WSFS Financial Corporation [WSFS]
4Q 2024 Earnings Conference Call
Tuesday, January 28, 2024, 1:00 PM ET

Company Participants:
Rodger Levenson; Chairman, President and Chief Executive Officer
David Burg; Executive Vice President, Chief Financial Officer
Art Bacci; Executive Vice President, Chief Operating Officer

Analysts:
Frank Schiraldi; Piper Sandler & Co.
Kelly Motta; Keefe, Bruyette, & Woods, Inc.
Manuel Navas; D.A. Davidson & Co.
Russell Gunther; Stephens Inc.

Presentation:
Operator: Thank you for standing by. My name is Janine, and I will be your conference operator for today. At this time, I would like to welcome everyone to the WSFS Financial Corporation Fourth Quarter Earnings Call. [Operator Instructions] I'd now like to turn the call over to David Burg, Chief Financial Officer. Sir, you may begin.

David Burg: Great. Thank you, Janine, and good afternoon, everyone, and thank you for joining our fourth 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 website. With me on this call are Rodger Levenson, Chairman, President and CEO, and Arthur Bacci, Chief Operating Officer.

Prior to reviewing our financial results, 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, in 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 the Safe Harbor statement.

I will now turn to our financial results. Our businesses continued to perform very well in the quarter, providing us with strong momentum moving into 2025. 4Q results included a core earnings per share of $1.11, core return on assets of 1.24%, and core return on tangible common equity of 16.55%. These results capped a successful 2024 with full year core earnings per share of $4.39, core return on assets of 1.26%, and core return on tangible common equity of 17.83%.

Our results for the quarter included the termination of a relationship with a longstanding Cash Connect® client as a result of adverse events in the client's overall business portfolio. This termination resulted in a negative $4.7 million pretax impact to our financials with a $2.8 million impact to core fee revenue and a $1.9 million impact to core noninterest expense. This event is an isolated incident that does not have a broader bearing on the Cash Connect® business. The team acted proactively to protect our interest, and we will be working to recover this loss through insurance and other avenues, where appropriate.

Despite the Cash Connect® event, WSFS delivered year-over-year core fee revenue growth of 7% in 4Q, powered by the Wealth and Trust business, which delivered a record fee quarter of $40 million on double-digit growth. For the full year 2024, the company achieved core fee growth of 19% relative to the prior year.

Core net interest margin was 3.80% for the quarter, up two basis points linked quarter despite the interest rate cuts that we experienced in 4Q 2024. We actively managed our deposit repricing and achieved an interest-bearing deposit beta of 26% for the quarter, with an exit beta as of the end of December of 35%.

Customer deposits grew 4% linked quarter driven by broad-based growth across the Wealth and Trust, Consumer, and Commercial business lines. Noninterest-bearing deposits grew 6% linked quarter and comprised 31% of average deposits in 4Q.

Loans declined 1% linked quarter, driven by higher seasonal payoffs and business sales. On a year-over-year basis, loans grew 3% with mid-single digit growth in C&I and Commercial Mortgage. We continue to have a strong originations pipeline while our business sales present important opportunities for our Wealth business to expand client relationships.

We finished the year with a loan-to-deposit ratio of 77%, providing ample balance sheet flexibility and capacity to fund future growth.

Our total net credit costs of $8.7 million decreased by $11.4 million from the prior quarter. This decrease reflects improvements in early-stage metrics of problem asset and delinquencies, as well as lower net charge-offs. Excluding our Upstart portfolio, which is in runoff, we recorded net charge-offs of 20 basis points for the quarter and 27 basis points for the year.

Nonperforming assets increased quarter-over-quarter due to the migration of one relationship with two loans, but we believe these loans are well-collateralized based on current valuations.

Our ACL coverage at the end of the year remains at 1.48%.

On the last page of the Supplement, we provided our outlook for 2025, which assumes one 25 basis point rate cut in June. Overall, we expect to deliver another year of high performance and growth with a full year core return on assets of approximately 1.25%.

We expect mid-single digit loan growth in our Commercial portfolio and flat growth in our Consumer portfolio. Our Consumer portfolio will be impacted by the runoff of our Upstart and Spring EQ partnership portfolios, which will be offset by WSFS-originated loan growth.

We expect continued broad-based deposit growth across our businesses in 2025, building on our recent momentum. Our outlook is for deposit growth in the low-single digits from our very strong levels in 4Q.

Our outlook for net interest margin is approximately 3.80% for the year, consistent with the level in 4Q, and this incorporates an additional interest rate cut in June. We will continue to focus on deposit repricing opportunities and expect to finish the year with an interest-bearing deposit beta of approximately 40%.

We continue to see strong momentum and growth opportunities in our fee businesses, which contribute almost a third of our total revenue. We expect the Wealth and Trust business to grow double-digits as we capitalize on talent additions and technology investments made in 2024.

Our overall fee revenue will grow mid-single digits as Cash Connect® revenues are expected to decline as a result of the interest rate reductions. As a reminder, this revenue decline is more than offset in Cash Connect's funding costs resulting in a higher profit margin for the business in 2025.

Net charge-offs are expected to be between 35 to 45 basis points of average loans for the year as the industry continues to see the normalization of credit. Our Commercial portfolio continues to perform well, but losses may remain uneven in 2025. We expect net charge-offs associated with Upstart to continue to decline as the portfolio runs off.

And lastly, we will continue to leverage opportunities to invest in the franchise while prudently managing our expense base. While we may have fluctuations in our efficiency ratio quarter-to-quarter, our outlook for the full year is for an efficiency ratio of 60%. We're excited about the future and remain very committed to delivering high performance.

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

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

Russell Gunther: I wanted to start on the expense outlook. I appreciate the efficiency guide for the year. Could you give some thought to us around how you're thinking about dollar expenses, how that 4Q – we kind of shake out as a run-rate, I hear your lumpy quarter-on-quarter. But sort of what's embedded in the top-line guide provided earlier and as a bit of a follow-up, just what type of margin of error are you assuming on the efficiency guide? I think for the past year, we were maybe 90 bps above the plus or minus range.

David Burg: Yes. Thanks, Russell. So let me talk about 4Q a little bit. And 4Q as you alluded to was a little bit of a noisy quarter. We obviously had the Cash Connect® one-timer, the $1.9 million one-timer. Also, when you look at a year-over-year basis, we had increases in Cash Connect® related to interest rate increases, which are offset in revenue. So those are purely variable expenses that flow through the expense line related to rates that are offset in revenue. So, if you normalize those two things out, our expenses for the year were up about 15%. And the majority of that, a large part of that was in salaries and benefits, and there are really two main drivers for that. I would say, one is at the end of the year in the fourth quarter, we always true up our incentive compensation to the actual performance that we had in the year. So that was part of it. And the second part is the investment that we're making in the business in terms of headcount.

And so, when you look at our heads, we added about 80 FTE year-over-year. About 2/3 of that went into three areas: Wealth, Commercial, and Technology. And these are the areas that we continue to invest in and when you look at our fee growth, particularly on the Wealth side, the double-digit growth that we're expecting this year and next year, I think those are – that's a manifestation of the investments that we're making. And I think we're in a fortunate position to be the platform of choice for many people. And in fact, there are two teams of advisers recently joined us from competitors just in the last few months as evidence of this, and we continue to see a lot of interest, both on the Commercial side and the Wealth side of people joining our team. So that's a little bit of color on the quarter.

In terms of the guide, I would say, obviously, the efficiency ratio can move around a little bit quarter-over-quarter, and it also moves around a little bit because of rate impact on the revenue side. So, I think this is a goal for the year and we may deviate from that quarter-over-quarter, but that's something that we're focused on managing. And with our goal of keeping efficiency generally flat, you can – that basically implies a revenue growth and expense growth that's kind of parallel so you can model it that way.

But I would say, that's our overall philosophy. We're going to continue to invest, we'll continue to be opportunistic, we think it's the right long-term trade-off and decision, but we're focused on managing the expenses appropriately.

Russell Gunther: Appreciate the color there. And then as it relates to Cash Connect®, can you talk about any potential levers you guys have yet to pull that could improve overall profitability in general sort of agnostic of what short rates do?

David Burg: Yes, yes, absolutely. And so, as you said, obviously, interest rates are going to impact the business, but important to remember that in – as interest rates have declined, that should be accretive to our profit margins. Even though you're going to see an impact on the top-line – on the fee line, that's more than offset on expenses. But beyond that, we are focused on driving the profit margin of the business up. And that's a combination of growth, it's a combination of – it's growth, it's optimizing our cash logistics, and making sure that we minimize noninterest-earning cash. And the third one, and an important one is pricing.

As we've consolidated market share following the USB client acquisitions that we've made, we do feel we have an opportunity for pricing leverage, and that's something that we're going to deploy. So, our goal is to definitely drive the profit margin up next year from where it is this year.

Russell Gunther: Got it. Okay. Helpful. And then just one last one from me, guys, in terms of how we should think about the overall size of the securities portfolio by the end of the year if you're still kind of targeting roughly 20% of average assets ultimately and maybe when we might get there?

David Burg: Yes. So, on the securities portfolio, it's about 22% of assets right now. You're right, we're targeting somewhere around the 20% mark, maybe a little bit lower. The security portfolio is about $4.5 billion. It throws off about $500 million of cash per year in principal as well as interest. So about $500 million a year. Most of that is going to be redeployed into growth in the business. But we may – we will look to probably redeploy a little bit of that into the securities portfolio. So, net-net, we do expect to come down even though some of the -- we will add to our securities portfolio a little bit. But net-net, it will be down.

Russell Gunther: Okay. Thanks very much for taking my questions.

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

Frank Schiraldi: Just wondering on – as I look at – we think about capital, your current capital levels on a regulatory basis. Any color on where those could trend to in either the short-term or the medium-term? Obviously, you've got – you've been buying back stock, and you have more firepower there, but also just thinking about other potential uses of capital and your interest level in additional M&A at this point?

David Burg: Yes. Maybe I'll start off on the capital, and I'll turn it to Rodger to talk about M&A. But Frank, on the capital side, so we have a philosophy, as you know, that we return about 35% of our net income every year, and that's about 15% in terms of dividend and the rest in terms of buyback. When you look at last year, we actually did about 50%, which was about 35% of that in buyback and about 15% in dividends. And so -- and the way we look at that is we look at the opportunities that we have to deploy cash – to deploy capital in the business versus where we're trading and the ability to buy back stock, and we kind of always balance that equation and we take a hard look at that, and we're constantly thinking through that balance.

So, I think next year, just as we did more this year, I think we will expect to do that again next year. And it's an equation that we're continuously looking at and revisiting. And I would say – the other point I would make is that over the last couple of years, we held a little bit more capital because of volatility in macro environment, credit, interest rates and so we still think it's prudent to hold a little bit more now. But again, we're definitely taking a hard look at buybacks, and we continue to be disciplined, but it's something we're focused on continuing to make sure that we carefully manage that and return as much as we can.

Rodger Levenson: Yes. Frank, it's Rodger. I would just add, as it relates to our appetite for M&A, we just completed our next strategic plan, '25, '26, '27 strategic plan. And the focus is really continuing to optimize this very unique market position that we have across all of our businesses and to really optimize that investment. That being said, as David outlined, we continue to invest in the franchise, and we would look to invest in both the fee businesses and the Banking side if it was something that could be accretive to those activities.

I will say that like any investment that we make, the bar is pretty high because any decision to deploy capital in those kinds of investments is a decision to not deploy it in the ordinary course of business. So we're open to looking at that, but we feel very confident that we can continue to achieve the kind of results that we have provided and what we've outlined in the outlook without having to do anything of any significant magnitude. But always open to opportunities that would strengthen the franchise.

Frank Schiraldi: Okay. Great. And then just couple of quick ones on sort of modeling – more modeling related. The really strong deposit growth in the quarter, I know sometimes you can have some customer inflows that – large customer inflows that are more temporary in nature. Anything that you see coming back out in terms of just sizing it in terms of coming out in 1Q or is this a pretty good run-rate all else considered?

David Burg: Yes, Frank, I think you're right. I think we will have a little bit of that. When we look at – like you said, I think we have very strong growth in the quarter – quarter-over-quarter, but also year-over-year, importantly, so even when you normalize for that seasonality. For example, if you look at last year and the growth that we had, we also had a strong fourth quarter last year, probably about half of that came out in the first quarter and then we built on that. So I think we would expect kind of a similar pattern this year, and that's why maybe you see the low single-digit growth in deposits off of that high point in 4Q. But I think importantly, when you look at our balances on average year-over-year, which kind of normalizes out for some of these things, we're still up 6% overall on average year-over-year. And I would say, even more importantly, we're up 7% when you look at the noninterest-bearing deposits.

And the noninterest-bearing deposit growth was really across all businesses, across Consumer, across Commercial, and across Wealth and Trust. And that's really, I would say, reflects the kind of the core fee relationships, the core fee operating business that we do with our clients. So, I think the deposit story is a very strong one. Yes, there's seasonality there. But I think any way you look at it quarter-over-quarter, year-over-year, I think net-net, we have solid growth.

Frank Schiraldi: Okay. No, that's great. And then just quickly, lastly, I think when you guys talk about the Cash Connect® business, there's one partnership that was terminated, I think the numbers you're giving are one-time in nature, one-time impacts. Just trying to size it, am I missing, is there a number you can provide, is it not meaningful in terms of the quarterly impact from just the lack of this customer being a partner anymore?

David Burg: Yeah. I would say, Frank, there are a few moving pieces there when you think about Cash Connect® for 2025. One is this client, two is the interest rate impact, and three are the levers that I previously discussed around pricing optimization and growth in the business. And so, when you net all of those things, we expect the top-line revenue to be down somewhat, but that's more than offset in expenses. And so, when you net all of those things including the absence of this client, we still expect a profit margin to increase from the mid-single digits to kind of the high single digits next year. So that's really how we look at the business, and that's how we're driving the business.

Frank Schiraldi: Okay. Just in terms of the specific fee from the absence of this one customer is just something you guys aren't disclosing or is it just not meaningful or both?

David Burg: Yes, I can't really – I don't want to get too much into specific client revenue. But again, I think I would focus on the bottom line, the profit margin, and run rating this quarter a little bit.

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

Kelly Motta: Maybe just one more quick question on this Cash Connect® business. Just from a high level, it sounds like what happened with this kind is somewhat idiosyncratic. What are the risks of this business? Is it mostly just mismanagement or potential fraud risk or theft, I'm just trying to understand what the risks are here beyond moves in interest rates? Maybe I'll start with that.

Rodger Levenson: Yes. So just to circle back to the particular situation, Kelly, as outlined in the materials, the business owner had financial stress in related enterprises that we felt elevated the risk profile of our relationship, and that's what led to the termination of that relationship.

More broadly, I think the risk as you think about the business here, is we're managing and keeping track of large amount of cash throughout the system and making sure that we have all the proper controls in place to manage and track that, which is obviously a lot of systems that have been built up over the 25 years or so that we've been in business.

And I would say, as a general statement, all of those controls work in this particular situation to our satisfaction. There are some loose ends that we're still working on that are reflected in those charges, and we have some avenues to pursue on that, but that's the biggest risk in this business. And I would say, as a general statement, I think the way we mitigate those risks and manage them were demonstrated very well in the ultimate outcome of that situation.

Kelly Motta: Got it. That's really helpful. And I appreciate all the color on kind of the investments you've made and talent you've brought on and kind of how you're managing expenses commensurate with revenue growth. Just wondering, as we look ahead, how much – when you're managing your expenses, are there still rooms for additional efficiencies and that would be perhaps if revenue came in lighter more challenged be the areas in which you could potentially get greater savings? Or would the plug here mostly be a toggle in your recruiting efforts?

David Burg: Kelly, it's a combination. I think, for example, again, one of the things that drove our expenses this time was when the fourth quarter typically is a true-up in our incentive accrual, which is very numeric and really relates to the company performance. So that's something that is clearly variable and something that is directly related to where ROAs are and where the company performance is. I think that is one thing.

The second thing is that as we've made investments in headcount, particularly when we talk about advisers, relationship managers, as you may know, the expenses, of course, start day one, but because of contractual limitations, the revenue really doesn't start flowing materially until the second year. And so, there's a little bit of a mismatch – there's a little bit of a timing mismatch between when the expenses and that revenue. But that's why we feel optimistic about continuing that double-digit trajectory, is on the back of these investments.

And I would say, the third thing is we have made – we had some major technology investments this year including upgrading our trust accounting system, which is one of the final kind of integration pieces from our acquisitions. And so that drove – when you look at the full year, that was really more of a third quarter, but when you look at the full year, that also is a lever. So, I do think we have levers, and it's something again that we manage – we take a very hard look at.

Rodger Levenson: Yes, Kelly, it's Rodger. Just to give a little bit of historical context. I think if you followed us over a period of time, our efficiency ratio has tended to be a little bit higher than some of our peers. We have dipped into the 50 – the mid-50s and high 50s periodically. We've kind of hovered around 60% as more of a long-term sustainable level and a big part of that is because the businesses that were in are service-driven businesses and fee businesses, which carry a little bit higher expense load to them. So that's why we talk about the efficiency ratio being around that 60%. That is our long-term goal.

Obviously, we always look at opportunities to become more efficient. You saw this quarter, we moved some owned real estate in held for sale. We're taking advantage, hopefully, of some opportunities in the marketplace to address some potential expense savings there. So, we're looking at it that way. But there shouldn't be an expectation that we're going to drop somewhere below that kind of historical level because I think our mix of businesses and our service-based model dictates a little bit higher efficiency ratio.

Kelly Motta: Understood. That's super helpful context. Maybe last question from me. This is the second quarter where you had an uptick in NPAs this quarter. I believe the presentation calls out land in Multi-family Construction. Can you provide us some color on the migration that occurred this quarter and your process of workout of some of these larger migrations over the back half of last year?

Rodger Levenson: Yes. So, I would say that really, there was only one credit of any size that moved to NPA, and it was that relationship. So, two loans right around $20 million each as we outlined in the materials, a land loan, industrial land loan in Central Jersey area and then another multifamily construction loan more in North Jersey. To a large sponsor that has run into some challenges in his global cash flow, we feel, as David said, we're very well secured, and we're working through that. Similarly, I would say, the other situations that we've had, that migrated over the course of last year into NPA, I think we continue to work on those in a very constructive way. As we've talked about with our borrowers, we hope to see some resolution in the near future. And obviously, all of that was incorporated into where the – where we've landed on the ACL going forward.

David Burg: Kelly, I would just add that a vast majority of our loans are with recourse as well. So, we have – we actively manage that. We have different tools. And so that's why you don't necessarily have the NPAs that turn into losses.

Operator: Our last question comes from the line of Manuel Navas from DA Davidson.

Manuel Navas: Could you go into a little bit more detail on the loan growth outlook and the mix for it, discuss pipelines and kind of what keeps consumer flat, what parts they're going to make up for the Upstart runoff? Let's start with that.

David Burg: Sure. Sure, sure. So when you look at the loan growth outlook, you really – as you alluded to, you have to break it down between the Consumer and the Commercial businesses. When you look at the Consumer, we have two partnership portfolios that will be running off. One is Upstart, which right now is about $140 million as of the end of the year. It runs off about $25 million a quarter. So really, by the end of the year, this portfolio will be kind of negligible by the end of this year.

The other runoff portfolio is $1 billion, and that portfolio runs off, the Spring EQ portfolio. In that portfolio, the runoff is a little bit subject to interest rates, but with prepayments. But generally, it runs off about $10 million to $15 million per month. So, this quarter, I think we had about $44 million was the runoff in that portfolio. So those are kind of the decliners. Offsetting that, we're definitely focused and have had success in growing are WSFS-originated loans and those are a combination of residential mortgage loans, which had nice growth this quarter as well as other consumer portfolios that we have and primarily kind of HELOC portfolios that, again, that we had nice growth this quarter.

So I think the combination of doing more on the mortgage side, which we feel we can do as well as some of our real estate – some of our other smaller portfolios, I think, largely is going to offset this growth to keep consumer flat. So that's kind of the Consumer story.

On the Commercial story, we had -- if you look at our -- we had larger payoffs this quarter due to seasonality, which always happens in the fourth quarter. But I think particularly in this quarter, we had some business sales, which accounted for about 25% of the payoffs. But generally, when you look at our -- the origination side of the equation and the pipeline, it's still solid, and we still – we feel good about it. We feel good about the momentum. And so, I think Commercial is going to continue to deliver mid-single digit growth. So, when you put all of that together, you get to kind of maybe a 3.5%, 4% growth between the two, and that's how it shakes out.

Manuel Navas: I appreciate that color. Does the resi mortgage origination or the HELOC origination, does that add households? Is it like kind of deeper relationships with folks you already have on the Wealth Management side? That was part of the thought process with Upstart and Spring EQ that you could add households. And I'm just wondering if you're finding new ways to do that? Just any color on some of that would be helpful.

David Burg: Yes. I think the residential mortgage, it's a combination. I think it's a business that we have capability and that we originate ourselves. We think that there's – and we obviously try to lend from a relationship perspective. So that can be an input influx of new clients that then we try to expand into deposit accounts. But also is an important source of cross-sell from our Wealth business as well, both ways. So, I think that is an entry point for new clients as well as also an area where we can expand relationships for clients that come in through other channels like Wealth.

Art Bacci: Manuel, I'd also remind you, this is Art. We have originated both mortgage loans for clients or prospects as well as non-clients, and we have the flexibility for the non-client relationships to be able to sell those loans into the secondary market and book a gain. So, it's a combination of sales and then where those relationships are there, we'd rather keep it on the books rather than expose that client to a competitor.

Manuel Navas: I appreciate that. With that kind of blended overall loan growth rate of 3.5% to 4%, a lot of that's covered with securities cash flows that could potentially leave you with a lot more capital build. You talked about having a similar level of buyback activity to last year. Could it meaningfully increase?

Rodger Levenson: Yes. I think, Manuel, we kind of touched on this before. Yes, we can fund the loan growth with the securities, there may be some excess, and we're certainly generating capital, and that will all be included in our ongoing analysis of the capital return philosophy that we've talked about a fair bit.

David Burg: Yes. Manuel, I would add that one of the things that – I mean, in this particular quarter, in the beginning of the quarter, we paid off our BTFP facility. We basically paid it off in cash, driven by the liquidity generation that we had in the business. So that's also been accretive to our net interest margin. So, I think we look at kind of all of those levers and opportunities to deploy liquidity. And as Rodger said, we'll continue to evaluate buybacks for sure.

Manuel Navas: Is there any other further takeaways on the strategic plan, the new 3-year plan, just kind of – obviously, it comes across with the near-term outlook for this year. But can you – is there anything else you can discuss on kind of what the focus is on that 3-year strategic plan?

Rodger Levenson: I think, first of all, the plan is consistent with the process that we've gone through before. It's every 3 years. It's a combination of management working with the Board. And I would tell you that it's very consistent with what you've been hearing us talk about. It's to continue to optimize the prior investments that we've made in the franchise and then continue to lean into those areas across all of our business lines.

As you've heard us talk about, we have a very unique market position in one of the most favorable markets in the country where really all the large players or much, much larger institutions where this market is just one small piece of their franchise, this is our – where our franchise is. And we think there's opportunities for growth to take market share, for us to get more of a share of wallet with our customers, and to continue to grow through some of the investments that we've made. And that's really the focus of the plan, and it's consistent with our long-term goal of delivering sustainable long-term high performance as you've seen demonstrated over the last several years.

We will invest in all of that. That could be similar to what you saw in '24 with adding talent, and we would be open to investments of a little bit larger size as well. But as I said, I think the bar for those will be high because we really want to have the organization focused on optimizing what's right in front of us and what's very unique and different.

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

David Burg: Okay. Thank you, everyone, for joining today's call. If you have any specific questions, please feel free to reach out to Andrew or me. Rodger, Art 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. Thank you.

Operator: This concludes our conference call for today. You may now disconnect.