



## COMPANY UPDATE/ ESTIMATES CHANGE/ PRICE TARGET CHANGE/ RATING CHANGE

### Key Metrics

|                                  |                 |
|----------------------------------|-----------------|
| CHFC - NASDAQ (as of 01/25/18)   | \$58.87         |
| Price Target                     | \$65.00         |
| 52-Week Range                    | \$43.61-\$59.67 |
| Shares Outstanding (mm)          | 71.2            |
| Market Cap. (\$mm)               | \$4,192         |
| 3-Mo. Average Daily Volume (000) | 325.4           |
| Institutional Ownership          | 79.3%           |
| Tangible Equity/ Tangible Assets | 9.5%            |
| ROE                              | 5.7%            |
| Tangible Book Value Per Share    | \$21.06         |
| Price/Tangible Book Value        | 279.5%          |
| Dividend Yield                   | 1.9%            |
| Price/LTM Earnings               | 28.3x           |

### Operating EPS CY 12/31

|      | Prior<br>2017A | Curr.<br>2018E | Prior<br>2019E | Curr.<br>2019E |
|------|----------------|----------------|----------------|----------------|
| 1Q   | \$0.70         | \$0.83         | \$0.90         | \$1.04         |
| 2Q   | \$0.73         | \$0.96         | \$0.96         | \$1.06         |
| 3Q   | \$0.75         | \$0.99         | \$1.02         | \$1.13         |
| 4Q   | \$0.87         | \$0.99         | \$1.05         | \$1.19         |
| Year | \$3.06         | \$3.76         | \$3.94         | \$4.41         |
| P/E  | 19.2x          |                | 15.0x          | 13.3x          |

### Common Dividends

|      | 2017A  | Curr.<br>2018E | Prior<br>%chg. | Curr.<br>2019E |
|------|--------|----------------|----------------|----------------|
| 1Q   | \$0.27 | \$0.28         | 3.7            | \$0.29         |
| 2Q   | \$0.27 | \$0.28         | 3.7            | \$0.29         |
| 3Q   | \$0.28 | \$0.29         | 3.6            | \$0.30         |
| 4Q   | \$0.28 | \$0.29         | 3.6            | \$0.30         |
| Year | \$1.10 | \$1.14         | 3.6            | \$1.18         |

**Company Description** – Chemical Financial Corporation (CHFC) is a commercial banking organization headquartered in Midland, Michigan. The company's footprint consists of Michigan, northern Ohio and northern Indiana. In addition to traditional commercial and retail banking services, Chemical Financial offers mortgage banking, trust and wealth management services.

### Banks

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January 26, 2018

## Chemical Financial Corporation

CHFC -- NASDAQ – Buy -- 2

### 4Q17 Review; Raising to Buy

- **Earnings Results:** Excluding \$0.74 of non-core items, CHFC reported operating EPS of approximately \$0.87, which was \$0.03 above our estimate and \$0.04 ahead of the Street. GAAP results included a \$0.65 charge related to the revaluation of the company's net deferred tax assets.
- **Positive Highlights:** Net interest income increased 1.6% linked-quarter (LQ) to \$145.9 million as a 1.9% rise in average earning assets more than offset one bp of net interest margin (NIM) compression to 3.39%. We had projected net interest income of \$146.7 million and a NIM of 3.46%.

Operating noninterest income surged 24.1% LQ to \$39.9 million due primarily to gains in "other" income (79.2%) and mortgage banking revenue (51.2%). Results were above our estimate of \$36.1 million.

Operating noninterest expense fell 0.9% LQ to \$97.5 million primarily on lower salaries, wages and employee benefits (8.1%) and outside processing and services fees (5.7%). We had projected noninterest expense of \$97.8 million.

End-of-period loans increased 2.3% sequentially, while average loans rose 1.1%.

- **Negative Highlights:** The provision for loan losses rose \$2.0 million sequentially to \$7.5 million. Excluding performing restructured loans, Nonperforming Assets/Assets rose three bps to 0.37%, while the net charge-off ratio fell six bps to 0.04%. We had modeled a provision of \$5.8 million and net charge-offs of 0.10%.
- **Estimates:** We are increasing our 2018 operating EPS estimate by \$0.18 to \$3.94 and introducing our 2019 estimate at \$4.41. We are increasing our 12-month price target by \$5.00 to \$65.00 and raising our rating to Buy from Long-term Buy.

**Note Important Disclosures on pages 5 and 6**  
**Note Analyst Certification on page 5**

**OTHER TAKEAWAYS & VALUATION**

- Management plans to increase investment securities portfolio to 16.5% of assets by year-end 2018 from its current level of approximately 14.4%, with a minimum spread of 110 bps. This strategy should enhance EPS and return on common equity.
- The company has previously stated its intention to increase the securities portfolio to approximately 20.0% of assets. Our former Long-term Buy rating reflected the risk that it might take an extended period to reach this objective given the flattish yield curve. Our current model does not assume any increase in the portfolio beyond 16.5% of assets, which is clearly easier to achieve near term. This factor is a major reason for our rating upgrade.
- Based on intraday trading, our price target suggests a potential return of 14.1%, including dividends.
- Management guided to 9%-10% annualized loan growth in coming quarters. Despite this superior growth, CHFC is currently trading at 14.7X 2018 earnings versus a median of 15.5X for other mid-cap banks.
- Chemical has added 14 commercial bankers since the 3Q17 earnings call and plans to make additional hires. These additions will help the company maintain and possibly enhance its strong revenue growth trajectory.
- Tangible book value declined \$0.15 LQ to \$21.21 and was impacted by the revaluation of net deferred tax assets and other nonrecurring charges.
- Management guided to an effective tax in 2018 of approximately 18.7% excluding the impact of income tax credits. Planned tax credit projects are expected to reduce the effective tax rate to ~15%.
- The surge in “other” income was primarily attributable to higher interest rate swap fees, while 3Q17 mortgage banking results were impacted by a large unfavorable valuation mark on servicing rights and seasonality.
- We derive our price target through our discounted dividend model and the application of a 15X forward multiple to our 2019 EPS estimate. The earnings multiple that we employ is appropriate relative to the company’s risk/reward prospects, in our opinion.
- Major model assumptions include two Fed rate hikes in 2018 and 2019 and continued flattening of the yield curve.

**SUITABILITY**

Our suitability rating on CHFC is 2 on our scale of 1 to 4 (1 = most conservative, 4 = most aggressive). Factors contributing to our suitability rating include the company’s market capitalization, liquidity and trading volume, diversity of revenues and the geographic diversification of its footprint.

**RISK FACTORS**

- **Economy** – If the economy softens, loan demand could wane and credit quality could deteriorate.
- **Geography** – The company’s operations are primarily clustered in the Midwest. Accordingly, its earnings are more vulnerable to any regional shock and/or slowdown.
- **Competition** – The industry is highly competitive and many of the company’s competitors have greater resources.
- **Sector Rotation** – The share price of the company’s common stock may be vulnerable to any sector rotation that might occur.

- **Regulatory Environment** – Banks operate in a highly regulated environment. Consequently, the company is vulnerable to regulatory uncertainties that could negatively impact shareholders.
- **Other** – Please see the company’s financial statements for a further discussion of risks and considerations.



*Additional information is available upon request.*

### **Analyst Certification**

I, Andrew W. Stapp, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

### **Important Disclosures**

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

### **Definitions of Ratings:**

**Buy** - We believe the stock has significant total return potential in the coming 12 months.

**Long-term Buy** - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

**Neutral** - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

**Underperform** - We believe the stock is vulnerable to a price decline in the next 12 months.

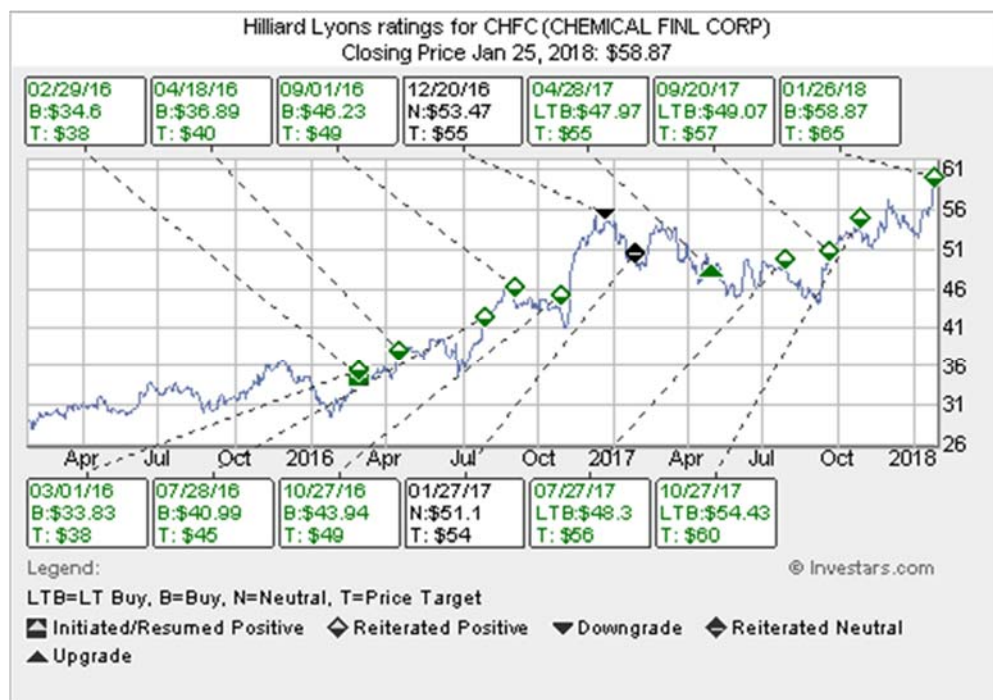
### **Definitions of Suitabilities:**

1. A large cap, core holding with a solid history.

2. A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks.

3. An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage.

4. Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base.



| Hilliard Lyons Recommended Issues |                     |                     | Investment Banking Provided in Past 12 Mo. |            |
|-----------------------------------|---------------------|---------------------|--|------------|
| Rating                            | # of Stocks Covered | % of Stocks Covered | Banking                                    | No Banking |
| Buy                               | 31                  | 28%                 | 10%  | 90%        |
| Hold/Neutral                      | 75                  | 67%                 | 9%   | 91%        |
| Sell                              | 6                   | 5%                  | 0%   | 100%       |

As of 8 January 2018

**Other Disclosures**

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

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