Call Participants

EXECUTIVES

Jeffrey M. Schweitzer
Vice Chairman, President & CEO

Brian J. Richardson
Senior Executive VP & CFO

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

ANALYSTS

Frank Joseph Schiraldi
Piper Sandler & Co.

Michael Anthony Perito
Keefe, Bruyette, & Woods, Inc.

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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Univest Financial Corporation Second Quarter 2023 Earnings Call. I would now like to turn the call over to Jeff Schweitzer, President and CEO of Univest Financial Corporation. Please go ahead.

Jeffrey M. Schweitzer
Vice Chairman, President & CEO

Thank you, Mandeep, and 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 could be found on our website at univest.net under the Investor Relations tab.

We reported net income of $16.8 million during the second quarter or $0.57 per share. This was a 26.7% increase in earnings per share over the second quarter of 2022. Our results during the quarter included a $1.1 million after-tax restructuring charge related to the reduction of 3 financial centers, along with reduced headcount, primarily focused on our commercial real estate and residential mortgage lending teams. These cost reduction initiatives were in response to the macroeconomic headwinds we are observing relating to rising funding costs. We anticipate these expense reduction initiatives will result in $5.4 million of annualized savings.

Like most in our industry, we continue to be impacted by the rising cost of funding, which negatively impacted our net interest margin, which contracted by 44 basis points during the quarter. Given the rising cost of funding, we continue to increase loan pricing and focus our lending on full relationship customers. While loan production was still strong during the second quarter. This is due to commitments we had already made to customers. And we anticipate lending to slow in the second half of the year and full year loan growth to approximate 9%.

Before I pass it over to Brian, I would like to thank the entire Univest family for the great work they do every day. Our team continues to focus on making a positive impact on our communities by 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 touching on five items from the earnings release.

First, as Jeff mentioned, we experienced continued pressure on funding costs during the quarter due to a mix shift of deposits as well as increased deposit betas and borrowing costs. Reported margin of 3.14% decreased 44 basis points compared to last quarter.

Our NIM contraction did slow during the quarter. NIM for the month of March was 3.41%. This decreased by 14 and 19 basis points during April and May, respectively. NIM contraction for the month of June was only 1 basis point, resulting in a monthly NIM of 3.07%. Our cycle-to-date interest-bearing deposit beta

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was 46.6% for the quarter and 33.7% when including total deposits. Our cost of funds was 2.19%, up from 1.53% last quarter.

Second, I would like to provide an update on our liquidity and funding position. During the quarter, deposits increased by $152.7 million. We experienced decreases of $46 million in personal accounts, $27.8 million in public funds and $77.9 million in business accounts, which includes outflows for 2 customers which totaled $157 million. Offsetting these decreases was a $304.4 million increase in brokered deposits, which ended the quarter at $431.4 million or 5.7% of total assets.

Noninterest-bearing deposits decreased by $216 million during the quarter, of which $151.6 million occurred in April and $25.5 million occurred in June. As of June 30, noninterest-bearing deposits represented 26.4% of total deposits compared to 30.8% at March 31. At June 30, unprotected deposits, which excludes insured, internal and collateralized and trust and public fund deposit accounts, totaled $1.4 billion and represented 23.3% of total deposits.

The corporation and its subsidiaries had committed borrowing capacity of $3.2 billion at June 30, of which $2 billion was available. We also maintained uncommitted funding sources from correspondent banks of $410 million at June 30, of which $285 million was unused.

Third, during the quarter, we recorded a provision for credit losses of $3.4 million. Our coverage ratio of 1.28% at June 30 was consistent with March 31. Net charge-offs for the quarter totaled $512,000 or 3 basis points annualized. During the quarter, we saw continued stability in nonperforming assets and a reduction in criticized and classified loans for the second consecutive quarter.

Fourth, noninterest income increased $835,000 or 4.4% compared to the second quarter of 2022. The value of our diversified business model continues to serve us well during the current interest rate cycle and the resulting pressure on our spread business.

Fifth, noninterest expense increased $2.4 million or 5.1% compared to the second quarter of 2022. Excluding the $1.3 million of restructuring charges incurred during the quarter, expenses increased $1.1 million or 2.3%. I believe the remainder of the earnings release was straightforward. And I would now like to provide an update to our 2023 guidance.

First, on last quarter's call, I had guided to loan growth of 5% to 8% for 2023. As Jeff mentioned earlier, we anticipate lending to slow in the second half of the year. And while our year-to-date loan growth was $339 million or 11% annualized, we expect full year loan growth of approximately 9%.

We expect net interest income to be flat to up 2% for the year based on current information. This reflects yesterday's 25 basis point rate increase and a cycle-to-date all-in deposit beta of approximately 40% by the end of the year. Deposit betas continue to be volatile in the current environment and could have a material impact on our actual net interest income.

Second, our provision for credit loss guidance remains unchanged at $12 million to $16 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 is being reduced from 4% to 6% to 2% to 4%. As a reminder, the 2% to 4% is off the 2022 base of $76.9 million, which excludes $977,000 of BOLI death benefits.

Fourth, our noninterest expense growth guidance is being reduced from 7% to 9% to 6% to 8%. This reflects the previously discussed cost-saving initiatives as well as the one-time restructuring charges incurred during the quarter. Lastly, as it relates to income taxes, we expect our effective tax rate to be approximately 20% based on current statutory rates.
That concludes my prepared remarks. We will be happy to answer any questions. Mandeep, would you please begin the question-and-answer session?

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Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Frank Schiraldi from Piper Sandler.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

It sounds like based on the guide or the outlook that you've got a little bit more to go on the deposit betas. But you also talked about, it kind of sounds like, seeing some NIM stabilization here in the month of June. So do you think that -- just wondering if you can talk about where new business is going on here and if you do think that the NIM has stabilized at this point at that sort of June level.

Brian J. Richardson
Senior Executive VP & CFO

Frank, this is Brian. Overall, I think there still will be a little bit of downward pressure on NIM, although it has slowed. One data point in the month of June is a little bit tough to reach a conclusion based on. But we are seeing on the asset side, loans continue to kind of ratchet up, now coming on in the mid-7% range.

The wildcard continues to be really on the deposit side and what occurs there. Of course, with the Fed pausing in the back half of the quarter, helped with yesterday's action, that will bring a little bit of an element of uncertainty here as we progress forward. But again, the 1 basis point of NIM contraction in the month of June was certainly a welcome data point.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Okay. And then I guess, same question on the -- just loan balance side. In terms of the growth, have you seen some stabilization in balances later in the quarter, just given your commentary about -- it sounded like this was just stuff that was already sort of in the pipeline that led to the growth this quarter.

And just to follow up on that, when we think about this new update, the 9% expected growth, is the bias that -- given the expansion markets and such that the bias is still to the upside there? Or how should we think about that?

Michael S. Keim
President

Frank, it's Mike Keim. Loan growth was solid throughout the quarter. And as we look through and project through the rest of the year, we are very focused on bringing in that 9% level. We think that, that's consistent with regard to where our deposit levels continue to grow to and also to maintain the current capital ratios that we have in place.

So when you balance that out plus what Brian indicated in terms of where we're pricing our loans at, all of those give us the indication that we will be able to hit that 9%. We're not trying to go above that 9% at this point in time. I will tell you demand would be there for us. We could do more than that. We just think it's a prudent target to hit at that point in time.

The other thing that combines into this is that our mortgage production is starting to swing towards much more oriented toward the agency side of the business. So we expect less residential mortgage to go on to our balance sheet and stay on our balance sheet throughout the rest of the year.

Operator

Our next question comes from the line of Michael Perito from KBW.

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Michael Anthony Perito
Keefe, Bruyette, & Woods, Inc., Research Division

I wanted to maybe follow up on a couple of Frank's questions around growth in NIM. I mean, just as we think about like some of the "expansion markets" that you guys are in, like Lancaster, maybe even the Jersey Shore, kind of outside your core market, I mean, can you give us a reminder or an update of how kind of self-funded those markets are?

And when you think about loan growth and putting stuff on, I mean, is there kind of a change in approach? Or kind of do you have to sit down with the teams there and maybe like rejigger around focuses in terms of making sure that there's as much focus on bringing in loans as deposits as maybe a year, 1.5 years ago, when there was just more funding available kind of across your franchise to you?

Michael S. Keim
President

Yes. So Mike, it's Mike Keim. I'll answer the last part of that question first. When we were sitting on excess liquidity of $0.5 billion to $0.75 billion, obviously, we were more focused on the loan side of the equation and using up that excess liquidity position. Given the current situation, we have actually further emphasized deposits as an equal weight relative to loans with our RM teams. And we're also looking at SBA volume, where we can do some things with regard to the gain-on-sale line items there.

So we have refocused the teams. But we're still going to take good care of our customers. 9% loan growth is still very healthy. But we do have an emphasis for our RM teams across our footprint to continue to raise and increase the level of deposits that we hold. From the new markets perspective, the way to just look at this is we would have ramped up hiring faster if what happened in early March did not happen.

So we're taking a more disciplined approach and a more patient approach with regard to the new markets. We're glad that we are in them. It gives us geographic distribution with regard to our loan portfolios. And we see that as a great part of our future. Those teams are also focused on deposits just as much as they are on loans. And like I said, we just have to be a little bit more patient in terms of the ramp-up period there. We understand that, we acknowledge that and we think that's appropriate.

Michael Anthony Perito
Keefe, Bruyette, & Woods, Inc., Research Division

That's helpful color. And maybe a question for Brian. Just the 100 basis points reduction in the range on the OpEx for this year, just as we think to next year, I mean, is it fair -- understand you probably stopped shy from giving us a number. But is it fair to think of that growth rate taking another step down next year just with the full benefit of some of these cost actions coming in and just kind of the more controlled posture you guys are having on the OpEx line as we think about 2024?

Brian J. Richardson
Senior Executive VP & CFO

Yes. So clearly not going to be giving full year guidance for 2024. But I think you're -- the way you're thinking about it would be correct, where there continue to be controls on the expense side of the house.

Michael Anthony Perito
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. And then just one last one for me for Jeff. I'm trying to get everyone involved this morning. I know historically, Jeff, you -- maybe let's call it the last couple of years, maybe a little longer, you've been pretty negative on bank M&A and been adamant that the organic growth opportunity was significant, and you guys clearly executed on that.

As we think about the next phase of Univest's growth here in the next few years, obviously right now, the bank M&A environment is really tough. But as we think about '24 and '25 and the current funding environment and rate environment, does bank M&A come back into the conversation more, assuming some of the basics like around your own currency recovery and things like that? Or do you not really foresee any change in your stance on that?

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Jeffrey M. Schweitzer
Vice Chairman, President & CEO

Mike, I don't really see any change in our stance. We've had a lot of success doing the lift-out approach. I'm excited about -- although Mike said, as he pointed out, we're going to be a little more patient. I'm excited about the teams that we are building in Pittsburgh and Baltimore and what we can do in those markets organically to go and do an M&A transaction on the bank side.

With what we've done on the digital front, with what we've done with nCino and a lot of the things that we've put in place, I'm not sure it would be a seamless a transition to acquire a smaller bank at this point as it might have been a few years ago. So I think we will continue to focus on the organic strategy, lifting out, growing those markets, getting them up to a sizable amount and then continue to look for new places to expand into as opposed to necessarily doing an M&A transaction.

Operator

I would now like to turn the call over to Jeff Schweitzer for closing remarks.

Jeffrey M. Schweitzer
Vice Chairman, President & CEO

Well, thank you, Mandeep, and thank you, everybody, for listening in today. We appreciate your interest in our organization. And while it is continuing to be a challenging environment, we're very, very confident of our ability to manage through it and excited about the future of Univest, and look forward to talking to everybody again next quarter. Have a great day.

Operator
Thank you, ladies and gentlemen. This does conclude today's call. Thank you for your participation. You may now disconnect.

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