Univest Corporation

Q4 2016 Results Earnings Conference Call

Thursday, January 26, 2017, 9:00 A.M. Eastern

CORPORATE PARTICIPANTS

Jeff Schweitzer - *President and CEO*

Roger Deacon - *CFO*

Mike Keim - *President, Univest Bank and Trust*

PRESENTATION

Operator
Good morning, everyone, and welcome to the Univest Corporation of Pennsylvania Fourth Quarter 2016 and Yearend Earnings 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 that this event is being recorded. I would now like to turn the conference over to Jeff Schweitzer, President and CEO. Please go ahead.

Jeff Schweitzer
Thank you, William. 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 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 $6.9 million during the fourth quarter, which is after the impact of certain onetime items, which Roger will detail in a minute. We expected that this quarter will continue to have certain onetime items as we work through the acquisition of Fox Chase and other strategic initiatives and work towards our goal of having a clean 2017. The highlight of the quarter was continued strong loan growth of $96 million, or 12% annualized, combined with solid deposit growth of $79 million or 10% annualized. We continue to see opportunities to take market share in our core historical markets, combined with our new expansion market in Lancaster County. Additionally, we opened our first financial center in the Lehigh Valley during the fourth quarter. While we entered the Lehigh Valley market back in 2008 with a loan production office and have expanded our services in the years since, we had no retail presence until now. This opening was offset by the planned closure of three legacy Univest financial centers on November 1.

Before we get to questions, I would now like to ask Roger to spend a few minutes going through the financials and the onetime items we recorded in the fourth quarter to help provide some clarity into our financials. Rog?

Roger Deacon
Thank you, Jeff, and I'd also like to thank everyone for participating on today's call. The goal of my remarks is to provide additional clarity to our fourth quarter earnings without totally repeating the earnings release. First, I want to discuss net interest margins. Our net interest income for the quarter was $34.2 million or a reported net interest margin of 3.81%. Included in these numbers is $1.8 million or 20 basis points of purchase accounting accretion. During the quarter, we recognized approximately $700,000.00, or eight basis points of favorable purchase accounting accretion, related to the exiting of three purchased credit impaired loans, which

totaled $7.1 million. Our total purchase credit impaired loans were reduced from $14.6 million at September 30 to $7.4 million at December 31. This should reduce future credit risk.

Our adjusted net interest margin after our purchase accounting adjustments is 3.61%, which is the same as the third quarter. For planning purposes, we are assuming purchase accounting accretion will approximate six basis points per quarter, filling out through 2017, although, as everyone knows, this estimate can be volatile. Additionally, our loan growth was primarily in December. Thus, our end of period loan balances of $3.268 billion is $60 million higher than our average loan balances for the fourth quarter, which will help our net interest income in the first quarter of 2017.

As it relates to noninterest income, nonrecurring income include a $450,000.00 associated with the proceeds from BOLI death benefits. This item is offset by approximately $236,000.00 of REO valuation adjustments, which is a negative to our other income. Finally, as it relates to noninterest expense, as Jeff mentioned, our goal for 2016 was to position the Company for a clean 2017. At the current time, we do not anticipate any significant acquisition, integration, or restructuring costs in 2017. Additionally, the Fox Chase integration is now complete and there should be no Fox Chase related expenses in 2017.

For the quarter, we reported noninterest expense of $38.4 million. We have previously communicated that our goal is $32.5 million per quarter and we believe we are on track to achieve this target during the first quarter of 2017. This will be achieved through the following items. Elimination of $2.2 million of acquisition, integration, and restructuring costs, which were recorded in the fourth quarter. Reduced intangible amortization expense of $2.1 million as the Girard Partners future obligation was settled in the fourth quarter. Additionally, we will see reduced compensation expense of approximately $700,000.00, due to the identified staffing rationalization initiative and reduced Fox Chase staffing costs. Also, we will see reduced professional fees of approximately $100,000.00 related to former Fox Chase employees that were on, that were still on the Univest books as consultants during the third and fourth quarter of last year. Another item is we will see reduced FDIC insurance of approximately $100,000.00 as we were under accrued at September 30 and we doubled up in the fourth quarter. The under accrual really related to the new FDIC assessment that came in during that quarter and the post-acquisition assessment came in at the same time.

Other fourth quarter nonrecurring charges were approximately $600,000.00, of which $350,000.00 were in other expense and $250,000.00 were in premises and equipment. Both line items were elevated during the fourth quarter and will run rate back towards the third quarter numbers. These adjustments bring us down to approximately $32.5 million. Finally, we believe our effective tax rate for 2017 will range between 28% and 28.5%.

And as I was long but wanted to provide as much transparency as possible, and I'd be happy to answer any further questions. Operator, would please begin the question-and-answer session?

QUESTIONS AND ANSWERS

Operator
Yes Sir. We will now begin the question-and-answer session. To ask a question, you may press star (*) then one (1) 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 (2). At this time, we will pause momentarily to assemble our roster. And the first question today comes from Michael Perito with KBW. Please go ahead.

Michael Perito
Hey, guys, I guess that was close enough. Quick question on the margin, Roger. The core NIM was flat, quarter-over-quarter. I think last quarter, you guys said you expected maybe a few basis point benefit from a 25 basis point hike in interest rates, in fed funds rather. Was there any benefit in that, material benefit in that 3.61 already in the fourth quarter or is there going to be maybe a little more meaningful benefit in the first quarter and, I guess, any more high-level kind of core NIM outlook commentary for 2017 and maybe what you guys are expecting in terms of additional rate hikes?

Roger Deacon
Sure, well, I'll answer the question first as if there were no rate hike. We did see a teeny bit of benefit, which helped keep the core NIM at the 3.61. If there's no rate hike, I would, as I've said consistently, I would anticipate a couple basis point decline per quarter in the NIM going forward. The rate hike, we have calculated a benefit of a 25 basis point hike to be, and this is a range, anywhere from $1 million to $2 million for the year and the reason I provide the range, it really depends on what happens with deposit pricing and, really, the competition around deposit pricing and whether we have to move off of the fairly low rates that we're paying at the current time.

Michael Perito
And so in terms of the kind of 1Q margin from the 25 basis point hike that we had already, is there any additional benefit that's going to come in in the first quarter?

Roger Deacon
There's a little bit, but it's not really that material.

Michael Perito
Okay and then maybe on the noninterest income side, as I look out into the first half of next year, obviously, in the first quarter, you guys typically have a pretty strong insurance production. Any other comments, I guess, as we kind of think about what's a realistic noninterest income growth range, given kind of all the newer locations you have, which I'm guessing are kind of underserved relative to the legacy Univest markets in terms like wealth and trust, etcetera?

Roger Deacon
We would target, and I think we've communicated this before, a mid-single-digit growth rate in our noninterest income.

You're right about the insurance. In the first quarter, we will have a seasonal benefit. Last year, it was a little bit more than $1 million, if you look at our numbers, and we'll see that something like that in the first quarter again. But on a longer-term run rate, more of that 5% to 7%, or mid-single-digit number is what we'll be targeting.

Michael Perito
Okay and then maybe just one last question for Mike. The loan growth was strong in the quarter, do you know what the contribution was from kind of the new Lancaster team that you guys brought on.

Mike Keim
Good morning, Mike. Roger can give you that specifically. I will tell you that the Lancaster outstanding portfolio, as of today, approximates $85 million. So we continue to see that strong

growth.

Roger Deacon
The growth in the fourth quarter for Lancaster was $40 million.

Michael Perito
Okay and as you guys look at the production, I guess from the first month of the first quarter on kind of where the pipelines are, is there going to be any kind of, at least as we move into the early part 2017 here, I mean, is there any kind of choppiness in the loan growth that you can see that's worth noting or do you think it's going to be relatively consistent, given where the pipelines are today?

Mike Keim
Mike, the pipelines remain strong and we remain committed to the 10% to 12% loan growth we've talked about in the previous couple calls. Will the first quarter maybe be slightly lower than that? That's possible, but I basically think we look to be consistent, more consistent than we have been just because of the add of the Lancaster group and the former Fox Chase team throughout quarters, than we were previously.

Michael Perito
Okay, great, thanks, guys, I appreciate it.

Mike Keim
Thanks, Mike.

Operator
Again, if you would like to ask a question, please press star (*) then one (1). The next questioner today is Matthew Breese with Piper Jaffray. Please go ahead.

Matthew Breese
Hey, good morning, everybody.

Jeff Schweitzer
Hey, Matt.

Roger Deacon
Good morning, Matt.

Matthew Breese
I appreciate the color on the expense side in getting to $32.5 million next quarter. I'm just curious, once we get there, what's the growth rate you expect on top of that? What's the organic growth rate and then considering the merger with Fox Chase, is there anything left in terms of cost saves there from potential branch closures? What are your thoughts on that going forward?

Roger Deacon
Well, we won't have additional costs in '17. There's probably about, based upon leased property we had at Fox Chase, that'll be part of my occupancy reduction as about $75,000.00 from the fourth quarter. But as it relates to Fox Chase branches, specifically, I mean, we're also adding branches. So we're kind of at net/net across the board from there.

Matthew Breese
Okay and then just from organically speaking, what's a good growth rate to apply to that $32.5 million run rate?

Roger Deacon
We're really targeting that number for the year 2017, Matt. After that, I would say we probably, we haven’t spent a lot of time on this, but we'll be targeting about 4% to 5%, probably, number. Obviously, the model is built around, you grow your revenues at higher single-digit type numbers and your expenses in that middle type number and you get the operating leverage. Obviously, that would be contingent on if we did any wealth or insurance deals or the like, but that's how I'm thinking about the model going forward out into '18.

Matthew Breese
Got it, okay and then the provision was a bit higher than I expected this quarter, but nonperforming assets looked relatively flat in terms of percentage to assets. Could you walk me through the components that got you to that provision and will that, is that a good run rate, going forward, that $2 million to $2.5 million, given the pace of growth?

Roger Deacon
No, Matt, I would say we think the run rate really would be $1.5 million to the $1.8 million type number. We leaned into it, fourth quarter, and a little bit of that leaning into, quite frankly, is we had this benefit in the margin and that benefit related to exiting the purchase accounting loans of $700,000.00, that's really a credit benefit. It's not really a NIM benefit, but it's just how the accounting makes you do it and so, if you offset that two/three with the seven, you're in the 1/6 range.

Matthew Breese
Got it. Okay, that's really helpful and then deposit growth is really strong this quarter. What's your outlook for deposit growth and how are you thinking about the loan to deposit ratio over the next 12 months?

Roger Deacon
So we are anticipating that our loan to deposit growth ratio will increase. We've targeted, obviously, as Mike said, this 10% to 12% loan growth and from a planning perspective, we're probably looking at 6% to 8% deposit growth, so there will be an increase in that loan to deposit ratio.

I think I've said this before, we will monitor the loan growth and be more aggressive on deposits following that loan growth. We won't lead with deposit growth and we’ll want to target and stay within that 100 to 105 number.

Mike Keim
Longer-term, we're very focused on our cash management business and continue to grow out that line of business as both a complement to our loan business, but also a way to drive new customers into the institution and that is how we'll close the gap on our longer-term growth on the loans versus deposits.

Matthew Breese
Okay. Okay, so a bit of a bell curve shape in terms of the loan to deposit ratio, long-term?

Mike Keim
Correct.

Matthew Breese
Okay and then last one, you mentioned potential wealth managed acquisitions, how is, how have discussions on that front progressed, pre- and post- the election? There seems to be some renewed optimism regarding the economy. Has that changed the acquisition landscape at all?

Jeff Schweitzer
We always are working a pipeline of acquisitions in both the wealth management and the insurance lines of business. I wouldn't say that there's been any tick up in activity since the election. We're obviously very focused on growing both businesses organically and then supplementing them with potential acquisitions as they come along. But we're always going to be working a pipeline, but I wouldn't say there's been anything that's really changed in the last two to three months.

Matthew Breese
Understood. Okay, thanks, guys. That's all I had.

Jeff Schweitzer
Thank you, Matt.

Roger Deacon
Thanks, Matt.

Mike Keim
Thanks, Matt.

Operator
Once again, if you would like to ask a question, please press star (*) then one (1). It looks like we have no further questioners so this will conclude our question-and-answer session. I would like to turn the conference back over to Jeff Schweitzer for any closing remarks.

CONCLUSION

Jeff Schweitzer
Thanks a lot to everyone for joining us today and we look forward to talking to you again after first quarter earnings are released in mid-to-late April. Thanks and have a great day.

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