

TFS Financial CORP
Form 10-Q
February 14, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period ended December 31, 2007

or

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

For transition period from to

Commission File Number 001-33390

TFS FINANCIAL CORPORATION

(Exact Name of Registrant as Specified in its Charter)

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United States
(State or Other Jurisdiction of
Incorporation or Organization)

52-2054948
(I.R.S. Employer
Identification No.)

7007 Broadway Avenue
Cleveland, Ohio
(Address of Principal Executive Offices)

(216) 441-6000

44105
(Zip Code)

Registrant's telephone number, including area code:

Not Applicable

(Former name or former address, if changed since last report)

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 ☒ 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. (Check one):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒
(do not check if a smaller reporting company)

Smaller Reporting Company ☐

Indicate the number of shares outstanding of each of the Registrant's classes of common stock as of the latest practicable date.

As of **February 11, 2008** there were 332,318,750 shares of the Registrant's common stock, par value \$0.01 per share, outstanding, of which 227,119,132 shares, or 68.34% of the Registrant's common stock, were held by Third Federal Savings & Loan Association of Cleveland, MHC, the Registrant's mutual holding company.

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

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****TFS FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CONDITION**

(In thousands, except share data)

	December 31, 2007 (unaudited)	September 30, 2007
ASSETS		
Cash and due from banks	\$ 50,029	\$ 45,666
Interest bearing deposits at other financial institutions	129,322	185,649
Federal funds sold	573,000	598,400
Cash and cash equivalents	752,351	829,715
Investment securities:		
Available for sale (amortized cost \$55,379 and \$57,025, respectively)	55,374	56,681
Held to maturity (fair value \$894,672 and \$825,342, respectively)	889,132	823,815
Mortgage loans held for sale, at lower of cost or market	113,192	107,962
Loans held for investment, net:		
Mortgage loans	8,319,002	8,103,300
Other loans	13,222	14,692
Deferred loan fees, net	(18,358)	(19,174)
Allowance for loan losses	(26,095)	(25,111)
Loans, net	8,287,771	8,073,707
Mortgage loan servicing assets, net	41,347	41,064
Federal Home Loan Bank stock, at cost	34,231	34,231
Real estate owned	12,455	9,903
Premises, equipment, and software, net	69,801	69,669
Accrued interest receivable	48,071	48,364
Bank owned life insurance contracts	146,131	144,498
Other assets	27,054	38,420
TOTAL ASSETS	\$ 10,476,910	\$ 10,278,029
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	\$ 8,266,373	\$ 8,141,215
Borrowers' advances for insurance and taxes	38,587	40,481
Principal, interest, and related escrow owed on loans serviced	77,699	77,908
Accrued expenses and other liabilities	86,114	32,224
Total liabilities	8,468,773	8,291,828
Commitments and contingent liabilities		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized, none issued and outstanding		
Common stock, \$0.01 par value, 700,000,000 shares authorized; 332,318,750 shares issued and outstanding.	3,323	3,323

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Paid-in capital	1,668,774	1,668,215
Unallocated ESOP shares	(98,316)	(100,597)
Retained earnings substantially restricted	440,319	421,503
Accumulated other comprehensive loss	(5,963)	(6,243)
Total shareholders' equity	2,008,137	1,986,201
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 10,476,910	\$ 10,278,029

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents**TFS FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME (unaudited)****(In thousands, except share and per share data)**

	For the Three Months Ended December 31,	
	2007	2006
INTEREST AND DIVIDEND INCOME:		
Loans, including fees	\$ 123,967	\$ 116,433
Investment securities available for sale	558	699
Investment securities held to maturity	11,636	1,520
Federal funds sold	8,246	5,840
Other interest earning assets	1,261	1,241
Total interest income	145,668	125,733
INTEREST EXPENSE:		
Deposits	92,696	80,792
Federal Home Loan Bank advances		315
Total interest expense	92,696	81,107
NET INTEREST INCOME	52,972	44,626
PROVISION FOR LOAN LOSSES	3,000	2,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	49,972	42,626
NON-INTEREST INCOME		
Fees and service charges	6,333	6,169
Gain (loss) on the sale of loans	1,199	(811)
Increase in and death benefits from bank owned life insurance contracts	1,657	1,565
Net income on private equity investments	1,928	2,604
Other	1,816	2,894
Total non-interest income	12,933	12,421
NON-INTEREST EXPENSE:		
Salaries and employee benefits	18,355	17,329
Marketing services	3,525	3,350
Office property, equipment, and software	4,519	4,502
Federal insurance premium	631	573
State franchise tax	707	984
Other operating expenses	6,366	4,784
Total non-interest expense	34,103	31,522
INCOME BEFORE INCOME TAXES	28,802	23,525
INCOME TAX EXPENSE	9,986	7,694

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NET INCOME	\$ 18,816	\$ 15,831
Earnings per share basic and fully diluted	\$ 0.06	\$ 0.07
Weighted average shares outstanding	322,327,418	227,119,132
See accompanying notes to unaudited interim consolidated financial statements.		

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TFS FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)

Three Months Ended December 31, 2007 and 2006

(In thousands)

					Accumulated other comprehensive income (loss)		
	Common stock	Paid-in capital	Unallocated common stock held by ESOP	Retained earnings	Unrealized losses on securities	Pension obligation	Total shareholders equity
Balance at September 30, 2006	\$	627,979		395,892	(714)	(10,563)	\$ 1,012,594
Comprehensive income:							
Net income				15,831			15,831
Change in unrealized losses on securities available for sale, net					51		51
Change in pension obligation, net						172	172
Total comprehensive income							16,054
Balance at December 31, 2006	\$	627,979		411,723	(663)	(10,391)	\$ 1,028,648
Balance at September 30, 2007	\$ 3,323	1,668,215	(100,597)	421,503	(223)	(6,020)	\$ 1,986,201
Comprehensive income:							
Net income				18,816			18,816
Change in unrealized losses on securities available for sale, net					220		220
Change in pension obligation, net						60	60
Total comprehensive income							19,096
ESOP shares committed to be released		559	2,281				2,840
Balance at December 31, 2007	\$ 3,323	1,668,774	(98,316)	440,319	(3)	(5,960)	\$ 2,008,137

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents**TFS FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)****(In thousands)**

	For the Three Months Ended December 31,	
	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 18,816	\$ 15,831
Adjustments to reconcile net income to net cash provided by operating activities:		
ESOP shares committed to be released	2,840	
Depreciation and amortization	1,668	1,341
Provision for loan losses	3,000	2,000
Net (gain) loss on the sale of loans	(1,199)	811
Other net losses	1,984	1,487
Principal repayments on and proceeds from sales of loans held for sale	133,025	337,539
Loans originated for sale	(137,834)	(165,787)
Increase in and death benefits for bank owned life insurance contracts	(1,633)	(1,565)
Net decrease in interest receivable and other assets	10,013	2,395
Net increase in accrued expenses and other liabilities	53,983	9,399
Other	(1,928)	(696)
Net cash provided by operating activities	82,735	202,755
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans originated	(751,641)	(566,006)
Principal repayments on loans	465,984	207,479
Proceeds from sales, principal repayments and maturities of:		
Securities available for sale	1,956	3,643
Securities held to maturity	45,167	5,093
Proceeds from sale of:		
Loans	62,639	360,789
Private equity fund		5,009
Purchases of:		
Securities available for sale	(320)	(7)
Securities held to maturity	(110,452)	(131,933)
Premises and equipment	(1,693)	(2,054)
Other	5,206	3,845
Net cash used in investing activities	(283,154)	(114,142)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	125,158	119,417
Net decrease in borrowings advances for insurance and taxes	(1,894)	(6,232)
Net (decrease) increase in principal and interest owed on loans serviced	(209)	970
Net increase in short-term advances		3
Net cash provided by financing activities	123,055	114,158
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(77,364)	202,771

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CASH AND CASH EQUIVALENTS	Beginning of period	829,715	252,927
CASH AND CASH EQUIVALENTS	End of period	\$ 752,351	\$ 455,698
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid for interest on deposits		\$ 95,410	\$ 83,488
Cash paid for interest on borrowed funds			311
Cash paid for income taxes			
SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Loans exchanged for mortgage-backed securities		195,461	467,779
Transfer of loans to real estate owned		6,099	2,524
See accompanying notes to unaudited interim consolidated financial statements.			

Table of Contents**TFS FINANCIAL CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS****1. BASIS OF PRESENTATION**

TFS Financial Corporation (the Holding Company), a federally chartered stock holding company, conducts its principal activities through its wholly owned subsidiaries. The principal line of business of TFS Financial Corporation and its subsidiaries (collectively, TFS Financial or the Company) is retail consumer banking; including mortgage lending, deposit gathering, and other insignificant financial services. On December 31, 2007, approximately 68% of the Holding Company was owned by a federally chartered mutual holding company, Third Federal Savings and Loan Association of Cleveland, MHC (Third Federal Savings, MHC). The thrift subsidiary of TFS Financial is Third Federal Savings and Loan Association of Cleveland (the Association).

The accounting and reporting policies followed by the Company conform in all material respects to accounting principles generally accepted in the United States of America (US GAAP) and to general practices in the financial services industry. The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for loan losses, the valuation of mortgage loan servicing assets, and the valuation of deferred tax assets are particularly subject to change.

The unaudited interim consolidated financial statements were prepared without an audit and reflect all adjustments of a normal recurring nature which, in the opinion of management, are necessary to present fairly the consolidated financial condition of TFS Financial at December 31, 2007, and its results of operations and cash flows for the periods presented. In accordance with Regulation S-X for interim financial information, these statements do not include certain information and footnote disclosures required for complete audited financial statements. The Holding Company's September 30, 2007 Annual Report on Form 10-K contains consolidated financial statements and related notes which should be read in conjunction with the accompanying interim consolidated financial statements. The results of operations for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2008.

2. EARNINGS PER SHARE

The following is a summary of our earnings per share calculation.

	Three Months Ended December 31,	
	2007	2006
	(In thousands except per share data)	
Net income	\$ 18,816	\$ 15,831
Weighted average shares outstanding	322,327	227,119
Earnings per share - basic and diluted	\$ 0.06	\$ 0.07

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For purposes of computing earnings per share amounts prior to the completion of our initial public offering on April 20, 2007, the 227,119,132 shares currently held by Third Federal Savings, MHC are assumed to have been outstanding in all prior periods. For periods subsequent to the offering date, outstanding shares include shares held by Third Federal Savings, MHC, shares held by the Third Federal Foundation, shares held by the Employee Stock Ownership Plan (ESOP) and shares held by the public except that shares held by the ESOP that have not been allocated to participants or committed to be released for allocation to participants are excluded from the computations.

3. INVESTMENT SECURITIES

Investments available for sale are summarized as follows:

	December 31, 2007			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
		(In thousands)		
U.S. government and agency obligations	\$ 28,995	\$ 175	\$ (97)	\$ 29,073
Fannie Mae certificates	726	3		729
Real estate mortgage investment conduits (REMICs)	19,266	9	(95)	19,180
Other	6,392			6,392
	\$ 55,379	\$ 187	\$ (192)	\$ 55,374

	September 30, 2007			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
		(In thousands)		
U.S. government and agency obligations	\$ 28,994	\$	\$ (217)	\$ 28,777
Fannie Mae certificates	761		(13)	748
REMICs	21,198	8	(122)	21,084
Other	6,072			6,072
	\$ 57,025	\$ 8	\$ (352)	\$ 56,681

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Investments held to maturity are summarized as follows:

	Amortized Cost	December 31, 2007 Gross Unrealized Gains Losses (In thousands)		Fair Value
U.S. government and agency obligations	\$ 22,995	\$ 10	\$ (12)	\$ 22,993
Freddie Mac certificates	11,837	80		11,917
Ginnie Mae certificates	9,719	204		9,923
REMICs	831,662	5,710	(935)	836,437
Fannie Mae certificates	12,913	496	(22)	13,387
Other	6	9		15
	\$ 889,132	\$ 6,509	\$ (969)	\$ 894,672

	Amortized Cost	September 30, 2007 Gross Unrealized Gains Losses (In thousands)		Fair Value
U.S. government and agency obligations	\$ 26,994	\$ 20	\$ (46)	\$ 26,968
Freddie Mac certificates	12,100	1		12,101
Ginnie Mae certificates	10,278	144	(4)	10,418
REMICs	761,172	2,325	(1,150)	762,347
Fannie Mae certificates	13,265	307	(88)	13,484
Other	6	18		24
	\$ 823,815	\$ 2,815	\$ (1,288)	\$ 825,342

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Loans held for investment consist of the following:

	December 31, 2007	September 30, 2007
	(In thousands)	
Real Estate Loans:		
Residential non-Home Today	\$ 5,957,752	\$ 5,842,827
Residential Home Today	308,293	304,046
Equity loans and lines of credit (1)	1,970,296	1,867,899
Construction	139,151	150,695
	8,375,492	8,165,467
Consumer loans:		
Auto loans	4,021	5,627
Loans on savings	8,649	8,490
Other	552	575
	13,222	14,692
Less:		
Deferred loan fees, net	(18,358)	(19,174)
Loans-in-process	(56,490)	(62,167)
Allowance for loan losses	(26,095)	(25,111)
Net loans	\$ 8,287,771	\$ 8,073,707

- (1) Includes bridge loans (loans where borrowers can utilize the existing equity in their current home to fund the purchase of a new home before they have sold their current home).

Home Today is an affordable housing program targeted to benefit low- and moderate-income home buyers. Through its Home Today program, the Association originates loans with standard terms to borrowers who might not qualify for such loans. Borrowers must complete financial management education and counseling and must be referred to the Association by a sponsoring organization with which the Association has partnered as part of the program. Borrowers must also meet a minimum credit score threshold. Because the Association applies less stringent underwriting and credit standards to these loans, loans originated under the Home Today program have greater credit risk than its traditional residential real estate mortgage loans.

Activity in the allowance for loan losses is summarized as follows:

	Period Ended December 31, 2007	2006
	(In thousands)	
Balance beginning of period	\$ 25,111	\$ 20,705
Provision charged to income	3,000	2,000
Charge-offs	(2,077)	(1,680)
Recoveries	61	196
Balance end of period	\$ 26,095	\$ 21,221

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5. DEPOSITS

Deposit account balances are summarized as follows:

	December 31, 2007	September 30, 2007
	(In thousands)	
Negotiable order of withdrawal accounts	\$ 1,379,710	\$ 1,464,631
Savings accounts	1,168,004	1,014,341
Certificates of deposit	5,717,608	5,658,478
	8,265,322	8,137,450
Accrued interest	1,051	3,765
Total deposits	\$ 8,266,373	\$ 8,141,215

6. INCOME TAXES

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and city jurisdictions. With few exceptions we are no longer subject to federal and state income tax examinations for tax years prior to 2003. The State of Ohio has examined the Association through 2006 with no adjustment.

The Company adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of SFAS 109 (FIN 48) on October 1, 2007. The implementation of FIN 48 did not have an effect on the Company's financial statements. As of October 1, 2007, there were no unrecognized tax benefits.

The Company recognizes interest and penalties on income tax assessments or income tax refunds, where applicable, in the financial statements as a component of its provision for income taxes.

7. EMPLOYEE BENEFIT PLANS

Defined Benefit Plan Third Federal Savings Retirement Plan (Plan) is a defined benefit pension plan. Effective December 31, 2002, the Plan was amended to limit participation to employees who met the Plan's eligibility requirements on that date. After December 31, 2002, employees not participating in the Plan will, upon meeting the applicable eligibility requirements, participate in a separate tier of the Company's 401(k) Savings Plan. Benefits under the Plan are based on years of service and the employee's average annual compensation (as defined in the Plan). The funding policy of the Plan is consistent with the funding requirements of U.S. Federal and other governmental laws and regulations.

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The components of net periodic benefit cost recognized in the statements of income are as follows:

	Three Months Ended December 31,	
	2007	2006
	(In thousands)	
Service cost	\$ 947	\$ 1,016
Interest cost	754	720
Expected return on plan assets	(808)	(724)
Amortization of net loss	109	279
Amortization of prior service cost	(15)	(15)
Net periodic benefit cost	\$ 987	\$ 1,276

Minimum employer contributions expected to be paid during the fiscal year ending September 30, 2008 are \$4.0 million.

Employee (Associate) Stock Ownership Plan (ESOP) The Company established an ESOP for its employees effective January 1, 2006. The ESOP is a tax-qualified plan, designed to invest primarily in the Company's common stock, that provides employees with an opportunity to receive a funded retirement benefit, based primarily on the value of the Company's common stock. The ESOP covers all eligible employees of the Company and its wholly-owned subsidiaries. Employees are eligible to participate in the ESOP after attainment of age 18, completion of 1,000 hours of service, and employment on the last day of the plan's calendar year. Company contributions to the plan are at the discretion of the board of directors. The ESOP is accounted for in accordance with the provisions of the American Institute of Certified Public Accountants Statement of Position No. 93-6, *Employers' Accounting for Employee Stock Ownership Plans*. Compensation expense for the ESOP is based on the market price of the Company's common stock and is recognized as shares are committed to be released to participants. The total compensation expense related to this plan for the three months ended December 31, 2007 and 2006 was \$2.8 million and \$2.3 million, respectively.

In 2007, the ESOP purchased 11,605,824 shares of the Company's common stock at a price of \$10 per share with a 2006 plan year cash contribution and the proceeds of a loan from the Company to the ESOP. The outstanding loan principal balance as of December 31, 2007 was \$95.1 million. Shares of the Company's common stock pledged as collateral for the loan are released from the pledge for allocation to participants as loan payments are made. At December 31, 2007, 1,774,194 shares have been allocated to participants; no additional shares were committed to be released. Shares that are committed to be released are allocated to participants at the end of the plan year (December 31). ESOP shares that are unallocated or not yet committed to be released totaled 9,831,630 at December 31, 2007, and had a fair market value of \$117.4 million.

8. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into commitments with off-balance-sheet risk to meet the financing needs of its customers. Commitments to extend credit involve elements of credit risk and interest rate risk in excess of the amount recognized in the consolidated statements of condition. The Company's exposure to credit loss in the event of nonperformance by the other party to the commitment is represented by the contractual amount.

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of the commitment. The Company generally uses the same credit policies in making commitments as it does for on-balance-sheet instruments. Interest rate risk on commitments to extend credit results from the possibility that interest rates may have moved unfavorably from the position of the Company since the time the commitment was made.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates of 60 to 360 days or other termination clauses and may require payment of a fee. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. At December 31, 2007, the Company had commitments to originate loans as follows (in thousands):

Fixed-rate mortgage loans	\$ 149,333
Adjustable-rate mortgage loans	16,108
Equity line of credit loans	55,359
 Total	 \$ 220,800

At December 31, 2007, the Company had unfunded commitments outstanding as follows (in thousands):

Equity lines of credit	\$ 2,122,855
Construction loans	56,489
Private equity investments	14,047
 Total	 \$ 2,193,391

The Company has entered into a commitment in the amount of \$1.5 million for the purchase and installation of a major software license. To date, all but the last installment of \$375 thousand has been paid and has been reflected in the statement of condition. The last installment is expected to be paid in fiscal year 2008.

The Company provides mortgage reinsurance on certain mortgage loans in its own portfolio, including Home Today loans and loans in its servicing portfolio through contracts with two primary mortgage insurance companies. Under these contracts, the Company absorbs mortgage insurance losses in excess of a specified percentage of the principal balance of a given pool of loans, subject to a contractual limit, in exchange for a portion of the pools' mortgage insurance premiums. As of December 31, 2007, approximately \$595.3 million of mortgage loans in our portfolios were covered by such mortgage reinsurance contracts. At December 31, 2007, the maximum losses under the reinsurance contracts were limited to \$16.8 million. The Company has not incurred any losses under these reinsurance contracts but has provided a liability for estimated losses totaling \$3.2 million as of December 31, 2007. Management believes it has made adequate provision for estimated losses.

Under the terms of a purchase agreement of a previously held equity investment in an unrelated corporation, the selling shareholder may require the Company to purchase an additional 21,448 shares of stock of the corporation at fair market value of the stock as determined by an independent valuation. Under an exit agreement, whereby the unrelated corporation has repurchased the original equity investment from the Company, the unrelated corporation has agreed to purchase any additional shares the Company is obligated to acquire from the selling shareholder, with the option of borrowing up to 50% of the funds for this purchase from the Company. As of December 31, 2007, the maximum additional investment

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under the purchase obligation is estimated at \$2.8 million. This obligation expires November 3, 2009.

In management's opinion, the above commitments will be funded through normal operations.

At December 31, 2007, the Company had \$75 million in commitments to securitize and sell mortgages.

On June 13, 2006, the Association was named as the defendant in a putative class action lawsuit, Gary A. Greenspan vs. Third Federal Savings and Loan, filed in the Cuyahoga County, Ohio Court of Common Pleas. The plaintiff has alleged that the Association impermissibly charged customers a document preparation fee that included the cost of preparing legal documents relating to mortgage loans. The plaintiff has alleged that the Association should disgorge the document preparation fees because the document preparation constituted the practice of law and was performed by employees who are not licensed attorneys in the State of Ohio. The plaintiff seeks a refund of all document preparation fees from June 13, 2000 to the present (approximately \$26.9 million from June 13, 2000 through March 31, 2007), as well as prejudgment interest, attorneys' fees and costs of the lawsuit. The Association vigorously disputes these allegations and answered the plaintiff's complaint with a motion for judgment on the pleadings. On April 26, 2007 the Court of Common Pleas issued a final order which granted the Association's motion. On May 11, 2007, the plaintiff appealed the final order of the Court of Common Pleas to the 8th District Court of Appeals (Cuyahoga County). The plaintiff has filed its appellate brief and the Association filed its answer brief on July 20, 2007.

9. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51 (SFAS 160). SFAS 160 requires that a noncontrolling interest in a subsidiary be reported as equity and the amount of consolidated net income specifically attributable to the noncontrolling interest be identified in the consolidated financial statements. It also calls for consistency in the manner of reporting changes in the parent's ownership interest and requires fair value measurement of any noncontrolling equity investment retained in a deconsolidation. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company is currently evaluating the impact adopting SFAS 160 will have on its consolidated financial condition, results of operations, and cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (SFAS 141R). SFAS 141R broadens the guidance of SFAS 141, extending its applicability to all transactions and other events in which one entity obtains control over one or more other businesses. It broadens the fair value measurement and recognition of assets acquired, liabilities assumed, and interests transferred as a result of business combinations. SFAS 141R expands on required disclosures to improve the statement users' abilities to evaluate the nature and financial effects of business combinations. SFAS 141R is effective for the first annual reporting period beginning on or after December 15, 2008. The Company does not expect the adoption of SFAS 141R to have a material effect on its consolidated financial condition, results of operations, or cash flows.

In November 2007, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 109 (SAB 109), an amendment of SAB No. 105, Application of Accounting

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Principles to Loan Commitments. Under SAB 109, the expected net future cash flows of associated servicing should be included in the measurement of written loan commitments accounted for at fair value through earnings. SAB 109 is applicable to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The Company does not expect the adoption of SAB 109 to have a material effect on its consolidated financial condition, results of operations, or cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 provides all entities, including not-for-profit organizations, with the option of reporting selected financial assets and liabilities at fair value. The objective of SFAS 159 is to improve financial reporting by providing opportunities to mitigate volatility in earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Most of the provisions in this statement apply only to entities which elect to adopt SFAS 159. However the amendment to FASB Statement No. 115, Accounting for Certain Investment in Debt and Equity Securities, applies to entities with available for sale and trading securities, and requires an entity to present separately fair value and non-fair value securities. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, Fair Value Measurements. The Company has not determined the effect of adopting SFAS 159 on its consolidated financial condition, results of operations, or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157). SFAS 157 enhances existing guidance for measuring assets and liabilities using fair value. Prior to the issuance of SFAS 157, guidance for applying fair value was incorporated in several pronouncements. SFAS 157 provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the fair value measure of assets and liabilities. SFAS 157 also emphasizes that fair value is a market-based measurement, not an entity specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS 157, fair value measurements are disclosed by level within that hierarchy. While SFAS 157 does not add any new fair value measurements, it does change current practice. Changes to current practice include: (1) a requirement for an entity to include its own credit rating in the measurement of its liabilities; (2) a modification of the transaction price presumption; (3) a prohibition on the use of block discounts when valuing large blocks of securities for broker-dealers and investment companies; and (4) a requirement to adjust the value of restricted stock for the effect of the restriction if the restriction lapses within one year. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company has not determined the effect of adopting SFAS 157 on its consolidated financial condition, results of operations, or cash flows.

In July 2006, the FASB issued FIN 48, which clarifies the accounting for uncertain tax positions. The Company is required to recognize the impact of a tax position if it is more likely than not that it will be sustained upon examination, based upon the technical merits of the position. The effective date for application of FIN 48 is for fiscal years beginning after December 15, 2006. The cumulative effect of applying the provisions of this interpretation must be reported as an adjustment to the opening balance of retained earnings for that fiscal period. The Company adopted FIN 48 on October 1, 2007. Its implementation did not have an effect on its consolidated financial condition, results of operations, or cash flows.

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10. SUBSEQUENT EVENTS

The Company announced on February 11, 2008 that its Board of Directors had declared the Company's first cash dividend of \$0.05 per share, payable on March 10, 2008 to all stockholders of record (other than Third Federal Savings, MHC) on February 25, 2008.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Forward Looking Statements

This report contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include:

statements of our goals, intentions and expectations;

statements regarding our business plans and prospects and growth and operating strategies;

statements regarding the asset quality of our loan and investment portfolios; and

estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following important factors that could affect the actual outcome of future events:

significantly increased competition among depository and other financial institutions;

inflation and changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;

general economic conditions, either nationally or in our market areas, that are worse than expected;

adverse changes in the securities markets;

adverse changes and volatility in credit markets;

legislative or regulatory changes that adversely affect our business;

our ability to enter new markets successfully and take advantage of growth opportunities, and the possible short-term dilutive effect of potential acquisitions or de novo branches, if any;

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changes in consumer spending, borrowing and savings habits;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies and the Financial Accounting Standards Board;

inability of third-party providers to perform their obligations to us; and

changes in our organization, compensation and benefit plans.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements.

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Overview

Our business strategy is to operate as a well-capitalized and profitable financial institution dedicated to providing exceptional personal service to our customers. We cannot assure you that we will successfully implement our business strategy.

Since being organized in 1938, we grew to become, prior to our initial public offering of stock in April 2007, the nation's largest mutually-owned savings and loan association based on total assets. We credit our success to our continued emphasis on our primary values: Love, Trust, Respect, and a Commitment to Excellence, along with some Fun. Our values are reflected in our pricing of loan and deposit products, as well as our Home Today program, as described below. Our values are further reflected in the Broadway Redevelopment Initiative (a long-term revitalization program encompassing the three-mile corridor of the Broadway-Slavic Village neighborhood in Cleveland, Ohio where our main office is located) and the education programs we have established and/or supported. We intend to continue to support our customers.

Approximately 80% of our assets consist of residential real estate loans and equity loans and lines of credit, the overwhelming majority of which were originated to borrowers in the States of Ohio and Florida. We have increased these assets by offering competitive interest rates and product features to customers in our marketplace. Part of this strategy involves programs such as our Lowest Rate Guarantee program (in which we will offer a better interest rate than a competitor's interest rate for certain types of loans or give the loan applicant cash after they close a loan at a lower interest rate) and our Home Today program (where we provide our standard interest rates and flexible credit terms to borrowers who would not normally qualify for such loans). We also offer loan products and features such as high loan-to-value loans that do not require private mortgage insurance, and adjustable-rate mortgage loans that can convert to fixed-rate loans at no cost to the borrower.

Recently there has been significant attention paid to the sub-prime predatory lending component of the residential mortgage origination market. We neither originate nor purchase any sub-prime or option ARM loans. However, we do offer an affordable housing program targeted to benefit low- and moderate-income home buyers. Through its Home Today program the Association originates loans with standard terms to borrowers who might not qualify for such loans. Borrowers in the Home Today program are not charged higher fees or interest rates than non-Home Today borrowers. Unlike sub-prime loans, these loans are not interest only or negative amortizing and contain no low initial payment features or adjustable interest rates. Because the Association applies less stringent underwriting and credit standards to these loans, loans originated under the Home Today program have greater credit risk than traditional residential real estate mortgage loans.

Historically, we have tried to provide our customers with attractive rates of return on our deposit products. Our deposit products typically offer rates that are competitive with the rates on similar products offered by other financial institutions. We intend to continue this practice. Our high-yield checking and high-yield savings accounts, which represented 27% of our total deposits as of December 31, 2007, have provided us with funds that reprice in a manner similar to our equity lines of credit, which has assisted us in managing interest rate risk.

We continue to focus on managing operating expenses. Our annualized ratio of non-interest expense to average assets was 1.31% for the quarter ended December 31, 2007. As of December 31, 2007, our average assets per full-time employee and our average deposits per full-time employee were \$11 million and \$9 million, respectively. Based on industry statistics published by the Office of Thrift Supervision, we believe that each of these measures compare favorably with the averages for our peer group. Our average deposits held at our branch offices

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(\$223 million per branch office as of December 31, 2007) contribute to our expense management efforts by limiting the overhead costs of serving our deposit customers. We will continue our efforts to control operating expenses as we use a portion of the capital we received in the stock offering to grow our business.

We expect to expand our branch office network. Our efforts to expand will focus primarily on eliminating gaps in our current market areas, most likely in the State of Florida. However, we have not established a timetable for expanding our branch network, nor have we determined the specific number of branch offices or specific locations for our expansion efforts.

Critical Accounting Policies

Critical accounting policies are defined as those that involve significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the most critical accounting policies upon which our financial condition and results of operations depend, and which involve the most complex subjective decisions or assessments, are our policies with respect to our allowance for loan losses, mortgage servicing rights, income taxes and pension benefits.

Allowance for Loan Losses. We provide for loan losses based on the allowance method. Accordingly, all loan losses are charged to the related allowance and all recoveries are credited to it. Additions to the allowance for loan losses are provided by charges to income based on various factors which, in our judgment, deserve current recognition in estimating probable losses. We regularly review the loan portfolio and make provisions for loan losses in order to maintain the allowance for loan losses in accordance with accounting principles generally accepted in the United States of America. The allowance for loan losses consists of three components:

- (1) specific allowances established for any impaired loans (generally construction loans and equity lines of credit, and occasionally residential real estate mortgage loans) for which the recorded investment in the loan exceeds the measured value of the loan;
- (2) general allowances for loan losses for each loan type based on historical loan loss experience; and
- (3) adjustments to historical loss experience (general allowances), maintained to cover uncertainties that affect our estimate of probable losses for each loan type.

The adjustments to historical loss experience are based on our evaluation of several factors, including:

delinquency statistics (both current and historical) and the factors behind delinquency trends;

the status of loans in foreclosure, real estate in judgment and real estate owned;

the composition of the loan portfolio;

national, regional and local economic factors;

asset disposition loss statistics (both current and historical); and

the current status of all assets classified during the immediately preceding meeting of the Asset Classification Committee.

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We evaluate the allowance for loan losses based upon the combined total of the specific, historical loss and general components. Generally when the loan portfolio increases, absent other factors, the allowance for loan loss methodology results in a higher dollar amount of estimated probable losses than would be the case without the increase. Generally when the loan portfolio decreases, absent other factors, the allowance for loan loss methodology results in a lower dollar amount of estimated probable losses than would be the case without the decrease.

As described above, loans originated under the Home Today program have greater credit risk than traditional residential real estate mortgage loans. At December 31, 2007, we had \$308 million of loans that were originated under our Home Today program, 29% of which were delinquent 30 days or more in repayments, compared to 1.5% for our portfolio of non-Home Today loans as of that date.

Equity loans and equity lines of credit generally have higher credit risk than traditional residential mortgage loans. These loans and lines are usually in a second position and when combined with the first mortgage, result in generally higher overall loan-to-value ratios. In a stressed housing market with increasing delinquencies and declining housing prices, such as currently exists, these higher loan-to-value ratios represent a greater risk of loss to the Association. A borrower with more equity in the property has a vested interest in keeping the loan current when compared to a borrower with little or no equity in the property. At December 31, 2007, we had \$1.97 billion of equity loans and equity lines of credit outstanding, 3.2% of which were delinquent 30 days or more in repayments.

Construction loans generally have greater credit risk than traditional residential real estate mortgage loans. The repayment of these loans depends upon the sale of the property to third parties or the availability of permanent financing upon completion of all improvements. In the event we make a loan on property that is not yet approved for the planned development, there is the risk that approvals will not be granted or will be delayed. These events may adversely affect the borrower and the collateral value of the property. Construction loans also expose us to the risk that improvements will not be completed on time in accordance with specifications and projected costs. In addition, the ultimate sale or rental of the property may not occur as anticipated.

We periodically evaluate the carrying value of loans and the allowance is adjusted accordingly. While we use the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of its examination process, the Office of Thrift Supervision periodically reviews the allowance for loan losses. The Office of Thrift Supervision may require us to recognize additions to the allowance based on its analysis of information available to it at the time of its examination.

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The following table sets forth the composition of the loan portfolio, by type of loan at the dates indicated, excluding loans held for sale.

	December 31, 2007		September 30, 2007		December 31, 2006	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Real estate loans:						
Residential non-Home Today	\$ 5,957,752	71.0%	\$ 5,842,827	71.5%	\$ 5,303,677	70.0%
Residential Home Today	308,293	3.7	304,046	3.7	291,840	3.9
Equity loans and lines of credit (1)	1,970,296	23.5	1,867,899	22.8	1,775,342	23.4
Construction	139,151	1.7	150,695	1.8	182,943	2.4
Commercial					2,323	
Consumer loans:						
Automobile	4,021		5,627	0.1	12,641	0.2
Other	9,201	0.1	9,065	0.1	8,248	0.1
Total loans receivable	\$ 8,388,714	100.0%	\$ 8,180,159	100.0%	\$ 7,577,014	100.0%
Deferred loan costs (fees)	(18,358)		(19,174)		(18,647)	
Loans in process	(56,490)		(62,167)		(72,953)	
Allowance for loan losses	(26,095)		(25,111)		(21,221)	
Total loans receivable, net	\$ 8,287,771		\$ 8,073,707		\$ 7,464,193	

(1) Includes bridge loans (loans where borrowers can utilize the existing equity in their current home to fund the purchase of a new home before they have sold their current home).

The following table sets forth the allowance for loan losses allocated by loan category, the total loan balances by category, and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	At December 31, 2007			At September 30, 2007			At December 31, 2006		
	Amount	Percent of Allowance to Total	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total	Percent of Loans in Category to Total Loans
	(Dollars in thousands)								
Real estate loans:									
Residential non-Home Today	\$ 5,437	17.1%	71.0%	\$ 4,781	19.1%	71.5%	\$ 4,503	21.2%	70.0%
Residential Home Today	6,056	26.9	3.7	6,361	25.3	3.7	5,532	26.1	3.9
Equity loans and lines of credit (1)	13,651	52.3	23.5	13,141	52.3	22.8	9,671	45.6	23.4
Construction	931	3.6	1.7	778	3.1	1.8	491	2.3	2.4
Commercial				23	0.1		965	4.5	
Consumer loans:									
Automobile loans	18	0.1		25	0.1	0.1	57	0.3	0.2
Other	2		0.1	2		0.1	2		0.1
Total allocated allowance	26,095	100.0	100.0	25,111	100.0	100.0	21,221	100.0	100.0
Unallocated allowance									

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Total allowance for loan losses	\$ 26,095	100.0%	100.0%	\$ 25,111	100.0%	100.0%	\$ 21,221	100.0%	100.0%
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- (1) Includes bridge loans (loans where borrowers can utilize the existing equity in their current home to fund the purchase of a new home before they have sold their current home).

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The following table sets forth activity in our allowance for loan losses for the periods indicated.

	As of and for the Three Months Ended		
	December 31, 2007	September 30, 2007	December 31, 2006
	(Dollars in thousands)		
Allowance balance (beginning of the quarter)	\$ 25,111	\$ 23,814	\$ 20,705
Charge-offs:			
Real estate loans:			
Residential non-Home Today	919	405	581
Residential Home Today	916	343	268
Equity loans and lines of credit (1)	240	685	828
Construction			
Commercial		517	
Consumer loans:			
Automobile loans	2	7	3
Other			
Total charge-offs	2,077	1,957	1,680
Recoveries:			
Real estate loans:			
Residential non-Home Today	38	3	71
Residential Home Today	21		108
Equity loans and lines of credit (1)		1	17
Construction			
Commercial			
Consumer loans:			
Automobile loans	2		
Other			
Total recoveries	61	4	196
Net charge-offs	(2,016)	(1,953)	(1,484)
Provision for loan losses	3,000	3,250	