Univest Financial Corporation

Second Quarter 2019 Earnings Conference Call

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

CORPORATE PARTICIPANTS

Jeffrey Schweitzer - *President and Chief Executive Officer*

Brian Richardson - *Executive VP and Chief Financial Officer*

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

PRESENTATION

Operator
Good morning and welcome to the Univest Financial Corporation Second Quarter 2019 Earnings Conference Call. Today, all participants will be in listen-only mode. Should you need assistance during the conference, please signal for a conference specialist by pressing the star key followed by zero on your telephone keypad. 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 a question, please press star then two. Please note today's event is being recorded.

At this time, I would like to turn the conference over to Jeffrey Schweitzer, President and CEO. Please go ahead.

Jeffrey Schweitzer
Thank you, Chris, 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 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 $16.5 million during the second quarter, or $0.56 per share. We were pleased with our results for the quarter, as loans grew $100 million, or 9.8% annualized, and deposits grew $119 million, or 11.9% annualized. Year to date, loans have grown $161.3 million, or 8.1% annualized, and deposits have grown $236.2 million, or 12.2% annualized. This growth has led to a 10.4% increase in our net interest income compared to the six months ending June 30, 2018.

We continue to see solid loan demand due to market disruption and the strength of our local economy. However, competition around rate and structure is increasing.

In our non-banking lines of business, wealth management revenues, which includes our trust business, rebounded in the second quarter as the market rebounded, as first quarter revenue was impacted by the market downturn in the fourth quarter. Insurance revenues increased 5.6% year over year due to strong contingent commission income and growth in commercialized and group health and life premiums.

I'll 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. I'd like to start off by saying I think we continued our positive trend of earnings growth and consistent financial performance.

As Jeff mentioned, we reported earnings per share of $0.56 for the quarter with no unusual or nonrecurring items. Through the first six months of 2019, we achieved a return on average assets of 1.29%, return on average equity of 10.28%, and return on tangible equity of 14.23%.

I would now like to touch on two items from the earnings release. First, as Jeff highlighted, net interest income for the first six months of 2019 is up 10.4% compared to the same period in 2018, due to strong average loan growth and a relatively flat net interest margin. Our core net interest margin for the second quarter of 3.66% decreased eight basis points from 3.74% in the first quarter. It is important to note that excess liquidity, which was driven by strong deposit growth during the quarter, negatively impacted core NIM by approximately five basis points. Excluding the impact of excess liquidity, core net interest margin was 3.71%, a decrease of three basis points when compared to the first quarter.

We would anticipate that core net interest margin for the third quarter would compress approximately 6 to 8 basis points to a range of 3.63% to 3.65%. This includes compression at a similar rate experienced in the second quarter plus the negative impact of the current decrease in short-term LIBOR rates and the anticipated 25 basis point reduction in primal [ph] rate later this month. Due to recent signs of deposit cost abatement, we do expect the core NIM to flatten out in the fourth quarter, absent any further prime rate decreases.

Second, as expected, our efficiency ratio continued to decline as compared to the prior year. Excluding 2018's restructuring charges, total non-interest expense for the six months ended June 30, 2019 increased by 5% from the same period in 2018. When combining significant revenue growth and continued expense discipline, our year-to-date efficiency ratio, excluding restructuring charges, declined to 61% from 63.2% in 2018.

It should also be noted that 2019 expense numbers include approximately $675,000 of year-to-date non-interest expense associated with hiring 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 non-interest expense growth, excluding restructuring charges, of 7% to 7.5% for the year. This translates to 2019 non-interest expense of $146 million to $147 million, which includes the incremental investments in lending teams that we have made during the year.

I believe the press release was straightforward for the remaining items, particularly related to non-interest income and, accordingly, that is it for my prepared remarks. We will be happy to answer any questions. Operator, will you please begin the question and answer session?

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. As a reminder, 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 it, please press star then two. At this time, we will pause momentarily to assemble our roster.

Today's first question comes from Frank Schiraldi of Sandler O'Neill and Partners. Please proceed.

Frank Schiraldi
Good morning. Just a couple of questions. I just wanted to start with the NIM outlook. Brian, you mentioned down 6 bps -8 bps on a core basis in the third quarter. I'm just wondering if we can extrapolate out, given a 25-basis-point rate cut, what does that mean for the NIM? Is that 6 bps -8 bps a good

number? Or I would imagine some of 2Q included the reduction in LIBOR that kind of front ran the reduction or the expected reduction in Fed funds. So, I'm just trying to get a sense for, just generically, given a 25-basis-point rate cut, what you think that impacts the margin.

Brian Richardson
Yes, Frank. On a normalized basis, we saw three basis points of compression in the current quarter, in the second quarter. We expect similar compression absent the decrease. So, with the 6-8 guidance of compression, that would be an incremental 3-4 as it relates to the primary decrease, Federal Reserve rate decrease.

Frank Schiraldi
Okay. So I guess the next 25 bps, are you think 3-4 basis points as well?

Brian Richardson
In that range. Of course, there is the uncertainty around deposit costs and pricing on the commercial loan side. But all things equal, our models today would suggest 3 basis points -4 basis points for a 25-basis point decrease.

Frank Schiraldi
Okay. And then why the 6-8? That includes, I guess, continued ramp up in deposit costs from the rate hike, I guess, in December?

Brian Richardson
Yes. We're starting to see some abatement but we have our public funds build that occurs during the third quarter and the like, so we do see a little bit of pressure for that. And then we expect it to normalize and flatten out in the fourth quarter, absent any further rate decreases.

Frank Schiraldi
Okay. And then just finally on the loan growth. Continued strong loan growth. You mentioned the eight-member team in Lancaster and York. Are they contributing at all in a big way or is that still sort of yet to come?

Michael Keim
Frank, it's Mike. They did some deals that came through in the second quarter. It was a small percentage of the overall growth. They are building pipelines so we are expecting to see them to be a stronger contributor as we move forward here.

Frank Schiraldi
Okay. Alright, great. Thank you.

Jeffrey Schweitzer
Thanks, Frank.

Michael Keim
Thank you.

Operator
Our next question comes from Michael Perito of KBW. Please proceed

Michael Perito
Hi, good morning, guys. Thanks for taking my questions. A quick clarification question. The earnings

release, the increase in other income within non-interest income, there were a couple things mentioned; fees on risk participation agreements, and then some gain on sale of SBA. I was wondering if you could, I guess on the first part, just give us a little bit more color about what that business actually is, the fees on risk participation agreements. And then, second, just give us a sense of kind of how big the SBA platform is today and your expectations there moving forward. If that continue to be as positive a contributor as it was in the second quarter?

Brian Richardson
Sure, Mike. This is Brian. As it relates to risk participation agreements, that's the vehicle we use to provide swaps and derivatives to our customer base. It's really situations where customers are seeking longer term fixed rate loans than what we would like to put on balance sheet. So, we achieve that via having them enter into a derivative and we participate in the risk via risk participation agreement. So, that's the instruments there.

On the SBA side, it was a very strong quarter as it relates to SBA. We expect that to taper off a little bit as we look into the third quarter, but we have been focusing on that over the last year to 18 months.

Michael Perito
And so as you think about it, the first half of the year here you've done north of $16 million a quarter in non-interest income core. As you think about that run rate as you're moving to the back half of the year, what's the thought process? Do you think that that is a sustainable level, just given the wealth, insurance, and investment momentum and some of the swap and SBA momentum as well? And another seasonally strong quarter for mortgage, even though I know, overall, the environment remains a little tough there locally. But what are your thoughts, broadly on the fee income line in the back half of the year?

Jeffrey Schweitzer
We had originally guided to 5% increase year-over-year compared to 2018 for the full year and we are affirming that guidance at this point.

Michael Perito
Okay. Helpful. And then just another clarification question on the margin guide. So, does that 6-8 assume a constant level of the Q2 liquidity or has that liquidity already run down? And more broadly, just not margin related, just on an absolute dollar basis, where do you expect the liquidity profile to kind of move forward, as I imagine there's quite the build in the deposit pipeline as well as the loan pipeline today?

Brian Richardson
Yes, Mike. This is Brian again. To answer that, the last part there, as it relates to normal liquidity levels, we operate around $40 million on a normalized basis. We were approximately $60 million to $65 million in excess of that throughout the second quarter. That 6-8 basis points does anticipate a normalization of excess liquidity. And so far through the quarter we see that occurring.

Michael Perito
Helpful. And just lastly, as we look out to next year and the back half of this year, capital levels are pretty healthy here. It sounds like growth is well-positioned to at least kind of continue in this upper single digit range minimally with the new teams coming on. I know that's part of kind of the long-term capital plan to continue to drive organic growth. But can you give us any thoughts, Jeff, maybe beyond that? It would seem like even with the 8% to 9% growth rate, you're still going to be building capital towards 10% on the CCD. I'm just curious what the updated thoughts on how to kind of manage that moving forward are.

Jeffrey Schweitzer

Yeah. Similar to what we've talked about in the past, our plan is to try to repay some of our sub-debt which starts to come due next year. So right now, you're correct. We should be building capital. And the intention would be to use that to repay our sub-debt.

Michael Perito
Can you remind us what comes due next year and what the rate on it is?

Jeffrey Schweitzer
It's a $50 million piece is what comes due at the end of the year. And the rate is approximately 5.1%.

Brian Richardson
Not sure we'll pay all of it off but we're going to try to eat into that and make a good dent on it at a minimum.

Michael Perito
Okay. And that's the end of next year, correct?

Brian Richardson
No, it's March. March 31st of 2020.

Michael Perito
Of 2020. Okay. Got it. Perfect. Thank you, guys, for taking my questions.

Jeffrey Schweitzer
Thanks, Mike.

Brian Richardson
Thank you, Mike.

Operator
As a reminder, if you do have a question, please press star then one. The next question comes from Matthew Breese of Piper Jaffray. Please proceed.

Matthew Breese
Good morning. I just wanted to talk about the other teams that the new team hired in the second quarter. New Jersey and Philly. Are they commercial real estate focused or C&I focused? Where would they be additive? And then just stepping back and considering further consolidation in your market with the WSFS beneficial deal, are there still good hiring opportunities or are there more or less? Could you just characterize the environment on that front?

Michael Keim
Hi, Matt, it's Mike. In terms of the guys in South Jersey, they are primarily business bankers. So, they're doing smaller deals, which would be more on the C&I side. But they also have a couple larger deals so there will be some mix of CRE. So, I'm being a little cryptic and I apologize for that but they have a good blend. On average, their deal size is going to be smaller, though, than what our average deal size is across the platform.

In terms of how's the environment for recruiting, we still get opportunities and we'll continue to do that. And I think the biggest value that we always can point to is we've done team lift-outs where we've been successful and we continue to invest in our process and get a way [ph] to demonstrate to folks that we can get deals done and we work well with our customers. So, I think we've created an environment that is attractive for people to come and join us and we'll continue to foster that environment and, therefore, we'll continue to get opportunities to bring additional folks onboard.

Matthew Breese
Understood. Just given they are in South Jersey and legacy Fox Chase had some exposure to South Jersey as well, do you ever see yourselves building out more of a physical presence in that market?

Michael Keim
So, the former Fox Chase team was more down at the shore. These guys are operating in kind of the Jersey suburbs to Philadelphia. We are going to look at putting an LPO in place. But at this point, we have no additional plans to add a financial center or a branch, that's what we call them.

Matthew Breese
Understood. Okay. And then I know you said that deposit competition is starting to abate. Could you give us a characterization of where you're seeing it abate? Have you seen it yet on the money market and high-cost savings kind of accounts? Or is it still on the CD front, the longer duration front that's following the curve, so to speak?

Brian Richardson
Hi, Matt. This is Brian. It certainly has occurred on the CD side and we are seeing signs of it starting to occur on the money market side as well. A lot of the promotional products that were out there, you start to see those being dialed back a little bit over the last couple of weeks to month or so.

Matthew Breese
Okay. And then just the last one. We're getting very close to seasonal implementation. Just curious where you stand in that process and any early indications of where we could see that first-day true-up allowance and what the go-forward provision could look like.

Jeffrey Schweitzer
The team that we assembled for the seasonal implementation project has made great progress over the last 18 months. We are very happy with where we are in that process but at this point, we are not ready to disclose the expected impact.

Matthew Breese
Understood. Okay. That's all I had. Thank you.

Jeffrey Schweitzer
Thanks, Matt.

CONCLUSION

Operator
This concludes our question and answer session. At this time, I would like to turn the call back over to Jeffrey Schweitzer for any closing remarks.

Jeffrey Schweitzer
Thanks, Chris, and thanks, everybody, for joining us today. And we're excited about the results we were able to publish for the second quarter and look forward to solid momentum as we head into the third quarter and the rest of the summer.

So, we look forward to talking to you in three months after we release earnings again. So, have a great day and enjoy the rest of your summer. Thanks.

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