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.

Timothy Jeffrey Switzer
Keefe, Bruyette, & Woods, Inc.

Presentation

Operator

Hello all, and welcome to Univest Financial Corporation's Third Quarter 2023 Earnings Call. My name is Lydia, and I will be your operator today. [Operator Instructions]

I'll now hand you over to your host, Jeffrey Schweitzer, President and CEO of Univest Financial Corporation to begin.

Jeffrey M. Schweitzer
Vice Chairman, President & CEO

Thank you, Lydia, 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 can be found on our website at univest.net under the Investor Relations tab.

We reported net income of $17 million during the third quarter or $0.58 per share. Like most in our industry, we continue to be impacted by the rising cost of funding, primarily driven by the mix shift in deposits, which negatively impacted our net interest margin during the quarter. We did see this shift slow during the third quarter compared to the second quarter. Given the rising cost of funding, we continue to increase loan pricing and focus our lending on full relationship customers. This has slowed lending by design as we focus on liquidity and maintaining capital for existing full-service customers.

We did experience significant deposit growth during the quarter due to the seasonal build of public fund deposits. Given the margin pressures, our diversified business model continues to serve us well throughout this cycle with combined wealth management insurance revenue up 5.2% year-to-date.

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 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 saw continued pressure on funding cost and net interest margin, primarily due to the ongoing net shift of deposits as well as increased deposit betas.

Reported NIM of 2.96% decreased 18 basis points compared to last quarter. Excess liquidity averaged $103 million for the quarter, which reduced reported NIM by 4 basis points. Core NIM, which excludes excess liquidity, was 3% compared to 3.14% in the second quarter. Our cycle-to-date interest-bearing

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deposit beta was 54% through the third quarter and 41% when including total deposits. Our cost of funds was 2.54%, up from 2.19% last quarter.

Second, I would like to discuss our loan and deposit activity during the quarter. Loans grew by $112.7 million and deposits increased by $451.8 million. We experienced a $501.2 million seasonal increase in public fund deposits, offset by decreases of $26.9 million in personal accounts, $16.4 million in business accounts and $6.2 million in broker deposits. Noninterest-bearing deposits decreased $150.2 million during the quarter. As of September 30, noninterest-bearing deposits represented 22.2% of total deposits compared to 26.4% at June 30. At September 30, unprotected deposits, which excludes insured, internal and collateralized deposit accounts totaled $1.3 billion and represented 20.8% of total deposits.

Third, during the quarter, we recorded a provision for credit losses of $2 million. Our coverage ratio was 1.28% at September 30, which was consistent with June 30. Net charge-offs for the quarter totaled $969,000 or 6 basis points annualized. During the quarter, nonperforming assets increased by $5.6 million. Nonperforming assets as of September 30 included a $5.8 million nonperforming loan that was sold on October 16 at par.

Fourth, noninterest income increased $732,000 or 4.1% compared to the third quarter of 2022. This was primarily driven by increased revenue from our wealth management, insurance and mortgage banking lines of business. As we have said before, our diversified business model continues to serve us well during the current interest rate cycle and a resulting pressure on our spread business.

Fifth, noninterest expense increased $2.3 million or 5% compared to the third quarter of 2022. This includes $596,000 of incremental FDIC expense, which is primarily driven by the industry-wide increased assessment rate and $527,000 of incremental retirement plan costs primarily driven by the current interest rate environment. Excluding these two items, expenses were up $1.2 million or 2.6% compared to the third quarter of 2022.

I believe the remainder of the earnings release was straightforward, and I would now like to provide an update for our 2023 guidance. First, on last quarter's call, I communicated that we expected loan growth of approximately 9%, and net interest income would be flat to up 2% for the year. This guidance remains unchanged.

Second, our provision for credit loss guidance for the year is being reduced to $12 million to $14 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 2% to 4% to 0% to 1%. As a reminder, this is of 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 6% to 8% to 6% to 7%. Lastly, as it relates to income taxes, we continue to expect that our effective tax rate will be approximately 20% based on current statutory rates.

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

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Question and Answer

[Operator Instructions] Our first question today comes from Tim Switzer of KBW.

Timothy Jeffrey Switzer
Keefe, Bruyette, & Woods, Inc., Research Division

So I think the first thing to start with is probably the trajectory of the NIM from here. I think when we last talked to you guys, you mentioned that there's possibility of it stabilizing towards the end of '23 or beginning of '24. Can you guys update us on your thoughts on how that will trend and deposit costs and when you think the NIM could possibly stabilize and then -- and select if we assume rates stay static from here?

Brian J. Richardson
Senior Executive VP & CFO

Sure, Tim, this is Brian Richardson. Assuming that there is no further rate increases and kind of we continue to operate in the environment that we're in, we expect that trough to kind of be in early 2024. We expect a little bit more compression and contraction here in the fourth quarter and then the trough to occur. And then you see stabilization with the upside potential thereafter.

Timothy Jeffrey Switzer
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Looking at your loan growth expectations, I said it's probably safe to assume at least mid to high single digits next year, assuming the economy stays okay, once deposit costs settle out, what kind of expansion on the NIM could you see quarter-to-quarter just driven by the loan growth and you probably have some back book repricing as well. Can you help maybe quantify that trajectory for us?

Brian J. Richardson
Senior Executive VP & CFO

Sure. Again, I think there could be some slight upside potential in growth that would occur in '24. But I do think just as you think about one of the benefits that you get in an uprate environment is churn that occurs in the portfolio. But in that uprate environment and as we get later into it, that churn definitely starts to slow down with prepayments and the like. So while we expect deposit costs to normalize and you'll have some incremental add on the asset side, I don't expect that to be overly meaningful, I would say, over the next five quarters.

Michael S. Keim
President

And Tim, you should expect our loan growth to be in the mid-single digits in 2024.

Timothy Jeffrey Switzer
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Any reason for maybe the slowdown year-over-year, something you've seen in the market? Or just that caution?

Jeffrey M. Schweitzer
Vice Chairman, President & CEO

Yes. Tim, this is Jeff. We -- as we've forecasted in the last quarter and we continue to talk about, we are deliberately slowing loan growth down given liquidity pressures, the cost of liquidity and also our desire

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to continue to maintain. And actually, what we would like to do is to start to in turn not eat into capital with loan growth but start to grow capital so that we could be more opportunistic when it comes to capital utilization on buybacks and the like. So we are -- trust me, we could have grown loans double digits this quarter if we wanted to. But given all of the other headwinds with liquidity, with making sure that we have strong capital, we have deliberately focused on full relationship customers that we have and making sure that we can support them.

There are still definitely opportunities out there on the loan side. The economy continues to stronger than I think everybody thought it would be at this point. So the opportunities do exist, but we're being pretty focused and prudent and which relationships we go after and making sure that there are full relationships, bringing deposits and other services.

Timothy Jeffrey Switzer
Keefe, Bruyette, & Woods, Inc., Research Division

And then the last question I have is kind of the flip side scenario with the NIM. If we start, say, once deposit costs settle down and we're in maybe the back half of '24, if we saw some rate cuts, can you talk to us about your sensitivity to that and how you think the balance sheet in NIM would move with a rate cut?

Brian J. Richardson
Senior Executive VP & CFO

Our baseline -- and this is Brian, our baseline kind of downside, down 200 scenario has NII drop in the low-single digit percentage range is what we would expect. However, the wildcard continues to be what happens on the deposit side as it relates to both customer behavior and competitive behavior of our peers. So that will kind of continue to play itself through. But there will be slight downward pressure in a down 200, say, scenario.

Operator

[Operator Instructions] Our next question comes from Frank Schiraldi of Piper Sandler.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Just on the deposit side, just curious if you -- wondering if you guys can remind us where given the increased seasonality where that moves to in 4Q and beyond? And do you think the next move, given the seasonality in the loan-to-deposit ratio would likely be back up a touch? Just what are your thoughts there?

Brian J. Richardson
Senior Executive VP & CFO

Yes. Based on normal seasonality, public funds for us tends to peak out at the end of the third quarter. And then you see a slight wind down in the fourth quarter and first quarter and into the second quarter with the Q2 being [6/30] being the kind of low point normally for the year. So we would expect kind of that deposit to offset or compounded with our growth during the quarter to increase the loan-to-deposit ratio from where it was at 9/30 when you look forward to 12/31 kind of back into that 105 range.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Okay. And then just curious how you're thinking about brokered at this point. I'm not sure -- I think you said brokered fell in the quarter. But is that -- where are those balances as a percentage of total? And what are your thoughts about where you want those to be? Is there a limitation as a percentage of total

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deposits? How do you think about brokered versus just customer CDs?

Brian J. Richardson
Senior Executive VP & CFO

Sure. So at $425 million is where we ended the quarter, our internal policy limits are 20% of total assets. So that would give us about $1.1 billion of incremental capacity on the brokered side. We used them opportunistically in the second quarter based on the public funds growth that we had in the third quarter. We did not, but we always kind of have that in the toolbox is something we will use to help manage liquidity in the like.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Okay. And then just curious if you could provide -- last question, curious if you could provide a little more color on that $5.8 million loan that was sold at par after quarter end. Obviously, it seems like a pretty good sign [indiscernible] at par. So any detail you can give on type of loan, just a story behind that?

Michael S. Keim
President

Yes. Frank, it's Mike. That was a development loan in the city of Philadelphia. They actually ran into project delays with regard to electrical panels and the like, which is kind of common in the real estate space at this point in time. The value was above. Basically, the developer in that case was running out of money to continue to hold the property and finish up the development. So the fair value exceeded our carrying value we got out of par.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Okay. And so that was before any sort of mark. You didn't take any -- it's par --

Michael S. Keim
President

No mark. The fair value exceeded our carrying value. There was no second quarter mark, no early third quarter mark, it's just totally sold at par.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Okay. And can you say, I mean, who the buyer of that is just type -- is it another bank? Is it alternative asset manager, who's the buyer of that loan?

Michael S. Keim
President

Yes, I won't get into the specifics. I will say it was an alternative. It wasn't a bank, alternate fund.

Operator

We have no further questions in the queue. So I'll turn the call back to Jeff Schweitzer for closing remarks.

Jeffrey M. Schweitzer
Vice Chairman, President & CEO

Thank you, Lydia, and thank you to everybody for listening in this morning, and we look forward to talking to you again at year-end. Have a great day.

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Operator

This concludes today's call. Thank you for joining. You may now disconnect your lines.

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