Camden National Corporation

First 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 First Quarter 2019 Earnings Conference Call. My name is Chad, and I will be your operator for today's call. All participants will be in 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 "*" then "0."

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 in 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 call 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 today's event is being recorded.

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

Greg Dufour
Thank you, and welcome to Camden National's first quarter earnings call. Earlier today we announced record quarterly earnings of $14.3 million or $0.91 per diluted share. I am happy to share a few thoughts on the quarter to be followed by Debbie's review of the financial results.

First of all, we are thrilled to start-off the year with such a strong note, continuing our momentum from last quarter. We had really strong commercial loan closings in the first quarter, although, total loan growth for the quarter was up slightly. This was due to increased prepayments we experienced driven by some of our commercial customers being acquired by other organizations and the lower interest rate environment driving refinancings. One example, as we noted in this morning's earnings release, was one commercial real estate customer refinanced $39.2 million of balances directly with a government-sponsored entity. We're still comfortable with our mid single-digit loan growth expectations, and we are monitoring the environment very closely.

Secondly, our net interest margin of 3.18% for the first quarter 2019 remained relatively stable compared to the previous quarter, supported by our investments in retail and commercial deposit gathering strategies that are proving beneficial in the current interest rate environment. However, we remain cautious and are closely watching both loan and deposit pricing in our marketplaces. Our 85% loan-to-deposit ratio places us in a strong position compared to other Northern New England institutions. We understand that deposits are at a premium and the need to protect our deposits is critical as other organizations may need to raise deposits through increased pricing.

Finally, we continue to see strong asset quality as the markets we operate in remain stable. We have seen some narrowing of loan margins and changes in credit structure and feel we have the balance sheet position, margins and ability to analyze the risk/reward opportunities in the market.

In addition to a $0.30 per share dividend, which translates into a 2.88% annualized dividend yield, through the end of last week, we repurchased nearly 96,000 shares under our repurchase program that started in January that average price was $41.87 per share.

To wrap up, we will be holding our Annual Shareholder Meeting later this afternoon and we'll be posting material from that meeting to our investor relations website shortly.

I like to now turn it over to Debbie to review the financials.

Deborah Jordan
Thank you, Greg and good afternoon everyone. We are pleased to report our first quarter results with quarterly net income of $14.3 million, resulting in a return on average assets of 1.33% and a return on average tangible equity of 17.08% for the quarter.

Net income increased $296,000, or 2%, compared to the previous quarter due to lower operating costs of $787,000 and growth in net interest income of $308,000, partially offset by an increase in the loan loss provision. Compared to the previous quarter, net interest income increased 1%, as we benefited this quarter from a strong finish to last year, with a surge in both loan and deposit growth.

Average loan and deposit balances were each up 3% compared to a quarter ago. When compared to the fourth quarter, our net interest margin declined 3 basis points this quarter, as asset yields increased 9 basis points, while funding costs increased 13 basis points. When excluding fair value accretion, net interest margin was flat between periods at 3.14%. Net interest margin was a little higher than anticipated in the first quarter as overnight borrowings were lower than usual this time of year due to our total deposit levels.

Our loan portfolio increased $16.2 million since December 31st, with just under a 1% growth rate. Residential mortgages grew 2% between quarters with about a 50/50 mix of adjustable rate mortgages versus fixed rate jumbo mortgages.

Commercial real estate balances declined 1% since year-end despite healthy loan origination volume as prepayments were almost double our normal rate. The larger commercial prepayments were anticipated and we expect to return to lower prepayment levels this quarter.

Total deposits grew $113.7 million, or 3%, between quarters. Interest checking balances were up $140 million since year-end primarily due to larger commercial deposit relationships, which included new funds and a shift from money markets to interest checking.

Brokered deposit balances also increased during the quarter by $70.7 million as we use brokered funds as an alternative to borrowings.

Total fee income declined $90,000 between quarters, or a 1% change. Debit card income decreased $829,000 between periods due to the seasonal decline in activity, as well as, receiving an annual Visa incentive bonus in the previous quarter. Partially offsetting the decline was an increase in back-to-back loan swap fee income of $124,000, as well as, security losses of $420,000 recorded in the fourth quarter of last year.

As Greg mentioned, asset quality remained strong with annualized net charge-offs of 3 basis points of average loans for the quarter, and a loan loss provision of $744,000 which translates to 10 basis points on average loans.

The increase in provision expense between quarters was largely due to the favorable resolution of a commercial credit in the fourth quarter last year that freed up our reserve on this relationship.

Operating expenses decreased $797,000 between quarters primarily due to the change in total collection costs of $677,000 between periods as certain expenses recorded in the fourth quarter were fully recovered in the first quarter. In forecasting the remainder of 2019, we anticipate our efficiency ratio to range between 57% and 57.5% as we expect to see increased operating cost related to compensation, occupancy and technology.

That concludes our comments on the first quarter results. We'll now open the call up for questions. Chad.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press "*" then "1" 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 "*" then "2." At this time, we will pause momentarily to assemble our roster.

The first question will come from Matthew Breese with Piper Jaffray. Please go ahead.

Matthew Breese
Good afternoon.

Greg Dufour
Hi, Matt.

Matthew Breese
Hi, I wanted to start by getting a little bit color on the net interest margin, that came in very strong this quarter and maybe to kick it off, in the release you mention that you have some large commercial deposit relationships that provided much of the deposit growth this quarter. You also note that it's subject to variability in balances. And so, as you look at what came in this quarter, could you just give us some better color around the stickiness of the relationships that came in and whether or not the margin was in any way artificially inflated this quarter due to that?

Deborah Jordan
Yes, Matt. I'll be happy to answer that. Some of the funds have actually already out-flowed, some have moved into CDs. And so, that's why we highlighted it in our earnings release. It is going to be more variable than in the past, and that certainly helped the margin a little bit. I think we have been fairly solid in managing our cost of funds, so that increase just has

happened as fast. I do think in the second quarter, when I look at our net interest margin, we are going to see a trend down of two to three basis points.

Matthew Breese
Right. Okay, 2 to 3 basis points in the second quarter. Now, as we think about the back half of the year, that's typically when you start to see some inflows of lower costs and deposits and, usually, we see a little bit of a bump in the NIM. Last year it was may be 8, 9, 10 basis points. Could you just describe given the backdrop of where the Fed is now? How you expect that the back half of the year NIM to behave?

Deborah Jordan
Sure, we are asset sensitive, and so certainly with the rising rate environment we were having our asset yields on the loan side in particular re-price at a higher level. So we were lagging our increase in cost of funds, and we were getting that pick-up in the net interest margin. Now, that it looks like the Fed is on hold, we won't be getting that asset yields pickup and our volume for the first quarter on the loan side went on at our portfolio yield. So we are not going to get any lift on the asset side. I think we are going to continue to see cost of funds edge up a little bit, and so when I take a step back and look for the remainder of the year, I think on average for the year we will be at our current level. You are right, we do have seasonality, so we'll see NIM drop down in the second quarter, but then we'll have a pickup in the third and fourth quarter NIM, but we will see our cost of funds rise a little bit.

Matthew Breese
Understood. Okay, if you could just give us some color on the loan growth and the competitive dynamics in your markets and how things have changed? And then give us a sense for this quarter's pipeline versus last quarter…that would be helpful.

Greg Dufour
Sure. And, let me start off with the competitive environment. It really is trending as we have seen it for the past couple of years. We have several strong good community bank competitors that are getting into transactions. Over the past couple of years, they tend to be up-scaling the size of deals that they will play in. Probably a bigger change is we're seeing more national players come into the market. Wells Fargo has an office in Portland. JP Morgan Chase opened up a loan office in Portland as well. And they're starting to play in some of the deals. The deals they play in tend to be on our upper-end obviously, but they are getting in there. So that makes it a pretty frothy market on the loan side.

From a pipeline perspective, we're seeing the pipeline come down, but that's because we had been running at record levels for two quarters. So we do expect that to come down, and that works into where we're comfortable with that mid-single-digit loan growth for the year.

Matthew Breese
Understood, okay. My last one is just in terms of M&A, potential M&A. I want to get a sense for how conversations are going, if there are any conversations? What parts of your geography that could happen? I understand it's probably a little bit more limited in terms of potential partner candidates, but I just wanted to get a sense for any activity that you're seeing.

Greg Dufour
Sure. We don't really comment on anything that we're doing on the M&A front, but, taking a step back. looking at the market, especially in the growth area or the target area that we have previously identified which is Southern Maine with Eastern Massachusetts and the like, those

players tend to be on the smaller side on the scale spectrum. But it's a pretty frothy market, especially if you're on the sell side. The good thing is that we're disciplined, we have spoken to a lot of investors and we understand the requirements for tangible book value earn-back and are focused on that. We feel that's a prudent way, in the long-term, to preserve our capital. We have shown as most recent as 2015, for the Bank of Maine acquisition, what's happened since then and we are very confident in our ability to execute on a transaction that we feel is appropriate for us.

Matthew Breese
Understood, alright. That's all I had. Thanks for taking my questions.

Greg Dufour
Great, thank you, Matt.

Operator
And our next question comes from Damon DelMonte with KBW. Please go ahead.

Damon DelMonte
Hi, good afternoon, guys. How is it going today?

Greg Dufour
Great, Damon. Thank you.

Damon DelMonte
Great. First question I have is on expenses. I may have missed some of the guidance that Debbie had given, so I know that there was a reversal in the OREO line item. So if we back that out and normalize that, it’s something in that $23 million, close to $23.5 million range for the second quarter. Is that a reasonable expectation?

Deborah Jordan
No. I think it's going to run higher than that. In the last quarter, I had said we expect to be around the $24 million mark on a quarterly basis going forward.

Damon DelMonte
Okay alright. Got it, that's helpful. On the fee income side, how are you looking at mortgage banking going through the second and third quarters, which typically are seasonally strong? I think first quarter here was little bit better than what we've seen in the fourth quarter and you had some weakness due to seasonality in the first quarter. So how do you think the middle part of the year shaping up?

Greg Dufour
We look at it as it will be good. It remains to be seen how refinancing will go through that business at this point. From a new home perspective, it's not as strong as in the peak of the market, but we are seeing and we are hearing reports that just the buying is still strong but tempered…it's not multiple offers coming in on homes, that type of thing. I think our benefit, when we look at the mortgage business, isn't just the level of the market activity, but the fact that we're expanding into that business line. We have a good model, we can bring in strong mortgage loan originators and get them up to speed relatively quickly, and we have a great processing area that can execute on those transactions when they come in.

Damon DelMonte
Got it. Okay. Okay. That's covers what I had. Thank you very much. Appreciate the color.

Greg Dufour
My pleasure. Thank you, Damon.

Operator
Once again if you have a question please press "*" then "1." We have a follow-up question from Matthew Breese with Piper Jaffray. Please go ahead.

Matthew Breese
Me again. Just a couple of follow-ups, if you don't mind.

Greg Dufour
No problem.

Matthew Breese
Just looking at your usage of capital, capital deployment, we saw a little bit of buyback this quarter. How are you thinking about using that lever? Do you think it will be more supplemental, or are you driving to a capital target? Just help us learn a little bit more about that plan.

Greg Dufour
Yes. Well, we're fortunate. We do have a capital committee of our board, which provides a lot of guidance and conversation that we have. And I think the guidance I'd give is really is block and tackling. Do we feel that we have a use of capital…there is obviously the M&A question part of that, but it's also the loan growth question that we want to maintain adequate capital to support that, and we're fortunate that we do. Once you get through that, then you get into, what is the right, call it target levels. We really don't disclose what those target levels are, but we do look at ways that we can return capital when we don't feel we need it. And, I think if you look historically at our history, that we do pretty well returning capital even through increasing dividends or repurchases like we're undergoing right now or even special dividends. And those are the discussions that we have in our board as we take that further future outlook.

Matthew Breese
Understood. And then following that line of questioning, how does the strategy on security portfolio fit in? And what should we expect there?

Deborah Jordan
Yes. We have a portfolio of a little over $900 million. We actually did a shift at the end of last year where we moved the bulk of our held to maturity into the AFS category. One, we had enough capital to absorb some of the volatility, but, also, we want to have the flexibility if we decide to restructure the portfolio. We keep roughly 24% of investments in assets. In the past that's run higher. We continue to have conversations, do we deleverage a little bit on the balance sheet side? We have a lot of flexibility on the investment side. We structured it that way so we have solid predictable cash flow coming from investments, so we can either decide to reinvest or deleverage. One of the things that we're having a lot of conversations on is where do we think the rates are going in the long-term and is it time to start extending out on investments. We're talking about that at ALCO meetings at this point, so we will use the investment portfolio to help manage interest rate risk, and we structured it to give us the greatest flexibility.

Matthew Breese
Okay, understood. Alright. And then last one just in regards to CECL. As I look at your reserve compared to a charge-offs, so historical charge-offs, it seems like you have north of five years with the charges-offs in your current reserve. So just thinking about where your first dates for preserve could go under CECL? Could you provide some color on what that could look like? And whether or not you're in a position to increase or even release a little bit of the reserve?

Greg Dufour
Sure. Well, we're not ready yet or willing yet to give out any estimates what we expect the financial impact of CECL will be. But within CECL, I will say we have been focused on this for about 3 years. We've got a strong team working through this, and I know there is a lot of talk about potential postponements, which from an industry perspective we support postponing it, because I think it's right for some, but we will be ready to go on January 1, 2020.

Matthew Breese
Got it. Okay. That's all I had. Thanks again.

Deborah Jordan
Thanks, Matt.

Greg Dufour
Thanks, Matt.

Operator
As we have no further questions, this concludes our question and answer session. I would like to turn the conference back over to Greg Dufour for any closing remarks.

CONCLUSION

Greg Dufour
Well, first of all, thank you all for taking the time to spend with us here on this earnings call and obviously review all the material that we're sending out. It really speaks to the engagement that we have from the analyst community, investor community, and our owners. That's really greatly appreciated, we are thrilled, that it's been a great quarter for us. And we're looking forward to the meeting this afternoon with other shareholders. I wish everyone a great day.

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