WSFS Financial Corporation [WSFS]
1Q 2022 Earnings Conference Call
Friday, April 22, 2022, 1:00 PM ET

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

Analysts:
Michael Perito; Keefe, Bruyette & Woods
Erik Zwick; Boenning & Scattergood
Brody Preston; Stephens, Inc.
Russell Gunther; D.A. Davidson & Co.
Frank Schiraldi; Piper Sandler & Co.

Presentation:

Operator: Thank you for standing by, and welcome to the WSFS Financial Corporation First Quarter 2022 Earnings Conference Call. (Operator Instructions) Please be advised that today's call is being recorded. (Operator Instructions) I would now like to hand the call over to your host for today, Dominic Canuso, Chief Financial Officer. Please go ahead.

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

Before I begin with 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 periodically file with the Securities and Exchange Commission. All comments made during today's call are subject to the Safe Harbor Statement.

Our earnings release and earnings release supplement, which we will refer to on today's call, can be found in the Investor Relations section of our company's website. We achieved significant and exciting milestones in the first quarter of the year. After the close of our combination with Bryn Mawr Trust on January 1, we successfully completed the bank, technology, branding and branch conversions over the weekend of March 18. We converted over 40,000 Customer households, consolidated 34 branches and began recognizing cost synergies from the transaction. We are slightly ahead of schedule to achieve or exceed the 65% of the identified annual transaction-related cost savings in 2022.

We also announced new branding supporting Bryn Mawr Trust as the prominent wealth management brand. The wealth technology integration is expected to occur throughout 2022 and into early 2023.

In addition, we closed out our 3-year strategic plan that included the combination with Beneficial and our Delivery Transformation initiative, both of which successfully positioned us for our combination with Bryn Mawr and the continued opportunities we see across our diversified business model. We are now rolling out our next 3-year strategic plan, which I will speak to in a few moments.

While our reported results in the quarter included significant impacts from one-time items resulting from the closing of the Bryn Mawr transaction, we had strong underlying core financial results. Reported net income was $3.8 million or 7 basis points of ROA and $0.06 EPS. This included $51.6 million of pre-tax corporate development and restructuring charges associated with the transaction or 76 basis points of ROA and $0.60 of EPS. And when also including the initial Bryn Mawr ACL provision of $23.5 million, our ROA was 1.17%.

While our performance metrics are noisy this quarter due to the combination with Bryn Mawr, our performance demonstrates the strength of the franchise and the momentum to deliver improved returns throughout the year. Our loan-to-deposit ratio of 64%, low Customer funding cost of 7 basis points, stable yields and an asset-sensitive balance sheet all position us well for the rising rate environment.

We anticipate NIM expansion of 50 basis points by the fourth quarter of 2022, assuming a total of 7 25 basis point increase in Fed funds throughout the year. As illustrated on Slide 6 of the earnings supplement, this is 30 basis points favorable to our original 4Q NIM outlook due to the anticipation of 4 additional rate increases and earlier phasing of the increases throughout the year. As NIM expands, and we continue to achieve cost synergies throughout the year, we anticipate our core ROA to improve approximately 20 to 25 basis points by 4Q in the range of 1.35% to 1.45%.

On Slide 12 of the supplement, our ACL coverage ratio of 1.19% is consistent with prior quarter. The $136.3 million of total ACL includes approximately $50 million of ACL from Bryn Mawr, including $23.5 million of initial BMT ACL provision for non-PCD loans and $26.1 million initial ACL for PCD loans. When excluding the initial BMT ACL provision, there would have been a provision release of $4.5 million in the quarter due to the continued improvement in credit trends in the portfolio. The coverage ratio is 1.53% when including estimated remaining credit marks on acquired loan portfolios.

We returned approximately $56 million of capital to shareholders in the quarter, including $8.5 million of common stock dividends and $47.6 million in share repurchases, which included routine share repurchases from 2021 that were paused in anticipation of the combination and incremental repurchases. Our regulatory capital ratios are substantially in excess of well capitalized and significantly favorable to our capital position anticipated post-close at the time of the BMT combination announcement, with CET1 and Tier 1 capital of 13.93% and total capital of 14.89%.

Tangible common equity ended the quarter at 7.7%. This is a 167 basis points lower than prior quarter, resulting from the changes in AOCI from the rising rate environment impact on the AFS portion of our investment portfolio plus the anticipated one-time costs associated with the Bryn Mawr transaction. The total current AOCI impact on TCE is a negative 155 basis points.

Similarly, as illustrated on Slide 6 of the supplement, our tangible book value per share decreased $6.25 in the quarter, resulting from the same two events, with approximately 2/3 of the reduction from AOCI and 1/3 from BMT one-time transaction impacts. The total estimated BMT transaction dilution is favorable to the transaction model expectations at the time of the deal announcement.

Regarding the impact of AOCI, it is important to note that given our strong diversified Customer deposit growth over the last few years and the consistent loan-to-deposit ratio in the low 60s, along with our strong capital position, we made the purposeful and strategic decision to deploy our excess liquidity into our investment portfolio. The strategy was to maximize earnings, maintain duration of cash flows from the deployment, minimize risk and to provide optionality. This optionality was to provide flexibility in the event Customer deposits ran off or to redeploy cash flows into net organic loan growth or to reinvest in cash flows back into securities.

We continue to believe this is the best option for us. Regardless of categorization, we do intend to hold these assets to maturity and expect the AOCI loss position to amortize off over the duration of the investment and back into tangible equity.

Lastly, as illustrated on Slide 7 in the supplement, we are sharing the financial targets supported by our 3-year strategic plan for 2022 through 2024, which focuses on optimizing our investments made over the last few years, including our combinations with Beneficial and Bryn Mawr and our Delivery Transformation initiative. We believe we are strongly positioned for above-market growth as the largest locally headquartered community bank in our market and differentiated from the other large market share banks that are all nationals or super regionals. Loan growth will be supplemented by continued strength of our diversified fee revenue businesses, in particular, our national franchises in Wealth and Cash Connect.

When combined with our asset-sensitive balance sheet and diversified low-cost deposits, our ROA is expected to improve during strategic plan period. In our planning, we have considered the macroeconomic volatility and recognize that there will likely be variability in our performance due to these external factors. We have captured the anticipated volatility in our range of ROA between 1.53% and 1.70% by the end of the planning period. Most importantly is that we continue to hold as our primary financial objective to deliver sustainable, high-performing results as defined by ROA in the top quintile of our peer group, which we believe our plan delivers.

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 of Piper Sandler.

Frank Schiraldi: I wondered, I guess you're not updating guidance on loan growth at this time. But is there any color you can provide on commercial in terms of your guys' strong pipeline. Paydowns have remained elevated. But have you seen that slow now that rates have moved higher? And any additional color just on that side of things?

Steve Clark: Frank, Steve Clark here. So yes, so commercial loan balances quarter-over-quarter were flat, but activity was very strong, Commercial loan funding last quarter of over $500 million on top of $490 million in the prior quarter. So, headwinds remain in the C&I space through excess liquidity, and there certainly has been historical refinance activity in CRE. We do believe rising interest rates should lessen some of the refinance activity going forward.

On top of that, our pipeline, as you mentioned, is very strong. The commercial 90-day weighted average is $330 million. On top of that is our Small Business pipeline of $30 million. And lastly, we have unfunded non-revolving commitments of a little over $400 million. So, these are loans that closed over the past year but have not yet started to fund, and we would expect those to start funding in future periods.

So, we feel really good about where we are, significant activity, very strong pipeline, and prospects remain very favorable. We are forecasting kind of that mid- to high single digit at the bank level. That includes activity coming out of our NewLane finance business, the leasing business, and the strategic partnerships we have on the consumer side, which have been doing very, very well.

Frank Schiraldi: Okay. All right. And then I guess just following up on the consumer side, is the growth split in the quarter, is that mostly the Upstart relationship? I'm not sure how much detail you can give there. But you're certainly on pace for that double-digit growth on that side of things. Just wondering if you're still comfortable with that sort of a growth level, just given maybe macro factors, if that's driving any change to your thinking on that side of things.

Rick Wright: Yes. We're continuing to do somewhere in the neighborhood of $20-plus million a month. We are obviously monitoring this portfolio closely because it is new to us. The delinquencies are still within our planning range. The loans are generally in our footprint, we are able to move on a dime in the ability to control either underwriting, pricing or geography, and 85% of those loans are prime and super prime with an average FICO of 695. So, at the moment, we are comfortable proceeding as we are.

Frank Schiraldi: Okay. Great. And if I can just sneak one more in on -- a quick one on NIM guidance. From the initial guidance last quarter assumed a drag from excess liquidity of 35 to 45 basis points. You're at the -- I guess, the high end of that in the first quarter. Is there any adjustment that you made to that for the updated guidance you provided in the slide deck?

Dominic Canuso: Frank, we have not updated guidance for that. And as we communicated at the original outlook last quarter is we anticipated the excess liquidity drag to continue to shrink throughout the year.

Operator: Our next question comes from Michael Perito of KBW.

Michael Perito: I wanted to spend a minute on the comments that you made, Dominic, around the liquidity position. I guess -- and I apologize if I missed this, I was trying to follow. But I guess the question is just you guys purchased -- continue to grow the securities book in the portfolio. But does that potentially continue going forward? Or do you think that has kind of capped out here? And as we look forward, it's more likely that any excess cash, like, let's say, deposit outpaces your projections or anything like that will just be held in more shorter-term flexible cash equivalents? Or do you think there could be a situation where the bond book grows further from the Q1 levels?

Dominic Canuso: Yes. Good question. For the most part, we've achieved the target balance sheet we're looking for. However, there is likely some additional expansion from the first quarter levels in the MBS portfolio, but not meaningful relative to the amount we've grown in the last few years.

Michael Perito: And what's the -- and once again, sorry, I don't know if you said this, but just the updated kind of blended duration of the investment portfolio after the purchases in the first quarter.

Dominic Canuso: Yes, it's still around 5 years, which is the duration we look to manage to within the portfolio.

Michael Perito: Got it. And then just secondly, kind of a quick 2-part question here. Just one, you guys updated the ROA Q4 exit run rate for the year with the new NIM guidance. Obviously, you can kind of back into it. But just is it safe to say that the efficiency ratio likely would come in lower as well? Or do you think that -- if the Fed has to raise rates that dramatically in response to kind of stubborn inflation, there's a chance that the expenses that are guided to in that scenario could drift as well, partly offsetting some of that benefit?

Dominic Canuso: Yes. I think you summarized the macro-economic impacts accurately. All else equal, obviously, a higher NIM leading to higher NII would reduce the efficiency ratio. But to your point, in this environment, the higher interest rate environment is to stem inflation, and the impacts of inflation are still playing out. So, we continue to expect improved efficiency ratio, and we expect the cost takeout that we -- the synergies from BMT to continue throughout the year.

Michael Perito: Great. And so actually, I'm going to sneak one last one in. Just curious, the 3-year strategic plan, if the thoughts around M&A have changed or altered at all just kind of strategically now with Bryn Mawr under your belt and obviously, a lot of space between you and $10 billion and 2 fairly large deals in the last few years. Just wondering if there's any different kind of indication or thoughts around M&A that are refreshing at this point.

Rodger Levenson: Mike, it's Rodger Levenson. So, the theme of our 3-year strategic plan is focus, optimize and integrate. And really, it is very much focused on organic growth. So, nothing significant is built into that plan as it relates to M&A, particularly on the bank side. That being said, we're always going to invest in the franchise. But the plan is achievable without any significant investment built into the model.

Operator: [Operator Instructions] Our next question comes from the line of Russell Gunther of D.A. Davidson.

Russell Gunther: Appreciate the update on the margin expectations and assumptions there. Could you give us a sense and update us in terms of how you're thinking about deposit betas against the backdrop of that 7 rate hikes in '22, how that might progress?

Dominic Canuso: Sure. I'll start with historical deposit betas had been in the 50% range. The most recent rising rate cycle in '17 and '18 was in the mid-20s. We would expect to be closer to the more recent rate environment. Typically, though, deposit betas have lagged about 6 to 9 months from when interest rates start to rise. That would likely mean that very low deposit betas would begin in 2022 and would more likely play out in the next year. But I think, at the end of the day, the inflationary environment in this cycle is different. So that may play out differently in deposit betas, although it's important to note that 14% of our deposit base is in Trust and Wealth at low interest rates, and we believe that will help stabilize the deposit beta in the rising rate environment.

Russell Gunther: Okay. Got it. Very helpful. And then the 2022 outlook slide, again, left unchanged, we've had some discussions around the longer-term plan and where profitability metrics are going. I guess is there any color you could share in terms of your expectations for total fee revenue contribution I know had been in the 30% range previously? Does NII outlook take that lower? Or is there any refreshed outlook in terms of the pro-forma franchise, particularly on the Wealth side?

Dominic Canuso: Sure. I'll start with absolute growth. In our outlook, we communicated that we expected mid-single-digit growth this year in fees. We continue to expect that, and that included some Durbin impact from BMT and the loss of PPP loans. But as we think through the strategic plan horizon, we would expect fees to grow in the high single digits to double-digit range, and that would continue. We look for fee income ratio around 30 or better. But obviously, that is directly impacted by the interest rate environment. So, depending on the number of rate increases, that could be in the high 20s to low 30s, but most importantly, that we continue to see it growing in the high single digits to low double digits over the next few years.

Russell Gunther: That's very helpful, Dominic. And then just last one for me on capital. I heard you on the M&A side of things and your commentary about expectations for that to continue to build. How should we think about buybacks going forward relative to 1Q Wealth?

Dominic Canuso: Yes. I think most importantly that we continue to hold that our historical practice and philosophy about capital return will continue, in this environment has proven a good maximizer of shareholder returns. And we will continue to evaluate our total capital position. Clearly, in this environment, we'll evaluate that first and ensure that we have the right amount of regulatory and tangible equity. And then we will return at least 25% of our core net income split equally between dividend and routine share repurchases regardless of price. And then anything incremental to that will be a function of those capital positions, loan growth opportunity and, ultimately, our share price, ensuring that any incremental share repurchases would deliver an IRR greater than 18%.

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

Dominic Canuso: Thank you for joining the call today. 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 participating. You may now disconnect.