UniVest Corporation of Pennsylvania

Third Quarter 2016 Earnings

Thursday, October 27, 2016, 9:00 A.M. Eastern

CORPORATE PARTICIPANTS

Jeffrey Schweitzer - *President, CEO*

Michael Keim - *President of UniVest Bank and Trust*

Roger Deacon - *CFO*

PRESENTATION

Operator
Good morning and welcome to the UniVest Corporation of Pennsylvania's third quarter 2016 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 (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on your telephone keypad. To withdraw your question, please press star (*) then two (2). Please note this event is being recorded.

I would now like to turn the conference over to Jeff Schweitzer, President and CEO of UniVest Corporation of Pennsylvania. Please go ahead.

Jeffrey Schweitzer
Thank you, Amy, and good morning and thank you to all of our listeners for joining us today. Joining me on this 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 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 $58,000.00 during the third quarter. As anticipated, our reported income includes after tax $9.2 million of acquisition-and-integration expenses related to the acquisition of Fox Chase Bancorp. Excluding these costs, earnings would have been $0.35 per share. Additionally, on a pro forma basis, we had solid loan growth during the quarter of $69 million, or 2.2% unannualized, along with deposit growth of $63 million, or 2% unannualized. During the quarter, we successfully completed the systems conversion of Fox Chase into UniVest and closed two of the legacy Fox Chase branch locations in New Jersey, consolidating these locations into the existing Ocean City location. Additionally, we are slated to close three more legacy UniVest locations on November 1, consolidating these locations into existing locations, which are located nearby as we continue to optimize our financial center footprint. These closures were offset by the opening of our first financial center in Lancaster County, in Willow Street, to support the talent lift out, we executed on in the second quarter.

Now I'd like to open it up for questions that anybody might have today. Amy, can you queue for questions, please?

QUESTIONS AND ANSWERS

Operator
Yes. To ask a question, you may press star (*) then one (1) on your touchtone phone. If using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*) then two (2). Our first question is from Michael Perito at KBW.

Michael Perito
Hi, good morning, guys.

Jeffrey Schweitzer
Morning, Mike.

Michael Perito
A few questions, I guess starting on maybe the loan growth outlook, had another strong quarter of growth, double digit growth on the organic basis. Can you maybe talk about the pipeline and maybe, more specifically, the Lancaster pipeline, and maybe where balances are already?

Michael Keim
Sure, Mike, it's Mike Keim and good morning. Pipelines remain healthy. As we'd talked about in the last earnings call, we continue to believe that on an annual basis, we'll have loan growth in the 10% to 12% range. That doesn't mean every single quarter will be at that perspective, but we continue to see the growth and the pipeline supporting that going forward. With regard to Lancaster, we finished the third quarter with a little, approximately $34 million in balances from that group and, as of yesterday, that had grown to $43 million. So, we see healthy production actually coming on the books, and we continue to see a pipeline that justifies that that pace of growth will continue.

Michael Perito
Okay, that was helpful, and then maybe a pivot question here, I think about legacy UniVest, you guys operated with a kind of a loan/deposit ratio in that 90%, plus or minus, range for, it was really, actually, below that for quite a few years before last year. Obviously, now, smacked at a hundred, sounds like the 10% to 12% loan growth outlook is unchanged. What's the expectation, in terms of funding that loan growth, and, I guess, how comfortable are you with that ratio rising into the 105 range at this point?

Roger Deacon
Hi, Michael, it's Roger. Yeah, it's a very good question. We are comfortable operating in a 100% to 110%-type loan-to-deposit ratio. Obviously, we'd like that to be in the 100 range, but what we'd like to do is have, if anything, you grow the loan book and you fund it with deposits at a little bit more as trail as opposed to leading with it. So if, for time to time we go up to a 102 or a 103, in my mind, that is okay and then we'll have separate initiatives along the way to continue to fund that, both on the commercial and consumer side.

Jeffrey Schweitzer
And I would add to that, Mike, we continue to have opportunities in the public fund market and, as Roger said, we'll have separate initiatives to continue growing on the commercial side as well as the consumer side. On the consumer side, as you well know, the, let's say marathon, in terms of continuing to grow those deposits. So, the more immediate impact will be on the public funds and commercial side.

Michael Perito
And is that public fund, commercial side, the biggest opportunity there in the Lancaster market, or are there other opportunities in the legacy market or Valley Green that are still meaningful?

Jeffrey Schweitzer
The answer, the quick answer is yes, there's opportunities across the board. We surely have opportunities in Lancaster. We also have opportunities in the Lehigh Valley, which we need to continue to pursue, as well.

Michael Keim
And the nice thing with the public fund side is that's where the local positioning actually does come into play somewhat. A lot of the school districts and such like to do business with banks in the market, not necessarily headquartered out of state, so we do see opportunities in our core market, along with our expanded markets.

Michael Perito
Okay and then maybe just one more. Balance sheet question. The NIM came in just about where I was expecting it, at least, I mean it seems like the cash position, though, was maybe a little higher than what it needs to be, at least on an average basis, I guess. Can you guys just remind us, I mean this sounds like, obviously, if you're searching for public funds, but it's just my guess is the securities portfolio will probably be relatively flat, at least, from here. But I guess, can you just provide any updated thoughts on kind of the cash and securities portion of the balance sheet as it overall continues to grow?

Roger Deacon
Yes, you're exactly right. My plan would be to keep the investment portfolio at about the same size that it is now. It's going to, obviously, we'll be opportunistic in terms of timing our purchases and sales, but then over time, then that becomes a slightly smaller percentage of the balance sheet. But that would be the plan right now. As it relates to your question about cash, I mean, really, we're in a borrowing position overnight. So the cash that's on the balance sheet is really cash in the branches and in process clearing items, it's not really cash that we're sitting, it's not funds that we're sitting on.

Michael Perito
Okay. So I mean, taking that at face value, the, it would sound like then the, I guess my next question would be the core kind of margin expectation, I mean it sounds like it could be relatively steady from here. I guess is that fair or is there still enough asset-side compression that we should expect some modest compression, sequentially, for the near future absent of hire rates?

Roger Deacon
Sure, I think that the bulk of our growth is still going to come through commercial and commercial pricing is still what I would say on average 50 basis points lower than our core portfolio right now. So our core portfolio and commercial is about a 430 yield. New business is coming in, on average, around at 370, 375. So you will, what I've said in the past is, I think this is still true, I think we're going to see a couple basis points of compression per quarter.

Michael Perito
Okay.

Roger Deacon
Assuming no change in the yield curve.

Jeffrey Schweitzer
Correct.

Roger Deacon
Right, so

Michael Perito
Right and can you remind us what the, at least as you guys see it, all else equal, what the impact would be to the third, an II, or the margin, rather, if we did see a 25 basis point hike in December?

Roger Deacon
Sure, it's not super material, it's probably about 3 basis points on the 25.]

Michael Perito
On the plus?

Roger Deacon
Yeah, on the plus, correct.

Michael Perito
Yes, okay.

Roger Deacon
I mean, 50% of our commercial loan portfolio is variable.

Michael Perito
Okay. All right, thank you, guys, appreciate it.

Michael Keim
Thanks, Mike.

Jeffrey Schweitzer
Thanks, Mike.

Operator
The next question is from Matthew Breese at Piper Jaffray.

Matthew Breese
Good morning, everybody.

Jeffrey Schweitzer
Hi, Matt.

Roger Deacon
Hi, Matt.

Michael Keim
Morning, Matt.

Matthew Breese
Just curious, what was the absolute dollar amount of total intangible assets at quarter end?

Roger Deacon
You have the goodwill and the intangible. Okay, the goodwill is $172 million; intangibles are $17 million and that does include MSRs, which are $6 million. So the combination is $79 million. Okay, I'm sorry, $189 million.

Matthew Breese
$189 million total.

Roger Deacon
Yes.

Matthew Breese
Okay and then, I know the message was third quarter/fourth quarter, we're going to be somewhat noisy. Can you just remind us of what remaining onetime items will occur in the fourth quarter, and are we still on track to see clean results in first quarter 2017?

Roger Deacon
Matt, it's Roger again. Yes, that continues to be our plan is to start off 2017 with a clean first quarter. As it relates to one-timers in the fourth quarter, there's not going to be much significant. We may have a few items that we're looking into that'll help to continue to position our self for 2017, but it shouldn't be too significant. We still had some Fox Chase, we still have some Fox Chase related costs that were in the third quarter. Some of those will bleed into the fourth quarter, but once you hit the first quarter, that'll be clean.

Jeffrey Schweitzer
Yes.

Matthew Breese
Did the systems conversion have any impact on service charges this quarter, especially on the Fox Chase side?

Roger Deacon
No. No.

Jeffrey Schweitzer
Not that we're aware of.

Roger Deacon
No.

Matthew Breese
Okay, okay and then, I know there are some moving parts, in terms of consolidating branches and opening some new ones. What would you expect is the operating expense run rate as we head into the first and second quarter of 2017?

Roger Deacon
Sure. I think, Matt, it's in the range of $32 to $32.5 million.

Matthew Breese
Okay and then my last one is, can you remind us of your overall profitability goals in 2017 and beyond and perhaps comment on your confidence in achieving those goals?

Jeffrey Schweitzer
Yes, our overall profitability goals still haven't changed. We're looking at north of a 110 ROA. We're very focused on efficiency ratio, I know that's not necessarily profitability goal, but it helps

drive it. Continuing to drive that down into the 62-63 range shorter term with the goal of long term getting even further, lower than that. ROTCE north of 13.5 to 14. So the goals that we've outlined in the presentations in the past, they haven't changed and we're still, we still feel confident that we can hit those as we get through '17 into '18.

Matthew Breese
That's all I had. Thank you very much.

Jeffrey Schweitzer
Thank you, Matt.

Roger Deacon
Thank you, Matt.

Operator
As a reminder, to ask a question, you may press star (*) then one (1) on your touchtone phone. And the next question is from Chris Reynolds at Nuburger Berman.

Chris Reynolds
Morning, gentlemen.

Jeffrey Schweitzer
Morning, Chris.

Roger Deacon
Good morning, Chris.

Michael Keim
Good morning, Chris.

Chris Reynolds
I have a question about new capital center of capital spending cost and break even, and I would think that the economics will vary quite a bit, depending on whether it's the Valley Green Bank division or operating in Lancaster County. Can you outline what that looks like?

Michael Keim
Yes, Chris, it's Mike Keim, and when you look at that breakeven, I mean, traditionally, you would have looked at it as a level of deposits and loans. With our diversified model, we also look at it in terms of what are we driving and with regard to the increases in the fee-driven business. So what we do from a mortgage perspective, what do we do from a wealth management perspective, as well as from an insurance perspective. The reality is the occupancy cost in the Lancaster market is dramatically lower than it would be in the Philadelphia market, which I think would make sense to everybody.

So as we consolidate branches, we're trying to consolidate branches and get them to be in the $50 million in deposit, per se, per branch. Now, as we open up new ones in new markets, that's obviously going to take a ramp up period, but when you combine that deposit base per branch with what we can sell from our other fee-driven businesses, that's how we look to drive to the, quite frankly, beyond a breakeven analysis for our new branch structure. We are looking at and, as we mentioned, we will have closed 11 branches in the last year and change with regard to the existing centers and those savings that we're getting from those shutdowns is what we're using to invest in the new locations, which expand the reach of our footprint and support all of our lines of businesses.

Chris Reynolds
Okay, thank you, terrific.

Jeffrey Schweitzer
Thanks, Chris.

Operator
Once again, that's star (*) then one (1) if you'd like to ask a question. And the next question is from Michael Perito of KBW.

Michael Perito
Hi, thanks for taking the follow up, guys. Question kind of stemming from your response on the target profitability goals. Obviously, my hunch is that the non-interest income platform growth is a big driver of achieving those. Can you maybe just give some comments on what you saw in the quarter? It seems like the mortgage, where you guys have hired some is starting to pick up some momentum. I guess where are we in that buildout and maybe then also some comments on the insurance and investment and trust platforms, as well, please?

Jeffrey Schweitzer
Yes, sure. The insurance investments, we obviously really like the diversified model. We want to continue to grow the diversified model. Our metrics have gotten a little skewed after buying two banks that were loan-and-deposit shops. So, our long term goal is to continue to increase those percentages of income from non-interest income and continue to grow those. With that said, it won't, it can't happen just organically because, obviously, the Bank is a big engine that will continue to grow. So for those lines of business to catch up, it's got to be a combination of organic growth plus acquisitions. And there's always opportunities out there, and while we're out of the acquisition market for banks, we continue to look at opportunities in those lines of business to fill out our footprint and fill out our capabilities.

With that said, we had a nice rise in the stock market in the third quarter, which always us, then, as we get paid on assets under supervision and as those grow, we make more money. Insurance, on the organic is a slower growth, 5% to 7% type of growth engine, and that continues. That's been kind of our growth, year to date, from written premium and also, on a revenue basis, and we feel comfortable with that. I would say wealth [technical difficulty] starting to see a change in the mix of our business, more moving, the growth we're seeing as an investment advisory, which is really nice, that's where we've been focused on growing and that's been growing significantly during the year. While we've seen some runoff in the trust business because there just, it's just a slower growth engine on the trust side. So a change in that mix is a favorable thing, long term, for us and we've been very focused on growing that investment advisory business. We've built out the mortgage banking side, we have a team in the Lehigh Valley now that is really starting to produce, we built that over the past year and they're starting to contribute to production now, which is really nice. We need to grow out Chester County more and into Lancaster, now that we've entered that market, so that we have the full diversified set of products and services in all of our markets.

Michael Perito
Okay, thanks for that color and then, I guess, taking those comments altogether, I mean, obviously, your points taken on as a percentage of your operating revenues organically, it's

going to be difficult just because you're growing loans 10%-12% a year.

Jeffrey Schweitzer
Right.

Michael Perito
But I guess what is a kind of realistic organic growth rate for you fee-income platform as you see the opportunities in front of you today?

Jeffry Schweitzer
Well, it kind of varies by line. As I said, insurance, organically, is more of a 5 to 7; I'd say wealth is more of an 8 to 10; mortgage, I'll kick it over to Mike, because they report up through him on what he sees.

Michael Keim
We should see mid-single digits, Mike, to some degree on the mortgage side. In terms of revenue growth, it depends on where interest rates go and you're also going to have from quarter to quarter seasonality. So we're going to come into a absent of rate decrease. If refis picking up, you're going to see the purchase market where we operate in slow down a little bit until the February timeframe, February, early March. But we continue, as Jeff referenced, we have not staffed up like we can and should in the Lancaster market nor the Chester markets, so we continued to see growth on the mortgage side. It's just going to be, realistically, I think, as it becomes more and more a purchase market with less refinance volume, you'll see margins net up, gain-on-sale margins come down a little bit, but we are also very focused on being more efficient as an organization and getting our cost per loan down. So the mortgage business will continue to grow. To some degree, the revenue growth might be more in that 5% range, but we, if we get more efficient like I know we can, from an operating basis, the pretax contribution could actually grow faster than that.

Michael Perito
Okay, thanks for that and then just one last question from me on the credit side of things. I think last time we spoke, you guys had mentioned some, not concern, but just a closer watch on some areas in the Philly market and I guess how should we be thinking about incremental credit costs, both I guess in terms of your views of credit overall in your markets plus taking into consideration that 10% to 12% growth expectation as we head into 2017?

Roger Deacon
Hey, Mike, it's Roger again. So here's how we're seeing about the provision. Obviously, you know that chargeoffs are event driven and that's going to be a driver of it from a quarter-to-quarter basis. But kind of going forward, we're going to provide for new loan growth and we're going to provide for charge offs. Loan growth, in general, is going to be at about a 75 to 80 basis points of loan growth. And then I think on the charge off front, if you look, this year, we're at $3.3 million of charge offs. I think, really, $1 million to $1.2 million per quarter on the average is probably an appropriate run rate.

Michael Perito
Okay, thanks, guys, appreciate it.

Jeffrey Schweitzer
Thanks.

Roger Deacon
Thanks.

Michael Keim
Thank you.

Operator
Once more, that's star (*) then one (1) if you'd like to ask a question. Seeing as we have no further questions, I would like to turn the conference back over to Jeff Schweitzer for closing remarks.

CONCLUSION

Jeffrey Schweitzer
Thanks, Amy, and I'd just like to thank everybody for participating this morning. We appreciate your interest in UniVest and your holdings in UniVest and we look forward to getting back and talking to you in January after we release fourth quarter earnings. Have a great day.

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