WSFS Financial Corporation [WSFS]
3Q 2023 Earnings Conference Call
Tuesday, October 24, 2023, 1:00 PM ET

Company Participants:
Rodger Levenson; Chairman, President and Chief Executive Officer
Art Bacci; Executive Vice President, Chief Wealth Officer and Interim Chief Financial Officer
Steve Clark; Executive Vice President, Chief Commercial Banking Officer

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

Presentation:
Operator: Hello and thank you for standing by. My name is Regina, and I will be your conference operator today. At this time, I would like to welcome everyone to the WSFS Financial Corporation Third Quarter 2023 Earnings Conference Call. [Operator Instructions] I'd now like to turn the conference over to your host for today, Mr. Art Bacci, Chief Wealth Officer, Interim Chief Financial Officer. Sir, you may begin.

Art Bacci: Thank you, Regina. Good afternoon and thank you again for joining our Third 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 website. With me on this call are Rodger Levenson, Chairman, President and CEO and Steve Clark, Chief Commercial Banking Officer.

Before I turn over the call to Rodger for his 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 Form 10-Q, as well as other documents we may periodically file with the Securities and Exchange Commission. All comments made during today's call are subject to the Safe Harbor statement.

I will now turn the call over to Rodger.

Rodger Levenson: Thank you Art and everyone else for joining us on the call today.

WSFS performed very well in the third quarter as we continue to demonstrate the strength and diversity of our business model. Core EPS of $1.23 and Core ROA of 1.46% represented growth from the second quarter of 6% and 4% respectively.

Our performance was driven by loan growth across all Commercial and Consumer segments. Deposits were essentially flat compared to 2Q, excluding the anticipated run-off of short-term, transaction-related deposits in our Corporate Trust business.

The Net Interest Margin remained very solid at 4.08% reflecting the impact of the Fed hike in short-term rates in July, expected increase in deposit betas, and very modest deposit attrition. Through the cycle interest-bearing deposit betas ended the quarter at 39% as the pace of growth continued to moderate. NIM was favorably impacted by about 5 basis points due to higher purchased loan accretion and maturity events in a few reverse mortgages.

Core fee revenue grew 9% linked quarter and was a record quarterly high. Growth came from each of our major business lines including Wealth & Trust, Cash Connect, Mortgage Banking, Capital Markets, and the Core Banking business. The core fee revenue ratio increased to 28.60%.

Consistent with the slowing economy and corresponding credit normalization, we did see a negative uptick in our Asset Quality metrics. Most of this variance was driven by two unrelated C&I credits that moved to non-performing status due to operating challenges specific to those businesses. Problem asset migration reflected downgrades in Commercial sectors including Office. Inclusive of these downgrades, the Office Loan portfolio has 6% problem loans, zero delinquency and less than $1 million in NPAs. Total Classified Assets to Tier 1 Capital plus ACL stood at 16.11% or just under 3% of total loans. Credit losses were relatively flat to Q2 at 45 basis points or 19 basis points excluding NewLane Leasing and Upstart portfolios.

Our balance sheet remains strong including significant liquidity capacity and regulatory capital levels that continue to exceed "well-capitalized."

On slide 14 of the Earnings Release Supplement, we have provided an update to our Mid-Year 2023 Outlook incorporating Q3 results and commentary on Q4 ranges on NIM, PPNR, and ROA percentages. Overall, we remain on track to achieve the Full-Year Outlook which assumes no additional short-term rate hikes and modest GDP growth in Q4.

Consistent with our historical practice, we will provide a 2024 Outlook when we announce Q4 Earnings in late January.

Thank you, and I will now turn it back to Art to facilitate the Q&A.

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

Questions & Answers:
Operator: [Operator Instructions] Our first question comes from the line of Frank Schiraldi from Piper Sandler.

Frank Schiraldi: I wanted to ask about the loan growth here. I mean, obviously quite strong in the quarter. You reiterated your guide overall for 2023. But as we sort of think about -- you guys have an opportunity given your low loan-to-deposit ratio, but also, we're seeing maybe a tougher credit environment. So how do you think about the opportunity versus a potential risk here? Do you think we start to see some moderation in this loan growth going forward here? What are your thoughts in general?

Steve Clark: Frank, this is Steve Clark speaking. So, I think the way we look at the loan growth is really about opportunity in the current macro environment in the current region we serve. So, on CRE, we continue to be very, very selective. We have focused on multi-family and residential, particularly at the beach and shore markets.

But the real opportunity for us is C&I. That pipeline is relatively strong. It's the result of some of our competitors being distracted and some of the service issues companies are experiencing from their incumbent banks. So that creates opportunity for us.

So, we're very active in C&I calling and prospecting very selective in CRE but do have a tailwind of fundings coming from commitments that were extended last year and were underwritten in a higher rate environment and very sensitized to the rate environment. So that's kind of my perspective.

Frank Schiraldi: Okay. All right. I appreciate it. And then just on credit, I think the coverage ratio -- reserve coverage ratio was flat linked quarter. Just given some of the downgrades on the problem asset side, could you just maybe speak to that a bit? And was this sort of -- was this credit migration kind of baked into the reserve already? Or just your general thoughts on reserving and the credit migration, particularly on the problem asset side?

Art Bacci: Frank, this is Art. The ACL was flat at 1.28%. Remember, a good portion of that was because of just loan growth. So that was less impacted by any migration issues. I mean, this is something we will continue to evaluate throughout the quarter as we look at the economic outlook and the trends we're seeing. But at this point, we feel pretty comfortable with the coverage ratio where it is.

Steve Clark: And Frank, this is Steve. I would only add that the credit migration you referenced is those assumptions are baked into the current ACL from both a qualitative and quantitative perspective.

Frank Schiraldi: Okay. And then if I could just sneak in one last one on the deposits. You guys mentioned the Trust deposits that flowed back out the transactional stuff. And I guess that was a driver of the non-interest bearing balances being down linked quarter. Just any of what you're seeing more generally there? Do you expect kind of a continued slow bleed in non-interest bearing balances in this kind of higher for longer rate environment?

Art Bacci: Frank, this is Art. I'll take that. When you look pre-COVID, our non-interest bearing to total deposits is around 27% - 28%. We're at about 31% now. So, we're still above where we were pre-COVID. There may be a little bit more bleed to go there, but I think we're kind of towards the bottom of it.

On the Trust deposits, there's really two components of our Trust deposits. One is kind of a I'd call it right now $700 million to $800 million base. It's just recurring cash flow coming in from loan payments that we pass on to investors.

Then there's a component where there may be certain types of Trust that are prefunded with cash, and we hold for a period of time, that's the lumpy component of it. And so that's really a function of how the securitization market is going. We do have a pipeline that we're looking at that potentially has some more non-interest bearing deposits in Q4. But it's really driven by the capital markets and the securitization activity and the type of deals that are being done in the market.

Rodger Levenson: Yeah. Frank, this is Rodger. The only thing I would add to it, just building on Steve's comments about our Commercial loan business. With C&I being the largest segment, the deposits come with those relationships and with the overall focus more broadly on relationships, in addition to Wealth, we have a strong focus on full relationships in the Commercial space, which should give us some ability to offset, as Art said, some of the lingering absorption of the excess liquidity in the Consumer book.

Operator: Our next question comes from the line of Russell Gunther with Stephens.

Russell Gunther: Just a quick follow-up on the loan growth question earlier. Appreciate your comments there. Obviously, a good environment for you guys to continue to take share from competitors, given your positioning. How is the environment for taking Commercial lending talent? Does that still remain an opportunity? And any wins in the quarter?

Steve Clark: So, Russell, Steve Clark. So yes, it remains an opportunity. No, there were no wins in the quarter, but we have active outreach, and we're receiving inbound calls from relationship managers in the market who are interested in joining the WSFS team. So, we have active dialogue, and we believe there will be some talent coming our way in future periods, but nothing to report in the third quarter.

Rodger Levenson: I'll just say that with our competitive positioning, we're the natural landing spot for talented relationship managers, particularly from larger banks. And you've seen that as the relationship manager group has expanded over the last several years under Steve's leadership. The bar though is very high to join us at this point. Obviously, we want people who can move business with them joining us and are also culturally consistent and have a same kind of philosophy around relationship banking. So, we get a lot of inbound calls, but the bar for us is definitely higher in terms of the quality of people that we would bring over.

Steve Clark: And Russell, Steve, this is Steve Clark again. I need to correct myself and had my quarters confused. So, we actually did add two RM talent in the quarter, one in the Philadelphia market, long tenured relationship manager came to us from a large national bank. So, he's housed in Philadelphia. And then a healthcare RM, long experienced RM in the market, joined our health care vertical. So those two RMs did occur in the third quarter.

Russell Gunther: Okay. Great. I appreciate the color on that. And then just quickly switching gears from a margin perspective, cash balances came down quite a bit this quarter. Can you just remind us kind of where they stand today relative to maybe a base you like to remain at but maybe relative to total assets?

Rodger Levenson: Yes. I would say, Russell, the balances are within the range of kind of what our long-term goals are. Remember, it fluctuates a little bit depending upon what's going on with Cash Connect, and the on-balance sheet, off-balance sheet business and then overall liquidity planning.

And right now, we're within our liquidity goals. So, it should stay in and around this range.

Russell Gunther: Okay. That's helpful. And then I know we'll get a full-year outlook in a few months. But as we think about your updated margin range for the fourth quarter, just bigger picture, how are you guys thinking about where that can ultimately trough even just from a timing perspective? We've seen competitors this quarter talking about trough in 3Q, 4Q, how are you guys generally thinking about the timing there?

Art Bacci: Yes. Russell, we're kind of -- assuming rates stay where they're at, we're thinking somewhere second quarter next year, we start to see bottoming of the margin. There's still some opportunity with -- to us to increase our betas slightly, we have some budget left in our beta to where we do see some competitors increasing rates, and we certainly want to protect our relationships.

And as Steve said, a lot of our new business comes with deposit relationships. But I think in the second quarter, we'd start to see a bottoming of the NIM.

Russell Gunther: Great. And last one for me. On the net charge-off outlook, again, bigger picture. You mentioned core kind of 19 basis points ex NewLane and Upstart. Just have a general sense for your expectation for Consumer charge-off trends in the near term?

Art Bacci: The Consumer charge-off trends have been pretty much within our expectations. The last two quarters, they've been consistent. So, I think we're kind of normalizing at a pretty steady rate for the -- and those being mostly the Upstart portfolio and the NewLane portfolio and even though that's more of a leasing small business, but those seem to have kind of leveled out at this level.

Operator: Your next question comes from the line of Feddie Strickland from Janney Montgomery Scott.

Feddie Strickland: Can you update us on expectations for earnings and total asset growth as you allow the investment portfolio to run off. I think in the slides, it says you're targeting 18% from 24% today. And then along those same lines, should we see the balance sheet relatively flat or maybe even shrink from here near term? Just trying to get a sense for where total assets could go?

Art Bacci: I think we would see total assets pretty much remain flat. I think our mortgage-backed securities portfolio had been elevated because we had the excess liquidity over the last few years, and we're allowing that to run down to more traditional levels, around 20% or so, and that's going to take a few years.

But we're seeing, as we said, in the supplement about $1 billion of run-off in that portfolio over the next two years to kind of look at that as $1 billion of runoff that can be redeployed into our loan portfolio and a nice pickup in yields on that transition and mix shift.

Feddie Strickland: That makes sense. And just one more from me. I mean, could we see overall fee income come down some in the fourth quarter, just given the guidance of mid-single digits for the year, and if so, is that driven by any business line in particular?

Art Bacci: I would tell you that the fee income has a little bit of noise at times just because of the income we generate from some BOLI and derivative costs. The core components of it, Wealth, Cash Connect and the core banking fees continue to have gone up at the range we projected.

We did have a strong quarter in our capital markets area, which helped drive up this quarter's fee revenue, so that's why you see the 9%. I wouldn't expect it to continue to grow at 9%. I think back to our normal expectations of mid-single digit would be more appropriate.

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

Manuel Navas: Just going back up to the loan growth expectations. So, I understand the selectivity in some portions of the book and the opportunity in others. How do you include the expectations for a bit of that recession at the end of the year in your growth projections?

Rodger Levenson: I would just generally say, as we mentioned, Manuel, most of our growth is coming from taking market share. And so even if there was a contraction from the run rate on GDP growth, which is obviously what we would expect. We don't believe that would have in the near-term, an immediate impact on the loan growth.

Longer term, it would depend on the path of the economy. But most of where we're seeing our growth is from taking market share and, to a lesser degree, expanding existing relationships.

Manuel Navas: And you talked about a pipeline of construction and there are some nice construction gains in the quarter. Can you just kind of talk about that a bit, just what trends you're seeing there?

Steve Clark: So, Manuel, Steve Clark. So, looking back over the past year, so into early 2022, when we approve construction financing for multi-family or for residential subdivision, equity from the borrower goes in first. And again, we're underwriting in the range of 65% to 75% loan-to-cost.

So that equity is significant, goes in first. And now those unfunded commitments that we settled on and closed on last year our funding this year. So that is a tailwind in our loan growth. And again, those loans were underwritten in a higher rate environment and sensitized to an even higher rate environment to make sure the appropriate coverage would be there at completion of the multi-family project or interest reserve on a residential lot subdivision project.

Manuel Navas: I'm sure that tailwind is captured in the guidance. Is -- can you quantify the benefit to 2024 from some of that?

Steve Clark: Yes. I can't quantify it at this point.

Manuel Navas: I'll shift questions. I understand we'll get an update next quarter. Thinking about that NIM bottom in the second quarter of '24, is the expectation there that you'll see stability in the NIM? Or could it even start to rise? And this is assuming no more hikes and kind of a flat Fed funds environment?

Art Bacci: Yes. I think it would stabilize and we see some leveling for a period of time. But again, as the portfolio mix changes from the MBS over to the loan, we'd be picking up 450 to 500 basis points on that mix shift. So that would start to bring the yields up over some period of time. Obviously, it's not going to be immediate, but yes, assuming all else equal, I would say, second half of the year, we'd start to see some lift in the NIM.

Manuel Navas: Kind of building on that, are we getting close to the peak of the loan yields? Or are we -- could that still mix a little bit higher? Just look at loan yields alone at around 680. What are kind of thoughts of that progression, if rates stay the same, stay flat from here?

Art Bacci: At this point, we have some originations that are coming in over 690 into the low 7s, but I think it really depends on the mix of loans we're bringing in. But the pricing, which is assuming no change in rates, I'll look at Steve, I think we're pretty much -- we're comfortable where our pricing on the loan side is.

Steve Clark: Yes. So, I would not expect a significant increase in yield unless the Fed raises interest rates are books 55% variable. So, we would benefit from a Fed increase. But I would not predict higher yields, significantly higher yields going forward absent that.

Manuel Navas: Okay. But you're still going to benefit from the securities yields of $230 million going to loan yields over time?

Steve Clark: Correct.

Manuel Navas: You made a comment about the -- some room on deposit beta versus kind of your target. It seems like you're kind of outperforming in the recent quarters. How are you thinking about using some of that leftover higher beta target to kind of maybe protect your deposit flows? Like just talk about that strategically, and I'll leave it there.

Art Bacci: We -- our ALCO committee looks at what the competitive pricing is and we talk about it every month. We do see some competitors that have some higher rates. And again, to protect relationships, we will do exception pricing where it's necessary, and that's really left up to a line of business leaders to determine that exception pricing.

So, we do believe we have the ability to where necessary increase some rates to manage the relationship. We're not doing it across the board to just go raise deposits. We're not in the position of needing to get additional liquidity. But certainly, we've acquired some very strong relationships and those we want to protect.

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

Art Bacci: Thank you again for joining the call today. If you have any specific follow-up questions, please 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. Have a good day.

Operator: That will conclude today's meeting. We thank you all of joining. You may now disconnect.