19-Jan-2018

Regions Financial Corp. (RF)

Q4 2017 Earnings Call

Copyright © 2001-2018 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

Dana W. Nolan
Executive Vice President - Head of Investor Relations, Regions Financial Corp.

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

John B. Owen
Senior Executive Vice President & Head-Regional Banking Group, Regions Financial Corp.

John Turner
President & Head of Corporate Banking Group, Regions Financial Corp.

Barbara I. Godin
Chief Credit Officer & Senior Executive Vice President, Regions Financial Corp.

OTHER PARTICIPANTS

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

John Pancari
Analyst, Evercore Group LLC

Ken Usdin
Analyst, Jefferies LLC

Geoffrey Elliott
Analyst, Autonomous Research LLP

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.

Stephen M. Moss
Analyst, B. Riley FBR Inc.

Steven Duong
Analyst, RBC Capital Markets LLC

Christopher William Marinac
Analyst, FIG Partners LLC

Copyright © 2001-2018 FactSet CallStreet, LLC

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 participant phone lines have been placed on listen-only. At the end of the call, there will be a question-and-answer session. [Operator Instructions]

I will now turn the call over to Ms. Dana Nolan to begin.

Dana W. Nolan

Executive Vice President - Head of Investor Relations, Regions Financial Corp.

Thank you, Paula. Good morning, and welcome to Regions' fourth quarter 2017 earnings conference call. Grayson Hall, our Chief Executive Officer, will review highlights of our year-over-year financial performance; and David Turner, our Chief Financial Officer, will take you through the details of the fourth quarter. Other members of management are also present and available to answer questions.

A copy of the slide presentation referenced throughout the call, as well as our earnings release and earnings supplement are available under the Investor Relations section of regions.com. Our forward-looking statements disclosure and non-GAAP reconciliations are included in the appendix of today's presentation, and within our SEC filings. These cover our presentation materials, prepared comments, as well as the question-and-answer segment of today's call.

I will now turn the call over to Grayson.

O. B. Grayson Hall, Jr.

Chairman, President & Chief Executive Officer, Regions Financial Corp.

Thank you, Dana. Good morning, and thank you for joining our call today. Let me begin by saying we're pleased with our fourth quarter and full year 2017 results. We successfully met our profitability targets for the year as we continue to diligently execute our strategic plan. For the full year, we reported solid earnings of $1.2 billion, up 9% with earnings per share of $1, an increase of 15%, while producing growth in pre-tax pre-position income, and generating positive operating leverage of approximately 2%. Keep in mind, these results include charges associated with tax reform, which speaks to our core performance in 2017. David will cover these details in a moment.

Looking back over the year, I'm particularly pleased with our unwavering focus on customer service and the recognition we've received in that regard. This is what relationship banking is all about, and it is at the core of our niche-based go-to-market strategy.

As a result of our efforts, the American Customer Satisfaction Index recently awarded Regions with a number one ranking. Our focus on outstanding customer service has led to year-over-year growth in checking accounts, households, credit cards, wealth management relationships, total assets under management and consumer loans, all of which are fundamental to growth and future income generation.

As announced a few weeks ago, we have embarked on a new initiative called Simplify and Grow, which enables us to continue enhancing our ability to serve our customers as we make it easier for them to bank with Regions.

Copyright © 2001-2018 FactSet CallStreet, LLC

The evaluation and discovery phase is well underway, and we expect to begin the execution phase in the first quarter.

With respect to our financial performance, full year results continued to benefit from our asset-sensitive balance sheet and strong deposit franchise, which drove a 4% increase in adjusted net interest income and a 19 basis point increase in adjusted net interest margin. Prudent expense management remained a top priority in 2017. On an adjusted basis, total non-interest expenses increased less than 1% over the prior year, in line with expectations, reflecting disciplined expense management along with prudent investments in technology and other revenue-generating opportunities.

In addition, we expect that our Simplify and Grow strategy will further enhance our efficiency efforts, which we would share with you later in the year. In terms of the economic backdrop, we are encouraged by improving conditions as well as customer sentiment, providing momentum as we head into 2018. As an example, loan production began to pick up in the second half of the year. For the full year, new and renewed loan production increased 8%, and total loans and leases grew approximately $600 million on a point-to-point basis in the fourth quarter. In 2017, deliberate risk management decisions regarding certain industries and asset classes within the Corporate Banking segment negatively impacted loan balances.

For the most part, these efforts are now complete and our improved credit metrics illustrate these strategies are paying off. To that end, we experienced broad-based improvements during the quarter, including a reduction in non-performing loans at the lowest level in over 10 years.

Regarding tax reform, we're encouraged by the legislation passed in December, and believe domestic businesses will be better positioned and more competitive in the global marketplace. For Regions, tax reform provided the opportunity to make additional investments that will benefit our associates, our customers, our communities and our shareholders. We announced increase to our minimum hourly wage benefiting approximately 25% of our workforce. We made a $40 million contribution to our charitable foundation to support financial education, job training, economic development and affordable housing. We also disclosed our plans to invest more in our company through a significant increase in our capital expenditures budget.

As we enter 2018, there are four key areas providing considerable momentum for Regions. First is our asset sensitivity and funding advantage, driven by our low cost deposit base, which we believe provides significant franchise value and a competitive advantage in a rising rate environment.

Second is asset quality. As reflected this quarter, we continue to report broad-based improvements in credit. Next, robust capital returns as we continue to move towards our target Common Equity Tier 1 ratio. In 2017, we returned $1.6 billion to shareholders through share repurchases and dividends, representing a $488 million or 42% increase over the prior year. Finally, we expect additional improvements in efficiency and core performance through our Simplify and Grow initiative. We will provide additional details of the expected financial impacts later this year.

Before I turn it over to David to cover the details of the fourth quarter, I would like to express my sincere appreciation and gratitude to our team of associates for their hard work and dedication in this past year. I'm proud of our accomplishments and results. We ended the year with good momentum and look forward to leveraging additional opportunities in 2018. David?

David J. Turner, Jr.

Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

Copyright © 2001-2018 FactSet CallStreet, LLC

Thank you, and good morning. Before we get started, let me summarize the impact tax reform had on our fourth quarter results. The company revalued its net deferred tax assets and revised its amortization associated with low-income housing investments, resulting in a combined $52 million charge through income tax expense. The company also reduced income associated with leveraged leases resulting in a $6 million reduction to net interest income, and a 2 basis point decline to net interest margin.

As a result of anticipated future savings, the company also contributed $40 million to its charitable foundation. As it relates to regulatory capital, tax reform also had a negative impact. The revaluation of deferred tax items included approximately $130 million included in equity as a component of other comprehensive income. Despite our prior election to exclude accumulated other comprehensive income from regulatory capital, the full revaluation charge was reflected in net income, as noted above, reducing regulatory capital by approximately 10 basis points.

Accounting rule makers subsequently issued a proposed rule change to correct this issue via a reclassification between accumulated other comprehensive income and retained earnings. At this juncture, we expect to reclassify these components and recapture those 10 basis points in the first quarter of 2018. Further impacting 2018, the fully taxable equivalent benefit, provided primarily from tax advantage loans, will reset in the first quarter. We estimate the impact to be a reduction to net interest margin of approximately 4 basis points.

Now, turning back to the quarter, as Grayson mentioned, we are pleased with our fourth quarter results, which reflect improvements in several areas. Let's start with the balance sheet and look at average loans. In the fourth quarter, average loan balances totaled $79.5 billion, relatively stable with the prior quarter. Loans ended the year at $79.9 billion, reflecting approximately $600 million in point-to-point growth over the prior quarter.

Within Consumer, we continued to grow despite the negative impacts associated with our exit of a third-party relationship within the indirect vehicle portfolio.

Average balances in the consumer lending portfolio increased $40 million in the fourth quarter. However, excluding the run-off in the indirect vehicle portfolio, average consumer loans increased $223 million.

For 2017, run-off in the third-party portfolio totaled $508 million, and we expect the full-year average decline in 2018 to be approximately $700 million. In the quarter, we experienced solid growth in residential mortgage, indirect-other consumer and consumer credit card, partially offset by continued declines in home equity lending.

Turning to the business lending portfolio, average balances totaled $48.2 billion, reflecting a modest decline from the third quarter. However, ending balances increased by approximately $500 million. Commercial and industrial loans grew $672 million on an ending basis, led by growth in specialized lending.

Owner-occupied commercial real estate loans declined $94 million, reflecting a slowing pace of decline. Additionally, investor real estate loans declined $101 million, as growth in term mortgage loans was offset by declines in construction loans. As we look to 2018, we expect full-year average loans to grow in the low-single-digits, excluding the third-party indirect vehicle portfolio run-off.

Let's move to deposits. We continue to execute a deliberate strategy to optimize our deposit base by focusing on valuable low-cost deposits, while reducing higher-cost brokered and collateralized deposits. Total average deposits increased modestly during the quarter, as growth in low-cost deposits exceeded strategic reductions within the Wealth and Other segments.

Copyright © 2001-2018 FactSet CallStreet, LLC

Certain institutional and corporate trust customer deposits within the Wealth segment, which require collateralization by securities, continued to shift out of deposits and into other fee income-producing customer investments. Average deposits in the Other segment decreased due to our strategy to reduce retail brokered sweep deposits, and we've reported solid consumer deposit and strong seasonal growth in corporate deposits during the quarter, consistent with our relationship banking focus. Looking forward, we expect 2018 full-year average deposits to grow in the low-single-digits, excluding brokered and Wealth Institutional Service deposits.

Let's take a look at the composition of our deposit base. Fourth quarter deposit costs remained unchanged at 17 basis points and total funding costs remained low at 38 basis points, illustrating the strength of our deposit franchise. As a reminder, our deposit base is more heavily weighted toward retail customers of approximately 67%. And those customers have been very loyal to Regions as more than 43% of our consumer low-cost deposits have been deposit customers for more than 10 years. Our top market share in core states positions us well for future growth and we expect continued benefit from lower deposit betas relative to peers. For these reasons, we believe our deposit base is a key component of our franchise value and the competitive advantage in a rising rate environment.

Now, let's take a look at how this impacted our results. Adjusted net interest income on a fully taxable equivalent basis, which excludes the tax-related reduction associated with leveraged leases, was $930 million, representing an increase of $9 million or 1% from the prior quarter. The resulting adjusted net interest margin was 3.39%, an increase of 3 basis points. The increases to adjusted net interest income and net interest margin were driven by higher market interest rates, offset by the full impact of debt issued during the third quarter and lower credit-related interest recoveries experienced in the fourth quarter.

With respect to the first quarter of 2018, and excluding the tax-related fully taxable equivalent adjustment of approximately 4 basis points, we expect adjusted net interest income and net interest margin to increase, reflecting the full benefit of the December rate increase and the expectation for a higher short-term rates consistent with current market expectations. Notably, modest growth in net interest income is expected despite two fewer days in the quarter, which reduces net interest income by approximately $10 million, but benefits margin by approximately 4 basis points. For the full-year of 2018, we expect adjusted net interest income growth in the 3% to 5% range.

Let's move on to fee revenue. We experienced strong growth in adjusted non-interest income, which increased $36 million or 7%, driven primarily by increases in capital markets, mortgage and card and ATM fees. Capital markets had a record quarter, coming in at $56 million, an increase of $21 million or 60%. The increase was driven by higher merger and acquisition advisory services, loan syndication income, and fees generated from the placement of permanent financing for real estate customers.

Excluding M&A revenue, which decreased in 2017, other areas within capital markets experienced growth, increasing 28% compared to the prior year. Although timing can be difficult to project, we do expect capital markets income to be a significant contributor to adjusted non-interest income growth in 2018.

As it relates to mortgage, production decreased seasonally 3%, while income increased $4 million or 13%. The increase was primarily due to MSR and related hedge valuation adjustments, recorded in the third quarter, which did not repeat at the same level in the fourth quarter.

Card and ATM fees increased $3 million or 3%, attributable to seasonally higher interchange income. Total consumer fee income is an important and stable component of fee revenue and is expected to continue to contribute to overall growth in 2018.

Copyright © 2001-2018 FactSet CallStreet, LLC

Total Wealth Management income is up 2% quarter-over-quarter and 7% year-over-year, primarily driven by improvement in equity markets, growth in customers and assets under management. In addition, the company incurred $10 million of operating lease impairments during the third quarter that did not repeat in the fourth quarter. With respect to 2018, we expect total adjusted non-interest income growth in the 3% to 6% range.

So, let's move on to expenses. On an adjusted basis, expenses increased $21 million or 2%, attributable primarily to increases in salaries and benefits, outside services and Visa class B shares expense. Total salaries and benefits increased $13 million or 3%, primarily due to higher production-based incentives and health insurance costs. Outside services increased $7 million or 17%, reflecting additional costs associated with the recent launch of our new Regions Wealth Platform in partnership with SEI Global Services. These cost increases will be offset by reductions in other expense categories, primarily salaries and benefits in the future.

The adjusted efficiency ratio improved 60 basis points to 61.1% and the company produced solid growth in adjusted pre-tax pre-provision income, increasing 5%, and reflecting its highest level since the third quarter of 2008. For 2018, we expect adjusted operating leverage of 3% to 5%, relatively stable adjusted expenses and an adjusted efficiency ratio of less than 60%.

With respect to taxes, clearly, there were a number of moving pieces in the fourth quarter. The reported effective tax rate was 39%. Excluding the $52 million of additional income tax expense related to tax reform, the effective tax rate would have been approximately 30%. Following corporate income tax reform, our 2018 guidance for the effective tax rate is now in the 20% to 22% range.

So, let's shift to asset quality. The company reported broad-based asset quality improvement during the quarter, non-performing, criticized and troubled debt restructured loans all declined. Non-performing loans, excluding loans held for sale, decreased $110 million or 14% and represented 0.81% of loans outstanding, marking the lowest level in over 10 years.

We also reported a 17% and 13% decline in business services criticized and total troubled debt restructured loans, respectively. As expected, early and late-stage delinquencies for residential mortgage loans increased within hurricane impacted markets, and the company's $40 million hurricane-related reserve remains unchanged. Despite the increase within residential mortgage, total delinquencies, excluding government guaranteed loans, declined approximately 1%.

Net charge-offs totaled $63 million or 31 basis points of average loans. a 17% decrease compared to the third quarter. For the full-year, net charge-off represented 38 basis points of average loans in line with expectations. Improving economic conditions drove broad-based improvements in credit metrics, particularly in risk ratings along with payoffs and paydowns of criticized loans, resulting in a negative provision expense of $44 million for the quarter. The allowance for loan and lease losses decreased 14 basis points to 1.17%. However, the allowance as a percent of total non-accrual loans increased 7 basis points to 144%.

For 2018, we expect net charge-offs to be in the range of 35 basis points to 50 basis points. And based on recent performance and current market conditions, we would expect to be at the lower end of that range. However, volatility in certain credit metrics can be expected, especially related to large-dollar commercial credits, fluctuating commodity prices, and the impact from hurricane exposures.

Let's move on to capital and liquidity. Similar to last quarter, we repurchased another $500 million or 31.1 million shares of common stock and declared $103 million in dividends to common shareholders. Our resulting capital

Copyright © 2001-2018 FactSet CallStreet, LLC

ratios remain robust. Under Basel III, the Tier 1 capital ratio was estimated at 11.7% and the fully phased-in Common Equity Tier 1 ratio was estimated at 10.8%. Finally, our liquidity position remains solid with a low loan-to-deposit ratio of 83%, and we were fully compliant with the liquidity coverage ratio rule as of quarter-end.

So, regarding 2018 expectations, tax reform changes made it necessary to recalibrate our long-term target for adjusted return on average tangible common equity. Our 2018 adjusted return on average tangible common equity ratio is now expected to be in the 14% to 16% range. Other targets have been discussed and are summarized again on this slide from your reference.

So, in conclusion, our strong fourth quarter results provide a solid foundation as we head into 2018. We believe our Simplify and Grow initiative, along with other opportunities and competitive advantages, positioned us well for 2018 and beyond.

With that, we thank you for your time and attention this morning, and I will now turn it back over to Dana.

Dana W. Nolan
Executive Vice President - Head of Investor Relations, Regions Financial Corp.

Thank you, David. Regarding Q&A, please limit your questions to one primary and one follow-up to accommodate as many participants as possible. We will now open the line for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions [Operator Instructions] Your first question comes from Matt O'Connor of Deutsche Bank.

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

A

Good morning, Matt.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Good morning. You mentioned later this year that you would quantify some of the initiatives that you have underway. And, I guess, first, is there going to be both a revenue and expense component as we think about some of these efforts?

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

A

Yeah, I mean, Matt, we've been working for a number of months now on this initiative and it does have both the expense and revenue components. But John Owen is with us today and John is leading that initiative. So, I'll ask John to make a few comments.

John B. Owen
Senior Executive Vice President & Head-Regional Banking Group, Regions Financial Corp.

A

Good morning. Just a little bit of background. Simplify and Grow, as you think about it as a multi-year strategy for the bank, we kicked off the planning process in the fourth quarter working with McKenzie. We wrapped that

Copyright © 2001-2018 FactSet CallStreet, LLC

planning process up in early January. I would tell you, we've now moved on to what I'll call the execution phase of the project now. There'll be three areas of focus. First is, how do we make banking easier for our customers; second will be, how do we accelerate revenue growth; and third will be about improving efficiency and effectiveness. But timing standpoint, I would tell you, many of these initiatives will go in, in second quarter and third quarter, some will span into 2019 as well. But it's very early. We've got about 10 work streams kicked off very early in the process still.

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.
A

And David, from how we'll respond to this publicly, you could speak to that for a moment?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.
A

Sure. Matt, so this Simplify and Grow, as you heard from John Owen, there is a number of initiatives and how it will affect our financial statements, both from revenue and expense standpoint. We have elements, Matt. We've given you our guidance for the year thus far and we'll be going to a number of conferences. And as we get clarity on exactly what this will do and how it will impact our numbers and ratios, we'll update you. I suspect it will be first quarter, second quarter – end of the first quarter, maybe second quarter, before we give you any specificity of what that will look like.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. That's helpful color. Thank you.

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

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.
A

Good morning, John.

John Pancari
Analyst, Evercore Group LLC
Q

Good morning. Regarding the investment program, I know you're going to give us a little bit more details later on, but in general, how are you thinking about the ultimate tax reform benefit and how much of that gets deployed into the program? And accordingly, how much eventually fall through the bottom line? Thanks.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.
A

Yeah, John, so, it's David. We wanted to give you some flavor for that. If you look at our expectation for return on tangible common equity, we've moved that up 200 basis points from 12% to 14% to 14% to 16%. We anticipated some tax reform coming. We believe that it was appropriate at the time to increase our capital expenditures to accelerate some opportunities, we think we have to better serve our customer. Those capital expenditures, they don't find their way into the income statement. They'll find themselves in an income statement over time. So, we have that baked into our guidance already. And we had our other initiatives where we made contributions to our foundation and our $15 for minimum wage, because we think it was important for us to continue to execute on our

Copyright © 2001-2018 FactSet CallStreet, LLC

mission of shared values, which is taking care of customers and associates and communities, as well as our shareholders.

John Pancari
Analyst, Evercore Group LLC

Q

Okay, So, no percentage reinvestment amount that you're willing to give?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

No. We – our – we increased our capital expenditures roughly [ph] in (00:29:06) $100 million. Right now, you can see that we're keeping our targets for Common Equity Tier 1 where they are. Therefore, the benefit that we see coming through from taxes will help increase our return on tangible common, that 200 basis points.

John Pancari
Analyst, Evercore Group LLC

Q

Got it. Okay. I was just getting there, if there is anything else beyond the CapEx amount. Okay. And the separately, in terms of capital deployment, I just want to hop to that. Wanted to get your updated thoughts around interest in M&A, as you're looking at opportunities here. Can you remind us of your deployment priorities? How you're thinking about that right now and where does M&A come into play both non-bank and bank? Thanks.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah. So, our priorities really haven't changed, John. We focus first and foremost on organic growth. It's important for us to take the capital we generate, put it back into the growth and the business appropriately. When we have opportunities to get an appropriate risk adjusted return from that organic growth, we've been very disciplined with regards to not just making any loan but making the loans that give our shareholders the appropriate risk-adjusted return. We will continue doing that.

Second, we wanted to make sure we have a fair dividend to our shareholders. We had talked about being in the range of earnings of 30% to 40%, and that we would be increasing that to 35% to 45% over time. We believe that's important. So as income increases, whether it'd be through tax savings or otherwise, you should expect that to find its way into that dividend calculation.

Then, we said we would look at opportunities to expand through non-bank acquisitions. We've had a number of those, [indiscernible] (00:31:00) business; First Sterling, our low-income housing tax credit syndicator business, which was basically on ice this year, but we're looking forward to that expansion this year with tax reform. So, that's been important.

Bank M&A, given the fact that we have excess capital, we really have to look at banks versus share buybacks, and we believe that the share buyback program that we've had going on will continue and that we will continue to work our capital ratios down to that Common Equity Tier 1 level of roughly 9.5%. As credit quality and de-risking continues, perhaps that number changes, perhaps could maybe go lower. If we tag on more risk, the number will go higher. But right now, our goal is to get back to 9.5%

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

A

Copyright © 2001-2018 FactSet CallStreet, LLC

John, I think that it's a great question, and if we look at how income state was generating more capital, how do we deploy that capital most constructively and most productively, and as David said, our first and foremost is organic, is making sure that we can – if we can put that capital back into our business constructively and productively, we'll do that. If we can't do that, obviously, we look at M&A and our primary focus has been bolt-on non-bank M&A. We continue to look at that.

Secondarily, we look at bank M&A, but we've had the economics of that make it particularly challenging at this point in time. We look at it. But our primary focus after we've gotten through the organic is – and the bolt-on acquisitions is, really to look at how do we give it back in the form of dividend and share repurchases. We want a competitive dividend, and we want share repurchases, as a lever to use when we can't deploy that capital in the other way, and we still – knowing what we know today, we still think that's going to be a productive and constructive use of the capital we're generating.

John Pancari
Analyst, Evercore Group LLC

Q

Got it. Thanks, Grayson.

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

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

A

Good morning, Ken.

Ken Usdin
Analyst, Jefferies LLC

Q

Hey. Good morning, guys. How are you doing? Just a question on the balance sheet. Thinking through the organic growth in loans and deposits, and then, the lingering runoff that you articulated clearly, how do we just think about the trajectory of the balance sheet? The balance sheet is clearly becoming more efficient, but do you expect – I guess when – should we see any average earning asset expansion this year? Or is it just kind of netting those – a final kind of mix to a better place?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah. So, we've given you some guidance on low-single digits on the balance sheet for loans and deposits. We see that continuing. We have not changed that guidance post tax reform. We'll see what demand for credit might look like, but right now, we feel pretty confident we can grow in the low-single digits on both of those. We do have the headwind of our indirect auto book that will affect us about $700 million, as I previously mentioned. But we can overcome that...

Ken Usdin
Analyst, Jefferies LLC

Q

Right.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Copyright © 2001-2018 FactSet CallStreet, LLC

...and continue to grow, and grow the balance sheet both in dollars but also, as you mentioned, it's far more effective and efficient in generating better returns for us.

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

A

Yeah, I mean, I think...

Ken Usdin
Analyst, Jefferies LLC

Q

And that sort of – yeah.

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

A

We're very pleased with sort of the super progress we've made on reshifting our balance sheet and the assets we've invested in. Clearly in 2016, 2017, we made some risk-based decisions regarding our balance sheet and reduced our risk appetite for certain asset classes, which created a headwind for us in terms of loan growth. We had very good loan production growth in 2017. That production actually strengthened in the second half of the year. We felt good about that. What we have not built into the guidance is any sort of optimism about loan growth above and beyond what we're seeing today is if business is more certain and more confident in 2018, then they have been thus far – that's an upside opportunity.

But for right now, we've built in what we know and what we see. Obviously, we'd be encouraged if it is better than that. We've John Turner with us. John, do you mind making a few comments about the potential for loan growth?

John Turner
President & Head of Corporate Banking Group, Regions Financial Corp.

A

Sure, Grayson. Happy to. As this has been suggested, we are currently projecting sort of low-single digit loan growth. That is based upon our assessment of economic conditions, market conditions prior to, as has been said, any tax reform. I would say that we are largely complete with the de-risking activities. We'll continue to focus on improving the quality of our portfolio, on client selectivity, on risk-adjusted returns in the business. And so, I anticipate that we will see just, as a result of better execution, continued improvement in execution for that low-single digit growth.

And if the economy does in fact pick up as a result of tax reform, then we should benefit from that. But in the meantime, we do believe we can deliver low-single digit growth just based upon our day to day activities and expectations of the business.

Ken Usdin
Analyst, Jefferies LLC

Q

Great. Understood. Thanks on all of that. And then, inside that efficiency comment, can you – is there a way you can help us separate how much that efficiency can help the NIM itself on its own versus how much rates can help the NIM, presuming the curve and the hikes that you're expecting?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Copyright © 2001-2018 FactSet CallStreet, LLC

I'm not exactly sure of your question, but let me see if I can give it a stab. So our efficiency ratio, we have a number of things we're going to have to deal with. The tax equivalent adjustment that we have does negatively impact the efficiency ratio, as it does the margin. So I told you the 4 basis points of the margin, but it also negatively impact the efficiency ratio about 50 basis points.

Ken Usdin
Analyst, Jefferies LLC
Q

50 bps, right.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.
A

50 bps, but we're still committed to having an efficiency ratio under that 60% that we mentioned. So, that will come from continuing to become more efficient. On expenses, we did a good job of having a less than 1% growth in expenses this year. We see renewed growth and revenue coming. We gave you the guidance of 3% to 5% on NII. We feel good about that based on the balance sheet growth and even more encouraged based on what we've seen off late with the market expectations for rates. And we also are getting back on the growth side of non-interest revenue, where we were down this year, but expect 3% to 6% growth in non-interest revenue.

So, if you put all of that together, and we'll get some incremental benefits from the Simplify and Grow strategy that we talked about. We feel pretty confident, we can be under 60%.

Ken Usdin
Analyst, Jefferies LLC
Q

Very, good. Thanks, David.

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

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.
A

Good morning, Geoffrey.

Geoffrey Elliott
Analyst, Autonomous Research LLP
Q

Good morning. Thanks for taking the question. I guess, if I look back at the 3Q presentation, you told about additional expense reductions beyond the $400 million, details to be provided later in the year. We're on the 4Q call in January, and it sounds like you've announced Simplify and Grow as a name project. But in terms of getting real financial details behind that, we're going to have to wait later into 2018. Has something changed that means you are taking a deeper look or are you thinking about things in a different way than you were back in October when you put out that 3Q presentation?

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.
A

No, Geoff, there's usually been no change on our perspective. As we talked about this in the third quarter, as you mentioned in your comments, we've been on a multi-year journey of really trying to manage expenses very rigorously and with a lot of discipline. We absolutely are confident. We've done a good job of that. That being said,

Copyright © 2001-2018 FactSet CallStreet, LLC

what we announced in the third quarter is, we were going to bring McKinsey in to help us take an even harder look at that. And we embarked on those work streams as John Owen spoke about a moment ago.

It's been a very in-depth evaluation. We've had people across the company involved in it and these things are best done very thoughtfully and very carefully. And we've taken our time to do that. And we're in the middle of execution at this point in time. And there's [indiscernible] (00:40:29), but nothing's changed from our perspective, everything's on schedule just as we had forecasted it would be.

Geoffrey Elliott Q
Analyst, Autonomous Research LLP

And I guess, the long-term ROTCE target, it sounds like that's 14% to 16% long term, but also 2018 target, if I am reading slide 13 right. So, is there a scope to take another look at that based on Simplify and Grow?

David J. Turner, Jr. A
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

Yeah. So, that 14% to 16% was a 2018 target. It was not necessarily a longer term target. We do expect, as I've mentioned before, we're in the 12% to 14% range that we will continue to move up expectations that we move up towards the mid-teens on return on tangible common. Since then, we've had tax reform. We've also had Simply and Grow. So, we will give you better guidance above 14% to – or that range 14% to 16% as that becomes known. We will be doing another Investor Day roughly this time next year. We'll give you a new three-year set of targets. We'll show you how we compare to the original set of targets that we gave you. But now, we expect that to continue to grow past 2018's results.

Geoffrey Elliott Q
Analyst, Autonomous Research LLP

Great. Thank you very much.

Operator: Your next question comes from Jennifer Demba of SunTrust.

O. B. Grayson Hall, Jr. A
Chairman, President & Chief Executive Officer, Regions Financial Corp.

Good morning, Jennifer.

Jennifer Demba Q
Analyst, SunTrust Robinson Humphrey, Inc.

Good morning. Could you just talk about what you think the main drivers of your forecasted fee income growth will be this year? And...

David J. Turner, Jr. A
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

Sure. Sure. So, as you looked at the detail of our non-interest revenue, we got out of the box a little slower in terms of our capital markets business. It recovered quite nicely in the fourth quarter. And as we've said in our prepared comments, we expect that capital markets in particular to be helpful to our 3% to 6% growth in 2018. We do have – our service charges have been a very stable component of our non-interest revenue. We grew that about a little over 2%, almost 3% a year. We expect that to contribute as we continue to grow core checking account households.

Copyright © 2001-2018 FactSet CallStreet, LLC

Card and ATM fees, we continue to grow those both in terms of sheer numbers. Transactions are up. So, that'll be a piece of it. Our Wealth Management group in particularly in the investment management trust area has continued to benefit from growth in customers, as well as assets under management. So that'll be a piece of it.

We think mortgage will rebound. We think mortgage will be up nicely from the production that we had this year. It was kind of a reset we believe for the industry. So, you should see mortgage continuing to rebound as well. Those are kind of the bigger items that we have that should contribute to that 3% to 6% growth.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Okay. Thank you very much.

Operator: Your next question comes from Steve Moss of B. Riley FBR.

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.
A

Good morning, Steve.

Stephen M. Moss
Analyst, B. Riley FBR Inc.
Q

Good morning. Circling back to loan growth, just wondering, how we should think about it; steady throughout the year, or perhaps backend weighted? And then, what do you think will be the primary drivers of growth, C&I and commercial real estate or Consumer?

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.
A

I think when you look at the 2018 and you think through, when loan demand occurs, I would tell you, there's still an awful a lot of liquidity in the markets. And if you look at 2017 as an example, we've started off with the year in pretty good shape from a production pipeline standpoint. In the second half of the year, we wound up having an awful lot of payoffs and paydowns, as people went into the public debt markets. We saw the [ph] strength of that (00:44:53) stronger in the third than in the fourth, but still elevated. And so, I do think that there's still a lot of liquidity that's out there and so there is competition for that. Internally, we've had debates about the implications of tax reform and what that has on loan demand. We don't see that changing really what's occurring on the Consumer side of the house.

Consumer is a good story and it's a steady story, other than the headwinds that we have from the indirect auto run-off portfolio we've got, it's a good story. Even in mortgage, 2017 turned out to be a very transformational year for mortgage, as that market went from a refinance market to a home purchase market, but we've always been a strong home purchase mortgage originator. And so most of the impact of that will be passed to us in 2017 on the Consumer side. The only lingering effect we've got on Consumer is just the indirect auto piece.

On the commercial side, we put together our forecast based on what we know today. If the economy strengthens – as John Turner said earlier, if the economy strengthens, we've got an upside opportunity, but knowing what we know today, we think the forecast that we've given you, the guidance we give you, we've got a fairly high degree of confidence in it.

Copyright © 2001-2018 FactSet CallStreet, LLC

John Turner, would you like to add to that?

John Turner
President & Head of Corporate Banking Group, Regions Financial Corp.

A

Yeah. Yeah, I would just add, typically the second and four quarters are going to be our better quarters. We began the year with a lot of momentum coming off of a high degree of production in the fourth quarter. So, pipelines are a little softer going into the year, but funding should be a little better in the first quarter, given that activity in the fourth.

We have confidence in our ability to deliver commercial banking and commercial lending activity this year. I think the difference is going to be that we have been shrinking, de-risking our investor real estate book, and we have an opportunity to grow that business with the economy, particularly as we see our term lending program begin to mature a bit, as we shift our focus on a different type real estate customer. We're beginning to see some of that positive activity. So, that will have an impact on loan growth as well in 2018.

Stephen M. Moss
Analyst, B. Riley FBR Inc.

Q

Okay. And then, on asset quality this quarter, nice improvement in the numbers. Wondering how much of that pay downs versus risk-weighted improvements and how should we think about the loan loss reserve going forward.

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

A

Barb Godin?

Barbara I. Godin
Chief Credit Officer & Senior Executive Vice President, Regions Financial Corp.

A

Yeah. This is Barb. And to answer your question directly, roughly 50% of what we saw in terms of the improvement in our business services classified loan book was payoff to pay down. The balance was just creating improvements and it is a broad based, it wasn't specific to just the energy sector. We certainly saw some improvement in energy, but we saw it right across the board and all the various asset classes.

As it relates to the allowance, going to 1.17%, again, we follow a very formulaic way of doing our allowance. And you've heard me say in the past, we're not going to let it fall substantially, but at the same time, we do have to ensure that we have the right amount of allowance against the right amount of risk. So I don't have a specific number for you that we either target or aim for. We just make sure that the allowance we do have is appropriate and prudent at all times.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

And I would add that, we gave you some guidance on the charge-offs being in the range of 35 basis points to 50 basis points. And based on what we know today, we think we would have charge-offs closer to the lower end of that, and you should think about provisioning equal to charge offs in that case. To the extent it's higher than that, you probably have something that happened in a hurricane or energy type reserve, where the reserve is already there, and didn't have to be replaced.

Copyright © 2001-2018 FactSet CallStreet, LLC

Stephen M. Moss
Analyst, B. Riley FBR Inc. Q

Thank you very much.

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

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp. A

Good morning, Gerard.

Steven Duong
Analyst, RBC Capital Markets LLC Q

Hi. Good morning. This is actually Steven Duong in for Gerard. Thanks for taking our questions. Just circling back on your comments about capital expenditures. You said you're looking to increase CapEx, which should help you boost your ROTCE target. What are these investments exactly? And is it safe to assume that they're capitalized, so they won't show in the P&L?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp. A

Yeah. So, the – so, a couple of things. The CapEx, roughly $100 million is over what we had in 2016. Those capital expenditures are really in areas that help make it easier for our customers to do business with us, that help us generate revenue. Don't tie that necessarily to return at least directly. We believe there are a lot of opportunities. These capital expenditures are exactly that, and they hit the balance sheet, they'll be depreciated over time. And depending on the nature of the project, they could be long dated, they could be tied to a branch. It may be tied to digital opportunities, it may be tied to cyber risk efforts. So, those – that number or that increase you should think about again hitting the balance sheet, but not hitting the income statement, but a little bit each year. And that's after it's spent, it'll be this year that we spend it. So, you won't see hardly any of that income this year.

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp. A

But, Steven, you're seeing a lot of our customers really start to have a high utilization rate in our digital channels. And so, obviously, those customers' expectations are being influenced probably by other banks they use, but other providers for other services. And so, we're having to compare ourselves to a larger community. We talk about digital, and so, we make investments there. We also have a number of technologies that we use to help us manage risk and compliance. And so, we have to continue to invest in those, continue to strength them and make them better each and every year, and cyber being one of the lead candidates there.

But lastly, I would tell you is, coming out of this Simplify and Grow initiative, we've identified a lot of places where technology can help us be not only more effective, but much more efficient. And so, you're going to see us continue to invest in technology as we go through that initiative.

And last, but certainly not least is, if you go into some of our branches, the technology we're deploying in our new branch format is entirely different than what we've had in the past. We've done a number of branches in the past in 2016 and 2017, but you'll see us accelerate that into 2018. Huge benefit from us from a customer service perspective and a customer experience perspective when they come into one of our offices.

Copyright © 2001-2018 FactSet CallStreet, LLC

Steven Duong
Analyst, RBC Capital Markets LLC

Q

Great. Thank you for the color on that. And just a follow-up question. You guys are trading at about 1.3 three times book, 2 times tangible book. Is there a price level where the buybacks don't make as much sense relative to the other opportunities that you have?

....

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

We continue to challenge ourselves on that very point, but we're sitting here with a pretty high Common Equity Tier 1 ratio relative to the risk that we have in the balance sheet. And so, when you have excess capital, it's hard to see how the market gives you full credit for being optimized on your capital stack. And so, we have to have a pretty high return hurdle for us to deviate from buying back our shares versus making some other type investment. So, when you get to the efficient frontier having your capital amount, your capital stack optimized and you got a different calculus, but for us, getting to that 9.5% is very important to us. And that's where we're marching.

....

Steven Duong
Analyst, RBC Capital Markets LLC

Q

Great. Thank you.

....

Operator: Our final question comes from the line of Christopher Marinac of FIG Partners.

....

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

A

Good morning, Chris.

....

Christopher William Marinac
Analyst, FIG Partners LLC

Q

Guys, how are you? Thanks for taking my question. You may have mentioned this earlier, I just missed it. Does any relief on the LCR rule get baked into your outlook for this year or could you describe sort of how that would be a benefit if it plays out in your favor?

....

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah, Chris. It's David. We do not have any relief in our – in the numbers we just told you from LCR, to the extent that the SIFI designation was changed and, therefore, we weren't subject to LCR. There are some deposits that were fairly low-cost deposits for us that, based on the rules, the run-off assumptions, caused us to price those where they weren't as favorable to us and we let those run off. So, LCR certainly would be somewhat beneficial to us. It would help us more from a liquidity standpoint where we could generate more liquidity there. But in terms of an explicit cost, we didn't quantify that at this point.

....

Christopher William Marinac
Analyst, FIG Partners LLC

Q

Okay, great. Could it also help fuel further buybacks as well?

....

Copyright © 2001-2018 FactSet CallStreet, LLC

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.
A

Not really – you're really talking about the difference. You're talking about liquidity in the bank versus liquidity at the holding company, those are different concepts.

Christopher William Marinac
Analyst, FIG Partners LLC
Q

Understand.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.
A

And our – whatever liquidity we need to holding the company to get our buybacks executed to help us get to our target capital ratios will fund by debt issuances like we've done before.

Christopher William Marinac
Analyst, FIG Partners LLC
Q

Got it. Okay. Sounds great. Thanks, David, for clarification.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.
A

Okay.

Operator: At this time, there are no further questions. I will now turn the floor back to Mr. Hall for any closing remarks.

O. B. Grayson Hall, Jr.
Chairman, President & Chief Executive Officer, Regions Financial Corp.

Okay. Well, thank you. I certainly appreciate everybody's time and attendance. We think we just ended a very solid 2017, and are positioned well for a strong 2018, and do appreciate you listening to our message this morning and our answers to your questions. So, thank you. Let's have a great year. Thank you.

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

Copyright © 2001-2018 FactSet CallStreet, LLC

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2018 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.