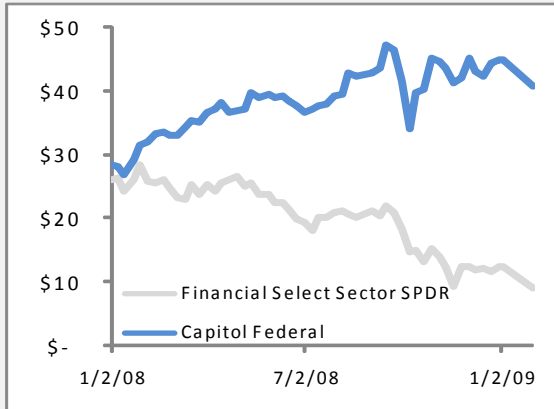


Recommendation: **HOLD**

Flight to Quality



Company: Capitol Federal
 Ticker: NASDAQ: CFFN
 Headquarters: Topeka, Kansas

Price Target: \$ 40.00
 Current Price (2/15/09): \$ 39.86
 52 Week Range: \$ 33.06 - 51.56

	Comps	CFFN
Market Cap (M):	1,580.0	2,953.6
Equity/Assets %(12/08):	12.8	11.0
Efficiency Ratio %(ttm):	67.1	50.5
Price/Book (2010):	0.7	0.9
Price/Earnings (2010):	12.0	13.8
Dividend Yield (%):	1.8	5.0

	Comps	CFFN
ROA %(ttm):	0.75	0.63
ROE %(ttm):	4.34	5.86
ROIC %(ttm):	4.15	6.74

Comps: Beneficial Mutual Bancorp, Investors Bancorp, Northwest Bancorp, and TFS Financial

We place a **HOLD** on Capitol Federal Financial shares.

INVESTMENT THESIS

- While the financial sector has fallen 65% since Jan.1, 2008, Capitol Federal shares have surged 43%. Capitol Federal's safety and relative lack of exposure to the current economic crisis have been priced into its shares. The company's current share price of \$39.86 nearly matches our price target of \$40.00.
- Capitol Federal has an attractive dividend yield of 5%. With cash flows expected to exceed \$55 million for the next three years, we do not predict a cut in the company's \$2 per share dividend (a total payout of \$41.8 million).
- Management is focused on keeping expenses to a minimum. Capitol Federal's efficiency ratio is only 50.5%, 16 percentage points lower than comparable thrifts. We anticipate management to continue to control costs.
- Capitol Federal appears to have superior assets relative to peer institutions, as its non-performing loans to total assets is 0.3%, compared to a peer average of 1.2%.

COMPANY OVERVIEW

Capitol Federal Financial (CFFN) was founded in 1893 and is a thrift headquartered in Topeka, Kansas. The company makes money by borrowing funds (deposits) at a low interest rate, and lending funds (loans) at a higher interest rate. It also earns revenue from principal and interest payments, as well as capital gains, on investment securities. Capitol Federal serves the northeast region of Kansas with 34 traditional branches and nine in-store banking offices as of the end of 2008.¹

Capitol Federal operates through its wholly owned subsidiary, Capitol Federal Savings Bank, which is majority-owned by Capitol Federal Savings Bank MHC, a federally chartered mutual holding company.

The company's primary business is the origination of one-to-four family mortgage loans funded through retail deposits.² By the end of the 2008 fiscal year (9/30/2008), Capitol Federal had total loans, deposits and borrowings of \$5.3 billion, \$3.9 billion and \$3.2 billion, respectively, with an increase of 0.6%, 0% and 13.5%, respectively, from fiscal year 2007.

¹ Capitol Federal. www.capfed.com. Accessed on 2/13/09.

² www.reuters.com CFFN Company Overview

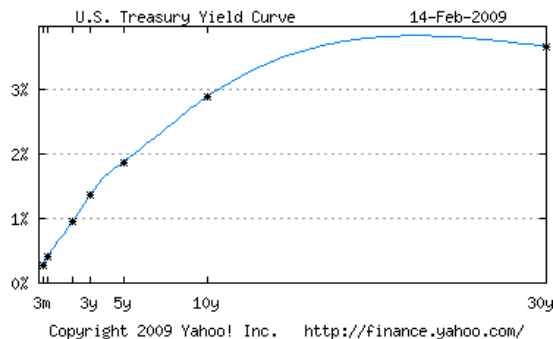
Capitol Federal paid dividends of \$2.11 per share in the fiscal year 2008, of which \$0.11 was a special dividend.³ Management plans to continue to pay a quarterly dividend of \$0.50 per share for the foreseeable future.⁴ Capitol Federal's mutual holding company, which owns approximately 70% of shares outstanding, continually waives its right to receive dividends. Therefore, Capitol Federal pays the \$0.50 quarterly dividend to only 20.9 million shares, or about 28% of the 74.1 million shares outstanding.⁵

The company's ownership structure could cause confusion for "surface analysis" investors. The following chart shows the substantial differences in three key metrics depending how shares are allocated.

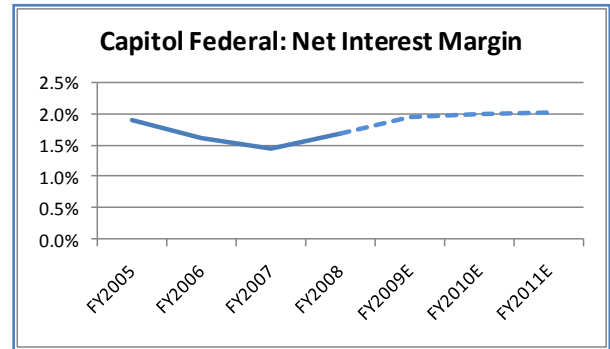
Allocating Capitol Federal Shares			
	P/E (2010)	P/B (2010)	Div. Yield
Shares outstanding (incl. MHC shares)	48.8	3.2	1.5%
Shares outstanding (excl. MHC shares)	13.8	0.9	5.0%

COMPANY FORECAST

The yield curve is a key factor effecting Capitol Federal's net interest margin. A flat or inverted yield curve will harm its net interest margin as the company borrows short-term and lends long-term, making money off the spread.



From the latest yield curve graph,⁶ we expect the yield curve in 2009 to remain upward sloping, and the net interest margin of Capitol Federal to increase due to increasing long-term rates.



Mortgage rates have recently hit all-time lows at around 5% for a 30-year fixed rate mortgage, but we expect mortgage rates to increase slightly in 2009 while the short-term rates remain near 0%.

Although Cap Fed was not hit by sub-prime crisis last year due to their maintenance of high lending standards,⁷ we predict continued deterioration of the U.S. economy will lower Capitol Federal's net income growth and deposit growth rate in 2009.

Capitol Federal Key Drivers Forecast (millions of dollars, except where indicated)					
	FY2007	FY2008	FY2009E	FY2010E	FY2011E
Interest Income	411.6	410.8	419.0	427.4	435.9
Interest Income Growth (%)		(0.2)	2.0	2.0	2.0
Interest Expense	305.1	276.6	268.3	271.0	273.7
Interest Expense Growth (%)		(9.3)	(3.0)	1.0	1.0
Net Income	32.3	51.0	60.0	60.5	62.7
Net Income Growth (%)		57.9	17.6	0.9	3.6
Loans	5,294.3	5,326.6	5,517.4	5,627.9	5,740.5
Loan Growth (%)		0.60	3.60	2.00	2.00
Deposits	3,922.8	3,923.9	3,867.3	3,886.6	3,925.5
Deposits Growth (%)		0.0	(1.4)	0.5	1.0

INDUSTRY ANALYSIS

As a savings and loan institution, Capitol Federal operates in the Financial Services Industry. Capitol Federal's competitors include other savings and loan banks and all other loan originating banks in northeast Kansas. The primary competitive advantages for Capitol Federal include its high quality loan portfolio, and its ability to stay highly efficient by minimizing costs.

Capitol Federal has maintained a high quality loan portfolio, unlike many of its competitors, by not participating in subprime, Alt-A, or negative amortization lending.⁸ In addition, the company continues to adhere to

³ Capitol Federal 10-K, filed 12/1/08. Pg. 43.

⁴ Capitol Federal 2008 Annual Report, filed 12/1/08. Pg. 13.

⁵ Capitol Federal 10-Q, filed 2/4/09. Pg. 4.

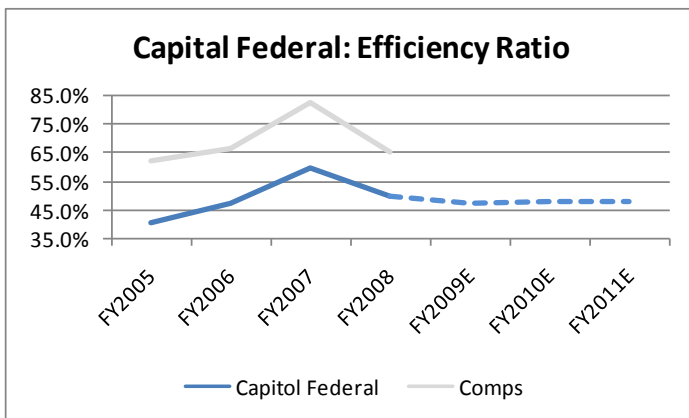
⁶ Found on www.finance.yahoo.com. Accessed 2/13/08.

⁷ Capitol Federal Financial 2008 Annual Meeting Presentation

⁸ Capitol Federal 2008 Annual Meeting Presentation. <http://ir.capfed.com/eventdetail.cfm?eventid=64418>. Accessed on 2/13/09.

traditional underwriting standards lending only to qualified borrowers and require full documentation. These high standards are a testament to the quality of its assets and the minimal risk involved in investing in Capitol Federal. As of Dec. 31, 2008, Capitol Federal's non-performing loans to total assets was only 0.3%, while the industry average was 1.2%.

Capitol Federal has been able to stay highly efficient by maintaining a high quality portfolio and minimizing costs. To measure Capitol Federal's efficiency relative to its peers, we calculated the efficiency ratio by taking the non-interest expense divided by the net interest income plus non-interest income. Capitol Federal's efficiency ratio is currently at 49.9% and has been trending slightly upward over the past few years. The ratio spiked to 59.6% in 2007 due to higher interest expenses primarily due to the fact that there was an inverted yield curve at that time. The efficiency ratio for Capitol Federal came back down in 2008 to 49.9%, nearing the 2006 level. The downward sloping yield curve decreased all thrift margins in 2007.



Compared to its peers Capitol Federal is significantly more efficient than its comparables. The comparables used were other savings and loans including: Investors Bancorp, Northwest Bancorp, TFS Financial Corp, and Beneficial Mutual Financial. The average comparable efficiency ratio was 65.4% in 2008, while Cap Fed's ratio was 49.9%. This indicates Capitol Federal is a very well run bank that knows how to control its costs effectively.

Capitol Federal is a conservative bank and has not tried to increase returns by creating risky loans. Even so, Capitol Federal still had a higher return on equity than the average comparable savings and loans. Capitol Federal's

return on equity was 5.9% in 2008, 2.1% higher than comps.

VALUATION

We valued Capitol Federal using a Dividend Discount Model and a Relative Valuation.

The Dividend Discount Model showed Capitol Federal to be slightly undervalued. Our key assumptions included a 6% cost of debt and an 8.2% cost of equity.

Dividend Discount Model	
2008 Dividend*	\$ 2.00
WACC	4.8%
P*	42.02
Current Price (2/6/09)	39.86
Premium/(discount)	-5%

For the Relative valuation we used Price/Book as our multiple. Based on this analysis, Capitol Federal is 29% overvalued.

Intrinsic Value: 2010 Price/Book	
Comparable Price/Book Ratio	0.7
x 2010 Book/Share (less MHC)	43.7
P*	30.92
Current Price (2/13/09)	39.86
Premium/(discount)	29%

We performed a sensitivity analysis on our models. If the WACC increases to 6% on the Dividend Discount Model, shares are 20% overvalued. If the 2010 P/B multiple increases to 0.9 on the Relative Valuation, shares would be 1% overvalued. At a 0.6 2010 P/B multiple, shares would be 52% overvalued. Because thrifts are trading at historically low levels, we tend to lend on the simplistic Dividend Discount Model to determine Capitol Federal's intrinsic value. Therefore our price target is \$40.00.

CONCLUSION

Capitol Federal is managed by a top-notch group of executives. It has heretofore successfully navigated the economic turbulence by sticking to its core principles: keeping costs low and writing sensible loans. However, the market has recognized the value of Capitol Federal, and we believe shares to be fairly priced. With a strong 5% dividend yield, we believe the portfolio should continue to hold the stock. As the financial sector begins to emerge from its current state, Capitol Federal shares could see a modest increase in price. Until then, we are happy to be partners with regarded management team.