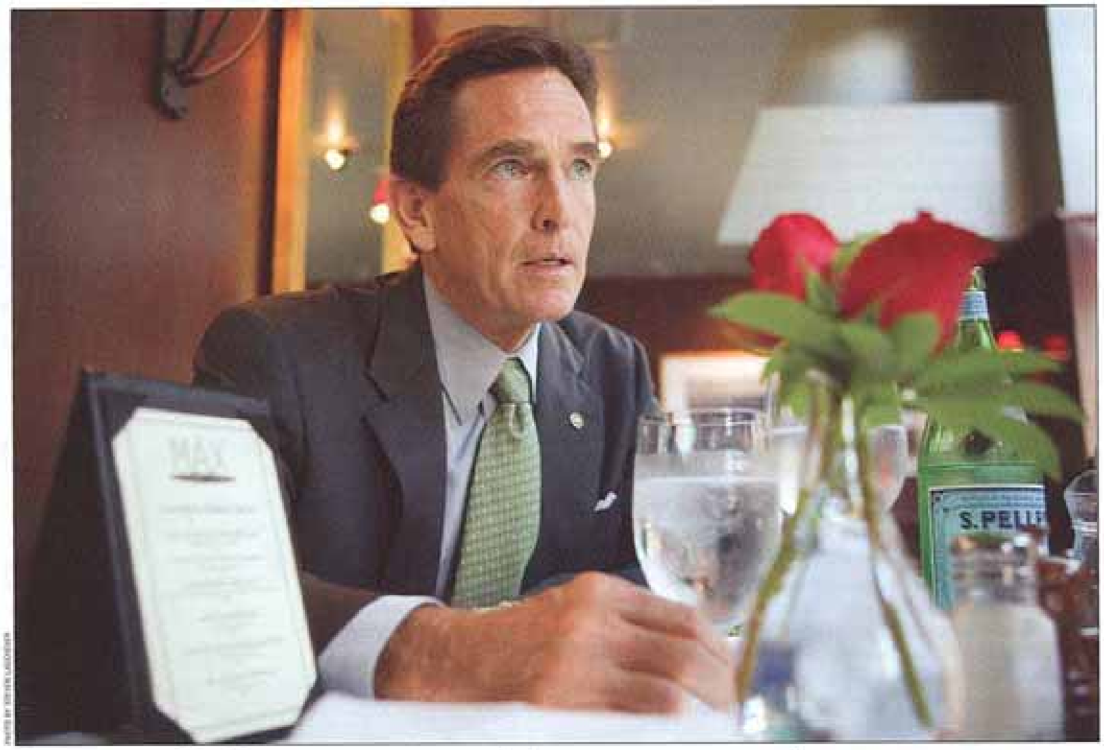
By Sujata Srinivasan

An interview with the movers and shakers of Connecticut businesses



Banking on Expansion

Webster Bank's chairman and CEO is spearheading the bank's growth in new markets.

Webster Bank [NYSE: WBS], the largest independent bank in New England, with assets of $18 billion and market capitalization of $2.5 billion, continues to expand across the state, and is achieving promising growth in commercial and consumer loans, deposits and retail earnings. Over a lunch of filet mignon and coffee at Max Downtown in Hartford, James C. Smith, Webster's chairman and CEO, tells *Connecticut Business Magazine* that the bank is "better than it's been in a long time."

Indeed. Going forward, WBS is positioned to increase its loans and deposits, reduce borrowings and lower exposure to the wholesale banking business.

Smith says the growth of WBS' market in Connecticut, in terms of line usage, is currently comparable with southeastern Massachusetts, and lower than Rhode Island and Westchester County—but higher in terms of job growth in the last year and a half.

"We'll grow with our customers as they grow; we'll grow as we try to expand in ever-increasing concentric circles as we've done in the last 20 years," he says. Plans are on the drawing board to launch new products, such as a primary education-oriented practice that will add to the bank's health care, not-for-profit, media and communications and financial services practices.

The small business segment and insurance are potentially strong growth areas for the future. Smith says that currently, almost 20 per cent of WBS' commercial banking customers take their insurance services from Webster Insurance. "We're looking to grow this to 30 percent or 40 percent. So we're working very well across our business lines to meet the full set of needs of our customers," he adds.

Smith points out that the bank's newest products and services, which are Web-linked, continue to be offered by the cash management group. "We're now attracting new customers with cash management services as the lead," he says.

However, issues surrounding better regulatory compliance—namely, implementing methods to detect money laundering—and pressures from short-term interest rates, have pummeled the bank's profits. Webster management's informal agreement with

At a Glance

Company: Webster Bank
Headquarters: Waterbury, Conn.
Parent Company: Webster Financial Corp.
Industry: Banking and financial services
Market: New England
Revenue 2005 [Webster Financial]: $871.85 million
No. of employees: 2,755
CEO: James C. Smith
CEO's salary: $1.3 million

the U.S. Office of the Comptroller of the Currency to shore up the bank's compliance process could result in "regulatory interference [that] may provoke reassessment of WBS's strategic alternatives," wrote Beth Messmore and Heather Wolf, research analysts for Merrill Lynch, in the latest available earnings review, released in July of this year.

However, the duo estimates the bank's takeout valuation at $55. "Because WBS trades at a 10 percent to 15 percent discount to peer banks on a forward PE basis, we view the stock as an unusual value play," they wrote. "We expect WBS's valuation gap to fade with broader recognition of improving EPS quality and margin stabilization. Our 12-month fair value target is $50."

Jared Shaw, a banking analyst and senior vice president at Keefe, Bruyette & Woods Inc. in Hartford, does not believe that WBS' regulatory issues will impact its outlook, since the industry in general has had to respond to increased scrutiny subsequent to the Bank Secrecy Act, the Sarbanes-Oxley Act and the USA Patriot Act. "This was more of a wake-up call for Webster" subsequent to Webster's transition to a commercial bank charter, he says. "The bank has a higher level of regulation now and has realized that it's important to add people in-house [in the compliance area]."

FINANCIALS

"As we grew very rapidly, we watched our capital very closely. So we underwrote all of our loan portfolios very conservatively. One of the changes in the last couple of years is that as we've increased our capital base through the quality of our earnings, we are willing to take some risks in order to grow with our customers," Smith explains. "We recognize that's essential if we are going to grow as financial partners. So, the fact that we have such a low ratio of non-accrual assets compared to any peer group is a real asset to us at this time. We can take incrementally more risk today than we would have taken two or three years ago."

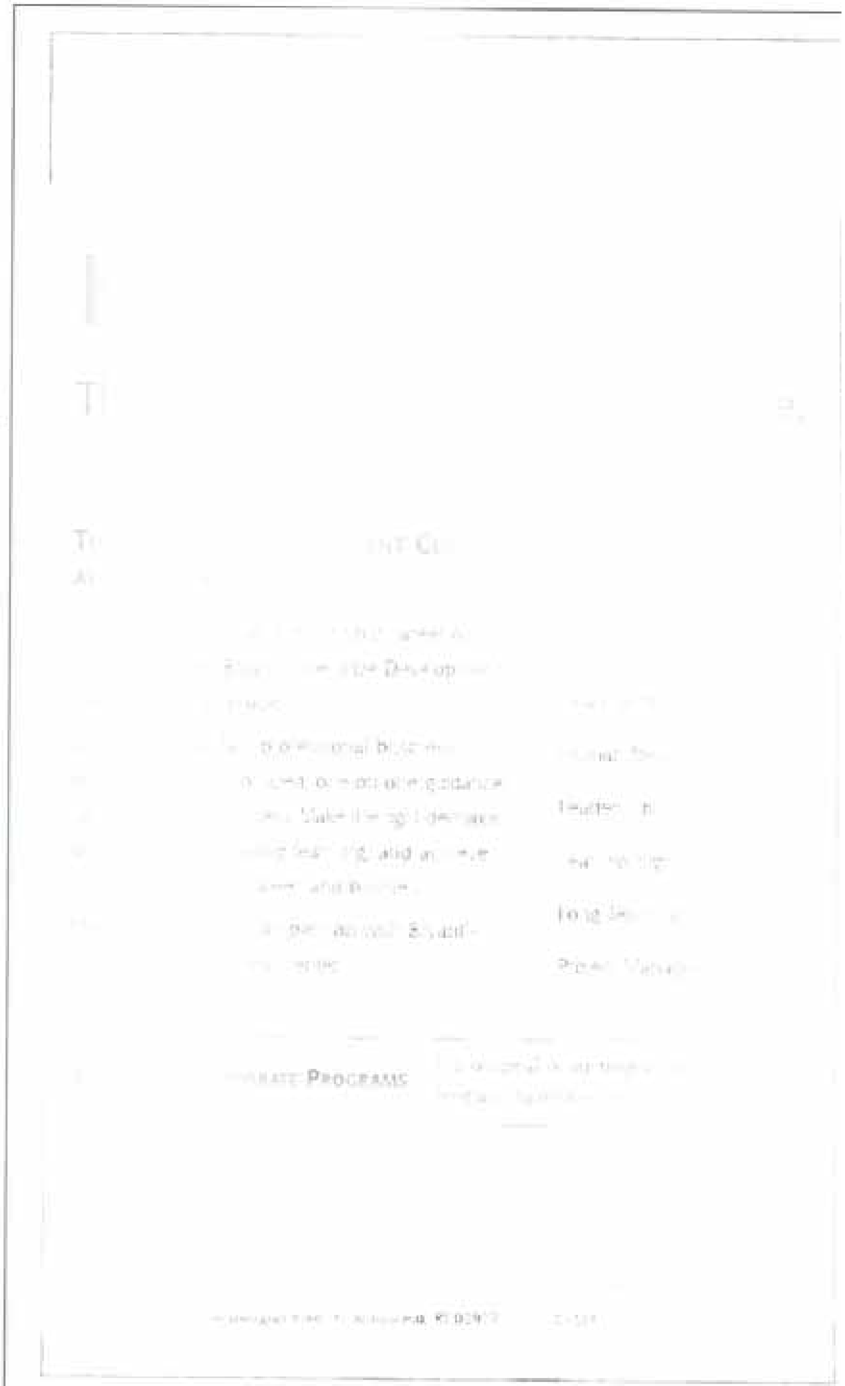
According to Shaw, the banking analyst, WBS' capital is tight and lower than that of the rest of its peers—the industry average of equity to assets is six to seven percent; Webster's ratio is closer to 5.5 percent.

Smith says the bank is building its tangible capital levels to about 6 percent. "We want to be rock strong in terms of capital levels," he says.

WBS has also taken steps to reduce its sensitivity to changing interest rates by closely managing the duration of its assets and liabilities. "We have been paying down our wholesale borrowings, which used to be a third of our assets, and now we're down about 22 percent or so. We've reduced our securities portfolio by a third also in the last couple of years. We believe we could develop a more reliable growing earnings stream if we were less reliable on mortgage assets. So you'll see that over the next couple of years, our balance sheet profile will change even more—we'll have more commercial loans [compared] to mortgage loans."

BALANCING ORGANIC AND INORGANIC GROWTH

WBS has made a series of acquisitions in the last 20 years, buying up commercial banks, savings banks, insurance agencies



and trust companies. "Yes, we risked some capital, but not too much, and we learned in the process," says Smith.

He points out that originally, the bank made acquisitions to enhance its competitiveness and grow into the commercial and retail banking, insurance and investment advisory services markets. "Now, most of our growth is organic—we're growing faster than the market and expanding continually in Connecticut and beyond, particularly in southeastern Massachusetts," he says.

But the bank is open to more acquisitions. "Our recent acquisition of the $800 million NewMilBank [based in New Milford, a subsidiary of NewMil Bancorp Inc.], strengthens our franchise in the western part of the state," he says.

These days, WBS approaches acquisitions with a very different mind-set. "Now, we want acquisitions to augment our growth, instead of driving our growth," he says. "In the 1990s, acquisitions were a main part of our business; now they are a supplemental part. We're big enough now, so acquisitions don't have the same impact on the balance sheet and revenue as they used to. We've recognized that, ultimately, to be successful, we need to be able to grow organically. So we have focused on organic growth as the primary means of growth."

The bank is growing fast in western, southwestern and eastern Connecticut. "Our market share in Fairfield County has moved up from nowhere to about number five now," says Smith. "But legislators and policymakers should help facilitate an environment in which we can create better and higher paying jobs. The state's got a long way to go. Frankly, one of the reasons that Webster expanded outside of Connecticut, was [that] we couldn't rely on a slow-growth market to deliver the kind of growth, revenue and profit that would be necessary to sustain ourselves as an independent organization." Since becoming a public bank in 1986, WBS has doubled in size every four years, he adds.

Smith says that when a bank buys an institution that has mostly mortgage loans on the balance sheet, it ends up with more commercial loans after the acquisition. And due to market overlap, it creates shareholder value through the efficiencies. Transactions where an entity is strong in commercial banking are more of an immediate revenue enhancement opportunity. "You've got to be able to identify the value in each acquisition and understand how it meets your strategic goals," he says.

With regard to the NewMil acquisition, which is expected to close in the next couple of months, WBS is set to buy back approximately 20 percent of its common stock in the open market, points out Smith.

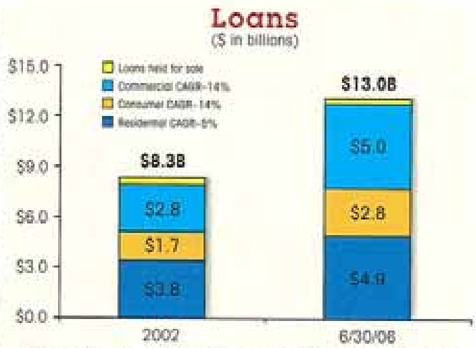
"The NewMil acquisition is a logical one for the bank, since it adds to its branches in Fairfield County," says Shaw. "A lot of banks are seeking to grow in Fairfield County. So being able to do an acquisition with a prime deposit base is good for the bank's business—it's cheaper in the long run when compared to expansion."

TECHNOLOGY AND PEOPLE

"We're increasingly using technology to be able to better deliver products and services to our customers, and to link overall customer relationships across our business lines," Smith says. And technology has been the bank's biggest challenge in the past few years, he notes. "Today, Webster employs three people per $1 million of assets—10 years ago, it was five people for $1 million in assets. Of course, we have grown our employee base in the last 10 years or so; but that they are managing a higher level of assets than they were able to before is a clear example of the importance of the efficiency of technology in delivering financial services."

Over the last two years, the bank has transitioned to Fidelity National systems, which has strengthened its commercial bank platform. "It will give us unit productivity gains as we add new customers and process more transactions, and it's scalable to at least three times our size without having to make any systems changes," Smith points out.

And what does the bank look for in its people? "When I'm recruiting somebody, I'm looking for someone who's an expert in their field; someone who knows more than I do, because my job is to bring the team together and create that extra synergy," says Smith. "I believe in the capacity of every individual to exceed expectations. [Toward this], we invest in our employees, encourage creativity, try not to be negative, create opportunities for advancement and invest in employee education."



All compound growth calculations exclude loans held for sale and $1.5 billion of Mass./RI loans acquired on 5/14/04 ($0.2 billion of consumer, $0.5 billion of commercial, $0.8 billion of residential).

FAMILY AND HOBBIES

Smith, who lives in Middlebury with his wife of 20 years, and their son and daughter, enjoys golf, classical music and theatre. "My son James loves to play golf, and one of the great rewards I get is being out there on the golf course with my 17-year-old, watching him shoot."

Friday nights are date nights. "Almost every Friday since we've known each other, Cathy and I have gone out for dinner. We've missed a few but not too many—even three days after our kids were born, we went out for dinner!"

His role model? "My father, who started our company in 1935, during the Depression, if you could imagine," says Smith. "My dad had three rules. First, remember you're in the business of taking risks. Second, never take a risk you can't afford. Third, you'd better know the difference between rules number one and two."