Univest Corporation of Pennsylvania

Second Quarter 2018 Earnings

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CORPORATE PARTICIPANTS

Jeffrey Schweitzer – *President and Chief Executive Officer, Univest Corporation of Pennsylvania*

Roger Deacon – *Chief Financial Officer and Senior Executive Vice President, Univest Corporation of Pennsylvania*

Michael Keim – *President of Univest Bank and Trust and Senior Executive Vice President, Univest Corporation of Pennsylvania*

PRESENTATION

Operator
Good morning ladies and gentlemen and welcome to the Univest Corporation of Pennsylvania Second Quarter 2018 Earnings conference call.

All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your telephone keypad. To withdraw from the question queue, please press star then two. Please, note this event is being recorded.

At this time, I would like to turn the conference over to Jeff Schweitzer, President and Chief Executive Officer of Univest Corporation of Pennsylvania. Please go ahead, sir.

Jeffrey Schweitzer
Thank you, Denise and good morning and thank you to all of our listeners for joining us. Joining me on the call this morning is Mike Keim, President of Univest Bank and Trust and Roger Deacon, our Chief Financial Officer.

Before we begin, we remind everyone of the forward-looking statements disclaimer. Please be advised that during the course of this conference call, management may make forward-looking statements that express management's intentions, beliefs or expectations within the meaning of the Federal Security's Laws. Univest's actual results may differ materially from those contemplated by these forward-looking statements.

I will refer you to the forward-looking cautionary statements in our earnings release and in our SEC filings. Hopefully, everyone had a chance to review our earnings release from yesterday. If not, it can be found on our website at Univest.net under the investor relations tab.

We reported net income of $4.4 million during the second quarter or $0.15 per share. Earnings for the quarter were significantly impacted by a $12.7 million charge-off or $0.34 per share related to alleged fraudulent activities perpetrated by one or more employees of a borrower for which we hold a participation interest, which was previously disclosed in a form 8-K filed with the SEC on May 31st 2018. This charge-off represented the entire remaining principle balance of the loan. Excluding this charge-off, we were very pleased with the growth we experienced during the quarter and our overall results for the second quarter.

Loan growth for the quarter was strong as loans during the quarter grew 13.9% annualized, bringing annualized loan growth for the first six months of 2018 to 11%. We continue to be comfortable with our previously communicated guidance of 8% to 10% growth in loans for the year.

Additionally, deposit growth kept pace during the quarter with loan growth as deposits grew 14.1% annualized during the quarter as some of our deposit initiatives have begun to produce positive results. We are very pleased with our deposit growth during the quarter as June 30th is typically the low point for deposits due to the seasonality of public funds deposits.

Finally, we continue to see benefits from our diversified business model as revenues for the first six months of 2018 and our wealth management, which includes our trust operations and insurance lines of business, are up 10.2% and 7% respectively, compared to the same period in the prior year.

I will now throw it over to Roger for some additional discussion on our results.

Roger Deacon
Thank you, Jeff, and I would also like to thank everyone for joining us today. I'm going to discuss a couple of items from the earnings release.

First, as it relates to our earnings per share, as Jeff mentioned, we reported earnings of $0.15 per fully diluted share, which includes BOLI death benefit claims of $446,000 or $0.02 per share and the previously disclosed charge-off of $12.7 million, which was $0.34 per share net of tax.

Second, as it relates to our net interest margin, core net interest margin of 3.70% was flat compared to the same ratio for the first quarter of the year. As noted in the exhibits to our press release, as compared to the prior quarter, our yield on the loan portfolio increased 11 basis points during the quarter, which benefitted from the 25 basis point increase in the fed fund's rate in March, as well as a modest increase in pricing our new commercial loan originations. This increase was offset by an increase in our cost on interest-bearing deposits of 11 basis points, which was due to pricing on our promotional CDs as well as increased exception pricing on money market accounts during the quarter. Our CD promotion raised $64 million of deposits during the quarter and an average rate of 2.50% for an average term of 40 months.

Our net interest income and margin have been helped by the fact that 35% of our loan portfolio is variable and another 16% is adjustable. Additionally, non-interest bearing deposits represent 29% of our total deposits, both which help make our balance sheets slightly asset sensitive. Due to the significant loan growth and stabilization of our margin, we would note that our reported net interest income increased 9.6% for the first half of 2018 as compared to the same period last year. Excluding purchase accounting accretion, which has declined this year, our net interest income for the first half of 2018 has increased a solid 11.3% from the first half of last year.

Next, as it relates to our provision for loan losses, excluding the previously mentioned $12.7 million charge-off, the provision for the quarter was $2.7 million, slightly higher than our prior guidance of $2 million to $2.2 million per quarter. The primary reason for this variance is the strong loan growth during the quarter. We continue to be comfortable with our overall guidance for the provision of $2 million to $2.2 million per quarter.

Finally, as expected, our non-interest expense and our efficiency ratios declined this quarter as compared to the first quarter due to the seasonal nature of certain expenses. We have no change to our prior guidance of $138 million of non-interest expense for the year excluding restructuring charges. This would represent an increase of 5.5% for the year.

I believe the press release was straightforward for the remaining items and accordingly that's it for my prepared remarks.

We will be happy to answer any questions. Operator, would you please begin the question and answer session?

QUESTIONS AND ANSWERS

Operator
Thank you, sir. We will now begin the question and answer session. To ask a question, you may press star then one on your telephone keypad. If you are using a speakerphone, please pick up your handset

before pressing the keys. If your question has been addressed, you may withdraw from the queue by pressing the star then two. Again, it is star one to ask a question.

The first question will come from Michael Perito of KBW. Please go ahead.

Michael Perito
Hi, good morning guys.

Jeff Schweitzer, Michael Keim, Roger Deacon
Morning, Mike.

Michael Perito
A couple of questions—one to start on the balance sheet growth. I was curious if you could maybe just give us a little bit more color on both sides. Obviously, it was pretty strong both on the loan and deposit side and wondering where you're seeing some of the new business pick up on both loans and deposits and, obviously, there's been a lot of chatter from peers about competition increasing. I'm sure you're seeing that somewhat, but it seems like you're still having some success. I'm curious, what you guys are seeing in the market.

Michael Keim
I would tell you, Mike, on the loan side, it's somewhat across the board as laid out in a couple of the analyst reviews. Competition does continue to increase, especially around the price side of the equation for us. People are putting some of the tax benefit back into the price side of the equation. We've held still. We did a nice job during the quarter in terms of getting a nice mix between additional loans coming in on the fixed rate side as well as variable, so we're leveraging our team. We are leveraging our team out in the Lancaster market that has continued to help us grow, and we're getting margins that aren't totally moving in lock step with where the fed has moved, but they are moving up and we're seeing solid growth there.

On the deposit side, we saw a pickup. We got an additional public fund even though it's a lower point in the quarter or the year for us, with regard to public funds. We continue to go after public fund money. We continue to work with our larger commercial customers to bring in additional deposit balances. So, really it's an across the board strategy with regard to us on the deposit side.

Roger referenced the CD specials and what we're doing on the consumer side. There's a series of initiatives that we're after and we're really seeing growth coming from all of those initiatives as we move forward.

Michael Perito
Great. Thanks for the color there, and just on the both, I guess, lending and deposit side, have you guys had any success on the hiring front? I mean, is there still a pipeline there or has most of the dust pretty much settled at this point?

Michael Keim
We hired four relationship managers during the quarter. We continue to go after and look for folks. We're in active discussions all the time, Mike. We'd love to do another lift out like we did previously, but those just aren't as easy to come by we are seeing. But, can we pick up one or two people and continue to bolster our teams? Yes.

Roger Deacon
Yes, I mean, I guess I would say to that, Mike that we're not going to limit ourselves to a number of hires.

To the extent we can find good folks during the year, we're going to hire them if we can do that, yes.

Michael Perito
Alright, and then switching over to the credit side, I understand the fraud situation and there's probably limitations to what you guys can actually say, but I'm just curious; is there anything that we should be thinking about maybe that drove the fraud, like are economic conditions in a certain area tougher, was business not doing as well there. Is there anything at all that could potentially seep into the rest of the portfolio? It seems pretty isolated, but just figured I'd ask if you guys are seeing anything at all that could be concerning today from this situation?

Roger Deacon
Hey, Mike, it's Roger. No, I mean, quite frankly, we really truly do view this to be an isolated situation. It does not appear that there's anything from a broader economic perspective that would have drove this situation. It's very unfortunate. It did happen, but we really believe it's isolated to this current situation.

Michael Perito
Okay, then maybe actually just one last question for Jeff. With capital deployment, going forward, I'm curious if there's been any change or update in how you guys are thinking about it? I mean, my guess it's still primarily organic growth dividend, but has there been any interesting things on the M&A side happening or anything else that's been discussed internally that we should be aware of?

Jeffrey Schweitzer
I would tell you it is an organic growth strategy. We are still open for business on acquisitions on the non-bank side, not that we're not open to looking at bank acquisitions. I just don't see as many opportunities out there or that are as exciting. We're growing the size of a small bank every year right now with our organic growth strategy, so to buy something right now, would be probably more disruptive than additive, but if an opportunity came along that was interesting, we would obviously take a look at it. I would just say that we would have more opportunity on the non-bank side, wealth management, potentially insurance, when you look a year out to execute on something there than we would on the bank side.

Michael Perito
Great. Thanks, guys. Thanks for taking my questions. I appreciate it.

Jeff Schweitzer, Michael Keim, Roger Deacon
Thank you.

Operator
The next question will be from Matthew Breese of Piper Jaffray. Please, go ahead.

Matthew Breese
Morning everybody.

Jeff Schweitzer, Michael Keim, Roger Deacon
Hey, Matt.

Matthew Breese
Hey, Roger, maybe one for you. The core margin came in a bit better than what I was looking for this quarter and you had some positive commentary regarding just how the balance sheet is situated. Should we be expecting anything different on the core margin outlook? Can you give us some color there?

Roger Deacon
The only thing I would say is we have seen—the betas on deposits are accelerating somewhat. So, the reason I just talked about the 11 basis points is there is increases on both sides of the balance sheet that are working. So, this quarter will have significant—well, we plan to have significant growth in public funds that tends to have a higher beta. So, we can have a little bit of deposit cost increase higher than our loan increase, but not significant. I've guided in the past a flat to declining a little bit and I think that's where I am for this quarter as well.

Matthew Breese
In the range of maybe one to three basis points; is that kind of right there?

Roger Deacon
Yes, yes.

Matthew Breese
Okay, and then, Mike, maybe on the new hires front, you noted that there's four new RMs this quarter. Could you just tally that since the capital raise, how many have been hired? Is that more or less in line with your expectations when you raised the capital was to hire the amount of people that you have?

Michael Keim
I'm going to off memory here, somewhere around eight RMs?

Jeffrey Schweitzer
Yes, it is eight.

Michael Keim
Since we raised the capital, Matt, and that would meet our expectations. Like I said, we continue to be out there and are active in the market to recruit solid folks and if we can do it, we're going to continue to do it. And to reemphasize Roger's point, there's not a limitation, there's not a cap on quality folks that we can add if we think they can help us grow the organization going forward.

Matthew Breese
Okay, and then as I think about the capital levels of the bank, still a little bit higher than when you were at the time of the capital raise, where should we think about that being levered down to over time?

Roger Deacon
You know, Matt, I think we're looking at 9% to slightly less than that. The Basel III changes that go into effect next year that requires an extra 50 basis points of capital—so, we're cognizant of that. So, we think it used to be where 8.5 was the number. We're probably targeting more of a 9% type number.

Jeffrey Schweitzer
Part of it is we also want to always have some extra room should we want to be able to execute on a non-bank acquisition, because that's a direct hit to capital because it's all on goodwill and intangibles. So, we want to always have flexibility to be able to execute on something like that.

Matthew Breese
Understood. Okay, last one, just a good tax rate from here, expectations there?

Roger Deacon
Yes, Matt, it would be about 18.2% to 18.5% for the rest of this year.

Matthew Breese
Alright, that's all I had. Thank you.

Jeff Schweitzer, Michael Keim, Roger Deacon
Thank you, too.

CONCLUSION

Operator
And ladies and gentlemen, this will conclude our question and answer session. I would like to hand the conference back over to Jeff Schweitzer for his closing remarks.

Jeffrey Schweitzer
Thank you, Denise, and thank you everybody for joining us this morning. Absent as I said at the beginning of the call, the unfortunate fraud that we experienced from a customer this quarter, we were very excited about the results, strong loan growth, strong deposit growth, continued growth on the non-interest income side and the wealth and insurance line. So, we feel good about where we're headed and look forward to talking to everybody at the end of the third quarter. Have a great day.

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