

Magyar Bancorp, Inc.  
Form 10-Q  
February 11, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Under Section 13 or 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2012

Commission File Number **000-51726**

**Magyar Bancorp, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**20-4154978**

(I.R.S. Employer Identification Number)

**400 Somerset Street, New Brunswick, New Jersey**

(Address of Principal Executive Office)

**08901**

(Zip Code)

**(732) 342-7600**

(Issuer's Telephone Number including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required

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to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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

Class	Outstanding at February 1, 2013
Common Stock, \$0.01 Par Value	5,807,344

MAGYAR BANCORP, INC.

Form 10-Q Quarterly Report

Table of Contents

PART I. FINANCIAL INFORMATION

	Page Number
<u>Item 1. Financial Statements</u>	1
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	33
<u>Item 4. Controls and Procedures</u>	33

PART II. OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	34
<u>Item 1a. Risk Factors</u>	34
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
<u>Item 3. Defaults Upon Senior Securities</u>	34
<u>Item 4. Mine Safety Disclosures</u>	34
<u>Item 5. Other Information</u>	34
<u>Item 6. Exhibits</u>	34
<u>Signature Pages</u>	36

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## MAGYAR BANCORP, INC. AND SUBSIDIARY

## Consolidated Balance Sheets

(In Thousands, Except Share and Per Share Data)

	December 31, 2012 (Unaudited)	September 30, 2012
Assets		
Cash	\$1,211	\$ 930
Interest earning deposits with banks	10,616	9,114
Total cash and cash equivalents	11,827	10,044
Investment securities - available for sale, at fair value	14,739	16,786
Investment securities - held to maturity, at amortized cost (fair value of \$42,268 and \$42,130 at December 31, 2012 and September 30, 2012, respectively)	41,213	41,068
Federal Home Loan Bank of New York stock, at cost	2,322	2,385
Loans receivable, net of allowance for loan losses of \$4,094 and \$3,858 at December 31, 2012 and September 30, 2012, respectively)	391,722	385,270
Bank owned life insurance	10,094	10,010
Accrued interest receivable	1,833	1,894
Premises and equipment, net	21,390	21,541
Other real estate owned ("OREO")	12,979	13,381
Other assets	6,485	6,467
Total assets	\$514,604	\$ 508,846
Liabilities and Stockholders' Equity		
Liabilities		
Deposits	\$424,377	\$ 416,518
Escrowed funds	863	769
Federal Home Loan Bank of New York advances	35,103	36,503
Securities sold under agreements to repurchase	5,000	5,000
Accrued interest payable	216	196
Accounts payable and other liabilities	3,874	4,855
Total liabilities	469,433	463,841

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Stockholders' equity		
Preferred stock: \$.01 Par Value, 1,000,000 shares authorized; none issued	—	—
Common stock: \$.01 Par Value, 8,000,000 shares authorized; 5,923,742 issued; 5,807,344 shares outstanding at December 31, 2012 and September 30, 2012, at cost	59	59
Additional paid-in capital	26,357	26,367
Treasury stock: 116,398 shares at December 31, 2012 and September 30, 2012, at cost	(1,301 )	(1,301 )
Unearned Employee Stock Ownership Plan shares	(1,087 )	(1,116 )
Retained earnings	21,882	21,600
Accumulated other comprehensive loss	(739 )	(604 )
Total stockholders' equity	45,171	45,005
Total liabilities and stockholders' equity	\$514,604	\$ 508,846

The accompanying notes are an integral part of these statements.

Table of Contents

## MAGYAR BANCORP, INC. AND SUBSIDIARY

## Consolidated Statements of Operations

(In Thousands, Except Per Share Data)

	For the Three Months Ended December 31, 2012      2011 (Unaudited)	
Interest and dividend income		
Loans, including fees	\$ 4,546	\$ 4,706
Investment securities		
Taxable	379	541
Tax-exempt	1	1
Federal Home Loan Bank of New York stock	28	24
Total interest and dividend income	4,954	5,272
Interest expense		
Deposits	816	1,102
Borrowings	358	504
Total interest expense	1,174	1,606
Net interest and dividend income	3,780	3,666
Provision for loan losses	441	370
Net interest and dividend income after provision for loan losses	3,339	3,296
Other income		
Service charges	231	267
Income on bank owned life insurance	84	84
Other operating income	17	28
Gains on sales of loans	265	116
Gains on sales of investment securities	64	84
Total other income	661	579
Other expenses		
Compensation and employee benefits	1,798	1,855
Occupancy expenses	698	729
Professional fees	225	233
Data processing expenses	140	122
OREO expenses	141	258

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FDIC deposit insurance premiums	174	176
Loan servicing expenses	52	96
Insurance expense	56	62
Other expenses	302	306
Total other expenses	3,586	3,837
Income before income tax expense	414	38
Income tax expense	132	7
Net income	\$ 282	\$ 31
Net income per share-basic and diluted	\$ 0.05	\$ 0.01

The accompanying notes are an integral part of these statements.

Table of Contents

MAGYAR BANCORP, INC. AND SUBSIDIARY

Consolidated Statements of Comprehensive Income

(In Thousands)

	For the Three Months Ended December 31, 2012          2011 (Unaudited)	
Net income	\$ 282	\$ 31
Other comprehensive loss:		
Net unrealized (loss) gain on securities available for sale	(129 )	73
Realized gains on sales of securities available for sale	(64 )	(84 )
Unrealized loss on derivatives	(20 )	(23 )
	(213 )	(34 )
Deferred income tax effect	78	11
Total other comprehensive loss	(135 )	(23 )
Total comprehensive income	\$ 147	\$ 8

The accompanying notes are an integral part of these statements.



Table of Contents

## MAGYAR BANCORP, INC. AND SUBSIDIARY

## Consolidated Statement of Changes in Stockholders' Equity

For the Three Months Ended December 31, 2012

(In Thousands, Except for Share Amounts)

	Common Stock Shares Outstanding (Unaudited)	Par Value	Additional Paid-In Capital	Treasury Stock	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, September 30, 2012	5,807,344	\$ 59	\$ 26,367	\$(1,301)	\$(1,116)	\$ 21,600	\$ (604 )	\$ 45,005
Net income	—	—	—	—	—	282	—	282
Other comprehensive loss	—	—	—	—	—	—	(135 )	(135 )
ESOP shares allocated	—	—	(14 )	—	29	—	—	15
Stock-based compensation expense	—	—	4	—	—	—	—	4
Balance, December 31, 2012	5,807,344	\$ 59	\$ 26,357	\$(1,301)	\$(1,087)	\$ 21,882	\$ (739 )	\$ 45,171

The accompanying notes are an integral part of these statements.

Table of Contents

## MAGYAR BANCORP, INC. AND SUBSIDIARY

## Consolidated Statements of Cash Flows

(In Thousands)

	For the Three Months Ended December 31,	
	2012	2011
	(Unaudited)	
Operating activities		
Net income	\$ 282	\$ 31
Adjustment to reconcile net income to net cash provided by operating activities		
Depreciation expense	228	247
Premium amortization on investment securities, net	46	65
Provision for loan losses	441	370
Proceeds from the sales of loans	2,936	2,926
Gains on sale of loans	(265 )	(116 )
Gains on sales of investment securities	(64 )	(84 )
Losses on the sales of other real estate owned	8	32
ESOP compensation expense	15	8
Stock-based compensation expense	4	102
Deferred income tax benefit	132	5
Decrease (increase) in accrued interest receivable	61	(51 )
Increase in surrender value bank owned life insurance	(84 )	(84 )
Increase in other assets	(90 )	(213 )
Increase in accrued interest payable	20	25
Increase (decrease) in accounts payable and other liabilities	(981 )	272
Net cash provided by operating activities	2,689	3,535
Investing activities		
Net increase in loans receivable	(9,564 )	(9,650 )
Purchases of investment securities held to maturity	(4,069 )	(5,988 )
Purchases of investment securities available for sale	—	(6,123 )
Sales of investment securities available for sale	1,064	2,479
Principal repayments on investment securities held to maturity	3,894	3,720
Principal repayments on investment securities available for sale	837	1,806
Purchases of premises and equipment	(77 )	(19 )
Investment in other real estate owned	(160 )	(5 )
Proceeds from the sale of other real estate owned	553	3,215
Redemption of Federal Home Loan Bank stock	63	—
Net cash used by investing activities	(7,459 )	(10,565 )
Financing activities		
Net increase in deposits	7,859	2,034

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Stock compensation tax benefit	—	—	
Net increase (decrease) in escrowed funds	94	(134	)
Net change in short-term advances	(1,400	)	—
Purchase of treasury stock	—	(21	)
Net cash provided by financing activities	6,553	1,879	
Net increase (decrease) in cash and cash equivalents	1,783	(5,151	)
Cash and cash equivalents, beginning of period	10,044	15,034	
Cash and cash equivalents, end of period	\$ 11,827	\$ 9,883	
Supplemental disclosures of cash flow information			
Cash paid for			
Interest	\$ 1,154	\$ 1,581	
Income taxes	\$ 50	\$ —	
Non-cash investing activities			
Real estate acquired in full satisfaction of loans in foreclosure	\$ —	\$ 1,373	

The accompanying notes are an integral part of these statements.

Table of Contents

**MAGYAR BANCORP, INC. AND SUBSIDIARY**

Notes to Consolidated Financial Statements

(Unaudited)

**NOTE A – BASIS OF PRESENTATION**

The consolidated financial statements include the accounts of Magyar Bancorp, Inc. (the “Company”), its wholly owned subsidiary, Magyar Bank (the “Bank”), and the Bank’s wholly owned subsidiaries Magyar Service Corporation, Hungaria Urban Renewal, LLC, and MagBank Investment Company. All material intercompany transactions and balances have been eliminated. The Company prepares its financial statements on the accrual basis and in conformity with accounting principles generally accepted in the United States of America ("US GAAP"). The unaudited information furnished herein reflects all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented.

Operating results for the three months ended December 31, 2012 are not necessarily indicative of the results that may be expected for the year ending September 30, 2013. The September 30, 2012 information has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by US GAAP for complete financial statements.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of other real estate owned, and the assessment of realizability of deferred income tax assets.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2012 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

NOTE B- RECENT ACCOUNTING PRONOUNCEMENTS

In connection with the preparation of quarterly and annual reports in accordance with the Securities and Exchange Commission's (SEC) Securities Exchange Act of 1934, SEC Staff Accounting Bulletin Topic 11.M requires the disclosure of the impact that recently issued accounting standards will have on financial statements when they are adopted in the future.

The FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, to amend FASB ASC Topic 820, Fair Value Measurements, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The ASU clarifies existing guidance for items such as: the application of the highest and best use concept to non-financial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity's stockholder's equity; and disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of level 3 assets. The ASU also creates an exception to Topic 820 for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The ASU also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in level 2 or 3 of the fair value hierarchy. Lastly, the ASU contains new disclosure requirements regarding fair value amounts categorized as level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of nonfinancial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. This ASU is effective for interim and annual periods beginning after December 15, 2011. The adoption of this ASU did not have a material impact on the consolidated financial statements.

Table of Contents

## NOTE C - CONTINGENCIES

The Company, from time to time, is a party to routine litigation that arises in the normal course of business. In the opinion of management, the resolution of this litigation, if any, would not have a material adverse effect on the Company's consolidated financial position or results of operations.

## NOTE D - EARNINGS PER SHARE

Basic and diluted earnings per share for the three months ended December 31, 2012 and 2011 were calculated by dividing net income by the weighted-average number of shares outstanding for the period. All stock options and restricted stock awards were anti-dilutive for the three months ended December 31, 2012 and the three months ended December 31, 2011. The following table shows the Company's earnings per share for the periods presented:

	For the Three Months Ended December 31,					
	2012			2011		
	Weighted average share Incomeshares	Per Amount	Weighted average share Incomeshares	Per Amount	Weighted average share Incomeshares	Per Amount
	(In thousands, except per share data)					
Basic EPS						
Net income available to common shareholders	\$282	5,809	\$0.05	\$31	5,813	\$0.01
Effect of dilutive securities						
Options and grants	—	—	—	—	—	—
Diluted EPS						
Net income available to common shareholders plus assumed conversion	\$282	5,809	\$0.05	\$31	5,813	\$0.01

Options to purchase 188,276 shares of common stock at a weighted average price of \$14.61 and 10,364 shares of restricted shares at a weighted average price of \$4.43 were outstanding and not included in the computation of diluted earnings per share for the three months ended December 31, 2012 because the grant (or option strike) price was greater than the average market price of the common shares during the periods. Options to purchase 188,276 shares of common stock at an average price of \$14.61 and 17,030 restricted shares at a weighted average price of \$9.22 were outstanding and not included in the computation of diluted earnings per share for the three months ended December 31, 2011 because the grant (or option strike) price was greater than the average market price of the common shares during the periods.

NOTE E – STOCK-BASED COMPENSATION AND STOCK REPURCHASE PROGRAM

The Company follows FASB Accounting Standards Codification (“ASC”) Section 718, Compensation-Stock Compensation, which covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. ASC 718 requires that compensation cost relating to share-based payment transactions be recognized in financial statements. The cost is measured based on the fair value of the equity or liability instruments issued.

ASC 718 also requires the Company to realize as a financing cash flow rather than an operating cash flow, as previously required, the benefits of realized tax deductions in excess of previously recognized tax benefits on compensation expense. In accordance with SEC Staff Accounting Bulletin (“SAB”) No. 107, the Company classified share-based compensation for employees and outside directors within “compensation and employee benefits” in the consolidated statement of operations to correspond with the same line item as the cash compensation paid.

Stock options generally vest over a five-year service period and expire ten years from issuance. Management recognizes compensation expense for all option grants over the awards’ respective requisite service periods. The fair values of all option grants were estimated using the Black-Scholes option-pricing model. Since there was limited historical information on the volatility of the Company’s stock, management also considered the average volatilities of similar entities for an appropriate period in determining the assumed volatility rate used in the estimation of fair value. Management estimated the expected life of the options using the simplified method allowed under SAB No. 107. The 7-year Treasury yield in effect at the time of the grant provided the risk-free rate for periods within the contractual life of the option. Management recognizes compensation expense for the fair values of these awards, which have graded vesting, on a straight-line basis over the requisite service period of the awards. Once vested, these awards are irrevocable. Shares will be obtained from either the open market or treasury stock upon share option exercise.

Table of Contents

Restricted shares generally vest over a five-year service period on the anniversary of the grant date. Once vested, these awards are irrevocable. The product of the number of shares granted and the grant date market price of the Company's common stock determine the fair value of restricted shares under the Company's restricted stock plans. Management recognizes compensation expense for the fair value of restricted shares on a straight-line basis over the requisite service period.

The following is a summary of the status of the Company's stock option activity and related information for its option plan for the three months ended December 31, 2012:

	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
Balance at September 30, 2012	188,276	\$ 14.61		
Granted	—	—		
Exercised	—	—		
Forfeited	—	—		
Balance at December 31, 2012	188,276	\$ 14.61	4.2 years	\$ —
Exercisable at December 31, 2012	188,276	\$ 14.61	4.2 years	\$ —

The following is a summary of the Company's non-vested stock awards as of December 31, 2012 and changes during the three months ended December 31, 2012:

	Number of Stock Awards	Weighted Average Grant Date Fair Value
Balance at September 30, 2012	13,402	\$ 4.43
Granted	—	—
Vested	—	—
Forfeited	—	—
Balance at December 31, 2012	13,402	\$ 4.43

Stock option and stock award expenses included with compensation expense were \$0 and \$4,000, respectively, for the three months ended December 31, 2012, and \$40,000 and \$62,000, respectively, for the three months ended December 31, 2011.

The Company announced in November 2007 its second stock repurchase program of up to 5% of its publicly-held outstanding shares of common stock, or 129,924 shares. Through December 31, 2012, the Company had repurchased



a total of 81,000 shares of its common stock at an average cost of \$8.33 per share under this program. No shares were repurchased during the three months ended December 31, 2012. Under the stock repurchase program, 48,924 shares of the 129,924 shares authorized remained available for repurchase as of December 31, 2012. The Company's intended use of the repurchased shares is for general corporate purposes, including the funding of awards granted under the 2006 Equity Incentive Plan.

The Company has an Employee Stock Ownership Plan ("ESOP") for the benefit of employees of the Company and the Bank who meets the eligibility requirements as defined in the plan. The ESOP trust purchased 217,863 shares of common stock in the open market using proceeds of a loan from the Company. The total cost of shares purchased by the ESOP trust was \$2.3 million, reflecting an average cost per share of \$10.58. The Bank will make cash contributions to the ESOP on an annual basis sufficient to enable the ESOP to make the required loan payments to the Company. The loan bears a variable interest rate that adjusts annually every January 1<sup>st</sup> to the then published Prime Rate (3.25% at January 1, 2012) with principal and interest payable annually in equal installments over thirty years. The loan is secured by shares of the Company's stock.

Table of Contents

As the debt is repaid, shares are released as collateral and allocated to qualified employees. Accordingly, the shares pledged as collateral are reported as unearned ESOP shares in the Consolidated Balance Sheet. As shares are released from collateral, the Company reports compensation expense equal to the then current market price of the shares, and the shares become outstanding for earnings per share computations.

At December 31, 2012, shares allocated to participants totaled 103,545. Unallocated ESOP shares held in suspense totaled 114,318 at December 31, 2012 and had a fair market value of \$480,136. The Company's expense for the ESOP was \$15,000 and \$8,000 for the three months ended December 31, 2012 and 2011, respectively.

## NOTE F – OTHER COMPREHENSIVE LOSS

The components of other comprehensive loss and the related income tax effects are as follows:

	Three Months Ended December 31,					
	2012		2011			
	Before Tax	Tax Benefit	Net of Tax	Before Tax	Tax Benefit	Net of Tax
	Amount	(Expense)	Amount	Amount	(Expense)	Amount
	(Dollars in thousands)					
Unrealized holding gains (losses) arising during period on:						
Available-for-sale investments	\$(129)	\$ 44	\$ (85 )	\$73	\$ (32 )	\$ 41
Less reclassification adjustment for gains realized in net income	(64 )	26	(38 )	(84)	34	(50 )
Interest rate derivatives	(20 )	8	(12 )	(23)	9	(14 )
Other comprehensive loss, net	\$(213)	\$ 78	\$ (135 )	\$(34)	\$ 11	\$ (23 )

## NOTE G – FAIR VALUE DISCLOSURES

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Our securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other assets or liabilities on a non-recurring basis, such as

held-to-maturity securities, mortgage servicing rights, loans receivable and other real estate owned, or OREO. These non-recurring fair value adjustments involve the application of lower-of-cost-or-market accounting or write-downs of individual assets.

In accordance with ASC 820, we group our assets and liabilities at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

**Level 1 -** Valuation is based upon quoted prices for identical instruments traded in active markets.

**Level 2 -** Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.

**Level 3 -** Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques. The results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability.

Table of Contents

We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The following is a description of valuation methodologies used for assets measured at fair value on a recurring basis.

Securities available-for-sale

Our available-for-sale portfolio is carried at estimated fair value on a recurring basis, with any unrealized gains and losses, net of taxes, reported as accumulated other comprehensive income/loss in stockholders' equity. Our securities available-for-sale portfolio consists of U.S government and government-sponsored enterprise obligations, municipal bonds, and mortgage-backed securities. The fair values of these securities are obtained from an independent nationally recognized pricing service. Our independent pricing service provides us with prices which are categorized as Level 2, as quoted prices in active markets for identical assets are generally not available for the securities in our portfolio. Various modeling techniques are used to determine pricing for our mortgage-backed securities, including option pricing and discounted cash flow models. The inputs to these models include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data.

Derivative financial instruments

The Company uses interest rate floors to manage its interest rate risk. The interest rate floors have been designated as cash flow hedging instruments. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities.

The following table provides the level of valuation assumptions used to determine the carrying value of our assets measured at fair value on a recurring basis.

	Fair Value at December 31, 2012			
	Total	Level 1	Level 2	Level 3
	(Dollars in thousands)			
Securities available for sale:				
Obligations of U.S. government agencies:				
Mortgage backed securities - residential	\$ 1,809	\$ —	\$ 1,809	\$ —
Obligations of U.S. government-sponsored enterprises:				
Mortgage-backed securities-residential	7,744	—	7,744	—
Mortgage backed securities-commercial	4,174	—	4,174	—

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Private label mortgage-backed securities-residential	1,012	—	1,012	—
Total securities available for sale	\$ 14,739	\$ —	\$ 14,739	\$ —

Fair Value at September 30, 2012  
 Total      Level 1      Level 2      Level 3  
 (Dollars in thousands)

Securities available for sale:				
Obligations of U.S. government agencies:				
Mortgage backed securities - residential	\$ 1,861	\$ —	\$ 1,861	\$ —
Obligations of U.S. government-sponsored enterprises:				
Mortgage-backed securities-residential	8,575	—	8,575	—
Mortgage backed securities-commercial	4,228	—	4,228	—
Debt securities	1,067	—	1,067	—
Private label mortgage-backed securities-residential	1,055	—	1,055	—
Total securities available for sale	\$ 16,786	\$ —	\$ 16,786	\$ —

The following is a description of valuation methodologies used for assets measured at fair value on a non-recurring basis.

Table of Contents

Impaired Loans

Loans which meet certain criteria are evaluated individually for impairment. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest and principal payments of a loan will be collected as scheduled in the loan agreement. Three impairment measurement methods are used, depending upon the collateral securing the asset: 1) the present value of expected future cash flows discounted at the loan's effective interest rate (the rate of return implicit in the loan); 2) the asset's observable market price; or 3) the fair value of the collateral, less anticipated selling and disposition costs, if the asset is collateral dependent. The regulatory agencies require this method for loans from which repayment is expected to be provided solely by the underlying collateral. Our impaired loans are generally collateral dependent and, as such, are carried at the estimated fair value of the collateral less estimated selling costs. Fair value is estimated through current appraisals, and adjusted as necessary, by management, to reflect current market conditions and, as such, are generally classified as Level 3.

Appraisals of collateral securing impaired loans are conducted by approved, qualified, and independent third-party appraisers. Such appraisals are ordered via the Bank's credit administration department, independent from the lender who originated the loan, once the loan is deemed impaired, as described in the previous paragraph. Impaired loans are generally re-evaluated with an updated appraisal within one year of the last appraisal. However, the Company also obtains updated appraisals on performing construction loans that are approaching their maturity date to determine whether or not the fair value of the collateral securing the loan remains sufficient to cover the loan amount prior to considering an extension. The Company discounts the appraised "as is" value of the collateral for estimated selling and disposition costs and compares the resulting fair value of collateral to the outstanding loan amount. If the outstanding loan amount is greater than the discounted fair value, the Company requires a reduction in the outstanding loan balance or additional collateral before considering an extension to the loan. If the borrower is unwilling or unable to reduce the loan balance or increase the collateral securing the loan, it is deemed impaired and the difference between the loan amount and the fair value of collateral, net of estimated selling and disposition costs, is charged off through a reduction of the allowance for loan loss.

Other Real Estate Owned

The fair value of other real estate owned is determined through current appraisals, and adjusted as necessary, by management, to reflect current market conditions. As such, other real estate owned is generally classified as Level 3.

The following table provides the level of valuation assumptions used to determine the carrying value of our assets measured at fair value on a non-recurring basis at December 31, 2012 and September 30, 2012.

	Fair Value at December 31, 2012		
Total	Level 1	Level 2	Level 3
(Dollars in thousands)			

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Impaired loans	\$ 3,755	\$	—	\$	—	\$ 3,755
Other real estate owned	—		—		—	—
	\$ 3,755	\$	—	\$	—	\$ 3,755

Fair Value at September 30, 2012

	Total	Level 1	Level 2	Level 3		
	(Dollars in thousands)					
Impaired loans	\$ 5,984	\$	—	\$	—	\$ 5,984
Other real estate owned	464		—		—	464
	\$ 6,448	\$	—	\$	—	\$ 6,448

The following methods and assumptions were used to estimate the fair value of each class of financial instruments not already disclosed above for which it is practicable to estimate fair value:

Cash and interest earning deposits with banks: The carrying amounts are a reasonable estimate of fair value.

Table of Contents

Held to maturity securities: The fair values of our held to maturity securities are obtained from an independent nationally recognized pricing service. Our independent pricing service provides us with prices which are categorized as Level 2, as quoted prices in active markets for identical assets are generally not available for the securities in our portfolio.

Loans: Fair value for the loan portfolio, excluding impaired loans with specific loss allowances, is estimated based on discounted cash flow analysis using interest rates currently offered for loans with similar terms to borrowers of similar credit quality.

Federal Home Loan Bank of New York (“FHLB”) stock: The carrying amount of FHLB stock approximates fair value and considers the limited marketability of the investment.

Bank-owned life insurance: The carrying amounts are based on the cash surrender values of the individual policies, which is a reasonable estimate of fair value.

Deposits: The fair value of deposits with no stated maturity, such as money market deposit accounts, interest-bearing checking accounts and savings accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is equivalent to current market rates for deposits of similar size, type and maturity.

Accrued interest receivable and payable: For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Federal Home Loan Bank of New York advances and securities sold under reverse repurchase agreements: The fair value of borrowings is based on the discounted value of contractual cash flows. The discount rate is equivalent to the rate currently offered by the Federal Home Loan Bank of New York for borrowings of similar maturity and terms.

The fair value of commitments to extend credit is estimated based on the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based on the amount of unearned fees plus the estimated cost to terminate the letters of credit. Fair values of unrecognized financial instruments including commitments to extend credit and the fair value of letters of credit are considered immaterial.



The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments carried at cost or amortized cost as of December 31, 2012 and September 30, 2012. This table excludes financial instruments for which the carrying amount approximates level 1 fair value. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For financial liabilities such as interest-bearing demand, NOW, and money market savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity.

Table of Contents

	Carrying Value	Fair Value	Fair Value Measurement (Level 1)	Measurement (Level 2)	Placement (Level 3)
(Dollars in thousands)					
December 31, 2012					
Financial instruments - assets					
Investment securities held-to-maturity	\$41,213	\$42,268	\$ 2,999	\$ 39,269	\$ —
Loans	391,722	402,568	—	—	402,568
Financial instruments - liabilities					
Certificate of deposit	157,504	159,528	—	159,528	—
Borrowings	40,103	42,193	—	42,193	—
September 30, 2012					
Financial instruments - assets					
Investment securities held-to-maturity	\$41,068	\$42,130	\$ 2,891	\$ 39,239	\$ —
Loans	385,270	396,111	—	—	396,111
Financial instruments - liabilities					
Certificate of deposit	158,461	160,753	—	160,753	—
Borrowings	41,503	43,898	—	43,898	—

## NOTE H - INVESTMENT SECURITIES

The following tables summarize the amortized cost and fair values of securities available for sale at December 31, 2012 and September 30, 2012:

	At December 31, 2012			
	Gross Amortized Cost	Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars in thousands)				
Securities available for sale:				
Obligations of U.S. government agencies:				
Mortgage backed securities - residential	\$1,814	\$ —	\$ (5 )	\$1,809
Obligations of U.S. government-sponsored enterprises:				
Mortgage-backed securities-residential	7,614	130	—	7,744
Mortgage backed securities-commercial	4,031	143	—	4,174
Private label mortgage-backed securities-residential	990	23	(1 )	1,012
Total securities available for sale	\$14,449	\$ 296	\$ (6 )	\$14,739



Table of Contents

	September 30, 2012			
	Gross Amortized Cost	Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities available for sale:				
Obligations of U.S. government agencies:				
Mortgage backed securities - residential	\$1,850	\$ 11	\$ —	\$1,861
Obligations of U.S. government-sponsored enterprises:				
Mortgage-backed securities-residential	8,368	207	—	8,575
Mortgage backed securities-commercial	4,053	175	—	4,228
Debt securities	1,000	67	—	1,067
Private label mortgage-backed securities-residential	1,031	25	(1 )	1,055
Total securities available for sale	\$16,302	\$ 485	\$ (1 )	\$16,786

The maturities of the debt securities and mortgage-backed securities available-for-sale at December 31, 2012 are summarized in the following table:

	At December 31, 2012	
	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within 1 year	\$ —	\$ —
Due after 1 but within 5 years	—	—
Due after 5 but within 10 years	—	—
Due after 10 years	—	—
Total debt securities	—	—
Mortgage-backed securities:		
Residential	10,418	10,565
Commercial	4,031	4,174
Total	\$ 14,449	\$ 14,739

The following tables summarize the amortized cost and fair values of securities held to maturity at December 31, 2012 and September 30, 2012:

	At December 31, 2012			
	Gross Amortized Cost	Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities held to maturity:				
Obligations of U.S. government agencies:				

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Mortgage-backed securities-residential	\$9,731	\$ 350	\$ (5	) \$10,076
Mortgage-backed securities-commercial	1,503	13	—	1,516
Obligations of U.S. government-sponsored enterprises:				
Mortgage backed securities-residential	19,592	681	(14	) 20,259
Debt securities	6,004	7	(11	) 6,000
Private label mortgage-backed securities-residential	1,342	34	—	1,376
Obligations of state and political subdivisions	41	1	—	42
Corporate securities	3,000	—	(1	) 2,999
Total securities held to maturity	\$41,213	\$ 1,086	\$ (31	) \$42,268

Table of Contents

	September 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Securities held to maturity:				
Obligations of U.S. government agencies:				
Mortgage-backed securities - residential	\$10,790	\$ 414	\$ (8	) \$11,196
Mortgage-backed securities - commercial	1,522	14	—	1,536
Obligations of U.S. government-sponsored enterprises:				
Mortgage backed securities - residential	18,578	722	(5	) 19,295
Debt securities	5,770	6	—	5,776
Private label mortgage-backed securities - residential	1,367	27	—	1,394
Obligations of state and political subdivisions	41	1	—	42
Corporate securities	3,000	—	(109	) 2,891
Total securities held to maturity	\$41,068	\$ 1,184	\$ (122	) \$42,130

The maturities of the debt securities and the mortgage backed securities held to maturity at December 31, 2012 are summarized in the following table:

	At December 31, 2012	
	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due within 1 year	\$ —	\$ —
Due after 1 but within 5 years	3,041	3,041
Due after 5 but within 10 years	1,000	994
Due after 10 years	5,004	5,006
Total debt securities	9,045	9,041
Mortgage-backed securities:		
Residential	30,665	31,711
Commercial	1,503	1,516
Total	\$ 41,213	\$ 42,268

## NOTE I – IMPAIRMENT OF INVESTMENT SECURITIES

The Company recognizes credit-related other-than-temporary impairment on debt securities in earnings while noncredit-related other-than-temporary impairment on debt securities not expected to be sold are recognized in other comprehensive income (“OCI”).

We review our investment portfolio on a quarterly basis for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in the market. We evaluate our intent and ability to hold debt securities based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position. In addition, the risk of future other-than-temporary impairment may be influenced by prolonged recession in the U.S. economy, changes in real estate values and interest deferrals.

Investment securities with fair values less than their amortized cost contain unrealized losses. The following tables present the gross unrealized losses and fair value at December 31, 2012 and September 30, 2012 for both available for sale and held to maturity securities by investment category and time frame for which the loss has been outstanding:

Table of Contents

	December 31, 2012						
	Number of Securities	Less Than 12 Months		12 Months Or Greater		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
		(Dollars in thousands)					
Obligations of U.S. government agencies:							
Mortgage-backed securities - residential	2	\$1,809	\$ (5 )	\$ 1,580	\$ (5 )	\$3,389	\$ (10 )
Obligations of U.S. government-sponsored enterprises							
Mortgage backed securities - residential	2	3,050	(14 )	—	—	3,050	(14 )
Debt securities	2	1,987	(11 )	—	—	1,987	(11 )
Private label mortgage-backed securities residential	1	—	—	26	(1 )	26	(1 )
Corporate securities	1	—	—	2,999	(1 )	2,999	(1 )
Total	8	\$6,846	\$ (30 )	\$ 4,605	\$ (7 )	\$11,451	\$ (37 )

	September 30, 2012						
	Number of Securities	Less Than 12 Months		12 Months Or Greater		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
		(Dollars in thousands)					
Obligations of U.S. government agencies:							
Mortgage-backed securities - residential	1	\$—	\$ —	\$ 1,729	\$ (8 )	\$1,729	\$ (8 )
Obligations of U.S. government-sponsored enterprises:							
Mortgage backed securities - residential	1	1,143	(5 )	—	—	1,143	(5 )
Private label mortgage-backed securities residential	3	—	—	26	(1 )	26	(1 )
Corporate securities	1	—	—	2,891	(109 )	2,891	(109 )
Total	6	\$1,143	\$ (5 )	\$ 4,646	\$ (118 )	\$5,789	\$ (123 )

The investment securities listed above currently have fair values less than amortized cost and therefore contain unrealized losses. The Company evaluated these securities and determined that the decline in value was primarily related to fluctuations in the interest rate environment and were not related to any company or industry specific event. At December 31, 2012 and September 30, 2012, there were eight and six, respectively, investment securities with unrealized losses.

The Company anticipates full recovery of amortized costs with respect to these securities. The Company does not intend to sell these securities and has determined that it is not more likely than not that the Company would be required to sell these securities prior to maturity or market price recovery. Management has considered factors regarding other than temporarily impaired securities and determined that there are no securities with impairment that is other than temporary as of December 31, 2012 and September 30, 2012.



NOTE J – LOANS RECEIVABLE, NET AND RELATED ALLOWANCE FOR LOAN LOSSES

Loans receivable, net were comprised of the following:

	December 31, 2012	September 30, 2012
	(Dollars in thousands)	
One-to four-family residential	\$ 158,236	\$ 157,536
Commercial real estate	155,991	148,806
Construction	18,322	17,952
Home equity lines of credit	22,562	23,435
Commercial business	31,548	29,930
Other	9,004	11,265
Total loans receivable	395,663	388,924
Net deferred loan costs	153	204
Allowance for loan losses	(4,094 )	(3,858 )
Total loans receivable, net	\$ 391,722	\$ 385,270

Table of Contents

The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The residential mortgage loan segment is further disaggregated into two classes: amortizing term loans, which are primarily first liens, and home equity lines of credit, which are generally second liens. The commercial real estate loan segment is further disaggregated into three classes. Commercial real estate loans include loans secured by multifamily structures, owner-occupied commercial structures, and non-owner occupied nonresidential properties. The construction loan segment consists primarily of loans to developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures and to a lesser extent one-to-four family residential construction loans made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. Construction loans to developers and investors have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the loan. The commercial business loan segment consists of loans made for the purpose of financing the activities of commercial customers and consists primarily of revolving lines of credit. The consumer loan segment consists primarily of stock-secured installment loans, but also includes unsecured personal loans and overdraft lines of credit connected with customer deposit accounts.

Management evaluates individual loans in all segments for possible impairment if the loan either is in nonaccrual status, or is risk rated Substandard and is greater than 90 days past due. Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Once the determination has been made that a loan is impaired, the recorded investment in the loan is compared to the fair value of the loan using one of three methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral securing the loan, less anticipated selling and disposition costs. The method is selected on a loan-by loan basis, with management primarily utilizing the fair value of collateral method. If there is a shortfall between the fair value of the loan and the recorded investment in the loan, the Company charges the difference to the allowance for loan loss as a charge-off and carries the impaired loan on its books at fair value. It is the Company's policy to evaluate impaired loans on an annual basis to ensure the recorded investment in a loan does not exceed its fair value.

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and charged-off and those for which a specific allowance was not necessary at the dates presented:

Impaired  
Loans with  
No Specific



Table of Contents

At and for the year ended September 30, 2012	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance		Total Impaired Loans	
	Recorded Investment (Dollars in thousands)	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment During the Year
One-to four-family residential	\$—	\$ —	\$ 7,124	\$7,124	\$ 7,594	\$ 5,342
Commercial real estate	3,999	798	2,425	6,424	7,204	7,094
Construction	—	—	5,141	5,141	6,927	9,807
Home equity lines of credit	1,340	122	967	2,307	2,475	1,579
Commercial business	—	—	57	57	57	217
Other	12	12	—	12	12	2
Total impaired loans	\$5,351	\$ 932	\$ 15,714	\$21,065	\$24,269	\$ 24,042

For the Three Months  
Ended December 31, 2011  
(Dollars in thousands)

One-to four-family residential	\$ 3,686
Commercial real estate	6,856
Construction	13,530
Home equity lines of credit	748
Commercial business	246
Other	—
Average investment in impaired loans	\$ 25,065

There was no interest income recognized on impaired loans during the periods presented.

Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than three months past due are considered Substandard. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as severe delinquency, bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis. The Asset Review Committee performs monthly reviews of all commercial relationships internally rated 6 ("Watch") or worse. Confirmation of the appropriate risk grade is performed by an external Loan Review Company that semi-annually reviews and assesses loans within the portfolio. Generally, the external consultant reviews commercial relationships greater than \$500,000 and/or criticized relationships greater than \$250,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a monthly basis.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the Bank's internal risk rating system at the dates presented:

Table of Contents

	Pass	Special Mention	Substandard	Doubtful	Total
(Dollars in thousands)					
December 31, 2012					
One-to four-family residential	\$ 146,366	\$ 4,481	\$ 7,389	\$ —	\$ 158,236
Commercial real estate	143,382	5,358	5,572	1,679	155,991
Construction	8,250	4,931	5,141	—	18,322
Home equity lines of credit	19,409	833	981	1,339	22,562
Commercial business	28,447	2,379	57	665	31,548
Other	9,004	—	—	—	9,004
Total	\$ 354,858	\$ 17,982	\$ 19,140	\$ 3,683	\$ 395,663

	Pass	Special Mention	Substandard	Doubtful	Total
(Dollars in thousands)					
September 30, 2012					
One-to four-family residential	\$ 146,487	\$ 3,925	\$ 7,124	\$ —	\$ 157,536
Commercial real estate	137,616	3,063	6,448	1,679	148,806
Construction	8,274	4,537	5,141	—	17,952
Home equity lines of credit	20,295	833	967	1,340	23,435
Commercial business	26,057	3,151	722	—	29,930
Other	11,253	—	12	—	11,265
Total	\$ 349,982	\$ 15,509	\$ 20,414	\$ 3,019	\$ 388,924

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans at the dates presented:

	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days + Past Due	Total Past Due	Non- Accrual	Total Loans
(Dollars in thousands)							
December 31, 2012							
One-to four-family residential	\$ 145,936	\$ 748	\$ 3,359	\$ 8,193	\$ 12,300	\$ 8,193	\$ 158,236
Commercial real estate	144,462	274	4,011	7,244	11,529	7,244	155,991
Construction	13,181	—	—	5,141	5,141	5,141	18,322
Home equity lines of credit	20,752	1,037	18	755	1,810	755	22,562
Commercial business	30,610	81	—	857	938	857	31,548
Other	8,988	6	—	10	16	10	9,004
Total	\$ 363,929	\$ 2,146	\$ 7,388	\$ 22,200	\$ 31,734	\$ 22,200	\$ 395,663

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	Current	30-59 Days Past Due	60-89 Days Past Due	90 Days + Past Due	Total Past Due	Non- Accrual	Total Loans
(Dollars in thousands)							
September 30, 2012							
One-to four-family residential	\$ 147,749	\$ 621	\$ 1,589	\$ 7,577	\$ 9,787	\$ 7,577	\$ 157,536
Commercial real estate	141,674	—	708	6,424	7,132	6,424	148,806
Construction	12,811	—	—	5,141	5,141	5,141	17,952
Home equity lines of credit	22,353	160	59	863	1,082	863	23,435
Commercial business	29,761	10	102	57	169	57	29,930
Other	11,253	—	—	12	12	12	11,265
Total	\$ 365,601	\$ 791	\$ 2,458	\$ 20,074	\$ 23,323	\$ 20,074	\$ 388,924

Table of Contents

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of NPLs.

The Bank’s methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative and economic factors.

The loans are segmented into classes based on their inherent varying degrees of risk, as described above. Management tracks the historical net charge-off activity by segment and utilizes this figure, as a percentage of the segment, as the general reserve percentage for pooled, homogenous loans that have not been deemed impaired. Typically, an average of losses incurred over a defined number of consecutive historical years is used. A 5 year history is currently utilized for all loan segments except for construction loans, where the highest single year loss percentage of the most recent five years is used in place of a 5 year average.

Non-impaired credits are segregated for the application of qualitative factors. Management has identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: national and local economic trends and conditions; levels of and trends in delinquency rates and non-accrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of lending staff; value of underlying collateral; and concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL. Since loans individually evaluated for impairment are promptly written down to their fair value, typically there is no portion of the ALL for loans individually evaluated for impairment.



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The following table summarizes the ALL by loan category and related activity for the three months ended December 31, 2012 and 2011:

	One-to Four- Family Residential	Commercial Real Estate	Construction	Home Equity Lines of Credit	Commercial Business	Other	Unallocated	Total
	(Dollars in thousands)							
Balance-September 30, 2012	\$ 610	\$ 1,929	\$ 640	\$ 232	\$ 383	\$ 23	\$ 41	\$ 3,858
Charge-offs	(192)	—	—	—	—	(13)	—	(205)
Recoveries	—	—	—	—	—	—	—	—
Provision	251	(85)	(169)	1	406	8	29	441
Balance-December 31, 2012	\$ 668	\$ 1,844	\$ 471	\$ 233	\$ 789	\$ 18	\$ 70	\$ 4,094

Table of Contents

	One-to Four- Family Residential	Commercial Real Estate	Construction	Home Equity Lines of Credit	Commercial Business	Other	Unallocated	Total
	(Dollars in thousands)							
Balance-September 30, 2011	\$ 734	\$ 1,266	\$ 1,043	\$ 101	\$ 551	\$ 13	\$ 104	\$ 3,812
Charge-offs	—	—	(184 )	(81 )	(69 )	—	—	(334 )
Recoveries	—	—	—	—	—	—	—	—
Provision	(148)	245	90	58	135	(7 )	(3 )	370
Balance-December 31, 2011	\$ 586	\$ 1,511	\$ 949	\$ 78	\$ 617	\$ 6	\$ 101	\$ 3,848

The following tables summarize the ALL by loan category, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of December 31, 2012 and September 30, 2012:

	One-to Four- Family Residential	Commercial Real Estate	Construction	Home Equity Lines of Credit	Commercial Business	Other	Unallocated	Total
	(Dollars in thousands)							
Allowance for Loan Losses:								
Balance- December 31, 2012	\$ 669	\$ 1,844	\$ 471	\$ 233	\$ 789	\$ 18	\$ 70	\$ 4,094
Individually evaluated for impairment	—	795	—	120	333	—	—	1,248
Collectively evaluated for impairment	669	1,049	471	113	456	18	70	2,846
Loans receivable:								
Balance-December 31, 2012	\$ 158,236	\$ 155,991	\$ 18,322	\$ 22,562	\$ 31,548	\$ 9,004	—	\$ 395,663
Individually evaluated for impairment	7,160	6,259	5,141	2,324	722	—	—	21,606
Collectively evaluated for impairment	151,076	149,732	13,181	20,238	30,826	9,004	—	374,057

	One-to Four- Family Residential	Commercial Real Estate	Construction	Home Equity Lines of Credit	Commercial Business	Other	Unallocated	Total
	(Dollars in thousands)							

Allowance for Loan Losses:

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Balance- September 30, 2012	\$ 610	\$ 1,929	\$ 640	\$ 232	\$ 383	\$ 23	\$ 41	\$ 3,858
Individually evaluated for impairment	—	798	—	122	—	12	—	932
Collectively evaluated for impairment	610	1,131	640	110	383	11	41	2,926
Loans receivable:								
Balance-September 30, 2012	\$ 157,536	\$ 148,806	\$ 17,952	\$ 23,435	\$ 29,930	\$ 11,265		\$ 388,924
Individually evaluated for impairment	7,124	6,424	5,141	2,307	57	12		21,065
Collectively evaluated for impairment	150,412	142,382	12,811	21,128	29,873	11,253		367,859

The allowance for loan losses is based on estimates, and actual losses will vary from current estimates. Management believes that the segmentation of the loan portfolio into homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

Table of Contents

The Bank has adopted FASB issue ASU No. 2011-02 on the determination of whether a loan restructuring is considered to be a Troubled Debt Restructuring (“TDR”). A TDR is a loan that has been modified whereby the Bank has agreed to make certain concessions to a borrower to meet the needs of both the borrower and the Bank to maximize the ultimate recovery of a loan. TDR occurs when a borrower is experiencing, or is expected to experience, financial difficulties and the loan is modified using a modification that would otherwise not be granted to the borrower. The types of concessions granted are generally included, but not limited to interest rate reductions, limitations on the accrued interest charged, term extensions, and deferment of principal.

During the three months ended December 31, 2012 and 2011, the bank entered into TDRs with borrowings having financial difficulties. These TDRs involved lower than market interest rates and are summarized as follows:

Three Months Ended December 31, 2012				
	Number of Loans (Dollars in thousands)	Investment Before TDR Modification	Investment After TDR Modification	
Construction	1	\$ 67	\$ 67	
Total	1	\$ 67	\$ 67	
Three Months Ended December 31, 2011				
	Number of Loans (Dollars in thousands)	Investment Before TDR Modification	Investment After TDR Modification	
One-to four-family residential	1	\$ 1,749	\$ 1,749	
Commercial real estate	1	249	249	
Total	2	\$ 1,998	\$ 1,998	

A default on a troubled debt restructured loan for purposes of this disclosure occurs when a borrower is 90 days past due or a foreclosure or repossession of the applicable collateral has occurred. During the three months ended December 31, 2012 and 2011, no defaults occurred on troubled debt restructured loans that were modified as a TDR within the previous 12 months.

## NOTE K - DEPOSITS

A summary of deposits by type of account are summarized as follows:

	December 31, 2012	September 30, 2012
	(Dollars in thousands)	
Demand accounts	\$ 64,418	\$ 50,897
Savings accounts	53,536	55,293
NOW accounts	39,198	44,312
Money market accounts	109,721	107,555
Certificates of deposit	129,357	129,716
Retirement certificates	28,147	28,745
	\$ 424,377	\$ 416,518

#### NOTE L – INCOME TAXES

The Company records income taxes using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled.

Table of Contents

Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The valuation allowance is assessed by management on a quarterly basis and adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant. In assessing whether it is more likely than not that some portion or all of the deferred tax assets will not be realized, management considers projections of future taxable income, the projected periods in which current temporary differences will be deductible, the availability of carry forwards, feasible and permissible tax planning strategies and existing tax laws and regulations. Due to the uncertainty of the Company's ability to realize the benefit of certain deferred tax assets within statutory time limits, the net deferred tax assets are partially offset by a valuation allowance at December 31, 2012, the amount of which has not materially changed from that in place at September 30, 2012.

A reconciliation of income tax between the amounts calculated based upon pre-tax income at the Company's federal statutory rate and the amounts reflected in the consolidated statements of operations are as follows:

	For the Three Months Ended December 31, 2012          2011 (in thousands)	
Income tax expense at 34% statutory federal tax rate	\$ 141	\$ 13
State tax expense	24	8
Other	(33 )	(14 )
Income tax expense	\$ 132	\$ 7

## NOTE M - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are commitments to extend credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets.

2012  
December          September 30  
31  
(Dollars in thousands)

Financial instruments whose contract amounts  
represent credit risk

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Letters of credit	\$ 1,436	\$ 1,450
Unused lines of credit	47,435	41,162
Fixed rate loan commitments	4,715	1,988
Variable rate loan commitments	3,423	14,112
	\$ 57,009	\$ 58,712

## Table of Contents

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

#### Forward-Looking Statements

When used in this filing and in future filings by the Company with the Securities and Exchange Commission, in the Company's press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases, "anticipate," "would be," "will allow," "intends to," "will likely result," "are expected to," "will continue," "is anticipated," "estimated," "projected," "believes", or similar expressions are intended to identify "forward looking statements." Forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, those risks previously disclosed in the Company's filings with the SEC, general economic conditions, changes in interest rates, regulatory considerations, competition, technological developments, retention and recruitment of qualified personnel, and market acceptance of the Company's pricing, products and services, and with respect to the loans extended by the Bank and real estate owned, the following: risks related to the economic environment in the market areas in which the Bank operates, particularly with respect to the real estate market in New Jersey; the risk that the value of the real estate securing these loans may decline in value; and the risk that significant expense may be incurred by the Company in connection with the resolution of these loans.

The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and advises readers that various factors, including regional and national economic conditions, substantial changes in levels of market interest rates, credit and other risks of lending and investing activities, and competitive and regulatory factors, could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from those anticipated or projected.

The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

#### **Critical Accounting Policies**

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. Critical accounting policies may involve complex subjective decisions or assessments. We consider the following to be our critical accounting policies.

***Allowance for Loan Losses.*** The allowance for loan losses is the amount estimated by management as necessary to cover credit losses in the loan portfolio both probable and reasonably estimable at the balance sheet date. The allowance is established through the provision for loan losses which is charged against income. In determining the allowance for loan losses, management makes significant estimates and has identified this policy as one of our most critical. Due to the high degree of judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses, the methodology for determining the allowance for loan losses is considered a critical accounting policy by management.



As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans and discounted cash flow valuations of properties are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisals and discounted cash flow valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals and discounted cash flow valuations are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans.

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. We consider a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic and industry concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal loan reviews and other relevant factors. This evaluation is inherently subjective as it requires material estimates by management that may be susceptible to significant change based on changes in economic and real estate market conditions.

The evaluation has a specific and general component. The specific component relates to loans that are delinquent or otherwise identified as impaired through the application of our loan review process and our loan grading system. All such loans are evaluated individually, with principal consideration given to the value of the collateral securing the loan and discounted cash flows. Specific impairment allowances are established as required by this analysis. The general component is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. We also analyze historical loss experience, delinquency trends, general economic conditions and geographic and industry concentrations. This analysis establishes factors that are applied to the loan groups to determine the amount of the general component of the allowance for loan losses.

Table of Contents

Actual loan losses may be significantly greater than the allowances we have established, which could have a material negative effect on our financial results.

**Other Real Estate Owned.** Real estate acquired through foreclosure, or a deed-in-lieu of foreclosure, is recorded at fair value less estimated selling costs at the date of acquisition or transfer, and subsequently at the lower of its new cost or fair value less estimated selling costs. Adjustments to the carrying value at the date of acquisition or transfer are charged to the allowance for loan losses. The carrying value of the individual properties is subsequently adjusted to the extent it exceeds estimated fair value less estimated selling costs, at which time a provision for losses on such real estate is charged to operations.

Appraisals are critical in determining the fair value of the other real estate owned amount. Assumptions for appraisals are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable.

**Deferred Income Taxes.** The Company records income taxes using the asset and liability method. Accordingly, deferred tax assets and liabilities: (i) are recognized for the expected future tax consequences of events that have been recognized in the financial statements or tax returns; (ii) are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases; and (iii) are measured using enacted tax rates expected to apply in the years when those temporary differences are expected to be recovered or settled.

Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period of enactment. The valuation allowance is adjusted, by a charge or credit to income tax expense, as changes in facts and circumstances warrant.

**Comparison of Financial Condition at December 31, 2012 and September 30, 2012**

Total assets increased \$5.8 million, or 1.1%, to \$514.6 million during the three months ended December 31, 2012. The increase was attributable to higher loans receivable, net of allowance for loan loss, which increased \$6.5 million.

Cash and interest bearing deposits with banks increased \$1.8 million, or 17.8%, to \$11.8 million at December 31, 2012 from \$10.0 million at September 30, 2012. Deposit inflows as well as sales and amortization of investment securities accounted for the year-to-date increase.

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Total loans receivable increased \$6.7 million during the three months ended December 31, 2012 to \$395.7 million and were comprised of \$158.2 million (40.0%) one-to-four family residential mortgage loans, \$156.0 million (39.4%) commercial real estate loans, \$31.5 million (8.0%) commercial business loans, \$22.6 million (5.7%) home equity lines of credit loans, \$18.3 million (4.6%) construction loans and \$9.0 million (2.3%) other loans. Expansion of the portfolio during the quarter ended December 31, 2012 occurred primarily in commercial real estate, which increased \$7.2 million, followed by commercial business loans, which increased \$1.6 million, one-to-four family residential mortgage loans, which increased \$700,000, and construction loans, which increased \$370,000. Offsetting the increases were decreases in other and home equity lines of credit, which decreased \$2.3 million and \$873,000, respectively.

Total non-performing loans (“NPLs”) defined as loans 90 days or more delinquent, increased by \$2.1 million, or 10.6%, to \$22.2 million at December 31, 2012 from \$20.1 million at September 30, 2012. The ratio of non-performing loans to total loans was 5.6% at December 31, 2012 compared to 5.2% at September 30, 2012.

Included in the non-performing loan totals were twenty-seven residential mortgage loans totaling \$8.2 million, seventeen commercial loans totaling \$8.1 million, six construction loans totaling \$5.1 million, five home equity lines of credit totaling \$755,000 and one consumer loan totaling \$10,000.

Table of Contents

During the three months ended December 31, 2012, the allowance for loan loss increased by \$236,000 to \$4,094,000. The increase during the quarter was primarily attributable to growth in the loan portfolio.

The allowance for loan losses as a percentage of non-performing loans decreased to 18.4% at December 31, 2012 from 19.2% at September 30, 2012. Our allowance for loan losses as a percentage of total loans increased to 1.03% at December 31, 2012 from 0.99% at September 30, 2012.

Future increases in the allowance for loan losses may be necessary based on the growth of the loan portfolio, the change in composition of the loan portfolio, possible future increases in non-performing loans and charge-offs, and the possible continuation of the current adverse economic environment.

Adverse economic conditions have led to high levels of NPLs, particularly in the Company's one-to four-family residential, commercial real estate and construction loan portfolios. The repayment of construction loans is typically dependent upon the sale of the collateral securing the loan, which has been negatively impacted by rapid deterioration in the housing market and decreased buyer demand. As a result, construction projects have slowed and reached their maturity dates. In order for the Company to extend the loans beyond the original maturity date, the value of the collateral securing the loan must be assessed, which is typically done by obtaining an updated third-party appraisal. Given the deterioration in the economy and, specifically, the housing market, updated valuations of the collateral reflect depreciation from earlier assessments. To the extent that an updated valuation of the collateral is insufficient to cover a collateral-dependent loan, the Company reduces the balance of the loan via a charge to the allowance for loan loss.

At December 31, 2012, non-performing construction loans consisted of six loans totaling \$5.1 million for the development of single family homes. These loans were used for land acquisition and construction in various locations in the States of New Jersey and Pennsylvania. Magyar Bank is pursuing foreclosure of the collateral securing the loans. Year-to-date, the Bank has not charged off any construction loan balances through a reduction of its allowance for loan loss.

Construction loans may contain interest reserves on which the interest is capitalized to the loan. At December 31, 2012, there was one performing construction loan with an interest reserve representing an outstanding balance of \$695,000, original interest reserves of \$75,000, advanced interest reserves of \$5,000, and a remaining interest reserve balance of \$70,000. At December 31, 2011, there was one performing construction loan with an interest reserve representing an outstanding balance of \$292,000, original interest reserves of \$95,000, advanced interest reserves of \$3,000, and a remaining interest reserve balance of \$92,000.

Underwriting for construction loans with and without interest reserves has followed a uniform process. Construction loan progress is monitored on a monthly basis by management as well as by the Board of Directors. Each time an

advance is requested, an inspection is made of the project by an outside engineer or appraiser, depending on the size and complexity of the project, to determine the amount of work completed and if the costs to date are supported adequately. The Bank's construction loan operations personnel compare the advance request with the original budget and remaining loan funds available to ensure the project is in balance and that at all times the amount remaining on the loan is sufficient to complete the project.

A number of the Bank's construction loans have been extended due to slower sales as a result of economic conditions. In cases where updated appraisals reflect collateral values insufficient to cover the loan, additional collateral and/or a principal reduction is required to extend the loan. Some of the Bank's loans that originally had interest reserves are non-performing. The Bank does not currently have any NPLs with active interest reserves. Once a loan is deemed impaired, any interest reserve is frozen and the loan is placed on non-accrual so that no future interest income is recorded on these loans.

NPLs secured by one-to four-family residential properties including home equity lines of credit increased \$508,000 to \$8.9 million at December 31, 2012 from \$8.4 million at September 30, 2012. There were thirty-two NPLs in the category in varying stages of foreclosure. The Company has not and does not intend to originate or purchase sub-prime loans or option-ARM loans. Fiscal year-to-date, the Bank has charged off \$192,000 in residential and home equity line of credit loans through a reduction of its allowance for loan loss.

Non-performing commercial real estate loans increased \$820,000 to \$7.2 million at December 31, 2012 from \$6.4 million at September 30, 2012. The eleven non-accrual loans were in various stages of foreclosure and collection at December 31, 2012. Fiscal year-to-date, there have been no charge-offs to commercial real estate loans.

Non-performing commercial business loans increased \$800,000 to \$857,000 at December 31, 2012 from \$57,000 at September 30, 2012. Fiscal year-to-date, there have been no charge-offs to commercial business loans.

Table of Contents

Non-performing consumer loans decreased \$3,000 to \$10,000 at December 31, 2012 from \$13,000 at September 30, 2012. Fiscal year-to-date, the Bank has charged off \$12,000 in consumer loans through a reduction of its allowance for loan loss.

The allowance for loan loss does not typically include a specific reserve for NPLs as all such loans are reported at the lower of amortized cost or fair value, based upon updated independent appraisals of collateral or the discounted value of expected loan repayments. Valuations of such loans are performed on an annual basis with charge-offs recorded when appraised values, net of estimated selling and disposition costs, are less than the loan balances. Specific reserves may be used on occasions where an updated valuation is unavailable or where a short-term resolution to the impairment is anticipated. At December 31, 2012, the Bank held specific reserves of \$1.2 million for six loans totaling \$6.0 million.

At December 31, 2012, investment securities totaled \$56.0 million, reflecting a decrease of \$1.9 million, or 3.3%, from September 30, 2012. Investment securities at December 31, 2012 consisted of \$44.6 million in mortgage-backed securities issued by U.S. government agencies and U.S. government-sponsored enterprises, \$6.0 million in U.S. government-sponsored enterprise debt securities, \$3.0 million in corporate notes, \$2.4 million in "private-label" mortgage-backed securities, and \$41,000 in state municipal bonds. There were no other-than-temporary-impairment charges for the Company's investment securities for the three months ended December 31, 2012. The Company purchased \$4.1 million of U.S. Government-sponsored enterprise obligations, received repayments totaling \$4.7 million and sold securities totaling \$1.0 million during the three months ended December 31, 2012.

Other real estate owned decreased \$402,000, or 3.0%, to \$13.0 million during the three months ended December 31, 2012. The decrease was due to the sale of three properties totaling \$561,000 during the quarter ended December 31, 2012 for a loss of \$8,000. The Bank is determining the proper course of action for its other real estate owned, which may include holding the properties until the real estate market improves, selling the properties to a developer and completing partially completed homes for either rental or sale.

Total deposits increased \$7.9 million, or 1.9%, to \$424.4 million during the three months ended December 31, 2012. The inflow in deposits occurred in non-interest checking accounts, which increased \$13.5 million, or 26.6%, to \$64.4 million and money market accounts, which increased \$2.2 million, or 2.0%, to \$109.7 million. Partially offsetting the increases were decreases in interest-bearing checking accounts, which decreased \$5.1 million, or 11.5%, to \$39.2 million, savings accounts, which decreased \$1.8 million, or 3.2%, to \$53.5 million, and certificates of deposit (including individual retirement accounts), which decreased \$957,000, or 0.6%, to \$157.5 million. Included with the total deposits at December 31, 2012 were \$7.0 million in brokered certificates of deposit, reflecting a \$500,000 decrease from \$7.5 million at September 30, 2012.

Federal Home Loan Bank of New York advances decreased \$1.4 million, or 3.4%, to \$35.1 million at December 31, 2012 from \$36.5 million at September 30, 2012, while securities sold under agreements to repurchase were unchanged at \$5.0 million at December 31, 2012.

Stockholders' equity increased \$166,000, or 0.4%, to \$45.2 million at December 31, 2012 from \$45.0 million at September 30, 2012. The increase was due to the Company's results from operations, partially offset by changes in the Company's accumulated other comprehensive loss during the three month period.

The Company did not repurchase shares of its common stock during the three months ended December 31, 2012. Through December 31, 2012, the Company had repurchased 81,000 shares at an average price of \$8.33 pursuant to the second stock repurchase plan, which has reduced outstanding shares to 5,807,344.

The Company's book value per share increased to \$7.78 at December 31, 2012 from \$7.75 at September 30, 2012. The increase was due to the Company's results of operations for the three months ended December 31, 2012.

#### **Average Balance Sheets for the Three Months Ended December 31, 2012 and 2011**

The table on the following page presents certain information regarding the Company's financial condition and net interest income for the three months ended December 31, 2012 and 2011. The table presents the annualized average yield on interest-earning assets and the annualized average cost of interest-bearing liabilities. We derived the yields and costs by dividing annualized income or expense by the average balance of interest-earning assets and interest-bearing liabilities, respectively, for the periods shown. We derived average balances from daily balances over the periods indicated. Interest income includes fees that we consider adjustments to yields.

Table of Contents

## MAGYAR BANCORP, INC. AND SUBSIDIARY

## Comparative Average Balance Sheets

(Dollars In Thousands)

	For the Three Months Ended December 31,					
	2012			2011		
	<u>Average Balance</u>	<u>Interest Income/ Expense</u>	<u>Yield/Cost (Annualized)</u>	<u>Average Balance</u>	<u>Interest Income/ Expense</u>	<u>Yield/Cost (Annualized)</u>
Interest-earning assets:						
Interest-earning deposits	\$ 10,063	\$ 7	0.27%	\$ 15,996	\$ 12	0.29%
Loans receivable, net	386,825	4,546	4.66%	382,126	4,706	4.89%
Securities						
Taxable	56,828	372	2.60%	72,582	529	2.89%
Tax-exempt <sup>(1)</sup>	41	1	9.09%	72	2	9.09%
FHLB of NY stock	2,546	28	4.34%	2,299	24	4.12%
Total interest-earning assets	456,303	4,954	4.31%	473,075	5,273	4.42%
Noninterest-earning assets	53,451			54,297		
Total assets	\$509,754			\$527,372		
Interest-bearing liabilities:						
Savings accounts <sup>(2)</sup>	\$54,460	37	0.27%	\$59,882	74	0.49%
NOW accounts <sup>(3)</sup>	146,693	136	0.37%	142,172	161	0.45%
Time deposits <sup>(4)</sup>	158,603	643	1.61%	173,698	867	1.98%
Total interest-bearing deposits	359,756	816	0.90%	375,752	1,102	1.16%
Borrowings	44,573	358	3.19%	49,916	504	4.01%
Total interest-bearing liabilities	404,329	1,174	1.15%	425,668	1,606	1.50%
Noninterest-bearing liabilities	60,183			57,188		
Total liabilities	464,512			482,856		
Retained earnings	45,242			44,516		
Total liabilities and retained earnings	\$509,754			\$527,372		
Tax-equivalent basis adjustment		—			(1 )	
Net interest and dividend income		\$ 3,780			\$ 3,666	
Interest rate spread			3.16%			2.92%
Net interest-earning assets	\$51,974			\$47,407		
Net interest margin <sup>(5)</sup>			3.29%			3.07%
Average interest-earning assets to average interest-bearing liabilities	112.85%			111.14%		



Table of Contents

**Comparison of Operating Results for the Three Months Ended December 31, 2012 and 2011**

**Net Income.** Net income increased \$251,000 during the three-month period ended December 31, 2012 compared with the three-month period ended December 31, 2011 due to a \$114,000, or 3.1% increase in net interest and dividend income to \$3.8 million at December 31, 2012 from \$3.7 million at December 31, 2011, an \$82,000, or 14.2% increase in non-interest income to \$661,000 at December 31, 2012 from \$579,000 at December 31, 2011, and a \$251,000, or 6.5% decrease in non-interest expense to \$3.6 million at December 31, 2012 from \$3.8 million at December 31, 2011.

**Net Interest and Dividend Income.** Net interest and dividend income increased \$114,000 to \$3.8 million due to a higher net interest margin, which increased 22 basis points to 3.29% for the three months ended December 31, 2012 compared to 3.07% for the quarter ended December 31, 2011. The yield on the Company's interest-earning assets fell 11 basis points to 4.31% for the three months ended December 31, 2012 from 4.42% for the three months ended December 31, 2011 primarily due to the lower overall interest rate environment. However, the cost of interest-bearing liabilities fell 35 basis points to 1.15% for the three months ended December 31, 2012 from 1.50% for the three months ended December 31, 2011. The decrease in the cost of interest-bearing liabilities was attributable to the lower rate environment and a more favorable funding composition comprised of a larger percentage of lower-cost deposit account balances.

**Interest and Dividend Income.** Interest and dividend income decreased \$318,000, or 6.0%, to \$5.0 million for the three months ended December 31, 2012 from \$5.3 million for the three months ended December 31, 2011. The decrease was attributable to lower average interest-earning assets, which declined \$16.8 million, or 3.5%, as well as a decrease in the yield on such assets of 11 basis points to 4.31% for the quarter ended December 31, 2012 compared with the prior year period.

Interest earned on loans decreased \$160,000, or 3.4%, to \$4.5 million for the three months ended December 31, 2012 compared with the prior year period due to a 23 basis point decrease in the average yield on such loans to 4.66% from 4.89%. The decrease in yield between the two periods was due primarily to the lower market interest rate environment.

Interest earned on our investment securities, including interest-earning deposits and excluding Federal Home Loan Bank of New York stock, decreased \$162,000, or 29.9%, to \$380,000 due to a \$21.7 million, or 24.5%, decrease in the average balance of such securities to \$66.9 million for the three months ended December 31, 2012. The average yield decreased 18 basis points to 2.25% for the three months ended December 31, 2012 from 2.43% for the three months ended December 31, 2011. The decrease in yield was due to the lower overall interest rate market.

**Interest Expense.** Interest expense decreased \$432,000, or 26.9%, to \$1.2 million for the three months ended December 31, 2012 from \$1.6 million for the three months ended December 31, 2011. The average balance of interest-bearing liabilities decreased \$21.3 million, or 5.0%, between the two periods, while the cost on such liabilities

fell 35 basis points to 1.15% for the quarter ended December 31, 2012 compared with the prior year period.

The average balance of interest bearing deposits decreased \$16.0 million to \$359.8 million from \$375.8 million while the average cost of such deposits decreased 26 basis points to 0.90% from 1.16% in the lower market interest rate environment. As a result, interest expense on deposits decreased \$286,000 to \$816,000 for the three months ended December 31, 2012 from \$1.1 million for the three months ended December 31, 2011.

Interest expense on advances and securities sold under agreements to repurchase decreased \$146,000, or 29.0%, to \$358,000 for the three months ended December 31, 2012 from \$504,000 for the prior year period due to a decrease in the average balance of such borrowings to \$44.6 million from \$49.9 million. In addition, the average cost of advances and securities sold under agreements to repurchase decreased 82 basis points to 3.19% for the three months ended December 31, 2012 from 4.01% for the prior year period, reflecting the repayment of a higher interest-bearing \$10 million security sold under agreements to repurchase between periods.

***Provision for Loan Losses.*** We establish provisions for loan losses, which are charged to earnings, at a level necessary to absorb known and inherent losses that are both probable and reasonably estimable at the date of the financial statements. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, peer group information and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events occur. After an evaluation of these factors, management recorded a provision of \$441,000 for the three months ended December 31, 2012 compared to a provision of \$370,000 for the prior year period. The provision for loan losses increased \$71,000, or 19.2%, during the current period compared with the prior year period primarily attributable to a \$4.7 million increase in an average balance in the loan portfolio.

Table of Contents

Net charge-offs were \$205,000 for the three months ended December 31, 2012 compared to \$334,000 for the three months ended December 31, 2011. The Bank reduced the carrying balance on four loans totaling \$416,000 by \$205,000 to the appraised fair value of collateral, net of estimated disposition costs, securing the loans. These consisted of two home equity loans, one mortgage loan, and one unsecured consumer loan.

Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Management reviews the level of the allowance on a quarterly basis, and establishes the provision for loan losses based on the factors set forth in the preceding paragraph. As management evaluates the allowance for loan losses, the increased risk associated with larger non-homogenous construction, commercial real estate and commercial business loans may result in larger additions to the allowance for loan losses in future periods.

**Other Income.** Non-interest income increased \$82,000, or 14.2%, to \$661,000 during the three months ended December 31, 2012 compared to \$579,000 for the three months ended December 31, 2011. The increase in non-interest income was primarily attributable to higher net gains on the sales of assets, which were \$329,000 for the three months ended December 31, 2012 compared with \$200,000 for the three months ended December 31, 2011. Offsetting these increases was a decrease in service charge fee income of \$36,000 which was a result of lower deposit and loan service fees received during the current year period.

**Other Expenses.** During the three months ended December 31, 2012, non-interest expenses decreased \$251,000 to \$3.6 million from \$3.8 million for the three months ended December 31, 2011. The decrease was primarily the result of lower Other Real Estate Owned expenses, which decreased by \$117,000 to \$141,000 for the three months ended December 31, 2012 from \$258,000 for the prior year period. In addition, compensation and employee benefit expenses fell \$57,000, or 3.1%, due to lower stock award and option expenses, loan servicing expenses fell \$44,000, or 45.8%, due to lower non-performing loan expenses, and occupancy expenses fell \$31,000, or 4.3%, due to the closure of a retail office in February 2012.

**Income Tax Expense.** The Company recorded tax expense of \$132,000 for the three months ended December 31, 2012, compared to \$7,000 for the three months ended December 31, 2011, reflecting increased pre-tax income.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Liquidity**

The Company's liquidity is a measure of its ability to fund loans, pay withdrawals of deposits, and other cash outflows in an efficient, cost-effective manner. The Company's short-term sources of liquidity include maturity, repayment and sales of assets, excess cash and cash equivalents, new deposits, other borrowings, and new advances from the Federal Home Loan Bank. There has been no material adverse change during the three months ended December 31, 2012 in the ability of the Company and its subsidiaries to fund their operations.

At December 31, 2012, the Company had commitments outstanding under letters of credit of \$1.4 million, commitments to originate loans of \$8.1 million, and commitments to fund undisbursed balances of closed loans and unused lines of credit of \$47.4 million. There has been no material change during the three months ended December 31, 2012 in any of the Company's other contractual obligations or commitments to make future payments.

### **Capital Requirements**

On April 22, 2010, Magyar Bank entered into agreements with the Federal Deposit Insurance Corporation ("FDIC"), its principal federal banking regulator, and the New Jersey Department of Banking and Insurance (the "Department"), which required the Bank to take certain measures to improve its safety and soundness. In connection with these agreements, the Bank stipulated to the issuance by the FDIC and the Department of consent orders against the Bank (the "Consent Orders") relating to certain findings from an examination of the Bank. The Consent Orders were filed with the Securities and Exchange Commission on Form 8-K as Exhibits 10.1 and 10.2 on April 23, 2010.

Among the corrective actions required were for the Bank to develop, within 30 days of the April 22, 2010 effective date of the Consent Orders, a written capital plan that details the manner in which the Bank will achieve a Tier 1 capital as a percentage of the Bank's total assets of at least 8%, and total qualifying capital as a percentage of risk-weighted assets of at least 12%. The Bank developed and filed a capital plan on a timely basis with the FDIC and the Department.

Table of Contents

On March 2, 2012 the Bank was informed in writing by the FDIC and the Department that the Consent Order entered into with the FDIC and the Department in April 2010 had been terminated. The FDIC and the Department cited the substantial compliance with the Order by the Bank as the reason for the termination of the Order. The Bank is required to maintain Tier 1 capital as a percentage of the Bank's total assets of at least 8%, and total qualifying capital as a percentage of risk-weighted assets of at least 12%.

At December 31, 2012, the Bank's Tier 1 capital as a percentage of the Bank's total assets was 8.56%, and total qualifying capital as a percentage of risk-weighted assets was 13.11%.

Item 3- Quantitative and Qualitative Disclosures about Market Risk

Not applicable to smaller reporting companies.

Item 4 – Controls and Procedures

Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective.

There has been no change in the Company's internal control over financial reporting during its three months ended December 31, 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II - OTHER INFORMATION

Item 1. Legal proceedings

On December 14, 2011, Elizabeth E. Hance, the former President and Chief Executive Officer of the Company and the Bank, filed a lawsuit against the Company and its directors in the Superior Court of New Jersey, Middlesex County. The lawsuit alleges, among other things, breach of contract and employment discrimination in connection with Ms. Hance's December 2009 separation from employment and seeks severance that she claims she was entitled to, as well as other compensatory and punitive damages. The Company believes that the failure to pay Ms. Hance severance was the result of applicable regulatory prohibitions, and intends to defend the suit vigorously.

Item 1A. Risk Factors

Not applicable to smaller reporting companies.

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

a.) Not applicable.

b.) Not applicable.

The Company did not repurchase shares of its common stock during the three months ended December 31, 2012. c.) Through December 31, 2012, the Company had repurchased 81,000 shares at an average price of \$8.33 pursuant to the second stock repurchase plan, which has reduced outstanding shares to 5,807,344.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

a.) Not applicable.

b.) None.

Item 6. Exhibits

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)

32.1 Certification of 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 Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Interactive data file containing the following financial statements formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets at December 31, 2012 and September 30, 2012; (ii) the Consolidated Statements of Operations for the three months ended December 31, 2012 and 2011; (iii) the Consolidated Statements of Comprehensive Income for the three months ended December 31, 2012 and 2011; (iv) the Consolidated Statements of Changes in Stockholders' Equity for the three months ended December 31, 2012; 101 (v) the Consolidated Statements of Cash Flows for the three months ended December 31, 2012; and (vi) the Notes to Consolidated Financial Statements, tagged as blocks of text. As provided in Rule 406T of Regulation S-T, this interactive data file shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, and shall not be deemed "filed" or part of any registration statement or prospectus for purposes of Section 11 or 12 under the Securities Act of 1933, or otherwise subject to liability under those sections.

32

Table of Contents

Signatures

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

MAGYAR BANCORP, INC.  
(Registrant)

Date: February 11, 2013

/s/ John S. Fitzgerald

John S. Fitzgerald  
President and Chief Executive Officer

Date: February 11, 2013 /s/ Jon R. Ansari

Jon R. Ansari  
Executive Vice President and Chief Financial Officer