Bank OZK

Transcript of the First Quarter 2024 Conference Call

April 18, 2024, 9:00 am

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

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

Joining me on the call to take your questions are:

- George Gleason, Chairman and CEO;
- Brannon Hamblen, President;
- Tim Hicks, Chief Financial Officer; and
- Cindy Wolfe, Chief Operating Officer.

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

Stephen Scouten – *Piper | Sandler*

Appreciate the time. Great quarter here again. I really appreciate the addition of Figure 30 in the Management Comments showing the loan floors and how that helps protect the NIM. I'm curious if you guys have done any sort of sensitivity around that to kind of frame up the magnitude of potential change that could happen there on a quarterly or yearly basis as we continue to be in this “higher for longer” environment and you add new loans? I mean you talked a lot about that, but I'm wondering if there's a way to frame up the magnitude of benefit moving forward?

George Gleason

Stephen, we don't disclose anything on that, but our regular ALCO runs that we do certainly provide that information to management, and we don't disclose that, because we run large numbers of those runs in various rate scenarios and so forth. I would tell you, we feel very good about our position there. Obviously, as we said in our Management Comments, “higher for longer” at current rates is an excellent scenario for us. It gives us time to reset that floor. And it also keeps repayments at a fairly muted level, both of which are very helpful to us from a net interest income perspective. Obviously, as we also said in our Management Comments, “higher for longer” is hard on some of our borrowers. So, we believe any incremental credit costs are far more than outweighed in that flat rate scenario by the additional net interest income that we earn.

We view that as a net positive, “higher for longer.” Obviously, we are pleased that expectations for cutting rates seem to be getting reduced a little bit. We view that as a scenario that will be constructive for us at a later date when we've had more opportunities to reset floors. So, we would just assume the Fed stay where they are and cut rates mid to late next year if they cut rates. And obviously, if the tail risk of higher rates come into play, that would be very beneficial for our net interest margin, but that incremental benefit would probably be offset by the higher provision expense that our models would roll out. So hopefully, that's helpful to you.

Stephen Scouten

It is very helpful. And as I'm looking at Figure 17 kind of where you showed the various tranches of credit size within RESG, it seems like especially this quarter, but really for the last couple of quarters, the additions have largely been coming in the lower -- at the lower end of that spectrum, more so in the $0 to $125 million tranche, which granted, that's the lion's share of the credits anyways. But I'm curious if that's

an intentional move from you guys to kind of focus on those smaller, slightly more granular credit function of market dynamics or what might be at play there?

George Gleason

We're still open to any good piece of business of any size. And I think it just is a reflection of the fact that equity is finding probably more opportunities to put together deals that make sense to the equity. And hence, we're seeing requests for loans toward that smaller end. And there are some larger transactions percolating through the pipe that may or may not get to a closing at some point in time. But yes, the deal sizes we're seeing from the sponsors are probably leaning a little smaller than what we have in the past. And that's just a reflection of what makes sense in the economy for the sponsors today.

Stephen Scouten

And then just lastly for me, I mean, we're seeing a lot of negative headlines and optics around office. And you guys are pretty well insulated, one, from a loan-to-cost perspective, obviously, and the newness of your projects. But I'm wondering if you could speak to the dynamics you're seeing from a capital supply perspective, similar to what you guys were able to do in the great financial crisis, where if a loan did for whatever reason, have some issues, other mezz providers or sponsors were able to step in? Are you seeing overall strength in terms of willingness to step in on maybe distressed products and overall capital in the system?

George Gleason

Brannon may have a better view on that than I do. Brannon, do you want to take a shot?

Brannon Hamblen

Your question is focused on our existing portfolio, but what's going on in the new side of the product is obviously there as well. I mean there are a lot fewer new projects going up, and that's true across a number of property types, Stephen, just returns are much harder for equity to hit and fewer deals are coming to market. But there's a strong data behind the proposition, the product that's call it 2015 vintage and later has such a material advantage over the older vintage product that the capital flows will be focused more narrowly on that vintage, whether it's brand new or constructed in the last 5 years as would be the case for most of our office portfolio.

So, the quality of the product does materially enhance the likelihood that you're going to see that support capital on an existing product in a portfolio. We've had a number of situations over the last year where that has been the case. I think we'll see additional situations over the next 12, 24 months where that will be the case. It all comes down to quality and ability and our focus on best-in-class sponsorship and with the demonstrable experience and financial wherewithal significantly improves the likelihood that those newly developed projects are going to be supported.

So yes, it's been the case, and from an opportunity in what we'll call the distressed world, —obviously that word carries a broad meaning -- people are gathering data or gathering capital to enter that space from the outside of deals. Of course, we've got a lot of great capital providers in our deals at lower attachment points than the equity, so they're more likely to defend. But there's capital being raised out there for that distress. I think the -- George brought up the resistance of equity to pull the trigger. That's the case on new deals, and I think in office even on distressed deals.

You're starting to see some transactions that will, I think, ultimately gain momentum as there's price discovery and more of that capital start to enter the marketplace in a rescue situation, if you want to call it that. It still hasn't materially developed, but there are transactions coming off. So, I think you'll see a lot of capital flow that way. There's the most opportunity, the lowest hanging fruit from the standpoint of uncertainty creates great buying opportunities that result in great long-term investments. So, I think we'll see more of that develop over the next 12 to 24 months. But again, I think a lot of it will be in that newer vintage product.

Catherine Mealor – *Keefe, Bruyette, & Woods, Inc.*
Could get a little bit of color on extensions? I know we talked a little bit about that last quarter and that you're continuing to see clients ask for short-term extensions just as we kind of wait for rates to be cut. In a higher for longer scenario, what's your gut on how that trend continues and kind of what that could do to the size of your balance sheet? And is there any way to quantify maybe the size of your portfolio that you've seen take some kind of extension or modification over the past few quarters?

George Gleason
Catherine, we have all that data. I don't have it at my fingertips, and we haven't disclosed it. But I would tell you, it's a business as usual sort of situation. I think we probably commented last quarter that our extensions, we are typically maintaining or improving the economics on the transactions for us. Our fees

are what they would normally be for as a right extensions. We're typically trying to reset floors and getting that done in the vast majority of those extensions and getting other appropriate contributions to improve the cap stack, replenish reserves and so forth in most cases.

So, we have not done any extension yet that in the old world would have been a TDR. These have all been flat to improved economics for us as these have extended. So, we think there's a very constructive by and large, as we've said in our Management Comments for quite some time, we expect the vast majority of our sponsors, certainly not all of them, but the vast majority of them, to step up and support their projects until interest rates get to a better place or economic conditions and uncertainties resolve. And that continues to be the case, and we're seeing that in the value driven from these sponsors in the extensions.

Catherine Mealor
Right. And then maybe a question on the margin, if I could. Is there any way to quantify or think about what the incremental cost of new deposits that were added this quarter? And how close we might be to kind of a peak in deposit rate? It feels like you've still got a lot of growth coming in CDs. And so, there's a thought that your deposit costs might peak a few quarters later than maybe some of your peers. But just curious how close we are to that gap closing as we get to peak deposit rates?

George Gleason
Yes. Well, what I would tell you is our incremental cost of deposits in Q1 were less than our incremental cost of deposits in Q4. And that's reflected on the fact that there was a high expectation at the beginning of the year that rates were going to get cut, and that led to a cut in deposit pricing. That has recoiled about halfway from where we saw it in January to probably where it was in Q4. So, you're still -- the run rate on that repricing is lower than the run rate on new issuance CDs in Q4 but not as low as it was in January. It seems to have stabilized here.

And we've said for 7 quarters now, I think, that we would have some continued escalation in pricing for several quarters after the last Fed increase, just because of the rollover in our CD portfolio. The longest maturities in that portfolio, are predominantly 13 months at a rich duration. So, we're getting down where we've got couple of more quarters where those CDs are going to be rolling over from lower rates to higher rates. But that rate of change, as we said in our Management Comments is at a decreasing rate of increase.

Matt Olney – ***Stephens Inc.***

The management commentary references that in 2025 and 2026, we could see higher levels of RESG repayments, and that obviously makes sense. We're seeing higher rates now and expectations for lower rates eventually. I'm just trying to appreciate the level of RESG loans that are currently eligible to be repaid, but for various reasons, have not yet been paid down. Is the best way to think about that, just looking at that Figure 12 and just looking at the RESG loans to have a vintage in 2020 or earlier and just assuming those are currently eligible and probably awaiting lower rates?

George Gleason

I think, obviously, age is probably the key indicator there. So that's probably a pretty reasonable way to look at it, Matt.

Matt Olney

And then if we do see that those paydowns over the next few years for RESG, there were some mentions in the management commentary about increased diversification in the next few years. So, I guess I'm curious more strategically, how do you think about loan mix longer term? I think RESG is now 65% of the non-purchased loans. And the feedback I hear from investors is they believe that RESG is the best in the business in terms of within that niche, but believe that it shouldn't be such a dominant part of a bank. So curious strategically, how you view RESG in terms of longer term, how big of a portion it will be of the overall bank?

George Gleason

We've said many times that we would agree with that statement from the investors you're quoting that RESG is the best in the business. I think we've built a fabulous team and have a great business model at Real Estate Specialties Group that generates excellent returns with below-average risk. So, our principle that is in our strategic plan and has been communicated many times is we're going to let RESG get as big as it can be, while maintaining its discipline and adhering to its stringent credit quality and servicing quality on that portfolio.

We agree that our company is worth more, and is more valuable as a more diversified business model, even if the other lines of business are not quite as good as RESG in regard to risk-adjusted returns. We think that diversification is very important, thus why we talk in this document, and have talked for quite a while about a growth, growth and diversification strategy. The first growth being let RESG grow as much

as it will naturally grow. The second growth being grow other lines of business more broadly and more quickly over time. That may not happen this year, but I think we'll see that really in a significant impact next year and in 2026. And I've privately stated that I would like to see RESG grow to 50% of our business. And I say, grow to 50%, it's 65% more or less now, but I want to continue to grow but get down to 50% of our business, even it is as it gets bigger. And I think our Indirect Lending, our Asset Based Lending Group, our Equipment Finance and Capital Solutions Group, our Fund Finance Group and the other augmentations in our Corporate and Institutional Banking ("CIB") group that we've newly named and created by rolling those groups together and adding a lot of talent over the last few months to that team.

I think we'll see significant growth out of CIB. I think we'll see significant growth out of our commercial banking, Community Banking group, the commercial banking part of community banking. We realigned some reporting structures. We've added quite a few people in that team in recent weeks and months. And realigned some reporting structures to take advantage of leadership capabilities of some of the members of that team that have now stepped up and are carrying a bigger role under Alan Jessup's leadership. And I think all that has real positive implications. We're also ramping up our consumer banking efforts that flow through Cindy Wolfe's retail banking franchise, the bank branches and the HELOCs are a big part of that. We just started, of course, we'll sell these loans, but it's an important part of growing our consumer business. We just started taking mortgage loan applications with our new secondary market mortgage team yesterday. So, we're focused on a lot of things that will help those other parts of our business grow and ultimately get to where collectively they equal or exceed RESG. It's going to be a multiyear process to get there, but we're headed that way.

Michael Rose – *Raymond James*

Nice step down in expenses this quarter. I know you reiterated the kind of mid-single-digit growth outlook. You mentioned opportunistic hiring, things of that such. Can you just size the opportunity for you guys and maybe what the expectations are for additions and how we should expect that to impact the run rate as we move through the year? I'm just trying to get a sense for cadence of how opportunistic you'll be?

George Gleason

We're going to be very opportunistic and already have been. Tim, through last quarter, we hired 40-something net new people. And over the last 4 quarters, I think we gave this data in our Management

Comments, somewhere between 110 and 120 net new people. It wouldn't surprise me at all to see us adding 40 people plus or minus a quarter going forward. A lot of banks have pulled back, a lot of banks have shut down entire teams and divisions. There's real talent out there to be acquired, veteran experienced people. And we see value in adding a lot of those team members. In the short run, it will mute our ability to increase EPS and net income, because we'll be hiring people and knowing that they won't produce much, if any, revenue for some number of quarters. But we think it's a great time to add some talent. And I talked about this 2 or 3 quarters ago on the call, making the comment that we believe that talent is essential. We've always placed a great emphasis on high intellect, high capability, high aptitude people, who work hard and fit our very team-oriented culture, and we continue to believe even in a world where technology and AI are going to do more and more of that, having the best people is going to separate winners from losers and highly successful from less successful current firms. So, we just continue to be very focused on talent, and there's a lot of talent for sale right now.

Michael Rose
George, are the additions going to be kind of across the business lines? Or is it going to be more focused on some of the branch and community type lending personnel?

George Gleason
It's really across all the business lines. As I mentioned, this Corporate and Institutional Banking Group that we're building under Brannon that as a combination of our Asset-Based Lending Group, Equipment Finance and Capital Solution Group and what we're now calling Fund Finance Group, is the kind of the foundation for a lot of new talent we're bringing in, including leadership at the top of that group from other banks, bigger banks that have a lot of experience and have a shared commitment to credit quality and profitability that aligns with us. So we're adding there. We've begun to add a lot of business bankers in the retail team. We're adding more staff and more branches on the retail side.

We had Cindy and her team did an excellent job generating $2 billion of deposit growth in the quarter just ended, really nice number with our existing branch network. But if we're going to be generating $2 billion a quarter in deposit growth in future years, we're going to need to continue to develop our infrastructure to do that, and we're doing that. So, we're doing the things that we need to do to continue to grow and grow in a very safe, very profitable manner going forward. And I'm very proud of the fact that even though we added 40-something people and over the last year when a lot of banks have been cutting staff, we've

added north of 110, close to 120 new people. Our efficiency ratio in the quarter just ended was sub-33%, and that just speaks to the significant revenue generation capabilities of our franchise.

Michael Rose

I saw that you guys are not going to be doing buybacks at this point. It sounds like the efforts are clearly focused on growing out your businesses, whether it be RESG or the others. Anything else that we should be thinking about in terms of why not just have a buyback in place as a tool, just given where the stock is trading, even if you don't use it? And then I think you just mentioned that maybe deposit growth could be a little bit stronger as we move forward. How does that all kind of interplay with the Board's decision not to at least just have a buyback in place in general?

Tim Hicks

Michael, yes, you saw our comments there and really the first 30 minutes of this call, been talking about how our -- we're focused on growing organically. And that's just really our primary focus, a lot of internal efforts around there. So, we don't have any plans to buy back stock this year given our growth last year and continued expectation for growth this year. So, we'll ask our Board at a later time when we're ready, so there's no reason to have a buyback in place if we don't have any plans to use it.

Michael Rose

Totally get it. If I could just squeeze one last one in. George, would you say that you're more confident in the ability to grow EPS and PPNR or NII this year at a kind of a record rate than you were maybe back in January, just given the strong first quarter? Is that a fair characterization?

George Gleason

Michael, we're going to spend some money, and there's a lot of uncertainties about the economy. So, I would take a cautious outlook about that. The guidance we gave in our January call was that we expected our EPS and net income for the full year of 2024 to be a record over 2023. And of course, we had record numbers every quarter in 2023, coming off a record quarter in Q4 2022. And we started out this year really good with a record. It wasn't a huge improvement, just $0.01 a share basically improvement over Q4. We're going to continue to grind and work and I think we're taking a cautious view of it, and I would reiterate guidance for full year of 2024, we expect to be at a record EPS and net income number on top of 2023's record EPS net income number. But I'm not sure about every quarter. We would love to put up a

little bit of improvement every quarter, but I can't guarantee it will be a linear deal, but we're confident about our guidance for the full year of '24.

Manan Gosalia – ***Morgan Stanley***
I appreciate the new disclosure on the loan floors. I think you might have mentioned this, but those floors should keep migrating higher in a higher for longer rate environment. Is that correct?

George Gleason
Yes, definitely.

Manan Gosalia
Okay. And then how do you think about the dynamic between capital market exits in these loan floors as we go through the next couple of years, with the loans that have higher floors automatically move into the capital markets when rates go below those floors? Would there be -- would some of these loans exit rather than remain on their floors? Or am I thinking about that the wrong way?

Brannon Hamblen
Sure. Well, certainly, our borrowers love to pay as low of interest rates as they can. But you have to look at, it's a very complex topic, whether the project is in its construction phase or whether it is in its lease-up phase. And also, where they think rates are going to go and how fast they're going to go. They all influence that. So, in a real simple world, yes, if they fall and they hit their floor, then they would be looking. But there are other considerations. And you have to remember, in our projects with the low loan-to-cost that we have, they would be looking not just at the rate they're paying but also at the proceeds they're going to get. So, there are multiple motivations involved in that.

So, look, we're happy for our loans to be repaid to have a successful sort of life cycle to them. It's a construction loan portfolio. We fully expect that. But there's much more to a successful move to the next stage for our sponsors than just where the interest rates are. So, in short, yes, rates are a part of it, but there's much more involved.

George Gleason
Manan, let me give a little more color on that, and Brannon can agree or disagree with this. But our construction loans, it is hard, but not impossible for those to move mid construction. And it's easier in

some stages because of laws and so forth than it is in other states. So, there's somewhat of a natural friction to a loan moving mid construction. In addition to that, our loans contain minimum interest requirements that we've got to be paid X amount of interest over the life of a loan. And if they pay us off before we earn that interest, they've got to pay the difference to us as a minimum interest charge.

So that tends to keep loans on the books, even if the floors become higher than market until they burned off that minimum interest unless there's an incredibly compelling reason to exit sooner. The loans that are fully completed projects, that have met their minimum interest requirements, which are loans that would sort of naturally be ripe to go to a permanent refinance anyway. Those loans are more susceptible to being refinanced, if that floor has that right above market rates. And we expect those loans to go anyway to the permanent market when they can, when it's advantageous for them to do so. So that's not a negative to us either.

Brannon Hamblen

I was just going to add to that. Well, you're absolutely right about all that, and the guys have been doing a phenomenal job with the floors, we mentioned that. But they've also done a great job in improving on multiple on our loans by setting the minimum interest amount. So, as a percentage of the loan amount, they work really hard on that piece of it as well. So yes, I was bad to leave that one out. That's a really important function.

George Gleason

And for those of you who are not familiar with it, the minimum interest is really not designed to be punitive to our customers. But it's designed to make sure we achieve a minimum return on our capital allocation to that project, because our typical loan is 50% of the cost of the project more or less. And so, we may have a commitment out for a full year or even 15 months or 18 months before we fund anything on that loan. We're required to hold capital against 50% of that commitment amount before it's funded. And so, we could have a huge capital allocation for 18 months and never fund if the customer decides they want to refinance to a lower rate or refinance to someone that will give them more leverage than we've allocated capital and never earned anything but an origination fee and some other fees on the loan. So, the minimum interest is necessary and calculated to make sure that we achieve a minimum return on equity over the life of the loan regardless of when it prepays.

Manan Gosalia

That's very helpful. I really appreciate the fulsome answer there. Maybe just pivoting, you spoke about distressed transactions starting to pick up a little. What do you think drives that meaningfully higher? I know there's a lot of private capital waiting on the sidelines. So, is it a function of them just waiting for valuations to fall more? Or is it a resolution on this uncertainty on rates? Or what should drive some of those transactions meaningfully higher in your view?

George Gleason

I'm going to let Brannon answer that question, but I'm going to make sure that we don't create any misunderstanding. Those distressed transactions we're talking about are not our transactions. They are other transactions we see in the market. We have a huge view of the market across the U.S. So those are not our transactions. But Brannon, with that caveat and clarification, can you give some color to what's going to be the precipitating event that causes more of that rescue capital to go to work.

Brannon Hamblen

Manan, great question. George, great clarification. We are talking about the broader world outside of our portfolio. But you identified a number of issues, all of which are in play. I think as it relates to multifamily, that's a much more active market. Cap rates are more quickly reset, buyers determining where those sort of level down will start to draw them at a greater velocity into that space. I think the one that is sort of the longer-term opportunity if you're looking at it from there is many funds have raised billions of dollars for the opportunity to start to invest in distressed office.

But they'll be much more selective as it relates to the product type. There's some pause waiting to see exactly how some of that falls out. You've got a lot of leases that are going to mature over the next couple of years and have a lot of visibility into where occupancies are going to fall out in some of those older vintage product or even later vintage that have been leased up, but now trying to figure out who's going to stay and who's going to go. The interest rate issue that you brought up very clearly, they've raised a lot of capital, but they want to be able to lever that. And quite frankly, just finding debt capital out there with which to lever it, there are a lot of institutions out there that are the holders of that distressed product type and not eager to re-up or expand their portfolio in that product type.

So, it's part capital markets, part interest rates, part just letting things play out in terms of who's going to stay and who's going to go in office in various markets. But you have seen some bites at the apple at basis

where either they don't think they can lose, or they've been in the market forever or they're not trying to turn it in 3 years. They're going to have been there. They're going to be there. They've got the patient money to see it play out over a longer period of term. But again, interest rate certainty, figure out how the world of office is going to play out more, capital markets a little bit freer to help lever deals. All those things are going to play into the rate at which that velocity begins to increase.

Timur Braziler – ***Wells Fargo Securities***
Looking at the deposit trends in a "higher-for-longer" environment -- I know you guys were able to bring down some deposit pricing in January. It sounds like half of that was brought back in just with a "higher-for-longer" environment here. Just looking at net interest margin and the linked quarter decline there at a decelerating pace. Can we actually see NIM kind of compress at a decelerating pace going forward? Or some of the deposit dynamics such that if we do end up in the "higher-for-longer" environment, then the margin compression can actually pick up a little bit here as we go into the next couple of quarters?

George Gleason
I think if we stay in a "higher-for-longer" environment at current rates, assuming that the tail risk of Fed rate increases don't materialize and the timing of the Fed cuts doesn't happen near term, I think we get to a relatively flat cost of interest-bearing deposits a couple of three quarters out.
That assumes we continue to achieve growth of $1 billion to $2 billion a quarter in deposits.

Timur Braziler
That makes sense. And then, I guess, on the way down and the ability to reprice time deposits lower, do you think that's going to be fairly formulaic as rates come down, you're going to have the ability to reprice those lower? Or is there something more idiosyncratic to just the reliance on time deposits that maybe costs are going to have to stay elevated for a longer bit of a lag as we start getting some of these rate cuts in place?

Cindy Wolfe
I think formulaic is probably a good way to describe it. We have begun the rise in maturities based on what we were doing a year ago. So that will pick up in May and June. And I'll say the only thing that we've noted that is better than we anticipated is our retention. So, I'll just give that little bit of color that we've been really pleased so far with our retention rate on our maturing CDs, and we hope that continues, because that makes it even more predictable.

Timur Braziler

Great. And then just looking at an update on substandard credits, the Seattle office that was new this quarter, I know last quarter, we had a couple of office loans in Seattle that were reappraised quite a bit higher from an LTV standpoint. I'm wondering, is this one of those loans from last quarter? And then maybe just give us broader expectations around your exposure in the Pacific Northwest and what you might be seeing there that's a little bit more punitive than some of your other markets?

Brannon Hamblen

Yes. The Seattle office that we called out, that we did downgrade to substandard was one of those bubbles that had floated up that we had previously described to you. So same issue there. I think to the broader question of the Northwest, I mean, obviously, we can't overgeneralize, but that particular market has had some various submarkets that have been sort of more affected by some of the turmoil in 2020 and 2021? Obviously, as it relates to office, you've got work from home that has impacted the entire industry and made that more challenging. But you've got other situations where mixed-use outcomes are superior – are having superior leasing results and just the place-making aspect of that really offsets the risk you might have in one product or the other, offset some of the risks that might be sort of overstated in any region.

But we've -- I will say, we've not been as active in the northwestern part of the country for a while. So, I would say that our views are somewhat laid out just in terms of the lower origination value. So, we're very happy that such a substantial part of our book does exist in the geographies that are having more positive trends in the last couple of years, although I did -- I don't recall the source, but did see Seattle return to sort of a top 10 opportunity list. I don't remember the resource or who was reporting on it. But I do think there are probably some more positive trends developing there. It will take a long time to play out. But yes, we've been less active in that part of the country.

Timur Braziler

Any update on the Chicago land loan? I know it's been extended to October. How would you handicap that being resolved in advance of October? And how should we think about it as that loan is still on the books in October?

George Gleason

Yes, Brannon, let me comment on that. I would tell you, I thought we had good progress on each of the specific assets that we've been discussing in our Management Comments documents over the last year. The Chicago land deal, they continue to work hard. They went way down the road with one potential capital source and concluded that was not the right solution. So, they stepped up to the plate and put up $8 million to reengage some previously interested parties in that. We view that positively, certainly not conclusive that they're going to be successful. But we viewed it positive that they came to the table with $8 million more capital to buy more time to continue to work on a recap of that project.

We have no way of handicapping the successor payer of that effort, but $8 million we viewed as a positive step. I described it to the team as first and 10 yards with the $8 million. There's a new set of downs, gets you 10 yards farther down the field, but they're still a long way from the end zone.

Likewise, the $11 million sale of the amenities, which should hopefully close this quarter on the development near Lake Tahoe, is a really significant step forward if we get that closed to the final wind down of what's been a long-term workout credit for a number of years on our books and been discussed for a number of years. So, we view that as an important step.

And the fact that our L.A. land project didn't close was disappointing to us. We'd certainly preferred it to close. But the flip side is they're spending a lot of money and a lot of energy and effort putting that project together. And the fact that they put $1 million fee to us, paid $1 million fee that went to income and put $1 million of nonrefundable earnest money up for a 90-day extension, shows they're serious about it. And as we mentioned, they've got 3 more 90-day extensions, each with a $1 million fee and an additional $1 million of nonrefundable earnest money they can exercise. So that we viewed as a positive commitment both for income and the earnings money going hard on that.

And then we sold the Minneapolis hotel loan, so that $18.8 million asset went off the books. We added the Seattle office, but that's an $11.4 million book value. So, I view it as another first down when you get rid of an $18.8 million asset and replace it with an $11.4 million assets. So, we viewed all those as main positive trends related to those credits.

Ben Gerlinger – *Citi*

Most of the questions I was thinking have kind of been addressed to some extent. So, I'll just follow up with Jay in terms of specifics. But I'm just kind of curious, when you think about the overall pace of growth this year and maybe give guidance that it was going to be a little bit softer than last year. But I mean, last year also a really strong year following 2022, which was also a strong year. Is the really strong deposit growth this quarter a leading indicator that 2Q could also be a really strong quarter and then kind of tapered down to the back half of the year? Or did 1Q potentially kind of pull forward some of the loan growth? Just I know the cadence of quarter-to-quarter is always difficult, but I'm just kind of curious on what you're seeing over the next kind of 3 quarters here and how the lumpiness might transform?

George Gleason

I don't think we have color on the lumpiness of quarter-to-quarter. We have made the comment in our Management Comments document for years that results of different parts of our performance could vary quite a bit from quarter-to-quarter, and that's certainly true of originations and certainly true of pay downs. Probably the deposit side of our business is less lumpy and much more granular and thus prone to less sort of wild swings quarter-to-quarter. I think about all that I can say is payoffs, originations and total balance sheet growth could be fairly lumpy quarter-to-quarter. I would expect more stability, and more of a sort of linear straight line basis, on the deposit growth. I mean, $1.2 billion or $1.5 billion and $2 billion or $1.8 billion, you can kind of have that sort of range, but we would expect steady growth with some variation quarter-to-quarter in the deposits.

Ben Gerlinger

And then kind of just thinking when you think about just the ratios on your balance sheet, I know that you said RESG just does what it does because it's kind of the best-in-class. But do you have any sort of targets in terms of just loan-to-deposit ratio just from a 10,000-foot view? Or is it really just kind of what the loans grow and then match what deposits where needed?

Tim Hicks

Historically, we've been in the low to mid-90% loan-to-deposit ratio. So, I don't anticipate that changing much at all. We do project out our funding needs on a monthly basis for 36 months in advance. And we adjust our deposit-gathering initiatives based on those projections. So we really look at it as how much earning asset growth do we need to fund and keep the loan-to-deposit ratio in the low to mid-90% range long term.

Brian Martin – *Janney Montgomery Scott*

George, any commentary on the headcount that you've added? I mean anything specific you can provide? And more broadly, just is it at least the ones hired already, kind of are these new teams? Are these adds to existing businesses? Just trying to understand given the talent that's out there, just kind of directionally how you're thinking about that?

George Gleason

We've not lifted any teams out. It's been one-offs. Now, as it turns out, we've hired people -- several people that have worked together in the past, but we didn't hire them as a team. We hired those who were individual initiations on our part to those individuals. We think we've acquired some really great talent, and we're getting those guys in and getting them ramped up and deployed as quickly and effectively as we can. But we're going to do it the right way. We're going to do it with proper governance and risk assessments and training and make sure that we're all lined up with everything we need to do. We started talking a little over a year ago about getting in the mortgage business, and we started originating yesterday in the mortgage business. So, we're going to take the time it takes to do it right because it's very important that the business that we generate from these new team members fully aligns with our corporate philosophy on credit risk and profitability. So, we're very excited about this. We've got some great team members hired and have our eye on some more great team members. And as we said in that earlier question, it's pretty much across all lines of business in our company, except RESG and Indirect. We're kind of fully built out where we need to be right now in those units, but everywhere else, we're adding talent.

Brian Martin

So, it's more adding talent to existing businesses rather than new business lines. I appreciate that. And then just maybe the last two is just -- I don't know if it's more for Tim, but just on the reserve build and just kind of how you're thinking about reserve levels here given the heavy lifting you guys have already done? Just maybe any commentary on the outlook, Tim, there? And then secondly, just on the capital side, I think given the growth in profitability, I guess, is your expectation that capital levels can be stable or maybe up as you go through the balance of the year?

George Gleason

Before you answer that, Tim. I do want to say some of these team members we've hired will introduce kind of incremental expansions of existing lines of business, broadening that scope of that business line

and ultimately, I think, bring some additional business lines to us that we will launch in future quarters and years. But we will do that in a very intentional, very controlled manner. But yes, I think we will not just incrementally add to existing businesses, which is the initial focus, but will broaden the scope of products and services offered by those businesses and add new lines over the next couple of years. Now, Tim?

Tim Hicks

Yes, Brian, on your provision question, as we mentioned earlier in the call, rates being higher for longer, certainly good from us, from an earnings perspective and our trajectory of net interest income. But that could put some pressure on some of our borrowers as rates stay higher for longer, which is why you continue to see the build that we had in the quarter. As rates come down, obviously, that puts less pressure on the interest costs of some of our borrowers. And so, I would anticipate a lower level of provision at a time, when rates were to start coming down.

And then on your capital question, yes, I mean, I think it depends on each quarter's growth of what it will do from a quarter -- of our capital ratios, what they will do from a quarter-to-quarter basis, but obviously, have a strong earnings profile, and a strong earnings retention profile and that can support a lot of growth. But as George said earlier, our growth can vary from quarter to quarter, and that may make one quarter a decline and another quarter an increase in our capital ratios. But over the year, I would certainly expect us to be able to maintain, to grow slightly our capital ratios -- risk-based capital ratios.

Brandon King – *Truist*

Just one for me and following up on the commentary around getting to that 50% RESG mix for the total loan portfolio. Do you think you need M&A to get there?

George Gleason

No. I think M&A possibly could accelerate that or augment that. But you never know if you're going to get an acquisition or not. So no, I don't think we need it. I think we get there organically.

Samuel Varga – *UBS*

George, last quarter, you talked a little bit about how the Fed fund cut expectations sort of made negotiating floors a bit more difficult for you. Since that has shifted as much as it has over the last 3, 4

months, has that become easier again to get the higher floors? Or once clients see the sort of the potential, they don't really like go for that?

George Gleason

No, Sam, it has not made it any easier. I don't think it's a lot more difficult either. But obviously, I think most of our customers think we're at the peak of rates, and they believe rates will come down at some point and they want some relief when they do. So that's making the negotiation of those floors a continued difficult conversation. But we need that -- we need to do what we can do in that regard. Our customers need to do what they can do. So, it's a very intense negotiation in every transaction.

Samuel Varga

Understood. And just a quick follow-up. You obviously have a pretty unique view on LTV migrations, and I appreciate all the disclosure you have quarter-over-quarter. I was wondering if the valuation adjustments that you've seen, if you think -- if your view is that, that's sort of appropriately baked into the Moody's scenarios? Or could there be sort of a lag effect in the allowance where it actually has to come up, not because of your own portfolio, but because Moody's catches up to what you're already seeing today?

George Gleason

I think our valuations that we're getting are good valuations based on the information that is available to the appraiser. If we get appraisals that we don't think are reflective our appraisal services guys that's an independent unit within our company push back and ask questions, and if there are bad assumptions or misinformation in the appraisals, they push back, get that cleaned up and get the appraisals lined up. So, I think the appraisals we're getting are good. Our belief is that all of the relevant factors are adequately and appropriately addressed in the various Moody models and our ACL calculation. We continue to maintain a pretty cautious distribution of assumptions. Our Moody's S4 scenario, which is sort of the adverse downside economic scenario-- I guess you maybe characterize that as a hard landing scenario -- and the Moody's S6, which is a stagflation scenario are the majority of our allocation of our distributions. The baseline is less than the combined effect of the S4 and the S6 scenario. So, I think we've got an appropriately conservative scenario selection and that scenario selections predicated on fact that just a lot of moving economic, political, geopolitical variables that could impact our customers and credit losses.

So, we've taken a fairly cautious view of that just because of the high degree of uncertainty in the global economy. So, I feel good about what we're doing. And as Tim mentioned, over the last 7 quarters since Fed started raising rates, our ACL has gone from $300 million to $537 million. We've had a $237 million increase in our ACL, which, I think, appropriately addresses the fact that we've had a 525 basis point increase in the Fed funds target rate, and it seems likely to stay there for a while.

Operator

That concludes the question-and-answer session. At this time, I would like to turn the call back to Chairman and CEO, George Gleason for closing remarks.

George Gleason

Thank you so much for joining the call. We look forward to talking with you and giving you an update in about 90 days. Have a great quarter. Thank you.