TIMBERLAND BANCORP INC
Form 10-Q
February 10, 2012

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2011

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 X 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 X 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 X

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 JANUARY 31, 2012
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
December 31, 2011 and September 30, 2011
(Dollars in thousands, except per share amounts)
(Unaudited)

	December 31, 2011	September 30, 2011
Assets		
Cash and cash equivalents:		
Cash and due from financial institutions	$ 12,671	$ 11,455
Interest-bearing deposits in banks	98,876	100,610
Total cash and cash equivalents	111,547	112,065
Certificates of deposit ("CDs") held for investment (at cost)	19,810	18,659
Mortgage-backed securities ("MBS") and other investments - held to maturity, at amortized cost (estimated fair value $4,006 and $4,229)	3,941	4,145
MBS and other investments - available for sale	6,284	6,717
Federal Home Loan Bank of Seattle ("FHLB") stock	5,705	5,705
Loans receivable	537,904	535,926
Loans held for sale	3,110	4,044
Less: Allowance for loan losses	(11,972)	(11,946)
Net loans receivable	529,042	528,024
Premises and equipment, net	17,353	17,390
Other real estate owned ("OREO") and other repossessed assets, net	7,714	10,811
Accrued interest receivable	2,388	2,411
Bank owned life insurance ("BOLI")	16,074	15,917
Goodwill	5,650	5,650
Core deposit intangible ("CDI")	360	397
Mortgage servicing rights ("MSRs"), net	2,169	2,108
Prepaid Federal Deposit Insurance Corporation ("FDIC") insurance assessment	1,873	2,103
Other assets	5,939	6,122
Total assets	$735,849	$738,224
Liabilities and shareholders' equity		
Liabilities:		
Deposits: Non-interest-bearing demand	$ 61,178	$ 64,494
Deposits: Interest-bearing	527,997	528,184
Total deposits	589,175	592,678

FHLB advances	55,000	55,000
Repurchase agreements	538	729
Other liabilities and accrued expenses	3,806	3,612
Total liabilities	648,519	652,019
Shareholders' equity		
Preferred stock, $.01 par value; 1,000,000 shares authorized; 16,641 shares, Series A, issued and outstanding; $1,000 per share liquidation value	16,048	15,989
Common stock, $.01 par value; 50,000,000 shares authorized; 7,045,036 shares issued and outstanding	10,464	10,457
Unearned shares - Employee Stock Ownership Plan ("ESOP")	(1,917)	(1,983)
Retained earnings	63,286	62,270
Accumulated other comprehensive loss	(551)	(528)
Total shareholders' equity	87,330	86,205
Total liabilities and shareholders' equity	$735,849	$738,224

See notes to unaudited condensed consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the three months ended December 31, 2011 and 2010
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended December 31, 2011	2010
Interest and dividend income		
Loans receivable	$7,805	$8,534
MBS and other investments	125	182
Dividends from mutual funds and FHLB stock	13	8
Interest-bearing deposits in banks	89	87
Total interest and dividend income	8,032	8,811
Interest expense		
Deposits	1,169	1,751
FHLB advances - long term	562	729
Total interest expense	1,731	2,480
Net interest income	6,301	6,331

Provision for loan losses	650	900
Net interest income after provision for loan losses	5,651	5,431
Non-interest income		
Other than temporary impairment ("OTTI") on MBS and other investments	(90)	(145)
Adjustment for portion recorded as other comprehensive loss (before taxes)	30	9
Net OTTI on MBS and other investments	(60)	(136)
Gain on sales of MBS and other investments	- -	79
Service charges on deposits	970	984
ATM transaction fees	517	411
BOLI net earnings	157	122
Gain on sales of loans, net	560	701
Servicing income (expense) on loans sold	9	(36)
Escrow fees	27	21
Valuation recovery on MSRs	84	634
Fee income from non-deposit investment sales	12	31
Other	168	140
Total non-interest income, net	2,444	2,951

See notes to unaudited condensed consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (continued)
For the three months ended December 31, 2011 and 2010
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended December 31,	
	2011	2010
Non-interest expense		
Salaries and employee benefits	$2,929	$3,127
Premises and equipment	673	694
Advertising	208	167
OREO and other repossessed items expense, net	502	428
ATM expenses	194	175
Postage and courier	118	115
Amortization of CDI	37	42
State and local taxes	149	166
Professional fees	178	182

FDIC insurance	225	340
Other insurance	56	154
Loan administration and foreclosure	161	98
Data processing and telecommunications	257	234
Deposit operations	223	106
Other	311	348
Total non-interest expense	6,221	6,376
Income before federal and state income taxes	1,874	2,006
Provision for federal and state income taxes	591	647
Net income	1,283	1,359
Preferred stock dividends	(208)	(208)
Preferred stock discount accretion	(59)	(54)
Net income to common shareholders	$1,016	$1,097
Net income per common share		
Basic	$ 0.15	$ 0.16
Diluted	$ 0.15	$ 0.16
Weighted average common shares outstanding		
Basic	6,780,516	6,745,250
Diluted	6,780,516	6,745,250

See notes to unaudited condensed consolidated financial statements

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TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the three months ended December 31, 2011 and 2010
(In thousands)
(Unaudited)

	Three Months Ended December 31, 2011	2010
Comprehensive income:		
Net income	$1,283	$1,359
Unrealized holding loss on securities available for sale, net of tax	(14)	(75)
Change in OTTI on securities held-to-maturity, net of tax:		
Additions	(14)	(47)
Additional amount recognized related to credit loss for which OTTI was previously recognized	(13)	(4)
Amount reclassified to credit loss for previously recorded market loss	7	45
Accretion of OTTI securities held-to-maturity, net		

of tax	11	6
Total comprehensive income	$1,260	$1,284

See notes to unaudited condensed consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS'
EQUITY
For the three months ended December 31, 2011 and the year ended September 30, 2011
(Dollars in thousands, except per share amounts)
(Unaudited)

	Number of Shares		Amount				
	Preferred Stock	Common Stock	Preferred Stock	Common Stock	Unearned Shares – ESOP	Retained Earnings	Accumu late Othe Compre hensiv Los
Balance, September 30, 2010	16,641	7,045,036	$15,764	$10,377	$(2,247)	$62,238	$ (724
Net income	- -	- -	- -	- -	- -	1,089	- -
Accretion of preferred stock discount	- -	- -	225	- -	- -	(225)	- -
5% preferred stock dividend	- -	- -	- -	- -	- -	(832)	- -
Earned ESOP shares	- -	- -	- -	(61)	264	- -	- -
MRDP (1) compensation expense	- -	- -	- -	134	- -	- -	- -
Stock option compensation expense	- -	- -	- -	7	- -	- -	- -
Unrealized holding gain on securities available for sale, net of tax	- -	- -	- -	- -	- -	- -	14
Change in OTTI on securities held to maturity, net of tax	- -	- -	- -	- -	- -	- -	139
Accretion of OTTI on securities held to maturity, net of tax	- -	- -	- -	- -	- -	- -	43
Balance, September 30, 2011	16,641	7,045,036	15,989	10,457	(1,983)	62,270	(528
Net income	- -	- -	- -	- -	- -	1,283	- -
Accretion of preferred stock discount	- -	- -	59	- -	- -	(59)	- -
5% preferred stock dividend	- -	- -	- -	- -	- -	(208)	- -
Earned ESOP shares	- -	- -	- -	(20)	66	- -	- -
MRDP (1) compensation expense	- -	- -	- -	25	- -	- -	- -
Stock option compensation expense	- -	- -	- -	2	- -	- -	- -

Unrealized holding loss on securities available for sale, net of tax	- -	- -	- -	- -	- -	- -	(14
Change in OTTI on securities held to maturity, net of tax	- -	- -	- -	- -	- -	- -	(20
Accretion of OTTI on securities held to maturity, net of tax	- -	- -	- -	- -	- -	- -	11
Balance, December 31, 2011	16,641	7,045,036	$16,048	$10,464	$(1,917)	$63,286	$(551

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(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 three months ended December 31, 2011 and 2010
(Dollars in thousands)
(Unaudited)

	Three Months Ended December 31, 2011	2010
Cash flow from operating activities		
Net income	$ 1,283	$ 1,359
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	650	900
Depreciation	234	253
Deferred federal income taxes	(12)	- -
Amortization of CDI	37	42
Earned ESOP shares	66	66
MRDP compensation expense	25	44
Stock option compensation expense	2	1
Loss (gain) on sales of OREO and other repossessed assets, net	271	(14)
Provision for OREO losses	57	251
Loss on disposition of premises and equipment	- -	5
BOLI net earnings	(157)	(122)
Gain on sales of loans, net	(560)	(701)
Decrease in deferred loan origination fees	(58)	(83)
Net OTTI on MBS and other investments	60	136
Gain on sales of MBS and other investments	- -	(79)
Valuations recovery on MSR's	(84)	(634)
Loans originated for sale	(22,203)	(25,045)
Proceeds from sales of loans	23,697	26,863
Decrease in other assets, net	463	874
Decrease in other liabilities and accrued expenses, net	(14)	(109)
Net cash provided by operating activities	3,757	4,007
Cash flow from investing activities		

Net increase in CDs held for investment	(1,151)	(454)
Proceeds from maturities and prepayments of securities available for sale	378	632
Proceeds from maturities and prepayments of securities held to maturity	184	252
Proceeds from sales of MBS and other investments	--	2,271
(Increase) decrease in loans receivable, net	(9)	207
Additions to premises and equipment	(197)	(112)
Proceeds from sales of OREO and other repossessed assets	234	370
Net cash (used in) provided by investing activities	(561)	3,166
Cash flow from financing activities		
Decrease in deposits, net	(3,503)	(1,475)
Repayment of FHLB advances	--	(20,000)
(Decrease) increase in repurchase agreements	(191)	20
ESOP tax effect	(20)	(33)
Net cash used in financing activities	(3,714)	(21,488)

See notes to unaudited condensed consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
For the three months ended December 31, 2011 and 2010
(Dollars in thousands)
(Unaudited)

	Three Months Ended December 31, 2011	2010
Net decrease in cash and cash equivalents	$ (518)	$(14,315)
Cash and cash equivalents		
Beginning of period	112,065	111,786
End of period	$111,547	$ 97,471
Supplemental disclosure of cash flow information		
Income taxes paid	$ --	$ 137
Interest paid	1,752	2,558
Supplemental disclosure of non-cash investing activities		
Loans transferred to OREO and other repossessed assets	$ 669	$ 1,700
Loan originated to facilitate the sale of OREO	3,204	--

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, 2011 ("2011 Form 10-K"). The unaudited condensed consolidated results of operations for the three months ended December 31, 2011 are not necessarily indicative of the results that may be expected for the entire fiscal year.

(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 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 December 31, 2011 presentation with no change to net income or total shareholders' equity previously reported.

(2) REGULATORY MATTERS

In December 2009, the FDIC and the Washington State Department of Financial Institutions, Division of Banks ("Division") determined that the Bank required supervisory attention and, on December 29, 2009, entered into an agreement on a Memorandum of Understanding with the Bank ("Bank MOU"). Under the Bank MOU, the Bank must, among other things, maintain Tier 1 Capital of not less than 10.0% of the Bank's adjusted total assets and maintain capital ratios above the "well capitalized" thresholds as defined under FDIC Rules and Regulations; obtain the prior consent from the FDIC and the Division prior to the Bank declaring a dividend to its holding company; and not engage in any transactions that would materially change the Bank's balance sheet composition including growth in total assets of five percent or more or significant changes in funding sources without the prior non-objection of the FDIC.

In addition, on February 1, 2010, the Federal Reserve Bank of San Francisco ("FRB") determined that the Company required additional supervisory attention and entered into a Memorandum of Understanding with the Company ("Company MOU"). Under the Company MOU, the Company must, among other things, obtain prior written approval or non-objection from the FRB to declare or pay any dividends, or make any other capital

distributions; issue any trust preferred securities; or purchase or redeem any of its stock. The FRB has denied the Company's requests to pay dividends on its Series A Preferred Stock issued under the U.S. Treasury Department's Capital Purchase Program ("CPP") for quarterly payments due for the last seven quarters commencing with the payments due May 15, 2010. For additional information on the CPP, see Note 3 below entitled "U.S Treasury Department's Capital Purchase Program."

(3) U.S. TREASURY DEPARTMENT'S CAPITAL PURCHASE PROGRAM

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. The CPP was established as part of the Troubled Asset Relief Program ("TARP"). The Company sold 16,641 shares of senior preferred stock with a related warrant to purchase 370,899 shares of the Company's common stock at a price of $6.73 per share at any time through December 23, 2018. The 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.

Preferred stock is initially recorded at the amount of proceeds received. Any 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 paid (or accrued) and any accretion is deducted from net income for computing income available to common shareholders and net income per share computations.

Under the Company MOU, the Company must, among other things, obtain prior written approval or non-objection from the FRB to declare or pay any dividends. The FRB has denied the Company's requests to pay dividends on its Series A Preferred Stock issued under the CPP for quarterly payments due for the last seven quarters commencing with the payment due May 15, 2010. There can be no assurances that the FRB will approve such payments or dividends in the future. The Company may not declare or pay dividends on its common stock or, with certain exceptions, repurchase common stock without first having paid all cumulative preferred dividends that are due. Since dividends on the Series A Preferred Stock have not been paid for at least six quarters, the Treasury has the right to appoint two members to the Company's Board of Directors.

(4) MBS AND OTHER INVESTMENTS

MBS and other investments have been classified according to management's intent and are as follows as of December 31, 2011 and September 30, 2011 (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2011				
Held to Maturity				
MBS:				
U.S. government agencies	$ 1,770	$ 47	$ (4)	$ 1,813
Private label residential	2,144	207	(188)	2,163
U.S. agency securities	27	3	- -	30
Total	$ 3,941	$ 257	$ (192)	$ 4,006
Available for Sale				
MBS:				
U.S. government agencies	$ 4,062	$ 163	$ - -	$ 4,225
Private label residential	1,148	60	(144)	1,064
Mutual funds	1,000	- -	(5)	995
Total	$ 6,210	$ 223	$ (149)	$ 6,284
September 30, 2011				
Held to Maturity				
MBS:				
U.S. government agencies	$ 1,831	$ 45	$ (4)	$ 1,872
Private label residential	2,287	311	(271)	2,327
U.S. agency securities	27	3	- -	30
Total	$ 4,145	$ 359	$ (275)	$ 4,229
Available for Sale				
MBS:				
U.S. government agencies	$ 4,395	$ 188	$ - -	$ 4,583
Private label residential	1,227	59	(152)	1,134
Mutual funds	1,000	- -	- -	1,000
Total	$ 6,622	$ 247	$ (152)	$ 6,717

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The estimated fair value of temporarily impaired securities, the amount of unrealized losses and the length of time these unrealized losses existed as of December 31, 2011 are as follows (dollars in thousands):

Less Than 12 Months	12 Months or Longer	Total

	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Held to Maturity						
MBS:						
U.S. government agencies	$ 106	$ (1)	$ 348	$ (3)	$ 454	$ (4)
Private label residential	76	(3)	1,118	(185)	1,194	(188)
Total	$ 182	$ (4)	$1,466	$ (188)	$1,648	$(192)
Available for Sale						
MBS:						
U.S. government agencies	$ - -	$ - -	$ - -	$ - -	$ - -	$ - -
Private label residential	- -	- -	724	(144)	724	(144)
Mutual funds	- -	- -	995	(5)	995	(5)
Total	$ - -	$ - -	$1,719	$ (149)	$1,719	$(149)

During the three months ended December 31, 2011 and 2010, the Company recorded net OTTI charges through earnings on residential MBS of $60,000 and $136,000, 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, prepayment speeds and 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 December 31, 2011 and September 30, 2011:

	Range		
	Minimum	Maximum	Weighted Average
At December 31, 2011			
Constant prepayment rate	6.00%	15.00%	8.45%
Collateral default rate	0.71%	30.03%	10.00%
Loss severity rate	25.92%	74.02%	49.39%
At September 30, 2011			
Constant prepayment rate	6.00%	15.00%	10.71%
Collateral default rate	0.43%	24.23%	8.03%
Loss severity rate	11.93%	64.54%	39.22%

The following tables present the OTTI for the three months ended December 31, 2011 and 2010 (dollars in thousands):

	Three months ended December 31, 2011		Three months ended December 31, 2010	
	Held To Maturity	Available For Sale	Held To Maturity	Available For Sale
Total OTTI	$ 52	$ 38	$ 145	$ - -
Portion of OTTI recognized in other comprehensive loss (before income taxes) (1)	(30)	- -	(9)	- -
Net OTTI recognized in earnings (2)	$ 22	$ 38	$ 136	$ - -

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(1) Represents OTTI related to all other factors.
(2) Represents OTTI related to credit losses.

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 three months ended December 31, 2011 and 2010 (in thousands):

	Three months ended December 31, 2011	2010
Beginning balance of credit loss	$3,361	$4,725
Additions:		
Credit losses for which OTTI was not previously recognized	1	46
Additional increases to the amount related to credit loss for which OTTI was previously recognized	59	90
Subtractions:		
Realized losses previously recorded as credit losses	(196)	(496)
Ending balance of credit loss	$3,225	$4,365

There were no gross realized gains on sale of securities for the three months ended December 31, 2011. There was a gross realized gain on sale of securities for the three months ended December 31, 2010 of $79,000. During the three months ended December 31, 2011, the Company recorded a $196,000 realized loss (as a result of the securities being deemed worthless) on 21 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 three months ended December 31, 2010, the Company recorded a $496,000 realized loss on 16 held to maturity residential MBS which had previously been recognized 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 $7.36 million and $7.88 million at December 31, 2011 and September 30, 2011, respectively.

The contractual maturities of debt securities at December 31, 2011 are 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	22	23	104	111
Due after five to ten years	37	39	- -	- -
Due after ten years	3,882	3,944	5,106	5,178
Total	$ 3,941	$ 4,006	$ 5,210	$ 5,289

(5) FHLB STOCK

The Company views its investment in the FHLB stock as a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recovery of the par value rather than recognizing temporary declines in value. The determination of whether a decline affects the ultimate recovery is influenced by criteria such as: 1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and length of time a decline has persisted; 2) the impact of legislative and regulatory changes on the FHLB; and 3) the liquidity position of the FHLB. On October 25, 2010, the FHLB announced that it had entered into a Consent Agreement with the Federal Housing Finance Agency ("FHFA"), which requires the FHLB to take certain specific actions related to its business and operations. As of its latest regulatory filing, the FHLB reported that it had met all of its regulatory capital requirements, but remained classified as "undercapitalized" by the FHFA. The FHLB will not pay a dividend or repurchase capital stock while it is classified as undercapitalized. While the FHLB was classified as undercapitalized, the Company does not believe that its investment in the FHLB is impaired as of December 31, 2011. However, this estimate could change in the near term if: 1) significant other-than-temporary losses are incurred on the FHLB's MBS causing a significant decline in its regulatory capital status; 2) the economic losses resulting from credit deterioration on the FHLB's MBS increases significantly; or 3) capital preservation strategies being utilized by the FHLB become ineffective.

(6) LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable and loans held for sale consisted of the following at December 31, 2011 and September 30, 2011 (dollars in thousands):

	December 31, 2011		September 30, 2011	
	Amount	Percent	Amount	Percent
Mortgage loans:				
One- to four-family (1)	$110,502	19.7%	$114,680	20.5%
Multi-family	30,866	5.5	30,982	5.5
Commercial	245,874	43.9	246,037	43.9
Construction and land development	57,803	10.3	52,484	9.4
Land	46,198	8.3	49,236	8.8
Total mortgage loans	491,243	87.7	493,419	88.1
Consumer loans:				
Home equity and second mortgage	34,607	6.2	36,008	6.4
Other	6,695	1.2	8,240	1.5
Total consumer loans	41,302	7.4	44,248	7.9
Commercial business loans	27,426	4.9	22,510	4.0
Total loans receivable	559,971	100.0%	560,177	100.0%
Less:				
Undisbursed portion of construction loans in process	(17,073)		(18,265)	
Deferred loan origination fees	(1,884)		(1,942)	
Allowance for loan losses	(11,972)		(11,946)	
Total loans receivable, net	$529,042		$528,024	

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(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 December 31, 2011 and September 30, 2011 (dollars in thousands):

	December 31, 2011		September 30, 2011	
	Amount	Percent	Amount	Percent
Custom and owner/builder	$ 28,797	49.8%	$ 26,205	49.9%
Speculative one- to four-family	2,186	3.8	1,919	3.7
Commercial real estate	16,693	28.9	12,863	24.5
Multi-family (including condominiums)	8,320	14.4	9,322	17.8
Land development	1,807	3.1	2,175	4.1

Total construction and land development loans	$ 57,803	100.0%	$ 52,484	100.0%

Allowance for Loan Losses

The following tables set forth information for the three months ended December 31, 2011 and December 31, 2010 regarding activity in the allowance for loan losses (dollars in thousands):

	For the Three Months Ended December 31, 2011				
	Beginning Allowance	Provision	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One-to four-family	$ 760	$ 92	$ 68	$ 1	$ 785
Multi-family	1,076	233	- -	- -	1,309
Commercial	4,035	(18)	508	- -	3,509
Construction - custom and owner / builder	222	38	- -	- -	260
Construction - speculative one-to four-family	169	(6)	- -	1	164
Construction - commercial	794	13	- -	- -	807
Construction - multi-family	354	(414)	- -	450	390
Construction - land development	79	247	230	- -	96
Land	2,795	76	285	71	2,657
Consumer loans:					
Home equity and second mortgage	460	(1)	50	- -	409
Other	415	(24)	1	- -	390
Commercial business loans	787	414	6	1	1,196
Total	$11,946	$ 650	$1,148	$ 524	$11,972

	Three Months Ended December 31, 2010
Balance at beginning of period	$11,264
Provision for loan losses	900
Loans charged off	(439)
Recoveries of loans previously charged off	24
Net charge-offs	(415)
Balance at end of period	$11,749

The following table presents information on the loans evaluated individually for impairment and collectively evaluated for impairment in the allowance for loan losses at December 31, 2011 and September 30, 2011 (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
December 31, 2011					
Mortgage loans:					
One- to four-family	$ 136	$ 649	$ 785	$ 4,335	$106,167
Multi-family	976	333	1,309	6,921	23,945
Commercial	214	3,295	3,509	21,552	224,322
Construction - custom and owner / builder	9	251	260	318	19,890
Construction - speculative one- to four-family	24	140	164	700	972
Construction - commercial	687	120	807	5,413	4,817
Construction - multi-family	- -	390	390	370	6,443
Construction - land development	- -	96	96	1,597	210
Land	583	2,074	2,657	9,527	36,671
Consumer loans:					
Home equity and second mortgage	12	397	409	1,236	33,371
Other	- -	390	390	- -	6,695
Commercial business loans	276	920	1,196	317	27,109
	$2,917	$9,055	$11,972	$52,286	$490,612
September 30, 2011					
Mortgage loans:					
One- to four-family	$ 45	$ 715	$ 760	$ 3,701	$110,979
Multi-family	632	444	1,076	5,482	25,500
Commercial	255	3,780	4,035	19,322	226,715
Construction - custom and owner / builder	11	211	222	320	16,777
Construction - speculative one- to four-family	37	132	169	700	906
Construction - commercial	738	56	794	5,435	2,479
Construction -					

multi-family	- -	354	354	632	4,867
Construction - land development	- -	79	79	1,882	221
Land	560	2,235	2,795	9,997	39,239
Consumer loans:					
Home equity and second mortgage	10	450	460	1,014	34,994
Other	1	414	415	1	8,239
Commercial business loans	- -	787	787	44	22,466
	$2,289	$9,657	$11,946	$48,530	$493,382

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 on-going 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 marginal 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.

The following table lists the loan credit risk grades utilized by the Company that serve as credit quality indicators. Each of the credit risk loan grades include high and low factors associated with their classification that are utilized to calculate the aggregate ranges of the allowance for loan losses at December 31, 2011 and September 30, 2011 (dollars in thousands):

Credit Risk Profile by Internally Assigned Grades

December 31, 2011	Loan Grades				
	Pass	Watch	Special Mention	Substandard	Total
Mortgage loans:					
One- to four-family	$ 96,715	$ 4,708	$ 3,291	$ 5,788	$110,502
Multi-family	18,995	68	4,696	7,107	30,866
Commercial	215,172	696	6,040	23,966	245,874
Construction - custom and owner / builder	19,629	261	- -	318	20,208
Construction - speculative one- to four-family	212	155	- -	1,305	1,672
Construction - commercial	4,817	- -	- -	5,413	10,230
Construction - multi-family	6,443	- -	- -	370	6,813
Construction - land development	- -	- -	- -	1,807	1,807
Land	25,168	5,947	5,233	9,850	46,198
Consumer loans:					
Home equity and second mortgage	31,083	931	1,355	1,238	34,607
Other	6,638	48	- -	9	6,695
Commercial business loans	24,080	60	192	3,094	27,426
Total	$448,952	$12,874	$20,807	$60,265	$542,898

September 30, 2011	Pass	Watch	Special Mention	Substandard	Total
Mortgage loans:					
One- to four-family	$100,159	$ 6,131	$ 2,450	$ 5,940	$114,680
Multi-family	19,279	199	10,380	1,124	30,982
Commercial	212,898	1,042	6,320	25,777	246,037
Construction - custom and owner / builder	16,522	255	- -	320	17,097
Construction - speculative one- to four-family	323	- -	700	583	1,606
Construction - commercial	2,479	- -	- -	5,435	7,914
Construction - multi-family	4,115	- -	752	632	5,499
Construction - land development	83	- -	- -	2,020	2,103
Land	26,825	6,604	5,084	10,723	49,236
Consumer loans:					
Home equity and second mortgage	32,389	901	1,513	1,205	36,008
Other	8,179	50	- -	11	8,240
Commercial business loans	19,060	20	220	3,210	22,510
Total	$442,311	$15,202	$27,419	$56,980	$541,912

The following tables present an age analysis of past due status of loans by category at December 31, 2011 and September 30, 2011 (dollars in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Non-Accrual (1)	Past Due 90 Days or More and Still Accruing	Total Past due	Current
Mortgage loans:						
One- to four-family	$2,889	$ - -	$ 2,788	$ - -	$ 5,677	$104,825
Multi-family	- -	- -	1,449	- -	1,449	29,417
Commercial	8,902	- -	10,445	- -	19,347	226,527
Construction - custom and owner / builder	- -	- -	318	- -	318	19,890
Construction - speculative one- to four-family	- -	- -	- -	201	201	1,471
Construction - commercial	- -	- -	666	- -	666	9,564
Construction - multi-family	- -	- -	370	- -	370	6,443
Construction - land development	- -	- -	1,597	- -	1,597	210
Land	5,727	82	9,264	1,586	16,659	29,539
Consumer loans:						
Home equity and second mortgage	816	39	589	890	2,334	32,273
Other	83	- -	- -	- -	83	6,612
Commercial business loans	- -	132	317	- -	449	26,977
Total	$18,417	$ 253	$27,803	$2,677	$49,150	$493,748
September 30, 2011						
Mortgage loans:						
One- to four-family	$ - -	$1,822	$ 2,150	$ - -	$ 3,972	$110,708
Multi-family	- -	- -	- -	1,449	1,449	29,533
Commercial	- -	12,723	6,571	- -	19,294	226,743
Construction - custom and owner / builder	- -	- -	320	- -	320	16,777
Construction - speculative one- to four-family	- -	- -	- -	- -	- -	1,606
Construction - commercial	- -	- -	688	- -	688	7,226
Construction - multi-family	- -	752	632	- -	1,384	4,115
Construction - land development	- -	- -	1,882	- -	1,882	221
Land	1,100	2,558	8,935	29	12,622	36,614
Consumer loans:						
Home equity and second mortgage	643	441	366	- -	1,450	34,558
Other	9	7	1	- -	17	8,223
Commercial business loans	- -	14	44	276	334	22,176
Total	$ 1,752	$18,317	$21,589	$1,754	$43,412	$498,500

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(1) Includes non-accrual loans past due 90 days or more and manual non-accrual loans.

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.

At December 31, 2011 and September 30, 2011, the Company had impaired loans totaling $52.29 million and $48.53 million, respectively. At December 31, 2011, the Company had loans totaling $2.68 million that were 90 days or more past due and still accruing interest. At September 30, 2011, the Company had loans totaling $1.75 million that were 90 days or more past due and still accruing interest. Interest income recognized on impaired loans for the three months ended December 31, 2011 and 2010 was $419,000 and $322,000, respectively. Interest income recognized on a cash basis on impaired loans for the three months ended December 31, 2011 and 2010, was $294,000 and $246,000, respectively. The average investment in impaired loans for the three months ended December 31, 2011 and 2010 was $48.64 million and $41.44 million, respectively.

The following table is a summary of information related to impaired loans as of and for the three months ended December 31, 2011 (dollars in thousands):

	Recorded Investment	Unpaid Principal Balance (Loan Balance Plus Charge Off)	Related Allowance	Average Recorded Investment	Interest Income Recognized(1)	Ca I Re
With no related allowance recorded:						

Mortgage loans:					
One- to four-family	$ 2,266	$ 2,486	$ - -	$ 2,623	$ 6
Multi-family	- -	982	- -	- -	- -
Commercial	17,704	19,354	- -	15,514	190
Construction - custom and owner / builder	209	209	- -	345	- -
Construction - speculative one- to four-family	- -	- -	- -	243	- -
Construction - multi-family	370	810	- -	1,071	- -
Construction - land development	1,597	7,124	- -	2,482	5
Land	5,214	8,750	- -	7,034	8
Consumer loans:					
Home equity and second mortgage	592	658	- -	534	- -
Other	- -	- -	- -	8	- -
Commercial business loans	41	61	- -	43	1
Subtotal	27,993	40,434	- -	29,897	210
With an allowance recorded:					
Mortgage loans:					
One- to four-family	2,069	2,069	136	1,181	22
Multi-family	6,921	6,921	976	5,768	73
Commercial	3,848	3,848	214	2,179	24
Construction - custom and owner / builder	109	109	9	67	- -
Construction - speculative one- to four-family	700	700	24	1,030	8
Construction - commercial	5,413	6,857	687	4,620	63
Land	4,313	4,337	583	3,428	8
Consumer loans:					
Home equity and second mortgage	644	644	12	412	11
Other	- -	- -	- -	1	- -
Commercial business loans	276	276	276	55	- -
Subtotal	24,293	25,761	2,917	18,741	209
Total					
Mortgage loans:					
One- to four-family	4,335	4,555	136	3,804	28
Multi-family	6,921	7,903	976	5,768	73
Commercial	21,552	23,202	214	17,693	214
Construction - custom and owner / builder	318	318	9	412	- -
Construction - speculative one- to four-family	700	700	24	1,273	8
Construction - commercial	5,413	6,857	687	4,620	63
Construction - multi-family	370	810	- -	1,071	5
Construction - land development	1,597	7,124	- -	2,482	- -
Land	9,527	13,087	583	10,462	16
Consumer loans:					
Home equity and second mortgage	1,236	1,302	12	946	11
Other	- -	- -	- -	9	- -
Commercial business loans	317	337	276	98	1
Total	$52,286	$66,195	$2,917	$48,638	$ 419

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(1) For the three months ended December 31, 2011

Following is a summary of information related to impaired loans as of and for the year ended Sept
2011 (in thousands):

	Recorded Investment	Unpaid Principal Balance (Loan Balance Plus Charge Off)	Related Allowance	Average Recorded Investment	Interest Income Recognized(1)	Ca I Re
With no related allowance recorded:						
Mortgage loans:						
One- to four-family	$ 2,092	$ 2,387	$ - -	$ 2,908	$ 30	
Multi-family	- -	982	- -	681	- -	
Commercial	18,137	19,279	- -	14,623	1,060	
Construction - custom and owner / builder	209	209	- -	303	7	
Construction speculative one- to four-family	- -	- -	- -	502	7	
Construction - multi-family	632	1,135	- -	1,287	4	
Construction - land development	1,882	7,179	- -	2,920	5	
Land	8,198	11,533	- -	7,883	69	
Consumer loans:						
Home equity and second mortgage	669	719	- -	430	26	
Other	- -	- -	- -	13	- -	
Commercial business loans	44	65	- -	44	2	
Subtotal	31,863	43,488	- -	31,594	1,210	
With an allowance recorded:						
Mortgage loans:						
One- to four-family	1,609	1,609	45	768	47	
Multi-family	5,482	5,482	632	4,798	298	
Commercial	1,185	1,185	255	1,409	50	
Construction - custom and owner / builder	111	111	11	45	2	
Construction - speculative one- to four-family	700	700	37	1,042	50	
Construction - commercial	5,435	6,879	738	3,537	273	
Construction - multi-family	- -	- -	- -	65	- -	
Land	1,799	1,821	560	2,946	114	
Consumer loans:						
Home equity and second mortgage	345	345	10	425	10	
Other	1	1	1	1	- -	
Subtotal	16,667	18,133	2,289	15,036	844	
Total						

Mortgage loans:					
One- to four-family	3,701	3,996	45	3,676	77
Multi-family	5,482	6,464	632	5,479	298
Commercial	19,322	20,464	255	16,032	1,110
Construction - custom and owner / builder	320	320	11	348	9
Construction - speculative one- to four-family	700	700	37	1,544	57
Construction - commercial	5,435	6,879	738	3,537	273
Construction - multi-family	632	1,135	- -	1,352	4
Construction - land development	1,882	7,179	- -	2,920	5
Land	9,997	13,354	560	10,829	183
Consumer loans:					
Home equity and second mortgage	1,014	1,064	10	855	36
Other	1	1	1	14	- -
Commercial business loans	44	65	- -	44	2
Total	$48,530	$61,621	$2,289	$46,630	$2,054

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(1) For the year ended September 30, 2011

The following table sets forth information with respect to the Company's non-performing assets at December 31, 2011 and September 30, 2011 (dollars in thousands):

Loans accounted for on a non-accrual basis:

	December 31, 2011	September 30, 2011
Mortgage loans:		
One- to four-family	$ 2,788	$ 2,150
Multi-family	1,449	- -
Commercial	10,445	6,571
Construction custom and owner / builder	318	320
Construction speculative one- to four-family	- -	- -
Construction commercial	666	688
Construction multi-family	370	632
Construction land development	1,597	1,882
Land	9,264	8,935
Consumer loans:		
Home equity and second mortgage	589	367
Commercial business	317	43
Total	27,803	21,589
Accruing loans which are contractually past due 90 days or more	2,677	1,754
Total of non-accrual and 90 days past due loans	30,480	23,343

Non-accrual investment securities	2,650	2,796
OREO and other repossessed assets	7,714	10,811
Total non-performing assets (1)	$ 40,844	$ 36,950
Troubled debt restructured loans on accrual status (2)	$ 18,297	$ 18,166
Non-accrual and 90 days or more past due loans as a percentage of loans receivable	5.64%	4.32%
Non-accrual and 90 days or more past due loans as a percentage of total assets	4.15%	3.16%
Non-performing assets as a percentage of total assets	5.55%	5.01%
Loans receivable (3)	$541,014	$539,970
Total assets	$735,849	$738,224

(1) Does not include troubled debt restructured loans on accrual status.
(2) Does not include troubled debt restructured loans totaling $7.33 million and $7.38 million reported as non-accrual loans at December 31, 2011 and September 30, 2011, respectively.
(3) Includes loans held for sale and is 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. The Company had $25.63 million in troubled debt restructured loans included in impaired loans at December 31, 2011 and had no commitments to lend additional funds on these loans. At December 31, 2011, $7.33 million of the $25.63 million in troubled debt restructured loans were on non-accrual status and included in non-performing loans. The Company had $25.54 million in troubled debt restructured loans included in impaired loans at September 30, 2011 and had $144,000 in commitments to lend additional funds on these loans. At September 30, 2011, $7.38 million of the $25.54 million in troubled debt restructured loans were on non-accrual status and included in non-performing loans.

The following table sets forth information with respect to the Company's troubled debt restructurings by portfolio segment at December 31, 2011 and September 30, 2011 (dollars in thousands):

December 31, 2011

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	End of Period Balance
One-to four-family	5	$ 1,619	$ 1,619	$1,547
Multi-family	4	6,534	5,482	5,472
Commercial	8	5,903	6,226	5,840
Construction - speculative one-to four-family	1	700	700	700
Construction - commercial	2	6,800	5,451	5,413
Construction - land development	4	5,433	5,433	756
Land	12	7,263	7,051	5,256
Home equity	3	654	654	647
Total	39	$34,906	$32,616	$25,631

September 30, 2011

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	End of Period Balance
One-to four-family	5	$ 1,619	$ 1,619	$1,618
Multi-family	4	6,534	5,482	5,482
Commercial	8	5,903	6,226	5,696
Construction - speculative one-to four-family	1	700	700	700
Construction - commercial	2	6,800	5,451	5,435
Construction - land development	4	5,433	5,433	756
Land	12	7,263	7,051	5,208
Home equity	3	654	654	647
Total	39	$34,906	$32,616	$25,542

There were no new troubled debt restructured loans that were recorded during the three months ended December 31, 2011. There were no troubled debt restructured loans that were recorded in the twelve months prior to December 31, 2011 that subsequently defaulted in the three months ended December 31, 2011.

(7) 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 net income per common share. At December 31, 2011 and 2010, there were 264,520 and 299,786 shares, respectively, that had not been allocated under the Bank's ESOP.

	Three Months Ended December 31, 2011	2010
	(in thousands, except for share and per share data)	
Basic net income per common share computation		
Numerator - net income	$ 1,283	$ 1,359
Preferred stock dividends	(208)	(208)
Preferred stock discount accretion	(59)	(54)
Net income to common shareholders	$ 1,016	$ 1,097
Denominator - weighted average common shares outstanding	6,780,516	6,745,250
Basic net income per common share	$ 0.15	$ 0.16
Diluted net income per common share computation		
Numerator - net income	$ 1,283	$ 1,359
Preferred stock dividend	(208)	(208)
Preferred stock discount accretion	(59)	(54)
Net income to common shareholders	$ 1,016	$ 1,097
Denominator - weighted average common shares outstanding	6,780,516	6,745,250
Effect of dilutive stock options (1)	- -	- -
Effect of dilutive stock warrant (2)	- -	- -
Weighted average common shares and common stock equivalents	6,780,516	6,745,250
Diluted net income per common share	$ 0.15	$ 0.16

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(1) For the three months ended December 31, 2011 and 2010, options to purchase 153,376 and 194,864 shares of common stock, respectively, were outstanding but not included in the computation of diluted net income per

common share because the options' exercise prices were greater than the average market price of the common stock, and, therefore, their effect would have been anti-dilutive.
(2) For the three months ended December 31, 2011 and 2010, 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.

(8) 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 December 31, 2011, options for 218,938 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 three months ended December 31, 2011 and 2010 is as follows:

	Three Months Ended December 31, 2011		Three Months Ended December 31, 2010	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding, beginning of period	137,726	$ 9.25	194,864	$ 8.71
Granted	33,500	4.01	- -	- -
Forfeited	2,200	4.55	- -	- -
Options outstanding, end of period	169,026	$ 8.27	194,864	$ 8.71
Options exercisable, end of period	123,326		174,064	

There was no aggregate intrinsic value of options outstanding at December 31, 2011.

At December 31, 2011, there were 46,700 unvested options with an aggregate grant date fair value of $69,000, all of which the Company assumes will vest. There was no aggregate intrinsic value of unvested options at December 31, 2011. There were 5,000 options with an aggregate grant date fair value of $6,000 that vested during the three months ended December 31, 2011.

At December 31, 2010, there were 20,800 unvested options with an aggregate grant date fair value of $27,000. There were 5,200 options with an aggregate grant date fair value of $7,000 that vested during the three months ended December 31, 2010.

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 33,500 options granted during the three months ended December 31, 2011 with an aggregate grant date fair value of $52,000. There were no options granted during the three months ended December 31, 2010.

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 three months ended December 31, 2011 were:

Expected Volatility	44%
Expected term (in years)	5
Expected dividend yield	- -%
Risk free interest rate	0.89%
Grant date fair value per share	$1.56

Stock Grant Plan

The Company adopted the Management Recognition and Development Plan ("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 are 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 three months ended December 31, 2011 and 2010.

At December 31, 2011, there were a total of 15,161 unvested MRDP shares with an aggregated grant date fair value of $155,000. There were 7,231 MRDP shares that vested during the three months ended December 31, 2011 with an aggregated grant date fair value of $79,000. There were 100 MRDP shares forfeited during the three months ended December 31, 2011 with a grant date fair value of $1,000. At December 31, 2011, there were no shares available for future awards under the MRDP.

At December 31, 2010, there were a total of 28,992 unvested MRDP shares with an aggregate grant date fair value of $329,000. There were 7,433 MRDP shares that vested during the three months ended December 31, 2010 with and aggregated grant date fair value of $81,000.

Expenses for Stock Compensation Plans

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

	Three Months Ended December 31,			
	2011		2010	
	(Dollars in thousands)			
	Stock Options	Stock Grants	Stock Options	Stock Grants
Compensation expense recognized in income	$ 2	$ 25	$ 1	$ 44
Related tax benefit recognized	- -	9	- -	15

As of December 31, 2011, 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 Options	Stock Grants	Total Awards
2012	$ 13	$ 80	$ 93
2013	17	39	56
2014	17	2	19
2015	11	- -	11
2016	10	- -	10
2017	2	- -	2
Total	$ 70	$ 121	$ 191

(9) 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 December 31, 2011 and September 30, 2011. 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. Major assumptions, methods and fair value estimates for the Company's significant financial instruments are set forth below:

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.

MBS and Other Investments

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 observable and unobservable inputs such as quoted market prices, dealer quotes, or discounted cash flows.

FHLB Stock

FHLB stock is not publicly traded; however, the recorded value of the stock holdings approximates the estimated fair value, as the FHLB is required to pay par value upon re-acquiring this stock.

Loans Receivable, Net

At December 31, 2011 and September 30, 2011, because of the illiquid market for loan sales, loans were priced using comparable market statistics. The loan portfolio was segregated into various categories and

a weighted average valuation discount that approximated similar loan sales was applied to each category.

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.

The estimated fair values of financial instruments were as follows as of December 31, 2011 and September 30, 2011 (dollars in thousands):

	December 31, 2011		September 30, 2011	
	Recorded Amount	Estimated Fair Value	Recorded Amount	Estimated Fair Value
Financial Assets				
Cash and cash equivalents	$111,547	$111,547	$112,065	$112,065
CDs held for investment	19,810	19,810	18,659	18,659
MBS and other investments	10,225	10,290	10,862	10,946
FHLB stock	5,705	5,705	5,705	5,705
Loans receivable, net	525,932	481,212	523,980	490,322
Loans held for sale	3,110	3,216	4,044	4,185
Accrued interest receivable	2,388	2,388	2,411	2,411
Financial Liabilities				
Deposits	$589,175	$591,595	$592,678	$595,331
FHLB advances - long term	55,000	60,878	55,000	61,009
Repurchase agreements	538	538	729	729
Accrued interest payable	525	525	545	545

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 minimize 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 minimize 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.

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 following table summarizes the balances of assets and liabilities measured at estimated fair value on a recurring basis at December 31, 2011, and the total losses resulting from these estimated fair value adjustments for the three months ended December 31, 2011 (dollars in thousands):

	Estimated Fair Value			
	Level 1	Level 2	Level 3	Total Losses
Available for Sale Securities				
Mutual funds	$ 995	$ - -	$ - -	$ - -
MBS	- -	5,289	- -	38
Total	$ 995	$5,289	$ - -	$ 38

The following table summarizes the balances of assets and liabilities measured at estimated fair value on a nonrecurring basis at December 31, 2011, and the total losses resulting from these estimated fair value adjustments for the three months ended December 31, 2011 (dollars in thousands):

	Estimated Fair Value			
	Level 1	Level 2	Level 3	Total Losses
Impaired loans (1)	$ - -	$ - -	$23,520	$ 1,148
MBS - held to maturity (2)	- -	267	- -	22
OREO and other repossessed items (3)	- -	- -	7,714	369
MSR's (4)	- -	- -	2,169	- -
Total	$ - -	$ 267	$33,403	$ 1,439

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(1) The loss represents charge offs on collateral dependent loans for estimated fair value adjustments based on the estimated fair value of the

collateral. A loan is considered to be impaired when, based on current information and events, it is probable 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, and known changes in the market and in the collateral.

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

(3) 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 items is subject to significant external and internal judgment. Management periodically reviews the recorded value to determine whether the property continues to be recorded at the lower of its recorded book value or estimated fair value, net of estimated costs to sell.

(4) 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 mortgage servicing rights based on the predominant risk characteristics that include the underlying loan's interest rate, cash flows of the loan, origination date and term. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights exceed their 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.

(10) RECENT ACCOUNTING PRONOUNCEMENTS

In December 2010, the FASB issued updated guidance on goodwill and other intangibles regarding when to perform step two of the goodwill impairment test for reporting units with zero or negative carrying amounts. This guidance became effective for the Company on October 1, 2011. The adoption of this guidance did not have a material effect on the Company's condensed consolidated financial statements.

In September 2011, the FASB issued guidance regarding testing goodwill for impairment. The new guidance allows an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of the reporting unit. The guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In April 2011, the FASB issued guidance regarding Transfer and Servicing for the Reconsideration of Effective Control for Repurchase Agreements. The guidance removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and the collateral maintenance implementation guidance related to that criterion. Other criteria applicable to the assessment of effective control are not changed by the amendments. The guidance is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In May 2011, the FASB issued amended guidance regarding the application of existing fair value measurement guidance. The provisions of the amended guidance clarify the application of existing fair value measurement guidance and revise certain measurement and disclosure requirements to achieve convergence of GAAP and International Financial Reporting Standards. The provisions of this amended guidance are effective for the Company's first reporting period beginning January 1, 2012, with early adoption not permitted. The Company is in the process of evaluating the impact of adoption of this guidance and does not expect it to have a material impact on its condensed consolidated financial statements.

In June 2011, the FASB issued amended guidance on the presentation of comprehensive income (loss). The new guidance eliminates the current option to present the components of other comprehensive income (loss) in the statement of changes in equity and requires the presentation of net income (loss) and other comprehensive income (loss) (and their respective components) either in a single continuous statement or in two separate but consecutive statements. The amendments do not alter any current recognition or measurement requirements with respect to the items of other comprehensive income (loss). The provisions of this guidance are effective for the Company's first reporting period beginning on January 1, 2012, with early adoption permitted. The Company does not expect it to have a material impact on its condensed consolidated financial statements.

In December 2011, the FASB issued guidance that defers the effective date of the requirement to present separate line items on the income statement for reclassification adjustments of items out of accumulated other comprehensive income into net income. The deferral is temporary until FASB reconsiders the operational concerns and needs of financial statement users. The FASB has not yet announced a timetable for its reconsideration. The Company does not expect this guidance to have a material impact on its condensed consolidated financial statements.

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

The following analysis discusses the material changes in the consolidated financial condition and results of operations of the Company at and for the three months ended December 31, 2011. 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. Forward-looking statements are not statements of historical fact and often include the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "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, among other things, expectations of the business environment in which we operate and projections of future performance. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause our actual results to differ materially from the results anticipated or implied by 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 require us, among other things, 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 or restrictions, which could adversely affect our liquidity and earnings; our compliance with regulatory enforcement actions, including regulatory memoranda of understandings ("MOUs") to which we are subject; 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 and any changes in the rules applicable to institutions participating in the TARP Capital Purchase Program; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the implementation of related rules and regulations; our ability to attract and retain deposits; further increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining the fair values 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; computer systems on which we depend could fail or experience a security breach; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may in the future 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 Financial Accounting Standards Board, 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 Annual Report on Form 10-K for the year ended September 30, 2011.

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 undertake no 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. We do not undertake and specifically disclaim any obligation to revise any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. These risks could cause our actual results for 2012 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 operations and 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 December 31, 2011, the Company had total assets of $735.85 million and total shareholders' equity of $87.33 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, comprised of 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 potential credit losses in its loan portfolio.

Net income is also affected by non-interest income and non-interest expenses. For the three month period ended December 31, 2011, non-interest income consisted primarily of service charges and fees on deposit accounts, gain on sale of loans, ATM transaction fees, an increase in the cash surrender value of life insurance, other operating income and a valuation recovery 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 expenses, deposit operation expenses, 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.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed to be sufficient to provide for estimated loan losses based on evaluating known and inherent risks in the loan portfolio. The allowance is provided based upon management's comprehensive analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the amount and composition of the loan portfolio, delinquency levels, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which the full collectability may not be assured. The detailed analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific and general components. The specific component relates to loans that are deemed impaired. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the recorded value of that loan. The general component covers loans that are not evaluated individually for impairment and is based on historical loss experience adjusted for qualitative factors. The appropriateness of the allowance for loan losses is estimated based upon these factors and trends identified by management at the time consolidated financial statements are prepared.

In accordance with the FASB guidance for receivables, a loan is considered impaired when it is probable that a creditor will be unable to collect all amounts (principal and interest) due according to the contractual terms of the loan agreement. Troubled debt restructured loans are considered impaired loans. Smaller balance homogenous loans, such as residential mortgage loans and consumer loans, may be collectively evaluated for impairment. When a loan has been identified as being impaired, the amount of the impairment is measured by using discounted cash flows, except when, as an alternative, the current estimated fair value of the collateral, reduced by estimated costs to sell, is used. The valuation of real estate collateral is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management considers third-party appraisals, as well as independent fair market value assessments from realtors or persons involved in selling real estate in determining the estimated fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received. When the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest and net deferred loan origination fees or costs), impairment is recognized by creating or adjusting an allocation of the allowance for loan losses and uncollected accrued interest is reversed against interest income. If ultimate collection of principal is in doubt, all cash receipts on impaired loans are applied to reduce the principal balance.

A provision for loan losses is charged against operations and is added to the allowance for loan losses based on quarterly comprehensive analyses of the loan portfolio. The allowance for loan losses is allocated to certain loan categories based on the relative risk characteristics, asset classifications and actual loss experience of the loan portfolio. While management has allocated the allowance for loan losses to various loan portfolio segments, the allowance is general in nature and is available for the loan portfolio in its entirety.

The ultimate recovery of all loans is susceptible to future market and other factors beyond the Company's control. These factors may result in losses or recoveries differing significantly from those provided in the consolidated financial statements. The Company has experienced a significant decline in valuations for some real estate collateral since October 2008. If real estate values continue to decline and as updated appraisals are received on collateral for impaired loans, the Company may need to increase the allowance for loan losses appropriately. In addition, bank regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses, and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

MSRs (Mortgage Servicing Rights)
MSRs are capitalized when acquired through the origination of loans that are subsequently sold with servicing rights retained and are amortized to

servicing income on loans sold in proportion to and over the period of estimated net servicing income. The value of MSRs at the date of the sale of loans is determined based on the discounted present value of expected future cash flows using key assumptions for servicing income and costs and prepayment rates on the underlying loans.

The estimated fair value is evaluated at least annually by a third party firm for impairment by comparing actual cash flows and estimated cash flows from the servicing assets to those estimated at the time the servicing assets were originated. The effect of changes in market interest rates on estimated rates of loan prepayments represents the predominant risk characteristic underlying the MSRs portfolio. The Company's methodology for estimating the fair value of MSRs is highly sensitive to changes in assumptions. For example, the determination of fair value uses anticipated prepayment speeds. Actual prepayment experience may differ and any difference may have a material effect on the fair value. Thus, any measurement of MSRs' fair value is limited by the conditions existing and assumptions as of the date made. Those assumptions may not be

appropriate if they are applied at different times.

For purposes of measuring impairment, the rights must be stratified by one or more predominant risk characteristics of the underlying loans. The Company stratifies its capitalized MSRs based on product type, interest rate and term of the underlying loans. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights for each stratum exceed their fair value. Impairment, if deemed temporary, is recognized through a valuation allowance to the extent that fair value is less than the recorded amount.

OTTIs (Other-Than-Temporary Impairments) in the Estimated Fair Value of Investment Securities Unrealized losses on available for sale and held to maturity investment securities are evaluated at least quarterly to determine whether declines in value should be considered "other than temporary" and therefore be subject to immediate loss recognition through earnings for the portion related to credit losses. Although these evaluations involve significant judgment, an unrealized loss in the fair value of a debt security is generally deemed to be temporary when the fair value of the security is less than the recorded value primarily as a result of changes in interest rates, when there has not been significant deterioration in the financial condition of the issuer, and it is more likely than not the Company will not have to sell the security before recovery of its cost basis. An unrealized loss in the value of an equity security is generally considered temporary when the estimated fair value of the security is less than the recorded value primarily as a result of current market conditions and not a result of deterioration in the financial condition of the issuer or the underlying collateral (in the case of mutual funds) and the Company has the intent and the ability to hold the security for a sufficient time to recover the recorded value. Other factors that may be considered in determining whether a decline in the value of either a debt or equity security is "other than temporary" include ratings by recognized rating agencies, capital strength and near-term prospects of the issuer, and recommendation of investment advisors or market analysts. Therefore, continued deterioration of current market conditions could result in additional impairment losses recognized within the Company's investment portfolio.

Goodwill

Goodwill is initially recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired and liabilities assumed. Goodwill is presumed to have an indefinite useful life and is analyzed annually for impairment. An annual test is performed during the third quarter of each fiscal year, or more frequently if indicators of potential impairment exist, to determine if the recorded goodwill is impaired. If the estimated fair value of the Company's sole reporting unit exceeds the recorded value, goodwill is not considered impaired and no additional analysis is necessary.

One of the circumstances evaluated when determining if an impairment test of goodwill is needed more frequently than annually is the extent and duration that the Company's market capitalization (total common shares outstanding multiplied by current stock price) is less than the total equity applicable to common shareholders. During the quarter ended June 30, 2011, the Company engaged a third party firm to perform the annual test for goodwill impairment. The test concluded that recorded goodwill was not impaired. As of December 31, 2011, there have been no events or changes in circumstances that would indicate a potential impairment. No assurance can be given, however, that the Company will not record an impairment loss on goodwill in the future.

OREO (Other Real Estate Owned) and Other Repossessed Assets

OREO and other repossessed assets consist of properties or assets acquired through or by deed in lieu of foreclosure, and are recorded initially at the estimated fair value of the properties less estimated costs of disposal. Costs relating to the development and improvement of the properties or assets are capitalized while costs relating to holding the properties or assets are expensed. The valuation of real estate is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management periodically obtains updated valuations from third party appraisals, as well as independent fair market value

assessments from realtors or persons involved in the selling of real estate in determining the estimated fair value of particular properties. A charge to earnings is recorded if the recorded value of a property exceeds its estimated net realizable value.

Comparison of Financial Condition at December 31, 2011 and September 30, 2011

The Company's total assets decreased by $2.37 million, or 0.3%, to $735.85 million at December 31, 2011 from $738.22 million at September 30, 2011. The decrease was primarily the result of a decrease in OREO and other repossessed assets.

Net loans receivable increased by $1.02 million, or 0.2%, to $529.04 million at December 31, 2011 from $528.02 million at September 30, 2011. The increase was primarily due to an increase in commercial business loan balances, commercial real estate construction loan balances and custom and owner/builder construction loan balances. These increases were partially offset by decreases in one-to four-family loan balances, land loan balances and consumer loan balances.

Total deposits decreased by $3.50 million, or 0.6%, to $589.18 million at

December 31, 2011 from $592.68 million at September 30, 2011, primarily as a result of decreases in certificates of deposit account balances and non-interest bearing account balances. These decreases were partially offset by increases in money market account balances, savings account balances and N.O.W. checking account balances.

Shareholders' equity increased by $1.13 million, or 1.3%, to $87.33 million at December 31, 2011 from $86.21 million at September 30, 2011.The increase in shareholders' equity was primarily a result of net income for the quarter.

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 increased by $633,000, or 0.5%, to $131.36 million at December 31, 2011 from $130.72 million at September 30, 2011. The increase was primarily due to a $1.15 million increase in CDs held for investment, which was partially offset by a $518,000 decrease in cash and cash equivalents.

MBS (Mortgage-backed Securities) and Other Investments: Mortgage-backed securities and other investments decreased by $637,000, or 5.9%, to $10.23 million at December 31, 2011 from $10.86 million at September 30, 2011. The decrease was primarily a result of scheduled amortization and prepayments on MBS and OTTI charges recorded on private label residential MBS. The securities on which the OTTI charges were recognized were acquired from the in-kind redemption of the Company's investment in the AMF family of mutual funds in June 2008. For additional information on MBS and other investments, see Note 4 of the Notes to Condensed Consolidated Financial Statements contained in "Item 1, Financial Statements."

Loans: Net loans receivable increased by $1.02 million, or 0.2%, to $529.04 million at December 31, 2011 from $528.02 million at September 30, 2011. The increase in the portfolio was primarily a result of a $4.92 million increase in commercial business loan balances, a $3.83 million increase in commercial real estate construction loan balances and a $2.59 million increase in custom and owner/builder construction loan balances. These increases to net loans receivable were partially offset by a $4.18 million decrease in one-to four-family loan balances and a $3.04 million decrease in land loan balances.

Loan originations increased to $51.63 million for the three months ended December 31, 2011 from $49.15 million for the three months ended December 31, 2010. 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 $22.92 million for the three months ended December 31, 2011 compared to $26.86 million for the three months ended December 31, 2010.

For additional information, see Note 6 of the Notes to Condensed Consolidated Financial Statements contained in "Item 1, Financial Statements."

Premises and Equipment: Premises and equipment decreased by $36,000, or 0.2%, to $17.35 million at December 31, 2011 from $17.39 million at September 30,

2011. The decrease was primarily a result of depreciation.

OREO (Other Real Estate Owned): OREO and other repossessed assets decreased by $3.10 million, or 28.6%, to $7.71 million at December 31, 2011 from $10.81 million at September 30, 2011, primarily due to the sale of OREO properties. During the three months ended December 31, 2011, 12 OREO properties and other repossessed assets totaling $3.70 million were sold for a net loss of $271,000. At December 31, 2011, OREO consisted of 52 individual properties and three other repossessed assets. The properties consisted of 37 land parcels totaling $3.50 million, ten single family homes totaling $1.60 million, three commercial real estate properties totaling $1.23 million, a condominium project of $842,000, and a land development project of $469,000. The three other repossessed assets totaled $73,000.

Goodwill and CDI: The recorded value of goodwill of $5.65 million at December 31, 2011 remained unchanged from September 30, 2011. The amortized value of the CDI decreased $37,000, or 9.3%, to $360,000 at December 31, 2011 from $397,000 at September 30, 2011. The decrease was attributable to scheduled amortization of the CDI.

Prepaid FDIC Insurance Assessment: The prepaid FDIC insurance assessment decreased $230,000, or 10.9%, to $1.87 million at December 31, 2011 from $2.10 million at September 30, 2011 as a portion of the prepaid amount was expensed.

Deposits: Deposits decreased by $3.50 million, or 0.6%, to $589.18 million at December 31, 2011 from $592.68 million at September 30, 2011. The decrease was primarily a result of an $8.62 million decrease in certificates of deposit account balances and a $3.32 million decrease in non-interest bearing deposit account balances. These decreases were partially offset by a $5.24 million increase in money market account balances, a $1.70 million increase in savings account balances and a $1.50 million increase in N.O.W. checking account balances. See the "Deposit Breakdown" schedule below for additional information.

FHLB Advances: FHLB advances were $55.00 million at December 31, 2011 and September 30, 2011. For additional information, see the "Borrowing Maturity Schedule" set forth below.

Shareholders' Equity: Total shareholders' equity increased by $1.13 million, or 1.3%, to $87.33 million at December 31, 2011 from $86.21 million at September 30, 2011. The increase was primarily due to net income of $1.02 million for the three months ended December 31, 2011.

The FRB has denied the Company's requests to pay cash dividends on its outstanding Series A Preferred Stock held by the Treasury for the quarterly dividend payments due for the last seven quarters commencing with the payment due May 15, 2010. Cash dividends on the Series A Preferred Stock are cumulative and accrue and compound on each subsequent date. Accordingly, during the deferral period, the Company will continue to accrue, and reflect in the consolidated financial statements, the deferred dividends on the outstanding Series A Preferred Stock. As a result of not receiving permission from the FRB to pay these dividends, the Company had not made seven quarterly dividend payments as of December 31, 2011. At December 31, 2011, the Company had accrued preferred stock dividends in arrears of $1.46 million.

Non-performing Assets: Non-performing assets consist of non-accrual loans,

loans past due 90 days or more and still accruing, non-accrual investment securities, and OREO and other repossessed assets. Non-performing assets increased by $3.89 million, or 10.5%, to $40.84 million at December 31, 2011 from $36.95 million at September 30, 2011. The increase in non-performing assets was primarily a result of a $6.21 million increase in non-accrual loans and a $923,000 increase in loans past due 90 days and still accruing. These increases to non-performing assets were partially offset by a $3.10 million decrease in OREO and other repossessed assets and a $146,000 decrease in non-performing investment securities. The increase in loans past due 90 days or more and still accruing was primarily due to a delay in obtaining final plat approval for a pre-sold residential building plat in King County, Washington. The Company expects the sale to be consummated by February 28, 2012, which will reduce the loans in the past 90 days and still accruing category by $2.32 million.

For additional information, see Note 6 of the Notes to Condensed Consolidated Financial Statements contained in "Item 1, Financial Statements."

Deposit Breakdown

The following table sets forth the composition of the Company's deposit balances.

	At December 31, 2011	At September 30, 2011
	(Dollars in thousands)	
Non-interest bearing	$ 61,178	$ 64,494
N.O.W. checking	156,799	155,299
Savings	85,335	83,636
Money market accounts	66,266	61,028
CDs under $100	136,859	141,899
CDs $100 and over	82,738	86,322
Total deposits	$589,175	$592,678

The Company had no brokered deposits at December 31, 2011 or September 30, 2011.

Borrowing Maturity Schedule

The Company has short- and long-term borrowing lines with the FHLB of Seattle with total credit available on the lines equal to 30% of the Bank's total assets, limited by available collateral. Borrowings are considered short-term when the original maturity is less than one year. FHLB advances consisted of the following:

	At December 31, 2011		At September 30, 2011	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Short-term	$ - -	- -%	$ - -	- -%
Long-term	55,000	100.0	55,000	100.0
Total FHLB advances	$55,000	100.0%	$55,000	100.0%

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The long-term borrowings mature at various dates through September 2017 and bear interest at rates ranging from 3.49% to 4.34%. The weighted average interest rate on FHLB borrowings at December 31, 2011 was

4.01%. Principal reduction amounts due for future years ending September 30 are as follows (dollars in thousands):

Remainder of 2012	$10,000
2013	- -
2014	- -
2015	- -
2016	- -
2017	45,000

Total	$55,000
	=======

A portion of these advances have a putable feature and may be called by the FHLB earlier than the above schedule indicates. As of December 31, 2011, the Company had additional available borrowing capacity of $117.79 million with the FHLB.

The Company also maintains a short-term borrowing line with the FRB with total credit based on eligible collateral. As of December 31, 2011, the Company had a borrowing line capacity with the FRB of $50.58 million of which none was outstanding.

Comparison of Operating Results for the Three Months Ended December 31, 2011 and 2010

The Company reported net income of $1.28 million for the quarter ended December 31, 2011 compared to net income of $1.36 million for the quarter ended December 31, 2010. Net income to common shareholders after adjusting for the preferred stock dividend and the preferred stock discount accretion was $1.02 million for the quarter ended December 31, 2011 compared to net income of $1.10 million for the quarter ended December 31, 2010. The slight decrease in earnings for the quarter was primarily a result of decreased non-interest income and decreased net interest income, which was partially offset by a decreased provision for loan losses and decreased non-interest expense. Net income per diluted common share was $0.15 for the quarter ended December 31, 2011 compared to net income per diluted common share of $0.16 for the quarter ended December 31, 2010.

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

Net Income: The Company reported net income of $1.28 million for the quarter ended December 31, 2011 compared to net income of $1.36 million for the quarter ended December 31, 2010. Net income to common shareholders after adjusting for preferred stock dividends of $208,000 and preferred stock discount accretion of $59,000 was $1.02 million, or $0.15 per diluted common share for the quarter ended December 31, 2011, compared to $1.10 million, or $0.16 per diluted common share for the quarter ended December 31, 2010.

The $76,000 decrease in net income for the quarter ended December 31, 2011 was primarily the result of a $507,000 decrease in non-interest income and a $30,000 decrease in net interest income. These decreases to net income were partially offset by a $250,000 decrease in the provision for loan losses, a $155,000 decrease in non-interest expenses and a $56,000 decrease in the provision for federal and state income taxes.

Net Interest Income: Net interest income decreased by $30,000, or 0.5%, to $6.30 million for the quarter ended December 31, 2011 from $6.33 million for the quarter ended December 31, 2010. The slight decrease in net interest income was primarily attributable to a decrease in the net interest margin, which was partially offset by an increase in the level of total interest-bearing assets.

Total interest and dividend income decreased by $779,000 or 8.8%, to $8.03 million for the quarter ended December 31, 2011 from $8.81 million for the quarter ended December 31, 2010 as the yield on interest bearing

assets decreased to 4.76% from 5.31% and average loans receivable declined $1.13 million as compared to the same period last year. The decrease in the weighted average yield on interest bearing assets was primarily a result of decreased market rates for loans and an increase in the amount of lower yielding cash equivalents and other liquid assets. Total interest expense decreased by $749,000, or 30.2%, to $1.73 million for the quarter ended December 31, 2011 from $2.48 million for the quarter ended December 31, 2010 as the average rate paid on interest bearing liabilities decreased to 1.18% for the quarter ended December 31, 2011 from 1.70% for the quarter ended December 31, 2010. The decrease in funding costs was primarily a result of a decrease in overall market rates and a change in the composition of the deposit base as the percentage of certificates of deposit account balances decreased. The net interest margin decreased to 3.73% for the quarter ended December 31, 2011 from 3.82% for the quarter ended December 31, 2010.

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-earning 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 December 31,					
2011			2010		
Average	Interest and	Yield/	Average	Interest and	Yield/

	Balance	Dividends	Cost	Balance	Dividends	Cost
Interest-bearing assets: (1)						
Loans receivable (2)	$537,876	$7,805	5.80%	$539,007	$8,534	6.33%
MBS and other investments (2)	9,616	125	5.20	13,195	182	5.52
FHLB stock and equity securities	6,704	13	0.78	6,689	8	0.47
Interest-bearing deposits	121,236	89	0.29	104,870	87	0.33
Total interest-bearing assets	675,432	8,032	4.76	663,761	8,811	5.31
Non-interest-bearing assets	60,833			58,246		
Total assets	$736,265			$722,007		
Interest-bearing liabilities:						
Savings accounts	$ 84,511	83	0.39	$ 68,040	123	0.72
Money market accounts	63,708	96	0.60	56,935	134	0.93
N.O.W. accounts	154,319	210	0.54	155,118	420	1.07
Certificates of deposit	223,562	780	1.38	243,128	1,074	1.75
Short-term borrowings (3)	559	-	0.05	546	-	0.05
Long-term borrowings (4)	55,000	562	4.05	55,000	729	5.26
Total interest-bearing liabilities	581,659	1,731	1.18	578,767	2,480	1.70
Non-interest-bearing liabilities	68,072			57,644		
Total liabilities	649,731			636,411		
Shareholders' equity	86,534			85,596		
Total liabilities and shareholders' equity	$736,265			$722,007		
Net interest income		$6,301			$6,331	
Interest rate spread			3.58%			3.61%
Net interest margin (5)			3.73%			3.82%
Ratio of average interest-bearing assets to average interest-bearing liabilities			116.12%			114.69%

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(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 and FRB advances with original maturities of less than one year and other short-term borrowings repurchase agreements.
(4) Includes FHLB advances with original maturities of one year or greater.
(5) Net interest income divided by total average interest bearing assets, annualized.

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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. (In thousands)

	Three months ended December 31, 2011 compared to three months ended December 31, 2010 increase (decrease) due to		
	Rate	Volume	Net Change
Interest-bearing assets:			
Loans receivable (1)	$ (712)	$ (17)	$ (729)
MBS and other investments	(10)	(47)	(57)
FHLB stock and equity securities	5	- -	5
Interest-bearing deposits	(10)	12	2
Total net decrease in income on interest-earning assets	(727)	(52)	(779)
Interest-bearing liabilities:			
Savings accounts	(65)	25	(40)
N.O.W. accounts	(208)	(2)	(210)
Money market accounts	(53)	15	(38)
CD accounts	(212)	(82)	(294)
Long-term borrowings	(167)	- -	(167)
Total net decrease in expense on interest bearing liabilities	(705)	(44)	(749)
Net decrease in net interest income	$ (22)	$ (8)	$ (30)

(1) Excludes interest on loans 90 days or more past due. Includes loans originated for sale.

Provision for Loan Losses: The provision for loan losses decreased $250,000, or 27.8%, to $650,000 for the quarter ended December 31, 2011 from $900,000 for the quarter ended December 31, 2010. The decrease in the provision for loan losses was primarily due to $524,000 in allowance for loan loss recoveries for the quarter ended December 31, 2011. Also contributing to the reduction in the provision for loan losses was a change in the composition of the loan portfolio as the level of higher risk loan categories (construction and land development loans and land loans) decreased at December 31, 2011 relative to December 31, 2010. Net charge-offs for the quarter ended December 31, 2011 were $624,000 compared to $1.60 million for the quarter ended September 30, 2011 and $415,000 for the quarter ended December 31, 2010.

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 $11.97 million at December 31, 2011 (2.21% of loans receivable and loans held for sale and 39.3% 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 held against each loan. The aggregate principal impairment amount determined at December 31, 2011 was $2.92 million. The allowance for loan losses was $11.75 million (2.19% of loans receivable and loans held for sale and 44.4% of non-performing loans) at December 31, 2010.

Non-accrual and loans past due 90 days or more and still accruing increased $7.14 million to $30.48 million at December 31, 2011 from $23.34 million at September 30, 2011. For additional information, see the section entitled "Comparison of Financial Condition at December 31, 2011 and September 30, 2011 - Non-performing Assets" included herein.

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 proven 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 Bank'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. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that substantial increases will not be necessary should the quality of any loans deteriorate. 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 Condensed Consolidated Financial Statements contained in "Item 1, Financial Statements."

Non-interest Income: Total non-interest income decreased $507,000, or 17.2%, to $2.44 million for the quarter ended December 31, 2011 from $2.95 million for the quarter ended December 31, 2010. The decrease was primarily a result of a $550,000 change in the valuation recovery on MSRs and a $141,000 decrease in gain on sale of loans. These decreases to non-interest income were partially offset by a $106,000 increase in ATM transaction fees and a $76,000 reduction in net OTTI on MBS and other investments.

The valuation recovery on MSRs is based on a third party valuation of the MSR asset. The Company recorded a valuation recovery on MSRs of $84,000 for the quarter ended December 31, 2011 compared to a recovery of $634,000 for the quarter ended December 31, 2010. At December 31, 2011, the MSR asset had a remaining valuation allowance of $400,000 that is available for future recovery. The decrease in gain on sale of loans was primarily a result of a decreased volume of fixed rate one-to four family loans sold during the quarter ended December 31, 2011.

Non-interest Expense: Total non-interest expense decreased by $155,000, or 2.4%, to $6.22 million for the quarter ended December 31, 2011 from $6.38 million for the quarter ended December 31, 2010. The decrease was primarily the result of a $198,000 decrease in salaries and employee benefits expense, a $115,000 decrease in FDIC insurance expense and a $98,000 decrease in other insurance expense. The decrease in salaries and employee benefits expense was primarily a result of increased loan origination fees that offset salary expense and a one-time benefit of $99,000 from changing the Company's employee medical insurance provider. These decreases to non-interest expense were partially offset by increases to deposit operations expense and OREO and other repossessed assets expense.

Provision for Federal and State Income Taxes: The provision for federal and state income taxes decreased $56,000, or 8.7%, to $591,000 for the quarter ended December 31, 2011 from $647,000 for the quarter ended December 31, 2010, primarily due to lower income before taxes. The Company's effective tax rate was 31.54% for the quarter ended December 31, 2011 and 32.25% for the quarter ended December 31, 2010.

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.

An analysis of liquidity should include a review of the Condensed Consolidated Statement of Cash Flows for the three months ended December 31, 2011. The Condensed Consolidated Statement of Cash Flows includes operating, investing and financing categories. Operating activities include net income, which is adjusted for non-cash items, and increases or decreases in cash due to changes in certain assets and liabilities. Investing activities consist primarily of proceeds from maturities and sales of securities, purchases of securities, the net change in loans and proceeds from the sale of OREO and other repossessed assets. Financing activities present the cash flows associated with the Company's deposit accounts, other borrowings and stock related transactions.

The Company's total cash and cash equivalents decreased by $518,000, or 0.5% to $111.55 million at December 31, 2011 from $112.07 million at September 30, 2011.

The Bank must maintain an adequate level of liquidity to ensure the availability of sufficient funds for loan originations and deposit withdrawals, to satisfy other financial commitments and to take advantage of investment opportunities. The Bank generally maintains sufficient cash and short-term investments to meet short-term liquidity needs. At December 31, 2011, 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 22.24%. The Bank maintained an uncommitted credit facility with the FHLB that provided for immediately available advances up to an aggregate amount equal to 30% of total assets, limited by available collateral, under which $55.00 million was outstanding and $117.79 million was available for additional borrowings at December 31, 2011. The Bank also maintains a short-term borrowing line with the FRB with total credit based on eligible collateral. At December 31, 2011, the Bank had $50.58 million available for borrowings with the FRB and there was no outstanding balance on this borrowing line.

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, federal funds sold, and other short-term investments. If the Bank requires funds that exceed its ability to generate them internally, it has additional borrowing capacity with the FHLB and the FRB.

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 December 31, 2011, the Bank had loan commitments totaling $33.13 million and undisbursed construction loans in process totaling $17.07 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 December 31, 2011 totaled $149.46 million. Historically, the Bank has been able to retain a significant amount of its non-brokered CDs as they mature. At December 31, 2011, the Bank had no brokered deposits.

Capital Resources

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 4.0%, (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 Bank is currently required to maintain a "well capitalized" status and a Tier 1 leverage capital ratio of at least 10.0% under terms of the Bank MOU.

At December 31, 2011, the Bank was in compliance with all applicable capital requirements.

The following table compares the Company's and the Bank's actual capital amounts at December 31, 2011 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	$82,250	11.26%	$29,226	4.00%	N/A	N/A
Timberland Bank (1)	75,967	10.45	72,676	10.00	$72,676	10.00%
Tier 1 risk adjusted capital:						
Consolidated	82,250	15.39	21,378	4.00	N/A	N/A
Timberland Bank (1)	75,967	14.25	31,989	6.00	31,989	6.00
Total risk based capital						
Consolidated	88,996	16.65	42,756	8.00	N/A	N/A
Timberland Bank (1)	82,967	15.51	53,315	10.00	53,315	10.00

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(1) Reflects the higher Tier 1 leverage capital ratio that the Bank is required to comply with under terms of the Bank MOU with the FDIC and the Division. Also reflects that the Bank is required to maintain Tier 1 risk adjusted capital ratio and Total risk-based capital ratio at or above the "well capitalized" thresholds under the terms of the Bank MOU.

TIMBERLAND BANCORP, INC. AND SUBSIDIARIES
KEY FINANCIAL RATIOS AND DATA
(Dollars in thousands, except per share data)

	Three Months Ended		
	December 31, 2011	September 30, 2011	December 31, 2010
PERFORMANCE RATIOS:			
Return (loss) on average assets (1)	0.70%	(0.04)%	0.75%
Return (loss) on average equity (1)	5.93%	(0.34)%	6.35%
Net interest margin (1)	3.73%	3.75%	3.82%
Efficiency ratio	71.14%	80.83%	68.69%

	At December 31, 2011	At September 30, 2011	At December 31, 2010
ASSET QUALITY RATIOS:			
Non-accrual loans	$27,803	$21,589	$26,166
Loans past due 90 days and still			

accruing	2,677	1,754	305
Non-performing investment securities	2,650	2,796	3,325
OREO & other repossessed assets	7,714	10,811	12,612
Total non-performing assets	$40,844	$36,950	$42,408
Non-performing assets to total assets	5.55%	5.01%	5.87%
Allowance for loan losses to non-performing loans	39%	51%	44%
Troubled debt restructured loans on accrual status (2)	$18,297	$18,166	$ 8,841
BOOK VALUES:			
Book value per common share	$ 10.12	$ 9.97	$ 10.04
Tangible book value per common share (3)	$ 9.26	$ 9.11	$ 9.17

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(1) Annualized
(2) Does not include troubled debt restructured loans totaling $7,334, $7,376 and $6,756 that were included as non-accrual loans at December 31, 2011, September 30, 2011 and December 31, 2010, respectively.
(3) Calculation subtracts goodwill and core deposit intangible from the equity component.

	Three Months Ended		
	December 31, 2011	September 30, 2011	December 31, 2010
AVERAGE BALANCE SHEET:			
Average total loans	$537,876	$537,612	$539,007
Average total interest-bearing assets (1)	675,432	675,800	663,761
Average total assets	736,265	737,152	722,007
Average total interest-bearing deposits	526,100	526,659	523,221
Average FHLB advances & other borrowings	55,559	55,502	55,546
Average shareholders' equity	86,534	86,465	85,596

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(1) Includes loans and MBS on non-accrual status

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, 2011.

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 December 31, 2011 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.

(b) 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 December 31, 2011, 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 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 2011 Form 10-K.

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

Not applicable

Item 3. Defaults Upon Senior Securities

See discussion in Item 2 of Part 1 with respect to cumulative preferred stock dividends in arrears, which discussion is incorporated here by reference.

Item 4. (Removed and Reserved)

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	Bylaws of the Registrant (1)
3.4	Amendment to Bylaws (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	Form of Compensation Modification Agreements (2)
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
101	The following materials from Timberland Bancorp Inc.'s Quarterly Report on Form 10-Q for the quarter ended December 31, 2011, formatted on Extensible Business Reporting Language (XBRL) (a) Condensed Consolidated Balance Sheets; (b) Condensed Consolidated Statements of Income; (c) Condensed Consolidated Statements of Shareholders' Equity; (d) Condensed Consolidated Statements of Comprehensive Income; and (e) Notes

to Unaudited Condensed Consolidated Financial Statements (8)

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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 Annual Report on Form 10-K for the year ended September 30, 2002.

(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) 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: February 8, 2012 By: /s/ Michael R. Sand

Michael R. Sand
Chief Executive Officer
(Principal Executive Officer)

Date: February 8, 2012 By: /s/ Dean J. Brydon

Dean J. Brydon
Chief Financial Officer
(Principal Financial Officer)

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EXHIBIT INDEX

Exhibit No.	Description of Exhibit
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31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
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