EFC BANCORP INC
Form 10-Q
August 12, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2003

or

o **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 1-13605

EFC BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-4193304**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1695 Larkin Avenue, Elgin, Illinois	**60123**
(Address of principal executive offices)	(Zip Code)

(847) 741-3900
(Registrant s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12(b)-2 of the Exchange Act).

Yes ý No o

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 4,574,799 shares of common stock, par value $0.01 per share, were outstanding as of August 12, 2003.

EFC Bancorp, Inc.

Form 10-Q

For the Quarter Ended June 30, 2003

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PART I. FINANCIAL INFORMATION

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Item 1. Financial Statements.

EFC BANCORP, INC.
AND SUBSIDIARIES

Consolidated Balance Sheets (unaudited)

June 30, 2003 and December 31, 2002

		June 30, 2003	December 31, 2002
Assets			
Cash and cash equivalents:			
On hand and in banks	$	2,823,092	4,277,209
Interest bearing deposits with financial institutions		44,659,112	28,567,081
Loans receivable, net		653,694,011	597,048,785
Mortgage-backed securities available-for-sale, at fair value		14,049,805	15,255,684
Investment securities available-for-sale, at fair value		89,654,075	87,981,884
Foreclosed real estate		39,109	1,985,741
Stock in Federal Home Loan Bank of Chicago, at cost		10,535,000	9,362,200
Accrued interest receivable		3,888,898	3,887,410
Office properties and equipment, net		17,217,636	16,796,685
Real estate held for development		3,418,387	2,934,072
Bank owned life insurance		17,568,625	12,246,803
Other assets		1,420,640	2,032,372
Total assets	$	858,968,390	782,375,926
Liabilities and Stockholders Equity			
Liabilities:			
Deposits	$	559,382,643	524,189,844
Borrowed money		210,802,569	171,778,743
Accrued expenses, income taxes payable and other liabilities		12,092,407	11,705,771
Total liabilities		782,277,619	707,674,358
Minority interest		(145,777)	(75,127)
Stockholders Equity:			
Preferred stock, par value $.01 per share, authorized 2,000,000 shares; no shares issued			
Common stock, par value $.01 per share, authorized 25,000,000 shares; issued 7,491,434 shares		74,914	74,914

Additional paid-in capital		71,918,198	71,834,834
Retained earnings, substantially restricted		44,349,458	41,911,421
Treasury stock, at cost, 2,903,635 and 2,854,293 shares at June 30, 2003 and December 31, 2002, respectively		(35,495,850)	(33,755,940)
Unearned employee stock ownership plan (ESOP), 379,567 and 399,544 shares at June 30, 2003 and December 31, 2002, respectively		(5,675,490)	(5,974,199)
Unearned stock award plan, 28,908 and 51,790 shares at June 30, 2003 and December 31, 2002, respectively		(321,602)	(576,164)
Accumulated other comprehensive income		1,986,920	1,261,829
Total stockholders equity		76,836,548	74,776,695
Commitments and contingencies			
Total liabilities and stockholders equity	$	858,968,390	782,375,926

See accompanying notes to consolidated financial statements.

EFC BANCORP, INC.

AND SUBSIDIARIES

Consolidated Statements of Income (unaudited)

For the three and six months ended June 30, 2003 and 2002

	Three months ended June 30, 2003	Three months ended June 30, 2002	Six months ended June 30, 2003	Six months ended June 30, 2002
Interest income:				
Loans secured by real estate	$ 8,576,037	8,598,090	17,190,375	17,278,170
Other loans	1,587,731	1,236,386	2,985,248	2,412,923
Mortgage-backed securities available-for-sale	134,755	167,499	308,302	353,027
Investment securities available-for-sale and interest bearing deposits with financial institutions	1,275,627	1,204,160	2,515,299	2,289,780
Total interest income	11,574,150	11,206,135	22,999,224	22,333,900
Interest expense:				
Deposits	3,052,728	3,420,884	6,220,630	6,784,290
Borrowed money	2,305,329	2,299,382	4,578,409	4,623,299
Total interest expense	5,358,057	5,720,266	10,799,039	11,407,589
Net interest income before provision for loan losses	6,216,093	5,485,869	12,200,185	10,926,311
Provision for loan losses	142,000	225,000	323,250	450,000
Net interest income after provision for loan losses	6,074,093	5,260,869	11,876,935	10,476,311
Noninterest income:				
Service fees	536,297	366,296	982,808	702,145
Insurance and brokerage commissions	55,165	79,825	114,029	310,340
Information technology sales and service income, net	227,564	438,478	496,254	740,880
Gain on sale of foreclosed real estate			41,315	
Gain on sale of securities	526,069		526,069	
Gain on sale of loans	156,223		156,223	
Bank owned life insurance	195,642	170,263	366,132	336,589
Other	48,680	28,996	73,229	71,409
Total noninterest income	1,745,640	1,083,858	2,756,059	2,161,363
Noninterest expense:				
Compensation and benefits	2,662,187	2,492,944	5,321,524	5,120,533
Office building, net	676,595	542,252	1,375,562	1,050,693
Federal insurance premiums	21,165	18,450	44,386	36,958

Advertising		250,485	118,895	433,126	268,572
Data processing		243,128	269,907	483,996	451,332
NOW/checking account expenses		122,760	124,836	255,772	247,415
Other		726,813	433,333	1,290,841	855,672
Total noninterest expense		4,703,133	4,000,617	9,205,207	8,031,175
Income before income taxes and minority interest		3,116,600	2,344,110	5,427,787	4,606,499
Income tax expense		1,132,994	732,308	1,876,935	1,445,920
Income before minority interest		1,983,606	1,611,802	3,550,852	3,160,579
Minority interest		49,938	(17,152)	70,650	2,509
Net income	$	2,033,544	1,594,650	3,621,502	3,163,088
Earnings per share:					
Basic	$	0.48	0.38	0.86	0.75
Diluted		0.46	0.36	0.81	0.72

See accompanying notes to consolidated financial statements.

EFC BANCORP, INC.

AND SUBSIDIARIES

Consolidated Statements of Cash Flows (unaudited)

For the six months ended June 30, 2003 and 2002

		2003	2002
Cash flows from operating activities:			
Net income	$	3,621,502	3,163,088
Adjustment to reconcile net income to net cash provided by operating activities:			
Amortization of premiums and discounts, net		54,691	(57,574)
Provision for loan losses		323,250	450,000
FHLB of Chicago stock dividends		(412,600)	(240,000)
Stock award plan shares allocated		254,562	314,392
ESOP shares committed to be released		298,709	298,714
Change in fair value of ESOP shares		83,364	2,558
Depreciation of office properties and equipment		561,530	377,544
Gain on sale of foreclosed real estate		(41,315)	
Gain on sale of securities		(526,069)	
Gain on sale of loans		(156,223)	
Change in minority interest in subsidiary		(70,650)	(19,953)
Increase in bank owned life insurance		(321,822)	(1,077,689)
(Increase)/decrease in accrued interest receivable and other assets, net		144,392	(1,406,590)
Increase in income taxes payable, accrued expenses and other liabilities, net		370,483	1,348,305
Net cash provided by operating activities		4,183,804	3,152,795
Cash flows from investing activities:			
Net increase in loans receivable		(21,458,659)	(1,630,329)
Purchases of loans receivable		(48,287,654)	(33,961,128)
Proceeds fom the sale of loans		12,894,951	
Increase in real estate held for development		(484,315)	(2,900,268)
Purchases of mortgage-backed securities available-for-sale		(2,549,222)	
Principal payments on mortgage-backed securities available-for-sale		3,684,435	2,682,224
Maturities of investment securities available-for-sale		12,680,478	12,421,819
Purchases of investment securities available-for-sale		(22,019,838)	(15,800,431)
Proceeds from the sale of investment securities		9,397,886	
Purchases of office properties and equipment		(982,481)	(1,746,853)
Investment in bank owned life insurance		(5,000,000)	
Purchases of stock in the Federal Home Loan Bank of Chicago		(760,200)	
Cash used in acquisition of majority-owned susidiary			(420,000)

Proceeds from the sale of foreclosed real estate		2,027,057	
Net cash used in investing activities		(60,857,562)	(41,354,966)
Cash flows from financing activities:			
Net increase in deposits		35,192,799	56,596,262
Proceeds from borrowed money		44,064,001	405,298
Repayments on borrowed money		(5,040,175)	(3,817,374)
Purchase of treasury stock		(2,244,670)	(4,200)
Stock options exercised		504,760	323,280
Cash dividends paid		(1,165,043)	(1,069,900)
Net cash provided by financing activities		71,311,672	52,433,366
Net increase in cash and cash equivalents		14,637,914	14,231,195
Cash and cash equivalents at beginning of period		32,844,290	18,175,290
Cash and cash equivalents at end of period	$	47,482,204	32,406,485
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	$	10,838,260	11,394,593
Income taxes		1,890,000	1,490,000
Noncash investing activities - transfer of loans to foreclosed real estate		39,190	

See accompanying notes to consolidated financial statements.

EFC BANCORP, INC.

Notes to Unaudited Consolidated Financial Statements

Note 1: BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of EFC Bancorp, Inc. (the Company), its majority-owned subsidiary, Computer Dynamics Group Inc. (CDGI), its wholly-owned subsidiary, EFS Bank (the Bank) and its wholly-owned subsidiary, EFS Service Corporation of Elgin. The Company purchased an 80% interest in CDGI for $420,000 in January 2002. The accompanying financial statements include the operating results of CDGI since the date of acquisition. CDGI is consolidated and a minority interest is recorded for the proportionate interest not owned by the Company. Certain amounts for the prior year have been reclassified to conform to the current year presentation. The Company operates as a single segment.

In the opinion of the management of the Company, the accompanying consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented. All significant intercompany transactions have been eliminated in consolidation. These interim financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission and therefore certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full year. It is suggested that the accompanying unaudited consolidated financial statements be read in conjunction with the Company s 2002 Annual Report on Form 10-K. Currently, other than investing in various securities, the Company does not directly transact any material business other than through the Bank. Accordingly, the discussion herein addresses the operations of the Company as they are conducted through the Bank.

Note 2: COMPREHENSIVE INCOME

The Company s comprehensive income for the three and six month periods ended June 30, 2003 and 2002 are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2003	**2002**	**2003**	**2002**
Net income	$ 2,033,544	1,594,650	$ 3,621,502	3,163,088
Other comprehensive income, net of tax:				
Unrealized holding gains on securities arising during the period, net of tax effect	776,414	752,939	725,091	555,686
Reclassification adjustment for net gain on sales of securities realized in net income	(331,423)		(331,423)	
Comprehensive income	$ 2,478,535	2,347,589	$ 4,015,170	$ 3,718,774

For both the three and six month periods ended June 30, 2003 the sale of securities resulted in a gain of $526,069 ($331,423 net of tax effect). There were no sales of investment securities as of and for the three and six months ended June 30, 2002.

Note 3: COMPUTATION OF PER SHARE EARNINGS

Basic earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares outstanding adjusted for the dilutive effect of outstanding stock options. ESOP shares are only considered outstanding for earnings per share calculations when they are released or committed to be released.

Presented below are the calculations for the basic and diluted earnings per share:

		Three months ended June 30,		Six months ended June 30,	
		2003	**2002**	**2003**	**2002**
Basic:					
Net income	$	2,033,544	1,594,650	3,621,502	3,163,088
Weighted average shares outstanding		4,215,597	4,207,308	4,217,099	4,193,973
Basic earnings per share	$	0.48	0.38	0.86	0.75
Diluted:					
Net income	$	2,033,544	1,594,650	3,621,502	3,163,088
Weighted average shares outstanding		4,215,597	4,207,308	4,217,099	4,193,973
Effect of dilutive stock options outstanding		238,963	236,119	233,487	202,536
Diluted weighted average shares outstanding		4,454,560	4,443,427	4,450,586	4,396,509
Diluted earnings per share	$	0.46	0.36	0.81	0.72

Note 4: STOCK OPTION PLANS

The Company accounts for the stock-based compensation plans under APB Opinion No. 25. For the stock option program, no compensation cost is recognized in connection with the granting of stock options with an exercise price equal to the fair market value of the stock on the date of the grant. For the stock award plan, the Company uses fixed method of accounting and records compensation expense, over the vesting period of the grant, based upon the fair market value of the stock at the date of grant. In accordance with the disclosure requirements of SFAS No. 123, as amended by SFAS No. 148, the following table provides the pro forma effect on net income and earnings per share if the fair value method of accounting for stock-based compensation had been used for all awards:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2003	2002	2003	2002
Net income as reported	$ 2,033,544	$ 1,594,650	$ 3,621,502	$ 3,163,088
Add: Stock-based compensation, net of tax, included in the determination of net income, as reported	127,281	157,196	254,562	314,392
Deduct: Stock-based compensation, net of tax, that would have been reported if the fair value based method had been applied to all awards	(245,185)	(269,291)	(487,016)	(538,581)
Pro forma net income	$ 1,915,640	$ 1,482,555	$ 3,389,048	$ 2,938,899
Basic earnings per share				
As reported	$ 0.48	$ 0.38	$ 0.86	$ 0.75
Pro forma	0.45	0.35	0.80	0.70
Diluted earnings per share				
As reported	$ 0.46	$ 0.36	$ 0.81	$ 0.72
Pro forma	0.43	0.33	0.76	0.67

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

The following analysis discusses changes in the financial condition at June 30, 2003 and results of operations for the three and six months ended June 30, 2003, and should be read in conjunction with the Company s Unaudited Consolidated Financial Statements and the notes thereto, appearing in Part I, Item 1 of this document.

Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identified by use of the words believe, expect, intend, anticipate, estimate, project, or similar expressions. The Company s ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company and the subsidiaries include, but are not limited to, changes in: interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company s market area and accounting principles and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning the Company and its business, including additional factors that could materially affect the Company s financial results, is included in the Company s filings with the

SEC, including its 2002 Annual Report on Form 10-K.

The Company does not undertake - and specifically disclaims any obligation - to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Comparison of Financial Condition at June 30, 2003 and December 31, 2002

Total assets at June 30, 2003 were $859.0 million, which represented an increase of $76.6 million, or 9.8%, compared to $782.4 million at December 31, 2002. The increase in total assets was primarily a result of an increase in loans receivable of $56.7 million, or 9.5%, to $653.7 million at June 30, 2003 from $597.0 million at December 31, 2002. The increase in loans receivable was primarily attributable to strong loan demand and loan purchases during the period. In addition, cash and cash equivalents increased $14.7 million, or 44.6%, to $47.5 million at June 30, 2003 from $32.8 million at December 31, 2002, investment securities increased $1.7 million, or 1.9%, to $89.7 million at June 30, 2003 from $88.0 million at December 31, 2002, and bank owned life insurance, which increased $5.4 million, or 43.5%, to $17.6 million at June 30, 2003 from $12.2 million at December 31, 2002. This increase was due to an investment of $5.0 million made in May 2003. These increases were partially offset by a decrease in mortgage-backed securities of $1.3 million, or 7.9% to $14.0 at June 30, 2003 from $15.3 million at December 31, 2002 and by the sale of foreclosed real estate of $1.9 million from December 31, 2002 to June 30, 2003. This property was sold in January 2003 resulting in a gain of approximately $41,000. The growth in total assets was funded by increases in deposits and borrowed money. Deposits increased $35.2 million to $559.4 million at June 30, 2003 from $524.2 million at December 31, 2002. Borrowed money, representing FHLB advances, increased $39.0 million to $210.8 million at June 30, 2003 from $171.8 million at December 31, 2002. Stockholders equity increased $2.0 million to $76.8 million at June 30, 2003 from $74.8 million at December 31, 2002. The increase in stockholders equity was primarily the result of the Company s net income for the six months ended June 30, 2003 and a $725,000 increase in the Company s accumulated other comprehensive income relating to the change in fair value of its available-for-sale investment portfolio, which were partially offset by stock repurchases and dividends paid.

Comparison of Operating Results For the Three Months Ended June 30, 2003 and 2002

General. The Company s net income increased $439,000, or 27.5%, to $2.0 million for the three months ended June 30, 2003 as compared to the prior year period.

Interest Income. Interest income increased $368,000, or 3.3%, to $11.6 million for the three months ended June 30, 2003, compared with $11.2 million for the same period in 2002. This increase resulted from an increase in the average balance of interest-earning assets, partially offset by a decrease in the average rate earned on those interest-earning assets. The average balance of interest-earning assets increased by $109.1 million, or 16.0%, to $789.9 million for the three months ended June 30, 2003 from $680.8 million for the comparable period in 2002. The average yield on interest-earning assets decreased by 73 basis points to 5.96% for the three

months ended June 30, 2003 from 6.69% for the three months ended June 30, 2002.

Mortgage loan interest income decreased by $22,000 for the three months ended June 30, 2003 compared with the same period in 2002. The average balance of mortgage loans increased $52.9 million, while the mortgage loan yield decreased by 71 basis points from 7.07% to 6.36%. Interest income from other loans increased $351,000 for the three months ended June 30, 2003. This increase resulted from a combination of an increase in average balance of $29.7 million, partially offset by a 46 basis point decrease in yield from 6.38% for the three months ended June 30, 2002 to 5.92% for the three months ended June 30, 2003. Interest income from investment securities, mortgage-backed securities and short-term deposits remained unchanged at $1.3 million for the three months ended June 30, 2003, compared with the same period in 2002. An increase in average balance of $25.7 million was offset by a 95 basis point decrease in yield from 5.30% for the three months ended June 30, 2002 to 4.35% for the three months ended June 30, 2003. The decrease in yield is largely attributed to the effect of the lower interest rate environment reducing yields on investment securities. The average yields are reported on a tax equivalent basis.

Interest Expense. Interest expense decreased by $362,000, or 6.3%, to $5.4 million for the three months ended June 30, 2003 from $5.7 million for the three months ended June 30, 2002. This decrease resulted from an increase in the average balance of interest-bearing liabilities, offset by a decrease in the average rate paid on those interest-bearing liabilities. The average balance of interest-bearing liabilities increased by $99.5 million, or 16.5%, to $704.3 million for the three months ended June 30, 2003 from $604.8 million for the three months ended June 30, 2002. This increase is partially attributed to the opening of a new branch office in July 2002. This change reflects an $82.8 million increase in the deposit accounts, which is attributable to a $30.9 million increase in money market accounts, a $13.1 million increase in passbook savings accounts, a $36.1 million increase in certificates of deposit and a $2.7 million increase in NOW accounts. In addition, advances from the FHLB Chicago increased $16.7 million to $188.4 million for the three months ended June 30, 2003 from $171.7 million for the comparable period in 2002. The average rate paid on combined deposits and borrowed money decreased by 74 basis points to 3.04% for the three months ended June 30, 2003 from 3.78% for the three months ended June 30, 2002.

Net Interest Income Before Provision for Loan Losses. Net interest income before provision for loan losses increased $730,000, or 13.3%, to $6.2 million for the three months ended June 30, 2003 from $5.5 million for the comparable period in 2002. The average balance of interest-earning assets increased $109.1 million for the three months ended June 30, 2003 compared to the comparable prior year period. The increase in interest-earning assets was primarily the result of an increase in the average balance of mortgage loans of $52.9 million and a $29.7 million increase in other loans. The tax equivalent net interest margin as a percent of interest-earning assets decreased by eight basis points to 3.25% for the three months ended June 30, 2003 from 3.33% for the comparable period in 2002.

Provision for Loan Losses. The provision for loan losses decreased by $83,000, to $142,000 for the three months ended June 30, 2003 from $225,000 in 2002. At June 30, 2003, December 31, 2002 and June 30, 2002, non-performing loans totaled $2.6 million, $2.4 million and $3.5 million, respectively. Nonperforming assets decreased $1.8 million to $2.6 million at June 30, 2003 from $4.4 million at December 31, 2002, largely due to the sale of foreclosed real estate in January 2003. At June 30, 2003, the ratio of the allowance for loan losses to non-performing loans was 132.7% compared to 131.1% at December 31, 2002 and 77.1% at June 30, 2002. The ratio of the allowance to total loans was 0.53%, 0.53% and 0.47%, at June 30, 2003, December 31, 2002 and June 30, 2002, respectively. There were no charge-offs for the three months ended June 30, 2003 and $2,000 for the comparable period in 2002. Management periodically calculates an allowance sufficiency analysis based upon the portfolio composition, asset classifications, loan-to-value ratios, probable impairments in the loan portfolio, and other factors.

Noninterest Income. Noninterest income totaled $1.7 million and $1.1 million for the three months ended June 30, 2003 and 2002, respectively. The increase in noninterest income is primarily attributable to increases of $526,000 in gain on sale of securities, $156,000 in gain on sale of loans and $170,000 in service fees. The gain on sale of securities was the result of repositioning the balance sheet and favorable market conditions. The gain on sale of loans was due to favorable market conditions and interest rate risk strategy. Service fees increased primarily due to the offering of an overdraft privilege account product to our customers. These increases were partially offset by decreases of $211,000 in income generated by Computer Dynamics Group, Inc. (CDGI) and $25,000 in insurance and brokerage commissions. The decrease in income generated by CDGI is largely due to a decrease in sales related to a weaker demand for technology services. The decrease in insurance and brokerage commissions is partially due to the lower interest rate environment.

Noninterest Expense. Noninterest expense increased $703,000, to $4.7 million for the three months ended June 30, 2003 from $4.0 million for the comparable period in 2002. Of this increase, $169,000 was directly related to compensation and benefits, and $134,000 is related to office building operations resulting from the costs related to the two new branch offices placed in service over the last year. In addition, expenses relating to advertising increased $131,000 to $250,000 for the three months ended June 30, 2003, respectively from $119,000 for the comparable period in 2002, respectively. The increase in advertising expense is partially attributed to the Bank s name change, which occurred in 2002. In addition, the Company incurred a goodwill impairment of $181,000, relating to its majority owned subsidiary CDGI, for the three months ended June 30, 2003. The goodwill impairment is primarily due to a weaker demand for technology services. Management continues to emphasize the importance of expense management and control while continuing to provide expanded banking services to a growing market base.

Income Tax Expense. Income tax expense totaled $1.1 million and $732,000 for the three months ended June 30, 2003 and 2002, respectively. This increase was primarily due to a $401,000 increase in earnings before income taxes. The effective tax rate was 36.4% and 31.2% for the three months ended June 30, 2003 and 2002, respectively. The increase in the effective tax rate is partially due to a reduction in the municipal bond investment portfolio and the goodwill impairment related to CDGI.

Comparison of Operating Results For the Six Months Ended June 30, 2003 and 2002

General. The Company s net income increased $458,000, or 14.5%, to $3.6 million for the three months ended June 30, 2003 as compared to the prior year period.

Interest Income. Interest income increased $665,000, or 3.0%, to $23.0 million for the six months ended June 30, 2003, compared with $22.3 million for the same period in 2002. This increase resulted from an increase in the average balance of interest-earning assets, partially offset by a decrease in the average rate earned on those interest-earning assets. The average balance of interest-earning assets increased by $102.1 million, or 15.2%, to $773.4 million for the six months ended June 30, 2003 from $671.3 million for the comparable period in 2002. The average yield on interest-earning assets decreased by 71 basis points to 6.05% for the six months ended June 30, 2003 from 6.76% for the six months ended June 30, 2002.

Mortgage loan interest income decreased by $88,000 for the six months ended June 30, 2003 compared with the same period in 2002. The average balance of mortgage loans increased $50.3 million, while the mortgage loan yield decreased by 71 basis points from 7.18% to 6.47%. Interest income from other loans increased $572,000 for the six months ended June 30, 2003. This increase resulted from a combination of an increase in average balance of $26.3 million, partially offset by a 59 basis point decrease in yield from 6.53% for the six months ended June 30, 2002 to 5.94% for the six months ended June 30, 2003. Interest income from investment securities, mortgage-backed securities and short-term deposits increased by $135,000 for the six months ended June 30, 2003, compared with the same period in 2002. This increase resulted from a combination of an increase in average balance of $24.7 million, offset by a 66 basis point decrease in yield from 5.17% for the six months ended June 30, 2002 to 4.51% for the six months ended June 30, 2003. The decrease in yield is largely attributed to the effect of the lower interest rate environment reducing yields on investment securities. The average yields are reported on a tax equivalent basis.

Interest Expense. Interest expense decreased by $609,000, or 5.3%, to $10.8 million for the six months ended June 30, 2003 from $11.4 million for the six months ended June 30, 2002. This decrease resulted from an increase in the average balance of interest-bearing liabilities, offset by a decrease in the average rate paid on those interest-bearing liabilities. The average balance of interest-bearing liabilities increased by $92.9 million, or 15.6%, to $689.6 million for the six months ended June 30, 2003 from $596.7 million for the six months ended June 30, 2002. This increase is partially attributed to the opening of a new branch office in July 2002. This change reflects an $85.8 million increase in the deposit accounts, which is attributable to a $33.0 million increase in money market accounts, a $12.7 million increase in passbook savings accounts, a $36.9 million increase in certificates of deposit and a $3.2 million increase in NOW accounts. In addition, advances from the FHLB Chicago increased $7.1 million to $181.4 million for the six months ended June 30, 2003 from $174.3 million for the comparable period in 2002. The average rate paid on combined deposits and borrowed money decreased by 69 basis points to 3.13% for the six months ended June 30, 2003 from 3.82% for the six months ended June 30, 2002.

Net Interest Income Before Provision for Loan Losses. Net interest income before provision for loan losses increased $1.3 million, or 11.7%, to $12.2 million for the six months ended June 30, 2003 from $10.9 million for the comparable period in 2002. The average balance of interest-earning assets increased $102.1 million for the six months ended June 30, 2003 compared to the comparable prior year period. The increase in interest-earning assets was primarily the result of an increase in the average balance of mortgage loans of $50.3 million and a $26.3 million increase in other loans. The tax equivalent net interest margin as a percent of interest-earning assets decreased by 10 basis points to 3.26% for the six months ended June 30, 2003 from 3.36% for the comparable period in 2002.

Provision for Loan Losses. The provision for loan losses decreased by $127,000, to $323,000 for the six months ended June 30, 2003 from $450,000 in 2002. At June 30, 2003, December 31, 2002 and June 30, 2002, non-performing loans totaled $2.6 million, $2.4 million and $3.5 million, respectively. Nonperforming assets decreased $1.8 million to $2.6 million at June 30, 2003 from $4.4 million at December 31, 2002, largely due to the sale of foreclosed real estate in January 2003. At June 30, 2003, the ratio of the allowance for loan losses to non-performing loans was 132.7% compared to 131.1% at December 31, 2002 and 77.1% at June 30, 2002. The ratio of the allowance to total loans was 0.53%, 0.53% and 0.47%, at June 30, 2003, December 31, 2002 and June 30, 2002, respectively. There were no charge-offs for the six months ended June 30, 2003 and $2,000 for the comparable period in 2002. Management periodically calculates an allowance sufficiency analysis based upon the portfolio composition, asset classifications, loan-to-value ratios, probable impairments in the loan portfolio, and other factors.

Noninterest Income. Noninterest income totaled $2.8 million and $2.2 million for the six months ended June 30, 2003 and 2002, respectively. The increase in noninterest income is primarily attributable to increases of $526,000 in gain on sale of securities, $156,000 in gain on sale of loans and $281,000 in service fees. The gain on sale of securities was the result of repositioning the balance sheet and favorable market conditions. The gain on sale of loans was due to favorable market conditions and interest rate risk strategy. Service fees increased primarily due to the offering of an overdraft privilege account product to our customers. These increases were partially offset by decreases of $245,000 in income generated by Computer Dynamics Group, Inc. (CDGI) and $196,000 in insurance and brokerage commissions. The decrease in income generated by CDGI is largely due to a decrease in sales related to a weaker demand for technology services. The decrease in insurance and brokerage commissions is partially due to the lower interest rate environment.

Noninterest Expense. Noninterest expense increased $1.2 million, to $9.2 million for the six months ended June 30, 2003 from $8.0 million for the comparable period in 2002. Of this increase, $201,000 was directly related to compensation and benefits, $325,000 is related to office building operations resulting from the costs related to the two new branch offices placed in service over the last year. In addition, expenses relating to advertising increased $164,000 to $433,000 for the six months ended June 30, 2003 from $269,000 for the comparable period in 2002. The increase in advertising expense is partially attributed to the Bank s name change, which occurred in 2002. In addition, the Company incurred a goodwill impairment of $200,000, relating to its majority owned subsidiary CDGI, for the six months ended June 30, 2003. The

goodwill impairment is primarily due to a weaker demand for technology services. Management continues to emphasize the importance of expense management and control while continuing to provide expanded banking services to a growing market base.

Income Tax Expense. Income tax expense totaled $1.9 million and $1.4 million for the six months ended June 30, 2003 and 2002, respectively. This slight increase was primarily due to a $431,000 increase in earnings before income taxes. The effective tax rate was 34.6% and 31.4% for the six months ended June 30, 2003 and 2002, respectively. The increase in the effective tax rate is partially due to a reduction in the municipal bond investment portfolio and the goodwill impairment related to CDGI.

Liquidity and Capital Resources

The Company s primary source of funding for dividends and periodic stock repurchases has been dividends from the Bank. The Bank s ability to pay dividends and other capital distributions to the Company is generally limited by OTS regulations.

The Bank s primary sources of funds are savings deposits, proceeds from the principal and interest payments on loans and proceeds from the maturity of securities and borrowings from the FHLB-Chicago. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit outflows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

The primary investing activities of the Bank are the origination and purchase of primarily residential one-to-four-family loans and, to a lesser extent multi-family and commercial real estate, construction and land, commercial and consumer loans and the purchase of mortgage-backed securities. In addition, the Bank purchases loans, secured by single-family, multi-family and commercial real estate. Deposit flows are affected by the level of interest rates, the interest rates and products offered by the local competitors and other factors.

In addition to the primary investing activities of the Bank, the Company has repurchased shares of its common stock from time to time in the open market. The Company is currently authorized to repurchase shares pursuant to its sixth stock repurchase program, which was previously announced in September 2001. Under this program the Company is authorized to repurchase up to 231,808, or 5.0% of its outstanding common stock. Under this current program, 204,900 shares of the Company s common stock have been repurchased at an average price per share of $17.43. During the three months ended June 30, 2003, 33,200 shares were purchased at an average price of $19.25. As of June 30, 2003, the Company repurchased a total of 3,060,173 shares of the Company s common stock at an average price per share of $12.02 since becoming a public company in 1998.

The Bank s most liquid assets are cash and interest-bearing demand accounts. The levels of these assets are dependent on the Bank s operating, financing, lending and investing activities during any given period. At June 30, 2003, cash and interest-bearing demand accounts totaled $47.5 million, or 5.5% of total assets.

See the   Consolidated Statements of Cash Flows   in the Unaudited Consolidated Financial Statements included in this Form 10-Q for the sources and uses of cash flows for operating, investing and financing activities for the six months ended June 30, 2003 and 2002.

At June 30, 2003, the Bank exceeded all of its regulatory capital requirements. The following is a summary of the Bank s regulatory capital ratios at June 30, 2003:

Total Capital to Total Assets	8.57%
Total Capital to Risk-Weighted Assets	12.47%
Tier I Leverage Ratio	8.58%
Tier I to Risk-Weighted Assets	12.13%

At June 30, 2003, the Company had a Total Capital to Total Assets ratio of 8.95%.

On June 18, 2003, the Company announced its second quarter dividend of $0.1425 per share. The dividend was paid on July 8, 2003 to stockholders of record on June 30, 2003.

Financial Instruments with Off-Balance Sheet Risk

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. Those financial instruments primarily include commitments to extend credit. Commitments to extend credit are agreements to lend to a customer so long as there is no violation of any condition established in the contract. The Bank evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained is based on management s credit evaluation of the customer. The Bank s exposure to credit loss in the event of nonperformance by the customer is represented by the contractual amount of those financial instruments. The commitments to originate first mortgage loans represent amounts, which the Bank plans to fund within a period of 30 to 90 days.

The Bank s approved, but unused lines of credit are based on underwriting standards that generally do not allow total borrowings, including the equity line of credit to exceed 80% of the current appraised value of the customer s residence. However, the Bank offers home equity lines of credit up to 90% of the home s current appraised value at a 1% higher interest rate.

The Bank s standby letters of credit are conditional commitments issued by the Bank to guarantee performance of a customer to a third party. The credit risk involved in these transactions is essentially the same as that involved in extending a loan to a customer in the normal course of business. Standby letters of credit are collateralized by mortgages, savings accounts or liens on business assets. The fair value of standby letters of credit approximates the amount of recorded related fees, which are not considered material. The maximum risk of accounting loss for these items, which is represented by the total commitment outstanding, totaled $5.2 million at June 30, 2003.

At June 30, 2003 and December 31, 2002, the bank had the following commitments:

	June 30, 2003	December 31, 2002
First mortgage loans	$ 15,990,000	$ 11,965,000
Construction loans	2,599,000	808,000
Unused lines of credit	35,029,000	32,666,000
Standby letters of credit	5,170,000	4,927,000

Recent Accounting Pronouncements

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). This Statement is effective for exit or disposal activities that are initiated after December 31, 2002. Adoption of this statement did not have a material effect on the Company s consolidated financial statements.

In December 2002, the FASB issued Statement 148, Accounting for Stock-Based Compensation Transition and Disclosure (FAS 148). FAS 148 amends FAS 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of FAS 123 to require prominent disclosures in both the annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. Adoption of this statement did not have a material effect on the Company s consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities which provides new accounting guidance on when to consolidate a variable interest entity. A variable interest entity exists when either the total equity investment at risk is not sufficient to permit the entity to finance its activities by itself, or the equity investors lack one of three characteristics associated with owning a controlling financial interest. Those characteristics include the direct or indirect ability to make decisions about an entity s activities through voting rights or similar rights, the obligation to absorb the expected loss of an entity if they occur, and the right to receive the expected residual return of the entity if they occur. We do not expect that the adoption of this Interpretation will have a material impact on our consolidated financial statements.

In April 2003, the FASB issued SFAS No.149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This Statement amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. This Statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. We do not expect that the adoption of this Statement will have a material impact on our consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This Statement would require that certain financial instruments with characteristics of both liabilities and equity be classified on the consolidated balance sheets as liabilities. The Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. We do not expect that the adoption of this Statement will have a material impact on our consolidated financial statements.

Average Balance Sheet

The following tables set forth certain information relating to the Bank for the three and six months ended June 30, 2003 and 2002, respectively. The average yields and costs are derived by dividing income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively, for the periods shown and reflect annualized yields and costs. Average balances are derived from average monthly balances. The yields and costs include fees, which are considered adjustments to yields. Tax exempt income has been calculated on a tax equivalent basis using a tax rate of 34% and amounted to $200,000 and $175,000 for the three months ended June 30, 2003 and 2002, and $414,000 and $346,000 for the six months ended June 30, 2003 and 2002, respectively.

	Three Months Ended June 30, 2003			Three Months Ended June 30, 2002		
(in thousands)	**Average Balance**	**Interest**	**Yield/Cost**	**Average Balance**	**Interest**	**Yield/Cost**
Assets:						
Interest earning assets:						
Short-term deposits and FHLB stock	$ 36,898	184	2.00%	34,243	176	2.06%
Investment securities	91,951	1,290	5.61%	71,311	1,202	6.74%
Mortgage-backed securities	14,839	135	3.63%	11,556	168	5.80%
Mortgage loans	538,990	8,576	6.36%	486,124	8,598	7.07%
Other loans	107,253	1,589	5.92%	77,556	1,237	6.38%
Total interest earning assets	789,931	11,774	5.96%	680,790	11,381	6.69%
Noninterest earning assets	45,628			38,902		
Total assets	$ 835,559			719,692		
Liabilities and stockholders equity						
Interest-bearing liabilities						
Deposits:						
Money market accounts	$ 145,926	707	1.94%	115,058	851	2.96%
Passbook savings accounts	116,922	479	1.64%	103,800	630	2.43%
NOW Accounts	35,325	64	0.73%	32,582	85	1.05%
Certificates of deposit	217,776	1,803	3.31%	181,667	1,855	4.08%
Total deposits	515,949	3,053	2.37%	433,107	3,421	3.16%
FHLB Advances	188,367	2,305	4.90%	171,700	2,299	5.36%
Total interest-bearing liabilities	704,316	5,358	3.04%	604,807	5,720	3.78%
Noninterest-bearing liabilities	54,988			43,698		
Total liabilities	759,304			648,505		
Total stockholders equity	76,255			71,187		
Total liabilities and stockholders equity	$ 835,559			719,692		
Net interest income before provision for loan losses		6,416			5,661	
Interest rate spread			2.92%			2.91%
Net interest margin as a percent of interest earning assets			3.25%			3.33%
Ratio of interest-earning assets to interest-bearing liabilities			112.16%			112.56%

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(in thousands)		Six Months Ended June 30, 2003 Average Balance	Interest	Yield/Cost	Six Months Ended June 30, 2002 Average Balance	Interest	Yield/Cost
Assets:							
Interest earning assets:							
Short-term deposits and FHLB stock	$	35,511	334	1.88%	33,255	334	2.01%
Investment securities		89,701	2,594	5.78%	70,165	2,292	6.53%
Mortgage-backed securities		15,826	308	3.90%	12,179	353	5.80%
Mortgage loans		531,767	17,190	6.47%	481,438	17,278	7.18%
Other loans		100,595	2,987	5.94%	74,247	2,422	6.53%
Total interest earning assets		773,400	23,413	6.05%	671,284	22,679	6.76%
Noninterest earning assets		43,774			36,518		
Total assets	$	817,174			707,802		
Liabilities and stockholders equity							
Interest-bearing liabilities							
Deposits:							
Money market accounts	$	145,731	1,461	2.01%	112,693	1,641	2.91%
Passbook savings accounts		112,493	957	1.70%	99,780	1,200	2.40%
NOW Accounts		34,520	143	0.82%	31,360	157	1.00%
Certificates of deposit		215,444	3,660	3.40%	178,568	3,786	4.24%
Total deposits		508,188	6,221	2.45%	422,401	6,784	3.21%
FHLB Advances		181,367	4,578	5.05%	174,283	4,623	5.31%
Total interest-bearing liabilities		689,555	10,799	3.13%	596,684	11,407	3.82%
Noninterest-bearing liabilities		52,123			40,684		
Total liabilities		741,678			637,368		
Total stockholders equity		75,496			70,434		
Total liabilities and stockholders equity	$	817,174			707,802		
Net interest income before provision for loan losses			12,614			11,272	
Interest rate spread				2.92%			2.94%
Net interest margin as a percent of interest earning assets				3.26%			3.36%
Ratio of interest-earning assets to interest-bearing liabilities				112.16%			112.50%

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Bank s interest rate sensitivity is monitored by management through the use of a Net Portfolio Value Model which generates estimates of the change in the Bank s net portfolio value (NPV) over a range of interest rate scenarios. NPV is the present value of expected cash flows from assets, liabilities, and off-balance sheet contracts. The NPV ratio, under any interest rate scenario, is defined as the NPV in that scenario divided by the market value of assets in the same scenario. The model assumes estimated prepayment rates, reinvestment rates and deposit decay rates. The Sensitivity Measure is the decline in the NPV ratio, in basis points, caused by a 2% increase or decrease in rates, whichever produces a larger decline. The higher the institution s Sensitivity Ratio, the greater its exposure to interest rate risk is considered to be. The following NPV Table sets forth the Bank s NPV as of June 30, 2003.

Change in Interest Rates in Basis Points (Rate Shock)	**Net Portfolio Value**			**NPV as% of Portfolio Value of Assets**	
	Amount	**$ Change**	**% Change**	**NPV Ratio**	**% Change**
	(In thousands)				
+300	$ 54,726	$ (39,839)	(42.13)%	6.54%	(38.94)%
+200	69,020	(25,545)	(27.01)	8.10	(24.37)
+100	84,762	(9,803)	(10.37)	9.76	(8.87)
Static	94,565			10.71	
-100	96,853	2,288	2.42	10.84	1.21
-200	92,859	(1,706)	(1.80)	10.34	(3.45)
-300	86,996	(7,569)	(8.00)	9.65	(9.90)

Certain shortcomings are inherent in the methodology used in the above interest rate risk measurements. Modeling changes in NPV require the making of certain assumptions which may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the NPV Table presented assumes that the composition of the Bank s interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the NPV Table provides an indication of the Bank s interest rate risk exposure at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on the Bank s net interest income and may differ from actual results.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures. The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the

Securities and Exchange Commission. Based upon their evaluation of those controls and procedures performed within 90 days of the filing date of this report, the chief executive officer and the chief financial officer of the Company concluded that the Company s disclosure controls and procedures were adequate.

(b) Changes in internal controls. The Company made no significant changes in its internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation of those controls by the chief executive officer and chief financial officer.

PART II. OTHER INFORMATION

Item 1.