Univest Financial Corporation

Q4 and Year End 2019 Earnings Conference Call

January 23, 2020 at 9:00 a.m. Eastern

CORPORATE PARTICIPANTS

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

Brian Richardson – *EVP and Chief Financial Officer, Univest Financial Corporation*

Michael Keim – *President, Univest Bank and Trust Co. and Senior EVP, Univest Financial Corporation*

PRESENTATION

Operator
Good morning. And welcome to the Univest Financial Corporation Fourth Quarter and Year End 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. Please note that 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, sir.

Jeff Schweitzer
Thank you, Chad. 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 $15.5 million during the fourth quarter, or $0.53 per share. Earnings for the quarter were impacted by $869,687 [ph] after tax charge related to a legal settlement with a former Fox Chase Bank customer in connection with the workout that occurred prior to our acquisition of Fox Chase Bank in 2016. This charge impacted earnings by $0.02 per share during the quarter. We were pleased with our results for the quarter as loans grew $134.9 million or 12.7% annualized, which resulted in total loan growth for 2019 of $380.3 million or 9.5%.

Additionally, although deposits only grew $16.8 million during the fourth quarter due to seasonal runoff of public funds deposits, growth for the year was $468.8 million or 12.1%. While we continue to see solid loan demand due to market disruption and the strength of our local economy, our net interest margin continues to be impacted by the overall lower interest rate environment, combined with increased competition around rate and structure.

Brian will discuss our net interest margin further in his comments. With the decreasing rate environment combined with investments we have made in home loan consultants, gain on sale from our mortgage banking operation increased $325,000 or 45.6% for the quarter and $821,000, or 26.3% for the year when compared to the same periods in 2018. Additionally, revenues from our other fee based businesses of wealth management which includes trust and insurance increased 4.2% and 5.7%, respectively, compared to the fourth quarter of 2018, helping offset the impact from the compression in our net interest margin.

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

Brian Richardson
Thank you, Jeff. And I would also like to thank everyone for joining us today. During the fourth quarter, we continued our trend of strong financial performance. As Jeff mentioned, we reported earnings per share of $0.53 or $0.55 when excluding the legal settlement charge. For the full year of 2019, we reported earnings per share of $2.24. I would like to touch on three items related to the earnings release before focusing on 2020 guidance.

First, despite pressure on net interest income during the second half of the year, 2019 was relatively strong from a metric perspective, with the return on average assets of 1.26%, return on average equity of 10.07%; return on tangible equity of 13.82% and an efficiency ratio of 61.4%. With regards to the efficiency ratio, I would like to remind everyone that as a Pennsylvania State Chartered Bank and Trust Company, our bank is subject to Pennsylvania bank shares tax instead of Pennsylvania state income tax. For 2019, Pennsylvania Bank shares tax expense totaled $3.9 million and was included in Other expense not income tax expense. Accordingly, this results in approximately 170 basis points of drag on our reported efficiency ratio.

Second, during 2019, we grew tangible book value per share $17.01, an increase of $1.76 or 11.5%. Third, net interest income for 2019 was up 7.1% compared to 2018. This is due to strong average loan growth of 9.8%, partially offset by net interest margin compression.

Our net interest margin for the fourth quarter of 3.44% decreased eight basis points from 3.52% in the third quarter. During the fourth quarter, we continued to have excess liquidity due to strong deposit growth throughout 2019. Average excess liquidity of approximately $166 million negatively impacted NIM by 12 basis points compared to $174 million or 13 basis points in the third quarter

Purchase accounting accretion contributed three basis points to NIM during the current quarter. Excluding the impact of excess liquidity and purchase accounting accretion, core NIM was 3.53%, a decrease of 12 basis points when compared to 3.65% in the third quarter. As communicated on last quarter's call, the pressure on net interest income highlights the importance of our diversified business model. For 2019, noninterest income represented 28% of total revenue. I believe the remainder of the earnings release was straightforward and I would now like to focus on five items as it relates to 2020 guidance.

First, due to the current rate environment and competition on the commercial lending side, we expect net interest margin excluding the impact of excess liquidity to compress by approximately 3 to 4 basis points in the first quarter of 2020. We then expect NIM to be flat to slightly down for the remainder of the year. Second, we expect the provision for credit losses to be approximately $9 million to $10 million for 2020 or on average $2.3 million to $2.5 million per quarter.

Third, we normally see noninterest income growth of approximately 5% per year, but we experienced outsize growth of 8.7% in 2019 due to strong swap fees, contingent income from our insurance business, and refinance activity in our mortgage banking business. Accordingly, we expect more normalized growth in noninterest income of 3% to 3.5% in 2020, off of the elevated level from 2019.

Fourth, we expect noninterest expense growth of approximately 5.5% to 6% in 2020. This includes the carryover impact of team lift-outs and investments in revenue producers and technology, which were made during 2019.

Lastly, as it relates to income taxes, we expect our effective tax rate to be approximately 18% to 18.5% for 2020.

That is 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. 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. To withdraw your question, please press star then two. At this time we'll pause momentarily to assemble our roster.

The first question today will be from Frank Schiraldi with Piper Sandler. Please go ahead.

Frank Schiraldi
Good morning. First, Brian, I didn't hear, I don't think you mentioned loan growth for 2020. Wondering if you had any expectations you could share with us on that front?

Brian Richardson
Sure, Frank. We're currently targeting 8% growth for 2020.

Frank Schiraldi
Okay. And then I want to ask you specifically about the team you hired recently. I think was a couple of quarters ago maybe in Lancaster. Just curious how that team is doing in terms of origination. I know that they came out of an attrition from a recent M&A deal out there. Just wondering if there's any impact on them in terms of short term, in terms of non-solicitation that might be slowing their growth output.

Michael Keim
Frank, it's my Mike Keim. They had no limitation in terms of from a contractual perspective. I will tell you that the acquiring company has been a little bit more aggressive in terms of trying to maintain their customer base. They've done a good job from that perspective versus the previous team that we had.

Frank Schiraldi
Gotcha. Okay. Finally, on the margin outlook, just curious if that includes any further rate cuts and what sort of impact the 25 basis point rate cut would have on NIM, all else equal?

Brian Richardson
Yes. Frank, that assumes a stable rate environment. There's no anticipated decreases included in that guidance. Consistent with prior quarter communications, a 25 basis point decrease translates into an immediate impact of roughly 3 to 4 basis points. Then you see 1 to 2 in the couple of quarters immediately following as a result of lagging on the deposit side and the like. So, 3 to 4 initially, and then slight pressure for the subsequent quarters.

Operator
Once again, if you'd like to ask to a question press star, then one. The next question will come from Michael Perito with KBW.

Michael Schiavone
Good morning, everyone, this is actually Michael Schiavone stepping in for Mike Perito. Can you guys provide a little more color on where you saw the loan growth in Q3, both geographically and by line of business? And given the recent momentum, do you have any updates to your growth targets for 2020?

Michael Keim
In terms of the growth, the vast majority of the growth came from our commercial line of business. And the growth in that quarter would be equally split between what we refer to our Delaware Valley Division and our Central Pennsylvania Division. With the Central PA Division slightly ahead. Overall, our growth rate for 2020 that we're targeting is 8%. And we would see that come across our entire footprint.

Michael Schiavone
Great. Thanks. And I know capital levels remain strong. Do you have any updates around capital deployment or priorities going into 2020?

Brian Richardson
Sure. This is Brian Richardson. As previously communicated, our priority has been to position ourselves to pay down sub debt. As a reminder on March 30th of this year, we have $50 million of sub debt that hits the five-year mark and flips from fixed rate to variable rate. And its favorable capital treatment starts to diminish. Accordingly, we plan to redeem this issuance. Once the sub debt is paid down, we will be evaluating all capital deployment options. However, as previously communicated, we do like keeping some powder dry to enable us to be opportunistic with future lift outs or fee income acquisition opportunities as they present themselves.

Michael Schiavone
Okay. And just one last question. On expenses, they were little lower in the quarter and I know you guys gave some initial guidance. Do you have any commentary on the geography of where you expect some movement in expenses in 2020?

Jeff Schweitzer
Geography on the income statement?

Michael Schiavone
Yeah, yeah. I mean I think as far as the investments you are making [overlapping voices].

Michael Keim
Investments are going to be in headcount. So you're going to see that in the compensation line items. And then also, we don't have any large significant investments still coming on the technology side, but investments that we did in 2019 that will roll over will continue to have some level of impact on the data processing technology line items.
Michael Schiavone

Great, thank you. That is all for me.

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, Chad. And thank you to everyone for listening today. And we feel really good about how we ended the year and the momentum we have entering 2020. Obviously, there are some headwinds with net interest margin, but overall the economy is very strong in our market and we feel very good about the year ahead of us.

We look forward to talking to you at the end of the first quarter. Have a great day.

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