# MidWestOne Financial Group, Inc.

## Q3 2017 Earnings Call

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**CORPORATE PARTICIPANTS**

**Charles Funk** – *Chief Executive Officer*

**Kent Jehle** – *Chief Credit Officer*

**Katie Lorenson** – *Chief Financial Officer*

**Kevin Kramer** – *Chief Operating Officer*

**Jim Cantrell** – *Chief Investment Officer*

## PRESENTATION

**Operator**

Good day, and welcome to the MidWestOne Financial Group Incorporated Third Quarter 2017 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation, there will be an opportunity to ask questions. To ask a question you may press star (*), then one (1) on your telephone keypad. To withdraw that question please press star (*), then two (2). Please note this event is being recorded.

I would now like to turn the conference over to Charles Funk. Please go ahead.

**Charles Funk**

Thank you very much, Brian, and good day to everyone. I will begin as I always do with the forward-looking message and remind you that 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 most 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 the 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 with that, I will thank everyone for joining us on the call this morning. We had a lot of positive things happen in the quarter, but unfortunately they were overshadowed by the larger-than-expected and anticipated loan loss provision. I want to start with credit and I'll spend a little bit of time on credit this morning. And then during the Q&A, if you would like for us to amplify it, we would be happy to do so.

We had an allocation, as we indicated in the earnings release, of $1.8 million on one credit, which is a small manufacturing company in rural Iowa. We had originally expected it to have a smaller provision this quarter, but literally, on the last day or two of the quarter, we got an appraisal that was significantly different than the one that was in our file and we'd even written it down a little bit from that, hence the larger provision. We think right now we are sufficiently reserved on this credit, and it's likely that we'll charge this credit off or most of the credit off in the fourth quarter.

The other factors, I'll give you some specifics on the other factors that affected the provision. In no particular order, we charged off roughly $550,000 that reflect three commercial loans; one in Iowa, two in Minnesota. And I really regard this as more of cost of doing business. These things happen. None of the three were large enough to cause us any great concern. But we had three. They were $550,000. I call it normal course of business.

We provided about $1.5 million during the quarter to account for our loan growth. And we had $300,000 that were required simply because we had migration from pass-rated credits to watch-rated credits, and we do reserve a small amount for watch-rated credits. I do want to give some guidance on the fourth quarter provision. Our prior guidance had been our run rate, which I think it was on our last earnings call of $1.2 million per quarter. You know, I'm going to give a wide range of $1.5 million to $2.5 million, but our best estimate today would be in the $1.8 million to $1.9 million range. That's where we would think that the provision would come today. As they say, there's a lot of baseball to be played yet this quarter.

We think that the increase in our reserves, or on our provision during the fourth quarter, will be to migration of credits. And I'll remind our listeners that the classifications go Pass then Watch then Substandard. We will probably have a few ag credits, we anticipate this, that could migrate from Pass to Substandard as we start the renewal season. And we do plan to start the renewal season a little early for our more troubled credits to get a handle on where that's going to go.

I will repeat what I've said many times over the last 90 days, and that is that in the Ag sector, I think we will have to have more reserves as we migrate from Pass to Watch to Substandard, but we still don't see a lot of charge-offs over the next couple of years coming out of our Ag portfolio. And that's primarily because we still sit in very good positions in most of the cases in terms of the collateral margin on the credits. There'll probably be some tough decisions with a few of the ag borrowers this year, and we'll see where those go. But as I said, overall in the portfolio, we'll require a few more reserves but we don't anticipate charge-offs.

There are two things as I ramp up the comments on credit. We've had an agricultural loan that for going on eight or nine years now has been a troubled credit. It's been a TDR for a long time. It's currently in foreclosure. We are well secured and we do expect a recovery in the range of $0.5 million. I'm not sure that will come in the fourth quarter but that is coming in the next couple of quarters, and we feel that we've talked about that for a while, and we feel that's very close to the finish line.

I'll also remind everyone what we've talked about for probably 2-to-2.5 years now. We have a large Iowa City-based commercial loan that has been on non-accrual for a couple of years. And what I can report on that credit is that, that credit sits in the best condition it's been since we've started mentioning it on this call. Their business is very good. They have lots of orders through the second quarter of next year in their particular line of business. But we are a long ways from the finish line. Nonetheless, the trends are probably, they're not probably, they are as good as they've been for some time.

Net charge-offs year-to-date, 12 basis points, which is, you know, 10-to-12 is where we've been historically. I think with the fourth quarter charge-off that I just spoke about, you could--we could probably see 16 to 18 basis points for the year in terms of our net charge-offs. 2017 non-performing loans, as we reported in the earnings release, continues to trend downward and we're pleased with that.

Turning to other areas of the company. I think our loan growth was outstanding for this particular quarter, certainly the best since our 2015 merger. We look for a little slower growth in the fourth quarter. It's fair to say that in prior quarters, we had been slow to get loans closed. This particular quarter, we had everything kind of come that we had in the pipeline. So right now, we forecast that our loan growth will slightly exceed our paydowns. So--but we'll see how the pipeline continues to develop during the quarter. But certainly, we expect growth during the fourth quarter; it won't be as robust as last quarter.

I also want to say that a lot of the growth that we've seen comes from two of our major markets, and I would highlight the Twin Cities markets as well as Denver. I'll talk about Denver in a minute, but I will say that our Twin Cities market, many will remember there was a lot of turmoil in that market 15 months ago. We have great leadership in the Twin Cities market, and much of the growth this quarter has come from that market and the leaders there and the commercial bankers are doing a very, very good job.

Denver opened for business on May 1st and at the end of the quarter, they had $46 million in loans, mostly C&I, not all but almost all C&I loans and they had $25 million in deposits. I think we're up to eight employees there now. Their pipeline has slowed somewhat but that growth should continue. And they will contribute for the first time to our income in, not as an expense item but income in the fourth quarter. And we feel very good in the six months' time, they've gotten up to a profitable level where they're actually making money.

I would also say that we have what I would consider very good leadership in our Denver market and a group of employees who truly have embraced our culture and done a very, very good job with growth.

Our deposit growth as a company has not been particularly good; in fact, we had some backsliding this past quarter. But if you look at most regions in our company, all but two regions have had deposit growth this year and many are up nicely. The Iowa City market had some seasonal outflows, and they are large enough that it's affected the entire company. Most of all of that outflow should come back in the fourth quarter, and it would not be surprising to see $50 million to $100 million in deposits come back into our company this quarter. We just got notification this morning that there's about $35 million that's coming in. So we don't like the seasonality, but we like it whenever they're in the bank. And for the most part, these deposits, I would say, are reasonably priced.

A lot of questions in the earnings calls to date this quarter about margin. And my comment there would be, if you would tell me what's going to happen to deposit cost, then I would tell you what's going to happen to our margin. We haven't seen a lot of beta movement yet, a little bit. I would say that the pressure on deposit cost is modest but it's rising. But I wouldn't call it high pressure by any stretch of the imagination. We think our core margin is in the low to mid-360s.

And I would remind everyone that last quarter we had roughly $500,000 of interest recovery, which helped our margin. So if our margin appears to have gone back, I think that would be the major reason for us, certainly not liability costs. Liability costs are up more than asset yields have risen. But I think our margin has been helped by the change in the mix as we've have more loans and we've been able to fund those loans in the wholesale markets fairly cheaply over the course of the quarter.

So if I look at our margin again, it all depends on what happens to deposit costs. The ALCO models we run tell us that we are ever so slightly asset-sensitive. We do expect a Fed increase in December and we'll see what happens. Noninterest income, mainly a, I think, slightly positive story. The wealth management unit in our company, very solid. They look the same in the fourth quarter. The challenge, as it has been for many quarters, is for us to add revenue producers in our wealth management units. We have not succeeded in that effort but we are still out looking for people who fit our culture and who can add to our bottom line.

Very pleased, and it's not all reflected in the numbers, but very pleased with what's going on in mortgage in our company. We have new leadership, as many of you know. While our mortgage originations are down from the prior year, we are down about the same percentage as the industry as a whole. What I would say about the leadership is that we are looking for new originators. We've added a few new originators. We continue to look for originators, and we will, over the course of the next six months add originators in Denver and in Florida but we're waiting to find the right people. And we've also been able to reduce the amount of days to close in our mortgage process. That's been a sore spot for many of the front-line people in our company for a long time. And we've made discernible progress over the last 15 to--well, over the last four weeks or so. We still have more to go, but the leadership is working on that and I think mortgage is something that will contribute to top line revenue over the next 12 months to 24 months.

Expense control, positive. One thing I did want to talk about on expense control, and I'm not willing to give any guidance right now, but our company, as I think all commercial banks are, are very aware that the landscape is changing and FinTech is going to be a part of the equation. We've had an active FinTech committee in our company since the first part of the year. We have some things planned. We don't have a price tag on them yet, but I can tell you they're not going to be cheap, and we're just going to have to work them in so that we can deliver the financial results that are expected. But at the same time, we do have a commitment to add FinTech as we can, because I think those that don't two or three years from now will be at a serious disadvantage. We're very serious about keeping our efficiency ratio in the 50s. It's a little bit--our efficiency ratio is a little bit understated this quarter in terms of the number. In other words, it's lower than it would have ordinarily otherwise been and that's because of some one-time items. Nevertheless, as I've said over the last 30 days, we should keep--we should be able to keep our efficiency in the 50s. If we happen to migrate up into the 60s, it shouldn't be for a long period of time. And we are very--we have laser-like focus in terms of keeping it in the 50s and moving it downward.

M&A, there have been discussions, I think significant discussions in our two major trade areas: Iowa and Minnesota, over the last 90 days. Certainly nothing to report right now or we would. But some of those discussions continue, and we continue to see smaller community banks looking for alternatives as the environment gets tougher and tougher for those particular companies.

Last, I would highlight that our company did complete its first strategic planning effort in some years, and our Board of Directors approved that at the October meeting. And we clearly have a plan and a desire to operate at 11%-to-14% return on tangible equity, and we think our sweet spot on return on tangible equity is in the 12%-to-12.5% range. That's calculating that we should keep 8%-to-8.5% tangible capital as our targeted levels.

So in summary, I would say that many areas of our company are coming together. We've had good loan growth. We will have deposit momentum in the fourth quarter, and we do have deposit momentum in many of the markets in our company that--and that was not the case 12 months ago. Non-interest income, I think, will continue to be marginally positive. And we have, I think, very good leadership in the key areas there. And our expense management is good and will continue to be, so that will continue to be good.

Unfortunately, and I've known this for 38 years that I've been in banking, that you can have a lot of things going right in your company but when you do have bumps in credit, that that seems to dwarf everything. And we understand and acknowledge that because, quite frankly, credit risk is the biggest risk that our company and most commercial banking companies face. So I would conclude and say that despite the hiccup we had this quarter, our nine-month return on assets is 88 basis points. Our nine-month return on tangible equity is just shy of 11.5%. And while those are not the numbers we want over the long term, we still feel like we are making lots of progress in this company.

And so with that, Brian, I will turn it back over to you, and the management team will be pleased to answer any questions that come our way.

## QUESTIONS AND ANSWERS

**Operator**
Thank you. We will now begin the question-and-answer session. To ask a question you may press star (*), then one (1) on your telephone keypad. We do ask if you are using a speakerphone to please pick up your handset before pressing the keys. To withdraw your question please press star (*), then two (2).

Our first question comes from Jeff Rulis with D.A. Davidson. Please go ahead.

**Jeff Rulis**
Thanks.  Good morning.

**Charles Funk**
Good morning, Jeff.

**Jeff Rulis**
Question on the originations, pretty strong clearly.  I guess, do you have the third quarter origination volume versus the second quarter?

**Kevin Kramer**
You mean in growth?  This is Kevin Kramer.  In terms of just…

**Jeff Rulis**
Just absolute originations, not net growth, just production.

**Kevin Kramer**
No, I don't have that in front of me.  From a growth, it was, you know, in the $60 million range on the portfolio.  I think originations were in the $80 million--or no, excuse me, it'd be more than that.  It's going to be about $130 million or so based on--but I don't have the exact number but it's in the $130 million range.

**Jeff Rulis**
Relative to 2Q, would you say double, I mean, net production was double sequentially.  Just wanted net growth, but from the second quarter…

**Kevin Kramer**
From the second quarter, yes, it's not quite double but pretty close to that number.

**Jeff Rulis**
Got you, okay.  And I guess you guys had mid-single-digit guidance for 2017, closing pretty strong.  I guess, any early thoughts on '18 on growth expectations?

**Charles Funk**
Yes, we knew we would get that question and I would answer it this way.  When we were just MidWestOne Financial Group before our last merger, we would just consistently give guidance 3%-to-5% because that just seemed appropriate for the Iowa footprint.  Now with the--some of the markets we're in, it seems like we should probably raise that a little bit.  So I would say 4%-to-6%, depending on the economy, and again ask everyone to keep in mind that roughly 30% of our footprint right now are experiencing, I wouldn't say bad economic conditions but I would say tough economic conditions, so 4%-to-6%.

**Jeff Rulis**
Got you.  Thanks.  And then I guess, on the credit side, I get the one commercial loan.  You talked about some charge-offs in cost of business-like activity, and then a significant portion of the provision on loan growth. I guess, the numbers don't suggest a major systemic worsening, and I guess you guys are taking it from a conservative standpoint.  But the credit picture, the balance of '18 outside of some Ag strain, maybe some expectations, broadly speaking, on how we kind of transition into '18, absent

the ag side.  Thanks.

**Charles Funk**
We--yes, it's a good question, Jeff, and we anticipated that question, too.  And I think right now, I think it is fair to say we don't see anything that's systemic.  It's also fair to say that when you have these things happening to your company, you're going to take away–you're going to take a hard look at the way you're doing business to make sure you're doing everything possible you can to deliver a superior product.  We felt it was important to give guidance on 2014--or excuse me, 2017 fourth quarter.  But I think we will wait and give better guidance for 2018, and that's not because we think that there's anything that's going to be out there.  That's just we want to be a little bit more accurate and a little bit closer to 2018 before we do that.  I think if we had set our budget for 2018, we would be comfortable in giving some, but we haven't set our budget yet.  And I think until we do that, we will wait and we'll cover that on the--on the fourth quarter earnings call that will be in January.  So, but to answer your first point, I don't see anything that's systemic here.

**Jeff Rulis**
Okay.  Thanks, appreciate it.

**Operator**
The next question comes from Nathan Race with Piper Jaffray.  Please go ahead.

**Nathan Race**
Hi, guys, good morning.

**Charles Funk**
Good morning.

**Nathan Race**
Staying on the Ag conversation for a second.  I think we've heard from other banks that they've had some success in moving some marginal or substandard credits out of the bank, and they've seen some other credit providers coming in and stepping in and taking on some of these relationships.  So I was just curious if you're seeing some of that.  And Charlie, I appreciate your commentary in terms of 4Q provision charge-off expectations, but if you could also help us frame-up charge-off expectations in 2018.

Obviously, it doesn't sound like you had a whole lot of loss content within your Ag book, but any additional commentary to that end, I think.

**Charles Funk**
I'll cover the charge-offs first.  It would be hard to provide guidance on that.  But to be honest with you, I don't see anything that would suggest anything much different than we've seen this year on charge-offs.  If we wind up at 16, 17, 18 basis points this year, based on what we know now, we wouldn't see that next year.  But we don't--it's more than likely lower.  We'll give better guidance on the fourth quarter earnings call.  But I don't see anything, I see the provision needs but I don't see the charge-off--net charge-offs.  And I'll let Kent answer the first part of your question.

**Kent Jehle**
Yes Nathan, on the Ag side, we have actually seen in the range of 12 credits that we've been working through throughout the year that we are transitioning out of the bank.  The good news is a lot of those, they've been proactive from a client standpoint.  They're realizing where they're at, and they want to preserve what equity they have on their balance sheet.  So we've been very, very active with that.  And

actually, we were out meeting with our clients before the harvest just to have those discussions. And we do meet with customers anyhow, but we were more focused on where we're going to be going into 2018.

So there'll be more to come on that as we get through the renewal season but very active with that. The other thing I will add is we are also very active with utilizing FSA guaranteed loans as we work through with clients. And we already have up to a handful of those that we have earmarked. And those are 90% guarantees that we can overlay to help us reduce our exposure if we feel comfortable moving forward with our clients. So a couple different fronts, and hopefully that answers your question.

**Charles Funk**
And let me jump on, I had intended to mention this in my opening comments but didn't. Usually, we get questions on the crop outlook and I would say that there's probably good news in that regard. You could probably break our footprint down north of I-80 and south of I-80 and more than 50% of our production is north of I-80. And quite frankly, the yields have been better than expected. It's been dry but the yields are much better than expected. And so I think that provides a little bit of relief. South of Interstate 80, it's not the same story. It's been much drier and the ground's not quite as good. And so that's a little bit tougher conversation, but that would--the south of I-80 would be less than 50% of our Ag portfolio.

**Nathan Race**
Got it. That's great color, Kent and Charlie. I appreciate that. And just changing gears and thinking about the margin for fourth quarter and into '18. Just maybe curious kind of obviously, you guys had pretty good production this quarter. So just curious in terms of what the weighted average rate of production is relative to maybe your core portfolio yield around 4.5%. And if we do get a rate hike in December, I'm just curious how you guys are thinking about deposit pricing and just the progression to early 2018.

**Charles Funk**
Somebody want--who wants to take the…

**Jim Cantrell**
I'd be happy to talk about it. This is Jim Cantrell. Let's see. You asked about oncoming loan production. I see what comes onto the books. It's pretty just a hair north of the 4.50% that you mentioned as the coupon, maybe we're in the 4.55%, 4.60% on average for new production. And so that just comes on-- -I guess I would say that comes on at a very glacial pace. It doesn't have a real big impact on the overall portfolio.

What was, you asked also about deposit. Yes, Charlie, I think, said it pretty well. We have not had to move wholesale pricing up. And when I say that, we haven't had to move, generally speaking, money market rates, savings rates, that type of thing. We have priced at the margin and made some exceptions. We haven't been required to by our--the market--level market competition we've seen. If that changes, then kind of all bets are off. We may see our deposit prices increase a little bit. But as it stands right now, I would say we're in the 2, 3, 4 basis points increase per quarter on our cost of funds.

**Nathan Race**
Okay. That's helpful. Yes, that's great. Thanks, Jim. And then just on the tax rate real quick. It came in a little lower this quarter. Just curious what you--what we should use going forward?

**Katie Lorenson**
Hi, Nathan. This is Katie. I stick to the 30% range, despite the--we did have a nice historic tax credit,

which was about a $400,000 credit to the expense this quarter. That is the last of those historic tax credits, so I think the run rate going forward is 30%.

**Nathan Race**
Okay. Got it. I appreciate the color guys. Thank you.

**Charles Funk**
Thank you.

**Operator**
The next question comes from Andrew Liesch with Sandler O'Neill. Please go ahead.

**Andrew Liesch**
Hello, everyone.

**Charles Funk**
Good morning, Andrew.

**Andrew Liesch**
Charlie, your comment of 16-to-18 basis points of charge-offs for the full year, being at 12 right around now, I mean, that would suggest maybe 25 basis points on an annualized basis here in the fourth quarter. Is that accurate?

**Charles Funk**
That, I …

**Kent Jehle**
Yep. I can answer that.

**Charles Funk**
Yes, go ahead.

**Kent Jehle**
Andrew, this is Kent. That would be related to the loan we talked about that we impaired in the third quarter that we will address that in the fourth quarter, whether we should realize that impairment and write that off. So if you use that number, that's where you're getting that annualized percentage. And then where it puts us year-to-date is what we looked at.

**Andrew Liesch**
Okay. Gotcha. And then loan growth is obviously strong this quarter. Would it be fair to say that it's related to the provision that if loan growth does continue, maybe not at this pace, but if it is solid that you would also be providing more than maybe you have in the past, more than the $1.2 million you talked about?

**Charles Funk**
Yes, I think a good metric, and this will vary as the financial analysis changes. But I think if you used 1.1% for new loan growth, that's--you're going to be really close. And it will be a few basis points on either side of that.

**Andrew Liesch**
Okay. All right. Thank you. And then just related to the Denver pipeline, it sounds like it slowed a little

bit. Just curious what the outlook is there. Were the folks that--the relationships that they brought over just low-hanging fruit and the growth's going to be a little bit tougher now that they have to bring in new business, or are there still opportunities for them to bring over their old clients?

**Kevin Kramer**
Yes, Andrew, this is Kevin Kramer. Yes, of course, you have some of that low-hanging fruit, but there is a mixture of new clients in that production we've seen this year. These were not relationships that they've brought from previous institutions. We did see a little bit of a lull in the latter half of the third quarter, but the fourth quarter pipeline has picked back up, not quite to the way it was at the end of second quarter and early third quarter. So it's--we're seeing some nice growth from that group. When we look at 2018 planning, they're going to be a leader in terms of per officer production in our Company in terms of the new loan production they bring in. So, while yes, you see that big spike at the beginning, the normalized production rate will be very, very strong for the Denver group to the point where we're--Charlie mentioned we have eight associates there. We'll look to continue to add good strong commercial bankers because our story is resonating very well in the Denver market and we have bankers interested to joining us. So we'll see--still see some nice growth in that market going forward.

**Charles Funk**
And I would just add that this is a team that is really focused, and they want to succeed. They want to contribute to the greater company. And so I expect nothing less than continued very, very good growth in Denver. It's just--it's a really good story right now.

**Andrew Liesch**
Great. Thank you for taking the questions.

**Charles Funk**
Thank you, Andrew.

**Operator**
The next question comes from Damon DelMonte with KBW. Please go ahead.

**Damon DelMonte**
Hi, good afternoon, everybody or good morning I guess, for your time. Just a quick question on the margin. I'm not sure if this was detailed in the release, but what was the actual accretable yield this quarter?

**Katie Lorenson**
It was $1.3 million, Damon.

**Damon DelMonte**
$1.3 million, okay. And then as we go forward, I think last quarter, it was pretty close to that level as well. Is that a decent run rate we should be incorporating?

**Katie Lorenson**
You know, that's been a little bit higher than we've forecasted by about--by several hundred thousand. So I think the $1 million a quarter is kind of the guidance I would give going forward for Q4 and then declining likely every quarter in 2018 as we see those balances drop.

**Damon DelMonte**
Gotcha. Okay. And then with regards to expenses, Charlie, you made the comment about the

potential investment in FinTech. I mean, could you provide just maybe a little bit of more color as to what you guys might have in mind? I know you might not be able to quantify dollars currently but maybe some of the ideas you guys are throwing around?

**Charles Funk**
Well, I can give you four or five, if I can remember. I have to write these things down because I feel like when it comes to FinTech, I'm a dinosaur. And if I don't write it down, I forget it. We've been looking at ways to streamline small business lending, and we're not ready to roll anything out yet but we're continuing to make good progress with our existing systems on that. We know that we need to upgrade our website and deliver more functional capabilities for our customers on our website.

And then in conjunction with that, so that's the second one. A third one would be a system that notifies our customers in a timely manner, and we have that now but we need to beef that up. So if your balance is getting low, you get a text message or you get an e-mail. And then we have some internal processes that we think can be streamlined by being automated. And those are things that the customer never sees but certainly improve the throughput and the efficiency in our company. So that's FinTech, as well.

And then the fifth one eludes me right now. But I got four out of five so that should give you an idea, Damon.

**Damon DelMonte**
No, that's helpful. I appreciate the color. And that's something you guys are going to start to work towards as you go through 2018?

**Charles Funk**
I think many of those will, if not all of them, will be in the budget in 2018. And as I said, we have to figure out how to pay for them because we really do regard this as an investment in our future.

**Damon DelMonte**
Gotcha. Okay. That's all that I had. Thank you very much.

**Charles Funk**
Yes. Thank you, Damon.

**Operator**
Again, if you have a question please press star (*), then one (1).

The next question comes from Brian Martin with FIG Partners. Please go ahead.

**Brian Martin**
Good morning.

**Charles Funk**
Good morning, Brian.

**Brian Martin**
Hey Charlie, just on that last question on the FinTech, I mean where is the greatest likelihood? I mean, when you look at the 2018 kind of in aggregate, if you have to pull dollars from somewhere, you've got better performance somewhere, it doesn't, I guess, can you just give some idea where the opportunity is to pull from to invest in the FinTech you're kind of talking about?

**Charles Funk**
Yes, that's a hard question and as we haven't had those discussions yet in our budget meetings, I'm not prepared to answer that. If you ask the same question on our fourth quarter earnings call, I'll address it. I just can't right now, because I don't know. But I will tell you, we have to find the money. And we do expect rising revenue streams next year. And some of those revenue streams need to be invested in FinTech. So give us 90 days, and we'll talk more specifically about it.

**Brian Martin**
Okay. Fair enough. Thanks, Charlie. And the other couple of things. Just maybe one for either, I don't know if it's Jim or Katie, just on the margin. And just, I understand the commentary about the funding costs and how you guys are going to manage that. But you know, all else equal, if we do get a rate increase, I mean, it looked like the core margin this quarter was around 367 if you adjust for the accretion income. I guess as you guys look forward, should that number have an upward bias? Modest, I guess, I understand, but if you get a rate increase in December as you look into the first quarter, just based on kind of what you're talking about in the loan yields and the deposit betas being at least reasonable at this point and then maybe the next rate increase is even less of an impact. But more of an upward bias than a negative bias at this point or is that unfair?

**Jim Cantrell**
Yes, well, this is Jim again. I would say, Brian, if we do get a Fed rate increase in December, we do have a little over $0.5 billion of prime-based loans, some of which are not going to price up, some of which still are on their floor, some of which are annual repricing. But we'll get some lift on the loan side from the repricing of those prime-based loans. And I'll go back to what I said before, I think it really is--on the deposit side, it will be largely a function of what we see if that next 25 basis-point increase by the Fed is kind of the straw that breaks the camel's back and we see local competition start to raise their deposit rates across the board, we're going to have to respond. If that doesn't happen, I would likely say we'd have a minor increase in margin. But it's all going to be predicated on market response to that Fed increase and how we have to respond to that. So that's the big unknown at this point.

**Charles Funk**
Yes, the other thing I would add to tack onto that, Brian, is we continue to see what I think is irrational pricing in our markets. We saw one just this week in the Minnesota market where a competitor offered 4.25% on a commercial real estate loan for seven years fixed and with a 30-year amortization and an 80% loan-to-value. And pricing like that, people are acting as if there's no tomorrow and rates are never going to go up. So hopefully at some point in time, some rationality will come back into pricing matrix.

**Brian Martin**
Okay, yes, that's fair. I guess, Charlie, you talked about the opportunities in Denver. Just, I guess, kind of went through that. But as far as opportunities to hire different folks, what's on the agenda? I guess are you satisfied with the team you have out there? Do you expect to add more people over time? What's the outlook there?

**Charles Funk**
I think you can tell that we're more than satisfied. We've been trying for longer than the office has been open to hire an SBA lender and we haven't found the right person yet. We've been close a couple of times. We think that that would be a great market for SBA. And we do SBA in this company pretty well; we just need to do more of it. I think there are other commercial bankers, as Kevin indicated. But

our mantra is: We're going to walk before we run. And they just need to get a little bigger base of assets out there. So I think that's probably a little further down the road. And then finally, we haven't forgotten about credit. And at some point, and I don't know exactly when, but I would say sometime in the next 12-to-18 months, we will have a credit administration person located in Denver because we think that it's very important to have someone in credit with a local market knowledge. That's sort of the near-term plan for Denver.

**Brian Martin**
Okay, perfect. And then maybe one for Katie. Just on the expenses, Katie, the--if we talk about kind of what you guys were thinking about for 2018 on the expense front, just kind of how to think about it broadly. Can you just remind me of what that outlook was prior to doing--making the adjustments, as Charlie alluded to, on this Fintech? I mean, what--how are you guys thinking about expenses that you've already kind of talked about or put out there?

**Katie Lorenson**
Well for Q4, I'll give guidance on that first. I think the run rate that we had this quarter is a pretty solid indication of what we expect next quarter. 2018, again, still in the works but I think we'll focus on more the--keeping the efficiency ratio in the 60s and letting that…

**Charles Funk**
60s?

**Katie Lorenson**
Excuse me, in the 50s.

**Charles Funk**
Thank you, Katie.

**Katie Lorenson**
And letting that be our guide. For the most part, this was a quarter that had a full quarter of Denver salaries and a little bit of noise in the drop in the FDIC assessment but that's a decent number going forward, given the capital we've injected into the bank. So the amortization, as you guys all know, comes down each quarter. That helps our net on the other--on the noninterest expense. So I guess that's where I would leave it with more detail to come on next quarter's call.

**Brian Martin**
Okay, that's helpful. And just the--Charlie, you called out a couple--I guess you mentioned there were some one-timers in the quarter. Outside of the provision, is there something that, I guess, we didn't see in the numbers that you can speak to? Or is it just the provision you were referring to?

**Katie Lorenson**
Brian, I'll take that. Real small stuff. In the noninterest income, we did have a loss-share termination that closed in July. That was $200,000 that's showing up in the other service charges and fees, so that number is a bit elevated this quarter. I would carve that out.

Also, in the loan origination, there is a one-time annual fee of about $100,000 that's coming through this quarter that will not be in the numbers next quarter.

On the expense side, on the other operating expense, we had some accrual adjustments that added or that brought that number $200,000 down from what I would see going forward. So those would be--they're all small but cumulatively make a little bit of a difference.

**Charles Funk**
And the tax.

**Katie Lorenson**
And then of course, the tax credit was the other piece.

**Brian Martin**
Okay, but that, the part on the expense side, Katie, that's--if you're kind talking about a similar type of expense level next quarter, it's got--that number may not adjust. The other one's on the revenue side or the tax rate probably changes. Fair to say?

**Katie Lorenson**
Right.

**Brian Martin**
Okay. All right. Okay, and then maybe just last one, Charlie. You talked about M&A and just kind of maybe discussions being a little bit better this quarter, I guess, or, you know, picked up a little bit. Can you talk about the--I mean, it seems like a lot of the banks in Iowa have ag exposure. I guess is that a concern in looking at M&A? Or just is there--if you talk about kind of the targets you're looking at, I mean, just remind us just from the size perspective, and it sounds like it's in-market deals but is there any reservation in doing something, given your outlook on ag? Or just if you price it appropriately, it is what it is, is that that fair?

**Charles Funk**
Yes, I think, it's a good question. On size, under $500 million, under $400 million most that we've been talking about. In terms of ag, I think what we want to do in credit due diligence is make sure that everything's been identified correctly and that everything has been accounted for correctly in the loan loss reserve. But as I said before, ag lending is still going to be a good business 10 years from now. The trick is to get through this tough period, understanding that if you're proactive, you're probably going to have more reserves. But if you're doing your job, you shouldn't have a lot of charge-offs because--and that's the difference between now and the 1980s, which was the last real serious ag crisis we had when land prices plummeted.

As I said on a swing I made on the East Coast at the end of September, land prices are down from their peak about 15% and they're flat over the last year. My sense is that if interest rates continue to go up that that will continue to put some pressure on land prices. But you don't see them down 50%, 60% like as was the case 30 years ago. So yes, the ag exposure doesn't scare us. We just want to make sure that everything's been properly identified and accounted for as we also want to see that in our own portfolios.

**Brian Martin**
Gotcha. Okay. And then a point on the provision. Your desire to hold off on kind of talking about the provision and reserving as you look to 2018, I mean, it sounds as though you're comfortable with the loss content in the Ag portfolio, and you have a pretty good handle on where the loan growth shakes out. So I mean, is the reservation in holding more on kind of what came about this quarter with this manufacturing credit, that it's more the commercial portfolio that you want to get a little bit more color on or a little bit more insight in how things are trending until you wait to talk a little bit more about the outlook for 2018? Is that--am I reading that right?

**Charles Funk**

Well, I think, that's a fair comment. I think that the commercial portfolio is probably an area we really need to focus on because quite frankly, that's where most of the surprises have been over the last five or six quarters, so we just need to make sure that we have a good handle on all of that. I think our ag--the folks who deal with our ag borrowers, especially over the last 90 days, have done a really good job of getting out in front of everything, hence the early discussions during the renewal season with our problem borrowers. And I think we just want to make sure that we know exactly where we stand in commercial. Having said that, I haven't seen any internal reports that indicate, as one of the prior questioners asked, that there's a systemic problem.

**Brian Martin**
Okay. That's fair enough. I appreciate you taking the questions.

**Charles Funk**
Thank you, Brian.

**Operator**
This concludes our question-and-answer session. I'd like to turn the conference back over to Charles Funk for any closing remarks.

**CONCLUSION**

**Charles Funk**
I would just say thank you to everyone for joining us on the call this morning. And to all of our institutional investors, feel to follow-up at any time. We will be very responsive. So thank you Brian and the call is now ended.

**Operator**
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.