Univest Financial Corporation

Fourth Quarter and Year End 2021 Earnings Call

January 27, 2022

CORPORATE PARTICIPANTS

Jeff Schweitzer, *President & CEO, Univest Financial Corporation*

Mike Keim, *President, Univest Bank and Trust Co. and Chief Operating Officer, Univest Financial Corporation*

Brian Richardson, *Chief Financial Officer, Univest Financial Corporation*

PRESENTATION

Operator

Hello, and welcome to the Univest Financial Corporation Fourth Quarter and Year End 2021 Earnings Call. My name is Alex and I'll be coordinating the call today.

I will now hand over to your host, Jeff Schweitzer, President and CEO of Univest Financial Corporation. Over to you, Jeff.

Jeffrey Schweitzer

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

We reported net income of $17.4 million during the fourth quarter or $0.59 per share. For the year, we reported net income of $91.8 million or $3.11 per share. We are very pleased with our results for the

quarter and the year, as we continue to experience strong loan production along with growth in our fee income businesses.

Even with the continued offset of payoffs due to the success of our customers, we experienced solid loan growth of $111.8 million or 8.7% annualized during the quarter, resulting in total growth for 2021 of $455.2 million or 9.4% excluding PPP loans. Since the acquisition of Fox Chase Bank and the lift-out of the Lancaster team, which both occurred in mid-2016, we have averaged 10% loan growth per year, excluding PPP loans.

Additionally, to bolster our fee income business, on December 1, we completed the acquisition of the Paul I. Sheaffer Insurance Agency, expanding our insurance team into the Lancaster market, where we have significant banking operations.

2021 was a strong year for Univest as we continue to grow our lines of businesses and make investments for the future in both people and technology.

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 living our core values each day and 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. I would also like to thank everyone for joining us today. As Jeff said, we are very pleased with our performance during 2021.

We produced a pre-tax pre-provision ROAA of 1.57%. This was a direct reflection of the strength of our diversified business model and continued ability to grow loans. I would like to touch on four items from the earnings release.

First, reported margin of 2.86% was down 25 basis points compared to the third quarter. Reported NIM was negatively impacted by 43 basis points of excess liquidity, which averaged $874 million for the quarter, compared to $490 million in the third quarter. This increase in average excess liquidity was driven by a $226 million seasonal increase in average public fund deposits as well as a $149 million increase in commercial deposits.

During the fourth quarter, PPP loans increased NIM by 8 basis points and contributed $1.6 million to net interest income. Core margin, which excludes the impact of excess liquidity and PPP, was 3.21%, an increase of 3 basis points when compared to the third quarter. As it relates to PPP, as of December 31, $817,000 of net deferred fees remained on the balance sheet. During 2021, we recognized net interest income of $15 million related to PPP loans.

Second, during the fourth quarter, we recorded a provision for credit losses of $1.4 million. The allowance for credit loss coverage ratio, excluding PPP loans, was 1.36% on December 31, which was consistent with September 30. During the quarter, our COVID-related deferral declined to $6.2 million or 0.1% of the portfolio. We experienced net recovery during the quarter of $243,000 and net charge-offs for the year totalled $213,000.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Third, noninterest income increased $4.9 million or 6.3% in 2021 compared to 2020, which reflects the continued benefit of our diversified business model. During 2021, noninterest income represented 31% of total revenue.

Fourth, noninterest expenses increased $12.4 million, or 8% for the full year when compared to 2020. Salaries, benefits, and commissions increased $11 million or 11.8% as we continue to be aggressive in hiring revenue producers when presented the opportunity.

We have also experienced cost increases due to merit increases, the impact of wage inflation, and variable incentive compensation cost, which increased $3.6 million year-over-year due to our strong performance in 2021. Excluding the increase in variable incentive compensation, noninterest expense increased 5.7% over 2020.

Professional fees increased $2.3 million or 44%, primarily attributable to increased consulting fees in support of our DE&I and training initiatives, as well as our treasury management product and process enhancements. During 2021, we spent $1.4 million on these initiatives.

Data processing expenses increased $1.4 million or 12.4%, primarily due to continued investments in our end-to-end loan origination solution for loans below $1 million, customer relationship management software, internal infrastructure improvements, and outsourced data processing solutions.

I believe the remainder of the earnings release was straightforward, and I would now like to focus on five items as it relates to 2022 guidance.

First, during 2021, net interest income totaled $173.4 million when excluding PPP income of $15 million. For 2022, we expect loan growth of approximately 8% to 9%, excluding PPP loans, and we expect this to result in net interest income growth of approximately 8% to 10% off the base of $173.4 million. This assumes one 25 basis point rate increase in March. Each additional 25 basis point increase is expected to result in annualized net interest income of approximately $3.5 million to $4 million.

Second, the provision for credit losses will continue to be driven by changes in economic forecasts, government stimulus, and performance of the portfolio. At this time, we expect the provision for 2022 to be approximately $6 million to $8 million.

Third, 2021 noninterest income included $1.1 million of BOLI (phon) death benefits. Excluding these BOLI death benefits, non-interest income totaled $82.1 million in 2021. For 2022, we expect non-interest income growth of approximately 1% to 3% off the base of $82.1 million. This translates to a compound annual growth rate of approximately 8% to 9% from 2019 to 2022.

Fourth, we reported noninterest expense of $167.4 million in 2021 and expect growth of approximately 6% to 8% in 2022.

Lastly, as it relates to income taxes, we expect our effective tax rate to be approximately 19% to 20%, assuming the current statutory rate remains unchanged.

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

Operator

Thank you. We will now proceed with the Q&A. Our first question comes from Michael Thereto, who is a private investor. Michael, over to you.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Michael Thereto

Hey, good morning, everybody. How are you?

Jeffrey Schweitzer

Good, Mike, how are you?

Michael Thereto

Good. Thanks. Just a couple of questions. Brian, appreciate the thorough guidance there on the 6% to 8% expense growth. How should we think about the split of that? You guys continue to invest in the business, but there seems to be some environmental pressure that a lot of your peers are citing when guiding up to expenses next year. Can you maybe just give us a little bit of how much of that is hiring budgeting, and how much of that is tech investments you're budgeting in and how much of that is general environmental pressures that could be pushing that number higher in 2022?

Brian Richardson

Yes, all in, as we look at adds to staff, just as we continue to grow and hire producers, as well as just the pressures that you're describing, we're in the high single-digit range assumption for salary benefits and commission growth year-over-year. Then the other big area would be on a data processing side. That's in that high single-digit, low double-digit growth range year-over-year. Those are the main drivers that get us to that 6% to 8%. Those numbers do include about $1 million dollars of assumed investment as we continue to evolve our digital products. That's reflective in that 6% to 8% guidance that I provided.

Michael Thereto

Helpful, thanks. Then maybe a question for Jeff or Mike, in terms of the competitive landscape from a loan growth perspective, obviously you guys have really been able to sustain your growth through a variety of environments here. I'm just curious if, as you look to next year and obviously the loan growth guidance is pretty strong, but do you think the environment could perhaps become even a bit more accommodating than it was over the last year? It seems like a lot of your regional peers are getting more bullish on growth, and they weren't even growing loans for the prior 12 months. I'm just trying to level set if you think there's some tailwinds, maybe that that could help you guys accelerate growth even further.

Mike Keim

Good morning, Mike. It's Mike. I think it's still going to be a competitive marketplace. I think at this point in time, I don't think everybody is fully thinking about the Fed increases and their pricing mechanisms. Larger competitors are. But that continues to be a competitive headwind for us. The secret to our loan growth continues to come back to the strength of our team. Even with the larger players becoming more bullish on what the market could be, I'm very comfortable with the guidance that Brian put forth as we move forward. We'll continue to grow the team as he also referenced in the operating expense detail.

Jeffrey Schweitzer

Yes. The other thing, Mike, you've got to remember, a lot of our customers have been very successful in selling their projects and we're seeing that continuing to happen. The loan growth that we're forecasting, while strong, is also net of some payoffs that we anticipate happening throughout the year that are sizable.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Michael Thereto

Got it. Very helpful. Thanks. Then, just lastly, on the NIM guide, Brian, just curious what you guys are thinking on the deposit side of the equation? What type of betas are you assuming? I think you guys have brought in a lot of new core funding, particularly as you've expanded into new markets. How are you generally thinking about some of the rate sensitivities of those fundings relative to some of the legacy like north of Philly funding you guys have, which I know the beta is historically extremely low?

Brian Richardson

Yes. The first couple of increases, especially with the excess liquidity that we're sitting with, we think the betas will be pretty low for the first couple of 25 basis point increases. Historically, in the last increasing rate environment, we saw a beta of roughly 45% and thinking that will be in that 20% to 30% range here for the first couple of increases, just again, sitting with the excess liquidity that we currently have. We do have roughly $600 million of deposits that are variable rate and tied to Fed funds. That will instantly adjust up. That will bring some incremental expense across with that. But otherwise, we think we'll be able to hold pricing relatively flat on the rest of the book with small deviations.

Michael Thereto

Can you just remind us on the asset side, what were prices immediately?

Brian Richardson

Yes. The book overall, our loan bulk of the book is 40% fixed, 23% adjustable and 37% variable. It's really that 37% that's variable will adjust immediately.

Michael Thereto

Perfect. Great. Thank you, guys. Good quarter. Appreciate the color.

Jeffrey Schweitzer

Thanks, Mike.

Mike Keim

Thank you, Mike.

Operator

Thank you, Michael. Our next question comes from Frank Schiraldi from Piper Sandler. Frank, your line is now open.

Frank Schiraldi

Good morning.

Jeffrey Schweitzer

Good morning, Frank.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Brian Richardson

Good morning, Frank.

Frank Schiraldi

Sorry if I missed it, Brian, but on the—on your NII guide, does that assume additional deployment through securities purchases as well or is the loan growth robust enough that that's really the driver and then what are your thoughts on the—obviously you mentioned deposits. You've got some room to let those run off if need be, but what is your base case there?

Brian Richardson

Yes, where we sit today, we see excess liquidity. We ended the year at $800 million from a spot perspective. We're currently down to the $700 million range. We see a path where, without meaningful incremental investment purchases or anything like that, we can be in the $0.5 billion range by midway through the year. Then into a $100 million to 200 million range by the end of the year. That said, in between the fourth quarter of last year and here in the first quarter of this year, we have purchased approximately $125 million of incremental investments, really to get our investment book back up to the percentage of the balance sheet that we've seen historically. But we're doing that in a disciplined fashion, just hard to get too excited about sub-2% yields on mortgage-backed. We're nibbling at it as we go through, but being disciplined, but opportunistic.

Frank Schiraldi

Okay. Then on the fee income side, I think the guide was for 1% to 3% off that normalized 2021. I wonder if you could just drill down a little bit there, wondering what you guys are expecting on the mortgage banking front and then what the specific offsets for growth are?

Brian Richardson

Yes, on the mortgage banking side, from a reported fee income perspective, we see that pulling back, in that 25% to 30% range versus what we experienced in 2021. Really, we expect volume to hold relatively steady, but margins are tightening up. We were in the low to mid threes for a good part of 2021. We'd expect that to fall on at 250 to 275 margin type range. That in and of itself drives about that 25%, 30% pullback. The areas offsetting that and driving growth would be investment advisory. We continue to see nice high single-digit, low double-digit growth there and on the insurance side as well, both organic, but then with the addition of the Paul I. Sheaffer Agency, we see that being a nice mid-to-high double-digit growth year-over-year.

Frank Schiraldi

Okay, all right. Great. Thanks for all the color.

Jeffrey Schweitzer

Thanks, Frank.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Operator

Thank you, Frank. We currently have no further questions, so I will hand back to Jeff Schweitzer for any closing remarks.

Jeffrey Schweitzer

Thanks, Alex, and thanks to everybody for participating on our call today. We are excited about 2021 and the year we were able to produce, and the momentum that we have as we head into '22, as we continue to make investments for the long-term success of Univest and to reward our shareholders.

With that, I hope everybody has a great day, and stay healthy. Thanks a lot.

Operator

Thank you for joining today's call. You may now disconnect.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com