

TIMBERLAND BANCORP INC  
Form 10-Q  
August 09, 2013

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2013

OR

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 0-23333

TIMBERLAND BANCORP, INC.  
(Exact name of registrant as specified in its charter)

Washington  
(State or other jurisdiction of incorporation or  
organization)

91-1863696  
(IRS Employer Identification No.)

624 Simpson Avenue, Hoquiam, Washington  
(Address of principal executive offices)

98550  
(Zip Code)

(360) 533-4747  
(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  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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated Filer  Non-accelerated filer  Smaller reporting company

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

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

| CLASS                         | SHARES OUTSTANDING AT JULY 31,<br>2013 |
|-------------------------------|--|
| Common stock, \$.01 par value | 7,045,036                              |

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY  
CONDENSED CONSOLIDATED BALANCE SHEETS

June 30, 2013 and September 30, 2012

(Dollars in thousands, except per share amounts)

(Unaudited)

|   | June 30, 2013 | September 30,<br>2012 |
|---|---------------|-----------------------|
| Assets  |               |                       |
| Cash and cash equivalents:  |               |                       |
| Cash and due from financial institutions  | \$10,757      | \$11,008              |
| Interest-bearing deposits in banks  | 71,788        | 85,660                |
| Total cash and cash equivalents   | 82,545        | 96,668                |
| Certificates of deposit ("CDs") held for investment (at cost which approximates fair value)   | 26,749        | 23,490                |
| Mortgage-backed securities ("MBS") and other investments - held to maturity, at amortized cost (estimated fair value \$3,639 and \$3,632) | 2,892         | 3,339                 |
| MBS and other investments - available for sale  | 4,370         | 4,945                 |
| Federal Home Loan Bank of Seattle ("FHLB") stock  | 5,502         | 5,655                 |
| Loans receivable  | 553,981       | 548,878               |
| Loans held for sale   | 2,433         | 1,427                 |
| Less: Allowance for loan losses   | (11,126)      | (11,825)              |
| Net loans receivable  | 545,288       | 538,480               |
| Premises and equipment, net   | 18,043        | 17,886                |
| Other real estate owned ("OREO") and other repossessed assets, net  | 15,314        | 13,302                |
| Accrued interest receivable   | 2,015         | 2,183                 |
| Bank owned life insurance ("BOLI")  | 16,956        | 16,524                |
| Goodwill  | 5,650         | 5,650                 |
| Core deposit intangible ("CDI")   | 151           | 249                   |
| Mortgage servicing rights ("MSRs"), net   | 2,333         | 2,011                 |
| Prepaid Federal Deposit Insurance Corporation ("FDIC") insurance assessment   | —             | 1,186                 |
| Other assets  | 4,967         | 5,386                 |
| Total assets  | \$732,775     | \$736,954             |
| Liabilities and shareholders' equity  |               |                       |
| Liabilities:  |               |                       |
| Deposits:   |               |                       |
| Non-interest-bearing demand   | \$83,043      | \$75,296              |
| Interest-bearing  | 513,021       | 522,630               |
| Total deposits  | 596,064       | 597,926               |
| FHLB advances   | 45,000        | 45,000                |
| Repurchase agreements   | —             | 855                   |
| Other liabilities and accrued expenses  | 2,477         | 2,854                 |
| Total liabilities   | 643,541       | 646,635               |
| See notes to unaudited condensed consolidated financial statements  |               |                       |



TIMBERLAND BANCORP, INC. AND SUBSIDIARY  
 CONDENSED CONSOLIDATED BALANCE SHEETS (continued)

June 30, 2013 and September 30, 2012

(Dollars in thousands, except per share amounts)

(Unaudited)

|  | June 30, 2013 | September 30,<br>2012 |
|--|---------------|-----------------------|
| Shareholders' equity   |               |                       |
| Preferred stock, \$.01 par value; 1,000,000 shares authorized;   |               |                       |
| 12,065 shares, Series A, issued and outstanding - June 30, 2013  | \$ 11,889     | \$ 16,229             |
| 16,641 shares, Series A, issued and outstanding - September 30, 2012;<br>redeemable at \$1,000 per share |               |                       |
| Common stock, \$.01 par value; 50,000,000 shares authorized;   |               |                       |
| 7,045,036 shares issued and outstanding  | 10,551        | 10,484                |
| Unearned shares issued to Employee Stock Ownership Plan ("ESOP")   | (1,521        | ) (1,719              |
| Retained earnings  | 68,665        | 65,788                |
| Accumulated other comprehensive loss   | (350          | ) (463                |
| Total shareholders' equity   | 89,234        | 90,319                |
| Total liabilities and shareholders' equity   | \$732,775     | \$736,954             |
| See notes to unaudited condensed consolidated financial statements                                       |               |                       |

TIMBERLAND BANCORP, INC. AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

For the three and nine months ended June 30, 2013 and 2012

(Dollars in thousands, except per share amounts)

(Unaudited)

|  | Three Months Ended<br>June 30, |         | Nine Months Ended<br>June 30, |          |
|--|--------------------------------|---------|-------------------------------|----------|
|  | 2013                           | 2012    | 2013                          | 2012     |
| Interest and dividend income   |                                |         |                               |          |
| Loans receivable   | \$7,422                        | \$7,842 | \$22,231                      | \$23,254 |
| MBS and other investments  | 69                             | 89      | 216                           | 323      |
| Dividends from mutual funds  | 5                              | 6       | 22                            | 26       |
| Interest-bearing deposits in banks   | 79                             | 82      | 247                           | 252      |
| Total interest and dividend income   | 7,575                          | 8,019   | 22,716                        | 23,855   |
| Interest expense   |                                |         |                               |          |
| Deposits   | 609                            | 925     | 1,987                         | 3,128    |
| FHLB advances  | 467                            | 466     | 1,399                         | 1,525    |
| Total interest expense   | 1,076                          | 1,391   | 3,386                         | 4,653    |
| Net interest income  | 6,499                          | 6,628   | 19,330                        | 19,202   |
| Provision for loan losses  | 1,385                          | 900     | 2,760                         | 2,600    |
| Net interest income after provision for loan losses  | 5,114                          | 5,728   | 16,570                        | 16,602   |
| Non-interest income  |                                |         |                               |          |
| Other than temporary impairment (“OTTI”) on MBS and other investments                                | (1                             | ) (60   | ) (9                          | ) (182   |
| Adjustment for portion recorded as (transferred from) other comprehensive income (loss) before taxes | (2                             | ) 23    | (30                           | ) (8     |
| Net OTTI on MBS and other investments  | (3                             | ) (37   | ) (39                         | ) (190   |
| Gain on sales of MBS and other investments   | —                              | 2       | —                             | 22       |
| Service charges on deposits  | 882                            | 955     | 2,657                         | 2,815    |
| ATM and debit card interchange transaction fees  | 526                            | 564     | 1,562                         | 1,621    |
| BOLI net earnings  | 144                            | 146     | 431                           | 457      |
| Gain on sales of loans, net  | 579                            | 567     | 2,054                         | 1,722    |
| Escrow fees  | 55                             | 30      | 135                           | 79       |
| Valuation recovery (allowance) on MSRs   | —                              | (82     | ) 475                         | 144      |
| Fee income from non-deposit investment sales   | 19                             | 20      | 92                            | 58       |
| Other  | 170                            | 176     | 498                           | 550      |
| Total non-interest income, net   | 2,372                          | 2,341   | 7,865                         | 7,278    |

See notes to unaudited condensed consolidated financial statements



TIMBERLAND BANCORP, INC. AND SUBSIDIARY  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME (continued)

For the three and nine months ended June 30, 2013 and 2012

(Dollars in thousands, except per share amounts)

(Unaudited)

|  | Three Months Ended |           | Nine Months Ended |           |   |
|--|--------------------|-----------|-------------------|-----------|---|
|  | June 30,           |           | June 30,          |           |   |
|  | 2013               | 2012      | 2013              | 2012      |   |
| Non-interest expense                         |                    |           |                   |           |   |
| Salaries and employee benefits               | \$3,176            | \$3,006   | \$9,376           | \$8,989   |   |
| Premises and equipment                       | 739                | 647       | 2,154             | 1,979     |   |
| Advertising                                  | 184                | 173       | 533               | 553       |   |
| OREO and other repossessed assets, net       | 313                | 363       | 1,107             | 1,299     |   |
| ATM  | 219                | 206       | 636               | 598       |   |
| Postage and courier                          | 107                | 124       | 342               | 381       |   |
| Amortization of CDI                          | 33                 | 37        | 98                | 111       |   |
| State and local taxes                        | 170                | 159       | 466               | 460       |   |
| Professional fees                            | 202                | 217       | 636               | 628       |   |
| FDIC insurance                               | 157                | 237       | 526               | 703       |   |
| Other insurance                              | 39                 | 51        | 133               | 161       |   |
| Loan administration and foreclosure          | 91                 | 82        | 278               | 615       |   |
| Data processing and telecommunications       | 319                | 303       | 911               | 918       |   |
| Deposit operations                           | 157                | 177       | 450               | 593       |   |
| Other  | 331                | 315       | 1,152             | 903       |   |
| Total non-interest expense                   | 6,237              | 6,097     | 18,798            | 18,891    |   |
| Income before federal and state income taxes | 1,249              | 1,972     | 5,637             | 4,989     |   |
| Provision for federal and state income taxes | 373                | 624       | 1,774             | 1,551     |   |
| Net income                                   | 876                | 1,348     | 3,863             | 3,438     |   |
| Preferred stock dividends                    | (151               | ) (208    | ) (559            | ) (624    | ) |
| Preferred stock discount accretion           | (47                | ) (61     | ) (236            | ) (179    | ) |
| Repurchase of preferred stock at a discount  | —                  | —         | 255               | —         |   |
| Net income to common shareholders            | \$678              | \$1,079   | \$3,323           | \$2,635   |   |
| Net income per common share                  |                    |           |                   |           |   |
| Basic  | \$0.10             | \$0.16    | \$0.49            | \$0.39    |   |
| Diluted                                      | \$0.10             | \$0.16    | \$0.48            | \$0.39    |   |
| Weighted average common shares outstanding   |                    |           |                   |           |   |
| Basic  | 6,818,752          | 6,780,516 | 6,816,772         | 6,780,516 |   |
| Diluted                                      | 6,902,497          | 6,780,516 | 6,870,751         | 6,780,516 |   |
| Dividends paid per common share              | \$0.03             | \$—       | \$0.06            | \$—       |   |

See notes to unaudited condensed consolidated financial statements



TIMBERLAND BANCORP, INC. AND SUBSIDIARY  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the three and nine months ended June 30, 2013 and 2012

(In thousands)

(Unaudited)

|  | Three Months Ended |         | Nine Months Ended |         |
|--|--------------------|---------|-------------------|---------|
|  | June 30,           |         | June 30,          |         |
|  | 2013               | 2012    | 2013              | 2012    |
| Comprehensive income:  |                    |         |                   |         |
| Net income   | \$876              | \$1,348 | \$3,863           | \$3,438 |
| Unrealized holding gain (loss) on securities available for sale, net of tax                              | 82                 | 39      | 55                | (17 )   |
| Change in OTTI on securities held to maturity, net of tax:   |                    |         |                   |         |
| Additions to OTTI  | —                  | —       | —                 | (27 )   |
| Additional amount recognized (recovered) related to credit loss for which OTTI was previously recognized | (1 )               | 5       | 17                | 1       |
| Amount reclassified to credit loss for previously recorded market loss                                   | —                  | 10      | 3                 | 21      |
| Accretion of OTTI securities held to maturity, net of tax  | 15                 | 11      | 38                | 37      |
| Total comprehensive income   | \$972              | \$1,413 | \$3,976           | \$3,453 |

See notes to unaudited condensed consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For the nine months ended June 30, 2013 and the year ended September 30, 2012

(Dollars in thousands, except per share amounts)

(Unaudited)

|   | Number of Shares   |                 | Amount             |                 | Unearned<br>Shares<br>Issued to<br>ESOP | Retained<br>Earnings | Accumulated<br>Other<br>Compre-<br>hensive<br>Loss | Total    |
|---|--------------------|-----------------|--------------------|-----------------|---|----------------------|--|----------|
|   | Preferred<br>Stock | Common<br>Stock | Preferred<br>Stock | Common<br>Stock |   |                      |  |          |
| Balance,<br>September 30, 2011  | 16,641             | 7,045,036       | \$15,989           | \$10,457        | \$(1,983 )                              | \$62,270             | \$ (528 )  | \$86,205 |
| Net income  | —                  | —               | —                  | —               | —                                       | 4,590                | —  | 4,590    |
| Accretion of preferred<br>stock<br>discount                                   | —                  | —               | 240                | —               | —                                       | (240 )               | —  | —        |
| 5% preferred stock<br>dividend  | —                  | —               | —                  | —               | —                                       | (832 )               | —  | (832 )   |
| Earned ESOP shares<br>MRDP (1)  | —                  | —               | —                  | (65 )           | 264                                     | —                    | —  | 199      |
| compensation<br>expense   | —                  | —               | —                  | 77              | —                                       | —                    | —  | 77       |
| Stock option<br>compensation<br>expense                                       | —                  | —               | —                  | 15              | —                                       | —                    | —  | 15       |
| Unrealized holding<br>gain on<br>securities available<br>for sale, net of tax | —                  | —               | —                  | —               | —                                       | —                    | 14   | 14       |
| Change in OTTI on<br>securities held to<br>maturity, net of tax               | —                  | —               | —                  | —               | —                                       | —                    | 5  | 5        |
| Accretion of OTTI on<br>securities held to<br>maturity, net of tax            | —                  | —               | —                  | —               | —                                       | —                    | 46   | 46       |
| Balance,<br>September 30, 2012  | 16,641             | 7,045,036       | 16,229             | 10,484          | (1,719 )                                | 65,788               | (463 )   | 90,319   |
| Net income  | —                  | —               | —                  | —               | —                                       | 3,863                | —  | 3,863    |
| Accretion of preferred<br>stock discount                                      | —                  | —               | 236                | —               | —                                       | (236 )               | —  | —        |
| Redemption of<br>preferred stock  | (4,576 )           | —               | (4,576 )           | —               | —                                       | 255                  | —  | (4,321 ) |
| 5% preferred stock<br>dividends   | —                  | —               | —                  | —               | —                                       | (583 )               | —  | (583 )   |
| Common stock<br>dividends (\$0.06 per<br>common share)                        | —                  | —               | —                  | —               | —                                       | (422 )               | —  | (422 )   |

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|  |        |           |          |          |          |     |          |        |     |          |
|--|--------|-----------|----------|----------|----------|-----|----------|--------|-----|----------|
| Earned ESOP shares   | —      | —         | —        | (2       | )        | 198 | —        | —      | 196 |          |
| MRDP compensation expense  | —      | —         | —        | 32       | —        | —   | —        | —      | 32  |          |
| Stock option compensation expense                                    | —      | —         | —        | 37       | —        | —   | —        | —      | 37  |          |
| Unrealized holding gain on securities available for sale, net of tax | —      | —         | —        | —        | —        | —   | —        | 55     | 55  |          |
| Change in OTTI on securities held to maturity, net of tax            | —      | —         | —        | —        | —        | —   | —        | 20     | 20  |          |
| Accretion of OTTI on securities held to maturity, net of tax         | —      | —         | —        | —        | —        | —   | —        | 38     | 38  |          |
| Balance, June 30, 2013   | 12,065 | 7,045,036 | \$11,889 | \$10,551 | \$(1,521 | )   | \$68,665 | \$(350 | )   | \$89,234 |

(1) 1998 Management Recognition and Development Plan (“MRDP”).

See notes to unaudited condensed consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the nine months ended June 30, 2013 and 2012

(Dollars in thousands)

(Unaudited)

|  | Nine Months Ended |           |
|--|-------------------|-----------|
|  | June 30,          |           |
|  | 2013              | 2012      |
| Cash flows from operating activities   |                   |           |
| Net income   | \$3,863           | \$3,438   |
| Adjustments to reconcile net income to net cash provided by operating activities:        |                   |           |
| Provision for loan losses  | 2,760             | 2,600     |
| Depreciation   | 810               | 684       |
| Deferred federal income taxes  | 522               | 366       |
| Amortization of CDI  | 98                | 111       |
| Earned ESOP shares   | 198               | 198       |
| MRDP compensation expense  | 32                | 85        |
| Stock option compensation expense  | 37                | 11        |
| (Gain) loss on sales of OREO and other repossessed assets, net                           | (261              | ) 290     |
| Provision for OREO losses  | 759               | 609       |
| Gain on sale of premises and equipment   | (7                | ) —       |
| BOLI net earnings  | (431              | ) (457    |
| Gain on sales of loans, net  | (2,054            | ) (1,722  |
| Decrease in deferred loan origination fees   | (272              | ) (181    |
| Net OTTI on MBS and other investments  | 39                | 190       |
| Gain on sale of MBS and other investments  | —                 | (22       |
| Valuation recovery on MSRs   | (475              | ) (144    |
| Loans originated for sale  | (73,559           | ) (67,112 |
| Proceeds from sales of loans   | 74,607            | 68,814    |
| Decrease in other assets, net  | 1,327             | 622       |
| (Decrease) increase in other liabilities and accrued expenses, net                       | (377              | ) 433     |
| Net cash provided by operating activities  | 7,616             | 8,813     |
| Cash flows from investing activities   |                   |           |
| Net increase in CDs held for investment  | (3,259            | ) (4,122  |
| Proceeds from maturities and prepayments of MBS and other investments available for sale | 666               | 829       |
| Proceeds from maturities and prepayments of MBS and other investments held to maturity   | 506               | 574       |
| Proceeds from the sale of MBS and other investments                                      | —                 | 743       |
| Redemption of FHLB stock   | 153               | —         |
| Increase in loans receivable, net  | (13,461           | ) (12,676 |
| Additions to premises and equipment  | (967              | ) (1,017  |
| Proceeds from sale of premises and equipment   | 7                 | —         |
| Proceeds from sale of OREO and other repossessed assets                                  | 2,661             | 1,047     |
| Net cash used in investing activities  | (13,694           | ) (14,622 |

See notes to unaudited condensed consolidated financial statements

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TIMBERLAND BANCORP, INC. AND SUBSIDIARY  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)  
 For the nine months ended June 30, 2013 and 2012  
 (Dollars in thousands)  
 (Unaudited)

|  | Nine Months Ended<br>June 30, |            |
|--|-------------------------------|------------|
|  | 2013                          | 2012       |
| Cash flows from financing activities                     |                               |            |
| Decrease in deposits, net                                | \$(1,862                      | ) \$(2,312 |
| Repayment of FHLB Advances                               | —                             | (10,000    |
| Increase (decrease) in repurchase agreements, net        | (855                          | ) 97       |
| ESOP tax effect  | (2                            | ) (53      |
| Repurchase of preferred stock                            | (4,321                        | ) —        |
| Dividends paid   | (1,005                        | ) (1,000   |
| Net cash used in financing activities                    | (8,045                        | ) (13,268  |
| Net decrease in cash and cash equivalents                | (14,123                       | ) (19,077  |
| Cash and cash equivalents                                |                               |            |
| Beginning of period                                      | 96,668                        | 112,065    |
| End of period  | \$82,545                      | \$92,988   |
| Supplemental disclosure of cash flow information         |                               |            |
| Income taxes paid  | \$1,793                       | \$1,463    |
| Interest paid  | 3,454                         | 4,770      |
| Supplemental disclosure of non-cash investing activities |                               |            |
| Loans transferred to OREO and other repossessed assets   | \$5,919                       | \$4,906    |
| Loans originated to facilitate the sale of OREO          | 748                           | 3,744      |

See notes to unaudited condensed consolidated financial statements

Timberland Bancorp, Inc. and Subsidiary  
Notes to Unaudited Condensed Consolidated Financial Statements

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation: The accompanying unaudited condensed consolidated financial statements for Timberland Bancorp, Inc. (“Company”) were prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with instructions for Form 10-Q and, therefore, do not include all disclosures necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with GAAP. However, all adjustments which are, in the opinion of management, necessary for a fair presentation of the interim condensed consolidated financial statements have been included. All such adjustments are of a normal recurring nature. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended September 30, 2012 (“2012 Form 10-K”). The unaudited condensed consolidated results of operations for the nine months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the entire fiscal year ending September 30, 2013.

(b) Principles of Consolidation: The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Timberland Bank (“Bank”), and the Bank’s wholly-owned subsidiary, Timberland Service Corp. All significant inter-company transactions and balances have been eliminated in consolidation.

(c) Operating Segment: The Company has one reportable operating segment which is defined as community banking in western Washington under the operating name, “Timberland Bank.”

(d) The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(e) Certain prior period amounts have been reclassified to conform to the June 30, 2013 presentation with no change to net income or total shareholders’ equity previously reported.

(2) PREFERRED STOCK RECEIVED IN TROUBLED ASSET RELIEF PROGRAM (“TARP”) CAPITAL PURCHASE PROGRAM (“CPP”)

On December 23, 2008, the Company received \$16.64 million from the U.S. Treasury Department (“Treasury”) as a part of the Treasury’s CPP, which was established as part of the TARP. The Company sold 16,641 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (“Series A Preferred Stock”), with a liquidation value of \$1,000 per share and a related warrant to purchase 370,899 shares of the Company’s common stock at an exercise price of \$6.73 per share (subject to anti-dilution adjustments) at any time through December 23, 2018. The Series A Preferred Stock pays a 5.0% dividend for the first five years, after which the rate increases to 9.0% if the preferred shares are not redeemed by the Company.

The Series A Preferred Stock was initially recorded at the amount of proceeds received. The discount from the liquidation value is accreted to the expected call date and charged to retained earnings. This accretion is recorded using the level-yield method. Preferred dividends accrued and any accretion is deducted from net income for computing net income to common shareholders and net income per share computations.

On November 13, 2012, the Company’s outstanding 16,641 shares of Series A Preferred Stock were sold by the Treasury as part of its efforts to manage and recover its investments under the TARP. While the sale of these Series A

Preferred shares to new owners did not result in any proceeds to the Company and did not change the Company's capital position or accounting for these securities, it did eliminate restrictions put in place by the Treasury on TARP recipients.

On June 12, 2013, the Treasury sold, to private investors, the warrant to purchase up to 370,899 shares of the Company's common stock. The sale of the warrant to new owners did not result in any proceeds to the Company and did not change the Company's capital position or accounting for the warrant.

During the nine months ended June 30, 2013, the Company purchased and retired 4,576 shares of its Series A Preferred Stock for \$4.32 million; a discount from par value of \$255,000. The discount from par value on the repurchased shares was recorded as an increase to net income to common shareholders. This increase to net income to common shareholders was partially offset by \$62,000 of accelerated discount accretion on the shares purchased.

## (3) MBS AND OTHER INVESTMENTS

MBS and other investments have been classified according to management's intent and are as follows as of June 30, 2013 and September 30, 2012 (dollars in thousands):

|                           | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|---------------------------|-------------------|------------------------------|-------------------------------|-------------------------|
| June 30, 2013             |                   |                              |                               |                         |
| Held to Maturity          |                   |                              |                               |                         |
| MBS:                      |                   |                              |                               |                         |
| U.S. government agencies  | \$1,272           | \$36                         | \$(2                          | ) \$1,306               |
| Private label residential | 1,607             | 725                          | (14                           | ) 2,318                 |
| U.S. agency securities    | 13                | 2                            | —                             | 15                      |
| Total                     | \$2,892           | \$763                        | \$(16                         | ) \$3,639               |
| Available for Sale        |                   |                              |                               |                         |
| MBS:                      |                   |                              |                               |                         |
| U.S. government agencies  | \$2,314           | \$109                        | \$—                           | \$2,423                 |
| Private label residential | 856               | 136                          | (6                            | ) 986                   |
| Mutual funds              | 1,000             | —                            | (39                           | ) 961                   |
| Total                     | \$4,170           | \$245                        | \$(45                         | ) \$4,370               |
| September 30, 2012        |                   |                              |                               |                         |
| Held to Maturity          |                   |                              |                               |                         |
| MBS:                      |                   |                              |                               |                         |
| U.S. government agencies  | \$1,493           | \$44                         | \$(3                          | ) \$1,534               |
| Private label residential | 1,819             | 309                          | (60                           | ) 2,068                 |
| U.S. agency securities    | 27                | 3                            | —                             | 30                      |
| Total                     | \$3,339           | \$356                        | \$(63                         | ) \$3,632               |
| Available for Sale        |                   |                              |                               |                         |
| MBS:                      |                   |                              |                               |                         |
| U.S. government agencies  | \$2,828           | \$147                        | \$—                           | \$2,975                 |
| Private label residential | 1,001             | 65                           | (109                          | ) 957                   |
| Mutual funds              | 1,000             | 13                           | —                             | 1,013                   |
| Total                     | \$4,829           | \$225                        | \$(109                        | ) \$4,945               |

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The following table summarizes the estimated fair value and gross unrealized losses for all securities and the length of time these unrealized losses existed as of June 30, 2013 (dollars in thousands):

|                           | Less Than 12 Months  |                         |     | 12 Months or Longer  |                         |     | Total                |                         |
|---------------------------|----------------------|-------------------------|-----|----------------------|-------------------------|-----|----------------------|-------------------------|
|                           | Estimated Fair Value | Gross Unrealized Losses | Qty | Estimated Fair Value | Gross Unrealized Losses | Qty | Estimated Fair Value | Gross Unrealized Losses |
| <b>Held to Maturity</b>   |                      |                         |     |                      |                         |     |                      |                         |
| <b>MBS:</b>               |                      |                         |     |                      |                         |     |                      |                         |
| U.S. government agencies  | \$1                  | \$—                     | 4   | \$91                 | \$(2)                   | 4   | \$92                 | \$(2)                   |
| Private label residential | 79                   | (5)                     | 3   | 250                  | (9)                     | 15  | 329                  | (14)                    |
| Total                     | \$80                 | \$(5)                   | 7   | \$341                | \$(11)                  | 19  | \$421                | \$(16)                  |
| <b>Available for Sale</b> |                      |                         |     |                      |                         |     |                      |                         |
| <b>MBS:</b>               |                      |                         |     |                      |                         |     |                      |                         |
| U.S. government agencies  | \$49                 | \$—                     | 1   | \$—                  | \$—                     | —   | \$49                 | \$—                     |
| Private label residential | —                    | —                       | —   | 125                  | (6)                     | 2   | 125                  | (6)                     |
| Mutual Funds              | 961                  | (39)                    | 1   | —                    | —                       | —   | 961                  | (39)                    |
| Total                     | \$1,010              | \$(39)                  | 2   | \$125                | \$(6)                   | 2   | \$1,135              | \$(45)                  |

The following table summarizes the estimated fair value and gross unrealized losses for all securities and the length of time the unrealized losses existed as of September 30, 2012 (dollars in thousands):

|                           | Less Than 12 Months  |                         |     | 12 Months or Longer  |                         |     | Total                |                         |
|---------------------------|----------------------|-------------------------|-----|----------------------|-------------------------|-----|----------------------|-------------------------|
|                           | Estimated Fair Value | Gross Unrealized Losses | Qty | Estimated Fair Value | Gross Unrealized Losses | Qty | Estimated Fair Value | Gross Unrealized Losses |
| <b>Held to Maturity</b>   |                      |                         |     |                      |                         |     |                      |                         |
| <b>MBS:</b>               |                      |                         |     |                      |                         |     |                      |                         |
| U.S. government agencies  | \$7                  | \$—                     | 1   | \$100                | \$(3)                   | 4   | \$107                | \$(3)                   |
| Private label residential | 17                   | (1)                     | 1   | 423                  | (59)                    | 28  | 440                  | (60)                    |
| Total                     | \$24                 | \$(1)                   | 2   | \$523                | \$(62)                  | 32  | \$547                | \$(63)                  |
| <b>Available for Sale</b> |                      |                         |     |                      |                         |     |                      |                         |
| <b>MBS:</b>               |                      |                         |     |                      |                         |     |                      |                         |
| Private label residential | \$—                  | \$—                     | —   | \$651                | \$(109)                 | 4   | \$651                | \$(109)                 |
| Total                     | \$—                  | \$—                     | —   | \$651                | \$(109)                 | 4   | \$651                | \$(109)                 |

During the three months ended June 30, 2013 and 2012, the Company recorded net OTTI charges through earnings on residential MBS of \$3,000 and \$37,000, respectively. During the nine months ended June 30, 2013 and 2012, the Company recorded net OTTI charges through earnings on residential MBS of \$39,000 and \$190,000, respectively.

The Company provides for the bifurcation of OTTI into (i) amounts related to credit losses which are recognized through earnings, and (ii) amounts related to all other factors which are recognized as a component of other comprehensive income (loss).

To determine the component of the gross OTTI related to credit losses, the Company compared the amortized cost basis of each OTTI security to the present value of its revised expected cash flows, discounted using its pre-impairment yield. The revised expected cash flow estimates for individual securities are based primarily on an analysis of default rates and prepayment speeds included in third-party analytic reports. Significant judgment by management is required in this analysis that includes, but is not limited to, assumptions regarding the collectability of principal and interest, net of related expenses, on the underlying loans. The following table presents a summary of the significant inputs utilized to measure management's estimate of the credit loss component on OTTI securities as of June 30, 2013 and September 30, 2012:

|                          | Range   |         | Weighted |   |
|--------------------------|---------|---------|----------|---|
|                          | Minimum | Maximum | Average  |   |
| At June 30, 2013         |         |         |          |   |
| Constant prepayment rate | 6.00    | % 15.00 | % 10.00  | % |
| Collateral default rate  | 0.19    | % 23.90 | % 7.26   | % |
| Loss severity rate       | 2.48    | % 73.69 | % 47.63  | % |
| At September 30, 2012    |         |         |          |   |
| Constant prepayment rate | 6.00    | % 15.00 | % 8.77   | % |
| Collateral default rate  | 0.06    | % 28.40 | % 8.74   | % |
| Loss severity rate       | 0.52    | % 76.03 | % 48.28  | % |

The following tables present the OTTI for the three and nine months ended June 30, 2013 and 2012 (dollars in thousands):

|   | Three Months Ended<br>June 30, 2013 |                       | Three Months Ended<br>June 30, 2012 |                       |
|---|-------------------------------------|-----------------------|-------------------------------------|-----------------------|
|   | Held To<br>Maturity                 | Available<br>For Sale | Held To<br>Maturity                 | Available<br>For Sale |
| Total OTTI  | \$—                                 | \$ (1 )               | \$ (60 )                            | \$—                   |
| Adjustment for portion recorded as (transferred from)<br>other comprehensive income (loss) before taxes (1) | (2 )                                | —                     | 23                                  | —                     |
| Net OTTI recognized in earnings (2)   | \$ (2 )                             | \$ (1 )               | \$ (37 )                            | \$—                   |
|   | Nine Months Ended<br>June 30, 2013  |                       | Nine Months Ended<br>June 30, 2012  |                       |
|   | Held To<br>Maturity                 | Available<br>For Sale | Held To<br>Maturity                 | Available<br>For Sale |
| Total OTTI  | \$ (7 )                             | \$ (2 )               | \$ (139 )                           | \$ (43 )              |
| Adjustment for portion recorded as (transferred from)<br>other comprehensive income (loss) before taxes (1) | (30 )                               | —                     | (8 )                                | —                     |
| Net OTTI recognized in earnings (2)   | \$ (37 )                            | \$ (2 )               | \$ (147 )                           | \$ (43 )              |

(1) Represents OTTI related to all other factors.

(2) Represents OTTI related to credit losses.



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The following table presents a roll-forward of the credit loss component of held to maturity and available for sale debt securities that have been written down for OTTI with the credit loss component recognized in earnings and the remaining impairment loss related to all other factors recognized in other comprehensive income for the nine months ended June 30, 2013 and 2012 (in thousands):

|  | Nine Months Ended June 30, |         |
|--|----------------------------|---------|
|  | 2013                       | 2012    |
| Beginning balance of credit loss   | \$2,703                    | \$3,361 |
| Additions:   |                            |         |
| Credit losses for which OTTI was not previously recognized   | 5                          | 81      |
| Additional increases to the amount related to credit loss for which OTTI was previously recognized | 39                         | 109     |
| Subtractions:  |                            |         |
| Realized losses previously recorded as credit losses   | (571                       | ) (661  |
| Ending balance of credit loss  | \$2,176                    | \$2,890 |

There was no realized gain on sale of securities for either the three or nine months ended June 30, 2013. There was a gross realized gain on sale of securities for the three and nine months ended June 30, 2012 of \$2,000 and \$22,000, respectively. During the three months ended June 30, 2013, the Company recorded a \$188,000 realized loss (as a result of the securities being deemed worthless) on 12 held to maturity residential MBS and six available for sale residential MBS, of which the entire amount had been recognized previously as a credit loss. During the nine months ended June 30, 2013, the Company recorded a \$571,000 realized loss (as a result of the securities being deemed worthless) on 17 held to maturity residential MBS and six available for sale residential MBS, of which the entire amount had been recognized previously as a credit loss. During the three months ended June 30, 2012, the Company recorded a \$242,000 realized loss (as a result of the securities being deemed worthless) on 19 held to maturity residential MBS and one available for sale residential MBS, of which the entire amount had been recognized previously as a credit loss. During the nine months ended June 30, 2012, the Company recorded a \$661,000 realized loss (as a result of the securities being deemed worthless) on 24 held to maturity residential MBS and one available for sale residential MBS, of which the entire amount had been recognized previously as a credit loss.

The amortized cost of residential mortgage-backed and agency securities pledged as collateral for public fund deposits, federal treasury tax and loan deposits, FHLB collateral, retail repurchase agreements and other non-profit organization deposits totaled \$4.87 million and \$5.70 million at June 30, 2013 and September 30, 2012, respectively.

The contractual maturities of debt securities at June 30, 2013 were as follows (dollars in thousands). Expected maturities may differ from scheduled maturities as a result of the prepayment of principal or call provisions.

|                                  | Held to Maturity |                      | Available for Sale |                      |
|----------------------------------|------------------|----------------------|--------------------|----------------------|
|                                  | Amortized Cost   | Estimated Fair Value | Amortized Cost     | Estimated Fair Value |
| Due within one year              | \$—              | \$—                  | \$—                | \$—                  |
| Due after one year to five years | 23               | 25                   | 30                 | 31                   |
| Due after five to ten years      | 27               | 26                   | 18                 | 18                   |
| Due after ten years              | 2,842            | 3,588                | 3,122              | 3,360                |
| Total                            | \$2,892          | \$3,639              | \$3,170            | \$3,409              |



#### (4) GOODWILL

The Company performed its fiscal year 2013 goodwill impairment test during the quarter ended June 30, 2013 with the assistance of a third-party firm specializing in goodwill impairment valuations for financial institutions. The third-party analysis was conducted as of May 31, 2013 and concluded that the fair value of goodwill was \$45.0 million, which exceeded the recorded value of \$5.7 million by 689%.

The goodwill impairment test involved a two-step process. Step one of the goodwill impairment test estimated the fair value of the reporting unit utilizing the allocation of corporate value approach, the income approach and the market approach in order to derive an enterprise value for the Company.

The allocation of corporate value approach applies the aggregate market value of the Company and divides it among the reporting units. The Company has a single reporting unit. The aggregate market value was based on the Company's common stock market price on May 31, 2013, adjusted for a control premium and the value of preferred stock (at its liquidation value). A key assumption in this approach is the control premium applied to the aggregate market value. A control premium is utilized as the value of a company from the perspective of a controlling interest and is generally higher than the widely quoted market price per share. The Company used an expected control premium of 30%, which was based on comparable transaction history.

The income approach uses a reporting unit's projection of estimated operating results and cash flows that are discounted using a rate that reflects current market conditions. The projection uses management's estimates of economic and market conditions over the projected period including growth rates in loans and deposits, estimates of future expected changes in net interest margins and cash expenditures. Key assumptions used by the Company in its discounted cash flow model (income approach) included an annual revenue growth rate that approximated 3.0% and a return on assets that ranged from 0.54% to 1.01% (average of 0.73%). In addition to the above projections of estimated operating results, key assumptions used to determine the fair value estimate under the income approach were the discount rate of 15.0% utilized for the Company's cash flow estimate and a terminal value of 1.25 times the ending book value of the reporting unit. The Company used a build-up approach in developing the discount rate that included an assessment of the risk free interest rate, the rate of return expected from publicly traded stocks based on an analysis of historical data, the industry the Company operates in and the size of the Company.

The market approach estimates the fair value by applying cash flow multiples to the reporting unit's operating performance. The multiples were derived from comparable publicly traded companies with operating and investment characteristics similar to those of the reporting unit. In applying the market approach method, the Company selected eight publicly traded institutions based on a variety of financial metrics (tangible equity, return on assets, return on equity, net interest margin, nonperforming assets, net charge-offs, and reserves for loan losses) and other relevant qualitative factors (geographical location, lines of business, risk profile, availability of financial information, etc.).

The Company calculated a fair value of its reporting unit of \$89 million using the corporate value approach, \$82 million using the income approach and \$96 million using the market approach. The concluded fair value based on the three methods under the step one test was \$87 million, with the most weighting given to the income approach. The results of the Company's step one test indicated that the reporting unit's fair value was less than its recorded value and therefore the Company performed a step two analysis.

The Company then calculated the implied fair value of its reporting unit under step two of the goodwill impairment test. Under this approach, the Company calculated the fair value for the assets and liabilities of the reporting unit. The calculated implied fair value of the Company's goodwill exceeded the recorded value by \$39.3 million.

Under the step two process significant adjustments were made to determine the estimated fair value of the Company's loans receivable compared to its recorded value. The Company utilized a discounted cash flow approach and a

comparable transaction approach to determine the fair value of its loans receivable.

The discounted cash flow approach was utilized to value performing loans with credit quality grades of pass. A key assumption in the discounted cash flow approach was determining an appropriate discount rate. In determining the discount rate for pass loans, the Company started with its contractual cash flows and its current lending rate for comparable loans and adjusted these for credit factors, estimated prepayments and liquidity premiums. Based on an analysis of these factors, performing loans with credit quality grades of pass were discounted by 5%.

The comparable transaction approach using comparable loan sales was utilized for performing loans with credit quality grades of watch, special mention or substandard and for non-performing loans. In the comparable transaction approach a weighted average discount rate was used that approximated the discount for similar loan sales by the FDIC. A key assumption used by

the Company in the comparable transaction approach was determining the appropriate discount rate to apply to each loan category. Performing loans with credit quality grades of watch, special mention or substandard were discounted by 25% and nonperforming loans were discounted by 50%. These weighted average discount rates approximated the discount for similar loan sales by the FDIC. Increases in the pricing for future reported loan sale transactions could have a significant impact on the implied fair value of goodwill under the step two process.

A significant amount of judgment is involved in determining if an indicator of goodwill impairment has occurred. Such indicators may include, among others; a significant decline in the expected future cash flows; a sustained, significant decline in the Company's stock price and market capitalization; a significant adverse change in legal factors or in the business climate; adverse assessment or action by a regulator; and unanticipated competition. Key assumptions used in the annual goodwill impairment test are highly judgmental and include: selection of comparable companies, amount of control premium, projected cash flows, discount rate applied to projected cash flows and method of estimating fair value of loans. Any change in these indicators or key assumptions could have a significant negative impact on the Company's financial condition, impact the goodwill impairment analysis or cause the Company to perform a goodwill impairment analysis more frequently than once per year.

As of June 30, 2013, management believes that there have been no events or changes in the circumstances that would indicate a potential impairment. No assurances can be given, however, that the Company will not record an impairment loss on goodwill in the future.

## (5) LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable and loans held for sale consisted of the following at June 30, 2013 and September 30, 2012 (dollars in thousands):

|  | June 30,<br>2013 |         | September 30,<br>2012 |         |   |
|--|------------------|---------|-----------------------|---------|---|
|  | Amount           | Percent | Amount                | Percent |   |
| Mortgage loans:                                      |                  |         |                       |         |   |
| One- to four-family (1)                              | \$ 104,784       | 18.3    | % \$ 106,979          | 18.8    | % |
| Multi-family   | 48,781           | 8.5     | 47,521                | 8.4     |   |
| Commercial   | 290,240          | 50.8    | 256,254               | 45.1    |   |
| Construction and land development                    | 38,916           | 6.8     | 56,406                | 9.9     |   |
| Land   | 31,673           | 5.5     | 39,655                | 7.0     |   |
| Total mortgage loans                                 | 514,394          | 89.9    | 506,815               | 89.2    |   |
| Consumer loans:                                      |                  |         |                       |         |   |
| Home equity and second mortgage                      | 31,936           | 5.6     | 32,814                | 5.8     |   |
| Other  | 6,013            | 1.1     | 6,183                 | 1.1     |   |
| Total consumer loans                                 | 37,949           | 6.7     | 38,997                | 6.9     |   |
| Commercial business loans                            | 19,557           | 3.4     | 22,588                | 3.9     |   |
| Total loans receivable                               | 571,900          | 100.0   | % 568,400             | 100.0   | % |
| Less:  |                  |         |                       |         |   |
| Undisbursed portion of construction loans in process | (13,816 )        |         | (16,325 )             |         |   |
| Deferred loan origination fees                       | (1,670 )         |         | (1,770 )              |         |   |
| Allowance for loan losses                            | (11,126 )        |         | (11,825 )             |         |   |
| Total loans receivable, net                          | \$ 545,288       |         | \$ 538,480            |         |   |

(1) Includes loans held for sale.

## Construction and Land Development Loan Portfolio Composition

The following table sets forth the composition of the Company's construction and land development loan portfolio at June 30, 2013 and September 30, 2012 (dollars in thousands):

|  | June 30,<br>2013 |         | September 30,<br>2012 |         |   |
|--|------------------|---------|-----------------------|---------|---|
|  | Amount           | Percent | Amount                | Percent |   |
| Custom and owner/builder                         | \$ 33,502        | 86.1    | % \$ 33,345           | 59.1    | % |
| Speculative one- to four-family                  | 1,020            | 2.6     | 1,880                 | 3.4     |   |
| Commercial real estate                           | 3,589            | 9.2     | 20,247                | 35.9    |   |
| Multi-family<br>(including condominiums)         | 289              | 0.8     | 345                   | 0.6     |   |
| Land development                                 | 516              | 1.3     | 589                   | 1.0     |   |
| Total construction and<br>land development loans | \$ 38,916        | 100.0   | % \$ 56,406           | 100.0   | % |



## Allowance for Loan Losses

The following tables set forth information for the three and nine months ended June 30, 2013 and June 30, 2012 regarding activity in the allowance for loan losses (dollars in thousands):

|  | Three Months Ended June 30, 2013 |                     |             | Recoveries | Ending Allowance |
|--|----------------------------------|---------------------|-------------|------------|------------------|
|  | Beginning Allowance              | Provision /(Credit) | Charge-offs |            |                  |
| Mortgage loans:                                |                                  |                     |             |            |                  |
| One-to four-family                             | \$1,846                          | \$1                 | \$3         | \$19       | \$1,863          |
| Multi-family                                   | 815                              | (1                  | ) —         | —          | 814              |
| Commercial                                     | 4,497                            | 179                 | 11          | 3          | 4,668            |
| Construction – custom and owner/builder        | 284                              | (29                 | ) 26        | —          | 229              |
| Construction – speculative one- to four-family | 141                              | (58                 | ) —         | —          | 83               |
| Construction – commercial                      | 85                               | 5                   | —           | —          | 90               |
| Construction – multi-family                    | —                                | —                   | —           | —          | —                |
| Construction – land development                | 12                               | (2                  | ) 10        | —          | —                |
| Land   | 2,197                            | 1,311               | 1,543       | 1          | 1,966            |
| Consumer loans:                                |                                  |                     |             |            |                  |
| Home equity and second mortgage                | 781                              | (2                  | ) —         | 5          | 784              |
| Other  | 239                              | 2                   | 8           | —          | 233              |
| Commercial business loans                      | 416                              | (21                 | ) —         | 1          | 396              |
| Total  | \$11,313                         | \$1,385             | \$1,601     | \$29       | \$11,126         |

|  | Nine Months Ended June 30, 2013 |                     |             | Recoveries | Ending Allowance |
|--|---------------------------------|---------------------|-------------|------------|------------------|
|  | Beginning Allowance             | Provision /(Credit) | Charge-offs |            |                  |
| Mortgage loans:                                |                                 |                     |             |            |                  |
| One-to four-family                             | \$1,558                         | \$792               | \$527       | \$40       | \$1,863          |
| Multi-family                                   | 1,156                           | (227                | ) 116       | 1          | 814              |
| Commercial                                     | 4,247                           | 1,035               | 667         | 53         | 4,668            |
| Construction – custom and owner/builder        | 386                             | (131                | ) 26        | —          | 229              |
| Construction – speculative one- to four-family | 128                             | (45                 | ) —         | —          | 83               |
| Construction – commercial                      | 429                             | (339                | ) —         | —          | 90               |
| Construction – multi-family                    | —                               | —                   | —           | —          | —                |
| Construction – land development                | —                               | (130                | ) 16        | 146        | —                |
| Land   | 2,392                           | 1,821               | 2,250       | 3          | 1,966            |
| Consumer loans:                                |                                 |                     |             |            |                  |
| Home equity and second mortgage                | 759                             | 204                 | 184         | 5          | 784              |
| Other  | 254                             | (7                  | ) 14        | —          | 233              |
| Commercial business loans                      | 516                             | (213                | ) —         | 93         | 396              |
| Total  | \$11,825                        | \$2,760             | \$3,800     | \$341      | \$11,126         |



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|  | Three Months Ended June 30, 2012 |                     |                 |              | Ending Allowance |
|--|----------------------------------|---------------------|-----------------|--------------|------------------|
|  | Beginning Allowance              | Provision /(Credit) | Charge-offs     | Recoveries   |                  |
| <b>Mortgage loans:</b>                         |                                  |                     |                 |              |                  |
| One-to four-family                             | \$ 931                           | \$ (10 )            | \$ 92           | \$ 3         | \$ 832           |
| Multi-family                                   | 1,288                            | (116)               | 3               | 3            | 1,172            |
| Commercial                                     | 3,737                            | 1,104               | 288             | —            | 4,553            |
| Construction – custom and owner/builder        | 267                              | 160                 | —               | —            | 427              |
| Construction – speculative one- to four-family | 71                               | (64)                | —               | —            | 107              |
| Construction – commercial                      | 861                              | 139                 | 622             | —            | 378              |
| Construction – multi-family                    | 504                              | (480)               | 24              | —            | —                |
| Construction – land development                | 95                               | (86)                | 9               | —            | —                |
| Land   | 2,737                            | 406                 | 526             | 1            | 2,618            |
| <b>Consumer loans:</b>                         |                                  |                     |                 |              |                  |
| Home equity and second mortgage                | 431                              | 91                  | 14              | 14           | 522              |
| Other  | 353                              | 15                  | 4               | —            | 364              |
| Commercial business loans                      | 889                              | (259)               | —               | —            | 630              |
| <b>Total</b>                                   | <b>\$ 12,264</b>                 | <b>\$ 900</b>       | <b>\$ 1,582</b> | <b>\$ 21</b> | <b>\$ 11,603</b> |

|  | Nine Months Ended June 30, 2012 |                     |                 |               | Ending Allowance |
|--|---------------------------------|---------------------|-----------------|---------------|------------------|
|  | Beginning Allowance             | Provision /(Credit) | Charge-offs     | Recoveries    |                  |
| <b>Mortgage loans:</b>                         |                                 |                     |                 |               |                  |
| One-to four-family                             | \$ 760                          | \$ 279              | \$ 211          | \$ 4          | \$ 832           |
| Multi-family                                   | 1,076                           | 96                  | 3               | 3             | 1,172            |
| Commercial                                     | 4,035                           | 1,314               | 796             | —             | 4,553            |
| Construction – custom and owner/builder        | 222                             | 205                 | —               | —             | 427              |
| Construction – speculative one- to four-family | 69                              | (63)                | —               | 1             | 107              |
| Construction – commercial                      | 794                             | 206                 | 622             | —             | 378              |
| Construction – multi-family                    | 354                             | (780)               | 24              | 450           | —                |
| Construction – land development                | 79                              | 160                 | 239             | —             | —                |
| Land   | 2,795                           | 801                 | 1,058           | 80            | 2,618            |
| <b>Consumer loans:</b>                         |                                 |                     |                 |               |                  |
| Home equity and second mortgage                | 460                             | 166                 | 118             | 14            | 522              |
| Other  | 415                             | (27)                | 24              | —             | 364              |
| Commercial business loans                      | 787                             | 243                 | 401             | 1             | 630              |
| <b>Total</b>                                   | <b>\$ 11,946</b>                | <b>\$ 2,600</b>     | <b>\$ 3,496</b> | <b>\$ 553</b> | <b>\$ 11,603</b> |

The following table presents information on the loans evaluated individually for impairment and collectively evaluated for impairment in the allowance for loan losses at June 30, 2013 and September 30, 2012 (dollars in thousands):

|  | Allowance for Loan Losses             |                                       |          | Recorded Investment in Loans          |                                       |           |
|--|---------------------------------------|---------------------------------------|----------|---------------------------------------|---------------------------------------|-----------|
|  | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Total    | Individually Evaluated for Impairment | Collectively Evaluated for Impairment | Total     |
| June 30, 2013                                  |                                       |                                       |          |                                       |                                       |           |
| Mortgage loans:                                |                                       |                                       |          |                                       |                                       |           |
| One- to four-family                            | \$947                                 | \$916                                 | \$1,863  | \$8,013                               | \$96,771                              | \$104,784 |
| Multi-family                                   | 396                                   | 418                                   | 814      | 6,222                                 | 42,559                                | 48,781    |
| Commercial                                     | 1,169                                 | 3,499                                 | 4,668    | 17,846                                | 272,394                               | 290,240   |
| Construction – custom and owner/builder        | —                                     | 229                                   | 229      | 73                                    | 19,915                                | 19,988    |
| Construction – speculative one- to four-family | 82                                    | 1                                     | 83       | 692                                   | 26                                    | 718       |
| Construction – commercial                      | —                                     | 90                                    | 90       | —                                     | 3,589                                 | 3,589     |
| Construction – multi-family                    | —                                     | —                                     | —        | 289                                   | —                                     | 289       |
| Construction – land development                | —                                     | —                                     | —        | 516                                   | —                                     | 516       |
| Land   | 254                                   | 1,712                                 | 1,966    | 2,558                                 | 29,115                                | 31,673    |
| Consumer loans:                                |                                       |                                       |          |                                       |                                       |           |
| Home equity and second mortgage                | 38                                    | 746                                   | 784      | 530                                   | 31,406                                | 31,936    |
| Other  | —                                     | 233                                   | 233      | 6                                     | 6,007                                 | 6,013     |
| Commercial business loans                      | —                                     | 396                                   | 396      | —                                     | 19,557                                | 19,557    |
| Total  | \$2,886                               | \$8,240                               | \$11,126 | \$36,745                              | \$521,339                             | \$558,084 |
| September 30, 2012                             |                                       |                                       |          |                                       |                                       |           |
| Mortgage loans:                                |                                       |                                       |          |                                       |                                       |           |
| One- to four-family                            | \$678                                 | \$880                                 | \$1,558  | \$5,282                               | \$101,697                             | \$106,979 |
| Multi-family                                   | 711                                   | 445                                   | 1,156    | 6,879                                 | 40,642                                | 47,521    |
| Commercial                                     | 667                                   | 3,580                                 | 4,247    | 17,192                                | 239,062                               | 256,254   |
| Construction – custom and owner/Builder        | 15                                    | 371                                   | 386      | 309                                   | 20,159                                | 20,468    |
| Construction – speculative one- to four-family | 109                                   | 19                                    | 128      | 1,027                                 | 495                                   | 1,522     |
| Construction – commercial                      | —                                     | 429                                   | 429      | —                                     | 17,157                                | 17,157    |
| Construction – multi-family                    | —                                     | —                                     | —        | 345                                   | —                                     | 345       |
| Construction – land development                | —                                     | —                                     | —        | 589                                   | —                                     | 589       |
| Land   | 686                                   | 1,706                                 | 2,392    | 8,613                                 | 31,042                                | 39,655    |
| Consumer loans:                                |                                       |                                       |          |                                       |                                       |           |
| Home equity and second mortgage                | 36                                    | 723                                   | 759      | 562                                   | 32,252                                | 32,814    |
| Other  | —                                     | 254                                   | 254      | 7                                     | 6,176                                 | 6,183     |
| Commercial business loans                      | —                                     | 516                                   | 516      | —                                     | 22,588                                | 22,588    |

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|       |         |         |          |          |           |           |
|-------|---------|---------|----------|----------|-----------|-----------|
| Total | \$2,902 | \$8,923 | \$11,825 | \$40,805 | \$511,270 | \$552,075 |
|-------|---------|---------|----------|----------|-----------|-----------|

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#### Credit Quality Indicators

The Company uses credit risk grades which reflect the Company's assessment of a loan's risk or loss potential. The Company categorizes loans into risk grade categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors such as the estimated fair value of the collateral. The Company uses the following definitions for credit risk ratings as part of the ongoing monitoring of the credit quality of its loan portfolio:

**Pass:** Pass loans are defined as those loans that meet acceptable quality underwriting standards.

**Watch:** Watch loans are defined as those loans that still exhibit acceptable quality, but have some concerns that justify greater attention. If these concerns are not corrected, a potential for further adverse categorization exists. These concerns could relate to a specific condition peculiar to the borrower, its industry segment or the general economic environment.

**Special Mention:** Special mention loans are defined as those loans deemed by management to have some potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the payment prospects of the loan. Assets in this category do not expose the Company to sufficient risk to warrant a substandard classification.

**Substandard:** Substandard loans are defined as those loans that are inadequately protected by the current net worth and paying capacity of the obligor, or of the collateral pledged. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. If the weakness or weaknesses are not corrected, there is the distinct possibility that some loss will be sustained.

**Loss:** Loans in this classification are considered uncollectible and of such little value that continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this loan even though partial recovery may be realized in the future.

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The following table lists the loan credit risk grades utilized by the Company that serve as credit quality indicators at June 30, 2013 and September 30, 2012 (dollars in thousands):

| June 30, 2013                                  | Loan Grades |          |                    |             |           |
|--|-------------|----------|--------------------|-------------|-----------|
|  | Pass        | Watch    | Special<br>Mention | Substandard | Total     |
| Mortgage loans:                                |             |          |                    |             |           |
| One- to four-family                            | \$91,821    | \$4,353  | \$1,301            | \$7,309     | \$104,784 |
| Multi-family                                   | 39,253      | 140      | 8,599              | 789         | 48,781    |
| Commercial                                     | 261,469     | 3,337    | 16,624             | 8,810       | 290,240   |
| Construction – custom and owner/builder        | 19,915      | —        | —                  | 73          | 19,988    |
| Construction – speculative one- to four-family | 26          | 692      | —                  | —           | 718       |
| Construction – commercial                      | 3,589       | —        | —                  | —           | 3,589     |
| Construction – multi-family                    | —           | —        | —                  | 289         | 289       |
| Construction – land development                | —           | —        | —                  | 516         | 516       |
| Land   | 21,023      | 5,041    | 2,266              | 3,343       | 31,673    |
| Consumer loans:                                |             |          |                    |             |           |
| Home equity and second mortgage                | 30,040      | 786      | 244                | 866         | 31,936    |
| Other  | 5,967       | 40       | —                  | 6           | 6,013     |
| Commercial business loans                      | 18,906      | 544      | 107                | —           | 19,557    |
| Total  | \$492,009   | \$14,933 | \$29,141           | \$22,001    | \$558,084 |
| September 30, 2012                             |             |          |                    |             |           |
| Mortgage loans:                                |             |          |                    |             |           |
| One- to four-family                            | \$93,668    | \$4,000  | \$4,343            | \$4,968     | \$106,979 |
| Multi-family                                   | 35,703      | 107      | 10,220             | 1,491       | 47,521    |
| Commercial                                     | 228,036     | 1,722    | 11,515             | 14,981      | 256,254   |
| Construction – custom and owner/builder        | 17,621      | —        | 2,538              | 309         | 20,468    |
| Construction – speculative one- to four-family | 304         | 191      | 700                | 327         | 1,522     |
| Construction – commercial                      | 17,157      | —        | —                  | —           | 17,157    |
| Construction – multi-family                    | —           | —        | —                  | 345         | 345       |
| Construction – land development                | —           | —        | —                  | 589         | 589       |
| Land   | 22,700      | 5,788    | 2,554              | 8,613       | 39,655    |
| Consumer loans:                                |             |          |                    |             |           |
| Home equity and second mortgage                | 29,777      | 1,488    | 788                | 761         | 32,814    |
| Other  | 6,136       | 40       | —                  | 7           | 6,183     |
| Commercial business loans                      | 20,777      | 834      | 286                | 691         | 22,588    |
| Total  | \$471,879   | \$14,170 | \$32,944           | \$33,082    | \$552,075 |

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The following tables present an age analysis of past due status of loans by category at June 30, 2013 and September 30, 2012 (dollars in thousands):

|  | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Non-<br>Accrual | Past Due<br>90 Days<br>or More<br>and Still<br>Accruing | Total<br>Past Due | Current   | Total<br>Loans |
|--|---------------------------|---------------------------|-----------------|---|-------------------|-----------|----------------|
| June 30, 2013                                      |                           |                           |                 |   |                   |           |                |
| Mortgage loans:                                    |                           |                           |                 |   |                   |           |                |
| One- to four-family                                | \$1,064                   | \$47                      | \$5,930         | \$—   | \$7,041           | \$97,743  | \$104,784      |
| Multi-family                                       | —                         | —                         | 789             | —   | 789               | 47,992    | 48,781         |
| Commercial   | —                         | —                         | 1,680           | 6   | 1,686             | 288,554   | 290,240        |
| Construction – custom and<br>owner/builder         | —                         | —                         | 74              | —   | 74                | 19,914    | 19,988         |
| Construction – speculative<br>one- to four- family | —                         | —                         | —               | —   | —                 | 718       | 718            |
| Construction – commercial                          | —                         | —                         | —               | —   | —                 | 3,589     | 3,589          |
| Construction – multi-family                        | —                         | —                         | 289             | —   | 289               | —         | 289            |
| Construction – land<br>development                 | —                         | —                         | 516             | —   | 516               | —         | 516            |
| Land   | 46                        | 56                        | 2,314           | —   | 2,416             | 29,257    | 31,673         |
| Consumer loans:                                    |                           |                           |                 |   |                   |           |                |
| Home equity and second<br>mortgage                 | 150                       | 193                       | 230             | 151   | 724               | 31,212    | 31,936         |
| Other  | —                         | —                         | 6               | —   | 6                 | 6,007     | 6,013          |
| Commercial business loans                          | 63                        | 16                        | —               | —   | 79                | 19,478    | 19,557         |
| Total  | \$1,323                   | \$312                     | \$11,828        | \$157   | \$13,620          | \$544,464 | \$558,084      |
| September 30, 2012                                 |                           |                           |                 |   |                   |           |                |
| Mortgage loans:                                    |                           |                           |                 |   |                   |           |                |
| One- to four-family                                | \$1,987                   | \$—                       | \$3,382         | \$142   | \$5,511           | \$101,468 | \$106,979      |
| Multi-family                                       | 3,402                     | —                         | 1,449           | —   | 4,851             | 42,670    | 47,521         |
| Commercial   | 1,071                     | —                         | 6,049           | 6   | 7,126             | 249,128   | 256,254        |
| Construction – custom and<br>owner/<br>builder     | —                         | —                         | 309             | —   | 309               | 20,159    | 20,468         |
| Construction – speculative<br>one- to four- family | —                         | —                         | 327             | 700   | 1,027             | 495       | 1,522          |
| Construction – commercial                          | —                         | —                         | —               | —   | —                 | 17,157    | 17,157         |
| Construction – multi-family                        | —                         | —                         | 345             | —   | 345               | —         | 345            |
| Construction – land<br>development                 | —                         | —                         | 589             | —   | 589               | —         | 589            |
| Land   | 943                       | —                         | 8,613           | 200   | 9,756             | 29,899    | 39,655         |
| Consumer loans:                                    |                           |                           |                 |   |                   |           |                |
| Home equity and second<br>mortgage                 | 277                       | 14                        | 261             | 150   | 702               | 32,112    | 32,814         |
| Other  | 4                         | —                         | 7               | —   | 11                | 6,172     | 6,183          |
| Commercial business loans                          | —                         | 15                        | —               | —   | 15                | 22,573    | 22,588         |
| Total  | \$7,684                   | \$29                      | \$21,331        | \$1,198   | \$30,242          | \$521,833 | \$552,075      |

### Impaired Loans

A loan is considered impaired when it is probable that the Company will be unable to collect all contractual principal and interest payments due in accordance with the original or modified terms of the loan agreement. Impaired loans are measured based on the estimated fair value of the collateral less estimated cost to sell if the loan is considered collateral dependent. Impaired loans that are not considered to be collateral dependent are measured based on the present value of expected future cash flows.

The categories of non-accrual loans and impaired loans overlap, although they are not coextensive. The Company considers all circumstances regarding the loan and borrower on an individual basis when determining whether an impaired loan should be placed on non-accrual status, such as the financial strength of the borrower, the estimated collateral value, reasons for the delay, payment record, the amount past due and the number of days past due.

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Following is a summary of information related to impaired loans as of June 30, 2013 and for the three and nine months then ended (in thousands):

|  | Recorded Investment | Unpaid Principal Balance (Loan Balance Plus Charge Off) | Related Allowance | QTD Average Recorded Investment (1) | YTD Average Recorded Investment (2) | QTD Interest Income Recognized (1) | YTD Interest Income Recognized (2) | QTD Cash Basis Interest Income Recognized (1) | YTD Cash Basis Interest Income Recognized (2) |
|--|---------------------|---|-------------------|-------------------------------------|-------------------------------------|------------------------------------|------------------------------------|---|---|
| With no related allowance recorded:            |                     |   |                   |                                     |                                     |                                    |                                    |   |   |
| Mortgage loans:                                |                     |   |                   |                                     |                                     |                                    |                                    |   |   |
| One- to four-family                            | \$ 2,668            | \$3,072   | \$ —              | \$ 2,289                            | \$ 1,809                            | \$ —                               | \$ 5                               | \$ —  | \$ 4  |
| Multi-family                                   | 789                 | 1,771   | —                 | 789                                 | 473                                 | —                                  | 3                                  | —   | 3   |
| Commercial                                     | 10,279              | 13,405  | —                 | 10,733                              | 10,597                              | 80                                 | 239                                | 61  | 205   |
| Construction – custom and owner/builder        | 73                  | 99  | —                 | 37                                  | 139                                 | —                                  | —                                  | —   | —   |
| Construction – speculative one- to four-family | —                   | —   | —                 | —                                   | 65                                  | —                                  | —                                  | —   | —   |
| Construction – commercial                      | —                   | —   | —                 | —                                   | —                                   | —                                  | —                                  | —   | —   |
| Construction – multi-family                    | 289                 | 754   | —                 | 317                                 | 334                                 | —                                  | —                                  | —   | —   |
| Construction – land development                | 516                 | 3,279   | —                 | 521                                 | 553                                 | —                                  | —                                  | —   | —   |
| Land   | 1,255               | 2,167   | —                 | 2,537                               | 4,667                               | 3                                  | 6                                  | 3   | 5   |
| Consumer loans:                                |                     |   |                   |                                     |                                     |                                    |                                    |   |   |
| Home equity and second mortgage                | 230                 | 532   | —                 | 213                                 | 277                                 | —                                  | —                                  | —   | —   |
| Other  | 6                   | 6   | —                 | 11                                  | 9                                   | —                                  | —                                  | —   | —   |
| Commercial business loans                      | —                   | 45  | —                 | —                                   | 6                                   | —                                  | —                                  | —   | —   |
| Subtotal                                       | 16,105              | 25,130  | —                 | 17,447                              | 18,929                              | 83                                 | 253                                | 64  | 217   |
| With an allowance recorded:                    |                     |   |                   |                                     |                                     |                                    |                                    |   |   |
| Mortgage loans:                                |                     |   |                   |                                     |                                     |                                    |                                    |   |   |
| One- to four-family                            | 5,345               | 5,429   | 947               | 5,151                               | 4,258                               | 22                                 | 76                                 | 30  | 56  |
| Multi-family                                   | 5,433               | 5,433   | 396               | 5,439                               | 6,303                               | 55                                 | 230                                | 73  | 175   |
| Commercial                                     | 7,567               | 8,233   | 1,169             | 7,149                               | 7,577                               | 139                                | 349                                | 172   | 282   |
| Construction – custom and owner/builder        | —                   | —   | —                 | 50                                  | 81                                  | —                                  | —                                  | —   | —   |
| Construction – speculative one- to four-family | 692                 | 692   | 82                | 695                                 | 698                                 | 7                                  | 22                                 | 9   | 15  |

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|                                 |       |       |     |       |       |   |    |   |    |
|---------------------------------|-------|-------|-----|-------|-------|---|----|---|----|
| Construction – commercial       | —     | —     | —   | —     | —     | — | 89 | — | 71 |
| Construction – multi-family     | —     | —     | —   | —     | —     | — | —  | — | —  |
| Construction - land development | —     | —     | —   | —     | —     | — | —  | — | —  |
| Land                            | 1,303 | 1,326 | 254 | 1,743 | 2,238 | 6 | 21 | 6 | 21 |
| Consumer loans:                 |       |       |     |       |       |   |    |   |    |

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|  |          |          |         |          |          |       |         |       |       |
|--|----------|----------|---------|----------|----------|-------|---------|-------|-------|
| Home equity and second mortgage                | 300      | 300      | 38      | 429      | 421      | 3     | 12      | 4     | 9     |
| Other  | —        | —        | —       | —        | —        | —     | —       | —     | —     |
| Commercial business loans                      | —        | —        | —       | —        | —        | —     | —       | —     | —     |
| Subtotal                                       | 20,640   | 21,413   | 2,886   | 20,656   | 21,576   | 232   | 799     | 294   | 629   |
| Total  |          |          |         |          |          |       |         |       |       |
| Mortgage loans:                                |          |          |         |          |          |       |         |       |       |
| One- to four-family                            | 8,013    | 8,501    | 947     | 7,440    | 6,067    | 22    | 81      | 30    | 60    |
| Multi-family                                   | 6,222    | 7,204    | 396     | 6,228    | 6,776    | 55    | 233     | 73    | 178   |
| Commercial                                     | 17,846   | 21,638   | 1,169   | 17,882   | 18,174   | 219   | 588     | 233   | 487   |
| Construction – custom and owner/builder        | 73       | 99       | —       | 87       | 220      | —     | —       | —     | —     |
| Construction – speculative one- to four-family | \$692    | \$692    | \$82    | \$695    | \$763    | \$7   | \$22    | \$9   | \$15  |
| Construction – commercial                      | —        | —        | —       | —        | —        | —     | 89      | —     | 71    |
| Construction – multi-family                    | 289      | 754      | —       | 317      | 334      | —     | —       | —     | —     |
| Construction – land development                | 516      | 3,279    | —       | 521      | 553      | —     | —       | —     | —     |
| Land   | 2,558    | 3,493    | 254     | 4,280    | 6,905    | 9     | 27      | 9     | 26    |
| Consumer loans:                                |          |          |         |          |          |       |         |       |       |
| Home equity and second mortgage                | 530      | 832      | 38      | 642      | 698      | 3     | 12      | 4     | 9     |
| Other  | 6        | 6        | —       | 11       | 9        | —     | —       | —     | —     |
| Commercial business loans                      | —        | 45       | —       | —        | 6        | —     | —       | —     | —     |
| Total  | \$36,745 | \$46,543 | \$2,886 | \$38,103 | \$40,505 | \$315 | \$1,052 | \$358 | \$846 |

(1) For the three months ended June 30, 2013

(2) For the nine months ended June 30, 2013

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The following is a summary of information related to impaired loans as of and for the year ended September 30, 2012 (in thousands):

|  | Recorded Investment | Unpaid Principal Balance (Loan Balance Plus Charge Off) | Related Allowance | YTD Average Recorded Investment (1) | YTD Interest Income Recognized (1) | YTD Cash Basis Interest Income Recognized (1) |
|--|---------------------|---|-------------------|-------------------------------------|------------------------------------|---|
| With no related allowance recorded:            |                     |   |                   |                                     |                                    |   |
| Mortgage loans:                                |                     |   |                   |                                     |                                    |   |
| One- to four-family                            | \$ 1,510            | \$ 1,605  | \$—               | \$ 1,838                            | \$ 20                              | \$ 16   |
| Multi-family                                   | —                   | 982   | —                 | —                                   | 1                                  | 1   |
| Commercial                                     | 7,596               | 8,664   | —                 | 14,491                              | 543                                | 348   |
| Construction – custom and owner/builder        | 208                 | 208   | —                 | 209                                 | —                                  | —   |
| Construction – speculative one- to four-family | 327                 | 327   | —                 | 65                                  | —                                  | —   |
| Construction – commercial                      | —                   | 2,066   | —                 | —                                   | 14                                 | 14  |
| Construction – multi-family                    | 345                 | 810   | —                 | 338                                 | —                                  | —   |
| Construction – land development                | 589                 | 3,497   | —                 | 1,089                               | 14                                 | 14  |
| Land   | 5,989               | 8,247   | —                 | 6,279                               | 28                                 | 16  |
| Consumer loans:                                |                     |   |                   |                                     |                                    |   |
| Home equity and second mortgage                | 261                 | 383   | —                 | 482                                 | —                                  | —   |
| Other  | 7                   | 7   | —                 | 5                                   | —                                  | —   |
| Commercial business loans                      | —                   | 166   | —                 | 32                                  | 2                                  | 2   |
| Subtotal                                       | 16,832              | 26,962  | —                 | 24,828                              | 622                                | 411   |
| With an allowance recorded:                    |                     |   |                   |                                     |                                    |   |
| Mortgage loans:                                |                     |   |                   |                                     |                                    |   |
| One- to four-family                            | 3,772               | 3,772   | 678               | 2,520                               | 81                                 | 62  |
| Multi-family                                   | 6,879               | 6,879   | 711               | 6,618                               | 294                                | 189   |
| Commercial                                     | 9,596               | 9,596   | 667               | 5,043                               | 60                                 | 39  |
| Construction – custom and owner/builder        | 101                 | 101   | 15                | 106                                 | —                                  | —   |
| Construction – speculative one- to four-family | 700                 | 700   | 109               | 700                                 | 29                                 | 20  |
| Construction – commercial                      | —                   | —   | —                 | 3,248                               | 230                                | 146   |
| Construction – multi-family                    | —                   | —   | —                 | 74                                  | —                                  | —   |
| Land   | 2,624               | 2,811   | 686               | 3,307                               | 37                                 | 36  |
| Consumer loans:                                |                     |   |                   |                                     |                                    |   |
| Home equity and second mortgage                | 301                 | 301   | 36                | 515                                 | 31                                 | 23  |
| Other  | —                   | —   | —                 | 55                                  | —                                  | —   |
| Subtotal                                       | 23,973              | 24,160  | 2,902             | 22,186                              | 762                                | 515   |
| Total  |                     |   |                   |                                     |                                    |   |
| Mortgage loans:                                |                     |   |                   |                                     |                                    |   |
| One- to four-family                            | 5,282               | 5,377   | 678               | 4,358                               | 101                                | 78  |
| Multi-family                                   | 6,879               | 7,861   | 711               | 6,618                               | 295                                | 190   |
| Commercial                                     | 17,192              | 18,260  | 667               | 19,534                              | 603                                | 387   |
|  | 309                 | 309   | 15                | 315                                 | —                                  | —   |

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|  |           |           |          |           |          |        |
|--|-----------|-----------|----------|-----------|----------|--------|
| Construction – custom and owner/builder        |           |           |          |           |          |        |
| Construction – speculative one- to four-family | 1,027     | 1,027     | 109      | 765       | 29       | 20     |
| Construction – commercial                      | —         | 2,066     | —        | 3,248     | 244      | 160    |
| Construction – multi-family                    | 345       | 810       | —        | 412       | —        | —      |
| Construction – land development                | 589       | 3,497     | —        | 1,089     | 14       | 14     |
| Land   | 8,613     | 11,058    | 686      | 9,586     | 65       | 52     |
| Consumer loans:                                |           |           |          |           |          |        |
| Home equity and second mortgage                | 562       | 684       | 36       | 997       | 31       | 23     |
| Other  | 7         | 7         | —        | 60        | —        | —      |
| Commercial business loans                      | —         | 166       | —        | 32        | 2        | 2      |
| Total  | \$ 40,805 | \$ 51,122 | \$ 2,902 | \$ 47,014 | \$ 1,384 | \$ 926 |

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(1) For the year ended September 30, 2012

The following table sets forth information with respect to the Company's non-performing assets at June 30, 2013 and September 30, 2012 (dollars in thousands):

|  | June 30,<br>2013 | September<br>30,<br>2012 |      |   |
|--|------------------|--------------------------|------|---|
| Loans accounted for on a non-accrual basis:  |                  |                          |      |   |
| Mortgage loans:  |                  |                          |      |   |
| One- to four-family  | \$5,930          | \$3,382                  |      |   |
| Multi-family   | 789              | 1,449                    |      |   |
| Commercial   | 1,680            | 6,049                    |      |   |
| Construction – custom and owner/builder  | 74               | 309                      |      |   |
| Construction – speculative one- to four-family                                     | —                | 327                      |      |   |
| Construction – multi-family  | 289              | 345                      |      |   |
| Construction – land development  | 516              | 589                      |      |   |
| Land   | 2,314            | 8,613                    |      |   |
| Consumer loans:  |                  |                          |      |   |
| Home equity and second mortgage  | 230              | 261                      |      |   |
| Other  | 6                | 7                        |      |   |
| Total loans accounted for on a non-accrual basis                                   | 11,828           | 21,331                   |      |   |
| Accruing loans which are contractually past due 90 days or more                    | 157              | 1,198                    |      |   |
| Total of non-accrual and 90 days past due loans (1)                                | 11,985           | 22,529                   |      |   |
| Non-accrual investment securities  | 2,327            | 2,442                    |      |   |
| OREO and other repossessed assets, net   | 15,314           | 13,302                   |      |   |
| Total non-performing assets (2)  | \$29,626         | \$38,273                 |      |   |
| Troubled debt restructured loans on accrual status                                 | \$18,958         | \$13,410                 |      |   |
| Non-accrual and 90 days or more past due loans as a percentage of loans receivable | 2.15             | %                        | 4.09 | % |
| Non-accrual and 90 days or more past due loans as a percentage of total assets     | 1.64             | %                        | 3.06 | % |
| Non-performing assets as a percentage of total assets                              | 4.04             | %                        | 5.19 | % |
| Loans receivable (3)   | \$556,414        | \$550,305                |      |   |
| Total assets   | \$732,775        | \$736,954                |      |   |

(1) Includes troubled debt restructured loans totaling \$2.5 million and \$10.1 million reported as non-accrual loans at June 30, 2013 and September 30, 2012, respectively.

(2) Does not include troubled debt restructured loans on accrual status.

(3) Includes loans held for sale and before the allowance for loan losses.



Troubled debt restructured loans are loans for which the Company, for economic or legal reasons related to the borrower's financial condition, has granted a significant concession to the borrower that it would otherwise not consider. The loan terms which have been modified or restructured due to a borrower's financial difficulty include but are not limited to: a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals and renewals. Troubled debt restructured loans are considered impaired loans and are individually evaluated for impairment. Troubled debt restructured loans can be classified as either accrual or non-accrual. Troubled debt restructured loans are classified as non-performing loans unless they have been performing in accordance with modified terms for a period of at least six months. The Company had \$21.4 million in troubled debt restructured loans included in impaired loans at June 30, 2013 and had \$1,000 in commitments to lend additional funds on these loans. The Company had \$23.5 million in troubled debt restructured loans included in impaired loans at September 30, 2012 and had \$1,000 in commitments to lend additional funds on these loans.

The following table sets forth information with respect to the Company's troubled debt restructured loans by interest accrual status as of June 30, 2013 and September 30, 2012 (dollars in thousands):

|  | June 30, 2013      |             |          |
|--|--------------------|-------------|----------|
|  | Accruing           | Non-Accrual | Total    |
| Mortgage loans:                                |                    |             |          |
| One- to four-family                            | \$2,082            | \$144       | \$2,226  |
| Multi-family                                   | 5,433              | —           | 5,433    |
| Commercial                                     | 10,207             | —           | 10,207   |
| Construction – speculative one- to four-family | 691                | —           | 691      |
| Construction – land development                | —                  | 516         | 516      |
| Land   | 245                | 1,651       | 1,896    |
| Consumer loans:                                |                    |             |          |
| Home equity and second mortgage                | 300                | 180         | 480      |
| Total  | \$18,958           | \$2,491     | \$21,449 |
|  |                    |             |          |
|  | September 30, 2012 |             |          |
|  | Accruing           | Non-Accrual | Total    |
| Mortgage loans:                                |                    |             |          |
| One- to four-family                            | \$1,900            | \$—         | \$1,900  |
| Multi-family                                   | 5,430              | —           | 5,430    |
| Commercial                                     | 5,079              | 4,862       | 9,941    |
| Construction – speculative one- to four-family | 700                | —           | 700      |
| Construction – land development                | —                  | 526         | 526      |
| Land   | —                  | 4,445       | 4,445    |
| Consumer loans:                                |                    |             |          |
| Home equity and second mortgage                | 301                | 261         | 562      |
| Total  | \$13,410           | \$10,094    | \$23,504 |

The following table sets forth information with respect to the Company's troubled debt restructurings by portfolio segment that occurred during the nine months ended June 30, 2013 and the year ended September 30, 2012 (dollars in thousands):

| Nine Months Ended      |           | Pre-         | Post-        |               |
|------------------------|-----------|--------------|--------------|---------------|
|                        | Number of | Modification | Modification | Balance at    |
| June 30, 2013          | Contracts | Outstanding  | Outstanding  | June 30, 2013 |
|                        |           | Recorded     | Recorded     |               |
|                        |           | Investment   | Investment   |               |
| One-to four-family (1) | 2         | \$353        | \$353        | \$352         |
| Commercial (2)         | 1         | 750          | 750          | 745           |
| Total                  | 3         | \$1,103      | \$1,103      | \$1,097       |
| Year Ended             |           | Pre-         | Post-        |               |
|                        | Number of | Modification | Modification | Balance at    |
| September 30, 2012     | Contracts | Outstanding  | Outstanding  | September 30, |
|                        |           | Recorded     | Recorded     | 2012          |
|                        |           | Investment   | Investment   |               |
| One-to four-family (1) | 1         | \$373        | \$373        | \$372         |
| Commercial (1)         | 1         | 2,718        | 2,718        | 2,657         |
| Land (2)               | 1         | 249          | 249          | 233           |
| Total                  | 3         | \$3,340      | \$3,340      | \$3,262       |

(1) Modifications were a result of a combination of changes (a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals and renewals).

(2) Modification was a result of a reduction in the stated interest rate.

There were no troubled debt restructured loans that were recorded in the nine months ended June 30, 2013 or the year ended September 30, 2012 that have subsequently defaulted.

#### (6) NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income to common shareholders by the weighted average number of common shares outstanding during the period, without considering any dilutive items. Diluted net income per common share is computed by dividing net income to common shareholders by the weighted average number of common shares and common stock equivalents for items that are dilutive, net of shares assumed to be repurchased using the treasury stock method at the average share price for the Company's common stock during the period. Common stock equivalents arise from the assumed conversion of outstanding stock options and the outstanding warrant to purchase common stock. In accordance with the Financial Accounting Standards Board ("FASB") guidance for stock compensation, shares owned by the Bank's ESOP that have not been allocated are not considered to be outstanding for the purpose of computing basic and diluted net income per common share. At June 30, 2013 and 2012, there were 225,070 and 264,520 shares, respectively, that had not been allocated under the Bank's ESOP.



Information regarding the calculation of basic and diluted net income per common share for the three months and nine months ended June 30, 2013 and 2012 is as follows (dollars in thousands, except per share amounts):

|   | Three Months Ended June 30                |           | Nine Months Ended June 30 |           |
|---|---|-----------|---------------------------|-----------|
|   | 2013                                      | 2012      | 2013                      | 2012      |
|   | (In thousands, except for per share data) |           |                           |           |
| <b>Basic net income per common share computation</b>        |   |           |                           |           |
| Numerator – net income                                      | \$876                                     | \$1,348   | \$3,863                   | \$3,438   |
| Preferred stock dividends                                   | (151                                      | ) (208    | ) (559                    | ) (624    |
| Preferred stock discount accretion                          | (47                                       | ) (61     | ) (236                    | ) (179    |
| Repurchase of preferred stock at a discount                 | —   | —         | 255                       | —         |
| Net income to common shareholders                           | \$678                                     | \$1,079   | \$3,323                   | \$2,635   |
| Denominator – weighted average common shares outstanding    | 6,818,752                                 | 6,780,516 | 6,816,772                 | 6,780,516 |
| Basic net income per common share                           | \$0.10                                    | \$0.16    | \$0.49                    | \$0.39    |
| <b>Diluted net income per common share computation</b>      |   |           |                           |           |
| Numerator – net income                                      | \$876                                     | \$1,348   | \$3,863                   | \$3,438   |
| Preferred stock dividends                                   | (151                                      | ) (208    | ) (559                    | ) (624    |
| Preferred stock discount accretion                          | (47                                       | ) (61     | ) (236                    | ) (179    |
| Repurchase of preferred stock at a discount                 | —   | —         | 255                       | —         |
| Net income to common shareholders                           | \$678                                     | \$1,079   | \$3,323                   | \$2,635   |
| Denominator – weighted average common shares outstanding    | 6,818,752                                 | 6,780,516 | 6,816,772                 | 6,780,516 |
| Effect of dilutive stock options (1)                        | 18,458                                    | —         | 13,035                    | —         |
| Effect of dilutive stock warrant (2)                        | 65,287                                    | —         | 40,944                    | —         |
| Weighted average common shares and common stock equivalents | 6,902,497                                 | 6,780,516 | 6,870,751                 | 6,780,516 |
| Diluted net income per common share                         | \$0.10                                    | \$0.16    | \$0.48                    | \$0.39    |

(1) For the three and nine months ended June 30, 2013, options to purchase 56,546 and 131,152 shares of common stock, respectively, were outstanding but not included in the computation of diluted net income per common share because their effect would have been anti-dilutive. For the three and nine months ended June 30, 2012, options to purchase 110,726 and 133,652 shares of common stock, respectively, were outstanding but not included in the computation of diluted net income per common share because their effect would have been anti-dilutive.

(2) For the three and nine months ended June 30, 2012, a warrant to purchase 370,899 shares of common stock was outstanding but not included in the computation of diluted net income per common share because the warrant's exercise price was greater than the average market price of the common stock, and, therefore, its effect would have been anti-dilutive.

## (7) STOCK PLANS AND STOCK BASED COMPENSATION

### Stock Option Plans

Under the Company's stock option plans (the 1999 Stock Option Plan and the 2003 Stock Option Plan), the Company was able to grant options for up to a combined total of 1,622,500 shares of common stock to employees, officers and directors. Shares issued may be purchased in the open market or may be issued from authorized and unissued shares. The exercise price of each option equals the fair market value of the Company's common stock on the date of

grant. Generally, options vest in 20% annual installments on each of the five anniversaries from the date of the grant. At June 30, 2013, options for 157,338 shares are available for future grant under the 2003 Stock Option Plan, and no shares are available for future grant under the 1999 Stock Option Plan.

Activity under the plans for the nine months ended June 30, 2013 and 2012 is as follows:

|  | Nine Months Ended<br>June 30, 2013 |  | Nine Months Ended<br>June 30, 2012 |  |
|--|------------------------------------|--|------------------------------------|--|
|  | Shares                             | Weighted<br>Average<br>Exercise<br>Price | Shares                             | Weighted<br>Average<br>Exercise<br>Price |
| Options outstanding, beginning of period | 195,626                            | \$7.97                                   | 137,726                            | \$9.25                                   |
| Granted                                  | 29,000                             | 6.00                                     | 33,500                             | 4.01                                     |
| Forfeited                                | (56,680)                           | ) 9.52                                   | (6,200)                            | ) 6.06                                   |
| Options outstanding, end of period       | 167,946                            | \$7.10                                   | 165,026                            | \$8.30                                   |
| Options exercisable, end of period       | 68,446                             | \$9.55                                   | 119,326                            | \$9.89                                   |

The aggregate intrinsic value of options outstanding at June 30, 2013 was \$375,000.

At June 30, 2013, there were 99,500 unvested options with an aggregate grant date fair value of \$208,000, all of which the Company assumes will vest. The aggregate intrinsic value of unvested options at June 30, 2013 was \$299,000. There were 8,800 options with an aggregate grant date fair value of \$13,000 that vested during the nine months ended June 30, 2013.

At June 30, 2012, there were 45,700 unvested options with an aggregate grant date fair value of \$68,000. There were 5,000 options with an aggregate grant date fair value of \$6,000 that vested during the nine months ended June 30, 2012.

The Company uses the Black-Scholes option pricing model to estimate the fair value of stock-based awards with the weighted average assumptions noted in the following table. The risk-free interest rate is based on the U.S. Treasury rate of a similar term as the stock option at the particular grant date. The expected life is based on historical data, vesting terms and estimated exercise dates. The expected dividend yield is based on the most recent quarterly dividend on an annualized basis in effect at the time the options were granted. The expected volatility is based on historical volatility of the Company's stock price. There were 29,000 options granted during the nine months ended June 30, 2013 with an aggregate grant date fair value of \$69,000. There were 33,500 options granted during the nine months ended June 30, 2012 with an aggregate grant date fair value of \$52,000.

The Black-Scholes option pricing model was used in estimating the fair value of option grants. The weighted average assumptions used for options granted during the nine months ended June 30, 2013 were:

|                                 |        |   |
|---------------------------------|--------|---|
| Expected Volatility             | 45     | % |
| Expected term (in years)        | 5      |   |
| Expected dividend yield         | —      | % |
| Risk free interest rate         | 0.76   | % |
| Grant date fair value per share | \$2.37 |   |

#### Stock Grant Plan

The Company adopted the MRDP in 1998 for the benefit of employees, officers and directors of the Company. The objective of the MRDP is to retain and attract personnel of experience and ability in key positions by providing them with a proprietary interest in the Company.

The MRDP allowed for the issuance to participants of up to 529,000 shares of the Company's common stock. Awards under the MRDP were made in the form of shares of common stock that are subject to restrictions on the transfer of ownership and are subject to a five-year vesting period. Compensation expense is the amount of the fair value of the common stock at the date of the grant to the plan participants and is recognized over a five-year vesting period, with 20% vesting on each of the five anniversaries from the date of the grant.

There were no MRDP shares granted to officers or directors during the nine months ended June 30, 2013 and 2012. At June 30, 2013, there were no shares available for future awards under the MRDP.

At June 30, 2013, there were a total of 3,248 unvested MRDP shares with an aggregate grant date fair value of \$23,000. There were 6,213 MRDP shares that vested during the nine months ended June 30, 2013 with an aggregate grant date fair value of \$62,000.

At June 30, 2012, there were a total of 11,561 unvested MRDP shares with an aggregated grant date fair value of \$104,000. There were 10,831 MRDP shares that vested during the nine months ended June 30, 2012 with an aggregated grant date fair value of \$130,000. There were 100 MRDP shares forfeited during the nine months ended June 30, 2012 with a grant date fair value of \$1,000. At June 30, 2012, there were no shares available for future awards under the MRDP.

#### Expenses for Stock Compensation Plans

Compensation expenses for all stock-based plans were as follows:

|   | Nine Months Ended June 30, |                 |                  |                 |
|---|----------------------------|-----------------|------------------|-----------------|
|   | 2013                       |                 | 2012             |                 |
|   | (Dollars in thousands)     |                 |                  |                 |
|   | Stock<br>Options           | Stock<br>Grants | Stock<br>Options | Stock<br>Grants |
| Compensation expense recognized in income | \$37                       | \$32            | \$11             | \$85            |
| Related tax benefit recognized            | \$13                       | \$11            | \$4              | \$29            |

As of June 30, 2013, the compensation expense yet to be recognized for stock-based awards that have been awarded but not vested for the years ending September 30 is as follows (dollars in thousands):

|                   | Stock<br>Options | Stock<br>Grants | Total<br>Awards |
|-------------------|------------------|-----------------|-----------------|
| Remainder of 2013 | \$13             | \$7             | \$20            |
| 2014              | 50               | 2               | 52              |
| 2015              | 44               | —               | 44              |
| 2016              | 44               | —               | 44              |
| 2017              | 35               | —               | 35              |
| 2018              | 1                | —               | 1               |
| Total             | \$187            | \$9             | \$196           |

#### (8) FAIR VALUE MEASUREMENTS

GAAP requires disclosure of estimated fair values for financial instruments. Such estimates are subjective in nature, and significant judgment is required regarding the risk characteristics of various financial instruments at a discrete point in time. Therefore, such estimates could vary significantly if assumptions regarding uncertain factors were to change. In addition, as the Company normally intends to hold the majority of its financial instruments until maturity, it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for certain items which are not defined as financial instruments but which may have significant value. The Company does not believe that it would be practicable to estimate a representational fair value for these types of items as of June 30, 2013 and September 30, 2012. Because GAAP excludes certain items from fair value disclosure requirements, any aggregation of the fair value amounts presented would not represent the underlying value of the Company.

Accounting guidance regarding fair value measurements defines fair value and establishes a framework for measuring fair value in accordance with GAAP. Fair value is the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. The following definitions describe the levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: Significant observable inputs other than quoted prices included within Level 1, such as quoted prices in markets that are not active, and inputs other than quoted prices that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions market participants would use in pricing an asset or liability based on the best information available in the circumstances.

The Company used the following methods and significant assumptions to estimate fair value on a recurring basis:

#### MBS and Other Investments Available for Sale

The estimated fair value of MBS and other investments are based upon the assumptions market participants would use in pricing the security. Such assumptions include quoted market prices (Level 1), market prices of similar securities or observable inputs (Level 2).

The following table summarizes the balances of assets and liabilities measured at estimated fair value on a recurring basis at June 30, 2013 (dollars in thousands):

|                               | Estimated Fair Value |         |         | Total   |
|-------------------------------|----------------------|---------|---------|---------|
|                               | Level 1              | Level 2 | Level 3 |         |
| Available for Sale Securities |                      |         |         |         |
| MBS:                          |                      |         |         |         |
| U.S. government agencies      | \$—                  | \$2,423 | \$—     | \$2,423 |
| Private label residential     | —                    | 986     | —       | 986     |
| Mutual funds                  | 961                  | —       | —       | 961     |
| Total                         | \$961                | \$3,409 | \$—     | \$4,370 |

There were no transfers among Level 1, Level 2 and Level 3 during the nine months ended June 30, 2013.

The following table summarizes the balances of assets and liabilities measured at estimated fair value on a recurring basis at September 30, 2012 (dollars in thousands):

|                               | Estimated Fair Value |         |         | Total   |
|-------------------------------|----------------------|---------|---------|---------|
|                               | Level 1              | Level 2 | Level 3 |         |
| Available for Sale Securities |                      |         |         |         |
| MBS:                          |                      |         |         |         |
| U.S. government agencies      | \$—                  | \$2,975 | \$—     | \$2,975 |
| Private label residential     | —                    | 957     | —       | 957     |
| Mutual funds                  | 1,013                | —       | —       | 1,013   |
| Total                         | \$1,013              | \$3,932 | \$—     | \$4,945 |

There were no transfers between Level 1, Level 2 and Level 3 during the year ended September 30, 2012.

The Company may be required, from time to time, to measure certain financial assets and financial liabilities at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market value that were recognized at fair value below cost at the end of the period.

The Company uses the following methods and significant assumptions to estimate fair value on a nonrecurring basis:

Impaired Loans: A loan is considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The

specific reserve for collateral dependent impaired loans was based on the estimated fair value of the collateral less estimated costs to sell. The estimated fair value of collateral was determined based primarily on appraisals. In some cases, adjustments were made to the appraised values due to various factors including age of the appraisal, age of comparables included in the appraisal,

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and known changes in the market and in the collateral. Such adjustments may be significant and typically result in a Level 3 classification of the inputs for determining fair value. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

**MBS and Other Investments Held to Maturity:** The estimated fair value of MBS and other investments are based upon the assumptions market participants would use in pricing the security. Such assumptions include quoted market prices (Level 1), market prices of similar securities or observable inputs (Level 2) and unobservable inputs such as dealer quotes, discounted cash flows or similar techniques (Level 3).

**OREO and Other Repossessed Assets, net:** The Company's OREO and other repossessed assets are initially recorded at estimated fair value less estimated costs to sell. This amount becomes the property's new basis. Estimated fair value was generally determined by management based on a number of factors, including third-party appraisals of estimated fair value in an orderly sale. Estimated costs to sell were based on standard market factors. The valuation of OREO and other repossessed assets is subject to significant external and internal judgment.

**MSRs:** The fair value of the MSRs was determined using a third-party model, which incorporates the expected life of the loans, estimated cost to service the loans, servicing fees received and other factors. The estimated fair value is calculated by stratifying the MSRs based on the predominant risk characteristics that include the underlying loan's interest rate, cash flows of the loan, origination date and term.

The following table summarizes the balances of assets measured at estimated fair value on a non-recurring basis at June 30, 2013, and the total losses resulting from these estimated fair value adjustments for the nine months ended June 30, 2013 (dollars in thousands):

|   | Estimated Fair Value |         |          | Total Losses |
|---|----------------------|---------|----------|--------------|
|   | Level 1              | Level 2 | Level 3  |              |
| Impaired loans:                                 |                      |         |          |              |
| Mortgage Loans;                                 |                      |         |          |              |
| One-to four-family                              | \$—                  | \$—     | \$4,398  | \$527        |
| Multi-family                                    | —                    | —       | 5,037    | 116          |
| Commercial                                      | —                    | —       | 6,398    | 667          |
| Construction – speculative one- to- four-family | —                    | —       | 610      | —            |
| Land  | —                    | —       | 1,049    | 2,250        |
| Consumer loans:                                 |                      |         |          |              |
| Home equity and second mortgage                 | —                    | —       | 262      | 184          |
| Total impaired loans (1)                        | —                    | —       | 17,754   | 3,744        |
| MBS – held to maturity (2):                     |                      |         |          |              |
| Private label residential                       | —                    | 23      | —        | 37           |
| OREO and other repossessed items (3)            | —                    | —       | 15,314   | 759          |
| Total   | \$—                  | \$23    | \$33,068 | \$4,540      |

(1) The loss represents charge-offs on collateral dependent loans for estimated fair value adjustment based on the estimated fair value of the collateral. Fair value is the recorded investment less the related allowance.

(2) The loss represents OTTI credit-related charges on held to maturity MBS.

The loss represents the results of management's periodic reviews of the recorded value to determine whether the (3) property continues to be recorded at the lower of its recorded book value or estimated fair value, net of estimated costs to sell.



The following table summarizes the balances of assets and liabilities measured at estimated fair value on a non-recurring basis at September 30, 2012 and the total losses resulting from these estimated fair value adjustments for the year ended September 30, 2012 (dollars in thousands):

|   | Estimated Fair Value |         |          | Total Losses |
|---|----------------------|---------|----------|--------------|
|   | Level 1              | Level 2 | Level 3  |              |
| Impaired loans:                               |                      |         |          |              |
| Mortgage Loans;                               |                      |         |          |              |
| One-to four-family                            | \$—                  | \$—     | \$3,094  | \$276        |
| Multi-family                                  | —                    | —       | 6,168    | 14           |
| Commercial                                    | —                    | —       | 8,929    | 1,215        |
| Construction – custom and owner/builder       | —                    | —       | 86       | —            |
| Construction – speculative one-to four-family | —                    | —       | 591      | —            |
| Land  | —                    | —       | 1,938    | 1,251        |
| Consumer loans:                               |                      |         |          |              |
| Home equity and second mortgage               | —                    | —       | 265      | 232          |
| Total impaired loans (1)                      | —                    | —       | 21,071   | 2,988        |
| MBS – held to maturity (2):                   |                      |         |          |              |
| Private label residential                     | —                    | 231     | —        | 164          |
| OREO and other repossessed items (3)          | —                    | —       | 13,302   | 947          |
| MSRs (4)                                      | —                    | —       | 2,011    | —            |
| Total   | \$—                  | \$231   | \$36,384 | \$4,099      |

(1) The loss represents charge-offs on collateral dependent loans for estimated fair value adjustment based on the estimated fair value of the collateral. Fair value is the recorded investment less the related allowance.

(2) The loss represents OTTI credit-related charges on held-to-maturity MBS.

The loss represents the results of management's periodic reviews of the recorded value to determine whether the (3) property continues to be recorded at the lower of its recorded book value or estimated fair value, net of estimated costs to sell.

The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights exceed their (4) estimated fair value. Impairment, if deemed temporary, is recognized through a valuation allowance to the extent that estimated fair value is less than the recorded amount.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at the date indicated (dollars in thousands):

| June 30, 2013           |            |                        |  |       |
|-------------------------|------------|------------------------|--|-------|
|                         | Fair Value | Valuation Technique(s) | Unobservable Input(s)  | Range |
| Impaired loans          | \$17,754   | Market approach        | Appraised value of underlying collateral less selling costs  | NA    |
| Other real estate owned | \$15,314   | Market approach        | Lower of appraised value or listing price less selling costs | NA    |



The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the estimated fair value of the Company's financial instruments will change when interest rate levels change, and that change may either be favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to appropriately manage interest rate risk. However, borrowers with fixed interest rate obligations are less likely to prepay in a rising interest rate environment and more likely to prepay in a falling interest rate environment. Conversely, depositors who are receiving fixed interest rates are more likely to withdraw funds before maturity in a rising interest rate environment and less likely to do so in a falling interest rate environment. Management monitors interest rates and maturities of assets and liabilities, and attempts to manage interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

The following methods and assumptions were used by the Company in estimating fair value of its other financial instruments:

**Cash and Cash Equivalents:** The estimated fair value of financial instruments that are short-term or re-price frequently and that have little or no risk are considered to have an estimated fair value equal to the recorded value.

**CDs Held for Investment:** The estimated fair value of financial instruments that are short-term or re-price frequently and that have little or no risk are considered to have an estimated fair value equal to the recorded value.

**FHLB Stock:** No ready market exists for this stock, and it has no quoted market value. However, redemption of this stock has historically been at par value. Accordingly, cost is deemed to be a reasonable estimate of fair value.

**Loans Receivable, Net:** At June 30, 2013, the fair value of loans was estimated using a discounted cash flow analysis and comparable market statistics. A discounted cash flow analysis was used to estimate the fair value of loans graded pass. The fair value of loans graded watch, special mention and substandard was estimated using comparable market statistics that approximated sales of similarly rated loans. At September 30, 2012, the fair value of loans was estimated using comparable market statistics that approximated sales of similar types of loans.

**Loans Held for Sale:** The estimated fair value is based on quoted market prices obtained from the Federal Home Loan Mortgage Corporation.

**Accrued Interest:** The recorded amount of accrued interest approximates the estimated fair value.

**Deposits:** The estimated fair value of deposits with no stated maturity date is included at the amount payable on demand. The estimated fair value of fixed maturity certificates of deposit is computed by discounting future cash flows using the rates currently offered by the Bank for deposits of similar remaining maturities.

**FHLB Advances:** The estimated fair value of FHLB advances is computed by discounting the future cash flows of the borrowings at a rate which approximates the current offering rate of the borrowings with a comparable remaining life.

**Repurchase Agreements:** The recorded value of repurchase agreements approximates the estimated fair value due to the short-term nature of the borrowings.

**Off-Balance-Sheet Instruments:** Since the majority of the Company's off-balance-sheet instruments consist of variable-rate commitments, the Company has determined that they do not have a distinguishable estimated fair value.



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The estimated fair values of financial instruments were as follows as of June 30, 2013 and September 30, 2012 (dollars in thousands):

|                                | June 30, 2013   |          |          |         |         |
|--------------------------------|-----------------|----------|----------|---------|---------|
|                                | Recorded Amount | Total    | Level 1  | Level 2 | Level 3 |
| Fair Value Measurements Using: |                 |          |          |         |         |
| Financial Assets               |                 |          |          |         |         |
| Cash and cash equivalents      | \$82,545        | \$82,545 | \$82,545 | \$—     | \$—     |
| CDs held for investment        | 26,749          | 26,749   | 26,749   | —       | —       |
| MBS and other investments      | 7,262           | 8,009    | 961      | 7,048   | —       |
| FHLB stock                     | 5,502           | 5,502    | 5,502    | —       | —       |
| Loans receivable, net          | 542,855         | 499,540  | —        | —       | 499,540 |
| Loans held for sale            | 2,433           | 2,523    | 2,523    | —       | —       |
| Accrued interest receivable    | 2,015           | 2,015    | 2,015    | —       | —       |
| Financial Liabilities          |                 |          |          |         |         |
| Deposits:                      |                 |          |          |         |         |
| Non-interest-bearing demand    | \$83,043        | \$83,043 | \$83,043 | \$—     | \$—     |
| Interest-bearing               | 513,021         | 514,524  | 331,539  | —       | 182,985 |
| Total deposits                 | 596,064         | 597,567  | 414,582  | —       | 182,985 |
| FHLB advances                  | 45,000          | 48,583   | —        | 48,583  | —       |
| Accrued interest payable       | 336             | 336      | 336      | —       | —       |

|                                | September 30, 2012 |          |          |         |         |
|--------------------------------|--------------------|----------|----------|---------|---------|
|                                | Recorded Amount    | Total    | Level 1  | Level 2 | Level 3 |
| Fair Value Measurements Using: |                    |          |          |         |         |
| Financial Assets               |                    |          |          |         |         |
| Cash and cash equivalents      | \$96,668           | \$96,668 | \$96,668 | \$—     | \$—     |
| CDs held for investment        | 23,490             | 23,490   | 23,490   | —       | —       |
| MBS and other investments      | 8,284              | 8,577    | 1,043    | 7,534   | —       |
| FHLB stock                     | 5,655              | 5,655    | 5,655    | —       | —       |
| Loans receivable, net          | 537,053            | 502,147  | —        | —       | 502,147 |
| Loans held for sale            | 1,427              | 1,504    | 1,504    | —       | —       |
| Accrued interest receivable    | 2,183              | 2,183    | 2,183    | —       | —       |
| Financial Liabilities          |                    |          |          |         |         |
| Deposits:                      |                    |          |          |         |         |
| Non-interest-bearing demand    | \$75,296           | \$75,296 | \$75,296 | \$—     | \$—     |
| Interest-bearing               | 522,630            | 524,823  | 317,181  | —       | 207,642 |
| Total deposits                 | 597,926            | 600,119  | 392,477  | —       | 207,642 |
| FHLB advances                  | 45,000             | 51,115   | —        | 51,115  | —       |
| Repurchase agreements          | 855                | 855      | 855      | —       | —       |
| Accrued interest payable       | 404                | 404      | 404      | —       | —       |

(9) RECENT ACCOUNTING PRONOUNCEMENTS



In February 2013, the FASB issued updated guidance regarding reporting amounts reclassified out of accumulated other comprehensive income. The guidance requires an entity to provide information about the amount reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments were effective for annual and interim reporting periods beginning on or after December 15, 2012. The adoption of this updated guidance did not have a material impact on the Company's condensed consolidated financial statements.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

As used in this Form 10-Q, the terms "we," "our" and "Company" refer to Timberland Bancorp, Inc. and its consolidated subsidiaries, unless the context indicates otherwise. When we refer to "Bank" in this Form 10-Q, we are referring to Timberland Bank, a wholly-owned subsidiary of Timberland Bancorp, Inc. and the Bank's wholly-owned subsidiary, Timberland Service Corporation.

The following analysis discusses the material changes in the condensed consolidated financial condition and results of operations of the Company at and for the three and nine months ended June 30, 2013. This analysis as well as other sections of this report contains certain "forward-looking statements."

Certain matters discussed in this Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 concerning our future operations. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and often include the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "projects," "outlook" or similar expressions or future or conditional verbs such as "may," "will," "should," "would" and "could." Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about future economic performance and projections of financial items. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from the results anticipated or implied by our forward-looking statements, including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets which may lead to increased losses and non-performing assets in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our loan loss reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market areas; secondary market conditions for loans and our ability to sell loans in the secondary market; results of examinations of us by the Board of Governors of the Federal Reserve System and our bank subsidiary by the Federal Deposit Insurance Corporation, the Washington State Department of Financial Institutions, Division of Banks or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, institute a formal or informal enforcement action against us or our bank subsidiary which could require us to increase our allowance for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits or impose additional requirements and restrictions on us, any of which could adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules, including as a result of Basel III; the impact of the Dodd-Frank Wall Street Reform

and Consumer Protection Act and implementing regulations; our ability to attract and retain deposits; increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our consolidated balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; the failure or security breach of computer systems on which we depend; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our business strategies; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; the availability of resources to

address changes in laws, rules, or regulations or to respond to regulatory actions; our ability to pay dividends on our common and preferred stock; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the FASB, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks detailed in our reports filed with the Securities and Exchange Commission, including our 2012 Form 10-K.

Any of the forward-looking statements that we make in this Form 10-Q and in the other public statements we make are based upon management's beliefs and assumptions at the time they are made. We do not undertake and specifically disclaim any obligation to publicly update or revise any forward-looking statements included in this report or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. We caution readers not to place undue reliance on any forward-looking statements. These risks could cause our actual results for fiscal 2013 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of us, and could negatively affect the Company's financial condition and results of operations as well as its stock price performance.

## Overview

Timberland Bancorp, Inc., a Washington corporation, is the holding company for Timberland Bank. The Bank opened for business in 1915 and serves consumers and businesses across Grays Harbor, Thurston, Pierce, King, Kitsap and Lewis counties, Washington with a full range of lending and deposit services through its 22 branches (including its main office in Hoquiam). At June 30, 2013, the Company had total assets of \$732.78 million and total shareholders' equity of \$89.23 million. The Company's business activities generally are limited to passive investment activities and oversight of its investment in the Bank. Accordingly, the information set forth in this report relates primarily to the Bank's operations.

The profitability of the Company's operations depends primarily on its net interest income after provision for loan losses. Net interest income is the difference between interest income, which is the income that the Company earns on interest-earning assets, which are primarily loans and investments, and interest expense, the amount the Company pays on its interest-bearing liabilities, which are primarily deposits and borrowings. Net interest income is affected by changes in the volume and mix of interest earning assets, interest earned on those assets, the volume and mix of interest bearing liabilities and interest paid on those interest bearing liabilities. Management strives to match the re-pricing characteristics of the interest earning assets and interest bearing liabilities to protect net interest income from changes in market interest rates and changes in the shape of the yield curve.

The provision for loan losses is dependent on changes in the loan portfolio and management's assessment of the collectability of the loan portfolio as well as prevailing economic and market conditions. The provision for loan losses reflects the amount that the Company believes is adequate to cover estimated credit losses in its loan portfolio.

Net income is also affected by non-interest income and non-interest expenses. For the three and nine month periods ended June 30, 2013, non-interest income consisted primarily of service charges on deposit accounts, gain on sale of loans, ATM and debit card interchange transaction fees, an increase in the cash surrender value of life insurance and other operating income. Non-interest income is increased by valuation recoveries on MSRs and reduced by valuation allowances on MSRs. Non-interest income is reduced by net OTTI losses on MBS and other investments. Non-interest expenses consisted primarily of salaries and employee benefits, premises and equipment, advertising, ATM expenses, OREO expenses, postage and courier expenses, professional fees, deposit insurance premiums, other insurance premiums, state and local taxes, loan administration and foreclosure expenses, deposit

operation expenses and data processing expenses and telecommunication expenses. Non-interest income and non-interest expenses are affected by the growth of our operations and growth in the number of loan and deposit accounts.

Results of operations may be affected significantly by general and local economic and competitive conditions, changes in market interest rates, governmental policies and actions of regulatory authorities.

The Bank is a community-oriented bank which has traditionally offered a variety of savings products to its retail customers while concentrating its lending activities on real estate mortgage loans. Lending activities have been focused primarily on the origination of loans secured by real estate, including residential construction loans, one- to four-family residential loans, multi-family loans, commercial real estate loans and land loans. The Bank originates adjustable-rate residential mortgage loans that do not qualify for sale in the secondary market. The Bank also originates commercial business loans.

## Critical Accounting Policies and Estimates

The Company has identified several accounting policies that as a result of judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company's Condensed Consolidated Financial Statements. Critical accounting policies and estimates are discussed in the Company's 2012 Form 10-K under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation – Critical Accounting Policies and Estimates." That discussion highlights estimates the Company makes that involve uncertainty or potential for substantial change. There have not been any material changes in the Company's critical accounting policies and estimates as compared to the disclosure contained in the Company's 2012 Form 10-K.

## Comparison of Financial Condition at June 30, 2013 and September 30, 2012

The Company's total assets decreased by \$4.18 million, or 0.6%, to \$732.78 million at June 30, 2013 from \$736.95 million at September 30, 2012. The decrease in total assets was primarily due to a decrease in total cash and cash equivalents, which was partially offset by increases in net loans receivable, CDs held for investment and OREO and other repossessed assets.

Net loans receivable increased by \$6.81 million, or 1.3%, to \$545.29 million at June 30, 2013 from \$538.48 million at September 30, 2012. The increase was primarily due to an increase in commercial real estate loan balances and, to a much lesser extent, multi-family loan balances. These increases were partially offset by decreases in construction and land development and land loan balances, and to a much lesser extent, the balances of all other loan categories.

Total deposits decreased by \$1.86 million, or 0.3%, to \$596.06 million at June 30, 2013 from \$597.93 million at September 30, 2012, primarily as a result of decreases in non-brokered certificates of deposit account balances, partially offset by increases in all other deposit account balances.

Shareholders' equity decreased by \$1.09 million, or 1.2%, to \$89.23 million at June 30, 2013 from \$90.32 million at September 30, 2012. The decrease in shareholders' equity was primarily a result of the repurchase of 4,576 shares of Series A Preferred Stock and the payment of dividends on preferred and common stock. These decreases to shareholder's equity were partially offset by net income for the nine months ended June 30, 2013.

A more detailed explanation of the changes in significant balance sheet categories follows:

**Cash and Cash Equivalents and CDs Held for Investment:** Cash and cash equivalents and CDs held for investment decreased by \$10.86 million, or 9.0%, to \$109.29 million at June 30, 2013 from \$120.16 million at September 30, 2012. The decrease was primarily used to fund loan growth and resulted in a \$14.12 million decrease in cash and cash equivalents, which was partially offset by a \$3.26 million increase in CDs held for investment.

**MBS (Mortgage-backed Securities) and Other Investments:** MBS and other investments decreased by \$1.02 million, or 12.3%, to \$7.26 million at June 30, 2013 from \$8.28 million at September 30, 2012, primarily as a result of scheduled amortization and prepayments on MBS. OTTI charges of \$39,000 were recorded on private label residential MBS during the nine months ended June 30, 2013. For additional information on MBS and other investments, see Note 3 of the Notes to Unaudited Condensed Consolidated Financial Statements contained in "Item 1, Financial Statements."

**Loans:** Net loans receivable increased by \$6.81 million, or 1.3%, to \$545.29 million at June 30, 2013 from \$538.48 million at September 30, 2012. The increase in the portfolio was primarily a result of a \$33.99 million increase in commercial real estate loan balances, a \$1.26 million increase in multi-family loan balances and a \$2.51 million decrease in the undisbursed portion of construction loans in process. These increases to net loans receivable were

partially offset by decreases of \$17.49 million in construction and land development loan balances, \$7.98 million in land loan balances, \$3.03 million in commercial business loan balances, \$2.20 million in one-to four-family loan balances and \$1.05 million in consumer loan balances. The increase in commercial real estate loan balances and the decrease in construction loan balances were partially due to several large commercial construction loan projects converting to permanent financing during the nine months ended June 30, 2013. The Company continued to reduce its exposure to land development and land loans. Land development loan balances decreased to \$516,000 at June 30, 2013. The land loan portfolio decreased to \$31.67 million at June 30, 2013, a 20.1% decrease from September 30, 2012. The land loan portfolio consists of 282 loans on a variety of land types including individual building lots, acreage, raw land and commercially zoned properties. The average loan balance for the entire land loan portfolio was approximately \$112,000 at June 30, 2013.

Loan originations decreased \$918,000, or 0.6%, to \$164.70 million for the nine months ended June 30, 2013 from \$165.61 million for the nine months ended June 30, 2012. The Company continued to sell longer-term fixed rate loans for asset liability management purposes and to generate non-interest income. The Company sold fixed rate one-to-four-family mortgage loans totaling \$74.61 million for the nine months ended June 30, 2013 compared to \$68.81 million for the nine months ended June 30, 2012.

For additional information, see Note 5 of the Notes to Unaudited Condensed Consolidated Financial Statements contained in "Item 1, Financial Statements."

**Premises and Equipment:** Premises and equipment increased by \$157,000, or 0.9%, to \$18.04 million at June 30, 2013 from \$17.89 million at September 30, 2012. The increase was primarily due to several remodeling projects at branch offices.

**OREO (Other Real Estate Owned):** OREO and other repossessed assets increased by \$2.01 million, or 15.1%, to \$15.31 million at June 30, 2013 from \$13.30 million at September 30, 2012. The increase was primarily due to the addition of \$5.92 million in OREO properties and other repossessed assets and was partially offset by the disposition of \$3.15 million in OREO properties and other repossessed assets and lower of cost or fair value losses of \$759,000.

At June 30, 2013, total OREO and consisted of 51 individual properties. The properties consisted of eight commercial real estate properties totaling \$6.06 million, 29 land parcels totaling \$5.24 million, 11 single family homes totaling \$1.48 million and three multi-family properties totaling \$2.41 million. Other repossessed assets totaled \$125,000 at June 30, 2013.

**Goodwill and CDI:** The recorded amount of goodwill of \$5.65 million at June 30, 2013 was unchanged from September 30, 2012. The recorded amount of the CDI decreased \$98,000, or 39.4%, to \$151,000 at June 30, 2013 from \$249,000 at September 30, 2012. The decrease was attributable to scheduled amortization of the CDI.

**Prepaid FDIC Insurance Assessment:** The prepaid FDIC insurance assessment decreased to \$0 at June 30, 2013 from \$1.19 million at September 30, 2012 as a portion of the prepaid amount was expensed and the FDIC returned the remaining prepaid balance.

**Deposits:** Deposits decreased by \$1.87 million, or 0.3%, to \$596.06 million at June 30, 2013 from \$597.93 million at September 30, 2012. The decrease was primarily the result of a \$25.16 million decrease in non-brokered certificates of deposit account balances. This decrease was partially offset by increases of \$7.75 million in non-interest account balances, \$6.15 million in money market accounts, \$5.67 million in savings account balance, \$2.54 million in N.O.W. checking account balances and \$1.19 million in brokered certificates of deposit account balances. The decrease in non-brokered certificates of deposit balances was primarily due the Company reducing interest rates for certificate of deposit accounts offered and focusing marketing efforts on transaction accounts.

**FHLB Advances:** The Company has short- and long-term borrowing lines with the FHLB with total credit available on the lines equal to 25% of the Bank's total assets, limited by available collateral. Borrowings are considered short-term when the original maturity is less than one year. At June 30, 2013 FHLB advances and other borrowings consisted of long-term FHLB advances with scheduled maturities at various dates in fiscal 2017 and bear interest at rates ranging from 3.69% to 4.34%. A portion of these advances may be called by the FHLB at a date earlier than the scheduled maturity date. FHLB advances remained unchanged at \$45.00 million at both June 30, 2013 and September 30, 2012.

**Shareholders' Equity:** Total shareholders' equity decreased by \$1.09 million, or 1.2%, to \$89.23 million at June 30, 2013 from \$90.32 million at September 30, 2012. The decrease was primarily due to the repurchase of 4,576 shares of Series A Preferred Stock for \$4.32 million and the payment of \$1.01 million in dividends on common and preferred stock. These decreases to shareholders' equity were partially offset by net income of \$3.86 million for the nine months

ended June 30, 2013.

Comparison of Operating Results for the Three and Nine Months Ended June 30, 2013 and 2012

Net income decreased \$472,000, or 35.0%, to \$876,000 for the quarter ended June 30, 2013 from \$1.35 million for the quarter ended June 30, 2012. Net income to common shareholders, after adjusting for the preferred stock dividend and the preferred stock discount accretion decreased \$401,000, or 37.2%, to \$678,000 for the quarter ended June 30, 2013 from \$1.08 million for the quarter ended June 30, 2012. The decrease in earnings for the quarter was primarily a result of increased provision for loan losses, increased non-interest expenses and decreased net interest income, which was partially offset by increased non-interest income. Net income per diluted common share decreased \$0.06, or 37.5%, to \$0.10 for the quarter ended June 30, 2013 from \$0.16 for the quarter ended June 30, 2012.

Net income increased \$425,000, or 12.4%, to \$3.86 million for the nine months ended June 30, 2013 from \$3.44 million for the nine months ended June 30, 2012. Net income to common shareholders after adjusting for the preferred stock dividend, the preferred stock discount accretion and the repurchase of preferred stock at a discount increased \$688,000, or 26.1%, to \$3.32 million for the nine months ended June 30, 2013 from \$2.64 million for the nine months ended June 30, 2012. The increase in earnings for the nine months ended June 30, 2013 was primarily a result of increased non-interest income, increased net interest income and decreased non-interest expenses, which were partially offset by increased provision for loan losses. Net income per diluted common share increased \$0.09, or 23.1%, to \$0.48 for the nine months ended June 30, 2013 from \$0.39 for the nine months ended June 30, 2012.

A more detailed explanation of the income statement categories is presented below.

**Net Interest Income:** Net interest income decreased by \$129,000, or 1.9%, to \$6.50 million for the quarter ended June 30, 2013 from \$6.63 million for the quarter ended June 30, 2012. The decrease in net interest income was primarily attributable to a decrease in the net interest margin to 3.88% for the quarter ended June 30, 2013 from 3.96% for the quarter ended June 30, 2012 as the decrease in interest income was greater than the decrease in interest expense.

Total interest and dividend income decreased by \$444,000 or 5.5%, to \$7.58 million for the quarter ended June 30, 2013 from \$8.02 million for the quarter ended June 30, 2012 as the yield on interest bearing assets decreased to 4.52% from 4.79%. The decrease in the weighted average yield on interest bearing assets was primarily a result of decreased market rates for loans. Total interest expense decreased by \$315,000, or 22.6%, to \$1.08 million for the quarter ended June 30, 2013 from \$1.39 million for the quarter ended June 30, 2012 as the average rate paid on interest bearing liabilities decreased to 0.77% for the quarter ended June 30, 2013 from 0.98% for the quarter ended June 30, 2012. The decrease in funding costs was primarily a result of a CDs repricing at lower market rates and changes in the composition of the deposit base as the percentage of non-interest bearing and lower costing transaction accounts increased.

Net interest income increased by \$128,000, or 0.7%, to \$19.33 million for the nine months ended June 30, 2013 from \$19.20 million for the nine months ended June 30, 2012. The net interest margin for the nine months ended June 30, 2013 increased to 3.83% from 3.80% for the nine months ended June 30, 2012 as the decrease in interest expense was greater than the decrease in interest income.

Total interest and dividend income decreased by \$1.14 million, or 4.8%, to \$22.72 million for the nine months ended June 30, 2013 from \$23.86 million for the nine months ended June 30, 2012 as the yield on interest bearing assets decreased to 4.50% for the nine months ended June 30, 2013 from 4.73% for the nine months ended June 30, 2012. Total interest expense decreased by \$1.27 million, or 27.2%, to \$3.39 million for the nine months ended June 30, 2013 from \$4.65 million for the nine months ended June 30, 2012 as the average rate paid on interest bearing liabilities decreased to 0.80% for the nine months ended June 30, 2013 from 1.08% for the nine months ended June 30, 2012.

## Average Balances, Interest and Average Yields/Cost

The following tables sets forth, for the periods indicated, information regarding average balances of assets and liabilities as well as the total dollar amounts of interest income from average interest-bearing assets and interest expense on average interest-bearing liabilities and average yields and costs. Such yields and costs for the periods indicated are derived by dividing income or expense by the average daily balance of assets or liabilities, respectively, for the periods presented. (Dollars in thousands)

|  | Three Months Ended June 30, |                        |             |                 |                        |             |   |
|--|-----------------------------|------------------------|-------------|-----------------|------------------------|-------------|---|
|  | 2013                        |                        |             | 2012            |                        |             |   |
|  | Average Balance             | Interest and Dividends | Yield/ Cost | Average Balance | Interest and Dividends | Yield/ Cost |   |
| Interest-bearing assets: (1)   |                             |                        |             |                 |                        |             |   |
| Loans receivable (2)   | \$557,234                   | \$7,422                | 5.33        | % \$548,450     | \$7,842                | 5.72        | % |
| MBS and other investments (2)  | 6,448                       | 69                     | 4.28        | 7,824           | 89                     | 4.55        |   |
| FHLB stock and equity securities   | 6,540                       | 5                      | 0.31        | 6,706           | 6                      | 0.36        |   |
| Interest-bearing deposits  | 100,020                     | 79                     | 0.32        | 106,735         | 82                     | 0.31        |   |
| Total interest-bearing assets  | 670,242                     | 7,575                  | 4.52        | 669,715         | 8,019                  | 4.79        |   |
| Non-interest-bearing assets  | 67,545                      |                        |             | 63,528          |                        |             |   |
| Total assets   | \$737,787                   |                        |             | \$733,243       |                        |             |   |
| Interest-bearing liabilities:  |                             |                        |             |                 |                        |             |   |
| Savings accounts   | \$92,187                    | 11                     | 0.05        | \$88,696        | 54                     | 0.24        |   |
| Money market accounts  | 87,047                      | 61                     | 0.28        | 71,122          | 81                     | 0.46        |   |
| N.O.W. accounts  | 152,712                     | 115                    | 0.30        | 151,578         | 150                    | 0.40        |   |
| Certificates of deposit  | 184,613                     | 422                    | 0.92        | 212,854         | 640                    | 1.21        |   |
| Short-term borrowings  | 162                         | —                      | 0.05        | 818             | —                      | 0.05        |   |
| Long-term borrowings (3)   | 45,000                      | 467                    | 4.16        | 45,000          | 466                    | 4.15        |   |
| Total interest-bearing liabilities   | 561,721                     | 1,076                  | 0.77        | 570,068         | 1,391                  | 0.98        |   |
| Non-interest-bearing liabilities   | 87,131                      |                        |             | 74,640          |                        |             |   |
| Total liabilities  | 648,852                     |                        |             | 644,708         |                        |             |   |
| Shareholders' equity   | 88,935                      |                        |             | 88,535          |                        |             |   |
| Total liabilities and shareholders' equity                                       | \$737,787                   |                        |             | \$733,243       |                        |             |   |
| Net interest income  |                             | \$6,499                |             |                 | \$6,628                |             |   |
| Interest rate spread   |                             |                        | 3.75        | %               |                        | 3.81        | % |
| Net interest margin (4)  |                             |                        | 3.88        | %               |                        | 3.96        | % |
| Ratio of average interest-bearing assets to average interest-bearing liabilities |                             |                        | 119.32      | %               |                        | 117.48      | % |

(1) Interest yield on loans and MBS is calculated assuming a 30/360 basis; interest yield on all other categories is based on daily interest basis.

(2) Average balances include loans and MBS on non-accrual status.

(3) Includes FHLB advances with original maturities of one year or greater.

(4) Net interest income divided by total average interest-bearing assets, annualized.



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|  | Nine Months Ended June 30,<br>2013 |                           |                | 2012 |                    |                           |                |   |
|--|------------------------------------|---------------------------|----------------|------|--------------------|---------------------------|----------------|---|
|  | Average<br>Balance                 | Interest and<br>Dividends | Yield/<br>Cost |      | Average<br>Balance | Interest and<br>Dividends | Yield/<br>Cost |   |
| Interest-bearing assets: (1)   |                                    |                           |                |      |                    |                           |                |   |
| Loans receivable (2)   | \$556,014                          | \$22,231                  | 5.33           | %    | \$542,378          | \$23,254                  | 5.72           | % |
| MBS and other investments (2)  | 6,755                              | 216                       | 4.26           |      | 8,825              | 323                       | 4.88           |   |
| FHLB stock and equity securities   | 6,597                              | 22                        | 0.45           |      | 6,704              | 26                        | 0.52           |   |
| Interest-bearing deposits  | 103,789                            | 247                       | 0.32           |      | 115,142            | 252                       | 0.29           |   |
| Total interest-bearing assets  | 673,155                            | 22,716                    | 4.50           |      | 673,049            | 23,855                    | 4.73           |   |
| Non-interest-bearing assets  | 65,662                             |                           |                |      | 61,089             |                           |                |   |
| Total assets   | \$738,817                          |                           |                |      | \$734,138          |                           |                |   |
| Interest-bearing liabilities:  |                                    |                           |                |      |                    |                           |                |   |
| Savings accounts   | \$89,894                           | 43                        | 0.06           |      | \$86,664           | 214                       | 0.33           |   |
| Money market accounts  | 84,900                             | 188                       | 0.30           |      | 67,655             | 263                       | 0.52           |   |
| N.O.W. accounts  | 151,154                            | 350                       | 0.31           |      | 153,829            | 516                       | 0.45           |   |
| Certificates of deposit  | 192,287                            | 1,406                     | 0.98           |      | 218,535            | 2,135                     | 1.30           |   |
| Short-term borrowings  | 470                                | —                         | 0.05           |      | 671                | —                         | 0.05           |   |
| Long-term borrowings (3)   | 45,000                             | 1,399                     | 4.16           |      | 48,467             | 1,525                     | 4.19           |   |
| Total interest-bearing liabilities   | 563,705                            | 3,386                     | 0.80           |      | 575,821            | 4,653                     | 1.08           |   |
| Non-interest-bearing liabilities   | 84,546                             |                           |                |      | 70,769             |                           |                |   |
| Total liabilities  | 648,251                            |                           |                |      | 646,590            |                           |                |   |
| Shareholders' equity   | 90,566                             |                           |                |      | 87,548             |                           |                |   |
| Total liabilities and shareholders' equity                                       | \$738,817                          |                           |                |      | \$734,138          |                           |                |   |
| Net interest income  |                                    | \$19,330                  |                |      |                    | \$19,202                  |                |   |
| Interest rate spread   |                                    |                           | 3.70           | %    |                    |                           | 3.65           | % |
| Net interest margin (4)  |                                    |                           | 3.83           | %    |                    |                           | 3.80           | % |
| Ratio of average interest-bearing assets to average interest-bearing liabilities |                                    |                           | 119.42         | %    |                    |                           | 116.89         | % |

(1) Interest yield on loans and MBS is calculated assuming a 30/360 basis; interest yield on all other categories is based on daily interest basis.

(2) Average balances include loans and MBS on non-accrual status.

(3) Includes FHLB advances with original maturities of one year or greater.

(4) Net interest income divided by total average interest-bearing assets, annualized.

## Rate Volume Analysis

The following table sets forth the effects of changing rates and volumes on the net interest income of the Company. Information is provided with respect to the (i) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate), and (ii) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume), and (iii) the net change (sum of the prior columns). Changes in rate/volume have been allocated to rate and volume variances based on the absolute values of each. (Dollars in thousands)

|  | Three months ended June 30, 2013<br>compared to three months<br>ended June 30, 2012<br>increase (decrease) due to |        |               | Nine months ended June 30, 2013<br>compared to nine months ended<br>June 30, 2012<br>increase (decrease) due to |        |               |
|--|---|--------|---------------|---|--------|---------------|
|  | Rate  | Volume | Net<br>Change | Rate  | Volume | Net<br>Change |
| <b>Interest-bearing assets:</b>                                    |   |        |               |   |        |               |
| Loans receivable (1)   | \$(540 )  | \$120  | \$(420 )      | \$(1,029 )  | \$6    | \$(1,023 )    |
| MBS and other investments  | (5 )  | (15 )  | (20 )         | (37 )   | (70 )  | (107 )        |
| FHLB stock and equity securities                                   | (1 )  | —      | (1 )          | (4 )  | —      | (4 )          |
| Interest-bearing deposits  | 2   | (5 )   | (3 )          | 5   | (10 )  | (5 )          |
| Total net (decrease) increase in income on interest-bearing assets | (544 )  | 100    | (444 )        | (1,065 )  | (74 )  | (1,139 )      |
| <b>Interest-bearing liabilities:</b>                               |   |        |               |   |        |               |
| Savings accounts   | (45 )   | 2      | (43 )         | (169 )  | (2 )   | (171 )        |
| N.O.W accounts   | (36 )   | 1      | (35 )         | (157 )  | (9 )   | (166 )        |
| Money market accounts  | (36 )   | 16     | (20 )         | (75 )   | —      | (75 )         |
| Certificates of deposit accounts                                   | (140 )  | (78 )  | (218 )        | (494 )  | (236 ) | (730 )        |
| Long-term borrowings   | 1   | —      | 1             | (17 )   | (108 ) | (125 )        |
| Total net decrease in expense on interest-bearing liabilities      | (256 )  | (59 )  | (315 )        | (912 )  | (355 ) | (1,267 )      |
| Net increase (decrease) in net interest income                     | \$(288 )  | \$159  | \$(129 )      | \$(153 )  | \$281  | \$128         |

(1) Excludes interest on non-accrual loans. Includes loans originated for sale.

**Provision for Loan Losses:** The provision for loan losses increased \$485,000, or 53.9%, to \$1.39 million for the quarter ended June 30, 2013 from \$900,000 for the quarter ended June 30, 2012. Net charge-offs for the quarter ended June 30, 2013 increased to \$1.57 million from \$1.56 million for the quarter ended June 30, 2012. The increase in the provision for the quarter ended June 30, 2013 compared to the quarter ended June 30, 2012 was primarily due to changes in the level of specific reserves on impaired loans. During the quarter ended June 30, 2013, the specific reserves on impaired loans increased \$98,000 to \$2.89 million and during the quarter ended June 30, 2012, the specific reserves on impaired loans decreased \$296,000 to \$2.69 million.

The provision for loan losses increased \$160,000, or 6.2% to \$2.76 million for the nine months ended June 30, 2013 from \$2.60 million for the nine months ended June 30, 2012. Net charge-offs for the nine months ended June 30, 2013 increased to \$3.46 million from \$2.94 million for the nine months ended June 30, 2012. The increase in the provision for loan losses for the nine months ended June 30, 2013 was primarily due to an increase in the level of net charge-offs. Partially offsetting the increase in net charge-offs was a reduction in non-accrual loans and a change in the composition of the loan portfolio.

The Company has established a comprehensive methodology for determining the provision for loan losses. On a quarterly basis the Company performs an analysis that considers pertinent factors underlying the quality of the loan portfolio. The factors include changes in the amount and composition of the loan portfolio, historic loss experience for various loan segments, changes in economic conditions, delinquency rates, a detailed analysis of impaired loans, and other factors to determine an appropriate level of allowance for loan losses. Based on its comprehensive analysis, management believes the allowance for loan losses of \$11.13 million at June 30, 2013 (2.00% of loans receivable and loans held for sale and 92.8% of non-performing

loans) was adequate to provide for probable losses based on an evaluation of known and inherent risks in the loan portfolio at that date. Impaired loans are subjected to an impairment analysis to determine an appropriate reserve amount to be allocated to each loan. The aggregate principal impairment reserve amount determined at June 30, 2013 was \$2.89 million compared to \$2.69 million at June 30, 2012. The allowance for loan losses was \$11.60 million (2.11% of loans receivable and loans held for sale and 46.5% of non-performing loans) at June 30, 2012.

While management believes the estimates and assumptions used in its determination of the adequacy of the allowance are reasonable, there can be no assurance that such estimates and assumptions will not be proved incorrect in the future, or that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provisions that may be required will not adversely impact the Company's consolidated financial condition and results of operations. In addition, the determination of the amount of the Company's allowance for loan losses is subject to review by bank regulators as part of the routine examination process, which may result in the establishment of additional reserves based upon their analysis of information available to them at the time of their examination. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations. For additional information, see Note 6 of the Notes to Unaudited Condensed Consolidated Financial Statements contained in "Item 1, Financial Statements."

Non-interest Income: Total non-interest income increased \$31,000 or 1.3%, to \$2.37 million for the quarter ended June 30, 2013 from \$2.34 million for the quarter ended June 30, 2012 primarily due to an \$82,000 decrease in the valuation allowance on MSR's and smaller increases in several categories, which were partially offset by a \$73,000 decrease in service charges on deposits.

Total non-interest income increased \$587,000, or 8.1%, to \$7.87 million for the nine months ended June 30, 2013 from \$7.28 million for the nine months ended June 30, 2012. The increase was primarily due to a \$332,000 increase in gain on sales of loans and a \$331,000 increase in the valuation recovery on MSR's. The increase in gain on sale of loans was primarily a result of an increased volume of fixed rate one-to four-family loans sold and an increased profit margin during the nine months ended June 30, 2013. The recent increase in mortgage rates may, however, reduce future volumes of loans originated for sale as refinancing activity declines.

The valuation allowance or recovery on MSR's was based on a third party valuation of the MSR asset. The Company recorded a valuation allowance on MSR's of \$82,000 for the three months ended June 30, 2012 and valuation recoveries of \$475,000 and \$144,000 for the nine months ended June 30, 2013 and 2012, respectively. At June 30, 2013, the MSR asset had no remaining valuation allowance available for future recovery.

Non-interest Expense: Total non-interest expense increased by \$140,000, or 2.3%, to \$6.24 million for the quarter ended June 30, 2013 from \$6.10 million for the quarter ended June 30, 2012. The increase was primarily the result of a \$170,000 increase in salary and employee expenses and a \$92,000 increase in premises and equipment expenses. These increases were partially offset by an \$80,000 decrease in FDIC insurance expense and a \$50,000 decrease in OREO and other repossessed assets expense. The increase in salary and employee benefits expense was primarily due to annual salary adjustments implemented during the quarter ended December 31, 2012 and the hiring of additional lending department personnel. The increase in premises and equipment expense was primarily due to increased depreciation expense from the recent remodel of several offices and increased equipment maintenance expenses. The decrease in FDIC insurance expense was primarily due to lower assessment rates. The decrease in OREO and other repossessed assets expense was primarily due to gains on sale of OREO properties that reduced the expense for the quarter ended June 30, 2013.

Total non-interest expense decreased \$93,000, or 0.5%, to \$18.80 million for the nine months ended June 30, 2013 from \$18.89 million for the nine months ended June 30, 2012. The decrease was primarily due to a \$337,000 decrease in loan administration and foreclosure expenses and a \$192,000 decrease in OREO and other repossessed assets expense. These decreases were partially offset by a \$387,000 increase in salaries and employee benefits expense. The

decrease in loan administration and foreclosures expenses were primarily due to a reduction in loans in the foreclosures process. The decrease in OREO and other repossessed assets expense was primarily due to gains on sale of OREO properties that reduced the expense for the nine months ended June 30, 2013. The increase in salaries and employee benefits expense was primarily due to annual salary adjustments implemented during the quarter ended December 31, 2012, the hiring of additional lending department personnel and a one-time benefit from changing the Company's employee medical insurance provider during the comparable period one year ago. This one-time benefit reduced the salaries and employee benefits expense for the nine months ended June 30, 2012 by \$99,000.

Provision for Federal and State Income Taxes: The provision for federal and state income taxes decreased \$251,000, or 40.2%, to \$373,000 for the quarter ended June 30, 2013 from \$624,000 for the quarter ended June 30, 2012, primarily as a

result of decreased income before taxes. The Company's effective tax rate was 29.86% for the quarter ended June 30, 2013 and 31.64% for the quarter ended June 30, 2012.

The provision for federal and state income taxes increased \$223,000, or 14.4%, to \$1.77 million for the nine months ended June 30, 2013 from \$1.55 million for the nine months ended June 30, 2012, primarily due to increased income before taxes. The Company's effective tax rate was 31.47% for the nine months ended June 30, 2013 and 31.09% for the nine months ended June 30, 2012.

#### Liquidity

The Company's primary sources of funds are customer deposits, proceeds from principal and interest payments on loans and MBS, proceeds from the sale of loans, proceeds from maturing securities and maturing CDs held for investment, FHLB advances, and other borrowings. While maturities and the scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

Liquidity management is both a short and long-term responsibility of the Bank's management. The Bank adjusts its investments in liquid assets based upon management's assessment of (i) expected loan demand, (ii) projected loan sales, (iii) expected deposit flows, and (iv) yields available on interest-bearing deposits. Excess liquidity is invested generally in interest-bearing overnight deposits and other short-term investments

The Bank generally maintains sufficient cash and short-term investments to meet short-term liquidity needs. At June 30, 2013, the Bank's regulatory liquidity ratio (net cash, and short-term and marketable assets, as a percentage of net deposits and short-term liabilities) was 16.9%.

The Company's total cash and cash equivalents decreased by \$14.12 million, or 14.6% to \$82.55 million at June 30, 2013 from \$96.67 million at September 30, 2012. If the Bank requires funds that exceed its ability to generate them internally, it has additional borrowing capacity with the FHLB and the Federal Reserve Bank of San Francisco ("FRB"). At June 30, 2013 the Bank maintained an uncommitted credit facility with the FHLB that provided for immediately available advances up to an aggregate amount equal to 25% of total assets, limited by available collateral, under which \$45.00 million was outstanding and \$139.35 million was available for additional borrowings. The Bank also maintains a short-term borrowing line with the FRB with available total credit based on eligible collateral. At June 30, 2013, the Bank had \$52.77 million available for borrowings with the FRB and there was no outstanding balance on this borrowing line.

The Bank's primary investing activity is the origination of one- to four-family mortgage loans, commercial mortgage loans, construction loans, consumer loans, and commercial business loans. At June 30, 2013, the Bank had loan commitments totaling \$43.55 million and undisbursed construction loans in process totaling \$13.82 million. The Bank anticipates that it will have sufficient funds available to meet current loan commitments. CDs that are scheduled to mature in less than one year from June 30, 2013 totaled \$116.60 million. Historically, the Bank has been able to retain a significant amount of its non-brokered CDs as they mature. At June 30, 2013, the Bank had \$1.19 million in brokered CDs.

#### Capital Resources

Timberland Bancorp, Inc. is a bank holding company registered with the Federal Reserve. Bank holding companies are subject to capital adequacy requirements of the Federal Reserve under the Bank Holding Company Act of 1956, as amended and the regulations of the Federal Reserve. Timberland Bank, as a state-chartered, federally insured savings bank, is subject to the capital requirements established by the FDIC.

The capital adequacy requirements are quantitative measures established by regulation that require Timberland Bancorp, Inc. and the Bank to maintain minimum amounts and ratios of capital. Federally-insured state-chartered

banks are required to maintain minimum levels of regulatory capital. Under current FDIC regulations, insured state-chartered banks generally must maintain (i) a ratio of Tier 1 leverage capital to total assets of at least 3.0%, (4.0% to 5.0% for all but the most highly rated banks), (ii) a ratio of Tier 1 capital to risk weighted assets of at least 4.0% and (iii) a ratio of total capital to risk weighted assets of at least 8.0%. The Federal Reserve requires Timberland Bancorp, Inc. to maintain capital adequacy that generally parallels the FDIC requirements. At June 30, 2013, Timberland Bancorp, Inc. and the Bank each exceeded all applicable capital requirements.

The following table compares the Company's and the Bank's actual capital amounts at June 30, 2013 to its minimum regulatory capital requirements at that date (dollars in thousands):

|                               | Actual   |       | Regulatory Minimum To Be "Adequately Capitalized" |       | To Be "Well Capitalized" Under Prompt Corrective Action Provisions |       |
|-------------------------------|----------|-------|---|-------|--|-------|
|                               | Amount   | Ratio | Amount  | Ratio | Amount   | Ratio |
| Tier 1 leverage capital:      |          |       |   |       |  |       |
| Consolidated                  | \$84,630 | 11.55 | % \$29,314  | 4.00  | % N/A  | N/A   |
| Timberland Bank               | 81,497   | 11.13 | 29,296  | 4.00  | \$36,620   | 5.00  |
| Tier 1 risk adjusted capital: |          |       |   |       |  |       |
| Consolidated                  | 84,630   | 15.15 | 22,342  | 4.00  | N/A  | N/A   |
| Timberland Bank               | 81,497   | 14.60 | 22,335  | 4.00  | 33,503   | 6.00  |
| Total risk-based capital      |          |       |   |       |  |       |
| Consolidated                  | 91,665   | 16.41 | 44,684  | 8.00  | N/A  | N/A   |
| Timberland Bank               | 88,530   | 15.85 | 44,670  | 8.00  | 55,838   | 10.00 |

## Key Financial Ratios and Data

(Dollars in thousands, except per share data)

|                              | Three Months Ended |        | Nine Months Ended |         |   |
|------------------------------|--------------------|--------|-------------------|---------|---|
|                              | June 30, 2013      | 2012   | June 30, 2013     | 2012    |   |
| PERFORMANCE RATIOS:          |                    |        |                   |         |   |
| Return on average assets (1) | 0.47               | %0.74  | % 0.70            | % 0.62  | % |
| Return on average equity (1) | 3.94               | %6.09  | % 5.69            | % 5.24  | % |
| Net interest margin (1)      | 3.88               | %3.96  | % 3.83            | % 3.80  | % |
| Efficiency ratio             | 70.31              | %67.98 | % 69.12           | % 71.34 | % |

|  | At June 30, 2013 | At September 30, 2012 | At June 30, 2012 |
|--|------------------|-----------------------|------------------|
| BOOK VALUES:                             |                  |                       |                  |
| Book value per common share              | \$10.98          | \$10.52               | \$10.38          |
| Tangible book value per common share (2) | 10.16            | 9.68                  | 9.53             |

(1) Annualized

(2) Calculation subtracts goodwill and core deposit intangible from the equity component.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes in information concerning market risk from the information provided in the Company's Form 10-K for the fiscal year ended September 30, 2012.

## Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures: An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial

Officer and several other members of the Company's senior management as of the end of the period covered by this report. The Company's Chief Executive Officer and Chief Financial Officer concluded that as of June 30, 2013 the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is (i) accumulated and

communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner to allow timely decisions regarding required disclosure, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Changes in Internal Controls: There have been no changes in our internal control over financial reporting (as defined in 13a-15(f) of the Exchange Act) that occurred during the quarter ended June 30, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. The Company continued, however, to implement suggestions from its internal auditor and independent auditors to strengthen existing controls. The Company does not expect that its disclosure controls and procedures and internal control over financial reporting will prevent all errors and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can (b) provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns in controls or procedures can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; as over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

Neither the Company nor the Bank is a party to any material legal proceedings at this time. From time to time, the Bank is involved in various claims and legal actions arising in the ordinary course of business.

### Item 1A. Risk Factors

There have been no material changes in the Risk Factors previously disclosed in Item 1A of the Company's 2012 Form 10-K, other than the risk factors related to the Memorandum of Understanding (the "Company MOU") with the FRB. On January 15, 2013, the FRB notified the Company that the Company MOU had been rescinded.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

### Item 3. Defaults Upon Senior Securities

Not applicable.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None to be reported.

Item 6. Exhibits

(a) Exhibits

- 3.1 Articles of Incorporation of the Registrant (1)
- 3.2 Certificate of Designation relating to the Company's Fixed Rate Cumulative Perpetual Preferred Stock Series A (2)
- 3.3 Amended and Restated Bylaws of the Registrant (3)
- 4.1 Warrant to purchase shares of Company's common stock dated December 23, 2008 (2)
- 4.2 Letter Agreement (including Securities Purchase Agreement Standard Terms attached as Exhibit A) dated December 23, 2008 between the Company and the United States Department of the Treasury (2)
- 10.1 Employee Severance Compensation Plan, as revised (4)
- 10.2 Employee Stock Ownership Plan (4)
- 10.3 1999 Stock Option Plan (5)
- 10.4 Management Recognition and Development Plan (5)
- 10.5 2003 Stock Option Plan (6)
- 10.6 Form of Incentive Stock Option Agreement (7)
- 10.7 Form of Non-qualified Stock Option Agreement (7)
- 10.8 Form of Management Recognition and Development Award Agreement (7)
- 10.9 Employment Agreement with Michael R. Sand (8)
- 10.10 Employment Agreement with Dean J. Brydon (8)
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act
- 32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes Oxley Act  
The following materials from Timberland Bancorp Inc's Quarterly Report 10-Q for the quarter ended June 30, 2013, formatted on Extensible Business Reporting Language (XBRL) (a) Condensed Consolidated Balance Sheets; (b) Condensed Consolidated Statements of Income; (c) Condensed Consolidated Statements of Comprehensive Income; (d) Condensed Consolidated Statements of Shareholder's Equity; (e) Condensed Consolidated Statements of Cash Flows; and (f) Notes to Unaudited Condensed Consolidated Financial Statements (9)

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(1) Incorporated by reference to the Registrant's Registration Statement on Form S-1 (333- 35817).

(2) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on December 23, 2008.

(3) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on April 29, 2010.

(4) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 1997; and to the Registrant's Current Report on Form 8-K dated April 13, 2007, and to the Registrant's Current Report on Form 8-K dated December 18, 2007.

(5) Incorporated by reference to the Registrant's 1999 Annual Meeting Proxy Statement dated December 15, 1998.

(6) Incorporated by reference to the Registrant's 2004 Annual Meeting Proxy Statement dated December 24, 2003.

(7) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended September 30, 2005.

(8) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on March 29, 2013.

(9) Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise not subject to liability under those sections.

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.

Timberland Bancorp, Inc.

Date: August 9, 2013

By: /s/ Michael R. Sand  
Michael R. Sand  
Chief Executive Officer  
(Principal Executive Officer)

Date: August 9, 2013

By: /s/ Dean J. Brydon  
Dean J. Brydon  
Chief Financial Officer  
(Principal Financial Officer)

EXHIBIT INDEX

Exhibit No. Description of Exhibit

|      |   |
|------|---|
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act  |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act  |
| 32   | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act   |
| 101  | The following materials from Timberland Bancorp Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted on Extensible Business Reporting Language (XBRL) (a) Condensed Consolidated Balance Sheets; (b) Condensed Consolidated Statements of Income; (c) Condensed Consolidated Statements of Comprehensive Income; (d) Condensed Consolidated Statements of Shareholders' Equity; (e) Condensed Consolidated Statements of Cash Flows; and (f) Notes to Unaudited Condensed Consolidated Financial Statements* |

\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise not subject to liability under those sections.