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Regions Financial Corp. (RF)

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CORPORATE PARTICIPANTS

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

John Turner
Senior Executive Vice President-Head of Corporate Banking Group, Regions Financial Corp.

OTHER PARTICIPANTS

Gerard Cassidy
Analyst, RBC Capital Markets LLC

MANAGEMENT DISCUSSION SECTION

Gerard Cassidy
Analyst, RBC Capital Markets LLC

We'd like to get started with the Regions fireside chat. Thank you. Today, we have David Turner, Senior Executive Vice President and Chief Financial Officer with Regions Bank. David joined the bank in 2006 and has served as the Chief Financial Officer since that time. Regions, as you may know, has over $125 billion in assets, and the market cap today is close to $19 billion. To David's right is, John Turner, Senior Executive Vice President, Head of Corporate Banking. John joined Regions in 2011 as the Head of this Group. As you've had with other fireside chats, we encourage questions from the audience when we sit down with David and John.

So let's get started.

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QUESTION AND ANSWER SECTION

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

David, we were just talking a moment ago and one of the other presenters talked about energy lending, and it seems very timely to talk about it since the redetermination is going on right now. And then we have the SNIC exam results that are coming out shortly. Maybe you can share with us what it was like a year ago versus this year.

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Okay. John, won't you take that?

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Sure.

John Turner
Senior Executive Vice President-Head of Corporate Banking Group, Regions Financial Corp.

A

Yeah. I mean, clearly, more stability in the energy space with pricing sort of stabilizing and then the above $50 per barrel range, we see E&P companies actually becoming more active, drilling activity picking up a bit. On the other side, the oilfield services space still under some stress and will continue to be, we think, through 2017 as services come back slower than the E&P activity will. In the fall, we expected to see some decline in borrowing bases and, actually, what we saw was effectively kind of stability in borrowing bases. And my guess is that we'll see stability again, maybe even a little uptick as companies have brought more reserves online.

All in all, we feel cautiously optimistic about how the energy business will perform. We're seeing a few opportunities to lend into the energy space and so, on a very selective basis, have done that both to two or three E&P companies, midstream and on one occasion oilfield services, and I think we'll continue to see a good positive momentum building in the energy business.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Can you share with us what the regulators asked you to classify last year? How have those loans behaved or performed relative to what the regulators were thinking?

John Turner
Senior Executive Vice President-Head of Corporate Banking Group, Regions Financial Corp.

A

Yeah. The big impact was primarily on the E&P portfolio, as we had to apply a different standard for the way to think about leverage. And as a result of that, we had a big shift in criticized and classified assets. Today more than 70% of our E&P book is criticized or classified. We believe that that portfolio will perform well. We've had no losses to date in the E&P space. Haven't historically had losses. We're not sure whether that guidance will change a bit and as a result of this exam. We won't know until the exam's completed.

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But until the guidance changes, it will be difficult to see really improvement in risk ratings, and so as a result any change in the allowance that we currently maintain for that business. All in all, I think it's performed, the portfolio has performed well and better than the regulatory guidance might have assumed given the change in the way we thought about it.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Yeah. Speaking of loans and loan growth, a lot of us have been watching the HA data that has a shown a slowdown in loan growth. So possibly, you can share with us what your corporate customers are feeling, and then on the consumer side, David, I don't know, if you want to touch on that, your inroads that you've made in credit card and on the mobile lending?

John Turner
Senior Executive Vice President-Head of Corporate Banking Group, Regions Financial Corp.

A

Yeah, I think our story is similar to so many of our peers. Our customers are clearly more optimistic. They believe they're going to get regulatory relief. They believe we're going to get tax reform, healthcare reform. I believe that the economy is improving but they're looking for some confirmation of that in the form of tangible action. And so, while they're more optimistic, that's not translating into any activity. Pipelines are up modestly, but not significantly. As a result, we expect very modest loan growth in the early part of the year. Still believe in the corporate banking group, our business lending will grow 2% to 4% over the course of 2017 but be more likely more backend loaded.

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

As we think about total loan growth, we have expectations for low single-digit growth this year which takes into account, the business side being at 2% to 4%. The consumer side, I would say healthy. We have a couple of things working against us, so we exited a third-party relationship on indirect auto, did renew our contract in November because the risk-adjusted return wasn't at an acceptable level for us. That'll cost us about $650 million of average balances in 2017 compared to 2016.

Additionally, we sold about $170 million of affordable housing loans at the end of the year. So, those are not in our averages. You'll see those averages in the first quarter and, of course, it'll work against us for the whole year. Outside of that, mortgage seems to be solid. We're about a 70% purchase shop versus 30% refi, a little different than our peers because we don't use third-party correspondence to the degree that others do. The mortgage ought to be pretty solid.

Home equity, we're starting to see a little bit of activity as home owners start to fix up their house. Perhaps that translates to not such a headwind that we've had on home equity. Credit card, credit card grew about 11% last year. We've penetrated our deposit customer with a Regions branded credit card about a little over 18%, that number ought to be 25%. So we expect there to be some growth there. Our point-of-sale initiative that we had and that we started a little over a year ago should have nice growth in it.

So I think the consumer is pretty healthy. Perhaps with those couple of headwinds, we ought to – we ought to have decent growth there, and coupled with the business side, we get the low single-digits. I do think that as you look at the HA data, a lot of that is pushed off a little bit to the back half of the year though.

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Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Yeah. And again, if there are any questions, please don't hesitate to ask them. And there has been some talk particularly amongst the smaller regional banks, and I guess you call it maybe saving banks about the excess concentration of commercial real estate that those banks have, and I know you guys don't. But is there any pressure from the regulators on commercial real estate lending for you guys? Again, I know it's not as big as some of the smaller banks.

John Turner
Senior Executive Vice President-Head of Corporate Banking Group, Regions Financial Corp.

A

Yeah. We've been very thoughtful and measured in our approach to investor real estate banking. We didn't have a very good experience in 2007, 2008 and 2009. One of the lessons that we learned from that experience was the importance of balance and diversity. And so, we've really been managing that exposure at a, again, kind of a peer leading level in terms of the limited amount of exposure that we have about 8% of our total portfolio. And we've recently begun shifting our focus on producing more term lending than construction, good bit of mix of our business was construction-oriented that turned over rapidly. It just requires that we commit lot of capital to the business and, frankly, it's just not very profitable and so we see an opportunity to shift the mix of business to term lending.

We haven't been able to perfectly match the timing of that and so we have seen more runoff in the investor real estate book. It will begin to grow as we realized the pipeline that we're building of term lending customers and opportunities, but we have not gotten much negative feedback or really any feedback about investor real estate because we have managed it I think so conservatively.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Right. Shifting to the other side of the balance sheet, deposits, obviously your company is chock full of consumer core deposits. Can you share with us with the rate increase that we saw in December the expectations for another one possibly next week? How the deposit pricing has changed the so called beta, have you seen any pressure on deposit pricing?

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Yes, a great question. So we gave you guidance on NII for the year using the November curve. Embedded in that were two rate hikes, one in June and one in December with the deposit beta starting out at 40% and going up to 60%. Last upright cycle we actually experienced a 54% beta. So subsequent to that, we got the December increase, very little beta associated with that. It's amazing how a couple of weeks change things so I would have told you not much of a chance in March, seems to be more probable today, I think the beta that we'll have there ought to be reasonably low as well.

The caution would be if we get on this increase every Fed meeting or three times a year for the next two or three years, there will be more pressure on beta. Our deposit base is really a competitive advantage for Regions. So, we have half of our deposits are in MSAs were less than a 1 million people, so very rate insensitive deposit base, which is our beta was low last time, why we believe it'll be low this time.

So, it's up to us to be able to extract appropriately the value out of the deposit base. We have to competitive, and we will be, but we don't have to rush the increased rates. We have a low loan deposit ratio. You have a low

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single-digit expectations of loan growth, so you really have – we have more ability to extract that value, and we think if rates will stay here perhaps we can perform above our 2% to 4%. The caution there is last year, about at this time, we were doing pretty well too with the 10-year, and then we hit a historic low. So, there's a volatility we have to contend with, but feel pretty good right now.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Yeah. When we – yes?

Q

You've got a history of growing by acquisition pre-crisis. Do you still have a lot of legacy systems on [inaudible] (10:59) are you on one technology platform?

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Yeah. We are on one technology platform. We've made all those conversations a long time ago. Our last big acquisition was in 2006, so we haven't been in the market for a while, but we've been able to migrate all that to one platform.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

One of the benefits of having a CEO who comes out of operations and technology early.

As a result, then some of your peers have had BSA/AML issues with their systems. Obviously, you guys haven't. Is that a fair assumption based on what you've done in the past on the one technology platform?

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Well, clearly, complying with all the rules and regulations are always a challenge for our industry. BSA/AMLs going to always be a hot topic to talk about. Our predecessor, AmSouth, had gone through that, and we've spent a lot of money and time, getting our systems and processes up to speed. So we feel very good about that. We have to continue to invest to make sure that our systems are up to speed, I think, from a total expense standpoint kind of where we need to be. So we save a little money here and spend a little money over there, but we don't expect there to be any type of issues from a technology standpoint on the compliance matters.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Coming back to deposits, how do you guys weigh to allow deposits maybe to leave? As you mentioned, you have a low loan-to-deposit ratio. Is it beneficial maybe for a certain deposits when rates go higher, just let them go, and maybe have little shrinkage in the balance sheet, become more profitable?

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Well, it's a great question. So last year, our consumer deposits grew about 5%, business services deposits grew about 4%, and our wealth management deposits were negative. Those were collateralized deposits that we didn't

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see the liquidity value in, they were more expensive, and so we have those and let those run off. So if you look at our deposit growth, it was about 1%, but if you dig underneath that, you'll see that we actually had a pretty robust growth. And that's a testament to us running to the bank on ensuring that we can maximize profitability.

I do think that we have to – like I said earlier, we have to be competitive, but we don't have to rush out and chase deposit from a class standpoint, just like a loan. If you're focusing on volumes and you're not focusing on profitability, you'll get yourself at trouble. At the core of regions, we are a relationship bank, loans, deposits, treasury management, all the products and services that we have, and so we're asking our teams think about the profitability and if that means we lose the deposit every now and then, so be it, because maximizing profitability is more important than volume to us. From a business service side, we'll see – starting to see some questions on deposit cost. We ask people to be patient, and so far it's working. Yes?

Q

Yeah, David, maybe just following up on that, commercial side [inaudible] (14:16-14:22)

John Turner
Senior Executive Vice President-Head of Corporate Banking Group, Regions Financial Corp.

A

It's really a one-off sort of opportunity, banks whose or bankers who opportunistically see a chance to go to a customer and pitch in a rising rate environment a higher rate, do that from time to time and our bankers respond by looking at the overall profitability of the relationship, then the length of the relationship, how deep and broad it is, and we're most often competitive. Whether it would be changing in the areas of credit rate or competing on a money market deposit rate, we just evaluate it, as David said, based upon the profitability and term of the relationship. It really is kind of a one-off transaction that's occurring. We're not seeing a lot of it, but we are beginning to see some.

Q

[inaudible] (15:08) do you measure your products per client [inaudible] (15:12) retail clients and do you look at each stage a different market, have a market share or ranking target [inaudible] (15:22)

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

So, we look at overall customer profitability. The main focus of us on the consumer side is a needs based program. What products or services do our customers need? Do we know that they have with another financial institution? We'd like to have more of the customer wallet, but only for products or services that they need to use and that's a subtle – those are subtle work. There's a big distinction. We don't want to push our product – we don't want to provide a product to a customer that they're not going to use. We don't incent that way. If you don't use the product, you don't get the incentive. So, we've really worked hard to make sure that that's pushed through our entire organization.

We do measure markets. We measure areas. We measure markets. We look at penetration into customers, both on a consumer, wealth management business service side. We know which products and geographies are more profitable than others, and that's a big part of our business review process as we seek to help those products and services in given markets to improve performance over time.

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Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

David, there's been obviously a lot of talk over the last couple of years about the digitalization of banking and the digital channel. You guys have been very active in shrinking your brick and mortal footprint. Can you elaborate on some of the successes you've had there, some of the challenges that what you've discovered in shrinking that footprint?

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Yeah, so our go-to-market strategy is to allow our customers to bank with us and the channel that they want, that's obviously expensive. Our branch channel is still very, very important to us. We've consolidated 28% of our branch network since the crisis far more than any competitor, and we'll still consolidate. We had a goal of 150 branch consolidations through 2018. Now we had a 103 last year 20 or something the year before, and we'll get to the 150 at the end of 2017, and then we'll continue to look for consolidation opportunities, but we're also going to invest in new branches too and to get in some density where we're not as strong as we want to be.

So I think that, the other things we have to do other than the branch channel, Noble Technology, we've continued to make investments there. We redid our online banking channel last year. So, we are making the investments because some people like different channels. I will tell you that 60% of our customers who walk through the branch doors over the next 30 days. And I'll let that sink in just a bit. 60% of our customers will walk through a branch in the next 30 days. 80% of our revenue of our sales go through the branch channel, so the branches are still very important regions and I don't know if it's just because of our geography, our rural footprint or what that is, but that's important to us, that network effect when you see the Regions green sign over and over again, that's important to us.

That being said, we realized we need to take the cost out, so we're making changing format. We just opened a new branch yesterday in our headquarter building, it's really neat. A lot of technology, fewer people and we have what's called a Universal Banker. You've heard people talk about that, where those bankers can do all the transactions that you could do on a branch. They'll do teller transactions or open loans or open checking accounts, provide advice, guidance and education.

So, we also have video tellers there, where you can pick up the phone and talk to the contact center, which has been really successful for us at other locations. So, continuing to make those investments to try to take out cost and leverage technology. I think it's what you're going to see for regions. I think you'll see that in the industry as well.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

In terms of the branches that you've closed, what were some of the behaviors of the customers? Did you lose 5%, 10%, 20%, none at all? Can you share with us some of the lessons you've learned?

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Yeah. So, when you consolidate as much as we have, our statistics are pretty strong. On average, we will retain about 95% of the revenue that goes into the receiving branch, we'll take even some people out of the branch that we closed and transfer them, so they can handle the volume.

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What we target is for – we have one-time cost that will go through our branch closure, severance, lease write-downs or if we own the branch, property write-downs. We try to pay for that one-time charge over three years. The ones we've consolidated have been slightly less than two. So we'll keep lot of that revenue, get rid of more expense and they've been very beneficial to us.

Now, the further the branch goes, so if they're a mile or two miles down the road, you have a better chance to keeping most of the revenue. You start getting 10 miles away, you have a little different story. But the bottom line is we lose revenue in every single one of them. But we take out a lot more cost than the revenue that we lost. So when you start this type of program early on, it's easier. And the fruit is not as low to the ground anymore, but we have to keep, like any good retail franchise, you close some, you open new ones and we'll continue to do that at Regions.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Yeah. When we look at this coming April, obviously ,you and your peers will send in your information for CCAR. It's changed this year for you folks on the qualitative side. Anybody under $250 billion in assets, we know won't be held accountable to that standard. Can you share with us your approach to this year versus last year? And last year, a couple of banks used the mulligan, what your thoughts are maybe on Regions using a mulligan?

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Well, so we're starting at a 11.2% common equity Tier 1. Our goal is 9.5% common equity Tier 1 and that's derived mathematically. It's not just – we didn't make it up. We start with 4.5%, which is regulatory minimum, we had 250 basis points of stress buffer. And then we look at the risk [indiscernible] (21:33) the balance sheet and we look at the severely adverse stress and then we add 20, 30 basis points. That's the extra 250 to go from 7% to 9.5%.

So getting from 11% to 9.5% is important because to have an appropriate total risk adjusted return for our shareholders, you need to have the capital base optimized. So we've been working on that. We clearly want to use our capital to grow organically. It's critically important to us. We have that. We clearly have the capital growth.

Next would be the dividend. Dividend, our policy has been 30% to 40% of our earnings we'd pay out in the form of dividend. We've been at the lower end of that, given where we were trading, as we've traded at least closer to fair value, not quite there, but closer that we would have a little bit more of a dividend, and that we'd still use our capital to help grow with bolt-on acquisitions. So First Sterling acquisition is an example of that, our mortgage servicing rights, and we're going to continue to do that as we grow and diversify revenue.

We then have this capital that haven't been deployed that we need to return to the shareholders. So last year, we had a total return of 105%, when you take into account the de minimis we leveraged. And you should expect a fairly robust return. The qualitative aspects of this give us more confidence because quantitatively, we know where our losses are. And there's a little bit of mystery at the Fed and their box, their calculation, their modeling, we have a reasonable idea as to what that's going to look like.

So we feel better about that. I do think there is – you have to be reasonable and rational about it. Now we have a very solid capital planning process that we put forth. Our loss forecasting is very strong. And so, I think you should expect a robust capital return that's fair and commensurate with the risk we have in our balance sheet. Can't tell you exactly what that number is, that'd be a problem but it would be – we should have a more robust offering than we had last year.

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Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Yes?

Q

Just as a follow-up to that, the plan is to get down to that 9.5% sort of by 2018.

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Yeah. Our goal is to get there by 2018. We can't quite get there unless something changes dramatically. Loan growth is higher than we thought. But we'll get closer now because, at the end of the day, our goal that we laid out at Investor Day was to have a return on tangible column between 12% and 14%. We still believe we can get there. We're more encouraged about being able to get there through the things that we have done to grow NII and leverage our deposit basis. We talked about growing NIR and control our expense base. So, we feel very good about getting there but we can't quite get to that number in 2018.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

I guess, just one final question, when you look at the quarter, we're into the third month of the quarter, how is it progressing relative to your expectations that you guys may have had in November and December?

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Well, clearly you're trying to guess what economic activities are going to be. As John mentioned, we have a lot of optimism out in our client base but they're waiting and they're waiting for certainty. And uncertainty is not helpful to any of us, tax policy, regulatory policy, whatever the case maybe. So, that's changed a little bit. That's probably a little more negative. We still feel comfortable for the year but I would say, if you look at the HA data, that's kind of what we're experiencing that, so our goal is to control the things we can control and so we feel good for the year and the guidance that we've provided.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Do you think if we get a rate hike next week, that kind of is – and I know it's not a first quarter event, but offsets maybe some of the slowness or the uncertainty for you and then your peers, I mean, not just for you?

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Well, we're in the third month, so the benefit of that coming through is probably not going to happen in the first quarter. The expectation would be that LIBOR kind of move ahead of that. We haven't seen – haven't looked at it today.

John Turner
Senior Executive Vice President-Head of Corporate Banking Group, Regions Financial Corp.

A

It's up a little.

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David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

A

Up a little bit. So I think it's probably more in the second quarter than on first.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Okay. Sorry, we've run out of time, and I want to thank David and John, and please join me for a round of applause. Thank you.

David J. Turner, Jr.
Senior EVP, CFO, Executive Council and Operating Committee, Regions Financial Corp.

Thank you.

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