WSFS Financial Corporation [WSFS]
4Q 2023 Earnings Conference Call
Friday, January 26, 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
Shari Kruzinski; Executive Vice President, Chief Consumer Banking Officer

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

Presentation:
Operator: Hello and welcome to the WSFS Financial Corporation Fourth Quarter Earnings Call. [Operator Instructions] I'd now like to turn the call over to your host for today, Mr. Art Bacci, Interim Chief Financial Officer. Sir, you may begin.

Art Bacci: Thank you. Good afternoon and thank you again for joining our Fourth 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, Steve Clark, Chief Commercial Banking Officer, and Shari Kruzinski, Chief Consumer 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 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 periodically file with the Securities and Exchange Commission. All comments made during today's call are subject to this 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 fourth quarter as we continued to demonstrate the strength and diversity of our business model. These results capped a successful 2023 with full year core earnings per share of $4.55, core return on tangible common equity of 22.48%, and a core return on assets of 1.38%. Each of these metrics exceeded 2022 levels.

Highlights for the quarter and full year included customer deposit growth of 3% linked quarter or 13% annualized. Growth occurred across our Wealth & Trust, Commercial and Consumer businesses. Deposit mix remained strong with 31% of average deposits in non-interest demand accounts. Loan growth of 1% linked quarter or 3% annualized. Full year customer deposit and loan growth of 2% and 7%, respectively, with the year-end loan-to-deposit ratio of 77%.

Core net interest margin of 3.99% for the quarter, with interest-bearing deposit beta at 44%. Core fee revenue growth of 6% linked quarter. Growth was driven by Wealth & Trust, Cash Connect, and capital markets businesses. Full-year core fee revenue growth of 10% and core fee revenue ratio of 30.4% in the fourth quarter.

The core efficiency ratio was 54.5% for the quarter, which included several favorable one-time adjustments of approximately $4 million for estimated incentive and employee benefit accruals. Excluding these adjustments, the core efficiency ratio would have been 56.2%.

Asset quality remained stable. Net charge-offs and problem loans were essentially flat to Q3, and NPAs ticked up 8 basis points. The balance sheet remains strong, with ACL coverage of 1.35% and all capital ratios significantly above well-capitalized levels.

In summary, our franchise growth was facilitated by the continued optimization of our investments and highly unique competitive market position. We enter 2024 with strong momentum and look forward to continuing to execute on our 2022 to 2024 Strategic Plan.

I will now turn it back to Art for commentary on our 2024 Outlook and to facilitate Q&A.

Art Bacci: Thank you, Rodger. I will now cover our Outlook for 2024.

Looking forward to 2024, we expect a full-year core return on assets of around 1.20%.

Our Outlook assumes no interest rate cuts in 2024. This assumption is a different approach from our prior periods whereby we tied our interest rate outlook to the forward curve. Our analysis demonstrates the forward curve has been a poor indicator of actual interest rate changes.

Additionally, recent economic data along with comments from the Federal Reserve and European Central Bank officials have combined to temper market expectations for lower interest rates.

We have also assessed our Outlook, assuming three interest rate cuts totaling 75 basis points, all in the second half of 2024. The impact potentially reduces our net interest margin by approximately 15 basis points in 2024. Further information on our interest rate sensitivity is provided on slide 10 of the Supplement.

WSFS' diverse business model provides management with multiple strategies to achieve our previously communicated goal of top-quartile performance.

Our favorable market position, a loan-to-deposit ratio of 77% and consistent cash flows from our securities portfolio enable us to opportunistically fund relationship-based loans in our markets.

Our multiple sources of core deposits provide us with favorable deposit cost and funding mix, further contributing to our top-tier net interest margin.

Fee income contributes almost one-third of our total revenue. Our fee-based businesses continue to be increasingly integrated with our overall business model, and all have significant growth opportunities because of joint relationships with our Commercial and Consumer customers, industry consolidation, and potential non-bank M&A activity.

I will also point out that gradual declining interest rates potentially enhance our financial results and capital positions from better equity and fixed income market performance, increased mortgage and asset securitization transactions, and higher market valuations of our investment portfolio and tangible book value as demonstrated during the fourth quarter.

Net charge-offs are expected to be between 50 and 60 basis points of average loans for the year, primarily driven by Upstart and NewLane, as well as continued normalization of credit trends. Overall, our portfolio credit metrics were stable this quarter, and our ACL coverage ratio is 1.35% of total loans and leases. Excluding the held-to-maturity securities and including acquisition credit marks, the ACL ratio stands at 1.64% of loans and leases. Further information on our ACL ratio is included on slide 13 of the Supplement.

Finally, our strong capital position and earnings enable us to absorb unfavorable developments in the economy to continue to invest in our franchise, capitalize on market opportunities, and to take steps to further enhance shareholder returns.

Thank you, and we will now open the line for questions.

Questions & Answers:
Operator: [Operator Instructions] Your first question comes from the line of Michael Perito from KBW.

Michael Perito: Hey guys, good afternoon. Happy New Year. Thanks for taking my questions.

Rodger Levenson: Happy to do it.

Michael Perito: Obviously, a lot of great extra color around margin and rates in the deck, so I appreciate that. Just to maybe put some guardrails around it. So I guess, first, just looking at slide 10 here, the '25 cut, the $9.6 million NII impact. So I mean, I guess, if we're just thinking pure NIM here, just want to sanity check my math, it would seem like every cut, all else equal, static balance sheet moves the 3.80% to 3.90% range down 5 bps, so like 3.75% to 3.85% and so forth. Would you guys generally agree directionally with that? And that is incorporating the benefit of the off-balance sheet hedging strategy? Is that all correct, or is there anything that you would change?

Art Bacci: Mike, I think that's directionally correct. And I would just reiterate, that's an annualized number. So if rates are going to get reduced in the second half of the year, we clearly wouldn't feel that full impact in 2024.

Michael Perito: Correct. Yes. Okay. And is that the 3.80%, I mean does that, the additional hedges, the $250 million, it says approved for additional floors. Would that potentially neutralize that range somewhat, or is that baked into that as well would you say?

Art Bacci: No, that's baked into that because any hedges we would put in would have to result in significantly lower rates. Today, the $750 million we've done is about 4% SOFR rate. So clearly, there have to be a material drop in the SOFR for the hedges to kick in.

Michael Perito: Got it. That's great. Thank you. And then switching over to the fee side, obviously, a very strong quarter. A couple of comments in the deck drove my attention. I just love it like a layer deeper on them. With substantial growth opportunity on the Wealth side and then a comment about Cash Connect and peer consolidation, and obviously, you guys have double-digit growth expectations for fees in '24, which is pretty robust. But can you maybe give a few more specifics about where some of those opportunities are coming from in driving that assumption?

Art Bacci: Sure. So this is Art again., Mike, one of the things that happened in the fourth quarter, late third quarter, fourth quarter is one of the largest players in the Cash Connect business exited the market, and we've been able to pick up that clientele. And we have continued to see inflows through the first and second quarter of 2024 in our pipeline from that situation, which is giving us a high degree of confidence that Cash Connect will continue to have some double-digit growth into 2024 over 2023.

And then on the Wealth side, I mean, the combination of our businesses are seeing very strong pipelines going into 2024. Institutional Trust businesses got a nice pipeline, including almost $100 million of potential deposits that we're looking at. And then increasingly, our Wealth Management business being integrated with our normal bank business and the referral activity we're seeing from both Commercial and Consumer banking is really giving us a great opportunity to continue to grow the AUM business as well.

Michael Perito: That's helpful, Art. Thanks. Just two more quick ones if I could. It seems like the unsecured consumer charge-offs were pretty stable and remain in the range I think you guys have communicated. Just any broader commentary there? The data points have been so mixed, right? Like for example, Discover, who's got a prime unsecured book, saw an uptick in charge-offs and delinquencies. Others have been more stable. We'll get a few more data points next week. But any updated thoughts around the unsecured consumer credit environment, particularly as it particularly relates to your portfolio as we think about '24?

Art Bacci: Yeah, I mean, this is Art again. If you strip out Upstart, we've seen the same thing. The charge-offs have been really benign and stable on the unsecured. Upstart have been the one area where we've seen higher levels of charge-offs in that. We believe it was tied to some of the earlier cohorts that we booked, and that is working its way through the system. And we hope that in the first, second quarter, that would start to decline.

We've also, we're not really materially adding to the Upstart portfolio. We've hit our concentration limits on unsecured. And so that is basically just replacing some run-off at this point of time. And we will continue to evaluate the charge-off experience, which could lead us to making other decisions.

Michael Perito: Got it. And then just lastly, obviously, the guide is very helpful in laying out how you guys are thinking about the year. The one thing that was absent is just any incremental commentary around buybacks. And just I know your model and your approach to it are pretty consistent all the time, but just any updated color or Board conversations that are happening about the buyback would be helpful just as we think about that moving forward.

Rodger Levenson: Hey, Michael, it's Rodger. Nothing's changed with our capital return philosophy. And it's been our historic practice from a forward-looking outlook or for our plan, to only put in there the routine buybacks that we use to supplement the dividend.

We continue to periodically evaluate potentially higher buyback levels. But as you know, that's dependent upon the forward look of the economy as well as assessment of our balance sheet and where the share price is because we have a model that targets at least the 16% IRR. So we'll continue to evaluate that as those factors play out, but nothing different from our ongoing philosophy.

Michael Perito: Very good. Listen, thanks, guys. I appreciate it. Have a great weekend. Talk to you soon.

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

Feddie Strickland: Hey, good afternoon, everyone. Just wanted to start back on the sensitivity analysis for a second. Could there be some level of upside there, just given the fact that that assumes a static balance sheet, and you're clearly going to grow loans within your guide? Just trying to think through in a little more detail about what happens with the margin if we as analysts do assume some level of rate cuts.

Art Bacci: Sure, Feddie. I do think there is some upside. The position we have today has been consistent. Our asset sensitivity over a long period of time, it certainly has benefited us when rates have gone up. And even through multiple rate cycles, we have consistently put out a top-quintile net interest margin.

The opportunities, because we have a lot of levers to pull, exist in a couple of areas. One, some of our betas, if rates were to start to climb, could be better than we anticipate. But right now, our view is that there's still a lot of banks out there with high loan-to-deposit ratios and some liquidity concerns. And so they're keeping rates higher than maybe we would. And we have the ability to basically defend our market position and go after those competitors.

Secondly, I think that the declining rate environment could very well trigger increased mortgage and other type of asset backed securitizations and refinancing of corporate debt, which would give our Institutional Trust business a nice kick in terms of further deposit growth. And a lot of that is tends to be non-interest bearing deposits. So those are just a couple of levers that could really work to our benefit as 2024 progresses.

Feddie Strickland: Understood. That makes a lot of sense. And I guess, along those same lines, can you remind us of where you feel like DDAs could end up over the next couple of quarters? I think I peg them at about 31% of average deposits today. Does that glide down into the high-20s, or what are your assumptions on the level of non-interest-bearing deposits over time?

Art Bacci: I think we've got the 30% rate target probably reflective of normalization for us. And on average, it's been pretty consistent. It might have some volatility from quarter to quarter because of the trust deposits. But when you look at the average, it has been about 30%, and that's the pre-pandemic level. So we feel pretty comfortable; 30% is a good area. And again, if rates decline and market securitization activity picks up, that could increase actually.

Feddie Strickland: Got it. And then just one last question for me on expenses. I know your guide mentions continued investment in the franchise. Are there any initiatives in particular that could move expenses up more earlier versus later in the year? And any detail you can give on any either technology initiatives, or hiring, or anything along those lines? What's driving some of those expenses?

Rodger Levenson: Feddie, this is Rodger. I don't think there's anything one big thing of note. We're continuing to invest in the franchise. So yes, we have a fair number of technology investments that continue, which has been the process that has been going on for several years.

And we're looking to hire. And we have some businesses that already have plans for hiring, most of that tied to potential revenue. And we could see more opportunity there if we think it's additive to us to hire folks, as well as something like the small RIA investment that we made in 2023.

So a combination of those things, we're looking to invest and grow the business. We think this is a time to move market share and to invest as others retrench. And that's really that’s reflected broad based across all of the NIE categories.

Feddie Strickland: Understood. So supportive more of long-term growth rather than any particular initiative, or new product line, or anything like that.

Rodger Levenson: That’s an accurate assessment.

Feddie Strickland: Thanks so much. I’ll step back into the queue.

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

Russell Gunther: Hey, good afternoon, guys. Art, I appreciate all the margin. Hey, Rodger and Art, I appreciate the discussion around the NIM and particularly sensitizing to the three cuts. So in that scenario, what do you guys assume your deposit beta does on the way down? It sounds like from broader comments you made, you're being conservative there, but curious what's baked into that three-cut sensitivity.

Art Bacci: Well, obviously, if rates start to go down, we will recalibrate our beta. We initially think early on the beta would be fairly low again because of the competitive environment. We do have opportunities. We have product, money market, products that are tied to an index. So if the index declines, obviously, our rates will go down.

We've done some exception pricing, primarily with some public money and commercial money that could be repriced down. But on the consumer side, there continues to be a fair amount of competition in the market. And so we believe that's probably going to be a slower decline.

Now, if that were to change, clearly, we could lower our rates. But that's our assumption, is the competitive market will require us to continue to provide some premium on deposits to protect our franchise.

Russell Gunther: Okay. I appreciate that Art. And then if you could, just as a follow up, remind us the amount of indexed deposits you have. If you have it.

Art Bacci: Yeah, we may have to get back to you.

Russell Gunther: No problem.

Art Bacci: Primarily in the money market account. Let us get back to you, Russell, on that.

Russell Gunther: I appreciate that. No problem. And then just last one for me, guys. The '24 outlook again with the stable rates, any risk to the fee guide if you were to sensitize to three cuts? I mean, it sounds like the Cash Connect is really a market share gain opportunity. But just thinking through that double-digit target in the three-cut scenario as well, how do you see that playing out?

Art Bacci: I think potentially through rate cuts, certainly, we'd increase the value of fixed-income AUM and potentially have an upside in the market, which would increase our AUM. And we're building in like a 3% market-based AUM growth. So that could potentially increase if the markets were to go up. As I mentioned previously, some rate decreases could enhance the securitization market and lead to further corporate debt refinancing, which would benefit our Institutional Trust business.

Russell Gunther: Okay. That's very helpful. Thank you, guys, for taking my question.

Operator: Your next question comes from the line of Frank Schiraldi with Piper Sandler.

Frank Schiraldi: Hi guys. Just on Cash Connect business, trying to get a sense, given the pickup in business here in the fourth quarter and potentially into the current year, is it, obviously, the double-digit growth year over year has got a pretty good starting jumping-off point. But when I think about just growth off of 4Q levels, I mean, is there enough low-hanging fruit where you could see double-digit growth off of 4Q levels in 2024? How are you thinking about growth from here, I guess, for Cash Connect?

Art Bacci: I think given the volume that's in the pipeline from the providers of ATM services that are moving from that other competitor, there's potential for some low double-digit growth from the fourth quarter.

Frank Schiraldi: Okay.

Rodger Levenson: I think, Frank, the other thing is, with the Cash Connect, it's Rodger. With some of this consolidation also comes some pricing power for us, which could be a tailwind as we pick up some business as well.

Frank Schiraldi: Okay. Yeah, I was going to ask about returns in that business. The ROA looked like got a pretty good boost; I don't know if that's sustainable. And if you even could see further ROA pick up in 2024, where that business could again be accretive to the bottom-line or ROA?

Rodger Levenson: Yeah. As you know and you hit on it. Historically, over time, Cash Connect has been accretive to the overall ROA, and we're getting back to those levels. We went through a period of significant investment in some product and some technology and the maturation of that combined with this opportunity in the traditional bailment business. We're getting some scale and some pricing power, and we think there's every opportunity for us to have it continue to be accretive to overall corporate ROA in the near term.

Art Bacci: Yeah. Frank, we pretty much saw a bottoming of the ROA in the first quarter this year. And between the first and fourth quarter, the ROA has increased 250%. So with additional volume being added in the first half of next year, we would expect that ROA to continue to move up.

Frank Schiraldi: Okay. Great. And then, Art, just on the AUM linked quarter, the growth noted, obviously, a lot of that was market driven. But just wondering if you have net flows you've seen in AUM from a customer standpoint over the last couple of quarters.

Art Bacci: Yeah. We saw a little bit more outflow in the fourth quarter. So we're pretty much break even through the first three quarters, which was a big improvement from prior years because we were still integrating Bryn Mawr Trust, and there was a lot of client change and some advisor departures. So we saw fourth quarter a little bit more departure. And some of that just tied to spend where we're seeing customers using up more assets in order to just maintain lifestyle given the higher inflation rate and higher rates, whereby they're buying houses and instead of financing and paying all cash.

Frank Schiraldi: Okay. And then just lastly, sorry if I missed it, but the uptick in NPA is obviously off a pretty low base, but what drove that primarily?

Steve Clark: Hey, Frank, this is Steve Clark speaking. That was really two specific loans, one, in the multi-family sector. This particular multi-family was master leased to a co-living operator who declared bankruptcy. So that sponsor is working to reposition that property into more of a traditional multi-family. The other was in our legacy healthcare book, the elder care. Frankly, facility just did not recover from COVID. So they were the two specific loans, one in multi-family, one in legacy elder care.

Frank Schiraldi: Okay. And then are either of those additions still current, or these are 90 days past due in NPAs?

Steve Clark: No, they're both NPAs.

Frank Schiraldi: Okay. All right. I appreciate it. Thank you.

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

Manuel Navas: Hey, good afternoon. Does the fee guidance include any acquisitions? And would any, I think you have some interest there, so would any acquisitions be on fee side would all be additive, if correct?

Art Bacci: Yeah, Manuel, this is Art. Any M&A would be additive. We have not baked in anything into our guidance for M&A.

Manuel Navas: And what's your appetite on the fee side?

Art Bacci: We continue to look at opportunities, namely across our fee businesses. And we did do the transaction in 2023, and we have a couple of other things we're looking at. But we're just looking at it, nothing definitive right now.

Manuel Navas: Okay. And there was a little bit of elevated paydown activity in Commercial. Do you have any view on how that continues? And can you just talk about loan growth across the year?

Steve Clark: Yeah, Manuel, Steve Clark again. So last year, year-over-year, we grew loans across all segments about 7%. We believe mid-single digit for 2024 is attainable, again, across all segments, C&I, CRE, consumer with our Spring EQ partnership, and residential mortgage as we made a strategic decision to hold more on the balance sheet. The focus certainly is still C&I, both in the Commercial bank and our Small Business bank.

Elevated payoffs in that C&I segment in the fourth quarter really revolve around three transactions. A totaled almost $80 million in the hospitality space. Two of our sponsors sold their assets and the third refinanced, and that resulted in some unplanned significant reductions in C&I. The rest of the reduction was line activity at year-end, with companies clearing out their line of credit balances in preparation for year-end.

Manuel Navas: Thank you. I appreciate that.

Operator: Your next question is a follow-up from of Feddie Strickland from Janney Montgomery Scott.

Feddie Strickland: Hey, thanks. Just sorry, I had one quick follow-up. Just wanted to ask about the growth of the balance sheet and earning assets relative to loans. I think it's been, if my math is right, it's been relatively low, even down a little bit over the last couple of quarters. I mean, should we see the balance sheet continue to stay overall relatively flat, or does that start to grow a bit with some of the loan growth?

Art Bacci: Feddie, this is Art. I would say that the balance sheet would probably remain generally flat. Remember, we have about $500 million a year roughly of cash flow coming off the mortgage-backed securities and investment portfolio, which would fund about a 3.5% growth in the loan portfolio. So the loans would have to really grow significantly in order for us to start to grow the balance sheet.

Feddie Strickland: Got it. Thanks, Art. That's it from me.

Operator: And with no further questions in queue, I'd like to turn the conference back over to Art 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 Andrew or myself. 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 nice weekend.

Operator: That concludes today's conference call. We thank you all for joining. You may now disconnect.