Univest Financial Corporation

Third Quarter 2021 Earnings

October 28, 2021 at 9:00 a.m. Eastern

CORPORATE PARTICIPANTS

Jeffrey Schweitzer – *President and Chief Executive Officer*

Michael Keim – *President of Univest Bank and Trust*

Brian Richardson – *Chief Financial Officer*

PRESENTATION

Operator
Good morning and welcome to the Univest Financial Corporation Third Quarter 2021 Earnings Conference Call. All participants will be in a 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 then one on your telephone keypad. To withdraw your question, please press star then two. Please note this event is being recorded.

I would now like to turn the conference over to Jeff Schweitzer, President and CEO. Please go ahead.

Jeffrey Schweitzer
Thank you, Danielle, and good morning and thank you to all of our listeners for joining us. Joining me on the call this morning is 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'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 $20.9 million during the third quarter, or $0.71 per share. We were very pleased with our results for the quarter as we continued to experience strong loan production. Even with payoffs due to the success of our customers, we experienced solid net loan growth of $92 million, or 7.3% annualized during the quarter, resulting in total growth over the past 12 months of $456 million, or 9.7% excluding PPP loans.

During the quarter, we recognized gains on the sale of SBA loans of $920,000 as the investments we made earlier in the year in our new SBA team have begun paying off. Additionally, we continue to have strong investment advisory income which increased 19.8% during the quarter and 19.1% in the first nine months of the year compared to the same period in the prior year due to favorable market conditions and new relationships.

Before I throw it over to Brian, I once again 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 adapt and work through the current environment and move Univest forward. Brian?

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

During the first nine months of the year, we produced a pre-tax pre-provision ROAA of 1.66%. This is a direct reflection of the strength of our diversified business model and continued ability to grow loans.

I would like to touch on three items from the earnings release. First, reported margin of 3.11% was down 4 basis points compared to the second quarter. Reported NIM was negatively impacted by 27 basis points of excess liquidity which averaged $490 million for the quarter compared to $175 million in the second

quarter. The increase in excess liquidity was driven by a $490 million seasonal increase in public funds and the forgiveness of PPP loans totaling $167 million.

During the third quarter, PPP loans increased NIM by 20 basis points and contributed $4.2 million to net interest income. Core margin, which excludes the impact of excess liquidity in PPP, was 3.18%, an increase of 4 basis points when compared to the second quarter. Core margin is expected to be relatively flat in the fourth quarter. As it relates to PPP, as of September 30, $2.4 million of net deferred fees remained on the balance sheet, which represents approximately 13% of the initial deferred fee amount.

Second, during the third quarter we recorded a reversal of provision for credit losses of $182,000, which was driven by a $2.9 million benefit due to favorable changes in economic related assumptions within our CECL model, offset by reserves on loans, securities, and unfunded commitments. The allowance for credit loss coverage ratio, excluding PPP loans, was 1.36% at September 30th compared to 1.41% at June 30th and 1.95% at September 30 of 2020.

During the quarter, our COVID-related deferral activity declined to $18.1 million, or 0.3% of the portfolio. We experienced net recoveries during the quarter of $75,000, and net charge offs for the first nine months of the year totaled $456,000 or 1 basis point on an annualized basis.

Third, non-interest expense increased $4.7 million or 12.3% for the quarter, and $10.8 million or 9.5% for the first nine months of the year when compared to 2020. In general, these variances were partially driven by relatively low expenses in the comparable periods in 2020 due to COVID-19 and the related impacts. More specifically, salaries, benefits, and commissions increased $2.6 million or 10.7% for the quarter and $7.2 million or 10.4% for the nine months ended September 30, 2021.

We continue to be aggressive in hiring talented revenue producers when presented with the opportunity. We have also experienced cost increases due to merit increases, the impact of wage inflation, and certain other variable costs. Variable incentive compensation cost increased $829,000 for the quarter and $2.6 million for the nine months ended September 30, 2021 due to an overall increase in consolidated profitability and increased performance in certain lines of business like wealth management. Another example is medical costs which increased $489,000 for the quarter and $629,000 for the nine months ended September 30, 2021, as elective and preventative claims returned to pre-pandemic levels.

Professional fees increased $853,000 for the quarter and $2 million for the nine months ended September 30, 2021, primarily attributable to increased consulting fees in support of our DE&I training initiatives as well as our treasury management, product, and process enhancements. During the first nine months of 2021, we have spent $1.4 million on these initiatives and we expect to incur approximately $70,000 of additional expense related to these in the fourth quarter of 2021, but are not anticipating these costs to continue in 2022.

I believe the remainder of the earnings release was straightforward and I would now like to provide a few updates to our full year 2021 guidance. First, I had previously guided to net interest income growth of 2% to 4% excluding PPP. We expect to finish the year on the higher end of that range.

Second, last quarter I had guided non-interest income growth of 1% to 2% for the year. Based on the strong performance of our mortgage banking and wealth management lines of business as well as the contributions from our recently higher SBA team, we are now expecting non-interest income growth of 4% to 5% for the year.

Third, last quarter I had guided non-interest expense growth of 4% to 6%. Based on the continued investment in people and the previously discussed increase in variable cost and wage inflation, we are

increasing our expense growth guidance to 6% to 8% for the year. It is important to note the net impact of these guidance updates is accretive to pre-tax, pre-provision income.

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

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star 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 then two.

The first question comes from Tim Switzer of KBW. Please go ahead.

Tim Switzer
Hi. Good morning. I'm on for Mike Farida. Thanks for taking my question.

Jeffrey Schweitzer
No problem, Tim. Good morning.

Brian Richardson
Good morning.

Tim Switzer
You guys had a pretty big surge in deposits this quarter with public funds, which I know is pretty seasonal, but was this maybe a little bit stronger than normal seasonality? And then would you expect any kind of reversal or outflow over the next few quarters? You gave the guidance for quarter NIM and I wasn't sure if that was including the cash impact amount. I'm just trying to judge where the cash levels go from here and if you have any opportunity to deploy that into a securities portfolio or into loans if that cash is sticking around.

Brian Richardson
Hi, Tim. This is Brian. As it relates to public funds growth, it is outsized compared to prior years. If you look at the 9/30 balances of this year compared to 9/30 last year, we're up about $350 million year-over-year. I think that's really a function of just the overall excess liquidity that's in the marketplace from the various stimulus initiatives and the like.

That said, we would expect—I mean as we continue to have strong growth on the loan side, we would expect that to continue to eat into our excess liquidity levels as we progress forward as well as there is a normal seasonality dynamic to public funds and we'd expect that to wind down through the fourth quarter and then into the first and second quarters of next year. That core NIM guidance that I had provided is excluding excess liquidity, when we're dealing with levels that's where it gets kind of hard to predict with specificity exactly where that'll go in the near-term, so I think it's most appropriate to kind of strip that out when we're looking at core NIM.

Tim Switzer
Okay. Yes, that makes total sense. And then talking about that core NIM, you guys had pretty solid expansion this quarter. I think it was up four basis points excluding the cash. What is kind of the main drivers behind that? Asset yields or security deployment? Or are you guys still able to lower some funding costs?

Brian Richardson
We have seen a reduction on deposit costs, roughly 3 basis points from 37 bps last quarter down to 34 this quarter. We continue to dial in exception priced accounts. We made some changes here in the beginning of the fourth quarter, which we expect to result in reductions going forward as well. The other dynamic that was at play was the redemption of sub debt back in July which helped drive some of the expansion that you see here in the third quarter.

Tim Switzer
Great. Thank you for that. And if I could have one more on the loans, it sounds like the competition dynamics on the market are pretty aggressive right now. I just would like to hear what you guys are seeing with pricing and maybe loosening terms by competitors, anything like that.

Michael Keim
Good morning, Tim. It's Mike Keim. I would say we see both of those. The good news is the strength of our team and the ability to source a rather significant pool of deals to consider allows us to stay true to our knitting with regard to credit and also, despite the competition, still be able to get deals at a pricing level that is appropriate for the current environment. Loan pricing basically was consistent quarter-over-quarter, so we are managing to maintain it.

Tim Switzer
Great. Thank you for taking my questions.

Brian Richardson
Thank you.

Michael Keim
Thank you.

Operator
As a reminder, if you have a question, please press star one. The next question comes from Matthew Breese of Stephens Inc. Please go ahead.

Matthew Breese
Good morning.

Jeffrey Schweitzer
Good morning, Matt.

Michael Keim
Good morning, Matt.

Brian Richardson
Good morning, Matt.

Matthew Breese
Hi. Just focused on expenses, so there were some moving parts the last few quarters and in the release you discussed $1.4 million year-to-date in kind of training initiative costs. How much of that occurred this quarter? And as we think about getting into next year, is it appropriate to not only back that out but you also mentioned an additional $70K coming for the fourth quarter. Maybe just help us level set and get a good core expense run rate for the beginning of next year.

Brian Richardson
Yes. Just to clarify there, that $1.4 million wasn't just training initiatives, it was various things including our DE&I initiative as well as enhancements to our treasury management product and processes, so there were a handful of things included there.

It was about $500,000 in the quarter related to those initiatives. And it's a little bit early quite honestly to give full year or give guidance as we progress forward, but I would expect—I mean that was incremental this year – we don't expect it to repeat in 2022, so I think it would be fair to adjust for that as you model forward. But again, not in a position to give full year 2022 guidance at this point.

Matthew Breese
Totally appreciate the guidance. I just want to get a good sense for what the base level is.

Brian Richardson
Sure.

Matthew Breese
You mentioned being aggressive in hiring new talent. I'd just like to get a sense for was that kind of back office talent? Was that lenders? If it's lenders, in what arenas? You also mentioned the SBA team. Just kind of curious the size, scale, and expectations for that team from a balance sheet and an income statement perspective.

Michael Keim
Yes. So the SBA team, we brought three people over and they added another internally and there was already somebody internally set up doing SBA. So that team works with the RMs across our commercial banking teams and they are assisting in driving SBA business. So they're not sourcing it necessarily independently, we already had a source. They're just helping with an expertise and a delivery mechanism as well as an execution mechanism on the sales side of the equation.

In terms of just the overall hiring, we are predominantly hiring on the producing, revenue producing side. That said, there are a couple positions that we think that we needed to add capabilities. Payments would be one area. As Brian referenced, the treasury process and product consulting review. But the predominant amount of the hires that we are doing are on the revenue side, both on the commercial side and on the wealth side.

Jeff Schweitzer
It's really across all of our lines of business. Mortgage, wealth, insurance, and commercial. We've been somewhat aggressively hiring on the production side.

Matthew Breese
Great. Okay. Next one for me, just wanted to get a sense for the size of the loan pipeline. You all have done a fantastic job this year putting up some great net loan growth. Just wanted to get a sense for the cadence of that going forward and if the pipeline still supports kind of high single or low double-digit loan growth.

Michael Keim
The pipelines are still strong. As Jeff alluded to, and we mentioned on last quarter's call, the real issue with net loan growth, which isn't—look, we still feel blessed and we still feel stronger relative to peers—but is the success of our customers in terms of payoff activity. And that's because values are increasing and there's a level of consternation over what is going to be tax policy this year versus next year. So that

is going to continue, at least for the foreseeable future, being the biggest moderator of our net loan growth. But new loan production, Matt, continues to be very strong and the pipeline supports that.

Matthew Breese
Okay. Last one for me, just wanted to get a sense, maybe hone down to the mortgage pipeline and get a sense for how gain on sale margins are holding up so far in the fourth quarter. Trying to get a sense for where gain on sale income could come in next quarter.

Michael Keim
Yes. From just a percentage perspective, the gain on sale into the fourth quarter should be relatively consistent with what we saw in the third quarter. We've been down year-over-year, but that has already started to occur in the second quarter, trailing into the third quarter. I don't see it changing dramatically in the fourth quarter. That said, refinance activity, just because of rates being up, you're going to see seasonal impact because purchase activity will slow as Thanksgiving and Christmas and Hanukah come into play.

Matthew Breese
That's all I had. Thanks for taking my questions.

Jeffrey Schweitzer
Thanks, Matt

Brian Richardson
Thank you.

Michael Keim
Thanks, Matt.

CONCLUSION

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Schweitzer for closing remarks.

Jeffrey Schweitzer
Thank you, Danielle. And thank you to everyone for listening in on our earnings call today. As I mentioned in my comments, we're very pleased with our results and we have good momentum as we head into the fourth quarter pretty much across the organization. So hope everybody has a healthy and safe Halloween this weekend, and dresses up and has a good time. And we look forward to talking to you at the end of our fourth quarter. Have a great day.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.