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ISBC.OQ - Investors Bancorp Inc. to Acquire 8 Berkshire Bank Branches - Conference Call

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PRESENTATION

Operator

Good morning, and welcome to the Investors Bancorp Investor and Analyst Call. (Operator Instructions) Please note this event is being recorded.

We'll begin this morning's call with the company's standard forward-looking statement disclosure. On this call, representatives of Investors Bancorp, Inc. may make some forward-looking statements with respect to its financial position, results of operations and business. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond Investors Bancorp's control, are difficult to predict and which can cause actual results to differ materially from those expressed or forecast in these forward-looking statements.

In last night's press release, the company included its safe harbor disclosure and refers you to that statement. That document is incorporated into this presentation. For a complete discussion of the certain risks and uncertainties affecting Investors Bancorp, please see the sections entitled, Risk Factors, Management Discussion and Analysis of Financial Conditions and Results of Operations set forth in Investors Bancorp's filings with the SEC.

And now I'd like to turn the call over to Kevin Cummings, Chairman and CEO of Investors Bancorp.

Kevin Cummings - *Investors Bancorp, Inc. - Chairman & CEO*

Thank you, Ellis, and good morning, and welcome to our call. Last night, at the close of business, we announced the acquisition or branch acquisition of Berkshire Hills' New Jersey franchise and Pennsylvania franchise. It's 8 branches, about $640 million in deposits and $309 million in loans.

We did extensive due diligence a lot of time on this transaction, and we feel we've had the correct box and the correct math for a very, very positive transaction. This will enhance our presence in Mercer County. We'll have the largest market share in Mercer County of any bank headquartered in New Jersey. And it continues -- it gives us 2 branches in Bucks County in Pennsylvania. So we're very excited about that, extending our Central Jersey presence.

We also announced that because of the quarter and the blackout period in relation to our third quarter earnings and then being involved in this transaction, we're certainly announcing today our re-continuance of our stock buyback program.

And this emphasizes what we've been doing here traditionally. This is our 10th acquisition, the 4-pronged approach to managing our equity. We have a strong equity base. We have strong reserves. We're very confident in our credit review of this portfolio. And I think it's one of the tools, M&A and buybacks, to leverage the capital and improve shareholder returns. It's organic growth, dividends, which will be increasing -- we expect to increase at 8% next year. M&A transactions, this follows our expansion in the Nassau and Suffolk Counties with the Gold Coast transaction closed this year on April 3, and then continuation of the buyback program.

We feel confident where we are today. And we look at this as a small, low-risk transaction where we can enhance our New Jersey presence and then move into Bucks County. I think it's, from a management point of view, similar to the Nassau and Suffolk deal last year that we announced in July, closed on April 3, in the height of the pandemic. It's -- it gives us some momentum going into next year and enhances our growth, improves our net interest margin. So we're very excited about it. And I think it's a low-risk transaction that we can execute on very effectively.

Dom, I'll turn it over to you.

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

Thank you, Kevin. Really not a lot -- much more to add to Kevin's comments and just want to make a few comments. The reason that we liked the deal, obviously, is because it sat right within our market down in Mercer County. We plan to consolidate 4 of the 8 branches. If you look at the branch map, you can see that 4 of the branches sit right on top of our own branches.

And also what we liked about the transaction is it gave us the opportunity to continue to reduce our reliance on wholesale funding. That's been a knock on the company that our loan-to-deposit ratio has been high. So we saw this as an opportunity to continue to pay off advances and wholesale borrowings and improve our deposit structure.

I know there's some question also about the fact that this was the First Choice franchise that Berkshire bought a number of years ago. And for the most part, First Choice was a mortgage banking operation. But I have to say that during our due diligence, what we found is that Berkshire did a very good job trying to start to change the mix of the deposits. And you can see that they did change the mix of the deposits, on Page 3, that 18% of their deposits fell into the checking category, which is not too different than our own portfolio.

So cost of funds was a little bit higher in the portfolio, but something that we thought we can handle. We like the idea that we can save about 50% of the expenses associated with the deal, and it really made a lot of sense to get involved here.

As Kevin mentioned, we went through a pretty aggressive due diligence process on the loan side. As a matter of fact, we had representatives from both our lending group and our credit risk group go through the portfolio. And I have Richard Spengler here with me today. And Rich can be able -- he'll be able to answer questions about the portfolio in the detail.

One other point that I wanted to make before really we can open it up for questions, because it's a small deal, and everything is right here, and that's the idea of the buybacks, right? We -- I know that there'll be some question about, "Well, why do this deal instead of doing buybacks?" And the fact is that we're going to do both. We'll continue to do both.

Someone may say, "Well, why didn't you do buybacks prior to your earnings release?" Well, a few reasons. One is we were in blackout, right? So 2 weeks before we released earnings, before the end of the period, we were in blackout. Then once we announced earnings, we were in the midst of this deal, and that put us in a position of not being able to buy the stock back until we announced it.

So I can assure you that we have buybacks built into our strategic plan here. We plan to execute on that going forward. We still think the stock is attractive at the level that it's trading at, despite the fact that it's up 17% or 18%. And so our investors should rest assured that we'll continue to execute on our strategic plan and make the best use of capital that we can going forward.

So at this point, I think it may be best to open it up for questions. Because as I said, there's really not a lot here, and it's really more about the questions that you folks have on the deal. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today comes from Mark Fitzgibbon with Piper Sandler.

Mark Thomas Fitzgibbon - *Piper Sandler & Co., Research Division - MD & Head of FSG Research*

The first question I had, probably it's for you, Sean. I wondered if you could give us some color on what the expense impact of this is likely to be when the transaction closed?

P. Sean Burke - *Investors Bancorp, Inc. - Executive VP & CFO*

Thanks, Mark. It's about a $3 million additional expense related to the branches that we plan to retain. So we do plan to consolidate around half the branches. So when all is said and done, we expect to have 4 branches in operation, and those will cost about $3 million of additional expense.

There is some lending staff that comes along with it that we are retaining. And then the restructuring charges that we've outlined in the presentation, those will be incurred in 2021 as well, Mark. But those are more onetime nonrecurring expenses.

Mark Thomas Fitzgibbon - *Piper Sandler & Co., Research Division - MD & Head of FSG Research*

And when you say $3 million, you're talking on an annualized basis or quarterly?

P. Sean Burke - *Investors Bancorp, Inc. - Executive VP & CFO*

Annualized basis.

Mark Thomas Fitzgibbon - *Piper Sandler & Co., Research Division - MD & Head of FSG Research*

Annualized. Okay. Great. And then secondly, I was curious if you could update us on deferrals -- loan deferrals through the end of November, if you had those -- that data available?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

Yes, Mark. The deferrals are at about the same place they were when we released earnings, which was just about $600 million. The one point that I wanted to make, though, on the deferrals is that approximately $400 million of the $600 million are paying interest on their loans. So while they've been deferred, they are -- they have agreed to pay interest on their loans. And that includes the hotel loans that we have on the balance sheet, which are about $240 million or so.

Mark Thomas Fitzgibbon - *Piper Sandler & Co., Research Division - MD & Head of FSG Research*

Okay. And then lastly, are these the kinds of transactions that we're likely to see you all do in coming quarters? Are there more of these kinds of branch-like transactions in your markets? Is that what we should expect from you folks over the next few quarters or so?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

Well, I'm not sure, Mark, if we can say specifically that there'll be more branch-type transactions. But I think one of the things that we always try to make sure of is that we not do anything that would significantly impact our capital levels and do something that's not right for shareholders.

So the one thing that I think we can expect is that we will continue to look at doing more single and double type transactions, things that make sense, that have earn back that is less than 3 years and has minimal impact on tangible book value.

Mark Thomas Fitzgibbon - *Piper Sandler & Co., Research Division - MD & Head of FSG Research*

And I assume buybacks are not inclusive to that?

Kevin Cummings - *Investors Bancorp, Inc. - Chairman & CEO*

Buybacks are a big part of our strategy moving forward, Mark, and we want to emphasize that.

Operator

Our next question comes from Jared Shaw with Wells Fargo Securities.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

I guess, maybe just following up on the last question with the buybacks. I guess, I was a little surprised that a branch deal would keep you out of the market for buybacks, given that's a relatively small deal. If there are other opportunities that come up like this, would that keep you out of the market? Or would you be able to do like a 10b5 plan or something like that to stay in as you're working through smaller deals or differentials?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

Yes. It is a good point, Jared. Obviously, we did not have a 10b5-1 plan going into earnings. When we're in buyback mode, that is for the past 10 years, we have put 10b5-1 plans in place prior to earnings so that we can continue to buy back stock. But just given the environment and what it was going into earnings, we did not have a 10b5-1 plan in place.

I can tell you that we asked the question specifically about general counsel, and he did a little research and he opined on the cautious side, saying it was probably best not to do any buybacks post the earnings announcement. So it's not like we didn't ask. We wanted to get it -- we wanted to do it, but the advice that we got was not to.

Kevin Cummings - *Investors Bancorp, Inc. - Chairman & CEO*

And Jared, to that point, we were -- even at the beginning of the quarter, like our period, we were trying to buy -- start buying some stock back, and we kind of missed that window. So that discussion was ongoing even in September.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Okay. All right. That's good color. And then you're talking about the positive impact to the loan-to-deposit ratio. Does that -- is this big enough to really change the long-term trajectory after that onetime benefit? Or is this really -- we should -- this will help restructure some of those borrowings? But the growth rate out of these branches, we shouldn't expect to be significantly different than the rest of the franchise?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

We're modeling about a 5% deposit growth in these branches, so not anything that's significant. A couple of things, though. You've got to like the idea that you're able take $600 million in deposits and split them into 4 different branches. You have to like that. We have to like the loan-to-deposit ratio, as you mentioned.

Also it meant keeping a competitor out of our markets. We are the #1 bank now in that Trenton Mercer County market. And there were some other banks, I think, looking at the deal. And I'm not saying that's our #1 -- that was our #1 objective. But clearly, it has the benefit of keeping a competitor out of the market.

The other point that we haven't made in this presentation is that we plan to open a branch in Princeton. We got approval from Princeton to open a branch right downtown, which has been not allowed for the last few years. And so that will continue to solidify our presence in this Mercer County market.

Jared David Wesley Shaw - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Okay. Great. And then just finally from me, I guess, how does this play into a broader theme -- the broader theme in the industry of reducing branches? Obviously, you've got to close half of the acquired runs. I mean, are there broader discussions going on around the branch footprint overall? And is there an opportunity to see additional cost saves on a bigger scale?

P. Sean Burke - *Investors Bancorp, Inc. - Executive VP & CFO*

Yes. We are -- actually we are looking at consolidating some branches in our markets in both in New Jersey and New York markets. And we have slated 10 branches for closure in 2021.

Operator

Our next question comes from Matthew Breese with Stephens, Inc.

Matthew M. Breese - *Stephens Inc., Research Division - MD & Analyst*

Just real quick. On the FHLB borrowings you're exiting, what's the cost of those? And then in the deck, you mentioned that you'll use liquidity to redeem. I'm assuming you're referring to cash? Or is it a mix of cash and securities?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

The borrowing rate was a little bit over 2%. So we're using 53 basis point money to pay down the 2%.

Matthew M. Breese - *Stephens Inc., Research Division - MD & Analyst*

Okay. The other question I had was you mentioned in the release that you applied a 4.2% loan mark. Could you just walk us through the process of applying that mark? In this environment, it's obviously a little bit more challenging. And if there were any asset classes where the mark was heftier than others, what would you -- could you provide some color on that?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

Yes. I will give you some broad-based numbers, and then I'll ask Rich Spengler to get into some of the more, I'll call them, hot categories. But on the commercial real estate side, we applied about a 6% mark on the commercial real estate portfolio, about a 20% mark on the C&I portfolio and a 5% mark on the residential portfolio. So those are the broad-based marks.

I think one of the other points that I wanted to make here, and I'm sure there'll be some questions about it, is what do you have in, like, from a NAICS Code perspective in accommodation. And of the portfolio, about $308 million in loans saw $21 million in accommodation and then $8 million in the arts, entertainment and recreation NAICS Codes.

So those are the 2 biggest categories there. And on those, for example, on the accommodation loans, we have a 21% mark on those loans. And on the arts and entertainment, that next biggest bucket at $8 million, we applied a 55% mark on it.

And we were actually prepared to give you a little more detail on what's in those categories, and I can have Rich Spengler speak to that.

Matthew M. Breese - *Stephens Inc., Research Division - MD & Analyst*

Yes, that would be helpful.

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

Rich, why don't you talk about the accommodation first?

Richard S. Spengler - *Investors Bancorp, Inc. - Executive VP & Chief Lending Officer*

So on the accommodation side, we see -- the total on the accommodation is just over $20 million, but it's made up of 19 loans. It's really 2 large loans, one of which is a hotel loan, it's a flagged hotel loan with a very strong liquid sponsor outside Philadelphia region. So that one is about $10 million. And then the second one is in New Jersey. It is actually a banquet and catering hall, once again, with a very strong liquid sponsor.

We put those 2 together. They probably make up just under 90% of that $20 million total. After that, it falls off dramatically to $500,000, $300,000, $200,000. I think by the time we get 7 loans into, we're down under $100,000 a piece. So they get to be very small, a couple of restaurants, some takeout, limited service cafes, 3 or 4 bagel shops. I mean it really changes dramatically.

So the majority of that is really made up of those 2 loans that do have very strong sponsorships and asset classes, which the hotel is actually doing fairly well right now at this point, considering where hotels are.

Matthew M. Breese - *Stephens Inc., Research Division - MD & Analyst*

Now these are combination loans. Just thinking about it, Dom, you gave me a 20% mark on C&I loans but a 6% mark on CRE. Are these combination loans in the CRE bucket or in the C&I portfolio?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

C&I bucket.

Matthew M. Breese - *Stephens Inc., Research Division - MD & Analyst*

Okay. That makes sense then. Okay. I appreciate that. Going back to expenses. Now you mentioned you're going to close 50% of the branches. What's the time frame on closure? Is that -- should we expect that day 1? Or is there going to be some lag?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

As soon as we get approval.

Matthew M. Breese - *Stephens Inc., Research Division - MD & Analyst*

Okay. Okay. And then you mentioned an additional 10 branches being closed. What's the cost on those branches or an average cost we should use?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

We budgeted about $3 million in expenses to be eliminated as a result of closing those branches.

Matthew M. Breese - *Stephens Inc., Research Division - MD & Analyst*

Okay. Last question is just you mentioned deal close in the first half of '21. Is there a month that you would kind of eye for modeling purposes?

P. Sean Burke - *Investors Bancorp, Inc. - Executive VP & CFO*

The reason that we said first half of '21 is because we think we can get the deal done in the first quarter. However, the Department of Banking in Massachusetts can take up to 90 days. So that's one of the reasons why we changed it from first quarter to first half.

So it's a small deal. It's mostly in New Jersey. I would expect that the Department of Banking in Massachusetts would not spend too much time on it. But -- so we're hoping first quarter, but to be safe, we use that first half.

Operator

Our next question comes from Laurie Hunsicker with Compass Point.

Laurie Katherine Havener Hunsicker - *Compass Point Research & Trading, LLC, Research Division - MD & Research Analyst*

Just wanted to stay on the loans, the $308 million loans. Sean or Rich, can either one of you just fill us in, is there any leisure in that C&I book? Is there any specific Firestone exposure in that book?

P. Sean Burke - *Investors Bancorp, Inc. - Executive VP & CFO*

No.

Laurie Katherine Havener Hunsicker - *Compass Point Research & Trading, LLC, Research Division - MD & Research Analyst*

Okay, great. And then of that, so (inaudible). Is that correct?

P. Sean Burke - *Investors Bancorp, Inc. - Executive VP & CFO*

I'm sorry, Laurie?

Laurie Katherine Havener Hunsicker - *Compass Point Research & Trading, LLC, Research Division - MD & Research Analyst*

So I'm sorry, that's no, there's no leisure and no Firestone exposure in that book?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

Well, there is a part in entertainment. So under leisure, we do have -- we have a golf course loan, country club loan. I think we would consider that to be leisure, I guess, but there's no firestone exposure.

Laurie Katherine Havener Hunsicker - *Compass Point Research & Trading, LLC, Research Division - MD & Research Analyst*

Perfect. Okay. And then can you just tell us, of the $308 million, how much is on deferral?

Domenick A. Cama - *Investors Bancorp, Inc. - President, COO & Director*

It's about $2 million to $3 million. Debit loans, 5 residential, 2 commercial.

Operator

That concludes our question-and-answer session. And I'd like to turn the call back over to management for any closing remarks.

Kevin Cummings - *Investors Bancorp, Inc. - Chairman & CEO*

Okay. Thank you. Well, first of all, I appreciate your time on the call today. I think we have a deal that has attractive transaction pricing, a great internal rate of return. We're bullish on the buybacks. And we did extensive due diligence, and we feel we have a handle around the risk exposures.

It gives us great momentum. It's going to excite some of our New Jersey employees, because we did the New York deal last time. And we think it's a good, safe transaction and moves us into '21 with some momentum.

I want to thank you for your participation. And if we don't speak before the holidays, everyone have a Merry Christmas, Happy Hanukkah and a great and healthy New Year. Be safe out there. Thank you.

Operator

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

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