WSFS Financial Corporation [WSFS]
2Q 2022 Earnings Conference Call
Tuesday, July 26 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

Analysts:
Michael Perito; Keefe, Bruyette & Woods
Frank Schiraldi; Piper Sandler & Co.

Presentation:

Operator: Ladies and gentlemen, thank you for standing by and welcome to the WSFS Financial Corporation Second Quarter Earnings Conference call. (Operator Instructions) I would now like to turn the call over to your host for today, Mr. Dominic Canuso, Chief Financial Officer. Sir you may begin.

Dominic Canuso: Thank you Andrew, 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 and Steve Clark, Chief Commercial Banking Officer. Rick Wright, Chief Retail Banking Officer is unable to join us on the call today.

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 are pleased to announce strong results for our first quarter after the BMT bank branding and branch conversion in late March.

The quarter demonstrated both the strength of our relationship-based business model and the diversity of our products and services. The quarter also illustrated the continued opportunities that lie ahead, given our strategic position as the largest locally headquartered bank and Wealth Management franchise in our region along with the growth potential of our nationwide businesses.

Reported ROA of 1.17% and EPS of $0.94 include a couple of nonrecurring items in the quarter. We sold approximately $55 million of C&I and CRE loans at par related to a legacy BMT small business real estate lending unit called KCMI.

In addition, we sold the BMT Insurance Advisors business to Patriot Growth Insurance, as noted on our press release on July 7th. After completing our strategic plan and aligning it with the BMT combination, these two businesses were the two product lines not considered areas of focus going forward.

These sales will not have a material impact to our ongoing financial results. One-time corporate development and restructuring costs in the quarter were $10.3 million pretax or $0.15 per share. Somewhat offsetting this was a $6 million unrealized pre-tax gain on our equity investment in cred.ai or $0.07 per share.

Summarized on Slide 3 of our supplement, when excluding these items, our core results included net income of $65.4 million or an ROA of 1.27%. With an EPS of $1.02 and an ROTCE of nearly 20%. These results were driven by consistent and strong performance across all areas of the company including positive growth in both loans and our diversified fee base, along with achieving the full cost synergy run rate anticipated from the BMT combination.

We are executing consistently with our expectations for the year and for our strategic plan. As noted on Slide 8, loan growth was 8% annualized when excluding the KCMI sale and the acquired residential mortgage portfolios. This was supported by 5% annualized commercial loan growth when excluding KCMI and supported by 18% annualized growth from New Lane leasing.

Net new commercial fundings were a record $685 million in the quarter, including line utilization increasing to 39.2%, the highest in two years. The commercial pipeline continues to grow with 90-day weighted average now over $350 million.

Consumer loans grew a robust 41% annualized, driven by continued success of both our Upstart and Spring EQ partnership lending products. Consumer loans are now 13% of total gross loans. Customer deposits decreased 7% annualized, nearly half of which driven by a decline in short-term transaction-related trust deposits.

We now have just over $1.5 billion in these transaction trust deposits or approximately 9% of our deposit base, which has grown $652 million over the past year or 73%. In addition, we moved approximately $59 million of customer deposits into sweep accounts.

The loan-to-deposit ratio stands at 66%, demonstrating the continued strong capacity to fund future net loan growth. During the quarter, we reclassified $1.1 billion or 19% of our AFS investment portfolio to HTM, reducing the potential negative impact on TCE from higher middle-of-the-curve rate increases.

I'll speak to capital more in a moment. As seen on Slide 10, NIM in the second quarter was 3.40%, a 39-basis point increase over 1Q as loan yields increased 27 basis points from the rising rate environment and churn in the portfolio, while customer deposit costs were relatively flat, increasing only 1 basis point.

In addition, the negative impact from excess liquidity decreased 8 basis points to 36 bps. Our fee revenue ratio was relatively flat from 1Q at 30.0% as fees grew $5.5 million or 9% non-annualized, driven by growth in Cash Connect and Capital Market fees of approximately $2 million each, as well as a $1.3 million increase in core banking, which was offset by weaker mortgage banking fees from lower resi refi volumes.

Both current and leading credit metrics remained positive and stable, with net charge-offs in the quarter of $2.6 million. Net loan growth and balance sheet mix resulted in an ACL increase of $5.6 million, illustrated on Slide 12.

The ACL coverage ratio is now 1.13%, or 1.42% when included estimated remaining credit marks on the acquired portfolios. When normalizing for the $1.1 billion investment portfolio reclassification, the ACL would have been 1.23% or 4 bps higher than prior quarter on a comparable basis.

Non-interest expense continues to be well managed, while at the same time achieving the full run rate impact of the BMT cost synergies early. The core efficiency ratio improved over 5 percentage points to 56.2%.

Consistent with the first quarter, we've returned $56.7 million of capital to shareholders, including $8.4 million of common stock dividend and $48.3 million in share repurchases or approximately 1.19 million shares.

Approximately 85% of core earnings was distributed in the quarter. Also, the Board approved a 15% increase in the quarterly dividend to $0.15 per share and approved an additional 10% share repurchase authorization. 14% of outstanding shares or 8.6 million shares are authorized for repurchase as of the quarter end.

Our bank regulatory capital ratios are substantially in excess of well capitalized with CET1 and Tier 1 capital of 13.6% and total risk-based capital of 14.57%. TCE decreased to 6.63%, driven by the continued interest rate impact on AOCI.

We continue to evaluate and consider both our AFS and HTM investment portfolio mix, along with balance sheet hedging strategies to best position us for the anticipated interest rate volatility in the next few years.

Lastly, as we typically do at mid-year, we have updated our outlook assumptions on Slide 5. As I mentioned at the beginning, we are executing consistent with our plan. While we anticipate the second half of the year loan growth rate to be in the mid- to high single digits, given the growth in 1Q, our full year growth expectation is now mid-single digits or the low end of our original range.

Also, given the lower residential refi volume in the markets, combined with the financial market's impact on AUM and the sale of the BMT Insurance business, annual fee revenue growth is anticipated in the low single digits. These expectations, combined with the higher interest rate environment and positive performance to date, our full year ROA is now anticipated near 1.35% excluding the initial CECL provision for BMT with a 4Q ROA around 1.65%.

Updated NIM, PPNR percent and ROA are illustrated on Slide 6 for both full year and 4Q. In summary, the growth and overall performance in the quarter demonstrates our strategic position in our markets, and we look forward to continued opportunities for substantial organic growth ahead.

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

Question and Answers:

Operator: [Operator Instructions] And our first question comes from the line of Frank Schiraldi with Piper Sandler.

Frank Schiraldi: Just first on the NIM guide. Obviously, better NIM guide driven by the additional rate hikes. But I wondered if you could give any additional color on it, if there's any other inputs in how they might have changed versus previous guide, whether it's cash or deposit betas or change in loan betas or anything other than just the additional rate hikes that are now baked in the 13%?

Dominic Canuso: Sure, Frank. This is Dominic. The increase in the NIM is primarily driven by the higher interest rate environment. We do expect betas to pick up in the second half of the year, but those betas would be somewhat less than a full cycle as betas would continue to increase into 2023.

But the higher interest rate benefit is really coming from variable rate loans, churn in the portfolio and churn in the investment portfolio as well.

Frank Schiraldi: Okay. In terms of the deposit betas, can you just remind us basically your expectation through the cycle that betas will be similar to last time around? And when do you have those sort of ramping up to that?

Dominic Canuso: Sure. Our long-term historical beta, it was closer to 50%. However, in the last rising rate environment, it peaked around 25%, which would be – we would expect to be the near-term performance over the next 1.5 years. For this year, given the timing of the rate increases, particularly with seven remaining in the second half of the year, we would expect the deposit beta to ramp up around 10% to 15% by year-end with some continued increases into 2023.

Frank Schiraldi: Okay. That's great. And then -- just in terms of the consumer growth in the quarter, I wondered if you could give any more detail, any more color on the growth in unsecured consumer versus home equity? And maybe if you just have the -- within that 13% of the loan book, the variances within consumer at this point?

Dominic Canuso: Sure. I'll provide a couple of data points. First, our partnership portfolios are about 45% of our total consumer lending. In the quarter, less than half was -- or about half was from upstart, which is unsecured. The remainder comes from the home equity line mortgage business or the traditional banking products. And as regarding the 13%, we have said strategically, we are comfortable with consumer loans growing to 20% of our total loan base.

Obviously, we will evaluate the product mix the credit environment and overall growth when we evaluate our investment on a quarter-to-quarter basis.

Frank Schiraldi: And within that comfort at 20%, is there -- has there been any detail on the unsecured portion, where your comfort level is there?

Dominic Canuso: We have internal limits on the unsecured limit. We are continuing to evaluate the performance, particularly of the Upstart product as we just launched it in the third quarter of last year. So, we're getting through our early vintage performance from a credit perspective, they are performing well. We still have capacity to grow that business meaningfully in the coming quarter and years to stay within our concentration limit.

Rodger Levenson: Yes. Frank, this is Rodger. Just to add to that, so the unsecured limit in our concentration policy is 20% of Tier 1 capital plus ACL. And we're – as Dominic said, we're well below that at this point. So we have some more headroom to grow. It's still a relatively modest portfolio, early days in credit vintage. So we'll continue to monitor it and adjust our originations as situation dictates.

Frank Schiraldi: Right. Okay. But just summarizing those numbers a little bit if I could. In terms of -- Dominic, you said the partnership portfolio is about 45% of total consumer. And then obviously, the unsecured portion is a portion of that. Did you say whether -- is that about half of that 45%? Did you guys give that detail? I'm sorry if I missed that.

Dominic Canuso: Yes, it's less than half. It's around $200 million.

Frank Schiraldi: Okay. Great. And then if I could just sneak in one more on the updated fee outlook. I just wondered if you could remind us in terms of I think you might have touched on it, but the Wealth Management business, just the building around that in terms of how much of the market volatility we've seen to date is already priced in, would you say, for the 2Q run rate?

Art Bacci: Frank, this is Art Bacci. I'd say we still have some declines to see in the third quarter. A good portion of our AUM business is billed in arrears. So you would see the third quarter would be based off second quarter AUM balances, which were down about 12% quarter-over-quarter. But I would also remind you that we have a pretty diversified Wealth business.

So while the AUM business is around 35%, 40% of our fees, we have -- rest of the business is pretty much tied to account based fees and transaction-based fees. So that helps to kind of offset some of that decline.

Operator: (Operator Instructions) And our next question comes from the line of Mike Perito with KBW.

Michael Perito: Apologies if I missed this. I don't think you guys mentioned this explicitly when answering Frank's questions around the consumer lending piece. But what -- the loan growth guide for the year, and it sounds like a little bit of a pickup maybe in the back half of the year, what's the mix of that?

Are you guys assuming that the consumer production kind of stays where it's been in the last quarter or 2, which has been fairly robust? Are you assuming there's some drop off of that just given some of the macro uncertainty that we're all kind of dealing with right now?

Dominic Canuso: Sure. The growth rates do include continued growth in the consumer loan book, particularly driven by those partnership products, but we anticipate the growth in the second half of the year to be less than the second quarter, but still robust.

Michael Perito: Got it. And at this point, particularly in the unsecured personal lending book of business, understanding that I believe if I recall, you guys had some fairly specific credit standards and it's all fairly geographical relevant types of credits that you guys are taking on. But are you guys changing your thought process around unsecured lending at all with inflation and rates moving higher? And has that kind of changed the equation for you guys at all or not yet?

Dominic Canuso: So, we continue to evaluate the performance, which is very strong and still favorable to expectations. As we just discussed, the unsecured product is still a very small portion of the overall total portfolio, less than 2%.

And given the yield that we are seeing on the product, and the ACL coverage that we have -- setting aside for this product, we are comfortable with continuing to look at it -- given the economic forecast, but we will continue to monitor on a quarter-to-quarter basis.

Michael Perito: Great. And then secondly, for me, it seems like the Bryn Mawr integration is going well. Some of the one-time charges should moderate in the back half of the year, which will be good for kind of your capital building, particularly with the NIM moving higher.

Obviously, quite a bit of buyback outstanding here. But how do you guys balance between AOCI and the Bryn Mawr transaction? Obviously, book value has taken a step lower here over the last 12 months or so?

And how do you guys balance continued kind of book value degradation with buybacks versus kind of the excess capital build that presumably you guys are going to start to see over the next few quarters with the NIM moving as high as it is?

Dominic Canuso: Yes. It's a good question, an important one. A couple of key points. We expect to continue to generate significant capital from our returns as we've seen in the last few quarters and expect that capital to return.

Our regulatory capital ratios, as I mentioned, are significantly ahead of well capitalized. So from a regulatory capital, we have significant capacity. While the AOCI is impacting the TCE ratio, and that is something that we consider in our decisioning for capital, we continue to look for opportunities to hedge as we have in the first quarter by migrating the investment portfolio along with other hedging strategies.

And as always, we utilize our long-standing practice of evaluating capital deployment. With that said, in addition to the 2 notable items of increasing the dividend 15% to $0.15 per share, and the share authorization, we have re-evaluated our capital return philosophy.

Historically, as you may have heard us speak over the last few years, we would return a minimum of 25% of our capital split equally between a purposely low dividend and share repurchases regardless of price. Given our returns and growth expectations, we have increased that to 35% with up to 35% of capital returned annually -- of earnings returned annually.

But now it's 1/3 purposely low dividend and 2/3 share repurchases regardless of price. So it gives us a little bit more capacity within our practice to do routine share repurchases. And then incremental to that would be dependent on capital need growth prospects economic view and then ultimately, the share price as that's a major contributor to our decision to buy back shares and ensuring we get a strong IRR on those purchases.

Michael Perito: Great. That's really helpful. Appreciate that. And then just last for me. The -- on the loan portfolio, at this point, is the runoff residential mortgage loans. Is that really the only thing of a significant size left that's running down that would impact your net growth as we move forward here?

I believe there might be a few other small things, but there's -- most everything else should have kind of concluded here. Is that correct? Or am I forgetting about anything else?

Dominic Canuso: No, that is correct. All other portfolios that we may have either historically called run-off have run their course, particularly from the Beneficial transaction. And then with this KCMI portfolio sale, the only portfolio that we're not continuing to book is the held for investment resident consumer residential portfolio.

Michael Perito: Okay. Which is just the $600-plus million?

Dominic Canuso: Correct.

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

Dominic Canuso: Thank you, and thank you, everyone, 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 then. Have a good day.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating, and you may now disconnect.