

TF FINANCIAL CORP  
Form 10-Q  
August 05, 2005

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### FORM 10-Q

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

**For the period ended June 30, 2005**

- or -

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

**For the transition period from** \_\_\_\_\_ **to** \_\_\_\_\_

**Commission file number: 0-24168**

## TF FINANCIAL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of Incorporation  
or Organization)

**3 Penns Trail, Newtown, Pennsylvania**  
(Address of Principal Executive Offices)

**74-2705050**  
(I.R.S. Employer Identification No.)

**18940**  
(Zip Code)

Registrant's telephone number, including area code: **(215) 579-4000**

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

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

**Common Stock, par value \$.10 per share**

(Title of Class)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant is an accelerated filer as defined in Exchange Act Rule 12b-2. YES  NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: July 27, 2005

<b>Class</b>	<b>Outstanding</b>
\$.10 par value common stock	2,924,810 shares

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- 32. Certification pursuant of Section 906 of the Sarbanes-Oxley Act of 2002

## TF Financial Corporation and Subsidiaries

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	Unaudited June 30, 2005	Audited December 31, 2004
	(in thousands)	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 10,970	\$ 7,900
Certificates of deposit in other financial institutions	40	38
Investment securities available for sale at fair value	23,658	17,625
Investment securities held to maturity (fair value of \$7,073 and \$7,188 respectively)	6,992	7,027
Mortgage-backed securities available for sale at fair value	95,595	103,610
Mortgage-backed securities held to maturity (fair value of \$12,966 and \$15,546, respectively)	12,510	14,900
Loans receivable, net (including loans held for sale of \$784 and \$680, respectively)	464,382	442,195
Federal Home Loan Bank stock at cost	6,819	7,460
Accrued interest receivable	2,590	2,500
Premises and equipment, net	5,932	5,963
Core deposit intangible asset, net of accumulated amortization of \$2,679 and \$2,611, respectively	145	213
Goodwill	4,324	4,324
Other assets	15,876	15,211
<b>TOTAL ASSETS</b>	<b>\$ 649,833</b>	<b>\$ 628,966</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Liabilities</b>		
Deposits	\$ 479,579	\$ 459,903
Advances from the Federal Home Loan Bank	101,130	102,747
Advances from borrowers for taxes and insurance	2,136	1,778
Accrued interest payable	1,984	1,638
Other liabilities	2,658	1,745
<b>Total liabilities</b>	<b>587,487</b>	<b>567,811</b>
<b>Stockholders equity</b>		
Preferred stock, no par value; 2,000,000 shares authorized at June 30, 2005 and December 31, 2004, none issued		
Common stock, \$0.10 par value; 10,000,000 shares authorized, 5,290,000 shares issued, 2,730,951 and 2,742,345 shares outstanding at June 30, 2005 and December 31, 2004, respectively, net of shares in treasury 2,365,795 and 2,345,746 respectively	529	529
Retained earnings	59,520	57,428
Additional paid-in capital	51,832	51,675
Unearned ESOP shares	(1,932)	(2,019)
Treasury stock at cost	(47,060)	(46,081)
Accumulated other comprehensive loss	(543)	(377)
<b>Total stockholders equity</b>	<b>62,346</b>	<b>61,155</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 649,833</b>	<b>\$ 628,966</b>

The accompanying notes are an integral part of these statements



## TF Financial Corporation and Subsidiaries

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in thousands, except per share data)			
Interest income				
Loans, including fees	\$ 6,703	\$ 5,960	\$ 13,174	\$ 11,950
Mortgage-backed securities	1,292	1,531	2,595	2,988
Investment securities	364	280	677	560
Interest-bearing deposits and other	12	4	22	7
<b>TOTAL INTEREST INCOME</b>	<b>8,371</b>	<b>7,775</b>	<b>16,468</b>	<b>15,505</b>
Interest expense				
Deposits	1,831	1,478	3,367	2,984
Borrowings	966	673	1,897	1,319
<b>TOTAL INTEREST EXPENSE</b>	<b>2,797</b>	<b>2,151</b>	<b>5,264</b>	<b>4,303</b>
<b>NET INTEREST INCOME</b>	<b>5,574</b>	<b>5,624</b>	<b>11,204</b>	<b>11,202</b>
Provision for loan losses	150	150	300	300
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>5,424</b>	<b>5,474</b>	<b>10,904</b>	<b>10,902</b>
Non-interest income				
Service fees, charges and other operating income	669	681	1,309	1,390
Gain on sale of loans	8		30	
<b>TOTAL NON-INTEREST INCOME</b>	<b>677</b>	<b>681</b>	<b>1,339</b>	<b>1,390</b>
Non-interest expense				
Employee compensation and benefits	2,303	2,247	4,694	4,521
Occupancy and equipment	640	644	1,301	1,239
Federal deposit insurance premium	16	18	33	36
Professional fees	211	132	437	338
Marketing and advertising	186	163	362	326
Other operating	553	625	1,179	1,246
Amortization of core deposit intangible asset	34	40	68	80
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>3,943</b>	<b>3,869</b>	<b>8,074</b>	<b>7,786</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>2,158</b>	<b>2,286</b>	<b>4,169</b>	<b>4,506</b>
Income taxes	553	630	1,088	1,241
<b>NET INCOME</b>	<b>\$ 1,605</b>	<b>\$ 1,656</b>	<b>\$ 3,081</b>	<b>\$ 3,265</b>

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Earnings per share basic	\$	0.59	\$	0.62	\$	1.12	\$	1.23
Earnings per share diluted	\$	0.57	\$	0.58	\$	1.09	\$	1.15
Dividends paid	\$	0.18	\$	0.17	\$	0.36	\$	0.32

The accompanying notes are an integral part of these statements

## TF Financial Corporation and Subsidiaries

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the six months ended	
	2005	2004
	June 30,	
	(in thousands)	
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 3,081	\$ 3,265
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of		
Mortgage loan servicing rights	2	
Deferred loan origination fees	(31)	(8)
Premiums and discounts on investment securities, net	42	41
Premiums and discounts on mortgage-backed securities, net	236	347
Premiums and discounts on loans, net	60	71
Core deposit intangibles	68	80
Provision for loan losses	300	300
Depreciation of premises and equipment	468	475
Increase in value of bank-owned life insurance	(252)	(270)
Stock-based benefit programs	258	274
Tax benefit arising from stock compensation	110	
Gain on sale of		
Real estate acquired through foreclosure		(1)
Mortgage loans available for sale	(30)	
(Increase) decrease in		
Accrued interest receivable	(90)	111
Other assets	(249)	604
Increase (decrease) in		
Accrued interest payable	346	(89)
Other liabilities	789	1,122
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>5,108</b>	<b>6,322</b>
<b>INVESTING ACTIVITIES</b>		
Loan originations	(61,280)	(71,106)
Purchases of loans		(3,546)
Loan principal payments	35,484	57,045
Principal repayments on mortgage-backed securities held to maturity	2,377	5,418
Principal repayments on mortgage-backed securities available for sale	16,484	17,242
Proceeds from loan sales	3,311	
Purchases and (maturities) of certificates of deposit in other financial institutions, net	(2)	117
Purchase of investment securities available for sale	(5,985)	(2,180)
Purchase of mortgage-backed securities available for sale	(8,956)	(27,701)
Proceeds from maturities of investment securities held to maturity		2,000
Redemption of Federal Home Loan Bank stock	641	84
Proceeds from sale of real estate		32
Purchase of premises and equipment	(437)	(294)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(18,363)</b>	<b>(22,889)</b>





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	For the six months ended June 30,	
	2005	2004
	(in thousands)	
<b>FINANCING ACTIVITIES</b>		
Net increase in demand deposit/NOW accounts, passbook savings accounts and certificates of deposit	19,676	8,409
Net increase (decrease) in advances from Federal Home Loan Bank	(1,617)	6,822
Net increase in advances from borrowers for taxes and insurance	358	358
Treasury stock acquired	(1,668)	(1,226)
Exercise of stock options	565	1,281
Common stock dividends paid	(989)	(851)
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>16,325</b>	<b>14,793</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>3,070</b>	<b>(1,774)</b>
Cash and cash equivalents at beginning of period	7,900	8,241
Cash and cash equivalents at end of period	\$ 10,970	\$ 6,467
<b>Supplemental disclosure of cash flow information</b>		
<b>Cash paid for</b>		
Interest on deposits and advances from Federal Home Loan Bank	\$ 4,918	\$ 4,392
Income taxes	\$ 60	\$
<b>Non-cash transactions</b>		
Transfers from loans to real estate acquired through foreclosure	\$	\$

The accompanying notes are an integral part of these statements

**TF FINANCIAL CORPORATION AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - PRINCIPLES OF CONSOLIDATION**

The consolidated financial statements as of June 30, 2005 (unaudited) and December 31, 2004 and for the six-month periods ended June 30, 2005 and 2004 (unaudited) include the accounts of TF Financial Corporation (the Company) and its wholly owned subsidiaries Third Federal Bank (the Bank), TF Investments Corporation and Penns Trail Development Corporation. The Company's business is conducted principally through the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

**NOTE 2 - BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all of the disclosures or footnotes required by accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for fair presentation of the consolidated financial statements have been included. The results of operations for the period ended June 30, 2005 are not necessarily indicative of the results which may be expected for the entire fiscal year or any other period. For further information, refer to consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004.

**NOTE 3 - CONTINGENCIES**

The Company, from time to time, is a party to routine litigation that arises in the normal course of business. In the opinion of management, the resolution of this litigation, if any, would not have a material adverse effect on the Company's consolidated financial position or results of operations.

**NOTE 4 - OTHER COMPREHENSIVE INCOME (LOSS)**

The Company's other comprehensive income (loss) consists of net unrealized gains (losses) on investment securities and mortgage-backed securities available for sale. Total comprehensive income (loss) for the three-month periods ended June 30, 2005 and 2004 was \$2,546,000 and \$(99,000), net of applicable income tax expense (benefit) of \$1,037,000 and \$(275,000), respectively. Total comprehensive income for the six-month periods ended June 30, 2005 and 2004 was \$2,915,000 and \$2,309,000, net of applicable income tax expense of \$1,003,000 and \$748,000, respectively.

**NOTE 5 - EARNINGS PER SHARE**

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The following tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per share computations (dollars in thousands, except per share data):

	<b>Three months ended June 30, 2005</b>		
	<b>Income (numerator)</b>	<b>Weighted average shares (denominator)</b>	<b>Per share Amount</b>
<b>Basic earnings per share</b>			
Income available to common stockholders	\$ 1,605	2,744,223	\$ 0.59
<b>Effect of dilutive securities</b>			
Stock options		74,383	(0.02)
<b>Diluted earnings per share</b>			
Income available to common stockholders plus effect of dilutive securities	\$ 1,605	2,818,606	\$ 0.57

	<b>Six months ended June 30, 2005</b>		
	<b>Income (numerator)</b>	<b>Weighted average shares (denominator)</b>	<b>Per share Amount</b>
<b>Basic earnings per share</b>			
Income available to common stockholders	\$ 3,081	2,746,625	\$ 1.12
<b>Effect of dilutive securities</b>			
Stock options		74,444	(0.03)
<b>Diluted earnings per share</b>			
Income available to common stockholders plus effect of dilutive securities	\$ 3,081	2,821,069	\$ 1.09

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There were options to purchase 27,594 shares of common stock at a price of \$34.14 per share which were outstanding during the six months ended June 30, 2005 that were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

	<b>Three months ended June 30, 2004</b>		
	<b>Income (numerator)</b>	<b>Weighted average shares (denominator)</b>	<b>Per share Amount</b>
<b>Basic earnings per share</b>			
Income available to common stockholders	\$ 1,656	2,672,534	\$ 0.62
<b>Effect of dilutive securities</b>			
Stock options		166,559	(0.04)
<b>Diluted earnings per share</b>			
Income available to common stockholders plus effect of dilutive securities	\$ 1,656	2,839,093	\$ 0.58

	<b>Six months ended June 30, 2004</b>		
	<b>Income (numerator)</b>	<b>Weighted average shares (denominator)</b>	<b>Per share Amount</b>
<b>Basic earnings per share</b>			
Income available to common stockholders	\$ 3,265	2,660,871	\$ 1.23
<b>Effect of dilutive securities</b>			
Stock options		169,012	(0.08)
<b>Diluted earnings per share</b>			
Income available to common stockholders plus effect of dilutive securities	\$ 3,265	2,829,883	\$ 1.15

There were options to purchase 31,913 shares of common stock at a price of \$34.14 per share which were outstanding during the the six months ended June 30, 2004 that were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

**NOTE 6- STOCK BASED COMPENSATION**

The Company has two fixed stock option plans. The Company's employee stock option plans are accounted for using the intrinsic value method under APB Opinion No. 25, as permitted by SFAS No. 123. No stock-based compensation expense is reflected in net income, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of the grant.

Had compensation cost for the plans been determined based on the fair value of options at the grant dates consistent with the method of SFAS No. 123, Accounting for Stock-Based Compensation, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below (in thousands, except per share data):

	<b>Three months ended June 30</b>	
	<b>2005</b>	<b>2004</b>
<b>Net income</b>		
As reported	\$ 1,605	\$ 1,656
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects	15	26
Pro forma	\$ 1,590	\$ 1,630
<b>Basic earnings per share</b>		
As reported	\$ 0.59	\$ 0.62
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects	0.01	0.01
Pro forma	\$ 0.58	\$ 0.61
<b>Diluted earnings per share</b>		
As reported	\$ 0.57	\$ 0.58
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects		
Pro forma	\$ 0.57	\$ 0.58

Stock-based compensation expense included in net income is related to stock grants in lieu of salary and the Company's employee stock ownership plan. Such expense totaled \$96,000 and \$106,000 for the three-month periods ended June 30, 2005 and 2004, respectively.

	<b>Six months ended June 30</b>	
	<b>2005</b>	<b>2004</b>
<b>Net income</b>		
As reported	\$ 3,081	\$ 3,265
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects	34	51
Pro forma	\$ 3,047	\$ 3,214
<b>Basic earnings per share</b>		
As reported	\$ 1.12	\$ 1.23
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects	0.01	0.02
Pro forma	\$ 1.11	\$ 1.21
<b>Diluted earnings per share</b>		

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As reported	\$	1.09	\$	1.15
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects				
Pro forma	\$	1.09	\$	1.15

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Stock-based compensation expense included in net income is related to stock grants in lieu of salary and the Company's employee stock ownership plan. Such expense totaled \$204,000 and \$227,000 for the six-month periods ended June 30, 2005 and 2004, respectively.

On April 27, 2005, the Company's shareholders approved the 2005 Stock-Based Incentive Plan (the 2005 Plan) which provides for grants of stock options and/or restricted stock aggregating up to 240,000 shares of the Company's common stock, with a maximum of 40,000 shares of restricted stock. No grants may be issued from the 2005 Plan prior to June 1, 2005.

**NOTE 7- EMPLOYEE BENEFIT PLANS**

Net periodic defined benefit pension cost included the following (in thousands):

	Three months ended June 30	
	2005	2004
Components of net periodic benefit cost		
Service cost	\$ 78	\$ 57
Interest cost	53	51
Expected return on plan assets	(56)	(53)
Amortization of prior service cost	16	16
Amortization of transition obligation (asset)		1
Recognized net actuarial (gain) loss	11	8
Net periodic benefit cost	\$ 102	\$ 80

	Six months ended June 30	
	2005	2004
Components of net periodic benefit cost		
Service cost	\$ 156	\$ 115
Interest cost	106	95
Expected return on plan assets	(103)	(105)
Amortization of prior service cost	32	31
Amortization of transition obligation (asset)		2
Recognized net actuarial (gain) loss	22	12
Net periodic benefit cost	\$ 213	\$ 150

The employer contribution made for the six months ended June 30, 2005 and 2004 was \$1,015,000 and \$0, respectively.

**NOTE 8- RECLASSIFICATIONS**



Certain prior year amounts have been reclassified to conform to the current period presentation.

**TF FINANCIAL CORPORATION AND SUBSIDIARIES**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL POSITION AND RESULTS OF OPERATIONS**

## GENERAL

The Company may from time to time make written or oral forward-looking statements, including statements contained in the Company's filings with the Securities and Exchange Commission (including this Quarterly Report on Form 10-Q and the exhibits thereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, estimates and intentions that are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services; the willingness of users to substitute competitors' products and services for the Company's products and services; the success of the Company in gaining regulatory approval of its products and services, when required; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes, acquisitions; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

## Financial Condition

The Company's total assets at June 30, 2005 and December 31, 2004 were \$649.8 million and \$629.0 million, respectively, an increase of \$20.8 million, or 3.31%, during the six-month period. Cash and cash equivalents increased by \$3.1 million. Investment securities available for sale increased by \$6.0 million due to purchases of \$3.0 million of tax free municipal bonds and purchases of \$3.0 million corporate notes. Mortgage-backed securities available for sale decreased by \$8.0 million as \$9.0 million of security purchases was off-set by \$16.5 million in principal pay-downs, a decrease in the market value of these securities totaling \$0.3 million and net premium amortization of \$0.2 million. Mortgage-backed securities held to maturity decreased by \$2.4 million as a result of principal repayments. Loans receivable increased by \$22.2 million for the first six months of 2005. Consumer and single-family residential mortgage loans of \$37.7 million and commercial loans of \$23.5 million were originated during the first six months of 2005. Proceeds from the sale of loans in the secondary market were \$3.3 million during the six-month period. In addition, principal repayments of loans receivable were \$35.5 million during this period.

Total liabilities increased by \$19.7 million. Deposit balances increased by \$19.7 million during the six-month period ended June 30, 2005. Non-interest bearing demand deposits grew by \$2.8 million and money market deposits increased by \$31.3 million while savings and interest-bearing checking accounts decreased by a combined \$14.2 million. Certificates of deposit decreased by \$0.2 million. Advances from the Federal Home Loan Bank decreased by \$1.6 million due to an \$11.4 million increase in long-term fixed rate advances less \$5.5 million repayment of short-term advances and scheduled amortization payments of \$7.5 million.

Total consolidated stockholders' equity of the Company was \$62.3 million or 9.59% of total assets at June 30, 2005. During the first half of 2005 the Company repurchased 54,922 shares of its common stock and issued 34,873 shares pursuant to the exercise of stock options. As of June 30,

2005, there were approximately 98,523 shares available for repurchase under the previously announced share repurchase plan.

**Asset Quality**

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During the first six months of 2005 and 2004, the Company's provision for loan losses was \$300,000. As of June 30, 2005, the Company owned one parcel of foreclosed real estate. This parcel has been recorded as real estate owned at the lower of the recorded investment in the loan or estimated fair value in the amount of \$0.7 million and is included in other assets in the statement of financial position at June 30, 2005. Management of the Company believes that there has not been any significant deterioration in its asset quality during the first six months of 2005.

The following table sets forth information regarding the Company's asset quality (dollars in thousands):

	June 30, 2005	December 31, 2004	June 30, 2004
Non-performing loans	\$ 724	\$ 960	\$ 2,054
Ratio of non-performing loans to gross loans	0.16%	0.22%	0.48%
Ratio of non-performing loans to total assets	0.11%	0.15%	0.33%
Foreclosed property	\$ 700	\$ 700	\$ 837
Foreclosed property to total assets	0.11%	0.11%	0.13%
Ratio of total non-performing assets to total assets	0.22%	0.26%	0.46%

Management maintains an allowance for loan losses at levels that are believed to be adequate; however, there can be no assurances that further additions will not be necessary or that losses inherent in the existing loan portfolio will not exceed the allowance. The following table sets forth the activity in the allowance for loan losses during the periods indicated (in thousands):

	2005	2004
Beginning balance, January 1,	\$ 2,307	\$ 2,111
Provision	300	300
Less: charge-offs (recoveries), net	147	207
Ending balance, June 30,	\$ 2,460	\$ 2,204

**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2005 AND 2004**

**Net Income.** The Company recorded net income of \$1,605,000, or \$0.57 per diluted share, for the three months ended June 30, 2005 as compared to net income of \$1,656,000, or \$0.58 per diluted share, for the three months ended June 30, 2004.

**Average Balance Sheet**





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The following table sets forth information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated. Yield and cost are computed by dividing income or expense by the average daily balance of interest-earning assets or interest-bearing liabilities, respectively, at-or for the three month periods indicated.

	2005		June 30,		2004		Average yld/cost
	Average balance	Interest	Average yld/cost	Average balance	Interest	Average yld/cost	
<b>ASSETS</b>							
<b>Interest-earning assets:</b>							
Loans receivable(1)	\$ 457,289	\$ 6,703	5.88%	\$ 418,545	\$ 5,960		5.73%
Mortgage-backed securities	112,939	1,292	4.59%	132,144	1,531		4.66%
Investment securities(2)	35,635	441	4.96%	30,111	334		4.46%
Other interest-earning assets(3)	2,368	12	2.03%	1,648	4		0.98%
Total interest-earning assets	608,231	8,448	5.57%	582,448	7,829		5.41%
Non interest-earning assets	36,599			35,974			
Total assets	\$ 644,830			\$ 618,422			
<b>LIABILITIES AND STOCKHOLDERS EQUITY:</b>							
<b>Interest-bearing liabilities</b>							
Deposits	466,679	1,831	1.57%	471,402	1,478		1.26%
Advances from the FHLB	111,734	966	3.47%	82,984	673		3.26%
Total interest-bearing liabilities	578,413	2,797	1.94%	554,386	2,151		1.56%
Non interest-bearing liabilities	6,331			5,801			
Total liabilities	584,744			560,187			
Stockholders equity	60,086			58,235			
Total liabilities and stockholders equity	\$ 644,830			\$ 618,422			
Net interest income		\$ 5,651			\$ 5,678		
Interest rate spread(4)			3.63%				3.85%
Net yield on interest-earning assets(5)			3.73%				3.92%
Ratio of average interest-earning assets to average interest-bearing liabilities			105%				105%

- (1) Nonaccrual loans have been included in the appropriate average loan balance category, but interest on nonaccrual loans has not been included for purposes of determining interest income.
- (2) Tax equivalent adjustments to interest on investment securities were \$77,000 and \$54,000 for the quarters ended June 30, 2005 and 2004, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.
- (3) Includes interest-bearing deposits in other banks.
- (4) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
- (5) Net yield on interest-earning assets represents net interest income as a percentage of average interest-earning assets.

**Rate/Volume Analysis**

The following table presents, for the periods indicated, the change in interest income and interest expense (in thousands) attributed to (i) changes in volume (changes in the weighted average balance of the total interest earning asset and interest bearing liability portfolios multiplied by the prior year rate), and (ii) changes in rate (changes in rate multiplied by prior year volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately based on the absolute value of changes due to volume and changes due to rate.

	<b>Three months ended June 30, 2005 vs 2004</b>			
	<b>Volume</b>	<b>Increase (decrease) due to Rate</b>		<b>Net</b>
<b>Interest income:</b>				
Loans receivable, net	\$ 577	\$ 166	\$ 743	
Mortgage-backed securities	(216)	(23)	(239)	
Investment securities (1)	66	41	107	
Other interest-earning assets	2	6	8	
Total interest-earning assets	429	190	619	
<b>Interest expense:</b>				
Deposits	(101)	454	353	
Advances from the FHLB	248	45	293	
Total interest-bearing liabilities	147	499	646	
Net change in net interest income	\$ 282	\$ (309)	\$ (27)	

(1) Tax equivalent adjustments to interest on investment securities were \$77,000 and \$54,000 for the quarters ended June 30, 2005 and 2004, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.

**Total Interest Income.** Total interest income, on a taxable equivalent basis, increased by \$0.6 million or 8.0% to \$8.4 million for the quarter ended June 30, 2005 compared with the second quarter of 2004 primarily because of a \$38.7 million increase in average loans outstanding. Additionally, there has been a rise in the yield on new loans added to the portfolio during the intervening period in part due to nine, 25 basis point increases in the Bank's prime rate during the period June 30, 2004 through June 30, 2005 corresponding to identical increases in the fed funds interest rate by the Federal Reserve Bank. The Bank has approximately \$50.6 million in primarily construction loans and commercial and consumer lines of credit which are indexed to the prime rate. Interest income from mortgage-backed securities was lower during the second quarter of 2005 in comparison to the same period of 2004. This decrease is consistent with the reduction of balances maintained in mortgage-backed securities. Investment securities interest income reflected an increase between the quarters as a result of investment security purchases during the intervening period.

**Total Interest Expense.** Total interest expense increased by \$0.6 million to \$2.8 million during the three-month period ended June 30, 2005 as compared with the second quarter of 2004. The decrease in the average balance of deposits was more than offset by an increase in interest rates on the Bank's demand deposit accounts in order to remain in line with short-term market interest rates and the Bank's competitors. Increases in the advances from the Federal Home Loan Bank during 2004 and the first half of 2005 is the primary cause for the increase in the related interest expense between the two quarters.

**Non-interest income.** Total non-interest income was \$677,000 for the three-month period ended June 30, 2005 compared with \$681,000 for the same period in 2004. Loan prepayment and other loan fees decreased by \$31,000 and mortgage brokered fees collected increased by \$44,000 in the second quarter of 2005 versus the same quarter of 2004. Retail banking fees were \$25,000 less in the second quarter of 2005 due to a decrease in demand deposit account fees. In contrast, during the second quarter of 2005 net gain on the sale of loans totaled \$8,000 while there was no such gain during the second quarter of 2004.

**Non-interest expense.** Total non-interest expense increased by \$74,000 to \$3.9 million for the three months ended June 30, 2005 compared to the same period in 2004. Compensation and benefit expenses were higher by \$56,000 mainly due to additional staffing as well as salary increases. Professional expenses of the Company were \$79,000 higher mainly because of technology-related compliance and audit work.

**RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004**

**Net Income.** The Company recorded net income of \$3,081,000, or \$1.09 per diluted share, for the six months ended June 30, 2005 as compared to net income of \$3,265,000, or \$1.15 per diluted share, for the six months ended June 30, 2004.

**Average Balance Sheet**

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The following table sets forth information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated. Yield and cost are computed by dividing income or expense by the average daily balance of interest-earning assets or interest-bearing liabilities, respectively, at-or for the six month periods indicated.

	2005		June 30,		2004	
	Average balance	Interest	Average yld/cost	Average balance	Interest	Average yld/cost
<b>ASSETS</b>						
<b>Interest-earning assets:</b>						
Loans receivable(1)	\$ 451,983	\$ 13,174	5.88%	\$ 414,761	\$ 11,950	5.79%
Mortgage-backed securities	115,861	2,595	4.52%	131,400	2,988	4.57%
Investment securities(2)	34,256	820	4.83%	30,282	663	4.40%
Other interest-earning assets(3)	1,755	22	2.53%	1,609	7	0.87%
Total interest-earning assets	603,855	16,611	5.55%	578,052	15,608	5.43%
Non interest-earning assets	34,870			36,133		
Total assets	\$ 638,725			\$ 614,185		
<b>LIABILITIES AND STOCKHOLDERS EQUITY:</b>						
<b>Interest-bearing liabilities</b>						
Deposits	461,028	3,367	1.47%	468,073	2,984	1.28%
Advances from the FHLB	111,810	1,897	3.42%	83,149	1,319	3.19%
Total interest-bearing liabilities	572,838	5,264	1.85%	551,222	4,303	1.57%
Non interest-bearing liabilities	5,703			5,517		
Total liabilities	578,541			556,739		
Stockholders equity	60,184			57,446		
Total liabilities and stockholders equity	\$ 638,725			\$ 614,185		
Net interest income		\$ 11,347			\$ 11,305	
Interest rate spread(4)			3.69%			3.86%
Net yield on interest-earning assets(5)			3.80%			3.93%
Ratio of average interest-earning assets to average interest-bearing liabilities			105%			105%

- (1) Nonaccrual loans have been included in the appropriate average loan balance category, but interest on nonaccrual loans has not been included for purposes of determining interest income.
- (2) Tax equivalent adjustments to interest on investment securities were \$143,000 and \$103,000 for the periods ended June 30, 2005 and 2004, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.
- (3) Includes interest-bearing deposits in other banks.
- (4) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
- (5) Net yield on interest-earning assets represents net interest income as a percentage of average interest-earning assets.

**Rate/Volume Analysis**

The following table presents, for the periods indicated, the change in interest income and interest expense (in thousands) attributed to (i) changes in volume (changes in the weighted average balance of the total interest earning asset and interest bearing liability portfolios multiplied by the prior year rate), and (ii) changes in rate (changes in rate multiplied by prior year volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately based on the absolute value of changes due to volume and changes due to rate.

	Six months ended June 30, 2005 vs 2004			
	Volume	Increase (decrease) due to Rate		Net
<b>Interest income:</b>				
Loans receivable, net	\$ 1,054	\$ 170		\$ 1,224
Mortgage-backed securities	(356)	(37)		(393)
Investment securities (1)	91	66		157
Other interest-earning assets	1	14		15
Total interest-earning assets	790	213		1,003
<b>Interest expense:</b>				
Deposits	(129)	512		383
Advances from the FHLB	478	100		578
Total interest-bearing liabilities	349	612		961
Net change in net interest income	\$ 441	\$ (399)		\$ 42

(1) Tax equivalent adjustments to interest on investment securities were \$143,000 and \$103,000 for the periods ended June 30, 2005 and 2004, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.

**Total Interest Income.** Total interest income, on a taxable equivalent basis, increased by \$1.0 million or 6.4% to \$16.6 million for the six months ended June 30, 2005 compared with the first six months of 2004 primarily because of a \$37.2 million increase in average loans outstanding. Interest income from mortgage-backed securities was lower during the first half of 2005 in comparison to the same period of 2004. This decrease is consistent with the reduction of balances maintained in mortgage-backed securities. Investment securities interest income reflected an increase between the periods as a result of investment security purchases during the intervening period.

**Total Interest Expense.** Total interest expense increased by \$1.0 million to \$5.3 million during the six-month period ended June 30, 2005 as compared with the same six-month period of 2004. The decrease in the average balance of deposits was more than offset by an increase in interest rates on the Bank's demand deposit accounts in order to remain in line with short-term market interest rates and the Bank's competitors. Increases in the advances from the Federal Home Loan Bank during 2004 and the first half of 2005 is the primary cause for the increase in the related interest expense between the two periods.

**Non-interest income.** Total non-interest income was \$1,339,000 for the six-month period ended June 30, 2005 compared with \$1,390,000 for the same period in 2004. Loan prepayment and other loan fees decreased by \$63,000 and mortgage brokered fees collected increased by \$29,000 during the first six months of 2005 versus the same period in

2004. Retail banking fees were \$53,000 less between the two periods due to a decrease in demand deposit account fees. In contrast, net gain on the sale of loans totaled \$30,000 in 2005 while there was no such gain during 2004.

**Non-interest expense.** Total non-interest expense increased by \$288,000 to \$8.1 million for the six months ended June 30, 2005 compared to the same period in 2004. Compensation and benefit expenses were higher by \$173,000 mainly due to additional staffing as well as salary increases. Office and occupancy costs rose \$62,000 between the two periods due to \$54,000 of additional space leased during the second quarter of 2004 for deposit services support, annual rent increases, additional security guard services and \$7,000 of greater office maintenance costs. Professional expenses of the Company were \$99,000 higher mainly because of technology-related compliance and audit work.

**LIQUIDITY AND CAPITAL RESOURCES**

**Liquidity**



The Company's liquidity is a measure of its ability to fund loans, pay withdrawals of deposits, and other cash outflows in an efficient, cost-effective manner. The Company's short-term sources of liquidity include maturity, repayment and sales of assets, excess cash and cash equivalents, new deposits, broker deposits, other borrowings, and new advances from the Federal Home Loan Bank. There has been no material adverse change during six-month period ended June 30, 2005 in the ability of the Company and its subsidiaries to fund their operations.

At June 30, 2005, the Company had commitments outstanding under letters of credit of \$1.1 million, commitments to originate loans of \$36.6 million, and commitments to fund undisbursed balances of closed loans and unused lines of credit of \$57.4 million. At June 30, 2005, the Bank had \$1.3 million outstanding commitments to sell loans. There has been no material change during the six months ended June 30, 2005 in any of the Company's other contractual obligations or commitments to make future payments.

### **Capital Requirements**

The Bank was in compliance with all of its capital requirements as of June 30, 2005.

### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**



**Asset and Liability Management**



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The Company's market risk exposure is predominately caused by interest rate risk, which is defined as the sensitivity of the Company's current and future earnings, the values of its assets and liabilities, and the value of its capital to changes in the level of market interest rates. Management of the Company believes that there has not been a material adverse change in market risk during the six months ended June 30, 2005.

### **CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)), the Company's principal executive officer and principal financial officer have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

#### **Changes in Internal Controls over Financial Reporting**

During the quarter under report, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### **CRITICAL ACCOUNTING POLICIES**

Certain critical accounting policies of the Company require the use of significant judgment and accounting estimates in the preparation of the consolidated financial statements and related data of the Company. These accounting estimates require management to make assumptions about matters that are highly uncertain at the time the accounting estimate is made. Management believes that the most critical accounting policy requiring the use of accounting estimates and judgment is the determination of the allowance for loan losses. If the financial position of a significant amount of debtors should deteriorate more than the Company has estimated, present reserves for loan losses may be insufficient and additional provisions for loan losses may be required. The allowance for loan losses was \$2,460,000 at June 30, 2005.

## NEW ACCOUNTING PRONOUNCEMENTS

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123(R) (SFAS 123 R), Share-Based Payment. This statement establishes standards for the accounting for transactions in which the entity exchanges its equity instruments in exchange for goods and services and addresses transactions in which an entity incurs liabilities in exchange for goods and services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. SFAS123(R) focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. Under SFAS123(R), all forms of share-based payments to employees, including employee stock options, will be treated the same as other forms of compensation by recognizing the related cost in the income statement. The expense of the award will generally be measured at fair value at the grant date. The grant-date fair value of employee share options and similar instruments will be estimated using option pricing models. Current accounting guidance requires that the expense relating to so-called fixed plan employee stock options only be disclosed in the footnotes to the financial statements. In April 2005, the Securities and Exchange Commission adopted a new rule amending Regulation S-X to amend the date for compliance with SFAS123(R). Under SFAS123(R), registrants would have been required to apply the provisions of SFAS123(R) as of the first interim of annual reporting period that begins after June 15, 2005 or after December 15, 2005 for small business issuers. The Commission's new rule allows registrants to implement SFAS123(R) at the beginning of their next fiscal year that begins after June 15, 2005 or after December 15, 2005 for small business issuers.

In March 2005, the FASB issued Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 requires an entity to recognize a liability for the fair value of a legal obligation to perform asset-retirement activities that are conditional on a future event if the amount can be reasonably estimated. The Interpretation provides guidance to evaluate whether fair value is reasonably estimable. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. FIN 47 is not expected to have a material impact on the Company's financial position or results of operations.

On June 29, 2005, the FASB decided to issue a staff position which will be titled FSP FAS 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, and will supercede EITF 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, and EITF Topic D-44, Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value. The staff position will replace the guidance in paragraphs 10-18 of EITF Issue 03-1 with references to already established other-than-temporary impairment guidance as is set forth in Statement 115, Accounting for Certain Investments in Debt and Equity Securities, Staff Accounting Bulletin 59, Accounting for Noncurrent Marketable Equity Securities and APB Opinion 18, The Equity Method of Accounting for Investments in Common Stock. FSP FAS 115-1 will codify the guidance set forth in EITF Topic D-44 and clarify that an investor should recognize an impairment loss no later than when the impairment is considered other than temporary, even if a decision to sell has not been made. FSP FAS 115-1 will be effective for other-than-temporary impairment analysis conducted in periods after September 15, 2005. The Company does not expect FSP FAS 115-1 to have a material impact on the Company's financial position or results of operations.

## TF FINANCIAL CORPORATION AND SUBSIDIARIES

## PART II

## ITEM 1. LEGAL PROCEEDINGS

As a result of a routine regulatory examination by the Office of Thrift Supervision ( OTS ) of the Bank 's information technology systems conducted in January 2005, the Bank recently entered into a Supervisory Agreement (the Agreement ) with the OTS related solely to information technology matters. No operating restrictions have been imposed on the Bank. The Bank continues to be in a safe and sound financial condition.

Pursuant to the Agreement, the Bank agreed to take all necessary steps to ensure that the Bank comply with OTS regulatory guidelines for establishing and maintaining operational and managerial standards for its information technology systems. Under the terms of the Agreement, the Bank has created and begun implementing an information technology remediation plan (the Plan ) which must be fully implemented by March 31, 2006. The Bank has made significant progress in implementing the Plan and believes that its information technology systems are currently in substantial compliance with all OTS regulatory guidelines and are being operated in a safe and secure manner.

The Bank has appointed a compliance committee of the Board of Directors to oversee compliance with the Agreement and implementation of the Plan. The Agreement will remain in effect until terminated, modified or suspended by the OTS. The Bank believes that the Agreement will be terminated by the OTS at the next regularly scheduled routine OTS examination of the Bank 's information technology systems, although no assurance can be given that the OTS will terminate the Agreement at that time. The Bank believes that the Agreement will not have a material adverse effect on the financial condition or results of operations of the Bank or the Company, taken as a whole. Failure to comply with the Agreement, however, could result in further regulatory action by the OTS. A copy of the Agreement has been filed as an exhibit to this Report and is incorporated herein by reference.

## ITEM 2. UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information on repurchases by the Company of its common stock in each month for the three months ended June 30, 2005:

Month	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
April 1, 2005 - April 30, 2005				101,123
May 1, 2005 - May 31, 2005	27,785	\$ 29.51	1,700	99,423

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June 1, 2005 - June 30, 2005	900	\$	28.08	900	98,523
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The repurchase poses no modification to the rights of stockholders. Furthermore, there has been no change in the ability of the Company to pay dividends or any material change in the working capital of the Company. The stock repurchase did not alter the previously approved stock repurchase plan of the Company.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None

**ITEM 5. OTHER INFORMATION**

None



**ITEM 6.**

**EXHIBITS**

(a) Exhibits

10. Supervisory Agreement

31. Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32. Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**TF FINANCIAL CORPORATION**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 5, 2005

/s/ Kent C. Lufkin  
Kent C. Lufkin  
President and CEO  
(Principal Executive Officer)

Date: August 5, 2005

/s/ Dennis R. Stewart  
Dennis R. Stewart  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial & Accounting Officer)