TIMBERLAND BANCORP INC
Form 10-Q
August 06, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from _____ to _____.

Commission file number 000-23333

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

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

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

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

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

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

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

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

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

Exchange Act.

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

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

CLASS	SHARES OUTSTANDING AT AUGUST 1, 2018
Common stock, $.01 par value	7,395,927

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (unaudited)
TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
June 30, 2018 and September 30, 2017
(Dollars in thousands, except per share amounts)

	June 30, 2018 (Unaudited)	September 30, 2017 *
Assets		
Cash and cash equivalents:		
Cash and due from financial institutions	$ 19,552	$ 17,447
Interest-bearing deposits in banks	137,274	130,741
Total cash and cash equivalents	156,826	148,188
Certificates of deposit (“CDs”) held for investment (at cost, which approximates fair value)	63,132	43,034
Investment securities held to maturity, at amortized cost (estimated fair value $8,440 and $7,744)	7,951	7,139
Investment securities available for sale, at fair value	1,176	1,241
Federal Home Loan Bank of Des Moines (“FHLB”) stock	1,190	1,107
Other investments, at cost	3,000	3,000
Loans held for sale	2,321	3,599
Loans receivable, net of allowance for loan losses of $9,532 and $9,553	717,324	690,364
Premises and equipment, net	18,515	18,418
Other real estate owned (“OREO”) and other repossessed assets, net	2,112	3,301
Accrued interest receivable	2,797	2,520
Bank owned life insurance (“BOLI”)	19,673	19,266
Goodwill	5,650	5,650
Mortgage servicing rights (“MSRs”), net	1,980	1,825
Other assets	2,736	3,372
Total assets	$ 1,006,383	$ 952,024
Liabilities and shareholders’ equity		
Liabilities		
Deposits:		
Non-interest-bearing demand	$ 229,201	$ 205,952
Interest-bearing	651,526	631,946
Total deposits	880,727	837,898
Other liabilities and accrued expenses	4,762	3,126
Total liabilities	885,489	841,024

* Derived from audited consolidated financial statements.

See notes to unaudited consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS (continued)
June 30, 2018 and September 30, 2017
(Dollars in thousands, except per share amounts)

	June 30, 2018 (Unaudited)	September 30, 2017 *
Shareholders' equity		
Preferred stock, $.01 par value; 1,000,000 shares authorized; none issued	$—	$ —
Common stock, $.01 par value; 50,000,000 shares authorized; 7,395,927 shares issued and outstanding - June 30, 2018 7,361,077 shares issued and outstanding - September 30, 2017	14,162	13,286
Unearned shares issued to Employee Stock Ownership Plan ("ESOP")	(199)	(397)
Retained earnings	107,065	98,235
Accumulated other comprehensive loss	(134)	(124)
Total shareholders' equity	120,894	111,000
Total liabilities and shareholders' equity	$1,006,383	$ 952,024

* Derived from audited consolidated financial statements.

See notes to unaudited consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the three and nine months ended June 30, 2018 and 2017
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Interest and dividend income				
Loans receivable and loans held for sale	$9,530	$9,652	$28,342	$27,280
Investment securities	51	69	147	207
Dividends from mutual funds, FHLB stock and other investments	31	23	83	60
Interest-bearing deposits in banks and CDs	845	421	2,209	1,081
Total interest and dividend income	10,457	10,165	30,781	28,628
Interest expense				
Deposits	730	549	1,996	1,637
FHLB borrowings	—	369	—	979
Total interest expense	730	918	1,996	2,616
Net interest income	9,727	9,247	28,785	26,012
Recapture of loan losses	—	(1,000)	—	(1,250)
Net interest income after recapture of loan losses	9,727	10,247	28,785	27,262
Non-interest income				
Recoveries (other than temporary impairment "OTTI") on investment securities	19	—	60	—
Adjustment for portion of OTTI transferred from other comprehensive income (loss) before income taxes	—	—	(5)	—
Net recoveries on investment securities	19	—	55	—
Service charges on deposits	1,137	1,153	3,447	3,348
ATM and debit card interchange transaction fees	921	855	2,648	2,448
BOLI net earnings	134	133	407	406
Gain on sales of loans, net	435	561	1,427	1,656
Escrow fees	47	51	158	191
Servicing income on loans sold	121	106	354	302
Other, net	331	297	868	873
Total non-interest income, net	3,145	3,156	9,364	9,224

See notes to unaudited consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (continued)
For the three and nine months ended June 30, 2018 and 2017
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Non-interest expense				
Salaries and employee benefits	$3,912	$ 3,741	$11,862	$ 11,176
Premises and equipment	795	764	2,361	2,295
(Gain) loss on sales of premises and equipment, net	—	3	(113)	3
Advertising	205	170	591	499
OREO and other repossessed assets, net	(92)	4	114	22
ATM and debit card interchange transaction fees	334	375	982	1,036
Postage and courier	104	109	340	324
State and local taxes	169	176	498	484
Professional fees	368	230	829	629
Federal Deposit Insurance Corporation ("FDIC") insurance	101	99	242	319
Loan administration and foreclosure	76	20	247	113
Data processing and telecommunications	465	480	1,427	1,394
Deposit operations	285	301	815	850
Other	400	466	1,324	1,462
Total non-interest expense	7,122	6,938	21,519	20,606
Income before income taxes	5,750	6,465	16,630	15,880
Provision for income taxes	1,334	2,188	4,331	5,328
Net income	$4,416	$ 4,277	$12,299	$ 10,552
Net income per common share				
Basic	$0.60	$ 0.59	$1.68	$ 1.49
Diluted	$0.59	$ 0.58	$1.64	$ 1.44
Weighted average common shares outstanding				
Basic	7,345,618	7,269,564	7,328,702	7,088,134
Diluted	7,535,157	7,432,171	7,518,447	7,348,486
Dividends paid per common share	$0.23	$ 0.11	$0.47	$ 0.31

See notes to unaudited consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the three and nine months ended June 30, 2018 and 2017
(Dollars in thousands)
(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Comprehensive income				
Net income	$4,416	$4,277	$12,299	$10,552
Unrealized holding (loss) gain on investment securities available for sale, net of income taxes of ($1), $3, ($5) and ($11), respectively	(7)	5	(32)	(22)
Change in OTTI on investment securities held to maturity, net of income taxes:				
Adjustments related to other factors for which OTTI was previously recognized, net of income taxes of $0, $0, ($2) and $0, respectively	—	—	(6)	—
Amount reclassified to credit loss for previously recorded market loss, net of income taxes of $0, $0, $1 and $0, respectively	—	—	4	—
Accretion of OTTI on investment securities held to maturity, net of income taxes of $2, $5, $8 and $18, respectively	5	11	24	35
Total other comprehensive (loss) income, net of income taxes	(2)	16	(10)	13
Total comprehensive income	$4,414	$4,293	$12,289	$10,565

See notes to unaudited consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the nine months ended June 30, 2018 and 2017
(Dollars in thousands, except per share amounts)
(Unaudited)

	Common Stock		Unearned Shares Issued to ESOP	Retained Earnings	Accumulated Other Compre-hensive Loss	Total
	Number of Shares	Amount				
Balance, September 30, 2016	6,943,868	$9,961	$ (661)	$87,709	$ (175)	$96,834
Net income	—	—	—	10,552	—	10,552
Other comprehensive income	—	—	—	—	13	13
Exercise of stock warrant	370,899	2,496	—	—	—	2,496
Exercise of stock options	39,810	265	—	—	—	265
Common stock dividends ($0.31 per common share)	—	—	—	(2,243)	—	(2,243)
Earned ESOP shares, net of income taxes	—	230	198	—	—	428
Stock option compensation expense	—	271	—	—	—	271
Balance, June 30, 2017	7,354,577	13,223	(463)	96,018	(162)	108,616
Balance, September 30, 2017	7,361,077	13,286	(397)	98,235	(124)	111,000
Net income	—	—	—	12,299	—	12,299
Other comprehensive loss	—	—	—	—	(10)	(10)
Exercise of stock options	34,850	292	—	—	—	292
Common stock dividends ($0.47 per common share)	—	—	—	(3,469)	—	(3,469)
Earned ESOP shares, net of income taxes	—	454	198	—	—	652
Stock option compensation expense	—	130	—	—	—	130
Balance, June 30, 2018	7,395,927	$14,162	$ (199)	$107,065	$ (134)	$120,894

See notes to unaudited consolidated financial statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the nine months ended June 30, 2018 and 2017
(In thousands)
(Unaudited)

	Nine Months Ended June 30, 2018	2017
Cash flows from operating activities		
Net income	$12,299	$10,552
Adjustments to reconcile net income to net cash provided by operating activities:		
Recapture of loan losses	—	(1,250)
Depreciation	940	946
Earned ESOP shares	652	428
Stock option compensation expense	130	271
Net recoveries on investment securities	(55)	—
Gain on sales of OREO and other repossessed assets, net	(217)	(53)
Provision for OREO losses	224	42
Gain on sales of loans, net	(1,427)	(1,656)
(Gain) loss on sales of premises and equipment, net	(113)	3
Loans originated for sale	(46,256)	(54,805)
Proceeds from sales of loans	48,961	56,542
Amortization of MSRs	363	369
BOLI net earnings	(407)	(406)
Increase in deferred loan origination fees	3	80
Net change in accrued interest receivable and other assets, and other liabilities and accrued expenses	1,445	(332)
Net cash provided by operating activities	16,542	10,731
Cash flows from investing activities		
Net (increase) decrease in CDs held for investment	(20,098)	11,813
Proceeds from maturities and prepayments of investment securities held to maturity	413	387
Purchase of investment securities held to maturity	(1,111)	—
Proceeds from maturities and prepayments of investment securities available for sale	28	49
Purchase of FHLB stock	(83)	(103)
Redemption of FHLB stock	—	1,200
Purchase of other investments	—	(3,000)
Increase in loans receivable, net	(27,287)	(23,566)
Additions to premises and equipment	(1,387)	(3,249)
Proceeds from sales of premises and equipment	463	—
Proceeds from sales of OREO and other repossessed assets	1,506	1,435
Net cash used in investing activities	(47,556)	(15,034)

See notes to unaudited consolidated financial statements

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TIMBERLAND BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
For the nine months ended June 30, 2018 and 2017
(In thousands)
(Unaudited)

	Nine Months Ended June 30,	
	2018	2017
Cash flows from financing activities		
Net increase in deposits	$42,829	$57,284
Repayment of FHLB borrowings	—	(30,000)
Proceeds from exercise of stock options	292	265
Proceeds from exercise of stock warrant	—	2,496
Payment of dividends	(3,469)	(2,243)
Net cash provided by financing activities	39,652	27,802
Net increase in cash and cash equivalents	8,638	23,499
Cash and cash equivalents		
Beginning of period	148,188	108,941
End of period	$156,826	$132,440
Supplemental disclosure of cash flow information		
Income taxes paid	$2,208	$5,376
Interest paid	1,939	2,701
Supplemental disclosure of non-cash investing activities		
Loans transferred to OREO and other repossessed assets	$324	$724
Other comprehensive (loss) income related to investment securities	(10)	13

See notes to unaudited consolidated financial statements

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

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

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

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

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

(e) Certain prior period amounts have been reclassified to conform to the June 30, 2018 presentation with no change to net income or total shareholders' equity as previously reported.

(2) INVESTMENT SECURITIES

Held to maturity and available for sale investment securities have been classified according to management's intent and were as follows as of June 30, 2018 and September 30, 2017 (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2018				
Held to maturity				
Mortgage-backed securities ("MBS"):				
U.S. government agencies	$ 1,466	$ 9	$ (19)	$ 1,456
Private label residential	489	575	(1)	1,063
U.S. Treasury and U.S government agency securities	5,996	—	(75)	5,921
Total	$ 7,951	$ 584	$ (95)	$ 8,440
Available for sale				
MBS: U.S. government agencies	$ 243	$ 9	$ —	$ 252
Mutual funds	1,000	—	(76)	924
Total	$ 1,243	$ 9	$ (76)	$ 1,176
September 30, 2017				
Held to maturity				
MBS:				
U.S. government agencies	$ 532	$ 11	$ (1)	$ 542
Private label residential	599	596	(2)	1,193
U.S. Treasury and U.S. government agency securities	6,008	10	(9)	6,009
Total	$ 7,139	$ 617	$ (12)	$ 7,744
Available for sale				
MBS: U.S. government agencies	$ 271	$ 18	$ —	$ 289
Mutual funds	1,000	—	(48)	952
Total	$ 1,271	$ 18	$ (48)	$ 1,241

Held to maturity and available for sale investment securities with unrealized losses were as follows for June 30, 2018 (dollars in thousands):

	Less Than 12 Months			12 Months or Longer			Total	
	Estimated Fair Value	Gross Unrealized Losses	Quantity	Estimated Fair Value	Gross Unrealized Losses	Quantity	Estimated Fair Value	Gross Unrealized Losses
Held to maturity								
MBS:								
U.S. government agencies	$1,010	$ (18)	2	$67	$ (1)	5	$1,077	$ (19)
Private label residential	—	—	—	52	(1)	8	52	(1)
U.S. Treasury and U.S. government agency securities	5,921	(75)	2	—	—	—	5,921	(75)
Total	$6,931	$ (93)	4	$119	$ (2)	13	$7,050	$ (95)
Available for sale								
MBS: U.S. government agency	$35	$ —	1	$—	$ —	—	$35	$ —
Mutual funds	—	—	—	924	(76)	1	924	(76)
Total	$35	$ —	1	$924	$ (76)	1	$959	$ (76)

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

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

The Company has evaluated the investment securities in the above tables and has determined that the decline in their value is temporary. The unrealized losses are primarily due to changes in market interest rates and spreads in the market for mortgage-related products. The fair value of these securities is expected to recover as the securities approach their maturity dates and/or as the pricing spreads narrow on mortgage-related securities. The Company has the ability and the intent to hold the investments until the market value recovers. Furthermore, as of June 30, 2018, management does not have the intent to sell any of the securities classified as available for sale where the estimated fair value is below the recorded value and believes that it is more likely than not that the Company will not have to sell such securities before a recovery of cost (or recorded value if previously written down).

The Company bifurcates OTTI into (1) amounts related to credit losses which are recognized through earnings and (2) amounts related to all other factors which are recognized as a component of other comprehensive income (loss). To determine the component of the gross OTTI related to credit losses, the Company compared the amortized cost basis of the OTTI security to the present value of its revised expected cash flows, discounted using its pre-impairment yield. The revised expected cash flow estimates for individual securities are based primarily on an analysis of default rates, prepayment speeds and third-party analytic reports. Significant judgment by management is required in this analysis that includes, but is not limited to, assumptions regarding the collectability of principal and interest, net of related expenses, on the underlying loans.

The following table presents a summary of the significant inputs utilized to measure management's estimates of the credit loss component on OTTI securities as of June 30, 2018 and 2017:

	Range Minimum	Maximum	Weighted Average
June 30, 2018			
Constant prepayment rate	6.00 %	15.00 %	11.58 %
Collateral default rate	— %	12.31 %	5.51 %
Loss severity rate	— %	74.00 %	42.49 %
June 30, 2017			
Constant prepayment rate	6.00 %	15.00 %	11.54 %
Collateral default rate	0.09 %	9.88 %	4.66 %
Loss severity rate	6.00 %	62.00 %	41.93 %

The following table presents the OTTI recoveries (losses) for the three and nine months ended June 30, 2018 and 2017 (dollars in thousands):

	Three Months Ended June 30, 2018 Held To Maturity	Three Months Ended June 30, 2018 Available For Sale	Three Months Ended June 30, 2017 Held To Maturity	Three Months Ended June 30, 2017 Available For Sale
Total recoveries	$ 19	$ —	$ —	$ —
Adjustment for portion of OTTI transferred from other comprehensive income (loss) before income taxes (1)	—	—	—	—
Net recoveries recognized in earnings (2)	$ 19	$ —	$ —	$ —

	Nine Months Ended June 30, 2018 Held To Maturity	Nine Months Ended June 30, 2018 Available For Sale	Nine Months Ended June 30, 2017 Held To Maturity	Nine Months Ended June 30, 2017 Available For Sale
Total recoveries	$ 60	$ —	$ —	$ —
Adjustment for portion of OTTI transferred from other comprehensive income (loss) before income taxes (1)	(5)	—	—	—
Net recoveries recognized in earnings (2)	$ 55	$ —	$ —	$ —

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

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The following table presents a roll forward of the credit loss component of held to maturity and available for sale debt securities that have been written down for OTTI with the credit loss component recognized in earnings for the nine months ended June 30, 2018 and 2017 (dollars in thousands):

	Nine Months Ended June 30,	
	2018	2017
Beginning balance of credit loss	$1,301	$1,505
Additions:		
Additional increases to the amount related to credit loss for which OTTI was previously recognized	14	—
Subtractions:		
Realized losses previously recorded as credit losses	(69)	(48)
Recovery of prior credit loss	(55)	—
Ending balance of credit loss	$1,191	$1,457

During the three months ended June 30, 2018, the Company recorded a $28,000 net realized loss (as a result of the securities being deemed worthless) on 16 held to maturity investment securities, of which the entire amount had been recognized previously as a credit loss. During the nine months ended June 30, 2018, the Company recorded a $69,000 net realized loss (as a result of securities being deemed worthless) on 17 held to maturity residential MBS, of which the entire amount had been previously recognized as a credit loss. During the three months ended June 30, 2017, the Company recorded a $12,000 net realized loss (as a result of the securities being deemed worthless) on 15 held to maturity investment securities, of which the entire amount had been recognized previously as a credit loss. During the nine months ended June 30, 2017, the Company recorded a $48,000 net realized loss (as a result of securities being deemed worthless) on 18 held to maturity residential MBS, of which the entire amount had been previously recognized as a credit loss.

The recorded amount of investment securities pledged as collateral for public fund deposits, federal treasury tax and loan deposits, FHLB collateral and other non-profit organization deposits totaled $7.20 million and $6.82 million at June 30, 2018 and September 30, 2017, respectively.

The contractual maturities of debt securities at June 30, 2018 were as follows (dollars in thousands). Expected maturities may differ from scheduled maturities due to the prepayment of principal or call provisions.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	$3,001	$ 2,983	$—	$ —
Due after one year to five years	4,018	3,943	—	—
Due after five years to ten years	42	42	—	—
Due after ten years	890	1,472	243	252
Total	$7,951	$ 8,440	$243	$ 252

(3) GOODWILL

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

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

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

Management's qualitative assessment takes into consideration macroeconomic conditions, industry and market considerations, cost or margin factors, financial performance and share price. Based on this assessment, the Company determined that it is not "more likely than not" that the Company's fair value is less than its carrying amount and therefore goodwill was determined not to be impaired at May 31, 2018.

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

As of June 30, 2018, management believes that there have been no events or changes in the circumstances since May 31, 2018 that would indicate a potential impairment of goodwill. No assurances can be given, however, that the Company will not record an impairment loss on goodwill in the future.

(4) LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable by portfolio segment consisted of the following at June 30, 2018 and September 30, 2017 (dollars in thousands):

	June 30, 2018		September 30, 2017	
	Amount	Percent	Amount	Percent
Mortgage loans:				
One- to four-family (1)	$114,148	14.4 %	$118,147	15.1 %
Multi-family	58,169	7.3	58,607	7.5
Commercial	345,543	43.5	328,927	41.9
Construction - custom and owner/builder	113,468	14.3	117,641	15.0
Construction - speculative one- to four-family	10,146	1.3	9,918	1.2
Construction - commercial	26,347	3.3	19,630	2.5
Construction - multi-family	15,225	1.9	21,327	2.7
Construction - land development	3,190	0.4	—	—
Land	23,662	3.0	23,910	3.0
Total mortgage loans	709,898	89.4	698,107	88.9
Consumer loans:				
Home equity and second mortgage	38,143	4.8	38,420	4.9
Other	3,674	0.4	3,823	0.5
Total consumer loans	41,817	5.2	42,243	5.4
Commercial business loans (2)	43,284	5.4	44,444	5.7
Total loans receivable	794,999	100.0%	784,794	100.0%
Less:				
Undisbursed portion of construction loans in process	65,674		82,411	
Deferred loan origination fees, net	2,469		2,466	
Allowance for loan losses	9,532		9,553	
	77,675		94,430	
Loans receivable, net	$717,324		$690,364	

(1) Does not include one- to four-family loans held for sale totaling $2,321 and $3,515 at June 30, 2018 and September 30, 2017, respectively.
(2) Does not include commercial business loans held for sale totaling $0 and $84 at June 30, 2018 and September 30, 2017, respectively.

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Allowance for Loan Losses

The following tables set forth information for the three and nine months ended June 30, 2018 and 2017 regarding activity in the allowance for loan losses by portfolio segment (dollars in thousands):

	Three Months Ended June 30, 2018				
	Beginning Allowance	Provision for (Recapture of) Loan Losses	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One- to four-family	$1,060	$ (33)	$ —	$ —	$ 1,027
Multi-family	386	21	—	—	407
Commercial	4,198	(15)	—	—	4,183
Construction – custom and owner/builder	705	(38)	—	—	667
Construction – speculative one- to four-family	99	34	—	—	133
Construction – commercial	445	74	—	—	519
Construction – multi-family	284	(137)	—	—	147
Construction – land development	48	32	—	—	80
Land	691	64	(16)	5	744
Consumer loans:					
Home equity and second mortgage	945	1	—	—	946
Other	120	2	(1)	—	121
Commercial business loans	563	(5)	—	—	558
Total	$9,544	$ —	$ (17)	$ 5	$ 9,532

	Nine Months Ended June 30, 2018				
	Beginning Allowance	Provision for (Recapture of) Loan Losses	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One-to four-family	$1,082	$ (55)	$ —	$ —	$ 1,027
Multi-family	447	(40)	—	—	407
Commercial	4,184	27	(28)	—	4,183
Construction – custom and owner/builder	699	(32)	—	—	667
Construction – speculative one- to four-family	128	(6)	—	11	133
Construction – commercial	303	216	—	—	519
Construction – multi-family	173	(26)	—	—	147
Construction – land development	—	80	—	—	80
Land	918	(172)	(16)	14	744
Consumer loans:					
Home equity and second mortgage	983	(37)	—	—	946
Other	121	2	(3)	1	121
Commercial business loans	515	43	—	—	558

Total	$9,553	$ —	$ (47)	$ 26	$ 9,532

	Three Months Ended June 30, 2017				
	Beginning Allowance	Provision for (Recapture of) Loan Losses	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One- to four-family	$1,126	$(11)	$ —	$ —	$ 1,115
Multi-family	480	(16)	—	—	464
Commercial	4,316	(1,040)	—	1,061	4,337
Construction – custom and owner/builder	695	17	—	—	712
Construction – speculative one- to four-family	85	(15)	—	5	75
Construction – commercial	268	15	—	—	283
Construction – multi-family	96	36	—	—	132
Land	947	1	(49)	5	904
Consumer loans:					
Home equity and second mortgage	957	(2)	—	—	955
Other	130	6	(2)	—	134
Commercial business loans	490	9	—	—	499
Total	$9,590	$(1,000)	$ (51)	$ 1,071	$ 9,610

	Nine Months Ended June 30, 2017				
	Beginning Allowance	Provision for (Recapture of) Loan Losses	Charge-offs	Recoveries	Ending Allowance
Mortgage loans:					
One-to four-family	$1,239	$(145)	$ —	$ 21	$ 1,115
Multi-family	473	(9)	—	—	464
Commercial	4,384	(1,095)	(13)	1,061	4,337
Construction – custom and owner/builder	619	93	—	—	712
Construction – speculative one- to four-family	130	(60)	—	5	75
Construction – commercial	268	15	—	—	283
Construction – multi-family	316	(184)	—	—	132
Land	820	120	(51)	15	904
Consumer loans:					
Home equity and second mortgage	939	16	—	—	955
Other	156	(18)	(6)	2	134
Commercial business loans	482	17	—	—	499
Total	$9,826	$(1,250)	$ (70)	$ 1,104	$ 9,610

The following tables present information on the loans evaluated individually and collectively for impairment in the allowance for loan losses by portfolio segment at June 30, 2018 and September 30, 2017 (dollars in thousands):

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
June 30, 2018						
Mortgage loans:						
One- to four-family	$—	$ 1,027	$1,027	$1,873	$ 112,275	$114,148
Multi-family	—	407	407	—	58,169	58,169
Commercial	—	4,183	4,183	2,801	342,742	345,543
Construction – custom and owner/builder	—	667	667	—	66,651	66,651
Construction – speculative one- to four-family	—	133	133	—	5,312	5,312
Construction – commercial	—	519	519	—	21,640	21,640
Construction – multi-family	—	147	147	—	6,526	6,526
Construction – land development	—	80	80	—	2,573	2,573
Land	—	744	744	540	23,122	23,662
Consumer loans:						
Home equity and second mortgage	297	649	946	570	37,573	38,143
Other	—	121	121		3,674	3,674
Commercial business loans	61	497	558	174	43,110	43,284
Total	$358	$ 9,174	$9,532	$5,958	$ 723,367	$729,325
September 30, 2017						
Mortgage loans:						
One- to four-family	$—	$ 1,082	$1,082	$1,443	$ 116,704	$118,147
Multi-family	—	447	447	—	58,607	58,607
Commercial	26	4,158	4,184	3,873	325,054	328,927
Construction – custom and owner/builder	—	699	699	—	63,538	63,538
Construction – speculative one- to four-family	—	128	128	—	4,639	4,639
Construction – commercial	—	303	303	—	11,016	11,016
Construction – multi-family	—	173	173	—	6,912	6,912
Land	125	793	918	1,119	22,791	23,910
Consumer loans:						
Home equity and second mortgage	325	658	983	557	37,863	38,420
Other	—	121	121	—	3,823	3,823
Commercial business loans	—	515	515	—	44,444	44,444
Total	$476	$ 9,077	$9,553	$6,992	$ 695,391	$702,383

The following tables present an analysis of loans by aging category and portfolio segment at June 30, 2018 and September 30, 2017 (dollars in thousands):

	30–59 Days Past Due	60-89 Days Past Due	Non-Accrual (1)	Past Due 90 Days or More and Still Accruing	Total Past Due	Current	Total Loans
June 30, 2018							
Mortgage loans:							
One- to four-family	$—	$—	$1,361	$ —	$1,361	$112,787	$114,148
Multi-family	—	—	—	—	—	58,169	58,169
Commercial	103	—	598	—	701	344,842	345,543
Construction – custom and owner/builder	—	—	—	—	—	66,651	66,651
Construction – speculative one- to four- family	—	—	—	—	—	5,312	5,312
Construction – commercial	—	—	—	—	—	21,640	21,640
Construction – multi-family	—	—	—	—	—	6,526	6,526
Construction – land development	—	—	—	—	—	2,573	2,573
Land	42	—	295	—	337	23,325	23,662
Consumer loans:							
Home equity and second mortgage	34	—	278	428	740	37,403	38,143
Other	4	—	—	—	4	3,670	3,674
Commercial business loans	110	—	174	—	284	43,000	43,284
Total	$293	$—	$2,706	$ 428	$3,427	$725,898	$729,325

September 30, 2017							
Mortgage loans:							
One- to four-family	$193	$—	$874	$ —	$1,067	$117,080	$118,147
Multi-family	—	—	—	—	—	58,607	58,607
Commercial	—	107	213	—	320	328,607	328,927
Construction – custom and owner/ builder	—	—	—	—	—	63,538	63,538
Construction – speculative one- to four- family	—	—	—	—	—	4,639	4,639
Construction – commercial	—	—	—	—	—	11,016	11,016
Construction – multi-family	—	—	—	—	—	6,912	6,912
Land	—	—	566	—	566	23,344	23,910
Consumer loans:							
Home equity and second mortgage	56	—	258	—	314	38,106	38,420
Other	36	—	—	—	36	3,787	3,823
Commercial business loans	110	—	—	—	110	44,334	44,444
Total	$395	$107	$1,911	$ —	$2,413	$699,970	$702,383

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

Credit Quality Indicators

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

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

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

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

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

Loss: Loans in this classification are considered uncollectible and of such little value that continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this loan even though partial recovery may be realized in the future. At June 30, 2018 and September 30, 2017, there were no loans classified as loss.

The following tables present an analysis of loans by credit quality indicator and portfolio segment at June 30, 2018 and September 30, 2017 (dollars in thousands):

	Loan Grades				
June 30, 2018	Pass	Watch	Special Mention	Substandard	Total
Mortgage loans:					
One- to four-family	$110,784	$888	$ 587	$ 1,889	$114,148
Multi-family	58,169	—	—	—	58,169
Commercial	335,497	5,961	3,199	886	345,543
Construction – custom and owner/builder	65,739	912	—	—	66,651
Construction – speculative one- to four-family	5,312	—	—	—	5,312
Construction – commercial	21,640	—	—	—	21,640
Construction – multi-family	6,526	—	—	—	6,526
Construction – land development	2,573	—	—	—	2,573
Land	20,610	996	1,761	295	23,662
Consumer loans:					
Home equity and second mortgage	37,559	144	—	440	38,143
Other	3,639	—	—	35	3,674
Commercial business loans	43,037	24	49	174	43,284
Total	$711,085	$8,925	$ 5,596	$ 3,719	$729,325

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

Impaired Loans

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

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

The following table is a summary of information related to impaired loans by portfolio segment as of June 30, 2018 and for the three and nine months then ended (dollars in thousands):

	Recorded Investment	Unpaid Principal Balance (Loan Balance Plus Charge Off)	Related Allowance	Quarter to Date ("QTD") Average Recorded Investment (1)	Year to Date ("YTD") Average Recorded Investment (2)	QTD Interest Income Recognized (1)	YTD Interest Income Recognized (2)	QTD Cash Basis Interest Income Recognized (1)	YTD Cash Basis Interest Income Recognized (2)
With no related allowance recorded:									
Mortgage loans:									
One- to four-family	$ 1,873	$ 2,020	$ —	$ 1,596	$ 1,514	$ 21	$ 62	$ 18	$ 53
Commercial	2,801	2,801	—	2,690	2,374	38	114	31	93
Land	540	644	—	493	332	5	11	5	10
Consumer loans:									
Home equity and second mortgage	195	195	—	190	173	—	3	—	3
Subtotal	5,409	5,660	—	4,969	4,393	64	190	54	159
With an allowance recorded:									
Mortgage loans:									
One- to four-family	—	—	—	—	11	—	—	—	—
Commercial	—	—	—	—	950	—	27	—	21
Land	—		—	98	479	—	9	—	8
Consumer loans:									
Home equity and second mortgage	375	375	297	335	350	5	16	3	13
Commercial business loans	174	174	61	178	134	—	—	—	—
Subtotal	549	549	358	611	1,924	5	52	3	42
Total:									
Mortgage loans:									
One- to four-family	1,873	2,020	—	1,596	1,525	21	62	18	53
Commercial	2,801	2,801	—	2,690	3,324	38	141	31	114
Land	540	644	—	591	811	5	20	5	18
Consumer loans:									
Home equity and second mortgage	570	570	297	525	523	5	19	3	16
Commercial business loans	174	174	61	178	134	—	—	—	—
Total	$ 5,958	$ 6,209	$ 358	$ 5,580	$ 6,317	$ 69	$ 242	$ 57	$ 201

(1) For the three months ended June 30, 2018.
(2) For the nine months ended June 30, 2018.

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

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

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

A troubled debt restructured loan ("TDR") is a loan for which the Company, for reasons related to a borrower's financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. Examples of such concessions include but are not limited to: a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market rates; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-amortizations, extensions, deferrals and renewals. TDRs are considered impaired and are individually evaluated for impairment. TDRs are classified as non-accrual (and considered to be non-performing) unless they have been performing in accordance with modified terms for a period of at least six months. The Company had $3.12 million and $3.60 million in TDRs included in impaired loans at June 30, 2018 and September 30, 2017, respectively, and had no commitments at these dates to lend additional funds on these loans. The allowance for loan losses allocated to TDRs at June 30, 2018 and September 30, 2017 was $0 and $10,000, respectively. There were no TDRs for which there was a payment default within the first 12 months of the modification during the nine months ended June 30, 2018.

The following tables set forth information with respect to the Company's TDRs by interest accrual status as of June 30, 2018 and September 30, 2017 (dollars in thousands):

	June 30, 2018		
	Accruing	Non-Accrual	Total
Mortgage loans:			
One- to four-family	$512	$ —	$512
Commercial	2,203	—	2,203
Land	245	155	400
Total	$2,960	$ 155	$3,115

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

There was one new TDR during the nine months ended June 30, 2018 as a result of a reduction in the face amount of the debt on a land loan. This TDR had a pre-modification balance of $214,000, a post-modification balance of $155,000 and a balance at June 30, 2018 of $155,000. There were no new TDRs during the year ended September 30, 2017.

(5) NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income to common shareholders by the weighted average number of common shares outstanding during the period, without considering any dilutive items. Diluted net income per common share is computed by dividing net income to common shareholders by the weighted average number of common shares and common stock equivalents for items that are dilutive, net of shares assumed to be repurchased using the treasury stock method at the average share price for the Company’s common stock during the period. Common stock equivalents arise from the assumed conversion of outstanding stock options and the outstanding warrant to purchase common stock. Shares owned by the Bank’s ESOP that have not been allocated are not considered to be outstanding for the purpose of computing basic and diluted net income per common share. At June 30, 2018 and 2017, there were 45,999 and 79,032 shares, respectively, that had not been allocated under the Bank’s ESOP.

Information regarding the calculation of basic and diluted net income per common share for the three and nine months ended June 30, 2018 and 2017 is as follows (dollars in thousands, except share and per share amounts):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Basic net income per common share computation				
Numerator – net income	$4,416	$ 4,277	$12,299	$ 10,552
Denominator – weighted average common shares outstanding	7,345,618	7,269,564	7,328,702	7,088,134
Basic net income per common share	$0.60	$ 0.59	$1.68	$ 1.49
Diluted net income per common share computation				
Numerator – net income	$4,416	$ 4,277	$12,299	$ 10,552
Denominator – weighted average common shares outstanding	7,345,618	7,269,564	7,328,702	7,088,134
Effect of dilutive stock options (1)	189,539	162,607	189,745	153,941
Effect of dilutive stock warrant (2)	—	—	—	106,411
Weighted average common shares outstanding - assuming dilution	7,535,157	7,432,171	7,518,447	7,348,486
Diluted net income per common share	$0.59	$ 0.58	$1.64	$ 1.44

(1) For the three months ended June 30, 2018, all outstanding options were included in the computation of diluted net income per share. For the nine months ended June 30, 2018, average options to purchase 38,709 shares of common stock were outstanding but not included in the computation of diluted net income per common share because their effect would have been anti-dilutive. For the three and nine months ended June 30, 2017, all outstanding options were included in the computation of diluted net income per share.

(2) Represented a warrant to purchase 370,899 shares of the Company's common stock at an exercise price of $6.73 per share (subject to anti-dilution adjustments) at any time through December 23, 2018 (the "Warrant"). On January 31, 2017, the Warrant was exercised and 370,899 shares of the Company's common stock were issued in exchange for $2.50 million.

(6) ACCUMULATED OTHER COMPREHENSIVE LOSS

The changes in accumulated other comprehensive loss ("AOCI") by component during the three and nine months ended June 30, 2018 and 2017 are as follows (dollars in thousands):

	Three Months Ended June 30, 2018		
	Changes in fair value of available for sale securities (1)	Changes in OTTI on held to maturity securities (1)	Total (1)
Balance of AOCI at the beginning of period	$(44)	$ (88)	$(132)
Net change	(7)	5	(2)
Balance of AOCI at the end of period	$(51)	$ (83)	$(134)

	Nine Months Ended June 30, 2018		
	Changes in fair value of available for sale securities (1)	Changes in OTTI on held to maturity securities (1)	Total (1)
Balance of AOCI at the beginning of period	$(19)	$ (105)	$(124)
Net change	(32)	22	(10)
Balance of AOCI at the end of period	$(51)	$ (83)	$(134)

	Three Months Ended June 30, 2017		
	Changes in fair value of available for sale securities (1)	Changes in OTTI on held to maturity securities (1)	Total (1)
Balance of AOCI at the beginning of period	$(23)	$ (155)	$(178)
Net change	5	11	16
Balance of AOCI at the end of period	$(18)	$ (144)	$(162)

Nine Months Ended June 30, 2017

	Changes in fair value of available for sale securities (1)	Changes in OTTI on held to maturity securities (1)	Total (1)
Balance of AOCI at the beginning of period	$4	$ (179)	$(175)
Net change	(22)	35	13
Balance of AOCI at the end of period	$(18)	$ (144)	$(162)

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(1) All amounts are net of income taxes.

(7) STOCK COMPENSATION PLANS

Under the Company's 2003 Stock Option Plan, the Company was able to grant options for up to 300,000 shares of common stock to employees, officers, directors and directors emeriti. Under the Company's 2014 Equity Incentive Plan, the Company is able to grant options and awards of restricted stock (with or without performance measures) for up to 352,366 shares of common stock to employees, officers, directors and directors emeriti. Shares issued may be purchased in the open market or may be issued from authorized and unissued shares. The exercise price of each option equals the fair market value of the Company's common stock on the date of grant. Generally, options and restricted stock vest in 20% annual installments on each of the five anniversaries from the date of the grant, and options generally have a maximum contractual term of 10 years from the date of grant. At June 30, 2018, there were 117,366 shares of common stock available which may be awarded as options or restricted stock pursuant to future grant under the 2014 Equity Incentive Plan.

At both June 30, 2018 and 2017, there were no unvested restricted stock awards. There were no restricted stock grants awarded during the nine months ended June 30, 2018 and 2017.

Stock option activity for the nine months ended June 30, 2018 and 2017 is summarized as follows:

	Nine Months Ended June 30, 2018			Nine Months Ended June 30, 2017		
	Number of Shares		Weighted Average Exercise Price	Number of Shares		Weighted Average Exercise Price
Options outstanding, beginning of period	380,120		$ 13.23	373,130		$ 9.82
Exercised	(34,850	)	8.39	(39,810	)	6.65
Forfeited	(5,150	)	13.39	(4,950	)	6.28
Options outstanding, end of period	340,120		$ 13.73	328,370		$ 10.26

The aggregate intrinsic value of options exercised during the nine months ended June 30, 2018 and 2017 was $741,000 and $545,000, respectively.

At June 30, 2018, there were 183,150 unvested options with an aggregate grant date fair value of $454,000, all of which the Company assumes will vest. The aggregate intrinsic value of unvested options at June 30, 2018 was $3.61 million. There were 43,900 options with an aggregate grant date fair value of $104,000 that vested during the nine months ended June 30, 2018.

At June 30, 2017, there were 201,100 unvested options with an aggregate grant date fair value of $393,000. There were 48,600 options with an aggregate grant date fair value of $111,000 that vested during the nine months ended June 30, 2017.

Additional information regarding options outstanding at June 30, 2018 is as follows:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices ($)	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
$ 4.01 - 4.55	6,000	$ 4.28	2.4	6,000	$ 4.28	2.4
5.86 - 6.00	30,300	5.96	4.3	30,300	5.96	4.3
9.00	72,800	9.00	5.3	54,600	9.00	5.3
10.26 - 10.71	121,320	10.58	6.8	57,470	10.54	6.7
15.67	52,200	15.67	8.3	8,600	15.67	8.3
29.69	57,500	29.69	9.3	—	N/A	NA
	340,120	$ 13.73	6.8	156,970	$ 9.16	5.7

The aggregate intrinsic value of options outstanding at June 30, 2018 and 2017 was $8.03 million and $4.93 million, respectively.

As of June 30, 2018, unrecognized compensation cost related to non-vested stock options was $358,000, which is expected to be recognized over a weighted average life of 2.10 years.

(8) FAIR VALUE MEASUREMENTS

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

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

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

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

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

The Company had no liabilities measured at fair value on a recurring basis at June 30, 2018 and September 30, 2017. The Company's assets measured at estimated fair value on a recurring basis at June 30, 2018 and September 30, 2017 were as follows (dollars in thousands):

June 30, 2018	Estimated Fair Value			
	Level 1	Level 2	Level 3	Total
Available for sale investment securities				
MBS: U.S. government agencies	$—	$252	$ —	$252
Mutual funds	924	—	—	924
Total	$924	$252	$ —	$1,176

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

There were no transfers among Level 1, Level 2 and Level 3 during the nine months ended June 30, 2018 and the year ended September 30, 2017.

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

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

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

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

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

The following table summarizes the balances of assets measured at estimated fair value on a non-recurring basis at June 30, 2018 (dollars in thousands):

	Estimated Fair Value		
	Level 1	Level 2	Level 3
Impaired loans:			
Consumer loans:			
Home equity and second mortgage	$ —	$ —	$ 78
Commercial business loans	—	—	113
Total impaired loans	—	—	191
Investment securities – held to maturity:			
MBS - private label residential	—	1	—
OREO and other repossessed assets	—	—	2,112
Total	$ —	$ 1	$ 2,303

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis as of June 30, 2018 (dollars in thousands):

	Estimated Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range
Impaired loans	$ 191	Market approach	Appraised value less selling costs	NA
OREO and other repossessed assets	$ 2,112	Market approach	Lower of appraised value or listing price less selling costs	NA

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

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

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

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

GAAP requires disclosure of estimated fair values for financial instruments. Such estimates are subjective in nature, and significant judgment is required regarding the risk characteristics of various financial instruments at a discrete point in time. Therefore, such estimates could vary significantly if assumptions regarding uncertain factors were to change. In addition, as the Company normally intends to hold the majority of its financial instruments until maturity, it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for certain items which are not defined as financial instruments but which may have significant value. The Company does not believe that it would be practicable to estimate a representational fair value for these types of items as of June 30, 2018 and September 30, 2017. Because GAAP excludes certain items from fair value disclosure requirements, any aggregation of the fair value amounts presented would not represent the underlying value of the Company.

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

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

Investment Securities: See descriptions above.

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

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

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

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

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

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

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

The recorded amounts and estimated fair values of financial instruments were as follows as of June 30, 2018 and September 30, 2017 (dollars in thousands):

	June 30, 2018				
		Fair Value Measurements Using:			
	Recorded Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	$156,826	$156,826	$156,826	$ —	$ —
CDs held for investment	63,132	63,132	63,132	—	—
Investment securities	9,127	9,616	3,862	5,754	—
FHLB stock	1,190	1,190	1,190	—	—
Other investments	3,000	3,000	3,000	—	—
Loans held for sale	2,321	2,366	2,366	—	—
Loans receivable, net	717,324	713,173	—	—	713,173
Accrued interest receivable	2,797	2,797	2,797	—	—
Financial liabilities					
Deposits:					
Non-interest-bearing demand	229,201	229,201	229,201	—	—
Interest-bearing	651,526	650,884	510,536	—	140,348
Total deposits	880,727	880,085	739,737	—	140,348
Accrued interest payable	218	218	218	—	—

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

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

(9) RECENT ACCOUNTING PRONOUNCEMENTS

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

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

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

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

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

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

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

In June 2018, the FASB issued ASU No. 2018-07, Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. This ASU was issued to expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. Previously, these awards were recorded at the fair value of consideration received or the fair value of the equity instruments issued and was measured at the earlier of the commitment date or the date performance was completed. The amendments in this ASU require nonemployee share-based payment awards to be measured at the grant-date fair value of the equity instrument. ASU No. 2018-07 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, but no earlier than an entity's adoption of Topic 606. The adoption of ASU No. 2018-07 is not expected to have a material impact on the Company's future consolidated financial statements.

(10) U.S. TAX REFORM

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

As a result of the new legislation, during the quarter ended December 31, 2017, the Company recorded a one-time income tax expense of $548,000 in conjunction with writing down its net deferred tax assets. The impact of using the 24.5% blended federal tax rate for the nine months ended June 30, 2018 versus a 35.0% rate reduced the provision for income taxes by approximately $1.62 million, which was partially offset by the $548,000 one-time net deferred tax asset write-down.

(11) DEFINITIVE AGREEMENT

On May 23, 2018, the Company announced the signing of a definitive agreement and plan of merger (the "Agreement") with South Sound Bank, a Washington-state chartered bank, pursuant to which South Sound Bank will merge with and into Timberland Bank. Under the terms of the Agreement, based on 1,213,027 shares of South Sound Bank outstanding as of the date of the Agreement, South Sound Bank shareholders will receive 904,918 shares of the Company's common stock and $6.90 million in cash (fixed per share consideration of (i) 0.7460 of a share of the Company's common stock and (ii) $5.68825 in cash). The transaction is expected to close during the fourth calendar quarter of 2018, subject to approval by South Sound Bank shareholders, the receipt of all required regulatory approvals, and the satisfaction of customary closing conditions.

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

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

The following analysis discusses the material changes in the consolidated financial condition and results of operations of the Company at and for the three and nine months ended June 30, 2018. This analysis as well as other sections of this report contains certain "forward-looking statements."

Certain matters discussed in this Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and often include the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook" or similar or future or conditional verbs such as "may," "will," "should," "would" and "could." Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about future economic performance. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from the results anticipated or implied by our forward-looking statements, including, but not limited to: the expected cost savings, synergies and other financial benefits from our pending acquisition of South Sound Bank
("merger") might not be realized within the expected time frames or at all; governmental approval of the merger may not be obtained or adverse regulatory conditions may be imposed in connection with governmental approvals of the merger; conditions to the closing of the merger may not be satisfied; the shareholders of South Sound Bank may fail to approve the consummation of the merger; the integration of the combined company, including personnel changes/retention, might not proceed as planned; and the combined company might not perform as well as expected; the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets which may lead to increased losses and non-performing loans in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our loan loss reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market areas; secondary market conditions for loans and our ability to sell loans in the secondary market; results of examinations of us by the Board of Governors of the Federal Reserve System ("Federal Reserve") and of our bank subsidiary by the

FDIC, the Washington State Department of Financial Institutions, Division of Banks or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, institute a formal or informal enforcement action against us or our bank subsidiary which could require us to increase our allowance for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits or impose additional requirements or restrictions on us, any of which could adversely affect our liquidity and earnings; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, or the interpretation of regulatory capital or other rules including as a result of Basel III; the impact of the Dodd Frank Wall Street Reform and Consumer Protection Act and implementing regulations; our ability to attract and retain deposits; increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risks associated with the loans on our consolidated balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; disruptions, security breaches, or other adverse events, failures or interruptions in, or attacks on, our information technology systems or on the third-party vendors who perform several of our critical processing functions; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our business strategies; our ability to manage loan delinquency rates; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; our ability to pay dividends on our common stock; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the FASB, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks described elsewhere in this Form 10-Q and in the Company's other reports filed with or furnished to the Securities and Exchange Commission, including our 2017 Form 10-K.

Any of the forward-looking statements that we make in this Form 10-Q and in the other public statements we make are based upon management’s beliefs and assumptions at the time they are made. We do not undertake and specifically disclaim any obligation to publicly update or revise any forward-looking statements included in this report to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements or to update the reasons why actual results could differ from those contained in such statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking statements discussed in this document might not occur and we caution readers not to place undue reliance on any forward-looking statements. These risks could cause our actual results for fiscal 2018 and beyond to differ materially from those expressed in any forward-looking statements by, or on behalf of us, and could negatively affect the Company’s consolidated financial condition and results of operations as well as its stock price performance.

Overview

Timberland Bancorp, Inc., a Washington corporation, is the holding company for Timberland Bank. The Bank opened for business in 1915 and serves consumers and businesses across Grays Harbor, Thurston, Pierce, King, Kitsap and Lewis counties, Washington with a full range of lending and deposit services through its 22 branches (including its main office in Hoquiam). At June 30, 2018, the Company had total assets of $1.01 billion and total shareholders’ equity of $120.89 million. The Company’s business activities generally are limited to passive investment activities and oversight of its investment in the Bank. Accordingly, the information set forth in this report relates primarily to the Bank’s operations.

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

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

Net income is also affected by non-interest income and non-interest expenses. For the three and nine month period ended June 30, 2018, non-interest income consisted primarily of service charges on deposit accounts, gain on sales of loans, ATM and debit card interchange transaction fees, an increase in the cash surrender value of BOLI, servicing income on loans sold and other operating income. Non-interest income is increased by net recoveries on investment securities and reduced by net OTTI losses on investment securities, if any. Non-interest expenses consisted primarily of salaries and employee benefits, premises and equipment, advertising, ATM and debit card interchange transaction fees, OREO and other repossessed asset expenses, postage and courier expenses, state and local taxes, professional fees, FDIC insurance premiums, loan administration and foreclosure expenses, data processing and telecommunication expenses, deposit operation expenses and other non-interest expenses. Non-interest expenses in certain periods are reduced by gains on the sale of premises and equipment and gains on the sale of OREO. Non-interest income and non-interest expenses are affected by the growth of the Company's operations and growth in the number of loan and deposit accounts.

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

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

On May 23, 2018, the Company announced the signing of a definitive merger agreement pursuant to which South Sound Bank will merge with and into Timberland Bank. The transaction is expected to close during the fourth calendar quarter of 2018, subject to approval by South Sound Bank shareholders, the receipt of all required regulatory approvals, and the satisfaction of customary closing conditions. South Sound Bank, a Washington-state chartered bank, operates two branch locations located in Lacey and Olympia, Washington. South Sound Bank reported $186.9 million in total assets at March 31, 2018. For additional information regarding the proposed transaction, see Note (11), Definitive Agreement.

Critical Accounting Policies and Estimates

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

Comparison of Financial Condition at June 30, 2018 and September 30, 2017

The Company's total assets increased by $54.36 million, or 5.7%, to $1.01 billion at June 30, 2018 from $952.02 million at September 30, 2017. The increase in total assets was primarily due to an increase in net loans receivable, CDs held for investment and total cash and cash equivalents. The increase in total assets was funded primarily by an increase in total deposits.

Net loans receivable increased by $26.96 million, or 3.9%, to $717.32 million at June 30, 2018 from $690.36 million at September 30, 2017. The increase was primarily due to increases in commercial real estate loans and construction loans. These increases to net loans receivable were partially offset primarily by decreases in one- to four-family loans.

Total deposits increased by $42.83 million, or 5.1%, to $880.73 million at June 30, 2018 from $837.90 million at September 30, 2017. The increase was a result of increases in non-interest bearing demand account balances, money market account balances, savings account balances, N.O.W. checking account balances and certificates of deposit account balances.

Shareholders' equity increased by $9.89 million, or 8.9%, to $120.89 million at June 30, 2018 from $111.00 million at September 30, 2017. The increase in shareholders' equity was primarily due to net income for the nine months ended June 30, 2018 and was partially offset by the payment of cash dividends to common shareholders.

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

Cash and Cash Equivalents and CDs Held for Investment: Cash and cash equivalents and CDs held for investment increased by $28.74 million, or 15.0%, to $219.96 million at June 30, 2018 from $191.22 million at September 30, 2017. The increase was primarily due to a $20.10 million increase CDs held for investment and a $6.53 million increase in interest-bearing deposits in banks.

Investment Securities: Investment securities increased by $747,000, or 8.9%, to $9.13 million at June 30, 2018 from $8.38 million at September 30, 2017. This increase was primarily due to the purchase of a $1.11 million U.S. government agency investment security, which was partially offset by scheduled amortization and prepayments. For additional information on investment securities, see Note 2 of the Notes to Unaudited Consolidated Financial Statements contained in "Item 1, Financial Statements."

Other Investments: Other investments consist solely of the Company's investment in the Solomon Hess SBA Loan Fund LLC which was unchanged at $3.00 million at both June 30, 2018 and September 30, 2017. This investment is utilized to help satisfy compliance with the Bank's Community Reinvestment Act investment test requirements.

Loans: Net loans receivable increased by $26.96 million, or 3.9%, to $717.32 million at June 30, 2018 from $690.36 million at September 30, 2017. The increase in the portfolio was primarily a result of a $16.74 million decrease in the amount of undisbursed construction loans in process, a $16.62 million increase in commercial real estate loans, a $6.72 million increase in commercial construction loans, a $3.19 million increase in land development loans, and smaller increases in other categories. These increases were partially offset by a $6.10 million decrease in multi-family construction loans, a $4.17 million decrease in custom and owner/building construction loans, a $4.00 million decrease in one-to four-family mortgage loans, a $1.16 million decrease in commercial business loans and smaller decreases in other categories.

Loan originations decreased by $30.61 million, or 11.7%, to $231.97 million for the nine months ended June 30, 2018 from $262.58 million for the nine months ended June 30, 2017. The Company continued to sell longer-term fixed rate one- to four-family mortgage loans for asset liability management purposes and to generate non-interest income. The Company also (on a much smaller volume) sells the guaranteed portion of U.S. Small Business Administration ("SBA") loans. Sales of fixed rate one- to four-family mortgage loans and SBA loans decreased by $7.58 million, or 13.4%, to $48.96 million for the nine months ended June 30, 2018 compared to $56.54 million for the nine months ended June 30, 2017.

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

Premises and Equipment: Premises and equipment increased by $97,000, or 0.5%, to $18.52 million at June 30, 2018 from $18.42 million at September 30, 2017. The increase was primarily due the purchase of a building that will be used as the Company's data center facility in the future, which was partially offset by the sale of excess land and normal depreciation.

OREO (Other Real Estate Owned): OREO and other repossessed assets decreased by $1.19 million, or 36.0%, to $2.11 million at June 30, 2018 from $3.30 million at September 30, 2017. The decrease was primarily due to the disposition of four OREO properties and one recreational vehicle. At June 30, 2018, total OREO and other repossessed assets consisted of 13 individual real estate properties. The properties consisted of 11 land parcels totaling $1.66 million and two commercial real estate properties with a carrying value of $448,000.

Goodwill: The recorded amount of goodwill of $5.65 million at June 30, 2018 was unchanged from September 30, 2017.

Deposits: Deposits increased by $42.83 million, or 5.1%, to $880.73 million at June 30, 2018 from $837.90 million at September 30, 2017. This increase was primarily due to a $23.25 million increase in non-interest bearing demand account balances, an $8.64 million increase in money market account balances, a $7.70 million increase in savings account balances, a $1.89 million increase in N.O.W. checking account balances and a $1.35 million increase in certificates of deposit account balances.

Deposits consisted of the following at June 30, 2018 and September 30, 2017 (dollars in thousands):

	June 30, 2018		September 30, 2017	
	Amount	Percent	Amount	Percent
Non-interest-bearing demand	$229,201	26.0 %	$205,952	24.5 %
N.O.W. checking	222,203	25.2 %	220,315	26.3 %

Savings	148,690	16.9 %	140,987	16.8 %
Money market	129,559	14.7 %	122,877	14.7 %
Money market - brokered	10,084	1.1 %	8,125	1.0 %
Certificates of deposit under $250	120,156	13.7 %	120,844	14.4 %
Certificates of deposit $250 and over	17,637	2.0 %	15,601	1.9 %
Certificates of deposit - brokered	3,197	0.4 %	3,197	0.4 %
Total	$880,727	100.0%	$837,898	100.0%

Shareholders' Equity: Total shareholders' equity increased by $9.89 million, or 8.9%, to $120.89 million at June 30, 2018 from $111.00 million at September 30, 2017. The increase was primarily due to net income of $12.30 million for the nine months ended June 30, 2018, which was partially offset by the payment of $3.47 million in cash dividends on the Company's common stock. The Company did not repurchase any shares of its common stock during the nine months ended June 30, 2018.

Asset Quality: The non-performing assets to total assets ratio improved to 0.56% at June 30, 2018 from 0.60% at September 30, 2017 as total non-performing assets decreased by $66,000, or 1.1%, to $5.68 million at June 30, 2018 from $5.75 million at September 30, 2017. The decrease was primarily due to a $1.19 million decrease in OREO and other repossessed assets, which was partially offset by a $795,000 increase in non-accrual loans which is primarily a result of two one- to four-family loans becoming delinquent and a $428,000 increase in accruing loans which are contractually past due 90 days or more.

TDRs on accrual status (which are not included in the non-performing asset totals) decreased by $382,000, or 11.4%, to $2.96 million at June 30, 2018 from $3.34 million at September 30, 2017.

The following table sets forth information with respect to the Company’s non-performing assets at June 30, 2018 and September 30, 2017 (dollars in thousands):

	June 30, 2018	September 30, 2017
Loans accounted for on a non-accrual basis:		
Mortgage loans:		
One- to four-family (1)	$ 1,361	$ 874
Commercial	598	213
Land	295	566
Consumer loans:		
Home equity and second mortgage	278	258
Commercial business loans	174	—
Total loans accounted for on a non-accrual basis	2,706	1,911
Accruing loans which are contractually past due 90 days or more	428	—
Total of non-accrual and 90 days past due loans	3,134	1,911
Non-accrual investment securities	433	533
OREO and other repossessed assets, net (2)	2,112	3,301
Total non-performing assets (3)	$ 5,679	$ 5,745
TDRs on accrual status (4)	$	