PARTICIPANTS

Corporate Participants

Stephen A. Fowle – Executive Vice President and Chief Financial Officer, WSFS Financial Corp.
Mark A. Turner – President and Chief Executive Officer, WSFS Financial Corp.
Rodger Levenson – Executive Vice President & Chief Commercial Banking Officer, WSFS Financial Corp.
Richard M. Wright – Executive Vice President and Chief Retail Banking Officer, WSFS Financial Corp.

Other Participants

Jason D. O'Donnell – Analyst, Merion Capital Group
Robert Haderer – Analyst, Sandler O'Neill & Partners LP
Matthew C. Schultheis – Analyst, Boenning & Scattergood Securities
Damon P. DelMonte – Analyst, Keefe, Bruyette & Woods, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the WSFS Financial Corporation Third Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions] As a reminder, this conference is being recorded.

I'd now like to turn the conference over to your host for today, Mr. Steve Fowle, Chief Financial Officer. Sir, you may begin.

Stephen A. Fowle, Executive Vice President and Chief Financial Officer

Thank you, Ben, and thanks to all of you for taking the time to participate on this call. Participating with me today in addition to myself are Mark Turner, President and CEO; Paul Geraghty, Chief Wealth Officer; Rodger Levenson, Chief Commercial Banking Officer; and Rick Wright, Chief Retail Banking Officer.

Before Mark begins with opening remarks, I'd like to read our Safe Harbor statement. Our discussions 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.

With that read, I'll turn the call over to Mark Turner.

Mark A. Turner, President and Chief Executive Officer

Thank you, Steve, and thank you everyone for your time and attention today. We're pleased to report third quarter earnings of $1.54 per share, our best quarter of earnings since 2008, on both a reported and core basis. This quarter, we will provide a little bit more color in our opening comments, as we'll be on the road in November with analysts and investors in a few different venues, I want to ensure as always we are disseminating important information as fairly as possible.

Earnings in the quarter were positively impacted by a $3.8 million pre-tax gain or $0.28 a share from consolidating our ownership interest in a 2002 reverse mortgage securitization. This is an interest we've owned since its origination 11 years ago and the majority of the underlying loans we have owned or serviced for almost 20 years. That is to say we are very familiar with the underlying collateral and its cash flow dynamics.

Our clean-up call became effective in the third quarter, which triggered the consolidation accounting and the gain. This gain reflects real value earned, and this asset also has longer term upside potential from, among other things, the future cash flows from the underlying collateral, much of which is in California residential real estate in good, mature neighborhoods. We don't have any other similar residual investments in our portfolio.

In the quarter, we also fully redeemed our preferred shares, (formerly TARP preferred). The interest and retirement of the issue cost us $0.04 per share this quarter, which cost will obviously be eliminated going forward. Setting these two positive events aside, this was also our best quarter of core earnings in some time, and reflects the continued momentum in growing our franchise and optimizing prior investments. Our core Return on Assets reached a cycle high of 1.04% and our core Return on Tangible Common Equity reached a healthy 13.6%.

Loans were up 5% annualized in the quarter, led by a 9% annualized growth in commercial and industrial lending. Because C&I activities generally come with longer term relationships and with more products and services, this is our most profitable lending segment. New funding of commercial loans was solid (and within expectations). Net commercial loan growth was impacted by two commercial relationships representing approximately $20 million, which were paid off on the last day of the quarter. Otherwise, net commercial loan growth would have been our highest quarter in 2013. In addition to continuing to take market share, we did see an uptick in borrowings from selected existing customers in support of their organic business expansion, as one sign of the continuing slow improvement in the local economy.

Looking forward, our probability-weighted 90-day expected-to-close commercial loan pipeline is $140 million and is at its high point for the year. Therefore, we would expect to see a continuation of our mid single-digit annualized growth rate in loans. This obviously includes some expected portfolio churn, which is a result of the strong competitive environment.

Credit costs continue to moderate, as most asset quality metrics modestly and steadily improved from already good levels. Total credit costs, (that is provision, REO cost, workout cost and related), were $2.2 million in the quarter, consistent with the prior quarter and our prior expectations. Nonperforming assets and classified loans also improved. Net charge-offs of $2 million were the lowest since mid-2008 before the financial crisis hit. And our provision matched charge-offs, so there was no contribution to our results from reserve releases. One large substandard credit went delinquent in the quarter and a large part of our provision this quarter was related to the risk of further deterioration in that credit. We continue to monitor this borrower closely through their heavy current fall selling season. While there is the possibility this may go non-accrual in the fourth quarter, based on our preliminary review of underlying collateral, we do not believe a negative change in status, if any, will materially affect credit costs at that time. And we continue to expect that total credit costs for the fourth quarter will be in the $2 million to $3 million range, but as always caution that credit costs can be uneven.

Deposits were up 13% annualized, helped by expected and normal seasonal growth in public funds. Aside from that, core deposits showed strong growth, and with our continued intentional run-off of higher-cost, usually single-service CDs, core deposits now represent a robust 82% of funds from our customers, with 43% of our total deposits being in usually stickier, multi-service, more profitable, no-and-low interest checking accounts.

Further, with the roll-out this quarter and next of our new deposit solution set MyWSFS, we believe we will help improve our deposit efficiency and our fee income. With this roll-out, we are moving from a free checking model to a more traditional fee-for-service model, and over time, we would expect to be reducing single-service accounts and rewarding customers for keeping more accounts and higher balances with us.

These market share gains and improving mix of loan and deposits, along with a disciplined pricing and the improving yield of our securities portfolio, all boosted our margin by a core 6 basis points this quarter to 3.56% and boosted our reported margin by 11 basis points to 3.61%, if we add about $0.5 million in prepayment and related fees that went through yield, some large loans I mentioned that paid off late in the quarter. With current trends, we expect that the core margin percentage will be in the mid to high 3.50s in the near-term.

Core fee income (that is excluding the securitization consolidation gain and gains on security sales) was flat from last quarter, despite some expected seasonality in our wealth business and the headwinds that higher rates were having on mortgage banking gains across the industry. More telling, core fee income was up a solid 8% from this quarter last year as our ATM, Wealth and traditional banking businesses continue to grow nicely.

In the mortgage fee area, we are pleased with the first couple months of our combination with Array and Arrow, which contributed solidly to fee income, were neutral to bottom line operating results despite being with us for only few months, with those months being two slower selling months and months where management team was rightly focused on integration activities. We have partnered with great talent, platform and brand and expect these businesses to be accretive in earnings in their first full-year with us.

We clearly demonstrated significant operating leverage this quarter, not only from growth in revenue, but also prudent cost control accomplished over an extended period of time. Despite nearly all of our businesses growing, the addition of new businesses and our increased performance, which led to appropriate increases in incentive compensation, expenses (excluding an accounting change) were slightly better than both last quarter and this quarter last year. And this includes about $190,000 or a little over $0.01 a share in transaction cost we incurred from the Array, Arrow integration.

Our effective tax rate was 34% this quarter, benefiting a little bit from building a modest high quality, bank-qualified municipal bond portfolio and also a small benefit from the positive outcome of a recent tax authority exam. We expect our normal effective tax rate going forward to be approximately 35%.

Finally, strategically, we are delivering on our brand promise of Engaged Associates Delivering Stellar Service, growing Customer Advocates and Value for our Owners. And tactically, we're also delivering on our earlier commitment to optimize the significant investments made in our franchise during a period of deep opportunity from 2009 through 2011. Our steadily improving financial results and our outside recognitions of being a Top Workplace and Top Bank in Delaware for several years running now, all demonstrate our successes. Our goals are, however, loftier; to enhance our best-in-class service model and to become a consistent high performer. For our business model, we define that as achieving a sustainable Return on Assets of 1.2% to 1.3% by the end of 2015. With continued good execution and a little help from the economy, we believe that will still be difficult but achievable.

Again, thank you for your time and attention, and at this point, we will take questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question today comes from the line of Jason O'Donnell of Merion Capital Group. Your line is open. Please go ahead.

<Q – Jason O'Donnell – Merion Capital Group>: Good afternoon and congratulations on a good quarter.

<A – Mark Turner – WSFS Financial Corp.>: Thank you, Jason. Good afternoon.

<Q – Jason O'Donnell – Merion Capital Group>: My first question, Mark, relates to your commentary around the outlook for mid single-digit loan growth going forward. Just to clarify, is that the annualized growth rate you're looking for over the next couple of quarters or is that what you're looking for just into the fourth quarter? Because I know the fourth quarter tends to be seasonally stronger and you get a weaker outcome typically into the first quarter.

<A – Mark Turner – WSFS Financial Corp.>: Yeah. I would – I'll have Rodger comment on this. But it certainly is the case for the fourth quarter, and given the momentum, probably into the early part of next year as well. However, we're going through, as everybody else is, the annual budget process and will update our guidance on that on this call next quarter.

<A – Rodger Levenson – WSFS Financial Corp.>: Yeah. The only thing I would add, Jason, would be, I think if you look back over the past 12 months, we've been pretty consistent in this growth rate on an annual basis and quarterly. So, it's really a continuation of the same trend.

<Q – Jason O'Donnell – Merion Capital Group>: Okay. Okay, great. And then with respect of to the loan yield, I apologize if I missed this, but how much of a lift did you get in the third quarter from commercial loan prepayment penalties and related fees? Is that significant, and if so, should we expect the loan yield to become a drag again on the margin over the near-term?

<A – Steve Fowle – WSFS Financial Corp.>: Yeah. This is Steve, Jason. Netting out other items, the loan yields were probably 3 basis points to 4 basis points higher than they would have been without those charges.

<Q – Jason O'Donnell – Merion Capital Group>: Okay, okay. So is it fair to assume that those moderate over time, the extra penalties, and that those come out of the earnings stream?

<A – Steve Fowle – WSFS Financial Corp.>: That's right. You may remember we got a little bit of benefit last quarter as well, but I wouldn't expect that to continue, ongoing.

<Q – Jason O'Donnell – Merion Capital Group>: Okay.

<A – Mark Turner – WSFS Financial Corp.>: Jason, all that is baked into our projection of the total margin being in the mid-to-high 3.50s in the near-term.

<Q – Jason O'Donnell – Merion Capital Group>: Okay, great. And then one more and I'm going to hop out. With regard to the uptrend in the MBS yield witnessed in the third quarter, where do you see that settling out assuming a static yield curve? I'm just trying to understand the dynamic underlying the guidance. Should we expect that to level out, given the duration strategy you're currently pursuing?

<A – Steve Fowle – WSFS Financial Corp.>: Yeah. You may remember we've talked in prior quarters about having actively managed the portfolios, so that we really brought our yields down quicker than a lot of other banks did.

<Q – Jason O'Donnell – Merion Capital Group>: Right.

<A – Steve Fowle – WSFS Financial Corp.>: So, we had reached a kind of equilibrium state a couple quarters ago. What you saw this quarter had to do with a slowdown in prepayment rates, giving a little bit of lift to that yield. So, I'd expect go-forward yields to kind of normalize near where they are. But that'll depend on again what happens in the rate environment and prepayment speeds.

<Q – Jason O'Donnell – Merion Capital Group>: Perfect. Thanks a lot, guys.

<A – Mark Turner – WSFS Financial Corp.>: Thank you.

Operator: Thank you. Our next question comes from the line of Frank Schiraldi of Sandler O'Neill. Your line is open. Please go ahead.

<Q – Rob Haderer – Sandler O'Neill & Partners LP>: Hey, good afternoon, guys. This is actually Rob Haderer filling in for Frank today. I just had a few quick ones here.

<A – Mark Turner – WSFS Financial Corp.>: Thanks Rob.

<Q – Rob Haderer – Sandler O'Neill & Partners LP>: Sure. Can you guys give maybe anymore color on the mortgage banking, just given the acquisition in the quarter and just kind of on a run rate going forward? It seems like you guys expect this line that it should pick-up in the coming quarters just as these guys ramp up. Could you give any more color there on sort of a go-forward run from here?

<A – Rick Wright – WSFS Financial Corp.>: Yeah. This is Rick. As Mark mentioned, for the past couple of months, Array and Arrow have been in the midst of trying to focus on integration issues. But even with that, they were responsible for about a third of our gain on sale for the quarter, and we expect them to represent about two-thirds of it going forward. And for the fourth quarter, at this point, we see gain on sales something in excess of $1 million.

<Q – Rob Haderer – Sandler O'Neill & Partners LP>: Got it. That's very helpful. And just one last question for me. Just wondering if you guys could give some more color on what's really driving the market share gains. You've highlighted some of the fall-out from the Wilmington Trust M&T merger. Is that still the case or just any color on what's driving the solid gains here would be very helpful?

<A – Mark Turner – WSFS Financial Corp.>: Yes. I'll comment and then Rodger, I think can jump in. We're in an unusual and fortunate position in our market, in that 90% of the traditional banking market share is occupied by us and other institutions that are large regional, national or international players. So, M&T, PNC, Wells Fargo, TD, Citizens Bank, they are all good banks, but all run a very similar large regional playbook of product and price and ubiquity.

We are the only player of size in our market that runs a local service model, typical super-community bank service model that stresses local knowledge, responsiveness, access to decision makers, and more flexibility. And so being the only one, we are getting a lot of business from those people that appreciate that model.

And there is a lot of potential flow to us, because Wilmington Trust had a similar business model, obviously not executed well in the last cycle. And since they've gone under and were assumed by M&T, we are the beneficiary of a lot of their market share over time that want to get back to that type of business model. Rodger?

<A – Rodger Levenson – WSFS Financial Corp.>: I don't really have anything else to add to that.

<Q – Rob Haderer – Sandler O'Neill & Partners LP>: Okay, great. Thanks a lot, guys.

<A – Mark Turner – WSFS Financial Corp.>: Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Matt Schultheis of Boenning & Scattergood. Your line is open. Please go ahead.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: Hi, good afternoon.

<A – Mark Turner – WSFS Financial Corp.>: Good afternoon, Matt.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: A quick question regarding the clean-up on this residual of the reverse mortgage securitization. What's the par value on that?

<A – Steve Fowle – WSFS Financial Corp.>: There is about $44 million in bonds outstanding.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: Okay. And what are they on your books for today?

<A – Steve Fowle – WSFS Financial Corp.>: They're on the books at that amount.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: Okay.

<A – Steve Fowle – WSFS Financial Corp.>: There is also assets that we picked up, mostly the reverse mortgage loans, that are on our balance sheet as well.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: Okay. So, there is no significant discount to taking earnings over time with this then?

<A – Mark Turner – WSFS Financial Corp.>: Well – so, it's a great question. The underlying liabilities, as I mentioned, are about $44 million. Our best estimate of the underlying collateral value that exists in the loans, and this is based on recent BPOs of the underlying loans, is about $76 million of underlying collateral value. So, there's about $32 million difference there. And that amount is significantly discounted back based on the time it will take for that income to come into our earnings stream.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: Is collecting those going to take a life event?

<A – Mark Turner – WSFS Financial Corp.>: Yes. So, the reverse mortgage owners are older, expecially the non-insured mortages. That is the product that came out in the early infancy of reverse mortgages, where the lender promises to provide a monthly payment for life, and then when the person dies or leaves the home, the whole value of the home reverts to the lender. So, yes, it does take a maturity event, somebody dying, somebody leaving a home, to get cash from that collateral. And then, obviously it takes some time to sell that once you get possession of the collateral.

So, the assumptions that we have to account for in terms of valuing this are when are people going to pass away, which is fairly predictable based on actuarial tables that are updated. And then what that house will be worth when they pass away, which again is – given the small number of loans that are left, something that we can go out and do BPOs on, on an annual basis and get pretty good valuations.

So, as I said, we have a very good understanding of the collateral and the dynamics to the cash flow having owned or serviced most of the underlying loans for the better part of 20 years now and modeling it for the better part of 20 years, and I think we are appropriate in assigning significant discounts to those future cash flows. As a result of all that, we expect to earn significant yield off of what's now an $8 million net investment on our balance sheet.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: So, you've got $72 million worth of collateral, $44 million of liability, the rest is...

<A – Mark Turner – WSFS Financial Corp.>: $76 million, sorry.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: Excuse me, $76 million. From your estimates knowing these loans as well as you do, when does that start happening? When do these life events start and when do they end from your actuary tables?

<A – Mark Turner – WSFS Financial Corp.>: I think there's about 110 loans there, and so the maturity events as we call them happen every day and the average age of the borrower on most of those loans, the ones that we know very well, is 94. So, obviously the people that are in that pool now are probably the healthier people with better genes in terms of long-livedness. But we would expect most of that cash flow to come in over the next five or six years just based on the age of the underlying homeowners.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: That's a significant increase to your capital base. What would you anticipate doing with that sort of deploying it? Your loan growth isn't quite going to absorb that from what I can tell. So looking forward, when those come in, does this mean that you might actually start buying back stock again or special dividends or anything along on those lines?

<A – Mark Turner – WSFS Financial Corp.>: So there's still risk involved. Residuals have risks, and so that's why we put a significant discount rate on it. And even though it's not a residual security anymore, it still is residual risk in that we get the remaining equity in those homes. So we have applied significant discounts to those estimated future cash flows to come up with what we think is a fair but conservative value when the assets are put on our books.

I think, Matt, it would be getting ahead of ourselves to start thinking about what we're going do with that capital until it starts coming in. But more broadly to your question, we just completed a $53 million repurchase of equity, the preferred formerly TARP equity that will add significant benefit to the bottom line. And right now, at about 7.75% tangible common equity ratio, we believe we're operating with the appropriate capital levels to support our business and the opportunities we see to grow our business in the near-term.

Longer term, we are very likely to continue our current philosophy. We much more heavily weight it on buybacks over dividends as a way to return to capital, because of the flexibility we see that it provides to both the company in managing our affairs and our owners in taking their cash and tax burden as they see fit.

<Q – Matt Schultheis – Boenning & Scattergood Securities>: Okay. That's it for me. Thank you.

<A – Mark Turner – WSFS Financial Corp.>: Okay. Thank you.

Operator: Thank you. Our next question comes from the line of Damon DelMonte from KBW. Your line is open. Please go ahead.

<Q – Damon DelMonte – Keefe, Bruyette & Woods, Inc.>: Hi, good afternoon, guys. How are you?

<A – Mark Turner – WSFS Financial Corp.>: Good, Damon. How are you?

<Q – Damon DelMonte – Keefe, Bruyette & Woods, Inc.>: Great. Thanks. I apologize if this has been addressed. I was bouncing between conference calls. But could you just talk a little bit about the pricing dynamics that you're seeing in your markets and maybe structure and how that plays in with competition and some of the players across your markets?

<A – Rodger Levenson – WSFS Financial Corp.>: Yeah. Hi Damon, it's Rodger. First of all, as it relates to those two large pay-offs, I would just broadly say that, without getting into all the specifics, obviously the risk-reward equation didn't work for us. And so for a combination of pricing and structural reasons, we let those relationships go. I would broadly say that we're still seeing fairly intense price competition.

Just to put some definition around that, five-year fixed rates can be as low as in the mid-3s, and we're still seeing some playing at the 10-year fixed rates sort of right around 4%-ish. I'd say that has moderated a little bit since earlier in the year, particularly the end of the first to early part of the second quarter when that was fairly intense. But there's still heavy price competition, and to some degree that's in our yield.

Structure, I wouldn't say there's any kind of broad statement I would make in terms of anybody being super-aggressive in structure. We don't play, as you know, very much in the sort of the broad syndication market, but I know there's been a lot of conversation around that kind of going back to pre-crisis dynamics. In our core business, structure isn't really what's driving things, except for those limited situations which I talked about previously.

<Q – Damon DelMonte – Keefe, Bruyette & Woods, Inc.>: Okay, that's helpful. Thank you. And then I guess as you guys look to manage your expense base, have you given thoughts to your branch network and your structure of maybe where you could become more efficient by either consolidating a couple or maybe re-designing and shrinking the size or something?

<A – Rick Wright – WSFS Financial Corp.>: This is Rick again. We are comfortable where we are for the short-term particularly in Delaware. We've closed a branch this year, we closed one last year. We continue to try to look at the options in design to get to the smaller footprints to take advantage of the electronic mobile opportunities that are out there. But there's not going to be a wholesale kind of pruning at this point and we're clearly still looking for opportunities in the Southeastern Pennsylvania market.

<Q – Damon DelMonte – Keefe, Bruyette & Woods, Inc.>: Okay. And then I guess my last question just regarding the dividend, any thought – I know, Mark, historically you guys have not focused on the dividend as much. But with pretty much a single-digit payout ratio and earnings continuing to increase, have you given any thought to maybe increasing that payout?

<A – Mark Turner – WSFS Financial Corp.>: We approach that subject once annually in April and intend to do so this April. And I think we'll take a full look at it at that time. But again I think if we increase it, it wouldn't be by much. I would expect that the management would still take a similar posture that if we have excess capital we can't use or foresee that we're going to use in the business in the near-term, that we much prefer buybacks.

<Q – Damon DelMonte – Keefe, Bruyette & Woods, Inc.>: Okay. That's all that I had. Thank you very much, guys.

<A – Mark Turner – WSFS Financial Corp.>: Thank you.

Operator: Thank you. And with no further questions in queue, I'd like to turn the conference back over to Mr. Mark Turner for any closing remarks.

Mark A. Turner, President and Chief Executive Officer

Okay, thank you. Finally, as I mentioned, Steve, Rodger and I will be on the road in November for investor relations activities and hope to see many of you out there. Thanks again for your time and attention, and have a great weekend.

Operator: Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program and you may all disconnect. Have a great rest of your day.