

CONSUMERS BANCORP INC /OH/

Form 10-K

September 14, 2006

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-K**

(Mark one)

**ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended June 30, 2006

OR

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 033-79130

**CONSUMERS BANCORP, INC.**

(Exact name of registrant as specified in its charter)

OHIO

34-1771400

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(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

614 East Lincoln Way,

P.O. Box 256, Minerva, Ohio 44657

(330) 868-7701

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

**Securities registered under Section 12(b) of the Exchange Act:**

NONE

**Securities registered under Section 12(g) of the Exchange Act:**

Common Shares, no par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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Based on the closing sales price on December 30, 2005, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$22,875,835.

The number of shares outstanding of the Registrant's common stock, without par value was 2,140,434 at September 1, 2006.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Certain specifically designated portions of Consumers Bancorp, Inc.'s definitive Proxy Statement dated September 14, 2006 for its 2006 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

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**PART I**

**ITEM 1 BUSINESS**

**Business**

Consumers Bancorp, Inc. (Corporation), is a bank holding company under the Bank Holding Company Act of 1956, as amended and is a registered bank holding company, incorporated under the laws of the State of Ohio. The Corporation owns all of the issued and outstanding capital stock of Consumers National Bank (Bank), a bank chartered under the laws of the United States of America. On February 28, 1995, the Corporation acquired all of the common stock issued by the Bank. The Corporation's activities have been limited primarily to holding the common stock of the Bank.

Serving the Minerva, Ohio area since 1965, the Bank's main office is located at 614 East Lincoln Way, Minerva, Ohio. The Bank's business involves attracting deposits from businesses and individual customers and using such deposits to originate commercial, mortgage and consumer loans in its market area, consisting primarily of Stark, Columbiana, Carroll and contiguous counties in Ohio. The Bank also invests in securities consisting primarily of U.S. government and government agency obligations, municipal obligations, mortgage-backed securities and other securities.

On October 1, 2004 the Bank sold Community Title Agency, Inc., a title agency company. The subsidiary accounted for less than 2% of the Corporation's consolidated assets and business.

**Supervision and Regulation**

The following discussion of supervision and regulation is qualified in its entirety by reference to the statutory and regulatory provisions discussed. Changes in applicable law or in the policies of various regulatory authorities could affect materially the business and prospects of the Corporation and the Bank.

**Regulation of the Corporation:**

*The Bank Holding Company Act:* As a bank holding company, the Corporation is subject to regulation under the Bank Holding Company Act of 1956, as amended (BHCA) and the examination and reporting requirements of the Board of Governors of the Federal Reserve System (Federal Reserve Board). Under the BHCA, the Corporation is subject to periodic examination by the Federal Reserve Board and required to file periodic reports regarding its operations and any additional information that the Federal Reserve Board may require.

The BHCA generally limits the activities of a bank holding company to banking, managing or controlling banks, furnishing services to or performing services for its subsidiaries and engaging in any other activities that the Federal Reserve Board has determined to be so closely

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related to banking or to managing or controlling banks as to be a proper incident to those activities. In addition, the BHCA requires every bank holding company to obtain the approval of the Federal Reserve Board prior to acquiring substantially all the assets of any bank, acquiring direct or indirect ownership or control of more than 5% of the voting shares of a bank or merging or consolidating with another bank holding company.

*Privacy Provisions of Gramm-Leach-Bliley Act:* The Gramm-Leach-Bliley Act of 2000 contains extensive provisions on a customer's right to privacy of non-public personal information. Under these provisions, a financial institution must provide to its customers the institution's policies and procedures regarding the handling of customers' non-public personal information. Except in certain cases, an institution may not provide personal information to unaffiliated third parties unless the institution discloses that such information may be disclosed and the customer is given the opportunity to opt out of such disclosure. The Corporation and the Bank are also subject to certain state laws that deal with the use and distribution of non-public personal information.

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*Interstate Banking and Branching:* Prior to enactment of the Interstate Banking and Branch Efficiency Act of 1995, the Corporation would have been prohibited from acquiring banks outside Ohio, unless the laws of the state in which the target bank was located specifically authorized the transaction. The Interstate Banking and Branch Efficiency Act has eased restrictions on interstate expansion and consolidation of banking operations by, among other things: (i) permitting interstate bank acquisitions regardless of host state laws, (ii) permitting interstate merger of banks unless specific states have opted out of this provision and (iii) permitting banks to establish new branches outside the state provided the law of the host state specifically allows interstate bank branching.

*Sarbanes-Oxley Act:* The Sarbanes-Oxley Act of 2002 contains important requirements for public companies in the area of financial disclosure and corporate governance. In accordance with section 302(a) of the Sarbanes-Oxley Act, written certifications by the Corporation's Chief Executive Officer and Chief Financial Officer are required. These certifications attest that the Corporation's quarterly and annual reports filed with the SEC do not contain any untrue statement of a material fact or omit to state a material fact. See Item 9A "Controls and Procedures" for the Corporation's evaluation of its disclosure controls and procedures.

### **Regulation of the Bank:**

*Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation Regulation:* As a national bank, Consumers National Bank is subject to regulation, supervision and examination by the Office of the Comptroller of the Currency (OCC). It is also subject to regulation, supervision and examination by the Federal Deposit Insurance Corporation (FDIC).

Under regulations promulgated by the OCC, the Bank may not declare a dividend in excess of its undivided profits. Additionally, the Bank may not declare a dividend if the total amount of all dividends, including the proposed dividend, declared by the Bank in any calendar year exceeds the total of its retained net income of that year to date, combined with its retained net income of the two preceding years, unless the dividend is approved by the OCC. The Bank may not declare or pay any dividend if, after making the dividend, the Bank would be undercapitalized, as defined in the federal regulations.

The FDIC is an independent federal agency, which insures the deposits of federally insured banks and savings associations up to certain prescribed limits and safeguards the safety and soundness of financial institutions. The deposits of the Bank are subject to the deposit insurance assessments of the Bank Insurance Fund of the FDIC. Under the FDIC's deposit insurance assessment system, the assessment rate for any insured institutions varies according to regulatory capital levels of the institution and other factors such as supervisory evaluations.

The FDIC is authorized to prohibit any insured institution from engaging in any activity that poses a serious threat to the insurance fund and may initiate enforcement actions against banks, after first giving the institution's primary regulatory authority an opportunity to take such action. The FDIC may also terminate the deposit insurance of any institution that has engaged in or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, order or condition imposed by the FDIC.

In addition to the supervision and regulation matters listed above, the Bank is also a member of the Federal Home Loan Bank of Cincinnati (FHLB), which is a privately capitalized, government sponsored enterprise that expands housing and economic development opportunities throughout the nation by providing loans and other banking services to community-based financial institutions.

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*Risk-Based Capital Requirements.* The Federal Reserve Board and the OCC employ similar risk-based capital guidelines in their examination and regulation of bank holding companies and national banks. If capital falls below the minimum levels established by the guidelines, the bank holding company or bank may be denied



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approval to acquire or establish additional banks or non-bank businesses or to open new facilities. Failure to satisfy capital guidelines could subject a banking institution to a variety of enforcement actions by federal bank regulatory authorities, including the termination of deposit insurance by the FDIC and a prohibition on the acceptance of brokered deposits.

In the calculation of risk-based capital, assets and off-balance sheet items are assigned to broad risk categories, each with an assigned weighting (0%, 20%, 50% and 100%). Most loans are assigned to the 100% risk category, except for first mortgage loans fully secured by residential property, which carry a 50% rating. Direct obligations of or obligations guaranteed by the United States Treasury or United States Government agencies have a 0% risk-weight. Off-balance sheet items are also taken into account in the calculation of risk-based capital, with each class of off-balance sheet item being converted to a balance sheet equivalent according to established conversion factors. From these computations, the total of risk-weighted assets is derived. Risk-based capital ratios therefore state capital as a percentage of total risk-weighted assets and off-balance sheet items. The ratios established by guideline are minimums only.

Current risk-based capital guidelines require bank holding companies and banks to maintain a minimum risk-based total capital ratio equal to 8% and a Tier 1 capital ratio of 4%. Intangibles other than readily marketable mortgage servicing rights are generally deducted from capital. Tier 1 capital includes stockholders' equity, qualifying perpetual preferred stock (within limits and subject to conditions, particularly if the preferred stock is cumulative preferred stock), and minority interests in equity accounts of consolidated subsidiaries, less intangibles, identified losses, investments in securities subsidiaries, and certain other assets. Tier 2 capital includes the allowance for loan losses, up to a maximum of 1.25% of risk-weighted assets, any qualifying perpetual preferred stock exceeding the amount includable in Tier 1 capital, mandatory convertible securities, and subordinated debt and intermediate term preferred stock, up to 50% of Tier 1 capital. The OCC's evaluation of an institution's capital adequacy takes into account a variety of other factors as well, including interest rate risks to which the institution is subject, the level and quality of an institution's earnings, loan and investment portfolio characteristics and risks, risks arising from the conduct of nontraditional activities, and a variety of other factors.

Accordingly, the OCC's final supervisory judgment concerning an institution's capital adequacy could differ significantly from the conclusions that might be derived from the absolute level of an institution's risk-based capital ratios. Therefore, institutions generally are expected to maintain risk-based capital ratios that exceed the minimum ratios discussed above.

The banking agencies have also established a minimum leverage ratio of 3%, which represents Tier 1 capital as a percentage of total assets, less intangibles. However, for all but the most highly rated banks and bank holding companies, the banking agencies expect an additional margin of at least 100 to 200 basis points. At June 30, 2006, the Bank was in compliance with all regulatory capital requirements. Actual and required capital amounts and ratios are presented elsewhere, specifically in Note 11 of the Corporation's audited financial statements for the year ended June 30, 2006.

*Prompt Corrective Action.* To resolve the problems of undercapitalized institutions and to prevent a recurrence of the banking crisis of the 1980s and early 1990s, the Federal Deposit Insurance Corporation Improvement Act of 1991 established a system known as prompt corrective action. Under the prompt corrective action provisions and implementing regulations, every institution is classified into one of five categories, depending on its total risk-based capital ratio, its Tier 1 risk-based capital ratio, its leverage ratio, and subjective factors. The categories are well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. A financial institution's operations can be significantly affected by its capital classification. For example, an institution that is not well capitalized generally is prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market, and the holding company of any undercapitalized institution must guarantee, in part, aspects of the institution's capital plan. Financial institution regulatory agencies generally are required to appoint

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a receiver or conservator shortly after an institution enters the category of weakest capitalization. The Federal Deposit Insurance Corporation Improvement Act of 1991 also authorizes the regulatory agencies to reclassify an institution from one category into a lower category if the institution is in an unsafe or unsound condition or engaging in an unsafe or unsound practice. Undercapitalized institutions are required to take specified actions to increase their capital or otherwise decrease the risks to the federal deposit insurance funds.

*Community Reinvestment Act:* The Community Reinvestment Act requires depository institutions to assist in meeting the credit needs of their market areas, including low and moderate-income areas, consistent with safe and sound banking practices. Under this Act, each institution is required to adopt a statement for each of its market areas describing the depository institution's efforts to assist in its community's credit needs. Depository institutions are periodically examined for compliance and assigned ratings. Banking regulators consider these ratings when considering approval of a proposed transaction by an institution.

*USA Patriot Act:* In 2001, Congress enacted the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot Act) Act of 2001 (Patriot Act). The Patriot Act is designed to deny terrorists and criminals the ability to obtain access to the United States' financial system and has significant implications for depository institutions, brokers, dealers, and other businesses involved in the transfer of money. The Patriot Act mandates financial services companies to implement additional policies and procedures with respect to additional measures designed to address any or all of the following matters: money laundering, terrorist financing, identifying and reporting suspicious activities and currency transactions, and currency crimes.

**Employees**

As of June 30, 2006, the Bank employed 97 full-time and 29 part-time employees. None of the employees are represented by a collective bargaining group. Management considers its relations with employees to be good.

**Statistical Disclosure**

The following statistical information is included on the indicated pages of this Report and is incorporated herein by reference:

|   |           |
|---|-----------|
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**Available Information**

The Corporation files annual, quarterly, and current reports, proxy statements, and other information with the SEC. These filings are available to the public over the Internet at the SEC's web site at [www.sec.gov](http://www.sec.gov). Shareholders may also read and copy any document that the Corporation files at the SEC's public reference room.

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located at 450 Fifth Street, NW, Washington, DC 20549. Shareholders may call the SEC at 1-800-SEC-0330 for further information on the public reference room.

Shareholders may request a copy of any of the Corporation's filings at no cost by writing or e-mailing the Corporation at the following address or e-mail address: Consumers Bancorp, Inc., Attn: Theresa J. Linder, 614 East Lincoln Way, Minerva, Ohio 44657 or e-mail to [shareholderrelations@consumersbank.com](mailto:shareholderrelations@consumersbank.com).

The Corporation's Code of Ethics Policy, which is applicable to all directors, officers and employees of the corporation, and its Code of Ethics for Principal Financial Officers, which is applicable to the principal executive officer and the principal financial officer, are each available on the Investor Relations section under Required Disclosures of the Corporation's website ([www.consumersbancorp.com](http://www.consumersbancorp.com)). Copies of either of the Code of Ethics Policies are also available in print to share owners upon request, addressed to the Corporate Secretary at Consumers Bancorp, Inc., 614 East Lincoln Way, Minerva, Ohio 44657. The Corporation intends to post amendments to or waivers from its Code of Ethics on its website.

## **ITEM 1A RISK FACTORS**

*The Corporation may be adversely affected if we fail to effectively manage our lending risks.* There are many risks in the business of lending, including risks associated with the duration over which loans may be repaid, risks resulting from changes in economic conditions, risks inherent in dealing with individual borrowers, and risks resulting from changes in the value of loan collateral. Our credit administration function employs risk management techniques to ensure that loans adhere to corporate policy and problem loans are promptly identified. A large percentage of our loan portfolio is secured by real estate collateral. In addition, commercial loans to small and medium-sized businesses represent a significant portion of our loan portfolio. Accordingly, the asset quality of our loan portfolio is largely dependent upon the area's economy and real estate markets. A downturn in the local economy would adversely affect our operations and limit our future growth potential.

*Accounting for probable loan losses is a critical accounting policy.* An allowance for loan losses recorded under generally accepted accounting principles is an institution's best estimate within a range of the probable amount of loans that, based on current information and events, the institution will be unable to collect. The amount of the allowance is a product of management's judgment and it is inevitably imprecise. Estimating the allowance requires significant judgment and the use of estimates related to many factors, including the amount and timing of future cash flows on problem loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which are susceptible to significant change. Our judgment about the adequacy of the loan loss allowance is based on assumptions that we believe are reasonable but that might nevertheless prove to be incorrect. We can give you no assurance that the allowance is sufficient to absorb future charge-offs.

*Changing interest rates have a direct and immediate impact on financial institutions.* The Federal Reserve Board regulates money and credit conditions and interest rates to influence general economic conditions, primarily through open market acquisitions or dispositions of United States Government securities, varying the discount rate on member bank borrowings and setting reserve requirements against member and nonmember bank deposits. Fluctuating rates of interest prevailing in the market affect a bank's net interest income, which is the difference between interest earned from loans and investments, on one hand, and interest paid on deposits and borrowings, on the other. Banks manage interest rate risk exposure by closely monitoring assets and liabilities, altering from time to time the mix and maturity of loans, investments, and funding sources. Changes in interest rates affect the volume of loans originated, as well as the value of loans and other interest-earning assets, including investment securities. Changes in interest rates could also result in an increase in higher-cost deposit liabilities as well as movement of funds from deposit accounts into direct investments (such as U.S. Government and corporate securities, and other investment instruments such as mutual funds) if the Bank does not pay competitive interest rates. The percentage of household financial assets held in the form of deposits has declined over the years, with banking customers investing a greater portion of their financial assets in stocks, bonds, and



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mutual funds. Federal Reserve Board monetary policies have had a significant effect on the interest income and interest expense of commercial banks, including the Bank, and are expected to continue to do so in the future.

*Consumers National Bank has significant competition in both attracting and retaining deposits and in originating loans.* Competition is intense in the markets the Bank serves. It is anticipated that the competition will remain intense. The Bank competes on price and service with other banks and financial services companies such as savings and loans, credit union, finance companies, and brokerage firms. Competition could intensify in the future as a result of industry consolidation, the increasing availability of products and services from non-banks, greater technological developments in the industry and banking reform.

*Concentration of service area could negatively affect financial performance.* A concentration of credit risk can arise with respect to loans and deposits. As of June 30, 2006, the Bank's deposit and lending market area is concentrated in Stark, Columbiana and Carroll Counties in northeastern Ohio. Because of the concentration of deposits and loans in these three counties, in the event of adverse economic conditions, the Bank could experience more difficulty in attracting deposits and experience higher rates of loss and delinquency on its loans than if the loans were more geographically diversified. Adverse economic conditions in this region of Ohio may reduce demand for credit of fee-based products and could negatively affect real estate and other collateral values, interest rate levels, and the availability of credit to refinance loans at or prior to maturity.

*The Corporation's common stock is thinly traded and therefore susceptible to wide price swings.* The Corporation's common stock is not traded or authorized for quotation on any exchanges or on NASDAQ. The Corporation's common stock is traded on the over-the-counter (OTC) Bulletin Board® under the ticker symbol CBKM, but trading volume is low. Thinly traded, illiquid stocks are more susceptible to significant and sudden price changes than stocks that are widely followed by the investment community and actively traded on an exchange or NASDAQ. The liquidity of the common stock depends upon the presence in the marketplace of willing buyers and sellers. We do not intend at the current time to seek listing of our common stock on a securities exchange and we do not intend to seek authorization for trading of our shares on NASDAQ.

*The banking industry is heavily regulated; the compliance burden to the industry is considerable; the principal beneficiary of federal and state regulation is the public at large and depositors, not shareholders.* The Corporation and the Bank are and will remain subject to extensive federal government supervision and regulation. Affecting many aspects of the banking business, including permissible activities, lending, investments, payment of dividends, the geographic locations in which banking services can be offered, and numerous other matters, federal supervision and regulation are intended principally to protect depositors, the public, and the deposit insurance funds administered by the FDIC. Protection of shareholders is not a goal of banking regulation.

Applicable statutes, regulations, agency and court interpretations, and agency enforcement policies have undergone significant changes, some retroactively applied, and they could change significantly again. Changes in applicable laws and regulatory policies could adversely affect the banking industry generally or the Corporation and Bank in particular. The burdens of banking regulation could place banks in general at a competitive disadvantage compared to less regulated competitors. The Corporation cannot predict whether any potential legislation will be enacted, and if enacted, the effect that it, or any implemented regulations, would have on the financial condition or results of operations of the Corporation or its subsidiaries. The Corporation is not aware of any current recommendations by regulatory authorities that, if they were to be implemented, would have a material effect on the Corporation.

*Government regulation could restrict our ability to pay cash dividends.* Dividends from the Bank are the most significant source of cash for the Corporation. Statutory and regulatory limits could prevent the Bank from paying dividends or transferring funds to the Corporation. We believe that the Corporation will be able to continue paying its regular quarterly cash dividend. However, we cannot assure you that the Bank's profitability will continue to allow it to pay dividends to the Corporation. We therefore cannot assure you that the Corporation will be able to continue paying regular quarterly cash dividends.



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*We could incur liabilities under federal and state environmental laws if we foreclose on commercial properties.* A high percentage of the Bank's loans are secured by real estate. Although many of these loans are residential mortgage loans with little associated environmental risk, some are commercial loans secured by property on which manufacturing and other commercial enterprises are carried on. The Bank has in the past and could again acquire property by foreclosing on loans in default. Under federal and state environmental laws, the Bank could face liability for some or all of the costs of removing hazardous substances, contaminants, or pollutants from properties acquired in this fashion. Although other persons might be primarily responsible for these costs, they might not be financially solvent or they might be unable to bear the full cost of clean up. Regardless of whether the Bank forecloses on property, it is also possible that a lender exercising unusual influence over a borrower's commercial activities could be required to bear a portion of the clean-up costs under federal or state environmental laws.

### **ITEM 1B UNRESOLVED STAFF COMMENTS**

None

### **ITEM 2 PROPERTIES**

The Bank owns and maintains the premises in which seven of the ten banking facilities are located, and leases offices in Carrollton, Alliance and Malvern. The location of each of the currently operating offices is as follows:

|                     |   |
|---------------------|---|
| Minerva Office:     | 614 E. Lincoln Way, P.O. Box 256, Minerva, Ohio, 44657        |
| Salem Office:       | 141 S. Ellsworth Ave., P.O. Box 798, Salem, Ohio, 44460       |
| Waynesburg Office:  | 8607 Waynesburg Dr. SE, P.O. Box 746, Waynesburg, Ohio, 44423 |
| Hanoverton Office:  | 30034 Canal St., P.O. Box 178, Hanoverton, Ohio, 44423        |
| Carrollton Office:  | 1017 Canton Rd. NW, P.O. Box 8, Carrollton, Ohio, 44615       |
| Alliance Office:    | 610 West State St., Alliance, Ohio, 44601                     |
| Lisbon Office:      | 7895 Dickey Dr., Lisbon, Ohio 44432                           |
| Louisville Office:  | 1111 N. Chapel St., Louisville, Ohio 44641                    |
| East Canton Office: | 440 W. Noble, East Canton, Ohio, 44730                        |
| Malvern Office:     | 4070 Alliance Rd., Malvern, Ohio 44644                        |

In the opinion of management, the properties listed above are adequately covered by insurance.

### **ITEM 3 LEGAL PROCEEDINGS**

The Corporation is not a party to any pending material legal or administrative proceedings, other than ordinary routine litigation incidental to the business of the Corporation. Further, there are no material legal proceedings in which any director, executive officer, principal shareholder or affiliate of the Corporation is a party or has a material interest that is adverse to the Corporation. No routine litigation in which the Corporation is involved is expected to have a material adverse impact on the financial position or results of operations of the Corporation.



**ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Nothing to be reported.

**Table of Contents****PART II****ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The Corporation had 2,140,434 common shares outstanding on June 30, 2006 with 679 shareholders of record and an estimated 172 additional beneficial holders whose stock was held in nominee name.

The common shares of Consumers Bancorp, Inc. are traded on the over-the-counter market primarily with brokers in the Corporation's service area. The following quoted market prices reflect inter-dealer prices, without adjustments for retail markups, markdowns, or commissions and may not represent actual transactions. The market prices represent highs and lows reported during the quarterly period.

| <b>Quarter Ended</b>          | <b>September 30,<br/>2005</b> | <b>December 31,<br/>2005</b> | <b>March 31,<br/>2006</b> | <b>June 30,<br/>2006</b> |
|-------------------------------|-------------------------------|------------------------------|---------------------------|--------------------------|
| High                          | \$ 17.25                      | \$ 18.25                     | \$ 16.65                  | \$ 15.00                 |
| Low                           | 16.50                         | 16.41                        | 14.99                     | 12.00                    |
| Cash dividends paid per share | 0.09                          | 0.09                         | 0.07                      | 0.07                     |

  

| <b>Quarter Ended</b>          | <b>September<br/>30,<br/>2004</b> | <b>December<br/>31,<br/>2004</b> | <b>March<br/>31,<br/>2005</b> | <b>June 30,<br/>2005</b> |
|-------------------------------|-----------------------------------|----------------------------------|-------------------------------|--------------------------|
| High                          | \$ 23.25                          | \$ 22.00                         | \$ 19.25                      | \$ 18.65                 |
| Low                           | 18.75                             | 19.00                            | 17.50                         | 16.75                    |
| Cash dividends paid per share | 0.09                              | 0.09                             | 0.09                          | 0.09                     |

Management does not have knowledge of the prices paid in all transactions and has not verified the accuracy of those prices that have been reported. Because of the lack of an established market for the Corporation's common shares, these prices may not reflect the prices at which the common shares would trade in an active market. See Note 1 for dividend restrictions.

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(Dollar amounts in thousands, except per share data)

|   | <u>June 30,<br/>2006</u> | <u>June 30,<br/>2005</u> | <u>June 30,<br/>2004</u> | <u>June 30,<br/>2003</u> | <u>June 30,<br/>2002</u> |
|---|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Interest income                                     | \$ 11,387                | \$ 10,384                | \$ 10,066                | \$ 11,618                | \$ 13,614                |
| Interest expense                                    | 3,029                    | 1,595                    | 1,554                    | 2,681                    | 4,278                    |
| Net interest income                                 | 8,358                    | 8,789                    | 8,512                    | 8,937                    | 9,336                    |
| Provision for loan losses                           | 730                      | 122                      | 381                      | 414                      | 917                      |
| Net interest income after provision for loan losses | 7,628                    | 8,667                    | 8,131                    | 8,523                    | 8,419                    |
| Other income  | 2,171                    | 2,298                    | 2,299                    | 2,258                    | 1,821                    |
| Other expense                                       | 8,353                    | 8,175                    | 7,432                    | 7,621                    | 7,008                    |
| Income before income taxes                          | 1,446                    | 2,790                    | 2,998                    | 3,160                    | 3,232                    |
| Income taxes  | 268                      | 835                      | 915                      | 955                      | 996                      |
| Net income  | \$ 1,178                 | \$ 1,955                 | \$ 2,083                 | \$ 2,205                 | \$ 2,236                 |
| Basic earnings per share                            | \$ 0.55                  | \$ 0.91                  | \$ 0.97                  | \$ 1.03                  | \$ 1.04                  |
| Cash dividends paid                                 | \$ 686                   | \$ 772                   | \$ 730                   | \$ 730                   | \$ 688                   |
| Weighted average number of shares outstanding       | 2,142,479                | 2,145,432                | 2,146,281                | 2,146,281                | 2,149,597                |
| Total assets  | \$ 203,550               | \$ 191,180               | \$ 186,237               | \$ 182,067               | \$ 184,704               |
| Securities available-for-sale                       | 37,470                   | 24,733                   | 30,141                   | 24,282                   | 33,360                   |
| Loans   | 148,002                  | 149,662                  | 140,145                  | 124,660                  | 125,122                  |
| Allowance for loan losses                           | 1,557                    | 1,523                    | 1,753                    | 1,685                    | 1,668                    |
| Deposits  | 167,308                  | 162,499                  | 154,768                  | 157,502                  | 160,068                  |
| Federal Home Loan Bank advances                     | 10,790                   | 2,335                    | 6,757                    | 822                      | 2,153                    |
| Total shareholders' equity                          | 19,102                   | 19,297                   | 18,110                   | 17,268                   | 15,820                   |
| Return on Average Assets                            | 0.59%                    | 1.03%                    | 1.13%                    | 1.21%                    | 1.22%                    |
| Return on Average Equity                            | 6.08                     | 10.24                    | 11.65                    | 13.11                    | 14.85                    |
| Dividend Payout Ratio                               | 58.23                    | 39.49                    | 35.05                    | 33.11                    | 30.77                    |
| Average Equity to Average Assets                    | 9.64                     | 10.04                    | 9.74                     | 9.23                     | 8.24                     |

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### **ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*(Dollars in thousands, except per share data)*

#### **General**

The following is management's analysis of the Corporation's financial condition and results of operations as of and for the year ended June 30, 2006, compared to prior years. This discussion is designed to provide a more comprehensive review of the operating results and financial position than could be obtained from an examination of the financial statements alone. This analysis should be read in conjunction with the consolidated financial statements and related footnotes and the selected financial data included elsewhere in this report.

#### **Forward-Looking Statements**

All statements set forth in this discussion or future filings by the Corporation with the Securities and Exchange Commission, or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, that are not historical in nature, including statements as to the Corporation's expectations, beliefs and strategies regarding the future, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may involve risks and uncertainties that are difficult to predict, may be beyond the Corporation's control and could cause actual results to differ materially from those described in such statements. Although the Corporation believes that the expectations reflected in such forward-looking statements are reasonable, the Corporation can give no assurance that such expectations will prove to be correct. The forward-looking statements included in this discussion speak only as of the date of this Form 10-K, and, except as required by law, the Corporation undertakes no obligation to update these forward-looking statements to reflect subsequent events or circumstances. Important factors that could cause actual results to differ materially from those suggested by these forward-looking statements and that could adversely affect the Corporation's performance are set forth under Item 1A Risk Factors in this Report on Form 10-K.

#### **Comparison of Results of Operations for the Years Ended June 30, 2006, June 30, 2005 and June 30, 2004**

**Net Income.** Net income decreased by 39.7% from 2005 to 2006 mainly as a result of an increase in provision expense and by an increase in our cost of funds due to higher market rates affecting the rates paid on borrowings and time deposits. Net income decreased by 6.1% from 2004 to 2005 as a result of charges of \$217, or \$143 after-tax, related to asset disposals, impairment and additional depreciation expense as old ATM and computer equipment was replaced and certain assets were fully depreciated as a result of a change in their estimated useful lives. Additionally, net income for 2005 was impacted by higher consulting and professional fees as the Corporation has begun to position itself for future growth.

**Net Interest Income.** Net interest income, the difference between interest income earned on interest-earning assets and interest expense incurred on interest-bearing liabilities, is the largest component of the Corporation's earnings. Net interest income is affected by changes in the volumes, rates and composition of interest-earning assets and interest-bearing liabilities. Net interest margin is calculated by dividing net interest income on a fully tax equivalent basis (FTE) by total interest-earning assets. FTE income includes tax-exempt income, restated to a pre-tax equivalent, based on the statutory federal income tax rate. All average balances are daily average balances. Non-accruing loans are included in average loan balances.

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Net interest income for the year of 2006 was \$8,358, a decrease of \$431, or 4.9%, from \$8,789 in the year of 2005. The Corporation's net interest margin for the year ended June 30, 2006 was 4.65%, a decrease of 42 basis points from 2005. Interest income on a FTE basis for the year of 2006 was \$11,642, an increase of \$1,170, or 11.2%, from \$10,472 in the year of 2005. This increase was mainly due to a \$9,017 increase in the average balance of tax-exempt municipal securities and due to an increase in the yield on loans of 27 basis points from

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

2005 to 2006. The yield on loans was positively impacted as variable rate loans within the portfolio repriced upward to higher market rates. Interest expense for the year of 2006 was \$3,029, an increase of \$1,434, or 89.9%, from \$1,595 in the year of 2005. This increase was mainly caused by higher market rates affecting the rates paid on borrowings and time deposits, as well as an increase in average time deposits and FHLB advances outstanding. Time deposits have increased as clients have moved money from lower yielding savings products to take advantage of the higher rates being offered on time deposits.

Net interest income for the year of 2005 was \$8,789, an increase of \$277, or 3.3%, from \$8,512 in the year of 2004. The increase in net interest income from 2004 was primarily attributable to a \$6,307 increase in average interest-earning assets. The Corporation's net interest margin decreased by 3 basis points from 2004 to 2005 primarily due to the Corporation's yield on average interest-earning assets declining to 5.98% for 2005 from 6.02%. The decline in the yield on average interest-earning assets was primarily impacted by sustained lower market rates throughout 2003 and the first six months of 2004. As a result of the lower market rates, a large portion of the variable rate loan portfolio automatically repriced or borrowers chose to refinance to lower rates. Even with the declines, the Corporation's net interest margin remains higher than most other banks in Ohio due to a higher than average commercial mortgage portfolio and our low cost of funds.

| <b>Net Interest Income Year ended June 30,</b> | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|--|-------------|-------------|-------------|
| Net interest income                            | \$ 8,358    | \$ 8,789    | \$ 8,512    |
| Taxable equivalent adjustments to net interest | 255         | 88          | 90          |
| Net interest income, fully taxable equivalent  | \$ 8,613    | \$ 8,877    | \$ 8,602    |
| Net interest margin                            | 4.51%       | 5.02%       | 5.05%       |
| Taxable equivalent adjustment                  | 0.14        | 0.05        | 0.05        |
| Net interest margin, fully taxable equivalent  | 4.65%       | 5.07%       | 5.10%       |

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

**Three-Year Average Balance Sheet and Net Interest Margin**

|  | 2006               |               |                | 2005               |               |                | 2004               |               |                |
|--|--------------------|---------------|----------------|--------------------|---------------|----------------|--------------------|---------------|----------------|
|  | Average<br>Balance | Interest      | Yield/<br>Rate | Average<br>Balance | Interest      | Yield/<br>Rate | Average<br>Balance | Interest      | Yield/<br>Rate |
| <b>Interest earning assets:</b>  |                    |               |                |                    |               |                |                    |               |                |
| Taxable securities   | \$ 23,480          | \$ 976        | 4.16%          | \$ 24,768          | \$ 945        | 3.82%          | \$ 26,740          | \$ 942        | 3.52%          |
| Nontaxable Securities (1)  | 12,790             | 780           | 6.10           | 3,773              | 217           | 5.75           | 3,823              | 217           | 5.68           |
| Loans receivable (1)   | 148,986            | 9,880         | 6.63           | 146,255            | 9,306         | 6.36           | 131,411            | 8,934         | 6.80           |
| Federal funds sold   | 146                | 6             | 4.11           | 221                | 4             | 1.81           | 6,736              | 63            | 0.94           |
| <b>Total interest earning assets</b>   | <b>185,402</b>     | <b>11,642</b> | <b>6.28</b>    | <b>175,017</b>     | <b>10,472</b> | <b>5.98</b>    | <b>168,710</b>     | <b>10,156</b> | <b>6.02</b>    |
| Non-interest earning assets  | 15,600             |               |                | 15,034             |               |                | 14,868             |               |                |
| <b>Total assets</b>  | <b>\$ 201,002</b>  |               |                | <b>\$ 190,051</b>  |               |                | <b>\$ 183,578</b>  |               |                |
| <b>Interest bearing liabilities:</b>   |                    |               |                |                    |               |                |                    |               |                |
| NOW  | \$ 11,898          | \$ 33         | 0.28%          | \$ 14,413          | \$ 78         | 0.54%          | \$ 14,059          | \$ 69         | 0.49%          |
| Savings  | 52,468             | 316           | 0.60           | 58,407             | 228           | 0.39           | 61,004             | 258           | 0.42           |
| Time deposits  | 58,967             | 1,990         | 3.37           | 45,074             | 1,004         | 2.23           | 46,375             | 1,092         | 2.36           |
| Short-term borrowings  | 5,721              | 134           | 2.34           | 6,176              | 80            | 1.30           | 5,427              | 66            | 1.22           |
| FHLB advances  | 12,431             | 556           | 4.47           | 6,184              | 205           | 3.32           | 1,386              | 69            | 4.98           |
| <b>Total interest bearing liabilities</b>  | <b>141,485</b>     | <b>3,029</b>  | <b>2.14</b>    | <b>130,254</b>     | <b>1,595</b>  | <b>1.22</b>    | <b>128,251</b>     | <b>1,554</b>  | <b>1.20</b>    |
| Non-interest bearing liabilities   | 40,149             |               |                | 40,707             |               |                | 37,445             |               |                |
| <b>Total liabilities</b>   | <b>181,634</b>     |               |                | <b>170,961</b>     |               |                | <b>165,696</b>     |               |                |
| Shareholders' equity   | 19,368             |               |                | 19,090             |               |                | 17,882             |               |                |
| <b>Total liabilities and shareholders' equity</b>                                      | <b>\$ 201,002</b>  |               |                | <b>\$ 190,051</b>  |               |                | <b>\$ 183,578</b>  |               |                |
| <b>Net interest income, interest rate spread</b>                                       |                    |               |                |                    |               |                |                    |               |                |
| (1)  |                    | \$ 8,613      | 4.14%          |                    | \$ 8,877      | 4.76%          |                    | \$ 8,602      | 4.82%          |
| Net interest margin (net interest as a percent of average interest earning assets) (1) |                    |               | 4.65%          |                    |               | 5.07%          |                    |               | 5.10%          |
| Average interest earning assets to interest bearing liabilities                        |                    |               | 131.04%        |                    |               | 134.37%        |                    |               | 131.55%        |

(1) calculated on a fully taxable equivalent basis

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The following table presents the changes in the Corporation's interest income and interest expense resulting from changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities. Changes attributable to both rate and volume that cannot be segregated have been allocated in proportion to the changes due to rate and volume.



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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

**INTEREST RATES AND INTEREST DIFFERENTIAL**

|                                      | 2006 Compared to 2005<br>Increase / (Decrease) |                            |                          | 2005 Compared to 2004<br>Increase / (Decrease) |                            |                          |
|--------------------------------------|--|----------------------------|--------------------------|--|----------------------------|--------------------------|
|                                      | Total<br>Change                                | Change<br>due to<br>Volume | Change<br>due to<br>Rate | Total<br>Change                                | Change<br>due to<br>Volume | Change<br>due to<br>Rate |
| (In thousands)                       |  |                            |                          |  |                            |                          |
| <b>Interest earning assets:</b>      |  |                            |                          |  |                            |                          |
| Taxable securities                   | \$ 31  | \$ (49)                    | \$ 80                    | \$ 3   | \$ (69)                    | \$ 72                    |
| Nontaxable securities (1)            | 563  | 519                        | 44                       | (3)  | (3)                        | 3                        |
| Loans receivable (2)                 | 574  | 174                        | 400                      | 372  | 1,009                      | (637)                    |
| Federal funds sold                   | 2  | (1)                        | 3                        | (59)   | (61)                       | 2                        |
| <b>Total interest income</b>         | <b>1,170</b>                                   | <b>643</b>                 | <b>527</b>               | <b>316</b>                                     | <b>876</b>                 | <b>(560)</b>             |
| <b>Interest bearing liabilities:</b> |  |                            |                          |  |                            |                          |
| NOW accounts                         | (45)   | (14)                       | (31)                     | 9  | 2                          | 7                        |
| Savings deposits                     | 88   | (23)                       | 111                      | (30)   | (11)                       | (19)                     |
| Time deposits                        | 986  | 309                        | 677                      | (88)   | (31)                       | (57)                     |
| Short-term borrowings                | 54   | (6)                        | 60                       | 14   | 9                          | 5                        |
| FHLB advances                        | 351  | 207                        | 144                      | 136  | 239                        | (103)                    |
| <b>Total interest expense</b>        | <b>1,434</b>                                   | <b>473</b>                 | <b>961</b>               | <b>41</b>                                      | <b>208</b>                 | <b>(167)</b>             |
| <b>Net interest income</b>           | <b>\$ (264)</b>                                | <b>\$ 170</b>              | <b>\$ (434)</b>          | <b>\$ 275</b>                                  | <b>\$ 668</b>              | <b>\$ (393)</b>          |

(1) Nontaxable income is adjusted to a fully tax equivalent basis utilizing a 34% tax rate.

(2) Non-accrual loan balances are included for purposes of computing the rate and volume effects although interest on these balances has been excluded.

**Provision for Loan Losses.** The provision for loan losses represents the charge to income necessary to adjust the allowance for loan losses to an amount that represents management's assessment of the estimated probable credit losses inherent in the Corporation's loan portfolio, which have been incurred at each balance sheet date. The provision for loan losses increased to \$730 in fiscal year 2006 compared to \$122 in fiscal year 2005 and \$381 in fiscal year 2004. The increased provision for loan losses for the twelve month period ended June 30, 2006 resulted from an increase in net charge-offs and an increase in non-performing loans.

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Net charge-offs were \$696 during fiscal year 2006, compared to \$352 for the same period last year. Net charge-offs for 2006 were mainly within the commercial, financial and agricultural and residential real estate portfolios. Within commercial, financial and agricultural charge-offs, \$362 was charged-off related to several multi-family rental unit loans that were made to a single borrower. For 2005, majority of the charge-offs were isolated to a single borrower and were specifically allocated for within the allowance for loan loss in a prior period when the probable loss had been identified. This resulted in a decline in the provision for loan losses from 2004 to 2005.

Non-performing loans as a percentage of total loans increased from 1.33% as of June 30, 2005 to 2.16% as of June 30, 2006. The increase in non-performing loans from June 30, 2005 to June 30, 2006 was primarily related to a \$1.8 million loan relationship that is secured by two multi-family rental unit loans. These properties are in the process of foreclosure and have been specifically reserved for within the allowance for loan losses.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

**Other Income.** Total other income primarily includes service charges on deposits and other miscellaneous income. Service charges on deposits have remained relatively consistent over the last three fiscal years at \$1,540, \$1,544 and \$1,598 for the fiscal years ended 2006, 2005 and 2004, respectively. Other income for 2006 increased by \$80, or 20.0%, from 2005. This increase in other income was mainly the result of an increase in alternative investment income, which is income from investment banking, advisory, brokerage, and underwriting. Our alternative investment program expanded in the latter part of 2006 with the addition of an experienced Financial Consultant. This program began to have an impact on other income in the fourth quarter of 2006 and we believe it will be an important component to earnings into the future. Other income declined by \$160 from 2004 to 2005 mainly due to the sale of Community Title Agency, Inc., which the Bank sold on October 1, 2004. Gains recognized on the sale of securities totaled \$66 during 2005 and there were no security gains recognized in 2006 or 2004. Gains recognized on the sale of other real estate owned, which represents property acquired by the Corporation as a result of foreclosure, or by deed in lieu of foreclosure, totaled \$6 during 2006, \$136 during 2005 and there were no such gains recognized in 2004.

**Other Expenses.** Total other expenses were \$8,353 for the year ended June 30, 2006, an increase of \$178, or 2.2% from \$8,175 for the year ended June 30, 2005, which had increased \$743, or 10.0%, from \$7,432 for the year ended June 30, 2004.

Salary and benefits expense increased \$380, or 9.6%, during the fiscal year ended June 30, 2006 and increased \$265, or 7.2%, during the fiscal year ended June 30, 2005. The increase in 2006 was the result of a full year's impact of salary and benefit expenses related to the management positions that were filled in 2005. The increase in 2005 was the result of several key management positions that were vacant in 2004 being filled in 2005.

Directors' fees decreased by \$15, or 10.3%, for 2006 from 2005 mainly due to the Directors implementing a voluntary fee reduction plan.

In 2006, professional fees decreased by \$213 since the senior management team is now performing services that were previously performed by outside consultants. In 2005, professional fees increased by \$203 from 2004 as the Corporation began to position itself for future growth.

The amortization of the intangible is directly related to the purchase premium of the Lisbon, Ohio branch.

An expense of \$167 was recognized in 2005 related to asset disposals and impairment as old ATM and computer equipment were replaced and due to the write down of a building in anticipation of its disposal. A new building was constructed for the Bank's Hanoverton branch. After the new building was completed, the existing structure was razed during the 2006 fiscal year.

Other expense totaled \$1,733 for the year ended June 30, 2006, an increase of \$162, from \$1,571 for the year ended June 30, 2005. Contributing to the increase in non-interest expenses were fees associated with moving to an imaged environment in the Proof department. As a result of the imaged environment, the Corporation is now able to electronically capture images at its branch locations eliminating the need to courier work

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from each branch to a central location. Long term objectives of moving to an imaged environment include: improving the ability to identify potential fraud by isolating checks that are inconsistent with historical account activity, intraday clearing allowing for quicker access to funds, recognizing operational savings related to equipment maintenance and repair, and reduced courier and employee costs. Other expense increased by \$186 from 2004 to 2005 primarily due to an increase in advertising expenses as the Corporation renewed its marketing efforts and due to losses incurred as a result of customer settlements that primarily related to an altered check received from an outside party.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

**Income Tax Expense.** The provision for income taxes totaled \$268, \$835 and \$915 for the years ended June 30, 2006, 2005 and 2004, respectively. The change in income tax expense from 2005 to 2006 was primarily attributable to the decrease in income before income taxes and the change in the after tax effect of tax-exempt income and other items. The respective effective tax rates were 18.5%, 29.9% and 30.5%. The effective tax rate differed from the federal statutory rate principally as a result of tax-exempt income from obligations of states and political subdivisions, loans and earnings on bank owned life insurance.

**Financial Condition**

Total assets at June 30, 2006 were \$203,550 compared to \$191,180 at June 30, 2005, an increase of \$12,370, or 6.5%. The increase in total assets was due primarily to an increase in the securities portfolio. Securities available-for-sale increased \$12,737 mainly due to the purchase of \$10.0 million of municipal securities.

**Securities.** The following table sets forth certain information regarding the amortized cost and fair value of the Corporation's securities at the dates indicated.

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value    |
|---|-------------------|------------------------------|-------------------------------|------------------|
| <b>June 30, 2006</b>                            |                   |                              |                               |                  |
| U.S. Treasury                                   | \$ 1,000          | \$                           | \$ (12)                       | \$ 988           |
| Obligations of government sponsored entities    | 10,121            |                              | (355)                         | 9,766            |
| Obligations of state and political subdivisions | 14,580            | 9                            | (291)                         | 14,298           |
| Mortgage-backed securities                      | 11,977            | 5                            | (564)                         | 11,418           |
| Equity securities                               | 1,000             |                              |                               | 1,000            |
| <b>Total securities</b>                         | <b>\$ 38,678</b>  | <b>\$ 14</b>                 | <b>\$ (1,222)</b>             | <b>\$ 37,470</b> |
| <b>June 30, 2005</b>                            |                   |                              |                               |                  |
| U.S. Treasury                                   | \$ 999            | \$                           | \$ (5)                        | \$ 994           |
| Obligations of government sponsored entities    | 5,238             |                              | (71)                          | 5,167            |
| Obligations of state and political subdivisions | 3,638             | 60                           | (1)                           | 3,697            |
| Mortgage-backed securities                      | 15,096            | 20                           | (241)                         | 14,875           |
| <b>Total securities</b>                         | <b>\$ 24,971</b>  | <b>\$ 80</b>                 | <b>\$ (318)</b>               | <b>\$ 24,733</b> |
| <b>June 30, 2004</b>                            |                   |                              |                               |                  |
| U.S. Treasury                                   | \$ 997            | \$                           | \$ (5)                        | \$ 992           |

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|   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|
| Obligations of government sponsored entities    | 5,775             | 21                | (94)              | 5,702             |
| Obligations of state and political subdivisions | 3,655             | 61                | (36)              | 3,680             |
| Mortgage-backed securities                      | 19,738            | 92                | (408)             | 19,422            |
| Equity securities                               | 299               | 46                |                   | 345               |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Total securities                                | \$ 30,464         | \$ 220            | \$ (543)          | \$ 30,141         |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

The following tables summarize the amounts and distribution of the Corporation's securities held and the weighted average yields as of June 30, 2006:

|  | <u>Amortized<br/>Cost</u> | <u>Fair<br/>Value</u> | <u>Average<br/>Yield /<br/>Cost</u> |
|--|---------------------------|-----------------------|-------------------------------------|
| <b>AVAILABLE-FOR-SALE</b>                                    |                           |                       |                                     |
| <b>U.S. Treasury:</b>  |                           |                       |                                     |
| Over 1 year through 5 years                                  | \$ 1,000                  | \$ 988                | 4.31%                               |
| <b>Total U.S. Treasury</b>                                   | 1,000                     | 988                   | 4.31                                |
| <b>Obligations of government sponsored entities:</b>         |                           |                       |                                     |
| Over 3 months through 1 year                                 | 1,000                     | 992                   | 2.00                                |
| Over 1 year through 5 years                                  | 4,240                     | 4,054                 | 3.80                                |
| Over 5 years through 10 years                                | 1,483                     | 1,447                 | 5.56                                |
| Over 10 years  | 3,398                     | 3,273                 | 5.43                                |
| <b>Total obligations of government sponsored entities</b>    | 10,121                    | 9,766                 | 4.44                                |
| <b>Obligations of state and political subdivisions:</b>      |                           |                       |                                     |
| Over 3 months through 1 year                                 | 588                       | 589                   | 6.09                                |
| Over 1 year through 5 years                                  | 1,497                     | 1,479                 | 5.66                                |
| Over 5 years through 10 years                                | 5,498                     | 5,373                 | 6.12                                |
| Over 10 years  | 6,997                     | 6,857                 | 6.32                                |
| <b>Total obligations of state and political subdivisions</b> | 14,580                    | 14,298                | 6.18                                |
| <b>Mortgage-backed securities:</b>                           |                           |                       |                                     |
| 3 months or less   | 17                        | 17                    |                                     |
| Over 3 months through 1 year                                 | 66                        | 65                    | 4.48                                |
| Over 1 year through 5 years                                  | 11,198                    | 10,678                | 3.91                                |
| Over 5 years through 10 years                                | 696                       | 658                   | 4.87                                |
| <b>Total mortgage-backed securities</b>                      | 11,977                    | 11,418                | 3.96                                |
| <b>Equity securities</b>                                     | 1,000                     | 1,000                 | 6.50                                |
| <b>Total securities</b>                                      | \$ 38,678                 | \$ 37,470             | 4.99%                               |

The weighted average interest rates are based on coupon rates for securities purchased at par value and on effective interest rates considering amortization or accretion if the securities were purchased at a premium or discount. The weighted average yield on tax-exempt obligations has been determined on a tax equivalent basis. Average yields are based on amortized cost balances.

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At June 30, 2006, available for sale securities included \$2,126 of municipal securities issued by Farmersville Texas school district that are insured by PSFG with an aggregate book value of \$2,175, or 11.4%, of shareholders' equity. Other than this issuance, there were no other holdings of securities of any one issuer, other than the U.S. government and its agencies and corporations, with an aggregate book value which exceeds 10% of shareholders' equity.

**Loans.** Major classifications of loans were as follows as of June 30:

|  | 2006              | 2005              | 2004              | 2003              | 2002              |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| Real estate mortgage                   | \$ 53,596         | \$ 61,936         | \$ 65,242         | \$ 57,497         | \$ 56,716         |
| Real estate construction               | 1,720             | 4,648             | 3,945             | 669               | 2,107             |
| Commercial, financial and agricultural | 86,397            | 75,815            | 64,362            | 58,484            | 53,535            |
| Installment loans to individuals       | 6,289             | 7,263             | 6,596             | 8,240             | 13,029            |
| <b>Total Loans</b>                     | <b>\$ 148,002</b> | <b>\$ 149,662</b> | <b>\$ 140,145</b> | <b>\$ 124,890</b> | <b>\$ 125,387</b> |



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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

The following is a schedule of contractual maturities and repayments of real estate construction, commercial, financial and agricultural loans, as of June 30, 2006:

|  |           |
|--|-----------|
| Due in one year or less                  | \$ 9,467  |
| Due after one year but within five years | 6,979     |
| Due after five years                     | 71,671    |
|  | <hr/>     |
| Total                                    | \$ 88,117 |
|  | <hr/>     |

The following is a schedule of fixed and variable rate real estate construction, commercial, financial and agricultural loans due after one year (variable rate loans are those loans with floating or adjustable interest rates) as of June 30, 2006:

|   | <u>Fixed<br/>Interest Rates</u> | <u>Variable<br/>Interest Rates</u> |
|---|---------------------------------|------------------------------------|
| Total real estate construction, commercial, financial and agricultural loans due after one year | \$ 12,706                       | \$ 65,944                          |

Foreign Outstandings there were no foreign outstandings during the periods presented. There are no concentrations of loans greater than 10% of total loans, which are not otherwise disclosed as a category of loans.

**Allowance for Loan Losses.** The allowance for loan losses balance and the provision charged to expense are judgmentally determined by management based upon the periodic review of the loan portfolio, an analysis of impaired loans, past loan loss experience, economic conditions, anticipated loan portfolio growth, and various other circumstances which are subject to change over time. In making this judgment, management reviews selected large loans as well as delinquent loans, non-accrual loans, problem loans, and loans to industries experiencing economic difficulties. The collectibility of these loans is evaluated after considering the current financial position of the borrower, the estimated market value of the collateral, guarantees and the Corporation's collateral position versus other creditors. Judgments, which are necessarily subjective, as to the probability of loss and the amount of such loss, are formed on these loans, as well as other loans in the aggregate.

Failure to receive principal and interest payments when due on any loan results in efforts to restore such loan to a current status. Loans are classified as non-accrual when, in the opinion of management, full collection of principal and accrued interest is in doubt. The loans must be brought and kept current for six sustained payments before being considered for removal from non-accrual status. Continued unsuccessful collection efforts generally lead to initiation of foreclosure or other legal proceedings.

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Properties acquired by the Corporation as a result of foreclosure, or by deed in lieu of foreclosure, are classified as other real estate owned until such time as it is sold or otherwise disposed. As of June 30, 2006, one of the properties classified as other real estate owned with a book value of \$469 is currently under a triple-net lease/purchase agreement with a tenant through 2007. It is anticipated that the tenant will purchase the land and building at the end of the lease at the agreed-upon price. A majority of the remaining properties within other real estate owned are under purchase agreements for the recorded value of the properties; therefore, no further loss on these properties is anticipated. Non-performing loans are either in the process of foreclosure or efforts are being made to work with the borrower to bring the loan current.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

The following schedule summarizes non-accrual, past due, and impaired loans for the years ended June 30:

|                                    | <u>2006</u>     | <u>2005</u>     | <u>2004</u>     | <u>2003</u>     | <u>2002</u>     |
|------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Non-accrual loans                  | \$ 3,198        | \$ 1,807        | \$ 2,092        | \$ 1,050        | \$ 829          |
| Accrual loans past due 90 days     |                 | 190             | 178             | 39              | 552             |
| <b>Total non-performing loans</b>  | <b>\$ 3,198</b> | <b>\$ 1,997</b> | <b>\$ 2,270</b> | <b>\$ 1,089</b> | <b>\$ 1,381</b> |
| Other real estate owned            | 749             | 524             | 585             | 35              |                 |
| <b>Total non-performing assets</b> | <b>\$ 3,947</b> | <b>\$ 2,521</b> | <b>\$ 2,855</b> | <b>\$ 1,124</b> | <b>\$ 1,381</b> |
| <b>Impaired Loans</b>              | <b>\$ 2,803</b> | <b>\$ 1,096</b> | <b>\$ 797</b>   | <b>\$ 505</b>   | <b>\$ 456</b>   |

There were no restructured loans for the periods presented.

**Potential Problem Loans.** There were no loans, not otherwise identified above, included on management's watch list that management has serious doubts as to the ability of such borrowers to comply with the loan repayment terms. Management's watch list includes both loans which management has some doubt as to the borrowers' ability to comply with the present repayment terms and loans which management is actively monitoring due to changes in the borrowers' financial condition. These loans and their potential loss exposure have been considered in management's analysis of the adequacy of the allowance for loan losses.

The following table summarizes the Corporation's loan loss experience, and provides a breakdown of the charge-off, recovery and other activity for the years ended June 30:

|  | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> |
|--|-------------|-------------|-------------|-------------|-------------|
| Allowance for loan losses at beginning of year | \$ 1,523    | \$ 1,753    | \$ 1,685    | \$ 1,668    | \$ 1,552    |
| Loans charged off:                             |             |             |             |             |             |
| Real estate mortgage                           | 209         |             | 84          | 56          | 174         |
| Real estate construction                       |             |             |             |             | 4           |
| Commercial, financial and agricultural         | 447         | 344         | 86          | 32          | 17          |
| Installment loans to individuals               | 168         | 161         | 283         | 515         | 740         |
| <b>Total charge offs</b>                       | <b>824</b>  | <b>505</b>  | <b>453</b>  | <b>603</b>  | <b>935</b>  |
| Recoveries:                                    |             |             |             |             |             |
| Real estate mortgage                           | 12          | 6           | 17          | 29          | 4           |

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|   |                 |                 |                 |                 |                 |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|
| Real estate construction                        |                 |                 |                 |                 |                 |
| Commercial, financial and agricultural          | 7               | 43              | 7               | 16              |                 |
| Installment loans to individuals                | 109             | 104             | 116             | 161             | 130             |
|   | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> |
| Total recoveries                                | 128             | 153             | 140             | 206             | 134             |
|   | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> |
| Net charge offs                                 | 696             | 352             | 313             | 397             | 801             |
| Provision for loan losses charged to operations | 730             | 122             | 381             | 414             | 917             |
|   | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> |
| Allowance for loan losses at end of year        | \$ 1,557        | \$ 1,523        | \$ 1,753        | \$ 1,685        | \$ 1,668        |
|   | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> |

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

The following schedule is a breakdown of the allowance for loan losses allocated by type of loan and related ratios:

|  | <b>Allocation of the Allowance for Loan Losses</b> |                    |                      |                    |
|--|--|--------------------|----------------------|--------------------|
|  | <b>Allowance</b>                                   | <b>% of Loan</b>   | <b>Allowance</b>     | <b>% of Loan</b>   |
|  | <b>Amount</b>                                      | <b>Type to</b>     | <b>Amount</b>        | <b>Type to</b>     |
|  | <b>June 30, 2006</b>                               | <b>Total Loans</b> | <b>June 30, 2005</b> | <b>Total Loans</b> |
| Commercial, financial and agricultural | \$ 1,124   | 58.4%              | \$ 662               | 50.7%              |
| Installment loans to individuals       | 156  | 4.2                | 173                  | 4.8                |
| Real estate                            | 277  | 37.4               | 580                  | 44.5               |
| Unallocated                            |  |                    | 108                  |                    |
|  | \$ 1,557   | 100.0%             | \$ 1,523             | 100.0%             |

|  | <b>Allocation of the Allowance for Loan Losses</b> |                    |                      |                    |
|--|--|--------------------|----------------------|--------------------|
|  | <b>Allowance</b>                                   | <b>% of Loan</b>   | <b>Allowance</b>     | <b>% of Loan</b>   |
|  | <b>Amount</b>                                      | <b>Type to</b>     | <b>Amount</b>        | <b>Type to</b>     |
|  | <b>June 30, 2004</b>                               | <b>Total Loans</b> | <b>June 30, 2003</b> | <b>Total Loans</b> |
| Commercial, financial and agricultural | \$ 639   | 46.0%              | \$ 681               | 46.8%              |
| Installment loans to individuals       | 272  | 4.7                | 596                  | 6.6                |
| Real estate                            | 676  | 49.3               | 302                  | 46.6               |
| Unallocated                            | 166  |                    | 106                  |                    |
|  | \$ 1,753   | 100.0%             | \$ 1,685             | 100.0%             |

|  | <b>June 30, 2002</b> |       |
|--|----------------------|-------|
| Commercial, financial and agricultural | \$ 680               | 42.7% |
| Installment loans to individuals       | 581                  | 10.4  |
| Real estate                            | 241                  | 46.9  |
| Unallocated                            | 166                  |       |

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|       |          |        |
|-------|----------|--------|
| Total | \$ 1,668 | 100.0% |
|-------|----------|--------|

While management's periodic analysis of the adequacy of the allowance for loan loss may allocate portions of the allowance for specific problem loan situations, the entire allowance is available for any loan charge-offs that occur. During 2006, the 2005 unallocated portion of the allowance for loan losses was allocated within the allowance for loan losses to the various loan types.

**Funding Sources.** Total deposits increased \$4,809, or 3.0%, from \$162,499 at June 30, 2005 to \$167,308 at June 30, 2006. Non-interest bearing deposits increased \$3,742, or 9.8%, from June 30, 2005 to June 30, 2006, while interest-bearing checking balances decreased \$2,745, or 21.3%, for the same period. Time deposits increased \$8,041, or 14.2%, and savings deposits decreased \$4,229, or 7.7%, as customers took advantage of the higher rates being offered on time deposits.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

The following is a schedule of average deposit amounts and average rates paid on each category for the periods included:

|                                      | Years Ended June 30, |              |                   |              |                   |              |
|--------------------------------------|----------------------|--------------|-------------------|--------------|-------------------|--------------|
|                                      | 2006                 |              | 2005              |              | 2004              |              |
|                                      | Amount               | Rate         | Amount            | Rate         | Amount            | Rate         |
| Non-interest bearing demand deposit  | \$ 39,005            |              | \$ 40,707         |              | \$ 36,103         |              |
| Interest bearing demand deposit      | 11,898               | 0.28%        | 14,413            | 0.54%        | 14,059            | 0.49%        |
| Savings                              | 52,468               | 0.60         | 58,407            | 0.39         | 61,004            | 0.42         |
| Certificates and other time deposits | 58,967               | 3.37         | 45,074            | 2.23         | 46,375            | 2.36         |
| <b>Total</b>                         | <b>\$ 162,338</b>    | <b>1.44%</b> | <b>\$ 158,601</b> | <b>0.83%</b> | <b>\$ 157,541</b> | <b>0.90%</b> |

The following table summarizes time deposits issued in amounts of \$100 or more as of June 30, 2006 by time remaining until maturity:

|                     |                  |
|---------------------|------------------|
| Maturing in:        |                  |
| Under 3 months      | \$ 11,774        |
| Over 3 to 6 months  | 263              |
| Over 6 to 12 months | 3,716            |
| Over 12 months      | 3,812            |
| <b>Total</b>        | <b>\$ 19,565</b> |

See Note 7 Short-Term Borrowings to the Consolidated Financial Statements, for information concerning short-term borrowings.

**Shareholders equity.** Total shareholders equity decreased by \$195 from \$19,297 at June 30, 2005 to \$19,102 at June 30, 2006. The decrease was primarily due to an increase in the unrealized loss on the mark-to-market of available-for-sale securities. In June 2006, the Board of Directors authorized a share repurchase program for up to 75,000 shares that can be repurchased through June 2007. Repurchases can be made from time-to-time in the open market or through privately negotiated transactions depending on market and/or other conditions. The repurchase program may be suspended or discontinued at any time.

## Liquidity

Management considers the asset position of the Bank to be sufficiently liquid to meet normal operating needs and conditions. The Bank's earning assets are divided primarily between loans and available-for-sale securities, with any excess funds placed in federal funds sold on a daily basis.

The Bank groups its loan portfolio into three major categories: real estate loans; commercial, financial and agricultural loans; and consumer loans. The Bank's real estate loan portfolio consists of three basic segments: conventional mortgage loans having fixed rates for terms not longer than fifteen years, variable rate home equity line of credit loans and fixed rate loans having maturity or renewal dates that are less than the scheduled amortization period. Real estate loan growth has declined the last two years as competition has become very heavy in the Bank's market for these types of loans, both from local and national lenders. The Bank became affiliated with third parties who allowed the Bank to offer attractive mortgage loan options to its customers. Commercial, financial and agricultural loans are comprised of both variable rate notes subject to daily interest rate changes based on the prime rate, and fixed rate notes having maturities of generally not greater than five



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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

years. These loans have increased during the past year, with outstanding balances rising by \$10,582, or 14.0%. Personal loans offered by the Bank are generally written for periods of up to five years, based on the nature of the collateral. These may be either installment loans having regular monthly payments or demand type loans for short periods of time.

Funds not allocated to the Bank's loan portfolio are invested in various securities having diverse maturity schedules. The majority of the Bank's securities are held in U.S. Treasury securities or other securities issued by U.S. Government entities, mortgage-backed securities, and investments in tax free municipal bonds. Tax equivalent yields for securities increased to 4.84% on a tax equivalent basis for the year ended June 30, 2006 as compared to 4.07% for the year ended June 30, 2005.

The Bank offers several forms of deposit programs to its customers. The rates offered by the Bank and the fees charged for them are competitive with others available currently in the market area. Time deposit interest rates have increased during the year. Rates continue to come under competitive pressures in the Bank's market area as financial institutions attempt to attract and keep new deposits to fund growth. Compared to our peers, the Corporation's cost of funds still remains at a relatively low level at 2.14%.

Jumbo time deposits (those with balances of \$100 and over) increased from \$18,555 at June 30, 2005 to \$19,565 at June 30, 2006. These deposits are monitored closely by the Bank and typically priced on an individual basis. The Bank has on occasion used a fee paid broker to obtain these types of funds from outside its normal service area as another alternative for its funding needs. The Bank had no brokered deposits at June 30, 2006. However, these deposits are not relied upon as a primary source of funding and the Bank can foresee no dependence on these types of deposits for the near term.

The net interest margin is monitored monthly. It is the Bank's goal to maintain the net interest margin at 4.0% or greater. The net interest margin on a tax equivalent basis for 2006 was 4.65% as compared to 5.07% for 2005 and 5.10% in 2004.

**Capital Resources**

At June 30, 2006, management believes the Bank complied with all regulatory capital requirements. Based on the Bank's computed regulatory capital ratios, the Office of the Comptroller of the Currency has determined the Bank to be well capitalized under the Federal Deposit Insurance Act as of its latest exam date. The Bank's actual and required capital amounts are disclosed in Note 11 of the consolidated financial statements. Management is not aware of any matters occurring subsequent to that exam that would cause the Bank's capital category to change.

**Impact of Inflation and Changing Prices**

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The financial statements and related data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and results of operations primarily in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of the Corporation are monetary in nature. Therefore, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. The liquidity, maturity structure and quality of the Corporation's assets and liabilities are critical to the maintenance of acceptable performance levels.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

**Critical Accounting Policies**

The financial condition and results of operations for Consumers Bancorp, Inc. presented in the Consolidated Financial Statements, accompanying notes to the Consolidated Financial Statements and management's discussion and analysis are, to a large degree, dependent upon the Corporation's accounting policies. The selection and application of these accounting policies involve judgments, estimates and uncertainties that are susceptible to change.

Presented below is a discussion of the accounting policy that management believes is the most important to the portrayal and understanding of the Corporation's financial condition and result of operations. This policy requires management's most difficult, subjective and complex judgments about matters that are inherently uncertain. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of materially different financial condition or results of operations is a reasonable likelihood. Also, see Note 1 of the Notes to Consolidated Financial Statements for additional information related to significant accounting policies.

**Allowance for Loan Losses.** Management periodically reviews the loan portfolio in order to establish an estimated allowance for loan losses (allowance) that are probable as of the respective reporting date. Additions to the allowance are charged against earnings for the period as a provision for loan losses. Actual loan losses are charged against the allowance when management believes that the collection of principal will not occur. Unpaid interest for loans that are placed on non-accrual status is reversed against current interest income.

The allowance is regularly reviewed by management to determine whether or not the amount is considered adequate to absorb probable losses. If not, an additional provision is made to increase the allowance. This evaluation includes specific loss estimates on certain individually reviewed loans, statistical loss estimates for loan groups or pools that are based on historical loss experience and general loss estimates that are based upon the size, quality, and concentration characteristics of the various loan portfolios, adverse situations that may affect a borrower's ability to repay, and current economic and industry conditions, among other things. The allowance is also subject to periodic examination by regulators whose review includes a determination as to its adequacy to absorb potential losses.

Those judgments and assumptions that are most critical to the application of this accounting policy are the initial and on-going credit-worthiness of the borrower, the amount and timing of future cash flows of the borrower that are available for repayment of the loan, the sufficiency of underlying collateral, the enforceability of third-party guarantees, the frequency and subjectivity of loan reviews and risk grading, emerging or changing trends that might not be fully captured in the historical loss experience, and charges against the allowance for actual losses that are greater than previously estimated. These judgments and assumptions are dependent upon or can be influenced by a variety of factors including the breadth and depth of experience of lending officers, credit administration and the loan review staff that periodically review the status of the loan, changing economic and industry conditions, changes in the financial condition of the borrower, and changes in the value and availability of the underlying collateral and guarantees.

While the Corporation strives to reflect all known risk factors in its evaluations, judgment errors may occur. If different assumptions or conditions were to prevail, the amount and timing of interest income and loan losses could be materially different. These factors are most

pronounced during economic downturns. Since, as described above, so many factors can affect the amount and timing of losses on loans it is difficult to predict, with any degree of certainty, the affect on income if different conditions or assumptions were to prevail.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

**Quantitative and Qualitative Disclosures about Market Risk**

The Bank measures interest-rate risk from the perspectives of earnings at risk and value at risk. The primary purpose of both the loan and securities portfolios is the generation of income. Credit risk is the principal focus of risk analysis in the loan portfolio, while interest-rate risk is the principal focus in the securities portfolio. Because of the greater liquidity of the securities portfolio, it is the vehicle for managing interest-rate risk for the entire balance sheet. The Bank manages interest rate risk position using simulation analysis of net interest income and net income over a two-year period. The Bank also calculates the effect of an instantaneous change in market interest rates on the economic value of equity or net portfolio value. Once these analyses are complete, management reviews the results, with an emphasis on the income-simulation results for purposes of managing interest-rate risk. The rate sensitivity position is managed to avoid wide swings in net interest margins. Measurement and identification of current and potential interest rate risk exposures is conducted quarterly, with reporting and monitoring also occurring quarterly. The Bank applies interest rate shocks to its financial instruments up and down 50, 100, 200, and 300 basis points. The projected volatility of net interest income to a +200 and -100 basis points change for all quarterly models during 2006 and 2005 fell within the Board of Directors guidelines for net interest income change.

The following table presents an analysis of the potential sensitivity of the Bank's annual net interest income and present value of the Bank's financial instruments to sudden and sustained increase of 200 basis points and 100 basis points decrease change in market interest rates:

|  | <u>2006</u> | <u>Guidelines</u> | <u>2005</u> | <u>Guidelines</u> |
|--|-------------|-------------------|-------------|-------------------|
| <b>One Year Net Interest Income Change</b> |             |                   |             |                   |
| +200 Basis Points                          | (1.7)%      | 16%               | 0.4%        | 16%               |
| -100 Basis Points                          | 1.4%        | 8%                | (1.4)%      | 8%                |
| <b>Net Present Value of Equity Change</b>  |             |                   |             |                   |
| +200 Basis Points                          | (13.7)%     | 20%               | (4.7)%      | 20%               |
| -100 Basis Points                          | (0.6)%      | 20%               | (1.6)%      | 20%               |

The preceding analysis is based on numerous assumptions, including relative levels of market interest rates, loan prepayments and reactions of depositors to changes in interest rates, and should not be relied upon as being indicative of actual results. Further, the analysis does not necessarily contemplate all actions the Bank may undertake in response to changes in interest rates.

**Contractual Obligations, Commitments and Contingent Liabilities**

The following table presents, as of June 30, 2006, the Corporation's significant fixed and determinable contractual obligations by payment date. The payment amounts represent those amounts contractually due to the recipient and do not include any unamortized premiums or discounts. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements.

|                            | <b>Note<br/>Reference</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>Thereafter</b> | <b>Total</b> |
|----------------------------|---------------------------|-------------|-------------|-------------|-------------|-------------|-------------------|--------------|
| Certificates of deposit    | 6                         | \$ 49,471   | \$ 12,149   | \$ 2,201    | \$ 849      | \$ 5        | \$ 33             | \$ 64,708    |
| Short-term borrowings      | 7                         | 5,049       |             |             |             |             |                   | 5,049        |
| Federal Home Loan Advances | 8                         | 4,413       | 5,274       | 243         | 198         | 133         | 529               | 10,790       |
| Salary continuation plan   | 9                         | 16          | 16          | 16          | 16          | 16          | 509               | 589          |
| Operating leases           | 4                         | 96          | 96          | 96          | 79          | 33          | 145               | 545          |
| Deposits without maturity  |                           |             |             |             |             |             |                   | 102,600      |

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (continued)**

(Dollars in thousands, except per share data)

Note 12 to the consolidated financial statements discuss in greater detail other commitments and contingencies and the various obligations that exist under those agreements. These commitments and contingencies consist primarily of commitments to extend credit to borrowers under lines of credit.

**Off-Balance Sheet Arrangements**

At June 30, 2006, the Corporation had no unconsolidated, related special purpose entities, nor did the Corporation engage in derivatives and hedging contracts, such as interest rate swaps, which may expose the Corporation to liabilities greater than the amounts recorded on the consolidated balance sheet. The Corporation's investment policy prohibits engaging in derivative contracts for speculative trading purposes; however, in the future, the Corporation may pursue certain contracts, such as interest rate swaps, in an effort to execute a sound and defensive interest rate risk management policy.

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**ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information required by this section appears under the caption "Quantitative and Qualitative Disclosures about Market Risk" located in Item 7 on page 23 of this Report.

**ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

Consumers Bancorp, Inc.

Minerva, Ohio

We have audited the accompanying consolidated balance sheets of Consumers Bancorp, Inc. as of June 30, 2006 and 2005 and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Consumers Bancorp, Inc. as of June 30, 2006 and 2005 and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2006, in conformity with U. S. generally accepted accounting principles.

/s/ Crowe Chizek and Company LLC

Crowe Chizek and Company LLC

Columbus, Ohio



August 14, 2006

**Table of Contents****CONSUMERS BANCORP, INC.****CONSOLIDATED BALANCE SHEETS**

As of June 30, 2006 and 2005

(Dollar amounts in thousands, except per share data)

|   | <u>2006</u>       | <u>2005</u>       |
|---|-------------------|-------------------|
| <b>ASSETS:</b>  |                   |                   |
| Cash and cash equivalents   | \$ 5,941          | \$ 5,969          |
| Securities, available-for-sale  | 37,470            | 24,733            |
| Federal bank and agency stocks, at cost   | 1,118             | 1,066             |
| Total loans   | 148,002           | 149,662           |
| Less allowance for loan losses  | (1,557)           | (1,523)           |
| Net loans   | 146,445           | 148,139           |
| Cash surrender value of life insurance  | 4,139             | 3,994             |
| Premises and equipment, net   | 4,648             | 4,381             |
| Intangible assets, net  | 894               | 1,055             |
| Other real estate owned   | 749               | 524               |
| Accrued interest receivable and other assets  | 2,146             | 1,319             |
| Total assets  | <u>\$ 203,550</u> | <u>\$ 191,180</u> |
| <b>LIABILITIES:</b>   |                   |                   |
| Deposits:   |                   |                   |
| Non-interest bearing demand   | \$ 41,869         | \$ 38,127         |
| Interest bearing demand   | 10,156            | 12,901            |
| Savings   | 50,575            | 54,804            |
| Time  | 64,708            | 56,667            |
| Total deposits  | 167,308           | 162,499           |
| Short-term borrowings   | 5,049             | 6,046             |
| Federal Home Loan Bank advances   | 10,790            | 2,335             |
| Accrued interest payable and other liabilities  | 1,301             | 1,003             |
| Total liabilities   | 184,448           | 171,883           |
| Commitments and contingent liabilities  |                   |                   |
| <b>SHAREHOLDERS EQUITY:</b>   |                   |                   |
| Common shares, no par value; 2,500,000 shares authorized; 2,160,000 shares issued                 | 4,869             | 4,869             |
| Retained earnings   | 15,333            | 14,841            |
| Treasury stock, at cost (19,566 and 16,556 common shares at June 30, 2006 and 2005, respectively) | (303)             | (256)             |
| Accumulated other comprehensive loss  | (797)             | (157)             |
| Total shareholders equity   | <u>19,102</u>     | <u>19,297</u>     |
| Total liabilities and shareholders equity   | <u>\$ 203,550</u> | <u>\$ 191,180</u> |

*See accompanying notes to consolidated financial statements.*

**Table of Contents****CONSUMERS BANCORP, INC.****CONSOLIDATED STATEMENTS OF INCOME**

Years Ended June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

|   | <u>2006</u>   | <u>2005</u>   | <u>2004</u>   |
|---|---------------|---------------|---------------|
| <b>Interest income:</b>                             |               |               |               |
| Loans, including fees                               | \$ 9,865      | \$ 9,288      | \$ 8,919      |
| Federal funds sold                                  | 6             | 4             | 63            |
| Securities:   |               |               |               |
| Taxable   | 976           | 945           | 942           |
| Tax-exempt  | 540           | 147           | 142           |
|   | <u>11,387</u> | <u>10,384</u> | <u>10,066</u> |
| Total interest income                               |               |               |               |
| <b>Interest expense:</b>                            |               |               |               |
| Deposits  | 2,339         | 1,310         | 1,419         |
| Federal Home Loan Bank advances                     | 556           | 205           | 69            |
| Short-term borrowings                               | 134           | 80            | 66            |
|   | <u>3,029</u>  | <u>1,595</u>  | <u>1,554</u>  |
| Total interest expense                              |               |               |               |
| Net interest income                                 | 8,358         | 8,789         | 8,512         |
| Provision for loan losses                           | 730           | 122           | 381           |
|   | <u>7,628</u>  | <u>8,667</u>  | <u>8,131</u>  |
| Net interest income after provision for loan losses |               |               |               |
| <b>Other income:</b>                                |               |               |               |
| Service charges on deposit accounts                 | 1,540         | 1,544         | 1,598         |
| Securities gains, net                               |               | 66            |               |
| Gain on sale of other real estate owned             | 6             | 136           |               |
| Bank owned life insurance income                    | 145           | 152           | 141           |
| Other   | 480           | 400           | 560           |
|   | <u>2,171</u>  | <u>2,298</u>  | <u>2,299</u>  |
| Total other income                                  |               |               |               |
| <b>Other expenses:</b>                              |               |               |               |
| Salaries and employee benefits                      | 4,322         | 3,942         | 3,677         |
| Occupancy   | 1,107         | 1,135         | 1,190         |
| Directors fees                                      | 130           | 145           | 109           |
| Professional fees                                   | 218           | 431           | 228           |
| Franchise taxes                                     | 193           | 228           | 218           |
| Printing and supplies                               | 230           | 173           | 163           |
| Amortization of intangible                          | 161           | 161           | 161           |
| Telephone and communications                        | 251           | 206           | 201           |
| Asset impairment/disposal, net                      | 8             | 167           |               |
| Other real estate owned                             |               | 16            | 100           |
| Other   | 1,733         | 1,571         | 1,385         |
|   | <u>8,353</u>  | <u>8,175</u>  | <u>7,432</u>  |
| Total other expenses                                |               |               |               |

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|                                 |                   |                   |                   |
|---------------------------------|-------------------|-------------------|-------------------|
| Income before income taxes      | 1,446             | 2,790             | 2,998             |
| Income tax expense              | 268               | 835               | 915               |
|                                 | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Net income</b>               | <b>\$ 1,178</b>   | <b>\$ 1,955</b>   | <b>\$ 2,083</b>   |
|                                 | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Basic earnings per share</b> | <b>\$ 0.55</b>    | <b>\$ 0.91</b>    | <b>\$ 0.97</b>    |

*See accompanying notes to consolidated financial statements.*

**Table of Contents****CONSUMERS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY**

Years Ended June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

|  | <u>Common<br/>Shares</u> | <u>Retained<br/>Earnings</u> | <u>Treasury<br/>Stock</u> | <u>Accumulated<br/>Other<br/>Comprehensive<br/>Income<br/>(Loss)</u> | <u>Total<br/>Shareholders<br/>Equity</u> |
|--|--------------------------|------------------------------|---------------------------|--|--|
| Balance, July 1, 2003                      | \$ 4,869                 | \$ 12,305                    | \$ (204)                  | \$ 298   | \$ 17,268                                |
| Comprehensive Income:                      |                          |                              |                           |  |  |
| Net income                                 |                          | 2,083                        |                           |  | 2,083                                    |
| Other comprehensive income (loss)          |                          |                              |                           | (511)  | (511)                                    |
| Total comprehensive income                 |                          |                              |                           |  | 1,572                                    |
| Cash dividends declared (\$0.34 per share) |                          | (730)                        |                           |  | (730)                                    |
| Balance, June 30, 2004                     | 4,869                    | 13,658                       | (204)                     | (213)  | 18,110                                   |
| Comprehensive Income:                      |                          |                              |                           |  |  |
| Net income                                 |                          | 1,955                        |                           |  | 1,955                                    |
| Other comprehensive income                 |                          |                              |                           | 56   | 56                                       |
| Total comprehensive income                 |                          |                              |                           |  | 2,011                                    |
| Cash dividends declared (\$0.36 per share) |                          | (772)                        |                           |  | (772)                                    |
| Purchase of 2,837 treasury shares          |                          |                              | (52)                      |  | (52)                                     |
| Balance, June 30, 2005                     | 4,869                    | 14,841                       | (256)                     | (157)  | 19,297                                   |
| Comprehensive Income:                      |                          |                              |                           |  |  |
| Net income                                 |                          | 1,178                        |                           |  | 1,178                                    |
| Other comprehensive income (loss)          |                          |                              |                           | (640)  | (640)                                    |
| Total comprehensive income                 |                          |                              |                           |  | 538                                      |
| Cash dividends declared (\$0.32 per share) |                          | (686)                        |                           |  | (686)                                    |
| Purchase of 3,010 treasury shares          |                          |                              | (47)                      |  | (47)                                     |
| Balance, June 30, 2006                     | \$ 4,869                 | \$ 15,333                    | \$ (303)                  | \$ (797)   | \$ 19,102                                |

*See accompanying notes to consolidated financial statements.*

**Table of Contents****CONSUMERS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years Ended June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

|  | <u>2006</u>     | <u>2005</u>    | <u>2004</u>    |
|--|-----------------|----------------|----------------|
| <b>Cash flows from operating activities:</b>                                     |                 |                |                |
| Net income   | \$ 1,178        | \$ 1,955       | \$ 2,083       |
| Adjustments to reconcile net income to net cash flows from operating activities: |                 |                |                |
| Depreciation   | 580             | 645            | 661            |
| Securities amortization, net   | 66              | 117            | 259            |
| Provision for loan losses  | 730             | 122            | 381            |
| Loss on disposal/impairment of premises  | 8               | 167            |                |
| Gain on sale of other real estate  | (6)             | (136)          |                |
| Deferred income taxes  | 9               | 80             | (23)           |
| Gain on sale of securities   |                 | (66)           |                |
| Stock dividend on FHLB stock   | (52)            | (47)           | (34)           |
| Intangible amortization  | 161             | 161            | 161            |
| Change in:   |                 |                |                |
| Cash surrender value   | (145)           | (152)          | (141)          |
| Accrued interest receivable  | (228)           | 44             | (5)            |
| Accrued interest payable   | 79              | 84             | (163)          |
| Other assets and other liabilities   | (59)            | (563)          | (110)          |
|  | <u>2,321</u>    | <u>2,411</u>   | <u>3,069</u>   |
| <b>Cash flows from investing activities:</b>                                     |                 |                |                |
| Securities available-for-sale  |                 |                |                |
| Purchases  | (18,157)        | (2,551)        | (23,127)       |
| Sales  |                 | 2,536          |                |
| Maturities and principal pay downs   | 4,384           | 5,303          | 16,234         |
| Net decrease in Federal funds sold   |                 | 210            | 14,125         |
| Net (increase) decrease in loans   | 11              | (10,314)       | (16,383)       |
| Acquisition of premises and equipment  | (869)           | (620)          | (145)          |
| Proceeds from sale/disposal of premises  | 14              | 48             |                |
| Proceeds from sale of other real estate owned                                    | 734             | 642            |                |
|  | <u>(13,883)</u> | <u>(4,746)</u> | <u>(9,296)</u> |
| <b>Cash flows from financing activities:</b>                                     |                 |                |                |
| Net increase (decrease) in deposit accounts                                      | 4,809           | 7,731          | (2,734)        |
| Proceeds from FHLB advances  | 9,080           |                | 6,050          |
| Repayments of FHLB advances  | (625)           | (4,422)        | (115)          |
| Change in short-term borrowings  | (997)           | 590            | 520            |
| Dividends paid   | (686)           | (772)          | (730)          |
| Purchase of treasury stock   | (47)            | (52)           |                |
|  | <u>11,534</u>   | <u>3,075</u>   | <u>2,991</u>   |
| Change in cash and cash equivalents  | (28)            | 740            | (3,236)        |
| Cash and cash equivalents, beginning of year                                     | 5,969           | 5,229          | 8,465          |

|   |                 |                 |                 |
|---|-----------------|-----------------|-----------------|
| <b>Cash and cash equivalents, end of year</b> | <u>\$ 5,941</u> | <u>\$ 5,969</u> | <u>\$ 5,229</u> |
| <b>Supplemental noncash disclosures:</b>      |                 |                 |                 |
| Transfers from loans to repossessed assets    | \$ 953          | \$ 445          | \$ 585          |

*See accompanying notes to consolidated financial statements.*



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**CONSUMERS BANCORP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Unless otherwise indicated, dollar amounts are in thousands, except per share data.

**Principles of Consolidation:** The consolidated financial statements include the accounts of Consumers Bancorp, Inc. (Corporation) and its wholly owned subsidiary, Consumers National Bank (Bank). All significant intercompany transactions have been eliminated in the consolidation.

**Business Segment Information:** Consumers Bancorp, Inc. is a bank holding company engaged in the business of commercial and retail banking, which accounts for substantially all of its revenues, operating income, and assets. Accordingly, all of its operations are reported in one segment, banking.

**Use of Estimates:** To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses and fair values of financial instruments are particularly subject to change.

**Cash Reserves:** The Bank is required by the Federal Reserve to maintain reserves consisting of cash on hand and non-interest bearing balances on deposit with the Federal Reserve Bank. The required reserve balance at June 30, 2006 and 2005 was \$1,536 and \$1,639, respectively.

**Securities:** Securities are generally classified into either held-to-maturity or available-for-sale categories. Held-to-maturity securities are those that the Corporation has the positive intent and ability to hold to maturity, and are reported at amortized cost. Available-for-sale securities are those that the Corporation may decide to sell if needed for liquidity, asset-liability management, or other reasons. Available-for-sale securities are reported at fair value, with unrealized gains or losses included in other comprehensive income as a separate component of equity, net of tax. Other securities, such as Federal Home Loan Bank stock, are carried at cost. Securities are written down to fair value when a decline in fair value is not temporary.

Realized gains or losses on sales are determined based on the amortized cost of the specific security sold. Amortization of premiums and accretion of discounts are computed under a system materially consistent with the level yield method and are recognized as adjustments to interest income. Prepayment activity on mortgage-backed securities is affected primarily by changes in interest rates. Yields on mortgage-backed securities are adjusted as prepayments occur through changes to premium amortization or discount accretion.

Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating, other-than-temporary losses, management considers: the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and the Corporation's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

Federal Home Loan Bank (FHLB) stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security and periodically evaluated for impairment based on ultimate recovery of par value. Since this stock is viewed as a long-term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

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**CONSUMERS BANCORP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

**Loans:** Loans are reported at the principal balance outstanding, net of unearned income, deferred loan fees and costs, and an allowance for loan losses. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income on mortgage and commercial loans is discontinued at the time the loan is 120 days delinquent unless the loan is well-secured and in the process of collection. Consumer loans are typically charged off no later than 90 days past due. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is not considered probable.

All interest accrued but not received on loans placed on non-accrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when the customer has exhibited the ability to repay and demonstrated this ability over a six month period and future payments are reasonably assured.

**Concentrations of Credit Risk:** The Bank grants consumer, real estate and commercial loans primarily to borrowers in Stark, Columbiana and Carroll counties. Automobiles and other consumer assets, business assets and residential and commercial real estate secure most loans.

**Allowance for Loan Losses:** The allowance for loan losses is a valuation allowance for probable incurred losses, increased by the provision for loan losses and decreased by charge-offs, less recoveries. Management estimates the allowance balance required based on past loan loss experience, known and probable losses in the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

Loan impairment is reported when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller-balance loans of similar nature such as residential mortgage and consumer loans on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance is allocated so the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected from the collateral. Loans are evaluated for impairment when payments are delayed, typically 90 days or more, or when it is probable that not all principal and interest amounts will be collected according to the original terms of the loan.

**Cash Surrender Value of Life Insurance:** The Bank has purchased single-premium life insurance policies to insure the lives of current and former participants in the salary continuation plan. As of June 30, 2006, the Bank had policies with total death benefits of \$9,881 and total cash surrender values of \$4,139. As of June 30, 2005, the Bank had policies with total death benefits of \$9,775 and total cash surrender values of \$3,994. The amount included in income (net of policy commissions and mortality costs) was \$145, \$152 and \$141 for the years ended June 30, 2006, 2005 and 2004.

**Premises and Equipment:** Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed over the assets useful lives on a straight-line basis. Useful lives range from three years for software to thirty-nine and one-half years for buildings.

Intangible Assets: Core deposit intangible is recorded at cost and is amortized over an estimated life of 12 years on a straight line method. Intangibles are assessed annually for impairment and written down as necessary.

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**CONSUMERS BANCORP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

**Long-term Assets:** Premises and equipment, core deposit and other intangible assets and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

**Other Real Estate Owned:** Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at fair value at the date of acquisition. Any reduction to fair value from the carrying value of the related loan at the time of acquisition is accounted for as a loan loss. After acquisition, a valuation allowance reduces the reported amount to the lower of the initial amount or fair value less costs to sell. Expenses, gains and losses on disposition, and changes in the valuation allowance are reported in other expenses. Other real estate owned was \$749 at June 30, 2006 and \$524 at June 30, 2005.

**Repurchase Agreements:** Substantially all repurchase agreement liabilities represent amounts advanced by various customers. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

**Profit Sharing Plan:** The Bank maintains a 401(k) profit sharing plan covering all eligible employees. Contributions are made and expensed annually.

**Income Taxes:** The Corporation files a consolidated federal income tax return. Income tax expense is the sum of the current-year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

**Loss Contingencies:** Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters that will have a material effect on the financial statements.

**Earnings and Dividends Declared per Share:** Earnings per common share are computed based on the weighted average common shares outstanding. The weighted average number of common shares outstanding was 2,142,479; 2,145,432 and 2,146,281 for the years ended June 30, 2006, 2005 and 2004. The Corporation's capital structure contains no dilutive securities.

**Statement of Cash Flows:** For purposes of reporting cash flows, cash and cash equivalents include the Corporation's cash on hand and due from banks. The Corporation reports net cash flows for customer loan, deposit, Federal Funds sold or purchased, and repurchase agreement

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transactions. The Bank paid \$2,950, \$1,511 and \$1,717 in interest and \$300, \$1,020, and \$845 in income taxes for the years ended June 30, 2006, 2005 and 2004, respectively.

**Comprehensive Income (loss):** Comprehensive income (loss) consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available-for-sale.

**Fair Value of Financial Instruments:** Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve

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**CONSUMERS BANCORP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

**Dividend Restrictions:** Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the holding company or by the holding company to shareholders. During the 2006 calendar year the Bank could, without prior approval, declare dividends of approximately \$2,304 plus any 2006 net profits retained to the date of the dividend declaration.

**Adoption of New Accounting Standards:** In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments: an amendment of FASB Statements No. 133 and 140 (FAS 155)*. FAS 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. FAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Corporation does not expect the adoption of FAS 155 to have a material effect on the results of operations or the statement of condition.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets: an amendment of FASB Statement No. 140* (FAS 140 and FAS 156). FAS 140 establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. This Statement amends FAS 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. Adoption of this Statement is required as of the beginning of the first fiscal year that begins after September 15, 2006. The Corporation does not expect the adoption of FAS 155 to have a material effect on the results of operations or the statement of condition.

In July 2006, the FASB released Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. This Interpretation revises the recognition tests for tax positions taken in tax returns such that a tax benefit is recorded only when it is more likely than not that the tax position will be allowed upon examination by taxing authorities. The amount of such a tax benefit to record is the largest amount that is more likely than not to be allowed. Any reduction in deferred tax assets or increase in tax liabilities upon adoption will correspondingly reduce retained earnings. The Corporation has not yet determined the effect of adopting this Interpretation, which is effective for it on July 1, 2007.

**Reclassifications:** Certain reclassifications have been made to the June 30, 2005 and 2004 financial statements to be comparable to the June 30, 2006 presentation.





**Table of Contents****CONSUMERS BANCORP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

**NOTE 2 SECURITIES**

The following table sets forth certain information regarding the amortized cost and fair value of the Corporation's securities at the dates indicated.

| Description of Securities                       | Fair<br>Value | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |
|---|---------------|------------------------------|-------------------------------|
| <b>June 30, 2006</b>                            |               |                              |                               |
| U.S. Treasury                                   | \$ 988        | \$                           | \$ (12)                       |
| Obligations of government sponsored entities    | 9,766         |                              | (355)                         |
| Obligations of state and political subdivisions | 14,298        | 9                            | (291)                         |
| Mortgage-backed securities                      | 11,418        | 5                            | (564)                         |
| Equity securities                               | 1,000         |                              |                               |
| Total securities                                | \$ 37,470     | \$ 14                        | \$ (1,222)                    |
| <b>June 30, 2005</b>                            |               |                              |                               |
| U.S. Treasury                                   | \$ 994        | \$                           | \$ (5)                        |
| Obligations of government sponsored entities    | 5,167         |                              | (71)                          |
| Obligations of state and political subdivisions | 3,697         | 60                           | (1)                           |
| Mortgage-backed securities                      | 14,875        | 20                           | (241)                         |
| Total securities                                | \$ 24,733     | \$ 80                        | \$ (318)                      |

Securities with a carrying value of approximately \$21,246 and \$19,396 were pledged at June 30, 2006 and 2005, respectively, to secure public deposits and commitments as required or permitted by law.

Proceeds from sales of all equity and debt securities during 2005 were \$2,536. Gross gains were \$66 with no losses recognized for the same period. There were no sales of equity or debt securities during 2006 and 2004.

**Table of Contents****CONSUMERS BANCORP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

Securities with unrealized losses at June 30, 2006 and 2005, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

| Description of Securities                        | Less than 12 Months |                 | 12 Months or more |                 | Total            |                   |
|--|---------------------|-----------------|-------------------|-----------------|------------------|-------------------|
|  | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value       | Unrealized Loss   |
| <b>June 30, 2006</b>                             |                     |                 |                   |                 |                  |                   |
| U.S. Treasury                                    | \$ 988              | \$ (12)         | \$                | \$              | \$ 988           | \$ (12)           |
| Obligations of government sponsored entities     | 4,720               | (161)           | 5,046             | (194)           | 9,766            | (355)             |
| Obligations of states and political subdivisions | 12,828              | (276)           | 312               | (15)            | 13,140           | (291)             |
| Mortgage-backed securities                       | 863                 | (10)            | 10,353            | (554)           | 11,216           | (564)             |
| <b>Total temporarily impaired</b>                | <b>\$ 19,399</b>    | <b>\$ (459)</b> | <b>\$ 15,711</b>  | <b>\$ (763)</b> | <b>\$ 35,110</b> | <b>\$ (1,222)</b> |
| <b>June 30, 2005</b>                             |                     |                 |                   |                 |                  |                   |
| U.S. Treasury                                    | \$                  | \$              | \$ 994            | \$ (5)          | \$ 994           | \$ (5)            |
| Obligations of government sponsored entities     | 3,163               | (42)            | 2,004             | (29)            | 5,167            | (71)              |
| Obligations of states and political subdivisions | 329                 | (1)             |                   |                 | 329              | (1)               |
| Mortgage-backed securities                       | 6,120               | (83)            | 7,464             | (158)           | 13,584           | (241)             |
| <b>Total temporarily impaired</b>                | <b>\$ 9,612</b>     | <b>\$ (126)</b> | <b>\$ 10,462</b>  | <b>\$ (192)</b> | <b>\$ 20,074</b> | <b>\$ (318)</b>   |

Unrealized losses on securities have not been recognized into income because the issuer(s) of the securities are of high credit quality and the decline in fair value is primarily due to changes in interest rates. The fair value is expected to recover as the securities approach their maturity dates.

The fair values of debt securities available-for-sale at June 30, 2006 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, primarily mortgage-backed securities, are shown separately.

|                         | <b>Fair Value</b> |
|-------------------------|-------------------|
| Due in one year or less | \$ 1,580          |

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|  |           |
|--|-----------|
| Due after one year through five years  | 6,521     |
| Due after five years through ten years | 6,821     |
| Due after ten years                    | 10,130    |
|  | <hr/>     |
| Total                                  | 25,052    |
| Mortgage-backed securities             | 11,418    |
| Equity securities                      | 1,000     |
|  | <hr/>     |
| Total                                  | \$ 37,470 |
|  | <hr/>     |

**Table of Contents****CONSUMERS BANCORP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

**NOTE 3 LOANS**

Major classifications of loans were as follows as of June 30:

|  | <u>2006</u>       | <u>2005</u>       |
|--|-------------------|-------------------|
| Real estate mortgage                   | \$ 53,630         | \$ 61,987         |
| Real estate construction               | 1,720             | 4,648             |
| Commercial, financial and agricultural | 86,621            | 76,023            |
| Installment loans to individuals       | 6,289             | 7,263             |
|  | <u>148,260</u>    | <u>149,921</u>    |
| Deferred loan fees and costs           | (258)             | (259)             |
| Allowance for loan losses              | (1,557)           | (1,523)           |
|  | <u>146,445</u>    | <u>148,139</u>    |
| <b>Net loans</b>                       | <b>\$ 146,445</b> | <b>\$ 148,139</b> |

The changes in the allowance for loan losses consists of the following for the years ended June 30:

|                               | <u>2006</u>     | <u>2005</u>     | <u>2004</u>     |
|-------------------------------|-----------------|-----------------|-----------------|
| Balance at beginning of year  | \$ 1,523        | \$ 1,753        | \$ 1,685        |
| Provision                     | 730             | 122             | 381             |
| Charge-offs                   | (824)           | (505)           | (453)           |
| Recoveries                    | 128             | 153             | 140             |
|                               | <u>1,557</u>    | <u>1,523</u>    | <u>1,753</u>    |
| <b>Balance at end of year</b> | <b>\$ 1,557</b> | <b>\$ 1,523</b> | <b>\$ 1,753</b> |

Impaired loans were as follows as of June 30:

| 2006 | 2005 |
|------|------|
|------|------|

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|   |             |             |
|---|-------------|-------------|
| Total impaired loans                          | \$ 2,803    | \$ 1,096    |
| Amount of allowance for loan losses allocated | 393         | 232         |
|   | <u>2006</u> | <u>2005</u> |
| Average of impaired loans during the year     | \$ 1,707    | \$ 1,190    |
| Interest income recognized during impairment  | 3           | 7           |
| Cash-basis interest income recognized         | 3           | 11          |

Nonperforming loans were as follows:

|  |             |             |
|--|-------------|-------------|
|  | <u>2006</u> | <u>2005</u> |
| Loans past due over 90 days and still accruing           | \$ 190      | \$ 190      |
| Loans on non-accrual                                     | 3,198       | 1,807       |
| Increase in interest income if loans had been on accrual | 157         | 104         |

The Bank has granted loans to certain of its executive officers, directors and their affiliates. A summary of activity during the year ended June 30, 2006 of related party loans were as follows:

|  |                 |
|--|-----------------|
|  | <u>2006</u>     |
| Principal balance at beginning of year | \$ 1,383        |
| New loans                              | 238             |
| Repayments                             | (196)           |
| Principal balance at end of year       | <u>\$ 1,425</u> |

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June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

**NOTE 4 PREMISES AND EQUIPMENT**

Major classifications of premises and equipment were as follows as of June 30:

|   | <u>2006</u>  | <u>2005</u>  |
|---|--------------|--------------|
| Land                                      | \$ 953       | \$ 803       |
| Land improvements                         | 311          | 356          |
| Building and leasehold improvements       | 3,287        | 3,493        |
| Furniture, fixture and equipment          | 5,186        | 5,071        |
|   | <u>9,737</u> | <u>9,723</u> |
| Total premises and equipment              | 9,737        | 9,723        |
| Accumulated depreciation and amortization | (5,089)      | (5,342)      |
|   | <u>4,648</u> | <u>4,381</u> |
| Premises and equipment, net               | \$ 4,648     | \$ 4,381     |

Depreciation was \$580, \$645 and \$661 for the years ended June 30, 2006, 2005 and 2004, respectively.

The Corporation is obligated under noncancelable operating leases for facilities. The approximate minimum annual rentals and commitments under these noncancelable agreements and leases with remaining terms in excess of one year are as follows:

|            |               |
|------------|---------------|
| 2007       | \$ 96         |
| 2008       | 96            |
| 2009       | 96            |
| 2010       | 79            |
| 2011       | 33            |
| Thereafter | 145           |
|            | <u>\$ 545</u> |

Rent expense incurred during the fiscal years ended June 30, 2006, 2005 and 2004 were \$81, \$58 and \$56, respectively.

During the 2006 fiscal year, Consumers National Bank entered into an operating lease agreement for the Malvern branch location. The lessor of the property is a member of the Corporation's Board of Directors. The initial term of the lease is a period of ten years. The base rent through the end of the fifth year is one percent of the total Project Cost, as defined in the lease agreement. At the beginning of year six, the rent to be paid shall be increased in accordance with the change in the Consumers Price Index. For years one through five, the estimated annual lease expense is \$32 per year.

For the year ended June 30, 2005, the Corporation recorded a net asset impairment/disposal loss of \$167, which included a non-cash impairment loss of \$122. At June 30, 2005, management determined that the fair value of ATMs and a building, which was in the process of being replaced, was less than their carrying values in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. The remaining \$45 loss was mainly related to the disposal of certain computer equipment.

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**NOTE 5 INTANGIBLE ASSETS**

The following summarizes the original balance and accumulated amortization of core deposit intangible assets at June 30, 2006 and 2005:

|                                | <u>2006</u>   | <u>2005</u>     |
|--------------------------------|---------------|-----------------|
| Original balance               | \$ 1,927      | \$ 1,927        |
| Less: accumulated amortization | 1,033         | 872             |
| Net balance, June 30           | <u>\$ 894</u> | <u>\$ 1,055</u> |

Amortization expense for the years ended June 30, 2006, 2005 and 2004 was \$161 for each year. Amortization expense is estimated to be \$161 for each of the next five years.

**NOTE 6 DEPOSITS**

The aggregate amount of time deposits, each with a minimum denomination of \$100, was \$19,565 and \$18,555 as of June 30, 2006 and 2005, respectively.

Scheduled maturities of time deposits at June 30, 2006 were as follows:

|            |                  |
|------------|------------------|
| 2007       | \$ 49,471        |
| 2008       | 12,149           |
| 2009       | 2,201            |
| 2010       | 849              |
| 2011       | 5                |
| Thereafter | 33               |
|            | <u>\$ 64,708</u> |



Related party deposits totaled \$1,488 as of June 30, 2006 and \$1,929 as of June 30, 2005.

#### NOTE 7 SHORT-TERM BORROWINGS

Short-term borrowings consisted of Federal funds purchased and repurchase agreements. Repurchase agreements are financing arrangements. Physical control is maintained for all securities pledged to secure repurchase agreements. Information concerning all short-term borrowings at June 30, maturing in less than one year is summarized as follows:

|                                       | <u>2006</u> | <u>2005</u> | <u>2004</u> |
|---------------------------------------|-------------|-------------|-------------|
| Balance at June 30                    | \$ 5,049    | \$ 6,046    | \$ 5,456    |
| Average balance during the year       | 5,721       | 6,176       | 5,427       |
| Maximum month-end balance             | 7,760       | 8,864       | 6,078       |
| Average interest rate during the year | 2.34%       | 1.30%       | 1.22%       |
| Weighted average rate June 30         | 2.94        | 1.75        | 1.00        |

Repurchase agreements mature daily. The Bank has pledged U.S. Treasury and agency securities with a carrying value of \$6,733 at June 30, 2006, as collateral for the repurchase agreements. Total interest expense on short-term borrowings was \$134, \$80 and \$66 for the years ended June 30, 2006, 2005 and 2004, respectively.

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**NOTE 8 FEDERAL HOME LOAN BANK ADVANCES**

A summary of Federal Home Loan Bank (FHLB) advances were as follows:

| <u>Maturity</u> | <u>Term</u> | <u>Interest Rate</u> | <u>Balance<br/>June 30, 2006</u> | <u>Balance<br/>June 30, 2005</u> |
|-----------------|-------------|----------------------|----------------------------------|----------------------------------|
| 09/25/2005      | Floating    | 3.48%                | \$                               | \$ 200                           |
| 08/08/2006      | Floating    | 5.43                 | 2,080                            |                                  |
| 09/13/2006      | Floating    | 5.43                 | 2,000                            |                                  |
| 02/01/2008      | Floating    | 5.21                 | 4,000                            |                                  |
| 06/20/2008      | Floating    | 5.54                 | 1,000                            |                                  |
| 07/01/2010      | Fixed       | 6.90                 | 64                               | 99                               |
| 10/01/2010      | Fixed       | 7.00                 | 82                               | 128                              |
| 12/01/2010      | Fixed       | 6.10                 | 226                              | 269                              |
| 04/01/2014      | Fixed       | 2.54                 | 669                              | 932                              |
| 04/01/2019      | Fixed       | 4.30                 | 669                              | 707                              |
|                 |             |                      | <u>\$ 10,790</u>                 | <u>\$ 2,335</u>                  |

Each fixed rate advance has a prepayment penalty equal to the present value of 100% of the lost cash flow based upon the difference between the contract rate on the advance and the current rate on the new advance. The following table is a summary of the scheduled principal payments for all advances:

| <u>Twelve Months Ending June 30</u> | <u>Principal<br/>Payments</u> |
|-------------------------------------|-------------------------------|
| 2007                                | \$ 4,413                      |
| 2008                                | 5,274                         |
| 2009                                | 243                           |
| 2010                                | 198                           |
| 2011                                | 133                           |
| Thereafter                          | 529                           |
|                                     | <u>\$ 10,790</u>              |

Pursuant to collateral agreements with the FHLB, advances are secured by all stock invested in the FHLB and certain qualifying first mortgage loans. As of June 30, 2006, the Bank could borrow a total of \$32,803 in advances based on the amount of FHLB stock owned. Qualifying first mortgage loans available to secure FHLB advances totaled approximately \$36,472 and \$60,095 at June 30, 2006 and 2005, respectively.

**NOTE 9 EMPLOYEE BENEFIT PLANS**

The Bank has a 401(k) savings and retirement plan available for substantially all eligible employees. Under the plan, the Bank is required to match each participant's voluntary contribution to the plan but not to exceed four percent of the individual compensation. Amounts charged to operations were \$84, \$71 and \$79, for the years ended June 30, 2006, 2005 and 2004.

The Bank has adopted a Salary Continuation Plan (the Plan) to encourage Bank executives to remain employees of the Bank. In consideration of executives entering into noncompetition, nonsolicitation and confidentiality agreements with the Bank, the Bank entered these executives into the Plan. The Plan provides

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executives with 180 months (and in the event of the executive's death, surviving spouse) salary continuation payments equal to a percentage of the executive's prior three year average of total W-2 compensation, which has not been reduced for other Bank benefit programs. Vesting under the Plan commences at age 50 and is prorated until age 65. The executive can become fully vested in the salary continuation benefits upon termination of employment following a change in control of the Bank. Payments under the Plan commence on the first day of the month following the executive's termination of employment (other than for termination for cause or suicide within two years of the date of entering into the Plan or any material misstatement of fact by the executive on any application for life insurance purchased by the Bank). For early termination benefits prior to age 65 for reasons other than death, disability, or change of control, interest is credited at an annual rate in a range of 6.0% to 7.5%, compounded monthly, on the unpaid balance of the 180 equal monthly salary continuation payments. The accrued liability for the salary continuation plan was \$589 as of June 30, 2006 and \$530 as of June 30, 2005. For the years ended June 30, 2006, 2005 and 2004, approximately \$137, \$111 and \$(17) have been charged (credited) to expense in connection with the Plan.

**NOTE 10 INCOME TAXES**

The provision for income taxes consists of the following for the years ended June 30:

|                       | <u>2006</u>   | <u>2005</u>   | <u>2004</u>   |
|-----------------------|---------------|---------------|---------------|
| Current income taxes  | \$ 259        | \$ 755        | \$ 938        |
| Deferred income taxes | 9             | 80            | (23)          |
|                       | <u>\$ 268</u> | <u>\$ 835</u> | <u>\$ 915</u> |

The net deferred income tax asset consists of the following components at June 30:

|                                  | <u>2006</u> | <u>2005</u> |
|----------------------------------|-------------|-------------|
| Deferred tax assets:             |             |             |
| Allowance for loan losses        | \$ 345      | \$ 356      |
| Deferred compensation            | 205         | 177         |
| Net unrealized securities losses | 411         | 81          |
| Intangibles                      | 67          | 56          |
| Deferred tax liabilities:        |             |             |
| Depreciation                     | (175)       | (174)       |
| Loan fees                        | (145)       | (149)       |

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|                      |                   |                   |
|----------------------|-------------------|-------------------|
| Prepaid expenses     | (73)              | (50)              |
| FHLB stock dividends | (142)             | (125)             |
|                      | <u>          </u> | <u>          </u> |
| Net deferred asset   | \$ 493            | \$ 172            |
|                      | <u>          </u> | <u>          </u> |

The difference between the provision for income taxes and amounts computed by applying the statutory income tax rate of 34% to statutory income before taxes consists of the following for the years ended June 30:

|  | <u>2006</u>       | <u>2005</u>       | <u>2004</u>       |
|--|-------------------|-------------------|-------------------|
| Income taxes computed at the statutory rate on pretax income | \$ 492            | \$ 949            | \$ 1,019          |
| Tax exempt income  | (181)             | (61)              | (56)              |
| Cash surrender value income                                  | (49)              | (52)              | (48)              |
| Other  | 6                 | (1)               |                   |
|  | <u>          </u> | <u>          </u> | <u>          </u> |
|  | \$ 268            | \$ 835            | \$ 915            |
|  | <u>          </u> | <u>          </u> | <u>          </u> |

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**NOTE 11 REGULATORY MATTERS**

The Bank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective-action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors and the regulators can lower classifications in certain cases. Failure to meet various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements.

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, under-capitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

In February 2006, the Board of Governors of the Federal Reserve System (Board) amended the asset size threshold and other criteria for determining whether a bank holding company qualifies for the Board's Small Bank Holding Company Policy Statement and an exemption from the Board's consolidated risk-based and leverage capital adequacy guidelines for bank holding companies. As of fiscal year-end 2006, the Corporation met the definition of a small bank holding company and, therefore was exempt from consolidated risk-based and leverage capital adequacy guidelines for bank holding companies. At year-end 2006, actual Bank and for year-end 2005, actual Corporation and Bank capital levels (in millions) and minimum required levels were as follows:

|  | Actual  |       | Minimum Required<br>For Capital<br>Adequacy Purposes |       | Minimum Required<br>To Be Well<br>Capitalized Under<br>Prompt Corrective<br>Action Regulations |       |
|--|---------|-------|--|-------|--|-------|
|  | Amount  | Ratio | Amount   | Ratio | Amount   | Ratio |
|  |         |       |  |       |  |       |
| June 30, 2006                            |         |       |  |       |  |       |
| Total capital (to risk weighted assets)  |         |       |  |       |  |       |
| Bank                                     | \$ 20.0 | 13.0% | \$ 12.3  | 8.0%  | \$ 15.4  | 10.0% |
| Tier 1 capital (to risk weighted assets) |         |       |  |       |  |       |
| Bank                                     | 16.4    | 10.7  | 6.2  | 4.0   | 9.2  | 6.0   |
| Tier 1 capital (to average assets)       |         |       |  |       |  |       |
| Bank                                     | 16.4    | 8.2   | 8.0  | 4.0   | 10.0   | 5.0   |
| June 30, 2005                            |         |       |  |       |  |       |
| Total capital (to risk weighted assets)  |         |       |  |       |  |       |

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|  |         |       |         |      |         |       |
|--|---------|-------|---------|------|---------|-------|
| Consolidated                             | \$ 19.9 | 13.5% | \$ 11.8 | 8.0% | \$ 14.8 | 10.0% |
| Bank                                     | 19.7    | 13.4  | 11.8    | 8.0  | 14.8    | 10.0  |
| Tier 1 capital (to risk weighted assets) |         |       |         |      |         |       |
| Consolidated                             | 18.4    | 12.5  | 5.9     | 4.0  | 8.9     | 6.0   |
| Bank                                     | 18.2    | 12.3  | 5.9     | 4.0  | 8.9     | 6.0   |
| Tier 1 capital (to average assets)       |         |       |         |      |         |       |
| Consolidated                             | 18.4    | 9.7   | 7.6     | 4.0  | 9.5     | 5.0   |
| Bank                                     | 18.2    | 9.6   | 7.6     | 4.0  | 9.5     | 5.0   |

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As of the latest regulatory examination, the Bank was categorized as well capitalized. There are no conditions or events since that examination that management believes may have changed the Bank's category.

The Corporation's principal source of funds for dividend payment is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. During the 2006 calendar year the Bank could, without prior approval, declare dividends of approximately \$2,304 plus any 2006 net profits retained to the date of the dividend declaration.

**NOTE 12 COMMITMENTS WITH OFF-BALANCE SHEET RISK**

The Bank is a party to commitments to extend credit in the normal course of business to meet the financing needs of its customers. Commitments are agreements to lend to customers providing there are no violations of any condition established in the contract. Commitments to extend credit have a fixed expiration date or other termination clause. These instruments involve elements of credit and interest rate risk more than the amount recognized in the statements of financial position. The Bank uses the same credit policies in making commitments to extend credit as it does for on-balance sheet instruments.

The Bank evaluates each customer's credit on a case by case basis. The amount of collateral obtained is based on management's credit evaluation of the customer. The amount of commitments to extend credit and the exposure to credit loss for non-performance by the customer was \$21,393 and \$15,491 as of June 30, 2006 and 2005, respectively. Of the June 30, 2006 commitments, \$20,180 carried variable rates of interest ranging from 1.99% to 10.25% and \$1,213 carried fixed rates of interest ranging from 4.50% to 8.00%. Of the June 30, 2005 commitments, \$13,400 carried variable rates of interest ranging from 1.99% to 8.00% and \$2,091 carried fixed rates of interest ranging from 5.00% to 8.00%. Financial standby letters of credit were \$2,118 and \$1,800 as of June 30, 2006 and 2005, respectively. In addition, commitments to extend credit of \$4,695 and \$4,861 as of June 30, 2006 and 2005, respectively, were available to checking account customers related to the overdraft protection program. Since some commitments to make loans expire without being used, the amount does not necessarily represent future cash commitments.



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**NOTE 13 FAIR VALUE DISCLOSURES OF FINANCIAL INSTRUMENTS**

The following table shows the estimated fair value at June 30, 2006 and 2005, and the related carrying value of financial instruments:

|  | 2006               |                            | 2005               |                            |
|--|--------------------|----------------------------|--------------------|----------------------------|
|  | Carrying<br>Amount | Estimated<br>Fair<br>Value | Carrying<br>Amount | Estimated<br>Fair<br>Value |
| <b>Financial Assets</b>                |                    |                            |                    |                            |
| Cash and cash equivalents              | \$ 5,941           | \$ 5,941                   | \$ 5,969           | \$ 5,969                   |
| Securities available-for-sale          | 37,470             | 37,470                     | 24,733             | 24,733                     |
| Loans, net                             | 146,445            | 146,967                    | 148,139            | 148,036                    |
| Cash surrender value of life insurance | 4,139              | 4,139                      | 3,994              | 3,994                      |
| Accrued interest receivable            | 889                | 889                        | 661                | 661                        |
| <b>Financial Liabilities</b>           |                    |                            |                    |                            |
| Demand and savings deposits            | (102,600)          | (102,600)                  | (105,832)          | (105,832)                  |
| Time deposits                          | (64,708)           | (64,674)                   | (56,667)           | (56,854)                   |
| Short-term borrowings                  | (5,049)            | (5,049)                    | (6,046)            | (6,046)                    |
| Federal Home Loan Bank advances        | (10,790)           | (10,768)                   | (2,335)            | (2,341)                    |
| Accrued interest payable               | (308)              | (308)                      | (229)              | (229)                      |

For purposes of the above disclosures of estimated fair value, the following assumptions were used. Estimated fair value for cash and due from banks was considered to approximate cost. Estimated fair value of securities was based on quoted market values for the individual securities or equivalent securities. Fair value for loans was estimated for portfolios of loans with similar financial characteristics. For adjustable rate loans that reprice at least annually and for fixed rate commercial loans with maturities of six months or less which possess normal risk characteristics, carrying value was determined to be fair value. Fair value of other types of loans (including adjustable rate loans which reprice less frequently than annually and fixed rate term loans or loans which possess higher risk characteristics) was estimated by discounting future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for similar anticipated maturities. Fair value for non-accrual loans was based on recent appraisals of the collateral or, if appropriate, using estimated discounted cash flows.

Fair value of core deposits, including demand deposits, savings accounts and certain money market deposits, was the amount payable on demand. Fair value of fixed-maturity certificates of deposit was estimated using the rates offered at June 30, 2006 and 2005, for deposits of similar remaining maturities. Estimated fair value does not include the benefit that result from low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market. Fair value of accrued interest was determined to be the carrying amounts since these financial instruments generally represent obligations that are due on demand. The fair value of unrecorded commitments at June 30, 2006 and 2005 was not material.



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**NOTE 14 PARENT COMPANY FINANCIAL STATEMENTS**

Condensed financial information of Consumers Bancorp. Inc. (parent company only) follows:

|   | <u>June 30,</u><br><u>2006</u> | <u>June 30,</u><br><u>2005</u> |
|---|--------------------------------|--------------------------------|
| <b>Condensed Balance Sheets</b>                   |                                |                                |
| Assets  |                                |                                |
| Cash  | \$ 544                         | \$ 167                         |
| Subordinated debenture receivable from subsidiary | 2,000                          |                                |
| Other assets                                      | 40                             | 8                              |
| Investment in subsidiary                          | 16,524                         | 19,122                         |
| Total assets                                      | <u>\$ 19,108</u>               | <u>\$ 19,297</u>               |
| Liabilities                                       |                                |                                |
| Other liabilities                                 | \$ 6                           | \$                             |
| Shareholders' equity                              | 19,102                         | 19,297                         |
| Total liabilities & shareholders' equity          | <u>\$ 19,108</u>               | <u>\$ 19,297</u>               |

|  | <u>Year Ended</u><br><u>June 30, 2006</u> | <u>Year Ended</u><br><u>June 30, 2005</u> | <u>Year Ended</u><br><u>June 30, 2004</u> |
|--|---|---|---|
| <b>Condensed Statements of Income</b>  |   |   |   |
| Cash dividends from subsidiary   | \$ 3,192                                  | \$ 797                                    | \$ 755                                    |
| Other income   |   | 43  | 6   |
| Other expense  | 82  | 59  | 20  |
| Income before income taxes and equity in undistributed net income of subsidiary      | <u>3,110</u>                              | <u>781</u>                                | <u>741</u>                                |
| Income tax benefit   | (26)                                      |   |   |
| Income before equity in undistributed net income of subsidiary                       | <u>3,136</u>                              | <u>781</u>                                | <u>741</u>                                |
| Equity in undistributed net income (dividends in excess of net income) of subsidiary | <u>(1,958)</u>                            | <u>1,174</u>                              | <u>1,342</u>                              |

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|   | \$ 1,178                            | \$ 1,955                            | \$ 2,083                            |
|---|-------------------------------------|-------------------------------------|-------------------------------------|
|   | <u>Year Ended<br/>June 30, 2006</u> | <u>Year Ended<br/>June 30, 2005</u> | <u>Year Ended<br/>June 30, 2004</u> |
| Net income                                      | \$ 1,178                            | \$ 1,955                            | \$ 2,083                            |
| <b>Condensed Statements of Cash Flows</b>       |                                     |                                     |                                     |
| Cash flows from operating activities            |                                     |                                     |                                     |
| Net income                                      | \$ 1,178                            | \$ 1,955                            | \$ 2,083                            |
| Dividends in excess of net income of subsidiary | 1,958                               | (1,174)                             | (1,342)                             |
| Gain on sale of securities                      |                                     | (31)                                |                                     |
| Change in other assets and liabilities          | (26)                                | (26)                                |                                     |
| Net cash flows from operating activities        | <u>3,110</u>                        | <u>724</u>                          | <u>741</u>                          |
| Cash flows from investing activities            |                                     |                                     |                                     |
| Sales of securities available-for-sale          |                                     | 177                                 |                                     |
| Issuance of subordinated note                   | (2,000)                             |                                     |                                     |
| Net cash flows from investing activities        | <u>(2,000)</u>                      | <u>177</u>                          |                                     |
| Cash flows from financing activities            |                                     |                                     |                                     |
| Dividend paid                                   | (686)                               | (772)                               | (730)                               |
| Purchase of treasury stock                      | (47)                                | (52)                                |                                     |
| Net cash used by financing activities           | <u>(733)</u>                        | <u>(824)</u>                        | <u>(730)</u>                        |
| Change in cash and cash equivalents             | 377                                 | 77                                  | 11                                  |
| Cash and cash equivalents, beginning of year    | 167                                 | 90                                  | 79                                  |
| Cash and cash equivalents, end of year          | <u>\$ 544</u>                       | <u>\$ 167</u>                       | <u>\$ 90</u>                        |

**Table of Contents****CONSUMERS BANCORP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

June 30, 2006, 2005 and 2004

(Dollar amounts in thousands, except per share data)

**NOTE 15 OTHER COMPREHENSIVE INCOME**

|  | <u>2006</u>     | <u>2005</u>  | <u>2004</u>     |
|--|-----------------|--------------|-----------------|
| Unrealized holding gains (losses) on available-for-sale securities     | \$ (970)        | \$ 151       | \$ (775)        |
| Less reclassification adjustments for gains later recognized in income |                 | (66)         |                 |
| Net unrealized gains (losses)  | (970)           | 85           | (775)           |
| Tax effect   | 330             | (29)         | 264             |
| Other comprehensive income (loss)                                      | <u>\$ (640)</u> | <u>\$ 56</u> | <u>\$ (511)</u> |

**NOTE 16 QUARTERLY FINANCIAL DATA (Unaudited)**

|                | <u>Interest<br/>Income</u> | <u>Net Interest<br/>Income</u> | <u>Net<br/>Income</u> | <u>Earnings<br/>per Share-Basic</u> |
|----------------|----------------------------|--------------------------------|-----------------------|-------------------------------------|
| <b>2006</b>    |                            |                                |                       |                                     |
| First Quarter  | \$ 2,707                   | \$ 2,109                       | \$ 378                | \$ 0.18                             |
| Second Quarter | 2,856                      | 2,109                          | 316                   | 0.15                                |
| Third Quarter  | 2,888                      | 2,057                          | 297                   | 0.14                                |
| Fourth Quarter | 2,936                      | 2,083                          | 187                   | 0.09                                |
| <b>2005</b>    |                            |                                |                       |                                     |
| First Quarter  | \$ 2,638                   | \$ 2,291                       | \$ 674                | \$ 0.31                             |
| Second Quarter | 2,574                      | 2,204                          | 561                   | 0.26                                |
| Third Quarter  | 2,551                      | 2,122                          | 444                   | 0.21                                |
| Fourth Quarter | 2,621                      | 2,172                          | 276                   | 0.13                                |

The fourth quarter of 2006 includes provision for loan loss expense of \$416, or \$275 after-tax due to information obtained during the fourth quarter related to two commercial real estate loan relationships. The fourth quarter of 2005 includes expense of \$155, or \$102 after-tax, related to asset disposals, impairment and additional depreciation expense as old ATM and computer equipment were replaced and due to fully depreciating assets as a result of a change in estimated useful lives.

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**ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A CONTROLS AND PROCEDURES**

The management of the Corporation is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934. As of June 30, 2006, an evaluation was performed under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure and controls procedures. Based on that evaluation, management concluded that the Corporation's disclosure controls and procedures as of June 30, 2006 were effective in ensuring that information required to be disclosed in this Annual Report on Form 10-K were recorded, processed, summarized and reported within the time period required by the United States Securities and Exchange Commission's rules and forms.

There was no change in the Corporation's internal control over financial reporting that occurred during the quarter ended June 30, 2006 that has materially affected, or is reasonably likely to materially affect the Corporation's internal control over financial reporting.

**ITEM 9B OTHER INFORMATION**

None.

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**PART III**

**ITEM 10 DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

The information required by this item as to the Corporation's directors and executive officers is set forth in the Corporation's Proxy Statement dated September 14, 2006 under the captions "Election of Directors" on page 2, "Directors and Executive Officers" on pages 3 and 4, "The Board of Directors and its Committees" on pages 5 and 6, "Section 16(a) Beneficial Ownership Reporting Compliance" on page 14, and "Certain Transactions and Relationships" on page 14, and is incorporated herein by reference.

The Corporation's Code of Ethics Policy, which is applicable to all directors, officers and employees of the Corporation, and its Code of Ethics for Principal Financial Officers, which is applicable to the principal executive officer and the principal financial officer, are each available on the Investor Relations section under Required Disclosures of the corporation's website ([www.consumersbancorp.com](http://www.consumersbancorp.com)). Copies of either of the Code of Ethics Policies are also available in print to share owners upon request, addressed to the Corporate Secretary at Consumers Bancorp, Inc., 614 East Lincoln Way, Minerva, Ohio 44657. The Corporation intends to post amendments to or waivers from its Code of Ethics on its website.

**ITEM 11 EXECUTIVE COMPENSATION**

The information required by this item is set forth in the Corporation's Proxy Statement dated September 14, 2006 under the captions "Compensation of Directors" on page 7, "Executive Compensation" on page 9, "Defined Contribution Plan" on page 9, "Salary Continuation Program" on page 10, "Change of Control Agreements" on pages 10-11, "Compensation Committee Report on Compensation" on pages 11-12, and "Executive & Compensation Committees Interlocks and Insider Participation" on page 13, and is incorporated herein by reference.

**ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item is set forth in the Corporation's Proxy Statement dated September 14, 2006 under the caption "Security Ownership of Certain Beneficial Owners and Management" on pages 7-8, and is incorporated herein by reference.

**ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information required by this item is set forth in the Corporation's Proxy Statement dated September 14, 2006 under the caption "Certain Transactions and Relationships" on page 14, and is incorporated herein by reference.

**ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this item is set forth in the Corporation's Proxy Statement dated September 14, 2006 under the caption "Auditor's Fees" on page 15, and is incorporated herein by reference.



**Table of Contents****PART IV****ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES****(a) 1. FINANCIAL STATEMENTS**

The consolidated financial statements required in response to this Item are incorporated by reference to Item 8 of this Report.

**(a) 2. FINANCIAL STATEMENT SCHEDULES**

Not applicable

**(a) 3. EXHIBITS**

| <b>Exhibit Number</b> | <b>Description of Document</b>   |
|-----------------------|--|
| 3.1                   | Amended and Restated Articles of Incorporation of the Corporation. Reference is made to Exhibit A to the Definitive Proxy Statement of the Corporation filed September 28, 2000, which exhibit is incorporated herein by reference. Reference is also made to page 5 of the Definitive Proxy Statement of the Corporation filed September 17, 2001 for an amendment to the Amended and Restated Articles of Incorporation to increase the number of Consumers Bancorp, Inc.'s authorized common shares to two million five hundred thousand. |
| 3.2                   | Amended and Restated Code of Regulations of the Corporation. Reference is made to Exhibit A to the Definitive Proxy Statement of the Corporation filed September 9, 2002, which is incorporated herein by reference.   |
| 4                     | Form of Certificate of Common Shares. Reference is made to Form 10-KSB of the Corporation filed September 26, 2002, which is incorporated herein by reference.   |
| 10.1                  | Salary Continuation agreement entered into with Mr. Muckley on March 1, 2005. Reference is made to Form 10-K of the Corporation filed September 15, 2005, which is incorporated herein by reference.   |
| 10.2                  | Form of Change of Control agreement entered into with Ms. Wood and Mr. Hugenberg on July 1, 2005. Reference is made to Form 10-K of the Corporation filed September 15, 2005, which is incorporated herein by reference.   |
| 10.3                  | Lease Agreement entered into between Furey Holdings, LLC and Consumers National Bank on December 23, 2005. Reference is made to Form 10-Q of the Corporation filed February 14, 2006, which is incorporated herein by reference.   |
| 11                    | Computation of Earnings per Share. Reference is made to this Annual Report on Form 10-K Note 1, page 32, which is incorporated herein by reference.  |
| 21                    | Subsidiaries of Consumers Bancorp, Inc. filed with this Annual Report on Form 10-K.  |

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- 31.1 Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer and Treasurer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of President and Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer and Treasurer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**CONSUMERS BANCORP, INC.**

Date September 14, 2006

By: */s/ STEVEN L. MUCKLEY*  
**President and Chief Executive Officer**

By: */s/ RENEE K. WOOD*  
**Chief Financial Officer and Treasurer**

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of registrant and in the capacities indicated on September 14, 2006.

**Signatures**

*/s/ LAURIE L. McCLELLAN*

**Laurie L. McClellan**

**Chairman of the Board of Directors**

*/s/ JOHN P. FUREY*

**John P. Furey**

**Director**

*/s/ DAVID W. JOHNSON*

**David W. Johnson**

**Director**

*/s/ THOMAS M. KISHMAN*

**Thomas M. Kishman**

**Director**

*/s/ JOHN E. TONTI*

**John E. Tonti**

**Director**

**Signatures**

*/s/ STEVEN L. MUCKLEY*

**Steven L. Muckley**

**President, Chief Executive Officer and Director**

*/s/ JAMES V. HANNA*

**James V. Hanna**

**Director**

*/s/ JAMES R. KIKO, SR.*

**James R. Kiko, Sr.**

**Director**

*/s/ HARRY W. SCHMUCK, JR.*

**Harry W. Schmuck, Jr.**

**Director**

*/s/ WALTER J. YOUNG*

**Walter J. Young**

**Director**



**Table of Contents****EXHIBIT INDEX**

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