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UBS Hosted Fireside Chat on Mortgage Finance and Investment Banking

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CORPORATE PARTICIPANTS

Matt Scurlock - *Chief Financial Officer*

Tim Storms – *Chief Risk Officer*

Dan Hoverman– *Head of Investment Banking*

Madison Simm– *President Mortgage Finance*

Speaker: Good afternoon, everyone.

Speaker: Thank you everyone for joining us today. I am here to introduce our host, UBS. Brock Vandervliet is going to be hosting this fireside chat. Hope to have a great conversation here, and I'm going to give the panelists an opportunity to introduce themselves. Thank you.

Matt Scurlock: Good afternoon. Matt Scurlock, Chief Financial Officer.

Dan Hoverman: Hey. Dan Hoverman. I'm the Head of the Investment Banking.

Madison Simm: Madison Simm, Head of Mortgage Finance.

Tim Storms: Hi, I'm Tim Storms. I'm the Chief Risk Officer.

Brock Vandervliet: Excellent. Very lengthy introductions.

Speaker: Better get right to it.

Brock Vandervliet: Yes, we're getting right to it. Well, yes, Brock Vandervliet for those of you who I haven't met yet. Mid-Cap Bank Analyst here at UBS. And this is – it's great to be with you all today. It's funny. I was checking back just this morning, but 19 years ago, Lehman Brothers, I believe, led the IPO of Texas Capital, and I was involved in that at that time. And it's great to be deeply involved in this name again only 19 years later. So it's great to get this opportunity with all of you.

And so why don't we – why don't we get right after it? I think this event is distinct in many ways. Not the least of which is not a CFO dog and pony. The CFO is in attendance and can chaperone, but it's really about the different lines of business that make the – make it go. And we're going to kind of get right into it and lead off with that today. So Dan, why don't you – why don't you just lead off with – I think of all the questions I get on Texas Capital, the most prevalent and obvious is why build an investment bank. Why not buy or why even bother? What are the synergies? What makes this a natural for Texas Capital?

Dan Hoverman: Yes. So happy to answer that. I've got that question a couple of times as well. The – if you take the step back and look at our strategy that we announced on 1st September, as we looked at the strategic landscape, we saw two things. We saw an opportunity to be the only full-service financial services firm in Texas, which sounds like an obvious strategy, but the reality is no one's done it and that competitor doesn't exist. And we think the Texas market is broad enough, deep enough, diverse enough, and receptive to the idea that a local full-service firm can partner with them, be attentive to their needs, be present in their market, to reinvest in their communities, and that that would have real resonance.

When we looked at our client base, we saw a unique set of businesses and clients that actually enabled us to deliver against that strategy. So when you think about the corporate world specifically, building an investment bank against only corporate lending financial services firm is hard because the corporate businesses and the corporate clients that you have transact infrequently. You need a large number of clients. Average company is going to maybe refinance their balance sheet once every three years. If they're private equity-owned, they will probably sell once every six years. If they're family-owned, they might never transact.

When we looked at our client base, we have a mortgage finance business that is market-leading, and it's a unique business in the sense that the mortgage finance originators that are Madison's clients are manufacturers of financial products. So that means that they make something every day that needs to be traded, sold, or securitized. They do so frequently at high volume and predictably. So we can now take a step back and say, all right, well, what do we need in order to deliver against this investment banking strategy?

We've answered the first part, which is we've been able to deliver clients because thanks to the sales and trading effort that we launched on Thursday, we now have trading capabilities to assist mortgage finance clients with gestation finance, TVA trading, pool trading, and other sales and trading transactions. The credibility that that gives us in terms of investing in talent and the people that we're able to attract then allows us to overinvest in sales and trading, bridging from mortgage finance into corporate. It gives us relevance to the buy-side so that when we go knock on the door at bulge bracket dealers, we go knock on the door at PIMCO, they'll actually answer a phone call because we've got billions of dollars of transaction flow that is coming through mortgage finance. And now we're able to go to those middle market clients in Texas with a real commitment to the strategy and real capabilities to be able to advise, underwrite, and distribute. And so it's the unique combination of bridging from a robust mortgage finance business into what we think of as a significantly underserved market for local advice, talent, and capabilities, and then being able to deliver against that.

Brock Vandervliet: Got it. Great. Anything – any other comments from [inaudible]? No. Okay. Where would you say you are at this point in terms of the build-out on the human capital side?

Dan Hoverman: We – across the bank, we continue to invest. So the build-out in human capital talent isn't only in the broker-dealer or investment banking generally. We have had great success frankly, attack – attracting a number of people from this great city to come and really have ownership of building out a platform and building something that is starting to get some momentum and that people perceive as being special on the market. That means that we're investing talent, not just behind sales and trading, where we've largely built out our mortgage sales and trading team. And we're continuing to build out our corporate sales and trading team. We've got – had to pose for a second.

We just wanted to have a proper welcome to New York City. That's good. Our time may be limited. So I'm going to talk quickly.

Dan Hoverman: No, no, no, I got you. I got you. So, in addition to the sales and trading side, we have hired into our mergers and acquisitions advisory where we're having some significant initial success. Again, behind that idea of local presence, local advice, local decision-makers we've invested significantly in syndicated and leveraged finance, and we'll continue to build out our origination capital markets activity.

We've also, under Rob's leadership and some of the other folks and our CNI and middle-market verticals, we've invested even more significantly into building out frontline facing coverage and then taking our investment banking efforts and partnering with our relationship managers that are either industry-focused in fields that you would expect; healthcare, financial institutions, restaurant, retail, others, or are geographically aligned against our middle market coverage in the state of Texas, and then partnering with those folks and delivering client solutions, whether that happens to be within treasury or the investment bank. So I think we will continue until we run out of talent. That is no longer additive to the platform, but I'm not sure the end is in sight there on any respect.

Matt Scurlock: Yes, I would just follow and add to Dan's comments and say it's front, middle, and back-office concurrently. So we're trying to build businesses that can scale over time. And that doesn't mean simply adding frontline talent on subscale platforms. That means building an infrastructure consistent with a much larger operation than what we currently have today. And to Dan's point, we don't view our opportunity set as one that drives 3% expense growth and 5% revenue growth and perpetuity. The market opportunity for us to deliver against is quite significant. And as an investor, you want us to invest against that.

Brock Vandervliet: And how do you, as you – especially as you hire in different verticals, do the heads of those verticals present business plans to you in terms – so you have a site line on the expense and revenue profile and expectations upfront so they're – I would think investors would have a concern of just the expense build is going to be obvious, and how do you – how do you benchmark as you build?

Dan Hoverman: So every product and service that we have launched and will continue to launch goes through a highly rigorous review that includes every front office, middle office, back office component from sales strategy to internal audit, which is the entire life cycle of everything and comes with a granular amount of financial discipline, both in terms of product acceptance, as well as cost to deliver. To your earlier point on buy versus build, with the level of talent that we've been able to attract, I can't imagine that we would be able to acquire another firm, deal with the difficulty and risk of integration as opposed to coming at it, building the systems that we want, building the processes that are more efficient, and delivering against a client need. And so, as we think about it, the broader strategy I think is defined by the market and defined by what our clients have already asked for, and to a large degree is a last-mile solution –

So it's important to think of our strategy as really being a last-mile solution that we're taking products and services that our clients are already using. And we're – we are aligning our efforts in order to deliver products that in some instances we have been referring to other broker-dealers or to other banks that are other counterparties. And so when we think about the business plan and how we deliver against it, we're not creating a product and hoping that there's client use, we're creating a product and we know that there is client use and we make what we think are conservative estimates as to client adoption. We understand how to deliver those products in a timely and cost-effective way and we're delivering against that.

Brock Vandervliet: Can you give a sense, you know, an average client, if there is such thing in mortgage warehouse, for example, where there are adjacencies, and maybe you can speak to this, Madison. With the investment banking function, if that revenue is X, what does it look like when these synergies are built out X plus what...

Madison Simm: Yes. So from a mortgage finance client perspective, obviously, from a legacy lens, warehouse was the primary product. And recently we've been cross-selling with other products and services, not yet in the investment banker dealer, which include MSR leverage. Prudently, it would include participating in the reverse mortgage space or participating in specific HUD programs. But those same clients have a dominant need for interest rate lock protection, or for those that are participating in HUD products gestation preceding the bond delivery in the market. And those clients have sought guidance from Texas Capital Bank historically, and we've referred that business away.

And if you think in terms of the notional that's financed by Texas Capital Bank from a warehouse lending perspective, they have nearly that same level of interest rate coverage as well as a need to deliver into the market. So arguably homogenous with the overall market size of Ginnie products or reverse products, and so extrapolating that to kind of a revenue accretion. We think that there could be comparably 50% to 70% [notional] opportunity above and beyond whatever mortgage finance is participating in today as we cross-sell into these other products and services that the broker-dealer is going to offer to us.

And from an efficiency perspective, to Dan's point, our clients have historically been asking for these services or asked for guidance, what vendors or other dealers could they steer their production to in these areas. And they're encouraged by our commitment to the space and the breadth of the program that the dealer provides to us. So there – to Dan's point from a forecasting or projection perspective, I think we're confident in our ability to attract that business.

Brock Vandervliet: 50 to 75, that's quite a step up. As you – as we all think back, the world has changed so dramatically since you first laid out this restructuring early September last year, what – fortunately, you didn't give near term guidance, but as you think of even the intermediate in the long term, what's changed and certainly a few things have, and how has it affected your business and how you look at the build-out.

Dan Hoverman: I maybe start that, and then you guys can fill in the gaps. Brock, I think when we laid out the strategy, we were agnostic to raider market cycle. So we're trying to build a business that can deliver top-tier returns irrespective of what's happening around us. You heard us say on the last earnings call that the market particularly interest rates has changed pretty significantly. Since we put out the strategy on 1st September.

To give you a sense for how significant it is, we had three rate hikes forecast over the duration of the strategic planning horizon, so through 2025 when we rolled out the strategy. So we now have three in our rearview mirror. So we said on the earnings call that we want to be very deliberate in trying to position the balance sheet in a way that insulates the strategy from changes in the macro. So six months into this thing, nine months into this thing, our conviction has only increased in our ability to execute. Part of that is driven by client's receptivity to the offering, and part of that candidly is driven by our ability to hit internal milestones. So we want to ensure that we can continue to invest appropriately to help these guys build the businesses. They're going to let them be extremely resonant to their clients.

The other things that have changed is the very tactically balance sheet size is smaller. Given the contraction of mortgage warehouse, the outlook for short-term earnings has increased given our inherent asset sensitivity. That's what precipitated us announcing the buyback, but in terms of the strategy where it was convicted as we ever have been, and we'll continue to invest aggressively against it. I don't know if you guys want to talk about things specific to your market?

Tim Storms: Yes. I'd actually like to add to that one, Brock, because it was purposeful that we didn't give short-term guidance because we are – we have a long-term plan and we have our next board to build us out and do it right to create value over the long term. Do we know the rates we're going to shoot through the roof like this? Obviously not. In our most recent earnings announcement we basically started with, when we think about the disproportionate reliance historically on the mortgage finance business, we said, this is why we've adopted this strategy. This is why we're doing the things we're doing to build this out the right way.

It's really hard work to build relationships and not just buy loans, if I can put it that way, to differentiate ourselves from the past. But this environment doesn't change a thing as it relates to building relationships. In fact, if anything, if we're about to navigate through tough times, it's an even better time to go to your clients and say, "Hey," or prospects and say, "How are you doing? How can we help you? What's going on?" And that's really – to me, I know this is corny, but it's a fundamental role of a bank and it's an optimal time to do that.

Brock Vandervliet: Madison, maybe you could chip in. I would think no other business has been impacted as much by rates as yours have – has.

Madison Simm: Yes, to Tim's point, obviously, nobody from a projection perspective anticipated quite the severity and speed with which mortgage rates backed up. And it's had a certain toll on the overall market size. That said, I'd probably zoom out a little bit and kind of rebalance what people's perceptions are coming off of two record volume years, 2020 and 2021 of – north of 4 trillion in US residential financing down to arguably a market that's 2.3 to 2.6 trillion, depending on which economist you're listening to. That's still north of the ten-year average, and certainly north of the preceding years, '17 through '19. So it's still a very healthy US residential market. And we have a generous share of that and clients that enjoy doing business with us not just in the warehouse, but the breadth of products that we have.

At the same time, we are being more of an advisory to our clients more so now than we were pre the pandemic in that they welcome us to interact with them on business strategy lens into how they're making the turn to this new water level, etcetera. And I think that the investment banking team will only augment that relationship with our clients as we bring more products and services and advisory capabilities to those clients, and they would view us as strategic partners which would earn us the right to sit down with them and win – and earn their business in the future.

And then thinking forward into the markets, again, depending on which economist you are following, I think that the next couple of years, even with moderate headwinds, it's still going to be a pretty healthy market. You have a constrained buyer because of inventory. You've got a need for folks that are moving out of rental property and into a purchase transaction, and that's going to continue for the next couple of years based on, again, the economists. So we're feeling pretty confident that we'll be able to succeed in that market space.

Brock Vandervliet: How many of your competitors and warehouse have approached it similarly in terms of let's build out these adjacencies? Or does it remain more of a single product?

Madison Simm: So I think, we Texas Capital Bank compete on a couple of fronts. We made an intentional strategy to move to the top quartile so that we had the best clients in the market. And that's proven to be successful even with the recent downturn in US housing size. That's not to say that we don't focus attention, products, and services to the middle market. So because we have really client segmentation and market segmentation, we earn business competing with the largest money center banks and street firms. And they have a full complement of services, not dissimilar from what Texas Capital Bank is launching with the investment bank. But the approach is different than ours. I think we differentiate ourselves in that trusted relationship and advisory and we can bring those services down into the market.

As you move to the second quartile and below as far as client segmentation, we're competing with other regional banks that offer a singular product, the warehouse lending capability, where I think we differentiate ourselves in that trusted relationship and advisory and we can bring those services down into the market. As you move, you know, to the second quartile and below as far as client segmentation, we're competing with other regional banks that offer a singular product – the warehouse lending capability – where I think we differentiate ourselves because we already have breadth of product, relationship, treasury services, customized lock-box solutions, and then now adding to that the investment banking products. I think we're a very strong value proposition in that space.

Brock Vandervliet: And how should investors think about growth in the warehouse vertical? Is it about taking share, is it really about building out the adjacent revenue streams, or both?

Speaker: I would say it's – our strategy is really around picking the best clients and then finding the right scale of products and services that match their need. And so we have, you know, some clients that we're well positioned to earn additional wallet-share of their business. Some of that is off of our operational capability or the success that we're having in the treasury products. Some of is certainly built off of the opportunities that the investment bank brings to bear with our clients, where they have needs today. And I would also say that the ability for us to differentiate ourselves – I used to be Texas Capital Bank's largest client before I joined, so I've been on the other side of the table, and having that advisory council role in interacting with these clients as they're making those decisions really earns us the business. We're not competing on price, we're not competing on necessarily scale, we're competing on the relationship and the products and services breadth. And we're here at the Mortgage Bankers Association, Capital Markets and Secondary Conference, as a sponsor. I've been in probably 40 meetings with clients and there's a repeated pattern of feedback that we get from our clients, which is they're impressed with the breadth of products that we deliver into our clients today, they're amazed by what we're bringing to the table with the launch of the investment bank, and I think that's where we are going to win in all client segments.

Brock Vandervliet: Okay. Great. Why don't we take a moment and see if there are any questions from our audience among the sharp-pencil types we have here? Any online viewers? Okay, sure.

Speaker: I just want an outline of deposits. If you can talk about deposit vertical play, how we [inaudible] beginning of the tightening cycle, and appears to me that there has been a surge of deposits around the [inaudible] balance sheet and QT eventually will also [inaudible]. Are you giving price to [inaudible]?

Madison Simm: Yeah, it's a great question. So I'm not sure of another bank our size that has more focus on growing operating deposits. It's core to the strategy. A large portion of our tech and investment spend matches up against that. We give some additional detail in our recent earning releases on what that looks like. Our deposit base going into this tightening cycle is certainly better than it was going into the last tightening cycle, so about 53% of the current mix are non-interest bearing versus about 48% last time. Last time, we had about 33% in institutional index, so 33% of your entire mix we price with 100% beta. Today we're at about 24%. Through-cycle beta last time was high 50s. I'm hopeful – I won't say optimistic, I won't say pessimistic – that we'll perform well relative to that. The base is better but it's not perfect. So you're going to see us continue to invest aggressively in building out that operating deposit base and one thing many in the room have heard us talk about before is that while we're certainly interested in providing credit to commercial and mortgage finance, really the clients are the core service that the bank provides, we're most interested in being their bank. And how we measure relevance is in large part based on our ability to be their operating bank. So you'll continue to see us invest aggressively on products and services that make us relevant to help us earn those operating accounts and you'll see that, in my view, grow throughout the tightening cycle.

And the last point I'll make on that is we're not – everyone in this room and on the call knows, we're not laser focused on maximizing EPS in 2022 or 2023; we're really focused on building a long-term valuable franchise. So if that means that in the interim we're going to sacrifice a few basis points here and there on deposit costs to support the type of relationships that we want to grow over time, we will. And that's part of what I mean when I'm describing that we're going to transition the balance sheet or use the balance sheet rather to sort of insulate the strategy from changes in the macro. So that's another thing that could be a bit different from other mid-size banks that you talk to.

I'm not sure if I'm able to point to you or not.

Speaker: You mentioned that 50-70% revenue opportunity, it's really an impressive number to throw out. How long do you think it takes to realize? I mean, to take that business away from the banks that you've basically ceded it to already?

Madison Simm: So with regard to the 50-75%, what I should've been describing is notional as opposed to revenue. But as far as the timeline in which we can get there, we've laid out a strategic plan on September, where these numbers are included in those directional guidance that Matt described. And you know, we're comfortable that we're going to achieve that mission by 2025. How we earn that business back is, you know, the relationships that we have with our clients today, where we've advocated for them outsourcing that activity to various strategic partners that Texas Capital Bank has, and earning that business back from a wallet-share perspective, you know, should match what we've provided as far as guidance between 2022 and 2025. So I don't think that the timeline that we're describing here is different than the previous guidance that we've shared.

And in level of effort that it takes, you know with the launch of the investment bank and the team that Dan Hoverman and Rob Holmes and others have assembled are really first class. And it starts literally right here in New York City this week with the launch of the investment bank and in-person meetings with our clients, where we're having really good traction in alerting them to these products and services and demonstrating what the value proposition is. So I'm increasingly confident that we're going to perform well against that outcome and the guidance that we've provided.

Tim Storms: When you think about it, there's a couple of different areas that are driving that growth. One is the folks that are coming on board are market-leading professionals known for their particular product. So our TVA gestation team is on board. Their universe of close contacts includes some of the folks that are currently mortgage finance clients, includes a large number of originators that are not currently mortgage finance clients, includes other folks within the ecosystem that are influential decision makers, like hedge advisory firms and others. So there's an additive element to it, that you're creating better and higher quality touchpoints when you think about being the go-to firm. We want to earn the right to be the first call.

You add on to that the mere presence of some of our products creates a more relevant use of our balance sheet. So there are certain products that are enabled because of the broker-dealer, gestation finance being one of them, where the principle area that – the principle benefit that we recognize from the gestation finance product is extending the dwell time on a line. So you could, whereas previously a mortgage loan might have sat on our line for 16 days and we would lose the loan to a financing provider that would provide a better advance rate or lower rate on certification by one of the GSEs, with a gestation finance product we can now extend dwell time by 5 to 7 days and suddenly you have mortgage balances that are equally as profitable as we've delivered historically, perhaps more so, and is extending duration by 25-30%.

Again, it's clearly not the entire portfolio, it'd be a subset, but being able to deliver that product, having it be operationally easy because we already have the loan in our system, we already have the tape, the client now doesn't need to worry about this interim financing step, just creates a better dialog. And that particular situation, the broker-dealer won't realize material revenue simply from receiving, you know, Gen-E[?] securities at the end of the process. But kind of to the last-mile idea, we were only taking the client through 16 days of a 21-day life cycle. Now we have a full solution, one stop and we can deliver all the way through the full 21 days. You would primarily see that on the mortgage finance balances and you know, improved – it'll look like improved loan growth when in reality it's just adding another product.

Matt Scurlock: A couple of quick things to add on to that. That's just such a prime example of what we mean when we talk about driving scale. So core to the strategy, very defined target market, you go capture the client once, deliver a ton of value through more products and services to that client, that's the foundation for ultimately driving long-term scale and value. That's just a great example, wanted to highlight that. It's also the foundation for attracting best-in-class talent. So the talent we're putting on the platform doesn't show up to engage with their clients using a single product, most often a loan product, they want the full suite and they want capable partners to help them deliver.

And then to the revenue comment, we laid out in September 1st was that we think the investment bank could be 10% of total revenue. And that's agnostic to where we are in a rate environment. So that doesn't mean we have to be in zero rate environment for that to be 10% of total revenue, it's a business that's going to generate 10% of total revenue through cycle. And our conviction in that again is not changed. If anything, it's sort of ratcheted up based on our early experience both in the sales and trading side as well as with our primarily middle-market and corporate bankers interacting with clients from an advisory perspective, which maybe is something that you want to talk a bit about, Dan?

Dan Hoverman: Yeah. I mean just anecdotally, one of the most pleasant surprises that I've had since joining – so I only joined in August. Our broker-dealer application was still in process. We didn't receive it till December. So the first couple meetings that we had, couldn't send out an engagement letter, couldn't solicit and the response that we got from Texas-based middle-market companies, family-owned businesses that wanted an advisor that was in their market, has been almost overwhelming, to the extent that it's humbling when you walk in and say, look, I can't really start working for you till January. We could start doing due diligence and learning about your company. And instead of saying, oh well, I'd like to go and talk to a whole bunch of other folks that happen to be located elsewhere, you get a real personal commitment to entrust your team, the Texas Capital Securities team, with something as important as selling your business. Right? It's a decision – for a family-owned business, it's a decision that's made at a minimum once in a lifetime and sometimes at a minimum once in generations. And so the early receptivity that we've had has been really humbling.

That level of connectivity and relevance has also given us a different level of engagement when we walk into some of our Texas-based businesses and clients and talk to them about the competitive landscape. All we really have to do is sit down with the business owner or CEO and ask them what their strategy is and what they want to achieve in the future, because nobody wants status quo. People want to grow, they want to build, they want to create. And with that dialog, we can almost point to the month and the day that they'll outgrow their current relationship. With Texas Capital Bank and what we've built, you won't ever outgrow our relationship. At some point we might need to bring in capital partners, there might be others that are relevant to delivering that strategy, but it's powerful to walk in and say the last time you'll ever have to move your operating accounts is when you move to us.

Brock Vandervliet: Michael, just to follow up on a question that Michael actually posed in terms of the deposits and the deposit beta, talk about – maybe Madison, you can lead with this – how critical are deposits to the mortgage warehouse business of total deposits at Texas Capital roughly? What's tied to your business? Go from there?

Madison Simm: Yes, so mortgage finance has had a long track record with our clients. We probably have the longest relationships with a number of clients in the space. And it's a full-service relationship. So it comes with warehouse, treasury services, deposit relationship, etc., they're tethered together, to Matt's point previously. And so we have a material kind of self-funding strategy within mortgage finance because of that relationship and the tether between the mortgage product, the related deposits, the operating accounts, the warehouse lending and the other ancillary products. So it is important to our business but it's part of the overall strategy and our relationship with clients. And to that point, I think historically if you look back to how our deposits behaved in the, call it 2016 through 2019 corridor of time, I would say it suggests that our deposit betas were low, lower than other sources of funding in the market, because of that relationship-based deposit and treasury services approach.

Brock Vandervliet: Okay. More questions from the room? Yeah.

Speaker: I was just going to ask about interest rate sensitivity, how you're thinking of managing the balance sheet in light of sensitivity, whether it's liquidity or hedging or other ways?

Matt Scurlock: Yeah, great question. So we were really deliberate starting third quarter of last year in preparing for rising rates. So you've seen our asset sensitivity increase the last few quarters and then we've concurrently been really clear that we don't want an asymmetric exposure to anything, let alone interest rates, and want to use this opportunity to begin to dampen that exposure, basically via two avenues. One is building businesses that are less rate-sensitive. So having the ability to serve our clients through something other than a loan, mainly through Dan's business as well as build-out of treasury solutions and private wealth, helps the business model itself be more resilient to changes in rates. And then we will start to take action on the balance sheet to lessen sensitivity. So we're fortunate enough to have capacity for fixed-rate loans where that makes sense. A lot of the value-add opportunities to extend in the securities portfolio and then we'll certainly contemplate a more active hedging program. But we do not enjoy being at the top of the list in terms of asset sensitivity. I personally don't enjoy that. We very much want to try to position that balance sheet in a manner that we can drive earnings through cycle and will use this opportunity to do so.

Brock Vandervliet: Vilas?

Vilas Abraham: Yeah, a couple of virtual questions here from the crowd in their offices or at home. So the first one, deposit-related again, so what does non-interest bearing mean exactly? Is that interest-bearing deposit yielding zero or is it really an operating deposit? And one more deposit-related, why are you offering Bask Bank at one and a quarter if the core deposit base has made progress?

Matt Scurlock: Yeah, both good questions. I'll maybe start with the second first. So we built a tech platform necessary to go drive deposits via digital channel a couple of years ago. So tech, ops, marketing expense, necessary to go source those funds, is all in the rear view mirror. Had on our roadmap the ability to offer a rate-only product against that fixed cost base, which gives us a source of contingent funding. We think through a cycle the betas on that may very well be lower than institutional index. We've given guidance that by 2025 we want that sliver of funding to be less than 15% of our overall deposit funding. So I would contemplate Bask is an additional piece of that 15% that you'll use similar to how you would use institutional index.

The move into the non-interest bearing. Again, I don't know anyone who's investing more in growing operating deposits, nor do I know anyone that's actually growing them faster than us. Said on the last call that gross P times V has grown over 20% in the last 12 months. So there is a portion of what's classified as non-interest bearing that isn't tethered to analysis, just like it would be for every other institution. The area we're focusing on growing is that which tethered to analysis or the true operating deposits.

Brock Vandervliet: Okay. And another one. On the investment bank, which product in the investment bank will show revenue sooner? And does the current environment get in the way of us seeing the revenue show up?

Dan Hoverman: So we have some revenue coming through from existing businesses and so syndicated finance and our rates business in particular as well as fees that we historically had collected through a relationship with a third-party broker-dealer to whom we had referred business, obviously last year not this year. This year, the mix has shifted within that existing business profile and so the rates business has been significantly more robust, as you would expect, as we're moving out of an environment where people might consider a cap and moving into an environment where more sophisticated and ultimately more profitable hedging strategies are of interest. The capital markets business has obviously been slow for us and for everyone.

Going forward, if you look at the new products that we have launched, the sales and trading business has printed revenue already and we would look for that to continue contributing in larger amounts through the end of the quarter, as we add more talent and more products that are part of the sales and trading suite. Moving from mortgage securities into loans and then corporate securities and loans, that will hopefully just continue increasing in terms of revenue contribution proportionately.

For M&A, there's new accounting guidance that suggests that you should defer a retainer payment even if it's non-refundable towards the conclusion of the assignment. So thanks to the accounting rules. Even though we're receiving retainer payments on M&A, you won't actually see that revenue show up until we close a first transaction. M&A is obviously long lead time, using a six-to-nine-month process and heavy involvement from a personnel perspective. But we do have multiple transactions that are either in market or about to be in market, and so we look to get some of those closed Q3 or Q4 of this year.

Brock Vandervliet: Anything else?

Vilas Abraham: Do upper-quartile clients look much different than middle-market clients?

Madison Simms: That's probably in relation to mortgage finance from a quartile. Do they look different? Yes, they do. So the top-quartile independent mortgage bankers are obviously from a scale perspective in a slightly different zip code than the next quartile down. Whether you take a look at some of the HUD Reports or *Inside Mortgage Finance,* they're a fairly distinct group of people and they're highly concentrated as far as their market size and participation. And they are more sophisticated in their needs as far as some of the investment banking products, they offer more sophisticated mortgage products across a number of channels and they are all typically retaining mortgage servicing. As you move down in the quartiles, you start to get into single or dual-channel origination capabilities and they're typically leveraging a sub-servicer, if they retain servicing, and as you continue to move further into the depth of the market, you're typically a single channel and they're selling whole loans. So the needs of each of those clients are custom to that particular segment and where we deliver products and services are certainly custom to their needs and scale.

Vilas Abraham: Yeah, that was a mortgage question, so that was the right answer.

Brock Vandervliet: Yeah, maybe related to this as well. Why does the TCBI mortgage finance customer desire to take their investment banking or sales and trading business to you versus a regional or money center? You know, does the loan as an attachment point mean something? You've touched on this already but if you could dive into that a little bit.

Madison Simms: Well, I'll start and I think Dan can jump in. The clients that are in that top quartile and looking for diversification and looking for an opportunity to do business with Texas Capital, because we've already demonstrated an expertise in mortgage warehouse operations or some of our other ancillary products and services. And so they're encouraged to experience similar top tier commitment and support from the investment bank. So from that perspective it's really a diversification of their wallet-share across the number of dealers.

As we move further into our client line-up or even in the prospects, I think that we drive a value into the market that may not be provided by the money center banks or the primary dealers, where we can truly be differentiated. I don't know, Dan, if you wanted to add to that?

Dan Hoverman: Yeah, I think at the end of the day, our strategy is really simple. It's delivering products and services that are relevant to our clients, doing it as well as we can if not perfectly, delivering it at scale and a timely way that is consistent and repeatable. That may or may not be a competitive differentiation because it seems obvious but in reality, having that common touch point, having a relationship of trust, knowing who is on the other side of the line, and knowing that they have your interests across the bank, not for a single product or a single transaction, we think is differentiating. The way that we've gone about building the business but also building the personnel that are on our platform are additive to that. You know, back to the buy versus build, you don't know what people you're actually going to get when you acquire a company. When you go out and do it brick by brick, and you know that when we go, talk to the gentleman running our mortgage securities business, Jerry Levy, who has got a great reputation on the street, who represented small and mid-cap broker-dealers for Sigma for 4210 purposes, who can sit down at a table with Madison and even though his knowledge is on the securities side, match Madison in terms of product depth, market understanding and ability to provide advice in the old-fashioned way, that has real resonance.

And so, at the end of the day, we don't want to play a game where we're winning because of basis points. At the end of the day, we want to win it – we want to play a game where we're winning because of the relationship that we have with our client and our desire to make them successful. Because if we make our client successful, then we'll end up delivering success for our shareholders.

Brock Vandervliet: Dan, just a follow up to that, maybe for Mad as well. As you focus on building out the business, what are metrics that you're looking at? And maybe talk about what metrics you eventually think you can share with investors in terms of benchmarking and how you define success?

Dan Hoverman: Yeah, so a couple of months ago, Rob and I were actually sitting down and when you launch the strategy and it's a whiteboard, you first have strategic risk. Where you think, hey, is there real market receptivity when we go out to clients? We had done some, you know, proof of concept testing, where we got on the phone, we understood that there would be good receptivity in mortgage finance, it made sense to underwrite the strategy and to come up with the numbers to know that it would make economic sense. Then you have to go out and deliver it and the next stage of that is the talent. You have to have the people to deliver the service, even if the service is a good idea.

And so the first metric we had was, are we getting the talent? Is it resonating? When you think about the market disruption that's had, if anything there's been more sanity. If you talk to somebody in Q4 about compensation expectations, you probably got a much higher number than what they got. With the market where it is, particularly in mortgages, the level of dialog, the quality of candidates that are now coming inbound as opposed to us looking outbound, has changed fundamentally. We feel very good about the people that we have on the platform and those that are coming.

The next is just timeline and delivering against our product. We actually circled May 16th for the launch of sales and trading, I think in November if I'm remembering correctly. We hit it four days early. But being able to identify that date and to deliver against it is a testament to the people that we've had join the platform and their ability to collaborate, to deliver against our objective. I don't think as a group we have ever had a disagreement about where we're going. I think our operating committee and probably four levels down in the organization knows exactly what we want to be.

What we do talk about a lot is how we get there and making sure we're doing it in a way that is intelligent, client-focused and cost effective. As we grow this business and we start getting closer to 2025, we'll move into those metrics that are traditionally used to value financial services firms. We'll look at efficiency ratio and ROE and all those good things and we hope deliver in a way that makes us all, I think, happy to be at the firm.

Madison Simm: I think that's very well said. The only thing I'd add on to that is that, and I think a lot of people in the room and certainly on the call are pretty familiar with the bank at this point; I mean we're just at a point in the firm's history where we're sort of the tail end of all this strategy work. Recast the balance sheet, recast the vision, what businesses do you want to be in, what business do you not want to be in, how do we build teams with products and services that could be relevant to these markets. We're sort of the tail end of that. And I've described it to a few of you before that this quarter, I think, matches sort of the peak disconnect between strategic success and financial success. And that's something we wrest with candidly a lot internally, every Monday morning in Operating Committee. You talk about the things that you're delivering against relative to your roadmaps and you feel really good, because to Dan's point we've largely yet to miss – I'm sorry, we've largely made every single one, we have not missed yet. But then you look at the financial outcomes and none of us are even close to satisfied with them.

So we're beginning to get to a part of the transformation as we enter into the back half of 2022 where the financial metrics become much more meaningful to you as you evaluate your results and become things that we start to focus on much more now that we're confident we have the capabilities, the products and the people to deliver longer term.

Brock Vandervliet: Excellent. Any last questions? We're right at the top of the hour. Alright.

Speaker: Have a couple more, I think. We started with a delay –

Brock Vandervliet: Choose the best one.

Dan Hoverman: It's a lot of pressure to choose the best one.

Vilas Abraham: Can we do a two in one, how about that? So one is, where are you in the process of rightsizing your cyclical loan portfolio concentrations? And a separate question, also loan related, can you describe your energy appetite today? Seems like a space that's somewhat starved for bank capital right now.

Tim Storms: So I'll take the loan on a risk note, how about that? So we're far along in terms of derisking the organization. As Rob has said, that started before Rob and I arrived. Texas Capital had grown through the loan product and gotten frankly out ahead of itself and I think it figured that out and it started derisking. We were underwriting differently as early as 2019. So for many quarters in a row, you've seen improvement not just because of the cycle but because of a strategy to derisk our loan portfolio. Our C&Cs as you saw are 3% of our non-mortgage finance book. If we do head into a recession period or stagflation period, Brock, we've got a clean book, we've got a lot of capital, we've got very good people, we're much more focused and aligned. So again, I sort of like our hand as to where we stand today.

Vis-a-vis the energy business, we are in the energy business, we're financing energy companies, we're a Texas-based, headquartered organization. What's different is that market. As you said, there's fewer – there's less appetite, there's so much infrastructure to be funded for this country. Terms and conditions are simply better than they were when everything, you know, was easy, if I can put it that way, and I think that market will stay very disciplined for the foreseeable future. I've seen a lot of cycles and the best time to provide credit or make investments is sometimes when you're coming out of a tough period, because you need quality, you need to focus on quality. And then again, this is a mantra for us, is we're going to underwrite through the cycle. So if things get silly in terms of terms and conditions, that's a commodity industry that will be very volatile and we are not interested in experiencing the loss, the default or the concentrated losses we experienced last time, so I think you're going to see us stay disciplined in that sector. But invest in it.

Matt Scurlock: The last thing I'd say relative to just the energy space is there's a tremendous amount of experience on this stage and certainly on the operating committee all the way through the team, both frontline and credit. We recently augmented that even further with the announcement that came out yesterday, that we're adding a new board member, Tom Long, who's the current CEO, former CFO, of Energy Transfer, a publicly traded energy company headquartered in Dallas. So you have that oversight from the very highest levels all the way down to the banker and creditor interaction with the client.

And then the last thing I'll mention, similar to Tim's comment, is we're not looking to grow that at a pace in excess of what we're growing the rest of the loan book. We don't look across our opportunity set and go, hey, this is – commodity prices are really high, we want to add assets, let's go grow energy. We look across our opportunity set and say, where do we bank really good clients? There's a lot of really good clients in the energy space, and we'll go deliver a full suite of products and services to that client set.

Brock Vandervliet: Excellent. Great. With that, join me in thanking the management of Texas Capital.

[END OF TRANSCRIPT]