WSFS Financial Corporation [WSFS]
First-Quarter 2021 Earnings Conference Call
Friday, April 23, 2021, 1:00 PM ET

Company Participants:
Rodger Levenson; Chairman, President and CEO
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
Dominic Canuso; Executive Vice President, Chief Financial Officer

Analysts:
Michael Perito; Keefe, Bruyette & Woods
Brody Preston; Stephens, Inc.

Presentation:
Operator: Thank you for standing by and welcome to the WSFS Financial Corporation First-Quarter 2021 Earnings Call. [Operator Instructions] Please be advised that today's call is being recorded. [Operator Instructions]

I now would 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, Michelle, and thanks to all of you for taking the time to participate on our call today. 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, 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 today are subject to the Safe Harbor Statement.

Good afternoon, everyone, and thank you for joining us on the call. Our earnings release and investor presentation, which we will refer to today, can be found in the Investor Relations section of our company's website.

We are very pleased with both the operating and financial results in the quarter and our ability to continue to serve our customers in this environment, especially during our due diligence announcement and ramp up of our conversion and integration efforts for the pending combination with Bryn Mawr Trust. The transaction is anticipated to close in early fourth quarter of this year, with anticipated bank conversion in early first quarter 2022.

WSFS had a strong first quarter of 2021, demonstrating the strength and diversity of our franchise and the stability of our performance a full year into the pandemic. We are beginning to see positive signs from the economic recovery and the reopening of our local economies, particularly in the positivity of our customers' and clients' sentiment and demonstrated in our credit quality metrics.

Highlighted on Slide 4 of our Investor Presentation, first-quarter reported net income is $65.1 million, a $1.36 earnings per share and a $1.39 earnings per share on a core basis, which excludes Corporate Development costs related to Bryn Mawr Trust transactions. Return on Assets in the quarter was 1.85% and 1.89% on a core basis.

Similar to the industry as a whole, customer liquidity continues to increase from PPP funding, stimulus checks and continued conservatism in spending through the first quarter. Detailed on Slide 5, customer deposits increased $580 million in the quarter, or 5%, and is up $2.8 billion, or 30%, year over year. With this excess liquidity over the past 12 months we have paid off around $440 million of wholesale funding and increased our investment portfolio by approximately $900 million and have $1.5 billion of additional cash that we will continue to optimize within our overall balance sheet strategy and risk tolerance. This excess liquidity is resulting in approximately 39 basis point reduction to net interest margin and 19 basis point reduction to ROA.
Consistent with the impact of excess liquidity in the market, net loans decreased $84 million, or 1%, when excluding both PPP forgiveness in the quarter and run-off portfolio performance. While revolving lines of credit exposures have held relatively constant over the past year, line utilization has decreased from over 45% to just under 36% since the first quarter of 2020. These trends, along with the continued portfolio churn, are headwinds against our original outlook of mid-single-digit loan growth and may continue in the near term.

A couple of additional points to note on our portfolio. We have almost completed the run-off of the non-relationship commercial loans acquired in the Beneficial transaction, with now only $55 million of CRE participations remaining. The remaining runoff portfolio is primarily in the residential held-for-investment portfolio and, at current attrition rates, could meaningfully run off by the end of 2023.

In addition, in the quarter we supported almost $300 million of PPP 2 origination for our customers and non-customers, which are not on our books and resulted in $2.2 million of fee income in the period and demonstrates our continued ability to serve our customers through this pandemic, with a total of almost $1.3 billion in PPP loans generated in the past year.

Net Interest Margin in the quarter, illustrated on Slide 6, is 3.59%, including a 12 basis point benefit from PPP, 37 basis points of PLA and offset by 39 basis points of negative impact from the excess liquidity levels previously mentioned. While loan yields have decreased 9 basis points in the quarter, resulting from portfolio churn, reductions in customer deposit costs offset much of that impact. Customer deposit costs are now at the same level as the low point after the Great Recession in 2015, which we were able to achieve in just one year's time after the economic slowdown started. Further details are on Slide 25.

Seen on Slide 7, Core Fee Revenue again demonstrated the strength of our diverse products and services and franchise value particularly in this lower interest rate environment. Core fee revenue percentage was just over 29% in the quarter, as core fees grew 20% or $8 million year over year, driven by continued strength in Mortgage banking and robust growth in Wealth fees driven by 17% growth in both AUA and AUM.

We continue to be disciplined in our expense management with focused investments in franchise growth, our Delivery Transformation Initiative and our controls environment. The Core Efficiency Ratio in the quarter was 57.9%. The strengthening macroeconomic trends and continued reopening of our local markets are seen directly in our credit quality metrics, with all leading credit quality indicators improving in the quarter. This, combined with continued low credit costs resulted in an ACL at quarter end of approximately $205 million and an ACL coverage ratio of 2.51%, excluding PPP. This is versus $229 million and a coverage ratio of 2.73% at year end. The $24 million lower ACL included a negative provision in the quarter of $20.2 million. Excluding this release, core ROA in the quarter is 1.46%. Additional details on ACL is on Slide 8. Assuming continued improvement in the economy and no material portfolio changes, we would continue to provide for loan growth, offset by reserve releases aligned with the economic forecast.

Capital levels continued to be robust while generating return on tangible common equity of 22.4%. The Board of Directors approved a quarterly cash dividend of $0.13 per share of common stock, an 8% increase from our cash dividend paid in 1Q 2021.
During the quarter, we repurchased 267,000 shares at an average price of $44.97, totaling $12 million of capital return. We do not anticipate further share repurchases until the close of the Bryn Mawr transaction.

In summary, it was a positive start to the year for WSFS. Although we are optimistic about both our near-term and long-term prospects, our performance for the remainder of 2021 will be directly influenced by the path and pace of the economic recovery and related health situation and the excess liquidity in the markets and impacts on both loan demand and deposit growth.
Thank you and we will be happy to take your questions.

Questions & Answers:

Operator: [Operator Instructions] Our first question comes from Michael Perito with KBW.

Michael Perito: Hey guys, good afternoon. Dominic, I wanted to just stick on your last comment there and I realize it's a bit challenging. But on the liquidity side, right, I mean, I guess we'll have to obviously make some assumptions about when that flows out over the course of the year. But I guess, can you maybe give us a little bit more color on how you're thinking about deployment, assuming that the cash maybe sticks around for a couple quarters here? I mean, is there a point where you just start putting into work in the investment book? I mean, obviously, loan growth is a little uncertain right now. Any expanded thoughts you're willing to provide there on the size of the balance sheet and liquidity appetite?

Dominic Canuso: Sure, it's a great question and we do anticipate for the excess liquidity to be around at least for a couple quarters. And I mentioned in my comments that over the last few quarters we've leveraged that excess liquidity to pay off wholesale funding and have increased our investment portfolio significantly. We will continue to evaluate and put that -- those dollars to use. And, while it is a drag to Net Interest Margin, the opportunity from the incremental volume could generate some NII and offset any lagging growth in the total portfolio.

Michael Perito: So, it sounds like it's not unreasonable to think that, looking at the period-end balance sheet, the cash balances were even higher than the average balance sheet would suggest. So, I mean, assuming that that liquidity stays in, it's not unreasonable to assume that you guys will continue to build the bond book here, just given your loan growth commentary that you mentioned in your prepared remarks?

Dominic Canuso: That is a good assumption.

Michael Perito: Okay. And then, on the fee side, just was wondering. Obviously, some good momentum on a couple business lines here. Just curious if you could maybe give an update on the Cash Connect outlook for the balance of the year. But also, on the mortgage side it's always been kind of a tight real estate market in your neck of the woods. I mean, is there still enough refi momentum here for that to remain elevated? Or any other thoughts there would be helpful.

Dominic Canuso: Sure, good question. So, we did see a decrease quarter over quarter in the fees from Cash Connect, even though both units served, and total dollars managed to increase. And that was primarily because of the seasonality slowdown in the first quarter and particularly harsh weather months in January and February across much of the country. But we do anticipate that the top-line growth will continue based on units served and dollars served in the mid- to high-single digits.

On the mortgage side, what we've seen in the first quarter is refi mix is still at 70% and still leading the volume. We do anticipate at some point in time, as the interest rates remain low, that those that could have refinanced would have. But we haven't necessarily seen a significant slowdown as of yet.

Michael Perito: Got it. And then, just some -- last question for me. I just apologize if I missed it in the prepared remarks or in the deck somewhere, but I was just looking for the quarter-to-date or the end-of- quarter modification or total deferral number. I was wondering if you have that and maybe just could parlay that into a quick comment about the directional here. I mean, you guys kind of stood by your provision costs, but obviously, with the deferrals coming down, which I'm assuming they did, and the economy kind of slowly chugging along here month by month, I mean, seems like that might be a little conservative. I was wondering if you had any updated thoughts?

Steve Clark: Hey, Mike, this is Steve Clark. Regarding the deferral question, just about 1% of our total book remains in some form of modification. For the Commercial book that represents $79 million and, of that, they are all paying interest. So, the deferrals we see no uptick. It's been very flat over the last two quarters and I feel pretty good about where we stand related to that.

Michael Perito: Got it. Thank you guys I appreciate it.

Operator: [Operator Instructions] Our next question comes from Brody Preston with Stephens Bank.

Brody Preston: First of all, I wanted to say thanks. Thanks for the earnings deck. You guys have revamped it over the last couple of quarters and there's a lot of great detail in there. So, it was nice to comb through that last night when you dropped it.
I did want to start by asking -- and I might have missed it, but do you have an average balance for the PPP loans for the quarter?

Dominic Canuso: We do, and we have shared in our materials. I think it's Slide 7 -- no -- Slide 5, I apologize. And on there you'll see that PPP loans ended at $527 million. And so, low 600s for the quarter.

Brody Preston: Oh, okay. So just a simple average kind of gets you there.

Dominic Canuso: Yes.

Brody Preston: All right. And then, it was good to see the fee income. I think it's the first quarter since the Beneficial deal you guys are back above 30%. And that's with some of the headwinds on Cash Connect that you saw. But just as we think about mortgage kind of trending lower, I think you'd love to have that mix kind of stay above 30%, as you lead into the Bryn Mawr deal. And so, I guess what levers do we have to pull to keep that percentage above 30 in the short-term?

Dominic Canuso: Sure. And, yes, I think it's an important context to note that that is 30% in this interest rate environment, of course, and we'd love to be able to maintain that level in a rising rate environment and would look to do that. And, while there may be a slowdown in Mortgage, we continue to see opportunities in both Cash Connect and Wealth growth to offset that. And, obviously, with the pending combination with Bryn Mawr, that would enhance the percentage as well.

Brody Preston: Okay, got it. And then, just wanted to circle back on the growth commentary. So, I understand there's headwinds, but you did kind of stick to the mid-single-digit guide, ex PPP and the runoff portfolios. And so now that the runoff portfolios, at least in the commercial side, are down -- I think it was $55 million or so is what you called out on the deck is -- is the growth to get to that guidance, more back-half loaded? And what are the categories that you expect to drive that growth from here?

Steve Clark: Yeah Brody, this is Steve Clark again. So, yes, we do remain comfortable in our expectations for the full year in terms of mid-single digits. So, from our view, kind of back half, second half of the year. Couple reasons for that. As we sit here today, our pipeline is as large as it's been since the fourth quarter of 2019. So, feeling optimistic there. We continue to receive and evaluate CRE requests and they are significant requests. We are pretty selective in that space and remain very disciplined regarding pricing and structure but, nonetheless, we have CRE opportunities.

And then, lastly, the C&I RMs that we added last October, November to the team, very pleased with the traction they're getting and expect them to continue to produce as we go through the second half of the year.

As it relates to C&I growth, I would just add, certainly dependent on the economy continuing to open up and really dependent on -- our customers are sitting on so much liquidity, it's dependent on that being used. And then, as it relates to companies changing banks, where do they stand in their PPP forgiveness process because, that is a bit of a headwind. But generally, again, for the full year feel mid-single digit is attainable.

Brody Preston: Okay. And what are the origination yields on new production averaging, Steve?

Steve Clark: So new production for the quarter, and this is all loans over $250,000 was 3.67%. So, that really compares favorably to the fourth quarter, which was 3.28%. So, we've stated in the past we're kind of shooting for that mid 3s and the first quarter we were pleased with that in terms of the weighted average yield on new fundings.

Brody Preston: Great, thank you for that. And, Dominic, this one's for you. The $17.5 million in net expected investment for this year tied to delivery transformation, I just wanted to ask how much of that was accomplished in the first quarter.

Dominic Canuso: Yes. So, I would say I think it's about $3 million or so. It will definitely ramp up as some of that is CapEx investment and would take -- come into the expense line through depreciation once those projects go live. But, overall, the $17.5 million is consistent with what we laid out at the beginning of the year versus our expectation and consistent with the overall strategy we've discussed over the last few years.

Brody Preston: Got it. And then, I do have a question on SBA, just with the relationship managers. From '19 to '20 you added a couple. And I think the PPP experience has kind of bolstered everybody's feelings about maybe being able to take advantage of SBA. And so, do you anticipate maybe building out this platform and being more, I guess, more involved in 7A lending moving forward, just given the fee income opportunities?

Steve Clark: Brody, this is Steve again. So, the SBA team has really, really gelled over the last year. So, we did add three new associates in that space, two kind of in-market and one kind of a national franchise. And, we're seeing opportunity coming out of our business banking book on the commercial side, in addition to the SBA RMs that are focused in that space. Companies that have struggled over the past year certainly are candidates for SBA 7A refinancing. And, if we're effective in that, we have the gain on sale possibility. So, I think SBA for the bank is a growth segment. And Rick Wright may have additional comments there, but that's our view.

Brody Preston: Awesome. Thank you for taking my questions.

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

Dominic Canuso: Thank you all for participating today. Rodger and I will be attending investor conference and events during the second quarter and look forward to meeting with many of you then. Have a good day.

Operator: Ladies and gentlemen, this does conclude the conference. You may now disconnect. Everyone have a great day.