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MSBI - Q1 2017 Midland States Bancorp Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Midland States Bancorp, Inc. first-quarter 2017 earnings conference call. (Operator Instructions). As a reminder, today's conference call is being recorded. I would now like to introduce your first speaker for today, Allison Pooley from Financial Profiles. You have the floor, ma'am.

Allison Pooley - *Financial Profiles, Inc. - IR Representative*

Thank you, Andrew. Good morning, everyone, and thank you for joining us today for Midland States Bancorp's first-quarter 2017 earnings call. From Midland's management team we have Leon Holschbach, President and Chief Executive Officer; Jeff Ludwig, Executive Vice President; and Kevin Thompson, Chief Financial Officer.

We will be using a slide presentation as part of our discussion this morning. If you have not done so already, please visit the webcasts and presentations page of Midland's Investor Relations website to download a copy of the presentation.

Leon, Jeff and Kevin will discuss the first-quarter results, and then we will open the call up for questions.

Before we begin, I'd like to remind you that this conference call contains forward-looking statements with respect to the future performance and financial condition of Midland States Bancorp that involve risks and uncertainties. Various factors could cause actual results to be materially different from any future results expressed or implied by such forward-looking statements. These factors are discussed in the Company's SEC filings, which are available on the Company's website. The Company disclaims any obligation to update any forward-looking statements made during the call.

Additionally, management may refer to non-GAAP measures, which are intended to supplement but not substitute for the most directly comparable GAAP measures. The press release, available on the website, contains the financial and other quantitative information to be discussed today as well as a reconciliation of the GAAP to non-GAAP measures.

And with that, I'll turn the call over to Leon.

Leon Holschbach - *Midland States Bancorp, Inc. - Vice Chairman, President, CEO, Midland States Bank Vice Chairman and CEO*

Thanks, Allison. Good morning, everyone. Welcome to Midland.

Slide 3 summarizes the highlights of the first quarter. We will start there.

We have gotten off to a very good start to the year with solid growth and stability across the Company. We generated $8.5 million and net income of $0.52 per diluted share in the first quarter. On a year-over-year basis, this represents a 67% increase in net income and a 24% increase in earnings per share. If you exclude the $1.3 million in integration and acquisition-related expenses we recorded in the quarter, then our adjusted earnings per share came out at $0.57. This translates into an adjusted ROA of $1.17 and an adjusted return on average tangible common equity of 14.2%. This compares to an ROA of $0.79 and a return on tangible of 12.6% in the first quarter of last year, and speaks to the improvement in the overall level of returns that we have been able to deliver as we have executed on our growth strategies over the last 12 months.

As we have mentioned before, we knew that we would be losing a significant amount of interest income by selling our portfolio of private-label CMOs and realizing the gain on these securities in the fourth quarter of 2016. However, we were able to completely replace that income in just two quarters, which was ahead of our expectations, and we are very pleased with that.

We had positive trends in most of our key metrics during the first quarter, including strong loan growth, an expanded net interest margin, higher noninterest income, greater efficiencies and a nice improvement in credit quality.

This quarter was also a good example of the value we derive from our revenue diversification, as we had strong contributions from many different areas of the Company.

The highlight of the quarter was our loan growth as total loans increased 23% on an annualized basis. The loan growth was broad based as we had increases in all of our major portfolios during the quarter with the exception of the construction land development portfolio.

Geographically, we are seeing a good loan demand across our footprint. One market that's making a particularly strong contribution is Colorado, where we have offices in Denver and Colorado Springs. These areas are seeing strong economic growth and our teams there have done a great job of building our presence and growing our customer base. It's our fastest-growing market, and we are very excited about the opportunities to continue expanding in Colorado.

I also want to touch upon the strong growth we've had over the past year in our consumer portfolio, principally through growth in our home improvement loan program. Our consumer home improvement program is noteworthy for several reasons, especially given that, over the past 30 years, banks have been almost completely dis-intermediated from the consumer lending business other than through indirect auto.

We have been originating home improvement loans over the past seven years through a partnership with Green Sky Credit, and this program has been very successful for us. Green Sky offers loan origination services to Midland and a select group of other banks, including larger regionals such as Regions, SunTrust and Fifth Third, principally for consumer loans in the home improvement space. To originate the loans, Green Sky provides a quick and easy application process that allows retailers, manufacturers, and contractors to provide financing to their customers on terms that are generally more attractive than if their customer used their credit card. Home Depot is one example of a national retailer that runs a program with Green Sky.

We set our own underwriting criteria for all of the loans originated by Midland. The average FICO score in the portfolio is a strong 748, and the average loan size is $11,000.

The benefits to Midland from the program are numerous. First of all, Green Sky bears all of the costs we would typically have in our brick-and-mortar business, including both origination and servicing costs. Green Sky also observes normal charge-offs in the portfolio and we have never had a loss of principal or interest on any of these loans in the seven years we've had the program.

The combination of essentially no overhead and zero charge-offs results in a comparatively strong pretax yield. The nationwide focus on small-ticket loans provides tremendous geographic diversification as well. We're also able to ratchet our loan volumes up or down, depending on our need, without impacting Green Sky's operations, and we have therefore been able to increase our consumer portfolio commensurate with the Bank's overall balance sheet growth. We have been very pleased with how this program has allowed us to grow our consumer credit business in such an impactful way.

Turning to other notable items in the quarter, our noninterest income was up 29% over the prior year, driven by strong growth in wealth management revenue, while our commercial FHA revenue was consistent with the level we had in the first quarter last year.

During the quarter, we took another step in growing our wealth management business as we acquired CedarPoint Investment Advisors, an RIA located in suburban Milwaukee. This acquisition increased our total assets under administration by over 10%, which allows us to improve the scale and efficiencies in our wealth management business. In the process, we added a talented team of investment advisors that operates with a similar philosophy and fee structure as our existing business. As with our Green Sky program, this is another example where we have been ahead of the curve. It has only recently become fashionable for banks and other investment advisors to tout a fiduciary-based model, but Midland moved to a fee-based fiduciary type model several years ago. As a result, CedarPoint's RIA model fits very well with our approach to complete fee transparency and unbiased investment advice.

Importantly, we believe that adding an RIA platform would also make it easier for us to attract more talent in the future and help us continue to grow the wealth management business.

As you might recall, last quarter, we talked about our new operational excellence initiative. We made good progress on this initiative during the first quarter, including completing our branch network optimization efforts.

As a result of the cost savings we have been able to achieve, our noninterest expense was $29.5 million in the first quarter when acquisition and integration-related expenses are excluded, which puts us right in the range we were targeting. The operational excellence initiative also extends to many other aspects of the Company, including our risk management and tax planning.

We recently established a captive insurance subsidiary to supplement our existing insurance coverages, which also has positive tax benefits. This will reduce our effective tax rate from the historical levels we've seen and enhance the after-tax returns we generate for shareholders.

Now, I will ask Jeff to take some time and go over the performance of our individual business units.

Jeff Ludwig - *Midland States Bancorp, Inc. - EVP, Midland States Bank President*

Thanks, Leon. I'm going to start on Slide 4 with Love Funding, which is our commercial FHA loan origination and servicing business that focuses on multi-family and healthcare facilities. On a linked-quarter basis, we had a significant increase in both originations and revenue during the first quarter. We originated $217 million in rate-locked commitments, an increase of 36% from the prior quarter. 86% of the rate-locked commitments this quarter were permanent loans, which has a positive impact on our gain-on-sale margin and revenue. This resulted in $6.7 million in commercial FHA revenue in the first quarter, which was consistent with the level we saw in the same period last year.

As an ancillary benefit to the commercial FHA business, we also originated $15 million in commercial real estate bridge loans in the quarter to customers of Love Funding. Our average servicing deposits in the quarter totaled $280 million, up 10% from last year, and our weighted average cost on these deposits was just 9 basis points. Looking ahead, the pipeline indicates that we are positioned for another good year at Love Funding.

Our positive trend impacting the pipeline is a byproduct of the heightened regulatory scrutiny on commercial real estate and construction loan concentration. We are seeing an increasing number of developers turning to HUD programs for credit after being turned down by community and regional banks that can't make a $5 million, $10 million or $15 million construction loan due to concerns about their concentration levels. Accordingly, this is driving more opportunities for Love Funding.

Turning to Slide 5, we will look at our residential mortgage business. We had $2.9 million in revenue this quarter. When you back out the recapture of mortgage servicing right impairment in both the first and fourth quarter, revenue was up approximately 7%, primarily due to higher servicing income.

We had $77 million in rate locks on loans originated for sale during the first quarter, which is a seasonally slower period for the home purchase market. We have seen an increase in our pipeline going into Q2.

Turning to Slide 6, we will look at Heartland Business Credit, our equipment leasing business. This business continued its strong performance and generated $22 million in originations. The total leasing portfolio has grown by 25% over the past year, and we continue to see very attractive yields in this business with average rate on the portfolio being 5.44%, excluding accretion income.

Turning to Slide 7, we will take a look at wealth management. This was our first full quarter with the operations and team we added in the Sterling Trust acquisition. As a result of the increase in assets under administration, our wealth management revenue increased to $2.9 million, up 15% from prior quarter. This represents a 61% increase in wealth management revenue over the first quarter of last year. With the acquisition of CedarPoint Investment Advisors, our total assets under administration increased to $1.9 billion as of the end of the first quarter, which will result in further growth in our wealth management revenue going forward.

Outside of the impact of the acquisitions, we are seeing solid organic growth in the wealth management business. Excluding the assets added from Sterling Trust and CedarPoint, our total assets under administration increased $109 million, or 9%, from the first quarter of 2016.

Now I'm going to turn the call over to Kevin to walk through some additional details on the first-quarter performance.

Kevin Thompson - *Midland States Bancorp, Inc. - CFO, Midland States Bank CFO*

Thanks, Jeff. Starting with Slide 8, I'll review our net interest income net of interest margin. Our net interest income increased by 5.8% from the fourth quarter. This is primarily the result of higher interest income on loans due to our strong loan growth and a higher net interest margin. Our net interest margin increased by 17 basis points on a reported basis and by 10 basis points, excluding accretion income. The increase was due to higher average loan yields as the two Fed rate increases are having a positive impact on our asset-sensitive balance sheet.

Moving to our noninterest income on Slide 9, with strong performances from our fee generating businesses, our noninterest income accounted for 37% of total revenue in the quarter. If you exclude the gain on sale of the CMOs, our noninterest income was essentially unchanged from last quarter, although, from a core operating perspective, if you exclude the ebbs and flows of MSR impairment charges, then all our major fee generating businesses were up from the prior quarter.

Turning to Slide 10, we will take a look at our expenses and efficiency ratio. We incurred $1.3 million in integration- and acquisition-related expenses in the quarter. Excluding these items and the branch network optimization charges recorded in the fourth quarter, our noninterest expense was down 3% on a linked-quarter basis. As a result of the cost savings and efficiencies driven by the operational excellence initiative, we had declines across most of our expense areas despite the full-quarter impact of the operations and personnel we added in the Sterling Trust acquisition. On an adjusted basis, excluding integration- and acquisition-related charges, our operating efficiency ratio was 66% in the first quarter, returning to the sub-70% range that we guided to on our last call.

I will also touch upon our tax expense for a moment. Our effective tax rate in the quarter was 26%. As Leon mentioned earlier, the effective tax rate benefited from the establishment of the Captive Insurance subsidiary. We also benefited from the adoption of new accounting rules related to the exercise of employee stock options, which had an outsized impact on the first-quarter tax rate. The adoption of this new accounting rule will add some degree of volatility in our effective tax rate.

Moving to the balance sheet on Slide 11, we will take a look at our loan portfolio. Our total loans were up $135 million from the end of the prior quarter, which represents 23% annualized growth. On an average basis, total loans were up 8.3% annualized. We saw nice increases across all our major portfolios with the strongest growth coming in our commercial real estate, residential real estate, and consumer loan portfolios. The growth in the consumer loan portfolio was primarily driven by our program that provides financing for home improvement projects.

Turning to Slide 12, we'll take a look at our deposits, which were up $123 million from the end of the prior quarter, or 5.1%. The majority of the growth came in our NOW and money market accounts. We also increased our level of brokered deposits during the first quarter to support the strong growth we had in total loans.

Moving to Slide 13, we saw improvement across all our asset quality metrics and the ratio of substandard loans to total capital is the lowest we've seen in 10 years. Our nonperforming loans decreased by $2.7 million from the end of the prior quarter. Our net charge-offs were just $600,000, or 10 basis points, of average loans, and we recorded a provision for loan losses of $1.5 million in the quarter, which primarily reflected the growth in the loan portfolio.

With that, I'll turn the call back over to Leon. Leon?

Leon Holschbach - *Midland States Bancorp, Inc. - Vice Chairman, President, CEO, Midland States Bank Vice Chairman and CEO*

All right, Kevin. So we will wrap up on Slide 14 with some comments on the outlook.

We continue to see generally healthy economic conditions in our markets, which should lead to a continuation of the positive trends we're seeing in both revenue growth and credit quality. While generating revenue growth, we have also been able to execute well on the operational excellence initiative and deliver the cost savings and efficiency improvement that we have been targeting.

Now, as we prepare to add another $1 billion in total assets through our pending acquisition of Centrue Financial, we are starting to invest in the resources needed to execute the integration plan for later this year. Having received approval from the Federal Reserve, we are expecting to close the Centrue transaction in midyear. Assuming that all goes as planned, we would expect to complete the system conversion around Labor Day and then have the projected cost savings completed during the fourth quarter. This would put us on track to start off 2018 with all of the cost savings phased in. Until then, given the investments we are making in preparation for the integration, we would expect our expense levels to remain somewhat elevated for the remainder of the year.

Looking ahead, we are very pleased with how we are positioned. We are executing well in all areas of the Company, attracting new customers in our core community bank and specialty business lines, and delivering profitable organic growth. Combined with the strategic and financial benefits projected from the Centrue acquisition, we feel confident in our ability to continue increasing our level of profitability and enhancing the value of our franchise.

And with that, will be very happy to take questions. Allison?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Terry McEvoy, Stephens.

Terry McEvoy - *Stephens Inc. - Analyst*

Could we just start with loan yields? Could you give us a sense for loan yields ex-accretion in the first quarter, what type of increase you saw and whether that same type of increase, I guess following the rate hike last month, should show up in the loan yields in Q2 to the same degree?

Kevin Thompson - *Midland States Bancorp, Inc. - CFO, Midland States Bank CFO*

That's a good question. We are definitely benefiting from the Fed rate increases with our asset-sensitive balance sheet. And so, ex-accretion, we are seeing about a 14-basis-point increase in our loan yields. And we do expect to see that not -- of course, loans reprice over time. So many of them reprice in the quarter. We will see some repricing but not see that same level of increase throughout the year until we see more Fed increases.

Terry McEvoy - *Stephens Inc. - Analyst*

Okay. And Jeff, you said Love Funding should have "a good year". Is that business expected to continue to be lumpiness, or should we think of that on a year-over-year basis?

And then as a follow-up, I keep reading about affordable housing tax credits continuing to come down since the election and having an impact on the financing of that market. I'm just trying to make sure I understand your comments correctly. Does some of the disruption in those markets actually benefit Love and should benefit volume going forward?

Jeff Ludwig - *Midland States Bancorp, Inc. - EVP, Midland States Bank President*

Yes, so I think -- I'll take the first question. I think we look at the Love Funding business on a year-over-year basis. Quarter-over-quarter, given the large loans that are rate locked, revenue can move in and out of quarters fairly easily. So, looking at it over a year period is the best way to do it. We had a good first quarter. Our pipeline looks good going into second quarter. But for even us to project quarter-to-quarter is difficult, but we expect for the year that we will have another solid year.

As it relates to tax credits, it's a part of the business that's not the driving part of the business. We are hearing from our Love Funding subsidiary that some of the tax credit valuation is they are seeing some of that impacting some project, but we don't believe that it's going to be a driver and take revenue off the table for us.

Leon Holschbach - *Midland States Bancorp, Inc. - Vice Chairman, President, CEO, Midland States Bank Vice Chairman and CEO*

And then if I could add this -- Kevin touched on it during his remarks. This messaging that banks are seeing across the country of approaching the 100% and 300% thresholds for construction and development, on the one hand, and all commercial real estate on the other, everyone is hearing that. We are not near either of those, but industry-wide we are hearing a lot of that. And one of the things that is clearly manifesting in Love's pipeline is an increasing amount of construction deals. And I think that that's going to be a great opportunity for us as we move forward, in particular as the banking industry kicks up against its real estate threshold. And anyway, so I think that's going to be a positive as we go forward.

Terry McEvoy - *Stephens Inc. - Analyst*

Thank you. And then just one last one. There is an FHA warehouse loan customer that impacted deposit flows in the fourth quarter. Did any of those deposits come back in the first quarter in a meaningful way that impacted any of the balances?

Kevin Thompson - *Midland States Bancorp, Inc. - CFO, Midland States Bank CFO*

Yes, I'll take that. So, we do have a large FHA customer, and those did not impact deposit balances in the first quarter.

Terry McEvoy - *Stephens Inc. - Analyst*

Thanks, everyone.

Operator

Kevin Reevey, D.A. Davidson.

Kevin Reevey - *D.A. Davidson & Co. - Analyst*

Leon or Jeff, I noticed that you had some really nice growth in your checking account. It looks like it was up about 15%. Was that mostly due to Love Funding or was that basically across all your businesses? And the same thing with the money market deposit balances, which were up about 4% in the quarter.

Jeff Ludwig - *Midland States Bancorp, Inc. - EVP, Midland States Bank President*

Yes. The drivers are mostly on the commercial side, so larger commercial customers bringing cash in is one of the big drivers there. But we are seeing -- we are working real hard every quarter to bring deposits in. So, I think we're bringing deposits in on a granular basis. But the big math is coming in on the commercial side.

Kevin Reevey - *D.A. Davidson & Co. - Analyst*

And then your home improvement project, is this expected to be a source of significant growth for your overall loan balances going forward, or was this just kind of an anomaly in the first quarter?

Leon Holschbach - *Midland States Bancorp, Inc. - Vice Chairman, President, CEO, Midland States Bank Vice Chairman and CEO*

No. In fact, as I touched on -- this is Leon. As I touched on, we actually started our partnership with Green Sky seven years ago. And we use it as -- it's been a wonderful thing. We use it as a balance to other organic growth that we have. And we have slowly increased it over that time from our initial purchase, which I think was maybe $25 million or so, up to a little over $200 million in its total portfolio today. So, it will be an ongoing tool in our loan growth toolbox.

Kevin Reevey - *D.A. Davidson & Co. - Analyst*

And then lastly, on credit quality, I notice your loans 30 to 89 days past due inched up. Was that just maybe one or two loans?

Jeff Ludwig - *Midland States Bancorp, Inc. - EVP, Midland States Bank President*

I think a big driver was probably on the consumer portfolio in our Green Sky portfolio. There's -- it's consumer paper, but the way we have structured the program is we have some credit enhancements there and we have not taken any losses. So I'm not concerned with a 10-or-15-basis-point and 20-basis-point uptick in those delinquencies.

Kevin Reevey - *D.A. Davidson & Co. - Analyst*

Okay, great. Thank you.

Operator

Andrew Liesch, Sandler O'Neill.

Andrew Liesch - *Sandler O'Neill & Partners - Analyst*

Just some more questions related to the loan yield rising this quarter. Was any of that driven by like higher loan fees or interest recoveries? Or maybe just was it from strength in -- or maybe the mix shifting towards more consumer loans? Just curious what else may have driven the loan yield higher.

Kevin Thompson - *Midland States Bancorp, Inc. - CFO, Midland States Bank CFO*

The loan yield and the mix was fairly consistent. It changed somewhat, but it really is solid growth in our repricing of our loan assets.

Andrew Liesch - *Sandler O'Neill & Partners - Analyst*

Okay. So really just improving pricing that you are getting across the board?

Kevin Thompson - *Midland States Bancorp, Inc. - CFO, Midland States Bank CFO*

Improving pricing, but as well as repricing of existing loans that are variable rate.

Andrew Liesch - *Sandler O'Neill & Partners - Analyst*

Great. And then just the pipeline for continued growth, it sounds like you guys are still running pretty optimistic. But are you thinking maybe it slows a little bit if the consumer is not going to grow as much in the coming quarters?

Kevin Thompson - *Midland States Bancorp, Inc. - CFO, Midland States Bank CFO*

Yes, I think that's fair. I think assuming that the consumer program is going to continue to grow at $70 million a quarter is not the right number. So that portfolio growth will slow as we move through the year, as we look at that to balance that portfolio against the overall portfolio from a mix and diversification of risk point of view.

Andrew Liesch - *Sandler O'Neill & Partners - Analyst*

Understood. And then were there any loan purchases in the quarter?

Leon Holschbach - *Midland States Bancorp, Inc. - Vice Chairman, President, CEO, Midland States Bank Vice Chairman and CEO*

No.

Andrew Liesch - *Sandler O'Neill & Partners - Analyst*

Very good. I'll step back. Thank you.

Operator

(Operator Instructions). Michael Perito, KBW.

Michael Perito - *Keefe, Bruyette & Woods, Inc. - Analyst*

Two questions for me, I guess. Number one, on the expenses, so it sounds like they are going to be a little higher over the balance of the year from the Centrue transaction. Is that excluding the costs that obviously will come on when the deal closes? Are you guys implying that the $29 million and $30 million, I think, expense kind of target you guys put out last quarter that, for the rest of the year here, like the legacy Midland expenses are going to drift higher than that?

Leon Holschbach - *Midland States Bancorp, Inc. - Vice Chairman, President, CEO, Midland States Bank Vice Chairman and CEO*

Yes. I think, as we begin to hire -- we need to hire some folks. And there will be some overlap between us hiring and then, after the conversion, the operational folks at Centrue, kind of those positions being eliminated will -- if you will, we will be doubling up on some staff for a period of time but then it will right-size itself again as we get past the conversion. So some of that hiring will start to begin this quarter. And then, obviously, when Centrue closes, whether that's in June or July of this year, that whole staffing is going to come in. So, that's kind of our thoughts there.

Michael Perito - *Keefe, Bruyette & Woods, Inc. - Analyst*

Any initial expectations or thoughts about where the total expense run rate could shake out in the early part of next year with the cost saves out and potentially some of those hires, I would guess, being removed?

Jeff Ludwig - *Midland States Bancorp, Inc. - EVP, Midland States Bank President*

Yes. So, I think, when we talked about that Centrue acquisition, we said 40% cost saves. That's a net number for us. So, that's our adds that we need to add their takeaways. And that net number of 40% cost saves is the cost save number we are talking about.

Michael Perito - *Keefe, Bruyette & Woods, Inc. - Analyst*

Okay. On the margin, it sounds like there's probably still some more room to move higher here on the loan yield side. I guess is that consistent with what you guys are seeing? I guess any commentary around what you are seeing on the funding side? Is it realistic with the March raise and then, depending on what your expectations are for the remainder of the year, that the core NIM could see some additional expansion?

Kevin Thompson - *Midland States Bancorp, Inc. - CFO, Midland States Bank CFO*

We see the same phenomenon that many banks see, that our assets, and many of our assets are variable-rate, that those rise immediately and there will still be some trickle as they continue to reprice. Of course, that will end at some point until the Fed raises rates again.

On the liability side, on the funding side, we see the phenomenon that oftentimes it has lagged, has lagged behavior and, of course, is inelastic in many ways. It doesn't rise as quickly in a lot of environments, as quickly as the asset size does. And that's why we are asset sensitive just like many banks. So we definitely benefit from this rising rate environment going forward.

Michael Perito - *Keefe, Bruyette & Woods, Inc. - Analyst*

All right. Just a couple more quick ones for me. Just on the tax rate going forward, so I understand that the new accounting guidance on the share comp can move around. But I think I heard in the prepared remarks that the overall tax rate should be lower because of this insurance establishment that you guys mentioned in the release. Is that the right way to think about it? And do you guys have a kind of an impact that that insurance side will have going forward?

Kevin Thompson - *Midland States Bancorp, Inc. - CFO, Midland States Bank CFO*

Yes. The insurance side is not very large. We still expect our effective tax rates on an unadjusted basis, the go-forward to be around 33%. And the insurance subsidiary benefits that slightly, less than 1%.

Michael Perito - *Keefe, Bruyette & Woods, Inc. - Analyst*

Okay. And then last one, just on capital for you, Leon. Once the Centrue transaction closes, you guys will lever the capital base pretty efficiently here. I think, in the past, you guys have discussed maybe trying to free up some capital and move on from the residential mortgage servicing business. Is that something that is still on your radar? And I guess any other updated thoughts on capital that are worth mentioning?

Leon Holschbach - *Midland States Bancorp, Inc. - Vice Chairman, President, CEO, Midland States Bank Vice Chairman and CEO*

Well, sure. So first on the MSRs, yes, we would appreciate an opportunity to recapture that capital and use it more effectively, but we need a little help with the 10-year treasury, Mike. So whatever you can do around that would be helpful. We need that thing up about 30 basis points from where it is. But we are prepared. The operations groups, for example, the mortgage team are prepared to execute on an MSR sale. We just need some help on rates.

And then, sure, so one thing we are very pleased about is that we will get to that closing sometime midyear, and we will be 13 or 14 months out from the IPO capital raise, and we will have fully leveraged that capital. We expect we will be able to, or we appreciated for the shareholders' sake that we did, yes. And then, from there, we will have to see what kind of acquisition opportunities are available and what demand for capital enhancement those might present.

Michael Perito - *Keefe, Bruyette & Woods, Inc. - Analyst*

And can you just remind us the Board's thoughts around dividend policy and the outlook there?

Leon Holschbach - *Midland States Bancorp, Inc. - Vice Chairman, President, CEO, Midland States Bank Vice Chairman and CEO*

Sure. Generally, so we are in our 16th year of increasing our dividend, just a snitch over 10% a year. We think that the -- and the Board strongly believes that the total return approach towards looking at our stock is best for all of our shareholders. And our expectation is for that kind of trend as we go forward.

Michael Perito - *Keefe, Bruyette & Woods, Inc. - Analyst*

All right, great. Thanks for taking my questions.

Operator

Terry McEvoy, Stephens.

Terry McEvoy - *Stephens Inc. - Analyst*

The $1.3 million of merger expenses last quarter, is that all in the other line, or is any of that spread out between salaries, etc.?

Kevin Thompson - *Midland States Bancorp, Inc. - CFO, Midland States Bank CFO*

Probably mostly in professional fees.

Terry McEvoy - *Stephens Inc. - Analyst*

I don't have your income statement in front of me. Is that number specifically broken out in the press release?

Jeff Ludwig - *Midland States Bancorp, Inc. - EVP, Midland States Bank President*

I think professional fees is.

Terry McEvoy - *Stephens Inc. - Analyst*

Okay, thanks. And then just one last follow-up, just getting back to Love, it was mentioned here on Slide 4 the permanent loans were up and that positively impacted revenue. From our standpoint, do we simply take the revenue in terms of gains and divide it by the lock rate, loan lock rates, to come up with that margin, which looks to go from -- going from 2.5% to 3%? Is that how we can back into that statement from a financial standpoint?

Jeff Ludwig - *Midland States Bancorp, Inc. - EVP, Midland States Bank President*

Yes. Yes, revenue is driven off of rate locks and we are showing gain on sales, so that's right. And prior quarters had some rate modifications, which are lower-margin transactions, and we had less of those in the quarter, and thus our margin was better in the quarter, and we would expect that going forward. As rates have drifted higher, there's less opportunity for rate modifications.

Terry McEvoy - *Stephens Inc. - Analyst*

Great, I'm all set. Thanks again.

Operator

Andrew Liesch, Sandler O'Neill.

Andrew Liesch - *Sandler O'Neill & Partners - Analyst*

Sorry, guys, you've covered my questions. Thanks.

Operator

I show no other questions. I would like to turn the call back over to management for any closing comments.

Leon Holschbach - *Midland States Bancorp, Inc. - Vice Chairman, President, CEO, Midland States Bank Vice Chairman and CEO*

Thanks for joining us, everyone. And we will talk again in a quarter.

Operator

Ladies and gentlemen, thank you again for your participation in today's conference call. This now concludes the program and you may now disconnect at this time. Everyone have a great day.