P Student
A Managed
C Investment
E Portfolio

Thursday, March 8, 2018
New York/North America
Equity Research
Commerical Banking

SunTrust, Inc.

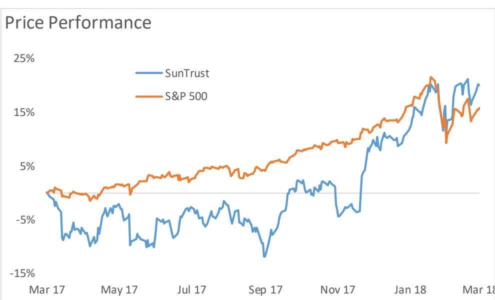
Overweight

Valuation Update / Model Update

Price:	$71.32
Target Price:	$89.95
52-Week Range:	$52.30 - $72.00
Net Interest Income:	$5,633 Million
Market Cap:	$33.4 Billion

Banks - Large Cap

Research Analyst:
Andre Sealy
Pace University
Finance / Economics Dual Degree



Valuation Update amid Federal Reserve Senior Loan Officer Survey

- **Weak Demand in January Survey:** Federal Reserve's Senior Loan Officer Survey indicates lending standards may have eased in commercial and industrial loans and residential mortgages, while they've tightened in the commercial real estate, credit cards, and auto. Competition from banks and nonbanks continues to be the

- **Impacts on SunTrust Financial Position:** Weak demand negatively impacts SunTrust's loan portfolio, as roughly 52.7% of all loans issued by SunTrust are commercial loans (down from 54.5% in 2016). Growth in total commercial loans fell -3.51% in 2017. Residential loans account for 27.2% of SunTrust portfolio but also experienced a -9.72% drop in 2016. Total consumer loans fell -0.08% in 2017.

- **Catalyst:** As demand for consumer loans decline, we expect SunTrust to loosen its lending standards loan with industry peers. Notable companies impacted are Comerica, SVB, Fifth Third, KeyCorp, PNC, East West and Regions Bank.

- **We project SunTrust's Return on Common Equity to decrease** to 8.84% from 9.04% in 2018; ROTCE to 14.31% in 2018 and 15% in 2019 from 12% - 13% in 2017.

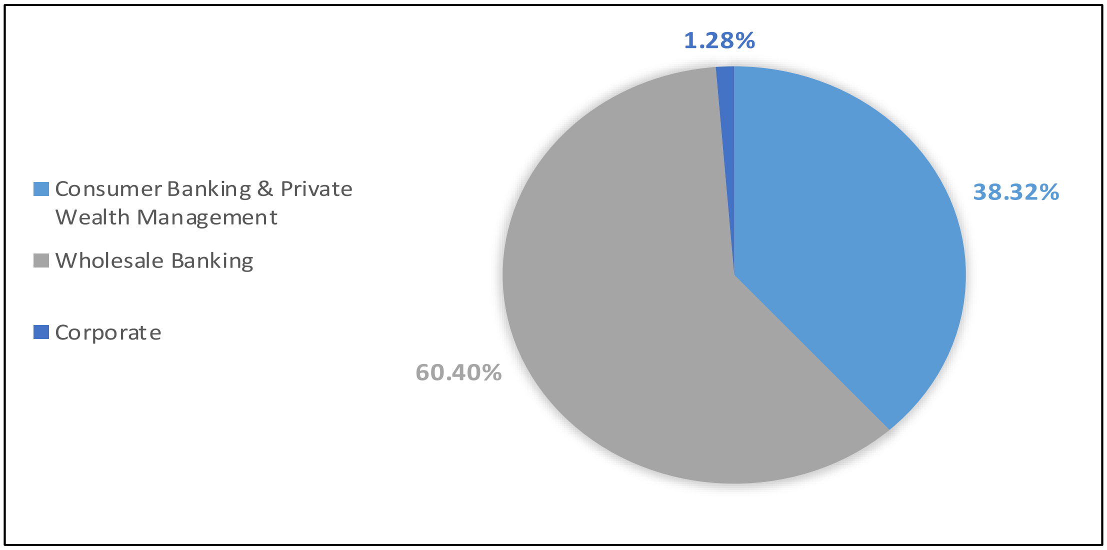
SunTrust Banks, Inc. (NYSE: STI US)

FYE Dec	2014 A	2015 A	2016 A	2017 A	2018 E	2019 E
EPS - Reported ($)						
Q1 (Mar)	0.73	0.78	0.84	0.91	1.11	-
Q2 (Jun)	0.72	0.89	0.94	1.03	1.27	-
Q3 (Sep)	1.06	1.00	0.91	1.06	1.32	-
Q4 (Dec)	0.72	0.91	0.90	1.48	1.35	-
FY	3.23	3.58	3.60	4.47	5.15	5.62
Market Estimates	3.21	3.38	3.53	4.04	5.03	5.54

Source: Company data, Bloomberg, SMIP estimates

Operations

Figure 1 – SunTrust's Revenue Producing Segments FY 2018



Source: Company Data

- The company operates and measures business activity across two segments: Consumer and Wholesale", with functional activities included in Corporate Other. Originally, there were three segments: Consumer Banking & Private Wealth Management, Wholesale Banking, and Mortgage Banking. The company began realigning its business structure from three segments to two segments based on, among other things, the manner in which management evaluates financial information. The Consumer Banking and Private Wealth Management segment and Mortgage Banking segment were combined into a signal segment.

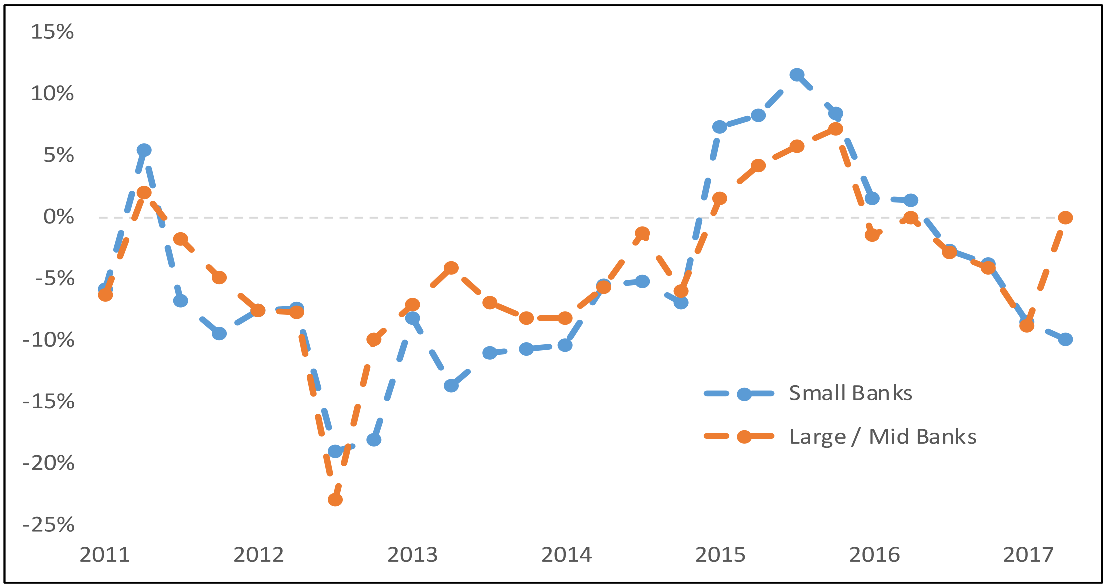
- **Wholesale banking has seen good revenue growth in the past few years**, led by the expansion of investment banking; however, the key is to sustain growth. SunTrust is trying to maintain revenue growth by 1) expanding its commercial real estate business with more fully-fledged product capability; 2) adding more industry subsectors; 3) entering into new cities; 4) continuing to expand its business with small private equity firms; and 5) trying to grow its equities and M&A business.

- **Consumer business to be a larger driver of further improvement of efficiency ratio.** The consumer banking segment hopes to improve its efficiency ratio by 500 bp over the next three years. SunTrust has planned to reduce the number of branches by 2% - 3% within the next couple of years. Branch count has declined sharply by about 25% since 2009. The wealth management division of the Consumer Banking & Private Wealth Management segment remains one of SunTrust's slower growth areas and is also one of the most difficult areas for regional banks to grow.

- **Asset Sensitivity has increased recently.** SunTrust has increased interest rate sensitivity by reducing the swaps against C&I loans – these had declined from $16.7 billion in FYE 2016 to $13.7 billion at Q3 2017. Also, SunTrust has improved its net interest margin slightly by restructuring $6 billion of securities in December post-tax reform.

Industry Outlook

Figure 2 – Net Percentage of Easing Credit Standards in Commercial & Industrial Lending



Source: Federal Reserve Senior Loan Officer Survey

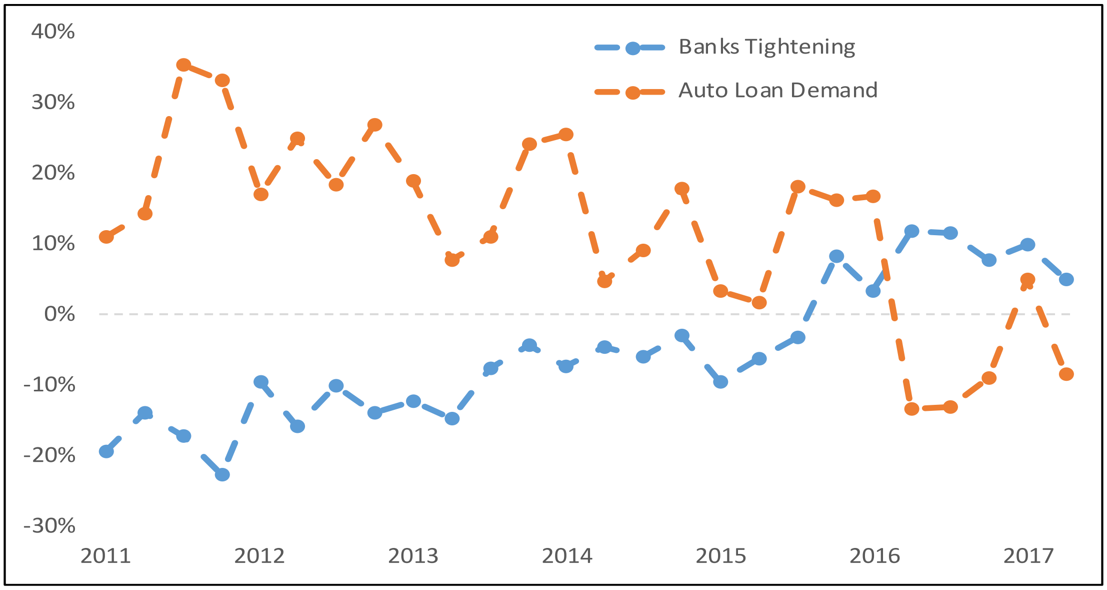
- A net number of U.S. banks reported easing credit standards on large and middle market commercial and industrial (C&I) lending in the January Senior Loan Officer Survey, continuing a trend observed since the April 2017 poll. Before that, banks had indicated net tightening. For small bank C&I lending, banks had been indicating net easing since July 2016, but the latest report showed an equal number of banks reporting easing and tightening. The C&I relaxation contrasts continued tightening in commercial real-estate lending.

- Banks also expect commercial and industrial loan demand to strengthen. With regard to loan credit performance, respondents anticipate improvements for C&I and deterioration in home-equity lines of credit, credit card and auto. The performance of commercial and residential real estate loans is expected to be unchanged.

- The most commonly cited reason for the easing of commercial and industrial lending standards in the past three months was heightening competition from banks and nonbanks lenders. It was a key driver of easing for 88% of respondents, as 90% of large banks and 80% of other banks cited it as “Somewhat” or “Very” important. The next-most cited, at 39%, was a more favorable or less uncertain economic outlook, up from 28% in the October survey.

- SunTrust is most exposed as a U.S. regional bank in the commercial and industrial lending space. Other banks impacted involves SunTrust industry peers, such as Comerica, Silicon Valley Bank, Fifth Third, KeyCorp, PNC and East West.

Figure 3 – Auto Credit Tightening, Demand Falls



Source: Federal Reserve Senior Loan Officer Survey

- U.S. banks continue to tighten lending standards in auto lending but reported neither net tightening nor net loosening in other consumer loans. Although demand for credit cards and other consumer lending remain neutral; however, demand outlook for auto lending was negative.

- The net number of U.S. banks tightening auto-lending standards was positive for the seventh-straight Fed Senior Loan Officer survey in January, at 4.9%, after net loosening in each period since 2011. This is down from 9.8% in the October survey. The January survey said the net number of banks seeing stronger auto-loan demand was negative. This reverses net strengthening demand in the October survey and is in-line with the three consecutive prior readings.

- While banks broadly expect credit quality to improve in 2018 for commercial and industrial loans, they also expect credit quality to deteriorate for home-equity lines of credit, credit cards, and auto loans. Responses to credit card and auto outlooks also saw large swings, though the outlook remains negative.

- Roughly 13.6% of banks see demand from individuals our households for auto loans as moderately weaker over the past three months.

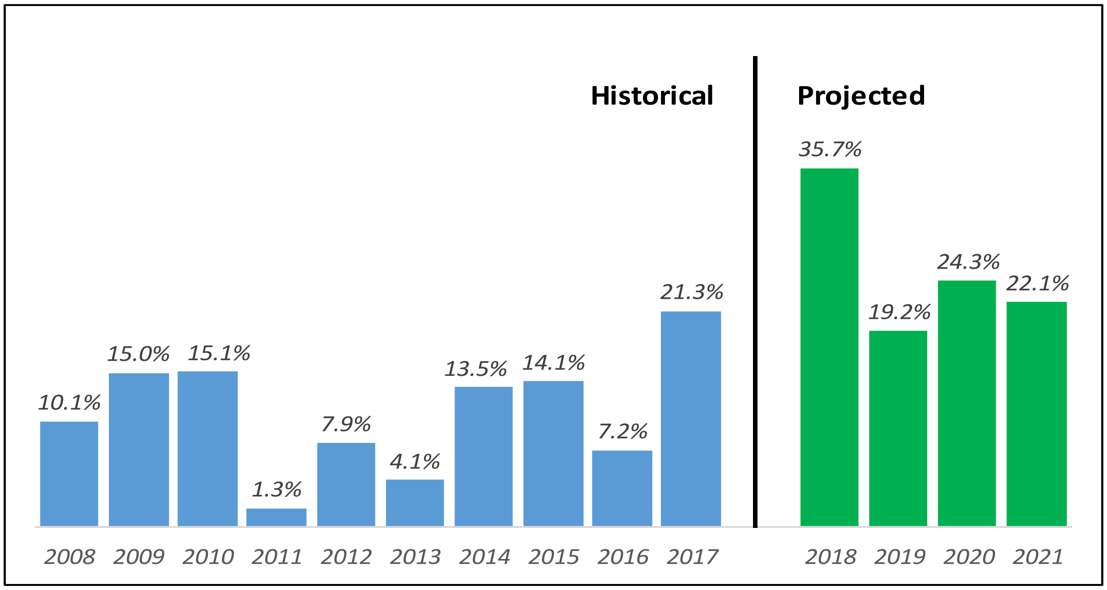
Figure 4 – Survey of Auto Loan Demand over the Past Three Months

	All Respondents		Large Banks		Other Banks	
	Banks	Percent	Banks	Percent	Banks	Percent
Substantially stronger	0	0.0	0	0.0	0	0.0
Moderately stronger	3	5.1	2	5.9	1	4.0
About the same	48	81.4	26	76.5	22	88.0
Moderately weaker	8	13.6	6	17.6	2	8.0
Substantially weaker	0	0.0	0	0.0	0	0.0
Total	59	100	34	100	25	100

Source: Federal Reserve Senior Loan Officer Survey

Investment Thesis

Figure 5 – SunTrust Investment Banking Revenue



Source: Company filings; SMIP estimates

- **The majority of Growth Will Originate from Investment Banking Fees:** SunTrust's earnings should benefit from continued growth in its middle market investment banking franchise and future improvement in its efficiency ratio. We rate SunTrust overweight relative to our coverage universe because we expect it to continue to successfully grow its investment banking business to drive revenue growth and manage expenses efficiency better than peers.

- SunTrust expects investment banking fees to be up sharply in 1Q18 due to a delay in the closing of some deals from 4Q to 1Q; 4Q fees were disappointing.

- We expect SunTrust to ease standards on residential mortgage and commerical and industrial (C&I) loans, but tighten on its commerical real estate and credit card sector. As such, we also expect C&I loan demand to strengthen. With regard to loan credit performance, we anticipate improvement for C&I and deteriotration in home equity lines of credit, credit card and auto loans. We expect this performance to reflect an increase in SunTrust's mortgage related income.

- SunTrust's business and earnings are sensitive to economic and general business conditions, particularly in the Southeast. Downside risk that may affect our outlook for the company and our rating includes factors such as regulatory risk, interest rate risk, risk from expansion into new areas of investment banking, higher-than-expected credit losses, the actions of rating agencies, changes in overall economic conditions and loan growth, and performance of the equity and fixed income markets.

Valuation

Summary

Our target price is based on a weighted average of the following:

- **Dividend Discount Model**: Our base case analysis, with a discount rate of 7.93% based on the Cost of Equity for SunTrust. The long-term perpetuity growth rate is estimated to be 4.0%; based on the sustainable long-term growth rate, which is calculated by multiplying the reinvestment rate by the return on equity in the terminal year.

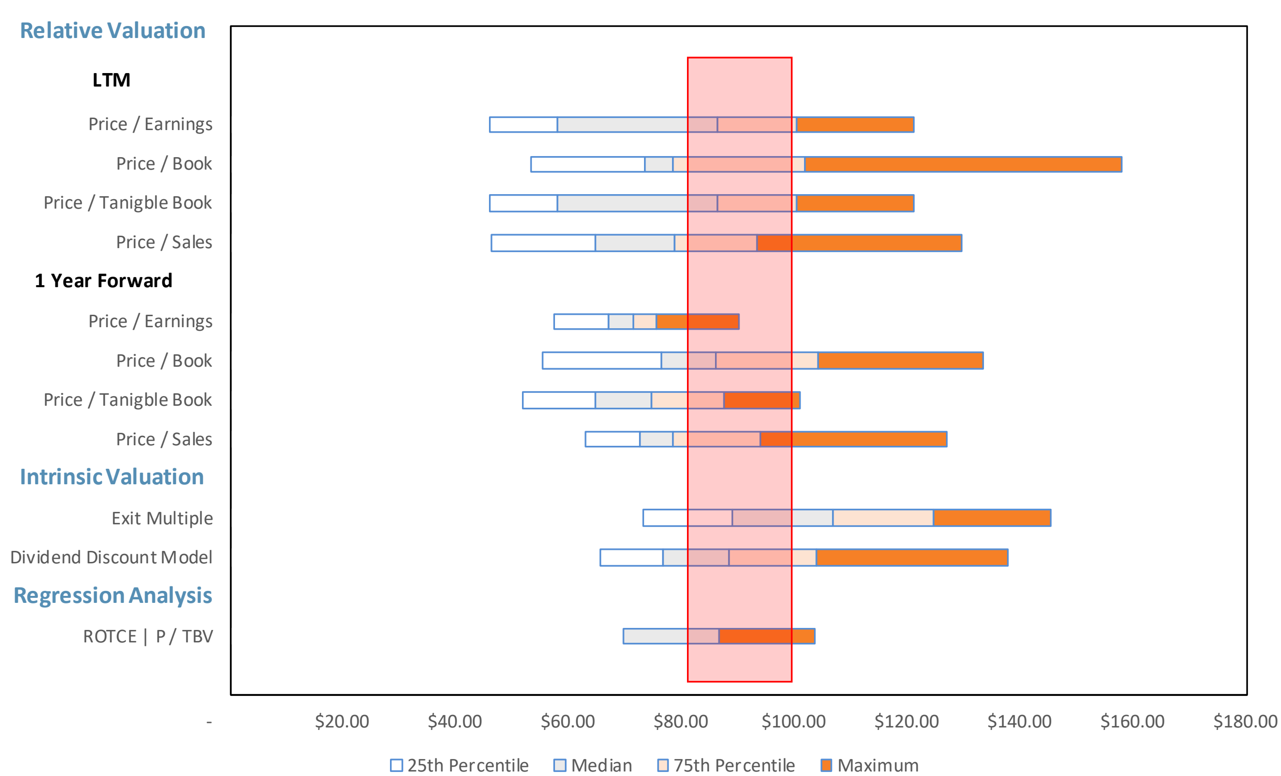
- **Relative Valuation**: Based on a LTM P/B of 1.82x; FY 18 P/B of 1.62x; and a FY 19 P/B of 1.49x for comparable companies.

- **Price / Book Exit Multiple**: The Exit Multiple uses the LTM P/B multiple of 1.82x, based on the comps derived multiple.

- **Regression Analysis** Uses the correlation between projected ROTCE and projected P/TBV, based on an implied P/TBV of 2.48x.

- **Other Methodologies**: Other methodologies we could have utilized involved a method known as the Precedent Transactions (Transaction Comp) method, which derives the value a company based on purchases price of comparable companies. Due to the lack of recent acquisitions, we have been unable to utilize this methodology for our analysis.

Figure 6 – SunTrust Valuation Summary and Current Share Price



Source: Pace SMIP estimates

Comparable Public Companies

To value SunTrust, we use a set of similar public companies with a focus on P / B multiples.

Figure 8 – SunTrust Comparable Public Companies and Valuation Output

Trading Comps		Market Cap (mm)	Stock Price	Percentage of 52 Week High	Last Twelve Months P / S	Last Twelve Months P / B	Last Twelve Months P / TBV	Last Twelve Months P / E	1 Year Forward P / S	1 Year Forward P / B	1 Year Forward P / TBV	1 Year Forward P / E	Return on Tanigible Common Equity	Dividend Yield
Retail Banking	Citizens Financial Group Inc	$22,037	$45.22	93.76%	3.08x	1.10x	1.68x	9.97x	3.61x	1.01x	1.60x	13.50x	17.09%	1.89%
	KeyCorp	$23,209	$21.81	98.15%	2.78x	1.66x	2.10x	15.45x	3.60x	1.60x	1.95x	12.98x	15.05%	2.69%
	M&T Bank Corp	$29,266	$194.69	98.64%	4.63x	1.95x	2.83x	19.27x	5.01x	1.85x	2.81x	16.00x	13.73%	1.84%
	BB&T Corp	$43,212	$55.02	98.00%	3.38x	1.62x	2.65x	20.36x	3.68x	1.57x	2.56x	13.96x	13.37%	2.93%
	Huntington Bancshares Inc/OH	$17,324	$16.16	97.76%	2.09x	1.78x	2.34x	9.38x	3.79x	1.63x	2.12x	13.36x	26.53%	3.18%
	Flushing Financial Corp	$804	$28.06	88.54%	3.80x	1.51x	1.71x	17.00x	4.29x	1.38x	1.47x	14.17x	3.68%	2.55%
	US Bancorp	$89,607	$53.94	92.21%	3.56x	2.03x	2.84x	11.17x	3.90x	1.79x	2.41x	13.25x	26.35%	2.62%
	Synovus Financial Corp	$6,187	$51.91	98.30%	3.60x	2.18x	2.24x	21.13x	4.33x	1.95x	2.16x	15.09x	10.62%	0.97%
	Wells Fargo & Co	$278,373	$56.72	85.54%	2.75x	1.52x	1.78x	13.49x	3.13x	1.38x	1.75x	11.94x	13.28%	3.30%
	Regions Financial Corp	$22,186	$19.76	98.31%	3.57x	1.44x	2.12x	20.26x	3.74x	1.40x	2.20x	14.75x	12.46%	1.98%
	Median			**97.88%**	**3.47x**	**1.64x**	**2.18x**	**16.22x**	**3.77x**	**1.58x**	**2.14x**	**13.73x**	**13.55%**	**2.59%**
WholeSale Banking	PNC Financial Services Group I	$75,214	$159.49	97.50%	3.83x	1.58x	1.96x	11.66x	4.37x	1.45x	2.06x	15.12x	16.83%	2.31%
	Fifth Third Bancorp	$23,374	$33.67	98.77%	2.74x	1.55x	1.86x	9.06x	3.63x	1.43x	1.86x	14.39x	21.88%	2.07%
	Zions Bancorporation	$11,073	$56.10	98.20%	3.69x	1.56x	1.82x	17.35x	4.02x	1.44x	1.81x	15.37x	11.29%	1.36%
	East West Bancorp Inc	$9,770	$67.59	97.60%	5.29x	2.54x	2.90x	17.08x	6.34x	2.01x	2.55x	15.36x	17.19%	1.20%
	SVB Financial Group	$14,104	$265.16	98.21%	5.89x	3.27x	3.27x	23.90x	6.07x	2.44x	2.86x	19.10x	13.85%	-
	Comerica Inc	$17,490	$100.34	98.45%	4.83x	2.20x	2.39x	18.10x	5.14x	1.94x	2.34x	15.34x	13.70%	1.19%
	Median			**98.20%**	**4.33x**	**1.89x**	**2.17x**	**17.22x**	**4.76x**	**1.70x**	**2.20x**	**15.35x**	**15.34%**	**1.28%**
Target	**SunTrust Banks Inc**	**$33,459**	**$71.32**	**98.21%**	**3.24x**	**1.48x**	**2.30x**	**14.08x**	**3.56x**	**1.30x**	**2.02x**	**14.26x**	**17.04%**	**2.64%**
Peer Group (Average)					**3.69x**	**1.82x**	**2.28x**	**15.81x**	**4.25x**	**1.62x**	**2.15x**	**14.59x**	**15.53%**	**2.04%**

Source: Company filings; Pace SMIP estimates

- **Peer Group:** SunTrust operations are divided into two segments: Retail Banking and Wholesale Banking. Currently, the majority of SunTrust's revenue originates from the Wholesale banking segment. SMIP has identified 16 different banks that are peers of SunTrust. For more accurate analysis, we have identified the firms that are predominately in the retail or wholesale banking side.

- **Metrics and Multiples:** Given the nature of banking, its composition, and its sources and uses of funds, it's challenging to apply enterprise value multiples to banks. Since the goal is always to find the cash flows that belong to just equity owners, we utilize equity value multiples such as price-to-sales, price-to-earnings, price-to-book, and price-to-tangible book. The nature of non-recurring and non-cash charges isn't as prevalent in the banking industry as it is in another sector.

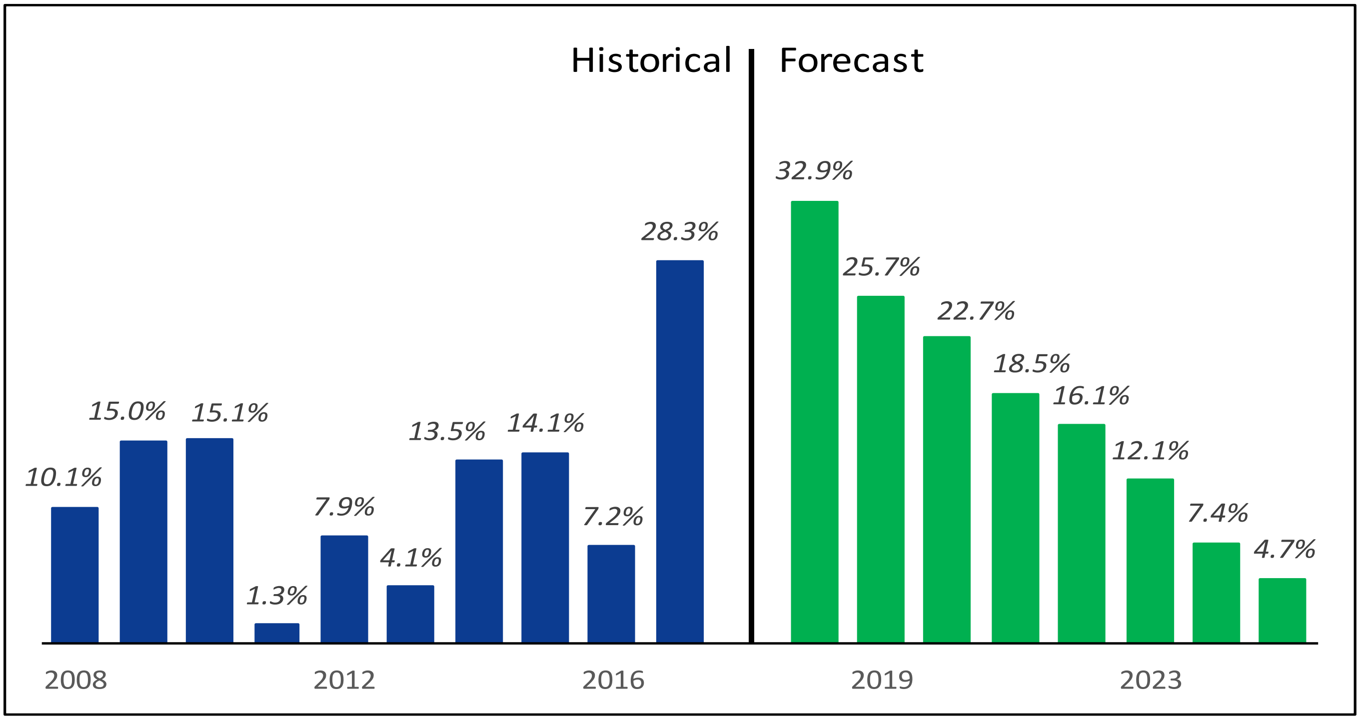
- **Target Price (Based on Comps):** SunTrust has the highest dividend yield and return on tangible common equity among our peer group. This performance leads us to believe that the company is undervalued and believe the price will increase as investors will realize that this asset is mispriced. Our investment thesis is supported by the LTM P/B and the Forward FY18 P/B multiple.

  We estimate the average of our peer group for the last twelve months should be 1.82x and 1.62 for 2018. By implying the multiple of the peer group to the SunTrust stock price, we estimate that SunTrust should currently be trading at $88.04 LTM and $88.76 for 2018.

- We recognize one of the drawbacks of using a comps analysis to value a company is the market's tendency to misprice certain financial assets. We also understand it is difficult to compare two different companies based on an Apples-to-Apples comparison; very few companies are comparable to SunTrust. However, the companies used in our analysis are identified competitors by SunTrust and provide a concise picture of how SunTrust should be valued when compared to these companies.

Dividend Discount Model & Exit Multiple Analysis

Figure 9 – SunTrust's Projected Dividend Growth Rate



Source: Company filings; Pace SMIP estimates

The dividend discount model, while academically respected, loses it's practical unless accompanied with assumptions and restrictions, such as 1) the company is already paying dividends, or will pay dividends at some point in the future; 2) dividends are growing at a constant rate; 3) the growth rate will never be more than the cost of equity.

Dividend Discount Model Assumptions

- **Net Income Growth:** Based on SMIP estimates, net income is projected to grow 8.13% on average for the next eight years. This growth will be fueled by the increase in SunTrust's investment banking revenue and an improvement in its efficiency ratio.

- **Dividend Growth Rate:** FY 2017 dividend growth rate for the firm was 26.70%; we expect dividends to continue to proliferate before stabilizing to 4.73% in FY 2026, and then a constant rate of 4.0% afterward.

- **Tier 1 Capital Ratio:** As large/mid-sized banks begin to ease its lending standards, we can expect banks to allocate capital to its risk-weighted assets; increasing the Tier 1 Capital Ratio in the short-term while decreasing it in the long-term.

Exit Multiple Assumptions

- Currently, the P/B multiple for LTM sits at 1.82x. We assume that this multiple will sustain itself, which means a stable growth in its share price as well as its book value.

Figure 10 – Dividend Discount Model Schedule

Dividend Projections (In millions)											
Fiscal year	**2016 A**	**2017 A**	**2018A**	**2019 E**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**	**2026E**
Fiscal year end date	*12/31/2016*	*12/31/2017*	*12/31/2018*	*12/31/2019*	*12/31/2020*	*12/31/2021*	*12/31/2022*	*12/31/2023*	*12/31/2024*	*12/31/2025*	*12/31/2026*
Net Income to Common Shareholders'	$1,942	$1,882	$2,273	$2,356	$2,470	$2,816	$3,259	$3,266	$3,428	$3,584	$3,743
% Growth	*9.22%*	*(3.09%)*	*20.78%*	*3.66%*	*4.84%*	*13.99%*	*15.72%*	*0.23%*	*4.95%*	*4.57%*	*4.42%*
Dividends	**$475**	**$499**	**$634**	**$842**	**$1,059**	**$1,300**	**$1,540**	**$1,789**	**$2,004**	**$2,153**	**$2,255**
% Growth	*28.03%*	*4.98%*	*27.15%*	*32.86%*	*25.71%*	*22.73%*	*18.52%*	*16.14%*	*12.05%*	*7.42%*	*4.73%*
% Payout	*24.46%*	*26.50%*	*27.89%*	*35.75%*	*42.87%*	*46.15%*	*47.27%*	*54.77%*	*58.48%*	*60.07%*	*60.25%*
Return on Equity	8.29%	7.97%	9.04%	8.84%	8.80%	9.51%	10.41%	10.43%	10.45%	10.48%	10.50%
Total stockholders' equity - EOP	23,437	23,618	25,154	26,668	28,079	29,595	31,313	32,790	34,214	35,645	37,133
Less: Goodwill	(6,337)	(6,337)	(6,337)	(6,331)	(6,331)	(6,331)	(6,331)	(6,331)	(6,331)	(6,331)	(6,331)
Plus: Other	886	704	905	799	799	799	799	799	1,649	2,049	1,799
Tier 1 Capital - EOP	17,986	17,985	19,722	21,136	22,547	24,063	25,781	27,258	29,532	31,363	32,601
Tier 1 Capital Ratio	*10.80%*	*10.28%*	*11.15%*	*11.79%*	*11.73%*	*11.16%*	*10.47%*	*10.23%*	*9.99%*	*9.74%*	*9.50%*
Dividend Discount Model Calulations											
Discount Factor (Assumes Mid-year Adjustment)				*96.25%*	*89.17%*	*82.60%*	*76.52%*	*70.89%*	*65.67%*	*60.84%*	*56.36%*
Present Value of Dividends				**$811**	**$944**	**$1,074**	**$1,179**	**$1,268**	**$1,316**	**$1,310**	**$1,271**

Source: Company filings; Pace SMIP estimates

As always, the terminal value is the present value of all future dividends discounted to the present at a rate that reflects the riskiness of achieving these cash flows.

Figure 11 – SunTrust Terminal Value Calculations

Perpetuity Growth Method	
Dividend Growth Rate	**4.00%**
Dividends$_{(t+1)}$	2,345
Terminal Value	59,450
Present Value of Terminal Value	33,507
Cumulative Present Value of Dividends	9,173
Equity Value	42,680
Shares Outstanding	469,137
STI Value Per Share	**$90.97**
Market premium / (discount) to fair value	*(21.60%)*

Exit Multiple Method	
Terminal Year Shareholders' Equity	37,133
Exit Multiple (Price / Book)	**1.82x**
Terminal Value	67,624
Present Value of Terminal Value	36,684
Cumulative Present Value of Dividends	9,173
Equity Value	45,857
Shares Outstanding	469,137
STI Value Per Share	**$97.75**
Market premium / (discount) to fair value	*(27.04%)*

Source: Pace SMIP estimates

Our target price is a reflection of both implied equity values. Due to the sensitivity of underlying growth assumptions in the perpetuity growth method, we have placed a greater weight on the exit multiple methods for our target price.

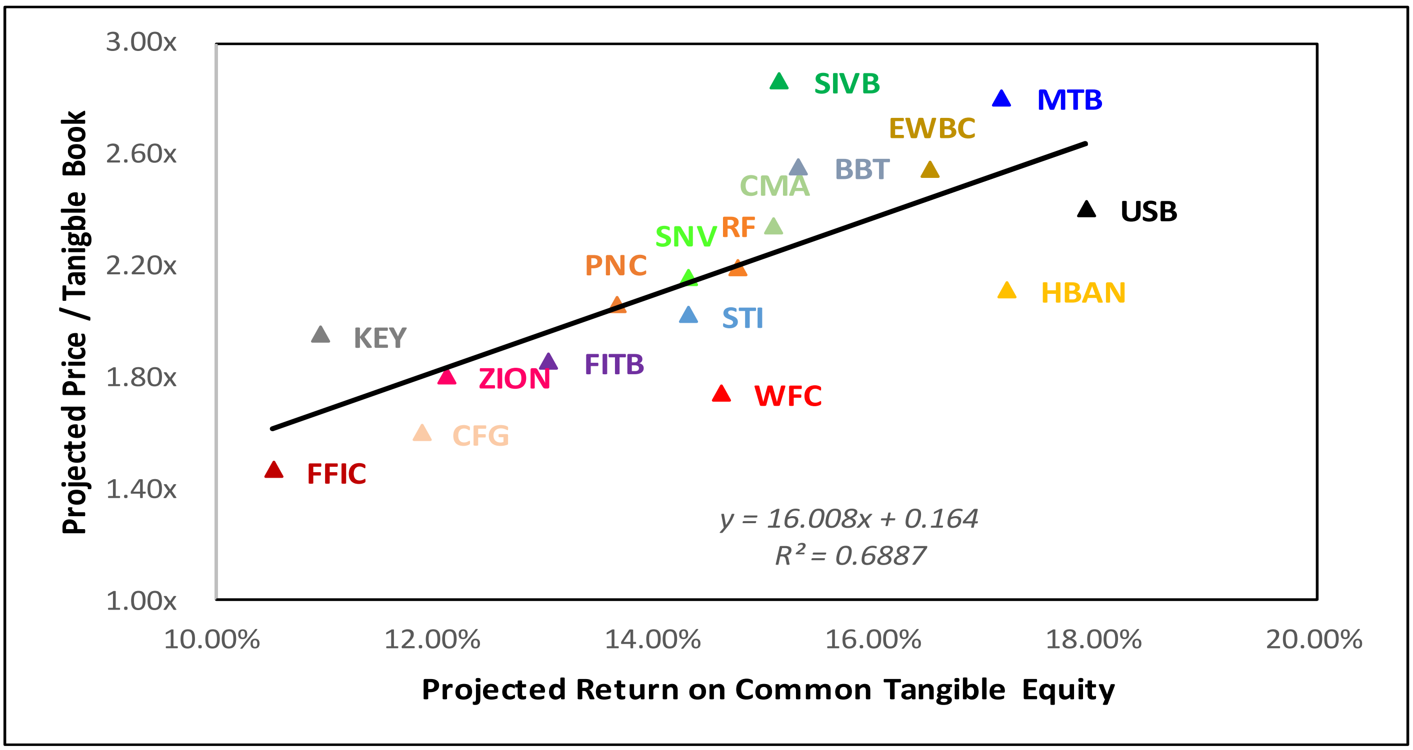
Regression Analysis

As a final valuation check, we also examined the output of a Regression Analysis which examined the SunTrust's peer group. The analysis explores the relationship between projected ROTCE for FY 18 and projected P/TBV for FY 18.

- **Peer group:** The same peer group used to the relative valuation analysis is used for the regression analysis. R^2checks for the variation between the dependent variable (projected P/TBV) and the independent variable (projected ROTCE). A higher R^2implies that these firms are related as comparable companies, while a lower R^2implies unrelated firms.

- **Assumptions:** The model assumes better performing banks will trade at higher multiples, while poorly performing banks will trade with lower multiples. The purpose of this method is to derive an implied multiple for SunTrust based on this statistical analysis.

Figure 12 – SunTrust Regression Analysis



Source: Bloomberg; Pace SMIP estimates

As shown above, STI appears to be significantly undervalued when utilizing this method. Using this method, the regression analysis has implied a P/TBV multiple of 2.45x, which can roughly be considered the multiple of the designated peer group. Using this multiple, we have derived an equity value per share of $86.47.

For our target price, we have placed a greater emphasis on this methodology rather than the intrinsic value multiples, due to their sensitivity to assumptions. On the other hand, due to the reliance on forward-looking multiples in the regression analysis, this method has less weight on our target price compared to the relative valuation method.

Target Price

We have a target price for SunTrust of $89.95, while its current price is $71.32. Our target price is based on each of our valuation methods weighted against its relative sensitivity of each method.

Figure 13 –SunTrust Target Price

Target Price Valuation Weights			
Valuation Metrics	**Weighting**	**Value**	**Comments**
Relative Valuation (Price / Book)	35%	$88.04	Trading Comps valuation are based on how they are trading on the market. Not manipulated by assumptions or synergies.
Perpetuity Growth Rate Method	15%	$90.97	Overall, intrinsic valuation methods tend to lead to higher valuations due to senstivity in modeling assumptions.
Exit Multiple Method	20%	$97.75	While sensitive to modeling assumptions, this method removes
Regression Analysis	30%	$86.47	Removes reliance on forecasting assumptions; however, still utilizes forward looking multiples based on market consensus
SunTrust Target Price		**$89.95**	

Source: Pace SMIP estimates

The Dividend Discount model is given the least amount of weight due to the over-optimistic projections analyst tend to provide, leading to higher valuations.

The Exit Multiple Method suffers from the same problem in the overly optimistic forecast. However, instead of using an arbitrary dividend growth rate, this method uses a terminal value multiple which is derived from a comps analysis. For this reason, we've given the Exit Multiple Method more weight than the Perpetuity Growth Rate Method.

The Regression Analysis Method eliminates the issue of overly optimistic forecast; however, it still relies on forward looking metrics such as the ROTCE and T/PBV

Relative Valuation (using the P/BV multiple) usually produce the lowest valuations, due to its reliance on only market derived multiples. Considering this feature, we have given this method the greatest weight.