Capitol Federal Financial Inc
Form 10-Q
May 05, 2014

UNITED STATES SECURITIES

AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2014

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d)

OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 001-34814

Capitol Federal Financial, Inc.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Maryland | 27-2631712 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 700 Kansas Avenue, Topeka, Kansas | 66603 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code:

(785) 235-1341

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 requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes No

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

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

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

As of April 23, 2014, there were 143,120,893 shares of Capitol Federal Financial, Inc. common stock outstanding.

PART I -- FINANCIAL INFORMATION
Item 1. Financial Statements

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS (Unaudited)
(Dollars in thousands)

| | March 31, 2014 | September 30, 2013 |
|---|---|---|
| ASSETS: | | |
| Cash and cash equivalents (includes interest-earning deposits of $94,431 and $99,735) | $ 114,835 | $ 113,886 |
| Securities: | | |
| Available-for-sale ("AFS") at estimated fair value (amortized cost of $887,543 and $1,058,283) | 895,623 | 1,069,967 |
| Held-to-maturity ("HTM") at amortized cost (estimated fair value of $1,735,084 and $1,741,846) | 1,720,283 | 1,718,023 |
| Loans receivable, net (allowance for credit losses ("ACL") of $8,967 and $8,822) | 6,053,897 | 5,958,868 |
| Bank-owned life insurance ("BOLI") | 60,163 | 59,495 |
| Capital stock of Federal Home Loan Bank ("FHLB"), at cost | 125,829 | 128,530 |
| Accrued interest receivable | 23,192 | 23,596 |
| Premises and equipment, net | 70,218 | 70,112 |
| Other real estate owned ("OREO") | 3,667 | 3,882 |
| Other assets | 47,710 | 40,090 |
| TOTAL ASSETS | $ 9,115,417 | $ 9,186,449 |
| | | |
| LIABILITIES: | | |
| Deposits | $ 4,693,762 | $ 4,611,446 |
| FHLB borrowings | 2,467,169 | 2,513,538 |
| Repurchase agreements | 320,000 | 320,000 |
| Advance payments by borrowers for taxes and insurance | 50,169 | 57,392 |
| Income taxes payable | 3,021 | 108 |
| Deferred income tax liabilities, net | 20,781 | 20,437 |
| Accounts payable and accrued expenses | 30,510 | 31,402 |
| Total liabilities | 7,585,412 | 7,554,323 |
| | | |
| STOCKHOLDERS' EQUITY: | | |
| | -- | -- |

| | | | | |
|---|---|---|---|---|
| Preferred stock ($0.01 par value) 100,000,000 shares authorized; no shares issued or outstanding | | | | |
| Common stock ($0.01 par value) 1,400,000,000 shares authorized; 143,120,893 and 147,840,268 | | | | |
| shares issued and outstanding as of March 31, 2014 and September 30, 2013, respectively | | 1,431 | | 1,478 |
| Additional paid-in capital | | 1,197,668 | | 1,235,781 |
| Unearned compensation, Employee Stock Ownership Plan ("ESOP") | | (43,777) | | (44,603) |
| Retained earnings | | 369,657 | | 432,203 |
| Accumulated other comprehensive income ("AOCI"), net of tax | | 5,026 | | 7,267 |
| Total stockholders' equity | | 1,530,005 | | 1,632,126 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ | 9,115,417 | $ | 9,186,449 |

See accompanying notes to consolidated financial statements.

3

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
(Dollars in thousands, except per share data)

| | For the Three Months Ended March 31, | | For the Six Months Ended March 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| INTEREST AND DIVIDEND INCOME: | | | | |
| Loans receivable | $ 57,117 | $ 56,936 | $ 114,065 | $ 115,403 |
| Mortgage-backed securities ("MBS") | 11,597 | 14,446 | 23,559 | 29,629 |
| Investment securities | 1,869 | 2,457 | 3,935 | 5,322 |
| Capital stock of FHLB | 1,229 | 1,105 | 2,425 | 2,233 |
| Cash and cash equivalents | 45 | 36 | 107 | 69 |
| Total interest and dividend income | 71,857 | 74,980 | 144,091 | 152,656 |
| | | | | |
| INTEREST EXPENSE: | | | | |
| FHLB borrowings | 15,311 | 17,909 | 32,174 | 36,537 |
| Deposits | 8,076 | 9,344 | 16,399 | 19,193 |
| Repurchase agreements | 2,743 | 3,407 | 5,546 | 6,976 |
| Total interest expense | 26,130 | 30,660 | 54,119 | 62,706 |
| | | | | |
| NET INTEREST INCOME | 45,727 | 44,320 | 89,972 | 89,950 |
| | | | | |
| PROVISION FOR CREDIT LOSSES | 160 | -- | 675 | 233 |
| | | | | |
| NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES | 45,567 | 44,320 | 89,297 | 89,717 |
| | | | | |
| NON-INTEREST INCOME: | | | | |
| Retail fees and charges | 3,454 | 3,521 | 7,264 | 7,513 |
| Insurance commissions | 1,204 | 979 | 1,762 | 1,550 |
| Loan fees | 404 | 418 | 854 | 885 |
| Income from BOLI | 330 | 361 | 668 | 743 |
| Other non-interest income | 335 | 665 | 679 | 1,021 |
| Total non-interest income | 5,727 | 5,944 | 11,227 | 11,712 |

(Continued)

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
(Dollars in thousands, except per share data)

| | For the Three Months Ended March 31, | | For the Six Months Ended March 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| NON-INTEREST EXPENSE: | | | | |
| Salaries and employee benefits | $ 10,724 | $ 12,155 | $ 21,450 | $ 24,336 |
| Occupancy | 2,634 | 2,391 | 5,183 | 4,709 |
| Information technology and communications | 2,320 | 2,232 | 4,612 | 4,430 |
| Regulatory and outside services | 1,157 | 1,290 | 2,553 | 3,055 |
| Deposit and loan transaction costs | 1,263 | 1,384 | 2,650 | 2,910 |
| Federal insurance premium | 1,103 | 1,116 | 2,186 | 2,230 |
| Advertising and promotional | 877 | 1,004 | 1,883 | 2,036 |
| Other non-interest expense | 1,750 | 1,645 | 4,098 | 4,252 |
| Total non-interest expense | 21,828 | 23,217 | 44,615 | 47,958 |
| INCOME BEFORE INCOME TAX EXPENSE | 29,466 | 27,047 | 55,909 | 53,471 |
| INCOME TAX EXPENSE | 9,778 | 9,332 | 18,408 | 18,193 |
| NET INCOME | $ 19,688 | $ 17,715 | $ 37,501 | $ 35,278 |
| Basic earnings per share | $ 0.14 | $ 0.12 | $ 0.26 | $ 0.24 |
| Diluted earnings per share | $ 0.14 | $ 0.12 | $ 0.26 | $ 0.24 |
| Dividends declared per share | $ 0.08 | $ 0.08 | $ 0.58 | $ 0.85 |
| Basic weighted average common shares | 139,489,033 | 145,381,605 | 141,204,147 | 146,645,899 |
| Diluted weighted average common shares | 139,489,324 | 145,381,718 | 141,204,751 | 146,646,006 |

(Concluded)

See accompanying notes to consolidated financial statements.

5

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
(Dollars in thousands)

| | For the Three Months Ended March 31, | | For the Six Months Ended March 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | $ 19,688 | $ 17,715 | $ 37,501 | $ 35,278 |
| Other comprehensive income (loss), net of tax: | | | | |
| Changes in unrealized holding gains/(losses) on AFS securities, net of deferred income tax (benefits) expenses of $(279) and $1,594 for the three months ended March 31, 2014 and 2013, respectively, and $1,363 and $3,907 for the six months ended March 31, 2014 and 2013, respectively | 459 | (2,621) | (2,241) | (6,426) |
| Comprehensive income | $ 20,147 | $ 15,094 | $ 35,260 | $ 28,852 |

See accompanying notes to consolidated financial statements.

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (Unaudited)
(Dollars in thousands, except per share data)

| | Common Stock | Additional Paid-In Capital | Unearned Compensation ESOP | Retained Earnings | AOCI | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| Balance at October 1, 2013 | $ 1,478 | $ 1,235,781 | $ (44,603) | $ 432,203 | $ 7,267 | $ 1,632,126 |
| Net income | | | | 37,501 | | 37,501 |
| Other comprehensive income (loss), net of tax | | | | | (2,241) | (2,241) |
| ESOP activity, net | | 188 | 826 | | | 1,014 |
| Restricted stock activity, net | | 87 | | | | 87 |
| Stock-based compensation | | 1,105 | | | | 1,105 |
| Repurchase of common stock | (48) | (39,903) | | (17,255) | | (57,206) |
| Stock options exercised | 1 | 410 | | | | 411 |
| Dividends on common stock to stockholders ($0.58 per share) | | | | (82,792) | | (82,792) |
| Balance at March 31, 2014 | $ 1,431 | $ 1,197,668 | $ (43,777) | $ 369,657 | $ 5,026 | $ 1,530,005 |

See accompanying notes to consolidated financial statements.

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands)

| | For the Six Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $ 37,501 | $ 35,278 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| FHLB stock dividends | (2,425) | (2,233) |
| Provision for credit losses | 675 | 233 |
| Originations of loans receivable held-for-sale ("LHFS") | (1,325) | (2,769) |
| Proceeds from sales of LHFS | 1,881 | 2,868 |
| Amortization and accretion of premiums and discounts on securities | 2,866 | 4,515 |
| Depreciation and amortization of premises and equipment | 3,122 | 2,581 |
| Amortization of deferred amounts related to FHLB advances, net | 3,631 | 4,143 |
| Common stock committed to be released for allocation - ESOP | 1,014 | 3,276 |
| Stock-based compensation | 1,105 | 1,586 |
| Changes in: | | |
| Prepaid federal insurance premium | -- | 1,977 |
| Accrued interest receivable | 404 | 1,645 |
| Other assets, net | 692 | (915) |
| Income taxes payable/receivable | 4,707 | 3,801 |
| Accounts payable and accrued expenses | (10,151) | (12,242) |
| Net cash provided by operating activities | 43,697 | 43,744 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of AFS securities | (120,817) | (379,187) |
| Purchase of HTM securities | (159,707) | (420,501) |
| Proceeds from calls, maturities and principal reductions of AFS securities | 291,348 | 529,899 |
| Proceeds from calls, maturities and principal reductions of HTM securities | 154,790 | 350,510 |
| Proceeds from the redemption of capital stock of FHLB | 7,845 | 4,524 |
| Purchases of capital stock of FHLB | (2,719) | -- |
| Net increase in loans receivable | (97,805) | (111,672) |
| Purchases of premises and equipment | (4,003) | (6,233) |
| Proceeds from sales of OREO | 2,814 | 5,858 |
| Net cash provided by (used in) investing activities | 71,746 | (26,802) |

(Continued)

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands)

| | For the Six Months Ended March 31, 2014 | 2013 |
|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Dividends paid | $ (82,792) | $ (125,325) |
| Deposits, net of withdrawals | 82,316 | 142,930 |
| Proceeds from borrowings | 420,180 | 403,130 |
| Repayments on borrowings | (470,180) | (453,130) |
| Change in advance payments by borrowers for taxes and insurance | (7,223) | (5,683) |
| Repurchase of common stock | (57,206) | (71,995) |
| Stock options exercised | 411 | -- |
| Net cash used in financing activities | (114,494) | (110,073) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 949 | (93,131) |
| CASH AND CASH EQUIVALENTS: | | |
| Beginning of period | 113,886 | 141,705 |
| End of period | $ 114,835 | $ 48,574 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Income tax payments | $ 13,700 | $ 14,391 |
| Interest payments | $ 50,880 | $ 58,747 |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| FHLB advances that will settle in a subsequent period | $ -- | $ 100,000 |

(Concluded)

See accompanying notes to consolidated financial statements.

9

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation - The accompanying consolidated financial statements of Capitol Federal® Financial, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2013, filed with the Securities and Exchange Commission ("SEC"). Interim results are not necessarily indicative of results for a full year.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Capitol Federal Savings Bank (the "Bank"). The Bank has a wholly-owned subsidiary, Capitol Funds, Inc. Capitol Funds, Inc. has a wholly-owned subsidiary, Capitol Federal Mortgage Reinsurance Company. All intercompany accounts and transactions have been eliminated in consolidation.

In preparing the financial statements, management is required 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 and revenues and expenses during the reporting periods. The ACL is a significant estimate that involves a high degree of complexity and requires management to make difficult and subjective judgments and assumptions about highly uncertain matters. The use of different judgments and assumptions could cause reported results to differ significantly. In addition, bank regulators periodically review the ACL of the Bank. Bank regulators have the authority to require the Bank, as they can require all banks, to increase the ACL or recognize additional charge-offs based upon their judgments, which may differ from management's judgments. Any increases in the ACL or recognition of additional charge-offs required by bank regulators could adversely affect the Company's financial condition and results of operations.

Recent Accounting Pronouncements - In December 2011, the Financial Accounting Standards Board ("FASB") issued 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. The Accounting Standards Update ("ASU") requires new disclosures regarding the nature of an entity's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. The new disclosures are designed to make GAAP financial statements more comparable to those prepared under International Financial Reporting Standards. The new disclosures entail presenting information about both gross and net exposures. The new disclosure requirements are effective for annual reporting periods beginning on or after January 1, 2013, which was October 1, 2013 for the Company, and interim periods therein; retrospective application is required. The adoption of this ASU was disclosure-related and therefore did not have an impact on the Company's consolidated financial condition or results of operations when adopted on October 1, 2013.

In January 2013, the FASB issued ASU 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The ASU clarifies the scope of the offsetting disclosure requirements in ASU 2011-11, Disclosures about Offsetting Assets and Liabilities. These standards are effective for fiscal years beginning on or after January 1, 2013, which was October 1, 2013 for the Company. The standards are disclosure-related and therefore, their adoption did not have an impact on the Company's consolidated financial condition or results of operations when adopted on October 1, 2013.

In February 2013, the FASB issued ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, which is intended to improve the transparency of changes in other comprehensive income and items reclassified out of AOCI. The standard requires entities to disaggregate the total change of each component of other comprehensive income and separately present reclassification adjustments and current period other comprehensive income. Additionally, the standard requires that significant items reclassified out of AOCI be presented by component either on the face of the statement where net income is presented or as a separate disclosure in the notes to the financial statements. ASU 2013-02 is effective for fiscal years beginning after December 15, 2012, which was October 1, 2013 for the Company, and should be applied prospectively. The adoption of this ASU is disclosure-related and therefore did not have an impact on the Company's consolidated financial condition or results of operations when adopted on October 1, 2013.

In February 2013, the FASB issued ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date. The ASU provides recognition, measurement, and disclosure guidance for certain obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. ASU 2013-04 is effective for fiscal years beginning after December 15, 2013, which is October 1, 2014 for the Company, and should be applied retrospectively. The Company has not yet completed its evaluation of this standard.

In January 2014, the FASB issued ASU 2014-01, Accounting for Investments in Qualified Affordable Housing Projects. The ASU revised the conditions that an entity must meet to elect to use the effective yield method when accounting for qualified affordable housing project investments. Per current accounting guidance, an entity that invests in a qualified affordable housing project may elect to account for that investment using the effective yield method if all required conditions are met. For those investments that are not accounted for using the effective yield method, current accounting guidance requires that the investments be accounted for under either the equity method or the cost method. Certain existing conditions required to be met to use the effective yield method are restrictive and thus prevent many such investments from qualifying for the use of the effective yield method. The ASU replaces the effective yield method with the proportional amortization method and modifies the conditions that an entity must meet to be eligible to use a method other than the equity or cost methods to account for qualified affordable housing project investments. If the modified conditions are met, the ASU permits an entity to use the proportional amortization method to amortize the initial cost of the investment in proportion to the amount of tax credits and other tax benefits received and recognize the net investment performance in the income statement as a component of income tax expense. Additionally, the ASU requires new disclosures about all investments in qualified affordable housing projects irrespective of the method used to account for the investments. ASU 2014-01 is effective for fiscal years beginning after December 15, 2014, which is October 1, 2015 for the Company, and should be applied retrospectively. The ASU is not expected to have a material impact on the Company's consolidated financial condition or result of operations when adopted.

In January 2014, the FASB issued ASU 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The ASU clarifies when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The ASU also requires disclosure of both (1) the amount of foreclosed residential real estate property held by a creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU 2014-04 is effective for fiscal years beginning after December 15, 2014, which is October 1, 2015 for the Company, and can be applied using either a modified retrospective transition method or a prospective transition method. The ASU is not expected to have a material impact on the Company's consolidated financial condition or result of operations when adopted.

## 2. Earnings Per Share

Shares acquired by the ESOP are not considered in the basic average shares outstanding until the shares are committed for allocation or vested to an employee's individual account. Unvested shares awarded pursuant to the Company's restricted stock benefit plans are treated as participating securities in the computation of earnings per share pursuant to the two-class method as they contain nonforfeitable rights to dividends. The two-class method is an earnings allocation that determines earnings per share for each class of common stock and participating security.

| | For the Three Months Ended March 31, | | For the Six Months Ended March 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |

| | | | | |
|---|---|---|---|---|
| | (Dollars in thousands, except per share data) | | | |
| Net income | $ 19,688 | $ 17,715 | $ 37,501 | $ 35,278 |
| Income allocated to participating securities | (44) | (51) | (94) | (111) |
| Net income available to common stockholders | $ 19,644 | $ 17,664 | $ 37,407 | $ 35,167 |
| | | | | |
| Average common shares outstanding | 139,447,275 | 145,242,074 | 141,183,271 | 146,576,142 |
| Average committed ESOP shares outstanding | 41,758 | 139,531 | 20,876 | 69,757 |
| Total basic average common shares outstanding | 139,489,033 | 145,381,605 | 141,204,147 | 146,645,899 |
| | | | | |
| Effect of dilutive stock options | 291 | 113 | 604 | 107 |
| | | | | |
| Total diluted average common shares outstanding | 139,489,324 | 145,381,718 | 141,204,751 | 146,646,006 |
| | | | | |
| Net earnings per share: | | | | |
| Basic | $ 0.14 | $ 0.12 | $ 0.26 | $ 0.24 |
| Diluted | $ 0.14 | $ 0.12 | $ 0.26 | $ 0.24 |
| | | | | |
| Antidilutive stock options, excluded from the diluted average common shares outstanding calculation | 2,060,216 | 2,463,165 | 2,396,610 | 2,466,339 |

3. Securities

The following tables reflect the amortized cost, estimated fair value, and gross unrealized gains and losses of AFS and HTM securities at the dates presented. The majority of the MBS and investment securities portfolios are composed of securities issued by U.S. government-sponsored enterprises ("GSEs").

| | March 31, 2014 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| | (Dollars in thousands) | | | |
| AFS: | | | | |
| GSE debentures | $ 579,853 | $ 364 | $ 8,677 | $ 571,540 |
| MBS | 304,034 | 16,603 | 70 | 320,567 |
| Trust preferred securities | 2,539 | -- | 170 | 2,369 |
| Municipal bonds | 1,117 | 30 | -- | 1,147 |
| | 887,543 | 16,997 | 8,917 | 895,623 |
| HTM: | | | | |
| MBS | 1,684,571 | 32,599 | 18,531 | 1,698,639 |
| Municipal bonds | 35,712 | 769 | 36 | 36,445 |
| | 1,720,283 | 33,368 | 18,567 | 1,735,084 |
| | $ 2,607,826 | $ 50,365 | $ 27,484 | $ 2,630,707 |

| | September 30, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| | (Dollars in thousands) | | | |
| AFS: | | | | |
| GSE debentures | $ 709,118 | $ 996 | $ 7,886 | $ 702,228 |
| MBS | 345,263 | 18,701 | -- | 363,964 |
| Trust preferred securities | 2,594 | -- | 171 | 2,423 |
| Municipal bonds | 1,308 | 44 | -- | 1,352 |
| | 1,058,283 | 19,741 | 8,057 | 1,069,967 |
| HTM: | | | | |
| MBS | 1,683,744 | 39,878 | 16,984 | 1,706,638 |
| Municipal bonds | 34,279 | 943 | 14 | 35,208 |
| | 1,718,023 | 40,821 | 16,998 | 1,741,846 |
| | $ 2,776,306 | $ 60,562 | $ 25,055 | $ 2,811,813 |

The following tables summarize the estimated fair value and gross unrealized losses of those securities on which an unrealized loss at the dates presented was reported and the continuous unrealized loss position for less than 12 months and equal to or greater than 12 months as of the dates presented.

| | March 31, 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | | Equal to or Greater Than 12 Months | | |
| | Count | Estimated Fair Value | Unrealized Losses | Count | Estimated Fair Value | Unrealized Losses |
| | (Dollars in thousands) | | | | | |
| AFS: | | | | | | |
| GSE debentures | 20 | $ 457,820 | $ 7,467 | 2 | $ 37,941 | $ 1,210 |
| MBS | 1 | 10,191 | 70 | -- | -- | -- |
| Trust preferred securities | -- | -- | -- | 1 | 2,369 | 170 |
| | 21 | $ 468,011 | $ 7,537 | 3 | $ 40,310 | $ 1,380 |
| HTM: | | | | | | |
| MBS | 44 | $ 784,469 | $ 17,239 | 2 | $ 22,566 | $ 1,292 |
| Municipal bonds | 8 | 5,386 | 36 | -- | -- | -- |
| | 52 | $ 789,855 | $ 17,275 | 2 | $ 22,566 | $ 1,292 |

| | September 30, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | | Equal to or Greater Than 12 Months | | |
| | Count | Estimated Fair Value | Unrealized Losses | Count | Estimated Fair Value | Unrealized Losses |
| | (Dollars in thousands) | | | | | |
| AFS: | | | | | | |
| GSE debentures | 19 | $ 426,482 | $ 7,213 | 1 | $ 24,327 | $ 673 |
| Trust preferred securities | -- | -- | -- | 1 | 2,423 | 171 |
| | 19 | $ 426,482 | $ 7,213 | 2 | $ 26,750 | $ 844 |
| HTM: | | | | | | |
| MBS | 40 | $ 710,291 | $ 16,984 | -- | $ -- | $ -- |
| Municipal bonds | 3 | 1,299 | 14 | -- | -- | -- |
| | 43 | $ 711,590 | $ 16,998 | -- | $ -- | $ -- |

On a quarterly basis, management conducts a formal review of securities for the presence of an other-than-temporary impairment. Management assesses whether an other-than-temporary impairment is present when the fair value of a security is less than its amortized cost basis at the balance sheet date. For such securities, other-than-temporary impairment is considered to have occurred if the Company intends to sell the security, if it is more likely than not the

Company will be required to sell the security before recovery of its amortized cost basis, or if the present value of expected cash flows is not sufficient to recover the entire amortized cost.

The unrealized losses at March 31, 2014 and September 30, 2013, excluding the trust preferred security discussed below, are primarily a result of an increase in market yields from the time the securities were purchased.  In general, as market yields rise, the fair value of securities will decrease; as market yields fall, the fair value of securities will increase.  Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired.  Additionally, the impairment is also considered temporary because scheduled coupon payments have been made, it is anticipated that the entire principal balance will be collected as scheduled, and management neither intends to sell the securities, nor is it more likely than not that the Company will be required to sell the securities before the recovery of the remaining amortized cost amount, which could be at maturity.  As a result of the analysis, management does not believe any other-than-temporary impairments existed at March 31, 2014 or September 30, 2013.

The unrealized losses related to the trust preferred security held by the Bank at March 31, 2014 and September 30, 2013 were primarily a result of a decrease in the security's credit rating since the time of purchase. Management reviews the underlying cash flows of this security on a quarterly basis. As of March 31, 2014 and September 30, 2013, the cash flow analysis indicated the present value of future expected cash flows are adequate to recover the entire amortized cost. In January 2014, five federal agencies, including the Office of the Comptroller of the Currency ("OCC") and the SEC, approved an interim final rule permitting banking entities to retain interests in certain collateralized debt obligations backed primarily by trust preferred securities from the investment prohibitions of section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Volcker Rule"). The final rule became effective on April 1, 2014. The Bank's trust preferred security is included on the non-exclusive list of issuers that meet the requirements of the interim and final rule (provided by the federal banking agencies) and is therefore exempt from the provisions of the Volcker Rule. Based on this, management neither intends to sell this security, nor is it more likely than not that the Company will be required to sell the security before the recovery of the remaining amortized cost amount, which could be at maturity. Based on its analysis, management does not believe any other-than-temporary impairments existed related to the trust preferred security at March 31, 2014 or September 30, 2013.

Maturities of MBS depend on the repayment characteristics and experience of the underlying financial instruments. Actual maturities of MBS may differ from contractual maturities because borrowers have the right to prepay obligations, generally without penalties. Additionally, issuers of callable investment securities have the right to call and prepay obligations with or without prepayment penalties prior to the maturity dates of the securities. The amortized cost and estimated fair value of securities by remaining contractual maturity, without consideration for call features or pre-refunding dates, as of March 31, 2014 are shown below.

| | AFS | | HTM | |
|---|---|---|---|---|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| | (Dollars in thousands) | | | |
| One year or less | $ 201 | $ 204 | $ 7,225 | $ 7,296 |
| One year through five years | 531,332 | 525,271 | 70,001 | 73,335 |
| Five years through ten years | 142,417 | 146,593 | 491,727 | 490,835 |
| Ten years and thereafter | 213,593 | 223,555 | 1,151,330 | 1,163,618 |
| | $ 887,543 | $ 895,623 | $ 1,720,283 | $ 1,735,084 |

The following table presents the carrying value of MBS in our portfolio by issuer at the dates presented.

| | March 31, 2014 | September 30, 2013 |
|---|---|---|
| | (Dollars in thousands) | |
| Federal National Mortgage Association ("FNMA") | $ 1,166,881 | $ 1,250,948 |

| | | |
|---|---|---|
| Federal Home Loan Mortgage Corporation ("FHLMC") | 666,209 | 629,216 |
| Government National Mortgage Association | 172,048 | 167,544 |
| | $ 2,005,138 | $ 2,047,708 |

The following table presents the taxable and non-taxable components of interest income on investment securities for the time periods presented.

| | For the Three Months Ended March 31, | | For the Six Months Ended March 31, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| | (Dollars in thousands) | | | |
| Taxable | $ 1,632 | $ 2,147 | $ 3,439 | $ 4,685 |
| Non-taxable | 237 | 310 | 496 | 637 |
| | $ 1,869 | $ 2,457 | $ 3,935 | $ 5,322 |

14

The following table summarizes the amortized cost and estimated fair value of securities pledged as collateral as of the dates presented.

| | March 31, 2014 | | September 30, 2013 | |
|---|---|---|---|---|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| | (Dollars in thousands) | | | |
| Repurchase agreements | $ 345,697 | $ 356,488 | $ 353,648 | $ 364,593 |
| Public unit deposits | 273,769 | 274,775 | 272,016 | 274,917 |
| Federal Reserve Bank | 29,425 | 30,351 | 34,261 | 35,477 |
| | $ 648,891 | $ 661,614 | $ 659,925 | $ 674,987 |

4. Loans Receivable and Allowance for Credit Losses

Loans receivable, net at the dates presented is summarized as follows:

| | March 31, 2014 | September 30, 2013 |
|---|---|---|
| | (Dollars in thousands) | |
| Real estate loans: | | |
| One- to four-family | $ 5,840,337 | $ 5,743,047 |
| Multi-family and commercial | 47,505 | 50,358 |
| Construction | 94,286 | 77,743 |
| Total real estate loans | 5,982,128 | 5,871,148 |
| | | |
| Consumer loans: | | |
| Home equity | 130,321 | 135,028 |
| Other | 4,991 | 5,623 |
| Total consumer loans | 135,312 | 140,651 |
| | | |
| Total loans receivable | 6,117,440 | 6,011,799 |

| | | |
|---|---|---|
| Less: | | |
| Undisbursed loan funds | 55,505 | 42,807 |
| ACL | 8,967 | 8,822 |
| Discounts/unearned loan fees | 23,653 | 23,057 |
| Premiums/deferred costs | (24,582) | (21,755) |
| | $ 6,053,897 | $ 5,958,868 |

Lending Practices and Underwriting Standards - Originating and purchasing loans secured by one- to four-family residential properties is the Bank's primary lending business, resulting in a loan concentration in residential first mortgage loans. The Bank purchases one- to four-family loans, on a loan-by-loan basis, from a select group of correspondent lenders in 24 states. Additionally, the Bank periodically purchases whole one- to four-family loans in bulk packages from nationwide and correspondent lenders. The Bank also originates consumer loans, commercial and multi-family real estate loans, and construction loans secured by residential, multi-family or commercial real estate. As a result of our one- to four-family lending activities, the Bank has a concentration of loans secured by real property located in Kansas and Missouri.

One- to four-family loans - Full documentation to support the applicant's credit and income, and sufficient funds to cover all applicable fees and reserves at closing, are required on all loans. Loans are underwritten according to the "ability to repay" and "qualified mortgage" standards, as issued by the Consumer Financial Protection Bureau, with total debt to income ratios not exceeding 43% of the borrower's verified income. Properties securing one- to four-family loans are appraised by either staff appraisers or fee appraisers, both of which are independent of the loan origination function and approved by our Board of Directors.

The underwriting standards for loans purchased from correspondent and nationwide lenders are generally similar to the Bank's internal underwriting standards. The underwriting of correspondent loans is performed by the Bank's underwriters. Before committing to a bulk loan purchase, the Bank's Chief Lending Officer or Secondary Marketing Manager reviews specific criteria such as loan amount, credit scores, loan-to-value ("LTV') ratios, geographic location, and debt ratios of each loan in the pool. If the specific criteria do not meet the Bank's underwriting standards and compensating factors are not sufficient, then a loan will be removed from the population. Before the bulk loan purchase is funded, an internal Bank underwriter or a third party reviews at least 25% of the loan files to confirm loan terms, credit scores, debt ratios, property appraisals, and other underwriting related documentation. The Bank last made a bulk loan purchase during the fourth quarter of fiscal year 2012. For the tables within this Note, correspondent purchased loans are included with originated loans, and bulk purchased loans are reported as purchased loans.

The Bank also originates construction-to-permanent loans secured by one- to four-family residential real estate. Construction loans are obtained by homeowners who will occupy the property when construction is complete. Construction loans to builders for speculative purposes are not permitted. The application process includes submission of complete plans, specifications, and costs of the project to be constructed. All construction loans are manually underwritten using the Bank's internal underwriting standards. Construction draw requests and the supporting documentation are reviewed and approved by management. The Bank also performs regular documented inspections of the construction project to ensure the funds are being used for the intended purpose and the project is being completed according to the plans and specifications provided.

Multi-family and commercial loans - The Bank's multi-family, commercial real estate and commercial construction loans are originated by the Bank or are in participation with a lead bank. These loans are granted based on the income producing potential of the property and the financial strength of the borrower and/or guarantor. At the time of origination, LTV ratios on multi-family, commercial real estate and commercial construction loans cannot exceed 80% of the appraised value of the property securing the loans. The net operating income, which is the income derived from the operation of the property less all operating expenses, must be in excess of the payments related to the outstanding debt at the time of origination. The Bank generally requires personal guarantees of the borrowers covering a portion of the debt in addition to the security property as collateral for these loans. Appraisals on properties securing these loans are performed by independent state certified fee appraisers.

Consumer loans - The Bank offers a variety of secured consumer loans, including home equity loans and lines of credit, home improvement loans, auto loans, and loans secured by savings deposits. The Bank also originates a very limited amount of unsecured loans. The Bank does not originate any consumer loans on an indirect basis, such as contracts purchased from retailers of goods or services which have extended credit to their customers. The majority of the consumer loan portfolio is comprised of home equity lines of credit for which the Bank also has the first mortgage or the home equity line of credit is in the first lien position.

The underwriting standards for consumer loans include a determination of the applicant's payment history on other debts and an assessment of the applicant's ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the security in relation to the proposed loan amount.

Credit Quality Indicators – Based on the Bank's lending emphasis and underwriting standards, management has segmented the loan portfolio into three segments: (1) one- to four-family loans; (2) consumer loans; and (3) multi-family and commercial loans. The one- to four-family and consumer segments are further grouped into classes for purposes of providing disaggregated information about the credit quality of the loan portfolio. The classes are: one- to four-family loans – originated, one- to four-family loans – purchased, consumer loans – home equity, and consumer loans – other.

The Bank's primary credit quality indicators for the one- to four-family loan and consumer – home equity loan portfolios are delinquency status, asset classifications, LTV ratios and borrower credit scores. The Bank's primary credit quality indicators for the multi-family and commercial loan and consumer – other loan portfolios are delinquency status and asset classifications.

The following tables present the recorded investment, by class, in loans 30 to 89 days delinquent, loans 90 or more days delinquent or in foreclosure, total delinquent loans, total current loans, and total recorded investment at the dates presented. The recorded investment in loans is defined as the unpaid principal balance of a loan (net of unadvanced funds related to loans in process), less charge-offs and inclusive of unearned loan fees and deferred costs. At March 31, 2014 and September 30, 2013, all loans 90 or more days delinquent were on nonaccrual status. At March 31, 2014 and September 30, 2013, the balance of loans on nonaccrual status was $28.7 million and $26.4 million, respectively.

| | March 31, 2014 | | | | |
|---|---|---|---|---|---|
| | 30 to 89 Days Delinquent | 90 or More Days Delinquent or in Foreclosure | Total Delinquent Loans | Current Loans | Total Recorded Investment |
| | (Dollars in thousands) | | | | |
| One- to four-family loans - originated | $ 14,111 | $ 9,921 | $ 24,032 | $ 5,238,614 | $ 5,262,646 |
| One- to four-family loans - purchased | 7,361 | 10,389 | 17,750 | 590,920 | 608,670 |
| Multi-family and commercial loans | -- | -- | -- | 56,236 | 56,236 |
| Consumer - home equity | 665 | 305 | 970 | 129,351 | 130,321 |
| Consumer - other | 52 | 8 | 60 | 4,931 | 4,991 |
| | $ 22,189 | $ 20,623 | $ 42,812 | $ 6,020,052 | $ 6,062,864 |

| | September 30, 2013 | | | | |
|---|---|---|---|---|---|
| | 30 to 89 Days Delinquent | 90 or More Days Delinquent or in Foreclosure | Total Delinquent Loans | Current Loans | Total Recorded Investment |
| | (Dollars in thousands) | | | | |
| One- to four-family loans - originated | $ 18,889 | $ 9,379 | $ 28,268 | $ 5,092,581 | $ 5,120,849 |
| One- to four-family loans - purchased | 7,842 | 9,695 | 17,537 | 631,050 | 648,587 |
| Multi-family and commercial loans | -- | -- | -- | 57,603 | 57,603 |
| Consumer - home equity | 848 | 485 | 1,333 | 133,695 | 135,028 |
| Consumer - other | 35 | 5 | 40 | 5,583 | 5,623 |
| | $ 27,614 | $ 19,564 | $ 47,178 | $ 5,920,512 | $ 5,967,690 |

In accordance with the Bank's asset classification policy, management regularly reviews the problem loans in the Bank's portfolio to determine whether any loans require classification. Loan classifications are defined as follows:

- Special mention - These loans are performing loans on which known information about the collateral pledged or the possible credit problems of the borrower(s) have caused management to have doubts as to the ability of the borrower(s) to comply with present loan repayment terms and which may result in the future inclusion of such loans in the non-performing loan categories.
- Substandard - A loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans include those characterized by the distinct possibility the Bank will sustain some loss if the deficiencies are not corrected.
- Doubtful - Loans classified as doubtful have all the weaknesses inherent as those classified as substandard, with the added characteristic that the weaknesses present make collection or liquidation in full on the basis of currently existing facts and conditions and values highly questionable and improbable.
- Loss - Loans classified as loss are considered uncollectible and of such little value that their continuance as assets on the books is not warranted.

The following table sets forth the recorded investment in loans classified as special mention or substandard at the dates presented, by class. Special mention and substandard loans are included in the formula analysis model if the loan is not individually evaluated for loss. Loans classified as doubtful or loss are individually evaluated for loss. At the dates presented, there were no loans classified as doubtful, and all loans classified as loss were fully charged-off.

| | March 31, 2014 | | September 30, 2013 | |
|---|---|---|---|---|
| | Special Mention | Substandard | Special Mention | Substandard |
| | (Dollars in thousands) | | | |
| One- to four-family - originated | $ 21,572 | $ 28,892 | $ 29,359 | $ 27,761 |
| One- to four-family - purchased | 1,982 | 14,441 | 1,871 | 14,195 |
| Multi-family and commercial | -- | -- | 1,976 | -- |
| Consumer - home equity | 126 | 882 | 87 | 819 |
| Consumer - other | -- | 16 | -- | 13 |
| | $ 23,680 | $ 44,231 | $ 33,293 | $ 42,788 |

The following table shows the weighted average credit score and weighted average LTV for originated and purchased one- to four-family loans and originated consumer home equity loans at the dates presented. Borrower credit scores are intended to provide an indication as to the likelihood that a borrower will repay their debts. Credit scores are updated at least semiannually, with the last update in March 2014, from a nationally recognized consumer rating agency. The LTV ratios provide an estimate of the extent to which the Bank may incur a loss on any given loan that may go into foreclosure. The LTV ratios were based on the current loan balance and either the lesser of the purchase price or original appraisal, or the most recent Bank appraisal, if available. In most cases, the most recent appraisal was obtained at the time of origination.

| | March 31, 2014 | | September 30, 2013 | |
|---|---|---|---|---|
| | Credit Score | LTV | Credit Score | LTV |
| One- to four-family - originated | 764 | 65 % | 762 | 65 % |
| One- to four-family - purchased | 748 | 67 | 747 | 67 |
| Consumer - home equity | 750 | 19 | 746 | 19 |