

TFS Financial CORP
Form 10-Q
February 08, 2018
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended December 31, 2017

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 of America	52-2054948
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

7007 Broadway Avenue	44105
Cleveland, Ohio	
(Address of Principal Executive Offices)	(Zip Code)
(216) 441-6000	

Registrant's telephone number, including area code:
Not Applicable

(Former name, former address and former fiscal year, 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, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

Edgar Filing: TFS Financial CORP - Form 10-Q

Non-accelerated filer (do not check if a smaller reporting company) Smaller Reporting Company

Emerging Growth Company

If an emerging company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of February 5, 2018, there were 280,860,417 shares of the Registrant's common stock, par value \$0.01 per share, outstanding, of which 227,119,132 shares, or 80.9% of the Registrant's common stock, were held by Third Federal Savings and Loan Association of Cleveland, MHC, the Registrant's mutual holding company.

Table of ContentsTFS Financial Corporation
INDEX

	Page
<u>Glossary of Terms</u>	<u>3</u>
PART I – FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (unaudited)</u>	
Consolidated Statements of Condition December 31, 2017 and September 30, 2017	4
<u>Consolidated Statements of Income</u> Three Months Ended December 31, 2017 and 2016	<u>5</u>
<u>Consolidated Statements of Comprehensive Income</u> Three Months Ended December 31, 2017 and 2016	6
<u>Consolidated Statements of Shareholders' Equity</u> Three Months Ended December 31, 2017 and 2016	7
Consolidated Statements of Cash Flows Three Months Ended December 31, 2017 and 2016	8
<u>Notes to Unaudited Interim Consolidated Financial Statements</u>	9
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>34</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>61</u>
Item 4. <u>Controls and Procedures</u>	<u>65</u>
Part II — OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	<u>65</u>
Item 1A. <u>Risk Factors</u>	<u>65</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>66</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>66</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>66</u>
Item 5. <u>Other Information</u>	<u>66</u>
Item 6. <u>Exhibits</u>	<u>67</u>

SIGNATURES

68

2

Table of Contents

GLOSSARY OF TERMS

TFS Financial Corporation provides the following list of acronyms and defined terms as a tool for the reader. The acronyms and defined terms identified below are used throughout the document.

ACT: Tax Cuts and Jobs Act	FRB-Cleveland: Federal Reserve Bank of Cleveland
AOCI: Accumulated Other Comprehensive Income	Freddie Mac: Federal Home Loan Mortgage Association
ARM: Adjustable Rate Mortgage	FRS: Board of Governors of the Federal Reserve System
ASC: Accounting Standards Codification	GAAP: Generally Accepted Accounting Principles
ASU: Accounting Standards Update	Ginnie Mae: Government National Mortgage Association
Association: Third Federal Savings and Loan Association of Cleveland	GVA: General Valuation Allowances
BOLI: Bank Owned Life Insurance	HARP: Home Affordable Refinance Program
CDs: Certificates of Deposit	HPI: Home Price Index
CFPB: Consumer Financial Protection Bureau	IRR: Interest Rate Risk
CLTV: Combined Loan-to-Value	IRS: Internal Revenue Service
Company: TFS Financial Corporation and its subsidiaries	IVA: Individual Valuation Allowance
DFA: Dodd-Frank Wall Street Reform and Consumer Protection Act	LIHTC: Low Income Housing Tax Credit
EaR: Earnings at Risk	LIP: Loans-in-Process
EPS: Earnings per Share	LTV: Loan-to-Value
ESOP: Third Federal Employee (Associate) Stock Ownership Plan	MGIC: Mortgage Guaranty Insurance Corporation
EVE: Economic Value of Equity	OCC: Office of the Comptroller of the Currency
Fannie Mae: Federal National Mortgage Association	OCI: Other Comprehensive Income
FASB: Financial Accounting Standards Board	OTS: Office of Thrift Supervision
FDIC: Federal Deposit Insurance Corporation	PMI: Private Mortgage Insurance
FHFA: Federal Housing Finance Agency	PMIC: PMI Mortgage Insurance Co.
FHLB: Federal Home Loan Bank	QTL: Qualified Thrift Lender
FICO: Financing Corporation	REMICs: Real Estate Mortgage Investment Conduits
	SEC: United States Securities and Exchange Commission
	TDR: Troubled Debt Restructuring
	Third Federal Savings, MHC: Third Federal Savings and Loan Association of Cleveland, MHC

Table of Contents

Item 1. Financial Statements

TFS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CONDITION (unaudited)
(In thousands, except share data)

	December 31, 2017	September 30, 2017
ASSETS		
Cash and due from banks	\$34,418	\$35,243
Interest-earning cash equivalents	289,147	232,975
Cash and cash equivalents	323,565	268,218
Investment securities available for sale (amortized cost \$548,087 and \$541,964, respectively)	538,991	537,479
Mortgage loans held for sale, at lower of cost or market (none measured at fair value)	1,259	351
Loans held for investment, net:		
Mortgage loans	12,579,194	12,434,339
Other consumer loans	2,886	3,050
Deferred loan expenses, net	33,251	30,865
Allowance for loan losses	(45,929)	(48,948)
Loans, net	12,569,402	12,419,306
Mortgage loan servicing rights, net	8,168	8,375
Federal Home Loan Bank stock, at cost	92,111	89,990
Real estate owned	4,290	5,521
Premises, equipment, and software, net	63,144	60,875
Accrued interest receivable	35,622	35,479
Bank owned life insurance contracts	207,426	205,883
Other assets	43,902	61,086
TOTAL ASSETS	\$13,887,880	\$13,692,563
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits	\$8,207,351	\$8,151,625
Borrowed funds	3,758,855	3,671,377
Borrowers' advances for insurance and taxes	95,398	100,446
Principal, interest, and related escrow owed on loans serviced	32,907	35,766
Accrued expenses and other liabilities	92,691	43,390
Total liabilities	12,187,202	12,002,604
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; 281,002,481 and 281,291,750 outstanding at December 31, 2017 and September 30, 2017, respectively	3,323	3,323
Paid-in capital	1,721,067	1,722,672
Treasury stock, at cost; 51,316,269 and 51,027,000 shares at December 31, 2017 and September 30, 2017, respectively	(741,034)	(735,530)
Unallocated ESOP shares	(52,001)	(53,084)
Retained earnings—substantially restricted	771,317	760,070
Accumulated other comprehensive loss	(1,994)	(7,492)
Total shareholders' equity	1,700,678	1,689,959
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$13,887,880	\$13,692,563

See accompanying notes to unaudited interim consolidated financial statements.

4

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,	
	2017	2016
INTEREST AND DIVIDEND INCOME:		
Loans, including fees	\$ 102,626	\$ 95,380
Investment securities available for sale	2,589	1,853
Other interest and dividend earning assets	2,014	981
Total interest and dividend income	107,229	98,214
INTEREST EXPENSE:		
Deposits	22,994	22,057
Borrowed funds	14,247	7,927
Total interest expense	37,241	29,984
NET INTEREST INCOME	69,988	68,230
PROVISION (CREDIT) FOR LOAN LOSSES	(3,000)	—
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	72,988	68,230
NON-INTEREST INCOME:		
Fees and service charges, net of amortization	1,760	1,776
Net gain on the sale of loans	478	883
Increase in and death benefits from bank owned life insurance contracts	1,554	1,604
Other	1,052	1,105
Total non-interest income	4,844	5,368
NON-INTEREST EXPENSE:		
Salaries and employee benefits	23,253	23,755
Marketing services	5,038	4,535
Office property, equipment and software	6,651	5,873
Federal insurance premium and assessments	2,718	2,272
State franchise tax	1,126	1,354
Real estate owned expense, net	583	1,051
Other expenses	6,407	6,422
Total non-interest expense	45,776	45,262
INCOME BEFORE INCOME TAXES	32,056	28,336
INCOME TAX EXPENSE	12,443	8,726
NET INCOME	\$ 19,613	\$ 19,610
Earnings per share—basic and diluted	\$ 0.07	\$ 0.07
Weighted average shares outstanding		
Basic	275,816,329	277,925,724
Diluted	277,624,292	280,272,455

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)
 (In thousands)

	For the Three Months Ended December 31,	
	2017	2016
Net income	\$19,613	\$19,610
Other comprehensive income (loss), net of tax:		
Net change in unrealized loss on securities available for sale	(4,270)	(6,027)
Net change in cash flow hedges	12,585	12,620
Change in pension obligation	(2,817)	345
Total other comprehensive income	5,498	6,938
Total comprehensive income	\$25,111	\$26,548
See accompanying notes to unaudited interim consolidated financial statements.		

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)
 (In thousands, except share and per share data)

	Common stock	Paid-in capital	Treasury stock	Unallocated common stock held by ESOP	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance at September 30, 2016	\$ 3,323	\$ 1,716,818	\$ (681,569)	\$ (57,418)	\$ 698,930	\$ (19,626)	\$ 1,660,458
Net income	—	—	—	—	19,610	—	19,610
Other comprehensive income, net of tax	—	—	—	—	—	6,938	6,938
ESOP shares allocated or committed to be released	—	913	—	1,084	—	—	1,997
Compensation costs for stock-based plans	—	1,103	—	—	(29)	—	1,074
Purchase of treasury stock (896,000 shares)	—	—	(16,119)	—	—	—	(16,119)
Treasury stock allocated to restricted stock plan	—	(749)	(1,444)	—	—	—	(2,193)
Dividends paid to common shareholders (\$0.125 per common share)	—	—	—	—	(6,432)	—	(6,432)
Balance at December 31, 2016	\$ 3,323	\$ 1,718,085	\$ (699,132)	\$ (56,334)	\$ 712,079	\$ (12,688)	\$ 1,665,333
Balance at September 30, 2017	\$ 3,323	\$ 1,722,672	\$ (735,530)	\$ (53,084)	\$ 760,070	\$ (7,492)	\$ 1,689,959
Net income	—	—	—	—	19,613	—	19,613
Other comprehensive income, net of tax	—	—	—	—	42	5,498	5,540
ESOP shares allocated or committed to be released	—	567	—	1,083	—	—	1,650
Compensation costs for stock-based plans	—	878	—	—	—	—	878
Purchase of treasury stock (492,000 shares)	—	—	(7,542)	—	—	—	(7,542)
Treasury stock allocated to restricted stock plan	—	(3,050)	2,038	—	—	—	(1,012)
Dividends paid to common shareholders (\$0.17 per common share)	—	—	—	—	(8,408)	—	(8,408)
Balance at December 31, 2017	\$ 3,323	\$ 1,721,067	\$ (741,034)	\$ (52,001)	\$ 771,317	\$ (1,994)	\$ 1,700,678

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,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$19,613	\$19,610
Adjustments to reconcile net income to net cash provided by operating activities:		
ESOP and stock-based compensation expense	2,528	3,071
Depreciation and amortization	5,394	5,787
Deferred income taxes	4,785	13
Provision (credit) for loan losses	(3,000))
Net gain on the sale of loans	(478)	(883)
Other net losses	69	224
Principal repayments on and proceeds from sales of loans held for sale	3,654	4,805
Loans originated for sale	(4,523)	(8,438)
Increase in bank owned life insurance contracts	(1,543)	(1,607)
Cash collateral received from derivative counterparties	16,850	17,702
Net decrease in interest receivable and other assets	4,092	6,302
Net increase in accrued expenses and other liabilities	50,577	50,570
Net cash provided by operating activities	98,018	97,156
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans originated	(780,652)	(866,302)
Principal repayments on loans	603,929	618,202
Proceeds from principal repayments and maturities of:		
Securities available for sale	35,452	46,226
Proceeds from sale of:		
Loans	26,268	67,467
Real estate owned	2,547	2,376
Purchases of:		
FHLB stock	(2,121)	(5,956)
Securities available for sale	(42,786)	(63,472)
Premises and equipment	(3,802)	(365)
Other	(11)	27
Net cash used in investing activities	(161,176)	(201,797)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (decrease) increase in deposits	55,726	(95,379)
Net decrease in borrowers' advances for insurance and taxes	(5,048)	(5,645)
Net decrease in principal and interest owed on loans serviced	(2,859)	(3,440)
Net increase in short-term borrowed funds	165,337	349,175
Proceeds from long-term borrowed funds	88	—
Repayment of long-term borrowed funds	(77,947)	(18,603)
Purchase of treasury shares	(7,372)	(17,670)
Acquisition of treasury shares through net settlement of stock benefit plans compensation	(1,012)	(2,193)
Dividends paid to common shareholders	(8,408)	(6,432)
Net cash provided by financing activities	118,505	199,813
NET INCREASE IN CASH AND CASH EQUIVALENTS	55,347	95,172

Edgar Filing: TFS Financial CORP - Form 10-Q

CASH AND CASH EQUIVALENTS—Beginning of period	268,218	231,239
CASH AND CASH EQUIVALENTS—End of period	\$323,565	\$326,411
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest on deposits	\$22,268	\$22,078
Cash paid for interest on borrowed funds	12,726	6,499
Cash paid for income taxes	287	218
SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of loans to real estate owned	1,293	1,403
Transfer of loans from held for investment to held for sale	26,141	66,968
Treasury stock issued for stock benefit plans	3,050	749
See accompanying notes to unaudited interim consolidated financial statements.		

8

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, a federally chartered stock holding company, conducts its principal activities through its wholly owned subsidiaries. The principal line of business of the Company is retail consumer banking, including mortgage lending, deposit gathering, and, to a much lesser extent, other financial services. As of December 31, 2017, approximately 81% of the Company's outstanding shares were owned by a federally chartered mutual holding company, Third Federal Savings and Loan Association of Cleveland, MHC. The thrift subsidiary of TFS Financial Corporation is Third Federal Savings and Loan Association of Cleveland.

The accounting and reporting policies followed by the Company conform in all material respects to 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 deferred tax assets, and the determination of pension obligations 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 the Company at December 31, 2017, and its results of operations and cash flows for the periods presented. Such adjustments are the only adjustments reflected in the unaudited interim financial statements. In accordance with SEC Regulation S-X for interim financial information, these statements do not include certain information and footnote disclosures required for complete audited financial statements. The Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017 contains audited 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, 2018 or for any other period.

2. EARNINGS PER SHARE

Basic earnings per share is the amount of earnings available to each share of common stock outstanding during the reporting period. Diluted earnings per share is the amount of earnings available to each share of common stock outstanding during the reporting period adjusted to include the effect of potentially dilutive common shares. For purposes of computing earnings per share amounts, outstanding shares include shares held by the public, shares held by the ESOP that have been allocated to participants or committed to be released for allocation to participants, the 227,119,132 shares held by Third Federal Savings, MHC, and, for purposes of computing dilutive earnings per share, stock options and restricted stock units with a dilutive impact. Unvested shares awarded pursuant to the Company's restricted stock plans are treated as participating securities in the computation of EPS pursuant to the two-class method as they contain nonforfeitable rights to dividends. The two-class method is an earnings allocation that determines EPS for each class of common stock and participating security. At December 31, 2017 and 2016, respectively, the ESOP held 5,200,076 and 5,633,416 shares, respectively, that were neither allocated to participants nor committed to be released to participants.

Table of Contents

The following is a summary of the Company's earnings per share calculations.

	For the Three Months Ended December 31,					
	2017		2016			
	Income	Shares	Per share amount	Income	Shares	Per share amount
	(Dollars in thousands, except per share data)					
Net income	\$ 19,613			\$ 19,610		
Less: income allocated to restricted stock units	244			204		
Basic earnings per share:						
Income available to common shareholders	\$ 19,369	275,816,329	\$ 0.07	\$ 19,406	277,925,724	\$ 0.07
Diluted earnings per share:						
Effect of dilutive potential common shares		1,807,962			2,346,731	
Income available to common shareholders	\$ 19,369	277,624,291	\$ 0.07	\$ 19,406	280,272,455	\$ 0.07

The following is a summary of outstanding stock options and restricted stock units that are excluded from the computation of diluted earnings per share because their inclusion would be anti-dilutive.

	For the Three Months Ended December 31,	
	2017	2016
Options to purchase shares	1,104,640	686,700
Restricted stock units	—	67,000

3. INVESTMENT SECURITIES

Investments available for sale are summarized as follows:

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
REMICs	\$ 539,703	\$ 15	\$(9,439)	\$ 530,279
Fannie Mae certificates	8,384	373	(45)	8,712
Total	\$ 548,087	\$ 388	\$(9,484)	\$ 538,991

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
REMICs	\$ 533,427	\$ 52	\$(4,943)	\$ 528,536
Fannie Mae certificates	8,537	419	(13)	8,943
Total	\$ 541,964	\$ 471	\$(4,956)	\$ 537,479

Table of Contents

Gross unrealized losses on available for sale securities and the estimated fair value of the related securities, aggregated by the length of time the securities have been in a continuous loss position, at December 31, 2017 and September 30, 2017, were as follows:

	December 31, 2017					
	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Available for sale—						
REMICs	\$214,771	\$ 2,929	\$307,337	\$ 6,510	\$522,108	\$ 9,439
Fannie Mae certificates	4,537	45	—	—	4,537	45
Total	\$219,308	\$ 2,974	\$307,337	\$ 6,510	\$526,645	\$ 9,484
	September 30, 2017					
	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Available for sale—						
REMICs	\$246,113	\$ 1,508	\$260,837	\$ 3,435		