Premier Financial Corp.

Q1 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Tera Murphy – *Vice President*

Gary Small – *CEO and President*

Paul Nungester – *Chief Financial Officer*

Matt Garrity – *Chief Lending Officer*

PRESENTATION

Operator
Good morning and welcome to the Premier Financial Corporation First Quarter 2021 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 (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*), then one (1) on your telephone keypad. To withdraw your question, please press star (*), then two (2). Please note this event is being recorded.

I would now like to turn the conference over to Tera Murphy, Vice President. Please go ahead.

Tera Murphy
Thank you. Good morning, everyone, and thank you for joining us for today's first quarter 2021 earnings conference call. This call is also being webcast and the audio replay will be available at the Premier Financial Corp. website at premierfincorp.com. Following 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 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. Small for his comments.

Gary Small
Thank you, Tera, and good morning to all; I appreciate having you with us today. We are very pleased to report record first quarter earnings of $41 million, or a $1.10 a share. We delivered well against our traditional earnings elements; and when combined with some very favorable outcomes on specific income drivers, it made for an outsized performance figure for the quarter.

Three topics certainly are merit discussion. First, the strengthening economic outlook combined with the benign credit charge-off levels drove our loan provision downward. Second, the escalation of the 10-year Treasury as of 3/31 led to a meaningful recapture of our MSR. That was not unexpected for 2021 over the course of the year, but certainly rates moved more quickly than we had anticipated. The third item, we've benefited from a favorable stock valuation move in our bank equity portfolio. We're up over 15% for the year. However, these favorable outcomes should not overshadow the more typical drivers of the financial performance delivered by the business units across the organization.

New commercial loan commitments for the quarter were very strong, closing in on $200 million. That effect was somewhat masked by the continued decline in commercial line utilization rates due to the superior liquidity positions our clients find they're experiencing. Currently, we run--or historically I should say--we run a commercial utilization rate of about 50%, and we're currently experiencing a 30% run rate and that moved downward 5% in the first quarter alone.

Our consumer line utilization is performing in a similar fashion with utilization rates down 10% in absolute terms versus normal levels. We do see these utilization declines as transitory as the economy reopens and consumer and businesses return to their normal if not more active behaviors, we expect to return to normal utilization levels.

Deposits expanded 5% for the quarter and we expect to see additional growth over the remainder of the year due to the success of this year's round of PPP funds combined with continuous stimulus benefits for households and new funding from Washington that's lending in municipal accounts.

The outsized growth in deposits will lead to a larger balance sheet and expanded securities portfolio. This is favorable in terms of net interest dollars, although it's a drag in terms of the net interest margin. We'll remain focused on serving our clients, welcoming their deposits and focus on investing those funds to the best balance of yield and duration considerations.

Our clients are handling their personal and business balance sheets very effectively. We see already historical low delinquency levels actually falling further across the board and the typical portfolio credit stats remain stable. Residential mortgage origination continues to excel--a continuation of last year's theme. March alone was the highest month of origination in our history with an equal mix of purchased new construction and refinance activity.

Volume is strong, gain on sale margins are still running ahead of historical levels, although moderating somewhat from the extremely favorable performance in 2021 and the servicing valuation allowance for the quarter is favorable as expected.

We see fees related to consumer behavior on the rise. So, think debit card income, etc. and certainly a good omen for the remainder of the year. Expenses ran a bit hot for the quarter for some understood reasons. Paul will share more details, but I would say that there was an increase related to 2020 performance payout true-ups that occurred in the first quarter, and a portion is just timing between quarters. There is an amount that we see as run rate related and we expect to address that over the remainder of the year and have it offset by year's end.

At this point, I'll turn it over to Paul for more comments, and I'll come back and close with some thoughts on guidance toward the end of the call.

Paul Nungester
Thank you, Gary. Good morning, everyone. I'll summarize our first quarter results and focus on certain areas of impact. Let's begin with the balance sheet that expanded due to continued high deposits growth, which were up 5% from year-end and continued to outpace expectations.

We improved mix and continued to reduce our all-in costs, which fell 7 basis points to 0.27% this quarter. For assets, loans were down in all categories except PPP due to continued line paydowns that Matt will discuss more shortly. While we await a loan growth rebound, we focused on securities to drive net interest income growth. During 1Q, we added $195 million of securities, including some bank equities that saw a nice gain in the quarter.

Next is the allowance, which decreased $7.3 million due to a provision credit for loans of $7.5 million and net recoveries of $189,000. This decrease is primarily related to another improvement in quantitative factors as well as a decline in non-PPP balances, and a welcome lack of charge-offs that helped expense by approximately $4 million.

Quantitative factors improved again due to an even better national unemployment forecast, but we did have some risk migration that partly offset this. At 3/31, our allowance coverage, excluding PPP loans and including acquisition marks was 1.69%, down from 1.84% at 12/31, and we are comfortable with this, given the current economic outlook.

To finish the balance sheet as capital where we ended 1Q with almost $1 billion of equity, the increase from year-end is due to net earnings in excess of dividends offset by a decline in unrealized securities gains. We briefly did some stock buybacks before the stock price accelerated for no real impact. At 3/31, our tangible equity ratio was 9.1% or 9.7% excluding PPP loans and our total risk-based capital is estimated to be about 13.5%.

Next, I'll turn to the income statement starting with net interest income of $57 million which is up 3% on a linked-quarter basis excluding the impact of marks and PPP, our net interest margin was 3.25%, down from 3.36% on a linked-quarter basis. This is a bit lower than projected due to the larger-than-expected deposit growth, which lowered margin by approximately 6 to 9 basis points.

NIM will remain challenged for the rest of the year and continue to contract, especially in light of the recently enacted stimulus act that will see public fund deposits climb significantly starting in 2Q.

We remain focused on net interest income growth, and we'll continue to invest prudently in securities in the interim until loan growth picks up. Non-interest income was $26 million for 1Q and represented 30% of total revenues. Several key items impacted this. First, mortgage banking income was strong again including a shift in MSR valuation to a positive $5.3 million this quarter due to the upswing in rates and slower prepaid speeds compared to the major drop in rates and accelerated prepaid speeds last year.

Second, we had a $2.1 million securities gain with $0.5 million from where we took advantage of Fed pricing to realize a gain and reinvest it to generate the same income over the next three years.

The other $1.6 million related to unrealized gains on our bank equities due to the improved market. For insurance commissions, the first quarter is the period each year when we generate contingent commissions and we earned $1.1 million for those, down from $1.3 million last year. Last BOLI income included a debt benefit of $0.3 million this quarter.

Next is expenses, which were $38.8 million, down 1% on a linked quarter basis excluding merger costs. Rather than discuss specifics, I will note that we did have some one-time items impacting the quarter primarily in compensation, such that expenses would have been about $37.5 million, and we also had a few run rate items that as Gary mentioned are under review, but we would currently estimate full year expenses to end closer to $153 million versus our prior $150 million estimate.

However, despite the somewhat elevated costs, we did produce an efficiency ratio of just under 48% this quarter and still expect 50% or better for the full year. Additionally, our first quarter pre-tax pre-provision income was $44 million, which generated a strong 2.43% return on average assets.

Bottom line, we reported net income of $41 million, or a $1.10 per share for the first quarter of 2021, which is well ahead of expectations due to good guidance and provision, mortgage and security gains, offset partly by some elevated cost. Factoring in these results and what we can see going forward we would estimate net income ending about 5% higher than prior expectation assuming those good guides don't reverse if the economy were to turn on us.

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

Matt Garrity
Thanks, Paul. This morning I will be providing an update on our commercial and residential mortgage areas as well as comments on asset quality. In our commercial business, when excluding PPP activity, originations were solid in the first quarter in line with our overall expectations, although we did see a balanced decline for the quarter. The decline was largely a result of approximately $53 million of line of credit paydowns along with some payoff activity that drifted into the first quarter from the fourth quarter. We believe that the 2021 round of PPP had an impact on line balances, and while timing is still unclear, we are optimistic that utilizations will begin to pick up as economic conditions continue to improve.

I would note the commercial line balances have fallen approximately $157 million over the past four quarters, which represents about a 4.6% impact to the portfolio. Adjusting year-over-year portfolio growth without the line balanced decline, loan growth is approximately 6.7%. On the deposit side, we experienced commercial deposit growth in excess of 8.5% for the quarter. We continue to support our customers with PPP loans.

We originated 1,645 loans during the first quarter in support of our customer base for a total of $171.7 million. Looking forward, we expect loan growth to resume during the second quarter as activity remains solid. While demand is not on par with pre-pandemic levels, we are beginning to see some green shoots coming up as client conversations around investment are happening with greater frequency, creating potential for an acceleration of demand in the second half of 2021.

We continue to look for opportunities to invest in the commercial business, and through April, we were successful in bringing in two additional bankers to the team with more additions expected during the quarter. In our residential mortgage business, we started the year off well in what we expect to be a more challenging environment in mortgage. Mortgage banking gain on sale for the first quarter was consistent with our expectations in comparison to the fourth quarter. As we have discussed previously, we expected margin to begin to normalize to pre-pandemic levels during 2021 and in the first quarter, we started to see evidence of this.

We expect this compression to continue into the second quarter. The biggest mover for mortgage banking revenue was the MSR adjustments, which brought back over $5.3 million into income for the first quarter. As we talked about on last quarter's call, we expected to bring back of MSR to occur in 2021 as part of maintaining mortgage banking contribution consistent overall with 2020 performance. While the MSR bring back for the first quarter was more than anticipated, it is in line with what we expected to happen during the year.

Our outlook for the second quarter is positive in terms of application and production activities as we begin to enter what is normally a more active period for the business, and we remain on track for delivering on our full year expectations for mortgage.

In terms of asset quality, we saw improvement in payment delinquency, non-performing loan levels while we had a net recovery in terms of charge-offs. In addition, we experienced another meaningful reduction in COVID-related payment deferrals consistent with our expectations. We did see an increase in classified loans of approximately $24.2 million during the first quarter, which is due primarily by the classification of a $26 million C&I loan. A portion of the borrowers' business is impacted by the moratorium on student loan collections as part of the CARES Act legislation.

We believe the business will improve with the restart of this collection activity, which is expected to return, and we continue to work with the client closely. In terms of outlook, while the economic stimulus and liquidity in the market has affected loan demand, it has been instrumental in providing what increasingly looks like a sufficient bridge to an improved economic environment for our clients.

While we will have individual credit issues from time-to-time, it remains more episodic in nature. It is not indicative of any portfolio-wide or portfolio segment-related concerns. We remain diligent in monitoring the performance of the portfolio and working with our clients as we continue to navigate our economic environment.

I would now like to call--turn the call back over to Gary Small. Gary…

Gary Small
Thank you, Matt. Now I'll provide a few comments on the guidance we provided in January, select comments on items of note. As Matt was saying, the end-of-period commercial loan expectations were affirming for the year with our original guidance in January; we do expect to see the growth more so in Q3 and Q4 for all the reasons noted. New business activity remains strong. It's just tempered with by some uncertainty as to how long it's going to take for the clients to burn through their built-up cash reserves.

From a credit perspective, we certainly expect net charge-offs to beat the low end of our original range provided in January. The continued macro environment improvement expected in the economy will create additional favorable allowance movement although an unexpected turn in the pandemic progress would have the opposite effect.

Relative to fee income, we affirm our expectations on the mortgage income generation for the year. The MSR is favorable as expected, but we do feel that as it tempers over the remainder of the year, it still meets our expectations that we have in the plan.

Balance sheet growth, $7.75 billion would not be an unreasonable expectation for the end of the year, driving up net interest income, driving NIM down. That's the right approach for us in 2021.

In summary, we're off to a good start of 2021. We expect favorable contributions in the areas of loss provision and MSR valuation over the entirety of 2021, a meaningful portion of these obviously have already been accelerated into Q1. Having acknowledged that acceleration, we did post strong normalized earnings. For additional perspective or to put a wrap on that comment, if we'd have known in January what we understand now, we would have projected our 2021 earnings run rate to be about 4% to 5% higher for the entire year than what we were thinking back in January. So, that's sort of the high-level umbrella statement on expectations.

With that, operator, we will turn it over for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star (*), then one (1) on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the key. To withdraw your question, please press star (*), then two (2).

At this time, we will pause momentarily to assemble our roster, and the first question comes from Michael Perito of KBW. Please go ahead.

Michael Perito.
Hi, guys. How is everybody?

Gary Small
Good morning, Mike.

Paul Nungester
Good morning.

Gary Small
Doing well, surviving the snowstorm.

Michael Perito
Thanks for taking--yes, sorry, thanks for taking my questions. I had a few things I want to hit. I appreciate the commentary on loan growth. It sounds like it's going to be back half loaded. I've had a bigger picture question for you guys. So, I mean, obviously last year and the majority of this year are going to be heavily impacted by the pandemic, but when I think about the two legacy institutions that combined, right, I mean they were both high single-digit growth net institutions. And I'm curious a year into the merger, obviously the environment hasn't helped, but how do you think about the long-term growth rate for this company as you see the market share disruption? And I'm just curious if you have any updated thoughts you're willing to offer on that.

Gary Small
Mike, this is Gary. I'll take the first swing at that and, Matt, feel free to jump in. Overall, when you take commercial and the consumer and the residential book combined, we would still target ourselves that 7% to 8% growth company over a longer period of time. The wild card this year and last year as well has been on the residential side with all the refi activity. That's a meaningful sized book on our balance sheet and it's been in decline as we're an originating and sell sort of shop and we were rolling off some of our existing book into Fannie and Freddie.

When it's performing normally, it will take off at 5% to 7% increase a year. Commercial will do closer to 8 plus percent a year, and consumer which is a little bit tied to your actual household effects would be less than 5% a year, and on average that will get you to that starting point that I mentioned. What's not counted in there is inordinate organic growth that we are always on the lookout for relative to entering new markets via commercial lift out and so forth. We'll count those when we get those, but that's icing on the cake relative to how we think about our targeted number.

Matt Garrity
Yes. Mike, good morning. It's Matt, and just to piggyback off the Gary's comments, I would agree with you that the last year has been--it creates a little bit more difficult comparison the effects of the pandemic on both institutions coming together in a merger, but after experiencing

what we’ve seen for the past year, I'm actually a little more optimistic than I would have been initially.

I think to Gary's point on the commercial front, I'm absolutely believing 8 plus percent organic growth paddling our own boat is in the cards for us, and I see expansion opportunities as there's a disruption as you mentioned. I also think in our mortgage business, we really saw the benefit of scale in 2020 and how that business performed, and we're also hearing a lot of positive impact within the industry on our model and how we go to market and our client experience, and we're increasingly seeing people reach out to us for more conversations, which provides us an opportunity to expand our business. So, I'm very optimistic long-term on what the expansion opportunities are for our businesses.

Michael Perito
Got it, very helpful, and then maybe a quick follow-up. So, the Gary the $7.75 billion, was that earning assets number for the end of the year?

Gary Small
I think of it more as end of period, Mike; but when we project, it's a pretty steady climb.

Michael Perito
Okay, and then just you mentioned Gary that the right play this year is to grow loans at the expense of margin per se and I imagine a lot of that has to do with the liquidity on the balance sheet and in the system right. But I guess, when do you see that dynamic shifting? Is it just a liquidity element? Is it--are there more considerations we should be mindful of in terms of when the loan growth at the expense of the margin dynamic could potentially change as you see it?

Gary Small
Mike, there are a few dynamics there relative to PPP and the burn off on those two tranches. The renormalization between Matt & Vince’s book on consumer probably $200 million of line draws that we'll experience and that's probably more of a 24-month cycle for that in its entirety.

I think what you’ll see--we'll manage--if we were to hit that number, we'll manage out of securities and let the loan growth that we start to develop over the remainder of this year and next year fill the bucket. So, you might actually see a little less growth in absolute balance sheet terms in 2022 as we swap out loans for securities, and we’re keeping the securities position very purposefully, there's liquidity there and we’re doing that with that in mind.

We--there’s no glory in having 7% too big of a balance sheet at 100 basis points. You make more money but every other metric that you respect and work for from an RO-anything is worse. So, we're going to--for this year, as I mentioned on the customer deposits, we're not turning anyone away, we're going to be there for them as we should be. We'll take the lump on some of those performance metrics. We'll make a little more money while we're doing it, but the long-term would not have us holding $500 million to $700 million of extra balance sheet just because we have the capital to do it. We’ve never played that way and we wouldn't start now, right.

Michael Perito
That makes sense, and then, just lastly for me, I mean, you mentioned the return metrics, Gary, I mean, if we just did the quick math, I mean, a sub 50% efficiency ratio should keep that pre-tax pre-provision ROI north of 200 basis points. Obviously, there's been good follow-through or at least better follow-through on the multiple for you guys now trading at almost 190 at tangible book. Strong currency, would love any updated thoughts on capital here? With that being said,

right, I mean, very different conversation that three months ago when you guys were trading at a much lower multiple, can you give us some updated thoughts around buyback? And then maybe on the M&A pipeline too as you guys now are about a year-plus removed from the closing of the merger?

Paul Nungester
I'll give you on those two plus the dividends. So, we've popped another $0.02 that’s two quarters of $0.02 increase back-to-back, unusual for our organization, but showing our commitment to getting to a sustainable earnings dividend payout ratio that's in keeping with our objective, and you'll see continuation of that.

On the buyback front, we’ve set a board meeting yesterday and we affirmed, we're authorized to do quite a bit and we affirm the levels of which we're comfortable in moving in, and you should expect that we will be opportunistic and watch for the moments and try not to bite the top of the market and that sort of thing, but that we are as enthusiastic on that front as we were three months ago when we mentioned the market is got a little hotter. We thought we've got time to execute, but that's still there.

On the M&A front, we've got enough capital to whether we see fee business cash opportunities to buy and so forth. We easily do that, and our ratios hold up nicely whether we've done buybacks or not as we enter into and model out other acquisition opportunities. Obviously, the market's heating up nationally on the M&A front, we're starting to feel a little bit more here in the upper Midwest, and we'll be in those discussions as we go.

Michael Perito
Very helpful guys. Thank you for taking my questions. Appreciate it.

Gary Small
Thank you, Mike.

Paul Nungester
Thanks, Mike.

Operator
Once again, if you would like to ask a question, please press star (*), then one (1).

And the next question will come from Scott Siefers of Piper Sandler. Please go ahead.

Scott Siefers
Good morning, guys. Thank you for taking my questions. So, Gary, just given their crosscurrents in the NII outlook, meaning sort of bigger securities portfolio, less robust net interest margin percentage, are you still comfortable with the NII guide that you guys have given? In other words, that while there are some crosscurrents, we're still getting to the same place basically and I think that had been sort of 7% to 8% NII growth this year or like 5% to 7% ex-PPP. Is that something you guys are still comfortable with?

Paul Nungester
Yes. Scott, this is Paul. We’re still comfortable with that, if anything we've got a little upside on that because of the continued growth in deposits coming in. So, we continue to put those out. On the securities front, those will keep growing, those dollars just not at a very high rate or on

an efficient basis there. So, we're definitely comfortable with that prior and would hedge it up if anything.

Scott Siefers
Okay. Perfect. Thank you, and then, just so I'm clear the base that we'd be talking off of is just the fourth quarter 2020 kind of annualized basis. Is that right as well?

Paul Nungester
Yes. Yes.

Scott Siefers
Yes. Perfect. Okay. Thank you, and then separate question on PPP, overall, maybe if you could let us know sort of your expectations for the pace of forgiveness both for the remaining round one loans and those from round two as well. How are you guessing those will ebb and flow?

Gary Small
Sure. I'll start with that one and then Matt can fill in any blanks here, but very consistent with what we had said before. So, we're still on pace for the round one forgiveness, and what we are targeting is about 80% of those originals, which represent basically everything under $2 million going through essentially in the first half of the year or so and we're still on pace for that, so those are coming through. And then on round two, I think we had said $180 million I think was the number we threw out there, which was essentially half of the original round one loans that were less than $2 million and we're at $172 million at the end of March.

Matt Garrity
Yes, and there is enough in the pipeline that's about to close that will get us just to touch over that number. So, that's a pretty good number.

Gary Small
And it cuts off here soon, doesn't it?

Matt Garrity
That's going to run with--the expectation is it's going to run out of money shortly, so.

Gary Small
So, in short, Scott, yes. We're still good with that original guidance.

Scott Siefers
Okay.

Gary Small
We've got one in our hip pockets, Scott. We don't have a very aggressive assumption on prepayment of the over $2 million on round one.

Scott Siefers
Got it.

Gary Small
As in zero assuming for this year with just because of the uncertainty of how folks will move. So that's a potential that could be a good guide.

Scott Siefers
Okay. Perfect, and then that round two, are we thinking that the stuff under $2 million sort of gone by the end of this year for the most part?

Gary Small
No. No. We see it being on the balance sheet at the end of the year.

Scott Siefers
Okay. Okay. Perfect. All right. Thank you, guys very much.

Gary Small
Thanks, Scott.

Paul Nungester
Thanks.

Operator
This concludes our question-and-answer session. I would 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
The conference is now concluded. Thank you for attending today's presentation and you may now disconnect.