WSFS FINANCIAL CORPORATION - THIRD QUARTER 2018 EARNINGS CONFERENCE CALL

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Officers
Mark Turner; *Chairman, President, CEO*
Rodger Levenson; *EVP & COO*
Dominic Canuso; *EVP, CFO*
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
Matt Schultheis; Boenning & Scattergood
Russell Gunther; DA Davidson

Presentation

Operator: Good day, ladies and gentlemen, and welcome to the WSFS Financial Corporation's Third Quarter 2018 Earnings Conference Call. (Operator Instructions)

As a reminder, this call will be recorded.

I would now like to introduce your host for today's conference, Mr. Dominic Canuso, Chief Financial Officer. Sir, you may begin.

Dominic Canuso: Thank you, Katherine. 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, 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 future expectations, plans and prospects that constitute forward-looking statements. Actual results may differ materially from historical results for those indicated by these forward-looking statements due to risks and uncertainties, including, but not limited to, the risk factors included on 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: Thank you Dominic and thanks to everyone for joining the call today.

The third quarter of 2018 was historic for WSFS as we achieved record operating performance and announced our combination with Beneficial Bank. I will provide a brief update on the Beneficial integration process toward the end of my comments, but will start with our financial results.

We are pleased to report core earnings per share of $0.96, which represent a 50% increase versus the third quarter of 2017. In addition, we recorded a core ROA of 1.73% and a core return on tangible common equity of 21%.

Core results exclude the impact of our previously announced Visa Class B share gains and insurance recoveries as well as securities gains and corporate development costs.

It is important to note that more than half of the increase in ROA, EPS, and ROTCE, when compared to the third quarter of 2017 was directly related to the Company's fundamental performance, with the remainder due to the tax law change.

A significant driver of our performance this quarter was our ability to generate six points of positive core operating leverage. Core net revenue growth was 12% and was supported by Core Non-Interest expense growth of 6%, again, when compared to the same quarter in 2017.

This core net revenue growth was balanced between a 12% increase in Core Net Interest Income and a 12% increase in Core Fee Income. The Core Fee Income increase excludes BOLI income from both periods as we divested our eligible BOLI policies during the first quarter of 2018.

Core net interest income growth was directly related to our net interest margin of 4.11%, or 16 basis points higher than the third quarter of 2017. As detailed in the release, 11 basis points of this increase was a result of being well positioned for the higher short-term rate environment. Looking ahead, we anticipate the continuation of the highly competitive commercial loan pricing environment and an increase in competition for deposits. This will likely result in higher deposit betas, which should offset the impact of the most recent, fed funds target increase in September. As a result, we see a net interest margin that will remain in a range of plus or minus a strong 4.10% for the fourth quarter. As a reminder, this level is significantly higher than the 3.90s, which was in our financial plan coming into the year.

Total loans grew 2% annualized for the quarter. Commercial loans were essentially flat on a linked quarter basis impacted by very aggressive pricing and continuation of the trend of elevated payoffs. Our strong margin and fee revenue growth during the course of 2018 have provided us with flexibility to remain disciplined on loan pricing. We could have been growing loans at higher levels but have intentionally decided to trade incremental loan growth for overall profitability.

Our year-to-date annualized total loan growth is 5%. Combined with our current commercial loan pipeline, which has a 90-day weighted average of $130 million, we expect our full year total loan growth in the mid-single digits when comparing December month averages.

Deposit growth was very strong this quarter. Excluding one $128 million temporary commercial deposit, total customer deposits increased 5.5%, not annualized, on a linked quarter basis with year-to-date annualized growth of 7.7%. Most of our growth this quarter came from lower cost core deposits. No and low cost checking accounts represented a strong 48% of total customer deposits at quarter end. We expect full year 2018 deposit growth to come within our previously communicated range of mid-to-high single digits.

Core fee income growth of 12%, excluding BOLI, versus the third quarter of 2017, was driven by highly diversified and steady year over year performance in our Cash Connect and Wealth Management businesses somewhat offset by lower mortgage banking, service charges, and SBA fees.

As previously noted, core expenses were well managed and translated into a core efficiency ratio of 57.6%. For the first nine months of 2018, we achieved a core efficiency ratio of 59.4% consistent with our full year outlook of just under 60%.

Our credit metrics remain stable and solid. Total credit costs for the quarter, which include both provision and workout and related expenses, were $3.7 million. While credit costs can be uneven in any one quarter, these levels were relatively consistent to both the linked and prior year's comparable quarters. Year-to-date total credit costs of $11 million puts us in line with our full year expectations of $13 million to $15 million.

In summary, these results demonstrate the strength of our business model, position us to well exceed our full year objective of a 1.50% core and sustainable ROA, and provide very good momentum as we move into 2019.

Turning to Beneficial, we are pleased with the progress over the first 75 days of our integration and planning process. Teams comprising of individuals from both organizations have been working together under the direction of a Steering Committee chaired by Dominic and our Chief Technology Officer, Lisa Brubaker, along with Tom Cestare, Chief Financial Officer, and Joanne Ryder, Chief Administrative Officer, at Beneficial.

We are well down the path of filing the necessary regulatory applications and a vote of approval from shareholders of both companies in early December. We remain on track with our previously announced timeline of a closing during the first quarter of 2019. This will be followed by the planned systems and brand conversion in the third quarter of 2019.

As has been our longtime practice, we welcome the opportunity to talk to investors about both Beneficial and our operating performance.

Since the Beneficial announcement, we have had the opportunity to meet in person or via teleconference with our sell side analysts and 33 investors through a series of individual and group meetings. If you would like to schedule time to meet with us, please contact either Dominic or myself.

Thank you again, and we will now be happy to answer your questions.

Questions and Answers

Operator: Thank you. (Operator Instructions) Frank Schiraldi with Sandler O'Neill.

Frank Schiraldi: Just a couple questions, if I could. Just first on the, Rodger, you talked about the guide, loan growth guide for the year. I think you talked about mid-single digit growth. Just wondering if we think about the run rate from here, are you seeing, are you expecting any slowdown, just given the commentary in the release? And then, I don't know if that gives us any preview at this point for what you think 2019 looks like. Thanks.

Rodger Levenson: Yes. So first, Frank, we've been talking about in combination with Beneficial at a high level 2019 growth in the low single digits combined. We'll obviously be updating that as we finalize both companies' budgets for 2019. So we'll have more to say in early 2019 on what that will look like in terms of loan growth.

All I would say is it relates to the forward-look is we continue to like our pipeline. There's lots of opportunities out there. We're going to remain disciplined on both [some] credit and a loan pricing standpoint. And that has all been factored into the full year outlook of mid-single digits.

Frank Schiraldi: Okay. And then maybe it's a bit of a moot point because you already talked about your expectations for 4Q NIM. But just wondering, the temporary, you called out the temporary DDA in the release. Did that have any meaningful impact on the NIM? Or did that come in later in the quarter?

Dominic Canuso: Frank, this is Dominic. It had about one basis point for the quarter as based on the timing of when it came in. We do expect it to provide a benefit of about two basis points ongoing for the remainder of the duration it is with the bank.

I will clarify that we talked about the headline net interest margin for the second and third quarter. But as you recall on our last call, our core business as usual net interest margin was about 2.04, and that increased three basis points to 2.07 for the quarter when normalizing for not only that outsized DDA account but for an outsized purchase loan accretion as well.

Frank Schiraldi: I'm sorry. Did you give a timeframe on that temporary DDA?

Dominic Canuso: Yes, sorry. Let me just clarify. I said 2.04 and 2.07. That's 4.04 and 4.07, obviously. But the timing is short-term in nature. We expect it to be with the bank a couple of months maybe into early next year.

Frank Schiraldi: And then just finally on the tax rate. It looked like the core tax rate was a little low this quarter, a little lower than what I had. And so just wondering what a decent tax rate looks like going forward.

Dominic Canuso: Yes. As we said before, our expected effective tax rate is in the 23% to 24% range with benefits bringing that lower due to stock-based comp and other non-reoccurring items. For the quarter, we had a true-up from the prior year reserves for the tax rate from the fourth quarter change from last year. But we would expect in the fourth quarter to be in the 22% to 23% range with that increasing next year slightly back to 23% to 24%.

Frank Schiraldi: All right. Thank you.

Operator: Austin Nicholas with Stephens.

Austin Nicholas: Maybe just on the margin guidance for the fourth quarter, maybe just a little color on maybe what gets you to the pluses and minuses. Is it really plus/minus 4.10? I guess is it really just the deposit picture and how fast that flows out. Or maybe if you can help us understand the levers that you have to kind of get to the bottom or the top end of where you're thinking about the margin for the fourth quarter.

Dominic Canuso: Sure. This is Dominic again. As I mentioned, our normalized net interest margin for 3Q was 4.07. When you layer in a full quarter's benefit of the rate increase from September that will add a couple basis points to net interest margin, offset somewhat by loan betas continuing to increase as we see with each consecutive rate increase. And then that would get us around a 4.10 and then plus or minus purchase loan accretion and some of these one-time larger deposit accounts.

And to provide some context, our deposit betas have increased from the 19% that I mentioned in the second quarter call, up to 24%. So we continue to see increases in the beta towards the historical average of 50%. But as we've noted and [it] provides our asset sensitivity to our performance, our loan betas have been in the low 40s on a fully loaded basis. And if you look at just our new loan pricing through the cycle, the new loan betas have about an 80% sensitivity to the rate environment. So continue to provide positive asset sensitivity in the continued expected rising rate environment.

Austin Nicholas: Understood. That's helpful. Maybe just shifting gears to expenses. Could you maybe give us some outlook on how we should be thinking about the expenses going into the fourth quarter? And then maybe more specifically on the marketing spend this quarter, is that a good run rate to think about in the near term as you kind of rebrand and kind of make the WSFS name known more deeply in the Philadelphia region?

Dominic Canuso: Sure. This is Dominic again. The marketing line item did increase quarter-over-quarter as we had expected based on a marketing branding campaign throughout our marketplace but specifically targeting our brand in the southeast Pennsylvania market. That will likely stay elevated into the fourth quarter, as that was a concerted effort in 2018 to increase our brand presence.

I would say all in all, the third quarter is representative of the fourth quarter and expect continued positive operating leverage from there, and the expected efficiency ratio to step down slightly as we see revenue growth outpace expense growth.

Austin Nicholas: Understood. Thanks for the questions guys. Appreciate it.

Operator: Michael Perito with KBW.

Michael Perito: Couple of questions still I wanted to kind of address here. I guess first on the capital side of things. Obviously, a lot of focus on the Beneficial deal and rightfully so. But I did notice you guys repurchased some shares in the quarter obviously at a price substantially higher than where the stock's trading today. And I'm just curious if you guys have any updated thoughts on kind of share repurchase activity over the next, call it six to nine months as this Beneficial deal closes and converts. I mean, is that something you guys are comfortable continuing, given the pro forma capital ratio still seem to be above kind of your target threshold? Or do you envision that going on hold for a bit as the deal kind of integrates in the early part of next year?

Dominic Canuso: Thanks, Mike, and great question regarding the capital. First, I'll reiterate our commitment to our capital return policy, which has been focused on returning a minimum 25% of our core earnings to shareholders split relatively equal between our consistent dividend and our share buybacks regardless of price. As we've mentioned before with regard to that policy is if the share price drops below what we see in our internal model, that would result in a IRR in the high teens and above, we would execute an additional share buyback program. We do foresee the opportunity to execute on such strategy in the fourth quarter and we believe we have both the capital and cash to do that and still deliver the targets that we've committed to as part of the transaction pro forma communicated last month.

Rodger Levenson: So Mike, I just would add just as a heads-up because of the transaction, once we file the S4 in early November, we will not be able to purchase shares up until five days before closing, so that would be sometime in the first quarter. But then we would resume the practice that Dominic talked about after closing.

Michael Perito: Okay. And can you guys just remind me the process in terms of I think you have about half a million shares left on the authorization. I mean obviously I don't expect you to comment on when you think you would finish that. But in terms of how quickly or aggressively you would be able to renew that with the board to the extent it's completed, I mean can you just remind us what the typical process looks like?

Mark Turner: So, yes. Michael, this is Mark Turner. Since I've been around the longest, I'll comment on that. Since we instituted a buyback some 20 years ago now, every time as we've gotten close to the end of that buyback the board has renewed a new authorization, usually 10% and subject to the same guidance that Dominic talked about earlier. And that's consistent with our philosophy to be a prudent yet aggressive manager of capital. So we want to make sure we have the authorization available should there be a downdraft in the market like we're seeing now or at other times that we think are appropriate. So I would expect that as we get close to utilizing this buyback authorization that the board would authorize another.

Michael Perito: Helpful, Mark. Thank you. And then just one last one for me just on the topic, Rodger, you mentioned on the Beneficial earnings. I briefly went through it. Obviously, it's a busy week. But it did look like they kind of struggle to post asset growth in the quarter again. And I'm just curious if you saw anything in kind of their loan growth production in the quarter that was different than maybe what you were expecting. And you mentioned kind of low single digit growth for next year. But are you guys still confident that some of the retooling and strategy stuff that you guys have put together can kind of turn around what seems to be kind of limited production recently at Beneficial, once the deal closes?

Rodger Levenson: Yes. Thanks, Mike. So obviously I can't comment specifically on Beneficial's numbers. I would just say that on a combined basis, we are modestly ahead of where we thought we would be in our original modeling and feel good about the strength of our core operating performance giving us the momentum going into 2019.

Mark Turner: And we haven't seen anything different -- this is Mark Turner again -- anything different in the first 75 days of formal integration -- as you know, we had 70 days before that while we were planning it -- that would lead us to believe that any of our assumptions about cost saves or revenue synergy opportunities are anything but accurate, if not even a little understated.

Michael Perito: Helpful, gentlemen. Thank you for taking my questions. Appreciate it.

Operator: Matt Schultheis with Boenning & Scattergood.

Matt Schultheis: Couple of quick questions. I was wondering if you could provide us any update on your planned technology investments after the Beneficial deal closes, if you have any insights into how that money looks to be spent. And if you can also quantify impact on the income statement of actually expense versus capitalized.

Rodger Levenson: So I'll just start it off, Matt. We provided, I think a fair bit of information in the materials that we put out there post the announcement of the deal. Obviously, since that point in time been very focused on the first steps of the integration. We have been, though, starting to meet with some potential partners that can help us with the delivery transformation and would expect to provide another update on that both in terms of context and impact to 2019, as we talk about 2019 combined performance early next year.

Matt Schultheis: Okay. And then I have a very specific question and I don't know -- I've seen a lot of advertisements for commercial real estate from various banks in your market, yourselves included, with relatively long fixed periods, relatively long amortizations. And was wondering -- but they have high yields, too. I was wondering, is this an SBA product that you're seeing advertised and that you're participating with? Or is this something for your balance sheet?

Rodger Levenson: Matt, this is Rodger. Don't know specifically the offer that you're referring to. But it would not be anything related to the SBA, I don't believe. Matt, hold on a second. Steve Clark wanted to jump in.

Steve Clark: Steve Clark here. We have been advertising a special product for owner-occupied commercial mortgage, pretty high coupon, I think in the 6% kind of as a teaser conversation starter, but have not gotten a lot of traction in booking that. It's really to get the conversation started with small business clients.

Matt Schultheis: Okay. Yes. I mean I saw like a 6-7/8% coupon and I thought that's certainly high enough and also sort of [smack at] SBA. So thanks for the color. And that's it for my questions. Thank you.

Operator: Thank you. (Operator Instructions) Russell Gunther with Davidson.

Russell Gunther: I just wanted to see if we could get a little bit more color on your comments about dialing back loan growth. Could you give us a sense for any particular products where this would show up and to the extent it's relevant geographically or regionally where you're seeing increased competition that makes you cautious?

Steve Clark: Russell, Steve Clark again. So no specific product or segment. Competition is fierce on both the C&I and CRE side. On the CRE side, a big portion of our book is construction and mini perm-type financing, and those credits are taken out by the permanent market with very aggressive two- to four-year interest only periods, 30-year amortizations, and floating rates typically swapped to fix that are below LIBOR plus

200. And we just choose not to compete there. We certainly have plenty of opportunity to keep those loans with our customers, but we just choose not to.

On the C&I side, similarly very competitive environment for good quality C&I opportunities. Pricing has gone below L plus 2 and, again, for us to go sub L plus 2, there needs to be a lot of other ancillary business that comes along with it. So we just continue to be really disciplined around pricing and structure on CRE for new opportunities.

Mark Turner: Russell, this is Mark Turner. Steve provided some good examples to the group of opportunities that we were involved in but missed. And Steve, maybe if you'd take an opportunity one of the CRE side of some size and one on the C&I side of opportunities that we were involved in but lost due to either pricing or structure.

Steve Clark: Sure, Mark. And these opportunities were on our pipeline during the third quarter one a C&I opportunity about $19.5 million credit package. This is kind of a leveraged finance deal. We were at LIBOR plus 2.50. The competition offered LIBOR plus 1.60 with a pricing grid that would take that pricing down at the low end of the grid to LIBOR plus 1. So again, its space we just chose not to go.

On the CRE side, I mentioned the permanent market. We had an $8.5 million multi-family permanent mortgage opportunity with an existing customer. We were in the construction, providing the construction financing L plus 3-1/4. That will go to the permanent market. And that is the example of 4 years interest-only followed by a 30-year [amort] with pricing based at 180 over 10-year treasuries. So again, permanent financing in the CRE space, we just chose not to go to.

Mark Turner: And I'll just add this broader context and philosophical color. This is Mark. And it's consistent with what we said. Because we have such a strong base in fee income and good growth in fee income and have a great base of customers and great base and net interest margin, we have purposefully chosen to forego these opportunities in favor of focusing on overall loan yield and profitability.

So just to give you some context, for the last 16 quarters, we've been able to positively grow, even despite the competitive environment, positively grow total commercial loans while at the same time over the last 16 quarters growing our NIM some 25 to 30 basis points.

So we could have been growing at much higher rates if we chose to take these opportunities. But we've purposefully chosen low to mid-single digits, which we've been able to grow, including this year-to-date and a margin that's increasing nicely. And that's what you should -- that's the business model. That's the discipline. That's the team. That's the philosophical approach that you should expect to see out of us as we take that into the broader greater Philadelphia market.

Russell Gunther: I appreciate all the color. Thank you both for that. My last one would be, we're getting towards the end of your kind of three-year plan, and was curious if that's something that you would be updating with fourth quarter results here and early 2019.

Rodger Levenson: So, Russell, its Rodger. Yes, as we talked about and has been our historical practice, we've been spending the better part of this year developing the next three-year strategic plan. We're in the final stages of that. Actually, we'll be updating our board on the progress of that later on this week. And then we'll be providing some additional details, including financial metrics early next year.

Russell Gunther: Very good. Thanks so much, guys.

Operator: Thank you. And with no further questions in queue, I'd like to turn the call back over to Mr. Rodger Levenson.

Rodger Levenson: Thank you. Mark, Dominic, and I will be back on the road in coming weeks and hope to see many of you at the KBW Philly Bank Day on November 1st, the Sandler O'Neill East Coast Financial Services Conference the following week, and an additional road trip to New York and Boston with Boenning and Scattergood in late November. Thanks again and have a good week.

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