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WSFS - Q1 2018 WSFS Financial Corp Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the WSFS Financial Corporation First Quarter 2018 Earnings Conference Call. (Operator Instructions) And as a reminder, this conference is being recorded. I would now like to turn the call over to your host today, Mr. Dominic Canuso, Chief Financial Officer. Sir, you may begin.

Dominic C. Canuso - *WSFS Financial Corporation - CFO & Executive VP*

Thank you, Amanda, and thanks to all of you for taking the time to participate on our call today. With me on this call are Mark Turner, Chairman, President and CEO; Rodger Levenson, Chief Operating 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 of 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. With that read, I'll turn the discussion over to Rodger Levenson.

Rodger Levenson - *WSFS Financial Corporation - COO & Executive VP*

Thank you Dominic and thank you all for your time and attention today.

We are pleased to report earnings of $37.4 million or $1.16 per share for the first quarter of 2018. Excluding the impact of the $1.7 million insurance recovery and the $15.3 million valuation increase of our Visa Class B shares, core earnings per share were $0.76, which is a 29% increase over earnings per share in the same quarter last year. These core results represent a core ROA of 1.43% and a core return on tangible common equity of 18.81%.

Our strong operating performance was driven by the combination of an 11% increase in core net revenue and an 8% increase in Core Non-interest expense compared to the same period in the prior year. This resulted in 3 percentage points of positive operating leverage. These results were achieved despite occurring in what has historically been our slowest quarter due to fewer days and heightened seasonality impacting both lower revenues and higher expenses.

Core net interest income grew by 9% when compared to the first quarter of 2017. A significant driver of this growth was our Net Interest Margin of 4.01%, which was 11 basis points higher than the first quarter of 2017. As detailed in the release, this growth was a result of the higher short-term rate environment, balance sheet growth, and the redemption of our $55 million senior notes in the third quarter of 2017.

Net loans increased 3% on an annualized basis, excluding the continued expected run-off of our residential mortgage portfolio. Commercial loan growth of 2% annualized was impacted by payoffs in our commercial real estate and C&I portfolios as well as overall lower originations, which were primarily related to the ongoing highly competitive pricing environment.

Total customer funding declined 1% on an annualized basis excluding the anticipated seasonal run-off of public funding dollars. This decline reflected seasonal trends as well as the impact of promotional deposit pricing which we have seen in our markets.

Loan and deposit growth was below our full year run rate expectations. However, we believe that our current strong margin, combined with the full impact of the recently completed rate increase of 25 basis points by the Fed on March 21st and potential additional increases, provides flexibility and optionality to respond to competition for both loans and deposits consistent with our mid to high single-digit growth rate expectations for the full year.

Core non-interest or fee income grew a very healthy 16% in the quarter when compared to the first quarter of 2017. This performance was driven by increased revenue across each of our major fee-based businesses reflecting solid organic growth.

Core non-interest expense growth of 8% was in-line with our expectations and included a one-time expense of $900,000 related to the surrender of our BOLI policies, which will be more than offset with the income related to the reinvestment of these funds over the next few quarters.

Our core efficiency ratio of 61.1% puts us on track to achieve a full-year core efficiency ratio of under 60%.

Credit remained stable with all key metrics showing either a slight improvement or remaining essentially flat compared to the fourth quarter of 2017. Total credit cost for the quarter were $4.1 million. We still expect full year total credit costs to be in the range of $13 million to $15 million, but, as we have discussed previously, with some level on of unevenness quarter to quarter.

During the quarter, we made the decision to update the calendar of our annual capital management planning process, moving from the third quarter of each year to the March/April timeframe. This will align with the completion of our annual planning cycle and with an early outlook on actual full-year performance. Our capital return policy has not changed. We target an annual cash dividend of 10% to 15% of earnings, with another 10% to 15% of earnings through stock buybacks regardless of price, with a combined target of at least 25% of earnings returned to our owners annually.

Consistent with these targets and in conjunction with our updated planning calendar, we announced a 22% increase in the quarterly dividend, to $0.11 per share, reflecting both our core operating performance and the impact of the tax law change at the end of 2017. This higher dividend would put us right around the midpoint of our 10% to 15% of earnings target based on our 2018 plan. This is the second increase in the past 3 quarters and represents a combined 57% increase in the dividend over that period of time.

In conclusion, the first quarter was a very solid start to the year. Our strong revenue growth demonstrated the strength and diversity of our franchise. Expenses were well managed especially during a quarter where they are typically elevated due to seasonality. Going forward we believe that our market position and brand will allow us to address the impact of the on-going competitive rate environment in a manner that will grow long-term franchise value. Considering all of these dynamics, we remain on track to achieve a full year ROA of 1.50%.

Thank you. At this time, the team will be glad to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Frank Schiraldi of Sandler O'Neill.

Frank Joseph Schiraldi - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Good afternoon guys. Just a couple of questions, if I could. First, I just wanted to ask on the NIM. I believe guidance was in the 3.90s. You're starting off the year pretty strong. Is that looking quite conservative here? Or would you say, given the slow start to loan growth, you might need that pricing flexibility to get to those goals and then that 3.90s number is still reasonable? I'm just wondering if you can remind us what's behind that guidance in terms of rate hikes and how you feel about it.

Dominic C. Canuso - *WSFS Financial Corporation - CFO & Executive VP*

Hi, Frank. This is Dominic. So first off, we did have a stronger than expected first quarter in net interest margin. There were a couple of factors attributing to that, foremost were a couple, well, I'll say, noncore items, specifically the restructuring of the BOLI, which will add a couple basis points to the run rate as we surrender that and reinvest portions of that into higher-yielding agency MBS investments. We also revalued the reverse mortgage portfolio, which will add a couple basis points on a full year basis, and then the higher FHLB dividend that was announced in the first quarter. So those add about 5 basis points, not only to the quarter, to the run rate for the year. But in addition to that, we have been able to maintain our beta to the low end of historical averages. As we've discussed before, our beta historically has been about 50%. Our beta through this rising rate environment for the last 6 increases is trending around 15%. And that is outperforming our expectations. In addition, the LIBOR curve has accelerated relative to the Fed funds rate, so we also are seeing higher yields on our loan book. So all of those contributed to a very strong quarter but all are expected to continue. We do have the expectation of one rate increase in our projections, which is in June. And while there is potential for more than that, that would provide tailwinds to allow us to focus on a balance of net interest margin and growth rate, as Rodger mentioned. So for the second quarter and the full year, we do expect net interest margin to be consistent with the first quarter.

Frank Joseph Schiraldi - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Great. Okay, thanks. And just my other question was on fee income, was on the Cash Connect business, and revenues were up, bottom line earnings did not grow, and I guess you're seeing greater expenses as the short-term rates move higher. Just wondering if that -- you can talk a little bit about the ROA on that business. I know it has, in the past, been higher, I think in the 2% range. And just wondering where that ROA is trending to and still -- if you're still confident in that being accretive to the overall blended ROA? Thanks.

Dominic C. Canuso - *WSFS Financial Corporation - CFO & Executive VP*

Good question, Frank. This is Dominic again. So just to restate the performance in the quarter, there was high double-digit growth for fee income that resulted in about 12% net revenue growth, that ends up with a core income of relatively flat. Historically, this business was now around 1.20% to 1.30% marginal ROA. And with pricing pressures in the market due to the consolidation within the industry, that pushed that ROA closer to 1%.

For the last year, with rising rates, that has compressed our margin in the business. What we are actively doing is optimizing the balance sheet between our on-balance sheet and off-balance sheet funding to shift more to off-balance sheet, which would improve our ROA. But as we've done that, it has compressed bottom line growth. We do expect that to continue somewhat throughout 2018. But once we're done that restructuring, the ROA would be back to its historical averages. In addition, as we invest in the Smart Safe business and other logistics fee income products, we expect the revenue to stay on track in that double-digit range. And once we do that, we expect that growth to drive additional net income.

Mark A. Turner - *WSFS Financial Corporation - Chairman, President & CEO*

And this is Mark. Just to add some historical context. The ROAs that Dominic made reference to, historical ROAs of that business, the kind of 1.30% to 1.50%, were pre the tax change, so that would equivalize a greater than 1.50% ROA. And it's our goal to have all of our business units being at that 1.50% or higher range and the Cash Connect business right now is in a bit of a transformation, with both the -- what's going on in their marketplace and customers and technology and interest rates, but they are actively working the plan and over time. They've been a great business for us, a great source of revenue, diversification, and we certainly would expect them to get back to that level.

Frank Joseph Schiraldi - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Thank you.

Operator

Our next question comes from the line of Joe Gladue of Merion Capital Group.

Joseph Gladue - *Merion Capital Group LLC, Research Division - Director of Research*

Afternoon, I just wanted to talk about the loan pipeline and loan growth size. Yet -- can you still -- I guess your expectation is still the same for full year growth and wondering if you could touch on where the loans are growing, what loan categories are driving growth?

Stephen P. Clark - *WSFS Financial Corporation - Chief Commercial Banking Officer and EVP*

Hey, Joe, this is Steve Clark speaking. Yes, so as Rodger indicated, we still believe mid to high single-digit loan growth remains forecasted for the year. It's kind of a combination of factors. Our pipeline remains fairly strong, kind of a 90-day weighted average of $102 million, plus or minus. There's still continued disruption in our Southeastern Pennsylvania market, so clearly, there's opportunity there. We have a significant amount of construction loans that have closed but have not yet funded. So those commitments will fund as we go through the next 2 quarters. And then lastly, we experienced some line of credit paydowns in the C&I book in the first quarter. We believe they're temporary, and we should see readvances on those lines as we go through this frame. So kind of 4 factors combining to lead us to -- continue to forecast that mid to high single-digit growth.

Mark A. Turner - *WSFS Financial Corporation - Chairman, President & CEO*

This is Mark. On top of that, as was mentioned earlier and alluded to, the margin for the company is much stronger than we expected starting the year, and typically, the first quarter is a weaker quarter in the margins. So we do have some flexibility there to provide for growth on both deposits and loans to react to the competitive price environment, but still show a margin with a fore handle.

Joseph Gladue - *Merion Capital Group LLC, Research Division - Director of Research*

Okay. And just I'd like to ask about the, I guess, the M&A appetite, particularly, I guess, in -- with the -- on the Wealth Management side.

Rodger Levenson - *WSFS Financial Corporation - COO & Executive VP*

So Joe, as we've talked about for a while, last year was a year of optimization and leveraging the prior investments that we had made, both on the traditional bank side and on the Wealth side. So we are back in what I would generally characterize as looking for opportunities in both spaces on the traditional bank side. Our focus continues to remain in Southeastern Pennsylvania, where we have built a really nice presence, but we think there's significant opportunity for more growth there. And then in the fee-based businesses, as particularly in the Wealth space, if there was opportunities to either expand our product offering or get some scale into some of our existing businesses, we would look to continue the pattern of several years ago relatively smaller fee-based deals that we could integrate relatively smoothly and not disrupt the momentum that we have in that business.

Joseph Gladue - *Merion Capital Group LLC, Research Division - Director of Research*

Thank you.

Operator

Our next question comes from the line of Catherine Mealor of KBW.

Catherine Fitzhugh Summerson Mealor - *Keefe, Bruyette, & Woods, Inc., Research Division - MD and SVP*

Thanks, good afternoon. On expenses, can you just update us on your thoughts on targeted efficiency ratio and your outlook for expense growth this year?

Dominic C. Canuso - *WSFS Financial Corporation - CFO & Executive VP*

Sure. As we provided, our expectations for the year is continued improved operating leverage and an efficiency ratio that's under 60%. And as you see in the results for the first quarter, we delivered stronger efficiency ratio this year than the first quarter of last year. We do expect that to help deliver the full year efficiency ratio below 60%. And as we always said, the beginning of the year, due to seasonality, it starts higher than 60% and then trends below into the high 50s, and we feel confident in delivering on that expectation.

Catherine Fitzhugh Summerson Mealor - *Keefe, Bruyette, & Woods, Inc., Research Division - MD and SVP*

Okay. Great. And then updated thoughts on the tax rate for this year. I think this quarter came in a little bit lower than expected.

Dominic C. Canuso - *WSFS Financial Corporation - CFO & Executive VP*

Sure. And as you may have seen in prior first quarters, the tax rate is affected by a benefit in stock option execution that reduces our effective tax rate by about 100, 150 basis points. We do expect our effective tax rate to be in the 23.5% to 24%, plus or minus any benefit or dilution from the tax rate for the full -- or from the ASU on tax base for stock comp. For the full year, we do expect it to be around 23%.

Catherine Fitzhugh Summerson Mealor - *Keefe, Bruyette, & Woods, Inc., Research Division - MD and SVP*

Okay. That's helpful, thank you. And then lastly, just off on credit, any kind of trends that you're seeing in classifieds and anything in particular that you're looking out for right now in your market? Thanks.

Rodger Levenson - *WSFS Financial Corporation - COO & Executive VP*

No. Catherine, as I said in my comments, we feel good, we think credit remains in a stable, positive bottom of the cycle. And both the leading indicators of delinquency and problem loans were essentially flat this quarter versus last quarter and hit historical, very low levels.

Catherine Fitzhugh Summerson Mealor - *Keefe, Bruyette, & Woods, Inc., Research Division - MD and SVP*

Great, thanks, you guys had a great quarter.

Mark A. Turner - *WSFS Financial Corporation - Chairman, President & CEO*

Thanks.

Operator

Our next question comes from the line of Russell Gunther of D. A. Davidson.

Russell Elliott Teasdale Gunther - *D.A. Davidson & Co., Research Division - VP & Senior Research Analyst*

Good afternoon, I'd like to follow up on Joe's question earlier on M&A within the Wealth space. You guys commented one of the things you'd look for would be to expand your product offering. I just wonder if you could give some color as to what you'd be looking for there.

Rodger Levenson - *WSFS Financial Corporation - COO & Executive VP*

There's nothing particular that we have targeted. But as we found with our acquisition of Powdermill there could be some niche areas in the Wealth space that we could find opportunities to, I would say, bolt-on to our existing platform. We feel very good that we have a full suite of Wealth Management products, but there could be unique sort of boutique businesses that are highly focused in one area that could be the kind of opportunity that we would look at.

Mark A. Turner - *WSFS Financial Corporation - Chairman, President & CEO*

On top of that -- on top of -- this is Mark. The only thing I'd add is in our Assets Under Management, there are some segments of the marketplace that we don't offer or don't have a robust offering in. So getting more scale and Assets Under Management and more products that would resonate with different classes of investors would be a priority for us as well.

Russell Elliott Teasdale Gunther - *D.A. Davidson & Co., Research Division - VP & Senior Research Analyst*

Okay. Great, thanks for that. And then last one for me. I thought I read during the quarter, you guys entered into a relationship with SoFi. Just wondering if you could give us some color on that and how that might manifest in your balance sheet or P&L, if at all?

Richard M. Wright - *WSFS Financial Corporation - Executive VP & Chief Retail Banking Officer, WSFS Bank*

Hi, this is Rick Wright. We are enabling them to offer a checking-like product and a debit card. That would be on their books, not ours. And that is probably something we'll see this quarter. They're out testing it with sort of the friends and family kind of thing right now. But it wouldn't affect our balance sheet. It would just be -- for us, it would be reimbursement of expenses and fee income.

Rodger Levenson - *WSFS Financial Corporation - COO & Executive VP*

Yes, so Russell, just remember, from a historical context, this is really a continuation of our partnership with a local company here, Zenbanx, that was acquired by SoFi. And we've been able to develop a nice relationship with them and extend that partnership, although it has a different content as Rick described. And the impact that we would expect to see this year with the rollout of the product would be nominal on our P&L.

Russell Elliott Teasdale Gunther - *D.A. Davidson & Co., Research Division - VP & Senior Research Analyst*

Ok great, I appreciate the color.

Operator

Our next question is from the line of Austin Nicholas of Stephens.

Austin Lincoln Nicholas - *Stephens Inc., Research Division - VP and Research Analyst*

Most of my questions have been answered, but maybe just on your Wealth Management and fee income outlook, I think the prior guidance was low double-digit range of growth for '18. Is that still what you're looking for, I guess, from a -- with 1 quarter behind you?

Rodger Levenson - *WSFS Financial Corporation - COO & Executive VP*

We are. That's overall for all of our fee businesses. The first quarter was particularly strong in our Wealth business, particularly the Christiana Trust business. A lot of that was tied to capital markets activities and bankruptcies. That business can tend to fluctuate a little bit. And then combine with some of the dynamics in Cash Connect that Mark alluded to and just what I call kind of normal cycle of our other fee businesses, would expect -- our current expectation is still that low double-digit full year growth expectation.

Austin Lincoln Nicholas - *Stephens Inc., Research Division - VP and Research Analyst*

Okay. That was great, thank you. And then maybe just on tax reform, any early positives or negatives you're seeing tangibly or hearing from both lending clients or within your Wealth Management business?

Mark A. Turner - *WSFS Financial Corporation - Chairman, President & CEO*

Yes, this is Mark Turner. No, I'd say the short answer to that is no. We haven't, it's early yet, and we haven't seen any tangible impacts. People continue to talk, but nothing is really showing up at the door yet. And so that's where we are. I think we, like everybody else, are hopeful that over the course of -- as people get through their planning of what it really means to them and get about executing those plans, so that's increasingly over the course of the year, we will show those opportunities in lending and in Wealth Management show up.

Austin Lincoln Nicholas - *Stephens Inc., Research Division - VP and Research Analyst*

Understood, thanks for the time guys, that's all I got.

Operator

Our next question is from the line of Matt Schultheis of Boenning.

Matthew Christian Schultheis - *Boenning and Scattergood, Inc., Research Division - Director of Research and Senior Analyst of Banks & Thrifts*

Good afternoon. I was just wondering if you are feeling any internal drive or external pressure to move more into the city of Philadelphia from the suburbs?

Mark A. Turner - *WSFS Financial Corporation - Chairman, President & CEO*

So that's a great question, Matt, in fact, one we just were discussing in our weekly staff meeting this morning. And so the answer to that question is yes, a little bit. And so we have a significant presence in the western suburbs, which are traditionally, we're a small urban, a great small urban, suburban bank. And we have that covered pretty well, but we're looking for more presence in the western suburbs, which are demographically rich and growing. But the fact is, if you're in this western suburbs they're suburbs of Philadelphia, so it makes sense to have some presence in Philadelphia. Just to reiterate, we already do have fairly significant commercial presence and Wealth presence in Philadelphia. So we have done several, several hundred million dollars worth, of construction and Commercial Real Estate lending in Philadelphia through our experienced team there that's been in that marketplace for a long time, that we picked up through acquisition of other institutions and then continue to do that business. And West Capital Management is right there in the heart of the business district at 18th and Market. But we have strongly considered, and probably within the next year or so, we'll be putting on a shingle in the business district of Philadelphia that acts as a loan production office, a place for customer relationship building and brand recognition right in the central business district. And then we'll kind of see where it goes from there. But we are in no hurry to build a big presence -- a big retail presence in Philadelphia. It's an extremely competitive market and with a different political and PR dynamic.

Matthew Christian Schultheis - *Boenning and Scattergood, Inc., Research Division - Director of Research and Senior Analyst of Banks & Thrifts*

Thank you.

Operator

(Operator Instructions) Our next question is from the line of John Anderson of Peoples Security Bank.

John Anderson

Good afternoon gentlemen and congratulations on a good quarter. My question centers around your -- the valuation of your class -- your Visa Class B shares and just the methodology that you put in place to generate that valuation as we're trying to get our hands around that, and it's hard for us to try to identify some transactions out there in the market?

Dominic C. Canuso - *WSFS Financial Corporation - CFO & Executive VP*

Sure. Good question, John. Thanks for joining the call. This is Dominic Canuso. So as our release stated, this investment was historically held at cost due to the reason that it was an illiquid market with very low number of transactions or even transparency into those transactions. Obviously, this ASU required a fair market value approach in using traditional fair market value methods or an alternative method. Because we have participated in this market for the last few years, and just as some background, with the IPO of Visa in 2008, we received about 50,000 shares over the last few years. As we've looked into this market and identified a dislocation in pricing, we found ourselves with the opportunity to acquire an additional 310,000 Visa Class B shares. And that participation in that market has created a network where we have some visibility and observations of transactions. And it is that visibility that required us to revalue these assets and book the $15.3 million gain for the quarter. Based on the ASU, the trigger to write the asset up or down is based on the individual's institutions' observation, and that's what caused or triggered the event for us. Because we are in the market, we have observed these private transactions. There is some public information out there, but we guess that with this ASU taking effect in the first quarter, that we would anticipate others who have these shares that will write the asset up or down, depending on their valuation, to create a market price that we'll see through earnings releases and quarterly filings.

Mark A. Turner - *WSFS Financial Corporation - Chairman, President & CEO*

This is Mark. If I could add a little bit more to that, at the risk of my CFO sneering at me. But this is publicly available information. The FDIC conducted auctions last year, which were publicized, and those are subject to foyer requests. So anybody interested could, with the time lag, get access to that information. And there was an institution in Florida in the fourth quarter, that if you googled this topic, you could find out what was in their release.

John Anderson

Yes. Yes. I've seen that Florida bank. Yes. Ok, thank you.

Operator

There are no further questions in queue. I would now like to turn the call back over to Mr. Rodger Levenson.

Rodger Levenson - *WSFS Financial Corporation - COO & Executive VP*

Thank you, again, for your time and attention. Mark, Dominic and I will be on the road a few times in the second quarter and look forward to seeing many of you. Have a good day.

Mark A. Turner - *WSFS Financial Corporation - Chairman, President & CEO*

Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program. You may now disconnect. Everyone, have a great day.
