First Defiance Financial Corp.

Second Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Don Hileman, *President and CEO*

Kevin Thompson, *Vice President and Chief Financial Officer*

Tera Murphy, *Vice President*

PRESENTATION

Operator
Good morning and welcome to the First Defiance Second Quarter 2017 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. Please note this event is being recorded.

I would now like to turn the conference over to Tera Murphy, with First Defiance Financial Corporation. Please go ahead.

Tera Murphy
Thank you. Good morning, everyone, and thank you for joining us for today's 2017 Second Quarter Earnings Conference Call. This call is also being webcast, and the audio replay will be available at the First Defiance website at fdef.com.

Providing commentary this morning will be Don Hileman, President and CEO of First Defiance, and Kevin Thompson, Executive Vice President and Chief Financial Officer. Following their prepared comments on the company's strategy and performance, they 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 First Defiance 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 Mr. Hileman for his comments.

Don Hileman
Thank you and good morning, and welcome to the First Defiance Financial Corp. Second Quarter Conference Call. Last night we issued our 2017 second quarter earnings release and now would like to discuss the second quarter results and give you an outlook for the remainder of '17. Joining me on the call this morning to give more detail on the financial performance for the quarter, is our CFO, Kevin Thompson. At the conclusion of our remarks, we will answer any questions you might have.

Overall, we continue to be pleased with the sustained momentum toward our strategic goals. The second quarter represented the first full quarter of combined results from the Commercial Bancshares transaction and also included the operating results of Corporate One Benefits, a full-service employee benefits consulting organization acquired in April. Net income for the second quarter of '17 on a GAAP basis, was $8.3 million, or 82 cents per diluted common share, compared with $7.3 million and 80 cents per diluted common share in the second quarter of '16.

Our second quarter financial results clearly reflect the expected operating performance enhancements from our recent acquisitions, as revenues were up 24.3 percent over the second quarter last year; the efficiency ratio improved to 59 percent, from 61.5; and pre-tax pre-provisions earning improved by 33 1/3 percent over the same period last year. While higher charge-offs for credit losses partially offset these improvements in the second quarter, we expect the benefits from our mergers to continue elevating our ongoing performance.

Our overall core performance this quarter helped drive a solid return on average assets of 1.15 percent. We experienced year-over-year and linked quarter annualized net loan growth of 24 percent and 2.8 percent, respectively. Second quarter loan growth was impacted by a large payoff in the $20 million range related to an apartment project.

We continue to focus on our ability to grow our loan portfolio with a balanced approach. The lending environment is very competitive, with rate and structure pressures relating to terms and conditions and the uncertain economic environment. We continue to be disciplined in our pricing approach and purposely pass on lending relationships that would force what we consider overly aggressive pricing and term concessions. We did not see any material movement in local market rates, either leading up to the Fed hike or subsequently to it. With contributions from across our entire footprint and a solid pipeline at the end of the second quarter, up from the first quarter end, we are optimistic we are on track to achieve our annual growth goal in the upper single digits.

Loan originations for the quarter were the highest since the fourth quarter of ’15, and loan yields was about 20 basis points higher in the aggregate than the first quarter. This, coupled with stronger confidence from segments of our clients concerning economic stability and the economic environment, leads us to believe we have positioned ourselves for continued disciplined loan growth during the remainder of ’17. We are also very pleased with our margin improvement this quarter over the second quarter of ’16 and on a linked quarter basis.

The growth in both our net interest income and our core non-interest income revenues on a quarterly basis is a result of contributions from our core business strategies. Kevin will provide more color on the detail in a few minutes. We saw a slight increase in mortgage banking revenues year over year despite a decrease on a linked quarter basis. Total non-interest expense decreased from the first quarter of ’17, primarily due to merger- and conversion-related costs in the first quarter.

The efficiency ratio of 59 percent in the second quarter reflected some of the benefit of the first quarter CSB acquisition and the overall expense control. The credit quality metric showed moderate regression this quarter from the second quarter of 2016 and on a linked quarter basis. Non-performing assets increased to 1.38 percent from .94 percent in the second quarter of ’16. Non-performing loans increased approximately $14 million. Approximately 85 percent of the non-performing loans continue to make payments. We also had a slight increase in restructured loans this quarter.

The level of 30-day and 90-day delinquencies were .26 percent of loans for the second quarter of ’17 compared with .3 percent at the second quarter of ’16 and .19 percent in March of ’17. While we are disappointed in the uptick in non-performing loans and associated charge-offs, we do not believe it indicates an overall trend but more relates to a couple of specific credits believed to be contained. We expect to work hard to see stable-to-improving asset quality trends across the board in the near term.

In regards to our capital management plan, we are also pleased to announce a 2017 second quarter dividend of 25 cents per share, representing a 14 percent increase over the prior year and an annual dividend yield of approximately 1.9 percent.

I will now ask Kevin Thompson to provide additional financial details for the quarter before I conclude. Thank you.

Kevin Thompson
Thank you, Don, and good morning to everybody. As Don stated, net income for the second quarter was $8.3 million, or 82 cents per diluted share, and these results reflect the first full quarter of operating results inclusive of both our Commercial Savings Bank, or CSB, merger, and our Corporate One Benefits agency or Corporate One merger.

The quarter also included a 2 cents per diluted share impact from merger and conversion expenses, primarily for the Corporate One acquisition, which was essentially offset by securities gains of 2 cents per diluted share.

The quarterly results compare to prior year's second quarter results of $7.3 million, or 80 cents per diluted share. As Don also indicated, while disappointed in the higher non-performing assets and credit costs this quarter, we are much more satisfied by our performance in all other areas of our financial results. Even with our higher credit costs, our return on assets for the quarter was a very respectable 1.15 percent.

Now, turning to the details and starting with the balance sheet, the second quarter total loan growth was $16.4 million, which was net of a large $20 million payoff right before the end of the quarter. Our average loan balances grew $212 million on a linked quarter basis, mostly due to the full-quarter impact of our CSB merger. On the other hand, total deposits reflected a decrease of $47 million from March 31st to June 30th. The decline resulted from a run-up in deposits of nearly $70 million right at the end of the first quarter, and those deposits exited the bank by the end of the second quarter.

The growth in average deposits of $237 million on a linked quarter basis was, again, mostly due to the full quarter impact from the CSB merger. Compared to June 30th a year ago, organic growth, excluding the CSB merger, shows loans have grown about $107 million, or 5.9 percent, and deposits up about $98 million, or 5.1 percent. We would expect to maintain these growth rates at a minimum, as well as our strong earning asset mix, low-cost deposit funding, and profitable margin going forward, which leads us to the income statement.

Our net interest income was $24.6 million for the second quarter of 2017, up from $21.6 million in the linked quarter and up $5.2 million, or 27 percent, from the $19.4 million in the second quarter last year. The increase over the prior year includes the addition of CSB for the full quarter as well as some benefit from recovered interest and prepayment penalties collected, which totaled $307,000 in the second quarter of 2017 versus only $119,000 in the same period last year. All in, our margin this quarter was 3.89 percent, up 9 basis points from last quarter and up 18 basis points, from 3.71 percent in the second quarter last year. On a linked quarter basis, our yield on earning assets was up 11 basis points as our loan portfolio yield rose to 4.55 percent, boosted about 5 to 6 basis points by the recovered interest and prepayment fees. Our cost of interest-bearing liabilities was up 2 basis points on a linked quarter basis, impacted by both rate and mix.

As we grow our balance sheet, we are very pleased with the strength and stability of our margin and our interest rate risk position, which remains basically neutral and well balanced for our expectation of continued action by the Fed.

Total non-interest income was $10.1 million in the second quarter of 2017, down from $10.5 million in the linked quarter, which included a $1.5 million enhancement gain on a [unintelligible at 11:30] purchase as well as seasonal contingent insurance commissions, but it was up from $8.6 million in the second quarter of 2016. The second quarter 2017 did include $267,000 of securities gains, while the second quarter last year included $227,000 of securities gains. Excluding the securities gains, quarterly non-interest income was up year over year about $1.5 million, or 18.3 percent. Other than gains on the sale of non-mortgage loans, we had increases in all categories of fee income, which were predominantly due to the contributions from the CSB and Corporate One mergers.

Regarding mortgage banking, revenues for the second quarter of 2017 were $1.8 million, up only $92,000 from the linked quarter and up $66,000 from the second quarter of 2016. The second quarter mortgage banking originations were $64.2 million compared to $48.9 million last quarter and $75.9 million in the second quarter of 2016.

Gain-on-sale income was $1.3 million in the second quarter compared to $1.1 million on a linked quarter basis and $1.4 million in the second quarter of last year. In addition, the second quarter included a positive valuation adjustment to mortgage servicing rights of $16,000 compared to a positive adjustment of $33,000 last quarter and a negative adjustment of $104,000 in the second quarter of 2016.

At June 30, 2017, First Defiance had $1.3 billion in loan service for others, and the mortgage servicing rights associated with those loans had a fair value of $9.7 mullion, or 72 basis points of the outstanding loan balances serviced. Total impairment reserves, which were available for recapture in future periods, totaled $474,000 at quarter end.

As for non-interest expense, second quarter expenses totaled $20.6 million, down from $23.1 million in the linked quarter, which included $3.6 million of merger and conversion expenses but up from $17.3 million in the second quarter of 2016. While the second quarter 2017 did include about $310,000 of acquisition costs for CSB and Corporate One, the bulk of the increase was attributable to the additional operating costs from those mergers. We were very pleased to see the improvement in our efficiency ratio this quarter. Cost synergies were the key driver in the CSB merger, and our efficiency ratio of 58.96 percent in the second quarter of 2017 versus 61.51 percent in the second quarter last year reflects this benefit.

Regarding asset quality, provision expense in the second quarter of 2017 totaled $2.1 million compared to a provision of $55,000 last quarter and $53,000 in the second quarter of last year. Provision expense increased — or the increase resulted from the downgrade of two larger credits in the quarter and net charge-offs recorded totaling just under $2 million, or 35 basis points annualized. This compared to net loan charge-offs of 4 basis points last quarter and net recoveries of 5 basis points in the second quarter a year ago.

Our allowance for loan loss at June 30, 2017, was $25.9 million, up $166,000 versus March 31st and basically even with a year ago. The allowance-to-loan ratio at June 30, 2017, remained at 1.15 percent, the same as last quarter, but down from 1.39 percent last year. The decline in the ratio from last year was primarily due to the addition of the acquired CSB loans which were discounted and recorded at fair value with no allowance. The CSB-acquired loans are currently carried at a discount of $5 million, or 1.7 percent of balances. As for the asset quality numbers, with the two large downgrades totaling $13.6 million, non-performing loans increased this quarter to $30.4 million from $15.1 million on a linked quarter basis and from $16.4 million at June 30,

2016. Our OREO balance remained low this quarter at $672,000 compared to $705,000 last quarter and $1.1 million in the second quarter of last year.

Overall, non-performing assets ended the quarter at $31 million, or 1.07 percent of total assets, up from $17.5 million, or 0.73 percent of total assets at June 30, 2016. Our troubled-debt restructured loans this quarter were $10.5 million, up from $9.8 million last quarter and $9.6 million a year ago. As a result of the increase in NPAs, at quarter end, the allowance coverage of non-performing assets was 84 percent compared to 148 percent at June 30th a year ago. While the numbers are impacted by the two downgrades on which the losses were taken, we are confident that the quality of the remainder of the portfolio continues to reflect strengthened asset quality from a year ago.

Looking at our capital position, total period-end stockholders' equity finished the quarter at $361.4 million, up from $293 million at June 30, 2016, reflecting the acquisition of Commercial Bancshares. And, thus, our capital position remains strong with quarter-end shareholders' equity and assets of 12.51 percent, up from 11.79 percent last year. The bank's total risk-based capital ratio is approximately 12.3 percent at June 30, 2017. Our healthy capital position continues to support our growth and shareholder value enhancement strategies.

So, in summary, our balance sheet remains solid, the acquisitions of CSB and Corporate One are delivering the expected benefits, our core operating profitability is strong. We believe the credit events this quarter are uncharacteristic of our asset quality, and, thus, our outlook remains clearly positive.

That completes my financial review, and I'll turn the call back over to Don.

Don Hileman
Thank you, Kevin. To achieve our goal of being a consistently high performing community bank, we recognize it involves more than numbers on the balance sheet. It takes balancing high performance with strong values. Earlier this year, we introduced our new mission, vision, and value statements that evolved from employee and customer feedback. Our mission statement now states, "As a high performing community bank, our engaged and valued employees provide smart solutions to our clients and communities." This key statement explains what we do and why we are here, which, above all else, is to provide our clients and community with solutions that fit their needs and add value to their lives and goals. By delivering these smart solutions, we help achieve our vision of remaining a high performing community organization. With our new mission, vision, and value statements, we believe we have re-energized our teams to now more than ever have a synergy when working to accomplish our goals. As a result, we have made significant progress on our initiatives to retain and attract top talent, grow our customer base, and build an environment that fosters innovative solutions for internal process enhanced client experience.

Our steady performance, clients-focused values, and our engaged employees blend together to deliver exceptional results to our shareholders. First Defiance leverages these principles to keep us moving forward as we look to expand our branch and agency network through mergers and acquisitions and to deeper relationships within our footprints, especially in our metro markets. We continue to pursue organic growth in Fort Wayne, Indiana, and Toledo and Columbus, Ohio, and we are seeing increased activity in these areas. We still have confidence that a high single-digit growth rate is achievable for the remainder of the year, despite the previously noted competitive lending environment. Loan growth and an increase in loan yields will be fueled by our model of building relationships and relationship pricing, not just performing transactions.

While we did see improvement in the metro market loan growth rate this quarter, we understand we'll be challenged to grow loans and maintain yield management where the asset yields continue to outpace liability costs year over year. However, we believe our delivery and service model is effective in contributing to solid margin growth performance.

Growth in our insurance and wealth management revenues will continue to be a focal point in our overall strategic plan. This is evidenced by our recent insurance acquisition of Corporate One Benefits and its contribution to revenue growth this quarter. We believe these revenue sources help in our ability to grow non-interest revenue in an environment with added pressures on assessed fees and other deposit-related fees. We are also pleased with the steady increase in wealth management and trust revenues. Our teams have made significant progress in enhancing our client experience. Within the next quarter, we look forward to adding convenience to the way our clients bank with us by offering People Pay, a digital payment solution; these smart ATMs at selected locations; an improved online mortgage experience; and, for First Insurance Group, a new app that allows clients to handle multiple aspects of their insurance relationship.

These advancements give our customers additional flexibility and add value as they look to bank beyond our branch doors. To continue this progression, we have dedicated resources working to expand operational capabilities and enhance the organization's overall efficiency, stability, and productivity. We are introducing new data management software that will allow us to deepen our understanding of our customers' banking relationships and behaviors to deliver more personalized banking solutions. As the banking behaviors of our clients change, we will focus on adapting our service and sales models for more convenience, better client banking experience for all our customers.

These strategic initiatives lead our focus and commitment to improving our results relative to our peer group. We are very pleased by our recent financial performance and look to be both financial performance-driven and people-focused as we look to obtain our goal of being a consistently high performing community bank. We remain strongly committed to our customers and shareholders, and we appreciate the confidence you have placed in us as we work to make First Defiance a company known for providing smart solutions to our customers and communities.

Thank you for your interest in First Defiance, and we thank you for joining us this morning. We will now be glad to take your questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and answer-session. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. At this time we will pause momentarily to assemble our roster.

The first question comes from Matthew Forgotson of Sandler-O'Neill & Partners. Please go ahead.

Matthew Forgotson
Hi, good morning, gentlemen.

Don Hileman

Good morning.

Kevin Thompson
Good morning, Matt.

Matthew Forgotson
Just wondering — I'm looking for a little bit more color here on the two large credits that moved on to non-accrual. Can you give us a little color as to the loan types, whether or not they're paying as agreed, where they're marked, and then, just lastly, any additional credit outstanding to these borrowers?

Don Hileman
Well, the credit that we took the large charge-off was in the C&I portfolio. We have entered into a forbearance agreement with that particular borrower, and they will be continuing to make payments on that particular credit, so we think we've got it appropriately marked with the charge-off that we took this quarter on that. And the other is in the commercial real estate portfolio, and we believe that's a timing issue on that credit, Matt.

Matthew Forgotson
Okay. So it sounds like you're clearly positioning these as one-off events, and it sounds like we should expect remediation, i.e., a lower level of non-performing loans in the not-too-distant future. Is that a reasonable expectation?

Don Hileman
That's our expectation, and then we want to work to that. Now, these two credits, they're not going to cure themselves next quarter, but we do not anticipate a higher level of non-performings going forward, and we looked at the similar circumstances, we looked at some larger credits, and a deep dive to get ourselves comfortable that this isn't a trend, you know, that these are, like you said, categorized more as a one-off, and that's what we really believe at this point.

Matthew Forgotson
Yeah. Okay. Were they — just out of curiosity, where they ag credits or small manufacturers, or which industry were they?

Don Hileman
They were not ag. One's in healthcare facilities, and the other is more of a small operating unit that provides services in certain utilities industry.

Matthew Forgotson
Okay. Okay. Great, and can you just zoom out, one of your themes coming out of the credit cycle was the commitment to managing proactively. And with that approach, we sense that you've got a pretty good pulse on the credit market and so forth. As you think through your portfolio, are there any areas where you're paying more attention just in light of what we've seen in auto, for example, or some incremental softening in ag? How are you feeling about those two books and any other pressure points?

Don Hileman
Well, clearly, we are spending a little bit more focus on ag. We have seen some early indications of some stress, especially with the smaller ag credits, and we're looking at, you know, the most recent wet Midwest here we've had and that impact on our clients. We don't see any material

losses in that portfolio at this point in time, but we are spending a little bit more attention to the ag portfolio.

Related to the other general question about other concentrations, I think we will continue to focus on some of our markets, the potential overbuilding of multi-family and how that relates to our portfolio and where we stand with that. We feel comfortable at this point, but I think there will be some possibly constraining of growth opportunities in that — in certain markets as we go forward. The auto industry, we're not very correlated with that as far as our direct relationships. We have several very indirect auto relationships that are providing a small part in the overall process, but generally we're not very dependent on how the auto industry goes, other than from the employment standpoint, but I don't really see any other sectors that we're overly concerned with now individually for us.

Matthew Forgotson
Great. Okay. And just the last for me, and then I'll hop out, but average loan growth was strong, end-of-period loan growth just a little bit sluggish, in large measure due to the prepayment you cited. However, year to date, organic loans are up only about 3 percent on an annualized basis by my math, and to get to the upper single digit implies a pretty steep ramp from here in the back half of the year. So when you say upper single digits, are you thinking — call it 7, 8, 9 percent, and is it really reasonable to get there?

Kevin Thompson
When I look at the numbers, Matt, and I know that pay-off, it happened, so you can't totally ignore it, but organic growth in the first quarter was about $13 million; second quarter we're showing $16.4 [million], but if you adjust that $16.4 [million] by the $20 [million], it would be $36.4 [million], which would be 6.4 percent. With the size of our current pipeline, which is at like an all-time high over the last three years, we're feeling pretty confident about being able to deliver in that mid-upper single digit growth over the remainder of the year.

Don Hileman
Yeah, and —

Matthew Forgotson
Thanks for —

Don Hileman
And we realize — we realize we have to execute on that.

Matthew Forgotson
Right.

Don Hileman
Our indications are, in talking to our loan people and market area presidents and — that they're feeling — it's not just Don and Kevin thinking we can do it, they're the ones driving our decision and our communications.

Kevin Thompson
But our momentum has certainly been building. As Don indicated, our loan originations were way up in the second quarter, so our outlook is that that's a very doable number for us.

Matthew Forgotson

Thank you very much.

Kevin Thompson
Sure.

Don Hileman
Thanks, Matt.

Operator
The next question comes from Damen DelMonte of KBW. Please go ahead.

Damen DelMonte
Hey, good morning, guys. How's it going today?

Don Hileman
Good.

Kevin Thompson
How are you doing?

Damen DelMonte
Good, thanks — good. Just to tack onto the loan growth question, the loans that you guys have been putting on that you're seeing in your pipeline, are these all self-originated loans, or are you guys participating in any shared national credits?

Don Hileman
No. No new originations in shared national credits.

Kevin Thompson
Right. So all originated by us.

Don Hileman
By us. We just have one shared national credit that we're involved in.

Damen DelMonte
Okay. Is that a local loan, or is that a local lender —

Don Hileman
It is.

Damen DelMonte
— that's outside of the market?

Don Hileman
Yeah. No. The loan and the business is inside our market footprint.

Damen DelMonte
Okay. Great. Okay. And then with regard to the margin, I think, roughly 5 basis points of a benefit from the interest recoveries. So if you look at, call it, a 383 or so as your core margin for this quarter, Kevin, how do we kind of frame that going forward, just given the two recent rate hikes and kind of what you're seeing on loan pricing?

Kevin Thompson
Right. You know, I don't see anything pushing it down at this point. As the rate increases have been coming through, that's generally had a slight benefit to us as loans have repriced in the portfolio. The pressure on the funding side has not been felt to date. We're not sensing that there's anything imminent that's going to change that either at this point. So we think the margin should remain strong as we finish out the year.

Damen DelMonte
Okay. So no change in the pricing dynamics, like larger banks aren't changing their rates —

Kevin Thompson
No.

Damen DelMonte
— at all, which is putting pressure on the smaller guys?

Kevin Thompson
Yeah. Not anything that's affecting our business.

Damen DelMonte
Okay. And then I guess just lastly, with the insurance agency acquisition, is first quarter still your seasonally high quarter for insurance commissions?

Kevin Thompson
It is. It is.

Damen DelMonte
And then can we expect something in the 3 to 3.2-ish, 3.3. range for the next couple quarters as like your normal run rate?

Kevin Thompson
Correct.

Damen DelMonte
Okay. Okay. Great. That's all that I had. Thanks a lot.

Don Hileman
All right. Thank you.

Kevin Thompson
Thank you.

Operator
The next question comes from Daniel Cardenas of Raymond James. Please go ahead.

Daniel Cardenas
Good morning, guys.

Dan Hileman
Good morning, Dan.

Daniel Cardenas
Just a couple of quick questions here. Going back to the two non-performers that were added on this quarter, were those from the legacy portfolio, or were those from some of the recent acquisitions that you guys have completed?

Dan Hileman
No, they were our origination, not related to the acquisition at all.

Daniel Cardenas
Okay.

Dan Hileman
One was one I would categorize as a fairly new credit to us that had issues, and that's the one we took the charge-off, but we originated those.

Kevin Thompson
Not part of the acquisition at all.

Dan Hileman
Yeah.

Daniel Cardenas
Okay. Perfect. Perfect. And then with People Pay, could you maybe give us a little bit of color as to what impact, if any, that's going to have on operating expenses going forward?

Dan Hileman
I'd say it's very minimal on operating expenses. It's just another service in our mobile and our electronic banking suite to allow customers more of a flexibility to pay individuals and other payments outside of electronic banking. So they don't necessarily have to have an account with us to receive a payment now, which we think what we're seeing in the industry is something that was very convenient for our customers, and they asked for it, but the additional incremental expense is going to be very minimal.

Daniel Cardenas
Okay. Then the core operating expense number that we saw this quarter, is that a good run rate to build off of for the second half of the year?

Kevin Thompson
I'd say, yeah, absolutely. We did have about $300,000 of one-time costs for the merger, but as we finish out the year and continue to grow — so I would expect a number very similar to what we had this quarter as we go forward.

Don Hileman
Yeah, we do have some additional facilities' adds for expansion, but that's going to be later in the fourth quarter, so it really won't affect our run rate here. I think we've mentioned we're going to expand facilities in Toledo.

Daniel Cardenas

Great. And then just the last question, I know you guys just completed Commercial, but maybe what's your appetite for additional acquisitions, and then what's the market like right now in your footprint? Is there a lot of activity, a lot of noise, or is it fairly quiet?

Don Hileman
Yeah, it's someplace in the middle. I wouldn't say there's a lot of activity, but there is activity. There's still a lot of questions going on, we're receiving books to look at. I'd say our appetite is, we feel good about our ability, where we are today, of absorbing CSB. With anything, we'd probably survey our people. Some are ready and some are saying, "Well, let me digest and finish up some of the things I didn't get done before you want to do another one," but I think generally our organization feels good about what we accomplished with CSB, and we feel really good about the integration process, the management of that integration process, and the corresponding results. And, like Kevin said, we're seeing those integration benefits right now. So, yeah, we would be receptive to looking at another transaction in the near term, Dan, if the right opportunity comes along.

Daniel Cardenas
Okay. Great. Perfect. Thanks, guys.

Don Hileman
All right. Thank you.

Operator
The next question is from Christopher Marinac of FIG Partners. Please go ahead.

Christopher Marinac
Thanks. Good morning, guys. I just wanted to ask a little bit more on the credit picture beyond the comments stated earlier. Do you have a sense of kind of directionally what happens with substandard and classifieds when you file the Q? Would those be directionally higher, or was a lot of that curtailed by taking the charge-off in the quarter?

Kevin Thompson
No, they'll be directionally higher.

Christopher Marinac
Okay.

Kevin Thompson
Due to these two adds. They're both going — yeah, they're both classified and substandard, right.

Christopher Marinac
Okay. And then I may have missed earlier in our remarks about were those C&I loans, or what was the history on those two deals?

Dan Hileman
The one we took the charge-off, Chris, was a C&I loan.

Christopher Marinac
Okay.

Dan Hileman
And the other one is a CRE.

Christopher Marinac
Got it. Okay. So one of each. All right, very good.

Dan Hileman
One of each, yeah, but the charge-off's all related to the C&I portfolio.

Christopher Marinac
And then, excluding those two credits, are there other trends that you see that would indicate higher issues or just more downgrades in the future, or, again, are these really isolated as you said?

Dan Hileman
I think there's early indications of the potential for more credit stress. We're not necessarily seeing it — I can't say this credit or this credit, but when I sit in committees and we sit and talk about things, a lot of that indication is when you get the year-end financials coming in, and some of those are a little — maybe not as strong as you would think in our environment. So that's an indicator that maybe things aren't as strong as what you would hope. So it's things like that, Chris. It's not necessarily to say that we're seeing obvious deterioration in trends, but I think we're maybe not seeing as much of the improvement that I would have hoped to have seen based on getting some of the year-end financials for some of our clients that I would have hoped at this point in time —

Kevin Thompson
I would agree with Don's comments. But, again, I don't think it's anything that noticeable. The only area that might have anything in my mind, is ag. Even there, our collateral positions are very strong, and, yeah, we don't see losses, but we do see that the customers have had a little more distress, if you will, over the last couple of years, and so that's the only thing that maybe is a little bit of an issue in my mind. Otherwise, I don't think the trends are really very different than what we've seen.

Christopher Marinac
And, Kevin, as you mentioned ag, it's not necessarily ag loans within First Defiance. It's more that the customers have potential issues, and that impacts other pieces of the portfolio. Is that a fair interpretation?

Kevin Thompson
I suppose on a broader sense, yeah. Sure.

Dan Hileman
Yes.

Christopher Marinac
Okay. Great. All right. And then a separate question, a different topic, is just on the People Pay program, did you have to pay sort of a per-user or a — I'm just curious if that ends up being a better economics for you than some of the other, Zelle and other things that the big banks are starting to adopt.

Dan Hileman

Well, it's an easier one for us at a lower cost entry point for us to get into this because of our relationship with our core provider. And that made this an easier, less costly relationship, a way to get into this — that market of the People Pay, Chris. We do — I believe we do have a set cost on this program by user, but it's not as dramatic as some of those other ones that maybe have more bells and whistles than our product, but we're excited about at least having a good product that we can offer our customers, and we'll continue to look at that, but I wouldn't necessarily match it up completely from a cost structure with some of those other products.

Christopher Marinac
Sounds great. Thank you for the background there, guys, appreciate it.

Don Hileman
All right.

Kevin Thompson
Sure. Appreciate it.

Christopher Marinac
Appreciate it.

Operator
Again, if you have a question, please press star, then 1. There are no additional questions at this time. This concludes our question-and-answer session. I would like to turn the conference back over to Tera Murphy for closing remarks.

CONCLUSION

Tera Murphy
Thank you for joining us today as we discussed our quarterly results. We appreciate your time and interest in First Defiance Financial Corp. Have a great day.

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