Univest Financial Corporation

Second Quarter 2021 Earnings

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CORPORATE PARTICIPANTS

Jeff Schweitzer – *President and Chief Executive Officer*

Brian Richardson – *Chief Financial Officer*

Mike Keim - *President of Univest Bank and Trust*

PRESENTATION

Operator
Good morning, and welcome to the Univest Financial Corporation's Second Quarter 2021 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 than one on your telephone keypad. To withdraw your question, please press star than two. Please note 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.

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; and Brian Richardson, our Chief Financial Officer. Before we begin, I'd like to start by saying I hope everyone listening is staying safe and you and your families are healthy.

I also need to 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 $20.9 million during the second quarter or $0.71 per share. We are very pleased with our results for the quarter as we experienced strong loan growth of $187.9 million or 15.4% annualized during the quarter resulting in total growth over the past 12 months of $621.6 million or 14% excluding PPP loans.

Generating this level of growth during a pandemic demonstrates the strength of our team and the commitment we have made to our customers and communities. We also continue to see strong results in mortgage banking due to the investments we have made in production talent and process enhancements over the past two years. Additionally, we had strong investment advisory income which has increased 18.7% in the first six months of the year compared to the same period in the prior year due to favorable market conditions and new relationships.

In spite of concerns over the Delta variant, activity in our markets continues to be solid and improving as our local economies have opened up.

Before I throw it over to Brian, I just want to thank the members of the Univest family. They continue to do a wonderful job serving our customers, our communities, and each other as we continue to work through the current environment and move Univest forward.

I'll now turn it over to Brian for further discussion on our results.

Brian Richardson
Thank you, Jeff. I would also like to thank everyone for joining us today. In addition to demonstrating our continued ability to grow loans, we continue to have strong performance in our core business. During the first six months of the year, we produced a pre-tax, pre-provision ROAA of 1.72%. I would like to touch on four items from the earnings release.

First, reported margin of 3.15% was up 3 basis points compared to the first quarter. Reported NIM was negatively impacted by 10 basis points of excess liquidity which averaged $175 million for the quarter. PPP loans increased NIM by 11 basis points and contributed $4.8 million to net interest income. Core margin excluding excess liquidity and the PPP impact was 3.14% a decrease of 5 basis points when compared to the first quarter.

Core margin excluding excess liquidity and the PPP impact is expected to expand slightly in the third quarter. This reflects quarterly savings of approximately $850,000 from the $75 million subordinated debt redemption at the end of the second quarter. As it relates to PPP, as of June 30th, $6.4 million of net deferred fees remained on the balance sheet which represents approximately 35% of the initial deferred fee amount.

Second, during the second quarter we recorded a reversal of provision for credit losses of $59,000 which was driven by a $2.8 million benefit due to favorable changes in economic-related assumptions within our CECL model primarily offset by reserves attributable to our 15.4% annualized loan growth during the quarter. The allowance for credit loss coverage ratio excluding PPP loans was 1.41% at June 30th compared to 1.46% at March 31st and 1.94% at June 30, 2020. During the quarter, our COVID-related deferral activity reduced to $54.2 million or 1.1% of the portfolio. Net charge offs for the quarter and the first half of the year were 2 basis points on an annualized basis.

Third, noninterest income was up $2.2 million or 12.4% when compared to the second quarter of 2020. As Jeff mentioned, this growth was primarily fueled by our investment advisory line of business. Additionally, the second quarter included an $893,000 BOLI debt benefit claim.

Fourth, noninterest expense increased $5.3 million or 14.8% for the quarter and $6.1 million or 8.1% for the first half of the year when compared to 2020. These variances were partially driven by relatively low expenses in the comparable periods in 2020 due to COVID-19 and the related impacts.

Specifically, capitalized compensation related to our PPP loans was $1.2 million lower in the second quarter of 2021 and $664,000 lower for the first half of 2021. Additionally, variable compensation costs increased $1 million for the quarter and $1.7 million for the six months ended June 30, 2021 due to an overall increase in profitability, and more specifically, in our mortgage banking and wealth management lines of business.

Professional fees increased $751,000 for the quarter and $1.2 million for the six months ended June 30, 2021 primarily attributable to increased consulting fees in support of our D&I training initiatives as well as our treasury management product enhancements.

During the first six months of 2021, we spent $781,000 on these initiatives, and we expect to incur approximately $650,000 of additional expenses in the second half of the year related to these initiatives. These expenses are not expected to reoccur in subsequent periods.

I believe the remainder of the earnings release was straightforward, and I would now like to provide a few updates to our full year 2021 guidance.

First, we had previously guided to loan growth of 7% to 8% excluding PPP. Based on our strong year-to-date growth, we are increasing this guidance to 10% which we expect to result in net interest income growth of 2% to 4% again excluding PPP.

Second, we had previously guided noninterest income contraction of 5% to 7% for the year. Based on the strong performance of our mortgage banking and investment advisory lines of business as well as our recently hired SBA team, we are now expecting noninterest income growth of 1% to 2% for the year.

Third, we had previously guided noninterest expense growth of 2% to 4%. Based on our continued investment in people and the previously discussed consulting initiatives and variable compensation costs, we are increasing our expense growth guidance to 4% to 6% for the year. It is important to note the net impact of these guidance updates is accretive to pre-tax, pre-provision income.

That concludes 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
We will now begin the question and answer session. To ask a question, you may press the 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 will pause momentarily to assemble our roster.

The first question comes from Frank Schiraldi with Piper Sandler. Please go ahead.

Frank Schiraldi
Hi, guys.

Jeff Schweitzer
Good morning, Frank.

Frank Schiraldi
Wondering about the strong long growth, obviously increased guidance here. You know, what would you say the primary driver there is? Is it some of the teams you guys have added sort of ramping up faster than you expected? Is it better demand in new markets, or maybe is it some of the M&A deals out there just providing a greater amount of opportunity?

Mike Keim
Good morning, Frank. It’s Mike. First and foremost would be just the quality of our teams and the fact that we never stopped lending during the pandemic. We kept momentum. Again, I think we talked about this last call as well, we did get more conservative in our underwriting guidance, but we kept the lending momentum going, so customers and prospects knew that we were going to continue to lend and have done that. So, that’s helped us.

The quality of our teams have been outstanding, and yes, we have seen pickup from some of the folks that we’ve hired. So, it’s all of the above, but the real secret sauce continues to be just the strength and quality of the overall team.

Frank Schiraldi
Okay. Then, just trying to drill down to some of the fee income drivers of the guide, Brian, just wondering

if you could give your thoughts on a fair growth rate for the investment advisory business over the next 12 months or so especially given some of the potential opportunity in the market, again, related to deals.

Brian Richardson
Yes, on the investment advisory side of course there's the market considerations there, but assuming that things were to stay flat, we'd expect kind of double-digit to mid double-digit growth is what we're expecting from a full year perspective year-over-year from '20 to '21.

Frank Schiraldi
Okay, great. Then, driving that is just expanding the business?

Brian Richardson
Yes, it's improvement of AUM from a valuation perspective as well as new business and continuing to expand customer relationships.

Jeff Schweitzer
Yes, I mean, Frank, we've been added to the Schwab referral network as one of the RIAs in that network and have, I believe 50 branches that have been assigned to us in the mid-Atlantic area, and we haven't even started that yet. We are getting all the documents in order, so that'll help also on top of what we're just doing normal organic growth.

Frank Schiraldi
Okay. Then, the other piece of it on fee income for me is a bit more volatile and more difficult to model is the mortgage banking business. I know last quarter you talked about the pipeline remaining strong there moving more to purchase activity as opposed to refi as that wave sort of wanes. Any expectations you can share on that side in terms of thoughts given where margins are now, given where volumes are, what we can see in the back half of the year in terms of revenues in the mortgage business?

Mike Keim
Yes. So, overall, pipelines are still strong, Frank, to what you just said. What has happened is simply that margins which were on a gross basis nearing 4% last year have kind of pulled down to the 2.75%, 3% range. We expect that that will continue, and absent anything else, I would tell you that the third quarter will be fairly strong unless, and I hope this doesn't happen, rates drop dramatically again and re-fis resurface, the fourth quarter cyclicality should come into play.

Our pipeline right now is slightly more than 50% purchase which reflects the new hires and the strength of their relationships with realtors and the like as we move forward.

Frank Schiraldi
Okay, so can we see that maybe—I think Q2 is usually stronger than the third quarter. Would that be the expectation versus the Q2 result?

Mike Keim
I wouldn't necessarily say it was stronger that 2Q just because 2Q is elevated because margins at the beginning of 2Q were closer to that 3.5% to 3.75% range.

Brian Richardson
So, we could see it fall back a little bit in the third quarter from where we were in the second quarter would be a reasonable expectation.

Frank Schiraldi

Got you.

Mike Keim
If you looked at it on a historical basis, we'll be strong relative to historical third quarters. If you're looking at it to a refi, it's dominated 4% margin, no.

Frank Schiraldi
Okay. Thanks, guys.

Operator
The next question comes from Tim Switzer with KBW. Please go ahead.

Tim Switzer
Good morning. This is Tim Switzer on for Mike Perito.

Jeff Schweitzer
Good morning, Tim.

Tim Switzer
Morning. So, you guys had several expense items that you touched on, and they look like they're pretty temporary such as the PPP origination comp, the DEI training, and you guys had some variable compensation going on as well. So, I mean, can you help us kind of quantify how many of these expenses this quarter were kind of transitory, and just trying to help us figure out what's going to exit the expense run rate going into 2022?

Brian Richardson
From an expense run rate perspective, again, I think if we look at the full year, that updated guidance that I had provided of 4% to 6% is reflective of the one-timers in the quarter and the additional kind of one-timers that we expect related to those initiatives in the back half of the year.

Certainly not in a position at this point to give guidance for full year 2022 expense growth, but we'll be going through that budget process later this year, and we'll be communicating accordingly thereafter, but I do expect things to certainly be normalizing overall from an expense growth perspective as we get these handful of items behind us.

Tim Switzer
Okay, and as these more temporary costs come out, will you maybe replace those with other growth investments or something else like that, or will you allow that to fall to the bottom line?

Brian Richardson
Those are case-by-case decisions depending on the environment. Obviously, on certain things, on digital and the like, everything continues to evolve and some incremental investments are required from time to time, however, we do understand the importance of operating leverage and will be focusing on maximizing that to the extent possible.

Tim Switzer
Okay, great. If I can move on to capital really quickly, you guys have really strong capital levels generating good returns but also growing your loan book pretty quickly here, so what are your capital priorities, and do you have any plans on excess capital deployment and how you'd like to deal with that?

Jeff Schweitzer
This is Jeff. On the capital front, as we said in the past, kind of everything is on the table right now. We want to make sure we have strong capital support, the loan growth that we're continuing to see which is really exciting and very positive for us for the long term.

Additionally, as we've talked in the past, we're actively trying to look for opportunities in wealth management, insurance from an M&A standpoint, and then once you peel that back even further, then we would look at if—depending on how things go on those fronts, we would always look dividend buybacks, etc. That's all on the table, but right now, I would say it's a focus of organic growth, making sure we're supporting that, and then also looking for any opportunities, keeping some dry powder in case opportunities arise on the M&A front.

Tim Switzer
Okay, great. Thank you. That's all from me.

Jeff Schweitzer
Thank you.

Operator
The next question is from Matthew Breese, but again, if you have any questions, please press star then one. Matthew Breese, you're on the podium now. Thank you.

Matthew Breese
Thank you. Good morning. I was hoping to learn a little bit more about the loan pipeline, maybe give us a sense for size and how that's changed over the last six months. Then, perhaps just some insight as to what geography is showing strength or what product sets.

Mike Keim
Good morning, Matt. It's Mike. Look, in terms of the pipeline, the second quarter and what projects to be the third quarter of the pipeline continues to look strong. The biggest issue with regard to loan growth going forward here is going to be whether we get payoff activity that was unanticipated, and the unanticipated payoff activity is largely coming because the market's pretty hot, and our customers are having the opportunity to either sell their business and/or if it's a CRE deal to sell perhaps in this area a warehouse facility which is very hot and very strong at this point in time. They sell it at a sizable gain.

In terms of whether there are—we continue to perform across all of our markets is the truth. The Lancaster market, Central PA market continues to be strong. We continue to perform well there. We continue to look for people to add to the team, and as we look at York and as we look at Cumberland and Dauphin Counties, and then in what we call the East Penn and New Jersey area, again, same issue. Very diversified loan book, very strong across the board.

We're not doing office in the traditional sense, but whether it's C&I, whether it's CRE, it's been very strong. Our markets perform well. The economy is strong. I think everybody knows that this area is more vaccinated than other parts of the country, so hopefully we continue to move forward without having any interruption as a result of the Delta variant, but things look good, and like I said, I just want to repeat and make sure because everybody looks at our loan growth and says, "Can you do more?"

The reality is that we have to be looking at what the payoff activity is that can net against that loan growth as we move forward.

Matthew Breese
Understood. Okay, and then you mentioned competitive conditions. Just maybe give us a sense for what incremental blended new loan yields are and maybe where the competition is.

Brian Richardson
Hi, Matt. This is Brian. From a production for the quarter, our traditional kind of C&I and CRE loan has averaged around 3.21% from a new production standpoint. That's up from around 3% in the first quarter, so of course, you have various loan types like SBLOCs and some other things like that that have unique characteristics that can lower those yields or have lower yields from time to time, but if you look at our traditional C&I and CRE production for the quarter, we're around a 3.20%.

Matthew Breese
Okay, great.

Mike Keim
From a competitive perspective, Matt, I'll tell you that you still have people doing some things that we just won't match and don't want to go there. So, there is still some craziness out there. I wish everybody the best of luck, but there's levels on the fixed rate side, and whether it's at five, seven, or ten years that we just will not go to.

Matthew Breese
Got it. Okay. Could you provide me with the percentage of your loan portfolio that's floating rate and unencumbered by floors at this point? I just want to get a sense for if we do, when and if, see if that hike how responsive loan yields would be on your end.

Brian Richardson
Overall, our loan book is 43% fixed, 20% adjustable, and the remainder being 37% is variable. From a loan floor perspective, as of the end of the second quarter, we had $346 million of loans that were at their floors and in the money. They're in the money by about 70 basis points, so two to three moves there would be what it would take to get lift on those. The rest of the book that is variable or adjustable depending on the reset dates would have more of an immediate impact in a rate increase environment.

Matthew Breese
Okay. Just a couple others on my end. So, just to clarify on expenses, you mentioned you expect an additional I think $680,000 of training fees in the back half of the year. I mean, professional fees are a bit higher already, should we expect this level to kind of continue or ramp up higher for that $680,000? Just wanted some clarification there.

Brian Richardson
Yes, and just to clarify it's $650,000 in the back half of the year, and that's related to DE&I, our treasury management product enhancements, and training, so it wasn't simply just training, but I would not expect there to be an incremental lift solely related to that $650,000 from the second quarter to the third quarter in all honesty. If you look at the kind of all-in guidance of 4% to 6%, you kind of expect expenses to be pretty level on a quarterly basis from here on out.

Matthew Breese
Okay, understood. Thank you. Just last one from me. The last couple quarters, the tax rate has just been a touch higher than my projections. Curious if 19% is the kind of new normal, or should we expect reversion back to kind of the 18%, 18.5% level?

Brian Richardson
No, as we continue to have income coming from PPP forgiveness and the like that is providing upside in taxable income which translates to increased effective tax rate, so in the near term, I would think that current effective rate is a good indicator. To the extent PPP income starts to kind of wind down, then you'd expect a reversion back to historical norms.

Matthew Breese
Perfect, okay. That's all I had. Thanks.

Jeff Schweitzer
Thank you, Matt.

CONCLUSION

Operator
At this time, there are no further questions. 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, Debbie, and thank you to everybody for participating today. We appreciate your participation and your good questions. We look forward to talking to you again at the end of the third quarter. Have a great day and stay safe.

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