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Industry: **Banking**

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BB&T (BBT) Earnings Report: Q1 2016 Conference Call Transcript

The following BB&T conference call took place on April 21, 2016, 08:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Alan Greer; BB&T Corporation ; IR
- Kelly King; BB&T Corporation ; Chairman and CEO
- Daryl Bible; BB&T Corporation ; CFO
- Clarke Starnes; BB&T Corporation ; Chief Risk Officer, Analyst

Other Participants

- Matt O'Connor; Deutsche Bank; Analyst
- Michael Rose; Raymond James & Associates, Inc.; Analyst
- Betsy Graseck; Morgan Stanley; Analyst
- Lana Chan; BMO Capital Markets; Analyst
- Gerard Cassidy; RBC Capital Markets; Analyst
- Paul Miller; FBR & Co.; Analyst
- Stephen Scouten; Sandler O'Neill; Analyst
- John Pancari; Evercore ISI; Analyst
- Kevin Barker; Piper Jaffray & Co.; Analyst
- Unidentified Participant; Jefferies & Co.; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to the BB&T Corporation first quarter earnings conference.

(Operator Instructions)

As a reminder, this event is being recorded.

It is now my pleasure to introduce your host, Alan Greer of Investor Relations for BB&T Corporation. Please go ahead, sir.

Alan Greer (IR):

Thank you, Operator. Good morning, everyone. Thanks to all of our listeners for joining us today.

We have with us today Kelly King, our Chairman and Chief Executive Officer; and Daryl Bible, our Chief Financial Officer who will review the results for the first quarter of 2016.

We also have with us other members of Executive Management who are with us to participate in the Q&A session. Chris Henson, our Chief Operating Officer; Clarke Starnes, Chief Risk Officer; and Ricky Brown, Community Banking President.

We will be referencing a slide presentation during our comments. A copy of the presentation, as well as

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our earnings release and supplemental financial information, are available on the BB&T website.

Before we begin, let me remind you that BB&T does not provide public earnings predictions or forecasts. However, there may be statements made during the course of this call that express Management's intentions, beliefs or expectations. BB&T's actual results may differ materially from those contemplated by these forward-looking statements. Please refer to the cautionary statements regarding forward-looking information in our presentation and our SEC filings.

Please also note that our presentation includes certain non-GAAP disclosures. Please refer to page 2 in the appendix of our presentation for the appropriate reconciliations to GAAP.

Now, I'll turn it over to Kelly.

Kelly King (Chairman and CEO):

Thank you, Alan. Good morning, everybody. Thank you very much for taking time to join our call.

Overall, we had what I'd call a solid quarter with nice increase in net income and record net interest income. Net income was $527 million, up 8% versus first quarter and 20% annualized versus the fourth, so solid performance. Diluted EPS was $0.67, which is flat to the first quarter 2015 but was up an annualized 18.9% versus the fourth quarter. GAAP ROA was 1.09% and GAAP ROTCE was 13.87%. If you adjust for mergers charges only, adjusted ROA was 1.12% and adjusted return on tangible common was 14.2%. Solid returns, there.

In terms of revenues, we had strong revenue growth, despite, really, just some challenges in mortgage banking income and service charges on deposits. Revenues totaled $2.6 billion, which was up 10.2% versus the first quarter and 4.2% annualized versus the fourth. We did have record net interest income as I indicated of $1.6 billion, up 16.4% versus the first and 6.8% annualized versus the fourth. Really happy about the [fact] net interest margin grew to 3.43%, up 8% or 8 basis points and Daryl will give more color on that.

Had a nice -- small but nice -- improvement in efficiency to 58.3% from 58.8%. Noninterest expenses were very well managed, decreased $52 million or 13.1% annualized and we did have positive operating leverage. Average loans were down slightly versus fourth quarter. Keep in mind, we continued to adjust our mix, letting our lower spread mortgage balances and sales finance portfolios decline. We are improving our profitability in those areas. So, that stage is working but it's just not producing [loan] volume increases.

Keep in mind we also have runoff in our Susquehanna Hann portfolio and we have a seasonal slower growth in a number of our specialized businesses. So average loans and leases for the quarter were $134.4 billion. And if you exclude our mortgage runoff and sales finance runoff, loans held for investment grew 2.2%, which is kind of the number we look at. That was led by a good performance in income-producing properties, direct retail, other lending subsidiaries and our dealer floor plan.

In terms of our strategic highlights, [we announced] we did convert Susquehanna in November. We've seen reductions in FTEs, other cost savings, overall, it is going very well. We did complete our acquisition of National Penn on April 1. We'll be converting that in most likely in mid-July. That's going very well. Scott Fainor, the CEO of National Penn is now our group president for our northern regions. He's off to a fast start. I feel really good about his leadership and the teams that we have in that area.

You know, we did complete our acquisition of Swett & Crawford on April 1. This is an outstanding company, 100-year-old company with a great brand, has $200 million in revenue. Keep in mind, and this is a little complex, but last year, very importantly from a strategic point of view, we sold American Coastal

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because it was outside our risk appetite. And, now, we've effectively completed that process by replacing it with Swett & Crawford . So we've got the revenue back and virtually no risk basis. So that completes that transition and we feel really good about it. The key now, of course, in the insurance business in particular with Swett & Crawford , is to get cost savings and overall improvement in margins.

Now, before I go through the rest of the points, I just want to make a few important key strategic points. With regard to M&A, as I said, things are going well. After we announced National Penn, we said we would take a pause. All of the deals that we have, we're really excited about. Texas, for example, where we acquired those branches from Citigroup , Ricky and I were down there a couple of weeks ago in Dallas and Houston and we could not be more pleased in terms of how we're being received and how well things are going. Frankly, the overall Texas market is still very, very vibrant, notwithstanding the questions around energy, it's really outstanding market, about 29 million people, it's growing 1,000 people a day. It's a fantastic market.

Really excited about what's going on in northern Kentucky and Cincinnati. Susquehanna, as I say, is off to a good start. National Penn is just getting started. It has enormous opportunities of synergies with Susquehanna and [into] overall revenue opportunities in Pennsylvania.

We feel, overall, really good about our merger strategy. But, now is the time for us to focus on the enormous opportunities that we have to improve performance in the areas of investments that we have made for the last several years. I want to be clear. Our focus is not on strategic deals, but on improving our profitability through, basically, two areas, which is what you'd expect, expense management and revenue enhancement.

In the expense management area we will be focusing on the cost synergies in the community bank, primarily in the Pennsylvania area. We've done a lot in the rest of the community bank over the last few years, but there's still some opportunity, particularly in Pennsylvania. We have a really good opportunity to rationalize the huge investments we've made in the back room in terms of processes and procedures. We've spent a fortune in the last several years building all that up and now's the time to rationalize that.

In terms of digital transformation, while we will be increasing our investment in digital transformation, there's also an opportunity to overall become more efficient as you link the front room and the back room. That's what our recent Executive Management changes is designed to do. So we think that will be a combination of revenue enhancement expense reduction. Then, of course, there's huge opportunities for insurance integration, particularly in Swett & Crawford .

On the revenue side, we'll continue to get huge revenue enhancements from our community bank. The rate of momentum improvement there, particularly on our new markets, is exponential. We feel very excited about that. We will continue really, really strong performance in wealth, corporate banking, insurance and others.

So, given our intense focus on realizing these benefits from our previous strategic investments, our stock repurchases or buybacks move up in priority as we think about CCAR 16 versus strategic initiatives. I'd be happy to answer questions later with regard to that, but we wanted to be sure you were clear about where we are, strategically.

If you would turn to page 4, I will just mention a couple of items that are unusual this quarter. We did have a [mergers] that was about $23 million or $0.02 negative effect on EPS. We did take security gains, about $45 million, which is a part of our strategy in terms of matching off security gains and credit issues. That was a $0.04 positive and then energy-related provision in excess of chargeoffs was $28 million, or $0.02.

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With regard to energy credits, the provision exceeded chargeoffs by $30 million or $0.02 as indicated. Daryl will give you a lot of detail on this. I just want to point out that the charge that we took does reflect the new regulatory guidance and the recent SNC exam results.

So while it's very possible we could have some more energy negative, we do not expect that. We think we built a significant allowance and we think we should expect our provision to be lower in the second quarter. So, we feel, frankly, really good. It's a relatively small part of our whole portfolio, about 1.2%. I know that's a big interest area and Clarke will be glad to give more detail on that later, but we feel really good about that.

If you look at the loan area, we feel really good about loan growth relative to the economy. Just a couple of comments about the economy. It is what I would call good but not great. It is okay. It's rocking along about like it's been rocking along, 2% to 2.5%. It will vary a little bit quarter to quarter. The United States economy is on a sustained 2% to 2.5% kind of growth pattern. It will stay that way, in my humble opinion, for a good while.

We see no practical possibilities of recession notwithstanding the fact that we've had a lot of conversation about that. The reason is because we think there is a very, very strong, solid, pent-up need for continuing investment. When I talk to business people, they are investing in a way that I call passive investment. That is to say, they're not excited enough about the future to go out and make major expansions and so forth. But, they're driving trucks that have 250,000 miles on it and they've got 10-year-old equipment, and so stuff just wears out. And so after a while you have to keep investing.

That creates kind of a floor on the economy, in my view. There's an upside if we were to get better positive leadership out of DC and make some changes in taxes, regulation, et cetera. But assuming that's not going to take the place, or case, we think there's a solid 2% to 2.5%.

I would point out I saw some numbers recently that suggested that most of our markets in the Mid-Atlantic and Southeast will be growing 1 point to 1.5 points faster than the national average. So being in the Mid-Atlantic and Southeast is still a good place to be. So we are focusing on, as I said, profitability in our portfolio. We believe profitable loan growth is more important than absolute loan growth.

Just a little bit more detail with regard to the loan area, C&I loans were down slightly. Most of that is due to decline in commercial loans in the branch network and mortgage warehouse. On the other hand, end of the period loans were better with C&I up 2.5% annualized. Good news is C&I spreads are stable compared to last quarter. Growth is affected by our strategies of restricted growth in multifamily and REIT, so we continue to be pretty conservative. We currently expect C&I to grow at a faster pace in the second quarter, probably in the mid-single digits. Daryl's going to give you a lot more color on energy, as I pointed out, but I'll just emphasize again that we have built our reserves and we are confident our exposures are manageable.

CRE growth was essentially flat with a decline in construction and our growth in income producing. So in income producing, it increased 7% annualized. Feel really good about that. Fastest growth coming from office and hospitality and some small decline in retail. The good news is market fundamentals generally continue to improve, [all new] spreads are still tight We expect CRE construction development to continue to decline somewhat in the second quarter and IPP to grow at similar paces in the first quarter.

Dealer floor plan had a very strong quarter, up $76 million or 26% annualized. That's being driven by expansion in our new markets and some new lines that we've introduced. That's going very well. Floor plan is expected to continue to grow into double digits for this year.

Average direct retail lending is a bright spot for us, increasing $211 million, or almost 8% annualized. A lot of that is HELOC and direct dollars from the branches. Rick and his team have really made a sea change

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in terms of our consumer production out of the branches. On the other hand, our wealth division continues to make a significant contribution in retail lending, really good production as they work closer together. We expect the retail lending to continue to grow at a similar pace.

Average sales finance, primarily large [prime holder] declined $484 million or 18%. That's a continuation of our execution of our flat rate compensation program. That is going well. It does produce less volumes but it produces better margins. So we felt really good about that. The lines will cross in terms of the old portfolio running off the new portfolio soon, so that will stabilize. We do have a continued runoff of the Hann portfolio for a bit longer. So, overall, we think once we get through the next quarter or so, that portfolio will be kind of flattish and then will start to grow.

Average residential mortgage loans were down $470 million or 16% linked quarter annualized. Keep in mind we continue to sell essentially all of our conforming production and we think, again, that's in terms of, overall, a quality management of the balance sheet. Originations in the quarter were $3.6 billion, about 2% more than the fourth. That was reflected in some seasonal improvement. And application volume, I was glad to see increased 39% compared to the fourth and totaled $6.9 billion. We're definitely seeing a resurgence in new home purchases. Young people are back buying homes again and that's a really good thing.

Our margins on gain of sale improved about 9%, that's leveled since the first quarter of 2015. So, looking forward, we believe this portfolio decline will slow and be about flat for the year, although lending subsidiaries continue to do well. They grew $158 million, or 5%. Keep in mind, that's a weak quarter for them, they will be back stronger in the second, due to a really good performance in Grandbridge and equipment financing, so we would expect the seasonally stronger other lending segment to accelerate in the second quarter because of seasonality.

Overall, the average loans are expected to be up 1% to 3% on a core basis next quarter. Obviously, with the impact of National Penn, growth will be closer to 20% and I will point out that is real growth, those are real assets, but we like to distinguish between organic and core growth. So average loans in the second quarter are expected to be about $141 billion.

If you look at slide 6, overall deposit program is going very well. Our deposit mix continues to improve. We continue to do a really good job managing our cost of interest-bearing deposits with costs going up only 1 basis point, even though we had the rate increase at the end of the year. Average total deposits increased $1.4 billion, or 3.7% annualized and that's a really good growth rate, given our intense focus on managing our cost.

So let me turn it to Daryl, now, for a little bit more color now on some of the numbers.

Daryl Bible (CFO):

Thank you, Kelly, and good morning everyone. Today I'm going to talk about credit quality, net interest margin, fee income, noninterest expense, capital and our segment results.

Turning to slide 7. Overall credit quality outside the energy portfolio remains stable. Net charge-offs totaled $154 million or 46 basis points. Excluding energy-related losses of $30 million, net charge-offs improved from the prior quarter to 37 basis points.

Loans 90 days or more past due declined $26 million, mostly driven by loans acquired from the FDIC, impaired loans and a decrease in residential mortgage. Loans 30 to 89 days past due decreased $205 million or 20%, mostly due to seasonality in regional acceptance as well as decreases in residential mortgage, sales finance, C&I and CRE.

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NPAs increased 27%, to 42 basis points, driven by $206 million in energy-related credits moved to nonaccrual. If you exclude energy, NPAs totaled 33 basis points, a modest improvement compared to fourth-quarter levels. We are about halfway through our spring redeterminations. We expect NPAs to remain in a similar range in the second quarter assuming no unexpected impact from that process. We expect net charge-offs to be in the range of 35 basis points to 45 basis points.

Continuing on slide 8. Our energy portfolio consists of 100 clients with $1.6 billion in outstandings consisting of 65% upstream, 27% midstream and 8% in support services. The coal portfolio total is $215 million in outstandings. We take a very conservative approach to energy lending. We do not lend to offshore producers, mezzanine and second lien facilities or take equity positions. During the quarter, we fully implemented the regulatory guidance from the SNC exam. The allocated reserves totaled 8.5% and 44% of the energy portfolio was criticized and classified. It's important to note, today, all borrowers are paying consistent with their agreements. As a result, we believe our energy portfolio is manageable.

Turning to slide 9. Our allowance coverage ratios remain strong at 2.4 times for net charge-offs, and 1.89 times for NPLs. The allowance to loans ratio improved to 1.10% compared to 1.07% last quarter. Excluding the acquired portfolios, the allowance to loan ratio is 1.17%, so our effective allowance coverage is higher. Remember, our acquired loans have a combined mark of about $636 million.

We recorded a provision of $184 million for the quarter compared to net charge-offs of $154 million. This includes [$3 million] in net charge-offs related to the energy portfolio and an additional provision of $30 million to build the allowance to 8.5%. Looking forward, our provision is expected to match net charge-offs plus loan growth. We believe that the provision will be much lower than this quarter's numbers, assuming no large deterioration in credit quality.

Turning to slide 10. Compared to last quarter, net interest margin was 3.43%, up 8 basis points and core margin was 3.18%, up 6 basis points. The margin increase resulted from a seasonal interest income on assets related to post-employment benefits, duration adjustments on acquired securities, and higher repricing of variable-rate assets combined with stable deposit rates.

Looking at the second quarter, assuming no Fed rate increases, we expect GAAP margin to decline a few basis points, driven by the runoff of PCI loans and the loss of a positive seasonal impact of interest income on benefit plans offset by National Penn. We expect core margins to remain relatively stable. Asset sensitivity remained relatively unchanged. We continue to forecast only one interest rate hike this year, happening in November.

Continuing on slide 11. Noninterest income totaled $1 million, relatively flat compared to last quarter. Our fee income ratio was 40.6%. Looking at a few of those components, insurance income increased $39 million, or 41% annualized, mostly due to seasonal factors, higher employee benefit and property-casualty commissions, offset by lower life insurance commissions.

Remember, our first quarter of last year included earnings of American Coastal, a business we sold last May. Excluding acquisitions, insurance income grew 1.9% versus last year. Mortgage banking income totaled $91 million, down $13 million, mostly due to lower commercial mortgage production. Other income decreased $58 million, due to a $43 million increase in income related to assets of certain post-employment benefits and $14 million decline in client-derivative income. Looking ahead to the second quarter, including both acquisitions, our total noninterest income is expected to increase 9% to 11% versus second quarter GAAP of $1.016 billion.

Turning to slide 12. Noninterest expenses totaled $1.5 billion, down 13% versus last quarter. Personnel expense increased $22 million, driven by a $34 million increase in Social Security and unemployment factors, as well as equity-based compensation for retirement eligible associates, and a $10 million

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increase in higher pension expense offset by $30 million decrease in post-employment benefits expense. Average FTEs declined 311, merger-related and restructuring charges declined $27 million, mostly due to Susquehanna conversion costs. In addition, other expense decreased $34 million, mostly due to lower operating charge-offs and charitable contributions.

Our effective tax rate was 30% and we expect second-quarter effective tax rate to be about 31%. We expect expenses to total $1.75 billion next quarter. This will include the initial expense base for National Penn and Swett & Crawford plus $40 million to $50 million in merger-related costs. We expect cost savings to accelerate after the third-quarter systems conversion of National Penn and the first quarter 2017 conversion of Swett & Crawford . But in the second quarter, we may have a slight uptick in the efficiency ratio, due to the timing of our acquisitions and the delayed timing of related cost savings and synergies. We remain confident we will achieve cost savings related to both acquisitions. We expect efficiency to improve later in the year.

Turning to slide 13. Capital ratios remain very healthy and fully phased-in. Common equity Tier 1 at 10.2%. Our LCR increased 135% and our liquid asset buffer at the end of the quarter was very strong at 14.5%. We successfully issued $465 million in preferred stock at 5.625%, which strengthens our regulatory capital in a cost-effective way. Our tangible book increased 2.7% this quarter. Finally, a comment on CCAR 2016. As Kelly mentioned, we expect to place greater priority on stock repurchases versus strategic initiatives.

Now, let's look at some segment results beginning on slide 14. Community Bank's net income totaled $310 million, an increase of $38 million from last quarter and up $101 million from the first quarter of last year. Net interest income increased $64 million from the fourth quarter with about two-thirds of the increase driven by Susquehanna.

Turning to slide 15. Residential mortgage net income totaled $39 million, down $10 million from last quarter driven by seasonally lower production and lower servicing fee income. Production mix was 55% purchase and 45% refi.

Looking to slide 16. Dealer financial services income totaled $42 million, essentially flat as declines in segment net interest income were substantially offset by lower loan processing expense. Regional acceptance continues to generate stable loan growth with prudent underwriting discipline. This portfolio totals $3.3 billion and losses have normalized to the 8% range. Net charge-offs for the prime portfolio remain excellent at 16 basis points.

Turning to slide 17. Specialized lending net income totaled $56 million, down $7 million from last quarter, driven by lower commercial mortgage and leasing income and higher provision.

Turning to slide 18. Insurance services net income totaled $53 million, up $17 million from last quarter, mostly driven by a seasonal increase in employee benefits and higher property and casualty commissions, partially offset by seasonally lower life insurance commissions. We expect Swett & Crawford to add revenues of approximately $160 million for the remainder of this year, coupled with $140 million in expenses. In 2017, we will realize synergies from the deal that will drive improved operating margins going forward.

Turning to slide 19. Financial services segment had $26 million in net income, down $77 million from last quarter, largely driven by a provision increase of $92 million related to the energy portfolio. Corporate banking generated 15% loan growth and wealth at 6% loan growth along with 29% transaction deposit growth.

In summary, for the quarter, we achieved improved efficiency, net interest margin expansion, positive operating leverage and we feel that we are set up to have a very strong second half of 2016.

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Now, let me turn it back over to Kelly for closing remarks and Q&A.

Kelly King (Chairman and CEO):

Thank you, Daryl. Overall, we feel like our M&A strategy is executing very, very well. Loan growth is good, particularly in the environment. Credit quality is very good. Ex-energy and energy relative to the marketplace is extremely good. So we feel, now, we just have a wonderful opportunity to focus on realizing the advantages that we've invested in for a number of years now. We feel really great about our opportunity to improve our efficiencies and our operating profit as we go forward. So we continue to believe that our best days are ahead.

Now we will turn it over to Alan.

Alan Greer (IR):

Thank you, Kelly. At this time we will begin our Q&A session. Operator, if you could please come back on the line and explain how our listeners can participate and ask questions.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Matt O'Connor.

Daryl Bible (CFO):

Matt, we can't hear you. You're on mute.

Operator:

One moment.

Matt O'Connor (Analyst - Deutsche Bank):

Can you guys hear me? All right, great. Okay.

Starting on the cost saves, can you remind us how much is still to come from all the deals that have closed? And then will these fall to the bottom line or are there some offsets as we think about, call it, core BB&T or legacy BB&T ?

Daryl Bible (CFO):

Matt, if you go back a year-plus ago, the city branches and Bank of Kentucky, all those are basically come in both cost savings and revenues and all that. From Susquehanna's perspectives, we are probably 85% to 90% through the cost saves from that. The rest of the cost saves will probably bleed into our run rate over the next couple of quarters or out of the Community Bank area. But that's where we stand there.

As far as the two deals that we just closed April 1, there's really no cost saves in those transactions. We expect National Penn had systems conversion third-quarter. You may see a little bit third quarter. But more of that in fourth quarter and first quarter.

And Swett & Crawford , maybe a little bit on revenue synergies this year but their systems conversion is the first part of 2017 and their cost saves and efficiencies will come in in probably in the first half of

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2017.

Matt O'Connor (Analyst - Deutsche Bank):

Okay. That's helpful. On the revenue side, bigger picture, how should we think about what areas you're trying to cross-sell into, just the broad Mid-Atlantic franchise?

There is the scale benefit. But what other product sets do you think can get ramped up in that franchise? And when do we start seeing some of those benefits in a more meaningful manner?

Kelly King (Chairman and CEO):

Matt, we think that number -- it's kind of pervasive. The standout ones are continuing to expand the benefits from our corporate banking relationships. Recall that over the last several years, we've been starting those relationships on the credit side and then the follow-on residual benefits in terms of deposits and other fee services come. That will be a big one.

Wealth Management continues to integrate very, very well in terms of loan balances and other fee balances that are coming in. Retail banking, retail lending is coming on very, very strong. Then the huge benefit from the insurance area as we integrate Swett & Crawford and continue to integrate Crump and continue to use the Crump cross-sell abilities throughout the entire community bank in terms of selling life insurance. All of those are some of the ones that are really big standouts.

Matt O'Connor (Analyst - Deutsche Bank):

Okay. Thank you very much.

Operator:

Michael Rose with Raymond James.

Michael Rose (Analyst - Raymond James & Associates, Inc.):

Kelly, just wanted to touch on the efficiency ratio. You may not hit your target this year, but that's okay. You obviously announced another insurance acquisition. Can you just give us your thoughts, in light of the environment, in terms of what we could expect for the insurance, or for the efficiency ratio both maybe in the near term and then longer term if there's any changes? Thanks.

Kelly King (Chairman and CEO):

Yes. I think we will end up this year with improvement. It may be in the [57-ish] kind of range. Pretty confident about that.

We still think over the next two or three years we will get to the mid-[50s], and I know some people talk about the low [50s]. That's not going to happen unless you get a substantial ramp-up in the yield curve. Remember this is a numerator/denominator problem.

We are assuming the economy will grow at 2%, 2.5% and there will be a slow ramp-up in the yield curve, but not dramatic. Therefore, it makes it harder to grind down efficiency improvements. Still, though, with the opportunities we have to generate additional revenues out of our investments we've made and the ability to generate additional efficiencies from the investments we've made, we think will be able to hit those targets.

Michael Rose (Analyst - Raymond James & Associates, Inc.):

Okay. That's helpful. As a follow-up, how should we think about the dividend payout ratio going forward?

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You guys are trending a little higher than you have historically. You mentioned the prepared remarks about CCAR being more focused on buybacks this year, but should we actually expect a dividend increase this year?

Kelly King (Chairman and CEO):

Our strategies, in terms of capital deployment, remain the same. We've always said they adjust from time to time. The ones that don't change, you always use capital (inaudible) to get the maximum organic growth you can get. Number two has been and will remain dividends. The swing is between buybacks and M&A.

So what I was leading to earlier is there is a flip there, going forward, for a while, in terms of buybacks being more important than M&A as we focus on realizing these opportunities. With regard to dividends, we would certainly hope -- our CCAR application is in and, as you know, we never can say for sure what's going to happen. We would certainly expect to have a dividend in increase. Because even though our dividend payout's somewhat high, it's not high by traditional standards and it's not high relative to the stable revenues streams that we have. So we are very comfortable with the dividend increase this year.

Michael Rose (Analyst - Raymond James & Associates, Inc.):

Okay. Maybe just one final one for me. And I know it's small, but in your coal portfolio, it seems like the criticize number of15% seems a little low from what I would expect. Any sort of trend to give you confidence that the portfolio, the loss content, won't be a lot worse than maybe my expectations? Thanks.

Clarke Starnes (Chief Risk Officer, Analyst):

Yes, Michael. This is Clarke Starnes. Fair question. I would tell you that we have been methodically reducing our exposure in the coal space for a long time. We believe a number of the residual bars we have are bankable, although we would continue to expect exposure to go down from here.

We also took part of that $30 million this quarter. We opportunistically exited one of our larger, long-time legacy watchlist coal credits and got it out completely. So we feel like with [Swift] we could manage through. Although the watchlist could go up, we feel like the exposure is manageable.

Michael Rose (Analyst - Raymond James & Associates, Inc.):

Okay. That's helpful. Thanks for the color. Appreciate it.

Operator:

Betsy Graseck with Morgan Stanley .

Betsy Graseck (Analyst - Morgan Stanley):

A question -- just one follow-up to the question on energy, as you did indicate and appreciate the color around the percentage of the portfolio that's criticized and classified. That's against the denominator that is both funded and unfunded? Or is that just the denominator that is funded?

Clarke Starnes (Chief Risk Officer, Analyst):

Betsy, that's based on funded balances.

Betsy Graseck (Analyst - Morgan Stanley):

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Right. Okay. Got it. That's great. Separately, as you're thinking about how the industry progresses from here, can you give us a sense as to how you work with your clients and how you're making the decisions to either continue to reinvest with them, or to potentially help them shrink or sell or exit or reduce your exposure to them? Or is it too late for that and what you have is what you have?

Kelly King (Chairman and CEO):

Betsy, are you talking about primarily the energy area?

Betsy Graseck (Analyst - Morgan Stanley):

Correct.

Kelly King (Chairman and CEO):

We made our decision, Betsy, some time ago, to be a long-term energy player in the energy market. We are not going to change that long-term strategy. Energy is an important business for the country, for the world, and for us. We enter into relationships on a very conservative selection basis and a conservative underwriting basis.

Obviously, everybody is really energized about -- no pun intended -- about concerns about energy now. And we're taking it very seriously and we're [marking our boot] really aggressively and all that. But, look, I think there's a much higher chance oil will be at $50 by the end of this year than $30. And I think, over the long term, the energy business will still be a really good business and we will stick with it and we will stick with [lugid] clients and will continue to be supportive to them.

Betsy Graseck (Analyst - Morgan Stanley):

Do I have it correct that if oil were to be at $30 for a while, that you've already done all the reserving that you need to do? Or the vast majority of the reserving, never say 100%, but the vast majority of the reserving that you need to do, in which case we should expect the provision could come down a bit next quarter?

Clarke Starnes (Chief Risk Officer, Analyst):

Absolutely, Betsy. We believe the provision expense -- unless we get something totally unforeseen -- would be much lower than last quarter. Remind you, we kind of said our NCO guidance is [35 to 45]. We would assume that we'd be able to load a mid-range of that if we don't have an energy surprise, if we have more energy deterioration, it might be mid to high.

As Daryl said, we're expecting to fund charge-offs and keep our reserve rate for growth. So we would not expect a larger build for the second quarter. In our 8.5%, we've assumed, I think, prudently and conservatively, draw assumptions and we fully implemented the guidance. We would not anticipate, from here, a significant increase in the provision.

I would mention, too, we've been through about 60% of our spring redeterminations already. Our average line reductions are about 20% and about two-thirds of those redeterminations we've gotten a structural enhancement with [any cording] provisions for more collateral. To Kelly's point, we are working with these borrowers and we certainly hope that we've reserved for what we know today.

Betsy Graseck (Analyst - Morgan Stanley):

Okay. Great. That's helpful. Thank you.

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Lana Chan with BMO.

Lana Chan (Analyst - BMO Capital Markets):

Two follow-up questions. One on the CCAR ask for 2016 and prioritizing buybacks and dividends. Is that just for the second half of this year? Or does that go extend into 2017?

Kelly King (Chairman and CEO):

That would be for the entire CCAR period, which would extend into 2017.

Lana Chan (Analyst - BMO Capital Markets):

Okay. Thank you. Daryl, if you could help me run through how we get from the first quarter expense level to the $1.75 billion in the second quarter? It just seems a little bit higher than what I would have modeled in what the adds on. I know you gave the Swett inclusion. What else is going up in terms of the stepup and what is coming from Nat Penn?

Daryl Bible (CFO):

If you look at National Penn and Swett & Crawford , those two add in approximately $100 million to $110 million in expenses into the second quarter off their base. If you add in maybe an additional $30 million more in expense saves, then that leaves about $60 million left, approximately. I would say second quarter, usually, we have higher revenue so you pay out higher commissions. That's a percentage there.

And then probably the next biggest increase that we have, across the board, is probably just in technology and IT. We continue to invest in those areas and those areas continue to increase some. I feel that we are very focused on our expenses. I think we have a chance of, maybe, exceeding what we are saying, beating it. But, right now, we are just putting out conservative numbers from an expense base.

As Kelly said, we will focus on improving efficiency throughout the year. With all these acquisitions closing first of this quarter, it's going to be really messy trying to put it all together.

Lana Chan (Analyst - BMO Capital Markets):

Okay. Then that starts really stepping down starting the fourth quarter?

Daryl Bible (CFO):

Yes. Correct.

Lana Chan (Analyst - BMO Capital Markets):

Thank you, Daryl.

Operator:

(Operator Instructions)

Gerard Cassidy with RBC.

Gerard Cassidy (Analyst - RBC Capital Markets):

Good morning, Kelly. Good morning, Daryl. This question maybe is more for Clarke. Clearly, BB&T has done a very good job in improving its credit quality post the financial crisis. BB&T , along with many

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of the other banks, all have built up the reserves this quarter for the energy SNC exam that took place very recently.

And so the question is, what did the regulators do that was so different that none of the banks had anticipated back in the fourth quarter? I know energy prices fell to below $30 in February, but were they doing stuff that just was unusual and we had not seen before which forced everybody to build up these reserves?

Clarke Starnes (Chief Risk Officer, Analyst):

Gerard, in my opinion, the fundamental change in the guidance, historically, as you know, reserve-based lending, asset classifications, accrual status, impairment view was based more from a senior secured collateral asset-based coverage standpoint against that primary bank debt.

What's happened with this boom in the shale production with this cycle is you have a lot more secondary bond financing behind the bank group and the new regulatory guidance is very explicit around you have to make sure that you have sufficient cash flow coverage and asset coverage for the total debt, including the secondary debt. Obviously, with the plunge in prices that nobody could've predicted, it puts enormous pressure on those ratios.

That's really the big c-change. We still believe, given all that, with enough time and with some recovery in the prices, that we have a good shot at having better recoveries. But we have to prudently reserve in the meantime.

Gerard Cassidy (Analyst - RBC Capital Markets):

Thank you. Speaking of Shared National Credit exams, obviously, we have the national one going on right now for all loan categories. Clarke, are you hearing of any c-changes there? Excluding the energy, since you guys all just did that. Is there any talk of they're looking at different categories of loans, quite a bit differently?

Clarke Starnes (Chief Risk Officer, Analyst):

We are not hearing anything yet, any sort of chatter like that like we had heard with the first exam around energy. At this point, we are not.

Gerard Cassidy (Analyst - RBC Capital Markets):

Kelly, in looking at your slide 11 in the presentation, where you focus on the fee income ratio, it's dropped down quite a bit and one of the hallmarks of your Company has always been a 45% or so fee revenue to total revenue. Is this a new change that we are going to be seeing it now closer to 40%? Or is this a temporary change?

Kelly King (Chairman and CEO):

No, Gerard. I think this is more temporary. I think that we've had a range of 41%, 42%. 45% has been kind of high, frankly. We think in terms of 42%, 43%, is kind of normal. We don't want to get too far out of balance one way or the other.

It depends on, again, the interest rate environment. If your interest rates go down, then your [net interest] income goes up as a percentage. But on a normalized basis, I'm very comfortable with our net interest income anywhere in the 40%, 42%, 43% level. Right now, you've got -- originally you had the net interest income being down which would drive the ratio up.

On the other hand, insurance is not at the level that it would be relatively because it affects the business

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and that would affect it. The temporary impact has been the removal of American Coastal last year, which, of course, will come right back now when we add Swett & Crawford . It's not any change from a long-term point of view at all. It will be right back where we want it to be, 42%, 43%. And then probably hopefully hang in that level because, hopefully, the net interest income comes back up.

Gerard Cassidy (Analyst - RBC Capital Markets):

Great. Appreciate the color. Thank you.

Operator:

Paul Miller with FBR & Company.

Paul Miller (Analyst - FBR & Co.):

Kelly, can you talk a little bit more, the comments you mentioned that you are going to focus less on M&A going forward? Did that mean both in the insurance side and the banking side and you are going to focus more on capital management through buybacks.

Kelly King (Chairman and CEO):

Yes, Paul. That's exactly right. I'm not trying to say that we wouldn't dare do any tiny little bitty something. But as a practical matter, we're just not focusing on M&A now, in the insurance or bank, which is our two primary areas. Truth is, we've got a lot going on in both of them. We've just set out so much opportunity.

And there is a time to buy and there's a time to run. The last 24 months, so the time to buy, the times were right, there was a window for us and it's really good opportunities and we are really happy about what we did. And now is the time to take some time and to adjust what we've done and run it really, really well and get the benefits for the benefit of our shareholder. This is a shareholder-driven strategy, (inaudible) that profitability up and reaping some of the benefits of the recent investments we've made. That applies to insurance and banking and basically everything else.

Paul Miller (Analyst - FBR & Co.):

So should we be modeling a higher buyback level? Or should we wait until the Fed comes out with their test where which got approved?

Kelly King (Chairman and CEO):

Well, all of us have to wait to see what Fed approves. As a practical matter, if I were you modeling, I would be modeling for higher buybacks.

Paul Miller (Analyst - FBR & Co.):

Thank you very much, guys.

Operator:

Stephen Scouten with Sandler O'Neill.

Stephen Scouten (Analyst - Sandler O'Neill):

I had a question for you on the forward loan growth expectations. I see you put 1% to 3% guidance for 2Q. Is that an expectation of slower resi runoff and sales finance runoff or is that just higher overall originations? What is going to drive that delta quarter over quarter?

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Kelly King (Chairman and CEO):

It's lower. The resi runoff is planning out, if you will. Then you get the seasonal activity buildup in the second.

Stephen Scouten (Analyst - Sandler O'Neill):

Okay. Makes sense. Is that kind of what you expect for the full year, as well, in that 1% to 3% range?

Kelly King (Chairman and CEO):

It's going to be -- from an organic basis, I would say we have a little bit more loan growth from second to third, how we sit now. Visibility out a couple of quarters is not perfect. But if we're 1% to 3%, you might add another percent or two to that for second to third. But we'll see how the economy plays out.

Stephen Scouten (Analyst - Sandler O'Neill):

Okay. Great. One follow-up on the uses of capital, buyback versus M&A. Is that something you would consider to be a hard and fast decision at this point through the next CCAR request? Or will you still have flexibility like you had this year to either do repurchases or M&A depending on opportunities? Or is your request even submitted as simply buyback and we won't see (multiple speakers)?

Kelly King (Chairman and CEO):

No, no, our request has the same flexibility in it that we've always had. But the guidance I'm giving you with regard to our focus on profitability management versus M&A is very hard.

Stephen Scouten (Analyst - Sandler O'Neill):

Got you. Thanks, guys. I appreciate it.

Operator:

John Pancari with Evercore ISI.

John Pancari (Analyst - Evercore ISI):

On the buyback topic, can you help us in how to size it up? If it's something that's much more of a -- that we could have much greater confidence in now, Kelly, how should we think about the magnitude of that? You are at a 40% payout right now on the dividend. You indicated that could go up a little bit. Where could we go on the buyback and could we be approaching the somewhere in the 80%s or 90%s in terms of a combined payout when you factor in the buyback activity? Thanks.

Daryl Bible (CFO):

John, this is Daryl. What I would say from a CCAR perspective, obviously nothing is approved yet, but last several years we've focused and we've traditionally been one of the higher ones on the payout ratio on dividend. We hope that would continue with CCAR 2016.

As far as the total payout ratio goes, I would say we like where our capital ratios are today. As Kelly said, we're going to probably used 25%-plus up in capital for organic growth. So the remaining percentage would probably be in buybacks.

John Pancari (Analyst - Evercore ISI):

Okay. All right. Separately, Kelly, I just want to get a little bit more color around the change in tone on

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that front, in terms of looking at more of the buyback opportunity with capital deployment versus M&A. Was there anything else that prompted that change, in terms of either a regulatory environment or anything in terms of the trend in your efficiency that you're trying to get on top of something here? Thanks.

Kelly King (Chairman and CEO):

John, it's really a matter of looking up the number of deals. Ideally, to be honest, we wouldn't have done as many deals in as short a period of time as we did. It's just they were available. You can't -- I wish you could, but you can't ideally lay out your M&A plans on a linear basis and reject them whenever you want to have them. They come when they come and you take advantage of them when they are there.

We took a bit more in the last year and a half at one time than I personally would like to have. And you combine that with all the other activities we have going on, there's huge investments in the back room in terms of systems and processes and so forth. It's my very strong intuitive judgment, (inaudible) judgment that it's time to focus on taking advantage of what we have.

Sometimes people think about M&A and all this as kind of a linear upward sloping line. It's not. It's more like a stairstep. You ramp up in terms of acquisitions and then you take a period of time and you rationalize them and then you ramp up again. We are in the flatter part of the stairstep where we are going to be focusing on rationalizing what we've already invested in.

We think that's shareholder friendly because if you continually roll up all the time, you're never getting any real payback until you stop growing for -- doing M&A for little while and that's not fair to the shareholders. This is more about taking advantage of what we did in the last year and a half and we will get that done we will be interested in M&A again. For right now, we are focused on getting advantage of what we've already done.

John Pancari (Analyst - Evercore ISI):

Thank you. One last, if I could, on the margin. I know you indicated you've got one rate hike modeled in in the back part of the year. If that doesn't materialize, is it fair to assume that the margin sees some erosion here if there is no Fed hike this year?

Daryl Bible (CFO):

You know, what I would say is right now we would be forecasting margins to probably be in the low [340s], probably throughout 2016. Our rate hike that we have in November helps us, but it's not a huge impact in the fourth quarter. We are pretty much not assuming on any real rate rise off that. We feel very good about our mix. The mix is going in our favor, loan mix, funding mix and our spreads are coming in nicely. Our core margin has stabilized, so I feel GAAP margin in the [340s], low [340s] is about right.

John Pancari (Analyst - Evercore ISI):

Got it. Thanks, Daryl.

Operator:

Kevin Barker with Piper Jaffrey.

Kevin Barker (Analyst - Piper Jaffray & Co.):

Regarding net interest income and your expectations going forward, you are modeling a rate hike. How are you looking at the long end of the yield curve at the same time?

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Daryl Bible (CFO):

Good question, Kevin. The rate hike is in November. It really didn't have a huge impact on net interest income. You look at the yield curve, we would keep our yield curve relatively constant where it is today. We don't really think it's going to steepen up much in our forecast that we have.

If you look at our balance sheet, our balance sheet is pretty balanced. About half of our assets are floating and half are fixed. When the curve actually came down some in the early part of 2016, the fixed portion got hurt a little bit from a net interest income perspective because those get priced off the yield curve.

We did a great job with our funding costs, keeping that very stable. All that is very sticky. We're having huge growth in funding and wider margins in our deposit franchise right now.

Kevin Barker (Analyst - Piper Jaffray & Co.):

Thanks. You mentioned that regional acceptance had a net charge-off rate of 7.9% and the prime focus roughly 19 basis points, which is very good. How does that compare to the year-over-year numbers and then quarter over quarter?

Clarke Starnes (Chief Risk Officer, Analyst):

Kevin, this is Clarke. Regional acceptances losses are up year over year. They are probably up 50 to 75 basis points or so. Our prime portfolio, today, is about 16 basis points, not 19 and it's relatively stable quarter to quarter and year over year.

While it's very manageable, regional acceptance had experienced some higher loss severities. They primarily finance economy cars. If you look at Mannheim over the last year or 18 months, that class of vehicles has been hit a little harder. We've adjusted for that over the last year or so and we are actually forecasting, notwithstanding the view of car prices over the next remainder of the year, we expect losses to be down more in the 7% range or so by the end of the year at regional.

Kevin Barker (Analyst - Piper Jaffray & Co.):

What would cause that decline in chargeoffs, given we're continuing to see pressure in used car prices?

Clarke Starnes (Chief Risk Officer, Analyst):

Absolutely. It's the adjustments we made12 to18 months ago on our advance rates and as those burned through, we believe we'll be in a much better severity position, even with the decline in prices. We've been wending into a lower advanced rate so we feel like we will work through some of the older credits and will be in a better position.

Kevin Barker (Analyst - Piper Jaffray & Co.):

Thank you for taking my questions.

Operator:

Ken Usdin with Jefferies.

Unidentified Participant (Analyst - Jefferies & Co.):

This is Amanda on for Ken. Daryl, given your strong first quarter NII result and the NIM dynamics you discussed, the guide range that you guys gave at the end of last year for plus, I think, 12% to 14% year-over-year for NII growth is the high side of the range in play now?

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Daryl Bible (CFO):

You know, on a year-over-year basis, Amanda, I think I grew very comfortable that we will have 12%-plus growth in NII on a year-over- year basis from 2016 to 2015.

Unidentified Participant (Analyst - Jefferies & Co.):

Okay. Thanks. Are you expected to have some MPBC PAA in the second half?

Daryl Bible (CFO):

Could you translate that for me a little bit, Amanda? (Laughter).

Unidentified Participant (Analyst - Jefferies & Co.):

I guess, do you expect to have some purchase account accretion from MPBC?

Daryl Bible (CFO):

Purchase accounting, what I could tell you is is that the Susquehanna purchase accounting is starting to come up a little bit but we have National Penn that will have the first time for go on for this quarter. So purchase accounting is going to be pretty robust for most of this year. It will trend down over time.

2016, I feel very comfortable that GAAP margin will be in the low [340s], second, third, fourth quarters and core margin, we feel, is stabilized, starting to improve some. That could actually get into the low [320s].

Unidentified Participant (Analyst - Jefferies & Co.):

All right. Thank you.

Operator:

That concludes today's question-and-answer session. Mr. Greer, at this time I will turn the conference back over to you for any additional or closing remarks.

Alan Greer (IR):

Thank you, Operator, and thanks to all of our listeners for joining. This concludes our call for the day. If you have further questions, please don't hesitate to call Investor Relations. And we hope that you have a good day.

Operator:

This concludes today's call.

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