United Financial Bancorp

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CORPORATE PARTICIPANTS

Bill Crawford - *Chief Executive Officer*

Eric Newell - *Chief Financial Officer*

Marliese Shaw – *Investor Relations*

PRESENTATION

Operator
Good morning and welcome to the United Financial Third Quarter Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation there'll be an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on your telephone keypad; to withdraw your question, please press star (*) then two (2). Please note this event is being recorded. I would now like to turn the conference over to Marliese Shaw. Please go ahead, Ma'am.

Marliese Shaw
Thank you, Frank. Good morning, everyone. Welcome to our third quarter conference call. Before we begin, we would like to remind you to read our Safe Harbor advisement on forward-looking statements on our earnings announcement. Forward-looking statements, by their nature, are subject to risks and uncertainties. Certain factors could cause actual results to differ materially from our expected results. Our comments today are intended to qualify for the Safe Harbor afforded by the advisement. And now, I would like to introduce Bill Crawford, our Chief Executive Officer.

Bill Crawford
Thanks, Marliese. Good morning and thank you for joining us on today's call and for your continued interest in our company. With me this morning, I have Eric Newell, our CFO and several other members of our executive team. I am pleased to report that on a year-to-date basis on average in 2015, our company has delivered an ROA of 95 basis points and an ROE of 8.67% in a difficult operating environment for banks.

Over the last two quarters, we've averaged 18% commercial loan growth, with three straight quarters of consistent loan level hedge income. We've also delivered three strong consecutive quarters of mortgage banking income. We've done this while reducing the duration of earning assets and positioning for an eventual rise of interest rates. This quarter, we've included more robust disclosures on our interest rate sensitivity; I think you'll see we're well positioned here. Fundamentally, we don't believe bankers can predict interest rates, so our aim is not to stray too far from the neutral line.

Our non-interest expense was elevated in the third quarter due to technology consulting and increased debit card losses. Over the last 4.75 years, we've grown assets and earnings at about a 30% compound annual growth rate. As we continue to grow, technology can help us more effectively and efficiently serve our customers. We will be making modest incremental investment in this area. The consulting is temporary but will persist through the fourth quarter of 2015. Debit card losses and expenses spiked due to changes with EMV. Eric Newell will cover this in more detail in his comments.

While we're not giving guidance for 2016, here is how I think about our upcoming year. Yes, we have headwinds, accretion burns down and the tax rate increases and it looks like we may not get the interest rate increases we had all hoped for. That said our ability to generate loan growth has become even stronger. We've shown consistency in growth in fee income in 2015 and we can drive better execution here going forward. As we implement our new cash management system, we can drive higher DDA deposit growth.

Controlling non-interest expense and fund cost will continue to be critical in this low rate environment. As we've done for the last four plus years, we will remain focused on executing for our customers every day and this will drive our ability to continue growing those earnings per share and tangible book value per share. I want to thank all of my United Bank teammates for their hard work in delivering for the clients every day. Now I'll turn the call over to our CFO, Eric Newell.

Eric Newell
Thanks, Bill. Good morning. Yesterday we reported net income of $13.4 million or $0.27 per diluted share for our third quarter, flat from our linked quarter performance. Today I'll focus on two items; first our expense management and financial performance during the quarter and then our new disclosure regarding our interest rate rest position and discussion of our net interest margin.

For the first time since our quarter ending in September 2014, we reported an increase in net interest income before provision, which was driven by our 15% annualized loan growth in both the second and third quarters of 2015. Revenue in the quarter decreased $813,000.00 to $49.5 million, while expenses increased by $1.5 million to $31.9 million in the quarter. Revenue declined in the third quarter from the linked period largely due to mortgage banking. The $733,000.00 decrease in mortgage banking revenue was due, in large part, because of the valuation of our mortgage servicing rights, which decreased in value by $1.3 million in the quarter.

While expenses increased in the quarter, they were driven by three factors that will subdue in 2016. First, we elected to engage in consultancy that will assist us in our information technology strategy and help us identify and implement best industry practices. We view this as a necessary investment to keep our products and services in line with our constituency and we believe it will result in improved efficiencies and operating leverage when our strategies are fully implemented and any additional expenses will not significantly increase our expense run rate. Second, we had expenses in the third quarter related to the planned fourth quarter mass deployment of EMV debit and credit cards, which are more costly than magstripe cards. Related to the EMV switch over and, thirdly, our debit card losses have significantly increased throughout the year and we would anticipate that this type of fraud will become more difficult as EMV cards are deployed. These three noted items resulted in increased expense over our second quarter run rate totaling $1.3 million, which is nearly all of the increase experienced from the linked quarter. We will see some of the same expenses in our fourth quarter, particularly with regards to the consultant spend, and I suspect we will remain elevated with our consumer debit card losses due to fraud.

We continue to have favorable metrics when looking at our efficiency ratio, as well as the ratio of non-interest expenses to average assets when compared to our peers. As discussed in the second quarter call, we continue to have expenses related to the sales of our loan level hedges, as well as commissions paid through our mortgage bankers. For the first time this quarter, in our earnings release presentation we disclosed net mortgage banking revenue, which removes the commissions paid to our bankers in the respective period. In the third quarter, this disclosure will lead you to see that we had $1.4 million of commissions in our non-interest expense line. I'd like to spend some time discussing our interest rate risk positioning and net interest margin. First you will notice in our investor presentation released last night, a new disclosure pertaining to our interest rate risk position under different data assumptions for our money market accounts, which is the most significant assumption in our modeling. We are reporting the net interest income impact, given a 300 basis point parallel shock to rates, and several different beta assumption scenarios. As you can see we have been using a fairly conservative assumption, which has caused us to be viewed at liability sensitive. However, if we experience lower betas when the rates rise, our sensitivity to interest, rising interest rates is significantly different from what we have previously disclosed. This data supports my comments earlier this year that assumptions on betas across companies are vastly different and sensitivity disclosures are very dependent on those beta assumptions. This leads me into a discussion pertaining to our net interest income.

Despite the favorable loan growth that we've experienced year-to-date, our net interest income revenue has been flat and our core net interest margin continues to compress. This is largely by design. Over the last five to six quarters, we have pulled in the duration of our commercial loan book by over one year, largely by the writing of loan level swaps, which results in adding adjustable rate paper to our book. Along with the sale of the majority of most of our 15 and 30 year residential mortgage production, the duration of our earning assets has fallen significantly, which should position us more ideally for rising interest rates. Noteworthy in the third quarter is the low level of prepayment fee income we received relative to the second quarter. When you exclude prepayment income from both quarters, the yield on loans would have declined by four basis points.

On the funding side, you may recall that we discussed in the prior quarter our promotional pricing for money market accounts, which ended on June 30th and I noted the expectation that we will have an improvement in the cost of interest bearing deposits in the second half of the year. We start to see that improvement in the third quarter. Our wholesale funding costs rose in the third quarter as we increased the duration of that funding slate, again in an effort to position the balance sheet for higher short-term interest rates.

This leads me to expectations. Relating to the net interest margin, coming into the 2015 it was fairly easy to model the expectation of GAAP and core net interest margin because of the expectation of flat rates throughout the year. For 2016, this is not as easy given the uncertainty regarding short-term rates and the duration of a potential flatter yield curve if the Federal Reserve strives for normalization. We have worked to position the balance sheet for a rising rate environment. If that were to come to fruition, it would largely slow our core NIM compression, but I do not expect that it would reverse in the first year. However, we do have a large pipeline and expect that larger loan balances will drive net interest income growth. The experience we've had with loan growth at approximately 15% annualized for the last couple of quarters is expected to continue. If we do not get an increase in the short-term rates, we make seek to balance our approach on bringing in the duration of assets with adding some more moderate term paper. However, given the duration of the current interest rate environment, we will continue to see assets originated at higher rates four to five years ago re-priced to mature, to current interest rates seen in the market. We will continue to focus on our funding costs, as well as our initiatives to grow DDA as a percentage of total deposits, which will have the effect of improving our cost of funds.

The four year compounded annual growth rate of our EPS is approximately 30% and while we do not expect EPS growth at that level in 2016, we do have expectations that positive operating leverage from investments we made in the business in late 2014 and ’15 and throughout 2015 will drive, better drive revenue growth from net interest income and fees in 2016. All other expectations for 2016 pertaining to purchased accounting benefit from loans, effective tax rate and the partnership expense that supports that tax rate, remain intact from what I disclosed on the second quarter earnings call. Thank you for your time this morning and now the management team and I would be happy to answer any questions you have.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star (*) then one (1) on your telephone keypad. If you're using a speakerphone, please pick up the handset before pressing the keys. To withdraw your questions, please press star (*) then two (2). At this time, we will pause momentarily to assemble our roster. The first question comes from Mark Fitzgibbon from Chamber O'Neill. Please go ahead.

Mark Fitzgibbon
It's Sandler O'Neill, but thank you. Hey, guys, first question, good morning, on the tax rate, Eric, was a little lower than we expected in the third quarter and I know you'd sort of given guidance of 25% to 28% for next year for the effective tax rate. How are you thinking about it for the fourth quarter?

Eric Newell
I would say that fourth quarter will be 16%.

Mark Fitzgibbon
16%, okay, great, and then secondly, I wondered if you could share with us the size of the commercial loan pipelines today and maybe the average rate on that?

Eric Newell
You know what, we do disclose but we have not disclosed the notional amount of the commercial pipeline, but on the presentation deck, you'll notice that what we do is provide a probability adjusted commercial pipeline. So relative to what we showed at the end of June 30th, it's pretty much the same level and so I think that that level will support the growth that we've been showing for last two quarters. In terms of a rate, what we do whenever we have quotes out there is we'll quote a variable rate so we have a loan level hedge associated with it or a fixed rate. So I would expect that the rate would be similar to what we've been putting on the books for the last couple of quarters.

Mark Fitzgibbon
Okay and then prepayment penalty income was a little softer this quarter. What's your outlook for prepayment penalty income, do you think, over the next quarter or two?

Eric Newell
You know what, generally, Mark, do you have a view on that?

Mark Kucia
I would think driven a lot by kind of the refi, if you will, when rates should come down, so that level has slowed a bit. So I would anticipate the prepays to slow a bit, commercial, as well.

Eric Newell
So I think that you could expect soft prepay income in the fourth quarter, as well.

Mark Fitzgibbon
Great, thank you.

Operator
And the next question comes from Travis Lan from KBW.

Travis Lan
Yeah, thanks, good morning, everyone.

Eric Newell
Good morning.

Travis Lan
Eric, could you just breakdown a little bit more granularly that the technology expense and kind of give us a better idea as to what amount could recur in the fourth quarter and then, just, is that the last that you expect to see of it?

Eric Newell
Sure. So right now, we're disclosing the professional fee line. I would say that that number that we disclosed or the numbers, the level that we have in the third quarter will be the same in the fourth quarter. I know you had a couple of questions in there.

Travis Lan
Yeah, sorry about that, I know I ask multiple questions at one time. Okay, so that stays the same, but the other portion of maybe that $1.4 million, will that runoff in the fourth quarter, so we won't see that in the fourth quarter?

Eric Newell
I would say that you are going to, I mean, we're not going to have the repeated costs of the deployment of the EMV cards because that was a onetime bulk purchase that we made on those cards. However, the consumer fraud is likely going to continue just because it's going to take us some time to get the folks off of the magstripe cards to an EMV card and that doesn't even mean that that debit, or that losses will go away. So of the $1.4 million, I would say probably 75% of that repeats in the fourth quarter.

Travis Lan
Okay, all right, that's helpful. Then you'd said that you expect net interest income growth despite core NIM compression, and when you're thinking about net interest income growth, is that inclusive of accretion impacts or just kind of core net interest income?

Eric Newell
Core.

Travis Lan
Okay, all right, and then I understand that you have customers that obviously want fixed rate loans and your swap strategy protects your asset sensitivity. But is there a point at which you feel you would have enough floating rate exposure and you would then be willing to kind of keep the fixed rate or is this something that's just you would expect to keep putting on the swaps to protect your asset sensitivity?

Bill Crawford
Hey, Travis, it's Bill Crawford. We look at that all the time and it's, there's always a trade-off there and the good thing is we have the ability to be opportunistic there. We want to do fixed rates, we can generally drive more towards fixed rates; if we want to do the loan level hedges

and take the variable, we can generally drive that, not with all of our customers but with our larger and more sophisticated customers and that's where a lot of our loan growth comes from.

Eric Newell
Furthermore, Travis, we look at everything on our ROE or Rate Lock basis, so there are situations where a fixed rate asset will have a more favorable ROE to us than a variable rate, and in that case, we would be willing to book that type of asset.

Travis Lan
Got it, okay. All right and then the last one, Bill, just obviously, you guys are getting really strong commercial growth from your relatively new lending teams, how do you think about the potential for adding additional hires to support the growth trajectory there?

Bill Crawford
Yeah, we are always looking for great talent, but the good thing is is the teams we have now have very large pipelines and are really hitting their stride. So, but we're always opportunistic looking for other teams that can bring significant value to us.

Travis Lan
All right, thank you very much.

Operator
Again, if you have a question, please press star (*) then one (1) on your touchtone phone. This concludes our question and answer session and I'd like to turn the conference back over to Bill Crawford for any closing remarks.

CONCLUSION

Bill Crawford
Okay, guys, well we've had $0.26, $0.27 and $0.27, so we're focused on building consistency. We appreciate your interest in the Company and we'll look forward to seeing y'all soon. Take care.

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