Berkshire Hills Bancorp

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Berkshire Hills Bancorp, Inc.

First Quarter 2022 Earnings Release Conference Call

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CORPORATE PARTICIPANTS

Kevin Conn, *Senior Vice President, Investor Relations and Corporate Development*

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Subhadeep Basu, *Senior Executive Vice President and Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Mark Fitzgibbon, *Piper Sandler*

Billy Young, *RBC Capital Markets*

Christopher O'Connell, *KBW*

PRESENTATION

Operator

Good morning or good afternoon all, and welcome to the Berkshire Hills Bancorp Q1 Earnings Release Conference Call.

I will now hand you over to Kevin Conn to begin. So Kevin, please go ahead when you are ready.

Kevin Conn

Good morning, and thank you for joining Berkshire Bank's first quarter earnings call.

My name is Kevin Conn, Investor Relations and Corporate Development Officer. Our news release is available in the Investor Relations section of our website, berkshirebank.com, and will be furnished to the SEC. Supplemental Investor information is provided in an information presentation at our website at ir.berkshirebank.com and we will refer to this in our remarks.

Our remarks will include forward-looking statements and actual results could differ materially from those statements. For details, please see our earnings release and most recent SEC reports on Forms 10-K and 10-Q.

In addition, certain non-GAAP financial measures will be discussed in this conference call. References to non-GAAP measures are only provided to assist you in understanding our results and performance trends and should not be relied on as financial measures of actual results or future projections. A comparison and reconciliation to GAAP measures is included in our news release.

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On the call today, we have Nitin Mhatre, President and Chief Executive Officer of Berkshire Hills Bancorp; Subhadeep Basu, our Chief Financial Officer; Sean Gray, our Chief Operating Officer; and Greg Lindenmuth, our Chief Risk Officer.

At this time, I'll turn the call over to our CEO, Nitin Mhatre.

Nitin Mhatre

Thank you, Kevin and good morning everyone and welcome once again to Berkshire's first quarter earnings call.

I'll begin my remarks on Slide 3, where you can see the highlights of the first quarter.

It was another solid quarter with strong financial performance, continued balance sheet strength, and steady progress on our BEST strategy.

Our earnings per share of $0.43 was up by 4% quarter-over-quarter and up 37% year-over-year. Revenues were lower year-over-year driven by runoff in the PPP and nonstrategic loan portfolios, while our continued expense discipline resulted in expenses flat quarter-over-quarter and lower by 8% year-over-year.

As we've said before, we will self-fund our BEST strategy through optimization initiatives, while reinvesting those saves in bankers, customer experience, and technology investments that enable our future growth. We are pleased to see that trend come through once again this quarter. Adjusted return on tangible common equity improved to 7.5% from 6% a year ago.

Moving to balance sheet update. As indicated on previous calls, we were expecting to reach an inflection point on the total loan balances growth in the first half of 2022. We are pleased to report a quarter-over-quarter growth of 3.1% and 6.5% in average and end-of-period loan balances. This growth was driven by strong loan originations this quarter. I'll provide more details on loan balances shortly.

Overall, our balance sheet remains strong. We deployed capital for balance sheet growth and returned $35 million of capital to Shareholders. We ended the quarter with an estimated CET1 ratio of 14%. We have ample capital to both fund loan growth and continue stock repurchases. Our share count has dropped by 6% over the past year.

On the strategy front, we've made good progress, and we'll continue to stay focused on the execution of our journey forward. We continue to add talent critical to our BEST plan. Our Board replenishment continues, and we've expanded our partnership with Narmi to further improve our digital experience and Net Promoter Score.

Turning to Slide 4, I wanted to spend a moment sharing more details on our loan growth. After seven quarters, we are starting to see loan balances grow once again, primarily driven by growth in commercial portfolio. Balances growth was driven by new loan originations that were up significantly quarter-over-quarter and year-over-year. Our existing bankers and new hires are winning new business across the board, which is reflected in our originations and pipeline growth. It is quite encouraging to see our loan book growing as we reactivate our organic growth muscle.

Finally, I'd like to thank all of our employees for their hard work in the quarter. They are the reason why we are making great progress on our transformation. Their dedication and commitment to Berkshire's customers is what is driving our success and our progress towards becoming a high-performing, leading, socially responsible community bank.

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With that, I'll turn the call over to Subhadeep to discuss our financials in more detail. Subhadeep?

Subhadeep Basu

Thank you, Nitin. Good morning everyone.

Slide 5 shows our quarterly income statement. Please see the appendix for a reconciliation of GAAP and adjusted financials. My comments will be on an adjusted basis and not GAAP.

Our revenues were up 1% quarter-over-quarter and down 11% year-over-year. Sequentially, we had stable net interest income despite two fewer days in the quarter. Fee revenues were up 5% quarter-over-quarter, and continued expense discipline resulted in flat expenses quarter-over-quarter and down 8% year-over-year. We had a provision benefit of $4 million this quarter, driven by improved credit performance. Our after-tax income rose 3% and 30% quarter-over-quarter and year-over-year, respectively.

Turning to Slide 6, Slide 6 highlights changes in our earning assets. As Nitin mentioned, we are pleased to report over 3% increase in average loans, with particular strength in C&I lending which is up 7% quarter-over-quarter. Growth in C&I lending was driven by asset-based lending. Our CRE and residential mortgage books were each up 2% quarter-over-quarter. It's nice to see loan growth again. Securities are up 12% quarter-over-quarter and up 21% year-over-year. It reflects continued reinvestment of cash.

Highlights in the quarter include selective purchases of short-term Treasuries to enhance near-term returns and allow for flexibility to invest at higher rates later on in the cycle. While available cash funded strong loan and securities growth in the quarter, ample liquidity remains to opportunistically deploy excess cash as rates rise.

Moving on to Slide 7, Slide 7 shows our average liabilities. Our funding mix continues to be meaningfully improved as lower-cost funding replaces higher-cost funding. Year-over-year, our cost of funds has dropped by 25 basis points to 23 basis points. Broker deposits and wholesale borrowings have dropped to $341 million, down 67% from $1 billion in the first quarter of 2021 and down 82% from $1.9 billion in the first quarter of 2020, a very significant decrease. We also plan to redeem $75 million of subordinated debt with a coupon of 6.85% no later than third quarter of 2022.

Our net interest margin was 2.61%, up a basis point in the first quarter. Adjusted NIM, excluding PPP and purchase loan accretion or PLA impacts, was 2.58% in the first quarter versus 2.46% a year ago. That is up 12 basis points. It's nice to see the impact of purchased loan accretion diminish to only three basis points versus higher levels in prior quarters.

Turning to Slide 8, we show our fee revenues. Our fee revenues were up 5% quarter-over-quarter and down 18% year-over-year. Sequential growth was primarily driven by higher wealth management fees, swap fees and lower tax credit impairments. The year-over-year fee decline was driven by the sale of our insurance business, lower SBA gain on sale, and mortgage banking revenues. Lower SBA lending revenue was driven by seasonality and a reduction of SBA guarantees from 90% to 75%. However, the pipeline and outlook for SBA loans and corresponding fees remain strong for the remainder of the year.

On Slide 9, we show our expenses. Continued expense discipline resulted in flat expenses quarter-over-quarter and down 8% year-over-year. We continue to benefit from expense saves from market exits and branch consolidations. We are also assessing our non-branch real estate footprint. Based on the post-pandemic work environment, we are targeting to reduce that square footage by a meaningful amount, which is an important self-help lever as we call it. Overall, our focus on expense management has helped us self-fund our investments in frontline bankers and technology.

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Moving to the next slide, Slide 10 is a summary of our asset quality metrics. Strong improvements in credit across the board, continuing the trend over the last several quarters. Delinquencies are down 45% year-over-year, and our net charge-offs dropped to 15 basis points. Our allowance for credit losses to loans ended the quarter at 1.37% of loans.

Next slide, Slide 11, shows detail on our capital and liquidity positions. Capital levels remained strong. Our common equity Tier 1 capital ratio ended the first quarter at an estimated 14%. Our top priority by far remains in deploying capital to support organic balance sheet growth. We are also biased to opportunistic stock repurchase, given our low stock valuation, and have repurchased about $29 million of stock in the first quarter. We also expect to grow our cash dividends over time.

Like many banks, we recorded a negative bond mark in other comprehensive income in our equity account, which amounts to $75 million. Our bond portfolio is managed within the context of our holistic balance sheet management and ALM strategy. As rates rise, the negative marks to the securities book are immediate, while the significant positive impact of higher asset yields and net interest income accrues over time. The OCI mark also does not impact our reg capital ratios.

So in summary, a solid quarter with robust balance sheet growth, strong capital position, ample deposits to fund future growth, and importantly, strong credit performance and expense management.

I would like to now close with comments on our outlook for the rest of 2022.

The New England economy is strong, labor markets are strong, and consumer demand which is two-thirds of GDP is high as we come out of the pandemic.

We are confident about achieving the 5% to 7% loan growth as announced as part of our BEST program. The pipeline is robust, and we're seeing solid loan growth momentum. We expect low single-digit deposit growth in 2022. We also expect NIM to trend higher.

Recall that our NII guidance in January was for mid single-digit NII growth of reported NII of $291 million and included four rate increases. Our current guidance includes six rate increases. As a result, we're expecting NII lift of approximately 6% in 2022. On an adjusted basis, excluding PPP and Mid-Atlantic, the NII growth in 2022 is expected to be low double-digits. The current market implied rate increase is 8% for the rest of the year. The macro environment can change quickly, and we have opted to remain conservative at this time.

About 60% of our loans are floating-rate loans, and we have loan growth. We are well-positioned for a rising rate environment. We expect expenses for the rest of the year to be stable at about $68 to $70 million quarterly run rate. However, I would like to remind you that expenses can be lumpy quarter-to-quarter.

Our asset quality remains strong, and underwriting continues to follow our conservative guidelines. We have had provision benefits for the last three quarters. We expect credit provision expense to start to normalize later in 2022 and hit a loss reserve-to-loans ratio of 115 to 120 basis points in the second half of 2022. That will be in line with our balance sheet growth and asset mix change. Our tax rate for 2022 should be in the high-teens.

Finally, we expect to continue to execute our new $140 million stock repurchase program in 2022 and complete the remainder of $111 million in buybacks in 2022.

With that, I'll turn it back to Nitin for further comments. Nitin?

Nitin Mhatre

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Thanks, Subhadeep.

On Slide 12, we have our BEST program's North Star chart which shows our progress on five key performance metrics of the program. The financial metrics continue to show steady improvement. NPS score remains at 50th percentile, and ESG percentile ranking improved further this quarter to 22nd percentile nationally. We were also ranked amongst the top 10 most trustworthy banks in the nation by Newsweek's America's Most Trustworthy Companies in 2022 Report published this month.

We are executing in all three pillars of our BEST program, optimize, digitize, and enhance, as planned. We have reignited our organic growth engine and have started to see growth in loan balances. Overall, the program is working as expected with potential upside to balances, revenues, and profitability over long term, if the current trend continues. As indicated during the last earnings call, we're updating our BEST program to reflect this positive momentum and a significantly higher rate environment we are in now compared to last year when the program was launched.

We also recognize that the geopolitical, macroeconomic and the rate environment has changed further since our last earnings call and is expected to evolve even more over the next few months. Given that, we will schedule an Investor call dedicated to provide details of the updated BEST program after second quarter earnings, which will also be around the time we complete the one-year anniversary of our BEST program launch.

Our differentiated technology roadmap is another important element of our BEST transformation program that will set us apart from competitors while maximizing value for all Stakeholders. Slide 13 shows the central tenet of our technology roadmap. We believe that it is highly effective and efficient for us to pursue the strategy of optimizing the core versus building a new core or wrap the core system with individual integrations, and that's the journey we are on. Cloud migration, API enablement, data warehousing, CRM system, and integrated digital banking experience are the foundational elements of our technology roadmap, and we've completed implementation of most of these elements over the last year or so.

Many of these foundational elements have been established through partnerships with best-in-class partners, some of whom are listed on the slide, with Narmi as the latest partner that will help us deliver exceptional customer experience for digital banking.

Slide 14 provides a more detailed view of the scope of the features, functionalities, and the overall ecosystem in which we can now participate as a result of this expanded relationship with Narmi. Narmi is one of the fastest-growing Software-as-a-Service providers with a mission to provide world-class digital banking experience to their bank partners. We began our partnership with them about two years ago with a focus on enabling digital account opening for our consumer segment.

We recently expanded our relationship with Narmi to include app management and online banking for consumers and small business segments. This partnership will ultimately further improve our Net Promoter Score and relationship deepening.

Slide 15 is a short bio of our new Board member, Mihir Desai. Mihir is a Professor of Finance at Harvard Business School and Professor of Law at Harvard Law School. He's also an accomplished author and expert in finance and tax policy, and serves as a Research Associate in the National Bureau of Economic Research's Public Economics and Corporate Finance Programs. We're delighted that he has joined our Board. Welcome, Mihir.

In summary, a solid quarter with continued momentum on our transformational BEST plan, strong loan growth, disciplined expense management, and improved financial returns.

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With that, I'll turn it over to the Operator for questions. Adam?

Operator

Thank you. The first question today comes from Mark Fitzgibbon from Piper Sandler. Mark, please go ahead. Your line is open.

Mark Fitzgibbon

Thank you. Good morning.

Nitin Mhatre

Good morning, Mark.

Mark Fitzgibbon

First, Subhadeep—hey, Nitin. Subhadeep, you had mentioned the pipelines were strong. I wondered if you could help us size those, how large those pipelines are, and maybe what the average rate for new loans was?

Nitin Mhatre

Hey, Mark, I'll start there. The pipeline is actually stronger as of now for the second quarter than it was at the end of the fourth quarter. I wouldn't give you the specific number, but I think it's sufficient for you to know that it is actually higher. The commercial is about the same level, a little bit of increase in the resi and consumer. The overall pipeline is modestly higher than the last quarter.

Subhadeep Basu

Hey, Mark, this is Subhadeep. Yes. That's exactly where I was going with that, Mark. I think on the yield side, we are seeing stabilization on the portfolio this quarter. Overall, portfolio yields went down but that was primarily due to some prepayment activity that we saw, and that's likely to reduce in a rising rate environment. So as we have guided also in our last call, we expect to see the yields increase. Obviously, we stand to benefit from the rising rates. Also, I would like to point out that 60% of our book are floating-rate loans.

Mark Fitzgibbon

Okay, and then secondly, Subhadeep, could you share with us what the AOCI was this quarter?

Subhadeep Basu

Yes. It was $75 million impact, about a 6% reduction in tangible book.

Mark Fitzgibbon

Okay. You guys have done a really good job of holding the line on operating expenses. I guess I'd be curious, at what point do you think operating expenses will start to rise? Is that a 2023 kind of event?

Subhadeep Basu

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So Mark, hi, this is Subhadeep. Great question. So as we have guided all along, and also our annual guidance, we expect to maintain $68 to $70 million run rate expenses for the remainder of 2022. It could be lumpy, so there could be some fluctuations, but overall that's the run rate we are targeting. If we expect an increase in those expenses, we'll be sure to guide in subsequent earnings calls.

Mark Fitzgibbon

Okay. Then last question I had, in the press release you referenced that you've hired a number of bankers. I guess I'm curious sort of roughly how many senior lenders you have today and how many of those are say new in the last year?

Nitin Mhatre

Hey, Mark, I wouldn't give you a specific number. What I would say is we continue to hire, especially on the commercial side and a little bit on the resi side. We have grown our workforce, and more importantly, the new producers that we're hiring are bringing in new pipeline and their production levels are higher than what we anticipated them to be early on.

Mark Fitzgibbon

Thank you.

Nitin Mhatre

Thanks Mark.

Operator

The next question comes from Billy Young at RBC Capital Markets. Billy, your line is open. Please go ahead.

Billy Young

Hey, good morning guys. How are you?

Nitin Mhatre

Good morning.

Subhadeep Basu

Good morning, Billy.

Billy Young

Just a quick question, a couple of quick questions here. Can you speak a little bit to the CD growth you saw this quarter, what the drivers there were?

Subhadeep Basu

Could you repeat that, Billy? You just broke up a little bit.

Billy Young

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I'm sorry. Could you speak a little bit to the CDs, the time deposit growth you saw this quarter and what the drivers were?

Subhadeep Basu

Yes, hi. So in terms of our deposit growth, I think overall for total deposits, that stayed more or less like flat. On an average basis, it was 1% up. On the overall—I think on an end-of-period basis, our deposits were up like around 6%. Was your question around sort of CDs?

Billy Young

Yes. It looks like CD balances are up about mid-20% quarter-over-quarter.

Subhadeep Basu

I'm not sure because if you look at Slide 7 of our earnings presentation, Billy, we talk about our liabilities, and it has CDs and time deposits. So it's down 7% quarter-over-quarter and 28% year-over-year.

Billy Young

Okay. That was my mistake then. I apologize for that.

Subhadeep Basu

Not a problem at all.

Billy Young

Then it was good to see the trends in loan originations this quarter and the commentary about the stronger pipelines. How should we think about the mix between consumer and commercial originations going forward here? It looked like consumer was stronger than I expected this quarter. Given some of your initiatives in things such as Upstart, how should we think about the mix going forward?

Nitin Mhatre

Yes. Billy, hi, Nitin here. Just so you know, I think on the—broadly speaking, for the first quarter, the originations mix was—about 60%-plus was commercial. We expect the commercial to have continued momentum. Consumer is picking up as well, along with resi. So I think overall, the mix would be 50%-plus commercial and the rest coming through resi and consumer.

Billy Young

Thank you. That's very helpful. My last question is just what kind of a drag was the lower day count this quarter on NII?

Subhadeep Basu

Hi, Billy, this is Subhadeep. Two days. You're looking for the day count, right?

Billy Young

Yes. Do you have a dollar amount of the drag?.

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Subhadeep Basu

Hi, Billy. We typically don't disclose the dollar amounts but I can give you a two-day count. I think you can probably estimate from the NII numbers that we have published.

Billy Young

Okay. Thank you very much. That's all I had.

Subhadeep Basu

It's typically 92 days versus 90 days for the quarter.

Billy Young

Okay, thank you.

Subhadeep Basu

Thanks.

Operator

The next question comes from Chris O'Connell at KBW. Chris, please go ahead. Your line is open.

Christopher O'Connell

Good morning.

Nitin Mhatre

Morning, Chris.

Christopher O'Connell

So I just wanted to follow up on the deposit growth discussion. I know you guys called out a couple of seasonal items regarding payroll in the press release. If you could just remind us exactly what those seasonal dynamics are. Then given the strong growth to start off the year, reconciling that with the low single-digit guide for the full year end deposits, are we going to see a decline from here or just how you're thinking about that?

Subhadeep Basu

Hi, Chris. So from a guidance perspective, we're still going to stick with our low single-digit deposit growth that we gave out. In terms of the payroll deposits, as you know, and as the business dictates, depending on sort of as the dates of the payrolls are processed, the balances come in, and then you see the balances getting drawn down in a matter of three or four days. I think this quarter, we experienced higher inflows of payroll deposits than normally we would expect to, and we are being watchful and seeing how that trend plays out.

Christopher O'Connell

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Okay. Got it. So how does the—there is a sharp decline in money market, and I'm assuming the payrolls are going into the NOW. So I guess what's the seasonality with the money market in the first quarter versus the fourth quarter, if you could just remind us of that?

Subhadeep Basu

So typically, that substantial movement you would see between money markets and NOW is almost always driven by payroll balances switching between those two accounts. So that's what drives the movement.

Nitin Mhatre

Hey, Chris, just to give you maybe a little bit of a macro color on this. This is Nitin here. On the payroll, which has its component of seasonality, like you said, and depending on the day or the week, there could be a spike at the end of period balances. But what we are seeing is it seems to be the payroll itself is growing, and as workers get back into the payroll, it looks like - at least our average for the first quarter - and we don't know if that makes a trend yet, but the average for the quarter was also significantly higher than the previous quarters.

So that could be a reflection of the workforce growth and people coming back to work. So if that continues, we should continue to see better averages than we have seen in the past.

Christopher O'Connell

Understood. Got it. Then maybe if you could just talk a little bit more about some of the loan growth sources that you talked about in the press release where you're developing new sourcing channels on the resi and consumer side to support loan growth this year.

Nitin Mhatre

Yes. So it's broad-based, Chris. On the commercial side, it's improved productivity from the existing bankers, new hires, and specific programs that we've kind of rolled out. So that is certainly getting the momentum on the commercial side. On the consumer side, we have the growth in the frontline bankers on the retail channel. We have corresponding partnerships. On the unsecured side, we have a partnership that we announced with Upstart.

So I think a combination of all of those is going to continue to improve the trajectory and the momentum on both fronts. As I said earlier, I think commercial will continue to be 50% to 55% of the originations and as the pie grows overall.

Christopher O'Connell

Okay. Got it. Then on the other fees this quarter, those came in a bit strong. Was that swap related? Are you seeing an increase in demand for swap activity going forward?

Subhadeep Basu

Hi, Chris, this is Subhadeep. So I would attribute that to primarily three buckets. One is tax credit impairment, which came in lower, which is a contra item, which shows up there. Second one is trailer revenues from credit card and other things which typically now show up post year-end in first quarter. The third component is swap fees. We do see a healthy pickup in swap fees, which we're very encouraged about.

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Christopher O'Connell

Got it. Thanks Subhadeep. That's it for now. I'll hop out. Thank you.

Subhadeep Basu

Thanks, Chris.

Nitin Mhatre

Thank you, Chris.

Operator

As we have no further questions, I'll hand back to Mr. Mhatre for any closing remarks.

Nitin Mhatre

Thank you, Adam and thank you all for joining us today on our call and for your interest in Berkshire. Have a great day and be well. Adam, you can close the call now.

Operator

This concludes today's call. Thank you very much for your attendance. You may now disconnect your lines.

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