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Regions Financial Corp. (RF)

Q1 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Regions Financial Corporation's Quarterly Earnings Call. My name is Paula and I'll be your operator for today's call. I would like to remind everyone that all participants online have been placed on listen-only. At the end of the call there will be a Q&A session. [Operator Instructions] I will now turn the call over to Mr. List Underwood to begin.

M. List Underwood

Head-Investor Relations

Thank you, operator and good morning, everyone. We appreciate your participation on our call today. Our presenters include Grayson Hall, our Chief Executive Officer; and David Turner, our Chief Financial Officer. Other members of our executive management team are present as well and available to answer questions as appropriate.

Also, as part of our earnings call, we will be referencing a slide presentation that is available under the Investor Relations section of regions.com. Let me remind you that in this call and potentially in the Q&A that follows, we may make forward-looking statements which reflect our current views with respect to future events and financial performance. For further details, please reference our forward-looking statement that is located in the appendix section of the presentation. Grayson?

O. B. Grayson Hall

Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

Thank you, List and good morning, everyone. We're pleased you could join us as we review our first quarter results. First quarter results reflect a solid start to 2015, as we reported earnings of $218 million or $0.16 per diluted share, which included $0.02 per share of significant items that negatively impacted EPS.

These results illustrate that we are successfully executing our strategic priorities which include diversifying revenue, generating positive operating leverage and effectively deploying capital. As notably, we achieved these results even with severe weather conditions in our markets during the first quarter. During the quarter, we grew loans and deposits, we grew checking accounts in all of our markets, we generated positive operating leverage while prudently managing expenses and receiving no objection to our CCAR submission.

Our loan growth in the first quarter was 1% with most loan categories experiencing growth. Deposit growth exceeded our expectations this quarter with balances growing 3% from the end of last year. As continued evidence of our Regions360 approach to relationship banking, we grew checking accounts in all of our markets, and importantly also increased our number of households.

Total revenue remained relatively steady from the fourth quarter despite seasonal declines in both net interest income and non-interest income. However our efforts around diversifying our revenue streams helped to offset these declines.

Wealth management delivered strong results growing revenue 8% and increasing assets under administration by 5%. While all segments within wealth management grew revenue, insurance was particularly noteworthy as revenue increased 13% in the quarter.

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Going forward, along with organic growth, we will continue to target lift-out and acquisition opportunities in this important business. This will also allow us to round out our product offerings and geographic coverage and will drive incremental revenue growth.

Adjusted expenses declined 2% for the fourth quarter as many of our expense categories declined. We continue to prudently manage expenses while focusing on expenses we can control, while appropriately investing for future growth. Total expense during the first quarter were impacted by a few planned actions where we incurred additional charges but our future run rate should benefit.

Let me spend a few moments and provide you with an update on our energy lending portfolio. We continue to use our corporate governance process to monitor oil price declines for direct and indirect impacts to our overall loan portfolio. While we have seen some downward risk [ph] breeding (4:18) migration in our oil field services portfolio, we are not seeing widespread financial stress within our customers in the portfolio. Obviously, if oil prices remain at low levels for an extended period of time additional migration is likely. However, we're staying engaged with our customers and will take necessary actions as we deem appropriate.

Conversely, we believe consumers are beginning to experience benefits from low oil prices. With consumer loan categories, net charge offs, delinquencies and non performing loans all declining during the quarter. In fact, total net charge offs to average loans is 28 basis points in the quarter, our lowest level in over seven years.

Also during the first quarter we received no objections to our planned capital actions from the Federal Reserve related to our CCAR submission. We believe our plan reaffirms our commitment to effectively managing our capitals to support long-term growth objectives while also increasing returns to shareholders. It also highlights our continued long-term approach to capital allocation and distribution as returning excess capital to shareholders remains a priority. Our capital plan included increasing quarterly dividend $0.01 per share to $0.06. Additionally, we plan to repurchase $875 million of outstanding shares over the next five quarters subject to board approval.

From an economic perspective we anticipate that growth should pick up over the remainder of the year and we expect continued improvement in housing prices across our markets. However we do not expect an increase in short-term rates until the latter part of 2015. We will continue to leverage our Regions360 approach to relationship banking to grow and expand our customer base.

In fact, during the first quarter, Regions was again recognized by leading customer experience research firms, the Temkin Group and Greenwich Associates for providing industry-leading service to both consumers and businesses in 2014. We are pleased to once again be recognized for providing exceptional customer experience.

With that I'll turn it over to David who'll cover the details for the first quarter. David?

David J. Turner, Jr.

Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

Thank you, and good morning, everyone. I'll take you through the first quarter details and then wrap up with our expectations for the remainder of 2015.

Loan balances totaled $78 billion at the end of the first quarter, up $936 million or 1%. Business lending achieved solid growth that was balanced across industry segments and geographic locations. Balances in this portfolio totaled $49 billion at the end of the quarter, an increase of $867 million or 2%. Investor real estate ending balances totaled $7 billion, an increase of $108 million or 2%. In commercial, industrial loans grew $949 million

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or 3%. And this growth was driven by our market based corporate and commercial bankers serving small corporate and middle market clients.

In addition, Regions Business Capital, our asset-based lending group and corporate real estate exhibited growth during the quarter. Line utilization increased 10 basis points, commitments for new loans increased 4% and our pipeline remains strong.

Now moving to consumer lending, loans in this portfolio totaled $29 billion as production increased 9% linked quarter. Mortgage loan balances increased $103 million and production increased 9% linked quarter. In addition indirect auto lending balances increased $59 million or 2% as this portfolio continues to expand.

New and enhanced consumer lending product offerings led to growth in our other consumer loan category. Loan balances increased $28 million and the portfolio totaled $1.2 billion at the end of the quarter while production also increased 58%. As expected, credit card balances declined following a seasonally high fourth quarter; balances declined $43 million or 4% from the previous quarter, however, production increased 20%. And finally, total home equity balances declined $78 million or 1%, while production also decreased 1%.

Let's take a look at deposits. Supported by our multi-channel platform total deposit growth was strong increasing $3 billion during the first quarter. Two-thirds of this growth was driven by consumer deposits which were broad based across a majority of our markets. Deposit costs remain near historically low levels and totaled 12 basis points while total funding costs were 29 basis points in the quarter. Let's look at how this impacted our results.

Net interest income on a fully taxable basis was $832 million, a decline of $5 million or 1% from the previous quarter. The low rate environment and fewer days in the quarter were the principal drivers of the decrease, but were partially offset by increases in average loans and reductions of higher cost borrowings. Net interest margin increased slightly from the previous quarter to 3.18% reflecting the benefits of reduced borrowing costs offset by higher levels of cash due to deposit growth.

Total non-interest income declined $4 million, or 1%, in the first quarter. Mortgage income increased $13 million, or 48%, as loan production increased, along with improvement in the market valuation of mortgage servicing rights. As Grayson noted, our Wealth Management Group delivered strong results for the quarter. Revenue increased 8%, led by higher insurance commissions, higher investment services fees, and increases in investment management and trust income. Service charges declined $6 million from the previous quarter, which was due to a $3 million decline in fees resulting from a product discontinuation in the fourth quarter and seasonally lower non-sufficient fund fees. Card and ATM fees decreased slightly as a result of lower spending and transaction volumes that are typically experienced in the first quarter. However, the number of active accounts continued to increase. Let's move on to expenses.

Total reported expenses in the first quarter were $905 million, a decline of 7%, while adjusted expenses declined 2%. During the first quarter, we redeemed $250 million of higher cost debt incurring $43 million of extinguishment charges but earnings will benefit from a lower run rate going forward. As previously noted, in the fourth quarter of 2014, we announced plans to consolidate 50 branches throughout 2015, as part of an ongoing evaluation of the branch network. We recorded $13 million of expense related to the consolidation in the first quarter of 2015. In addition, we have a space planning initiative underway which will reduce occupancy expense going forward. This initiative resulted in an incremental charge of $9 million.

Salaries and benefits remained relatively flat from the previous quarter, despite a seasonal increase in payroll taxes of $11 million, which was offset by a decline of $15 million in incentives that is not expected to repeat next quarter. Pension expenses increased $2 million, lower than our original estimate for the quarter, and should

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remain at this level for the remainder of 2015. In the second quarter, we expect an increase in salaries and benefits commensurate with annual merit increases.

Occupancy in furniture and fixtures declined a total of $5 million, and outside services declined $6 million. Professional, legal and regulatory expenses, excluding the previous quarter's $100 million legal and regulatory approval, declined $15 million to $19 million for the quarter. Although there are opportunities for expense reductions, we expect expenses in this category to increase somewhat, and some amount of volatility should be expected.

Our adjusted efficiency ratio was 64.9% in the quarter, an improvement of 120 basis points from the prior period. Prudent expense management remains a top priority as we remain committed to generating positive operating leverage over time. Our effective tax rate for the first quarter was 28.7%. This rate reflects the impact of the adoption of new guidance related to the accounting for investments and qualified affordable housing projects, which increased income tax expense and non-interest income.

All prior periods have been restated to conform to this new presentation. In addition, the first quarter's tax expense includes a one-time benefit related to an improved methodology to determine state-deferred taxes of approximately $10 million, which reduced our effective tax rate by approximately 300 basis points.

Moving to asset quality, total commercial investor real estate criticized and classified loans increased $125 million, or 5% from the prior quarter as the company experienced some weakening in large dollar commercial and industrial loans within the energy, healthcare, and other portfolios. However, we do not believe this weakening is systemic in nature. As Grayson noted, we are closely monitoring the energy portfolio and have experienced some risk rating downgrades this quarter. However, because the number of our energy clients are limited, we are in a position to maintain frequent contact and will continue to be diligent through our normal processes of credit servicing these loans.

Compared to the prior quarter, total delinquencies declined 12% and troubled debt restructurings, or TDRs, declined 5%. Our non performing loans, excluding loans held for sale, decreased 3% linked quarter and at quarter end our loan loss allowance to non-performing loans or coverage ratio was 137%.

Again, as Grayson mentioned, total net charge offs declined $29 million and represented 28 basis points of average loans. The provision for loan losses was $49 million or $5 million less than net charge offs. Given where we are in the credit cycle and the large dollar commercial credits in our portfolio, along with fluctuating oil prices, the volatility in certain credit metrics can be expected.

Let's talk about capital and liquidity. During the quarter, we repurchased $102 million of shares of common stock which completes the $350 million program that was part of our 2014 CCAR submission. Additionally during the first quarter, we began the transition period for the Basel III capital rules. As such we will report Basel III capital ratios under the phase in provisions for regulatory reporting purposes. But we will also continue to report ratios as if fully implemented.

Under these new provisions, we maintained industry leading capital levels as the Tier 1 ratio was estimated at 12% and the common equity Tier 1 was estimated at 11.2%. In addition the common equity Tier 1 was estimated at 10.9% on a fully phased in basis.

Liquidity at both the bank and holding company remained solid with a low loan-to-deposit ratio of 80%. And regarding the liquidity coverage ratio rule, Regions remains well positioned to be fully compliant with the January 2016 implementation deadline. Throughout 2015 we will update customer agreements to include LCR friendly

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language, we will modify our existing deposit products and we also plan to create new products and services to compliment our strong position of high-quality liquid assets. It is important to note that no major balance sheet initiatives are expected in order for us to be compliant.

Let's take a few minutes and touch on our expectations for the remainder of 2015. With respect to loans, we continue to expect total loan growth in the 4% to 6% range on a point-to-point basis. Commercial and industrial loans are expected to drive loan growth within the business lending portfolio. And while owner-occupied commercial real estate is not expected to provide meaningful growth, the pace of runoff is expected to slow.

Looking at the consumer lending book, we expect continued growth from indirect auto lending. We will continue to focus on driving better pull-through rates, increasing margins and improving overall credit profiles. We also expect to augment growth through new partnerships later in the year. Additionally, continued growth in other consumer loans is expected. We are focused on expanding lending through online and point of sale financing alternatives and as a result we expect growth in this category to accelerate in 2015.

Moving to credit card, as we remain focused on increasing our penetration rates, this should drive balance growth in the near term. And finally, we expect the pace of home equity runoff to moderate throughout the year.

Regarding deposits, while we had a better than anticipated first quarter, we expect full year average deposit growth in the 1% to 2% range. As a reminder, a significant portion of our deposits are made up of consumer deposits, which tend to be more granular and smaller in size, which based on our research, should be more stable and less rate-sensitive in a rising rate environment.

With respect to margin, our expectations for the year have not changed materially. We expect to drive net interest income and margin growth over the balance of the year under our baseline expectations for loan growth and an increase in interest rates late in the year. Further, we expect to benefit from revenue initiatives within mortgage, capital markets, and wealth management, while at the same time diligently managing expenses.

That being said, we are committed to generating positive operating leverage. We believe that the first quarter was a solid start to 2015, and we will continue to execute on our strategic priorities of diversifying revenue, generating positive operating leverage, and effectively deploying our capital.

With that, we thank you for your time and attention this morning, and I'll now turn it back over to List for instructions on the Q&A portion of the call.

M. List Underwood

Head-Investor Relations

Thank you, David. We are now ready to begin the Q&A session of our call. In order to accommodate as many participants as possible this morning, and there are a number of you in the queue, I would ask each caller to please limit yourself to one primary question and one related follow-up. Now, let's open the line for your questions.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Erika Najarian of Bank of America.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Erika.

Erika Penala Najarian
Bank of America Merrill Lynch

Q

Good morning. My first question is on the $949 million in C&I loan growth in the quarter. How much of that 949 million was related to your oil and gas sector?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Erika, during the quarter, we really had kind of moved sideways in terms of our oil and gas. That was really a far broader-based expansion of the loan portfolio outside of the energy sector.

Erika Penala Najarian
Bank of America Merrill Lynch

Q

Great. And my follow-up question is, in terms of your guidance for positive operating leverage, it sounds like you're still accounting for some rate increases in the back half of the year which many investors are sort of stripping out of their model. Could you still hit positive operating leverage if the Fed doesn't raise rates this year?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Erika, it would be very difficult if rates stayed in the 1.75% to 2% range to do that. We could get close, but it would be difficult. As I mentioned, in the prepared comments, we do expect – we have baked in a little bit of an increase in September and a little one in December. But really loan growth for us is important. When we saw loan growth this quarter and the deposit growth and the earning asset growth, that's a pretty big positive for us going into this whole concept of generating positive operating leverage, so it's not out of the question, it does make it more difficult.

Erika Penala Najarian
Bank of America Merrill Lynch

Q

Got it, thank you.

Operator: Your next question comes from Michael Rose of Raymond James.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Michael.

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Michael E. Rose
Raymond James & Associates, Inc.

Q

Hey, good morning. Just wanted to follow up on the energy topic. Can you disclose how much of this quarter's provision related to the review of the energy book? And then where do reserves stand, and if you can't give us a specific number maybe you can give us some context where they stand now versus maybe where they stood in 2009 when you had a similar price decline?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, so Michael, we won't disclose the specific dollar amount attributable to this but clearly we have a process, I talked in the prepared comments about our servicing that we are going through. We have a relatively small number of customers in this sector, whether it be our E&P customer base or our oil field services customer. So we're spending a lot of time with them. And we understand where those credits are. We had some migration down. The migration you saw, though was not just in the energy sector, it was other sectors, healthcare and even some other industries that really contributed to that. But we have a very disciplined process from a lending standpoint. We do have amounts obviously in our calculation attributable to energy. That allocation has increased as our credits continue to migrate down this past quarter but we feel like we have those credits appropriately reserved right now.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Yeah, Michael, we've got a very rigorous, very disciplined process for credit servicing and risk ratings and, obviously, we saw a number of risk rating downgrades in the energy portfolio, in particular in the oil field services part of that portfolio. That being said, we've got a lot of confidence that our customer selection and in our risk rating process and feel very good about where we're at today. That being said, I had asked John Turner if he would, John runs our Corporate Banking Group here at Regions and all of our energy lending reports up to John, ask if he would make a few comments about oil field services in particular.

John M. Turner, Jr.
Senior EVP, Head-Corporate Bank & Member-Operating Committee

A

Happy to. Thank you, Grayson. Just comment from a risk mitigation standpoint with respect to oil field services, we have been through the process of reviewing about 80% of our outstandings. We did that about 45 days ago. We'll begin to do that on a quarterly basis.

As a result of that review, what we observed was that about 25% of the book had previously been downgraded. Virtually all of those downgrades were within the past category. And as a result of that quarterly review, because our bankers have previously downgraded credit, really didn't downgrade any additional credit.

We do anticipate given what has clearly been some reduction in capital spending, that in the latter part of the second quarter, the third quarter and the fourth quarter as we begin to get year-end results for some of these companies, we should see some additional downward migration. But as David pointed out, we have a small group of customers that represent our exposure here. We're close to those customers and we think they're doing the right things to manage their business in a difficult environment.

Separately, we think about our reserve base lending portfolio, we have now been through the borrowing base re-determination for 25% of our book. And what we've observed is about a 20% reduction in borrowing-based availability. Customers still have about 40% availability on average under their lines of credit. Half of the credits

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we've reviewed have remained at their current risk rating. The other half have seen, again, some downward migration in risk rating. But virtually all of that has been within the past category, and so we remain cautiously comfortable with the credit exposure we have in both the reserve base lending and the oil field services books.

Michael E. Rose
Raymond James & Associates, Inc.

Q

Okay, that's great color. And then, maybe as a follow-up to Erika's question, asking it a different way. If rates do stay lower for longer, what areas in the expense side would you look to maybe trim a little bit or take some more action to maybe meet that positive operating leverage goal? Thanks.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, Mike, I will tell you we're not waiting to see what happens with the rate environment. I think being disciplined around expense management is just part of who we are. We've talked about that for a number of years. Clearly, the big drivers for us, our three largest categories of expense, salaries and benefits. Occupancy, furniture and fixtures are the areas that you have to boo the meter on to get any meaningful change. We have deployed a lot of Six Sigma initiatives throughout our company to improve processes. Those process improvements are – some of those are actually revenue enhancement opportunities, but some of those are from a cost standpoint to control costs.

We are down in head count, 122, from the end of the year to the end of the first quarter. And so, you should see us look at those three categories and really every other one, you saw legal and professional down as we continue to watch, really, third party spend, that's probably the fourth biggest one, making sure that we're – when we need a third party, that we hold them accountable and that – in the good old days when we were kind of going through all the changes in the industry, we'd go hire a consultant, and through a lot of labor hours and expense to solve whatever problem we have. Today, we're a little more disciplined in terms of needing to go out for third parties, so that's why that cost is down. And we will continue to look at that category and outside services being probably the fifth one. Those are five areas we'd target.

Michael E. Rose
Raymond James & Associates, Inc.

Q

Great, thank you for taking my questions.

Operator: Your next question comes from John McDonald of Sanford Bernstein.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, John.

John Eamon McDonald
Sanford C. Bernstein & Co. LLC

Q

Hi, good morning, guys. David, I wanted to ask about the deposit service charge line. Just in terms of the first quarter number, if we look at the $161 million, is the Ready Advance fully out of that, and should we see separately some pickup seasonally from the first quarter level?

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David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

That's right. So it was embedded in the decline from the fourth quarter to the first. Half of that was the Ready Advance rolling out, finally. We should not have anything going forward on that in the second quarter. And, as you mentioned, the first quarter is a seasonal low for NSF. And so based on those, we'll see what customer behavior does going forward. The good thing is, we're growing accounts. So if we continue to grow accounts, service charges would be expected to grow commensurate with that.

John Eamon McDonald
Sanford C. Bernstein & Co. LLC

Q

And then in the second half of this year, do we still expect some incremental pressure from changes in posting order, and do you have any update in terms of your plans on rolling that out and timing?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

We've gone through a pilot or so, and our expectation is that that update is still in the $10 million to $15 million per quarter change when we implement, which we expect right now to be in the back half of the year. We have not been as definitive on that date yet, but we're continuing to go through pilots and learning, and as we get closer, we'll give you more specific guidance.

John Eamon McDonald
Sanford C. Bernstein & Co. LLC

Q

Okay, thank you.

Operator: Your next question comes from Bill Carcache of Nomura Securities.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning.

Bill Carcache
Nomura Securities International, Inc.

Q

Thank you. Good morning. On credit this quarter, we saw the smallest release since 2011. And given your comments on what's happening with energy, is it reasonable to expect that the provision is going to start to exceed charge-offs as we look ahead at the rest of the year?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Bill, I think that at this juncture, what we saw this quarter is the vast majority of our credit metrics all improved. And so, we're still feeling very confident about the direction that our asset quality is moving. That being said, we did have a pretty solid loan growth this quarter, as well as, as we discussed, some risk rating downward migration of some of our credits. But I would tell you, it's fairly broad. Certainly, there were two or three credits in energy, two or three credits in healthcare, and some general industries that drove that migration.

But that being said, we're sticking to our process, sticking to our methodology. Making sure we're going through that with a lot of rigor, a lot of discipline. And so, when you look at the quarters going forward, we still believe that

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the general direction holds true, that we should continue to see improvements in asset quality. That being said, you can always have, given where we're at in the cycle, and given the level that our problem loans are at today, you can always have just a handful of credits that will create some level of volatility from quarter to quarter, but we're still confident in the direction of the portfolio.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

I'll add to that. To the extent you continue to see net charge-offs coming down and non-performing loans coming down, our release was only $5 million, which dropped our coverage of loans from $143 million to $140 million. But you could see, if that continues, charge-offs down, NPLs down, you can see that ratio continue to migrate down as credit continues to improve. Notwithstanding Grayson's point that you can have volatility in some of this from time to time.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Well, and we're hoping that loan growth continues at a prudent and modest rate, and that's going to, again, have to be calculated into our provision expense.

Bill Carcache
Nomura Securities International, Inc.

Q

Understood. Thank you. The other question that I had is on the consumer side. We're seeing growth, as you discussed. But it looks like it's a pretty steady deceleration in credit card and in direct auto loans for the last few quarters. So, certainly growth, but decelerating year-over-year growth. I was hoping that you could maybe go a little deeper into both of those businesses. Should we expect that rate of growth to continue to decelerate there?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Well, I think, and I'll speak, and then David can add to this. I think when you look at the consumer, what we've seen is that consumer appears to be paying down debt and servicing debt at a faster rate than they were, and holding more liquidity in their depository accounts. And so, we're seeing a generally healthier consumer from a credit and deposit perspective. As long as the prices at the oil pump stay where they're at – the gas pumps stay where they're at, I think the customer has a lot more liquidity, disposable income than they previously had. And they appear to be very conservative in the way they're using that.

I do think when you look at the two sectors you mentioned, credit card, we're seeing – we're still seeing very strong production in our credit card portfolio. We think that production does translate into an increase in outstanding balances as we go forward. But, there's a lot of seasonality to credit card and we think we're seeing some of that this quarter. But we still think that we've got – given the growth rate of new credit cards, which is growing at about 10,000 cards this quarter, we think we've got – or a month, rather. We think we've got an opportunity there to continue to grow that portfolio.

The auto sector is a little bit different question in that auto sales are still very strong, but there's more competition in that marketplace today and we're more disciplined each and every day in that space. And I think that our pace of growth for that portfolio has moderated. But we're still growing and we still are active in that marketplace. But you should expect us to retain our discipline in how we lend into that space. And so, we still feel good about it, but I do think the pace of growth will moderate.

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David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, I would add credit card, it's a seasonal low. If you go back and look at the trend, we're down in the first quarter historically. But, I mean, the growth over last year at this same time is 5% for credit card. And you heard the growth that we're getting on production. From an indirect standpoint, I'd add a couple things. One, we were up almost 14% if you look year-on-year. Linked quarter it was only 1.6%.

What we've done over the past is we've really weeded out some of the dealers that we were doing business with, as we believed we were getting adversely selected, our loss rates were higher. And so, we actually are down several hundred dealers. And we're looking at getting with the larger dealer groups. We worked on some Six Sigma initiatives to help us [ph] from (37:41) pull-through rates to expand production there. And the industry – the automobile industry had been in the 16 million units, going to – we've seen estimates as high as 17 million units for this year, so we think we'll get our fair share of that and look to grow indirect in 2015.

Bill Carcache
Nomura Securities International, Inc.

Q

That's very helpful. Thank you for taking my questions.

Operator: Your next question comes from Stephen Scouten of Sandler O'Neill.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Steven.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

Hey. Good morning, guys. Question on kind of asset sensitivity and NIM. I mean, I know you said you're forecasting a rate increase maybe in September and December. But, would you guys foresee any changes in the way you look at your portfolio, whether it be adding on swaps or other kind of miscegenations if that rate hike doesn't play out as you expect currently?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Well, we ask ourselves every day what we ought to do to manage our interest rate risk, and given where rates are, we, we believe have been and continue to believe being asset sensitive is the right thing to do. If perhaps we got a quick rise in rates where we might want to lock in a little bit of – and buy some downside protection from there, that might be a time to put on some interest rate swaps.

But right now, where we're looking at the 10-year where it is and expecting a rate increase to come. Because we do know, in particular on the short rates, we're just at a kind of a false bottom. We know that has to increase. And whether or not we get the long end to steepen or whether we have a flat year, we do not yet know. But there will be a time where we consider that stronger than we are right this minute. We think there's more bias to the up rate than there is to the down rates.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

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Okay, that makes sense. And then, just as it pertains to kind of the balance between the loan growth that you expect to see in deposit growth. I know you said for the year maybe deposit growth should be 1% to 2%. But, if you had another quarter like the strong deposit growth you saw this quarter, what would your expectation be there, increased security investments? Or kind of, how would you manage that loan-to-deposit ratio, where would you want that to pan out? Thanks, guys.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

I mean, clearly we'd love to. We're encouraged to see deposit growth as strong as it was in this quarter. It exceeded our internal expectations, but was very promising news. But one quarter doesn't necessarily make a trend. And we're still projecting for the full year sort of a 1% to 2% deposit growth. We'd love to be wrong on that and deposits exceed that. But I think we've got to have another quarter or so before we're convinced that that's true.

I do think from a loan-to-deposit standpoint, we certainly would like to see loan growth more robust than it is to allow us to get a better balance and come closer to peers on our loan-to-deposit ratio. But given the growth in deposits we saw this quarter, well, we backed up 1% or so in that regard. So we are seeing strong lending pipelines and hopefully we'll have a – we'll see continued strength in loan demand. But I don't – at this juncture don't see it strong enough to offset the growth in deposits that we're seeing.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee
A

Yeah, I think as a result of that, you're seeing us, in our securities book, still pretty high percentage of our earning asset base a little higher than we would like. But we're not going to manufacture loan growth. If the loan growth is there and it's prudently underwritten, then we'll deploy that cash there. But if not, we'll put it in the securities book. We've been relatively short on securities and we paid a price for that in terms of the lower NIM, but we think that's the right call. And to the extent, we had deposit growth outsizing that 1% to 2%, that's what we would do absent the loan growth.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP
Q

Thanks so much, guys.

Operator: Your next question comes of Ryan Nash of Goldman Sachs.

Ryan M. Nash
Goldman Sachs & Co.
Q

Hey, good morning, guys.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

Good morning.

Ryan M. Nash
Goldman Sachs & Co.
Q

David, I'm trying to get some clarity on the outlook for the net interest margin. Clearly, you're saying that there's increases for rates in your budget. But how do we think about the trajectory of the NIM before we actually get

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interest rates rising? I just wanted to make sure that your guidance you gave us last quarter was still applicable. So, if the 10-year stays at around the current level, the downside case could be 10 basis points to 12 basis points.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah. Ryan, you're right, it's gotten a little better. We think to the extent we stay – again, last quarter we said the 1.75% to 2% 10-year -- if we took that today, that would probably be in the 9 basis point to 10 basis point range. So a tad better than what we disclosed to you last quarter.

Ryan M. Nash
Goldman Sachs & Co.

Q

And just the trajectory of it?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, I think we would continue to have pressure leading into 2016 with this low rate environment now that the near term quarter is not as impacted as it is. It's the back half of the year that's most negatively impacted by maintaining this low rate environment.

Ryan M. Nash
Goldman Sachs & Co.

Q

Got it. And just then on expenses, you're obviously down year-over-year in the first quarter and you're talking about remaining committed to prudent expense management. But, I was just wondering, given what you're doing on the branch side, you talked about reducing professional fees and you referenced something about spacing. Should we see the absolute level of expenses decline for the remainder of this year relative to 2014?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

We gave you a little bit in the prepared comments. We had a couple things. So, we had some benefits from a $15 million benefit in the first quarter that offset the payroll tax increase that won't repeat. We also will have the impact of our merit increases that we gave our folks, we'll have a full quarter of that. And then, we had a – our legal and professional fees were down quite a bit from historical quarters. We think that there is some volatility there. I don't think it'll be back where it was a quarter before, but I'm not as confident that it could repeat at the level that we had this past quarter. So you might see a little bit of a tick up from that. But that being said, we are looking at every expense category every day to control those going forward in 2015 into 2016.

Ryan M. Nash
Goldman Sachs & Co.

Q

And David one quick follow-up on that, when I look back on past years there's not much seasonality heading into 2Q on the comp line. I was just wondering if you maybe size for us how big of an increase we should expect for things like merit increases.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

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Well, if you – we have increases that have been in that 2.5% range on salaries for merit and then I told you about the $15 million that won't repeat so you can do some – and we had $11 million that was in there already for payroll taxes. So if you take those three things you'll get pretty close.

Ryan M. Nash
Goldman Sachs & Co.

Q

Thanks for taking my questions.

Operator: Your next question comes from Eric Wasserstrom of Guggenheim Securities.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Hi, Eric.

Eric Wasserstrom
Guggenheim Securities LLC

Q

Hi, thanks very much for taking my question. Just wanted to circle back on the credit quality issue. The information that you've given about the energy portfolio is perhaps better than what we might have expected but it sounds like maybe some of the other stuff is a little bit worse, considering that there isn't necessarily evident pressure on other sectors of the economy. So I'm wondering if you could just maybe give us some insight about what's causing the negative rating migration in areas outside of the energy portfolio.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, I think one of the things we wanted to communicate to you is that migration was really with a handful of large credits. And some in energy, some in healthcare and other industries. And really, if you look behind that, it's idiosyncratic issues with each of those, there's nothing systemic with them that caused that rating downgrade – there were downgrades within the past category, you saw the downgrades into classified but there's really nothing, again, systemic there that causes us concern with the overall portfolio.

Eric Wasserstrom
Guggenheim Securities LLC

Q

Okay. So just in terms – I mean, you've been very clear about your overall expectations for [ph] MPL (46:58) but I guess my – is that just a function, then, of the expectation that these idiosyncratic issues have now been sort of addressed and there's nothing similar on the horizon, is that, basically, the interpretation?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

That's right, we feel like we recognize what the issues are clearly, each of these has their own story and depending on where that story goes you could have further downgrades and further deterioration. We're just trying to send the message that there's nothing systemic, that these are a handful of credits that really cause this issue. So hopefully – we believe we recognize the issues that are there today and where they go from here, they can get better, they might get worse and we'll pick that up real time in our provisioning. But we think we've gotten our arms around it.

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Eric Wasserstrom
Guggenheim Securities LLC Q

Thanks very much.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee A

I'll let Barb Godin our Chief Credit Officer, if you would make a few comments.

Barbara I. Godin
Senior EVP, Chief Credit Officer & Member-Operating Committee A

Yes, I was just going to jump in and say, looking at the list of what did migrate, and firstly, the majority of them are paying as agreed. We are very close to our customers in terms of the credit servicing and making sure that if we see anything at all that we will move that into a non-pas rated category until things cure themselves. But as I'm looking at the reasons, fail to renew largest contract, another was a systems issue, delay, another was a billing and order processing issue, et cetera, so there is nothing that I saw in there as – and we do go through each and every one of these credits with a fine-toothed comb, that said there's a warning signal or there's an emerging risk that we haven't recognized. I also would anticipate that the majority of these credits will move back to a past category in the next few quarters.

Eric Wasserstrom
Guggenheim Securities LLC Q

Thanks very much.

Operator: Your next question comes from Ken Usdin of Jefferies.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee A

Good morning Jeff.

Kenneth Michael Usdin
Jefferies LLC Q

Hi, good morning. Just the question on the securities portfolio. It's been about the same size and your yields actually went up a little bit sequentially and I just want to understand as you're trying to manage the rate environment, LCR et cetera, are your investment yields coming in higher or was there a delta in premium amortization that you could perhaps explain as well? Thanks.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee A

Yes, Ken, it's a couple things. One the day count does impact that. So we moved, I think it was what, [ph] 244 to 251 (49:23) and premium amortization for us was down a little bit about $3 million. So, it didn't take a whole lot to move that around a little bit. I think your basis – your question is, are we doing anything structurally different, and the answer is no.

Kenneth Michael Usdin
Jefferies LLC Q

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Okay. And then second question is just, given – you've talked about this in the past this year relatively strong positioning from a capital perspective, and you did do a good job in terms of raising your CCAR ask relative to prior years. But, you're still sitting on a tremendous bed of excess capital. So, with regards to opportunities like you did this quarter to take down the long-term debt, can you just give us any updated thoughts on whether it's the outstanding commercial portfolios that are out there potentially or acquisition appetite? Any updated thoughts on your incremental usage of excess capital? Thanks.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, so, one of our three strategic pillars is really effectively deploying our capital. We did that through our 2015 CCAR, as you mentioned. We do realize that we have excess still, but the things we want deployed in, the way we think about it is, we want it deployed in our loan growth, and when we have excess after that, we look to have acquisitions, whether it's banks or non-banks. We're doing a lot of work around that. To use the excess capital, I want to be real clear that when we think about acquisitions, it's more about using the excess capital in cash, versus using our shares where they're priced today. And so, we're looking at that to the extent we can do some transactions and still have some excess capital, perhaps. We'll return that to the shareholders because we don't want that denominator of the return on tangible common equity to continue to grow and accrete. We need to get that more optimized so that we can get our return metrics where we want them to be. It just takes time, and we will get there.

Kenneth Michael Usdin
Jefferies LLC

Q

Thank you, David.

Operator: Your next question comes from John Pancari at Evercore ISI.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, John.

John Pancari
Evercore ISI

Q

Good morning. I wanted to see if you can give a little more color on loan yields in the first quarter. We saw quite a few increases in select portfolios, including commercial real estate, owner occupied, investor mortgage, all up selectively. I just wanted to get the drivers of that, and if we should expect that such yields could remain stable or even move higher from here.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

John, you mentioned – so, overall loan yields you can see we're down 1 point. Some of that can be driven by mix. We're trying to stay pretty disciplined with our pricing. If you look at our loan growth relative to peers all through 2014, we grew nicely at 3.6% for that year, but we are below our peers. Part of that's being discipline in terms of what we want to put on our books and making sure we're getting paid for the risk that we take.

As we think about expectations for increasing or improving, the easiest portfolio for that to happen is really in our home equity portfolio, because we still have a portion of our home equity portfolio that was priced at prime minus

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a half, or prime minus one. And as refinance activity takes that out, we get a little bit of an increase in home equity. You can see it was up just 1 point this past quarter.

So, we're really trying. I guess the main thing is we're trying to be disciplined with regards to pricing. But I would not expect any major increase in loan yields over the near term.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

Yeah and John, we're trying to remain very disciplined around loan pricing, and think we've done a pretty good job there. That being said, it's a very competitive marketplace today. And you're trying to book the prudent loans that you have the opportunity to, but with the level of competition in the market, it's hard to move those rates up absent some kind of interest rate increase.

John Pancari
Evercore ISI
Q

Right, but I guess what I was getting at also is that, if you look at the linked quarter change in the portfolio yield for your commercial real estate mortgage owner occupied, as well as the non-owner occupied portfolios, they actually saw an increased linked quarter in the average yield, and I'm just wondering how you accomplish that.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

They actually did. And, predominantly, that's the mix of loans in those categories, is we got new and renewed production.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee
A

And if you look at the sheer dollars that are in our supplement, you'll see that the interest income from those portfolios remained relatively the same. And in the case of investor real estate mortgage, we had some properties that rolled out of the portfolio that were at lower rates than what was going on. So it just looks a little odd that we increased – it's showing 10 basis points but the income is only $1 million difference. You get a little bit of an anomaly when you look at it just quarter to quarter.

John Pancari
Evercore ISI
Q

Okay, and then my second topic was just around the credit deterioration, again, in the healthcare and other portfolios. Were they shared national credits at all? And then separately what was the average size of those credits that moved on to classified status?

Barbara I. Godin
Senior EVP, Chief Credit Officer & Member-Operating Committee
A

Yes, a handful of them were shared national credits. In fact, the majority of them were shared national credits that did move – wherein we don't lead any of those shared national credits. And in terms of the average size, it would be approximately $30 million each.

John Pancari
Evercore ISI
Q

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Okay, thank you.

Operator: Your next question comes from Betsy Graseck of Morgan Stanley.

Betsy Graseck Q
Morgan Stanley

Hi, good morning -- Morgan Stanley.

O. B. Grayson Hall A
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

Good morning.

Betsy Graseck Q
Morgan Stanley

I just had a question around the debt refinancing. You have a stack of high-cost debt behind what you just re-fied and I'm wondering what your thoughts are on continuing that process?

David J. Turner, Jr. A
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

Yeah, Betsy. So we – the remaining debt that we have is really tied to capital instrument, so anything that's a capital instrument has to be subject to the CCAR process. As we think about – have thought about that, we want to be careful in terms of just getting high-cost debt, if it's uneconomical, in other words, the payback period being so excessively long wouldn't make sense to us.

If you recalculate the payback period on what we did take out between two, three years, so that works for us. When you start going out, six and seven, eight, nine years it just doesn't make it worth our while, notwithstanding the fact that we know we have excess capital, but we just don't think that's the right thing for us to do – go ahead.

Betsy Graseck Q
Morgan Stanley

I was just going to say if the rate environment continues say lower for longer or tougher for longer, does the math start to work in your favor to take down some more of this debt?

David J. Turner, Jr. A
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

You know, if it's lower, it still works against us because, yeah, we may be able to get an issue out there that's fairly cheap relatively to what we have, the premium that you have to pay to take it out is just enormous and that's certainly where we'll get tripped up.

Betsy Graseck Q
Morgan Stanley

Yeah.

A – [09K6X4-E David Turner]>: If we can get the holders to take without a premium that'd be good.

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Betsy Graseck
Morgan Stanley

Q

Unlikely to happen. Thank you.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Thank you.

Operator: Your next question comes from Matt Burnell of Wells Fargo Securities.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Matt.

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Good morning, folks. Just have a question on the deposit growth which you've mentioned a couple times. And perhaps this is specific to David's comments about retail deposits, but it looked like the non-interest bearing deposits balances were up about $1.8 billion on an end of period basis versus being up only about $300 million on an average basis. What's going on there? And does that have any implication for your outlook for deposit growth in the next couple of quarters?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Yeah, I mean we spend a lot of time obviously analyzing the deposit growth. And I think the good news is what we found is that the growth has been broad in terms of across our markets. It was not isolated to a particular market or a group of markets but was fairly broad-based across the markets that we serve.

To David's point a moment ago, we are growing accounts and growing households that are banking with us and so we are, you know, obviously starting to see the benefit of that. But most of our growth, as you've seen, was in the low-cost deposit, or non-interest bearing deposit categories which is some of the more favorable deposit mix that we could have hoped for.

We do know that there is some seasonality to these deposits. There's tax refunds that are occurring for consumers today. We also know that the consumer is having a fairly substantial benefit in reduction in gasoline prices that they're having to pay. When you aggregate all of that, consumers, as we mentioned, are really servicing and paying down consumer debt in a much more productive manner this quarter than we've seen last quarter, and we also are seeing much more liquidity on the part of those consumers. So, it's a behavioral change, at least for this quarter that we've seen in our consumer base. I think we've got to have a little more time before we absolutely agree that that's a behavioral change with some length to it. But, so far, it's a very promising start to 2015, in that regard. We just got to see how well it holds up.

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

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Okay. And David, a quick administrative question for you. In terms of the branch consolidation charge this quarter, you mentioned that was related to your plans to reduce branches by about 50 this year. Should we expect future charges along those lines, or is that it for this year related to the 50 you've mentioned?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee **A**

We don't have any current plans for further consolidation at this time. That being said, we constantly look at our network, including where we might want to consolidate and where we might want to build new branches. We still believe that is a very important channel for our customer base. And so, while we don't have plans today, we will continue to look at refining and, to the extent we see opportunities to consolidate, we'll do so.

Matthew Hart Burnell
Wells Fargo Securities LLC **Q**

Okay, thank you for the color.

Operator: Your next question comes from Paul Miller of FBR Capital Markets.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee **A**

Good morning, Paul.

Paul J. Miller
FBR Capital Markets & Co. **Q**

Yeah, thank you very much. Most of the questions have been already asked, but I wanted to ask a little bit about the mortgage side of the business. One of your competitors in your region was seeing very strong purchase production growth over the last couple months, especially out of the state of Florida. Can you add any color around that? Have you seen the same thing?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee **A**

We have. If we look at our production, you can see this in our supplement, but our production, from a purchase standpoint, with 60% of our volume and refi 40%. So, we're seeing a strong purchase. It was down a little bit for us in the first quarter relative to the fourth. Refi has really picked up, given the rate environment that we saw and we like that volume that we're seeing going into the quarter. So, we're looking for continuation of improvement throughout the year, in particular, next quarter. But, yeah, we're fairly consistent with what you're describing.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee **A**

I mean, all the metrics that we're following in the mortgage business are positive at the moment. We, like most people, anticipate a very strong second and third quarter. The mix shift in purchase versus refinance moved around a little bit on this quarter because of the rate move. But, overall, much better picture in the mortgage business.

Paul J. Miller
FBR Capital Markets & Co. **Q**

Okay. Hey, guys, thank you very much.

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Operator: Your next question comes from Geoffrey Elliott of Autonomous Research.

Geoffrey Elliott
Autonomous Research LLP

Q

Hello there. You've talked a couple of times this year about the opportunity to acquire some servicing assets on the mortgage side. Could you just give an update on your appetite there and how that fits into your broader thoughts on deployment of capital?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, so, there are three pillars to our strategy, as we've mentioned, and one of them is diversifying revenue. Another one is deploying capital. Positive operating leverage is the third one in the middle. So, if you think about diversifying revenue for us, we believe we have a competitive advantage in servicing. We're very good at it. It's a low-cost operation for us. And we have room to put that on our books, even though capital charge coming through and Basel III is a little more onerous. We believe that's a good use of our capital, and have been looking for portfolios to purchase.

But we aren't going to buy just any portfolio. We want to buy a portfolio that's in our market. We want a portfolio where those can be our customers. We did do one deal, $406 million, but we're out there looking. There are people shopping some today that we've taken a look at, but we're pretty strict in terms of what we're willing to take on.

Geoffrey Elliott
Autonomous Research LLP

Q

And, in terms of the size of portfolio that you're looking at, can you give us a sense on that?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

The sense of the portfolios that we're looking at?

Geoffrey Elliott
Autonomous Research LLP

Q

Yeah.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Well, we want them to be in our footprint.

Geoffrey Elliott
Autonomous Research LLP

Q

The size. Sorry, the size of the portfolios.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

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Yeah. Somewhere in the $500 million to $1 billion range is what we'd be looking at.

Geoffrey Elliott
Autonomous Research LLP

Q

Great. Thank you very much.

Operator: Your next question comes from Marty Mosby of Vining Sparks.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Marty.

Marty Lacey Mosby
Vining Sparks IBG LP

Q

Good morning. Thanks for taking the question. David, I had a very technical kind of accounting. When you talked about the affordable housing, you talked about the increase in the tax rate and then you talked about an increase in fee income, I think. Was there just a compression of fee income from the affordable housing? Because I've seen it in expenses and not income, so I just wanted to make sure that was the right geography.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, it's an income for us, Marty. It's an offset – it had been an offset to income historically for us and we adopted a new accounting literature. We took that offset, which was a debit, and we moved it down to the tax line. So it actually improved our NIR. And our tax expense obviously went higher by that 300 basis points I mentioned.

Marty Lacey Mosby
Vining Sparks IBG LP

Q

Thanks.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

So just geography.

Marty Lacey Mosby
Vining Sparks IBG LP

Q

Okay. And then, the other thing that I was looking at was we've kind of hit what you might call a stall point here with a couple of issues creating some headwind. What are the catalysts that you're really looking for, besides rates, that could create the next earnings momentum for you over the next year or two? Thanks.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Well, I think that deploying our capital is important to us. There's no single one thing that would knock it out of the park. It's doing a lot of things well. It's executing our business plan. It's continuing to grow loans and deposits. It's continuing to deploy our capital, looking at acquisitions for banks and non-banks, making the investments in people. You can look at wealth management as a prime example. We've taken the medicine of making investments in people knowing that it's going to take time to generate revenue.

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We believe further investment in those people in wealth management, as an example, is the right thing to do. There are other businesses we're looking at doing the same thing, too. Capital markets is an area where we'd like to expand and be larger in, as we differentiate or diversify away from spread. And so, we are like you, we're not sitting here waiting for rates to bail us out. We're making a difference by growing these revenue sources, watching our expenses as we go, but needing to make the investments of dollars to generate revenue growth.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

Yeah, Marty, I mean, it's a great question. And a very relevant question, where the industry is right now. And quite honestly we don't see some one thing that we could do that would alter our forward momentum. What we are committed to is very steady and consistent progress in strengthening our balance sheet, strengthening our business. And we've had – we had over the last couple of years, really trying to put in a whole new set of strategies for how we grow our core business. And we're starting to see the fruits of that labor in that we're seeing growth more broadly across our markets and more broadly across our product lines. We obviously are augmenting our product lines and we're augmenting the number of people we're partnering with to grow our business.

But I think, to David's point, the biggest thing that would help from an earnings standpoint is the rate environment. But we can't wait on that. We can't depend on that. And plus, our core business is really the long-term sustainable health for the company. And so, I think you're going to continue to see us very broadly in a very diversified way, continue to try to grow all aspects of our business. And if we can do that in a very steady and consistent manner, I think we've got a very sustainable business model and one where shareholders benefit long-term.

Marty Lacey Mosby
Vining Sparks IBG LP
Q

Thanks.

Operator: Your next question comes from Gerard Cassidy of RBC.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

Good morning, Gerard.

Gerard Sean Cassidy
RBC Capital Markets LLC
Q

Good morning, Grayson. Question, David. You were talking about using the excess capital to potentially buy portfolios or even obviously give it back to shareholders but you did also mention that your primary purpose is to grow the loan portfolio, of course. If we put aside your excess capital that you have today and we just look at your ongoing earnings, how much loan growth do you need every year to optimize the excess capital you create every year so you don't need to go out and buy a portfolio or buy another bank?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee
A

That's a great question. I think if you looked at our generation, you could almost have a third of that to be used, 30%, 40% of that be used up for loan growth. You're going to have 30% to 35%, maybe 40% in dividends over time and then the other would be returned to the shareholders. That's kind of what the math would lead you to. But we

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want to grow. We do have the excess so we have to put that to work. But outside of the excess I think it's almost a third, a third, a third.

Gerard Sean Cassidy
RBC Capital Markets LLC Q

And when you look at the third for loan growth, what kind of loan growth would you need to use that third of the capital? Is it 8% or 9% per annum, or 3% or 4%?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee A

It's in that 4% or 5% range.

Gerard Sean Cassidy
RBC Capital Markets LLC Q

Good. And then circling back to your syndicated loans, of the oil presence or energy presence that you have with that portfolio of over $2 billion, if I recall, how much of that is in syndicated loans? And second, as part of that, is your approach when one moves into a classified category, is your approach to a syndicated loan where you're a participant different than your approach when it's not a syndicated loan and you're the lead and you're working with the customer?

Barbara I. Godin
Senior EVP, Chief Credit Officer & Member-Operating Committee A

Firstly, the majority of our product in energy is syndicated loans. I believe, just roughly 86% are syndicated. Secondly where we're the lead versus a participant, irrespective we're still required even as a participant to make sure we have all the appropriate information about that customer, we work with the agent and we make our own determination as to what that risk rating should be and it can be different from the agent, often it is not different from the agent, however. And they are synced up once a year typically during the shared national credit exam.

Gerard Sean Cassidy
RBC Capital Markets LLC Q

Thank you.

Operator: Your next question comes from Sameer Gokhale of Janney Montgomery Scott.

Sameer Shripad Gokhale
Janney Montgomery Scott LLC Q

Hi, thank you.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee A

Good morning.

Sameer Shripad Gokhale
Janney Montgomery Scott LLC Q

Morning. Or afternoon here. I had a question about the pull-through rates in your indirect auto business, again, just to revisit that. I think you had mentioned that you're doing some Six Sigma initiatives there and that's led to

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some improvement in pull-through rates. But, I was curious if that improvement was related to maybe any sort of bottlenecks in terms of your ability to underwrite those loans. Have you automated underwriting or can you just tell us specifically what you may have changed there that's helped improve pull-through rates?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah. That's a great question. So, I had mentioned earlier we deployed our Six Sigma teams throughout the bank, some of them are revenue producing and some of them are expense management. This particular one was revenue producing. And what we found is they analyzed our process and noted that in some cases, when an application would come through our center, that it would get kicked out for certain underwriting exceptions that would then force a human being to look at the underwriting and force that person to make a decision whether or not they're going to approve it.

Now, by the time that happens, that deal's already been done with the dealer because the dealer requires speed of execution. So what we did is we found that those cases where an underwriter is approving the deal, we changed our algorithm to build into that the acceptance so that it wouldn't kick out. And that improved – that one change improved our pull-through rate quite substantially, and that was a big driver of our increase in revenue over the past couple of quarters.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

We've really tried to focus our teams on the larger dealer groups. And if you look at this business, obviously quality of answer is important, quality of answer is important both to the customer, to the dealer and to us. But speed of answer is also very critical. And so, we worked on both. We greatly improved our quality of answer and we greatly improved our speed of answer all through automation. And also in terms of targeting who we want to do business with, from a dealer standpoint. And so, that rationalization of how we do business and who we do it with has made a tremendous difference in our pull-through rates.

Sameer Shripad Gokhale
Janney Montgomery Scott LLC

Q

That's very interesting. Thank you. And then, just another question, in terms of the consolidation of your bank branches. I think it sounded like you're more or less done based on your guidance, the 50 branches, but could look at ongoing opportunities. But are you using any sort of Six Sigma initiatives there also, to rationalize these branches?

And, as you think about consolidating these branches or the process that you follow, to what extent do you look at just kind of the marginal profitability? So marginal revenue minus marginal cost, because it seems like you probably have a lot of centralized technology and IT costs that are spread across branches and, to the extent you shut down these branches, if they're marginally profitable, then you don't get to leverage those technology costs. So, are other efficiency items more important, or do you look at it marginal revenue, marginal cost? How do you think about that?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Yeah, I mean, first of all, our branch rationalization process is a continuous process. And we're constantly looking at transaction activities, marginal costs, marginal profitability, and trying to figure out what our branches deliver in terms of direct contribution. Making sure that all of our branches are profitable on a direct basis.

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But when you look at the analytics of the branch system, and where we consolidate, and where we expand, that process is very comprehensive, and you have to factor in the relevance of the branch because, still, 80% of our new account sales come from the branch offices. And so, we're very careful to determine, if we consolidate a branch, how many of those customers did we lose? That has a lot to do with where they're being consolidated into. How far away that receiving branch is from the consolidated branch. We also have to factor in the community impact of that. Even though a lot of our customers bank with us over digital channels, that bank branch is still a community asset, and it's still an asset that that community values, and we have to think through all of those issues before we consolidate.

We have tried to really still be engaged in all of our communities and deliver service in all of our communities. We try to do that in the most efficient way we can. So, those analytics are comprehensive and they're done on an ongoing basis. And we think that, while we will continue to see consolidation opportunities, we also see the need where some communities need more branches. And so, on a net-net basis, when we think about it, we're not sure that our number of branches, over time, diminishes that much. In fact, we think, over the next few years, we'll be relatively stable. But we're going to let the analytics drive that. And so, we let the analytics tell us where we ought to expand and where we ought to contract.

Sameer Shripad Gokhale
Janney Montgomery Scott LLC — Q

Great. Thank you very much. I appreciate the explanation.

Operator: Your next question comes from David Eads of UBS.

David Eads
UBS Securities LLC — Q

Hi, guys. Thanks for taking the question. You've given some pretty good color on various kind of line items in loans, and I was wondering if you could talk a little about what you're seeing in the real estate construction portfolio? You guys did have had some pretty strong growth there recently. Just kind of curious how big that can get and how – kind of what trends you're seeing there?

John M. Turner, Jr.
Senior EVP, Head-Corporate Bank & Member-Operating Committee — A

Yeah, this is John Turner. When you speak about construction, I guess you mean overall, just generally in the portfolio I would say...

David Eads
UBS Securities LLC — Q

Well, in the investor real estate, real estate construction line.

John M. Turner, Jr.
Senior EVP, Head-Corporate Bank & Member-Operating Committee — A

Yeah, so we're very focused on managing that exposure fairly tightly as a finite resource across all the markets that we do business in. Majority of exposure would break down between homeowner finance, which is a $700 million-plus portfolio, and then our multi-family business. And I think what you're seeing is, as that portfolio grows its fundings under previously approved construction facilities. We really have not been originating a lot of additional multi-family credit over the last six-plus months. And so, primarily, the growth is fundings under a portfolio that

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currently has a duration of about 23 months plus or minus. So fairly short duration, a lot of turnover and, again, we're managing it as a very finite resource, given what we believe is some softness in a few of the markets that we operate in.

David Eads
UBS Securities LLC Q

All right. So you sort of expect that growth to taper off here pretty quickly?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee A

I would say, yes, expect it to moderate.

David Eads
UBS Securities LLC Q

Great, thank you.

Operator: Your final question comes from the line of Vivek Juneja of JPMorgan.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee A

Good afternoon.

Vivek Juneja
JPMorgan Securities LLC Q

Good afternoon, John, Grayson. If I look at your efficiency ratio, if I add back the $15 million your core efficiency ratio is 66% which is similar to the last quarter and a year ago. And we factor in the deposit advance – sorry, not the deposit but the NSF fees declines that you'll be seeing in the second half. It seems to me it's going to be tough to go much below this, even though you're working on cost cuts and just continued improvement. Can you walk through what else you need to do to try and get the efficiency ratio really down materially?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee A

Well, we have focused on our efficiency ratio. The big driver there is revenue generation. And we've made the investments, we've talked about the growth that we've seen in NIR, we've seen the loan growth. So as our revenue grows and it takes a little bit of pressure off the expense side, but we're working on that, too. If you take all three, two revenue improvements NII and NIR and work it on expense, we do expect the efficiency ratio to drift down where our goal is just to get down into the lower 60%s. We really want to be in the 55% to 59% range, but we'll have to have a rate increase to get there. So absent that, we would be in the – we expect to be in the lower 60%s. So it's our focus every day.

Vivek Juneja
JPMorgan Securities LLC Q

Lower 60%s even post the NSF reduction, David?

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David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

With a rate increase, yes.

Vivek Juneja
JPMorgan Securities LLC

Q

Oh, with a rate increase. Okay, got it. Okay, great, thank you.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

Thank you. I believe that was the last question. We appreciate everyone's time and attention today. Thank you very much.

Operator: This concludes today's conference call. You may now disconnect.

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