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COMMERCIAL BANKING

Texas Capital CEO vows not to cut corners in the bank's turnaround

By Jordan Stutts | September 6, 2023

Vanja Savic/Photo by Vanja Savic

"We flipped to positive operating leverage in the third quarter of 2022 and have remained positive for four quarters," said Texas Capital CEO Rob Holmes. "Eventually, this will reflect in the financials. It's just now starting to."

Two years into an attempted turnaround at Texas Capital Bank, Rob Holmes, chief executive of the Dallas-based commercial lender, says he's committed to steady growth and is telling investors to remain patient.

Holmes took leadership of the $40 billion-asset bank in January 2021 following a failed merger and the resignation of former CEO Keith Cargill the previous year. Several months after joining, Holmes announced an overhaul of Texas Capital's strategy that he now says will soon pay off.

Over the last two years, the bank has sought to expand corporate, treasury and investment banking services to both new clients and existing ones who have previously only borrowed from the lender.

The bank has also raised capital, while investing in talent and technology to support its new initiatives. At the end of the second quarter, Texas Capital had $2.8 billion of liquidity and a 12.2% capital ratio.

"We're recycling capital, growing businesses other than loans and being aggressively financially conservative," Holmes said in a recent interview.

The bank's return on common equity was 9.17% in the second quarter, which was up from 4.35% during the same period last year.

Since Holmes took over as CEO, Texas Capital's stock price has fallen by 5% to of $61.60. The KBW Nasdaq Bank Index is down by 24% over the same period.

Some investors are pressing for better returns, which could be generated by renewing stock repurchases. For now, buybacks remain off the table, Holmes said.

The effects of Texas Capital's new strategy may not be "fully encapsulated" in the bank's current valuation, said Stephen Scouten, an analyst at Piper Sandler. He said that some investors may be getting impatient due to the decision not to buy back shares.

Texas Capital is in the "prove-it stage" of its attempted rebound, and paying investors excess cash through share buybacks "might not be the best for building a franchise and maximizing the value of capital," Scouten said.

"Balance sheet positioning has led to an improvement in valuation," Scouten said. "Now they've got to execute what they've built."

During Holmes' interview with American Banker, he said that he's convinced Texas Capital is headed in the right direction. Profit generation is just now starting to improve, he said, after the bank has generated positive operating leverage for four successive quarters.

"It's going to reflect itself in the financials," Holmes said. "It's just starting to."

The interview, which has been edited and condensed, is below.

What was Texas Capital's first priority when you became CEO?

Within the first three months, we raised capital by offering redemption of perpetual preferred stock, completed a subordinated debt deal and a securitization, and we exited a correspondent lending business. These four moves improved the bank's capital by about 270 basis points, which is a lot for a $40 billion balance sheet.

We also needed a different level of talent to build a full-service financial services firm, and have hired a group of people who have demonstrated capacity and aptitude to thrive in much more complex platforms. Each is a great cultural fit and has the same shared vision.

Does Texas Capital's valuation reflect the turnaround effort you began as CEO?

I don't think the current value of Texas Capital is equal to or represents the potential of this business, the talent we've aggregated and the clients we're onboarding.

But I do think it's fair. We have to continue doing what we've already done. We've completed our first co-managed equity and debt deals, but haven't done it 100 times.

When we announced this strategy, we projected negative operating leverage possibly through the first quarter of this year. We flipped to positive operating leverage in the third quarter of 2022 and have remained positive for four quarters.

We don't plan on going back. Eventually, this will reflect in the financials. It's just now starting to.

Why did you commit to an overhaul when you took over as CEO?

There was no choice but to do an overhaul. We didn't do this based on hubris or arrogance or opportunity. Redoing a financial services firm places the burden of having to do it.

I announced our strategy in September 2021, saying: "Here's what we've done, and here's what we're going to do." We've done every single thing we said so far — on time, on budget and within capability. And frankly, it's encouraging to me because, while I was confident that we could succeed, it certainly came with a lot of risk.

What was the risk in Texas Capital's transformation?

The risk was doing everything at once, instead of just a couple things. We did everything at once because our business needed to be connected. The first priority was to stabilize the bank.

Previously, there was no strategy or capital discipline, no industry expertise. It was loosely affiliated business efforts. There wasn't a credit risk problem. The bank was just built wrong. The infrastructure was wrong. It did not have specialization and lacked ancillary products and services to remain relevant to clients.

How has the bank transformed?

Before transformation, the majority of our clients were loan-only, and we weren't relevant to them beyond that. A loan-only bank can't thrive. There are more ways to create value by finding ways to be relevant to clients, versus selling a commodity, which is capital.

We rebuilt our entire treasury services function to include new payments and merchants platforms, a new corporate card offering and a new lockbox service. Where we are now, we don't want to rebuild any more core banking platforms. We want to own our client's journey.

For example, people don't like to change banks, because it's hard. So we developed a digital client onboarding platform that now onboards 90% of treasury management clients. By the end of this quarter, the platform will account for 80% of straight-through processing of treasury management products and services. That's a superior client journey we want to own.

The platform is currently offered in private wealth and will soon move into sales and trading accounts and across the entire business.

How are you balancing reorganization with shareholder expectations for returns?

Some shareholders have been upset that we weren't maximizing returns. And we could spend less on tech, take less provisions, not hire as many people, invest in products and services or carry less capital. The fact is, I'm not interested in returns.

I'm interested in growing how you tell that a bank is healthy — tangible book value. We may not maximize returns, but the risk-adjusted return for shareholders will be good. We're recycling capital, growing businesses other than loans and being aggressively financially conservative.

Holding too much capital is financially conservative. The bank has a capital ratio just under 12.5%, compared to other banks that were under 8% and are now trying to reach 10%.

We wanted fee income to generate between 15% and 20% of total revenue. It hit 15% last quarter. High-quality fees from high-quality clients is financially conservative.