

United Financial Bancorp, Inc.

United Financial Bancorp, Inc. Q1 2017  
Earnings Call

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Eastern

**CORPORATE PARTICIPANTS**

**Melissa Etheridge** - *Finance & Risk Business Planning Associate*

**Bill Crawford** - *Chief Executive Officer*

**Eric Newell** - *Chief Financial Officer*

**Mark Kucia** – *Chief Credit Officer & EVP*

**David Paulson** - *EVP & Head of Wholesale Banking*

## **PRESENTATION**

### **Operator**

Good morning and welcome to the United Financial Bancorp, Inc. Quarter 1 2017 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 will 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) and please note this event is being recorded. I would like now to turn the conference over to Melissa Etheridge, please go ahead.

### **Melissa Etheridge**

Thank you and good morning, everyone. Welcome to our first 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 expected results. Our comments today are intended to qualify for the safe harbor afforded by that advisement.

And now I would like to introduce Bill Crawford, our Chief Executive Officer.

### **Bill Crawford**

Thank you, Melissa, and thanks to all of you for joining us on today's call. Today, I'll hit a few highlights and Eric Newell, our CFO, will go into more detail on our financial results.

In April 2016, management outlined 4 key objectives, which are listed on Page 8 of our first quarter's earnings deck. The following highlights some of our progress towards these 4 objectives. Year-over-year, loans increased 6.3%, deposits grew 5.7%, capital increased 5.2%, after paying our dividend. The Company and Bank maintained strong capital, liquidity, and asset quality ratios. Our net interest margin increased from 2.96% to 3.03% linked quarter, reflecting the asset sensitivity in our balance sheet and discipline around loan and deposit pricing. For the last 3 consecutive quarters, United has averaged 87 basis points return on assets and 10.89% return on tangible common equity. Our earnings stream is becoming more consistent than in prior periods. In Q1 '17, we had 21% annualized C&I and owner-occupied commercial real estate loan growth and 7% annualized deposit growth, and 3.4% annualized total loan growth. Q1 is seasonally a slower quarter for us, but we had very strong commercial loan production across our different teams. Some of this was offset by commercial real estate pay offs due to our clients selling properties. Our asset quality trends remain strong and stable. Year-over-year, our DDA and NOW, our transaction accounts, have increased from 23% to 26% of total deposits, driven by improving unit and dollars sales from our banking teams. This is the mix shift we've been talking about. I'm especially pleased with the deposit momentum I'm seeing from our retail team. This is driven through improved product offerings, service, delivery, and sales execution. Our tangible book value increased from \$10.53 to \$10.75, linked quarter, after paying our dividend.

In Q1 '17, we delivered record revenue, record pretax profit, and invested in our IT and project management area, while posting a 2.11% noninterest expense to average assets number. We have an attractive cost structure and our investments in IT and project management will drive increased revenue, improve customer service and lower cost as we go forward in time.

Overall, I remain bullish on our ability to grow earnings in 2017 and 2018 and improve our core

profitability profile based upon what we're currently seeing in our flat rate and our dynamic interest rate earnings modeling. We have seasonally robust loan pipelines, given the expectation for higher rates, the mortgage business will be tougher, but we have very strong execution capabilities in mortgage banking. In Q1 '17, we clearly outperformed our deposit betas, but we're in the early innings here. Outperforming deposit betas will likely be a key success differentiator for banks over the next few years.

Organizationally, we're very focused on growing transaction accounts, retaining and growing core deposit relationships, improving our customer offerings, and growing high-quality variable rate loans with attractive risk-adjusted returns. While we have more work to become a high-performing bank, the last 3 consecutive quarters evidenced progress towards our 4 key objectives, which we believe will deliver attractive shareholder value over time.

Now I'll turn the call over to Eric Newell, our CFO.

### **Eric Newell**

Thanks, Bill, and good morning. Our results this quarter indicate further stability. It is our third quarter without the noise in the merger and we continue to benefit from execution on our 4 key objectives that Bill mentioned in his comments: To continue to drive more of our revenue growth in our net interest income, build stability in core fee income, reduce volatility from our mortgage banking income, and maintain our expense discipline. All of these factors are major contributors to our success in posting \$0.27 this quarter.

There aren't many aspects of our results in the quarter ending March 31 that did not fall in line with my forecast I disclosed on our fourth quarter conference call and I know, with the exception of NIM, the forecast for the remainder of the year will remain unchanged from my initial forecast made in January 2017.

I'll expand on a couple of relevant noteworthy items. First, while loan growth was slower in the first quarter than our annualized growth forecast, we continue to be committed to a high single-digit loan growth metric for 2017 and our pipeline growth during the quarter supports this assumption.

Over the last year, we've gained traction with growth and transaction account unit growth, as we've been more consistent with our approach to special pricing for deposit acquisition, attempting to be more proactive to rate specials in the market versus taking a reactionary approach. This has had the effect of mitigating a higher incremental cost of deposit acquisition, as we've let higher price deposits go across the street.

Next, our interest rate margin forecast is revised to 3.05% from 3.00% for the full year of 2017. This reflects changes to interest rates in the first quarter due to actions taken by the FOMC. I will note this forecast reflects flat interest rates. In other words, we're not modeling any further actions of the FOMC into this number. We continue to be asset-sensitive.

In our last earnings call, I disclosed a couple metrics to indicate the extent of our asset sensitivity. First, using a static balance sheet, I had indicated that September 30, when we had 150 basis point ramp over one year, our net interest income increased 4.6%. At December 31, that same metric is now 6.2%, indicating our year-end balance sheet to be more asset-sensitive than our September 30 balance sheet.

We have yet to complete our model, or finalize our modeling, for this metric using our March 31

balance sheet, but initial results indicate no significant changes in our asset sensitivity position using the fact set.

Further, in the last earnings call, I mentioned that 41% of our loan book was tied to LIBOR and Prime as of year-end. As of March 31, we now have 42% of our loan book tied to LIBOR and Prime and 30% of earning assets are tied to the same indices once you include the LIBOR-based investments in our investment portfolio.

As it pertains to noninterest expense, I continue to be committed to the ratio of NIE to average assets for the year that is closer to 2.00% and I did note that this metric would be higher in the first quarter due to some seasonality of expenses. There's nothing notable to mention with salaries, as I indicated that we're expecting about \$60 million of salaries for the full year of 2017 and our first quarter is tracking towards that forecast.

I'll note that occupancy and equipment expenses were up notably in the linked quarter due to winter weather-related expenses totaling nearly \$600,000. I'm hopeful that won't be repeated in the second quarter.

With that, I'll open it up to questions.

## **QUESTIONS AND ANSWERS**

### **Operator**

Ladies and gentlemen, 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 are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (\*) then two (2). At this time, we will pause momentarily to assemble our roster. And our first question comes from Mark Fitzgibbon with Sandler O'Neill and Partners. Please go ahead.

### **Mark Fitzgibbon**

Hey, guys, good morning.

### **Bill Crawford**

Hey, Mark.

### **Mark Fitzgibbon**

Eric, first question for you is on the tax rate. I know in your slide presentation, you suggested the effective tax rate would stay in that 13% range for the year. Are we likely to see much volatility during the course of the year? And also, how should we think about the net loss on investment partnerships, is that also likely to be somewhat volatile during the course of the year?

### **Eric Newell**

No, in terms of volatility on the tax rate, I suspect that we will fall into that 13% for the full year. There is actually some accounting that, pronouncement that changed this year where we do have some tax impacts when we have folks that exercise options, but that actually creates, while it does create some uncertainty, I would think that it wouldn't necessarily round to any type of issue when it, or it wouldn't change our effective tax rate. So we, I continue to think that we're going to show 13% for the year. In terms of the limited partnerships, yes, that number was lower this quarter. I try not to give a forecast on that or I just tackle that by giving you a, some

goalposts on total fee income. But one of the reasons why you're seeing some changes there is that those limited partnerships are essentially all being fair valued every quarter and we have some legacy partnerships that we acquired from legacy United that had some beneficial changes in their underlying valuations in the first quarter and that's why that number was lower than you normally see it.

**Mark Fitzgibbon**

Okay and then secondly, I wondered if there was any prepayment penalty income in the net interest margin this quarter.

**Eric Newell**

Very little.

**Mark Fitzgibbon**

Very little, okay, and then you guys had pointed out that your pipelines are strong, could you share with us the dollar amount of both your loan pipeline as well as your mortgage pipeline?

**Eric Newell**

No, unfortunately, I can't. We haven't generally done that, but I will say that the pipelines that we're showing now are measurably improved over what we were seeing at the beginning of the first quarter. So I think that, in the C&I, and I think that that is one of the reasons why we're committed to our high single-digit loan growth for the year.

**Mark Fitzgibbon**

Okay and then lastly, it looked like that those 2 money market promotions that you guys ran during the quarter generated a lot of flows. Is that something that's likely to stay in place for a while or was that sort of a one-shot?

**Eric Newell**

Money market specials. Well, we do have, constantly have one money market that we're running that, we've had it out there for a while. I wouldn't call it a market leader in terms of rate and we do find it to be fairly effective. So that will be something that we'll continue to assess and likely have something out there.

**Mark Fitzgibbon**

Great, thank you.

**Operator**

Our next question comes from Kevin Fitzsimmons with Hovde Group. Please go ahead.

**Eric Newell**

Hey, Kevin.

**Kevin Fitzsimmons**

Hey, good morning, guys, how are you?

**Bill Crawford**

Good.

**Eric Newell**

Good.

**Kevin Fitzsimmons**

Just have a couple follow-on questions on the margin. I'm, I hear you that the fed rate hikes that have already occurred are in that outlook. Is it right to assume that most of the lift in the margin you got this quarter was reflecting the December rate hike and there's still more lift to come from the one in March?

**Eric Newell**

Correct and in fact, I don't know the exact date of the FOMC rate movement, but I suspect it was after our reset date. Reset dates are generally around the 10th of the month, and I think the FOMC meeting was after that. So we might not have gotten any benefit from our LIBOR-based loans, one month LIBOR-based loans from the FOMC change.

**Kevin Fitzsimmons**

That's kind of, that's where I was going with that. Okay, great, and then secondly, can you guys give an update how the maritime lending unit is going and your progress there, how you feel about it? And are there, is there any outlook for doing other kind of non-bank or specialized lending type of deals like that in the future?

**Bill Crawford**

Hey, Kevin, it's Bill Crawford. That, the retail portion of that remains around 2.5% of assets, so pretty small in the retail. On the wholesale side, we do have more floor plan we're doing there, that's going well. It's centered on a few key customers, large customers. But in terms of other specialty lines of business, we look at different things from time to time, but there's nothing out there in terms of a new specialty line of business that we're involved with.

**Kevin Fitzsimmons**

Okay, great. That's all I had, thanks, guys.

**Operator**

Again, if you have a question, please press star (\*) and then one (1). And our next question comes from Brody Preston with Piper Jaffray. Please go ahead.

**Brody Preston**

Good morning, everyone, this is on for Brody Preston on for Matt Breese. How are you?

**Eric Newell**

Good, how are you?

**Brody Preston**

I'm doing well, thanks. I wanted to touch first on your retail CRE exposure. There's been a lot of negative headlines surrounding retail CRE, especially the big-box retailers and strip malls. I want to know, and it says 27% of your, I think, investor CRE is retail exposure, so I wanted to get a feel for what's backing this retail exposure.

**Bill Crawford**

Great, we'll have Mark Kucia, our Chief Credit Officer, answer the question. Mark?

**Mark Kucia**

Sure, that's something we monitor closely and address as new deals come in with our underwriting, et cetera. We also look at our exposure to tenants, national retailers; we have a very diverse tenant base. We have no material concentrations with any of the high-end retailers

that are experiencing issues. We have no mall exposure. We continue to look at retail deals. We favor kind of nondiscretionary grocery-anchored, drug-anchored type centers. But we have, in terms of the space that's being most dramatically impacted, we really don't have exposure there.

**Brody Preston**

All right, great, thank you very much for that. Also on the deposit competition front, you mentioned that you've been able to do a pretty good job, I mean, outperforming your deposit beta and that it would be key moving forward. Have you seen sort of competition pickup in your areas, and I guess like, do you think you'll be able to continue keeping that deposit beta low moving forward?

**Eric Newell**

I wouldn't say competition has picked up because it really has kind of been present for the last couple of years, just given structural liquidity ratios in New England. So if you want to grow, you incrementally need to compete against the folks across the street, maybe more so versus other geographies since we're in a slower growth market for deposits. But in terms of the betas, I don't expect that what we were able to do last year for betas, that's something that we're going to be able to repeat this year. However, we're certainly going to be able to do better than what we're currently modeling, which is fairly conservative. So I think, back to Bill's point, it's all about continuing to build our transaction account, deposits as a percentage of total, because that's going to help our total deposits, because that's going to help that incremental cost of funds in terms of our growth.

**Brody Preston**

Okay, great, and on the tax rate, I want to know your thoughts, has a potential for tax reform changed your strategy regarding investing in credits to help manage your tax rate lower?

**Eric Newell**

Can you repeat the question? There were a couple of words I didn't catch.

**Brody Preston**

Yes, I was just wondering if the potential for tax reform is changing some of your thoughts or your strategy regarding investing in tax credits that help keep your tax rate low.

**Eric Newell**

We'd certainly, once there was something more tangible that came out, we would certainly look at our current strategy and make some decisions. I don't really want to make any declarations on what we would or wouldn't do at this point, given that the fact set hasn't changed. But it's certainly something we would look at.

**Brody Preston**

All right, and touching on sort of your core Hartford area markets and the markets up in Western Mass, I wanted to get a feel for what's driving the majority of the growth there and just curious about the comparison there in terms of activity in other markets.

**Bill Crawford**

This is Bill Crawford, CEO. What I would say is, the teams we lifted out a couple of years ago, we're just seeing good balance growth again across all of our different commercial banking teams and so it's really us taking share. We look at a lot of deals. We have big pipelines, but we're very selective around what we book. We're very focused on getting strong risk-adjusted

returns on capital and deposit relationships with that business. But overall, I would say it's going well.

**Brody Preston**

Okay, great, and then last one from me. I know you talked about sort of in your NIM guide having no fed funds hikes for the rest of the year, but I kind of wanted to flip-flop that, I wanted to know if you could speak about the margin trajectory now when the back end of the curves come down a bit.

**Eric Newell**

I think, given that a lot of our growth has been in the C&I and consumer space and lots of our growth has been on the investor CRE and residential space, that the comments that I had on the LIBOR and Prime exposure is probably more indicative of what could happen to our margin with additional rate changes on the front end of the curve. If we were continuing to focus on residential and investor CRE in a way that we had in previous quarters, certainly, that 2/10 spread would probably be a little more of a concern for us.

**Brody Preston**

All right, great. Thank you very much, guys.

**Eric Newell**

Thank you.

**Operator**

Our next question comes from Collyn Gilbert with KBW. Please go ahead.

**Collyn Gilbert**

Thanks, good morning, guys. Hey, there.

**Eric Newell**

Hi, Collyn. Good morning.

**Collyn Gilbert**

Just to sort of follow up a little bit on the loan discussion. So, Eric, I understand not necessarily giving the dollars of the pipeline, but can you just sort of talk about maybe what the mix of the pipeline looks like, tying into your comment that, obviously, you're focusing less on the resi side, and Part B of that is, you guys put on really good C&I growth this quarter, do you think you can accelerate that from here even? And then Part 3 of this question is kind of what types of C&I credits and where are you seeing the success within that specific segment? And then I've got some other questions, as well.

**Eric Newell**

How about we'll pick the third question first since it's the type of C&I, and maybe, David, you could speak to that.

**David Paulson**

Sure, we're actually seeing a very broad range of opportunities across our footprint, depending on what demographic we're looking in. But we're seeing really good activity from the education businesses and seeing some good service providers and manufacturing. So we're seeing a broad mix as Bill alluded to, depending on what makes itself available in the various footprints and the strong calling activities that we're seeing in those markets. In terms of the percentage,



an earlier question, question one, I think was the percentage of our pipeline that is weighted toward C&I is about 80% of our pipeline and 20% is in that investor CRE. So we're really focusing on those businesses that enhance shareholder value, especially with the accompanying deposits and cash management fees.

**Collyn Gilbert**

Okay. Okay and so [multiple voices], oh, go ahead.

**Eric Newell**

Just the third part of that comment on the acceleration, I wouldn't want to characterize that we could accelerate growth in the C&I versus what we've done in the quarter. But I would note our year-over-year changes, when you look at investor nonoccupied CRE, we're up year-over-year just 3%. So I think that there is probably some opportunity to maybe have that 3% year-over-year change grow a little bit more, given that we're under 300% for the regulatory CRE ratio and there are, certainly are opportunities out there for CRE deals that meet our hurdle rates for ROEs, even with a more compressed 2/10 spread than what we saw just a couple of months ago.

**Collyn Gilbert**

Okay. All right, that's very helpful and then, Eric, just on, a question on kind of provision and the reserve, so the provision was a little bit lighter than what are expecting this quarter and I think you guys had indicated that you were likely going to maybe build the reserve on the covered portfolio, just as the mix shift is changing, but that the reserve on the covered portfolio did come down this quarter. Can you just speak a little bit to how you're thinking about the provision and just the overall reserve on the covered portfolio from here?

**Eric Newell**

Yes, I think, historically, when I talked about the coverage of the covered portfolio and it growing, it was more of a convergence of just the true, the native ratio, where it started 76 basis points first quarter 2016, and now we're at 88 basis points and then, obviously, the covered, I think, we're at 102. What I really focus in on the provision is our coverage. Certainly, the covered portfolio is important, but I also look at the coverage of our nonperforming loans and you can see there that we were fairly stable with that in the quarter, relative to the linked quarter, and we've improved that coverage from 97% a year ago to 125% in this most recent quarter. So I think that that's an important ratio. The provision was lower, linked quarter, certainly because of some lower loan growth as well as I would note that the 30 basis points of provisions, that average loans forecast for the year remains unchanged and some of that is driven by our expectations of that purchase portfolio transitioning over to that covered portfolio. If we didn't have that phenomenon, I don't think we would be guiding, not guiding, forecasting at 30 basis points, just because we have to provide for that portion of loan portfolio that we purchased. So that transition has also slowed a little bit. Lot of the transition from the purchase that are covered in last several years had been lumpy because of commercial moving in and now we're starting to see that normalize and a big portion of the portfolio that remains in the purchase bucket is residential and that's a lot more slower in terms of transitioning over. So at this point, based on what we're seeing, Collyn, I continue to think 30 basis points is a good number for the year.

**Collyn Gilbert**

Okay, that's super helpful and then just going back to the discussion on fees and understanding, it's hard to predict the LP component. But just even taking that out, the core fee guidance, as you said, you haven't adjusted that, so that assumes a pretty nice ramp from here. Can you just

talk about kind of what you think will be driving that and then how mortgage banking factors into that, are you assuming kind of a rebound in mortgage banking from this quarter's level?

**Eric Newell**

We do. Mortgage banking is seasonably slow for us in the first quarter. Somebody told me recently, it's not recently, but I was told that most people don't buy homes from Thanksgiving to Super Bowl and so, obviously, that drives your results in the first quarter. So we are seeing a pickup in our pipelines there that will support an improvement, linked quarter. When you look at year-over-year, though, we do expect there probably will be some softness of what are, based on what we posted in the second quarter of '16 versus what we likely will show in the second quarter of this year, just given that we have a higher interest rate environment and so when you look at the composition of, or the incidence of refinance in our pipeline is lower than what was last year. But I don't think it's going to be dramatically lower, but we are modeling that.

So mortgage is going to contribute more in the second and the third quarter and then also our wealth management practice, UNFA, has some seasonality and they also do better in the second and third quarters as well as continued growth in that unit. We did reconstitute that whole group, I believe, at the end of 2015 and so that we're still seeing some good positive operating leverage improvement there through the second half of '16 and will continue to see that in '17 and we do also expect to continue to, again, look at some of our fee schedules in the summer to understand how does that compare to our competition, and we might reassess some of our fees, which will help in the back half of the year.

**Collyn Gilbert**

Okay, that's great. All right, thank you very much.

**Eric Newell**

Thank you.

**Operator**

This concludes our question-and-answer session. I'd like to turn the conference back over to Bill Crawford for any closing remarks.

**CONCLUSION**

**Bill Crawford**

Okay, everyone, thank you for your continued interest in the Company. We hope everybody has a great day.

**Operator**

Ladies and gentlemen, the conference has now concluded. Thank you for attending today's presentation. You may now disconnect.