Univest Financial Corporation

First Quarter 2019 Earnings Conference Call

April 25, 2019 at 9:00 a.m. Eastern

CORPORATE PARTICIPANTS

Jeffrey Schweitzer – *President and Chief Executive Officer*

Mike Keim – *President of Univest Bank and Trust*

Roger Deacon – *Chief Financial Officer*

Brian Richardson – *Executive Vice President and Director of Finance*

PRESENTATION

Operator
Good morning, and welcome to the Univest Financial Corporation First Quarter 2019 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 your question, please press star then two. Please note this event is being recorded.

I would now like to turn the conference over to Jeffrey Schweitzer, President and CEO of Univest Financial Corporation. Please go ahead.

Jeffrey Schweitzer
Thank you, Brandon. Good morning, and thank you to all of our listeners for joining us. Joining me on the call this is Mike Keim, President of Univest Bank and Trust; Roger Deacon our Chief Financial Officer; and Brian Richardson, Executive Vice President and Director of Finance.

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 securities 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 $16.1 million during the first quarter, or $0.55 per share, which is a 19.6% increase over the first quarter of 2018 when you exclude restructuring costs recorded in the first quarter of 2018. We were pleased with our results for the quarter as loans grew $61.3 million or 6.1% annualized. And, deposits grew $117.2 million or 12.1% annualized. The first quarter is historically a slower quarter for us so we were pleased with the growth we experienced and have strong pipelines as we head into the second quarter.

We continue to see solid loan demand due to market disruption and the strength of our local economy. In our non-banking lines of business, bulk management revenues, which includes our trust business, was essentially flat with the prior year as assets under management were impacted by the market downturn in the fourth quarter. We expect this line of business to rebound in the second quarter as the markets recovered during the first quarter. Insurance revenues increased 5.2% year-over-year due to strong contingent commission income and growth in commercial lines and group health and life premiums.

Another exciting development during the first quarter was our lift out of the commercial banking team of eight individuals, including five relationship managers and business developers in the Western Lancaster County market into York County. This complements our existing Lancaster team and we are excited about the continued growth opportunities the new team brings to us in the expanded market. Additionally, we hired a three-person team in the South Jersey/Philadelphia market in April as we continue to expand our presence in the growing Greater Philadelphia marketplace.

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. I'd like to start off by saying I think we had our third consecutive quarter of very solid earnings and loan growth. We report a $0.55 per fully diluted share for the quarter with no reportable unusual or non-recurring items. This translates to a return on average assets of 1.30%, return on equity of 10.3%, and return on tangible equity of 14.4%.

Our tangible book value per share has increased to $15.72 per share, representing an 8.1% increase from the prior year. Yesterday's closing price also represented 1.58 times tangible book value per share and we believe given our current business and capital plan that we could increase this by 8% to 10% per year. Additionally, we continue to pay a $0.20 per quarter dividend, which equates to an annualized yield of 3.2%.

As it relates to net interest margin, our core margin was 3.74%, up 3 basis points compared to 3.71% in the fourth quarter of 2018. As a reminder, last quarter included 3 basis point negative impact of excess liquidity, and this quarter includes a 2 basis point benefit associated with reduced funding costs due to less days in the quarter. Accordingly, we believe our core net interest margin is relatively flat from the prior quarter. Given the Federal Reserve's pause in rate increases this quarter, similar to other asset-sensitive financial institutions, we would anticipate the net interest margin expansion that we have experienced over the past two-and-a-half years will likely end this quarter as deposit costs are likely to rise slightly faster than loan yields.

Second, the provision for loan losses was negatively impacted by one large shared national credit loan, which was downgraded from pass to substandard during the shared national credit review cycle, which was performed by regulators as of January 2019. The loan is performing and is not considered impaired. The loan balance was $14.6 million, and we recorded an incremental provision of $1.5 million during the quarter on this downgrade. As we look forward for the rest of 2019, we will continue to guide to approximately $2.2 million to $2.4 million of provision per quarter.

Third, as expected, our efficiency ratio continued to decline this quarter compared to the prior year. Excluding 2018 restructuring charges, our total non-interest expense increased by 2.9% from the same period in the prior year. When combining significant revenue growth and expense discipline, our efficiency ratio, excluding restructuring charges, declined to 60.5% for the quarter compared to 64.3% in the first quarter of 2018. It should also be noted that these expense numbers included approximately $225,000 of non-interest expense associated with our hires in Lancaster County that Jeff previously mentioned.

As it relates to the full year 2019, we are going to increase our guidance by 150 basis points from our prior range of 5.5% to 6% to 7% to 7.5% to account for the incremental investments in lending teams that we made during the quarter. Please note that this increase is against 2018 expense, excluding restructuring charges.

I believe the rest of the press release is straightforward for the remaining items, particularly related to non-interest income, and accordingly, that's it for my prepared remarks. We'll be happy to answer any questions.

Operator, would you please begin the Q&A session?

QUESTIONS AND ANSWERS

Operator
Yes, thank you. 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 at any time your question has been addressed and you would like to withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster.

Our first question comes from Frank Schiraldi with Sandler O'Neill. Please go ahead.

Justin Crowley
Hi, good morning. It's actually Justin Crowley on for Frank this morning.

Jeffrey Schweitzer
Hi, Justin.

Justin Crowley
First, on the downgraded SNC in the quarter, are you able to give any color on geography and/or the industry? And then, secondly, in that same vein, what is the total size of the SNC portfolio? Where does that stand today?

Roger Deacon
Yes, this is Roger. I'll answer that question. It is in the energy business and geographically, it's in our locale. It's within Pennsylvania.

Mike Keim
Then, total, we have about $62 million in SNC credits outstanding.

Justin Crowley
So, $62 million. Okay. And then I guess just more broadly, apart from the downgrade in the quarter, are you seeing any other deterioration in the broader book or what are you kind of seeing there?

Mike Keim
No, overall, we're very happy with credit performance. The previous quarter, we had this SNC downgrade and this quarter we did, as well. We believe those are isolated instances, and in both cases, we don't believe we'll actually take losses on those loans. We're very pleased with how we continue to move forward on the credit side.

Justin Crowley
Okay, that's helpful. Then, secondly on expenses, so you increased your expense guidance for the year and then you had the two-team lift out. Are you guys anticipating continuing that strategy? Do you expect to lift out any other teams throughout the year, or what are your thoughts there?

Mike Keim
Generally speaking, if we can bring on additional talent, we will continue to do that. As we mentioned on several calls before, it's not always that easy to get these teams, so when we have the opportunity to do it, we will do it, but it's a very difficult thing to forecast. Overall, do you want to speak on this Roger?

Roger Deacon
Yes, I was just going to go down the path more and I totally agree with what Mike said about how you have to be opportunistic, and for everyone to remember, we raised the capital back in the fourth quarter of 2017 with the intent of growing the business through hiring of lenders and that's really part of that strategy. You can't pick the moments. It just so happened that these opportunities happened this quarter and we took advantage of it.

Justin Crowley
Okay, great. I appreciate the color. That's all I had. Thank you for taking my questions.

Mike Keim
Thank you.

Operator
Our next question comes from Michael Perito with KBW. Please go ahead.

Adela Dashian
Hi, everyone. This is actually Adela Dashian on for Mike. Thanks for taking our questions.

Roger Deacon
Sure.

Adela Dashian
My first question is, could you just provide a little more detail on the recent hire in Lancaster, like what type of production you expect and overall how big you think that market can be?

Mike Keim
Well, we continue to grow that market. The hires that came on, Jeff referenced that there was five RMs/BDs. There was not a lot of overlap to the existing Lancaster team that was in place.

I mean, generally speaking, I would tell you that an RM in that market should be able to do $10 million to $15 million a year, but there's a ramp-up period of time that has to get taken into consideration and you go from there.

In terms of the type of business they do, they're C&I and CRE. They do not do Ag like the existing group did, so it's a good complement. And, they focus more on the western part of the Lancaster County marketplace, so we think it's a good add.

The team in South Jersey, those folks are more of a business banking team, so a little bit smaller of loan size, but we think that's also a great addition to what we have in place.

Adela Dashian
Okay, and then if I could also ask what the next steps are in Lehigh Valley for growth?

Mike Keim
Yes, we continue to look at the Lehigh Valley. We've been there obviously for about ten years now. We think that's a market that, from our perspective, we have an underutilized market share there, so like we do in all of our other markets, if we could lift out a team, we would certainly do that. But otherwise, we will continue to hire people on a one-off basis.

Adela Dashian
Got it. And my last question, capital deployment, what are your plans there?

Roger Deacon
Really, it's not much of a change from what we've talked about in the past in our overall plan. We don't really intend to increase our dividend until we get to peer level payout ratios. Longer term—we don't intend to do buybacks. What our plan is to come next March, redeem a portion of the sub debt that we have that converts from—it hits its five-year mark and converts from a fixed to a floating rate. That's our number one goal as it relates to capital is the redemption of the sub debt first.

Adela Dashian
Okay, that's all we had. Thank you.

Roger Deacon
Thank you.

Operator
As a reminder, if you would like to ask a question, please press star then one. Our next question comes from Matthew Breese with Piper Jaffray. Please go ahead.

Matthew Breese
Hi, good morning.

Roger Deacon
Good morning, Matt.

Matthew Breese
I'm just kind of doing rough, back-of-the-envelope math on the new hires, so the five RMs plus the three folks down in South Jersey. If we kind of split the difference and call it $12 million each, is that roughly $100 million annual benefit to loan growth? Is that a good way to think about it?

Mike Keim
I'm just going to caution you a little bit, Matt, in terms of you're trying to apply that to the current year, but overall, yes. Now, remember, we have some trade-offs up and down, in terms of the overall staffing level, but those folks, if they were to hit those levels—I would tell you, the Lancaster folks are what I said was traditional kind of CRE and C&I. The folks in South Jersey are more of a business banking team, so their loan sizes are going to be a little bit smaller, but at least for 2019, factor in the ramp-up period.

Matthew Breese
Yes, completely agree, but let's just call it by 2020 once they're fully ramped up, it's about a $100 million benefit.

Mike Keim
Yes, $75 million to $100 million, yes.

Matthew Breese
Okay, and then, Roger, you did note that with the Fed on pause, it might be the end of core NIM expansion. Could you quantify a little bit what you think the downside potential is on a quarterly basis or if it's more of a stability in the core NIM?

Roger Deacon
Sure, so here's how I'm thinking about it, and again, I'm going back to say that if you take the 2 basis point benefit, just the sure number of cost of funds days [ph] this quarter, we were really around [ph] 372. I think we could decline this quarter, on the max side, 3 to 5 basis points, and that assumes there's no reduction in price pressure on deposits. So, in our market, we have yet to see that. I know in other markets there has been, with the Fed pause, a little bit of reduction of price pressure. So, if we do get that reduction, maybe it's not that significant, but when I look at the next quarter, that's where it could land if I don't catch a break on the pricing.

Matthew Breese
Understood, okay.

Roger Deacon
Then, after that, the markets are going to take over and I do think that that would slow after that, but it's still, you have an inverted yield curve and that's going to be a little bit of a challenge going forward.

Matthew Breese
Understood, okay. I hope you don't mind, I have a couple other questions on CECL.

Roger Deacon
We were anticipating that.

Matthew Breese
Okay. Well, at this point, do you have an idea of where the true-up reserve could go, what the impacts could be day one?

Roger Deacon
We do not.

Matthew Breese
Okay. Let me try it a couple of different ways here. As you've gone through the process of determining what the true-up reserve could be, could you give us an idea of the change in methodology? How much of the allowance today is driven by qualitative factors and in a pro forma CECL world, what do you expect the quantitative portion to be?

Roger Deacon
Today, quantitatively, its 25% to 30% is quantitative, the rest is qualitative, and we don't have an answer on the second part of your question yet.

Matthew Breese
Do you expect heavily quantitative?

Roger Deacon
We don't honestly know, Matt. We're not there yet and we just haven't gotten that far down the path.

Matthew Breese
Okay. And as you're going through the process of looking at historical losses, I'm just curious, how far back do you have to look to get a good data set of historical losses?

Roger Deacon
Brian, you can answer that.

Brian Richardson
We're going back six years on our own data and looking at peer data for an extended period of time, including ourselves.

Matthew Breese
Six years on your own, and then is there an additional time frame beyond that or is six years sufficient?

Brian Richardson
There's an additional time period beyond that.

Matthew Breese
And, what is that additional time period?

Brian Richardson
Three to four years.

Matthew Breese
I'm just curious thinking about this. At the time of implementation, we will have seen the worst years of the crisis basically rolling off the historical look back. Is that accurate?

Brian Richardson
Yes, correct.

Matthew Breese
Okay. And then just looking at your current reserve, just summing up, it looks like it's five, maybe six years of historical charge-offs. As you think about whether that's going up or down, is it more likely than not that you could see reserves flat to down given how much of historical charge-offs you already have in there?

Roger Deacon
This is Roger. I would just say, Matt, to us that would not make any sense.

Matthew Breese
Okay.

Roger Deacon
That's all I would say. I don't understand at all how—and maybe we're missing it, we're not there yet. I don't understand how you could go from an incurred loss model to a projected loss model and actually have a decline.

Matthew Breese
Right.

Roger Deacon
It just doesn't make sense. But again, we'll work through it but I don't see that happening.

Matthew Breese
Understood. I'll leave it there. Thanks for taking my questions.

Roger Deacon
Sure.

Brian Richardson
Thanks, Matt.

Operator
Again, if you have a question, please press star then one. At this time, there are no further questions. I would like to turn the conference back over to Jeffrey Schweitzer for any closing remarks.

CONCLUSION

Jeffrey Schweitzer
Thanks, Brandon. Thank you to everybody for listening in today. For those of you who have followed us for the last three years, this is Roger's last conference call as he announced his retirement on June 30th, and we're excited for him as he enters his next phase of life and I just want to personally thank him for everything he's done for us over the last three years since he joined us from Fox Chase. We wish him nothing but the best and I'm sure all of you do, too. Brian will be taking over the CFO duties come July 1st and we're very excited about him as he enters his next phase of his career, also.

Thank you again. We're excited about the quarter and we look forward to talking to everybody again at the end of the second quarter. Have a great day.

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