

S&P Global

Market Intelligence

Premier Financial Corp.

NasdaqGS:PFC

Earnings Call

Wednesday, July 26, 2023 4:00 PM GMT

CALL PARTICIPANTS	2
PRESENTATION	3
QUESTION AND ANSWER	6

Call Participants

EXECUTIVES

Gary M. Small

President, CEO & Director

Paul D. Nungester

CFO & Executive VP

ANALYSTS

Brendan Jeffrey Nosal

*Piper Sandler & Co., Research
Division*

Michael Anthony Perito

*Keefe, Bruyette, & Woods, Inc.,
Research Division*

Presentation

Operator

Good morning, and welcome to the Premier Financial Corp. Second Quarter 2023 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded. I would now like to turn the conference over to Paul Nungester with Premier Financial Corp. Please go ahead.

Paul D. Nungester
CFO & Executive VP

Thank you. Good morning, everyone, and thank you for joining us for today's second quarter 2023 earnings conference call. This call is also being webcast, and the audio replay will be available at the Premier Financial Corp. website at PremierFinCorp.com.

Following our prepared comments on the company's strategy and performance, we will be able to take your questions. Before we begin, I'd like to remind you that during the conference call today, including during the question-and-answer period, you may hear forward-looking statements related to the future financial results and business operations for Premier Financial Corp.

Actual results may differ materially from current management forecasts and projections as a result of factors over which the company has no control. Information on these risk factors and additional information on forward-looking statements are included in the news release and in the company's reports on file with the Securities and Exchange Commission.

I'll now turn the call over to Gary for his opening comments.

Gary M. Small
President, CEO & Director

Thank you, Paul, and good morning to all. Thank you for joining us. On behalf of the Premier team, I'm pleased to announce second quarter earnings of \$1.35 per share with \$0.68 of the earnings falling into the core operating category and another \$0.67 per share, resulting from a well-executed sale of our First Insurance Group agency.

Coming out of our first quarter call, we shared our expectations for a more normalized quarterly core earnings range, and our team worked very hard to deliver on that expectation over the quarter. First, to comment on the First Insurance Group transaction. The genesis for the sale emanated from a strategic assessment of each of Premier's core business segments, taking into account earnings growth trajectory, effective capital utilization and operating execution management.

While the agency's financial performance has been consistently strong and currently on par with the industry, from a strategic perspective, we felt we could achieve a higher return on capital and better position the agency to achieve its potential by pursuing alternatives in today's very dynamic agency valuation environment. The net result, an excellent bump in Premier's reported current earnings for the quarter a \$1.37 increase in tangible book value per share and all with no EPS dilution effect on a go-forward basis. We improved capital and liquidity, and we're well positioned to support future growth in our core banking businesses, a win on all fronts.

I'll now move to Premier's banking performance highlights for the quarter. We continue to see commercial opportunities in the market that are being very selective. We stay focused on supporting our existing clients along with targeted C&I opportunities. Annualized loan growth totaled in excess of 8% for the quarter and the commercial loan growth was 7% on the same annualized pace, with C&I representing 49% of our new business origination during the quarter.

Total deposits grew 3% in absolute terms with a slight drop in customer deposits over the course of the quarter. We continue to see migration of deposits to higher earnings products consistent with the industry. We are having success in neutralizing the effect of prior deposit premium offers upon repricing, while at

the same time attracting new money with higher rate offers primarily in the time deposit category. The core noninterest income category was up 9.4% versus the second quarter of last year with wealth and deposit-related fee income reporting high single-digit increases. Targeted expense reduction initiatives are on track with full quarter effects on the reductions to be felt over the remainder of the year.

Loan portfolios continue to perform well, NPA and delinquency numbers are in check, very much solid with the 4-quarter averages, and we were in a net recovery position from a net charge-off perspective for the quarter. Consistent with expectations, we said on our call last quarter, we engaged in hedging activity in early June, which will provide a near-term boost to net interest income, while also protecting margin from unfavorable impacts of future Fed funds rate increases.

We've also taken additional steps in rightsizing our residential mortgage operation given the continued softness of the business. In doing so, trims our expectations for balance sheet growth in the President's Portfolio segment, our unfunded construction commitments are down 70% versus this time last year.

And with that, I'm going to turn it over to Paul for some more details.

Paul D. Nungester
CFO & Executive VP

Thank you, Gary. I'll begin by describing a couple of important transactions during the quarter. First, on June 30, as Gary said, we completed the sale of First Insurance Group to Risk Strategies Corporation. This sale generated a significant gain of \$36.3 million before transaction costs of \$3.7 million and taxes of \$8.5 million, representing \$0.67 of EPS. The transaction strengthened capital by increasing tangible equity \$48.8 million through the net gain and recovery of \$24.7 million of goodwill and intangibles, which added 54 basis points or \$1.37 of tangible value.

We had a full quarter of operations in 2Q and going forward, the utilization of proceeds will effectively offset the agency's pretax earnings then become accretive as they are deployed in the loans. Separately, we completed a series of balance sheet hedges during June to improve asset sensitivity and provide some protection against additional rate increases. These hedges were all pay fixed, receive variable swaps, including \$250 million of 2-year and \$250 million of 3 years. These swaps carry an average 4.12% pay rate and are expected to generate \$4.7 million of annualized pretax net interest income as of June 30.

Going forward, each 25 basis point increase in SOFR is expected to generate an additional \$625,000 of annualized pretax net interest income, including the net impact of these new swaps and our prior \$250 million notional received fixed pay variable swaps. Including the impact of all swaps, we now estimate that each 25 basis point increase in the federal funds rate could reduce annualized pretax net interest income by approximately \$0.5 million based on our June 30 balance sheet compared to \$1.5 million as of March 31.

For the balance sheet, capital levels improved significantly during the quarter, in part because of the FIG sale. Tangible equity increased 8.4% in dollar terms, and our TE ratio improved by 52 basis points to 7.55%, including AOCI, or 9.6% excluding AOCI. Our regulatory ratios also increased and they all continue to exceed well-capitalized guidelines, including the impact of AOCI. Credit quality was steady, including a net decrease in criticized loans and net recoveries for the quarter.

Total deposits increased by 3.25%, primarily due to an increase in brokered deposits. We also experienced an impactful mix migration during the quarter including a \$155 million net decrease in savings, demand and noninterest-bearing deposits, mostly offset by a \$117 million increase in money market time and public fund deposits as customers look for higher deposit yields. Total liquidity improved during 2Q with quantifiable sources increasing more than \$360 million to \$2.8 billion, including \$1.5 billion of FHLB borrowing capacity at June 30.

The increase was primarily due to successfully expanding our capacity at the Federal Reserve by more than \$300 million in the second quarter via the borrower and custody program. Separately, our level of uninsured deposits declined to 31.5% or 17.3% when adjusting for collateralized deposits such as OPCS, and other insured deposits such as the Indiana PDIF.

As a result, our total liquidity was 230.5% of adjusted uninsured deposits at June 30. Primarily due to the deposit mix migration I previously mentioned, we experienced additional NIM compression during 2Q. Interest-bearing deposit costs increased 38 basis points to 1.69% for 2Q, which was primarily due to higher utilization of broker deposits and increased rates for public ICS, CDARS accounts, money market accounts and time deposits as customers migrated for the yield. Excluding brokered deposits and marks accretion, average interest-bearing customer deposit costs were 2.08% during June for a cumulative beta of 37%, up from 35% in March compared to the change in the monthly average effective federal funds rate, which increased 500 basis points to 5.08% from December 2021.

Net interest margin was positively impacted by the combination of previous loan growth and higher loan yields, which were 4.86%, up 20 basis points from first quarter. Excluding the impact of PPP and yields were 4.89% in June 2023 for an increase of 108 basis points since December 2021. This represents a cumulative beta of 22% compared to the change in the monthly average effective federal funds rate for the same period. However, deposit costs outpacing loan yields led to the compression of net interest income and margin during the second quarter.

Next, excluding the \$36 million FIG gain, noninterest income was \$17.1 million for 2Q, up 36.8% or \$4.6 million from 1Q. This increase was primarily due to a lack of security losses and a \$3.2 million increase in mortgage banking income, primarily due to an increase in hedge valuations. Excluding \$3.7 million of transaction costs for the FIG sale, expenses were \$40.8 million, down \$2 million or 4.6% on a linked-quarter basis, primarily due to cost saving initiatives we began implementing during the second quarter.

For the full year, we now expect total core expenses of approximately \$158 million down \$5 million from our prior estimate, including \$6 million from FIG, offset by \$1 million of other costs like higher FDIC premiums. Overall, we are pleased with our core performance in the second quarter. Excluding the impact of the FIG sale, pretax pre-provision income increased \$4.2 million or 16% on a linked-quarter basis or a 1.41% return on average assets.

Net income increased \$6.1 million or 33.5% or 1.13% return on average assets and EPS increased \$0.17 or 33% to \$0.68. As we look forward, positive momentum includes the deployment of FIG sale proceeds and the earning assets, the full impact of the swaps completed in June and the continued execution of our cost-saving initiatives. Headwinds include the continued inverted curve environment with the potential for further rate increases, additional deposit mix migration or runoff and possible changes in the regulatory front that could lead to increased costs such as even higher FDIC premiums.

That completes my financial review, and I'll now turn the call back over to Gary for his closing remarks.

Gary M. Small

President, CEO & Director

Thank you, Paul. I'll share some thoughts for the remainder of the year that will helpfully be hopeful in your modeling work. I would stick with the average earning asset growth of 4%, which we said earlier in the year, I do expect the second half will be much less robust than the first half. Customer positive growth 2% range plus for the remainder of the year. We do expect some additional margin compression driven by our deposit mix movement much more moderate quarter-to-quarter movement than we saw in Q2. Revised noninterest income figures adjust quarter 3 and 4 downward by \$4 million each to reflect the FIG transaction and revised expense expectations downwards by \$5 million in total for the remainder of the year for the same rationale.

I will note that without FIG of the part of the organization, our efficiency ratio improves about 240 basis points. From a loss provision perspective, we're expecting no more than 5 to 8 basis points in net charge-offs for the remainder of the year.

And with that said, operator, we'll turn it over for questions.

Question and Answer

Operator

[Operator Instructions] So our first question comes from the line of Michael Perito of KBW.

Michael Anthony Perito

Keefe, Bruyette, & Woods, Inc., Research Division

I wanted to start on just the kind of the incremental spread or margin, Gary or Paul, whoever wants to take a stab at it. Kind of curious, you mentioned it doesn't sound like the balance sheet should grow a ton in the back half of the year, Gary, based on the earning asset guidance of 4% for the full year. I kind of suggest my rough math was pretty flat from here. So just wondering, I'm sure you're still going to be originating loans and trying to bring on new customer deposits. So just how do we think about kind of the incremental spread of what you're targeting for the back half of the year? And then how does that kind of trickle down to the NIM, which it sounds like you guys expect compression to moderate relative to the first half of the year based on what you're seeing in the first few weeks of the third quarter and the end of the last quarter, I should say.

Paul D. Nungester

CFO & Executive VP

Yes, Mike, you got that right there. So we are projecting minimal additional growth on the asset side through loans and a good portion of that, as we've seen in the last couple of quarters even comes from the existing commitments on construction lines and things like that, but those are slowing down as they've been burning down, right? But we've been cutting back on production in mortgage, especially in even to some extent on the commercial front, although we're always looking for the best deals there. So we've definitely had the commercial teams, especially understanding the environment in terms of pricing loans, right, to get the appropriate spreads. So thinking about our incremental cost of borrowing being our kind of base these days and the -- definitely starting with a 5 there and then the spread on top of that.

So new loans coming in the front door in the 7, 8 even 9 to some extent. But also trying to focus a lot on the C&I piece of it instead of either fixed or adjustable. So we've been making good progress on that. I think it's -- it's in the 40% for the origination front on our commercial in terms of the C&I business there. And obviously, those would continue to float out if rates were to continue to increase from here as well.

In terms of overall NIM then, Mike, if we maintain what we just said in terms of the asset growth and bring those in at an appropriate spread as well as succeed on some of our initiatives on the deposit front and most importantly, the recent trends, while we had a lot of mix migration in the quarter, it was predominantly early in the quarter. Our monthly NIM was within a few basis points of each other, April, May and June. So that migration had an early impact and then kind of settled down. And if that were to continue, that would help with some stabilization to NIM.

Our expectation would be that some of that would continue. So we could see a few more bips out of it, but absent major movements.

Gary M. Small

President, CEO & Director

Mike, we'll have 2 unique items that are true for third and fourth quarter that weren't true so much for the first 2 quarters.

One will, you'll see some margin movement just based on the FIG transaction, converting all that to cash and what it does relative to our liquidity and the 5% borrowing that Paul mentioned. And also the hedging activities that we got into. Certainly, we're looking at, in today's environment, meaning this month with rates as they are and so forth, that's a \$400,000 plus a month sort of improvement to the numbers. So when we look at the second half, the combination of those 2, probably \$4 million more in net interest

income, it hasn't got so much to do with portfolio loan balances and the mix changes of the deposit base. Little tailwind there, right?

Michael Anthony Perito

Keefe, Bruyette, & Woods, Inc., Research Division

No, that's all really helpful. I guess just as a kind of a high-level follow-up, Gary. I mean at what point does it make sense? I mean does the balance sheet growth not turn back on until you guys can comfortably be generating kind of 3% incremental spreads like to get that margin back up to 3% and above? I mean it makes sense to just hold flat until the environment is kind of supportive of that? Or how do you guys think about that nature? Because I mean you guys are still -- you still have the same team of lenders, right? There's still opportunities to take share. I mean I imagine that hasn't changed. It's just you guys being a little bit more deliberate than what you're willing to look at. So when does that switch -- or why would that switch turn? Is it just the incremental spreads? Is it macro? Is it credit? Like what are some of the considerations you guys take as we think about that moving forward?

Gary M. Small

President, CEO & Director

The spreads are a little bit more the result of the activity. We do have other constraints that we put on ourselves like our loan-to-deposit ratio and so forth. We've got a reasonable amount of borrowed money right now through a Federal Home Loan Bank, and we're using broker. And we're trying to be conservative, if you will, relative to how much we would move the balance sheet before we were feeling stabilized in those categories as well. So it's more about capacity that will free ourselves up with. And we mentioned we're stepping -- have stepped away from the mortgage business and so forth. That will create capacity for the commercial group.

Retail, indirect auto and so forth, those are the things you step away from at a time like this, and we have, and you see that in the consumer numbers trending slightly down. And that's the way we'll create capacity. And I think as Paul was mentioning, the loans are going on at 8%. So even at the worst borrowing rate, we're still making 3% on it. It's more about some of those other balance sheet factors that we want to make sure we can get in a nice predictable and safe position or maintain that position, that's probably our first -- first thing on our mind when we're thinking about growth. We had 20% loan growth last year. So we really got to digest and get the right side of the balance sheet in as good a shape as we've got the left side of the balance sheet at so...

Michael Anthony Perito

Keefe, Bruyette, & Woods, Inc., Research Division

Makes sense. Just 2 last quick ones for me. Just you guys kind of talked about it a little bit, but are you willing to share any kind of budgeting expectations around mortgage gain on sale for the back half of the year? And then just secondly, I know that the insurance sale impacted the tax rate this quarter. Paul, do you have kind of an accrual rate for the back half of the year that you guys are running that we should be using? Thank you.

Paul D. Nungester

CFO & Executive VP

Yes, I'll answer that last 1 there first, real quick, Mike. So when you excluded the impact of the FIG transaction, it's -- our effective tax rate is around the 19% level. Consistent with kind of our historical patterns, right?

Gary M. Small

President, CEO & Director

Yes, that was the incremental rate on the FIG transaction because of the difference in tax basis is and so forth, was like 25%. So how we back into the \$0.68 normalized.

Paul D. Nungester

CFO & Executive VP

Yes.

Michael Anthony Perito

Keefe, Bruyette, & Woods, Inc., Research Division

And then on the mortgage.

Paul D. Nungester

CFO & Executive VP

Yes, mortgage.

Gary M. Small

President, CEO & Director

Mike, I think if you took the 2 quarters just reported and split them in half, that would be about your expectation going forward for the following 2 quarters.

Michael Anthony Perito

Keefe, Bruyette, & Woods, Inc., Research Division

So about \$3 million in the back half of the year, give or take?

Gary M. Small

President, CEO & Director

Give or take yes.

Operator

[Operator Instructions] Our next question comes from the line of Brendan Nosal of Piper Sandler.

Brendan Jeffrey Nosal

Piper Sandler & Co., Research Division

Just wanted to walk through your thought process behind adding the hedges this quarter after rates have already risen so much, yes. I guess, on the one hand, you get an immediate interest income benefit today with lower upside, should rates move higher. But on the other hand, it stands to reason if rates fall, you're kind of giving up a little bit of the recapture on the margin with rates down as well. Just kind of walk through the puts and takes and why now is the right time to add these hedges?

Gary M. Small

President, CEO & Director

I'll let Paul comment on that and then I may have a follow-up.

Paul D. Nungester

CFO & Executive VP

Thanks, Brendan. Yes, it's a fair question. A couple of things there. As you noted, yes, we get the immediate accretion, right, out of that trade, which is a benefit to NIM and PPNR there, plus the -- it helped stabilize NIM as we're alluding to earlier. It does give us some protection as rates continue to rise here. We're expecting to hear 25 bps from the Fed here soon, and we'll see if there's any more from there if they truly settle in. But stepping back from it, Brendan, the issue with it is you're going to do it, you've got to do it when you've got the benefit. So the opportunity -- while you can only do a swap rate, right, the spreads weren't there, the differences between the current and the expected future curve weren't where they were when we did the execution.

So we could have done it certainly quarters earlier or even a year earlier, but the benefits were there at the time. It wasn't until -- there was describe between what the market was expecting in terms of near-term rates possibly dropping and what the Fed continues to talk about in terms of higher for longer. That created the opportunity that's when we stepped in. We got the immediate benefit, which is almost \$5

million annualized here, which will be a near-term benefit. And then if it does continue to rise, we'll just continue to benefit from that even more.

And then in terms of our exposure, that's why we kept them short, right? So we didn't go out too long on this. We kept them in the 2- to 3-year range for now to deal with the near-term horizon that we foresee these rates being at the elevated level and those will roll off then and if rates have fallen by that point, which is certainly a long-term expectation for us, then we'll just have the old one which will be back into a positive initiative at point and continue to benefit on that side.

Gary M. Small

President, CEO & Director

I think when you look at the [indiscernible] now, we do believe higher for longer as the Fed position in this first year will be in the money. And to the extent the swap markets and the market expectations and what it looks like in year and 2, 3 come to bear, the swap itself will lose its positive aspect. But the rest of our portfolio will benefit in such a great way from the retreat, if you will of that, it will neutralize it. And then by the end of the second year, we'll all just be left with the lower -- the lower rates that come from that high beta dollar. So puts and takes on that.

In a perfect world, if I had my wizard hat on back in first quarter '22, I would have gone under water and paid for 500 basis points of protection. But to Paul's point, as we were going through the year, the swap curve versus our balance sheet at the time it never seemed advantageous not to do it. I will also say that we're probably about 6 weeks later on the trade than we initially planned to be we were ready to move and we lost our price window waited another couple 3 weeks before we have computed to see if it would come back. But it was never going to be before the beginning of April for us.

Brendan Jeffrey Nosal

Piper Sandler & Co., Research Division

Okay. Really appreciate the thoughts there on a more complicated moving piece. Maybe 1 more follow-up on the same topic. Does this hedge materially change how fast you will recapture AOCI on the securities book and average down scenario presumably brakes down the fair value of these hedges would decline. So how much of securities you captured to that counter?

Paul D. Nungester

CFO & Executive VP

Yes. No, the swaps themselves don't make a big difference to the potential AOCI accretion that's predominantly from the securities book. We've run some numbers, and we're looking at -- if rates stay where they're at a curve plays out as of the June 30 curve. We've got potential accretion of 23% of the AOCI pool, most of them that from securities and that would be another \$1.08 of tangible coming in over the next 6 quarters by the end of next year.

Operator

As there are no additional questions at this time, I'd like to hand the conference call back over to Gary Small for closing remarks.

Gary M. Small

President, CEO & Director

Well, again, thank you all. It's been another interesting quarter for seasonal results. Appreciate your interest in the organization and look forward to more good news next quarter. Thank you very much.

Operator

Ladies and gentlemen, this concludes today's Primary Financial Corp. Second Quarter 2023 Earnings Conference Call. Thank you for joining. You may now disconnect your lines.

Copyright © 2023 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

© 2023 S&P Global Market Intelligence.