

TFS Financial CORP
Form 10-K
December 21, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended September 30, 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)

United States
(State or Other Jurisdiction of

Incorporation or Organization)

7007 Broadway Avenue

Cleveland, Ohio
(Address of Principal Executive Offices)

52-2054948
(I.R.S. Employer

Identification No.)

44105
(Zip Code)

(216) 441-6000

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(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value \$0.01 per share

(Title of class)

The NASDAQ Stock Market, LLC

(Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

At December 14, 2007 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.

DOCUMENTS INCORPORATED BY REFERENCE (to the Extent Indicated Herein)

Portions of the registrant's Proxy Statement for the 2008 Annual Meeting of Stockholders are incorporated by reference in Part III hereof.

TFS Financial Corporation

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PART I

Item 1. Business
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;

changes in consumer spending, borrowing and savings habits;

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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. Please see **Item 1A. Risk Factors**, for a discussion of certain risks related to our business.

TFS FINANCIAL CORPORATION

TFS Financial Corporation (we us our or the Company) was organized in 1997 as the mid-tier stock holding company for Third Federal Savings and Loan Association of Cleveland (Third Federal Savings and Loan or the Association). We completed our initial public stock offering on April 20, 2007 and issued 100,199,618 shares of common stock, or 30.16% of our post-offering outstanding common stock, to subscribers in the offering. Additionally, at the time of the public offering, 5,000,000 shares of our common stock, or 1.50% of our outstanding shares, were issued to our newly formed charitable foundation, Third Federal Foundation (the Foundation). Third Federal Savings and Loan Association of Cleveland, MHC (Third Federal Savings, MHC), our mutual holding company parent, holds the remainder of our outstanding common stock (227,119,132 shares, or 68.34%). Net proceeds from our initial public stock offering were approximately \$886

million and reflected the costs we incurred in completing the offering as well as a \$106.5 million loan to the Third Federal Employee Stock Ownership Plan related to its acquisition of shares in the initial public offering.

Our ownership of the Association remains our primary business activity.

We also operate Third Capital, Inc. as a wholly-owned subsidiary.

As the holding company of Third Federal Savings and Loan, we are authorized to pursue other business activities permitted by applicable laws and regulations for savings and loan holding companies, which include making equity investments and the acquisition of banking and financial services companies. We have no plans for any mergers or acquisitions at the present time.

Our cash flow depends primarily on earnings from the investment of the portion of the net offering proceeds we retained, and any dividends we receive from Third Federal Savings and Loan and Third Capital, Inc. The majority of our officers are also officers of the Association. In addition, we use the services of the support staff of the Association from time to time. We may hire additional employees, as needed, to the extent we expand our business in the future.

THIRD CAPITAL, INC.

Third Capital, Inc. is a Delaware corporation that was organized in 1998 as our wholly-owned subsidiary. At September 30, 2007, Third Capital, Inc. had consolidated assets of \$74 million, and for the fiscal year ended September 30, 2007, Third Capital, Inc. had consolidated net income of \$5.3 million. Third Capital, Inc. has no separate operations other than as the holding company for its operating subsidiaries, and as a minority investor or partner in other entities. The following is a description of the entities in which Third Capital, Inc. is the owner, an investor or a partner.

Hazelmere Investment Group I, Ltd. and Hazelmere of California Limited Partnership. These entities engage in net lease transactions of commercial buildings in targeted United States markets. Third Capital, Inc. is a partner of each of these entities, receives a preferred return on amounts contributed to acquire investment properties and has a 70% ownership interest in remaining earnings. James Gascoigne, a director of the Company, indirectly owns or controls the majority of the remaining 30% ownership interest of these entities. During fiscal 2007, property owned by Hazelmere of California Limited Partnership was sold. A pre-tax gain of \$3.2 million was recognized in connection with that sale. Overall, the Hazelmere entities had pre-tax income of \$5.0 million during fiscal 2007.

Third Cap Associates, Inc. This corporation maintains minority investments in private equity funds, and also owns between 49% and 60% of three title agencies that provide escrow and settlement services in the State of Ohio, primarily to customers of Third Federal Savings and Loan. For the fiscal year ended September 30, 2007, Third Cap Associates, Inc. recorded net income of \$2.8 million. Third Capital, Inc. also invests in private equity funds.

Third Capital Mortgage Insurance Company. This Vermont corporation reinsures private mortgage insurance on residential mortgage loans originated by Third Federal Savings and Loan. For the fiscal year ended September 30, 2007, Third Capital Mortgage Insurance Company incurred a net loss of \$1.3 million.

THIRD FEDERAL SAVINGS AND LOAN ASSOCIATION OF CLEVELAND

General

Third Federal Savings and Loan is a federally chartered savings and loan association headquartered in Cleveland, Ohio that was organized in 1938. In May 1997, the Association reorganized into its current two-tier mutual holding company structure. The Association's principal business consists of originating residential real estate mortgage loans and equity loans and lines of credit and attracting retail savings deposits.

The Association's business strategy is to originate mortgage loans with interest rates that are competitive with those of similar products offered by other financial institutions in its markets. Similarly, the Association offers high-yield checking accounts and high-yield savings accounts and certificate of deposit accounts, each bearing interest rates that are competitive with similar products offered by other financial institutions in its markets. The Association expects to continue to pursue this business philosophy. While this strategy does not enable it to earn the highest rates of interest on loans it offers or pay the lowest rates on its deposit accounts, the Association believes that this strategy is the primary reason for its successful growth in the past.

The Association attracts retail deposits from the general public in the areas surrounding its main office and its branch offices. It also utilizes its internet website and its telephone call center to generate loan applications and attract retail deposits. In addition to residential real estate mortgage loans and equity loans and lines of credit, the Association originates residential construction loans. The Association retains in its portfolio the majority of the loans that it originates. Loans that the Association sells consist primarily of long-term, fixed-rate residential real estate mortgage loans. The Association retains the servicing rights on all loans that it sells. The Association's revenues are derived primarily from interest on loans and, to a lesser extent, interest on interest-bearing deposits in other financial institutions, federal funds sold, and investment securities including mortgage-backed securities. The Association also generates revenues from fees and service charges. The Association's primary sources of funds are deposits, borrowings, principal and interest payments on loans and securities and proceeds from loan sales.

The Association's website address is www.thirdfederal.com. Information on that website is not and should not be considered a part of this document.

Market Area

Third Federal Savings and Loan conducts its operations from its main office in Cleveland, Ohio, and from 36 additional, full-service branches and eight loan production offices located throughout the states of Ohio and Florida. In Ohio, the Association's 23 full-service offices are located in the northeast Ohio counties of Cuyahoga, Lake, Lorain, Medina and Summit, four loan production offices are located in the central Ohio county of Franklin (Columbus, Ohio) and four loan production offices are located in the southern Ohio county of Hamilton (Cincinnati, Ohio). In Florida, 14 full-service branches are located in the counties of Pasco, Pinellas, Hillsboro, Sarasota, Lee, Collier, Miami-Dade and Palm Beach.

Competition

The Association faces intense competition in its market areas both in making loans and attracting deposits. Its market areas have a high concentration of financial institutions, including large money center and regional banks, community banks and credit unions and it faces additional competition for deposits from money market funds, brokerage firms, mutual funds and insurance companies. Some of its competitors offer products and services that the Association currently does not offer, such as commercial business loans, trust services and private banking.

The majority of the Association's deposits are held in its offices located in Cuyahoga County, Ohio. As of June 30, 2007 (the latest date for which information is publicly available), the Association had \$4.3 billion of deposits in Cuyahoga County, and ranked fourth among all financial institutions with offices in the county in terms of deposits, with a market share of 8.85%. As of that date, the Association had \$5.3 billion of deposits in the State of Ohio, and ranked 11th among all financial institutions in the state in terms of deposits, with a market share of 2.53%. As of June 30, 2007, the Association had \$2.7 billion of deposits in the State of Florida, and ranked 22nd among all financial institutions in terms of deposits, with a market share of 0.72%.

From January 2007 through September 2007, the Association had the largest market share of conventional purchase mortgage loans originated in Cuyahoga County, Ohio. For the same period, it also had the largest market share of conventional purchase mortgage loans originated in Cuyahoga, Summit, Lake and Lorain counties, four of the largest northeast Ohio counties. In addition, based on the same statistic, the Association has consistently been one of the six largest conventional purchase mortgage loan lenders in Franklin County (Columbus, Ohio) and Hamilton County (Cincinnati, Ohio) since it entered those markets in 1999.

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The Association's primary strategy for increasing and retaining its customer base is to offer competitive deposit and loan rates and other product features, delivered with exceptional customer service, in each of the markets it serves.

Lending Activities

The Association's principal lending activity is the origination of first mortgage loans to purchase or refinance residential real estate. Its current policies generally provide that it will maintain between 40% and 70% of its assets in fixed-rate, residential real estate, first mortgage loans and up to 20% of its assets in adjustable-rate, residential real estate, first mortgage loans, subject to its liquidity levels and the credit demand of its customers. The Association also originates a significant amount of equity loans and equity lines of credit, and, to a lesser extent, residential construction loans. At September 30, 2007, residential real estate mortgage loans totaled \$6.1 billion, or 75.2% of our loan portfolio, equity loans and lines of credit totaled \$1.9 billion, or 22.8% of our loan portfolio, and residential construction loans totaled \$150.7 million, or 1.8% of our loan portfolio.

Loan Portfolio Composition. The following table sets forth the composition of the Association's loan portfolio, by type of loan at the dates indicated, excluding loans held for sale.

	2007		2006		At September 30, 2005		2004		2003	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in thousands)										
Real estate loans:										
Residential non-Home										
Today	\$ 5,842,827	71.5%	\$ 5,278,290	69.4%	\$ 5,257,601	67.5%	\$ 4,572,814	61.9%	\$ 4,305,605	63.5%
Residential Home Today	304,046	3.7	285,492	3.8	250,068	3.2	194,715	2.6	93,317	1.4
Equity loans and lines of credit(1)										
Construction	150,695	1.8	207,634	2.7	270,136	3.5	236,681	3.2	208,175	3.1
Commercial		0.0	2,335	0.0	2,383	0.0	3,354	0.0	5,333	0.1
Consumer loans:										
Automobile	5,627	0.1	15,676	0.2	33,410	0.4	70,647	1.0	65,732	1.0
Other	9,065	0.1	12,793	0.2	10,847	0.2	11,243	0.2	10,805	0.1
Total loans receivable	\$ 8,180,159	100.0%	\$ 7,606,120	100.00%	\$ 7,790,049	100.00%	\$ 7,391,231	100.00%	\$ 6,780,627	100.00%
Deferred loan costs										
(fees)	(19,174)		(18,698)		(22,783)		(16,602)		(18,894)	
Loans in process	(62,167)		(89,676)		(127,944)		(114,413)		(106,909)	
Allowance for loan losses	(25,111)		(20,705)		(18,601)		(15,080)		(11,932)	
Total loans receivable, net	\$ 8,073,707		\$ 7,477,041		\$ 7,620,721		\$ 7,245,136		\$ 6,642,892	

(1) Includes bridge loans.

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Loan Portfolio Maturities. The following table summarizes the scheduled repayments of the Association's loan portfolio at September 30, 2007. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in the fiscal year ending September 30, 2008. Maturities are based on the final contractual payment date and do not reflect the impact of prepayments and scheduled principal amortization.

Due During the Years Ending September 30,	Residential Real Estate		Equity Loans	Construction Loans	Automobile Loans	Other Consumer Loans	Total
	non-Home Today	Home Today	and Lines of Credit(1)				
(Dollars in thousands)							
2008	\$ 12,623	\$	\$ 82,372	\$ 37,525	\$ 1,953	\$ 8,490	\$ 142,963
2009	11,701	3	5,249	22,407	3,292		42,652
2010	4,108		5,633		383		10,124
2011 to 2012	27,489		41,503				68,992
2013 to 2017	339,325	568	84,199			575	424,667
2018 to 2022	820,425	6,023	245,738	9,914			1,082,100
2022 and beyond	4,627,155	297,452	1,403,205	80,849			6,408,661
Total	\$ 5,842,826	\$ 304,046	\$ 1,867,899	\$ 150,695	\$ 5,628	\$ 9,065	\$ 8,180,159

(1) Includes bridge loans.

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at September 30, 2007 that are contractually due after September 30, 2008.

	Due After September 30, 2008		
	Fixed	Adjustable	Total
(Dollars In thousands)			
Real estate loans:			
Residential non-Home Today	\$ 5,044,476	\$ 785,727	\$ 5,830,203
Residential Home Today	303,806	240	304,046
Equity Loans and Lines of Credit(1)	208,952	1,576,575	1,785,527
Construction	97,305	15,865	113,170
Consumer Loans:			
Automobile	3,675		3,675
Other	575		