

TFS Financial CORP
Form 10-Q
February 09, 2011
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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, 2010

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 of America (State or Other Jurisdiction)	52-2054948 (I.R.S. Employer
of Incorporation or Organization)	Identification No.)
7007 Broadway Avenue	
Cleveland, Ohio (Address of Principal Executive Offices)	44105 (Zip Code)
(216) 441-6000	

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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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 <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (do not check if a smaller reporting company)	Smaller Reporting Company <input type="checkbox"/>

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 2, 2011 there were 308,418,393 shares of the Registrant's common stock, par value \$0.01 per share, outstanding, of which 227,119,132 shares, or 73.65% of the Registrant's common stock, were held by Third Federal Savings and 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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TFS Financial Corporation

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****TFS FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CONDITION (unaudited)****(In thousands, except share data)**

	December 31, 2010	September 30, 2010
ASSETS		
Cash and due from banks	\$ 37,401	\$ 38,804
Other interest-bearing cash equivalents	305,091	704,936
Cash and cash equivalents	342,492	743,740
Investment securities:		
Available for sale (amortized cost \$18,104 and \$24,480, respectively)	18,095	24,619
Held to maturity (fair value \$557,147 and \$657,076, respectively)	551,255	646,940
	569,350	671,559
Mortgage loans held for sale (includes \$0 measured at fair value at September 30, 2010)	0	25,027
Loans held for investment, net:		
Mortgage loans	9,861,694	9,323,073
Other loans	7,237	7,199
Deferred loan fees, net	(16,241)	(15,283)
Allowance for loan losses	(148,246)	(133,240)
Loans, net	9,704,444	9,181,749
Mortgage loan servicing assets, net	33,532	38,658
Federal Home Loan Bank stock, at cost	35,620	35,620
Real estate owned	16,472	15,912
Premises, equipment, and software, net	62,142	62,685
Accrued interest receivable	36,697	36,282
Bank owned life insurance contracts	165,974	164,334
Other assets	97,949	100,461
TOTAL ASSETS	\$ 11,064,672	\$ 11,076,027
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits	\$ 8,793,314	\$ 8,851,941
Borrowed funds	64,155	70,158
Borrowers' advances for insurance and taxes	55,044	51,401
Principal, interest, and related escrow owed on loans serviced	292,452	284,425
Accrued expenses and other liabilities	112,131	65,205
Total liabilities	9,317,096	9,323,130
Commitments and contingent liabilities		
Preferred stock, \$0.01 par value, 100,000,000 shares authorized, none issued and outstanding	0	0

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Common stock, \$0.01 par value, 700,000,000 shares authorized; 332,318,750 shares issued; 308,395,893, and 308,395,000 outstanding at December 31, 2010 and September 30, 2010, respectively	3,323	3,323
Paid-in capital	1,687,535	1,686,062
Treasury stock, at cost; 23,922,857 and 23,923,750 shares at December 31, 2010 and September 30, 2010, respectively	(288,354)	(288,366)
Unallocated ESOP shares	(82,335)	(82,699)
Retained earnings substantially restricted	445,285	452,633
Accumulated other comprehensive loss	(17,878)	(18,056)
Total shareholders equity	1,747,576	1,752,897
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 11,064,672	\$ 11,076,027

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,	
	2010	2009
INTEREST INCOME:		
Loans, including fees	\$ 103,200	\$ 107,048
Investment securities available for sale	111	113
Investment securities held to maturity	3,337	5,073
Other interest and dividend earning assets	793	569
 Total interest and dividend income	 107,441	 112,803
INTEREST EXPENSE:		
Deposits	47,278	55,013
Borrowed funds	477	485
 Total interest expense	 47,755	 55,498
NET INTEREST INCOME	59,686	57,305
PROVISION FOR LOAN LOSSES	34,500	16,000
 NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	 25,186	 41,305
NON-INTEREST INCOME		
Fees and service charges, net of amortization	2,904	5,470
Mortgage servicing assets impairment	(284)	(73)
Net gain on the sale of loans	0	3,041
Increase in and death benefits from bank owned life insurance contracts	1,640	1,608
Income on private equity investments	183	115
Other	2,376	1,472
 Total non-interest income	 6,819	 11,633
NON-INTEREST EXPENSE		
Salaries and employee benefits	17,485	21,171
Marketing services	2,101	2,025
Office property, equipment and software	5,110	5,253
Federal insurance premium	5,985	4,209
State franchise tax	939	1,042
Real estate owned expense, net	1,925	1,735
Other operating expenses	9,399	4,664
 Total non-interest expense	 42,944	 40,099
(LOSS) INCOME BEFORE INCOME TAXES	(10,939)	12,839
INCOME TAX (BENEFIT) EXPENSE	(3,591)	3,913
 NET (LOSS) INCOME	 \$ (7,348)	 \$ 8,926

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(Loss) earnings per share - basic and diluted	\$	(0.02)	\$	0.03
Weighted average shares outstanding				
Basic		300,140,571		299,658,526
Diluted		300,140,571		300,150,676

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents**TFS FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (unaudited)****Three Months Ended December 31, 2010 and 2009****(In thousands)**

	Common stock	Paid-in capital	Treasury stock	Unallocated common stock held by ESOP	Retained earnings	Unrealized gains/(losses) on securities	Accumulated other comprehensive income (loss) Pension obligation	Total shareholders equity
Balance at September 30, 2009	\$ 3,323	1,679,000	(287,514)	(87,896)	456,875	240	(18,163)	\$ 1,745,865
Comprehensive Income								
Net income					8,926			8,926
Change in unrealized losses on securities available for sale						(62)		(62)
Change in pension obligation							339	339
Total comprehensive income								9,203
Purchase of treasury stock (161,400 shares)			(1,810)					(1,810)
ESOP shares allocated or committed to be released		194		1,228				1,422
Compensation costs for stock-based plans		1,644						1,644
Excess tax effect from stock-based compensation		41						41
Dividends paid to common shareholders (\$0.07 per common share)					(5,168)			(5,168)
Balance at December 31, 2009	\$ 3,323	1,680,879	(289,324)	(86,668)	460,633	178	(17,824)	\$ 1,751,197
Balance at September 30, 2010	\$ 3,323	1,686,062	(288,366)	(82,699)	452,633	90	(18,146)	\$ 1,752,897
Comprehensive Income								
Net loss					(7,348)			(7,348)
Change in unrealized losses on securities available for sale						(97)		(97)
Change in pension obligation							275	275
Total comprehensive loss								(7,170)
ESOP shares allocated or committed to be released		(321)		364				43
Compensation costs for stock-based plans		1,795	12					1,807
Excess tax effect from stock-based compensation		(1)						(1)
Balance at December 31, 2010	\$ 3,323	1,687,535	(288,354)	(82,335)	445,285	(7)	(17,871)	\$ 1,747,576

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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,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	\$ (7,348)	\$ 8,926
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
ESOP and stock-based compensation expense	1,850	3,066
Depreciation and amortization	7,779	3,992
Mortgage servicing asset impairment	284	73
Deferred income taxes	800	0
Provision for loan losses	34,500	16,000
Net gain on the sale of loans	0	(3,041)
Other net gains	940	3,718
Principal repayments on and proceeds from sales of loans held for sale	0	49,263
Loans originated for sale	0	(86,538)
Increase in bank owned life insurance contracts	(1,640)	(1,606)
Net decrease (increase) in interest receivable and other assets	925	(45,699)
Net increase in accrued expenses and other liabilities	47,349	50,146
Other	276	(176)
Net cash provided by (used in) operating activities	85,715	(1,876)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans originated	(1,162,813)	(527,250)
Principal repayments on loans	625,397	351,264
Proceeds from sales, principal repayments and maturities of:		
Securities available for sale	8,380	3,498
Securities held to maturity	94,393	58,257
Proceeds from sale of:		
Loans	0	122,636
Real estate owned	3,746	5,339
Purchases of:		
Securities available for sale	(2,041)	(2,105)
Securities held to maturity	0	(107,431)
Premises and equipment	(874)	(615)
Other	(190)	136
Net cash used in investing activities	(434,002)	(96,271)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in deposits	(58,627)	36,911
Net increase (decrease) in borrowings advances for insurance and taxes	3,643	(124)
Net increase in principal and interest owed on loans serviced	8,027	37,190
Net (decrease) increase in short term borrowed funds	(3)	5
Repayment of borrowings	(6,000)	0
Purchase of treasury shares	0	(1,810)
Excess tax benefit related to stock-based compensation	(1)	41
Dividends paid to common shareholders	0	(5,168)

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Net cash (used in) provided by financing activities	(52,961)	67,045
NET DECREASE IN CASH AND EQUIVALENTS	(401,248)	(31,102)
CASH AND CASH EQUIVALENTS Beginning of period	743,740	307,046
CASH AND CASH EQUIVALENTS End of period	\$ 342,492	\$ 275,944
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest on deposits	\$ 48,359	\$ 57,405
Cash paid for interest on borrowed funds	473	480
Cash paid for income taxes	4,500	5,500
SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of loans to real estate owned	5,057	7,435
Transfer of loans from held for sale to held for investment	25,027	0
See accompanying notes to unaudited interim consolidated financial statements.		

Table of Contents**TFS FINANCIAL CORPORATION AND SUBSIDIARIES****NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands unless otherwise indicated)

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, 2010, approximately 74% of the Holding Company's outstanding shares were 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 (U.S. GAAP) and to general practices in the financial services industry. The preparation of financial statements in conformity with U.S. 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 rights, the valuation of deferred tax assets, and the determination of pension obligations and stock-based compensation 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, 2010, 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 Annual Report on Form 10-K for the fiscal year ended September 30, 2010 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, 2011.

2. EARNINGS PER SHARE

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

	Income	For the Three Months ended December 31,		Income	Shares	Per share amount
		2010	2009			
		Shares	Per share amount			
		(Dollars in thousands, except per share data)				
Net (loss) income	\$ (7,348)			\$ 8,926		
Less: (loss) income allocated to restricted stock units	(42)			140		
Basic (loss) earnings per share:						
(Loss) income available to common shareholders	\$ (7,306)	300,140,571	\$ (0.02)	\$ 8,786	299,658,526	\$ 0.03
Diluted (loss) earnings per share:						
Effect of dilutive potential common shares		0			492,150	

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(Loss) income available to common shareholders	\$ (7,306)	300,140,571	\$ (0.02)	\$ 8,786	300,150,676	\$ 0.03
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Earnings per share is computed by dividing the income available to common stockholders by the weighted average number of shares outstanding for the period. 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), stock options and

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restricted stock units with a dilutive impact granted under the Company's 2008 Equity Incentive Plan 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.

Due to the net loss for the three months ended December 31, 2010, the diluted earnings per share calculation excludes all common stock equivalents, including 1,703,200 shares of unvested restricted stock, 4,865,434 of unvested outstanding stock options and 152,991 of vested outstanding stock options. The shares were excluded from the computation of net loss per diluted share because their inclusion would have been anti-dilutive to earnings per share. For the three months ended December 31, 2009, there were 4,601,925 of unvested outstanding stock options excluded from the computation of net income per diluted share because their inclusion would have been anti-dilutive to earnings per share.

3. INVESTMENT SECURITIES

Investments securities available for sale are summarized as follows:

	December 31, 2010			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
U.S. government and agency obligations	\$ 2,000	\$ 0	\$ (64)	\$ 1,936
Real estate mortgage investment conduits (REMICs)	7,395	67	(12)	7,450
Money market accounts	8,709	0	0	8,709
	\$ 18,104	\$ 67	\$ (76)	\$ 18,095

	September 30, 2010			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
U.S. government and agency obligations	\$ 7,000	\$ 63	\$ 0	\$ 7,063
REMICs	8,718	90	(14)	8,794
Money market accounts	8,762	0	0	8,762
	\$ 24,480	\$ 153	\$ (14)	\$ 24,619

Investments held to maturity are summarized as follows:

	December 31, 2010			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
Freddie Mac certificates	\$ 3,421	\$ 190	\$ 0	\$ 3,611
Ginnie Mae certificates	21,815	444	0	22,259
REMICs	517,477	4,842	(372)	521,947
Fannie Mae certificates	8,542	788	0	9,330
	\$ 551,255	\$ 6,264	\$ (372)	\$ 557,147

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	September 30, 2010			
	Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses	
Freddie Mac certificates	\$ 4,441	\$ 231	\$ 0	\$ 4,672
Ginnie Mae certificates	22,375	598	0	22,973
REMICs	611,000	8,754	(268)	619,486
Fannie Mae certificates	9,124	821	0	9,945
	\$ 646,940	\$ 10,404	\$ (268)	\$ 657,076

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans held for investment consist of the following:

	December 31, 2010	September 30, 2010
Real estate loans:		
Residential non-Home Today	\$ 6,795,483	\$ 6,138,454
Residential Home Today	276,197	280,533
Home equity loans and lines of credit	2,737,188	2,848,690
Construction	89,433	100,404
Real estate loans	9,898,301	9,368,081
Consumer and other loans	7,237	7,199
Less:		
Deferred loan fees net	(16,241)	(15,283)
Loans-in-process (LIP)	(36,607)	(45,008)
Allowance for loan losses	(148,246)	(133,240)
Loans held for investment, net	\$ 9,704,444	\$ 9,181,749

A large concentration of the Company's lending is in Ohio. As of December 31, 2010 and September 30, 2010, the percentage of residential real estate loans held in Ohio and Florida were 80% and 18%, respectively. As of December 31, 2010 and September 30, 2010, home equity loans and lines of credit held in Ohio and Florida were 40% and 28%, respectively. The percentage Home equity loans and lines of credit in California, as of December 31, 2010 and September 30, 2010 were 12% and 11%, respectively. The economic conditions and market for real estate in those states have a significant impact on the ability of borrowers in those areas to repay their loans. Effective June 28, 2010, the Association suspended the acceptance of new equity line of credit applications.

Home Today is an affordable housing program targeted to benefit low- and moderate-income home buyers. Through this program, prior to March 27, 2009, the Association provided loans to borrowers who would not otherwise qualify for our loan products, generally because of low credit scores. Although the credit profiles of borrowers in the Home Today program prior to March 27, 2009 might be described as sub-prime, Home Today loans generally contain the same features as loans offered to our non-Home Today borrowers. Borrowers in the Home Today program 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 prior to March 27, 2009 the Association applied less stringent underwriting and credit standards to these loans, loans originated under the Home Today program prior to that date have greater credit risk than its traditional residential real estate mortgage loans. Effective March 27, 2009, the Home Today underwriting guidelines are substantially the same as our traditional first mortgage product. As of December 31, 2010, the balance of Home Today loans originated prior to March 37, 2009 was \$274,092. The Association does not offer, and has not offered, loan products frequently considered to be designed to target sub-prime borrowers containing features such as higher fees or higher rates, negative amortization, a loan-to-value ratio greater than 100%, or option adjustable-rate mortgages.

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The recorded investment of loan receivables in non-accrual status is summarized in the following table. Balances are net of deferred fees.

	December 31, 2010	September 30, 2010
Real estate loans:		
Residential non-Home Today	\$ 131,634	\$ 135,109
Residential Home Today	87,690	91,985
Home equity loans and lines of credit	52,596	54,481
Construction	3,621	4,994
Total real estate loans	275,541	286,569
Consumer and other loans	1	1
Total non-accrual loans	\$ 275,542	\$ 286,570

Loans are placed in nonaccrual status when they are contractually 90 days or more past due. At December 31, 2010 and September 30, 2010, there were no loans 90 days or more past due and still accruing. Loans modified in troubled debt restructurings that were in nonaccrual status prior to the restructurings remain in nonaccrual status for a minimum of six months. Accrued interest on loans in non-accrual status is reversed by a charge to interest income and income is subsequently recognized only to the extent cash payments are received. A loan in nonaccrual is returned to accrual status, when, in management's judgment, the borrower's ability to make periodic interest and principal payments is back to normal. Total nonaccrual loans at December 31, 2010 and September 30, 2010 includes \$24.2 and \$32.4 million, respectively, in troubled debt restructurings which are current but included with nonaccrual loans for a minimum period of six months from the restructuring date due to their nonaccrual status prior to restructuring.

Age analysis of the recorded investment in loan receivables that are past due at December 31, 2010 and September 30, 2010 is summarized in the following tables. Balances are net of deferred fees and any applicable LIP.

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total
December 31, 2010						
Real estate loans:						
Residential non-Home Today	\$ 19,712	\$ 14,000	\$ 122,729	\$ 156,441	\$ 6,609,222	\$ 6,765,663
Residential Home Today	12,707	9,100	72,761	94,568	180,417	274,985
Home equity loans and lines of credit	12,780	9,672	52,330	74,782	2,677,960	2,752,742
Construction	1,543	0	3,621	5,164	46,899	52,063
Total real estate loans	\$ 46,742	\$ 32,772	\$ 251,441	\$ 330,955	\$ 9,514,498	\$ 9,845,453
Consumer and other loans	0	0	1	1	7,236	7,237
Total	\$ 46,742	\$ 32,772	\$ 251,442	\$ 330,956	\$ 9,521,734	\$ 9,852,690

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total
September 30, 2010						
Real estate loans:						
Residential non-Home Today	\$ 20,748	\$ 9,933	\$ 121,601	\$ 152,282	\$ 5,955,965	\$ 6,108,247
Residential Home Today	12,836	8,970	74,831	96,637	182,515	279,152
Home equity loans and lines of credit	14,144	7,233	53,948	75,325	2,790,611	2,865,936

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Construction	558	0	3,980	4,538	49,917	54,455
Total real estate loans	48,286	26,136	254,360	328,782	8,979,008	9,307,790
Consumer and other loans	0	0	1	1	7,198	7,199
Total	\$ 48,286	\$ 26,136	\$ 254,361	\$ 328,783	\$ 8,986,206	\$ 9,314,989

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

	Beginning Balance	For the Three Months Ended December 31, 2010			Ending Balance
		Provisions	Charge-offs	Recoveries	
Real estate loans:					
Residential non-Home Today	\$ 41,246	\$ 11,474			