WSFS Financial Corporation [WSFS]
1Q 2024 Earnings Conference Call
Friday, April 26, 2024, 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.
Kelly Motta; Keefe, Bruyette, & Woods, Inc.
Manuel Navas; D.A. Davidson & Co.
Feddie Strickland; Janney Montgomery Scott LLC
Russell Gunther; Stephens Inc.

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

Art Bacci: Thank you, Ron. Good afternoon and thank you for joining our first quarter 2024 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 today are Rodger Levenson, Chairman, President and Chief Executive Officer, Steve Clark, Chief Commercial Banking Officer, and Shari Kruzinski, Chief Consumer Banking Officer.

Before I turn the call over 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 the 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, 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 had a good start to 2024 continuing to demonstrate the strength of our franchise and diverse business model. Our first quarter results included a Core EPS of $1.11, Core ROTCE of 19.2%, and a Core ROA of 1.31%.

Our results continue to reflect the benefits of the investments we are making in our company and our unique competitive market position.

Highlights for the quarter included gross loan growth of 2% linked quarter, or 7% annualized. This growth was spread across our Commercial Mortgage, Consumer, and C&I books.

Quarter-end customer deposits were up 3% linked quarter after excluding expected Trust activity and a short-term Commercial deposit withdrawal. Average deposit balances increased 4.9% (annualized) linked quarter. Deposits remain well diversified across our Commercial, Consumer, Wealth, and Trust businesses with 30% of average deposits in non-interest bearing demand accounts.

The Core Net Interest Margin was 3.84% for the quarter with interest-bearing deposit beta of 47%. While our average cost of funds increased 17 basis points during the quarter, the increase mostly occurred early in the quarter and the rate of increase in cost of funds declined meaningfully in March.

Excluding the income from our equity position in Spring EQ of $3.5 million in the fourth quarter of 2023, core fee revenue increased 2.7% linked quarter. As a reminder, Spring EQ was acquired effective year-end 2023, and we will therefore no longer recognize income from this investment. Our core fee revenue ratio was 30.3% in the first quarter.

The Core Efficiency Ratio stood at 58.6% for the quarter. Non-interest expenses in both the fourth quarter of 2023 and the first quarter of this year included a number of non-recurring adjustments. Normalizing for these items, expenses increased $7.2 million or 5% linked quarter with Cash Connect external funding costs representing $5.2 million of the increase.

Cash Connect added 4,336 service non-bank ATMs during the quarter due to the previously discussed exit of a large industry participant. We anticipate opportunities for additional unit growth during the second quarter. Expenses were higher in the quarter due to one-time onboarding costs and increased use of external funding.

Asset quality remained stable. Problem loans and delinquencies were flat at 4.41%, and 81 basis points of gross loans, respectively. NPAs declined to 33 basis points of total assets, primarily due to the resolution of two non-performing C&I credits. Net charge-offs decreased to 27 basis points of average gross loans, including a net recovery excluding the Upstart and Leasing portfolios. The ACL coverage was 1.48% as we continued to build reserves for potential future credit losses.

In summary, we remain well positioned to deliver top-quintile financial performance in 2024. We are tracking well to the full-year outlook communicated in January. Thank you, I will not have Art facilitate Q&A.

Questions & Answers:
Operator: [Operator Instructions] Your first question comes from the line of Russell Gunther from Stephens.

Russell Gunther: I wanted to circle up on Cash Connect, and I appreciate some of the puts and takes you just discussed, Rodger, but can you guys share where the market share is mostly coming from? Who the competitor is that left the space? How you kind of quantify for us what the market share gain opportunity can be? And then you touched on this just a bit a moment ago, but how we should think about the modeling dynamics around related expenses?

Art Bacci: Yes, Russell, this is Art. I think we've communicated this previously that the participant that exited was U.S. Bancorp in the fourth quarter of last year. In aggregate, we've added somewhere close to 12,000 units between the first quarter and fourth quarter of last year. It's probably, I'd say 75% to 80% of what we think we will onboard. We've got a few more cash purchases in the process here in Q2.

I think when you kind of look at some of the expenses and the lower profitability, I'd say in the first quarter was just because of some of the transition I have to go on and we sat on some additional non-earning cash in the vaults, as well as the fact that in order to make the transition smoother rather than optimize where we source cash, we wound up just using our external funding source exclusively so that the carriers, there would be no confusion of where the carriers would go to get cash.

As we move along here with these cash purchases, we'll start to kind of optimize the usage of cash, which involves looking at distances between various vaults and the ATMs and so that will kind of bring us back down into a more normalized mix of funding between WSFS and our external funding sources.

Rodger Levenson: Yes. Russell, I would just add to that as we've said historically, as you think about the profitability of the business, it should be accretive to the overall bank over time. And so, we feel like as we move through this transition, we should return to those levels of profitability over the course of this year.

Russell Gunther: Okay, guys. Thank you, that's very helpful. And then if I could just switch gears a bit, with regard to WSFS getting out of the customer originations being on pause with Upstart expectations for that portfolio to start to decline. Can you just talk a bit about the strategic shift there? And then what, if any, impact you would expect us to have on your net charge-off guidance over time?

Art Bacci: Russell, this is Art. We really think that we're well reserved for the losses that we will incur in the portfolio and without further originations of any meaningful amounts, clearly, the provision under the CECL methodology will decline. But we do think we have a good handle on the charge-offs and that they will we'll probably see another couple of quarters of level charge-offs with declining as the portfolio continues to shrink.

Rodger Levenson: Yes. Russell, just as a reminder, on the first part of your question, the strategy. That was the Upstart partnership was a strategy that was really driven by two dynamics. One, it did plug a gap in our consumer credit product offering and it also was an opportunity for us to experiment, somewhat, with digitally originated customers to see if we could cross-sell into those.

So, the combination, I would say, of getting to the size that we wanted to get to, seeing the credit performance, and candidly did not give us the kinds of returns on the cross-sell that we expected, and that's really the reason for the pause.

I will just clarify that we still have the channel available to our customers, but we expect fairly modest originations and overall, with the size of that portfolio and the total loan book, obviously does not have a material impact on our earnings.

Russell Gunther: Okay. Great. Roger, Art thank you for that. And then just last one for me and I'll step back and again, switching gears, could you guys just talk a bit about your M&A appetite here on the depository side, just overall level of discussions or activity and then an ideal profile of any potential partner?

Rodger Levenson: Yeah, so Russell and really that has not changed for us as we've talked about for the last couple of years. After the significant investments we made with the Beneficial and Bryn Mawr franchises, we feel we're very uniquely positioned in a great market for significant organic growth over time, extended time, so we're really not focusing on or contemplating any traditional bank M&A that would revolve around additional deposits.

Additionally, though, I would say we continue to invest in the business. And we are seeing opportunities in both the Wealth and the Commercial areas to add talent as well as what you see happening in Cash Connect, so we will continue to invest in the business if we see the opportunities for returns consistent with our business model. But traditional bank M&A at this point is not in our line of sight.

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

Frank Schiraldi: Just wanted to start with Wealth Management and commentary around the adjustment in deferred revenue driving a part of the decline. And just curious if you could talk through that in terms of is this quarter a better run rate? Does that come back out? Or how to think about run rate here with that commentary around deferred revenue?

Art Bacci: That was really a one-time item. We had moved some accounts to a different billing platform and in doing so, we realized that we had about $1.3 million overstated of deferred revenue. So that was the impact of this quarter's revenue was the $1.3 million, that's really a one-time item.

In addition to that, there's just some seasonality, both in the Trust Company of Delaware activity and in the Institutional Trust businesses. There's usually a rush, to get trust and securitizations done at year-end. So that when you compare it to linked quarter it's definitely going to be down somewhat. But if you compare like our Institutional Trust business to a year ago quarter were actually up year-over-year. So, I think the pipeline is still very robust and we continue to still feel comfortable in the Outlook we provided in terms of the growth of our fee businesses.

Frank Schiraldi: Okay. So that $1.3 million, and it is a hit to revenues this quarter and will come back out?

Art Bacci: Yes, we'll earn it back as it was deferred revenue.

Frank Schiraldi: Okay. And then just wondering if you could give a little more detail or a little more color on NIM. Obviously, you have the guidance out there from the beginning of the year, and you mentioned you guys are kind of on track there. Just look like there was some maybe excess liquidity in the quarter that helped drive NIM lower. And I don't know if that's in part, an arbitrage opportunity and just wondering how that kind of fits in with your NIM outlook and any kind of color in NIM moving forward from 1Q?

Art Bacci: Frank, the NIM really was, the first thing that really impacted most was just an increase in cost of deposits and funding. It went up 17 bps. And just to give you some color in March, cost of funds only increased two basis points. So as Rodger mentioned in his opening comments, most of that increase was early in the quarter and it was because of the lag in repricing deposits. We still see kind of a plateauing of our NIM in the second quarter.

And the other contributing factor, little to some degree was, ironically, was the AOCI or the mark on the investment securities portfolio declined, the yield actually goes down because you have a higher balance. So that was another roughly 9 basis point decline on the mortgage-backed securities.

So short answer is we continue to believe very confidently that second quarter we'll see the low point and that NIM starts to kind of accrete back up in the second half of the year, namely because of the paydown in the mortgage-backed securities portfolio and redeploying that cash flow into either loans or even if we put into Fed funds, it will be a 300 basis point pickup in the yield there.

Frank Schiraldi: Okay. And I'm sorry, just to clarify, Art you said, I think you said, deposit costs were down two basis points in March?

Art Bacci: The deposit costs only increased 2 basis points in March relative to February. So, like I said, that 17 was mostly, 17 basis point increase in cost of funds was the first half.

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

Feddie Strickland: Just wanted to ask how much repricing opportunity do you see on fixed rate loans in the near-term that could potentially move the needle on loan yield? Or do you think yield stays kind of where it is at this point, just given the floating portion of the portfolio?

Steve Clark: Steve Clark here. Really there's no significant repricing opportunity in our fixed rate commercial loan book. I think yield will be fairly consistent throughout the rest of the year. Unless the Fed increases rates, given our variable rate loan book. So, all things being equal, the yield should still be in that 7%, low 7% range going forward.

Feddie Strickland: Got it, that's helpful. And then just wanted to switch back to, I was surprised at the level of asset growth this quarter and earning assets. I know you talked about having a little bit of extra liquidity there. Can you talk through what drove some of that and what we might see next quarter in terms of asset growth?

Art Bacci: Yes, Feddie, this is Art. I think really, when you look at the earning asset growth, there was probably about $300 million or $400 million there of excess liquidity above the prior quarter, and that's because in the first quarter, we did take down about $800 million of bank-term funding. Refinance some we had, and we actually took advantage of the lower rate and the fact that we can borrow at face value of the securities.

Going forward, I'd still say that's probably flat generally to this quarter. I think usually in the second quarter, we'll see some more significant cash flows coming in and out because of tax payments or the tax receipts and the tax payments going out will keep the cash a little bit more elevated for the quarter.

Feddie Strickland: That's helpful. And then just one last question, going back to charge-offs. I know the guidance is 50 to 60 basis points this year, and you came in well below that. Is the variance versus guidance just effectively driven by what you're expecting or what we should expect from the Consumer book over time to NewLane and Upstart? Is that pretty much the delta between what we saw in the first quarter and what we potentially see in future quarters versus the guidance?

Rodger Levenson: Yes. So, Feddie, I'll just jump in here. So as Art mentioned, we think for both NewLane and for Upstart, we see the level of charge-offs having plateaued and we'll start to drift down here just a little bit, especially with the Upstart portfolio as it probably trades a little bit more quickly. I think the delta really for us on charge-offs will be how the commercial portfolio performs. Obviously, we're pleased with the net recovery this quarter but we're still coming off of historically low levels, and credit in the C&I book tends to be a little bit lumpy.

So, you can see a spike or two depending upon one or two credits and the size of those credits. And it's kind of averaging all of what we have seen as historical charge-off rate that got us to that range that we provided in the Outlook. And we continue to assume that some of that will occur during the remainder of the year.

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

Manuel Navas: A great start to the year in terms of loan growth. How are pipelines? And are they impacted at all with rates staying high? Any issue with demand from rates?

Steve Clark: Steve Clark again. Pipeline in the Commercial bank and the Small Business group remain fairly strong. Our 90-day weighted average is just a little over $300 million. So, activity and opportunities continue to present themselves. I think a significant portion of that is from the disruption that's occurring at some of the bigger players in our market, and that is generating opportunity, as Rodger said earlier, for both customer acquisition and talent acquisition.

So, interest rate environment on the C&I side has not impacted our pipeline. And certainly, on the CRE side, we remain very, very selective in terms of new customer acquisition, new sponsor acquisition and continue to focus on supporting our existing customer base.

Manuel Navas: Okay, that's great. In terms of shifting over to deposits a bit, any early take on movements in trust deposits and other flows that you're looking out for?

Art Bacci: Manuel, this is Art. I think things right now are pretty steady. We continue to have a very strong pipeline in securitization deals. Remember, some of those deposits, as I mentioned in the past, are really cash pre-funding a trust that's going to go out and acquire assets for mortgages for the trust. And that, we can't really forecast as easily. That's really up to securitization markets and different client type of deals they bring us. But the teams got a very active pipeline and there could be some nice opportunities here, if not in the second quarter, certainly in the second half of the year.

Manuel Navas: In the past, you've talked about having a little bit of a budget in your deposit beta assumptions to defend deposits more. How is that progressed and what are your updated thoughts on that ability to defend your deposit even more, if necessary?

Art Bacci: I'll turn it over to Shari, but I'd say we're still tracking. We have a beta was about 47% on interest-bearing. We said 50% and we kind of think we'll be close to that. But the pressure seems to have declined in terms of having to really use excess budget, if you will, to defend our deposit pricing. Shari can talk more about what we're seeing in the market.

Shari Kruzinski: Sure. I would say that as Art mentioned, the competitive pressure, although it still exists it's subsided somewhat. And we are still seeing customers interested in certificates of deposit, the money market, we've been successful attracting new customers to those products, but I'm really pleased and feeling very comfortable. In fact, our CD retention rates are actually running a lot higher than we had expected. Really proactive management on the exception pricing front as well.

Manuel Navas: That's really helpful. And just my last question shift to the buyback and capital return. You kind of gone above the 35% threshold. Just any updated comments on that?

Art Bacci: No. We continue to stick to the 35% long term. We had some makeup to do from Q4 where we were a little bit under 35% and we made up for it in Q1. But no, generally, we're going to stick to the 35% for the year. So, there may be some timing differences between quarters, but no real change.

Rodger Levenson: It's an ongoing event. Art obviously articulated it well. But it is an ongoing evaluation, Manuel. And so as we go through our capital stress testing, and we see opportunities to go above that what we call the routine buybacks, we will evaluate that. It's just not in our current near-term thinking.

Operator: Your next question comes from the line of Kelly Motta from KBW.

Kelly Motta: Hi. Thank you so much for the question. Most of mine have been asked and answered, but maybe looking at slide 10, it says you've continually been reviewing all $2.5 million plus loans maturing in the next 24 months? And just given the investor focus on CRE and Office, if you could provide, you know what your findings have been any conversations with borrowing borrowers whose loans are coming due or

up for repricing and how you are managing with those?

Steve Clark: Kelly, Steve Clark again. So yes, as we've noted we've had for several quarters now, an ongoing project or protocol to look two years out and roll quarters forward as the year progresses at all loans that are scheduled to mature during this time period. And we just want to be proactive and get in front of our customers well in advance of any maturity dates.

And so far, we've been quite successful in working with our customers for loans that have matured during the first quarter of this year and the end of last year with really minor, minor challenges. So that will be ongoing each quarter, and we'll continue to work with all of our customers as it relates to their maturities.

There could be and likely will be some discussions with certain borrowers with certain loans as we move forward. But we really view it as really episodic in a loan-by-loan basis versus a broad concern.

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

Art Bacci: Thank you for joining the call today. If you have any specific follow-up questions, please feel free to reach out to me directly or Andrew Basile. 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 great day.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect.