

Capitol Federal Financial Inc  
Form 10-Q  
May 07, 2012

---

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

---

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 001-34814

---

Capitol Federal Financial, Inc.

(Exact name of registrant as specified in its charter)

Maryland

27-2631712

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

(State or other jurisdiction of incorporation  
or organization)

(I.R.S. Employer  
Identification No.)

700 Kansas Avenue, Topeka, Kansas

66603

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code:

(785) 235-1341

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

(do not check if a smaller  
reporting company)

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

As of April 30, 2012, there were 164,000,593 shares of Capitol Federal Financial, Inc. common stock outstanding.

1

---

PART I -- FINANCIAL INFORMATION	Page
	Number
Item 1. Financial Statements (Unaudited):	
Consolidated Balance Sheets at March 31, 2012 and September 30, 2011	3
Consolidated Statements of Operations for the three and six months ended March 31, 2012 and 2011	4
Consolidated Statement of Stockholders' Equity for the six months ended March 31, 2012	6
Consolidated Statements of Cash Flows for the six months ended March 31, 2012 and 2011	7
Notes to Consolidated Financial Statements	9
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	31
Financial Condition – Loans	36
Financial Condition – Asset Quality	44
Financial Condition – Liabilities	52
Financial Condition – Stockholders' Equity	56
Results of Operations for the six months ended March 31, 2012 and 2011	57
Results of Operations for the three months ended March 31, 2012 and 2011	63
Results of Operations for the three months ended March 31, 2012 and December 31, 2011	67
Item 3. Quantitative and Qualitative Disclosure about Market Risk	77
Item 4. Controls and Procedures	81
 PART II -- OTHER INFORMATION	
Item 1. Legal Proceedings	81
Item 1A. Risk Factors	81
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	82
Item 3. Defaults Upon Senior Securities	82

Item 4. Mine Safety Disclosures	82
Item 5. Other Information	82
Item 6. Exhibits	82
Signature Page	83
INDEX TO EXHIBITS	84

2

---

PART I -- FINANCIAL INFORMATION

## Item 1. Financial Statements

## CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEETS (Unaudited)

(Dollars in thousands)

	March 31, 2012	September 30, 2011
<b>ASSETS:</b>		
Cash and cash equivalents (includes interest-earning deposits of \$127,154 and \$105,292)	\$ 143,707	\$ 121,070
<b>Securities:</b>		
Available-for-sale ("AFS") at estimated fair value (amortized cost of \$1,675,479 and \$1,443,529)	1,715,445	1,486,439
Held-to-maturity ("HTM") at amortized cost (estimated fair value of \$2,227,621 and \$2,434,392)	2,165,036	2,370,117
Loans receivable, net (of allowance for credit losses ("ACL") of \$12,559 and \$15,465)	5,224,178	5,149,734
Bank-owned life insurance ("BOLI")	57,333	56,534
Capital stock of Federal Home Loan Bank ("FHLB"), at cost	130,614	126,877
Accrued interest receivable	27,424	29,316
Premises and equipment, net	51,746	48,423
Real estate owned ("REO"), net	11,799	11,321
Other assets	45,862	50,968

TOTAL ASSETS	\$ 9,573,144	\$ 9,450,799
LIABILITIES:		
Deposits	\$ 4,657,010	\$ 4,495,173
Advances from FHLB, net	2,525,535	2,379,462
Other borrowings	365,000	515,000
Advance payments by borrowers for taxes and insurance	49,643	55,138
Income taxes payable	1,881	2,289
Deferred income tax liabilities, net	22,259	20,447
Accounts payable and accrued expenses	39,344	43,761
Total liabilities	7,660,672	7,511,270
STOCKHOLDERS' EQUITY:		
Preferred stock (\$0.01 par value) 100,000,000 shares authorized; none issued	--	--
Common stock (\$0.01 par value) 1,400,000,000 shares authorized; 165,299,033 and 167,498,133 shares issued and outstanding as of March 31, 2012 and September 30, 2011, respectively	1,653	1,675
Additional paid-in capital	1,376,093	1,392,691
Unearned compensation, Employee Stock Ownership Plan ("ESOP")	(49,061)	(50,547)
Unearned compensation, Recognition and Retention Plan ("RRP")	(81)	(124)
Retained earnings	559,014	569,127
Accumulated other comprehensive income ("AOCI"), net of tax	24,854	26,707
Total stockholders' equity	1,912,472	1,939,529
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 9,573,144	\$ 9,450,799

See accompanying notes to consolidated financial statements.

3

## CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY

### CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(Dollars in thousands, except per share data)

	For the Three Months Ended March 31,		For the Six Months Ended March 31,	
	2012	2011	2012	2011
INTEREST AND DIVIDEND INCOME:				
Loans receivable	\$ 59,785	\$ 61,554	\$ 120,460	\$ 127,497
Mortgage-backed securities ("MBS")	18,169	17,320	36,542	32,760
Investment securities	4,115	4,743	8,752	9,518
Capital stock of FHLB	1,111	883	2,202	1,785

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Cash and cash equivalents	94	441	145	628
Total interest and dividend income	83,274	84,941	168,101	172,188
INTEREST EXPENSE:				
FHLB advances	20,443	21,968	42,782	45,099
Deposits	11,835	16,069	24,622	33,450
Other borrowings	3,530	6,348	7,857	13,078
Total interest expense	35,808	44,385	75,261	91,627
NET INTEREST INCOME	47,466	40,556	92,840	80,561
PROVISION FOR CREDIT LOSSES	1,500	520	2,040	1,170
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	45,966	40,036	90,800	79,391
OTHER INCOME:				
Retail fees and charges	3,854	3,561	8,018	7,504
Insurance commissions	774	888	1,343	1,706
Loan fees	560	621	1,135	1,276
Income from BOLI	387	504	799	836
Other income, net	597	570	1,029	1,139
Total other income	6,172	6,144	12,324	12,461
OTHER EXPENSES:				
Salaries and employee benefits	10,586	11,067	21,173	21,058
Communications, information technology, and occupancy	3,925	3,977	7,834	7,853
Regulatory and outside services	1,113	1,139	2,548	2,328
Deposit and loan transaction costs	1,245	1,274	2,505	2,626
Federal insurance premium	1,084	1,128	2,176	2,986
Advertising and promotional	841	693	1,751	1,524
Contribution to Capitol Federal Foundation ("Foundation")	--	--	--	40,000
Other expenses, net	3,175	3,577	6,049	7,818
Total other expenses	21,969	22,855	44,036	86,193
INCOME BEFORE INCOME TAX EXPENSE	30,169	23,325	59,088	5,659
INCOME TAX EXPENSE	10,854	7,689	20,984	1,281
NET INCOME	\$ 19,315	\$ 15,636	\$ 38,104	\$ 4,378

(Continued)

4

---

Basic earnings per common share	\$ 0.12	\$ 0.10	\$ 0.24	\$ 0.03
Diluted earnings per common share	\$ 0.12	\$ 0.10	\$ 0.24	\$ 0.03
Dividends declared per public share	\$ 0.08	\$ 0.68	\$ 0.25	\$ 1.48

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Basic weighted average common shares	161,721,616	161,499,795	161,822,674	163,542,495
Diluted weighted average common shares	161,727,618	161,507,374	161,829,691	163,550,750

(Concluded)

See accompanying notes to consolidated financial statements.

5

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(Unaudited)

(Dollars in thousands, except per share data)

	Common Stock	Additional Paid-In Capital	Unearned Compensation - ESOP	Retained Earnings	AOCI (Loss)	Total Stockholders' Equity	
Balance at October 1, 2011	\$ 1,675	\$ 1,392,691	\$ (50,547)	\$ (124)	\$ 569,127	\$ 26,707	\$ 1,939,529
Comprehensive income:							
Net income				38,104			38,104
Changes in unrealized gain/losses on securities AFS, net of deferred income taxes of \$1,091					(1,853)	(1,853)	

Total comprehensive income							36,251
ESOP activity, net		1,665		1,486			3,151
RRP activity, net		(6)					(6)
Stock based compensation - stock options and RRP		40		43			83
Repurchase of common stock	(22)	(18,297)			(7,734)		(26,053)
Dividends on common stock to stockholders (\$0.25 per share)					(40,483)		(40,483)
Balance at March 31, 2012	\$ 1,653	\$ 1,376,093	\$ (49,061)	\$ (81)	\$ 559,014	\$ 24,854	\$ 1,912,472

See accompanying notes to consolidated financial statements.

6

---

CAPITOL FEDERAL FINANCIAL, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	For the Six Months Ended March 31,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 38,104	\$ 4,378
Adjustments to reconcile net income to net cash provided by operating activities:		
FHLB stock dividends	(2,202)	(1,785)
Provision for credit losses	2,040	1,170
Originations of loans receivable held-for-sale ("LHFS")	(2,491)	(8,106)



Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Proceeds from sales of LHFS	3,207	9,597
Amortization and accretion of premiums and discounts on securities	4,279	3,375
Depreciation and amortization of premises and equipment	2,400	2,218
Amortization of deferred amounts related to FHLB advances, net	4,010	3,492
Common stock committed to be released for allocation - ESOP	3,151	2,902
Stock based compensation - stock options and RRP	83	134
Changes in:		
Prepaid federal insurance premium	1,921	2,743
Accrued interest receivable	1,892	(558)
Other assets, net	1,934	2,478
Income taxes payable/receivable	2,489	(7,458)
Accounts payable and accrued expenses	(10,094)	(8,245)
Net cash provided by operating activities	50,723	6,335
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of AFS securities	(563,330)	(405,815)
Purchase of HTM securities	(516,374)	(1,658,451)
Proceeds from calls, maturities and principal reductions of AFS securities	329,721	206,371
Proceeds from calls, maturities and principal reductions of HTM securities	718,835	582,910
Proceeds from the redemption of capital stock of FHLB	2,117	--
Purchases of capital stock of FHLB	(3,652)	--
Net (increase) decrease in loans receivable	(81,808)	62,530
Purchases of premises and equipment	(4,348)	(4,011)
Proceeds from sales of REO	4,583	5,774
Net cash used in investing activities	(114,256)	(1,210,692)

(Continued)

7

	For the Six Months Ended March 31,	
	2012	2011
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Dividends paid	(40,483)	(125,899)
Deposits, net of withdrawals	161,837	342,569
Deferred FHLB prepayment penalty	(7,937)	--
Proceeds from borrowings	600,100	300,000
Repayments of borrowings	(600,100)	(325,000)
Change in advance payments by borrowers for taxes and insurance	(5,495)	(6,941)
Repurchase of common stock	(21,752)	--

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Net proceeds from common stock offering	--	1,076,412
Excess tax benefits from stock options	--	1
Net cash provided by financing activities	86,170	1,261,142
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>22,637</b>	<b>56,785</b>
<b>CASH AND CASH EQUIVALENTS:</b>		
Beginning of period	121,070	65,217
End of period	\$ 143,707	\$ 122,002
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Income tax payments	\$ 18,560	\$ 8,738
Interest payments	\$ 72,177	\$ 88,477
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH</b>		
<b>INVESTING AND FINANCING ACTIVITIES:</b>		
<b>INVESTING AND FINANCING ACTIVITIES:</b>		
Note received from ESOP in exchange for common stock	\$ --	\$ 47,260
Customer deposit holds related to common stock offering	\$ --	\$ 17,690
Loans transferred to REO	\$ 5,865	\$ 8,355

(Concluded)

See accompanying notes to consolidated financial statements.

8

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation - The accompanying consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. These statements should be read in conjunction with the consolidated financial statements and

notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2011, filed with the Securities and Exchange Commission ("SEC"). Interim results are not necessarily indicative of results for a full year.

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

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

Loans Receivable - Loans receivable that management has the intent and ability to hold for the foreseeable future are carried at the amount of unpaid principal, net of ACL, undisbursed loan funds, unamortized premiums and discounts, and deferred loan origination fees and costs. Net loan origination fees and costs and premiums and discounts are amortized as yield adjustments to interest income using the level-yield method, adjusted for the estimated prepayment speeds of the related loans when applicable. Interest on loans is credited to income as earned and accrued only if deemed collectible.

Existing loan customers, whose loans have not been sold to third parties and who have not been delinquent on their contractual loan payments during the previous 12 months have the opportunity, for a fee, to endorse their original loan terms to current loan terms being offered. The fee assessed for endorsing the mortgage loan is deferred and amortized over the remaining life of the endorsed loan using the level-yield method and is reflected as an adjustment to interest income. Each endorsement is examined on a loan-by-loan basis and if the new loan terms represent more than a minor change to the loan, then the unamortized balance of the pre-endorsement deferred fees and/or costs associated with the mortgage loan are recognized in interest income at the time of the endorsement. If the endorsement of terms does not represent more than a minor change to the loan, then the unamortized balance of the pre-endorsement deferred fees or costs continue to be deferred.

For borrowers experiencing financial difficulties, the Bank may grant a concession to the borrower. Generally, the Bank grants a short-term payment accommodation to borrowers who are experiencing a temporary cash flow problem. The most frequently used accommodation is to reduce the monthly payment amount for a period of six to 12 months, often by requiring payments of only interest and escrow during this period. These restructurings result in an

extension of the maturity date of the loan. For more severe situations requiring long-term solutions, the Bank also offers interest rate reductions to currently-offered rates and more lengthy extensions of the maturity date. All such concessions are considered a troubled debt restructuring (“TDR”). The Bank does not forgive principal or interest nor does it commit to lend additional funds to debtors whose terms have been modified in TDRs. Restructured loans are reported as nonaccrual if the loan was nonaccrual at the time of restructuring or if the borrower(s) did not receive a credit evaluation prior to the restructuring, and have not made six consecutive monthly payments per the restructured loan terms.

A loan is considered delinquent when payment has not been received within 30 days of its contractual due date. The accrual of income on loans is discontinued when interest or principal payments are 90 days in arrears or, until a nonaccrual TDR has made six consecutive monthly payments per the restructured loan terms. Loans on which the accrual of income has been discontinued are designated as nonaccrual and outstanding interest previously credited beyond 90 days delinquent is reversed. A nonaccrual loan is returned to accrual status once the contractual payments have been made to bring the loan less than 90 days past due or in the case of a TDR, the borrower has made six consecutive payments under the restructured terms.

9

---

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. Interest income on impaired loans is recognized in the period collected unless the ultimate collection of principal is considered doubtful. Management considers the following loans to be impaired loans: all nonaccrual loans, loans classified as substandard, loans with charge-offs and TDRs that have not yet been performing under the new terms for 12 consecutive months or are required by the accounting literature to be classified as a TDR for the life of the loan due to a reduction in the stated interest rate to a rate lower than the current market rate for new debt with similar risk.

Allowance for Credit Losses - The ACL represents management’s best estimate of the amount of inherent losses in the loan portfolio as of the balance sheet date. Management’s methodology for assessing the appropriateness of the ACL consists of a formula analysis model, along with analyzing several other factors. Management maintains the ACL through provisions for credit losses that are charged to income.

For one- to four-family secured loans, losses are charged-off when the loan is generally 180 days delinquent. Losses are based on new collateral values obtained through broker price opinions (“BPOs”) or appraisals, less estimated costs to sell. Anticipated private mortgage insurance (“PMI”) proceeds are taken into consideration when calculating the loss amount. An updated fair value is requested, at a minimum, every 12 months thereafter. If the Bank holds the first and second mortgage, both loans are combined when evaluating whether there is a potential loss on the loan. However, charge-offs for real estate-secured loans may also occur at any time if the Bank has knowledge of the existence of a potential loss. For all other real estate loans that are not secured by one- to four-family property, losses are charged-off when the collection of such amounts is unlikely. When a non-real estate secured loan is 120 days delinquent, any identified losses are charged-off.

The Bank's primary lending emphasis is the origination and purchase of one- to four-family first mortgage loans on residential properties and, to a lesser extent, second mortgage loans on one- to four-family residential properties, resulting in a loan concentration in residential mortgage loans. The Bank has a concentration of loans secured by residential property located in Kansas and Missouri. Based on the composition of the Bank's loan portfolio, the primary risks inherent in the one- to four-family and consumer loan portfolios are the continued weakened economic conditions, continued high levels of unemployment or underemployment, and a continuing decline in residential real estate values. Any one or a combination of these events may adversely affect borrowers' ability to repay their loans, resulting in increased delinquencies, non-performing assets, loan losses, and future loan loss provisions. Although the multi-family and commercial loan portfolio is subject to the same risk of continued weakened economic conditions, the primary risks for this portfolio include the ability of the borrower to sustain sufficient cash flows from leases and to control expenses to satisfy their contractual debt payments, and/or the ability to utilize personal and/or business resources to pay their contractual debt payments if the cash flows are not sufficient. Additionally, if the Bank were to repossess the secured collateral of a multi-family or commercial loan, the pool of potential buyers is limited more than that for a residential property. Therefore, the Bank could hold the property for an extended period of time and/or potentially be forced to sell at a discounted price, resulting in additional losses.

Each quarter, an analysis ("formula analysis") is prepared which segregates the loan portfolio into categories based on certain risk characteristics. The categories include the following: one- to four-family loans; multi-family and commercial loans; consumer home equity loans; and other consumer loans. Home equity loans with the same underlying collateral as a one- to four-family loan are combined with the one- to four-family loan in the formula analysis model to calculate a combined loan-to-value ("LTV") ratio. Loans individually evaluated for loss are excluded from the formula analysis model. The one- to four-family loan portfolio and related home equity loans are segregated into additional categories based on the following risk characteristics: originated or bulk purchased; interest payments (fixed-rate, adjustable-rate, and interest-only); LTV ratios; borrower's credit scores; and geographic location. The categories were derived by management based on reviewing the historical performance of the one- to four-family loan portfolio and taking into consideration current economic conditions, such as trends in residential real estate values in certain areas of the U.S. and unemployment rates. The geographic location category pertains primarily to certain states in which the Bank has experienced measurable loan losses.

Quantitative loss factors are applied to each loan category in the formula analysis model based on the historical loss experience for each respective loan category. Each quarter, management reviews the historical loss time periods and utilizes the historical loss time periods believed to be the most reflective of the current economic conditions and recent charge-off experience for each respective loan category.

Qualitative loss factors are applied to each loan category in the formula analysis model. The qualitative factors for the one- to four-family and consumer loan portfolios are: unemployment rate trends; collateral value trends; credit score trends; and delinquent loan trends. The qualitative factors for the multi-family and commercial loan portfolio are: unemployment rate trends; collateral value trends; and delinquent loan trends. As loans are classified as special mention or become delinquent, the qualitative loss factors increase. The qualitative factors were derived by management based on a review of the historical performance of the respective loan portfolios and consideration of current economic conditions and their likely impact to the loan portfolio.

Management utilizes the formula analysis, along with analyzing several other factors, when evaluating the adequacy of the ACL. Such factors include the trend and composition of delinquent loans, results of foreclosed property and short sale transactions, the current status and trends of local and national economies, particularly levels of unemployment, trends and current conditions in the real estate and housing markets, and loan portfolio growth and concentrations. Since the Bank's loan portfolio is primarily concentrated in one- to four-family real estate, management monitors residential real estate market value trends in the Bank's local market areas and geographic sections of the U.S. by reference to various industry and market reports, economic releases and surveys, and management's general and specific knowledge of the real estate markets in which the Bank lends, in order to determine what impact, if any, such trends may have on the level of ACL. Reviewing these factors assists management in evaluating the overall credit quality of the loan portfolio and the reasonableness of the ACL on an ongoing basis, and whether changes need to be made to the Bank's ACL methodology. Management seeks to apply the ACL methodology in a consistent manner; however, the methodology can be modified in response to changing conditions.

Assessing the adequacy of the ACL is inherently subjective. Actual results could differ from estimates as a result of changes in economic or market conditions. Changes in estimates could result in a material change in the ACL. In the opinion of management, the ACL, when taken as a whole, is adequate to absorb estimated losses inherent in the loan portfolio. However, future adjustments may be necessary if loan portfolio performance or economic or market conditions differ substantially from the conditions that existed at the time of the initial determinations.

Repurchase of Common Stock - Prior to the second-step stock offering in December 2010 (the "corporate reorganization"), common stock that was repurchased was classified as treasury stock and recorded at cost. Effective with the corporate reorganization, the Company became a Maryland corporation which does not recognize treasury shares but considers common stock repurchases as the retirement of stock.

Recent Accounting Pronouncements - In December 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05, which defers certain provisions of ASU 2011-05, Presentation of Comprehensive Income. One of ASU 2011-05's provisions requires entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented (for both interim and annual financial statements). Accordingly, this requirement is indefinitely deferred by ASU 2011-12 and will be further deliberated by the FASB at a future date. ASUs 2011-05 and 2011-12 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, which is October 1, 2012 for the Company, and should be applied retrospectively for all periods presented in the financial statements. The Company has not yet decided which statement format it will adopt.

In December 2011, the FASB issued ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. The ASU requires new disclosures regarding the nature of an entity's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. The new disclosures are designed to make GAAP financial statements more comparable to those prepared under International Financial Reporting Standards. The new disclosures entail presenting information about both gross and net exposures. The new disclosure

requirements are effective for annual reporting periods beginning on or after January 1, 2013, which is October 1, 2013 for the Company, and interim periods therein; retrospective application is required. The Company has not yet completed its evaluation of this ASU; however, since the provisions of ASU 2011-11 are disclosure-related, the Company's adoption of this ASU is not expected to have an impact to its financial condition or results of operations.

11

---

## 2. Earnings Per Share

The Company accounts for the shares acquired by its ESOP and the shares awarded pursuant to its RRP in accordance with Accounting Standards Codification ("ASC") 260, which requires that unvested RRP awards that contain nonforfeitable rights to dividends be treated as participating securities in the computation of earnings per share pursuant to the two-class method. The two-class method is an earnings allocation that determines earnings per share for each class of common stock and participating security. Shares acquired by the ESOP are not considered in the basic average shares outstanding until the shares are committed for allocation or vested to an employee's individual account.

	For the Three Months Ended March 31,		For the Six Months Ended March 31,	
	2012	2011	2012	2011
	(Dollars in thousands, except per share data)			
Net income (1)	\$ 19,315	\$ 15,636	\$ 38,104	\$ 4,378
Average common shares outstanding	161,582,102	161,381,230	161,752,544	163,483,221
Average committed ESOP shares outstanding	139,514	118,565	70,130	59,274
Total basic average common shares outstanding	161,721,616	161,499,795	161,822,674	163,542,495
Effect of dilutive RRP shares	1,982	2,104	3,169	3,250
Effect of dilutive stock options	4,020	5,475	3,848	5,005
Total diluted average common shares outstanding	161,727,618	161,507,374	161,829,691	163,550,750
Net earnings per share:				
Basic	\$ 0.12	\$ 0.10	\$ 0.24	\$ 0.03
Diluted	\$ 0.12	\$ 0.10	\$ 0.24	\$ 0.03

Antidilutive stock options and RRP shares,  
excluded

from the diluted average common shares  
outstanding calculation

881,128	902,945	883,608	902,939
---------	---------	---------	---------

(1) Net income available to participating securities (unvested RRP shares) was inconsequential for the three and six months ended March 31, 2012 and 2011.

12

### 3. Securities

The following tables reflect the amortized cost, estimated fair value, and gross unrealized gains and losses of AFS and HTM securities at March 31, 2012 and September 30, 2011. The majority of the MBS and investment portfolios are composed of securities issued by U.S. government-sponsored enterprises (“GSEs”).

		March 31, 2012		
	Amortized Cost (Dollars in thousands)	Gross Unrealized Gains	Estimated Unrealized Losses	Estimated Fair Value
AFS:				
GSE debentures	\$ 1,071,472	\$ 2,922	\$ 1,018	\$ 1,073,376



Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Municipal bonds	2,444	113	--	2,557
Trust preferred securities	2,954	--	863	2,091
MBS	598,609	38,812	--	637,421
	1,675,479	41,847	1,881	1,715,445
HTM:				
GSE debentures	124,936	861	--	125,797
Municipal bonds	50,977	2,015	--	52,992
MBS	1,989,123	61,837	2,128	2,048,832
	2,165,036	64,713	2,128	2,227,621
	\$ 3,840,515	\$ 106,560	\$ 4,009	\$ 3,943,066

		September 30, 2011		
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	Losses	Value
	(Dollars in thousands)			
AFS:				
GSE debentures	\$ 746,545	\$ 1,996	\$ 233	\$ 748,308
Municipal bonds	2,628	126	--	2,754
Trust preferred securities	3,681	--	740	2,941
MBS	690,675	41,764	3	732,436
	1,443,529	43,886	976	1,486,439
HTM:				
GSE debentures	633,483	3,171	--	636,654
Municipal bonds	56,994	2,190	4	59,180
MBS	1,679,640	59,071	153	1,738,558
	2,370,117	64,432	157	2,434,392
	\$ 3,813,646	\$ 108,318	\$ 1,133	\$ 3,920,831

---

The following tables summarize the estimated fair value and gross unrealized losses of those securities on which an unrealized loss at March 31, 2012 and September 30, 2011 was reported and the continuous unrealized loss position for at least 12 months or less than 12 months as of March 31, 2012 and September 30, 2011.

	March 31, 2012					
	Less Than 12 Months			Equal to or Greater Than 12 Months		
	Count	Estimated Fair Value	Unrealized Losses	Count	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
AFS:						
GSE debentures	11	\$ 258,683	\$ 1,018	--	\$ --	\$ --
Trust preferred securities	--	--	--	1	2,091	863
MBS	--	--	--	--	--	--
	11	\$ 258,683	\$ 1,018	1	\$ 2,091	\$ 863
HTM:						
GSE debentures	--	\$ --	\$ --	--	\$ --	\$ --
Municipal bonds	--	--	--	--	--	--
MBS	14	318,068	2,128	--	--	--
	14	\$ 318,068	\$ 2,128	--	\$ --	\$ --
	September 30, 2011					
	Less Than 12 Months			Equal to or Greater Than 12 Months		
	Count	Estimated Fair Value	Unrealized Losses	Count	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
AFS:						
GSE debentures	7	\$ 230,848	\$ 233	--	\$ --	\$ --
Trust preferred securities	--	--	--	1	2,941	740
MBS	5	1,189	3	--	--	--
	12	\$ 232,037	\$ 236	1	\$ 2,941	\$ 740
HTM:						
GSE debentures	--	\$ --	\$ --	--	\$ --	\$ --
Municipal bonds	2	615	4	--	--	--
MBS	1	25,142	153	--	--	--
	3	\$ 25,757	\$ 157	--	\$ --	\$ --

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

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

14

The unrealized losses at March 31, 2012 and September 30, 2011 are primarily a result of increases in market yields from the time of purchase. In general, as market yields rise, the fair value of securities will decrease; as market yields fall, the fair value of securities will increase. Management generally views changes in fair value caused by changes in interest rates as temporary; therefore, these securities have not been classified as other-than-temporarily impaired. Additionally, the impairment is also considered temporary because scheduled coupon payments have been made, it is anticipated that the entire principal balance will be collected as scheduled, and management neither intends to sell the securities, nor is it more likely than not that the Company will be required to sell the securities before the recovery of the remaining amortized cost amount, which could be at maturity.

The amortized cost and estimated fair value of securities by remaining contractual maturity without consideration for call features or pre-refunding dates as of March 31, 2012 are shown below. Actual maturities of MBS may differ from contractual maturities because borrowers have the right to prepay obligations, generally without penalties. As of March 31, 2012, the amortized cost of the securities in our portfolio which are callable or have pre-refunding dates within one year totaled \$715.0 million. Maturities of MBS depend on the repayment characteristics and experience of the underlying financial instruments. Issuers of certain investment securities have the right to call and prepay obligations with or without prepayment penalties.

	AFS		HTM	
	Amortized Cost (Dollars in thousands)	Estimated Fair Value	Amortized Cost	Estimated Fair Value
One year or less	\$ 180,677	\$ 180,993	\$ 3,139	\$ 3,164
One year through five years	868,556	870,266	156,110	158,292
Five years through ten years	166,141	177,920	428,868	445,260
Ten years and thereafter	460,105	486,266	1,576,919	1,620,905
	\$ 1,675,479	\$ 1,715,445	\$ 2,165,036	\$ 2,227,621

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

March 31, 2012      September 30, 2011

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

	(Dollars in thousands)	
Federal National Mortgage Association (“FNMA”)	\$ 1,519,902	\$ 1,384,396
Federal Home Loan Mortgage Corporation (“FHLMC”)	910,520	823,728
Government National Mortgage Association	194,981	202,340
Private Issuer	1,141	1,612
	\$ 2,626,544	\$ 2,412,076

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

	For the Three Months Ended March 31, 2012		For the Six Months Ended March 31, 2011	
	2012	2011	2012	2011
	(Dollars in thousands)			
Taxable	\$ 3,688	\$ 4,266	\$ 7,885	\$ 8,537
Non-taxable	427	477	867	981
	\$ 4,115	\$ 4,743	\$ 8,752	\$ 9,518

15

---

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

	March 31, 2012		September 30, 2011	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)			
Repurchase agreements	\$ 408,898	\$ 430,453	\$ 571,016	\$ 597,286
Retail deposits	--	--	44,429	44,991
Public unit deposits	213,028	224,448	116,472	124,785
Federal Reserve Bank	56,873	59,062	26,666	27,939
	\$ 678,799	\$ 713,963	\$ 758,583	\$ 795,001

4. Loans Receivable and Allowance for Credit Losses

Loans receivable, net at March 31, 2012 and September 30, 2011 is summarized as follows:

	March 31, 2012	September 30, 2011
	(Dollars in thousands)	
Real estate loans:		
One- to four-family	\$ 5,010,076	\$ 4,918,778
Multi-family and commercial	52,421	57,965
Construction	52,390	47,368
Total real estate loans	5,114,887	5,024,111
Consumer loans:		
Home equity	153,345	164,541
Other	7,064	7,224
Total consumer loans	160,409	171,765
Total loans receivable	5,275,296	5,195,876
Less:		
Undisbursed loan funds	29,425	22,531
ACL	12,559	15,465
Discounts/unearned loan fees	20,844	19,093
Premiums/deferred costs	(11,710)	(10,947)
	\$ 5,224,178	\$ 5,149,734

Lending Practices and Underwriting Standards - Originating and purchasing loans secured by one- to four-family residential properties is the Bank's primary business, resulting in a loan concentration in residential first mortgage loans. The Bank purchases one- to four-family loans, on a loan-by-loan basis, from a select group of correspondent lenders located throughout the central United States. As a result of originating loans in our branches, along with the correspondent lenders in our local markets, the Bank has a concentration of loans secured by real property located in Kansas and Missouri. Additionally, the Bank periodically purchases whole one- to four-family loans in bulk packages from nationwide and correspondent lenders. The Bank also makes consumer loans, construction loans secured by residential or commercial properties, and real estate loans secured by multi-family dwellings.

One- to four-family loans - One- to four-family loans are underwritten manually or by an automated underwriting system developed by a third party. The system's components closely resemble the Bank's manual underwriting standards which are generally in accordance with FHLMC and FNMA manual underwriting guidelines. The automated underwriting system analyzes the applicant's

data, with emphasis on credit history, employment and income history, qualifying ratios reflecting the applicant's ability to repay, asset reserves, and LTV ratio. Full documentation to support the applicant's credit, income, and sufficient funds to cover all applicable fees and reserves at closing is required on all loans. Loans that do not meet the automated underwriting standards are referred to a staff underwriter for manual underwriting. Properties securing one- to four-family loans are appraised by either staff appraisers or fee appraisers, both of which are independent of the loan origination function.

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

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

Multi-family and commercial loans - The Bank's multi-family and commercial real estate loans are secured primarily by properties generally located in the Bank's market areas or surrounding areas. These loans are granted based on the income producing potential of the property and the financial strength of the borrower. At the time of origination, LTV ratios on multi-family and commercial real estate loans cannot exceed 80% of the appraised value of the property securing the loans. The net operating income, which is the income derived from the operation of the property less all operating expenses, must be sufficient to cover the payments related to the outstanding debt at the time of origination. The Bank generally requires personal guarantees of the borrowers covering a portion of the debt in addition to the security property as collateral for these loans. Appraisals on properties securing these loans are performed by independent state certified fee appraisers. Bank policy permits a limited amount of construction-to-permanent loans secured by multi-family dwellings and commercial real estate.

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

the consumer loan portfolio is comprised of home equity lines of credit.

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

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

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

The following table presents the recorded investment of loans, defined as the unpaid loan principal balance (net of unadvanced funds related to loans in process) inclusive of unearned loan fees and deferred costs, of the Company's loans 30 to 89 days delinquent, loans 90 or more days delinquent, total delinquent loans, total current loans, and the total loans receivable balance at March 31, 2012 and September 30, 2011 by class. In the formula analysis model, delinquent loans not individually evaluated for impairment are assigned

17

---

a higher loss factor than corresponding performing loans. At March 31, 2012 and September 30, 2011, all loans in the 90 or more days delinquent category were on nonaccrual status. In addition to loans 90 or more days delinquent, the Bank also had \$5.1 million of TDRs classified as nonaccrual at March 31, 2012, as the borrowers had not yet made six consecutive payments per the restructured loan terms. At March 31, 2012 and September 30, 2011, there were no loans 90 or more days delinquent that were still accruing interest.

March 31, 2012					
	30 to 89 Days Delinquent	90 or More Days Delinquent	Total Delinquent Loans	Current Loans	Total Recorded Investment
(Dollars in thousands)					
One- to four-family loans - originated	\$ 13,396	\$ 12,437	\$ 25,833	\$ 4,484,374	\$ 4,510,207
One- to four-family loans - purchased	7,405	12,618	20,023	491,169	511,192
Multi-family and commercial loans	--	--	--	54,929	54,929
Consumer - home equity	616	327	943	152,402	153,345
Consumer - other	342	10	352	6,712	7,064
	\$ 21,759	\$ 25,392	\$ 47,151	\$ 5,189,586	\$ 5,236,737
September 30, 2011					
	30 to 89 Days Delinquent	90 or More Days Delinquent	Total Delinquent Loans	Current Loans	Total Recorded Investment
(Dollars in thousands)					
One- to four-family loans - originated	\$ 19,682	\$ 12,363	\$ 32,045	\$ 4,362,498	\$ 4,394,543
One- to four-family loans - purchased	6,243	13,836	20,079	520,876	540,955
Multi-family and commercial loans	--	--	--	57,936	57,936
Consumer - home equity	759	380	1,139	163,402	164,541
Consumer - other	92	3	95	7,129	7,224
	\$ 26,776	\$ 26,582	\$ 53,358	\$ 5,111,841	\$ 5,165,199

18

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

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



Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

existing facts and conditions and values highly questionable and improbable.

Loss - Loans classified as loss are considered uncollectible and of such little value that their continuance as assets on the books is not warranted.

Special mention and substandard loans are included in the formula analysis model, if the loan is not individually evaluated for impairment. Loans classified as doubtful or loss are individually evaluated for impairment.

The following tables set forth the recorded investment in loans, less charge-offs and special valuation allowances ("SVAs"), classified as special mention or substandard at March 31, 2012 and September 30, 2011, by class. At March 31, 2012 and September 30, 2011, there were no loans classified as doubtful or loss that were not fully charged-off or reserved.

	March 31, 2012		September 30, 2011	
	Special Mention	Substandard	Special Mention	Substandard
	(Dollars in thousands)			
One- to four-family - originated	\$ 35,023	\$ 25,521	\$ 32,673	\$ 18,419
One- to four-family - purchased	435	17,258	447	15,987
Multi-family and commercial	2,284	--	7,683	--
Consumer - home equity	44	515	50	592
Consumer - other	--	11	--	5
	\$ 37,786	\$ 43,305	\$ 40,853	\$ 35,003

The following table shows the weighted average LTV and credit score information for originated and purchased one-to four-family loans and originated consumer home equity loans at March 31, 2012 and September 30, 2011. Borrower credit scores are intended to provide an indication as to the likelihood that a borrower will repay their debts. Credit scores are typically updated in the last month of the quarter and are obtained from a nationally recognized consumer rating agency. The LTV ratios provide an estimate of the extent to which the Bank may incur a loss on any given loan that may go into foreclosure. The LTV ratios were based on the current loan balance and either the lesser of the purchase price or original appraisal, or the most recent bank appraisal, or BPO, if available. In most cases, the most recent appraisal was obtained at the time of origination.

	March 31, 2012		September 30, 2011		
	Weighted Average Credit Score	Weighted Average LTV	Weighted Average Credit Score	Weighted Average LTV	
One- to four-family - originated	763	66	% 762	66	%
One- to four-family - purchased	740	59	740	60	
Consumer - home equity	740	19	742	20	
	760	64	% 759	64	%

Troubled Debt Restructurings - The following table presents the recorded investment of TDRs at the dates presented, including restructurings granted to borrowers who were experiencing financial difficulties and certain restructurings of loans to current market interest rates through the Bank's loan endorsement program. The endorsed loans classified as TDRs represent loans where there has been a decrease in soft credit scores and/or estimated LTV ratios since the time the loan was originated. As a result of these decreases,

19

---

the borrower could be experiencing financial difficulties even though they have not been delinquent in the previous 12 months on their existing loan payments with the Bank.

	March 31, 2012		
	Restructurings		
	Due to	Loan	
	Financial	Endorsement	
	Difficulties	Program	Total
	(Dollars in thousands)		
One- to four-family loans - originated	\$ 27,119	\$ 32,340	\$ 59,459
One- to four-family loans - purchased	5,163	--	5,163
Multi-family and commercial loans	541	--	541
Consumer - home equity	387	--	387
Consumer - other	1	--	1
	\$ 33,211	\$ 32,340	\$ 65,551

	September 30, 2011		
	Restructurings		
	Due to	Loan	
	Financial	Endorsement	
	Difficulties	Program	Total
	(Dollars in thousands)		
One- to four-family loans - originated	\$ 23,534	\$ 19,624	\$ 43,158
One- to four-family loans - purchased	6,155	--	6,155
Multi-family and commercial loans	563	--	563
Consumer - home equity	413	--	413
Consumer - other	2	--	2
	\$ 30,667	\$ 19,624	\$ 50,291

The following table presents the recorded investment prior to restructuring and immediately after restructuring for all loans restructured during the three and six months ending March 31, 2012. This table does not reflect the recorded investment at March 31, 2012. The increase in the recorded investment at the time of the restructuring was generally due to the capitalization of delinquent amounts due.

	For the Three Months Ended March 31, 2012			For the Six Months Ended March 31, 2012		
	Number of Contracts	Pre- Restructured Outstanding (Dollars in thousands)	Post- Restructured Outstanding	Number of Contracts	Pre- Restructured Outstanding	Post- Restructured Outstanding
One- to four-family loans - originated	55	\$ 9,394	\$ 9,446	125	\$ 19,725	\$ 19,816
One- to four-family loans - purchased	--	--	--	--	--	--
Multi-family and commercial loans	--	--	--	--	--	--
Consumer - home equity	--	--	--	1	--	10
Consumer - other	--	--	--	--	--	--
	55	\$ 9,394	\$ 9,446	126	\$ 19,725	\$ 19,826

As of March 31, 2012, the recorded investment of TDRs 30 to 89 days delinquent and over 90 days delinquent was \$1.6 million and \$3.3 million, respectively. The following table provides information on TDRs restructured within the last 12 months that subsequently became delinquent during the three and six months ended March 31, 2012. Of the six loans in the table that became delinquent during the quarter, three loans, with a recorded investment of \$353 thousand as of March 31, 2012, had returned to current status as of March 31, 2012.

	For the Three Months Ended March 31, 2012		For the Six Months Ended March 31, 2012	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
One- to four-family loans - originated	6	\$ 762	7	\$ 838
One- to four-family loans - purchased	--	--	1	401
Multi-family and commercial loans	--	--	--	--
Consumer - home equity	--	--	--	--
Consumer - other	--	--	--	--
	6	\$ 762	8	\$ 1,239

21

Impaired loans - Substantially all of the impaired loans at March 31, 2012 and September 30, 2011 were secured by residential real estate. Impaired loans related to residential real estate are individually evaluated to ensure that the carrying value of the loan is not in excess of the fair value of the collateral, less estimated selling costs. Fair values of residential real estate are estimated through such methods as current appraisals, BPOs, or listing prices. Fair values may be adjusted by management to reflect current economic and market conditions. If the outstanding loan balance is in excess of the estimated fair value determined by management, less estimated costs to sell, then a charge-off is recorded for the difference.

March 31, 2012

	Recorded Investment	Unpaid Principal Balance	Related ACL	Current Quarter Average Recorded Investment	Fiscal Year-to-Date Average Recorded Investment	Current Quarter Interest Income Recognized	Fiscal Year-to-Date Interest Income Recognized
With no related allowance recorded							
One- to four-family - originated	\$ 50,973	\$ 51,163	\$ --	\$ 49,682	\$ 49,025	\$ 481	\$ 872
One- to four-family	16,203	16,045	--	11,876	9,942	49	108

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

- purchased							
Multi-family							
and							
commercial	--	--	--	277	372	--	--
Consumer -							
home equity	348	348	--	466	467	3	5
Consumer -							
other	11	11	--	10	9	--	--
	67,535	67,567	--	62,311	59,815	533	985
With an allowance							
recorded							
One- to							
four-family							
- originated	3,744	3,738	149	3,225	3,249	24	70
One- to							
four-family							
- purchased	1,489	1,483	226	7,022	9,228	13	18
Multi-family							
and							
commercial	--	--	--	--	--	--	--
Consumer -							
home equity	167	167	4	138	180	1	3
Consumer -							
other	--	--	--	--	--	--	--
	5,400	5,388	379	10,385	12,657	38	91
Total							
One- to							
four-family							
- originated	54,717	54,901	149	52,907	52,274	505	942
One- to							
four-family							
- purchased	17,692	17,528	226	18,898	19,170	62	126
Multi-family							
and							
commercial	--	--	--	277	372	--	--
Consumer -							
home equity	515	515	4	604	647	4	8
Consumer -							
other	11	11	--	10	9	--	--
	\$ 72,935	\$ 72,955	\$ 379	\$ 72,696	\$ 72,472	\$ 571	\$ 1,076

September 30, 2011

Unpaid

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

	Recorded Investment	Principal Balance	Related ACL
(Dollars in thousands)			
With no related allowance recorded			
One- to four-family - originated	\$ 47,710	\$ 47,845	\$ --
One- to four-family - purchased	6,075	6,056	--
Multi-family and commercial	563	565	--
Consumer - home equity	468	468	--
Consumer - other	5	5	--
	54,821	54,939	--
With an allowance recorded			
One- to four-family - originated	3,297	3,299	335
One- to four-family - purchased	13,640	13,546	3,280
Multi-family and commercial	--	--	--
Consumer - home equity	264	264	140
Consumer - other	--	--	--
	17,201	17,109	3,755
Total			
One- to four-family - originated	51,007	51,144	335
One- to four-family - purchased	19,715	19,602	3,280
Multi-family and commercial	563	565	--
Consumer - home equity	732	732	140
Consumer - other	5	5	--
	\$ 72,022	\$ 72,048	\$ 3,755

23

---

Allowance for credit losses - The following is a summary of the activity in the ACL by segment and the ending balance of the ACL based on the Company's impairment methodology for and at the periods presented. In January 2012, management implemented a loan charge-off policy change as Office of the Comptroller of the Currency ("OCC") Call Report requirements do not permit the use of SVAs, which the Bank was previously utilizing for potential loan losses, as permitted by the Bank's previous regulator. As a result of the implementation of the charge-off policy change, \$3.5 million of SVAs were charged-off during the current quarter. These charge-offs did not impact the provision for credit losses, and therefore had no additional income statement impact, as the amounts were expensed in previous periods. There was no ACL for loans individually evaluated for impairment at March 31, 2012, as all potential losses were charged-off.

For the Three Months Ended March 31, 2012

One- to Four- Family -	One- to Four- Family -	One- to Four- Family -	Multi-family and
------------------------------	------------------------------	------------------------------	---------------------

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Quarter	Originated (Dollars in thousands)	Purchased	Total	Commercial	Consumer	Total
Beginning balance	\$ 4,921	\$ 10,342	\$ 15,263	\$ 83	\$ 259	\$ 15,605
Charge-offs	(497)	(3,850)	(4,347)	--	(199)	(4,546)
Recoveries	--	--	--	--	--	--
Provision for credit losses	368	1,000	1,368	(1)	133	1,500
Ending balance	\$ 4,792	\$ 7,492	\$ 12,284	\$ 82	\$ 193	\$ 12,559

Ratio of net charge-offs to average loans outstanding during the quarter	0.09	%
Ratio of net charge-offs during the quarter to average non-performing assets	11.11	%

ACL for loans collectively evaluated for impairment	\$ 4,792	\$ 7,492	\$ 12,284	\$ 82	\$ 193	\$ 12,559
---	----------	----------	-----------	-------	--------	-----------

24

For the Six Months Ended March 31, 2012

	One- to Four-Family - Originated	One- to Four-Family - Purchased	One- to Four-Family - Total	Multi-family and Commercial	Consumer	Total
(Dollars in thousands)						
Year-to-Date Beginning balance	\$ 4,915	\$ 9,901	\$ 14,816	\$ 254	\$ 395	\$ 15,465
Charge-offs	(587)	(4,154)	(4,741)	--	(205)	(4,946)
Recoveries	--	--	--	--	--	--
Provision for credit losses	464	1,745	2,209	(172)	3	2,040
Ending balance	\$ 4,792	\$ 7,492	\$ 12,284	\$ 82	\$ 193	\$ 12,559

Ratio of net charge-offs to average loans outstanding year-to-date	0.10	%
Ratio of net charge-offs year-to-date to average non-performing assets	12.37	%

The following is a summary of the loan portfolio at March 31, 2012 and September 30, 2011 by loan portfolio segment disaggregated by the Company's impairment method.

	March 31, 2012					
	One- to Four- Family - Originated	One- to Four- Family - Purchased	One- to Four- Family - Total	Multi-family and Commercial	Consumer	Total
	(Dollars in thousands)					
Recorded investment of loans collectively evaluated for impairment	\$ 4,459,234	\$ 494,989	\$ 4,954,223	\$ 54,929	\$ 160,050	\$ 5,169,202
Recorded investment of loans individually evaluated for impairment	50,973 \$ 4,510,207	16,203 \$ 511,192	67,176 \$ 5,021,399	-- \$ 54,929	359 \$ 160,409	67,535 \$ 5,236,737
	September 30, 2011					
	One- to Four- Family - Originated	One- to Four- Family - Purchased	One- to Four- Family - Total	Multi-family and Commercial	Consumer	Total
Recorded investment of loans collectively evaluated for impairment	\$ 4,343,536	\$ 521,240	\$ 4,864,776	\$ 57,373	\$ 171,028	\$ 5,093,177
Recorded investment of loans individually evaluated for impairment	51,007	19,715	70,722	563	737	72,022



\$ 4,394,543	\$ 540,955	\$ 4,935,498	\$ 57,936	\$ 171,765	\$ 5,165,199
--------------	------------	--------------	-----------	------------	--------------

As noted above, the Bank has a loan concentration in residential first mortgage loans. Continued declines in residential real estate values could adversely impact the property used as collateral for the Bank's loans. Adverse changes in the economic conditions and increasing unemployment rates may have a negative effect on the ability of the Bank's borrowers to make timely loan payments, which would likely increase delinquencies and have an adverse impact on the Bank's earnings. Further increases in delinquencies would decrease interest income on loans receivable and would likely adversely impact the Bank's loan loss experience, resulting in an increase in the Bank's ACL and provision for credit losses. Although management believes the ACL was at an adequate level to absorb known and inherent losses in the loan portfolio at March 31, 2012, the level of the ACL remains an estimate that is subject to significant judgment and short-term changes. Additions to the ACL may be necessary if future economic and other conditions differ substantially from the current environment.

26

## 5. Fair Value of Financial Instruments

Fair Value Measurements - ASC 820, Fair Value Measurements and Disclosures, defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820 applies only to fair value measurements already required or permitted by other accounting standards and does not impose requirements for additional fair value measures. ASC 820 was issued to increase consistency and comparability in reporting fair values.

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. The Company did not have any liabilities that were measured at fair value at March 31, 2012 and September 30, 2011. The Company's AFS securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets or liabilities on a non-recurring basis, such as REO, LHFS, and impaired loans. These non-recurring fair value adjustments involve the application of lower-of-cost-or-fair value accounting or write-downs of individual assets.

In accordance with ASC 820, the Company groups its assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 — Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 — Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

- Level 3 — Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Company’s own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques. The results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability.

The Company bases its fair values on the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. As required by ASC 820, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

The following is a description of valuation methodologies used for assets measured at fair value on a recurring basis.

AFS Securities - The Company’s AFS securities portfolio is carried at estimated fair value, with any unrealized gains and losses, net of taxes, reported as AOCI in stockholders' equity. The Company’s major security types based on the nature and risks of the securities are included in the table below. The majority of the securities within the AFS portfolio are issued by U.S. GSEs. The fair values for all AFS securities are based on quoted prices for similar securities. Various modeling techniques are used to determine pricing for the Company’s securities, including option pricing and discounted cash flow estimates. The inputs to these models may include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, benchmark securities, bids, offers and reference data. There is an AFS security in the AFS portfolio that has significant unobservable inputs requiring the independent pricing services to use some judgment in pricing it. This AFS security is classified as Level 3. All other AFS securities are classified as Level 2.

27

---

The following table provides the level of valuation assumption used to determine the carrying value of the Company’s assets measured at fair value on a recurring basis, which consists of AFS securities, at March 31, 2012 and September 30, 2011.

	March 31, 2012		
	Quoted		
	Prices	Significant	Significant
	in Active	Other	
	Markets	Observable	Unobservable
Carrying	for	Inputs	Inputs
	Identical		

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

	Value (Dollars in thousands)	Assets		
		(Level 1)	(Level 2)	(Level 3) (1)
AFS Securities:				
GSE debentures	\$ 1,073,376	\$ --	\$ 1,073,376	\$ --
Municipal bonds	2,557	--	2,557	--
Trust preferred securities	2,091	--	--	2,091
MBS	637,421	--	637,421	--
	\$ 1,715,445	\$ --	\$ 1,713,354	\$ 2,091

	Carrying Value (Dollars in thousands)	September 30, 2011		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (2)
AFS Securities:				
GSE debentures	\$ 748,308	\$ --	\$ 748,308	\$ --
Municipal bonds	2,754	--	2,754	--
Trust preferred securities	2,941	--	--	2,941
MBS	732,436	--	732,436	--
	\$ 1,486,439	\$ --	\$ 1,483,498	\$ 2,941

- (1) The Company's Level 3 AFS securities had no activity from September 30, 2011 to March 31, 2012, except for principal repayments of \$929 thousand and increases in net unrealized losses recognized in other comprehensive income. Increases in net unrealized losses included in other comprehensive income for the six months ended March 31, 2012 were \$77 thousand.
- (2) The Company's Level 3 AFS securities had no activity from September 30, 2010 to September 30, 2011, except for principal repayments of \$87 thousand and reductions in net unrealized losses recognized in other comprehensive income. Reductions of net unrealized losses included in other comprehensive income for the year ended September 30, 2011 were \$115 thousand.

The following is a description of valuation methodologies used for significant assets measured at fair value on a non-recurring basis.

Loans Receivable - Loans which meet certain criteria are evaluated individually for impairment. A loan is considered impaired when, based upon current information and events, it is probable the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. The unpaid principal balance of impaired loans at March 31, 2012 and September 30, 2011 was \$72.9 million and \$72.0 million, respectively. Substantially all of the Bank's impaired loans at March 31, 2012 and September 30, 2011 were secured by residential real estate. These impaired loans are individually assessed to ensure that the carrying value of the loan is not in excess of the fair value of the collateral, less estimated selling costs. Fair value is estimated through current appraisals, BPOs, or listing prices. Fair values may be adjusted by management to reflect current economic and

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

market conditions and, as such, are classified as Level 3. Based on this evaluation, the Company maintained an ACL of \$379 thousand and \$3.8 million at March 31, 2012 and September 30, 2011, respectively, for such impaired loans. The decrease in ACL between period ends was due to the loan charge-off policy change implemented in January 2012.

REO - REO primarily represents real estate acquired as a result of foreclosure or by deed in lieu of foreclosure and is carried at lower-of-cost or fair value. Fair value is estimated through current appraisals, BPOs, or listing prices. As these properties are actively marketed, estimated fair values may be adjusted by management to reflect current economic and market conditions and, as such, are

28

---

classified as Level 3. The fair value of REO at March 31, 2012 and September 30, 2011 was \$11.8 million and \$11.3 million, respectively.

The following table provides the level of valuation assumption used to determine the carrying value of the Company's assets measured at fair value on a non-recurring basis at March 31, 2012 and September 30, 2011.

	March 31, 2012			
	Quoted	Significant	Significant	
	Prices	Other	Unobservable	
	in Active	Observable		
	Markets			
	for			
	Identical			
Carrying	Assets	Inputs	Inputs	
Value	(Level 1)	(Level 2)	(Level 3)	
(Dollars in thousands)				
Impaired loans	\$ 72,955	\$ --	\$ --	\$ 72,955
REO	11,799	--	--	11,799
	\$ 84,754	\$ --	\$ --	\$ 84,754
	September 30, 2011			
	Quoted	Significant	Significant	
	Prices	Other	Unobservable	
	in Active	Observable		
	Markets			
Carrying		Inputs	Inputs	

	Value	for Identical Assets		
	(Dollars in thousands)	(Level 1)	(Level 2)	(Level 3)
Impaired loans	\$ 72,048	\$ --	\$ --	\$ 72,048
REO	11,321	--	--	11,321
	\$ 83,369	\$ --	\$ --	\$ 83,369

Fair Value Disclosures - The Company determined estimated fair value amounts using available market information and a selection from a variety of valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amount the Company could realize in a current market exchange. The use of different market assumptions and estimation methodologies may have a material impact on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of March 31, 2012 and September 30, 2011. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since those dates.

29

---

The estimated fair values of the Company's financial instruments as of March 31, 2012 and September 30, 2011 were as follows.

	March 31, 2012		September 30, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(Dollars in thousands)			
Assets:				
Cash and cash equivalents	\$ 143,707	\$ 143,707	\$ 121,070	\$ 121,070
AFS securities	1,715,445	1,715,445	1,486,439	1,486,439
HTM securities	2,165,036	2,227,621	2,370,117	2,434,392
Loans receivable	5,224,178	5,537,081	5,149,734	5,475,150
BOLI	57,333	57,333	56,534	56,534
Capital stock of FHLB	130,614	130,614	126,877	126,877
Liabilities:				
Deposits	4,657,010	4,710,824	4,495,173	4,553,516
Advances from FHLB	2,525,535	2,699,768	2,379,462	2,569,958
Other borrowings	365,000	390,079	515,000	545,096

The following methods and assumptions were used to estimate the fair value of the financial instruments:

Cash and Cash Equivalents - The carrying amounts of cash and cash equivalents are considered to approximate their fair value due to the nature of the financial asset.

AFS and HTM Securities - Estimated fair values of securities are based on one of three methods: 1) quoted market prices where available, 2) quoted market prices for similar instruments if quoted market prices are not available, 3) unobservable data that represents the Bank's assumptions about items that market participants would consider in determining fair value where no market data is available. AFS securities are carried at estimated fair value. HTM securities are carried at amortized cost.

Loans Receivable - Fair values are estimated for portfolios with similar financial characteristics. Loans are segregated by type, such as one- to four-family residential mortgages, multi-family residential mortgages, nonresidential, and consumer loans. Each loan category is further segmented into fixed- and adjustable interest rate categories. Market pricing sources are used to approximate the estimated fair value of fixed- and adjustable-rate one- to four-family residential mortgages. For all other loan categories, future cash flows are discounted using the LIBOR curve plus a margin at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturity.

BOLI - The carrying value of BOLI is considered to approximate its fair value due to the nature of the financial asset.

Capital Stock of FHLB - The carrying value of FHLB stock equals cost. The fair value is based on redemption at par value.

Deposits - The estimated fair value of demand deposits, savings and money market accounts is the amount payable on demand at the reporting date. The estimated fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using a margin to the LIBOR curve.

Advances from FHLB - The estimated fair value of advances from FHLB is determined by discounting the future cash flows of each advance using a margin to the LIBOR curve.

Other Borrowings - Other borrowings consists of repurchase agreements. The estimated fair value of the repurchase agreements is determined by discounting the future cash flows of each agreement using a margin to the LIBOR curve.

## 6. Subsequent Events

In preparing these financial statements, management has evaluated events occurring subsequent to March 31, 2012, for potential recognition and disclosure. There have been no material events or transactions which would require adjustments to the consolidated financial statements at March 31, 2012.

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

The Company and its wholly-owned subsidiary may from time to time make written or oral "forward-looking statements," including statements contained in documents filed or furnished by the Company with the SEC. These forward-looking statements may be included in this Quarterly Report on Form 10-Q and the exhibits attached to it, in the Company's reports to stockholders, in the Company's press releases, and in other communications by the Company, which are made in good faith by us pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements about our beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties, and are subject to change based on various factors, some of which are beyond our control. The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan" and similar expressions are intended to identify forward-looking statements. The following factors, among others, could cause our future results to differ materially from the plans, objectives, goals, expectations, anticipations, estimates and intentions expressed in the forward-looking statements:

- our ability to continue to maintain overhead costs at reasonable levels;
- our ability to continue to originate a significant volume of one- to four-family mortgage loans in our market areas or to purchase loans through correspondents;
- our ability to acquire funds from or invest funds in wholesale or secondary markets;
- the future earnings and capital levels of the Bank and the continued non-objection by our primary federal banking regulators, to the extent required, to distribute capital from the Bank to the Company, which could affect the ability of the Company to pay dividends in accordance with its dividend policies;
-

- fluctuations in deposit flows, loan demand, and/or real estate values, as well as unemployment levels, which may adversely affect our business;
- the credit risks of lending and investing activities, including changes in the level and direction of loan delinquencies and write-offs, changes in property values, and changes in estimates of the adequacy of the ACL;
  - results of examinations of the Bank and the Company by their respective primary federal banking regulators, including the possibility that the regulators may, among other things, require us to increase our ACL;
  - the strength of the U.S. economy in general and the strength of the local economies in which we conduct operations;
  - the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System (“FRB”);
  - the effects of, and changes in, foreign and military policies of the United States government;
  - inflation, interest rate, market and monetary fluctuations;
  - our ability to access cost-effective funding;
  - the timely development and acceptance of our new products and services and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors’ products and services;
  - the willingness of users to substitute competitors’ products and services for our products and services;
  - our success in gaining regulatory approval of our products and services and branching locations, when required;
  - the impact of changes in financial services laws and regulations, including laws concerning taxes, banking, securities and insurance and the impact of other governmental initiatives affecting the financial services industry;
  - implementing business initiatives may be more difficult or expensive than anticipated;
  - technological changes;
  - acquisitions and dispositions;
  - changes in consumer spending and saving habits; and
  - our success at managing the risks involved in our business.

This list of important factors is not all inclusive. We do not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company or the Bank.

31

---

As used in this Form 10-Q, unless we specify otherwise, “the Company,” “we,” “us,” and “our” refer to Capitol Federal Financial, Inc., a Maryland corporation, and its predecessor, Capitol Federal Financial, a United States corporation. “Capitol Federal Savings,” and “the Bank,” refer to Capitol Federal Savings Bank, a federal savings bank and the wholly-owned subsidiary of Capitol Federal Financial, Inc.

The following discussion and analysis is intended to assist in understanding the financial condition, results of operations, liquidity and capital resources of the Company. It should be read in conjunction with the consolidated financial statements and notes presented in this report. The discussion includes comments relating to the Bank, since the Bank is wholly-owned by the Company and comprises the majority of its assets and is the principal source of income for the Company. This discussion and analysis should be read in conjunction with management’s discussion and analysis included in the Company’s 2011 Annual Report on Form 10-K filed with the SEC.



## Executive Summary

The following summary should be read in conjunction with our Management's Discussion and Analysis of Financial Condition and Results of Operations in its entirety.

We have been, and intend to continue to be, a community-oriented financial institution offering a variety of financial services to meet the needs of the communities we serve. We generally attract retail deposits from the general public and invest those funds primarily in permanent loans secured by first mortgages on owner-occupied, one- to four-family residences. To a much lesser extent, we also originate consumer loans, loans secured by first mortgages on non-owner-occupied one- to four-family residences, multi-family and commercial real estate loans, and construction loans. While our primary business is the origination of one- to four-family mortgage loans funded through retail deposits, we also purchase whole one- to four-family mortgage loans from correspondent and nationwide lenders, and invest in certain investment securities and MBS funded through retail deposits, advances from FHLB, and repurchase agreements. The Company is significantly affected by prevailing economic conditions including federal monetary and fiscal policies and federal regulation of financial institutions. Retail deposit balances are influenced by a number of factors including interest rates paid on competing personal investment products, the level of personal income, and the personal rate of savings within our market areas. Lending activities are influenced by the demand for housing and other loans, changing loan underwriting guidelines, as well as interest rate pricing competition from other lending institutions. The primary sources of funds for lending activities include deposits, loan repayments, investment income, borrowings, and funds provided from operations.

The Company's results of operations are primarily dependent on net interest income, which is the difference between the interest earned on loans, MBS, investment securities and cash, and the interest paid on deposits and borrowings. On a weekly basis, management reviews deposit flows, loan demand, cash levels, and changes in several market rates to assess all pricing strategies. We generally price our loan and deposit products based upon an analysis of our competition and changes in market rates. The Bank generally prices its first mortgage loan products based on secondary market and competitor pricing. Generally, deposit pricing is based upon a survey of competitors in the Bank's market areas, and the need to attract funding and retain maturing deposits. The majority of our loans are fixed-rate products with maturities up to 30 years, while the majority of our deposits have maturity or repricing dates of less than two years.

The Federal Open Market Committee of the Federal Reserve (the "FOMC") noted in their April 2012 statement that the economy continues to expand at a moderate pace. Labor market conditions have improved and the unemployment rate has declined notably in recent months, yet still remains elevated. The March 2012 unemployment data indicated an unemployment rate of 8.2%, compared to recent levels as high as 9.1%. The FOMC noted that household spending and business fixed investment has continued to advance, but that the housing sector continues to be depressed. As a result, the FOMC decided to continue its program to extend the average maturity of its holdings of securities as announced in September 2011. The FOMC also indicated in the April 2012 statement that the overnight lending rate would remain at zero to 0.25% through at least late in 2014. The decision to leave the overnight lending rate unchanged has kept short-term market interest rates at low levels during the first half of fiscal year 2012.

Economic conditions in the Bank's local market areas have a significant impact on the ability of borrowers to repay loans and the value of the collateral securing these loans. Our local market areas have not experienced the large fluctuations in property values as experienced by many segments of the United States, and our unemployment rate has remained relatively low, currently at 6.2% for Kansas and 7.4% for Missouri, compared to the national average of 8.2%. The unemployment rate remains relatively low, compared to the national average, due to diversified industries within our market areas, primarily in the Kansas City metropolitan statistical area, but it is higher than the historical average. The Federal Housing Finance Agency ("FHFA") price index for Kansas and Missouri has not experienced significant fluctuations during the past ten years, which indicates relative stability in property values. Our Kansas City market area comprises the largest segment of our loan portfolio and deposit base, and the average household income for our Kansas City market area is approximately \$79 thousand per annum, based on 2011 estimates from the U.S. Bureau of Economic

32

---

Analysis. The average household income in our combined market areas is approximately \$68 thousand per annum, with 92% of the population at or above poverty level, also based on the 2011 estimates from the U.S. Bureau of Economic Analysis.

Total assets increased \$122.3 million, from \$9.45 billion at September 30, 2011 to \$9.57 billion at March 31, 2012, due to a \$74.4 million increase in loans receivable, an increase in securities of \$23.9 million, and an increase in cash and cash equivalents of \$22.6 million. The increase in loans receivable was due primarily to an increase in the one- to four-family portfolio as a result of originations and purchases. Additionally, \$571.1 million of one- to four-family loans were endorsed during the first six months of fiscal year 2012. The growth in the loan portfolio was funded primarily by a \$161.8 million increase in the deposit portfolio since September 30, 2011. Each category within the deposit portfolio increased, led by the checking portfolio with a \$70.6 million increase followed by the money market portfolio with a \$45.8 million increase. Additional growth in the loan portfolio, if any, will likely be funded by growth in deposits and/or repayments from the MBS and/or investment securities portfolio.

Loans 30 to 89 days delinquent decreased \$5.0 million from \$26.8 million at September 30, 2011 to \$21.7 million at March 31, 2012. The decrease was primarily in our originated one- to four-family loan portfolio. Loans more than 90 days delinquent decreased \$1.2 million from \$26.5 million at September 30, 2011 to \$25.3 million at March 31, 2012. The decrease was in our purchased one- to four-family loan portfolio.

During the current quarter, the Bank prepaid a \$200.0 million fixed-rate FHLB advance with an interest rate of 3.88% and a remaining term to maturity of 15 months. The prepaid FHLB advance was replaced with a \$200.0 million fixed-rate FHLB advance, with a contractual interest rate of 0.86% and a term of 46 months. The Bank paid a \$7.9 million penalty to the FHLB as a result of prepaying the FHLB advance. The prepayment penalty was deferred and will be recognized in interest expense over the life of the new advance and thereby effectively increased the interest rate on the new advance 108 basis points, to 1.94%, at the time of the transaction.

Stockholders' equity decreased \$27.1 million, from \$1.94 billion at September 30, 2011 to \$1.91 billion at March 31, 2012. The decrease was due primarily to dividends paid of \$40.5 million, repurchase of 2,199,100 shares of common stock for \$26.1 million, partially offset by net income of \$38.1 million.

Net income for the quarter ended March 31, 2012 was \$19.3 million, compared to \$15.6 million for the quarter ended March 31, 2011. The \$3.7 million, or 23.5%, increase for the current quarter was due primarily to a \$6.9 million, or 17.0%, increase in net interest income, from \$40.6 million for the quarter ended March 31, 2011 to \$47.5 million for the current quarter. The increase in net interest income was due primarily to a decrease in interest expense of \$8.6 million, or 19.3%, partially offset by a decrease in interest income of \$1.7 million, or 2.0%. The net interest margin increased 36 basis points, from 1.70% for the quarter ended March 31, 2011 to 2.06% for the quarter ended March 31, 2012, largely due to the decrease in interest expense on the certificate of deposit portfolio and other borrowings.

Net income for the six months ended March 31, 2012 was \$38.1 million, compared to \$4.4 million for the six months ended March 31, 2011. The \$33.7 million increase for the current year was due primarily to the \$40.0 million (\$26.0 million, net of income tax benefit) contribution to the Foundation in connection with the second step conversion and stock offering completed in December 2010 (the "corporate reorganization"). Additionally, net interest income increased \$12.2 million, or 15.2%, from \$80.6 million for the prior year six month period to \$92.8 million for the current year six month period. The increase in net interest income was due primarily to a decrease in interest expense of \$16.4 million, or 17.9%, partially offset by a decrease in interest income of \$4.1 million, or 2.4%. The net interest margin increased 24 basis points, from 1.78% for the prior year six month period to 2.02% for the current six month period largely due to the decrease in interest expense on the certificate of deposit portfolio and other borrowings.

The Bank has two branches expected to open in calendar year 2012 in our Kansas City market area. Management continues to consider expansion opportunities in all of our market areas.

33

---

#### Available Information

Financial and other Company information, including press releases, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports can be obtained free of charge from our investor relations website, <http://ir.capfed.com>. SEC filings are available on our website immediately after they are electronically filed with or furnished to the SEC, and are also available on the SEC's website at [www.sec.gov](http://www.sec.gov).

#### Critical Accounting Policies

Our most critical accounting policies are the methodologies used to determine the ACL and fair value measurements. These policies are important to the presentation of our financial condition and results of operations, involve a high degree of complexity, and require management to make difficult and subjective judgments that may require assumptions or estimates about highly uncertain matters. The use of different judgments, assumptions, and estimates could cause reported results to differ materially. These critical accounting policies and their application are reviewed at least annually by our audit committee. The following is a description of our critical accounting policies and an explanation of the methods and assumptions underlying their application.

**Allowance for Credit Losses.** Management maintains an ACL to absorb inherent losses in the loan portfolio based upon ongoing quarterly assessments of the loan portfolio. The ACL is maintained through provisions for credit losses which are charged to income. The methodology for determining the ACL is considered a critical accounting policy by management because of the high degree of judgment involved, the subjectivity of the assumptions used, and the potential for changes in the economic environment that could result in changes to the amount of the recorded ACL. Additionally, bank regulators have the ability to require the Bank, as they can require all banks, to increase the ACL or recognize additional charge-offs based upon their judgments, which may differ from management's judgments. Although management believes that the Bank has established and maintained the ACL at appropriate levels, additions may be necessary if economic and other conditions continue or worsen substantially from the current operating environment, and/or if bank regulators require the Bank to increase the ACL and/or recognize additional charge-offs.

Our primary lending emphasis is the origination and purchase of one- to four-family mortgage loans on residential properties, and, to a lesser extent, home equity and second mortgages on one- to four-family residential properties, resulting in a loan concentration in residential first mortgage loans. As a result of our lending practices, we also have a concentration of loans secured by real property located in Kansas and Missouri. At March 31, 2012, approximately 75% and 15% of the Bank's loans were secured by real property located in Kansas and Missouri, respectively. We believe the primary risks inherent in our one- to four-family and consumer portfolios are the continued weakened economic conditions, continued high levels of unemployment or underemployment, and a continuing decline in home real estate values. Any one or a combination of these events may adversely affect borrowers' ability or desire to repay their loans, resulting in increased delinquencies, non-performing assets, loan losses, and future loan loss provisions. Although the multi-family and commercial loan portfolio also shares the risk of continued weakened economic conditions, the primary risks for the portfolio include the ability of the borrower to sustain sufficient cash flows from leases and to control expenses to satisfy their contractual debt payments, or the ability to utilize personal and/or business resources to pay their contractual debt payments if the cash flows are not sufficient.

Each quarter, we prepare an analysis ("formula analysis") which segregates our loan portfolio into categories based on certain risk characteristics such as loan type (one- to four-family, multi-family, etc.), interest payments (fixed-rate, adjustable-rate), loan source (originated or purchased), LTV ratios, borrower's credit score and payment status (i.e. current or number of days delinquent). Consumer loans, such as second mortgages and home equity lines of credit, with the same underlying collateral as a one- to four-family loan are combined with the one- to four-family loan in the formula analysis to calculate a combined LTV ratio. All loans that are not individually evaluated for impairment are included in the formula analysis. Quantitative loss factors are applied to each loan category in the formula analysis based on the historical net loss experience for each respective loan category. Additionally, qualitative loss factors that management believes impact the collectability of the loan portfolio as of the evaluation date are applied to certain loan

categories. Such qualitative factors include changes in collateral values, unemployment rates, credit scores and delinquent loan trends. Loss factors increase as loans are classified or go delinquent.

The factors applied in the formula analysis are reviewed quarterly by management to assess whether the factors adequately cover probable and estimable losses inherent in the loan portfolio. Our ACL methodology permits modifications to the formula analysis in the event that, in management's judgment, significant factors which affect the collectability of the portfolio or any category of the loan portfolio, as of the evaluation date, have changed from the current formula analysis. Management's evaluation of the qualitative factors with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with a specific problem loan or portfolio segments.

34

---

Management utilizes the formula analysis, along with several other factors, when evaluating the adequacy of the ACL. Such factors include the trend and composition of delinquent loans, results of foreclosed property and short sale transactions, the current status and trends of local and national economies, particularly levels of unemployment, trends and current conditions in the real estate and housing markets, and loan portfolio growth and concentrations. Since our loan portfolio is primarily concentrated in one- to four-family real estate, we monitor one- to four-family real estate market value trends in our local market areas and geographic sections of the U.S. by reference to various industry and market reports, economic releases and surveys, and our general and specific knowledge of the real estate markets in which we lend, in order to determine what impact, if any, such trends may have on the level of our ACL. We seek to apply ACL methodology in a consistent manner; however, the methodology can be modified in response to changing conditions. In addition, the adequacy of the Company's ACL is reviewed during bank regulatory examinations. We consider any comments from our regulator when assessing the appropriateness of our ACL. Reviewing these quantitative and qualitative factors assists management in evaluating the overall reasonableness of the ACL and whether changes need to be made to our assumptions.

Generally, when a one- to four-family secured loan is 180 days delinquent, new collateral values are obtained through BPOs or appraisals. If the estimated fair value of the collateral, less estimated costs to sell, is less than the current loan balance, the difference is charged-off. Anticipated PMI proceeds are taken into consideration when calculating the amount of the charge-off. An updated fair value is requested, at a minimum, every 12 months thereafter. If the Bank holds the first and second mortgage, both loans are combined when evaluating whether there is a potential loss on the loan. However, charge-offs for real estate-secured loans may also occur at any time if we have knowledge of the existence of a potential loss. For all other real estate loans that are not secured by one- to four-family property, losses are charged-off when we believe the collection of such amounts is unlikely. When a non-real estate secured loan is 120 days delinquent, any identified losses are charged-off.

**Fair Value Measurements.** The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures, per the provisions of ASC 820, Fair Value Measurements and Disclosures. In accordance with ASC 820, the Company groups its assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the underlying assumptions used to determine fair value, with Level 1 (quoted prices for identical assets in an active market) being considered the most reliable, and Level 3 having the most unobservable inputs and therefore being considered the least reliable. The Company bases its fair

values on the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. As required by ASC 820, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The Company did not have any liabilities that were measured at fair value at March 31, 2012.

The Company's AFS securities are our most significant assets measured at fair value on a recurring basis. Changes in the fair value of AFS securities are recorded, net of tax, in accumulated other comprehensive income, which is a component of stockholders' equity. As part of determining fair value, the Company obtains fair values for all AFS securities from independent nationally recognized pricing services. Various modeling techniques are used to determine pricing for the Company's securities, including option pricing and discounted cash flow models. The inputs to these models may include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, benchmark securities, bids, offers and reference data. There is a security in the AFS portfolio that has significant unobservable inputs requiring the independent pricing services to use some judgment in pricing the related securities. This AFS security is classified as Level 3. All other AFS securities are classified as Level 2.

Loans receivable and REO are the Company's significant assets measured at fair value on a non-recurring basis. These non-recurring fair value adjustments involve the application of lower-of-cost-or-fair value accounting or write-downs of individual assets. Fair value for these assets is estimated using current appraisals, BPOs, or listing prices. Fair values may be adjusted by management to reflect current economic and market conditions and, as such, are classified as Level 3.

35

---

## Financial Condition

Total assets increased \$122.3 million, from \$9.45 billion at September 30, 2011 to \$9.57 billion at March 31, 2012, due to a \$74.4 million increase in loans receivable, an increase in securities of \$23.9 million, and an increase in cash and cash equivalents of \$22.6 million. Total liabilities increased \$149.4 million, from \$7.51 billion at September 30, 2011 to \$7.66 billion at March 31, 2012. The increase in total liabilities was due primarily to a \$161.8 million increase in the deposit portfolio. Stockholders' equity decreased \$27.1 million, from \$1.94 billion at September 30, 2011 to \$1.91 billion at March 31, 2012. The decrease was due primarily to dividends paid of \$40.5 million, repurchase of common stock of \$26.1 million, partially offset by net income of \$38.1 million.

	Balance at			
	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2011
	(Dollars in thousands)			
Total assets	\$ 9,573,144	\$ 9,421,040	\$ 9,450,799	\$ 9,602,457
				March 31, 2011
				\$ 9,733,111

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Cash and cash equivalents	143,707	170,175	121,070	161,872	122,002					
AFS securities	1,715,445	1,570,730	1,486,439	1,269,987	1,250,153					
HTM securities	2,165,036	2,129,417	2,370,117	2,693,719	2,953,661					
Loans receivable, net	5,224,178	5,224,942	5,149,734	5,162,846	5,096,615					
Capital stock of FHLB	130,614	129,503	126,877	125,797	122,651					
Deposits	4,657,010	4,501,144	4,495,173	4,558,574	4,711,189					
Advances from FHLB	2,525,535	2,531,304	2,379,462	2,453,642	2,351,863					
Other borrowings	365,000	365,000	515,000	565,000	643,609					
Stockholders' equity	1,912,472	1,931,309	1,939,529	1,934,011	1,926,409					
Equity to total assets at end of period	20.0	%	20.5	%	20.5	%	20.1	%	19.8	%

Loans Receivable. The loans receivable portfolio increased \$74.4 million, or at an annualized rate of 2.9%, to \$5.22 billion at March 31, 2012, from \$5.15 billion at September 30, 2011. The increase in loans receivable was due primarily to an increase in the one- to four-family portfolio as a result of originations and purchases. During the first six months of fiscal year 2012, the Bank originated \$381.3 million in one- to four-family loans and purchased \$111.2 million in one- to four-family loans from correspondent lenders. The growth in the loan portfolio was funded by an increase in deposits. Additional growth in the loan portfolio, if any, will likely be funded by growth in deposits and/or repayments from the MBS and/or investment securities portfolio.

Included in the loan portfolio at March 31, 2012 were \$153.7 million, or 2.9% of the total loan portfolio, of adjustable-rate mortgage (“ARM”) loans that were originated as interest-only. Of these interest-only loans, \$125.0 million were purchased in bulk loan packages from nationwide lenders, primarily during fiscal year 2005. Interest-only ARM loans do not typically require principal payments during their initial term, and have initial interest-only terms of either five or ten years. The \$125.0 million of purchased interest-only ARM loans had a weighted average credit score of 723 and a weighted average LTV ratio of 72% at March 31, 2012. In order to reduce future credit risk, the Bank has not purchased any interest-only ARM loans since 2006 and discontinued offering the product in its local markets during 2008. At March 31, 2012, \$76.6 million, or 50%, of interest-only loans were still in their interest-only payment term. At March 31, 2012, \$8.5 million, or 28% of non-performing loans, were interest-only ARMs.

During the quarter ended March 31, 2012 the Bank was notified by the Department of Housing and Urban Development (“HUD”) of a violation of their lender qualifications guidelines. Acting on the notice of violation, and from the results of our internal investigation, the Bank expects to be assessed a civil money penalty not material to the results of our operations and to receive non-monetary penalties. It is anticipated that the final settlement will not impair the Bank’s ability to make Federal Housing Administration (“FHA”) loans. The Bank has modified its internal review processes in an effort to ensure this type of violation does not occur in the future. We expect this issue to be resolved in the June 2012 quarter.

The following table presents information concerning the composition of our loan portfolio as of March 31, 2012 and September 30, 2011. The weighted average rate of the loan portfolio decreased 24 basis points from 4.69% at September 30, 2011 to 4.45% at March 31, 2012. The decrease in the weighted average portfolio rate was due to loan endorsements and refinances, along with originations and purchases at rates which were lower than the rates on loan repayments. During the six months ended March 31, 2012, the Bank

36

endorsed \$571.1 million of one- to four-family loans, with a weighted average rate decrease of 113 basis points. Within the one- to four-family loan portfolio at March 31, 2012, 74% of the loans had a balance at origination of less than \$417 thousand.

	March 31, 2012		September 30, 2011	
	Amount	Average Rate	Amount	Average Rate
	(Dollars in thousands)			
Real Estate Loans:				
One-to four-family	\$ 5,010,076	4.40 %	\$ 4,918,778	4.65 %
Multi-family and commercial	52,421	6.15	57,965	6.13
Construction	52,390	4.22	47,368	4.27
Total real estate loans	5,114,887	4.42	5,024,111	4.66
Consumer Loans:				
Home equity	153,345	5.46	164,541	5.48
Other	7,064	4.79	7,224	5.10
Total consumer loans	160,409	5.43	171,765	5.46
Total loans receivable	5,275,296	4.45 %	5,195,876	4.69 %
Less:				
Undisbursed loan funds	29,425		22,531	
ACL	12,559		15,465	
Discounts/unearned loan fees	20,844		19,093	
Premiums/deferred costs	(11,710)		(10,947)	
Total loans receivable, net	\$ 5,224,178		\$ 5,149,734	

37



The following tables present the weighted average credit score, LTV ratio, and the average unpaid principal balance for our one- to four-family loans as of the dates presented. Credit scores are typically updated in the last month of the quarter and are obtained from a nationally recognized consumer rating agency. The LTV ratios were based on the current loan balance and either the lesser of the purchase price or original appraisal, or the most recent bank appraisal or BPO. In most cases, the most recent appraisal was obtained at the time of origination.

	March 31, 2012			
	Balance	Credit Score	LTV	Average Balance
	(Dollars in thousands)			
Originated	\$ 4,034,400	763	65 %	\$ 124
Correspondent purchases	469,584	760	64	291
Bulk purchases	506,092	740	58	253
	\$ 5,010,076	761	64 %	\$ 139

  

	September 30, 2011			
	Balance	Credit Score	LTV	Average Balance
	(Dollars in thousands)			
Originated	\$ 3,986,957	763	66 %	\$ 123
Correspondent purchases	396,063	759	64	290
Bulk purchases	535,758	740	60	252
	\$ 4,918,778	760	65 %	\$ 137

The following table presents the weighted average life (“WAL”), which reflects prepayment assumptions, of our one- to four-family loan portfolio, excluding construction loans and loans 90 or more days delinquent, as of March 31, 2012.

Original Term	Principal Balance	Average WAL (years)
	(Dollars in thousands)	
Fixed-Rate	\$ 4,155,805	4.58
Adjustable-Rate	829,344	3.41
	\$ 4,985,149	4.38
Weighted average rate	4.40	%
Average remaining contractual term (in years)	21	

The following table presents our fixed-rate one- to four-family loan portfolio, including construction loans and loans 90 or more days delinquent, and the annualized prepayment speeds for the quarter ended March 31, 2012 by interest rate tier. Loan endorsements and refinances are considered a prepayment and are included in the prepayment speeds presented below.

Rate Range	Original Term 15 years or less			More than 15 years				
	Principal Balance	Prepayment Speed (annualized)		Principal Balance	Prepayment Speed (annualized)			
		Including Endorsements	Excluding Endorsements		Including Endorsements	Excluding Endorsements		
	(Dollars in thousands)							
<=3.50%	\$ 238,918	2.04	% 2.04	%	\$ 202,978	1.72	% 1.72	%
3.51 - 3.99%	281,447	7.63	6.89		255,021	6.71	3.98	
4.00 - 4.50%	176,550	29.48	14.24		1,075,409	18.36	7.16	
4.51 - 4.99%	149,020	58.78	28.10		338,643	45.43	10.09	
5.00 - 5.50%	153,310	28.18	22.63		808,994	64.81	17.73	
5.51 - 5.99%	32,790	33.88	23.72		220,859	40.15	17.52	
>=6.00%	23,264	28.71	19.99		236,174	37.05	14.28	
	\$ 1,055,299	23.19	% 14.00	%	\$ 3,138,078	36.59	% 11.45	%

The following table summarizes the activity in the loan portfolio for the periods indicated, excluding changes in loans in process, deferred fees, and ACL. Loans that were paid-off as a result of refinances are included in repayments. Loan endorsements are not included in the activity in the following table because a new loan is not generated at the time of the endorsement. The endorsed balance and rate are, however, included in the ending loan portfolio balance and rate.

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

	For the Three Months Ended							
	March 31, 2012		December 31, 2011		September 30, 2011		June 30, 2011	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
	(Dollars in thousands)							
Beginning balance	\$ 5,282,485	4.53 %	\$ 5,195,876	4.69 %	\$ 5,211,991	4.79 %	\$ 5,144,050	4.81 %
Originations and refinances:								
Fixed	139,295	3.79	180,198	3.77	141,123	4.11	118,438	4.55
Adjustable	41,139	3.67	57,321	3.52	47,009	3.77	37,721	4.12
Purchases and Participations:								
Fixed	31,165	4.29	44,800	4.03	29,585	4.47	102,030	5.49
Adjustable	16,426	3.07	53,206	3.79	13,864	3.49	5,114	3.65
Repayments	(228,203)		(247,928)		(244,512)		(192,676)	
Principal charge-offs(1)	(4,546)		(7)		(95)		(6)	
Other (2)	(2,465)		(981)		(3,089)		(2,680)	
Ending balance	\$ 5,275,296	4.45 %	\$ 5,282,485	4.53 %	\$ 5,195,876	4.69 %	\$ 5,211,991	4.79 %

	For the Six Months Ended			
	March 31, 2012		March 31, 2011	
	Amount	Rate	Amount	Rate
	(Dollars in thousands)			
Beginning balance	\$ 5,195,876	4.69 %	\$ 5,209,313	5.07 %
Originations and refinances:				
Fixed	319,493	3.78	398,523	4.18
Adjustable	98,460	3.58	94,431	3.92
Purchases and Participations:				
Fixed	75,965	4.14	21,445	4.45
Adjustable	69,632	3.62	9,933	3.72
Repayments	(476,131)		(581,932)	
Principal charge-offs(1)	(4,553)		(86)	
Other (2)	(3,446)		(7,577)	
Ending balance	\$ 5,275,296	4.45 %	\$ 5,144,050	4.81 %

(1) Principal charge-offs represent potential loss amounts that reduce the unpaid principal balance of a loan.

(2) "Other" consists of transfers to REO, endorsement fees advanced, and reductions in commitments.

The Bank generally prices its first mortgage loan products based on secondary market and competitor pricing. During the six months ended March 31, 2012, the average rate offered on the Bank's 30-year fixed-rate one- to four-family

loans, with no points paid by the borrower, was approximately 210 basis points above the average 10-year Treasury rate, while the average rate offered on the Bank's 15-year fixed-rate one- to four-family loans was approximately 130 basis points above the average 10-year Treasury rate.

40

The following table presents loan origination, refinance and purchase activity for the periods indicated. Loan originations, purchases and refinances are reported together. The fixed-rate one- to four-family loans less than or equal to 15 years have a maturity at origination of less than or equal to 15 years, while fixed-rate one- to four-family loans greater than 15 years have a maturity at origination of greater than 15 years. The adjustable-rate one- to four-family loans less than or equal to 36 months have a term to first reset of less than or equal to 36 months at origination and adjustable-rate one- to four-family loans greater than 36 months have a term to first reset of greater than 36 months at origination. Of the \$162.9 million of one- to four-family loan originations and refinances for the three months ended March 31, 2012, 84% had loan values of \$417 thousand or less. Of the \$47.6 million of one- to four-family correspondent and bulk loan purchases for the three months ended March 31, 2012, 18% had loan values of \$417 thousand or less.

	For the Three Months Ended					
	March 31, 2012			March 31, 2011		
	Amount	Rate	% of Total	Amount	Rate	% of Total
	(Dollars in thousands)					
<b>Fixed-Rate:</b>						
<b>One- to four-family:</b>						
<= 15 years	\$ 58,990	3.41	% 25.9	\$ 62,372	3.96	% 28.5
> 15 years	110,785	4.11	48.6	106,243	4.54	48.5
Multi-family and commercial real estate	--	--	--	--	--	--
Home equity	400	7.44	0.2	866	6.83	0.4
Other	285	8.33	0.1	259	8.39	0.1
<b>Total fixed-rate</b>	<b>170,460</b>	<b>3.88</b>	<b>74.8</b>	<b>169,740</b>	<b>4.35</b>	<b>77.5</b>
<b>Adjustable-Rate:</b>						
<b>One- to four-family:</b>						
<= 36 months	2,355	2.54	1.0	2,816	3.22	1.3
> 36 months	38,347	2.98	16.8	31,985	3.51	14.6
Multi-family and commercial real estate	--	--	--	--	--	--
Home equity	16,127	4.89	7.1	14,327	4.80	6.5
Other	736	3.39	0.3	285	3.81	0.1
<b>Total adjustable-rate</b>	<b>57,565</b>	<b>3.50</b>	<b>25.2</b>	<b>49,413</b>	<b>3.87</b>	<b>22.5</b>
<b>Total originations, refinances and purchases</b>	<b>\$ 228,025</b>	<b>3.79</b>	<b>% 100.0</b>	<b>\$ 219,153</b>	<b>4.24</b>	<b>% 100.0</b>
<b>Purchased and participation loans included above:</b>						
<b>Fixed-Rate:</b>						
Correspondent - one- to four-family	\$ 31,165	4.29	%	\$ 16,468	4.47	%

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Bulk - one- to four-family	--	--	--	--
Participations - commercial real estate	--	--	--	--
Participations - other	--	--	--	--
Total fixed-rate purchases/participations	31,165	4.29	16,468	4.47
Adjustable-Rate:				
Correspondent - one- to four-family	16,426	3.07	5,979	3.57
Bulk - one- to four-family	--	--	--	--
Participations - commercial real estate	--	--	--	--
Participations - other	--	--	--	--
Total adjustable-rate purchases/participations	16,426	3.07	5,979	3.57
Total purchased/participation loans	\$ 47,591	3.87 %	\$ 22,447	4.23 %

41

	For the Six Months Ended March 31, 2012			March 31, 2011		
	Amount	Rate	% of Total	Amount	Rate	% of Total
Fixed-Rate:						
One- to four-family:						
<= 15 years	\$ 172,106	3.43	% 30.6 %	\$ 168,323	3.83	% 32.1 %
> 15 years	221,616	4.15	39.3	248,776	4.41	47.4
Multi-family and commercial real estate	--	--	--	892	6.00	0.2
Home equity	1,007	7.18	0.2	1,451	6.85	0.3
Other	729	7.44	0.1	526	8.32	0.1
Total fixed-rate	395,458	3.85	70.2	419,968	4.19	80.1
Adjustable-Rate:						
One- to four-family:						
<= 36 months	5,114	2.55	0.9	4,119	3.14	0.8
> 36 months	113,964	3.11	20.2	66,788	3.51	12.7
Multi-family and commercial real estate	13,975	5.00	2.5	--	--	--
Home equity	33,463	4.86	5.9	32,608	4.80	6.2
Other	1,576	3.33	0.3	849	4.08	0.2
Total adjustable-rate	168,092	3.60	29.8	104,364	3.90	19.9
Total originations, refinances and purchases	\$ 563,550	3.77 %	100.0 %	\$ 524,332	4.13 %	100.0 %
Purchased and participation loans included above:						
Fixed-Rate:						
Correspondent - one- to four-family	\$ 75,440	4.14 %		\$ 21,445	4.45 %	
Bulk - one- to four-family	392	3.25		--	--	
Participations - commercial real estate	--	--		--	--	

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Participations - other	133	2.57	--	--
Total fixed-rate purchases/participations	75,965	4.14	21,445	4.45
Adjustable-Rate:				
Correspondent - one- to four-family	35,789	3.12	9,933	3.72
Bulk - one- to four-family	19,868	3.55	--	--
Participations - commercial real estate	13,975	5.00	--	--
Participations - other	--	--	--	--
Total adjustable-rate purchases/participations	69,632	3.62	9,933	3.72
Total purchased/participation loans	\$ 145,597	3.89 %	\$ 31,378	4.22 %

42

---

The following table presents the origination and purchase activity in our one- to four-family loan portfolio for the three and six months ended March 31, 2012, excluding endorsement activity, and the LTV and credit score at the time of origination.

	For the Three Months Ended March 31, 2012			For the Six Months Ended March 31, 2012		
	Amount	LTV	Credit Score	Amount	LTV	Credit Score
	(Dollars in thousands)					
Originations	\$ 89,822	75	% 761	\$ 215,014	74	% 763
Refinances by Bank customers	73,064	68	774	166,297	67	774
Correspondent purchases	47,591	68	764	111,229	67	768
Bulk purchases	--	--	--	20,260	60	763
	\$ 210,477	71	% 766	\$ 512,800	70	% 768

The following table summarizes our one- to four-family loan commitments for originations, refinances, and purchases at the dates noted. Commitments to originate and refinance one- to four-family loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a rate lock fee. Some of the commitments are expected to expire without being fully drawn upon; therefore, the amount of total commitments disclosed below does not necessarily represent future cash requirements.

	December		
	March 31, 2012	31, 2011	March 31, 2011
	(Dollars in thousands)		
Originate/refinance fixed-rate	\$ 79,776	\$ 79,627	\$ 61,985
Originate/refinance adjustable-rate	13,824	18,253	10,476
Purchase/participate fixed-rate	30,327	27,232	6,201
Purchase/participate adjustable-rate	15,931	19,070	7,791
	\$ 139,858	\$ 144,182	\$ 86,453

43

---

#### Asset Quality – Loans and REO

The Bank's traditional underwriting guidelines have provided the Bank with generally low delinquencies and low levels of non-performing assets compared to national levels. Of particular importance is the complete and full documentation required for each loan the Bank originates and purchases. This allows the Bank to make an informed credit decision based upon a thorough assessment of the borrower's ability to repay the loan compared to underwriting methodologies that do not require full documentation. See additional discussion regarding underwriting standards in "Lending Practices and Underwriting Standards" in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2011. In the following asset quality discussion, correspondent purchased loans are included with originated loans and bulk purchased loans are reported as purchased loans.

#### Delinquent and non-performing loans and REO

The following tables present the Company's 30 to 89 day delinquent loans, non-performing loans, and REO at the dates indicated. Non-performing loans are nonaccrual loans that are 90 or more days delinquent, are in the process of foreclosure or TDRs that were either nonaccrual or did not receive a credit evaluation prior to the restructuring and have not made six consecutive monthly payments per the restructured loan terms. At all dates presented, there were no loans 90 or more days delinquent that were still accruing interest. TDR's 30 to 89 days delinquent totaled \$1.6 million and TDR's 90 or more days delinquent totaled \$3.3 million at March 31, 2012. REO primarily includes assets acquired in settlement of loans. Non-performing assets include non-performing loans and REO.

#### Loans Delinquent for 30 to 89 Days at:

March 31, 2012		December 31, 2011		September 30, 2011		March 31, 2011	
Number	Amount	Number	Amount	Number	Amount	Number	Amount

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Loans 30 to 89 Days (Dollars in thousands)

Delinquent:

One- to four-family:

Originated	122	\$ 13,434	169	\$ 18,165	178	\$ 19,710	141	\$ 16,797
Purchased	38	7,343	40	6,799	34	6,199	30	5,600
Multi-family and commercial	--	--	--	--	--	--	--	--
Construction	--	--	--	--	--	--	--	--
Consumer Loans:								
Home equity	33	616	38	518	43	759	35	456
Other	20	342	12	225	14	92	12	180
	213	\$ 21,735	259	\$ 25,707	269	\$ 26,760	218	\$ 23,033

30 to 89 days  
delinquent loans  
to total loans  
receivable, net

0.42 % 0.49 % 0.52 % 0.45 %

44

Non-Performing Loans and REO at:

March 31, 2012		December 31, 2011		September 30, 2011		March 31, 2011	
Number	Amount	Number	Amount	Number	Amount	Number	Amount
(Dollars in thousands)							

Loans 90 or More

Days Delinquent:

One- to four-family:

Originated	103	\$ 12,442	110	\$ 13,814	106	\$ 12,375	126	\$ 13,899
Purchased	49	12,485	50	14,106	46	13,749	49	15,131
Consumer Loans:					--	--		
Home equity	14	327	26	520	21	380	22	428
Other	4	10	5	8	3	3	8	59
	170	25,264	191	28,448	176	26,507	205	29,517

Nonaccrual TDRs

Less than

90DaysDelinquent:

(1)

One- to four-family:

Originated	31	4,771	--	--	--	--	--	--
Purchased	1	324	--	--	--	--	--	--
Consumer	1	10	--	--	--	--	--	--
	33	5,105	--	--	--	--	--	--



Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Total non-performing loans	203	30,369	191	28,448	176	26,507	205	29,517	
Non-performing loans as a percentage of total loans		0.58	%	0.54	%	0.51	%	0.58	%
REO:									
One- to four-family:									
Originated (2)	76	7,425	77	6,630	74	6,942	73	7,161	
Purchased	11	2,851	11	3,040	12	2,877	19	4,176	
Consumer Loans:									
Home equity	2	21	2	17	--	--	--	--	
Other	--	--	--	--	--	--	--	--	
Other (3)	1	1,502	1	1,502	1	1,502	--	--	
	90	11,799	91	11,189	87	11,321	92	11,337	
Total non-performing assets	293	\$ 42,168	282	\$ 39,637	263	\$ 37,828	297	\$ 40,854	
Non-performing assets as a percentage of total assets		0.44	%	0.42	%	0.40	%	0.42	%

(1) Included in the nonaccrual amount at March 31, 2012 are \$635 thousand of TDRs that are also reported in the 30-89 days delinquent category, and \$4.5 million that are currently performing in accordance with the restructured terms.

(2) Real estate related consumer loans where we also hold the first mortgage are included in the one- to four-family category as the underlying collateral is one- to four-family property.

(3) The \$1.5 million property classified as Other REO represents a single property the Bank purchased for a potential branch site but now intends to sell.

45

Of the \$12.5 million of purchased loans 90 or more days delinquent, \$11.2 million, or 90%, were originated in calendar year 2004 or 2005. Of the \$12.4 million of originated loans 90 or more days delinquent, \$10.3 million, or 83%, were originated in calendar year 2007 or earlier.

The following table presents the top 12 states where the properties securing our one- to four-family loans are located and the corresponding balance of 30 to 89 day delinquent loans, 90 or more day delinquent loans and the corresponding weighted average LTV ratios at March 31, 2012. The LTV ratios were based on the unpaid principal balance, less charge-offs, and either the lesser of the purchase price or original appraisal or the most recent bank appraisal or BPO, if available. At March 31, 2012, losses expected to be realized, after taking into consideration potential PMI proceeds and the costs to sell the property, have been charged-off.

State	Loans 30 to 89						Loans 90 or More Days			
	One- to Four-Family		Days Delinquent		Delinquent		Average			
	Balance	% of Total	Balance	% of Total	Balance	% of Total	LTV			
	(Dollars in thousands)									
Kansas	\$ 3,703,137	73.9 %	\$ 10,328	49.7 %	\$ 10,433	41.9 %	84	%		
Missouri	792,355	15.8	3,106	14.9	2,472	9.9	77			
Nebraska	55,015	1.1	770	3.7	--	--	n/a			
Illinois	46,609	0.9	168	0.8	1,477	5.9	80			
Florida	32,285	0.7	458	2.2	2,797	11.2	76			
Texas	31,730	0.6	870	4.2	--	--	n/a			
New York	28,498	0.6	198	1.0	949	3.8	89			
Minnesota	26,978	0.5	368	1.8	748	3.0	79			
Colorado	24,214	0.5	182	0.9	523	2.1	91			
Arizona	21,676	0.4	68	0.3	977	3.9	90			
Connecticut	20,877	0.4	--	--	--	--	n/a			
Virginia	19,420	0.4	--	--	927	3.7	83			
Other states	207,282	4.2	4,261	20.5	3,624	14.6	81			
	\$ 5,010,076	100.0 %	\$ 20,777	100.0 %	\$ 24,927	100.0 %	82	%		

### Troubled Debt Restructurings

A TDR is a situation in which the Bank may grant a concession to a borrower experiencing financial difficulties. Generally, the Bank grants a short-term payment accommodation to borrowers who are experiencing a temporary cash flow problem. The most frequently used accommodation is to reduce the monthly payment amount for a period of six to 12 months, often by only requiring payments of interest and escrow during this period. These restructurings result in an extension of the maturity date of the loan. For more severe situations requiring long-term solutions, the Bank also offers interest rate reductions to currently-offered rates and more lengthy extensions of the maturity date. The Bank does not forgive principal or interest nor does it commit to lend additional funds to debtors whose terms have been modified in TDRs.

At March 31, 2012 and September 30, 2011, the Bank had TDRs with principal balances of \$65.8 million and \$50.5 million, respectively. The \$15.3 million increase was due primarily to restructuring loans to current market interest rates through the Bank's loan endorsement program. The endorsed loans classified as TDRs represent loans where there has been a decrease in soft credit scores and/or estimated LTV ratios since the time the loan was originated. As a result of these decreases, the borrower could be experiencing financial difficulties even though they have not been delinquent in the previous 12 months on their existing loan payments. For additional information regarding our TDRs, see "Note 4 – Loans Receivable and Allowance for Credit Losses." Of the \$65.8 million of TDRs at March 31, 2012, \$59.7 million were one- to four-family originated loans and \$5.1 million were one- to four-family purchased

loans. At March 31, 2012, \$1.6 million of TDRs were 30 to 89 days delinquent and \$3.3 million were more than 90 days delinquent.

46

---

#### Allowance for credit losses and provision for credit losses

Management maintains an ACL to absorb inherent losses in the loan portfolio based on ongoing quarterly assessments of the loan portfolio. Our ACL methodology considers a number of factors including: the trend and composition of our delinquent and non-performing loans, results of foreclosed property and short sale transactions, the status and trends of the local and national economies, the trends and current conditions of the residential real estate markets, and loan portfolio growth and concentrations. Our local market areas did not experience significant fluctuations in home values over the past 10 years as did other areas of the U.S., which is reflected in our charge-off experience for originated loans as compared to purchased loans.

The ACL is maintained through provisions for credit losses which are charged to income. The provision for credit losses is established after considering the results of management's quarterly assessment of the ACL. For the six months ended March 31, 2012, the Company recorded a provision for credit losses of \$2.0 million, which was a result of charge-offs, primarily on bulk purchased loans, the increase in and/or establishment of allowance for credit losses on new delinquent and classified loans and adjustments to the formula allowance model in the first quarter of the current fiscal year.

At March 31, 2012, our ACL was \$12.6 million, or 0.24% of the total loan portfolio and 41.35% of total non-performing loans. This compares with an ACL of \$15.5 million, or 0.30% of the total loan portfolio and 58.3% of total non-performing loans as of September 30, 2011. Our ACL balance decreased from September 30, 2011 due to the implementation of a loan charge-off policy change during the second quarter of fiscal year 2012 as OCC Call Report requirements do not permit the use of SVAs, which the Bank was previously utilizing for potential loan losses, as permitted by our previous regulator. As a result of the implementation of the charge-off policy change, \$3.5 million of SVAs were charged-off during the current quarter. These charge-offs did not impact the provision for credit losses, and therefore had no additional income statement impact, as the amounts were expensed in previous periods.

See Item 2 - "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" and "Note 1 - Summary of Significant Accounting Policies" for a full discussion of our ACL methodology. For additional information regarding our ACL activity, see "Note 4 - Loans Receivable and Allowance for Credit Losses."

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

The following table presents the Company's allocation of the ACL to each respective loan category at March 31, 2012 and September 30, 2011. At March 31, 2012 and September 30, 2011, our ratio of ACL to non-performing loans was 41.4% and 58.3%, respectively, and our ratio of ACL to loans receivable, net was 0.24% and 0.30%, respectively.

	At March 31, 2012				At September 30, 2011			
	Amount of ACL (Dollars in thousands)	% of Total ACL	Total Loans	% of Loans to Total Loans	Amount of ACL	% of Total ACL	Total Loans	% of Loans to Total Loans
One- to four-family:								
Originated	\$ 4,772	38.0 %	\$ 4,503,984	85.4 %	\$ 4,898	31.7 %	\$ 4,383,020	84.4 %
Purchased	7,492	59.6	506,092	9.6	9,899	64.0	535,758	10.3
Multi-family			52,421		254		57,965	
Commercial	82	0.7		1.0		1.6		1.1
Construction	20	0.2	52,390	1.0	19	0.1	47,368	0.9
Consumer:								
Home equity	156	1.2	153,345	2.9	354	2.3	164,541	3.2
Other			7,064		41		7,224	
Consumer	37	0.3		0.1		0.3		0.1
	\$ 12,559	100.0 %	\$ 5,275,296	100.0 %	\$ 15,465	100.0 %	\$ 5,195,876	100.0 %

Securities. The following table presents the distribution of our MBS and investment securities portfolios, at amortized cost, at the dates indicated. Overall, fixed-rate securities comprised 77% of these portfolios at March 31, 2012. The WAL is the estimated remaining maturity (in years) after projected prepayment speeds and projected call option assumptions have been applied. The increase in the WAL between September 30, 2011 and March 31, 2012 was due to the maturity and call of short-term investment securities that were reinvested into longer-term MBS and investment securities. The WAL decreased on fixed-rate MBS due primarily to the purchase of MBS with WALs shorter than the existing portfolio. The decrease in the yield between September 30, 2011 and March 31, 2012 was primarily a result of the purchase of MBS at market rates which resulted in average yields lower than that of the existing portfolios, repayments of MBS with yields higher than that of the remaining portfolio, and adjustable-rate MBS resetting to lower coupons due to a decline in related indices. Yields on tax-exempt securities are not calculated on a taxable equivalent basis.

	March 31, 2012			September 30, 2011			March 31, 2011		
	Balance	Yield	WAL	Balance	Yield	WAL	Balance	Yield	WAL
	(Dollars in thousands)								
Fixed-rate securities:									
MBS	\$ 1,696,435	2.97	% 3.76	\$ 1,476,660	3.51	% 4.23	\$ 1,370,970	3.71	% 3.95
GSE debentures	1,196,408	1.14	1.36	1,380,028	1.09	0.86	1,781,628	1.11	1.45
Municipal bonds	53,421	3.02	2.07	59,622	3.02	2.29	63,321	2.96	2.70
Total fixed-rate securities	2,946,264	2.23	2.75	2,916,310	2.36	2.59	3,215,919	2.25	2.54
Adjustable-rate securities:									
MBS	891,297	2.79	7.66	893,655	2.85	7.07	941,279	3.05	5.18
Trust preferred securities	2,954	1.73	25.23	3,681	1.60	25.73	3,708	1.57	26.23
Total adjustable-rate securities	894,251	2.79	7.72	897,336	2.85	7.17	944,987	3.04	5.26
Total securities portfolio, at amortized cost	\$ 3,840,515	2.36	% 3.91	\$ 3,813,646	2.47	% 3.67	\$ 4,160,906	2.43	% 3.16

At March 31, 2012, Capitol Federal Financial, Inc., at the holding company level, had \$181.0 million in investment securities with a yield of 0.58% and a WAL of 0.39 years. All of the securities are classified as AFS. The securities have laddered maturities in order to provide cash flows that can be used to pay dividends, repurchase stock, reinvest into higher yielding assets if interest rates rise, or pursue other corporate strategies, as deemed appropriate. The yields on these securities are less than the yields on the Bank's current investment portfolio due to the short-term nature of the securities.

Mortgage-Backed Securities. The balance of MBS, which primarily consists of securities of U.S. GSEs, increased \$214.5 million from \$2.41 billion at September 30, 2011 to \$2.63 billion at March 31, 2012. The increase in MBS during the first six months of fiscal year 2012 was due to purchases funded, primarily, with cash flows from the investment securities portfolio and growth in deposits. The following table provides a summary of the activity in our portfolio of MBS for the periods presented. The yields and WAL for purchases are presented as recorded at the time of purchase. The yields for the beginning balances are as of the last day of the period previous to the period presented and the yield for the ending balances are as of the last day of the period presented and are generally derived from recent prepayment activity on the securities in the portfolio as of the dates presented. The yield of the MBS portfolio decreased from September 30, 2011 to March 31, 2012 as a result of purchases of securities with yields lower than the existing portfolio, the maturity and repayment of securities with higher yields than the overall portfolio, and adjustable-rate MBS resetting to lower coupons due to a decline in related indices, which are generally based upon short-term interest rates. The beginning and ending WAL is the estimated remaining maturity (in years) after projected prepayment speeds have been applied. The decrease in the WAL at March 31, 2012 compared to September 30, 2011 was due to the purchase of MBS with WALs shorter than the existing portfolio.

	For the Three Months Ended			December 31, 2011			September 30, 2011			June 30, 2011		
	March 31, 2012			Amount	Yield	WAL	Amount	Yield	WAL	Amount	Yield	
	(Dollars in thousands)											
Beginning balance -	\$ 2,405,685	3.10	% 5.03	\$ 2,412,076	3.26	% 5.31	\$ 2,342,545	3.41	% 5.09	\$ 2,355,899	3.44	%
Change in value												
Amortizations and	(142,937)			(152,322)			(130,137)			(105,142)		
Amortization of												
Premiums/(discounts)	(1,550)			(1,507)			(1,168)			(781)		
Other changes:												
Change in value	313,481	1.86	4.53	126,498	2.12	4.18	157,720	2.65	4.05	92,010	2.88	
Change in valuation	52,867	1.69	6.29	22,887	2.20	4.50	45,564	2.12	6.24	--	--	
Change in MBS securities	(1,002)			(1,947)			(2,448)			559		
Ending balance -	\$ 2,626,544	2.91	% 5.11	\$ 2,405,685	3.10	% 5.03	\$ 2,412,076	3.26	% 5.31	\$ 2,342,545	3.41	%
	For the Six Months Ended			March 31, 2011			March 31, 2011			March 31, 2011		
	March 31, 2012			Amount	Yield	WAL	Amount	Yield	WAL	Amount	Yield	WAL

(Dollars in thousands)

ing balance -						
g value	\$ 2,412,076	3.26	% 5.31	\$ 1,607,864	4.00	% 3.58
ties and						
ments	(295,259)			(244,860)		
ortization of						
ms/(discounts)	(3,057)			(1,321)		
ses:						
	439,979	1.93	4.43	670,048	2.92	4.41
able	75,754	1.84	5.75	332,393	2.54	4.99
e in valuation						
S securities	(2,949)			(8,225)		
g balance -						
g value	\$ 2,626,544	2.91	% 5.11	\$ 2,355,899	3.44	% 4.45

49

The following table presents our fixed-rate MBS portfolio, at amortized cost, based on the underlying weighted average loan rate, the annualized prepayment speeds for the quarter ended March 31, 2012, and the net premium/discount by interest rate tier. Our fixed-rate MBS portfolio is somewhat less sensitive than our fixed-rate one- to four-family loan portfolio to repricing risk due to external refinancing barriers such as unemployment, income changes, and decreases in property values, which are generally more pronounced outside of our local market areas. However, we are unable to control the interest rates and/or governmental programs that could impact the loans in our fixed-rate MBS portfolio, and are therefore more likely to experience reinvestment risk due to principal prepayments. Additionally, prepayments impact the amortization/accretion of premiums/discounts on our MBS portfolio. As prepayments increase, the related premiums/discounts are amortized/accreted at a faster rate. The amortization of premiums decreases interest income while the accretion of discounts increases interest income. As noted in the table below, the fixed-rate MBS portfolio had a net premium of \$16.1 million as of March 31, 2012. Given that the weighted average coupon on the underlying loans in this portfolio are above current market rates, the Bank could experience an increase in the premium amortization should prepayment speeds increase significantly, potentially reducing future interest income.

Rate Range	Original Term 15 years or less		More than 15 years		Total	Net Premium/ (Discount)
	Amortized Cost	Prepayment Speed (annualized)	Amortized Cost	Prepayment Speed (annualized)		
< =3.50%	\$ 396,457	4.79 %	\$ --	-- %	\$ 396,457	\$ 7,809
3.51 - 3.99%	617,187	13.37	49,015	8.22	666,202	5,010
4.00 - 4.50%	158,534	22.94	47,841	8.19	206,375	3,458
4.51 - 4.99%	176,611	24.18	5,568	7.86	182,179	(309)





ing balance -							
g value	\$ 1,444,480	1.17	% 1.00	\$ 1,332,656	1.47	% 0.84	
ies and calls	(753,297)			(544,421)			
ortization of							
ms/(discounts)	(1,221)			(2,054)			
ses:							
	563,970	1.14	2.81	1,061,825	1.05	1.37	
e in valuation							
securities	5			(91)			
balance -							
g value	\$ 1,253,937	1.22	% 1.46	\$ 1,847,915	1.17	% 1.55	

51

---

Liabilities. Total liabilities increased \$149.4 million, from \$7.51 billion at September 30, 2011 to \$7.66 billion at March 31, 2012. The increase in total liabilities was due to a \$161.8 million increase in the deposit portfolio and a \$146.1 million increase in FHLB advances, partially offset by a \$150.0 million decrease in other borrowings. Each category within the deposit portfolio increased, led by the checking portfolio with a \$70.6 million increase followed by the money market portfolio with a \$45.8 million increase. During the first quarter of fiscal year 2012, a \$150.0 million repurchase agreement matured and was replaced with a \$150.0 million fixed-rate FHLB advance, which accounts for the majority of the balance changes in both portfolios during the year.

During the current quarter, the Bank prepaid a \$200.0 million fixed-rate FHLB advance with an interest rate of 3.88% and a remaining term to maturity of 15 months. The prepaid FHLB advance was replaced with a \$200.0 million fixed-rate FHLB advance, with a contractual interest rate of 0.86% and a term of 46 months. The Bank paid a \$7.9 million penalty to the FHLB as a result of prepaying the FHLB advance. The prepayment penalty was deferred and will be recognized in interest expense over the life of the new advance and thereby effectively increased the interest rate on the new advance 108 basis points, to 1.94%, at the time of the transaction.

Deposits – Deposits increased \$161.8 million between September 30, 2011 and March 31, 2012, due to growth in all categories, but primarily in the checking and money market portfolios. The checking portfolio increased \$70.6 million from \$551.6 million at September 30, 2011 to \$622.2 million at March 31, 2012. The increase in our checking portfolio was due to customers keeping more cash readily available, as reflected by a 13.1% increase in the average customer checking account balance between period ends. The money market portfolio increased \$45.8 million from \$1.07 billion at September 30, 2011 to \$1.11 billion at March 31, 2012. The increase in the money market portfolio was due to customers reinvesting funds from maturing certificates of deposit into the money market portfolio and some customers maintaining higher cash balances due to the current economic uncertainty and in anticipation of market rates increasing, which would provide flexibility to reinvest at higher rates, when available. If interest rates were to rise, it is possible our money market and checking account customers may move those funds to higher-yielding deposit products inside of the Bank or withdraw their funds to invest in higher yielding investments outside of the Bank.

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

The following table presents the amount, average rate and percentage of total deposits for checking, savings, money market and certificates at the periods presented.

March 31, 2012				December 31, 2011				September 30, 2011				March 31, 2011	
Amount	Average Rate	% of Total		Amount	Average Rate	% of Total		Amount	Average Rate	% of Total		Amount	Average Rate
(Dollars in thousands)													
\$ 622,216	0.08 %	13.4 %		\$ 574,854	0.08 %	12.8 %		\$ 551,632	0.08 %	12.3 %		\$ 541,061	0.08 %
264,586	0.15	5.7		252,223	0.15	5.6		253,184	0.41	5.6		250,296	0.52
1,111,898	0.30	23.9		1,090,510	0.35	24.2		1,066,065	0.35	23.7		1,038,706	0.54
1,697,959	1.64	36.4		1,702,129	1.75	37.8		1,741,485	1.91	38.8		1,812,407	2.14
960,351	1.49	20.6		881,428	1.65	19.6		882,807	1.80	19.6		1,068,719	1.66
\$ 4,657,010	1.00 %	100.0 %		\$ 4,501,144	1.09 %	100.0 %		\$ 4,495,173	1.21 %	100.0 %		\$ 4,711,189	1.36 %

At March 31, 2012, \$83.7 million in certificates were brokered deposits, unchanged from September 30, 2011. The \$83.7 million of brokered deposits at March 31, 2012 had a weighted average rate of 2.58% and a remaining term to maturity of 2.4 years. The Bank monitors the cost of brokered deposits and considers them as a potential source of funding, provided that investment opportunities are balanced with the funding cost. As of March 31, 2012, \$184.3 million in certificates were public unit deposits, compared to \$106.4 million in public unit deposits at September 30, 2011. The \$184.3 million of public unit deposits at March 31, 2012 had a weighted average rate of 0.25% and a remaining term to maturity of six months. Management will continue to monitor the wholesale deposit market for attractive opportunities relative to the use of proceeds for investments.

52

---

The following tables set forth maturity information for our certificate of deposit portfolio at March 31, 2012.

	Amount Due					Total
	1 year or less	More than 1 year to 2 years	More than 2 to 3 years	More than 3 years		
	(Dollars in thousands)					
0.00 – 0.99%	\$ 559,214	\$ 177,739	\$ 11,970	\$ 5,000	\$ 753,923	
1.00 – 1.99%	492,905	116,870	204,873	169,693	984,341	
2.00 – 2.99%	79,957	206,682	215,524	217,764	719,927	
3.00 – 3.99%	117,487	42,891	13,841	7,775	181,994	
4.00 – 4.99%	16,913	638	285	289	18,125	
	\$ 1,266,476	\$ 544,820	\$ 446,493	\$ 400,521	\$ 2,658,310	
Weighted average rate	1.19	% 1.75	% 1.97	% 2.20	% 1.59	
Weighted average maturity (in years)	0.44	1.42	2.53	3.69	1.49	
Weighted average maturity for the retail certificate of deposit portfolio (in years)					1.53	

	Maturity				Total
	3 months or less	Over 3 to 6 months	Over 6 to 12 months	Over 12 months	
	(Dollars in thousands)				
Retail certificates of deposit less than \$100,000	\$ 229,499	\$ 214,527	\$ 369,056	\$ 884,877	\$ 1,697,959
Retail certificates of deposit of \$100,000 or more	75,259	89,774	130,216	397,139	692,388
Public units/brokered deposits	108,000	26,071	24,074	109,818	267,963
Total certificates of deposit	\$ 412,758	\$ 330,372	\$ 523,346	\$ 1,391,834	\$ 2,658,310

53

Borrowings –The following table presents FHLB advance and repurchase agreement activity for the periods presented. The weighted average maturity (“WAM”) is the remaining weighted average contractual term in months. The effective rate includes the net impact of the amortization of deferred prepayment penalties resulting from the prepayment of certain FHLB advances and deferred gains related to the termination of interest rate swaps. Rates on new borrowings are fixed-rate.

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

	For the Three Months Ended March 31, 2012				December 31, 2011				September 30,	
	Amount	Contractual Rate	Effective Rate	WAM	Amount	Contractual Rate	Effective Rate	WAM	Amount	R
Beginning principal balance	\$ 2,915,000	3.19	% 3.47	% 36.10	\$ 2,915,000	3.48	% 3.76	% 36.02	\$ 3,041,000	3.
Maturities and prepayments										
FHLB advances	(350,000)	3.22	3.22		(100,000)	3.94	3.94		(76,000)	5.
Repurchase agreements	--	--	--		(150,000)	4.41	4.41		(50,000)	3.
New borrowings										
FHLB advances	350,000	0.76	1.37	39.77	250,000	0.84	0.84	35.23	--	--
Repurchase agreements	--	--	--	--	--	--	--	--	--	--
Ending principal balance	\$ 2,915,000	2.89	% 3.25	% 37.01	\$ 2,915,000	3.19	% 3.47	% 36.10	\$ 2,915,000	3.

	For the Six Months Ended March 31, 2012				2011			
	Amount	Contractual Rate	Effective Rate	WAM	Amount	Contractual Rate	Effective Rate	WAM
Beginning principal balance	\$ 2,915,000	3.48	% 3.76	% 36.02	\$ 2,991,000	3.70	% 3.98	% 35.93
Maturities and prepayments								
FHLB advances	(450,000)	3.38	3.38		(200,000)	4.71	4.71	
Repurchase agreements	(150,000)	4.41	4.41		(125,000)	3.97	3.97	
New borrowings								
FHLB advances	600,000	0.79	1.15	37.88	200,000	2.83	2.83	82.09

Repurchase agreements	--	--	--	--	100,000	3.35	3.35	83.70
Ending principal balance	\$ 2,915,000	2.89	% 3.25	% 37.01	\$ 2,966,000	3.55	% 3.83	% 38.60

54

The following table presents the maturity of FHLB advances, at par, and repurchase agreements as of March 31, 2012. The balance of FHLB advances excludes the deferred gain on the terminated interest rate swaps and the deferred prepayment penalty. Management will continue to monitor the Bank's investment opportunities and balance those opportunities with the cost of FHLB advances or other funding sources.

Maturity by Fiscal year	FHLB Advances Amount	Repurchase Agreements Amount	Weighted Average Contractual Rate	Weighted Average Effective Rate(1)	
(Dollars in thousands)					
2012	\$ 100,000	\$ --	4.27	% 4.27	%
2013	325,000	145,000	3.68	4.06	
2014	450,000	100,000	3.33	3.96	
2015	600,000	20,000	1.73	1.97	
2016	475,000	--	2.60	3.35	
2017	400,000	--	3.17	3.21	
2018	200,000	100,000	2.90	2.90	
	\$ 2,550,000	\$ 365,000	2.89	% 3.25	%

Weighted average maturity (in years) 3.08

(1) The effective rate includes the net impact of the amortization of deferred prepayment penalties resulting from the prepayment of certain FHLB advances and deferred gains related to the termination of interest rate swaps.

The following table presents the maturity of FHLB advances and repurchase agreements for the next four quarters as of March 31, 2012.

Maturity by Quarter End	Amount (Dollars in thousands)	Weighted Average Contractual Rate	
June 30, 2012	\$ --	--	%
September 30, 2012	100,000	4.27	
December 31, 2012	100,000	3.06	
March 31, 2013	50,000	3.48	
	\$ 250,000	3.63	%

55

---

Stockholders' Equity. Stockholders' equity decreased \$27.1 million, from \$1.94 billion at September 30, 2011 to \$1.91 billion at March 31, 2012. The decrease was due primarily to dividends paid of \$40.5 million and the repurchase of common stock of \$26.1 million, partially offset by net income of \$38.1 million.

The \$40.5 million of dividend payments consisted of quarterly dividends of \$24.3 million and a special dividend of \$16.2 million related to fiscal year 2011 earnings, per the Company's dividend policy. Dividend payments depend upon a number of factors including the Company's financial condition and results of operations, the Bank's regulatory capital requirements, regulatory limitations on the Bank's ability to make capital distributions to the Company, and the amount of cash at the holding company. On April 20, 2012, the Company declared a quarterly cash dividend of \$0.075 per share, which will equate to approximately \$11.9 million, payable on May 18, 2012.

On December 21, 2011, the Company announced that the Board of Directors authorized the repurchase of up to \$193.0 million of the Company's common stock. During the quarter ended March 31, 2012, 2,199,100 shares were repurchased at an average price of \$11.85 per share and retired. Subsequent to March 31, 2012, the Company repurchased 1,298,440 shares at an average price of \$11.77 per share, for a total of 3,497,540 shares at an average price of \$11.82.

At the annual meeting of stockholders on January 24, 2012, the proposal for the stock benefits plan was approved by our stockholders. It is expected that awards to be granted under the plan will primarily be restricted stock and stock option grants. While no timetable has been established for awards to be granted under the plan, it is likely the first grants will be made during the quarter ending June 30, 2012. In addition, it is likely that the size of the initial grants will be smaller and the vesting term shorter than those typically seen in a thrift conversion, in which case generally 100% of the equity shares are granted immediately and the vesting term is five years. The Stock Benefits Committee intends to make grants as an incentive to management and not solely as a reward for prior service.

The following table presents quarterly dividends paid in calendar years 2012, 2011, and 2010. For the quarter ended March 31, 2012, the table below does not present the actual dividend payout, but rather management's estimate of the dividend payout as of April 30, 2012.

	Calendar Year		
	2012	2011	2010
	(Dollars in thousands)		
Quarter ended March 31			
Total dividends paid	\$ 12,145	\$ 12,105	\$ 10,739
Quarter ended June 30			
Total dividends paid	11,883	12,105	10,496
Quarter ended September 30			
Total dividends paid		12,106	10,496
Quarter ended December 31			
Total dividends paid		12,145	10,597
Welcome dividend			
Total dividends paid		96,838	--
Special year end dividend			
Total dividends paid		16,193	6,359
Calendar year-to-date dividends paid	\$ 24,028	\$ 161,492	\$ 48,687

56

---

## Operating Results

The following table presents selected income statement and other information for the quarters indicated.

For the Three Months Ended				
March 31,	December 31,	September	June 30,	March 31,
2012	2011	2011	2011	2011
(Dollars in thousands, except per share data)				

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Interest and dividend income:															
Loans receivable	\$	59,785		\$	60,675		\$	62,019		\$	62,393		\$	61,554	
MBS		18,169			18,373			18,953			19,619			17,320	
Investment securities		4,115			4,637			4,456			5,103			4,743	
Other interest and dividend income		1,205			1,142			1,166			968			1,324	
Total interest and dividend income		83,274			84,827			86,594			88,083			84,941	
Interest expense:															
FHLB advances		20,443			22,339			22,660			22,539			21,968	
Deposits		11,835			12,787			14,602			15,516			16,069	
Other borrowings		3,530			4,327			5,467			5,720			6,348	
Total interest expense		35,808			39,453			42,729			43,775			44,385	
Provision for credit losses		1,500			540			1,650			1,240			520	
Net interest income (after provision for credit losses)		45,966			44,834			42,215			43,068			40,036	
Other income		6,172			6,152			6,434			6,100			6,144	
Other expenses		21,969			22,067			23,022			23,102			22,855	
Income tax expense		10,854			10,130			8,861			8,807			7,689	
Net income	\$	19,315		\$	18,789		\$	16,766		\$	17,259		\$	15,636	
Efficiency ratio		40.96	%		42.83	%		45.77	%		45.83	%		48.94	%
Basic earnings per share	\$	0.12		\$	0.12		\$	0.10		\$	0.10		\$	0.10	
Diluted earnings per share		0.12			0.12			0.10			0.10			0.10	

Comparison of Operating Results for the Six Months Ended March 31, 2012 and 2011

Net income for the six months ended March 31, 2012 was \$38.1 million, compared to \$4.4 million for the six months ended March 31, 2011. The \$33.7 million increase for the current year was due primarily to the \$40.0 million (\$26.0 million, net of income tax benefit) contribution to the Foundation in connection with the second step conversion and stock offering completed in December 2010 (the “corporate reorganization”). Additionally, net interest income increased \$12.2 million, or 15.2%, from \$80.6 million for the prior year six month period to \$92.8 million for the current year six month period. The increase in net interest income was due primarily to a decrease in interest expense of \$16.4 million, or 17.9%, partially offset by a decrease in interest income of \$4.1 million, or 2.4%.

Non-GAAP Presentation

The following table presents selected financial results and performance ratios for the Company for the six months ended March 31, 2012 and 2011. Because of the magnitude and non-recurring nature of the \$40.0 million contribution to the Foundation in connection with the corporate reorganization, management believes it is important for comparability purposes to present selected financial results and performance ratios excluding the contribution to



the Foundation. The adjusted financial results and ratios for the six months ended March 31, 2011 are not presented in accordance with GAAP.

57

	For the Six Months Ended									
	March 31, 2012		March 31, 2011		Actual (GAAP)		Contribution to Foundation		Adjusted (1) (Non-GAAP)	
	(Dollars in thousands, except per share data)									
Net income (loss)	\$	38,104	\$	4,378	\$	(26,000)	\$	30,378		
Operating expenses		44,036		86,193		40,000		46,193		
Basic earnings (loss) per share		0.24		0.03		(0.16)		0.19		
Diluted earnings (loss) per share		0.24		0.03		(0.16)		0.19		
Return on average assets (annualized)	0.81	%	0.09	%	(0.57)	%	0.66	%		
Return on average equity (annualized)	3.93		0.57		(3.36)		3.93			
Operating expense ratio	0.93		1.86		0.86		1.00			
Efficiency ratio	41.87	%	92.66	%	43.00	%	49.66	%		

(1) The adjusted financial results and ratios are not presented in accordance with GAAP as the amounts and ratios exclude the effect of the contribution to the Foundation, net of income tax benefit. The contribution to the Foundation of \$26.0 million takes into account the \$14.0 million of income tax benefit associated with the \$40.0 million contribution.

#### Interest and Dividend Income

Total interest and dividend income for the current six month period was \$168.1 million compared to \$172.2 million for the prior year six month period. The \$4.1 million, or 2.4%, decrease was primarily a result of a decrease in interest income on loans receivable of \$7.0 million, or 5.5%, partially offset by an increase in interest income on MBS of \$3.7 million, or 11.5%.

Interest income on loans receivable was \$120.5 million for the current six month period, compared to \$127.5 for the prior year six month period. The \$7.0 million, or 5.5%, decrease in interest income on loans receivable was the result of a 35 basis point decrease in the average yield to 4.62% for the current six month period, partially offset by an increase of \$79.8 million in the average balance of the portfolio. The decrease in the weighted average yield was due to a significant amount of loan endorsements and refinances, along with originations and purchases at rates which were lower than the rates on loan repayments.

Interest income on MBS was \$36.5 million for the current six month period, compared to \$32.8 million for the prior year six month period. The \$3.7 million increase in interest income on MBS was a result of a \$644.5 million increase in the average balance of the portfolio, partially offset by a decrease of 67 basis points in the weighted average yield to 3.03% for the current six month period. The increase in the average balance was a result of purchases funded primarily by the proceeds from the corporate reorganization and partially from cash flows from the investment security portfolio and growth in the deposit portfolio. The weighted average yield decreased between the two periods due to purchases of MBS at market rates which were at a lower average yield than the existing portfolio between the two periods, repayments on MBS with yields higher than the average yield of the remaining portfolio, and adjustable-rate securities repricing to lower market rates.

Interest income on investment securities was \$8.8 million for the current six month period, compared to \$9.5 million for the prior year six month period. The \$766 thousand decrease was due to a decrease in the average balance of \$168.6 million, partially offset by an increase in the weighted average yield of four basis points to 1.32% for the current six month period. The decrease in the average balance was due to calls and maturities not being replaced in their entirety, rather, the cash flows were used to fund MBS purchases and repurchase common stock. Investment securities that matured at the holding company level were not reinvested in this portfolio, but rather were used to repurchase common stock and retained in deposit accounts at the Bank.

#### Interest Expense

Interest expense decreased \$16.3 million, or 17.9%, to \$75.3 million for the current six month period, from \$91.6 million for the prior year period. The decrease in interest expense was due to a decrease in interest expense on deposits of \$8.8 million, or 26.4%, other borrowings of \$5.2 million, or 40.0%, and FHLB advances of \$2.3 million, or 5.1%.

Interest expense on deposits decreased \$8.8 million to \$24.6 million for the current six month period, from \$33.4 million for the prior year six month period due primarily to a 39 basis point decrease in the average rate paid on the certificate of deposit portfolio to 1.71% for the current six month period, and partially to a 24 basis point decrease in the money market portfolio to 0.34% for the

58

---

current six month period, as both portfolios continued to reprice to lower market rates. Additionally, interest expense on the certificate of deposit portfolio decreased due to a \$225.2 million decrease in the average balance of the portfolio. The decrease in the average balance was due largely to the maturity and payout of one retail certificate of deposit related to a legal settlement to which the Bank was not a party and partially to decreases in medium and short-term certificates, partially offset by an increase in long-term certificates, as management competitively priced our longer term certificates in order to lengthen the weighted average maturity of the retail certificate of deposit portfolio in this lower rate environment.

Interest expense on FHLB advances decreased \$2.3 million to \$42.8 million for the current six month period, from \$45.1 million for the prior year six month period due to a decrease of 41 basis points in the average rate paid, from 3.85% for the prior year six month period to 3.44% for the current six month period. The decrease in the average rate paid was due primarily to advances that were renewed/prepaid between the two period ends. The decrease in interest expense was partially offset by an increase of \$136.9 million in the average balance of FHLB advances as some maturing repurchase agreements were replaced with advances as the rates on the advances were more favorable than comparable repurchase agreements. Additionally, \$76.0 million of advances with a weighted average contractual rate of 5.31% matured and were not renewed.

Interest expense on other borrowings decreased \$5.2 million to \$7.9 million for the current six month period, from \$13.1 million for the prior year six month period due primarily to a \$266.0 million decrease in the average balance. Between periods, \$225.0 million of repurchase agreements matured, some of which were replaced with FHLB advances and \$50.0 million of which were not replaced. Additionally, the Junior Subordinated Deferrable Interest Debentures of \$53.6 million were repaid.

#### Net Interest Margin

The net interest margin, which is calculated as the difference between interest income and interest expense divided by average interest-earning assets, increased 24 basis points, to 2.02% for the current six month period, largely due to the decrease in interest expense on the certificate of deposit portfolio and other borrowings.

#### Provision for Credit Losses

The Bank recorded a provision for credit losses of \$1.2 million in the prior year six month period, compared to a provision for credit losses of \$2.0 million in the current six month period. The provision for credit loss amount in the current six month period was composed of the replenishment of ACL for \$1.0 million of charge-offs, primarily on bulk purchased loans, while the remaining \$1.0 million primarily related to the increase in and/or establishment of allowance for credit losses on new delinquent and classified loans and adjustments to the formula allowance model in the first quarter of the current fiscal year.

#### Other Income and Expense

Total other income decreased slightly between periods, at \$12.3 million for the current six month period compared to \$12.5 million for the prior year six month period.

Total other expenses for the current six month period were \$44.0 million, compared to \$86.2 million in the prior year six month period. The \$42.2 million, or 49.0%, decrease was due primarily to a \$40.0 million cash contribution to the Foundation in connection with the corporate reorganization in December 2010. Other expenses, net decreased \$1.8 million, or 22.6%, primarily due to an impairment and valuation allowance taken on the mortgage-servicing rights

asset in the prior year six month period and a decrease in expenses related to REO operations.

In February 2011, the Federal Deposit Insurance Corporation adopted a new assessment structure for insured institutions effective April 2011. One of the significant changes includes using average total Bank consolidated assets minus average tangible equity for the assessment base instead of average deposits and secured liabilities for the period. As a result of the change, the deposit insurance assessment is anticipated to decrease by approximately \$700 thousand for fiscal year 2012, as compared to fiscal year 2011.

#### Income Tax Expense

Income tax expense for the current six month period was \$21.0 million compared to \$1.3 million in the prior year six month period. The increase in income tax expense between the periods was primarily a result of the \$40.0 million contribution to the Foundation in the prior year six month period, which resulted in \$14.0 million of income tax benefit, along with overall higher pretax income. The effective tax rate for the current six month period was 35.5% compared to 22.6% in the prior year six month period. The difference in the effective tax rate between periods was due primarily to a \$686 thousand tax return to tax provision adjustment in the prior year six month period. Excluding that adjustment, the effective income tax rate would have been 34.8% for the prior year six month period.

59

#### Average Balance Sheet

The following table presents the average balances of our assets, liabilities and stockholders' equity and the related annualized yields and rates on our interest-earning assets and interest-bearing liabilities for the periods indicated and the weighted average yield/rate on our interest-earning assets and interest-bearing liabilities at March 31, 2012. Average yields are derived by dividing annualized income by the average balance of the related assets and average rates are derived by dividing annualized expense by the average balance of the related liabilities, for the periods shown. Average outstanding balances are derived from average daily balances. The yields and rates include amortization of fees, costs, premiums and discounts which are considered adjustments to yields/rates. Yields on tax-exempt securities were not calculated on a tax-equivalent basis.

	At March 31, 2012	For the Six Months Ended						
		March 31, 2012			March 31, 2011			
	Yield/ Rate	Average Outstanding Balance (Dollars in thousands)	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate	
Assets:								
Interest-earning assets:								
Loans receivable (1)	4.61%	\$ 5,214,027	\$ 120,460	4.62 %	\$ 5,134,193	\$ 127,497	4.97 %	

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

MBS (2)	2.91	2,415,850	36,542	3.03	1,771,375	32,760	3.70
Investment securities							
(2)(3)	1.22	1,323,899	8,752	1.32	1,492,469	9,518	1.28
Capital stock of							
FHLB	3.45	127,995	2,202	3.44	121,322	1,785	2.95
Cash and cash							
equivalents	0.25	117,751	145	0.25	509,407	628	0.25
Total interest-earning							
assets (1) (2)	3.61	9,199,522	168,101	3.65	9,028,766	172,188	3.81
Other							
noninterest-earning							
assets		234,260			237,487		
Total assets		\$ 9,433,782			\$ 9,266,253		

Liabilities and  
stockholders' equity:

Interest-bearing									
liabilities:									
Checking	0.08%	\$ 548,356	\$ 216	0.08	% \$ 501,810	\$ 219	0.09	%	
Savings	0.15	254,786	236	0.18	238,056	631	0.53		
Money market	0.30	1,085,811	1,852	0.34	993,382	2,858	0.58		
Certificates	1.59	2,608,987	22,318	1.71	2,834,225	29,742	2.10		
Total deposits	1.00	4,497,940	24,622	1.09	4,567,473	33,450	1.47		
FHLB advances (4)	3.17	2,486,771	42,782	3.44	2,349,838	45,099	3.85		
Repurchase									
agreements	3.83	399,699	7,857	3.87	612,115	12,250	3.96		
Other borrowings	--	--	--	--	53,609	828	3.05		
Total borrowings	3.25	2,886,470	50,639	3.50	3,015,562	58,177	3.86		
Total interest-bearing									
liabilities	1.86	7,384,410	75,261	2.03	7,583,035	91,627	2.42		
Other									
noninterest-bearing									
liabilities		111,361			135,540				
Stockholders' equity		1,938,011			1,547,678				
Total liabilities									
and stockholders' equity		\$ 9,433,782			\$ 9,266,253				

(Continued)

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

	Yield/ Rate	Average Outstanding Balance (Dollars in thousands)	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate
Net interest income (5)			\$ 92,840			\$ 80,561	
Net interest rate spread (6)	1.75%			1.62 %			1.39 %
Net interest-earning assets		\$ 1,815,112			\$ 1,445,731		
Net interest margin (7)				2.02			1.78
Ratio of interest-earning assets to interest-bearing liabilities				1.25			1.19
Selected performance ratios:							
Return on average assets (annualized)				0.81 %			0.09 %
Return on average equity (annualized)				3.93			0.57
Average equity to average assets				20.54			16.70
Operating expense ratio				0.93			1.86
Efficiency ratio				41.87			92.66

(Concluded)

(1) Calculated net of unearned loan fees and deferred costs, and undisbursed loan funds. Loans that are 90 or more days delinquent are included in the loans receivable average balance with a yield of zero percent. Balances include LHFS.

(2) MBS and investment securities classified as AFS are stated at amortized cost, adjusted for unamortized purchase premiums or discounts.

(3) The average balance of investment securities includes an average balance of nontaxable securities of \$57.4 million and \$66.5 million for the six month periods ended March 31, 2012 and 2011, respectively.

(4) FHLB advances are stated net of deferred gains and deferred prepayment penalties.

(5) Net interest income represents the difference between interest income earned on interest-earning assets, such as mortgage loans, investment securities, and MBS, and interest paid on interest-bearing liabilities, such as deposits, FHLB advances, and other borrowings. Net interest income depends on the balance of interest-earning assets and interest-bearing liabilities, and the interest rates earned or paid on them.

(6) Net interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(7) Net interest margin represents net interest income as a percentage of average interest-earning assets.

61

---

#### Rate/Volume Analysis

The table below presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities, comparing the six months ended March 31, 2012 to the six months ended March 31, 2011. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in volume, which are changes in the average balance multiplied by the previous year's average rate and (2) changes in rate, which are changes in the average rate multiplied by the average balance from the previous year. The net changes attributable to the combined impact of both rate and volume have been allocated proportionately to the changes due to volume and the changes due to rate.

	For the Six Months Ended March 31, 2012 vs. March 31, 2011 Increase (Decrease) Due to		
	Volume	Rate	Total
	(Dollars in thousands)		
<b>Interest-earning assets:</b>			
Loans receivable	\$ 1,930	\$ (8,967)	\$ (7,037)
MBS	10,449	(6,667)	3,782
Investment securities	(1,068)	302	(766)
Capital stock of FHLB	104	313	417
Cash and cash equivalents	(483)	--	(483)
Total interest-earning assets	10,932	(15,019)	(4,087)
<b>Interest-bearing liabilities:</b>			
Checking	20	(26)	(6)
Savings	42	(440)	(398)
Money market	249	(1,276)	(1,027)
Certificates	(2,217)	(5,180)	(7,397)
FHLB advances	2,270	(4,587)	(2,317)
Other borrowings	(4,949)	(272)	(5,221)
Total interest-bearing liabilities	(4,585)	(11,781)	(16,366)
Net change in net interest income	\$ 15,517	\$ (3,238)	\$ 12,279

---

### Comparison of Operating Results for the Quarter Ended March 31, 2012 and 2011

Net income for the quarter ended March 31, 2012 was \$19.3 million, compared to \$15.6 million for the quarter ended March 31, 2011. The \$3.7 million, or 23.5%, increase for the current quarter was due primarily to a \$6.9 million, or 17.0%, increase in net interest income, from \$40.6 million for the prior year quarter to \$47.5 million for the current quarter. The increase in net interest income was due primarily to a decrease in interest expense of \$8.6 million, or 19.3%, partially offset by a decrease in interest income of \$1.6 million, or 2.0%.

#### Interest and Dividend Income

Total interest and dividend income for the current quarter was \$83.3 million compared to \$84.9 million for the prior year quarter. The \$1.6 million, or 2.0%, decrease was primarily a result of a decrease in interest income on loans receivable of \$1.8 million, or 2.9%, and interest income on investments securities of \$628 thousand, or 13.2%, partially offset by an increase in interest income on MBS of \$849 thousand, or 4.9%.

Interest income on loans receivable for the current quarter was \$59.8 million compared to \$61.6 million for the prior year quarter. The \$1.8 million decrease in interest income on loans receivable was the result of a 23 basis point decrease in the average yield to 4.57% for the current year quarter, partially offset by an increase of \$105.6 million in the average balance of the portfolio. The decrease in the weighted average yield was due to a significant amount of loan endorsements and refinances, along with originations and purchases at rates which were lower than the rates on loan repayments.

Interest income on MBS for the current quarter was \$18.2 million compared to \$17.3 million for the prior year quarter. The \$849 thousand increase in interest income on MBS was a result of a \$507.4 million increase in the average balance of the portfolio, partially offset by a decrease of 60 basis points in the weighted average yield to 2.97% for the current quarter. The increase in the average balance was a result of purchases funded by an increase in deposits and proceeds from calls and maturities from the investment securities portfolio. The weighted average yield decreased between the two periods due to purchases of MBS at market rates with lower average yields than the existing portfolio between the two periods, repayments of MBS with yields higher than the average yield of the remaining portfolio, and adjustable-rate securities repricing to lower market rates.



Interest income on investment securities for the current quarter was \$4.1 million compared to \$4.7 million for the prior year quarter. The \$628 thousand decrease in interest income on investment securities was due to a \$380.6 million decrease in the average balance of the portfolio, partially offset by an increase of 15 basis points in the weighted average yield to 1.31% for the current quarter. The decrease in the average balance was due to calls and maturities of securities, including \$90.0 million at the holding company with a weighted average yield of 0.31%, that were not entirely replaced. Investment securities that matured at the holding company level were not reinvested in this portfolio, but rather were used to repurchase common stock and retained in a money market deposit account at the Bank. The weighted average yield increased between the two periods due to purchases of investment securities with yields greater than the existing portfolio and an increase in discount accretion on the trust preferred securities due to principal repayments during the current quarter.

### Interest Expense

Interest expense decreased \$8.6 million, or 19.3%, to \$35.8 million for the current quarter, from \$44.4 million for the prior year quarter. The decrease in interest expense was due to a decrease in interest expense on deposits of \$4.2 million, or 26.4%, other borrowings of \$2.8 million, or 44.4%, and FHLB advances of \$1.5 million, or 7.0%.

Interest expense on deposits for the current quarter was \$11.8 million compared to \$16.1 million for the prior year quarter. The \$4.3 million decrease was due primarily to a decrease of 36 basis points in the average rate paid on the certificate of deposit portfolio, from 2.00% for the prior year quarter to 1.64% for the current year quarter, as the portfolio continued to reprice to lower market rates, and a \$264.2 million decrease in the average balance of the certificate of deposit portfolio. The decrease in the average balance was primarily in medium and short-term certificates, partially offset by an increase in long-term certificates, as management competitively priced our longer term certificates in order to lengthen the weighted average maturity of the retail certificate of deposit portfolio in this lower rate environment. Additionally, the decrease was due to the maturity and payout of one retail certificate of deposit related to a legal settlement to which the Bank was not a party.

Interest expense on FHLB advances was \$20.4 million for the current quarter compared to \$22.0 million in the prior year quarter. The \$1.6 million decrease was due to a decrease of 54 basis points in the average rate paid, from 3.79% for the prior year quarter to 3.25% for the current year quarter, partially offset by an increase of \$176.1 million in the average balance. The decrease in the weighted average rate was due to the renewal/prepayment of \$450.0 million of advances with a weighted average effective rate of 3.38% between the two periods. The new advances have a weighted average effective rate of 1.25%. The increase in the average balance

63

---

was due to replacing certain maturing repurchase agreements as the rates on the advances were more favorable than comparable repurchase agreements.

Interest expense on other borrowings was \$3.5 million for the current quarter compared to \$6.3 million in the prior year quarter. The \$2.8 million decrease in interest expense on other borrowings was due primarily to a \$297.8 million decrease in the average balance. Between periods, \$225.0 million of repurchase agreements matured, some of which were repaid with FHLB advances and \$50.0 million of which were not replaced. Additionally, the Junior Subordinated Deferrable Interest Debentures of \$53.6 million were repaid.

#### Net Interest Margin

The net interest margin, which is calculated as the difference between interest income and interest expense divided by average interest-earning assets, increased 36 basis points, from 1.70% for the prior year quarter to 2.06% for the current quarter, largely due to the decrease in interest expense on the certificate of deposit portfolio and other borrowings.

#### Provision for Credit Losses

The Bank recorded a provision for credit losses of \$1.5 million during the current quarter, compared to a provision of \$520 thousand for the prior year quarter. The provision recorded in the current year quarter was a result of the replenishment to the ACL of \$1.0 million for charge-offs during the quarter, primarily on bulk purchased loans, and the increase in and/or establishment of allowance for credit losses on new delinquent and classified loans.

#### Other Income and Expense

Total other income remained relatively unchanged between periods at \$6.2 million for the current year quarter compared to \$6.1 million for the prior year quarter.

Total other expenses for the current quarter were \$22.0 million, compared to \$22.9 million in the prior year quarter. The \$886 thousand, or 3.9%, decrease was due primarily to decreases in salaries and employee benefits of \$481 thousand and other expenses, net of \$402 thousand. The decrease in salaries and employee benefits was due primarily to a decrease in expenses related to the ESOP. Other expenses, net decreased \$402 thousand, or 11.2%, primarily due to a decrease in expenses related to our low-income housing partnerships.

#### Income Tax Expense

Income tax expense was \$10.9 million for the current quarter, compared to \$7.7 million for the prior year quarter. The increase in the current quarter was due to higher pretax income and to a \$686 thousand tax return to tax provision adjustment in the prior year quarter, which reduced income tax expense. The effective tax rate for the current quarter was 36.0% compared to 33.0% for the prior year quarter. The effective tax rate in the prior year quarter included higher deductible expenses, than the current year quarter, that were associated with the ESOP due to the new ESOP loan and the \$0.60 per share welcome dividend paid in March 2011. Additionally, the effective tax rate in the prior year quarter included the tax return to tax provision adjustment, which also lowered the effective tax rate.

## Average Balance Sheet

As mentioned above, average yields are derived by dividing annualized income by the average balance of the related assets and average rates are derived by dividing annualized expense by the average balance of the related liabilities, for the periods shown. Average outstanding balances are derived from average daily balances. The yields and rates include amortization of fees, costs, premiums and discounts which are considered adjustments to yields/rates. Yields on tax-exempt securities were not calculated on a tax-equivalent basis.

	For the Three Months Ended			March 31, 2011		
	March 31, 2012			March 31, 2011		
	Average	Interest	Yield/	Average	Interest	Yield/
	Outstanding	Earned/	Rate	Outstanding	Earned/	Rate
	Balance	Paid		Balance	Paid	
	(Dollars in thousands)					
Assets:						
Interest-earning assets:						
Loans receivable (1)	\$ 5,236,465	\$ 59,785	4.57 %	\$ 5,130,904	\$ 61,554	4.80 %
MBS (2)	2,450,532	18,169	2.97	1,943,172	17,320	3.57
Investment securities (2)(3)	1,257,852	4,115	1.31	1,638,448	4,743	1.16
Capital stock of FHLB	129,515	1,111	3.45	121,778	883	2.94
Cash and cash equivalents	152,735	94	0.25	721,407	441	0.25
Total interest-earning assets	9,227,099	83,274	3.61	9,555,709	84,941	3.56
Other noninterest-earning assets	238,195			234,608		
Total assets	\$ 9,465,294			\$ 9,790,317		
Liabilities and stockholders' equity:						
Interest-bearing liabilities:						
Checking	\$ 561,799	\$ 109	0.08 %	\$ 512,707	\$ 105	0.08 %
Savings	256,970	86	0.13	240,843	312	0.53
Money market	1,096,620	907	0.33	1,021,935	1,413	0.56
Certificates	2,624,122	10,733	1.64	2,888,322	14,239	2.00
Total deposits	4,539,511	11,835	1.05	4,663,807	16,069	1.40
FHLB advances (4)	2,526,848	20,443	3.25	2,350,722	21,968	3.79
Repurchase agreements	365,000	3,530	3.83	609,167	5,939	3.90
Other borrowings	--	--	--	53,609	409	3.05
Total borrowings	2,891,848	23,973	3.32	3,013,498	28,316	3.80
Total interest-bearing liabilities	7,431,359	35,808	1.94	7,677,305	44,385	2.34
Other noninterest-bearing liabilities	98,696			96,596		
Stockholders' equity	1,935,239			2,016,416		
Total liabilities and stockholders' equity	\$ 9,465,294			\$ 9,790,317		

(Continued)

	For the Three Months Ended					
	March 31, 2012			March 31, 2011		
	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate
	(Dollars in thousands)					
Net interest income (5)		\$ 47,466			\$ 40,556	
Net interest rate spread (6)			1.67 %			1.22 %
Net interest-earning assets	\$ 1,795,740			\$ 1,878,404		
Net interest margin (7)			2.06			1.70
Ratio of interest-earning assets to interest-bearing liabilities			1.24			1.24
Selected performance ratios:						
Return on average assets (annualized)			0.82 %			0.64 %
Return on average equity (annualized)			3.99			3.10
Average equity to average assets			20.45			20.60
Operating expense ratio			0.93			0.93
Efficiency ratio			40.96			48.94

(Concluded)

(1) Calculated net of unearned loan fees and deferred costs, and undisbursed loan funds. Loans that are 90 or more days delinquent are included in the loans receivable average balance with a yield of zero percent. Balances include LHFS.

(2) MBS and investment securities classified as AFS are stated at amortized cost, adjusted for unamortized purchase premiums or discounts.

(3) The average balance of investment securities includes an average balance of nontaxable securities of \$56.1 million and \$64.5 million for the quarters ended March 31, 2012 and 2011, respectively.

(4) FHLB advances are stated net of deferred gains and deferred prepayment penalties.

(5) Net interest income represents the difference between interest income earned on interest-earning assets, such as mortgage loans, investment securities, and MBS, and interest paid on interest-bearing liabilities, such as deposits, FHLB advances, and other borrowings. Net interest income depends on the balance of interest-earning assets and interest-bearing liabilities, and the interest rates earned or paid on them.

(6) Net interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(7) Net interest margin represents net interest income as a percentage of average interest-earning assets.

66

---

### Rate/Volume Analysis

The table below presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities, comparing the quarter ended March 31, 2012 to the quarter ended March 31, 2011. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in volume, which are changes in the average balance multiplied by the previous year's average rate and (2) changes in rate, which are changes in the average rate multiplied by the average balance from the previous year. The net changes attributable to the combined impact of both rate and volume have been allocated proportionately to the changes due to volume and the changes due to rate.

	Quarter Ended March 31, 2012 vs. 2011 Increase (Decrease) Due to		
	Volume	Rate	Total
	(Dollars in thousands)		
Interest-earning assets:			
Loans receivable	\$ 1,238	\$ (3,007)	\$ (1,769)
MBS	4,063	(3,214)	849
Investment securities	(1,193)	565	(628)
Capital stock of FHLB	61	167	228
Cash equivalents	(347)	--	(347)
Total interest-earning assets	3,822	(5,489)	(1,667)
Interest-bearing liabilities:			
Checking	9	--	9
Savings	21	(246)	(225)
Money market	101	(604)	(503)
Certificates	(1,184)	(2,331)	(3,515)
FHLB advances	1,490	(3,015)	(1,525)
Other borrowings	(2,714)	(104)	(2,818)
Total interest-bearing liabilities	(2,277)	(6,300)	(8,577)
Net change in net interest income	\$ 6,099	\$ 811	\$ 6,910

## Comparison of Operating Results for the Quarters Ended March 31, 2012 and December 31, 2011

For the current quarter, the Company recognized net income of \$19.3 million, compared to net income of \$18.8 million for the quarter ended December 31, 2011. The \$526 thousand, or 2.8%, increase in net income was due primarily to an increase in net interest income of \$2.1 million, or 4.6%, partially offset by an increase in the provision for loan losses of \$960 thousand and an increase in income tax expense of \$724 thousand.

### Interest and Dividend Income

Total interest and dividend income for the current quarter was \$83.3 million compared to \$84.8 million for the prior quarter. The \$1.5 million, or 1.8%, decrease was primarily a result of decreases in interest income on loans receivable and investment securities.

Interest income on loans receivable was \$59.8 million for the current quarter, compared to \$60.7 million for the prior quarter. The \$890 thousand, or 1.5%, decrease was due to a 10 basis point decrease in the weighted average yield to 4.57% for the current quarter, partially offset by an increase of \$44.6 million in the average balance of the portfolio. The decrease in the weighted average yield was due to loan endorsements and refinances, along with originations and purchases at rates which were lower than loan repayments. The increase in the average balance was due to originations and correspondent loan purchases. See additional discussion regarding loan portfolio activity in “Financial Condition – Loans Receivable.”

Interest income on investment securities decreased \$522 thousand, or 11.3%, primarily due to a decrease of \$131.4 million in the average balance of the portfolio due to calls and maturities of investment securities that were used to purchase MBS and repurchase common stock.

67

---

Interest income on MBS for the current quarter was \$18.2 million compared to \$18.4 million for the prior quarter. The \$204 thousand, or 1.1%, decrease was due to a decrease of 12 basis points in the average yield to 2.97%, partially offset by an increase of \$69.0 million in the average balance of the portfolio. The decrease in the weighted average

yield between the two periods was due primarily to purchases of MBS at market rates which resulted in a lower average yield than the existing portfolio between the two periods, and repayments on MBS with yields higher than the remaining portfolio, and ARMs repricing. The increase in the average balance was a result of an increase in the deposit portfolio and cash flows from the investment securities portfolio that were used to purchase MBS.

#### Interest Expense

Total interest expense decreased \$3.7 million, or 9.2%, to \$35.8 million for the current quarter from \$39.5 million for the prior quarter. The decrease in interest expense was due to a \$1.9 million, or 8.5%, decrease in interest expense on FHLB advances, a \$951 thousand, or 7.4%, decrease in interest expense on deposits, and a \$797 thousand decrease in interest expense on other borrowings.

Interest expense on deposits was \$11.8 million for the current quarter, compared to \$12.8 million for the prior quarter. The \$952 thousand decrease, or 7.5%, in interest expense on deposits was due primarily to a decrease of 13 basis points in the average rate paid on the certificate of deposit portfolio, from 1.77% for the prior quarter to 1.64% for the current quarter, as the portfolio continued to reprice to lower market rates.

Interest expense on FHLB advances was \$20.4 million for the current quarter, compared to \$22.3 million for the prior quarter. The \$1.9 million decrease in interest expense on FHLB advances was due to a \$200.0 million advance that was prepaid during the current quarter, along with \$100.0 million of advances that were renewed late in the prior quarter with a rate decrease of 313 basis points, and \$150.0 million of advances that were renewed in the current quarter with a rate decrease of 173 basis points. The decrease in interest expense on FHLB advances was partially offset by an \$81.0 million increase in the average balance.

Interest expense on other borrowings was \$3.5 million for the current quarter, compared to \$4.3 million for the prior quarter. The \$797 thousand, or 18.4%, decrease in interest expense on other borrowings was due primarily to a \$69.0 million decrease in the average balance due to the maturity of repurchase agreements during the prior quarter that were not renewed, but were replaced with FHLB advances.

#### Net Interest Margin

The net interest margin increased eight basis points, from 1.98% for the prior quarter to 2.06% for the current quarter, due to an overall decrease in the cost of funds, but most notably, a decrease in interest expense on FHLB advances.

#### Provision for Credit Losses

The Bank recorded a provision for credit losses of \$1.5 million during the current quarter, compared to a provision of \$540 thousand for the prior quarter. The provision recorded in the current quarter was a result of the replenishment of ACL for \$1.0 million of charge-offs during the quarter, primarily on bulk purchased loans, and the increase in and/or

establishment of allowance for credit losses on new delinquent and classified loans.

#### Other Income and Expense

Total other income and total other expense remained relatively unchanged between quarters. Total other income was \$6.2 million for both quarters. Total other expense was \$22.0 million for the current quarter compared to \$22.1 million for the prior quarter.

#### Income Tax Expense

Income tax expense was \$10.9 million for the current quarter, compared to \$10.1 million for the prior quarter. The effective tax rate for the current quarter was 36.0% compared to 35.0% for the prior quarter. The higher effective tax rate in the current quarter was due primarily to a true-up adjustment in the current quarter required to reach the effective tax rate of 35.5% for the fiscal year. The increase in the effective tax rate between quarters was due to adjustments to certain state income tax expenses, and a decrease in the estimated non-taxable increase in the cash surrender value of BOLI from prior quarter, partially offset by an increase in low income housing tax credits in the current quarter.

68

#### Average Balance Sheet

As mentioned above, average yields are derived by dividing annualized income by the average balance of the related assets and average rates are derived by dividing annualized expense by the average balance of the related liabilities, for the periods shown. Average outstanding balances are derived from average daily balances. The yields and rates include amortization of fees, costs, premiums and discounts which are considered adjustments to yields/rates. Yields on tax-exempt securities were not calculated on a tax-equivalent basis.

	For the Three Months Ended					
	March 31, 2012			December 31, 2011		
	Average	Interest		Average	Interest	
	Outstanding	Earned/	Yield/	Outstanding	Earned/	Yield/
	Balance	Paid	Rate	Balance	Paid	Rate
Assets:	(Dollars in thousands)					
Interest-earning assets:						
Loans receivable (1)	\$ 5,236,465	\$ 59,785	4.57 %	\$ 5,191,834	\$ 60,675	4.67 %
MBS (2)	2,450,532	18,169	2.97	2,381,545	18,373	3.09
Investment securities (2)(3)	1,257,852	4,115	1.31	1,389,228	4,637	1.34



Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

Capital stock of FHLB	129,515	1,111	3.45	126,491	1,091	3.42
Cash and cash equivalents	152,735	94	0.25	83,148	51	0.24
Total interest-earning assets	9,227,099	83,274	3.61	9,172,246	84,827	3.70
Other noninterest-earning assets	238,195			230,366		
Total assets	\$ 9,465,294			\$ 9,402,612		

Liabilities and stockholders' equity:

Interest-bearing liabilities:							
Checking	\$ 561,799	\$ 109	0.08	%	\$ 535,058	\$ 107	0.08 %
Savings	256,970	86	0.13		252,626	150	0.24
Money market	1,096,620	907	0.33		1,075,119	945	0.35
Certificates	2,624,122	10,733	1.64		2,594,016	11,585	1.77
Total deposits	4,539,511	11,835	1.05		4,456,819	12,787	1.14
FHLB advances (4)	2,526,848	20,443	3.25		2,447,129	22,339	3.62
Repurchase agreements	365,000	3,530	3.83		434,022	4,327	3.90
Other borrowings	--	--	--		--	--	--
Total borrowings	2,891,848	23,973	3.32		2,881,151	26,666	3.66
Total interest-bearing liabilities	7,431,359	35,808	1.94		7,337,970	39,453	2.13
Other noninterest-bearing liabilities	98,696				123,889		
Stockholders' equity	1,935,239				1,940,753		
Total liabilities and stockholders' equity	\$ 9,465,294				\$ 9,402,612		

(Continued)

69

	For the Three Months Ended			December 31, 2011		
	March 31, 2012			December 31, 2011		
	Average Outstanding Balance	Interest Earned/Paid	Yield/Rate	Average Outstanding Balance	Interest Earned/Paid	Yield/Rate
	(Dollars in thousands)					
Net interest income (5)		\$ 47,466			\$ 45,374	
Net interest rate spread (6)			1.67 %			1.57 %
Net interest-earning assets	\$ 1,795,740			\$ 1,834,276		
Net interest margin (7)			2.06			1.98
Ratio of interest-earning assets to interest-bearing liabilities			1.24			1.25
Selected performance ratios:						
Return on average assets (annualized)			0.82 %			0.80 %
Return on average equity (annualized)			3.99			3.87
Average equity to average assets			20.45			20.64

Operating expense ratio	0.93	0.94
Efficiency ratio	40.96	42.83

(Concluded)

- (1) Calculated net of unearned loan fees and deferred costs, and undisbursed loan funds. Loans that are 90 or more days delinquent are included in the loans receivable average balance with a yield of zero percent. Balances include LHFS.
- (2) MBS and investment securities classified as AFS are stated at amortized cost, adjusted for unamortized purchase premiums or discounts.
- (3) The average balance of investment securities includes an average balance of nontaxable securities of \$56.1 million and \$58.8 million for the quarters ended March 31, 2012 and December 31, 2011, respectively.
- (4) FHLB advances are stated net of deferred gains and deferred prepayment penalties.
- (5) Net interest income represents the difference between interest income earned on interest-earning assets, such as mortgage loans, investment securities, and MBS, and interest paid on interest-bearing liabilities, such as deposits, FHLB advances, and other borrowings. Net interest income depends on the balance of interest-earning assets and interest-bearing liabilities, and the interest rates earned or paid on them.
- (6) Net interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
- (7) Net interest margin represents net interest income as a percentage of average interest-earning assets.

70

---

#### Rate/Volume Analysis

The table below presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities, comparing the quarter ended March 31, 2012 to the quarter ended December 31, 2011. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in volume, which are changes in the average balance multiplied by the previous year's average rate and (2) changes in rate, which are changes in the average rate multiplied by the average balance from the previous year. The net changes attributable to the combined impact of both rate and volume have been allocated proportionately to the changes due to volume and the changes due to rate.

Quarter Ended

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

March 31, 2012 vs. December 31,  
2011  
Increase (Decrease) Due to

	Volume	Rate	Total
	(Dollars in thousands)		
Interest-earning assets:			
Loans receivable	\$ 507	(1,397)	\$ (890)
MBS	523	(727)	(204)
Investment securities	(422)	(100)	(522)
Capital stock of FHLB	15	5	20
Cash and cash equivalents	41	2	43
Total interest-earning assets	664	(2,217)	(1,553)
Interest-bearing liabilities:			
Checking	6	--	6
Savings	2	(81)	(79)
Money market	17	(59)	(42)
Certificates	116	(953)	(837)
FHLB advances	604	(2,500)	(1,896)
Other borrowings	(716)	(81)	(797)
Total interest-bearing liabilities	29	(3,674)	(3,645)
Net change in net interest income	\$ 635	\$ 1,457	\$ 2,092

## Liquidity and Capital Resources

Liquidity refers to our ability to generate sufficient cash to fund ongoing operations, to pay maturing certificates of deposit and other deposit withdrawals, to repay maturing borrowings, and to fund loan commitments. Liquidity management is both a daily and long-term function of our business management. The Company's most available liquid assets are represented by cash and cash equivalents, AFS MBS and investment securities, and short-term investment securities. The Bank's primary sources of funds are deposits, FHLB advances, other borrowings, repayments and maturities of outstanding loans and MBS and other short-term investments, and funds provided by operations. The Bank's borrowings primarily have been used to invest in U.S. GSE debentures and MBS securities in an effort to manage the Bank's interest rate risk with the intent to improve the earnings of the Bank while maintaining capital ratios in excess of regulatory standards for well-capitalized financial institutions. In addition, the Bank's focus on managing risk has provided additional liquidity capacity by remaining below FHLB borrowing limits and by increasing the balance of MBS and investment securities available as collateral for borrowings.

We generally intend to maintain cash reserves sufficient to meet short-term liquidity needs, which are routinely forecasted for 10, 30, and 365 days. Additionally, on a monthly basis, we perform a liquidity stress test in accordance with the Interagency Policy Statement on Funding and Liquidity Risk Management. The liquidity stress test incorporates both short-term and long-term liquidity scenarios in order to identify periods of and to quantify liquidity risk. In the event short-term liquidity needs exceed available cash, the Bank has access to lines of credit at the FHLB and the Federal Reserve Bank. The FHLB line of credit, when combined with FHLB advances, may generally not exceed 40% of total assets. Our excess capacity at the FHLB as of March 31, 2012 was \$942.3 million, which decreased \$314.8 million from \$1.26 billion at September 30, 2011. The decrease was primarily due to a change in lending guidelines at the FHLB which resulted in a reduction of the lending percentage on one- to four-family loans from 85% to 78% between period ends, and our FHLB advance balance increasing \$150.0 million since September 30, 2011. The Federal Reserve Bank line of credit is based upon the fair values of the securities pledged as collateral and certain other characteristics of those securities, and is used only when other sources of short-term liquidity are unavailable. At March 31, 2012, the Bank had \$2.20 billion of securities that were eligible but unused as collateral for borrowing or other liquidity needs. This collateral amount is comprised of AFS and HTM securities with individual fair values greater than \$10.0 million, which is then reduced by a collateralization ratio of 10% to account for potential market value fluctuations. Borrowings on the lines of credit are outstanding until replaced by cash flows from long-term sources of liquidity, and are generally outstanding no longer than 30 days.

If management observes a trend in the amount and frequency of lines of credit utilization, the Bank will likely utilize long-term wholesale borrowing sources, such as FHLB advances and/or repurchase agreements, to provide permanent fixed-rate funding. The maturity of these borrowings is generally structured in such a way as to stagger maturities in order to reduce the risk of a highly negative cash flow position at maturity. Additionally, the Bank could utilize the repayment and maturity of outstanding loans, MBS and other investments for liquidity needs rather than reinvesting such funds into the related portfolios.

While scheduled payments from the amortization of loans and MBS and payments on short-term investments are relatively predictable sources of funds, deposit flows, prepayments on loans and MBS, and calls of investment securities are greatly influenced by general interest rates, economic conditions and competition, and are less predictable sources of funds. To the extent possible, the Bank manages the cash flows of its loan and deposit

portfolios by the rates it offers customers.

At March 31, 2012, cash and cash equivalents totaled \$143.7 million, an increase of \$22.6 million from September 30, 2011.

During the first six months of fiscal year 2012, loan originations and purchases, net of principal repayments and related loan activity, resulted in a cash outflow of \$81.8 million, compared to a cash inflow of \$62.5 million in the same period in the prior year, as principal repayments exceeded loan originations and purchases in the prior year period. See additional discussion regarding loan activity in “Financial Condition – Loans Receivable.”

During the six months ended March 31, 2012, the Company received principal payments on MBS of \$295.3 million and proceeds from called or matured investment securities of \$753.3 million, which were reinvested into investment securities and MBS. During the six months ended March 31, 2012, the Company purchased \$564.0 million of investment securities and \$515.7 million of MBS. The growth in the securities portfolio was funded by an increase in deposits.

72

The following table presents the contractual maturity of our loan, MBS, and investment securities portfolios at March 31, 2012. Loans and securities which have adjustable interest rates are shown as maturing in the period during which the contract is due. The table does not reflect the effects of possible prepayments or enforcement of due on sale clauses.

	Loans (1)		MBS		Investment Securities		Total	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in thousands)							
Amounts due:								
Within one year	\$ 28,539	4.60 %	\$ --	-- %	\$ 184,132	1.82 %	\$ 212,671	2.19 %
After one year:								
Over one to two	39,895	4.49	--	--	30,896	1.39	70,791	3.14
Over two to three	6,958	5.33	--	--	98,256	1.44	105,214	1.70
Over three to five	57,371	5.41	2,076	6.00	895,148	1.33	954,595	1.59
Over five to ten	355,821	4.82	570,481	3.81	36,307	1.91	962,609	4.11
Over 10 to 15	1,360,888	4.08	1,010,636	3.01	3,015	5.24	2,374,539	3.63
After 15 years	3,425,824	4.53	1,043,351	3.06	6,183	3.57	4,475,358	4.19

Total due after one year	5,246,757	4.45	2,626,544	3.21	1,069,805	1.39	8,943,106	3.71
	\$ 5,275,296	4.45 %	\$ 2,626,544	3.21 %	\$ 1,253,937	1.45 %	\$ 9,155,777	3.68 %

(1) Demand loans, loans having no stated maturity, and overdraft loans are included in the amounts due within one year. Construction loans are reported based on the term to complete construction. The maturity date for home equity loans assumes the customer always makes the required minimum payment.

The Bank utilizes FHLB advances to provide funds for lending and investment activities. The Bank's policies allow advances up to 40% of total Bank assets. At March 31, 2012, the Bank's ratio of the face amount of advances to total assets, as reported to the OCC, was 27%. The advances are secured by a blanket pledge of our loan portfolio, as collateral, supported by quarterly reporting to the FHLB. Currently, the blanket pledge is sufficient collateral for the FHLB advances. It is possible that increases in our borrowings or decreases in our loan portfolio or changes in FHLB lending guidelines could require the Bank to pledge securities as collateral on the FHLB advances. The Bank relies on FHLB advances as a primary source of borrowings. The outstanding amount of FHLB advances was \$2.55 billion at March 31, 2012, of which \$200.0 million is scheduled to mature in the next 12 months. Maturing advances will likely be replaced with borrowings with terms between 36 and 60 months.

The Bank has access to and utilizes other sources for liquidity, such as secondary market repurchase agreements, brokered deposits, and public unit deposits. The Bank's policy limits total borrowings to 55% of total assets. At March 31, 2012, the Bank had repurchase agreements of \$365.0 million, or approximately 4% of assets, \$50.0 million of which are scheduled to mature in the next 12 months. The Bank may enter into additional repurchase agreements as management deems appropriate, not to exceed 15% of total assets. The Bank has pledged securities with an estimated fair value of \$430.5 million as collateral for repurchase agreements at March 31, 2012. The securities pledged for the repurchase agreements will be delivered back to the Bank when the repurchase agreements mature.

As of March 31, 2012, the Bank's policy allows for brokered deposits up to 10% of total deposits and public unit deposits up to 5% of total deposits. At March 31, 2012, the Bank had brokered deposits of \$83.7 million, or approximately 2% of total deposits and public unit deposits of \$184.3 million, or approximately 4% of total deposits. Management continuously monitors the wholesale deposit market for opportunities to obtain brokered and public unit deposits at attractive rates. The Bank has pledged securities with an estimated fair value of \$224.4 million as collateral for public unit deposits. The securities pledged as collateral for public unit deposits are held under joint custody receipt by the FHLB and generally will be released upon deposit maturity.

At March 31, 2012, \$1.27 billion of the \$2.66 billion in certificates of deposit were scheduled to mature within one year. Included in the \$1.27 billion are \$158.1 million in public unit deposits scheduled to mature within the same time period. Based on our deposit retention experience and our current pricing strategy, we anticipate the majority of the maturing retail certificates of deposit will renew or transfer to other deposit products at the prevailing rate, although no assurance can be given in this regard.

As of March 31, 2012, the Bank had entered into \$15.3 million of agreements with a third party in connection with the remodeling of the Bank's home office. As of March 31, 2012, \$5.0 million of those agreements were outstanding. The existing home office building was constructed in 1961 and has been fully depreciated since 1997. The project scope includes replacement of all mechanical and electrical systems, interior finishes, and exterior building components. The completed project will result in a more energy efficient building which is expected to lower our utility and maintenance expenses. There will be additional agreements and expenses related to the project through fiscal year 2013, which is when the project is expected to be completed. Costs related to the project will be capitalized and depreciated according to the estimated useful life of the assets as they are placed in service.

#### Limitations on Dividends and Other Capital Distributions

Although savings and loan holding companies are not currently subject to regulatory capital requirements or specific restrictions on the payment of dividends or other capital distributions, the OCC does prescribe such restrictions on subsidiary savings associations. The OCC regulations impose restrictions on savings institutions with respect to their ability to make distributions of capital, which include dividends, stock redemptions or repurchases, cash-out mergers and other transactions charged to the capital account. In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the OCC and the agency has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution.

Generally under OCC and FRB regulations, savings institutions, such as the Bank, may make capital distributions during any calendar year equal to earnings of the previous two calendar years and current year-to-date earnings. It is generally required under OCC and FRB regulations that the Bank remain well-capitalized before and after the proposed distribution. However, an institution deemed to be in need of more than normal supervision by the OCC and FRB may have its dividend authority restricted by the OCC and FRB. Savings institutions proposing to make any capital distribution within these limits must submit written notice to the OCC and FRB 30 days prior to such distribution. The OCC and FRB may object to the distribution during that 30-day period based on safety and soundness concerns. Savings institutions that desire to make a larger capital distribution, or are under special restrictions, or are not, or would not be, well-capitalized following a proposed capital distribution, however, must obtain OCC and FRB approval prior to making such distribution.

The long-term ability of the Company to pay dividends to its stockholders is based primarily upon the ability of the Bank to make capital distributions to the Company. So long as the Bank continues to remain "well-capitalized" after each capital distribution, operate in a safe and sound manner, provide the OCC and FRB with updated capital levels, non-performing asset balances and ACL information as requested, and comply with the capital management and interest rate risk management guidelines of the OCC and FRB, it is management's belief that the OCC and FRB will

continue to allow the Bank to distribute its net income to the Company, although no assurance can be given in this regard.

In connection with the corporate reorganization, a "liquidation account" was established for the benefit of certain depositors of the Bank in an amount equal to Capitol Federal Savings Bank MHC's ownership interest in the retained earnings of Capitol Federal Financial as of June 30, 2010. Under applicable federal banking regulations, neither the Company nor the Bank is permitted to pay dividends of its capital stock to its stockholders if stockholders' equity would be reduced below the amount of the liquidation account at that time.

The Company paid cash dividends of \$40.5 million during the six months ended March 31, 2012. The \$40.5 million of dividend payments consisted of quarterly dividends of \$24.3 million and a special dividend of \$16.2 million related to fiscal year 2011 earnings, per the Company's dividend policy. On April 20, 2012, the Company declared a quarterly cash dividend of \$0.075 per share, which will equate to approximately \$11.9 million, payable May 18, 2012. Dividend payments depend upon a number of factors including the Company's financial condition and results of operations, the Bank's regulatory capital requirements, regulatory limitations on the Bank's ability to make capital distributions to the Company, and the amount of cash at the holding company.

At March 31, 2012, Capitol Federal Financial, Inc., at the holding company level, had \$287.4 million on deposit with the Bank and \$181.0 million in investment securities with a WAL of 0.39 years. As of March 31, 2012, \$60.2 million of these securities will mature within 90 days.

In December, 2011, the Company announced that the Board of Directors approved the repurchase of up to \$193.0 million of the Company's common stock. The Company repurchased 2,199,100 shares of common stock at an average price of \$11.85 per share

74

---

during the current quarter. This plan has no expiration date. See additional discussion regarding repurchase activity in "Financial Condition – Stockholders' Equity."

#### Off Balance Sheet Arrangements, Commitments and Contractual Obligations

The Company, in the normal course of business, makes commitments to buy or sell assets or to incur or fund liabilities. Commitments may include, but are not limited to:

- the origination, purchase, or sale of loans,



Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

- the purchase or sale of investment securities and MBS,
- extensions of credit on home equity loans and construction loans,
- terms and conditions of operating leases, and
- funding withdrawals of deposit accounts at maturity.

The following table summarizes our contractual obligations and other material commitments as of March 31, 2012.

	Maturity Range				
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
	(Dollars in thousands)				
Operating leases	\$ 12,861	\$ 1,269	\$ 2,221	\$ 1,817	\$ 7,554
Certificates of deposit	\$ 2,658,310	\$ 1,266,476	\$ 991,313	\$ 398,294	\$ 2,227
Weighted average rate	1.59	% 1.19	% 1.85	% 2.20	% 2.67
FHLB advances	\$ 2,550,000	\$ 200,000	\$ 1,175,000	\$ 575,000	\$ 600,000
Weighted average rate	2.76	% 3.67	% 2.53	% 2.64	% 3.01
Repurchase agreements	\$ 365,000	\$ 50,000	\$ 195,000	\$ 20,000	\$ 100,000
Weighted average rate	3.83	% 3.48	% 4.10	% 4.45	% 3.35
Commitments to originate and purchase/participate in loans	\$ 139,858	\$ 139,858	\$ --	\$ --	\$ --
Weighted average rate	3.78	% 3.78	% --	% --	% --
Commitments to fund unused home equity lines of credit and commercial commitments	\$ 266,276	\$ 266,276	\$ --	\$ --	\$ --
Weighted average rate	4.54	% 4.54	% --	% --	% --
Unadvanced portion of construction loans	\$ 29,425	\$ 29,425	\$ --	\$ --	\$ --
Weighted average rate	4.27	% 4.27	% --	% --	% --

A percentage of commitments to originate mortgage loans are expected to expire unfunded, so the amounts reflected in the table above are not necessarily indicative of future liquidity requirements. Additionally, the Bank is not obligated to honor commitments to fund unused home equity lines of credit if a customer is delinquent or otherwise in violation of the loan agreement.

We anticipate we will continue to have sufficient funds, through repayments and maturities of loans and securities, deposits and borrowings, to meet our current commitments.

## Contingencies

In the normal course of business, the Company and its subsidiary are named defendants in various lawsuits and counter claims. In the opinion of management, after consultation with legal counsel, none of the currently pending suits are expected to have a materially adverse effect on the Company's consolidated financial statements for the current interim or future periods.

## Capital

Consistent with our goal to operate a sound and profitable financial organization, we actively seek to maintain a "well-capitalized" status in accordance with regulatory standards. As of March 31, 2012, the Bank exceeded all regulatory capital requirements. The following table presents the Bank's regulatory capital ratios at March 31, 2012 based upon regulatory guidelines.

	Bank	Regulatory Requirement	
	Ratios	For "Well-Capitalized"	Status
Tier 1 (core) capital	14.5 %	5.0	%
Tier 1 (core) risk-based capital	37.6 %	6.0	%
Total risk-based capital	37.9 %	10.0	%

A reconciliation of the Bank's equity under GAAP to regulatory capital amounts as of March 31, 2012 is as follows (dollars in thousands):

Total Bank equity as reported under GAAP	\$ 1,383,204
Unrealized gains on AFS securities	(24,663)
Other	(156)
Total tangible and core capital	1,358,385
ACL	12,559
Total risk-based capital	\$ 1,370,944

---

### Item 3. Quantitative and Qualitative Disclosure about Market Risk

For a complete discussion of the Bank's asset and liability management policies, as well as the potential impact of interest rate changes upon the market value of the Bank's portfolios, see "Management's Discussion and Analysis of Financial Condition and Results of Operations - Asset and Liability Management and Market Risk" in the Company's Annual Report to Stockholders for the year ended September 30, 2011, attached as Exhibit 13 to the Company's Annual Report on Form 10-K for the year ended September 30, 2011. The analyses presented in the tables below reflect the level of market risk at the Bank and does not include the assets of the Company, at the holding company level. Assets at the holding company are not managed in accordance with the interest rate risk objectives of the Bank. A general discussion of the impact of the holding company assets is included for each table.

The rates of interest the Bank earns on assets and pays on liabilities generally are established contractually for a period of time. Fluctuations in interest rates have a significant impact not only upon our net income, but also upon the cash flows and market values of our assets and liabilities. Our results of operations, like those of other financial institutions, are impacted by changes in interest rates and the interest rate sensitivity of our interest-earning assets and interest-bearing liabilities. Risk associated with changes in interest rates on the earnings of the Bank and the market value of its financial assets and liabilities is known as interest rate risk. Interest rate risk is our most significant market risk and our ability to adapt to changes in interest rates is known as interest rate risk management.

The general objective of our interest rate risk management program is to determine and manage an appropriate level of interest rate risk while maximizing net interest income in a manner consistent with our policy to reduce, to the extent practicable, the exposure of net interest income to changes in market interest rates. The Asset and Liability Committee ("ALCO") regularly reviews the interest rate risk exposure of the Bank by forecasting the impact of hypothetical, alternative interest rate environments on net interest income and the market value of portfolio equity ("MVPE") at various dates. The MVPE is defined as the net of the present value of cash flows from existing assets, liabilities and off-balance sheet instruments. The present values are determined based upon market conditions as of the date of the analysis as well as in alternative interest rate environments providing potential changes in the MVPE under those alternative interest rate environments. Net interest income is projected in the same alternative interest rate environments, both with a static balance sheet and with management strategies considered. The MVPE and net interest income analyses are also conducted to estimate our sensitivity to rates for future time horizons based upon market conditions as of the date of the analysis. In addition to the interest rate environments presented below, management also reviews the impact of non-parallel rate shock scenarios on a quarterly basis. These scenarios consist of flattening and steepening the yield curve by changing short-term and long-term interest rates independent of each other, and simulating cash flows and valuations as a result of these hypothetical changes in rates. This analysis helps management quantify the Bank's exposure to changes in the shape of the yield curve.

For each period presented in the following table, the estimated percentage change in the Bank's net interest income based on the indicated instantaneous, parallel and permanent change in interest rates is presented. The percentage change in each interest rate environment represents the difference between estimated net interest income in the 0 basis point interest rate environment ("base case", assumes the forward market and product interest rates implied by the yield curve are realized) and estimated net interest income in each alternative interest rate environment (assumes market and product interest rates have a parallel shift in rates across all maturities by the indicated change in rates). Estimations of net interest income used in preparing the table below are based upon the assumptions that the total composition of interest-earning assets and interest-bearing liabilities does not change materially and that any repricing of assets or

liabilities occurs at anticipated product and market rates for the alternative rate environments as of the dates presented. The estimation of net interest income does not include any projected gain or loss related to the sale of loans or securities, or income derived from non-interest income sources, but does include the use of different prepayment assumptions in the alternative interest rate environments. It is important to consider that the estimated changes in net interest income are for a cumulative four-quarter period. These do not reflect the earnings expectations of management.

Change (in Basis Points)	Percentage Change in Net Interest Income		
	At		
	March 31, 2012	December 31, 2011	September 30, 2011
in Interest Rates(1)			
-100 bp	N/A	N/A	N/A
000 bp	--	--	--
+100 bp	1.64 %	3.28 %	4.46 %
+200 bp	1.06 %	2.38 %	3.75 %
+300 bp	-1.01 %	-0.29 %	-0.33 %

- (1) Assumes an instantaneous, permanent and parallel change in interest rates at all maturities.

At March 31, 2012, the percentage change in the net interest income projections were less positive in the +100 and +200 basis point scenarios and more negative in the +300 basis point scenario than at December 31, 2011 and September 30, 2011. The change in the

77

---

sensitivity was a result of a reduction in the amount of cash flows projected to reprice in the next twelve months compared to December 31, 2011 and September 30, 2011, due to an increase in interest rates during the current quarter. As interest rates increase, the amount of cash flows on mortgage-related assets and callable agency debentures expected to reprice decrease as borrowers' have less economic incentive to refinance their mortgages into lower interest rates and agency debt issuers' have less economic incentive to exercise their call options and issue lower costing debt. The Bank benefits from rising interest rates in the +100 and +200 basis point interest rate scenarios at March 31, 2012, due to a decrease in the amount of assets projected to reprice to lower market interest rates as interest rates rise, and to repricing assets being in excess of repricing liabilities over the next twelve months. In the +300 basis point interest rate scenario, repricing assets slow to a point where repricing liabilities more than offset the benefit of the higher interest rates on repricing assets.

The securities held at the holding company are short-term bullet agency debentures. The inclusion of these securities in the net interest income projections at March 31, 2012 would have resulted in a more positive impact in the rising interest rate environments. The cash flows from these securities do not change as interest rates rise and, as a result, provide cash flows that could be reinvested at the higher interest rates in these scenarios. Currently, securities at the holding company are not being reinvested into new short-term securities upon their maturity. Rather, the proceeds from maturing securities are being retained in a money market deposit account at the Bank which is thereby being invested in the Bank's investment portfolio. As a result, the impact this portfolio would have on net interest income projections has been reduced.

The following table sets forth the estimated percentage change in the MVPE for each period end presented based on the indicated instantaneous, parallel and permanent change in interest rates. The percentage change in each interest rate environment represents the difference between the MVPE in the base case and the MVPE in each alternative interest rate environment. The estimations of the MVPE used in preparing the table below are based upon the assumptions that the total composition of interest-earning assets and interest-bearing liabilities does not change, that any repricing of assets or liabilities occurs at current product or market rates for the alternative rate environments as of the dates presented, and that different prepayment rates are used in each alternative interest rate environment. The estimated MVPE results from the valuation of cash flows from financial assets and liabilities over the anticipated lives of each for each interest rate environment. The table below presents the effects of the changes in interest rates on our assets and liabilities as they mature, repay or reprice, as shown by the change in the MVPE for alternative interest rates.

Change (in Basis Points)	Percentage Change in MVPE		
	At		
in Interest Rates(1)	March 31, 2012	December 31, 2011	September 30, 2011
-100 bp	N/A	N/A	N/A
000 bp	--	--	--
+100 bp	-2.47 %	0.28 %	0.61 %
+200 bp	-10.97 %	-6.30 %	-5.69 %
+300 bp	-20.78 %	-15.75 %	-14.91 %

(1) Assumes an instantaneous, permanent and parallel change in interest rates at all maturities.

Changes in the estimated market values of our financial assets and liabilities drive changes in estimates of the MVPE. Shorter term-to-maturity financial instruments are less sensitive to changes in interest rates than are longer term-to-maturity financial instruments. Because of this, our certificates of deposit (which have relatively short average lives) tend to display less sensitivity to changes in interest rates than do our mortgage-related assets (which have relatively long average lives). The average life expected on our mortgage-related assets varies under different interest rate environments because borrowers have the ability to prepay their mortgage loans.

The sensitivity of the MVPE to changes in interest rates at March 31, 2012 increased from December 31, 2011 and September 30, 2011 due to an increase in interest rates during the current quarter. As interest rates increase, the estimated fair values of liabilities with short average lives do not respond in the same manner as do longer maturity assets such as loans, which are primarily fixed-rate and have longer average lives. Prepayment assumptions on loans, fixed-rate loans in particular, decrease in rising interest rate environments. Cash flows from these assets are typically only realized through normal changes in customers' lives, such as divorce, death, job-related relocations, or other life changing events. The lower prepayment assumptions extend the expected average lives of these assets, thereby increasing their sensitivity to changes in interest rates. The net effect of these characteristics (short-lived liabilities and long-lived assets) is to increase the sensitivity of the Bank to changes in interest rates.

The inclusion of the holding company securities in the MVPE analysis would result in a lower level of sensitivity to the rising interest rate environments at March 31, 2012 due to their short-term nature, which would reduce the overall WAL of assets. This would cause the market value of total assets to be less sensitive to changes in interest rates, thereby reducing the sensitivity of the MVPE at March 31, 2012. As noted above, proceeds from securities maturing at the holding company are being retained in a money market deposit

78

---

account at the Bank which is thereby being invested in the Bank's investment portfolio. As a result, the impact this portfolio would have on MVPE has been reduced.

The ability to maximize net interest income is dependent largely upon the attainment of a positive interest rate spread that can be sustained despite fluctuations in prevailing interest rates. The asset and liability repricing gap is a measure of the difference between the amount of interest-earning assets and interest-bearing liabilities which either reprice or mature within a given period of time. The difference provides an indication of the extent to which an institution's interest rate spread will be affected by changes in interest rates. A gap is considered positive when the amount of interest-earning assets exceeds the amount of interest-bearing liabilities maturing or repricing during the same period. A gap is considered negative when the amount of interest-bearing liabilities exceeds the amount of interest-earning assets maturing or repricing during the same period. Generally, during a period of rising interest rates, a negative gap within shorter repricing periods adversely affects net interest income, while a positive gap within shorter repricing periods results in an increase in net interest income. During a period of falling interest rates, the opposite would generally be true.

The following gap table summarizes the anticipated maturities or repricing of the Bank's interest-earning assets and interest-bearing liabilities as of March 31, 2012, based on the information and assumptions set forth in the notes below. Cash flow projections for mortgage loans and MBS are calculated based on current interest rates. Prepayment projections are subjective in nature, involve uncertainties and assumptions and, therefore, cannot be determined with a high degree of accuracy. Although certain assets and liabilities may have similar maturities or periods to repricing, they may react differently to changes in market interest rates. Assumptions may not reflect how actual yields and costs respond to market changes. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as ARM loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. In the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the gap table. For additional

information regarding the impact of changes in interest rates, see the Percentage Change in Net Interest Income and Percentage Change in MVPE discussion and tables within this section.

79

Gap Table. The gap table summarizes the anticipated maturities or repricing of the Bank's interest-earning assets and interest-bearing liabilities as of March 31, 2012 based on the information and assumptions set forth in the notes below.

	Within Three Months (Dollars in thousands)	Three to Twelve Months	More Than One Year to Three Years	More Than Three Years to Five Years	Over Five Years	Total
<b>Interest-earning assets:</b>						
Loans receivable: (1)						
Mortgage loans:						
Fixed-rate	\$ 300,284	\$ 794,403	\$ 1,239,719	\$ 580,881	\$ 1,310,663	\$ 4,225,950
Adjustable-rate	88,398	443,741	226,717	78,839	17,311	855,006
Other loans	119,599	13,900	16,269	5,187	4,987	159,942
Investment securities (2)	56,866	264,770	52,844	695,951	1,673	1,072,104
MBS (3)	321,638	668,433	769,384	369,362	458,915	2,587,732
Other interest-earning assets	118,909	--	--	--	--	118,909
Total interest-earning assets	1,005,694	2,185,247	2,304,933	1,730,220	1,793,549	9,019,643
<b>Interest-bearing liabilities:</b>						
Deposits:						
Checking (4)	87,679	46,708	99,876	80,758	307,195	622,216
Savings (4)	84,392	12,008	27,687	21,475	119,024	264,586
Money market (4)	61,487	239,576	339,726	184,726	573,779	1,399,294
Certificates	432,155	840,537	985,097	398,374	2,147	2,658,310
Borrowings (5)	--	250,000	1,375,499	595,000	747,259	2,967,758
Total interest-bearing liabilities	665,713	1,388,829	2,827,885	1,280,333	1,749,404	7,912,164
Excess (deficiency) of interest-earning assets over interest-bearing liabilities	\$ 339,981	\$ 796,418	\$ (522,952)	\$ 449,887	\$ 44,145	\$ 1,107,479
Cumulative excess (deficiency) of interest-earning assets over interest-bearing liabilities	\$ 339,981	\$ 1,136,399	\$ 613,447	\$ 1,063,334	\$ 1,107,479	

Cumulative excess  
(deficiency) of  
interest-earning  
assets over interest-bearing  
liabilities as a  
percent of total Bank assets  
at

March 31, 2012	3.62	% 12.10	% 6.53	% 11.32	% 11.79	%
December 31, 2011	3.41	18.79	16.61	18.08	12.10	
September 30, 2011	0.84	18.60	18.18	18.21	12.51	

80

- 
- (1) ARM loans are included in the period in which the rate is next scheduled to adjust or in the period in which repayments are expected to occur, or prepayments are expected to be received, prior to their next rate adjustment, rather than in the period in which the loans are due. Fixed-rate loans are included in the periods in which they are scheduled to be repaid, based on scheduled amortization and prepayment assumptions. Balances have been reduced for loans 90 or more days delinquent, which totaled \$25.3 million at March 31, 2012.
  - (2) Based on contractual maturities, terms to call date or pre-refunding dates as of March 31, 2012, and excludes the unrealized gain adjustment of \$839 thousand on AFS investment securities.
  - (3) Reflects estimated prepayments of MBS in our portfolio, and excludes the unrealized gain adjustment of \$38.8 million on AFS MBS.
  - (4) Although the Bank's checking, savings and money market accounts are subject to immediate withdrawal, management considers a substantial amount of these accounts to be core deposits having significantly longer effective maturities. The decay rates (the assumed rate at which the balance of existing accounts would decline) used on these accounts are based on assumptions developed from our actual experience with these accounts. If all of the Bank's checking, savings and money market accounts had been assumed to be subject to repricing within one year, interest-bearing liabilities which were estimated to mature or reprice within one year would have exceeded interest-earning assets with comparable characteristics by \$617.8 million, for a cumulative one-year gap of (6.6)% of total assets.
  - (5) Borrowings exclude \$24.8 million of deferred prepayment penalty costs and \$367 thousand of deferred gain on the terminated interest rate swap agreements.

The one-year gap at March 31, 2012 was 12.10%, down from 18.79% and 18.60% at December 31, 2011 and September 30, 2011, respectively. The decrease was due primarily to an increase in interest rates during the current quarter, which reduced the amount of assets projected to reprice in the next twelve months. As interest rates increase, the amount of cash flows on mortgage-related assets and callable agency debentures expected to reprice decrease as borrowers' have less economic incentive to refinance their mortgages into lower interest rates and agency debt issuers' have less economic incentive to exercise their call options and issue lower costing debt.

Item 4. Controls and Procedures



## Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, the "Act") as of March 31, 2012. Based upon this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that as of March 31, 2012, such disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Act is accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) to allow timely decisions regarding required disclosure, and is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

## Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Act) identified in connection with the evaluation required by Rule 13a-15(d) of the Act that occurred during the Company's quarter ended March 31, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## Part II - OTHER INFORMATION

### Item 1. Legal Proceedings

We are not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. We believe that these routine legal proceedings, in the aggregate, are immaterial to our financial condition and results of operations.

### Item 1A. Risk Factors

There have been no material changes to our risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2011. For a summary of risk factors relevant to our operations, see Part I, Item 1A in our 2011 Annual Report on Form 10-K.

81

---

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

See "Liquidity and Capital Resources - Capital" in "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" regarding the OCC restrictions on dividends from the Bank to the Company.

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

The following table summarizes our share repurchase activity during the three months ended March 31, 2012 and additional information regarding our share repurchase program. On December 21, 2011, the Company announced that the Board of Directors approved the repurchase of up to \$193.0 million of the Company's common stock. This plan has no expiration date.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Additional Number of Shares Allowed for Repurchase Under New Plan	Approximate Dollar Amount of Shares that May Yet Be Purchased Under the Plan
January 1, 2012 through January 31, 2012	-	\$ -	-	-	\$ -
February 1, 2012 through February 29, 2012	-	-	-	-	-
March 1, 2012 through March 31, 2012	2,199,100	11.85	2,199,100	-	166,947,819
Total	2,199,100		2,199,100		\$ 166,947,819

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

See Index to Exhibits.

82

---

SIGNATURES

Pursuant to the requirement 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.

CAPITOL FEDERAL FINANCIAL, INC.

Date: May 4, 2012 By: /s/ John B. Dicus  
John B. Dicus, Chairman, President and Chief Executive Officer

Date: May 4, 2012 By: /s/ Kent G. Townsend  
Kent G. Townsend, Executive Vice President,  
Chief Financial Officer, and Treasurer

83

---

## INDEX TO EXHIBITS

### ExhibitNumber

	Document
2.0	Amended Plan of Conversion and Reorganization filed on October 27, 2010 as Exhibit 2 to Capitol Federal Financial, Inc.'s Post Effective Amendment No. 2 Registration Statement on Form S-1 (File No. 333-166578) and incorporated herein by reference
3(i)	Charter of Capitol Federal Financial, Inc., as filed on May 6, 2010, as Exhibit 3(i) to Capitol Federal Financial, Inc.'s Registration Statement on Form S-1 (File No. 333-166578) and incorporated herein by reference
3(ii)	Bylaws of Capitol Federal Financial, Inc., as filed on May 6, 2010, as Exhibit 3(ii) to Capitol Federal Financial Inc.'s Registration Statement on Form S-1 (File No. 333-166578) and incorporated herein by reference
10.1(i)	Capitol Federal Financial's Thrift Plan filed on November 29, 2007 as Exhibit 10.1(i) to the Annual Report on Form 10-K for Capitol Federal Financial and incorporated herein by reference

Edgar Filing: Capitol Federal Financial Inc - Form 10-Q

- 10.1(ii) Capitol Federal Financial, Inc.'s Stock Ownership Plan, as amended, filed on May 10, 2011 as Exhibit 10.1(ii) to the March 31, 2011 Form 10-Q for Capitol Federal Financial, Inc. and incorporated herein by reference
- 10.1(iii) Form of Change of Control Agreement with each of John B. Dicus, Kent G. Townsend, R. Joe Aleshire, Larry Brubaker, and Rick C. Jackson filed on January 20, 2011 as Exhibit 10.1 to the Registrant's Current Report on Form 8-K and incorporated herein by reference
- 10.2 Capitol Federal Financial's 2000 Stock Option and Incentive Plan (the "Stock Option Plan") filed on April 13, 2000 as Appendix A to Capitol Federal Financial's Revised Proxy Statement (File No. 000-25391) and incorporated herein by reference
- 10.3 Capitol Federal Financial's 2000 Recognition and Retention Plan filed on April 13, 2000 as Appendix B to Capitol Federal Financial's Revised Proxy Statement (File No. 000-25391) and incorporated herein by reference
- 10.4 Capitol Federal Financial Deferred Incentive Bonus Plan, as amended, filed on May 5, 2009 as Exhibit 10.4 to the March 31, 2009 Form 10-Q for Capitol Federal Financial and incorporated herein by reference
- 10.5 Form of Incentive Stock Option Agreement under the Stock Option Plan filed on February 4, 2005 as Exhibit 10.5 to the December 31, 2004 Form 10-Q for Capitol Federal Financial and incorporated herein by reference
- 10.6 Form of Non-Qualified Stock Option Agreement under the Stock Option Plan filed on February 4, 2005 as Exhibit 10.6 to the December 31, 2004 Form 10-Q for Capitol Federal Financial and incorporated herein by reference
- 10.7 Form of Restricted Stock Agreement under the RRP filed on February 4, 2005 as Exhibit 10.7 to the December 31, 2004 Form 10-Q for Capitol Federal Financial and incorporated herein by reference
- 10.8 Description of Named Executive Officer Salary and Bonus Arrangements filed on November 29, 2011 as Exhibit 10.8 to the Registrant's Annual Report on Form 10-K and incorporated herein by reference
- 10.9 Description of Director Fee Arrangements filed on February 9, 2011 as Exhibit 10.9 to the December 31, 2010 Form 10-Q and incorporated herein by reference
- 10.10 Short-term Performance Plan filed on August 4, 2011 as Exhibit 10.10 to the June 30, 2011 Form 10-Q and incorporated herein by reference
- 10.11 Capitol Federal Financial, Inc. 2012 Equity Incentive Plan (the "Equity Incentive Plan") filed on December 22, 2011 as Appendix A to Capitol Federal Financial, Inc.'s Proxy Statement (File No. 001-34814) and incorporated herein by reference
- 10.12 Form of Incentive Stock Option Agreement under the Equity Incentive Plan filed on February 6, 2012 as Exhibit 10.12 to the December 31, 2011 Form 10-Q and incorporated herein by reference
- 10.13 Form of Non-Qualified Stock Option Agreement under the Equity Incentive Plan filed on February 6, 2012 as Exhibit 10.13 to the December 31, 2011 Form 10-Q and incorporated herein by reference
- 10.14 Form of Stock Appreciation Right Agreement under the Equity Incentive Plan filed on February 6, 2012 as Exhibit 10.14 to the December 31, 2011 Form 10-Q and incorporated herein by reference
- 10.15 Form of Restricted Stock Agreement under the Equity Incentive Plan filed on February 6, 2012 as Exhibit 10.15 to the December 31, 2011 Form 10-Q and incorporated herein by reference
- 11 Statement re: computation of earnings per share\*
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 made by John B. Dicus, Chairman, President and Chief Executive Officer
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 made by Kent G. Townsend, Executive Vice President, Chief Financial Officer and Treasurer

Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 made by John B. Dicus, Chairman, President and Chief Executive Officer, and Kent G. Townsend, Executive Vice President, Chief Financial Officer and Treasurer

101 The following information from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, filed with the SEC on May 4, 2012, has been formatted in eXtensible Business Reporting Language: (i) Consolidated Balance Sheets at March 31, 2012 and September 30, 2011, (ii) Consolidated Statements of Operations for the three and six months ended March 31, 2012 and 2011, (iii) Consolidated Statement of Stockholders' Equity for the six months ended March 31, 2012, (iv) Consolidated Statements of Cash Flows for the six months ended March 31, 2012 and 2011, and (v) Notes to the Unaudited Consolidated Financial Statements \*\*

84

---

\*No statement is provided because the computation of per share earnings can be clearly determined from the Financial Statements included in this report.

\*\*Pursuant to SEC rules, this exhibit will not be deemed filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liability of that section.

85

---