
MANAGEMENT DISCUSSION SECTION

Operator: Good day everyone and welcome to the Tower Bancorp Fourth Quarter Earnings Conference Call. Today's call is being recorded. I'd now like to turn the conference over to Mr. Brent Smith. Please go ahead.

Brent Smith, Investor Relations

Thank you, Dana. Good morning everyone. Thank you for taking time to join us this morning. With me today are Andrew Samuel, Chairman and Chief Executive Officer; and Mark Merrill, our Executive Vice President and Chief Financial Officer. We'll begin with Andrew providing us with an overview of the key accomplishments during 2009, and then Mark would be providing us with the summary of our fourth quarter of 2009 financial results; followed up by a time for question and answers. If anyone has not yet seen our press release, there is a copy available on Tower Bancorp's website at: www.towerbancorp.com.

Before we begin, let me remind you that this call is also available simultaneously through webcast. A replay option for the call will be available on our website this afternoon through February 3rd. I also want to remind you that today's remarks may contain forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to access. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted. For a list and description of these risks and uncertainties, I'd like to refer you to the Safe Harbor statement in the press release and other information provided in our SEC filings.

I also want to point out that we will not be able to comment beyond Andrew and Mark's opening comments regarding our pending merger with First Chester County Corporation.

It is now my pleasure to turn the call over to Andrew Samuel, our Chairman and Chief Executive Officer.

Andrew Samuel, President and Chief Executive Officer

Good morning ladies and gentlemen. Thank you for joining us this morning. Let me first start by just saying we had a solid fourth quarter and Mark Merrill will talk through that in a little bit. But I just want to take a few minutes to just recap 2009 for Tower.

Just as a way of background, again, Tower Bancorp Inc. is the parent of Graystone Tower Bank. Just so everybody is aware, Graystone Tower Bank is a four-year old – a little over four-year old [inaudible] that was started in November 2005. We grew that company to about \$650 million, and then in March of 2009 we did a partnership with the First National Bank of Greencastle, which was over a 140-year old bank based in Franklin County, which created Tower Bancorp Inc.

So, March 30th, we closed a deal with the First National Bank of Greencastle. We quickly followed that up with listing on the NASDAQ global market. We went from there to conversion in June 2009. Our conversion was pretty successful as evidenced by the deposit growth at the First National Bank of Greencastle. From there in June of 2009 we completed a sub-debt raised up \$10 million, which was primarily done with friends and family, just with our local community folks here. We followed that up with a major capital raise of \$52 million in late August, which was very successful. And then moving on from there, in October where we've announced that we were going to be closing two legacy offices of First National of Bank of Greencastle in February, which is slated to close in about a month.

We also followed up with two new offices, a new office in Elizabethtown, Lancaster County and another new office in Lebanon, Lebanon County, both of those offices are really off to a very, very good start. E-town is averaging about a \$1 million in deposits weekly, and Lebanon is averaging about \$2 million a week in the new deposits. We finally then capped the year with our announcement on the December 28th of our intention to acquire First Chester County Corp. So, very, very busy year, not just financially but also strategically. And what I'd like to do now is actually turn it over to Mark to kind of walk through the fourth quarter numbers.

Mark Merrill, Chief Financial Officer

Thank you, Andrew. We appreciate you taking the time to join us this morning. I'd like to comment on our fourth quarter results. My comments will be comparisons of the current quarter results versus the previous quarter, unless otherwise noted.

We report a GAAP net income of 2.1 million or \$0.29 per diluted share, which is a 21% increase over GAAP net income of 1.7 million in the [inaudible] quarter. Operating income was 34% over the third quarter to 2.6 million or \$0.36 per diluted share. Moving to the balance sheet, our total assets grew 98.5 million or 28.6% on an annualized basis, nearly 1.5 billion at December 31, 2009.

The fourth quarter of 2009 proved to be very strong for loan and core deposit growth. Excluding 51.7 million of loans purchased from the from the First National Bank of Chester County, loans grew 83.9 million, representing an annualized growth rate of 33%. This annualized number is higher than what we expect to see moving forward. However, we continue to believe we will be a top performer for loan growth relative to our peers. The growth in the loan portfolio was primarily in commercial loans, which included both the C&I and the commercial real estate portfolio. The reduction in the mortgage loan portfolio is a result of our continued efforts to sell mortgage loans into the secondary market that were previously held in the legacy Tower's loan portfolio.

Regarding the commercial portfolio, we have successfully inserted interest rate floors 85% of available rate portion of the commercial loan portfolio. Our loan strategy will be to continue to grow both the commercial and consumer portfolios within our footprint, without compromising the disciplined credit and underwriting standards that got us to where we are today.

On the funding side, core deposits, which excludes time deposits, grew 78.2 million during the fourth quarter, representing an annualized growth rate of 43%. I've mentioned in regard to loans that annualized rate is higher than our expectations for future periods, but is validate that our relationship-focused approach to banking is working in the markets we serve. We have proven our ability to grow De Novo branches very quickly, as evidenced by over \$60 million in average – in market total deposits per branch for our three newest branches operating at least three months and opened within the last two years. Furthermore, we have opened 11 De Novo branches since 2005, with over 65 million in average total deposits per branch gathered in those markets. The deposit competition in these offices includes over 70% in core deposits and less than 30% in time deposits. Moving forward, we continue to focus on growing core deposits through our existing branch network as well the addition of three approved De Novo branches scheduled to open in 2010.

Moving on to net interest income, we reported an increase of 1.1 million in net interest income over the linked quarter to 11.3 million. The increase is supported by strong growth in our interest-earning assets and interest-bearing liabilities, while our net interest margin was 3.53% compared to 3.57% in the linked quarter. The slight drop in the margin was driven by a higher level of liquidity on our balance sheet, as our average rate received on loans remained at 5.95% and our average rate paid on interest-bearing liabilities decreased from 2.04% to 1.86%.

As of December 31, 2009 our balance sheet liquidity position without giving effect to available credit was approximately 20% of total deposits. Given the strong loan demand, we expect in the coming year, we expect some reduction in the level of liquidity, which should have a positive impact on margin. Furthermore, we have carefully elected to invest most of our excess liquidity in short-term securities with the proceeds expected to fund loan growth in the coming periods. The transfer from investment securities to loans over time should expand the average rate received on interest earning assets.

Regarding our source of funds over 90% of our total funding is attributed to end-market deposits with 5% of funding coming from the Federal Home Loan Bank, and less than 5% coming from broker deposits and other sources of funding. Core deposits now represent over 65% of our total deposits. Also, 52% of our time deposit portfolio we'll re-price within next 12 months with a weighted average rate on that portfolio of 2.23%. Our deposit growth strategy will be to continue our sales and marketing efforts to gather core deposits and longer-term time deposits within our branch – footprint.

At this point, I'd like to comment on our asset quality. We are proud of the asset quality we have been able to maintain during the recent economic slowdown. As a community bank, we focus on lending end-market to people we know. We believe our relationship banking model with experienced end-market credit and lending teams have paved the way for our continued success as an organization in this regard.

Non-performing assets, the total assets were 0.52%, a slight increase from 0.45% at the end of the third quarter. We do not have any one individual loan relationship with an outstanding balance greater than 500,000 in our non-performing assets. Net charge-offs were 188,000 during the fourth quarter or just 0.07% annualized based on average loans in the quarter. The provision for loan losses was 1.4 million in the fourth quarter of 2009 compared to 800,000 for the previous quarter. The provision reflects both the credit risk in our loan portfolio, and the strong loan growth, which totaled 136 million in net growth during the fourth quarter. We continued to provide adequate reserve coverage on our non-performing loans through the allowance for loan losses, which was 142% at December 31, 2009. Our allowance for credit losses to non-performing loans, which include the allowance for credit losses and the credit for value adjustment on non-impaired purchased loans, was 185% at the end of the fourth quarter.

Before I turn it back over to Andrew, I just want to comment briefly on the capital front. As you recall, we successfully completed a common stock offering during the third quarter of 2009, which resulted in net proceeds of approximately 51.7 million. That offering along with our consistent earnings during the recent economic downturn has put us in a position of strength to grow the core franchise, both organically as evidenced by our strong fourth quarter loan and deposit growth and strategically as evidenced by the announcement of the First Chester acquisition in the fourth quarter. In conclusion we are very pleased with our 2009 results, and are excited for the growth opportunities that we see in 2010.

Thanks for your time. I will now turn it back over to Andrew.

Andrew Samuel, President and Chief Executive Officer

Thank you, Mark. I just want to just quickly close up with – as we look towards the next few quarters we're really focusing on two fronts. One is the continued core organic growth of our core bank and under Janak Amin's leadership that core bank is really poised for growth. The pipeline is very, very strong in all of our distinct markets. We also have three new branches planned this year. So, with that focus continues. And then on the integration front of First Chester County core the integration is underway under Jeff Renninger and Jane Tompkins' leadership. Currently, we are on schedule with all of our plans there, and in addition to that, we have been very, very well received

by the community, the employees in the Chester County market. Finally, I am very optimistic about 2010. We are cautious – primarily because of the general economy and the unemployment rate and levels and particularly as it relates to our mortgage and consumer portfolio.

So, having said that, let's open it up for questions; and Mark and I are here and would be happy to answer any questions that are available.

QUESTION AND ANSWER SECTION

Operator: Thank you. The question-and-answer session will be conducted electronically. [Operator Instructions]. And we will go first to Whitney Young with Raymond James.

<Q – Whitney Young>: Good morning.

<A – Andrew Samuel>: Good morning, Whitney.

<Q – Whitney Young>: I was just wondering if you could comment on the increase in loans 90 days past due kind of what was the driver there, please? Thanks.

<A – Mark Merrill>: Yeah. Thanks Whitney and good morning. We did see some increase in our loans 90 days past due, it's still accruing. They represent about \$2 million at the end of the quarter. There – there is a concentration in that portfolio related to the residential and home equity portfolio, primarily in the legacy Tower market, and we are focused on that. Our relationship managers are on top of that. But given the uncertainty in the economy today, and as we move forward, that will depend on where we go when it comes to that portfolio.

<Q – Whitney Young>: And I was also just wondering if you would mind commenting just very generally on what you're seeing in that Pennsylvania middle-market business category. What are you seeing in terms of just a general health of those businesses and the kind of the prospects for 2010? Thanks.

<A – Andrew Samuel>: Right. Very good question, as I mentioned earlier, with the general economy and unemployment we are cautiously watching our mortgage and resident – and consumer portfolio. But the interesting thing is our commercial clients certainly aren't faring as well as three or four years ago, but overall seem to be holding up. So, what we are seeing generally is – now, let me just give you a sense. Most of those commercial clients we deal with are primarily family-owned businesses with average revenues of probably in the 10 to \$30 million range, that's our net. So, in that particular category we are seeing some stress, but not to the extent of the creating major problems. So, it -- they certainly aren't making the kind of money they were a few years ago, but they are holding their own in this climate so.

<A – Whitney Young>: Okay. So, that – that sounds like it's pretty much unchanged from your comments last quarter. Is that safe to say?

<A – Mark Merrill>: Absolutely.

<Q – Whitney Young>: Great. Thank you.

Operator: [Operator Instructions]. And we'll go next to [inaudible]

<Q>: Good morning gentlemen. How are you?

<A – Andrew Samuel>: Good morning. How are you?

<Q>: Could you talk about some – could you talk about what you're seeing in ReFi and mortgage business, and with that do you see – do you expect a continuation in that line of business?

<A – Andrew Samuel>: Ross, are you primarily referring to the residential mortgage side?

<Q>: Yes and – and again on mortgage sales.

<A – Andrew Samuel>: Okay. Mark, do you want to...?

<A – Mark Merrill>: Yeah. Thank you. Our mortgage subsidiary had a great year. We funded a little over 100 million in loans into the secondary market. We do not hold those mortgage loans on our balance sheet. Our mortgage loan portfolio that is on the balance sheet was the purchased mortgage portfolio from the legacy Tower Bancorp. But in regards to your question, we didn't really see much of the slowdown between the second and third quarter and the fourth quarter when it comes to refinances in our mortgage company. We expect that to continue in the first-half of 2010, given some of the federal tax credits for new home buyers and step-up buyers, although the outlook beyond that, there is some uncertainty on whether or not we can continue to maintain that level. I also do want to mention though that our originators are also focused on purchase business and purchase business is property between 30 and 50% of the business of our mortgage company. So, we don't provide just on refinancing as we move forward.

<A – Andrew Samuel>: And Ross, what I emphasize, in a residential mortgage lending for a community bank like us is a critical component of the services we provide in the market. However, it is not necessarily a key driver of our model. So, we have a solid Graystone Mortgage Company that provides community mortgage lending. And so, our philosophy has always been to provide that as a service, but not have it drive the earnings of the company.

<Q>: Okay. Could I, just one follow-up because I'm, going back to the commercial loan growth, putting aside – put aside the acquisition what kind of net total loan growth are you expecting in – for calendar 2010 putting aside the acquisition?

<A – Andrew Samuel>: Yeah, outside of the acquisition, as I've said the pipeline is very strong. We are very optimistic on that, in that area. And as we look to this year, I mean, I'd certainly – we expect to see strong commercial loan growth as we go forward. But I do want to emphasize that it's not going to be in the 40, 50% growth range. I think, it will be well above our peer group, but at a much more manageable cost, so.

<Q>: All right guys, thanks again and best of luck.

<A – Mark Merrill>: Okay. Thank you.

Operator: [Operator Instructions]. And it appears we have no further questions at this time.

Andrew S. Samuel, President and Chief Executive Officer

Thank you all.

Mark S. Merrill, Chief Financial Officer

Thank you.

Operator: That does conclude today's presentation. We thank you for your participation.

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