Company: Chemical Bank- MI

Conference Title: Chemical Financial Corporation Earnings

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Moderator: Jennifer Russeau

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Operator: Please stand by we're about to begin. Good morning, ladies and gentlemen and thank you for standing by. Welcome to the Chemical Financial Corporation First Quarter Earnings conference call. At this time, all participants are in a listen-only mode. Later, we'll 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 onto chemicalbank.com and selecting the Investor Information tab at the top of the Web site. Also included is a slide presentation on our Investor information 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 and Chemical Financial Corporation and CEO of Chemical Bank, and Dennis Klaeser, Chief Financial Officer. After brief comments from management, the call will be opened for 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 in our earnings release, our periodic filings with the SEC, including our annual report and pages two to three of slide presentation for a description of risks and uncertainties that could cause actual results to differ materially from those reflected in forward-looking statements.

On today's call, we will also be discussing certain non-GAAP financial measures. These non-GAAP measures are described and reconciled to their GAAP counterparts in the slide presentation. And now, I'd like to turn the conference over to David Provost.

David Provost: Thank you. God good morning everyone. We are pleased with our strong earnings results of $70.2 million for the quarter and earnings per diluted share of 97 cents for the quarter. This is up 11% from the fourth quarter of 2017 excluding significant items and up 39% compared to the first quarter of 2017 excluding significant items.

Our earnings results were driven by strong growth in our net interest income helped by improvement in our net interest margin as our loan yields increased the benefit from the effects of repositioning our investment securities, portfolio at the end of last year and the reduction in the federal corporate tax rate.

While our earnings were strong in the quarter, our loan growth was lower than previously anticipated as we reduced our exposure to lower margin indirect auto lending and slowed the addition to our residential mortgage portfolio to position us to expand our higher yielding loan portfolios as the interest rates move upward.

We reduced our total outstanding consumer installment loans by $41 million in the quarter and grew our residential mortgage portfolio by only $12 million in the first quarter compared to $31 million in the fourth quarter of 2017. We have an optimistic outlook as we began reinvesting a portion of our cost savings. We created from the restructuring efforts we took in the second half of last year in the top notch commercial lenders in building our banking teams in our high growth market areas.

Through the addition of our team, we are positioning ourselves for increased market share in these high growth areas, as we focus our services and product lines that provide the greatest opportunity to create value. While we make strategic market investments in addition to investing and upgrading our core systems this year, we will continue to balance our disciplined expense management philosophy with a strong focus on driving revenue growth as we continue to make progress towards our goal of being Midwest Premier Community Bank providing an optimum best-in-class customer service experience for our clients.

We are happy with the progress we are making with our institutional and retail customers to grow our deposit base as we continue the optimism regarding outlook of the economy especially in our target market areas. As we move to expand our market presence through loan and deposit growth, we continued to have a keen focus on our foundation and expense management.

Let me turn it over to Tom Shafer, who'll give you an overview of some of the steps we're taking and plan to achieve these goals.

Tom Shafer: Thank you, David. Good morning everyone. On our earnings call last quarter, we discussed the positive results of our restructuring efforts mutually identified strategies to drive revenue growth and took steps to improve our operating efficiency. This project refined and clarified our overall strategic plan of how we allocate our capital across the organization and we believe it has better positioned us for growth.

With the cost reduction portion of our restructuring efforts being completed during 2017, we are now keenly focused on solidifying and growing our foundation through maintaining our strong market share in historical markets and increasing brand recognition and driving growth in West Michigan, Southeast Michigan and the Cleveland markets.

Our plans includes strategic staffing additions and implementing substantial upgrades to our core operating system to assists our preparation for future growth, regulatory compliance and customer satisfaction. The project upgrade to our core operating system is growing well and we believe is on schedule to be completed by July of this year.

The system upgrade, which was in the plan at the time of our merger with Talmer Bancorp will move us to a core system that would support the scale and complexity of a 20 plus billion dollar bank. We'll support improved integration of current and future technology and we'll provide us with the enhanced stability to automate processes and we'll improve access to data and analytics.

Since our last earning call in January of this year, we have hired an additional seven commercial bankers based and what we believe is our highest potential growth markets of Southwest Michigan, Grand Rapids Michigan, and Northeast Ohio. In total, we now hired 21 commercial bankers since the restructuring that was completed in the third quarter of last year.

We believe these hires will help drive commercial lending market share gains for us in growth markets, in the middle market segment, commercial lending as well as in the niche specialties of commercial finance and asset based lending. For the most part, these new hires contributed very little to loan growth in the first quarter of 2018, as they're just beginning to ramp up their calling efforts.

We expect our new bankers will have a smaller impact on commercial loan growth in the second quarter but more significant impact on growth during the latter half of this year and into '19. We've originally kicked off the spring deposit campaign in addition to working to build new and expand current relationships with our institutional clients to grow our deposits also.

With the effort we have put forth this far we are pleased with the future potential we are seeing. In addition, we have set our top four priorities for 2018 which we refer to as our big four initiatives. These include generating strategic organic loan growth and deposit growth, increasing operating efficiency and accountability, developing an exceptional customer service model, and creating the chemical culture.

Our management team has developed specific action items around each of these priorities, which are currently being implemented throughout our organization. With that, let me turn it over to Dennis to go through the financial results and further detail. Dennis?

Dennis Klaeser: Okay, thank you, Tom, and good morning everyone. I'd like to first note that for purposes of non-GAAP measures, the first quarter results do not include any items identified as significant items or when I speak comparatively to prior periods. I will use adjusted non-GAAP measures for those prior periods to provide a fair comparison.

On Slide 7 net income was $70.2 million in the first quarter of 2018, an increase of $7.5 million from the previous quarter's net income, excluding significant items and up $19.9 million, excluding significant items from the same quarter a year ago.

Diluted earnings per share were 97 cents per diluted share in the first quarter of 2018, up from 87 cent excluding significant items in the fourth quarter of 2017 and 70 cents excluding significant items in the first quarter of 2017. Please note however that the 97 cents of earnings per share in the first quarter includes approximately 4 cents benefit from a positive fair value adjustment to our loan servicing rights.

As shown on Slide 8, year-over-year, our total loan portfolio has grown by $946 million to $14.2 billion as of March 31, 2018. This growth was driven by growth in our commercial loan portfolio, which grew by 10% year-over-year whereas our consumer and residential loans grew by only 3% year-over-year. With this mix shift in the composition of our loan growth, our total commercial loan portfolio now comprises just over 60% of total loans, up from 59% one year ago.

Turning to Slide 9, we had $64 million of loan growth in the first quarter representing an annualized growth rate of 1.8% compared to 9.3% annualized growth rate in the fourth quarter of ’17. While this pace is lower than previously expected as discussed by Dave and Tom, we have a strong pipeline of loans and expect to have stronger loan growth in the second quarter and we are still targeting annualized loan growth in the high single digit range for the full year of 2018.

From Slide 10, you can see that our $64 million of net loan growth for the quarter is a result of $265 million of growth in the originated portfolio, offset by $201 million of runoff in our acquired loan portfolio. Moving onto deposits as you can see on Slide 12, overall deposit growth year-over-year totaled almost $900 million comprised primarily of growth in non-interest and interest bearing checking accounts.

The strong growth in non-interest bearing checking accounts is primarily driven by our focus on growing our banking relationships with our C&I loan customers. Our average cost of deposits was 46 basis points in the first quarter compared to 42 basis points in the fourth quarter of ’17 and 28 basis points in the first quarter of 2017.

Looking at overall funding on Slide 12, our average cost of funds increased to 64 basis points. During the first quarter of 2018 compared to 56 basis points in the prior quarter and 35 basis points one year earlier, primarily driven by the rising rate environment and increased competition for deposits.

Turning to Slide 13, our asset quality remains high. The provision for loan losses was $6.3 million in the first quarter of 2018, which reflects the result of a lower amount of loan growth. Net loan charge-offs continued to be low at only 10 basis points of average loans in the first quarter with the increase in the prior quarter and in related to charge-offs taken on loans individually evaluated for impairment, but that had previously established specific reserves.

Our ratio of non-performing loans to total loans decreased to 43 basis points, as of the end of the quarter compared to 45 basis points as of the end of the year. As shown on Slide 14, net interest income increased $6 million to $151.9 million in the first quarter compared to $145.9 million in the prior quarter with the increase primarily due to increases in yield earned and average loan balances and investment securities.

These benefits to net interest income were partially offset by interest expense impact of two less days in the first quarter and an increase in cost of funds. The net interest margin on a tax equivalent basis improved to 3.56% in the first quarter, compared to 3.47% in the fourth quarter of 2017 and 3.49% in the first quarter of 2017.

We are pleased with our improve margin even after the compression of approximately 4 basis points in the first quarter compared to the fourth quarter due to the fully taxable equivalent adjustment caused by the corporate tax rate decline to 21%.

Our net interest margin benefited from a 17 basis points yield increase on total loans due to significantly higher average coupon rates, the increase in interest rates, resets that occurred due to the improves in fed funds and LIBOR rates and an increasing benefits from accretion on acquired loan and the acquired loan portfolios. Our margin also benefited from the investments we made in our investment securities portfolio.

Moving on to non-interest income on Slide 15, the increase in non-interest income of largely due to the $7.6 million losses on sale of investment securities taken in the fourth quarter of ’17 and a $3.8 million benefit earnings due to the changing fair value of loan servicing rights in the first quarter of ’18. This $3.8 million benefit compared to a slight $13,000 detriment in the fourth quarter of ’17 and $0.5 million detriment in the first quarter of ’17.

As I’ve spoken about before, at this point, we are choosing not to hedge our servicing rights and we expecting the modest earnings volatility that comes from our fair value accounting treatment of this asset. ((Inaudible)) with rates moving to higher, we are evaluating different strategies for hedging the loan servicing asset and we may implement such a hedging strategy later this quarter.

As seen on Slide 16, core operating expenses excluding merger and restructuring expenses and impairment associated with income tax credits realized during the quarter were $101.7 million in the first quarter of 2018 compared to $91.3 million in the fourth quarter.

Quarter-over-quarter the increase was primarily due to $8.7 million increase in salary, wages and employee benefits and a $2.3 million increase an outside processing servicing fees primarily due to the costs incurred related to comparing for the conversion of our core operating system.

The increased in salaries and wages and employee benefits was due to annual merit increases, hiring additional lenders and key management and operation staff and increased some payroll taxes and a decrease in deferral of loan originations costs due to loan production during the quarter. Approximately $2 million of the salary increases due to the seasonally increased in payroll taxes that occurs in the first quarter of each year.

Total costs specifically attributable to our efforts to upgrade our core operating system totaled $2.7 million in the first quarter of 2018, which includes the $2.3 million increase in outside processing and servicing fees. These costs are expected to increase in the second quarter and drop back down in the third quarter of 2018 and then significantly trend downward in the fourth quarter of 2018.

Expenses associated with historic tax credits added $1.6 million to our reported operating expenses in the first quarter of 2018 compared to $6.2 million of such expenses in the fourth quarter of 2017. We expect an additional $10 million of historic tax credit impairment expenses over the course of the remainder of 2018 with about $5 million of this occurring in the second quarter.

As before, these historic tax credit impairment expenses are expected to be more than offset by a reduction in overall tax rate. Our current projection for total operating expenses for the second quarter of 2018 is approximately $110 million inclusive of about $6 million of costs associated with the plant systems conversion and about $5 million of costs associated with historic tax credits.

Our adjusted efficiency ratio was $52.5 million in the first quarter of '18 compared to 47.4% in the fourth quarter of 2017 and 57.4% one year ago. This ratio includes the costs we incurred related to the core conversion in the first quarter of $2.7 million that I mentioned earlier. Our long-term goal is to drive our efficiency ratio closer to 50% or even lower following the conversion of our core systems.

Our effective tax rate was 15.3% in the first quarter of 2018 and included the benefit of the Tax Cut and Jobs Act, which reduced the corporate tax rate to a 21% effective rate, effective January 1, 2018 and the benefit from a federal housing tax credit placed into service during the quarter.

We continue to anticipate an approximately 15% tax rate for the full year. For the second quarter of 2018, however, our tax rate is expected to dip down to 13% assuming our historic tax credit deals are completed as expected. Turning to Slide 17, we ended the quarter with tangible book value of $21.66, which represents a 6.6% growth in our tangible book value compared to one year ago.

Our TCE to total asset ratio remains strong at 8.3% at March 31, 2018 and our regulatory capital ratios are strong at an estimated 10.4% for our Tier 1 capital ratio and 11.2% for our total risk-based capital ratio. I will now turn it back to David for some closing remarks.

David Provost: All right, thanks Dennis. Key factors that will drive future earnings are revenue growth and the continuation of our disciplined expense management. While the reinvestments we're making in our foundation come at a cost, we believe the benefits to come in the future are very much worth the current expense.

From an M&A standpoint, we periodically evaluate mergers and acquisitions and believe activity in our geographic market area can offer the potential for additional opportunities to better leverage our capital and further accelerate our forward momentum. However, as always, we strive to appropriately balance risk and return and not every deal is created equal. As always, we appreciate your time and interest in Chemical Financial. On that note, moderator, let's open it up for questions.

Operator: Thank you. If you would like to ask a question please signal by pressing star 1 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 the phone line will indicate when your line is open. Please state your name before posing your question.

Again, press star 1 to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions. And we'll go to our first question.

David Long: Hi guys, it's Dave Long from Raymond James.

David Provost: Hello David.

David Long: You guys seem pretty optimistic about the loan growth and the pace of recent hiring. I just wanted to ask about your high single digit loan growth guide. And it seems like that's been your target for quite some time here, but the pace of higher seems to be pretty robust. Can you maybe tell us how you're balancing that loan growth guide with the amount of hires that you're doing right now?

Thomas Shafer: Sure. David, Tom Shafer. Firstly, what we're talking about is the remixing in the balance sheet. So, we've decelerated some of our indirect and certain types of mortgage product. And so, we're growing in the large marketplaces that we've entered. We've got not only commercial bankers, but some of our commercial leadership and group managers have been hired in those marketplaces.

So, I think that the overemphasis creates strong momentum for us. I think look at our pipelines, the activity that we're working on activity this quarter, I feel very good about this. But it's not just about run rate growth, it's about remix and that's why I think over emphasizing this activities are very important both in commercial and middle markets and specialty lines that we're developing.

David Long: Okay. Great. I appreciate the color. And then as a follow-up on the other side of the balance sheet as you're funding this quarter on the deposits and other funds, Can you maybe talk about your appetite to price up a bit for deposits to grow deposits or how should we expect the makeup of your funding to shift as we get that loan growth this year? Thanks.

Thomas Shafer: Sure. So obviously the key focus in terms of deposit growth is growing the core deposit base. And one of the reasons for the focus on commercial lending is that we believe that we'll get at least some levels of balances from those commercial customers as well as generally it's richer in terms of fee income with the variety of services and treasure management services that we're providing. So that's a key focus.

Our branches are all very diligently working to be selling core deposit relationships to be existing customers and reaching out to new customers. At the margin, we are willing to do some CD specials to bring in new relationships with the hope that we then cross sell a broader deposit suite of services. Additionally, we had a great deal of focus in terms of our municipal deposit gathering.

And I think I've mentioned in prior calls, we're relatively weak in that niche in the historic Talmer part of the franchise, and whereas legacy Chemical was exceptionally doing that and has very strong long-term relationships with its municipalities particularly across the State of Michigan. And so, we're hoping to see stronger growth in that area as well.

Another area is as we sort of-- we take our position as the largest bank headquartered in Michigan, there are a lot of larger sort of corporate entities that have very little if any deposit relationships with us and we're reaching out to those corporate entities to try to capture some of those deposits as well.

David Long: Excellent. Thanks guys. Appreciate the color.

David Frost: Thanks.

Operator: And we'll take our next question.

Scott Siefers: Morning guys, it's Scott Siefers from Sandler. How are you guys doing?

David Frost: Good …

(Crosstalk)

David Frost: Good. Let's see, Dennis, appreciate the commentary on roughly $110 million or so in cost for the 2Q. I was wondering if you could -- would be willing to go out a little further and maybe in the say the fourth quarter after you've absorbed all the systems conversion costs and those go back down. You have a sense for where you'll be ending this year, you know, just from a cost perspective, just to give us a sense for what the study state will look like once you get these investments all behind you?

Dennis Klaeser: Sure. Sure. So, first of all in the fourth quarter, we do project that we're going to have a $5 million or so worth of the historic tax credit impairment charges occurring. But again also more than offset by tax benefit. So, the expected sort of core level of operating expenses, right now we are expecting around $103 million, $104 million at that point in time.

And so that is primarily reflecting ramp up in hiring of commercial lenders, various support people and bolstering back office support for the organization.

Scott Siefers: Okay. And just to be clear, when you talk about that $103 million, $104 million, did that include or exclude the impairments related to the historic tax credit?

Dennis Klaeser: That excludes. So with the impairments, the historic tax credits, the totaling operating expense right around $109 million, $110 million.

Scott Siefers: One hundred nine, 110. Okay. All right. So basically we go to about $110 million in the 2Q and then even though the costs for the conversion will come down substantially, there are going to be other investment costs such that you guys kind of hang out at $110 million rate ending this year? Is that the correct interpretation?

Dennis Klaeser: Yes.

Scott Siefers: Okay. All right. And then can you talk a little bit about the margin and where you would see things going there and then also where you stand with the securities portfolio build?

Dennis Klaeser: Sure. First on the margin. I think we are very pleased with the margin trend in the quarter. It was a bit stronger than we expected. Now part of that is due to the increase in accretive yield of the purchase accounting which added about 7 basis points. But on a real core basis that particularly given the adjustment -- the FTA adjustment, we did see some real core improvement in the margin. So, we're real pleased with that.

I think a key driver of that is that as we have been making success in repositioning our loan portfolio our loan portfolio is more reactive to the rising rate environment. When we look at the commercial loan portfolio, 43% of our commercial loan portfolio which comprises just over 60% of our loans, 43% of those loans are pure floating rate loans whereas a year ago 39% of our commercial loan portfolio was pure floating rate.

And when we look at production in the first quarter, the new commercial loan originations, it's over 50% of them are pure floating rate. So clearly the shift to the focus on the balance sheet of commercial lending is not only because it's a higher ROE lending niche relative to the other categories, but also it's a category that's going to be more active, more asset sensitive in the rising question.

So with that, I also just caution that I think at some point the entire industry will experience substantially higher betas on deposit cost, that's hard to predict. But so far the deposit betas have been reasonable for us we think. But overall, I think, the industry trend will be for increasing our deposit beta. So I'm still a bit cautious about the margin. And so, I think my bias is in expectation of the margin remain overall relative flat to very slight pressure overtime.

Scott Siefers: And is that inclusive of partial accounting benefits or you talking about margin?

Dennis Klaeser: Yes, that's inclusive of the purchase accounting. The purchase accounting all things being equal, if there is no changes in our expected cash flows each quarter the purchase accounting benefit burdens down by 2 or 3 basis points particularly in the first couple of quarters and then the headwind moderates overtime.

Scott Siefers: Yes. Okay. All right, thank you.

Dennis Klaeser: Thanks Scott.

Operator: And we'll take our next question.

Chris McGratty: Hi, good morning guys. It's Chris McGratty from KBW. I just want to make sure ((inaudible)) expenses for a second. Understanding the moving offsets between the impairment and the tax rate, is the message you're trying to communicate on near-term costs perhaps a bit higher rate of investment versus maybe three to six months ago with the hires?

Dennis Klaeser: You know, modestly it's not materially different. I do recognize that in the fourth quarter here our sort of core expenses around $100 million was $2 million or $3 million higher than what I had previously guided to. And some of that is due to the timing of the hires and the cost of hires. But a portion of that, actually the larger portion of that, miss is due to the fact that our loan production was lower than what we have anticipated.

And therefore there is less salary costs that gets capitalized as a result of the accounting. When you put loans on the balance sheets, you have to capitalize the loan origination costs. So, there this just was less loan origination costs capitalize than I expected.

Chris McGratty: Okay. Okay. Great. Thanks for that. And in terms of the lever strategy with rates about three now, maybe a comment on the pace of adds to the investment book over the balance ((inaudible)).

Dennis Klaeser: Yes we're - you know, it's a long process to move up to that long-term target of 20% of the balance sheet being in securities. And the pace that we saw in the first quarter is probably a little bit faster than the pace you should expect or the next two, three quarters. But, you know, our long-term goal again is to build from our current level. So the overall security portfolio will grow a little bit faster than the loan portfolio.

Chris McGratty: Got it. Got it. And then maybe one last one for David. The M&A comments, now the taxes are kind of in everyone's estimates and the ((inaudible)) hopefully getting some momentum, is there more … How would you describe the overall deal environment in terms of books being sent around, size of portfolios, any more or less optimism then maybe three to six months ago?

David Provost: Yes, probably a little more optimism. But pricing is still a concern for us. And, you know, this management team is always looking for opportunities that create shareholder value rather than building an empire. So when we see those opportunities, we'll take advantage on them.

Chris McGratty: Okay. Thanks so much.

Operator: And we'll take our next question.

Terry McEvoy: Hello?

David Provost: Yes. You're on.

Dennis Klaeser: You're up.

Terry McEvoy: Hi, it's Terry McEvoy at Stephens. Sorry about that. I wonder-

(Crosstalk)

Terry McEvoy: … if you could just talk about … Hi. If you could talk about the breakeven times for these new commercial lenders, ultimately, what is the size of the portfolio for each lender? And how do you take into consideration the reserve built as part of that process as they bring on these commercial loans?

David Provost: Sure. You know, the type of bankers that we're hiring, you know, I would expect that as we gave in the guidance that during their second quarter with us they're calling activities are ramping up, their brand is getting out into the marketplace, that they've moved to Chemical.

I'd expect that they would see deal flow in their third quarter with us and we'd expect to breakeven by almost Q5 after they join us. Their size of the portfolios we're talking, you know when we're talking about the commercial finance ABL that a market teams is little larger.

So as they build out mature there, I would say, you know, 75 to 150 depending on the type of portfolios that they're carrying. And our commercial teams that are embedded in our community banks and regional banks probably a little -- it's a longer build, but they're much more balanced both in loans deposits and fee based services.

But in all cases so far we're hiring people that I consider tenured in the marketplaces in the Cleveland market, the Detroit market and Grand Rapids. And actually in Grand Rapids, we're holding our annual meeting here today. We've hired some outstanding group managers recently which also add to strength of our teams here.

Dennis Klaeser: In terms of the reserve build, you know, I don't think there's anything unique about the new higher lending there and the reserve build in your modeling. You know, you start with a overall expected charge-off rate for the entire portfolio and obviously we would replenish that. And then for net growth in the organic loan portfolio, you know, providing at roughly the 1% level is a reasonable estimate at this point given, our current reserve levels.

Terry McEvoy: And then just one follow-up, the upgrade to the core operating systems, what's the all in cost? I know we had something in the first quarter and Dennis you talked about it I think $6 million here in the second quarter. What's the all-in cost? And then I'm just curious why wasn't that done when Chemical and Talmer went through their initial conversion? Why wait a few years?

Dennis Klaeser: So, you know, why wait a few years, I think that the core system that Chemical Bank has been on for decades was geared towards the, you know, going to be the ultimate solution for us. We've upgraded our client facing technology and applications. We did that last year as part of the staged approach to upgrade our technology, and so now we're at the point where the core is now being upgraded. And again this has been somewhat of a plan with Chemical Bank prior to the merger.

Terry McEvoy: Yes. Thank you …

(Crosstalk)

David Provost: Yes, it's a two stage conversion process. So, Talmer first converted to the existing Chemical system. We couldn't immediately convert Chemical's wells to the new system. And now we're converting, this final conversion is -- we're converting from IBS Bank way, which is one service provided by FIS to FIS-

Male: IBS.

David Provost: … IBS. And so, we're upgrading to a higher grade system, the highest grade system provided by FIS. The total cost that we expect to incur this year is nearly $14 million. So, it's a substantial investment to us but we think it provides substantial leveragability for us. It's going to serve our interest for really the long-term.

It provides us the foundation for substantial growth opportunity and the shift in terms of the focus of the organization offering more sophisticated products and services particularly to our commercial service.

Dennis Klaeser: Yes, it's foundational. We have to make this movement and continue to the momentum of the organization.

Terry McEvoy: great. Thanks. Enjoy the day in Grand Rapids guys.

Male: Thanks.

Male: Thank you.

Operator: And we'll take our next question.

Kevin Reevey: Hi, it's Kevin Reevey with D.A. Davidson.

David Provost: Hi Kevin.

Kevin Reevey: Hi. So Dennis, when you said your efficiency ratio goal of 50% or even lower, is that by the end of the fourth quarter of 2018 or is that for the full year of 2018?

Dennis Klaeser: That would be by the end of the -- by the fourth quarter of next year -- of this year, fourth quarter.

Kevin Reevey: And then the 56 million of salary benefits, I think, you'd mentioned 2 million with seasonal. So was 54 million roughly a good run rate to use for the salary and benefits line item going forward?

Dennis Klaeser: Yes, but building a bit from there because as I suggested the sort of core operating expenses excluding ((inaudible)) tax credits migrating up, you know, a few million dollars between now and the end of the year. And some of that is …

Kevin Reevey: Okay.

Dennis Klaeser: … a large chunk of that, probably half of that is really compensation, the other half is other expenses.

Kevin Reevey: Okay, I was not aware of that. And then lastly, the growth over the last 12 months in CRE and construction development, what markets are you seeing the biggest growth coming from in that line item?

Thomas Shafer: Yes, so most of the growth … This is Tom Shafer. Most of the growth is coming out of our large marketplaces. Although, the economy is strong in all of our markets, throughout the state of Michigan and where we're operating in Ohio. But the majority is coming out of our larger marketplaces.

Kevin Reevey: Great. Thank you.

Dennis Klaeser: Thanks.

Operator: And we'll our next question.

Nat Race: Hi guys. Good morning. Nat Race with Piper Jaffray. How are you guys doing?

Male: Great.

Nat Race: Tom, just going back to the discussion around the hires that you guys have coming onboard and that you've already completed. Just kind of curious, I think you mentioned that you have some C&I specialties within some of these individuals. So just curious if you see some of their production been accretive to your kind of core portfolio yield that's I think around 410 as we sit here today?

Thomas Shafer: I do. So when we think about the equipment finance, the equipment finance team, the deals that we're seeing them generate would be ABL, clearly would be. And even I would say that selectively on the commercial side of the bank, I would say very -- it's a competitive marketplace.

The middle market is extraordinarily competitive today. And our commercial team has been involved in that for a couple of years now. But, the specialties have a greater likelihood of higher placement rates, but not dramatic.

Nat Race: That makes sense. And then Dennis just going back to the discussion over the opportunities around some of the public funds that you guys are looking to go after with some the teams you have in place. Just curious if you kind of speak to the rate sensitivity of some of these opportunities with some of these depositors.

And just if you expect as you on board some of these relationships, if you would kind of can increase your deposit ((inaudible)) going forward relative to what we saw on 2017.

Dennis Klaeser: Not necessarily, but it's a key strategic focus. There's really two segments of the municipal deposit market. One is the highly rate sensitive high beta part of the market. There's another part of it which is the municipal operating accounts where it's basically the municipalities checking accounts.

And those accounts are accounts where we're providing lots of services, intense flows of cash in and out. And so, we're really after those operating accounts. And of the roughly, if I remember correctly, $2.4 billion of municipal deposits we have as of the end of the first quarter, $1.7 billion of them are operating accounts. Those very attractive operating accounts that have relatively low betas, low costs that's very similar to the overall cost of our current deposit base.

Nat Race: Yes, that's great to hear. Appreciate ((inaudible)).

Male: Thanks.

Operator: And we'll take our next question.

Andy Stapp: Andy Stapp, Hilliard Lyons. Nice quarter. All my questions have been asked and answered. Thank you.

David Provost: All right, thanks, Andy.

Operator: And we'll take our next question.

Scott Siefers: Hey, guys, Scott Siefers again. I appreciate you for taking the follow-up. What are … Like once we get all through the sort of the transition and investments this year, do you guys have any specific financial goals that we should be looking for just to gauge progress? Because I guess what I'm wondering is, as we look at all the investment spend by the time it's all done even when it abates despite a pretty significant cost reduction program last year the cost base is still going to be about 10% higher than when we started.

So, just as we look at the kind of profitability payoff, is there anything that we should be looking at whether it's ROA, ROE, return on tangible common equity target that sort of gets us to our goalpost so to speak?

David Provost: Yes, we're hesitant to sort of put specifically goalposts out there. I think on the efficiency ratio, we're making some sacrifices to that currently even though it's still very low relative to peers, getting down to right around 50% for the fourth quarter. That queues us up to be sub 50% next year. I think one of the key issues that we are focused on is sustaining above peer average EPS growth.

And so, that's a major key focus of ours. So, above peer average EPS growth results in above peer average stock price appreciation, so that's what we're trying to deliver. We believe we can deliver that through organic growth in our strategic focus that we've laid out. And then longer term, we also have later great foundation to add additional value, when and if acquisitions at the right value come around.

Scott Siefers: Okay. And then just additionally on the operating system conversion. With you guys in the midst of this now does that take you out of being interested in M&A until it's done? In other words, are we sort of still on a pause button until like July of this year or would you be comfortable announcing something even in the midst of the conversion?

David Provost: No. I think the conversion is really pretty much set. Any acquisition opportunities we had, even if we were to announce one, you know, the conversion of a target wouldn't happen for another nine months anyway. So, it's not really a gaining factor for us.

Scott Siefers: Okay. All right. Thank you guys.

David Provost: All right, thanks.

Operator: And are there any additional questions?

David Provost: All right, operator. I'm hearing no additional questions. We want to thank everybody for their participation. We did have some great questions. We appreciate your interest in Chemical Financial. It's a great day in Midland or in Grand Rapids, I hope it's a great day for wherever you are. And we look forward to talking to you next quarter. Thanks.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.