



COMPANY UPDATE/ ESTIMATES CHANGE/ PRICE TARGET CHANGE

Key Metrics

CHFC - NASDAQ (as of 10/26/17)	\$54.43
Price Target	\$60.00
52-Week Range	\$40.93-\$55.55
Shares Outstanding (mm)	71.2
Market Cap. (\$mm)	\$3,873
3-Mo. Average Daily Volume (000)	311.2
Institutional Ownership	81.4%
Tangible Equity/ Tangible Assets	9.5%
ROE	7.0%
Tangible Book Value Per Share	\$21.12
Price/Tangible Book Value	257.7%
Dividend Yield	2.1%
Price/LTM Earnings	20.8x

Operating EPS CY 12/31

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$0.67	\$0.70A	\$0.70A	\$0.83	\$0.83
2Q	\$0.72	\$0.73A	\$0.73A	\$0.93	\$0.96
3Q	\$0.72	\$0.77	\$0.75A	\$0.96	\$0.99
4Q	\$0.76	\$0.82	\$0.84	\$0.98	\$0.99
Year	\$2.87	\$3.03	\$3.03	\$3.70	\$3.76
P/E	19.0x		18.0x		14.5x

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	\$0.28A	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

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Chemical Financial Corporation

CHFC -- NASDAQ – Long-term Buy -- 2

3Q17 Review; Reaffirming Long-term Buy

- **Earnings Results:** Excluding \$0.19 of merger and restructuring charges, CHFC reported operating EPS of approximately \$0.75, which was \$0.02 below our estimate and the Street consensus. Results included an unfavorable non-cash valuation mark on loan servicing rights that negatively impacted EPS by \$0.04.
- **Positive Highlights:** Net interest income surged 4.1% linked-quarter (LQ) to \$143.6 million as a 3.6% rise in average earning assets and an extra day in the quarter more than offset one bp of net interest margin (NIM) compression to 3.40%. We had projected net interest income of \$141.1 million and a NIM of 3.37%.
- **Negative Highlights:** Operating noninterest income plummeted 22.6% LQ to \$32.1 million due primarily to the impact of the adoption of the Durbin amendment on interchange fees and the aforementioned valuation mark on loan servicing rights. Results were below our estimate of \$39.0 million.
End-of-period loans increased 1.2% sequentially, while average loans rose 2.1%. We estimated 2.2% growth in period end loans.
Operating noninterest expense rose 0.6% LQ to \$98.3 million primarily on higher outside processing and service fees (7.9%) and “other” expense (11.8%). We had projected noninterest expense of \$97.7 million.
The loan loss provision fell \$0.7 million sequentially to \$5.5 million. Nonperforming Assets/Assets fell one bp to 0.34%, while the net charge-off ratio rose six bps to 0.10%. We had modeled a provision of \$5.0 million and net charge-offs of 0.08%.
- **Estimates:** We are maintaining our 2017 operating EPS estimate at \$3.03 and increasing our 2018 estimate by \$0.06 to \$3.76. We are increasing our 12-month price target by \$3.00 to \$60.00 and reaffirming our Long-term Buy rating.

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

OTHER TAKEAWAYS & VALUATION

- In its 1Q17 earnings call, management announced its intention to increase the securities portfolio over the next few quarters to approximately 20% of assets. CHFC now expects it will take two to three years to reach this target.
- CHFC grew its securities portfolio by approximately \$250 million in the third quarter and is expected to grow the portfolio by more than \$100 million in the fourth quarter.
- Management noted that the loan pipeline is robust and looks for stronger loan growth in Q4. It guided to 9%-10% annualized loan growth in coming quarters.
- CHFC launched an efficiency initiative in 3Q17 that should result in the reduction of approximately 7% of full-time equivalent employees and the consolidation of 23 branch offices in addition to the 13 offices consolidated in August. The restructuring efforts are expected to generate over \$20 million in annualized savings. Approximately 50% of these savings are expected to be spent on the recruitment of commercial lenders and other bankers.
- The NIM benefitted from a nine bps increase in the yield on total loans, but this was offset by the increase in the investment securities portfolio. Purchase accounting accretion contributed 23 bps to the NIM in 3Q17, up from 21 bps in 2Q17. Management guided to a stable core margin in Q4.
- The substantial increase in “other” expense was primarily attributable to a \$3.1 million impairment charge associated with a historical tax credit project.
- The 3Q17 effective tax rate was 20.2% versus 30.7% in 2Q17. The lower tax rate was the result of the benefit the company received from a tax credit project that was placed into service during the quarter.
- Management anticipates additional tax credit projects going into service in Q4, with an associated \$5 million to \$6 million charge. The charge will be more than offset by the resulting tax benefit. The Q4 effective tax rate is expected to be approximately 23%-24%. More tax credit projects are anticipated in 2018.
- The impact of the Durbin amendment, which limits interchange fees on debit card transactions came in higher than expected. Management originally expected the impact to be approximately \$2.5 million, but the actual quarterly hit is approximately \$3.0 million.
- We derive our price target through our discounted dividend model and the application of a 15X forward multiple to our 4Q18-3Q19 EPS estimates. The earnings multiple that we employ is appropriate relative to the company’s risk/reward prospects, in our opinion.
- In addition to the increase in our 2018 EPS estimate, the increase to our price target is attributable to stronger EPS growth in the outer years of our discounted dividend model.
- 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					
Millions, Except for Per Share Data										FY 2016 A	FY 2017 E	FY 2018 E	FY 2018 E		
										YOY Change					
Balance Sheet Data:															
Assets	9,303.6	9,514.2	17,383.6	17,355.2	18,781.4	19,354.3	19,347.9	19,347.9	19,347.9	17,355.2	19,347.9	22,134.4	11.5%	88.9%	14.4%
Loans Held for Investment	7,366.9	7,647.3	12,715.8	12,990.8	13,273.4	13,667.4	14,151.5	14,151.5	14,151.5	12,990.8	14,151.5	15,511.8	8.9%	78.7%	9.6%
Average Earning Assets	8,526.7	8,636.6	11,058.1	11,556.1	15,395.5	16,229.0	17,165.6	17,165.6	17,165.6	10,826.1	16,401.3	18,402.7	51.5%	38.1%	12.2%
Deposits	7,650.1	7,484.6	13,272.9	12,873.1	13,132.3	13,204.4	13,770.9	13,770.9	13,770.9	12,873.1	13,770.9	15,420.7	7.0%	72.6%	12.0%
Equity	1,032.3	1,050.3	2,563.7	2,581.5	2,600.1	2,639.4	2,673.1	2,712.9	2,712.9	2,581.5	2,712.9	2,898.8	5.1%	154.1%	6.9%
Statement of Operations:															
FTE Net Interest Income	76.5	79.6	99.2	135.4	133.2	141.1	146.9	149.7	149.7	390.7	570.9	625.9	46.1%	38.8%	9.6%
Net Interest Income	74.3	77.5	96.8	132.4	130.1	137.9	143.6	146.7	146.7	381.1	558.4	613.4	46.5%	39.1%	9.8%
Provision for Loan Losses	1.5	3.0	4.1	6.3	4.1	6.2	5.5	5.8	5.8	6.5	21.6	25.6	45.0%	128.8%	18.5%
Non-Interest Income:															
Deposit Service Charges	5.7	6.3	7.7	8.4	8.0	8.8	9.1	8.9	8.9	25.5	34.9	34.7	23.9%	10.4%	-0.4%
Wealth Management Revenue	5.2	5.8	5.6	6.0	5.8	7.0	6.2	6.3	6.3	20.6	25.3	27.9	11.9%	10.0%	10.4%
Other Customer Service Fees	6.0	6.5	7.4	10.0	8.9	9.7	6.6	6.7	6.7	23.9	32.0	27.9	6.9%	25.1%	-12.7%
Mortgage Banking	1.4	1.6	4.4	14.4	9.2	9.9	5.2	8.1	8.1	6.1	21.9	36.6	48.2%	256.4%	13.0%
Other	1.0	0.7	2.7	15.3	6.0	6.1	4.9	6.0	6.0	3.5	19.7	24.6	17.1%	461.6%	6.5%
Securities Gains	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.1	0.2	0.0	-79.5%	30.2%	-100.0%
Total Non-Interest Income	19.4	20.9	27.8	54.3	38.0	41.6	32.1	36.1	36.1	80.2	122.4	151.7	20.8%	52.5%	2.7%
Non-Core Adjustment	0.0	0.0	0.0	-7.5	-0.1	-0.1	0.0	0.0	0.0	(0.6)	(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	32.1	36.1	36.1	79.6	114.8	151.7	28.6%	44.3%	2.8%
Non-Interest Expense:															
Salaries & Benefits	33.9	33.1	40.6	57.6	60.2	52.6	52.6	51.0	51.0	127.9	165.2	216.5	31.0%	29.1%	0.8%
Occupancy Expense	4.9	5.5	5.5	7.6	7.4	8.7	6.9	6.4	6.4	18.2	23.5	26.1	25.0%	29.2%	-11.2%
Equipment & Software	4.4	4.9	6.4	8.7	8.5	8.1	7.6	7.1	7.1	18.9	24.4	29.0	28.5%	29.1%	-7.5%
Other	13.1	12.5	16.2	22.3	23.9	28.3	31.3	33.3	33.3	51.0	64.1	114.6	82.0%	25.7%	-1.8%
Total Non-Interest Expense	58.9	59.1	106.1	114.3	104.2	98.2	119.5	97.8	97.8	223.9	338.4	388.1	24.1%	51.2%	-7.6%
Non-Core Adjustment	-2.6	-3.1	-37.5	-18.0	-4.2	-0.5	-21.2	0.0	0.0	(7.8)	(61.1)	0.0	-57.7%	683.4%	-100.0%
Adjusted Non-Interest Expense	56.3	56.0	68.7	96.3	100.0	97.8	98.3	97.8	97.8	216.1	277.3	388.1	42.1%	28.3%	-1.5%
Pretax Income	35.9	39.3	51.8	76.7	63.9	75.4	71.9	79.2	79.2	131.0	203.8	351.5	55.5%	55.5%	21.0%
Income Taxes	10.1	11.7	16.0	22.5	13.6	23.2	18.3	18.6	18.6	38.5	60.2	81.6	22.5%	56.4%	10.8%
Operating Net Income	25.8	27.7	35.8	54.2	50.3	52.3	53.6	60.6	60.6	92.5	143.6	269.9	3.0%	3.0%	24.5%
Share & Per Share Data:															
Diluted EPS	0.60	0.67	0.22	0.66	0.67	0.73	0.57	0.84	0.84	2.39	2.15	2.80	30.6%	-10.1%	34.1%
Operating EPS	0.67	0.72	0.72	0.76	0.70	0.73	0.75	0.84	0.84	2.53	2.87	3.76	5.6%	13.3%	24.1%
Dividends Per Share	0.26	0.26	0.27	0.27	0.27	0.27	0.28	0.28	0.28	1.00	1.06	1.18	3.8%	6.0%	7.3%
Tangible Book Value	18.81	19.31	19.73	19.94	20.07	20.65	21.13	21.71	21.71	18.38	19.94	24.39	8.9%	8.5%	12.4%
Common Shares Outstanding	38,248	38,267	70,497	70,599	71,118	71,131	71,152	71,152	71,152	38,168	70,599	71,152	85.0%	85.0%	0.0%
Average Diluted Shares	38,521	38,600	49,631	71,304	71,415	71,443	71,505	71,746	71,746	36,314	49,426	71,527	44.7%	36.1%	0.3%
Key Financial Statistics:															
Return on Assets	1.01%	1.10%	0.35%	1.09%	1.08%	1.14%	1.13%	1.25%	1.25%	1.02%	0.89%	1.15%	16	(13)	26
Return on Equity	9.14%	9.95%	2.75%	7.36%	7.37%	7.98%	6.07%	8.92%	8.92%	9.40%	7.32%	7.59%	203	(208)	27
Net Interest Margin	3.60%	3.70%	3.58%	3.56%	3.49%	3.48%	3.48%	3.46%	3.46%	3.58%	3.61%	3.40%	3	3	(13)
Operating Non-Int. Inc./Operating Rev.	20.70%	21.22%	22.28%	26.11%	22.57%	23.12%	18.28%	19.74%	19.74%	22.51%	23.16%	20.91%	65	65	(225)
Efficiency Ratio	57.48%	54.56%	53.06%	51.84%	57.58%	52.71%	54.18%	51.94%	51.94%	59.23%	54.26%	49.26%	(484)	(497)	(15)
Tangible Common Ratio	8.00%	8.03%	8.58%	8.70%	8.67%	8.34%	8.27%	8.50%	8.50%	7.91%	8.70%	8.28%	(20)	79	(20)
NCOs/Average Loans	0.25%	0.10%	0.08%	0.06%	0.11%	0.04%	0.10%	0.10%	0.10%	0.13%	0.12%	0.09%	(1)	(3)	4

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.

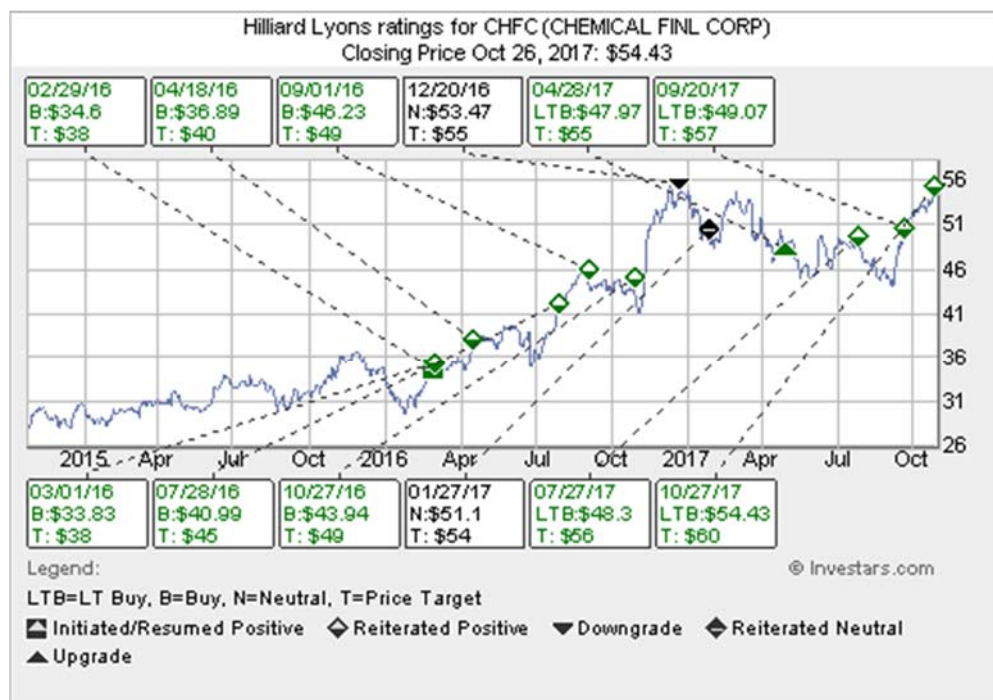
Definitions of Suitabilities:

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	No Banking
Buy	39	32%	8%	92%
Hold/Neutral	74	60%	9%	91%
Sell	8	7%	0%	100%
Restriction	2	2%	100%	0%

As of 5 October 2017

Other Disclosures

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