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Texas Capital Bancshares, Inc.

Q2 2024 Earnings Conference Call

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**CORPORATE PARTICIPANTS**

**Rob Holmes** - *President, Chief Executive Officer*

**Matt Scurlock** - *Chief Financial Officer*

**Jocelyn Kukulka** - *Head of Investor Relations & Corporate Development*

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**Operator**

Good morning, all. I would like to welcome you all to the Texas Capital Bancshares Inc. Q2 2024 Earnings Call. (Operator Instructions) I would now like to pass the conference over to your host, Jocelyn Kukulka at TCBI to begin. Jocelyn, please go ahead.

**Jocelyn Kukulka**

Good morning. And thank you for joining us for TCBI's second quarter 2024 earnings conference call. I'm Jocelyn Kukulka, Head of Investor Relations. Before we begin, please be aware this call will include forward-looking statements that are based on our current expectations 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 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 cautionary statements or information contained in today's earnings release and on our annual report on Form 10-K and subsequent filings with the SEC.

We will refer to slides during the presentation which can be found along with the press release in the Investor Relations section of our website at [texascapitalbank.com](http://texascapitalbank.com). Our speakers on the call today are Rob Holmes, President and CEO; and Matt Scurlock, CFO. At the conclusion of our prepared remarks, our operator will open the Q&A session. I'll now turn the call over to Rob for opening remarks.

**Rob Holmes**

Thank you for joining us today.

We continue to make material progress translating our now clearly differentiated strategy and operating model into outcomes consistent with our targeted results.

The Firm's industry leading liquidity and capital continue to be a competitive advantage, as current and prospective clients seek a financial partner with both a product suite, and balance sheet, capable of supporting them through market and rate cycles. We finished the quarter with Tangible Common Equity to Tangible Assets of 9.6% - ranked first amongst the largest banks in the country, a reserve ratio of 1.84%, when excluding mortgage finance loans, which is top decile amongst our peer group, and liquid assets of 24%.

We continue to experience sustained momentum in our fee income areas of focus which collectively increased 21% linked quarter, and 11% year over year, with Treasury, Wealth, and Investment Banking delivering results consistent with expectations. Non-interest income comprised 19% of total revenue for the quarter, which is the second consecutive quarter inside our target range for fee income as a percentage of total revenue by full year 2025.

The Investment Bank, now just two years from its launch, has an increasingly granular and diverse pipeline which is contributing to more sustainable fee growth in this developing business. Investment Banking and Trading Income increased 33% quarter over quarter to a record of \$30.7 million. Syndications, Capital Markets, and Capital Solutions all delivered quarter over quarter revenue growth, with Capital Markets delivering records in both fees and transaction volumes. We continue to hit milestones in the still maturing investment banking offering every quarter and are building a base of consistent and repeatable revenues that will be both a differentiator in the marketplace and a meaningful contributor to future earnings.

Our Treasury Solutions platform, after nearly three years of deliberate and material investment, now provides both payment products and services in parity with the major money center banks, and a client onboarding process that is faster and more efficient. Client and product onboarding continues on pace with expectations, as year over year treasury product fees increased 14% led by an 11% increase in gross payment revenue year to date. This is now 5 consecutive quarters with growth 3x the industry, as our sustained focus increasingly earns us the right to become our clients' primary operating bank.

The Private Wealth business is undergoing a full rebuild, which I have detailed in prior quarters, and we anticipate that it will be complete by year end. The expanded product suite, and materially enhanced client journey, should enable improved connectivity to the rest of our platform allowing for significant future scale. Total AUM was flat quarter over quarter; however, managed investment assets were up 5%, an early sign of anticipated increase in client adoption and associated revenue growth resulting from initial components of our new offering coming online.

Distinctive cash management capabilities enabled the Firm to retain and grow client funds during 2023, with those trends continuing through the first half of this year. Non-interest-bearing deposit accounts outside of Mortgage Finance remained flat at \$3.3 billion for the quarter, while non-brokered interest-bearing deposits grew again this quarter, and are now up 23%, or \$2.9 billion year-over-year.

A foundational tenant of the financial resiliency we have established, and will preserve, is continued focus on tangible book value which is up over 7% year-over-year, ending at \$62.23 per share, an all-time high for our Firm. While we continue to bias capital use towards supporting franchise accretive client segments where we are delivering our entire platform, we do recognize that at times of market dislocation, it can be prudent to utilize share repurchases as a tool for creating longer-term shareholder value. During the quarter, we repurchased \$50 million or 1.8% of total shares outstanding at a weighted average price equal to 95% of the prior month tangible book value and at 84% of tangible book value when adjusting for AOCI impacts.

The Firm remains fully committed to improving financial performance and believes that our position of unprecedented strength is enabling us to serve the best clients in our markets. We will drive attractive, thru-cycle shareholder returns, with both higher quality earnings and a lower cost of capital as we scale high value businesses through increased client adoption, improved client journeys, and realized operational efficiencies – all objectives that we made significant headway on year to date. Now I'll turn it over to Matt to discuss the financials results.

**Matt Scurlock**

Thanks, Rob, and good morning.

Starting on slide 5 - Total revenue increased \$11 million, or 4% for the quarter to \$267 million as a \$1.6 million increase in net interest income was augmented by a \$9 million, or 22% linked quarter increase in non-interest revenue. The \$50.4 million of fee income delivered this quarter is the high-water mark since we began the transformation in January of 2021, and our YTD non-interest revenue of \$92MM is 30% higher than full-year 2020 when normalizing warehouse related fees and adjusting for businesses we've sold or wound down.

Quarterly total adjusted non-interest expense decreased 2% linked quarter coming off seasonally higher first quarter salaries and benefits related to annual payroll and compensation expenses.

Taken together, linked quarter adjusted PPNR increased 24% to \$79 million, recovering off seasonally lower first quarter results, and generally in line with internal expectations.

This quarter's provision expense of \$20 million resulted from charge-offs associated with previously identified problem credits and a sustained conservative posture related to our economic outlook. Year-to-date provision expense as a percentage of LHI excluding mortgage finance is consistent with expectations at 47 bps annualized.

Net income to common was \$37.4 million, an increase of 71% linked quarter, while adjusted Net income to common was \$37.7 million, up 27% linked quarter. The tax rate for the quarter increased 3.7%, resulting in a \$2.2 million reduction in net income to common, primarily due to the timing of booking certain discrete items this quarter. We still expect the full year blended tax rate to remain around 25%.

Our balance sheet metrics continue to be exceptionally strong with ending period cash balances of 10% of total assets and cash and securities of 24%, both trending in line with year-end targeted ratios. Ending period gross LHI balances increased by approximately \$950 million, or 5% linked quarter, driven predominantly by expected growth in the Mortgage Finance business off seasonal troughs and modest increases in C&I loans.

Total deposits declined 1% during the quarter, as continued increases in client interest bearing accounts were offset by proactive reductions of our highest cost deposits in the mortgage finance and brokered categories.

Total gross LHI excluding mortgage finance was relatively flat linked quarter as higher interest rates and lingering economic concerns suppress previously anticipated client and prospect needs for bank credit.

After repositioning over \$1 billion of funded loans during the last 6 quarters, our multi-year process of recycling capital into a client base that benefits from our broadening platform of available product solutions has slowed significantly, although we do continue to identify select opportunities each quarter as legacy positions reach maturity. While our platform breadth is enabling new client acquisition at a pace consistent with internal expectations, with year-to-date new relationships onboarded now over 65% of

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new relationships onboarded for full year 2023, lower near-term system-wide demand for bank credit is limiting immediate earning asset expansion. We do still expect the sustained pace of new client acquisition to result in modest balance sheet and loan growth this year, although at a potentially slower pace than contemplated in our original guidance.

Commercial real estate period end balances decreased \$133 million, or 2% in the quarter, as payoff rates increased from the depressed levels in the prior period. The portfolio remains weighted to multifamily, which comprises \$2.4 billion or 42% of outstanding balances, reflecting both our deep experience in the space and observed performance through credit and interest rate cycles.

After a difficult fourth and first quarter for the mortgage space where seasonal weakness was exacerbated by persistent rate pressure, average mortgage finance loans increased \$840 million, or 24% in the quarter, to \$4.4 billion reflective of increased homebuying in the spring and summer months.

Our expectation remains that the industry will remain historically challenged in the near term. Ambiguity on the forward rate outlook is causing a dispersion in origination volume estimates from professional forecasters, with some reputable sources still calling for an up to 15% increase in annual origination volume. Given ongoing rate volatility, we remain more cautious, and reaffirm reduced full-year expectations shared on the Q1 call for a full-year increases in average warehouse volumes of 10%, down from 15% at the beginning of the year.

Ending period deposit balances decreased 1% quarter over-quarter as sustained success in attracting quality funding associated with our core offerings enabled the Firm to proactively manage down select higher-cost funding sources, both in Mortgage Finance, and Brokered Deposits which are now at a 10-year low.

Period end Mortgage Finance non-interest-bearing deposit balances decreased \$473 million quarter-over-quarter predominantly driven by the selective reduction of over \$500 million of the highest cost deposits where we were unable to earn additional business necessary to generate an appropriate return on capital. Average mortgage finance deposits were 120% of average mortgage finance loans, a decline quarter over quarter but in line with our guidance, as the deposit reduction now more appropriately matches funding levels to reduced mortgage client credit needs resulting from the system-wide contraction in mortgage origination volumes. We expect the ratio of average mortgage finance deposits to average mortgage finance loans to remain relatively flat in the third quarter as the predictable growth in client deposits should match that of anticipated warehouse fundings.

As detailed in previous calls, select mortgage finance deposits feature relationship pricing credits which are applied to both clients mortgage finance and commercial loans based on each loan type's contribution to interest income during the quarter. Attribution of interest credits are expected to follow a similar distribution for the duration of the year with approximately 60% associated with mortgage finance, and 40% aligned to commercial loans to mortgage finance clients.

Ending and average period non-interest bearing deposits excluding mortgage finance stayed flat in the quarter, as the pace of clients shifting excess balances to interest-bearing deposits or to other cash

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management options on our platform has slowed significantly. Ending period non-interest bearing deposits excluding mortgage finance remain 14% of total deposits, and our expectation is that this percentage remains relatively stable in the near-term.

Brokered deposits declined \$78 million during the quarter as growth in client-focused deposits consistent with our long-term strategy remains sufficient to satisfy desired near-term balance sheet demands. Over the third quarter, \$330 million will mature with an average rate of 5.3% and we do anticipate replacing a portion of these deposits.

Our modeled earnings at risk was relatively consistent linked quarter due to proactive measures taken over the last two years which are resulting in a more neutral posture at this stage of the rate cycle. It is important to note these are measures of net interest income sensitivity and do not include inevitable rate driven changes in loan volumes or fee-based income.

We continue to reinvest cash flows into the securities portfolio and purchased nearly \$100 million in agency backed securities during the quarter with an average coupon of 6%. We do anticipate continued reinvestment over the duration of the year which will improve securities yield while maintaining rate positioning.

Net interest margin declined 2 basis points this quarter, and net interest income increased modestly to \$216.6 million. The impacts of balance sheet repositioning into higher earnings assets associated with our long-term strategy, coupled with continued momentum Rob described in our fee generating businesses should continue over the next few quarters as we look to resume year-over-year quarterly PPNR growth in the fourth quarter of this year.

Total adjusted non-interest expenses decreased 2% linked quarter as Q2 salaries and benefits expenses decreased \$9.9 million from a seasonally high first quarter. The realization of structural efficiencies associated with our go forward operating model are improving near-term financial performance while also enabling continued specific investments to drive long-term capabilities.

As industry wide asset quality normalization continues so does our multi-year posture of prudently building the reserve to effectively address communicated legacy credits and buffer against the potential impact of an uncertain economic outlook. The total allowance for credit loss including off balance sheet reserves increased \$8 million on a linked quarter basis to \$313 million, up \$31 million year-over-year, which when excluding Mortgage Finance is 1.84% of total LHI, a high since the adoption of CECL in 2020.

Criticized loans stayed flat at \$860 million, and declined to 3.9% of total LHI, as modest increases in special mention were offset by resolutions in substandard including of non-accrual loans. The composition of criticized loans remains weighted towards well-structured commercial real estate loans supported by strong sponsors plus commercial clients with dependencies on consumer discretionary income.

During the quarter we recognized net charge-offs of \$12.0 million, or 0.23% of average LHI. The charge offs were comprised of a small number of commercial credits and the resolution of a single hospitality

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loan. Our identified legacy problem credits have now been reduced to approximately \$40 million, down from \$200 million at the end of 2020.

Consistent with prior quarters, capital levels remain at or near the top of the industry.

Total regulatory capital remains exceptionally strong relative to both the peer group and our internally assessed risk profile. CET1 finished the quarter at 11.62%, a 76 bps decrease from prior quarter related to the maturity of the credit linked note which had a 46bps impact, quarterly loan growth, and execution under the share repurchase authorization.

Tangible common equity to tangible assets finished at 9.63%, ranked first amongst the largest banks in the country.

We continue to deploy the capital base in a disciplined and analytically rigorous manner focused on driving long-term shareholder value. During the second quarter, we repurchased approximately 852 thousand shares or 1.8% of prior quarter shares outstanding, for a total of \$50 million at a weighted average price of \$58.14 per share or 95% of prior month TBVPS.

Our guidance accounts for the market-based forward rate curve which now assumes Fed Funds of 5.25% exiting the year.

For the full year, we are modestly reducing our revenue guidance and now anticipate low to mid-single digit growth as moderated expectations for current year balance sheet expansion is only partially offset by continued momentum in our fee income areas of focus. Despite the near-term impacts, slowing capital recycling efforts through the year, coupled with sustained new client acquisition, will result in resumption of risk appropriate loan growth when clients' appetite for bank credit improves.

Our intent to move towards an 11% CET1 at year end remains intact, with our consistent capital priorities focused on growing the core business, improving future earnings generation, and increasing tangible book value per share. Given our risk-weighted asset heavy commercial orientation, effectively deploying excess regulatory capital should still result in sector leading tangible common equity levels.

Multi-year investments in infrastructure, data, and process improvements continue yielding expected operating and financial efficiencies enabling targeted additional investment in talent and capabilities, while limiting structural increases in non-interest expense. The increase in guidance to low-mid single digits contemplates elevated levels of revenue generation from higher efficiency ratio sources alongside continued spend associated with resolution of select existing problem credits.

We expect resumption of quarterly increases in year over year PPNR growth to begin in Q4 2024, accelerating as we enter 2025.

Finally, we maintain our conservative outlook and reiterate our annual provision expense guidance as 50 bps of LHI excluding Mortgage Finance.

Operator – we'd now like to open the call up for questions. Thank you.

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**Operator**

(Operator Instructions) We have the first question on the phone line from Ben Gerlinger with Citi.

**Ben Gerlinger**

I know you guys gave the guidance just a second ago here. And the balance sheet sensitivity obviously moves quarter-to-quarter. You're looking at just strictly on a static basis, largely due to the more warehouse differential. But if the market were just kind of see a cut a quarter, it's like 3Q, 4Q and then one to early next year. Can you -- I know it's not an official guidance. Can you just talk about maybe the potential impact that you would see either left and right side of the balance sheet, considering you guys cut out some of the higher cost deposits? I'm just trying to think about repricing across both sides.

**Matt Scurlock**

Yes, Ben, this is Matt. Happy to take that question.

We've been pretty deliberate in getting to a position of relative neutrality in the shock scenario as rates are starting to flatten out at least on the short side. So we think that the business model and balance sheet transformation over the last few years gives us the ability to drive improved revenue really across different rate environments.

So a main difference, obviously in this quarter's guidance relative to guidance in the beginning of the year has been the reduction in anticipated rate cuts, which for us has mostly shown up in reduction in needs for clients to put on big debt. So we've got 25 basis points sitting over the remainder of the year.

If you see that accelerate a bit, we've got hedge profile that picks up about \$7.5 million of NII for every 25 basis points of cuts, that's actually essentially winding down over the duration of next year. You'll see about \$500 million come off over the first half of the year, and then about another \$1.5 billion in the third and fourth quarter.

So you do see some level of some removal of the downside rate protection, but SOFR forward is about 90 basis points in excess of [receive] fix. And then obviously the mortgage finance portfolio quite sensitive to reductions in interest rates. We anticipate that you'll see that flex up to about \$4.8 billion on average in the third and fourth quarter, which gets you to about a 10% increase full year and then there's associated fees that would come from both warehouse volume primarily in sales and trading as well as the expansion of capital markets income if you see a declining rate environment.

**Ben Gerlinger**

Okay. That's helpful. And I know you guys from a capital perspective, like to have excess capital. I mean it makes a lot of sense for new client wins, especially in the investment banking business. But now with shares notably above tangible, you guys road the rally that the rest of the bank space has seen. Is it fair to assume that the share repurchases are pretty limited here, considering you're above tangible? Or can we think of the same pace given the lack of [loan growth] as of late?

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**Matt Scurlock**

Yes. I think the framework that we use to evaluate marginal capital deployment has been pretty well described at this point. And you're exactly right. Year-to-date capital in excess of near-term balance sheet has been deployed into about \$80 million of buybacks, which over the past couple of years has been pretty important ingredient for us to drive book value in ways other than just through the income statement. You're exactly right that the current stock price makes that a less appealing option, which means to move to other options on our capital menu.

One example of that this quarter, Ben, was expiration of the CRT where we just simply didn't need additional risk-weighted asset benefit instead are prioritizing improved earnings and associated tangible capital generation. That move is pretty consistent with our continued message around emphasizing tangible common equity over regulatory capital. And then you're also right on potential future loan growth. I mean the platform is to serve all the financial needs of our clients. We've said repeatedly that it's not one set of clients for treasury and one set of clients for the investment bank, and another set of clients for the commercial bank. We generally compete and win because once the client comes here, they never have to leave. And eventually, that does mean that clients are going to need the balance sheet and levels that are greater than today, and we want to make sure that we have that capital available for them.

**Operator**

Your next question comes from Steve Scouten with Piper Sandler.

**Steve Scouten**

I appreciate it. So investment banking remains extremely strong, growing. I know it's kind of to the 10% contribution rate that you guys have laid out at one point in time. I mean do you think we go appreciably through that contribution rate now that we're already to the 10.3% level year-to-date? Or kind of how should we think about investment banking contribution as we continue to move forward.

**Matt Scurlock**

Yes. Pleased to call out another record quarter in investment banking. I'd note that Rob mentioned this in his opening comments, the fee contribution was significantly more granular and broad than other record quarters, namely the second and third quarter of last year. Capital Markets was the main contributor this quarter, record level of fees, record level of transactions.

We continue to compete and win against both money center and pure-play investment banks, despite 85% of industry volumes and capital markets being refi, which is going to disproportionately favor the incumbent. I'd say the pipeline right now, Steve, is elevated including those transactions that are mandated. And while that does continue to expand and certainly our expectations for long-term performance business, probably also continue to increase.

We still suggest modeling this as next -- modeling next quarter's fees rather using a trailing four quarter average. I mean it's still a brand-new business only two years in. And while I think at this point,

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unquestionably, the trend is going to be for it to be an increasing contributor to Texas Capital Bank, for now I try to temper expectations and plug in somewhere in the mid-20s for the next couple of quarters.

**Steve Scouten**

Got it. And just as I think about the 2025 target, obviously still a pretty big gap between year-to-date in that kind of 1.10% ROA. It feels like for me, like the difficulty is the delta between what we can see in the financial results to date versus the sentiment of progress that you all communicate.

So where is the lever there that maybe we can't see yet that would create this large magnitude shift in terms of financial results? Any color there? Or do we have to read about those targets at this point, I don't know.

**Matt Scurlock**

No. I'll answer the first questions that no need to readjust the targets at this point.

So you're right, we see a ton of underlying momentum in the business. And the elements required for improved returns are the same elements that we called out in 2021. So we are continuing to gain relevance with clients and prospects at a pace necessary to deliver against our fee income targets.

We think that at this point, we've proven clear ability to leverage tech investments and process improvements to drive real structural efficiency which is foundational for future scale. And then we're highly consistent with market-facing posture and do so with a pretty differentiated platform. So over time, that's going to result in balance sheet growth when folks again start to look to bank credit as a vehicle to expand their business.

We still think you get to the back end of the year, and there would be some balance sheet expansion, particularly supported by a decrease in interest rates, which then sets you up for a pretty nice trajectory heading into 2025 and that's generally why we think those results are still obtainable even in what is certainly a challenging operating environment.

**Stephen Scouten**

Got it. So kind of, I guess, contingent the execution on what you've built in just a little bit of time for that to play out.

**Matt Scurlock**

Yes. I think the biggest difference halfway through the year relative to our expectation, Steve, has really just been client appetite for bank credit. So average loan balances for us, excluding mortgage finance, they're up \$600 million year-to-date or about 8% annualized. But clients' appetite is much less than assumed in the January call, likely to elevated interest rates. So we continue to think we're going to get pickup in the third and fourth quarter.

But to date, clients onboarding has showed up elsewhere in the financials, which is making us making loan growth in excess of the 8% that we achieved last year a bit more challenging. That's really been the main difference if we think about guidance laid out at the beginning of the year relative to current state. So if we see that pick up back into the year, the trajectory is potentially not as steep, but still quite steep as you move into an important 2025.

**Operator**

You now have Matt Olney with Stephens.

**Matt Olney**

I want to ask about operating expenses. And it sounds like the 2Q expense level was in line with the internal expectations, but you did increase the outlook for expenses for the full year. Just any more color on kind of what the driver of the updated outlook there?

**Matt Scurlock**

Yes. You got it, Matt. The expense priorities are essentially unchanged. So the slight move higher in guidance from low single digits to mid-single digits is really the result of potentially higher in salary benefits expense that is associated with onboarded talent, primarily in the broker-dealer and then improved anticipated revenue from fee-based sources, which as you know, generally are going to have a slightly higher efficiency ratio.

So overall, salaries and benefits should still be in that mid-single-digit range, but does have potential to move to higher end. All other expenses, as you know Matt, we generally have tagged in previous calls, it's about \$70 million a quarter, are mostly evolving as anticipated. So the heaviest area growth is tech and communications expense, which reflects the previously discussed ramp of our project portfolio to target persistent funding levels this year. But the one area that's not coming down quite as fast as anticipated is legal, where ongoing resolution of a few legacy credits should keep the spend around current levels for the next few quarters. So I think about for the remainder of the year, Matt, total expenses not associated with salaries and benefits potentially coming in right above that \$70 million that we gave you in January and in April.

**Matt Olney**

Okay. That's helpful, Matt. I appreciate the commentary there.

And then I guess, switching gears on the deposit side. I think you mentioned you took some steps to exit higher cost deposits late in the quarter. Just curious, is this a function of just needing less funding given the slower loan growth? Or is there something other drivers beyond that?

**Matt Scurlock**

Yes. We talked a bit about that on the last call Matt. So I'd say multi-quarter seems really continued in the deposit base period. Rob mentioned in the opening comments, we once again saw material in clients interest-bearing deposit balances. So non-broker about \$415 million in the quarter, 2% linked quarter. That's \$2.9 billion, 23% year-over-year.

So the growth in client deposits is driving a reduction in broker deposits, now down to historically low levels. And then we've got a lot of stability in commercial noninterest-bearing deposits, which have sat around this \$3.4 billion average the last few quarters.

So you're right that we did begin this quarter to selectively reduce some of our very highest cost deposits which happened to reside in mortgage finance, where we were unable to gain sufficient relevancy with that client or an adequate return.

That said, Matt, and you know this from having covered us for a long time, you will, this year, just like every year, start to see those mortgage finance deposits move seasonally higher in the third and fourth quarter.

Our anticipated quarterly averages are around \$5.8 billion, and that's primarily just related to industry volumes increases and then increases in that, of course, accounts building prior to late year tax remittances. So the deposit flows in the business are actually a bit more predictable than the loan balances.

So rate driven loan growth in warehouse is really going to be the key in the back end of the year to maintaining this 120% or so self-funding ratio that we referenced in our remarks, which obviously has an impact on the margin.

**Operator**

We now have Woody Lay with KBW.

**Wood Lay**

I wanted to -- wanted to start on the 2024 revenue guide. So the updated range implies a pretty large range over the back half of the year. Can you just go through the puts and the takes in coming in at the high end of the range versus the low end? It sounds like it comes down the loan growth in the back half of the year?

**Matt Scurlock**

I think that's a fair assessment. We have a lot of confidence in the growth in the fee income base. So we've got multi-quarter tracker at this point. I think it's fair to assume a similar growth rate for the duration of the year on treasury product fees. We're pleased with obviously results and momentum in the Investment Bank.

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So I think the revenue guide does hinge a bit on clients' appetite for bank credit I mean that is obviously a near-term guidance important. 2024 results are important, Woody, but the reality of whether Texas Capital can, over time, deliver returns in excess of our cost is much more dependent on us just onboarding clients at a pace consistent with plan.

We referenced in the comments that we're onboarding clients at a record pace right now, just the products and services that they're using do not require the balance sheet, which is why we've been as aggressive as we have been on the buyback trying to build tangible book value in ways other than just simply through net interest income.

But pulling it back to 2024, I really do. I think it's back into the year loan growth that will be the driver of where we come in within the revenue range.

**Rob Holmes**

I just want to point out, I think it's important that in '21, we said that loan growth was going to be a byproduct or an outcome. We weren't going to target loan growth.

We're targeting onboarding the right clients and the allocation of capital being very disciplined. And so we could get loan growth if we want a loan growth for loan growth, that's not consistent with the strategy, and that's what we said since day one. So we're onboarding great clients in every one of our markets and segments, and it will be up to them on when we have loan growth.

**Matt Scurlock**

We noted in the comments as well that pace of capital recycling has slowed. I mean we still exited close to \$250 million of mid-single-digit returns this quarter including \$50 million sale of a portion of a loan portfolio at par.

So we are still seeing some opportunities to pull capital out of low-return relationships where we just haven't been able to earn the necessary portion of the wallet to deem it a relevant and worthwhile use of capital and either return to shareholders via immediately accretive buybacks and/or use it to build a best-in-class tangible common equity ratios, which will over time be deployed into the capital needs that clients on the balance sheet you're going to have.

**Wood Lay**

All right. That's really helpful color there. Maybe lastly, shifting to credit. I know it was really good to see criticized loans flat quarter-over-quarter. Were there any material inflows and outflows there? Or were the ratings pretty consistent on a linked-quarter basis?

**Matt Scurlock**

Yes. We did observe stability both in the number of downgrades to special mention and the move of credits from special mention into substandard.

We also saw a pickup in velocity, both of pay downs, up aids and then certainly a payoffs including through the sale of certain accrual loans, which was also down nicely linked quarter and is relatively flat year-over-year.

I think another thing that causes just our approach to commercial real estate underwriting and monitoring, which relies really heavily on the more punitive of current or stress submarket level information to assess current cash flow and the ability of that cash flow to effectively meet debt service coverage thresholds.

We believe that's driven the appropriate grade migration cycle today. The other thing we've called out before has been commercial loans that are dependent on consumer discretionary income is an area that we are focused on.

We did see some structural stabilization in that business across those credits this quarter as operators starting to make some tactical adjustments to deliver improvements in their models and improvements in margin, but it's definitely going to be an area that we continue to watch.

So the last thing that I'd point out on credit is we've been -- our term would be aggressively conservative since Rob got here, to date, we've generally expressed that philosophy through timely changes in the risk ratings and then appropriately waiting in our view downside scenarios, both in underwriting and in the reserve calculation. So we said on that last call that our risk outlook hasn't changed. And although we're certainly happy with the credit trends, I think that sentiment still holds. We need additional clarity on either the forward economic outlook or a sustained reduction in criticized loans for us to adjust our full year provision as a percentage of total LHI.

**Operator**

(Operator Instructions) And we have the next questioner, Jon Arfstrom with RBC.

**Jon Arfstrom**

Can you guys talk a little bit -- can you talk a little bit more about some of the new client onboarding numbers, a little bit in the kind of core banking relationships in treasury. Can you just help us understand the momentum a little bit more?

**Rob Holmes**

Sure. So look, we had a record year in '22. We then had another record year in '23. And for the first half of this year, we're on pace to meet internal expectations and stack a third record year of client onboarding. I think more importantly, that it's broad across the entirety of the platform. So it's business banking, it's middle market banking, it's corporate banking. It's every subsegment within the corporate bank, so all the businesses are maturing well across the platform in C&I and even private wealth. And I think that obviously manifests itself in the clients are doing a lot of things with us through the increase in investment

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-- the record quarter investment banking fees, very diverse, granular broad fees compared to other really high quarters pipeline is really strong, of high-quality, high-quality clients, treasury management outperforming the industry on a consistent basis. Pipeline is strong momentum heading into the back half of the year.

I think half of that growth is coming from expansion of business with clients on the platform and half of that growth is coming through ramp with new clients coming to the platform, which, as you know can take anywhere from a year to 1.5 years to fully ramp but really good, high-quality, large treasury client.

So the receptivity of the strategy is really strong. And I just got to say again, the way to tangibly lever the excess capital in the balance sheet is in conversations with CEOs and boards of companies that want a solution like ours that needed to be safe and with a high-quality financial institution. So we're really encouraged by the receptivity. Its momentum is building, and I think it's manifested itself in the numbers.

**Jon Arfstrom**

So we're seeing it in your investment banking, we're seeing it in some of the treasury business but not yet in loan demand. And I understand your point of view on that, Rob. But Matt, you mentioned rates is maybe a sticking point. What are the -- some of the other sticking points you hear from potential borrowers. And could a couple of cuts spur a little bit better core loan demand for you?

**Rob Holmes**

Can I -- let me just grab that just real quick then Matt can answer it however he wants. But I think it's more being a CEO, myself, I think it's more sentiment than rate. I think rate certainly goes into it because the return has to be higher, obviously but the marginal investment is probably deferred.

We're in an election year. There's a lot going on. The economy is uncertain. I just think it's more sentiment. We can argue that. And I'm not -- we'll see who's right, but I think it's more sentiment than rate. Because if there's a good marginal product, it would hurdle. So I don't know. I think it's more sentiment. And so that will come with the -- as the economy starts to recover. Matt, you a different view?

**Jon Arfstrom**

No? Okay. Matt, just one quick one on capital markets. Do you feel like there's a lower band on your capital markets revenues? I'm looking at the fourth quarter of '23, that number compared to what you've done recently. I know your business has changed a lot in the last two quarters, but is there a new floor, a new lower band in your mind?

**Matt Scurlock**

We really like the trailing four quarter for now, Jon. I mean it's a 2-year old business.

So you see material improvements every single quarter and just confidence in go to market, our ability to successfully execute our external calls, which are enabling us to go win more business -- so it's just building. It's such a rapid clip, but is so new that I think trailing four quarters is the right way to go for now.

**Operator**

We currently have no questions registered. So I would like to hand back to Rob Holmes for some closing remarks.

**Rob Holmes**

Thanks for your interest in the firm, have a great quarter.

**Operator**

Thank you all for joining. That does conclude the Texas Capital Bancshares, Inc. Q2 2024 earnings call. You may now disconnect your lines. And please enjoy the rest of your day.