WSFS Financial Corporation
3rd Quarter 2019 Earnings Call
Tuesday, Oct 22, 2019, 1:00 PM Eastern Time

***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'Neil & Partners
Michael Perito; Keefe, Bruyette & Woods
Russell Gunther; D.A. Davidson & Co.
Joe Gladue; Alden Securities

Presentation

Operator: Ladies and gentlemen, thank you for standing by. And welcome to the WSFS Financial Corp. Third Quarter 2019 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker for today, Dominic Canuso, Chief Financial Officer. Sir, you may begin.

Dominic Canuso: Thank you, Towanda. 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: Thank you, Dominic. And thanks again to everyone for joining us on the call today.

In the second full quarter since the closing of the Beneficial acquisition, WSFS reported solid operating results, with Core Net Income of $52 million and Core Earnings Per Share of $0.98, both increasing approximately 10% when compared to the second quarter of this year. These results drove a Core Return on Assets of 1.66% and a Core Return on Average Tangible Common Equity of 16.93%.

Dominic will be providing additional commentary on our results in a few moments. Similar to the last two quarters, we have provided an earnings release supplement posted on our website. The supplement includes additional details on our financial performance as year-over-year comparisons are impacted by the timing of the Beneficial acquisition.

During the third quarter, we completed the last major milestone of the Beneficial integration with the very successful brand and systems conversion over the weekend of August 24th and 25th. This was a very large and complex project, including the closing of 20 retail office locations. Combined with the sale of five retail offices to the Bank of Princeton in May, we have now reduced our retail footprint by 25 locations. The remaining five retail location closures of our original branch optimization plan will occur by the end of 2020.

We are pleased with our progress on Beneficial and the entire WSFS team is enthusiastic and very well positioned to deliver on the promise and opportunity from being the largest locally headquartered bank in the greater Philadelphia and Delaware regions.

I will now turn it over to Dominic to provide details on our financial results.

Dominic Canuso: Thanks, Rodger.

Good afternoon, everyone. We are very pleased with the financial performance of the quarter on both a GAAP and Core basis, especially so given the intense focus of the team on executing a successful brand and technology conversion. I will first comment on the reported GAAP earnings in the quarter, then provide additional context to the core results Rodger mentioned earlier.

Our GAAP results of 1.72% ROA and $1.02 Earnings Per Share includes $18.9 million of pretax net restructuring and corporate development costs, all associated with the Beneficial transaction and conversion. These costs and costs-to-date for the transaction are consistent with our original expectations.

More than offsetting this in the quarter is an unrealized gain on our visa Class B share investment of $21.3 million pre-tax, bringing our life-to-date realized and unrealized gains to $50.1 million.

These items are outlined in our GAAP-to-Core Earnings reconciliation included in both our Earnings Release and on Page 4 of the Supplemental slides. Also included in our Supplement on Page 5 is detail on our Loan and Deposit growth for the quarter clarifying both headline growth rates and growth after adjusting to normalize for attrition in the run-off portfolios.

While total gross loans declined $69 million in the quarter, when excluding the $101 million of attrition in the runoff portfolios, loans grew $32 million or 2% annualized, resulting from $27 million in consumer loans and $12 million in C&I. This loan growth is consistent with our updated full-year expectations outlined in the second quarter call.

Total customer deposits increased $19 million for the quarter, which included expected attrition related to the recent branch consolidations and cyclicality in customer funding, with both more than offset by growth in the low-and-no cost public funding and trust deposits.

Net interest margin for the quarter was a very healthy 4.38%, led by our strong relationship-based C&I loan yields and the stability of our almost 48% of total customer deposits in no-and-low cost products. NIM was lower 6 basis points in the quarter due to the $2 billion short-term non-interest-bearing Trust deposit that was held at the bank for 15 days. While dilutive to NIM, it contributed $1.7 million in net interest income. The interest rate environment, specifically a 50-basis point decrease in Prime and LIBOR in the quarter, reduced Net Interest Margin by 10 basis points, which is consistent with performance expected during a declining rate environment. Additional information on Net Interest Margin is in the supplement on Slide 7.

Credit quality metrics remain strong and maintain at the positive low end of historical trends and consistent with second quarter ratios. Total Credit Cost of $5 million or 22 basis points on Loans improved significantly from the second quarter and is in line with our long-term trends.

Core Fee Income Ratio for the quarter was 25.3% as a result of $41 million in fees diversified across our over 16 various products and businesses from our three reporting segments, Banking, Wealth and Cash Connect. It is worth noting that our well-diversified fee income base adds stability and consistency to revenue and earnings in a declining rate environment.

Our Core Efficiency Ratio of 55.9% was relatively consistent with second quarter results from continued cost management discipline and delivering on the acquisition cost synergies of achieving 50% cost savings in 2019, which increases to 90% in 2020 as we get the full year benefit of the cost saves from the integration and conversion, which increases to 100% by 2021.

Lastly, in the quarter, we returned $47 million in Capital to our shareholders through our quarterly dividend of $0.12 per share and $40.6 million or 959,000 in share repurchases. This leaves just over 1.9 million in shares remaining under our current authorization. And we will continue to be active buyers at and even above current market prices.

I would like to pass it over to Rodger for some final comments.

Rodger Levenson: Before we turn to Q&A, I wanted to share some early perspective headed into 2020. Consistent with the entire industry, our 2020 planning process is being impacted by the recent significant shift in interest rates. When we initially modeled 2020 as part of our Strategic Plan, we envisioned a stable economy and rate environment with one Fed Funds increase each in 2019 and 2020, along with a relatively normal shaped yield curve. As a result of the two Fed rate cuts already this year, along with one more cut expected next week, we're facing a fairly strong headwind in our Net Interest Margin. However, we are fortunate to be in a position to offset those headwinds in whole or in part with the tailwinds of higher cost and revenue synergies from Beneficial. We are currently assessing these dynamics as part of the 2020 planning process and will provide an update upon the completion of the Plan, as has been our regular practice in January.

Thanks. And now we will be happy to take your questions.

Questions and Answers

Operator: [Operator Instructions] Our first question comes from the line of Frank Schiraldi, with Sandler O'Neill.

Frank Schiraldi: Just had a couple questions. I wonder if I could start on the margin. If I look at the slide deck, on Page 7, the 4Q '19 margin, the range you give is 4.10 to 4.20. Does that include -- is that inclusive of a rate decrease in October?

Dominic Canuso: It does not. Which is why we added the bullet in the far right column of Slide 7 on the supplements, just clarifying that an additional fed rate decrease in October and the impact from the large short-term deposits would reduce full year from 4.30 to 4.20.

Rodger Levenson: Frank was asking specifically for the fourth quarter. So the fourth quarter does include the cut.

Dominic Canuso: It does.

Rodger Levenson: Yes.

Dominic Canuso: Thank you.

Frank Schiraldi: Okay. So the 4.10 to 4.20 does include the cut, or no? I'm sorry.

Dominic Canuso: It does. It does. I apologize for that. I was starting with the full year. 4.10 to 4.20 range does include it, to understand the dynamics between the third and fourth quarter. But the full year 2019 outlook was maintained at the second quarter outlook provided, just for consistency purposes.

Frank Schiraldi: Okay.

And then, I'm thinking about what you guys give for the full year and the linked quarter compression, excluding the Beneficial accretion of, it looks like, 8 basis points. And I'm thinking about the impact of the large deposit in the quarter as well. And it seems like interest rates -- let me know, is there anything else sort of baked into this -- but the interest rate reduction would seem to impact the margin by double digits linked quarter. Is that fair? And then, if that's the case, just kind of wondering if you guys can give your thoughts on a given 25-basis point decrease in fed funds, how that would impact the margin on sort of a normalized basis?

Dominic Canuso: Sure. And obviously, with the timing of interest rate cuts, it's not always a straightforward answer. What I would say is the fourth quarter impact -- because these are averages for the full quarter -- incorporates the full quarter impact to the most recent rate cut, a full quarter impact of an additional rate cut, and a full quarter impact of the conversion alignment of our products, which accentuates what would otherwise look to be a more sensitive interest rate sensitivity for net interest margin.

Frank Schiraldi: Okay. So in that case, is it possible to, on a normalized basis, just what a 25-basis point cut sort of does in terms of NIM compression, all else aside?

Dominic Canuso: Yes. All else equal, and presuming a historical deposit beta, if you will, a full-year impact of a 25-basis point rate cut would be about $2 million.

Frank Schiraldi: Thanks and then, finally, just on cost saves, certainly where the efficiency ratio is, you guys are ahead of schedule. Obviously, the revenue picture plays into that. So just kind of curious if you could -- and I think you kind of alluded to it, Dominic -- are you still kind of on trend for the 50% and the 90% cost saves? Or has that picture changed at all? And then, if you can give any detail on the tech spend that was talked about as part of the deal?

Dominic Canuso: Sure. So first, I would say yes, we continue to see a clear line of sight of delivering the 50% cost saves in 2019. And with the annualization of the run rate benefit of the post-conversion cost saves, we also see a clear line of sight of the 90% in 2020 growing to 100%; obviously a lot of that resulting from the annualization of reduced branch count facility and some FTE count.

Rodger Levenson: Yes. And Frank, this is Rodger. As you'll recall, when we announced the deal, we said 50% of the cost saves related to the branch optimization plan -- roughly between $6 million and $7 million a year -- would go into the tech spend. So we have been working on that project very diligently alongside this integration process. Think one of the things that we will update as part of the 2020 plan is likely an acceleration of that plan. Just because our observation over the past 18 months since we initially developed that plan, as things are moving faster, we want to move faster along that original roadmap. I think our first year of working with our consultant and just our own internal assessment indicates that we need to continue to accelerate that process. But we'll have more specificity in early January as we pull that together with all the other pieces of the plan.

Operator: Our next question comes from the line of Michael Perito, with KBW.

Michael Perito: I wanted to ask a follow-up on the call side. As we look at that kind of core just under $91 million in the third quarter, I think the conversion, at least according to the press release, though, happened fairly late in August. So I mean, can you provide any near-term insight about kind of where the cost save expense number for the fourth quarter will shake out in a range? Because my guess is that $91 million or just under $91 million still incorporates some elevated cost that likely won't be -- wasn't in the back 2 months of the quarter.

Dominic Canuso: That's right. So it's a fair question. Again, given explicit guidance on the 4th quarter cost, what I can say is, as we've discussed, between the branch consolidation, the technology conversion and reduced FTE count, you would expect a full quarter's benefit of those saves, which would reduce from that third quarter core cost by a couple million dollars, offset by normal business growth and investing in revenue-generating efforts.

Michael Perito: And then, on kind of the overall revenue side of Beneficial, obviously there's been some press releases out on some hires that you guys have made. And I think you made some comments in the earnings release about some of the progress you're making there. But as we kind of think about it from an analysis standpoint, what should we be looking for to kind of see how successful some of these hires are being? And what are your initial expectations for some of these additions you guys are making on the revenue producing side in the Philadelphia market?

Rodger Levenson: Yes, so I'll jump in here, Michael. So we're very pleased, not only with the progress from some of the hires, but the overall lift from the team that we've gotten, particularly as now we're past conversion and that last major milestone of integration. Part of what Dominic was alluding to was the investment that we've made in some of the business cases, particularly in those product areas that Beneficial didn't offer and we needed to staff up to support the revenue growth next year. We're in the middle of that. I think we're way down the road in certain areas; others, we still have a little hiring to do. And that will all be reflected when you see the 2020 plan. And that's the plan I was referring to. We're in the middle of pulling all those pieces together.

Michael Perito: And then, just lastly, if I could, on capital -- I mean, you guys paid out $47 million in the quarter, made $54 million and still saw capital levels build. So I guess it's kind of a multi-part question here. But I guess, to try and ask it succinctly, one, is it at a point now where your profitability and capital levels likely would need to -- it makes sense to maybe establish a bit more of a competitive dividend policy to help kind of take off some of the upward pressure on your already excess capital ratios? And, two, I would think that the overall risk of your balance sheet is lower post-Beneficial than pre. But obviously, you're carrying 300, 400 basis points more capital. And I guess as you guys view it internally, how much of an area of focus is that? Are you guy’s fairly content to just kind of run near term with that level of capital, with kind of limited options at your disposal? Or can we expect you guys to try and be as aggressive as possible within reason to limit any further capital appreciation, given the lack of overall balance sheet growth?

Dominic Canuso: Sure. Thanks, Mike. Clearly a couple points there which I'll try to discern.

First, regarding your question on the dividend policy. We have a longstanding disciplined capital practice of returning a minimum 25% of our annual earnings split evenly between that low and consistent dividend and minimum level of share buybacks. Anything incremental to that would be evaluated based on the share price and our IRR model determining incremental share buybacks.

We have evaluated that. And we reevaluate that every year. And we believe the balance of the dividend and the share buyback is optimal for our capital structure, our investor base and our overall capital strategy; which blends to your second question of the risk of the balance sheet being lower, primarily because of the strong capital position. First off, when we look at capital levels above kind of our target of what we've historically said, between 7% and 8% of TCE ratio, we would look to first reinvest it in the business; second, look for inorganic opportunities. And obviously, post-Beneficial, we're focused very much on that acquisition and the integration and the opportunities that brings. But we would look for other opportunities in appropriate fee income businesses that would align with our offering today; and then lastly, return that capital to shareholders through share buybacks.

Continuing with the strong capital position we're in and the remaining authorization we have available to us, we would continue repurchasing shares consistent with what you've seen in the third quarter and reevaluate that as part of our 2020 planning process.

Michael Perito: Got it, that is very helpful. And then, just lastly -- I'll jump back -- just any -- especially with the Beneficial deal, I know there's quite a few moving pieces here -- but are you guys prepared or in the process of providing any thoughts around CECL adoption at this point, or not quite yet?

Dominic Canuso: Yes. So clearly, it's an area of focus in the third quarter as we start heading in towards the end of the year and the cut over to CECL on January 1, 2020. Our team has been very active on CECL from a project perspective, ensuring we have the right technology, clean data and a strong governance structure. We have been working on our side-by-side modeling over the last 3 to 6 months, ensuring we have the right transparency and assumptions around our methodology on our economic expectations and qualitative adjustment factors. We continue to model those and validate those. As part of the third quarter, we will not be disclosing a range as we continually annualize those impacts. But we will be fully prepared for the cutover on January 1, 2020.

Rodger Levenson: Yes, Mike, this is Rodger.

Michael Perito: Sorry, go ahead.

Rodger Levenson: As you know, part of the complexity for us is almost half of our loan book now is in acquired loan very differently under CECL in it. So we just think it's prudent, as we do this parallel modeling, to incorporate all of the various scenarios and assumptions that we need in several iterations to make sure that when we do the crossover that we have a good handle on that. And that's just part of the process of validation that we're going through.

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

Russell Gunther: I wanted to circle back to the growth conversation a bit and just get first your kind of high-level thoughts on C&I, CRE. Appreciate all the color on the run-off portfolios. But maybe give us a sense of what the opportunity there is from a gross loan perspective, what some of the drivers there are? Perhaps you could comment on pipelines and really try to get a sense for when we might see a return to net loan growth?

Steve Clark: Hey, Russell, this is Steve Clark.

So regarding pipeline -- pipeline is relatively strong. Our 90-day weighted average is about $195 million as we sit. About two-thirds of that is in Pennsylvania, and another, say, about three-quarters of that is in C&I. So we're optimistic that we'll continue the trend of increasing C&I as a percent of total. And that'll be helped a little bit by the CRE participation portfolio that continues to run off. So all in all, pretty optimistic about growth prospects.

Russell Gunther: And then, are you guys contemplating any additional commercial lender hires within any particular markets, perhaps Philadelphia? Seeing any opportunities to do so?

Steve Clark: So I would say yes. We certainly have continuing interests. Over the last year, we've added three relationship managers to our Pennsylvania-based legacy team. And then we added one new RM and one very experienced portfolio manager to the Beneficial team. We're in active conversations and continue to entertain opportunities to add talent. And we think with our presence now in Philadelphia, we should continue to have those opportunities.

Russell Gunther: And then, from a big-picture perspective, is there a point in which you guys are comfortable that you'll be able to outpace the kind of ring-fenced run-off portfolios and start to think about or be able to put up even a low single-digit organic number going forward?

Rodger Levenson: So I'll jump in on that, Russell.

I think, as you can see from the slide, we think that we've worked our way through the significant amount of that leverage loan portfolio. That's all C&I, that's really down to two relationships. I think you see the trajectory on the consumer books, particularly resi mortgage and student loans. And I'd say the auto, as you can see, is coming to an end in terms of a material standpoint as well.

The one factor that is a little bit dependent upon the economy and interest rate cycle are those CRE participations. But we clearly see the pace of the attrition slowing, moderating, to a more what I would call kind of normal run rate, versus what we originally thought. And I think most of that this year is a combination of decisions on our part to exit some portfolios that didn't fit; and the interest rate environment, which accelerated some refinances. So I would say -- and you will see this in 2020 in terms of our plan -- we certainly see that moderating, and then us returning to the growth rates that we've enjoyed historically versus our peers.

Russell Gunther: And just briefly switching gears -- hear you loud and clear about waiting on CECL disclosure -- but any just broad-stroke comments on the credit quality outlook? Anything within your footprints or asset classes that's of a concern, where we would see a kind of quicker pace to normalizing credit costs? Just appreciate your general thoughts.

Steve Clark: Yes, Russell, Steve Clark again.

So no. Currently, underlying credit trends are very stable. As Dominic mentioned, we're kind of back to the historical low end of the range in terms of credit costs and, sitting here today, feel comfortable with where we are.

Operator: Our next question comes from the line of Joe Gladue with Alden Securities.

Joe Gladue: Yes, I just have one question. Just looking at the loan yields, particularly on the commercial real estate portfolio, looks like yields were down over 100 basis points from second quarter to third quarter. And just wondering if you could give us a little color on what was driving that rapid decline.

Dominic Canuso: If you're referring to the schedule that's in the earnings release, the yield on all of the loan categories includes purchase accounting accretion and the significant step down in that portfolio from the second quarter to third quarters, primarily driven to the volatility in the purchase accounting accretion. There was a significant shift in the third quarter. More of the accretion came from CRE. I'm sorry, in the second quarter, it mostly CRE; in the third quarter, it was mostly C&I. So you'll see kind of an offsetting step up in the C&I yield within the earnings release material.

Operator: I will now turn the call over to Rodger Levenson for closing remarks.

Rodger Levenson: Thank you. And thanks again for everybody participating on the call today. Dominic and I look forward to seeing many of you when we go back on the road in November and December. And as always, we are happy to address any other questions you may have in the interim. Please don't hesitate to contact us.

Thanks again for joining us. And have a good day.

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