Premier Financial Corp.

First Quarter 2022 Earnings Conference Call

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CORPORATE PARTICIPANTS

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R. Scott Siefers, *Piper Sandler*

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Christopher Marinac, *Janney Montgomery Scott, LLC*

PRESENTATION

Operator

Hello, everyone, and welcome to the Premier Financial Corp. First Quarter 2022 Earnings Conference Call.

I'll now pass over to your host, Paul Nungester, to begin. Please go ahead.

Paul D. Nungester

Good morning, everyone, and thank you for joining us for today's First Quarter 2022 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 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.

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

Gary M. Small

Thank you, Paul, and good morning. Thank each of you for joining us today.

Premier's results for the first quarter built on some familiar themes from prior quarters. We had very good loan growth across the board, with the Commercial Banking group achieving double-digit growth for the second consecutive quarter, and they're up over 7.6% versus Q1 of last year; strong performance in each of our markets with excellent C&I growth.

Consumer lending in Q1 was very active as well. Our HELOC origination activity was ahead of our internal plan for the quarter, and we experienced the highest auto finance origination numbers in our history in the month of March, and based on what we see in April, we'll eclipse that record in April. Consumer households are maintaining their strong cash positions. They seem well-prepared to weather the near-term bumps that are brought about by inflation and other news of the day.

Mortgage application activity was very good for the quarter. We were 15% ahead of our expectations from an application dollar standpoint. We added originators to our teams across the markets, and we also established a new team in the very strong Ann Arbor market.

And now onto some performance highlights.

For the quarter, we reported a net income of $26.4 million or $0.73 a share. ROA and ROE were 1.42% and 10.34%, respectively, and our average tangible equity return was 15.44%. These figures generally matched our expectations for the quarter.

Loan growth was strong, as mentioned, for the quarter. Adjusted for PPP, annualized loan growth was 10.1%. Commercial loans led the way with an 11% move.

Net interest income for the quarter expanded three basis points, and that was aided by some additional PPP fee income recognition as the portfolio rolls down. Our core margin was relatively flat for the quarter, and with the Fed action not really affecting the results as of 3/31.

Our non-interest income met expectations when you adjust for the $642,000 mark-to-market we took on our bank equities portfolio. We're happy with that portfolio. It's a dividend yield play as much as a valuation play, but again, you do feel the mark-to-mark from time to time.

Residential mortgage income of $4.3 million was actually ahead of our expectations, but we do anticipate we'll see a challenging environment going forward. Gain on sale margin is expected to be under pressure into the third quarter.

On the plus side, bank service fees - this would be debit, credit card, account fees, and so forth - continue to climb. We were up 9.7% versus the first quarter of '21, and clearly, households are out there active and spending, as they have been the last couple of quarters.

Expenses are generally in check. We saw an uptick in variable comp related to our commercial loan production, so that's a good rationale, but we also see our healthcare expenses continuing to run higher than normal. This is the third quarter in a row for that; certainly, deferred maintenance for some of us coming out of the COVID environment, but we're keeping a close eye on how much of it is that versus inflationary-driven.

Capital-wise, in addition to capital reductions that all banks are experiencing this quarter due to marks on AFS securities and so forth, we were also reasonably active in buybacks in the first quarter, 2.2% of our shares. We are comfortable with our capital position as we head into what appears to be an active period for the Fed over the next couple of months.

With that, I'll turn it over to Paul and he'll provide some '22 performance info as well.

Paul D. Nungester

Thank you, Gary.

Starting with the balance sheet, deposits were up almost 2.25% from prior quarter, annualized. Our mix was stable, and we again improved our all-in deposit costs which dropped another two basis points to 0.14% this quarter. Total cost of funds declined one basis point to 0.19%.

For assets, we are pleased to report $132.4 million in core loan growth this quarter, or 10.1% annualized, led by Commercial, which increased $97.4 million, or 11% annualized.

NIM expanded another three basis points to 3.44% on a reported basis, including PPP and purchase accounting marks accretions, and was 3.20% excluding those items, and we expect that to begin expanding as loan growth continues and rising rates take effect.

Next is the allowance, which increased $0.7 million due to a provision expense for loan growth of $0.6 million and net recoveries of $0.1 million.

Our asset quality improved during the quarter, with decreases in non-performing assets, classified loans, and loan delinquencies. At March 31, our allowance coverage, excluding PPP loans and including acquisition marks, was 1.34%, which is down slightly from 12/31, but still higher than our pre-pandemic level of 1.21%.

Finishing the balance sheet is capital, with a quarterly decrease primarily due to a $59 million decrease negative valuation adjustment on the available-for-sale securities portfolio, plus buybacks. During the quarter, we completed approximately $793,000 of share buybacks for a total of $24.2 million.

At March 31, our tangible equity ratio was 8.3%, down from 9.5% at 12/31. However, our regulatory ratios, which are not impacted by those securities marks, remain solid, including 11.2% for Tier 1 and 13.0% for total risk-based capital.

Next, I'll turn to the income statement, starting with net interest income of $58 million, which is up 2.4% from prior year's first quarter or 7.5% excluding PPP and purchase accounting marks accretion from both periods. The year-over-year improvement is primarily due to our efforts on the deposit side where cost decreased $2 million as a result of a 13 basis point reduction in our average cost of deposits.

On the income side, loans interest income declined due to less PPP and marks accretion, but this was mostly offset by increases in our securities interest income. Going forward, the combination of our recent loan growth trends and rising rates will generate increasing levels of loans interest income.

Non-interest income was $16.9 million for 1Q, which is down from prior quarter and prior year, primarily due to mortgage banking and security gains. Mortgage banking income was up $1.2 million from prior quarter, but down from prior year.

Mortgage gains in 1Q were $2.5 million, down $0.2 million from 4Q and $3.1 million from the first quarter of 2021, primarily due to lower production, compressed margins, and lower saleable mix.

Separately, the 10-year increased 81 basis points to 2.32% from 12/31, resulting in a meaningful gain in the MSR valuation from $1.2 million after only a $150,000 gain in 4Q. However, we had a $5.3 million MSR gain in the first quarter of 2021 when the 10-year had a similarly large increase, but from a much lower starting point. Overall, we had a $1.2 million increase in mortgage banking on a linked-quarter basis, but a $6.3 million increase on a year-over-year basis.

Separately, we experienced a $0.6 million unrealized loss on our bank equities in the first quarter compared to $1.1 million of gains last quarter and $1.6 million of gains in the first quarter of 2021.

Next is expenses which were $41.3 million, a decrease of $0.4 million from 4Q, but an increase of $2.5 million from the first quarter of 2021. The increases were due to the combination of higher costs related to enhanced staffing levels for our growth initiatives, continued higher healthcare benefit costs, and lower deferred costs related to lower residential mortgage production. We now expect expenses to be around $162 million for 2022.

To wrap up, our first quarter pre-tax pre-provision income was over $33.7 million, which generated a robust 1.8% ROA, and bottom line, we reported net income of $26.4 million or $0.73 per share.

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

Matthew T. Garrity

Thanks, Paul.

We're very pleased with our first quarter lending performance, with overall loan growth of more than 10% led by commercial growth of 11%. In our commercial business, our balance growth of $97.4 million for the quarter was consistent with our expectations, and it represents another solid quarter of portfolio growth following a strong fourth quarter performance. C&I loan production was once again solid in the first quarter, accounting for approximately 43% of our total commercial originations. Line utilization rates remain suppressed in the low 30% range, which should act as a further accelerant for loan growth once line usage returns. Given the high level of loan production we generated in the first quarter, we're also very encouraged by the continued expansion of our commercial loan pipeline heading into the second quarter. In terms of loan growth, we expect another very good quarter of performance there.

In our residential mortgage business, we experienced a softer start to the year in terms of mortgage gain on sale, largely driven by the industry's ongoing margin challenges that comes with overcapacity. In addition, our decision to portfolio a greater percentage of our first quarter production was influenced by the margin challenges in the quarter. While this represents better execution in the long run, it obviously impacts mortgage revenue on a quarterly basis. As we mentioned on last quarter's call, we expect this environment to remain with us during the second quarter. As we have discussed previously, residential mortgage lending is an important part of our overall business, and as such, we tend to take a long-term view as we manage the business.

As Gary mentioned earlier, we're very pleased with the launch of our Ann Arbor market in the first quarter, as well as the overall growth of our Mortgage Sales team, adding 14 new members so far this year. As a reminder, our sales force is primarily commission-based, so the fixed-cost investment is relatively modest. This expansion, which is consistent with our strategy for mortgage, positions us to participate more actively as industry conditions improve in the future.

In terms of asset quality, we experienced another quarter of overall improvement, as levels of classified and criticized loans improved by 13.32% and 11.65%, respectively. Net charge-offs for the quarter were a net recovery of $101,000.

With respect to the individual non-performing C&I credit discussed on previous calls, there are no updates from last quarter's call, and we continue to believe we are adequately reserved for a range of outcomes.

While there is uncertainty with respect to the overall economy with concerns about the impacts of inflation in a rising rate environment, our portfolio continues to perform well. While we continue to monitor the performance of our portfolio for signs of stress, our outlook for the second quarter remains stable.

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

Gary M. Small

Thank you, Matt, and now I'll provide a guidance update on our performance for the remainder of ‘22.

From a balance sheet perspective, I want to affirm our expectation that we expressed on our January call, portfolio loan growth at 8%. In that January guidance, we projected commercial loan growth of 10% for the year, and we remain comfortable with 10% for the first half of the year, but we do have some appropriate caution due to the economic uncertainty in the second half of the year. This would be the magnitude of Fed actions, world events, etc. We have no specific segments of concern, but events may cause a pause in the business cycle. We still target 10% commercial growth. That remains our target through the year, and we remind ourselves that we did some very good loan growth at these rates in prior periods. Money's still relatively inexpensive.

From a net interest income perspective, again, I will affirm our net interest range of 8% to 10% when you exclude the impact of PPP. Our margin outlined in the January call for a year-over-year average basis was three to five basis points, and certainly, with the news of the day, it appears that we’re likely light. We only had two turns in—Fed turns in for the '22 budget assumption, so you'd have to count that as a likely tailwind for the year.

On the fee business side, if you exclude the security gains and losses and our bank equity gain and loss category, I would say we're revising the mortgage fee income guidance downward a bit from our first quarter discussion. In that first quarter, income was on target for us for the year, but we do feel that on a full year basis, we’re likely to be about 10% off the number we posted in ‘21. Our guidance in the first quarter was that we'd be off 5%, so directionally the same, but just a little bit more caution for the remainder of the year. We expect mortgage production to be on target, but the gain on sale is challenging, and our saleable versus portfolio mix dynamics are changing a bit. We may see a higher percentage being assigned to the portfolio in the near term.

I'm affirming that bank fees will be up 5% over the ‘21, consistent with our prior guidance, but I would also revise the wealth fee income line downward just a bit to high single-digit. We were 10%-plus coming out of the January period, and that's really reflective of the valuation weakening that we've seen in the equity and fixed income marketplace during the first quarter. We'll wait until that rebounds before we revise upward.

From an expense standpoint, we had projected $162 million for the year. We’re going to bump that up $1 million for the items that Paul and I had commented on earlier. We see strong commercial activity and the variable comp that comes with that. That's a good guide, but as I mentioned, healthcare, higher than typical, and we’re not seeing that stemmed over recent history.

Additional revenue producing rolls, lift outs, market expansions, and so forth in the commercial and residential mortgage business, particularly, you know that we're always on the move when talent becomes available, because we do think of playing the long game, and we incorporate that typically in our year expectations, and we continue to do that.

I would affirm that our efficiency ratio of 52% is in the same range that we projected back in January, so no change there, and we always run a little higher in the first quarter.

Credit-wise, loss provision is driving the loan grow—or loan growth is being driven, I should say, by the loss—is driving the loan provision for the quarter. Net charge-offs are running favorable to plan, and our underwriting approach protects us against unfavorable impact of reasonable rate hikes. The portfolio characteristics continue to be strong and improving, and I'd have to say, this potential tailwind as well.

On the equity front, we did repurchase 800,000 shares in the first quarter. That's really not a pace that we would anticipate staying on for the remainder of the year, by any means. It's 2.2%, and based on our typical business model, that's about a full year's take. However, we'll remain opportunistic as things may make themselves available as we go through the year.

With that, Operator, I will turn it over to you for questions.

Operator

Perfect. Thank you.

Our first question comes from Scott Siefers from Piper Sandler. Please go ahead. Your line is open.

R. Scott Siefers

Good morning, guys. Thanks for taking the question.

Gary M. Small

Good morning Scott.

R. Scott Siefers

Hey. I think sort of the starting point for the margin on sort of a core-core basis is roughly 3.20% or so. We still thinking about the 2% benefit to NII from each Fed rate hike?

Paul D. Nungester

Yes. Yes. Yes, it's just that now we're seeing an expectation for more of those hikes than we had previously thought, so yes.

R. Scott Siefers

Okay, and can you talk a little bit about how you see the margin trajecting at the beginning of the cycle, meaning, say these first 100 basis points or so versus how it does later in the cycle, and maybe another way of asking is how are you thinking about deposit betas through the cycle as well?

Paul D. Nungester

Yes. Yes, a good question, so the first few—the early ones, we'll be dragging our feet on deposit costs and helping our beta and things like that, but on the flip side, we've still got to clear some hurdles on some loan floors and whatnot, and then once we get through that and the pace of these Fed fund bonds start to take place, that'll accelerate some of the deposit costs, but we will have cleared our floors on the variables, so net-net, it's going to be somewhat of a smooth kind of rise in our NIM just due to some offsetting factors that are in there, but Gary was saying earlier, our guidance for the year, obviously, previously thinking, too, total for the year versus now, we'll see what they—I think the recent talk is 50 and 50, but 100 bps doesn't seem unreasonable over the relatively near term.

R. Scott Siefers

Yes. Okay, perfect. Thank you very much.

Paul D. Nungester

Yes.

Operator

Perfect. Thank you, Scott, for your question.

Our next question comes from Michael Perito from KBW. Please go ahead.

Michael Perito

Hey, Gary, Paul, Matt. How are you guys?

Gary M. Small

Very good.

Paul D. Nungester and Matthew T. Garrity

Good morning, Mike.

Michael Perito

Good. Just a quick clarification on Scott's line of questioning, but so the 8% to 10% NII growth in 2022 ex PPP, that's incorporating just the two hikes that you guys had laid out in your January guide, correct?

Paul D. Nungester

Correct, yes.

Michael Perito

Okay, and it sounds like, just to make sure I was hearing the second answer there correctly, that between the floors and the accelerating betas, the 2% pick-up for each hike, that largely will actually stay fairly constant through the first, call it, three to six hikes just because of the dynamics of timing around when the floors flow through and when the betas accelerate, and they'll kind of offset each other?

Paul D. Nungester

Yes, so we've already gotten one bump in, and we had previously thought about 50 bps, two bumps, would essentially clear us from floors, and we're still seeing that, so once we get to this 50, and certainly, if they do 50 at this next one, we've essentially cleared those hurdles. There might be a couple of old ones that need a little bit more than that, but it won't mean anything to the numbers.

Gary M. Small

We'll be 98%.

Paul D. Nungester

Yes, 98%, 99% at that point, yes. Yes.

Michael Perito

Got it, and then just, you know Gary, I appreciate kind of the uncertainty around the back half of the year from a growth perspective. It's just hard to know with where we're at with everything, frankly, but, just competitively, any updates in the markets you're in, where you're seeing worse conditions? Some of your smaller reporting peers have said that some lenders have moved around. Are you seeing any talent move around or any accelerated opportunities to bring other people on, or has that—has labor, price wages and what have you made that very hard to do? Just curious competitively what the update is from a commercial lending standpoint.

Gary M. Small

Well, it's a good question, Mike, and I'm going to turn that over to Matt, but first, I'll say getting some comment from Matt on where we're at on the current pipeline and how Q2 looks could be a little bit instructive to the second half of the year as well. Let's just say the second half, it seems like it's appropriate to at least curb the enthusiasm, but there's actually no reason on paper that would put us in that position as we see it right now, and with that, Matt, I'll turn that over to see if you'd share what you've got.

Matthew T. Garrity

Sure. Well, just a quick pipeline comment before we move to talent.

Yes, we'll actually entering second quarter with a larger pipeline than where we entered the year at, and we had a really good first quarter of production and very good balance growth, so we're very comfortable with another really good quarter here in Q2 on the growth side, and as the quarter progresses and as we get sort of the latter stages of Q2, I think we'll have better visibility on the second half of the year and we'll see how those pipelines react, but there's nothing in front of us right now that suggests a slowdown, but I think that the wariness on the second half is probably appropriate given the times that we're in today.

On the talent front, it's still a very active market for talent. The TCF/Huntington merger, although that's a few months in the rear-view window, continues to be something that provides opportunities for us to have conversations, as people have found themselves in their new chairs and they don't necessarily like those in a new organization, so those conversations continue to happen and we remain very active on the talent front in Commercial Banking in particular. We've brought over a couple of new folks here in Q1, and you should expect us to continue to do that throughout the balance of the year, as well as continuing to have conversations around market lift-outs and things like that, so those activities are still very, very robust, I would say.

On the residential side, as we talked about in the earnings call a moment ago, had a—we're off to a really good start on the sales front there, so 14 new folks and a new market in Ann Arbor, which we've had some track record of having successful team lift-outs in newer markets with success. If you go back to when we entered Morgantown, for example, this should pay those types of dividends for us.

Michael Perito

That's helpful, Matt. Thank you, and then just—I'll jump back, but just one last quick one. Just Paul, on the tax rate moving forward, just is the first quarter a good level, or it seemed a little lower than I was thinking? Just a quick update there before I let someone else jump in?

Paul D. Nungester

Yes. On a full year, we're still expecting about a 20% effective tax rate for the year. We're not assuming any change on the corporate tax rate front, especially with midterms coming up.

Michael Perito

Great. Thank you.

Operator

Thank you, Michael, for your question.

Our next question comes from Christopher Marinac from Janney Montgomery Scott. Please go ahead.

Christopher Marinac

Thanks. Good morning. Paul, Gary, thank you for the information on the margin for the call. I just want to go one more layer, if you will. In the month of April, how have loan yields acted with the first Fed hike, and then how do you think they'll play out in May and June just in terms of loan yields and how that interacts with competition?

Paul D. Nungester

Yes, no, they're definitely on the rise, so the competitive market, obviously, we're all chasing loans now in this environment, but we're all reacting to our funding costs as well, so those are starting to rise. April has started off well from that perspective. You didn't see the NIM bump per se in these first quarter results given the timing of that. We'll start to feel that here in 2Q, and then depending on what actually happens here in May, if they do 50 bps like they are currently talking, that'll help set us up for a strong second quarter.

Christopher Marinac

Great. Thanks for that, and just given your footprint, does the competitor at STAR Ohio create any issue for funding for you, government deposits, or is that just not a focus at this point?

Paul D. Nungester

It does, but not to a large extent. We do have to react to that, for sure. Some of our depositors use that as a benchmark.

Gary M. Small

When we think about our beta, we use about 30% beta on deposits, and that'll probably be, as Matt or as Paul was mentioning earlier, a little slower, but we do have deposits that will move, and we have a product that's tied to the STAR Ohio for treasury management. That's going to move. We have some wealth management variable money market. That's going to move, so—but when you get down to the real deposit rate sensitive piece that needs to move, we're talking less than $1 billion, probably less than $700 million that would be on the move, and that's consistent with our 30% thought on the beta overall.

Christopher Marinac

Great. No, that makes sense. I just wanted to flesh that out there. Thank you very much. Appreciate it.

Operator

Perfect. Thank you so much, Christopher, for your question.

At this time, there are no further questions, and I would like to pass back over to Gary Small for any final remarks.

Gary M. Small

Well, thank you. We passed a lot of information, and feel free to follow up with us as needed for clarification, and I'd summarize with it feels like we're—we have pluses on the growth and pluses on the NIM, a little caution and mark on the fee income side, and the provision side looks very good as well, so directionally, I think, versus where we started the year, that kind of sums it up, and as Matt was saying, from a asset generation standpoint, there's plenty of activity in this market right now, and we're taking full advantage of it, so thanks again. We look forward to talking to you next quarter.

Operator

Perfect. Thank you, everybody, for joining today's call. You may now disconnect your lines.