Univest Financial Corporation

Third Quarter Earnings Conference Call

October 24, 2019 at 9:00 a.m. Eastern

CORPORATE PARTICIPANTS

Jeff Schweitzer - *President and Chief Executive Officer*

Brian Richardson - *Executive Vice President and Chief Financial Officer*

Mike Keim - *President of Univest Bank and Trust Co. and Senior Executive Vice President*

PRESENTATION

Operator
Good morning and welcome to the Univest Financial Corporation's Third 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 Jeff Schweitzer, President and CEO of Univest Financial Corporation. Please go ahead.

Jeff Schweitzer
Thank you, Eilie, 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 Brian Richardson, 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 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 $17.7 million, during the third quarter or $0.60 per share. Earnings for the quarter included a $988,000 or $781,000 after tax FDIC small bank assessment credit. Excluding this credit, our earnings for the quarter were $0.57 per share. We were pleased with our results for the quarter as loans grew $84 million or 8.1% annualized, and deposits grew $215.9 million or 20.9% annualized. Year-to-date, loans have grown $245.4 million or 8.2% annualized and deposits have grown $452.1 million or 15.5% annualized. This growth has led to an 8.7% increase in our net interest income compared to the nine months ending September 30, 2018.

We continue to see solid loan demand due to market disruption and the strength of our local economy. However, with the unfavorable change in the yield curve, combined with increased competition around rate and structure, we, like most banks, are experiencing pressure on our net interest margin, which Brian will discuss shortly.

With the decreasing rate environment, our mortgage banking operation had a strong quarter with the net gain on mortgage bank activities increasing $875,000 for the quarter and $496,000 for the nine months ended September 30, 2019, compared to the comparable periods in the prior year. During the quarter, we did add an $11.3 million credit to nonaccrual. This relates to a relationship we have with an auto dealer that is still operating and current, and we do not anticipate any loss related to this relationship at this time.

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

Brian Richardson
Thank you, Jeff. I would also like to thank everyone for joining us today. During the third quarter, we continued our positive trend of earnings growth and consistent financial performance.

As Jeff mentioned, we reported earnings per share of $0.60 or $0.57 when excluding the FDIC small bank assessment credit. Through the first nine months of 2019, we have achieved a return on average assets of 1.30%, return on average equity of 10.40% and return on tangible equity of 14.33%.

I would now like to touch on three items from the earnings release. First, as Jeff highlighted net interest income for the first nine months of 2019 is up 8.7% compared to the same period in 2018. This is due to strong average loan growth of 9.8%, partially offset by net interest margin compression. Our core net interest margin for the third quarter of 3.52% decreased 14 basis points from 3.66% in the second quarter.

During the third quarter, we continued to have excess liquidity due to strong deposit growth throughout 2019. Average excess liquidity of approximately $174 million negatively impacted core NIM by approximately 13 basis points compared to $63 million or 5 basis points in the second quarter. Excluding the impact of excess liquidity, core NIM was 3.65%, a decrease of 6 basis points when compared to 3.71% in the second quarter. Due to the decreasing rate environment and increased competition on the commercial lending side, we expect continued net interest margin compression in the fourth quarter. The anticipated pressure on net interest income highlights the importance of our diversified business model. For the first nine months of 2019, noninterest income represented 28% of total revenue.

Second, the provision for loan losses was favorably impacted by one large substandard Shared National Credit loan, which paid off during the third quarter. During the first quarter of 2019, this loan had been downgraded from pass to substandard in conjunction with the regulators' Shared National Credit review cycle. The loan balance was $14.6 million and the pay-off favorably impacted the provision by $1.5 million. As we look forward, we would continue to guide the provision at approximately $2.2 million to $2.4 million per quarter.

Third, as expected, our efficiency ratio continued to decline as compared to the prior year. Excluding 2018's restructuring charges and 2019's FDIC assessment credit, total noninterest expense for the nine months ended September 30, 2019, increased by 6.1% from the same period in 2018. Although we've continued to invest in the business through people and technology, with significant revenue growth and continued expense discipline, our year-to-date efficiency ratio, excluding restructuring charges and FDIC assessment credits, declined to 61.3% from 62.5% in 2018. It should be noted that 2019 expense numbers include approximately $1.1 million of year-to-date noninterest expense associated with the hiring of the eight-person team in Lancaster and York counties during the first quarter of the year.

As it relates to the full year of 2019, I would like to remind everybody that we expect noninterest expense growth, excluding restructuring charges and FDIC assessment credits, of 7% to 7.5% for the year. This translates to 2019 noninterest expense of $146 million to $147 million or $145 million to $146 million when including the FDIC assessment credits.

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

Operator, would you please begin the question-and-answer session?

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two.

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

Frank Schiraldi
Morning.

Jeff Schweitzer
Morning.

Frank Schiraldi
Jeff, I know you touched on it in your prepared remarks, but on the credit that went into NPA in the quarter. I know others have had some SNC downgrades. From what you said, it didn't sound like this was a SNC, and I did hear you say you didn't expect loss but can you just give a little more color on sort of what happened here? And it didn't sound like you've had much previous provisioning for this then if you don't expect loss.

Mike Keim
Frank, it's Mike. No, we didn't have a provision for this previously. Without going into a lot of details, the company is dealing with some liquidity issues; we're working with them. We thought it was prudent to put it on nonaccrual based on that. But based on the collateral we have, we do not believe that at this time we would take a loss on the credit.

Frank Schiraldi
And I missed, what sort of credit. Did you give any more color on what that collateral is? Or is it real estate-related?

Mike Keim
It's an auto dealership and it's secured by the real estate, the building, the dealership itself, the service bays, etc.

Frank Schiraldi
Okay. And just curious, how you are feeling about credit overall? Still seeing any more broader issues whether it be geography or loan type? Or how do you feel about credit overall?

Mike Keim
On a general basis, we feel good about credit. But you do see, as we deal with the instance that we're dealing with, onesie twosie issues, but there's no overriding trend. Otherwise, our numbers would be very strong.

Frank Schiraldi
Okay. And then, just wondered if there was any more detail you can give, Brian, in terms of the NIM guide, the expectation that it will be lower into 4Q. I know, obviously, liquidity played a big part and then the 3Q contraction, just trying to think about magnitude of the NIM compression from here.

Brian Richardson
Sure, Frank. Assuming no additional Fed rate decreases, we expect NIM to compress by approximately 6 to 7 basis points from the normalized Q3 NIM of 365. So that's assuming no further decreases; that's

where we would expect it to land in the fourth quarter.

Frank Schiraldi
Okay. And I assume a 25 bp decrease does add some compression to that?

Brian Richardson
Yes. Again, a full quarter impact of a decrease is roughly in that 3 to 4 basis point range. If we have it late October, potentially 2 to 3 incremental basis point compression in the fourth quarter.

Frank Schiraldi
Okay. And so when you say 6 bps to 7 bps without a rate cut, I think you mentioned that's on a normalized basis so then liquidity does whatever it does linked quarter and that might be an offset.

Brian Richardson
Yes.

Frank Schiraldi
Okay. Thank you.

Operator
Again, if you have a question, please press star then one. Our next question comes from Michael Perito with KBW.

Michael Perito
Good morning, guys.

Jeff Schweitzer
Good morning, Mike.

Michael Perito
I was wondering if you could give us an update, loan growth has been strong year-to-date, again, in the third quarter. Maybe some more color about what particular segments and geographies kind of drove the strength this quarter, and then, how the respective pipelines are building, and if there's still, presumably, I would imagine, quite a bit of demand from some of the newer hires that you guys made that can sustain growth going forward.

Mike Keim
So on a net basis, Mike, we still see what we now label as the central Pennsylvania market being a significant driver to our overall growth. We are seeing growth across all product lines and segments. The new teams that have come on board have funded loans, have building pipelines. We're very pleased with the progress that they have made to date. I would tell you, the environment overall is getting more competitive and difficult. We're happy with where we are.

We feel that we will continue to grow. We haven't worked through our budget process for next year yet finally, so we're not ready to commit to what we would have as a growth number for next year. But we feel good about the fact that we can continue to grow. But we're not going to ever give up on structure, and we are seeing some people do that a little bit. And the pricing environment certainly is competitive and that is adding to the pressures that Brian alluded to on our net interest margin.

Michael Perito
Helpful. And then can you remind us the size of your Shared National Credit portfolio and how that's

trended over the last several quarters?

Mike Keim
Yes. Somewhere in that $30 million to $40 million would be our Shared National Credit, and it is going down.

Michael Perito
So fairly small?

Mike Keim
Yes.

Michael Perito
Okay.

Mike Keim
The one that Brian talked about in the beginning of the third quarter that paid off, that was a big chunk of it. So we're down pretty sizably and we have not added to it.

Michael Perito
Okay. And then on the expense side, it seems like based on the third quarter, the trend would be on pace, may be a little below the guidance. Obviously, the FDIC credit helps, but just any updated thoughts on kind of the Q4 expense run rate? And I think you'll get a little carryover from the FDIC credit although not quite as substantial.

And then just also, as we think to next year, it doesn't sound like you guys are ready to put numbers out, but just any conceptual items or investments we should be thinking about that could potentially impact your expense growth rate?

Brian Richardson
Mike, this is Brian. As you normalize the third quarter and project that forward, I would think the guidance provided is pretty much spot-on for the full year of 2019 from an expense perspective. As it relates to 2020, as Mike said, we are going through the budget process and at this point we're not in a position to kind of provide too much commentary on that. So we hope to do that consistent with our past practice, on the January call is where we look to give the general guidance for 2020.

Michael Perito
But do you guys, in the investment process—I know, you guys have been kind of steadily upgrading just in terms of platforms on the commercial side, on the retail side. I mean is there anything notable that, that's on the docket for 2020 rather at this point that you guys can report? Or are you guys still sorting that stuff out as well?

Mike Keim
Mike, we're still working through that. I will tell you that we've had Salesforce installed for more than a year across the entire enterprise. So we continue to work on that. We continue to ramp up what we're dealing with Encino. So we will continue to make investments to keep pushing the business forward but there is nothing notable in dollar terms that would be incremental from our current run rate at this time.

Michael Perito
Okay. And then just one last quick one. Can you just maybe provide, Mike, some pipeline commentary specifically to the mortgage business. Obviously the rate environment helped, but I know your region

has had some supply issues in the past couple of years. Just any updated thoughts around that business and what we should expect going forward?

Mike Keim
Yes. So, you're right. The third quarter activity was largely rate-driven, refinance activity certainly helped out. We carried through some of that into the October period. Rates have backed up a little bit; we continue to watch it. The ten-year for mortgages is really the key. So pipeline was solid coming into the end of the third quarter.

Really what is more of important for us longer term is we are out there, we have them and we continue to recruit new loan officers to join us. We worked through the process; we implemented our new system in the past year.

Our new head of mortgage banking is doing a great job. So we feel good about the fact that we are kind of a source for good, solid loan producers to come through; they can get deals done. We can get them done in a relatively short period of time, good turnaround and good experience for the customer base. So we're confident we can continue to push forward on the mortgage side. I would just kind of somewhat caution you that ask if the rates further going down, you are going to get cyclicality and seasonality coming into play.

Michael Perito
All right. Great, thank you guys for taking my questions appreciate it.

Mike Keim
Thanks, Mike.

Jeff Schweitzer
Thanks, Mike.

CONCLUSION

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Jeff Schweitzer for any closing remarks.

Jeff Schweitzer
Thank you, everybody, for joining us today. We're pleased with our results for the third quarter. While the environment is still obviously very competitive out there, we continue to drive solid earnings and solid results and look forward to talking to everybody in January after our fourth quarter earnings are released. Have a great day.

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