Premier Financial Corp.

Third Quarter 2021 Earnings

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CORPORATE PARTICIPANTS

Gary Small - *President and Chief Executive Officer*

Paul Nungester - *Executive Vice President and Chief Financial Officer*

Matt Garrity - *Executive Vice President, Chief Lending Officer and Head of Residential Lending*

PRESENTATION

Operator
Good day and welcome to the Premier Financial Corporation Third Quarter 2021 Earnings Conference Call. All participants will be in a listen-only mode.

Should you need assistance, please signal a conference specialist, by pressing the "*" key, followed by "0". After today's presentation, there will be an opportunity to ask questions.

To ask a question, you may press "*", then "1" on your touchtone phone. And to withdraw your question, please press "*" then "2". Please note this event is being recorded.

I would now like to turn the conference over to Paul Nungester, CFO. Please go ahead, sir.

Paul Nungester
Thank you, Chuck. Good morning, everyone. And thank you for joining us for today's Third Quarter 2021 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 available 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 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.

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

Gary Small
Thank you, Paul, and good morning to all. We appreciate you joining us, today. I'll start off by stating that macroeconomic indicators across our market continue to be positive. Order boards are in good shape for our clients and supply chain issues are not proving to be overwhelming or, at least, unsolvable for the majority of the folks we do business with.

We maintain a very positive outlook, only tempered by the typical uncertainties coming out of Washington, lingering COVID impacts and a tough employment environment. The spike in current costs are certainly real, but not a detriment to business, at this point.

We at Premier are pleased with the third quarter performance, and we had many strengths that were reflected in the numbers for the quarter. We reported $28.4 net income, $0.76 per share, which for us from our perspective, gave us a strong 1.49% return on assets and 16.7% return on tangible capital. And we'll be fine with each of those numbers.

Strong pre-tax pre-provision return at 1.91% return on assets, as well. We had solid core loan growth north of 5%. Our core margin was up 7 basis points and we returned to our more typical residential mortgage contribution for the quarter, as we telegraphed on our last quarter's earnings call.

Commercial activity is very robust. New business book for the quarter and the commercial loan pipeline each remained very strong. The existing commercial line draw down rate saw slight improvement versus the second quarter, but it remains well off normal levels.

Expenses for the quarter were a bit higher than expectation, driven by healthcare benefit costs. We are self-insured, so we feel the impact of cyclicality and any high impact incidences as incurred, and it makes for more uneven figures from quarter to quarter. No trend should be inferred from Q3's numbers.

The loan portfolio, as a whole, continues to perform, well. Low delinquencies continued to experience low MPLs, in general. However, during the quarter, we did move a single relationship to nonaccrual status, returning our non-performing staff back to a range that we experienced at the end of 2020, the relationship had moved to classified status, earlier in this year.

Our portfolio quality indicators remained strong, and we're in familiar and very manageable territory. This particular relationship is current, and it did not participate in COVID deferral programs that were available, over the last 18 months.

They faced challenges due to an interruption of business on significant government contracts that remain affected by COVID related policy decisions. Matt Garrity will touch on this more in his comments. At this point, I'll turn it back over to Paul to cover a few more performance details.

Paul Nungester
Thank you, Gary. I will review our third quarter and year to date results. Beginning with the balance sheet, deposits were less than 1--were down, less than 1.1% point to point, as customers have begun using funds with the end of stimulus programs.

The mix also declined, as businesses continue using liquidity, but we still managed to reduce our all-in cost of funds, which dropped another 2 basis points to 0.24% this quarter, largely due to further reducing our total deposit costs down to only 20 basis points.

For assets, we generated over $64 million of core loan growth, or 5.1% annualized this quarter, led by commercial which Matt will discuss, shortly.

In addition, we are very pleased by our NIM expansion, which rose 4 basis points on a reported basis, or 7 basis points to 3.27% when excluding PPP, and purchase accounting marks amortization.

Next is the allowance, which increased $1.8 million, due to a provision expense for loans of $1.6 million and net recoveries of $256,000. This increase is primarily related to an increase in specific reserves for one commercial relationship that turned non-performing during the quarter, plus growth in non-PPP balances, but then mostly offset by further improvement in economic forecasts and a lack of charge offs.

At September 30, our allowance coverage excluding PPP loans, and including acquisition mark was 1.57%, flat from 6/30 but still not back to pre-pandemic levels yet, which were 1.21% under CECL pre-pandemic and excluding marks from the UCFC merger.

Finishing the balance sheet is capital where we ended 3Q with over $1 billion of equity with a quarterly increase primarily due to net earnings in excess of dividends. We also completed about 206,000 of share buybacks for $6 million in the quarter.

At September 30 our tangible equity ratio was 9.9%, excluding PPP loans, and total risk-based capital was about 13.7%.

Next, I'll turn to the income statement starting with net interest income of $57 million, which is up 1% on a linked quarter basis. Excluding the impact of marks and PPP, our net interest margin was 3.27%, up from 3.20% in the second quarter. This is consistent with or slightly better than our expectation, driven by the rebound in loan growth, plus having a full quarter benefit of a swap we executed in the middle of 2Q. We expect NIM to generally remain at this level and, hopefully, continue to tick up slightly, as loan growth continues.

Non-interest income was $18.3 million for 3Q, which is up from prior quarter but down from prior year, primarily due to mortgage banking. Mortgage gains were $5.4 million in 3Q, which is up $2.7 million from 2Q but down $8.5 million from third quarter, 2020.

As discussed last quarter, total mortgage production continues to meet expectations and the increase from last quarter was due to our expected improvement and saleable mix. Additionally, we saw a slight rise in the 10-year, which increased from 1.45% at June 30 to 1.52% at 9/30.

So, we had $0.8 million gain in the MSR valuation, after the $0.5 million loss in 2Q when the 10-year dropped.

Overall, we had a $4 million improvement mortgage banking on a linked quarter basis. But much of that was offset by some declines and other lines of business, including insurance and wealth, plus we had that $1.3 million nonrecurring item in other income, last quarter.

Next is expenses which were up to $39 million, 1.7% on a linked quarter basis. As mentioned last quarter, we began addressing run rate items starting in the latter half of 2Q, which continued to help in 3Q. But there are also some items like costs related to ATM and debit card usage that have benefits up in revenues, as seen by the strong performance and service fees.

However, this quarter, we again saw a spike in medical benefit costs, similar to what we experienced in the first quarter, which led to the overall increase in expenses for this quarter. Given this trend, we now estimate full year expenses to possibly end higher than previously expected, or around $155 million.

Our year-to-date efficiency ratio is now slightly above 50% at 50.5% and could potentially be around that level for the full year. Separately, our third quarter pre-tax pre-provision income was over $37 million, which again led to a strong 1.9% ROA for 3Q and 2.1%, year-to-date.

Bottom line, we reported net income of $28 million, or $0.76 per share for third quarter 2021, just generally consistent with our expectations, due to the good guys and provision in NIM, offset partly by higher expenses.

That completes my financial review. And I'll now turn the call over to Matt for a discussion of lending and credit.

Matt Garrity
Thanks, Paul. I'll be providing an update on our commercial and residential mortgage areas, as well as an update on asset quality. In our commercial business, we were able to achieve balanced growth in the third quarter, consistent with second quarter growth levels, while overall loan production activity showed continued momentum.

Loan production for the third quarter improved by over 25%, compared to the second quarter, driven by continued improvement in the C&I lending category.

C&I loan production, as a percentage of total loan production, was 48.8% in the third quarter and while production mix will vary from quarter to quarter, we are starting to see more consistent performance in the C&I category.

In terms of loan growth, when excluding the effects of PPP, commercial balance growth continued at a 4.4% annualized pace in the third quarter. Growth for the quarter was impacted somewhat with the timing of loan payoffs.

In addition, we continue to see relatively low levels of line utilization and we will benefit when more normal levels of utilization return.

As we look forward, pipeline levels are at their highest level since the merger with strong activity in all of our markets, and we expect commercial loan growth for the fourth quarter to be more robust than what we have seen the last two quarters.

In our residential mortgage business, we were pleased with our improved performance in terms of mortgage banking revenue with loan production levels remaining solid in a very competitive operating environment.

Mortgage banking gain on sale rebounded solidly in the third quarter of 2021, when compared to the prior quarter, as we were able to improve our saleable mix as Paul mentioned earlier, while maintaining our margin expectations. Looking ahead, we expect the current competitive operating environment to be with us during the fourth quarter and into the first half of 2022.

As we've stated on previous calls, we view residential mortgage as a business we will continue to invest in and steadily grow.

With respect to asset quality, we saw improvement in several asset quality indicators, while non-performing loan levels increased during the third quarter. Criticized and classified loan levels improved by 9.8% and 11.1%, respectively, when comparing the third quarter of 2021 to the prior quarter, while we experienced another quarter of net recoveries with respect to charge offs.

Non-performing loans increased by approximately $18.6 million in the third quarter, driven primarily by the designation of a previously classified single C&I relationship into non-performing status.

While we continue to work with the client and although the client remains current on their contractual payments, current circumstances warranted the non-performing designation, and we are properly reserved for the credit, at this time.

As we have discussed on previous calls, we believe any credit challenges we see in the portfolio are going to be more episodic in nature, just as the C&I loan we just mentioned to you.

We continue to work with all of our clients to navigate the current economic environment while monitoring our portfolio, closely.

I now like to turn the call back over to Gary Small, Gary?

Gary Small
Thank you, Matt. As we look forward to full year performance, given that we only have a few weeks to go, I'll limit my comments to a few items. As Matt noted, loan balances for the fourth quarter will continue to be strong, particularly, on the commercial side.

Residential mortgage activity enters into what we would think of as a seasonal period, in a typical year in Q4, at least versus Q2 and Q3 business levels. For Q4, the volume is good.

Pricing obviously remains very competitive, and if I were working the model, I guess I would expect the total mortgage related fee income to come in more in the $4 million range than what we experienced in the prior quarter.

From an expense standpoint, run rate for Q4, think we'd guide to 39-ish. We may experience something better than that. But let's wait and see.

From a capital standpoint, I would expect that you all should expect us to be--continue to be in the market from a repurchase activity perspective. We were fine with the level of activity we had in the third quarter. We would not be disappointed to have more on a per quarter basis, going forward.

And with that, I'll turn it back over to Chuck and we'll take calls.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question-and answer-session. To ask a question, you may press "*", then "1" on your touchtone phone. If you're using a speaker phone, please pick up your handset, before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press "*", then "2".

And at this time, we'll pause, momentarily, to assemble our roster.

And the first question will come from Scott Siefers with Piper Sandler. Please go ahead.

Scott Siefers
Good morning, guys. Thanks for taking the question.

Gary Small
Good morning, Scott.

Scott Siefers
Hey. First question I wanted to ask was just on the credit that moved to nonaccrual. I guess to the extent possible, maybe if you could discuss sort of what changed to make it, I think you said the circumstances warrant, which I can totally appreciate. But so what changed in your mind to take it from, I think you said criticized to nonaccrual?

And then I guess more importantly, just maybe any thoughts you can share with what gives you confidence that the reserve you guys have established is sufficient and any thoughts on will there be sort of an exit strategy for this or will it just sort of work out, over time?

Matt Garrity
Sure, Scott, this is Matt. I'll give you a couple of points here and, hopefully, I touch on your topics. The business is a student loan servicer. I think we've disclosed that, previously. As you had noted, we had classified this loan, earlier in the year.

And the business has certainly been impacted by a pause in a government contract, as a result of the COVID measures. And there's always expectations on when that pause was going to get lifted, during the year.

So, again, circumstances warranted as the year went on and as circumstances continue to change that we thought it was prudent during Q3 to move that loan into non-performing status; not atypical of a lending relationship in terms of how it would migrate.

In terms of the reserve, without getting into forward looking type of statements regarding this individual credit, we are comfortable with the reserve levels that we have, today.

We continue to work with the client and we're certainly partnering with the client, as they think about next steps and what exit strategies look like. So, we'll continue to monitor it and continue to work with the client and just stay on top of the details, as they evolve.

Scott Siefers
Okay, perfect. Thank you. And then switching gears a little maybe, Paul, when you talked about the margin being flat to up, you're talking about the sort of that core-core 327 ex-PPP and PAAs, right?

Paul Nungester
Correct-yeah

Scott Siefers
Okay. Perfect. All right, thank you.

Gary Small
Thank you, Scott.

Operator
The next question will come from Tim Switzer with KBW. Please go ahead.

Tim Switzer
Hey, good morning, I'm on for Mike Perrito. Thanks for taking my question.

Paul Nungester
Good morning, Tim.

Tim Switzer
I had a follow up kind of on the core NIM you guys are talking about. You had pretty good expansion this quarter, it looks like it should be able to at least sustain these levels. Could you talk about kind of the primary drivers behind this? It seems like both asset yields, and deposit costs are helping.

So, I was just curious on what the drivers are behind all those and then it seems like you're expecting even more deposit cost reductions, next quarter. Can you talk about where that's coming from? And I guess if you're able to quantify maybe how low deposit costs could go, that would be great.

Paul Nungester
Yeah, sure thing. So, the change for this quarter is a combination of a few things. One, we have a full quarter benefit of the swap that we talked about, last quarter. We only had a little bit of lift last quarter.

So, we got a couple more bips out of that here on a quarter-over-quarter basis, which is nice, two, with loan growth and bringing on those assets at, yields better than the existing average yields in the book, including rolling out of the securities that we had been doing earlier in the year, before loan growth came back. That helped provide some lift.

And then you're right, we did make some more progress on our cost of funds. Got that down again, primarily on the deposit costs front there. And I think we've kind of said it before, we're pretty much at the bottom on those.

We keep looking for pockets and if we find another bip or two or so out of that book, that'd be great. But we pretty much found what we could on that front. So, asset yields should start driving us back up, at this point.

Tim Switzer
Okay, and then improvement on asset yields is just going to be driven by loan growth, right? And can you talk about kind of how loan pricing is? You said they're coming on higher than what's actually on the book, right now.

Matt Garrity
Yeah, this is Matt. It's coming on at rates and yields above the NIM, and I would say from a pricing perspective, it's always a very-very competitive environment and really in all our businesses, but I would say it's stabilized. I would say the rate of decline on the rate side is tended to flatten out a little bit, and it's still ultra-competitive. And--but it seems like it's flattened out a little bit.

Paul Nungester
Right, right.

Paul Nungester
And we're referring, overall, to either NIM or the average asset yield because we are rolling out of securities, now. So, that's part of the lift, too.

Gary Small
By design, we ladder those securities so that we'd be able to exit as the loan portfolios picked up. So, we're swapping 100 basis points, 80 basis points stuff for true loan yields.

Tim Switzer
Okay, that that makes sense. Thank you. And then could I ask one real quick on your return of capital. You seem pretty focused on it with the buyback and increasing the dividend, as well. With your share price being a little bit higher than when you started the buyback this year, are you--would you--are you price sensitive at all, I guess this quarter?

Maybe the share price continues to rally higher and then I believe last quarter you guys said you're kind of hoping to glide down to like a 9%, 9.25%, TCE ratio ex-PPP, over time. Is that still kind of a good target for you? And I guess how quickly would you like to get there?

Gary Small
This is Gary, I'll make a general comment in reverse there. Yeah, 9.25% for the way our balance sheet is constructed right now, as far as mix would feel very good. I think without PPP, Paul, we're running close to 10%, and our projections would say if we don't manage our capital well, that's going to move deep into 10%, as we go through '22.

Buybacks have always been a part of the game, along with the dividend and keeping capital there for growth and acquisition opportunities. And we'll continue to play that balance game rather than over commit one direction or the other. I think over the course of this year, we're always price sensitive back to where you started. We wake up that way.

But having said that, that can't overrun our ability to redeploy the capital back to the shareholder or in the shareholders best interest, as long as it's at a reasonable earned-back rate.

And so, we're cognizant of that, and we're flexible on what those earned-back rates need to be in a reasonable way that match what's going on in the market. At the end of the day, we just will not let capital stack up and go underutilized.

Tim Switzer
Got it. All right, very clear. Thank you.

Operator
Again, if you have a question, please press "*", then "1". Our next question will come from Feddie Strickland with Janney Montgomery Scott. Please go ahead.

Feddie Strickland
Thanks, good morning.

Unknown
Good morning.

Feddie Strickland
I appreciate the color on expenses with respect to the health care benefit costs. But I was just curious, as you're out there looking to hire new talent. Are you seeing, incrementally, more competition from either a wage perspective, or I guess just what you're having to offer?

Gary Small
I'd say any, I call it the $22 and under entry level or near entry level. There's so much competition for those--the qualities that those folks have, we might have in the past, go back to pre-COVID, had a bit of an edge relative to benefits, work environment, professionalism of the environment, versus just a regular retail job, wherever it might be.

And certainly what we've all experienced across our market and across the broader set is the fact that jobs that might have rated lower on those qualities in the past are throwing dollars at folks to fill their gap. And so, you do have to be cognizant of that.

Having said that, we're not doing wholesale changes across the board to address in any way that would be noteworthy, but we're very cognizant of our up front.

And I wouldn't be surprised if we didn't see the industry as a whole, and we'd be included in that, make some small movement relative to P&L impact on the entry level roles. But we really have to find ways to pull the other levers that make us attractive to potential candidates, as well. We just can't throw money at it. And one of those levers that we're working real hard is our approach on return to office.

And I don't know that it's wholly unique, but I think we work harder or as hard as any of my peers that I've talked to, to customize our return to office answers by department, by role, by the impact on customer service, internally and externally in development so that we can offer the very best mix of something that would be appreciated by the individual, and still be a good thing for our customers and the shareholder.

The easy answer would be "everybody back in the office." And we've got competitors that have done that. Everybody back in. We didn't feel like that was reflective of where the world's at and going to be, and we would miss the mark on being attractive to new candidates coming down the road. So, but there are folks out there that are--that's their goalpost.

I think we're a little closer to the other goalpost. So, that's just one of the things that you can do as an organization, other than just dollars and cents.

Feddie Strickland
Got it. So, just kind of the intangibles of being a little bit more flexible is kind of something you can add, incrementally, to make you more attractive as an employer is what you're saying.

Gary Small
It's pretty specific. We don't guarantee in this scenario, we let folks know this is all subject to change as the business needs change. We've got to be able to flex. So, don't plan your life around always being able to have three days away from the office.

But, if it's a job that's well performed two days in and three days off and this is by department, by management group as to how this is evaluated, we will offer that opportunity.

So, it's a little more certain than just flexible. It's not like Friday afternoon off if you like it. It's a little more specific than that.

Feddie Strickland
Got it. That makes sense. And you actually answered my follow-up in your answer there. So, thanks so much for taking my question.

Gary Small
You bet. Good question.

Paul Nungester
Thanks, Feddie.

Operator
The next question will come from David Long with Raymond James. Please go ahead.

David Long
Good morning, everyone.

Paul Nungester
Good morning, David

David Long
I want to ask specifically about the utilization rate on the commercial side of things. It sounds like it's picked up a little bit. Did you give any numbers how, where it stands and where it may have stood on June 30, and then where were you pre-pandemic? Did you give the actual numbers, there?

Matt Garrity
Today, it's in the mid-30s. I'll say it's about 35% utilization, today. And we were closer to more of a 50% utilization, pre-pandemic. The other thing I would say we did see an increase in line balance up $7 million or $8 million bucks for the quarter. But part of that was driven by some of the new C&I origination that I mentioned in my comments.

So, some new C&I relationships coming on that had lines of credit that got utilized at closing. It's more of that activity than it would have been our existing business just continuing to draw more. It's just not moving a whole heck of a lot, right now.

Gary Small
It may be moved 2% from Q2. I think we did the math for an earlier call, Matt, and for those existing relationships if we returned to our normal levels, $130 million, $140 million--

Matt Garrity
--$135 million.

Gary Small
--$135 million difference in outstanding.

David Long
Got it, okay. And when you're talking about then loan growth decent here in the quarter on the commercial side, seems like the pipeline is very good. And that number's poised to accelerate. Is that going to come from then, new relationships?

Is it with new relationships with your current bankers? Is it have you added people? Is there market disruption that you're taking advantage? Where really, what is Premier benefiting from and how are you driving that growth on the commercial side?

Matt Garrity
Yeah, great question. It's really from all of those things. We've mentioned on prior calls we've been very successful in bringing in some good talent, some good regional bank talent in our markets. They come, somewhat, from the disruption in the industry.

So, if you think about the TCF Huntington transaction, that's been very beneficial for us on the client side but really on the lender side, too. So, we've seen benefit there. We've seen our existing clients, as well, who have been on the sideline through COVID but have performed very well, feeling more comfortable in expanding their business and investing in their business and borrowing again. So, we've seen some of that.

But I think the bigger part of it is the talent that we're bringing in and the relationships that they're attracting and bringing into the bank. That's been really beneficial for us. And that'll continue. As I mentioned, our pipeline levels are really, really strong right now, really in all stages and across our markets.

So, we do feel like we're well poised into the fourth quarter on the growth side, but it's momentum that's really going to kick in to 2022, as well. It's got some legs to it.

David Long
Got it. No, I appreciate the additional color there. Thanks, guys.

CONCLUSION

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Gary Small for any closing remarks. Please go ahead, sir.

Gary Small
Well I'll just say thank you all for joining us, today, and if you have any follow-up questions, and so forth, as you're working through your day, don't hesitate to reach out to Paul or myself. Again, we feel very good momentum-wise, as we move through fourth quarter and into '22, and I think the planning horizon which was positive when we looked at it six months ago and three months ago, we still feel just as positive for '22 and beyond, as we did then.

So, I'll leave you with that and thank you very much.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.