WSFS Financial Corporation [WSFS]
2Q 2021 Earnings Conference Call
Friday, July 23, 2021, 1:00 PM ET

Company Participants:
Rodger Levenson; Chairman, President and Chief Executive Officer
Dominic Canuso; Executive Vice President, Chief Financial Officer
Art Bacci; Executive Vice President, Chief Wealth Officer
Steve Clark; Executive Vice President, Chief Commercial Banking Officer
Rick Wright; Executive Vice President, Chief Retail Banking Officer

Analysts:
Michael Perito; Keefe, Bruyette & Woods
Erik Zwick; Boenning & Scattergood
Brody Preston; Stephens, Inc.
Manuel Navas; D.A. Davidson & Co.

Presentation:

Operator: Ladies and gentlemen, thank you for standing by and welcome to the WSFS Financial Corporation Second-Quarter 2021 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

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

Dominic Canuso: Thank you, Livia. With me on this call are Rodger Levenson, Chairman, President and CEO; Art Bacci, Chief Wealth Officer; Steve Clark, Chief Commercial Banking Officer; and Rick Wright, Chief Retail Banking Officer.

Before I begin with remarks on the quarter, I would like to read our Safe Harbor Statement.

Our discussion today will include information about our management's view of our future expectations, plans and prospects that constitute forward-looking statements. Actual results may differ materially from historical results or those indicated by these forward-looking statements due to risks and uncertainties, including, but not limited to, the risk factors indicated 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.

Good afternoon, everyone, and thank you for joining us on the call today.

Our Earnings Release and Investor Presentation, which we will refer to on today's call, can be found in the Investor Relations section of our company website.

We continue to see positive signs of recovery and reopening of local economies across our region, which is demonstrated in our Customers and Clients' sentiments, consumer spending trends, loan growth and credit quality metrics.

WSFS had another strong quarter, rounding out a robust first half of 2021, demonstrating the strength and diversity of the franchise and the stability of our performance through various economic and rate environments.

Highlighted on Slide 4 of our Investor Presentation, second quarter Reported Net Income is $95.7 million, a $2.01 earnings per share and a $2.60 ROA. Reported and Core performance were comparable this quarter, as a large one-time gain was offset by a few noncore expenses, as laid out in the earnings materials.

The significant excess liquidity environment continues to have an impact on the balance sheet, as seen on Slides 5 and 25. Loans grew 2% annualized versus prior quarter, when excluding PPP and purposeful run-off portfolios. Growth was primarily in commercial lending, from higher new loan originations and line utilizations, and from our NewLane leasing business. Loans at NewLane are up 37% year over year and are just under $300 million in total loans.

Customer Deposits grew $445 million, or 15% annualized, in the quarter, primarily from Trust relationships and Commercial customers. Versus prior year, Customer Deposits have increased $1.9 billion, or 17%. Total Customer Deposit costs are at historic lows of 11 basis points, as low and no-cost checking and savings accounts represent 70% of customer deposits, with a weighted average cost of only 3 basis points.

Net Interest Margin in the quarter, detailed on Slide 6, is 3.23%, which includes 24 basis points of purchase accounting accretion and 8 basis points of PPP income, both more than offset by 50 basis points of negative impact from excess liquidity. Pressure from excess liquidity is expected to persist throughout 2021 and into 2022, particularly given our broad-based, strong customer deposit relationships across Commercial, Small Business, Consumer and Trust and Wealth.

Second quarter Fee Revenue again demonstrated the strength and diversity of our fee products and services and franchise value, especially in this lower interest rate environment. Core Fee Revenue was a healthy 30% of revenue when excluding PPP and supported by 7% year-over-year core fee growth. When excluding the impacts from the Durbin Amendment, year-over-year Core Fees grew 16%, driven by a 41% increase in Wealth Management fees, supported by a record $26.7 billion of AUA and AUM, along with a 24% increase from Cash Connect. This was offset by reduced mortgage banking fees from the recent slowdown in refi volume and housing market supply shortages.

The Core Efficiency Ratio increased to 60.7%, resulting from lower PPP, lower purchase accounting accretion and lower mortgage banking revenue, all in line with our expectations for the year. We continued to be disciplined in our expense management, with investments focused in franchise growth and Delivery Transformation.

Regarding our ACL and Provision, in the second quarter of 2020 at the onset of COVID we were very proactive in evaluating the portfolios believed to be most vulnerable to the emerging economic stress. As a result of this process, ACL reserves built with the anticipation of potential losses in these portfolios. Fortunately, due to the impact of PPP, additional government stimulus, loan modifications and the strength of our borrowers, these portfolios performed much better than expected. Combined with the improving economic environment, these factors led to a meaningful reduction in problem loans and the reserve release this quarter.

Shown on Slide 8, ACL at quarter end was $132.4 million, with an ACL coverage ratio of 1.63% excluding PPP and 1.93% when including the remaining credit mark on acquired portfolios. The ACL now stands $100 million, or 1.11 percentage points less than the peak in the third quarter of 2020, as all credit metrics continued to improve and trend toward pre-COVID lows, with continued low loss content across the portfolio. Potential modest reserve releases in the second half of the year will be dependent upon continued improvement in the credit performance in the portfolio and economic outlook and offset by loan growth.

We continue to generate significant capital through earnings and have a strong capital position heading into the anticipated combination with BMT, as TCE increased 55 basis points in the quarter to 9.13% and the Bank's CET1 ratio improved 101 basis points to 14.21%. The Board of Directors approved a quarterly cash dividend of $0.13 per share of common stock and no shares were purchased in the quarter as we have paused repurchases until the close of the BMT transaction.

Our original outlook for 2021 on Slide 10 anticipated a gradual and uneven economic recovery, which has played out in the first half of the year, and we are pleased with the continued strong operational and financial performance delivered in this environment. The gradual and uneven pace of recovery continues to be our expectation for the remainder of 2021. And, while excess liquidity may impact loan growth in the short term, through our diversified business model and disciplined expense management we anticipate our full-year results to be consistent with our original 2021 plan for PPNR as a percentage of assets in the range of 1.5% to 1.6%.

We are optimistic and excited about our future prospects, given our unique competitive and strategic position in our market, the strength of our national fee-based businesses, along with the upcoming combination with BMT.

Regarding BMT, on June 10, both WSFS and Bryn Mawr stockholders approved the merger of Bryn Mawr into WSFS at a special meeting of stockholders for each company.

We are also excited to share that this week we received OCC approval for the combination.

Our highly engaged teams at Bryn Mawr and WSFS are actively working together, designing and implementing our Conversion and Integration plans as the transaction is anticipated to close early fourth quarter of the year, pending receipt of the remaining required regulatory approvals. The Bank conversion, including bank branding and branch consolidation is planned for early first quarter 2022.

Thank you, and we will be happy to take your questions.

Questions & Answers:

Operator: [Operator Instructions] And our first question coming from the line of Michael Perito with KBW.

Michael Perito: Good afternoon and thanks for taking my questions. I wanted to start on the growth piece of it, it seems like you're obviously a really strong C&I franchise in your core markets. But it seems like other areas, like some of your consumer partnerships and NewLane and some of the equipment financing, are seeing better growth. And my guess is part of that's because of having a little bit more geographic diversification. I was just curious if you could maybe update us on how you kind of view that element of your loan portfolio today. And do you kind of see yourself exploring more of those opportunities in the future to try and enhance growth outside of the Metro Philadelphia/Wilmington area?

Dominic Canuso: Sure. Good question. A lot there, but I'll start off. We do see strength in the commercial loan. Obviously, as we've mentioned, excess liquidity continues to play into the loan demand in our market. And particularly we continue to be disciplined in our pricing and terms, which results in the loan growth you're seeing here.

On the consumer side, we do have various partnerships and avenues generating the appropriate products and services for our customers, including partnerships with Spring EQ, which is secondary-market, mobile-based lending. We have LendKey generating student lending and we're just launching a new product in the third quarter here, which is unsecured lending with Upstart, which we anticipate to add to the loan growth in the second half of the year.

Rodger Levenson: Yes. And if I could just add on that, Mike, just some historical context. Obviously -- this is Rodger. Obviously, we're a regionally focused, commercial driven C&I bank. And so I would think that we've always liked to have some diversity in our loan book. We've kind of targeted we'd like to have at least 20% of our loans, consumer loans. That may go a little below or a little above depending upon where things are at. But with our investments that we've made in the franchise here locally, I would expect that the majority of our growth over time will come from local-based lending, with C&I being the leading category for us in the commercial area.

Obviously, that's a little bit challenged right now because of, as Dominic said, the unevenness of the recovery and overall conservatism by a lot of our borrowers. But I think we've demonstrated over time the value of those relationships. And I think it's important to point out that many of those relationships are the drivers of some of the deposit growth that we've seen, which I think, again, just solidifies the premise of the strategy around full relationships.

Michael Perito: Got it. Very helpful. Just two more I wanted to hit on real quick. Both yourselves and BMT had really strong quarters growing the Wealth Management AUM and revenues. And obviously, I think when you guys announced the deal that was a pretty important element of the pro forma franchise. And I'm just curious if you have any -- I know you have the broader fee income guide, but I was just curious if you have any more general outlook comments about combining the two Wealth platforms and the type of growth that you think you could achieve once that happens?

Rodger Levenson: This is Rodger again. I'll start and then I'll let Art give you a little bit more specificity. I would just tell you that everything that we thought coming into the discussions through our due diligence and since then about the Wealth opportunity has been confirmed. We think there's just significant opportunity with our combined franchise. The integration process is going very well. The teams have come together. The leadership under Art and Jen Fox from BMT has really started to put together a very significant integration plan and it's being very well received by our customers and in the marketplace. So I think everybody recognizes the value of the combined Wealth businesses, and we see as much, if not more, potential than when we did the original modeling. I'll throw it over to Art for any kind of specific color.

Art Bacci: Thanks, Rodger. Mike, this is Art. And, yes, I'd add maybe three points to that. One is as Jen and I have worked through the integration, getting to know each other and we look at each other's strategic plan, we laugh a little bit in that it's almost like we were looking over each other's shoulders as we were preparing our plans independently. And so we're finding the businesses are very complementary and the teams are realizing that and seeing the potential that's coming out of this. And they're all very excited, so that leads us to believe that this is going to be a great combination.

Secondly, Rick, Steve and I have been working over the last couple of years to really make sure the retail commercial wealth businesses are going to market on a more holistic basis. And we're seeing a lot of good interaction between our end and our advisors. And so we have, in some cases, commercial relationships where the owners are selling the business and we're getting good referrals. So, while we may not get the loan growth, we're certainly getting the fee benefit from that. And we're seeing the same thing on the retail side with all the excess liquidity and people looking for other places to invest the business.

And then, thirdly, our Corporate Trust business is really hitting on all cylinders and partly due to just the market securitization activity is very high. Secondly, our team, with the addition of a new business development officer, has made inroads into new relationships, so that's really helping. And we see a pipeline that continues to be very robust on that front.

Michael Perito: Helpful color. Thanks. And then just lastly from me and I'll kick it to someone else. Rodger, this is probably a quick answer. I just want to confirm. I mean, is it fair for us to assume that once the Bryn Mawr Trust deal closes that your approach to capital deployment will probably mirror what you guys did leading into the announcement as regards to share repurchase appetite and kind of the steady dividend payout?

Rodger Levenson: Yes. There will be no change to our long-term capital philosophy and strategy. Obviously, it just paused because of where we're at in the combination.

Michael Perito: Appreciate it. Thank you, guys.

Operator: Our next question coming from the line of Erik Zwick with Boenning & Scattergood.

Erik Zwick: Good afternoon everyone, wanted to first start with thinking about the outlook for loan growth going forward. Curious if you could provide an update on just where the pipeline stands today relative to maybe three months ago and also kind of how the average yield is trending at this point?

Steve Clark: Yes, Erik, Steve Clark. The pipeline is fairly consistent with what it has been over the past quarter or so. So our 90-day weighted average pipeline for commercial is around $235 million. That remains strong and as high as it's been since the fourth quarter of 2019. So despite the headwinds, we are getting opportunities across our C&I and CRE businesses and feel good about it.

Regarding yields, new loans [have] booked greater than $250,000 for the second quarter. The weighted average yield was 3.52%. So we target that mid-3s, feel good about that. That compares to 3.67% in the first quarter, but fairly consistent.

Rodger Levenson: Yes. This is Rodger, if I could just add to that. Our Commercial loan fundings were up in the second quarter, just I think to a little bit under about $450 million. It's just a challenge right now, candidly, to stay in front of the payoffs, for all the reasons that we've talked about. So we feel good about the momentum. It's just the churn has been a little greater than we had anticipated. And that's really what you see reflected in the outlook for the second half of the year.

Erik Zwick: That's good color. I appreciate it, guys. Switching gears to credit, if I look back to the press release from the second quarter of last year, that hotel portfolio that had $247 million of loans that received I think risk rating downgrades and this quarter, Q2 '21, the press release indicated that total problem assets declined by about $100 million or so, mainly due to the hotel portfolio. So just curious; as you look at it today, what is the percentage of that -- those original loans that were downgraded that have yet to be upgraded? And what are you seeing within those? Any commonalities from geography or hotel type or occupancy? Or what are you still kind of watching and maybe gives you some concern today?

Steve Clark: Yes. So, Steve again. So, yes, last year of our hotel book, which was about $540 million, we did downgrade and criticize a little over 50% of that book. So we thought that was the correct action at that time. And as you've read, we've seen improvement there and we have upgraded some of that exposure here in the second quarter. So the percent of criticized assets in the hotel book has been reduced down to 39%.

So all of those borrowers are paying. All but $44 million are paying their original contractual payment. The remaining, the $44 million which represents 4 or 5 properties, are paying interest only. So the book really has held up and rebounded from where we thought we were back in kind of the second quarter last year.

Occupancies continue to kind of trend upward. About a third of our book is leisure. So at the Jersey Shore or Delaware beaches you cannot get a room this time of year at those locations. So very, very, very strong occupancy at the leisure hotel.

As our business travel is coming back, occupancies have continued to increase. I don't have specifics, but I can share anecdotally one borrower that we spoke to just this week has 15 properties, all business focused, and his current occupancies are approaching 70%. So anecdotally that's one example of just the positive trend we're seeing kind of across that entire portfolio.

Erik Zwick: Thanks, Steve. And just last one for me and then I'll jump off. Dominic, in your prepared comments you mentioned that you expect the excess liquidity and the drive on the margin to persist into 2022. As you look at all of the deposits that have come in from the stimulus efforts across both your commercial and consumer customers, how do you guys try and look at it and figure out what might be kind of sticky and then ultimately be long-term core deposits and what might fall out the door at some point and relieve some of the pressure on the margin?

Dominic Canuso: Sure. It's a great question. I think it first stems from the fact that we focus on relationship-based banking. And I would just add to your list the Trust and Wealth deposits continue to grow as well and really leads to our outsized and lower loan-to-deposit ratio in the mid-60s. And so it's really partnering with them, speaking to them, understanding their demands. I think it will trend probably consistently with the overall growth in the economy, GDP and the impact it's having on prices and spending overall.

We do anticipate with the continued growth and there's even more stimulus that could be on its way that we're really focused on utilizing it appropriately. We've paid off $100 million of our senior debt in the past quarter. We paid off $0.5 billion of wholesale funding over the last year and we've doubled our investment portfolio and stayed within our risk tolerance and liquidity expectations. And we'll look to do that incrementally over the next quarter and then really, once we close on BMT, optimize the combined balance sheet with the ability to flex back down if we see the excess liquidity run off.

Erik Zwick: Thanks for taking my questions today.

Operator: [Operator Instructions] And our next question coming from the line of Brody Preston with Stephens.

Brody Preston: Good afternoon everyone, I had a question for you just regarding the run-off portfolio. So I'll speak for myself and say that it's a little challenging to model the runoff portfolio on a quarter-to-quarter basis, particularly the residential side. And so I know you have Bryn Mawr coming up in the beginning of the fourth quarter here. But has there been any thought given to potentially selling the residential run-off portfolio and I guess maybe cleaning things up on the loan side just a little bit faster than letting it just run off, so that way you can kind of maybe reset and at that point, with the deal closing, maybe you could use some of that capital to buy back a bigger slug of shares to plug the earnings hole? I'm just trying to think about the puts and the takes of pursuing a strategy like that.

Rodger Levenson: Yes, appreciate that. I'll address the resi mortgage specifically. I think, as you know, Brody, these run-off portfolios all really originate, with the exception of residential mortgage, from the Beneficial transaction. And we thought initially it would take about 4 years for that stuff to attrite off. It's happened sooner, right around 3 years by the time it -- the end of this year, primarily because of the rate environment. And really, when you look at it, the commercial portfolios will have run off by the end of the year. And there's a very small student loan portfolio left. And we don't see any addition to the commercial run-off portfolios from BMT.

So what will be left will be the residential mortgage book. And this strategy for us predated Beneficial. And obviously we evaluate lots of different things, but most of these mortgages are either relationships today or potential for relationships because of where -- a significant portion are originated through our Retail network or our Mortgage Loan Officers who operate within this region. And so we want to use the opportunity to see if we can enhance those relationships over time. And really the "run off" going forward, including what will come over from BMT, is really just the normal amortization of letting it attrite off.

And we would expect that since we've kind of gone through this period where the rates dropped significantly, we wouldn't expect to see as much refi activity, although there will be some. So I think that will flatten out and be of a normal sort of Portfolio Mortgage duration attrition rate. And, again, we want to focus on seeing if we can grow those relationships. So, I wouldn't expect in the near term a wholesale transaction as it relates to our resi mortgage portfolio.

Brody Preston: Got it. Thank you for that. Maybe just to -- I guess maybe just as a follow-up to that, I'm assuming that the residential mortgages that you pegged as runoff are kind of single relationship. They've just got their mortgage with you. So I guess what products are you trying to cross-sell them into? And I guess what have you been most successful with so far in terms of customers that might have been designated as a runoff loan originally and you've converted them maybe to a more full relationship?

Rodger Levenson: Yes. So the large percentage of the resi mortgages that came over from Beneficial were, I would call, sort of single-service relationships. So they were originated primarily through broker and builder arrangements and they were never actively engaged with. We've undertaken an effort to make those fuller relationships. We've had a team of people who have been in contact with these customers to not only hopefully capture a refinance opportunity, but also additional banking products because they're located here. These are all located here in our geographic footprint.

And then the remainder of it is we operate, as you know, an originate-and-sell model. So in many cases these loans that are sitting here that are attriting off are already part of significant relationships, including referrals that come out of our private bank, our commercial group, as well as the broader retail network.

Brody Preston: Got it. Thank you for that color, Rodger. I appreciate it. I guess just maybe one -- I'm switching gears. Dominic, it was another quarter of significant liquidity growth, despite the significant securities builds you have. And so, with the buybacks being in suspension for another quarter and the loan growth guidance coming down a little bit, are you expecting for that liquidity to just kind of hang around? Or are there any sort of near-term deployment opportunities from here that we should be thinking about?

Dominic Canuso: Sure. I'd just mention we have optimized a significant amount of the excess liquidity over the last year, including the June payoff of the $100 million Senior Debt and the doubling of the investment portfolio over the last year. We would look to continue to do that. And we're doing it with an eye toward the BMT transaction and the post-combination balance sheet optimization. So we do see the opportunity to continue to increase the size of the investment portfolio that works within our framework of acceptable investment, the low-risk, moderate yield and providing the cash flow liquidity that we expect from the portfolio. So you'd likely see that continue to increase in the second half of the year.

Brody Preston: Got it. And then, one of the slides that stood out to me in the deck was the digital slide. And given the sustained shift you all have seen in the digital channels for customer interaction, just wanted to get an update on how your view may have been shaped over the last year or so on the branch network. Do you see the digital channel as an additional sort of customer acquisition tool? Or do you think it's becoming more of an alternative to physical locations at this point?

Rick Wright: This is Rick. I think what we're seeing is there's obviously a more rapid adoption of the digital products and services that we have. But we're never going to be a digital-first company. We think the relationships are important and we're going to do everything to try to humanize the digital touch. And that's what we're doing in our Delivery Transformation effort. And we hope to see more of that hit the market over the next year.

Brody Preston: All right. Great. And then last one for me. I'm sorry if I missed it in the deck, Dominic. But could you remind us what percent of the loan portfolio is floating rate and then if there are any floors in place, what percent of the loan portfolio is at or below floor levels?

Dominic Canuso: Sure. We're running about 50-50, between variable and fixed. And that we would look to continue to increase the variable portion of that portfolio, as we talked about, with the run-off of the resi mortgage portfolio and continue to grow the relationship-based C&I lending.

Steve Clark: And, Brody, this is Steve. And about a third of that variable rate book have floors in the note. And all of our new originations over the past year and a half have floors, either 0% LIBOR floors or a floor of 3% when we can get it.

Brody Preston: Got it. And, Steve, of that third, do you happen to know what percent of that is currently at or below floor levels?

Steve Clark: So, I think we'd have to get back to you with an exact answer. My guess is a couple hundred million at most.[1]

Brody Preston: Okay. All right. Thank you very much, everyone. I appreciate you taking my questions.

Operator: And our next question coming from the line of Russell Gunther with D.A. Davidson.

[1] *After review, approximately $800 million at their contractual floor as of June 30th 2021*

Manuel Navas: This is Manuel Navas on for Russell. Just wanted to check in on the efficiency ratio target of low 60s. Do you have a kind of -- what expense run rate should we expect to help achieve that?

Dominic Canuso: Sure. Yes, so we do anticipate, as I've mentioned, to continue our expense discipline in this environment and monitor the growth rate of the portfolio. But we will continue to invest in our Delivery Transformation efforts as we've laid out in our materials and in franchise growth, particularly in Wealth and Cash Connect. And so we would continue to see some step up in the run rate of absolute dollar cost in the second quarter into the second half of the year, but would look to maintain positive operating leverage and ensure that revenues are growing faster than the expense growth rate.

Manuel Navas: Thank you. You got all the rest of my questions. Thank you very much.

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

Dominic Canuso: Thank you for participating on the call today. Rodger and I will be attending investor conferences and events throughout the third quarter and we look forward to meeting with many of you then. Enjoy the summer. Thank you.

Rodger Levenson: Thank you, everybody.

Operator: Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect.