

**WSFS Financial Corporation [WSFS]
3Q 2022 Earnings Conference Call
Tuesday, October 25, 2022, 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:

Manuel Navas; D.A. Davidson & Co.
Frank Schiraldi; Piper Sandler & Co.

Presentation:

Operator: Good day and thank you for standing by. Welcome to the WSFS Financial Corporation Third Quarter 2022 Earnings Call. (Operator Instructions) Please be advised that today's call is being recorded. (Operator Instructions) I would now like to hand the call over to your host for today, 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, 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.

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's website. Our third quarter results demonstrated the momentum and diversity of the franchise, strong balance sheet positioning and the opportunities from our unique competitive position in our markets. We remain on track to deliver our full-year core ROA of between 1.30% and 1.40%, with a 4Q ROA between 1.60% and 1.70%. Reported ROA in the third quarter of 1.44% and EPS of \$1.16 included \$2.6 million of Corporate Development and Restructuring costs and a \$2.3 million non-recurring valuation adjustment on Visa Class B structured sale derivative, which was established in 2Q 2020.

As summarized on Slide 3 of the Supplement, excluding these items, our Core results included an ROA of 1.52% or 25 basis points favorable to 2Q, EPS of \$1.23 or 21 cents favorable to 2Q, and ROTCE of 24.01%.

Illustrated on Slide 5, loan growth, when excluding the acquired HFI Resi-Mortgage portfolio, was 9% annualized in the quarter and was broad-based with 40% annualized growth in both Construction and Consumer loans, and 17% annualized growth in Commercial Leases. The 90-day weighted average Commercial pipeline ended the quarter at approximately \$300 million, which was down approximately from \$350 million from 2Q due to pipeline closings at the end of the quarter, with the expectation that the pipeline will rebuild in 4Q.

Deposits decreased 3% or 13% annualized in the quarter, with 40% or over \$220 million coming from transactional trust deposits, driven by timing of customer trust transactions and not tied to the broader market deposit trends. To provide some context, these trust deposits grew almost 60% year-over-year, from our services as paying agent and custodian on various types of capital market trust. These deposits are transactional in nature and can vary period to period; however, over the long-term we continue to see opportunities to grow our market share and ultimately deposit levels.

Excluding these trust accounts, deposits decreased 2% or 8% annualized, resulting from customer liquidity run-off across small and large balance customers in retail and small business, demonstrating the broader macroeconomic impact on liquidity, as we are not seeing increased customer account attrition. Additionally in the quarter, Municipal and public funded accounts increased \$182 million.

Our strong deposit diversity continues with 55% coming from Commercial, Wealth & Trust and Small Business and 58% from low and noninterest-bearing accounts. Our Loan-to-deposit ratio now stands at 70% as we continue to be well positioned to fund continued organic loan growth.

Net Interest Margin detailed on Slide 7, increased 59 basis points to 3.99% and up almost 100 basis points since 1Q, driven by the higher interest rate environment and our asset-sensitive balance sheet position. Loan yields increased 72 basis points as our fixed/variable mix hold steady around 45%/55% with 50% of the book tied to the short end of the curve. Total deposit cost increased 7 basis points to 15 basis points as the cycle-to-date interest-bearing deposit beta reached 7%. As we mentioned on prior calls, we expect deposit betas to increase to 10% to 15% by year-end and potentially reaching 25% to 30% by the end of the cycle. At quarter end, we were not utilizing short-term wholesale funding with total wholesale funding capacity available of \$5 billion.

Our Core Fee Revenue was 26.8% in the quarter, down from 30.0% in 2Q, primarily driven by the 15% growth in NII quarter-over-quarter. Core fees, while down \$1.1 million quarter over quarter demonstrated the benefits of our diversification of revenue, particularly in this environment, with lower fees in Wealth, Capital Markets and Mortgage almost fully offset by increases in Cash Connect and Other Fees.

Current and leading credit metrics continued the post-pandemic positive and stable trends with net charge-offs in the quarter of \$3.2 million or 11 basis points of average gross loans. Detailed on Slide 9, the ACL increased \$4.2 million with provision in the quarter of \$7.5 million. The ACL coverage ratio stands at 1.14% or 1 basis point higher than 2Q, and when including estimated remaining credit marks on the acquired loan portfolio the coverage ratio is 1.40%.

The Core Efficiency Ratio decreased to 53.8% from 56.2% in 2Q, driven by the growth in NII and stable fees, offset by Core Noninterest Expense increase of \$6.6 million, primarily driven by \$2.6 million of higher performance-based incentive, \$1.6 million in other one-time personnel costs, \$1.5 million from higher funding costs for Cash Connect and \$1.2 million higher loan workout and other credit costs. Excluding these items, all other costs were relatively flat quarter over quarter.

Capital ratios remain strong and well above well-capitalized and internal target levels, with CET1 and Tier 1 Capital of 12.38% and Total Risk-based Capital at the Bank of 13.34%. Consistent with the first half of the year, we returned \$90.5 million of capital to shareholders, including \$9.5 million in Common Stock dividend and \$81 million in share repurchases or 1.7 million shares or 3% of outstanding shares. Year-to-date, we have returned 109% of Adjusted Net Income to shareholders.

As depicted on Slide 10, TCE ratio ended at 5.73%. Excluding AOCI, TCE ratio would be 9.5%, while we continue to monitor the sensitivity of AOCI to the forward curve, as I mentioned earlier, we continue to have strong liquidity levels with our full wholesale borrowing capacity available protecting our Investment Portfolio as a liquidity source. Over 40% of the decline in TCE quarter over quarter was attributable to the capital return to shareholders, as I previously mentioned.

We continue to evaluate and consider both our AFS and HTM investment portfolio mix, along with balance sheet hedging strategies, to best position us for the anticipated interest rate volatility in the next few years. I also wanted to point out that in our current version of our earnings release on Page 18, there is a geography error between MBS and Investment Securities as the \$1.1 million of MBS that was moved to HTM was incorrectly included in our Investment Securities. This will be corrected, and we will repost the earnings release shortly. All totals on the page are correct.

In summary, the growth in overall performance in the quarter demonstrated the continued opportunity resulting from our unique competitive position as the largest locally headquartered community bank and wealth franchise in our region, the diversity of our loan and product fees, along with the returns from our strategic investments made over the past few years.

We will now open the line to answer any questions you may have.

Questions & Answers:

Operator: [Operator Instructions] Our first question comes from the line of Frank Schiraldi of Piper Sandler.

Frank Schiraldi: Just wondered if you could talk about the adjustment to guide as far as the expectation -- the updated expectation on fee income growth. Is that market related? Or just any more color you could provide there.

Dominic Canuso: Sure, Frank. Yes, in our outlook update, we did note that fee growth for the year would be lower than we had established in the second quarter. This is all market driven. As you would expect in a higher interest rate environment impacting capital market swap volume, mortgage volume and the equity markets impacting AUM.

Frank Schiraldi: Okay. And then on the subject of AUM in terms of the contraction this quarter, obviously, you just noted market-related. If you pull out the impact from the market, just curious if you can talk at all about any inflows, outflows in terms of business there?

Art Bacci: Frank, this is Art. Most of the decline was really market driven. We had a small net client cash flow number for the quarter, but it was much smaller than we saw in the prior quarter when we had a significant outflow just due to seasonality with tax payments. But this quarter really from a net client cash flow was, I'd say, almost flat, and it was really the decline in AUM that was market driven.

Frank Schiraldi: And then -- just on the consumer growth, can you break that down at all in terms of -- I know in the release, you talked about home equity and the Upstart relationship, both contributing to growth linked quarter. Could you just talk a little bit about what the growth was on the unsecured side? And then just remind us of what your thresholds or internal ceilings are on that business in terms of size?

Rick Wright: This is Rick. I'll take the growth. We did about \$34 million increase on the Upstart product. We did another \$90 million on the SpringEQ product. Do you want to take the others?

Dominic Canuso: Yes. Sure. So -- for unsecured lending book, which is primarily Upstart and credit cards, we have an internal limit of 20% of capital plus ACL. And we're approaching that. So, at this point in time, what you would expect through the fourth quarter and for the foreseeable future is that the Upstart portfolio staying relatively consistent with the levels it's at today.

Frank Schiraldi: Great. I appreciate it. And then if I could sneak in one last one. Just on the significant buyback activity in the quarter. Can you talk a little bit about your appetite for further buybacks with the stock where it is currently? And how if at all, the AOCI marks and contraction in tangible book value plays into that thinking?

Dominic Canuso: Sure. Good question, Frank. Our overall capital return philosophy, as we've articulated over the years and over the last few quarters has not changed, in which we always evaluate our capital ratios, particularly our regulatory capital, and view opportunities to deploy our excess capital and liquidity, first, by protecting the balance sheet, then looking at our organic growth opportunities and then inorganic. And as you've seen over the years coming out of the Beneficial transaction where we were sitting on significant capital, we returned significant amounts to shareholders, then paused during the COVID environment, then reengaged meaningfully and paused again with BMT.

I think that demonstrates what we do is take a quarterly view and ensure that each quarter we're evaluating that kind of waterfall of risk and opportunity. And as over the last few quarters, leading up to the current environment, we were -- we felt our capital ratios were strong. Obviously, with the economic environment and the lack of certainty in the forecast, we will take that into consideration in the fourth quarter.

With regard to AOCI, we keep a close eye on it, as I mentioned in my script, that we continue to have significant capacity and liquidity, either through our loan-to-deposit ratio or our wholesale funding, in which we do not foresee the need to leverage our investment portfolio for liquidity other than the natural runoff that will occur as it cash flows. And so therefore, while the AOCI impact is meaningful, we take that funding availability into consideration when we think about our total capital ratios and focus on the regulatory capital, both at the company and the bank levels.

Operator: [Operator Instructions] Our next question comes from the line of Manuel Navas of D.A. Davidson.

Manuel Navas: Sorry about that. Could you add any more color on what you're describing with -- in the prepared remarks about options for the securities portfolio?

Dominic Canuso: Sure. I think you're speaking to the categorization between available for sale and held to maturity?

Manuel Navas: Yes. That's correct? Yes.

Dominic Canuso: Yes. So, as we've discussed over the last two years, we've significantly increased our Investment Portfolio to deploy excess liquidity, therefore, having a significant amount invested in the last two years over the lower interest rate environment. We continue to evaluate the right categorization. And in the second quarter of this year, we allocated \$1.1 million of it to HTM as that portfolio was the most rate sensitive to future impacts. We continue to look at tranches throughout the portfolio, and we'll continue to monitor going forward. But nothing was moved in the third quarter.

Manuel Navas: That's helpful. Remind me what's the current like runoff from that -- from the portfolios?

Dominic Canuso: Yes. The portfolio is cash flowing about \$50 million a month, which was part of the optionality of why we determined the investment portfolio was the best option for deployment of the excess liquidity because of the cash flowing and the opportunity to either fund any excess liquidity runoff loan growth or reinvest it at a higher rate environment.

Manuel Navas: Okay. That's helpful. You've had really strong deposit cost performance so far. Are you seeing any kind of competition pick up since the close of the quarter, just kind of any color there? I mean I think that your deposit beta trajectory is still pretty low.

Rick Wright: Yes. This is Rick again. I think what we're seeing on deposits, and it seems to be an industry trend is that the higher balance customer is finding some alternatives, for instance, treasuries, where there's a pretty big delta between that and what banks are offering. And we see the lower balance customer going through some of that money they got during the COVID relief. And that trend is pretty much across the board, but we are not seeing significant competition from banks and money. We're not seeing money going out even to the Internet banks at this point.

Dominic Canuso: Manuel, this is Dominic. Just to add color to that. Where appropriate when we're working with our customers, if they are looking for a redeployment of their deposits into wealth assets, we are working with Private Banking and the Wealth group to maintain those funds just in a different form, whether it's AUM or in treasuries or something like that. And then the backdrop of this is our well-diversified deposit base across all of our relationship lending, and that tends to result in a lower beta through cycles. We expect the beta to increase, as I mentioned in my script, but we see we're in a strong position to manage through that and both maintain lower funding costs and deposit levels.

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

Dominic Canuso: Thank you for joining the call today. Rodger and I, along with Art Bacci, our Chief Wealth Officer, 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: This concludes today's conference call. Thank you for participating. You may now disconnect.