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TIMBERLAND BANCORP INC
Form 10-Q
February 08, 2008

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2007

OR

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

Commission file number 0-23333

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

Washington 91-1863696
(State of Incorporation) (IRS Employer Identification No.)

624 Simpson Avenue, Hoquiam, Washington 98550
(Address of principal executive office) (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 No

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

Large accelerated filer _____ Accelerated Filer Non-accelerated filer _____

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

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

CLASS	SHARES OUTSTANDING AT JANUARY 31, 2008
Common stock, \$.01 par value	6,860,675

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TIMBERLAND BANCORP, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 December 31, 2007 and September 30, 2007
 Dollars in thousands, except share amounts

	December 31, 2007	September 30, 2007

	(Unaudited)	
Assets		
Cash equivalents:		
Non-interest bearing	\$ 15,301	\$ 10,813
Interest bearing deposits in banks	502	2,082
Federal funds sold	1,015	3,775
	-----	-----
	16,818	16,670
	-----	-----
Investments and mortgage-backed securities: held to maturity	67	71
Investments and mortgage-backed securities: available for sale	45,037	63,898
Federal Home Loan Bank ("FHLB") stock	5,705	5,705
Loans receivable	542,644	519,381
Loans held for sale	-	757
Less: Allowance for loan losses	(5,997)	(4,797)
	-----	-----
Net loans receivable	536,647	515,341
	-----	-----
Accrued interest receivable	3,407	3,424
Premises and equipment	16,512	16,575
Other real estate owned ("OREO") and other repossessed items	-	-
Bank owned life insurance ("BOLI")	12,535	12,415
Goodwill	5,650	5,650
Core deposit intangible ("CDI")	1,158	1,221
Mortgage servicing rights	1,071	1,051
Other assets	1,987	2,827
	-----	-----
Total assets	\$646,594	\$644,848
	=====	=====
Liabilities and shareholders' equity		
Deposits	\$461,247	\$466,735
FHLB advances	106,380	99,697
Other borrowings: repurchase agreements	611	595
Other liabilities and accrued expenses	3,367	3,274
	-----	-----
Total liabilities	571,605	570,301
	-----	-----
Commitments and contingencies	-	-
Shareholders' equity		
Preferred stock, \$.01 par value; 1,000,000 shares authorized; none issued		
Common stock, \$.01 par value; 50,000,000 shares authorized; December 31, 2007 - 6,917,675 shares issued and outstanding		
September 30, 2007 - 6,953,360 shares issued		

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and outstanding	69	70
Additional paid in capital	9,314	9,923
Unearned shares - Employee Stock Ownership Plan ("ESOP")	(2,974)	(3,040)
Retained earnings	69,300	68,378
Accumulated other comprehensive loss	(720)	(784)
	-----	-----
Total shareholders' equity	74,989	74,547
	-----	-----
Total liabilities and shareholders' equity	\$646,594	\$644,848
	=====	=====

See notes to unaudited condensed consolidated financial statements

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TIMBERLAND BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
For the three months ended December 31, 2007 and 2006
Dollars in thousands, except per share amounts
(unaudited)

	Three Months Ended Dec. 31,	
	2007	2006
	-----	-----
Interest and dividend income		
Loans receivable	\$10,764	\$8,786
Investments and mortgage-backed securities	249	454
Dividends from mutual funds and FHLB stock	423	420
Federal funds sold	31	65
Interest bearing deposits in banks	10	39
	-----	-----
Total interest and dividend income	11,477	9,764
	-----	-----
Interest expense		
Deposits	3,334	2,589
FHLB advances - short term	468	359
FHLB advances - long term	748	523
Other borrowings	8	17
	-----	-----
Total interest expense	4,558	3,488
	-----	-----
Net interest income	6,919	6,276
Provision for loan losses	1,200	--
	-----	-----
Net interest income after provision for loan losses	5,719	6,276
	-----	-----
Non-interest income		
Service charges on deposits	696	706
Gain on sale of loans, net	92	107
BOLI net earnings	120	114
Servicing income on loans sold	118	132
ATM transaction fees	299	263
Fee income from non-deposit investment sales	39	20
Other	133	139
	-----	-----
Total non-interest income	1,497	1,481
	-----	-----

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Non-interest expense		
Salaries and employee benefits	2,920	2,785
Premises and equipment	464	624
Advertising	182	177
Loss (gain) from other real estate operations	-	(17)
ATM expenses	148	119
Postage and courier	118	105
Amortization of CDI	62	72
State and local taxes	151	139
Professional fees	147	177
Other	659	716
	-----	-----
Total non-interest expense	4,851	4,897
	-----	-----
Income before federal income taxes	2,365	2,860
Federal income taxes	750	906
	-----	-----
Net income	\$ 1,615	\$1,954
	=====	=====
Earnings per common share:		
Basic	\$ 0.25	\$ 0.28
Diluted	\$ 0.24	\$ 0.27
Weighted average shares outstanding:		
Basic	6,515,428	7,007,766
Diluted	6,674,773	7,246,216
Dividends paid per share:		
	\$ 0.10	\$ 0.09

See notes to unaudited condensed consolidated financial statements

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TIMBERLAND BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the year ended September 30, 2007 and the three months ended December 31, 2007
Dollars in thousands, except per share amounts and common stock shares

	Common Stock Shares Outstanding	Common Stock Amount	Additional Paid-In Capital	Unearned Shares Issued to ESOP	Retained Earnings	Accumu- lated Other Compre- hensive Loss
	-----	-----	-----	-----	-----	-----
Balance, Sept. 30, 2006	7,515,352	\$38	\$20,700	(\$3,305)	\$62,933	(\$1,001)
Net income	--	--	--	--	8,163	--
Stock split	--	36	--	--	(36)	--
Issuance of MRDP (1) shares	15,080	--	--	--	--	--
Repurchase of common stock	(687,542)	(4)	(12,427)	--	--	--
Exercise of stock options	110,470	--	1,207	--	--	--
Cash dividends (\$.37 per share)	--	--	--	--	(2,682)	--
Earned ESOP shares	--	--	354	265	--	--
MRDP compensation expense	--	--	64	--	--	--
Stock option compensation exp.	--	--	25	--	--	--

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Unrealized holding gain on securities available for sale, net of tax	- -	- -	- -	- -	- -	217
Balance, Sept. 30, 2007	6,953,360	\$70	\$9,923	(\$3,040)	\$68,378	(\$784)
(Unaudited)						
Net income	- -	- -	- -	- -	1,615	- -
Stock split	- -	- -	- -	- -	- -	- -
Issuance of MRDP shares	14,315	- -	- -	- -	- -	- -
Repurchase of common stock	(50,000)	(1)	(702)	- -	- -	- -
Exercise of stock options	- -	- -	- -	- -	- -	- -
Cash dividends (\$.10 per share)	- -	- -	- -	- -	(693)	- -
Earned ESOP shares	- -	- -	62	66	- -	- -
MRDP compensation expense	- -	- -	30	- -	- -	- -
Stock option compensation exp.	- -	- -	1	- -	- -	- -
Unrealized holding gain on securities available for sale, net of tax	- -	- -	- -	- -	- -	64
Balance, Dec. 31, 2007	6,917,675	\$69	\$9,314	(\$2,974)	\$69,300	(\$720)

(1) 1998 Management Recognition and Development Plan.

See notes to unaudited condensed consolidated financial statements

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TIMBERLAND BANCORP, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 For the three months ended December 31, 2007 and 2006
 In thousands
 (unaudited)

Cash flow from operating activities	Three Months Ended December 31,	
	2007	2006
Net income	\$ 1,615	\$ 1,954
Non-cash revenues, expenses, gains and losses included in income:		
Provision for loan losses	1,200	- -
Depreciation	283	253
Deferred federal income taxes	(399)	- -
Amortization of CDI	62	72
Earned ESOP shares	66	66
MRDP compensation expense	30	11
Stock option compensation expense	1	7
Stock option tax effect less excess tax benefit	- -	69
Gain on sale of OREO, net	- -	(18)
Gain on the disposition of premises and equipment	(171)	(5)
BOLI cash surrender value increase	(120)	(114)
Gain on sale of loans	(92)	(107)
Increase (decrease) in deferred loan origination fees	(40)	91
Loans originated for sale	(6,564)	(5,944)
Proceeds from sale of loans	7,413	7,245
Decrease in other assets, net	1,225	871
Decrease (increase) in other liabilities and accrued		

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expenses, net	93	(72)
	-----	-----
Net cash provided by operating activities	4,602	4,379
Cash flow from investing activities		
Proceeds from maturities of securities available for sale	18,938	11,821
Proceeds from maturities of securities held to maturity	3	1
Increase in loans receivable, net	(23,223)	(28,512)
Additions to premises and equipment	(224)	(279)
Proceeds from the disposition of premises and equipment	175	5
Proceeds from sale of OREO	- -	33
	-----	-----
Net cash used in investing activities	(4,331)	(16,931)
Cash flow from financing activities		
Increase (decrease) in deposits, net	(5,488)	3,188
Proceeds from FHLB advances - long term	25,000	30,000
Repayment of FHLB advances - long term	(15,017)	(15)
Decrease in FHLB advances - short term	(3,300)	(14,300)
Increase in repurchase agreements	16	375
Proceeds from exercise of stock options	- -	290
ESOP tax effect	62	95
Stock option excess tax benefit	- -	150
Repurchase of common stock	(703)	(4,176)
Payment of dividends	(693)	(678)
	-----	-----
Net cash provided (used in) by financing activities	(123)	14,929
Net increase in cash equivalents	148	2,377
Cash equivalents		
Beginning of period	16,670	22,789
	-----	-----
End of period	\$ 16,818	\$ 25,166
	-----	-----

See notes to unaudited condensed consolidated financial statements
(continued)

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TIMBERLAND BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (concluded)
For the three months ended December 31, 2007 and 2006
In thousands
(unaudited)

	Three Months Ended December 31,	
	2007	2006
	-----	-----
Supplemental disclosure of cash flow information		
Income taxes paid	\$ - -	\$ 833
Interest paid	4,414	3,444
Supplemental disclosure of non-cash investing		

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activities		
Change in unrealized holding gain on securities held for sale, net of tax	\$ 64	\$ 127
Loans transferred to OREO and other repossessed assets	- -	2
Supplemental disclosure of non-cash financing activities		
Shares issued to MRDP	\$ 210	\$ 56

See notes to unaudited condensed consolidated financial statements

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TIMBERLAND BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the three months ended December 31, 2007 and 2006
In thousands
(unaudited)

	Three Months Ended December 31,	
	2007	2006

Comprehensive income:		
Net income	\$1,615	\$1,954
Unrealized holding gain on securities available for sale, net of tax	64	127

Total comprehensive income	\$1,679	\$2,081
	=====	

See notes to unaudited condensed consolidated financial statements

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Timberland Bancorp, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation: The accompanying unaudited condensed consolidated financial statements for Timberland Bancorp, Inc. ("Company") were prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions for Form 10-Q and therefore, do not include all disclosures necessary for a complete presentation of financial condition, results of operations, and cash flows in

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conformity with accounting principles generally accepted in the United States of America. However, all adjustments which are in the opinion of management, necessary for a fair presentation of the interim condensed consolidated financial statements have been included. All such adjustments are of a normal recurring nature. The unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended September 30, 2007 ("2007 Form 10-K"). The results of operations for the three months ended December 31, 2007 are not necessarily indicative of the results that may be expected for the entire fiscal year.

(b) Stock Split: On June 5, 2007 the Company's common stock was split two-for-one in the form of a 100% stock dividend. Each shareholder of record as of May 22, 2007 received one additional share for every share owned. All share and per share amounts (including stock options) in the condensed consolidated financial statements and accompanying notes were restated to reflect the split, except as otherwise noted.

(c) Principles of Consolidation: The interim condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Timberland Bank ("Bank"), and the Bank's wholly-owned subsidiary, Timberland Service Corp. All significant inter-company balances have been eliminated in consolidation.

(d) Operating Segment: The Company provides a broad range of financial services to individuals and companies located primarily in western Washington. These services include demand, time and savings deposits; real estate, business and consumer lending; and investment advisory services. While the Company's chief decision maker monitors the revenue streams from the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the Company's operations are considered by management to be one reportable operating segment.

(e) The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(f) Certain prior period amounts have been reclassified to conform to the December 31, 2007 presentation with no change to net income or shareholders' equity previously reported.

(2) EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed by dividing net income by the weighted average number of common shares outstanding during the period, without considering any dilutive items. Diluted EPS is computed by dividing net income 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 assumed conversion of outstanding stock options and awarded but not released MRDP shares. In accordance with

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Statement of Position ("SOP") 93-6, Employers' Accounting for Employee Stock Ownership Plans, issued by the American Institute of Certified Public Accountants, shares owned by the Bank's ESOP that have not been allocated are not considered to be outstanding for the purpose of computing earnings per share. At December 31, 2007 and 2006, there were 405,562 and 440,830 ESOP shares, respectively, that had not been allocated.

The following table is in thousands, except for share and per share data:

	Three Months Ended December 31,	
	2007	2006
Basic EPS computation		
Numerator - net income	\$ 1,615	\$ 1,954
Denominator - weighted average common shares outstanding	6,515,428	7,007,766
Basic EPS	\$ 0.25	\$ 0.28
Diluted EPS computation		
Numerator - net income	\$ 1,615	\$ 1,954
Denominator - weighted average common shares outstanding	6,515,428	7,007,766
Effect of dilutive stock options	159,345	236,998
Effect of dilutive MRDP shares	-	1,452
Weighted average common shares and common stock equivalents	6,674,773	7,246,216
Diluted EPS	\$ 0.24	\$ 0.27

(3) STOCK BASED COMPENSATION

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards ("SFAS" or "Statement") No. 123(R), Share Based Payment, which requires measurement of the compensation cost for all stock-based awards based on the grant-date fair value and recognition of compensation cost over the service period of stock-based awards. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the Company's valuation methodology previously utilized for options in footnote disclosures required under SFAS No. 123. The Company has adopted SFAS No. 123(R) using the modified prospective method, which provides for no restatement of prior periods and no cumulative adjustment to equity accounts. It also provides for expense recognition, for both new and existing stock-based awards.

(4) STOCK COMPENSATION PLANS

Stock Option Plans

Under the Company's stock option plans (i.e., the 1999 Stock Option Plan and the 2003 Stock Option Plan), the Company may grant options for up to a combined total of 1,622,500 shares of common stock to employees, officers and directors. Shares issued may be purchased in the open market or may be issued from authorized and unissued shares. The exercise price of each option equals the fair market value of the Company's common stock on the date of grant. The options generally vest over a ten-year period, which may be accelerated if the Company meets certain performance criteria. Generally, options vest in annual installments 10% on each of the ten anniversaries from the date of the grant and if the Company meets three of four established performance criteria the

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vesting is accelerated to 20% for that year. These four performance criteria are: (i) generating a return on assets which exceeds that of the median of all thrifts in the 12th FHLB District having assets within

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\$250 million of the Company; (ii) generating an efficiency ratio which is less than that of the median of all thrifts in the 12th FHLB District having assets within \$250 million of the Company; (iii) generating a net interest margin which exceeds the median of all thrifts in the 12th FHLB District having assets within \$250 million of the Company; and (iv) increasing the Company's earnings per share over the prior fiscal year. The Company performs the accelerated vesting analysis in February of each year based on the results of the most recently completed fiscal year. At December 31, 2007, options for 279,416 shares are available for future grant under these plans.

Following is activity under the plans:

	Three Months Ended December 31, 2007 Total Options Outstanding -----		
	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value
	-----	-----	-----
Options outstanding, beginning of period	412,674	\$ 7.39	\$1.87
Exercised	--	--	--
Forfeited	--	--	--
Granted	--	--	--

Options outstanding, end of period	412,674	\$ 7.39	\$1.87
Options exercisable, end of period	393,670	\$ 7.30	\$1.85

	Three Months Ended December 31, 2006 Total Options Outstanding -----		
	Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value
	-----	-----	-----
Options outstanding, beginning of period	524,144	\$ 7.26	\$1.85
Exercised	(48,300)	6.01	1.63
Granted	--	--	--

Options outstanding, end of period	475,844	\$ 7.38	\$1.87
Options exercisable, end of period	431,836	\$ 7.23	\$1.84

The aggregate intrinsic value of all options outstanding at December 31, 2007 was \$1.98 million. The aggregate intrinsic value of all options that were

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exercisable at December 31, 2007 was \$1.92 million. The aggregate intrinsic value of all options outstanding at December 31, 2006 was \$5.32 million. The aggregate intrinsic value of all options that were exercisable at December 31, 2006 was \$4.89 million.

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At December 31, 2007 there were 19,004 unvested options, all of which are assumed to vest, with an aggregate intrinsic value of \$54,000. There were no options that vested during the three months ended December 31, 2007. The total grant date fair value of options vested during the three months ended December 31, 2006 was \$2,000.

Proceeds, related tax benefits realized from options exercised and intrinsic value of options exercised were as follows:

	Three Months Ended December 31, ----- (In thousands)	
	2007	2006
	----	----
Proceeds from options exercised	\$ --	\$ 290
Related tax benefit recognized	--	219
Intrinsic value of options exercised	--	562

Options outstanding at December 31, 2007 were as follows:

		Outstanding		Exercisable		
Range Exercise Prices	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
-----	-----	-----	-----	-----	-----	-----
\$ 6.00-6.19	233,810	\$ 6.00	1.0	233,810	\$ 6.00	1.0
6.80-7.45	66,638	7.35	2.9	66,638	7.35	2.9
7.60-7.98	6,000	7.91	4.4	4,000	7.85	4.4
9.53	56,680	9.52	5.2	39,676	9.52	5.2
11.46-11.63	49,546	11.51	6.0	49,546	11.51	6.0
	412,674	\$ 7.39	2.6	393,670	\$ 7.30	2.4

There were no options granted during the three months ended December 31, 2007 and December 31, 2006.

Stock Grant Plans

The Company adopted the MRDP in 1998, which was subsequently approved by shareholders in 1999 for the benefit of employees, officers and directors of the Company. The objective of the MRDP is to retain and attract personnel of experience and ability in key positions by providing them with a proprietary interest in the Company.

The MRDP allows for the issuance to participants of up to 529,000 shares of the Company's common stock. Shares may be purchased in the open market or may be issued from authorized and unissued shares. Awards under the MRDP are made in the form of restricted shares of common stock that are subject to

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restrictions on the transfer of ownership. Compensation expense in the amount of the fair value of the common stock at the date of the grant to the plan participants is recognized over a five-year vesting period, with 20% vesting on each of the five anniversaries from the date of the grant. During the three months ended December 31, 2007, the Company awarded 14,315 MRDP shares to officers and directors. These shares had a weighted average grant date fair value of \$14.69 per share. During the three months ended December 31, 2006 the Company awarded 3,080 shares to directors. These shares had a weighted average grant date fair value of \$18.24 per share.

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At December 31, 2007, there were a total of 38,379 unvested MRDP shares with an aggregated grant date fair value of \$618,000. There were 616 MRDP shares that vested during the three months ended December 31, 2007 with an aggregated grant date fair value of \$11,000. There were no MRDP shares that vested during the three months ended December 31, 2006. At December 31, 2007, there were 77,751 shares available for future award under the MRDP.

Expenses for Stock Compensation Plans

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

	Three Months Ended December 31,			
	2007	2006	-----	
	(In thousands)			
	Stock Options -----	Stock Grants -----	Stock Options -----	Stock Grants -----
Compensation expense recognized in income	\$ 1	\$ 34	\$ 7	\$ 11
Related tax benefit recognized	--	12	2	4

The compensation expense yet to be recognized for stock based awards that have been awarded but not vested for the years ending September 30 is as follows (in thousands):

	Stock Options -----	Stock Grants -----	Total Awards -----
Remainder of 2008	\$ 4	\$100	\$104
2009	2	134	136
2010	1	134	135
2011	--	127	127
2012	--	74	74
2013	--	3	3
	----	----	----
Total	\$ 7	\$572	\$579

(5) INCOME TAXES

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's

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financial statements in accordance with FASB Statement 109, Accounting for Income Taxes. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted the provisions of FIN 48 on October 1, 2007 and it did not have a material impact on the Company's consolidated financial statements. As of December 31, 2007, the Company had an insignificant amount of unrecognized tax benefits.

The Company and its subsidiary file income tax returns in the U.S. federal jurisdiction. The Company is no longer subject to U.S. federal examination by tax authorities for tax years before 2003. The Company's policy is to recognize interest and penalties accrued related to unrecognized tax benefits in income tax expense. The amount of interest and penalties accrued for the three months ended December 31, 2007 was immaterial.

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(6) DIVIDEND / SUBSEQUENT EVENT

On January 22, 2008, the Company announced a quarterly cash dividend of \$0.11 per common share, payable February 22, 2008, to shareholders of record as of the close of business on February 8, 2008.

(7) RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value under Generally Accepted Accounting Principles ("GAAP"), and expands disclosures about fair value measurements. SFAS No. 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under SFAS No. 157, fair value measurements are disclosed by level within that hierarchy. This Statement is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of adoption of SFAS 157 on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. This Statement permits companies to elect to follow fair value accounting for certain financial assets and liabilities in an effort to mitigate volatility in earnings without having to apply complex hedge accounting provisions. The standard also establishes presentation and disclosure requirements designed to facilitate comparison between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The adoption of this Statement is not expected to have a material impact on the Company's consolidated financial statements.

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

The following analysis discusses the material changes in the financial condition and results of operations of the Company at and for the three months ended December 31, 2007. This analysis as well as other sections of this report contains certain "forward-looking statements." The Company desires to

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take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 and is including this statement for the express purpose of availing itself of the protection of such safe harbor with forward looking statements. These forward looking statements may describe future plans or strategies and include the Company's expectations of future financial results. The words "believe," "expect," "anticipate," "estimate," "project," and similar expressions identify forward-looking statements. The Company's ability to predict results or the effect of future plans or strategies is inherently uncertain. The Company's actual results, performance, or achievements may differ materially from those suggested, expressed, or implied by forward looking statements as a result of a wide variety or range of factors including, but not limited to: interest rate fluctuations; economic conditions in the Company's primary market areas; deposit flows; demand for residential, commercial real estate, consumer, and other types of loans; real estate values; success of new products and services; technological factors affecting operations; and other risks detailed in the Company's reports filed with the SEC, including its 2007 Form 10-K. Accordingly, these factors should be considered in evaluating forward-looking statements, and undue reliance should not be placed on such statements. The Company undertakes no responsibility to update or revise any forward-looking statements.

Overview

Timberland Bancorp, Inc., a Washington corporation, was organized on September 8, 1997 for the purpose of becoming the holding company for Timberland Savings Bank, SSB upon the Bank's conversion from a Washington-chartered mutual savings bank to a Washington-chartered stock savings bank ("Conversion"). The Conversion was completed on January 12, 1998 through the sale and issuance of 13,225,000 shares of common stock by the Company. At December 31, 2007, the Company had total assets of \$646.59 million and total shareholders' equity of \$74.99 million. The Company's business activities generally are limited to passive

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investment activities and oversight of its investment in the Bank. Accordingly, the information set forth in this report relates primarily to the Bank.

The Bank was established in 1915 as "Southwest Washington Savings and Loan Association." In 1935, the Bank converted from a state-chartered mutual savings and loan association to a federally-chartered mutual savings and loan association, and in 1972 changed its name to "Timberland Federal Savings and Loan Association." In 1990, the Bank converted to a federally chartered mutual savings bank under the name "Timberland Savings Bank, FSB." In 1991, the Bank converted to a Washington-chartered mutual savings bank and changed its name to "Timberland Savings Bank, SSB." In 2000, the Bank changed its name to "Timberland Bank." The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") up to applicable legal limits. The Bank has been a member of the Federal Home Loan Bank System since 1937. The Bank is regulated by the Washington State Department of Financial Institutions, Division of Banks and the FDIC.

The Bank is a community-oriented bank which offers a variety of deposit and loan products to its customers. The Bank operates 21 branches (including its main office in Hoquiam) and a loan production office in the following market areas:

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- * Grays Harbor County
- * Thurston County
- * Pierce County
- * King County
- * Kitsap County
- * Lewis County

Critical Accounting Policies and Estimates

The Company has identified two 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.

Allowance for Loan Losses. The allowance for loan losses is maintained at a level sufficient to provide for probable loan losses based on evaluating known and inherent risks in the portfolio. The allowance is based upon management's comprehensive analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the amount and composition of the loan portfolio, actual loss experience, current economic conditions, and detailed analysis of individual loans for which the full collectibility may not be assured. The appropriate allowance for loan loss level is estimated based upon factors and trends identified by management at the time consolidated financial statements are prepared.

While the Company believes it has established its existing allowance for loan losses in accordance with accounting principles generally accepted in the United States, there can be no assurance that regulators, in reviewing the Company's loan portfolio, will not request the Company to significantly increase or decrease its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that substantial increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed elsewhere in this document. Although management believes the levels of the allowance as of both December 31, 2007 and September 30, 2007 were adequate to absorb probable losses inherent in the loan portfolio, a decline in local economic conditions, or other factors, could result in a material increase in the allowance for loan losses and may adversely affect the Company's financial condition and results of operations.

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

income on loans sold in proportion to and over the period of estimated net servicing income. The value of MSRs at the date of the sale of loans is determined based on the discounted present value of expected future cash flows using key assumptions for servicing income and costs and prepayment rates on the underlying loans. The estimated fair value is periodically evaluated for impairment by comparing actual cash flows and estimated cash flows from the servicing assets to those estimated at the time servicing assets were originated. The effect of changes in market interest rates on estimated rates of loan prepayments represents the predominant risk characteristic underlying the MSR portfolio. The Company's methodology for estimating the fair value of MSRs is highly sensitive to changes in assumptions. For example, the determination of fair value uses anticipated prepayment speeds. Actual

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prepayment experience may differ and any difference may have a material effect on the fair value. Thus, any measurement of MSRs' fair value is limited by the conditions existing and assumptions as of the date made. Those assumptions may not be appropriate if they are applied at different times.

Comparison of Financial Condition at December 31, 2007 and September 30, 2007

The Company's total assets increased by \$1.75 million, or 0.3%, to \$646.59 million at December 31, 2007 from \$644.85 million at September 30, 2007, primarily attributable to a \$21.31 million, or 4.1%, increase in net loans receivable. This increase was partially offset by an \$18.87 million decrease in investment and mortgage-backed securities.

Total deposits decreased by \$5.49 million, or 1.2%, to \$461.25 million at December 31, 2007 from \$466.74 million at September 30, 2007 primarily attributable to a decrease in non-interest bearing account balances, savings account balances and certificate of deposit account balances. These decreases were partially offset by an increase in N.O.W. checking account balances.

Shareholders' equity increased by \$442,000, or 0.6%, to \$74.99 million at December 31, 2007 from \$74.55 million at September 30, 2007. The increase in shareholders' equity was primarily a result of retained net income, which was partially offset by share repurchases and cash dividends.

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

Cash Equivalents: Cash equivalents increased by \$148,000, or 0.9%, to \$16.82 million at December 31, 2007 from \$16.67 million at September 30, 2007. The increase was primarily a result of an increase in non-interest bearing accounts, which were partially offset by a decrease in federal funds sold and interest bearing deposits in banks.

Investment Securities and Mortgage-backed Securities: Investment and mortgage-backed securities decreased by \$18.87 million, or 29.5%, to \$45.10 million at December 31, 2007 from \$63.97 million at September 30, 2007, as a result of the maturity or call of U.S. agency securities and regular amortization and prepayments on mortgage-backed securities. At December 31, 2007, the Company's securities' portfolio was comprised of mutual funds of \$31.85 million, U.S. agency securities of \$1.0 million, and mortgage-backed securities of \$12.19 million. The mutual funds invest primarily in mortgage-backed products and U.S. agency securities. For additional information, see the "Investment Securities" table included herein.

Loans: Net loans receivable increased by \$21.31 million, or 4.1%, to \$536.65 million at December 31, 2007 from \$515.34 million at September 30, 2007. The increase in the portfolio was primarily a result of a \$24.81 million increase in construction loans (net of undisbursed portion of construction loans in process) and a \$3.67 million increase in multi-family loans. These increases were partially offset by a \$3.67 million decrease in land loans and a \$1.86 million decrease in commercial real estate loans.

Loan originations decreased to \$65.51 million for the three months ended December 31, 2007 compared to \$80.76 million for the three months ended December 31, 2006. The Bank also continued to sell longer-term fixed rate loans for asset liability management purposes. The Bank sold fixed rate one- to four-family mortgage loans totaling \$7.41 million for the three months

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ended December 31, 2007 compared to \$7.24 million for the three months ended December 31, 2006.

For additional information, see the sections entitled "Loan Portfolio Composition" and "Construction and Land Development Loan Portfolio Composition" included herein.

Premises and Equipment: Premises and equipment decreased to \$16.51 million at December 31, 2007 from \$16.58 million at September 30, 2007, primarily as a result of depreciation recorded on depreciable assets.

Goodwill and Core Deposit Intangible: The value of goodwill remained unchanged. The amortized value of core deposit intangible decreased to \$1.16 million at December 31, 2007 from \$1.22 million at September 30, 2007. The decrease is attributable to scheduled amortization of the core deposit intangible.

Deposits: Deposits decreased by \$5.49 million, or 1.2%, to \$461.25 million at December 31, 2007 from \$466.74 million at September 30, 2007. The decrease was primarily a result of a \$4.37 million decrease in non-interest bearing accounts, a \$1.70 million decrease in certificate of deposit accounts and a \$1.67 million decrease in savings accounts. These decreases were partially offset by an increase of \$3.22 million in N.O.W. checking accounts. For additional information, see the section entitled "Deposit Breakdown" included herein.

FHLB Advances and Other Borrowings: FHLB advances and other borrowings increased by \$6.70 million to \$106.99 million at December 31, 2007 from \$100.29 million at September 30, 2007 as the Bank used additional advances to fund loan portfolio growth. For additional information, see "FHLB Advance Maturity Schedule" included herein.

Shareholders' Equity: Total shareholders' equity increased by \$442,000 to \$74.99 million at December 31, 2007 from \$74.55 million at September 30, 2007, primarily as a result of net income of \$1.62 million. The increase from net income was partially offset by share repurchases of \$703,000 and cash dividends to shareholders of \$693,000.

During the three months ended December 31, 2007 the Company repurchased 50,000 shares of its common stock for \$703,000, an average price of \$14.06 per share. Cumulatively, the Company has repurchased 7,688,984 shares (58.1%) of the 13,225,000 shares that were issued in its 1998 initial public offering, at an average price of \$8.93 per share. For additional information, see Item 2 of Part II of this Form 10-Q.

Non-performing Assets: Non-performing assets to total assets were 0.60% at December 31, 2007 compared to 0.23% at September 30, 2007, as total non-performing assets increased to \$3.91 million at December 31, 2007 from \$1.49 million at September 30, 2007.

Total non-performing assets of \$3.91 million at December 31, 2007 were comprised of 15 loans including eight single family speculative home loans totaling \$3.19 million, two home equity consumer loans totaling \$293,000, three land loans totaling \$212,000, one commercial business loan for \$120,000 and one commercial real estate loan for \$90,000. The Company had no charge-offs during the three months ended December 31, 2007. For additional information, see the section entitled "Non-performing Assets" and "Activity in the Allowance for Loan Losses" included herein.

Investment Securities

The following table sets forth the composition of the Company's investment

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securities portfolio.

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	At December 31, 2007		At September 30, 2007	
	Amount	Percent	Amount	Percent
----- (Dollars in thousands)				
Held-to-maturity:				
Mortgage-backed securities	\$ 67	0.2%	\$ 71	0.1%
Available-for-sale (at fair value)				
U.S. agency securities	999	2.2	18,975	29.7
Mortgage-backed securities	12,186	27.0	13,048	20.4
Mutual funds	31,852	70.6	31,875	49.8
	-----	-----	-----	-----
Total portfolio	\$45,104	100.0%	\$63,969	100.0%
	=====	=====	=====	=====

Loan Portfolio Composition

The following table sets forth the composition of the Company's loan portfolio.

	At December 31, 2007		At September 30, 2007	
	Amount	Percent	Amount	Percent
----- (Dollars in thousands)				
Mortgage loans:				
One- to four-family (1)	\$101,971	16.8%	\$102,434	17.4%
Multi-family	38,828	6.4	35,157	6.0
Commercial	126,003	20.8	127,866	21.7
Construction and land development	206,105	34.0	186,261	31.6
Land	57,033	9.4	60,706	10.3
	-----	-----	-----	-----
Total mortgage loans	529,940	87.4	512,424	87.0
Consumer loans:				
Home equity and second mortgage	47,071	7.8	47,269	8.0
Other	10,627	1.7	10,922	1.9
	-----	-----	-----	-----
	57,698	9.5	58,191	9.9
Commercial business loans	18,642	3.1	18,164	3.1
	-----	-----	-----	-----
Total loans	606,280	100.0%	588,779	100.0%
	=====	=====	=====	=====
Less:				
Undisbursed portion of construction loans in process	(60,708)		(65,673)	
Deferred loan origination fees	(2,928)		(2,968)	
Allowance for loan losses	(5,997)		(4,797)	

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Total loans receivable, net	----- \$536,647 =====	----- \$515,341 =====
-----------------------------	-----------------------------	-----------------------------

(1) Includes loans held-for-sale.

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Construction and Land Development Loan Portfolio Composition

The following table sets forth the composition of the Company's construction and land development loan portfolio.

	At December 31, 2007		At September 30, 2007	
	Amount	Percent	Amount	Percent

	(Dollars in thousands)			
Custom and owner/builder const.	\$ 50,748	24.6%	\$ 52,375	28.1%
Speculative construction	41,251	20.0	43,012	23.1
Commercial real estate	66,949	32.5	50,518	27.1
Multi-family	22,060	10.7	18,064	9.7
Land development	25,097	12.2	22,292	12.0
	-----	-----	-----	-----
Total construction loans	\$206,105	100.0%	\$186,261	100.0%
	=====	=====	=====	=====

Activity in the Allowance for Loan Losses

The following table sets forth information regarding activity in the allowance for loan losses.

	Three Months Ended December 31,	
	2007	2006

	(In thousands)	
Balance at beginning of period	\$4,797	\$4,122
Provision for loan losses	1,200	- -
Loans charged off	--	(1)
Recoveries on loans previously charged off	--	- -
	-----	-----
Net charge-off	--	(1)
	-----	-----
Balance at end of period	\$5,997	\$4,121
	=====	=====

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Non-performing Assets

The following table sets forth information with respect to the Company's non-performing assets.

	At December 31, 2007	At September 30, 2007

(In thousands)		
Loans accounted for on a non-accrual basis:		
Mortgage loans:		
One- to four-family	\$ - -	\$ 252
Commercial real estate	90	90
Construction and land development	3,193	1,000
Land	212	28
Consumer loans	293	- -
Commercial business loans	120	120
	-----	-----
Total	3,908	1,490
Accruing loans which are contractually past due 90 days or more:	- -	- -
	-----	-----
Total	- -	- -
 Total of non-accrual and 90 days past due loans	 3,908	 1,490
 OREO and other repossessed items	 - -	 - -
	-----	-----
Total non-performing assets	\$ 3,908	\$ 1,490
	=====	=====
 Restructured loans	 2,462	 - -
 Non-accrual and 90 days or more past due loans as a percentage of loans receivable (1)	 0.72%	 0.29%
 Non-accrual and 90 days or more past due loans as a percentage of total assets	 0.60%	 0.23%
 Non-performing assets as a percentage of total assets	 0.60%	 0.23%
 Loans receivable (1)	 \$542,644	 \$520,138
	=====	=====
 Total assets	 \$646,594	 \$644,848
	=====	=====

(1) Includes loans held-for-sale and is before the allowance for loan losses.

Deposit Breakdown

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

At

At

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	December 31, 2007 -----	September 30, 2007 -----
	(In thousands)	
Non-interest bearing	\$ 50,590	\$ 54,962
N.O.W. checking	83,594	80,372
Savings	54,738	56,412
Money market accounts	47,102	48,068
Certificates of deposit under \$100	133,676	159,605
Certificates of deposit \$100 and over	68,527	67,316
Certificates of deposit - brokered	23,020	--
	-----	-----
Total deposits	\$461,247 =====	\$466,735 =====

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FHLB Advance Maturity Schedule

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

	At December 31, 2007		At September 30, 2007	
	Amount	Percent	Amount	Percent

	(Dollars in thousands)			
Short-term	\$ 26,700	25.1%	\$30,000	30.1%
Long-term	79,680	74.9	69,697	69.9
	-----	-----	-----	-----
Total FHLB advances	\$106,380 =====	100.0% =====	\$99,697 =====	100.0% =====

The Bank's FHLB borrowings mature at various dates through September 2017 and bear interest at rates ranging from 3.69% to 5.54%. The weighted average interest rate on FHLB borrowings at December 31, 2007 was 4.37%. Principal reduction amounts due for future years ending September 30 are as follows (in thousands):

Remainder of 2008	\$ 26,753
2009	4,627
2010	15,000
2011	10,000
2012	--
Thereafter	50,000

Total	\$106,380 =====

A portion of these advances have a puttable feature and may be called by the FHLB earlier than the above schedule indicates.

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Comparison of Operating Results for the Three Months Ended December 31, 2007 and 2006

The Company's net income decreased by \$339,000, or 17.3%, to \$1.62 million for the quarter ended December 31, 2007 from \$1.95 million for the quarter ended December 31, 2006. Diluted earnings per share decreased 11.1% to \$0.24 for the quarter ended December 31, 2007 from \$0.27 for the quarter ended December 31, 2006.

The decrease in diluted earnings per share was primarily a result of a \$1.20 million increase in the provision for loan losses during the quarter ended December 31, 2007 compared to the quarter ended December 31, 2006. The increased provision was primarily a result of an increase in the level of non-performing loans, the reclassification of certain loans, continued loan portfolio growth, and a weakening in the housing market in certain market areas. The decrease in earnings per share attributable to the increased provision for loan losses was partially offset by increased net interest income and a decrease in the weighted average number of shares outstanding as a result of share repurchases.

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

Net Income: Net income for the quarter ended December 31, 2007 decreased by \$339,000, or 17.3%, to \$1.62 million from \$1.95 million for the quarter ended December 31, 2006. Earnings per diluted share for the quarter ended December 31, 2007 decreased to \$0.24 from \$0.27 for the quarter ended December 31, 2006. The \$0.03 decrease in diluted earnings per share for the quarter ended December 31, 2007 was primarily a result of a \$1.20 million (\$780,000 net of income tax - \$0.11 per diluted share) increase in the provision for loan losses. This decrease in earnings per share was partially offset by a \$643,000 (\$418,000 net of income tax - \$0.06 per diluted share) increase in net interest income and a decrease in the number of weighted average shares outstanding (\$0.02 per diluted share) primarily as a result of share repurchases.

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Net Interest Income: Net interest income increased by \$643,000, or 10.2%, to \$6.92 million for the quarter ended December 31, 2007 from \$6.28 million for the quarter ended December 31, 2006, primarily as a result of a larger interest earning asset base. Total interest and dividend income increased by \$1.71 million, or 17.5%, to \$11.48 million for the quarter ended December 31, 2007 from \$9.76 million for the quarter ended December 31, 2006 as average total interest earning assets increased by \$73.06 million. The yield on interest earning assets increased to 7.62% for the quarter ended December 31, 2007 from 7.38% for the quarter ended December 31, 2006. Total interest expense increased by \$1.07 million, or 30.7%, to \$4.56 million for the quarter ended December 31, 2007 from \$3.49 million for the quarter ended December 31, 2006 as average total interest bearing liabilities increased by \$76.37 million. The average rate paid on interest bearing liabilities increased to 3.49% for the quarter ended December 31, 2007 from 3.13% for the quarter ended December 31, 2006. The net interest margin decreased to 4.59% for the quarter ended December 31, 2007 from 4.74% for the quarter ended December 31, 2006.

The margin compression was primarily attributable to increased funding costs

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which were greater than the increased yield on interest earning assets. Increased funding costs resulted from an increase in interest rates on deposits and an increased reliance on wholesale sources (FHLB advances and brokered deposits) to fund loan growth. For additional information, see the section entitled "Rate Volume Analysis" included herein.

Rate Volume Analysis

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

	Three months ended December 31, 2007 compared to three months ended December 31, 2006 increase (decrease) due to -----		
	Rate ----	Volume -----	Net Change -----
	(In thousands)		
Interest-earning assets:			
Loans receivable (1)	(\$1)	\$1,979	\$1,978
Investments and mortgage-backed securities	29	(235)	(206)
FHLB stock and equity securities	- -	3	3
Federal funds sold	(9)	(25)	(34)
Interest-bearing deposits	(5)	(23)	(28)
	-----	-----	-----
Total net increase in income on interest- earning assets	14	1,699	1,713
Interest-bearing liabilities:			
Savings accounts	- -	(10)	(10)
NOW accounts	15	(6)	9
Money market Accounts	68	30	98
Certificate accounts	190	458	648
Short-term borrowings	(46)	146	100
Long-term borrowings	(110)	335	225
	-----	-----	-----
Total net increase in expense on interest bearing liabilities	117	953	1,070
Net increase (decrease) in net interest income	(\$103)	\$ 746	\$ 643

(1) Includes loans originated for sale.

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Provision for Loan Losses: A provision for loan losses of \$1.20 million was made during the quarter ended December 31, 2007 compared to no provision made during the quarter ended December 31, 2006. The provision was made primarily as a result of an increase in non-performing loans, an increase in the level of loans classified as substandard and special mention under the Bank's loan grading system, and loan portfolio growth in higher risk loan categories such as construction loans.

The Bank has established a comprehensive methodology for determining the provision for loan losses. On a quarterly basis the Bank performs an analysis that considers pertinent factors underlying the quality of the loan portfolio. The factors include changes in the amount and composition of the loan portfolio, historic loss experience for various loan segments, changes in economic conditions, delinquency rates, a detailed analysis of loans on non-accrual status, and other factors to determine an appropriate level of allowance for loan losses. Based on its comprehensive analysis, management deemed the allowance for loan losses of \$6.00 million at December 31, 2007 (1.11% of loans receivable and 153% of non-performing loans) adequate to provide for probable losses based on an evaluation of known and inherent risks in the loan portfolio at that date. The allowance for loan losses was \$4.12 million (0.91% of loans receivable and 1,724% of non-performing loans) at December 31, 2006. The Company had no charge-offs during the quarter ended December 31, 2007 and a net charge-off of \$1,000 for the quarter ended December 31, 2006.

Non-performing loans increased by \$2.42 million to \$3.91 million during the quarter ended December 31, 2007 primarily as a result of two speculative construction builders becoming delinquent on their loans from the Bank. One builder has six single-family home construction loans (\$343,000 average per loan) in Pierce County that became 90 days delinquent during the quarter, while the other builder had one single-family home construction loan (\$521,000) in Pierce County that also become 90 days delinquent during the quarter.

Management also downgraded additional loans to its special mention and substandard loan grade classifications during the quarter ended December 31, 2007. Under the Bank's Classification of Assets Policy, special mention loans are defined as those credits deemed by management to have some potential weakness 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 loans have one or more defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Under the Bank's allowance for loan loss methodology loans classified as special mention or substandard are assumed to have more risk and therefore have higher loss factors associated with them. A majority of the loans downgraded during the quarter ended December 31, 2007 were to borrowers involved in construction and land development activities. As a result of a slowdown in the sales of one- to four-family homes and other uncertain

economic conditions, management believes that certain speculative construction and land development loans have assumed a higher risk profile and were

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therefore downgraded during the quarter. During the quarter the Bank also restructured \$2.46 million in loans to a speculative construction borrower by reducing the interest rates on the loans for a 90 day period.

For additional information, see the section entitled "Activity in the Allowance for Loan Losses" included herein.

Non-interest Income: Total non-interest income increased by \$16,000, or 1.1%, to \$1.50 million for the quarter ended December 31, 2007 from \$1.48 million for the quarter ended December 31, 2006, primarily as a result of an increase in ATM transaction fees and an increase in fee income from the sale of non-deposit investment products. These increases were partially offset by a decrease in income from loan sales, a decrease in servicing income on loans sold, and a decrease in service charges on deposits.

Non-interest Expense: Total non-interest expense decreased by \$46,000, or 0.9%, to \$4.85 million for the quarter ended December 31, 2007 from \$4.90 million for the quarter ended December 31, 2006. The decrease was primarily attributable to a \$160,000 decrease in premises and equipment expense and a \$30,000 decrease in professional fees. The decrease in premises and equipment expense was primarily attributable to an insurance settlement for damage to the Bank's previous data center facility that reduced expenses by \$172,000 during the quarter. This decrease was partially offset by a \$135,000 increase to salaries and employee benefit expense. The increased salary and benefit expense was attributable to annual salary adjustments (effective October 1, 2007) and the addition of several employees. The Company's efficiency ratio improved to 57.64% (or 59.68% if the \$172,000 insurance settlement was removed) for the quarter ended December 31, 2007 from 63.13% for the quarter ended December 31, 2006.

Provision for Income Taxes: The provision for income taxes decreased to \$750,000 for the quarter ended December 31, 2007 from \$906,000 for the quarter ended December 31, 2006 primarily as a result of lower income before taxes. The Company's effective tax rate was 31.71% for the quarter ended December 31, 2007 and 31.68% for the quarter ended December 31, 2006.

Liquidity and Capital Resources

The Company's primary sources of funds are customer deposits, brokered deposits, proceeds from principal and interest payments on loans and mortgage-backed securities, proceeds from the sale of loans, proceeds from maturing securities, FHLB advances, and other borrowings. While maturities and the scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

An analysis of liquidity should include a review of the Condensed Consolidated Statement of Cash Flows for the three months ended December 31, 2007. The statement of cash flows includes operating, investing and financing categories. Operating activities include net income, which is adjusted for non-cash items, and increases or decreases in cash due to changes in assets and liabilities. Investing activities consist primarily of proceeds from maturities and sales of securities, purchases of securities, and the net change in loans. Financing activities present the cash flows associated with the Company's deposit accounts, other borrowings and stock related transactions.

The Company's total cash equivalents increased by 0.9% to \$16.82 million at December 31, 2007 from \$16.67 million at September 30, 2007. The increase in liquid assets were primarily reflected in an increase in non-interest bearing cash equivalents and were partially offset by a decrease in federal funds sold and other interest bearing deposits in banks.

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The Bank must maintain an adequate level of liquidity to ensure the availability of sufficient funds for loan originations and deposit withdrawals, to satisfy other financial commitments and to take advantage of

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investment opportunities. The Bank generally maintains sufficient cash and short-term investments to meet short-term liquidity needs. At December 31, 2007, the Bank's regulatory liquidity ratio (net cash, and short-term and marketable assets, as a percentage of net deposits and short-term liabilities) was 9.20%. The Bank maintained an uncommitted credit facility with the FHLB of Seattle that provided for immediately available advances up to an aggregate amount equal to 30% of total assets, limited by available collateral, under which \$106.38 million was outstanding at December 31, 2007. The Bank also has a \$10.00 million overnight credit line with Pacific Coast Banker's Bank. At December 31, 2007, the Bank did not have any outstanding advances on this credit line.

Liquidity management is both a short and long-term responsibility of the Bank's management. The Bank adjusts its investments in liquid assets based upon management's assessment of (i) expected loan demand, (ii) projected loan sales, (iii) expected deposit flows, and (iv) yields available on interest-bearing deposits. Excess liquidity is invested generally in interest-bearing overnight deposits, federal funds sold, and other short-term investments. If the Bank requires funds that exceed its ability to generate them internally, it has additional borrowing capacity with the FHLB and Pacific Coast Banker's Bank.

The Bank's primary investing activity is the origination of one- to four-family mortgage loans, commercial mortgage loans, construction and land development loans, land loans, consumer loans, and commercial business loans. At December 31, 2007, the Bank had loan commitments totaling \$41.91 million and undisbursed loans in process totaling \$60.71 million. The Bank anticipates that it will have sufficient funds available to meet current loan commitments. Certificates of deposit that are scheduled to mature in less than one year from December 31, 2007 totaled \$207.00 million. Historically, the Bank has been able to retain a significant amount of its non-brokered certificates of deposit as they mature. At December 31, 2007, the Bank had \$23.02 million in brokered certificate of deposit accounts, all of which are scheduled to mature in less than one year. As these brokered certificate of deposit accounts approach maturity, the Bank will evaluate its liquidity needs and the cost of other alternative funding sources before determining if additional brokered deposits will be acquired to replace the maturing brokered deposits.

Federally-insured state-chartered banks are required to maintain minimum levels of regulatory capital. Under current FDIC regulations, insured state-chartered banks generally must maintain (i) a ratio of Tier 1 leverage capital to total assets of at least 3.0% (4.0% to 5.0% for all but the most highly rated banks), (ii) a ratio of Tier 1 capital to risk weighted assets of at least 4.0% and (iii) a ratio of total capital to risk weighted assets of at least 8.0%. At December 31, 2007, the Bank was in compliance with all applicable capital requirements. For additional details see the section below entitled "Regulatory Capital."

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Regulatory Capital

The following table compares the Bank's regulatory capital at December 31, 2007 to its minimum regulatory capital requirements at that date (Dollars in thousands):

	Amount	Percent of Adjusted Total Assets (1)
	-----	-----
Tier 1 (leverage) capital	\$59,799	9.32%
Tier 1 (leverage) capital requirement	25,664	4.00
	-----	-----
Excess	\$34,135	5.32%
	=====	=====
Tier 1 risk adjusted capital	\$59,799	10.93%
Tier 1 risk adjusted capital requirement	21,890	4.00
	-----	-----
Excess	\$37,909	6.93%
	=====	=====
Total risk based capital	\$65,796	12.02%
Total risk based capital requirement	43,780	8.00
	-----	-----
Excess	\$22,016	4.02%
	=====	=====

(1) For the Tier 1 (leverage) capital, percent of total average assets calculation, total average of assets were \$641.60 million. For the Tier 1 risk-based capital and total risk-based capital calculations, total risk-weighted assets were \$547.26 million.

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

	For the Three Months Ended		
	December 31, 2007	September 30, 2007	December 31, 2006
	-----	-----	-----
PERFORMANCE RATIOS:			
Return on average assets (1)	0.99%	1.36%	1.35%
Return on average equity (1)	8.61%	11.66%	9.94%
Net interest margin (1)	4.59%	4.60%	4.74%
Efficiency ratio	57.64%	58.47%	63.13%
	-----	-----	-----
	At	At	At
	December 31,	September 30,	December 31,
	2007	2007	2006

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ASSET QUALITY RATIOS:

Non-performing loans	\$3,908	\$1,490	\$ 239
OREO & other repossessed assets	- -	--	2
Total non-performing assets	\$3,908	\$1,490	\$ 241
Non-performing assets to total assets	0.60%	0.23%	0.04%
Allowance for loan losses to non-performing loans	153%	322%	1,724%
Restructured loans	\$2,462	- -	- -
Book value per share (2)	\$10.84	\$10.72	\$10.53
Book value per share (3)	\$11.50	\$11.39	\$11.19
Tangible book value per share (2) (4)	\$ 9.86	\$ 9.73	\$ 9.56
Tangible book value per share (3) (4)	\$10.46	\$10.34	\$10.16

(1) Annualized

(2) Calculation includes ESOP shares not committed to be released

(3) Calculation excludes ESOP shares not committed to be released

(4) Calculation subtracts goodwill and core deposit intangible from the equity component

For the Three Months Ended
December 31, September 30, December 31,
2007 2007 2006

AVERAGE BALANCE SHEET:

Average total loans	\$538,284	\$509,166	\$439,294
Average total interest earning assets	602,628	586,056	529,572
Average total assets	650,893	634,762	580,114
Average total interest bearing deposits	411,766	405,078	376,365
Average FHLB advances & other borrowings	106,937	96,442	65,970
Average shareholders' equity	75,002	73,916	78,646

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes in information concerning market risk from the information provided in the Company's Form 10-K for the fiscal year ended September 30, 2007.

Item 4. Controls and Procedures

- (a) Evaluation of Disclosure Controls and Procedures: An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) was carried out under the supervision and with the participation of the

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Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management as of the end of the period covered by this report. The Company's Chief Executive Officer and Chief Financial Officer concluded that as of December 31, 2007 the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

- (b) **Changes in Internal Controls:** There have been no changes in our internal control over financial reporting (as defined in 13a-15(f) of the Exchange Act) that occurred during the quarter ended December 31, 2007, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. The Company continued, however, to implement suggestions from its internal auditor and independent auditors to strengthen existing controls. The Company does not expect that its disclosure controls and procedures and internal controls over financial reporting will prevent all error and fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns in controls or procedures can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; as over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There have been no material changes in the Risk Factors previously disclosed in Item 1A of the Company's 2007 Form 10-K.

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

Not applicable

Stock Repurchases

The following table sets forth the shares repurchased by the Company during the quarter ended December 31, 2007:

Period	Total No. of Shares Purchased	Average Price Paid per Share	Total No. of Shares Purchased as Part of Publicly Announced Plan (1)	Maximum No. of Shares that May Yet Be Purchased Under the Plan(1)
10/01/2007 - 10/31/2007	--	--	--	144,950
11/01/2007 - 11/30/2007	--	--	--	144,950
12/01/2007 - 12/31/2007	50,000	14.06	50,000	94,950
Total	50,000	\$14.06	50,000	94,950

(1) On May 25, 2007, the Company announced a share repurchase plan authorizing the repurchase of up to 5% of its outstanding shares, or 356,950 shares. As of December 31, 2007, a total of 262,000 shares had been repurchased at an average price of \$16.90 per share. All shares were repurchased through open market broker transactions and no shares were directly repurchased from directors or officers of the Company.

Item 3. Defaults Upon Senior Securities

None to be reported.

Item 4. Submission of Matters to a Vote of Security Holders

None to be reported

Item 5. Other Information

None to be reported.

Item 6. Exhibits

- (a) Exhibits
 - 3.1 Articles of Incorporation of the Registrant (1)
 - 3.2 Bylaws of the Registrant (1)
 - 3.3 Amendment to Bylaws (2)
 - 10.1 Employee Severance Compensation Plan, as revised (3)

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- 10.2 Employee Stock Ownership Plan (3)
- 10.3 1999 Stock Option Plan (4)
- 10.4 Management Recognition and Development Plan (4)
- 10.5 2003 Stock Option Plan (5)
- 10.6 Form of Incentive Stock Option Agreement (6)
- 10.7 Form of Non-qualified Stock Option Agreement (6)
- 10.8 Form of Management Recognition and Development Award Agreement (6)
- 10.9 Employment Agreement between the Company and the Bank and Michael R. Sand (7)
- 10.10 Employment Agreement between the Company and the Bank and Dean J. Brydon (7)
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act
- 32 Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes Oxley Act

-
- (1) Incorporated by reference to the Registrant's Registration Statement of Form S-1 (333- 35817).
 - (2) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended September 30, 2002.
 - (3) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 1997; and to the Registrant's Current Report on Form 8-K dated April 13, 2007, and to the Registrant's Current Report on Form 8-K dated December 18, 2007.
 - (4) Incorporated by reference to the Registrant's 1999 Annual Meeting Proxy Statement dated December 15, 1998.
 - (5) Incorporated by reference to the Registrant's 2004 Annual Meeting Proxy Statement dated December 24, 2003.
 - (6) Incorporated by reference to the Registrant's Annual Report on Form 10-K for the year ended September 30, 2005.
 - (7) Incorporated by reference to the Registrant's Current Report on Form 8-K dated April 13, 2007.

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SIGNATURES

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

Timberland Bancorp, Inc.

Date: February 6, 2008

By: /s/ Michael R. Sand

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

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Date: February 6, 2008

By: /s/ Dean J. Brydon

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

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EXHIBIT INDEX

Exhibit No.	Description of Exhibit
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
32	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act

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Exhibit 31.1

Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act

I, Michael R. Sand, certify that:

1. I have reviewed this Form 10-Q of Timberland Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

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- (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 6, 2008

/s/ Michael R. Sand

Michael R. Sand
Chief Executive Officer

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Exhibit 31.2
Certification of Chief Financial Officer Pursuant to Section 302 of the
Sarbanes Oxley Act

I, Dean J. Brydon, certify that:

1. I have reviewed this Form 10-Q of Timberland Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

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3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 6, 2008

/s/ Dean J. Brydon

Dean J. Brydon
Chief Financial Officer

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EXHIBIT 32

Certification Pursuant to Section 906 of the Sarbanes Oxley Act

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
OF TIMBERLAND BANCORP, INC.
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), each of the undersigned hereby certifies in his capacity as an officer of Timberland Bancorp, Inc. (the "Company") and in connection with the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2007 ("Report"), that:

- * the Report fully complies with the requirements of Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, and
- * the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods presented in the financial statements included in the Report.

/s/ Michael R. Sand

/s/ Dean J. Brydon

Michael R. Sand
Chief Executive Officer

Dean J. Brydon
Chief Financial Officer

Date: February 6, 2008