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Enterprise Financial Services Corp NasdaqGS:EFSC

Earnings Call

Thursday, October 22, 2026 4:00 PM GMT

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Presentation

Operator

Hello, everyone. Thank you for joining us, and welcome to the Enterprise Financial Services Corp Third Quarter 2026 Earnings Conference Call. [Operator Instructions] I will now hand the conference over to Jim Lally, President and CEO. Please go ahead.

James Brian Lally
President, CEO & Director

Thank you all very much for joining us this morning, and welcome to our 2026 third quarter earnings call. Joining me this morning is Keene Turner, EFSC's Chief Financial Officer and Chief Operating Officer; and Doug Bauche, Chief Banking Officer of Enterprise Bank & Trust.

Before we begin, I'd like to remind everybody on the call that a copy of the release and accompanying presentation can be found on our website. The presentation and earnings release were furnished on SEC Form 8-K yesterday. Please refer to Slide 2 of the presentation titled Forward-Looking Statements and our most recent 10-K for reasons why actual results may vary from any forward-looking statements that we make today.

Our financial scorecard begins on Slide 3. For the quarter, we earned $42 million or $1.14 per diluted share. This compared to the $1.09 that we earned in the second quarter of this year and $1.19 that we earned during the third quarter of 2025. This level of performance produced a return on average assets of 95 basis points and a pre-provision ROAA of 1.67%. While our pre-provision earnings improved from the linked quarter, a larger-than-expected provision expense impacted the operating results for the period.

Net interest income expanded by $5.9 million to $175 million, and net interest margin remained stable at 4.30% when compared to the linked quarter. Higher loan and investment balances, coupled with a steeper yield curve and relatively stable deposit costs contributed to these results. Given the increasingly competitive environment that we find ourselves in, I am pleased with how we were able to grow net interest income through a combination of relationship-driven loan and deposit growth, coupled with net interest margin defense.

Our well-positioned balance sheet continues to be a strength for our company as it continues to provide great flexibility with respect to capital planning. Capital levels at quarter end moved into our target range as our tangible common equity to tangible assets ratio came in at 8.13%. Return on tangible common equity for the quarter was 10.74%, a slight improvement to the 10.39% that we reported in the linked quarter. Capital management actions in the quarter included the repurchase of over 525,000 shares totaling $34 million and increasing our quarterly dividend by $0.01 to $0.36 per common share for the fourth quarter.

Turning to Slide 4, you will see that the momentum in loan and deposit growth continued in the third quarter. Building off solid growth in the second quarter, loan balances grew by $452 million in the quarter. Doug will get into the specifics of where we saw this growth and other nuances related to our markets and businesses, but I appreciate the diversity of where we experienced this growth. Our pipelines would suggest that we'll continue to see mid- to high single-digit growth for the remainder of 2026 with this normalizing back to the mid-single-digit growth for the first part of 2027.

Our diversified deposit base continues to be a differentiator for us. Total deposits exceeded $15 billion at quarter end, with growth in the quarter coming in at $624 million. As expected, our geographic markets began to see the normal second half of the year growth, producing 80% of this quarter's production. DDA to total deposits came in at 33%, and our loan-to-deposit ratio was 82%. Our teams have worked extremely hard for many years to garner full relationships, the results of which are the combination of larger, more sophisticated commercial relationships, granular business banking and consumer accounts and the expanding national deposit verticals.

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Our credit statistics remained elevated in the quarter. While we continue to make progress on the Southern California OREO property that we've discussed for over a year, an improvement in loan credit quality is a top priority. The $18 million of provision expense for the quarter was largely driven by loan growth and $11 million in net charge-offs. During our second quarter call, we discussed that our expectation for the remainder of 2026 was that our charge-off level will return to a 15 to 20 basis point annual run rate. This obviously did not occur as our results for the third quarter were higher than this coming in at 36 basis points annualized.

During the quarter, we experienced a $7 million charge related to a loan to a private club in the St. Louis market that abruptly ceased operations in August. We've also set aside reserves for the remaining balance of the loan. The other larger charge in the quarter represented the write-down of a flag hotel in Southern California that we took into OREO in the quarter. This totaled approximately $2.6 million. Looking closer at our nonperforming assets, $150 million of the $183 million net of government guarantees are real estate secured. Because these properties have mostly undergone recent appraisals, we have strong tangible collateral backing these positions.

Turning to Slide 5, you will see our priorities for the remainder of the year. While credit is not where it needs to be, we have a structured path to get it back to historical levels over the next few quarters. I have great confidence that we'll continue to expand pre-provision returns, and you can also see that the normalization of credit is slightly above industry expectations produces a significant improvement to the return levels that we've reported over the last 2 quarters.

Specifically, a normalization of credit expense and tax credit income would have added 10 to 15 basis points to our PPNR ROAA this quarter. Along the way, we will continue our automation journey using the existing technology framework that we've invested in, focusing on integrating manual procedures into automated workflow processes. We are already seeing strong adoption of various automation tools throughout our company, the benefits of which will produce better overall associate and client experience. In my most recent travels and discussions with clients throughout our footprint, it's encouraging to hear the continued optimism that they have despite some headwinds related to higher interest rates, increased energy costs and other inflationary factors that are present in our economy.

Companies in and around the data center ecosystem, power generation, defense and aerospace continue to have a clear and robust run ahead of them. We're also still seeing pockets of industrial and retail demand in faster-growing markets throughout our footprint. Competition for new clients is fierce, but I'm confident that the value-added relationship model that has been our hallmark for our company since our founding will continue to be a differentiator for us in garnering new relationships while defending our current book.

Our third quarter produced exceptional loan and deposit growth amid disciplined pricing and controlled expenses. Overall earnings were compressed due to elevated credit costs that will reduce as our credit statistics normalize over the next few quarters. The earnings power that exists in this company is strong, and I'm confident that we'll see improved results in 2027 and beyond.

With that, I would like to turn the call over to Doug Bauche. Doug?

Douglas N. Bauche
Senior EVP & Chief Banking Officer

Thank you, Jim, and good morning, everyone. Our banking teams performed well in the third quarter, delivering robust organic loan and deposit growth while maintaining disciplined pricing and underwriting standards across all of our geographic markets and specialty verticals. Building on the positive momentum we discussed in the prior quarter, we continue to successfully win high-quality business clients, expand existing credit and treasury management relationships and leverage our differentiated platform to drive sustainable profitability.

Turning to Slide 6. Total loans reached $12.3 billion at quarter end, representing a net quarterly expansion of $453 million or nearly 4% sequentially. Gross loan originations and advances were particularly strong during the quarter at $1.3 billion, outpacing repayment activity of $800 million. Over the last 12 months,

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total loan outstandings increased $762 million or 6.6%, largely driven by expansion of our C&I, CRE owner-occupied CRE investor-owned and life insurance premium finance portfolios.

Core commercial and industrial lending expanded by $79 million quarter-over-quarter to $2.7 billion. New C&I production was broad-based, spanning equipment financing and working capital lines to mid-market, privately held manufacturing, wholesale distribution and specialized commercial service providers across our geographic markets. On a trailing 12-month basis, C&I balances have expanded by $386 million or 17%. Our CRE investor-owned real estate portfolio increased by $138 million during the quarter to just over $3 billion. Similar to what we highlighted in Q2, new investor CRE fundings were centered on well-capitalized experienced developers and sponsor groups.

Projects funded in Q3 included industrial centers, multi-tenant neighborhood retail complexes and stabilized logistics assets across our key growth markets, including Phoenix, Dallas, Kansas City, San Diego and Southern Nevada. Our life insurance premium finance business delivered $100 million in net quarterly growth and 8% sequential expansion, bringing the portfolio's balance to $1.4 billion. We continue to capitalize on our strong national brand recognition, deep partnerships and high net worth client acquisition network in this low-risk, highly collateralized asset class.

Within our specialized business channels, SBA 7(a) owner-occupied real estate financing remained stable, ending the quarter at $1.25 billion, maintaining our position as a leading SBA originator nationally. Sponsor finance balances held steady at $714 million, while tax credit lending increased slightly to $750 million due to modest advances on new markets and low-income housing tax credit projects. Overall, line of credit utilization remained steady and controlled at 46.6% compared to 46.7% in the linked quarter. Slide 7 illustrates the continued balance and diversification of our portfolio across geographic markets and specialty lending divisions. Our primary geographic community banking regions in the Midwest, Southwest and West represent $7.9 billion or roughly 64% of total loans, while our diverse national lending verticals account for $4.4 billion or 36% of the total book.

Moving to deposits on Slide 8 and 9. Total deposits increased by $624 million or 4.3% in the linked quarter and by $1.5 billion or 11.5% over the last 12 months, climbing to $15.1 billion. Consistent with our historic seasonal patterns, deposit inflows accelerated during Q3 across both our community banking footprint and our specialized channels, fully recovering the typical tax and distribution-related outflows experienced earlier in the year.

Deposits from our specialty verticals contributed 20% or $123 million of quarterly growth with our core community banking markets driving 80% or $500 million of growth in the quarter. The overall deposit mix remains high quality, sticky and relationship-driven. Noninterest-bearing demand accounts totaled $5 billion, representing a consistent 33% of total bank deposits. Slide 10 provides additional detail on our differentiated deposit verticals, including property management, community associations and legal and escrow services, which represented a combined $4.2 billion or 28% of total bank deposits at quarter end. Our Property Management division includes $1.8 billion of deposits, roughly 43% of total vertical deposits. Our recently announced partnership and investment in technology will enhance system integration and automation and improve efficiency and overall experience for our valued property management firm clients across the country.

Through disciplined pricing and earnings credit optimization, the average cost of funds across these 3 deposit verticals improved by 17 basis points to 2.52% from 2.69% in the linked quarter. Finally, Slide 11 details our core funding composition. Core commercial deposits account for $5.4 billion of our total deposit base, demonstrating the operational integration of these corporate clients, approximately 80% utilize our treasury management platform and 60% maintain an active lending relationship with us. This commercial base is complemented by $4.6 billion in highly granular business banking and consumer deposits, contributing average account sizes of $79,000 and $23,000 with attractive weighted average funding cost of 1.17% and 1.46%, respectively.

Through proactive pricing discipline across all client channels, our total cost of deposits remained well controlled at 1.54% for the third quarter. In summary, it was a very solid and well-balanced growth quarter on both sides of the balance sheet, and our current pipeline suggests this momentum should continue well into the next quarter. Thank you for your time.

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And with that, I'll turn the call over to Keene Turner for his comments.

Keene S. Turner
Senior EVP, CFO & COO

Thanks, Doug, and good morning, everyone. Turning to Slide 12. We reported earnings per share of $1.14 in the third quarter on net income of $42 million. Excluding certain nonrecurring items, earnings per share on an adjusted basis was $1.17 compared to $1.13 in the linked quarter. Pre-provision earnings totaled $75 million, a $6 million increase from the linked quarter, primarily due to higher net interest income. On the cost side, noninterest expense decreased compared to the second quarter, primarily driven by a reduction in accrued bonus compensation and efforts to improve pricing in certain deposit verticals.

The linked quarter increase in the provision for credit losses was primarily due to the net charge-offs on 2 relationships Jim detailed, along with reserves for the increase in nonperforming loans and $453 million of loan growth in the period. Turning to Slide 13 with more details to follow on 14. Net interest income in the third quarter was $175 million, an increase of $6 million or 14% annualized from the second quarter, resulting mainly from higher average loan balances and enhanced investment returns resulting from the investment portfolio restructure in the prior quarter.

The total cost of deposits was managed at a stable level, but balanced growth combined with the first full quarter of the $175 million sub-debt issuance increased interest expense. Interest income increased $9 million in the quarter, including $7 million on increased loan balances and $2 million from cash and investment securities. Interest expense increased $3 million compared to the linked quarter, including an increase of $2 million in deposit expense and $2 million in additional expense related to our most recent sub debt issuance. These were partially offset by reduced expense on short-term FHLB advances and retired term debt at the holding company.

Our net interest margin for the third quarter was stable from the linked period at 4.30%. Earning asset yields expanded 2 basis points, mainly due to the securities repositioning trade and an improved earning asset mix. The rate on loans booked in the quarter was 6.61%, and the average tax equivalent purchase yield on investments was 4.74%, both of which improved the yield on those assets. The cost of interest-bearing liabilities increased 3 basis points, mainly attributable to the additional sub debt, along with a 2 basis point increase in the cost of interest-bearing deposits.

Net interest income remains modestly asset sensitive under parallel interest rate shock simulations with each 0.25 point change in rates affecting net interest income $1 million to $2 million per quarter or a couple of basis points in net interest margin. Recent steepening of the yield curve should reinforce beneficial pricing on loans and investment purchases and the September federal funds rate increase should prove accretive to net interest income. Including deposit-related noninterest expense in this analysis, we model that we are effectively neutral. However, for the most recent increase, we have largely held noncontractual rates stable in order to regain some profitability in those businesses.

We also added $150 million in additional loan hedges during the third quarter to further stabilize our interest rate risk profile. With the last Fed increase, we anticipate margin to move a couple of basis points higher in the fourth quarter. Disciplined pricing and cost of funds management will continue to drive expansion of net interest income. While changes in the yield curve have been favorable, spreads have compressed as the market adjusts. Deposit balances should reflect normal seasonal growth. Slide 15 reflects our credit trends.

Net charge-offs totaled $11 million in the third quarter, down from $13.6 million in the linked quarter. The charge-offs primarily related to a C&I credit in the St. Louis region and a California hotel that we took possession of in the quarter. The ratio of nonperforming assets to total assets increased by 11 basis points compared to the linked quarter, primarily due to the addition of $18 million in agricultural loans, an $8 million commercial real estate relationship and a $4 million C&I relationship. Net charge-offs totaled 36 basis points of average loans compared to 46 basis points for the second quarter of 2026.

The provision for credit losses was $18.1 million compared to $14.2 million in the linked quarter. The provision was attributable to net charge-offs, the increase in nonperforming loans and loan growth. Slide

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16 shows the allowance for credit losses. The ratio of allowance to total loans was stable with the linked quarter at 1.17%. When adjusting for government-guaranteed loans, the ratio increases to 1.27% of total loans.

On Slide 17, third quarter noninterest income was $13 million, relatively stable with the linked quarter. A notable item includes lower tax credit income from a decline in projects carried at fair value. Turning to Slide 18. Third quarter noninterest expense of $115 million was approximately $1 million lower than the linked quarter. Employee compensation and benefits declined by $2.5 million, largely due to lower short-term incentive expense in the quarter. In addition, we have begun refocusing and streamlining operations, which are anticipated to incrementally improve the prospective expense run rate and efficiency ratio.

Deposit costs decreased $0.4 million quarter-over-quarter as we actively manage this line item but could face rate pressure in the near term. Other expenses increased by $1.8 million from the linked quarter, primarily from operating expenses related to OREO properties. The core efficiency was 58.9% for the quarter compared to 61.1% in the linked quarter, largely due to the expansion of net interest income. Our capital metrics are shown on Slide 19. Compared to the linked quarter, tangible book value per share decreased to $39.45 from $42.30, and our tangible common equity ratio decreased to 8.13% from 9.04%. The decrease in tangible common equity was primarily due to a reduction in the fair value of securities and cash flow hedges that was caused by the change in interest rates.

Our capital management actions in the quarter also included the repurchase of 526,000 shares of common stock for approximately $34 million and an increase to the quarterly dividend of $0.01 per share. Year-to-date, we returned approximately $122 million to shareholders through common stock repurchases and common stock dividends. Our operating results drove a 1% return on average assets and an 11% return on average tangible common equity. Our return metrics this year have been impacted by elevated charge-offs and nonperforming asset levels. As Jim discussed, we are highly focused on improving asset quality. The opportunity for earnings improvement from credit losses returning to historical norms and the redeployment of nonperforming assets into earning assets is significant. We have also taken steps to optimize certain parts of our business that will further benefit our earnings run rate. The combination of these items on year-to-date results puts our return on average assets in line with both the prior year and our expectations. While there is still work to do, we firmly believe that the core business fundamentals remain strong. I appreciate your time today, and we will now open the floor to answer analyst questions.

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Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Jeff Rulis with D.A. Davidson.

Jeffrey Allen Rulis
D.A. Davidson & Co., Research Division

Jim and Keene, you guys you talked about the expectation for credit to normalize in the next few quarters. Maybe a little more granular, starting with the California OREO. Any update on those have been contracted for sale. Just wanted to get an update on those.

James Brian Lally
President, CEO & Director

Yes, sure. So as we sit here today, we're still working through a few things in the courts. We had some really positive progress in the quarter. You mentioned those properties being under contract. They represent well over half of the value related to those properties with the other ones with great interest and just waiting for a few things to clear up before those go under full PSAs. But progress was made -- really good progress is made in the quarter, and we would think that further progress will be made later this quarter and into the first part of 2027.

Jeffrey Allen Rulis
D.A. Davidson & Co., Research Division

So if that's ongoing, I guess, just kind of narrowing the next couple of quarters is kind of vague, understanding that's going through the courts and otherwise. I guess, absent those properties, any other broad-based credit recovery? Just trying to get into that normalized comment. It sounds like it's imminent, but yet it's not real tangible. Any other detail you could offer there?

Douglas N. Bauche
Senior EVP & Chief Banking Officer

Yes, Jeff, it's Doug. And Jim made the point that relative to the large proportionate share of our nonperforming assets, it is the Laguna portfolio. And we are making good progress there. We don't obviously control the court's timing, but we are optimistic that we're going to be in a position to monetize some of these assets in Q1. As it relates to other normalization of credit, I think this, right, we see our criticized classified levels that are still elevated about 6.3%, consistent really with the prior 2 quarters, but elevated.

And we would expect, based upon the progress that we're making to see those numbers come down and class more to our normal historical operating percentages of 4.5% to 5%. And we'll see that through a combination of payoffs and upgrades as well as some of these credits that have been downgraded are showing improving operating trends. So through the combination of payoffs and upgrades, we should see crit class return back to that 4.5% to 5% range. And as we get through the Laguna portfolio, obviously, we'll see our nonperforming assets return back to a much more normalized level of closer to 45 to 50 basis points. We did have, Jeff, as you heard, in Jim and Keene's comments, we did have a hotel project in Southern California, 284-room flagged hotel that we took into OREO in the quarter, and we did take a $2.5 million write-down on that asset.

Jeffrey Allen Rulis
D.A. Davidson & Co., Research Division

Okay. If I could hop to the noninterest income, just the expectations for maybe a normalized level there, if we -- maybe an update on the state tax credit line as well as the -- well, just sort of expectations, maybe just cleanly speaking, the fee income line run rate we could expect?

Keene S. Turner

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Senior EVP, CFO & COO

Yes, Jeff, this is Keene. We had roughly $7 million of negative impact there, mostly in the tax credit line item. We're working diligently to try to eliminate that from the income statement. Even if just rates calm down and really don't do much, that line item won't have an impact. And to the extent the ORE was a technical timing issue. But I think to Jim and Doug's comments, the overall for the total workout, I think, remains positive and optimistic. But I think 4Q, we look at the 13 and add 7 back, and that's a good run rate for us. And if we can just continue to repeat that for the next several quarters, we'll be happy.

Operator

Your next question comes from the line of Daniel Tamayo with Raymond James.

Daniel Tamayo
Raymond James & Associates, Inc., Research Division

Got a few more on credit, if you don't mind. But I guess, first, the increase in NPAs, you called out a few different categories there, including several million of ag credits. Just curious if you could give us a little color around what was driving the ag in particular.

James Brian Lally
President, CEO & Director

Yes. Dan. So overall, the ag portfolio for us is down to less than $50 million today. And there was 2 credits in that portfolio that we took in the NPAs. And we did it looking at the collateral that we have, which is largely equipment and farmland and actually some crops in the ground. And we look at it, and we feel as if what we have currently on the books, we should be in good shape relative to liquidation. The other one was a distributor. So it really wasn't even in the farming business, if you will. And that too, we believe through a refinance will be taken care of here in the fourth quarter.

Doug, any more there?

Douglas N. Bauche
Senior EVP & Chief Banking Officer

No, I wouldn't. As Jim pointed out, it's 2 credits. One is really a row crop farmer, and it is largely secured. It's $13 million largely secured by farm ground. And the other one, as Jim pointed out, was really a company that's a distributor of seed and fertilizers and chemicals used in farming operations, and it's today $4.5 million, and we would expect to exit that credit quickly. So other movements, though, Daniel, that you're mentioning, $7 million into nonperforming loans in the quarter. One is an owner-occupied commercial industrial building in Southern California that was the front end of an SBA 504 structure. So extremely well secured there. And the other one of materiality, about a $5 million C&I credit to a metal fabrication and installation company in Southern Nevada.

Daniel Tamayo
Raymond James & Associates, Inc., Research Division

Also that takes me to my next question, which is the SBA portion of your balance sheet. Curious how you're seeing that react to higher rates and how you're thinking about if we do get rates higher, either with just one more cut or one more hike in December or further in '27. Certainly, some folks have been talking about having some concern with SBA overall.

Douglas N. Bauche
Senior EVP & Chief Banking Officer

We would share that concern in terms of defaults in the portfolio, Daniel. It's listen not only higher rates, but overall higher inflationary pressures are causing challenges for some of the smaller, less capitalized businesses. So we do experience defaults to increase in the SBA space. But as a reminder of our position and what we do there on the owner-occupied first mortgage real estate side, our history has been exceptionally low loss given defaults in the portfolio. So average loan sizes in our book, about $1.2 million,

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$1.3 million. Keene show me $1.5 million average loan size. So these are owner-occupied commercial real estate buildings. And while defaults will be up, loss given default should be minimal as we go forward.

Daniel Tamayo
Raymond James & Associates, Inc., Research Division

And then lastly, I just wanted to come back to the previous question around your comment on kind of what core normalized profitability would be without the noise and just kind of give the give you an opportunity if you want to take it in terms of when you think you might be able to get back to something that looks more like what you're talking about?

Keene S. Turner
Senior EVP, CFO & COO

Yes. I'm maybe going to say a step back from timing, but I'm happy to talk about the level. So in the quarter, if you normalize out really the noninterest income stuff and maybe some of the carrying costs for the ORE properties, your PPNR is about 180 basis points. And just from a range perspective, if you get even net charge-offs down from the current level to around 25 basis points, you're knocking down a 1.30% ROAA. So I think timing on that, we need to get those ORE properties moved so that we can return those to earning assets and get the operating costs and legal expenses out of the out of the run rate.

But I think the underlying fundamentals, the PPNR is growing. And it would have been -- even with the credit where it is, it would have been a pretty good quarter if you didn't have the noninterest income hits in and of itself. So we're obviously not happy with that, but I think it's -- we're happy with the trajectory of the profitability. And I think we feel like in the next few quarters, we're going to see some progress here, and we're going to return to a level that we're proud of.

Operator

Your next question comes from the line of Brandon Rud with Stephens Inc.

Brandon Jay Rud
Stephens Inc., Research Division

My first, maybe just on capital. With the change in AOCI, the TCE ratio is kind of more towards the bottom end of the target range now. I'm just curious, does that have an impact on your expectations for buybacks near term? Should we anticipate that those may moderate a bit?

Keene S. Turner
Senior EVP, CFO & COO

So I would say that while we're at the bottom of our range, I think we continue to be optimistic, and we continue to expect and plan that we're going to net accrete capital. We had a pretty good growth quarter this quarter. I think we expect that will continue. But I think we'll be -- we'll continue to be active in the buyback, maybe not quite as quite as assertive as when we were at 913, being down at 813, but I think we'll still see some buyback activity here in 4Q.

Brandon Jay Rud
Stephens Inc., Research Division

And then maybe one on expenses. I think you said there were some moving parts in there. So as you kind of look on a go-forward basis near term, I guess, what are your expectations really for the fourth quarter here in terms of go forward on expenses?

Keene S. Turner
Senior EVP, CFO & COO

Yes. So I would expect that ex-deposit costs, 4Q run rate is relatively level to where 3Q is. And then I expect that deposit ECR line item with growth and what happened with the Fed funds hike and what was contractually tied to Fed funds, we expect that line to move up $1.5 million to $2 million sequentially.

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Brandon Jay Rud
Stephens Inc., Research Division

And I guess if I could squeeze one more in on that topic. Should we think about the deposit cost line in noninterest expenses similar to traditional deposit costs where there may be some lag on the first hike, but then as you get later on in the cycle, there's some acceleration?

Keene S. Turner
Senior EVP, CFO & COO

Well, I don't know that there's necessarily acceleration there. I think it's fairly linear on that book. There is lag because of when the change goes into effect and how it goes through the statement. So there's really a month lag there. So you didn't really see much this quarter, but you'll see it more in the full quarter. We have been working hard to make sure that our pricing in the ones that are not contractual that they're appropriate, that pricing has crept up on us a little bit over the last couple of years. and with some of the liquidity stress in the industry, and we're working diligently to try to improve upon that.

And I think that's sort of baked into the third quarter results here, and I think we expect that, that will continue. But we're still expecting growth in those balances to continue to help fund the loan growth that Jim and Doug both talked about.

Operator

Your next question comes from the line of Damon DelMonte with KBW.

Damon Paul DelMonte
Keefe, Bruyette, & Woods, Inc., Research Division

First question, Keene, on the margin, I heard the commentary you expect a couple of basis point increase probably here in the fourth quarter. Just kind of curious how you're thinking about '27. If we do have additional rate hikes or if we don't, do you still feel like there's just an upward bias kind of a grind higher just given the optimism on loan growth and ongoing efforts to control deposit costs?

Keene S. Turner
Senior EVP, CFO & COO

Yes. I couldn't have said it better myself. September margin was up a handful of basis points over what the quarter was already. So we're working into 4Q here with, call it, the mid-430s margin. And we do expect that, that's got some upward buoyancy and with additional rate improvement, so to speak, that would just add to that. But when we've got some growth going, the positive remixing helps as well, just earning asset proportions are helping to drive that higher. So we're pretty bullish on net interest income growth and net interest margin growth over the next several quarters.

Damon Paul DelMonte
Keefe, Bruyette, & Woods, Inc., Research Division

And then with regards to like provisioning and kind of ballparking how we think about that, obviously, the last 2 quarters were pretty elevated. If you go back to the first quarter of this year and kind of the back half of last year, is that -- I think the average, is that a reasonable expectation for the forthcoming quarters?

Keene S. Turner
Senior EVP, CFO & COO

Yes. I would say nothing has really changed in terms of provisioning for new loan growth. I think we're emphasizing businesses that have a lower risk profile. We had very good life insurance growth this quarter. SBA has been good. Both of those are low provision requirements and have had really tremendous loss history and performance. And then -- so we're 100 basis points to 115 basis points kind of on new growth. And then we tend to think about net charge-offs as a spectrum. We're at the high end of that right now. The 25 basis points isn't where we necessarily want to land. But given where we've been, that would feel

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like a victory in the short term. So that's how we're thinking about it, and we need to deliver it, not just say it, but that's how we're thinking about provisioning.

Operator

Your next question comes from the line of Nathan Race with Piper Sandler.

Nathan James Race
Piper Sandler & Co., Research Division

Keene, I think in your comments, you mentioned you're working to just eliminate the state tax credit business from fee income going forward, just given some of the volatility in that line. Can you kind of just speak to timing of that? And is that just like a vertical that you guys are essentially looking to exit at some point in the next quarter or 2?

Keene S. Turner
Senior EVP, CFO & COO

I would say, yes, the next quarter or 2 is a reasonable expectation for how we're working it. We've been working on it for a long time. And I would say that we're not exiting the business. We're just changing the way we participate in it. We're going to continue to be an active lender in that business. That's what we do best. We don't as a public company, this line item, while has life-to-date driven good economics is just too volatile to live with. Given what it is, we spend way too much time talking to you all about it and every investor we meet with, we talk about it. So we're looking to make some steps there and ideally exit that. It's already market fair value every month, every quarter. So we're hopeful that we can get that moved out.

James Brian Lally
President, CEO & Director

I'll add to that, we've also looked at other businesses in our company and areas and markets that were subscale, and we've already taken that out of our run rate of expenses. If you think about what we call business banking. We're in it in our markets where we have great density and concentration, but in other markets where we're much more prolific commercial bank. If you think about our newer markets out West, where our brand for granular micro businesses isn't as great. We've exited that in those markets. We also recently announced that we don't -- we're exiting the mortgage business as it relates to an originator. So we're taking expenses out where we're not adding a great deal of value and really can scale.

Nathan James Race
Piper Sandler & Co., Research Division

Got it. That's helpful. And I don't think there's any correlation, Keene, but as you get out of the state tax credit business, is there any impact on the go-forward tax rate in terms of what you're expecting there?

Keene S. Turner
Senior EVP, CFO & COO

No. The tax rate will continue to be sort of in line with where it is today, roughly 22% is the number that's top of mind for me. And we will use some of those in the planning, but we'll still have access to it. It's not like we were stacking that up and we were really using it to drive down the tax rate. So we use it in NITs and NAS, but it's not really going to have a big impact there.

Nathan James Race
Piper Sandler & Co., Research Division

And then just one last one, maybe for Jim and/or Doug. Just thinking about kind of incremental growth, obviously, really strong growth on both sides of the balance sheet this quarter. Just based on what you're seeing from a competitive perspective on new loan pricing and kind of incremental deposit growth these days, are you seeing that production on both sides of the balance sheet kind of be margin neutral or

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accretive? I'm just trying to get a sense of kind of what incremental growth on both sides of the balance sheet for the margin.

James Brian Lally
President, CEO & Director

Let me start with just maybe the overall outlook and tenor within the markets, and then we can talk about where we're originating and things of that nature. Overall, we feel as if the end of the year will be strong. I said in my comments, it's going to be mid- to higher single digits, and I believe in that wholeheartedly as I look at the pipeline. As we turn the corner into '27, I feel that we'll settle in that mid-single. And -- but remember, as you build the plan, it starts off in the first quarter is a little bit slower for us and it picks up during -- throughout the year just due to some idiosyncrasies of our portfolio.

But overall, as I go around and spend time with the teams and with clients, very bullish about their businesses and making the investments and things of that nature. Certainly, there are some segments that aren't as bullish, you think about small trucking companies, which we have very little exposure to and then those businesses in and around housing and things of that nature. But it's remarkable and very optimistic in terms of what our clients are thinking and doing. But Doug, maybe you can talk about how we're originating in rates and things of that nature.

Douglas N. Bauche
Senior EVP & Chief Banking Officer

Well, Jim mentioned, too, obviously, it's highly competitive out there, and we do see some compression in terms of credit spreads. But that's why discipline on the liability side of the balance sheet is so important for us as well. And we've done a good job of controlling those deposit costs to combat the compression of spreads on the origination side. But listen, we price for a holistic relationship. And as you can see in our margin, we continue to protect it and defend it well. Keene pointed out, too, I think just that where we're originating now is probably lower risk categories.

We saw great production in the life insurance premium finance space were $100 million in the quarter, up $150 million year-to-date. And that typically is a back-ended growth business as well. And so we'll see contribution from that in the fourth quarter. But listen, we were down 100 in Q1. We were up 200 in Q2, then we had $450 million here in Q3. We're not going to continue that $450 million growth rate, right? But even if we settle back in at that $200 million to $250 million growth rate per quarter on the loan side, as Keene pointed out earlier, we'll have adequate deposit growth as well to fund that. So I think that's kind of the outlook, and we just feel good about the diversification. It's coming from all of our geographic markets. We've got good momentum in North Texas and Southern Nevada and Arizona will contribute significantly here in the fourth quarter.

James Brian Lally
President, CEO & Director

And Doug, you bring a good point. I think it really is the beauty of the strategy and the way we built the business is that it doesn't require us to get all the growth out of any one market, right? We've got 7 great markets and many national businesses that find the growth. So the charge to the team is bringing the very best, and then we'll continue to do that.

Operator

Your next question comes from the line of Andrew Liesch with StoneX Financial.

Andrew Brian Liesch
StoneX Financial, Inc., Research Division

Just following up on a comment you just made, Jim, on loan growth for next year. You mentioned mid-single digit. I guess what's going to -- it seems like you'll exceed that this year. So what would cause growth to slow down? I mean a lot of your products aren't necessarily driven by the state of the economy or rates, they just have some natural demand built in them. So what would cause growth to be weaker next year than this year, just hearing really positive momentum commentary.

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James Brian Lally
President, CEO & Director

Yes. So Andrew, I would look at it this way. As Doug mentioned, the first quarter we were flat to negative, and then we picked up growth. Really, we're running at that run rate now for a full year at that mid-single-digit pace, okay? So to me, we don't want to run the machine too hot. Additionally, going back to our credit discussion, we're very focused on making sure that we resolve the NPAs well. We resolve those that are also on the criticized list well. And so that will level us out. That will require us if we're going to grow in that 6%, 5% to 6% range, we're going to have to be close to $900 million to $1 billion net in order to achieve that rate. And I'm confident we can do it in a balanced way without any type of ridiculous focus and/or concentration in any one market or business to do so.

Operator

Your last question comes from the line of Brian Martin with Brean Capital.

Brian Joseph Martin
Brean Capital, LLC, Research Division

Just 1 or 2 for me. Just Keene, just going back to the margin, I appreciate the color on that and the hedges. Just remind us for each rate hike, how to think about the impact to the margin. I know you're more neutral now and you've given some commentary on the next quarter -- next couple of quarters, but just remind us on the hikes, what that does now with kind of the change in the neutrality?

Keene S. Turner
Senior EVP, CFO & COO

Yes. It's $1 million to $2 million if all of our betas come through. But we're pretty focused on the deposit pricing front, and we've done a good job. So my expectation is that we will be slightly better there.

Brian Joseph Martin
Brean Capital, LLC, Research Division

And the deposit betas, I guess, you're anticipating similar to kind of last cycle or just broadly today?

Keene S. Turner
Senior EVP, CFO & COO

Yes. We've modeled 55%. But again, we expect to perform better than that.

Brian Joseph Martin
Brean Capital, LLC, Research Division

And just your comment, Keene, earlier on the kind of the ins and outs on fees this quarter. Obviously, the -- you mentioned $7 million is kind of the noncore. Just the $5 million was a tax credit, reconciling that $7 million, just high level, what was the ins and outs to get to that $7 million?

Keene S. Turner
Senior EVP, CFO & COO

It's mostly the loss on ORE and then there's a couple of miscellaneous line items, but you got $1.5 million on ORE. And then there's another item of $0.5 million. So...

Brian Joseph Martin
Brean Capital, LLC, Research Division

That gets you there. Okay. And then just on -- maybe for Doug. I think, Doug, you mentioned -- I guess, broadly, it seems as though the California credit resolution is maybe more of a first quarter or more so in the first quarter. Doug, I thought you mentioned there was something that could come a credit you're going to exit quickly. I didn't know if that meant just in terms of the progression of improvement in credit, what might be possible in the fourth quarter, if that was fair.

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Douglas N. Bauche
Senior EVP & Chief Banking Officer

Yes. No, I think the one, Brian, that I had mentioned that I expected to exit more so in the fourth quarter would be one of the ag credits that we had as well as a nonperforming loan, the owner-occupied real estate loan, the front end of that 504. So $7 million real estate loan and a $5 million C&I credit, I think we would expect to probably exit here in the fourth quarter.

The timing of the Laguna portfolio, trust me, there's no one more anxious to exit that than I. But we just don't control all of that. But I just -- we reiterated, right, just kind of where we are in terms of our confidence with the market and our buyers that are lined up on this. We'll get there. It's just a matter of timing with the courts. But I think realistically, we're saying that's Q1 of next year before we really start seeing the monetization of sales occur in that Laguna portfolio.

Brian Joseph Martin
Brean Capital, LLC, Research Division

Yes. No, and I appreciate all the transparency and the thoughtful comments this morning. It's helpful. It's frustrating, I understand. So -- and maybe just the last one for me, just on the efficiency and kind of operating leverage as we step into fourth quarter and first quarter, can you just give some thoughts on kind of where you -- in terms of -- are we expecting positive operating leverage as you move into '27 kind of from this 59% type of level? And that's my last question.

Keene S. Turner
Senior EVP, CFO & COO

Yes. I mean it's going to be a daily fight. And -- but I do think we are focused on the key drivers there. We have made some moves. And again, with some more growth in the loan portfolio, we're attacking it on both fronts. So the -- being in the 60% -- below 60% efficiency is great. And again, if you just have kind of a normal quarter on fees, that gets a little bit better. So we are optimistic that we're going to make some progress there. And I think it's pretty clear we're focused on it, and we're focused on returns and all of those fronts. So again, nothing happens quickly. We're methodical, we're deliberate, and we're going to continue to make progress.

Operator

There are no further questions at this time. I will now turn the call back to Jim Lally, President and CEO, for closing remarks.

James Brian Lally
President, CEO & Director

Kristen, thank you, and thank you all very much for joining us this morning and your interest in our company. Have a great day, and we'll speak to you again at the end of the fourth quarter, if not sooner. Take care.

Operator
This concludes today's call. Thank you for attending. You may now disconnect.

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