

**WSFS Financial Corporation [WSFS]
2Q 2024 Earnings Conference Call
Friday, July 26, 2024, 1:00 PM ET**

Company Participants:

Rodger Levenson; Chairman, President and Chief Executive Officer
Art Bacci; Executive Vice President, Chief Wealth Officer and Interim Chief Financial Officer
Steve Clark; Executive Vice President, Chief Commercial Banking Officer
Shari Kruzinski; Executive Vice President, Chief Consumer Banking Officer

Analysts:

Frank Schiraldi; Piper Sandler & Co.
Kelly Motta; Keefe, Bruyette, & Woods, Inc.
Manuel Navas; D.A. Davidson & Co.
Jake Civiello; Janney Montgomery Scott LLC
Russell Gunther; Stephens Inc.

Presentation:

Operator: Thank you for standing by. At this time, I would like to welcome everyone to today's WSFS Financial Corporation Second Quarter Earnings Call. [Operator Instructions] I'd now like to turn the call over to your host for today, Mr. Art Bacci, Chief Wealth Officer and Interim Chief Financial Officer. Sir, you may begin.

Art Bacci: Good morning or good afternoon and thank you for joining our second quarter 2024 earnings call.

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

With me on this call today are Rodger Levenson, Chairman, President and Chief Executive Officer, Steve Clark, Chief Commercial Banking Officer, and Shari Kruzinski, Chief Consumer Banking Officer.

Before I turn the call over to Rodger for his 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 those 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, our most recent quarterly reports on Form 10-Q, as well as other documents we may periodically file with the Securities and Exchange Commission. All comments made during today's call are subject to the Safe Harbor statement.

I will now turn the call over to Rodger.

Rodger Levenson: Thank you Art and everyone else for joining us on the call today.

During the second quarter, WSFS continued to demonstrate the strength of our franchise and diverse business model. Results included a core earnings per share of \$1.08, core return on assets of 1.25%, and core return on tangible common equity of 18.83%.

Core fee revenue of \$86 million was up 13% linked quarter and 28% year-over-year, driven by growth across all major fee businesses.

Wealth Management fee revenue grew 14% linked quarter and 16% over the second quarter of 2023, driven by strong results in WSFS Institutional Services, higher activity at Bryn Mawr Trust Company of Delaware and seasonal fees for tax services.

Cash Connect has added nearly 8,000 service non-bank ATMs since the third quarter of 2023 by gaining market share from the previously discussed exit of a large industry participant. This, combined with the optimization of its unit and funding mix increased Cash Connect's ROA to 1.72% in the second quarter.

Our Capital Markets and Mortgage businesses increased fee revenue by 13% and 35%, respectively, over the prior quarter due to increased activity.

In addition, we saw growth in both loans and deposits, which increased 6% and 3%, respectively, on an annualized basis.

The Core Net Interest Margin was 3.85% for the quarter. The higher income from our continued loan growth and re-deployment of cash flows from the securities portfolio offset the increase in our cost of funds resulting from the current interest rate environment and high retention in our maturing CD portfolio as outlined in the release.

Asset quality remained stable. NPAs declined to 32 basis points of total assets, while delinquencies dropped 13 basis points. Problem loans increased primarily due to the downgrades of three C&I loans.

Net charge-offs for the quarter were 44 basis points or 17 basis points, excluding Upstart and Leasing portfolios, in line with net charge-off levels over the past year.

During the quarter, we returned \$48.7 million or approximately 70% of earnings to shareholders in the form of \$9 million in dividends and \$39.7 million from a mix of routine and incremental stock buybacks. We continue to have substantial capital levels above the well-capitalized regulatory benchmarks, including the full impact of AOCI.

Despite the economic uncertainty, WSFS continued to grow and deliver a strong first half of 2024. We remain well-positioned to execute our strategy and produce sustainable top-quintile financial performance. Just as importantly, the strength in our earnings, liquidity and capital positions provides us a cushion to absorb any unexpected changes we might face going forward.

I will now turn it over to Art to update you on our mid-year outlook.

Art Bacci: Thank you, Rodger.

We are tracking above the full year outlook communicated in January with first half core ROA of 1.28%, Core EPS of \$2.19, and Core ROTCE of 19.01%.

As we look to the second half of 2024, we remain well positioned to execute our strategy and deliver top-quintile financial performance with a full-year Core ROA of around 1.25%.

The underlying components of our mid-year outlook remain relatively unchanged from our January outlook. I will highlight several items.

We continue to assume no interest rate cuts in 2024. While the Fed has made indications to reduce rates, we have found it best to use a no-cut scenario as a baseline for our business. Our analysis shows that a 25 basis point reduction or alternatively, an increase would have a full-year annualized impact of 3 basis points to ROA. Assuming any rate cuts would occur later this year, it would not materially impact our full-year performance.

Deposit growth is projected to be flat year-over-year, primarily due to competitive pressures as well as the natural volatility and seasonality of trust and certain Commercial deposits. We expect our interest-bearing deposit beta to be less than 55% compared to the previously communicated 50%. The higher beta is due to the continued shift in deposit mix, repricing of CDs, and the competitive marketplace pricing. Our loan-to-deposit ratio is forecasted to end the year at 83%.

Net charge-offs of 30 basis points, excluding Upstart and NewLane, reflect potential weakness in a small group of problem loans where we are actively working with the borrowers in this continued softening economy.

Finally, I would reiterate our long-term commitment to return approximately 35% of our net income in the form of dividends and routine stock buybacks. Any incremental stock repurchases would be determined by the economic environment, our financial results and would need to be in line with our historic buyback framework.

Thank you and we will now open the line for questions.

Questions & Answers:

Operator: [Operator Instructions] Your first question comes from the line of Russell Gunther from Stephen Inc..

Russell Gunther: I wanted to first ask, if I could, on the fee outlook and more specifically, bailment fees. Can you guys give us a sense for where they shook out this quarter and what we should expect for the back half of the year?

Art Bacci: Sure, Russell. I think fee income still -- I'll break it up into the divisions that we have. I think the Mortgage and Capital Markets, we're continuing to see good activity levels going into July. I will caution us sometimes in August, September, the summer months tend to slow down. But at this point, we're seeing really good activity there.

Wealth, the same thing. We've got some really nice pipeline potential wins here in the third quarter, which would help in the activity level at our Delaware Trust Company or Bryn Mawr Trust Company of Delaware remains pretty elevated as well as our Institutional Trust services are seeing really good volumes in July.

Cash Connect, I would expect somewhat of a slowdown in the growth of the revenue there. We have pretty much onboarded all the new ATMs that came over from the other player. So, the 8,000 ATMs Rodger referred to is pretty much it. So, I would see that returning to more of a normal growth rate in the second half of the year.

Russell Gunther: And then maybe switching gears a second on to expenses. So, appreciate the overall guide and the efficiency ratio target. Could you guys just maybe walk through the step-up in the salary benefits line this quarter? And then similarly, just broad stroke expectations for that trend in the back half of the year?

Art Bacci: Sure. On the salary line, recall that we reversed about \$3.2 million in the first quarter because we paid out incentives that were less than targeted in -- for 2023, but we had accrued at target, so we had to reverse those per GAAP. What you'll see is this quarter -- when you look at the gross increase, it's coming off an artificially low first quarter because of that reversal. So, the net increase is more like 4% quarter-over-quarter. Now probably half of that is really the Cash Connect external funding that as we transitioned those 8,000 accounts, we used more external funding than internal funding in that process.

The other thing is we've just had merit increases in the first quarter, and it was late in the first quarter that we processed merit increases. So we've now got a full year -- or a full quarter of those increases. We've continued to invest in the business and hiring people. And we will look to kind of continue to run rate probably a little bit higher on incentive accruals for the second half of the year because we are running above target, and so we'll have to start accruing for that. So those are kind of really the drivers. We also did - - just to highlight, we did have an elevated medical -- we call it a medical benefits, but there's some claims, medical claims from our associates. It's a small portion of the population that had higher-than-average claims. We can't get into the reason, but that kind of drove a little bit higher expense this quarter. We don't think that will continue.

Russell Gunther: Okay. I appreciate it. And then I guess just to follow up in terms of with the Cash Connect and the onboarding of the ATMs, the use of external versus internal funding? How should we extrapolate that from an expense perspective next -- for the next couple of quarters?

Art Bacci: I think you'll see that come down from an expense perspective slightly. We are targeting to have roughly 75% of that funding done with external partners and 25% internally. So that coming from a much higher level of external funding in the first half of the year. So that should help on there. Obviously, that will also impact our ROA. The 1.70% we saw in the second quarter would probably drop more to like a 1.30%, 1.40% as we've used more of our own cash to fund the ATMs.

Russell Gunther: Okay. That's very helpful. And then guys, last one for me would just be on the net charge-off expectations. Those are unchanged which implies the second half of the year steps up a bit. I'm just curious as to what you're seeing or expecting that would drive that?

Rodger Levenson: Russell, this is Rodger. I'd say Art outlined in his comments, we saw a little bit of an increase in our problem loans, and there are some situations we're monitoring closely. And so we feel that the Outlook reflects potential losses depending upon how those work out.

Operator: Your next question comes from the line of Manuel Navas from D.A. Davidson.

Manuel Navas: How does the exit NIM in 4Q kind of that range shift if we do have a September rate cut?

Art Bacci: Manuel, I think that if the rate cut is happening late in the year as we've kind of projected, we probably would see on a full year basis, about a 1.5% impact on NII. What that would translate into NIM is probably about 5 bps of lower NIM going in as an exit rate. If rates were to be cut later in the quarter.

Manuel Navas: Okay. That's similar to what you said in the past. So I appreciate that. How is the 55% deposit beta expectation kind of arrived at? Are you seeing increased competition? Is it just staying in this higher rate for longer? Just can you kind of give some extra thoughts on that projection?

Art Bacci: I'll let Shari talk about the competitive environment on the consumer side. I think the other thing we've looked at really closely is just our back book on the CD side. And as we've been able to retain a higher percentage of those CDs as they mature but they're coming off a lower price. And as they mature and reprice, they are being renewed at higher rates. Shari, do you want to cover some of the competitive?

Shari Kruzinski: Sure. Manuel, this is Shari. I would say that the competitive landscape though it is eased a bit, it's still something that we're monitoring very closely and certainly very focused on protecting our customer base. So again, as Art said, we see as the CDs mature, we do have some specials available for customers based on the current rate environment that they're taking advantage of. And, so most of that is being driven by our success really retaining those clients.

Art Bacci: I'd also add that about 65%, 70% of our money market accounts are exception priced¹. And that's usually in reaction to the competitive environment.

Manuel Navas: That's all really helpful. Can I circle back to your long-term commitment to that 35% of net income return as buybacks. You had a really strong amount of buybacks this past quarter. Pricing has moved higher. Can you just talk a little bit about thoughts with that?

And then buyback is a huge tool for keeping ROE up, and you're about to enter another 3-year planning process. I think ROE is where you stand out. And just kind of thoughts on where buyback fits in on maintaining ROEs high?

Art Bacci: Yes, Manuel, I mean, our philosophy hasn't changed about the 35% that we will continue to do routine dividends and stock buybacks as we've had in the past. Clearly, anything incremental will have to be driven by what we're seeing in terms of our own financial results, the economy and more importantly, our historic framework where we generally target the 16% IRR on our incremental buyback. So we've been very disciplined about that. And clearly, in the second quarter, we saw some really nice opportunities, so we got aggressive in the buybacks.

The stock has appreciated materially here. So, we would have to really look at our framework and determine if longer term, we think there's still some changes in the underlying assumptions to get us to a 16% IRR if we're going to do incremental buybacks.

Operator: Your next question comes from the line of Kelly Motta from KBW.

Kelly Motta: I was hoping to circle back to asset quality. I mean everything looks really strong and NPAs came down. But I noticed the reserves built particularly on the Investor CRE side. I was hoping to get additional color on the driver of that, and it's at 116 basis points now comfort level there.

Rodger Levenson: Kelly, it's Rodger. And you'll recall, we've been talking about for several quarters, this process that we have a 24-month roll forward look at all maturing CRE loans over \$2.5 million. And we're sensitizing those for the current interest rate environment, with no changes in their cash flow. And so based upon that analysis every time we go through that and we roll forward another quarter, we update the impact of that into our ACL model where wherever we see potential weakness.

So, what you're seeing there is just reflecting the continued roll forward of that project. It's a modest amount of reserves that they're increased there. You saw we also continue to increase in the office sector of CRE. And so that's really what's driving that build in the CRE overall.

Kelly Motta: Got it. Last question from me. I know I apologize if this was covered already, I joined a little bit late. But with the revised deposit growth guidance being flat for the year. Is the right way to think of the balance sheet from here just kind of steady as cash flows are redeployed into loans? Or any kind of puts or takes that you could help us out with in terms of that with putting together with the margin guide?

Art Bacci: Kelly, this is Art. I would absolutely say that the balance sheet should be pretty steady. I don't see a lot of material change in the size of the balance sheet. I would tell you that part of the flat in deposits, we really ended the end of 2023 with an elevated level of deposits coming from our Institutional Trust business and some Commercial business.

¹ 67% of money market accounts are either exception-priced or in the high-yield product, which can be repriced quickly.

And that put a lot of extra cash on our balance sheet that we were able to deploy in Fed funds. We're probably down cash, \$250 million quarter-over-quarter on an average basis. So that impacts NII but it doesn't really impact the NIM. But bottom line, the overall balance sheet really won't change much.

Operator: Your next question comes from the line of Frank Schiraldi from Piper Sandler.

Frank Schiraldi: Just curious, are you doing anything balance sheet-wise naturally or synthetically here that you would expect that 3 basis point impact from a given 25 bps in rate cuts, see that move at all lower? Or is that just kind an acceptable asset sensitivity of the business here.

Art Bacci: Frank, I would just highlight that when you look at our loan portfolio and you look at the Spring EQ portfolio, some of our consumer loans, about 50% of our loan book is fixed rate. And we feel pretty balanced right now that regardless of whether rates go up or down 25 basis points, it has the same impact in both directions.

We did put on -- we have put on about \$1.2 billion of hedges, and we are authorized to do another \$300 million. Yes. And so to protect on the downside -- and I'd also just kind of remind everyone that we've been through these rate cycles and we continue to produce top-quintile NIM regardless of whether rates are higher or lower. And so we want to make sure we're not over-insuring against down rates because as we've seen over the last few years, all the rate projections have tended to be wrong. And there's still potential that rates could go up at some point. So we feel very comfortable having that balance where we're protected on both sides.

Frank Schiraldi: Okay. Got you. And then on -- Art, you mentioned on the Cash Connect. You've kind of built in that large piece of business that you added in terms of increasing shares in the run rate at this point. So talked about more normal growth rate. Is that high single digits here? And do you see further sort of chunky opportunity to pick up significant market share or is it more just maybe onesie, twosie from here?

Art Bacci: Yes. I think it's the latter, Frank. And I don't know, it would be high single digits. I think we did have a nice win this quarter with one client where they gave back a fair number of ATMs that we were just doing reconciliation work, and we got back about half the number of ATMs, but it was more full bailment services, and that bailment services are 3x more profitable for us than just pure reconciliation. So, if we could do those kinds of things, and it wouldn't really increase the number, but deeper services at better profit margins, we would certainly do those types of things all day long.

Frank Schiraldi: Great. And then if I could just sneak in a quick one. Sorry if I missed it, but in terms of the three C&I downgrades that led to the increase in problem assets. Any common thread there?

Steve Clark: Frank, this is Steve. There really is no common thread. The three C&I customers were in three different geographies in three different industries: one, a cultural institution in Center City Philadelphia that is going through a repositioning of its business; a logistics fulfillment trucking company up in the Lehigh Valley-Allentown-Bethlehem area that had some softness in the fourth quarter of last year and first quarter of this year; and then a newly built hotel property in Ocean City, Maryland that has been slow to stabilize.

So all good customers, all performing loans, no real related causes, so totally distinct geographically and industry-wide.

Operator: Your next question comes from the line of Jake Civiello from Janney Montgomery Scott.

Jake Civiello: Just one additional question from me. Is there any change in your appetite at all to consider recognizing a loss on the AFS securities portfolio to more quickly get to that 18% to 20% ratio of securities to assets target?

Art Bacci: Jake, we'll look at transactions, but we continue not to see anything that really pencils out for us that makes sense. And we continue to see very consistent cash flow coming off that portfolio. We're able to deploy it in new originations that have a mid-seven handle kind of yield. And we think that's just the best approach to go and continue to let that cash flow get redeployed naturally. If rates drop, maybe we'd take another look at that. But at this point, no, there's no real plans to restructure the portfolio.

Operator: And our final question today comes from the line of Manuel Navas with D.A. Davidson.

Manuel Navas: I just wanted to hop on and see if there's anything going on in the Commercial loan pipeline. Are you seeing any changes based on rate forecasts or borrowers getting more excited or less excited. Just kind of thoughts there in context of your mid-single-digit loan growth rate.

Steve Clark: Manuel, Steve again. So our 90-day weighted average pipeline is actually down to a little over \$200 million, which is as low as it's been in several quarters. And that is really a reflection of the strong closings we had in the first half of the year². Having said that, we still remain very optimistic about that mid-single-digit growth for the full year. We have significant opportunities in the early stage of our process and believe they'll pull through at our normal pull-through rate. So sitting here today, looking at the second half of the year, still comfortable with our full-year forecast.

Manuel Navas: And are those kind of pricing in that 7.5% yield range? Is that kind of the right new loan origination yields?

Steve Clark: Yes. So, looking at our activity through June for all Commercial loans funded over \$250,000. Our yield in January for that population was 7.2%, and we came out of June, for the month of June, 7.8%. So we -- as Art mentioned, that securities portfolio amortizing down and being redeployed definitely, we're in that mid-to-high 7% yield range.

Operator: And with no further questions in queue, I would like to turn the conference back over to Mr. Bacci. Art, the floor is yours.

Art Bacci: Thank you for joining the call today. If you have any specific follow-up questions, feel free to reach out to Andrew. Rodger and I will be attending conferences and investor meetings throughout the quarter, and we look forward to meeting with many of you. Have a good day.

Operator: And ladies and gentlemen, that concludes today's call. Thank you all for joining, and you may now disconnect.

² Lower Commercial pipeline is also related to internal efforts to apply a more consistent methodology to deal likelihood. Activity levels and interest remain like prior quarters.