

Call Participants

EXECUTIVES

Jeffrey M. Schweitzer
Chairman, President & CEO

Brian J. Richardson
Senior Executive VP & CFO

Michael S. Keim
COO & President, Univest Bank and Trust Co.

ANALYSTS

Emily Noelle Lee
*Keefe, Bruyette, & Woods, Inc.,
Research Division*

Frank Joseph Schiraldi
*Piper Sandler & Co., Research
Division*

Matthew M. Breese
Stephens Inc., Research Division

Presentation

Operator

Good morning, all. Thank you for joining us for the Univest Financial Corporation Third Quarter 2024 Earnings Call. My name is Karli, and I'll be the call coordinator for today. [Operator Instructions]. I'd now like to hand over to your host, Jeff Schweitzer, Chairman, CEO, to begin. The floor is yours.

Jeffrey M. Schweitzer *Chairman, President & CEO*

Thank you, Karli. Good morning, and thank you to all of our listeners for joining us. Joining me on the call this morning is Mike Keim, our Chief Operating Officer and President of Univest Bank and Trust; and Brian Richardson, our Chief Financial Officer.

Before we begin, I would like 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 \$18.6 million during the third quarter or \$0.63 per share. During the quarter, we saw a large increase in deposits of \$358.8 million due to our seasonal build of public funds deposits. Loan growth was slightly muted during the quarter at \$45.9 million or 2.8% annualized. While loan production was solid, we have been impacted by declining line usage by customers as they continue to utilize existing cash on hand as opposed to drawing down on their lines combined with elevated payoff activity. Our diversified business model continues to serve us well as our noninterest income was up \$1.5 million or 7.8% compared to the prior year as we have seen growth in our nonbanking lines of business with wealth management and insurance up 9.8% and 8%, respectively, compared to the third quarter of the prior year. Additionally, we continue to prudently manage expenses as noninterest expenses were down \$436,000 or 0.9% compared to the prior year.

With respect to capital, we continue to be active and plan on continuing to be active with stock buybacks as we repurchased 156,728 shares of stock during the quarter and 663,043 shares year-to-date, which represents 2.25% of shares outstanding as of December 31, 2023 while growing tangible book value per share 7.32% year-to-date. Finally, at our Board meeting yesterday, the Board approved an increase of 1 million shares available for repurchase.

Before I pass it over to Brian, I would like to thank the entire Univest family for the great work they do every day and for their continued efforts serving our customers, communities and each other. I will now turn it over to Brian for further discussion on our results.

Brian J. Richardson *Senior Executive VP & CFO*

Thank you, Jeff, and I would also like to thank everyone for joining us today.

I would like to start by highlighting a few items from the earnings release. First, during the quarter, reported NIM of 2.82% decreased 2 basis points from 2.84% in the prior quarter due to the increase in excess liquidity from the seasonal public funds bill. As expected, core NIM of 2.91%, which excludes the impact of excess liquidity, expanded 5 basis points compared to the second quarter. We expect core NIM to be flat to slightly up in the fourth quarter, assuming a 25 basis point rate cut at each of the FOMC meetings in November and December.

Second, during the quarter, we recorded a provision for credit losses of \$1.4 million. Our coverage ratio at September 30 was 1.28%, which was unchanged from June 30. Net charge-offs for the quarter totaled \$820,000 or 5 basis points annualized. During the third quarter, we saw continued stability in nonperforming assets, loan delinquencies and criticized and classified loans.

Third, noninterest income increased \$1.5 million or 7.8% compared to the third quarter of 2023. We saw increased contributions from our wealth management and insurance lines of business and increased gains on sale of SBA loans. Offsetting these increases was a reduction in service fee income, which was primarily driven by a \$785,000 valuation allowance recorded on our mortgage servicing asset. This allowance was driven by an increase in assumed prepayment speeds due to the decrease in interest rates during the quarter. Overall, we continue to be very happy with the diversification and contributions from our fee income businesses.

Fourth, noninterest expense decreased \$436,000 or 0.9% compared to the third quarter of 2023. This reflects the continued benefit of the various expense reduction strategies we deployed during 2023 and our ongoing commitment to prudent expense management.

I believe the remainder of the earnings release was straightforward, and I would now like to provide an update to our 2024 guidance.

First, for the full year of 2024, we expect loan growth of approximately 4%, and we expect net interest income to contract 4% to 5% for the full year of 2024 compared to 2023. Second, our provision for credit loss guidance for the year is being reduced to \$6 million to \$8 million. However, the provision will continue to be event-driven, including loan growth, changes in economic-related assumptions and the credit performance of the portfolio, including specific credits. Third, our noninterest income growth guidance for the year remains at the 7% to 9% when excluding the \$3.4 million pretax gain on the sale of MSR's in the first quarter. Including the gain on the sale of MSR's, noninterest expense growth guidance for the year remains at 11% to 13%. As a reminder, this is off the 2023 base of \$76.8 million. Fourth, in 2023, our noninterest expense totaled \$195.8 million when excluding the \$1.5 million of restructuring charges. For 2024, we expect growth of 1% to 2% off the base of \$195.8 million. Lastly, as it relates to income taxes, we expect our effective tax rate to be approximately 20.5% based on current statutory rates.

That concludes my prepared remarks. We will be happy to answer any questions. Karli, would you please begin the question-and-answer session?

Question and Answer

Operator

Our first question comes from Frank Schiraldi of Piper Sandler.

Frank Joseph Schiraldi

Piper Sandler & Co., Research Division

Just on the expense front, Brian, you mentioned the, I think, 1% to 2% growth, and that would seem to imply a little bit over \$50 million -- little over \$50 million in the fourth quarter. Can you just talk about linked quarter growth there? What might be driving that, if I have that right? And then, is that a decent kind of run rate for starting things off for next year?

Brian J. Richardson

Senior Executive VP & CFO

Yes, it would put you in that \$50 million range, give or take, for the fourth quarter. And I do think that's a reasonable starting point for next year. Of course, with some growth that occurs early in the year for merit increases and the like occur in the early part of the year, so you start to see that ramp up but that would be a good jumping point going into next year.

Frank Joseph Schiraldi

Piper Sandler & Co., Research Division

Okay. And when you think about the 3Q results versus a bit of an uptick to get to that \$50 million, is that mostly driven by kind of other expenses normalizing? Or any sort of color you can give there for modeling?

Brian J. Richardson

Senior Executive VP & CFO

Yes, I think it is just the normalization of a couple of small things that were benefits in the current quarter, and you would see that start to normalize, but we have run favorable throughout the year. So just looking forward to the fourth quarter, you'd expect some things to normalize.

Frank Joseph Schiraldi

Piper Sandler & Co., Research Division

Okay. And then can you just remind us in terms of the muni, the seasonality there, how much of that \$350 million is the seasonal muni? And how does that kind of run off or run through the balance sheet again in terms of timing?

Brian J. Richardson

Senior Executive VP & CFO

Yes. So the overall build occurs in the third quarter every year. And then we'll see \$100 million, give or take, a month potential outflows depending on specific cases in the fourth quarter. You see that build and then you start to see that wind back down in the fourth quarter into the first quarter and then again hitting the trough in at the end of the second quarter.

Frank Joseph Schiraldi

Piper Sandler & Co., Research Division

Okay. And that -- the inflows this quarter were \$350 million, is that about that? Is that right?

Brian J. Richardson

Senior Executive VP & CFO

They were a little bit higher than that. It was closer to \$400 million and change on muni specifically.

Frank Joseph Schiraldi*Piper Sandler & Co., Research Division*

Okay, great. And then just lastly, if I could sneak in one more on the buyback. I saw the uptick in activity this quarter. Just curious, do you think that's a reasonable place to be in terms of a quarterly level of activity? Could you ramp that up given the, I think, 1 million shares? Is that -- maybe ramp that up and that's a reasonable kind of annual expectation of 1 million shares? I'm just trying to get a sense of guardrails around buybacks going forward.

Jeffrey M. Schweitzer*Chairman, President & CEO*

Yes. So Frank, we're using basically -- we have capital levels we want to maintain and that excess capital that we're generating we're using towards buybacks. So \$1 million is not a year -- wouldn't be used up in a year -- 1 million shares, sorry, wouldn't be used up in a year. But we're basically, as we continue to grow capital, excess capital that we have generated we'll be using towards buybacks is our plan.

Operator

Our next question comes from Emily Lee of KBW.

Emily Noelle Lee*Keefe, Bruyette, & Woods, Inc., Research Division*

I'm on for Tim Switzer today. I wanted to ask what factors could drive upside or downside to your guidance.

Brian J. Richardson*Senior Executive VP & CFO*

Sorry, can you repeat that question? I didn't catch the end of it.

Emily Noelle Lee*Keefe, Bruyette, & Woods, Inc., Research Division*

Yes, I was just wondering what factors could potentially drive some upside or downside in either direction to the guidance -- the updated guidance that you just gave?

Brian J. Richardson*Senior Executive VP & CFO*

Sure. So as you kind of go through, if you look at the net interest income side, clearly, what occurs on the competitive side and the overall environment on deposit pricing continues to be the wildcard there. As you go through the fee income line, of course, market valuations and the like has an impact on our wealth management business and some other areas. But one of the bigger wildcards right now is that valuation allowance on MSRs and how that would continue to play through or subside in the fourth quarter or subsequent quarters.

And then on the expense side, really event-driven. Again, we've maintained prudent management over that, but you have things that occur from time to time, both positive and negative, that could potentially drive variances to the guidance that I provided.

Emily Noelle Lee*Keefe, Bruyette, & Woods, Inc., Research Division*

Great. And another question I had was just related to NII margin and the impact of Fed cuts. I was wondering if the Fed cuts moved more than expected, what do you estimate the potential impact to be to the margin?

Brian J. Richardson*Senior Executive VP & CFO*

We really expect ourselves to be neutral for the foreseeable future in rate cuts. We have a variable rate loan book. And when you look at our cash, that's going to automatically reprice. We have a largely offsetting deposit book that will also offset automatically, and then there's a portion that's exception price that we adjust accordingly. So we have pretty good matching as it relates to the first several moves that are expected to be made. So we really view ourselves as being neutral here. With, of course, upside to NII and NIM being the inherent repricing of loan book as you have maturities and churn, that provides a potential tailwind to NIM and NII, all other things equal.

Emily Noelle Lee*Keefe, Bruyette, & Woods, Inc., Research Division*

Great. I just have a few more if that's all right. I was wondering how competition is trending in your markets for loans and deposits, particularly with rates coming down. So has deposit pricing been rational so far? And I guess, what's your customers' reaction to lower rates?

Michael S. Keim*COO & President, Univest Bank and Trust Co.*

So I mean, if you look from a deposit perspective, yes, deposit pricing in general has come down with the Fed rate move. And as we talk to our customers, our customers are a lot more cognizant of the Fed moves perhaps than they might have been 3 to 5 years ago. So I think people were on top of that. But competition is still stiff for deposits. I don't think any call you're going to be on, people are not going to talk about the competition being more intense with regard to deposits and liquidity that it provides.

From a loan perspective, we continue -- despite that we had some payoffs and line activity was down, we still had, to Brian's point earlier in his remarks, a strong quarter from a new production perspective, and we are able to get price where we want to be. I would tell you that the pricing on larger credits seems to be -- actually we've seen several credits that people are offering tighter spreads, which is somewhat surprising to us. And therefore, we'll evaluate that as we move forward, because in a world where deposit pricing is a little bit higher, we need to make sure that we are priced accordingly on the loan side to maintain our NIM.

Emily Noelle Lee*Keefe, Bruyette, & Woods, Inc., Research Division*

That's great. And then the last question I had was, we spoke about how you plan to continue deploying excess capital into share repurchases. But I was wondering if you would like to reserve any capital for potential M&A in the future.

Jeffrey M. Schweitzer*Chairman, President & CEO*

So at this point, we feel still that the best investment we can make is in our own stock and buying that back. With a still challenging interest rate environment, as the Fed cuts, it will get -- hopefully, the yield curve will get more like historical norm. However, with still a challenging interest rate environment, doubling down on the margin business is not something that we are -- is not really part of our short-term strategic plan. So we anticipate that the excess capital will really be used more towards buybacks than building a war chest to do some type of deal in the future.

Operator

[Operator Instructions] Our next question comes from Matthew Breese of Stephens Inc.

Matthew M. Breese*Stephens Inc., Research Division*

Brian, I was first hoping to start with cash and the excess cash position on the balance sheet today. Obviously, there's going to be some volatility due to munis, but I was hoping you could walk us through,

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one, when you expect that to kind of normalize? Is that over the next couple of quarters? And two, how much will be used for muni swings? And how much can be kind of reinvested potentially into securities loans?

Brian J. Richardson

Senior Executive VP & CFO

Yes. So as we look at average excess liquidity, we'd expect that to hold relatively stable Q3 to Q4. But of course, your point-to-point would inherently drop as we get towards the latter half of the fourth quarter or latter portion of the fourth quarter. But there will be -- you kind of think about \$150 million to \$250 million running out and then the remaining amount of excess liquidity that was built would be available for deployment into other asset classes going forward.

Matthew M. Breese

Stephens Inc., Research Division

Great. Okay. And then maybe you could talk a little bit about the loan pipeline. What's in it? Where are you kind of spending your time? And what does the pipeline loan yield look like? Just give us an overall sense for kind of near-term loan growth.

Michael S. Keim

COO & President, Univest Bank and Trust Co.

Yes. So overall, Matt, the pipeline is fairly healthy. It's primarily in C&I. We do have some CRE in there, but those are full relationship CRE customers. So we continue to move forward the pricing. Like I said before, we're in the above 7s at the present time. We'll see what the Fed does in terms of where that drives fixed rates as we move forward here. But what we've alluded to throughout in our write-up for the quarter as well as the discussion here is that we are maintaining our pricing discipline. There may be a time where we will -- that we participate in a credit today that we will not participate going forward because quite frankly those are variable priced credits at SOFR less 200 and that in the current environment and the go-forward environment that we foresee is just not something that we can play in. So at least not play in and maintain the NIM to where it needs to be. So healthy pipeline for the fourth quarter. Brian gave overall guidance where we think loan growth will come in for the full year. And maintaining our pricing discipline and making sure that our NIM continues to bounce off the bottom here.

Matthew M. Breese

Stephens Inc., Research Division

Got it. Okay. I was hoping you could talk a little bit about the Fed cut and deposit actions taken so far. Brian, I think you had mentioned you have some kind of higher cost deposits, exception deposits. Maybe give us some sense for how much of your deposit base kind of fits into the higher-cost categories and have already moved and by what amount?

Brian J. Richardson

Senior Executive VP & CFO

Sure, Matt. I'd be happy to walk through that. So we have just about \$2 billion that automatically on the deposit side that automatically reprice that are indexed. So that automatically occurs. Then we have a portfolio of, call it, \$1 billion in chain, \$1.1 billion, that is exception-priced, kind of a wide range of exception pricing where those fall there. But I will tell you, we had roughly \$325 million that were exception-priced that we had 100% beta on from a ratcheting down as a result of the Fed move in September. So that's something we went out to actively kind of ratcheted down at \$320 million worth of deposits with 100% beta, so a full 50 basis point reduction on those. And the plan would be to kind of navigate that similar actions going forward as the Fed moves.

Matthew M. Breese

Stephens Inc., Research Division

Are you kind of expecting similar loan and deposit betas on the way down as we saw during the last hiking cycle?

Brian J. Richardson

Senior Executive VP & CFO

I would -- yes, I mean, of course, on the way up, they behave a bit differently, but we would expect on the way down. Again, competition becomes a wildcard on the deposit side. We'd expect that to initially fall in that kind of 30% range on the deposit side as we migrate down and then some potential upside as you get a little bit further out in the process. But I would think looking at -- absent anything else, looking at historical norms would be a reasonable thing to do here depending on what happens from the competition side.

Matthew M. Breese

Stephens Inc., Research Division

Okay. Last one for me. I think the year-over-year fee income guide is 7% to 9% growth, excluding the MSR stuff. Is that a reasonable place to be for 2025? And I'm assuming that the primary business lines, trust wealth insurance will be kind of in that higher single-digit range. Are those fair assumptions?

Brian J. Richardson

Senior Executive VP & CFO

Yes, I think we're in that general range, give or take. Of course, we had a bump this year when you look at kind of mortgage year-over-year. So that's something that there's the opportunity for that to be a bump as we go forward as well. But if you look at wealth, they're kind of high single digits, low double digits is what they would be putting up this year. You would expect it to be somewhere in that similar neighborhood going forward. Insurance did have a big contingent income year. So as you kind of -- you look at that potentially normalizing next year, that's a little bit of an offset. But yes, I think in that general range with some potential upside is a reasonable thing to conclude.

Operator

We currently have no further questions. So I'd like to hand back to Jeff Schweitzer for any closing remarks.

Jeffrey M. Schweitzer

Chairman, President & CEO

Thank you, Karli. And thank you, everyone, for listening today, and we look forward to speaking to you at the end of the year. Have a great day.

Operator

As we conclude today's call, we would like to thank everyone for joining. You may now disconnect your lines.

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