Univest Financial Corporation

First Quarter 2022 Earnings Call

April 28, 2022

CORPORATE PARTICIPANTS

Jeff Schweitzer, *President and Chief Executive Officer*

Mike Keim, *Chief Operating Officer*

Brian Richardson, *Chief Financial Officer*

PRESENTATION

Operator

Hello, and welcome to today's Univest Financial Corporation First Quarter 2022 Earnings call. My name is Bailey and I will be the moderator for today's call.

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

Jeff Schweitzer

Thank you, Bailey, 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 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'll 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 $20.3 million during the first quarter or $0.68 per share. During the quarter, we continued to experience solid loan growth as loans grew $112.2 million or 8.5% annualized excluding PPP loans.

In addition to our solid results in the quarter, we're excited to announce our expansion into two new markets with the hiring of market presidents for Western Pennsylvania and Maryland as we continue our organic growth strategy.

We are excited by the addition of Chris and Matt to the Univest family. While they are experienced commercial bankers, in addition to building their teams, they will be working with all our lines of business in growing and serving these new markets.

Additionally during the quarter, we began the development of a comprehensive digital platform, building off the investments we have been making in technology over the past few years. This digital platform will allow us to be more efficient and less reliant on physical locations in the future as we expand and build out this initiative. While this will be a significant investment, we're confident it will position us very well for the future as customer expectations and preferences continue to evolve.

Finally, due to our strong performance and strong capital position, the Board of Directors has declared a 5% increase in our quarterly cash dividend and the repurchase of shares targeted at 150,000 per quarter. While we have been utilizing our internally-generated capital to fund growth over the past few years, we are excited that our strong performance, along with our strong capital position, is enabling us to increase the value we returned to our shareholders.

As detailed in our release and my comments, there's a lot to be excited about at Univest as we continue to grow. This could not be possible without the hard work of the over 900 members of the Univest family. I would like to thank them for all their efforts, serving our customers, communities, and each other.

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

Brian Richardson

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

As Jeff said, we're pleased with our performance during the quarter. While we incurred incremental expenses totaling $1.6 million associated with our digital transformation, onboarding of new mortgage lenders and costs associated with a customer who was defrauded, our core business performed well during the quarter.

I would like to touch on four items from the earnings release.

First, reported margin of 2.89% was down 3 basis points compared to the fourth quarter. Reported NIM was negatively impacted by 33 basis points of excess liquidity which averaged $693 million for the quarter compared to $874 million in the fourth quarter.

During the first quarter, PPP loans increased NIM by 3 basis points and contributed $591,000 to net interest income. Core margin, which excludes the impact of excess liquidity and PPP, was 3.19%, a decrease of 2 basis points when compared to the fourth quarter. This modest decrease is attributable to incremental investment purchases during the fourth quarter of 2021 and the first quarter of 2022, totaling $135 million at a weighted average yield of 1.9%.

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Assuming the Federal Reserve raises rates by 50 basis points in May, we expect core NIM to expand by approximately 12 to 15 basis points in the second quarter.

Second, during the quarter, we recorded a reversal of provision for credit losses of $3.5 million. This was driven by a $5.7 million benefit from changes in economic-related assumptions, offset by provisioning for loan growth and specific reserves.

The allowance for credit loss coverage ratio, excluding PPP loans, was 1.27% on March 31, compared to 1.36% at December 31 and September 30. During the quarter, we experienced net charge-offs of $76,000 and non-performing loans and leases decreased to 7.6% from year-end.

Third, non-interest income decreased $2.8 million or 12% compared to the first quarter of 2021 which was driven by a $4 million decrease in net gains on mortgage banking activities, offset by increases in our investment management and insurance lines of business and our other service fee income streams.

Fourth, non-interest expense increased $5.9 million or 14.9% compared to the first quarter of 2021. This includes $779,000 related to our digital transformation project, $488,000 resulting from the inclusion of the Paul I. Sheaffer Insurance Agency which was acquired on December 1 of last year, $470,000 of guarantees paid to recently hired mortgage producers and $330,000 of expense related to the customer who was defrauded. Excluding these items, expenses increased $3.8 million or 9.6% compared to the first quarter of 2021.

I believe the remainder of the earnings release is straightforward and I would now like to provide updates to our 2022 guidance.

First, as a reminder, during 2021, net interest income totaled $173.4 million when excluding PPP income of $15 million. We had originally guided loan growth of approximately 8% to 9% in 2022 excluding PPP loans and net interest income growth of 8% to 10%. Our loan growth guidance is being increased to 9% to 10% to reflect the Western PA and Maryland expansion markets and the addition of the previously discussed mortgage producers. We expect this to result in net interest income growth of approximately 15% to 17% off the base of $173.4 million from 2021. This includes the impact of the 25-basis-point increase in March and the anticipated 50 basis-point increase in May. Each additional 25-basis-point rate increase is expected to result in annualized net interest income of approximately $4 million to $4.5 million for the first several increases.

Second, 2021 non-interest income included $1.1 million of BOLI death benefits. Excluding these BOLI death benefits, non-interest income totaled $82.1 million for the year. We had previously expected non-interest income growth of approximately 1% to 3%. We now expect non-interest income for the full year of 2022 to be flat to slightly down. This is primarily driven by reduced margins and salable volume in the mortgage line of business based on the current interest rate environment.

Third, we reported non-interest expense of $167.4 million for 2021 and had previously guided to growth of approximately 6% to 8% for 2022. We expect to incur roughly $3.5 million to $4 million of expense in 2022 in conjunction with our digital transformation initiative. Additionally, we expect to incur approximately $2 million to $2.5 million of incremental expenses related to our investment in the Western PA and Maryland expansion markets during the year. Including these three investments, we expect 2020 expenses to increase 10% to 11% off the base of $167.4 million from 2021.

As it relates to our Western PA and Maryland expansion markets, we expect these investments to be accretive to pre-provision earnings in approximately 24 months and fully earned back in three to three and half years, again, on a pre-provision basis. We continue to prefer this method of entering new

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markets as compared with doing whole bank acquisitions which inherently include more integration risks, intangible recognition, and tangible book value dilution.

Lastly, as it relates to income taxes, based on our increased pre-tax earnings from these guidance updates, we expect our effective tax rate to be on the higher end of the 19% to 20% range that was provided during last quarter's call.

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

Operator

Our first question today comes from Frank Schiraldi from Piper Sandler. Frank, please go ahead. Your line is now open.

Frank Schiraldi

Good morning.

Jeff Schweitzer

Good morning, Frank. How are you?

Frank Schiraldi

I wanted to start with—Jeff, if you could maybe give us a little more detail on the digital platform; the digital initiative, and how that differentiates you from others your size. Does that get you to where you need to be in terms of in line with others your size? If you can just give us a little more color there. That would be great. Thanks.

Mike Keim

Frank. It's Mike and I'm going to take this one. The background on the digital initiative, both Jeff and Brian alluded to, we've made significant investments in core platforms over the last several years. What we're doing now is using the investments we made in Salesforce and expanded tools with Salesforce to wrap all those core platforms into the Salesforce eco-structure and deliver that, hopefully, which will be a differentiator, is ultimately delivering human touch with a digital capability, but it goes beyond that.

We need to look at making sure that the organization is available for customers when customers want to do business with us, not necessarily stated hours that we previously may have had and we need to be much better at data. That will allow us to personalize things from a digital perspective as well as make sure that we continue to deepen our relationships with existing customers.

In terms of how this views us relative to our peers, I think peers our size, as we enact this initiative, we will move forward. We need to make sure that we're on par with our larger peers or larger competitors so that we continue to move forward and we can thrive in the future.

Frank Schiraldi

Is this like a middle-ware investment and how much of this is external in terms of going to consultant, and external IT, and how much is it internal and just going to continue to be in run rate beyond planned implementation?

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Mike Keim

The numbers that Brian alluded to were external. Is that correct?

Brian Richardson

Correct. That's our 2022 expense associated with that. Whenever you do an initiative like this, there's capitalization, so there will be a tail that results from that in future periods as a result of capitalizing those external costs, but what we actually expect to run through the P&L for this year is the guidance I provided.

Mike Keim

Beyond, deeper into your questions. We are partnering with two consulting entities, one would be helping us just step back, look at who we're serving, how we need to serve them, and make sure we build the infrastructure to do that, and then we were also partnering with a content, branding and digital marketing firm. Those two entities, combined with our internal staff, will work together to deliver the product and deliver the solutions as we move forward.

Just as importantly, like I said, this is about changing how we operate as a core Company, and how we are available for our customers, and how we move forward. There will be an increased investment in our customer care center, so we are available for our customers and we can be more of a concierge type of approach to serving them, and we also need to make sure that we get much better at data.

We have tons of data. Every company has tons of data, but we need to make sure that we make a significant investment in data so that we can be predictive and personalize experiences as we move forward. It will be a combination of internal and external resources.

Frank Schiraldi

Got you. Then just lastly, if I could sneak one in, in terms of—Brian, sorry, I didn't get a chance to do the math, but in terms of the increase in expense from 6% to 8% to the 10% to 11%. I know you noted the building out the expansion markets and also the digital initiatives. Is there any increase as well for just general inflationary expense, and is that—if not, is that a risk to that 10% to 11% growth?

Brian Richardson

That's our updated expectation, all things considered. There's a little bit in there for inflation. Some of these, the mortgage producer investment that I spoke to, as well as the fraud loss item as well. That's baked in there, but there is a little bit of an inflationary increase, but we had anticipated a fair bit of that when we set our original targets and guidance for 2022 and things seem to be tracking pretty close to that at this point.

Frank Schiraldi

Great. Okay. Thanks, guys.

Mike Keim

Thank you, Frank.

Operator

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Thank you. The next question today comes from Tim Switzer from KBW. Tim, please go ahead. Your line is now open.

Tim Switzer

Hey good morning. I'm on for Mike Perito. Thanks for taking my question.

Mike Keim

Good morning, Tim.

Tim Switzer

We can talk about the expansion markets real quick. You talked about in the press release about your success entering the central PA region and how you started with the lift out of 15 employees and now you have about $1.2 billion in loans outstanding. Do you have a similar trajectory you think for these new markets? I know you just hired the presidents, but if you give us any guidelines on maybe how many employees you plan on starting with or want to, and just exactly what's the trajectory after this year, really?

Mike Keim

Tim, it's Mike. No, we will not have the same level of trajectory as we had in Central Pennsylvania. There was a couple of factors that played into that. One, we were able to get a team of that size and also there was significant market disruption at that time which allowed us to expedite the process of growing the business and moving forward there.

We think we have found two extremely talented individuals to lead our teams in both of those markets. We will be actively looking to recruit and build out those teams on the commercial side, but as Jeff referenced in his opening remarks, we are going to bring all of our products and services to bear. We will be hiring mortgage loan officers, adding to our wealth management capabilities, putting a treasury management person in each marketplace.

We are optimistic, but we're not prepared at this point in time to give future loan targets because that will be dependent upon how quickly and how many RMs we hire in that marketplace.

Tim Switzer

Okay. Great, and then could you talk about your general strategy when entering new markets and your go-to-market strategy, what's your plans on winning business and maybe it's unique in each market but if you could talk about that real quick, please?

Mike Keim

Yes, I would say, first and foremost, it's fairly basic. Find an extremely talented leader in each marketplace, and then grow a team of talented individuals, and then we will supplement that. We know that we need to make certain community investments, we know we have to spend marketing dollars, and we need to be, most importantly Jeff and myself need to be in market meeting with prospects, people that can influence building business, and over time, obviously current customers.

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This is an investment of time and talent, and that's what we need to do and that will make us successful. We feel very confident about that. We know who we are as a Company. We know that the focus on taking care of the customer and making sure that we build a team of people that are focused on taking care of the customer and doing the right thing day-in, day-out, and that will allow us to be successful in each market.

Jeff Schweitzer

Tim, we've been very successful by leading with the commercial bank. That's who we are. Our bread and butter is commercial lending, small business, and middle market lending. Bringing on these two market presidents to really build out commercial lending teams and then supplement it with mortgage bankers and wealth advisors and the like, and then layering on the digital initiatives on top of it, we think we can have very good impact on the market, grow successfully, but do it in an efficient way.

With the digital initiative, it's a hub-and-spoke with the spoke being digital and the hub being more of a regional headquarters type of presence. We're excited about bringing these two individuals. We're excited about what we think they can do building out a team, but it's really going to be commercial focused at the beginning and then we'll layer on consumer as we go along.

Tim Switzer

Got you. That makes a lot of sense. Thank you for taking my questions.

Jeff Schweitzer

No problem. Thank you.

Operator

Thank you, Tim.

The next question today comes from Brody Preston from Stephens. Brody, please go ahead. Your line is now open.

Brody Preston

Good morning, everyone.

Jeff Schweitzer

Good morning, Brody.

Mike Keim

Morning Brody.

Brody Preston

Hey, I just wanted to follow up on the regional expansion with Chris and Matthew. Could you give us a sense for what size businesses they've historically done business with and if that's smaller or larger than your core customer cohort?

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Mike Keim

I think it's consistent with what we've done. Revenue size is smallest $5 million and take it up to $50 million. Would there be something that could be bigger? Yes. But in terms of that wide of a broth, and that's where we play well in and we will continue to do that. Could we go to a larger size? Of course we could. But that you're looking at loans, typical loan size is of a couple of million dollars to $10 million on average, I would say.

Jeff Schweitzer

What's exciting is what they prospect and target fit in very well with what we historically have been successful in growing the business.

Brody Preston

Got it. Thanks for that. Maybe on the capital management front, I just wanted to ask how along you anticipated repurchasing? I think it's been 150,000 shares a quarter.

Jeff Schweitzer

Yes. We have 600 and some odd thousand available. As long as we can continue to generate capital at the pace we expect to, especially with the rate increases that are coming and how we will benefit greatly from that, we would expect to continue purchasing those as long as economically as a good investment and makes sense. I would think that right now we have 600 and some thousand available. As we start to fill that up, we'll assess at that time if we need to get authorization for more to continue to repurchase shares.

Brian Richardson

Clearly, that gives us about a year's worth of current coverage. As we look at it, we are targeting an earn-back of three years or less, quite honestly. At current levels, we were less than half of that. It's certainly attractive at this point for us to be active on that front.

Brody Preston

Got it. Just on the—turning to loan yields, could you give us a sense for what new blended loan yields are and whether or not you've started to see any compression on spread compression?

Brian Richardson

As we looked at new yields in the first quarter, they were up slightly from the fourth quarter, but still done in that low-to-mid three range. However, that was really a closed deals which would've been locked earlier on and then as we know, the rate expectations increased pretty drastically throughout the quarter. Most recently we've seen things in that low-to-mid four range and trending higher over the last month or so.

Brody Preston

Got it. Then just last one for me, just on deposit prices, on spot basis, have you changed rates at all so far? Have you begun to make any exceptions as it relates to pricing for some of your customers?

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Brian Richardson

No. We've held steady on, really, on all fronts. With the level of excess liquidity that we have and continue to project to have, we think that gives us a little bit of room to operate, quite honestly, on the deposit cost side for the foreseeable future.

Brody Preston

Got it. Thank you very much for taking my questions. I appreciate it.

Jeff Schweitzer

Thanks, Brody.

Operator

Thank you, Brody.

The next question today comes from Chris Reynolds from Neuberger Berman. Chris, please go ahead. Your line is now open.

Chris Reynolds

Good morning, gentlemen, and thank you for taking my question.

Mike Keim

Morning, Chris.

Chris Reynolds

I wanted to follow up on the dividend increase. I thought that was quite positive. From my recollection, you haven't increased your dividend in maybe 10 years or more. Is this a change in long-term policy? Should we expect the dividend to continue to grow as our Company grows, or is this just a function of the excess liquidity that you discussed?

Jeff Schweitzer

Yes, Chris. This is Jeff. Yes, it's true, we haven't increased in quite a number of years. We didn't cut it during the 2008-09 cycle like most of our peers would have done; we held steady back then. But in looking at our projections for earnings and our capital position, where we are and obviously as I've said, we will benefit greatly from the rate increases that are coming from the Fed, it felt prudent at this time to raise the dividend and return some value back to our shareholders through a dividend increase. We will continue to assess that as time goes on, as far as where our earnings position is, where our growth and our overall capital position is. Obviously, we would like nothing more than to continue to reward our shareholders going forward. We will continue to assess that as time goes on with the Board.

But it had nothing to do with the excess liquidity. It really had to do with where we see earnings going, combined with growth, combined with our strong capital position.

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Chris Reynolds

Thank you.

Operator

We have a follow-up question, excuse me, from Tim Switzer from KBW. Tim, please go ahead. Your line is now open.

Tim Switzer

Hey, guys. Thanks for taking my extra question. I just had a couple of more. On the quarter, you guys had $775 million cash balances. Last quarter, you talked about not being too excited about buying securities at the current yields, but with the recent increase in rates, has that changed your mind at all? Do you plan on stepping up investment purchases or just letting the excess liquidity be deployed through loan growth?

Brian Richardson

This is Brian. Just to work through that one. We had purchased $100 million incremental in the fourth quarter and then another $35 million incremental in the first quarter. Little bit taking advantage of that increase in yield, as you described. That said, we ended the quarter at $675 million of excess liquidity. We expect roughly $350 million to $400 million based on our loan guidance of utilization of that through the remainder of the year, as well as rundown of seasonality in public funds.

That said, we don't plan to really bolster the investment portfolio much further than we have at this point based on current facts and circumstances. We tend to target 8% to 9% of total assets. When you adjust for the excess liquidity and the like, we're right around 8.4% right now. We're operating in that range that we like to be.

Tim Switzer

Nice. Then related to that, but just on the securities portfolio, you guys had a pretty minimal impact AOCI and TCE (phon) from the higher interest rates and a lot of your peers are actually getting hit pretty hard. Do you guys have any hedging on that? Is it just your smaller securities portfolio and the way you have it structured?

Brian Richardson

We don't have any hedging strategy, is really a function of the portfolio itself mixed between HCM and available for sale. We did have a $20 million unrealized loss increase that was recognized during the period and our earnings for the quarter offset that. That's why you don't see—largely offset that. That's why you didn't see as much of a deterioration in our reported ratios in book value, but we did see a hit consistent with what others have seen. Just not maybe to the extent of same magnitude.

Tim Switzer

Great. Well, thanks for taking my extra questions.

Brian Richardson

You're welcome.

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Operator

Thank you, Tim.

There are no additional questions waiting at this time. I'd like to pass the conference back over to Jeff Schweitzer for closing remarks.

Jeff Schweitzer

Thank you, Bailey, and thank you, everybody, for joining us today. As I think you can see in our release, there's a lot of exciting stuff going on with respect to all of these initiatives that we're working on to continue to position us very strongly for the future. We look forward to speaking with everybody after we release second quarter earnings, and I hope you all have a great day.

Operator

That concludes the Univest Financial Corporation First Quarter 2022 Earnings Call. Thank you for your participation. You may now disconnect your lines.

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