Camden National Corporation

Q1 2020 Earnings Conference Call

Tuesday, April 28, 2020, 1:00 PM Eastern

CORPORATE PARTICIPANTS

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

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

Greg White - *Executive Vice President, Chief Financial Officer*

PRESENTATION

Operator
Good day and welcome to the Camden National Corporation First Quarter 2020 Earnings Conference Call. My name is Grant, 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 "*" 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 2019 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, Deborah Jordan, Executive Vice President, Chief Operating Officer; and Greg White, Executive Vice President, Chief Financial Officer. Please 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 thank you, Grant. I want to welcome everyone to Camden National Corporation's first quarter 2020 earnings release call. I hope you, your families, and associates are healthy and safe during this very trying time.

I'd like to welcome to the call Greg White, who joined us on April 15th as our Executive Vice President and Chief Financial Officer, as well as, recognize Debbie Jordan, who announced her intention to retire on April 30th from the company last October, but has agreed to stay on as EVP and Chief Operating Officer until early-June to help assist with the transition and help oversee our coronavirus response work. Bill Martel also joined us as Executive Vice President of Technology and Support Services on April 30th. Both Greg and Bill joined a very strong staff in their respective areas who, along with all of our leaders and employees, have done an amazing job the past several weeks.

We provided a presentation for your review in addition to our normal earnings release information. But before we review that, I'd like to provide a few comments regarding our approach and response to the coronavirus pandemic.

At the outset of the crisis, our focus has been on our four constituents – employees, customers, communities, and our owners. Believing that our employees are our greatest asset, we took several actions to ensure their safety, wellness, and economic wellbeing.

As our local schools closed, we took immediate action to revise our paid time off policies, allowing many employees to work from home or access their paid time off to care for their children or the loved ones. We also announced, we would provide financial support, once PTO was exhausted.

We added $100,000 to our Employee Emergency Relief Fund to help those employees that may experience financial stress due to a variety of factors, including spouses and significant others, who may be laid off.

To help make our work environments as safe as they could be, we moved over 300 additional employees to work-from-home status and provided premium pay for those employees who would be working in our banking centers and the other high-risk areas.

Even though our employees are personally going through an extremely stressful period, I am proud of how they responded to our customers. Just some of the examples include that, we transitioned our retail banking centers to service customers by drive up or in our lobbies by appointment-only.

In March, we saw our banking center transactions decline by 13% compared to the same month last year, while our digital banking activity increased 14% and calls to our customer care center increased by 16%.

Our response to the CARES Act, Paycheck Protection Program has been significant with 1,649 loans totaling $197 million processed as of April 22nd, and behind the scenes we asked over 70 lenders, portfolio managers, banking center managers, and loan processing employees to be reassigned to this effort. We were also one of the first banks in Maine to offer payment deferrals and late fee waivers as well.

As of April 22nd, we have provided payment deferrals on over 1,500 loans with outstanding loan balances of almost $550 million. We asked nine individuals to shift from their normal work duties to assist our special assets and collection teams.

Equally as important is our role in the communities we serve. Usually, our employees are hands-on with the many community organizations we work with, and they are frustrated by being limited during this time, but our support has included leveraging our Hope@Home efforts with local homeless shelters, which provides unrestricted funding to those who serve the homeless. We're providing financial support to local food banks, and we initiated support to Finding Our Voices, an emerging organization that provides support to victims of domestic violence, an issue which is increasing during this time of isolation.

Our focus on our owners, our shareholders, is equally as strong. In addition to our financial results, which Debbie will discuss, I'd like to point out a few highlights on our current financial strength and position. As of March 31st, 2020, we had a tangible common equity ratio of 8.78%, our Tier 1 leverage ratio of 9.53%, and a total risk-based capital ratio of 13.81%. This provides a solid capital capacity as we enter the uncertainty in the next several weeks.

Asset quality was in a strong position at March 31st, 2020, with non-performing assets at 0.23% of total assets and an annualized first quarter net charge off of just 5 basis points of average loans. Our reserve for loan losses was $26.5 million at March 31st, 2020, or 0.84% of total loans.

During the first quarter of 2020, we provided $1.8 million provision expense for loan losses. We decided to delay adoption of CECL, as allowed by the CARES Act, so we could reallocate resources to our pandemic response activities and further support our customers during this time.

We repurchased over 217,000 shares in the first quarter before suspending the program on March 20, 2020, as health crisis unfolded, and we prioritized capital preservation. After analyzing our capital position, we declared a $0.33 per share dividend for the first quarter.

I'd like to now introduce Debbie, who will provide a more detailed financial review.

Deborah Jordan
Good afternoon, everyone. We appreciate you joining us for the call today. I will spend a few minutes reviewing first quarter operating results, as well as highlight a few items included in the supplemental earnings call presentation that was included within our release earlier today.

Net income was $13.5 million for the first quarter, resulting in a return on average assets of 1.21%, and return on tangible common equity of 14.35%. In comparing results to the previous quarter, net income declined $1.7 million, or 11%, as a result of an increase in credit provision of $1.6 million combined with a 2% decline in revenue between periods.

From a pre-provision perspective, we had a solid quarter of operating results. Since year-end, our loan portfolio grew 2% with increases in both commercial real estate and C&I loans, and our total deposit base grew 1%.

Net interest income of $31.8 million, declined 1% from the previous quarter due to a 4 basis point decrease in our net interest margin to 3.08%. We are very pleased with our margin at this level, which was nearly flat compared to the previous quarter, when excluding prepayment fees that drove a 3 basis point increase in our fourth quarter margin. Back in January, we forecasted net interest margin to be around 3.05% in the first half of 2020. Obviously, the interest rate environment has changed significantly since then, but we are still targeting that margin level. Despite the ongoing pressure of our loan and investment yields re-pricing down, we have been aggressive in reducing our funding cost.

On page six of the supplemental earnings call presentation, we've reported deposit costs for the last six months, including a month-over-month decline of 15 basis points in March.

On a linked quarter basis, fee income for the first quarter of $11.4 million decreased 5% compared to the fourth quarter. Last quarter we recognize equity security gains of $866,000 and our annual debit card incentive of $579,000. Banking fees increased $1.4 million between periods, due to record level refinancing activity. Our mortgage pipeline at March 31st was $258 million compared to $89 million at year-end.

Operating expenses of $24.6 million for the first quarter declined 1% compared to the previous quarter, and our non-GAAP efficiency ratio for the quarter was 56.45%.

As disclosed in our earnings release, the company did not adopt CECL during the first quarter, as we refocused internal resources on pandemic-related activities, including the loan relief programs discussed by Greg. The company will adopt CECL, as required by the CARES Act, at the earlier of the termination of the national emergency concerning COVID-19 or December 31. This will likely have the effect of increasing the allowance for loan losses and reducing shareholders' equity. The company expects to continue to exceed regulatory capital requirements under current regulatory calculations.

The increase in the loan loss provision for the first quarter was driven by growth in loans and the uncertainty around the current economic environment resulting from COVID-19. We would expect the level of provision for loan losses in 2020 to increase as more data becomes available regarding trends in our loan portfolio and the economic conditions in our geographic footprint.

The supplemental presentation includes information related to our investment and liquidity position, our loan portfolio, and regulatory capital capacity. In particular, pages nine and ten of the presentation provide additional transparency into our loan mix and industry concentrations. It is difficult to quantify the COVID-19 impact to our customers. We have, however, disclosed segments of our portfolio that we believe are more susceptible to the impact of COVID-19.

As of March 31st, 2020, lodging represented $252 million, or 8% of total loans outstanding. Over half these loans are from major hotel brands and most of the properties are managed and owned by operators as their primary business. The total exposure in this segment is within New England, with our major exposure primarily on properties located within major cities such as Portland, Portsmouth, Boston, and Burlington.

In addition, our top 10 clients account for almost 50% of our commercial real estate hotel exposure. Each of these sponsors have extensive hotel experience. Slides 12 and 13 of the presentation depict our strong asset quality and capital position as of March 31st.

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

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.

Our first question will come from Damon DelMonte with KBW. Please go ahead.

Damon DelMonte
Hi, good afternoon, everyone. Hope everybody is doing well today.

Greg Dufour
Hi, Damon.

Damon DelMonte
Great. So, first question, just talk a little bit more about the margin, Debbie, could you just kind of repeat your thoughts on the margin? You said last quarter your expectation for the first half of the year was to try to hold it around 3.05% for the core margin. And you kind of feel that you could still do that at this point?

Deborah Jordan
Yes, when we forecasted the 3.05%, we didn't have the 150 basis point decline and Treasury rates coming down. And so, normally, I would say, we'd see more margin compression, but we

were fairly aggressive on our deposit pricing. And that's why in the supplement, we provided the monthly deposit cost, because we really even haven't felt the full effect of our deposit repricing strategy in March. So, that will continue to trend down. And then we have index funding that's also going to reprice down. So, we believe the step down in our funding cost is going to offset the step down on the asset side. So, we're hoping for that 3.05% level.

Damon DelMonte
Got it. Okay. And so, the reported was 3.08% this quarter. Was the core actually 3.05%, like you usually have a little bit of accretion income in there, right?

Deborah Jordan
Yes. I think its 2 basis points differential, and…Yes, the core margin was 3.06%. The fourth quarter core margin was 3.09%.

Damon DelMonte
Got it, okay. Great, and then you know, just with respect to the outlook for provisioning, obviously, with the incurred model, and so you start to see some more deterioration, the provision levels will remain lower than, obviously if you are under CECL. Do you have an idea as to where you think the loan loss reserve level should kind of trend towards, I mean, you did 3 basis points this quarter, would we expect something along those lines again or do you expect a sizable increase in the second quarter?

Deborah Jordan
Well, a couple of things. One, we will be adopting CECL if the national emergency gets lifted. And so, we have gotten pretty far along on the CECL modeling. If we had adopted as of March 31st, we could have seen our allowance increase by 25% to 33% as of March 31st. So yes, with CECL going live, we definitely will see higher provisions for the company.

Damon DelMonte
Got it, okay. Okay. And then, I guess, just this last question. Are you guys expecting net loan growth here in the second quarter and in the third quarter, just given what's going on in your economies, or do you think that things kind of just hold steady as people try to kind of get the feedback underneath them?

Greg Dufour
Sure. I think, Damon, we'll be happy with it holding steady. And honestly, a lot of our focus is just on the loan deferral and PPP programs right now. As is our customers.

Damon DelMonte
Got it, okay. And then, I guess, one last quick question on the PPP. What was the average rate for those loans…like average fee?

Greg Dufour
Well, the average fee, I don't have that. I don't know if you do, Debbie.

Deborah Jordan
It was over 4%.

Damon DelMonte
Over 4%. Okay, great. That's all that I had. Thank you very much.

Greg Dufour
Alright. Thank you, Damon.

Operator
The next question will come from Jake Civiello with Janney. Please go ahead.

Jake Civiello
Hi, good afternoon, everybody.

Greg Dufour
Hi, Jake.

Deborah Jordan
Hi, Jake.

Jake Civiello
Hi, so mortgage banking fees. Maybe I'll start there. They were nice surprises in the quarter, especially in what's usually a seasonally slow period. What trends are you seeing there today and then how are you thinking about the business as we enter a time of year when sales volume normally ticks higher in conjunction with what's going on with COVID-19 of course?

Deborah Jordan
Greg, I'll take that one. We hit an all-time high with the mortgage pipeline and it continues to step down from the March 31st level. I will tell you we will hit a record…almost $100 million of mortgage closings in the month of April compared to $500 million last year. So, we do see that pipeline coming down as we work through a number of refinance activity. It's hard to predict the second half of the year. I mean, we'll be working what's in the pipeline now. And we do have new applications coming in, it is mostly refinancing activity, as you would expect. So, I think the first half is going to be really solid. The second half it is really is difficult to forecast what that looks like.

Jake Civiello
No, that's fair. And I can certainly appreciate that…appreciate the color in the second quarter certainly. Related to mortgage banking revenue, is there any timing difference at all for when you recognize the revenue and then when the corresponding incentive compensation is actually paid out?

Deborah Jordan
There is a little timing. And, of course, at quarter ends you have, you do a fair value mark on the commitments. So, it's not a cash gain as of March 31st. And so, you're right, we recognize that gain in the first quarter, we'll be paying commissions in the second quarter. So, there is a little bit of timing.

Jake Civiello
Okay. Alright, thanks for that. With respect to the deposit side, how much do you have in municipal deposits? And then is there any meaningful impact that you can see to timing of funding, as many cities and towns are potentially delaying their real estate and property tax payments?

Deborah Jordan
Yes, we do have a sizable municipal deposit base at the state level and the local level. And we normally this time of year see a seasonal outflow in the first quarter. We have not seen that and some of that is certainly related to the municipal side. Governments are getting more money, and so that has resulted in a little higher cash level than we would expect at this time a year. It's hard to predict what our seasonal inflow in August and September. We don't anticipate that kind of pickup for this year.

Jake Civiello
Okay. That's helpful…helpful color. Thank you very much. Coming back to the margins, the 3.05% that you referenced for the first half of the year, is that inclusive of the PPP loans that you have booked to-date and inclusive of what you might expect to add in kind of the second tranche of funding that's come along?

Deborah Jordan
Yes, great question. It excludes the PPP. We have not run the margin with that included. Obviously, we'd get a pickup with the average fee on those PPP. I do have to correct myself, our average fee is 3.5% not the 4% that I provided, Damon.

Jake Civiello
Okay. So, the fee is 3.5% plus you get the 1% rate on top of it?

Deborah Jordan
Right, yes.

Jake Civiello
But the timing for receiving the fee is obviously impacted by whenever the forgiveness process starts. So, I'm assuming that in the short term, that your reported margin will probably be negatively impacted by the PPP, due to the fact that you, assuming that you don't have a meaningful amount of the loans forgiven in the second quarter. Is that fair to say?

Deborah Jordan
Yes. We'll be amortizing the fee upfront. You're right. And so, the true benefit comes when the loans are forgiven.

Jake Civiello
Okay, cool. Thanks. Then one more for me, if I can. This is kind of more theoretical, I guess. So, the main economy is generally thought to be heavily reliant on tourism that kind of gets amplified in the summer months. Some reports I've seen mentioned Maine as one of the most economically impacted states in the country from COVID-19. I know it's a tough question obviously, but can you quantify what percentage of your loan portfolios you think has outsized exposure to seasonal businesses that have some reliance on tourism?

Greg Dufour
Well, I think if you look at just the tourism aspect of it, Jake, that anything related to hospitality is obviously impacted by that. Then you get into the restaurant, which is about 3% of the commercial book. So, you're right. We have to see it play out to see what happens with not only people returning to work, but people returning to normal and being back out socially.

Jake Civiello
That's fair. I know it's a tough question to ask, but there's so much uncertainty, I guess, that any additional color that you're able to provide is helpful.

Greg Dufour
What I will say is, and part of the loan deferral program, our commercial team, led by Tim Nightingale and special assets, led by Al Butler, as well as our CRE team started to reach out to all the hospitality loans that we have, their sponsors, their owners, to really start talking to them and getting a feel for what they're seeing. That only gets us up to this point in time. But opening up those communication channels now will help us better understand as the next few months unfold for all of them.

Jake Civiello
Is most of the deferral activity to-date in that kind of 13% of total loans that you identified, those the lodgings, living facilities, restaurants, things like that?

Greg Dufour
Yes. I don't have that broken down by within the commercial book. I can say right now, the deferrals are leaning a little bit more to the commercial side. We expect the retail residential side to pick up probably over the next coming weeks. I don't have that breakdown within hospitality, within that, call it, commercial breakdown.

Deborah Jordan
Greg, I have that. Regarding the lodging portfolio, in particular, about 70% of the balances have elected to do the 90-day deferral.

Jake Civiello
Okay, great. That's it from me. Thank you for your time and see you all.

Operator
Again, if you have a question, it is "*", then"1", "*", then "1" to ask a question.

Our next question comes from William Wallace with Raymond James. Please go ahead.

William Wallace
Good afternoon, Debbie.

Greg Dufour
Hi Wally.

Deborah Jordan
Hi Wally.

William Wallace
As a follow-up to the last line of questioning, since I'm kind of new to the name and newer to Maine, can you talk a little bit about the tourist season, when it starts to pick up? When are maybe the peak months? And then, I'm curious to know how far in advance in the lodging sector do people book trips to Maine? And if it is, say, two or three months in advance, are those trips being canceled? Or are we in wait-and-see mode?

Greg Dufour
Yes. Typically, we would see, call it, the shoulder season starts off, call around Memorial Day. And starts to really ramp up from 4th of July to Labor Day with the peak within August. Then typically, we should see a pretty good, solid shoulder season from Labor Day through mid- to late October. That's the, call it, the normal cycle that happens. The whole reservation industry has changed quite a bit over the past 10 years, if you will. It used to be people would book months and months ahead of time. And no matter what, they would always follow through in that reservation. So, where now people will change those reservations very quickly because the online feature of it. But it goes property-by-property and location. If you're looking for a place, Coastal Maine, there are some higher-end properties that you got to be a year ahead of time. There are some that you can be two or three months. If you're looking for a room in downtown Portland in August of last year, you probably should have been a month or two, at least ahead of time.

It's one thing that the bookings are definitely changing right now. And first of all, I think everyone is in a wait-and-see mode. First of all, the hotels have to open up and to figure out if the guests are going to show up. And that's where everybody is. I know not necessarily a hotel, but I had a conversation with a restaurant owner the other day. He's struggling with, when do I open my doors? If I can open them, who's going to show up?

And that's the big question right now. And I think as we get clarity around return to work, and you're seeing this even in the big cities and what those terms are in return to work and opening up restaurants, hotels, that will help determine what guests and customers will do. So, it's kind of a chicken-and-egg type of scenario right now that I think everybody is in. No one really has a clear answer.

William Wallace
Okay. And then, what at the peak, what portion of your deposits are coming from customers that rely on the tourism industry? In other words, if we're not back to some resemblance of normal in Maine through July and August time, what kind of pressure might you see in your core deposit portfolio? Any way to measure that?

Deborah Jordan
I think it is a little challenging to measure that, but you are correct that when you think of the impact of this, it's more than just the loan side. Its also the deposits. We normally get deposit pickups because a lot of businesses and individuals are benefiting from the summer season for us. And so sorry, I don't have a great answer for you right now, Wally, on that. It's hard to estimate.

William Wallace
Understood.

Greg Dufour
And this is where it'd be good if Debbie and I were across the table from each other, looking at each other, but we're socially distant in distant rooms, but I do recall Debbie saying in a few calls ago, our deposit base has shifted dramatically over the past five years. We have a lot more commercial deposits that we have built up as well as retail deposits. And Debbie, I remember you saying that even though we've expanded it, we have very big commercial customers that aren't necessarily related to tourism, but we still have that seasonal flow. And so, I would just say, Wally, that yes, we'll still have that seasonal flow, but that our deposits

aren’t solely dependent on that, even though it's a big part. But we have built up a really good core, albeit may be dependent on other industries.

William Wallace
Okay. Alright. Thank you. Last question is, as it relates to PPP with the second part of it opening up this week, can you give us a sense as kind of the amount of loans in the pipeline that you would hope to get approved in round two?

Greg Dufour
Yes. We probably have, call it, about 800 loans, call it, some time earlier today that we had in our pipeline. We're still taking in applications every single day. The big concern that we have, these are the real small transactions now, and it's really yesterday was a very frustrating day for the E-Tran system from the SBA. And so, now everybody is just in a race to try to get the loans processed, get them approved, and get the money into our customers' hands where they belong. But hopefully, by the end of the day, when we recap, it will be a better picture than what is yesterday from a system perspective.

William Wallace
Do you know the dollar amount of those 800 loans?

Greg Dufour
Yes, probably, call it, $26 million to $30 million, in that range.

William Wallace
Okay. Great. Thanks for the time. I appreciate it.

Greg Dufour
My pleasure. Thank you.

Operator
Again, if you are with Janney, KBW, or Raymond James, it is "*", then "1" to ask a question, "*", then "1" to ask a question.

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
Great. First of all, I'd like to thank everyone for attending the call and listening-in, and obviously, our analysts for their questions and interest and coverage of our stock. I want to conclude this time by really thanking Debbie. She's been with us for 11 years in this organization. She joined us in the fall of 2008 and jumped into a leadership role for us in that financial crisis, and now she's providing that same level of energetic and stronger leadership in this current crisis, albeit there's a little bit of symmetry in the entrance and exit of Debbie's time with us.

But I just want to publicly say, Debbie, thank you for everything you've been to this organization. We're much better off with you being here, and we wish you the best. We have some great people joining us, with Greg White and Bill Martel, really complementing a strong executive team that is really just providing excellent leadership to the company and for our shareholders.

To all of you, I want to say, again, thank you for your time today. Be safe, be well and be healthy. Take care.

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