Camden National Corporation

Q4 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 Fourth Quarter 2019 Earnings Conference Call. My name is Sarah, 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 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
Thank you, Sarah. Good afternoon and welcome to the Camden National Fourth Quarter Earnings Call. Before I provide an overview, I would like to welcome two analysts and their firms who initiated cover to Camden National Corporation since our last call. We're joined by Wally Wallace from Raymond James, and Jake Civiello from Janney Securities. I will note, Jake is travelling right now and may not be on the call. They are joined by Damon DelMonte from KBW, who has covered Camden since 2015.

Earlier today, we announced record annual earnings for 2019 of $57.2 million, or $3.69 per diluted share and fourth quarter earnings of $15.2 million, or $0.99 per diluted share. We are very pleased with our strong finish to 2019, which led to a return on average assets of 1.3%, return on average equity at 12.44% and a non-GAAP efficiency ratio under 56%.

Net interest income increased 8% over 2018 and EPS was up 9%. Debbie will provide a deeper look into our financial performance, but I'd like to take a few moments to highlight some additional information.

During 2019, our average loans grew 8% over 2018 while our average deposits grew 14% over the similar time period. This resulted in a loan deposit ratio of 87%, which positions us very well against our Northern New England peers. In the end, loan growth was 2% in 2019, due to elevated prepayments throughout the year.

Our guidance for 2020 is still mid-single digit loan growth. Our focus on deposits will continue as we enjoy both the pricing and liquidity impact of the strong deposit base, but I'll repeat my caution from prior quarters that we do remain cautious as we see aggressive pricing on deposits, particularly from competitors who have higher loan to deposit ratios and less liquidity than we do.

I'd like to share that our wealth management group reached an important milestone by achieving over $1 billion of assets under management at December 31, 2019. When combined with assets administered by our brokerage crew, we oversee nearly $1.5 billion of client assets.

Behind the scenes, our commercial, retail, wealth, brokerage, and treasury management teams work collaboratively to present Camden National's full set of products and services. More importantly, our analytical capabilities, such as credit underwriting and investment research, combined with our technology capabilities, positions us strongly against competitors much larger than we are, which complements our ability to position our decision-makers at the table with customers and clients.

Although, we've seen great progress on many strategic funds, we've not lost sight of asset quality. As of December 31, 2019, non-performing assets reached a historical low of 0.25% of total assets and non-performing loans were 0.36% of total loans. This is the result of a strong credit culture, starting with the lenders and working through our underwriting teams. Equally as important are the special assets and collection teams, who do a great job in those instances when our customers are behind on loan payments or unable to pay their loans.

We are one of the banks required to adopt the new accounting standard CECL in the first quarter 2020 and continue to be very pleased with our work on CECL up to this point, and our overall readiness for adoption in the first quarter. We're currently working with our auditors as they wrap up their reviews, and we fully expect to share the impact at the end of the first quarter.

Our capital at the end of 2019 was well in excess of regulatory capital requirements as shown by our total risk-based capital ratio of 14.44% and a Tier 1 leverage ratio at 9.55%. Our total common equity was 8.66%, which we feel positions us very well in the current environment. With our strong capital position, we were still able to redeploy over $20.8 million of capital through the repurchase of over 488,000 shares of our stock during the year and pay $19 million in cash dividends to our shareholders in 2019. In addition, in the fourth quarter, we announced an increase in our quarterly dividend of $0.03 per share, or 10%. With this most recent increase, our payout ratio for the fourth quarter was 33% and current yield was 2.86%, based on last Friday's close of business stock price. Our book value per share ended the year with $31.26, up 12% from $27.95 at the end of 2018.

We announced last quarter that Debbie will be retiring on April 30, 2020. We're currently working with recruiters to find a replacement with the goal of having a person on board just prior to Debbie's retirement. I do want to thank Debbie for not only her service but working hard to make a smooth transition.

And with that, I'd like to turn it over to Debbie to review our financial performance.

Deborah Jordan
Thanks, Greg, and good afternoon, everyone. We are pleased to report strong fourth quarter operating results with net income of $15.2 million, a return on average assets of 1.35%, and a return on tangible common equity of 16.26%.

Net income increased 9%, compared to the fourth quarter of 2018 with revenue growth of 8% and operating expenses up 5%. When comparing results to the previous quarter, net income increased $750,000, or 5% with revenue growth of 4% and a lower credit provision, partially offset by a 4% increase in operating costs between periods.

On a linked-quarter basis, fee income increased $1.2 million or 11% with growth in most fee categories plus an unrealized gain on equity securities of $866,000. Mortgage banking fees declined almost $500,000 between periods due to seasonality. However, we posted strong gains of $2.2 million for the quarter as we benefited from refinancing activity. Our mortgage pipeline at December 31st was $90 million compared to $135 million at September 30th.

Net interest income grew $316,000, or 1% from the previous quarter with a 3 basis point increase in our net interest margin to 3.12%. The margin expansion was the result of a 14 basis point decline in funding costs from the third quarter, while the asset yield decreased 9 basis points, or 12 basis points when excluding loan prepayments income.

We were able to lower funding costs to 94 basis points for the fourth quarter due to changes in rates and funding mix. Overall, borrowing costs declined 20 basis points reflecting the cuts in the Fed funds rate, while total deposit costs decreased 8 basis points with the re-pricing of index deposits and active management of exception pricing. We also experienced our typical deposit seasonal inflow with average checking accounts growing 3% between the third and fourth quarter, which allowed us to reduce higher cost borrowing. We are extremely happy to have margin expansion during the fourth quarter. However, we maintain our outlook of margin compression in 2020. Camden National remains asset sensitive and the ability to re-price deposits lower may be limited due to market competition.

Total loans outstanding of $3.1 billion declined slightly from September 30th with the CRE portfolio decreasing 1% and consumer and home equity balance declining 3%. This was partially offset by growth in the residential portfolio of 1%. As Greg mentioned, elevated prepayments have impacted loan growth for the year.

Operating expenses of $24.8 million for the fourth quarter increased 4%, compared to the previous quarter, primarily due to an increase in incentive compensation associated with exceeding budget expectations for the year. On a non-GAAP efficiency ratio for the quarter reached 55.64%.

As disclosed in our earnings release, we will be closing three banking centers in April of 2020. Current employees at these locations will be redeployed into surrounding banking centers and will be integral to the customer transition. On an annual basis, this translates to a reduction in operating expenses of approximately $1 million.

That concludes our comments on the fourth quarter results. We're now happy to open call 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. If you are using a speakerphone, please pick up 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 comes from Damon DelMonte with KBW. Please go ahead.

Damon DelMonte
Hi, good afternoon, guys. How are you doing today?

Greg Dufour
Good, Damon.

Damon DelMonte
Good. First question, I just want to talk a little bit about the margin. Debbie in your prepared remarks, you indicated you expect some pressure likely as we go through 2020. Can you put a little framework around that as far as how much you're expecting and maybe a range of that?

Deborah Jordan
Sure. Glad to hear your voice, Damon. We had a great fourth quarter on the margin and it did exceed expectation. Part of it was the prepayment income that was recorded in the fourth quarter and would have been about 3 basis points less. But even with that, we did have a slight increase in our margin between quarters. We have, as we've talked about in the past, the seasonality of our deposit base. Third and fourth quarter are really strong, and we were fairly aggressive on the exception pricing of readjusting some of our preferred pricing down. We are very happy with our management of the cost of funds. When we look at the first quarter, we expect about a 5% outflow of deposits. We'll have shifting from checking accounts into borrowed funds, and so that certainly impacts the margin for the first and second quarter of each year. My take is, we'll will be down around 3.05% to 3.06% mark for the first half of this year.

Damon DelMonte
Okay. Great, that's helpful. Thank you. And then with regard to the three branches that are being closed, I believe you said in April that goes into effect, so we can kind of build-in some of those cost savings starting in the second quarter. And would that just be in the occupancy line or how should we think about modeling that?

Deborah Jordan
Yes, I would build it in certainly in the latter part of the second quarter. Occupancy and personnel cost lines. There are seven employees in those banking centers now, they will be filling vacant positions that are in other locations. And so, certainly, in the personnel cost line, there'll be a reduction in run rate as well.

Damon DelMonte
Got you. Okay, great. And then if I could just squeeze one more in, just kind of broadly on the loan outlook. Where are you seeing the best opportunities in your footprint for growth right now?

Greg Dufour
Sure, I will take that, Damon. We're still seeing it. Obviously, it's oriented in Southern Maine and in New Hampshire, some of that is due to just the economy in that part. It tends to be stronger than north of Portland, but also, we've hired some lenders in there that have done extremely well. The other part of it is, is that we've been doing hiring focused on C&I lenders as well. So, we do get a little bit of a product diversification coming through there.

With that said, we've had some good years in our Bangor market, probably had one of our stronger years lending-wise. Lewiston and Auburn also had a good 2019. And then in MidCoast, albeit, there we have a much higher market share, but that's held up real well. It was one of these time periods of everything was kind of focused and doing the right things. That did temper the prepayments. We expect the same thing to continue in 2020. All of our markets are important to us and we look to get more than our fair share of any growth that's out there.

Damon DelMonte
Great. Okay, that's all I have. I will stop off for now. Appreciate the color. Thank you.

Greg Dufour
Thank you.

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

William Wallace
Thanks for taking my call. Good afternoon, Greg, Debbie.

Greg Dufour
Hi, Wally.

William Wallace
Maybe just to follow-up on the last line of questioning, your loans were actually down in the second half of the year. What gives you confidence? I'm assuming there's payoff pressures that's driving that. I'm just curious, what gives you confidence in the mid-single digit guide for 2020? Is there anything you're seeing that gives you confidence in your outlook that prepays will decline or that production will accelerate?

Greg Dufour
Well, I won't say it's necessarily on the prepayments declining, because they are still pretty steady because of the interest rate cycle. I think it's really just as we're expanding and developing the talent that we have in the lending staff as well as in our underwriting capabilities, it gives us that focus. With the economy, we're still seeing strong activity. So, we can pick that up and cover what's being prepaid and then some, albeit not that any year is easy, but it will be tougher to point.

Deborah Jordan
Wally, I hope we see prepayment settle down a little bit because when we look at fourth quarter, CPR, both on the CRE side and on the residential side were in the 20 CPR rate and are historically is around 15 each. And so, my hope is, we'll see some of these larger transactions came through and certainly impact that rate. We had record mortgage originations in 2019 and we're still investing in that and new lenders on the mortgage side. And the CRE side of that, we actually had strong originations, I think there was record originations in the CRE side too. So, continuing to do more of that with a little relief on the prepayment side.

William Wallace
Okay. And then if you kind of look, Debbie, to the commentary you said around net interest margin, you said 305, 306-ish in the first half of the year, the next two quarters or so. You'll start to get deposits back. Would you think that there's a decent chance that you could see a bottom

in the first half of the year. And then, assuming the Fed is on pause, and then some expansion in the second half as you get the deposits back and can shift your funding mix a little bit?

Deborah Jordan
Yes, typically, we would see that. The one caution that Greg and I both referenced, this is the competitive environment, which is the one wildcard. But normally, yes, we would see that lift in the second half of the year. We've been successful. Let's hope, we continue to be successful to manage the pricing down.

William Wallace
Okay. And it's good to see that you've identified some opportunity in the branch network. Are there, I think you said based on…I can't remember the wording in the press release an analysis or something of the network. Is there more work being done around the branch network to find opportunities or do you feel like you've kind of identified the opportunities for now with these three?

Greg Dufour
We do it on a more continuous basis. So, obviously, these three were the ones that we landed on for this round and as we've discussed before some of it, Wally, is dependent upon leases expiring. It could be staffing considerations, albeit with this one, all of them will be redeployed in the franchise, as well as other factors. I do want to stress, it's something that we're always looking at fine-tuning. We typically just say, look, this is what is obvious to us now. We'll do this and we'll keep looking, and if something becomes obvious, we'll announce it at that time.

William Wallace
Okay. Thank you for that color. I will step out and let somebody else ask a question. Thanks.

Greg Dufour
Thank you.

Operator
Again, if you have questions, please press "*", then "1." As there are 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. Well, thank you all for attending the call, and your interest in Camden National. Again, thank you to Wally and his team and we'll hear from Jake next quarter. Also, thanks again to Damon, we do appreciate the coverage that we have. It's important not only to us, but obviously to our shareholders and keeps everybody on their toes and having good discussions with good questions.

Other than that, I just want to congratulate the Camden National team for really putting in a great effort. I cannot overemphasize, these results are really the hard work of many people. Whether they're on the front lines or in support areas or finance asking the tough questions and pushing things forward and underwriters. It's a true team effort and reflecting on that, we did also announce that we issued $750 bonus to all non-executive, non-senior management employees in recognition, and sharing the success of the company with them. It's gone over very well today here with the company.

With that, thank you all and look forward to chatting with you over the next quarter.

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