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Premier Financial Corp.

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Earnings Call

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Call Participants

EXECUTIVES

Gary M. Small
President, CEO & Director

Paul D. Nungester
CFO & Executive VP

ANALYSTS

Andrew DeFranco

Brendan Jeffrey Nosal
Piper Sandler & Co., Research Division

Presentation

Operator

Hello, everyone, and thank you for your patience. The Premier Financial Corp. earnings call will begin shortly. Please stand by. Hello, everyone. Good morning, and welcome to the Premier Financial Corp. First Quarter 2023 Earnings Conference Call.[Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] I would now like to turn the call over to Paul Nungester with Premier Financial Corp.

Paul D. Nungester
CFO & Executive VP

Thank you. Good morning, everyone, and thank you for joining us for today's first 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 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 M. Small
President, CEO & Director

Thank you, Paul, and good morning, everyone. Last evening, we reported net income for the quarter of $18.1 million or $0.51 per share. The results reflected expected challenges related to margin management, funding repricing and mix changes, and we also included a number of unfavorable nonrecurring items that we highlighted in the release. We wanted to provide our path to a more recognizable quarterly performance figure. While our call will focus on ALCO elements of our performance for the most part, we'll be happy to share more color on the nonrecurring and timing items that were outlined in the release. Before moving to the balance sheet management topics, I'll touch on a few Q1 business performance highlights. Commercial loans were up 6.5% on an annualized basis for the first period and 41% was C&I oriented, which is consistent with the progress that we've made in prior quarters, and that's our main focus of the day.

Wealth and asset management team growth saw new business growth in the first quarter was the best that we had had in 2 years of any quarter, very strong. Our insurance business saw property and casualty premium-driven revenue up $300,000 for the quarter versus our expectations, and we expect a continuation of that theme over the remainder of the year. Credit remains well in check. We're steady on our NPAs, lower delinquency, and an ongoing commercial credit review process. It's a rigorous review, stress testing, and all that goes with that. At this point, our clients are handling the new environment very effectively. First quarter margin landed at 290 basis points for the quarter. Results reflected that full quarter impact of margin deterioration that we began to experience towards the end of the fourth quarter of last year. Our January efforts focused on addressing deposit repricing velocity, product mix movement, and adjusting promotional programs to stabilize our margin. February and March margin did stabilize. They were separated by just 2 basis points. Although the headline-grabbing industry events in March drove more unfavorable mix activity in the commercial and public fund sectors.

Going forward, we're focused on addressing the needs of the most elastic components of our funding sources and to continue to attract new money in all business segments. We need to grow our deposit base. Ultimately, looking to improve our loan-to-deposit ratio as well. We're going to work both sides of that equation. We'll improve balance sheet efficiency, net interest income, margin and capital utilization. To give a little history, beginning in the mid-November '22 time frame, we came out very strong with the consumer deposit offering to drive new business and retain our great existing book. Our promotions generated new business activity and a bit too much velocity of movement within our existing book. We see that in our deposit betas. We are running a touch higher than the industry-based data that we have available, and that's an opportunity for us to recalibrate as we come to the end of promotional periods over the next few months.

Business deposits, certainly a strength for Premier over the last 2 years experienced a pause in the first quarter. We expected a cyclical decline in the book, and that's what we received. It's isolated to a handful of clients, and it's not a systemic issue. However, March events change the story a bit. Balances did remain steady over the month, but the mix was less favorable as commercial clients looked for more protection given the circumstances. And those were more costly solutions, such as ICS and so forth. We have details to share regarding liquidity, capital, uninsured deposits, all the issues of the day, and I'm going to turn it back to Paul to provide more specifics.

Paul D. Nungester
CFO & Executive VP

Thank you, Gary. I'll first discuss some of the unique items that impacted quarterly results. As noted in our release, first quarter 2023 earnings included the impact of the following pretax items: $1.4 million of equity investment losses due to the downturn in bank stocks the last couple of weeks of March, a $1.5 million negative mortgage pipeline hedge adjustment that should revert in 2023, a commercial charge-off of $1.5 million related to an annual appraisal update that will not recur in 2023 and $1.5 million of timing-related expenses that only occur in the first quarter. Excluding the impact of these items that were $0.03 each, first quarter 2023 earnings would have been $0.63 per share. Separately, we are implementing cost cuts that represent an estimated $3 million pretax per quarter beginning in the second quarter. And last, we currently estimate that each 25 basis point change in the federal funds rate could impact net interest income by approximately $1.5 million annualized pretax based on our 3/31/'23 balance sheet and assuming we didn't take any actions such as hedges.

Now regarding the balance sheet, capital levels remained solid and improved during the quarter. Tangible equity increased 5% in dollar terms, and our PE ratio improved by 25 basis points to 7.03%, including AOCI or 8.9% excluding AOCI. Our regulatory ratios also increased during the quarter. And it's important to note that they all exceed well-capitalized guidelines, even when including the impact of AOCI. During the first quarter, total deposits did decline about 2% due to a decrease in noninterest-bearing deposits, which was offset partly by an increase in interest-bearing deposits. It's critical to note this happened prior to the industry turmoil that occurred in March following the 2 large bank failures. In fact, total consumer deposits increased $14 million during the month of March. The runoff we experienced early in the quarter was more anomalous in nature with $107 million related to commercial clients using our moving funds related to their business dispositions and acquisitions as well as the repayment of funds that are on commercial lines of credit prior to year-end.

We also experienced a mix migration during the quarter with $67 million of noninterest-bearing deposits transferring into ICS and other interest-bearing deposits or investments as customers sought out a combination of deposit insurance protection and yield. Speaking of deposit insurance, our level of uninsured deposits declined to 32.3% or 19.6% when adjusting for collateralized deposits such as OPCS, other insured deposits, such as the Indiana PDIF and internal accounts. Our press release provided a detailed list of quantifiable liquidity sources at 3/31, which exceeded $2.45 billion, including $1.36 billion of borrowing capacity with the FHLB.

We are also in the process of expanding our capacity at the Federal Reserve and expect to increase that by at least $300 million in the second quarter. Primarily due to deposit runoff, increasing our reliance on higher cost FHLB and an accelerated deposit beta, we experienced NIM compression during 1Q. Interest-bearing deposit costs increased 62 basis points to 1.69% for 1Q '23. This increase was primarily due to public ICS Cedars accounts, money market accounts and time deposits as customers migrated for insurance protection and yield. However, as a result of actions we took, the velocity of increase slowed during the quarter, resulting in average interest-bearing deposit costs only increasing by 2 basis points to 1.79% during the month of March. This represents a cumulative beta of 35% compared to the change in the monthly average effective federal funds rate, which increased 457 basis points to 4.65% from December 2021. Net interest margin was positively impacted by the combination of previous loan growth and higher loan yields, which were 4.66%, up 12 basis points from 4Q '22. Excluding the impact of PPP in March, loan yields were 4.76% in March 2023 for an increase of 94 basis points since December 2021, which represents a cumulative beta of about 21% compared to the change in the monthly average effective federal funds rate for the same period.

However, the combination of deposit costs outpacing loan yields and a heavier reliance on FHLB from deposit runoff led to the compression of net interest income and margin during the first quarter. Next, noninterest income of $12.5 million for 1Q was down $1.8 million from the prior quarter, primarily due to $1.4 million of security losses from the decreased valuations on equity securities compared to a gain of $1.2 million in 4Q, primarily from $1.3 million of gains on the sale of $8.7 million of equity securities. Separately, noninterest income declined $4.4 million from the first quarter of 2022 due to mortgage banking as a result of a $3.4 million decline in gains from a decrease in hedge valuations and lower production, plus a $0.1 million MSR valuation loss in 1Q '23 compared to a $1.2 million gain in 1Q '22. As previously discussed, hedge valuations even out over time, but individual quarters can be volatile depending on changes in market rates and pricing. In less volatile rate environment, short-term results have less sensitivity to rate movements. However, due to the wide dispersion of interest rates within the pipeline and limited liquidity and hedge markets, we have experienced larger volatility in monthly and quarterly results.

Expenses of $42.8 million were down 1% on a linked-quarter basis and included about $2 million of nonrecurring or timing-related items such as payroll taxes and benefits for annual incentive payouts. As mentioned earlier, we are implementing $9 million in cost-saving plans over the remainder of the year, bringing our full-year expenses to approximately $163 million versus our original $170 million estimate. Overall, credit quality was stable during the quarter with a significant decrease in delinquencies and no meaningful increases in NPAs or criticized loans. Net charge-offs of $2.5 million were primarily due to an annual appraisal update for a commercial relationship that will not recur during the remainder of 2023. At March 31, our allowance coverage was 1.13% of total loans and 216% of nonperforming loans. That completes my financial review, and I'll now turn the call back over to Gary for some closing remarks.

Gary M. Small
President, CEO & Director

Thank you, Paul, and I'll share some thoughts for the remainder of '23. Our 12/31 point-to-point earning asset growth, we're still looking at 3% to 4% for the year. Focus on loan and deposit ratio reduction over the remainder of the year is a key element for us. First quarter growth in loans was more reflective of funding of '22 commitments. The 23 new business effort is really zeroed in on some very focused and contained growth. Credit indicators remain strong, as Paul mentioned, lower portfolio expectations will help us on the provision side. And there still are uncertainties around macro factors such as unemployment, recession, pacing and severity and so forth. But of what we control, we feel very good about our provision prospects. Margin was stable in February and March, as we've discussed, and we're targeting a funded beta improvement by the end of the year on the debt-positive side. Loan betas lagged, but you'll see some improvement over there, all things being equal.
There's continued evaluation of alpha toolbox options. And examples would be a hedge to lower the cost of our near-term embedded funding costs. A second item would be to position to provide partial insulation from the impact of potential future Fed increases, and we have opportunities to trim the balance sheet and the corresponding wholesale funding components that support it. The list could go on, but you get the idea of we are -- we and I'm sure many in the industry are looking at many of the tools that can help maintain that stable environment and earnings stability as well. We have a path to an improved net interest income and margin performance. Although the full earnings power of the balance sheet will not be realized until we see some progress on the unwinding of the inverted curve. We can expect continued strong fee income performance in the insurance and asset management businesses. Residential mortgage, the volume and the gain on sale realization is expected to remain challenging for the remainder of '23. And on the expense front, as Paul mentioned, we've got commitments made, we're well underway, and we'll continue to assess as we go forward. And with that, operator, I'll turn it over for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Brendan Nosal from Piper Sandler.

Brendan Jeffrey Nosal
Piper Sandler & Co., Research Division

Just to start off here on maybe kind of deposits and margins. On the one hand, it sounds like you're trying to grow deposits and lower loan-to-deposit ratio, which can be costly in this environment. But on the other hand, you saw some flattening of pricing increases in March. Can you kind of maybe help us understand the balance of those 2 factors and what that means for the margin over the next couple of quarters?

Gary M. Small
President, CEO & Director

I'll let Paul follow up with better detail, but I would break the book into a couple of portions, Brendan. On the consumer and the private banking side, I think you'll see the typical growth initiatives relative to deposit growth that you have come to expect. I think on the business side, where we're feeling more velocity is the movement, whether it's from noninterest-bearing to interest-bearing or lesser interest-bearing to more interest-bearing. And that bit of volatility is probably provides the most uncertainty relative to margin growth relative to that segment.

Paul D. Nungester
CFO & Executive VP

Yes. Yes. That's right, Brendan. We're not looking to disturb the piles that are performing well. I think your basic consumer stuff, checking, savings, even some money markets, things like that. Those are holding steady and, frankly, haven't moved from a beta perspective, this whole cycle. In terms of where we can help the margin, as Gary alluded to in his comments earlier, we have some opportunities coming up near term to recoup some of the costs from promotions, and we're going to look to do some of that. Now part of that will depend on additional Fed fund rate movements, of course. So we're keeping a close eye on that, and we'll factor that into our repricing abilities. That could lead to some runoff in those piles but overall would be a benefit to our deposit betas. And then separately, continuing to focus on trying to grow the overall book. Some of that will come and it's chunky from public funds as their seasonality comes into play, but CDs, time deposits, things like that, to lock them in before additional Fed fund increases, things like that will help grow the book. And then ultimately, that's somewhat of a push at the top end, given where FHLB costs are. So from an all-in perspective on our interest-bearing liabilities or total cost of funds, the intention is to try and maintain and stabilize where we're at and pick our spots to make some improvements.

And then the last piece would be the strategies that we kind of alluded to, looking for the benefits potentially of maybe some hedging or other ideas that are out there. So we're taking a look pretty much at all options at this point.

Gary M. Small
President, CEO & Director

Brendan, one other comment on that. I mentioned in my comments, we came out of the gate pretty fast in Q4, and we were probably ahead of the pack relative to repricing of our existing book and the more price-sensitive wealth management private banking book. When we got into January and started our adjustments, if you will, one of the decisions we made we'll sit on our hands for the next couple of rounds of Fed movement. And we really did, and we did not feel any demission in that consumer in that wealth management business. The mix moved around a little bit, but the balances stood. So that told us 1 of 2 things. We had moved pretty well out of the gate in December and late November, and that was supporting us well in that January, and February time frame. Or there's still just more elasticity in the book than you might suspect, either way, we didn't harm ourselves in any way by not being very active with those moves. But it's a matter of degree. The Fed comes out onesie-two, here and there, we can be very diligent in how we go about it. If the pace or the actual size of movements return to the sort of movements they were in the fourth quarter, that's a different discussion.

Brendan Jeffrey Nosal
Piper Sandler & Co., Research Division

Yes, understood. Thanks for all those comments and the detail in the release on kind of the monthly trends as well. Perhaps one more for me just on the mortgage line. Obviously, a lot of adjustments over the past couple of quarters on MSR and the hedging noise. Can you just give us a sense of what you view as the run rate for that line item and where you could be heading over the next several quarters?

Gary M. Small
President, CEO & Director

Brendan, I think when we were setting out our guidance on that, as we're in January, we were sitting on about $8 million of fee income out of the mortgage side. A couple of that was on servicing income net of amortization, and that's coming in stronger than ever. And the remaining 6 or 6 and change was in the regular gain on sale. And it's going to take everything we've got to get to that 6.5% for the gain on sale, but we'll stand with that number right now. But this is a challenging environment. And what I can say about the hedge activity, I think Paul gave you the pieces that make that easy to understand the lumpiness. When we look at it over the last 5 quarters, we're a net $1.5 million ahead in that, which is what we should be. But in any one quarter, as Paul mentioned, it can be up $1 million or down $2 million. But we do track about a 6-quarter cycle because of the construction period on houses to check the overall effectiveness of our hedge program to not take it for granted. But there are -- the last 2 quarters are a good example. We had a downstroke in the fourth quarter, and we had another one in the first quarter as rates were falling. But that was falling a big uptick in the third quarter of last year. It's bumpiness, it used to be hidden a bit in the larger mortgage gain on sale number. But with volume down the external sales, I think we're running at about 40% to 50% of our pace as an industry in the first quarter of last year. So you see just a lot more visibility and the lumpiness of what standard mark-to-market activity for those hedges.

Paul D. Nungester
CFO & Executive VP

Yes, reality is this is always kind of going on in the weeds in the background. It just didn't stick out. And nowadays, it does partly for the -- a little bit bigger on the volatility side. But as Gary said, just less air cover from normal production and activity.

Operator

[Operator Instructions] Our next question comes from Andrew DeFranco from KBW.

Andrew DeFranco

This is Andrew filling in for Mike. I was just wondering if we could touch on the loan book here for a minute. I know you talked about the C&I and the new business growth in the prepared remarks. But could you just provide some more color there on where you're seeing good opportunities in regards to that focused and contained growth you mentioned?

Gary M. Small
President, CEO & Director

I'll break it down into the portfolio segments if you will. We are purposefully constraining ourselves on residential real estate as far as portfolio growth and on consumer. So think indirect lending into auto, the home equity books and so forth, keeping those flat to down going forward, leaving our capacity for the commercial book to expand. We do have commitments from '22, both in commercial construction and residential real estate construction funding commitments that are part of the balanced growth that you see, particularly in the first half of '23. But generally speaking, I think our guidance back in January was that the commercial book was targeted to grow perhaps 5% or so on our way to an earning asset growth that was closer to 5. We would say now we're looking at 4% or so at max, perhaps less than that on the commercial side and the broader earning asset side down as well. And it's more about our containment of growing the left side of the balance sheet because we want to take some action to get a better handle on the balance between our asset and liability situation. And so there's business there. We're being very selective. And we're working with our existing clients always. And that's -- there are exceptions to that, but that's where we're spending our capacity right now is to fulfill the need of existing clients.

Andrew DeFranco

Great. Appreciate all the color there. And then lastly for me, just a quick one. Any M&A discussions happening today or anything you guys are excited about on that front?

Gary M. Small
President, CEO & Director

Nothing to share at this point.

Operator

We currently have no further questions. I would like to hand the call back to Gary Small for final remarks. Please go ahead.

Gary M. Small
President, CEO & Director

Well, again, thanks, everyone, for joining us this morning, a turbulent quarter for the industry. And I think we all have a good challenge ahead of us, and I'm very confident in our Squad's ability to deliver a good year. So we look forward to talking to you in the future.

Operator
Ladies and gentlemen, this concludes today's call. You may now disconnect your lines. Thank you.