People's United Financial, Inc.
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Matthew Keating: So I'm Matt Keating. I cover regional banks for Barclays. We're very pleased to welcome back People's United Financial for the conference. They're presenting here for several years at this point. So leading the Company's presentation today, will be President and CEO, Jack Barnes; and CFO of People's United Bank, David Rosato.

Also in attendance for the Company are Chief Financial Officer of People's United Financial, Inc., Kirk Walters; and SVP of Corporate Development and Investor Relations, Peter Goulding.

So with that as an introduction, I'll turn the podium over to Jack.

Jack Barnes: Good morning. Thanks for joining us today. I'm Jack Barnes, Chief Executive Officer of People's United Financial. I'd like to take this time to share my perspectives on how our Company continues to grow and improve. And after my prepared remarks, I'd use the remainder of our time to share more about our company by answering any of your questions.

On slide 2 you can see some of the essential characteristics of People's United, as well as a map of our footprint, which stretches from the New York Metro region, up into New England, including the Greater Boston market.

People's United has more than 170 years of operating history, and is headquartered in Bridgeport, Connecticut. As of June 30, we had approximately $34 billion in total assets, funded primarily by customer deposits, customer repurchase agreements and common equity.

We operate 407 branches in New England and New York, the strongest commercial banking markets in the country. Approximately 35% of our branches are in-store branches. Our largest markets, as defined by dollars of deposits, are the Bridgeport, Stamford, Boston and New York MSAs.

Slide 3 outlines a few points we feel differentiate People's United. Clearly we have benefited from our geographic footprint, as the Northeast remains a robust market with excellent population density and wealth characteristics. We think it is one of the best markets for commercial banks in the United States, as our core competency is commercial banking.

We have demonstrated solid loan growth while maintaining superior credit quality. Along with demonstrating that we can grow without M&A and not compromise our credit standards, we have been working hard to improve our operating leverage.

We anticipate profitability improvements as we grow our balance sheet, increase fee income, and hold costs relatively constant. It isn't a coincidence that we have a diverse balance sheet on the asset side. This reflects our markets and our clients. It is also a deliberate risk-management tool, as we actively seek to diversify credit risk.

Slide 4 details the strength of our footprint and our position within several key MSAs. Approximately 75% of our deposits are in People's United Bank’s top five MSAs, which are some of the most densely populated and wealthy markets in the United States.

The New York to Boston corridor is the single best piece of commercial banking real estate in the country, with significant wealth, commercial activity and population density. This region is home to a substantial number of small-to-mid-sized companies in a variety of industries. Notably the education and healthcare sectors add considerable stability to the region.

Slide 5 illustrates our deposit share in our core markets. Franchise-wide, we have approximately 850,000 commercial, business banking, consumer and wealth management relationships. We hold the number-five deposit market share in New England, with particular strength in Fairfield County, Connecticut, where we are and have been for many years ranked number one.

Slide 6 outlines our approach to the deposit side of the business. As our tag line, “what know-how can do” suggests, we leverage the experience and expertise of our branch teams and relationship managers. Increasingly, we have been shifting incentives to reflect the importance of multi-product relationships, particularly relationships where deposit balances are a key component.

We continue to successfully grow the acquired Citizen's branches in New York, by leveraging our extensive experience in operating in-store branches in Connecticut, which we have done since 1995.

As we mentioned earlier, approximately 35% of our branches are in-store branches. On slide 7, we compare our in-store branch model to our traditional branches. There are a number of positive synergies that occur when combining traditional and in-store branches, including the benefits of business banking and commercial banking customers who make use of our in-store 7-day facilities.

In Connecticut, approximately 75% of our in-store branches are within five miles of a traditional branch. In New York, approximately 65% of our in-store branches are within five miles of a traditional branch.

It's also worth noting that of the 162 branches in Connecticut, 84 or 52% are in-store branches. We've been very successful leveraging our strong relationship with Stop & Shop since 1995. Our current license agreements extend to 2022 and contain additional five-year renewal options.

We have a great relationship with Stop & Shop. We know that our presence in their supermarkets drives additional traffic into their stores. Nearly 3 million people visit our Stop & Shop locations weekly in Connecticut and New York, which significantly bolsters our brand awareness, and creates constant opportunities to meet potential new customers.

From a cost perspective, in-store locations are open 37% more hours per week than the traditional branches, but are 30% less expensive to operate. The smaller in-store footprint allows us to operate at a lower cost.

Keep in mind that these are full branches, not just deposit-taking shops. Our in-store personnel have a successful track record in offering a full product suite, such as home equity, residential mortgage and small business loans, as well as services such as wealth management, insurance and payroll.

For example, approximately 30% of our total Connecticut business banking, mortgage, and home equity loan originations, as well as investment sales occur in our in-store branches. It's worth noting that we have experienced very low turnover in our in-store branches, which highlights the importance of hiring the right people and personalities.

Slide 8 illustrates our consistent loan growth over the last few years. Since the end of 2010, People's United is one of only six banks in the top 50 by assets that has grown loans in each quarter, a testament to the strength of our franchise and the footprint in which we operate.

Despite this growth, net interest income has experienced headwinds over the past year, primarily due to the prolonged period of low interest rates, and significant run-off in our acquired loan portfolio. As we've mentioned before, we believe that outsized net interest margin compression is behind us.

A more stable margin, combined with robust loan pipelines and strong originated loan growth gives us confidence that net interest income and internal earnings are well-positioned for growth.

On slide 9, deepening our presence refers to a number of activities undertaken to leverage our brand within and around our deposit footprint, both in our heritage markets and in the larger markets of New York Metro and Greater Boston. Over the past few years, we have significantly increased both our branch presence and the number of relationship managers we have in these markets. We continue to see significant opportunity to grow relationships as we remain underrepresented in these large markets.

For the past few years, we have been deepening our presence with respect to our product offering, selectively adding talent to strengthen underrepresented product types such as C&I lending, mid-corporate and government banking, New York commercial real estate, private banking, in addition to asset-based lending, mortgage warehouse lending, and wealth management.

We've long provided these services, yet they have historically been an underrepresented portion of our business. We will continue to hire talent as opportunities present themselves. But at the moment, we are primarily focused on improving productivity from the teams currently in place.

Finally, we are deepening our presence with our new and existing customers by way of cross sell. While loans and deposits will always be core to our franchise, this management team is focused on the larger opportunity which exists to serve our legacy and new customers more completely.

For example, most of our commercial customers also have cash management, private banking, wealth management, insurance, international trade finance, foreign exchange, interest rate protection and brokerage needs, to name just a few. We are able to more completely serve these customers by delivering our full product suite.

Slide 11 provides one such example of a quality commercial real estate customer in the New York Metro area. One of our relationship managers, who has over 20 years of experience in the Long Island commercial real estate market, has a multiyear relationship with a customer, and was able to leverage People's United's longstanding commitment to exceptional customer service.

At the time, the customer was unhappy with the existing bank and looking for a new institution to provide a full array of depository and treasury management services for their 100-plus business accounts. A customer was also seeking a new lending relationship to refinance existing loans, and help with potential future acquisitions.

In addition, there was an opportunity to provide wealth management services for the personal funds and trust accounts of each of the principals. The customer has given us the opportunity to look at all of the financing needs going forward, and we have built deep product, and multi-product relationships with a valued customer. I personally met with this customer recently. They are a very professional, family-oriented operation.

Slide 12 provides an example of success that we've achieved in building quality relationships in the Greater Boston market. One of our in-market relationship managers had a long-standing relationship with a customer from his time at a prior institution. The customer chose People's United not only due to this relationship, but also due to our full suite of high-quality products and services, as well as the strong commitment to the relationship of our local senior management.

I've also met this customer and heard about that strong relationship with senior management over time. The customer was seeking to refinance their existing working capital line of credit, equipment term loan, and commercial real estate loan. People's United delivered on these credit needs, and the customer now also relies on People's United for treasury management, interest rate risk management, foreign exchange, and merchant services.

Slide 13 illustrates the substantial progress we've made over the past two years growing loans and deposits at compounded annual rates of 17% and 15%, respectively. We know that if we grow loans and deposits per share, increase fee income, and continue to manage expenses, we will produce greater recurring earnings per share.

On slide 14 we detail the rigorous process that we have in place to contain costs from a horizontal as well as a traditional vertical business unit level. It's important to understand that this is not a project or an initiative. It is how we manage the bank.

As you can see, there is a commitment to this process from the top of the house, beginning with me, and it includes the CFO, the Chief Administrative Officer, and the Chief Human Resource Officer. We implement strategies to manage ongoing expenses, including early negotiation of all long-term contracts.

Just as importantly, we conduct periodic reviews of revenue initiatives that receive funding to ensure their progress is in line with expectations, and learn if there are new opportunities or challenges facing those initiatives. The broader goal is, of course, to increase operating leverage, in essence, growing revenues while decreasing or holding costs flat.

Slide 15 reinforces our proactive expense management approach. As you can see from the chart, we have successfully held expenses relatively flat over the past two years. Importantly, we have accomplished this while investing in our franchise for the long term.

On the business side, we are driving both revenue and deposit-gathering initiatives, primarily through investments in people. At the same time, we have absorbed additional costs related to higher FDIC insurance premiums and compliance initiatives as the regulatory environment of heightened expectations continues.

Despite that headwind, we remain committed to constantly improving the customer experience by investing in enhancing the delivery of our products and services.

Before we close, I'd like to remind you of our approach to the business. We take a long-term conservative approach to running our franchise. We have shifted incentives to better reflect the importance of relationship profitability, particularly relationships where deposits are a significant component.

We will not sacrifice credit quality to achieve growth. I can assure that we will not be changing our approach to underwriting, which has served us so well through the last several business cycles. As a real-time example, we plan for much lower levels of multifamily originations this year, as compared to last, anticipating competition in this asset class would continue to increase.

As we just discussed, we have a proactive management approach to expenses and have successfully held expenses flat while investing in our business, and keeping up with heightened regulatory expectations. Most importantly, we view a change in the interest rate environment as both an opportunity and a risk. Accordingly, our loan portfolio is set up to benefit from rising short rates. Our securities portfolio is positioned to minimize mark-to market losses from rising short rates. And we continue to focus on gathering core customer deposits which are less sensitive to increases in short rates.

As we've described, we continue to fortify our advantaged position. Superior customer service and relationship-based banking will drive organic balance sheet and earnings growth. Profitability improvements will further enhance our returns to shareholders.

Now I'd be glad to take any questions you might have.

Matthew Keating: Okay. So before going to questions, we are going to have some audience response questions. So if you can bring up the first slide, it would be appreciated. Thanks.

So our first question for People's is - if you don't own shares of People's or are underweight the stock, what might cause you to change your opinion?

1, faster organic loan growth; 2, net interest margin pressure subsiding; 3, ongoing improvements in its efficiency ratio; 4, progress is reducing its loans-to-deposits ratio; or 5, comfort that its compliance infrastructure is appropriately built out at the moment. So we'll take a few seconds to vote.

Okay, so audience response is the number one reason why they may be underweight or don't own People's at the moment is they're waiting for net interest margin pressure to subside. So yeah, I guess you talked during your presentation about the interest rate environment and how you would be potentially better positioned for a higher rate environment.

So I guess maybe the second choice after that was choice 4, which was progress in reducing its loan-to-deposits ratio. So maybe we can talk about that instead, since it's not so macro driven. Can you talk about, I guess, what's kind of put some pressure on that metric and what you're doing to sort of bring that down over time? Thanks, Jack.

Jack Barnes: Sure. I can't resist the temptation on the margin side. I'd just say regarding that, that our remarks did address it. But if you look at what happened to our results in the last two years, you can see that margin compression that resulted from both the long-term lower rates and where rates loans are being originated, and the falloff of accretion that had to do with prior acquisitions, and you see that the offset to that was growth in the loan portfolios and trying to get net interest income turned back in the right direction, which we've been successful in doing the last several quarters.

So if your perspective is are you going to continue to grow the net interest income from here, following that compression? We're confident that we're going to be able to do that.

So let me address then the loan-to-deposit ratio. We have had outstanding loan growth over the last several years. And that is a result of all of the initiatives that we had undertaken that I described in the presentation. We've been very pleased with that.

We have also had deposit growth, but it did not keep pace with the loan growth. And so it has resulted in our loan-to-deposit ratio going over 100% for the first time I think in our memory. And we put several initiatives in place to begin to bring that back to below 100% over the next period of time.

In the short term and in terms of a bridge approach, we looked for and were able to successfully establish some broker deposit relationships. And the bulk of that money is in the form of money market broker deposits. So the relative cost is low. And that's allowing us to continue to work on many things on the retail bank side that we've undertaken.

One of the most obvious opportunities and continued progress that we're making is the branches that we bought in New York, both from Smithtown and Citizens had very low average deposits per branch. We bought those at a very good price. We did that because we had confidence that we could bring our brand into those markets, and our model in the in-store bank, and grow those average deposits in those branches. And we're doing that very successfully, and we see that progress continuing. And that will improve our deposit-gathering capabilities.

On the commercial side we've changed incentives, and we've focused relationship managers on more success in gathering deposits, along with other revenue from our clients, and broadening the relationships, and we're having success there. We have a tremendous amount of focus on it, and we're confident that those several initiatives, if you will, will result in improved loans-to-deposits over time.

Matthew Keating: Okay. If we could move to the next question, please. So this question is actually talking about the broker deposits. You mentioned before that you've kind of turned to that channel, and I guess broker deposits at the end of the second quarter were around $1.3 billion, on their way towards $2 billion by the end of this year.

I guess so the question for the audience is basically- in your view of this recent growth, or what best describes your view of the recent growth in broker deposits?

1, you're not concerned if its cost of broker deposits is at or below its average deposit cost; 2, not concerned since broker deposits remain a relatively small portion of the overall deposit mix; 3, you're concerned since broker deposits may not prove as sticky as core deposits once interest rates start to rise; or 4, you're concerned with its average cost of deposits, by the fact that its average cost of deposits is higher than its cost of broker deposits at the moment.

So we'll take a few seconds to vote.

Okay, so the result here is choice 3, with 69% of the audience voting that way, where they say they're concerned, since broker deposits may not prove as sticky once interest rates start to rise.

So perhaps you could comment on how you are thinking about—I mean granted, it's a relatively small portion of your overall deposit mix, but maybe you could talk about your expectations for that chunk of deposits as rates start to increase.

Jack Barnes: Yeah, so the first thing I would say is we're not concerned about the stickiness of those arrangements, if you will. They're with very large firms with very broad customer bases, and it's the customer choosing to deposit with us consistent with that current, again, predominantly money-market type accounts.

So if we had a concern that we focus on, it's more that those deposits are rate sensitive. Right? That as rates start to rise that the cost of those deposits will start to rise, and mitigating that risk where one will be our significant retail and commercial base, if money market accounts and rates start to rise, then we can certainly look at our rates and decide if we want to move our customers into those products and provide an attractive rate.

So given our 407 branch system, and given the size of our deposit base, we feel certain that we could attract more deposits if we chose to, if we wanted to be more competitive.

So those are kind of key factors for us in terms of looking at the dynamics. We also looked at our peers. One of the reasons that we decided to go down the broker deposit path was we realized as we looked across our landscape that still on a relative basis, we have very low level of broker deposits compared to our peer group. It's not something that we had typically looked to get involved with until we had the loan growth that we had, and we were looking for how to manage through that transition.

So we're comfortable that those are the dynamics around the situation. It's very manageable, and not a significant piece of risk for us.

Matthew Keating: Okay. So I guess before moving on, maybe we could talk about loan growth. A few banks at the conference this week have talked about loan growth trends moderating. It's still growing, but moderating from the very strong second quarter. So People's obviously has been calling for this year for high single digits to mid-teens overall loan growth. Are you seeing anything in your footprint basically that would point to a moderation in loan growth in the third quarter?

Jack Barnes: Well, we do see ourselves in terms of the range through the first half of the year, and based on what we see going forward, we would say we'll probably end up on the low end of the range of our guidance for the year. The most significant change that we've seen is in commercial real estate.

I mentioned in the presentation that we had anticipated ourselves doing a little less volume in multifamily. In fact, that has happened, and we actually would see maybe even less in the second half than we did in the first half.

In other parts of the commercial real estate world, we see a tremendous valuation change as low rates have continued. A lot of investors are coming in and being quite aggressive. And so some of our customers are actually choosing to sell properties at a considerable profit, and take advantage of where the market is. In many of those instances, we don't get to do the following transaction, or choose not to.

So that's impacting our growth. We just had a little bit more payoff than we're expecting.

In the other parts of our portfolio, on the C&I side, equipment finance, ABL, mortgage warehouse, we're actually doing very well. I would say the pace of growth across those C&I categories is pretty similar to where it has been in the last few years. And we anticipate that will continue.

And the residential portfolio is just about on plan. So I'd say the biggest change then would be commercial real estate.

Matthew Keating: I think we have a question from the audience. Perhaps we could turn to that, please.

Unidentified Participant: Could you just talk a little bit about your ROA, specifically what are your targets? And secondly, despite the healthy loan growth, why ROA has kind of stayed in somewhat of a tight range?

Jack Barnes: Sure. So I would say if we had a general target in mind right now in this environment, it's 100 basis points on assets. We're not satisfied at all on that 70 basis point range. When we look at the dynamic around it, I would say there are multiple factors. But the big one is that we have made investments in the initiatives that I described in the presentation. So we've taken on people and we've built a number of our businesses by adding to the talent in them over the last several years.

And while we've been very satisfied with how those initiatives are playing out in terms of the amount of business they've moved during a certain timeframe, we at the same time haven't fully leveraged that. So if you brought a team over in commercial banking and you expect them to move $250 million worth of business in six months or 12 month range, and you've done that successfully, but you're still expecting that that would become $500 million or $700 million in a year or two, that type of leverage we believe is what's going to move that 70 basis points up.

If you look at how we manage expenses, I think you can see relatively flat in an environment where we've added these people, plus we've dealt with the regulatory challenge over the last two or three years really. We've demonstrated that we're very focused on managing the expense environment. It's really about building on the potential of our franchise on the revenue side.

And we're doing a very good job there, but we've had margin compression, and we've just had a very competitive environment on the rate side. And we need these initiatives to continue to build, and that will improve the profitability. So we do have an expectation it will improve.

Matthew Keating: Okay, great. And maybe we can go to the next question, please. So the next question is - where would you like to see People's focus its resources over the next year?

1, growing its core deposit base; 2, keeping its expense base relatively stable as revenues continue to grow; 3, making financially disciplined acquisitions; 4, strengthening its online and mobile banking capabilities; or 5, enhancing its financial return profile?

So we'll take a few seconds to vote.

So the audience's number-one response to this question is choice 5 at 38% of the group, where they'd like to see it enhance its financial return profile, which is a question we just addressed in pretty good detail.

Jack Barnes: All of the above.

Matthew Keating: Right, exactly. So maybe we'll move on to the fourth and final question. So over the next two years, in your view, People's is more likely to - 1, acquire a smaller bank; 2, enter inter a merger of equals transaction; 3, sell to a larger bank; or 4, refrain from M&A entirely?

So the result here is sort of split. So 42% thought People's is likely to acquire a smaller bank. And 35% thought it might refrain from M&A entirely.

So I know your premise as it relates to acquisitions starts with you don't need to do another acquisition. But maybe you could talk about what might change that view, and maybe what you're seeing in the competitive environment for deals at this point? Thanks.

Jack Barnes: Sure. So I would say we have continued to build relationships across our footprint. And if we think about where we look for potential acquisitions, it's in our footprint and in adjacent markets. So we're looking to be more of what you see with us, premier Northeast regional commercial bank. So we look at banks that are more commercially oriented. They have a customer base that is more likely to want our products and services.

They culturally approach the business in a similar fashion to us. And that footprint, that presence and deposit base is also attractive to us.

So those are the dynamics that we're looking for when we think about it. We are very much focused on and determined to be a disciplined acquirer. We want a situation that's win-win. We believe our shareholders expect us to be thoughtful and disciplined, but opportunistic in the area of M&A.

And we certainly work at it, so that we hope to create those opportunities if they come about. We're very proud of our track record there in terms of execution, in integration and being successful. I think from the conversations I have in building relationships that we do have that reputation. I think people are very comfortable with us in terms of the way we operate and approach moving through integrations.

And it's one of those things where I do believe that banks are still sold, they're not bought. And the important thing is to have good relationships and be someone that they may think about if they get to that decision as a Board and management group that you're the preferred party.

Matthew Keating: Question from the audience in the back.

Unidentified Participant: I'm just curious if you could kind of describe your in-store branches. Because I was surprised to hear how many loans that you actually have written within the store. And when I walk into the ones that we have in my area, I'm not from this area, it's just your front looks like you walked into the bank. And you've got the teller windows and you can do some deposits and checking and things like that. But I don't see anything where I'm going to sit, unless I'm going to find some register to stand up next to and do loans. So if you could explain with your branch, the difference, how that works, and it will be interesting to hear that.

Jack Barnes: Sure. So we do have the typical two stations for teller work. And usually an ATM and access to retail type transactions if somebody's looking for that, [and in a hurry]. We also have a room. We actually have two rooms behind the teller line that typically are glassed in, but they have a smoked color and our logo on it. So there's privacy. And we can bring people once they want to engage in that conversation about maybe getting a mortgage or a home equity application, or talking about a small-business type of transaction, privacy to get out of the flow of the store and have a situation where they can have a quiet conversation with their banker.

And that, I think, is key to the success in selling the other products. We get a lot of good feedback on two primary issues on that end. And one is small businesses really like the idea that they can come in and make a deposit directly on a Saturday and Sunday as opposed to a bag drop. A lot of them like that, and when they do come in, they can engage on other things.

It's really the same with a mortgage application. A lot of people working their 40 hours a week, if they can come in on a Saturday or Sunday and sit down with someone in that room and talk about how to complete a mortgage application. Or they're thinking about a home equity loan, and get the process going.

And what we do there, in all of our branches, traditional or in-stores, we call it a mortgage certification, a home-equity certified employee. So we have a training program, and we have incentives for them to go through that learning curve. I keep wanting to hit that. Go through that learning curve, and be in a position to be able to have that dialog with the customer.

So it's a win-win. Our employees feel more empowered, and better able to serve customers. And the customers appreciate the convenience of it, particularly on the weekends.

Matthew Keating: Any other questions?

Unidentified Participant: I've got another one. You already touched on it a little bit. But you sounded almost like you were alluding to the loan growth was starting to offset the accretion in your NII that was going to be coming forward. Can you kind of put some numbers on that? Is that really like you're saying by next year that will be gone? Is it next quarter that could flatten out?

I thought that headwind was going to last a little bit longer than that.

Jack Barnes: Yeah. So I believe, and everybody check me—last quarter we, on an annualized basis, had growth in our net interest income of about 2%. Is that right? And I believe it was at least the fourth quarter last year, and the first and second quarter of this year we've had positive growth. So we kind of hit the trough toward the latter half of last year where that accretion was coming down at a much faster pace, despite double-digit loan growth.

And a lot of it, most of it was the acquisition accounting, and the way that that was handled. A lot, a big chunk of it was also what was going on with the fact that rates were staying low as long as they have been, and so new originations were coming on at a lower rate, as older loans ran off that were carrying a higher coupon.

So we've turned the corner, we believe, and we certainly see that at this point moving forward, continuing.

Matthew Keating: Well with that, we're actually out of time. So please join me in thanking People's for their presentation this afternoon.

Jack Barnes: Thank you.