



## COMPANY UPDATE / ESTIMATES CHANGE / PRICE TARGET CHANGE

### Key Metrics

CHFC - NASDAQ (as of 07/26/17)	\$48.30
Price Target	\$56.00
52-Week Range	\$39.52-\$55.55
Shares Outstanding (mm)	71.1
Market Cap. (\$mm)	\$3,436
3-Mo. Average Daily Volume (000)	321.5
Institutional Ownership	79.3%
Tangible Equity / Tangible Assets	9.5%
ROE	7.0%
Tangible Book Value Per Share	\$20.65
Price/Tangible Book Value	233.9%
Dividend Yield	2.3%
Price/LTM Earnings	21.1x

### Operating EPS CY 12/31

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$0.67	\$0.70A	\$0.70A	\$0.85	\$0.83
2Q	\$0.72	\$0.75	\$0.73A	\$0.92	\$0.93
3Q	\$0.72	\$0.79	\$0.78	\$0.97	\$0.97
4Q	\$0.76	\$0.82	\$0.80	\$1.01	\$1.00
Year	\$2.87	\$3.07	\$3.02	\$3.74	\$3.74
P/E	16.8x		16.0x		12.9x

### Common Dividends

	2016A	Curr. 2017E	Prior %chg.	Curr. 2018E
1Q	\$0.26	\$0.27A	3.8	\$0.28
2Q	\$0.26	\$0.27A	3.8	\$0.28
3Q	\$0.27	\$0.28	3.7	\$0.31
4Q	\$0.27	\$0.28	3.7	\$0.31
Year	\$1.06	\$1.10	3.8	\$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

Analyst: Andrew W. Stapp  
502-588-4190 / [astapp@hilliard.com](mailto:astapp@hilliard.com)  
Institutional Sales Desk: George Moorin  
502-588-9141 / [gmoorin@hilliard.com](mailto:gmoorin@hilliard.com)  
J.J.B. Hilliard, W.L. Lyons, LLC  
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## Chemical Financial Corporation

CHFC -- NASDAQ – Long-term Buy -- 2

### Net Interest Income Pops on Securities Purchases; Reiterating Long-term Buy

- **Earnings Results:** CHFC reported GAAP and operating EPS of \$0.73, which was below our estimate of \$0.75 and the Street consensus of \$0.74.
- **Positive Highlights:** Net interest income surged 6.0% linked-quarter (LQ) to \$137.9 million as a 5.4% rise in average earning assets and an extra day in the quarter more than offset one bp of net interest margin (NIM) compression to 3.48%. We had projected net interest income of \$135.9 million and a NIM of 3.48%.

Operating noninterest income ramped up 9.4% LQ to \$41.5 million on gains in all line items. Results modestly exceeded our estimate of \$41.4 million.

Operating noninterest expense dropped 2.3% LQ to \$97.8 million as declines in salaries & benefits (12.7%) and equipment & software expenses (4.3%) were partially offset by increases in occupancy (18.3%) and “other” noninterest expense (18.5%). Our estimate was \$96.3 million.

Growth in end-of-period loans was robust at 3.0%, while average loans rose 2.7%.

- **Negative Highlights:** The provision for loan losses rose \$2.2 million sequentially to \$6.2 million. Excluding performing restructured loans, Nonperforming Assets/Assets fell one bp to 0.35%, while the net charge-off ratio dropped seven bps to 0.04%. We had modeled a provision of \$5.1 million and net charge-offs of 0.10%.
- **Estimates:** We are reducing our 2017 operating EPS estimate by \$0.05 to \$3.02 and maintaining our 2018 estimate at \$3.74. We are raising our 12-month price target by \$1.00 to \$56.00. With our price target suggesting an attractive return of 18%, including dividends, we are reaffirming our Long-term Buy rating.

**Note Important Disclosures on pages 4 and 5**  
**Note Analyst Certification on page 4**

**OTHER TAKEAWAYS & VALUATION**

- The decline in the NIM was primarily attributable to a shift in earning asset mix resulting from the purchase of approximately \$500 million of securities during the quarter. Purchase accounting accretion contributed 21 bps to the NIM in 2Q17, up from 12 bps in 1Q17.
- Subsequent to quarter-end, CHFC purchased approximately \$120 million of investment securities and expects to purchase another \$80 million in 3Q17. This amount is below what management previously anticipated due to the unfavorable slope in the yield curve
- Approximately \$700 million of loan originations was partially offset by \$306 million of run-off from CHFC's acquired loan portfolio. Management noted that the loan pipeline remains robust and continued strong loan growth is expected.
- The 2Q17 effective tax rate was 30.7% versus 20.5% in 1Q17. The Q1 rate benefitted from tax credits associated with the exercise of stock options. Management expects an effective tax rate of approximately 28%-29% in 2H17.
- We derive our price target through our discounted dividend model and the application of a 14.5X forward multiple to our 3Q18-2Q19 EPS estimates. The earnings multiple that we employ is appropriate relative to the company's risk/reward prospects, in our opinion.
- Major model assumptions include a Fed rate hike in December followed by two additional hikes in 2018, continued flattening of the yield curve and a 28% corporate tax rate in 2018. Given the considerable uncertainties regarding corporate tax reform, we are employing conservative hurdle rates in establishing our ratings.

**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.

	CHEMICAL FINANCIAL CORPORATION										CHFC: LONG-TERM BUY				
	1Q016 A	2Q016 A	3Q016 A	4Q016 A	1Q17 A	2Q17 A	3Q17 E	4Q17 E	FY 2015 A	FY 2016 A	FY 2017 E	FY 2018 E	FY 2017 E	FY 2018 E	
\$Millions, Except for Per Share Data															
<b>Balance Sheet Data:</b>															
Assets	9,303.6	9,514.2	17,383.6	17,355.2	17,637.0	18,781.4	19,344.8	20,063.7	9,188.8	17,355.2	20,063.7	22,201.3	88.9%	15.6%	10.7%
Loans Held for Investment	7,366.9	7,647.3	12,715.8	12,990.8	13,273.4	13,667.4	14,104.7	14,415.0	7,271.1	12,990.8	14,415.0	15,761.7	78.7%	11.0%	9.3%
Average Earning Assets	8,526.7	8,636.6	11,058.1	15,156.1	15,395.5	16,229.0	16,938.4	17,419.3	7,839.7	10,826.1	16,495.5	18,626.1	38.1%	52.4%	12.9%
Deposits	7,650.1	7,464.6	13,272.9	12,873.1	13,132.3	13,204.4	13,759.0	13,724.1	7,456.8	12,873.1	13,724.1	15,006.2	72.6%	6.6%	9.3%
Equity	1,032.3	1,050.3	2,563.7	2,581.5	2,600.1	2,639.4	2,675.8	2,713.5	1,016.0	2,581.5	2,713.5	2,897.7	154.1%	5.1%	6.8%
<b>Statement of Operations:</b>															
FTE Net Interest Income	76.5	79.6	99.2	135.4	133.2	141.1	144.3	147.5	281.5	390.7	566.0	620.9	38.8%	44.9%	9.7%
Net Interest Income	74.3	77.5	96.8	132.4	130.1	137.9	141.4	144.5	274.0	381.1	553.9	608.4	39.1%	45.4%	9.8%
Provision for Loan Losses	1.5	3.0	4.1	6.3	4.1	6.2	5.5	5.7	6.5	14.9	21.5	25.9	128.8%	44.4%	20.5%
<b>Non-Interest Income:</b>															
Deposit Service Charges	5.7	6.3	7.7	8.4	8.0	8.8	8.5	8.3	25.5	28.1	33.6	33.4	10.4%	19.3%	-0.5%
Wealth Management Revenue	5.2	5.8	5.6	6.0	5.8	7.0	6.0	6.5	20.6	22.6	25.3	27.8	10.0%	11.9%	10.0%
Other Customer Service Fees	6.0	6.5	7.4	10.0	8.9	9.7	7.2	7.3	23.9	29.9	33.2	30.4	25.1%	10.9%	-8.4%
Mortgage Banking	1.4	1.6	4.4	14.4	9.2	9.9	11.1	9.3	6.1	21.9	39.5	40.9	256.4%	80.5%	3.8%
Other	1.0	0.7	2.7	15.3	6.0	6.1	6.2	6.3	3.5	19.7	24.7	25.7	461.6%	25.0%	4.2%
Securities Gains	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.6	0.1	0.2	0.0	-79.5%	29.5%	-100.0%
Total Non-Interest Income	19.4	20.9	27.8	54.3	38.0	41.6	39.0	37.7	80.2	122.4	156.3	158.3	52.5%	27.8%	1.3%
Non-Core Adjustment	0.0	0.0	0.0	-7.5	-0.1	-0.1	0.0	0.0	(0.6)	(7.5)	(0.2)	0.0	1093.7%	-97.8%	-100.0%
Adjusted Non-Interest Income	19.4	20.9	27.8	46.8	37.9	41.5	39.0	37.7	79.6	114.8	156.1	158.3	44.3%	36.0%	1.4%
<b>Non-Interest Expense:</b>															
Salaries & Benefits	33.9	33.1	40.6	57.6	60.2	52.6	55.0	55.0	127.9	165.2	222.8	229.3	29.1%	34.9%	2.9%
Occupancy Expense	4.9	5.5	5.5	7.6	7.4	8.7	8.0	7.6	18.2	23.5	31.7	30.8	29.2%	34.7%	-2.8%
Equipment & Software	4.4	4.9	6.4	8.7	8.5	8.1	8.2	8.3	18.9	24.4	33.1	33.7	29.1%	35.8%	1.7%
Other	13.1	12.5	16.2	22.3	23.9	28.3	25.0	25.2	51.0	64.1	102.3	102.7	25.7%	59.6%	0.3%
Total Non-Interest Expense	58.9	59.1	106.1	114.3	104.2	98.2	96.2	96.0	223.9	338.4	394.7	396.5	51.2%	16.6%	0.5%
Non-Core Adjustment	-2.6	-3.1	-37.5	-18.0	-4.2	-0.5	0.0	0.0	(7.8)	(61.1)	(4.6)	0.0	683.4%	-92.4%	-100.0%
Adjusted Non-Interest Expense	56.3	56.0	68.7	96.3	100.0	97.8	96.2	96.0	216.1	277.3	390.0	396.5	28.3%	40.7%	1.7%
Pretax Income	35.9	39.3	51.8	76.7	63.9	75.4	78.7	80.4	131.0	203.8	298.5	344.3	55.5%	46.5%	15.3%
Income Taxes	10.1	11.7	16.0	22.5	13.6	23.2	22.4	22.9	38.5	60.2	82.1	76.2	56.4%	36.4%	-7.2%
Operating Net Income	25.8	27.7	35.8	54.2	50.3	52.3	56.3	57.5	92.5	143.6	216.5	268.2	3.0%	50.8%	23.9%
<b>Share &amp; Per Share Data:</b>															
Diluted EPS	0.60	0.67	0.22	0.66	0.67	0.73	0.78	0.80	2.39	2.15	2.98	3.74	-10.1%	38.8%	25.4%
Operating EPS	0.67	0.72	0.72	0.76	0.70	0.73	0.78	0.80	2.53	2.87	3.02	3.74	13.3%	5.3%	23.6%
Dividends Per Share	0.26	0.26	0.27	0.27	0.27	0.27	0.28	0.28	1.00	1.06	1.10	1.18	6.0%	3.8%	7.3%
Tangible Book Value	18.81	19.31	19.73	19.94	20.07	20.65	21.18	21.72	18.38	19.94	21.72	24.38	8.5%	8.9%	12.2%
Common Shares Outstanding	38,248	38,267	70,497	70,599	71,118	71,131	71,131	71,131	38,168	70,599	71,131	71,131	85.0%	0.8%	0.0%
Average Diluted Shares	38,521	38,600	49,631	71,304	71,415	71,443	71,755	71,755	36,314	49,426	71,592	71,755	36.1%	44.8%	0.2%
<b>Key Financial Statistics:</b>															
Return on Assets	1.01%	1.10%	0.35%	1.09%	1.09%	1.14%	1.17%	1.16%	1.02%	0.89%	1.14%	1.28%	(13)	25	14
Return on Equity	9.14%	9.95%	2.75%	7.36%	7.37%	7.98%	8.41%	8.47%	9.40%	7.32%	8.06%	9.56%	(208)	74	150
Net Interest Margin	3.60%	3.70%	3.58%	3.56%	3.49%	3.48%	3.38%	3.36%	3.58%	3.61%	3.43%	3.33%	3	(18)	(9)
Operating Non-Int. Inc./Operating Rev.	20.70%	21.22%	22.28%	26.11%	22.57%	23.12%	21.63%	20.69%	22.51%	23.16%	21.99%	20.64%	65	(117)	(135)
Efficiency Ratio	57.48%	54.56%	53.06%	51.84%	57.58%	52.71%	51.76%	51.13%	59.23%	54.26%	53.30%	50.28%	(497)	(96)	(302)
Tangible Common Ratio	8.00%	8.03%	8.58%	8.70%	8.67%	8.34%	8.29%	8.18%	7.91%	8.70%	8.18%	8.24%	79	(52)	7
NCOs/Average Loans	0.25%	0.10%	0.08%	0.06%	0.11%	0.04%	0.08%	0.08%	0.13%	0.12%	0.08%	0.13%	(1)	(4)	5

Source: Company reports and Hilliard Lyons estimates.

*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.

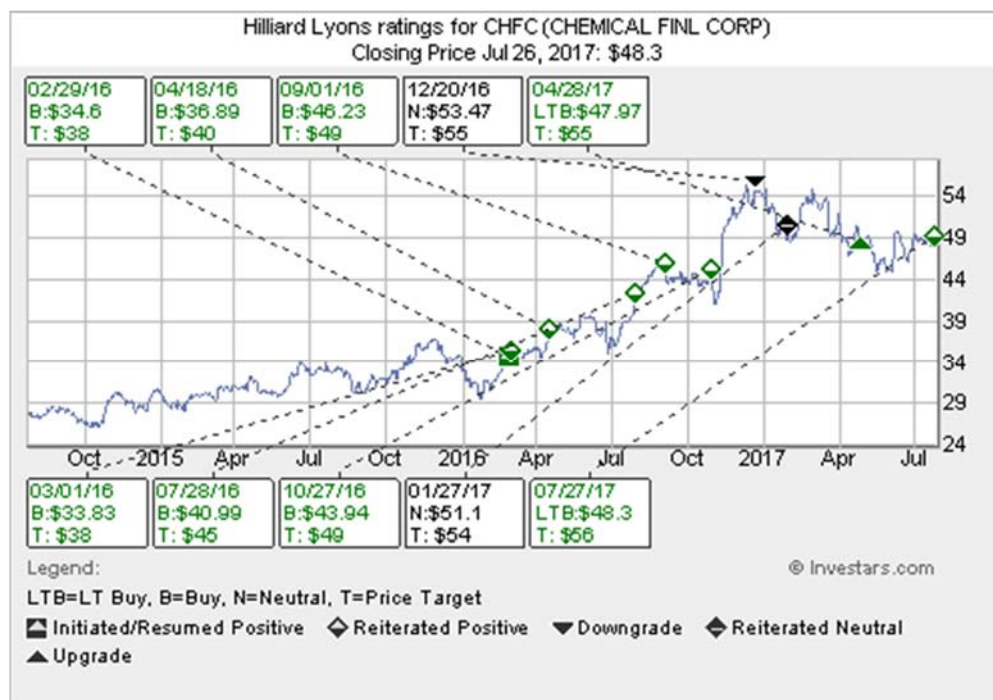
### **Definitions of Suitabilities:**

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
Buy	36	29%	14%
Hold/Neutral	79	63%	5%
Sell	10	8%	0%
			No Banking
			86%
			95%
			100%

As of 7 July 2017

**Other Disclosures**

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