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FRME - Q3 2019 First Merchants Corp Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the First Merchant Corporation Third Quarter Earnings Conference Call. (Operator Instructions) Please note that this event is being recorded.

I would now like to turn the conference over to Michael Rechin, President and CEO. Please go ahead, sir.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Thank you, Chuck, and welcome to our earnings conference call and webcast for the third quarter ending September 30, 2019. Joining me today are Mark Hardwick, our Chief Financial Officer and Chief Operating Officer; and John Martin, our Chief Credit Officer.

First Merchants released our earnings in a press release this morning at approximately 8:00 Eastern Time, and our presentation speaks to material from that release. The directions that point to the webcast were also contained at the back end of the release, and my comments begin on Page 4, a slide titled, Third Quarter 2019 Highlights.

So our quarter's signature event was the legal closing and the acquisition of Monroe Bank & Trust, MBT Financial Corporation, which was completed September 1, 2019. So the third quarter results that I'll cover and John and Mark as well capture 1 month of their results within First Merchants Corporation.

The front end of the release then contains several of the details of the financial results, including the company having earned $36.8 million in net income or $0.71 per share. The results include acquisition-related expense, totaling $11.2 million or $0.17 per share. Total assets of the company totaled $12.3 billion, and grew by 25.9% over the end of the third quarter of 2018. Our annualized organic loan growth for the quarter was 3.1%, and our annualized organic deposit growth 16.4%. I look to speak more about our balance sheet activities near the call end. The bottom of Page 4, our tangible book value per share of $21.26 is an annualized 15% increase since the fourth quarter of 2018.

Mark's going to walk us through in greater detail the financial results for the quarter.

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Thanks, Mike, and good afternoon, everyone. My portion of the presentation will begin on Slide 6. Our total assets, on Line 7, increased by $2.4 billion or 32.9% on an annualized basis of this year and now total $12.3 billion. Total loans, on Line 2, have increased by $1.1 billion this year or 19.9% on an annualized basis. Acquired loans totaled $731 million, as organic growth totaled 6.4%.

Investments, on Line 1, increased $856 million or nearly 70% annualized since year-end due to strong deposit growth and acquired liquidity. Additionally, on Line 4, goodwill and other intangibles increased by $110 million, net of amortization due to the purchase of Monroe Bank & Trust on September 1, 2019. The composition of our $8.3 billion loan portfolio shown on the left side of Slide 7 continues to produce strong yields of 5.28% or 5.15%, excluding fair value. As the graph on the right illustrates 65% of our loans are variable, demonstrating the asset sensitivity of our bank. Monroe's portfolio mix is very similar to our core loan portfolio with a slightly larger concentration in owner-occupied real estate and mortgage loans in a slightly more fixed-rate bias.

On Slide 8, our investment portfolio has a longer than -- than peer duration, which is a good offset to our variable rate loan portfolio. During the year, we've increased the portfolio to $2.5 billion from $1.6 billion at year-end 2018, to deploy excess liquidity and to protect the bank against falling interest rates. As of December 31, 2018, our unrealized loss in the portfolio was $8 million. Over the first 3 quarters of 2019, as rates have fallen, the unrealized loss has become an unrealized gain of $75.8 million.

On Slide 9, total deposits increased by $2 billion year-to-date. Monroe Bank & Trust accounted for $1.1 billion of the growth, while organic deposit growth totaled $905 million or an annualized 15.6%.

Common equity, on Line 7, has increased $341 million year-to-date. Beyond normal earnings, dividends and OCI fluctuation, the all-stock purchase of Monroe Bank & Trust increased equity by $230 million as we repurchased $19 million of stock through the announced share repurchase program in September.

On Slide 10, second quarter interest-bearing deposit cost totaled 1.33%, up 1 basis point from the second quarter of 2019 on rate of 1.32%. We feel that deposit costs have finally peaked, and we're looking forward to a full quarter with Monroe given their low cost of funds.

Now on Slide 11, all regulatory capitals are above the regulatory definition of well-capitalized and our internal targets. We believe the strength of our 9.95% tangible common equity ratio and our 14.37% total risk-based capital ratio will continue to provide optimal flexibility into the future.

The corporation's net interest margin, on Slide 12, declined by 9 basis points, in line with our guidance from last quarter's call. We also suggested that we could continue to grow net interest income despite margin compression through balance sheet growth, and we have both organically and through M&A.

Looking ahead, given the addition of Monroe, we feel net interest margin will stabilize in the fourth quarter, assuming no further rate cuts. If we do have more reductions in the Fed funds rate, which many are predicting, our interest rate simulation suggests that we will lose 3 to 4 basis points per 25 basis point cut.

Noninterest income, on Slide 13, increased again in this quarter. The trend in customer-related fees, if you total lines 1 through 6, is on a very nice trend line and increasing from $16.3 million in Q1 of '19 to $17.7 million in Q2 and now totaled $20.1 million in the third quarter of 2019.

Noninterest expense, on Slide 14, increased during the quarter by $9.7 million. Merger-related expenses accounted for $11.2 million of the increase, offset by net reduction of FDIC expense quarter-over-quarter of $1.4 million due to assessment credits issued for meeting the FDIC's target minimum reserve ratio.

On Slide 15, EPS totaled $0.71 for the third quarter. As previously stated, our merger-related expenses totaled $0.17 per share, and we're also pleased by our sub-50% quarterly efficiency ratio when adjusted for merger-related cost.

On Slide 16, we have highlights of our positive trend lines, including tangible book value per share, that is over $21 per share post merger.

Slide 17 highlights our dividend trends and our double-digit compound annual growth rate of tangible book value per share dating back to 2010. We're proud of our growth in tangible book value per share during this time period as it also includes 8 acquisitions during that time frame.

Thanks for your attention, now John Martin will discuss our loan composition and related asset quality trends.

John J. Martin - *First Merchants Corporation - Executive VP & Chief Credit Officer*

All right. Thanks, Mark, and good afternoon. I'll begin my comments on Slide 19 with changes in the loan portfolio, review asset quality and the asset quality roll forward, cover the allowance and provisioning and then close with some summary remarks.

So turning to Slide 19. In the third quarter, the loan portfolio grew $59 million or a little less than 3.1% annualized, as Mike mentioned earlier. Loan production was a little lighter this quarter, coming off a strong second quarter that saw the loan portfolio grow at an annualized 12% rate.

With the exception of CRE nonowner-occupied loans and ag lending, on lines 4 and 6, respectively, all other areas of the portfolio has posted increases. We've seen strong demand for investment real estate in the secondary market, which has resulted in early payoffs and refinancing in the CRE nonowner-occupied book.

Despite this, we continue to see good demand for our commercial, industrial credit, including owner-occupied commercial real estate as well as Private Banking, where portfolio mortgages grew $16 million on line 9.

The MBT loan portfolio contributed $731 million to the balance sheet with a similar composition to the existing loan portfolio and results in total loans at the end of the quarter of $8.3 billion.

And finally, on the bottom of the slide, our concentration -- our construction concentrations continue to hover around 50% of risk-based capital, with the investment real estate concentrations hovering around 220% of risk-based capital. These levels give us ample concentration room for real estate growth as opportunities present themselves.

Turning to the asset quality on Slide 20. Asset quality remains stable and healthy. On the line 1, nonaccrual loans decreased in the pre-MBT portfolio for the quarter by $8.4 million to $17.2 million or 23 basis points of loans with other real estate owned increasing $5.9 million. There were 4 nonaccrual loans, or relationships greater than $1 million at the end of the quarter, which makes for a remaining granular nonperforming loan portfolio. With both renegotiated and 90-day delinquent loans down $100,000, NPAs and 90-day past due loans, on line 5, were down $2.7 million or roughly 11%.

Turning to Slide 21, which reconciles the migration of the nonperforming assets, including the change from the MBT portfolio. We started the quarter in the column titled Q3 '19, it's the third column from the right, which excludes MBT loans with $28 million in NPAs and 90-day delinquencies.

Summarizing, we added $2 million of new nonaccrual loans in the quarter, resolved $2.1 million of the same on line 3 with $6.4 million of new ORE on Line 4 from the full closure of a participation in a senior living facility.

Skipping down to the other real estate-owned changes, on lines 7 through 9, where we added $6.4 million from nonaccrual loans. We sold $400,000 of other real estate and had $100,000 of ORE write-downs, which resulted in an increase in OREO of $5.9 million. This leaves us with total NPAs and 90-day delinquent loans of $24.9 million pre-MBT. Sliding over a column, we include the impact of the -- of MBT, where we acquired $5.5 million of nonaccrual loans and $100,000 of ORE. We ended the quarter then with combined NPAs and 90-day delinquent assets of $30.5 million or roughly 37 basis points of total -- which is roughly 37 basis points of total loans.

Then moving to Slide 22, which highlights the ALLL and fair value summary. We began the quarter with an allowance of $8.3 million or 1.08% of loans. In the quarter, charge-offs exceeded provision expenses -- expense, on lines 2 and 3, resulting in a decrease in the allowance of $700,000, ending the quarter at $80.6 million. The percentage decline in the allowance to loans from 1.08% to 0.97% is reflected on line 8 and correlates to both the addition of the MBT $731 million loan portfolio and continue -- and continued improvement in credit quality. This is highlighted on line 6 with the allowance now covering nonaccrual loans at 355%, up from 317% last quarter.

Finally, dropping down to line 9, we started the quarter with $25.6 million in fair value adjustments. We booked $18.4 million in fair value adjustments for MBT. Accreted $2.5 million from -- or $2.5 million with $200,000 of offset charge-offs, ending the quarter with $41.3 million in fair value adjustments.

Then summarizing on Slide 23, we experienced further improvement in credit quality metrics for the quarter, while keeping an eye on what is happening on a regional, national and global level. There are a number of threats to the economy that we'll keep watching while communicating with our borrowers. But for the time being, we continue to see low unemployment, low inflation and low interest rates, which have made for a stable credit environment.

Third quarter loan growth of 3.1% annualized is coming off a prior quarter at 12% annualized, and we continue to see loan growth with respect to MBT. I feel we are positioned well to integrate the sales and underwriting teams and view the existing portfolio mix and credit culture as a nice organizational mesh. And finally, the credit and sales teams are working well together early on with consumer and commercial monitoring and servicing in place for most whatever the economy might bring.

Thank you for your attention, and I'll turn the call over to Mike Rechin.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Thank you, John. Since our last call on July 25, we had a legal closing on September 1, as we mentioned. We announced a stock buyback program. We made material advances in our seasonal modeling for implementation next year. And we completed the quarter of financial results, and we feel very positive about the results that Mark and John just spoke to. And as Mark covered, we kind of were able to outrun the net interest margin pressure to grow net interest income independent of MBT.

We had strength in several fee categories, stronger maybe even in the totals that are depicted on Page 13, in that bond gains were down in the third quarter and we had a 6-figure vendor rebate in the second quarter that we had to normalize from. Our client-centric fees in the third quarter really grew nicely. Service charges, wealth management fees, gain on sale of mortgages and our customer derivative sales were all up. And while derivative sales are probably least easy to forecast going forward, the other categories I mentioned, continued strength in our wealth business, our service charges through the use of client-facing technology, and our mortgage business clearly looks like they're going to stay strong here in the near term.

Our expense management, I think, was strong. It was highlighted well in the release and in Mark's comments. And all of the opportunity we saw in expense savings relative to Monroe appear to be there, many of which have been realized and some of which will come to us on the back end of the current quarter's integration activities.

John spoke to the asset quality, both on the overall portfolio, really stable, and I think actively managed. And I also feel like as he said, we have a great understanding of the new Monroe portfolio that joins ours, both in the mix of it and the asset quality, based on the managers of that company who still do their work with us.

So moving to a couple of the other bullet points on Page 25. We like Monroe Bank & Trust for several reasons, every bit as much as the tail end of last year when we first talked out loud about it. For instance, the raw franchise expansion we think is a great opportunity for us to move the company a little bit north and a little bit east. The funding, we've touched on a couple of times. They have market share that gives them pricing power and it shows itself in their funding costs, which is really attractive for us. The management additions are really compatible. Now they got some strength in the way that they ran that business that are going to flow into First Merchants, we're excited about. And that speaks somewhat, but I'll just explicit -- more explicitly said that there's a cultural fit that we like early on. So we're going to get off to a good start there.

The integration activities themselves next month, it's more than data and technology, it's more the cultural sharing and a lot of training that's really heavy right now. I think that's going to pay off. We have a historical capability in doing a nice job with the clients through the integration period, and that's clearly in our playbook for next month and through the balance of the calendar year and in 2020.

The remaining bullet points on the page, I've somewhat touched on, whether it's in the third quarter or not. But we need -- if we feel like the deposit costs have crested and can, in fact, potentially come down, but if the net margin can stabilize, then with the continued growth of earning assets, I look for a net interest income to continue to grow. That obviously requires some pricing discipline. We're trying to sharpen our 2020 operating plan, which calls for crisp execution on loan and deposit pricing. We're going to enter the year with, I think, a terrifically flexible balance sheet, lots of liquidity, lots of capital and asset quality, obviously.

Have a pipeline that would suggest we ought to really be in line with our annualized growth targets. I was somewhat surprised to see that we came in at a number at 3% annualized because we closed a lot of loans. We went into the quarter with a nice pipeline. We continue to have one. I would tell you that our $2 billion -- $2.1 billion C&I portfolio, we actually had 2% less utilization on. So when I think about the number of loans and the new fundings that went in, it was offset by our clients not having the same high level of utilization on their committed lines, 2% down, as I mentioned.

So we look forward to next year really optimistically. The last bullet point on the page speaks to our desire to formalize what we do across the company against the needs of all the communities we serve. So we've got some great ideas there to take our brand in a tangible way out into the marketplace to improve the economies that we actively participate in.

So those are my thoughts. And Chuck, at this point, if there are folks on the line for questions, we're happy to take them.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from Scott Siefers of Sandler O'Neill.

Robert Scott Siefers - *Sandler O'Neill + Partners, L.P., Research Division - Principal of Equity Research*

I think just a couple of questions. Maybe Mark, start out with you. If you could walk us through where your rate sensitivity stands now? I think from my perspective, the margin declined but consistent with what you had said in July. And if anything, the rate environment got a lot tougher in the interim than versus now. So I would've expected if anything worse. So maybe just any changes in your rate sensitivity?

And then last quarter, your had sort of suggested the same 3 to 4 basis points hit from each 25 basis point cut, as you articulated a moment ago. But at the time, it seemed that you might have thought something like 5 basis points was more realistic. I think that was predicated on still deposit pricing pressures. It feels like you might be a little more confident in the 3 to 4 now. How are you thinking about those dynamics as well?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

We were anticipating -- I know we've said it on our last call that we thought the third quarter margin would be down around 10 basis points and down 9 on a reported basis, 10 if you back out fair value. So we feel good about the guidance that we had in the third quarter. This is the first time that we feel like deposit costs have finally peaked, or it's the first time we've really been confident in that. As we've had increases in prior quarters of 12, 16, 14, 9, just kind of going backwards. And so it's good to see our interest expense on interest-earning deposits only up 1 basis point. And that was with Monroe just for 1 month of the 3. And they helped stabilize our interest expense on deposits even more going forward.

We know that as the prime rate comes down, we're still asset-sensitive, not as much as we were 4 or 5 quarters ago as we have taken some steps primarily in the bond portfolio to just extend term. And the assets, the loans that we acquired from Monroe, are a little more fixed rate than the rest of our balance sheet. So I do feel like instead of it being more like 5 basis points in a declining rate environment that we'll be able to have better success on the deposit side and keep the net interest margin compression more to like 3 or 4 basis points.

Robert Scott Siefers - *Sandler O'Neill + Partners, L.P., Research Division - Principal of Equity Research*

Okay. Perfect. That's helpful. And maybe a more ticky-tack one on the purchase accounting benefits expectations going forward. About 9 basis points help to the margin this quarter. What would be your best guess as we look into the subsequent quarters?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. I think we have to kind of model it the way it is. The way -- at our current run rate, 9 or 10 basis points. And we have had experience in the past where immediately after an acquisition, it seems to ramp up a little. But 9 to 10 basis points, I think, is still the right guidance and the right modeling.

Robert Scott Siefers - *Sandler O'Neill + Partners, L.P., Research Division - Principal of Equity Research*

Perfect. And then if I can slip one final one in there. The expense base came in quite a bit better than what I would've thought. And I know there was some noise with the FDIC stuff. But maybe your -- some extended thoughts on exactly what happened that allowed them to stay so low in your outlook going forward?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. I think if you go back to our second quarter of '19, just excluding Monroe and a normalized FDIC expense level, we were close to $58 million. And when you include Monroe on a go-forward basis, we think that Monroe, for an entire quarter, is more like $7.5 million of expense. So we think if you look at those 2 together, that gets to be closer to what the run rate should be on a go-forward basis. And yet, in the fourth quarter, we still have some FDIC benefit that we'll recognize. So we had an income of $700,000 this quarter. Next quarter, the number should be 0. And so that will help us again in the fourth quarter, and then we get back to a run rate that is more kind of third quarter plus the $7.5 million of Monroe expenses.

This particular quarter, we only had Monroe for 1 month. And it was a strong quarter and partially because our acquisition closed a little later than what we traditionally have happened in most announced mergers and we've been able to take out quite a bit of the expense already. So even though the integration is scheduled for this -- in the fourth quarter, in November, we don't have as much of benefit to recognize post merger, a lot of that has already been done.

Robert Scott Siefers - *Sandler O'Neill + Partners, L.P., Research Division - Principal of Equity Research*

Okay. Perfect. So it sounds like the expense is sort of low $60 millions per quarter going forward on an all-in basis then?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. We think low to mid-60s is kind of the go-forward level.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Because of the FDIC.

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

And FDIC will be the biggest variable in the fourth quarter and then again next year as it increases as part of the large bank acquisition cost.

Operator

The next question will come from Terry McEvoy of Stephens.

Terence James McEvoy - *Stephens Inc., Research Division - MD and Research Analyst*

Maybe a question on just the liquidity or excess liquidity. The loan-to-deposit ratio went from 90% to 85% after the closing of the acquisition. Just what are your thoughts on managing liquidity? And that loan-to-deposit ratio over time, is 90%, closer to the targeted level you'd like to operate at?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. We think 90% is an optimal level to operate at. And I think we have a nice track record acquisition to acquisition of ramping up the growth or the momentum that comes out of each market that we acquire, that ultimately uses the acquisition -- the liquidity that is on the balance sheet. So we feel great about the position and where we stand today, but on an organic basis, our loan growth always exceeds deposit growth, especially over time.

Terence James McEvoy - *Stephens Inc., Research Division - MD and Research Analyst*

And then just as a follow-up, you mentioned you repurchased $19 million of stock in September. Do you have -- just the period-end share count? I didn't see that in the release. Just kind of be helpful for the fourth quarter shares in our model. And then what are your thoughts on additional repurchase activity from here?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. We announced $75 million. We have seen an uptick in the price the last week or so which is obviously good for shareholders. I mean we're just going to be opportunistic as we use the remaining amount of that, what, $55 million, $56 million.

And the period-end share count, I'll get for you in just a moment. Yes, it's in our press release, on the balance sheet. 55,345,672. 55,345,672.

Operator

Our next question will come from Nathan Race of Piper Jaffray.

Nathan James Race - *Piper Jaffray Companies, Research Division - VP & Senior Research Analyst*

Mike, curious to get your thoughts on just kind of loan growth outlook from here. Little softer production seasonally, perhaps, here in 3Q. Curious kind of where the pipeline stands. If you would anticipate any runoff at MB&T? And if you -- I think last quarter, you kind of talked about some of the disruption in some of your -- so I'm just curious if there's been any hires to date to speak of?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Yes. Let me speak to the dollar volumes first at the front end of your question. So yes, in terms of period-end to period-end loan growth, I thought it might have trended a little bit higher. Our loan closings in the quarter would've supported a higher number in that the pipeline, the commercial pipeline that we had at the end of last quarter, about $460 million, we had a lot of closings, predominantly in those business lines that stick to our balance sheet, like consumer lending and our structured finance group and traditional commercial banking. We also had a lot of loan closings in a strong mortgage business like most entities that are in residential mortgage.

I mentioned in my earlier remarks that we had line utilization down, a couple of percent on $2 billion is about $40 million. I don't know if that's tariff-related. I really don't have a good understanding of the borrower by borrower, other than it tends to move in a fairly tight number.

Our pipeline going forward is even stronger than the $460 million commercial pipeline we had a quarter ago. It's actually about $100 million higher, $550 million, and it's broad-based. It's in our structured group. It's in Ohio. It's in Indianapolis. And so that when I think about market disruption, it didn't necessarily manifest itself for us in people adds because I like the team that we have. It really just plays into more opportunity, more chances to share term sheets on our ideas.

And while the third quarter might have been a little bit lesser than I expected, we're off to a fast October start. So any of the annualized numbers in that 6% to 8% range that we used, we continue to feel good about independent of what takes place in Monroe. We don't know that market place like the bankers do that joined us. So they're obviously going to be leading their efforts, taking a -- hopefully, a calm through the integration period to let them get used to us, but we clearly have the horsepower to make their growth plans happen. And again, we like the talent level, the bankers that are joining us, so we feel good about it. And the client feedback we're getting about their 2020 plans is also upbeat. So we're ending that year confident.

Nathan James Race - *Piper Jaffray Companies, Research Division - VP & Senior Research Analyst*

Got it. That's great color. So it doesn't sound like your expecting any runoff, perhaps, intentional on the MBTF side of things?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

No. We really don't. John identified some of those specific nonaccrual numbers, which are really quite modest. I think they're $5 million. But behind that there -- to your point, there is not a list of names that have an asset quality profile that suggests we shouldn't be serving them anymore. So no, they're going to -- they're not really starting out at all with a yellow light. It's kind of green, once we get the integration activities completed.

Nathan James Race - *Piper Jaffray Companies, Research Division - VP & Senior Research Analyst*

Got it. That's great to hear. And if I could just ask one more housekeeping question. The tax rate, little light this quarter. Mark, fair to expect it to go back closer to 17% going forward?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. We think 15% in 3 quarters, the 16% is a little more normal.

Operator

The next question will come from Kevin Reevey of D.A. Davidson.

Kevin Kennedy Reevey - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

So first question is, earlier in your prepared remarks, you'd mentioned that you're going to remain disciplined with respect to pricing. I'm just curious how comfortable you feel that you can grow loans and be able to more than offset margin compression, given the competitive environment and paydowns, while still maintaining pricing discipline?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Well, I think it's out there, Kevin. When we look at what's coming through our, what we call, early stage pipeline, where we get to share ideas as to how we think First Merchants' capital gets deployed inside of our customers, we put a price on it that we think is fair. And obviously, we don't win all of those.

Mark mentioned just a moment ago that historically, our loan growth has been higher than our organic deposit growth, and for the most part, that's true. The last 12 months might be a little bit different than that because we were taking advantage without an acquisition through 2018 and trying to make sure we fortified our funding. And so we did go into some institutional deposits that were expensive relative to our core funding cost. And now with the addition of Monroe, the funding cost, the resultant loan-to-deposit ratio that Mark cited at 85%, it just allows us to really apply our best market knowledge on incremental credit and incremental funding. Did that answer your question?

Kevin Kennedy Reevey - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

No, that's perfect. I'm just curious where are you in terms of deposit pricing in your market? Are you mid-market? Are you at the higher end or the lower end currently?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Well, I got to tell you, it differs a little bit market to market. In Ohio, we've been on the aggressive side from a funding cost because our presence there is newer than it is through large parts of our company. In our most mature markets where we have the greatest pricing power, whether that's our headquarters in Muncie, the newest market in Monroe, we're definitely moving away from CD-led pricing. We're trying to keep our attraction points in the money market categories, but trying to be market smart about everything else. If you're asking me, are we high, middle or low, I would say we're in the middle. We're trying to lead the declines down based on the markets where we have pricing power.

Kevin Kennedy Reevey - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

And then lastly, how should we think about credit -- provisioning in credit costs going forward?

John J. Martin - *First Merchants Corporation - Executive VP & Chief Credit Officer*

Kevin, this is John. And I would say that what we've been doing kind of historically about that $600,000 to $1 million has been kind of our run rate. I think we've said historically about $1 million to $1.2 million, but we've been running the last several quarters less than that. So our provision expense, that's what I would use, say $600,000 to $1 million. The other thing too is with CECL into next year, things are going to change. So that may have an impact on what you model.

Operator

Our next question will come from Damon DelMonte of KBW.

Damon Paul DelMonte - *Keefe, Bruyette, & Woods, Inc., Research Division - SVP and Director*

Just to kind of follow-up on that last question regarding CECL. Have you guys finalized your expectations for the increase to the loan-loss reserve?

John J. Martin - *First Merchants Corporation - Executive VP & Chief Credit Officer*

The third -- what we've done thus far, Damon, is we've gone through an exercise of acquiring the software. We've built our models. We're conducting at this point parallel runs. And really into the fourth quarter, we're working with a third party to validate our model. So really any adjustments to the models as a result of the validators are going to happen in the fourth quarter and really be able to give you more clarity into January of next year.

But at this point, we really don't have a number other than to know that with the acquisition of Monroe, there's going to be $1.4 billion in purchased loans, so -- that are included in the allowance calculation under CECL. That is not incurred -- excuse me, included in the incurred loss method today. So we know that the allowance under CECL obviously will increase. It's about as much clarity, I think, that I can give you at this point.

Damon Paul DelMonte - *Keefe, Bruyette, & Woods, Inc., Research Division - SVP and Director*

Got it. Okay. And then my next question, Mike, I think you mentioned that your utilization rates on C&I loans were down, like, 2% this quarter. Any color on what maybe was the reason for that? Are there any concerns from your borrowers that you're hearing anecdotally about trends in the economy? Any concerns about other prolonged impacts from the trade war or slowdown in manufacturing? Anything you could provide on that?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Yes, Damon, it's all anecdotal when it gets to me. And I'm talking about nearly $2.2 billion aggregation of C&I lines, right in between $2.1 billion and $2.2 billion. And so when it goes down 2%, I don't really get great clarity around it. If there's anything that I hear, it's that people need employees. And so they are -- top lines of our clients would probably be growing if we had more talent for them to access. Cash flows are strong. And so they've just been relying on us a little bit less for their working capital.

Damon Paul DelMonte - *Keefe, Bruyette, & Woods, Inc., Research Division - SVP and Director*

Okay. So no kind of impacts from the -- in the manufacturing sector. I know there's been some data points that haven't been as strong as they have in the past?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

No. I mean we're a logistics center in the crossroads of America out here in the state of Indiana, and so we have a lot of transportation-related industries. That has -- if you read, tractor trailer sales have softened a little bit, but the commitments, when I mentioned the denominator for the utilization between $2.1 billion and $2.2 billion, that's growing. So our C&I commitments actually grew $110 million through the quarter. The utilization overall is down.

Operator

The next question will come from Brian Martin of Janney Montgomery.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

So just a couple for me, guys. Just Mark, going back to buybacks for a minute. I know you said you're optimistic that you can continue to do some. I guess do you intend to use the full authorization? Or is that kind of subject to the pricing, as you mentioned?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

We intend to use the full $75 million. There's just been enough price volatility that we're trying to take advantage of some of the low points.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Got you. Okay. I just wanted to know how -- from a modeling perspective. Okay. And then just your comment on the FDIC assessment. So 0 in 4Q and then I guess, can you give -- I guess, does it go back to a higher level with the large organization? And just kind of any clarity on kind of where that -- how that shapes up?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. It's been -- obviously, there is a lot of volatility. We were anticipating higher rates in 2020. And now with these assessment credits, it makes for a pretty dramatic change from '19 to '20. So we were at $1.4 billion in the second quarter -- $1.4 million in the second quarter of expense. We -- because of the credits, it becomes $700,000 benefit to us in the third quarter. It should be flat in the fourth quarter and then increases next year to an annualized rate of $5.5 million. So the credits go away and then we have increased pricing. And so it's a big swing year-over-year.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Yes. Okay. Okay. Just want to make sure I'm clear on that. And that full annualized run rate begins in 2Q, is that how to think about that?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

It should begin mostly -- really 1Q.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Okay. Perfect. That's helpful, Mark. And just the last 2 was just -- maybe one for Mike or whomever, just on kind of M&A. I know with Monroe closed and I know you're still integrating it. But just kind of where do you guys stand on your outlook on M&A? I guess, are there discussions? Are they active? Are you more focused on -- at least in the short term on getting Monroe integrated and getting the benefits realized out of that before you progress, if there is something else that comes up?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

No. I would think we would be ready to engage, should a great opportunity take place. So we're not in the middle of anything. We are focused on the integration. We are focused on getting off to a great start. As you know, it's been a protracted closing period in 2019, so we're kind of ready. I would say, the frequency of the conversation is kind of constantly -- it's kind of stable. There's always something taking place in the 3- or 4- or 5-state area that we pay very close attention to. We're always feeling like we're having dialogues where they're well intended and a good use of each other's time. So we continue to believe in the power of scale and will be looking for franchise help when it's appropriate.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Okay. And would you say your outlook today, Mike, is getting over the $10 billion, larger deals versus smaller? Or no preference at this point, just...

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Well, I think you have to move your targeting up a little bit for the magnitude of the effort that goes into it. And so if you think about the last handful of companies that have joined First Merchants, we've had a couple of smallish ones, well beneath $0.5 billion. I don't see those as being great fits for us at this point. But certainly, companies the size of Monroe or more sizable, we clearly feel like we have the capital for and the capability to execute again. So probably to answer your question more succinctly, we're probably moving our appetite up a little bit.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Got you. Okay. And last one, Mark, was just on your commentary, I appreciate the commentary on the margin. Just the -- if we assume there is -- I know you initially talked about maybe being stable with no rate cuts, but if you were to get 3 cuts in there, fair to just think about the cuts impacting as you go forward, equal amounts and they wouldn't decline? So if you do assume 3, it means the next 3 meetings, you'd be looking to see the margin be 9 to 10 -- call it 10 basis points lower than where it sits today on the core side?

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

Yes. I think that probably has -- that has to be the case. We would see compression given our asset-sensitive position. And so if we -- so 9 to 12 basis points.

Brian Joseph Martin - *Janney Montgomery Scott LLC, Research Division - Director of Banks and Thrifts*

Okay. Yes. And do you -- remind me, do you guys have floors on the loan portfolio? Or is it a small portion?

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Not really.

Mark K. Hardwick - *First Merchants Corporation - Executive VP, CFO & COO*

No. We really don't. Pretty close to 0.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Michael Rechin for any closing remarks. Please go ahead, sir.

Michael C. Rechin - *First Merchants Corporation - President, CEO & Director*

Thanks, Chuck. My only remark would be I appreciate people's attention to our results. Hope that if there is follow-up questions, you can get them to us, but appreciate the attention, and look forward to talking to at the end of the -- following the end of the year, talk to you then.

Operator

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