Company: Chemical Bank - MI

Conference Title: Chemical Financial Corporation Earnings

Conference ID: 9148182

Moderator: Jennifer Russeau

Date: January 24, 2018

Operator: Good morning ladies and gentlemen and thank you for standing by. Welcome to the Chemical Financial Corporation fourth quarter earnings conference call. At this time all participants are in a listen-only mode. Later we will conduct a question and answer session and instructions will be given at that time. As a reminder today's conference is being recorded.

Chemical would like to remind you that a copy of today's earnings release can be accessed by logging on to chemicalbank.com and selecting the Investor Info tab at the top of the website. Also included is a slide presentation on our Investor Info page with supplemental information that will be referenced in today's call.

With us today are David Provost, CEO and President of Chemical Financial Corporation; Thomas Shafer, Vice Chairman of Chemical Financial Corporation and CEO of Chemical Bank; and Dennis Klaeser with Chief Financial Officer. After brief comments from management the call will be open to your questions.

Before we begin the corporation would like to caution listeners that this conference call may contain forward-looking statements about Chemical, its business, strategies, and prospects. Please refer to the forward-looking statements disclaimer and other information on pages 2 through 3 of the slide presentation for a description of risks and uncertainties that could cause actual results to differ materially from those reflected in forward-looking statements. And now I would like to turn the call over to Mr. David Provost. Please go ahead sir.

David Provost: Thanks (Cody) and good morning everyone. We are very pleased with the quarter results as the outcome from our restructuring efforts are clear. In addition to the improvement in our efficiency ratio we produced high quality loan growth while maintaining a stable net interest margin and hired additional commercial bankers. We believe we are well positioned to expand our market share in our high growth geographies and continue our focus on those services and product lines that provide the greatest opportunity to create value.

As we look forward we continue to expect to make investments in our commercial lending and banking teams, make key operational staff additions, and enhance our core operating systems. While we make these investments we will continue to balance our disciplined expense management philosophy with a strong focus on driving revenue growth as we continue to make progress toward our goal of being the Midwest's premiere community bank.

While we are pleased with our overall results we will continue to have a keen focus on the ways to lay an even stronger foundation for continued growth in quarters ahead. Let me turn it over to Tom Shafer who will give you an overview of some of the steps we have taken and will be taking to achieve that goal. Tom?

Tom Shafer: Thank you David. Good morning everyone. At our earnings call last quarter I provided details on the steps we were taking to refine and clarify our overall strategic plan with how we allocate our capital across the organization and to better position the company for growth.

As we are now in the first quarter of 2018 we have completed our staff reduction and consolidation of 25 branches in the fourth quarter in addition to the 13 we consolidated in the third quarter of 2017, discontinued our title insurance services, and completed our reduction of resources to indirect auto lending. These efforts helped drive a significant reduction in our operating expenses in the fourth quarter which drove a significant increase in our adjusted diluted earnings per share to 87 cents and resulted in an adjusted efficiency ratio improving to 47.4%.

As we discussed last quarter, a large portion of the savings we realized from our restructuring initiatives will be reinvested with a goal of sustaining strong growth over the longer term. We have already begun to make those investments with the hiring of a number of new commercial bankers and key operational staff as well as making investments to further enhance our core operating systems.

I am especially pleased with our success in adding a number of new commercial bankers. We have hired 14 new commercial bankers since our last earnings call. The majority of these senior bankers will be focused on driving C&I relationships in Southeast Michigan, Grand Rapids, and Cleveland and will help sustain our strong loan growth and loan mix initiative.

The investments we are making will increase our operating expense run rate going forward but more importantly will enhance our overall long term growth prospects and will allow us to deliver on the goals that were established as part of the Chemical-Talmer merger. With that let me turn it over to Dennis to go through the financial results in further detail. Dennis?

Dennis Klaeser: Thank you Tom. On slide 7 net income excluding significant items was $63 million in the fourth quarter of 2017, an increase of $8 million from the previous quarter and up $9 million from the same quarter a year ago. Diluted earnings per share excluding significant items were 87 cents per diluted share in the fourth quarter, up from 76 cents in the third quarter and 75 cents in the fourth quarter of 2016.

As shown on slide 8 year over year our total loan portfolio has grown by $1.2 billion to $14.2 billion as of December 31, 2017 or a year over year growth rate of 9%. The overall composition of our loan portfolio has remained relatively similar to a year ago with 60% of our loans in commercial - to commercial borrowers and 40% to consumer borrowers at the end of the fourth quarter.

Turning to slide 9, we had $322 million worth of loan growth in the fourth quarter representing an annualized loan growth rate of 9.3% compared to an annualized rate of growth in the third quarter of 4.9%. Loan growth for the quarter included strong growth in both commercial real estate and C&I lending.

From slide 10 you can see that our $322 million worth of net loan growth for the quarter is a result of $591 million of growth in our originated portfolio offset by $269 million runoff of our acquired loan portfolios. Our net loan growth for the quarter primarily benefited from an increase in new loan originations but were also benefited by a slowdown in runoff of our acquired loan portfolio.

Moving on to deposits as you can see on slide 11, our average deposit base increased slightly in the fourth quarter of 2017 while period end balances declined primarily due to seasonal decreases in municipal deposits. Our average cost of deposits were 42 basis points in the fourth quarter compared to 38 basis points in the third quarter and 27 basis points in the fourth quarter of 2016.

Looking at our overall funding on slide 12 our average cost of funds increased to 56 basis points during the fourth compared to 53 in the prior quarter and 33 basis points one year earlier. The increase in cost of funds compared to the third quarter was primarily due to increases in rates associated with our short term FHLB borrowings which have been primarily utilized to fund growth in our investment securities and loan portfolios and an increase in rate on savings and time deposits due to the rising rate environment.

Turning to slide 13, asset quality remains high. The provision for loan losses on originated loans was $8.1 million in the fourth quarter of 2017 which reflects increased organic loan growth in the quarter. For the quarter we were able to release $579,000 of reserve for one of the pools of our acquired loan portfolios so our net loan loss provision in our income statement was $7.5 million for the fourth quarter.

Net loan charge offs decreased only 4 basis points on average loans in the fourth quarter compared to 10 basis points in the prior quarter. The charge off rate for the full year 2017 was only 7 basis points compared to 11 basis points in 2016.

Our ratio of non-performing loans to total loans increased to 45 basis points as of December 31, 2017 compared to 39 basis points as of the end of the third quarter and 34 basis points at the end of last - at the end of 2016. The increase in non-performing loans as a percentage of loans as of December 31, 2017 compared to the year ago was primarily due to previously accruing commercial trouble debt restructuring loans that were downgraded to non-accrual status.

As shown on slide 14 our net interest income increased to $145.9 million in the fourth quarter compared to $143.6 million in the third quarter. The increase primarily was attributable to increases in average loans and investment securities.

The net interest margin on a tax equivalent basis was 3.47% in the fourth quarter compared to 3.48% in the third quarter and 3.56% in the fourth quarter of 2016. Our average yield on loans was 4.31% in both the fourth and third quarters of 2017. Interest accretion from purchase accounting discounts on acquired loans contributed 22 basis points to the net interest margin of fourth quarter compared to 23 basis points in the third quarter of 2017 and 14 basis points in the fourth quarter of 2016.

Moving on to non interest income on slide 15, non interest income of $32.3 million in the fourth quarter of 2017 included $7.6 million of losses on the sale of investment securities taken as part of the company's treasury and tax management objectives. Excluding investment securities losses non interest income was $39.9 million for the fourth quarter of 2017 compared to $32.1 million in the third quarter. Third quarter was negatively impacted by a $4 million decrease in the valuation of our mortgage servicing rights whereas MSR valuation was relatively flat in the fourth quarter.

The core increase of non interest income was due to a variety of factors including a strong increase in interest rate swap income related to our commercial lending business and that is reported in the other line item. We had stronger electronic banking fees and stronger wealth management revenue. This was all partially offset by mortgage bank - the decrease in mortgage banking gain on sale revenue which declined sequentially by about $1.3 million.

The $7.6 million losses on sale of investment securities taken as part of a treasury and tax management objectives included the sale of approximately $400 million of securities that has - where there was a loss position and they were sold fairly late in the quarter when it was a near certainty that the tax reform bill was going to pass.

By quarter end we had reinvested approximately $250 million of the proceeds from those sold securities and by early this week we successfully reinvested 100% of the proceeds from those securities that we sold. We estimate that we will earn back the securities losses in about five quarters given a modestly higher yield on the new securities that we acquired in addition to the lower tax rate on the earnings going forward.

As seen on slide 16 core operating expenses including merger and restructuring expenses and impairments associated with historic tax credits realized during the quarter or excluding those items were $91.3 million in the fourth quarter compared to $95.2 million in the third quarter of 2017. The quarter over quarter decline in our core operating revenues was reflective of the impact of the restructuring - in our core operating expenses was reflecting the impact of the restructuring efforts that began in the third quarter of 2017.

It is important to remind you that our comments that we made last quarter that while restructuring efforts are producing about $20 million worth of annualized savings, half or more of these savings will be invested in the hiring of additional commercial lenders and other bankers in key markets as well as additional key management and operational staff to support customer service enhancements. The impacts of these investments will begin to be evident in the first quarter of 2018.

In addition to the investments in additional hires we will see increases in spending related to the conversion of our core operating system that is now targeted for implementation in July of 2018. Also first quarter 2018 will be impacted by our annual - by annual salary increases that went into effect as of the - January 1 of this year as well as additional expenses caused by seasonal increases in payroll taxes. All of these things combined are expected to result in a sequential increase in operating expenses in the range of $7 million or $8 million for the first quarter of 2018 compared to the fourth quarter of 2017.

Our adjusted efficiency ratio improved to 47.4% in the fourth quarter compared to 51.2% in the third quarter and 53.7% one year ago. The improvement in our efficiency ratio was due to the reduction in our operating expenses as a result of our restructuring efforts. With the increase in operating expenses in the first quarter we expect our efficiency ratio to move back up over 50% and then we expect it to trend back down below 50% by the latter part of 2018.

Looking forward our tax rate in 2018 excluding the impact of federal housing income tax credits, we expect the tax rate to be about 18.7% for the full year. However, we have a number of historic tax credits in our pipeline. As we saw in our income statement for last two quarters when these historic tax credits projects go into service we will generate an impairment charge which is offset by tax benefits that run through the income tax line item. With these historic tax credits that are in our pipeline for 2018 we expect our historic - our effective tax rate for the full year 2018 to drop to about 15%.

Turning to slide 17, we ended the quarter with tangible book value of $21.21 which represents 5% improvement in our tangible book value compared to $20.20 one year ago. Our TCE to total assets remains healthy at 8.3% as of the end of the year and our regulatory capital ratios are strong at an estimated 10.1% for the tier one capital ratio and 10.9% for the total risk based capital ratio. I will now turn it back to David for some closing remarks.

David Provost: Thanks Dennis. Let me conclude by saying the economies in the markets we serve continue to show favorable improvement and we are optimistic of the benefits that we will receive following the enhancement of the Tax Cuts and Jobs Act. Even so we continue to retain our focus on what we can control. Keys to our success in driving future earnings involve revenue growth and disciplined expense management.

We believe the recent efforts we have taken have positioned us for future success. We are pleased with the level of quality loans we have originated in the quarter and have in our pipeline to produce another high quality loan growth quarter ahead. We also remain focused on consistently identifying, measuring and mitigating our key business risk. We continue to execute our strategy as we take steps towards reaching our goal of being Midwest Premier Community Bank. We believe that our combination of market focus, balance sheet strength, talent and convenience provides a compelling choice to consumers and businesses alike.

As always, we appreciate your time and interest in Chemical. On that note, moderator, let's open the call up for questions.

Operator: Absolutely. If you'd like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. A voice prompt on your phone line will indicate once your line has been opened. We ask that you please state your name before posing your question. Once again that is star one if you'd like to ask a question and we'll pause for just a moment to allow everyone an opportunity to signal.

And we'll now take our first question. Caller, please go ahead. Your line is now open.

(Dave Wong): Hey, guys. It's (Dave Wong).

David Provost: Hey, David.

(Dave Wong): A couple things. Dennis, you talked about the expenses in the first quarter in your prepared remarks and you said I think up maybe $7 million to $8 million in the first quarter. Is that from the $91.3 million number that you highlighted in the press release?

Dennis Klaeser: Yes, I was referring to the core number excluding the charges related to historic tax credits, correct.

(Dave Wong): Got it. Okay. Thank you. And then with the hires that you guys have made since, I think you said 14 since October, looking out the rest of the year, what's your pipeline like now and how many additional commercial bankers do you think you can bring in over the next several quarters?

David Provost: So of those, a lot of them started in the end of the quarter and I think we had six or eight start in the first couple of weeks of this quarter. I would anticipate another ten that we have in the next two quarters that really should add out very nicely. It's our goal of really growing in our core markets of Detroit, Grand Rapids, and Cleveland where we feel the growth opportunities are and these lenders are really coming from a lot of different banks, most of them the larger regional banks in our area.

(Dave Wong): Okay, and then a follow-up to that. You have talked about loan growth targeting around 10% on an annualized basis. What should we be looking at for 2018? Is that still the case or do the hires seem to be running a little bit higher than at least what I was expecting? Do you think you'd be in the low double-digits with loan growth then?

Dennis Klaeser: It's possible, (David). We're planning for 9%, 10% growth and we're focused on the quality of the growth and the composition of the growth. And we talked before about our intention to add a mixed shift in overall growth. So in past quarters, consumer lending, including auto lending added a fair amount to growth but going forward, the growth is going to be driven primarily we believe by commercial lending, which we believe will help overall margin and overall help ROE.

(Dave Wong): Excellent. Thanks for taking my questions, guys.

Operator: Thank you. We'll now take our next question. Caller, please go ahead. Your line has now been opened.

Scott Siefers: Morning guys. This is Scott Siefers at Sandler. I was hoping to revisit the expense question. Dennis, so expenses up $7 million to $8 million from the core in the fourth quarter. So it implies somewhere in the neighborhood of call it $98 million or so in the first quarter. Can you talk a little bit about where you would anticipate they go afterward? I know you gave the efficiency ratio commentary for after the first quarter but just was hoping I might be able to pin you down on a dollar expectation for core expenses beyond the first quarter.

Dennis Klaeser: So in the first quarter, there is probably a couple million dollars related to the seasonal uptake in payroll taxes that then comes down in the third quarter -- in the second quarter. But there will be some additional expense build related to additional hiring. So overall, probably relatively flat given the assumption that there's going to be some continued expense build with the growth of the company and growth of some of the additional hires that we're talking about.

Scott Siefers: Okay, all right. So then full year I guess we'd be talking about somewhere in the neighborhood of $390 million or so in core expenses if you just stayed flat with the anticipated first quarter run rate. Is that a fair approximation?

Dennis Klaeser: In that ballpark range. Again, we're going to be opportunistic and the hiring that we are doing we think pays for itself fairly quickly and creates very good momentum going into 2019. And again, we feel there's a great opportunity right now for us to build market share and capture market share. And so we want to exploit that opportunity to its fullest.

Scott Siefers: Loan growth is going to be a key area that will be visible where we'll see the benefits of the investment. Any other particular line items we should be keeping an eye on that would in particular accelerate enough that we could expect to see that improved efficiency ratio back down below 50% starting in the second quarter?

Dennis Klaeser: Well, we are doing some hiring within the mortgage banking area as well and again, mortgage loan officers that we hire and we hope the pay for themselves very quickly because for the most part, their compensation is commission based. The other thing that we're focused on is a bit of shift in the strategy of that business because in 2017, we sold only about half or less than half of what we produced. So our goal in 2018 is to sell the majority, maybe 60%, 65% of what we produce.

So with some of the additional hires, we expect to get a little bit of pickup in volume. But also with a larger proportion sold, we expect that to help our fee income from a mortgage banking business this year.

Scott Siefers: Perfect. And then final question just on expectations regarding the margin. I think both ideally it would be helpful if you could maybe give your outlook for the year for both the reported and then the core margin excluding purchase accounting benefits.

Dennis Klaeser: The margin really in the past two quarters has behaved better than I expected and I think the reason why is because we're getting a little bit better yields on the new loan production than I expected. Additionally, our betas on deposits continues to be fairly low. In our sort of base budget, we are assuming betas are going to be substantially higher in 2018 and as a result of that, we do see some modest pressure over the course of the year.

And as you know, particularly what the betas are going to be is very difficult to do. So we hope we're being conservative on that and I hope I'm being conservative on the yields that we're going to get on the new loan production. So I think most analysts in their ((inaudible)) are assuming some modest pressure over the course of the year. I think that's a reasonable conservative baseline but of course, we're going to try our best to beat that expectation.

Scott Siefers: Okay, and do you have a sense for the likely contribution of purchase accounting benefits this year? I think you had about $32 million in 2017. Where does that flesh out in 2018 based on your expectations?

Dennis Klaeser: In one of the charts, we reflected as a contribution of basis points to the net interest margin and it ticked down just slightly third to fourth quarter to 22 basis points. And as we look again sort of the baseline assumption is a very modest deterioration of that, reduction of that over the course of the year. But I think we're still being fairly conservative in terms of our credit assumptions. We've got approximately 2.4% credit mark on that entire purchase portfolio but yet it's behaving more and more like our originated portfolio. So there may be some upside on that accretable yield if that prior performance continues to be very strong.

Scott Siefers: Perfect. Thank you very much.

Operator: Thank you. We'll now move onto our next question. Caller, please go ahead. Your line is now open.

David Provost: Dennis, I'm interested if you could give us an update on the securities and leverage strategy that you’ve been putting on given the moving rates. How quickly should we be expecting the investment book to grow and any comments on yield pickup would be great? Thanks.

Dennis Klaeser: So first of all, during the quarter we sold $400 million and then by quarter end, we reinvested $250 million of those early in the fourth quarter, early in the first quarter, we added another $150 million. So really for the most part, beginning the year we're at $150 million to the year-end balances.

Over the -- and so that puts us at about -- securities as a percentage of assets at 14.4%. We expect to get it to about 16.5% at least by year-end and depending on the interest rate environment we could grow it more aggressively. So that would suggest $600 million to $700 million at least growth in the securities portfolio and hopefully, a bit stronger than that. And that growth probably is concentrated more in the early part of the year.

David Provost: Okay, great. And the rate at which you're able to lock in, any change from when you first disclosed this strategy? Has it gotten any better?

Dennis Klaeser: Yes, we're still -- if we add incremental leverage, our goal is to have a minimum of 1.1% spread and again, we're funding with FHLB, short-term borrowings. So we're entering into a hedge where in essence extending the duration of that funding to match fairly closely the duration of the securities that we're putting on. So the impact would be relatively neutral to the net interest rate position but adding that minimum spread of about 1.1%. So again, it creates a cosmetic compression of the overall NIM, but yet it helps my net interest income.

David Provost: Understood. Maybe just a quick clarification on the efficiency guide that you talked about in the tax rate. I think you said 15% tax rate fully loaded with the tax credit amortization. What's that predicated on in terms of expense and is that expense in the sub-50 guidance or is that separate? Thanks.

Dennis Klaeser: That's separate. In our efficiency ratio, if you look at the definition of it, we exclude these impairment charges related to the federal historic tax credits. Obviously, an efficiency ratio, we're not going to be able to calculate in the offsetting tax benefit. But over the course of the year, the total impairment charge is related to the historic tax credits is approximately $13 million for an after tax equivalent of about $10 million. The tax benefits, which dollar for dollar reduce the taxes we pay, is a little bit more than $12 million for the full year. And in the first quarter of this year, we're going to have impairment charge, right now, based on the expected timing of these historic tax credits, we have a $2 million impairment charge offset by approximately $2 million tax benefit. And that's going to be about a little more than double that in the second quarter and then the balance of it we expect it to all occur in the fourth quarter of this year.

David Provost: Great caller. Just if I could sneak one in on capital. Obviously, with the hit to the DTA hit in the quarter, pressure capital ratios a little bit. I'm wondering, Dennis, the updated thoughts on capital mix and levels given the growth aspirations? Thanks.

Dennis Klaeser: Obviously, we build that back, the charge we took for DTA, we'll build that back pretty quickly because of the increased profitability because of the lower tax rate. So the 10.9% total risk based capital I talked before about how that ratio is the one we're more sensitive to in terms of the regulatory capital on ratios. We're still reasonably comfortable based on the growth, you know, retained earnings at a time, we are not - we don't feel pressure to issue equity right now, but when we get to a point where either because of, you know, growth being very strong and or there being some acquisition in the future, the next capital raise would be likely a subordinated debt offering.

But again, we don't have anything planned in the short-term horizon, but that potentially could be something we would do later this year.

Dennis Klaeser: Great, thanks for taking the questions. Appreciate it.

Operator: Thank you and then we'll move on to our next question. Caller please go ahead. Your line is now open.

(Terry Macavoy): Hi, good morning, guys. It's (Terry Macavoy). I guess can you talk about any deposits, attrition, given some of the branch closures and then thinking about nine to 10% loan growth in 18, possibly better, how are you planning on funding the long growth given that deposit growth has been trending about half that in recent years?

Dennis Klaeser: Yes, (Terry), I'll just touch on the branch closures and effect on deposits. So measuring the deposits that we had during third quarter when we closed 13 branches, tracking those relationships to new branches, we've virtually lost no relationships in that process. There was one relationship that moved forward for non-reasons - had nothing to do with the branch closure.

But our retail transactions and commercial relationships migrated to the new branches and our regional commercial teams did an outstanding job of maintaining those relationships. It's too early to talk about 4th Quarter, but I would expect similar results. We closed those at the end of the quarter and we're keeping close track of that right now.

David Provost: So for deposits going forward, that is a key focus of ours. We have instigated a couple of deposit generation programs. The goal is core deposits and continuing to attract stable relationships that will require a premium. That's really where we're focused, and we think we can achieve that goal.

Dennis Klaeser: And personally, I'd also just - you know, when we merged the companies together with the scale of the platform that we have, we also implemented behavior changes and activity changes within the organization with operating models, especially on the retail side. We're focused on client engagement and product growth. So we're in year two of that. I was very impressed with the level of performance during the campaigns that we had during 17 and the design - and liked the design of the campaigns that we have as we head into 18.

(Terry Macavoy): Okay, a question on 4Q commercial growth. The new teams that were hired in the 4th Quarter, were they up and running? Did they contribute to any of that $168 million of C&I growth?

Dennis Klaeser: The new group has not contributed at all to 4th Quarter growth. That was our existing teams throughout the organization and just, you know, pipeline build throughout the year.

(Terry Macavoy): And just then just a last question from me. Big picture, it's been, what, about five quarters since the merger was closed. There was some changes in management that led to some questions. And given the hires on the mortgage side, all the hires on the commercial side, is it a safe bet to say now that any internal disruption is now behind the company and that going forward, that the team is the team and growth should accelerate and there should not be any additional noise?

Dennis Klaeser: We worked very hard to create, you know, a Chemical Bank. We're working on a number of issues to make sure that there's consistency of understanding of, you know, our vision values, the intent of the organization, how we take care of, you know, our team members and focus on our marketplaces. So today, 5 quarters out, I would say that we're one Chemical Bank.

(Terry Macavoy): Perfect, thank you.

Operator: Thank you. We'll now take our next question. Caller please go ahead.

(Kevin Reedy): Morning gentlemen.

Dennis Klaeser: Morning.

(Kevin Reedy): So, (Dennis) how much of the loan growth in the 4th Quarter came from Southeast Michigan versus Grand Rapids and your other markets?

Dennis Klaeser: Yes, so we had - as a percent, I don't really have that - when I take a look at the goals that we had for each of the marketplaces, the areas that we had the growth initiatives in, we hit our objectives during the 4th Quarter and for 17. The areas that we expected to be growing, we are. And, but a - I don't know the percentage, we can get that. But it's a larger percent than the rest of the company just because of the scale of the marketplace.

(Kevin Reedy): Good, no, that's what I figured.

Dennis Klaeser: Grand Rapids performed well, and we're also excited about the activities in Cleveland.

(Kevin Reedy): And then on the commercial real estate side, you had some pretty strong growth. I'd say probably the strongest we've seen of the Midwest banks that have reported thus far, this earnings season. Can you talk about - was this timing and what kind of CRE loans have you been putting on?

Dennis Klaeser: Yes, a lot of it was timing. You know, the gestation period for these transactions is a while. There's also some construction funding that's taken place that - at the end of the year. You know, some of this is - there's a significant amount of owner occupied that was in there. And, I would say, we're very focused on making sure that we're lending to high-quality borrowers, high-quality projects, that can withstand, you know, change both in ((inaudible)) environment and economic environment.

So it's, you know, we are - you know, and one of the reasons for the type of hires that we're making right now -- both in marketplace and history -- is to continue to work on our next.

(Kevin Reedy): And then on the - my last question on the wealth management C line item that was up nicely, how should we think about that line item in 2018?

David Provost: There is a correlation there with the market, so we do get a bit of a tail wind from, you know, more asset-centered management. You know, second quarter is always a seasonally strong quarter, because we do a lot of tax services for some of our clients. So hopefully you continue to see some build there and benefited, you know, partly by the strong equity markets.

(Kevin Reedy): Great, thanks guys.

Operator: Thank you, we'll move on to our next question. Caller please go ahead. Your line's been opened.

(Andy Staff): Good morning, (Andy Staff). How much were swap pays in both Q4 and Q3.

Dennis Klaeser: Hey (Andy).

David Provost: In Q4 we jumped significantly. We were, if I remember correctly, around $2.8 million and it had only been - it was substantially less than that, I think, 1/2, 3/4 of a million dollars in the third quarter. However, we were over $2 million in the second quarter. So, we were just significantly down in the 3rd Quarter. So that $2 plus million range is - we hope is a sustainable level for us going forward.

(Andy Staff): Okay, and customer service fees are up at about 900 thousand end quarter. What were the drivers of the increase?

Dennis Klaeser: You know, we did some tweaking on a variety of fees after Durbin and I don't really have the exact breakdown of that, but...

(Crosstalk)

Male 4: Yes, we changed some of our ATM fees, really rationalized all the costs that we were - fees that we had.

Dennis Klaeser: And there were, you know, some changes associated with the earnings improvement project of the 3rd Quarter, but we'll have to get that for you.

(Andy Staff): So that's a - Q4 is a good run rate, then?

Dennis Klaeser: We expect so, yes.

(Andy Staff): Okay, all right, thank you. The rest of my questions have been answered.

David Provost: Thank you.

Operator: Thank you and I'll take a follow-up question. Caller please go ahead. Your line is now open.

(Scott Seifers): Hey guys, (Scott Seifers) again. Just wanted to ask another question on the tax rate. You've got the guidance for the effective rate of 18.7. What would that translate to on an FTE basis? I guess, I'm sort of back of the enveloping maybe, you know, a couple percent higher. Is that a fair way to think of it? So FTE would be in the, you know, 21% range? Is that fair, (Dennis)?

David Provost: You know, I'm not sure how you're doing your calculations, so.

(Scott Seifers): Okay, well, I mean, all I did was removed most of the FTE investment from the FDNNI and taxes as well. I think, you know, you historically have maybe a 300-basis point gap between the effective tax rate and the FTE tax rate. So I guess I'm just trying to figure out what the FTE tax rate expectation would be within the context of an 18.7% effective expectation.

David Provost: Yes, I think how you're doing the calculation - it's a little bit more than - it's 21%. So the difference between the corporate tax rate of 21% and the 18.7 is a combined impact of, primarily, municipal deposits, but we also get some continuing benefit from low-income housing tax credits that flow through there.

(Scott Seifers): Okay, all right. That sounds good and I think you addressed the other one - the other question I had with the swap commentary from the last question. So I think I'm good. Thank you very much.

David Provost: Good, excellent.

Operator: And once again as a reminder, that is Star 1 if you'd like to ask a question. We'll now take our next question. Caller, please go ahead. You line is now open.

(Scott Barry): Hey, good morning guys. This is (Scott Barry) at Benning.

Dennis Klaeser: (Scott).

(Scott Barry): So most of my questions have been answered, but on the credit quality, I was looking at the non-performing assets table and saw that you had roughly $4 million increase in C&I and

CRE in the non-accrual bucket and I was just wondering if you had any color or background on kind of what was the driver there?

Dennis Klaeser: Yes, most of it was mostly - (Dennis) talked about the TRs that moved to non-performing. They're all relative - very granular in size. There's a couple that we've been watching for a number of quarters. So there's - and we're doing this is with our credit group and markets. This is, I think, a very manageable change that we'll work it down from here.

(Scott Barry): Okay, so there's no geographic or industry concentration? ((Inaudible)).

Dennis Klaeser: No, there is - you know, I'm looking at the list and there's - the largest is a million nine. We're managing it. It's a small Ag relationship and we believe that we're, you know, we're well collateralized and have full understanding of the situation.

(Scott Barry): Okay, thank you. That's all my questions.

Operator: Thank you, we'll move on to our next question.

(Andy Staff): (Andy Staff) again. Does the margin guidelines that you gave take into consideration the impact of tax reform on the FTE margin?

David Provost: Yes, it takes into account the entire competitive environment.

(Andy Staff): Okay, thank you.

Operator: Thank you. We'll now move onto our next question. Caller, please go ahead. Your line is now open.

(Rachel Watson): Hi, (Rachel Watson).

David Provost: Hi, (Rachel).

(Rachel Watson): Hi, how many of the planned hires in commercial banking will be in Grand Rapids?

Dennis Klaeser: You know, that - I wouldn't provide that specific guidance, but a number of them would be. But I don't want to specifically break it down by geography where we're hiring.

(Rachel Watson): Okay, that would be all.

David Provost: All right, thank you.

Operator: Thank you and that does conclude today's question and answer session. I'd like to turn the conference back over to Mr. Provost for additional closing remarks?

David Provost: All right, again, we run a little longer. We had a great quarter. We appreciate your time and interest in Chemical Financial Corporation. We remain confident in our future success. We believe we are well-positioned to achieve additional competitive and market share gains as we move forward. Thanks for participating and everybody have a great day. Thank you.

Operator: Thank you, and that does conclude today's Chemical Financial Corporation Earnings conference call. Thank you for your participation and you may now disconnect.