Bank of the Ozarks

Conference Call – October 11, 2017

Transcript – Prepared Remarks

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 of the Ozarks. The purpose of this call is to discuss the Company's results for the quarter just ended and our outlook for upcoming quarters.

During today's call, and in other disclosures and presentations, we may make certain statements about our plans, estimates, strategies and outlook that are forward-looking statements. These statements are based on management's current expectations concerning future events that, by their nature, are subject to risks and uncertainties. Actual results and future events could differ, possibly materially, from those anticipated in our statements and from historical performance due to a variety of risks and other factors. Information about such factors, as well as GAAP reconciliations and other information on non-GAAP financial measures we discuss, is included in today's earnings press release and in our 10-K, 10-Qs and various other public filings and investor materials. These are all available on our corporate website, www.bankozarks.com, under "Investor Relations." The Company disclaims any obligation to update or revise any forward-looking statement based on the occurrence of future events, the receipt of new information or otherwise.

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Now, let me turn the call over to our Chairman and CEO, George Gleason.

George Gleason:

We are very pleased today to report our excellent third quarter results, which include our 8th consecutive quarter of record net income and numerous other record results. I want to send a huge "shout out" to our entire team for the excellent results they achieved in the quarter just ended. Despite the temporary distraction of a leadership transition at Real Estate Specialties Group ("RESG"), two major hurricanes, and a major focus on our infrastructure build-out and DFAST implementation, the team stayed very disciplined and focused on achieving excellence in our business while delivering great service and value to our customers. I am deeply honored to serve with so many talented, high-performing and hard-working men and women. Well done and thank you!

Now, let me turn the call back to Tim.

Tim Hicks:

Our $20.8 billion in total assets at September 30, 2017 was a 13% increase from September 30 last year. This balance sheet growth has contributed to excellent income growth. Our net income for the quarter just ended was a record $96.0 million and a 26% increase from the third quarter of 2016. Our diluted earnings per common share for the quarter just ended were a record $0.75 and a 14% increase compared to the third quarter of 2016.

Our strong growth continues. In the quarter just ended, the funded balance of our non-purchased loans and leases grew $1.02 billion and our unfunded balance of closed loans grew another $636 million. For the first nine months of 2017, the funded balance of our non-purchased loans and leases grew $2.4 billion and our unfunded balance of closed loans grew $2.5 billion. Our unfunded balance of closed loans was a record $12.5 billion at September 30, 2017, which will be important in achieving our loan growth goals in the remainder of 2017, 2018 and early 2019.

RESG accounted for about 52% of our growth in the funded balance of non-purchased loans and leases in the quarter just ended, while our other loan and lease teams accounted for 48% of the third-quarter growth. As most of you know, RESG has been our largest growth engine for earning assets for many years. We expect RESG will continue to be our largest growth engine and that it will continue to increase its volume of originations, but we are pleased by the positive contributions and momentum from our various other loan and lease teams. For several years, we have been working on various initiatives to achieve greater contributions to our growth in earning assets from our other lines of business and from product types other than commercial real estate. You can see the success we are having in this regard. We expect to continue to increase our growth in these other lines of business.

At September 30, 2017, the RESG portfolio accounted for 66% of the funded balance and 94% of the unfunded balance of our total non-purchased loans and leases. At quarter-end, our average loan-to-cost for the RESG portfolio was a conservative 48.9% and our average loan-to-appraised-value was even lower at just 41.5%. The very low leverage of this portfolio exemplifies our conservative credit culture and is one of the many reasons we have such confidence in the quality of our loan and lease portfolio.

As we have said all year, we expect 2017's growth in the funded balance of non-purchased loans and leases to be between $3.1 billion and $4 billion, although, as we noted in our July conference call, we revised that expectation for growth to be in the lower half of that range. Longer-term prospects for growth in the funded balance of non-purchased loans and leases continue to appear good based on the growth in our customer base, our robust pipeline of transactions currently in underwriting and closing, and our largest-ever unfunded balance of closed loans. Accordingly, we expect our dollar volume of growth in non-purchased loans and leases in 2018 to exceed our 2017 growth. While it is early to make comments about 2019, based on our business plans and the positive momentum we have in RESG and a number of other loan categories, we expect our dollar volume of growth in non-purchased loans and leases in 2019 to exceed 2018's growth.

Organic growth of loans, leases and deposits continues to be our top growth priority, and we have demonstrated our ability to achieve substantial growth apart from acquisitions. With that said, we believe acquisitions will provide opportunities to augment our robust organic growth. Our 15 acquisitions since 2010 have been "triple accretive," being accretive to book value per share and tangible book value per share at closing and accretive to earnings per share in the first 12 months following closing. We expect to continue to be disciplined in our acquisition strategy and to apply this "triple accretive" standard to future opportunities. We continue to identify and analyze M & A opportunities, and we believe our disciplined approach will help us create significant additional shareholder value over time.

Let's turn to capital. As most of you know, we expect to file our first Dodd-Frank Act Stress Test, or DFAST, submission in July 2018 based on year-end 2017 financials. As you may recall, during the second quarter, we completed the issuance and sale of common stock for net proceeds of approximately $300 million to support our expected growth over the nine quarters covered by our initial DFAST test period. We will continue to monitor our capital position considering our expected growth, expected performance under our initial and subsequent DFAST submissions, and other relevant factors. If we determine we need additional capital, whether for our initial or subsequent DFAST submissions or otherwise, we think the most likely avenue for our next capital formation would be issuance of subordinated debt. At the current time, we consider it likely that we will issue some level of subordinated debt by year-end 2018.

During the quarter just ended, because of Hurricanes Harvey and Irma, we had approximately 122 offices in six states, which either had reduced hours or closed from one to seven days. While we cannot quantify the lost revenue or lost production from these temporary closures, the hurricanes did have an impact on our employees and operations in those offices.

During the hurricanes, the well-being of our employees was our top concern. We provided financial assistance totaling approximately $113,000 to 234 employees in Texas, Florida and Georgia impacted by the hurricanes.

In addition, we waived late fees, overdrafts fees, and ATM fees and granted short-term payment deferrals for certain customers meeting certain criteria. We have conducted a review of the majority of our loans with collateral in the impacted areas. While we are aware of damage to some of our collateral, in most cases, such damage was minor, and we expect most customers to be able to repair the damage with their own funds or with funds received from insurance. Based on this review, we determined that we should not make any additional provision for loan and lease losses during the third quarter because of the hurricanes.

Let me turn the call over to our Chief Financial Officer and Chief Accounting Officer, Greg McKinney.

Greg McKinney:

We have long focused on three disciplines – margin, efficiency and asset quality. I want to spend my time today providing some details on our net interest margin and related matters.

In the quarter just ended, our net interest income was a record $209.7 million, but our net interest margin decreased to 4.84%, down 15 basis points from this year’s second quarter. In recent calls, we have mentioned that we are more focused recently on our “core spread” than our net interest margin. “Core spread” is the term we use to describe the difference between our yield on non-purchased loans and leases, which is our largest category of earning assets, and our cost of interest-bearing deposits. In the quarter just ended, our yield on non-purchased loans and leases increased 21 basis points to 5.63%, while our cost of interest bearing deposits increased 12 basis points to 0.79%, resulting in a nine basis point increase in our core spread. Our core spread has increased 29 basis points over the last five quarters. Increases in Libor rates and the Federal Reserve's fed funds target rate have contributed, among other factors, to this improvement. The improvement in our core spread in the quarter just ended largely reflected the full-quarter benefit from the last increase in the fed funds target rate in mid-June.

There are many factors which affect our core spread, but we expect that the most meaningful factor in coming quarters will be Federal Reserve's actions related to the fed funds target rate. If the Federal Reserve continues to increase the fed funds target rate, this should typically help us continue to increase our core spread, because 80% of our non-purchased loans and leases at September 30, 2017 had variable rates. The benefit from the increases in yield on these variable rate loans from an increase in the fed funds target rate should more than offset the increased cost of interest bearing deposits resulting from our deposit gathering initiatives such as our "spin-up" offices. Conversely, if the Federal Reserve were to discontinue increases in the fed funds target rate, this would likely put some downward pressure on our core spread.

As a result of our robust level of loan originations in the quarter, we had $47.6 million in net deferred credits at September 30, 2017, meaning we had $47.6 million more in unamortized deferred loan origination fees than unamortized deferred loan origination costs. These net deferred credits will contribute to net interest income as they are recognized in future periods.

Our second largest component of earning assets is purchased loans, which are the remaining loans we have acquired in our fifteen acquisitions since 2010. Our purchased loans have a higher yield than our non-purchased loans and leases. Our portfolio of purchased loans is, of course, paying down every quarter, so this constant reduction in this higher yielding portfolio puts downward pressure on our net interest margin. As of September 30, 2017, we have $105.3 million in valuation discounts remaining on our purchased loans.

Our third largest component of earning assets is our investment securities portfolio. We have made a number of adjustments to that portfolio in recent quarters. Our yield on investment securities was 3.05% in the quarter just ended, which represented a 56 basis point decrease from 3.61% in this year's second quarter. As we discussed in our July conference call, during the second quarter, we increased our investment portfolio by a net $631 million, which resulted from our purchasing approximately $728 million of highly liquid, short-duration government agency mortgage-backed pass through securities in mid-June. Because of the high quality and short duration of these securities, they yield only about 2%. Despite their relatively low yields, we added these securities to provide another tool for managing our balance sheet liquidity, while trying to avoid any significant interest rate and market risks. Our results for the quarter just ended, including our third quarter net interest margin, reflect the full quarter's impact of the addition of these lower yielding securities in mid-June.

We continued to make adjustments in our investment securities portfolio in the quarter just ended as market conditions provided an excellent opportunity to reduce the portfolio's market and interest rate risks. As you probably know, the yield on ten-year U.S. Treasury bonds dropped sharply during the middle of the quarter. Considering this, along with possible additional Fed Funds rate increases, uncertainty surrounding the Federal Reserve unwinding its balance sheet, and uncertainty regarding the impact of possible changes in tax rates on the value of tax-exempt bonds, we elected to shorten the duration of our investment portfolio and reduce our exposure to longer-term tax-exempt bonds. Specifically, during the third quarter, we sold $149.6 million of mostly longer duration tax-exempt municipal bonds. We recognized both gains and losses in this process, with net gains of $2.43 million.

While these sales reduced our investment portfolio exposure to the risk of rising rates and the risk that reductions in effective tax rates might affect valuations on our tax exempt municipal bonds, the sales will also reduce our investment securities portfolio yield. For the fourth quarter, we expect the fully tax equivalent yield on our total securities portfolio to be between 2.80% and 3.00%. Obviously, this could fluctuate based on purchases, sales, calls, prepayments, and other factors during the quarter.

Let me turn the call over to our Chief Operating Officer and Chief Banking Officer, Tyler Vance.

Tyler Vance:

Our efficiency ratio has been among the top decile of the industry every year for 15 consecutive years. In the quarter just ended, our efficiency ratio was an excellent 34.4% and for the first nine months of 2017 was 34.9%.

While our efficiency ratio has been excellent, we have a longer-term goal of improving that ratio even further. However, we don't expect much, if any, improvement over the next few quarters. In fact, our efficiency ratio might increase slightly for one or more quarters in the near-term.

As we have discussed for many quarters now, we have been focused on developing our products and infrastructure to allow us to continue to achieve high performance, even as we become a much larger bank. We have previously discussed our increased focus on developing technology-based products and solutions through our OZRK Labs, which we think will be critical to our success in the rapidly evolving retail banking environment. We have also talked about our focus on expanding and enhancing our infrastructure for information technology, information systems, cybersecurity, business resilience, enterprise risk management, internal audit, compliance, BSA/AML monitoring, training and other important areas, as well as expanding our human and physical infrastructure to serve low-to-moderate income and majority-minority markets and customer segments. All these initiatives are important elements in our preparation for significant future growth, and we have already made significant progress. These initiatives have been and will continue to be an important emphasis for us during the fourth quarter of this year and into 2018 as we complete most of this infrastructure build that has been underway through 2016 and 2017. We expect our total non-interest expense to increase during the fourth quarter by approximately $3 million to $5 million compared to the level of non-interest expense in the third quarter. We also believe that we will continue to have further increases in our level of non-interest expense during the first half of 2018. We anticipate that we will see that rate of increase subside in the second half of 2018 after most of our infrastructure build is complete and our expenditures for consulting fees subside from the current level.

Accordingly, after mid-2018, we expect to see a generally improving long-term trend in our efficiency ratio. There are several key factors, among others, needed to accomplish our long-term efficiency goals. First, we expect to ultimately utilize a large amount of the excess capacity of our extensive branch network, tapping many billions of dollars of additional deposits through existing offices. That potential is very evident in the recently released FDIC bank deposit market share data as of June 30, 2017. For the 156 cities and towns, excluding New York City, in which we had deposit gathering offices, we had 4.13% of the branches but only 1.40% of the deposits. We believe we can grow to, or near, market share parity. Our ability to achieve substantial deposit growth in many of these cities and towns while adding minimal amounts of overhead should have favorable implications for our efficiency ratio. Second, we expect to achieve further efficiencies over time from our ongoing deployment of technology applications from OZRK Labs. We believe these factors, among others, will allow us to achieve an improving efficiency ratio long term. Of course, our guidance regarding our improving efficiency ratio does not consider the potential impact of any future acquisitions.

Let me change subjects and discuss liquidity. We have long expected that we could accelerate deposit growth as needed to fund our loan and lease growth. Our experience in recent years has validated that expectation. At least monthly, and more often as needed, we update a comprehensive 36-month projection of our expected loan fundings, loan paydowns and other sources and uses of funds. These detailed monthly projections of needed deposit growth provide the goals for our deposit growth strategies. This has proven to be a very effective process.

Currently we have 47 offices in 34 cities in "spin-up" mode offering various deposit specials along with an enhanced level of marketing activity. Our branch network of approximately 243 deposit offices continues to have substantial untapped capacity as I just mentioned, and we believe that capacity is sufficient to fund our expected loan and lease growth over the next several years. At the same time, we plan to add *de novo* branches in new markets, which should provide the additional deposit capacity to support future growth.

At September 30, 2017, our total deposits were $16.8 billion, which was a $582 million increase in total deposits from the previous quarter-end. Our organic deposits, which exclude brokered deposits, grew a very healthy $934 million in the quarter just ended. Because of this significant growth in organic deposits in the quarter just ended, we decreased our volume of brokered deposits by $352 million from $1.57 billion, or 9.7% of total deposits, at June 30, 2017 to $1.22 billion, or 7.2% of total deposits, at September 30, 2017. For the first nine months of 2017, we have decreased brokered deposits by $771 million. Of course, we're not subject to any regulatory limitations on our volume of brokered deposits and our internal policy calls for a 15% limit, which we are well below, but we are nonetheless pleased to see our percentage of brokered deposits continue the downward trend over the past six quarters.

We consider net growth in core checking accounts as one of our most important deposit metrics. We achieved excellent organic growth in our number of net new core checking accounts with 6,173 net accounts added during the quarter just ended, bringing our total net new core checking accounts to a record 17,000-plus for the first nine months of this year.

As we discussed in previous conference calls, the Durbin Amendment started impacting our service charge income as of July 1. During the third quarter of 2017, our service charge income was $9.7 million, which was a decrease of $2.0 million from this year's second quarter. This was consistent with our estimate given in the July conference call that the Durbin amendment would result in a pre-tax reduction in service charge income of about $1.95 million per quarter.

In the quarter just ended, our cost of interest bearing deposits increased 12 basis points compared to the second quarter of 2017, as we increased rates on competitively bid deposits and rates at certain offices in "spin-up" mode in order to grow deposits to fund growth. Given our expectation for strong growth in non-purchased loans and leases in the fourth quarter, we expect to continue to grow deposits significantly. Based on this, combined with possible further increases in the fed funds target rate, we expect additional increases in our cost of interest bearing deposits. Our goal is to hold the rate of increase in our cost of interest bearing deposits below, and hopefully well below, the rate of increase in our yield on non-purchased loans and leases. As Greg noted, if the Federal Reserve continues the recent pattern of fed funds rate increases, that goal should be achievable, as it has been over the last five quarters.

Now, let me turn the call back to George.

George Gleason:

Our asset quality metrics during the third quarter were excellent. These ratios reflect our longstanding commitment to conservative underwriting standards and excellent asset quality, which has resulted in our having asset quality consistently better than the industry as a whole. Our annualized net charge-off ratios during the quarter just ended were eight basis points for non-purchased loans and leases and nine basis points for total loans and leases. In our 20 years as a public company, our net charge-off ratio has averaged about 34% of the industry's net charge-off ratio, and we have beaten the industry's net charge-off ratio in every year. Our outperformance has been even better recently, as evidenced by the fact that our net charge-off ratio was just 13% of the industry's net charge-off ratio last year and just 12% of the industry's net charge-off ratio for the first six months of this year.

At quarter-end, excluding purchased loans, our nonperforming loans and leases as a percent of total loans and leases were just 11 basis points, our nonperforming assets as a percent of total assets were just 20 basis points, and our loans and leases past due 30 days or more, including past due non-accrual loans and leases, to total loans and leases were a record low 0.12%. This was our seventh consecutive quarter of reporting a record low past due ratio reflecting the outstanding work of our loan and lease teams.

That concludes our prepared remarks. At this time we will entertain questions. Let me ask our operator to once again remind our listeners how to cue in for questions.

Transcript of Q & A

Ken Zerbe – *Morgan Stanley*

I guess first question, now that you've had a few months of Dan Thomas being gone from the bank, can you just talk about what you're seeing from a client perspective, or sponsor perspective, in terms of their demand for growth? Has this changed in any way the longer-term growth outlook of RESG?

George Gleason

Thank you, Ken. I do not believe that Dan's departure, despite his significantly positive contributions to RESG for many years, in any way affects our growth trajectory. Dan was one member of a very effective team that he helped assemble. And that team has tremendous capabilities and we have not seen any loss of business or loss of momentum as a result of that. And that was clearly evident in our closings during the quarter. It's clearly evident in the application volume going forward. For example, I'll give you just an indicative stat. When I looked at the closing forecast for RESG at the beginning of the quarter, we had about $2 billion in loans already approved and in closing for Q4 as of the beginning of the quarter. Now we'll close more loans than that in an average quarter, but that's a very healthy starting point as of the beginning of the quarter. So we've not seen any loss of customers, loss of opportunity or slowdown in our production. The various loan origination teams, Tucker Hughes's team in Dallas, Rich Smith's team in New York, Greg Newman's team in the Southeast, Jason Choulochas's team in Los Angeles, Mason Ross's team in San Francisco, those guys are doing an excellent job and it truly is business as usual in every respect.

Ken Zerbe

Okay, and a question on the unfunded lines, I think it's up $640 million in total, the growth there, a little slower than it has been in some of the more recent quarters. Just so I know, is there any seasonality in that number? Is there any reason to assume that that's an indication of sort of future growth from here? Or is it just a volatile number?

George Gleason

Ken, I don't think there's any seasonality that we have detected in that number in the past. I'm not surprised at that number nor concerned about that number. You know our unfunded balance grew very significantly over the last couple of years as we were doing more, larger loans. It takes longer to fund on a larger loan because it takes longer to build a larger, more complex construction project. The types and nature and the funding schedule on loans that we've originated this year are consistent with those we originated last year and the year before, so we're sort of growing into that bigger project, longer-funding schedule that tended to swell that volume of unfunded balances in prior years. So we had a couple of years where our unfunded balances were growing at 10% or 20% or 30% higher growth rate than our funded balances. We would expect going forward those funded and unfunded balances to grow more in tandem as the unfunded loans that swelled that balance a year and two years ago fund, the newly created unfunded balances will tend to offset those with a more normalized growth rate. So I don't think that has any adverse implications whatsoever for future growth in our funded balances. Does that make sense?

Ken Zerbe

It completely makes sense. And then just one quick final question, just want to make sure you're reaffirming the lower half of $3.1 billion, $4.0 billion loan growth guidance this quarter, and that the 2018, 2019 comments were on that you see growth over the 2017, but that's growth over the lower half, is that all correct?

George Gleason

Well, it's growth over whatever our actual number ends up being. And yes, we have reaffirmed the lower half of that $3.1 billion to $4 billion range for this year for non-purchased loans and leases. And I think, Tim's remarks were we expect growth in 2018 to exceed our 2017 growth, whatever that number ends up being. And we expect growth in 2019 to, in dollar terms, exceed 2018's growth.

Jennifer Demba – *SunTrust Robinson Humphrey, Inc.*

I just wondered if you could give some more color on the expected expense growth in the fourth quarter and first half of next year. You said cyber security, compliance, CRA, things like that. Is there any one thing that is a big percentage of it? Or is it just a lot of little things?

George Gleason

It is a lot of little things. If you look at our FTE headcount at September 30, we had 2,410 and a half FTEs -- we've got to get off this half FTE issue -- 2,410 FTEs compared to 2,315 at the beginning of the year. So we've added, what is that, 95 full-time equivalent employees so far this year. A large number of those have been people added in this very broad-based enterprise risk management, IT/IS, cyber security, loan review, internal audit compliance, BSA/AML. As Greg has articulated and enumerated those things and Tyler, in previous calls and conferences, we're trying to basically build the risk management and operational IT/IS infrastructure for a $40 billion to $50 billion bank. And we're going to be building a lot of that any way to move from a $20 billion to a $30 billion over the next couple of years. And as we built it, we concluded that while it will be costly to do so, that we would be greatly advantaged in our flexibility and ability to grow in the future if we went ahead and built a much broader bases infrastructure. So we are heavily into that, that's been a more involved process than I probably personally envisioned when we started it. And we're adding more people, and we've engaged a number of consulting firms to work on parts of that, including our DFAST build, but also on a number of other parts of that, and we expect to see a significant increase in cost and personnel related to that infrastructure build this quarter, and Q1, that we hopefully will complete that process toward the end of Q2 of next year, and then we'll see elimination of a lot of those consulting fee cost and a significant cessation in the rate of that increase and overhead cost. I'm hopeful that our efficiency ratio over the next 3 quarters we'll be able to maintain it through strong revenue growth at about the same level or near the same level we've been in the last several quarters. And that then once we get that infrastructure build complete mid-year next year, we will see a gradual but steady downtrend in the efficiency ratio for years to come.

Michael Rose – *Raymond James & Associates, Inc.*
I just wanted to follow up again on the expenses, $3 million to $5 million up in the fourth quarter and a little bit more in the first half of next year, how much of that increase do you can kind of consider to be one-time in nature? Because I assume some of it is going to be part of the run rate as we move forward. Can you guys quantify that at all?

George Gleason
Michael, I think it's a pretty much permanent addition to the run rate because other than consulting expenses, which we hope will be a temporary phenomenon, as I said, and begin to abate considerably middle of next year, other than those, the people we are adding permanent additions to staff as this is a permanent infrastructure build. So I think we've got to include that in our run rate going forward.

Michael Rose
All right, that's helpful, and then just to follow-up that, the salaries costs were down pretty markedly quarter-to-quarter, was that the impact of Dan going away? Was that -- can you just give some color on what drove the sequential decline?

George Gleason
Dan's departure did have an impact on certain benefit accruals, and when Dan left, there were recorded costs for options and stock grants that have been granted in previous periods, which because those will not be realized, were reversed and so forth. So there was a couple of million dollars or more of impact

in those numbers because of that. And that is embedded in that guidance we've given for overhead expense in Q4.

Michael Rose

Understood. All right. Just another quick one. The other fee income line item was up about $2.5 million this quarter. Can you guys reconcile that? Was there any one-time gains in that or anything like that?

George Gleason

Not particularly one-time gains, but we've talked for the last 6 quarters or so that with the accelerated repayments in our RESG loan book, particularly that we were trying to protect our return on equity on those loans by including unused commitment fees in certain loans and underwriting fees and asset management fees as well as minimum interest and exit fees when we could. And that increase in that line item, to a large extent, reflects the fact that we are getting more of those asset management fees as those loans originated with those monthly asset management fees began to become a bigger and bigger part of the RESG portfolio, those fees are growing. And the unused commitment fees are even larger and a more significant part of that and as those unused commitment fees are being built into more of the loans that are getting closed and are on RESG's books, that number is getting bigger. So you can definitely see that in that number. And while no one can absolutely predict the future, our expectation would be that line item of fee income will continue to grow as those fees become a more normal part of the business model.

Michael Rose

That's very helpful, and maybe one more quick one. I think you mentioned this quarter's growth, 48% of it was non RESG. I know you guys have continued to build out some business lines, and it seems like you're having some success, obviously some pay downs in RESG impacting that number. But can you kind of talk about the areas outside of RESG, where you're seeing momentum or growth in terms of the average or end of period balances in a lot of those categories?

George Gleason

Yes. Our indirect Marine and RV business was up about $174 million during the quarter. If I'm eyeballing this correctly, $173 million. You've actually got it written down for me, Tim, thank you. $173 million there. We had $113 million, $114 million growth in our Corporate Loans Specialties Group, Leasing was negligible. The largest non-RESG component was Community Banking, which was about $201 million in growth. So it was broad-based, and we're very pleased with the progress that we're making in getting more growth of the quality and pricing that we want from our other lines of business. We expect to continue to emphasize that, and that is the positive momentum we have there was sort of generally alluded to, I think by Tim when he commented about our expectations for stronger growth in dollar terms in 2018 and 2019. We expect those units to contribute more to growth in the future years than they have this year. They've certainly contributed more this year than last year, and we expect that trend to continue, although we do expect RESG will continue to be the dominant growth engine.

Timur Braziler – *Wells Fargo Securities, LLC*
I guess first question, maybe talk about the overall health of the construction industry and more specifically, what paydown and payoff activity looked like this quarter compared to some of the last few quarters we had?

George Gleason
Paydown and payoff activity continued to be extremely robust in the quarter just ended as it was in the second quarter and the first quarter. We're not seeing any change in that velocity of prepayments that's material either way in my view. We're getting a lot of payoffs, and they're coming very quickly. So that continues to be a reality of the market with which we've been dealing for a couple of years now and expect to continue to deal with certainly in 2018 and the fourth quarter of this year. Our view on the construction and development industry at large is that there's been a significant degree of discipline shown by our customers, and the product that we're financing seems to be very much justified by the supply-demand metrics that we're seeing and the supply-demand analyses that we're doing and the supply-demand analyses that our customers are doing on each project. So we continue to be fairly constructive about conservatively underwritten transactions done with a thorough analytical review of the market conditions surrounding those. And because of that, we're finding a lot of opportunities that make sound economic sense to us and that fit the conservative risk profile of our underwriting.

Timur Braziler
Okay, that's helpful, and then maybe one more for Tyler. What's the difference in deposit costs at the spin-up branches versus the legacy branches?

Tyler Vance

It really depends on the market. The current CD specials that we have are anywhere from a 10-month term to a 17-month term. And depending on the market in those 47 offices we have spin-up in, those could be as low as a 1.10% APY or as high as a 1.61% APY, and a lot of the non-spin-up offices, we're still at 50 basis points or 25 basis points on a 1-year CD.

Timur Braziler

Okay. And then how much of the new deposit growth is coming out of the spin-up offices versus the existing ones?

Tyler Vance

I actually don't have that breakdown with me. We tended to outrun recently our need for funding as evidenced by the $771 million of broker deposits we paid down. So we tended to throttle the spin-up markets a little more recently, but I actually don't have an exact breakdown of that for you today.

George Gleason

One of the things I would add, and Tyler, you might want to comment on this, is we don't actually consider our deposit office at One Rockefeller Center as a spin-up office. But we've added deposit gathering staff there over the last 12 months and really focused on high net worth and corporate business customers and various types and have had, Tyler, $1 billion?

Tyler Vance

Yes, sir. $1 billion of growth.

George Gleason

$1 billion of growth in the last year, or really 3 quarters, in that New York office. So that has reduced, to some extent, the need to be more aggressive with putting more offices in spin-up mode in our Community Banking footprint in the other 7 states where we take deposits.

Tyler Vance

Yes. That will be true.

George Gleason

New York's been a big help to us on the deposit side in the last 3 or 4 quarters.

Timur Braziler

Okay. And then, I guess, the comment that you had made about entering new markets through de novo, can you give us some examples of the markets you'd be looking to enter? And does this complement or does this replace some of the existing M&A strategy that's been talked about in the past?

George Gleason

It has nothing to do with the M&A strategy we talked about in the past. We've always said we've got the capacity to grow our company organically, and M&A is icing on the cake. So it really has nothing to do with M&A at all. We have a version of a branch called a *de novo* 2.0 branch that we've yet to open any of. We expect to open *de novo* 2.0 branches in Orlando, Florida, Nashville, Tennessee and Atlanta, the Buckhead area of Atlanta, over the next 6 quarters. Those will be our first *de novo* 2.0 branches that we'll open. These are very different than our traditional branches we've opened in the past. They're very technology driven. They are very sales oriented, sales force-oriented, branches. They'll be larger. They'll be in very highly visible locations, and they will focus longer term on top 100 MSAs in the U.S. that have really strong growth rates and so forth. We would expect these *de novo* 2.0 branches to be much more potent as far as the volume of deposits that they'll handle because they're going to be in very large markets, and we think we've got a tremendous business model for them. So to give you an idea of how we think this will roll out over time, if you look at our longer-term strategic plan and look at our organic growth from where we are today to about almost $50 billion in assets organically, we would anticipate that over that period of time our number of offices would grow from the current 252 offices to somewhere in the 290 office range. And that, that would include *de novo* 2.0 branches and the companion branches that go with them. Typically, the *de novo* 2.0 branches will be in very high demographic areas, but we also have a need to serve the low to moderate, majority minority customer segments in the markets, where we'll be locating the *de novo* 2.0 branches. So we're anticipating one or more companion branches with them, a small number, 1 or 2 in most cases, of companion branches to meet our CRA obligations or otherwise provide a little bit of additional infrastructure. So if you can imagine that we are talking about 1 to 3 offices and a million person or larger MSA, and we expect these branches to be perhaps like our One Rockefeller Center office, $1 billion, hundreds of millions or $1 billion of deposits. So we expect them to be very large. The expectation is that as we grow towards $50 billion in assets organically, just ignoring acquisitions, although we would expect to make acquisitions.

So the expectation, Timur, is that we will add about 60 offices, gross over that period of time. We will close about 20 of our existing offices as those offices become less valuable or unprofitable in the evolving landscape that we see for consumer banking. So we'll be net up about 40 offices, and we'll achieve which is about a 16% increase in office count at the same time that we're achieving about 150% growth in our total assets, or a little less than that, but close to 150%. So you can see as we model that projection out and allocate staff and so forth to that why we are optimistic that we've got the business strategy that will ultimately help us achieve a much lower efficiency ratio.

Will Curtis – *Piper Jaffrey*
Maybe just go back to some comments about the community bank and kind of your positive momentum you're seeing there and expectations. I'm just curious if there are any opportunities to leverage RESG as it relates to the bank and how you're thinking about that relationship between the two going forward?

George Gleason
Actually, I do think that there are opportunities to leverage that. In the past, we've really kept a buffer between RESG and the commercial real estate business of our community bank, and that has kept our community bankers away from serving some opportunities that they would have probably served but really too small of an opportunity to utilize our RESG resources for. So we've had considerable success recently in Florida, getting better integration between community banking and RESG. We're now working on that in the Carolinas. I think you'll see us roll that into other areas. I think that will help us serve more customers, get more deposits, miss less CRE opportunities and provide a more seamless solution in the markets where we have both RESG presence and community banking presence going forward. So that's clearly an area of improvement and capturing opportunities on which we are focused.

Brian Martin – *FIG Partners, LLC*
George, can you just comment a little bit on the, I guess, maybe it's just the uncertainty, but on the purchased loan run-off, it still seems that it is at an elevated level, but I guess should we just assume that from this point that it's going to be a little bit higher than was initially anticipated, or if there was an initially anticipated type of level, but maybe just give a little thought on that?

George Gleason
Brian, I wish I knew the answer to that. We have expected every quarter that rate of purchased loan run-off to subside and slow a bit, and it is not slowed very much. I don't -- honestly, I don't know what to expect on it. It's running off a little faster than we modeled.

Brian Martin

Okay. And then maybe just back to two things, on the expense number, the growth rate, you've talked about your next quarter and then into early '18, when you get to the second half of '18, it sounds as though the expenses will continue to grow just the rate of growth will slow, is that how to think about that? And then maybe as you get into '19, it's more normalized level after this buildup continues you've outlined?

George Gleason

Yes. In the second half of '18 and into '19, we expect the company will continue to grow and grow at a very healthy rate, and that will obviously require increases in overhead expense. But our thinking is that the rate of increase in overhead expense will subside significantly starting really in mid-2018, and that will allow us to begin to notch a fairly steady improving trend in our efficiency ratio from mid-'18 on out.

Brian Martin

Okay. Perfect. And just the last two things from me, maybe just more to Tyler. Tyler, it sounds as though the payoffs in the brokered CDs you have gotten down here in the last couple of quarters, what's really driving the kind of the core organic growth on the deposit side? And then I think you mentioned, I missed your comment on capital, if you could just go back to kind of what your outlook was on capital going forward. That's all I have.

Tyler Vance

On the deposit side, Brian, it's really those two factors. It's still good success in our spin-up campaigns that we're utilizing, but then certainly as George mentioned, the New York office has performed exceptionally well. We did add a team now of 3 individuals in that office that are gathering deposits. So the combined efforts of growth in New York, and then the CD campaign, and then just our normal good, every day organic growth, every office, every day adding customers. The net checking numbers were certainly outstanding. Those combined factors have given us the opportunity to pay down that brokered number, and I'm going to let Tim answer your question on capital.

Tim Hicks

On my prepared remarks on capital, obviously, we'll be going through our first DFAST submission at the end of this year that we'll submit in July of next year. Again, reference the $300 million that we raised in the second quarter, obviously anticipating really strong growth during that 9-quarter DFAST period. And I'll remind you back on our comments from our second quarter, it's really our base case is requiring the capital. So in a more normal economic scenario, that we feel like our business plan is going to be very strong and that capital was needed in our projections. If we decide -- we're constantly monitoring projections -- for this DFAST submission, and certainly for future DFAST submissions, if we decide we need to augment our capital position again, we would expect that to be in subordinated debt. And based on our current thoughts around that, we think sometime by the end of 2018, we'll need to augment our capital position with subordinated debt. The timing and amount of that is still to be determined.

George Gleason

I would add a comment to that, as shareholders, you ought to hope that the amount of that is more than less because more than less means we're expecting more loan growth than less.

Brian Martin

Got it. I appreciate it, and maybe one last thing I forgot. The securities portfolio, you talked about the increase you guys did last quarter and some of the changes you've made. Going forward, and I guess the level that's at, given where rates are in your outlook, do you anticipate kind of keeping that where it's at? Or does that number grow going forward?

George Gleason

That number will probably grow, even though it shrunk in the quarter just ended. Longer-term, that securities portfolio will probably grow, because we have identified that as a tool that we want to use in the effective management of our liquidity position on our balance sheet. So we'll probably be adding more to that, and as long as we're in an environment like we are today, where the uncertainties would dictate one staying shorter we think on the yield curve and taking less interest rate risk, we'll probably load short securities, which will be low yielding to that portfolio. If we get a different environment in the future where we think rates are more likely to go down than up, we would probably reverse our strategy and tend to go more medium or longer term than short term with that portfolio, which would be more profitable for us. But right now, we're more concerned about defensively positioning that portfolio than trying to maximize yield on it.

Matthew Olney – *Stephens Inc.*

I apologize that my phone line dropped for a few minutes. So you may have addressed this, but on the margin looking forward to the fourth quarter, can you give us some direction and some color on the margin? I appreciate the commentary on the margin being somewhat dependent upon the Fed. I'm just trying to understand if the Fed does move in December, would this be impactful enough to move the margin higher in the fourth quarter.

George Gleason

Well, Greg provided you such good commentary on net interest margin in his remarks, I'm not really going to try to add any additional color to that. As I think the most important thing from my perspective as CEO is what Greg said about our core spread, which is where our focus really is. And if the Fed continues to raise interest rates, then we ought to be able to continue to improve that core spread because of the significant percentage of our loans, about 80%, that are variable. If the Fed were to take a break and not raise the Fed fund's target rate for a period of time then that would tend to flatten out or slightly decrease that core spread. I don't know that we can add any color really beyond what Greg already said. So I would encourage a listener to just read Greg's remark again, look at all the different comments he made about that core spread, which really is driven by our yield on non-purchased loans -- and look at what he said about the purchased loan portfolio running off, which it will over time. And look at what he said about the investment securities portfolio. There's not anything else I can add.

Matthew Olney

Okay. And then lastly, given the commentary on the infrastructure build, I'm curious how you're thinking about the long-term goal of achieving the efficiency ratio below 30%. Is that still realistic? And is there a time frame where you can help us out with?

George Gleason

Yes, as I responded to Timur's question, we do think that we can achieve a steadily improving efficiency ratio after we complete this infrastructure build mid-year next year for all the reasons I've already articulated. So we are optimistic that we can ultimately achieve that goal.

Stephen Scouten - *Sandler O'Neill + Partners, L.P.*

So I had a follow-up question here just in regards to the M&A conversations. It sounds like, obviously, those continue to be ongoing, but can you give any further color about maybe the veracity of some of those conversations? And what might be the impediment to an additional deal today? Is it just kind of the spread between where the multiple is today and what sellers are wanting? And is there maybe a threshold of where you'd like to see your valuation to where that math will be more justifiable in your mind?

George Gleason

Well, as we've talked about previously, for many years, our stock traded with an extremely high correlation between our stock price and our tangible book value per share and our stock price to earnings per share. And as we had those short seller issues emerge early last year and as conversation about CRE got accelerated to levels that were really, in many cases, based on really poor information or lack of understanding of our business model, we've had a situation where our stock price multiple has gone from 1 or 2 premiums to peer based on our excellent financial performance and above peer growth rate to a situation where our stock multiple is a couple of 3 multiples or turns below peer. And that clearly as we can all do the math that clearly affects our ability to do M&A transactions in our very disciplined M&A world of seeking to do transactions that are triple accretive. It doesn't knock us out of the game, but it makes the math much less compelling. So I think the only thing I can say really in response to your question is that. And add one comment, is that we continue to be active in considering opportunities, and we think that we will get that multiple back in due time and that will make M&A a more attractive opportunity for us than it is today, not that we would rule it out today. But the math is what the math is.

Stephen Scouten

Yes, I know, that makes sense. And then maybe thinking about growth just for one more second, the growth in the quarter there's obviously a pretty decent gap between end of period non-purchased and average non-purchased, was there anything unusual in terms of the timing of loan closings in the quarter that is leading to that spread there? Or can you give any color about maybe the timing of loan closures and how that might impact fourth quarter numbers on an average basis?

George Gleason

In the second quarter, we closed roughly 5/8 of our loans in the last month of Q2, and we were slightly more skewed that way. It was almost 80-something percent of our loans closed in September of Q3. So we've had a long history. And even if you go back to Q1, March was our most heavy quarter of loan growth. So we've had a long history of closing a large percentage, and often a majority or a very high majority, super majority, of our loans in the last month of the quarter. I'm encouraged from the funding forecast that we have for Q4 that we might get fortunate enough, I hope, we've got to get them closed, but we've got a lot of closings scheduled earlier this quarter than we did at this point last quarter. So we're very hopeful that we'll get away from that situation where the vast majority of our loans closed late in the quarter. It is a phenomenon, it's been a long-term phenomenon, we commented on it intermittently on calls for several years that we just seem to have a lot of loans get closed in closing weeks or week of the quarter.

Stephen Scouten

Okay, that's great, and then one last one for me. I think, for me, one of the exciting things that I've heard you, George, talk about lately is the potential for growth you could have from trying to leverage your influence, maybe your relationship with your RESG clients into their other lines of businesses. Any progress on that front or anything you can speak to on what you -- how long it might take to achieve and what you think that could look like for the company longer term?

George Gleason

I think there is considerable opportunity there. And that's not been a preeminent focus the last couple of months because we've been just focused on making sure that we have a totally effective transition of leadership and handle our customers in the manner they've been accustomed being handled while delivering our customers the level of expertise and execution that they've been accustomed to. But we have started in a couple of customer meetings, I've had started having discussions about other business opportunities that are non-real estate related. A lot of our RESG customers have multiple other verticals in which they do business. And I do believe over time, we will harvest significant additional business opportunities from that effort.

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

Just a couple of last questions. One is on the margin and looking more on the asset side, can you quantify how much of the June hike impacted the 21 bps increase in non-purchased loans versus the better pricing that you've been talking about that you've been getting on recent productions? Just trying to think about how we can think about that going into the fourth quarter where we won't get the benefit of a full quarter of a recent rate hike.

George Gleason

I would -- we can't specifically quantify, but I would tell you it was a very important factor. I mean, obviously, 80% of our loans are variable rate. And most of those were not at a floor. So I don't know what the exact number was, but say it was 70% of our loans repriced a quarter as a result of that. You can do the math. And if it was 60%, you can do the math. A big part of the increase was a result of the Fed funds increase. The other element was better pricing, as you alluded to. So as we're looking at Q4, we -- again if the Fed seems on go in December that will be helpful because we would get a partial month of that. Of course, most of our loans are tied to LIBOR, and most of them are tied to 30-day LIBOR. So that would begin to price in to a lesser extent over the 30-day period before an actual increase in the Fed fund's target rate. So we would get some benefit from a December increase. Obviously, it wouldn't be as a big a benefit as it was this quarter, where we got the full impact for the whole quarter of the June increase.

Catherine Mealor

Got it. So maybe fair to say, or is it a fair assumption that the core spread, while it still remains positive, could narrow a little bit next quarter? And then in quarters where we see a full impact of a rate hike, that's when it kind of widens to this 9 bps range that we saw this past quarter?

George Gleason

I think that's a very accurate prognostication.

Catherine Mealor

Okay. And then one last kind of big picture regulatory question, if we do see the $10 billion threshold move higher, would that change your outlook on the amount of expenses that you're spending on your enterprise risk management build out?

George Gleason

No. Because I think we're committed to do that regardless of what happens with the $10 billion threshold. I think the more interesting thing to us is the $50 billion threshold at this point as we think forward. We built the infrastructure and designed it and fleshing all that out now and building all the teams. I don't see us going back at this point.

Blair Brantley – *Brean Capital, LLC*

I have one question on RESG. Has there been any change in kind of the pull-through rate from what you guys have been seeing?

George Gleason

Blair, not that I'm aware of. I've actually not looked at that data, but I don't think there has been. We have not moved our credit strike zone at all, we're not 1 micron more conservative or more -- 1 micron more aggressive than we were 3 months ago or 6 months ago or 9 months ago, so our credit parameters haven't changed, our volume of deals coming in, I’ve not discerned any noticeable change in that, but I'm not really looked at the data.

George Gleason

All right. Thank you, guys for joining our call today. I apologize for the telephone problems, I'm not sure where there were, we appreciate you joining the call. We look forward to talking with you again in about 90 days. Have a great day.