MidWestOne Financial Group, Inc.

2015 First Quarter Earnings Release

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CORPORATE PARTICIPANTS

Charles Funk – *President, Chief Executive Officer and Director*

Kent Jehle – *Executive Vice President and Chief Credit Officer*

Gary Ortale – *Chief Financial Officer and Executive Vice President*

PRESENTATION

Operator
Good day, everyone, and welcome to the MidWestOne Financial Group, Incorporated, 2015 Q1 Earnings Release conference call. All participants will be in a listen-only mode. Should you need assistance, you may signal a conference specialist by pressing the * key followed by 0. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press * and then 1, using a touchtone telephone. To withdraw your question, you may press * and 2. Please also note, that today's event is being recorded.

At this time, I would like to turn the conference call over to Mr. Charles Funk, President and CEO. Sir, please go ahead.

Charles Funk
Thank you, Jaime. And thank you, everyone, for joining us this morning or this afternoon if you are on the East Coast. I'll begin as I always do with the forward-looking statements and remind everyone this presentation contains forward-looking statements relating to the financial condition, results of operations and business of MidWestOne Financial Group.

Forward-looking statements generally include words such as believes, expects, anticipates and other similar expressions. Actual results could differ materially from those indicated. Among the important factors that could cause actual results to differ materially are interest rates, changes in the mix of the company's business, competitive pressures, general economic conditions and risk factors detailed in the company's periodic reports and registration statements filed with the SEC. MOFG undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances after the date of this presentation.

And now that our attorneys are happy and our regulators, let me go ahead with a brief overview of what we thought was a fine first quarter. Clearly the headline numbers are good, but with or without special charges we're very, very pleased with the quarter. Excluding the transaction costs, we had a terrific quarter of $0.62 a share. I think the headline, perhaps, within the numbers is the net interest margin of 3.72%, we don't think that's sustainable. February, as all of you know or many of you know, is normally a month with an elevated margin. We also had a little bit of interest recovery in the quarter, and of course the loan pools with an 11% return even with a diminished number outstanding 11% is very, very good, almost three times what it was a year ago.

One thing that may not be quite as obvious that probably helped the margin is that we have been shedding some higher-cost liabilities as we seek to pay for the Central Bank transaction. And in that we had an amount of Federal Home Loan Bank pre-pays, which tend be higher cost. We also have less some retail CDs and jumbo CDs run-off and again, those tend to be a little higher cost liabilities.

The other headline would be $44 million of loan growth in the quarter; those of you that have followed our company for a long period of time know that we tend to be plotters and not put up spectacular numbers. I don't know if I would call this spectacular, but for our company it's a very, very, very strong quarter. Kent Jehle can further comment on some of the activity. All I would say is that we did see some in-market moves where larger commercial customers switched their business to MidWestOne Bank. In our footprint, we have a lot of good community banks and they have loyal customers and we benefited during this quarter with several in-market moves. You never can predict that that'll continue or not, but we're certainly happy with what happened this quarter.

We lost a few deals on pricing. I think most of the $44 million in growth came at terms that were at or near our price, but there were a number of deals that we could have booked but didn't because we weren't at the right price and there might have been one or two on structure, but I think most of the deals that we didn't book were on price. So there's still a lot of competition out there and I think the media has played up on that a little bit as first quarter earnings have been reported.

Looks to us like asset quality continues to be in good shape. I will comment within our loan loss reserve that we have what we consider to be a required reserve inside of our reserve and the surplus over the required reserve has moved down a little bit and that's due entirely to the long growth we've experienced. We've certainly put more in our loan loss reserve than we had budgeted for, but that's because of the growth and the fact that we did put a little excess in, got us back over above 1.4 as a percentage of total loans.

I am very pleased, as I commented in the earnings release, very pleased with NPA coverage of over 130%. That's as good as it's been for several quarters in our company. Within the balance sheet, and many of you have noticed this already, but we clearly have been selling investments and we've been selling both winners and losers but as I reflect back on the first quarter and even into April, this has been a very, very good time to sell investments. We have gotten some phenomenal bids on some of the bonds we've owned. In fact, we sold a couple of mortgage-backed securities, but they were shorter mortgage-backed securities but we did sell several mortgage-backed securities where the give up yield or the yield that we were giving up over the life of the bond, we calculated to be under 50 basis points. So clearly, very strong bids, a very good time to sell bonds.

Non-interest income, for the most part a decent quarter, not a great quarter if I go through it by the major line items. The mortgage business is impacted a little bit by the fact that our servicing rights adjustment was a negative number in this income statement. If you take the servicing rights adjustment out, I think probably our mortgage activity was fine; we do have a nice pipeline. So the second quarter should show good results, assuming we get them all closed and closed on time.

Wealth management, I would say the rate of growth overall in wealth management has slowed a little bit but is still positive. And I don't know that I would call this a trend in terms of the slowing revenue growth, part of it was we have some trustees that we thought we were going to collect in the first quarter that we didn't. We expect to collect those in the second quarter and if we do, we should be back on a little bit more sustainable, or a little bit higher, path.

Service charge income continues to be up as a comparison to last year. And I've said the only thing we're noticing there is also a nationwide trend and that is that NSF fees, I think customers are much more aware of NSF fees, especially those that use mobile banking and they track it a little bit closer. We're not the only bank that has seen that, still up from a year ago, but behind what we had budgeted.

Expenses appear to us to be okay, other than what you see that is tied directly to the merger. If you look around our footprint I would say the local economies are fine, certainly not a boom time, certainly not a bust time. We've talked a lot about the Ag economy and Kent can comment more, but I think we made it to the agricultural loan renewal season in good shape without a large amount of carryover debt.

We continue to think that if corn and bean prices stay at these levels that the first effects are probably going to be seen in terms of the small businesses where farmers spend their money. So there won't be as many new pickup trucks bought; there won't be as many implements purchased from the implement dealers. But in terms of our agricultural borrowers, we didn't see a lot of carryover debt and they appear to be ready to go for this crop season.

There continues to be a lot of competition for pricing and that's also within the Ag sector. So we're mindful of that. Overall I think there is good momentum in the Iowa economy but certainly not a boom but certainly not a bust as I said before.

Before I close, a short update on the merger. You all know we've received Federal Reserve approval; we received shareholder approval yesterday with over 99% of the votes being in favor of the merger. We still are pointing toward May 1st close. We're very excited as I've traveled around and talked to folks about the merger, the reception has been very good. And I continue to say that it is transformational for our company but it still all comes down to execution and management has to execute on what we've said we would do and that's what we will be focused on, that's what we have been focused on, but once we get the deal closed, we'll be very, very focused on the execution part of this transaction.

So that would be my brief overview and with that I'm happy to answer any questions that you might have. And I'll turn it back to you, Jaime.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time we'll begin the question and answer session. To ask a question, you may press * and then 1. If you are using a speakerphone, we do ask that you please pick up your handset before pressing the keys to ensure the best sound quality. If at any time your question has been addressed and you would like to withdraw your question, you may press * and 2. Again, it is * and then 1 to join the question queue.

And our first question comes from Jeff Rulis from D.A. Davidson. Please go ahead with your question.

Jeff Rulis
Thanks, good morning.

Charles Funk
Good morning.

Kent Jehle
Good morning, Jeff.

Jeff Rulis
Just a question on the margin. It sounds like a lot of some factors that led to the sizable jump. Thoughts on core margin going forward and maybe even give us an update on what you think the merger, how that will impact core margins as well.

Charles Funk
Well, I can start and then perhaps others can comment. We would think it would definitely come in, we've been running 345 to 355, I think, in that range. It seems to me that that's a reasonable run rate, as I said in the press release we were pleasantly surprised when we get to 372. The Central Bank margin a lot will depend on purchase accounting but if you look and we can't predict that with great accuracy but we can predict it with some accuracy. But if you look at what we think their core margin is it's a little higher than ours, their cost of funds tends to be a little lower than ours and so going forward we would think that would be accretive, if that's the right word, to the margin.

But in terms of a specific number, I'm reluctant to give you one. Gary, I don't know if you want to add anything to what's said.

Gary Ortale
Yes, I don't know that I can add anything. I think Charlie has summed it up pretty nicely, because our experience is that they have had a slightly higher margin than we have and I think it has to do with their asset mix as well as the low cost of funds, as Charlie indicated. What the impact will be of the marks on their margin going forward, again, it's hard to be specific as to what it might do or how it might impact our margins going forward. But I think it's safe to say that, given that we're slightly larger in terms of bank size, that the prevailing rate that has been out there in the 350s will most likely continue.

Jeff Rulis
Got it, and then could you just update us on your expectations for additional merger related expense and maybe the timeline of the conversion and how that looks going forward.

Charles Funk
Yes, great question. So if you look at the merger projections, there were $8 million of expense saves. We think that there will be some this year, probably in the neighborhood of $1 million. If you look probably 2016, but especially toward the end of that year, is probably where they will start to come a little bit quicker.

The second part of your question ties perfectly to the first. What we have to do is get the banks merged together and we've made that clear to their employees and our own that we know that we need to move, not hastily, but steadily, toward getting that done. Part of the problem is that we're both Fiserv banks and when can you get the time scheduled with Fiserv. So my best guess would be within a year and if we can get it done sooner than that, that's great.

We've got a couple of dates reserved with Fiserv, but lot of that depends on our ability to get in and analyze things and have working groups that are formed and get all that needs to be done, ready to go. Things like payroll, payroll is a huge issue trying to get people paid on the first payroll after you do a merger like this. It sounds simple to people like you and me, but that's a very complicated thing.

So that's a long way of saying within the first year, Jeff, but every bit of advice I have gotten from other CEOs around the United States is, get the banks merged sooner rather than later. And so, we know there will be people who will not want that to happen quite as quickly, but I think the best practice is to get it done sooner rather than later and you can be assured that we'll be working very hard and that will be one of our top priorities. But, having said all that, we have to do it in a way that doesn't upset the boat.

Jeff Rulis
Okay, thanks.

Gary Ortale
Jeff, this is Gary, I didn't know Charlie addressed the saves. I think your question was also about the expense side or the merger expenses and I would just add that in addition to the $8 million in saves that were modeled, we modeled roughly $5 million in merger related costs. And I would suggest that $1.5 million of that has already been spent. So, and I would expect that the remaining $3.5 million would be certainly over the course of this year with most of it or a good chunk of it falling in the second quarter here.

Jeff Rulis
I appreciate it. Thanks, thanks for the color.

Gary Ortale
Thanks.

Operator
Once again, if you would like to ask a question, please press * and then 1. Our next question comes from Brian Martin from FIG Partners. Please go ahead with your question.

Brian Martin
Hey, guys.

Charlie Funk
Hey, Brian.

Gary Ortale
Hi, Brian.

Brian Martin
Hey, I joined a bit late so I just didn't hear the one comment in the last question just the savings, Gary, when did the savings begin? I know your plan is to merge the banks and you've got the dates, but when would you expect this realistic to start thinking about some of those savings beginning to flow through the P&L?

Gary Ortale
Yes, we modeled, Brian, that a total of $8 million in saves over this year and the next two primarily, with only maybe a $1 million of that coming in this current year. The bulk of it would be in 2016 and 2017 and my guess is that even in 2016, I don't want to imply that if it's $4 million in 2016 and $3 million in 2017, that the $4 million will be evenly throughout the year, but it may be weighted a little more towards the end of the year.

Brian Martin
Okay, perfect, that's helpful. Then, Charlie, on the margin, I get the lift this quarter and some of the things that were going on. Why would you expect the margin to drift back lower to that 345 to 355 range? What's the catalyst to push it back down now that you've remixed a little bit, grown the loans and you're still kind of focused on the funding? The one thing that stands out is that the loan pools, which certainly they will drop a bit, conceivably, but why the drop all the way back down to where it was earlier versus just some give back?

Charles Funk
That's a great question and probably the two word answer is because you're speaking to a cautious banker. It just doesn't seem like we're operating that kind of a run rate. One thing I did neglect to mention, Brian, and others, is that I noticed in our board report from our board meeting that our investment portfolio yield has actually gone up. Well, that's helpful to our margin, because most of what Jim's been selling has been lower yielding bonds, even though we've taken a lot of gains, they've been lower yielding bonds. And I believe our investment portfolio yield was right at 3.5% and the duration really hasn't changed that much.

So that would also be a reason to argue for a little higher margin going forward, because we've been running in the 330 range and that's a sizable portion of our balance sheet. So I don't really have a good counter to what you're saying, other than there was some interest recovery in there that you can't forecast. And I don't know how many basis points that contributed to the margin, but it's entirely possible it might be a higher run rate. I'm just reluctant to forecast that.

Brian Martin
Okay. And was it true that the loan growth was more back-end loaded? Does that sound right?

Charles Funk
I think the loan growth was it was back-end in the fourth quarter, but I think it was pretty consistent throughout the quarter.

Kent Jehle
Yes, Brian, this is Kent. I can jump in a little more on the loan growth. Charlie alluded to the in-market moves, which at this point in time, we don't have any additional of those of any size in our pipeline. And also when you look at the 2014 operating lines, we didn't see the pay down—

Gary Ortale
For Ag.

Kent Jehle
For Ag, as we've seen in the past and that's because of grain being held right now. We would anticipate that being liquidated over the next 60 days to 90 days. So we'll see a little bit of a back-off on the totals from that. So between those two that happened in the first quarter that was roughly about half of our growth and when you take that into consideration, we've discussed an annual run rate of about 7% plus or minus the loan growth as we go throughout the rest of the year when things normalize. If that's helpful for you.

Brian Martin
Yes, okay, yes, because the end-of-period balance was the 1176 versus the 1154 for the average. So it seemed like it was more back-end loaded, which to my point in the margin it seemed like it would have more favorable implications than less favorable.

Kent Jehle
Yes, part of that's our 2015 operating lines ramping up and also our construction lines starting to kick in, in the later part of the first quarter. So it was the combination of those that listed in the second half of the quarter.

Brian Martin
Okay. And some of those you're saying we'll get back in the second quarter. Is that right?

Kent Jehle
Yes, some of that will related to the Ag 2014 operating line.

Brian Martin
Okay, okay. And then maybe just a second question, was the loan pick up this quarter and just maybe the outlook over the balance of the year. It sounds like from what your comments are, Charlie, that the economy is not great. This is kind of stealing some business if you will in your markets. And is it more plotting, I guess as you call it, as you go to the balance of the year, is that how you would think about things?

Charles Funk
That's how I think about things, but I also want to say that we've seen, I think, due to better economic conditions, some of our customers are buying other businesses. In the case of one of our large borrowers buying the business in another state, so I think that reflects growth in terms of the economic

vibrancy of our footprint. But most of the time it just seems to me that the Iowa part of this franchise is going to be 3% to 5% loan growth and if we happened to get a quarter like we had this past quarter, that's great because the compounding will add to itself.

Brian Martin
Right, okay, that's helpful. And then maybe we talked last quarter, Charlie, we talked little bit about the balance sheet remixing. Some of that was done this quarter, I guess. Before this deal closes, how do we think about any other changes you make to the balance sheet? Is it positioned the way you want right now, or is there more changes that occur within the bond portfolio and/or how to think about that for next quarter?

Charles Funk
Well, yes, another good question. I think the first way to think about it would be there's going be a $65 million cash payment that goes out of our company. The second thing would be that we have sold more investments during the month of April and I think we're about where we need to be right now to close from a cash point of view next Friday.

So going forward, and I'm just going to speak about Iowa right now, going forward, we continue to see reasonable loan demand, maybe not $44 million every quarter, but reasonable loan demand. Seems to me deposits are going to be harder to come by in this environment, especially if rates start to trend up. There's no guarantee they will, but I think you could see, easily, the loan to deposit ratio drift a little bit higher. We're fine with that. Our goal is to be in the 80s; when it gets into the 90s that's a lot of leverage for us. But we're in the sweet spot right now of our loan-to-deposit ratio target, it wouldn't surprise any of us if it goes little bit higher.

Brian Martin
Okay, alright, maybe just two other questions. The capital position at close here and the need to add capital, I guess, how are you thinking about where capital stands and anything any steps you might take? Are you satisfied with how low it would go or would you look at adding some additional capital or—?

Charles Funk
Yes, great question. The strategic target for our company and, as you know, we look at TCE and we like to be in the 8, 8.5 range. And so at 10.5 plus where we are now, that's way above the range, and that's one of the reasons we're so delighted that we have some way to employ our excess, deploy our excess capital. A week from today that number is probably, I can't give you an exact number, but it's going to be 7.5, 7.6, somewhere in that range, TCE. That doesn't concern us because we will see the earnings power and when you pro forma it out we get back above 8% and we start to accumulate capital pretty quickly.

If you look at what's happened with our stock price currently, we would be responsible to consider what our alternatives are. So if we have the chance to raise a little bit of common equity, we might consider that, depending on the price. But it would not be a big number and it would be probably a little bit just to augment the current position of the company. But there really haven't been any final decisions made on that, but it's certainly something we are considering.

Brian Martin
Okay. And just two last housekeeping things and I'll let someone else hop on. The service charge income, you talked about it being up this quarter. Would your expectation, if you look year-over-year in the second quarter, you still see some growth there as well? I know it's a lumpy number when you look from first to second quarter but if you just compare year-over-year, the second quarter of a year ago to

the second quarter this year, your expectation, do you see some growth?

Charles Funk
As I recall, we rolled this program out in May for the most part of last year. So when you're comparing to the prior year, we're still going to have a little bit of a lift, but it won't be a full quarter lift. So you're getting pretty close to, well, I think you see what the run rate is the last three quarters and in terms of pick up from prior year probably two-third, let's say one month's worth in this quarter and then you'll have an apples-to-apples comparison in May and June.

Brian Martin
Okay, alright. And the reduction in investments that has occurred this quarter, Charlie, is it a big number? Just trying to get an idea on the size of the balance sheet for our modeling from the sales in quarter-to-date.

Charles Funk
I don't recall, but it's in, I hate to put a number out there, but it's, what, Gary?

Gary Ortale
$30 million, $40 million of sales, I would guess, from what I see at the end of the first quarter that it would be in that $25 million to $30 million range that's been sold additionally.

Brian Martin
Okay, perfect, thanks, Gary. Thanks for taking the questions, guys.

Charles Funk
Yes, you're welcome, Brian.

Operator
Once again, if you would like to ask a question, please press * and 1. Our next question comes from Daniel Cardenas from Raymond James. Please go ahead with your question.

Daniel Cardenas
Good morning, guys.

Gary Ortale
Hello, Dan.

Charles Funk
Hello, Dan.

Daniel Cardenas
Thanks for all the color so far. Just a quick couple of questions, as I look at your Ag portfolio, can you maybe remind us what if any type of exposure you have to the poultry industry?

Charles Funk
That is a good question, Dan and I can tell you we have no exposure to the poultry industry in our portfolio right now. Yes, it could ripple in to other businesses, that could be the case, but there is nothing specific to producers that we have in the mix.

Daniel Cardenas
Great, great. I think that was it, most of my other questions were asked and answered, thanks, guys.

Charles Funk
You're welcome. Jim Cantrell just stuck his head inside our conference room here and indicated we've sold about $55 million in bonds this quarter. So we were close; well, depends what you call close.

CONCLUSION

Operator
And ladies and gentlemen, at this time, I'm showing no additional questions. I'd like to turn the conference call back over for any closing remarks.

Charles Funk
Yes, thank you to everybody for joining the call this morning and be assured that we know that we have a lot to do over the next months ahead and to the extent anyone needs to call or ask or have further clarification on issues, please don't hesitate to give Gary or give me a call.

And with that, I would just wish everyone a good day and say thank you for joining the call this morning.

Operator
Ladies and gentlemen that does conclude today's conference call. We do thank you for attending. You may now disconnect your telephone lines.