Waterstone Financial, Inc.
Form 10-Q
October 27, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

T Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2017

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number 001-36271

WATERSTONE FINANCIAL, INC.
(Exact name of registrant as specified in its charter)

Maryland	90-1026709
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
11200 W. Plank Court Wauwatosa, Wisconsin	53226
(Address of principal executive offices)	(Zip Code)

(414) 761-1000
(Registrant's telephone number, including area code)

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 T No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes T No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer T Non-accelerated filer Smaller reporting company
Emerging growth company	(Do not check if smaller reporting company)

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No T

The number of shares outstanding of the issuer's common stock, $0.01 par value per share, was 29,489,346 at October 26, 2017.

WATERSTONE FINANCIAL, INC.

10-Q INDEX

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	(Unaudited) September 30, 2017	December 31, 2016
	(Dollars In Thousands, except share and per share data)	
Assets		
Cash	$39,308	$7,878
Federal funds sold	34,916	26,828
Interest-earning deposits in other financial institutions and other short term investments	18,367	12,511
Cash and cash equivalents	92,591	47,217
Securities available for sale (at fair value)	200,840	226,795
Loans held for sale (at fair value)	175,137	225,248
Loans receivable	1,261,160	1,177,884
Less: Allowance for loan losses	14,063	16,029
Loans receivable, net	1,247,097	1,161,855
Office properties and equipment, net	22,889	23,655
Federal Home Loan Bank stock (at cost)	18,450	13,275
Cash surrender value of life insurance	65,665	61,509
Real estate owned, net	4,568	6,118
Prepaid expenses and other assets	26,891	24,947
Total assets	$1,854,128	$1,790,619
Liabilities and Shareholders' Equity		
Liabilities:		
Demand deposits	$123,133	$120,371
Money market and savings deposits	148,607	162,456
Time deposits	685,033	666,584
Total deposits	956,773	949,411
Borrowings	435,503	387,155
Advance payments by borrowers for taxes	25,107	4,716
Other liabilities	24,815	38,647
Total liabilities	1,442,198	1,379,929
Shareholders' equity:		
Preferred stock (par value $.01 per share)		
Authorized - 50,000,000 shares in 2017 and in 2016, no shares issued	-	-
Common stock (par value $.01 per share)		
Authorized - 100,000,000 shares in 2017 and in 2016		
Issued - 29,483,346 in 2017 and 29,430,123 in 2016		
Outstanding - 29,483,346 in 2017 and 29,430,123 in 2016	295	294
Additional paid-in capital	325,753	322,934
Retained earnings	183,578	184,565

Unearned ESOP shares	(19,288)	(20,178)
Accumulated other comprehensive income (loss), net of taxes	328	(378)
Cost of shares repurchased (6,030,900 shares at September 30, 2017 and 5,908,150 shares at December 31, 2016)	(78,736)	(76,547)
Total shareholders' equity	411,930	410,690
Total liabilities and shareholders' equity	$1,854,128	$1,790,619

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(In Thousands, except per share amounts)			
Interest income:				
Loans	$15,855	$14,754	$45,078	$42,611
Mortgage-related securities	647	743	2,021	2,371
Debt securities, federal funds sold and short-term investments	951	833	2,680	2,692
Total interest income	17,453	16,330	49,779	47,674
Interest expense:				
Deposits	1,981	1,923	5,614	5,477
Borrowings	2,439	3,082	6,756	10,724
Total interest expense	4,420	5,005	12,370	16,201
Net interest income	13,033	11,325	37,409	31,473
Provision for loan losses	20	135	(1,166)	340
Net interest income after provision for loan losses	13,013	11,190	38,575	31,133
Noninterest income:				
Service charges on loans and deposits	300	789	1,148	1,742
Increase in cash surrender value of life insurance	688	734	1,476	1,446
Loss on sale of securities	-	-	(107)	-
Mortgage banking income	31,863	35,552	92,774	91,146
Other	203	337	941	874
Total noninterest income	33,054	37,412	96,232	95,208
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	26,153	27,573	73,732	70,968
Occupancy, office furniture, and equipment	2,533	2,319	7,587	7,074
Advertising	821	661	2,414	1,974
Data processing	623	616	1,854	1,897
Communications	394	374	1,170	1,088
Professional fees	629	474	1,953	1,486
Real estate owned	(20)	37	258	344
FDIC insurance premiums	129	140	366	500
Other	3,054	3,347	10,227	9,663
Total noninterest expenses	34,316	35,541	99,561	94,994
Income before income taxes	11,751	13,061	35,246	31,347
Income tax expense	4,362	5,556	12,397	12,214
Net income	$7,389	$7,505	$22,849	$19,133
Income per share:				
Basic	$0.27	$0.28	$0.83	$0.71
Diluted	$0.26	$0.27	$0.82	$0.70
Weighted average shares outstanding:				
Basic	27,532	27,043	27,449	26,976
Diluted	27,953	27,429	27,927	27,283

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(In Thousands)			
Net income	$7,389	$7,505	$22,849	$19,133
Other comprehensive income (loss), net of tax:				
Net unrealized holding gain (loss) on available for sale securities:				
Net unrealized holding gain (loss) arising during the period, net of tax (expense) benefit of ($59), $385, ($416), ($1,341), respectively	91	(596)	641	2,079
Reclassification adjustment for net loss included in net income during the period, net of tax benefit of $0, $0, ($42), $0, respectively	-	-	65	-
Total other comprehensive income (loss)	91	(596)	706	2,079
Comprehensive income	$7,480	$6,909	$23,555	$21,212

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Cost of Shares Repurchased	Total Shareholders' Equity
	(Dollars In Thousands, except per share amounts)							
Balances at December 31, 2015	29,407	$ $294	$ 317,022	$ 168,089	$ (21,365)	$ 582	$ (72,692)	$ 391,930
Comprehensive income:								
Net income	-	-	-	19,133	-	-	-	19,133
Other comprehensive income	-	-	-	-	-	2,079	-	2,079
Total comprehensive income								21,212
ESOP shares committed to be released to Plan participants	-	-	278	-	890	-	-	1,168
Cash dividend, $0.21 per share	-	-	-	(5,762)	-	-	-	(5,762)
Stock compensation activity, net of tax	263	3	3,434	-	-	-	-	3,437
Stock compensation expense	-	-	1,430	-	-	-	-	1,430
Repurchase of common stock returned to authorized but unissued	(284)	(3)	-	-	-	-	(3,855)	(3,858)
Balances at September 30, 2016	29,386	$ $294	$ 322,164	$ 181,460	$ (20,475)	$ 2,661	$ (76,547)	$ 409,557
Balances at December 31, 2016	29,430	$ $294	$ 322,934	$ 184,565	$ (20,178)	$ (378)	$ (76,547)	$ 410,690
Comprehensive income:								
Net income	-	-	-	22,849	-	-	-	22,849
Other comprehensive income	-	-	-	-	-	706	-	706
Total comprehensive income								23,555

ESOP shares committed to be released to Plan participants	-	-	572	-	890	-	-	1,462
Cash dividend, $0.86 per share	-	-	-	(23,836)	-	-	-	(23,836)
Stock based compensation activity	176	2	820	-	-	-	-	822
Stock compensation expense	-	-	1,427	-	-	-	-	1,427
Repurchase of common stock returned to authorized but unissued	(123)	(1)	-	-	-	-	(2,189)	(2,190)
Balances at September 30, 2017	29,483	$ $295	$ 325,753	$ 183,578	$ (19,288)	$ 328	$ (78,736)	$ 411,930

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine months ended September 30, 2017	2016
	(In Thousands)	
Operating activities:		
Net income	$22,849	$19,133
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	(1,166)	340
Provision for depreciation	1,549	2,061
Stock based compensation	1,427	1,430
Net amortization of premium/discount on debt and mortgage related securities	524	749
Amortization of unearned ESOP shares	1,462	1,168
Amortization and impairment of mortgage servicing rights	71	513
Gain on sale of loans held for sale	(94,219)	(93,481)
Loans originated for sale	(1,881,351)	(1,756,454)
Proceeds on sales of loans originated for sale	2,025,682	1,788,685
Increase in accrued interest receivable	(294)	(204)
Increase in cash surrender value of life insurance	(1,476)	(1,446)
Increase (decrease) in accrued interest on deposits and borrowings	2	(615)
Increase in other liabilities	336	5,893
Increase in accrued tax receivable	(2,088)	(172)
Loss on sale of securities	107	-
Net gain related to real estate owned	(11)	(123)
Gain on sale of mortgage servicing rights	(308)	-
Other	440	(3,784)
Net cash provided by (used in) operating activities	73,536	(36,307)
Investing activities:		
Net increase in loans receivable	(85,685)	(41,096)
Net change in FHLB stock	(5,175)	6,900
Purchases of:		
Debt securities	(6,140)	(4,140)
Mortgage related securities	(6,940)	(5,236)
Premises and equipment, net	(939)	(925)
Bank owned life insurance	(2,680)	(10,180)
Proceeds from:		
Principal repayments on mortgage-related securities	25,177	29,689
Maturities of debt securities	13,941	6,620
Sale of debt securities	448	-
Sales of real estate owned	3,104	5,304
Net cash used in investing activities	(64,889)	(13,064)
Financing activities:		
Net increase in deposits	7,362	62,288
Net change in short term borrowings	(7,652)	56,780
Repayment of long term debt	(69,000)	(220,000)

Proceeds from long term debt	125,000	100,000
Net change in advance payments by borrowers for taxes	6,021	9,405
Cash dividends on common stock	(23,636)	(4,832)
Purchase of common stock returned to authorized but unissued	(2,190)	(3,858)
Proceeds from stock option exercises	822	3,437
Net cash provided by financing activities	36,727	3,220
Increase (decrease) in cash and cash equivalents	45,374	(46,151)
Cash and cash equivalents at beginning of period	47,217	100,471
Cash and cash equivalents at end of period	$92,591	$54,320
Supplemental information:		
Cash paid or credited during the period for:		
Income tax payments	$14,141	$11,009
Interest payments	12,368	16,816
Noncash activities:		
Loans receivable transferred to real estate owned	1,609	3,442
Dividends declared but not paid in other liabilities	3,877	2,322

See Accompanying Notes to Unaudited Consolidated Financial Statements.

Note 1 — Basis of Presentation

The unaudited interim consolidated financial statements include the accounts of Waterstone Financial, Inc. (the "Company") and the Company's subsidiaries.

WaterStone Bank SSB (the "Bank") is a community bank that has served the banking needs of its customers since 1921. WaterStone Bank also has an active mortgage banking subsidiary, Waterstone Mortgage Corporation.

WaterStone Bank conducts its community banking business from 11 banking offices located in Milwaukee, Washington and Waukesha Counties, Wisconsin, as well as a loan production office in Minneapolis, Minnesota. WaterStone Bank's principal lending activity is originating one- to four-family, multi-family residential real estate, and commercial real estate loans for retention in its portfolio. WaterStone Bank also offers home equity loans and lines of credit, construction and land loans, and commercial business loans, and consumer loans. WaterStone Bank funds its loan production primarily with retail deposits and Federal Home Loan Bank advances. Our deposit offerings include: certificates of deposit, money market savings accounts, transaction deposit accounts, non-interest bearing demand accounts and individual retirement accounts. Our investment securities portfolio is comprised principally of mortgage-backed securities, government-sponsored enterprise bonds and municipal obligations.

WaterStone Bank's mortgage banking operations are conducted through its wholly-owned subsidiary, Waterstone Mortgage Corporation. Waterstone Mortgage Corporation originates single-family residential real estate loans for sale into the secondary market. Waterstone Mortgage Corporation utilizes lines of credit provided by WaterStone Bank as a primary source of funds, and also utilizes a line of credit with another financial institution as needed.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information, Rule 10-01 of Regulation S-X and the instructions to Form 10-Q. The financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position, results of operations, changes in shareholders' equity, and cash flows of the Company for the periods presented.

The accompanying unaudited consolidated financial statements and related notes should be read in conjunction with the Company's December 31, 2016 Annual Report on Form 10-K. Operating results for the nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017 or for any other period.

The preparation of the unaudited consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include the allowance for loan losses, deferred income taxes and real estate owned. Actual results could differ from those estimates.

Certain prior period amounts have been reclassified to conform to current period presentation. These reclassifications did not result in any changes to previously reported net income or shareholders' equity.

Impact of Recent Accounting Pronouncements

Accounting Standards Codification (ASC) Topic 606 "Revenue from Contracts with Customers." New authoritative accounting guidance under ASC Topic 606, "Revenue from Contracts with Customers" amended prior guidance to require an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services and to provide clarification on identifying performance obligations and licensing implementation guidance. The new authoritative guidance was initially effective for reporting periods after January 1, 2017 but was deferred to January 1, 2018. The Company's revenue is comprised of interest and non-interest revenue. The guidance does not apply to revenue associated with financial instruments, including loans and securities. The Company is substantially complete with its overall assessment of revenue streams and reviewing of related contracts potentially affected by the guidance, including asset management fees, deposit related fees, and other non-interest related fees. The Company's assessment suggests that adoption of this guidance should not materially change the method in which we currently recognize revenue for these revenue streams. In addition, the Company is evaluating the guidance's expanded disclosure requirements. The Company plans to adopt ASC 606 on January 1, 2018 utilizing the modified retrospective approach with a cumulative effect adjustment to opening retained earnings, if such adjustment is deemed to be material.

ASC Topic 825 "Financial Instruments." New authoritative accounting guidance under ASC Topic 825, "Financial Instruments" amended prior guidance to require equity investments (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. An entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. The new guidance simplifies the impairment assessment of equity investments without readily determinable fair values, requires public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from changes in the instrument-specific credit risk when the entity has selected the fair value option for financial instruments and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset. The new authoritative guidance will be effective for reporting periods after January 1, 2018 and is not expected to have a material impact on the Company's statements of operations or financial condition.

ASC Topic 842 "Leases." New authoritative accounting guidance under ASC Topic 842, "Leases" amended prior guidance to require lessees to recognize the assets and liabilities arising from all leases on the balance sheet. The new authoritative guidance defines a lease as a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. In addition, the qualifications for a sale and leaseback transaction have been amended. The new authoritative guidance also requires qualitative and quantitative disclosures by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The new authoritative guidance will be effective for reporting periods after January 1, 2019. The Company is evaluating the new guidance and its impact on the Company's statements of operations and financial condition.

ASC Topic 718 "Compensation - Stock Compensation." New authoritative accounting guidance under ASC Topic 718, "Compensation - Stock Compensation" amended prior guidance on several aspects, including the income tax consequences, classification of awards as either equity or liability, and classification on the statement of cash flows. The new authoritative guidance allows for all excess tax benefits and tax deficiencies to be recognized as income tax benefit or expense in the income statement. The tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. An entity also should recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. For earnings per share, anticipated excess tax benefits will not be included in assumed proceeds when applying the treasury method for computing dilutive shares. For the statement of cash flows, excess tax benefits should be classified along with other income tax cash flows as an operating activity, and cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity. The new authoritative guidance also allows an entity to make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur. In addition, the threshold to qualify for equity classification permits withholding up to the maximum statutory tax rates in the applicable jurisdictions. The Company adopted this standard on January 1, 2017. See Note 9 for the impact on the Company's statement of operations.

ASC Topic 326 "Financial Instruments - Credit Losses." New authoritative accounting guidance under ASC Topic 326, "Financial Instruments - Credit Losses" amended the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information for credit loss estimates. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The new authoritative guidance also requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected (net of the allowance for credit losses). In addition, the credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses rather than a write-down. The new authoritative guidance will be effective for reporting periods after January 1, 2020. The Company is evaluating the new guidance and its impact on the Company's statements of operations and financial condition.

ASC Topic 310 "Receivables - Nonrefundable Fees and Other Costs." New authoritative accounting guidance under ASC Topic 310 "Receivables - Nonrefundable Fees and Other Costs" amends prior guidance by shortening the amortization period for certain callable debt securities held at a premium requiring the premium to be amortized to the earliest call date. The new authoritative guidance will be effective for reporting periods after January 1, 2019 with early adoption permitted. The Company is evaluating the new guidance and its impact on the Company's statements of operations and financial condition.

Note 2— Securities Available for Sale

The amortized cost and fair values of the Company's investment in securities available for sale follow:

	September 30, 2017			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	$61,692	$ 631	$ (105)	$62,218
Collateralized mortgage obligations:				
Government sponsored enterprise issued	54,949	56	(345)	54,660
Mortgage-related securities	116,641	687	(450)	116,878
Government sponsored enterprise bonds	2,500	-	(1)	2,499
Municipal securities	64,100	1,578	(16)	65,662
Other debt securities	15,005	61	(492)	14,574
Debt securities	81,605	1,639	(509)	82,735
Certificates of deposit	1,225	3	(1)	1,227
	$199,471	$ 2,329	$ (960)	$200,840

December 31, 2016
Amortized cost