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Premier Financial Corp.

Fourth Quarter 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Gary Small, *President and Chief Executive Officer*

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

PRESENTATION

Paul Nungester

Good morning, everyone, and thank you for joining us for today's Fourth 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.

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

Gary Small

Thank you, Paul, and good morning to everyone. We appreciate you joining us today.

Let me start by affirming a message delivered on last quarter's call. The business environment across our markets continues to be strong, and our current new business loan portfolio pipeline reflects the extensive opportunities.
While labor availability continues to be a constraint for some, folks are managing through the impacts in a reasonable fashion.

Consumer household balance sheets remain in very good shape with plenty of excess cash on hand. We really just need the supply to catch up with the demand. We at Premier maintain a very positive outlook for '22.

Now on to our performance results highlights for '21 fourth quarter. For the quarter, we reported $25.3 million in net income or $0.69 a share, which brings our full year to $126 million and $3.39 a share, respectively. Full year ROA and ROE were 1.68% and 12.49%, respectively, and very solid.

The fourth quarter pre-tax pre-provision ROA came in at 1.76%. That figure is a bit low versus our normal standard, and it's due to a combination of a seasonal slowdown in residential mortgage revenue and an incremental spending increase relative to some specific cost reduction initiatives and efforts we put underway in the fourth quarter.

Loan growth was strong for the quarter, as expected. On a PPP adjusted basis, annual loan growth for the quarter totalled 8.7% with commercial growth leading the way at 10.3%. It's worth noting that the annualized loan growth for the combined third and fourth quarters was over 7%, and that reflects the growth trajectory that we expect for 2022.

Net interest income for the quarter expanded to 3.41%, while core margin remained steady at 3.21%. We continue to see reductions in our cost of funds.

Non-interest income results were lower than expected for the quarter. As I mentioned, residential mortgage income at $3 million reflected a tight pricing environment and a seasonal slowdown in the second half of the fourth quarter. Certainly, COVID escalations in December contributed to that outcome. We are very pleased with the full year residential mortgage results. The profit contribution is second only to the record performance of 2020. On the plus side, bank service fees climbed 17% in the fourth quarter ahead of last year's results.

Expenses were elevated in the fourth quarter. The quarter included onetime expenses of approximately $2 million, as I mentioned, for initiatives designed to immediately improve our expense run rate for '22 and beyond.

From a credit perspective, more topic here than is typical for us. On our last quarter call, we discussed the specific credit that was placed on nonaccrual, reflecting uncertainties regarding a key contract with the Federal government, which was negatively affected by ongoing moratorium on the collection of student loan debt.

Unfortunately, that contract was formally terminated by the Department of Education in the fourth quarter. While the loan remains current and our client has other revenue flows, the elevated level of repayment uncertainty made prudent to take a charge-off—significant charge-off during the quarter. As you'll hear in later comments, the portfolio as a whole is performing very well, and all leading indicators credit performance remains strong.

Now I'll turn it over to Paul, and I'll provide some thoughts on the '22 performance expectations at the end of our presentation.

Paul Nungester

Thank you, Gary.

I'll provide some more details for our fourth quarter and full year results. Starting with the balance sheet, deposits were up 2% from prior quarter annualized and 4% for the year. The mix also improved as businesses accrued liquidity at year-end. So we improved our all-in cost of funds, which dropped another 3 basis points to 0.21% this quarter, largely due to further reducing our total deposit costs down to only 16 basis points.

For assets, we generated $111.6 million of core loan growth or 8.7% annualized this quarter, led by commercial, which increased $88.5 million or 10.3% annualized.

NIM expanded another 3 basis points on a reported basis, including PPP and purchase accounting marks to amortization, and it was 3.21% excluding those items, and we expect it to generally remain at this level and begin to tick up as loan growth continues.

Next is the allowance, which decreased $6.7 million due to our provision expense for loans of $2.8 million and net charge-offs of $9.6 million. This was primarily related to a charge-off for the commercial relationship that turned nonperforming in the prior quarter and provision would have been a recovery, excluding it.

At December 31, our allowance coverage, excluding PPP loans and including acquisition marks was 1.37%, which is down from 9/30, but still higher than our pre-pandemic level of 1.21%.

Finishing the balance sheet is capital, where we ended the year with over $1 billion of equity with the quarterly increase primarily due to net income in excess of dividends. We also completed about 595,000 of share buybacks for $18.8 million in the quarter and just announced an increased authorization to 2 million shares.

At December 31, our tangible equity ratio was 9.6%, excluding PPP loans, down from 9.9% at 9/30, and our total risk-based capital was about 13.2%.

Next, I'll turn to the income statement, starting with net interest income of $57.2 million, which is up 4% from the prior year fourth quarter. The year-over-year improvement is primarily due to our efforts on the deposit side, where costs decreased over $2.5 million, thanks to the decrease in our average cost of deposits by 18 basis points to only 0.16% in the fourth quarter.

On the income side, we are pleased with our efforts to keep it relatively flat year-over-year by investing excess funds in such a way that investment income increased enough to mostly offset our decrease in loan interest driven by the downgrade environment in 2021.

Non-interest income was $17.8 million for 4Q, which is down from prior quarter and prior year, primarily due to mortgage banking. Mortgage gains were $2.8 million in 4Q, which is down $2.6 million for 3Q and down $3.4 million from the fourth quarter of 2020. Total mortgage production continues to generally meet expectations, and the decrease from last quarter was due to seasonally lower originations.

Separately, the 10-year was flat at 1.52% from 9/30, so we only had a minor gain in the MSR valuation after the $0.8 million in gain in 3Q when the 10-year increased. Overall, we had a $3 million decrease in mortgage banking on a linked-quarter basis. However, that was mostly offset by BOLI, which had $1.1 million of claim gains plus $1.1 million of unrealized gains on our bank equities portfolio.

Next is expenses, which were $41.7 million for the quarter and $158 million for the year. This is higher than previously expected, primarily due to approximately $2 million of onetime costs related to executive office realignment and operational enhancement projects. In addition, healthcare costs were further elevated partly due to the ongoing COVID environment, but also higher claims activity. We currently expect expenses to increase to $160 million or so in 2022, which would represent an increase of about 3% to 3.5% from 2021, excluding the unusual items in the fourth quarter.

Our full year efficiency ratio was just under 52%, and we expect it to remain in the low 50's for 2022.

To wrap up, our full year pre-tax pre-provision income was over $149 million, which represents a strong 2.0% ROA for the year. Bottom line, we reported net income of $126 million or $3.39 per share for 2021, up significantly from $99 million or $2.76 per share of core earnings in 2020, excluding merger provision and costs.

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

Matthew Garrity

Thanks, Paul.

I'll be providing an update on our commercial and residential mortgage areas as well as an update on asset quality.

Overall, we're pleased with the annualized loan growth of approximately 9% for the quarter, with contributions coming from commercial, residential mortgage and consumer lending.

In our commercial business, we saw a solid improvement in loan growth during the fourth quarter as we had expected and communicated during last quarter's call. Commercial balance growth was approximately $88.5 million for the fourth quarter, a growth rate of 10.3% on an annualized basis, while loan growth for the second half of 2021 was approximately 7.3% on an annualized basis.

Line utilization for the portfolio remains in the low 30% range, with overall utilization declining for the quarter and full year. Loan production improved by approximately 19% in the fourth quarter compared to the third quarter, with continued strong contributions from the C&I category.

We entered 2022 with strong momentum in our commercial business, with pipeline levels having doubled when comparing year-end 2021 to year-end 2020. Our expectations for the year are for 8% to 10% growth for 2022.

In our residential mortgage business, we experienced a seasonal decline with respect to overall mortgage activity, including loan production and mortgage banking revenue. Salable mix was also a factor in terms of mortgage banking revenue, somewhat reflective of the competitive landscape.

As we have discussed on prior calls, margin compression driven by market overcapacity impacted the quarter.

While mortgage banking income fell on a comparative year basis, following an extraordinary 2020, overall originations in 2021 were 87% of the prior year. We did achieve some measure of balance growth in the residential mortgage portfolio of approximately $32 million in the second half of the year, which represents a 5.1% annualized growth rate. As the year progressed, we were also able to effectively improve our expense base in mortgage, primarily as a result of position attrition.

Looking ahead, while we expect the current competitive operating environment to persist during the first half of 2022, our expectation is for a more rational environment as the year progresses. In terms of asset quality, we saw improvement across our asset quality indicators for the quarter and full year, while we experienced net charge-offs for the first time this year.

Criticized and classified loan levels improved by 20% and 22.8%, respectively, when comparing the fourth quarter of 2021 to the prior quarter. On a year-over-year basis, criticized and classified loan levels improved by 20.3% and 23.1%, respectively. Additionally, nonaccrual loans declined approximately 20%

when comparing the fourth quarter of 2021 to the prior quarter, while on a year-over-year basis, they declined 7.6%.

Net charge-offs for the quarter were $9,565,000, largely driven by charges taken to the C&I relationship, which was discussed on last quarter's call. The business has been impacted by the cancellation of a student loan collection contract that was with the Department of Education, which occurred during the fourth quarter. Given that development, the charge taken on the credit reflects the uncertainty of outcome and in conjunction with the established reserve on the credit we believe we are adequately positioned for a range of resolutions.

Overall, with the exception of this individual credit, which is more episodic in nature, we are pleased with the overall direction of the portfolio.

I'd now like to turn the call over to Gary Small. Gary?

Gary Small

Thank you, Matt.

Now I'll provide some color on our performance expectations for '22. Start with the balance sheet. Should expect total loan growth to be north of 8% for the year, with commercial loan growth projected to come in at 10% for a 12/31 point-to-point growth. And, there is no assumption for line utilization improvement in '22, in those figures.

In total, interest earning assets are expected to be up 7.5%, should help with modelling. Net interest income, up 8% to 10%, excluding the impact of PPP, and that was true for the balance numbers that I just gave you as well and PPP adjusted.

Expect year-over-year core margin expansion to be 3 to 5 basis points that should take us into the $3.30 to $3.34 range for the full year 2022.

Fee businesses, excluding securities gains, will be relatively flat overall. From a component standpoint, residential mortgage fee income is projected to be down about 5% in total to flat if we had to put a range on it with the '21 figures, very good figures for '21 and happy to keep them that way.

Origination remains good. Margin is a bit of a question mark relative to the timing of the pricing rebound. We haven't booked anything in until the second half of the year. And we do expect a favorable impact from MSR and amortization components to the income contribution.

Bank fees, I expect they would be up 5% year-over-year. Our wealth revenue, up 10% plus year-over-year. Insurance will have moderate growth. And, our BOLI and other categories, we would come out unfavorable versus '21 and that we never assume anything aggressive relative to BOLI experience. And, our bank equities portfolio, which was very favorable in '21, will assume is flat for the '22 planning period.

For expenses in '22, $161 million is our target, which would be up 3.5% of what we would call our normalized '21 expense base. Unplanned additions to the team in revenue-producing roles, so these would be lift outs or market expansions for commercial or residential mortgage groups could always be a potential factor that could impact that number.

Our projected efficiency ratio for '22 would be 51% to 52%. And operating leverage, excluding PPP and securities impacts from year-to-year are returning to their normal levels, and we expect about 400 basis points of positive operating leverage for the year.

Credit-wise, the provision calculation for the year works out to be about 20 bps of the outstanding loans. Driving it is a loan growth, relatively low net charge-off assumption and an additional favorable environment should see CECL-related environmental factors improving over the course of the year.

From an equity standpoint, as Paul mentioned, we have raised our share repurchase authorization levels of 2 million shares, and we raised the quarterly dividend to $0.30 a share. Stock repurchase and the dividend activity reflect our commitment to effective capital management and our confidence in future performance. And of course, we'll continue to keep enough capital available for expansion flexibility.

With that, Gemma, I would turn it back over to you, and we can take questions.

Operator

Thank you very much.

We have our first question in from Scott Siefers of Piper Sandler. Scott, your line is open, please go ahead with your question.

Scott Siefers

Thank you. Good morning, guys. Thank you for taking the question.

I wanted to start off maybe with the loan that got charged off. I guess maybe Matt or Gary, sort of in your minds, what makes $9 million or $9 million-ish, I guess, the right amount to charge off? I think the amount that went on NPA last quarter was bigger. So, just curious as to how you came at that appropriate amount? Then are there any recovery options from here as we go forward in your view?

Matthew Garrity

Hey, Scott, this is Matt. I'll give you a little bit more color on that loan.

I would first off state that the company continues to operate and they continue to pay us. So, they're paying us current. So, that's still a factor here as we work through this with the client. Clearly, the cancellation of the contract was a moment where we thought that was where a charge was appropriate.

When we look at the remaining outcomes as the client works through the exit of their Department of Education business, along with their ongoing business, that was also instrumental in not only the charge that was established for the credit, but the reserve that we established to bolster the bank relative to the range of those outcomes and how they work out.

And to the last part of your question, as that business continues to operate and rebuild their non-Department of Education revenue streams, we continue to work with them on the entire relationship and what's—so hopefully, that answers your question.

Gary Small

I think the only thing I would add to that, Matt, is that—or Scott, is that the amount that we did charge off was the effect of our view of relative to uncertainty. It was a calculation that went with that.

Scott Siefers

Okay. Perfect. Thank you very much.

Maybe, Paul, next one for you just on the margins. The starting point is sort of the 3.21% underlying margin, excluding PPP and PAAs. It sounds like that should advance pretty well from here. I guess, number one, a little bit more of the nuance as to what makes it advance? What kind of Fed rate environment are you assuming, in other words, how many Fed rate hikes? I guess just to finish it, do you have sort of a best estimate for how much your NII or margin benefits from each rate hike upward by the Fed?

Paul Nungester

Yes. Thanks, Scott.

You're right. So our current base is down there at the 3.20% level. A little light quarter-over-quarter. We had a small good guy in 3Q and a small bad guy in 4Q that kind of makes that spread. So call it the mid 3.20% is more at the current base on a go-forward basis. And expansion from here will primarily be driven by our loan growth, which you know we're highlighting here, not just in the quarter, but our future expectations for '22 there. So, that will start pushing that back up. Well, as we've said before, we'll keep dragging our feet on the funding side as that begins to take effect here in '22.

There's obviously a range of possibilities on the Fed forecast, right? So we tend not to be too aggressive or too conservative on that. So you can think of it as we've got a baked-in assumption of two bumps in the year, mostly for the back half of the year. Just to show that coming through on the NII side and the margin side, but allowing us some potential upside if that were to accelerate either in terms of the number of hikes or how fast they did them.

In terms of the impact, I think, Gary, you were saying we're expecting about 5% on our net interest income expansion. So a couple—each turn is probably, call it, 2% of that. If you want to think about it that way, Scott.

Scott Siefers

Okay. Perfect.

Gary Small

Scott, in the fourth quarter, the 3.21% number was a little crimped by an odd item in the same way third quarter was just a hair high, and so the move is not as dramatic from 3.21% to that 3.30% range to 3.34% ranges that might feel on an annual basis.

Scott Siefers

Got it. All right. Perfect. Thank you, guys very much.

Paul Nungester

Sure. Thanks, Scott.

Operator

Thank you, Scott. Our next question comes in from Michael Perito of KBW. Michael, your line has been open, please go ahead with your question.

Michael Perito

Thank you. Hey, everybody. Thanks for taking my questions.

Paul Nungester

Hey, Mike.

Michael Perito

On the loan growth guide, I was wondering maybe you guys mentioned, I believe, that doesn't assume anything on the line utilization side. Can you maybe map out, I guess, one, what a point tick-up there could look like to that guide? But then secondly, you know I mean, at this point, where is your kind of degree of confidence on seeing that move higher?

I mean it sounds like in your early opening remarks, Gary, that there's some pent-up demand and maybe that could bode well for that. But obviously, you guys at this point, aren't budgeting anything in. Just wondering if you could spend a minute breaking that up a little bit more.

Gary Small

Mike, is the question when you—relative to the utilization rate or is it why we're not having it moved?

Michael Perito

Yes. Sorry. The question was basically why—what some tick-up there would do to the loan growth guidance. Based on some of the positive economic commentary you had, why choose to kind of keep the budget flat there?

Gary Small

I think when we look at our normal utilization rate pre-COVID, versus with the utilization rate we're experiencing now is that $140 million or $150 million in balance, Matt, $135 million?

Matthew Garrity

A hundred and thirty-five million to go to normal.

Gary Small

That's where it's been sitting, for the most part, for the majority of the year. And we're sort of from Missouri on this one, Mike. We expect it to go up, but we're not going to count on or be dependent upon it going up for planning purposes. So where we left it flat, and it will be a gift when it comes. But frankly, our commercial deposits continue to grow. Although there's lots of demand out there loan wise and so forth, there's not—we're not feeling the corresponding reduction in cash on hand that would make them perform drawdowns and so forth. Until we see something demonstrated there, we're not going to be too aggressive in our planning on that.

Michael Perito

Got it. Helpful.

Then on the efficiency ratio, the low 50s target, that's generally speaking, where you guys were this year. Obviously, there are some anomaly items this year with like PPP and elevated mortgage and stuff like that. But I guess, generally speaking, Gary, do you see any kind of difference in how you guys are running the bank in terms of the positive operating leverage longer term, you expect to be able to generate on an annual basis?

Gary Small

Mike, we still start with operating—positive operating which is one of the top priorities so that whether it's a low-growth environment, high growth environment, we try to keep 300 to 400 basis points range between revenue increase and expense increase in any given year. And the last couple of years, it's been kind of odd with 2020 being the way it was and '21 being the rebound, but we could look from a normalized '21 to what we have in for '22, and we're back to our 400 basis points or so of positive operating leverage.

You know the formula should work. We grow assets a little faster than most. We keep overall expenses in check. That math with a 50% efficiency ratio will get us the 8% to 10% earnings growth year-over-year that fits our three-year strategic plan sort of horizon.

Michael Perito

Great. Very helpful. Thank you, guys.

Operator

Thank you for your question there Mike.

We currently have no further questions registered, so I'll hand it back over to the team for closing remarks.

Gary Small

Well, we thank you all for joining us again this morning. Follow-up questions and so forth, they're encouraged as the remainder of the reporting season comes in, and we look forward to talk to you soon. Thank you. Bye-bye.