Camden National Corporation

Second Quarter 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Greg Dufour - *President, Chief Executive Officer, Director*

Deborah Jordan - *Executive Vice President, Chief Operating Officer, Chief Financial Officer*

PRESENTATION

Operator
Good day and welcome to the Camden National Corporation Second Quarter 2019 Earnings Conference Call. My name is Chuck and I will be your operator for today's call. All participants will be in a listen-only mode during today's presentation. Following the presentation, we will conduct a question and answer session. If you require operator assistance at any time during the call, please press star then zero.

Please note that this presentation contains forward-looking statements which involve significant risks and uncertainties that may cause actual results to vary materially from those projected in the forward-looking statements.

Additional information concerning factors that could cause actual results to differ materially from those in such forward-looking statements are described in the company's earnings press release, the company's 2018 annual report on Form 10-K and other filings with the SEC.

The company does not undertake any obligation to update any forward-looking statements to reflect circumstances or events that occur after the forward-looking statements are made. Any references in today's presentation to non-GAAP financial measures are intended to provide meaningful insights and are reconciled with GAAP in your press release.

Today's presenters are Greg Dufour, President, Chief Executive Officer and Director, and Deborah Jordan, Executive Vice President, Chief Operating Officer and Chief Financial Officer. Please also note that this event is being recorded.

At this time, I would like to turn the conference over to Greg Dufour. Please go ahead, sir.

Greg Dufour
Good afternoon and welcome. Earlier today, we released our second quarter 2019 earnings of $13.2 million which reflected an 8% increase over our second quarter 2018 earnings. Earnings per diluted share was $0.85 for the quarter, a 9% increase over EPS for the second quarter of 2018.

Our performance ratios for the quarter were also strong, with return on average assets of 1.21%, return on average equity, 11.63% and a non-GAAP efficiency ratio of 57.27%. This performance helped drive our first half results with earnings of $27.5 million and diluted earnings per share of $1.76, both an increase of 10% over the first half of 2018. These are record first half levels of performance for us and needless to say, something we are really pleased with.

In a few minutes, Debbie will review some of the specifics on our performance, but I'd like to first provide some insights into our markets. For the past year, we've seen strong loan growth with our portfolio growing over 8% from June 2018 to June 2019. In addition, our long-term focus on deposit generation paid off with 17.5% growth over the same period.

Over the past few months, we've seen several changes in the market. Overall, loan activity in commercial areas has slowed, we've seen a continued loosening of loan structures and we are seeing significant lowering of margins. Fortunately, we've built a strong team of lending and credit professionals. We can selectively pursue transactions, and, on an increasing basis, we are stepping away from transactions where the margins are too thin for our liking.

On the deposit side of the house, we're also seeing pricing pressures resulting in us being more selective. We're uniquely positioned as we have product and technology capabilities that allow us to compete against our larger competitors. At the same time, we have a great team of commercial, treasury and retail professionals on both the sales and service sides.

We're seeing many competitors in the marketplace putting in place pricing strategies we believe are not in our long term best interest. Here again, we expect to step away from some opportunities that we feel are not appropriately priced for short and long term market considerations.

Fortunately, with the loan deposit growth we've experienced over the past year, as well as our solid loan-to-deposit ratio positioning, we have the flexibility in these market conditions to remain opportunistic for the right customer and client.

As you know, we don't give a lot of guidance, but I will share we feel our view of looking at the long term will serve us and our shareholders extremely well. You'll also note that our total share repurchases were 166,778 shares for the first half at an average cost of $42.62 per share.

During the quarter, S&P Global Market Intelligence named Camden National to its list of the top 50 best performing community banks with assets ranging from $3 billion to $10 billion, and bankrate.com named Camden National as the most popular bank in Maine.

Finally, we are extremely proud that our Hope@Home program which addresses homelessness in our communities surpassed the $400,000 giving mark for donations to homeless shelters, since its inception in 2014.

I'd now like to ask Debbie to review our financial performance.

Deborah Jordan
Good afternoon, everyone. As Greg mentioned, we are pleased with our second quarter results with net income up 8% over the same period last year due to strong loan and deposit growth, net interest margin expansion and an increase in fee income.

When comparing results to the previous quarter, net income of $13.2 million decreased $1.1 million, or 7%, primarily due to a 5% increase in operating cost and a slight decline in net interest income.

Operating expenses reached an expected $24 million level for the second quarter, representing an increase of $1.2 million between periods. Foreclosure and collection cost increased $716,000 between periods, due to a recovery recorded in the previous quarter. In addition, personnel costs were up 4%, reflecting a full quarter of merit increases.

During the quarter, we had solid loan and deposit generation and healthy fee income growth. The loan portfolio increased $57.9 million since March 31st, with 8% growth in C&I balances and residential mortgages up 2%. We're very pleased with our net C&I growth of $34.9 million, with unit volume increasing for the quarter. Commercial real estate balances and home equity balances were slightly up between quarters.

Core deposits and CD balances increased $94.3 million, or 3%, between quarters. When adjusting for the shift of $70 million from checking to CDs related to one large deposit relationship, checking account balances grew 2% between quarters.

Despite solid loan and deposit growth for the quarter, the company's net interest income declined 1% compared to the previous quarter, due to a decrease in the net interest margin of 7 basis points to 3.11%. Net interest margin compression between quarters was the result of the asset yield decreasing 2 basis points and total funding costs increasing 6 basis points for the quarter.

The company's average cost of deposits was 0.86% for the second quarter. This reflects an increase of 8 basis points between quarters which was a little higher than anticipated. We have been happy with our management of funding cost over the rising interest rate cycle.

The Federal Reserve has raised its Fed funds rate nine times from December 2015 through June of this year, for a total increase of 225 basis points. During this period, the company's average cost of deposits increased by 60 basis points, resulting in a full cycle deposit beta of 27%.

Given the interest rate outlook of lower rates for a longer period and the company's current balance sheet position, we have taken several actions to reduce the impact to net interest income. We have emphasized fixed rate lending for both commercial and residential, and have added duration to our investment portfolio through more recent purchases. The company also entered into a $100 million hedge during the quarter to help protect us against downward rate movements.

In providing net interest margin expectations for the remainder of this year, we anticipate the 25 basis point Fed rate cut tomorrow to eliminate the benefit we normally received from seasonal core deposits in the third and fourth quarter. We estimate the impact of this will result in our net interest margin remaining relatively flat for the second half of the year.

The quality of our loan portfolio remains strong, with non-performing assets at the $15 million level for the past three quarters and year-to-date net charge-offs of under $500,000 or just 3 basis points to average loss on an annualized basis. The increase in provision expense between quarters was largely due to loan growth.

The final area worthy of mention is fee income. Our second quarter fee income topped $10 million, which is a 7% increase over the last quarter and a 6% increase over the second quarter of 2018. Fee income was up over each of these periods across most fee categories. The increase over the previous quarter was largely due to seasonality.

That concludes our comments on the second quarter results. We'll now open the call up for questions. Thank you.

QUESTION AND ANSWER

Operator
Thank you. And we will now begin the question and answer session. To ask a question you may press star then one on your touchtone phone keypad. If you are using a speakerphone, please pickup your handset before pressing the keys, to withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster.

The first question comes from Damon DelMonte with KBW. Please go ahead.

Damon DelMonte
Hey, good afternoon, guys. How's it going today?

Greg Dufour
Great, Damon. How are you?

Damon DelMonte
Good, thanks. First question, Deb, I was just looking for a little bit more color on the margin. I think you said that given some actions that you guys have taken to prepare for a rate cut and the rate cut coming in you expect to hold the margin relatively flat for the back half of the year. Is that correct?

Deborah Jordan
Yes, we still are slightly asset sensitive. With the Fed rate cut, normally you would see a slight decline in net interest income and margin. Keep in mind that the second half of each year we do get around a 2% pickup in our demand deposit base. What we are envisioning is the benefit that we have on the deposits will help offset the impact of a rate cut. When you look at our balance sheet, about one third of our loan portfolio will reprice in the next 30 days versus on our deposit side, it's about 18% that will reprice within 30 days. We certainly, like most banks, will feel a slight impact with the rate cut. The other thing that we're seeing in our markets, and you saw it between quarters, deposit rates are still moving up. We did great through the whole rising rate environment, but we knew we were lagging rate increases on the deposit funding. Although promotions seem to have dropped off, as well as our exception pricing, there's still a lot of competition in our market. We still think we're going to feel a little pressure on some of our deposits, especially if they shift to the CD side. What I'm hoping for is just a flat margin for the rest of this year, given our deposit seasonality.

Damon DelMonte
Got it. You mentioned in the deposits, this past quarter you had a large borrower that moved from the interest bearing checking accounts into CDs? Is that correct?

Deborah Jordan
Yes, that is correct.

Damon DelMonte
Okay. And then I guess quickly on loan growth, C&I growth this quarter was pretty strong. Any color on what drove the quarter-end balance increase?

Deborah Jordan
The great news on that is it came from all fronts. We had one larger credit of $10 million, but when we drilled in, our unit count was up 18% compared to the first quarter. Part of that is we have BusinessTouch which helps automate the application process. We really saw more activity on the banking center side…retail lenders participating on the business loan side. Across the board, we are happy to see that kind of volume.

Damon DelMonte
And then, Greg, your initial comments about some softening in the greater commercial market, in your footprint. How does that play into growth for the back half of the year?

Greg Dufour
Sure. What I'd say, Damon is we don't expect the first half growth to replicate, obviously, in the back half. However, as we've said all along, we look to mid single-digit loan growth and we're seeing it a little bit on the higher end. We expect what will happen on the back end and will bring us in on the year where we expect to be.

Damon DelMonte
Okay. That's that mid single-digit range?

Greg Dufour
Yes.

Damon DelMonte
Okay. Alright, great. That's all that I had. Thank you.

Greg Dufour
You're welcome. Thank you.

Operator
The next question comes from Matthew Breese with Piper Jaffray. Please go ahead.

Matthew Breese
Good afternoon.

Greg Dufour
Hi, Matt.

Matthew Breese
Yes, I just wanted to focus in on the margin and the margin outlook for the back half of the year. In years past, when I look from the second quarter to third quarter, it can vary in terms of the benefit you receive. I know the guidance is flattening, but without a Fed cut, what would have the margin benefit been? I want to get a good idea of what is expected to happen in 2020.

Deborah Jordan
Yes, Matt, I think we probably would have seen 3 to 4 basis point increase in the back half of the year.

Matthew Breese
Okay.

Deborah Jordan
If we didn't have a rate cut, and we weren't seeing some of this deposit competitive pricing pressure.

Matthew Breese
Right. Okay, and on both those fronts, you mentioned an increase of competition both on the loan front and on the deposit front. I was hoping you could provide some anecdote. For instance, if it's a C&I loan or CRE loan that you were both being competitive on, you lost it, how much more competitive is it on a rate and structure perspective? Could you give us some color there?

Greg Dufour
Yes, sure. It tends to be on the larger transactions which tend to be more CRE. The CRE market especially in our markets in New England are primarily broker driven. In effect, all deals are being shopped. I would say, on some credits, we're seeing that we could be out of the market as much as 50 to 60 basis points on a spread basis. Now, we will get competitive for the high credit quality deals, not to say that we would get down over our benchmark by that dramatic approach, but we will be more competitive on the pricing for better credits. We see 50 to 60 below…that's out of our box.

On the structure side, we still tend to see pressures to increase LTV, as well as, spread out amortizations. It's pretty normal to see the starting point on conversation or amortization being a 30 year mark. Right credit, right transaction, right market, that may be acceptable, but you can't apply that to all deals that come across the transit.

Matthew Breese
Right. Okay, and then just stepping back and looking at the numbers, that explains the last two quarters of commercial real estate growth. As we think about getting to that mid single-digit growth, should we consider residential and C&I loans pulling the wagon here?

Greg Dufour
They should. Of course, residential is always a bit more variable given the housing market conditions and whether we choose to hold them or sell them. It's a little bit more fungible asset that way. We do always want to see C&I grow, that's been a very long term strategic commitment for us. We are seeing some good movement, as Deb referenced, not just from our C&I lenders that tend to be aiming for the larger transactions, but we like those bread and butter small business loans coming through our retail and small business franchises. We do want to see more of that. The big struggle that probably all banks in our situation has is, it takes a lot of work to get $5 million of growth on a C&I book of business because that could be multiple loans and you can have one CRE deal doing $10 million. We always have to monitor that.

Deborah Jordan
Hey, Matt, and I will also say our mortgage committed pipeline is really strong, it's over the $100 million mark as of June 30th.

Matthew Breese
And that compares to…what did that compare to last quarter?

Deborah Jordan
Last quarter, I want to say we were at around $70 million.

Matthew Breese
Okay, well. Okay…

Greg Dufour
Again, this is seasonal, it should be a lot higher.

Matthew Breese
Correct. Yes. Okay, understood. And then just going back to expenses, they picked up this quarter and in the release, you note that there were some additional expenses tied to OREO, $360,000. First, is the $360,000 something that we should expect to continue? Then secondly,

if we were to back that out, you're still a little bit higher than what I was expecting. Is there anything else in there that is onetime or unusual in nature?

Deborah Jordan
Yes, I would say on a normalized basis, we should see around $250,000 a quarter in that line item. We did have something related to subservicing portfolio that hit during the quarter. That is not recurring, and that was about $300,000.

Matthew Breese
Okay. And then everything else was normal course of business?

Deborah Jordan
Yes.

Matthew Breese
Okay. And then the last thing I just wanted to touch on is our share repurchases. Given everything you've laid out in that environment, it's difficult, it's…growth will be a little bit more challenging. Could we see the pace of repurchases pick up and if so, to what extent do you think?

Greg Dufour
I would say that we always look at it almost like making an investment. Probably like anybody else, we prefer to buy on a dip. We get comfortable when we're trading up. I don't want to really make a commitment to pick up the pace or not, because it is just really price driven.

Matthew Breese
Right.

Greg Dufour
On the flip side of that, Matt, when you look at overall capital management, even though the share repurchasing is a good tool and a tool we believe in, looking at the economic conditions, we're still capital focused, if you will, for whatever may pop up over the next few quarters here or several quarters.

Matthew Breese
Right, okay. That's all I had, I will leave it there. Thanks for taking my questions.

Greg Dufour
You're welcome. Thank you.

Deborah Jordan
Thank you.

Operator
Again, if you a questions, please press star then one. As we have no further questions, this concludes our question and answer session. I would like to turn conference back over to Greg Dufour for any closing remarks.

CONCLUSION

Greg Dufour
Thank you, Chuck. I want to say we are pleased with the quarter, pleased with our positioning for rate declines and economic conditions. As with anything, I do want to recognize, for those of you on the call, our shareholders and investors, really we have a great team of people that are getting a great job done for us, positioning us well. They have put a lot of thought and a lot of hard work into that. I just want to publicly acknowledge and recognize those efforts.

With that, I also, as always, appreciate your attention and support of the company. Have a great day and look forward to talking to you all in the future.

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