TIMBERLAND BANCORP INC
Form 10-Q
February 08, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2017

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 000-23333

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

Washington	91-1863696
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

624 Simpson Avenue, Hoquiam, Washington	98550
(Address of principal executive offices)	(Zip Code)

(360) 533-4747
(Registrant’s telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company

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

Exchange Act.

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

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

CLASS	SHARES OUTSTANDING AT FEBRUARY 1, 2018
Common stock, $.01 par value	7,378,127

INDEX

PART I.	FINANCIAL INFORMATION	Page
Item 1.	Financial Statements (unaudited)	
	Consolidated Balance Sheets	3
	Consolidated Statements of Income	5
	Consolidated Statements of Comprehensive Income	7
	Consolidated Statements of Shareholders' Equity	8
	Consolidated Statements of Cash Flows	9
	Notes to Unaudited Consolidated Financial Statements	11
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	34
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	45
Item 4.	Controls and Procedures	45
PART II.	OTHER INFORMATION	
Item 1.	Legal Proceedings	46
Item 1A.	Risk Factors	46
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	46
Item 3.	Defaults Upon Senior Securities	46
Item 4.	Mine Safety Disclosures	46
Item 5.	Other Information	46
Item 6.	Exhibits	47

SIGNATURES
Certifications
Exhibit 31.1
Exhibit 31.2
Exhibit 32
Exhibit 101

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (unaudited)
TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2017 and September 30, 2017
(Dollars in thousands, except per share amounts)

	December 31, 2017 (Unaudited)	September 30, 2017 *
Assets		
Cash and cash equivalents:		
Cash and due from financial institutions	$ 16,952	$ 17,447
Interest-bearing deposits in banks	149,255	130,741
Total cash and cash equivalents	166,207	148,188
Certificates of deposit (“CDs”) held for investment (at cost, which approximates fair value)	53,528	43,034
Investment securities held to maturity, at amortized cost (estimated fair value $7,609 and $7,744)	7,077	7,139
Investment securities available for sale, at fair value	1,221	1,241
Federal Home Loan Bank of Des Moines (“FHLB”) stock	1,107	1,107
Other investments, at cost	3,000	3,000
Loans held for sale	3,407	3,599
Loans receivable, net of allowance for loan losses of $9,565 and $9,553	705,268	690,364
Premises and equipment, net	18,307	18,418
Other real estate owned (“OREO”) and other repossessed assets, net	2,887	3,301
Accrued interest receivable	2,743	2,520
Bank owned life insurance (“BOLI”)	19,402	19,266
Goodwill	5,650	5,650
Mortgage servicing rights (“MSRs”), net	1,871	1,825
Other assets	2,220	3,372
Total assets	$ 993,895	$ 952,024
Liabilities and shareholders’ equity		
Liabilities		
Deposits:		
Non-interest-bearing demand	$ 210,108	$ 205,952
Interest-bearing	665,966	631,946
Total deposits	876,074	837,898
Other liabilities and accrued expenses	3,709	3,126
Total liabilities	879,783	841,024

* Derived from audited consolidated financial statements.

See notes to unaudited consolidated financial statements

3

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS (continued)
December 31, 2017 and September 30, 2017
(Dollars in thousands, except per share amounts)

	December 31, 2017 (Unaudited)	September 30, 2017 *
Shareholders’ equity		
Preferred stock, $.01 par value; 1,000,000 shares authorized; none issued	$ —	$ —
Common stock, $.01 par value; 50,000,000 shares authorized;		
7,367,327 shares issued and outstanding - December 31, 2017 7,361,077 shares issued and outstanding - September 30, 2017	13,540	13,286
Unearned shares issued to Employee Stock Ownership Plan (“ESOP”)	(331)	(397)
Retained earnings	101,039	98,235
Accumulated other comprehensive loss	(136)	(124)
Total shareholders’ equity	114,112	111,000
Total liabilities and shareholders’ equity	$ 993,895	$ 952,024

* Derived from audited consolidated financial statements.

See notes to unaudited consolidated financial statements

4

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the three months ended December 31, 2017 and 2016
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended December 31,	
	2017	2016
Interest and dividend income		
Loans receivable and loans held for sale	$9,328	$8,788
Investment securities	58	70
Dividends from mutual funds, FHLB stock and other investments	26	24
Interest-bearing deposits in banks and CDs	623	281
Total interest and dividend income	10,035	9,163
Interest expense		
Deposits	601	543
FHLB borrowings	—	307
Total interest expense	601	850
Net interest income	9,434	8,313
Provision for loan losses	—	—
Net interest income after provision for loan losses	9,434	8,313
Non-interest income		
Recoveries (other than temporary impairment "OTTI") on investment securities	27	—
Adjustment for portion of OTTI transferred from other comprehensive income before income taxes	(5)	—
Net recoveries on investment securities	22	—
Service charges on deposits	1,179	1,105
ATM and debit card interchange transaction fees	845	800
BOLI net earnings	136	137
Gain on sales of loans, net	521	689
Escrow fees	59	76
Servicing income on loans sold	116	97
Other, net	259	312
Total non-interest income, net	3,137	3,216

See notes to unaudited consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (continued)
For the three months ended December 31, 2017 and 2016
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended December 31,	
	2017	2016
Non-interest expense		
Salaries and employee benefits	$3,950	$ 3,680
Premises and equipment	768	755
Advertising	209	162
OREO and other repossessed assets, net	113	30
ATM and debit card interchange transaction fees	331	311
Postage and courier	105	95
State and local taxes	161	155
Professional fees	218	201
Federal Deposit Insurance Corporation ("FDIC") insurance	65	113
Loan administration and foreclosure	79	94
Data processing and telecommunications	467	450
Deposit operations	278	309
Other	432	455
Total non-interest expense	7,176	6,810
Income before income taxes	5,395	4,719
Provision for income taxes	1,781	1,572
Net income	$3,614	$ 3,147
Net income per common share		
Basic	$0.49	$ 0.46
Diluted	$0.48	$ 0.43
Weighted average common shares outstanding		
Basic	7,312,531	6,862,749
Diluted	7,508,169	7,235,515
Dividends paid per common share	$0.11	$ 0.09

See notes to unaudited consolidated financial statements

6

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the three months ended December 31, 2017 and 2016
(Dollars in thousands)
(Unaudited)

	Three Months Ended December 31,	
	2017	2016
Comprehensive income		
Net income	$3,614	$3,147
Unrealized holding loss on investment securities available for sale, net of income taxes of ($2) and ($14), respectively	(7)	(27)
Change in OTTI on investment securities held to maturity, net of income taxes:		
Adjustments related to other factors for which OTTI was previously recognized, net of income taxes of ($6) and $0, respectively	(21)	—
Amount reclassified to credit loss for previously recorded market loss, net of income taxes of $1 and $0, respectively	4	—
Accretion of OTTI on investment securities held to maturity, net of income taxes of $3 and $7, respectively	12	13
Total other comprehensive loss, net of income taxes	(12)	(14)
Total comprehensive income	$3,602	$3,133

See notes to unaudited consolidated financial statements

7

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the three months ended December 31, 2017 and 2016
(Dollars in thousands, except per share amounts)
(Unaudited)

	Common Stock		Unearned Shares Issued to ESOP	Retained Earnings	Accumulated Other Compre-hensive Loss	Total
	Number of Shares	Amount				
Balance, September 30, 2016	6,943,868	$9,961	$ (661)	$87,709	$ (175)	$96,834
Net income	—	—	—	3,147	—	3,147
Other comprehensive loss	—	—	—	—	(14)	(14)
Exercise of stock options	12,700	80	—	—	—	80
Common stock dividends ($0.09 per common share)	—	—	—	(626)	—	(626)
Earned ESOP shares, net of income taxes	—	62	66	—	—	128
Stock option compensation expense	—	85	—	—	—	85
Balance, December 31, 2016	6,956,568	10,188	(595)	90,230	(189)	99,634
Balance, September 30, 2017	7,361,077	13,286	(397)	98,235	(124)	111,000
Net income	—	—	—	3,614	—	3,614
Other comprehensive loss	—	—	—	—	(12)	(12)
Exercise of stock options	6,250	61	—	—	—	61
Common stock dividends ($0.11 per common share)	—	—	—	(810)	—	(810)
Earned ESOP shares, net of income taxes	—	149	66	—	—	215
Stock option compensation expense	—	44	—	—	—	44
Balance, December 31, 2017	7,367,327	$13,540	$ (331)	$101,039	$ (136)	$114,112

See notes to unaudited consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three months ended December 31, 2017 and 2016
(In thousands)
(Unaudited)

	Three Months Ended December 31,	
	2017	2016
Cash flows from operating activities		
Net income	$3,614	$3,147
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	310	313
Earned ESOP shares	215	128
Stock option compensation expense	44	85
Net recoveries on investment securities	(22)	—
Gain on sales of OREO and other repossessed assets, net	(12)	(3)
Provision for OREO losses	94	9
Gain on sales of loans, net	(521)	(689)
Loans originated for sale	(15,193)	(21,914)
Proceeds from sales of loans	15,906	24,199
Amortization of MSRs	120	125
BOLI net earnings	(136)	(137)
Increase (decrease) in deferred loan origination fees	38	(45)
Net change in accrued interest receivable and other assets, and other liabilities and accrued expenses	1,301	760
Net cash provided by operating activities	5,758	5,978
Cash flows from investing activities		
Net increase in CDs held for investment	(10,494)	(432)
Proceeds from maturities and prepayments of investment securities held to maturity	11	136
Proceeds from maturities and prepayments of investment securities available for sale	126	14
Increase in loans receivable, net	(15,105)	(5,994)
Additions to premises and equipment	(199)	(1,970)
Proceeds from sales of OREO and other repossessed assets	495	902
Net cash used in investing activities	(25,166)	(7,344)

See notes to unaudited consolidated financial statements

9

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
For the three months ended December 31, 2017 and 2016
(In thousands)
(Unaudited)

	Three Months Ended December 31,	
	2017	2016
Cash flows from financing activities		
Net increase in deposits	$38,176	$28,441
Proceeds from exercise of stock options	61	80
Payment of dividends	(810)	(626)
Net cash provided by financing activities	37,427	27,895
Net increase in cash and cash equivalents	18,019	26,529
Cash and cash equivalents		
Beginning of period	148,188	108,941
End of period	$166,207	$135,470
Supplemental disclosure of cash flow information		
Income taxes paid	$—	$200
Interest paid	584	834
Supplemental disclosure of non-cash investing activities		
Loans transferred to OREO and other repossessed assets	$163	$45
Other comprehensive loss related to investment securities	(12)	(14)

See notes to unaudited consolidated financial statements

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

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(a) Basis of Presentation: The accompanying unaudited consolidated financial statements for Timberland Bancorp, Inc. ("Company") were prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with instructions for Form 10-Q and, therefore, do not include all disclosures necessary for a complete presentation of consolidated financial condition, results of operations, and cash flows in conformity with GAAP. However, all adjustments which are, in the opinion of management, necessary for a fair presentation of the interim consolidated financial statements have been included. All such adjustments are of a normal recurring nature. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended September 30, 2017 ("2017 Form 10-K"). The unaudited consolidated results of operations for the three months ended December 31, 2017 are not necessarily indicative of the results that may be expected for the entire fiscal year ending September 30, 2018.

(b) Principles of Consolidation: The unaudited consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Timberland Bank ("Bank"), and the Bank's wholly-owned subsidiary, Timberland Service Corporation. All significant intercompany transactions and balances have been eliminated in consolidation.

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

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

(e) Certain prior period amounts have been reclassified to conform to the December 31, 2017 presentation with no change to net income or total shareholders' equity as previously reported.

(2) INVESTMENT SECURITIES

Held to maturity and available for sale investment securities have been classified according to management’s intent and were as follows as of December 31, 2017 and September 30, 2017 (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2017				
Held to maturity				
Mortgage-backed securities ("MBS"):				
U.S. government agencies	$ 502	$ 9	$ —	$ 511
Private label residential	580	561	(2)	1,139
U.S. Treasury and U.S government agency securities	5,995	—	(36)	5,959
Total	$ 7,077	$ 570	$ (38)	$ 7,609
Available for sale				
MBS: U.S. government agencies	$ 260	$ 15	$ —	$ 275
Mutual funds	1,000	—	(54)	946
Total	$ 1,260	$ 15	$ (54)	$ 1,221
September 30, 2017				
Held to maturity				
MBS:				
U.S. government agencies	$ 532	$ 11	$ (1)	$ 542
Private label residential	599	596	(2)	1,193
U.S. Treasury and U.S. government agency securities	6,008	10	(9)	6,009
Total	$ 7,139	$ 617	$ (12)	$ 7,744
Available for sale				
MBS: U.S. government agencies	$ 271	$ 18	$ —	$ 289
Mutual funds	1,000	—	(48)	952
Total	$ 1,271	$ 18	$ (48)	$ 1,241

Held to maturity and available for sale investment securities with unrealized losses were as follows for December 31, 2017 (dollars in thousands):

	Less Than 12 Months			12 Months or Longer			Total	
	Estimated Fair Value	Gross Unrealized Losses	Quantity	Estimated Fair Value	Gross Unrealized Losses	Quantity	Estimated Fair Value	Gross Unrealized Losses
Held to maturity								
MBS:								
U.S. government agencies	$8	$ —	2	$74	$ —	5	$82	$ —
Private label residential	—	—	—	81	(2)	10	81	(2)
U.S. Treasury and U.S. government agency securities	5,959	(36)	2	—	—	—	5,959	(36)
Total	$5,967	$ (36)	4	$155	$ (2)	15	$6,122	$ (38)
Available for sale								
Mutual funds	$—	$ —	—	$946	$ (54)	1	$946	$ (54)
Total	$—	$ —	—	$946	$ (54)	1	$946	$ (54)

Held to maturity and available for sale investment securities with unrealized losses were as follows for September 30, 2017 (dollars in thousands):

	Less Than 12 Months			12 Months or Longer			Total	
	Estimated Fair Value	Gross Unrealized Losses	Quantity	Estimated Fair Value	Gross Unrealized Losses	Quantity	Estimated Fair Value	Gross Unrealized Losses
Held to maturity								
MBS:								
U.S. government agencies	$—	$ —	—	$114	$ (1)	6	$114	$ (1)
Private label residential	—	—	—	85	(2)	10	85	(2)
U.S. Treasury and U.S. government agency securities	2,984	(9)	1	—	—	—	2,984	(9)
Total	$2,984	$ (9)	1	$199	$ (3)	16	$3,183	$ (12)
Available for sale								
Mutual funds	$—	$ —	—	$952	$ (48)	1	$952	$ (48)
Total	$—	$ —	—	$952	$ (48)	1	$952	$ (48)

The Company has evaluated the investment securities in the above tables and has determined that the decline in their value is temporary. The unrealized losses are primarily due to changes in market interest rates and spreads in the market for mortgage-related products. The fair value of these securities is expected to recover as the securities approach their maturity dates and/or as the pricing spreads narrow on mortgage-related securities. The Company has the ability and the intent to hold the investments until the market value recovers. Furthermore, as of December 31, 2017, management does not have the intent to sell any of the securities classified as available for sale where the estimated fair value is below the recorded value and believes that it is more likely than not that the Company will not have to sell such securities before a recovery of cost (or recorded value if previously written down).

The Company bifurcates OTTI into (1) amounts related to credit losses which are recognized through earnings and (2) amounts related to all other factors which are recognized as a component of other comprehensive income (loss). To determine the

component of the gross OTTI related to credit losses, the Company compared the amortized cost basis of the OTTI security to the present value of its revised expected cash flows, discounted using its pre-impairment yield. The revised expected cash flow estimates for individual securities are based primarily on an analysis of default rates, prepayment speeds and third-party analytic reports. Significant judgment by management is required in this analysis that includes, but is not limited to, assumptions regarding the collectability of principal and interest, net of related expenses, on the underlying loans.

The following table presents a summary of the significant inputs utilized to measure management's estimates of the credit loss component on OTTI securities as of December 31, 2017 and 2016:

	Range Minimum	Range Maximum	Weighted Average
December 31, 2017			
Constant prepayment rate	6.00 %	15.00 %	9.91 %
Collateral default rate	— %	11.08 %	4.77 %
Loss severity rate	— %	62.00 %	37.32 %
December 31, 2016			
Constant prepayment rate	6.00 %	15.00 %	12.28 %
Collateral default rate	0.34 %	13.35 %	5.66 %
Loss severity rate	5.00 %	81.00 %	46.05 %

The following table presents the OTTI recoveries (losses) for the three months ended December 31, 2017 and 2016 (dollars in thousands):

	Three Months Ended December 31, 2017		Three Months Ended December 31, 2016	
	Held To Maturity	Available For Sale	Held To Maturity	Available For Sale
Total recoveries	$ 27	$ —	$ —	$ —
Adjustment for portion of OTTI transferred from other comprehensive income before income taxes (1)	(5)	—	—	—
Net recoveries recognized in earnings (2)	$ 22	$ —	$ —	$ —

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

14

The following table presents a roll forward of the credit loss component of held to maturity and available for sale debt securities that have been written down for OTTI with the credit loss component recognized in earnings for the three months ended December 31, 2017 and 2016 (dollars in thousands):

	Three Months Ended December 31,	
	2017	2016
Beginning balance of credit loss	$1,301	$1,505
Additions:		
Additional increases to the amount related to credit loss for which OTTI was previously recognized	6	—
Subtractions:		
Realized losses previously recorded as credit losses	(22)	(13)
Recovery of prior credit loss	(26)	—
Ending balance of credit loss	$1,259	$1,492

During the three months ended December 31, 2017, the Company recorded a $22,000 net realized loss (as a result of the securities being deemed worthless) on 12 held to maturity investment securities, all of which had been recognized previously as a credit loss. During the three months ended December 31, 2016, the Company recorded a $13,000 net realized loss (as a result of the securities being deemed worthless) on 11 held to maturity investment securities, all of which had been recognized previously as a credit loss.

The recorded amount of investment securities pledged as collateral for public fund deposits, federal treasury tax and loan deposits, FHLB collateral and other non-profit organization deposits totaled $6.77 million and $6.82 million at December 31, 2017 and September 30, 2017, respectively.

The contractual maturities of debt securities at December 31, 2017 were as follows (dollars in thousands). Expected maturities may differ from scheduled maturities due to the prepayment of principal or call provisions.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due after one year to five years	$5,997	$ 5,961	$—	$ —
Due after five years to ten years	34	34	—	—
Due after ten years	1,046	1,614	260	275
Total	$7,077	$ 7,609	$260	$ 275

(3) GOODWILL

Goodwill is initially recorded when the purchase price paid in a business combination exceeds the estimated fair value of the net identified tangible and intangible assets acquired and liabilities assumed. Goodwill is presumed to have an indefinite useful life and is analyzed annually for impairment. The Company performs an annual review during the third quarter of each fiscal year, or more frequently if indicators of potential impairment exist, to determine if the recorded goodwill is impaired. For purposes of goodwill impairment testing, the services offered through the Bank and its subsidiary are managed as one strategic unit and represent the Company's only reporting unit.

The annual goodwill impairment test begins with a qualitative assessment of whether it is "more likely than not" that the reporting unit's fair value is less than its carrying amount. If an entity concludes that it is not "more likely than not" that the fair value of a reporting unit is less than its carrying amount, it need not perform a two-step impairment test. If the Company's qualitative assessment concluded that it is "more likely than not" that the fair value of its reporting unit is less than its carrying amount, it must perform the two-step impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized, if any. The first step of the goodwill impairment test compares the estimated fair

15

value of the reporting unit with its carrying amount, or the book value, including goodwill. If the estimated fair value of the reporting unit equals or exceeds its book value, goodwill is considered not impaired, and the second step of the impairment test is unnecessary.

The second step, if necessary, measures the amount of goodwill impairment loss to be recognized. The reporting unit must determine fair value for all assets and liabilities, excluding goodwill. The net of the assigned fair value of assets and liabilities is then compared to the book value of the reporting unit, and any excess book value becomes the implied fair value of goodwill. If the carrying amount of the goodwill exceeds the newly calculated implied fair value of goodwill, an impairment loss is recognized in the amount required to write-down the goodwill to the implied fair value.

Management's qualitative assessment takes into consideration macroeconomic conditions, industry and market considerations, cost or margin factors, financial performance and share price. Based on this assessment, the Company determined that it is not "more likely than not" that the Company's fair value is less than its carrying amount and therefore goodwill was determined not to be impaired at May 31, 2017.

A significant amount of judgment is involved in determining if an indicator of goodwill impairment has occurred. Such indicators may include, among others: a significant decline in expected future cash flows; a sustained, significant decline in the Company's stock price and market capitalization; a significant adverse change in legal factors or in the business climate; adverse assessment or action by a regulator; and unanticipated competition. Any change in these indicators could have a significant negative impact on the Company's financial condition, impact the goodwill impairment analysis or cause the Company to perform a goodwill impairment analysis more frequently than once per year.

As of December 31, 2017, management believes that there have been no events or changes in the circumstances since May 31, 2017 that would indicate a potential impairment of goodwill. No assurances can be given, however, that the Company will not record an impairment loss on goodwill in the future.

(4) LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable by portfolio segment consisted of the following at December 31, 2017 and September 30, 2017 (dollars in thousands):

	December 31, 2017		September 30, 2017	
	Amount	Percent	Amount	Percent
Mortgage loans:				
One- to four-family (1)	$116,976	14.6 %	$118,147	15.1 %
Multi-family	61,366	7.7	58,607	7.5
Commercial	333,085	41.8	328,927	41.9
Construction - custom and owner/builder	123,365	15.5	117,641	15.0
Construction - speculative one- to four-family	7,253	0.9	9,918	1.2
Construction - commercial	22,000	2.8	19,630	2.5
Construction - multi-family	24,601	3.1	21,327	2.7
Land	21,122	2.7	23,910	3.0
Total mortgage loans	709,768	89.1	698,107	88.9
Consumer loans:				
Home equity and second mortgage	38,975	4.9	38,420	4.9
Other	4,050	0.5	3,823	0.5
Total consumer loans	43,025	5.4	42,243	5.4
Commercial business loans (2)	43,993	5.5	44,444	5.7
Total loans receivable	796,786	100.0%	784,794	100.0%
Less:				
Undisbursed portion of construction loans in process	79,449		82,411	
Deferred loan origination fees, net	2,504		2,466	
Allowance for loan losses	9,565		9,553	
	91,518		94,430	
Loans receivable, net	$705,268		$690,364	

(1) Does not include one- to four-family loans held for sale totaling $3,236 and $3,515 at December 31, 2017 and September 30, 2017, respectively.
(2) Does not include commercial business loans held for sale totaling $171 and $84 at December 31, 2017 and September 30, 2017, respectively.

Allowance for Loan Losses

The following tables set forth information for the three months ended December 31, 2017 and 2016 regarding activity in the allowance for loan losses by portfolio segment (dollars in thousands):

	Three Months Ended December 31, 2017				
	Beginning Allowance	Provision for (Recapture of) Loan Losses	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One- to four-family	$1,082	$ 43	$ —	$ —	$ 1,125
Multi-family	447	(17)	—	—	430
Commercial	4,184	(91)	—	—	4,093
Construction – custom and owner/builder	699	89	—	—	788
Construction – speculative one- to four-family	128	(61)	—	8	75
Construction – commercial	303	93	—	—	396
Construction – multi-family	173	55	—	—	228
Land	918	(142)	—	4	780
Consumer loans:					
Home equity and second mortgage	983	(25)	—	—	958
Other	121	8	(1)	1	129
Commercial business loans	515	48	—	—	563
Total	$9,553	$ —	$ (1)	$ 13	$ 9,565

	Three Months Ended December 31, 2016				
	Beginning Allowance	Provision for (Recapture of) Loan Losses	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One- to four-family	$1,239	$ (83)	$ —	$ 21	$ 1,177
Multi-family	473	(73)	—	—	400
Commercial	4,384	144	(5)	—	4,523
Construction – custom and owner/builder	619	17	—	—	636
Construction – speculative one- to four-family	130	(30)	—	—	100
Construction – commercial	268	14	—	—	282
Construction – multi-family	316	69	—	—	385
Land	820	13	(2)	5	836
Consumer loans:					
Home equity and second mortgage	939	(80)	—	—	859
Other	156	2	(3)	1	156
Commercial business loans	482	7	—	—	489

Total	$9,826	$ —	$ (10)	$ 27	$ 9,843

The following tables present information on the loans evaluated individually and collectively for impairment in the allowance for loan losses by portfolio segment at December 31, 2017 and September 30, 2017 (dollars in thousands):

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
December 31, 2017						
Mortgage loans:						
One- to four-family	$1	$ 1,124	$1,125	$1,467	$ 115,509	$116,976
Multi-family	—	430	430	—	61,366	61,366
Commercial	16	4,077	4,093	4,044	329,041	333,085
Construction – custom and owner/builder	—	788	788	—	71,548	71,548
Construction – speculative one- to four-family	—	75	75	—	2,723	2,723
Construction – commercial	—	396	396	—	14,390	14,390
Construction – multi-family	—	228	228	—	9,109	9,109
Land	72	708	780	944	20,178	21,122
Consumer loans:						
Home equity and second mortgage	291	667	958	484	38,491	38,975
Other	—	129	129		4,050	4,050
Commercial business loans	55	508	563	181	43,812	43,993
Total	$435	$ 9,130	$9,565	$7,120	$ 710,217	$717,337
September 30, 2017						
Mortgage loans:						
One- to four-family	$—	$ 1,082	$1,082	$1,443	$ 116,704	$118,147
Multi-family	—	447	447	—	58,607	58,607
Commercial	26	4,158	4,184	3,873	325,054	328,927
Construction – custom and owner/builder	—	699	699	—	63,538	63,538
Construction – speculative one- to four-family	—	128	128	—	4,639	4,639
Construction – commercial	—	303	303	—	11,016	11,016
Construction – multi-family	—	173	173	—	6,912	6,912
Land	125	793	918	1,119	22,791	23,910
Consumer loans:						
Home equity and second mortgage	325	658	983	557	37,863	38,420
Other	—	121	121	—	3,823	3,823
Commercial business loans	—	515	515	—	44,444	44,444
Total	$476	$ 9,077	$9,553	$6,992	$ 695,391	$702,383

The following tables present an analysis of loans by aging category and portfolio segment at December 31, 2017 and September 30, 2017 (dollars in thousands):

	30–59 Days Past Due	60-89 Days Past Due	Non-Accrual (1)	Past Due 90 Days or More and Still Accruing	Total Past Due	Current	Total Loans
December 31, 2017							
Mortgage loans:							
One- to four-family	$325	$—	$947	$—	$1,272	$115,704	$116,976
Multi-family	—	—	—	—	—	61,366	61,366
Commercial	502	—	402	—	904	332,181	333,085
Construction – custom and owner/builder	—	—	—	—	—	71,548	71,548
Construction – speculative one- to four- family	—	—	—	—	—	2,723	2,723
Construction – commercial	—	—	—	—	—	14,390	14,390
Construction – multi-family	—	—	—	—	—	9,109	9,109
Land	43	—	395	—	438	20,684	21,122
Consumer loans:							
Home equity and second mortgage	101	—	188	—	289	38,686	38,975
Other	—	36	—	—	36	4,014	4,050
Commercial business loans	—	—	181	—	181	43,812	43,993
Total	$971	$36	$2,113	$—	$3,120	$714,217	$717,337
September 30, 2017							
Mortgage loans:							
One- to four-family	$193	$—	$874	$—	$1,067	$117,080	$118,147
Multi-family	—	—	—	—	—	58,607	58,607
Commercial	—	107	213	—	320	328,607	328,927
Construction – custom and owner/builder	—	—	—	—	—	63,538	63,538
Construction – speculative one- to four- family	—	—	—	—	—	4,639	4,639
Construction – commercial	—	—	—	—	—	11,016	11,016
Construction – multi-family	—	—	—	—	—	6,912	6,912
Land	—	—	566	—	566	23,344	23,910
Consumer loans:							
Home equity and second mortgage	56	—	258	—	314	38,106	38,420
Other	36	—	—	—	36	3,787	3,823
Commercial business loans	110	—	—	—	110	44,334	44,444
Total	$395	$107	$1,911	$—	$2,413	$699,970	$702,383

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

Credit Quality Indicators

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

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

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

Special Mention: Special mention loans are defined as those loans deemed by management to have some potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the payment prospects of the loan.

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

Loss: Loans in this classification are considered uncollectible and of such little value that continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this loan even though partial recovery may be realized in the future. At December 31, 2017 and September 30, 2017, there were no loans classified as loss.

The following tables present an analysis of loans by credit quality indicator and portfolio segment at December 31, 2017 and September 30, 2017 (dollars in thousands):

	Loan Grades				
December 31, 2017	Pass	Watch	Special Mention	Substandard	Total
Mortgage loans:					
One- to four-family	$113,235	$902	$595	$ 2,244	$116,976
Multi-family	61,366	—	—	—	61,366
Commercial	322,737	6,028	3,522	798	333,085
Construction – custom and owner/builder	70,989	559	—	—	71,548
Construction – speculative one- to four-family	2,723	—	—	—	2,723
Construction – commercial	14,390	—	—	—	14,390
Construction – multi-family	9,109	—	—	—	9,109
Land	17,929	1,014	1,784	395	21,122
Consumer loans:					
Home equity and second mortgage	38,463	149	—	363	38,975
Other	4,014	—	—	36	4,050
Commercial business loans	43,728	29	55	181	43,993
Total	$698,683	$8,681	$5,956	$ 4,017	$717,337

September 30, 2017	Pass	Watch	Special Mention	Substandard	Total
Mortgage loans:					
One- to four-family	$115,481	$422	$644	$ 1,600	$118,147
Multi-family	56,857	—	1,750	—	58,607
Commercial	318,717	6,059	3,540	611	328,927
Construction – custom and owner/builder	63,210	328	—	—	63,538
Construction – speculative one- to four-family	4,639	—	—	—	4,639
Construction – commercial	11,016	—	—	—	11,016
Construction – multi-family	6,912	—	—	—	6,912
Land	20,528	1,022	1,794	566	23,910
Consumer loans:					
Home equity and second mortgage	37,828	152	—	440	38,420
Other	3,787	—	—	36	3,823
Commercial business loans	43,416	973	55	—	44,444
Total	$682,391	$8,956	$7,783	$ 3,253	$702,383

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

The categories of non-accrual loans and impaired loans overlap, although they are not identical.

The following table is a summary of information related to impaired loans by portfolio segment as of December 31, 2017 and for the three months then ended (dollars in thousands):

	Recorded Investment	Unpaid Principal Balance (Loan Balance Plus Charge Off)	Related Allowance	Year to Date ("YTD") Average Recorded Investment (1)	YTD Interest Income Recognized (1)	YTD Cash Basis Interest Income Recognized (1)
With no related allowance recorded:						
Mortgage loans:						
One- to four-family	$ 1,423	$ 1,569	$ —	$ 1,433	$ 19	$ 16
Commercial	2,151	2,151	—	2,059	24	17
Land	45	141	—	171	—	—
Consumer loans:						
Home equity and second mortgage	188	188	—	156	2	2
Subtotal	3,807	4,049	—	3,819	45	35
With an allowance recorded:						
Mortgage loans:						
One- to four-family	44	44	1	22	—	—
Commercial	1,893	1,893	16	1,900	27	21
Land	899	899	72	861	9	8
Consumer loans:						
Home equity and second mortgage	296	296	291	365	6	5
Commercial business loans	181	181	55	91	—	—
Subtotal	3,313	3,313	435	3,239	42	34
Total:						
Mortgage loans:						
One- to four-family	1,467	1,613	1	1,455	19	16
Commercial	4,044	4,044	16	3,959	51	38
Land	944	1,040	72	1,032	9	8
Consumer loans:						
Home equity and second mortgage	484	484	291	521	8	7
Commercial business loans	181	181	55	91	—	—
Total	$ 7,120	$ 7,362	$ 435	$ 7,058	$ 87	$ 69

(1) For the three months ended December 31, 2017.

The following table is a summary of information related to impaired loans by portfolio segment as of and for the year ended September 30, 2017 (dollars in thousands):

	Recorded Investment	Unpaid Principal Balance (Loan Balance Plus Charge Off)	Related Allowance	Average Recorded Investment (1)	Interest Income Recognized (1)	Cash Basis Interest Income Recognized (1)
With no related allowance recorded:						
Mortgage loans:						
One- to four-family	$ 1,443	$ 1,589	$ —	$ 1,108	$ 68	$ 62
Commercial	1,967	1,967	—	3,901	188	143
Construction – custom and owner/builder	—	—	—	147	7	7
Land	297	410	—	512	8	6
Consumer loans:						
Home equity and second mortgage	123	123	—	284	—	—
Commercial business loans	—	—	—	11	—	—
Subtotal	3,830	4,089	—	5,963	271	218
With an allowance recorded:						
Mortgage loans:						
One- to four-family	—	—	—	721	50	38
Commercial	1,906	1,906	26	3,326	182	144
Land	822	881	125	666	35	29
Consumer loans:						
Home equity and second mortgage	434	434	325	530	29	26
Other	—	—	—	17	—	—
Subtotal	3,162	3,221	476	5,260	296	237
Total:						
Mortgage loans:						
One- to four-family	1,443	1,589	—	1,829	118	100
Commercial	3,873	3,873	26	7,227	370	287
Construction – custom and owner/builder	—	—	—	147	7	7
Land	1,119	1,291	125	1,178	43	35
Consumer loans:						
Home equity and second mortgage	557	557	325	814	29	26
Other	—	—	—	17	—	—
Commercial business loans	—	—	—	11	—	—
Total	$ 6,992	$ 7,310	$ 476	$ 11,223	$ 567	$ 455

(1) For the year ended September 30, 2017.

A troubled debt restructured loan ("TDR") is a loan for which the Company, for reasons related to a borrower’s financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. Examples of such concessions include but are not limited to: a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market rates; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-amortizations, extensions, deferrals and renewals. TDRs are considered impaired and are individually

evaluated for impairment. TDRs are classified as non-accrual (and considered to be non-performing) unless they have been performing in accordance with modified terms for a period of at least six months. The Company had $3.48 million and $3.60 million in TDRs included in impaired loans at December 31, 2017 and September 30, 2017, respectively, and had no commitments at these dates to lend additional funds on these loans. The allowance for loan losses allocated to TDRs at December 31, 2017 and September 30, 2017 was $33,000 and $10,000, respectively. There were no TDRs for which there was a payment default within the first 12 months of the modification during the three months ended December 31, 2017.

The following tables set forth information with respect to the Company's TDRs by interest accrual status as of December 31, 2017 and September 30, 2017 (dollars in thousands):

	December 31, 2017		
	Accruing	Non-Accrual	Total
Mortgage loans:			
One- to four-family	$520	$ 44	$564
Commercial	2,214	—	2,214
Land	548	155	703
Total	$3,282	$ 199	$3,481

	September 30, 2017		
	Accruing	Non-Accrual	Total
Mortgage loans:			
One- to four-family	$569	$ —	$569
Commercial	2,219	—	2,219
Land	554	253	807
Total	$3,342	$ 253	$3,595

There was one new TDR during the three months ended December 31, 2017 as a result of a reduction in the face amount of the debt on a land loan. This TDR had a pre-modification balance of $214,000, a post-modification balance of $155,000 and a balance at December 31, 2017 of $155,000. There were no new TDRs during the year ended September 30, 2017.

(5) NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income to common shareholders by the weighted average number of common shares outstanding during the period, without considering any dilutive items. Diluted net income per common share is computed by dividing net income to common shareholders by the weighted average number of common shares and common stock equivalents for items that are dilutive, net of shares assumed to be repurchased using the treasury stock method at the average share price for the Company's common stock during the period. Common stock equivalents arise from the assumed conversion of outstanding stock options and the outstanding warrant to purchase common stock. Shares owned by the Bank's ESOP that have not been allocated are not considered to be outstanding for the purpose of computing basic and diluted net income per common share. At December 31, 2017 and 2016, there were 51,105 and 84,964 shares, respectively, that had not been allocated under the Bank's ESOP.

Information regarding the calculation of basic and diluted net income per common share for the three months ended December 31, 2017 and 2016 is as follows (dollars in thousands, except per share amounts):

	Three Months Ended December 31,	
	2017	2016
Basic net income per common share computation		
Numerator – net income	$3,614	$ 3,147
Denominator – weighted average common shares outstanding	7,312,531	6,862,749
Basic net income per common share	$0.49	$ 0.46
Diluted net income per common share computation		
Numerator – net income	$3,614	$ 3,147
Denominator – weighted average common shares outstanding	7,312,531	6,862,749
Effect of dilutive stock options (1)	195,638	139,493
Effect of dilutive stock warrant (2)	—	233,273
Weighted average common shares outstanding - assuming dilution	7,508,169	7,235,515
Diluted net income per common share	$0.48	$ 0.43

(1) For the three months ended December 31, 2017, average options to purchase 14,651 shares of common stock were outstanding but not included in the computation of diluted net income per common share because their effect would have been anti-dilutive. For the three months ended December 31, 2016, all outstanding options were included in the computation of diluted net income per share.

(2) Represented a warrant to purchase 370,899 shares of the Company's common stock at an exercise price of $6.73 per share (subject to anti-dilution adjustments) at any time through December 23, 2018 (the "Warrant"). The Warrant was granted on December 23, 2008 to the U.S. Treasury Department ("Treasury") as part of the Company's participation in the Treasury's Troubled Asset Relief Program ("TARP"). On June 12, 2013, the Treasury sold the Warrant to private investors. On January 31, 2017, the Warrant was exercised and 370,899 shares of the Company's common stock were issued in exchange for $2.50 million.

(6) ACCUMULATED OTHER COMPREHENSIVE LOSS

The changes in accumulated other comprehensive loss ("AOCI") by component during the three months ended December 31, 2017 and 2016 are as follows (dollars in thousands):

	Three Months Ended December 31, 2017		
	Changes in fair value of available for sale securities (1)	Changes in OTTI on held to maturity securities (1)	Total (1)
Balance of AOCI at the beginning of period	$(19)	$ (105)	$(124)
Net change	(7)	(5)	(12)
Balance of AOCI at the end of period	$(26)	$ (110)	$(136)

	Three Months Ended December 31, 2016		
	Changes in fair value of available for sale securities (1)	Changes in OTTI on held to maturity securities (1)	Total (1)
Balance of AOCI at the beginning of period	$4	$ (179)	$(175)
Net change	(27)	13	(14)
Balance of AOCI at the end of period	$(23)	$ (166)	$(189)

(1) All amounts are net of income taxes.

(7) STOCK COMPENSATION PLANS

Under the Company's 2003 Stock Option Plan, the Company was able to grant options for up to 300,000 shares of common stock to employees, officers, directors and directors emeriti. Under the Company's 2014 Equity Incentive Plan, the Company is able to grant options and awards of restricted stock (with or without performance measures) for up to 352,366 shares of common stock to employees, officers, directors and directors emeriti. Shares issued may be purchased in the open market or may be issued from authorized and unissued shares. The exercise price of each option equals the fair market value of the Company's common stock on the date of grant. Generally, options and restricted stock vest in 20% annual installments on each of the five anniversaries from the date of the grant, and options generally have a maximum contractual term of 10 years from the date of grant. At December 31, 2017, there were 116,516 shares of common stock available which may be awarded as options or restricted stock pursuant to

future grant under the 2014 Equity Incentive Plan.

At both December 31, 2017 and 2016, there were no unvested restricted stock awards. There were no restricted stock grants awarded during the three months ended December 31, 2017 and 2016.

Stock option activity for the three months ended December 31, 2017 and 2016 is summarized as follows:

	Three Months Ended December 31, 2017		Three Months Ended December 31, 2016	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding, beginning of period	380,120	$ 13.23	373,130	$ 9.82
Exercised	(6,250)	9.65	(12,700)	6.31
Forfeited	(4,300)	11.66	—	—
Options outstanding, end of period	369,570	$ 13.31	360,430	$ 9.94

The aggregate intrinsic value of options exercised during the three months ended December 31, 2017 and 2016 was $124,000 and $157,000, respectively.

At December 31, 2017, there were 203,250 unvested options with an aggregate grant date fair value of $499,000, all of which the Company assumes will vest. The aggregate intrinsic value of unvested options at December 31, 2017 was $1.94 million. There were 29,500 options with an aggregate grant date fair value of $75,000 that vested during the three months ended December 31, 2017.

At December 31, 2016, there were 221,950 unvested options with an aggregate grant date fair value of $438,000. There were 28,500 options with an aggregate grant date fair value of $67,000 that vested during the three months ended December 31, 2016.

Additional information regarding options outstanding at December 31, 2017 is as follows:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices ($)	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
$ 4.01 - 4.55	10,000	$ 4.28	2.9	10,000	$ 4.28	2.9
5.86 - 6.00	39,000	5.94	4.8	39,000	5.94	4.8
9.00	78,000	9.00	5.8	59,800	9.00	5.8
10.26 - 10.71	131,520	10.57	7.3	48,070	10.56	7.2
15.67	53,050	15.67	8.8	9,450	15.67	8.8
29.69	58,000	29.69	9.8	—	N/A	N/A
	369,570	$ 13.31	7.2	166,320	$ 8.83	6.0

The aggregate intrinsic value of options outstanding at December 31, 2017 and 2016 was $4.89 million and $3.86 million, respectively.

As of December 31, 2017, unrecognized compensation cost related to non-vested stock options was $446,000, which is expected to be recognized over a weighted average life of 2.25 years.

(8) FAIR VALUE MEASUREMENTS

GAAP defines fair value and establishes a framework for measuring fair value. Fair value is the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. The three levels for categorizing assets and liabilities under GAAP's fair value measurement requirements are as follows:

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

Level 2: Significant observable inputs other than quoted prices included within Level 1, such as quoted prices for similar (as opposed to identical) assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted prices that are observable or can be corroborated by observable market data.

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

The Company's assets measured at fair value on a recurring basis consist of investment securities available for sale. The estimated fair values of MBS are based upon market prices of similar securities or observable inputs (Level 2). The estimated fair values of mutual funds are based upon quoted market prices (Level 1).

The Company had no liabilities measured at fair value on a recurring basis at December 31, 2017 and September 30, 2017. The Company's assets measured at estimated fair value on a recurring basis at December 31, 2017 and September 30, 2017 were as follows (dollars in thousands):

December 31, 2017	Estimated Fair Value			
	Level 1	Level 2	Level 3	Total
Available for sale investment securities				
MBS: U.S. government agencies	$—	$275	$ —	$275
Mutual funds	946	—	—	946
Total	$946	$275	$ —	$1,221

September 30, 2017	Estimated Fair Value			
	Level 1	Level 2	Level 3	Total
Available for sale investment securities				
MBS: U.S. government agencies	$—	$289	$ —	$289
Mutual funds	952	—	—	952
Total	$952	$289	$ —	$1,241

There were no transfers among Level 1, Level 2 and Level 3 during the three months ended December 31, 2017 and the year ended September 30, 2017.

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

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

Impaired Loans: The estimated fair value of impaired loans is calculated using the collateral value method or on a discounted cash flow basis. The specific reserve for collateral dependent impaired loans is based on the estimated fair value of the collateral less estimated costs to sell, if applicable. In some cases, adjustments are made to the appraised values due to various factors including age of the appraisal, age of comparables included in the appraisal and known changes in the market and in the collateral. Such adjustments may be significant and typically result in a Level 3 classification of the inputs for determining fair value. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Investment Securities Held to Maturity: The estimated fair value of investment securities held to maturity is based upon the assumptions market participants would use in pricing the investment security. Such assumptions include quoted market prices (Level 1), market prices of similar securities or observable inputs (Level 2) and unobservable inputs such as dealer quotes, discounted cash flows or similar techniques (Level 3).

OREO and Other Repossessed Assets, net: OREO and other repossessed assets are recorded at estimated fair value less estimated costs to sell. Estimated fair value is generally determined by management based on a number of factors, including third-party appraisals of estimated fair value in an orderly sale. Estimated costs to sell are based on standard market factors. The valuation of OREO and other repossessed assets is subject to significant external and internal judgment (Level 3).

29

The following table summarizes the balances of assets measured at estimated fair value on a non-recurring basis at December 31, 2017 (dollars in thousands):

	Estimated Fair Value		
	Level 1	Level 2	Level 3
Impaired loans:			
Mortgage loans:			
One- to four-family	$—	$—	$43
Commercial	—	—	1,877
Land	—	—	827
Consumer loans:			
Home equity and second mortgage	—	—	5
Commercial business loans	—	—	126
Total impaired loans	—	—	2,878
Investment securities – held to maturity:			
MBS - private label residential	—	112	—
OREO and other repossessed assets	—	—	2,887
Total	$—	$112	$5,765

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis as of December 31, 2017 (dollars in thousands):

	Estimated Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range
Impaired loans	$ 2,878	Market approach	Appraised value less selling costs	NA
OREO and other repossessed assets	$ 2,887	Market approach	Lower of appraised value or listing price less selling costs	NA

The following table summarizes the balances of assets measured at estimated fair value on a non-recurring basis at September 30, 2017 (dollars in thousands):

	Estimated Fair Value		
	Level 1	Level 2	Level 3
Impaired loans:			
Mortgage loans:			
Commercial	$—	$—	$1,880
Land	—	—	697
Consumer loans:			
Home equity and second mortgage	—	—	109
Total impaired loans	—	—	2,686
Investment securities – held to maturity:			
MBS - private label residential	—	125	—
OREO and other repossessed assets	—	—	3,301
Total	$—	$125	$5,987

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis as of September 30, 2017 (dollars in thousands):

	Estimated Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range
Impaired loans	$ 2,686	Market approach	Appraised value less selling costs	NA
OREO and other repossessed assets	$ 3,301	Market approach	Lower of appraised value or listing price less selling costs	NA

GAAP requires disclosure of estimated fair values for financial instruments. Such estimates are subjective in nature, and significant judgment is required regarding the risk characteristics of various financial instruments at a discrete point in time. Therefore, such estimates could vary significantly if assumptions regarding uncertain factors were to change. In addition, as the Company normally intends to hold the majority of its financial instruments until maturity, it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for certain items which are not defined as financial instruments but which may have significant value. The Company does not believe that it would be practicable to estimate a representational fair value for these types of items as of December 31, 2017 and September 30, 2017. Because GAAP excludes certain items from fair value disclosure requirements, any aggregation of the fair value amounts presented would not represent the underlying value of the Company.

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

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

Investment Securities: See descriptions above.

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

Other Investments: The Bank invests in the Solomon Hess SBA Loan Fund LLC. Shares in the fund are not publicly traded and therefore have no readily determinable fair market value, therefore they are recorded on the balance sheet at cost. An investor can have its investment in the funds redeemed for the balance of its capital account at any quarter end with 60 days notice to the fund.

Loans Held for Sale: The estimated fair value is based on quoted market prices (for one-to four-family loans) and the guaranteed value of U.S. Small Business Administration ("SBA") loans (made to small businesses under the SBA's 7(a) loan programs). Quoted market prices are obtained from the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the FHLB.

Loans Receivable, Net: The fair value of non-impaired loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers for the same remaining maturities. Prepayments are based on the historical experience of the Bank. Fair values for impaired loans are estimated using the methods described above.

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

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

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

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

The recorded amounts and estimated fair values of financial instruments were as follows as of December 31, 2017 and September 30, 2017 (dollars in thousands):

	December 31, 2017				
		Fair Value Measurements Using:			
	Recorded Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$166,207	$166,207	$166,207	$ —	$ —
CDs held for investment	53,528	53,528	53,528	—	—
Investment securities	8,298	8,830	3,910	4,920	—
FHLB stock	1,107	1,107	1,107	—	—
Other investments	3,000	3,000	3,000	—	—
Loans held for sale	3,407	3,501	3,501	—	—
Loans receivable, net	705,268	697,940	—	—	697,940
Accrued interest receivable	2,743	2,743	2,743	—	—
Financial liabilities					
Deposits:					
Non-interest-bearing demand	210,108	210,108	210,108	—	—
Interest-bearing	665,966	665,783	528,543	—	137,240
Total deposits	876,074	875,891	738,651	—	137,240
Accrued interest payable	178	178	178	—	—

	September 30, 2017				
		Fair Value Measurements Using:			
	Recorded Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$148,188	$148,188	$148,188	$ —	$ —
CDs held for investment	43,034	43,034	43,034	—	—
Investment securities	8,380	8,985	3,954	5,031	—
FHLB stock	1,107	1,107	1,107	—	—
Other investments	3,000	3,000	3,000	—	—
Loans held for sale	3,599	3,619	3,619	—	—
Loans receivable, net	690,364	688,332	—	—	688,332
Accrued interest receivable	2,520	2,520	2,520	—	—
Financial liabilities					
Deposits:					
Non-interest-bearing demand	205,952	205,952	205,952	—	—
Interest-bearing	631,946	632,629	492,305	—	140,324
Total deposits	837,898	838,581	698,257	—	140,324
Accrued interest payable	161	161	161	—	—

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the estimated fair value of the Company's financial instruments will change when interest rate levels change, and that change may either be favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to appropriately manage interest rate risk. However, borrowers with fixed interest rate obligations are less likely to prepay in a rising interest rate

environment and more likely to prepay in a falling

32

---

interest rate environment. Conversely, depositors who are receiving fixed interest rates are more likely to withdraw funds before maturity in a rising interest rate environment and less likely to do so in a falling interest rate environment. Management monitors interest rates and maturities of assets and liabilities, and attempts to manage interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company’s overall interest rate risk.

(9) RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). The core principle of this ASU is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In general, the new guidance requires companies to use more judgment and make more estimates than under current guidance, including identifying performance obligations in the contract and estimating the amount of variable consideration to include in the transaction price related to each separate performance obligation. This ASU is effective for annual periods beginning after December 15, 2017, including interim periods within that reporting period. The Company's primary source of revenue is interest income, which is recognized when earned and is deemed to be in compliance with this ASU. Accordingly, the adoption of ASU No. 2014-09 is not expected to have a material impact on the Company's future consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The main provisions of this ASU address the valuation and impairment of certain equity investments along with simplified disclosures about the fair value of financial instruments. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Management is in the planning stages of developing processes and procedures to comply with the disclosure requirements of this ASU, which could impact the disclosures the Company makes related to the fair value of its financial instruments; however, the adoption of ASU No. 2016-01 is not expected to have a material impact on the Company's future consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This ASU is intended to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet and disclosure of key information about leasing arrangements. The principal change required by this ASU relates to lessee accounting, and is that for operating leases, a lessee is required to (1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position, (2) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis, and (3) classify all cash payments within operating activities in the statement of cash flows. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. This ASU also changes disclosure requirements related to leasing activities and requires certain qualitative disclosures along with specific quantitative disclosures. The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early application of the amendments in this ASU is permitted. The effect of adoption will depend on leases at the time of adoption. Once adopted, the Company expects to report higher assets and liabilities as a result of including right-of-use assets and lease liabilities related to certain banking offices and certain equipment under non-cancelable operating lease agreements; however, based on current leases the adoption of ASU No. 2016-02 is not expected to have a material impact on the Company's future consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses. This ASU replaces the existing incurred losses methodology with a current expected losses methodology with respect to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held to maturity investment securities and off-balance sheet commitments. In addition, this ASU requires credit losses relating to available for sale debt securities to be recorded through an allowance for credit losses rather than as a reduction of the carrying amount. ASU No. 2016-13 also changes the accounting for purchased credit-impaired debt securities and loans. The standard retains many of the current disclosure requirements in GAAP and expands disclosure requirements. ASU No. 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Upon adoption, the Company expects a change in the processes and procedures to calculate the allowance for loan losses, including changes in the assumptions and estimates to consider expected credit losses over the life of the loan versus the current accounting practice that utilizes the incurred loss model. In addition, the current policy for other-than-temporary impairment on investment securities available for sale will be replaced with an allowance approach. The Company is reviewing the requirements of ASU No. 2016-13 and expects to begin developing and implementing processes and procedures to ensure it is fully compliant with the amendments at

the adoption date. At this time, the Company anticipates the allowance for loan losses will increase as a result of the implementation of this ASU; however, until its evaluation is complete, the magnitude of the increase will be unknown.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles - Goodwill and Other: Simplifying the Test for Goodwill Impairment. This ASU simplifies the subsequent measurement of goodwill and eliminates Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value of its assets and liabilities (including unrecognized assets and liabilities) at the impairment testing date following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Under ASU No. 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. ASU No. 2017-04 is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early application of this ASU is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of ASU No. 2017-04 is not expected to have a material impact on the Company's future consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The ASU shortens the amortization period for certain callable debt securities held at a premium. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The adoption of ASU No. 2017-08 is not expected to have a material impact on the Company's future consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation--Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU was issued to provide clarity as to when to apply modification accounting when there is a change in the terms or conditions of a share-based payment award. According to the ASU, an entity should account for the effects of a modification unless the fair value, vesting conditions, and balance sheet classification of the award are the same after the modification as compared to the original award prior to modification. ASU No. 2017-09 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. The adoption of ASU No. 2017-09 is not expected to have a material impact on the Company's future consolidated financial statements.

(10) U.S. TAX REFORM

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). The Tax Act significantly revises the future ongoing U.S. corporate income tax by, among other things, decreasing U.S. corporate income tax rates to 21.0% from 35.0%. As the Company has a September 30 fiscal year-end, the lower corporate income tax rate will be phased in, resulting in a blended U.S. statutory federal rate of approximately 24.5% for the Company's fiscal year ending September 30, 2018, and 21.0% for subsequent fiscal years. In addition, the reduction of the corporate tax rate required the Company to revalue its deferred tax assets and liabilities based on the lower federal tax rate of 21.0%.

As a result of the new legislation, during the quarter ended December 31, 2017, the Company recorded a one-time income tax expense of $548,000 in conjunction with writing down its net deferred tax assets. The impact of using the 24.5% blended federal tax rate for the quarter ended December 31, 2017 versus a 35.0% rate reduced the provision for income taxes by approximately $551,000.

The changes included in the Tax Act are broad and complex. The final transition impacts of the Tax Act may differ from the above estimates, possibly materially, due to, among other things, changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, and any changes in accounting standards for income taxes or related interpretations in response to the Tax Act.

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

As used in this Form 10-Q, the terms "we," "our" and "Company" refer to Timberland Bancorp, Inc. and its consolidated subsidiaries, unless the context indicates otherwise. When we refer to "Bank" in this Form 10-Q, we are referring to

Timberland Bank, a wholly-owned subsidiary of Timberland Bancorp, Inc. and the Bank's wholly-owned subsidiary, Timberland Service Corporation.

The following analysis discusses the material changes in the consolidated financial condition and results of operations of the Company at and for the three months ended December 31, 2017. This analysis as well as other sections of this report contains certain "forward-looking statements."

Certain matters discussed in this Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and often include the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook" or similar or future or conditional verbs such as "may," "will," "should," "would" and "could." Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about future economic performance. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from the results anticipated or implied by our forward-looking statements, including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets which may lead to increased losses and non-performing loans in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our loan loss reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market areas; secondary market conditions for loans and our ability to sell loans in the secondary market; results of examinations of us by the Board of Governors of the Federal Reserve System ("Federal Reserve") and of our bank subsidiary by the FDIC, the Washington State Department of Financial Institutions, Division of Banks or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, institute a formal or informal enforcement action against us or our bank subsidiary which could require us to increase our allowance for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits or impose additional requirements or restrictions on us, any of which could adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules including as a result of Basel III; the impact of the Dodd Frank Wall Street Reform and Consumer Protection Act and implementing regulations; our ability to attract and retain deposits; increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risks associated with the loans on our consolidated balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; disruptions, security breaches, or other adverse events, failures or interruptions in, or attacks on, our information technology systems or on the third-party vendors who perform several of our critical processing functions; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our business strategies; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we may acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; our ability to pay dividends on our common stock; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution

regulatory agencies or the FASB, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks described elsewhere in this Form 10-Q and in the Company's other reports filed with or furnished to the Securities and Exchange Commission, including our 2017 Form 10-K.

Any of the forward-looking statements that we make in this Form 10-Q and in the other public statements we make are based upon management's beliefs and assumptions at the time they are made. We do not undertake and specifically disclaim any obligation to publicly update or revise any forward-looking statements included in this report to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this document

might not occur and we caution readers not to place undue reliance on any forward-looking statements. These risks could cause our actual results for fiscal 2018 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of us, and could negatively affect the Company's consolidated financial condition and results of operations as well as its stock price performance.

Overview

Timberland Bancorp, Inc., a Washington corporation, is the holding company for Timberland Bank. The Bank opened for business in 1915 and serves consumers and businesses across Grays Harbor, Thurston, Pierce, King, Kitsap and Lewis counties, Washington with a full range of lending and deposit services through its 22 branches (including its main office in Hoquiam). At December 31, 2017, the Company had total assets of $993.90 million and total shareholders' equity of $114.11 million. The Company's business activities generally are limited to passive investment activities and oversight of its investment in the Bank. Accordingly, the information set forth in this report relates primarily to the Bank's operations.

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

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

Net income is also affected by non-interest income and non-interest expenses. For the three month period ended December 31, 2017, non-interest income consisted primarily of service charges on deposit accounts, gain on sales of loans, ATM and debit card interchange transaction fees, an increase in the cash surrender value of BOLI, servicing income on loans sold and other operating income. Non-interest income is increased by net recoveries on investment securities and reduced by net OTTI losses on investment securities, if any. Non-interest expenses consisted primarily of salaries and employee benefits, premises and equipment, advertising, ATM and debit card interchange transaction fees, OREO and other repossessed asset expenses, postage and courier expenses, state and local taxes, professional fees, FDIC insurance premiums, loan administration and foreclosure expenses, data processing and telecommunication expenses, deposit operation expenses and other non-interest expenses. Non-interest income and non-interest expenses are affected by the growth of the Company's operations and growth in the number of loan and deposit accounts.

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

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

originates commercial business loans and other consumer loans.

Critical Accounting Policies and Estimates

The Company has identified several accounting policies that as a result of judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company’s Consolidated Financial Statements. Critical accounting policies and estimates are discussed in the Company’s 2017 Form 10-K under Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operation – Critical Accounting Policies and Estimates.” That discussion highlights estimates the Company makes that involve uncertainty or potential for substantial change. There have been no material changes in the Company’s critical accounting policies and estimates as previously disclosed in the Company’s 2017 Form 10-K.

Comparison of Financial Condition at December 31, 2017 and September 30, 2017

The Company's total assets increased by $41.87 million, or 4.4%, to $993.90 million at December 31, 2017 from $952.02 million at September 30, 2017. The increase in total assets was primarily due to an increase in total cash and cash equivalents, CDs held for investment and net loans receivable. The increase in total assets was funded primarily by an increase in total deposits.

Net loans receivable increased by $14.90 million, or 2.2%, to $705.27 million at December 31, 2017 from $690.36 million at September 30, 2017. The increase was primarily due to increases in custom and owner/builder one- to four-family construction loans, commercial real estate loans, multi-family construction loans, multi-family loans, commercial construction loans and a decrease in the undisbursed portion of construction loans in process. These increases to net loans receivable were partially offset by a decrease in land loans, speculative one- to four-family construction loans and one- to four-family loans.

Total deposits increased by $38.18 million, or 4.6%, to $876.07 million at December 31, 2017 from $837.90 million at September 30, 2017. The increase was primarily a result of a $36.46 million increase in money market accounts and smaller increases in non-interest bearing demand accounts and savings accounts. These increases were partially offset by decreases in N.O.W. checking accounts and certificates of deposit accounts.

Shareholders' equity increased by $3.11 million, or 2.8%, to $114.11 million at December 31, 2017 from $111.00 million at September 30, 2017. The increase in shareholders' equity was primarily due to net income for the three months ended December 31, 2017 and was partially offset by the payment of dividends to common shareholders.

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

Cash and Cash Equivalents and CDs Held for Investment: Cash and cash equivalents and CDs held for investment increased by $28.51 million, or 14.9%, to $219.74 million at December 31, 2017 from $191.22 million at September 30, 2017. The increase was primarily due to a $18.02 million increase in cash and cash equivalents and a $10.49 million increase in CDs held for investment.

Investment Securities: Investment securities decreased by $82,000, or 1.0%, to $8.30 million at December 31, 2017 from $8.38 million at September 30, 2017. This decrease is primarily due to scheduled amortization and prepayments. For additional information on investment securities, see Note 2 of the Notes to Unaudited Consolidated Financial Statements contained in "Item 1, Financial Statements."

FHLB Stock: FHLB stock was unchanged at $1.11 million at both December 31, 2017 and September 30, 2017.

Other Investments: Other investments consist solely of the Company's investment in the Solomon Hess SBA Loan Fund LLC which was unchanged at $3.00 million at both December 31, 2017 and September 30, 2017. This investment is utilized to help satisfy compliance with the Bank's Community Reinvestment Act investment test requirements.

Loans: Net loans receivable increased by $14.90 million, or 2.2%, to $705.27 million at December 31, 2017 from $690.36 million at September 30, 2017. The increase in the portfolio was primarily a result of a $5.72 million increase in custom and owner/builder construction loans, a $4.16 million increase in commercial real estate loans, a $3.27 million increase in multi-family construction loans, a $2.96 million decrease in the amount of undisbursed construction loans in process, a $2.76 million increase in multi-family mortgage loans, a $2.37 million increase in commercial construction loans and smaller increases in other categories. These increases were partially offset by a $2.79 million decrease in land loans, a $2.67 million decrease in speculative one- to four-family construction loans, a $1.17 million decrease in one-to four-family mortgage loans and smaller decreases in other categories.

Loan originations decreased by $7.64 million, or 8.5%, to $82.51 million for the three months ended December 31, 2017 from $90.15 million for the three months ended December 31, 2016. The Company continued to sell longer-term fixed rate one- to four-family mortgage loans for asset liability management purposes and to generate non-interest income. The Company also (on a much smaller volume) sells the guaranteed portion of U.S. Small Business Administration ("SBA") loans. Sales of fixed rate one- to four-family mortgage loans and SBA loans decreased by $8.29 million, or 34.3%, to $15.91 million for the three months ended December 31, 2017 compared to $24.20 million for the three months ended December 31, 2016.

For additional information, see Note 4 of the Notes to Unaudited Consolidated Financial Statements contained in “Item 1, Financial Statements.”

Premises and Equipment: Premises and equipment decreased by $111,000, or 0.6%, to $18.31 million at December 31, 2017 from $18.42 million at September 30, 2017. The decrease was primarily due to normal depreciation.

OREO (Other Real Estate Owned): OREO and other repossessed assets decreased by $414,000, or 12.5%, to $2.89 million at December 31, 2017 from $3.30 million at September 30, 2017. The decrease was primarily due to the disposition of two OREO properties. At December 31, 2017, total OREO and other repossessed assets consisted of 14 individual real estate properties and one recreational vehicle. The properties consisted of 12 land parcels totaling $2.03 million, one single-family home with a carrying value of $516,000 and one commercial real estate property with a carrying value of $332,000.

Goodwill: The recorded amount of goodwill of $5.65 million at December 31, 2017 was unchanged from September 30, 2017.

Deposits: Deposits increased by $38.18 million, or 4.6%, to $876.07 million at December 31, 2017 from $837.90 million at September 30, 2017. This increase was primarily due to a $36.46 million increase in money market account balances, a $4.16 million increase in non-interest bearing demand account balances and a $1.67 million increase in savings account balances. These increases were partially offset by a $2.22 million decrease in certificates of deposit account balances and a $1.89 million decrease in N.O.W. checking account balances. The increase in money market account balances was primarily due a commercial customer making a large deposit ($28.70 million) in December 2017. The majority of this deposit is expected to be withdrawn during January 2018.

Deposits consisted of the following at December 31, 2017 and September 30, 2017 (dollars in thousands):

	December 31, 2017			September 30, 2017		
	Amount	Percent		Amount	Percent	
Non-interest-bearing demand	$210,108	24	%	$205,952	25	%
N.O.W. checking	218,422	25	%	220,315	26	%
Savings	142,660	16	%	140,987	17	%
Money market	156,665	18	%	122,877	15	%
Money market - brokered	10,796	1	%	8,125	1	%
Certificates of deposit under $250	118,017	14	%	120,844	14	%
Certificates of deposit $250 and over	16,208	2	%	15,601	2	%
Certificates of deposit - brokered	3,198	—	%	3,197	—	%
Total	$876,074	100	%	$837,898	100	%

Shareholders' Equity: Total shareholders' equity increased by $3.11 million, or 2.8%, to $114.11 million at December 31, 2017 from $111.00 million at September 30, 2017. The increase was primarily due to net income of $3.61 million for the three months ended December 31, 2017, which was partially offset by the payment of $810,000 in dividends on the Company's common stock. The Company did not repurchase any shares of its common stock during the three months ended December 31, 2017.

Asset Quality: The non-performing assets to total assets ratio improved to 0.55% at December 31, 2017 from 0.60% at September 30, 2017 as total non-performing assets decreased by $245,000, or 4.3%, to $5.50 million at December 31, 2017 from $5.75 million at September 30, 2017. The decrease was primarily due to a $414,000 decrease in OREO and other repossessed assets, which was partially offset by a $202,000 increase in non-accrual loans.

TDRs on accrual status (which are not included in the non-performing asset totals) decreased by $60,000, or 1.8%, to $3.28 million at December 31, 2017 from $3.34 million at September 30, 2017.

The following table sets forth information with respect to the Company's non-performing assets at December 31, 2017 and September 30, 2017 (dollars in thousands):

	December 31, 2017	September 30, 2017
Loans accounted for on a non-accrual basis:		
Mortgage loans:		
One- to four-family (1)	$ 947	$ 874
Commercial	402	213
Land	395	566
Consumer loans:		
Home equity and second mortgage	188	258
Commercial business loans	181	—
Total loans accounted for on a non-accrual basis	2,113	1,911
Accruing loans which are contractually past due 90 days or more	—	—
Total of non-accrual and 90 days past due loans	2,113	1,911
Non-accrual investment securities	500	533
OREO and other repossessed assets, net (2)	2,887	3,301
Total non-performing assets (3)	$ 5,500	$ 5,745
TDRs on accrual status (4)	$ 3,282	$ 3,342
Non-accrual and 90 days or more past due loans as a percentage of loans receivable	0.30 %	0.27 %
Non-accrual and 90 days or more past due loans as a percentage of total assets	0.21 %	0.20 %
Non-performing assets as a percentage of total assets	0.55 %	0.60 %
Loans receivable (5)	$ 714,833	$ 699,917
Total assets	$ 993,895	$ 952,024

(1) As of December 31, 2017 and September 30, 2017, the balance of non-accrual one- to-four family properties included $100 and $100, respectively, in the process of foreclosure.
(2) As of December 31, 2017 and September 30, 2017, the balance of OREO included $516 and $875, respectively, of foreclosed residential real estate property recorded as a result of obtaining physical possession of the property.
(3) Does not include TDRs on accrual status.
(4) Does not include TDRs totaling $199 and $253 reported as non-accrual loans at December 31, 2017 and September 30, 2017, respectively.
(5) Does not include loans held for sale and loan balances are before the allowance for loan losses.

Comparison of Operating Results for the Three Months Ended December 31, 2017 and 2016

Net income increased by $467,000, or 14.8%, to $3.61 million for the quarter ended December 31, 2017 from $3.15 million for the quarter ended December 31, 2016. Net income per diluted common share increased $0.05, or 11.6%, to

$0.48 for the quarter ended December 31, 2017 from $0.43 for the quarter ended December 31, 2016.

The increase in net income for the three months ended December 31, 2017 was primarily due to an increase in net interest income, which was partially offset by a decrease in non-interest income and an increase in non-interest expense. A more detailed explanation of the income statement categories is presented below.

Net Interest Income: Net interest income increased by $1.12 million, or 13.5%, to $9.43 million for the quarter ended December 31, 2017 from $8.31 million for the quarter ended December 31, 2016. The increase in net interest income was due to an increase in interest income and a decrease in interest expense.

Total interest and dividend income increased by $872,000, or 9.5%, to $10.04 million for the quarter ended December 31, 2017 from $9.16 million for the quarter ended December 31, 2016, primarily due to increases in both the average balance and average yield earned on interest-earning assets. Average total interest-earning assets increased by $51.84 million, or 6.1%, to $901.57 million for the quarter ended December 31, 2017 from $849.73 million for the quarter ended December 31, 2016. Average loans receivable increased by $24.17 million, or 3.5%, while the average yield on loans receivable increased 13 basis points between the periods. In addition, contributing significantly to the increase in total interest and dividend income was a 65 basis point increase in the average yield earned on interest-earning deposits. The average yield on interest-earning assets increased to 4.45% for the quarter ended December 31, 2017 from 4.31% for the quarter ended December 31, 2016, primarily due to increases in short term interest rates as the Federal Reserve increased the Fed Funds rate by 75 basis points during 2017. During the quarter ended December 31, 2017, the Company collected $45,000 in non-accrual interest compared to $21,000 in non-accrual interest collected during the quarter ended December 31, 2016.

Total interest expense decreased by $249,000, or 29.3%, to $601,000 for the quarter ended December 31, 2017 from $850,000 for the quarter ended December 31, 2016. The decrease in interest expense was primarily due to a $307,000 decrease in interest expense on FHLB borrowings, as the Company repaid all FHLB borrowings during the quarter ended June 30, 2017. The decrease in interest expense on FHLB borrowings was partially offset by a $58,000 increase in interest expense on deposits as both the average balance and average cost of interest-bearing deposits increased during the quarter ended December 31, 2017 compared to the quarter ended December 31, 2016.

As a result of these changes, the net interest margin ("NIM") increased to 4.19% for the quarter ended December 31, 2017 from 3.91% for the quarter ended December 31, 2016. The NIM for the current quarter was increased by approximately two basis points due to the collection of non-accrual interest as compared to a one basis point increase for the comparable quarter one year ago.

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

	Three Months Ended December 31,					
	2017			2016		
	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
Interest-earning assets:						
Loans receivable (1)(2)	$709,079	$ 9,328	5.26 %	$684,911	$ 8,788	5.13 %
Investment securities (2)	7,395	58	3.14	7,822	70	3.58
Dividends from mutual funds, FHLB stock and other investments	5,056	26	2.04	3,167	24	3.01
Interest-earning deposits	180,038	623	1.37	153,831	281	0.72
Total interest-earning assets	901,568	10,035	4.45	849,731	9,163	4.31
Non-interest-earning assets	60,128			57,105		
Total assets	$961,696			$906,836		
Interest-bearing liabilities:						
Savings	$141,266	21	0.06	$127,656	18	0.06
Money market	136,466	132	0.38	120,311	97	0.32
N.O.W. checking	212,550	113	0.21	202,385	118	0.23
Certificates of deposit	138,687	335	0.96	147,433	310	0.83
Long-term borrowings (3)	—	—	—	30,000	307	4.07
Total interest-bearing liabilities	628,969	601	0.38	627,785	850	0.54
Non-interest-bearing deposits	216,907			176,768		
Other liabilities	3,732			4,495		
Total liabilities	849,608			809,048		
Shareholders' equity	112,088			97,788		
Total liabilities and shareholders' equity	$961,696			$906,836		
Net interest income		$ 9,434			$ 8,313	
Interest rate spread			4.07 %			3.77 %
Net interest margin (4)			4.19 %			3.91 %
Ratio of average interest-earning assets to average interest-bearing liabilities			143.34 %			135.35 %

---

(1) Does not include interest on loans on non-accrual status. Includes loans held for sale. Amortized net deferred loan fees, late fees, extension fees and prepayment penalties are included with interest and dividends.
(2) Average balances include loans and investment securities on non-accrual status.
(3) Includes FHLB borrowings with original maturities of one year or greater.
(4) Net interest income divided by total average interest-earning assets, annualized.

41

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

	Three months ended December 31, 2017 compared to three months ended December 31, 2016 increase (decrease) due to		
	Rate	Volume	Net Change
Interest-earning assets:			
Loans receivable and loans held for sale	$225	$ 315	$540
Investment securities	(8)	(4)	(12)
Dividends from mutual funds, FHLB stock and other investments	(9)	11	2
Interest-earning deposits	287	55	342
Total net increase in income on interest-earning assets	495	377	872
Interest-bearing liabilities:			
Savings	1	2	3
Money market	21	14	35
N.O.W. checking	(11)	6	(5)
Certificates of deposit	44	(19)	25
Long term FHLB borrowings	(153)	(154)	(307)
Total net decrease in expense on interest-bearing liabilities	(98)	(151)	(249)
Net increase in net interest income	$593	$ 528	$1,121

Provision for Loan Losses: There was no provision for loan losses for the quarters ended December 31, 2017 and 2016, as improved overall credit quality measures have been sufficient to cover any additional reserves needed for growth and changes in the mix of the loan portfolio. For the quarter ended December 31, 2017 there were net recoveries of $12,000 compared to net charge-offs of $57,000 for the quarter ended September 30, 2017 and net recoveries of $17,000 for the quarter ended December 31, 2016. Non-accrual loans increased by $202,000, or 10.6%, to $2.11 million at December 31, 2017, from $1.91 million at September 30, 2017 and decreased by $251,000, or 10.6%, from $2.36 million at December 31, 2016. Total delinquent loans (past due 30 days or more) and non-accrual loans increased by $707,000, or 29.3%, to $3.12 million at December 31, 2017, from $2.41 million at September 30, 2017 and decreased by $940,000, or 23.2%, from $4.06 million one year ago.

The Company has established a comprehensive methodology for determining the allowance for loan losses. On a quarterly basis the Company performs an analysis that considers pertinent factors underlying the quality of the loan portfolio. These factors include changes in the amount and composition of the loan portfolio, historic loss experience for various loan segments, changes in economic conditions, delinquency rates, a detailed analysis of impaired loans, and other factors to determine an appropriate level of allowance for loan losses. Impaired loans are subjected to an impairment analysis to determine an appropriate reserve amount to be allocated to each loan. The aggregate principal impairment reserve amount determined at December 31, 2017 was $435,000 compared to $476,000 at September 30,

2017 and $756,000 at December 31, 2016.

Based on its comprehensive analysis, management believes the allowance for loan losses of $9.57 million at December 31, 2017 (1.34% of loans receivable and 452.7% of non-performing loans) was adequate to provide for probable losses inherent in the loan portfolio based on an evaluation of known and inherent risks in the loan portfolio at that date. The allowance for loan losses was $9.55 million (1.36% of loans receivable and 499.9% of non-performing loans) at September 30, 2017 and $9.84 mil1ion (1.45% of loans receivable and 393.9% of non-performing loans) at December 31, 2016. While the Company believes it has established its existing allowance for loan losses in accordance with GAAP, there can be no assurance that bank regulators, in reviewing the Company's loan portfolio, will not request the Company to increase significantly its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that a substantial increase will not be necessary should the quality of any loans deteriorate. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations. For additional information, see Note 4 of the Notes to Unaudited Consolidated Financial Statements contained in “Item 1, Financial Statements.”

Non-interest Income: Total non-interest income decreased slightly by $79,000, or 2.5%, to $3.14 million for the quarter ended December 31, 2017 from $3.22 million for the quarter ended December 31, 2016. The decrease in non-interest income was primarily due to a $168,000 decrease in gain on sale of loans, net, and smaller decreases in several other categories. These decreases were partially offset by a $74,000 increase in services charges on deposits and smaller increases in several other categories. The decrease in gain on sale of loans was primarily due to a decrease in the dollar volume of fixed-rate one- to four-family loans sold during the current quarter. The increase in service charges on deposits was primarily due to an increase in the amount of service charges collected on checking accounts owned by businesses associated with the marijuana (or Initiative-502) industry in Washington State. It is permissible in Washington State to handle accounts associated with this industry in compliance with federal regulatory guidelines.

Non-interest Expense: Total non-interest expense increased by $366,000, or 5.4%, to $7.18 million for the quarter ended December 31, 2017 from $6.81 million for the quarter ended December 31, 2016. The increased expense was primarily due to a $270,000 increase in salaries and employee benefits expense, an $83,000 increase in OREO and other repossessed assets expense and smaller increases in several other categories. The increase in salary and employee benefits expense was primarily due to annual salary adjustments and the hiring of additional lending personnel. The increase in OREO and other repossessed assets expense was primarily due to market value write-downs on two real estate properties and one personal property during the quarter.

The efficiency ratio for the current quarter improved to 57.08% from 59.07% for the comparable quarter one year ago as the increases in revenue outpaced the increase in non-interest expense.

Provision for Income Taxes: The provision for income taxes increased by $209,000, or 13.3%, to $1.78 million for the quarter ended December 31, 2017 from $1.57 million for the quarter ended December 31, 2016, primarily as a result of increased income before income taxes and the Tax Act. As a result of the Tax Act (which decreases the federal corporate income tax rate to 21.0% from 35.0%), Timberland recorded a one-time income tax expense of $548,000 in conjunction with writing down its net deferred tax assets ("DTA"). Since Timberland is a September 30th fiscal year-end corporation, it will use a blended tax rate of 24.5% to calculate current income tax expense for the fiscal year ending September 30, 2018 and then use a 21.0% rate thereafter. The impact of using the 24.5% blended tax rate for the current quarter versus a 35.0% tax rate reduced the provision for income tax expense by approximately $551,000 and offset the one-time DTA write-down. The Company's effective tax rate was 33.01% for the quarter ended December 31, 2017 and 33.31% for the quarter ended December 31, 2016. For additional information, see Note 10 of the Notes to Unaudited Consolidated Financial Statements contained in “Item 1, Financial Statements.”

Liquidity

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

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

The Bank generally maintains sufficient cash and short-term investments to meet short-term liquidity needs. At December 31, 2017, the Bank's regulatory liquidity ratio (net cash, and short-term and marketable assets, as a percentage of net deposits and short-term liabilities) was 25.47%.

The Company's total cash and cash equivalents and CDs held for investment increased by $28.51 million, or 14.9%, to $219.74 million at December 31, 2017 from $191.22 million at September 30, 2017. If the Bank requires funds that exceed its ability to generate them internally, it has additional borrowing capacity with the FHLB, the Federal Reserve Bank of San Francisco ("FRB") and Pacific Coast Bankers' Bank ("PCBB"). At December 31, 2017, the Bank maintained an uncommitted credit facility with the FHLB that provided for immediately available advances up to an aggregate amount equal to 35% of total assets, limited by available collateral. The Bank also has a Letter of Credit ("LOC") of up to $32.0 million with the FHLB for the purpose of collateralizing Washington State public deposits. Any amount pledged for public deposit under the LOC reduces the Bank's available borrowing amount under the FHLB advance agreement. At December 31, 2017, the Bank had $32.00 million pledged under the LOC, which left $268.20 million available for additional FHLB borrowings. The Bank maintains a short-term borrowing line with the FRB with available total credit based on eligible collateral. At December 31, 2017, the Bank had $71.19 million available for borrowings with the FRB and there was no outstanding balance on this borrowing line. The Bank also maintains a $10.00 million overnight borrowing line with PCBB. At December 31, 2017, the Bank did not have an outstanding balance on this borrowing line.

The Bank's primary investing activity is the origination of one- to four-family mortgage loans, commercial mortgage loans, construction loans, consumer loans, and commercial business loans. At December 31, 2017, the Bank had loan commitments totaling $65.14 million and undisbursed construction loans in process totaling $79.45 million. The Bank anticipates that it will have sufficient funds available to meet current loan commitments. CDs that are scheduled to mature in less than one year from December 31, 2017 totaled $74.18 million. Historically, the Bank has been able to retain a significant amount of its non-brokered CDs as they mature. At December 31, 2017, the Bank had $3.20 million in brokered CDs.

Capital Resources

The Bank, as a state-chartered, federally insured savings bank, is subject to the capital requirements established by the FDIC. Under the FDIC's capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting and other factors.

Based on its capital levels at December 31, 2017, the Bank exceeded all regulatory capital requirements as of that date. Consistent with the Bank's goals to operate a sound and profitable organization, it is the Bank's policy to maintain a "well-capitalized" status under the regulatory capital categories of the FDIC. Based on capital levels at December 31, 2017, the Bank was considered to be "well-capitalized" under applicable regulatory requirements. Management monitors the capital levels to provide for current and future business opportunities and to maintain the Bank's "well-capitalized" status.

The following table compares the Bank's actual capital amounts at December 31, 2017 to its minimum regulatory capital requirements at that date (dollars in thousands):

	Actual	Regulatory Minimum To Be "Adequately Capitalized"	To Be "Well Capitalized" Under Prompt Corrective Action

					Provisions		
	Amount	Ratio	Amount	Ratio	Amount	Ratio	
Leverage Capital Ratio:							
Tier 1 capital	$106,583	11.16%	$38,209	4.00%	$47,761	5.00	%
Risk-based Capital Ratios:							
Common equity tier 1 capital	106,583	16.04	29,900	4.50	43,188	6.50	
Tier 1 capital	106,583	16.04	39,866	6.00	53,155	8.00	
Total capital	114,903	17.29	53,155	8.00	66,444	10.00	

In addition to the minimum common equity Tier 1 ("CET1"), Tier 1 and total capital ratios, the Bank now has to maintain a capital conservation buffer consisting of additional CET1 capital above the required minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses based on percentages of retained income that could be utilized for such actions. The new capital conservation buffer requirement began to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and increases each year until fully implemented to an amount equal to 2.5% of risk weighted assets in January 2019. At December 31, 2017, the conservation buffer was 1.25%.

Timberland Bancorp, Inc. is a bank holding company registered with the Federal Reserve. Bank holding companies are subject to capital adequacy requirements of the Federal Reserve under the Bank Holding Company Act of 1956, as amended, and the regulations of the Federal Reserve. For a bank holding company with less than $1.0 billion in assets, the capital guidelines apply on a bank only basis and the Federal Reserve expects the holding company's subsidiary bank to be well capitalized under the prompt corrective action regulations. If Timberland Bancorp, Inc. were subject to regulatory guidelines for bank holding companies with $1.0 billion or more in assets, at December 31, 2017, Timberland Bancorp, Inc. would have exceeded all regulatory requirements.

The following table presents the regulatory capital ratios for Timberland Bancorp, Inc. as of December 31, 2017 (dollars in thousands):

	Actual	
	Amount	Ratio
Leverage Capital Ratio:		
Tier 1 capital	$109,592	11.45%
Risk-based Capital Ratios:		
Common equity tier 1 capital	109,592	16.49
Tier 1 capital	109,592	16.49
Total capital	117,917	17.74

Key Financial Ratios and Data
(Dollars in thousands, except per share data)

	Three Months Ended December 31,	
	2017	2016
PERFORMANCE RATIOS:		
Return on average assets	1.50 %	1.39 %
Return on average equity	12.90%	12.87%
Net interest margin	4.19 %	3.91 %
Efficiency ratio	57.08%	59.07%

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes in information concerning market risk from the information provided in the Company’s Form 10-K for the fiscal year ended September 30, 2017.

Item 4. Controls and Procedures

(a)

Evaluation of Disclosure Controls and Procedures: An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management as of the end of the period covered by this report. The Company's Chief Executive Officer and Chief Financial Officer concluded that as of December 31, 2017 the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is (i) accumulated and

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

(b) Changes in Internal Controls: There have been no changes in our internal control over financial reporting (as defined in 13a-15(f) of the Exchange Act) that occurred during the quarter ended December 31, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. The Company continued, however, to implement suggestions from its internal auditor and independent auditors to strengthen existing controls. The Company does not expect that its disclosure controls and procedures and internal control over financial reporting will prevent all errors and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns in controls or procedures can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; as over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There have been no material changes in the Risk Factors previously disclosed in Item 1A of the Company's 2017 Form 10-K.

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

(a) Not applicable

(b) Not applicable

(c) Stock Repurchases

There were no shares repurchased by the Company during the quarter ended December 31, 2017. On July 28, 2015 the Company announced a plan to repurchase 352,681 shares of the Company's common stock. As of December 31, 2017, a total of 130,788 shares had been repurchased at an average price of $11.69 per share and there were 221,893 shares still authorized to be repurchased under the plan. All shares were repurchased through open market broker transactions and no shares were directly repurchased from directors or officers of the Company.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None to be reported.

Item 6. Exhibits

(a) Exhibits

3.1	Articles of Incorporation of the Registrant (1)
3.3	Amended and Restated Bylaws of the Registrant (2)
10.1	Employee Severance Compensation Plan, as revised (3)
10.2	Employee Stock Ownership Plan (4)
10.4	2003 Stock Option Plan (5)
10.5	Form of Incentive Stock Option Agreement (6)
10.6	Form of Non-qualified Stock Option Agreement (6)
10.8	Employment Agreement with Michael R. Sand (7)
10.9	Employment Agreement with Dean J. Brydon (7)
10.10	Timberland Bancorp, Inc. 2014 Equity Incentive Plan (8)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes OxleyAct
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes Oxley Act
101	The following materials from Timberland Bancorp Inc's Quarterly Report 10-Q for the quarter ended December 31, 2017, formatted on Extensible Business Reporting Language (XBRL) (a) Consolidated Balance Sheets; (b) Consolidated Statements of Income; (c) Consolidated Statements of Comprehensive Income; (d) Consolidated Statements of Shareholders' Equity; (e) Consolidated Statements of Cash Flows; and (f) Notes to Unaudited Consolidated Financial Statements

---

(1) Incorporated by reference to the Registrant’s Registration Statement on Form S-1 (333-35817).
(2) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on June 1, 2017.
(3) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on April 16, 2007.
(4) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 1997.
(5) Incorporated by reference to the Registrant’s 2004 Annual Meeting Proxy Statement dated December 24, 2003.
(6) Incorporated by reference to the Exhibit 99.2 included in the Registrant's Registration Statement on Form S-8 (333-1161163).
(7) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on March 29, 2013.
(8) Attached as Appendix A to the Registrant's Annual Meeting Proxy Statement filed on December 19, 2014.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	Timberland Bancorp, Inc.
Date: February 8, 2018	By: /s/ Michael R. Sand Michael R. Sand Chief Executive Officer (Principal Executive Officer)
Date: February 8, 2018	By: /s/ Dean J. Brydon Dean J. Brydon Chief Financial Officer (Principal Financial Officer)

EXHIBIT INDEX

Exhibit No.	Description of Exhibit
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
32	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act
101	The following materials from Timberland Bancorp Inc.’s Quarterly Report on Form 10-Q for the quarter ended December 31, 2017, formatted on Extensible Business Reporting Language (XBRL) (a) Consolidated Balance Sheets; (b) Consolidated Statements of Income; (c) Consolidated Statements of Comprehensive Income; (d) Consolidated Statements of Shareholders’ Equity; (e) Consolidated Statements of Cash Flows; and (f) Notes to Unaudited Consolidated Financial Statements