TFS Financial CORP
Form 10-Q
August 14, 2007
Table of Contents

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 June 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	**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 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 x No ¨.

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 x

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

As of **August 10, 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.

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

Table of Contents

TFS Financial Corporation

INDEX

		Page
PART I FINANCIAL INFORMATION		
Item 1.	Financial Statements	
	Consolidated Statements of Condition June 30, 2007 (unaudited) and September 30, 2006	3
	Consolidated Statements of Operations (unaudited) Three and nine months ended June 30, 2007 and 2006	4
	Consolidated Statements of Shareholders Equity (unaudited) Nine months ended June 30, 2007 and 2006	5
	Consolidated Statements of Cash Flows (unaudited) Nine months ended June 30, 2007 and 2006	6
	Notes to Unaudited Interim Consolidated Financial Statements	7
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	36
Item 4.	Controls and Procedures	40
Part II OTHER INFORMATION		
Item 1.	Legal Proceedings	40
Item 1A.	Risk Factors	41
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	41
Item 3.	Defaults Upon Senior Securities	41
Item 4.	Submission of Matters to a Vote of Security Holders	41
Item 5.	Other Information	41
Item 6.	Exhibits	41
SIGNATURES		43

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)

	June 30, 2007 (unaudited)	September 30, 2006
Cash and due from banks	$ 62,675	$ 42,021
Interest bearing deposits at other financial institutions	18,593	122,006
Federal funds sold	1,026,000	88,900
Cash and cash equivalents	1,107,268	252,927
Investment securities:		
Available for sale (amortized cost $59,859 and $64,753, respectively)	58,982	63,655
Held to maturity (fair value $642,028 and $67,386, respectively)	646,213	67,319
Mortgage loans held for sale, at lower of cost or market	57,326	314,956
Loans held for investment, net:		
Mortgage loans	7,778,466	7,487,975
Other loans	16,960	28,469
Deferred loan fees, net	(18,818)	(18,698)
Allowance for loan losses	(23,814)	(20,705)
Loans, net	7,752,794	7,477,041
Mortgage loan servicing assets, net	41,740	40,366
Federal Home Loan Bank stock, at cost	34,231	73,125
Real estate owned	8,663	6,895
Premises, equipment, and software, net	68,305	82,067
Accrued interest receivable	44,962	41,994
Bank owned life insurance contracts	143,654	139,260
Other assets	52,235	35,962
TOTAL ASSETS	$ 10,016,373	$ 8,595,567
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits	$ 7,821,140	$ 7,401,077
Federal Home Loan Bank advances	25,103	25,103
Borrowers advances for insurance and taxes	16,489	38,279
Principal, interest, and related escrow owed on loans serviced	60,314	74,910
Accrued expenses and other liabilities	112,901	26,184
Deferred income taxes	20,223	17,420
Total liabilities	8,056,170	7,582,973
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 as of June 30, 2007, 300,000,000 shares authorized as of September 30, 2006; 332,318,750 shares issued and outstanding as of June 30, 2007, 1,000 shares issued and outstanding as of September 30, 2006	3,323	
Paid-in capital	1,667,575	627,979
Unallocated ESOP shares	(106,530)	
Retained earnings substantially restricted	406,453	395,892
Accumulated other comprehensive loss	(10,618)	(11,277)
Total shareholders equity	1,960,203	1,012,594
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 10,016,373	$ 8,595,567

See accompanying notes to interim financial statements

3

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(In thousands, except share data)

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2007	2006	2007	2006
INTEREST AND DIVIDEND INCOME:				
Loans, including fees	$ 116,088	$ 121,175	$ 347,653	$ 349,469
Investment securities available for sale	624	740	1,984	2,354
Investment securities held to maturity	7,235	921	12,623	2,896
Federal funds sold	15,370	11	26,898	20
Other interest earning assets	797	1,062	3,209	3,176
Total interest income	140,114	123,909	392,367	357,915
INTEREST EXPENSE:				
Deposits	87,029	70,451	250,215	199,476
Federal Home Loan Bank advances	310	3,693	933	9,401
Total interest expense	87,339	74,144	251,148	208,877
NET INTEREST INCOME	52,775	49,765	141,219	149,038
PROVISION FOR LOAN LOSSES	2,100	1,005	6,350	2,950
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	50,675	48,760	134,869	146,088
NON-INTEREST INCOME:				
Fees and service charges	6,481	5,735	18,840	16,873
Loss on the sale of loans	(630)	(9,188)	(995)	(18,699)
Increase in and death benefits from bank owned life insurance contracts	1,595	1,515	4,720	4,754
Net income on private equity investments	1,293	912	4,630	1,160
Other	5,442	2,618	10,505	7,367
Total non-interest income	14,181	1,592	37,700	11,455
NON-INTEREST EXPENSE:				
Salaries and employee benefits	17,956	14,945	54,275	46,017
Marketing services	3,353	2,792	10,055	7,982
Office property, equipment and software	5,018	4,440	14,393	13,635
Federal insurance premium	591	580	1,749	1,722
State franchise tax	841	985	2,655	2,894
Contribution to charitable foundation	55,000		55,000	
Other operating expenses	5,898	4,907	16,988	13,779
Total non-interest expense	88,657	28,649	155,115	86,029
INCOME (LOSS) BEFORE INCOME TAXES	(23,801)	21,703	17,454	71,514
INCOME TAX EXPENSE (BENEFIT)	(6,544)	7,004	6,893	23,234

NET INCOME (LOSS)	$ (17,257)	$ 14,699	$ 10,561	$ 48,280
Earnings (loss) per share basic and fully diluted	$ (0.06)	$ 0.06	$ 0.04	$ 0.21

See accompanying notes to interim consolidated financial statements.

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (unaudited)

Nine Months Ended June 30, 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 liability or obligation	Total shareholders equity
Balance at September 30, 2005	$		627,979		352,353	(683)	(5,775)	$ 973,874
Comprehensive income:								
Net income					48,280			48,280
Change in unrealized losses on securities available for sale, net						(552)		(552)
Total comprehensive income								47,728
Balance at June 30, 2006	$		627,979		400,633	(1,235)	(5,775)	$ 1,021,602
Balance at September 30, 2006	$		627,979		395,892	(714)	(10,563)	$ 1,012,594
Comprehensive income:								
Net income					10,561			10,561
Change in unrealized losses on securities available for sale, net						144		144
Change in pension obligation, net							515	515
Total comprehensive income								11,220
Stock dividend of 227,118,132 shares to the mutual holding company		2,271	(2,271)					
Issuance of 105,199,618 shares in the initial public offering		1,052	1,041,867					1,042,919
Purchase of common stock by the ESOP				(106,530)				(106,530)
Balance at June 30, 2007	$	3,323	1,667,575	(106,530)	406,453	(570)	(10,048)	$ 1,960,203

See accompanying notes to interim consolidated financial statements

Table of Contents

TFS FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(In thousands)

	For the Nine Months Ended June 30, 2007	For the Nine Months Ended June 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 10,561	$ 48,280
Adjustments to reconcile net income to net cash provided by operating activities:		
Contribution of stock to charitable foundation	50,000	
Depreciation and amortization	5,135	5,600
Provision for loan losses	6,350	2,950
Net loss on the sale of loans	995	18,699
Other net gains (losses)	(549)	791
Principal repayments on and proceeds from sales of loans held for sale	598,702	763,290
Loans originated for sale	(345,131)	(385,583)
Increase in and death benefits from bank owned life insurance contracts	(4,720)	(4,751)
Net (decrease) increase in interest receivable and other assets	(22,893)	318
Net increase in accrued expenses and other liabilities	89,397	4,131
Other	(1,576)	(2,057)
Net cash provided by operating activities	386,271	451,668
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loans originated	(1,612,080)	(2,424,359)
Principal repayments on loans	1,080,672	1,323,277
Proceeds from sales, principal repayments and maturities of:		
Securities available for sale	10,593	25,675
Securities held to maturity	51,037	20,721
Proceeds from sale of:		
Loans	233,436	518,576
Private equity fund	5,009	
FHLB stock	40,000	
Premises and equipment	17,363	1,863
Purchases of:		
Securities available for sale	(633)	
Securities held to maturity	(629,903)	
Premises and equipment	(5,772)	(2,284)
Death benefits on bank owned life insurance contracts		445
Other	8,282	4,868
Net cash used in investing activities	(801,996)	(531,218)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	420,063	223,865
Net proceeds from sale of common stock	992,919	
Loan to ESOP	(106,530)	
Net (decrease) increase in borrowers advances for insurance and taxes	(21,790)	42,901
Net (decrease) in principal and interest owed on loans serviced	(14,596)	(31,272)
Net (decrease) in short-term advances		(210,607)

Net cash provided by (used in) financing activities	1,270,066	24,887
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	854,341	(54,663)
CASH AND CASH EQUIVALENTS Beginning of year	252,927	120,320
CASH AND CASH EQUIVALENTS End of period	$ 1,107,268	$ 65,657
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest on deposits	$ 249,405	$ 198,654
Cash paid for interest on Federal Home Loan Bank advances	933	9,406
Cash paid for income taxes	27,000	30,500
SUPPLEMENTAL SCHEDULES OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Loans exchanged for mortgage-backed securities	839,190	1,290,639
Transfer of loans to real estate owned	10,971	6,070

See accompanying notes to 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 subsidiaries (collectively, TFS Financial or the Company) is retail consumer banking; including mortgage lending, deposit gathering, and other insignificant financial services. On June 30, 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 June 30, 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. TFS Financial s audited financial statements for the year ended September 30, 2006 in the prospectus filed with the Securities and Exchange Commission on February 23, 2007 pursuant to Rule 424(b)(3) of the Securities Act of 1933 (file no. 333-139295), contain 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, 2007.

2. STOCK OFFERING

The Holding Company completed its initial public stock offering on April 20, 2007 and sold 100,199,618 shares, or 30.15% of its outstanding common stock, to subscribers in the offering. Third Federal Savings, MHC, the Company s mutual holding company parent, holds 227,119,132 shares, or 68.34% of TFS Financial s outstanding common stock.

Table of Contents

Net proceeds from the initial offering were approximately $886 million. Additionally, the Association contributed $5.0 million in cash and the Holding Company issued 5,000,000 shares of common stock, or 1.50% of shares sold in the initial public offering to Third Federal Foundation, resulting in a pre-tax non-interest expense charge of $55.0 million, which was recorded in the quarter ended June 30, 2007. However, under current Federal income tax regulations, charitable contribution deductions are limited to 10% of taxable income. Accordingly, our $55 million contribution will create a carryforward for income tax purposes and a deferred tax asset for financial statement purposes. Our current estimate is that a $4.0 million deferred tax valuation allowance will be required at September 30, 2007, and this valuation allowance adversely impacts our estimated annual effective tax rate.

3. EARNINGS PER SHARE

In connection with the stock offering, the Holding Company declared and distributed to Third Federal Savings, MHC a stock dividend of 227,118,132 shares which, when added to the 1,000 shares of Holding Company stock previously owned by Third Federal Savings, MHC resulted in a total of 227,119,132 shares owned by Third Federal Savings, MHC. For purposes of computing earnings per share amounts prior to the offering date, 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 and shares sold to subscribers except that shares of the Employee Stock Ownership Plan that have not been allocated to participants are excluded for the computations. Since the offering date, unallocated Employee Stock Ownership Plan shares totaled 10,653,024.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands except per share data)			
Net income (loss)	$ (17,257)	$ 14,699	$ 10,561	$ 48,280
Weighted average shares outstanding	300,886	227,119	251,708	227,119
Earnings (loss) per share	$ (0.06)	$ 0.06	$ 0.04	$ 0.21

4. REGULATORY CAPITAL

The Association is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements of the Association. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Association must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Association to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier I Capital (as defined in the regulations) to Risk Weighted Assets (as defined), Core Capital (as defined) to Adjusted Assets (as defined), and Tangible Capital (as defined) to Tangible Assets (as defined). Management believes, as of June 30, 2007, that the Association meets all

Table of Contents

capital adequacy requirements to which it was subject. The most recent notification from the Office of Thrift Supervision categorized the Association as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum Total risk-based, Tier I risk-based and Core capital leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the categories of the Association.

The actual capital amounts (in thousands) and ratios of the Association compared to the minimum capital adequacy requirement and the requirements for a well capitalized institution are presented in the tables below.

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To be Well Capitalized Under Prompt Corrective Action Provision	
Capital Ratios of the Association	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
June 30, 2007						
Total Capital to Risk Weighted Assets	$ 1,345,645	21.26%	$ 506,282	8.00%	$ 632,852	10.00%
Core Capital to Adjusted Tangible Assets	1,322,800	13.29	398,240	4.00	497,800	5.00
Tangible Capital to Tangible Assets	1,322,800	13.29	149,340	1.50	N/A	N/A
Tier 1 Capital to Risk Weighted Assets	1,322,800	20.90	N/A	N/A	379,711	6.00
September 30, 2006						
Total Capital to Risk Weighted Assets	$ 902,401	15.00%	$ 481,121	8.00%	$ 601,402	10.00%
Core Capital to Adjusted Tangible Assets	883,510	10.35	341,407	4.00	426,759	5.00
Tangible Capital to Tangible Assets	883,510	10.35	128,028	1.50	N/A	N/A
Tier 1 Capital to Risk Weighted Assets	883,510	14.69	N/A	N/A	360,841	6.00

Table of Contents

5. INVESTMENT SECURITIES

Investments available for sale are summarized as follows:

	June 30, 2007			
		Gross Unrealized		
	Amortized Cost	Gains	Losses	Fair Value
	(In thousands)			
U.S. government and agency obligations	$ 28,992	$	$ (587)	$ 28,405
Fannie Mae certificates	835		(20)	815
Real estate mortgage investment conduits (REMICs)	24,278	25	(295)	24,008
Other	5,754			5,754
	$ 59,859	$ 25	$ (902)	$ 58,982

	September 30, 2006			
		Gross Unrealized		
	Amortized Cost	Gains	Losses	Fair Value
	(In thousands)			
U.S. government and agency obligations	$ 28,990	$	$ (713)	$ 28,277
Fannie Mae certificates	1,051		(16)	1,035
REMICs	34,712	25	(394)	34,343
	$ 64,753	$ 25	(1,123)	$ 63,655

Table of Contents

Investments held to maturity are summarized as follows:

	June 30, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
U.S. government and agency obligations	$ 26,993	$ 7	$ (115)	$ 26,885
Freddie Mac certificates	12,898		(141)	12,757
Ginnie Mae certificates	10,973	259	(1)	11,231
REMICs	581,760	116	(4,369)	577,507
Fannie Mae certificates	13,583	215	(176)	13,622
Other	6	20		26
	$ 646,213	$ 617	$ (4,802)	$ 642,028

	September 30, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
U.S. government and agency obligations	$ 11,997	$	$ (118)	$ 11,879
Ginnie Mae certificates	12,949	311	(1)	13,259
REMICs	27,438	9	(429)	27,018
Fannie Mae certificates	14,929	347	(68)	15,208
Other	6	16		22
	$ 67,319	$ 683	$ (616)	$ 67,386

Table of Contents

6. LOANS

Loans held for investment consist of the following:

	June 30, 2007	September 30, 2006
	(In thousands)	
Real Estate Loans:		
One- to four-family residential	$ 5,904,242	$ 5,563,782
Home equity loans and lines of credit (1)	1,783,247	1,803,900
Commercial	2,291	2,335
Construction	154,686	207,634
	7,844,466	7,577,651
Consumer loans:		
Auto loans	7,596	15,676
Loans on savings	8,765	7,005
Other	599	5,788
	16,960	28,469
Less:		
Deferred loan fees, net	(18,818)	(18,698)
Loans-in-process	(66,000)	(89,676)
Allowance for loan losses	(23,814)	(20,705)
Net loans	$ 7,752,794	$ 7,477,041

(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).

7. DEPOSITS

Deposit account balances are summarized as follows:

	June 30, 2007	September 30, 2006
	(In thousands)	
Negotiable order of withdrawal accounts	$ 1,538,938	$ 1,601,832
Passbook accounts	820,073	335,859
Certificates of deposit	5,458,629	5,459,974
	7,817,640	7,397,665
Accrued interest	3,500	3,412
Total deposits	$ 7,821,140	$ 7,401,077

Table of Contents

8. OTHER COMPREHENSIVE INCOME (LOSS)
Other comprehensive income (loss) consisted of the following:

	Three months ended June 30,		Nine months ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Changes in unrealized gains and losses on securities available for sale - net of reclassification	$ (68)	$ (159)	$ 144	$ (552)
Reclassification adjustment for amounts recognized in periodic benefit cost of retirement plan	171		515	
Total other comprehensive income (loss)	$ 103	$ (159)	$ 659	$ (552)

9. 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.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Service cost	$ 1,017	$ 1,076	$ 3,049	$ 3,226
Interest cost	721	686	2,161	2,057
Expected return on plan assets	(725)	(673)	(2,174)	(2,018)
Amortization of net loss	279	388	837	1,163
Amortization of prior service cost	(16)	(16)	(46)	(46)
Net periodic benefit cost	$ 1,276	$ 1,461	$ 3,827	$ 4,382

The Company anticipates no minimum required contribution to the Plan during fiscal 2007.

Employee (Associate) Stock Ownership Plan (ESOP) The Company established an ESOP for its employees effective January 1, 2006. The ESOP covers all of the

Table of Contents

Company s eligible employees. Employees are eligible to participate in the ESOP after satisfaction of the following requirements: attainment of age 18, completion of 1,000 hours of service, and employment on the last day of the plan year. The ESOP acquired 952,800 shares in the stock offering for cash, which it held as a result of prior year Company contributions. In addition, it acquired 10,653,024 shares with the proceeds of a loan totaling $106 million from the Company. Company contributions to the ESOP are at the discretion of the board of directors but will be sufficient to service the debt of the ESOP. The Company accounts for its ESOP in accordance with Statement of Position 93-6 Employers Accounting for Employees Stock Ownership Plans. Accordingly, the shares pledged as collateral are reported as unallocated ESOP shares in the statement of condition. Shares will be released from collateral to settle the Company s obligation under the ESOP at the ESOP s year end. The number of shares to be released will be based on the fair value of the shares at that date required to settle the liability. As shares are released from collateral, the shares become outstanding for EPS computations. The total expense related to the ESOP for the nine months ended June 30, 2007 and 2006 was $7.2 million and $0**,** respectively.

10. 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 of the commitment. The Company 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 June 30, 2007, the Company had commitments to originate loans as follows (in thousands):

Fixed rate mortgage loans	$ 231,324
Adjustable rate mortgage loans	41,192
Equity line of credit loans	83,226
Total	$ 355,742

At June 30, 2007, the Company had unfunded commitments outstanding as follows (in thousands):

Equity lines of credit	$ 2,009,202
Construction loans	66,000
Private equity investments	14,147
Total	$ 2,089,349

Table of Contents

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, $750 thousand has been paid and reflected in the statement of condition, with the remaining $750 thousand payable in installments, based upon completion of the installation, through fiscal year 2008.

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

At June 30, 2007, the Company had no 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. At this time, we are unable to predict an outcome, favorable or unfavorable, or to estimate the amount of any potential loss in this matter.

11. RECENT ACCOUNTING PRONOUNCEMENTS

In February 2007, the Financial Accounting Standards Board (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 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.

Table of Contents

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 September 2006, the FASB ratified Emerging Issues Task Force Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements (EITF 06-4). An endorsement split-dollar arrangement is an arrangement whereby an employer owns a life insurance policy that covers the life of an employee and using a separate agreement endorses a portion of the policy death benefit to the insured employee s beneficiary. EITF 06-4 applies only to those endorsement split-dollar arrangements that provide a death benefit postretirement. This requirement is effective for fiscal years beginning after December 15, 2007. The Company maintains endorsement split-dollar life arrangements for certain key officers. These arrangements do not provide a death benefit postretirement and, therefore, the Company does not expect the adoption of EITF 06-4 to have a material effect on its consolidated financial condition, results of operations or cash flows.

In September 2006, the FASB ratified Emerging Issues Task Force Issue No. 06-5, Accounting for Purchases of Life Insurance-Determining the Amount That Could be Realized in Accordance With FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance (EITF 06-5). EITF 06-5 addresses the diversity in practice of the calculation of the amount that can be realized for life insurance contracts. EITF 06-5 requires a policyholder to consider any additional amounts, such as Claims Stabilization Reserve, Deferred Acquisition Costs Tax Receivable and Waiver of Surrender Charges, in determining the amount that could be realized under the insurance contract as an asset. EITF 06-5 also concluded that the realized amount should be determined on an individual policy level and should not take into account amounts that are solely realizable if all the individual policies are surrendered at the same time. This requirement is effective for fiscal years beginning after December 15, 2006. The Company s current policies do not contain the features in question, and therefore, it does not expect the adoption of EITF 06-5 to have a material effect on its consolidated financial condition, results of operations or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 established an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the Company s financial statements and the related financial statement disclosures. This model is commonly referred to as a dual approach because it requires quantification of errors under both the iron curtain and the roll-over methods. SAB 108 permits initial adoption of its provisions either by (i) restating prior financial statements as if the dual approach had always been applied; or (ii) recording the cumulative effect of initially applying the dual approach as adjustments to the carrying values of assets and liabilities as of the date of adoption with an offsetting adjustment recorded to the opening balance of retained earnings. SAB 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006, with earlier application encouraged for any interim period of the first fiscal year ending after November 15, 2006, filed after the publication of SAB 108 (September 13, 2006). The Company is currently evaluating the potential impact, if any, that the application of SAB 108 will have on its consolidated financial condition, results of operations and cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of SFAS No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. The Company will be 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 is currently evaluating the effect this interpretation will have on its consolidated financial condition, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156 Accounting for Servicing of Financial Assets: an amendment of SFAS No. 140 (SFAS 156). This statement requires all separately recognized servicing rights be initially measured at fair value, if practicable. For each class of separately recognized servicing assets and liabilities, this statement permits the Company to choose either to report servicing assets and liabilities at fair value or at amortized cost. Under the fair value approach, servicing assets and liabilities are recorded at fair value at each reporting date with changes in fair value recorded in earnings in the period in which the changes occur. Under the amortized cost method, servicing assets and liabilities are amortized in proportion to and over the period of net servicing income or net servicing loss and are assessed for impairment based on fair value at each reporting date. Adoption of this statement is required for fiscal years beginning after September 15, 2006. The Company adopted SFAS 156 effective October 1, 2006 and is applying the requirements for recognition and initial measurement of servicing assets and liabilities prospectively to all transactions. The Company is using the amortized cost method for subsequent measurement of servicing rights. Adoption of SFAS 156 did not have a material effect on the Company s consolidated financial condition, results of operations or cash flows.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140 (SFAS 155), which amends Statement No. 133 to simplify the accounting for certain derivatives embedded in other financial instruments (hybrid financial instruments) by permitting fair value remeasurement for any hybrid financial instrument that contains an embedded

Table of Contents

derivative that otherwise required bifurcation, provided that the entire hybrid financial instrument is accounted for on a fair value basis. SFAS 155 also establishes the requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, which replaces the interim guidance in Derivative Instrument Group Issue D1, Recognition and Measurement of Derivatives: Application of Statement No. 133 to Beneficial Interests in Securitized Financial Assets. SFAS 155 amends SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities a replacement of FASB Statement No. 125 (SFAS 140), to allow a qualifying special-purpose entity to hold a derivative financial instrument that pertains to beneficial interests other than another derivative financial instrument. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006, with earlier adoption allowed. The Company adopted SFAS 155 effective October 1, 2006, and it did not have a material effect on its consolidated financial condition, results of operations or cash flows.

In November 2005, the FASB authorized the issuance of FASB Staff Position FAS 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application of Certain Investments (FSP FAS 115-1). FSP FAS 115-1 replaces and codifies guidance previously provided by the Emerging Issues Task Force. The FSP FAS 115-1 provides guidance to clarify when an investment impairment has occurred, to evaluate whether that impairment is other-than-temporary, on accounting for investments subsequent to the other-than-temporary, and on appropriate disclosure for investments in an unrealized loss position. The guidance in the FSP FAS 115-1 must be applied to reporting periods beginning after December 15, 2005. The Company adopted FSP FAS 115-1 effective October 1, 2006, and it did not have a material effect on its consolidated financial condition, results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections-a replacement of APB Opinion No. 20 and SFAS No. 3 (SFAS 154). SFAS 154 replaces APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS 154 changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted SFAS 154 effective October 1, 2006, and it did not have a material effect on its consolidated financial condition, results of operations, or cash flows.

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;

- 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;

- 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.

Comparison of Financial Condition at June 30, 2007 and September 30, 2006

Total assets increased $1.42 billion, or 17%, to $10.02 billion at June 30, 2007 from $8.60 billion at September 30, 2006. The growth in our assets was funded principally by the net proceeds of our stock offering, $886 million, which was completed on April 20, 2007, and to a lesser extent by a $420 million increase in deposits.

Cash and cash equivalents (cash and due from banks, federal funds sold and interest-bearing deposits) increased $854 million, or more than threefold, to $1.11 billion at June 30, 2007 from $253 million at September 30, 2006. Consistent with the increase in total assets, the increase in cash and cash equivalents arose primarily as a result of the net proceeds of our offering and from the success of our deposit gathering efforts. The combination of offering proceeds and a successful deposit gathering program exceeded the pace of our redeployment into investment and loan products and resulted in the increase in cash and cash equivalents.

In addition to the increase in cash and cash equivalents, investment securities held to maturity increased $579 million to $646 million at June 30, 2007 from $67 million at September 30, 2006. This increase reflected our reinvestment of cash equivalents into assets offering slightly higher returns with limited risk of asset life extension, should interest rates increase.

Mortgage loans held for sale decreased $258 million, or 82%, to $57 million at June 30, 2007 from $315 million at September 30, 2007. This reduction reflected the lower amount of

Table of Contents

loan sales during the nine months ended June 30, 2007 of $839 million as compared to $1.3 billion during the nine months ended June 30, 2006. The reduction reflected the sluggish nature of the current mortgage market. The total amount of our first mortgage loan originations has declined to $1.3 billion during the nine months ended June 30, 2007 from $2.1 billion during the nine months ended June 30, 2006.

Loans, net, comprised primarily of mortgage loans held for investment increased $276 million, or 4%, to $7.75 billion at June 30, 2007 from $7.48 billion at September 30, 2006 as we retained more of our mortgage loan originations in our owned portfolio to accelerate the redeployment of cash and cash equivalents into assets that provide greater yields.

Our investment in Federal Home Loan Bank (FHLB) stock decreased $39 million, or 53%, to $34 million at June 30, 2007, from $73 million at September 30, 2006 as $40.0 million of FHLB stock was redeemed at par. No gain or loss was recognized in connection with this redemption.

Our premises, equipment and software decreased $14 million, or 17%, to $68 million at June 30, 2007 from $82 million at September 30, 2006. The reduction reflected the sale of a commercial building, owned by our subsidiary, Hazelmere of California Limited Partnership, which was leased to an unaffiliated party.

Other assets increased $16 million, or 45%, to $52 million at June 30, 2007 from $36 million at September 30, 2006. The increase reflected $25 million of deferred and prepaid income taxes (primarily deferred income taxes related to our charitable contribution carryforward created in conjunction with the formation of the Third Federal Foundation as a part of our stock offering), offset by an $8 million reduction of our investments in private equity ventures.

Deposits increased $420 million, or 6%, to $7.82 billion at June 30, 2007 from $7.40 billion at September 30, 2006. The increase in deposits resulted from a $546 million increase in high-yield savings accounts (a subcategory of our passbook accounts), which more than offset modest declines in our other deposit products (other passbook accounts, high yield checking and other NOW accounts and certificates of deposit). Our high-yield savings account, the highest tier of which provides a current yield of 5.10%, was redesigned and actively marketed beginning in early March 2007. We have focused on promoting the high-yield savings as well as high yield checking as we believe that these types of deposit products provide a stable source of funds. In addition, our high-yield checking and high-yield savings accounts are expected to reprice in a manner similar to our equity loan products, and therefore assist us in managing interest rate risk.

The $87 million increase in accrued expenses and other liabilities, to $113 million at June 30, 2007 from $26 million at September 30, 2006 primarily reflects the in transit status of $78 million of real estate tax payments which had been collected from borrowers and are being remitted to various taxing agencies.

Shareholders equity increased $948 million, to $1.96 billion at June 30, 2007 from $1.01 billion at September 30, 2006. Of this increase, $936 million reflects the impact of our April 20, 2007 public offering and $11 million reflects our net income during the nine month period.

Table of Contents

Comparison of Operating Results for the Three Months Ended June 30, 2007 and 2006

Average balances and yields. The following table sets forth average balance sheets, average yields and costs, and certain other information at and for the periods indicated. No tax-equivalent yield adjustments were made, as the effects thereof were not material. All average balances are monthly average balances. Non-accrual loans were included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or interest expense.

	Three Months Ended June 30, 2007			Three Months Ended June 30, 2006		
	Average Balance	Interest Income/ Expense	Yield/ Cost(1)	Average Balance	Interest Income/ Expense	Yield/ Cost(1)
			(Dollars in thousands)			
Interest-earning assets:						
Cash on hand and in banks	$ 17,754	$ 242	5.45%	$ 6,284	$ 43	2.74%
Federal funds sold	1,173,324	15,370	5.24%	904	11	4.87%
Investment securities	61,055	643	4.21%	39,941	381	3.82%
Mortgage-backed securities	528,748	7,216	5.46%	106,009	1,280	4.83%
Loans	7,698,883	116,088	6.03%	8,221,397	121,175	5.90%
Federal Home Loan Bank stock	34,231	555	6.49%	71,232	1,019	5.72%
Total interest-earning assets	9,513,995	140,114	5.89%	8,445,767	123,909	5.87%
Noninterest-earning assets	341,012			365,291		
Total assets	$ 9,855,007			$ 8,811,058		
Interest-bearing liabilities:						
NOW accounts	$ 1,616,065	16,472	4.08%	$ 1,515,732	13,832	3.65%
Passbook savings and subscription proceeds	919,609	6,277	2.73%	371,580	862	0.93%
Certificates of deposit	5,402,340	64,280	4.76%	5,367,688	55,757	4.16%
FHLB advances	25,104	310	4.94%	366,728	3,693	4.03%
Total interest-bearing liabilities	7,963,118	87,339	4.39%	7,621,728	74,144	3.89%
Noninterest-bearing liabilities	85,000			174,885		
Total liabilities	8,048,118			7,796,613		
Shareholder s equity	1,806,889			1,014,445		
Total liabilities and shareholder s equity	$ 9,855,007			$ 8,811,058		
Net interest income		$ 52,775			$ 49,765	
Interest rate spread (2)			1.50%			1.98%
Net interest-earning assets (3)	$ 1,550,877			$ 824,039		
Net interest margin (4)		2.22%(1)			2.36%(1)	
	119.48%			110.81%		

Average interest-earning assets to average interest-bearing liabilities		
Selected performance ratios:		
Return on average assets	-0.70%(1)	0.67%(1)
Return on average equity	-3.82%(1)	5.80%(1)
Average equity to average assets	18.33%	11.51%

(1) Annualized

(2) Interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by total interest-earning assets.

Table of Contents

General. Net income decreased $32.0 million, reflecting a net loss of $17.3 million for the three months ended June 30, 2007 as compared to net income of $14.7 million for the three months ended June 30, 2006. The decrease was attributable primarily to the $55 million contribution expense incurred in connection with the formation of the Third Federal Foundation (Foundation) which was created at the time of our public offering. Other factors that significantly impacted our earnings for the three month periods are described below.

Interest Income. Interest income increased $16.2 million, or 13%, to $140 million for the three months ended June 30, 2007 from $124 million for the three months ended June 30, 2006. The increase in interest income resulted from increases in interest income on federal funds sold and on mortgage-backed securities.

Interest income on federal funds sold was $15.4 million for the three months ended June 30, 2007, compared to $11 thousand for the three months ended June 30, 2006. The increase resulted from our maintaining higher levels of liquid assets during the three months ended June 30, 2007, as our average balance of federal funds sold was $1.17 billion for the three months ended June 30, 2007 compared to $904 thousand for the three months ended June 30, 2006. The higher average balances resulted from the combined effect of significant loan sales during the fourth quarter of fiscal 2006 and the proceeds of our stock offering which was competed in April 2007. The average yield on federal funds sold increased 37 basis points to 5.24% for the three months ended June 30, 2007 from 4.87% for the three months ended June 30, 2006, primarily as a result of increases in market interest rates.

Interest income on mortgage-backed securities increased $5.9 million, to $7.2 million for the three months ended June 30, 2007, compared to $1.3 million for the three months ended June 30, 2006. The increase resulted primarily from increased balances and to a lesser extent, increased average rates of interest. The increase in balances resulted from the reinvestment of proceeds from sales of first mortgage loans during the fourth quarter of fiscal 2006, our public offering and the receipt of funds from new savings deposits. In addition, the average yield on mortgage-backed securities increased 63 basis points to 5.46% for the three months ended June 30, 2007 as compared to 4.83% for the three months ended June 30, 2006, due principally to increases in market interest rates.

Interest Expense. Interest expense increased $13.2 million, or 18%, to $87.3 million for the three months ended June 30, 2007 from $74.1 million for the three months ended June 30, 2006. The increase in interest expense resulted from increases in interest expense in each category of deposits and was partially offset by a decrease in interest expense on Federal Home Loan Bank advances.

Interest expense on NOW accounts increased $2.6 million, or 19%, to $16.5 million for the three months ended June 30, 2007 from $13.8 million for the three months ended June 30, 2006. The increase was caused primarily by a 43 basis point increase in the average rate we paid on NOW accounts to 4.08% for the three months ended June 30, 2007 from 3.65% for the three months ended June 30, 2006. We increased rates on deposits in response to increases in market interest rates. In addition, the average balance of NOW accounts increased $100 million, or 7%, to $1.6 billion for the three months ended June 30, 2007 from $1.5 billion for the three months ended June 30, 2006. The increase in NOW accounts reflects our customers pursuit of higher interest-paying deposit products during a period of rising market interest rates.

Table of Contents

Interest expense on passbook savings and subscription proceeds increased $5.4 million, to $6.3 million for the three months ended June 30, 2007 from $0.9 million for the three months ended June 30, 2006. The increase was caused by a combination of (1) a 180 basis point increase in the average rate we paid on these accounts to 2.73% for the three months ended June 30, 2007 from 0.93% for the three months ended June 30, 2006; and (2) a $548 million increase in the average balance of these accounts to $920 million for the three months ended June 30, 2007 from $372 million for the three months ended June 30, 2006. The increases in both average rate and average balance resulted primarily from the introduction in early March 2007 of a new high yield savings account that offers depositors a yield of up to 5.10%. This yield has remained unchanged since March. The impact of subscription proceeds on interest expense was relatively modest ($0.5 million) for the three months ended June 30, 2007 with, of course, no impact during the three months ended June 30, 2006. We increased rates on deposits in response to increases in market interest rates.

The increases in the balances of high yield checking and high yield savings accounts reflect our belief that these types of deposits provide a stable source of funds that re-price in a manner similar to our equity loan products and therefore assist us in managing interest rate risk.

Interest expense on certificates of deposit increased $8.5 million, or 15%, to $64.3 million for the three months ended June 30, 2007 from $55.8 million for the three months ended June 30, 2006. Substantially all of the increase was caused by a 60 basis point increase in the average rate we paid on certificates of deposit to 4.76% for the three months ended June 30, 2007 from 4.16% for the three months ended June 30, 2006. We increased rates on deposits in response to increases in market interest rates. The average balance of certificates of deposit increased by $34.7 million, or less than 1%, to $5.40 billion for the three months ended June 30, 2007 from $5.37 billion for the three months ended June 30, 2006.

Interest expense on Federal Home Loan Bank advances decreased $3.4 million to $310 thousand for the three months ended June 30, 2007, from $3.7 million for the three months ended June 30, 2006. The decrease was caused by a decrease in our average balance of Federal Home Loan Bank advances. The average balance decreased $342 million to $25 million for the three months ended June 30, 2007 from $367 million for the three months ended June 30, 2006. Throughout the fiscal year ended September 30, 2006, we repaid nearly all of our Federal Home Loan Bank advances, without incurring prepayment penalties.

Net Interest Income. Net interest income increased by $3.0 million, or 6%, to $52.8 million for the three months ended June 30, 2007 from $49.8 million for the three months ended June 30, 2006. The increase resulted primarily from interest income earned on the proceeds from our public offering. While net interest income increased during the quarter, we nevertheless experienced a further compression of our interest rate spread and our net interest margin. Our interest rate spread decreased 48 basis points to 1.50% for the three months ended June 30, 2007 from 1.98% for the three months ended June 30, 2006, and our net interest margin decreased 14 basis points to 2.22% for the three months ended June 30, 2007 from 2.36% for the three months ended June 30, 2006. The decreases in our interest rate spread and net interest margin are consistent with flat or inverted U.S. Treasury yield curves. From June 30, 2004 to June 30, 2006, the Federal Reserve Board increased its target for the federal funds rate from 1.0% to 5.25%. Since June 30, 2006, the target rate has remained unchanged at 5.25%. While short-term market interest rates (which we generally use as a guide to price our deposits) have increased, longer-term market interest rates (which we generally use as a guide to price our longer-term loans) have not increased to the same degree. The compression in our net interest margin was partially offset by an increase in net interest-earning assets, which resulted primarily from the net proceeds of our public offering. Our net interest-earning assets increased $727 million, to $1.55 billion for the three months ended June 30, 2007 from $824 million for the three months ended June 30, 2006.

Provision for Loan Losses. We establish provisions for loan losses, which are charged to operations, in order to maintain the allowance for loan losses at a level we consider necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. In determining the level of the allowance for loan losses, we consider past and current loss experience, evaluations of real estate collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower s ability to repay a loan and the levels of nonperforming and other classified loans. The amount of the allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available or conditions change. We assess the allowance for loan losses on a quarterly basis and make provisions for loan losses in order to maintain the allowance.

Based on our evaluation of the above factors, we recorded a provision for loan losses of $2.1 million for the three months ended June 30, 2007 and a provision of $1.0 million for the three months ended June 30, 2006. The provisions recorded reflected net chargeoffs of $1.1 million and $1.1 million for the three months ended June 30, 2007 and 2006, respectively. The allowance for loan losses was $23.8 million, or 0.30% of total loans receivable at June 30, 2007, compared to $19.3 million, or 0.25% of total loans receivable, at June 30, 2006. We increased the allowance for loan losses to reflect an increase in non-performing loans from June 30, 2006 to June 30, 2007. Nonperforming loans increased by $23.4 million to $95.9 million, or 1.22% of total loans, at June 30, 2007 from $72.5 million, or 0.93% of total loans, at June 30, 2006. The increase in nonperforming loans occurred primarily in our one- to four-family residential real estate mortgage loan portfolio, and included a $14.6 million increase in non-performing loans originated through our Home Today program, which was established in 2000. Through our Home Today program, we offer loans with our standard terms to borrowers who might not otherwise qualify for such loans. To qualify for our Home Today program, a borrower must complete financial management education and counseling and must be referred to us by a sponsoring organization with whom we have partnered as part of the program. Of our nonperforming loans, we had previously reported that we had one impaired loan with a principal balance of $2.3 million. During the quarter ended June 30, 2007 that loan was restructured into two loans. One loan of $1.7 million is performing as agreed. The second loan of $0.6 million is fully reserved.

We used the same general methodology in assessing the allowance at the end of the three-month periods. We believe we have recorded all losses that are both probable and reasonable to estimate for the three months ended June 30, 2007 and 2006.

Non-Interest Income. Non-interest income increased $12.6 million to $14.2 million for the three months ended June 30, 2007 from $1.6 million for the three months ended June 30, 2006. The increase was primarily caused by our recognizing losses of $0.6 million on loan sales for the three months ended June 30, 2007, compared to losses of $9.2 million on loan sales for the three months ended June 30, 2006. Additionally, a gain of $3.2 million

Table of Contents

was recognized in connection with the sale during the three months ended June 30, 2007, of a commercial office building owned by our subsidiary, Hazelmere California Limited Partnership (Hazelmere), a company that invests in commercial office buildings and leases them to unaffiliated parties.

Non-Interest Expense. Non-interest expense increased $60.0 million, to $88.7 million for the three months ended June 30, 2007 from $28.6 million for the three months ended June 30, 2006. The increase resulted from a number of factors, the most significant of which was the $55.0 million contribution expense incurred in conjunction with the formation of the Foundation as contemplated as a part of our public offering. The remainder of the increases occurred in the areas of salaries and employee benefit expense, marketing, and other operating expenses.

Salaries and employee benefits expense increased $3.0 million, or 20%, to $18.0 million for the three months ended June 30, 2007 from $14.9 million for the three months ended June 30, 2006. This increase is related primarily to $2.5 million of expense for the three months ended June 30, 2007 that resulted from the funding of our employee stock ownership plan, with the remainder reflective of normal employee salary adjustments. No employee stock ownership plan expense was recognized during the three months ended June 30, 2006.

Expenses associated with our marketing services increased $561 thousand, or 20%, to $3.4 million for the three months ended June 30, 2007 from $2.8 million for the three months ended June 30, 2006 due primarily to new programs undertaken to promote our equity line of credit product.

Office property and equipment expenses increased $578 thousand, or 13%, to $5.0 million for the three months ended June 30, 2007, from $4.4 million for the comparable period in fiscal 2006, due primarily to costs associated with normal technology-related infrastructure upgrades.

Contribution expense of $55.0 million, related to the formation of the Foundation in conjunction with our public stock offering in April 2007, was incurred during the three months ended June 30, 2007.

Other operating expenses increased $1.0 million, or 20%, to $5.9 million for the three months ended June 30, 2007 from $4.9 million for the three months ended June 30, 2006. Of the changes in this category, the largest was an increase of $612 thousand during the three months ended June 30, 2007 in expenses, disposition costs and losses associated with real estate owned parcels, followed by an increase of $222 thousand during the three months ended June 30, 2007 in costs related to our conversion to a public company.

Income Tax Expense. For the three months ended June 30, 2007, we recognized an income tax benefit of $6.5 million, or 27.5% of our loss before income taxes as compared to an income tax provision of $7.0 million, or 32.2% of earnings before income taxes for the three months ended June 30, 2006. Our provision for income taxes adjusts our cumulative income tax expense in accordance with our expectations for the full fiscal year. Our current estimate for the fiscal year ending September 30, 2007, is that our effective income tax rate will be 39.5%. This rate reflects the beneficial impact of our ownership of bank-owned life insurance, which is more than offset by our current estimate that a valuation allowance will be required with respect to the deferred tax asset generated by the charitable contribution

Table of Contents

expense carryforward that resulted from our contribution to the Foundation. For financial statement purposes, the entire $55 million contribution has been recognized as an expense during the three months ended June 30, 2007. However, under current Federal income tax regulations, charitable contribution deductions are limited to 10% of taxable income. Accordingly, our $55 million contribution will create a carryforward for income tax purposes and a deferred tax asset for financial statement purposes. Our current estimate is that a $4.0 million deferred tax valuation allowance will be required at September 30, 2007, and this valuation allowance adversely impacts our estimated annual effective tax rate. For the first nine months of the fiscal year ended September 30, 2006, our effective tax rate of 32.5% reflected the statutory rate of 35.0% adjusted for the beneficial impact of our ownership of bank owned life insurance. No deferred tax asset valuation reserves were required at June 30, 2006.

Table of Contents

Comparison of Operating Results for the Nine Months Ended June 30, 2007 and 2006

Average balances and yields. The following table sets forth average balance sheets, average yields and costs, and certain other information at and for the periods indicated. No tax-equivalent yield adjustments were made, as the effects thereof were not material. All average balances are monthly average balances. Non-accrual loans were included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or interest expense.

	Nine Months Ended June 30, 2007			Nine Months Ended June 30, 2006		
	Average Balance	Interest Income/ Expense	Yield/ Cost(1)	Average Balance	Interest Income/ Expense	Yield/ Cost(1)
			(Dollars in thousands)			
Interest-earning assets:						
Cash on hand and in banks	$ 15,204	$ 591	5.18%	$ 7,560	$ 162	2.86%
Federal funds sold	684,692	26,898	5.24%	580	20	4.60%
Investment securities	52,027	1,548	3.97%	40,532	1,134	3.73%
Mortgage-backed securities	327,618	13,059	5.31%	118,273	4,117	4.64%
Loans	7,680,778	347,653	6.04%	8,044,823	349,469	5.79%
Federal Home Loan Bank stock	58,368	2,618	5.98%	70,233	3,013	5.72%
Total interest-earning assets	8,818,687	392,367	5.93%	8,282,001	357,915	5.76%
Noninterest-earning assets	335,880			367,167		
Total assets	$ 9,154,567			$ 8,649,168		
Interest-bearing liabilities:						
NOW accounts	$ 1,661,553	50,948	4.09%	$ 1,432,016	36,067	3.36%
Passbook savings and subscription proceeds	560,322	8,306	1.98%	392,026	2,731	0.93%
Certificates of deposit	5,462,386	190,961	4.66%	5,341,751	160,678	4.01%
FHLB advances	25,104	933	4.96%	330,010	9,401	3.80%
Total interest-bearing liabilities	7,709,365	251,148	4.34%	7,495,803	208,877	3.72%
Noninterest-bearing liabilities	157,987			155,971		
Total liabilities	7,867,352			7,651,774		
Shareholder s equity	1,287,215			997,394		
Total liabilities and shareholder s equity	$ 9,154,567			$ 8,649,168		
Net interest income		$ 141,219			$ 149,038	
Interest rate spread (2)			1.59%			2.05%
Net interest-earning assets (3)	$ 1,109,322			$ 786,198		
Net interest margin (4)		2.14%(1)			2.40%(1)	
	114.39%			110.49%		

Average interest-earning assets to average interest-bearing liabilities		
Selected performance ratios:		
Return on average assets	0.15%(1)	0.74%(1)
Return on average equity	1.09%(1)	6.45%(1)
Average equity to average assets	14.06%	11.53%

(1) Annualized

(2) Interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by total interest-earning assets.

Table of Contents

General. Net income decreased $37.7 million, or 78%, to $10.6 million for the nine months ended June 30, 2007 from $48.3 million for the nine months ended June 30, 2006. The decrease was attributable primarily to the $55.0 million charitable contribution expense incurred in conjunction with the formation of the Foundation which was created at the time of our public stock offering in April 2007. Other factors that significantly impacted our earnings for the nine month periods are described below.

Interest Income. Interest income increased $34.5 million, or 10%, to $392 million for the nine months ended June 30, 2007 from $358 million for the nine months ended June 30, 2006. The increase in interest income resulted from both a higher level of interest earning assets in most categories as well as higher average yields in all categories, as more fully discussed below.

Interest income on federal funds sold was $26.9 million for the nine months ended June 30, 2007, compared to $20 thousand for the nine months ended June 30, 2006. The increase resulted from our maintaining higher levels of liquid assets during the nine months ended June 30, 2007, as our average balance of federal funds sold was $685 million for the nine months ended June 30, 2007 compared to $580 thousand for the nine months ended June 30, 2006. The higher average balances resulted from the combined effect of significant loan sales during the fourth quarter of fiscal 2006 and the proceeds of our stock offering, which was competed in April 2007. The average yield on federal funds sold increased 64 basis points to 5.24% for the nine months ended June 30, 2007 from 4.60% for the nine months ended June 30, 2006, primarily as a result of increases in market interest rates.

Interest income on mortgage-backed securities increased $8.9 million, to $13.1 million for the nine months ended June 30, 2007, compared to $4.1 million for the nine months ended June 30, 2006. The increase resulted primarily from increased balances and to a lesser extent, increased average rates of interest. The increase in balances resulted from the reinvestment of proceeds from our public stock offering as well as proceeds from sales of first mortgage loans and the receipt of funds from new savings deposits. The increased average rates of interest reflected the general trend of market interest rates.

Interest income on loans decreased $1.8 million, or 0.5%, to $348 million for the nine months ended June 30, 2007, compared to $349 million for the nine months ended June 30, 2006. The decrease reflected the reduced interest income derived from smaller average balances which exceeded the beneficial impact of increasing interest rates, particularly on the variable rate equity line of credit loans. The smaller average balance was due primarily to the sales of fixed-rate mortgage loans as part of our management of interest rate risk.

Interest Expense. Interest expense increased $42.3 million, or 20%, to $251 million for the nine months ended June 30, 2007 from $209 million for the nine months ended June 30, 2006. The increase in interest expense resulted from increases in interest expense in each category of deposits, partially offset by a decrease in interest expense on Federal Home Loan Bank advances.

Interest expense on NOW accounts increased $14.9 million, or 41%, to $50.9 million for the nine months ended June 30, 2007 from $36.1 million for the nine months ended June 30, 2006. The increase was caused primarily by a 73 basis point increase in the average rate we paid on NOW accounts to 4.09% for the nine months ended June 30, 2007 from 3.36% for the nine months ended June 30, 2006. We increased rates on deposits in response to increases in market interest rates. In addition, the average balance of NOW accounts increased $230 million, or 16%, to $1.7 billion for the nine months ended June 30, 2007 from $1.4 billion for the nine months ended June 30, 2006. The increase in NOW accounts reflects our customers pursuit of higher interest-paying deposit products during a period of rising market interest rates.

Interest expense on passbook savings and subscription proceeds increased $5.6 million, to $8.3 million for the nine months ended June 30, 2007 from $2.7 million for the nine months ended June 30, 2006. The increase was caused by a combination of (1) a 105 basis point increase in the average rate we paid on these accounts to 1.98% for the nine months ended June 30, 2007 from 0.93% for the nine months ended June 30, 2006; and (2) a $168 million increase in the average balance of these accounts to $560 million for the nine months ended June 30, 2007 from $392 million for the nine months ended June 30, 2006. The increases in both average rate and average balance resulted primarily from the introduction in early March 2007 of a new high yield savings account that offers depositors a yield of up to 5.10%. This yield has remained unchanged since March. The impact of subscription proceeds on interest expense was relatively modest ($0.7 million) for the nine months ended June 30, 2007 with, of course, no impact during the nine months ended June 30, 2006. We increased rates on deposits in response to increases in market interest rates.

The increases in the balances of high yield checking and high yield savings accounts reflect our belief that these types of deposits provide a stable source of funds that re-price in a manner similar to our equity loan products and therefore assist us in managing interest rate risk.

Interest expense on certificates of deposit increased $30.3 million, or 19%, to $191 million for the nine months ended June 30, 2007 from $161 million for the nine months ended June 30, 2006. Substantially all of the increase was caused by a 65 basis point increase in the average rate we paid on certificates of deposit to 4.66% for the nine months ended June 30, 2007 from 4.01% for the nine months ended June 30, 2006. We increased rates on deposits in response to increases in market interest rates. The average balance of certificates of deposit increased by $121 million, or 2%, to $5.5 billion for the nine months ended June 30, 2007 from $5.3 billion for the nine months ended June 30, 2006.

Interest expense on borrowed funds, which are comprised entirely of Federal Home Loan Bank advances, decreased $8.5 million, to $933 thousand for the nine months ended June 30, 2007 from $9.4 million for the nine months ended June 30, 2006. The decrease was caused by a decrease in our average balance of Federal Home Loan Bank advances. The average balance decreased $305 million to $25 million for the nine months ended June 30, 2007 from $330 million for the nine months ended June 30, 2006. During the fiscal year ended September 30, 2006, we repaid nearly all of our Federal Home Loan Bank advances, without incurring prepayment penalties.

Net Interest Income. Net interest income decreased by $7.8 million, or 5%, to $141 million for the nine months ended June 30, 2007 from $149 million for the nine months ended June 30, 2006. The decrease resulted from the compression of our interest rate spread and our net interest margin, as our interest rate spread decreased 46 basis points to 1.59% for the nine months ended June 30, 2007 from 2.05% for the nine months ended June 30, 2006, and our net interest margin decreased 26 basis points to 2.14% for the nine months ended June 30, 2007 from 2.40% for the nine months ended June 30, 2006. The decreases in our interest rate spread and net interest margin are consistent with an inverted

Table of Contents

U.S. Treasury yield curve. From June 30, 2004 to June 30, 2006, the Federal Reserve Board increased its target for the federal funds rate from 1.0% to 5.25%. From June 30, 2006 through June 30, 2007 the target rate has remained at 5.25%. While short-term market interest rates (which we use as a guide to price our deposits) have increased, longer-term market interest rates (which we use as a guide to price our longer-term loans) have not increased to the same degree. The compression in our net interest margin was partially offset by an increase in net interest-earning assets which resulted primarily from the net proceeds of our public stock offering. Our net interest-earning assets increased $323 million, to $1.11 billion for the nine months ended June 30, 2007 from $786 million for the nine months ended June 30, 2006.

Provision for Loan Losses. We establish provisions for loan losses, which are charged to operations, in order to maintain the allowance for loan losses at a level we consider necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. In determining the level of the allowance for loan losses, we consider past and current loss experience, evaluations of real estate collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower s ability to repay a loan and the levels of nonperforming and other classified loans. The amount of the allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available or conditions change. We assess the allowance for loan losses on a quarterly basis and make provisions for loan losses in order to maintain the allowance.

Based on our evaluation of the above factors, we recorded a provision for loan losses of $6.35 million for the nine months ended June 30, 2007 and a provision of $2.95 million for the nine months ended June 30, 2006. The provisions recorded reflected net chargeoffs of $3.2 million and $2.3 million for the nine months ended June 30, 2007 and 2006, respectively. The allowance for loan losses was $23.8 million, or 0.30% of total loans receivable, at June 30, 2007, compared to $19.3 million, or 0.25% of total loans receivable, at June 30, 2006. We increased the allowance for loan losses to reflect an increase in non-performing loans from June 30, 2006 to June 30, 2007. Nonperforming loans increased by $23.4 million to $95.9 million, or 1.22% of total loans, at June 30, 2007 from $72.5 million, or 0.93% of total loans, at June 30, 2006. The increase in nonperforming loans occurred almost entirely in our one- to four-family residential real estate mortgage loan portfolio, and included a $14.6 million increase in non-performing loans originated through our Home Today program. Of our nonperforming loans, we had previously reported that we had one impaired loan with a principal balance of $2.3 million. During the quarter ended June 30, 2007 that loan was restructured into two loans. One loan of $1.7 million is performing as agreed. The second loan of $0.6 million is fully reserved.

We used the same general methodology in assessing the allowance at the end of the six-month periods. We believe we have recorded all losses that are both probable and reasonable to estimate for the nine months ended June 30, 2007 and 2006.

Non-Interest Income. Non-interest income increased $26.2 million to $37.7 million for the nine months ended June 30, 2007 from $11.5 million for the nine months ended June 30, 2006. The increase was primarily caused by our recognizing losses of $1.0 million on loan sales for the nine months ended June 30, 2007, compared to $18.7 million of such losses for the nine months ended June 30, 2006. The increase was also caused by an increase in net income on private equity investments of $3.5 million, to $4.6 million for the nine months ended June 30, 2007 from $1.2 million for the nine months ended June 30,

30

Table of Contents

2006. This increase reflected gains from private equity fund investments. Additionally, the other category of other non-interest income increased $3.1 million, to $10.5 million for the nine months ended June 30, 2007, from $7.4 million for the nine months ended June 30, 2006. This increase was due to a $3.2 million gain recognized in connection with the sale, during the three months ended June 30, 2007, of a commercial office building owned by our Hazelmere subsidiary, a company that invests in commercial office buildings and leases them to unaffiliated parties.

Non-Interest Expense. Non-interest expense increased $69.1 million, or 80%, to $155 millio