower. That's not a specifically articulated purpose or goal of our company for them to do so, but I do think market conditions, combined with our strong earnings, will do that. And there's some benefits to that too if we can generate significantly more growth in other parts of our company and have a more diversified portfolio, which we think we can do.

Michael Rose

All right. So I know you have a kind of a targeted upper limit range but is there an optimal range you'd like to be on the CRE and construction concentration ratios over the intermediate to long-term?

George Gleason

No.

Michael Rose

Okay. Final one for me. Some of the banks have thrown out initial day one CECL estimates and what the capital impact might be in moving some of the loans from PCI to PCD. Just wanted to see if you were ready to at least give some initial guidance around that.

Greg McKinney

Michael, it's Greg. I'll take that. We still have a plan of working through our CECL implementation. We are making good progress with that. It's really kind of a two-phased project. We're developing scorecards across the entirety of our portfolio. That project is really getting close to being completed that will allow us to do some initial testing and validation with that project. In parallel, we are also developing our CECL platform. We are still on line or, on time, on a timeline to have that done probably either late Q2 or early in Q3. The goal being to be able to run some parallel runs using June 30 added during the third quarter. So at this point we still don't have a day one number or even an estimate that we can throw out or we'd be comfortable throwing out. But we do think that probably in the next 90 days or so, next 120 days, we'll be getting pretty close to that point. So as we continue to move forward down the path of finalizing both those projects and then making some parallel runs, we will certainly provide some day one feedback. But at this point, we're still a little too early to give you guys any feedback or ranges there.

Matt Olney – *Stephens Inc.*

I just wanted to circle back on loan growth. With your expectations of paydowns being elevated for the rest of 2019, I'm curious if you'd be surprised if 1Q results represented the high-water mark for your quarterly loan growth for 2019? I'm trying to get a better idea of the pace of growth throughout 2019 since you guys have pretty good visibility when you expect to fund some of your larger loans?

George Gleason

Matt, we articulated in our January call our management comments and reiterated exactly the same guidance in the management comments just issued that for the full year of 2019 we expect non-purchased loans to grow in a low- to mid-teens percentage range, and that continues to be our expectation. I think we also reiterated that we expect significant variation in that growth from quarter-to-quarter. So I think that’s the guidance we gave in January, we still think it's very good guidance. So let me leave it at that.

Matt Olney

Okay -- digging back on the margin -- it sounds like there were some miscellaneous fees that were once again a nice tailwind for your loan yields in 1Q. I think this is also the case in the fourth quarter. And I know there are many things that go into those fees that you've described previously. Is there anything unique about the current loan production or the current loan payoff that you expect that 2019 you could maintain those fees at a higher level? Or should we just conclude that back-to-back quarters is not quite a trend and this will eventually move lower?

George Gleason

We commented, I think in October of last year, in regard to our third quarter earnings that our unusual, or not unusual, but our items such as minimum interest and exit fees and prepayment penalties, those sort of things that push that run rate of loan yield up or down -- that they were unusually low for Q3. They were better and above-average in Q4 and better and above-average in Q1. Now it's a little bit hard to describe sometimes what is the average you're measuring against because it's a fairly variable component and it moves around quite a bit from quarter-to-quarter. So we would hope that every quarter would be a good quarter. But our experience has told us that we'll have some quarters that are below par and some quarters that are above par in that regard. We're glad to have had an above-par Q1.

I don't think, to your question specifically, there is anything unique about what we're doing today. We did start adding minimum interest figures into our loans, and the majority of our loans, almost all of them now have a minimum interest requirement in them. We've been doing that for a couple of years now. So we're beginning to harvest some pretty good benefits from that. For example, we had a condo loan in New York that paid off yesterday. It completed about, I don't know, probably a month ago, CO'd, then they immediately started selling condos and they paid our loan off yesterday. And the sales velocity on their project was so brisk that the loan was underwritten to have $7 million of minimum interest in it. We had only collected through payoff $5.6 million. So we booked a $1.4 million minimum interest number yesterday as income from the payoff of that condo project. So as long as projects continue to pay off much more rapidly than you would have thought, that tends to generate some of those extra income items.

Matt Olney

Okay. That's helpful, George. And then just lastly for me, over the last few years, you've ramped up investments in several areas, from compliance, to audit, enterprise risk management, and a few more. Can you just talk about where the bank is within this ramp and are we now at a more steady state? In other words, is that now in the run rate? Or is there still some ramp that will come?

George Gleason

I think the big build is done there. And the comments that we put in the management comments document I think said we'll continue to build that infrastructure commensurate with our growth and the increases in the size and complexity of our organization over time. And certainly, our expectation and regulators' expectation, and I hope our stockholders' expectations, is that we would make sure we've got appropriate infrastructure in place and built to run the company. But the big lift there has been done over the last several years. And I don't know that we're ever at a steady state because I think it always improves and always evolves, but the big lift is behind us.

Brian Martin – *FIG Partners, LLC*

George, just one question -- one or two questions that haven't been covered. Just -- the quarterly loan originations for RESG, the quarter you talked about in 1Q being a bit stronger, can you -- I guess is there anything to read into that number? Are there more projects you're looking at here that contributed to that? Is it bigger projects like you mentioned earlier? Or just any more color on what was driving that this quarter?

George Gleason

Brian, part of it is just the timing that these things close on. One of the projects, I guess the largest loan that we closed in Q1 could have easily been a closing in Q4 of last year. But various details and nuances of that project and the evolution of it from approval in October to closing in Q1 of this year just resulted in that sliding a couple of months farther than we would have considered ideal, but our sponsor used that time very advantageously to continue to enhance their profitability and prospects with projects. So sometimes these things, as I said earlier, just take a long time to incubate, particularly the larger, more complex transactions. Sometimes it's not unusual to work on it three or four or five or even six quarters before you get an approved transaction closed and actually begin to execute the project. So part of it is just the timing of these things and how long it takes to get them done.

Brian Martin

You spent a lot of time talking about the deposits and kind of trends you're seeing there. Is there more opportunity, George, to increase loan yields from where they are today as you're booking new credits? I mean outside of obviously with the rate sensitivity, if rates don't go up and the variable rate nature, but just with the new loans you're booking, is there opportunity to have some benefit there going forward? Are you seeing any of that today?

George Gleason

Brian, that's what I said, it's all about execution, and we're certainly trying to do that, but it's a very competitive environment. And as I said, the slight down drift in LIBOR rates and flat yield curve are a couple of factors that make it harder to get loan yields up. Competition makes it harder to get loan yields up. But the challenge that our lenders are given every day is to go out and find great quality assets that we can get paid a fair return on and work hard to maximize our returns. So it's a battle out there, and we fight it every day. And as our 4.53% net interest margin suggests, we've done a pretty good job over the long term of getting good yields on our assets, and we expect to continue to try to do that.

Brian Martin

Okay. Perfect. And maybe one for Greg, it was just on the expenses, it sounds as though of that much of that build is done, the expense run rate is a pretty good level heading into 2Q and maybe on the fee side that the fees are a bit on the lower side given some of the seasonality in first quarter.

Greg McKinney

Yes, Brian, on the fee side, I mean we've given guidance that like, over the last four or five quarters, I think they have bounced around between roughly $24 million and $28 million. We think that's a pretty good range from the standpoint of what we expect on a go-forward basis. Obviously, there's those things have a tendency to bounce a little bit from quarter-to-quarter but we certainly feel like that's an appropriate range. On the expense side, as George talked about, the build-out there and yes, we are probably from that build, we're probably bottom of the ninth inning on that from just the build out there. There are still a few key positions in audit, BSA, IT that we're looking to add over the course of '19. But really, it's going to become more of a maintenance-type of an add as we go forward. We are continuing to try to bring in resources as part of our team and reduce our reliance on third-parties and consultants. So our hope is that over the next several quarters, we can continue to push those consultants out of the bank and bring in the skill sets and expertise we need to handle those technical aspects, whether it's in BSA or whether it's in audit or technology or elsewhere across the bank. So yes, we feel pretty good about those growth rates. I think they're pretty clean. We did have on the salary fee front a reversal related to Tyler. But that was a small number there so it really had no impact on salaries either.

George Gleason

All right. Thank you very much. We appreciate all of you being on the call today, and we've enjoyed talking about our first quarter results. We look forward to talking with you in about 90 days. Thank you very much. Have a great rest of the day. That concludes our call.