WSFS Financial Corporation
First Quarter 2019 Earnings Conference Call
Friday, April 26, 2019, 1:00 PM Eastern

Officers

Rodger Levenson; President, CEO
Dominic Canuso; EVP, Chief Financial Officer
Art Bacci, EVP, Chief Wealth Officer
Steve Clark, EVP, Chief Commercial Banking Officer
Rick Wright, EVP, Chief Retail Banking Officer

Analysts

Frank Schiraldi; Sandler O'Neill
Austin Nicholas; Stephens
Michael Perito; KBW
Russell Gunther; D.A. Davidson

Presentation

Operator: Good day, ladies and gentlemen, and welcome to the WSFS Financial Corporation First Quarter 2019 Earnings Conference Call. (Operator Instructions)

As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host, Mr. Dominic Canuso, Chief Financial Officer. Sir, you may begin.

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

Before Rodger begins with his remarks, 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. With that read, I'll turn the discussion over to Rodger Levenson.

Rodger Levenson: Thanks, Dominic. And thank you again to everyone for joining us on the call.

As expected, there is a fair bit of noise in the numbers due to the closing of the Beneficial acquisition on March 1st. Additional detailed information on the Day-1 transaction impact and purchase accounting adjustments are included in the earnings release supplement posted on our website. Dominic will provide additional context and details on the financial results after my overview comments.

We are pleased to report very solid results for the first quarter of 2019. Core earnings per share were $0.91, representing a 20% increase from first quarter of 2018. Core ROA was 1.59%, compared to 1.43% in the first quarter of 2018 as well.

Each of our business lines demonstrated very good performance this quarter. Loan and deposit growth was supported by our Net Interest Margin which expanded 14 basis points on a linked quarter basis highlighting the strength of our customer relationships and the value of our combined core deposit franchise.

Fee income also grew nicely and was well diversified. Expenses were well managed. Credit Costs were elevated, primarily related to an increase in reserves on one existing, legacy WSFS non-performing loan.

As outlined on Page 4 of the supplemental materials the transaction metrics of Beneficial at closing have improved when compared to pro forma estimates communicated at announcement last August.

Due primarily to the change in the overall market, underlying performance of the Beneficial portfolio, and the interest rate environment, the transaction is immediately accretive to tangible book value.

We also have higher starting capital levels than original modeling and projections in our regulatory application. Since both earnings potential and capital are stronger than anticipated, we will look to be an aggressive buyer of our stock at current price levels.

Although it has been less than two months since the close of the merger, the early signs of the potential power of the combination are evident with 240 referrals received from Beneficial branches into our Mortgage, Small Business, and Wealth businesses, and consistent with our expectations for tremendous revenue synergy opportunities.
Additionally, we have attracted new talent to our organization with four new C&I Relationship Managers, three in Pennsylvania and one in New Jersey; and two new Wealth advisors joining us over the past two quarters--all eager to capitalize on our unique market position.

We are also pleased with the progress on the Beneficial integration. Our teams are working collaboratively in preparation for the conversion and integration of our systems scheduled for the weekend of August 24th and 25th.

We are also looking forward to the first step in our retail office optimization plan, with the previously announced divestiture of five branches in New Jersey to the Bank of Princeton, scheduled for May 17th. The majority of the remaining 25 office consolidations will occur with the systems conversion in August.

Our strong performance in what has typically been our seasonally weakest quarter in terms of revenue and expenses sets us up nicely to deliver our full year ROA goal of 1.50%.

I will turn it back to Dominic to walk you through the numbers.

Dominic Canuso: Thanks, Rodger. Good afternoon, everyone. Before jumping into our first quarter results, I would like to comment on some notable updates regarding the Beneficial transaction economics, which is summarized in our supplement financial information posted on the Investor Relations section of our website.

Based on the Day-1 transaction value and consideration, Price to Tangible Book Value and Core Deposit Premium both considerably improved to 130.6% and 7.2%, respectively. Also, given the inherently stronger performance in the Beneficial portfolio yields, stable credit performance, and lower interest rate environment, Day-1 purchased loan marks were $63 million lower, with a longer estimated life than estimated at the time of the transaction announcement. While this will result in lower purchase accounting accretion, this is materially offset by higher base Net Interest Margin due to the higher yields and lower Beta of the combined portfolio.

Now on to our first quarter results.

Our Reported results for the quarter included only one full month of combined performance post-acquisition and $31 million of Corporate Development and Restructuring charge all related to the Beneficial Transaction and consistent with our original expectations. In addition, we recognized $3.8 million of unrealized gains on Visa Class B shares, which brings our total realized and unrealized gains on Visa Class B shares to $28.3 million, life-to-date.

Our core results for the quarter demonstrated both a successful close of the Beneficial transaction along with strong business performance across our segments, continuing the positive momentum from 2018.

Core performance highlights for the quarter include the following:

1. Net loan growth was 6% annualized, which included three months of WSFS growth and one month of Beneficial growth. When looking at the total growth for the quarter compared to a combined WSFS and Beneficial 12/31/18 view, loan growth was 5% annualized for the quarter and more indicative of actual performance. This excludes the designated runoff portfolios of residential mortgage, auto loans, and legacy Beneficial student lending, and this was slightly ahead of our expectations and led by strong growth in Construction loans and Consumer lending. We continue to maintain our pricing and structure discipline as evidenced in expanding loan yields and stable leading credit metrics. We are pleased with a healthy, initial combined 90-day-weighted-average Commercial pipeline of approximately $200 million.

2. Customer deposits grew five -- was 5% annualized, which included three months of WSFS growth and one month of Beneficial growth. When looking at the total growth during the quarter compared to a combined 12/31/18 view, customer deposits grew just over 1% annualized for the quarter, and excludes one large legacy Beneficial relationship that was anticipated to exit the bank since late last year. This is also more indicative of the true performance and is in line with our expectations and considered a positive result, as the first quarter's typically soft due to seasonal reductions of public and municipal funding. WSFS and Beneficial through-the-cycle Deposit Betas, both held flat quarter-over-quarter at 25% and 11%, respectively, as the marginal deposit betas in the quarter was zero across both portfolios. This demonstrates the continued strength of the combined low-and no-cost relationship-based deposit franchise across our expanded footprint.

3. NIM for the quarter was 4.30%, and is 14 basis points higher than the fourth quarter of 2018. This includes one month impact of the Beneficial portfolio, including NIM compression from the lower loan yields from that portfolio, somewhat offset by purchase accounting accretion. The improvement in the quarter resulted from expanded loan yields across the total portfolio, the previously mentioned flat deposit betas, along with a positive impact from the planned balance sheet optimization and repositioning strategy.
While we see opportunity in NIM versus our previous full-year Outlook, this would be offset by a smaller balance sheet resulting in the balance sheet optimization and upcoming branch sale. We see the second quarter NIM performance closer to 4.40% due to these aforementioned factors.

4. Core fee income was $37.3 million and 16% higher when compared to the first quarter of 2018. When excluding one month of fees from Beneficial, Fee Income grew 12% across legacy WSFS' well-diversified products and services. While our Fee Income ratio of 30.9% for the quarter is expected to normalize in the 26% - 28% range through the remainder of 2019 due to the lower historical fee income ratio from Beneficial, as Rodger mentioned, we are seeing early and positive results of implementing our revenue synergy strategies across mortgage banking, small business, private banking, and wealth.

5. Total credit costs were $7.9 million for the quarter, including reserves on a previously classified, nonperforming commercial loan. Leading credit indicators remained strong and steady at historically low levels.

It is important to note that the increase in reported delinquencies is due to the acquired Beneficial loans, primarily driven by approximately $24 million of U.S. Government-guaranteed student loans that continue to accrue interest with little risk of credit loss. Charge-offs were also low for the quarter. Excluding the incremental reserve from the one aforementioned NPL, credit costs would have been below the low end of our range for the quarter. And while credit costs can be uneven quarter-to-quarter, we continue to expect full year credit cost in the range of $18 million to $22 million on a full year basis.

6. The Core Efficiency Ratio of 55% demonstrated significant improvement compared to both 4Q 2018 and 1Q 2018. When normalizing for a few non-reoccurring revenue and expense items, the Core Efficiency Ratio would have been approximately 57% and slightly favorable to our expectations as we continue on pace to deliver a full-year Core Efficiency Ratio of 58%.

While an expectedly noisy quarter, we are pleased with both the results and the trajectory of the business, and remain on track to deliver on a full year 1.50% Core ROA.

We are happy to answer any questions you may have at this time.

Questions and Answers

Operator: (Operator Instructions) Frank Schiraldi from Sandler O'Neill.

Frank Schiraldi: Just trying to get my arms around the NIM here. Dominic, what did you say the NIM was going to look more like in 2Q?

Dominic Canuso: 4.40%.

Frank Schiraldi: And how would you break out the benefit from purchase accounting accretion from the -- how much of that is PAA?

Dominic Canuso: So that would approximately include 38 basis points of Beneficial specific purchase loan accounting -- purchase accounting accretion.

Frank Schiraldi: Now, was there anything -- the contribution in the first quarter from purchase accounting seemed kind of outside, given that Beneficial was only closed one month, so just wondering if you could maybe speak to that. And also, the change in amortization method, the effective interest, is that an accelerated method?

Dominic Canuso: Sure. First I would say there was only a few basis points of incremental benefit in the quarter from Beneficial purchase accounting accretion, due to some shift in more benefit coming from the CD mark than the loan mark, but not necessarily out-sized for what we would expect for the remainder of the year.

Frank Schiraldi: Okay.

Dominic Canuso: And your second question?

Frank Schiraldi: Was on the effective -- the amortization method for the marks.

Dominic Canuso: Thank you. Yes. So the method we're using is consistent with what we have done in previous deals and what you would expect. The straight-line method used at the time of announcement was a simplified method to anticipate, conservatively anticipate the life of the loans prior to fully analyzing the portfolio and loans.

Frank Schiraldi: Okay. I'm just wondering. It seems like the -- certainly the marks have been reduced significantly. But it seems like we're still going to see this very similar purchase accounting accretion here in the near term. So is it front-loaded now, the purchase accounting accretion? Or is that not the case?

Dominic Canuso: Yes. The first thing I would clarify is that the marks are lower. But because we have a lower balance sheet, the impact on the net interest margin is higher than we anticipated. So if you recall at the time of announcement and over the last few quarters, we had mentioned the expectation of 30 basis points from purchase accounting accretion specifically from Beneficial. That will be closer to 37 basis points due to the lower balance sheet.

There is some front-end loading due to some of the marks, the higher marks from the CD portfolio. But in total for the year, we're relatively flat for the impact. But the marks in the long term are offset by higher yields on the portfolio, lower deposit cost from the lower betas, and the lower interest rate environment.

Frank Schiraldi: Okay. And then just you spoke to credit already. You saw criticized and classifieds looked like they ticked up a bit, even excluding Beneficial. But it sounds like that's just sort of bouncing around here. And then you're not seeing any sort of signs of deterioration?

Dominic Canuso: That is correct.

Frank Schiraldi: Okay. And then just finally, just a question on Cash Connect. It seems like you're growing the number of ATMs you guys are servicing, pretty rapidly, I don't know, just given what I saw in the 10-K and what you have here in the release. And I wonder if you could just talk a little bit about that. And then also the disclosure on one of your customers no longer using WSFS for the bailment business, and if that's something that we should just anticipate that business may contract just given the lower margins. Thanks.

Dominic Canuso: Sure. Thanks for those questions. First on the number of ATMs, I want to clarify that you'll see in the release we communicate both the ATM and the Smart Safe amounts. So ATMs continue to grow, but a lot of the growth is coming from the Smart Safe business as well, and we combine those numbers in the release now, when you see a 28,000-plus ATM metric.

We still see opportunities for both of them to grow strongly, and we'll look for those opportunities and price them appropriately to continue to grow the ROA of the business.

Specifically to the one customer attrition that we had in this quarter, that was anticipated in our full year expectations, and we were looking to do that this quarter. And in fact, is part of our grander exercise to improve the return for the business from the 80 basis point range back over 100 basis points closer to 150 and beyond, to be accretive to the bank overall. And you'll in fact see, while net income quarter-over-quarter is flat, that's coming with a reduced balance sheet of about 15% as we reposition the portfolio and business to generate higher returns so that as we continue the growth story, we'll be able to take advantage of that growth.

Rodger Levenson: Yes. This is Rodger. I would just add some color. As Dominic said, this is a very large, strong relationship, which we knew about this for some period of time. And we think that, obviously, we've made the proper tradeoff, while still preserving some of the fee income parts of that relationship, the value-added services. We don't see anything else of that magnitude in the near term that would indicate there's any kind of a trend.

Frank Schiraldi: All right. Thank you.

Operator: Austin Nicholas from Stephens.

Austin Nicholas: Appreciate the commentary on the margin and the expectations for the second quarter, Dominic. But maybe as you think about the full year for 2019, can you maybe give us a sense of where you'd expect the margin to come in from a top line reported number? And then, I guess excluding purchasing accounting accretion, really just kind of updating us from the, call it just under 4.1% that was the previous guidance.

Dominic Canuso: Sure. Thanks, Austin. At this point in time, clearly, we have one month of reported performance under our belt. And so while we feel comfortable with sharing our expectations for the second quarter, we continue to look at that full year impact. But it would likely continue in that range of 4.40% for the remainder of the year. But at this point in time, like I said, given the size of the balance sheet, we still hold to the 1.5% ROA for a full year basis.

Austin Nicholas: Understood.

Rodger Levenson: Yes. This is Rodger. I would add color to that. Obviously that's our forward view, assuming we are able to hold deposit betas at the current levels, there's no significant change in the interest rate or economic environment, or in loan pricing yield.

Austin Nicholas: Understood. That's helpful. And then I guess maybe just looking out to 2020 and 2021, are there any changes to the core return on average assets, I guess goals in 2020 and 2021, given some of the dynamics with purchase accounting accretion?

Dominic Canuso: So great question. And in our supplemental material that we posted on the website, you'll see that our EPS accretion expectations from the transaction are consistent with the original announcement. And that's a result of us continuing to hold that our ROA trajectory that we previously communicated for 2019, 2020, and 2021, are consistent.

As I mentioned earlier, while there is lower purchase accounting accretion, much of that is due to the stronger underlying performance of the business both on loan yield and credit metrics, along with the lower interest rate environment that is demonstrated in our lower deposit betas and a lower wholesale funding. So we believe, in total, they are balanced, and our expectations for the out years remain the same.

Austin Nicholas: Understood. That's very helpful. And then maybe just one last one on capital. You mentioned kind of being more aggressive on the buyback given where the stock is. I guess, could we see the total payout come above the 25% kind of minimum that the company targets as you combine the dividend with the buyback? And any thoughts on just how you're thinking about capital from here? I know it's early.

Dominic Canuso: Yes, it's clearly early. But we're very pleased with the capital levels and capital ratio post-close. And we continue on our path to deliver a minimum 25% of our earnings through the dividend and share buyback and would look to do more as we vet the full year expectation, clearly incremental to our original plan, original pro forma, and a regulatory application, and would look to increase that throughout the year.

Austin Nicholas: Understood. Thanks for taking my questions.

Operator: Michael Perito from KBW.

Michael Perito: I have a two things, couple follow-ups, wanted to start maybe just on the margin ex the purchase accounting accretion. Is it correct to assume that it was about in that 4.13% range for the first quarter, and then there's still another 12 basis points to come out of that just from the full quarter's impact of Beneficial, which I think you guys mentioned was a 6 basis point drag in the first quarter?

Dominic Canuso: You are correct.

Michael Perito: Okay. And then as it relates to -- and I know I probably know the answer already, but I'm going to try it anyway. But just as related to CECL, I know you guys are probably still in the process and, obviously, with the Beneficial deal have had other things occupying some of your time here.

But can you give us maybe a little maybe high level thoughts, if not number-specific, about how CECL could change both the margin and the reserve as it relates to the credit market and just the absolute reserve level and how that dynamic could maybe play out in early 2020?

Dominic Canuso: Sure. Thank you, Mike. And while we have been focused on Beneficial, we have also been focused on CECL, and we are in the midst of implementing our new solution and doing parallel testing for the full year of 2019. It is a little early for us to provide an indication. But we would expect at the end of our second quarter results and our disclosures for the second quarter, to include some of that material, and we'll be better suited to speak to it then.

Michael Perito: Is it fair to say, though, that as you see it today, it's not going to really change anything materially that you -- I mean I guess if we stayed focused on that ROA target, which seems to be the easiest thing, just because obviously there's moving pieces elsewhere, you don't anticipate that really altering that in any meaningful way, correct?

Dominic Canuso: So let me clarify. The ROA targets that we've been discussing since the announcement of the combination last August, for both the 2019 ROA expectations and the out years, did include an impact from, the lease accounting, from CECL, from crossing $10 billion, and Durbin, and at this point in time all of our assumptions continue to hold, and we don't see anything from those particular items impacting at this time.

Michael Perito: Got it. Helpful. Thank you. Just a couple other things I wanted to hit quickly. Can you maybe help us a little bit, some of the expense commentary in the prepared remarks was helpful and, obviously, the core expense run rate looked pretty solid in the first quarter. But just from a timing perspective, can you give us a little bit of a sense of maybe how you expect the operating expenses to trend over the balance of 2019, given the first month you've seen and the first quarter of legacy WSFS expense?

Dominic Canuso: Sure. First I'll say we do reiterate our expectations of the 58% efficiency ratio. The first quarter was particularly favorable due to some nonreoccurring and one-time items. It was also favorable to our own expectations just because of the focus within the organization ensuring a very strong legal Day-1 of the combination. We expect those costs to increase in the second quarter, with a full quarter run rate of the Beneficial transaction. And then with the third quarter, when we rationalize the branch count, rebrand, and consolidate our technologies through the conversion and integration late August, we will begin to see the significant cost saves, so we'll have some of that in the third quarter, with the fourth quarter really being a full quarter impact and more indicative of the future run rate, post the Beneficial combination.

Michael Perito: And are you guys willing at this point to provide a range about where you think that kind of run rate Q4 number could end up? Or is it still too early at this point?

Dominic Canuso: It's a little early. But as we mentioned, we still believe and expect the 1.50% ROA, which is dependent on us hitting a full year 58% efficiency ratio and improvement year-after-year on that ratio due to the annualization of those cost saves. And the improvement of our cost saves, if you recall in the pro forma, we had expected in 2019 to achieve 50% of the cost saves, increasing to 90% in 2020, and then 100% by 2021. And those will play out in the efficiency ratio as well.

Michael Perito: Got it.

Rodger Levenson: Yes, Mike. This is Rodger. Obviously on CECL, I think that the best way for us to give you an indication is, as Dominic said, to run our models parallel for a quarter or so, especially considering how things landed with the Beneficial loan book. And as you can imagine, there's just literally dozens of assumptions. And so it'll be a much more educated estimate this time next quarter.

Michael Perito: Got it. No, I appreciate that. Thank you, guys. And then just one last quick one. Dominic, can you share what your initial expectations are for average earning assets in the second quarter, just with the full -- with all the kind of the repositioning you did on the balance sheet and the full quarter's impact from Beneficial? I just want to make sure I'm thinking about that average earning asset base right as we move to 2Q.

Dominic Canuso: Sure. Yes. What I would say is our spot balance at the end of the quarter for interest-earning assets is more indicative of the second quarter, because of the balance sheet optimization and repositioning. We do look to relever and make some purchases in the second quarter of some MBS in our investment portfolio. And so we would see it in the $10.4 million dollar range.

Michael Perito: Got it.

Rodger Levenson: Billion.

Dominic Canuso: Billion. Thank you.

Michael Perito: Yes, I got you. Helpful, guys. Thank you for the color. Appreciate it.

Operator: Russell Gunther from D.A. Davidson.

Russell Gunther: Just following up on Mike's question here. I think you got to the meat of it. But is the balance sheet optimization and repositioning, is that complete and in this number? Is there anything else considered that's forthcoming and in that kind of $10.4 billion earning asset range?

Dominic Canuso: So for the most part, we're about 85% to 90% complete. At this point, we continue to just pace in the repurchasing of the investment portfolio to dollar cost average our purchases. But other than levering back up a couple hundred million, the majority of the repositioning was complete just prior to and within the first few weeks of the combination.

Russell Gunther: Okay. Great. Thanks, Dominic. And then going forward, could you just remind us of, in consideration of perhaps some runoff portfolios, where you'd expect net loan growth to pace on a quarterly basis for the remainder of the year?

Dominic Canuso: Yes. So as we mentioned before and we still hold to these, and, again, reminding that we've had only one full month of the combination. The loan growth expectations for the year are in the low single digits, and that would include organic growth, purchase loan accounting, and some runoff portfolios.

Russell Gunther: Perfect. All right. Very good. That's it for me. Thanks, guys.

Operator: (Operator Instructions) And with no further questions in the queue, I would now like to turn the call back to Mr. Rodger Levenson for any further remarks.

Rodger Levenson: Thank you. And again thanks everybody for joining on our call today. Dominic and I will be on the road at Investor Conference, along with various other investor meetings during the coming weeks. We look forward to seeing many of you, and again appreciate your time today. And as always, please feel free to contact us directly with any other further questions. Thank you and have a good day.

Operator: Ladies and gentlemen, thank you for your participation in today's conference. This concludes today's program. You may all disconnect. Everyone have a great day.