Univest Financial Corporation

Second Quarter 2022 Earnings Call

July 28, 2022

CORPORATE PARTICIPANTS

Jeff Schweitzer, *President and Chief Executive Officer*

Mike Keim, *Chief Operating Officer*

Brian Richardson, *Chief Financial Officer*

PRESENTATION

Operator

Good morning, and thank you for attending today's Univest Financial Corporation Second Quarter 2022 Earnings call.

I would now like to pass the conference over to our host, Jeff Schweitzer with Univest. Jeff, you may proceed.

Jeff Schweitzer

Thank you, Austin, 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 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 $13.2 million during the second quarter or $0.45 per share. Our net interest income increased 10.3% from the first quarter of the year as we benefited from rising interest rates due to

our asset sensitivity. Additionally, we continue to have very strong loan growth as loans grew $265.9 million or 19.6% annualized, excluding PPP loans during the quarter. This strong loan growth resulted in an increased provision for loan and lease losses under CECL during the quarter, which Brian will go into more detail on in his comments.

We are happy with our results for the quarter, and while there is volatility in the provision for loan and lease losses due to CECL as a result of our strong loan growth, our pretax pre-provision income continues to be solid and increased 6.4% from the first quarter. Additionally, while mortgage banking and wealth revenues have been negatively impacted by increasing rates and decreasing margins for mortgage banking, along with the decline in financial markets impacting assets under management supervision for wealth management, the growth engine we have established across all of our lines of businesses continues to set us up for future and continued growth.

Before I pass it over to Brian, I would like to thank the entire Univest family for the great work they do every day and for their continued 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, and I would also like to thank everyone for joining us today.

We are very pleased with our continued ability to generate strong loan growth during this rising rate environment. During the quarter, as Jeff said, loans increased $265.9 million or 19.6% annualized, excluding PPP loans. For the first six months of the year, loans have increased $378.2 million or 14.4% annualized.

I would now like to touch on four items from the earnings release. First, reported margin of 3.19%, increased 30 basis points compared to the first quarter. Reported NIM was negatively impacted by 23 basis points of excess liquidity, which averaged $434 million for the quarter compared to $693 million in the first quarter. However, during the quarter, our excess liquidity diminished, and we ended the quarter in a $93.6 million borrowing position. This was primarily driven by our strong loan growth, seasonal public fund declines and a large outflow in the second half of June for one commercial customer.

During the quarter, PPP loans increased NIM by 1 basis point and contributed $154,000 to net interest income. Core margin, which excludes the impacts of excess liquidity and PPP, was 3.41%, an increase of 27 basis points when compared to the first quarter. Net interest income increased $4.8 million or 10.3% compared to last quarter.

On May 4, the Company entered into a four-year $250 million interest rate swap, under which the bank receives a fixed rate of 5.99% and pays a variable rate equal to prime. The notional amount of $250 million equates to approximately 13% of our variable loans. We view this as an opportunity to lock in a portion of the benefit implied by the forward curve.

Second, during the quarter, we recorded a provision for credit losses of $6.7 million. This was primarily driven by a $5.5 million provision resulting from our strong loan growth during the quarter and a provision totalling $1.8 million associated with two non-accrual loans. Our coverage ratio, excluding PPP loans, was 1.27% on June 30, which was consistent with March 31.

During the quarter, we experienced net charge-offs of $1.7 million or 12 basis points annualized. This was primarily driven by a charge-off related to one nonaccrual commercial loan. For the first six months of the year, we had net charge-offs of $1.8 million or 7 basis points annualized. Despite the event-driven

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

provision and charge-off related to nonaccrual loans, we are not seeing signs of pervasive credit quality deterioration in the portfolio.

Third, non-interest income decreased $1.2 million or 6.1% compared to the second quarter of 2021, which was driven by a $2.1 million decrease in net gains on mortgage banking and a $915,000 decrease in BOLI income primarily due to an $893,000 debt benefit claim in the second quarter of last year. Offsetting these decreases were increases in our insurance and investment management lines of business and our other service fee income streams.

Fourth, non-interest expense increased $6.1 million or 14.7% compared to the second quarter of 2021. This includes $1.4 million related to the digital transformation project, $511,000 resulting from the inclusion of the Paul I. Sheaffer Insurance Agency, which was acquired on December 1 of last year, $322,000 of guarantees paid to recently hired mortgage producers and $291,000 related to our expansion into Western PA and Maryland. Excluding these items, non-interest expense increased $3.6 million or 8.7% compared to the second quarter of 2021.

I believe the remainder of the earnings release was straightforward, and I would like to—we would now like to provide an update to our 2022 guidance. First, as a reminder, during 2021, net interest income totalled $173.4 million when excluding PPP income of $15 million. On last quarter's call, I had guided to loan growth of 9% to 10% for 2022.

Based on our strong growth during the quarter, we are increasing this guidance to 10% to 11%. We expect this to result in net interest income growth of approximately 21% to 23%, off the base of $173.4 million in 2021. This includes the impact of yesterday's 75 basis point rate increase and an assumed increase of 50 basis points in September.

Second, our provision for credit losses will continue to be driven by loan growth, changes in economic-related assumptions and the credit performance of the portfolio, including that of specific credits.

Third, excluding $1.1 million of BOLI debt benefits, 2021's non-interest income totalled $82.1 million. Last quarter, I guided that non-interest income would be flat to slightly down in 2022. We expect additional pressure on non-interest income due to the reduced saleable volume in our mortgage banking line of business and equity market volatility impacting our wealth management AUM. As a result, we expect non-interest income for the full year of 2022 to be down 5% to 8%, off the base of $82.1 million.

Fourth, our non-interest expense growth guidance of 10% to 11% off the 2021 base of $167.4 million remains unchanged. This includes our investments in the Maryland and Western PA expansion markets and our digital transformation. Excluding these investments, expenses are expected to be up approximately 7% for the year.

Lastly, as it relates to income taxes, based on our increased pretax earnings from the guidance updates, we expect our effective tax rate to be approximately 20% for the full year of 2022.

The cumulative impact of the above guidance for 2022 results in a core pretax pre-provision increase of 15% to 17% compared to 2021. We often highlight the strength of our diversified business model with approximately 29% of our year-to-date revenue being non-interest income. This diversification served us very well during the pandemic and during the last declining rate cycle. While we certainly—while certain fee income lines of business are now under pressure, it is more than offset by the benefit we are seeing in net interest income from our asset sensitivity.

This concludes my prepared remarks. We will be happy to answer any questions.

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

Austin, would you please begin the question-and-answer session?

Operator

Thank you.

Our first question is from Tim Switzer from KBW. Tim, your line is open.

Tim Switzer

Hey. Good morning. Thanks for taking my question.

Jeff Schweitzer

Good morning, Tim.

Brian Richardson

Good morning, Tim.

Tim Switzer

With the increase in loan guidance, a lot of that seems like it's probably driven off of the upside in Q2. I'm curious, are you guys still being conservative on—obviously, still strong loan growth going forward, but do you expect a moderation from here in the second half of the year at all just given like the Fed tightening and things like that or I'm just kind of wondering what your puts and takes are there.

Mike Keim

This is Mike Keim, Tim.

We feel comfortable with the guidance that Brian gave. The two things that have us kind of moderating guidance for lack of a better term because we don't believe we will continue the same pace that we did, obviously, in the second quarter is we continue to see some payoff activity with our customers. That's always kind of pulling us back a little bit. I think to the heart of your question is, the question would be is loan growth being pulled forward as a result of what people see the Fed doing from an interest rate perspective. That we don't have a definitive answer for, but those are two cautionary things relative to the pace of growth that we've had previously and driving the guidance that Brian gave everybody.

Tim Switzer

Okay.

Yes, I mean, obviously, it's still pretty strong growth. I guess my question is like, is there a chance for upside if, say, the economy—I guess the GDP numbers just came out two negative quarters GDP growth. But if the economy can come out of this, we don't have a hard landing. There's—you would think there's probably upside here? Like have you seen a deceleration in loan growth yet at the beginning of Q3 or anything?

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

Mike Keim

No. We have not seen any demand for loans slow down, but we do always have the risk for payoff activity that we manage. Like I said, while we haven't seen it, there is the possibility that some activity has been pulled forward as people reflect on the fact that the Fed continues to raise interest rates.

Tim Switzer

Right. Okay. That all makes sense.

On your NII sensitivity, I think last quarter, you guys mentioned there was about $4 million to $4.5 million of annual NII for each 25 basis points. How does the swap impact that? Just given that we're deeper into the rate cycle, rates are higher, that should probably lessen the impact as well. If you could maybe update us on the sensitivity?

Brian Richardson

Correct. This is Brian.

Yes. It was a little bit higher when we had given last quarter. However, you would expect, clearly, the swap has an impact. But also, as you said, as we move through this rising rate environment, we said the initial handful of 25 basis point moves were expected to contribute kind of in that $4 million range.

Considering that we've kind of migrated forward here, had some increases up to this point as well as the impact of the swap, we expect each incremental 25 basis point after the 50 in September to contribute in that $2 million to $3 million range on an annualized basis.

Tim Switzer

Okay. That's great. That's all from me. Thank you, guys.

Brian Richardson

Thank you.

Operator

Our next question is with Frank Schiraldi from Piper Sandler. Frank, your line is open.

Frank Schiraldi

Good morning, guys.

On the liquidity front, you mentioned you're getting back to pre-pandemic levels. Obviously, you have some seasonal swings in deposit balances. I was just wondering what a good (inaudible) it might be for where you targeting or where you expect the loan-to-deposit ratio to trend here in the coming quarters.

Brian Richardson

Frank, this is Brian.

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

Pre-pandemic, we had managed kind of in that 100 to 105 loan-to-deposit ratio range. We would expect to continue to do that going forward. While we did see kind of that runoff of excess liquidity, it was really largely isolated to the handful of things that I called out in the earnings release as well as in my prepared remarks.

Quite honestly, we saw personal accounts, consumer accounts down like a total of $13 million on a $2.3 billion base for the quarter. We didn't see significant decreases across the board. It was really driven by that public fund decline, which is seasonal, as well as one large outflow related to a commercial customer.

Frank Schiraldi

Right. Yes.

On that—that was my follow-up on the large outflow. Any more color there? Was it all rate? Have you gotten any more aggressive in maybe defending these relationships?

Brian Richardson

It wasn't rate-driven at all, quite honestly. It was funds that had been held by a fund that were ultimately deployed for investment purposes. It was just kind of capital calls that have been funded up and then deployed subsequently.

Frank Schiraldi

Okay.

Then in terms of the buyback, you bought back, I think, like 300,000 shares. You have a little bit, I guess, more than that under the current authorization. I know it's a Board decision, but just trying to think about buybacks here going forward. Is that something you think you continue to utilize in the coming quarters?

Jeff Schweitzer

Yes. Similar to what we announced last quarter, Frank, this is Jeff, is we continue to be planned to be on that pace of 150,000 shares a quarter until we exhaust what's currently authorized. Then we'll have a discussion with the Board on do we provide some more powder there to continue going forward.

Frank Schiraldi

Okay.

Then just lastly on that specific reserve related to the commercial real estate loan that was put on nonaccrual, any color you can give there in terms of geography or any further detail on that one?

Brian Richardson

Yes. The specific reserve, not the charge-off, but the one that was placed on nonaccrual when we booked the $1.1 million reserve on. It's a CRE property mixed use in our core market. There's been some occupancy challenges as well as some delinquent taxes that really drove the current—putting it on nonaccrual as well as the reserve need. However, we are working through that and discussing it with the borrower, and we'll continue to kind of do so. But we thought it was prudent to put it on nonaccrual year in the quarter.

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

Frank Schiraldi

Okay. Is that retail mix with multifamily?

Brian Richardson

Yes.

Frank Schiraldi

Okay. Thank you.

Brian Richardson

You're welcome. Thank you.

Operator

Our next question is from Samuel Varga from Stephens. Samuel, your line is open.

Samuel Varga

Good morning.

Brian Richardson

Good morning, Samuel.

Samuel Varga

I wanted to ask just one more question on the loan growth front. Could you give some color on the C&I utilization rates at this point?

Mike Keim

Is that line utilization rates that you're asking about?

Samuel Varga

Yes, that's correct.

Mike Keim

Our commercial line utilization is somewhere around 38% to 39%.

Samuel Varga

Do you expect to there to be any sort of the expansion?

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

Mike Keim

That's—the 38% to 39% is kind of in that historical range as it has been for us.

Brian Richardson

Pre-COVID.

Mike Keim

Pre-COVID. In the COVID cycle, it did decline. This is a jump back a little bit. We did benefit somewhat in our loan growth in the second quarter from line utilization, but these are at historical levels.

Samuel Varga

Understood. Thank you.

Then my last question is just on the public funds. Could you give some specific color on kind of the size of what sort of inflows you're expecting in the second half of this year as those return?

Brian Richardson

Yes. We always kind of see that build with tax collections and the like kind of anywhere from that $200 million to $500 million range in the third quarter into the fourth quarter is what we normally see out of the public funds book.

Samuel Varga

I guess just as a follow-up to that, if I can sneak one more in. We've heard some commentary this quarter around these relationships being slightly more rate-sensitive. Could you give some color on what you're seeing specific to your relationships?

Brian Richardson

Sure. On the public fund side, they tend to certainly be more rate-sensitive. Largely, as they build on an annual basis, you see pretty close to, give or take, 100% beta as you look at it overall. There'll be certainly some pressure there.

In the last rising rate environment, we saw a 45% beta on deposits. We expect that to kind of play through here through this rising rate cycle. There will be just based on the timing of the build and the like that there could be some volatility in beta quarter-to-quarter, but we expect these things to normalize over the coming quarters or coming year that will end through this cycle. We'll see that 45% beta on the rising rate environment.

Samuel Varga

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

Jeff Schweitzer

Thank 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

Operator

At this time, there are no further questions registered. So I would like to pass the conference back to the management team for any closing remarks.

Jeff Schweitzer

Thank you, Austin, and thank you, everybody, for joining us today. We continue to—as I said earlier, our growth engine continues to really provide us benefits and will provide us future benefits, obviously, as we continue to manage through this and help pay for our investments in technology in new markets. We're pleased with the quarter, and we look forward to talking to everybody again at the end of the third quarter. Have a great day.

Operator

That concludes today's call. Thank you for your participation. You may now disconnect your lines.

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