WSFS Financial Corporation [WSFS]
1Q 2023 Earnings Conference Call
Tuesday, April 25, 2023, 1:00 PM ET

Company Participants:
Rodger Levenson; Chairman, President and Chief Executive Officer
Dominic Canuso; Executive Vice President, Chief Financial Officer
Art Bacci; Executive Vice President, Chief Wealth Officer
Steve Clark; Executive Vice President, Chief Commercial Banking Officer
Shari Kruzinski; Executive Vice President, Chief Consumer Banking Officer

Analysts:
Frank Schiraldi; Piper Sandler & Co.
Timothy Switzer; Keefe, Bruyette, & Woods, Inc.
Manuel Navas; D.A. Davidson & Co.
Feddie Strickland; Janney Montgomery Scott LLC
Russell Gunther; Stephens Inc.

Presentation:
Operator: Welcome everyone to the WSFS Financial Corporation First Quarter 2023 Earnings Call. (Operator Instructions) I'd now like to turn the call over to your host for today, Mr. Dominic Canuso, Chief Financial Officer. Sir, you may begin.

Dominic Canuso: Thank you, Brent, and thanks to all of you for taking the time to participate on our call today. With me on this call are Rodger Levenson, Chairman, President and CEO; Art Bacci, Chief Wealth Officer; Steve Clark, Chief Commercial Banking Officer; and Shari Kruzinski, Chief Consumer Banking Officer.

Before I begin with the remarks on the quarter, I would like to read our Safe Harbor Statement. Our discussion today will include information about our management's view of our future expectations, plans and prospects that constitute forward-looking statements. Actual results may differ materially from historical results or those indicated by these forward-looking statements due to risks and uncertainties, including, but not limited to, the risk factors included in our annual report on Form 10-K and our most recent quarterly reports on Forms 10-Q as well as other documents we periodically filed with the Securities and Exchange Commission. All comments made during today's call are subject to the safe harbor statement.

Good afternoon and thank you again for joining our first quarter 2023 earnings call.

Our Earnings Release and Earnings Release Supplement, which we will refer to on today's call, can be found in the Investor Relations section of our company's website.

The strength of the WSFS franchise was demonstrated in this unique quarter. As a result of our relationship-based banking model, concentration risk management, and diversified fee revenues, first quarter Core PPNR% was 2.29% and Core ROA was 1.27%.

Given the significant noise and disruption throughout the industry during the quarter, I will first share details and perspectives on the strength and composition of our customer deposit base, liquidity capacity, and Capital position, followed by additional details on our financial performance in the quarter.

Shown on slide 4, our customer deposit franchise is very diversified with significant deposits from our Consumer branch network, Commercial, Small Business, Trust and Wealth lines of business, with a bank average balance per account of $33,000. We also have granular concentrations with no more than 5% of deposits sourced from any one industry.

73% of our deposits are insured and protected with 64% FDIC insured and another 9% Collateralized or otherwise protected. Non-interest-bearing demand deposits comprise 33% of customer deposits, with no-and-low interest demand making up 53%. From year-end 2022 through March 8th, deposits were flat, and declined 1% in the full quarter.

Presented on slide 8, at quarter end, we utilized $1.1 billion of wholesale funding, which is only 6% of total balance sheet funding and 13% of total readily available funding, leaving $7.9 billion of readily available and secured borrowing capacity. This capacity equates to 50% of customer deposits and almost double uninsured and unprotected deposits.

Capital levels remain well above well-capitalized. Illustrated on slide 12, we provide details of our Investment Portfolio and Capital levels. When reducing Capital by the effective AOCI, which includes the full impact of the HTM portfolio, all regulatory bank ratios remain above well-capitalized.

Detailed on slide 5, Gross loans grew $230 million in the quarter with $155 million from Commercial and $68 million from our Spring EQ Consumer Partnership. Our Consumer loan growth moderated in the quarter as the Upstart portfolio was flat at $237 million or 2% of total Gross Loans. Our Commercial loan composition is highly diversified in both the C&I and Owner-Occupied Portfolio and the CRE Investor and Construction Portfolio, as seen on Page 6.

The first quarter Net Interest Margin was 4.25% with loan yields increasing 44 basis points to 6.42% as more than 50% of total loans are variable. The interest-bearing deposit beta increased to 28%, resulting in total deposit costs of 80 basis points in the quarter with no-and-low interest demand deposits cost of 23 basis points.

With over 25 discrete fee lines of businesses or products, Core fee revenue was $63.7 million with 5% growth versus the first quarter of 2022 with a Core fee revenue ratio of 25.8%. Wealth Management contributed just under 50% of total Core Fees. Excluding fee income from BMT Insurance Advisors, which was sold in 2Q 2022, the year-over-year fee growth was 7%.

The core efficiency ratio in the quarter was 53.9%, demonstrating continued discipline in cost management. Expenses in the quarter included a $2.3 million benefit for a couple non-recurring items in salaries and benefits. When excluding these items, the efficiency ratio would be approximately 55%.

Overall asset quality remained relatively stable, as shown on slides 10 and 11. Problem Assets continued the post-COVID positive trend and NPAs remain stable and at historical lows. Delinquencies increased 32 basis points to 83 basis points of gross loans primarily due to two C&I long-term problem loan relationships with one of these relationships still accruing. Although these relationships pertain to long-term care facilities, our overall long-term care portfolio is approximately $130 million in total outstandings or 1% of gross loans.

In the quarter, net charge-offs increased to 40 basis points of average gross loans driven by slightly higher Commercial portfolio charge-offs, normal maturation of both NewLane Leasing and the Upstart portfolio, along with lower recoveries in the quarter.

Provision in the quarter was $29 million, which includes a $17.3 million increase in the ACL due to economic forecast and uncertainty along with new loan originations and other credit trends in the portfolio.

The ACL coverage ratio increased 11 basis points to 1.28% and is 1.50% when including estimated remaining credit marks on the acquired portfolio.

Clearly there are rapidly changing dynamics in our industry impacting the financial results, and this uncertainty is expected to continue. As we typically do each year, we will provide an update to our full-year Outlook when we report our second quarter earnings.

In summary, overall we had a solid performance in the quarter with a strong ending balance sheet. And while uncertainty remains in the macro-economic outlook and near-term market conditions, WSFS is well positioned to continue to focus and execute on our Strategic Plan objectives and to serve our current customers and communities.

We will now open the line to answer any questions you may have.

Questions & Answers:
Operator: [Operator Instructions] Your first question is from the line of Frank Schiraldi with Piper Sandler.

Frank Schiraldi: Just wondered if you could, Dominic, talk a little bit about -- and recognizing that you will update guidance next quarter, but any sort of color you can give on thoughts, updated thoughts on deposit betas, just given what we saw in the industry late in the quarter and what you guys saw mix shift in the quarter?

Dominic Canuso: Sure. Thanks, Frank. Clearly, deposit betas had stepped up in the quarter to 28%. That's slightly higher than the run rate expected at the earlier stages of the year. Our Outlook at the beginning of the year suggested that deposit betas would end 2023 in the high 30s. Given the disruption and a higher rate environment, it's possible that those deposit betas end in the mid-to-high 40s, but it's still clearly early in the year.

Frank Schiraldi: Okay. And that's interest-bearing deposit beta, correct?

Dominic Canuso: That is correct.

Frank Schiraldi: Okay. And then just if you can share with us -- I know given the Trust business, there are some nuances to your deposit base. But I wonder if you could maybe talk a little bit about the non-interest-bearing portion of the deposit base and where you see -- I don't know if you can talk to what you've seen early here in the second quarter. But just curious what your thoughts are on maybe continued outflows there or where you could see maybe these levels stabilizing as a percentage of total deposits.

Dominic Canuso: Sure, Frank. So, I would say we continue to see opportunity overall to grow the Trust deposit business, but it is impacted by flows in capital markets. And given the disruption in the rate environment and the liquidity environment, those have slowed. Much of that is non-interest-bearing, however, some are, and we would expect to continue to be competitive and look for opportunities to grow.

But similar to the market conditions in the near term, it may be a little bit difficult to predict the pace of new deals coming to market and the deposits from that business. But overall, we believe we're well positioned to grow our market share and increase deposits over time.

Frank Schiraldi: And then just lastly if I could, just given some of the uncertainties you spoke to in the industry at large, what are your -- any updated thoughts on putting capital to work through organic growth and how you -- how that sort of stacks up against further buybacks here in the near term?

Dominic Canuso: Sure. As we've said in the past, when we think about our capital return philosophy, we first look through the lens of the economic and credit environment then look to fund organic growth and inorganic growth. And then to the extent there is excess capacity, we would return that to shareholders.

Given the environment we're in, we continue to evaluate that macro-economic and credit environment. And we'll typically, as we do, take a quarter-to-quarter basis for those share repurchases. There continues to be opportunity for organic loan growth as seen in the quarter, and we will continue to serve our customers, retain our customers and grow where we feel appropriate, but we believe we have the capacity to do that.

Operator: [Operator Instructions] Your next question is from the line of Feddie Strickland with Janney Montgomery Scott.

Feddie Strickland: Thanks for the detail in the deck on liquidity. Am I understanding correctly, you have $4.2 billion of capacity of FHLB based on currently pledged securities, and then that $2.1 billion is unpledged but pledgeable so, there's a $6.3 billion total capacity at FHLB. Is that right?

Dominic Canuso: That's right. That's the distinction we've made to differentiate between what's readily available and what we could do over time to increase our capacity if needed.

Feddie Strickland: Got it. And given that, do you expect that you'll continue to utilize wholesale funding just via brokered and FHLB borrowings on the balance sheet? And I guess, is the trajectory higher from here for that?

Dominic Canuso: Clearly, that will be driven by net loan growth. And we do expect the Investment Portfolio to continue to cash flow at $50 million a month, so that will fund some of the loan growth. But to the extent loan growth is greater than that and depending on deposit trends, we would utilize wholesale funding and typically, we would be opportunistic across the various sources based on rate. What we focused on more recently was brokered CDs, given the advantage we have on the rate side there, but we would leverage all lending sources as appropriate.

Feddie Strickland: Got it. And then just one last one for me, just trying to interpret where we see provision going from here and understand you guys will provide updated guidance next quarter. But understand the economic factors changed this quarter, but does that mean provision continues to be around this $30 million a quarter number all else equal? Or is that change now factored in, and we see provision potentially normalize back to something around the fourth quarter number?

Dominic Canuso: Yes. So it's a good question. I think as the ACL model incorporates forecast itself, I think it has captured the current level of economic uncertainty and forecast, but that could change by the quarter. It will primarily be driven by the net loan growth and mix in the portfolio. This quarter was relatively outsized as we stepped up from a 1.17% ACL coverage to the 1.28%. We feel good that, that represents the risk identified in the forecast that we're using. From here on out, it's really going to be driven on that economic forecast and the net loan growth.

Operator: [Operator Instructions] Your next question is from the line of Tim Switzer with KBW.

Timothy Switzer: I'm on for Mike Perito. I had a quick follow-up on kind of the credit talk there. It seems like a lot of the charge-offs this quarter was driven by your Consumer portfolio such as Upstart. Can you talk about the expected impact if that normalization continues, like where net charge-offs could drift from here at least the impact from those select consumer portfolios?

Dominic Canuso: Sure. The first thing I would clarify though is they still continue to be relatively small in the charge-off pool. But because they are maturing portfolios, they had stepped up over the last few quarters. We would expect Upstart and NewLane leasing from here to be relatively stable and then really driven by the larger portfolios.

Timothy Switzer: Okay. Were you saying you expect the charge-offs to be stable or the size of those portfolios?

Dominic Canuso: The size of the portfolios.

Timothy Switzer: Oh, okay. All right. That's understood. And on the securities portfolio, have you guys seen any opportunities to maybe reposition it a little bit or sell some parts when you get some rate volatility maybe gives you an opportunity to sell and re-deploy into some builds or something like that?

Dominic Canuso: Sure. Great question. And as a reminder, we continue to evaluate that portfolio. In the second quarter of 2022, we did reposition about $1 billion from AFS to HTM. We continue to monitor and at this point in time, it would be NPV negative. And given our liquidity position and capital positions, we're comfortable with the Investment Portfolio cash flowing at this point in time.

Operator: [Operator Instructions] Your next question comes from the line of Russell Gunther with Stephens.

Russell Gunther: I wanted to ask on the loan growth outlook and appetite, whether yours has changed at all and if you're seeing any opportunity from a commercial lender lift-out perspective as perhaps some peers with dialed back expectations struggle a bit?

Steve Clark: Russell, this is Steve Clark speaking. So, I would say, broadly, we remain open for business. And we certainly continue to entertain both C&I and CRE opportunities. I would say the focus is on supporting our customer base. And certainly, the bar is higher in the CRE space. But we believe staying relationship-focused when there is an opportunity, it has to be a meaningful new relationship coming to us, and we'll entertain that. In terms of talking to other potential relationship managers in the market, there certainly is disruption. We have ongoing dialogue with candidates across the footprint, and we'll just have to see where those leads. Nothing definitive at this point in time.

Russell Gunther: Okay. Great. I appreciate that. And then, Dominic, are you guys contemplating any steps to kind of lock in asset sensitivity as we think about the potential for rates to go the other way maybe as early as the beginning of next year?

Dominic Canuso: Yes, absolutely. We continue to evaluate our interest rate risk profile, particularly the asset sensitivity and the potential for a down rate environment, although that may be a little longer than expected. And we have taken some positions to put some floors in place, again, really managing more from an interest rate risk profile perspective than significant changes in the overall asset sensitivity of the balance sheet.

Russell Gunther: Okay. Got it. Helpful. And then just the last one for me. I appreciated the thought around where interest-bearing deposit betas may end up. Are you guys able to share kind of what the March margin was and kind of where the cost of deposits exited the quarter?

Dominic Canuso: Sure. I can share. We in the materials show an 80 basis point cost deposits and that ended March just under 1%.

Operator: [Operator Instructions] Your next question comes from the line of Manuel Navas with D.A. Davidson.

Manuel Navas: What should we expect out of kind of medium-term loss rates in the NewLane portfolio or the Upstart portfolio?

Dominic Canuso: Sure. Yes. So, we've underwritten the Upstart portfolio to the mid-6 levels and have reserved for those levels. They are just starting to approach the model levels as the portfolio matures. Similarly, on the leasing portfolio, it's going to be around 1%, if not just under. And again, as that total book matures as it's getting to, we would see those levels stabilize.

Manuel Navas: You were getting on the leases about 9% yields last quarter. Is there an update to that number this quarter?

Dominic Canuso: Yes. It's, I believe, slightly over 10% at this point.

Manuel Navas: On new leases?

Dominic Canuso: Yes. On new business.

Manuel Navas: Okay. And roughly, what's the Upstart yields currently?

Dominic Canuso: Currently, it's about 16%.[1]

Operator: And with no further questions in queue, I'd like to turn the conference back over to Mr. Canuso.

Dominic Canuso: Thank you all for joining the call today. If you have any specific questions following this meeting, feel free to reach out to me directly. Also, Rodger and I will be attending conferences and investor meetings throughout the quarter, and we look forward to meeting with many of you then. Have a good day.

Operator: This concludes today's conference. You may now disconnect.

[1] For additional clarification, the stated rate refers to the customer interest rate; our current yield on newly originated Upstart loans, net of fees and costs, were between 13% - 14%