City National Corp. (CYN)

Banking on Asset Sensitivity:

Bank Investing in a Rising Rate Environment. A Comprehensive Review of 10 Aspirational Regional Banks

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IMPORTANT

Important Terminology: When I say QoQ I mean 2Q2013 compared to 1Q2013. When I say YoY I mean 2Q2013 compared to 2Q2012. This terminology is different than the industry standard. In addition I will use fee income and non-interest income interchangeably as I do not have the detail, in every case, necessary to discern the two. Additionally, earnings are on a dilutive basis as is the multiple being applied to them for purposes of valuation.

I am well aware that most loans are tied to LIBOR 3/6m. I put heavy analytical emphasis on the 10 yr treasury note. While a move in the short end of the curve is what will dramatically drive earnings, the long end informs us of what is to come. As no foreseeable change will be occurring at the fed funds (and similarly the "market" derived LIBROR rate) in the near term, we can only look to the long end of the curve (the 5 & 10yr swap rates and its continual steepening) to inform us about the future. As such, I will be referring to the 10yr treasury as a rate indicator through this research.

Introduction/ Thesis

I believe it is impossible to analyze a bank without analyzing, with significant scrutiny, its peers. Banks are a commoditized product and as such, factors such as niches, bps in ROA, and interest rate profile make all the difference. This report looks at 10 aspirational regional banks; City National (CYN), BB&T (BBT), Fifth Third (FITB), Huntington Bancorp (HTBN), KeyCorp (KEY), M&T (MBT), PNC (PNC), Regions Financial (RF), US Bancorp (USB), and Zions (ZION). A comprehensive 4-5 page write-up can be found on each bank along with a detailed analysis of City National. Additionally, there is an economic forecast accompaniment that outlines the economic paradigm by witch these banks are judged.

When analyzing financial institutions, more so than nearly any other sector, macro variables are extremely important. The most pertinent of these, is the interest rate environment. Banks position and accordingly hedge themselves for and against various rate environments. I believe rates are set to rise and as such I covet the banks with the most asset sensitivity (changes in assets are more sensitive than changes in liabilities to changes in rates). **Combining asset sensitivity with quality underlying metrics, a defined and clear strategy, operating demographics, and valuation led me to solicit City National as the best bank in the peer group. PNC, FITB, and USB are all strong, but for various reasons based on the above mentioned criteria, City National was chosen.**

Please read the Macro Economic Outlook for the US section to inform yourselves as to the mentality I have taken when making the investing decisions as done here.

The banks were compared on the following factors

- Asset Sensitivity
    - Asset sensitivity is when a change in rates has a larger effect on the asset side of the balance sheet than on the liability side. As such, in a rising rate environment, interest income should increase faster than interest expense and thus EVE will rise.
    - I am looking for firms that are asset sensitive as I predict a rising rate environment.
    - The checked boxes below represent the sort of asset sensitivity that I want to see in a bank.
- Story

- Management has been able to communicate a clear and concise strategy for growth. They have made sufficient progress toward executing on this strategy.
- The firm is in the right types of businesses with the right demographics (state unemployment, housing appreciation, wealth) and the right clientele for those lines of business.
- The checked boxes below represent firms with well communicated stories and good management

- Metrics
  - A comprehensive review of the meaningful metrics has been done. I focus primarily on equity related returns (ROE, ROTE, ROAE). The top 50% are selected below
- Valuation
  - Banks sell a commodity like product. They also have off balance sheet exposure (swap portfolios, ect) that make evaluation on a traditional fundamental basis very difficult. CF models do not work well for banks. Banks historically trade in a tight multiple range. As such, I use the individual banks average P/E multiple over the last 13 years (with corrective measures taken over the stressed periods of 08-10) and spend considerable time developing strong earnings projections.
  - The check boxes below represent firms that still have return potential above 9% (including dividends)
- Regulatory/Legal
  - Legal disputes with regulators, class actions, or other entities that could materially affect the firm
  - The Fed implements nearly all the Basel III rules for banks with >50 B in assets. More rules apply for banks with greater than 250 B in assets
  - Dodd Frank may have a material impact on the firm and its ability to conduct business as it used to.
  - The checked boxes below represent the banks that have light regulatory or legal issues.

	Asset Sensitivity		Story	Legal/Reg	Metrics	Valuation	Rating
FITB	+200bp = adds 2.5% to NII +100bp = adds 1.2% to NII	√		√	√	√	OW (ST,LT)
MTB	+200bp = adds 6.9% to NII +100bp = adds 3.85% to NII	√	√		√	√	EW (ST), OW(LT)
HBAN	+200bp = adds 3% to NII +100bp = adds 1.8% to NII			√	√		UW (ST) EW(LT)
KEY	+200bp = adds 1.9% to NII +100bp = adds 1% to NII			√			Sell (ST) UW(LT)
BBT	+200bp = adds 3.55% to NII +100bp = adds 2.7% to NII	√		√	√		UW (ST) EW(LT)
RF	+200bp = adds 3% to NII +100bp = adds 2.1% to NII						Sell (ST) UW(LT)
ZION	+200bp = adds 15% to NII +100bp = adds 7% to NII	√		√			Sell (ST) UW(LT)
USB	+200bp = adds 1.63% to NII +100bp = adds 1% to NII		√		√	√	EW(ST) OW(LT)
PNC	+200bp = adds 3% to NII +100bp = adds 2.1% to NII		√		√	√	EW(ST) OW(LT)
CYN	+200bp = adds 5% to NII +100bp = adds 3.5% to NII	√	√	√	√	√	OW (ST,LT)

UW = underweight, EW = Equal Weight, OW = Overweight, ST=short term, LT=long term

Bank	Ticker	Mkt Cap	Current Price	EPS	P/E	Beta	Shares Oust.	Dividend	2y Target Price
City	CNY	3.52B	$62.37	$3.90	16.78x	1.47	531.5 M	1.4%	$80.27
Recommendation: Overweight (Short and Long Term) Strong strategy and execution, multiple is not forward looking									

City National Bank is a bank holding company headquartered in Los Angeles, CA and formally headquartered in Beverly Hills. City offers complete banking services, investment and trust services, through 78 banking offices in five states(Southern California, San Francisco and Palo Alto, Nevada, New York City, and recently in Boston are primary state/city/locations). There are 8 wholly owned subsidiaries which manage 45.8 billion in client investment assets with 28.4 billion on balance sheet. City National's strategy is to focus on delivering specialized and highly personal service and complete financial solutions to mid-size businesses and affluent individuals. They have recently expanded into Palo Alto and Boston to take advantage of the entrepreneurship of those areas, and serving as a bank to VCs. City is well positioned to meet the needs of an affluent client base.

Thesis

Why I like City National

- Good execution on earnings and earnings growth (7 straight quarters of loan growth, primarily from C&I).
- Over 60% utilization of loans and leases.
- Strong asset quality as all metrics point to overall improvement of credit and reduction in non performing assets.
- Meets capitalization requirements but is simultaneously exempt from the regulatory headache of banks with greater than 50 billion in assets. (this keeps costs down).
- 75% of loans reset once the short end of the curve moves.
- Solid underlying demographics (geography, wealth) of their client base.
- Highly asset sensitive
- Exceptional credit management
- Good metrics and strong growth potential
- Anticipate 13.5% annual return for the next two years (not including dividends)
- A clearly communicated strategy with evidence of successful execution. Increased expansion into the Bay Area (notably Palo Alto) as well as New York (see Rochdale Investments acquisition) as well as new territories such as Boston.
- emulates the benefits of a community bank while having national satellite offices
- Niche lending market such as entertainment, export finance, banking services for VC firms.
- Lowest deposit cost in peer group (65% non interest bearing and still experiencing deposit growth).

Strategy

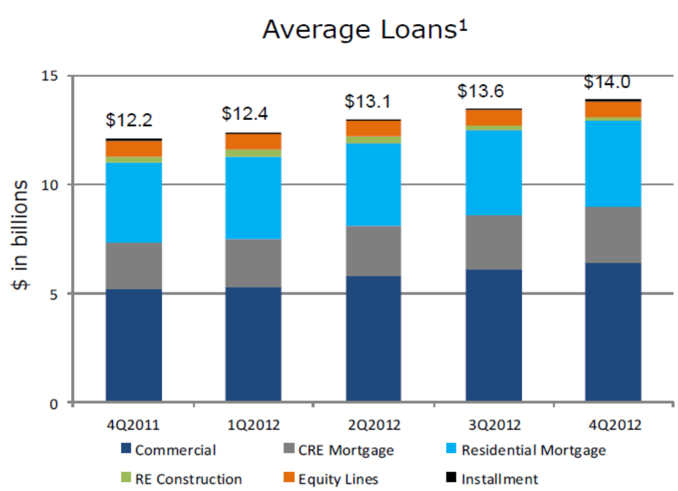
City National is becoming increasingly more aggressive in their expansion into new wealth markets. CYN recently announced it will be moving into Boston to take advantage of the venture capital scene. They currently have an office and good relations in Palo Alto and are going to continue to expand in that area. City has been focused on high net worth individuals and mid sized business banking since its inception (note they were headquartered in Beverly Hills). Furthermore, they have acquired new talent across all areas, such as their new technology executive, Mohamad Ali, who was the chief strategy officer at Hewlett-Packard. CYN opened up their first ground floor branch in New York city. They have been banking there on the business front for some time, and despite NYC being well banked, they believe they can maintain and expand high net worth client relationships through offering retail services.

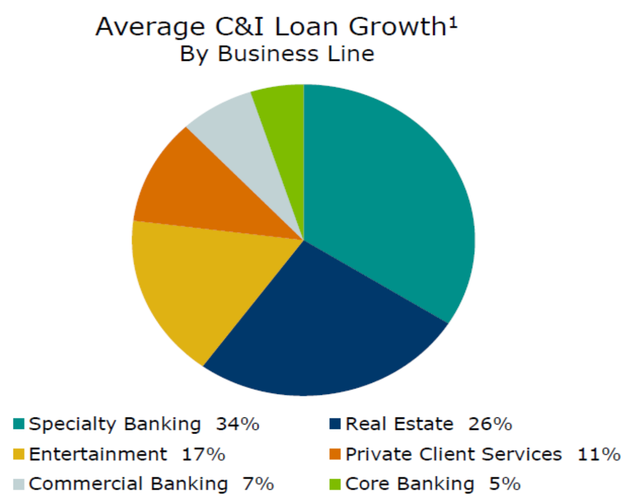
City National behaves much more like a community bank with select national satellite offices. New York and the San Francisco bay area are the two locations where City sees the most growth and Boston is a developing interest, as these three cities have large concentrations of entrepreneurs that fit the private and business banking and upscale banking business model City has. Historically they have had strong entertainment and technology lending businesses with secondary specializations in tourism, healthcare, agricultural and professional services lending.

While New York and Boston are wealthy locations for business, California as a whole is the 9th largest economy in the world. There are over 500,000 millionaire households in California (much of it concentrated in the Bay area and Los Angeles County).

City has a strong history of lending to alternative industries such as the entertainment industry. They have proven competence in acquiring specialized skill sets where other firms struggle. City's strategy is to capitalize on these talents, on and with a wealthy client base, to expand their portfolio and margin. Their continued expansion into New York and the Bay area, as well as into Boston, should position them well for wealth management and business banking.

Loans and Leases





(Graphs from 2012 City National Investor Presentation)

Housing Exposure

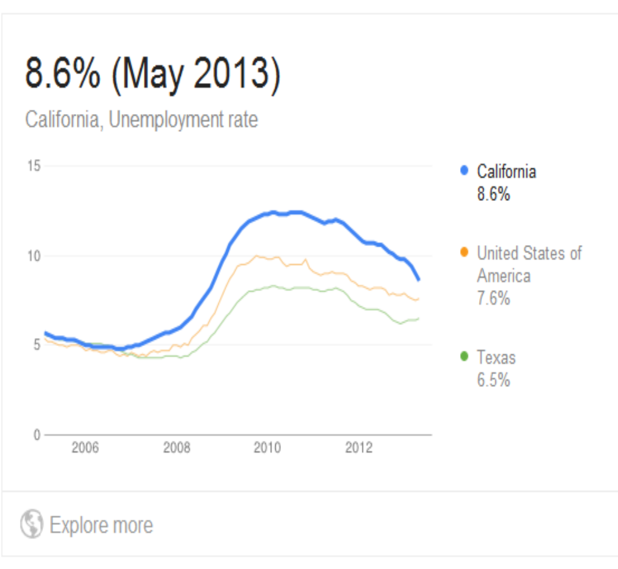
Residential housing exposure makes up less than 25% of the total loan exposure. As City has been in the business of banking with wealthy individuals, the NCOs and defaults have been extremely low as the credit rating and income level of their average mortgage recipient is very high.

City experienced $37,000 in recoveries last quarter. Net charge offs were 1.57 million in 2012. These numbers are quite insignificant to the overall picture of a 4 billion dollar residential real estate portfolio. Their most heavy real estate (residential or commercial) exposure is in Orange County, the San Francisco Bay area, New York, and San Diego.

According to Zillow (and sanity checked against other searches), Los Angeles metro area (inclusive of orange county) saw residential real estate prices rise 2% MoM, 4.9% QoQ and 21.5% YoY. San Francisco Metro saw 2.6% MoM, 6.9% QoQ, and 27.8% YoY. San Diego Metro saw prices rise 2.1% MoM, 5.1% QoQ, and 23.1% YoY. New York Metro is a bit less impressive but still positive with .5% MoM, .9% QoQ, and 2.2% YoY. Strong growth in the housing market that City services (and thus expansion of their consumers balance sheet) serves as a strong indicator of the health of the underlying credit of their customers.

While it is certainly true that the unemployment rate in California (8.6%) is higher than the national average (7.6%), both values have been on the decline since early 2010. Additionally, the unsold inventory index is down to 3 months. The negative slope of the California unemployment curve is much higher than that of the national curve. The unemployment rate amongst the wealth is significantly lower than the national average rate. Unemployment doesn't seem to affect City's consumers' balance sheet too much as they have seen the utilization rate on loans and leases increase 4 quarters in a row. All in all stable rental demand and attractable affordability signal that the housing valuations are not as they were pre-recession and the trend of gradual decline in loss severity continues. In fact, the buy to rent business has increased which is where a great deal of market demand comes from. City, being the entrepreneurial focused company they are, likely finances many of these investors in the California market.

REOs jumped from zero to a high of 58 million in 2010 and is back down to 20 now. Success in REO reductions didn't come out of the substitute to short sale. Normally short sales decrease liquidation times but the time lag between the two methods is normally most observed I n subprime collateral. As the stock of residential exposure City has is of high quality (Jumbo I predict), they have been able to extinguish bad properties quickly and without much cost (time or money).



All in all the balances for average residential single family mortgages was up 7% YoY and 3% QoQ. Additionally, CYN has no substantial portion of their revenues derived from mortgage refinancing (compared to peers FITB, MTB, USB, and HBAN). Statewide unsold inventory index is down to 3 months.

Commercial Real Estate and Real Estate Construction

CRE makes up about 12% of the total loan portfolio while RE Construction accounts for a little less then 1%. As such, I will refer to them both as CRE. Blances fro CRe were up 29% YoY and 3% QoQ (declines were experienced in real estate construction). The CRE market has some headwinds and as such I'm comforted by the relatively low CRE exposure City has.

The CRE market, much like the residential housing market, has experienced significant improvement in the underlying value of the mortgage. However, many managers may only be avoiding default because rates are so low. As rates rise, the increase in interest costs may push CRE portfolios into default. This is a concern for all banks. The quality of the CRE portfolio has a very significant part to play in the future success of the firm (strip malls w/ 50% occupancy v DTLA office buildings with 95% occupancy). Considering City's key markets, commercial real estate has largely participated in the uptrend, commerce has restored, and defaults will not be as prevalent.

Warehouse, Industrial and Office												
Property Type	2006	2007	2008	2009	2010	2011	2012	2013f	2014f	2015f	2016f	2017f
Rent Growth	7.5%	7.4%	1.8%	-11.5%	-3.8%	0.5%	2.1%	2.9%	3.3%	3.9%	3.7%	2.7%
Vacancy	7.6%	7.4%	8.5%	10.3%	11.6%	10.2%	9.0%	8.2%	7.8%	7.3%	7.3%	7.4%

(data from NCREIF)

We have seen office demand recover quicker than retail demand which has in turn recovered quicker than manufacturing. As City has significantly less manufacturing CRE exposure, the trend is comforting. Furthermore, credit quality is approaching a bottom and construction wages are beginning to increase. Wages have reached their 2005 levels. To conclude, most components of CRE have bottomed and demand for CRE space is qucily accelerating (notably in multi-family, although City has little exposure to this particular sector). According to the FDIC, delinquencies in construction and development loans held by regional banks improved to 9.45% in 3Q12 from a peak of 16.6% in June 2010. The delinquency rate was a low 0.4% in 2005.

All in all, CYN has an appropriate amount of CRE exposure in high quality demographics unlike some of their overexposed peers (ZION, MTB, BB&T).

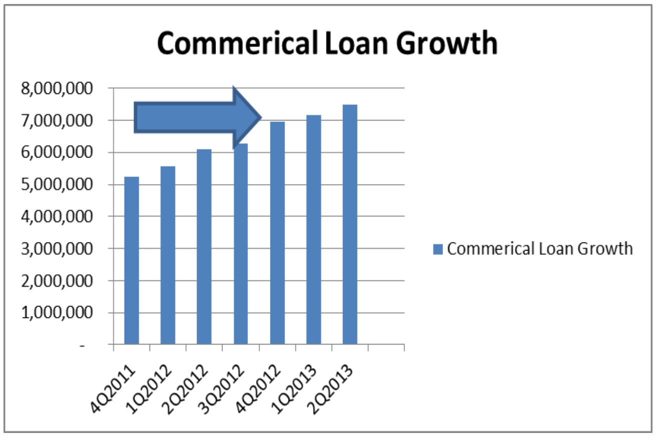
Commercial Loans

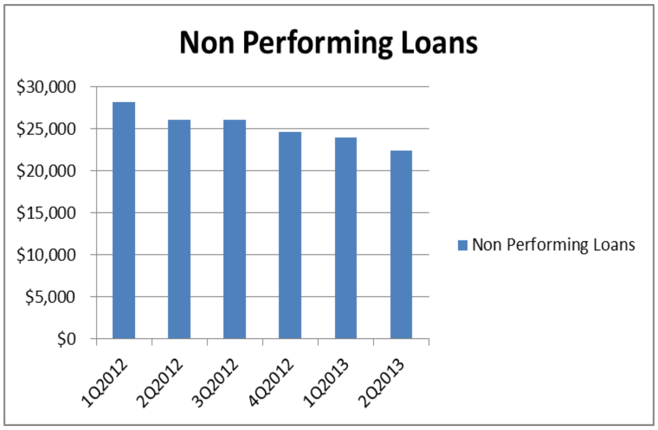
Commercial loans were up 25% YoY and 6% QoQ. City is very asset sensitive with a large variable rate commercial loan portfolio funded by low cost core deposits. Commercial loans consists of entertainment, technology and small-mid sized business loans. There has, and should continue to be, a large rebound in bank lending. Average return is about 300 bps over LIBOR. As such we need to see some movement in the short end of the curve before these firms really begin to do well.

City National has a prudent credit culture and as such did not suffer on loan defaults as significantly as many of its peers (RF, ZIONS, MTB). They appear to have good portfolio management as their risk reward payoff seems balanced. Their aggregate loans and commitments are not concentrated amongst few borrowers (ex. Small Business lines cannot exceed 2 million), they have good geographic diversity while still simultaneously focusing on select and key markets. They have a desirable loan consumer, and a good collections and charge offs history in times of stress and illiquidity.

Net charge-offs were 3.1 million for the quarter but against 10.6 million in recoveries shows a very pretty picture for the quality of the loan portfolio. Non accruals were 48bps and down 7bps QoQ. Furthermore, the loans that were 30-90 days past due decreased from 37 million to 20 million.

From the credit line side, CYN has seen utilization rates rise the last four quarters by 5.7% to 61.4%. They also have (in part through acquisition) a strong asset based lending program. City has a niche export financing unit.

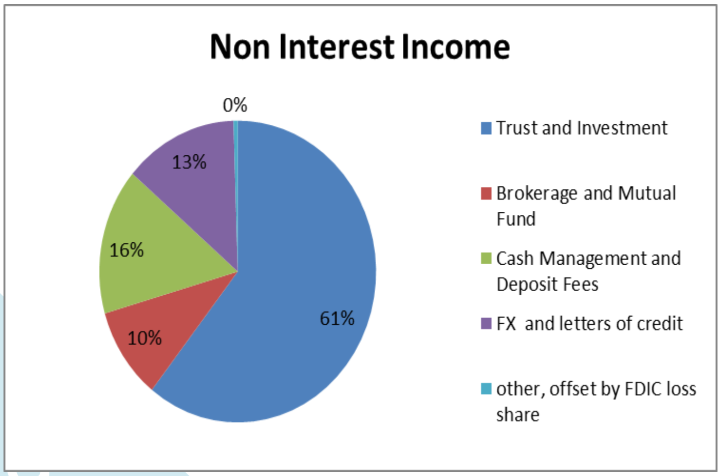




Asset Management

The asset management business is a natural one for City to be in given the affluence of their depositor base, they manage or administers 59 billion of client investment assets. Recall, City was founded in Beverly Hills, CA and has been apart of the affluent wealth community for over 50 years. There are over 500,000 millionaire households in the state of California. City's four largest markets are Los Angeles (245,000 millionaire households), The Bay Area (121,000 millionaire households), New York (448,000 millionaire households), and the San Diego Area (67,000 millionaire households). These geographies constitute he 1st ,2nd ,8th and 17th most densely populated millionaire household locations in the US.

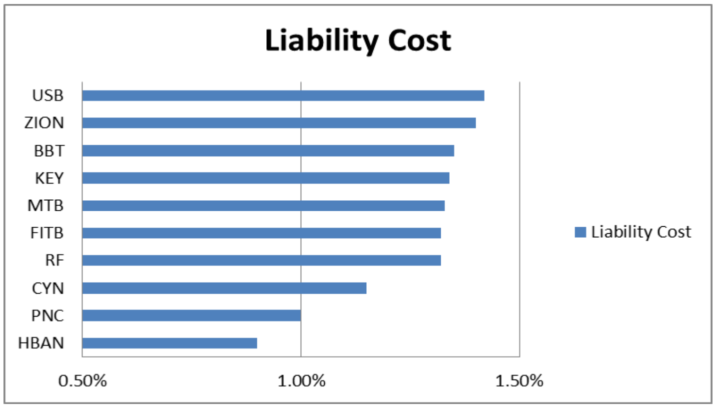
The recent acquisition of Rochdale Investment Management added 5.2 billion in AUM as well as some select talent both from the asset management and client facing perspective. Trust and investment fees contributed 50 million to non interest income and was up 46% YoY and 7% QoQ.

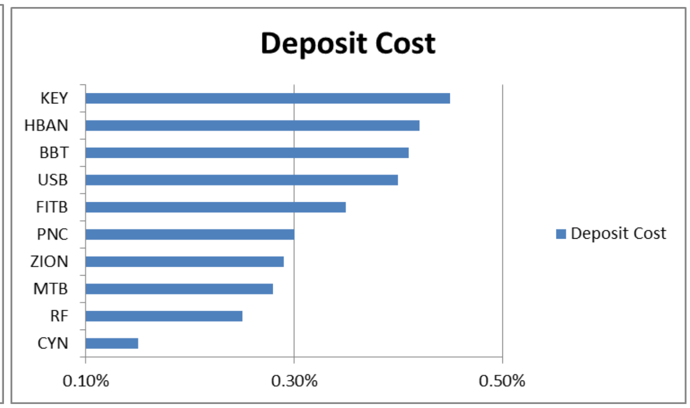


Other income was 20.4 million up 17% YoY and 11% QoQ. This was due primarily to hgiehr client swap transactions and two months lease income from the acqusiition of First American Equipment Finacne. This was offset almost entirely by FDIC loss share and other

Deposits

Core deposits increased 13% this last quarter to contribute to an overall deposit base for 23.7 billion. City National has done a very good job keeping their deposit base low cost. This will be a key driver to expanding NIM when rates move. This is a result of the significant amount of MMDA and Savings accounts (constituting 85% of deposits). Close to 60% of the deposit base is noninterest bearing and a very small contribution comes from CDs> 100k.





City has reported success in cross selling and engaging users to capitalize on the City platform by doing all of their deposit and loan needs with them.

Available for Sale Securities Portfolio

While a rising interest rate environment is certainly helpful for NIM expansion, the available for sale securities portfolio (AFS) will likely take a hit. As a first course in finance will tell you, when interest rates rise, prices fall. The recent 100bp hike in the 10yr has done some damage to AFS portfolios. This damage will not be seen on the income statement until the bonds are sold, but instead, we can look to 3Q2013 capital ratios against 2Q2013 and 1Q2013 to judge the capital hit as the B3 ratios require OCI adjustments. Two bad things have (will) happen to MBS portfolios when rates rose (rise);

1. The value of the MBS will decrease
2. The prepayment option on the mortgage/loan will decrease in value. This inadvertently causes the duration of the portfolio to increase which is the exact opposite of what everyone is trying to do at the moment.

For City, the AFS portfolio is relatively small and as such will have a muted impact on decrease in AFS gains and increase in AFS losses as they become recognized (unless held to maturity, however City's securities book is over 85% AFS). Look to Regions, PNC, and FITB to be on the losing end of this.

Perhaps due to size, or the lack of complexity of their underlying balance sheet, CYN seems to take a slightly more antiquated duration matching ALM strategy. They seem to have consistently 20% sensitivity to rate rises when looking at their portfolio from a gap analysis perspective. This is purely speculation, as we have limited insight into their ALCO policies, ALM strategies, or breakdown of their securities portfolio in general (the type of credit exposure they like out of CMBS, CLOs, ect).

From an AFS portfolio standpoint, given their securities yield is one of the lowest in the industry combined with the fact they are buyers of RMBS (prepay option for increasing rate environment already well priced in), it seems evident they are working hard to keep duration low. Christopher Carrey (CFO) stated in a conference call that the securities portfolio (approximately 7 billion) as roughly 2.5 billion or 35% in <1 yr duration securities.

Odds are they will need to fund loan growth through their AFS portfolio if deposits runoff for more competitive rates, until that happens, I would expect to see some continued tiptoeing into the CMBS and CLO arena.

Valuation

Below you can find a pro forma income statement and balance sheet. City has a long term multiple of 14.2x. When multiplying against a blended 2013/2014 EPS of $5.65 we get to a 2yr price target of $80.27. When factoring in dividends, an investment in CYN will return approximately 15% annually for the next two years. When looking further into the future, the earnings potential is significantly more attractive. I believe that over the next four years, CYN should return (including dividends) an annualized 20% per year as most of the earnings will come in 2015/2016 when the short end of the curve jumps. Once the asset level gets to just shy of 50billion, City will need to make a choice to continue to be a small bank or a big bank (as the increased cost of regulation makes a 55 billion AUM bank not economical). That decision is a few years out.

Income Statement Forecast

	2010	2011	2012	2013E	2014E	2015E	2016E
Avg Earning Assets	19300	20800	23600	26819	30621	34709	39510
NIM	3.86%	3.80%	3.63%	3.20%	3.25%	3.54%	4.00%
NII	745.0	790.4	856.7	858.2	995.2	1227.8	1580.4
Provisions	76	44	45	40	40	54	84
Fee Income	296	318	347	354	422	519	633
Operating Revenue	965.0	1064.4	1158.7	1171.9	1377.5	1692.8	2129.9
Expenses	682.0	740.0	783.0	814.7	905.3	994.0	1173.0
EBIT	283.0	324.4	375.7	357.2	472.2	698.8	956.9
Adjust for FTE, securities, nonrecurring gains/losses and other	135	80	75	80	129	137	118
Tax Rate	16%	31%	32%	30%	30%	30%	30%
NI	124.0072	169.858	204.4624	194.062396	240.22448	393.236399	587.2485849
Dilluted Average Shares	52.5	52.8	53.5	54.7	55	60	60
Dilluted EPS	2.362	3.217	3.822	3.548	4.368	6.554	9.787

Balance Sheet Forecast

	2010	2011	2012	2013	2014	2015	2016
Assets	21.4	23.7	28.8	29.2	33.3	37.7	42.9
Securities	5.7	8	10.6	8.8	10.3	12.1	14.3
Loans	13.2	13.8	14.8	17.2	19.8	22.5	25.5
Deposits	18.2	20.4	23.5	25.2	28.7	32.5	36.8
Other	1.2	1.2	2.8	1.7	2.2	2.4	2.9
Equity	2	2.1	2.5	2.3	2.4	2.9	3.2
TCE	1.5	1.6	1.8	1.6	1.7	2.2	2.5
Shares Repurchased			0	0	0	0	0
Div payout Ratio		24%	22%	23%	25%	30%	30%
Dividend		0.7720818	0.84077996	0.81598448	1.0919294	1.96618199	2.936242925

Metrics of Interest

	2010	2011	2012	2013	2014	2015	2016
ROE	6.20%	8.09%	8.16%	8.51%	9.89%	13.80%	18.16%
ROTE	8.27%	10.62%	11.33%	12.27%	13.90%	18.29%	23.18%
ROA	0.58%	0.72%	0.71%	0.67%	0.72%	1.04%	1.37%

	1Q2012	2Q2012	3Q2012	4Q2012	1Q2013	2Q2013	3Q2013	4Q2013	1Q2014	2Q2014
NIM	**3.74%**	**3.91%**	**3.58%**	**3.27%**	**3.21%**	**3.24%**	**3.20%**	**3.15%**	**3.10%**	**3.20%**
Earning Assets	$22,103,000	$22,769,000	$23,892,000	$25,468,000	$26,046,600	$25,819,900	$25,861,644	$26,819,406	$27,640,276	$28,643,556
1 Interest expense	$12,879	$13,410	$14,846	$14,580	$14,727	$14,076	$14,498	$14,933	$15,381	$15,843
Net Interest Income	**$206,542.63**	**$222,435.89**	**$213,700.53**	**$208,081.71**	**$208,905.78**	**$209,027.17**	**$206,777.17**	**$211,085.23**	**$214,092.93**	**$229,021.70**
	92%	91%	90%	89%	94%	94%	92%	92%	92%	92%
2 Provisions for credit losses and losses on covered loans and misc adjustments	13466	20293	24089	18498	15892	-4927	12116	12295	12433	12616
Non Interest Income										
3 Trust and Investment	33654	34067	43477	44026	46653	49830	53567	57585	61904	66546
4 Brokerage and Mutual Fund Fees	5028	5293	9059	8424	8066	8107	8269	8435	8603	8775
5 Cash Management	11168	11475	11526	11480	13009	12880	13266	13664	14074	14497
6 International Services	8785	10017	9819	11342	9619	10911	11347	11801	12273	12764
7 Other	17065	13916	33376	24606	16181	481	0	0	0	0
Total Non Interes Income	**75700**	**74768**	**107257**	**99878**	**93528**	**82209**	**86450**	**91485**	**96855**	**102583**
Non Interest Expense										
8 Salaries	120245	115035	120210	123812	128195	127168	131619	136226	140993	145928
9 Occupancy	13686	14056	16238	17554	15989	16205	16756	17326	17915	18524
Legal	11880	11359	11757	17844	11612	13163	15000	15000	15000	15000
Information Services	8149	8539	8660	8896	9391	9183	9458	9742	10035	10336
D&A	7428	8013	8324	8720	8172	8249	8500	8500	8500	8500
Amortization of Intangibles	1886	1518	1932	1932	1932	1931	2000	2000	2000	2000
Marketing	6816	7597	7141	9111	8316	8644	9000	9000	9000	9000
Other	30630	28399	33624	34147	27733	26886	30000	30000	30000	30000
Total Noninterest Expense	**200720**	**194516**	**207886**	**222016**	**211340**	**211429**	**222333**	**227793**	**233443**	**239288**
EBT	$68,057	$82,395	$88,983	$67,446	$75,202	$84,734	$58,778	$62,481	$65,072	$79,701
Taxe rate	31.80%	33.10%	32.60%	30.50%	29.00%	29.70%	30.50%	30.50%	30.50%	30.50%
Net Income	$46,415	$55,122	$59,974	$46,875	$53,393	$59,568	$40,850	$43,425	$45,225	$55,392
Non Controlling Interests	$243	$409	$372	$60	$585	$463	$500	$500	$500	$500
Net Income to Shareholders	**$46,172**	**$54,713**	**$59,602**	**$46,815**	**$52,808**	**$59,105**	**$40,350**	**$42,925**	**$44,725**	**$54,892**
Payout Ratio	30%	25%	23%	86%	28%	24%	24%	24%	30%	30%
Dividend	$0.26	$0.26	$0.26	$0.75	$0.27	$0.26	$0.18	$0.19	$0.24	$0.30
Diluted Shares	53021	53373	53711	53743	54068	54500	54700	54700	55000	55000
Diluted EPS	**$0.87**	**$1.03**	**$1.11**	**$0.87**	**$0.98**	**$1.08**	**$0.74**	**$0.78**	**$0.81**	**$1.00**

	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015	4Q2015	1Q2016	2Q2016	3Q2016	4Q2016
NIM	**3.30%**	**3.40%**	**3.50%**	**3.55%**	**3.55%**	**3.55%**	**3.80%**	**3.90%**	**4.00%**	**4.50%**
Earning Assets	$29,529,021	$30,621,000	$31,497,020	$32,583,445	$33,535,116	$34,709,205	$35,743,365	$37,012,703	$38,136,830	$39,509,687
1 Interest expense	$16,318	$16,807	$17,312	$17,831	$18,366	$18,917	$19,484	$20,069	$20,671	$21,291
Net Interest Income	**$243,479.80**	**$260,135.64**	**$275,447.45**	**$289,019.82**	**$297,461.15**	**$307,876.30**	**$339,376.87**	**$360,678.18**	**$381,161.59**	**$444,244.45**
	92%	92%	92%	92%	92%	92%	92%	92%	92%	92%
2 Provisions for credit losses and losses on covered loans and misc adjustments	12763	12961	13095	13281	13426	13625	13780	13992	14159	14386
Non Interest Income										
3 Trust and Investment	71205	76189	80760	85606	90742	96187	101958	108076	114560	121434
4 Brokerage and Mutual Fund Fees	8951	9130	9312	9499	9689	9882	10080	10282	10487	10697
5 Cash Management	14931	15379	15841	16316	16805	17310	17829	18364	18915	19482
6 International Services	13275	13806	14358	14932	15530	16151	16797	17469	18168	18894
7 Other	0	0	0	0	0	0	0	0	0	0
Total Non Interes Income	**108362**	**114504**	**120272**	**126353**	**132766**	**139530**	**146664**	**154190**	**162130**	**170507**
Non Interest Expense										
8 Salaries	151036	156322	161793	167456	173317	179383	185661	192160	198885	205846
9 Occupancy	19154	19805	19805	19805	19805	19805	19805	19805	19805	19805
Legal	15000	15000	15000	15000	15000	15000	15000	15000	15000	15000
Information Services	10646	10965	11294	11633	11982	12341	12711	13093	13486	13890
D&A	8500	8500	8500	8500	8500	8500	8500	8500	8500	8500
Amortization of Intangibles	2000	2000	2000	2000	2000	2000	2000	2000	2000	2000
Marketing	9000	9000	9000	9000	9000	9000	9000	9000	9000	9000
Other	30000	30000	30000	30000	30000	30000	30000	30000	30000	30000
Total Noninterest Expense	**245335**	**251592**	**257392**	**263394**	**269604**	**276029**	**282678**	**289557**	**296676**	**304041**
EBT	$93,744	$110,087	$125,232	$138,698	$147,198	$157,752	$189,583	$211,319	$232,457	$296,325
Taxe rate	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%	30.50%
Net Income	$65,152	$76,511	$87,036	$96,395	$102,303	$109,638	$131,761	$146,866	$161,558	$205,946
Non Controlling Interests	$500	$500	$500	$500	$500	$500	$500	$500	$500	$500
Net Income to Shareholders	**$64,652**	**$76,011**	**$86,536**	**$95,895**	**$101,803**	**$109,138**	**$131,261**	**$146,366**	**$161,058**	**$205,446**
Payout Ratio	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
Dividend	$0.35	$0.41	$0.47	$0.52	$0.56	$0.60	$0.66	$0.73	$0.81	$1.03
Diluted Shares	55000	55000	55000	55000	55000	55000	60000	60000	60000	60000
Diluted EPS	**$1.18**	**$1.38**	**$1.57**	**$1.74**	**$1.85**	**$1.98**	**$2.19**	**$2.44**	**$2.68**	**$3.42**

		1Q2012	2Q2012	3Q2012	4Q2012	1Q2013		2Q2013		3Q2013
	Assets						interest rate		interest rate	
	Beginning Cash Position	210,799	162,894	235,038	151,969	144,290		146,338		145,000
1	*Commerical*	5,573,782	6,086,947	6,264,562	6,949,073	7,170,370	3.71%	7,497,105	3.58%	7,946,931
2	*CRE Mortgages*	2,213,114	2,424,333	2,463,664	2,829,694	2,937,457	4.00%	3,101,169	4.01%	3,256,227
3	*Residential Mortgages*	3,805,807	3,822,630	3,897,690	3,962,205	4,027,741	3.83%	4,153,051	3.72%	4,236,112
4	*RE Construction*	313,409	301,829	242,137	222,780	247,114	4.64%	217,808	4.25%	167,808
5	*HELOC*	715,997	741,270	718,966	711,750	696,679	3.68%	700,681	3.60%	700,000
6	*Installment*	125,793	130,200	137,632	142,793	137,545	4.22%	149,438	4.69%	158,404
	Total Loans & Leases ex covered lc	12,747,902	13,507,209	13,724,651	14,818,295	15,216,906		15,819,252		16,465,483
7	Covered lonas and allowances	1,069,608	947,454	830,919	708,335	627,235	4.40%	553,665	4.45%	500,000
8	Net Loans and Leases	13,817,510	14,454,663	14,555,570	15,526,630	15,844,141	4.42%	16,372,917	4.43%	16,965,483
8	Securites AFS	6,838,710	6,865,881	7,872,064	9,205,989	7,738,051	1.91%	7,044,571	1.98%	6,500,000
	Securities HTM	996,613	1,100,229	1,174,161	1,398,403	1,400,890	1.91%	1,503,973	1.98%	2,000,000
9	Other Assets	2,385,656	2,381,200	2,649,733	2,487,470	2,450,672		2,458,041		2,500,000
	Total Assets	**$ 24,038,489**	**$ 24,964,867**	**$ 26,486,566**	**$ 28,770,461**	**$ 27,578,044**	**3.44%**	**$ 27,525,840**	**3.46%**	**$ 28,110,483**
	Liabilities									
10	*Non Interest Bearing*	11,550,000	12,187,075	13,432,413	14,264,797	13,800,017		14,288,001		14,859,521
11	*Interest Bearing*	9,237,737	8,921,977	9,079,903	9,237,558	9,137,569	0.54%	9,363,756	0.52%	9,551,031
	Total Deposits	20,787,737	21,109,052	22,512,316	23,502,355	22,937,586		23,651,757		24,410,552
12	ST Borrowings	222,776	322,077	211,739	1,423,798	806,760		2,675		250,000
12	LT debt	482,024	712,280	706,035	706,051	702,967		706,537		750,000
13	Other Liabilities	302,951	361,300	449,728	439,858	388,439		433,822		449,440
	Total Liabilities	**$ 21,795,488**	**$ 22,504,709**	**$ 23,879,818**	**$ 26,072,062**	**$ 24,835,752**	**0.54%**	**$ 24,794,791**	**0.52%**	**$ 25,859,992**
	Equity									
	Preferred Stock	-	-	-	169,920	169,920		169,920		169,920
	Common Stock	53886	53886	53886	53886	54133		54274		54,000
	APIC	489717	491,439	485,975	490,339	496,013		507,560		512,636
	RE	1726203	1,768,970	1,826,341	1,825,539	1,862,263		1,838,310		1,539,738
	Treasury Shares	-70241	(58,930)	(35,878)	(34,366)	(25,440)		(25,296)		(25,802)
	Shareholder Equity	**$ 2,199,565**	**$ 2,255,365**	**$ 2,330,324**	**$ 2,505,318**	**$ 2,556,889**		**$ 2,544,768**		**$ 2,250,491**

		4Q2013	1Q2014	2Q2014	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015	4Q2015	1Q2016	2Q2016	3Q2016	4Q2016
	Assets													
	Beginning Cash Position	145,000	145,000	145,000	145,000	145,000	145,000	145,000	145,000	145,000	145,000	145,000	145,000	145,000
1	*Commerical*	*8,423,747*	*8,844,935*	*9,287,181*	*9,751,540*	*10,239,117*	*10,648,682*	*11,074,629*	*11,517,614*	*11,978,319*	*12,457,452*	*12,955,750*	*13,473,980*	*14,012,939*
2	*CRE Mortgages*	*3,419,039*	*3,419,039*	*3,589,991*	*3,589,991*	*3,769,490*	*3,769,490*	*3,957,965*	*3,957,965*	*4,155,863*	*4,155,863*	*4,363,656*	*4,363,656*	*4,581,839*
3	*Residential Mortgages*	*4,320,834*	*4,407,251*	*4,495,396*	*4,585,304*	*4,677,010*	*4,770,550*	*4,865,961*	*4,963,280*	*5,062,546*	*5,163,797*	*5,267,073*	*5,372,414*	*5,479,863*
4	*RE Construction*	*150,000*	*150,000*	*150,000*	*150,000*	*150,000*	*150,000*	*150,000*	*150,000*	*150,000*	*150,000*	*150,000*	*150,000*	*150,000*
5	*HELOC*	*700,000*	*735,000*	*757,050*	*779,762*	*803,154*	*827,249*	*852,066*	*877,628*	*903,957*	*931,076*	*959,008*	*987,779*	*1,017,412*
6	*Installment*	*167,909*	*176,304*	*185,119*	*194,375*	*204,094*	*214,299*	*225,013*	*236,264*	*248,077*	*260,481*	*273,505*	*287,181*	*301,540*
	Total Loans & Leases ex covered lc	17,181,529	17,732,528	18,464,737	19,050,972	19,842,866	20,380,270	21,125,635	21,702,752	22,498,763	23,118,669	23,968,993	24,635,010	25,543,592
7	Covered lonas and allowances	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000
8	Net Loans and Leases	17,681,529	18,232,528	18,964,737	19,550,972	20,342,866	20,880,270	21,625,635	22,202,752	22,998,763	23,618,669	24,468,993	25,135,010	26,043,592
8	Securites AFS	6,825,000	7,166,250	7,524,563	7,900,791	8,295,830	8,710,622	9,146,153	9,603,460	10,083,633	10,587,815	11,117,206	11,673,066	12,256,719
	Securities HTM	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
9	Other Assets	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000
	Total Assets	**$ 29,151,529**	**$ 30,043,778**	**$ 31,134,300**	**$ 32,096,762**	**$ 33,283,696**	**$ 34,235,892**	**$ 35,416,788**	**$ 36,451,213**	**$ 37,727,396**	**$ 38,851,484**	**$ 40,231,198**	**$ 41,453,076**	**$ 42,945,312**
	Liabilities													
10	*Non Interest Bearing*	*15,453,902*	*15,994,788*	*16,554,606*	*17,134,017*	*17,733,708*	*18,310,053*	*18,905,130*	*19,519,547*	*20,153,932*	*20,808,935*	*21,485,225*	*22,183,495*	*22,904,459*
11	*Interest Bearing*	*9,742,052*	*10,034,313*	*10,335,343*	*10,645,403*	*10,964,765*	*11,293,708*	*11,632,519*	*11,981,495*	*12,340,940*	*12,711,168*	*13,092,503*	*13,485,278*	*13,889,836*
	Total Deposits	25,195,954	26,029,102	26,889,949	27,779,420	28,698,473	29,603,761	30,537,649	31,501,042	32,494,872	33,520,103	34,577,728	35,668,773	36,794,295
12	ST Borrowings	400,000	600,000	800,000	1,000,000	1,100,000	1,200,000	1,300,000	1,400,000	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000
12	LT debt	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000	750,000
13	Other Liabilities	465,619	482,382	499,747	517,738	536,377	555,687	575,691	596,416	617,887	640,131	663,176	687,050	711,784
	Total Liabilities	**$ 26,811,573**	**$ 27,861,483**	**$ 28,939,696**	**$ 30,047,159**	**$ 31,084,850**	**$ 32,109,448**	**$ 33,163,341**	**$ 34,247,458**	**$ 35,362,759**	**$ 36,410,234**	**$ 37,490,904**	**$ 38,605,823**	**$ 39,756,079**
	Equity													
	Preferred Stock	169,920	169,920	169,290	169,290	169,290								
	Common Stock	54,000	54,000	54,000	54,000	54,000	54,000	54,000	54,000	54,000	54,000	54,000	54,000	54,000
	APIC	517,762	522,940	528,169	533,451	538,785	544,173	549,615	555,111	560,662	566,269	571,931	577,651	583,427
	RE	1,565,793.68	1,593,765.11	1,621,009.98	1,654,700.21	1,695,180.69	2,082,150.01	2,137,864.79	2,200,087.93	2,266,403.31	2,337,809.93	2,424,658.66	2,522,037.46	2,629,655.71
	Treasury Shares	(26,318)	(26,844)	(27,381)	(27,929)	(28,487)	(29,057)	(29,638)	(30,231)	(30,836)	(31,452)	(32,081)	(32,723)	(33,378)
	Shareholder Equity	**$ 2,281,158**	**$ 2,313,780**	**$ 2,345,088**	**$ 2,383,512**	**$ 2,428,768**	**$ 2,651,266**	**$ 2,711,841**	**$ 2,778,968**	**$ 2,850,230**	**$ 2,926,626**	**$ 3,018,509**	**$ 3,120,965**	**$ 3,233,705**

Bank	Ticker	Mkt Cap	Current Price	EPS	P/E	Beta	Shares Oust.	Dividend	2y Target Price
BB&T	BBT	24.26B	$34.45	$2.43	14.19x	1.19	703.87 M	2.6%	$35.10

Recommendation: Sell (Short Term), Underweight (Long Term), I do not like the corporate governance model

BB&T is a multi-bank holding company that conducts its operations in the south east (Washington DC – Florida, Indiana – Texas, expanding west). BB&T is a full service commercial and retail bank, with insurance, investment brokerage , IB and several other competencies. Their strategy exists on a local level where each subsidiary is organized into groups of community banks. Their strategy is to effectively manage credit and client relationship enhancement.

Positive

- **Average loan growth of around 4%**
- Non interest deposits up 13% from the first quarter 2013
- **EPS up 6.9% YoY, NII up 7.3% YoY**
- NCO/Avg loans down 5 quarters straight, 9.7% reduction in NPAs
- Industry comparable improvements in credit quality
- **Successful expansion into Texas**
- Commercial loan pipeline increased over 50% QoQ

Negative

- **I do not like the localized model of governance. Suntrust tried this and it was a disaster for them. From a corporate governance perspective, its not an efficient way to run a company as you allocate to much decision making to way to many different people. A bank is a complex machine. When different groups have different interest rate perspectives, different interpretations of governance and human management, different macro economic assumptions, different information, and most importantly different clients, combine all this with autonomy, there fails to be consistency across the board leading to redundancy (as will be observed through expense)**
- 100m a year in preferred dividend payments. (not recognized in the valuation model)
- The firm is very complex with operations in community/ corporate banking, residential banking, dealer financial services, insurance, specialized lending, asset management, investment counseling, capital markets, trust services, ect.
- **Non interest expense up 23.3% QoQ**
- Fee income not expanding at the rate management has outlined over the last year.
- **Efficiency ratio trending the wrong direction**

Thesis

BB&T is to complex an organization to understand well, let alone manage. Investing with BB&T is investing in hundreds of leaders (of whose communication with each other is unknown) across diverse lines of business and client appetites for those businesses. Despite the long term 11.5x earnings, I will allow for a higher multiple of 13x as the company has displayed a propensity for growing (the health and management of that growth is in question). Taking that multiple against a blended 2014/2015 EPS gives a 2yr price target of $35.10 or factoring in dividends, an annual return of 3.6%. As such, and given the corporate governance model which very much concerns me, I would rate BB&T a sell/do not initiate in the short term and underweight over the long term

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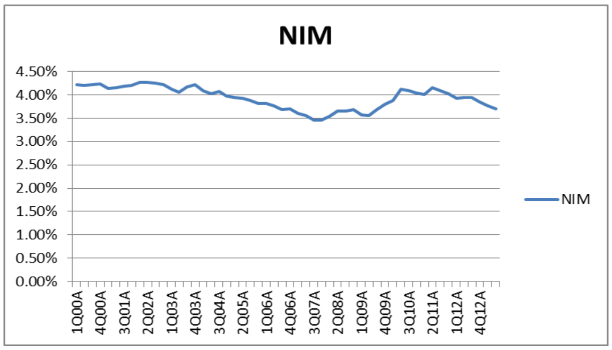
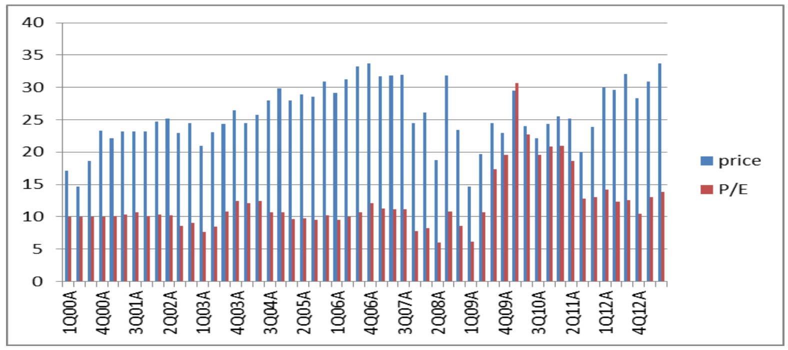
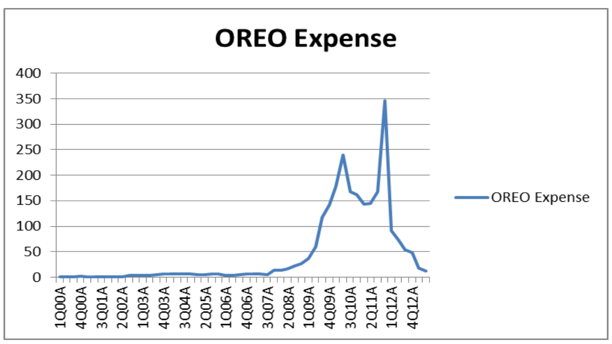
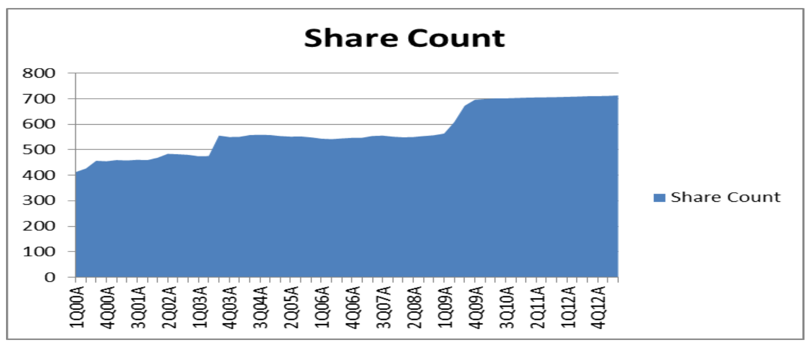
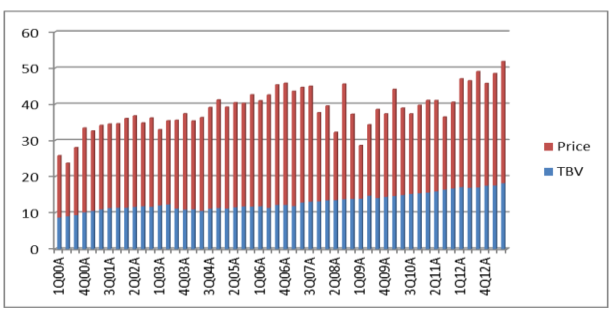
Analysis

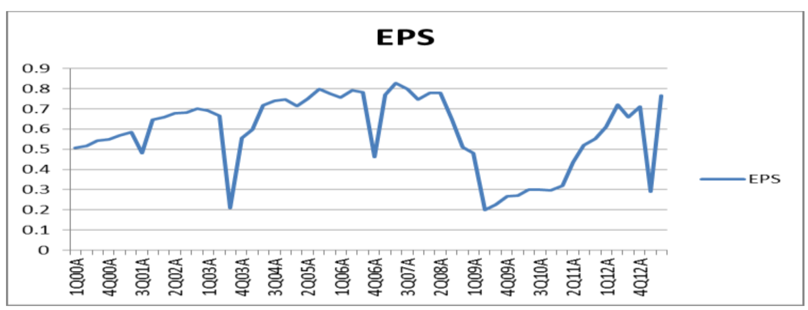












A combination of the above graphs tell an interesting story about BBT. NIM has been relatively constant and strong for the last 12 years yet EPS has been all over the place and is currently at all time highs while NIM is nearing all time lows. Fee income has increased at almost the exact same rate as interest income over the period so revenues aren't being proportionally driven faster by non interest income. We can conclude from the above comments that BBT is not as interest rate sensitive as many of its peers. The interest rate outlook for the markets is ever steepening and going in an exponential fashion from the lower left to the upper right of the page. I believe BBT is not best positioned from an on balance sheet perspective

Furthermore, we look at the price relationships. Price graphed against P/E is widening and suggestive that either earnings are increasing. While they have increased, the price is nearing its all-time highs but NIM is on the slip and share count is rising very quickly. I believe the market is looking to heavily in their efficiency at managing their portfolio from a risk perspective (look at LTV and OREO) but not enough at BBT's potential to have earnings come into what is a relatively pricy stock.

Their stated, rates up 200, NII impact is 3.55% but given the diversity of their business lines, I'm not sure if that is entirely accurate (better said as, I'm not sure what segments of the portfolio that applies to). They are middle of the pack from an asset sensitivity perspective. Furthermore, they have a large percentage of overall revenues coming from mortgage banking fee income. Their 1Q duration on their securities portfolio was 3.7 which is middle of the pack for peers but still bad when pressed against rising rates. More importantly, when we see 4Q2012-1Q2013 effective duration jump 1 whole year, it means they are either doing that intentionally or they hold a majority of their exposure in MBSs which experience duration expansion as prepayment risk decreases (look to drop in refis).

Valuation

	Income Statement Forecast						
	2010	2011	2012	2013	2014	2015	2016
Avg Earning Assets	135300	139000	153500	158500	164500	171000	175000
NIM	4.03%	4.07%	3.90%	3.65%	3.50%	3.50%	3.48%
NII	5452.59	5657.3	5986.5	5785.25	5757.5	5985	6090
loan loss provision	2640	1190	1050	900	1100	1350	1550
Fee Income	3520	3340	4150	4225	4350	4500	4650
Operating Revenue	6332.59	7807.3	9086.5	9110.25	9007.5	9135	9190
Expenses	4880	4960	5450	5640	5760	5840	6000
EBIT	1452.59	2847.3	3636.5	3470.25	3247.5	3295	3190
Adjust for FTE, securities, nonrecurring gains/losses	250	1000	800	600	600	600	600
Tax Rate	12%	18%	28%	36.5%	26.5%	26.5%	26.5%
NI	838.2792	1299.786	1926.463	1792.609	1915.913	1950.825	1873.65
Dilluted Average Shares	701	705	709	712.5	715	717	720
Dilluted EPS	1.195833	1.843668	2.717154	2.515942	2.679598	2.720816	2.602292
Preferred Dividends	220	215	130	30	30	30	30
	Balance Sheet Forecast						
	2010	2011	2012	2013	2014	2015	2016
Assets	160	163	178	185	190	195	205
Securities	27.5	30	36	37	38	39	40
Loans	102.5	103.8	110.8	115	120	126	130
Deposits	107	112	127.5	130	135	140	145
Other	36	34	31	33	31.5	30.5	33.5
Equity	17	17	19.5	22	23.5	24.5	26.5
TCE	10	11	13.7	16.3	18	19	21
Shares Repurchased							
Div payout Ratio		36%	30%	35%	35%	35%	35%
Dividend		0.663721	0.815146	0.88058	0.937859	0.952286	0.910802
	Metrics of Interest						
	2010	2011	2012	2013	2014	2015	2016
ROE	4.93%	7.65%	9.88%	8.15%	8.15%	7.96%	7.07%
ROTE	8.38%	11.82%	14.06%	11.00%	10.64%	10.27%	8.92%
ROA	0.52%	0.80%	1.08%	0.97%	1.01%	1.00%	0.91%

Misc Events

- On February 2013 BB&T announced that it will record a charge of 281 million in the first quarter to increase reserves related to a disputed tax liability.
- On December 2012, BB&T (through its wholly owned subsidiary Grandbridge Real Estate Capital), purchased Dwyer-Curlett which is a leading commercial real estate finance firm in southern California.
- On Aug 2012 BankAtlantic announced the completion of the merger with BB&T
- April 2012 BB&T Corporation announced it has acquired the life and property and causality insurance operating divisions of Crump Group. This merger culminated in BB&T being one of the largest providers of wholesale commercial insurance brokerage programs in the US.

Bank	Ticker	Mkt Cap	Current Price	EPS	P/E	Beta	Shares Oust.	Dividend	2y Target Price
Fifth Third	FITB	15.56B	$18.27	1.91	9.56x	1.52	851.5 M	2.50%	$23.48
Overweight (short and long term). Excellent ROE,ROTE,ROA,ROAE. Multiple currently below long run average.									

Fifth Third Bancorp is a diversified financial services company headquartered in Ohio. They have approximately 120 billion I assets and have 18 affiliates with 1160 full service banking centers in the Midwest and southeast. Fifth Third focuses on local markets and attempts to be a low cost provider in the financial services space. As this is their strategy, A linked second focus would be cost controls. They are the industry leader in efficiency and have the second highest ROAE in the peer group.

Positives

- **Net income up QoQ and YoY (43% and 65% respectively)**
- Good credit trends
- Non-interest income up 5%.
- C&I loans up 3% sequentially and 15% from 2Q2012
- Good trend in efficiency ratio
- Surprisingly good mortgage banking results relative to peers and the change in rate environment (up QoQ and YoY)
- **2013E ROE 10.17%, ROTE 14.13%, ROAE 14.42%, ROA 1.24%**

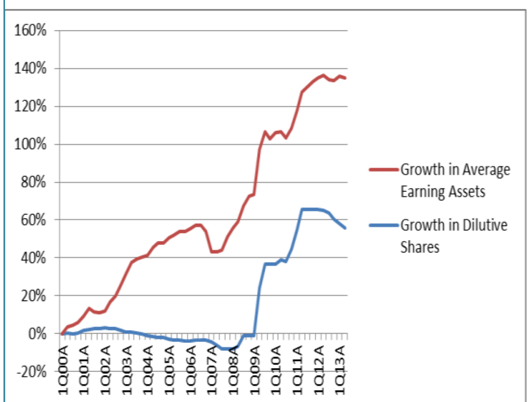
Negatives

- NII down 1% sequentially
- NIM trending down (not unlike the rest of the peer group)
- CRE down 3% and 13% QoQ and YoY
- **98%/2% AFS/HTM portfolio in Q1 will certainly cause some hurt in the future. Until something is sold, you don't see impacts on mark to market losses in the income statement but instead in the capital ratios. As such, we may expect some decline in the capital ratios.**
- Outstanding claims increased 13% QoQ (nominally not significant)

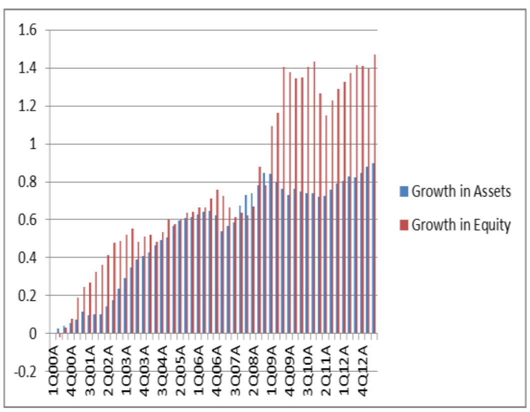
Thesis

Strong company with good margins. Surprisingly, given their metrics, the multiple has stayed compressed. While growth has been slow as of recent, they are excellent at utilizing their assets at generating wealth for shareholders. The only reason this stock wasn't pitched, was due to the uncertainty around their AFS portfolio and any effect that may have on their impressive capital ratio as well as their middle of the pack sensitivity to a rise in rates (up 200 is 2.3% to NII). At 11.8x EPS on a blended 2014/2015 earnings of $1.99 gives a 2yr price target of $23.48. When factoring in dividends this results in an annual return of 14.56%.

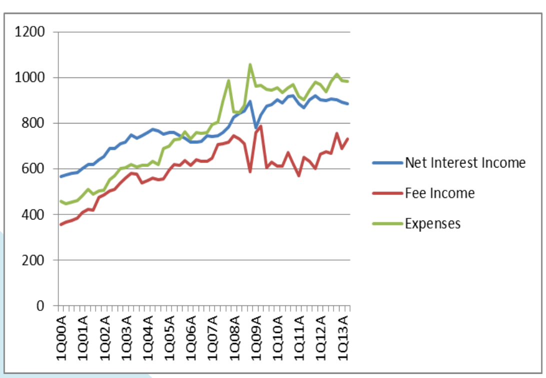
Analysis



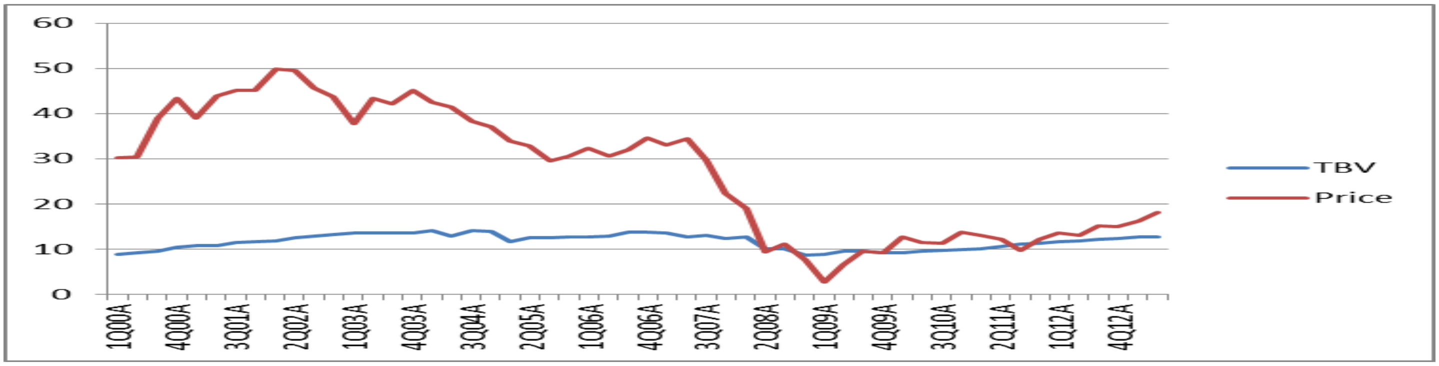
On the negative side, FITB has had trouble, post crisis, at controlling expenses. In plotting the NII, Fee income, and expenses we see there has been a change for the worse. This is in a large part due to the fee income side of the income statement failing to return its upward trend. Recent improvements in this area have been made. Service charges on deposits and corporate banking revenue are up 4% YoY, mortgage banking revenue is up 28% YoY (which may get dampened in the near term), and card and processing revenues and investment advisory revenue are up 6%. FITB's primary goal should be to either revitalize fee income or otherwise dampen expenses.



On the plus side, FITB does an excellent job using its underlying assets to generate shareholder wealth via equity expansion. We observe that they have been able to grow average earning assets at a very fast clip and sufficiently above the rate of dilutive share growth such that they can practically cover expenses on NII. We see a reduction in dilutive shares and should expect that going forward. When observing asset growth against equity growth we see strong propulsion in equity which can be seen in % form in the ROTE, ROAE, and ROE ratios of (14.13%, 14.42%, and 10.17% respectively). A large driver of this is ROA which sits at the highest in its peer group.



FITB is very appealing from a TBV perspective. We see that FITB historically trades at 3x TBV. However, the crisis has brought this down to about 1.5x. Given the great metrics, I could see FITB trading at a longer term multiple closer to 2x.



Valuation

Income Statement Forecast	2010	2011	2012	2013E	2014E	2015E	2016E
Avg Earning Assets	98900	97700	102000	107000	112000	115000	118000
NIM	3.66%	3.66%	3.55%	3.35%	3.40%	3.45%	3.45%
NII	3619.74	3575.82	3621	3584.5	3808	3967.5	4071
loan loss provision	1538	425	305	260	365	500	500
Fee Income	2518	2450	2760	2710	2730	2750	2770
Operating Revenue	4599.74	5600.82	6076	6034.5	6173	6217.5	6341
Expenses	3815	3745	3905	3860	3900	3900	3900
EBIT	784.74	1855.82	2171	2174.5	2273	2317.5	2441
Adjust for FTE, securities, nonrecurring gains/losses	150	180	0	0	0	0	0
Tax Rate	20%	30%	29%	29%	29%	29%	29%
NI	507.792	1173.074	1545.752	1554.768	1625.195	1657.013	1745.315
Dillulted Average Shares	800	950	945	900	850	800	750
Dillulted EPS	0.63474	1.234815	1.635716	1.727519	1.911994	2.071266	2.327087

Balance Sheet Forecast	2010	2011	2012	2013	2014	2015	2016
Assets	112.4	112.7	117.5	125	130	135	140
Securities	16.4	15.5	15.5	15.5	16	16	16.25
Loans	77	78.5	82.75	88	92	96	100
Deposits	82.5	82.5	85.5	92	97	100	103
Other	16.2	17.2	18.3	18.5	18.25	20	21.75
Equity	13.7	13	13.7	14.5	14.75	15	15.25
TCE	8	10.5	10.9	11	11.5	11.75	12
Shares Repurchased			23.3	61	45	45	45
Div payout Ratio		24%	22%	23%	25%	30%	30%
Dividend		0.296356	0.359858	0.397329	0.477999	0.62138	0.698126

Metrics of Interest	2010	2011	2012	2013	2014	2015	2016
ROE	3.71%	9.02%	11.28%	10.72%	11.02%	11.05%	11.44%
ROTE	6.35%	11.17%	14.18%	14.13%	14.13%	14.10%	14.54%
ROA	0.45%	1.04%	1.32%	1.24%	1.25%	1.23%	1.25%

Misc Information

- 2Q2013 sale of Vantiv for 242 million
- Feb 2011 FITB announced completion of repurchase of preferred stock for TARP and CPP.
- September 2012 Federated Investors and FITB asset management have reorganized 4.4 Billion in FITB money market funds.
- Sept 2012 Touchstone Investments, a subsidiary of Western and Southern Financial Group announced completion of its acquisition of the assets of 16 mutual funds from Fifth Third Asset Management

Bank	Ticker	Mkt Cap	Current Price	EPS	P/E	Beta	Shares Oust.	Div	2y Target Price
Huntington	HBAN	6.87B	$8.27	$0.72	11.61x	1.22	829.67 M	2.30%	$7.60
Recommendation: Sell/Do not initiate (Short Term), Underweight (Long Term), bad metrics									

Provides retail and commercial financial products through 600 regional banking offices predominantly in Indiana, Kentucky, Michigan, Ohio, Pennsylvania, and West Virginia. They have a strong automobile finance team and are moving into the southeast while still focused on maintaining relations in the Midwest. They hope to redeploy capital to shareholders

Positive

- C&I/auto drive growth with auto up 37% annualized
- Remixing deposit base (likely for the benefit of regulation)
- Overall average interest bearing liabilities declined 6%
- Expenses flat YoY (although not accompanied by loan growth, more a sign of the ability to scale costs)
- NCO/avg loans down 50% YoY suggesting credit quality rapidly improving
- Good geographic position
- 2013 NIM > 3.3% due to a robust C&I pipeline and stabilization (or so management hopes) in CRE
- Downside protection to flat rates as they are not that asset sensitive.

Negative

- Efficiency ratio trending the wrong direction (up 2% points YoY)
- CRE down 18% YoY
- Hurt by refis leaving (down 12%)
- 2% decrease in YoY non interest income as expenses were up QoQ
- Not as asset sensitive as peers (up 200 gives 3.1% while up 100 gives 1.8% to NII).
- Weak deposit mix (although they are working on this)
- Lost CFO to a competitor

Thesis

HBAN is a middle of the road to below middle of the road bank. There isn't much to get excited about with the exception of a CEO that does a fair job at selling the firm to analysts. HBAN is back to its pre-recession levels and up 100% since August 2011, up 25% YTD on mute quarterly earnings. The company must be hoping that their auto yield continues to grow along with expansive volume while defaults stay low (especially given they have explicitly stated they have no plan to securitize these products). I don't see the growth drivers for the firm. Most alarming is the increase in the dilutive share base from 200 million share to 800 million in the last six years. Combined with lower NI/Rev and higher Expense/Rev, there is little validation for HBAN to trade at the multiple it does today. With an average multiple of 10.86x (post crisis multiple as their dilutive multiple prior was not helpful) against a blended 2014/2015 EPS, my 2yr target for HBAN is $7.60.

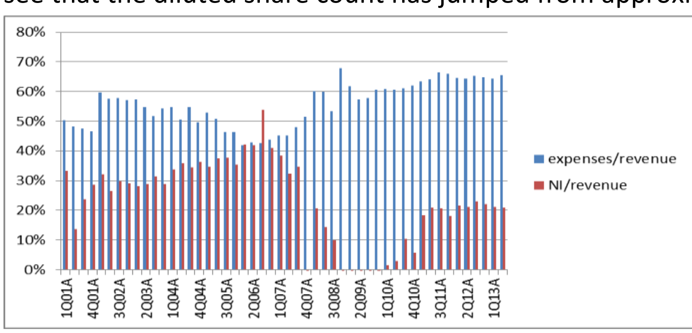
Analysis

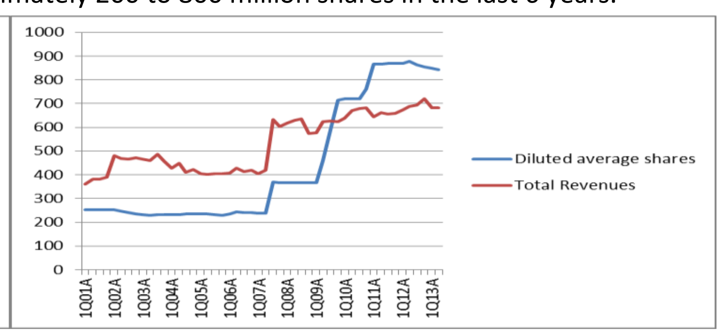
HBAN is a middle of the pack bank. They have a good auto business which is to be coveted, however muted growth and an unrecognizable franchise which makes advances in non-interest income more difficult to accomplish. On the positive side they have seen growth in consumer checking accounts (10.6% YoY) and growth in commercial relationships (7.4% YoY). They do have a good securities portfolio mix (the highest concentration is 46% in RMBSs). However NII sensitivity to an up 200 is about 3.1% and 1.8% in an up 100 scenario making HBAN on of the less asset sensitive banks.

HBAN also has a large (around 8%) of their revenues tied to mortgage origination fees. With Refi's backing up, and home applications dropping, it is unclear if they can resurrect this area of the income statement (although the street seems to think they can).

The main question to ask oneself is if they can grow NIM faster than deposits reprice in a rising rate environment? I'm not so sure they can as C&I balances were flat in the quarter, loan growth was sluggish. Capital deployment to shareholders will be the only thing that can help this company maintain its elevated stock price.

HBAN struggles in cost controls as their non interest expense over average assets is one of the highest in the peer group. When observing expense trends they seem to be steadily up over the last 13 years. In 2000 expense to revenue was about 50% and today it sits at 62%. Net income as a % or revenues which used to sit around 30% is down to a normalized 20% today. This trend in profitability can only be mitigated when the share base is in decline. However, we see that the diluted share count has jumped from approximately 200 to 800 million shares in the last 6 years.





Valuation

Income Statement Forecast	2010	2011	2012	2013E	2014E	2015E	2016E
Avg Earning Assets	47400	48600	50700	51600	53000	55000	57000
NIM	3.44%	3.40%	3.41%	3.35%	3.30%	3.50%	3.50%
NII	1630.56	1652.4	1728.87	1728.6	1749	1925	1995
loan loss provision	635	175	150	120	190	220	260
Fee Income	1040	975	1040	998	1040	1075	1100
Operating Revenue	2035.56	2452.4	2618.87	2606.6	2599	2780	2835
Expenses	1635	1705	1795	1770	1800	1850	1900
EBIT	400.56	747.4	823.87	836.6	799	930	935
Adjust for FTE, securities, nonrecurring gains/losses	250	200	50	100	100	100	100
Tax Rate	12%	24%	23%	26%	27%	27%	27%
NI	133.2456	418.761	599.7493	548.767	513.765	610.05	613.725
Dilluted Average Shares	729	857	865	840	815	790	765
Dilluted EPS	0.182779	0.488636	0.693352	0.653294	0.630387	0.772215	0.802255
Balance Sheet Forecast	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Assets	52.6	53.8	55.7	56.5	59	63	67
Securities	9.2	9.25	9.25	9.5	9.75	9.75	10
Loans	37.3	38.9	40.2	41.5	43	44	45
Deposits	40.7	42.2	45.5	46.5	49	51	53
Other	6.4	6.4	4.45	4.1	3.95	5.8	7.65
Equity	5.5	5.2	5.75	5.9	6.05	6.2	6.35
TCE	4	4.5	4.8	4.9	5	5.1	5.2
Shares Repurchased			23.3	30	25	25	25
Div payout Ratio		17%	22%	28%	30%	30%	30%
Dividend		0.083068	0.152537	0.182922	0.189116	0.231665	0.240676
Metrics of Interest	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
ROE	2.42%	8.05%	10.43%	9.30%	8.49%	9.84%	9.66%
ROTE	3.33%	9.31%	12.49%	11.20%	10.28%	11.96%	11.80%
ROA	0.25%	0.78%	1.08%	0.97%	0.87%	0.97%	0.92%

Misc Information

- March 2012 Huntington Bancshares announced that it purchased Fideltiy Bank from the FDIC.
- January 2011 announced repurchase of TARP funds.
- Dec 2010 Huntington announced that it priced an offering of 146 million shares of common stock at 6.30 a share or 920 million in aggregate gross proceeds.

Bank	Ticker	Mkt Cap	Current Price	EPS	P/E	Beta	Shares Oust.	Div	2y Target Price
KeyCorp	Key	10.93B	$12.20	88₵	13.83x	1.68	911.35 M	1.80%	9.90
Recommendation: Sell or Do not Initiate Position when market price is north of $9									

KeyCorp is an aspirational commercial regional banking. Their goal is to be one of the top three largest named servicers of commercial/multifamily loans and servicer of CMBS in the US. They have been acquisitive in the commercial mortgage servicing space attempting to build scale. With only 3.5% of the portfolio in residential real estate (43% in commercial/financial/agricultural loans, 24% CRE/commercial lease financing) KeyCorp is a pure play commercial bank.

Positive

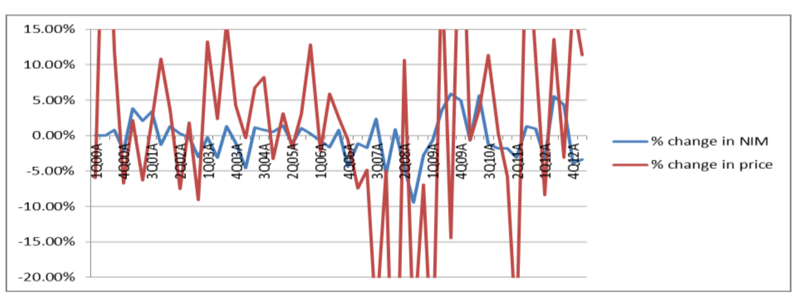
- Consolidated 33 branches
- Repurchased 112m shares
- Increased common shareholder dividend by 10%
- NIM up 7bps last quarter (3.13%)
- Strong Tier 1 position (north of 10% B3)
- Decent loan mix (despite light on residential exposure, makes it up in RMBS holdings)
- 2.2 wtd average duration on securities portfolio.
- Not as impacted by recent trend in refi falloffs
- 425 million shares authorized for repurchase through 2014.
- Continuing credit card penetration.
- NCOs down considerably and overall good trend in criticized loans
- Deposit costs declining (although still high)

Negative

- NIM down 11bps YoY
- Loans flat against deposit increases
- After tax gains on Victory divestiture anticipated to be less than expected (75-90m cash)
- Even if all approved share buybacks occur at todays price, KEY can only reduce share count by 1.5% or approximately one cent a quarter which is equivalent to adding 40-45 cents to the share price.
- Took on duration in Q2 so some repercussions could show in Q3 (large MBS exposure, approximately 25% of AEA)
- Will not benefit much from a rising rate environment (rates up 200 will give 1.8% add to NIM)
- No deposit mix (85% from MMDA and savings)
- Share count has nearly doubled over last 12 years

Thesis

I would not be a buyer of KeyCorp. They have been challenged at producing revenues QoQ and YoY and it is unclear (outside of acquisitions) how they can gain share in the market they are in. Furthermore, they are challenged on the regulatory front as commercial banks face difficulty when forced to stress their books as commercial clients have significantly higher (25-100%) runoff rates compared to retail deposits (3-10%). Furthermore, they will face a larger drawdown on loans, larger haircuts at the FHLB and Repo markets, and will in no way be B3 compliant (although they don't have to be at this stage).

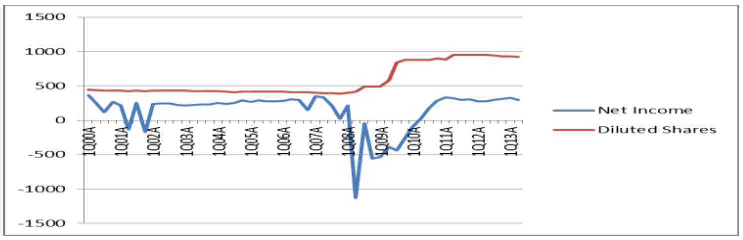


Correlation .24

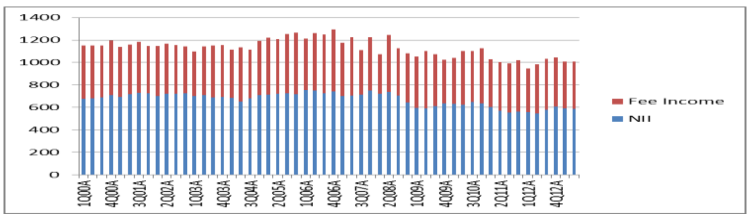
With a long term EPS trend (although many exceptions had to be made to make that determination) of 10.5x, and a blended 2014/2015 EPS 95 cents we get to a 2yr price target of $9.90 which even when factoring dividends is a negative return from todays inflated price. Currently trading at a multiple higher than I believe the underlying fundamentals of the company would suggest (and against forward EPS higher than my expectation), I recommend the investor sell or do not initiate a position.

Analysis

I do not understand the markets equivalence between their revenue growth rate, NIM trend, regulatory challenges,



brand name, and the multiple (and forward EPS) that KeyCorp has been given. When looking at price NIM, (as well as multiple oscillation) we see this company trades erratically and less linked to underlying fundamentals.



Regardless of the approval to buy back over 400 million of shares, their share count has climbed exponentially over the last couple of years with diluted shares nearly doubling since the financial crisis (in a large part due to preferred securities, although these will be run off in the next year which is what the stock may be lining up for). NII and Fee income over the last 12 years has steadily trended downward which leaves little confidence to the investor and prompts the most important question one could have in regards to KEY; What/Where will revenue growth come from?

Likely current shareholders are encouraged by the large deposit increase (about 7.6%) due to acquisitions (Western New York). When digging into the fundamentals, KEY seems weak compared to their peers. They are the worst of the peer group in NIM/Average Assets, net interest spread on earning assets, the lowest loan yield and the second highest weighted deposit cost (the largest cost for large time deposits. In other categories, they are at best middle of the pack.

In the up 200 scenario KEY sees a 1.85% jump in NIM making them one of the less asset sensitive firms. In a rising rate environment (which is the supposition of this research) they will not perform as well as peers. With 60/40 NII/Non-interest revenues culminating to net income, KEY isn't poised to experience significant increases from the interest income side and must make that up in the services and fee income (of which they are not a strong player by brand).

Valuation

Income Statement Forecast	2010	2011	2012	2013	2014	2015	2016
Avg Earning Assets	78400	73000	72000	75500	79000	82500	85000
NIM	3.23%	3.17%	3.21%	3.15%	3.10%	3.10%	3.10%
NII	2532.32	2314.1	2311.2	2378.25	2449	2557.5	2635
loan loss provision	638	-60	230	165	250	315	380
Fee Income	1835	1750	1720	1710	1805	1860	1910
Operating Revenue	3729.32	4124.1	3801.2	3923.25	4004	4102.5	4165
Expenses	2980	2775	2845	2770	2820	2890	2970
EBIT	749.32	1349.1	956.2	1153.25	1184	1212.5	1195
Adjust for FTE, securities, nonrecurring gains/losses	0	50	-150	30	50	50	50
Tax Rate	24%	28%	22%	26.5%	26.5%	26.5%	26.5%
NI	378.2298	821.8475	865.6015	825.5888	833.49	854.4375	841.575
Dilluted Average Shares	878	935	943	915	885	855	825
Dilluted EPS	0.430786	0.878981	0.917923	0.902283	0.941797	0.999342	1.020091
Preferred Dividends	195	120	0	0	0	0	0

Balance Sheet Forecast	2010	2011	2012	2013	2014	2015	2016
Assets	94.2	88.5	86.5	89.5	94	98	102
Securities	19	19.5	17	16.5	17.5	18.5	19.5
Loans	54	48.5	50	53.1	55.5	57.5	59.5
Deposits	63.5	59.35	61.8	65.25	68	72	76
Other	19.5	18.85	14.5	13.75	15.25	15	14.75
Equity	11.2	10.3	10.2	10.5	10.75	11	11.25
TCE	7.5	8.75	8.8	9	9.25	9.5	9.75
Shares Repurchased		0	30	36	25	25	25
Div payout Ratio		11%	20%	25%	30%	30%	30%
Dividend		0.096688	0.183585	0.225571	0.282539	0.299803	0.306027

Metrics of Interest	2010	2011	2012	2013	2014	2015	2016
ROE	3.38%	7.98%	8.49%	7.86%	7.75%	7.77%	7.48%
ROTE	5.04%	9.39%	9.84%	9.17%	9.01%	8.99%	8.63%
ROA	0.40%	0.93%	1.00%	0.92%	0.89%	0.87%	0.83%

Misc Information

- July 2013 KeyBank acquired 37 banking branches owned by HSBC (predominantly NYC and Rochester)
- May 2013 CFO retiring and Keybank Real Estate Capital purchased certain commercial mortgage servicing rights from Bank of America
- February 2013 announced it will sell Victory Capital to Crestview Partners for 246 million in cash and debt.
- March 2011 underwrote a public offering of 625 million in common stock (in part to repurchase cumulative perpetual preferred stock, TARP related).

Bank	Ticker	Mkt Cap	Current Price	EPS	P/E	Beta	Shares Oust.	Dividend	2y Target Price
M&T	MTB	14.82BB	$114.06	$8.86	12.86x	.69	130 M	2.40%	$136.7

Recommendation: Equal Weight (ST), Overweight (LT), Wait for 3Q earnings, good exposure to rate hikes.

M&T is a bank holding company with approximately 70 billion in assets (after a recent merger with Partners Trust), and includes banking subsidiaries M&T Bank and M&T Bank, National Association. They are predominantly a north east commercial and investment services bank with some mortgage exposure on the west coast. M&T has stated it is interested in growth through acquisition and seeks revenue enhancements through cost control and growth in the commercial banking and wealth management business. Excellent exposure to a rising rate environment

Positive

- **NI up 49% YoY and 29% QoQ. Second quarter EPS was $2.55.**
- M&T sold substantially all of its CMOs in the AFS portfolio for an after tax loss of 28 million offset by a sale of Visa and Mastercard shares for after tax gain of 62 million
- **Excellent NIM exposure as NII up 7% in up 200 rate environment and up 3.8 in up 100 rate environment. Note that NII is 60% of revenues.**
- 1:1 loan to deposit ratio
- NIM was 3.71% in 2Q2013 due largely to average earning assets increasing by 3.4 Billion
- Strong noninterest income performance this quarter and year over year.
- Net interest expense down 5% QoQ
- Good ROAE driven primarily by the ROAA side

Negative

- **Reduction of exposure to private label MBS for purchases of Ginnie Mae shows M&T is reaching for LCR compliance.**
- Strong non interest income came at the benefit of higher mortgage banking revenues which should be expected to dissipate next quarter. (over 8% of 1Q2013 revenues were tied to mortgage fee income)
- If we saw increases in refis in the CRE portfolios, MTB could be exposed
- After selling off RMBSs, its unclear if the portfolio mix of (82/18 AFS/HTM) has changed
- Heavy on CRE exposure (although good loan mix otherwise)
- High borrowing costs (around 4%, only Zion is worse)
- 1% interest earning cash as % of AEA which is low.
- **Possible credit quality pressure as provisions raised (where nearly all peers saw substantial decreases). Poor trend in NCOs**

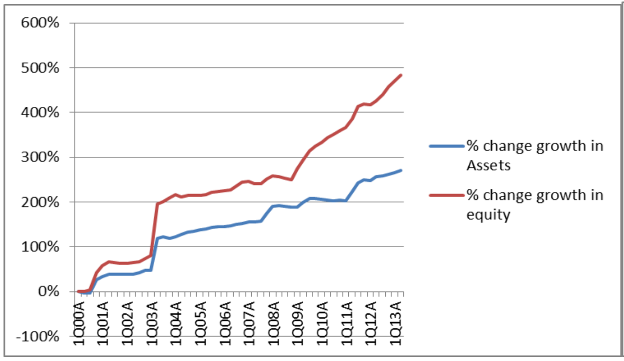
Thesis

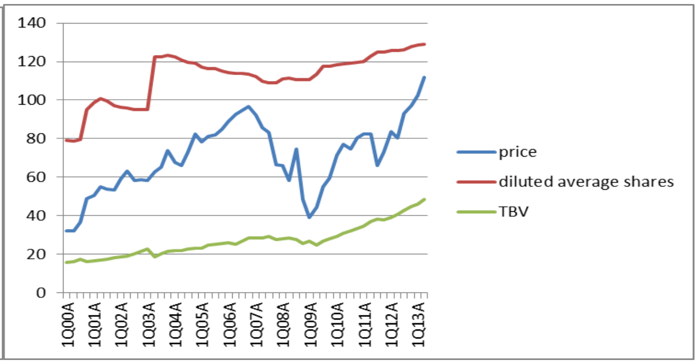
M&T has a 13.35 average P/E. When multiplying that against a blended average of 2014/2015 EPS of $10.24 resulting in a 2yr price target of $136.7. When factoring in dividends, the average return on the investment should be 12.5% annually or 27% over the next two years.

Analysis

This will be M&Ts first year doing the full CCAR. As such, they attempted to use this as an excuse for why they were selling private label MBS and stock and instead buying Ginnies. While that isn't at face false, Ginnies perform much better as they are the only form of level 1 capital (from an LCR perspective) and they get limited haircuts in down scenarios, It may be prudent to dig in a bit further into M&Ts strategy. They said they have 5-10 bps of drag on NIM due to excess liquidity in interest bearing deposits which they have recently run off. This is their intention to expand earnings, byy reducing costs. However, by reinvesting in Ginnies, it suggests they are unable to put that money to work in more profitable ventures (loans, ect) or they are LCR deficient. Furthermore, their Tier 1 capital under Basel III seems weak compared to peers and is only teetering the line of acceptability form a regulatory perspective. While they have some residential exposure in the west, their primary business is commercial. Thus the sale of MBS should have been to replaced RMBS (no matter what sort of duration risk they face) but instead it was to sell RMBSs, thus, Ginnies are purely a profit reducing regulatory play.

Issues with the Fed over their recent acquisition of Hudson, specifically regarding bank security act violations and antimony laundering charges should bring some concern as penalties for this sort of crime average in the 200 million range or 1/3 of earnings. Furthermore, with all the acquisitions, it is unclear how well the bank is doing at managing the integration process which may well be the most challenging aspect to M&A. It is unclear why MTB issued 800 m in long term debt n 1Q2013. It may be for acquisition, regulatory compliance, or because they are in need of the cash. This is a question worth asking oneself.





I really like the % change growth in assets and % change growth in equity graph as it shows a strong bank. M&T is able to generate growth organically and not just keep expenses in check but keep them growing at a slower pace then revenues. Furthermore, we see TBV grow nearly 3x in the past 13 years. As suck we can have some comfort in the strong movement in the stock price and be assured, so some degree, that price well represents the firm. While there was some dilution in the recent financial crisis, they have ended the blood letting and it seems likely that diluted averages shares will not change dramatically into the future.
Expenses should rise in Q3 as they have added 500 people to the Buffalo office which are not factored into 2Q results.

Valuation

Income Statement Forecast	2010	2011	2012	2013E	2014E	2015E	2016E
Avg Earning Assets	59700	64700	70500	85000	104000	108000	110000
NIM	3.84%	3.75%	3.75%	3.68%	3.75%	4.00%	4.00%
NII	2292.48	2426.25	2643.75	3128	3900	4320	4400
loan loss provision	368	270	205	220	500	400	400
Fee Income	1190	1415	1738	1800	1825	1860	1900
Operating Revenue	3114.48	3571.25	4176.75	4708	5225	5780	5900
Expenses	1915	2285	2500	2570	2700	2800	2900
EBIT	1199.48	1286.25	1676.75	2138	2525	2980	3000
Adjust for FTE, securities, nonrecurring gains/losses	200	180	250	350	400	400	400
Tax Rate	33%	30%	34%	34%	33%	33%	33%
NI	674.649	774.375	948.7888	1189.02	1434.375	1741.5	1755
Dilluted Average Shares	119	123	126	135	155	155	155
Dilluted EPS	5.669319	6.295732	7.530069	8.807556	9.254032	11.23548	11.32258

Balance Sheet Forecast	2010	2011	2012	2013	2014	2015	2016
Assets	68.4	74	80	92	120	123	125
Securities	8	7.2	7.1	5.8	6	6.5	6.5
Loans	51.3	56.2	63	73	98	100	105
Deposits	48	55.8	62	72.5	76	80	85
Other	12.3	9.2	8	8	31.5	29	26
Equity	8.1	9	10	11.5	12.5	13.5	14
TCE	4	4.7	5.7	10	10.5	11.5	12.5
Shares Repurchased			0	0	0	0	0
Div payout Ratio		44%	37%	32%	45%	45%	45%
Dividend		2.770122	2.786126	2.818418	4.164315	5.055968	5.095161

Metrics of Interest	2010	2011	2012	2013	2014	2015	2016
ROE	8.33%	8.60%	9.49%	10.34%	11.48%	12.90%	12.54%
ROTE	16.87%	16.48%	16.65%	11.89%	13.66%	15.14%	14.04%
ROA	0.99%	1.05%	1.19%	1.29%	1.20%	1.42%	1.40%

Misc Events

- On April 2013 M&T announced the need for more time with their merger with Hudson City Bancorp as regulators have identified certain concerns related to the Bank Secrecy Act and anti money laundering compliance (BSA/AML).
- Aug 2012, Newman Ferrara LLP began an investigation into claims against the board of directors of Hudson concerning the acquisition by M&T
- On Aug 28, 2009 M&T assumed assets and deposits of Bradford Bank (of Maryland) which was closed by the FDIC.
- On May 26, 2009 M&T acquired Provident Bankshares Crop.

Bank	Ticker	Mkt Cap	Current Price	EPS	P/E	Beta	Shares Oust.	Dividend	2y Target Price
PNC	PNC	39.5B	$74.80	$6.67	11.19x	1.3	531.5 M	2.36%	$87.42

Recommendation: Equal Weight (Short Term), Overweight (Long Term), Strong LT strategy, 3Q2013 headwinds

PNC is a national bank based in Pittsburg which ranks around the 5th -7th largest bank in the country depending on the metric used. PNC hopes to expand its residential mortgage and retail banking business in the south east (RBS acquisition) which should help reduce costs and increase income (specifically in their asset management practice). Their strategy is to go long the markets as they believe in a rising rate environment and have positioned (positioning) their book as such while simultaneously attempting to ramp up their fee income business.

Positive

- Strong pre-provision earnings growth (26%) paired with reduction in expenses of 15% over the last couple of quarters
- Strong underlying credit trends and credit quality improvement
- Basel III Tier 1 common of 8% well positioned for LCR
- Dividend close to pre- crisis levels
- **Good growth and expansion story (into south east benefit of the RBS acquisition)**
- RMBB up 30% YoY
- **Consolidated 200 Branches over 2013 (78 last quarter**)
- Added 55k new DDA households
- Expect significant declines in PAA
- 2013 goal to capture 700m in cost savings (already captured 600m in 1H 2013)
- Stable funding costs
- Seeing increase in utilization rates
- **Gaining share in mortgage market as originations are outpacing peers**
- **Phasing out of free checking with little observed change in attrition. (love it)**

Negative

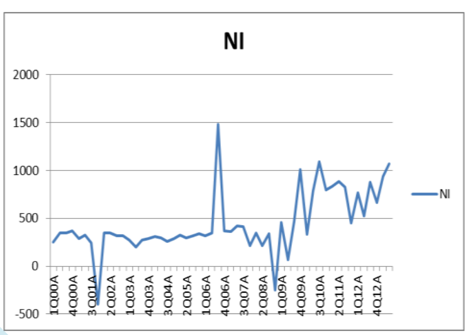
- Share count has nearly doubled over last 12 years
- Freddie requested information on Nat City originations in the mid 00s and have asked for over 18k files. Investigations thus far have caused an increase in repurchase (put back) provisions for residential mortgages and could be some issues going forward.
- **Expecting pressure on loan and NIM yields in Q3 and into the future**
- Continued increase in credit quality m y not be possible and possible ramp up of provisions could occur
- Level of net charge offs may not be sustainable
- **½ of non-interest income growth in the last year comes from reduction in provisions for residential mortgages as opposed to revenue generating sources.**
- Might see AFS net gains decrease or net losses increase in Q3 (approximately 80% of securities portfolio is AFS, 20% HTM).

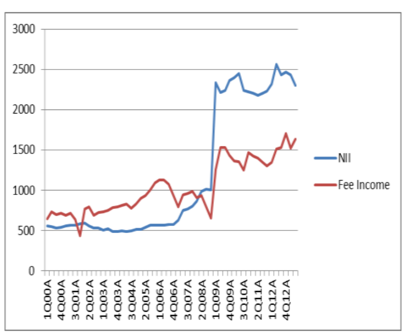
Thesis

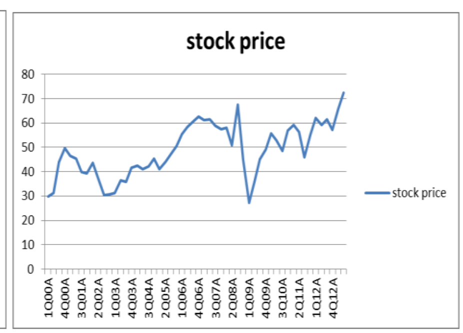
PNC, as an investment, need be viewed over the longer term. Compression of NIM in the quarters to come will not lend itself to large gains in the traded price of the firm. Good strategy (notably in the long term, duration of equity is quite negative) paired with appropriate positioning for rising rates should allow PNC to experience profitability over the next three years. PNC anticipates adding credit exposure as well as entering new markets (see RBC acquisition, the south east is a less competitive market). Starting 2014 PNC anticipates giving back more to shareholders (we will have to see what the 2014 CCAR brings). PNC's average P/E over the last 12 years (on a diluted basis and excluding observations during the crisis that distort the average) is 12.1x. Assuming a 2 yr holding period (blended average of 2014 and 2015 EPS) we get a price target of $87.42 or an annual return of 10.5% with dividends. In conclusion, PNC will not benefit as much as some of its peers from the rise in rates, however, they have taken steps from a strategic acquisition and market penetration position to enhance their overall market share over the longer run. Considering the above, PNC is considered an Equal Weight (near term) Overweight (long term). Q3 may have surprise loses on the AFS portfolio (depending on the duration of the RMBS exposure and hedging tactics, the securities portfolio in Q1 had a weighted average duration of 4.1). Furthermore, 2Q2013 EPS was driven by one-time events (accounting treatment, sale of Visa stock, securities gains). I would suggest waiting for Q3 earnings before investing as the market timing investor may enjoy a pull back off Q3 earnings.

Analysis

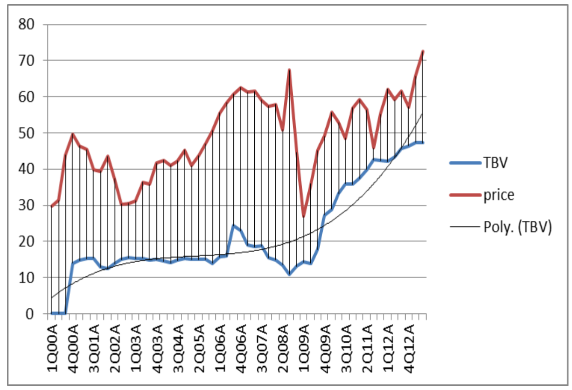
I believe the below three graphs tells an interesting story for PNC. They have been able to generate large NII over the last couple of years as well as a healthy increase in non-interest income (albeit the latest increases are a product of non-recurring reductions in expenses). This reflects itself well in the net income for common shareholders yet the increase in stock price hasn't moved as significantly. While it is true that the share base has risen by over 25% in the last few years, we look to EPS gains and discern that it is more a factor of a muted P/E (high 10s low 11s) from its long run average of 12.1x. Furthermore, PNCs +200bp EAR tells a story of a not so (or medium) interest sensitive bank. I believe that PNC are prudent risk managers and most likely are on the floating side of the popular fixed for floating swap arrangement held with banks who are interest rate sensitive. I believe that a withholding of earnings now will reflect in the next coming years. That was not factored into the EPS values in the valuation of the firm as there is no way to know definitively this is or is not the case. However, I do believe that PNC has the most growth potential from a NI perspective.







Approximately 80% of the securities portfolio is held in AFS which suggests future pain. ONC did sell 2m shares of Visa for a pretax gain of 83 million and still holds about 12.4 million shares or 950 million dollars. Swaps settling in 2014 will add to NII which suggests they are on the floating side of the swap and have probably benefited well in recent months.



Good improvements in credit quality over the last quarter signifies a focus on balance sheet improvements as opposed to balance sheet expansion. Accruing loans past due for 30-90 days dropped by 17% and for the 90+ days dropped 9%. Non performing loans are down 3% YoY and net charge offs declined 456 to 208 million year over year. Provisions are also down 33% it is unlikely such significant improvements in credit quality can continue.

Increase in share price has been accompanied by a strong increase in tangible book value. For all metrics that one may judge the comparative increase in value of a firm, tangible book may well be the most suitable for discerning the quality and sustainability of hat price improvement. This suggests that the increase in price is not reflective of optimism in the economics of the IS or the firm itself but instead by 'tangible' evidence of execution on performance initiatives.

Management may be sandbagging a bit in their claims that rising rates will put pressure on mortgage application volume. While this seems to be an industry claim, rates are still well blow their longer term average short term rate increases don't have a significantly stronger correlation with originations. PNC did see a freeze in leveraged credit, larger syndicated loans, and some other high yield products as consumers digest the recent rate change. This is probably a nationwide issue.

Both ROTA and ROTE have approached long term averages and appear to be suitable at current levels given the YoY consistency. When deconstructing the ROAE we see that the asset to equity ratio si in fact on the lower end. This is as previously mentioned, due o the increased share count. We get a strong ROAE of 10.77% led primarily by the ROAA. When diving further we realize that it is earnings led. Their net interest margin on earning assets is one of the strongest in the peer groups as well as the net interest spread on earning assets. By maximizing on earning assets in a way that drives earnings, PNC becomes one of the better firms in the peer group.

Valuation

	2010	2011	2012	2013	2014	2015	2016
Income Statement Forecast							
Avg Earning Assets	225000	240000	248000	258000	268000	278000	280000
NIM	4.14%	3.91%	3.91%	3.61%	3.70%	3.80%	3.90%
NII	9315	9384	9696.8	9313.8	9916	10564	10920
loan loss provision	2400	1150	990	810	1200	1250	1300
Fee Income	5440	5460	6090	6400	6450	6700	7100
Operating Revenue	12355	13694	14796.8	14903.8	15166	16014	16720
Expenses	8350	8590	9810	9680	9800	10000	10300
EBIT	4005	5104	4986.8	5223.8	5366	6014	6420
Adjust for FTE, securities, nonrecurring gains/losses	-50	1100	1300	250	500	500	500
Tax Rate	26%	25%	24%	25%	27%	27%	27%
NI	3020.975	3003	2801.968	3730.35	3552.18	4025.22	4321.6
Dilluted Average Shares	520	526	529	530	520	520	500
Dilluted EPS	5.809567	5.709125	5.296726	7.038396	6.831115	7.740808	8.6432
Balance Sheet Forecast							
	2010	2011	2012	2013	2014	2015	2016
Assets	265	265	295	305	311	317	324
Securities	58	60	61	60	61	65	70
Loans	153	152	177	190	194	198	202
Deposits	182	183	201	210	220	230	240
Other	51.5	46.5	54	52	46.6	40.322	34.66844
Equity	31.5	35.5	40	43	44.5	47	49
TCE	20.5	22.3	24.5	26	28	30	33
Shares Repurchased			3.5	1	15	15	20
Div payout Ratio		20%	30%	25%	30%	30%	32%
Dividend		1.141825	1.589018	1.759599	2.049335	2.322242	2.765824
Metrics of Interest							
	2010	2011	2012	2013	2014	2015	2016
ROE	9.59%	8.46%	7.00%	8.68%	7.98%	8.56%	8.82%
ROTE	14.74%	13.47%	11.44%	14.35%	12.69%	13.42%	13.10%
ROA	1.14%	1.13%	0.95%	1.22%	1.14%	1.27%	1.34%

Misc Information

- March 2013 PNC announced a new CFO, Robert Q Reilley
- May 2012 PNC sold Smartstreet, an Atlanta based financial services firm to Union Bank
- January 2011 BankAtlantic Bancorp, BankAtlantic sold its Tampa – St. Petersburg franchises which gave PNC 19 branches, 2 related facilities, and 450 million in deposits.

Bank	Ticker	Mkt Cap	Current Price	EPS	P/E	Beta	Shares Oust.	Dividend	2y Target Price
Regions	RF	13.11B	$9.89	$0.81	12.2x	2.38	531.5 M	1.20%	$9.18

Do Not Own (long or short term): poor demographics, management, and comparable metrics

Regions is headquartered in Birmingham Alabama and is a full service retail and commercial (small business) bank with about 120 billion in assets and 1900 banking offices across 16 states (mostly the south and Midwest). They own the trust and asset management firm Morgan Keegan & Co which has 400 offices. Their strategy is to aggressively reduce their stress portfolio of construction loans, second lien home equity, and condominium credits.

Positives

- Net income up from last quarter to 3.16%
- Growth in auto, credit card (auto up 21% last quarter)
- **Deposit and funding costs declined QoQ. Redeemed 350, 498 and 100 mil of debt with 7.75%, 6.3% and 7.75% cost respectively and replaced with 750 mil senior notes at 2%**
- Decrease in nonperforming assets and loans
- Seeing signs of demand for credit
- Utilization was up and strong (driven more by new production and less on drawdowns)
- **Owns Morgan Keegan and Company**

Negatives

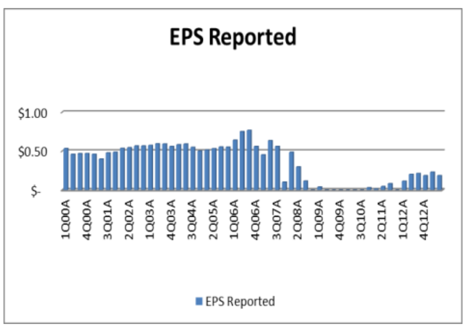
- **Reported NI down QoQ and YoY (20% and 9% respectively)**
- Consumer loans flat (largely due to refis)
- Non interest expenses of 885 million increased 5% over the prior quarter. Headcount increased by 226 positions.
- **Leveraged to multi-family homes but claim that their homebuilder product is starting to come back. This indicates that they have not been (despite a supposed competency in this area) able to capitalize on the homebuilding recovery the last two years. It appears now they are chasing CRE when the big move may be over.**
- Management does not answer questions on earnings calls well.
- **"out of the markets we're serving, we had over 70% of our markets show net growth this quarter for the first time" – CEO O.B. Grayson on 2Q2013 conference call. This is not a good thing where peers have seen growth for the last few years**
- High exposure to the mid income/ low-mid income families in Florida and Georgia which were hit particularly hard and housing prices have not rebounded commensurate with the national average.
- Third quarter is a slow quarter for their business

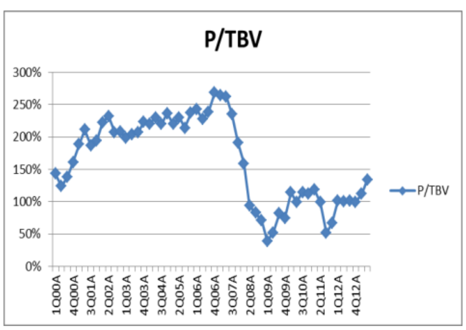
Thesis

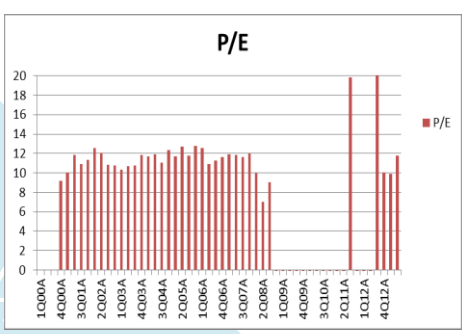
Regions management is very quick to blame the market (consumer deleveraging, refis down, rates rise, ect.). This consistently is used as a reason for poor performance in particular areas. The nature of this business is one that requires a stomach for, and the insight to navigate, a consumer and business model that is highly leveraged toward macro economic factors. Furthermore a comment by David J Turner in the 2Q2013 conference call "..we are a middle market company, small business lender. If we can get the small business segment really demanding credit, then our overall yields and spreads will improve." To this I have two comments. One, they certainly will improve, accompanied by an increase in net charge offs as you take on credit risk, the question would be is heightened credit risk at this stage in the recovery what a bank should be taking on? The second comment would be, small business are looking for credit, by nearly every metric and comment I have seen across peer banks, small business is seeking credit. The problem is the yield on that credit isn't commensurate with the risk that has to be taken (PDs and LGDs are still pretty high across the board). There has also been a significant increase in the sharecount (over 500%). All in all, I do not like management. I don't think they understand hedging the balance sheet well, or at least they do not communicate it well, nor do I like the poor answers on the conference call. 82 cents is the blended average of 2014/2015 EPS with a multiple attached at 10.8x gives a 2yr price target of $8.86. When factoring dividends, that's an annualized return of -4%.

Analysis

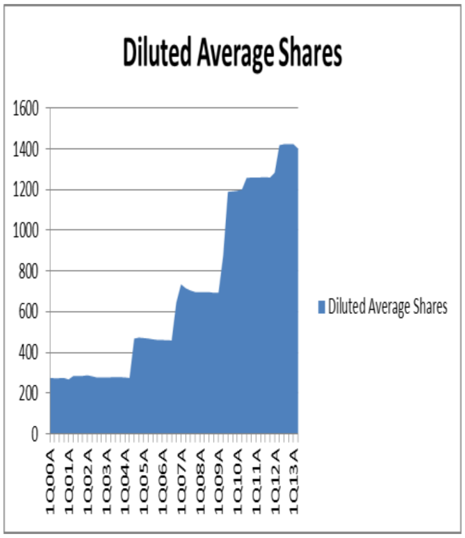
Comparing the graphs on the left (P/TBV and P/E) we see an interesting relation before the financial crisis of consistent – increasing multiple and very strong P/TBV growth. However, now that the P/E multiple is approaching its longer term average of 11.2x we see a surprising lack of participation in the P/TBV. This may be because TBV is growing at a faster rate than the price is (which would be good) or because tangible book value is decreasing. As it turns out, TBV is down 30% from its longer term average. This performance has not gone unpunished as RF is down 65% from its longer term price average. Combining the resurgence of the multiple, the reduction in TBV, the associated price depression, as well as an observation of earnings which have yet to rebound in any significant way convinces me the price is probably well descriptive of the value of the firm. There may be a bargain here, however it comes with significant risks associated with it.

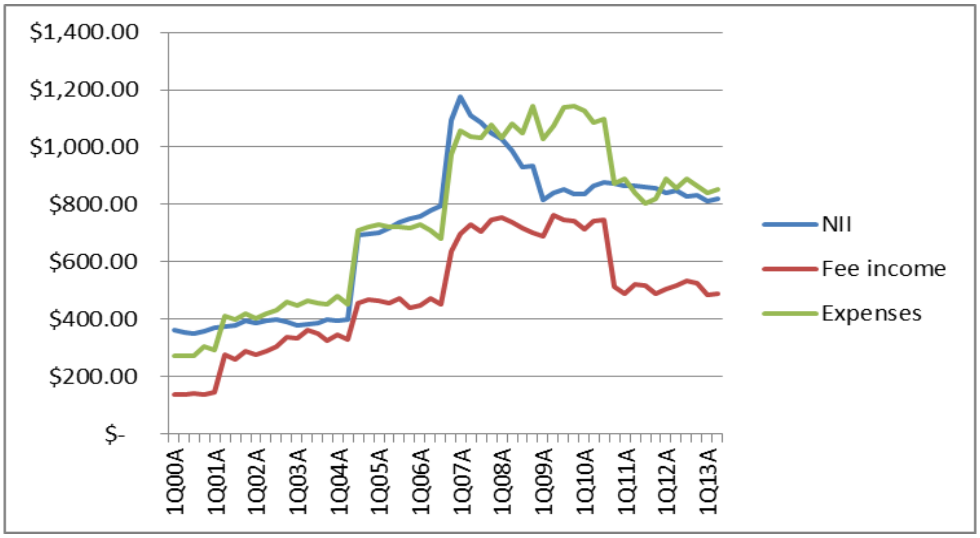






The performance of NII and Fee income since the financial crisis leaves little to aspire to. There seems to be no growth in either category. While they have sufficiently plugged the bleeding, they have been unable to return earnings to either their previous nominal level, or even display any signs of meaningful growth. Troubling most is the flat fee income curve. Surprisingly RF still returns a respectable NIM. Of course, few things are more detrimental to a price of a stock then an acceleration of the share base. RF went from





RF's ROAE is very weak. The primary source of that weakness is in their ability to use the assets they have to drive equity growth (look to the Asset / Equity ratio).

Valuation

	2010	2011	2012	2013	2014	2015	2016
Income Statement Forecast							
Avg Earning Assets	119500	112000	108000	105000	107500	110000	112500
NIM	2.90%	3.07%	3.11%	3.15%	3.15%	3.15%	3.20%
NII	3465.5	3438.4	3358.8	3307.5	3386.25	3465	3600
loan loss provision	2863	1530	200	90	500	700	700
Fee Income	2700	210	2080	2030	2100	2200	2300
Operating Revenue	3302.5	2118.4	5238.8	5247.5	4986.25	4965	5200
Expenses	4180	3350	3500	3400	3400	3400	3600
EBIT	-877.5	-1231.6	1738.8	1847.5	1586.25	1565	1600
Adjust for FTE, securities, nonrecurring gains/losses	0	-1800	200	50	0	0	0
Tax Rate	39%	-17%	29%	28.5%	28.5%	28.5%	28.5%
NI	-757.03	450.028	962.548	1255.213	1104.169	1088.975	1114
Dilluted Average Shares	1227	1260	1385	1400	1365	1320	1275
Dilluted EPS	-0.61698	0.357165	0.694981	0.89658	0.808915	0.824981	0.873725
Preferred Dividends	220	215	130	30	30	30	30
Balance Sheet Forecast							
	2010	2011	2012	2013	2014	2015	2016
Assets	136	127	122	118	120	125	130
Securities	25	24	26	27	28	29	30
Loans	86	80	76	74.5	77.5	80	82.5
Deposits	96.5	95.5	95.5	94.5	98	102	105
Other	22	16	11.5	8	6	6	7.5
Equity	17.5	15.5	15	15.5	16	17	17.5
TCE	7.6	8	10.5	10.5	11	11.5	11.75
Shares Repurchased			0	35	35	50	50
Div payout Ratio		5%	11%	18%	25%	25%	25%
Dividend		0.017858	0.076448	0.161384	0.202229	0.206245	0.218431
Metrics of Interest							
	2010	2011	2012	2013	2014	2015	2016
ROE	-4.33%	2.90%	6.42%	8.10%	6.90%	6.41%	6.37%
ROTE	-9.96%	5.63%	9.17%	11.95%	10.04%	9.47%	9.48%
ROA	-0.56%	0.35%	0.79%	1.06%	0.92%	0.87%	0.86%

Misc Events

- May/April 2012 Regions announced repurchase of warrants and repurchase of preferred stock issued by the Treasury (fulfilling TARP obligations)
- April 2012 Regions announced the completion of its sale Morgan Keegan and Co for 1.2 B.
- October 2010 Izard Nobel LLP (a law firm) announced a lawsuit seeking class action status on behalf of purchasers of the common stock of RF claiming the company was operating with significantly overstated goodwill and deficient internal controls. A similar law suit as filed with law firm Robbins Geller Rudman.

Bank	Ticker	Mkt Cap	Price	EPS	P/E	Beta	Shares Oust.	Div	2y Target Price
US Bancorp	USB	68.64B	$37.20	$2.95	12.65x	.89	1.84B	2.5%	$42.73

Recommendation: Equal Weight (Short Term), Overweight (Long Term) – 73% return of earnings to shareholders

US Bancorp is a middle to west coast bank. They are, depending on the metric, the fifth or sixth largest bank in the US. 50% consumer and small business, 20% wholesale banking and CRE, 30% other (wealth management, securities services, ect). USB intends to invest 20-40% of their NI in reinvestment and acquisition, 30-40% in dividends, and 30-40% in share repurchases. USB is a mature bank and participates internationally. They operate 3000 banking offices and 5200 ATMs. They plan to reduce credit and earning volatility, control expenses, and provide high quality customer service.

Positives

- **A leading auto lender (good product and posted good returns this last quarter)**
- Moody's A1, S&P A+, Fitch AA-
- Net charge offs are down as are non performing assets
- Flush with liquidity
- From a regulatory perspective, retail deposits are very useful. As such, a reduced runoff should benefit in strong LCR numbers and reduce extent of capital wasting GNMA purchases.
- Residential RE up 19.7% YoY
- See stable charge offs going forward
- **Strong (18%) increase in dividend and 19m share buyback resulting in 73% of earnings returned to shareholders**
- Good capital position and diverse loan mix

Negatives

- Recent slow in revenue growth (although long term average trends nicely upward. Most segments revenues are down YoY
- Deposits are growing very quickly and at a significantly faster pace than loans (downside to being very liquid)
- 3000 branches may be to large.
- 25% utilization rates on wholesale lines of credit is low
- Some regulatory concerns in Europe relating to their merchant acquirer business
- Seems to have meaningful government spend exposure
- Long duration book (wtd average maturity 4.5yrs)
- Up 200 produces approximately 1.6% increase to NII
- Strong refi exposure which hurt in Q2 and may in Q3.

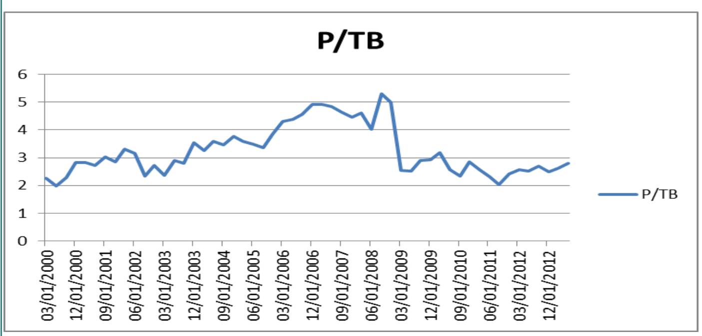
Thesis

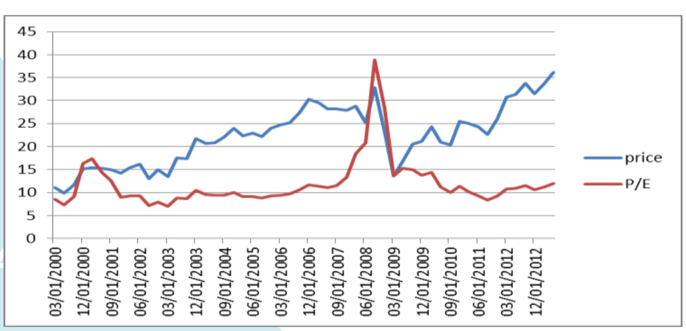
Us Bancorp has transitioned to a mature bank (and much more utility like) I suspect that USB's strategy will be to return capital to shareholders. They have target up to 20-50% reinvestment and 30-40% to dividend and share repurchases each. They will attempt to maximize the dividend limit while minimizing share repurchases as the firm seems fully valued. A long term P/E average of 12.34x against a blended average of 2014 and 2015 EPS gets us to $42.73 when factoring in dividends over the time period, the investor should expect an annualized 9.5% return with little hope of significant outperformance unless utilization rates rise or USB becomes more acquisitive. USB is fairly priced but ove the long term it should be accretive to the investor from the perspective of stability (see beta) as well as returns generated by dividends and shareholder buybacks. I should note that my estimates are weak compared to the street which has an overweight/buy rating on this security.

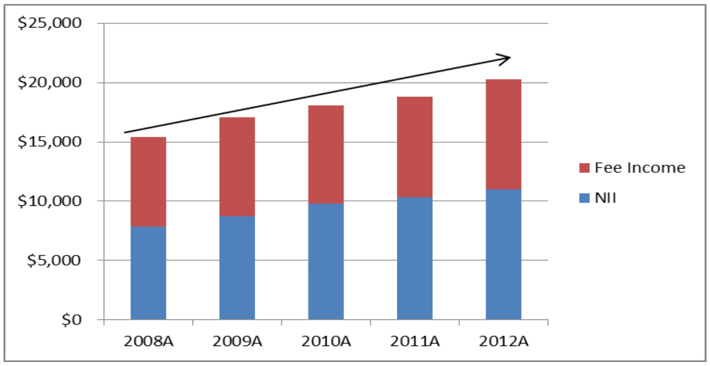
Analysis

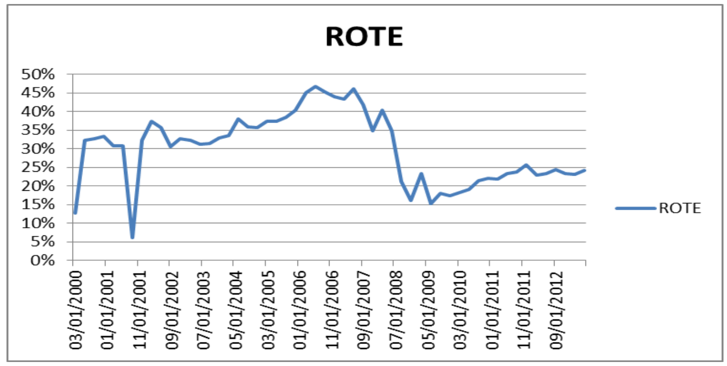
While I assume a middle of the target range dividend yield, I do not suppose any significant reduction in shares (at least in a way that follows through to a diluted basis) for the sake of conservatism. I do suppose strong accumulation of earning assets and stable NIM. I suggest loan loss provisions will grow in line with revenue growth but at a slower pace as can be observed by their efficiency ratio (one of the highest in the industry), stable REO, and declining loan loss provisions. USB has one of the strongest ROE in the industry and a good ROA which should continue forward. While not a favorable trend in my opinion, I do see deposits continuing to increase at a faster rate than loan origination which should hurt tangible asset to equity ratios into the future. While its unclear what USB intends to do with these deposits, as they are certainly flush in liquidity, it may be beneficial for acquisition purposes which USB is in an excellent position to do as the top 4 banks are limited from this practice as regulation becomes more and more stringent.

USB has consistently performed well from a revenue generating perspective. Revenues are up YoY (and QoQ) for the last five years. While there has been a bit of a slowdown in revenue growth so far in 2013 (most likely due to fee income reduction from a drop-off in refis), we should anticipate solid revenue (but at a slower pace) into the future. ROTE is a useful ratio when comparing banks over time. It seems ROTE averaged at the mid 30% in the early and mid 00s and now sits consistently at 25%. This stabilization in ROTE is very motivating, not only because USB is able to hold such a high level, but also because there appears to be upward 10% more points in ROTE to strive for.









We have two contradicting metrics from a price value perspective that should be addressed. On one hand, the price to tangible book has near approached its long run average at around 3x. this may suggest that the company has fully valued back to its historical level. On the other hand, when comparing the price to P/E we see a recent expansion in the spread between the two (earning growth). I believe that the strong growth in the value of a USB security is probably over. There is the chance for P/E expansion, but this is unlikely as the multiple sits at both its longer term average and the industry average. Instead, one should look to a growth in the earnings to drive the firm forward. With ROTE in the low 20s its likely we could see earnings growth of approximately 6% per year. While we could see dividend growth of 10% per year, share reductions, and strategic acquisitions

What decent growth SB has experienced has been in CRE and residential real estate. CRE is an area that I would leverage down from. US Bancorp identifies their strategy very the last 5 years as one of developing relationships with high net worth and high quality clientele to enhance their exposure to the “right” consumer and hopefully benefit form cross selling. Mortgage banking revenues came in light so there isn’t to significant of a benefit form their plan, at least on the residential side. CEO Richard Davis gave the following quote in 2Q2013 conference call “I do think the secret sauce in USB’s business line is that we’ve got this flight to quality that’s now turning into a – we auditioned, we perfume well, and now were getting the lead part”

Meanwhile on a liked quarter basis non interest expenses were higher as were market and business development. The 66m QoQ increase in regulatory expenses should be considered the new normal. Their MBs portfolio makes up around 20% of assets (of which 80% is RMBS). ISB has a surprisingly large borrowing cost for such a good credit rating and higher than expected liability cost as well.

Operating fees increased 4% YoY. Of the many segments that go into this fee structure, I believe that credit card fees are the most important. ROAE is top of tis peer group and driven primarily by non interest margin over average tax assets and in general, superior ROAA.

Income Statement Forecast	2010	2011	2012	2013	2014	2015	2016
Avg Earning Assets	252000	283000	306000	315000	330000	345000	350000
NIM	3.90%	3.65%	3.60%	3.50%	3.55%	3.60%	3.65%
NII	9828	10329.5	11016	11025	11715	12420	12775
loan loss provision	4400	2350	1900	1500	1700	2100	2450
Fee Income	8300	8500	9300	9000	9250	9500	9750
Operating Revenue	13728	16479.5	18416	18525	19265	19820	20075
Expenses	9400	9800	10300	10100	10300	10600	10900
EBIT	4328	6679.5	8116	8425	8965	9220	9175
Adjust for FTE, securities, nonrecurring gains/losses			250	250	500	500	800
Tax Rate	23%	28%	28%	28%	28%	28%	28%
NI	3332.56	4809.24	5663.52	5886	6094.8	6278.4	6030
Dilluted Average Shares	1920	1923	1900	1850	1825	1750	1675
Dilluted EPS	1.735708	2.500905	2.9808	3.181622	3.339616	3.587657	3.6

Balance Sheet Forecast	2010	2011	2012	2013	2014	2015	2016
Assets	307	340	355	360	380	400	420
Securities	53	70	74	76	78	80	82
Loans	197	210	220	235	250	260	270
Deposits	205	230	250	260	275	285	295
Other	72	77	67	58	62	71	79
Equity	30	33	38	42	43	44	46
TCE	17	20	23	25	26	27	28
Shares Repurchased		22	59	68	65	65	65
Div payout Ratio		20%	28%	30%	30%	35%	35%
Dividend		0.500181	0.81972	0.954486	1.001885	1.25568	1.26

Metrics of Interest	2010	2011	2012	2013	2014	2015	2016
ROE	11.11%	14.57%	14.90%	14.01%	14.17%	14.27%	13.11%
ROTE	19.60%	24.05%	24.62%	23.54%	23.44%	23.25%	21.54%
ROA	1.09%	1.41%	1.60%	1.64%	1.60%	1.57%	1.44%

Misc Information

- On march 2013 USB (through its subsidiary US Bank National Association) purchased a municipal bond trustee business from Deutsche Bank which added approximately 57 billion to the AUM within the banks corporate trust division.
- February 2013 USB through their subsidiary Elavon, acquired Collective Point of Sale Solutions
- Nov 2012 USB acquired FSV payments system in Florida which manages prepaid programs for companies, governments and other financial services firms.
- March 2011 the board of directors announced a 150% increase in the quarterly dividend

Bank	Ticker	Mkt Cap	Current Price	EPS	P/E	Beta	Shares Oust.	Dividend	2y Target Price
Zions	Zion	5.23B	$28.34	$1.30	21.8x	2.15	184.5 M	0.50%	$29.28
Recommendation: Sell or Do Not Initiate Position (Short and Long Term). Overvalued									

Zions operates predominantly in Utah, Texas, and California and is a conglomerate of 98 banking subsidiaries. Zions is a large SBA lender and has strong public finance advisory service. Their growth strategy is driven by focusing on growth markets, local decision making while centralizing technology to reach economies of scale, and controlling for key risks given their SBA exposure Zions takes on a great deal of credit risk. They have approximately 54 billion under managed and based out of Salt Lake City, Utah.

Positive

- Good **reported** interest rate sensitivity to a rising rate environment (up 100bps = 9% increase in NII) *Although this may not be the case*
- **Duration is low (<2yrs on loan/securities portfolio)**
- Expansion/creation of credit card services over last few years
- NII up modestly in the quarter largely due to FDIC supported loans
- Non interest income up (although largely due to a reduction in impairment on CDOs)
- Net loans and lease change offs down 68% OREO on significant decline and forecast to stabilize nonperforming assets declined 12%
- **Overhaul of systems, upgrading technology across the board, notably in the accounting department**

Negative

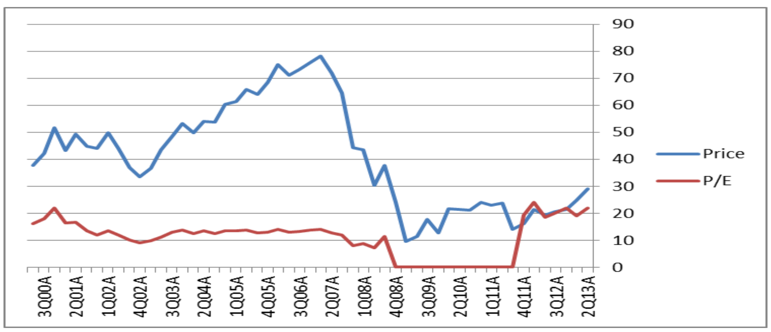
- Very small securities portfolio suggesting they face even more credit risk as we know their customers aren't double/triple A tranche worthy
- **Highly dilutive compared to peers**
- Highest P/E ratio and lowest ROAE in peer group
- **Seeing some competition in loan pricing, possibly getting priced out of their Texas market due to new entrants (PNC, UB, USB)**
- **30 cent dilutive EPS in Q2 compared to 48 cents dilutive EPS in Q1, flat YoY**
- Non interest expense up 13.1% this quarter
- Double digit basis point drop in NIM

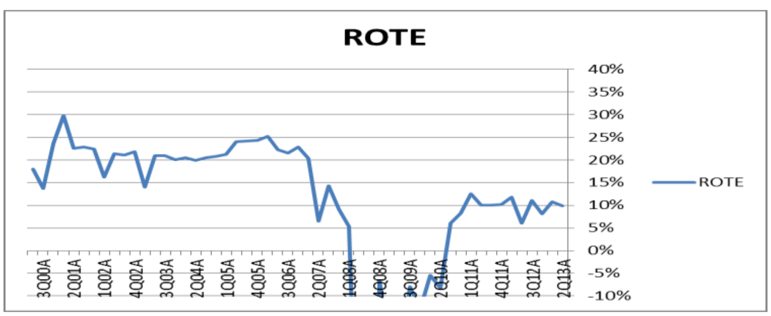
Thesis

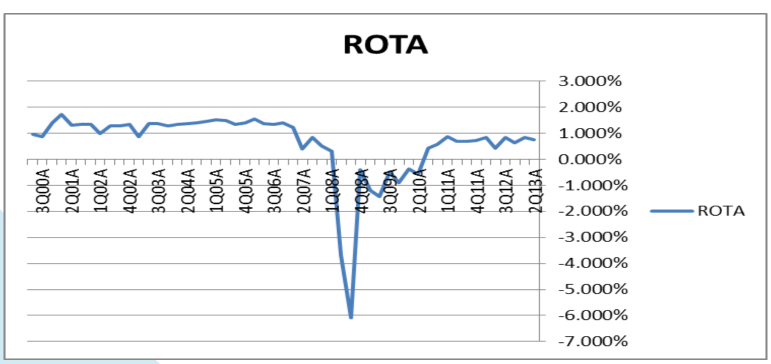
Zions is serving as a leveraged banking play. The fundamentals of the company do not well reflect the multiple (21x) that it has been awarded. At a blended 2014/2015 earnings of $1.83 against a 16x historical multiple against diluted EPS awards a 2 yr price target of $29.28. When factoring dividends, this results in an annual return on investment of 5.2%. I believe the pricing of the company is based on the assumption that rates will rise considerably. While I do assume a rate rise, and Zions will experience strong NIM expansion, it's not likely they can maintain (and deserve) the multiple they have today unless rates go to 400 bps on the 10 year and the short end bumps up 50 or so bps, which I do not see happening.

Analysis

Zions is very appealing in its interest rate sensitivity. As my base projection for interest rates see the 10yr at 3.5% by the end of 2014 and 4% by 2015 (with little adjustment in the short end of the curve), Zions is well positioned to enjoy the benefits. That being said, Zions has significant exposure to a downside move in rates (or a flat one for that matter). Furthermore, their ROE, ROAE, and ROTE are abysmal compared to peers. They have seen (despite recent increase in rates) NIM pressure as they have declined over 10bps the last two quarters. To sanity check their earnings sensitivity to rising rates I plot the 30yr fixed against their NIM over the last 13 years. There should be an equal change to the 30 yr fixed (barometer of rate movement) in their NIM, however, NIM is unchanged to slightly down over the period which suggest they are either highly fixed in their interest income or they are unable to create a greater spread between their interest bearing liabilities and their inters bearing assets in an increasing rate environment.







From a valuation perspective, they seem highly overvalued. They are awarded a 22.6x multiple but when mapping that against price we see that earnings are basically zero. Either earnings are anticipated to rocket up (which I don't know why anyone would think that would happen) or the multiple (and thus the price) must drop. I believe they will not see earnings expansion for three reasons; 1) as mentioned above, they seem unable to enjoy NIM expansion in a rising rate environment., 2) Their long term ROTE is twice what it is today and even then was under many of its peers, 3) ROAE is the lowest of its peers.

ROAE is driven down primarily by a very low non interest income over average assets summated with a very high non interest expense over adjusted assets. Their return on assets is at the lower end of the peer group. Return on tangible assets suggests even worse relative performance and is indicative of a firm unable to create value in the non interest income space (even during the last few years where Refis basically drove that income). They have issued over 600 and could issue another 200 million in preferred securities.

Valuation

	Income Statement Forecast						
	2010	2011	2012	2013	2014	2015	2016
Avg Earning Assets	47	47	49	51	53	55	57
NIM	3.73%	3.80%	3.58%	3.42%	3.50%	3.65%	3.65%
NII	1749	1788	1750	1740	1830	2000	2000
loan loss provision	852	74	14	-60	100	200	200
Fee Income	498	501	524	530	550	580	600
Operating Revenue	1395	2215	2260	2330	2280	2380	2400
Expenses	1550	1580	1570	1600	1650	1650	1650
EBIT	-155	635	690	730	630	730	750
Adjust for FTE, securities, nonrecurring gains/losses	250	90	160	100	50	50	50
Tax Rate	27%	38%	35%	35%	37%	37%	37%
NI	-417.675	167.9	174.5	309.5	305.4	368.4	381
Dilluted Average Shares	166	182	183	184	184	184	184
Dilluted EPS	-2.51611	0.922527	0.953552	1.682065	1.659783	2.002174	2.070652
Preffered Dividends	120	170	170	100	60	60	60
	Balance Sheet Forecast						
	2010	2011	2012	2013	2014	2015	2016
Assets	51.5	51.5	53	55	57.5	59	60
Securities	4.5	4.5	4	4	4	4.5	4.5
Loans	38	37	37	37.5	40	41	42
Deposits	41.7	41.3	43.4	45	47.5	50	52
Other	3.8	3.2	3.1	3.5	3	2	0.5
Equity	6	7	6.5	6.5	7	7	7.5
TCE	3.5	3.5	4	4.25	4.5	4.75	5
Shares Repurchased							
Div payout Ratio		5%	5%	8%	20%	20%	20%
Dividend		0.046126	0.047678	0.134565	0.331957	0.400435	0.41413
	Metrics of Interest						
	2010	2011	2012	2013	2014	2015	2016
ROE	-6.96%	2.40%	2.68%	4.76%	4.36%	5.26%	5.08%
ROTE	-11.93%	4.80%	4.36%	7.28%	6.79%	7.76%	7.62%
ROA	-0.81%	0.33%	0.33%	0.56%	0.53%	0.62%	0.64%

Misc Information

- May 2013 Opus bank bought four branches from California Bank and Trust (a subsidiary of Zions)
- On September 26, 2012 Zions announced it has redeemed its remaining 700 million series D preferred stock (aka TARP funds).
- Aug 2010, NetDeposit (a subsidiary of Zions) sold itself to BankServ.
- July 2009 CB&T purchased Vineyard Bank which included 1.4 billion in loans in western San Bernardino County.

Comp Analysis

ROA	2011	2012	2013	2014	2015	2016	Average
FITB	1.04%	1.32%	1.24%	1.25%	1.23%	1.25%	1.22%
MTB	1.05%	1.19%	1.29%	1.20%	1.42%	1.40%	1.26%
HBAN	0.78%	1.08%	0.97%	0.87%	0.97%	0.92%	0.93%
KEY	0.93%	1.00%	0.92%	0.89%	0.87%	0.83%	0.91%
BBT	0.80%	1.08%	0.97%	1.01%	1.00%	0.91%	0.96%
RF	0.35%	0.79%	1.06%	0.92%	0.87%	0.86%	0.81%
ZION	0.32%	0.33%	0.57%	0.56%	0.63%	0.72%	0.52%
USB	1.41%	1.60%	1.64%	1.60%	1.57%	1.44%	1.54%
PNC	1.13%	0.95%	1.22%	1.14%	1.27%	1.34%	1.18%
CYN	0.72%	0.71%	0.67%	0.72%	1.04%	1.37%	0.87%

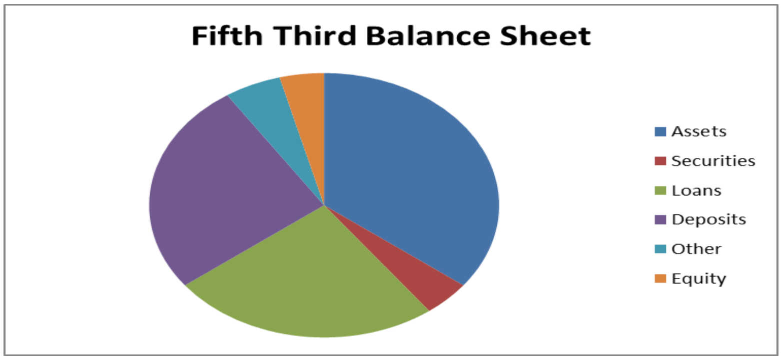
Return On Equity	2011	2012	2013	2014	2015	2016	Average
FITB	9.02%	11.28%	10.72%	11.02%	11.05%	11.44%	10.62%
MTB	8.60%	9.49%	10.34%	11.48%	12.90%	12.54%	10.56%
HBAN	8.05%	10.43%	9.30%	8.49%	9.84%	9.66%	9.22%
KEY	7.98%	8.49%	7.86%	7.75%	7.77%	7.48%	7.97%
BBT	7.65%	9.88%	8.15%	8.15%	7.96%	7.07%	8.36%
RF	2.90%	6.42%	8.10%	6.90%	6.41%	6.37%	6.15%
ZION	2.38%	2.73%	4.80%	4.59%	5.33%	5.76%	3.97%
USB	14.57%	14.90%	14.01%	14.17%	14.27%	13.11%	14.39%
PNC	8.46%	7.00%	8.68%	7.98%	8.56%	8.82%	8.14%
CYN	10.62%	11.33%	12.27%	13.90%	18.29%	23.18%	13.28%

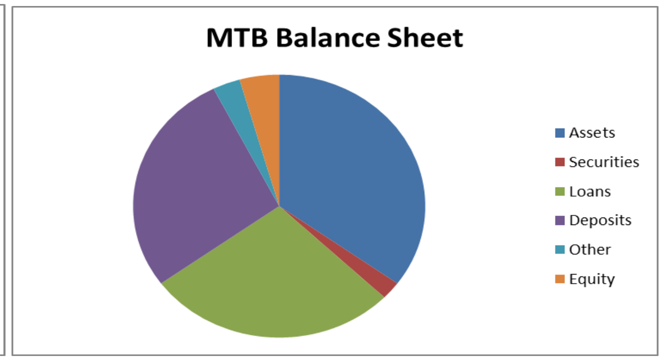
Various Annualized Growth rates 00-12	NII	AEA	Fee Income
MTB	10.52%	9.46%	12.59%
HBAN	5.61%	6.57%	7.43%
KEY	-1.67%	-0.51%	-6.36%
BBT	8.82%	8.92%	13.27%
RF	8.02%	9.15%	12.67%
ZION	7.04%	8.63%	7.97%
USB	6.75%	7.01%	7.82%
PNC	14.46%	13.79%	7.29%
CYN	6.58%	10.21%	12.41%

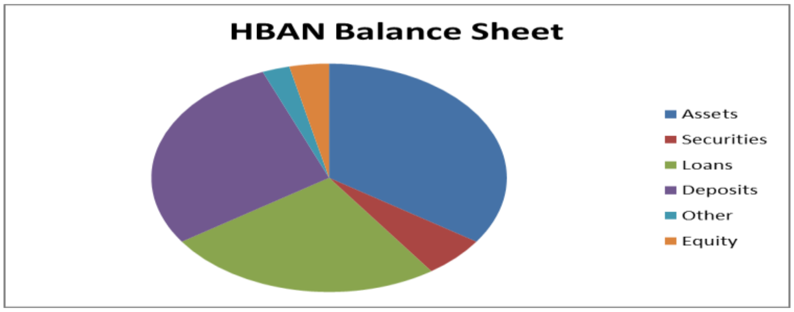
Approx and avg ratios between 4Q00 and 4Q12	ROE 00'	ROE 12'	ROTE 00'	ROTE 12'	ROA 00'	ROA 12'
MTB	18.88%	9.49%	32.35%	16.65%	1.72%	1.19%
HBAN	20.13%	10.43%	28.95%	12.49%	1.70%	1.08%
KEY	16.25%	8.49%	20.25%	9.84%	1.25%	1.00%
BBT	19.64%	9.88%	21.60%	14.06%	1.63%	1.08%
RF	15.05%	6.42%	17.21%	9.17%	1.18%	0.79%
ZION	11.73%	2.73%	18.05%	4.43%	0.93%	0.33%
USB	23.00%	14.90%	30.85%	24.62%	1.96%	1.60%
PNC	23.57%	7.00%	37.55%	11.44%	2.20%	0.95%
CYN	18.39%	11.33%	24.12%	11.33%	1.51%	0.71%

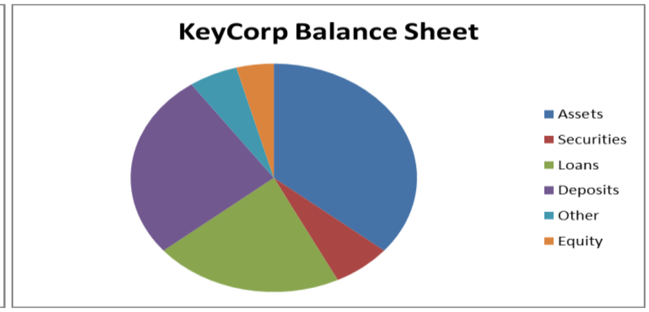
ROTE	2011	2012	2013	2014	2015	2016	Average
FITB	11.17%	14.18%	14.13%	14.13%	14.10%	14.54%	13.71%
MTB	16.48%	16.65%	11.89%	13.66%	15.14%	14.04%	14.64%
HBAN	9.31%	12.49%	11.20%	10.28%	11.96%	11.80%	11.17%
KEY	9.39%	9.84%	9.17%	9.01%	8.99%	8.63%	9.17%
BBT	11.82%	14.06%	11.00%	10.64%	10.27%	8.92%	11.12%
RF	5.63%	9.17%	11.95%	10.04%	9.47%	9.48%	9.29%
ZION	4.76%	4.43%	7.35%	7.14%	7.86%	8.63%	6.69%
USB	24.05%	24.62%	23.54%	23.44%	23.25%	21.54%	23.41%
PNC	13.47%	11.44%	14.35%	12.69%	13.42%	13.10%	13.07%
CYN	10.62%	11.33%	12.27%	13.90%	18.29%	23.18%	14.00%

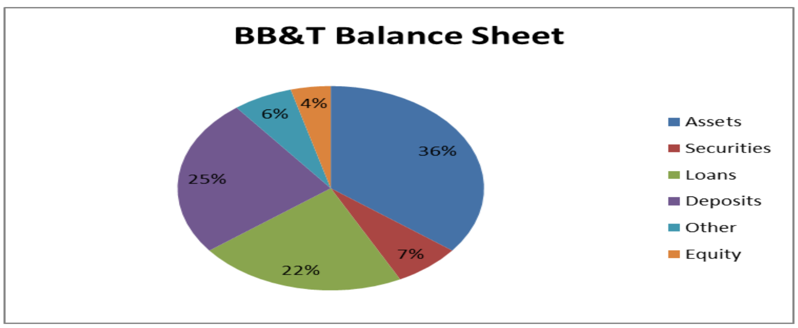
The balance sheets are for the 2013 Expected

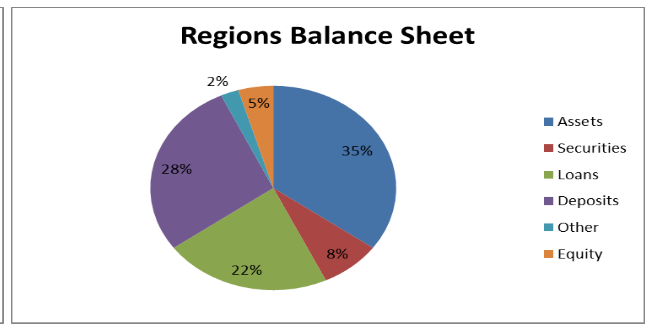


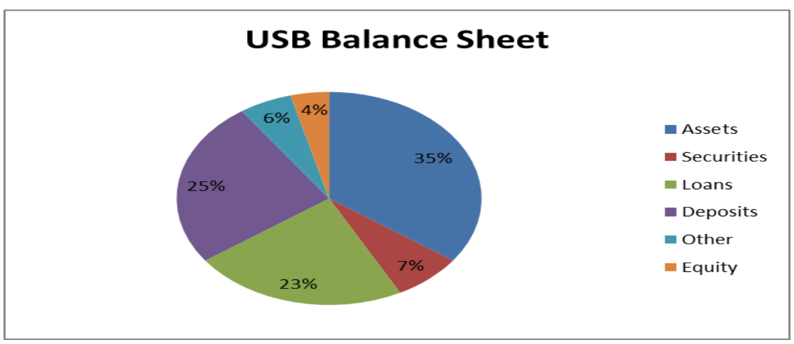


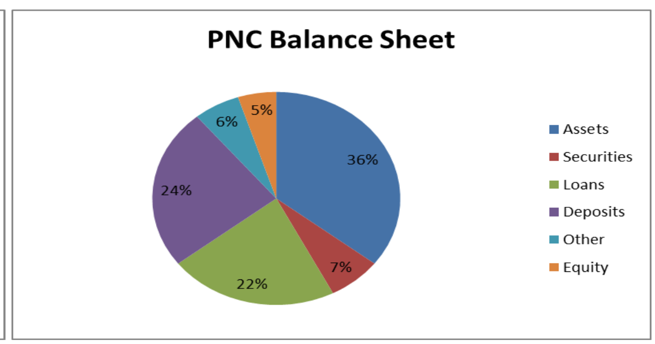


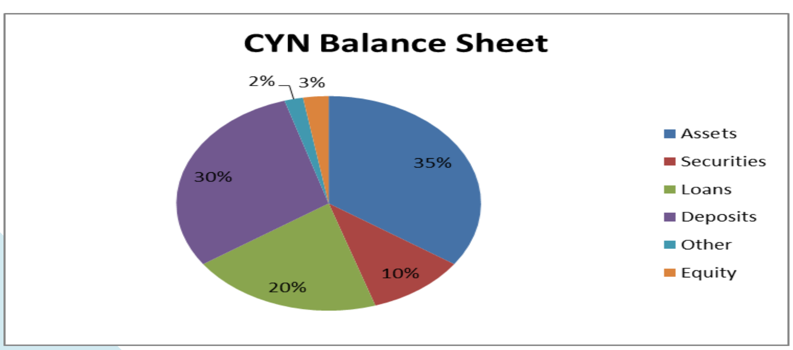


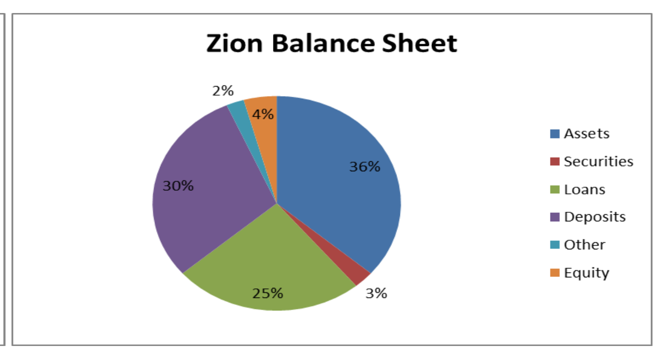




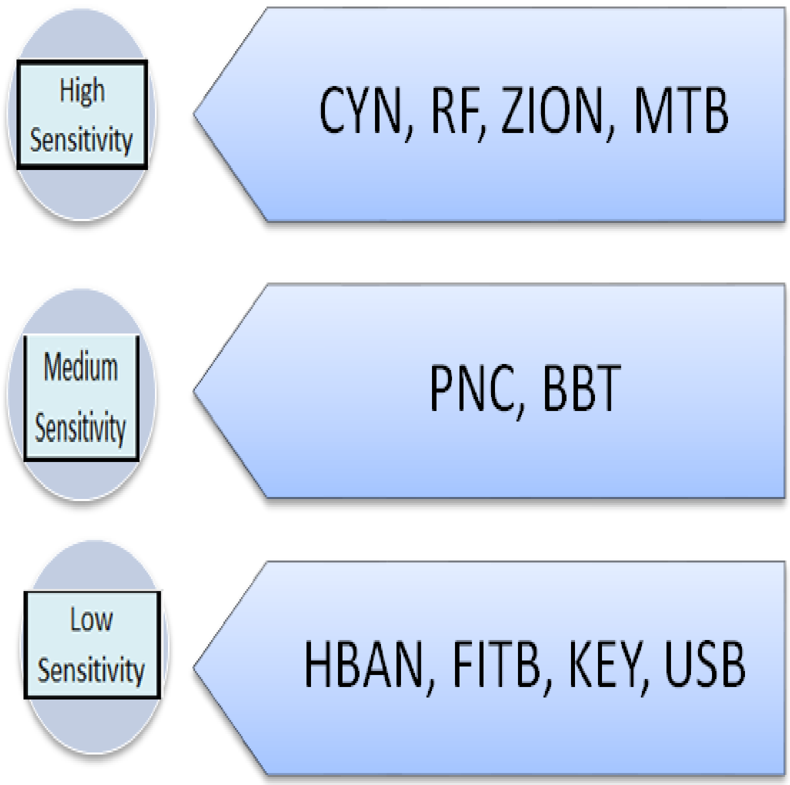


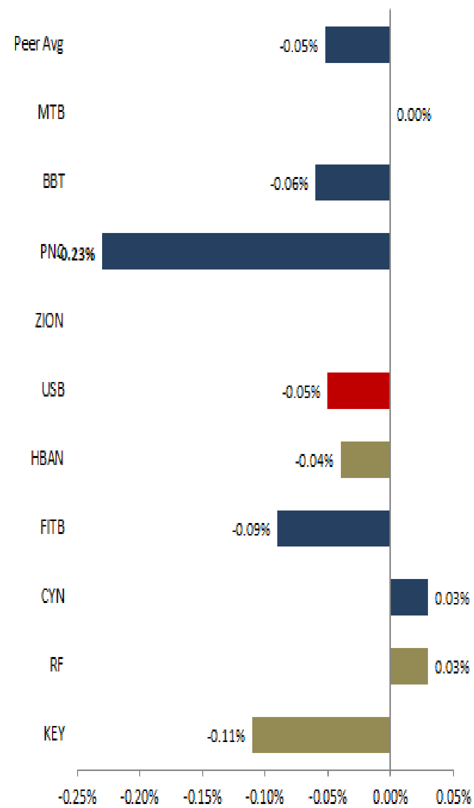






On an absolute asset sensitivity basis, CYN, RF, Zion and MTB are most sensitive where BBT and PNC come in second and HBAN, FITB, KEY, and USB are less sensitive. The bar graph below and to the right represents the percentage change from 4Q2012 to 1Q2013 NIM before (or at the very beginning) of the jump in yields.

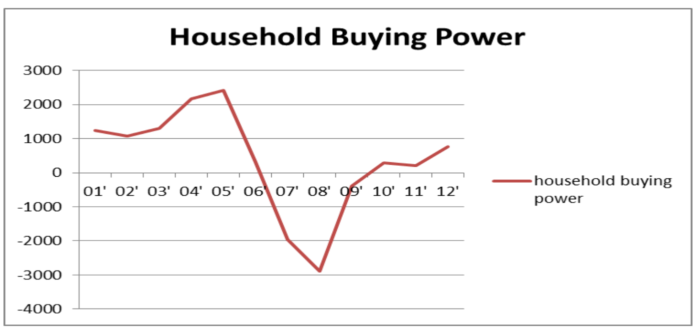


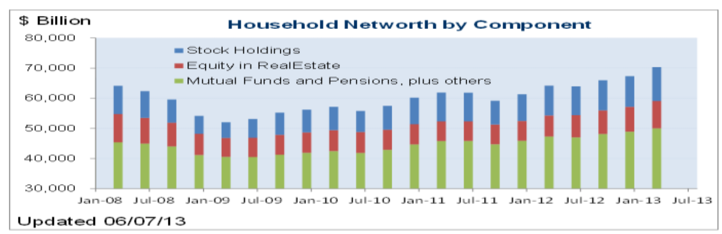


- Important Comments on the US Economy as they Relate to Banking -

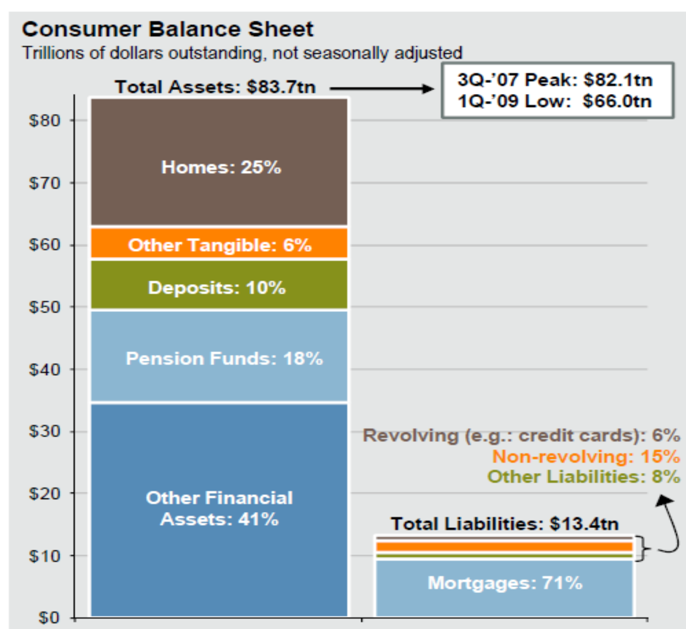
I will review economic conditions of the US consumer, the data most widely viewed by banks, explain the rational for why I believe in a rising rate environment over the next couple of years, and display other assumptions. As half of banks earnings are derived from net interest income (NII), the nature of the yield curve, and the sensitivity toward changes in that curve, is very important when discerning valuation and making investment decisions. I assume a rising rate environment and all valuations herein reflect that paradigm.

There has been significant improvement in household finances both in terms of home equity appreciation as well as an improving consumer balance sheet. The deleveraging of the US consumer has aided in significant pent up demand which should be supporting of future gains in consumer spending. Payroll growth was ahead of expectations in June and we have observed a recent (although slight) uptick in the labor force participation rate. Labor force data looks good (over nearly any perspective time period) and should lead to a continued improving US economy. If consumers can fuel consumption with savings or debt, and we have seen a meaningful increase in savings and reduction in debt, it indicates that consumers have been signficantly deleveraging. However, as rates have remained low and NIM has been compressed, banks are beginning to loosen credit standards in order to expand profits and consumers, thanks to record low rates, are begnining to take on cheap debt. Furthermore, consumer confidence, sentiment, and comfort all are trending up.





Deutche Bank produces a household buying power index which sheds light on the improving household buying power position (an abridged graph can be seen below). We learn from this report that at present its less important if personal income increase faster than mortgage interest rates but instead more important that owners equity in real estate increase.



(*Graphs: Household buying power based on output read from research by Joseph LaVorgna at Deutche Bank, Household Networth from exported data from Bloomberg, Consumer Confidence from exported Data by the fed, Household Debt Service Ratio and Consumer Balance Sheet graphs are taken from JP Morgan Guide to the Markets 2Q2013*)

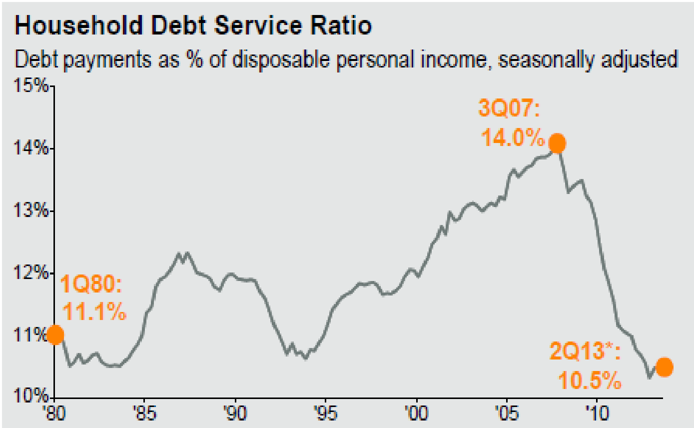
Key Points:

- Home equity is the dominant component in household buying power and as home prices continue to rise, buying power continues to rise.

- Vacancies have tended lower as the rental market matures quicker than the home origination market.
- Mortgage applications have gone flat in 2013 which supports the assumption of pent up demand.
- Refinancing has plunged as rates have risen, evidence suggests residential refinancing trend may be over (or at least largely completed).
- An improving labor market supports an improving consumer balance sheet.
- Strong trends in labor force data suggest the consumer's ability to consume credit.

(*The above graphs were formulated from FRB data except for the payrolls data which came from the Bureau of Labor Statistics*)

The consumer is clearly resiliant and this should bode well for banks that have credit card exposure (outright like Capital One or tangentially such as PNC's 1 billion holding of Visa stock). We assume, in the research of each bank, that the consumer is strong, his/her appetite for credit has been largely suppressed, there is significant pent up demand, and very soon the propensity to consume units of credit (as we've already seen sufficient consumption of housing credits) will return. Note, the willingness to consume credit is hindered by an inherent lack of available credit. Given the low rate environment, its not prudent to offer credit at current rates given the default profile of the average borrower.

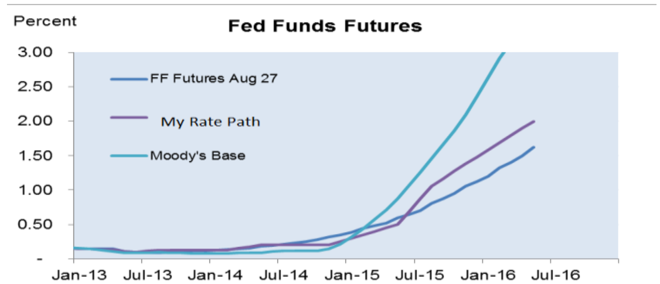


From a housing (and bank lending) perspective, things are generally strong but weak in the immediate term. July new home sales were down significantly and with the recent jump in rates, AFS portfolios took mark to market hits (although the rise of rates may well encourage and attract new and/or previously hesitant entrants) which was in part reflected in 2Q2013 but will likely have residual effects in 3Q2013 results.

Home sales are trending up as are home prices. Most banks have been stubborn on loosening credit (especially within the home ownership space) and as such I believe these values represent economic recovery as opposed to irresponsible credit consumption (akin to what we experienced in the mid 2000s). Prices are largely elevated by the declines in housing inventory (supply). The demand for home ownership is promoted in by the Fed's low rate policy. Looking to the fixed rate mortgage and adjustable rate mortgage graphs, we can see that we are nowhere near the average mortgage rate. With the recent back up in rates, we did see some declines in mortgage purchases. However, even after the rate hike, mortgages are below their long term average and significantly more affordable relative to other goods. Individuals should be consuming less units of other products and increase consumption of housing units.

Banks are well aware of the economics of the above graphs and as such, in an excessively liquid environment, have expanded home ownership while carefully managing the risk they want to take on the builders (notably the CRE portfolios).

It is troubling that builder confidence is so high. While this is an observation for housing starts, we see the same confidence displayed in commercial real estate. As housing applications fall, I feel less comfortable with such excessive builder confidence as they may extend supply a bit too far.

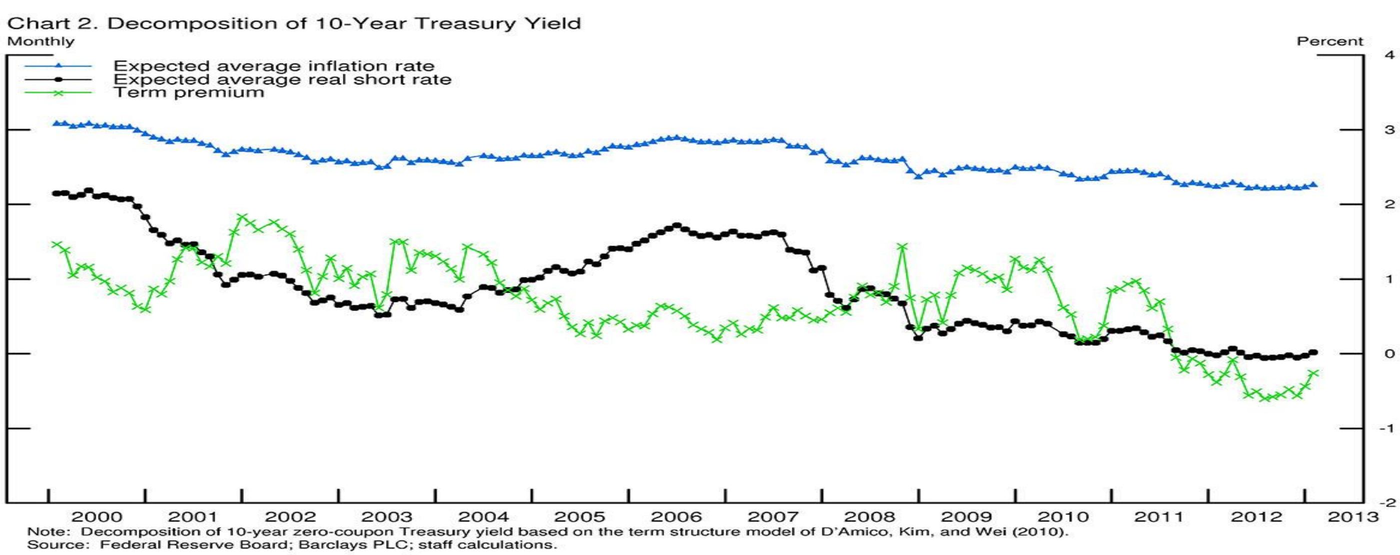


Key points for the US housing market

- refinancing is down and as such mortgage fee application should be down (while it may come back in some minor way, the long term refi trend is over)
- mortgages are very affordable and as such consumers should consider consuming more units of housing than units.
- Recent drop in mortgage applications, combined with strong homebuilder confidence, leads me to believe there will be near term ramifications as builders reconsider future plans (or at least the rate by which they will execute on plans) which may reduce CRE and commercial loans for the purpose of real estate development.

Finally, I would like to speak about the current rate environment (which is ever steepening) and why I anticipate a long term trend in rising rates. In March, Ben Bernanke put out a paper "Long-Term Interest Rates" whereby he identified the long end of the US treasury curve is driven by three factors; The short end (Fed Funds Rate), the expected inflation over the term of the security, and the term premium. A decomposition can be seen in the below graph

(*the below graph is from Ben Bernanke's paper Long Term Interest Rates*)



As for the short end of the curve, I have never come across a single estimate (as the Fed has been quite explicit) that believes the Fed Funds rate to exceed 25 bps.. This number will stay still until unemployment reaches 6% which most projections don't anticipate occurring within the 2 year scope of this project.

The term premium is "the extra return investors expect to obtain from holding long term bonds as opposed to holding and rolling over a sequence of short term securities over the same period" (from the Bernanke publication). There has been downward movement in this curve as it used to help compensate investors for interest rate risk. The reduction of this value (to currently about -25bps), is due to the increased volatility in treasury securities and the negative correlation treasuries share with equities.

The term premium is currently negative due to the Feds quantitative easing policies. Another reason the term premium is so low is that foreign investors have a stronger appetite over the last 5 years for US debt as a “safe haven”. As the term premium normalizes, it should catapult the treasury yields up. When this normalizes is unknown, but once the tapering begins, we could see a strong corrective uptrend in this component of the three variable 10yr rate model set forth by Bernanke. The benefit of increasing rates will likely come from this, although we don’t know when and to what degree. We can only speculate that the Fed tapering will have a significant impact on this particular portion of the curve.

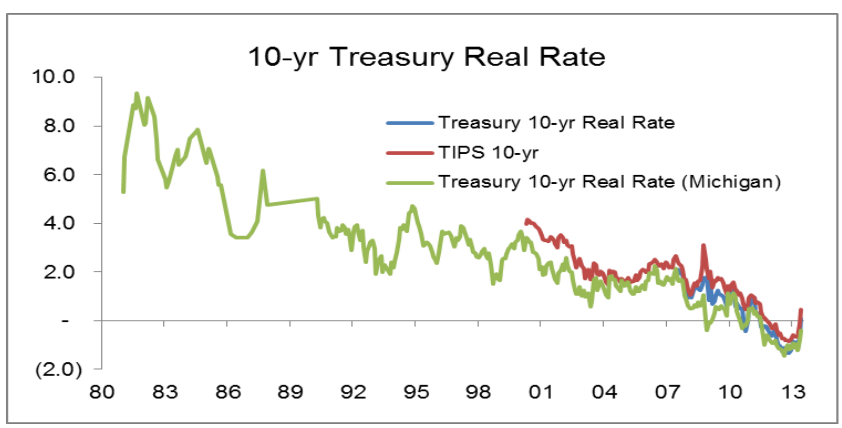
Clearly, the term premium and short end of the curve cancel each other out, for now. This awards nearly all influences to the expected inflation rate. Inflation in the US is remaining stubbornly low, which could be an excuse not to let up on the expansive monetary policies in place. To understand what the market perceives, we look to the 5 and 10yr swap market to better inform ourselves about the curve.

Monetary policy targets the short and middle end of the curve but the longer term rate environment is much more based on market factors such as strength of the economy and capital investment. The genesis of the disinflationary pressures may best be traced to the slowdown in china which has dampened demand for goods and caused a significant fall in the commodities space in 2013. Static wages are another impedes to good inflation.

While inflation isn’t just based on the size of the monetary base, but also on the velocity of money, it is clear the monetary base has expanded by over 50%. As unemployment improves, and more workers are not just in the market , but are competing for jobs, the employer will no longer have such a bountiful pick of qualified candidates and will need to raise wages to attract the best talent. This begins in the high income producing talent sector of the economy but trickles down quickly. Furthermore, national minimum wages can be set (although I should note I’m not a fan of this policy) to help spur wage inflation. Wage growth propagates inflation which propagates rates which propagates interest income which (*ceteris paribus*) propagates bank earnings.

When consulting the major indices to gauge the economy (Real GDP, Consumption, Govt Spending, retail investments, equipment investments, IP investments, Chicago PMI, Construction spending, Net Exports, unemployment, non-farm payrolls, personal income) nearly all important categories show improvement, a reduction in deceleration, or stabilization.

(The below graphs are from Moody’s Analytics Asset Management conference “Will There be a Great Rotation?”)



With the exception of the interest rate projections (which we already know to be outdated), I am using the CBO's "The Budget and Economic Outlook: Fiscal Years 2013 to 2023" paper, particularly Table B.2 as copied below, as a guideline for GDP and other valuable metrics.

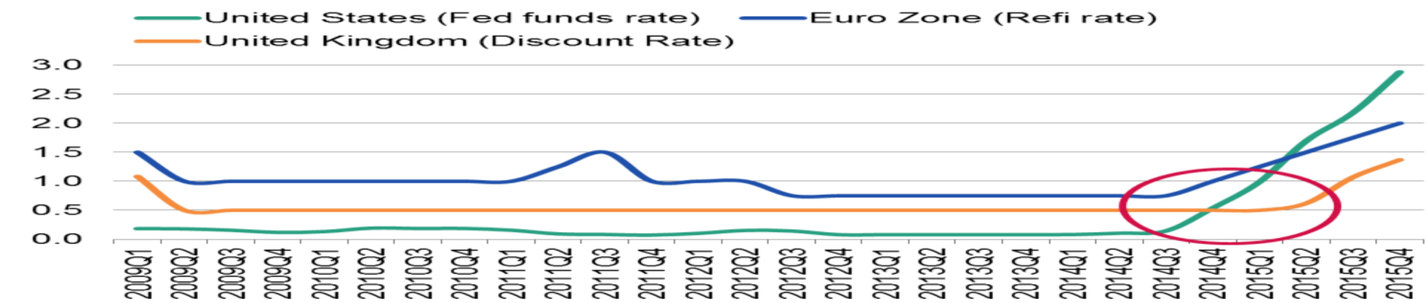


Table B-2.

CBO's Economic Projections, by Fiscal Year

	Actual, 2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Year to Year (Percentage change)							
Real GDP	2.3	1.5	2.1	3.9	4.4	4.0	2.8	2.4	2.3	2.2	2.2	2.2
Nominal GDP	4.2	3.1	3.8	5.9	6.6	6.2	4.9	4.5	4.4	4.3	4.3	4.2
PCE Price Index	2.0	1.3	1.5	1.9	1.9	1.9	2.0	2.0	2.0	2.0	2.0	2.0
Core PCE Price Index[a]	1.8	1.3	1.7	1.9	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Consumer Price Index[b]	2.4	1.7	1.7	2.1	2.1	2.2	2.3	2.3	2.3	2.3	2.3	2.3
Core Consumer Price Index[a]	2.2	1.7	1.9	2.1	2.1	2.2	2.3	2.3	2.3	2.3	2.3	2.3
GDP Price Index	1.8	1.5	1.7	2.0	2.1	2.1	2.1	2.1	2.0	2.1	2.0	2.0
Employment Cost Index[c]	1.8	2.0	2.6	3.7	4.0	4.1	4.1	3.9	3.7	3.6	3.6	3.6
						Fiscal Year Average						
Unemployment Rate (Percent)	8.3	7.9	7.9	7.3	6.5	5.7	5.5	5.5	5.4	5.4	5.3	5.3
Payroll Employment (Monthly change, in thousands)	157	110	156	224	223	183	91	84	84	80	70	63
Interest Rates (Percent)												
Three-month Treasury bills	0.1	0.1	0.1	0.2	1.0	2.9	4.0	4.0	4.0	4.0	4.0	4.0
Ten-year Treasury notes	1.9	1.9	2.5	3.2	4.1	4.9	5.2	5.2	5.2	5.2	5.2	5.2
Tax Bases (Percentage of GDP)												
Wages and salaries	43.8	43.7	43.9	43.9	44.0	44.2	44.4	44.6	44.7	44.9	45.1	45.2
Domestic economic profits	9.7	9.4	9.5	9.9	10.2	9.9	9.2	8.6	8.1	7.8	7.5	7.3
Tax Bases (Billions of dollars)												
Wages and salaries	6,812	7,014	7,300	7,748	8,274	8,818	9,300	9,757	10,224	10,704	11,201	11,707
Domestic economic profits	1,506	1,503	1,589	1,742	1,913	1,978	1,929	1,873	1,847	1,854	1,871	1,890
Nominal GDP (Billions of dollars)	15,549	16,034	16,646	17,632	18,792	19,959	20,943	21,890	22,854	23,842	24,858	25,910

Source: Congressional Budget Office. (Actual values for 2012 are from Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve.)

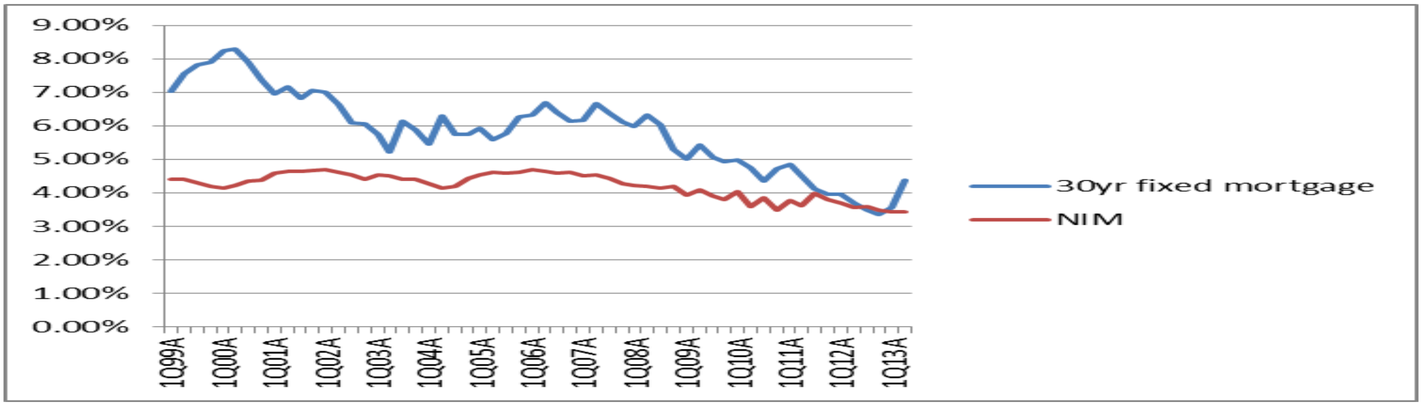
Note: GDP = gross domestic product; PCE = personal consumption expenditures.

a. Excludes prices for food and energy.

Estimates Used Throughout This Research	3Q2012	4Q2013	1Q2013	2Q2013	3Q2013	4Q2013	1Q2014	2Q2014
GDP growth	3.10%	4.00%	1.80%	1.70%	2.50%	2.80%	2.80%	3.00%
Fed Funds	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Unemployment	7.80%	7.80%	7.70%	7.60%	7.50%	7.30%	7.10%	690.00%
10yr treasury	1.62%	1.71%	1.91%	2.10%	2.70%	2.75%	3.00%	3.20%

As for the inflation target….. We recently saw a 10yr treasury nearly hit the 3% before dropping back down to 2.75%. The 10 yr seems to have a lot of positive momentum. Goldman Sachs predicts the 10yr to find stability north of 3% by 2014. I think this estimate is a bit too conservative. Technically there is resistance at 2.46% and the 200 day EMA keeps us assuming an upward trend. Maury Harris at UBS thinks we will be at 3.5% by 2014. This is in line with my expectations. I think the 10yr will continue to rise to 4% in 2014. Recall the long term treasury yield is around 5.5% and as such mean reversion compels the yield north over the next few years. There are a significant amount of speculative shorts on the 10yr treasury note futures and bearish speculators exceed bullish ones. What we take away from this is that a September tapering is very much likely. The 5 and 10yr swap rate confirms the direction of rates. I attached some commentary for your reading pleasure regarding meaningful events over the last 3 years.

To conclude this section, I would like to present some interesting evidence for the argument that rates can no longer decrease.



At what point do firms stop participating in an industry? A first course in macro economcis would tell you it is when the firm is no longer able to earn greater than or equal to zero economic profit (or otherwise, the marginal cost of production is higher than the variable cost or, the investor is not able to get a return s(he) would prefer for the risk s(he) is taking). Looking at the 30yr fixed mortgage graphed against net interest margin. We observe that firms are no longer earning much margin on their investment due to the downward push in rates. Now, the down rate environment is much more a factor of quantitative easing and the IMPLIED ?? guarantee of the federal government behind fannie and freddie MBSs. Never the less, the above graph is very telling and suggestive that rates cannot fall much further, otherwise you will see new rounds of bank forclosures and the industry will continue (and expeditiously) consolidate.