Call Participants

EXECUTIVES

Jeffrey M. Schweitzer
Chairman, President & CEO

Brian J. Richardson
Senior Executive VP & CFO

Michael S. Keim
President & Director

ANALYSTS

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Matthew M. Breese
Stephens Inc., Research Division

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

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Presentation

Operator

Good morning, everyone, and welcome. My name is Drew, and I'll be your operator today. At this time, I would like to welcome everyone to the Univest Financial Corporation Fourth Quarter 2023 Earnings Call. [Operator Instructions].

I will now turn the call over to your host, Jeff Schweitzer, President and CEO of Univest Financial Corporation. Please go ahead.

Jeffrey M. Schweitzer
Chairman, President & CEO

Thank you, Drew, 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 Co.; and Brian Richardson, our Chief Financial Officer.

Before we begin, I'd 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 $16.3 million during the fourth quarter or $0.55 per share. During the quarter, we started to see stabilization and the shift in the mix of deposits along with the cost of deposits. While loans declined slightly during the quarter due to the higher rate environment, the payoff of some potential problem credits and a general slowdown in economic activity, we continue to have solid pipelines as we enter 2024. We continue to focus on full relationship customers and prospects. Brian will provide additional guidance for 2024 in his comments. Before I pass it over to Brian, I'd just like to thank the entire Univest family for the great work that they do every day and their continued efforts serving our customers, our communities and each other.

I'll 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 six items from the earnings release. First, during the quarter, we saw signs of NIM stabilization.

Reported NIM of 2.84%, declined 12 basis points from 2.96% in the third quarter. This compares to an 18 basis point decline during the third quarter. Additionally, core NIM, which excludes excess liquidity of 2.94%, declined 6 basis points compared to the third quarter. This compares to a 14 basis point decline during the last quarter. Second, as it relates to our loan and deposit activity, loans contracted by $7.7 million during the quarter and grew $444 million or 7.3% during 2023.

Deposits contracted by $63.4 million in the quarter and grew by $462.3 million or 7.8% during 2023. The $63.4 million decrease in the fourth quarter included a $57.5 million reduction in brokered CDs. During the fourth quarter, we saw signs of stabilization as it relates to noninterest-bearing deposits, which increased by $35.8 million compared to a decrease of $150 million last quarter.

As of December 31, noninterest-bearing deposits represented 23% of total deposits compared to 22.2% at September 30. Third, during the quarter, we recorded a provision for credit losses of $1.9 million. Our

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coverage ratio was 1.3% at December 31 compared to 1.28% at September 30. Net charge-offs for the quarter totaled $1.1 million or 6 basis points annualized.

Fourth, noninterest income decreased $1.8 million or 9% compared to the fourth quarter of 2022. This was primarily driven by decreases in wealth management revenue, BOLI income and swap related fees. These decreases were driven by a $1.2 million adjustment for previously recorded wealth management revenue and $526,000 of BOLI death benefits, both of which were recognized during the fourth quarter of 2022. Interest rate swap income also decreased $1.5 million compared to the fourth quarter of 2022.

Fifth, noninterest expense increased $1.7 million or 3.6% compared to the fourth quarter of 2022. This includes $642,000 of incremental FDIC expense which is primarily driven by the industry-wide increased assessment rate.

Lastly, during the fourth quarter, we repurchased 26,485 shares of stock and plan to opportunistically repurchase shares in 2024. I believe the remainder of the earnings release was straightforward, and I would now like to focus on 5 items as it relates to 2024 guidance.

First, for 2023, net interest income totaled $220 million. For 2024, we expect loan growth of approximately 4% to 5%, and we expect net interest income to be flat to down 3%. This assumes a stable rate environment and NIM bottoming out in the first half of the year and in climbing thereafter as we start to see stability on the liability side, coupled with continued repricing of assets.

Second, the provision for credit losses will continue to be driven by changes in economic forecast and the credit performance of the portfolio. At this time, we expect the provision for 2024 to be approximately $11 million to $13 million. Third, 2023 noninterest income totaled $26.8 million. For 2024, we expect noninterest income growth of approximately 4% to 6% of the $76.8 million base. Fourth, we reported noninterest expense of $197.4 million for 2023.

For 2024, we expect growth of approximately 3% to 5%. Lastly, as it relates to income taxes, we expect our effective tax rate to be approximately 20% to 20.5% based on current statutory rates.
That concludes my prepared remarks. We will be happy to answer any questions. Drew, would you please begin the question-and-answer session.

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Question and Answer

Operator

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

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

I think the first question I have is your NII guide assuming stable rates. Could you talk about maybe what the impact of rate cut, or two, would be if we get some in the back half of the year. So after the NIM has bottomed, assuming maybe deposit competition has moderated a little bit. What's the impact you expect from just a couple of rate cuts. And then does that impact change if we get deeper into the cut cycle saying like 2025 and the Fed cut say, 4 to 5x or more.

Brian J. Richardson
Senior Executive VP & CFO

Sure, Tim. This is Brian. I'll take that one. So a little bit of it -- rate environment and forward rates has certainly got an impact on things, but it's really customer expectations and customer behavior, coupled with that really of competition on the liability side. So that said, we would really expect the first couple based on kind of forward expectations right now on Fed actions and the like, we have seen some abatement on deposit cost pressures. .

I do think the first couple will have an impact but be relatively minimal because we do have variable rate loans that will automatically reprice as well as variable deposits of variable funding that will automatically reprice. We have about $1.1 billion of variable rate deposits, which is -- its largely public funds driven, which will reprice instantly. So that's a natural offset. And I think the first couple of moves will be pretty minimal impact on our financials.

Jeffrey M. Schweitzer
Chairman, President & CEO

Yes. Just Brian pointing out competition, Tim, it's going to have a huge impact on this. Everybody is looking for deposits. So I'm not so sure that the first 25 or 50 basis points is really going to cause a lot of movement when on the competition side of things. There's -- everybody is looking for deposits right now and any type of lower-cost deposits. So it's still a very, very competitive market when it comes to the funding side of things.

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

Yes, that makes a lot of sense. And that's kind of what I was expecting. So the second part of my question is, if we start to get 4 to 5 or more rate cuts, I know this is looking far down the line. But given the makeup of your balance sheet now, how would you then expect that to impact your NII?

Brian J. Richardson
Senior Executive VP & CFO

So coming into this rising rate cycle, we were asset sensitive as we had modeled it, clearly, the behaviors across the industry that were a little bit different than that, and we have flipped to liability-sensitive. So if things would continue to hold, you'd expect there to be a benefit as rates continue to decline, you start to see that flow through. But again, it really gets back to what customer behavior and competitive pressures are at that point in time.

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

Okay. And you mentioned, $1.1 billion of variable rate deposits. Can you talk about what you have on the asset side that would be variable rate kind of instantly.

Brian J. Richardson
Senior Executive VP & CFO

Yes. Effectively, it's about 29% of our loan book would reprice effective immediately. It's slightly higher than that on a notional basis, but we do have on-pay variable received fixed swap that we've done a couple of years ago, which brings that down so slightly, like I said, to the 29% range of our loan book, instantly reprices. We have another 32% that's adjustable, that's a little bit more long dated, but the instant variables in that 29% range.

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

Okay. I got you. Do you have maybe the adjustable -- Yes, that makes sense. The last question I have then is your CD maturity schedule, what does that look like?

Brian J. Richardson
Senior Executive VP & CFO

We have some tranches coming through in 2024, in total, probably $100 million in the first half of the year. That would be anything that was kind of nonpromotional rates, the promotional rate stuff would backfill at a similar rate. And quite honestly, at a lower rate because we were doing 7-month promotional at [5 to 5.25], which will start to roll off in the current environment. We expect those to come on at a lower level. So there will be some pressure from CD maturities. But at this point, I don't expect that to be overly impactful.

Operator

Our next question today comes from Frank Schiraldi from Piper Sandler.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Curious on the -- Brian, on the fee income guide. So I think you said a flat rate environment as far as the NII guide. Just curious what the drivers of the fee income growth. If we do see rates -- does that imply some growth in mortgage banking? Or is that sort of -- on the come if we do have lower rates in the --rate cuts in the back half of the year?

Brian J. Richardson
Senior Executive VP & CFO

Yes. So there's a couple of components that play into that. Of course, in our insurance and wealth businesses, we expect kind of mid- to high single digit to low double-digit growth in those businesses in a stable environment. And on the mortgage banking side, we do expect some level of increase while production is expected to be less year-over-year. We have a larger focus on saleable production, which will generate more gain on sale income and benefit the noninterest income line.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Okay. The driver is more outside of mortgage banking, I guess, in terms of the growth year-over-year, it sounds like?

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Brian J. Richardson
Senior Executive VP & CFO

But mortgage is a component of it, but it's kind of the diversified businesses that we have all of them will be contributors to the growth.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Okay. And then can you -- I'm sorry if I missed, just in terms of -- it sounds like core NIM is approaching stabilization. I don't know if you said, you expect to get there in early 2024. But also just curious about reported NIM, if you -- if maybe that takes a little bit longer to inflect in terms of do you assume some continued build of liquidity here, maybe as loan growth a little bit more measured in the near term.

Brian J. Richardson
Senior Executive VP & CFO

I think both the -- again, this is Brian. Frank. I think both of those will continue to move in line with each other. What we -- as we kind of see some runoff of public funds and the like, I would actually expect that excess liquidity to diminish in the near term and kind of reported and core will start to converge as well. But I do expect both of those to bottom out in the first half of the year and then see increases thereafter.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Okay. And then just you mentioned the variable rate piece of the loan book that will reprice immediately. If you can just maybe talk a little bit about the longer duration book, the CRE book, is it fair to just basically assume 20% reprices a year? I'm just curious what the pickup in rates you're seeing currently in terms of that renewal?

Brian J. Richardson
Senior Executive VP & CFO

Yes. I mean we've definitely seen a slowdown, I would say, historically, 20% to 25% would have been a reasonable kind of churn number. We see that slowing down a little bit in the current environment in the back half from '23, but somewhere in that 15% to 20% range is what you could reasonably expect there.

And as far as rates -- our current commercial portfolio yield is just below 6%. It's at 5.93%. For the fourth quarter, commercial production -- kind of core production was at 7.70%, and that was up 20 basis points, 25 basis points from last quarter. So again, there's an opportunity there as all those assets reprice and nearest churn, you get a lift there as well.

Frank Joseph Schiraldi
Piper Sandler & Co., Research Division

Okay. Great. And then if I could just sneak in one last one. Just on -- I'm not sure if I didn't see it maybe somewhere in the release. But in terms of loan modifications that you are making or have made on the rate or term side. Do you guys disclose that? And just curious what sort of level of modifications you guys have made on the rate side in the CRE book.

Brian J. Richardson
Senior Executive VP & CFO

We disclosed it in our Q and 10-K in our loan footnote, it will be ultimately disclosed there. But I will say there has not been substantial modifications rate or structure that would be included in that disclosure.

Operator

[Operator Instructions] our next question today comes from Matthew Breese from Stephens Inc.

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Matthew M. Breese
Stephens Inc., Research Division

I was telling we could just first start with where we are in the manageable deposit cycle? And how much that played a role in the deposit dynamics this quarter?

Michael S. Keim
President & Director

It's Mike. Where we are in the cycle, if you're thinking for fourth quarter -- at the end of the third quarter, very early part of the fourth quarter is the peak and the municipal deposits for us traditionally. And do you start to see a small kind of a ramp down in the fourth quarter and gradual ramp down continues in the first quarter and then you get pronounced by the end of the second quarter and then it resets itself. What we've done is be able to work with some county and other municipalities to kind of fill in to reduce that peak and valley. But when you look at our financials, especially in the September, like third quarter end, that's really like peak [municipality] deposits we want to have on our balance sheet going forward.

Brian J. Richardson
Senior Executive VP & CFO

Yes, Matt, just to put some numbers around that -- sorry, Matt, this is Brian. At 9/30, we were at $1.433 billion of public funds that would decrease by $165 million in the fourth quarter, and we'd expect that to kind of continue to wind down through the second quarter and see that rebuild next year in the third quarter.

Matthew M. Breese
Stephens Inc., Research Division

Okay. Very helpful. All right. And I appreciate all the guidance. One thing I was hoping for a little bit more color on was expectations around deposits for this year in terms of both growth and then composition as well. It sounds like we're starting to hit the stability point on the critical noninterest-bearing fee, but I want to [drive] this.

Brian J. Richardson
Senior Executive VP & CFO

Matt, this is Brian. As it relates to deposits, will -- we really look to match or we'll look to match the loan growth with deposit growth. That said, with public funds kind of being at an all-time high in 2023. If you saw some normalization there and then normalized growth on the remaining deposit book, you might see a slight mismatch there. The overall goal, as we progress forward, is matching or exceeding loan growth with deposit growth.

As it relates to composition, we saw again a slight increase in the quarter in noninterest-bearing. But that said, I think if that stabilizes in that low 20% range, we ended at 23% here at the fourth quarter, I think that's a reasonable component to look at. As Mike said, we'll look for public funds to kind of beat cap out at that level that we saw in 2023 and be backfilling with other components of deposits to help bolster the deposit base.

Matthew M. Breese
Stephens Inc., Research Division

Okay. And where do you expect the cost of total deposits to peak out this year? Does it align with your NIM guidance? So first half of [2024], do you expect it to peak out after that.

Brian J. Richardson
Senior Executive VP & CFO

No, we expect it to really peak in '24. That will kind of be a little bit more of the tail end. There will be slight rationing up that would occur throughout the year, but really kind of expect it to normalize by the end of '24.

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Matthew M. Breese
Stephens Inc., Research Division

Okay. You mean peak at the end of '24.

Brian J. Richardson
Senior Executive VP & CFO

Right. Peak at the end of '24.

Matthew M. Breese
Stephens Inc., Research Division

Got it. Okay. Last one for me was just on the securities portfolio. Just any color or guidance there on expectations, whether it's growing or shrinking or stay in cloud.

Brian J. Richardson
Senior Executive VP & CFO

No. We really look at portfolio to remain where it's at. We've kind of at least targeted that to be in that 6% to 8% range, give or take, of total assets. That's where it currently stands, right around 7% when you exclude the mark-to-market, and we look to keep that in a similar size and composition as we've had in the past.

Matthew M. Breese
Stephens Inc., Research Division

Okay. Got it. And just sneaking in one more. It sounds like from a credit front, the provision will kind of be determined by what comes your way. I'm curious what you're seeing boots on the ground, customer by customer. Are you starting to see weakness on rate rolls? Are you starting to see concerns on debt-to-coverage ratios, things like that. And your general expectations for kind of credit trends, NPAs and charge-offs in '24.

Michael S. Keim
President & Director

I'll let Brian give you the specific on the guidance as we go forward. But just the feel for the environment, elevated rates obviously put [more] pressure on everybody, but we've been doing a very good job proactively working with our customer base, getting out ahead of things, make sure that we know it will happen with rates reset on given projects and working through that.

The most part, generally, everybody is doing still fairly yet. About the only thing that we continue to look at that has some level of slowness as luxury to homes that exist in the Philadelphia market itself. And to be honest, our exposure there is $26 million. So it's not significant. But those projects seem to be struggling the most at this point in time. We got to say a combination of just price point and interest rates if somebody was going to do the financing with it.

Brian J. Richardson
Senior Executive VP & CFO

Matt, this is Brian. As it relates to guidance, we do not normally kind of give detailed guidance on expectations of nonperforming and criticized loans, but [indiscernible] loans. But as Mike said, nothing at this point suggest a fundamental change that will continue to be event-driven quarter-by-quarter.

Operator

We have no further questions at this time. So I will now hand you back over to Jeff for any final remarks.

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Jeffrey M. Schweitzer
Chairman, President & CEO

Thank you, Drew, and thank you, everybody, for listening in today. While it was a challenging year in 2023 for the industry, I feel we've made a lot of good progress and pulled a lot of good levers to position us as we head into '24 and beyond. As Brian noted, we feel that there'll be some wind at our backs as we get into the second half of the year. And we're optimistic about what we have in place, the team we have in place in the markets we're in. So we look forward to talking to everybody at the end of the first quarter. Thanks a lot.

Operator

That concludes today's Univest Financial Corporation Fourth Quarter 2023 Earnings Call. You may now disconnect your lines.

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