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Texas Capital Bancshares, Inc.

Q3 2022 Earnings Conference Call

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CORPORATE PARTICIPANTS

Rob Holmes - *President, Chief Executive Officer*

Matt Scurlock - *Chief Financial Officer*

Jocelyn Kukulka - *Director of Investor Relations*

Operator

Hello, and welcome to TCBI Q3 2022 Earnings Call.

I would now like to hand over to Jocelyn Kukulka, Head of Investor Relations. The floor is yours. Please go ahead.

Jocelyn Kukulka

Good morning and thank you for joining us for TCBI's Third Quarter 2022 Earnings Conference Call.

I'm Jocelyn Kukulka, Head of Investor Relations.

Before we begin, please be aware that this call will include forward-looking statements that are based on our current expectation of future results or events. Forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from these statements. Our forward-looking statements are as of the date of this call, and we do not assume any obligation to update or revise them. Statements made on this call should be considered together with the cautionary statements and other information contained in today's earnings release, our most recent annual report on Form 10-K, and subsequent filings with the SEC.

We will refer to slides during today's presentation, which can be found, along with the press release, in the Investor Relations section of our website at texascapitalbank.com.

Our speakers for the call today are Rob Holmes, President and CEO, and Matt Scurlock, CFO.

At the conclusion of our prepared remarks, our Operator will open up a Q&A session.

Now, I'll turn the call over to Rob for opening remarks.

Rob.

Rob Holmes

Thank you for joining us today to discuss our third quarter activities.

We have made significant progress against both our near-term objectives and longer-term goals to build a platform capable of delivering products and services relevant to Texas-based businesses and entrepreneurs at every stage of their life cycles.

We have been transparent that this transformation would begin with a period of sustained investment to reorganize the operating model around client delivery, while we realized our expenses directly against expanded coverage and improved capabilities and refocused the capital base to support businesses where we can be relevant to clients by offering a full suite of products and services.

We also committed to give you guideposts to mark our progress along the way and are pleased to have achieved an important one this quarter, delivering operating leverage or quarterly year-over-year growth in PPNR.

Early on, I often said the biggest risk to our strategy was the need to build so much of the platform concurrently, which was an acknowledgement of both our opportunity and the limited infrastructure in place upon arrival. Through a year of sustained and focused execution by people across the firm, this risk has slowly dissipated as businesses were built and capabilities landed.

While our long-term plan accounts for continued investment, much of the initial lift to deliver the foundational talent, technology, products and capabilities has been incurred. We are increasingly transitioning the Firm's focus from a period of concentrated build into a state of execution as we start to mature a uniquely broad and client centric offering, currently in its infancy, into a robust and scaling platform, consistent with our long-term objectives.

Our value proposition continues to resonate through sustained market share gains as C&I loans increased again this quarter and are now up 38% year over year. Likewise, year to date, our balance sheet committee has now seen opportunities in excess of $10 billion of total commitments with the majority of relationships where we would expect to provide more than just a loan product throughout the client lifecycle. Mid-teens growth and new Treasury Solutions clients in the last 12 months is an early indicator that our rapidly expanding product suite is gaining traction with clients.

Treasury product fees are up 27% year over year, which is largely driven by the improvement in deposit service charges as well as growth in recently launched products like our commercial card. We remain confident that the opportunity for increased client penetration with our full suite of treasury products is significant. This is in part due to continued progress against our digital product roadmap and digital client experience using the competitive advantage inherent in our branch-light network to focus resources on owning the technology-enabled client experience across products with a focus on simplified interactions and client enablement.

During the third quarter, we rolled out our internally developed digital onboarding platform and are on track to deliver full-service capability to our commercial clients by the end of the year. As discussed in previous calls, this new platform reduces total onboarding time through an entirely digital experience, lowering risk, limiting internal handoffs, and enabling our clients to move at their pace of their business.

We have also been clear in our desire to rebuild and significantly enhance our successful but subscale Private Wealth business. We are currently two quarters into systematically revamping our offering, including updating our go-to market strategy, expanding our products, improving our back-office operations, investing in our front-end client experience, and adding quality talent. The foundational build

should be largely complete by the middle of next year, resulting in best-in-class offering. We continue to experience strong organic inflows, with about half coming from new clients.

Year to date, net organic inflows were over $225 million, supporting the change in AUM balances of down 6% compared to an S&P market decline of 25%. In a period of tremendous market uncertainty, Texas Capital Securities is yet another way we can now partner with our commercial clients in a unique and differentiated manner. While overall market conditions pressured realized investment banking revenue this quarter, both the quality and frequency of dialogue is improving, resulting in expanding pipelines across multiple product types.

I would also note that, in just it's second quarter of operation, mortgage sales and trading assisted our clients this quarter in navigating a historically complex interest rate environment, generating over $1 million in fee-based revenue and further substantiating our ability to deliver considerable value to this important client segment.

As we undertook this transformation, we understood the concentrations of the loan portfolio against the capital base required rationalization. In early September, we announced the strategic divestiture of our insurance premium finance portfolio, which is on track to close in the fourth quarter, subject to customary closing conditions. This transaction will further increase our ability to sustainably deliver value-accretive growth in our Texas-focused offering, while the equity return to our balance sheet through this transaction will have the immediate effect of increasing our tangible book value per share by approximately 6.5%.

Upon close, we expect common equity Tier 1 to increase approximately 200 basis points, resulting in regulatory capital ratios and top decile of our peer group and placing us in the most favorable capital position in the history of our firm. The accretive impacts on our balance sheet further include a reduced loan-to-deposit ratio and an increased highly-liquid assets ratio as $3.4 billion of cash proceeds will be held in liquid assets in the near term. Following the closing of the transaction, the loan portfolio composition will also be more representative of our areas of focus, namely core C&I, which will comprise approximately 50% of the total portfolio, a significant differentiator from our peers.

We know that delivering shareholder returns is dependent on not only higher quality earnings, but on a lower cost of capital earned through financial resiliency. Compared to our starting point at the end of 2020, we have notably improved our position relative to this objective.

Capital ratios are considerably higher, with loss absorption capacity supported by consistently conservative and elevated reserve coverage ratios. Liquid assets are stable, with reduced reliance on higher-cost, lower-quality funding sources. Our loan portfolio is increasingly representative of our stated focus on banking the best clients in our markets, and we continue to reduce the volatility of future earnings through expanded capabilities and a proactive interest rate risk-management program.

A final comment on the operating environment. Sentiment across all sectors is that inflationary pressures in the ensuing rate environment will create headwinds for businesses, if they have not already begun. Our strategic planning process acknowledged that we would go through a cycle during our planned horizon.

As such, we are prepared and positioned to continue investing against the strategy to make meaningful market share gains.

We continue to proactively monitor for recessionary exposures caused by economic and geopolitical uncertainty, established credit disciplines include quarterly borrowing specific reviews, quarterly portfolio reviews, and client-specific strategy assessments are now mature. Elevated Awareness continues both in monitoring the existing portfolio and ensuring our desired credit risk appetite is being consistently applied throughout new client acquisition.

We do not manage the Bank in a risk-on, risk-off posture, but instead based on the belief that client selection is always paramount, including as we enter what we expect to be a challenging operating environment in 2023.

Thank you for your continued interest in and in support of our firm. I'll turn it over to Matt to discuss the quarterly results.

Matt.

Matt Scurlock

Thanks, Rob. Good morning.

Beginning on Slide 8. Total revenue was up $32.6 million, or 14% linked quarter, and increased $49.1 million, or 23% when compared to the third quarter of 2021. Quarterly results benefited from a $33.6 million increase in net interest income, mainly attributable to realized benefits of our asset-sensitive balance sheet and augmented by continued C&I loan growth.

Market-driven headwinds led to a linked quarter decline and total non-interest income of a million dollars, primarily driven by a reduction in investment banking and trading income coming off a strong second quarter.

As Rob described, we're making progress on the execution of our fee-generating businesses, which will over time grow in contribution as we improve our relevance within our consistently expanding client base. The pace and complexion of non-interest expense growth continues to evolve consistent with our expectations as we focus investment on pre-identified high-value initiatives that are the foundational tenants for future scale.

Q3 expenses included $13.7 million in salaries and benefits expense, and $3 million in legal and professional expense related to the sale of our insurance premium finance business. Salaries and benefits, excluding transaction-related expenses, increased this quarter and are now up over 30% year over year, while total non-interest expense, excluding transaction related expenses, increased 18%, marking continued success and repositioning the expense base towards expanded coverage and broadening capabilities needed to structurally improve earnings generation over time.

Taken together, PPNR, excluding transaction expenses, increased 25% linked quarter to $84.1 million, marking a milestone in our transformation by achieving year-over-year quarterly PPNR growth one quarter earlier than previously guided.

Net income to common was $37.1 million for the quarter, up 24%, and $49.6 million, excluding transaction expenses, up 66% compared to the second quarter. Net income improved due in part to a $10 million reduction in quarter-over-quarter provision expense as we recorded a $12 million provision in the third quarter compared to a $22 million provision in the second.

Overall, credit quality remains strong. Criticized loans decreased $120 million quarter over quarter to 2.45% of LHI, primarily as a result of the resolution of the one mortgage finance credit that was downgraded in Q2, and non-performing loans contracted again to now just 0.18% of loans held for investment.

This quarter's provision expense was impacted by our increasingly conservative views on the downside risks to the economic forecast, partially offset by the positive observed portfolio trends mentioned previously.

Finally, the continued rapid rise in interest rates over the quarter resulted in a further decline in AOCI of $163.2 million. Portfolio sensitivity is primarily driven by changes along the two- through 10-year points on the curve, and less by changes in short-term rates.

Turning to Slide 9, ending (phon) period C&I loans increased again this quarter, up $569 million, or 6%, signifying focused execution on our defined strategy. Sustained loan growth over the past several quarters has driven C&I balances, excluding PPP and insurance premium finance loans, $2.7 billion, or 38%, higher year over year.

Consistently delivering our improving value proposition to core Texas-based businesses is resulting in a balance sheet increasingly comprised of a client base who benefits from our broadening platform and available product solutions.

Growth continues to come primarily from new and expanded relationships as utilization rates moved only slightly higher in the quarter to 52% and remain in line with our pre-COVID average of low 50s.

The announced divestiture of BankDirect Capital Finance in September resulted in the transfer of the associated C&I loan portfolio into loans held for sale. On a linked quarter basis, balances in this portfolio were flat at $3.1 billion.

Moving to real estate. As expected, period-end real estate balances declined by $100 million, or 2%, in the quarter as payoffs remained elevated in the pace of new origination moderated. As a reminder, this is a through-cycle business for us, focused squarely on client selection, and managed with established and well-tested concentration limits.

Consistent with our long-standing strategy and previous disclosure, new origination volume is focused on multi-family, reflecting both our deep experience in the space and preference for this property type given observed performance through credit and interest rate cycles.

Average mortgage finance loans declined by 10% in the quarter, comparing favorably to estimated levels of broader industry contraction as the breadth of our segment-specific offerings prove increasingly compelling in what is and is likely to continue to be a historically challenged market environment.

Year-over-year industry originations contracted over 55% this quarter compared to the 42% decline in ending balances we experienced, and we would expect traditional fourth and first quarter seasonal declines to be exacerbated by the tightening rate environment.

Current near-term pipelines are reflective of a more cautious client sentiment. As we've said before, our strategy is focused on client selection, not timing cycles, and we would expect future loan growth to simply be an output of our stated strategy.

Moving to Slide 10. We've consistently communicated that transitioning the funding base to our target state would be both difficult and take time. Through a series of actions, most recently, the announced sale of BankDirect Capital Finance, we have increasingly shifted our balance sheet away from a model reliant on a collection of separate funding sources and credit distribution channels, and instead to businesses where we believe multiple client touch points will, over time, result in a higher-quality funding base, increasingly comprised of our clients' core operating deposits.

Performance through the third quarter affirmed the outlook shared on the last call. While we are not at target state, the early improvements made to the balance sheet and business model are yielding positive results thus far relative to the last tightening cycle; however, we are still in the early stages, and we do anticipate deposit costs increasing as market pricing responds to the rapid pace of Fed increases.

Total ending period deposits declined 4% quarter over quarter, with changes in the underlying mix reflective of a continued funding transition and a tightening rate environment. Non-interest-bearing deposits represented 47% of total deposits at period end and were down 8% linked quarter as mortgage finance deposits continue to be pressured by the sustained contraction in industry-wide liquidity. Commercial deposit accounts on analysis have now increased 18% year over year, reflecting our focused strategy to generate and sustain core operating account growth.

The increase in short-term rates experienced over the last 90 days also drove additional repositioning within our interest-bearing deposit base, resulting in continued deemphasis of our highest-cost, most rate-sensitive deposit sources in favor of more granular and modestly less rate-sensitive options, including Bask. Ending-period balances and high beta index deposits contracted $700 million, and now represents 15% of total deposits, consistent with our previously disclosed target level.

During the quarter, $610 million of brokered CDs matured at a rate of 70 basis points, and we purchased $730 million of new brokered CDs with a weighted average duration of 11 months and a coupon of 2.74%. Looking to the quarter ahead, mortgage finance deposits will be impacted by seasonal factors as

property tax distributions are made from escrow accounts in December and January before starting to rebuild in mid-Q1.

Turning to NII sensitivity on Page 11. Shown in the middle on the slide is a result of our asset sensitivity modeling, which declined this quarter to 7.3%, or $77 million, and a plus-100 basis point shock scenario on a static balance sheet. During the quarter, we continued to prudently reduce the amount of future earnings exposed to changes in forward interest rates beyond those already contemplated in the curve by adding $2.25 billion in received fixed interest rate swaps largely tied to one-month SOFR at an average receive rate of 3.1%.

The core component of our asset sensitivity profile is a large portion of our earning asset mix that reprices with changes in short-term rates. After moving loans associated with the insurance premium finance business to held for sale, 92% of the total LHI portfolio, excluding MFLs, is now variable rate, with 87% of these loans tied to either prime or a one-month index.

Assuming proceeds from the pending divestiture of our insurance premium finance business are reinvested in cash, adjusted net interest income sensitivity in a plus-100 basis point shock scenario increases by an estimated 1.7% that were disclosed at 3Q levels.

The net interest income generated by our mortgage finance business will not be as sensitive as the rest of the portfolio to changes in index rates, due to the pricing dynamic of the associated deposits held in non-interest-bearing accounts, which in some cases receive interest credit. As in previous quarters, the total asset sensitivity figures depicted on the slide account for this dynamic.

We continue to have a variety of tools to prudently manage our balance sheet positioning, including expanding use of fixed rate loans, managing duration on the investment portfolio, and the use of derivatives. If the current outlook remains intact of the quarter, we will continue to proactively use the levers at our disposal.

Moving to Slide 12. Net interest margin increased by 37 basis points this quarter, while net interest income rose $33.6 million, predominantly as a function of elevated loan balances repricing at higher yields, partially offset by an expected increase in funding costs. Similar to last quarter, the timing associated with the late-quarter Fed moves, coupled with observed spot rates at September month end, suggests the full impact of the 3Q rate moves will be more fully realized in the fourth quarter.

The investment portfolio declined slightly during the quarter, with cash flow slowing from approximately $90 million last quarter to roughly $80 million this quarter. We purchased $28 million in three-year treasuries this quarter, which are coming on the books at a 4.2% yield versus those rolling off at around 1.5%, and we'll look to match purchase volume with cash flows based on market opportunities to redeploy at higher yields.

Turning to Page 13. Expense trends established over the last year remain intact, and we continue the disciplined process of systematically aligning our expense base with our published strategic priorities. We continue to note that our primary objective is not absolute size, but instead productivity, and we remain focused on investing against what we believe is a significant and unique market opportunity.

Consistent with our guidance, total non-interest expense when including transaction expenses increased $16 million, or 10% quarter over quarter and $27.3 million from the third quarter of last year. As previously mentioned, the cadence of expense redeployment will not be linear. And given the noted pace of capability build, we are moving the full year expense guidance to the mid-teens, which is the high end of our previously disclosed range.

Moving to capital. We remain committed to managing the capital base in a disciplined and analytically rigorous manner, focused on driving long-term shareholder value. CET1 and total risk-based capital finished the quarter at 11.08% and 15.25%, respectively. In the top 20% appear medians and well ahead of stated medium-term internal CET1 target of 10%.

Of note, tangible common equity to tangible assets finished the quarter at 8.5%, an important characteristic of our financially resilient business model and a key metric as we manage the balance sheet through the next phases of the cycle. We expect the capital generation from the pending sale of our insurance premium finance portfolio to generate approximately 200 basis points of CET1, putting the Firm in the top decile of the peer group.

Consistent with our previously disclosed framework, our preference remains reinvesting capital into the value-accretive growth of our Texas-based franchise, and we are pleased to be operating with a strong hand heading into a potentially more challenged operating environment.

Regarding asset quality, criticized loans declined this quarter as the previously downgraded mortgage finance credit was resolved. As we anticipated, our proven structures, response time and firm-wide expertise resulted in a no-loss event for both the Firm and the credit-risk transfer noteholders.

Reserve levels, which are an important piece of our conservative capital structure, are strong at 1.51% of loans held for investment, excluding MFLs, and at 6.5 times non-accrual loans, also positioned favorably relative to historical performance and our peers.

An update to Full Year 2022 guidance is contained on Page 14. Consistent with the methodology disclosed last quarter to both account for the velocity of change in the interest rate environment, and to better highlight the impact on our potential financial performance, our guidance accounts for the forward rate curve and assumes a terminal 2022 Fed funds rate of 4.5%.

Last quarter, mortgage industry market expectations for the year indicated a 40% decline in the total origination market. With the advancement in rates, those expectations have now risen to 50%. Year to date, we have outperformed the mortgage market. Based on our experience to date and the additional products we can now offer our mortgage finance clients through the investment bank, we expect to maintain outperformance with mortgage finance loans declining mid-30% for the year.

Due to the current and expected rate environment and the movement of loan rates off floors, coupled with multi-quarter core loan build, we expect total revenue to increase year over year in the mid- to high single-digit percent range.

As I indicated earlier, in addition to already in-flight investments, we're pulling forward expenses related to planned infrastructure build and expect full-year non-interest expense growth of mid-teens. Together, these expectations result in the maintenance of operating leverage as defined as year-over-year quarterly PPNR growth.

With that, I'll hand the call back over to Rob.

Rob Holmes

Thanks, Matt.

Operator, do you want to open up for questions?

Operator

Thank you. Our first question today comes from Michael Rose from Raymond James. Your line is open, please go ahead.

Michael Rose

Hi. Good morning. Thanks for taking my questions.

Just wanted to start on deposits. Obviously, the costs increased pretty big, you've had historically higher beta than peer, but I look at your non-interest-bearing composition, and I'm just trying to understand how much of it was kind of push and pull between client growth and trying to secure maybe through rate a little bit. Just capturing more deposits versus what the market is giving you in terms of beta.

Just trying to get a sense for how much flexibility, as we move forward and rates move higher, that you have to maybe let deposits potentially run off because of cost, because you do have such a low loan-to-deposit ratio, ex the premium finance sale. Thanks.

Matt Scurlock

Hi, Michael. This is Matt. I appreciate the question.

Maybe just a couple of comments on beta in general. I think rates-paid beta, both for us and the industry as a whole, is just going to be a function of the need to raise or retain marginal dollar deposits required to support any sort of incremental asset growth. We've said, really since the first quarter, that we would be willing to use higher-cost deposit channels as required to onboard what we think are the right C&I relationships that over time are going to bring with them the operating deposits, but that those relationships may begin with credit.

The process of onboarding those clients, and over time earning the right to be their operating bank, is what ultimately is going to transition our funding base from current to target state, and that we measure success this cycle not solely by plus or minus or beta relative to the last cycle, but by our ability to really drive those core operating deposits.

I think both Rob and I said in our comments that we are pleased with the growth in the commercial bank, non-interest-bearing deposits and C&I are up 18% year over year, so the majority of the decline in published non-interest-bearing is coming from the mortgage finance deposits, which are down, as you would expect, as liquidity exits the system.

Michael Rose

Very helpful. I appreciate it.

Operator

Our next question comes from Jennifer Demba from Truist. Your line is open, please go ahead.

Jennifer Demba

Hi. Thank you for taking my question.

My question is also on deposits. Just wondering when you think—do you have any sense of when you think deposits may stabilize for Texas Capital? Is that a mid-2023 event, or is it just too soon to have an idea?

Matt Scurlock

I think that the deliberate actions, Jennifer, to remix the deposit base, namely the deliberate reduction in the institutional index, is largely complete. So, we had an externally published target. We wanted to get that inside of 15%. We achieved that this quarter.

As you know, those are 100% beta and should improve our go-forward pricing dynamics. I think a function of absolute deposit levels is going to be really contingent on our success, continuing to drive the core operating deposits that we're after, and we have plenty of options to fund the additional onboarding of those C&I clients.

I think the material decline that you've seen across the board in the last 12 months is likely to begin abating as we move into 2023.

Rob Holmes

I would just add, Jennifer, that, in addition to the deposit actions Matt talked about, the business activity of driving the majority of balance sheet discussions coinciding with treasury opportunities is a very good indicator of business to come.

And then also our new digital onboarding capabilities, which are improving each week and quarter and will be substantially complete at kind of the end of the first quarter, will speed the pace of deposit onboarding while reducing costs, which is very helpful, because, as you know, when you do win an operating client, you win the business, then you have to do the onboard, then you have to do the ramp. With digital onboarding, they'll bring that business forward. So, we're actually focused on it from a variety of different perspectives.

Jennifer Demba

All right. Thanks.

Operator

Our next question comes from Brad Milsaps from Piper Sandler. Your line is open, please go ahead.

Brad Milsaps

Hi. Good morning, guys.

Matt Scurlock

Hi, Brad.

Brad Milsaps

Thanks for taking my question.

Matt, I wanted to start on Slide 11. The net interest income sensitivity slide. The base NII scenario that you guys outlined is up about $125 million over the second quarter to $1.45 billion. Just wanted to walk through that and make sure I understand correctly. That assumes kind of where all balances were at period end and then the forward curve, correct?

And I was curious, has that been adjusted for the premium finance loan sale? I just wanted to kind of understand, if you could give us some more color on the moving parts behind that number.

Matt Scurlock

Yes, Brad, I think you described it accurately. We snapped the line at the end of quarter and assumed that cash flows are reinvested. That does include the impact of the pending BDCF transaction assumes that the proceeds are simply parked in cash.

Brad Milsaps

Got it. So, any loan growth would be additive on top of that. Is that correct?

Matt Scurlock

You got it.

Brad Milsaps

Okay. I was curious, just in that same vein, would you happen to have—I know the average balance sheet is a little quirky this quarter with some of those loans are moving to held for sale for a month. But I was curious, do you have a clean sort of loan held for investment yield sort of ex the premium finance loans? Have they been out of the balance the entire quarter?

Matt Scurlock

Yes, Brad, you could add about 10 basis points to the disclosed yield looking at total loans.

Brad Milsaps

Okay. Great. Matt, maybe finally, just on expenses, I know that you guys are investing heavily, and you give data in a year on sort of multiples of new frontline talent. I was curious if you could maybe put some numbers maybe behind some of those multiples. How many lenders do you have now versus when you started? Just kind of want to get a sense of capacity in numbers in terms of people that you brought on. Maybe just to get a little more color behind some of those multiples.

Matt Scurlock

We're reluctant to give the absolute number, Brad. But maybe just to talk more broadly about non-interest expense, I think it's an important component of the quarter. When we started this year, to your point, we had a guide of low double-digit percent increase in total non-interest expense of a $600 million base, and we said we'd look for opportunities to invest more aggressively, or really pull forward our transformation agenda as internal capacity or revenue allowed, because for us, perhaps a bit different than other banks,

but we thought our path to operating leverage looked like was one where we built capabilities and coverage necessary to grow revenue, not one where we look to reduce expenses.

We feel like we've been able to execute well against that, pulling forward by one quarter our PPNR target that we disclosed last year, and that's really been driven by revenue growth of 14% in each of the last two quarters. If you look at just the total expense base, you move the transaction-related expense, we're up $16 million, or 9.8%, quarter over quarter, $11.5 million of that is salaries and benefits, about $3 million is tech-related expense that primarily focuses on better flipping the frontline as well as moving some of our storage to the cloud and away from on-prem.

At this point, salaries and benefits for us are now 65% of total non-interest expense. This was a noted target for us, up from 57% last year. As you note, it was definitely a strong quarter for hiring. So, the total employee base was up 8%. That was focused primarily on increases in private wealth and investment banking. We have now increased frontline talent by 1.8x since the end of 2020 and 2.5 times on front line as it relates to C&I. So, we're really pleased with our progress to date in matching that expense base directly against the priorities that we've laid out.

Brad Milsaps

Great. Thank you.

Operator

Our next question comes from Brady Gailey from KBW. Your line is open.

Brady Gailey

Hi. Thanks. Good morning, guys.

I wanted to stick with the expense topic, 15% growth, or mid-teens growth, this year is a big number. I know you guys are investing a lot internally, which makes sense. But as you look to next year, did you think it will require a similar amount of internal investment? I'm just wondering, your expenses were up 15% this year, should we expect that pace to slow at all next year?

Matt Scurlock

Yes, Brady, it's Matt.

The period of the transformation where we're incurring significant costs without the corresponding revenue is largely behind us, and we do anticipate continued build-out, but not without revenue to support it. So, on the guide, I mean, we started the year, as I mentioned, with the low double digit, now moving to mid-teens, so we started to migrate that up as we had success actually deploying those investment dollars against the stated objectives. And only did so because we felt confident in being able to pull forward that PPNR target.

You'll notice in the guide, as well, on the quarterly operating leverage we have it set as maintain, which indicates to you that we believe year over year in each quarter, so 4Q this year relative to 4Q last year, 1Q next year relative to 1Q last year, that we'll continue to maintain operating leverage and ultimately expand it.

Brady Gailey

Okay. All right. Your common equity Tier 1 moved up to 11% this quarter. If you look at it with the sale of the premium finance business, all else equal, that will take it up to 13%, so even at a higher level. I noticed you guys—it doesn't appear you repurchased any stock in the quarter, but your share price is 1.15 at tangible. So, your capital base is growing, your stock is still cheap on tangible, but no buybacks. How should we think about that going forward?

Rob Holmes

Hi, Brady. I'll take it. It's Rob.

Look, I think we've talked about this before. We have a clear understanding of corporate finance and value creation through capital actions. As you know, this Management team put in place the first buyback program in the Company's history. We had $150 million on the program. We used $50 million. We bought it back at average price of 97% of book. So, it was highly successful. Having said that, there's a couple of things happening. I think any bank in this economic environment with this business or economic outlook sentiment needs to be highly cautious before buying back shares, irrespective of capital position or liquidity, and we're really, really happy that this bank has more capital than any time in its history, and we have ample liquidity, and both will just improve.

But having said that, we're highly cautious on the go-forward outlook. We will consider buybacks, for sure. But we have, unlike most banks, a plan to create value through organic investment and growth, unlike no other in the best economic state in the country.

We're going to continue to focus on the strategic plan. If a buyback becomes opportunistic where we need to do it, because we owe it to our shareholders, we will. But it's not the number one lever to financially grow earnings versus organically grow.

Brady Gailey

Okay. All right. That makes sense. Finally for me, as the premium finance sale nears closing, you're going to have so much excess funding generated from that. I heard Matt say right now you're planning to just leave it in cash. But longer term, what do you do with that? Do you use it to just fund loan growth? Do you think about increasing the bond book? Do you go to the other side and get rid of some high-cost funding? There's a huge opportunity there with that liquidity; what do you do with it longer term?

Rob Holmes

Yes, Brady, I think that this transaction is—it's a great transaction for Truist and what it does for them. It's also a great transaction for us. As you saw, and Matt mentioned, we totally repositioned the entire balance sheet since I got here: C&I loan 50%, mortgage warehouse rightsized and profitable. We're really, really pleased with the reallocation of the balance sheet in our front line and where we're generating business and being more in state and being way more relevant to our clients, unlike BDCF was.

We are going to go in really slow with the deployment of that capital, and obviously be incredibly thoughtful. There's a number of things that we can do with it, and we're going to take the next three months to do a strategic review of how to best fix the balance sheet and financial condition of the Company to match the go-forward strategy.

Brady Gailey

Okay. All right. Thank you, guys.

Operator

Our next question comes from Matt Olney from Stephens. Your line is open.

Matt Olney

Hi. Good morning.

Just a few follow-ups on the insurance premium sale. Any more color on the timing of the deal closing? What does the updated guidance assume on the timing of the closing? Lastly, just remind us on the amount of expense levels that should fall out following the sale closing. Thanks.

Rob Holmes

Yes. The guidance on the timing of the closing is fourth quarter this year. No further update. It's subject to customary closing conditions. We fully expect it to close in the fourth quarter, but that's the update on timing.

I didn't hear your second question, Matt.

Matt Scurlock

Was it around the operating expense, Matt? The operating expense associated with the business.

Matt Olney

Yes, it was around the operating expense that falls out.

Matt Scurlock

Yes, $36 million full year.

Matt Olney

Okay. Just to clarify, any impact on the updated guidance from the sale?

Matt Scurlock

No.

Matt Olney

Okay. Thanks. Shifting gears on the mortgage warehouse, I think you mentioned it's outperformed the industry so far this year. I think the results definitely proved that out. The updated guidance implies that warehouse is down pretty considerably in the fourth quarter. I think even more than some of the industry forecasts I've seen so far for 4Q. What are you seeing in mortgage volumes that make you more cautious in 4Q than lots of the industry forecasts out there?

Rob Holmes

Well, I'll take it, and Matt can comment.

I said it in the last couple of calls, I believe. If not, I should have. This is a vertical now, not a warehouse, so we do many things with these clients. Many, many banks our size, smaller or even bigger, have a mortgage warehouse, and that's it. We have a robust treasury management relationship with these companies. We have a robust risk management relationship with Capital Solutions. We have robust sales and trading, TBA, gestation, and others. We even have private wealth and corporate advisory in the infancy of some relationships. So, we look at it as a vertical.

We also understand and deliberately rotated up market during the course of this year for a couple of reasons. Those happened to coincide with companies that were more positioned for purchase instead of refi in their sales pipelines and their areas of focus. They happen to be safer and sounder. While we think this is an LGD zero business, we don't need to spend time remediating credit issues, like we did earlier this year. So, we are doing what we said was client selection. We have excellent relationships. You have seen us relinquish market share on purpose, and then gain market share on purpose. The actions and mortgage warehouse, which is mortgage finance now, have been extremely deliberate.

Matt Olney

Thank you.

Rob Holmes

I wouldn't look at the outstandings of our warehouse as totally market-volume driven, as you would have two years ago.

Operator

Our next question comes from Jon Arfstrom from RBC Capital Markets. Your line is open.

Jon Arfstrom

Hi. Thanks. Good morning, everyone.

Rob Holmes

Good morning, Jon.

Jon Arfstrom

Rob, I just want to get away from the numbers for a second and ask about a comment you made during the prepared comments, and you've kind of alluded to it a couple of times, but you mentioned the phrase challenging operating environment in '23. Just kind of curious what you're expecting on that and what you think that means potential for your credit outlook and for the industry's credit outlook.

Rob Holmes

Yes. First of all, we do quarterly segment-level and borrow-specific reviews every quarter, with a focus on the macroeconomic environment. It's a risk-based approach that prioritizes reviews, including large exposures to high-risk industries to overhaul exposures. We are extremely diligent and highly complemented in our processes and cadences as around risk. You'll see that we are well provisioned. That's a direct result of a management team with a conservative posture, which is today and always, even in the best economic environments. So, I feel really, really good about our loan book and where we are.

I would say that, just factually, even though we talked about being in Texas and what a great business climate it is on a relative basis, even good economic news is moving in the wrong direction, such as employment growth in Texas. Texas produced more jobs between February 2020 and August 2022 than any other state, but it did slow in the third quarter. While there's job growth, it's slowing. Home sales have declined, and inventories have risen, even though inventories are low.

Even the good news is getting worse, and on top of that there's a lot of bad news. I mean, the strong dollar does hurt Texas companies. Inflationary pressure does hurt consumer-facing companies no longer available to pass along cost. You can see an inventory glut at Nike in the third quarter. You saw GM had more cars in inventories in the third quarter than three times a number they did before. So, you see a broad slowdown, we feel. But I think we're well positioned for it.

I actually think, ironically, it's an opportunity for us.

There are still irrational banks in the marketplace, competing on price and structure. We want to compete on value of relationship, banker and platform. We are still—as early as this morning and balance sheet committee, we said no true opportunities with irrational banking behavior and market. We think we are poised to benefit from an economic downturn, given our market share and our credit discipline that we have today going forward.

Jon Arfstrom

Yes. That makes sense. You kind of hit my follow-up, but it sounds like you're saying a challenging operating environment probably helps your ability to take share and hire the right people. Or is that incorrect?

Rob Holmes

Totally. Totally. I'm glad you picked up on this. Even though Matt talked about our success in hiring, we did delay a couple of spots in loan syndications, M&A, some other roles, because of the economic environment. We didn't change our strategy; we just delayed. You'll see that talent coming on board now to take advantage of the market environment, but it wasn't there this past year. So, we're managing the business. We're aware of the market environment that's managing the business for the long term.

I think the word rolling recession is something that people are saying a lot more, which I didn't really hear until this cycle of my career, but I think it's probably a good term. I mean, we have some industries in Texas that are doing much better than others. We have some regions of the country doing better than others and some regions of the globe doing better than others. But I will say, I didn't understand when you use the word transitory inflation; it's anything but that now, as we know.

I also don't understand the current definition of recession, because the first two quarters the U.S. contracted. Europe is in a hard recession, so it may be mild, but the economy has contracted longer than two quarters.

I think that irrational behavior by some banks is unwarranted, and we'll remain cautious.

Jon Arfstrom

Okay. All right. Thanks for the help.

Rob Holmes

But we will be on offense. Sorry.

Operator

This concludes our Q&A. I'll now hand over to Rob Holmes, CEO, for final remarks.

Rob Holmes

We continue to be grateful for everybody's interest in the Firm. We're excited about the transaction that we announced; it will close this quarter. We're very pleased with where we are in the build, the continuation of the strategic plan, and we look forward to continue communicating as we move forward. Thank you.

Operator

Today's call is now concluded. We'd like to thank you for your participation.