Univest Financial Corporation

First Quarter 2021 Earnings

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CORPORATE PARTICIPANTS

Jeffrey Schweitzer – *Chief Executive Officer and President*

Brian Richardson – *Chief Financial Officer*

Michael Keim – *President, Univest Bank and Trust*

PRESENTATION

Operator
Good morning, and welcome to Univest Financial Corporation's First Quarter 2021 Earnings 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 and then one on your telephone keypad. To withdraw your question, please press star and then two. Please note, this event is being recorded.

I would now like to turn the conference over to Mr. Jeffrey Schweitzer. Please go ahead, sir.

Jeffrey Schweitzer
Thank you, Chris. And good morning, and thank you to all of our listeners for joining us. Joining me on the call this morning are Mike Keim, President of Univest Bank and Trust, and Brian Richardson, our Chief Financial Officer.

Before we begin, I would 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 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 $32.6 million during the first quarter or $1.11 per share. We were very pleased with our results for the quarter, as our pre-tax pre-provision income for the quarter was up $7 million, or 31.9% compared to the first quarter of last year. During the quarter, we experienced solid loan growth, with loans—excluding PPP loans—growing $63.5 million, or 5.3% annualized.

The first quarter is historically one of our lighter quarters for loan growth. Additionally, deposits grew in-step with loans, growing $68.9 million, or 5.3% annualized. Our mortgage banking team continues to perform very well, as both volume and margins continue to be strong, despite low inventory in our markets. Additionally, we had strong investment advisory income, which increased 10.4% compared to the same period in the prior year due to favorable market conditions and new relationships. As our local economies continue to open, and vaccinations continue to be administered, the economy, for the foreseeable future, looks solid and improving. As a result, we were able to reverse $11.3 million of our provision for credit losses, with $12.9 million, due to favorable changes in economic-related assumptions within our CECL model.

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 will now turn it over to Brian for further discussion on our results. Brian?

Brian Richardson
Thank you, Jeff. And I would also like to think everyone for joining us today. During the quarter, we displayed our continued ability to generate organic loan growth.

In 2020, we achieved loan growth of 9.9%, excluding PPP loans, despite the inherent headwinds presented by the pandemic. As Jeff mentioned, the first quarter is traditionally a slower-growth quarter for us, but we were still able to achieve annualized growth of 5.3% despite a $58.1 million decrease in commercial line utilization. As of March 31, 2021, commercial line utilization was 30.2% compared to 34% at December 31, 2020, and 37.4% at December 31, 2019. In addition to demonstrating our continued ability to grow loans, we continue to have strong performance in our core business. For the quarter, we produced a pre-tax pre-provision ROAA of 1.82%.

I would now like to touch on four items from the earnings release. First, as Jeff mentioned, our reversal of provision for credit losses was $11.3 million for the quarter, which was driven by a $12.9 million benefit due to favorable changes in economic-related assumptions within our CECL model offset by reserves attributable to our 5.3% annualized loan growth during the quarter. The allowance for credit loss coverage ratio, excluding PPP loans, was 1.46% at March 31, 2021 compared to 1.72% at December 31, 2020, and 1.53% at March 31, 2020.

During the first quarter, our COVID-related deferral activity was relatively stable, ending March at $73 million, or 1.5% of the portfolio. Additionally, the reserve release was supported by decreases in nonperforming assets, net charge-offs, and delinquencies during the quarter. Second, reported margin of 3.12% was up 10 ten basis points compared to the fourth quarter. Reported NIM was negatively impacted by 11 basis points of excess liquidity, which averaged $198 million for the quarter compared to $256 million in the fourth quarter and $329 million in the third quarter of 2020.

PPP loans increased NIM by 4 basis points during the quarter and contributed $4.5 million to net interest income, of which $2.3 million was the result of forgiveness and pay downs of loans totaling $119.7 million. Core margin, excluding excess liquidity and the PPP impact was 3.19%, a decrease of 3 basis points when compared to the fourth quarter of 2020. As of March 31st, $9.5 million of net deferred fees from PPP loans remained on the balance sheet, which represents approximately 55% of the initial net deferred fee amount.

Third, non-interest income was up $4.9 million, or 26.5% when compared to the first quarter of 2020. As Jeff mentioned, our mortgage banking business continues to perform very well, driven by strong volumes and margins. Additionally, investment advisory income also saw a nice increase year-over-year. Insurance commission and fee income included contingent income of $1.1 million, which was consistent with the first quarter of 2020. Swap fees also totaled $1.1 million for the quarter compared to $1.6 million for the fourth quarter and $140,000 for the first quarter of 2020.

Fourth, non-interest expense was up 2% compared to the first quarter of 2020. This includes $582,000 of incremental capitalized compensation associated with PPP loans originated during the quarter. Additionally, the first quarter of 2020 included long-term debt extinguishment charges of $656,000. After adjusting for these two items, our expenses were up 5.2% compared to the first quarter of 2020. This increase was partially driven by variable compensation due to strong pre-tax pre-provision income during the quarter.

I believe the remainder of the earnings release was straightforward, and 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
Thank you very much, sir. Ladies and gentlemen, we will now begin the Q&A session. To ask a question, you may press star and 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 and then two.

Our first question is from Andrew DeFranco of KBW. Please go ahead.

Andrew DeFranco
Hi, guys; good morning. This is Andrew; I'm stepping in for Mike today. Thanks for taking our questions.

Jeffrey Sweitzer
Good morning, Andrew.

Brian Richardson
Good morning.

Michael Keim
Good morning, Andrew.

Andrew DeFranco
So, you guys mentioned the improving economic conditions, but loan growth opportunities also seemed to be pretty active, so how do you guys think about the balance and the provision expense going forward and the overall reserve ratio level?

Brian Richardson
That's going to continue to be a function of economic conditions as we see those improving, and leads our ties to Moody's, so as Moody's forecasts improve, we would see that come through. That's what we experienced in the fourth quarter and again here in the first quarter. Being at that 146 coverage ratio, if we think back to where our coverage was at the implementation of CECL, we were at a 110 coverage ratio. So, I would expect us to operate in that range of 146 where we are, trending down slightly as things would continue to improve—should they continue to improve—but I think you can conceptually think about that initial implementation level of a 1.1% coverage as a longer-term place of where things would land.

Andrew DeFranco
Great, thanks. And you guys had strong fee contribution as well in the first quarter, just a couple of questions on that. Wondering if you had any updates on the mortgage pipeline and the dynamics in the market right now? And secondly, I think Q1 benefits seasonally on the insurance and wealth side, but any update on the growth pipelines and those businesses, as well?

Michael Keim
I'll take the first part of this, Andrew. It's Mike Keim. On the mortgage side, our pipeline remains strong, but the mix clearly is changing from refi to more purchase-oriented, and as Jeff alluded to in his opening comments, the biggest problem on the purchase side in our area is a lack of inventory. But we continue to hire loan officers when we continued to drive the business to be purchase-oriented and then live off of refis when we get them.

Jeffrey Sweitzer
And on the fee income side, you're correct. With respect to insurance, the first quarter, we get contingent income, which is really profit-sharing from the carriers that we do business with. As Brian alluded that was around $1.1 million this quarter. That doesn't repeat itself in the following quarters during the year; that's a first-quarter dynamic.

And with respect to wealth, there aren't necessarily any first quarter unusual items that would drive the increases that we've seen. The real driver there is what's happened with the market. Our assets under management supervision are up over $900 million from last year at this time, when the market pulled back. So, we've seen a lot of appreciation as a result of market, which increased revenue, but also, I would say on the wealth side things have opened up a lot more. We started a private banking office where we're getting good traction working with our wealth group. And just overall, with the market conditions, we're seeing a lot of opportunities on the wealth side, and the pipelines are solid.

The insurance side, pipelines are a little lighter than they historically are. Predominantly, with people working remotely, it's still a little harder to get appointments and the like with HR directors and when it comes to employee benefits. So, while they are starting to improve as things are opening up and people are getting vaccinated, that's been a little bit more of a lag compared to wealth, which is pretty much back to historical levels with respect to pipelines.

Andrew DeFranco
Great, thank you for that. And lastly, capital is building nicely; any update on capital deployment priorities, including share repurchases and bank and non-bank M&A?

Brian Richardson
So, with respect to capital, as we've alluded to in the past, our first goal is to pay off our subordinated debt that will be losing its capital treatment, and we have about $75 million of that which will be happening in the end of June. With respect to share buybacks, that's not something we're necessarily entertaining right now.

Once we pay back the subordinating debt, everything will be on the table. But we still continue to see solid loan growth opportunities in organic growth as we've continued to expand our markets. And we do want to keep some dry powder, as we've challenged our heads of wealth and insurance to start to build more robust pipelines when it comes to M&A. So, we do want to keep some dry powder for potential M&A on the wealth and insurance side, and combined with what we see as really solid loan growth for the rest of the year, as the economy continues to operate in our markets fairly well. We think we have adequate capital for all of those opportunities.

Andrew DeFranco
Awesome. Thank you so much for taking our questions.

Jeffrey Sweitzer
Thank you.

Brian Richardson
Thank you.

Michael Keim
Thank you.

Operator
Thank you very much. The next question is from Matthew Breese, of Stephens, Inc. Please go ahead.

Matthew Breese
Hi, good morning.

Jeffrey Sweitzer
Good morning, Matt.

Brian Richardson
Good morning.

Michael Keim
Good morning, Matt.

Matthew Breese
I think the cadence and extent of charge-offs over the last—now this quarter and over the last 12 months has certainly taken us all by surprise, given where we were. From your current vantage and looking at the nonperforming assets on the books, do you feel like charge-offs this year will more closely resemble what we've seen over the last two years or could you give us some color on how you think charge-offs might play out, now that we have a little bit more of a firmer ground underneath us?

Brian Richardson
Yes. I think for the foreseeable future, the kind of experience that we've had the last couple of quarters is what we expect to occur. Again, there is just the inherent uncertainty as we come out of the pandemic. And as long as everything continues to head in the right direction, I think holding charge-offs relatively flat is to where that we've seen in the last couple of quarters would be a reasonable expectation.

Matthew Breese
Okay. Okay, and then just on the margin, stripping away PPP and liquidity, I just wanted to get a sense for where you think we are in the process of finding a bottom on the margin and have we hit that inflection point, and where you think core net interest income can go from here?

Brian Richardson
Yes, I think we're certainly starting to hit that trough. There could be slight pressure going forward. You're going to have noise, like you said, on a reported basis due to PPP and excess liquidity, but I think on a normalized basis, we're certainly hitting that trough at this point in time.

Matthew Breese
Could you just remind us of the terms of the sub-debt that you could repay and what the impact on the NIM could be from that?

Brian Richardson
Yes, so the interest expense savings will be roughly $3 million annualized. There is a piece of those that's fixed today that'll be flipping around the 5% level; that would be flipping to 4% once it goes variable. And our other one is just below 4%, so when you look at that, you're right around $3 million of annualized interest expense savings.

Matthew Breese
Okay. Great. And the last question from me is there has continued to be a lot of disruption in Eastern Pennsylvania. Historically, you all have done a great job on the hiring front, particularly in commercial

lending on the lending side. How does that pipeline look? Then, the more recent deals there have actually been some fee income verticals also disrupted. Just curious if there is hiring opportunity on the wealth and insurance front as well?

Jeffrey Schweitzer
Well, I'll kick off on the wealth and insurance front. Unfortunately, the same challenge that we always have on wealth and insurance is non-competes and non-solicits. And just because somebody gets acquired doesn't mean that those go away. So, the hiring part of it will still be a challenge.

It's not like with the commercial bank, where you can lift out a team or take talent away from somebody. When they're being acquired on the wealth and insurance side, they still have the non-competes and non-solicits which carry over. With that said, obviously, disruption's still always a good thing in our eyes for us because it does provide opportunity on the customer side of things, where they're going to be changing in one way or the other, so maybe they might be open to a conversation.

Michael Keim
And on the banking side, Matt, we've added people in the first quarter on the commercial side of the equation. We'd look to continue to grow in our expanded markets in Central Pennsylvania and the capitol region. And on the mortgage side of the equation, we had a very active pipeline of recruits and our benefit and value prop to them as we can get deals closed for them. So, we continue to be active and getting after it.

Matthew Breese
Got it, okay. I'm sorry, just one more to sneak in. Could you just give us a sense for what you think core ex-PPP loan growth could look for the year? I think you had mentioned previously maybe like a mid-to high-single-digit growth, but just curious if there are any updates there?

Brian Richardson
Yes, Matt. We had previously guided to 7% to 8% excluding PPP for the year, and we think that continues to hold true at this point in time.

Matthew Breese
Great. I appreciate it. That's all I had. Thank you.

Jeffrey Sweitzer
Thanks, Matt.

Brian Richardson
Thanks, Matt.

Michael Keim
Thanks, Matt.

Operator
Thank you. Ladies and gentlemen, again, if you wish to ask a question, please press star and then one. The next question is from Frank Schiraldi of Piper Sandler. Please go ahead.

Frank Schiraldi
Good morning.

Jeffrey Sweitzer
Good morning, Frank.

Brian Richardson
Good morning, Frank.

Michael Keim
Good morning, Frank.

Frank Schiraldi
Most of my questions have been answered, but just a follow-up on the question of hiring lenders. I would imagine that there's a lot of competition or even more so than usual for good commercial lenders in the footprint, so just wondering if that's been the case; if it's been tougher to bring over teams, bring over individuals? And how does that impact your expectations for loan growth? Are your expectations such that you anticipate hiring another certain amount of individuals per quarter, or what are your thoughts on loan growth, if you're able to continue to hire people or if that doesn't to fruition through the rest of the year?

Michael Keim
Yes, so the first part of it, Frank, the competition for good quality people is always strong. And I would tell you, the bigger impact on us is that because we're successful, people would like to come after and grab our folks. So, we're strongly defending our position and making sure that we keep our good folks because that is really, the secret sauce to our loan growth success is the quality of our folks.

We continue to get after it. I feel that we can deliver that 7% to 8% that Brain referenced with our existing staff. Remember, there's always a ramp-up period as we add people anyway.

But there is no magic number for who we're trying to recruit. I don't like to put a number on that. What I'd like to do is say any time that we can find a quality person that will add strength to our team, then we'll add them. But on the broader scale, we can deliver the 7% go 8% with the team that we have today.

Frank Schiraldi
Okay, great. Thank you.

Jeffrey Sweitzer
Thank you.

Brian Richardson
Thank you.

Michael Keim
Thanks, Frank.

CONCLUSION

Operator
Thank you very much. So we have no further questions in the queue. And I'd like to hand the conference back to Mr. Schweitzer for any closing remarks.

Jeffrey Schweitzer
Thank you, Chris, and thank you, everyone, for joining us this morning. We appreciate the attention and participation on our call and the questions. We look forward to what looks to be a strong 2021 as the economy continues to open up, and activity looks pretty robust in our markets. And we look to definitely participate in that and look forward to talking to everybody again after we release earnings in the second quarter. Have a great day.

Operator
Thank you very much, sirs. Ladies and gentlemen, the conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.