

Kaiser Federal Financial Group, Inc.

Form 10-Q

November 08, 2012

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended: September 30, 2012

**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: 001-34979

**KAISER FEDERAL FINANCIAL GROUP, INC.**

(Exact name of registrant as specified in its charter)

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**Maryland**  
(State or other jurisdiction

of incorporation)

**1359 N. Grand Avenue, Covina, CA**  
(Address of principal executive offices)

**26-1500698**  
(I.R.S. Employer

Identification No.)

**91724**  
(Zip Code)

**(800) 524-2274**

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ Smaller Reporting Company ☐

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

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

Common Stock, \$.01 par value 8,737,391 shares outstanding as of November 5, 2012.

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**KAISER FEDERAL FINANCIAL GROUP, INC.**

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**Table of Contents****Part I FINANCIAL INFORMATION****Item 1. Financial Statements****KAISER FEDERAL FINANCIAL GROUP, INC. AND SUBSIDIARY****Consolidated Statements of Financial Condition****(Unaudited)****(Dollars in thousands, except per share data)**

|                                                                                                                                 | <b>September 30,<br/>2012</b> | <b>June 30,<br/>2012</b> |
|---------------------------------------------------------------------------------------------------------------------------------|-------------------------------|--------------------------|
| <b>ASSETS</b>                                                                                                                   |                               |                          |
| Cash and due from banks                                                                                                         | \$ 8,716                      | \$ 9,783                 |
| Federal funds sold                                                                                                              | 70,855                        | 56,235                   |
| Total cash and cash equivalents                                                                                                 | 79,571                        | 66,018                   |
| Securities available-for-sale, at fair value                                                                                    | 48,562                        | 53,397                   |
| Securities held-to-maturity, fair value of \$1,015 and \$1,229 at September 30, 2012 and June 30, 2012, respectively            | 986                           | 1,197                    |
| Federal Home Loan Bank stock, at cost                                                                                           | 8,085                         | 8,525                    |
| Loans held for sale                                                                                                             | 5,739                         |                          |
| Loans receivable, net of allowance for loan losses of \$6,392 and \$7,502 at September 30, 2012 and June 30, 2012, respectively | 743,457                       | 764,717                  |
| Accrued interest receivable                                                                                                     | 2,856                         | 2,778                    |
| Premises and equipment, net                                                                                                     | 2,847                         | 2,850                    |
| Goodwill                                                                                                                        | 3,950                         | 3,950                    |
| Bank-owned life insurance                                                                                                       | 13,450                        | 13,334                   |
| Real estate owned (REO)                                                                                                         | 610                           | 1,280                    |
| Other assets                                                                                                                    | 5,300                         | 5,284                    |
| Total assets                                                                                                                    | \$ 915,413                    | \$ 923,330               |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                                                                                      |                               |                          |
| <b>Liabilities</b>                                                                                                              |                               |                          |
| Deposits                                                                                                                        |                               |                          |
| Noninterest bearing                                                                                                             | \$ 61,358                     | \$ 71,319                |
| Interest bearing                                                                                                                | 616,534                       | 611,570                  |
| Total deposits                                                                                                                  | 677,892                       | 682,889                  |
| Federal Home Loan Bank advances, short-term                                                                                     | 20,000                        | 20,000                   |
| Federal Home Loan Bank advances, long-term                                                                                      | 60,000                        | 60,000                   |
| Accrued expenses and other liabilities                                                                                          | 5,213                         | 6,293                    |
| Total liabilities                                                                                                               | 763,105                       | 769,182                  |
| <b>Commitments and contingent liabilities</b>                                                                                   |                               |                          |
| <b>Stockholders equity</b>                                                                                                      |                               |                          |
| Nonredeemable serial preferred stock, \$.01 par value;<br>25,000,000 shares authorized; issued and outstanding                  | none                          |                          |

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Common stock, \$0.01 par value; 100,000,000 authorized;

September 30, 2012 8,791,292 shares issued

June 30, 2012 8,960,366 shares issued

|                                                      |                |                |
|------------------------------------------------------|----------------|----------------|
|                                                      | 88             | 90             |
| Additional paid-in capital                           | 89,418         | 92,197         |
| Retained earnings                                    | 67,431         | 66,723         |
| Accumulated other comprehensive loss, net of tax     | (40)           | (169)          |
| Unearned employee stock ownership plan (ESOP) shares | (4,589)        | (4,693)        |
| <b>Total stockholders' equity</b>                    | <b>152,308</b> | <b>154,148</b> |

|                                            |            |            |
|--------------------------------------------|------------|------------|
| Total liabilities and stockholders' equity | \$ 915,413 | \$ 923,330 |
|--------------------------------------------|------------|------------|

**The accompanying notes are an integral part of these unaudited consolidated financial statements**

**Table of Contents****KAISER FEDERAL FINANCIAL GROUP, INC. AND SUBSIDIARY****Consolidated Statements of Income****(Unaudited)****(Dollars in thousands, except per share data)**

|                                                            | <b>Three Months Ended<br/>September 30,</b> |              |
|------------------------------------------------------------|---------------------------------------------|--------------|
|                                                            | <b>2012</b>                                 | <b>2011</b>  |
| <b>Interest income</b>                                     |                                             |              |
| Interest and fees on loans                                 | \$ 9,718                                    | \$ 10,028    |
| Interest on securities, taxable                            | 81                                          | 156          |
| Federal Home Loan Bank dividends                           | 10                                          | 7            |
| Other interest                                             | 32                                          | 86           |
| Total interest income                                      | 9,841                                       | 10,277       |
| <b>Interest expense</b>                                    |                                             |              |
| Interest on deposits                                       | 1,748                                       | 2,073        |
| Interest on borrowings                                     | 469                                         | 794          |
| Total interest expense                                     | 2,217                                       | 2,867        |
| <b>Net interest income</b>                                 | <b>7,624</b>                                | <b>7,410</b> |
| Provision for loan losses                                  | 850                                         |              |
| <b>Net interest income after provision for loan losses</b> | <b>6,774</b>                                | <b>7,410</b> |
| <b>Noninterest income</b>                                  |                                             |              |
| Service charges and fees                                   | 409                                         | 435          |
| ATM fees and charges                                       | 526                                         | 533          |
| Referral commissions                                       | 88                                          | 79           |
| Loss on equity investment                                  | (52)                                        | (94)         |
| Bank-owned life insurance                                  | 116                                         | 120          |
| Net gain on sales of loans                                 | 424                                         |              |
| Other noninterest income                                   | 4                                           | 5            |
| Total noninterest income                                   | 1,515                                       | 1,078        |
| <b>Noninterest expense</b>                                 |                                             |              |
| Salaries and benefits                                      | 3,222                                       | 2,662        |
| Occupancy and equipment                                    | 713                                         | 676          |
| ATM expense                                                | 521                                         | 490          |
| Advertising and promotional                                | 132                                         | 74           |
| Professional services                                      | 495                                         | 499          |
| Federal deposit insurance premiums                         | 153                                         | 121          |
| Postage                                                    | 63                                          | 64           |
| Telephone                                                  | 228                                         | 187          |
| REO foreclosure expenses and sales gains/losses, net       | (15)                                        | (26)         |

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|                                         |                 |                 |
|-----------------------------------------|-----------------|-----------------|
| Other operating expense                 | 578             | 440             |
| Total noninterest expense               | 6,090           | 5,187           |
| <b>Income before income tax expense</b> | <b>2,199</b>    | <b>3,301</b>    |
| Income tax expense                      | 806             | 1,248           |
| <b>Net income</b>                       | <b>\$ 1,393</b> | <b>\$ 2,053</b> |
| <b>Earnings per common share:</b>       |                 |                 |
| Basic                                   | \$ 0.16         | \$ 0.22         |
| Diluted                                 | \$ 0.16         | \$ 0.22         |

The accompanying notes are an integral part of these unaudited consolidated financial statements

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**KAISER FEDERAL FINANCIAL GROUP, INC. AND SUBSIDIARY**

**Consolidated Statements of Comprehensive Income**

**(Unaudited)**

**(Dollars in thousands)**

|                                                         | <b>Three Months Ended<br/>September 30,</b> |                 |
|---------------------------------------------------------|---------------------------------------------|-----------------|
|                                                         | <b>2012</b>                                 | <b>2011</b>     |
| Net income                                              | \$ 1,393                                    | \$ 2,053        |
| Other comprehensive income (loss):                      |                                             |                 |
| Unrealized gain (loss) on securities available for sale | 219                                         | (15)            |
| Income tax effect                                       | (90)                                        | 6               |
| Other comprehensive income (loss), net of tax           | 129                                         | (9)             |
| <b>Comprehensive income</b>                             | <b>\$ 1,522</b>                             | <b>\$ 2,044</b> |

**The accompanying notes are an integral part of these unaudited consolidated financial statements**

**Table of Contents****KAISER FEDERAL FINANCIAL GROUP, INC. AND SUBSIDIARY****Consolidated Statements of Stockholders' Equity****(Unaudited)****(Dollars in thousands, except per share data)**

|                                                                       | <b>Common Stock</b> |               |                                           |                              | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss, Net</b> | <b>Unearned<br/>ESOP<br/>Shares</b> | <b>Total</b> |
|-----------------------------------------------------------------------|---------------------|---------------|-------------------------------------------|------------------------------|--------------------------------------------------------------|-------------------------------------|--------------|
|                                                                       | <b>Shares</b>       | <b>Amount</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Retained<br/>Earnings</b> |                                                              |                                     |              |
| Balance, July 1, 2011                                                 | 9,574,960           | \$ 96         | \$ 100,599                                | \$ 61,832                    | \$ (21)                                                      | \$ (5,107)                          | \$ 157,399   |
| Net income                                                            |                     |               |                                           | 2,053                        |                                                              |                                     | 2,053        |
| Other comprehensive loss: unrealized loss on securities, net of tax   |                     |               |                                           |                              | (9)                                                          |                                     | (9)          |
| Dividends declared (\$0.06 per share)                                 |                     |               |                                           | (548)                        |                                                              |                                     | (548)        |
| Stock options earned                                                  |                     |               | 17                                        |                              |                                                              |                                     | 17           |
| Stock options exercised                                               | 7,194               |               | 78                                        |                              |                                                              |                                     | 78           |
| Allocation of stock awards                                            |                     |               | 46                                        |                              |                                                              |                                     | 46           |
| Issuance of stock awards                                              | 25,000              |               |                                           |                              |                                                              |                                     |              |
| Forfeiture of stock awards                                            | (2,000)             |               |                                           |                              |                                                              |                                     |              |
| Allocation of ESOP common stock                                       |                     |               | 22                                        |                              |                                                              | 104                                 | 126          |
| Balance, September 30, 2011                                           | 9,605,154           | \$ 96         | \$ 100,762                                | \$ 63,337                    | \$ (30)                                                      | \$ (5,003)                          | \$ 159,162   |
| Balance, July 1, 2012                                                 | 8,960,366           | \$ 90         | \$ 92,197                                 | \$ 66,723                    | \$ (169)                                                     | \$ (4,693)                          | \$ 154,148   |
| Net income                                                            |                     |               |                                           | 1,393                        |                                                              |                                     | 1,393        |
| Other comprehensive income: unrealized gain on securities, net of tax |                     |               |                                           |                              | 129                                                          |                                     | 129          |
| Dividends declared (\$0.08 per share)                                 |                     |               |                                           | (685)                        |                                                              |                                     | (685)        |
| Repurchase of common stock                                            | (193,533)           | (2)           | (2,911)                                   |                              |                                                              |                                     | (2,913)      |
| Stock options earned                                                  |                     |               | 11                                        |                              |                                                              |                                     | 11           |
| Allocation of stock awards                                            |                     |               | 69                                        |                              |                                                              |                                     | 69           |
| Issuance of stock awards                                              | 25,259              |               |                                           |                              |                                                              |                                     |              |
| Forfeiture of stock awards                                            | (800)               |               |                                           |                              |                                                              |                                     |              |
| Allocation of ESOP common stock                                       |                     |               | 52                                        |                              |                                                              | 104                                 | 156          |
| Balance, September 30, 2012                                           | 8,791,292           | \$ 88         | \$ 89,418                                 | \$ 67,431                    | \$ (40)                                                      | \$ (4,589)                          | \$ 152,308   |

**The accompanying notes are an integral part of these unaudited consolidated financial statements**

**Table of Contents****KAISER FEDERAL FINANCIAL GROUP, INC. AND SUBSIDIARY****Consolidated Statements of Cash Flows****(Unaudited)****(Dollars in thousands)**

|                                                                                    | <b>Three Months Ended<br/>September 30,</b> |             |
|------------------------------------------------------------------------------------|---------------------------------------------|-------------|
|                                                                                    | <b>2012</b>                                 | <b>2011</b> |
| <b>OPERATING ACTIVITIES</b>                                                        |                                             |             |
| Net income                                                                         | \$ 1,393                                    | \$ 2,053    |
| Adjustments to reconcile net income to net cash provided by operating activities:  |                                             |             |
| Amortization of net premiums on securities                                         | 225                                         | 78          |
| Amortization (Accretion) of net premiums (discounts) on loan purchases             | 98                                          | (2)         |
| Amortization of net loan origination costs                                         | 34                                          | 9           |
| Provision for loan losses                                                          | 850                                         |             |
| Net gain on sale of REO                                                            | (16)                                        | (40)        |
| Net gain on sales of loans held for sale                                           | (424)                                       |             |
| Loans originated for sale                                                          | (16,656)                                    |             |
| Proceeds from sales of loans held for sale                                         | 11,322                                      |             |
| Depreciation and amortization                                                      | 243                                         | 200         |
| Amortization of core deposit intangible                                            | 6                                           | 10          |
| Loss on equity investment                                                          | 52                                          | 94          |
| Earnings on cash surrender value of bank-owned life insurance                      | (116)                                       | (120)       |
| Allocation of ESOP common stock                                                    | 156                                         | 126         |
| Allocation of stock awards                                                         | 69                                          | 46          |
| Stock options earned                                                               | 11                                          | 17          |
| Net change in accrued interest receivable                                          | (78)                                        | (50)        |
| Net change in other assets                                                         | (164)                                       | (171)       |
| Net change in accrued expenses and other liabilities                               | (1,080)                                     | (932)       |
| Net cash (used in) provided by operating activities                                | (4,075)                                     | 1,318       |
| <b>INVESTING ACTIVITIES</b>                                                        |                                             |             |
| Purchase of available-for-sale securities                                          |                                             | (26,615)    |
| Proceeds from maturities and principal repayments of available-for-sale securities | 4,829                                       | 6,046       |
| Proceeds from maturities and principal repayments of held-to-maturity securities   | 211                                         | 198         |
| Net change in interest earning time deposits with other financial institutions     |                                             | 3,938       |
| Purchases of loans                                                                 |                                             | (35,432)    |
| Net change in loans                                                                | 20,297                                      | 13,741      |
| Proceeds from sale of real estate owned                                            | 686                                         | 1,102       |
| Redemption of FHLB stock                                                           | 440                                         | 460         |
| Purchases of premises and equipment                                                | (240)                                       | (682)       |
| Net cash provided by (used in) investing activities                                | 26,223                                      | (37,244)    |
| <b>FINANCING ACTIVITIES</b>                                                        |                                             |             |
| Proceeds from FHLB advances                                                        |                                             | 60,000      |
| Repayment of FHLB Advances                                                         |                                             | (20,000)    |
| Dividends paid on common stock                                                     | (685)                                       | (548)       |

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|                                                     |           |            |
|-----------------------------------------------------|-----------|------------|
| Repurchase of common stock                          | (2,913)   |            |
| Net change in deposits                              | (4,997)   | 17,404     |
| Exercise of stock options                           |           | 78         |
| Net cash (used in) provided by financing activities | (8,595)   | 56,934     |
| Net change in cash and cash equivalents             | 13,553    | 21,008     |
| Cash and cash equivalents at beginning of period    | 66,018    | 89,654     |
| Cash and cash equivalents at end of period          | \$ 79,571 | \$ 110,662 |

**The accompanying notes are an integral part of these unaudited consolidated financial statements**

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**KAISER FEDERAL FINANCIAL GROUP, INC. AND SUBSIDIARY**

**Consolidated Statements of Cash Flows (Continued)**

**(Unaudited)**

**(Dollars in thousands)**

|                                           | <b>Three Months Ended<br/>September 30,</b> |             |
|-------------------------------------------|---------------------------------------------|-------------|
|                                           | <b>2012</b>                                 | <b>2011</b> |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION</b> |                                             |             |
| Interest paid on deposits and borrowings  | \$ 2,211                                    | \$ 2,850    |
| Income taxes paid                         | 1,000                                       | 1,229       |
| <b>SUPPLEMENTAL NONCASH DISCLOSURES</b>   |                                             |             |
| Transfer from loans to real estate owned  | \$                                          | \$ 289      |

**The accompanying notes are an integral part of these unaudited consolidated financial statements**

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**KAISER FEDERAL FINANCIAL GROUP, INC. AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

**Note 1 Nature of Business and Significant Accounting Policies**

**Nature of Business:** Kaiser Federal Financial Group, Inc. (the "Company") is a Maryland corporation that owns all of the outstanding common stock of Kaiser Federal Bank (the "Bank"). It is the successor to K-Fed Bancorp following the completion of the second-step conversion and offering in November 2010. The Company's primary activity is holding all of the outstanding shares of common stock of Kaiser Federal Bank. The Bank is a federally chartered savings bank headquartered in Covina, California. The Bank's principal business activity consists of attracting retail deposits from the general public and originating or purchasing primarily loans secured by first mortgages on owner-occupied, one-to-four family residences and multi-family residences located in its market area, and to a lesser extent, commercial real estate, automobile and other consumer loans. While the Bank originates many types of residential loans, the Bank purchased, using its own underwriting standards, a significant number of first mortgages on owner-occupied, one-to-four family residences secured by properties located throughout California.

The Company's business activities generally are limited to passive investment activities and oversight of its investment in the Bank. Unless the context otherwise requires, all references to the Company include the Bank and the Company on a consolidated basis.

**Principles of Consolidation and Basis of Presentation:** The financial statements of Kaiser Federal Financial Group, Inc. have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and predominant practices followed by the financial services industry. The consolidated financial statements presented in this report include the accounts of Kaiser Federal Financial Group, Inc. and its wholly-owned subsidiary, Kaiser Federal Bank. All material intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company's management, all adjustments consisting of normal recurring accruals necessary for a fair presentation of the financial condition and results of operations for the interim periods included herein have been made.

The results of operations for the three months ended September 30, 2012 are not necessarily indicative of the results of operations that may be expected for any other interim period or for the fiscal year ending June 30, 2013. Certain information and note disclosures normally included in the Company's annual financial statements have been condensed or omitted. Therefore, these consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes included in the 2012 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

**Use of Estimates in the Preparation of Consolidated Financial Statements:** The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Changes in these estimates and assumptions are considered reasonably possible and may have a material impact on the consolidated financial statements and thus actual results could differ from the amounts reported and disclosed herein. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of real estate owned and financial instruments.

**Loans Held for Sale:** Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Loans held for sale consist primarily of long-term fixed-rate loans secured by first trust deeds on one-to-four-family residences that are Freddie Mac loan products. The loans are offered to customers located in California and are generally sold with servicing rights retained. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

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### **Recent Accounting Pronouncements:**

#### **Effect of Newly Issued But Not Yet Effective Accounting Standards:**

In July 2012, the FASB issued ASU 2012-02, *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*. Under these amendments, an entity would not be required to calculate the fair value of an indefinite-lived intangible asset unless the entity determines, based on qualitative assessment, that it is not more likely than not, the indefinite-lived intangible asset is impaired. In accordance with the amendments in this Update, an entity will have an option not to calculate annually the fair value of an indefinite-lived intangible asset if the entity determines that it is not more likely than not that the asset is impaired. An entity will be able to resume performing the qualitative assessment in any subsequent period. Permitting an entity to assess qualitative factors when testing indefinite-lived intangible assets for impairment results in guidance that is similar to the goodwill impairment testing guidance in ASU 2011-08. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The adoption of this guidance is not expected to have a material effect on the Company's result of operations or financial position.

**Table of Contents****Note 2 Earnings Per Share**

The following table sets forth earnings per share calculations for the three months ended September 30, 2012 and 2011:

|                                                       | Three months ended<br>September 30,           |           |
|-------------------------------------------------------|-----------------------------------------------|-----------|
|                                                       | 2012                                          | 2011      |
|                                                       | (Dollars in thousands, except per share data) |           |
| <b>Basic</b>                                          |                                               |           |
| Net income                                            | \$ 1,393                                      | \$ 2,053  |
| Less: Net income allocated to restricted stock awards | 10                                            | 10        |
| Net income allocated to common shareholders           | \$ 1,383                                      | \$ 2,043  |
| Weighted average common shares outstanding            | 8,433,462                                     | 9,084,176 |
| Basic earnings per common share                       | \$ 0.16                                       | \$ 0.22   |
| <b>Diluted</b>                                        |                                               |           |
| Net income                                            | \$ 1,393                                      | \$ 2,053  |
| Less: Net income allocated to restricted stock awards | 10                                            | 10        |
| Net income allocated to common shareholders           | \$ 1,383                                      | \$ 2,043  |
| Weighted average common shares outstanding            | 8,433,462                                     | 9,084,176 |
| Add: Dilutive effect of stock options                 | 17,404                                        | 2,004     |
| Average shares and dilutive potential common shares   | 8,450,866                                     | 9,086,180 |
| Diluted earnings per common share                     | \$ 0.16                                       | \$ 0.22   |

The two-class method is used in the calculation of basic and diluted earnings per share. Under the two-class method, earnings per share is determined for each class of common stock and participating securities according to dividends declared (or accumulated) and participation rights in undistributed earnings. Restricted stock contains rights to non-forfeitable dividends and qualifies as a participating security. Employee Stock Ownership Plan ( ESOP ) shares are considered outstanding for this calculation unless unearned. For the three months ended September 30, 2012, 10,355 ESOP shares were allocated and 414,207 ESOP shares remained unearned.

Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options. For the three months ended September 30, 2012 and 2011, outstanding stock options to purchase 199,935 shares and 294,530 shares, respectively, were anti-dilutive and not considered in computing diluted earnings per common share. Stock options are not considered participating securities as they do not contain rights to non-forfeitable dividends.

**Note 3 Fair Value Measurements**

FASB ASC 820-10 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

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**Level 2:** Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

**Level 3:** Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

There were no financial or nonfinancial instruments transferred in or out of Level 1, 2, or 3 input categories during the three month ended September 30, 2012 and 2011.

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**Investment Securities:** The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

**Impaired Loans:** At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value generally receive allocations of the allowance for loan losses that are individually evaluated. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a monthly basis for additional impairment and adjusted accordingly.

**Other Real Estate Owned:** Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

As of September 30, 2012 and June 30, 2012, there were no liabilities measured at fair value.

Assets measured at fair value on a recurring basis are summarized in the following table (in thousands):

|                                                   | Fair Value Measurements Using                                                       |                                                        |                                                    |    |
|---------------------------------------------------|-------------------------------------------------------------------------------------|--------------------------------------------------------|----------------------------------------------------|----|
|                                                   | Quoted<br>Prices<br>in<br>Active Markets for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |    |
| <b>Assets at September 30, 2012:</b>              |                                                                                     |                                                        |                                                    |    |
| <u>Available-for-sale securities</u>              |                                                                                     |                                                        |                                                    |    |
| Mortgage-backed securities (residential)          | \$ 17,341                                                                           | \$                                                     | \$ 17,341                                          | \$ |
| Collateralized mortgage obligations (residential) | 31,221                                                                              |                                                        | 31,221                                             |    |
| Total available-for-sale securities               | \$ 48,562                                                                           | \$                                                     | \$ 48,562                                          | \$ |
| <b>Assets at June 30, 2012:</b>                   |                                                                                     |                                                        |                                                    |    |
| <u>Available-for-sale securities</u>              |                                                                                     |                                                        |                                                    |    |
| Mortgage-backed securities (residential)          | \$ 19,371                                                                           | \$                                                     | \$ 19,371                                          | \$ |
| Collateralized mortgage obligations (residential) | 34,026                                                                              |                                                        | 34,026                                             |    |
| Total available-for-sale securities               | \$ 53,397                                                                           | \$                                                     | \$ 53,397                                          | \$ |

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Nonrecurring fair value measurements typically involve assets that are periodically evaluated for impairment and for which any impairment is recorded in the period in which the remeasurement is performed. The following assets were measured at fair value on a non-recurring basis (in thousands):

|                                      | Fair Value Measurements Using                                                    |                                                        |                                                    |           |
|--------------------------------------|----------------------------------------------------------------------------------|--------------------------------------------------------|----------------------------------------------------|-----------|
|                                      | Quoted<br>Prices<br>in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |           |
| <b>Assets at September 30, 2012:</b> |                                                                                  |                                                        |                                                    |           |
| <b>Impaired Loans</b>                |                                                                                  |                                                        |                                                    |           |
| One-to-four family residential       | \$ 3,811                                                                         | \$                                                     | \$                                                 | \$ 3,811  |
| <b>Assets at June 30, 2012:</b>      |                                                                                  |                                                        |                                                    |           |
| <b>Impaired Loans</b>                |                                                                                  |                                                        |                                                    |           |
| One-to-four family residential       | \$ 11,359                                                                        | \$                                                     | \$                                                 | \$ 11,359 |
| Multi-family residential             | 1,456                                                                            |                                                        |                                                    | 1,456     |
| Commercial real estate               | 1,299                                                                            |                                                        |                                                    | 1,299     |
| Total impaired loans                 | \$ 14,114                                                                        | \$                                                     | \$                                                 | \$ 14,114 |

Loans are considered impaired when it is probable that the Company will be unable to collect all amounts due as scheduled according to the contractual terms of the loan agreement, including contractual interest and principal payments. Impaired loans are measured for impairment using the fair value of the collateral for collateral dependent loans. The fair value of collateral is calculated using an independent third party appraisal. Impaired loans measured at fair value had a recorded investment balance of \$4.7 million at September 30, 2012 as compared to \$16.9 million at June 30, 2012. The valuation allowance for these loans was \$899,000 at September 30, 2012 as compared to \$2.8 million at June 30, 2012. The reduction of valuation allowance for impaired loans was primarily attributable to charge-offs of specific valuation allowances previously identified during the three months ended September 30, 2012.

Real estate owned is measured at fair value less estimated costs to sell at transfer. If the fair value of the asset declines, a write-down is recorded through expense. During the three months ended September 30, 2012 and September 30, 2011, the Company did not incur a charge to reduce real estate owned to fair value.

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at September 30, 2012 (dollars in thousands):

| September 30, 2012             | Fair Value | Valuation Techniques      | Unobservable Inputs                                         | Range<br>(Weighted Avg)   |
|--------------------------------|------------|---------------------------|-------------------------------------------------------------|---------------------------|
| <b>Impaired Loans</b>          |            |                           |                                                             |                           |
| One-to-four family residential | \$ 3,811   | Sales comparison approach | Adjustment for the differences between the comparable sales | -14.7% to 4.3%<br>(-1.2%) |

**Fair Value of Financial Instruments**

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a market exchange. The use of different

assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

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The following methods and assumptions were used to estimate fair value of each class of financial instruments for which it is practicable to estimate fair value:

### **Cash and Cash Equivalents**

The carrying amounts of cash and cash equivalents approximate fair values. Cash on hand and non-interest due from bank accounts are classified as Level 1 and federal funds sold are classified as Level 2.

### **Investments**

Estimated fair values for securities held-to-maturity are obtained from quoted market prices where available and are classified as Level 1. Where quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments and are classified as Level 2.

Securities available-for-sale that are previously reported are excluded from the fair value disclosure below.

### **FHLB Stock**

It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

### **Loans**

Fair value for loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously and are excluded from the fair value disclosure below. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

### **Accrued Interest Receivable**

Consistent with the asset or liability they are associated with, the carrying amounts of accrued interest receivable approximate fair value resulting in a either Level 2 or Level 3 classification.

### **Deposits**

The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts) resulting in a Level 2 classification. The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

### **FHLB Advances**

The fair values of the Company's FHLB advances are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

### **Off-Balance Sheet Financial Instruments**

The fair values for the Company's off-balance sheet loan commitments are estimated based on fees charged to others to enter into similar agreements taking into account the remaining terms of the agreements and credit standing of the Company's customers. The estimated fair value of these commitments is not significant.

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The carrying amounts and estimated fair values of the Company's financial instruments are summarized as follows (in thousands):

|                                           | Fair Value Measurements at<br>September 30, 2012 Using:        |          |  |                                   |                                           |            |
|-------------------------------------------|----------------------------------------------------------------|----------|--|-----------------------------------|-------------------------------------------|------------|
|                                           | Quoted Prices in Active Markets for Identical Assets (Level 1) |          |  | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Fair Value |
| Carrying Amount                           |                                                                |          |  |                                   |                                           |            |
| <b>Financial assets:</b>                  |                                                                |          |  |                                   |                                           |            |
| Cash on hand                              | \$ 8,716                                                       | \$ 8,716 |  | \$                                |                                           | \$ 8,716   |
| Federal funds sold                        | 70,855                                                         |          |  | 70,855                            |                                           | 70,855     |
| Securities held-to-maturity               | 986                                                            |          |  | 1,015                             |                                           | 1,015      |
| Federal Home Loan Bank Stock              | 8,085                                                          |          |  |                                   | NA                                        | NA         |
| Loans receivable, net                     | 744,486                                                        |          |  |                                   | 777,878                                   | 777,878    |
| Accrued interest receivable - loans       | 2,767                                                          |          |  |                                   | 2,767                                     | 2,767      |
| Accrued interest receivable - investments | 89                                                             |          |  | 89                                |                                           | 89         |
| <b>Financial liabilities:</b>             |                                                                |          |  |                                   |                                           |            |
| Deposits                                  | 677,892                                                        |          |  | 687,927                           |                                           | 687,927    |
| FHLB Advances                             | 80,000                                                         |          |  | 84,625                            |                                           | 84,625     |

|                                           | Fair Value Measurements at<br>June 30, 2012 Using: |                                                                         |                                         |                                                 | Fair<br>Value |
|-------------------------------------------|----------------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------|-------------------------------------------------|---------------|
|                                           | Carrying<br>Amount                                 | Quoted Prices in Active<br>Markets for Identical<br>Assets (Level<br>1) | Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |               |
| <b>Financial assets:</b>                  |                                                    |                                                                         |                                         |                                                 |               |
| Cash on hand                              | \$ 9,783                                           | \$ 9,783                                                                | \$                                      | \$                                              | \$ 9,783      |
| Federal funds sold                        | 56,235                                             |                                                                         | 56,235                                  |                                                 | 56,235        |
| Securities held-to-maturity               | 1,197                                              |                                                                         | 1,229                                   |                                                 | 1,229         |
| Federal Home Loan Bank Stock              | 8,525                                              |                                                                         |                                         | NA                                              | NA            |
| Loans receivable, net                     | 750,603                                            |                                                                         |                                         | 777,672                                         | 777,672       |
| Accrued interest receivable - loans       | 2,676                                              |                                                                         |                                         | 2,676                                           | 2,676         |
| Accrued interest receivable - investments | 102                                                |                                                                         | 102                                     |                                                 | 102           |
| <b>Financial liabilities:</b>             |                                                    |                                                                         |                                         |                                                 |               |
| Deposits                                  | 682,889                                            |                                                                         | 692,971                                 |                                                 | 692,971       |
| FHLB Advances                             | 80,000                                             |                                                                         | 82,960                                  |                                                 | 82,960        |

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The amortized cost and fair value of available-for-sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income were as follows (in thousands):

|                                                    | Fair Value | Gross Unrealized Gains | Gross Unrealized Losses | Amortized Cost |
|----------------------------------------------------|------------|------------------------|-------------------------|----------------|
| <b>September 30, 2012</b>                          |            |                        |                         |                |
| Mortgage-backed (residential):                     |            |                        |                         |                |
| Fannie Mae                                         | \$ 12,523  | \$ 264                 | \$                      | \$ 12,259      |
| Freddie Mac                                        | 4,818      | 77                     |                         | 4,741          |
| Collateralized mortgage obligations (residential): |            |                        |                         |                |
| Fannie Mae                                         | 19,079     | 49                     | (79)                    | 19,109         |
| Freddie Mac                                        | 12,142     | 49                     |                         | 12,093         |
| Total                                              | \$ 48,562  | \$ 439                 | \$ (79)                 | \$ 48,202      |
| <b>June 30, 2012</b>                               |            |                        |                         |                |
| Mortgage-backed (residential):                     |            |                        |                         |                |
| Fannie Mae                                         | \$ 13,961  | \$ 183                 | \$                      | \$ 13,778      |
| Freddie Mac                                        | 5,410      | 46                     |                         | 5,364          |
| Collateralized mortgage obligations (residential): |            |                        |                         |                |
| Fannie Mae                                         | 21,060     | 8                      | (108)                   | 21,160         |
| Freddie Mac                                        | 12,966     | 26                     | (14)                    | 12,954         |
| Total                                              | \$ 53,397  | \$ 263                 | \$ (122)                | \$ 53,256      |

The carrying amount, unrecognized gains and losses, and fair value of securities held-to-maturity were as follows (in thousands):

|                                                    | Carrying Amount | Gross Unrecognized Gains | Gross Unrecognized Losses | Fair Value |
|----------------------------------------------------|-----------------|--------------------------|---------------------------|------------|
| <b>September 30, 2012</b>                          |                 |                          |                           |            |
| Mortgage-backed (residential):                     |                 |                          |                           |            |
| Fannie Mae                                         | \$ 129          | \$ 4                     | \$                        | \$ 133     |
| Freddie Mac                                        | 89              | 5                        |                           | 94         |
| Ginnie Mae                                         | 42              | 2                        |                           | 44         |
| Collateralized mortgage obligations (residential): |                 |                          |                           |            |
| Fannie Mae                                         | 515             | 16                       |                           | 531        |
| Freddie Mac                                        | 211             | 2                        |                           | 213        |
| Total                                              | \$ 986          | \$ 29                    | \$                        | \$ 1,015   |
| <b>June 30, 2012</b>                               |                 |                          |                           |            |
| Mortgage-backed (residential):                     |                 |                          |                           |            |
| Fannie Mae                                         | \$ 133          | \$ 3                     | \$                        | \$ 136     |
| Freddie Mac                                        | 92              | 6                        |                           | 98         |
| Ginnie Mae                                         | 44              | 2                        |                           | 46         |

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|                                                    |          |       |    |          |
|----------------------------------------------------|----------|-------|----|----------|
| Collateralized mortgage obligations (residential): |          |       |    |          |
| Fannie Mae                                         | 596      | 17    |    | 613      |
| Freddie Mac                                        | 332      | 4     |    | 336      |
| Total                                              | \$ 1,197 | \$ 32 | \$ | \$ 1,229 |

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There were no sales of securities during the three months ended September 30, 2012 and September 30, 2011.

All mortgage-backed securities and collateralized mortgage obligations have varying contractual maturity dates at September 30, 2012. Expected maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or repayment penalties. There were no mortgage-backed securities called prior to the maturity date during the three month ended September 30, 2012.

Securities with unrealized losses at September 30, 2012 and June 30, 2012, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (in thousands):

|                                                   | Less than 12 months |                 | 12 months or more |                 | Total      |                 |
|---------------------------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                                                   | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| <b>September 30, 2012</b>                         |                     |                 |                   |                 |            |                 |
| <u>Description of Securities</u>                  |                     |                 |                   |                 |            |                 |
| Collateralized mortgage obligations (residential) | \$ 1,354            | \$ (18)         | \$ 5,421          | \$ (61)         | \$ 6,775   | \$ (79)         |
| Total temporarily impaired                        | \$ 1,354            | \$ (18)         | \$ 5,421          | \$ (61)         | \$ 6,775   | \$ (79)         |
| <b>June 30, 2012</b>                              |                     |                 |                   |                 |            |                 |
| <u>Description of Securities</u>                  |                     |                 |                   |                 |            |                 |
| Collateralized mortgage obligations (residential) | \$ 18,390           | \$ (84)         | \$ 3,026          | \$ (38)         | \$ 21,416  | \$ (122)        |
| Total temporarily impaired                        | \$ 18,390           | \$ (84)         | \$ 3,026          | \$ (38)         | \$ 21,416  | \$ (122)        |

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the Company does not have the intent to sell these securities and it is not more likely than not that it will be required to sell the securities before their anticipated recovery. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

At September 30, 2012, three debt securities had an aggregate unrealized loss of 0.2% of the Company's amortized cost basis. At June 30, 2012, six debt securities had an unrealized loss of 0.2% of the Company's amortized cost basis. The unrealized losses relate principally to the general change in interest rates and liquidity, and not credit quality, that has occurred since the securities' purchase dates, and such unrecognized losses or gains will continue to vary with general interest rate level fluctuations in the future. As management has the intent and ability to hold debt securities until recovery, which may be maturity, and it is not more likely than not that it will be required to sell the securities before their anticipated recovery, no declines in fair value are deemed to be other-than-temporary as of September 30, 2012 and June 30, 2012.

There were no investments in any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders equity.

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### Note 5 Loans

The composition of loans consists of the following (in thousands):

|                                         | September 30,<br>2012 | June 30,<br>2012 |
|-----------------------------------------|-----------------------|------------------|
| Real Estate:                            |                       |                  |
| One-to-four family residential          | \$ 367,270            | \$ 371,251       |
| Multi-family residential                | 270,748               | 283,553          |
| Commercial real estate                  | 81,414                | 86,964           |
|                                         | 719,432               | 741,768          |
| Consumer:                               |                       |                  |
| Automobile                              | 18,453                | 17,349           |
| Home equity                             | 688                   | 808              |
| Other consumer loans, primarily secured | 9,854                 | 10,722           |
|                                         | 28,995                | 28,879           |
| Loans held for sale                     | 5,739                 |                  |
| Total loans                             | 754,166               | 770,647          |
| Deferred net loan origination costs     | 563                   | 615              |
| Net premium on purchased loans          | 859                   | 957              |
| Allowance for loan losses               | (6,392)               | (7,502)          |
|                                         | \$ 749,196            | \$ 764,717       |

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The following is an analysis of the changes in the allowance for loan losses (in thousands):

|                              | Allowance for loan losses for the<br>Three months ended September 30, 2012 |                             |                           |            |                |       |          |
|------------------------------|----------------------------------------------------------------------------|-----------------------------|---------------------------|------------|----------------|-------|----------|
|                              | One-to-four<br>family                                                      | Multi-family<br>residential | Commercial<br>real estate | Automobile | Home<br>equity | Other | Total    |
| Balance, beginning of period | \$ 4,692                                                                   | \$ 1,519                    | \$ 1,131                  | \$ 62      | \$ 63          | \$ 35 | \$ 7,502 |
| Provision for loan losses    | 964                                                                        | (238)                       | 68                        | 40         | 19             | (3)   | 850      |
| Recoveries                   | 41                                                                         |                             |                           | 7          |                | 1     | 49       |
| Loans charged-off            | (1,176)                                                                    | (224)                       | (527)                     | (21)       | (56)           | (5)   | (2,009)  |
| Balance, end of period       | \$ 4,521                                                                   | \$ 1,057                    | \$ 672                    | \$ 88      | \$ 26          | \$ 28 | \$ 6,392 |

|                              | Allowance for loan losses for the<br>Three months ended September 30, 2011 |                             |                           |            |                |       |           |
|------------------------------|----------------------------------------------------------------------------|-----------------------------|---------------------------|------------|----------------|-------|-----------|
|                              | One-to-four<br>family                                                      | Multi-family<br>residential | Commercial<br>real estate | Automobile | Home<br>equity | Other | Total     |
| Balance, beginning of period | \$ 6,365                                                                   | \$ 2,654                    | \$ 2,254                  | \$ 59      | \$ 13          | \$ 22 | \$ 11,367 |
| Provision for loan losses    | 321                                                                        | 335                         | (637)                     | (19)       |                |       |           |
| Recoveries                   | 102                                                                        |                             |                           | 23         |                | 15    | 140       |
| Loans charged-off            | (396)                                                                      | (223)                       |                           |            |                | (14)  | (633)     |
| Balance, end of period       | \$ 6,392                                                                   | \$ 2,766                    | \$ 1,617                  | \$ 63      | \$ 13          | \$ 23 | \$ 10,874 |

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The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of September 30, 2012 and June 30, 2012 (in thousands):

| September 30, 2012                            | One-to-four<br>family | Multi-family<br>residential | Commercial<br>real estate | Automobile | Home<br>equity | Other | Total    |
|-----------------------------------------------|-----------------------|-----------------------------|---------------------------|------------|----------------|-------|----------|
| <u>Allowance for loan losses:</u>             |                       |                             |                           |            |                |       |          |
| Ending allowance balance attributed to loans: |                       |                             |                           |            |                |       |          |
| Individually evaluated for impairment         | \$ 2,202              | \$                          | \$                        | \$ 27      | \$             | \$ 2  | \$ 2,231 |
| Collectively evaluated for impairment         | 2,319                 | 1,057                       | 672                       | 61         | 26             | 26    | 4,161    |
| Total ending allowance balance                | \$ 4,521              | \$ 1,057                    | \$ 672                    | \$ 88      | \$ 26          | \$ 28 | \$ 6,392 |

|                                       | One-to-four<br>family | Multi-family<br>residential | Commercial<br>real estate | Automobile | Home<br>equity | Other    | Total      |
|---------------------------------------|-----------------------|-----------------------------|---------------------------|------------|----------------|----------|------------|
| <u>Loans:</u>                         |                       |                             |                           |            |                |          |            |
| Individually evaluated for impairment | \$ 19,164             | \$ 2,198                    | \$ 5,026                  | \$ 27      | \$             | \$ 2     | \$ 26,417  |
| Collectively evaluated for impairment | 353,845               | 268,550                     | 76,388                    | 18,426     | 688            | 9,852    | 727,749    |
| Total ending loan balance             | \$ 373,009            | \$ 270,748                  | \$ 81,414                 | \$ 18,453  | \$ 688         | \$ 9,854 | \$ 754,166 |

| June 30, 2012                                 | One-to-four<br>family | Multi-family<br>residential | Commercial<br>real estate | Automobile | Home<br>equity | Other | Total    |
|-----------------------------------------------|-----------------------|-----------------------------|---------------------------|------------|----------------|-------|----------|
| <u>Allowance for loan losses:</u>             |                       |                             |                           |            |                |       |          |
| Ending allowance balance attributed to loans: |                       |                             |                           |            |                |       |          |
| Individually evaluated for impairment         | \$ 2,233              | \$ 226                      | \$ 279                    | \$         | \$ 37          | \$ 3  | \$ 2,778 |
| Collectively evaluated for impairment         | 2,459                 | 1,293                       | 852                       | 62         | 26             | 32    | 4,724    |
| Total ending allowance balance                | \$ 4,692              | \$ 1,519                    | \$ 1,131                  | \$ 62      | \$ 63          | \$ 35 | \$ 7,502 |

|                                       | One-to-four<br>family | Multi-family<br>residential | Commercial<br>real estate | Automobile | Home<br>equity | Other     | Total      |
|---------------------------------------|-----------------------|-----------------------------|---------------------------|------------|----------------|-----------|------------|
| <u>Loans:</u>                         |                       |                             |                           |            |                |           |            |
| Individually evaluated for impairment | \$ 19,535             | \$ 2,426                    | \$ 4,215                  | \$         | \$ 37          | \$ 3      | \$ 26,216  |
| Collectively evaluated for impairment | 351,716               | 281,127                     | 82,749                    | 17,349     | 771            | 10,719    | 744,431    |
| Total ending loan balance             | \$ 371,251            | \$ 283,553                  | \$ 86,964                 | \$ 17,349  | \$ 808         | \$ 10,722 | \$ 770,647 |

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A loan is impaired when it is probable, based on current information and events, the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. When it is determined that a loss is probable, a valuation allowance is established and included in the allowance for loan losses. The amount of impairment is determined by the difference between the recorded investment in the loan and the present value of expected cash flows, or estimated net realizable value of the underlying collateral on collateral dependent loans.

The difference between the recorded investment and unpaid principal balance of loans relates to accrued interest, net deferred origination costs, net premiums on purchased loans, and charge-offs. The following tables present loans individually evaluated for impairment by class of loans as of September 30, 2012 and June 30, 2012 (in thousands):

|                                                   | Unpaid Principal<br>Balance | Recorded<br>Investment | Allowance for Loan<br>Losses<br>Allocated |
|---------------------------------------------------|-----------------------------|------------------------|-------------------------------------------|
| <b>September 30, 2012</b>                         |                             |                        |                                           |
| <b><u>With no related allowance recorded:</u></b> |                             |                        |                                           |
| <b><u>Real estate loans:</u></b>                  |                             |                        |                                           |
| One-to-four family                                | \$ 8,648                    | \$ 7,432               | \$                                        |
| Multi-family residential                          | 3,435                       | 2,198                  |                                           |
| Commercial real estate                            | 5,552                       | 5,026                  |                                           |
|                                                   | 17,635                      | 14,656                 |                                           |
| <b><u>With an allowance recorded:</u></b>         |                             |                        |                                           |
| <b><u>Real estate loans:</u></b>                  |                             |                        |                                           |
| One-to-four family                                | 11,919                      | 11,732                 | 2,202                                     |
| Multi-family residential                          |                             |                        |                                           |
| Commercial real estate                            |                             |                        |                                           |
| <b><u>Other loans:</u></b>                        |                             |                        |                                           |
| Automobile                                        | 27                          | 27                     | 27                                        |
| Home equity                                       |                             |                        |                                           |
| Other                                             | 2                           | 2                      | 2                                         |
|                                                   | 11,948                      | 11,761                 | 2,231                                     |
| Total                                             | \$ 29,583                   | \$ 26,417              | \$ 2,231                                  |

|                                                   | Unpaid Principal<br>Balance | Recorded<br>Investment | Allowance for Loan<br>Losses<br>Allocated |
|---------------------------------------------------|-----------------------------|------------------------|-------------------------------------------|
| <b>June 30, 2012</b>                              |                             |                        |                                           |
| <b><u>With no related allowance recorded:</u></b> |                             |                        |                                           |
| <b><u>Real estate loans:</u></b>                  |                             |                        |                                           |
| One-to-four family                                | \$ 6,509                    | \$ 5,943               | \$                                        |
| Multi-family residential                          | 1,757                       | 744                    |                                           |
| Commercial real estate                            | 2,636                       | 2,636                  |                                           |
|                                                   | 10,902                      | 9,323                  |                                           |
| <b><u>With an allowance recorded:</u></b>         |                             |                        |                                           |
| <b><u>Real estate loans:</u></b>                  |                             |                        |                                           |
| One-to-four family                                | 14,172                      | 13,592                 | 2,233                                     |
| Multi-family residential                          | 1,682                       | 1,682                  | 226                                       |
| Commercial real estate                            | 1,579                       | 1,579                  | 279                                       |
| <b><u>Other loans:</u></b>                        |                             |                        |                                           |

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|             |           |           |          |
|-------------|-----------|-----------|----------|
| Automobile  |           |           |          |
| Home equity | 37        | 37        | 37       |
| Other       | 3         | 3         | 3        |
|             | 17,473    | 16,893    | 2,778    |
| Total       | \$ 28,375 | \$ 26,216 | \$ 2,778 |

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The following table presents monthly average of individually impaired loans by class as of September 30, 2012 and September 30, 2011 (in thousands):

|                                 | <b>Three months ended<br/>September 30,</b> |                  |
|---------------------------------|---------------------------------------------|------------------|
|                                 | <b>2012</b>                                 | <b>2011</b>      |
| <b><u>Real estate loan:</u></b> |                                             |                  |
| One-to-four family              | \$ 19,347                                   | \$ 18,429        |
| Multi-family residential        | 2,312                                       | 3,272            |
| Commercial real estate          | 4,620                                       | 4,912            |
| <b><u>Other loans:</u></b>      |                                             |                  |
| Home Equity                     | 19                                          |                  |
| <b>Total</b>                    | <b>\$ 26,298</b>                            | <b>\$ 26,613</b> |

Payments received on impaired loans are recorded as a reduction of principal or as interest income depending on management's assessment of the ultimate collectability of the loan principal. Generally, interest income on an impaired loan is recorded on a cash basis when the outstanding principal is brought current.

The following table presents income recorded on impaired loans by class (in thousands). Interest income recorded on impaired loans for all periods presented was recorded on a cash basis.

|                                 | <b>Three months ended<br/>September 30,</b> |               |
|---------------------------------|---------------------------------------------|---------------|
|                                 | <b>2012</b>                                 | <b>2011</b>   |
| <b><u>Real estate loan:</u></b> |                                             |               |
| One-to-four family              | \$ 98                                       | \$ 196        |
| Multi-family residential        | 18                                          | 14            |
| Commercial real estate          | 46                                          | 70            |
| <b>Total</b>                    | <b>\$ 162</b>                               | <b>\$ 280</b> |

The following table presents nonaccrual loans by class of loans (in thousands):

| <b>Non-accrual loans:</b>        | <b>September 30, 2012</b> | <b>June 30, 2012</b> |
|----------------------------------|---------------------------|----------------------|
| <b><u>Real estate loans:</u></b> |                           |                      |
| One-to-four family               | \$ 18,358                 | \$ 18,720            |
| Multi-family residential         | 2,197                     | 2,426                |
| Commercial                       | 5,026                     | 4,214                |
| <b><u>Other loans:</u></b>       |                           |                      |
| Automobile                       | 27                        |                      |
| Home Equity                      |                           | 37                   |
| Other                            | 3                         | 3                    |
| <b>Total non-accrual loans</b>   | <b>\$ 25,611</b>          | <b>\$ 25,400</b>     |

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The following tables present the aging of past due loans by class of loans (in thousands):

| <b>September 30, 2012</b> | <b>30-59<br/>Days<br/>Delinquent</b> | <b>60-89<br/>Days<br/>Delinquent</b> | <b>90 Days<br/>or<br/>More<br/>Delinquent</b> | <b>Total<br/>Delinquent<br/>Loans</b> | <b>Total<br/>Current<br/>Loans</b> | <b>Total Loans</b> |
|---------------------------|--------------------------------------|--------------------------------------|-----------------------------------------------|---------------------------------------|------------------------------------|--------------------|
| <u>Real estate loans:</u> |                                      |                                      |                                               |                                       |                                    |                    |
| One-to-four family        | \$ 1,310                             | \$ 1,494                             | \$ 6,736                                      | \$ 9,540                              | \$ 363,469                         | \$ 373,009         |
| Multi-family              |                                      |                                      | 744                                           | 744                                   | 270,004                            | 270,748            |
| Commercial                |                                      |                                      |                                               |                                       | 81,414                             | 81,414             |
| <u>Other loans:</u>       |                                      |                                      |                                               |                                       |                                    |                    |
| Automobile                | 61                                   |                                      | 11                                            | 72                                    | 18,381                             | 18,453             |
| Home Equity               |                                      |                                      |                                               |                                       | 688                                | 688                |
| Other                     | 9                                    | 4                                    | 3                                             | 16                                    | 9,838                              | 9,854              |
| <b>Total loans</b>        | <b>\$ 1,380</b>                      | <b>\$ 1,498</b>                      | <b>\$ 7,494</b>                               | <b>\$ 10,372</b>                      | <b>\$ 743,794</b>                  | <b>\$ 754,166</b>  |

| <b>June 30, 2012</b>      | <b>30-59<br/>Days<br/>Delinquent</b> | <b>60-89<br/>Days<br/>Delinquent</b> | <b>90 Days<br/>or<br/>More<br/>Delinquent</b> | <b>Total<br/>Delinquent<br/>Loans</b> | <b>Total<br/>Current<br/>Loans</b> | <b>Total Loans</b> |
|---------------------------|--------------------------------------|--------------------------------------|-----------------------------------------------|---------------------------------------|------------------------------------|--------------------|
| <u>Real estate loans:</u> |                                      |                                      |                                               |                                       |                                    |                    |
| One-to-four family        | \$ 2,311                             | \$ 1,787                             | \$ 6,815                                      | \$ 10,913                             | \$ 360,338                         | \$ 371,251         |
| Multi-family              |                                      |                                      | 744                                           | 744                                   | 282,809                            | 283,553            |
| Commercial                |                                      |                                      |                                               |                                       | 86,964                             | 86,964             |
| <u>Other loans:</u>       |                                      |                                      |                                               |                                       |                                    |                    |
| Automobile                | 30                                   | 21                                   |                                               | 51                                    | 17,298                             | 17,349             |
| Home Equity               |                                      |                                      |                                               |                                       | 808                                | 808                |
| Other                     | 12                                   | 1                                    | 3                                             | 16                                    | 10,706                             | 10,722             |
| <b>Total loans</b>        | <b>\$ 2,353</b>                      | <b>\$ 1,809</b>                      | <b>\$ 7,562</b>                               | <b>\$ 11,724</b>                      | <b>\$ 758,923</b>                  | <b>\$ 770,647</b>  |

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### **Troubled Debt Restructurings:**

Troubled debt restructurings totaled \$14.1 million and \$13.7 million at September 30, 2012 and June 30, 2012, respectively. Troubled debt restructurings of \$13.3 million and \$12.9 million are included in the non-accrual loans at September 30, 2012 and June 30, 2012. The Bank has allocated \$1.6 million of valuation allowance to customers whose loan terms have been modified in troubled debt restructurings and are on non-accrual status as of September 30, 2012 and June 30, 2012. Troubled debt restructured loans are included in non-accrual loans until there is a sustained period of payment performance (usually six months or longer and determined on a case by case basis) and there is a reasonable assurance that the timely payment will continue. During the three months ended September 30, 2012, no troubled debt restructurings were returned to accrual status. This compares to two troubled debt restructurings with an aggregate outstanding balance of \$807,000 that were returned to accrual status as a result of the borrowers paying the modified terms as agreed for a sustained period of more than six months during the year ended June 30, 2012. There were no further commitments to customers whose loans were troubled debt restructurings at September 30, 2012 and June 30, 2012.

During the three month ended September 30, 2012, the terms of three one-to-four family loans with an aggregate outstanding balance of \$1.1 million at September 30, 2012 were modified as troubled debt restructurings. The modification of the terms was a temporary reduction of the stated interest rates of the loans for a period of 24 months. There was no modification of terms involving an extension of the maturity dates or a permanent reduction of the recorded investment in the loans.

Prior to the modification of the terms, the troubled debt restructurings described above were already considered impaired and were assessed for impairment individually and no charge offs were recorded. The individually evaluated allowance associated with these loans was \$165,000 at September 30, 2012.

At September 30, 2012 and September 30, 2011, there were no loans modified as a troubled debt restructuring within the previous 12 months for which there was a payment default. A loan is considered to be in payment default once it is 60 days contractually past due under the modified terms.

The terms of certain other loans were modified during the three months ended September 30, 2012 that did not meet the definition of a troubled debt restructuring. During the three months ended September 30, 2012, twenty-two loans in the amount of \$11.3 million were modified and not accounted for as troubled debt restructurings. The modifications were made to refinance the credits to maintain the borrowing relationships and generally consisted of term or rate modifications. The borrowers were not experiencing financial difficulty or delay in loan payments and the modifications were made at market terms.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

### **Credit Quality Indicators**

The Company categorizes loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation and current economic trends among other factors. This analysis is performed monthly. The Company uses the following definitions for risk ratings:

**Special Mention.** Loans are classified as special mention when it is determined a loan relationship should be monitored more closely. Loans that are 60 days to 89 days past due are generally classified as special mention. In addition, loans are classified as special mention for a variety of reasons including changes in recent borrower financial conditions, changes in borrower operations, changes in value of available collateral, concerns regarding changes in economic conditions in a borrower's industry, and other matters. A loan classified as special mention in many instances may be performing in accordance with the loan terms.

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Substandard. Loans that are 90 days or more past due are generally classified as substandard. A loan is also considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable.

Loss. Assets classified as loss are considered uncollectible and of such little value that continuance as an asset, without establishment of a valuation allowance individually evaluated or charge-off, is not warranted.

Loans not meeting the criteria as part of the above described process are considered to be Pass rated loans. Pass rated loans are generally well protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. Pass rated assets are not more than 59 days past due and are generally performing in accordance with the loan terms.

As of September 30, 2012 and June 30, 2012, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows (in thousands):

| <b>September 30, 2012</b>        | <b>Pass</b>       | <b>Special Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Loss</b>  |
|----------------------------------|-------------------|------------------------|--------------------|-----------------|--------------|
| <b><u>Real estate loans:</u></b> |                   |                        |                    |                 |              |
| One-to-four family               | \$ 335,143        | \$ 8,998               | \$ 23,129          | \$              | \$           |
| Multi-family                     | 261,635           | 4,198                  | 4,915              |                 |              |
| Commercial                       | 66,669            | 6,213                  | 8,532              |                 |              |
| <b><u>Other loans:</u></b>       |                   |                        |                    |                 |              |
| Automobile                       | 18,172            | 125                    | 119                | 10              | 27           |
| Home equity                      | 688               |                        |                    |                 |              |
| Other                            | 9,829             |                        | 18                 | 5               | 2            |
| <b>Total loans</b>               | <b>\$ 692,136</b> | <b>\$ 19,534</b>       | <b>\$ 36,713</b>   | <b>\$ 15</b>    | <b>\$ 29</b> |

| <b>June 30, 2012</b>             | <b>Pass</b>       | <b>Special Mention</b> | <b>Substandard</b> | <b>Doubtful</b> | <b>Loss</b> |
|----------------------------------|-------------------|------------------------|--------------------|-----------------|-------------|
| <b><u>Real estate loans:</u></b> |                   |                        |                    |                 |             |
| One-to-four family               | \$ 337,924        | \$ 9,801               | \$ 23,526          | \$              | \$          |
| Multi-family                     | 272,581           | 6,280                  | 4,692              |                 |             |
| Commercial                       | 71,611            | 6,254                  | 9,099              |                 |             |
| <b><u>Other loans:</u></b>       |                   |                        |                    |                 |             |
| Automobile                       | 17,110            | 117                    | 95                 | 27              |             |
| Home equity                      | 771               |                        | 37                 |                 |             |
| Other                            | 10,699            |                        | 19                 | 1               | 3           |
| <b>Total loans</b>               | <b>\$ 710,696</b> | <b>\$ 22,452</b>       | <b>\$ 37,468</b>   | <b>\$ 28</b>    | <b>\$ 3</b> |

**Table of Contents****Note 6 Real Estate Owned**

Changes in real estate owned are summarized as follows (in thousands):

|                          | <b>September 30, 2012</b> | <b>June 30, 2012</b> |
|--------------------------|---------------------------|----------------------|
| Beginning of period      | \$ 1,280                  | \$ 828               |
| Transfers in             |                           | 1,529                |
| Capitalized improvements |                           | 41                   |
| Sales                    | (670)                     | (1,118)              |
| End of period            | \$ 610                    | \$ 1,280             |

Net income (expenses) related to foreclosed assets are as follows and are included in other operating expense (in thousands):

|                                          | <b>Three months ended<br/>September 30,<br/>2012</b> | <b>September 30,<br/>2011</b> |
|------------------------------------------|------------------------------------------------------|-------------------------------|
| Net gain on sales                        | \$ 16                                                | \$ 40                         |
| Operating expenses, net of rental income | (1)                                                  | (14)                          |
| Total                                    | \$ 15                                                | \$ 26                         |

The company has no valuation allowance or activity in the valuation allowance account during the three months ended September 30, 2012 and 2011.

**Note 7 Federal Home Loan Bank Advances**

FHLB advances were \$80.0 million at September 30, 2012 and June 30, 2012. At September 30, 2012, the stated interest rates on the Bank's advances from the FHLB ranged from 0.85% to 4.40% with a weighted average stated rate of 2.33%. The range of the stated interest rates and the weighted average stated rate remain unchanged from June 30, 2012.

The contractual maturities by fiscal year of the Bank's FHLB advances over the next five years and thereafter are as follows (in thousands):

| <b>Fiscal Year of Maturity</b> | <b>September 30,<br/>2012</b> | <b>June 30,<br/>2012</b> |
|--------------------------------|-------------------------------|--------------------------|
| 2013                           | \$ 20,000                     | \$ 20,000                |
| 2014                           |                               |                          |
| 2015                           | 20,000                        | 20,000                   |
| 2016                           |                               |                          |
| 2017                           | 20,000                        | 20,000                   |
| Thereafter                     | 20,000                        | 20,000                   |
| Total                          | \$ 80,000                     | \$ 80,000                |

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### **Note 8 Repurchase of Common Stock**

In November 2011, the Board of Directors authorized a stock repurchase program pursuant to which the Company repurchased 5% of its issued and outstanding shares, or approximately 480,257 shares. Upon completion of the aforementioned stock repurchase program in April 2012, the Board of Directors authorized a second stock repurchase program pursuant to which the Company intends to repurchase up to 5% of its issued and outstanding shares, or up to approximately 456,378 shares.

For the three months ended September 30, 2012, the Company repurchased 193,533 shares at aggregate cost of \$2.9 million, including commissions. The shares were repurchased at prices between \$14.75 and \$15.25 per share with a weighted average price of \$15.05. There were 96,650 shares remaining under the second stock repurchase program at September 30, 2012.

### **Note 9 Subsequent Events**

On October 9, 2012, the Company announced effective November 13, 2012, the Bank will be renamed Simplicity Bank. In addition, the Company will change its name to Simplicity Bancorp, Inc. and its trading symbol to SMPL. This new name aligns well with the core principles the Company was founded upon - to provide value, personal service and financial well being for our customers and communities. As Simplicity Bank, the Company will continue this legacy as the Bank grows and improves to make the banking experience for the customers even easier with more options, better technology, enhanced service capacity, a fresh look and a renewed vision. In conjunction with the name change, the Company is developing an extensive branding campaign which will include signage, branch remodeling, advertising, training and other operating costs.

On October 29, 2012, the Company announced that its Board of Directors authorized the third stock repurchase program pursuant to which the Company intends to repurchase up to 5% of its issued and outstanding shares upon completion of the second stock repurchase program, or up to approximately 434,732 shares. The timing of the repurchases will depend on certain factors, including but not limited to, market conditions and prices, the Company's liquidity requirements and alternative uses of capital. The stock repurchase program may be carried out through open-market purchases, block trades, negotiated private transactions and pursuant to a trading plan that may be adopted in accordance with Rule 10b5-1 of the SEC's rules. Any repurchased shares will be available for general corporate purposes.

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

#### **Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains certain forward-looking statements and information relating to the Company and the Bank that are based on the beliefs of management as well as assumptions made by and information currently available to management. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words like believe, expect, anticipate, estimate, and intend or future or conditional verbs such as will, should, could, or may and similar expressions or the negative of such words. Certain factors that could cause actual results to differ materially from expected results include, changes in the interest rate environment, changes in general economic conditions, legislative and regulatory changes that adversely affect the business of Kaiser Federal Financial Group, Inc. and Kaiser Federal Bank, and changes in the securities markets. Should one or more of these risks or uncertainties materialize or should underlying assumptions prove incorrect, actual results may vary materially from those described herein. We caution readers not to place undue reliance on forward-looking statements. The Company disclaims any obligation to revise or update any forward-looking statements contained in this Form 10-Q to reflect future events or developments.

#### **Recent Developments**

On October 9, 2012, the Company announced effective November 13, 2012, the Bank will be renamed Simplicity Bank. In addition, the Company will change its name to Simplicity Bancorp, Inc. and its trading symbol to SMPL. This new name aligns well with the core principles the Company was founded upon - to provide value, personal service and financial well being for our customers and communities. As Simplicity Bank, the Company will continue this legacy as the Bank grows and improves to make the banking experience for our customers even easier with more options, better technology, enhanced service capacity, a fresh look and a renewed vision. In conjunction with the name change, the Company is developing an extensive branding campaign which will include signage, branch remodeling, advertising, training and other operating costs. The capital expenditures related to these activities are estimated at \$600,000 in fiscal 2013 which will result in annual depreciation expense of \$120,000. We also expect an increase in advertising and promotional expense in fiscal 2013 in the amount of \$650,000 and an increase in other categories of noninterest expense of \$180,000 related to these efforts.

#### **Market Area**

Our success depends primarily on the general economic conditions in the California counties of Los Angeles, Orange, San Diego, San Bernardino, Riverside, Santa Clara and Alameda, as nearly all of our loans are to customers in this market area. Economic conditions remain weak both nationally and in our market area of California. According to the Beige Book published by the Federal Reserve Bank in October 2012, economic activity continued to expand at a moderate pace from July to September 2012. Although there were signs of improvement in home demand, sales pace of new and existing homes is still well below its historical average. We continue to experience distressed home prices and California in particular has experienced significant declines in real estate values. In addition, while both California and national unemployment rates improved during the three months ended September 30, 2012, unemployment rates remain at historically high levels. In particular, California continues to experience elevated unemployment rates as compared to the national average. Unemployment rates in California were 10.2% in September 2012 as compared to 10.7% in June 2012. This compares to the national unemployment rate of 7.8% in September 2012 and 8.2% in June 2012.

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

**Assets.** Total assets declined to \$915.4 million at September 30, 2012 from \$923.3 million at June 30, 2012 due primarily to a decrease in gross loans receivable and securities available for sale, partially offset by an increase in cash and cash equivalents.

Cash and cash equivalents increased by \$13.6 million, or 20.5% to \$79.6 million at September 30, 2012 from \$66.0 million at June 30, 2012. The increase was primarily due to an increase of \$14.6 million in federal funds sold as a result of proceeds received from newly originated conforming fixed rate loans sold in the secondary market as well as principal repayments and payoffs.

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Securities available-for-sale decreased by \$4.8 million, or 9.1%, to \$48.6 million at September 30, 2012 from \$53.4 million at June 30, 2012 due to principal repayments and amortization.

Our gross loan portfolio decreased by \$16.5 million, or 2.1% to \$754.2 million at September 30, 2012 from \$770.6 million at June 30, 2012 due primarily to principal repayments and payoffs in addition to the sale of newly originated conforming fixed rate loans in the secondary market. Multi-family loans decreased \$12.8 million, or 4.5%, to \$270.7 million at September 30, 2012 from \$283.6 million at June 30, 2012. Commercial real estate loans decreased \$5.6 million, or 6.4%, to \$81.4 million at September 30, 2012 from \$87.0 million at June 30, 2012. Other loans, which were comprised primarily of automobile and secured loans increased \$116,000, or 0.4%, to \$29.0 million at September 30, 2012 from \$28.9 million at June 30, 2012. The decrease in multi-family loans and commercial real estate loans were primarily attributable to principal repayments and payoffs. One-to-four family real estate loans increased \$1.8 million, or 0.5%, to \$373.0 million at September 30, 2012 from \$371.2 million at June 30, 2012. Real estate loans comprised 96.2% of the total loan portfolio at September 30, 2012, compared with 96.3% at June 30, 2012. During the quarter ended September 30, 2012, the Company made the decision to sell newly originated fixed rate conforming one-to-four family residential real estate loans in the secondary market while retaining the servicing rights. The ability to sell mortgage assets and retain the customer relationship is instrumental in ensuring the Bank is a viable option for customers that desire a mortgage loan. Included in our gross loan portfolio of \$754.2 million were \$5.7 million in loans held for sale.

The allowance for loan losses decreased by \$1.1 million, or 14.8%, to \$6.4 million at September 30, 2012 from \$7.5 million at June 30, 2012. The decrease was due primarily to net charge-offs of \$2.0 million, of which \$1.1 million was previously reserved for loans individually evaluated for impairment, as well as a decline in the loan receivable balance collectively evaluated for impairment. The reductions in the allowance for loan losses were partially offset by an increase in valuation allowances on impaired loans secured by one-to-four family residential loans, and the \$850,000 provision expense recorded during the three months ended September 30, 2012 primarily due to short sale losses and charge-offs on impaired loans.

**Deposits.** Total deposits decreased \$5.0 million, or 0.7%, to \$677.9 million at September 30, 2012 from \$682.9 million at June 30, 2012. The decrease in deposits was comprised of a \$10.0 million decrease in noninterest bearing deposits, partially offset by a \$5.0 million increase in interest bearing deposits.

The \$5.0 million increase in interest bearing deposits consisted of a \$7.4 million, or 4.7%, increase in money market accounts from \$156.0 million at June 30, 2012 to \$163.4 million at September 30, 2012 and a \$2.6 million, or 34.1%, increase in interest-bearing checking product from \$7.8 million at June 30, 2012 to \$10.4 million at September 30, 2012. This increase was partially offset by a \$3.0 million, or 2.2%, decrease in savings accounts from \$140.9 million at June 30, 2012 to \$137.9 million at September 30, 2012 and a \$2.0 million, or 0.7%, decrease in certificates of deposit from \$306.9 million at June 30, 2012 to \$304.9 million at September 30, 2012. The increase in interest bearing deposits was primarily a result of continued growth of new money market and interest-bearing checking products introduced during fiscal 2012. The decrease in noninterest bearing deposits was primarily a result of the timing of customer payroll deposits as compared to June 30, 2012.

**Borrowings.** FHLB advances were at \$80.0 million at September 30, 2012 and June 30, 2012. The weighted average cost of FHLB advances of 2.33% remains unchanged from June 30, 2012.

**Stockholders' Equity.** Total stockholders' equity, represented 16.64% of total assets and decreased to \$152.3 million at September 30, 2012 from \$154.1 million at June 30, 2012. The decrease in stockholders' equity was primarily attributable to shares repurchased during the three months ended September 30, 2012 pursuant to the stock repurchase program previously announced of \$2.9 million as well as cash dividends paid of \$685,000, partially offset by an increase in retained earnings of \$1.4 million.

**Table of Contents****Average Balances, Net Interest Income, Yields Earned and Rates Paid**

The following table sets forth certain information for the three months ended September 30, 2012 and 2011, respectively.

|                                                                  | For the three months ended September 30,<br>2012 <sup>(1)</sup> |          |                                                     | 2011 <sup>(1)</sup> |           |                           |
|------------------------------------------------------------------|-----------------------------------------------------------------|----------|-----------------------------------------------------|---------------------|-----------|---------------------------|
|                                                                  | Average<br>Balance                                              | Interest | Average<br>Yield/<br>Cost<br>(Dollars in thousands) | Average<br>Balance  | Interest  | Average<br>Yield/<br>Cost |
| <b>INTEREST-EARNING ASSETS</b>                                   |                                                                 |          |                                                     |                     |           |                           |
| Loans receivable <sup>(2)</sup>                                  | \$ 762,251                                                      | \$ 9,718 | 5.10%                                               | \$ 698,247          | \$ 10,028 | 5.74%                     |
| Securities <sup>(3)</sup>                                        | 52,165                                                          | 81       | 0.62                                                | 27,266              | 156       | 2.29                      |
| Federal funds sold                                               | 57,838                                                          | 32       | 0.22                                                | 108,049             | 69        | 0.26                      |
| Federal Home Loan Bank stock                                     | 8,305                                                           | 10       | 0.48                                                | 10,104              | 7         | 0.28                      |
| Interest-earning deposits in other financial institutions        |                                                                 |          |                                                     | 9,762               | 17        | 0.70                      |
| Total interest-earning assets                                    | 880,559                                                         | 9,841    | 4.47                                                | 853,428             | 10,277    | 4.82                      |
| Noninterest earning assets                                       | 38,019                                                          |          |                                                     | 38,689              |           |                           |
| Total assets                                                     | \$ 918,578                                                      |          |                                                     | \$ 892,117          |           |                           |
| <b>INTEREST-BEARING LIABILITIES</b>                              |                                                                 |          |                                                     |                     |           |                           |
| Interest-bearing checking                                        | \$ 9,050                                                        | \$ 2     | 0.09%                                               | \$                  | \$        | %                         |
| Money market                                                     | 160,170                                                         | 128      | 0.32                                                | 135,060             | 222       | 0.66                      |
| Savings deposits                                                 | 139,998                                                         | 49       | 0.14                                                | 136,452             | 113       | 0.33                      |
| Certificates of deposit                                          | 305,622                                                         | 1,569    | 2.05                                                | 311,896             | 1,738     | 2.23                      |
| Borrowings                                                       | 80,000                                                          | 469      | 2.35                                                | 82,500              | 794       | 3.85                      |
| Total interest-bearing liabilities                               | 694,840                                                         | 2,217    | 1.28                                                | 665,908             | 2,867     | 1.72                      |
| Noninterest bearing liabilities                                  | 70,123                                                          |          |                                                     | 67,942              |           |                           |
| Total liabilities                                                | 764,963                                                         |          |                                                     | 733,850             |           |                           |
| Equity                                                           | 153,615                                                         |          |                                                     | 158,267             |           |                           |
| Total liabilities and equity                                     | \$ 918,578                                                      |          |                                                     | \$ 892,117          |           |                           |
| Net interest/spread                                              |                                                                 | \$ 7,624 | 3.19%                                               |                     | \$ 7,410  | 3.09%                     |
| Margin <sup>(4)</sup>                                            |                                                                 |          | 3.46%                                               |                     |           | 3.47%                     |
| Ratio of interest-earning assets to interest bearing liabilities | 126.73%                                                         |          |                                                     | 128.16%             |           |                           |

(1) Yields earned and rates paid have been annualized.

(2) Calculated net of deferred fees, loss reserves and includes non-accrual loans.

(3) Calculated based on amortized cost of held-to-maturity securities and fair value of available-for-sale securities.

(4) Net interest income divided by interest-earning assets.



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### **Comparison of Results of Operations for the Three Months Ended September 30, 2012 and September 30, 2011.**

**General.** Net income for the three months ended September 30, 2012 was \$1.4 million, a decrease of \$660,000 as compared to net income of \$2.1 million for the three months ended September 30, 2011. Earnings per basic and diluted common share were \$0.16 for the three months ended September 30, 2012, compared to \$0.22 for the three months ended September 30, 2011. The decrease in net income was due primarily to an increase in noninterest expense and provision for loan losses partially offset by an increase in noninterest income and improvement in net interest income.

**Interest Income.** Interest income decreased \$436,000, or 4.2%, to \$9.8 million for the three months ended September 30, 2012 from \$10.3 million for the three months ended September 30, 2011. The decline in interest income was primarily due to decreases in interest and fees on loans and decreases in interest income on securities.

Interest and fees on loans decreased \$310,000 to \$9.7 million for the three months ended September 30, 2012 from \$10.0 million for the three months ended September 30, 2011. The primary reason for the decrease was a decline of 64 basis points in the average yield on loans from 5.74% for the three months ended September 30, 2011 to 5.10% for the three months ended September 30, 2012, partially offset by an increase of \$64.1 million in the average balance of loans receivable to \$762.3 million for the three months ended September 30, 2012 from \$698.2 million for the three months ended September 30, 2011. The decrease in the average yield on loans was primarily caused by lower yields earned on loan originations during the period as a result of the low interest rate environment. The increase in the average loan receivable balance was attributable to new loan originations as well as loans purchased.

Interest income on securities decreased \$75,000, or 48.1%, to \$81,000 for the three months ended September 30, 2012 from \$156,000 for the three months ended September 30, 2011. The decrease in interest income on securities was primarily due to a decrease of 167 basis points in average yield on securities from 2.29% to 0.62% for the three months ended September 30, 2012. The decline in yield was partially offset by an increase of \$24.9 million in the average balance of securities to \$52.2 million for the three months ended September 30, 2012 from \$27.3 million for the three months ended September 30, 2011 due to new purchases of lower yielding securities as well as increased amortization of investment premium as a result of accelerated principal paydown.

**Interest Expense.** Interest expense decreased \$650,000, or 22.7% to \$2.2 million for the three months ended September 30, 2012 from \$2.9 million for the three months ended September 30, 2011. The decrease was primarily attributable to a 44 basis points decline in the average cost of interest bearing liabilities to 1.28% for the three months ended September 30, 2012 from 1.72% for the three months ended September 30, 2011, partially offset by an increase of \$28.9 million to \$694.8 million in average total interest bearing liabilities for the three months ended September 30, 2012 from \$665.9 million for the three months ended September 30, 2011. The decrease in the average cost of interest bearing liabilities reflected a reduction in the cost of funds such as interest on deposits and borrowings as a result of the low interest rate environment and repayment of higher costing FHLB advances in fiscal 2012 which were replaced by lower costing advances. The increase in the average balance of total interest-bearing liabilities was due primarily to the increase in the average balance of money market and interest-bearing checking deposits resulting from continued growth of new money market and interest-bearing checking products introduced during fiscal 2012.

**Provision for Loan Losses.** Provision for loan losses increased to \$850,000 for the three months ended September 30, 2012 as compared to no provision for the same period last year. Non-performing loans increased slightly to \$25.6 million, or 3.40% of total loans at September 30, 2012 as compared to \$25.4 million, or 3.29% of total loans at June 30, 2012. Delinquent loans 60 days or more totaled \$9.0 million, or 1.19% of total loans at September 30, 2012 as compared to \$9.4 million, or 1.22% of total loans at June 30, 2012.

The provision for loan losses of \$850,000 during the three months ended September 30, 2012 was comprised of a \$964,000 provision on one-to-four family loans, a \$238,000 reduction in provision on multi-family loans, a \$68,000 provision on commercial real estate loans, a \$40,000 provision on automobile loans, a \$19,000 provision on home equity loans and a \$3,000 reduction in provision on other loans. The increase in provision on one-to-four family loans was primarily due to short sale losses and charge-offs on impaired loans. Short sale activity increased during the first fiscal quarter primarily as a result of the transfer of servicing from a third party servicer to us. The reduction in provision on multi-family loans was primarily due to a decline in the overall historical loss factors on loans collectively evaluated for impairment and a reduction in the balance of multi-family loans collectively evaluated for impairment.

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There was also a charge-off of approximately \$253,000 on a commercial real estate loan that exhibited weakness during the first fiscal quarter but remained current on its loan payments. The provision reflects management's continuing assessment of the credit quality of the Company's loan portfolio, which is affected by various trends, including current economic conditions.

**Noninterest Income.** Our noninterest income increased \$437,000, or 40.5%, to \$1.5 million for the three months ended September 30, 2012 as compared to \$1.1 million for the three months ended September 30, 2011 due primarily to \$424,000 in pre-tax gains on \$10.9 million of fixed rate conforming one-to-four family loans sold.

**Noninterest Expense.** Our noninterest expense increased \$903,000, or 17.4% to \$6.1 million for the three months ended September 30, 2012 as compared to \$5.2 million for the three months ended September 30, 2011 primarily due to an increase in salaries and benefits expense, other operating expenses, and advertising and promotional expenses.

Salaries and benefits expense increased \$560,000, or 21.0% to \$3.2 million for the three months ended September 30, 2012 as compared to \$2.7 million for the three months ended September 30, 2011 due primarily to employees hired in the areas of eCommerce, marketing and lending. Employees hired in eCommerce and marketing will focus on aligning marketing efforts under the Bank's new name and brand. eCommerce employees will also continue to focus on expanding customer relationships through enhanced delivery channels such as online and mobile banking. Over the past year we also hired seasoned loan officers, underwriters and support staff in the income property and one-to-four family loan origination departments to accommodate for increased loan origination and sale activity.

Other operating expenses increased \$138,000, or 31.4%, to \$578,000 for the three months ended September 30, 2012 as compared to \$440,000 for the three months ended September 30, 2011. The increase was primarily due to increases in expenditures on supplies, subscriptions and web-based electronic services.

Advertising and promotional expenses increased \$58,000, or 78.4%, to \$132,000 for the three months ended September 30, 2012 as compared to \$74,000 for the three months ended September 30, 2011. The increase was primarily due to expenses incurred related to new branding initiatives. We also expect an increase in advertising and promotional expense in fiscal 2013 in the amount of \$650,000 and an increase in other categories of noninterest expense of \$300,000 related to these efforts.

**Income Tax Expense.** Income tax expense decreased \$442,000, or 35.4% to \$806,000 for the three months ended September 30, 2012 compared to \$1.2 million for the three months ended September 30, 2011. This decrease was primarily the result of lower pretax income for the three months ended September 30, 2012 compared to the three months ended September 30, 2011. The effective tax rates were 36.7% and 37.8% for the three months ended September 30, 2012 and 2011, respectively.

## **Asset Quality**

**General.** We continue our disciplined lending practices including our strict adherence to a long standing regimented credit culture that emphasizes the consistent application of underwriting standards to all loans. In this regard, we fully underwrite all loans based on an applicant's employment history, credit history and an appraised value of the subject property. With respect to loans we purchase, we underwrite each loan based upon our own underwriting standards prior to making the purchase except for loans purchased with a credit guarantee. The credit guarantee requires the seller to substitute or repurchase any loans sold to the Bank that become 60 days or more delinquent at the Bank's option. The purchased loans with a credit guarantee are seasoned loans with stable employment base and reasonable collateral value. We reviewed the credit quality of a sample of the purchased loans with a credit guarantee prior to purchasing the loans and we plan to complete our review within the contractual review period in November 2012 which allows us to substitute loans with credit or collateral quality not to our satisfaction.

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The following underwriting guidelines, among other things, have been used by us as underwriting tools to further limit our potential loss exposure:

All variable rate one-to-four family residential loans are underwritten using the fully indexed rate.

We only lend up to 80% of the lesser of the appraised value or purchase price for one-to-four family residential loans without private mortgage insurance ( PMI ), and up to 95% with PMI.

We only lend up to 75% of the lesser of the appraised value or purchase price for multi-family residential loans.

We only lend up to 65% of the lesser of the appraised value or purchase price for commercial real estate loans. Additionally, our portfolio has remained strongly anchored in traditional mortgage products. We do not originate or purchase construction and development loans, teaser option-ARM loans, negatively amortizing loans or high loan-to-value loans.

All of our real estate loans are secured by properties located in California. The following tables set forth our real estate loans and non-accrual real estate loans by county (dollars in thousands):

**Real Estate Loans by County as of September 30, 2012**

| County         | One-to-four family | Multi-family residential | Commercial real estate | Total      | Percent |
|----------------|--------------------|--------------------------|------------------------|------------|---------|
| Los Angeles    | \$ 147,236         | \$ 216,111               | \$ 38,593              | \$ 401,940 | 55.42%  |
| Orange         | 59,829             | 18,403                   | 24,868                 | 103,100    | 14.22   |
| San Diego      | 27,655             | 14,286                   | 2,626                  | 44,567     | 6.15    |
| San Bernardino | 22,157             | 12,763                   | 3,388                  | 38,308     | 5.28    |
| Riverside      | 15,434             | 3,447                    | 8,913                  | 27,794     | 3.83    |
| Santa Clara    | 23,254             | 512                      |                        | 23,766     | 3.28    |
| Alameda        | 16,110             | 31                       | 452                    | 16,593     | 2.29    |
| Other          | 61,334             | 5,195                    | 2,574                  | 69,103     | 9.53    |
| Total          | \$ 373,009         | \$ 270,748               | \$ 81,414              | \$ 725,171 | 100.00% |

**Real Estate Loans by County as of June 30, 2012**

| County         | One-to-four family | Multi-family residential | Commercial | Total      | Percent |
|----------------|--------------------|--------------------------|------------|------------|---------|
| Los Angeles    | \$ 144,739         | \$ 223,768               | \$ 41,848  | \$ 410,355 | 55.32%  |
| Orange         | 63,681             | 22,140                   | 27,067     | 112,888    | 15.22   |
| San Diego      | 29,556             | 15,437                   | 2,636      | 47,629     | 6.42    |
| San Bernardino | 17,601             | 12,849                   | 3,406      | 33,856     | 4.57    |
| Riverside      | 16,037             | 3,544                    | 8,968      | 28,549     | 3.85    |
| Santa Clara    | 22,481             | 530                      |            | 23,011     | 3.10    |
| Alameda        | 16,652             | 32                       | 453        | 17,137     | 2.31    |
| Other          | 60,504             | 5,253                    | 2,586      | 68,343     | 9.21    |
| Total          | \$ 371,251         | \$ 283,553               | \$ 86,964  | \$ 741,768 | 100.00% |



**Table of Contents****Non-accrual Real Estate Loans by County as of September 30, 2012**

| County         | One-to-four family | Multi-family residential | Commercial real estate | Total            | Percent of Non-accrual to Loans in Each Category |
|----------------|--------------------|--------------------------|------------------------|------------------|--------------------------------------------------|
| Los Angeles    | \$ 5,815           | \$                       | \$ 1,295               | \$ 7,110         | 1.77%                                            |
| Orange         | 2,062              |                          | 1,104                  | 3,166            | 3.07                                             |
| San Diego      | 1,692              | 548                      | 2,627                  | 4,867            | 10.92                                            |
| San Bernardino | 2,446              | 1,511                    |                        | 3,957            | 10.33                                            |
| Riverside      | 1,346              | 138                      |                        | 1,484            | 5.34                                             |
| Santa Clara    | 1,850              |                          |                        | 1,850            | 7.78                                             |
| Alameda        | 418                |                          |                        | 418              | 2.52                                             |
| Other          | 2,729              |                          |                        | 2,729            | 3.95                                             |
| <b>Total</b>   | <b>\$ 18,358</b>   | <b>\$ 2,197</b>          | <b>\$ 5,026</b>        | <b>\$ 25,581</b> | <b>3.53%</b>                                     |

**Non-accrual Real Estate Loans by County as of June 30, 2012**

| County         | One-to-four family | Multi-family residential | Commercial      | Total            | Percent of Non-accrual to Loans in Each Category |
|----------------|--------------------|--------------------------|-----------------|------------------|--------------------------------------------------|
| Los Angeles    | \$ 5,863           | \$                       | \$ 1,578        | \$ 7,441         | 1.81%                                            |
| Orange         | 1,914              |                          |                 | 1,914            | 1.70                                             |
| San Diego      | 2,081              | 647                      | 2,636           | 5,364            | 11.26                                            |
| San Bernardino | 2,438              | 1,555                    |                 | 3,993            | 11.79                                            |
| Riverside      | 1,259              | 224                      |                 | 1,483            | 5.19                                             |
| Santa Clara    | 1,855              |                          |                 | 1,855            | 8.06                                             |
| Alameda        | 421                |                          |                 | 421              | 2.46                                             |
| Other          | 2,889              |                          |                 | 2,889            | 4.23                                             |
| <b>Total</b>   | <b>\$ 18,720</b>   | <b>\$ 2,426</b>          | <b>\$ 4,214</b> | <b>\$ 25,360</b> | <b>3.42%</b>                                     |

At September 30, 2012, \$137.0 million, or 36.7% of our one-to-four family residential mortgage portfolio was serviced by others. As a result of a higher level of delinquent loans nationwide, certain third party servicers have been unable to service and in certain circumstances foreclose on properties in a timely manner. Currently, we track the servicing of these loans on our core mortgage servicing system. We have hired additional experienced mortgage loan workout staff and reallocated existing staff to monitor the collection activity of the servicers and perform direct customer outreach when a loan falls 30 days past due. In many instances, our role has been to provide direction to the third party servicers regarding loan modification requests and to develop collection plans for individual loans, while maintaining contact with the borrower. Due to a number of factors, including the high rate of loan delinquencies, we believe our servicers have not vigorously pursued collection efforts on our behalf. We had previously filed legal suit against two servicers seeking to obtain the transfer of servicing rights. During the year ended June 30, 2012, we settled with one of the servicers and obtained the servicing of \$54.6 million in one-to-four family loans previously serviced by this servicer. During the three months ended September 30, 2012, we also reached a servicing release agreement with the other servicer to obtain the servicing of \$75.0 million in one-to-four family residential loans in November 2012. Included in the \$75.0 million in loans were \$3.6 million in delinquent loans 60 days or more at September 30, 2012.

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The following table presents information concerning the composition of the one-to-four family residential loan portfolio by servicer at September 30, 2012:

|                                           | Amount     | Percent | Non-accrual<br>(Dollars in thousands) | Percent of Non-<br>accrual<br>to Loans<br>in Each Category |
|-------------------------------------------|------------|---------|---------------------------------------|------------------------------------------------------------|
| Purchased and serviced by others          | \$ 136,974 | 36.72%  | \$ 6,106                              | 4.46%                                                      |
| Purchased and servicing transferred to us | 68,209     | 18.29   | 9,875                                 | 14.48                                                      |
| Originated and serviced by us             | 167,826    | 44.99   | 2,377                                 | 1.42                                                       |
| Total                                     | \$ 373,009 | 100.00% | \$ 18,358                             | 4.92%                                                      |

**Delinquent Loans.** The following table sets forth certain information with respect to our loan portfolio delinquencies at the dates indicated.

|                              | Loans Delinquent:  |          |                    |                                  | Total Delinquent Loans |          |
|------------------------------|--------------------|----------|--------------------|----------------------------------|------------------------|----------|
|                              | 60-89 Days         |          | 90 Days or More    |                                  | Number of              |          |
|                              | Number of<br>Loans | Amount   | Number of<br>Loans | Amount<br>(Dollars in thousands) | Loans                  | Amount   |
| <b>At September 30, 2012</b> |                    |          |                    |                                  |                        |          |
| <u>Real estate loans:</u>    |                    |          |                    |                                  |                        |          |
| One-to-four family           | 3                  | \$ 1,494 | 18                 | \$ 6,736                         | 21                     | \$ 8,230 |
| Multi-family                 |                    |          | 1                  | 744                              | 1                      | 744      |
| <u>Other loans:</u>          |                    |          |                    |                                  |                        |          |
| Automobile                   |                    |          | 1                  | 11                               | 1                      | 11       |
| Other                        | 4                  | 4        | 3                  | 3                                | 7                      | 7        |
| Total loans                  | 7                  | \$ 1,498 | 23                 | \$ 7,494                         | 30                     | \$ 8,992 |
| <b>At June 30, 2012</b>      |                    |          |                    |                                  |                        |          |
| <u>Real estate loans:</u>    |                    |          |                    |                                  |                        |          |
| One-to-four family           | 4                  | \$ 1,787 | 17                 | \$ 6,815                         | 21                     | \$ 8,602 |
| Multi-family                 |                    |          | 1                  | 744                              | 1                      | 744      |
| <u>Other loans:</u>          |                    |          |                    |                                  |                        |          |
| Automobile                   | 3                  | 21       |                    |                                  | 3                      | 21       |
| Other                        | 1                  | 1        | 2                  | 3                                | 3                      | 4        |
| Total loans                  | 8                  | \$ 1,809 | 20                 | \$ 7,562                         | 28                     | \$ 9,371 |

Delinquent loans 60 days or more past due totaled \$9.0 million or 1.19% of total loans at September 30, 2012 as compared to \$9.4 million or 1.22% of total loans at June 30, 2012. Delinquent one-to-four family residential loans decreased to \$8.2 million at September 30, 2012 from \$8.6 million at June 30, 2012. The decrease in delinquent loans 60 days or more was primarily related to short sales and charge-offs of previously identified specific valuation allowances. As a result of the transfer of servicing from a third party servicer, short sale and charge-offs activities increased during the first fiscal quarter. We are able to actively manage these delinquent loans, directly work with the borrowers, conduct loan modifications, short sales or initiate foreclosure proceedings to further improve credit quality. Delinquent multi-family loans remained unchanged at \$744,000 at September 30, 2012 and June 30, 2012. There were no delinquent commercial loans at September 30, 2012 and June 30, 2012. In addition, there were eight one-to-four family loans totaling \$2.9 million that were over 90 days delinquent at September 30, 2012 and in the process of foreclosure.



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**Non-Performing Assets.** Non-performing assets consist of non-accrual loans and foreclosed assets. Loans to a customer whose financial condition has deteriorated are considered for non-accrual status whether or not the loan is 90 days and over past due. All loans past due 90 days and over are classified as non-accrual. At the time the loan is placed on non-accrual status, interest previously accrued but not collected is reversed and charged against current income. Payments received on non-accrued loans are recorded as a reduction of principal or as interest income depending on management's assessment of the ultimate collectibility of the loan principal. Generally, interest income on a non-accrual loan is recorded on a cash basis when the outstanding principal is brought current. Non-accrual loans also include troubled debt restructurings that are on non-accrual status. At September 30, 2012 and June 30, 2012, there were no loans past due more than 90 days and still accruing interest. Included in non-accrual loans were troubled debt restructuring of \$13.3 million and \$12.9 million as of September 30, 2012 and June 30, 2012, with specific valuation allowances of \$1.6 million for both periods.

Non-accrual loans continue to remain at historically elevated levels as a result of the decline in the housing market as well as the prolonged levels of high unemployment in our market area. We have worked with responsible borrowers to keep their properties and as a result we have restructured \$14.1 million in mortgage loans of which \$12.5 million were performing in accordance with their revised contractual terms at September 30, 2012. This compares to \$13.7 million in restructured loans at June 30, 2012. Of the \$14.1 million in restructured loans, \$13.3 million were reported as non-accrual at September 30, 2012. Troubled debt restructured loans are included in non-accrual loans until there is a sustained period of payment performance (usually six months or longer and determined on a case by case basis) and there is a reasonable assurance that timely payment will continue. During the three months ended September 30, 2012, no troubled debt restructurings were returned to accrual status. This compares to two troubled debt restructurings with an aggregate outstanding balance of \$807,000 that were returned to accrual status as a result of the borrowers paying the modified terms as agreed for a sustained period of more than six months during the year ended June 30, 2012. There were no further commitments to customers whose loans were troubled debt restructurings at September 30, 2012 and June 30, 2012.

Any changes or modifications made to loans are carefully reviewed to determine whether they are troubled debt restructurings. The modification of the terms of loans that are reported as troubled debt restructurings included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan. There are other changes or modifications made for borrowers who are not experiencing financial difficulties. During the three months ended September 30, 2012, there were twenty-two loans in the amount of \$11.3 million which were modified and not accounted for as troubled debt restructurings. The modifications were made to refinance the credits to maintain the borrowing relationships and generally consisted of term or rate modifications. The borrowers were not experiencing financial difficulty and the modifications were made at market terms.

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The following table sets forth the amounts and categories of our non-performing assets at the dates indicated (in thousands).

|                                                               | At September 30,<br>2012 | At June 30,<br>2012 | At June 30,<br>2011 |
|---------------------------------------------------------------|--------------------------|---------------------|---------------------|
| <b><u>Non-accrual loans:</u></b>                              |                          |                     |                     |
| <b><u>Real estate loans:</u></b>                              |                          |                     |                     |
| One-to-four family                                            | \$ 8,345                 | \$ 9,332            | \$ 9,513            |
| Multi-family                                                  | 1,511                    | 1,555               | 1,757               |
| Commercial                                                    | 2,399                    | 1,578               | 2,252               |
| <b><u>Other loans:</u></b>                                    |                          |                     |                     |
| Automobile                                                    | 27                       |                     |                     |
| Home equity                                                   |                          | 37                  |                     |
| Other                                                         | 3                        | 3                   | 5                   |
| <b><u>Troubled debt restructurings:</u></b>                   |                          |                     |                     |
| One-to-four family                                            | 10,013                   | 9,388               | 8,872               |
| Multi-family                                                  | 686                      | 871                 | 1,332               |
| Commercial                                                    | 2,627                    | 2,636               | 2,665               |
| Total non-accrual loans                                       | \$ 25,611                | \$ 25,400           | \$ 26,396           |
| <b><u>Other real estate owned and repossessed assets:</u></b> |                          |                     |                     |
| <b><u>Real estate:</u></b>                                    |                          |                     |                     |
| One-to-four family                                            | \$                       | \$ 669              | \$ 828              |
| Commercial                                                    | 610                      | 610                 |                     |
| <b><u>Other loans:</u></b>                                    |                          |                     |                     |
| Automobile                                                    |                          |                     | 10                  |
| Total other real estate owned and repossessed assets          | \$ 610                   | \$ 1,279            | \$ 838              |
| Total non-performing assets                                   | \$ 26,221                | \$ 26,679           | \$ 27,234           |
| <b><u>Ratios:</u></b>                                         |                          |                     |                     |
| Non-performing loans to total loans <sup>(1)</sup>            | 3.40%                    | 3.29%               | 3.73%               |
| Non-performing assets to total assets                         | 2.86%                    | 2.89%               | 3.18%               |
| Non-accrued interest <sup>(2)</sup>                           | \$ 474                   | \$ 456              | \$ 364              |

(1) Total loans are net of deferred fees and costs.

(2) If interest on the loans classified as non-accrual had been accrued, interest income in these amounts would have been recorded. At September 30, 2012, there were \$18.4 million of one-to-four family residential mortgage loans on non-accrual for which valuation allowances individually evaluated totaling \$2.1 million have been applied. Of the \$18.4 million in one-to-four family residential mortgage loans on non-accrual status, the terms or rates of \$10.0 million in loans were modified as troubled debt restructurings.

At September 30, 2012, there were \$7.2 million of multi-family residential and commercial real estate loans ( income property ) on non-accrual for which no valuation allowances individually evaluated have been applied. Included in the \$7.2 million of income property loans on non-accrual status were four multi-family residential loans totaling \$2.2 million and three commercial real estate loans totaling \$5.0 million.

The first multi-family residential loan was made to one borrower with a principal balance of \$744,000, net of charge-off, at September 30, 2012, located in Adelanto, California. This loan was over 90 days delinquent and had a court appointed receiver in place to manage the property and collect the rents during the judicial foreclosure process. There was no valuation allowance recorded for this loan during the three months ended September 30, 2012 as \$1.0 million of previously identified specific valuation allowances on this loan was already charged-off in the prior fiscal

year.

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The second multi-family residential loan was made to one borrower with a principal balance of \$767,000 at September 30, 2012 located in San Bernardino, California, which was current at September 30, 2012 but was previously delinquent. The property value has been slightly lower than the current loan balance for more than six months and accordingly, \$40,000 of previously identified specific valuation allowances on this loan was charged-off during the three months ended September 30, 2012. The remaining two multi-family residential loans on non-accrual status in the aggregate amount of \$686,000 at September 30, 2012 were troubled debt restructurings and \$184,000 of previously identified specific valuation allowances on these loans were charged-off during the three months ended September 30, 2012 because they were collateral dependent and the fair value of the collateral was determined to be deficient.

At September 30, 2012, we had three non-accruing commercial real estate loans with an aggregate balance of \$5.0 million. The first commercial real estate loan had a principal balance of \$2.6 million secured by a strip mall in San Diego, California. This loan was current and was a troubled debt restructuring at September 30, 2012. The second commercial real estate loan had a principal balance of \$1.6 million secured by an office building in Los Angeles County, California, which was current at September 30, 2012 but has experienced cash flow problems. Accordingly, \$274,000 of previously identified specific valuation allowances on this loan was charged-off during the three months ended September 30, 2012. The third commercial real estate loan had a principal balance of \$1.4 million secured by an office building in Orange County, California, which was current at September 30, 2012. However, the property is 100% vacant with a lack of verifiable outside financial support. In addition, the property value is lower than the current loan balance and accordingly, \$253,000 was charged-off on this loan during the three months ended September 30, 2012. The level of non-accrual loans is taken into consideration in our determination of the allowance for loan losses at September 30, 2012. Non-accrual loans are assessed to determine impairment. Loans that are found to be impaired are individually evaluated and a valuation allowance is applied or charged-off if warranted.

**Real Estate Owned.** Real estate owned and repossessed assets consist of real estate and other assets which have been acquired through foreclosure on loans. At the time of foreclosure, assets are recorded at fair value less estimated selling costs, with any write-down charged against the allowance for loan losses. The fair value of real estate owned is determined by a third party appraisal of the property.

**Classified Assets.** We regularly review potential problem assets in our portfolio to determine whether any assets require classification in accordance with applicable regulations. The total amount of classified and special mention assets represented 37.0% of our equity capital and 6.1% of our total assets at September 30, 2012, as compared to 38.9% of our equity capital and 6.5% of our total assets at June 30, 2012. At September 30, 2012 and June 30, 2012, there were \$25.6 million and \$25.4 million in non-accrual loans included in classified assets, respectively.

The aggregate amount of our classified and special mention assets at the dates indicated were as follows (in thousands):

|                                               | September 30,<br>2012 | June 30,<br>2012 |
|-----------------------------------------------|-----------------------|------------------|
| <b>Classified and Special Mention Assets:</b> |                       |                  |
| Loss                                          | \$ 29                 | \$ 3             |
| Doubtful                                      | 15                    | 28               |
| Substandard                                   | 36,713                | 37,468           |
| Special Mention                               | 19,534                | 22,452           |
| Total                                         | \$ 56,291             | \$ 59,951        |

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**Allowance for Loan Losses.** We maintain an allowance for loan losses to absorb probable incurred losses inherent in the loan portfolio. The allowance is based on ongoing, quarterly assessments of the probable losses inherent in the loan portfolio. In accordance with generally accepted accounting principles the allowance is comprised of general valuation allowances and valuation allowances on loans individually evaluated for impairment.

The general component covers non-impaired loans and is based both on our historical loss experience as well as significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. Loans that are classified as impaired are individually evaluated. We consider a loan impaired when it is probable that we will be unable to collect all amounts due according to the terms of the loan agreement and determine impairment by computing a fair value either based on discounted cash flows using the loan's initial interest rate or the fair value of the collateral, less estimated selling costs, if the loan is collateral dependent.

The general valuation allowance is calculated by applying loss factors to outstanding loans based on the internal risk evaluation of the loans or pools of loans. Changes in risk evaluations of both performing and non-performing loans affect the amount of the allowance. The appropriateness of the allowance is reviewed and established by management based upon its evaluation of then-existing economic and business conditions affecting key lending areas and other conditions, such as credit quality trends (including trends in non-performing loans expected to result from existing conditions), collateral values, loan volumes and concentrations, specific industry conditions and peer data within portfolio segments, and recent loss experience in particular segments of the portfolio that existed as of the balance sheet date and the impact that such conditions were believed to have had on the collectability of the loan. Significant factors reviewed in determining the allowance for loan losses included loss ratio trends by loan product; levels of and trends in delinquencies and impaired loans; levels of and trends in classified assets; levels of and trends in charge-offs and recoveries; trends in volume of loans by loan product; effects of changes in lending policies and practices; industry conditions and effects of concentrations in geographic regions and by third party servicers.

Valuation allowances on real estate loans that are individually evaluated for impairment are charged-off when management believes a loan or part of a loan is deemed uncollectible. Subsequent recoveries, if any, are credited to the allowance when received. A loan is generally considered uncollectible when the borrower's payment is six months or more delinquent.

Our multi-family residential loan portfolio had been a significant growth area in our loan portfolio beginning in fiscal 2009 and as a result this portfolio was considered unseasoned in prior fiscal years. As of September 30, 2012, we re-evaluated the historical loss history for the multi-family residential loan portfolio and concluded that we have accumulated sufficient history to capture a full loss cycle for the historical loss migration analysis. For the multi-family residential loans, we review the loan portfolio's historical loss history, debt service coverage ratios, and seasoning. Due to a decline in the overall historical loss factors and a reduction in the balance on multi-family loans collectively evaluated for impairment, the general valuation portion of our multi-family portfolio declined by \$236,000 at September 30, 2012 compared to June 30, 2012.

Our commercial real estate portfolio grew significantly beginning in fiscal 2008. Due to the economic downturn, in order to proactively limit commercial real estate loan credit losses, we currently consider the origination of commercial real estate loans on a case by case basis based on the borrower's credit qualification and the property offered for collateral. As a result, we did not originate any commercial real estate loans since 2009 and therefore, this portfolio is considered unseasoned. For the commercial real estate loan portfolio, we review the loan portfolio's historical loss history, debt service coverage ratios, seasoning and peer group data. In fiscal 2010, we also expanded our migration analysis to include the credit loss migration from published sources, including the FDIC, in order to determine the allowance for loan losses on commercial real estate loans, given the characteristics of the peer group as compared to our portfolio. Due to improved loss experience of our peer group and a decline in the balance of commercial real estate loans collectively evaluated for impairment, the general valuation portion of our commercial real estate portfolio declined by \$180,000 at September 30, 2012 compared to June 30, 2012.

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Senior management reviews these conditions quarterly in discussions with our senior credit officers. To the extent that any of these conditions is evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management's estimate of the effect of such conditions may be reflected as an allowance specifically applicable to such credit or portfolio segment. Where any of these conditions is not evidenced by a specifically identifiable problem credit or portfolio segment as of the evaluation date, management's evaluation of the loss related to this condition is reflected in the general allowance. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments.

Given that management evaluates the adequacy of the allowance for loan losses based on a review of individual loans, historical loan loss experience, the value and adequacy of collateral and economic conditions in our market area, this evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Large groups of smaller balance homogeneous loans that are collectively evaluated for impairment and are excluded from loans individually evaluated for impairment; their allowance for loan losses is calculated in accordance with the allowance for loan losses policy described above.

Because the allowance for loan losses is based on estimates of losses inherent in the loan portfolio, actual losses can vary significantly from the estimated amounts. Our methodology as described above permits adjustments to any loss factor used in the computation of the formula allowance in the event that, in management's judgment, significant factors which affect the collectability of the portfolio as of the evaluation date are not reflected in the loss factors. By assessing the estimated losses inherent in the loan portfolio on a quarterly basis, we are able to adjust individual and inherent loss estimates based upon any more recent information that has become available. We continue to review our allowance for loan losses methodology for appropriateness to keep pace with the size and composition of the loans and the changing economic conditions and credit environment. We believe that our methodologies continue to be appropriate given our size and level of complexity. In addition, management's determination as to the amount of our allowance for loan losses is subject to review by the Office of the Comptroller of the Currency ( OCC ) and the FDIC, which may require the establishment of additional general allowances or allowances on loans individually evaluated for impairment based upon their judgment of the information available to them at the time of their examination of our Bank.

Provision for loan losses increased to \$850,000 for the three months ended September 30, 2012 as compared to no provision for the same period last year. The increase in the overall provision was primarily due to short sale losses and charge-offs on impaired loans. As a result of the transfer of servicing from a third party servicer, short sale activity increased during the quarter. There was also a charge-off of approximately \$253,000 on a commercial real estate loan that exhibited weakness during the quarter but remains current on its loan payments. Delinquent loans 60 days or more totaled \$9.0 million, or 1.19% of total loans at September 30, 2012 as compared to \$9.4 million, or 1.22% of total loans at June 30, 2012. Non-performing loans increased slightly to \$25.6 million, or 3.40% of total loans at September 30, 2012 as compared to \$25.4 million, or 3.29% of total loans at June 30, 2012. The allowance for loan losses to non-performing loans was 24.96% at September 30, 2012 as compared to 29.54% at June 30, 2012. The decline in the allowance for loan losses to non-performing loans was a result of \$1.1 million in charge-offs of previously identified specific valuation allowances on loans generally six months or more delinquent during the quarter ended September 30, 2012. The provision reflected management's continuing assessment of the credit quality of the Company's loan portfolio, which is affected by various trends, including current economic conditions.

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The distribution of the allowance for losses on loans at the dates indicated is summarized as follows.

|                                 | September 30,<br>2012 | Percent of<br>Loans in Each<br>Category to<br>Total Loans<br>(Dollars in thousands) | June 30,<br>2012 | Percent of<br>Loans in Each<br>Category to<br>Total Loans |
|---------------------------------|-----------------------|-------------------------------------------------------------------------------------|------------------|-----------------------------------------------------------|
| Amount                          |                       |                                                                                     | Amount           |                                                           |
| <u>Real estate loans:</u>       |                       |                                                                                     |                  |                                                           |
| One-to-four family              | \$ 4,521              | 49.46%                                                                              | \$ 4,692         | 48.17%                                                    |
| Multi-family                    | 1,057                 | 35.90                                                                               | 1,519            | 36.79                                                     |
| Commercial                      | 672                   | 10.80                                                                               | 1,131            | 11.28                                                     |
| <u>Other loans:</u>             |                       |                                                                                     |                  |                                                           |
| Automobile                      | 88                    | 2.45                                                                                | 62               | 2.25                                                      |
| Home equity                     | 26                    | 0.09                                                                                | 63               | 0.10                                                      |
| Other                           | 28                    | 1.31                                                                                | 35               | 1.39                                                      |
| Total allowance for loan losses | \$ 6,392              | 100.00%                                                                             | \$ 7,502         | 100.00%                                                   |

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### **Liquidity, Capital Resources and Commitments**

Liquidity may increase or decrease depending upon the availability of funds and comparative yields on investments in relation to the return on loans. Historically, we have maintained liquid assets at levels above the minimum requirements previously imposed by our regulator and above levels believed to be adequate to meet the requirements of normal operations, including potential deposit outflows. Cash flow projections are regularly reviewed and updated to assure that adequate liquidity is maintained.

Our liquidity, represented by cash and cash equivalents, interest earning accounts and mortgage-backed and related securities, is a product of our operating, investing and financing activities. Our primary sources of funds are deposits, amortization, prepayments and maturities of outstanding loans and mortgage-backed and related securities, and other short-term investments and funds provided from operations. While scheduled payments from the amortization of loans and mortgage-backed related securities and maturing investment securities and short-term investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions, and competition. In addition, we invest excess funds in short-term interest earning assets, which provide liquidity to meet lending requirements. We also generate cash through borrowings. We utilize FHLB advances to leverage our capital base and provide funds for our lending and investment activities as well as enhance our interest rate risk management.

Liquidity management is both a daily and long-term function of business management. Excess liquidity is generally invested in short-term investments such as overnight deposits. On a longer-term basis, we maintain a strategy of investing in various investment securities and lending products. We use our sources of funds primarily to meet ongoing commitments, to pay maturing certificates of deposit and savings withdrawals, to fund loan commitments and to maintain our portfolio of mortgage-backed and related securities. At September 30, 2012, total approved loan commitments amounted to \$3.5 million and the unadvanced portion of loans was \$2.2 million.

Certificates of deposit and advances from the FHLB of San Francisco scheduled to mature in one year or less at September 30, 2012, totaled \$125.5 million and \$20.0 million, respectively. Based on historical experience, management believes that a significant portion of maturing deposits will remain with the Bank and we anticipate that we will continue to have sufficient funds, through deposits and borrowings, to meet our current commitments.

At September 30, 2012, we had available additional advances from the FHLB of San Francisco in the amount of \$289.2 million. We also had a short-term line of credit with the Federal Reserve Bank of San Francisco of \$59.3 million at September 30, 2012, which has not been drawn upon.

**Table of Contents****Contractual Obligations**

In the normal course of business, we enter into contractual obligations that meet various business needs. These contractual obligations include certificates of deposit to customers, borrowings from the FHLB, lease obligations for facilities, and commitments to purchase, sale and/or originate loans.

The following table summarizes our long-term contractual obligations at September 30, 2012 (in thousands).

|                                                      | <b>Total</b>      | <b>Less than<br/>1 year</b> | <b>1 3<br/>Years</b> | <b>Over 3 5<br/>Years</b> | <b>More than 5<br/>years</b> |
|------------------------------------------------------|-------------------|-----------------------------|----------------------|---------------------------|------------------------------|
| FHLB advances                                        | \$ 80,000         | \$ 20,000                   | \$ 20,000            | \$ 20,000                 | \$ 20,000                    |
| Operating lease obligations                          | 5,897             | 1,026                       | 2,026                | 1,170                     | 1,675                        |
| Loan commitments to originate                        | 3,497             | 3,497                       |                      |                           |                              |
| Loan sale commitments                                | 3,529             | 3,529                       |                      |                           |                              |
| Available home equity and unadvanced lines of credit | 2,173             | 2,173                       |                      |                           |                              |
| Certificates of deposit                              | 304,830           | 125,463                     | 88,048               | 91,179                    | 140                          |
| <b>Total commitments and contractual obligations</b> | <b>\$ 399,926</b> | <b>\$ 155,688</b>           | <b>\$ 110,074</b>    | <b>\$ 112,349</b>         | <b>\$ 21,815</b>             |

**Off-Balance Sheet Arrangements**

As a financial service provider, we routinely are a party to various financial instruments with off-balance sheet risks, such as commitments to extend credit and unused lines of credit. While these contractual obligations represent our future cash requirements, a significant portion of commitments to extend credit may expire without being drawn upon. Such commitments are subject to the same credit policies and approval process accorded to loans we make.

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### Capital

The table below sets forth Kaiser Federal Bank's capital position relative to its regulatory capital requirements at September 30, 2012 and June 30, 2012. The definitions of the terms used in the table are those provided in the capital regulations issued by the OCC.

| September 30, 2012                                  | Actual     |        | Minimum Capital Requirements |       | Minimum required to be Well Capitalized Under Prompt Corrective Actions Provisions |        |
|-----------------------------------------------------|------------|--------|------------------------------|-------|------------------------------------------------------------------------------------|--------|
|                                                     | Amount     | Ratio  | Amount                       | Ratio | Amount                                                                             | Ratio  |
| (Dollars in thousands)                              |            |        |                              |       |                                                                                    |        |
| Total capital (to risk-weighted assets)             | \$ 132,808 | 21.95% | \$ 48,403                    | 8.00% | \$ 60,503                                                                          | 10.00% |
| Tier 1 capital (to risk-weighted assets)            | 126,416    | 20.89  | 24,201                       | 4.00  | 36,302                                                                             | 6.00   |
| Tier 1 (core) capital (to adjusted tangible assets) | 126,416    | 13.86  | 36,482                       | 4.00  | 45,602                                                                             | 5.00   |

| June 30, 2012                                       | Actual     |        | Minimum Capital Requirements |       | Minimum required to be Well Capitalized Under Prompt Corrective Actions Provisions |        |
|-----------------------------------------------------|------------|--------|------------------------------|-------|------------------------------------------------------------------------------------|--------|
|                                                     | Amount     | Ratio  | Amount                       | Ratio | Amount                                                                             | Ratio  |
| (Dollars in thousands)                              |            |        |                              |       |                                                                                    |        |
| Total capital (to risk-weighted assets)             | \$ 131,832 | 21.10% | \$ 49,993                    | 8.00% | \$ 62,491                                                                          | 10.00% |
| Tier 1 capital (to risk-weighted assets)            | 124,330    | 19.90  | 24,996                       | 4.00  | 37,494                                                                             | 6.00   |
| Tier 1 (core) capital (to adjusted tangible assets) | 124,330    | 13.52  | 36,781                       | 4.00  | 45,976                                                                             | 5.00   |

Consistent with our goal to operate a sound and profitable financial organization, we actively seek to continue as a well-capitalized institution in accordance with regulatory standards. At September 30, 2012, Kaiser Federal Bank was a well-capitalized institution under regulatory standards.

### Impact of Inflation

The unaudited consolidated financial statements presented herein have been prepared in accordance with GAAP. These principles require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

Our primary assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on our performance than the effects of general levels of inflation. Interest rates, however, do not necessarily move in the same direction or with the same magnitude as the price of goods and services, since such prices are affected by inflation. In a period of rapidly rising interest rates, the liquidity and maturity structure of our assets and liabilities are critical to the maintenance of acceptable performance levels.

The principal effect of inflation, as distinct from levels of interest rates, on earnings is in the area of noninterest expense. Such expense items as employee compensation, employee benefits and occupancy and equipment costs may be subject to increases as a result of inflation.

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### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

**Our Risk When Interest Rates Change.** The rates of interest we earn on assets and pay on liabilities generally are established contractually for a period of time. Market interest rates change over time. Our fixed rate loans generally have longer maturities than our fixed rate deposits. Accordingly, our results of operations, like those of other financial institutions, are impacted by changes in interest rates and the interest rate sensitivity of our assets and liabilities. The risk associated with changes in interest rates and our ability to adapt to these changes is known as interest rate risk and is our most significant market risk.

**How We Measure Our Risk of Interest Rate Changes.** As part of our attempt to manage our exposure to changes in interest rates and comply with applicable regulations, we monitor our interest rate risk. In monitoring interest rate risk we continually analyze and manage assets and liabilities based on their payment streams and interest rates, the timing of their maturities, and their sensitivity to actual or potential changes in market interest rates.

In order to minimize the potential for adverse effects of material and prolonged increases in interest rates on our results of operations, we have adopted investment/asset and liability management policies to better match the maturities and repricing terms of our interest-earning assets and interest-bearing liabilities. The board of directors sets and recommends the asset and liability policies of Kaiser Federal Bank, which are implemented by the asset/liability management committee.

The purpose of the asset/liability management committee is to communicate, coordinate and control asset/liability management consistent with our business plan and board approved policies. The committee establishes and monitors the volume and mix of assets and funding sources taking into account relative costs and spreads, interest rate sensitivity and liquidity needs. The objectives are to manage assets and funding sources to produce results that are consistent with liquidity, capital adequacy, growth, risk, and profitability goals.

The asset/liability management committee generally meets at least monthly to review, among other things, economic conditions and interest rate outlook, current and projected liquidity needs and capital position, anticipated changes in the volume and mix of assets and liabilities and interest rate risk exposure limits versus current projections pursuant to net present value of portfolio equity analysis and income simulations. The asset/liability management committee recommends appropriate strategy changes based on this review. The chairman or his designee is responsible for reviewing and reporting on the effects of the policy implementations and strategies to the board of directors at least monthly.

In order to manage our assets and liabilities and achieve the desired liquidity, credit quality, interest rate risk, profitability and capital targets, we have focused our strategies on: (1) maintaining an adequate level of adjustable rate loans; (2) originating a reasonable volume of short-term and intermediate-term loans; (3) managing our deposits to establish stable deposit relationships; and (4) using FHLB advances, and pricing on fixed-term non-core deposits to align maturities and repricing terms.

At times, depending on the level of general interest rates, the relationship between long-term and short-term interest rates, market conditions and competitive factors, the asset/liability management committee may determine to increase our interest rate risk position somewhat in order to maintain our net interest margin.

The asset/liability management committee regularly reviews interest rate risk by forecasting the impact of alternative interest rate environments on net interest income and economic value of portfolio equity, which is defined as the net present value of an institution's existing assets, liabilities and off-balance sheet instruments, and evaluating such impacts against the maximum potential changes in net interest income and economic value of portfolio equity that are authorized by the board of directors of Kaiser Federal Bank.

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An independent third party provides the Bank with the information presented in the following tables, which are based on information provided by the Bank. The tables present the sensitivity of net interest income for the 12-month period subsequent to the three months ended September 30, 2012 and the year ended June 30, 2012, and the immediate, permanent and parallel movements in interest rates of +/-100, +200 and +300 basis points, as well as the change in the Bank's net portfolio value at September 30, 2012 that would occur upon an immediate change in interest rates without giving effect to any steps that management might take to counteract that change.

| September 30, 2012                  |                                  | June 30, 2012                       |                                     |
|-------------------------------------|----------------------------------|-------------------------------------|-------------------------------------|
| Basis Point (bp)<br>Change in Rates | Change in Net<br>Interest Income | Basis Point (bp)<br>Change in Rates | Change in Net<br>Interest<br>Income |
| +300 bp                             | 2.87%                            | +300 bp                             | 0.27%                               |
| +200                                | 2.22                             | +200                                | 0.40                                |
| +100                                | 1.21                             | +100                                | 0.44                                |
| -100                                | (3.95)                           | -100                                | (2.41)                              |

| September 30, 2012                                        |                                 |             |                                   |                                                                  |                                          |
|-----------------------------------------------------------|---------------------------------|-------------|-----------------------------------|------------------------------------------------------------------|------------------------------------------|
| Estimated Increase (Decrease)<br>in NPV                   |                                 |             |                                   | NPV as a percentage of Present<br>Value of Assets <sup>(3)</sup> |                                          |
| Change in Interest Rates<br>(basis points) <sup>(1)</sup> | Estimated<br>NPV <sup>(2)</sup> | Amount      | Percent<br>(Dollars in thousands) | NPV ratio<br><sup>(4)</sup>                                      | Increase<br>(Decrease)<br>(basis points) |
| +400                                                      | \$ 119,884                      | \$ (27,866) | (18.86)%                          | 13.87%                                                           | (154)                                    |
| +300                                                      | 130,252                         | (17,498)    | (11.84)                           | 14.65                                                            | (76)                                     |
| +200                                                      | 139,096                         | (8,655)     | (5.86)                            | 15.22                                                            | (19)                                     |
| +100                                                      | 145,156                         | (2,595)     | (1.76)                            | 15.49                                                            | 8                                        |
|                                                           | 147,750                         |             |                                   | 15.41                                                            |                                          |
| -100                                                      | 144,348                         | (3,403)     | (2.30)                            | 14.87                                                            | (54)                                     |

(1) Assumes an instantaneous uniform change in interest rates at all maturities.

(2) NPV is the discounted present value of expected cash flows from assets, liabilities and off-balance sheet contracts.

(3) Present value of assets represents the discounted present value of incoming cash flows on interest-earning assets.

(4) NPV Ratio represents NPV divided by the present value of assets.

The analysis uses certain assumptions in assessing interest rate risk. These assumptions relate to interest rates, loan prepayment rates, deposit decay rates, and the fair values of certain assets under differing interest rate scenarios, among other things.

As with any method of measuring interest rate risk, shortcomings are inherent in the method of analysis presented in the foregoing tables. For example, although assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in the market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable rate mortgage loans, have features, that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, if interest rates change, expected rates of prepayments on loans and early withdrawals from certificates of deposit could deviate significantly from those assumed in calculating the table.

**Item 4. Controls and Procedures**

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Act")) as of the end of the period covered by this report. The Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as of the end of the period covered by this report are effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms.



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There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Act) that occurred during the quarter ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Part II. OTHER INFORMATION****Item 1. Legal Proceedings**

From time to time, we are involved as plaintiff or defendant in various legal actions arising in the normal course of business. We do not anticipate incurring any material liability as a result of this litigation or any material impact on our financial position, results of operations or cash flows.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors that were previously disclosed in the Company's annual report on Form 10-K for the fiscal year ended June 30, 2012.

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

| Period  |          | Purchases of Equity Securities by the Issuer |                      |                                                       |                                                 |
|---------|----------|----------------------------------------------|----------------------|-------------------------------------------------------|-------------------------------------------------|
|         |          | Total Number of                              | Weighted Average     | Total Number of                                       | Maximum Number of                               |
|         |          | Shares Purchased                             | Price Paid Per Share | Shares Purchased as Part of Publicly Announced Plans* | Shares That May Yet be Purchased Under the Plan |
| 07/1/12 | 07/31/12 |                                              | \$                   | 646,452                                               | 290,183                                         |
| 08/1/12 | 08/31/12 | 73,999                                       | 14.81                | 720,451                                               | 216,584                                         |
| 09/1/12 | 09/30/12 | 119,534                                      | 15.20                | 839,985                                               | 96,650                                          |

\* On November 29, 2011, the Company announced its intention to repurchase up to 5% of its issued and outstanding shares, or up to approximately 480,257 shares. Upon completion of the first stock repurchase program, the Company announced on April 26, 2012, a second stock repurchase program pursuant to which the Company intends to repurchase up to 5% of its issued and outstanding shares, or up to approximately 456,378 shares. 193,533 shares were purchased under this plan in the three months ended September 30, 2012.

On October 29, 2012, the Company announced that its Board of Directors authorized the third stock repurchase program pursuant to which the Company intends to repurchase up to 5% of its issued and outstanding shares upon completion of the second stock repurchase program, or up to approximately 434,732 shares. The timing of the repurchases will depend on certain factors, including but not limited to, market conditions and prices, the Company's liquidity requirements and alternative uses of capital. The stock repurchase program may be carried out through open-market purchases, block trades, negotiated private transactions and pursuant to a trading plan that may be adopted in accordance with Rule 10b5-1 of the SEC's rules. Any repurchased shares will be available for general corporate purposes.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable

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**Item 5. Other Information**

None.

**Item 6. Exhibits**

|          |                                                                                            |
|----------|--------------------------------------------------------------------------------------------|
| 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 |
| 32.1     | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act |
| 32.2     | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act |
| 101.INS* | XBRL Instance Document                                                                     |
| 101.SCH* | XBRL Taxonomy Extension Schema Document                                                    |
| 101.CAL* | XBRL Taxonomy Calculation Linkbase Document                                                |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document                                       |
| 101.LAB* | XBRL Taxonomy Label Linkbase Document                                                      |
| 101.PRE* | XBRL Taxonomy Presentation Linkbase Document                                               |

\* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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**KAISER FEDERAL FINANCIAL GROUP, INC. AND SUBSIDIARY**

**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.

KAISER FEDERAL FINANCIAL GROUP, INC.

Dated: November 8, 2012

/s/ Dustin Luton  
Dustin Luton  
President and Chief Executive Officer

/s/ Jean M. Carandang  
Jean M. Carandang  
Chief Financial Officer