WSFS FINANCIAL CORP
Form 10-Q
May 10, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ______

Commission File Number 0-16668

WSFS FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**22-2866913**
(State or other jurisdiction of	**(I.R.S. Employer**
Incorporation or organization)	**Identification Number)**
500 Delaware Avenue,	
Wilmington, Delaware	**19801**
(Address of principal executive offices)	**(Zip Code)**

(302) 792-6000

Registrant s telephone number, including area code:

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files), Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of May 3, 2013:

Common Stock, par value $.01 per share	**8,793,920**
(Title of Class)	**(Shares Outstanding)**

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WSFS FINANCIAL CORPORATION

FORM 10-Q

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PART I. Financial Information

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WSFS FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,	
	2013	2012
	(Unaudited)	
	(In Thousands, Except Per Share Data)	
Interest income:		
Interest and fees on loans	$ **31,452**	$ 33,395
Interest on mortgage-backed securities	**3,729**	5,718
Interest on reverse mortgages	**243**	(29)
Interest and dividends on investment securities	**142**	130
Other interest income	**25**	9
	35,591	39,223
Interest expense:		
Interest on deposits	**2,019**	4,015
Interest on Federal Home Loan Bank advances	**443**	1,937
Interest on federal funds purchased and securities sold under agreements to repurchase	**249**	247
Interest on trust preferred borrowings	**329**	375
Interest on senior debt	**943**	
Interest on other borrowings	**28**	119
	4,011	6,693
Net interest income	**31,580**	32,530
Provision for loan losses	**2,231**	8,245
Net interest income after provision for loan losses	**29,349**	24,285
Noninterest income:		
Credit/debit card and ATM income	**5,668**	5,422
Deposit service charges	**4,014**	4,014
Investment management and fiduciary revenue	**3,728**	3,031
Securities gains, net	**1,644**	2,036
Mortgage banking activities, net	**737**	516
Loan fee income	**495**	610
Bank owned life insurance income	**40**	185
Other income	**1,748**	944
	18,074	16,758
Noninterest expense:		
Salaries, benefits and other compensation	**17,983**	16,235
Occupancy expense	**3,383**	3,048
Equipment expense	**1,829**	1,667
Data processing and operations expense	**1,349**	1,322
FDIC expenses	**1,166**	1,437
Professional Fees	**947**	1,164
Marketing Expense	**517**	779
Loan workout and OREO expense	**170**	836
Other operating expense	**5,026**	4,501

		32,370		30,989
Income before taxes		**15,053**		10,054
Income tax provision		**5,313**		3,610
Net income		**9,740**		6,444
Dividends on preferred stock and accretion of discount		**692**		692
Net income allocable to common stockholders	**$**	**9,048**	$	5,752
Earnings per share:				
Basic	**$**	**1.03**	$	0.66
Diluted	**$**	**1.02**	$	0.66

The accompanying notes are an integral part of these Consolidated Financial Statements.

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WSFS FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three months ended March 31,	
	2013	2012
	(Unaudited) (In Thousands)	
Net Income	**$ 9,740**	$ 6,444
Other comprehensive income (loss):		
Unrealized (losses) gains on securities available for sale	**(7,725)**	540
Tax expense	**2,898**	(224)
Net of tax amount	**(4,827)**	316
Reclassification adjustment for gains included in net income	**(1,644)**	(2,036)
Tax expense	**625**	774
Net of tax amount	**(1,019)**	(1,262)
Total other comprehensive loss	**(5,846)**	(946)
Total comprehensive income	**$ 3,894**	$ 5,498

The accompanying notes are an integral part of these Consolidated Financial Statements.

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WSFS FINANCIAL CORPORATION

CONSOLIDATED STATEMENT OF CONDITION

	Mar 31, 2013	Dec 31, 2012
	(Unaudited)	
	(In Thousands, Except Per Share Data)	
Assets		
Cash and due from banks	$ 75,379	$ 93,629
Cash in non-owned ATMs	454,955	406,627
Interest-bearing deposits in other banks	278	631
Total cash and cash equivalents	530,612	500,887
Investment securities, available-for-sale	829,341	907,498
Investment securities, trading	12,590	12,590
Loans held-for-sale	16,825	12,758
Loans, net of allowance for loan losses of $42,948 at March 31, 2013 and $43,922 at December 31, 2012	2,739,892	2,723,916
Bank owned life insurance	62,955	62,915
Stock in Federal Home Loan Bank of Pittsburgh, at cost	31,527	31,165
Assets acquired through foreclosure	6,522	4,622
Accrued Interest receivable	10,028	9,652
Premises and equipment	37,836	38,257
Goodwill	28,146	28,146
Intangible assets	4,988	5,174
Other assets	43,381	37,568
Total assets	$ 4,354,643	$ 4,375,148
Liabilities and Stockholders Equity		
Liabilities:		
Deposits:		
Noninterest-bearing demand	$ 626,751	$ 631,026
Interest-bearing demand	560,394	538,195
Money market	848,966	933,901
Savings	401,453	389,977
Time	297,689	316,986
Jumbo certificates of deposit	264,600	294,237
Total customer deposits	2,999,853	3,104,322
Brokered deposits	188,666	170,641
Total deposits	3,188,519	3,274,963
Federal funds purchased and securities sold under agreements to repurchase	95,000	110,000
Federal Home Loan Bank advances	455,262	376,310
Trust preferred borrowings	67,011	67,011
Senior debt	55,000	55,000
Other borrowed funds	33,895	28,945
Accrued interest payable	1,874	1,099
Other liabilities	33,813	40,766
Total liabilities	3,930,374	3,954,094

Stockholders Equity:				
Serial preferred stock $.01 par value, 7,500,000 shares authorized; issued 52,625 at March 31, 2013 and December 31, 2012	**$**	**1**	$	1
Common stock $.01 par value, 20,000,000 shares authorized; issued 18,373,873 at March 31, 2013 and 18,354,055 at December 31, 2012		**184**		184
Capital in excess of par value		**224,045**		222,978
Accumulated other comprehensive income		**7,097**		12,943
Retained earnings		**441,222**		433,228
Treasury stock at cost, 9,580,569 shares at March 31, 2013 and December 31, 2012		**(248,280)**		(248,280)
Total stockholders equity		**424,269**		421,054
Total liabilities and stockholders equity	**$**	**4,354,643**	$	4,375,148

The accompanying notes are an integral part of these Consolidated Financial Statements.

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WSFS FINANCIAL CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

	Three months ended March 31,	
	2013	2012
	(Unaudited) (In Thousands)	
Operating activities:		
Net Income	**$ 9,740**	$ 6,444
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**2,231**	8,245
Depreciation of premises and equipment	**1,370**	1,256
Amortization, net	**3,571**	2,732
(Increase) decrease in accrued interest receivable	**(376)**	161
Increase in other assets	**(3,225)**	(1,401)
Origination of loans held-for-sale	**(53,177)**	(30,406)
Proceeds from sales of loans held-for-sale	**49,802**	33,205
Gain on mortgage banking activities, net	**(737)**	(516)
Security gains, net	**(1,644)**	(2,036)
Stock-based compensation expense	**877**	608
Excess tax benefits from share-based payment arrangements	**(83)**	(7)
Increase in accrued interest payable	**775**	1,907
Decrease in other liabilities	**(7,359)**	(1,827)
Loss on sale of assets acquired through foreclosure and valuation adjustments, net	**9**	595
Increase in value of bank-owned life insurance	**(40)**	(185)
Decrease in capitalized interest, net	**(253)**	(165)
Net cash provided by operating activities	**$ 1,481**	$ 18,610
Investing activities:		
Maturities of investment securities		4,524
Sale of investment securities available for sale	**139,249**	84,808
Purchase of investment securities available-for-sale	**(91,368)**	(162,404)
Repayments of investment securities available-for-sale	**21,008**	40,376
Disbursements for reverse mortgages	**(32)**	(17)
Net increase in loans	**(21,047)**	(33,311)
Net decrease in stock of Federal Home Loan Bank of Pittsburgh	**(362)**	1,788
Sales of assets acquired through foreclosure, net	**364**	7,310
Investment in premises and equipment, net	**(956)**	(1,933)
Net cash provided by (used for) investing activities	**$ 46,856**	$ (58,859)
Financing activities:		
Net (decrease) increase in demand and saving deposits	**(50,178)**	41,052
(Increase) Decrease in time deposits	**(48,934)**	(956)
Increase in brokered deposits	**18,025**	9,244
Receipts from FHLB advances	**15,642,397**	4,349,754
Repayments of FHLB advances	**(15,563,445)**	(4,360,463)
Receipts from federal funds purchased and securities sold under agreement to repurchase	**5,865,000**	3,765,000
Repayments of federal funds purchased and securities sold under agreement to repurchase	**(5,880,000)**	(3,740,000)
Repayment of unsecured debt		(30,000)
Dividends paid	**(1,711)**	(1,700)

Issuance of common stock and exercise of common stock options		**151**		(11)
Excess tax benefits from share-based payment arrangements		**83**		7
Net cash (used for) provided by financing activities	**$**	**(18,612)**	$	31,927
(Decrease) increase cash and cash equivalents		**29,725**		(8,322)
Cash and cash equivalents at beginning of period		**500,887**		468,017
Cash and cash equivalents at end of period	**$**	**530,612**	$	459,695
Supplemental Disclosure of Cash Flow Information:				
Cash paid for interest during the period	**$**	**3,236**	$	4,786
Cash paid for income taxes, net		**5,416**		4,221
Loans transferred to assets acquired through foreclosure		**2,273**		2,918
Net change in other comprehensive income		**(5,846)**		(946)

The accompanying notes are an integral part of these Consolidated Financial Statements.

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WSFS FINANCIAL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED MARCH 31, 2013

(UNAUDITED)

1. BASIS OF PRESENTATION

Our Consolidated Financial Statements include the accounts of WSFS Financial Corporation (the Company , our Company , we , our or us), Wilmington Savings Fund Society, FSB (WSFS Bank or the Bank) and Montchanin Capital Management, Inc. (Montchanin). We also have one unconsolidated affiliate, WSFS Capital Trust III (the Trust). WSFS Bank has two fully-owned subsidiaries, WSFS Investment Group, Inc. (WIG) and Monarch Entity Services LLC (Monarch) and Montchanin has one wholly owned subsidiary, Cypress Capital Management, LLC (Cypress).

Founded in 1832, the Bank is one of the ten oldest banks continuously operating under the same name in the United States. We provide residential and commercial real estate, commercial and consumer lending services, as well as retail deposit and cash management services. In addition, we offer a variety of wealth management and trust services to personal and corporate customers through our Wealth Management division. Lending activities are funded primarily with customer deposits and borrowings. The Federal Deposit Insurance Corporation (FDIC) insures our customers deposits to their legal maximums. We serve our customers primarily from our 51 offices located in Delaware (42), Pennsylvania (7), Virginia (1) and Nevada (1) and through our website at www.wsfsbank.com. Information on our website is not incorporated by reference into this quarterly report.

Amounts subject to significant estimates are items such as the allowance for loan losses and reserves for lending related commitments, goodwill, intangible assets, post-retirement benefit obligations, the fair value of financial instruments, investment in reverse mortgage, income taxes and other-than-temporary impairments. Among other effects, changes to such estimates could result in future impairments of investment securities, goodwill and intangible assets and establishment of allowances for loan losses and lending related commitments as well as increased post-retirement benefits expense.

Our accounting and reporting policies conform with U.S. generally accepted accounting principles and prevailing practices within the banking industry for interim financial information and Rule 10-01 of the Securities and Exchange Commission (SEC) Regulation S-X. Rule 10-01 of Regulation S-X does not require us to include all information and notes for complete financial statements and prevailing practices within the banking industry. Operating results for the three month period ended March 31, 2013 are not necessarily indicative of the results that may be expected for any future quarters or for the year ending December 31, 2013. For further information, refer to the consolidated financial statements and the accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the SEC.

Whenever necessary, reclassifications have been made to prior period Consolidated Financial Statements to conform to the current period s presentation. All significant intercompany transactions were eliminated in consolidation.

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Accounting for Stock-Based Compensation

Stock-based compensation is accounted for in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 718, *Stock Compensation*. After stockholder approval in 2005, the 1997 Stock Option Plan (1997 Plan) was replaced by the 2005 Incentive Plan (2005 Plan). No future awards may be granted under the 1997 Plan; however, we still have options outstanding under the 1997 Plan for our officers, directors and Associates. The 2005 Plan will terminate on the tenth anniversary of its effective date, after which no awards may be granted. We have stock options outstanding under the 1997 Plan and the 2005 Plan (collectively, Stock Incentive Plans). The number of shares reserved for issuance under the 2005 Plan is 1,197,000. At March 31, 2013, there were 49,175 shares available for future grants under the 2005 Plan.

The Stock Incentive Plans provide for the granting of incentive stock options as defined in Section 422 of the Internal Revenue Code as well as non-incentive stock options (collectively, Stock Options). Additionally, the 2005 Plan provides for the granting of stock appreciation rights, performance awards, restricted stock and restricted stock unit awards, deferred stock units, dividend equivalents, other stock-based awards and cash awards. All Stock Options are to be granted at not less than the market price of our common stock on the date of the grant. All Stock Options granted during 2013 and 2012 vest in 25% per annum increments, start to become exercisable one year from the grant date and expire five years from the grant date. Generally, all awards become exercisable immediately in the event of a change in control, as defined within the Stock Incentive Plans. In addition, the Black-Scholes option-pricing model is used to determine the grant date fair value of stock options.

Stock Options

The following table provides information about our stock options outstanding for the three months ended March 31, 2013 and 2012:

	March 31, 2013		March 31, 2012	
	Shares	**Weighted-Average Exercise Price**	Shares	Weighted-Average Exercise Price
Stock Options:				
Outstanding at beginning of period	**335,730**	**$ 42.14**	416,886	$ 43.52
Granted	**122,357**	**47.50**	32,830	40.89
Exercised	**(22,283)**	**31.36**	(1,815)	24.94
Outstanding at end of period	**435,804**	**44.19**	447,901	43.41
Exercisable at end of period	**197,943**	**$ 44.52**	337,764	$ 45.00
Weighted-average fair value of awards granted	**$ 10.32**		$ 12.38	

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The following table provides vesting information about our stock options outstanding for the three months ended March 31, 2013 and 2012:

	March 31, 2013		March 31, 2012	
	Shares	**Weighted-Average Exercise Price**	Shares	Weighted-Average Exercise Price
Stock Options:				
Unvested at beginning of period	**157,298**	**$ 38.57**	112,258	$ 36.08
Granted	**122,357**	**47.50**	32,830	40.89
Vested	**(41,794)**	**34.30**	(34,951)	32.89
Unvested at end of period	**237,861**	**$ 43.92**	110,137	$ 38.53

The total amount of compensation cost to be recognized relating to non-vested stock options as of March 31, 2013 was $1.6 million. The weighted-average period over which it is expected to be recognized is 2.7 years. We issue new shares upon the exercise of options.

Restricted Stock

We issued 11,357 restricted stock awards during the first quarter of 2013. These awards vest over a four year period. The total amount of compensation cost to be recognized relating to non-vested restricted stock as of March 31, 2013, was $1.9 million. The weighted-average period over which it is expected to be recognized is 2.3 years.

Performance Stock Awards

The Board approved a plan in which Marvin N. Schoenhals, Chairman of the Board, was granted 22,250 shares of restricted stock effective January 3, 2011, with a five-year performance vesting schedule starting at the end of the second year. These awards are based on acquiring new business relationships in which Mr. Schoenhals has played a meaningful role in helping us establish the new business. These shares are subject to vesting in whole or in part based on the role Mr. Schoenhals plays in establishing new business relationships that, over a two year period of time, achieve at least a 50% return on the investment of restricted stock cost. We recognized compensation expense of $69,000 related to this award during the first quarter of 2013 compared to $103,000 during the first quarter of 2012. Based on Mr. Schoenhals performance during 2012; 5,563 shares of restricted stock vested during the first quarter of 2013.

For the three months ended March 31, 2013, the effect of stock-based compensation, including stock options, restricted stock, and performance stock, on salaries, benefits and other compensation was $946,000 pre-tax ($804,000 after tax) or $0.09 per share. This compares to $711,000 pre-tax ($545,000 after tax) or $0.06 per share during the three months ended March 31, 2012. During the first quarter of 2013, we recorded approximately $521,000 of stock option expense (primarily related to options granted to retirement eligible Associates); which was an increase from the first quarter 2012 expenses as a majority of the 2012 retirement eligible expenses were recorded during the second quarter.

Subsequent Events

Non-Plan Stock Option Agreement and Other Awards

On April 25, 2013, stockholders approved a change in the future compensation of Mark A. Turner our CEO. As result, Mr. Turner was granted 250,000 non-statutory stock options. Further Mr. Turner will no longer be eligible for any new equity awards for the next five years beginning with 2013. These options have an exercise price of $49.52 and expire in seven years with vesting to occur over five years, with a longer and slower vesting schedule than our standard options (40% vesting after the second year and 20% vesting in each of the following three years). As a result of this approval, 150,000 incentive stock options also were issued to certain Executives of the Company with the same exercise price, expiration and vesting schedule as the non-plan stock option awards.

The total amount of compensation cost to be recognized relating to these non-statutory stock options is $3.7 million, which will be reduced based on Mr. Turner s ineligibility for new equity awards. The total amount of compensation cost to be recognized relating to other Executive awards is $2.2 million. The weighted-average period over which these awards are expected to be recognized is five years. Because these awards were subject to approval by our stockholders , the grants are accounted for at the time of stockholder approval.

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2. EARNINGS PER SHARE

The following table shows the computation of basic and diluted earnings per share:

	For the three months ended March 31,	
	2013	2012
	(In Thousands, Except Per Share Data)	
Numerator:		
Net income allocable to common stockholders	**$ 9,048**	$ 5,752
Denominator:		
Denominator for basic earnings per share weighted average shares	**8,781**	8,687
Effect of dilutive employee stock options and warrants	**92**	73
Denominator for diluted earnings per share adjusted weighted average shares and assumed exercise	**8,873**	8,760
Earnings per share:		
Basic:		
Net income allocable to common shareholders	**$ 1.03**	$ 0.66
Diluted:		
Net income allocable to common shareholders	**$ 1.02**	$ 0.66
Outstanding common stock equivalents having no dilutive effect	**265**	480

3. INVESTMENT SECURITIES

The following tables detail the amortized cost and the estimated fair value of our investment securities held-to-maturity and securities available-for-sale (which include reverse mortgages):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
Available-for-sale securities:				
March 31, 2013:				
Reverse mortgages	**$ (425)**	**$**	**$**	**$ (425)**
U.S. Government and government sponsored enterprises (GSE)	**46,707**	**218**	**(2)**	**46,923**
State and political subdivisions	**23,883**	**144**	**(450)**	**23,577**
Federal National Mortgage Association (FNMA)	**361,501**	**6,588**	**(755)**	**367,334**
Collateralized Mortgage Obligation (CMO) (1)	**172,137**	**4,530**	**(583)**	**176,084**
Government National Mortgage Association (GNMA)	**123,454**	**2,741**	**(534)**	**125,661**
Federal Home Loan Mortgage Corporation (FHLMC)	**89,986**	**498**	**(297)**	**90,187**
	$ 817,243	**$ 14,719**	**$ (2,621)**	**$ 829,341**
December 31, 2012:				
Reverse mortgages	$ (457)	$	$	$ (457)
GSE	46,726	266	(2)	46,990
State and political subdivisions	3,120	89		3,209
FNMA	396,910	9,588	(243)	406,255
CMO (1)	251,848	7,849	(301)	259,396
GNMA	129,288	3,221	(54)	132,455
FHLMC	58,596	1,171	(117)	59,650
	$ 886,031	$ 22,184	$ (717)	$ 907,498
Trading securities				
March 31, 2013:				
CMO	$ 12,590	$	$	$ 12,590
December 31, 2012:				
CMO	$ 12,590	$	$	$ 12,590

(1) Includes agency CMO and SASCO 2002 RM-1 Class O securities classified as available-for-sale

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The scheduled maturities of investment securities available-for-sale at March 31, 2013 and December 31, 2012 were as follows:

	Available-for-Sale Amortized Cost	Available-for-Sale Fair Value
	(In Thousands)	
March 31, 2013		
Within one year (1)	**$ 18,567**	**$ 18,647**
After one year but within five years	**29,547**	**29,771**
After five years but within ten years	**276,659**	**281,321**
After ten years	**492,470**	**499,602**
	$ 817,243	**$ 829,341**
December 31, 2012		
Within one year (1)	$ 18,544	$ 18,658
After one year but within five years	28,855	29,034
After five years but within ten years	321,103	329,580
After ten years	517,529	530,226
	$ 886,031	$ 907,498

(1) Reverse mortgages do not have contractual maturities. We have included reverse mortgages in maturities within one year.

The portfolio of available-for-sale MBS includes 143 securities with an amortized cost of $747.1 million. All securities were AAA-rated at the time of purchase. All securities were re-evaluated for other-than-temporary-impairment (OTTI) at March 31, 2013. The result of this evaluation showed no OTTI for 2013. The weighted average duration of the MBS portfolio was 5.4 years at March 31, 2013.

MBS have expected maturities that differ from their contractual maturities. These differences arise because borrowers may have the right to call or prepay obligations with or without a prepayment penalty.

At March 31, 2013, investment securities with market values aggregating $443.6 million were pledged as collateral for retail customer repurchase agreements, municipal deposits, and other obligations. From time to time, investment securities are also pledged as collateral for FHLB borrowings. There were no FHLB pledged investment securities at March 31, 2013.

During the first three months of 2013, we sold $139.2 million of investment securities categorized as available-for-sale for net gains of $1.6 million. In the first quarter of 2012, proceeds from the sale of investment securities available-for-sale were $84.8 million and resulted in net gains of $2.0 million. During the first quarter of 2013, the objectives were to complete the deleveraging that began in the fourth quarter of 2012, reduce the duration of the portfolio, and monetize premiums at risk due to faster prepayments. The cost basis of all investment securities sales is based on the specific identification method.

As of March 31, 2013, our investment securities portfolio had remaining unamortized premiums of $22.6 million. In addition, at March 31, 2013, we had $138,000 of unaccreted discounts related to our investment securities portfolio.

At March 31, 2013, we owned investment securities totaling $238.8 million in which the amortized cost basis exceeded fair value. Total unrealized losses on those securities were $2.6 million at March 31, 2013. The temporary impairment is the result of changes in market interest rates subsequent to the purchase of the securities. Our investment portfolio is reviewed each quarter for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in the market. We evaluate our intent and ability to hold securities based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position. In addition, we do not have the intent to sell, nor is it more likely-than-not we will be required to sell these securities before we are able to recover the amortized cost basis.

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During the first three months of 2013, we purchased $17.6 million of municipal bonds. The purpose was to improve return and reduce the effective tax rate.

For these investment securities with unrealized losses, the table below shows our gross unrealized losses and fair value by investment category and length of time that individual securities were in a continuous unrealized loss position at March 31, 2013.

	Less than 12 months		12 months or longer (In Thousands)		Total	
	Fair Value	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
Available-for-sale						
U.S Government and agencies	$	$	$ 2,006	$ 2	$ 2,006	$ 2
State and political subdivisions	18,603	450			18,603	450
FNMA	79,795	755			79,795	755
CMO	58,170	568	835	15	59,005	583
GNMA	61,140	534			61,140	534
FHLMC	18,263	297			18,263	297
Total temporarily impaired investments	$ 235,971	$ 2,604	$ 2,841	$ 17	$ 238,812	$ 2,621

For these investment securities with unrealized losses, the table below shows our gross unrealized losses and fair value by investment category and length of time that individual securities were in a continuous unrealized loss position at December 31, 2012.

	Less than 12 months		12 months or longer (In Thousands)		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Available-for-sale						
U.S Government and agencies	$ 2,008	$ 2	$	$	$ 2,008	$ 2
State and political subdivisions						
FNMA	43,696	243			43,696	243
CMO	40,358	268	1,364	33	41,722	301
GNMA	10,029	54			10,029	54
FHLMC	13,884	117			13,884	117
Total temporarily impaired investments	$ 109,975	$ 684	$ 1,364	$ 33	$ 111,339	$ 717

We own $12.6 million par value of SASCO RM-1 2002 class B securities which are classified as trading. We expect to recover all principal and interest due to seasoning and excess collateral. Based on FASB ASC 320, *Investments Debt and Equity Securities* (ASC 320) when these securities were acquired they were classified as trading because it was our intent to sell them in the near term. We use the guidance under ASC 320 to provide a reasonable estimate of fair value. We estimated the value of these securities based on the pricing of BBB+ securities that have an active market through a technique which estimates the fair value of this asset using the income approach as of March 31, 2013.

During 2011, we purchased 100% of SASCO 2002-RM1 Class O certificates for $2.5 million. As of March 31, 2013, the market value of the SASCO 2002-RM1 O securities was determined in accordance with FASB ASC 820-10, *Fair Value Measurement* to be $6.1 million. These securities have been included in our available-for-sale CMO since their purchase.

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4. ALLOWANCE FOR LOAN LOSSES AND CREDIT QUALITY INFORMATION

Allowance for Loan Losses

We maintain an allowance for loan losses and charge losses to this allowance when such losses are realized. We established our loan loss allowance in accordance with guidance provided in the Securities and Exchange Commission s Staff Accounting Bulletin 102 (SAB 102). The determination of the allowance for loan losses requires significant judgment reflecting our best estimate of impairment related to specifically identified impaired loans as well as probable loan losses in the remaining loan portfolio. Our evaluation is based upon a continuing review of these portfolios. The following are included in Allowance for Loan Losses:

- Specific reserves for impaired loans
- Allowances for pools of homogenous loans based on historical loss experience
- Adjustments for qualitative and environmental factors
- Allowance for model estimation and complexity risk

Specific reserves are established for impaired loans where we have identified significant conditions or circumstances related to specific credits that indicate losses are probable. Unless loans are well-secured and collection is imminent, all loans that are 90 days past due are deemed impaired. Reserves for impaired loans are generally charged-off within 90 days of impairment recognition. Estimated losses are based on collateral values, estimates of future cash flows, or market valuations.

Allowances for pooled homogeneous loans, that are not deemed impaired, are based on historical loss experience. Estimated losses for pooled portfolios are determined differently for commercial loan pools and consumer loan pools. Commercial loans are pooled into following segments: Business Loans (Commercial and Industrial Loans), Commercial Real Estate Owner-Occupied, Commercial Real Estate Investor, and Construction Loans. Each pool is further segmented by internally assessed risk ratings. Loan losses for commercial loans are estimated by determining the probability of default and expected loss severity upon default. Probability of default is calculated based on the historical rate of migration to impaired status during the last three years. Loss severity is calculated as the actual loan losses (net of recoveries) on impaired loans in the respective pool during the last three years. Retail loans are pooled into following segments: residential mortgage loans, home equity secured loans, and all other consumer loans. Pooled reserves for retail loans are calculated based solely on the previous three year average loss rate.

Qualitative and environmental adjustment factors are taken into consideration when determining the above reserve estimates or core reserves. These adjustment factors are based upon our evaluation of various current internal and external conditions including:

- Assessment of current underwriting policies, staff, and portfolio mix
- Internal trends of delinquency, non-accrual and criticized loans by segment
- Assessment of risk rating accuracy, control and regulatory assessments/environment
- General economic conditions locally and nationally

Market trends impacting collateral values

Competitive environment as it could impact loan structure and underwriting

The above factors are based on their relative standing compared to the period which historic losses are used in core reserve estimates and current directional trends. Each individual qualitative and environmental factor in our model can add or subtract to core reserves. As of March 31, 2013, these factors, in aggregate, increased core reserves by 7.6%.

The final component of the allowance is a reserve for model estimation and complexity risk. The calculation of reserves is generally quantitative; however, qualitative estimates of valuations and risk assessment are necessary. We currently increase our calculated reserves by 2% to account for model estimation and complexity risk.

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Our loan officers and risk managers meet at least quarterly to discuss and review the conditions and risks associated with individual problem loans. In addition, various regulatory agencies and loan review consultants periodically review our loan ratings and allowance for loan losses.

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The following tables provide the activity of the allowance for loan losses and loan balances for the three months ended on March 31, 2013 and 2012:

	Commercial	Owner Occupied Commercial	Commercial Mortgages	Construction	Residential	Consumer	Complexity Risk(1)	Total
				(In Thousands)				
Three months ended March 31, 2013								
Allowance for loan losses								
Beginning balance	$ 13,663	$ 6,108	$ 8,079	$ 6,456	$ 3,124	$ 5,631	$ 861	$ 43,922
Charge-offs	(256)	(1)	(1,697)	(19)	(440)	(1,294)		(3,707)
Recoveries	226	12	3	15	18	228		502
Provision	(865)	219	808	333	579	1,176	(19)	2,231
Ending balance	$ 12,768	$ 6,338	$ 7,193	$ 6,785	$ 3,281	$ 5,741	$ 842	$ 42,948
Period-end allowance allocated to:								
Loans individually evaluated for impairment	$ 868	$ 47	$ 2,000	$	$ 922	$ 12	$	$ 3,849
Loans collectively evaluated for impairment	11,900	6,291	5,193	6,785	2,359	5,729	842	39,099
Ending balance	$ 12,768	$ 6,338	$ 7,193	$ 6,785	$ 3,281	$ 5,741	$ 842	$ 42,948
Period-end loan balances evaluated for:								
Loans individually evaluated for impairment	$ 4,991	$ 13,263	$ 11,240	$ 1,216	$ 19,578	$ 6,210	$	$ 56,498(2)
Loans collectively evaluated for impairment	727,831	$ 752,961	622,510	132,265	218,276	277,096		2,730,939
Ending balance	$ 732,822	$ 766,224	$ 633,750	$ 133,481	$ 237,854	$ 283,306	$	$ 2,787,437(3)

	Commercial	Owner Occupied Commercial	Commercial Mortgages	Construction	Residential	Consumer	Complexity Risk(1)	Total
				(In Thousands)				
Three months ended March 31, 2012								
Allowance for loan losses								
Beginning balance	$ 15,067	$ 9,235	$ 7,556	$ 4,074	$ 6,544	$ 10,604	$	$ 53,080
Charge-offs	(2,331)	(502)	(190)	(1,506)	(324)	(1,229)		(6,082)
Recoveries	53	6	313	28	25	130		555
Provision	(1,164)	(1,734)	2,851	6,321	155	748	1,068	8,245
Ending balance	$ 11,625	$ 7,005	$ 10,530	$ 8,917	$ 6,400	$ 10,253	$ 1,068	$ 55,798
Period-end allowance allocated to:								
	$ 1,615	$ 2,191	$ 1,156	$ 2,750	$ 869	$ 96	$	$ 8,677

Loans individually evaluated for impairment								
Loans collectively evaluated for impairment	10,010	4,814	9,374	6,167	5,531	10,157	1,068	47,121
Ending balance	$ 11,625	$ 7,005	$ 10,530	$ 8,917	$ 6,400	$ 10,253	$ 1,068	$ 55,798
Period-end loan balances evaluated for:								
Loans individually evaluated for impairment	$ 6,526	$ 21,760	$ 11,625	$ 24,246	$ 15,723	$ 2,912	$	$ 82,792(2)
Loans collectively evaluated for impairment	792,293	665,180	605,601	99,937	251,310	282,548		2,696,869
Ending balance	$ 798,819	$ 686,940	$ 617,226	$ 124,183	$ 267,033	$ 285,460	$	$ 2,779,661(3)

(1) Represents the portion of the allowance for loan losses established to account for the inherent complexity and uncertainty of estimates.
(2) The difference between this amount and nonaccruing loans at March 31, 2013, represents accruing troubled debt restructured loans.
(3) Ending loan balances do not include deferred costs.

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Non-Accrual and Past Due Loans

The following tables show our nonaccrual and past due loans at the dates indicated:

March 31, 2013 (In Thousands)	30 59 Days Past Due and Still Accruing	60 89 Days Past Due and Still Accruing	Greater Than 90 Days Past Due and Still Accruing	Total Past Due And Still Accruing	Accruing Current Balances	Nonaccrual Loans	Total Loans
Commercial	**$ 900**	**$ 223**	**$ 103**	**$ 1,226**	**$ 726,605**	**$ 4,991**	**$ 732,822**
Owner occupied commercial	**511**			**511**	**752,450**	**13,263**	**766,224**
Commercial mortgages					**622,510**	**11,240**	**633,750**
Construction					**132,265**	**1,216**	**133,481**
Residential	**2,925**	**315**	**297**	**3,537**	**223,507**	**10,810**	**237,854**
Consumer	**627**	**167**		**794**	**278,311**	**4,201**	**283,306**
Total	**$ 4,963**	**$ 705**	**$ 400**	**$ 6,068**	**$ 2,735,648**	**$ 45,721**	**$ 2,787,437**
% of Total Loans	**0.18%**	**0.03%**	**0.01%**	**0.22%**	**98.14%**	**1.64%**	**100%**

December 31, 2012 (In Thousands)	30 59 Days Past Due and Still Accruing	60 89 Days Past Due and Still Accruing	Greater Than 90 Days Past Due and Still Accruing	Total Past Due And Still Accruing	Accruing Current Balances	Nonaccrual Loans	Total Loans
Commercial	$ 1,214	$	$	$ 1,214	$ 698,416	$ 4,861	$ 704,491
Owner occupied commercial	1,264			1,264	755,316	14,001	770,581
Commercial mortgages					618,731	12,634	631,365
Construction	269	70		339	131,489	1,547	133,375
Residential	5,383	606	786	6,775	226,863	9,989	243,627
Consumer	971	526		1,497	282,776	4,728	289,001
Total	$ 9,101	$ 1,202	$ 786	$ 11,089	$ 2,713,591	$ 47,760	$ 2,772,440
% of Total Loans	0.33%	0.04%	0.03%	0.40%	97.88%	1.72%	100%

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Impaired Loans

The following tables provide an analysis of our impaired loans at March 31, 2013 and December 31, 2012:

March 31, 2013 (In Thousands)	**Ending Loan Balances**	**Loans with No Specific Reserve (1)**	**Loans with Specific Reserve**	**Related Specific Reserve**	Contractual Principal Balances	Average Loan Balances
Commercial	**$ 4,991**	**$ 1,691**	**$ 3,300**	**$ 868**	$ 12,162	$ 4,795
Owner-Occupied Commercial	**13,263**	**12,171**	**1,092**	**47**	15,592	16,066
Commercial mortgages	**11,240**	**5,130**	**6,110**	**2,000**	21,777	9,319
Construction	**1,216**	**1,216**			17,377	7,057
Residential	**19,578**	**11,834**	**7,744**	**922**	22,059	17,588
Consumer	**6,210**	**5,554**	**656**	**12**	7,025	5,232
Total	**$ 56,498**	**$ 37,596**	**$ 18,902**	**$ 3,849**	$ 95,992	$ 60,057

December 31, 2012 (In Thousands)	Ending Loan Balances	Loans with No Specific Reserve (1)	Loans with Specific Reserve	Related Specific Reserve	Contractual Principal Balances	Average Loan Balances
Commercial	$ 4,861	$ 1,598	$ 3,263	$ 2,100	$ 12,060	$ 4,993
Owner-Occupied Commercial	14,001	13,827	174	1	18,658	16,856
Commercial mortgages	12,634	5,422	7,212	1,887	22,192	10,233
Construction	1,547	1,172	375	28	17,711	11,239
Residential	18,483	11,053	7,430	919	20,771	16,917
Consumer	6,329	5,635	694	16	7,265	4,514
Total	$ 57,855	$ 38,707	$ 19,148	$ 4,951	$ 98,657	$ 64,752

(1) Reflects loan balances at their remaining book balance.

Interest income of $238,000 was recognized on impaired loans during the three months ended March 31, 2013 compared to $93,000 during the three months ended March 31, 2012.

Credit Quality Indicators

Commercial Loans

Below is a description of each of our risk ratings for all commercial loans including commercial mortgages:

Pass. These borrowers presently show no current or potential problems and their loans are considered fully collectible. We further segment Pass ratings into six classifications ranging from Substantially Risk Free (secured by marketable securities within margin and cash secured) to Acceptable Risk.

Special Mention. Borrowers have potential weaknesses that deserve management s close attention. Borrowers in this category may be experiencing adverse operating trends, e.g.: declining revenues or margins, high leverage, tight liquidity, or increasing inventory without increasing sales. These adverse trends can have a potential negative effect on the borrower s repayment capacity. These assets are not adversely classified and do not expose the Bank to significant risk that would warrant a more severe rating. Borrowers in this category may also be experiencing significant management problems, pending litigation, or other structural credit weaknesses.

Substandard. Borrowers have well-defined weaknesses that require extensive oversight by management. Borrowers in this category may exhibit one or more of the following: inadequate debt service coverage, unprofitable operations, insufficient liquidity, high leverage, and weak or inadequate capitalization. Relationships in this category are not adequately protected by the sound financial worth and paying capacity of the obligor or the collateral pledged on the loan, if any. The distinct possibility exists that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful. Borrowers have well-defined weaknesses inherent in the Substandard category with the added characteristic that the possibility of loss is extremely high. Current circumstances in the credit relationship make collection or liquidation in full highly questionable. A doubtful asset has some pending event that may strengthen the asset that defers the loss classification. Such impending events include: perfecting liens on additional collateral, obtaining collateral valuations, an acquisition or liquidation preceding, proposed merger, or refinancing plan.

Loss. Borrowers are uncollectible or of such negligible value that continuance as a bankable asset is not supportable. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical to defer writing off this asset even though partial recovery may be recognized sometime in the future.

Residential and Consumer Loans

The residential and consumer loan portfolios are monitored on an ongoing basis using delinquency information and loan type as credit quality indicators. These credit quality indicators are assessed in the aggregate in these relatively homogeneous portfolios. Loans that are greater than 90 days past due are generally considered nonperforming and placed in nonaccrual status.

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The following tables provide an analysis of problem loans as of March 31, 2013 and December 31, 2012:

Commercial credit exposure credit risk profile by internally assigned risk rating (in thousands):

	Commercial		Owner-Occupied Commercial		Commercial Mortgages		Construction		Total Commercial			
									March 31, 2013		December 31, 2012	
	Mar 31, 2013	Dec. 31, 2012	**Mar 31, 2013**	Dec. 31, 2012	**Mar 31, 2013**	Dec. 31, 2012	**Mar 31, 2013**	Dec. 31, 2012	Amount	Percent	Amount	Percent
sk Rating:												
pecial ention	**$ 9,091**	$ 14,611	**$ 26,906**	$ 27,398	**$ 14,908**	$ 29,267	**$ 2,318**	$ 2,453	**$ 53,223**		$ 73,729	
bstandard:												
ccrual	**66,483**	63,074	**45,129**	44,899	**6,078**	6,222	**5,990**	5,755	**123,680**		119,950	
onaccrual	**1,691**	1,598	**12,171**	13,827	**5,130**	5,422	**1,216**	1,172	**20,208**		22,019	
oubtful/ onaccrual	**3,300**	3,263	**1,092**	174	**6,110**	7,212		375	**10,502**		11,024	
otal Special ention and ubstandard	**80,565**	82,546	**85,298**	86,298	**32,226**	48,123	**9,524**	9,755	**207,613**	**9%**	226,722	10%
ss	**652,257**	621,945	**680,926**	684,283	**601,524**	583,242	**123,957**	123,620	**2,058,664**	**91**	2,013,090	90
otal ommercial oans	**$ 732,822**	$ 704,491	**$ 766,224**	$ 770,581	**$ 633,750**	$ 631,365	**$ 133,481**	$ 133,375	**$ 2,266,277**	**100%**	$ 2,239,812	100%

Consumer credit exposure credit risk profile based on payment activity (in thousands):

	Residential		Consumer		Total Residential and Consumer			
					March 31, 2013		December 31, 2012	
	Mar 31, 2013	Dec. 31, 2012	**Mar 31, 2013**	Dec. 31, 2012	Amount	Percent	Amount	Percent
Nonperforming	**$ 19,578(1)**	$ 18,483	**$ 6,210(1)**	$ 6,329	**$ 25,788**	**5%**	$ 24,812	5%
Performing	**218,276**	225,144	**277,096**	282,672	**495,372**	**95**	507,816	95
Total	**$ 237,854**	$ 243,627	**$ 283,306**	$ 289,001	**$ 521,160**	**100%**	$ 532,628	100%

(1) Includes $10.8 million of troubled debt restructured mortgages and home equity installment loans performing in accordance with modified terms and are accruing interest

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Troubled Debt Restructurings (TDR)

The balance of TDRs at March 31, 2013 and December 31, 2012 was $22.8 million and $22.0 million, respectively. The balances at March 31, 2013 include approximately $12.0 million of TDRs in nonaccrual status and $10.8 million of TDRs in accrual status compared to $11.9 million of TDRs in nonaccrual status and $10.1 million of TDRs in accrual status at December 31, 2012. Approximately $1.9 million and $936,000 in related reserves have been established for these loans at March 31, 2013 and December 31, 2012, respectively.

During the first quarter of 2013, the terms of three loans were modified in TDR s one of which was a commercial loan that had already been placed on nonaccrual. The remaining loans represented residential and consumer loans. Our concessions on restructured loans consisted mainly of forbearance agreements, reduction in interest rates or extensions of maturities. Principal balances are generally not forgiven by us when a loan is modified as a TDR. Nonaccruing restructured loans remain in nonaccrual status until there has been a period of sustained repayment performance, typically six months.

The following table presents loans identified as TDRs during the three months ended March 31, 2013 and 2012:

(In Thousands)	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Commercial	$	$ 9,276
Commercial mortgages	235	
Construction		378
Residential		451
Consumer	474	
Total	$ 709	$ 10,105

The TDRs described did not have a related allowance for loan losses through allocation of a related reserve, and resulted in charge offs of $119,000 during the three months ending March 31, 2013, compared to increased reserves of $38,000 and charge-off s of $795,000 for the same period of 2012.

There were no TDR s that defaulted (defined as past due 90 days) during the three months ended March 31, 2013.

5. TAXES ON INCOME

We account for income taxes in accordance with FASB ASC 740, *Income Taxes* (ASC 740) (Formerly SFAS No. 109, *Accounting for Income Taxes* and FASB Interpretation No. 48, *Accounting for Uncertainty In Income Taxes, an Interpretation of FASB Statement 109*). ASC 740 requires the recording of deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We exercise significant judgment in the evaluation of the amount and timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are updated based upon changes in business factors and the tax laws. If actual results differ from the assumptions and other considerations used in estimating the amount and timing of tax recognized, there can be no assurance that additional expenses will not be required in future periods. No valuation allowance has been recorded on our deferred tax assets due to our history of prior earnings along with our expectations of future income. ASC 740 prescribes a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. We recognize, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the financial statements. Assessment of uncertain tax positions under ASC 740 requires careful consideration of the technical merits of a position based on our analysis of tax regulations and interpretations.

There were no unrecognized tax benefits as of March 31, 2013 and December 31, 2012. We record interest and penalties on potential income tax deficiencies as income tax expense. Our Federal and state tax returns for the 2009 through 2012 tax years are subject to examination as of March 31, 2013. Our 2010 federal tax return is currently being audited by the IRS. No state income tax return examinations are currently in process.

6. SEGMENT INFORMATION

Under the definition of FASB ASC 280, *Segment Reporting* (ASC 280) (Formerly SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*) we discuss our business in three segments. There is one segment for each of WSFS Bank, Cash Connect, (the ATM division of WSFS Bank), and Trust and Wealth Management. Trust and Wealth Management is comprised of Montchanin, Christiana Trust, Private Banking and WSFS Investment Group, Inc. in a single reportable segment because each has similar economic characteristics, products, customers and distribution methods. As required by ASC 280, all prior years information has been updated to reflect this presentation.

The WSFS Bank segment provides financial products to commercial and retail customers through its 51 offices located in Delaware (42), Pennsylvania (7) and Virginia (1) and Nevada (1). Retail and Commercial Banking, Commercial Real Estate Lending and other banking business units are operating departments of WSFS. These departments share the same regulator, the same market, many of the same customers and provide similar products and services through the general infrastructure of the Bank. Because of these and other reasons, these departments are not considered discrete segments and are appropriately aggregated within the WSFS Bank segment in accordance with ASC 280.

Cash Connect provides turnkey ATM services through strategic partnerships with several of the largest networks, manufacturers and service providers in the ATM industry. The balance sheet category Cash in non-owned ATMs includes cash from which fee income is earned through bailment arrangements with customers of Cash Connect.

The Wealth Management division provides a broad array of fiduciary, investment management, credit and deposit products to clients through four businesses. WSFS Investment Group, Inc. provides insurance and brokerage products primarily to our retail banking clients. Cypress Capital Management, LLC is a registered investment advisor with over $624 million in assets under management. Cypress primary market segment is high net worth individuals, offering a balanced investment style focused on preservation of capital and current income. Christiana Trust, with $16.4 billion in assets under administration, provides fiduciary and investment services to personal trust clients, and trustee, agency, custodial and commercial domicile services to corporate and institutional clients. WSFS Private Banking serves high net worth clients by delivering credit and deposit products and partnering with Cypress, Christiana and WSFS Investment Group to deliver investment management and fiduciary products and services.

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An operating segment is a component of an enterprise that engages in business activities from which it may earn revenues and incur expenses, whose operating results are regularly reviewed by the enterprise s chief operating decision makers to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available. We evaluate performance based on pretax ordinary income relative to resources used, and allocate resources based on these results. The accounting policies applicable to our segments are those that apply to our preparation of the accompanying Consolidated Financial Statements. Segment information for the three months ended March 31, 2013 and 2012 follows:

For the three months ended March 31, 2013

	WSFS Bank	Cash Connect	Trust & Wealth Management	Total
		(In Thousands)		
External customer revenues:				
Interest income	$ 33,600	$	$ 1,991	$ 35,591
Noninterest income	9,227	5,027	3,820	18,074
Total external customer revenues	42,827	5,027	5,811	53,665
Inter-segment revenues:				
Interest income	903		1,431	2,334
Noninterest income	1,650	200	26	1,876
Total inter-segment revenues	2,553	200	1,457	4,210
Total revenue	45,380	5,227	7,268	57,875
External customer expenses:				
Interest expense	3,840		171	4,011
Noninterest expenses	26,430	2,992	2,948	32,370
Provision for loan loss	2,246		(15)	2,231
Total external customer expenses	32,516	2,992	3,104	38,612
Inter-segment expenses				
Interest expense	1,431	371	532	2,334
Noninterest expenses	226	550	1,100	1,876
Total inter-segment expenses	1,657	921	1,632	4,210
Total expenses	34,173	3,913	4,736	42,822
Income before taxes	$ 11,207	$ 1,314	$ 2,532	$ 15,053
Provision for income taxes				5,313
Consolidated net income				$ 9,740
As of March 31, 2013				
Cash and cash equivalents	$ 53,517	$ 474,842	$ 2,253	$ 530,612
Other segment assets	3,640,122	2,943	180,966	3,824,031
Total segment assets	$ 3,693,639	$ 477,785	$ 183,219	$ 4,354,643

Capital expenditures	**$ 773**	**$ 183**	**$**	**$ 956**

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For the three months ended March 31, 2012

	WSFS Bank	Cash Connect	Trust & Wealth Management	Total
		(In Thousands)		
External customer revenues:				
Interest income	$ 37,036	$	$ 2,187	$ 39,223
Noninterest income	9,528	4,074	3,156	16,758
Total external customer revenues	46,564	4,074	5,343	55,981
Inter-segment revenues:				
Interest income	960		1,227	2,187
Noninterest income	2,061	173		2,234
Total inter-segment revenues	3,021	173	1,227	4,421
Total revenue	49,585	4,247	6,570	60,402
External customer expenses:				
Interest expense	6,475		218	6,693
Noninterest expenses	26,338	1,972	2,679	30,989
Provision for loan loss	8,296		(51)	8,245
Total external customer expenses	41,109	1,972	2,846	45,927
Inter-segment expenses				
Interest expense	1,227	334	626	2,187
Noninterest expenses	173	525	1,536	2,234
Total inter-segment expenses	1,400	859	2,162	4,421
Total expenses	42,509	2,831	5,008	50,348
Income (loss) before taxes	$ 7,076	$ 1,416	$ 1,562	$ 10,054
Provision for income taxes				3,610
Consolidated net income		.		$ 6,444
As of December 31, 2012				
Cash and cash equivalents	$ 68,419	$ 430,382	$ 2,086	$ 500,887
Other segment assets	3,683,073	1,605	189,583	3,874,261
Total segment assets	$ 3,751,492	$ 431,987	$ 191,669	$ 4,375,148
Capital expenditures	$ 1,713	$ 156	$ 64	$ 1,933

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7. FAIR VALUE DISCLOSURES OF FINANCIAL ASSETS

FAIR VALUE OF FINANCIAL ASSETS

ASC 820-10 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820-10 establishes a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that are derived principally from or can be corroborated by observable market data by correlation or other means.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

The table below presents the balances of assets measured at fair value as of March 31, 2013 (there are no material liabilities measured at fair value):

Description	Quoted Prices in Active Markets for Identical Asset (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
		(in Thousands)		
Assets Measured at Fair Value on a Recurring Basis				
Available-for-sale securities:				
Collateralized mortgage obligations	$	$ 169,961	$ 6,123	$ 176,084
FNMA		367,334		367,334
FHLMC		90,187		90,187
GNMA		125,661		125,661
U.S. Government and agencies		46,923		46,923
State and political subdivisions		23,577		$ 23,577
Reverse mortgages			(425)	(425)
Trading Securities			12,590	12,590
Total assets measured at fair value on a recurring basis	**$**	**$ 823,643**	**$ 18,288**	**$ 841,931**
Assets Measured at Fair Value on a Nonrecurring Basis				
Other real estate owned	$	$	$ 6,522	$ 6,522
Impaired Loans			52,649	52,649
Total assets measured at fair value on a nonrecurring basis	**$**	**$**	**$ 59,171**	**$ 59,171**

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The table below presents the balances of assets measured at fair value as of December 31, 2012 (there are no material liabilities measured at fair value):

Description	Quoted Prices in Active Markets for Identical Asset (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
		(in Thousands)		
Assets Measured at Fair Value on a Recurring Basis				
Available-for-sale securities:				
Collateralized mortgage obligations	$	$ 252,300	$ 7,096	$ 259,396
FNMA		406,255		406,255
FHLMC		59,650		59,650
GNMA		132,455		132,455
U.S. Government and agencies		46,990		46,990
State and political subdivisions		3,209		$ 3,209
Reverse mortgages			(457)	(457)
Trading Securities			12,590	12,590
Total assets measured at fair value on a recurring basis	**$**	**$ 900,859**	**$ 19,229**	**$ 920,088**
Assets Measured at Fair Value on a Nonrecurring Basis				
Other real estate owned	$	$	$ 4,622	$ 4,622
Impaired Loans			52,904	52,904
Total assets measured at fair value on a nonrecurring basis	**$**	**$**	**$ 57,526**	**$ 57,526**

Fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models or obtained from third parties that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include unobservable parameters. Our valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While we believe our valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Available- for-sale securities. As of March 31, 2013, securities classified as available for sale are reported at fair value using both Level 2 and Level 3 inputs. Included in the Level 2 total are approximately $46.9 million in Federal Agency debentures, $753.1 million in Federal Agency MBS, and $23.6 million in municipal bonds. Agency and MBS securities are predominately AAA-rated. We believe that this Level 2 designation is appropriate for these securities under ASC 820-10 as, with almost all fixed income securities, none are exchange traded, and all are priced by correlation to observed market data. For these securities we obtain fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, U.S. government and agency yield curves, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the security s terms and conditions, among other factors. Included in the Level 3 total is a small equity traunche of a reverse mortgage security purchased on July 15, 2011. This security is Level 3 because there is no active market for this security and no observable inputs that reflect quoted prices for identical assets in active markets (Level 1) or inputs other than quoted prices that are observable for the asset through corroboration with observable market data (Level 2). In order to establish the fair value for a Level 3 asset a mark-to-model has been developed using the income approach described in ASC 820-10-35-32 and is similar to the methodology used to value our trading securities described below.

Trading securities. The amount included in the trading securities category represents the fair value of a BBB-rated traunche of a reverse mortgage security. There has never been an active market for these securities. As such, we classify these trading securities as Level 3 under ASC 820-10. As prescribed by ASC 820-10 management used various observable and unobservable inputs to develop a range of likely fair value prices where this security would be exchanged in an orderly transaction between market participants at the measurement date. The unobservable inputs reflect management s assumptions about the assumptions that market participants would use in pricing this asset. Included in these inputs were the median of a selection of other BBB-rated securities as well as quoted market prices from higher rated traunches of this asset class. The unobservable inputs consist of prepayments, house price appreciation and interest rates. Management has completed a sensitivity analysis at March 31, 2013, which showed any increase or decrease in these inputs would not have a significant impact on the fair value of these assets. As a result, the value assigned to this security is determined primarily through a discounted cash flow analysis. All of these assumptions require a significant degree of management judgment.

Reverse Mortgages. The amount of our investment in reverse mortgages represents the estimated value of future cash flows of the reverse mortgages at a rate deemed appropriate for these mortgages, based on the market rate for similar collateral. The projected cash flows depend on assumptions about life expectancy of the mortgagor and the future changes in collateral values. Due to the significant amount of management judgment and the unobservable input calculations, these reverse mortgages have been classified as Level 3.

The changes in Level 3 assets measured at fair value on a recurring basis are summarized as follows:

(In Thousands)	Trading Securities	Reverse Mortgages	Available-for-sale Securities	Total
Balance at December 31, 2011	$ 12,432	$ (646)	$ 3,936	$ 15,722
Total net income (losses) for the period included in net income	33	12		45
Purchases, sales, issuances, and settlements, net		177		177
Mark-to-market adjustment	125		3,160	3,285
Balance at December 31, 2012	$ 12,590	$ (457)	$ 7,096	$ 19,229
Total net income (losses) for the period included in net income		243	1,227	1,470
Purchases, sales, issuances, and settlements, net		(211)		(211)
Mark-to-market adjustment			(2,200)	(2,200)
Balance at March 31, 2013	**$ 12,590**	**$ (425)**	**$ 6,123**	**$ 18,288**

Other real estate owned. Other real estate owned consists of loan collateral which has been repossessed through foreclosure or other measures. Initially, foreclosed assets are recorded as held for sale at the lower of the loan balance or fair value of the collateral less estimated selling costs. Subsequent to foreclosure, valuations are updated periodically and the assets may be marked down further, reflecting a new cost basis. The fair value of our real estate owned was estimated using Level 2 inputs based on appraisals obtained from third parties.

Impaired loans. We evaluate and value impaired loans at the time the loan is identified as impaired, and the fair values of such loans are estimated using Level 3 inputs in the fair value hierarchy. Each loan s collateral has a unique appraisal and management s discount of the value is based on the factors unique to each impaired loan. The significant unobservable input in determining the fair value is management s subjective discount on appraisals of the collateral securing the loan, which range from 10% 50%. Collateral may consist of real estate and/or business assets including equipment, inventory and/or accounts receivable and the value of these assets is determined based on the appraisals by qualified licensed appraisers hired by us. Appraised and reported values may be discounted based on management s historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management s expertise and knowledge of the client and the client s business.

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Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a gross amount of $52.6 million and $52.9 million at March 31, 2013 and December 31, 2012, respectively. The valuation allowance on impaired loans was $3.8 million as of March 31, 2013 and $5.0 million as of December 31, 2012.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The reported fair values of financial instruments are based on a variety of factors. In certain cases, fair values represent quoted market prices for identical or comparable instruments. In other cases, fair values have been estimated based on assumptions regarding the amount and timing of estimated future cash flows that are discounted to reflect current market rates and varying degrees of risk. Accordingly, the fair values may not represent actual values of the financial instruments that could have been realized as of period-end or that will be realized in the future.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Short-Term Investments: For cash and short-term investments, including due from banks, federal funds sold, securities purchased under agreements to resell and interest-bearing deposits with other banks, the carrying amount is a reasonable estimate of fair value.

Investments and Mortgage-Backed Securities: Since quoted market prices are not available, fair value is estimated using quoted prices for similar securities, which we obtain from a third party vendor. We utilize one of the largest providers of securities pricing to the industry and management periodically assesses the inputs used by this vendor to price the various types of securities owned by us to validate the vendor s methodology. The fair value of our investment in reverse mortgages is based on the net present value of estimated cash flows, which have been updated to reflect recent external appraisals of the underlying collateral. For additional discussion of our mortgage-backed securities-trading or our internally developed models, see Fair Value of Financial Assets, to the Consolidated Financial Statements.

Loans held-for-sale: Loans held-for-sale are carried at the lower of cost or market of the aggregate, or in some cases, individual loans.

Loans: Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type: commercial, commercial mortgages, construction, residential mortgages and consumer. For loans that reprice frequently, the book value approximates fair value. The fair values of other types of loans are estimated by discounting expected cash flows using the current rates at which similar loans would be made to borrowers with comparable credit ratings and for similar remaining maturities. The fair value of nonperforming loans is based on recent external appraisals of the underlying collateral. Estimated cash flows, discounted using a rate commensurate with current rates and the risk associated with the estimated cash flows, are utilized if appraisals are not available. This technique does not contemplate an exit price.

Bank-Owned Life Insurance: The estimated fair value approximates the book value for this investment.

Stock in the Federal Home Loan Bank of Pittsburgh: The fair value of FHLB stock is assumed to be essentially equal to its cost basis, since the stock is non-marketable but redeemable at its par value.

Demand Deposits, Savings Deposits and Time Deposits: The fair value of demand deposits and savings deposits is determined by projecting future cash flows using an estimated economic life based on account characteristics. The resulting cash flow is discounted using rates available on alternative funding sources. The fair value of time deposits is estimated using the rate and maturity characteristics of the deposits to estimate their cash flow. The cash flow is discounted at rates for similar term wholesale funding.

Borrowed Funds: Rates currently available to us for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

Off-Balance Sheet Instruments: The fair value of off-balance sheet instruments, including commitments to extend credit and standby letters of credit, approximates the recorded net deferred fee amounts, which are not significant. Because commitments to extend credit and letters of credit are generally unassignable by either us or the borrower they only have value to us and the borrower.

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The book value and estimated fair value of our financial instruments are as follows:

	Fair Value	March 31, 2013		December 31, 2012	
(In Thousands)	Measurement	Book Value	Fair Value	Book Value	Fair Value
Financial assets:					
Cash and cash equivalents	Level 1	**$ 530,612**	**$ 530,612**	$ 500,887	$ 500,887
Investment securities	See Footnote 7	**841,931**	**841,931**	920,088	920,088
Loans held for sale	Level 3	**16,825**	**16,825**	12,758	12,758
Loans, net	Level 3	**2,739,892**	**2,755,066**	2,723,916	2,746,001
Stock in Federal Home Loan Bank of Pittsburgh	Level 2	**31,527**	**31,527**	31,165	31,165
Accrued interest receivable	Level 2	**10,028**	**10,028**	9,652	9,652
Financial liabilities:					
Deposits	Level 2	**3,188,519**	**3,055,822**	3,274,963	3,174,907
Borrowed funds	Level 2	**706,168**	**706,988**	637,266	638,375
Standby letters of credit	Level 3	**167**	**167**	224	224
Accrued interest payable	Level 2	**1,874**	**1,874**	1,099	1,099

8. INDEMNIFICATIONS AND GUARANTEES

Secondary Market Loan Sales. Given the current interest rate environment and current customer preference for long-term fixed rate mortgages, coupled with our desire not to hold these assets in our portfolio, we generally sell newly originated fixed rate conventional, 15 to 30 year loans in the secondary market to government sponsored enterprises such as FHLMC or to wholesale lenders. Loans held-for-sale are carried at the lower of cost or market of the aggregate. Gains and losses on sales of loans are recognized at the time of the sale. We sometimes retain the servicing rights on residential mortgage loans sold which results in monthly service fee income. Otherwise, we sell loans with servicing released on a nonrecourse basis.

We generally do not sell loans with recourse except to the extent arising from standard loan sale contract provisions covering violations of representations and warranties and, under certain circumstances first payment default by the borrower. These are customary repurchase provisions in the secondary market for conforming mortgage loan sales. These indemnifications may require our repurchase of the loans. Repurchases and losses are rare, and no provision is made for losses at the time of sale. There were no such repurchases for the three months ended March 31, 2013 or March 31, 2012.

Swap Guarantees. We entered into agreements with three unaffiliated financial institutions whereby those financial institutions entered into interest rate derivative contracts (interest rate swap transactions) with customers referred to them by us. By the terms of the agreements, those financial institutions have recourse to us for any exposure created under each swap transaction in the event the customer defaults on the swap agreement and the agreement is in a paying position to the third-party financial institution. This is a customary arrangement that allows smaller financial institutions like us to provide access to interest rate swap transactions for our customers without creating the swap ourselves.

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At March 31, 2013 there were 97 variable-rate swap transactions between the third party financial institutions and our customers, compared to 95 at December 31, 2012. The initial notional amount aggregated approximately $367.6 million at March 31, 2013 compared with $381.7 million at December 31, 2012. At March 31, 2013 maturities ranged from approximately five months to 12.5 years. The aggregate market value of these swaps to the customers was a liability of $31.5 million at March 31, 2013 and $35.5 million at December 31, 2012.

9. ASSOCIATE (EMPLOYEE) BENEFIT PLANS

Postretirement Benefits

We share certain costs of providing health and life insurance benefits to retired Associates (and their eligible dependents). Substantially all Associates may become eligible for these benefits if they reach normal retirement age while working for us.

We account for our obligations under the provisions of FASB ASC 715, *Compensation Retirement Benefits* (ASC 715). ASC 715 requires that the costs of these benefits be recognized over an Associate s active working career. Disclosures are in accordance with ASC 715.

The following disclosures of the net periodic benefit cost components of postretirement benefits were measured at January 1, 2013 and 2012:

	Three months ended March 31,	
	2013	2012
(In Thousands)		
Service cost	**$ 86**	$ 72
Interest cost	**44**	44
Amortization of transition obligation		15
Net loss recognition	**20**	17
Net periodic benefit cost	**$ 150**	$ 148

10. CHANGE IN ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income includes unrealized gain and losses on available-for-sale investments, unrealized gains and losses on interest only strip, and unrecognized prior service costs on BOLI. Changes to other accumulated other comprehensive income are presented net of tax effect as a component of equity. Reclassification out of accumulated other comprehensive is recorded on the statement of operations either as a gain or loss.

Changes to accumulated other comprehensive income by components are shown in the following tables for the period indicated:

	Net unrealized gains on investment securities available for sale	**Net unrealized losses on defined benefit pension plan**	**Total**
Balance, December 31, 2012	**$ 13,415**	**$ (472)**	**$ 12,943**
Other comprehensive income (loss) before reclassifications	(4,827)		(4,827)
Less: Amounts reclassified from accumulated other comprehensive income (loss)	(1,019)		(1,019)
Net current-period other comprehensive income (loss)	(5,846)		(5,846)
Balance, March 31, 2013	**$ 7,569**	**$ (472)**	**$ 7,097**
Balance, December 31, 2011	**$ 11,674**	**$ (472)**	**$ 11,202**

Other comprehensive income (loss) before reclassifications		316			316
Less: Amounts reclassified from accumulated other comprehensive income (loss)		(1,262)			(1,262)
Net current-period other comprehensive income (loss)		(946)			(946)
Balance, March 31, 2012	**$**	**10,728**	**$**	**(472)**	**$ 10,256**

The statement of operations line items impacted by components of other comprehensive income are presented in the table below.

	Three Months Ended March 31,		**Affected line item in Statements of Operations**
	2013	**2012**	
Securities available for sale:			
Realized gains on securities transactions	$ 1,644	$ 2,036	Securities gains, net
Income taxes	(625)	(774)	Income tax provision
Net of tax	**$ 1,019**	**$ 1,262**	

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11. GOODWILL AND INTANGIBLES

Our goodwill and other intangible assets were accounted for in accordance with the accounting guidance in FASB ASC Topic 350 *Intangibles Goodwill and Other.*

At December 31, 2012, we completed the Step One test of the analysis to determine potential goodwill impairment of the WSFS Bank and Trust and Wealth Management reporting units. The valuation incorporated a market-based analysis and indicated the fair values of our WSFS Bank and Trust and Wealth Management reporting units were above their carrying amounts. Therefore, in accordance with FASB ASC 350-20-35-6, the Step Two analysis was not required at that time. During the three months ended March 31, 2013 we determined there were no events or other indicators of impairment as it relates to goodwill or other intangibles.

FASB ASC 350, also requires that an acquired intangible asset be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the asset can be sold, transferred, licensed, rented or exchanged, regardless of the acquirer s intent to do so.

The following table summarizes other intangible assets:

	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
		(In Thousands)	
March 31, 2013			
Core deposits	**$ 4,370**	**$ (2,166)**	**$ 2,204**
Other	**4,503**	**(1,719)**	**2,784**
Total other intangible assets	**$ 8,873**	**$ (3,885)**	**$ 4,988**
December 31, 2012			
Core deposits	$ 4,370	$ (2,020)	$ 2,350
Other	4,464	(1,640)	2,824
Total other intangible assets	$ 8,834	$ (3,660)	$ 5,174

Core deposits are amortized over their expected lives using the present value of the benefit of the core deposits and straight-line methods of amortization. During the three months ended March 31, 2013, we recognized amortization expense on other intangible assets of $204,000.

The following presents the estimated amortization expense of intangibles:

(In Thousands)	Amortization of Intangibles
Remaining in 2013	$ 679
2014	832
2015	801
2016	477
2017	332
Thereafter	1,867
Total	$ 4,988

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12. LEGAL & OTHER PROCEEDINGS

There were no material changes or additions to other significant pending legal or other proceedings involving us other than those arising out of routine operations. Management does not anticipate that the ultimate liability, if any, arising out of such other proceedings will have a material effect on the Consolidated Financial Statements.

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Item 2. MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

We are a thrift holding company headquartered in Wilmington, Delaware. Substantially all of our assets are held by our subsidiary, WSFS Bank, one of the ten oldest banks continuously operating under the same name in the United States. As a federal savings bank, which was formerly chartered as a state mutual savings bank, we enjoy broader fiduciary powers than most other financial institutions. A fixture in the community, WSFS has been in operation for more than 181 years. In addition to its focus on stellar customer service, the Bank has continued to fuel growth and remain a leader in our community. We are a relationship-focused, locally-managed, community banking institution that has grown to become the largest thrift holding company in the State of Delaware, one of the top commercial lenders in the state and the third largest bank in terms of Delaware deposits. We state our mission simply: We Stand for Service. Our strategy of Engaged Associates delivering Stellar Service growing Customer Advocates and value for our Owners focuses on exceeding customer expectations, delivering stellar service and building customer advocacy through highly-trained, relationship-oriented, friendly, knowledgeable and empowered Associates.

Our core banking business is commercial lending funded by customer-generated deposits. We have built a $2.3 billion commercial loan portfolio by recruiting the best seasoned commercial lenders in our markets and offering a high level of service and flexibility typically associated with a community bank. We fund this business primarily with deposits generated through commercial relationships and retail deposits. We service our customers primarily from our 51 offices located in Delaware (42), Pennsylvania (7), Virginia (1) and Nevada (1) and through our website at www.wsfsbank.com. Information on our website is not incorporated by reference into this quarterly report. We also offer a broad variety of consumer loan products, retail securities and insurance brokerage through our retail branches.

Our Cash Connect division is a premier provider of ATM Vault Cash and related services in the United States. Cash Connect manages nearly $520 million in vault cash in nearly 14,000 ATMs nationwide and also provides online reporting and ATM cash management, predictive cash ordering, armored carrier management, ATM processing and equipment sales. Cash Connect also operates nearly 450 ATMs for the Bank, which has, by far, the largest branded ATM network in Delaware.

As a leading provider of ATM Vault Cash to the U.S. ATM industry, Cash Connect is exposed to substantial operational risk, including theft of cash from ATMs, armored vehicles, or armored carrier terminals, as well as general risk of accounting errors or fraud. This risk is managed through a series of financial controls, automated tracking and settlement systems, contracts, and other risk mitigation strategies, including both loss prevention and loss recovery strategies. Throughout its 12-year history, Cash Connect periodically has been exposed to theft through theft from armored courier companies and consistently has been able to recover any losses through its risk management strategies.

The Wealth Management division provides a broad array of fiduciary, investment management, credit and deposit products to clients through four businesses. WSFS Investment Group, Inc. provides insurance and brokerage products primarily to our retail banking clients. Cypress Capital Management, LLC is a registered investment advisor with over $624 million in assets under management. Cypress primary market segment is high net worth individuals, offering a balanced investment style focused on preservation of capital and current income. Christiana Trust, with $16.4 billion in assets under administration, provides fiduciary and investment services to personal trust clients, and trustee, agency, custodial and commercial domicile services to corporate and institutional clients. WSFS Private Banking serves high net worth clients by delivering credit and deposit products and partnering with Cypress, Christiana and WSFS Investment Group to deliver investment management and fiduciary products and services.

We have two consolidated subsidiaries, WSFS Bank and Montchanin Capital Management, Inc (Montchanin). We also have one unconsolidated affiliate, WSFS Capital Trust III (the trust). WSFS Bank has two fully-owned subsidiaries, WSFS Investment Group, Inc. and Monarch Entity Services LLC (Monarch) and Montchanin has one fully-owned subsidiary, Cypress.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, and exhibits thereto, contains estimates, predictions, opinions, projections and other forward-looking statements as that phrase is defined in the Private Securities Litigation Reform Act of 1995. Such statements include, without limitation, references to our financial goals, management s plans and objectives for future operations, financial and business trends, business prospects, and management s outlook or expectations for earnings, revenues, expenses, capital levels, liquidity levels, asset quality or other future financial or business performance, strategies or expectations. Such forward-looking statements are based on various assumptions (some of which may be beyond our control) and are subject to risks and uncertainties (which change over time) and other factors which could cause actual results to differ materially from those currently anticipated. Such risks and uncertainties include, but are not limited to, those related to the economic environment, particularly in the market areas in which we operate, including an increase in unemployment levels; our level of nonperforming assets; the volatility of the financial and securities markets, including changes with respect to the market value of financial assets; changes in market interest rates which may increase funding costs and reduce earning asset yields thus reducing margin; increases in benchmark rates would also increase debt service requirements for customers whose terms include a variable interest rate, which may negatively impact the ability of borrowers to pay as contractually obligated; changes in government regulation affecting financial institutions, including the Dodd-Frank Wall Street Reform and Consumer Protection Act and the rules and regulations being issued in accordance with this statute and potential expenses and elevated capital levels associated therewith; possible additional loan losses and impairment of the collectability of loans; possible changes in trade, monetary and fiscal policies, laws and regulations and other activities of governments, agencies, and similar organizations, may have an adverse effect on business; possible rules and regulations issued by the Consumer Financial Protection Bureau or other regulators which might adversely impact our business model or products and services; possible stresses in the real estate markets, including possible continued deterioration in property values that affect the collateral value underlying our real estate loans; our ability to expand into new markets, develop competitive new products and services in a timely manner, and to maintain profit margins in the face of competitive pressures; possible changes in consumer and business spending and saving habits could affect our ability to increase assets and to attract deposits; our ability to effectively manage credit risk, interest rate risk, market risk, operational risk, legal risk, liquidity risk, reputational risk, and regulatory and compliance risk; the effects of increased competition from both banks and non-banks; the effects of geopolitical instability and risks such as terrorist attacks; the effects of weather and natural disasters such as floods, droughts, wind, tornados and hurricanes, and the effects of man-made disasters; possible changes in the speed of loan prepayments by our customers and loan origination or sales volumes; possible acceleration of prepayments of mortgage-backed securities (MBS) due to low interest rates, and the related acceleration of premium amortization on prepayments on MBS due to low interest rates; and the costs associated with resolving any problem loans, litigation and other risks and uncertainties. Such risks and uncertainties are discussed herein, including under the heading Risk Factors, and in our Form 10-K for the year ended December 31, 2012 and other documents filed by us with the Securities and Exchange Commission from time to time. Forward looking statements are as of the date they are made, and we do not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of us.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of the financial condition and results of operations are based on the Consolidated Financial Statements, which are prepared in conformity with GAAP. The preparation of these Consolidated Financial Statements requires us to make estimates and assumptions affecting the reported amounts of assets, liabilities, revenue and expenses. We regularly evaluate these estimates and assumptions including those related to the allowance for loan losses, deferred taxes, fair value measurements, goodwill and other intangible assets. We base our estimates on historical experience and various other factors and assumptions that are believed to be reasonable under the circumstances. These form the basis for making judgments on the carrying value of assets and liabilities that are not readily apparent from other sources. Although our current estimates contemplate current economic conditions and how we expect them to change in the future, for the remainder of 2013, it is reasonably possible that actual conditions may be worse than anticipated in those estimates, which could materially affect our results of operations and financial condition. Actual results may differ from these estimates under different assumptions or conditions.

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The following are critical accounting policies that involve more significant judgments and estimates. See further discussion of these critical accounting policies in the 2012 Annual Report on Form 10-K.

Allowance for Loan Losses

We maintain allowances for loan losses and charge losses to these allowances when realized. We consider the determination of the allowance for loan losses to be critical because it requires significant judgment reflecting our best estimate of impairment related to specifically evaluated impaired loans as well as the inherent risk of loss for those in the remaining loan portfolio. Our evaluation is based upon a continuing review of the portfolio, with consideration given to evaluations resulting from examinations performed by regulatory authorities.

Deferred Taxes

We account for income taxes in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740, *Income Taxes* (ASC 740), which requires the recording of deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We consider our accounting policies on deferred taxes to be critical because we regularly assess the need for valuation allowances on deferred income tax assets that may result from, among other things, limitations imposed by Internal Revenue Code and uncertainties, including the timing of settlement and realization of these differences. No valuation allowance is required as of March 31, 2013.

Fair Value Measurements

We adopted FASB ASC 820-10 *Fair Value Measurements and Disclosures* (ASC 820), which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. We consider our accounting policies related to fair value measurements to be critical because they are important to the portrayal of our financial condition and results, and they require our subjective and complex judgment as a result of the need to make estimates about the effects of matters that are inherently uncertain. See Note 7, Fair Value Disclosures of Financial Assets to our Consolidated Financial Statements.

Goodwill and Other Intangible Assets

Intangible assets resulting from acquisitions under the purchase method of accounting consist of goodwill and other intangible assets. Goodwill is not amortized and is subject to at least annual assessments for impairment by applying a fair value based test. We review goodwill annually and again at any quarter-end if a material event occurs during the quarter that may affect goodwill. This review evaluates potential impairment by determining if our fair value has fallen below carrying value.

Other intangible assets consist mainly of core deposits and covenants not to compete obtained through acquisitions and are amortized over their estimated lives using the present value of the benefit of the core deposits and straight-line methods of amortization. Core deposit intangibles are evaluated for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

FINANCIAL CONDITION, CAPITAL RESOURCES AND LIQUIDITY

Financial Condition

Our total assets decreased $20.5 million to $4.4 billion as of March 31, 2013. Included in this decrease was a $78.2 million, or 9%, decrease in investment securities, available-for sale, and an $18.3 million, or 19%, decrease in cash and due from banks. The decrease in investment securities reflects the deleverage strategy we began in the fourth quarter of 2012 and completed during the first quarter of 2013. Partially offsetting these decreases, cash in non-owned ATMs increased $48.3 million, or 12%, due to growth in our Cash Connect division, and net loans increased $16.0 million during the quarter reflecting our continued success winning market share.

Total liabilities decreased $23.7 million during the quarter to $3.9 billion as of March 31, 2013. This decrease was primarily the result of decreased customer deposits of $104.5 million, or 3%. The decrease is mainly due to a net decrease in temporary trust accounts (temporary deposits collected through our Wealth Management Division that are expected to remain on deposit for only a short period of time), the intentional decrease of high-cost time deposits, and a decrease in money market accounts due to normal seasonal decreases in public fund accounts. Partially offsetting these decreases, Federal Home Loan Bank advances increased $79.0 million, or 21%, interest-bearing demand accounts increased $22.2 million, or 4 %, brokered deposits increased $18.0 million, or 11%, and savings accounts increased $11.5 million, or 3%, during the quarter.

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Capital Resources

Stockholders equity increased $3.2 million between December 31, 2012 and March 31, 2013. This increase was mainly due to net income of $9.7 million. Partially offsetting this increase was a decrease of $5.8 million in the value of our available-for-sale securities portfolio combined with the payment of common and preferred dividends of $1.7 million during the three months ended March 31, 2013.

Book value per common share was $48.25 at March 31, 2013 an increase of $0.26 from $47.99 reported at December 31, 2012. Tangible common book value per common share (a non-GAAP measurement) was $38.51 at March 31, 2013, an increase of $0.30, from $38.21 reported at December 31, 2012. See Reconciliation of Non-GAAP Measurements to GAAP for a reconciliation of tangible common book value per common share to common book value per common share, the most directly comparable GAAP measurement. We believe this measure is important to management and investors to better understand and assess changes from period to period in stockholders equity exclusive of changes in intangible assets.

On April 9, 2013, we requested approval from our primary regulators to redeem our outstanding $52,625,000 Fixed-Rate Cumulative Perpetual Preferred Stock, Series A. These shares were originally issued to the U.S. Treasury as part of the Troubled Asset Reduction Plan (TARP) Capital Purchase Plan (CPP). As of March 31, 2013, we held $61.0 million in available cash at the parent holding company.

Below is a table comparing the Bank s consolidated capital position to the minimum regulatory requirements as of March 31, 2013:

	Consolidated Bank Capital		For Capital Adequacy Purposes		To be Well-Capitalized Under Prompt Corrective Action Provisions	
(Dollars in Thousands)	Amount	% of Assets	Amount	% of Assets	Amount	% of Assets
Total Capital (to Risk-Weighted Assets)	$ 477,182	14.52%	$ 262,876	8.00%	$ 328,595	10.00%
Core Capital (to Adjusted Total Assets)	436,069	10.12	172,384	4.00	215,480	5.00
Tangible Capital (to Tangible Assets)	436,069	10.12	64,644	1.50	N/A	N/A
Tier 1 Capital (to Risk-Weighted Assets)	436,069	13.27	131,438	4.00	197,157	6.00

Under guidelines issued by banking regulators, savings institutions such as the Bank must maintain tangible capital equal to 1.5% of adjusted total assets, core capital equal to 4.0% of adjusted total assets, Tier 1 capital equal to 4.0% of risk weighted assets and total or risk-based capita (a combination of core and supplementary capital) equal to 8.0% of risk-weighted assets. Failure to meet minimum capital requirements can initiate certain mandatory actions and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our bank s financial statements.

At March 31, 2013, the Bank was in compliance with regulatory capital requirements and was considered a well-capitalized institution. The Bank s core capital ratio of 10.12%, Tier 1 capital ratio of 13.27% and total risk based capital ratio of 14.52%, all remain substantially in excess of well-capitalized regulatory benchmarks, the highest regulatory capital rating. In addition, and not included in Bank capital, the holding company held $61.0 million in cash to support dividends, acquisitions, strategic growth plans.

Liquidity

We manage our liquidity risk and funding needs through our Treasury function and our Asset/Liability Committee. We have a policy that separately addresses liquidity, and management monitors our adherence to policy limits. Also, liquidity risk management is a primary area of examination by the banking regulators.

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As a financial institution, the Bank has ready access to several sources to fund growth and meet its liquidity needs. Among these are: net income, retail deposit programs, loan repayments, borrowing from the FHLB, repurchase agreements, access to the Federal Reserve Discount Window, and access to the brokered deposit market as well as other wholesale funding avenues. In addition, we have a large portfolio of high-quality, liquid investments, primarily short-duration mortgage-backed securities and government sponsored enterprises (GSE) notes that provide a near-continuous source of cash flow to meet current cash needs, or can be sold to meet larger discrete needs for cash. Management believes these sources are sufficient to maintain required and prudent levels of liquidity.

During the three months ended March 31, 2013, cash and cash equivalents increased $29.7 million to $530.6 million. This increase was primarily a result of the following: $79.0 million from the net proceeds from FHLB advances; $68.9 million from the sale and maturities (net of purchases) of available for sale securities; $18.0 million increase in brokered deposits and $1.6 million increase in cash provided by operating activities. Offsetting these increases in cash were: a $99.1 million reduction in cash due to decreases in demand, savings, and time deposits and a $15.0 million reduction in cash due to the decrease in federal funds purchased and securities sold under repurchase agreements.

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NONPERFORMING ASSETS

The following table shows our nonperforming assets and past due loans at the dates indicated. Nonperforming assets include nonaccruing loans, nonperforming real estate, assets acquired through foreclosure and restructured mortgage and home equity consumer debt. Nonaccruing loans are those on which the accrual of interest has ceased. Loans are placed on nonaccrual status immediately if, in the opinion of management, collection is doubtful, or when principal or interest is past due 90 days or more and the value of the collateral is insufficient to cover principal and interest. Interest accrued but not collected at the date a loan is placed on nonaccrual status is reversed and charged against interest income. In addition, the amortization of net deferred loan fees is suspended when a loan is placed on nonaccrual status. Subsequent cash receipts are applied either to the outstanding principal balance or recorded as interest income, depending on management s assessment of the ultimate collectability of principal and interest. Past due loans are loans contractually past due 90 days or more as to principal or interest payments but which remain on accrual status because they are considered well secured and in the process of collection.

	March 31, 2013	December 31, 2012
	(In Thousands)	
Nonaccruing loans:		
Commercial	**$ 4,991**	$ 4,861
Owner-occupied commercial	**13,263**	14,001
Consumer	**4,201**	4,728
Commercial mortgage	**11,240**	12,634
Residential mortgage	**10,810**	9,989
Construction	**1,216**	1,547
Total nonaccruing loans	**45,721**	47,760
Assets acquired through foreclosure	**6,522**	4,622
Troubled debt restructuring (accruing)	**10,777**	10,093
Total nonperforming assets	**$ 63,020**	$ 62,475
Past due loans (1):		
Residential Mortgages	**297**	786
Commercial and commercial mortgages	**103**	
Total past due loans	**$ 400**	$ 786
Ratios:		
Allowance for loan losses to total loans (2)	**1.54%**	1.58%
Nonperforming assets to total assets	**1.45%**	1.43%
Nonaccruing loans to total loans (2)	**1.64%**	1.73%
Loan loss allowance to nonaccruing loans	**93.93%**	91.96%
Loan loss allowance to total nonperforming assets	**68.15%**	70.30%

(1) Past due loans are accruing loans which are contractually past due 90 days or more as to principal or interest. These loans are well secured and in the process of collection.

(2) Total loans exclude loans held for sale.

Nonperforming assets increased $545,000 between December 31, 2012 and March 31, 2013. As a result, nonperforming assets as a percentage of total assets increased slightly from 1.43% at December 31, 2012 to 1.45% at March 31, 2013. There were a total of $5.3 million in new loans transitioned to nonperforming. However, this was off-set by $1.5 million in collections and $3.4 million of nonperforming assets written down of which one loan was written down by $1.3 million. We have transferred $2.2 million into Other Real Estate Owned (OREO).

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The following table summarizes the changes in nonperforming assets during the period indicated:

	For the three months ended March 31, 2013	For the year ended December 31, 2012
	(In Thousands)	
Beginning balance	**$ 62,475**	$ 91,675
Additions	**6,041**	73,170
Collections	**(1,510)**	(46,514)
Collections from loan dispositions		(14,305)
Transfers to accrual	**(498)**	(552)
Charge-offs / write-downs, net	**(3,488)**	(40,999)
Ending balance	**$ 63,020**	$ 62,475

The timely identification of problem loans is a key element in our strategy to manage our loan portfolio. Timely identification enables us to take appropriate action and, accordingly, minimize losses. An asset review system established to monitor the asset quality of our loans and investments in real estate portfolios facilitates the identification of problem assets. In general, this system utilizes guidelines established by federal regulation.

INTEREST SENSITIVITY

The matching of maturities or repricing periods of interest rate-sensitive assets and liabilities to promote a favorable interest rate spread and mitigate exposure to fluctuations in interest rates is our primary tool for achieving our asset/liability management strategies. We regularly review our interest-rate sensitivity and adjust the sensitivity within acceptable tolerance ranges established by the Board of Directors. At March 31, 2013, interest-earning assets exceeded interest-bearing liabilities that mature or reprice within one year (interest-sensitive gap) by $8.2 million. Our interest-sensitive assets as a percentage of interest-sensitive liabilities within the one-year window increased from 98.09% at December 31, 2012, to 100.35% at March 31, 2013. Likewise, the one-year interest-sensitive gap as a percentage of total assets changed to 0.19% at March 31, 2013 from -1.02% at December 31, 2012. The change in sensitivity since December 31, 2012 reflects the current interest rate environment and our continuing effort to effectively manage interest rate risk.

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Market risk is the risk of loss from adverse changes in market prices and rates. Our market risk arises primarily from interest rate risk inherent in our lending, investing, and funding activities. To that end, we actively monitor and manage our interest rate risk exposure. One measure, required to be performed by federal regulation, measures the impact of an immediate change in interest rates in 100 basis point increments on the economic value of equity ratio. The economic value of equity ratio is defined as the economic value of the estimated cash flows from assets and liabilities as a percentage of economic value of cash flows from total assets. The table below shows the estimated impact of immediate changes in interest rates on our net interest margin and economic value of equity ratio at the specified levels at March 31, 2013 and December 31, 2012:

	March 31, 2013		December 31, 2012	
% Change in Interest Rate (Basis Points)	**% Change in Net Interest Margin (1)**	**Economic Value of Equity (2)**	% Change in Net Interest Margin (1)	Economic Value of Equity (2)
+300	**5%**	**13.46%**	4%	12.49%
+200	**2%**	**13.43%**	1%	12.62%
+100	**-2%**	**13.26%**	-3%	12.54%
	0%	**12.95%**	0%	12.31%
-100	**-1%**	**12.08%**	-1%	11.56%
-200(3)	**NMF**	**NMF**	NMF	NMF
-300(3)	**NMF**	**NMF**	NMF	NMF

(1) The percentage difference between net interest margin in a stable interest rate environment and net interest margin as projected under the various rate change environments.
(2) The economic value of equity ratio of the Company in a stable interest rate environment and the economic value of equity ratio as projected under the various rate change environments.
(3) Sensitivity indicated by a decrease of 200 or 300 basis points is not deemed meaningful at March 31, 2013 given the low absolute level of interest rates at that time.

We also engage in other business activities that are sensitive to changes in interest rates. For example, mortgage banking revenues and expenses can fluctuate with changing interest rates. These fluctuations are difficult to model and estimate.

COMPARISON OF THE THREE MONTHS ENDED MARCH 31, 2013

Results of Operations

We recorded net income of $9.7 million for the quarter ended March 31, 2013, a 51% increase over $6.4 million for the quarter ended March 31, 2012. Income allocable to common stockholders (after preferred stock dividends) was $9.0 million, or $1.02 per diluted common share, for the quarter ended March 31, 2013, or a 55% increase in EPS compared to income allocable to common shareholders of $5.6 million, or $0.66 per diluted common share, for the quarter ended March 31, 2012.

The increase in earnings for the first quarter of 2013 reflected strong growth in noninterest income (8%), despite decreased net gains from sale of investment securities, and lower provision for loan losses, offset by a 4% increase in noninterest expenses and a slight decline in net interest income. The increase in noninterest income reflects continued growth in our Wealth Management division (23%) and our Cash Connect ATM division (8%), as well as increases in most other categories. The decrease in the provision for loan losses over the previous year was the result of continued broad improvement in credit quality resulting from prudent credit management and active problem asset disposition efforts in 2012. The increase in noninterest expenses was due to higher salaries, benefits and other compensation as a result of increased incentive costs related to performance and the timing of certain retirement eligible stock option expenses in the first quarter of 2013, while similar expenses in 2012 were lower and were spread between the first and second quarters.

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Net Interest Income

The following tables provide information concerning the balances, yields and rates on interest-earning assets and interest-bearing liabilities during the periods indicated.

	Three Months Ended March 31,			
Sales and marketing	73.8		67.5	
General and administrative	18.5		16.4	
Total	126.4	%	108.0	%

(1) Includes stock-based compensation expense:		
Research and development	$ 15,352	$ 4,405
Sales and marketing	21,075	5,947
General and administrative	7,770	2,815
Total stock-based compensation expense	$ 44,197	$ 13,167

Research and development expense. Research and development expense increased $20.6 million primarily due to a $17.6 million increase in salaries and benefits, which includes a $10.9 million increase in stock-based compensation expense, as we increased headcount as part of our focus on further developing and enhancing our products. We also had an increase of $2.6 million related to overhead costs.

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Sales and marketing expense. Sales and marketing expense increased $32.7 million primarily due to a $24.6 million increase in salaries and benefits, which includes a $15.1 million increase in stock-based compensation expense, as we increased headcount to expand our field sales organization and experienced higher commission expense as a result of increased customer orders. We experienced an increase of $4.3 million in expenses due to increased facilities and overhead, as well as an increase of $2.3 million in marketing program fees as a result of increases due to our annual users' conference, marketing events and advertising. Additionally, we had an increase of $1.1 million in travel expenses due to increased travel from our growing field sales organization.

General and administrative expense. General and administrative expense increased $8.5 million due primarily to an increase of $7.8 million related to salaries and benefits, which includes a $5.0 million increase in stock-based compensation expense, due to increased headcount.

Interest and Other Income (Expense), net

	Three Months Ended October 31, 2014	2013
	(in thousands)	
Interest and other income (expense), net:		
Interest income	$199	$55
Other income (expense), net	(52)	(283)
Total interest and other income (expense), net	$147	$(228)

Interest and other income (expense), net reflects a net increase in income primarily due to an increase in interest income from our investments.

Income Tax Provision (Benefit)

	Three Months Ended October 31, 2014	2013
	(in thousands)	
Income tax provision (benefit)	$447	$(500)

For the three months ended October 31, 2014, we recorded an income tax expense that was primarily attributable to an increase in tax expense from our increased activity in our foreign operations and state franchise tax and the absence of a partial release of the valuation allowance as a result of a prior year acquisition.

Comparison of the Nine Months Ended October 31, 2014 and 2013

Revenues

	Nine Months Ended October 31, 2014	2013	% Change
	($ amounts in thousands)		
Revenues			
License	$185,109	$130,230	42.1%
Maintenance and services	118,374	72,483	63.3%

Total revenues	$303,483		$202,713		49.7	%
Percentage of revenues						
License	61.0	%	64.2	%		
Maintenance and services	39.0		35.8			
Total	100.0	%	100.0	%		

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The increase in license revenues of $54.9 million was primarily driven by increases in our total number of customers, sales to existing customers and an increase in the number of large orders. For example, we had 683 and 502 orders greater than $100,000 for the nine months ended October 31, 2014 and 2013, respectively. Our total number of customers increased from approximately 6,400 at October 31, 2013 to more than 8,400 at October 31, 2014. The increase in maintenance and services revenues of $45.9 million was due to increases in sales of maintenance agreements as well as sales of professional services resulting from the growth of our installed customer base.

Cost of Revenues and Gross Margin

	Nine Months Ended October 31,					
	2014		2013		% Change	
	($ amounts in thousands)					
Cost of revenues						
License	$685		$229		199.1	%
Maintenance and services	46,153		24,398		89.2	%
Total cost of revenues	$46,838		$24,627		90.2	%
Gross margin						
License	99.6	%	99.8	%		
Maintenance and services	61.0	%	66.3	%		
Total gross margin	84.6	%	87.9	%		

Total cost of revenues increased $22.2 million due to the increase in cost of maintenance and services revenues. The increase in cost of maintenance and services revenues was primarily related to an increase of $15.5 million in salaries and benefits expense, which includes a $8.9 million increase in stock-based compensation expense, due to increased headcount, an increase of $4.8 million related to professional services expense, an increase of $2.3 million related to overhead costs and an increase of $1.3 million of travel expenses from our services organizations. These increases were partially offset by a $2.1 million decrease due to the absence of a prior year impairment charge of a long-lived asset for previously capitalized software development costs for our Splunk Storm product as a result of our decision to make Splunk Storm available to customers at no cost.

Operating Expenses

	Nine Months Ended October 31,					
	2014		2013		% Change	
	($ amounts in thousands)					
Operating expenses (1)						
Research and development	$103,455		$49,635		108.4	%
Sales and marketing	236,776		138,999		70.3	%
General and administrative	75,125		35,275		113.0	%
Total operating expenses	$415,356		$223,909		85.5	%
Percentage of revenues						
Research and development	34.1	%	24.5	%		
Sales and marketing	78.0		68.6			
General and administrative	24.8		17.4			
Total	136.9	%	110.5	%		

(1) Includes stock-based compensation expense:

Research and development	$41,517	$10,995
Sales and marketing	61,458	15,425
General and administrative	36,357	6,969
Total stock-based compensation expense	$139,332	$33,389

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Research and development expense. Research and development expense increased $53.8 million primarily due to a $46.3 million increase in salaries and benefits, which includes a $30.5 million increase in stock-based compensation expense, as we increased headcount as part of our focus on further developing and enhancing our products. We also had an increase of $6.2 million related to overhead costs and an increase of $1.3 million due to payroll related taxes as a result of increased headcount.

Sales and marketing expense. Sales and marketing expense increased $97.8 million primarily due to a $78.8 million increase in salaries and benefits, which includes a $46.0 million increase in stock-based compensation expense, as we increased headcount to expand our field sales organization and experienced higher commission expense as a result of increased customer orders. We experienced an increase of $10.2 million in expenses due to increased facilities and overhead as a result of our international expansion efforts. We had a $4.3 million increase in marketing program fees as a result of increases due to our annual users' conference, marketing events and advertising. Additionally, we had an increase of $4.0 million in travel expenses due to increased travel from our growing field sales organization.

General and administrative expense. General and administrative expense increased $39.9 million due primarily to an increase of $37.3 million related to salaries and benefits, which includes a $29.4 million increase in stock-based compensation expense, in part due to an acceleration of stock-based compensation expense of $13.1 million related to the return of two restricted stock unit grants from our Chief Executive Officer, as well as increased headcount.

Interest and Other Income (Expense), net

	Nine Months Ended October 31,	
	2014	2013
	(in thousands)	
Interest and other income (expense), net:		
Interest income	$492	$174
Other income (expense), net	(326)	(459)
Total interest and other income (expense), net	$166	$(285)

Interest and other income (expense), net reflects a net increase in income primarily due to an increase in interest income from our investments.

Income Tax Provision

	Nine Months Ended October 31,	
	2014	2013
	(in thousands)	
Income tax provision	$1,543	$269

For the nine months ended October 31, 2014, we recorded an income tax expense that was primarily attributable to an increase in tax expense from our increased activity in our foreign operations and state franchise tax and the absence of a partial release of the valuation allowance as a result of a prior year acquisition.

Liquidity and Capital Resources

	October 31, 2014	January 31, 2014
	(in thousands)	
Cash and cash equivalents	$329,553	$897,453

	Nine Months Ended October 31, 2014	2013
	(in thousands)	
Cash provided by operating activities	$52,452	$39,419
Cash used in investing activities	(641,977)	(16,223)
Cash provided by financing activities	21,745	22,728

Since fiscal 2010 we have funded our operations primarily through cash generated from operations. At October 31, 2014, our cash and cash equivalents of $329.6 million were held for working capital purposes, a majority of which was invested in money market funds. We intend to increase our capital expenditures for the remainder of fiscal 2015, consistent with the growth in our business and operations. We believe that our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors including our growth rate, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced software and services offerings, the continuing market acceptance of our products and our planned investments, particularly in our product development efforts or acquisitions of complementary businesses, applications or technologies.

In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us if at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition could be adversely affected.

Operating Activities

In the nine months ended October 31, 2014, cash inflows from our operating activities were $52.5 million, which reflects our net loss of $160.1 million, adjusted by non-cash charges of $158.5 million, consisting primarily of $151.0 million for stock-based compensation, $9.0 million for depreciation and amortization, $0.4 million for amortization of investment premiums, partially offset by $1.1 million for excess tax benefits from employee stock plans and $0.8 million for deferred income taxes. Sources of cash inflows were from changes in our working capital, including a $37.0 million increase in deferred revenue, a $12.7 million increase in accrued expenses and other liabilities, a $4.6 million increase in accrued payroll and compensation, a $1.0 million increase in accounts payable and a $0.8 million decrease in accounts receivable due to strong collections. These cash inflows were offset by a $2.0 million increase in prepaid expense and other current and non-current assets.

In the nine months ended October 31, 2013, cash inflows from our operating activities were $39.4 million, which reflects our net loss of $46.4 million, adjusted by non-cash charges of $41.0 million, consisting primarily of $36.1 million for stock-based compensation, $4.5 million for depreciation and amortization, $2.1 million related to the impairment of a long-lived asset, partially offset by $1.2 million for deferred income taxes and $0.5 million for excess tax benefits from employee stock plans. Sources of cash inflows were from changes in our working capital, including a $10.0 million decrease in accounts receivable due to strong collections, a $26.4 million increase in deferred revenue, a $5.2 million increase in accrued expenses and other liabilities and a $2.5 million increase in accrued payroll and compensation. These cash inflows were partially offset by a $0.4 million increase in prepaid expense and other current and non-current assets.

Investing Activities

In the nine months ended October 31, 2014, cash used in investing activities of $642.0 million was primarily attributable to $691.3 million of investments in U.S. treasury securities, $11.2 million of capital expenditures for the purchase of technology and hardware as well as purchases related to our facilities and infrastructure and $2.5 million which was used for a technology asset acquisition. These cash outflows were partially offset by $63.0 million cash inflow due to the maturities of our investments.

In the nine months ended October 31, 2013, cash used in investing activities of $16.2 million was primarily attributable to $9.0 million of cash purchase price paid, net of cash acquired, for an acquisition and $7.3 million of capital

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expenditures for technology and hardware, as well as leasehold improvements on our corporate headquarters in San Francisco, California to support the growth of our business.

Financing Activities

In the nine months ended October 31, 2014, cash provided by financing activities of $21.7 million consisted primarily of $12.8 million of proceeds from the exercise of stock options, $8.3 million of proceeds from our employee stock purchase plan and $1.1 million of proceeds from excess tax benefits from employee stock plans, partially offset by a $0.5 million lease deposit payment which, for accounting purposes only, is treated as a payment related to a build-to-suit lease obligation.

In the nine months ended October 31, 2013, cash provided by financing activities of $22.7 million consisted primarily of $18.9 million of proceeds from the exercise of stock options and $6.1 million of proceeds from our employee stock purchase plan, partially offset by $2.8 million of taxes paid related to the net settlement of RSUs.

Loan and Security Agreement

On May 9, 2013 we entered into a Loan Agreement with Silicon Valley Bank. The agreement provides for a revolving line of credit facility, which expires May 9, 2015. Under the agreement, we are able to borrow up to $25 million. Interest on any drawdown under the revolving line of credit accrues either at the prime rate (3.25% in October 2014) or the LIBOR rate plus 2.75%. As of October 31, 2014, we had no balance outstanding under this agreement. The agreement includes restrictive covenants, in each case subject to certain exceptions, that limit our ability to: sell or otherwise dispose of our business or property; change our business, liquidate or dissolve or undergo a change in control; enter into mergers, consolidations and acquisitions; incur indebtedness; create liens; pay dividends or make distributions; make investments; enter into material transactions with affiliates; pay any subordinated debt or amend certain terms thereof; or become an investment company.

In addition, the agreement contains customary financial covenants and other affirmative and negative covenants. We were in compliance with all covenants as of October 31, 2014.

Contractual Payment Obligations

We lease our office spaces under non-cancelable leases with rent expense recognized on a straight-line basis over the lease term. Rent expense was $2.6 million and $1.9 million for the three months ended October 31, 2014 and 2013, respectively, and $7.5 million and $4.3 million for the nine months ended October 31, 2014 and 2013, respectively.

On April 29, 2014, we entered into an office lease (the "Lease") for approximately 182,000 square feet located at 270 Brannan Street, San Francisco, California (the "Premises"). The Premises will be allocated to approximately 95,000 square feet of rentable space (the "Initial Premises") which we expect to occupy in January 2016 and approximately 87,000 square feet of rentable space (the "Must-Take Premises"), which we expect to occupy one year thereafter. The Initial Premises and the Must-Take Premises each have a term of 84 months, subject to the completion of certain pre-occupancy improvements by our landlord. Our total obligation for the base rent is approximately $92.0 million. On May 13, 2014, we entered into an irrevocable, standby letter of credit with Silicon Valley Bank for $6.0 million to serve as a security deposit for the Lease.

As a result of our involvement during the construction period, whereby we have certain indemnification obligations related to the construction, we are considered for accounting purposes only, the owner of the construction project under build-to-suit lease accounting. We have recorded estimated project construction costs incurred by the landlord as an asset and a corresponding long term liability in “Property and equipment, net” and “Other liabilities, non-current” respectively, on our condensed consolidated balance sheets. We will increase the asset and corresponding long term liability as additional building costs are incurred by the landlord during the construction period. Once the landlord completes the construction of the Initial Premises, which is estimated to be in January 2016, we will evaluate the Lease in order to determine whether or not the Lease meets the criteria for "sale-leaseback" treatment.

The following summarizes our contractual commitments and obligations as of October 31, 2014:

	Payments Due by Period*				
	Total	Less Than 1 year	1-3 years	3-5 years	More Than 5 years
	(in thousands)				
Office lease obligations	$148,884	$9,582	$37,200	$41,804	$60,298

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*We entered into a sublease agreement on November 16, 2012 for a portion of our office space in the United Kingdom, and the future sublease rental income of $0.9 million has been included as an offset to our future minimum rental payments.

Off-Balance Sheet Arrangements

During the three months and nine months ended October 31, 2014 and 2013, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities, that have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Indemnification Arrangements

During the ordinary course of business, we may indemnify, hold harmless and agree to reimburse for losses suffered or incurred, our customers, channel partners, vendors and each of their affiliates for certain intellectual property infringement and other claims by third parties with respect to our products and services, in connection with our commercial license arrangements or related to general business dealings with those parties.

As permitted under Delaware law, we have entered into indemnification agreements with our officers, directors and certain employees, indemnifying them for certain events or occurrences while they serve as our officers or directors.

To date, there have not been any costs incurred in connection with such indemnification obligations; therefore, there is no accrual of any amounts at October 31, 2014. We are unable to estimate the maximum potential impact of these indemnifications on our future results of operations.

Critical Accounting Policies and Estimates

We prepare our condensed consolidated financial statements in accordance with U.S. GAAP. The preparation of condensed consolidated financial statements also requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ significantly from the estimates made by our management. To the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K, filed with the SEC on March 31, 2014.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to financial market risks, primarily changes in interest rates and foreign currency exchange rates.

Interest Rate Risk

We hold our cash, cash equivalents and investments for working capital purposes. Some of the securities we invest in are subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. To minimize this risk, we maintain our portfolio of cash, cash equivalents and investments in a variety of securities, including money market funds and government debt securities. The risk associated with fluctuating interest rates is limited to our investment portfolio. Due to the short-term nature of these instruments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, would reduce future interest income.

The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. This objective is accomplished by making diversified investments, consisting only of investment grade securities. The effect of a hypothetical 10% increase or decrease in overall interest rates would not have had a material impact on our operating results or the total fair value of the portfolio.

Any draws under our revolving credit facility bear interest at a variable rate tied to the prime rate or the LIBOR rate. As of October 31, 2014, we had no balance outstanding under this agreement.

Foreign Currency Exchange Risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. All of our revenues are generated in U.S. dollars. Our expenses are generally denominated in the currencies in which our operations are located, which is primarily in the United States and to a lesser extent in Europe and Asia. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates and may be adversely affected in the future due to changes in foreign exchange rates. The effect of a hypothetical 10% change in foreign currency exchange rates applicable to our business would not have a material impact on our historical consolidated financial statements. To date, we have not engaged in any hedging strategies. As our international operations grow, we will continue to reassess our approach to manage our risk relating to fluctuations in currency rates.

Inflation

We do not believe that inflation had a material effect on our business, financial condition or results of operations in the three and nine months ended October 31, 2014 and 2013. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of October 31, 2014. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of October 31, 2014, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at the reasonable assurance level. However, our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth above under Legal Proceedings in Note 3 contained in the "Notes to Condensed Consolidated Financial Statements" is incorporated herein by reference.

Item 1A. Risk Factors

Our operations and financial results are subject to various risks and uncertainties including those described below. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, also may become important factors that affect us. If any of the following risks or others not specified below materialize, our business, financial condition and results of operations could be materially adversely affected. In that case, the trading price of our common stock could decline.

The market for our products is new and unproven and may not grow.

We believe our future success will depend in large part on the growth, if any, in the market for products that provide operational intelligence, particularly from machine data. We market our products as targeted solutions for specific use cases and as an enterprise solution for machine data. In order to grow our business, we intend to expand the functionality of our products to increase their acceptance and use by the broader market as well as develop new products. It is difficult to predict customer adoption and renewal rates, customer demand for our products, the size and growth rate of this market, the entry of competitive products or the success of existing competitive products. Any expansion in our market depends on a number of factors, including the cost, performance and perceived value associated with our products. If our products do not achieve widespread adoption or there is a reduction in demand for products in our market caused by a lack of customer acceptance or expansion, technological challenges, decreases in accessible machine data, competing technologies and products, pricing pressure, decreases in corporate or information technology spending, weakening economic conditions, or otherwise, it could result in reduced customer orders, early terminations, reduced renewal rates or decreased revenues, any of which would adversely affect our business operations and financial results. We believe that these are inherent risks and difficulties in this new and unproven market.

Our future operating results may fluctuate significantly, and our recent operating results may not be a good indication of our future performance.

Our revenues and operating results could vary significantly from period to period as a result of various factors, many of which are outside of our control. For example, we have historically generated a majority of our license revenues from perpetual license agreements, whereby we generally recognize the license fee portion of the arrangement upfront, assuming all revenue recognition criteria are satisfied. Our customers also have the choice of entering into term licenses for our software, whereby the license fee is recognized ratably over the license term, and, in combination with our introduction of enterprise adoption agreements, we have seen the proportion of our customer orders where revenue will be recognized ratably increase steadily as a percentage of total orders. At the beginning of each quarter, we do not know the ratio between perpetual licenses and term licenses that we will enter into during the quarter. In the third quarter of fiscal 2015, 34% of total license orders will be recognized ratably. As a result, our operating results could be significantly impacted by unexpected shifts in the ratio between perpetual licenses and term licenses. In addition, the size of our licenses varies greatly, and a single, large perpetual license in a given period could distort our operating results. The timing and size of large transactions are often hard to predict in any particular period. Further, since we recognize a portion of our revenue ratably over the life of the term license agreements and maintenance agreements, a portion of the revenue we report in each quarter is the result of agreements entered into during previous quarters. Consequently, a decline in business from term license agreements or maintenance agreements in any quarter may not be reflected in our revenue results for that quarter. Any such decline, however, will negatively affect our revenue in future quarters. Accordingly, the effect of downturns in sales and market acceptance of our products and services may not be fully reflected in our results of operations until future periods. Comparing our revenues and operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance.

We may not be able to accurately predict our future revenues or results of operations. In particular, approximately half of the revenues we currently recognize each quarter has been attributable to sales made in that same quarter with the balance of the revenues being attributable to sales made in prior quarters in which the related revenues were not recognized upfront. As a result, our ability to forecast revenues on a quarterly or longer-term basis is extremely limited. We base our current and future expense levels on our operating plans and sales forecasts, and our operating costs are expected to be relatively fixed in the short-term. As a result, we may not be able to reduce our costs sufficiently to compensate for an unexpected shortfall in revenues, and even a small shortfall in revenues could disproportionately and adversely affect our financial results for that quarter.

In addition to other risk factors described elsewhere in this “Risk Factors” section, factors that may cause our financial results to fluctuate from quarter to quarter include:

- the timing of our sales during the quarter, particularly because a large portion of our sales occur toward the end of the quarter, or the loss or delay of a few large contracts;
- the mix of revenues attributable to larger transactions as opposed to smaller transactions and the impact that a change in mix may have on the overall average selling price of our products;
- the mix of revenues attributable to perpetual and term licenses, subscriptions, maintenance and professional services and training, which may impact our gross margins and operating income;
- the renewal and usage rates of our customers;
- changes in the competitive dynamics of our market;
- changes in customers' budgets and in the timing of their purchasing decisions;
- customers delaying purchasing decisions in anticipation of new products or software enhancements by us or our competitors;
- customer acceptance of and willingness to pay for new versions of our products or new solutions for specific product and end markets;
- our ability to successfully introduce and monetize new products and licensing and service models for our new products, such as Hunk: Splunk Analytics for Hadoop and NoSQL Data Stores ("Hunk"), Splunk Cloud and Splunk MINT Express;
- our ability to control costs, including our operating expenses;
- the timing of satisfying revenue recognition criteria;
- our ability to qualify and compete for government contracts;
- the collectability of receivables from customers and resellers, which may be hindered or delayed; and
- general economic conditions, both domestically and internationally, as well as economic conditions specifically affecting industries in which our customers participate.

Many of these factors are outside our control, and the variability and unpredictability of such factors could result in our failing to meet or exceed our financial expectations for a given period. We believe that quarter-to-quarter comparisons of our revenues, operating results and cash flows may not necessarily be indicative of our future performance.

We have a short operating history, which makes it difficult to evaluate our future prospects and may increase the risk that we will not be successful.

We have a short operating history, which limits our ability to forecast our future operating results and subjects us to a number of uncertainties, including our ability to plan for and model future growth. We have encountered and will continue to encounter risks and uncertainties frequently experienced by growing companies in developing industries.

If our assumptions regarding these uncertainties, which we use to plan our business, are incorrect or change in reaction to changes in our markets, or if we do not address these risks successfully, our operating and financial results could differ materially from our expectations and our business could suffer. Moreover, although we have experienced rapid growth historically, we may not continue to grow as rapidly in the future. Any success that we may experience in the future will depend in large part on our ability to, among other things:

- improve the performance and capabilities of our products and technology through research and development;
- continue to develop and expand adoption of our cloud-based services, including Splunk Cloud;
- successfully develop, introduce and expand adoption of new products, such as Hunk;
- increase revenues from existing customers through increased or broader use of our products within their organizations;

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- successfully expand our business domestically and internationally;
- maintain and expand our customer base and the ways in which our customers use our products;
- successfully compete with other companies, open source projects and custom development efforts that are currently in, or may in the future enter, the markets for our products;
- successfully provide our customers a compelling business case to purchase our products in a time frame that matches our and our customers’ sales and purchase cycles and at a compelling price point;
- respond timely and effectively to competitor offerings and pricing models;
- generate leads and convert users of the trial versions of our products to paying customers;
- prevent users from circumventing the terms of their licenses and subscriptions;
- continue to invest in our application development platform to deliver additional content for our platform products and to foster an ecosystem of developers and users to expand the use cases of our products;
- maintain and enhance our website and cloud services infrastructure to minimize interruptions when accessing our software or cloud services;
- process, store and use our customers’ data in compliance with applicable governmental regulations and other legal obligations related to data privacy and security; and
- hire, integrate and retain world-class professional and technical talent.

If we fail to address the risks and difficulties we face, including those described elsewhere in this “Risk Factors” section, our business will be adversely affected and our business operations and financial results will suffer.

If we fail to effectively manage our growth, our business and operating results could be adversely affected.

Although our business has experienced significant growth, we cannot provide any assurance that our business will continue to grow at the same rate or at all. We have experienced and may continue to experience rapid growth in our headcount and operations, which has placed and will continue to place significant demands on our management and our operational and financial infrastructure. As of October 31, 2014, approximately 36% of our employees had been with us for less than one year. As we continue to grow, we must effectively integrate, develop and motivate a large number of new employees, while maintaining the effectiveness of our business execution and the beneficial aspects of our corporate culture. In particular, we intend to continue to make directed and substantial investments to expand our research and development, sales and marketing, and general and administrative organizations, as well as our international operations.

To effectively manage growth, we must continue to improve our operational, financial and management controls, and our reporting systems and procedures by, among other things:

- improving our key business applications, processes and IT infrastructure to support our business needs;
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enhancing information and communication systems to ensure that our employees and offices around the world are well-coordinated and can effectively communicate with each other and our growing base of customers and channel partners;

- enhancing our internal controls to ensure timely and accurate reporting of all of our operations and financial results; and
- appropriately documenting our IT systems and our business processes.

These systems enhancements and improvements will require significant capital expenditures and allocation of valuable management and employee resources. If we fail to implement these improvements effectively, our ability to manage our expected growth, ensure uninterrupted operation of key business systems and comply with the rules and regulations that are

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applicable to public reporting companies will be impaired. Additionally, if we do not effectively manage the growth of our business and operations, the quality of our products could suffer, which could negatively affect our brand, financial results and overall business.

We face intense competition in our markets, and we may be unable to compete effectively for sales opportunities.

Although our products target the new and emerging market for software and cloud services that provide operational intelligence, we compete against a variety of large software vendors and smaller specialized companies, open source projects and custom development efforts, which provide solutions in the specific markets we address. Our principal competitors include:

- IT departments of potential customers which have undertaken custom software development efforts to analyze and manage their machine data;
- security, systems management and other IT vendors, including BMC Software, CA Technologies, Compuware, HP, IBM, Intel, Microsoft, TIBCO and VMware;
- web analytics vendors, including Adobe Systems, Google, IBM and Webtrends;
- business intelligence vendors, including IBM, Oracle and SAP;
- companies targeting the big data market by commercializing open source software, such as the various Hadoop distributions and NoSQL data stores; and
- small-specialized vendors, which provide complementary and competitive solutions in enterprise data analytics, data warehousing and big data technologies that may compete with our products.

The principal competitive factors in our markets include product features, performance and support, product scalability and flexibility, ease of deployment and use, total cost of ownership and time to value. Some of our actual and potential competitors have advantages over us, such as longer operating histories, significantly greater financial, technical, marketing or other resources, stronger brand and business user recognition, larger intellectual property portfolios and broader global distribution and presence. Further, competitors may be able to offer products or functionality similar to ours at a more attractive price than we can, such as by integrating or bundling their software products with their other product offerings. In addition, our industry is evolving rapidly and is becoming increasingly competitive. Larger and more established companies may focus on operational intelligence and could directly compete with us. For example, companies may commercialize open source software, such as Hadoop, in a manner that competes with our products or causes potential customers to believe that such product and our products perform the same function. If companies move a greater proportion of their data and computational needs to the cloud, new competitors may emerge that offer services comparable to ours or that are better suited for cloud-based data, and the demand for our products may decrease. Smaller companies could also launch new products and services that we do not offer and that could gain market acceptance quickly.

In recent years, there have been significant acquisitions and consolidation by and among our actual and potential competitors. We anticipate this trend of consolidation will continue, which will present heightened competitive challenges to our business. In particular, consolidation in our industry increases the likelihood of our competitors offering bundled or integrated products, and we believe that it may increase the competitive pressures we face with respect to our products. If we are unable to differentiate our products from the integrated or bundled products of our competitors, such as by offering enhanced functionality, performance or value, we may see decreased demand for those products, which would adversely affect our business operations, financial results and growth prospects. Further, it is possible that continued industry consolidation may impact customers' perceptions of the viability of smaller or even medium-sized software firms and consequently their willingness to use software solutions from such firms. Similarly, if customers seek to concentrate their software license purchases in the product portfolios of a few large providers, we may be at a competitive disadvantage regardless of the performance and features of our products. We believe that in order to remain competitive at the large enterprise level, we will need to develop and expand relationships with resellers and large system integrators that provide a broad range of products and services. If we are unable to compete effectively, our business operations and financial results could be materially and adversely affected.

Because we derive substantially all of our revenues and cash flows from sales of licenses of one software product, failure of this product to satisfy customer demands or to achieve increased market acceptance would adversely affect our business, results of operations, financial condition and growth prospects.

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Although we have recently introduced several new product offerings, we derive and expect to continue to derive substantially all of our revenues and cash flows from sales of licenses and maintenance of our Splunk Enterprise product. As such, the market acceptance of Splunk Enterprise is critical to our continued success. Demand for licenses to Splunk Enterprise is affected by a number of factors beyond our control, including continued market acceptance of Splunk Enterprise by referenceable accounts for existing and new use cases, the timing of development and release of new products by our competitors, technological change, and growth or contraction in our market. In addition, users of software that provides operational intelligence may seek a cloud-based service, and only recently we began to offer a cloud service with the features and functionality of our Splunk Enterprise software. Our cloud-based services currently represent a de minimis percentage of our overall revenues. We expect the proliferation of machine data to lead to an increase in the data analysis demands of our customers, and our products may not be able to scale and perform to meet those demands or may not be chosen by users for those needs. If we are unable to continue to meet customer demands or to achieve more widespread market acceptance of Splunk Enterprise, our business operations, financial results and growth prospects will be materially and adversely affected.

We have a history of losses, and we may not be profitable in the future.

We have incurred net losses in each year since our inception. As a result, we had an accumulated deficit of $329.8 million at October 31, 2014. Because the market for our products is rapidly evolving and has not yet reached widespread adoption, it is difficult for us to predict our future operating results. We expect our operating expenses to increase over the next several years as we hire additional personnel, expand and improve the effectiveness of our distribution channels, and continue to develop features and functionality for our products. In addition, as we grow as a public company, we have incurred and will continue to incur significant legal, accounting and other operating expenses, including compliance with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act. If our revenues do not increase to offset these increases in our operating expenses, we may not be profitable in future periods. Our historical revenue growth has been inconsistent and should not be considered indicative of our future performance. Further, in future periods, our revenue growth could slow or our revenues could decline for a number of reasons, including slowing demand for our products, increasing competition, a decrease in the growth of our overall market, or our failure, for any reason, to continue to capitalize on growth opportunities. Any failure by us to achieve, sustain or increase profitability on a consistent basis could cause the value of our common stock to decline.

If customers do not expand their use of our products beyond the current predominant use cases, or if they react adversely to our pricing models as the amount of their indexed data grows, our ability to grow our business and operating results may be adversely affected.

Most of our customers currently use our products to support application management, IT operations, security and compliance functions. Our ability to grow our business depends in part on our ability to persuade current and future customers to expand their use of our products to additional use cases, such as facilities management, supply chain management, business analytics and customer usage analytics. If we fail to achieve market acceptance of our products for these applications, or if a competitor establishes a more widely adopted solution for these applications, our ability to grow our business and financial results will be adversely affected. In addition, as the amount of data indexed or Hadoop data nodes covered by our products for a given customer grows, that customer must agree to higher license fees for our products or limit the amount of data indexed in order to stay within the limits of its existing license. If their fees grow significantly, customers may react adversely to this pricing model, particularly if they perceive that the value of our products has become eclipsed by such fees or otherwise. If customers react adversely to our pricing models, our ability to grow our business and operating results could be adversely affected.

If we do not effectively expand and train our sales force, we may be unable to add new customers or increase sales to our existing customers and our business will be adversely affected.

We continue to be substantially dependent on our sales force to obtain new customers and to drive additional use cases and adoption among our existing customers. We believe that there is significant competition for sales personnel with the skills and technical knowledge that we require. Our ability to achieve significant revenue growth will depend, in large part, on our success in recruiting, training and retaining sufficient numbers of sales personnel to support our growth. New hires require significant training and may take significant time before they achieve full productivity. Our recent hires and planned hires may not become productive as quickly as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals in the markets where we do business or plan to do business. In addition, as we continue to grow rapidly, a large percentage of our sales force is new to the company and our products. Our growth creates additional challenges and risks with respect to attracting, integrating and retaining qualified employees, particularly sales personnel. If we are unable to hire and train sufficient numbers of effective sales personnel, or the sales personnel are not successful in obtaining new customers or increasing sales to our existing customer base, our business will be adversely affected.

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Our sales cycle is long and unpredictable, particularly with respect to large customers, and our sales efforts require considerable time and expense.

Our operating results may fluctuate, in part, because of the resource intensive nature of our sales efforts, the length and variability of the sales cycle of our software licensing offerings and the short-term difficulty in adjusting our operating expenses. Our operating results depend in part on sales to large customers and conversions of users of the trial versions of our products into paying customers. The length of our sales cycle, from initial evaluation to delivery of and payment for the software license, varies substantially from customer to customer. In addition, the introduction of our cloud-based service Splunk Cloud has generated interest from our customers who are also considering purchasing and deploying Splunk Enterprise, our on-premise solution. In some cases, our customers may wish to consider a combination of these products, potentially further slowing our sales cycle. Our sales cycle can extend to more than a year for certain customers, particularly large customers. It is difficult to predict exactly when, or even if, we will make a sale with a potential customer or if a user of a trial version of one of our products will upgrade to the paid version of that product. As a result, large individual sales have, in some cases, occurred in quarters subsequent to those we anticipated, or have not occurred at all. The loss or delay of one or more large transactions in a quarter could impact our operating results for that quarter and any future quarters for which revenue from that transaction is delayed. As a result of these factors, it is difficult for us to forecast our revenues accurately in any quarter. Because a substantial portion of our expenses are relatively fixed in the short-term, our operating results will suffer if revenues fall below our expectations in a particular quarter, which could cause the price of our common stock to decline.

Our business and growth depend substantially on customers renewing their term licenses and maintenance agreements with us. Any decline in our customer renewals could adversely affect our future operating results.

While much of our software is sold under perpetual license agreements, all of our maintenance and support agreements are sold on a term basis. In addition, we also enter into term license agreements for our software and cloud services. In order for us to improve our operating results, it is important that our existing customers renew their term licenses, if applicable, and maintenance and support agreements when the initial contract term expires. Our customers have no obligation to renew their term licenses or maintenance and support contracts with us after the initial terms have expired. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our software, our cloud services, our pricing, the effects of economic conditions, competitive offerings or alterations or reductions in our customers' spending levels. If our customers do not renew their agreements with us or renew on terms less favorable to us, our revenues may decline.

Our international sales and operations subject us to additional risks that can adversely affect our business operations and financial results.

During the three and nine months ended October 31, 2014, we derived approximately 21% and 24% of our total revenues from customers outside the United States, respectively, and we are continuing to expand our international operations as part of our growth strategy. We currently have sales personnel and sales and support operations in the United States and certain countries around the world. However, our sales organization outside the United States is substantially smaller than our sales organization in the United States, and we rely heavily on our sales channel for non-U.S. sales. Our ability to convince customers to expand their use of our products or renew their maintenance agreements with us is directly correlated to our direct engagement with the customer. To the extent we are unable to engage with non-U.S. customers effectively with our limited sales force capacity or our indirect sales model, we may be unable to grow sales to existing customers to the same degree we have experienced in the United States.

Our international operations subject us to a variety of risks and challenges, including:

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increased management, travel, infrastructure and legal compliance costs associated with having multiple international operations;

- reliance on channel partners;
- longer payment cycles and difficulties in collecting accounts receivable or satisfying revenue recognition criteria, especially in emerging markets;
- increased financial accounting and reporting burdens and complexities;
- general economic conditions in each country or region;

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- economic and political uncertainty around the world;
- compliance with multiple and changing foreign laws and regulations, including those governing employment, tax, privacy and data protection, and the risks and costs of non-compliance with such laws and regulations;
- compliance with laws and regulations for foreign operations, including the United States Foreign Corrupt Practices Act, the United Kingdom Bribery Act, import and export control laws, tariffs, trade barriers, economic sanctions and other regulatory or contractual limitations on our ability to sell our products in certain foreign markets, and the risks and costs of non-compliance;
- heightened risks of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of financial statements and irregularities in financial statements;
- fluctuations in currency exchange rates and the related effect on our financial results;
- difficulties in repatriating or transferring funds from or converting currencies in certain countries;
- the need for localized software and licensing programs;
- reduced protection for intellectual property rights in some countries and practical difficulties of enforcing intellectual property and contract rights abroad; and
- compliance with the laws of numerous foreign taxing jurisdictions and overlapping of different tax regimes.

Any of these risks could adversely affect our international operations, reduce our international revenues or increase our operating costs, adversely affecting our business operations, financial results and growth prospects.

In addition, compliance with laws and regulations applicable to our international operations increases our cost of doing business in foreign jurisdictions. We may be unable to keep current with changes in foreign government requirements and laws as they change from time to time. Failure to comply with these regulations could have adverse effects on our business. In many foreign countries it is common for others to engage in business practices that are prohibited by our internal policies and procedures or United States regulations applicable to us. In addition, although we have implemented policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors, channel partners and agents will comply with these laws and policies. Violations of laws or key control policies by our employees, contractors, channel partners or agents could result in delays in revenue recognition, financial reporting misstatements, fines, penalties, or the prohibition of the importation or exportation of our products and cloud services and could have a material adverse effect on our business operations and financial results.

If we are unable to maintain successful relationships with our channel partners, our business operations, financial results and growth prospects could be adversely affected.

In addition to our direct sales force, we use indirect channel partners, such as distributors and resellers, to license and support our products. We derive a portion of our revenues from sales of our products through our channel partners, particularly in the Europe, Middle East and Africa, or EMEA, and Asia Pacific, or APAC, regions and for sales to government agencies. We expect that sales through channel partners in all regions will continue to grow as a portion of our revenues for the foreseeable future.

Our agreements with our channel partners are generally non-exclusive, meaning our channel partners may offer customers the products of several different companies, including products that compete with ours. If our channel partners do not effectively market and sell our products, choose to use greater efforts to market and sell their own products or those of our competitors, or fail to meet the needs of our customers, our ability to grow our business and sell our products may be adversely affected. Our channel partners may cease marketing our products with limited or no notice and with little or no penalty. The loss of a substantial number of our channel partners, our possible inability to replace them, or the failure to recruit additional channel partners could materially and adversely affect our results of operations. In addition, sales by channel partners are more likely than direct sales to involve collectability concerns, in particular sales by our channel partners in developing markets, and accordingly, variations in the mix between revenues attributable to sales by channel partners and revenues attributable to direct sales may result in fluctuations in our operating results.

Our ability to achieve revenue growth in the future will depend in part on our success in maintaining successful relationships with our channel partners, and to help our channel partners enhance their ability to independently sell and deploy our products. If we are unable to maintain our relationships with these channel partners, or otherwise develop and expand our indirect distribution channel, our business, results of operations, financial condition or cash flows could be adversely affected.

We employ unique pricing models, which subject us to various pricing and licensing challenges that could make it difficult for us to derive value from our customers.

We employ unique and evolving pricing models for our products. For example, we generally charge our customers for their use of our Splunk Enterprise software based on their estimated peak daily indexing capacity. In addition, our Splunk Cloud service is generally priced based on peak daily indexing capacity and length of data retention, and our Hunk software is priced based on the number of Hadoop data nodes. Our pricing methods may ultimately result in a higher total cost to our customers generally as data volumes increase over time, making it more difficult for us to compete in our markets. As the amount of machine data within our customers' organizations grows, we may face downward pressure from our customers regarding our pricing, which could adversely affect our revenues and operating margins. In addition, our unique pricing models may allow competitors with different pricing models to attract customers unfamiliar or uncomfortable with our pricing models, which would cause us to lose business or modify our pricing models, both of which could adversely affect our revenues and operating margins.

Furthermore, while our products can measure and limit customer usage, such limitations may be improperly circumvented or otherwise bypassed by certain users. Similarly, we provide our customers with an encrypted key for enabling their use of our products. There is no guarantee that users of our products will abide by the terms of these encrypted keys, and if they do not, we may not be able to capture the full value for the use of our products. For example, our enterprise license is generally meant for our customers' internal use only. If our internal use customers improperly make our products available to their customers, for example, through a cloud or managed service offering, it may displace our end user sales or commoditize our products in the market. Additionally, if an internal use customer that has received a volume discount from us improperly makes available our products to its end customers, we may experience price erosion and be unable to capture the appropriate value from those end customers.

We recently increased the license capacity of our entry-level licenses for Splunk Enterprise. Although we believe that this price reduction will enable our customers to more rapidly increase their ability to adopt Splunk Enterprise, there is no guarantee this will occur. It is possible that such price reduction will not be offset by an increase in sales of additional license capacity, which would have the effect of lowering our revenue and negatively impacting our financial results.

Our license agreements generally provide that we can audit our customers' use of our products to ensure compliance with the terms of our license agreement. However, a customer may resist or refuse to allow us to audit their usage, in which case we may have to pursue legal recourse to enforce our rights under the license agreement, which would require us to spend money, distract management and potentially adversely affect our relationship with our customers and users.

Incorrect or improper implementation or use of our software could result in customer dissatisfaction and negatively affect our business, operations, financial results and growth prospects.

Our software is deployed in a wide variety of technology environments. Increasingly, our software has been deployed in large scale, complex technology environments, and we believe our future success will depend on our ability to increase sales of our software licenses for use in such deployments. We often must assist our customers in achieving successful implementations for large, complex deployments. If we or our customers are unable to implement our software successfully, or are unable to do so in a timely manner, customer perceptions of our company may be impaired, our reputation and brand may suffer, and customers may choose not to increase their use of our products. In addition, our software imposes server load and index storage requirements for implementation. If our customers do not have the server load capacity or the storage capacity required, they may not be able to effectively implement and use our software and, therefore, may not choose to increase their use of our products.

Our customers and third-party partners may need training in the proper use of and the variety of benefits that can be derived from our software to maximize its potential. If our software is not implemented or used correctly or as intended, inadequate performance may result. Because our customers rely on our software and maintenance and support services to manage a wide range of operations, the incorrect or improper implementation or use of our software, our failure to train customers on how to efficiently and effectively use our software, or our failure to provide maintenance services to our customers, may result in negative publicity or legal claims against us. Also, as we continue to expand our customer base, any failure by us to properly provide these services will likely result in lost opportunities for follow-on sales of our software and services.

Interruptions or performance problems associated with our technology and infrastructure, and our reliance on Software-as-a-Service, or SaaS, technologies from third parties, may adversely affect our business operations and financial results.

Our continued growth depends in part on the ability of our existing and potential customers to access our cloud services or our website in order to download our on-premise software or encrypted access keys for our software within an acceptable amount of time. We have experienced, and may in the future experience, website and service disruptions, outages and other performance problems due to a variety of factors, including infrastructure changes, human or software errors, capacity constraints due to an overwhelming number of users accessing our website and services simultaneously and denial of service or fraud or security attacks. In some instances, we may not be able to identify the cause or causes of these website and service performance problems within an acceptable period of time. It may become increasingly difficult to maintain and improve our website and service performance, especially during peak usage times and as our products become more complex and our user traffic increases. If our website or services are unavailable or if our users are unable to download our software or encrypted access keys within a reasonable amount of time or at all, our business would be negatively affected. We expect to continue to make significant investments to maintain and improve website and service performance and to enable rapid releases of new features and apps for our software and cloud services. To the extent that we do not effectively address capacity constraints, upgrade our systems as needed and continually develop our technology and network architecture to accommodate actual and anticipated changes in technology, our business and operating results may be adversely affected.

In addition, we rely heavily on hosted SaaS technologies from third parties in order to operate critical functions of our business, including enterprise resource planning services and customer relationship management services. Further, our cloud-based services, such as Splunk Cloud, are hosted exclusively by third parties. If any of these services fail or become unavailable due to extended outages, interruptions or because they are no longer available on commercially reasonable terms or prices, our revenue could be reduced, our reputation could be damaged, we could be exposed to legal liability, expenses could increase, our ability to manage our finances could be interrupted and our processes for managing sales of our products and supporting our customers could be impaired until equivalent services, if available, are identified, obtained and implemented, all of which could adversely affect our business.

Our systems and third-party systems upon which we rely are also vulnerable to damage or interruption from catastrophic occurrences such as earthquakes, floods, fires, power loss, telecommunication failures, terrorist attacks, geopolitical events and similar events. Our United States corporate offices and certain of the facilities we lease to house our computer and telecommunications equipment are located in the San Francisco Bay Area, a region known for seismic activity. Despite any precautions we may take, the occurrence of a natural disaster or other unanticipated problems at our and third parties' hosting facilities could result in interruptions, performance problems or failure of our infrastructure.

We are subject to governmental export and import controls that could impair our ability to compete in international markets or subject us to liability if we violate the controls.

Our products are subject to United States export controls, and we incorporate encryption technology into certain of our products. These encryption products and the underlying technology may be exported outside of the United States only with the required export authorizations, including by license, a license exception or other appropriate government authorizations, including the filing of an encryption registration. We shipped our encryption products prior to obtaining the required export authorizations. Accordingly, we have not fully complied with applicable encryption controls in the Export Administration Regulations. We have taken a number of actions to prevent such violations from recurring and continue to review and make enhancements to our export compliance procedures that are designed to further strengthen compliance with the laws.

Furthermore, our products are subject to United States export controls that prohibit the shipment of certain products and services without the required export authorizations or export to countries, governments, and persons targeted by United States sanctions. While we take precautions to prevent our products and services from being exported in violation of these laws, including implementing IP address blocking and screenings against U.S. Government and international lists of restricted and prohibited persons, we cannot guarantee that the precautions we take will prevent violations of export control and sanctions laws. For example, in certain instances, we shipped our encryption products prior to obtaining the required export authorizations and certain of our products that are available at no cost have been downloaded by persons in countries that are the subject of United States embargoes. These exports were likely made in violation of United States export control and sanction laws. In March 2012, we filed Final Voluntary Self Disclosures with the U.S. Department of Commerce’s Bureau of Industry and Security (“BIS”), and the U.S. Department of Treasury’s Office of Foreign Assets Control (“OFAC”), concerning these potential violations. On July 3, 2012, OFAC notified us that it had completed its review of these matters and closed its review with the issuance of a Cautionary Letter, and on November 15, 2012, BIS notified us that it had completed its review of these matters and closed its review with the issuance of a Warning Letter. No monetary penalties were assessed against us by either OFAC or BIS with respect to the 2012 filings. In addition, we filed an Initial Voluntary Self Disclosure in October 2014 with BIS and OFAC. We are currently in the process of preparing the Final Voluntary Disclosure for submission to BIS and OFAC.

Based upon our internal review, we believe that we have not had any paying customers in countries sanctioned by the United States Government, and have instituted procedures, including IP blocking, that are intended to prevent any downloads from being made into sanctioned countries in the future. In addition, we have implemented screening of our customers against the United States Government and international lists of prohibited persons, including the Treasury Department's List of Specially Designated Nationals and the Commerce Department's List of Denied Persons. Based upon our internal review, we believe that we do not have any paying or non-paying customers on any United States Government lists of prohibited persons. We have instituted a process for screening all paying and non-paying customers against United States Government lists of prohibited persons going forward.

In the future, if we are found to be in violation of United States sanctions or export control laws, it could result in fines or penalties for us and for individuals, including civil penalties of up to $250,000 or twice the value of the transaction, whichever is greater, per violation, and in the event of conviction for a criminal violation, fines of up to $1 million and possible incarceration for responsible employees and managers for willful and knowing violations.

We also note that if our channel partners fail to obtain appropriate import, export or re-export licenses or permits, we may also be adversely affected, through reputational harm as well as other negative consequences including government investigations and penalties. We presently incorporate export control compliance requirements in our channel partner agreements. Complying with export control and sanctions regulations for a particular sale may be time-consuming and may result in the delay or loss of sales opportunities.

In addition, various countries regulate the import and export of certain encryption and other technology, including import and export permitting and licensing requirements, and have enacted laws that could limit our ability to distribute our products or could limit our customers' ability to implement our products in those countries. Changes in our products or future changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products globally or, in some cases, prevent the export or import of our products to certain countries, governments, or persons altogether. Any change in export or import regulations, economic sanctions or related legislation, or change in the countries, governments, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business operations and financial results.

If our new products and product enhancements do not achieve sufficient market acceptance, our financial results and competitive position will suffer.

We spend substantial amounts of time and money to research and develop new product offerings and enhanced versions of our existing products to incorporate additional features, improve functionality or other enhancements in order to meet our customers' rapidly evolving demands. In addition, we continue to invest in solutions that can be deployed on top of our core platform to target specific use cases and to cultivate our community of application developers and users. When we develop a new or enhanced version of an existing product, we typically incur expenses and expend resources upfront to market, promote and sell the new offering. Therefore, when we develop and introduce new or enhanced products, they must achieve high levels of market acceptance in order to justify the amount of our investment in developing and bringing them to market. For example, if our cloud-based services such as Splunk Cloud do not garner widespread market adoption and implementation, our financial results and competitive position could suffer.

Further, we may make changes to our products that our customers do not like, find useful or agree with. We may also discontinue certain features, begin to charge for certain features that are currently free or increase fees for any of our features or usage of our products.

Our new products or product enhancements and changes to our existing products could fail to attain sufficient market acceptance for many reasons, including:

- our failure to predict market demand accurately in terms of product functionality and to supply products that meet this demand in a timely fashion;

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- defects, errors or failures;
- negative publicity about their performance or effectiveness;
- delays in releasing to the market our new products or enhancements to our existing products to the market;
- introduction or anticipated introduction of competing products by our competitors;
- poor business conditions for our end-customers, causing them to delay IT purchases; and
- reluctance of customers to purchase products incorporating open source software.

If our new products or enhancements and changes do not achieve adequate acceptance in the market, our competitive position will be impaired, and our revenues will be diminished. The adverse effect on our financial results may be particularly acute because of the significant research, development, marketing, sales and other expenses we will have incurred in connection with the new products or enhancements.

Our business depends, in part, on sales to the public sector, and significant changes in the contracting or fiscal policies of the public sector could have a material adverse effect on our business.

We derive a portion of our revenues from contracts with federal, state, local and foreign governments, and we believe that the success and growth of our business will continue to depend on our successful procurement of government contracts. Factors that could impede our ability to maintain or increase the amount of revenues derived from government contracts, include:

- changes in fiscal or contracting policies;
- decreases in available government funding;
- changes in government programs or applicable requirements;
- the adoption of new laws or regulations or changes to existing laws or regulations;
- potential delays or changes in the government appropriations or other funding authorization processes; and
- delays in the payment of our invoices by government payment offices.

The occurrence of any of the foregoing could cause governments and governmental agencies to delay or refrain from purchasing licenses of our products in the future or otherwise have an adverse effect on our business operations and financial results.

Failure to comply with laws or regulations applicable to our business could cause us to lose customers in the public sector or negatively impact our ability to contract with the public sector.

We must comply with laws and regulations relating to the formation, administration and performance of contracts with the public sector, including United States federal, state and local governmental bodies, which affect how our channel partners and we do business with governmental agencies. These laws and regulations may impose added costs on our business, and failure to comply with these or other applicable regulations and requirements, including non-compliance in the past, could lead to claims for damages from our channel partners, penalties, termination of contracts, loss of exclusive rights in our intellectual property, and temporary suspension or permanent debarment from government contracting. Any such damages, penalties, disruptions or limitations in our ability to do business with the public sector could have a material adverse effect on our business operations and financial results.

The SaaS version of our Splunk Enterprise product, Splunk Cloud, is a nascent product offering, and a lack of market adoption of this SaaS offering could adversely affect our business.

SaaS is a model of software deployment in which a software provider typically licenses an application to customers for use as a service on demand through web browser technologies. In October 2013, we released Splunk Cloud, our cloud-based service that provides a fully functional version of Splunk Enterprise. In recent years, companies have begun to expect that key software, such as customer relationship management and enterprise resource planning systems, be provided through a SaaS model. In order to provide Splunk Cloud via a SaaS deployment, we have made and will continue to make capital investments to implement this alternative business model, which could negatively affect our financial results. Even with these investments, the SaaS business model for Splunk Cloud may not be successful. Moreover, sales of Splunk Cloud could displace sales of our Splunk Enterprise software licenses. In addition, the change to a SaaS model results in changes in the manner in which we recognize revenues. Changes in revenue recognition would affect our operating results and could have an adverse effect on our business operations and financial results.

Real or perceived errors, failures or bugs in our products could adversely affect our financial results and growth prospects.

Because our products are complex, undetected errors, failures or bugs may occur, especially when new products, versions or updates are released. Our on-premise software is often installed and used in large-scale computing environments with different operating systems, system management software, and equipment and networking configurations, which may cause errors or failures of our software or other aspects of the computing environment into which it is deployed. In addition, deployment of our software into complicated, large-scale computing environments may expose undetected errors, failures or bugs in our software. Despite testing by us, errors, failures or bugs may not be found in our products until they are released to our customers. In the past, we have discovered errors, failures and bugs in some of our offerings after their introduction. Real or perceived errors, failures or bugs in our products could result in negative publicity, loss of or delay in market acceptance of our products, loss of competitive position or claims by customers for losses sustained by them. In such an event, we may be required, or may choose, for customer relations or other reasons, to expend additional resources in order to help correct the problem.

In addition, if an actual or perceived failure of our on-premise software occurs in a customer’s deployment, regardless of whether the failure is attributable to our software, the market perception of the effectiveness of our products could be adversely affected. Alleviating any of these problems could require significant expenditures of our capital and other resources and could cause interruptions, delays or cessation of our licensing, which could cause us to lose existing or potential customers and could adversely affect our financial results and growth prospects.

Failure to protect our intellectual property rights could adversely affect our business.

Our success depends, in part, on our ability to protect proprietary methods and technologies that we develop under patent and other intellectual property laws of the United States and other jurisdictions outside of the United States so that we can prevent others from using our inventions and proprietary information. If we fail to protect our intellectual property rights adequately, our competitors might gain access to our technology, and our business might be adversely affected. However, defending our intellectual property rights might entail significant expenses. Any of our patent rights, copyrights, trademarks or other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. Our issued patents and any patents issued in the future may not provide us with any competitive advantages, and our patent applications may never be granted. Additionally, the process of obtaining patent protection is expensive and time-consuming, and we may not be able to file and prosecute all necessary or desirable patent applications, or we may not be able to do so at a reasonable cost or in a timely manner. Even if issued, there can be no assurance that these patents will adequately protect our intellectual property, as the legal standards relating to the infringement, validity, enforceability and scope of protection of patent and other intellectual property rights are complex and often uncertain.

Any patents that are issued may subsequently be invalidated or otherwise limited, allowing other companies to develop offerings that compete with ours, which could adversely affect our competitive business position, business prospects and financial condition. In addition, issuance of a patent does not guarantee that we have a right to practice the patented invention. Patent applications in the United States are typically not published until 18 months after filing or, in some cases, not at all, and publications of discoveries in industry-related literature lag behind actual discoveries. We cannot be certain that we were the first to use the inventions claimed in our issued patents or pending patent applications or otherwise used in our products, that we were the first to file patent applications, or that third parties do not have blocking patents that could be used to prevent us from marketing or practicing our products or technology. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our products are available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the United States (in particular, some foreign jurisdictions do not permit patent protection for software), and mechanisms for enforcement of intellectual property rights may be inadequate. Additional uncertainty may result from recent and future changes to intellectual property legislation in the United States (including the “America Invents Act”) and other countries and from interpretations of the intellectual property laws of the United States and other countries by applicable courts and agencies. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property.

We rely in part on trade secrets, proprietary know-how and other confidential information to maintain our competitive position. We generally enter into confidentiality agreements with our employees, consultants, vendors and customers, and generally limit access to and distribution of our proprietary information. Although we endeavor to enter into non-disclosure agreements with our employees, licensees and others who may have access to this information, we cannot assure you that these agreements or other steps we have taken will prevent unauthorized use, disclosure or reverse engineering of our technology. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an extent as the laws of the United States, and many foreign countries do not enforce these laws as diligently as government agencies and private parties in the United States. Moreover, third parties may independently develop technologies or products that compete with ours, and we may be unable to prevent this competition.

We might be required to spend significant resources to monitor and protect our intellectual property rights. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Litigation also puts our patents at risk of being invalidated or interpreted narrowly. Additionally, we may provoke third parties to assert counterclaims against us. We may not prevail in any lawsuits that we initiate, and the damages or other remedies awarded, if any, may not be adequate to compensate us for the harm suffered. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel, which may adversely affect our business operations or financial results.

We have been, and may in the future be, subject to intellectual property rights claims by third parties, which are extremely costly to defend, could require us to pay significant damages and could limit our ability to use certain technologies.

Companies in the software and technology industries, including some of our current and potential competitors, own large numbers of patents, copyrights, trademarks and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. In addition, many of these companies have the capability to dedicate substantially greater resources to enforce their intellectual property rights and to defend claims that may be brought against them. The litigation may involve patent holding companies or other adverse patent owners that have no relevant product revenues and against which our patents may therefore provide little or no deterrence. From time-to-time, third parties, including certain of these leading companies, have asserted and may assert patent, copyright, trademark or other intellectual property rights against us, our channel partners, our technology partners or our customers. We have received, and may in the future receive, notices that claim we have misappropriated, misused, or infringed other parties' intellectual property rights, and, to the extent we gain greater market visibility, we face a higher risk of being the subject of intellectual property infringement claims, which is not uncommon with respect to the enterprise software market.

There may be third-party intellectual property rights, including issued or pending patents, that cover significant aspects of our technologies or business methods.   We may be exposed to increased risk of being the subject of intellectual property infringement claims as a result of acquisitions, as, among other things, we have a lower level of visibility into the development process with respect to such technology or the care taken to safeguard against infringement risks. Any intellectual property claims, with or without merit, could be very time-consuming, could be expensive to settle or litigate and could divert our management's attention and other resources. These claims could also subject us to significant liability for damages, potentially including treble damages if we are found to have willfully infringed patents or copyrights. These claims could also result in our having to stop using technology found to be in violation of a third party's rights. We might be required to seek a license for the intellectual property, which may not be available on reasonable terms or at all. Even if a license were available, we could be required to pay significant royalties, which would increase our operating expenses. As a result, we may be required to develop alternative non-infringing technology, which could require significant effort and expense. If we cannot license or develop technology for any infringing aspect of our business, we would be forced to limit or stop sales of our products and may be unable to compete effectively. Any of these results would adversely affect our business operations and financial results.

One of our marketing strategies is to offer trial versions of our products, and we may not be able to realize the benefits of this strategy.

We offer trial version licenses of certain of our products to users free of charge as part of our overall strategy of developing the market for products that provides operational intelligence and promoting additional penetration of our products in the markets in which we compete. Some users never convert from the trial version license to the paid version license. To the extent that these users do not become paying customers, we will not realize the intended benefits of this marketing strategy and our ability to grow our revenues will be adversely affected.

If we are not able to maintain and enhance our brand, our business and operating results may be adversely affected.

We believe that maintaining and enhancing the "Splunk" brand identity is critical to our relationships with our customers and channel partners and to our ability to attract new customers and channel partners. The successful promotion of our brand will depend largely upon our marketing efforts, our ability to continue to offer high-quality products and our ability to successfully differentiate our products from those of our competitors. Our brand promotion activities may not be successful or yield increased revenues. In addition, independent industry analysts often provide reviews of our products, as well as those of our competitors, and perception of our products in the marketplace may be significantly influenced by these reviews. If these reviews are negative, or less positive as compared to those of our competitors' products and services, our brand may be adversely affected.

Moreover, it may be difficult to maintain and enhance our brand in connection with sales through channel or strategic partners. The promotion of our brand requires us to make substantial expenditures, and we anticipate that the expenditures will increase as our market becomes more competitive, as we expand into new markets and as more sales are generated through our channel partners. To the extent that these activities yield increased revenues, these revenues may not offset the increased expenses we incur. If we do not successfully maintain and enhance our brand, our business may not grow, we may have reduced pricing power relative to competitors with stronger brands, and we could lose customers and channel partners, all of which would adversely affect our business operations and financial results.

Our future performance depends in part on proper use of our community website, Splunk Apps, and support from third-party software developers.

Our products enable third-party software developers to build apps on top of our platform. We operate a community website, Splunk Apps, for sharing these third-party apps, including add-ons and extensions. While we expect Splunk Apps to support our sales and marketing efforts, it also presents certain risks to our business, including:

- third-party developers may not continue developing or supporting the software apps that they share on our community website, Splunk Apps;

- we cannot provide any assurance that these apps meet the same quality standards that we apply to our own development efforts, and, to the extent they contain bugs or defects, they may create disruptions in our customers' use of our products or negatively affect our brand;

- we do not currently provide support for software apps developed by third-party software developers, and users may be left without support and potentially cease using our products if the third-party software developers do not provide support for these apps;

- these third-party software developers may not possess the appropriate intellectual property rights to develop and share their apps; and

- some of these developers may use the insight they gain using our products and from documentation publicly available on our website to develop competing products.

Many of these risks are not within our control to prevent, and our brand may be damaged if these apps, add-ons and extensions do not perform to our customers' satisfaction and that dissatisfaction is attributed to us.

If poor advice or misinformation is spread through our community site, Splunk Answers, users of our products may experience unsatisfactory results from using our products, which could adversely affect our reputation and our ability to grow our business.

We host Splunk Answers for sharing knowledge about how to perform certain functions with our products. Our users are increasingly turning to our Splunk Answers community site for support in connection with their use of our products. We do not review or test the information that non-Splunk employees post on our Splunk Answers community site to ensure its accuracy or efficacy in resolving technical issues. Therefore, we cannot ensure that all the information listed on our Splunk Answers community site is accurate or that it will not adversely affect the performance of our products. Furthermore, users who post such information on our Splunk Answers community site may not have adequate rights to the information to share it publicly, and we could be the subject of intellectual property claims based on our hosting of such information. If poor advice or misinformation is spread among users of our Splunk Answers community site, our customers or other users of our products may experience unsatisfactory results from using our products, which could adversely affect our reputation and our ability to grow our business.

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Our use of “open source” software could negatively affect our ability to sell our products and subject us to possible litigation.

We use open source software in our products and expect to continue to use open source software in the future. We may face claims from others claiming ownership of, or seeking to enforce the terms of, an open source license, including by demanding release of the open source software, derivative works or our proprietary source code that was developed using such software. These claims could also result in litigation, require us to purchase a costly license or require us to devote additional research and development resources to change our products, any of which would have a negative effect on our business and operating results. In addition, if the license terms for the open source code change, we may be forced to re-engineer our products or incur additional costs. Finally, we cannot assure that we have not incorporated additional open source software in our products in a manner that is inconsistent with our current policies and procedures.

If our security measures are breached or unauthorized access to customer data is otherwise obtained, our products may be perceived as not being secure, customers may reduce the use of or stop using our products, and we may incur significant liabilities.

Our software and cloud services involve the storage and transmission of data, and security breaches could result in the loss of this information, litigation, indemnity obligations and other liability. While we have taken steps to protect the confidential information that we have access to, including confidential information we may obtain through our customer support services or customer usage of our cloud-based services, our security measures could be breached. In addition, we do not have the ability to monitor or review the content that customers of Splunk Enterprise store, and therefore, we have no direct control over the substance of that content. Therefore, if customers use our products for the transmission or storage of personally identifiable information and our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, our reputation could be damaged, our business may suffer, and we could incur significant liability. Because techniques used to obtain unauthorized access or sabotage systems change frequently and generally are not identified until they are launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any or all of these issues could negatively impact our ability to attract new customers and increase engagement by existing customers, cause existing customers to elect to not renew their subscriptions, or subject us to third-party lawsuits, regulatory fines or other action or liability, thereby adversely affecting our financial results.

We use third-party technology and systems for a variety of reasons, including, without limitation, encryption and authentication technology, employee email, content delivery to customers, back-office support and other functions. Although we have developed systems and processes that are designed to protect customer information and prevent data loss and other security breaches, including systems and processes designed to reduce the impact of a security breach at a third-party vendor, such measures cannot provide absolute security.

Because our products could be used to collect and store personal information, domestic and international privacy concerns could result in additional costs and liabilities to us or inhibit sales of our products.

Privacy and data information security have become a significant issue in the United States and in many other countries where we offer licenses of our software and subscriptions of our cloud services. The regulatory framework for privacy and personal information security issues worldwide is rapidly evolving and is likely to remain uncertain for the foreseeable future. Many federal, state and foreign government bodies and agencies have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information. In the United States, these include rules and regulations promulgated under the authority of the Federal Trade Commission, the Health Insurance Portability and Accountability Act (HIPAA) of 1996 and state breach notification laws. Internationally, virtually every jurisdiction in which we operate has established its own data security and privacy legal framework with which we or our customers must comply, including the Data Protection Directive established in the European Union and the Federal Data Protection Act implemented in Germany.

In addition to government regulation, privacy advocates and industry groups may propose new and different self-regulatory standards that either legally or contractually apply to us. Because the interpretation and application of privacy and data protection laws are still uncertain, it is possible that these laws may be interpreted and applied in a manner that is inconsistent with our existing data management practices or the features of our software and cloud services. If so, in addition to the possibility of fines, lawsuits and other claims, we could be required to fundamentally change our business activities and practices or modify our products, which could have an adverse effect on our business. Any inability to adequately address privacy concerns, even if unfounded, or comply with applicable privacy or data protection laws, regulations and policies, could result in additional cost and liability to us, damage our reputation, inhibit sales and adversely affect our business.

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Furthermore, the costs of compliance with, and other burdens imposed by, the laws, regulations, and policies that are applicable to the businesses of our customers may limit the use and adoption of, and reduce the overall demand for, our products. Privacy and personal information security concerns, whether valid or not valid, may inhibit market adoption of our products particularly in certain industries and foreign countries.

Federal, state and industry regulations as well as self-regulation related to privacy and data security concerns pose the threat of lawsuits and other liability.

We may collect and utilize demographic and other information, including personally identifiable information, from and about users (such as customers, potential customers, and others) as they interact with Splunk over the internet and otherwise provide us with information whether via our website, through email, or through other means. Users may provide personal information to us in many contexts such as when signing up for certain services, registering for seminars, participating in a survey, when answering questions on our Splunk Answers community site, when posting reviews or otherwise commenting on Splunk apps, when using other community or social networking features, when participating in polls or when signing up to receive e-mail newsletters.

Within the United States, various federal and state laws and regulations govern the collection, use, retention, sharing and security of the data we receive from and about users. Outside of the United States, various jurisdictions actively regulate and enforce laws regarding the collection, retention, transfer, and use (including loss and unauthorized access) of personal information. Privacy advocates and government bodies have increasingly scrutinized the ways in which companies link personal identities and data associated with particular users or devices with data collected through the internet, and we expect such scrutiny to continue to increase. Loss, retention or misuse of certain information and alleged violations of laws and regulations relating to privacy and data security, and any relevant claims, may expose us to potential liability and may require us to expend significant resources on data security and in responding to and defending such allegations and claims.

If we are unable to attract and retain key personnel, our business could be adversely affected.

We depend on the continued contributions of our senior management and other key personnel, the loss of whom could adversely affect our business. All of our executive officers and key employees are at-will employees, which means they may terminate their employment relationship with us at any time. We do not maintain a key-person life insurance policy on any of our officers or other employees.

Our future success also depends on our ability to identify, attract and retain highly skilled technical, managerial, finance and other personnel, particularly in our sales and marketing, research and development, general and administrative, and professional service departments. We face intense competition for qualified individuals from numerous software and other technology companies.

In addition, competition for qualified personnel, particularly software engineers, is particularly intense in the San Francisco Bay Area, where our headquarters are located. We may incur significant costs to attract and retain them, and we may lose new employees to our competitors or other technology companies before we realize the benefit of our investment in recruiting and training them. As we move into new geographies, we will need to attract and recruit skilled personnel in those areas. If we are unable to attract and retain suitably qualified individuals who are capable of meeting our growing technical, operational and managerial requirements, on a timely basis or at all, our business will be adversely affected.

Volatility or lack of performance in our stock price may also affect our ability to attract and retain our key employees. Many of our senior management personnel and other key employees have become, or will soon become, vested in a substantial amount of stock, restricted stock units or stock options. Employees may be more likely to leave us if the shares they own or the shares underlying their vested restricted stock units or options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the options, or, conversely, if the exercise prices of the options that they hold are significantly above the market price of our common stock. If we are unable to retain our employees, or if we need to increase our compensation expenses to retain our employees, our business, results of operations, financial condition and cash flows would be adversely affected.

Prolonged economic uncertainties or downturns could materially adversely affect our business.

Current or future economic downturns or uncertainty could adversely affect our business operations or financial results. Negative conditions in the general economy both in the United States and abroad, including conditions resulting from financial and credit market fluctuations and terrorist attacks on the United States, Europe, Asia Pacific or elsewhere, could cause a decrease in corporate spending on enterprise software in general and negatively affect the rate of growth of our business.

General worldwide economic conditions have experienced a significant downturn and continue to remain unstable. These conditions make it extremely difficult for our customers and us to forecast and plan future business activities accurately, and they could cause our customers to reevaluate their decision to purchase our products, which could delay and lengthen our sales cycles or result in cancellations of planned purchases. Furthermore, during challenging economic times our customers may face issues in gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may be required to increase our allowance for doubtful accounts, which would adversely affect our financial results.

We have a significant number of customers in the business services, energy, financial services, healthcare and pharmaceuticals, technology, manufacturing, media and entertainment, online services, retail, telecommunications and travel and transportation industries. A substantial downturn in any of these industries may cause firms to react to worsening conditions by reducing their capital expenditures in general or by specifically reducing their spending on information technology. Customers in these industries may delay or cancel information technology projects or seek to lower their costs by renegotiating vendor contracts. To the extent purchases of our products are perceived by customers and potential customers to be discretionary, our revenues may be disproportionately affected by delays or reductions in general information technology spending. Also, customers may choose to develop in-house software as an alternative to using our products. Moreover, competitors may respond to market conditions by lowering prices and attempting to lure away our customers. In addition, the increased pace of consolidation in certain industries may result in reduced overall spending on our products.

We cannot predict the timing, strength or duration of any economic slowdown, instability or recovery, generally or within any particular industry or geography. If the economic conditions of the general economy or industries in which we operate worsen from present levels, our business operations and financial results could be adversely affected.

We may require additional capital to support business growth, and this capital might not be available on acceptable terms, if at all.

We intend to continue to make investments to support our business growth and may require additional funds to respond to business challenges, including the need to develop new features or enhance our products, improve our operating infrastructure or acquire complementary businesses and technologies. Accordingly, we may need to engage in equity or debt financings to secure additional funds. If we raise additional funds through future issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing that we may secure in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. We may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly impaired, and our business may be adversely affected.

We have in the past made and may in the future make acquisitions that could prove difficult to integrate and/or adversely affect our business operations and financial results.

From time to time, we may choose to expand by making acquisitions that could be material to our business, results of operations, financial condition and cash flows. Our ability as an organization to successfully acquire and integrate technologies or businesses is unproven. Acquisitions involve many risks, including the following:

- an acquisition may negatively affect our financial results because it may require us to incur charges or assume substantial debt or other liabilities, may cause adverse tax consequences or unfavorable accounting treatment, may expose us to claims and disputes by third parties, including intellectual property claims and disputes, or may not generate sufficient financial return to offset additional costs and expenses related to the acquisition;

- potential goodwill impairment charges related to acquisitions;

- costs and potential difficulties associated with the requirement to test and assimilate the internal control processes of the acquired business;

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- we may encounter difficulties or unforeseen expenditures in integrating the business, technologies, products, personnel or operations of any company that we acquire, particularly if key personnel of the acquired company decide not to work for us;
- we may not realize the expected benefits of the acquisition;
- an acquisition may disrupt our ongoing business, divert resources, increase our expenses and distract our management;
- an acquisition may result in a delay or reduction of customer purchases for both us and the company acquired due to customer uncertainty about continuity and effectiveness of service from either company;
- the potential impact on relationships with existing customers, vendors and distributors as business partners as a result of acquiring another company or business that competes with or otherwise is incompatible with those existing relationships;
- the potential that our due diligence of the acquired company or business does not identify significant problems or liabilities;
- we may encounter difficulties in, or may be unable to, successfully sell any acquired products;
- an acquisition may involve the entry into geographic or business markets in which we have little or no prior experience or where competitors have stronger market positions;
- an acquisition may require us to comply with additional laws and regulations or result in liabilities resulting from the acquired company's pre-acquisition failure to comply with applicable laws;
- our use of cash to pay for an acquisition would limit other potential uses for our cash;
- if we incur debt to fund such acquisition, such debt may subject us to material restrictions on our ability to conduct our business as well as financial maintenance covenants; and
- to the extent that we issue a significant amount of equity securities in connection with future acquisitions, existing stockholders may be diluted and earnings per share may decrease.

The occurrence of any of these risks could have a material adverse effect on our business operations and financial results.

If currency exchange rates fluctuate substantially in the future, our financial results, which are reported in U.S. dollars, could be adversely affected.

As we continue to expand our international operations, we become more exposed to the effects of fluctuations in currency exchange rates. Although most of our sales contracts are denominated in U.S. dollars, and therefore substantially all of our revenues are not subject to foreign currency risk, a strengthening of the U.S. dollar could increase the real cost of our products to our customers outside of the United States, adversely affecting our business operations and financial results. We incur expenses for employee compensation and other operating expenses at our non-U.S. locations in the local currency. Fluctuations in the exchange rates between the U.S. dollar and other currencies could result in the dollar equivalent of such expenses being higher. This could have a negative impact on our reported operating results. To date, we have not engaged in any hedging strategies, and any such strategies, such as forward contracts, options and foreign exchange swaps related to transaction exposures that we may implement to mitigate this risk may not eliminate our exposure to foreign exchange fluctuations.

The enactment of legislation implementing changes in the United States of taxation of international business activities or the adoption of other tax reform policies could materially impact our financial position and results of operations.

Recent changes to United States tax laws, including limitations on the ability of taxpayers to claim and utilize foreign tax credits and the deferral of certain tax deductions until earnings outside of the United States are repatriated to the United States, as well as changes to United States tax laws that may be enacted in the future, could impact the tax treatment of our foreign earnings. Due to expansion of our international business activities, any changes in the United States taxation of such activities may increase our worldwide effective tax rate and adversely affect our financial position and results of operations.

Our ability to use our net operating losses to offset future taxable income may be subject to certain limitations.

In general, under Section 382 of the United States Internal Revenue Code of 1986, as amended, or the Code, a corporation that undergoes an “ownership change” is subject to limitations on its ability to utilize its pre-change net operating losses, or NOLs, to offset future taxable income. If our existing NOLs are subject to limitations arising from previous ownership changes, our ability to utilize NOLs could be limited by Section 382 of the Code. Future changes in our stock ownership, some of which are outside of our control, could result in an ownership change under Section 382 of the Code. Furthermore, our ability to utilize NOLs of companies that we may acquire in the future may be subject to limitations. There is also a risk that due to regulatory changes, such as suspensions on the use of NOLs, or other unforeseen reasons, our existing NOLs could expire or otherwise be unavailable to offset future income tax liabilities. For these reasons, we may not be able to utilize a portion of the NOLs reflected on our balance sheet, even if we attain profitability.

Taxing authorities may successfully assert that we should have collected or in the future should collect sales and use, value added or similar taxes, and we could be subject to liability with respect to past or future sales, which could adversely affect our financial results.

We do not collect sales and use, value added and similar taxes in all jurisdictions in which we have sales, based on our belief that such taxes are not applicable. Sales and use, value added and similar tax laws and rates vary greatly by jurisdiction. Certain jurisdictions in which we do not collect such taxes may assert that such taxes are applicable, which could result in tax assessments, penalties and interest, and we may be required to collect such taxes in the future. Such tax assessments, penalties and interest or future requirements may adversely affect our financial results.

Our international operations subject us to potentially adverse tax consequences.

We generally conduct our international operations through wholly owned subsidiaries, branches and representative offices and report our taxable income in various jurisdictions worldwide based upon our business operations in those jurisdictions. We are in the process of organizing our corporate structure to more closely align with the international nature of our business activities. Our intercompany relationships are subject to complex transfer pricing regulations administered by taxing authorities in various jurisdictions. The relevant taxing authorities may disagree with our determinations as to the income and expenses attributable to specific jurisdictions. If such a disagreement were to occur, and our position were not sustained, we could be required to pay additional taxes, interest and penalties, which could result in one-time tax charges, higher effective tax rates, reduced cash flows and lower overall profitability of our operations. We believe that our financial statements reflect adequate reserves to cover such a contingency, but there can be no assurances in that regard.

We could be subject to additional tax liabilities.

We are subject to federal, state and local taxes in the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and our worldwide provision for taxes. During the ordinary course of business, there are many activities and transactions for which the ultimate tax determination is uncertain. We previously discovered that we have not complied with various tax rules and regulations in certain foreign jurisdictions. We are working to resolve these matters. In addition, our tax obligations and effective tax rates could be adversely affected by changes in the relevant tax, accounting and other laws, regulations, principles and interpretations, including those relating to income tax nexus, by our earnings being lower than anticipated in jurisdictions where we have lower statutory rates and higher than anticipated in jurisdictions where we have higher statutory rates, by changes in foreign currency exchange rates, or by changes in the valuation of our deferred tax assets and liabilities. We may be audited in various jurisdictions, and such jurisdictions may assess additional taxes against us. Although we believe our tax estimates are reasonable, the final determination of any tax audits or litigation could be materially different from our historical tax provisions and accruals, which could have a material adverse effect on our operating results or cash flows in the period or periods for which a determination is made.

Our stock price has been volatile, may continue to be volatile and may decline regardless of our financial performance.

The trading prices of the securities of technology companies have been highly volatile. The market price of our common stock has fluctuated significantly and may continue to fluctuate significantly in response to numerous factors, many of which are beyond our control, including:

- actual or anticipated fluctuations in our financial results;

- the financial projections we provide to the public, any changes in these projections or our failure to meet or exceed these projections;
- failure of securities analysts to initiate or maintain coverage of our company, changes in financial estimates by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors;
- ratings changes by any securities analysts who follow our company;
- announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;
- changes in operating performance and stock market valuations of other technology companies generally, or those in our industry in particular;
- price and volume fluctuations in certain categories of companies or the overall stock market, including as a result of trends in the global economy;
- any major change in our board of directors or management;
- lawsuits threatened or filed against us; and
- other events or factors, including those resulting from war, incidents of terrorism or responses to these events.

In addition, the stock markets, and in particular the market on which our common stock is listed, have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the financial performance of those companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business and adversely affect our business, results of operations, financial condition and cash flows.

If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, our share price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business, our market and our competitors. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our shares or change their opinion of our shares, our share price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

Substantial future sales of shares of our common stock could cause the market price of our common stock to decline.

The market price of shares of our common stock could decline as a result of substantial sales of our common stock, particularly sales by our directors, executive officers, employees and significant stockholders, a large number of shares of our common stock becoming available for sale, or the perception in the market that holders of a large number of shares intend to sell their shares. As of October 31, 2014, we had outstanding approximately 120.9 million shares of our common stock. We have also registered shares of common stock that we may issue under our employee equity incentive plans. These shares will be able to be sold freely in the public market upon issuance.

The requirements of being a public company may strain our resources, divert management's attention and affect our ability to attract and retain executive management and qualified board members.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, or the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Act, the listing requirements of The NASDAQ Stock Market and other applicable securities rules and regulations. Compliance with these rules and regulations has increased our legal and financial compliance costs, made some activities more difficult, time-consuming or costly and increased and will continue to increase demand on our systems and resources. The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and operating results. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and,

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if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. As a result, management's attention may be diverted from other business concerns, which could adversely affect our business and operating results. Although we have already hired additional employees to comply with these requirements, we may need to hire more employees in the future or engage outside consultants, which will increase our costs and expenses.

In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming. These laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as regulatory and governing bodies provide new guidance. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We will continue to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to their application and practice, regulatory authorities may initiate legal proceedings against us and our business may be adversely affected.

As a result of disclosure of information as a public company, our business and financial condition have become more visible, which we believe may result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business operations and financial results could be adversely affected, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and adversely affect our business operations and financial results. These factors could also make it more difficult for us to attract and retain qualified employees, executive officers and members of our board of directors.

We are obligated to develop and maintain proper and effective internal control over financial reporting. These internal controls may not be determined to be effective, which may adversely affect investor confidence in our company and, as a result, the value of our common stock.

We are required, pursuant to Section 404 of the Sarbanes-Oxley Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting. This assessment includes disclosure of any material weaknesses identified by our management in our internal control over financial reporting. We are also required to have our independent registered public accounting firm issue an opinion on the effectiveness of our internal controls over financial reporting on an annual basis. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal controls are effective.

If we are unable to assert that our internal control over financial reporting is effective, or if, when required, our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal control over financial reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, which would cause the price of our common stock to decline, and we may be subject to investigation or sanctions by the SEC.

We do not intend to pay dividends for the foreseeable future.

We have never declared or paid any cash dividends on our common stock and do not intend to pay any cash dividends in the foreseeable future. We anticipate that we will retain all of our future earnings for use in the development of our business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of our board of directors. Accordingly, price appreciation of our common stock, which may never occur, may be the only way our stockholders realize any future gains on their investments.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of our company more difficult, limit attempts by our stockholders to replace or remove our current management and limit the market price of our common stock.

Provisions in our certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. Our certificate of incorporation and bylaws include provisions that:

- authorize our board of directors to issue, without further action by the stockholders, shares of undesignated preferred stock with terms, rights and preferences determined by our board of directors;

- require that any action to be taken by our stockholders be effected at a duly called annual or special meeting and not by written consent;
- specify that special meetings of our stockholders can be called only by our board of directors, the Chairman of our board of directors, or our Chief Executive Officer;
- establish an advance notice procedure for stockholder proposals to be brought before an annual meeting, including proposed nominations of persons for election to our board of directors;
- establish that our board of directors is divided into three classes, Class I, Class II and Class III, with each class serving three-year staggered terms;
- prohibit cumulative voting in the election of directors;
- provide that our directors may be removed only for cause;
- provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum; and
- require the approval of our board of directors or the holders of a supermajority of our outstanding shares of capital stock to amend our bylaws and certain provisions of our certificate of incorporation.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits a Delaware corporation from engaging in any of a broad range of business combinations with any “interested” stockholder for a period of three years following the date on which the stockholder became an “interested” stockholder.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

a) Not applicable.

Item 6. Exhibits.

The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Quarterly Report.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: December 10, 2014

SPLUNK INC.

By: /s/ David F. Conte
David F. Conte
Chief Financial Officer
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Description
3.1	Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit 3.1 filed with the Registrant's Current Report on Form 8-K filed on September 15, 2014).
31.1	Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Principal Executive Officer and Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Schema Linkbase Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Labels Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document