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Texas Capital Bancshares, Inc.

Q4 2024 Earnings Conference Call

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CORPORATE PARTICIPANTS

Rob Holmes – Chairman-Elect, *President, & Chief Executive Officer*

Matt Scurlock - *Chief Financial Officer*

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

Operator

Good morning all. And thank you for attending the Texas Capital Bancshares, Inc. Q4 2024 Earnings Conference Call. (Operator Instructions)

I would now like to pass the conference over to your host, Jocelyn Kukulka, Head of Investor Relations at TCBI. Thank you.

Jocelyn Kukulka

Good morning, and thank you for joining us for TCBI's Fourth 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 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](https://www.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 the call for Q&A.

And now I'll turn the call over to Rob for opening remarks.

Rob Holmes

Thank you for joining us today.

Our Firm materially progressed its transformation in 2024, increasingly translating our proven track record of strategic success into the financial outcomes aligned with our well communicated plans. Our differentiated Texas-based platform continues to provide an increasing number of clients with the widest possible range of products and services, customized to their needs. Multi-year client acquisition trends accelerated again this year - with nearly 40% more new significant clients onboarded in 2024 compared to 2023.

Contributions from across the platform enabled full year adjusted financial results highlighted by fee revenue growth of 30%, pre-provision net revenue growth of 9%, earnings per share growth of 15%, and tangible book value growth of 8%, finishing the year at the highest level in Firm history. On an adjusted basis, full year return on average assets of 0.74%, return on average common equity of 7%, pre-provision net revenue of \$369 million, fee income of \$211 million, and earnings per share of \$4.43 all reached record levels since the beginning of the transformation.

Importantly, we achieved these financial milestones while maintaining industry leading capital and liquidity, a proven competitive advantage, through market and rate cycles. Year-end Tangible Common Equity to Tangible Assets of 10.0% - ranking 1st amongst the largest banks in the country, with cash and securities of 25%, together allow for a consistent and proactive market facing posture that clients and prospects have come to trust. Our sustained market momentum and unwavering strategic focus position the firm to continue delivering on stated goals throughout 2025.

As the materially expanded offerings and capabilities of the firm mature, persistent progress in our fee income areas of focus continue to contribute meaningfully to improved financial results. Fees generated by Investment Banking, Treasury Solutions, and Private Wealth grew 36% or \$47 million this year to \$178 million, as our ability to support clients across the full breadth of their financial needs is increasingly represented by accelerating revenue contribution from non-interest income.

Investment Banking and Trading Income increased 47% year over year, led by elevated contribution from Syndications, Capital Markets, and Sales & Trading. We believe the proven success of these still maturing offerings continues to warrant additional investment in products, services, and talent, all of which are incorporated in the 2025 outlook that Matt will detail later in the call.

The deliberate evolution of our Treasury Solutions platform, while both time and resource-intensive, is consistently proving to be one of the most critical investments made during the transformation. Client adoption, across our now best-in-class cash management suite, continued this quarter with gross payment revenues increasing over 10% for the second consecutive year. Earning the right to become our client's core operating bank is resulting in both improved fee income and increased deposit balances, with Treasury Product fees growing 18% this year, non-interest-bearing deposits, excluding mortgage finance, increasing 4%, and total deposits expanding \$2.9bn, or 13% for the year.

The full rebuild of our wealth platform is now substantially complete, with a notably improved client experience and significantly expanded suite of private banking solutions providing the foundation for accelerating growth this year.

Moving into 2025 we remain steadfast in our commitment to delivering improved risk-adjusted returns consistent with firm-wide objectives, while maintaining financially resilient posture necessary to support our clients through all stages of their business or personal life, regardless of the market or rate cycle, resulting in achievement of our financial targets in the second half of this year.

Finally, I want to express my appreciation to all our employees, whose relentless commitment and daily efforts over the last four years in executing our strategy are the foundation of our Firm's current and future success.

Now I'll turn it over to Matt for the financials results.

Matt Scurlock

Thanks, Rob, and good morning.

Starting on slide 5 –

Year-over-year quarterly revenue increased 15% to \$283.7 million, as strong fee generation and realized structural efficiencies supported the second consecutive quarter of pre-provision net revenue at or near all-time highs.

For the full year, total adjusted revenue increased \$36 million or 3% as the modest rate driven decline in net interest income was more than offset by a record year of adjusted fee revenue, which increased 30% or \$49 million for the full year.

Quarterly total non-interest expense declined 9% compared to Q3 on an adjusted basis as the full impact of third quarter actions were realized alongside regular adjustments to compensation accruals. Full year adjusted non-interest expense increased less than 1% as we executed on our strategy of realizing operational enhancements associated with prior investments, while effectively positioning the firm for future scale.

Taken together, full year adjusted PPNR increased \$31 million or 9% to \$369 million, which as Rob mentioned, represents the high-water mark since the transformation began.

This quarter's provision expense of \$18 million resulted from charge-offs against previously identified problem credits, and moderate loan growth, with full year provision expense in line with guidance as a percentage of average LHI excluding mortgage finance at 40 bps.

Net income to common was \$67 million for the quarter or \$1.43 per share, with full year adjusted net income to common of \$208 million, an 11% increase over adjusted 2023 levels. Our continued financial progress coupled with disciplined capital management, contributed to a 15% increase in full year adjusted earnings per share.

Our balance sheet positioning remains exceptionally strong with period end cash balances of 10% of total assets and cash and securities of 25%, in line with year-end targeted ratios. Ending period gross LHI balances increased by approximately \$162 million, or 1% linked quarter, as C&I and real estate loan growth offset expected seasonal declines in Mortgage Finance loans.

Total deposits decreased by \$627 million or 2% during the quarter, driven predominantly by known seasonality from annual tax payments remitted out of mortgage finance non-interest bearing accounts. Excluding that anticipated and temporary reduction, deposits grew nearly \$1.0 billion, or 5%, with now well-established growth trends augmented by expected seasonal inflows from select commercial clients.

Total gross LHI excluding mortgage finance increased 5% for the full year, and 11% annualized linked quarter. Commercial loan balances expanded \$178 million or 6% annualized with broad contributions across areas of industry and geographic coverage. Real Estate loan growth of \$301 million was driven by increased client activity and slightly slower payoffs resulting from the material move higher in 10-yr US Treasury rates this quarter.

We continue to provide value in multiple ways for those clients to whom we chose to extend balance sheet, which manifests in sustainability of the deposit and fee income trends noted earlier.

Average mortgage finance loans increased 5% during the quarter driven by mortgage rate declines late in the 3rd quarter and modestly increased dwell times.

Given ongoing rate volatility, we remain cautious on our outlook going into 2025. Estimates from professional forecasters suggest total market originations to increase by mid-teens percent in 2025, compared to our internal estimates of approximately 10% should the rate outlook remain intact.

Full year deposit growth of \$2.9 billion or 13% was driven predominantly by our continued ability to effectively leverage growth in core operating relationships to serve the entirety of our clients' cash management needs. Q4 marked the second consecutive quarter of growth in non-interest bearing deposits, excluding mortgage finance, which increased 4%, or \$127 million year over year, finishing at the highest levels since the 3rd quarter of 2023. When combined with client interest bearing deposit growth of \$943 million over the same period, our sustained success in attracting high-quality funding associated with our core offerings is enabling maintenance of decade low brokered deposit levels and continued select reduction of higher cost deposits where we are unable to earn an adequate return on the aggregate relationship.

Period end mortgage finance non-interest bearing deposits decreased \$1.6 billion quarter-over quarter as escrow balances related to tax payments are remitted in late November and run through January, before beginning to predictability rebuild over the course of the year. For the quarter, average mortgage finance deposits were 107% of average mortgage finance loans, down modestly from the prior quarter and in line with our previous guidance of 110%.

Ending period non-interest bearing deposits excluding mortgage finance were 14% of total deposits, and our expectation is that this percentage remains relatively stable in the near-term.

Our modeled earnings at risk were relatively flat quarter over quarter, with current and prospective balance sheet positioning continuing to reflect a business model that is intentionally more resilient to changes in interest rates.

Given both the volume of maturing swaps and currently more conducive interest rate curve, we do anticipate future interest rate derivative or securities actions in 2025, augmenting potential rates fall earnings generation at materially better terms than available during our deliberate pause through the mid-part of last year.

Predictable quarterly decline in NIM and net interest income of 23 bps, and \$10.5 million respectively was primarily related to seasonal mortgage warehouse factors as well as timing differences associated with the impact of lower interest rates on our SOFR-weighted loan portfolio relative to fed funds driven realized benefits of rate reductions on overall deposit costs which will be more fully reflected in January financials.

Adjusted non-interest expense decreased \$17.9 million to \$172.2 million as the full quarter expense benefit of the strategic actions taken in the third quarter were realized, along with regular adjustments to compensation accruals. As a reminder, first quarter non-interest expense will be elevated due to certain seasonal expenses related to payroll and compensation expense.

The total allowance for credit loss including off balance sheet reserves increased \$5.9 million on a linked quarter basis to \$325 million, up \$29 million year-over-year, which when excluding Mortgage Finance is 1.87% of total LHI, a high since the adoption of CECL in 2020.

Quarter over quarter criticized loans declined \$184 million or 20% driven by both more upgrades, and fewer downgrades, across commercial and real estate credits than in any quarter since 2022. Criticized loans as a percentage of LHI exited the year at 3.18%, down 45 basis points or \$24 million relative to the fourth quarter of last year.

Despite these notable improvements, we remain highly focused on proactively managing credit risk across both a range of macroeconomic and portfolio-specific scenarios, including those associated with the recent back-up in interest rates.

Net charge-offs of \$12.1 million, or 22bps of average LHI, was driven predominantly by the partial resolution of previously identified problem credits.

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 11.38%, a 19bps increase from prior quarter as capital generation outpaced increased risk weighted assets associated with quarterly loan growth.

We continue to manage capital in a proactive and analytically rigorous manner, with near-term capital availability supported by the implementation of enhanced credit structures for a portion of our mortgage warehouse facilities which could result in a subset of that loan portfolio being eligible for reduced risk weighting.

The Firm ended fourth quarter with tangible common equity to tangible assets of 10.0%, which continues to be ranked first amongst the largest banks in the country, and experienced an increase in tangible book value per share of 8% year over year to \$66.32, a record level for the firm.

Turning to the full-year outlook which incorporates continued realized momentum associated with multi-year investments across the platform. Total revenue growth of high single to low double digit percent contemplates another year of industry-leading client adoption and associated growth in our fee income areas of focus, with full-year targeted 2025 total non-interest revenue reaching \$270 million.

Anticipated non-interest expense growth of high single digits, is higher than previously established guidance, and accounts for increased salaries and benefits related spend associated with the improved fee income outlook.

After the multi-year process of effectively building the reserve to record levels reflecting our consistently conservative posture, limited remaining legacy problem credits and recent migration trends support our full year provision outlook of 30 to 35 bps of average LHI, excluding Mortgage Finance, which more closely tracks with trailing charge-off rates while preserving industry leading coverage levels.

Taken together, this outlook suggests another year of meaningful earnings growth and achievement of quarterly 1.1% ROAA in the second half of the year.

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

Operator

(Operator Instructions) We have the first question from Benjamin Gerlinger Citi.

Benjamin Gerlinger

I was wondering if we could kind of unpack the expense guidance a little bit.

I get that you're implying stronger fee income, specifically the investment banking just typically has a higher expense base. And I know you're not going to give '26 guidance, but is there kind of a plateauing effect? Or should we kind of assume kind of a similar correlation, is stronger fee income higher expense base kind of going forward? I'm just trying to understand the relative change on the expense front.

Matt Scurlock

Yes, happy to give you some detail on that, Ben.

The midpoint of that high single-digit guide puts you right around \$800 million or so for the year, which is \$30 million higher than the \$770 million that we noted on the third quarter call. That increase is almost entirely driven by additional frontline talent, primarily in investment banking and treasury solutions, which we started adding in late '24 and would anticipate to grow through the first half of the year. You'll note that the fee income guidance was also increased by a similar amount to \$270 million from the \$240 million that we noted in October.

As previously discussed, platform maturity is driving significantly tighter earn-backs on incremental investment.

Based on the timing of those new frontline ads, Ben, we'd expect the fees to ramp over the duration of the year, which is consistent with our outlook of delivering a 1.10% [ROAA] in the back half of '25. And then, to your point, given ability to translate investments into high-quality revenue growth, we would expect continued pick up in '26. It should be nicely accretive to the full return profile.

And then maybe one other comment on expenses. As you work your way from the fourth quarter into the first quarter, do want to call out the first quarter noninterest expense always includes seasonal adjustments associated with comp and benefits. That number should be between about \$15 million to \$17 million this year, up slightly year-over-year. We have a larger portion of the employee base who receives variable comp.

Excluding that amount, the impact of the new adds late in the year through the first quarter should push salaries and benefits back up to about \$120 [million] or so exiting Q1, given both annual incentive accrual resets as well as the new talent being onboarded to drive additional fee income.

Benjamin Gerlinger

Got you. That's helpful. And then I know previously when you're talking investment banking or just general fee income upside, and some of it was predicated on lower rates, you're going to get a different mix of investment banking fees.

With rates not coming in as much as previously expected, do you think that transition still takes place? Or just trying to get a sense of the fee cadence and where that business specifically is?

Matt Scurlock

Yes. Ben, I think at some point, we will be big enough to be more correlated to the macro. At this point, we're pretty confident in our ability to generate fee income, the growth this year was significant across all three areas of focus. Each one of them grew by more than 10%.

We did over 30 capital markets transactions this year. We're just outside the top 10 for middle market book runners on syndicated facilities, north of \$100 billion of notional trades. There's significant momentum in the investment bank. Rob noted in his comments that we'd anticipate another year of record new client growth. As those clients land on the platform, we're increasingly able to solve a wide range of potential financing issues for them, which is likely to result in continued upward trajectory on noninterest income.

Operator

Your next question comes from Peter Winter with D.A. Davidson.

Peter Winter

I wanted to also ask about the guidance. Just I saw the increase of the total revenue growth to high single digit to low double digit versus prior guidance of high single digit.

So the question is, although it's strong, I'm just surprised you didn't change the lower end of the guidance given the stronger outlook for fee income. And you talked about last quarter that with less rate cuts in the forward curve, that would lead to upside as well to the forecast.

Matt Scurlock

Thanks for the question, Peter.

Obviously a lot of uncertainty in the rate outlook. The path to the higher end of the revenue guide, we gave you a 60% interest-bearing deposit beta by the mid part of the year. Expect with a 7% 30-year fixed rate mortgage, you're going to have a \$1.9 trillion market, which should drive about a 10% increase in average warehouse balances for us to about \$5 billion full year average \$270 million of fees.

If you're able to deliver between, call it, mid-to-high single-digit LHI growth, that could push it to the higher end of the revenue guide. Rob said since he been here and at this point, is fully indoctrinated through the culture, the intent is not to grow loans. The intent is to add high-quality clients and help them solve problems. To the extent that, that results in additional loan growth, that obviously be accretive to the revenue guide.

Peter Winter

Got it. And then, this quarter, you had realized a 32% deposit beta. I'm just wondering if the Fed is done raising rates. Is there still room to lower deposit costs? And where do you think the beta can go to?

Matt Scurlock

Yes. We think it could get to 60%.

So 32% is what showed up in the quarterly financials, but through year-end, Peter, we pushed pricing down to closer to a 50% rate. So we had about \$550 million of CDs mature in the quarter. They rolled off at a rate of about 515 basis points.

Of those [\$460 million] or so came back on at a rate closer to 440 basis points. Those actions reduced interest-bearing deposit costs of [4.15%] in December relative to [4.63%] in September. That's not a spot number, that's a full month number.

We got about \$820 million of CDs that are going to mature in Q1 at an average rate of 5% relative to posted rates of about 4.4%, and we'll look to replace or reprice those based on a variety of factors related to balance sheet positioning. So it's with those components that we think we get to the [60] interest-bearing beta by midyear.

Peter Winter

And that's even without any rate cuts?

Matt Scurlock

Yes.

Operator

We now have a question from Jared Shaw with Barclays Capital.

Jared Shaw

Maybe can you spend a little bit of time on margin and how are we should thinking about that? And then in light of your [110] ROAA goal at the second half of the year?

Matt Scurlock

Yes. Starting with Q1, it's again important to just note that there's still some remaining seasonality in the balance sheet. So with mortgage finance declines, you are likely to see a bit of a pullback in NII in Q1. The rate reduction in November and December has not yet flowed through to mortgage finance yields. There's a bit of a delay on that. So that should support actual expansion of margin in Q1 north of 3% back to levels that we saw in Q1 of last year.

And then, I think, Jared, maybe better than trying to articulate a forward margin would just be to think through the guidance that we just provided on kind of move to the higher end of that revenue growth. I think you're just going to be sustainably above 3% based on that outlook, but have a variety of different paths to deliver the revenue targets.

Jared Shaw

Okay. All right. And then looking at capital and the buyback announcement, should we be thinking that buybacks are a bigger part of the plan going forward? Or is this more of just an administrative renewal of the prior buyback?

Matt Scurlock

We'll use the same approach that we've used since Rob's arrival, to be honest, Jared. So we said before, we're trying to build business model and balance sheet for all cycles, which includes inevitable increase at some point in client appetite for bank debt. We've been quite adamant that having especially high tangible common equity levels is what we believe to be a competitive advantage.

We also noted in the remarks the potential for increased regulatory capital from enhanced credit structures for a portion of the mortgage warehouse facilities. That's not enabled through use of an expensive derivative, but instead adjustments to facility structure, which reflects what clients are used to with large bank counterparties.

We did migrate a few clients into that structure prior to year-end and have potential for up to 10% of warehouse balances to qualify for a reduced risk weighting by end of Q1. Too early to get into full year impacts on that, but we'll certainly keep you up to date as it moves along. Obviously would potentially create some excess regulatory capital.

Jared Shaw

Okay. And then just finally for me, I guess, what would be the sensitivity of that -- of the fee income guide if we got one or 0 rate cuts from the ECR impact to that?

Matt Scurlock

We feel pretty confident in the [\$270 million] regardless of the rate outlook. I mean our ability to onboard Gross PxV I think is peer leading. We grew at 11% this year, 18% growth in treasury product fees. That's not an initiative that was spun up post Silicon Valley Bank. That's a core component of how we want to build the franchise.

I anticipate continued growth in core operating deposits this year alongside continued growth in treasury product fees. And again, feel pretty good about the [\$270 million] regardless of economic outlook. Rob, do you have anything you want to add on that?

Rob Holmes

I think you articulated it well.

Operator

Your next question comes from Anthony Elian with JPMorgan.

Anthony Elian

Just a follow-up on the outlook. Last quarter, you guided 2025 NII to increase high single digits. But if I do the math right, your revenue guide implies NII increasing about mid-single digits now. Matt, just what changed in the implied lowered NII guide? Is it just a higher for longer rate outlook?

Matt Scurlock

Yes. I'm not sure that the NII guide has changed a whole lot.

So if you get mid-to-high single-digit loan growth, which is just going to be an outcome of the products and services that clients choose to use on the platform, you could settle into the higher end of that revenue guide.

Anthony Elian

Okay. So even using the -- Go ahead.

Matt Scurlock

Alongside \$5 billion of average warehouse, 60% interest-bearing deposit beta in the midyear, \$270 million of fees.

Anthony Elian

Okay. And then my follow-up, the additional frontline talent you plan to make this year, is this in segments and products you are already in? Or are there still areas you are maybe considering to enter as well?

Rob Holmes

It is furthering the skill set and talent base across all of our different industry verticals and segments in the investment bank as well as treasury services.

So no real new introduction of new products and services other than what we've recently introduced such as public finance, but none for the quarter going forward.

Operator

[Technical difficulties]

Operator

This concludes the question-and-answer session here. I would like to hand it back to Rob Holmes for some closing remarks.

Rob Holmes

I just want to thank everybody for your interest in joining the call today, and we look forward to next quarter. Thank you.
