TIMBERLAND BANCORP INC
Form 10-Q
August 09, 2006

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, 2006

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 X 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 X Non-accelerated filer ____

Indicate by check mark whether the registrant is a shell company (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 JULY 31, 2006
Common stock, $.01 par value	3,785,576

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

TIMBERLAND BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

June 30, 2006 and September 30, 2005
In Thousands, Except Share Amounts

	June 30, 2006	September 30, 2005
Assets	(Unaudited)	
Cash and due from financial institutions		
Non-interest bearing	$ 13,720	$ 20,015
Interest bearing deposits in banks	2,565	3,068
Federal funds sold	10,450	5,635
	26,735	28,718
Investments and mortgage-backed securities:		
Held to maturity	86	104
Available for sale	84,822	89,595
Federal Home Loan Bank ("FHLB") stock	5,705	5,705
	90,613	95,404
Loans receivable	401,014	389,853
Loans held for sale	1,024	2,355
Less: Allowance for loan losses	(4,120)	(4,099)
Net loans receivable	397,918	388,109
Accrued interest receivable	2,416	2,294
Premises and equipment	16,416	15,862
Other real estate owned ("OREO") and other repossessed items	112	509
Bank owned life insurance ("BOLI")	11,835	11,502
Goodwill	5,650	5,650
Core deposit intangible	1,588	1,834
Mortgage servicing rights	888	928
Other assets	2,373	1,955
Total Assets	$556,544	$552,765
Liabilities and Shareholders' Equity		
Deposits	$419,384	$411,665
FHLB advances	53,776	62,353
Other borrowings: repurchase agreements	1,152	781
Other liabilities and accrued expenses	3,409	3,324
Total Liabilities	477,721	478,123
Shareholders' Equity		
Preferred Stock, $.01 par value; 1,000,000 shares authorized; none issued		
Common Stock, $.01 par value; 50,000,000 shares authorized;		
June 30, 2006 - 3,785,576 shares issued and outstanding		
September 30, 2005 - 3,759,937 shares issued and outstanding	38	38
Additional paid in capital	22,111	22,040
Unearned shares - Employee Stock Ownership Plan ("ESOP")	(3,437)	(3,833)
Retained earnings	61,471	57,268

Accumulated other comprehensive loss	(1,360)	(871)
Total Shareholders' Equity	78,823	74,642
Commitments and contingencies	--	--
Total Liabilities and Shareholders' Equity	$556,544	$552,765

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 and nine months ended June 30, 2006 and 2005
Dollars in Thousands, Except Per Share Amounts
(unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Interest and Dividend Income				
Loans receivable	$8,036	$7,170	$23,144	$20,271
Investments and mortgage-backed securities	529	550	1,642	1,459
Dividends from investments	370	270	1,036	788
Federal funds sold	121	34	292	196
Interest bearing deposits in banks	18	13	54	56
Total interest and dividend income	9,074	8,037	26,168	22,770
Interest Expense				
Deposits	2,058	1,382	5,554	3,819
FHLB advances	718	839	2,201	2,325
Other borrowings	10	7	36	22
Total interest expense	2,786	2,228	7,791	6,166
Net interest income	6,288	5,809	18,377	16,604
Provision for loan losses	--	96	--	116
Net interest income after provision for loan losses	6,288	5,713	18,377	16,488
Non-Interest Income				
Service charges on deposits	769	723	2,226	2,062
Gain on sale of loans, net	60	181	264	613
BOLI net earnings	112	111	333	320
Escrow fees	32	38	87	97
Servicing income on loans sold	80	110	266	199
ATM transaction fees	266	223	742	632
Other	209	162	674	503
Total non-interest income	1,528	1,548	4,592	4,426
Non-Interest Expense				
Salaries and employee benefits	2,727	2,528	8,095	7,726
Premises and equipment	589	597	1,828	1,675

Advertising	185	187	501	565
Loss (gain) from real estate operations	(1)	19	(93)	(11)
ATM expenses	105	134	299	350
Postage and courier	123	80	370	381
Amortization of core deposit intangible	82	94	246	273
State and local taxes	138	116	427	322
Professional fees	222	133	611	496
Other	621	577	1,863	2,119
Total non-interest expense	4,791	4,465	14,147	13,896
Income before federal income taxes	3,025	2,796	8,822	7,018
Federal income taxes	964	961	2,809	2,238
Net Income	$2,061	$1,835	$ 6,013	$ 4,780
Earnings Per Common Share:				
Basic	$ 0.58	$ 0.54	$ 1.70	$ 1.37
Diluted	$ 0.56	$ 0.51	$ 1.65	$ 1.31
Weighted average shares outstanding:				
Basic	3,570,850	3,415,644	3,529,058	3,486,589
Diluted	3,691,438	3,574,410	3,652,502	3,645,658
Dividends paid per share:	$ 0.16	$ 0.15	$ 0.48	$ 0.45

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, 2005 and the nine months ended June 30, 2006
In Thousands, Except Common Stock Shares

	Common Stock Shares Outstanding	Common Stock Amount	Additional Paid-In Capital	Unearned Shares Issued to Employee Stock Ownership Trust	Unearned Shares Issued to Management Recognition Plan	Retained Earnings	Accumulated Other Comprehensive Income (Loss)
Balance, Sept. 30, 2004	3,882,070	$ 39	$24,867	($4,362)	($537)	$52,967	($157)
Net income	- -	- -	- -	- -	- -	6,618	- -
Repurchase of common stock	(174,434)	(2)	(4,062)	- -	- -	- -	- -
Exercise of stock options	52,301	1	813	- -	- -	- -	- -
Cash dividends ($.61 per share)	- -	- -	- -	- -	- -	(2,317)	- -
Earned ESOP shares		- -	293	529	- -	- -	- -
Earned MRDP shares (1)		- -	129	- -	537	- -	- -
Change in fair value of securities available							

for sale, net of tax	- -	- -	- -	- -	- -	- -	(714)
Balance, Sept. 30, 2005	3,759,937	38	22,040	(3,833)	- -	57,268	(871)
(Unaudited)							
Net income	- -	- -	- -	- -	- -	6,013	- -
Repurchase of common stock	(58,200)	(1)	(1,745)	- -	- -	- -	- -
Exercise of stock options	83,839	1	1,479	- -	- -	- -	- -
Cash dividends ($.48 per share)	- -	- -	- -	- -	- -	(1,810)	- -
Earned ESOP shares	- -	- -	299	396	- -	- -	- -
Stock option compensation expense	- -	- -	38	- -	- -	- -	- -
Change in fair value of securities available for sale, net of tax	- -	- -	- -	- -	- -	- -	(489)
Balance, June 30, 2006	3,785,576	$ 38	$22,111	($3,437)	$- -	$61,471	($1,360)

(1) Shares issued under the Timberland Bancorp, Inc. 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 nine months ended June 30, 2006 and 2005
In Thousands
(unaudited)

	Nine Months Ended June 30, 2006	2005
Cash Flow from Operating Activities		
Net income	$ 6,013	$ 4,780
Noncash revenues, expenses, gains and losses included in income:		
Depreciation	755	696
Amortization of core deposit intangible	246	273
FHLB stock dividends	- -	(23)
Earned ESOP Shares	695	618
Earned MRDP Shares	- -	500
Stock option compensation expense	38	- -
Gain on sale of other real estate owned, net	(49)	(38)
Loss on sale of premises and equipment	- -	13
Gain on disposal of premises and equipment	(38)	- -
BOLI cash surrender value increase	(333)	(320)
Gain on sale of loans	(264)	(613)
Decrease in deferred loan origination fees	(322)	(197)
Provision for loan and other real estate owned losses	- -	128
Loans originated for sale	(16,000)	(18,319)
Proceeds from sale of loans	17,595	16,869
(Increase)Decrease in other assets, net	(203)	481
Increase in other liabilities and accrued expenses, net	85	578
Net Cash Provided by Operating Activities	8,218	5,426
Cash Flow from Investing Activities		

Purchase of securities available for sale	- -	(38,972)
Proceeds from maturities of securities available for sale	4,011	6,485
Proceeds from maturities of securities held to maturity	17	46
Increase in loans receivable, net	(10,868)	(40,346)
Additions to premises and equipment	(1,271)	(497)
Purchase of branches, net of cash and cash equivalents	- -	76,630
Proceeds from the disposition of premises and equipment	- -	6
Proceeds from sale of other real estate owned	473	368
Net Cash Provided by (Used in) Investing Activities	(7,638)	3,720
Cash Flow from Financing Activities		
Increase (decrease) in deposits, net	7,719	(4,748)
Increase (decrease) in FHLB advances - long term	(577)	7,464
Decrease in FHLB advances - short term	(8,000)	(5,485)
Increase in repurchase agreements	371	1,091
Proceeds from exercise of stock options	1,479	436
Purchase and retirement of common stock	(1,745)	(4,064)
Payment of dividends	(1,810)	(1,717)
Net Cash Used in Financing Activities	(2,563)	(7,023)

See notes to unaudited condensed consolidated financial statements (continued)

TIMBERLAND BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (concluded)
For the nine months ended June 30, 2006 and 2005
In Thousands
(unaudited)

	Nine Months Ended June 30, 2006	2005
Net Increase (Decrease) in Cash	(1,983)	2,123
Cash and Due from Financial Institutions		
Beginning of period	28,718	15,268
End of period	$26,735	$17,391
Supplemental Disclosure of Cash Flow Information		
Income taxes paid	$ 2,625	$ 1,450
Interest paid	7,544	5,984
Supplemental Disclosure of Non-cash Investing Activities		
Market value adjustment of securities held for sale, net of tax	(489)	(381)
Loans transferred to other real estate owned	27	268

Supplemental Disclosure of Branch Purchase		
Premium paid on deposits	- -	(7,848)
Fair value of assets acquired, principally property and equipment	- -	(2,064)
Deposits assumed	- -	86,495
Other liabilities assumed	- -	47
Net cash provided by branch purchase	- -	76,630

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 and nine months ended June 30, 2006 and 2005
In Thousands
(unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Comprehensive Income:				
Net Income	$2,061	$1,835	$6,013	$4,780
Change in fair value of securities available for sale, net of tax	(197)	211	(489)	(381)
Total Comprehensive Income	$1,864	$2,046	$5,524	$4,399

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 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, 2005 ("2005 Form 10-K"). The results of operations for the three and nine months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the entire fiscal year.

(b) Principles of Consolidation: The interim condensed consolidated financial statements include the accounts of Timberland Bancorp, Inc. 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.

(c) 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.

(d) Certain prior period amounts have been reclassified to conform to the June 30, 2006 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 Statement of Position ("SOP") 93-6, "Employers' Accounting for Employee Stock Ownership Plans (ESOP),"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 June 30, 2006 and 2005, there were 255,682 and 290,949 ESOP shares, respectively, that had not been allocated.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2006	2005	2006	2005
Basic EPS computation				
Numerator - Net income	$2,061,000	$1,835,000	$6,013,000	$4,780,000
Denominator - Weighted average common shares outstanding	3,570,850	3,415,644	3,529,058	3,486,589

Basic EPS	$ 0.58	$ 0.54	$ 1.70	$ 1.37
Diluted EPS computation				
Numerator - Net income	$2,061,000	$1,835,000	$6,013,000	$4,780,000

Denominator - Weighted average common shares outstanding	3,570,850	3,415,644	3,529,058	3,486,589
Effect of dilutive stock options	120,588	129,094	123,444	136,275
Effect of dilutive MRDP	- -	29,672	- -	22,794
Weighted average common shares and common stock equivalents	3,691,438	3,574,410	3,652,502	3,645,658
Diluted EPS	$ 0.56	$ 0.51	$ 1.65	$ 1.31

(3) STOCK BASED COMPENSATION

Prior to October 1, 2005, the Company accounted for stock-based compensation expense using the intrinsic value method as required by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and as permitted by Statement of Financial Accounting Standards ("SFAS" or "Statement") No. 123, "Accounting for Stock-Based Compensation." No compensation cost for stock options was reflected in net income for the fiscal year ended September 30, 2005, as all options granted had an exercise price equal to the market price of the underlying common stock at the date of the grant.

On October 1, 2005, the Company adopted SFAS No. 123(R) (revised version of SFAS No. 123) 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 (1999 Stock Option Plan and 2003 Stock Option Plan), the Company may grant options for up to a combined total of 811,250 shares of common stock to certain key employees and directors. The exercise price of each option equals the fair market value of the Company's common stock on the date of grant. An option's maximum term is ten years. Options vest in annual installments 10% on each of the ten anniversaries from the date of the grant. If the Company meets three of four established performance criteria the 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 $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. The Company met all four of the performance criteria items for the year ended September 30, 2005. At June 30, 2006, options for 139,208 shares are available for future grant under these plans.

Following is activity under the plans:

	Nine Months Ended June 30, 2006 Total Options Outstanding		
	Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Options outstanding, beginning of period	362,411	$13.86	$3.58
Exercised	(83,839)	12.07	3.27
Granted	--	--	--
Options outstanding, end of period	278,572	$14.40	$3.68
Options exercisable, end of period	255,068	$14.12	$3.62

	Nine Months Ended June 30, 2005 Total Options Outstanding		
	Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Options outstanding, beginning of period	414,712	$13.86	$3.54
Exercised	(31,101)	12.00	3.25
Granted	--	--	--
Options outstanding, end of period	383,611	$13.76	$3.57
Options exercisable, end of period	344,271	$13.39	$3.50

The aggregate intrinsic value of all options outstanding at June 30, 2006 was $4.69 million. The aggregate intrinsic value of all options that were exercisable at June 30, 2006 was $4.36 million. The aggregate intrinsic value of all options outstanding at June 30, 2005 was $3.34 million. The aggregate intrinsic value of all options that were exercisable at June 30, 2005 was $3.13 million.

	Nine Months Ended June 30, Total Unvested Options			
	2006		2005	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Unvested options, beginning of period	38,840	$4.17	77,346	$4.57

Vested	(15,336)	4.00	(38,006)	5.00
Granted	--	--	--	
Unvested options, end of period	23,504	$4.27	39,340	$4.16

The total fair value of options vested during the nine months ended June 30, 2006 was $61,000. The total fair value of options vested during the nine months ended June 30, 2005 was $190,000.

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

	Nine Months Ended June 30, (In Thousands) 2006	2005
Proceeds from options exercised	$1,012	$373
Related tax benefit recognized	468	126
Intrinsic value of options exercised	1,377	370

Options outstanding at June 30, 2006 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)
$12.00-12.38	175,555	$12.01	2.6	175,055	$12.01	2.6
13.59-14.90	33,339	14.70	5.1	30,005	14.70	5.1
15.20-15.96	10,500	15.52	5.7	5,000	15.35	5.6
19.05	28,340	19.05	6.7	14,170	19.05	6.7
22.92-23.25	30,838	23.06	7.6	30,838	23.06	7.6
	278,572	$14.40	4.0	255,068	$14.12	3.8

Options outstanding at June 30, 2005 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)
$12.00-12.38	279,094	$12.01	3.6	277,594	$12.01	3.6
13.59-14.90	33,339	14.70	6.1	23,337	14.70	6.1
15.20-15.96	12,000	15.56	6.7	4,000	15.39	6.6
19.05	28,340	19.05	7.7	8,502	19.05	7.7
22.92-23.25	30,838	23.06	8.6	30,838	23.06	8.6
	383,611	$13.76	4.6	344,271	$13.39	4.4

The fair value of stock-based awards to employees and directors is calculated using the Black-Scholes option pricing model. There were no options granted during the nine months ended June 30, 2006 and June 30, 2005.

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Stock Grant Plans

The Company adopted the MRDP in 1998, which was subsequently approved by shareholders in 1999 for the benefit of officers, employees and non-employee 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 264,500 shares of the Company's common stock. The Company awarded 204,927 shares under the MRDP to officers and directors in 2001. No shares have been awarded since 2001. Awards under the MRDP were made in the form of restricted shares of common stock that were subject to 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 was recognized over a five-year vesting period, with 20% vesting immediately upon grant. At June 30, 2006, participants were fully vested in all shares awarded. There was no activity during the three and nine months ended June 30, 2006 related to MRDP shares.

Expenses for Stock Compensation Plans

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

	Nine Months Ended June 30, 2006		2005	
	(In Thousands)			
	Stock Options	Stock Grants	Stock Options	Stock Grants
Compensation expense recognized in income	$38	$ --	$ --	$502
Related tax benefit recognized	13	--	--	171

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 2006	$13	$ --	$13
2007	7	--	7
2008	4	--	4
2009	2	--	2
Total	$26	$ --	$26

(5) DIVIDEND / SUBSEQUENT EVENT

On July 18, 2006, the Company announced a quarterly cash dividend of $0.18 per common share, payable August 23, 2006, to shareholders of record as of the close of business August 9, 2006.

(6) RECENT ACCOUNTING PRONOUNCEMENTS

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) " The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The new interpretation is effective for fiscal years beginning after December 15, 2006. The Company will adopt the provisions of FIN 48 on October 1, 2007 and is currently evaluating the guidance contained in FIN 48 to determine the effect adoption of the guidance will have on the Company's financial condition and results of operations.

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In March 2006, FASB issued Statement No. 156, Accounting for Servicing of Financial Assets ("SFAS No. 156"). SFAS No. 156 amends Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, to require all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS No. 156 also permits servicers to subsequently measure each separate class of servicing assets and liabilities at fair value rather than at the lower of cost or market. For those companies that elect to measure their servicing assets and liabilities at fair value, SFAS No. 156 requires the difference between the recorded value and fair value at the date of adoption to be recognized as a cumulative effect adjustment to retained earnings as of the beginning of the fiscal year in which the election is made. The Company will adopt SFAS No. 156 beginning in the first quarter of 2007. The Company is currently assessing the impact of adopting SFAS No. 156 but does not expect the standard to have a material impact on the Company's consolidated financial statements.

In February 2006, FASB issued FASB Staff Position ("FSP") No. 123R-4, "Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event." This Staff Position addresses the classification of options and similar instruments issued as employee compensation that allow for cash settlement upon the occurrence of a contingent event. FSP No. 123R-4 provides that cash settlement features that can be exercised only upon the occurrence of a contingent event that is outside the employee's control does not require classifying the option or similar instrument as a liability until it becomes probable that the event will occur. The Company implemented the guidance of FSP No. 123R-4 in the first quarter of fiscal year 2006.

On December 16, 2004, FASB issued SFAS No. 123 (Revised), "Share-Based Payment (SFAS 123(R))." This Statement establishes standards for accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments, or that may be settled by the issuance of those equity instruments. SFAS No. 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS No. 123(R) replaces existing requirements under SFAS No. 123, "Accounting for Stock-Based Compensation," and eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, "Accounting for Stock Issued to Employees." Adoption of the Statement impacts the consolidated financial statements by requiring compensation expense to be recorded for the unvested portion of stock options, which have been granted or are subsequently granted. This Statement became effective for the Company on October 1, 2005.

In May 2005, FASB issued SFAS No. 154, "Accounting Changes for Error Corrections (SFAS No. 154)." SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It established, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transaction requirements specific to the newly adopted accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in the fiscal years ending after December 15, 2005. The adoption of SFAS No. 154 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 Operation

The following analysis discusses the material changes in the financial condition and results of operations of the Company at and for the three and nine months ended June 30, 2006. This analysis as well as other sections of this report contains certain "forward-looking statements." The Company desires to 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 area; deposit flows; demand for residential, commercial real estate, consumer, technological factors affecting operations and other types of loans; real estate values; success of new products and services; and other risks detailed in the Company's reports filed with the SEC, including its 2005 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 6,612,500 shares of common stock by the Company. At June 30, 2006, the Company had total assets of $556.54 million and total shareholders' equity of

$78.82 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.

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." On December 29, 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 under the Savings Association Insurance Fund. The Bank has been a member of the Federal Home Loan Bank ("FHLB") System since 1937. The Bank is regulated by the Washington Department of Financial Institutions, Division of Banks and the FDIC.

The Bank is a community-oriented bank which has traditionally offered a variety of savings products to its customers while concentrating its lending activities on real estate mortgage loans. The Bank operates 21 branches (including its main office in Hoquiam) and a loan production office in the following market areas:

* 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 size 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 detailed analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. 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.

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 as an offset 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 prepayment experience may differ and any difference may have a material effect of 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 June 30, 2006 and September 30, 2005

The Company's total assets increased by $3.77 million to $556.54 million at June 30, 2006 from $552.77 million at September 30, 2005, primarily attributable to a $9.81 million increase in net loans receivable. This increase was partially offset by a $4.79 million decrease in investment and mortgage-backed securities and a $1.98 million decrease in cash and due from financial institutions.

Total deposits increased by $7.71 million to $419.38 million at June 30, 2006 from $411.67 million at September 30, 2005 primarily attributable to an increase in certificate of deposit accounts. Shareholders' equity increased by $4.18 million to $78.82 million at June 30, 2006 from $74.64 million at September 30, 2005 primarily attributable to retained net income.

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

Cash and Due from Financial Institutions: Cash and due from financial institutions decreased to $26.74 million at June 30, 2006 from $28.72 million at September 30, 2005. The decrease was primarily a result of non-interest bearing accounts and interest bearing deposits in banks decreasing by $6.80 million to $16.29 million at June 30, 2006 from $23.08 million at September 30, 2005. The decrease was partially offset by an increase of $4.81 million in federal funds sold to $10.45 million at June 30, 2006 from $5.64 million at September 31, 2005.

Investment Securities and Mortgage-backed Securities: Investment and mortgage-backed securities decreased by $4.79 million to $90.61 million at June 30, 2006 from $95.40 million at September 30, 2005, due to regular amortization and prepayments on mortgage-backed securities. At June 30, 2006, the Company's securities' portfolio was comprised of U.S. agency securities of $33.52 million, mutual funds of $31.91 million, mortgage-backed securities of $19.40 million, and FHLB stock of $5.70 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 $9.81 million to $397.92 million at June 30, 2006 from $388.11 million at September 30, 2005. The increase in the portfolio was primarily a result of a $12.95 million increase in construction loans (net of undisbursed portion), a $4.55 million increase in consumer loans, and a $4.28 million increase in land loans. Partially offsetting these increases were decreases of $5.94 million in one-to-four family mortgage loans, $2.88 million in commercial real estate loans, $1.86 million in commercial business loans, and $1.59 million in multi-family loans.

Loan demand remained strong as loan originations totaled $60.06 million and $169.82 million for the three and nine months ended June 30, 2006 compared to $58.25 million and 168.63 million for the three and nine months ended June 30, 2005. 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 $4.54 million and $17.60 million for the three and nine months ended June 30, 2006, respectively compared to $8.30 million and $16.26 million for the three and nine months ended June 30, 2005, respectively.

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

Other Real Estate Owned and Other Repossessed Items: Other real estate owned ("OREO") and other repossessed items decreased to $112,000 at June 30, 2006 from $509,000 at September 30, 2005 as several properties were sold. At June 30, 2006, OREOs were comprised of three land parcels totaling $112,000. For additional information, see the section entitled "Non-performing Assets" included herein.

Premises and Equipment: Premises and equipment increased by $554,000 to $16.42 million at June 30, 2006 from $15.86 million at September 30, 2005, primarily attributable to remodeling costs associated with several branch and administrative facilities.

Goodwill and Core Deposit Intangible: The value of goodwill and the amortized value of core deposit intangible decreased $246,000 to $7.24 million at June 30, 2006 from $7.48 million at September 30, 2005. The decrease is attributable to scheduled amortization of the core deposit intangible.

Deposits: Deposits increased by $7.71 million to $419.38 million at June 30, 2006 from $411.67 million at September 30, 2005. The deposit increase was primarily as a result of a $21.65 million increase in certificate of deposit accounts and a $2.58 million increase in non-interest bearing accounts. These increases were partially offset by decreases of $11.33 million in money market accounts, $3.40 million in savings accounts, and $1.78 million in N.O.W. checking accounts. For additional information, see the section entitled "Deposit Breakdown" included herein.

FHLB Advances: FHLB advances decreased to $53.78 million at June 30, 2006 from $62.35 million at September 30, 2005 as the Bank repaid several advances that matured. For additional information, see "FHLB Advance Maturity Schedule" included herein.

Shareholders' Equity: Total shareholders' equity increased by $4.18 million to $78.82 million at June 30, 2006 from $74.64 million at September 30, 2005, primarily as a result of net income of $6.01 million and a $1.82 million increase in additional paid in capital from the exercise of stock options and vesting associated with the Company's benefit plans. Also increasing shareholders' equity was a decrease of $396,000 in the equity component related to unearned shares issued to the ESOP. These increases to shareholders' equity were partially offset by the payment of $1.81 million in dividends to shareholders, the repurchase of 58,200 shares of the Company's common stock for $1.75 million and a $489,000 increase in accumulated other comprehensive loss.

On April 7, 2005, the Company announced a plan to repurchase up to 5% of the Company's outstanding shares, or 187,955 shares. This represents the Company's 13th stock repurchase plan. As of June 30, 2006, the Company had repurchased 86,050 of these shares at an average price of $27.79. Cumulatively, the Company has repurchased 3,425,321 shares (51.8%) of the 6,612,500 shares that were issued when the Company went public in January 1998. The 3,425,321 shares have been repurchased at an average price of $15.64 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 decreased to 0.37% at June 30, 2006 from 0.62% at September 30, 2005, as total non-performing assets decreased to $2.05 million at June 30, 2006 from $3.44 million at September 30, 2005. The ratio decreased primarily as a result of a $991,000 decrease in non-performing loans and a $397,000 decrease in OREO.

The non-performing loan total of $1.94 million at June 30, 2006 consisted of a $1.36 million commercial construction loan, $542,000 in one-to-four family loans, $29,000 in consumer loans, and an $8,000 land loan. Despite having a higher historical percentage of non-performing loans than the Company's relevant peer group, the Company's actual charge-offs have remained low. The Company had a net recovery of $21,000 during the nine months ended June 30, 2006 and during the last five fiscal years its net charge-offs to outstanding loans ratio has averaged less than 0.10% per year. For additional information, see the section entitled "Non-performing Assets" included herein.

Investment Securities

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

	At June 30, 2006		At September 30, 2005	
	Amount	Percent	Amount	Percent
	(In Thousands)			
Held-to-maturity:				
Mortgage-backed securities	$ 86	0.09%	$ 104	0.11%
Available-for-sale (at fair value)				
U.S. agency securities	33,515	36.99	33,695	35.32
Mortgage-backed securities	19,399	21.41	23,735	24.88
Mutual funds	31,908	35.21	32,165	33.71
FHLB stock	5,705	6.30	5,705	5.98
Total portfolio	$90,613	100.00%	$95,404	100.00%

Loan Portfolio Composition

The following table sets forth the composition of the Company's loan portfolio by type of loan as of the dates indicated.

	At June 30, 2006		At September 30, 2005	
	Amount	Percent	Amount	Percent

	(In Thousands)			
Mortgage Loans:				
One-to-four family (1)	$ 95,828	21.02%	$101,763	23.24%

Multi- family	18,582	4.08	20,170	4.61
Commercial	121,966	26.75	124,849	28.51
Construction and land development	133,977	29.38	112,470	25.68
Land	29,259	6.42	24,981	5.71
Total mortgage loans	399,612	87.65	384,233	87.75
Consumer Loans:				
Home equity and second mortgage	35,935	7.88	32,298	7.38
Other	10,239	2.24	9,330	2.13
	46,174	10.12	41,628	9.51
Commercial business loans	10,158	2.23	12,013	2.74
Total loans	455,944	100.00%	437,874	100.00%
Less:				
Undisbursed portion of construction loans in process	(51,333)		(42,771)	
Deferred loan origination fees	(2,573)		(2,895)	
Allowance for loan losses	(4,120)		(4,099)	
Total loans receivable, net	$397,918		$388,109	

(1) Includes loans held-for-sale.

Construction and Land Development Loan Portfolio Composition

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

	At June 30, 2006		At September 30, 2005	
	Amount	Percent	Amount	Percent
Custom and owner/builder const.	$ 44,552	33.26%	$ 41,810	37.17%
Speculative construction	37,306	27.85	29,635	26.35
Commercial real estate	32,990	24.62	24,064	21.40
Multi-family	7,388	5.51	10,754	9.56
Land development	11,741	8.76	6,207	5.52
Total construction loans	$133,977	100.00%	$112,470	100.00%

Activity in the Allowance for Loan Losses

Activity in the allowance for loan losses for the three and nine months ended June 30, 2006 and 2005 is as follows:

	Three Months Ended June 30, 2006	2005
	(In Thousands)	
Balance at beginning of period	$4,119	$4,007
Provision for loan losses	- -	96
Loans charged off	(2)	(1)
Recoveries on loans previously charged off	3	1
Net recoveries (charge-offs)	1	- -
Balance at end of period	$4,120	$4,103

	Nine Months Ended June 30, 2006	2005
	(In Thousands)	
Balance at beginning of period	$4,099	$3,991
Provision for loan losses	- -	116
Loans charged off	(2)	(14)
Recoveries on loans previously charged off	23	10
Net recoveries (charge-offs)	21	(4)
Balance at end of period	$4,120	$4,103

Non-performing Assets

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

	At June 30, 2006	At September 30, 2005
	(Dollars In Thousands)	
Loans accounted for on a non-accrual basis:		
Mortgage loans:		
One-to-four family	$542	$2,208
Commercial	- -	261
Construction and land development	1,356	- -

Land	8	23
Consumer loans	29	133
Commercial business loans	- -	301
Total	1,935	2,926
Accruing loans which are contractually past due 90 days or more:	- -	- -
Total	- -	- -
Total of non-accrual and 90 days past due loans	1,935	2,926
Other real estate owned and other repossessed items	112	509
Total non-performing assets	$2,047	$3,435
Restructured loans	- -	- -
Non-accrual and 90 days or more past due loans as a percentage of loans receivable (1)	0.48%	0.75%
Non-accrual and 90 days or more past due loans as a percentage of total assets	0.35%	0.53%
Non-performing assets as a percentage of total assets	0.37%	0.62%
Loans receivable (1)	$402,038	$392,208
Total assets	$556,544	$552,765

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

Deposit Breakdown

The following table sets forth the balances of deposits in the various types of accounts offered by the Bank at the dates indicated.

	At June 30, 2006	At September 30, 2005
	(Dollars In Thousands)	
Non-interest bearing	$ 54,372	$ 51,792
N.O.W. checking	91,694	93,477
Savings	60,878	64,274
Money market accounts	37,962	49,295

Certificates of deposit under $100,000	125,085	117,618
Certificates of deposit $100,000 and over	49,393	35,209
Total Deposits	$419,384	411,665

FHLB Advance Maturity Schedule

The Bank has long- and short-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 June 30, 2006		At September 30, 2005	
	Amount	Percent	Amount	Percent
	(In Thousands)			
Short-term	$ - -	- - %	$ --	--%
Long-term	53,776	100.00	62,353	100.00
Total FHLB advances	$53,776	100.00%	$ 62,353	100.00%

The Bank's FHLB borrowings mature at various dates through January 2016 and bear interest at rates ranging from 4.16% to 6.18%. Principal reduction amounts due for future years ending September 30 are as follows (In thousands):

2006	$20,014
2007	9,064
2008	15,070
2009	4,628
2010	- -
Thereafter	5,000
Total	$53,776

A portion of these advances have a putable feature and may be called by the FHLB earlier than the above schedule indicates. The Bank was notified on June 30, 2006 that a $20.0 million putable advance with a rate of

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4.77% would be called in July 2006. The Bank anticipates replacing a portion of this advance with short-term advances.

Comparison of Operating Results for the Three and Nine Months Ended June 30, 2006 and 2005

The Company's net income increased by $226,000, or 12.3% to $2.06 million for the quarter ended June 30, 2006 from $1.84 million for the quarter ended June 30, 2005. Diluted earnings per share increased by 9.8% to $0.56 for the quarter ended June 30, 2006 from $0.51 for the quarter ended June 30, 2005.

For the nine months ended June 30, 2006 net income increased by $1.23 million or 25.8% to $6.01 million from $4.78 million for the nine months ended June 30, 2005. Diluted earnings per share increased by 26.0% to $1.65 for the nine months ended June 30, 2006 from $1.31 for the nine months ended June 30, 2005.

The improved profitability for the first three quarters of the fiscal year is largely a result of the Company's focus on balancing the re-pricing characteristics of its assets and liabilities. This has allowed the maintenance of a healthy net interest margin in spite of the current flat yield curve environment. The net interest margin increased to 5.00% and 4.90% for the three and nine months ended June 30, 2006, respectively, from 4.74% and 4.62% for the three and nine months ended June 30, 2005, respectively.

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

Net Income: Net income for the quarter ended June 30, 2006 increased to $2.06 million, or $0.56 per diluted share ($0.58 per basic share) from $1.84 million, or $0.51 per diluted share ($0.54 per basic share) for the quarter ended June 30, 2005. The $0.05 increase in diluted earnings per share for the quarter ended June 30, 2006 was primarily a result of a $575,000 ($380,000 net of income tax - $0.11 per diluted share) increase in net interest income after provision for loan losses. This increase was partially offset by a $326,000 ($215,000 net of income tax - $0.06 per diluted share) increase in non-interest expense.

Net income for the nine months ended June 30, 2006 increased $1.23 million to $6.01 million, or $1.65 per diluted share ($1.70 per basic share) from $4.78 million, or $1.31 per diluted share ($1.37 per basic share) for the nine months ended June 30, 2005. The $0.34 increase in diluted earnings per share for the nine months ended June 30, 2006 was primarily the result of a $1.89 million ($1.25 million net of income tax - $0.35 per diluted share) increase in net interest income after provision for loan losses and a $166,000 ($110,000 net of income tax - $0.03 per diluted share) increase in non-interest income. These items were partially offset by a $251,000 ($166,000 net of income tax - $0.04 per diluted share) increase in non-interest expense.

Net Interest Income: Net interest income increased $479,000 to $6.29 million for the quarter ended June 30, 2006 from $5.81 million for the quarter ended June 30, 2005, primarily as a result of a larger interest earning asset base and the collection of $216,000 in prepayment penalties on two participation loans that paid off during the quarter ended June 30, 2006. The prepayment penalties were recorded as interest income and contributed 17 basis points to the quarterly net interest margin. Total interest income increased $1.03 million to $9.07 million for the quarter ended June 30, 2006 from $8.04 million for the quarter ended June 30, 2005 as average total interest earning assets increased by $12.45 million. The yield on interest earning assets increased to 7.22% for the quarter ended June 30, 2006 from 6.56% for the quarter ended June 30, 2005. Total interest expense increased by $558,000 to $2.79 million for the quarter ended June 30, 2006 from $2.23 million for the quarter ended June 30, 2005 as the average rate paid on interest bearing liabilities increased to 2.65% for the quarter ended June 30, 2006 from 2.10% for the quarter ended June 30, 2005. Partially offsetting the increased rate on interest-bearing liabilities was a $1.89 million decrease in the average balance of interest-bearing liabilities during the quarter ended June 30, 2006. The net interest margin increased to 5.00% for the quarter ended June 30, 2006 from 4.74% for the quarter ended June 30, 2005.

Net interest income increased $1.78 million to $18.38 million for the nine months ended June 30, 2006 from $16.60 million for the nine months ended June 30, 2005, primarily due to a larger interest earning asset base and an increase in the Company's interest rate spread. Total interest income increased $3.40 million to $26.17 million for the nine months ended June 30, 2006 from $22.77 million for the nine months ended June 30, 2005 as average total interest earning assets increased by $20.07 million. The yield on interest earning assets was 6.98% for the nine months ended June 30, 2006 compared to 6.33% for the nine months ended June 30, 2005. Total interest expense increased by $1.63 million to $7.79 million for the nine months ended June 30, 2006 from $6.17 million for the nine months ended June 30, 2005 as average interest bearing liabilities increased by $8.39 million. The average rate paid on interest bearing liabilities increased to 2.47% for the nine months ended June 30, 2006 from 2.00% for the nine months ended June 30, 2005. The net interest margin increased to 4.90% for the nine months ended June 30, 2006 from 4.62% for the nine months ended June 30, 2005.

Provision for Loan Losses: There was no provision for loan losses established for the nine months ended June 30, 2006 as credit quality remained strong. The allowance for loan losses, however, did increase during this period as a result of a net recovery of $21,000.

The Bank has established a comprehensive methodology for determining the provision for loan losses. On a quarterly basis the Bank performs an analysis taking into consideration pertinent factors underlying the quality of the loan portfolio. The factors include changes in the size 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 the level of allowance for loan losses needed. Based on its comprehensive analysis, management deemed the allowance for loan losses of $4.12 million at June 30, 2006 (1.03% of loans receivable and 212.92% 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 $4.10 million (1.05% of loans receivable and 137.87% of non-performing loans) at June 30, 2005. The Company had net recovery of $1,000 for the three months ended June 30, 2006 and did not have any charge-offs for the three months ended June 30, 2005. The Company had a net recovery of $21,000 for the nine months ended June 30, 2006 compared to a net charge-off of $4,000 for the nine months ended June 30, 2005. For additional information, see the section entitled "Activity in the Allowance for Loan Losses" included herein.

Non-interest Income: Total non-interest income decreased $20,000 to $1.53 million for the quarter ended June 30, 2006 from $1.55 million for the quarter ended June 30, 2005, primarily due to $121,000 decrease in gains on sale of loans and a $30,000 decrease in servicing income on loans sold. The decrease in income from loan sales was primarily due to a decreased volume of fixed rate qualifying loans that were originated and sold during the quarter. The Bank sold fixed rate loans totaling $4.54 million during the quarter ended June 30, 2006 compared to sales of $8.30 million for the quarter ended June 30, 2005. These decreases were partially offset by a $48,000 increase in fees from the sale of non-deposit investment products (which are recorded in the "other" non-interest income category), a $46,000 increase in service charges on deposits, and a $43,000 increase in ATM transaction fees.

Total non-interest income increased by $166,000 to $4.59 million for the nine months ended June 30, 2006 from $4.43 million for the nine months ended June

30, 2005, primarily due to a $227,000 increase in fees from the sale of non-deposit investment products, a $164,000 increase in service charges on deposits, and a $110,000 increase in ATM transaction fees. These increases were partially offset by a $349,000 decrease in gains from loan sales. Income from loan sales was larger in the period a year ago in part due to the sale of the Bank's credit card portfolio in December 2004, which resulted in a gain of $245,000.

Non-interest Expense: Total non-interest expense increased by $326,000 to $4.79 million for the quarter ended June 30, 2006 from $4.47 million for the quarter ended June 30, 2005. The increase was primarily a

result of a $199,000 increase in salary expense, an $89,000 increase in professional fees, and a $43,000 increase in postage and courier expense.

Total non-interest expense increased by $251,000 to $14.15 million for the nine months ended June 30, 2006 from $13.90 million for the nine months ended June 30, 2005. The increase was primarily attributable to a $369,000 increase in salary and benefit expense, a $153,000 increase in premises and equipment expense, a $115,000 increase in professional fees, and a $105,000 increase in state and local taxes. Partially offsetting these increases was a $256,000 decrease in the other non-interest expense category. For the nine months ended June 30, 2005 the other non-interest expense category included expenses related to the October 2004 branch acquisition and expenses related to one of the Company's benefit plans. Also partially offsetting the increases to non-interest expense were decreases in advertising expense, ATM expense, core deposit intangible amortization expense, and a net improvement in the real estate operations category. The Company's efficiency ratio improved to 61.59% for the nine months ended June 30, 2006 from 66.08% for the nine months ended June 30, 2005.

Provision for Income Taxes: The provision for income taxes increased to $964,000 for the quarter ended June 30, 2006 from $961,000 for the quarter ended June 30, 2005 primarily as a result of increased net income before taxes. The Company's effective tax rate was 31.87% for the quarter ended June 30, 2006 and 34.37% for the quarter ended June 30, 2005. The higher effective tax rate in the previous year was primarily a result of tax adjustments relating to the Company's branch acquisition.

The provision for income taxes increased to $2.81 million for the nine months ended June 30, 2006 from $2.24 million for the nine months ended June 30, 2005 primarily as a result of increased net income before taxes. The Company's effective tax rate was 31.84% for the nine months ended June 30, 2006 and 31.89% for the nine months ended June 30, 2005.

Liquidity and Capital Resources

The Company's primary sources of funds are customer deposits, proceeds from principal and interest payments on loans and mortgage-backed securities, and proceeds from the sale of loans, maturing securities and FHLB advances. 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 also include a review of the changes that appear in the Condensed Consolidated Statement of Cash Flows for the nine months ended June 30, 2006. 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 certain 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 of cash and due from financial institutions decreased by $1.98 million to $26.74 million at June 30, 2006 from $28.72 million at September 30, 2005. The Company's liquid assets decreased primarily due to funding a portion of the loan portfolio growth.

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 investment opportunities. The Bank generally maintains sufficient cash and short-term investments to meet short-term liquidity needs. At June 30, 2006, 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 13.25%. The Bank also

maintained an uncommitted credit facility with the FHLB of Seattle that provided for immediately available advances up to an aggregate amount of $136.68 million, under which $53.78 million was outstanding at June 30, 2006.

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 beyond its ability to generate them internally, it has additional borrowing capacity with the FHLB and collateral for repurchase agreements.

The Bank's primary investing activity is the origination of one-to-four family mortgage loans, commercial mortgage loans, construction and land development loans, and consumer loans. At June 30, 2006, the Bank had loan commitments totaling $49.24 million and undisbursed loans in process totaling $51.33 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 June 30, 2006 totaled $132.32 million. Historically, the Bank has been able to retain a significant amount of its certificates of deposit as they mature.

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 June 30, 2006, the Bank was in compliance with all applicable capital requirements. For additional details see the section below entitled

"Regulatory Capital."

Regulatory Capital

The following table compares the Bank's regulatory capital at June 30, 2006 to its minimum regulatory capital requirements at that date (in thousands):

	Amount	Percent of Adjusted Total Assets (1)
Tier 1 (leverage) capital	$62,027	11.39%
Tier 1 (leverage) capital requirement	21,790	4.00
Excess	$40,237	7.39%
Tier 1 risk adjusted capital	$62,027	15.21%
Tier 1 risk adjusted capital requirement	16,310	4.00
Excess	$45,717	11.21%
Total risk based capital	$66,147	16.22%
Total risk based capital requirement	32,620	8.00
Excess	$33,527	8.22%

(1) For the Tier 1 (leverage) capital, percent of total average assets of $544.75 million. For the Tier 1 risk-based capital and total risk-based capital calculations, percent of total risk-weighted assets of $407.8 million.

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

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Nine Months Ended June 30, 2006	Nine Months Ended June 30, 2005
PERFORMANCE RATIOS:				
Return on average assets (1)	1.49%	1.35%	1.45%	1.20%
Return on average equity (1)	10.57%	10.19%	10.48%	8.77%
Net interest margin (1)	5.00%	4.74%	4.90%	4.62%
Efficiency ratio	61.30%	60.69%	61.59%	66.08%

	June 30, 2006	September 30, 2005
ASSET QUALITY RATIOS:		

Non-performing loans	$ 1,935	$ 2,926
OREO & other repossessed assets	112	509
Total non-performing assets	$ 2,047	$ 3,435
Non-performing assets to total assets	0.37%	0.62%
Allowance for loan losses to non-performing loans	212.92%	140.09%
Book value per share (2)	$ 20.82	$ 19.85
Book value per share (3)	$ 22.16	$ 21.30
Tangible book value per share (2) (4)	$ 18.91	$ 17.86
Tangible book value per share (3) (4)	$ 20.13	$ 19.16

(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

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Nine Months Ended June 30, 2006	Nine Months Ended June 30, 2005
AVERAGE BALANCE SHEET:				
Average total loans	$ 399,849	$ 385,592	$ 396,141	$ 372,183
Average total interest earning assets	502,804	490,359	499,624	479,551
Average total assets	554,716	544,149	552,100	532,025
Average total interest bearing liabilities:				
Average total interest bearing deposits	366,228	355,367	363,246	353,622
Average FHLB advances & other borrowings	55,597	68,345	58,218	59,455
Average shareholders' equity	77,969	72,027	76,478	72,708

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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, 2005 .

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures: An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management as of the end of the period covered by this report. The Company's Chief Executive Officer and Chief Financial Officer concluded that as of June 30, 2006 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 March 31, 2006, 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 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:

Period	Total No. of Shares Purchased	Average Price Paid per Share	Total No. of Shares Purchased as Part of Publicly Announced Plan	Maximum No. of Shares that May Yet Be Purchased Under the Plan(1)

04/01/2006 - 04/30/2006	- -	$ - -	- -	151,905
05/01/2006 - 05/31/2006	- -	- -	- -	151,905
06/01/2006- 06/30/2006	50,000	31.06	50,000	101,905
Total	50,000	$ 31.06	50,000	

(1) On April 7, 2005, the Company announced a share repurchase plan authorizing the repurchase of up to 5% of its outstanding shares, or 187,955 shares. As of June 30, 2006, a total of 86,050 shares had been repurchased at an average price of $27.79 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 (3)
- 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)
- 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 906 of the Sarbanes Oxley Act
- 32 Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes Oxley Act

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(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.
(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.

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: August 8, 2006

By: /s/Michael R. Sand

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

Date: August 8, 2006

By: /s/Dean J. Brydon

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

EXHIBIT INDEX

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

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;

   (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: August 8, 2006 /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;

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: August 8, 2006

/s/Dean J. Brydon

Dean J. Brydon
Chief Financial Officer

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

The undersigned hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with this Quarterly Report on Form 10-Q, 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 company's financial condition and results of operations.

/s/Michael R. Sand

Michael R. Sand
Chief Executive Officer

/s/Dean J. Brydon

Dean J. Brydon
Chief Financial Officer

Date: August 8, 2006