Premier Financial Corporation

Q3 2020 Earnings Conference Call

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CORPORATE PARTICIPANTS

Don Hileman – *Chief Executive Officer*

Gary Small – *President*

Paul Nungester – *EVP, Chief Financial Officer*

Matt Garrity – *EVP, Chief Lending Officer*

Vince Luizzi – *EVP, Chief Banking Officer*

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PRESENTATION

Operator
Good morning and welcome to the Premier Financial Corporation Third Quarter 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. 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. Please go ahead.

Tera Murphy
Thank you. Good morning, everyone, and thank you for joining us for today's 2020 Third Quarter 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 leadership's 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 Premier Financial Corp. Actual results may differ materially from current and forecasted 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
Thanks, Tera, and good morning and welcome to the Premier Financial Corporation's Third Quarter 2020 Conference Call. Joining me on the call this morning to give more details on our financial performance for the quarter is our CFO, Paul Nungester; as well as Gary Small, Bank President; Matt Garrity, Chief Lending Officer; and Vince Luizzi, Chief Banking Officer.

Last night we issued our 2020 Third Quarter Earnings Release. Now we'd like to discuss that release and provide insight into the opportunities and challenges for the remainder of 2020. At the conclusion of our remarks, the team will take any questions you might have.

As we continue to navigate through the challenging operating environment, our focus remains on our clients and providing solutions to their needs. We are seeing divergence in the operating environment for different sectors of our client base. The hospitality industry continues to struggle, while housing and home sales are strong. All of our associates are working very hard to provide our clients the service and attention they expect from Premier Financial, and I want to thank them all for their efforts and dedication during these very stressful times.

The third quarter continued to be challenging for our company. We, as well as the entire country, continued to deal with the impacts of the current COVID-19 pandemic. We are consistently monitoring how it is affecting our clients and our own operations. We expect the economic impacts related to COVID-19 to be with us well into 2021 as the search for a vaccine continues and as baseline consumer confidence builds from a health standpoint. The pandemic and the resulting economic fallout is a major concern for all as we continue to focus on serving the immediate needs of our clients, concerning the health and well-being of our employees, and supporting the communities in which we live and serve.

I am very pleased with the strong core performance in the third quarter and the completion of our core conversion in July. Third quarter 2020 net income on a GAAP basis was $25.7 million, or $0.69 cents per diluted common share, compared with $13.2 million, or $0.66 cents per diluted common share, in the third quarter of 2019. On a core basis, net income for the quarter was $28.6 million, or $0.77 cents per diluted share.

Pre-tax, pre-provision return on average assets was strong at 1.99 percent compared to 2.1 percent for the third quarter of ’19. We’ve been able to maintain our efficiency ratio below 50 percent on a core basis, with the third quarter at 49.9 percent. Our provision for loan loss was also in line this quarter with moderating expectations of higher credit losses due to the economic environment. Net charge-offs did elevate slightly this quarter to 24 basis points; however, this was offset by a provision for loan losses, which resulted in a net impact of a one-basis point increase in the allowance to 1.63 percent.

Overall, credit quality was generally stable in the quarter, with very moderate increases in NPLs and restructured loans. We see this continued improvement in the amount of loans on deferrals, dropping from 16 at June quarter end and 9 percent at September quarter end. Matt will have more details on this category in a few minutes.

We continue to be very diligently monitoring and communicating with our loan clients. Ongoing strong levels of activity and gain on sale led to another very strong quarter in the mortgage area. Overall growth in the third quarter was 3.1 percent for loans and 4.5 percent for deposits, with a shift in the non-interest-bearing deposits as a percentage of total deposits as the trend of strong deposit activity continues. Our overall capital levels are solid and were bolstered by the successful debt offering of $50 million in September. We felt that the environment for the additional Tier capital was present, and it was the appropriate opportunity for us to further strengthen our capital stack. We were quite satisfied with the execution of the offering coming in at a 4 percent rate.

We are also pleased to announce the continuation of our dividend with a 2020 fourth quarter dividend at 22 cents per share, flat with a year ago and an annual dividend yield of approximately 4.8 percent.

At quarter end, we had 570,000 shares of common stock remaining for purchase under our repurchase plan authorization. In these uncertain times, we continue to assess uses of the authorization as well as other capital strategies.

I will now ask Paul to provide details for the quarter before I conclude with an overview. Paul.

Paul Nungester
Thank you, Don. Good morning, everyone. I’ll summarize our third quarter results and highlight certain impactful items. First is the balance sheet. Total loan growth was muted as commercial loan growth was mostly offset by continued shrinkage in residential and consumer lending. We generated $55 million of commercial loan growth, including some additional PPP. Residential loans had very strong origination volumes again, but pre-payments and refinancing continued to drive the net portfolio reduction, although we did have a $48 million increase in loans held for sale.

For deposits, we added another $36 million from June 30, for a 2.5 percent annualized growth rate. Non-interest deposits declined as businesses began using funds and represented about 23 percent of total deposits at September 30th versus 25 percent at June 30th.

Next, I'll explain the allowance. As previously noted, we did adopt CECL effective January 1st, and we've discussed the impact of that on previous calls. For 3Q, the allowance only increased slightly, by $363,000, due to provision expense for loans of $3.7 million, offset by net charge-offs of $3.3 million. Approximately $4.2 million of gross charge-offs is related to one credit that was a PCD loan from the UCFC acquisition. That loan had a specific reserve established; however, accounting rules require that to be reflected through provision expense rather than a credit against the charge-off. If, instead, reflected as a credit against a charge-off, those would be $0.9 million, or 7 basis points, for 3Q and a net recovery of one basis point on an LTM basis.

The net increase in the allowance is related to an increase in qualitative factors and risk migration offset by improved quantitative factors. Qualitative factors were increased in 3Q again, primarily due to continued concerns for potential future charge-offs. Quantitative factors improved, primarily due to a better economic forecast, including a further improved national unemployment forecast.

And, last, while non-PPP volumes only increased slightly, risk migration began to have an impact as we experienced some increases in our special-mentioned and classified balances. At 9/30, our allowance coverage to total loans was 1.63 percent, which is up from 1.62 percent at 6/30. But if you exclude PPP loans, the ratio would be 1.77 percent from 1.76 percent at 6/30. In addition, if you include the unamortized balance of purchase-accounting marks, the coverage ratio would be 2.04 percent.

To finish the balance sheet, I'll discuss capital, where we ended with $959 million of equity at September 30, up $18 million from June 30, primarily due to continued strong net earnings. At September 30, our tangible equity ratio was 9.2 percent, and our total risk-based capital was estimated to be about 12.9 percent. We did complete a very successful capital issuance on 9/30 for $50 million of fixed-to-floating sub-debt, with an initial rate of 4.00 percent--the lowest this year for a triple B minus, pro-rated bank holding company. This helped to boost total capital and enhances the holding company's ability to serve as a source of strength to the bank during this economic recession.

Next, I'll turn to the income statement. I will preface this with noting that year-over-year comparisons are obviously skewed by the fact that we had three months of operations, including UCFC, in the third quarter of 2020, compared to none in third quarter of 2019.

I'll start with net interest income, which was $53.3 million for the third quarter of 2020. This resulted in a net interest margin of 3.47 percent. This does include the benefit of accretion from purchase accounting marks, with $1.1 million coming through interest income and $0.8 million coming through interest expense. This also includes $2.7 million of interest income on PPP loans, with an average balance of $440 million. Excluding the impact of those items, our net interest margin would be 3.41 percent, which is up from 3.34 percent on a linked quarter basis. This improvement was attributable to our continued efforts to reduce funding costs as well as addressing excess liquidity from the significant deposit growth experienced year to date.

Non-interest income was $25 million for 3Q and represented almost 32 percent of total revenues. First, mortgage banking income was $12 million for third quarter 2020. Gains on sale of mortgage loans were $13.8 million, up from $11.5 million last quarter, primarily due to pricing along with continued high volumes. Offsetting those gains were MSR amortization expense of $2 million, fairly consistent with last quarter, and a negative valuation adjustment of $1.7 million, which is up from $1.4 million last quarter. The valuation adjustment was negative again this quarter due to continued increased pre-pay fees. As rates improve and pre-paid fees revert back to normal levels, we will be able to recover against that valuation allowance.

Next, wealth management income came in at $1.5 million, an increase from $0.7 million last year, and insurance commissions were $3.7 million, up from $3.3 million last year. Service fees and other charges increased to $4.8 million from $4.0 million last year, and we had $1.4 million of security gains, which I'll discuss more shortly.

Next, I'll discuss expenses. First, we incurred $3.7 million in merger-related costs in the third quarter of 2020. So, cumulatively we have incurred $34 million to date, and we do not expect much more, if any, to occur in 4Q since we have largely completed implementation of synergies and the core conversion. So, excluding merger costs, total expenses were $39.9 million compared to $35.6 million the second quarter of 2020, with the increase primarily due to other expenses and FDIC premiums.

First, we early extinguished $30 million of fixed rate FHLB advances that had a weighted average rate of 2.0 percent and incurred a pre-payment penalty of $1.4 million, which is recognized in other expenses. Separately, we sold $55 million of MBS securities, yielding approximately 1.8 percent, at a gain of $1.4 million, thus resulting in no impact to net income. The proceeds from the sales are being reinvested into securities yielding approximately 1.5 percent, funded by overnight advances with a cost of approximately 20 basis points. The net effect of the transactions is expected to increase pre-tax income approximately $425,000 over the next 12 months and enhance net interest margin by one basis point.

Next, FDIC insurance premiums were a $1.5 million expense in the third quarter of 2020, up from a $411,000 expense in the second quarter of 2020 and a $255,000 credit in the third quarter of 2019. The increase in expense from prior quarter is largely due to the impact of PPP and includes a year-to-date accrual estimate true-up. Although PPP loan balances are excludable from the asset-based component, they are not excludable from the leverage-ratio component because we did not borrow from the PPPLF; plus, any loan funds that were in our deposit base would also increase the asset base component. FDIC insurance premiums were a credit of $255,000 in the third quarter of 2019 due to the receipt of small bank assessment credits.

So, excluding the merger costs as well as the FHLB pre-payment costs, since we exclude security gains, we generated a core efficiency ratio of 49.9 percent, which compares very favorably to 55.5 percent in the third quarter of 2019. Additionally, our core pre-tax, pre-provision income was $34.7 million, which generated a robust 2.20 percent return on average assets. We are very pleased with our third quarter operating profitability as we continue to realize our merger benefits.

I'll wrap up with a summary of net earnings. On a GAAP basis, we reported net income of $25.7 million, or $0.69 cents per share. Merger costs this quarter represented $2.9 million on an after-tax basis, or $0.08 cents per share. Excluding those costs, core earnings were $28.6 million, or $0.77 cents per share.

In conclusion, we had another strong quarter as we completed our core conversation and near-final implementation of synergies. Our healthy capital levels and sturdy operating profitability remain a solid foundation in the current recessionary environment.

That completes my financial review, and I'll now turn the call over to Gary for highlights on our community banking initiatives, merger integration progress, and continued COVID impact. Gary.

Gary Small
Thanks, Paul, and hello to all. We certainly had a terrific performance quarter, and I'll provide a few comments that will give some additional color. We are 90 days post our integration date, which was July 13th, and, again, an MOU—or, excuse me, an MOE combination is a large undertaking and we're very pleased to report it as a successful effort. And we're now in the stage of typical cleanup and adjustment activities and those continue today. We see that we'll wind down those efforts over the next few weeks. Work will continue on operational improvement initiatives that we have slated over the next few months, with our goal to optimize our resources and provide the very best client experience possible.

You might note that deposit-related, non-interest income was down a bit for the quarter versus the norm. There were fee grace periods and liberal fee weighed activity for clients that were affected by the integration, which was the movement between the two core systems of their accounts. Fee income is returning to normal levels as we enter into Q4—deposit fee income, that is.

We have also discontinued select points programs, et cetera, re-setting our fee income base, and that's a more permanent effect. Those fee reductions are more than offset by the corresponding expense reductions related to the cost of administering those programs.

From a business perspective, regardless of the uncertainty created by COVID and the near-term election cycle, each of our business units ran on a good pace as we go into Q4. Our residential mortgage business continues its excellent year, and we expect to carry over that, at least into early '21. The commercial activity is stronger than might be expected under the circumstances, although pipelines are understandably a bit less than normal. Across the retail shops, we're returning to a more business-as-usual mode, with sales campaigns underway and home equity investments in small business services, and we're getting excellent early initial activity results.

And I would want to say that our insurance and our wealth management businesses continue to post strong results. And all of these fee businesses, it's worth remembering, are big enough to matter and provide a very diverse revenue stream for the organization, adding to some of the resilience of our performance.

Margin management's always top of mind, and, as evidenced by the end of the third quarter's rapid decline in our overall cost of funding, competitors are flush with cash, and there's little promotional activities in the market. And we've seen our funding costs drop by as much as five basis points within a single-month period. We'll continue to manage deposit pricing very closely, and we expect to see a continuation of this lowering theme over the next couple quarters. Regarding loan yields, we continue to use floors and have de-emphasized swap activity for the foreseeable future in an effort to protect our yield.

In terms of delivery channel activity, we have recently announced the closing of three branch locations effective in the first quarter of ’21. COVID-19 has certainly affected how our clients interact with us from a brick-and-mortar perspective. Consistent with past efforts, we continue to look for opportunities to realign our resources and better enable us to do business with the customers in their space and responding to their service preferences.

A comment on credit—we see delinquencies trending upward but in a very measured pace. We closed Q3 at approximately 90 basis points. Commercial reflected no meaningful change from our Q1 levels. And consumer and residential levels are up but steadily increasing but remaining very—at very manageable levels. We keep a close eye on the migration and we’re generally very pleased with where we stand.

A final thought—we continue to build a business model in the fashion that we will deliver a strong operating leverage over time. This approach builds better performance resiliency under almost all market conditions. It’s worked for us to this point, and you should expect no change going forward.

With that, I’ll turn it over to Matt.

Matt Garrity
Thanks, Gary. I’d like to update you this morning on the return-to-pay activity of our borrowers that have received payment accommodations as a result of the COVID-19 pandemic, comments on our portfolio performance for the quarter, and our thoughts on asset quality moving forward.

With respect to payment deferral activity during the third quarter, we’re pleased to report the total loan deferrals to clients by approximately 41 percent as borrowers return to payment. We saw approximately 76.4 percent of third quarter expiring deferrals returning to payment. As we discussed on last quarter’s call, October is our largest month of expiring payment deferrals, and as of Monday, our return-to-pay percentage is tracking to what we experienced for the third quarter. This should put us in the mid-single digits by the end of the month.

I would note that our reduction in deferred loans was also seen in our high-sensitivity portfolios. Balances under deferral reduced over 33 percent in our accommodation and foodservice category, over 48 percent in our retail trade category, and over 58 percent in our long-term care category. As outlined in our earnings release, we also saw some extension of deferrals during the quarter, but these extensions largely represent maturing 90-day deferrals that were deferred for any additional 90 days. On the consumer side, mortgage portfolio deferrals were at approximately 3.6 percent, which compares very favorably to the national average of over 6.8 percent.

In terms of portfolio performance during the quarter, I would characterize it as in line with our expectations and consistent with what we communicated previously. We did see asset quality migration as expected during the quarter, but the migration during the quarter was largely contained in our hotel segment. The remaining portfolio remained relatively stable during the third quarter. Our expectation is that while performance continues to improve slowly in the hotel segment, that several of these borrowers will require additional support while they continue to recover.

In terms of the asset quality migration we did see during the quarter, much of the hotel segment migration was to the special-mention category, with one $4.9 million hotel loan moving to sub-standard. While we do expect further migration in this segment, I would note that by design, the hotel portfolio represents a relatively small segment of our overall loan portfolio, at 2.8 percent of total loans. We continue to monitor the performance of this portfolio and our entire loan portfolio closely.

As Paul mentioned in his remarks, we had net charge-offs of $3.3 million for the third quarter, from an individual loan that had a specific reserve established. I would not characterize the charge-off as being completely COVID-19 driven as it had previously been identified as having performance issues and having had a mark established against the loan at the time of merger. The loan was in the retail portfolio and we believe the remaining balance is appropriately reserved for.

Our overall outlook for asset quality remains unchanged from our comments last quarter, as there remains a high level of uncertainty. We believe continued economic recovery remains reliant on the duration of the pandemic, vaccine development, and what future economic stimulus looks like. So far, the impact of the pandemic has been uneven across customer segments, with businesses and consumers tied to more contact-dependent segments under greater duress than those that are not. Our team continues to stay close to our customers and monitor performance.

In spite of the challenging environment, we were well positioned entering the cycle, given our strong asset quality position; a strong balance sheet, bolstered further during the quarter with our successful sub-debt raise; and a strong risk management team in place. We also believe that our borrowers have come into this cycle stronger overall than in prior cycles. While we fully expect continued asset quality migration and additional credit losses in future quarters during this cycle, we believe we are well positioned to see it through.

I'd now like to turn the call back over to Don for closing remarks. Don.

Don Hileman
Thank you, Matt. While the future will continue to bring challenges for the company, I believe that we as a company have worked hard to position ourselves to proactively address these challenges. As noted, credit challenges and the uncertainty related to the credit environment continue to develop, and we expect it to be at least several quarters until we see that playing out with more clarity.

We believe we have made consistent progress in our execution of the merger integration, as noted on the emphasis to shift our focus to the future. The dedication and teamwork of our employees have proven that our "Powered by People" philosophy is a driving factor behind our success. I am so proud of their commitment to our clients and communities during this challenging time.

We appreciate the trust you have placed in us and thank you for joining us and for your interest in Premier Financial Corp. We will now be glad to take any 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 will come from Scott Siefers of Piper Sandler.

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

Don Hileman
Good morning, Scott.

Scott Siefers
Hi. Okay, I think the first question I wanted to ask is just within the hotel portfolio. When you talked, Matt, about the need for additional support for some borrowers in that portfolio, what do you mean by that? Like how are you contemplating working those out? Are those just as simple as extensions of deferrals, or are we talking something more substantial than that?

Matt Garrity
Scott, it's really just extension of deferrals, consistent with some of the regulatory guidance that came out recently really encouraging banks to continue to support these clients that are impacted by COVID. We've taken the approach to continue to assist those, although I would say for those hotel loans and really any of our deferred borrowers that need additional assistance, we're really approaching it with a little bit more of a value exchange this time around. So, we would be thinking about enhancements, be they economic or structural with collateral or increases in recourse, things of that nature. But we do expect that, particularly in this hotel segment—and, thankfully, it's relatively small compared to the overall portfolio—that we're going to need to continue to support these folks for a little while longer.

Scott Siefers
Okay. Perfect. Thank you. And then maybe a question for Paul. So, the core margin, when we back out all the noise, I was surprised by how well it held up. Just curious if you can give us maybe a little more color on the puts and takes as you see them and sort of where it goes from here.

Paul Nungester
Yes, so a couple things there. Part of it is a little bit of pick-up from what I described earlier during the prepared remarks about the restructuring transaction we did. We've been able to take some liquidity, get rid of borrowings for the most part. In addition, we did get active in the third quarter here ramping up some security investments. So, just as we were an issuer, we were also a buyer on that front, buying some sub-debt and other securities as well as the normal stuff. But given we had that ability because of the strong deposit growth, which came in surprisingly strong in the second quarter and was a drag to NIM, we obviously put that to work as best we could, and that helped prop things up there.

Scott Siefers
Okay. Perfect. And then just as you look forward, you know, is it—were you able overall to support that at sort of the current level?

Paul Nungester
Yes. Yes, we think absent any additional shocks to the system here, we think we've for the most part hit a trough at the three-fourths level. You know, most of our loan portfolio, especially

the variable stuff, has already rolled down. We will continue to get a little more compression on there as our five-year ARM portfolio comes up for those resets and whatnot, but we've been beating down our funding costs very strongly—CDs especially—which will continue to turn. And we've got a little bit more opportunity. You know, we've still got some higher-cost deposit funds out there, certain money markets and private banking and things like that, that we could look at if needed to continue to bring that down over time.

Scott Siefers
Perfect. Thank you very much.

Paul Nungester
Yes.

Operator
The next question is from Michael Perito of KBW.

Michael Perito
Hi, guys. How is everybody?

Don Hileman
Good. Good.

Michael Perito
Good. Good to hear. The first question for Matt on—the commercial loan balances—XTTP—at least as it would seem to me from the financials, have seen some steady —not quite as robust as it was, but some steady growth, and I'm just curious how the market for commercial loan growth looks today as you guys see it from a credit risk-appetite standpoint, from a pricing standpoint, from a competition standpoint. I mean, if there's some confidence that as we move into next year here, that you can continue to drive maybe and see some acceleration of commercial loan growth, organic commercial loan growth?

Matt Garrity
Sure, Mike. It's still a very competitive market. I would characterize our activity in our commercial bank as being solid and some good growth in the third quarter, but I wouldn't obviously characterize it as the kind of growth that really either institution has experienced historically over the last couple of years. But the growth is there, a fair amount of growth in Q3.

I think as we get into Q4, I would expect a similar amount of growth. What will impact us in Q4 is some pretty strong payoff activity. These are planned payoffs, people going out in a permanent market, but in spite of that, we'll see some growth.

Our aspirations for 2021 will—includes loan growth in the commercial portfolio, but, again, I wouldn't say it's going to be to the robust levels that both organizations enjoyed historically pre-pandemic, pre-COVID, but we've got a really solid team out there looking for the right deals.

Credit philosophy and how we operate in this market, I think both institutions were relatively conservative and had a fairly well-defined set of goalposts over what deals make sense and which ones don't. So, one of the things that we bring to market is some consistency there. Clearly, we'll probably be asking a few more questions because of what's going on with COVID and the questions that those raise, but we haven't also—we haven't pulled our oars in either. We'll still look to grow this portfolio next year.

Gary Small
Mike, this is Gary. As additional evidence on that, in the last quarter we've added five commercial bankers from some strong competitors. We're in the mood for selective growth and adding talent folks to the team to get it done.

Michael Perito
Helpful, guys. Thanks. And then on the mortgage side, as we look out to the next quarter or two here, can you help us just balance what—some historical seasonal trends versus what's clearly some environmental elevated activity here and how we should think about that unit's production near term?

Matt Garrity
Mike, this is Matt. We've got a very strong pipeline going into Q4. As we saw production on the refi side dial down a little bit, it was really backfilled nicely with purchase and construction firm activity, so we think our Q4 is going to be pretty solid, and we've been pretty transparent—is that we're enjoying some really outsized margins because of—as we reach capacity internally, you know, in turn, we're pricing up a little bit in reflection of that. That clearly won't last forever. It won't last with us all through '21, for example, but we do feel that this expanded profitability that we're experiencing relative to what both banks would have seen in the norms will be with us during Q3 and will bleed into Q1 next year as well.

Michael Perito
Helpful, Matt, thank you. And then just last for me, Gary, you mentioned the three branches that you guys have closed and the changing kind of customer preference that you've seen during the pandemic. I'm just curious, how do you see Premier in terms of evolving its delivery methods and products and services? How far along do you guys see yourselves today? I mean, with the three branch closures just kind of the initial stuff that's stood out and there's more ongoing, or do you feel like the combined footprint is now somewhat rightsized? I guess I'll start there.

Gary Small
I'll unpack that a bit. The three branches that we announced, two are pure consolidations, and given the transaction levels and the market movement, easy to do. One's a little less of a pure consolidation. We're not exiting the market, but it's not as easy as just being down the road. And they've been on the board for some time. Both organizations historically had selectively pruned the branch complement on a pretty recurring basis, so, I don't expect we're going to have the big shop announcement of 25 percent of our locations going down in a year or anything like that. When you look at the branch component that we have now, there continues to be some potential opportunities there. But, again, I wouldn't expect a large announcement like that, but Vince could comment a little bit on the network as a whole.

Vince Luizzi
Sure. Thank you, Gary. I would just also remind everybody that as part of our prudent distribution management program, we're also looking at opportunities where we do see growth. I'll remind everybody I think in the second quarter we announced the opening of our branch in Columbus, and so as we're constantly looking at the retail network and opportunities that we've got to optimize and meet customers when, where, and how they want to interact with the bank, you'll see more focus, not just around retail branch distribution but around our digital strategy and our ability to connect with customers digitally. And so I would just remark that this is really a function of an ongoing optimization retail distribution strategy program that helps us make the decisions to meet the customer need and demand.

Gary Small
That speaks to my comments earlier, Mike, relative to realigning the resources, and if you were to look into our strategic plan as it stands today, you would see significant dollars going into the digital-space channel and all things digital, and you'd see a trimming of commitment in some of our more traditional channel support. They'll continue to see what they need to be, but priority-wise we move into that digital space.

Michael Perito
And as we think about the expense outlook from here, do you—it sounds like your NIM actually—relatively is going to be pretty resilient here, but still a difficult rate environment. You have the mortgage offset, which certainly helps, but I imagine there's not a huge appetite to grow expenses in a significant way in this environment. I mean, do you feel like you're on the trajectory where these digital enhancements and upgrades and [unintelligible] that you're making to your platform are at a point were efficiencies that they generate and potential—you as you scale, can limit the upfront negative impact to your expense growth as you move along this path?

Gary Small
I don't know if it will be a one-for-one in the year expended, but over a reasonable period of time, you can expect that you'd get your earn back in terms of other physical delivery methods and support and processes, because a lot of digital is process improvement and just efficiency in customer acquisition expense. So, it may not be within the year spent, but that certainly is a goal. It's a lot of activity, and I think traditionally in banking, as we've expanded our channels, that you incur new costs and, again, you either optimize or get the opportunity to exit some old delivery methodologies, and you tend to see a net benefit to the bottom line with the technology coming onboard.

Michael Perito
Okay, a helpful and interesting discussion. Thanks, you guys, for taking my questions. Stay well.

Gary Small
You're welcome.

Operator
The next question will be from Freddie Strickland of Fig Partners.

Freddie Strickland
Hi, good morning, guys.

Don Hileman
Hi, good morning.

Freddie Strickland
Just a question on the merger discount. It was a little less than $15 million at June 30th. Is the approximately $1 million of accretion a direct reduction in the mark? Should we be thinking that's around $13.5 mil, or what was that number?

Paul Nungester
Yes, the accretion on the asset side—the net of loan and securities was the million bucks, yes. And your—can you clarify what you're talking about on the discount side?

Freddie Strickland
Yes, just like when we're trying to look at reserves plus the credit mark, is that credit mark now like $13.5 million?

Paul Nungester
Yes. Yes, I got you, yes.

Freddie Strickland
Got you. Sorry, I just phrased it a little [inaudible] —

Paul Nungester
You were talking dollars. You're correct, yes, yes.

Feddie Strickland
Okay, and then one follow-up for me. You know, you guys had a great 220 pre-tax, pre-provision ROA this quarter. Do you guys see that as being sustainable, and do you think you can expand it into 2021?

Don Hileman
You know, I think it's going to—this is Don, Freddie. I think it's realistic to expect that we can target this level. Whether we can expand on that level with some of the headwinds and some of the additional items we anticipate will be a challenge, but, clearly, we're focused on the things that we just talked about. But I think any kind of significant expansion would probably not be what we would be looking for net that ratio.

Freddie Strickland
Got it. Thanks so much. Thanks for taking my questions, guys.

Don Hileman
Oh, you're welcome. Thank you.

Operator
The next question will be from David Long of Raymond James.

David Long
Good morning, everyone.

Don Hileman
Good morning.

David Long
At the beginning of the call, you talked about your qualitative versus your quantitative part of the reserve, and curious on the qualitative side. What are your assumptions baked into your reserves today on the next stimulus package?

Paul Nungester
Well, we do believe that there's obviously the possibility of it, but given the current political environment, we're not putting a whole lot of credence in it just yet. You know, that's something that we'll hopefully clarify here in the fourth quarter post-election. We'll get a lot more visibility into that, but while we see it as a possibility, it would certainly be unofficial, we're not going to put a lot of weight into that at this point.

David Long
Okay, got it. And then in response to a discussed question earlier, you mentioned purchasing securities, and I thought you mentioned sub-debt. So, I'm just curious, are you guys—you've issued sub-debt, but are you buying other banks' sub-debt in the year's portfolio at this point?

Paul Nungester
Yes, yes, we are. It's a—on an alternative investment, it's a better yield than some of the traditional stuff that we get, so it helps from that perspective. It also helps with some durations and things like that.

Don Hileman
Yes, we've put some—this is Don—we've put some fences around how much of that we have an appetite for, and we're generally going to be looking for companies we know and understand rather than just any kind of sub-debt to purchase. So, I think we'll have a pretty high-quality portfolio of that on our books here as we move forward through the quarter.

David Long
Got it. Okay. Thanks. And then, lastly, the PPP loans and the timing of forgiveness there, have you started to take applications for forgiveness, and how are you thinking about the timing on your customers going through that process?

Don Hileman
Yes, I'll let Matt answer that one for you.

Matt Garrity
Sure. We—to your first question, we've seen very little activity on forgiveness, really just literally handfuls of clients that want to go through the process. I think the lion's share of our client base has been anticipating what comes next out of Washington. What modifications or what happens to the forgiveness process is part of a future stimulus package. So, I think that's a bit of a gating issue right now, and to the extent of the timing of that additional—getting that stimulus rolled out, that might be the accelerant that we need. But our thinking is that this gets—more of this forgiveness process really gets pushed out into early '21 and into Q1.

David Long
Got it. Thanks for taking my questions, guys.

Don Hileman
Thank you.

Operator
Once again, if you have a question, please press star, then 1.

The next question is a follow-up from Scott Siefers or Piper Sandler.

Scott Siefers
Hi, guys, thanks for taking the question. I just wanted to talk about mortgage. I mean, for you guys and for everyone in the industry, it's just been so shockingly strong. Just, I guess, I'm curious about sort of where and when you guys think it all begins to settle out. I mean, just based on where rates are, I would imagine it has some legs for a while, but whether it's a gain-on-sale margin normalization, how much refi is really left? How are you guys thinking about those dynamics?

Matt Garrity
The margin will—this is Matt, Scott—the margin will start to normalize as we get into really Q2 through Q4 of '21. That's our thought process at least for now. Although the mortgage business is pretty dynamic, I don't think anyone would have expected the kind of mortgage activity that we've experienced this year.

I think what's a little bit unique about our model that we probably need to remember is–and it sort of gets to the comment I made a moment ago, where we've seen–as that refi activity has declined, we've seen a nice refill of that decline from our purchase and construction perm business. Strategically, we view mortgage as a business that we can continue to grow, so while our expectations for '21 is while we won't see the robust refinance activity, we also don't feel like that we're going to drop right back off either.

We feel that there's opportunities for us to continue to expand this business, both within the markets we're in and probably within some contiguous markets as well. We're keeping our eyes open for that. So, kind of a long answer to—margins normalizing. Yes, we will definitely see that in '21, but I wouldn't necessarily call for a full drop-off in volume as a result of the reduced refinance activity next year. We think we've got a few different oars in the water there.

Scott Siefers
Perfect.

Gary Small
Scott, it's kind of counterintuitive, but if rates stayed as they are today and pricing did normalize, I think we'd see another refinance boom. There's probably, not just for us but our competition, 5/8 to 3/4 of a percent difference between a 15-year refi and a purchase or a purchased money. Those usually don't have that kind of gap. So, again, if rates stay as they are, pricing will come back into line as volume sort of slips away, and there will be a new type of volume, and it will be the refi at that much lower rate versus that already good rate that they might have experienced, and if there's enough vig in there, we could see another volume boost next year.

Scott Siefers
Yes, that's a good point. Okay. Perfect. Thanks, you guys.

Don Hileman
Thank you.

Operator
And this concludes our question-and-answer session. I would now like to turn the conference back over to Tera Murphy for any closing remarks.

CONCLUSION

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

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