Univest Corporation of Pennsylvania

Q1 2018 Earnings

Thursday, April 26, 2018, 9:00 AM Eastern

CORPORATE PARTICIPANTS

Jeff Schweitzer - *President and Chief Executive Officer*

Roger Deacon – *Senior Executive Vice President and Chief Financial Officer*

Mike Keim - *President, Univest Bank and Trust Co.*

PRESENTATION

Operator
Good morning, and welcome to the Univest Corporation of Pennsylvania First 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 “*” key followed by “0.” After today’s presentation, there will be an opportunity to ask questions. To ask a question, you may press “*”, then “1” on your telephone keypad. To withdraw your question, please press “*”, then “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.

Jeff Schweitzer
Thank you, Debbie, 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 Co.; 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 $12.9 million during the first quarter, or $0.44 per share. This included a charge of $451,000 or $0.01 per share related to the closure of three of our financial centers as we continue to optimize our financial center network by consolidating centers in our historical core markets into other nearby centers and reinvesting these dollars into technology and new centers in our newer expansion markets.

We were pleased with loan growth during the quarter as loans increased $69.8 million during the quarter, or 7.7% annualized. The first quarter is typically a slower quarter for us. However, we saw solid activity. We are still comfortable with our previously communicated guidance of 8% to 10% growth in loans for the 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 highlight a couple of items from the earnings release. First, as it relates to earnings, as Jeff mentioned, we reported earnings of $0.44 per fully diluted share, including the restructuring costs related to the financial center closures and--which was a penny a share.

Second, as it relates to net interest margin, our core net interest margin was 3.70 for the quarter compared to 3.72 for the fourth quarter. However, I remind everyone that our net interest margin is presented on a fully tax-equivalent basis, and therefore, the current quarter reported margin was negatively impacted by the reduction of our federal tax rate from 35% to 21%.

Using a 21% federal tax rate, our pro forma fourth quarter 2017 and first quarter 2017, core net interest margin were both 3.64%. Accordingly, on an apple-to-apple basis, this quarter's margin represents a 6 basis point increase from the fourth quarter of 2017.

This improvement in margin compared to the prior quarter is primarily due to the benefit received from the December 2017 Federal Reserve 25 basis point rate increase, as our balance sheet continues to be slightly asset sensitive. We would note that, beginning in March of this past quarter, we started to see increased price competition across all deposit lines, and accordingly, we would anticipate that our margin will be flat to possibly a slight decline for the second quarter.

Additionally, our reported net interest income increased 8.7% for the quarter as compared to the first quarter of last year. As noted in our press release, the benefit of purchase accounting has declined significantly, and our net interest income, excluding purchase accounting, has increased a solid 10.8% from the first quarter of 2017.

Third, from a credit perspective and as disclosed in the press release, we did have one $12.4 million CRE loan placed on nonaccrual during the quarter. This loan is secured by a special use property, which is an extended workout situation. We have recorded a specific reserve of $656,000 on this loan, based on our estimated net realizable value. That said, we do see continued credit quality improvement as our criticized and classified loans have decreased by 44% to 73.5 million at quarter end versus 132 million a year ago, and decreased 21% in the quarter. We have no change to our prior guidance of provision for loan losses of 2 million to 2.2 million per quarter.

Fourth, we would remind everyone that, consistent with many other financial institutions, our noninterest expense are elevated in the first quarter due to seasonal items, such as payroll taxes, merit increases, and property-related expenses. We believe we are still on track for our prior guidance of 5.5% to 6% increase in expense ignoring one-time restructuring charges.

I believe the press release is fairly 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?

QUESTION AND ANSWER

Operator
We will now begin the question-and-answer session. To ask a question, you may press "*", then "1" on your touchtone phone. If you are using a speaker phone, please pick up your handset before pressing the keys. To withdraw your question, please press "*", then "2". At this moment, we'll pause momentarily to assemble our roster.

The first question comes from Michael Perito with KBW.

Michael Perito
Hi, guys, good morning.

Jeff Schweitzer
Morning, Mike.

Roger Deacon
Hi, Mike.

Michael Perito
Thanks for taking the questions. I wanted to start on the deposit side. So, it sounds like things are continuing to be competitive there, per your comments, Roger. I was curious what--how you guys are thinking about growing incrementally here as some of that pricing pressure is starting to manifest on the liability side? And obviously, the loan growth was pretty good for the first quarter, and funding is top of mind here. So just curious if you have any updated thoughts around that?

Mike Keim
Good morning, Mike. It's Mike Keim. In terms of growing our deposits, we have a series of strategic initiatives, and it's really an all of the above type of strategy. Several of the initiatives are more time sensitive in terms of being able to make an immediate difference, and some of them are more strategic that'll add deposits over time. We're looking at it, continuing as we spoke in the past, grow our cash management business that generates most fee income and depository relationships. We are looking at our commercial customers, and we're seeing how we can get additional share of their wallet, for lack of a better term.

We're currently running several CD specials in our market, and we're seeing growth in CDs on the consumer side. And then we continue to go from there. I have some historical relationships on the mortgage servicing side that we're trying to tap into. We're working with title companies that we work with as well as real estate brokers. So, there's a series of initiatives that go across the board, and we will continue to focus on that.

With regard to public funds, Roger alluded to pricing competition. The public fund market is getting very price sensitive, but we still have, in the Lancaster market and the Lehigh Valley market, opportunities to tap into public funds that we hadn't in the past. So, like I said, it's an all of the above strategy, and we continue to remain focused on it, and we continue to be committed to keeping our loan to deposit ratio in the spectrum that it's at today.

Michael Perito
Helpful. Thanks, Mike. Maybe switching to the expense side, I know you guys continue to invest for growth, and there were some things I think in the first quarter that you'd spoken to previously that kind of impacted the expense number. I was just curious--I guess two-part question--are there any other major--well, maybe not major, but are there any other notable investments you guys plan to make over the balance of the year here? And I guess, secondly, I mean, is it fair to say that most of the 2018 expense growth was in that first quarter, so to speak, and the run rate should kind of flatten out a little bit from here, or do you think there's more that could come through as you guys continue to invest for growth?

Roger Deacon
Yes, so it's Roger. As I mentioned, the first quarter is just elevated because of some seasonal expenses. I would say for the year, back to the--we are looking at a--quite frankly it's about a $138 million number, it's about a--between a 5.5% to 6% increase for the year. If you annualize the first quarter, ignoring restructuring charges, you're right at that 138. So, the decline related to the seasonal stuff that will occur going forward will be offset by continued investment in the business. So, we've kind of got that baked into our numbers.

Michael Perito
Perfect, yes, okay. That makes sense. And then just last one, Jeff--it's been--we had a full quarter here with the lower tax rate. As we move through almost into May now, are you starting to see any notable difference either from your competitors or from your customers as it relates to tax reform? Just curious if you're starting to see anything manifest in the market as people react to that?

Jeff Schweitzer
I wouldn't say anything notable other than our pipelines remain very strong on the lending side. I think customers are feeling good about the economy and about where their businesses are. I'd say, right now, there's a labor shortage. Some of them could probably grow faster than they are currently if they could find quality labor to add to their businesses. So, I would say, overall, people are feeling good, and the extra money in their pockets is just making them feel even better.

Michael Perito
All right. Great, guys, I appreciate you taking my questions. Thank you.

Jeff Schweitzer
Thank you.

Roger Deacon
Thank you.

Operator
As a reminder, press "*" then "1" if you have a question.

Our next question comes from Matthew Breese with Piper Jaffray.

Matthew Breese
Good morning, everybody.

Jeff Schweitzer
Good morning.

Roger Deacon
Morning, Matt.

Matthew Breese
Maybe just touching base on the new hires that were noted in the press release related to revenue generation. Could you just give us a better idea of what areas they will be driving revenue?

Mike Keim
We hired additional four RMs on the commercial banking side, Matt, and then we did hire some additional what we call home loan consultants, but loan officers on the mortgage side. But, quite frankly, that was a net push in terms of the number of home loan consultants we have. We brought on stronger producers, and we let go of several under producers--under performers.

Jeff Schweitzer
We added another new producer in wealth management, a couple of other business developers in our leasing business, so it's kind of across the board.

Matthew Breese
Right. Now, the four RMs on the commercial banking side, going back to the capital raise, some of that was due to potential for new hires. Does that fit into that bucket? And if we could just talk about the ramp up timeframe for those individuals and potential loan growth potential from them, that would be helpful.

Mike Keim
At this point in time, look, we continue to look to add quality RMs, and clearly, that's one of the reasons that we added the capital and raised the capital in December. We are still committed to our 8% to 10% loan growth at this point in time. I would also add, just as a little bit of color, I think that--we believe that that'll be a little bit more even flowed through the year versus, in the past, we've had pretty good spike up in the second quarter. Jeff referenced we had strong pipeline for the second quarter. We do, but I would also think it's going to continue to trend a little bit more towards the 8% to 10% range throughout the year. In terms of what the ramp up time is, typically, you're going to get somebody on board here, and it's at least three-to-six months for them to get going, build a pipeline and bring folks over.

Matthew Breese
Understood. Okay. And then maybe just talk about the loan to deposit ratio, understanding the deposit competition dynamics of your market. But, are there limits on how high you're willing to bring that loan to deposit ratio? And then maybe just talk about some of the success you've had with the promotional deposit efforts like the CD special.

Roger Deacon
Sure. So, Matt, it's Roger. We have targeted, and we've said this consistently, a range of 100% to 105% loan to deposit ratio. Obviously, we're at the higher end of that range. We do look at it on an average basis rather than spot, because there is some volatility around commercial customers. So, as it relates to the promotions that we did, we are out there at the current time with a 59-month 3% APY CD supplemented with an 11-month 1.75% APY. And we started that, like I said, in the middle of March but we actually went print advertisement near the end of March. And we're seeing about $1 million a day of new CDs on that when you combine the two. You're looking at a weighted average rate around 2.50 for 3.5 year money, which isn’t bad. But, if you had to go out and get 3.5 year money from--if you had to borrow that, you'd be borrowing that at a 2.80 or a 2.90. So, we strategically did that promotion to extend the balance sheet with retail customer CDs, and the program is going very well so far.

Matthew Breese
Got it. Okay. No, very helpful. And then maybe to the other side, can you talk about the deposit betas are picking up, but what about loan betas? Are you seeing any sort of spread compression, your typical commercial real estate loans? Is that going on to any extent?

Roger Deacon
We've seen a nominal pickup in rates on new loan production. And so, if you think about it, we're getting a nice benefit on our variable rate loans. Fortunately, we do have 50% of our portfolio being variable or adjustable over time. We're almost completely out of the floors that existed. And so, it's almost somewhat of a neutral between new production and where the current portfolio is. It's been a nominal increase. Where we've done well is on the variable-rate

side of the equation. We do have a strategy that does target variable-rate. And obviously, when prime's at 4.75% and you offer somebody a prime, that's not bad. And we're able to do fairly well getting variable-rate new loans.

Matthew Breese
Right, right, okay. And then, Jeff, maybe one for you-- could you just talk about--your fee income businesses are doing really well, trust, investment, insurance--what the outlook is from here over the next 12 months for those lines of business?

Jeff Schweitzer
Yes, they have been performing very well. I'd say wealth management continues to grow--absent the trust business--the trust business is pretty slow growth. You're talking 3%-type of growth. But, the rest of the wealth management, the RIA business, is really growing double digits, and I don't necessarily see that slowing down. Volatility in the market is actually our friend. When everything keeps going up, everybody thinks they can manage their own money, but when you get some peaks and valleys, everybody starts to realize they might need some advice.

So, I would say the wealth management on the RIA side will still grow 10% to 12% probably for the next year, I would say offset by trust, which is lower in the 3%-type of range. So, you're talking high single digits overall for wealth. Insurance is more in that 5% to 7%-type of growth. We've repositioned the business to really focus more on middle-market type of customers, and we've been successful in doing that. We brought over a new Head of our Commercial Insurance Lines business on the sales side this first quarter. He's really starting to get some traction in managing that group and starting to get a good pipeline of business.

So, I'd say across the board, those lines of business are doing well, and I don't see that changing at least for the next 12 months.

Matthew Breese
Great. I appreciate the color. That's all I had. Thank you.

Jeff Schweitzer
Thanks, Matt.

Operator
At this time there are no further questions, so I'll turn the conference back over to Jeff Schweitzer for any closing remarks.

CONCLUSION

Jeff Schweitzer
Thank you, Debbie, and thank you everybody for joining us this morning. If you have any further questions, you can always reach out to Roger, Mike, or myself. We look forward to talking to everybody at the end of the second quarter. Have a great day.

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