SECURITY FEDERAL CORP
Form 10-Q
February 14, 2007

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark one)
(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2006

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD:

FROM: ---------------- TO: -----------------

COMMISSION FILE NUMBER: 0-16120

SECURITY FEDERAL CORPORATION

| | |
|---|---|
| South Carolina | 57-0858504 |
| (State or other jurisdiction of incorporation or organization | (IRS Employer Identification No.) |
| 1705 WHISKEY ROAD, AIKEN, SOUTH CAROLINA | 29801 |
| (Address of Principal Executive Office) | (Zip code) |

(803) 641-3000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO

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

Large accelerated filed [ ]   Accelerated filer[ ]   Non-accelerated filer [X]

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

YES NO X

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

| CLASS: | OUTSTANDING SHARES AT: | SHARES: |
|---|---|---|

| | | |
|---|---|---|
| Common Stock, par value $0.01 per share | January 31, 2007 | 2,609,601 |

INDEX



SCHEDULES OMITTED

All schedules other than those indicated above are omitted because of the absence of the conditions under which they are required or because the information is included in the consolidated financial statements and related notes.

Part I. Financial Information

Item 1. Financial Statements (Unaudited)

Security Federal Corporation and Subsidiaries
Consolidated Balance Sheets

| | December 31, 2006 | March 31, 2006 |
|---|---|---|
| Assets: | (Unaudited) | (Audited) |
| Cash And Cash Equivalents | $ 10,694,191 | $ 14,351,208 |
| Investment And Mortgage-Backed Securities: | | |
| Available For Sale: (Amortized cost of $180,261,315 at December 31, 2006 and $166,808,236 at March 31, 2006) | 178,496,125 | 163,445,066 |
| Held To Maturity: (Fair value of $65,028,212 at December 31, 2006 and $73,084,450 at March 31, 2006) | 65,980,541 | 74,987,805 |
| Total Investment And Mortgage-Backed Securities | 244,476,666 | 238,432,871 |
| Loans Receivable, Net: | | |
| Held For Sale | 4,548,662 | 1,320,644 |
| Held For Investment: (Net of allowance of $7,133,315 at December 31, 2006 and $6,704,734 at March 31, 2006) | 416,934,692 | 373,788,432 |
| Total Loans Receivable, Net | 421,483,354 | 375,109,076 |
| Accrued Interest Receivable: | | |
| Loans | 1,484,714 | 1,096,014 |
| Mortgage-Backed Securities | 546,965 | 508,432 |
| Investments | 1,081,033 | 945,620 |
| Premises And Equipment, Net | 14,597,007 | 11,662,976 |
| Federal Home Loan Bank Stock, At Cost | 7,933,400 | 7,149,800 |
| Bank Owned Life Insurance | 5,721,583 | 5,000,001 |
| Repossessed Assets Acquired In Settlement Of Loans | - | 91,022 |
| Goodwill | 1,197,954 | - |
| Other Assets | 5,407,999 | 4,330,795 |
| Total Assets | $ 714,624,866 | $ 658,677,815 |
| Liabilities And Shareholders' Equity | | |
| Liabilities: | | |
| Deposit Accounts | $ 507,562,059 | $ 479,229,339 |
| Advances From Federal Home Loan | | |

| | | |
|---|---|---|
| Bank | 148,353,041 | 131,363,000 |
| Other Borrowed Money | 6,862,120 | 7,289,773 |
| Advance Payments By Borrowers For Taxes And Insurance | 299,780 | 501,998 |
| Mandatorily Redeemable Financial Instrument | 1,417,312 | - |
| Junior Subordinated Debentures | 5,155,000 | - |
| Other Liabilities | 3,407,746 | 2,691,946 |
| Total Liabilities | $ 673,057,058 | $ 621,076,056 |
| Shareholders' Equity: | | |
| Serial Preferred Stock, $.01 Par Value; Authorized Shares - 200,000; Issued And Outstanding Shares - None | $ - | $ - |
| Common Stock, $.01 Par Value; Authorized Shares - 5,000,000; Issued - 2,635,942 And Outstanding Shares - 2,616,077 At December 31, 2006 And 2,558,234 And 2,537,378 At March 31, 2006 | 25,794 | 25,582 |
| Additional Paid-In Capital | 4,801,947 | 4,404,110 |
| Treasury Stock, (At Cost, 19,865 and 11,312 Shares, Respectively) | (437,055) | (238,656) |
| Indirect Guarantee Of Employee Stock Ownership Trust Debt | - | (215,503) |
| Accumulated Other Comprehensive Loss | (1,095,078) | (2,086,509) |
| Retained Earnings, Substantially Restricted | 38,272,200 | 35,712,735 |
| Total Shareholders' Equity | $ 41,567,808 | $ 37,601,759 |
| Total Liabilities And Shareholders' Equity | $ 714,624,866 | $ 658,677,815 |

See accompanying notes to consolidated financial statements.



Security Federal Corporation and Subsidiaries
Consolidated Statements of Income (Unaudited)

| | Three Months Ended December 31, | |
|---|---|---|
| | 2006 | 2005 |
| Interest Income: | | |
| Loans | $ 7,986,476 | $ 6,017,333 |
| Mortgage-Backed Securities | 1,456,544 | 1,333,025 |
| Investment Securities | 1,314,913 | 962,379 |
| Other | 29,551 | 10,835 |
| Total Interest Income | 10,787,484 | 8,323,572 |
| Interest Expense: | | |
| NOW And Money Market Accounts | 1,684,765 | 1,358,825 |

| | | |
|---|---|---|
| Passbook Accounts | 41,189 | 43,143 |
| Certificate Accounts | 2,846,184 | 1,523,634 |
| Advances And Other Borrowed Money | 1,715,572 | 1,186,344 |
| Junior Subordinated Debentures | 91,983 | - |
| Total Interest Expense | 6,379,693 | 4,111,946 |
| Net Interest Income | 4,407,791 | 4,211,626 |
| Provision For Loan Losses | 150,000 | 165,000 |
| Net Interest Income After Provision For Loan Losses | 4,257,791 | 4,046,626 |
| Other Income: | | |
| Gain On Sale Of Loans | 88,137 | 121,138 |
| Service Fees On Deposit Accounts | 296,135 | 303,173 |
| Income From Cash Value Of Life Insurance | 62,037 | - |
| Commissions On Insurance | 198,772 | 6,966 |
| Other Agency Income | 46,494 | - |
| Trust Income | 110,211 | 81,579 |
| Other | 212,558 | 147,867 |
| Total Other Income | 1,014,344 | 660,723 |
| General And Administrative Expenses: | | |
| Salaries And Employee Benefits | 2,361,104 | 1,847,482 |
| Occupancy | 359,530 | 331,501 |
| Advertising | 98,672 | 44,402 |
| Depreciation And Maintenance Of Equipment | 300,211 | 274,324 |
| FDIC Insurance Premiums | 4,624 | 14,561 |
| Other | 692,571 | 692,196 |
| Total General And Administrative Expenses | 3,816,712 | 3,204,466 |
| Income Before Income Taxes | 1,455,423 | 1,502,883 |
| Provision For Income Taxes | 478,638 | 544,908 |
| Net Income | $ 976,785 | $ 957,975 |
| Basic Net Income Per Common Share | $ 0.37 | $ 0.38 |
| Diluted Net Income Per Common Share | $ 0.37 | $ 0.37 |
| Cash Dividend Per Share On Common Stock | $ 0.06 | $ 0.04 |
| Basic Weighted Average Shares Outstanding | 2,617,037 | 2,536,304 |
| Diluted Weighted Average Shares Outstanding | 2,625,945 | 2,570,767 |

See accompanying notes to consolidated financial statements.



Security Federal Corporation and Subsidiaries

Consolidated Statements of Income (Unaudited)

| | Nine Months Ended December 31, | |
|---|---|---|
| | 2006 | 2005 |
| Interest Income: | | |
| Loans | $ 22,679,587 | $ 16,906,298 |
| Mortgage-Backed Securities | 4,223,959 | 4,084,033 |
| Investment Securities | 3,646,142 | 2,634,484 |
| Other | 62,023 | 47,122 |
| Total Interest Income | 30,611,711 | 23,671,937 |
| Interest Expense: | | |
| NOW And Money Market Accounts | 4,982,221 | 3,905,361 |
| Passbook Accounts | 125,095 | 132,262 |
| Certificate Accounts | 7,437,930 | 4,077,011 |
| Advances And Other Borrowed Money | 4,690,964 | 3,270,366 |
| Junior Subordinated Debentures | 101,985 | - |
| Total Interest Expense | 17,338,195 | 11,385,000 |
| Net Interest Income | 13,273,516 | 12,286,937 |
| Provision For Loan Losses | 450,000 | 495,000 |
| Net Interest Income After Provision For Loan Losses | 12,823,516 | 11,791,937 |
| Other Income: | | |
| Gain On Sale of Investments | - | 48,962 |
| Gain On Sale Of Loans | 295,390 | 374,701 |
| Service Fees On Deposit Accounts | 865,638 | 875,237 |
| Income From Cash Value Of Life Insurance | 180,582 | - |
| Commissions On Insurance | 413,407 | 15,870 |
| Other Agency Income | 140,802 | - |
| Trust Income | 327,767 | 260,172 |
| Other | 539,354 | 424,079 |
| Total Other Income | 2,762,940 | 1,999,021 |
| General And Administrative Expenses: | | |
| Salaries And Employee Benefits | 6,789,633 | 5,443,785 |
| Occupancy | 1,027,793 | 962,678 |
| Advertising | 234,622 | 113,392 |
| Depreciation And Maintenance Of Equipment | 908,006 | 784,443 |
| FDIC Insurance Premiums | 33,586 | 43,247 |
| Other | 1,995,577 | 2,024,699 |
| Total General And Administrative Expenses | 10,989,217 | 9,372,244 |
| Income Before Income Taxes | 4,597,239 | 4,418,714 |
| Provision For Income Taxes | 1,571,083 | 1,581,817 |
| Net Income | $ 3,026,156 | $ 2,836,897 |
| Basic Net Income Per Common Share | $ 1.17 | $ 1.12 |

| | | |
|---|---|---|
| Diluted Net Income Per Common Share | $ 1.16 | $ 1.11 |
| Cash Dividend Per Share On Common Stock | $ 0.18 | $ 0.12 |
| Basic Weighted Average Shares Outstanding | 2,588,864 | 2,531,885 |
| Diluted Weighted Average Shares Outstanding | 2,600,966 | 2,565,949 |

See accompanying notes to consolidated financial statements.



Security Federal Corporation and Subsidiaries
Consolidated Statements of Shareholders' Equity and Comprehensive Income (Unaudited)

| | Common Stock | Additional Paid-In Capital | Treasury Stock | Indirect Guarantee of ESOP Debt | Accumulated Other Comprehen-sive Income (Loss) | Retained Earnings | |
|---|---|---|---|---|---|---|---|
| Balance At March 31, 2005 | $ 25,438 | $4,181,804 | $(165,089) | $(276,217) | $ (961,504) | $32,306,633 | $ |
| Net Income | - | - | - | - | - | 2,836,897 | |
| Other Comprehensive Income, Net Of Tax: | | | | | | | |
| Unrealized Holding Losses On Securities Available For Sale | - | - | - | - | (865,866) | - | |
| Plus Reclassification Adjustments For Gains Included In Net Income | - | - | - | - | (30,356) | - | |
| Comprehensive Income | - | - | - | - | - | - | |
| Purchase Of Treasury Stock At Cost, 1,635 shares | - | - | (35,167) | - | - | - | |
| Exercise Of Stock Options | 126 | 192,318 | - | - | - | - | |
| Decrease In Indirect Guarantee Of ESOP Debt | - | - | - | 60,714 | - | - | |
| Cash Dividends | - | - | - | - | - | (304,832) | |
| Balance At December 31, 2005 | $ 25,564 | $4,374,122 | $(200,256) | $(215,503) | $(1,857,726) | $34,838,698 | $ |

| | Common Stock | Additional Paid-In Capital | Treasury Stock | Indirect Guarantee of ESOP Debt | Accumulated Other Comprehen-sive Income (Loss) | Retained Earnings | |
|---|---|---|---|---|---|---|---|

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Balance At March 31, 2006 | $ 25,582 | $4,404,110 | $(238,656) | $(215,503) | $(2,086,509) | $35,712,735 | $ |
| Net Income | - | - | - | - | - | 3,026,156 | |
| Other Comprehensive Income, Net Of Tax: | | | | | | | |
| Unrealized Holding Gains On Securities Available For Sale | - | - | - | - | 991,431 | - | |
| Comprehensive Income | - | - | - | - | - | - | |
| Purchase Of Treasury Stock At Cost, 8,553 shares | - | - | (198,399) | - | - | - | |
| Decrease In Indirect Guarantee Of ESOP Debt | - | - | - | 215,503 | - | - | |
| Exercise Of Stock Options | 212 | 393,033 | - | - | - | - | |
| Stock Compensation Expense | - | 4,804 | - | - | - | - | |
| Cash Dividends | - | - | - | - | - | (466,691) | |
| Balance At December 31, 2006 | $ 25,794 | $4,801,947 | $(437,055) | $ - | $(1,095,078) | $38,272,200 | $ |

See accompanying notes to consolidated financial statements.



Security Federal Corporation and Subsidiaries
Consolidated Statements of Cash Flows (Unaudited)

| | Nine Months Ended December 31, 2006 | Nine Months Ended December 31, 2005 |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net Income | $ 3,026,156 | $ 2,836,897 |
| Adjustments To Reconcile Net Income To Net Cash Provided (Used) By Operating Activities: | | |
| Depreciation And Amortization Expense | 745,479 | 731,381 |
| Amortization Of Intangible Assets | 45,000 | - |
| Stock Option Compensation Expense | 4,804 | - |
| Discount Accretion And Premium Amortization | 321,311 | 762,876 |
| Provisions For Losses On Loans And Real Estate | 450,000 | 495,000 |
| Gain On Sale Of Loans | (295,390) | (374,701) |
| Gain On Sale Of Mortgage Backed Securities Available For Sale | - | (48,962) |
| Loss (Gain) On Sale Of Real Estate | (48,678) | 21,416 |
| Amortization Of Deferred Fees On Loans | (227,638) | (139,852) |
| Loss on Disposition of Premises and Equipment | 215 | 4,469 |
| Proceeds From Sale Of Loans Held For Sale | 17,846,130 | 24,294,189 |
| Origination Of Loans For Sale | (20,778,758) | (22,355,760) |
| (Increase) Decrease In Accrued Interest Receivable: | | |
| Loans | (388,700) | (236,254) |
| Mortgage-Backed Securities | (38,533) | 46,878 |
| Investments | (135,413) | (51,709) |

| | | |
|---|---|---|
| Increase (Decrease) In Advance Payments By Borrowers | (202,218) | 150,219 |
| Other, Net | (578,090) | 674,086 |
| Net Cash Provided (Used) By Operating Activities | (254,323) | 6,810,173 |
| Cash Flows From Investing Activities: | | |
| Principal Repayments On Mortgage-Backed Securities Available For Sale | 27,419,083 | 39,543,268 |
| Principal Repayments On Mortgage-Backed Securities Held To Maturity | - | 10,407 |
| Purchase Of Investment Securities Available For Sale | (18,941,966) | (20,046,195) |
| Purchase Of Mortgage-Backed Securities Available For Sale | (26,982,890) | (24,569,383) |
| Maturities Of Investment Securities Available For Sale | 4,738,645 | 4,674,853 |
| Maturities of Investment Securities Held To Maturity | 9,000,000 | 1,000,000 |
| Proceeds From Sale Of Mortgage-Backed Securities Available For Sale | - | 3,797,360 |
| Proceeds From Sale Of Mortgage-Backed Securities Held To Maturity | - | 249,650 |
| Purchase Of FHLB Stock | (5,482,400) | (4,697,800) |
| Redemption Of FHLB Stock | 4,698,800 | 3,848,400 |
| Increase In Loans To Customers | (43,368,622) | (40,527,093) |
| Proceeds From Sale Of Repossessed Assets | 139,700 | 96,499 |
| Purchase And Improvement Of Premises And Equipment | (3,679,725) | (2,323,574) |
| Purchase Of Bank Owned Life Insurance | (721,582) | - |
| Net Cash Used By Investing Activities | (53,180,957) | (38,943,608) |
| Cash Flows From Financing Activities: | | |
| Increase In Deposit Accounts | 28,332,720 | 19,885,007 |
| Proceeds From FHLB Advances | 222,223,450 | 181,395,000 |
| Repayment Of FHLB Advances | (205,233,409) | (160,920,000) |
| Net (Repayments) Proceeds Of Other Borrowings | (427,653) | 466,778 |
| Proceeds From Junior Subordinated Debentures | 5,155,000 | - |
| Dividends To Shareholders | (466,691) | (304,832) |
| Purchase Of Treasury Stock | (198,399) | (35,167) |
| Proceeds From Exercise of Stock Options | 393,245 | 192,444 |
| Net Cash Provided By Financing Activities | 49,778,263 | 40,679,230 |

(Continued)



Security Federal Corporation and Subsidiaries
Consolidated Statements of Cash Flows (Unaudited)

| | Nine Months Ended December 31, 2006 | Nine Months Ended December 31, 2005 |
|---|---|---|
| (Decrease) Increase In Cash And Cash Equivalents | (3,657,017) | 8,545,795 |
| Cash And Cash Equivalents At Beginning Of Period | 14,351,208 | 7,916,488 |
| Cash And Cash Equivalents At End Of Period | $ 10,694,191 | $ 16,462,283 |
| Supplemental Disclosure Of Cash Flows Information: | | |
| Cash Paid During The Period For Interest | $ 16,896,006 | $ 11,161,678 |
| Cash Paid During The Period For Income Taxes | $ 1,117,000 | $ 1,742,825 |
| Additions To Repossessed Acquired Through Foreclosure | $ - | $ 210,785 |
| Decrease (Increase) In Unrealized Net Loss On Securities Available For Sale, Net Of Taxes | $ 991,431 | $ (896,222) |
| Issuance Of A Mandatorily Redeemable Financial Instrument Through The Issuance Of Common Stock | 1,417,312 | - |

See accompanying notes to consolidated financial statements.



Security Federal Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and accounting principles generally accepted in the United States of America; therefore, they do not include all disclosures necessary for a complete presentation of financial condition, results of operations, and cash flows. Such statements are unaudited but, in the opinion of management, reflect all adjustments, which are of a normal recurring nature and necessary for a fair presentation of results for the selected interim periods. Users of financial information produced for interim periods are encouraged to refer to the footnotes contained in the audited financial statements appearing in Security Federal Corporation's (the "Company") 2006 Annual Report to Shareholders when reviewing interim financial statements. The results of operations for the nine month period ended December 31, 2006 are not necessarily indicative of the results that may be expected for the entire fiscal year. This Quarterly Report on Form 10-Q contains certain forward-looking statements with respect to the financial condition, results of operations, and business of the Company. These forward-looking statements involve certain risks and uncertainties. Factors that may cause actual results to differ materially from those anticipated by such forward-looking statements include, but are not limited to, changes in interest rates, the demand for loans, the regulatory environment, general economic conditions and inflation, and the securities markets. Management cautions readers of this Form 10-Q not to place undue reliance on the forward-looking statements contained herein.

2. Principles of Consolidation

The accompanying unaudited consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Security Federal Bank (the "Bank"), and the Bank's wholly owned subsidiaries, Security Federal Insurance, Inc. ("SFINS"), Security Federal Investments, Inc. ("SFINV"), Security Federal Trust, Inc. ("SFT"), and Security Financial Services Corporation ("SFSC"). The Bank is primarily engaged in the business of accepting savings and demand deposits and originating mortgage and other loans to individuals and small businesses for various personal and commercial purposes. SFINS, SFINV, and SFT were formed during the year ended March 31, 2002 and began operation during the December 2001 quarter. SFINS is an insurance agency offering business, health, home and life insurance. SFINV engages primarily in investment brokerage services. SFT offers trust, financial planning and financial management services. SFSC is currently inactive.

3. Critical Accounting Policies

The Company has adopted various accounting policies, which govern the application of accounting principles generally accepted in the United States in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to the audited consolidated financial statements at March 31, 2006 included in our 2006 Annual Report to Stockholders, which was filed as an exhibit to our Annual Report on Form 10-K for the year ended March 31, 2006. Certain accounting policies involve significant judgments and assumptions by management, which have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgments and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we make, actual results could differ from these judgments and estimates which could have a material impact on our carrying values of assets and liabilities and our results of operations.

The Company believes the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in preparation of the consolidated financial statements. The Company provides for loan losses using the allowance method. Accordingly, all loan losses are charged to the related allowance and all recoveries are credited to the allowance for loan losses. Additions to the allowance for loan losses are provided by charges to operations based on various factors, which, in management's judgment, deserve current recognition in estimating possible losses. Such factors considered by management include the fair value of the underlying collateral; stated guarantees by the borrow, if applicable, the borrower's ability to repay from other economic resources, growth and composition of the loan portfolios, the relationship of the allowance for loan losses to the outstanding loans, loss experience, delinquency trends, and general economic conditions. Management evaluates the carrying value of the loans periodically and the allowance is adjusted accordingly. While management uses the best information available to make evaluations, future adjustments may be necessary if economic conditions differ substantially from the assumptions used in making these evaluations. Allowance for loan losses are subject to periodic evaluations by various authorities and may be subject to adjustments based upon the information that is available at the time of their examination.

Security Federal Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Unaudited)

3. Critical Accounting Policies, continued

The Company values impaired loans at the loan's fair value if it is probable that the Company will be unable to collect all amounts due according to the terms of the loan agreement at the present value of expected cash flows, the market price of the loan, if available, or the value of the underlying collateral. Expected cash flows are required to be discounted at the loan's effective interest rate. When the ultimate collectibility of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal. When this doubt does not exist, cash receipts are applied under the contractual terms of the loan agreement first to interest and then to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income to the extent that any interest has been foregone. Further cash receipts are recorded as recoveries of any amounts previously charged off.

4. Acquisition

On June 30, 2006, the Company completed the acquisition of the insurance and premium finance businesses of Collier-Jennings Financial Corporation and it subsidiaries Collier-Jennings, Inc., The Auto Insurance Store, Inc., and Collier-Jennings Premium Pay Plans, Inc (the "Collier-Jennings Companies"). The purpose of the acquisition was to expand the insurance services and increase non-interest income. The shareholder of the Collier-Jennings Companies received $180,000 in cash and 54,512 shares of the Company's common stock valued at $26 per share for an approximate purchase price of $1,597,312. The Company will release the shares to the shareholder of the Collier-Jennings Companies over a three-year period. The stock is mandatorily redeemable by the shareholder of Collier-Jennings Companies at his option in cumulative increments of 20% per year for a five-year period at the greater of $26 per share or one and one-half times the book value of the Company's stock. A summary of the purchase price of the transaction is as follows:

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at June 30, 2006, the date of acquisition, including subsequent adjustments to the allocation of the purchase price.

| | |
|---|---|
| Cash And Cash Equivalents | $ 43,192 |
| Accounts Receivable | 784,247 |
| Premises And Equipment | 41,696 |
| Other Assets | 56,289 |
| Intangible Assets | 600,000 |
| Goodwill | 1,197,954 |
| Total Assets Acquired | 2,723,378 |
| Notes Payable | 386,185 |
| Other Liabilities | 739,881 |
| Total Liabilities Assumed | 1,126,066 |
| Net Assets Acquired | $ 1,597,312 |

5. Earnings Per Share

The Company calculates earnings per share ("EPS") in accordance with Statement

of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." SFAS No. 128 specifies the computation, presentation and disclosure requirements for EPS for entities with publicly held common stock or potential common stock such as options, warrants, convertible securities or contingent stock agreements if those securities trade in a public market.
This standard specifies computation and presentation requirements for both basic EPS and, for entities with complex capital structures, diluted EPS. Basic EPS is computed by dividing net income by the weighted average number of common shares outstanding. Diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. The dilutive effect of options outstanding under the Company's stock option plan is reflected in diluted earnings per share by application of the treasury stock method.





5. Earnings Per Share, Continued

The following table provides a reconciliation of the numerators and denominators of the basic and diluted EPS computations:

| | For the Quarter Ended December 31, 2006 | | |
|---|---|---|---|
| | Income (Numerator) Amount | Shares (Denominator) | Per Share |
| Basic EPS | $ 976,785 | 2,617,037 | $ 0.37 |
| Effect of Diluted Securities: | | | |
| Stock Options | - | 8,908 | - |
| Diluted EPS | $ 976,785 | 2,625,945 | $ 0.37 |

| | For the Quarter Ended December 31, 2005 | | |
|---|---|---|---|
| | Income (Numerator) Amount | Shares (Denominator) | Per Share |
| Basic EPS | $ 957,975 | 2,536,304 | $ 0.38 |
| Effect of Diluted Securities: | | | |
| Stock Options | - | 24,919 | (.007) |
| ESOP | - | 9,544 | (.003) |
| Diluted EPS | $ 957,975 | 2,570,767 | $ 0.37 |

| | For the Nine Months Ended December 31, 2006 | | |
|---|---|---|---|
| | Income (Numerator) Amount | Shares (Denominator) | Per Share |
| Basic EPS | $3,026,156 | 2,588,864 | $ 1.17 |
| Effect of Diluted Securities: | | | |
| Stock Options | - | 12,102 | (.01) |
| Diluted EPS | $3,026,156 | 2,600,966 | $ 1.16 |

| | For the Nine Months Ended December 31, 2005 | | |
|---|---|---|---|
| | Income (Numerator) Amount | Shares (Denominator) | Per Share |
| Basic EPS | $2,836,897 | 2,531,885 | $ 1.12 |
| Effect of Diluted Securities: | | | |
| Stock Options | - | 24,471 | (0.007) |
| ESOP | - | 9,593 | (0.003) |
| Diluted EPS | $2,836,897 | 2,565,949 | $ 1.11 |





6. Stock-Based Compensation

On April 1, 2006, the Company adopted the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123R, "Accounting for Stock-Based Compensation," to account for compensation costs under its stock option plans. The Company previously utilized the intrinsic value method under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees (as amended)" ("APB 25"). Under the intrinsic value method prescribed by APB 25, no compensation costs were recognized for the Company's stock options because the option exercise price in its plans equals the market price on the date of grant. Prior to January 1, 2006, the Company only disclosed the pro forma effects on net income and earnings per share as if the fair value recognition provisions of SFAS 123R had been utilized.

In adopting SFAS No. 123, the Company elected to use the modified prospective method to account for the transition from the intrinsic value method to the fair value recognition method. Under the modified prospective method, compensation cost is recognized from the adoption date forward for all new stock options granted and for any outstanding unvested awards as if the fair value method had been applied to those awards as of the date of grant. The following table illustrates the effect on net income and earnings per share as if the fair value based method had been applied to all outstanding and unvested awards in each period.

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Net income, as reported | $ 976,785 | $ 957,975 | $3,026,156 | $2,836,897 |
| Add: Stock-based compensation expense included in reported net income, net of related tax effects | 2,883 | - | 4,804 | - |
| Deduct: Stock-based compensation expense determined under fair market value based method on all awards, net of related tax effects | (2,883) | (30,570) | (4,804) | (91,710) |
| Pro forma net income including stock-based compensation cost based on fair-value method | $ 976,785 | $ 927,405 | $3,026,156 | $2,745,187 |
| Earnings per share: | | | | |
| Basic - as reported | $ 0.37 | $ 0.38 | $ 1.17 | $ 1.12 |
| Basic - pro forma | $ 0.37 | $ 0.37 | $ 1.17 | $ 1.08 |
| Diluted - as reported | $ 0.37 | $ 0.37 | $ 1.17 | $ 1.11 |
| Diluted - pro forma | $ 0.37 | $ 0.36 | $ 1.17 | $ 1.07 |

The following is a summary of the activity under the Company's incentive stock option plan.

| | Three Months Ended December 31, 2006 | | Nine Months Ended December 31, 2006 | |
|---|---|---|---|---|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Balance, Beginning of Period/Year | 111,446 | $ 20.19 | 118,046 | $ 19.50 |
| Options granted | - | - | 13,500 | 23.03 |
| Options exercised | 3,596 | 11.79 | 23,196 | 16.95 |
| Options forfeited | 6,750 | 18.90 | 7,250 | 19.27 |
| Balance, December 31, 2006 | 101,100 | $ 20.58 | 101,100 | $ 20.58 |
| Options Exercisable | 87,600 | $ 20.20 | 87,600 | $ 20.20 |
| Options Available For Grant | 57,500 | | 57,500 | |

Security Federal Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Unaudited), Continued

6. Stock-Based Compensation, Continued

The following table summarizes the stock-based awards granted by the Company, the fair market value of each award granted as estimated on the date of grant using the Black-Scholes option-pricing model, and the weighted average assumptions used for such grants for the periods indicated

| | For Awards Granted During The Three Month Period Ended December 31, | | For Awards Granted During The Nine Month Period Ended December 31, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Awards granted | - | - | 13,500 | - |
| Dividend Yield | - | - | 1.03% | - |
| Expected Volatility | - | - | 30.21% | - |
| Risk-free interest rate | - | - | 4.36% | - |
| Expected life | - | - | 9.01 | - |

At December 31, 2006, the Company had the following options outstanding:

| Grant Date | Outstanding Options | Option Price | Expiration Date |
|---|---|---|---|
| 10/19/99 | 30,600 | $16.67 | 9/30/05 to 9/30/09 |
| 9/1/03 | 3,000 | $24.00 | 8/31/13 |
| 12/1/03 | 3,000 | $23.65 | 11/30/13 |
| 1/01/04 | 7,000 | $24.22 | 12/31/13 |
| 3/8/04 | 13,000 | $21.43 | 2/28/14 |
| 6/7/04 | 2,000 | $24.00 | 5/31/14 |
| 1/1/05 | 21,000 | $20.55 | 12/31/14 |
| 1/1/05 | 2,000 | $22.61 | 12/31/15 |
| 1/1/06 | 6,000 | $23.91 | 12/31/16 |
| 8/24/06 | 13,500 | $23.03 | 8/24/16 |



Security Federal Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Unaudited), Continued

7. Accounting and Reporting Changes

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and / or disclosure of financial information by the Company.

In February 2006, FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments-an amendment of FASB Statements No. 133 and 140." This Statement amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." This Statement resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." SFAS No. 155 permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest only-strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company does not believe that the adoption of SFAS No. 155 will have a material impact on its financial position, results of operations and cash flows.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets-an amendment of FASB Statement No. 140." This Statement amends FASB No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract; requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; permits an entity to choose its subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value; and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. An entity should adopt SFAS No. 156 as of the beginning of its first fiscal year that begins after September 15, 2006. The Company does not believe the adoption of SFAS No. 156 will have a material impact on its financial position, results of operations and cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes". FIN 48 clarifies the accounting for uncertainty in income taxes recognized in enterprises' financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently analyzing the effects of FIN 48.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This standard does not require any new fair value measurements, but rather eliminates inconsistencies found in various prior pronouncements. SFAS 157 is effective for the Company on January 1, 2008 and is not expected to have a significant impact on the Company's financial statements.





7. Accounting and Reporting Changes, Continued

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," which amends SFAS No. 87 and SFAS No. 106 to require recognition of the over-funded or under-funded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS No. 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS No. 87 and SFAS No. 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. The measurement date the date at which the benefit obligation and plan assets are measured is required to be the company's fiscal year end. SFAS No. 158 is effective for publicly held companies for fiscal years ending after December 15, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The Company does not have a defined benefit pension plan. Therefore SFAS No. 158 will not impact the Company's financial condition or results of operations.

In September, 2006, The FASB ratified the consensuses reached by the FASB's Emerging Issues Task Force ("EITF") relating to EITF 06-4 "Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements". EITF 06-4 addresses employer accounting for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods should recognize a liability for future benefits in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," or Accounting Principles Board ("APB") Opinion No. 12, "Omnibus Opinion 1967". EITF 06-4 is effective for fiscal years beginning after December 15, 2006. Entities should recognize the effects of applying EITF 06-4 through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The Company does not believe the adoption of EITF 06-4 will have a material impact on its financial position, results of operations and cash flows.

In September 2006, the FASB ratified the consensus reached related to EITF 06-5, "Accounting for Purchases of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance." EITF 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF 06-5 is effective for fiscal years beginning after December 15, 2006. The Company does not believe the adoption of EITF 06-5 will have a material impact on its financial position, results of operations and cash flows.

In September 2006, the SEC issued Staff Accounting Bulleting No. 108 ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, companies might evaluate the materiality of financial statement misstatements using either the income statement or balance sheet approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company's balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach. The Company has analyzed SAB 108 and determined that upon adoption it will have no impact on the reported results of operations or financial conditions.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations and cash flows.





8. Securities

Investment And Mortgage-Backed Securities, Available For Sale

The amortized cost, gross unrealized gains, gross unrealized losses, and fair values of investment and mortgage-backed securities available for sale are as follows:

| December 31, 2006 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| US Government and Agency Obligations | $ 42,681,560 | $ 14,079 | $ 188,673 | $ 42,506,966 |
| Mortgage-Backed Securities | 137,476,817 | 169,149 | 1,760,907 | 135,885,059 |

| | | | | |
|---|---|---|---|---|
| Equity Securities | 102,938 | 1,162 | - | 104,100 |
| Total | $180,261,315 | $ 184,390 | $1,949,580 | $178,496,125 |
| **March 31, 2006** | | | | |
| US Government and Agency Obligations | $ 28,466,546 | $ - | $ 311,234 | $ 28,155,312 |
| Mortgage-Backed Securities | 138,238,752 | 126,648 | 3,178,584 | 135,186,816 |
| Equity Securities | 102,938 | - | - | 102,938 |
| Total | $166,808,236 | $ 126,648 | $3,489,818 | $163,445,066 |

Investment and Mortgage-Backed Securities, Held to Maturity

The amortized cost, gross unrealized gains, gross unrealized losses, and fair values of investment and mortgage-backed securities held to maturity are as follows:

| December 31, 2006 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| US Government and Agency Obligations | $ 65,980,541 | $ 12,820 | $ 965,149 | $ 65,028,212 |
| **March 31, 2006** | | | | |
| US Government and Agency Obligations | $ 74,987,805 | $ - | $1,903,355 | $ 73,084,450 |



Security Federal Corporation and Subsidiaries
Notes to Consolidated Financial Statements (Unaudited), Continued

9. Loans Receivable, Net

Loans receivable, net, at December 31, 2006 and March 31, 2006 consisted of the following:

| | December 31, 2006 | March 31, 2006 |
|---|---|---|
| Residential Real Estate | $ 126,507,744 | $ 122,026,298 |
| Consumer | 64,814,782 | 58,612,669 |
| Commercial Business & Real Estate | 238,785,530 | 209,214,332 |
| Loans Held For Sale | 4,548,662 | 1,320,644 |
| | 434,656,718 | 391,173,943 |
| Less: | | |
| Allowance For Possible Loan Loss | 7,133,315 | 6,704,734 |

| | | |
|---|---|---|
| Loans In Process | 5,776,071 | 9,185,133 |
| Deferred Loan Fees | 263,978 | 175,000 |
| | 13,173,364 | 16,064,867 |
| | $ 421,483,354 | $ 375,109,076 |

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Security Federal Corporation and Subsidiaries
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Safe Harbor Statement

Certain matters in this Quarterly Report on Form 10-Q for the quarter ended December 31, 2006 constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements relate to, among others, expectations of the business environment in which the Company operates, projections of future performance, perceived opportunities in the market, potential future credit experience, and statements regarding the Company's mission and vision. These forward-looking statements are based upon current management expectations, and may, therefore, involve risks and uncertainties. The Company's actual results, performance, or achievements may differ materially from those suggested, expressed, or implied by forward-looking statements as a result of a wide range of factors including, but not limited to, the general business environment, interest rates, the South Carolina real estate market, the demand for loans, competitive conditions between banks and non-bank financial services providers, regulatory changes, and other risks detailed in the Company's reports filed with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the fiscal year ended March 31, 2006. Forward-looking statements are effective only as of the date that they are made and the Company assumes no obligation to update this information

Comparison Of Financial Condition At December 31, 2006 and March 31, 2006

General - Total assets increased $55.9 million or 8.5% to $714.6 million at December 31, 2006 from $658.7 million at March 31, 2006. The primary reason for the growth in total assets was a $46.4 million or 12.4% increase in net loans receivable to $421.5 million. For the nine months ended December 31, 2006, the demand for loans was funded with decreased cash and cash equivalents of $3.7 million or 25.5%, increased deposits of $28.3 million or 5.9% and advances from the Federal Home Loan Bank ("FHLB") of $17.0 million or 12.9%.

Assets - The increases and decreases in total assets were primarily concentrated in the following asset categories:

| | December 31, 2006 | March 31, 2006 | Increase (Decrease) Amount | Percent |
|---|---|---|---|---|
| Cash And Cash Equivalents | $10,694,191 | $14,351,208 | $(3,657,017) | (25.5)% |
| Investment And Mortgage-Backed Securities Available For Sale | 178,496,125 | 163,445,066 | 15,051,059 | 9.2 |
| Investment And Mortgage-Backed Securities Held To Maturity | 65,980,541 | 74,987,805 | (9,007,264) | (12.0) |

| | | | | |
|---|---|---|---|---|
| Loan Receivable, Net | 421,483,354 | 375,109,076 | 46,374,278 | 12.4 |
| Premises And Equipment, Net | 14,597,007 | 11,662,976 | 2,934,031 | 25.2 |
| FHLB Stock, At Cost | 7,933,400 | 7,149,800 | 783,600 | 11.0 |
| Bank Owned Life Insurance | 5,721,583 | 5,000,001 | 721,582 | 14.4 |
| Goodwill | 1,197,954 | - | 1,197,954 | 100.0 |
| Other Assets | 5,407,999 | 4,330,795 | 1,077,204 | 24.9 |

Cash and cash equivalents decreased $3.7 million to $10.7 million at December 31, 2006 from $14.4 million at March 31, 2006. The reason for the decrease is the Company used cash and cash equivalents to fund loans.

Investments and mortgage-backed securities increased $6.0 million or 2.5% to $244.5 million at December 31, 2006 from $238.4 million at March 31, 2006. The increase in investments and mortgage-backed securities is attributable to purchases and an increase in market value on mortgage-backed securities and investments.





Loans receivable, net increased $46.4 million or 12.4% to $421.5 million at December 31, 2006 from $375.1 million at March 31, 2006. Residential real estate loans increased $4.5 million to $126.5 million at December 31, 2006 from $122.0 million at March 31, 2006. Consumer loans increased $6.2 million to $64.8 million at December 31, 2006 from $58.6 million at March 31, 2006. The increase in consumer loans is attributable to a special rate promotion that was being advertised in print media. Commercial business and real estate loans increased $29.6 million to $238.8 million at December 31, 2006 from $209.2 million at March 31, 2006. The increase in commercial loans was attributable to the Company's continued focus on originating this type of loan. Loans held for sale increased $3.2 million to $4.5 million at December 31, 2006 from $1.3 million at March 31, 2006. The increase is attributable to the lag between the time a mortgage loan is originated and sold to an investor.

Premises and equipment, net increased $2.9 million to $14.6 million at December 31, 2006 from $11.7 million at March 31, 2006. The majority of the increase is for furniture and equipment for our main office and the acquisition of land in Ballentine, South Carolina and northeast Richland County for future branch offices.

FHLB stock, at cost, increased $784,000 to $7.9 million at December 31, 2006 from $7.1 million at March 31, 2006. The increase is attributable to a FHLB requirement that the Company maintain stock equal to 0.20% of total assets at December 31, 2006 plus a transaction component, which equals 4.5% of outstanding advances (borrowings) from the FHLB of Atlanta.

Bank owned life insurance increased $722,000 to $5.7 million at December 31, 2006 from $5.0 million at March 31, 2006. The Company purchased additional life insurance to provide key man life insurance for additional officers and the cash surrender value continues to increase.

Goodwill was $1.2 million at December 31, 2006 compared to zero at March 31, 2006. Goodwill is related to the acquisition of the Collier-Jennings Companies.

Other assets increased $1.1 to $5.4 million at December 31, 2006 from $4.3 million at March 31, 2006. The majority of the increase is the result of the acquisition of the Collier-Jennings Companies. Accounts receivable, intangible assets-net associated with the acquisition of the Collier-Jennings Companies are included in other assets.

Liabilities

Deposit Accounts

| | December 31, 2006 | | March 31, 2006 | | Balance Increase (Decrease) | |
|---|---|---|---|---|---|---|
| | Balance | Weighted Rate | Balance | Weighted Rate | Amount | Percent |
| Demand Accounts: | | | | | | |
| Checking | $100,787,190 | 0.80% | $105,347,713 | 0.97% | $(4,560,523) | (4.3)% |
| Money Market | 142,821,464 | 4.15 | 151,494,548 | 3.50 | (8,673,084) | (5.7) |
| Regular Savings | 16,097,801 | 0.98 | 17,795,109 | 0.98 | (1,697,308) | (9.5) |
| Total | 259,706,455 | 2.65 | 274,637,370 | 2.36 | (14,930,915) | (5.4) |
| Certificate Accounts | | | | | | |
| 0.00 - 1.99% | - | | 59,797 | | (59,797) | (100.0) |
| 2.00 - 2.99% | 1,938,491 | | 26,836,415 | | (24,897,924) | (92.8) |
| 3.00 - 3.99% | 34,825,565 | | 72,831,817 | | (38,006,252) | (52.2) |
| 4.00 - 4.99% | 57,365,265 | | 94,240,989 | | (36,875,724) | (39.1) |
| 5.00 - 5.99% | 153,726,283 | | 10,622,951 | | 143,103,332 | 1,447.1 |
| Total | 247,855,604 | 4.92 | 204,591,969 | 3.98 | 43,263,635 | 21.2 |
| Total Deposits | $507,562,059 | 3.76% | $479,229,339 | 3.05% | $28,332,720 | 5.9% |

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Security Federal Corporation and Subsidiaries
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Advances From FHLB - FHLB advances are summarized by year of maturity and weighted average interest rate in the table below:

| | December 31, 2006 | | March 31, 2006 | | Balance Increase (Decrease) | |
|---|---|---|---|---|---|---|
| Fiscal Year Due: | Balance | Rate | Balance | Rate | Balance | Percent |
| 2007 | 10,000,000 | 4.07% | 18,000,000 | 2.83% | $ (8,000,000) | (44.4)% |
| 2008 | 10,000,000 | 4.31 | 5,000,000 | 3.09 | 5,000,000 | 100.0 |
| 2009 | 25,000,000 | 4.76 | 20,000,000 | 3.28 | 5,000,000 | 25.0 |
| 2010 | 5,000,000 | 3.09 | 5,000,000 | 3.09 | - | - |
| 2011 | 10,000,000 | 4.76 | 20,000,000 | 4.37 | (10,000,000) | (50.0) |
| Thereafter | 88,353,041 | 4.22 | 63,363,000 | 4.04 | 24,990,041 | 39.4 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total Advances | $148,353,041 | 4.31% | $131,363,000 | 3.74% | $16,990,041 | 12.9% |

These advances are secured by a blanket collateral agreement with the FHLB by pledging the Bank's portfolio of residential first mortgage loans and investment securities with approximate amortized cost and fair value of $80.8 million and $79.6 million at December 31, 2006. Advances are subject to prepayment penalties.

The following table shows callable FHLB advances as of the dates indicated. These advances are also included in the above table. All callable advances are callable at the option of the FHLB. If an advance is called, the Bank has the option to payoff the advance without penalty, re-borrow funds on different terms, or convert the advance to a three-month floating rate advance tied to LIBOR.

As of December 31, 2006

| Borrow Date | Maturity Date | Amount | Int. Rate | Type | Call Dates |
|---|---|---|---|---|---|
| 11/07/02 | 11/07/12 | $5,000,000 | 3.354% | 1 Time Call | 11/07/07 |
| 02/20/04 | 02/20/14 | 5,000,000 | 3.225 | 1 Time Call | 02/20/09 |
| 04/16/04 | 04/16/14 | 3,000,000 | 3.330 | 1 Time Call | 04/16/08 |
| 09/16/04 | 09/16/09 | 5,000,000 | 3.090 | 1 Time Call | 09/17/07 |
| 06/24/05 | 06/24/15 | 5,000,000 | 3.710 | 1 Time Call | 06/24/10 |
| 07/22/05 | 07/22/15 | 5,000,000 | 3.790 | 1 Time Call | 07/22/08 |
| 11/10/05 | 11/10/15 | 5,000,000 | 4.400 | 1 Time Call | 11/10/09 |
| 11/23/05 | 11/23/15 | 5,000,000 | 3.933 | Multi-Call | 11/23/07 and quarterly thereafte |
| 11/29/05 | 11/29/13 | 5,000,000 | 4.320 | 1 Time Call | 05/29/09 |
| 12/14/05 | 12/14/11 | 5,000,000 | 4.640 | 1 Time Call | 09/14/09 |
| 01/12/06 | 01/12/16 | 5,000,000 | 4.450 | 1 Time Call | 01/12/11 |
| 03/01/06 | 03/03/14 | 5,000,000 | 4.720 | 1 Time Call | 03/03/10 |
| 03/24/06 | 03/24/16 | 5,000,000 | 4.120 | Multi-Call | 03/26/07 and quarterly thereafte |
| 03/24/06 | 03/25/13 | 5,000,000 | 4.580 | 1 Time Call | 03/25/08 |
| 04/21/06 | 04/22/13 | 5,000,000 | 4.530 | Multi-Call | 04/23/07 and quarterly thereafte |
| 06/02/06 | 06/02/16 | 5,000,000 | 5.160 | 1 Time Call | 06/02/11 |
| 07/11/06 | 07/11/08 | 5,000,000 | 4.800 | Multi-Call | 07/11/08 and quarterly thereafte |
| 10/25/06 | 12/25/11 | 5,000,000 | 4.830 | 1 Time Call | 10/27/08 |
| 11/29/06 | 11/29/16 | 5,000,000 | 4.025 | Multi-Call | 11/29/07 |

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Security Federal Corporation and Subsidiaries
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

As of March 31, 2006

| Borrow Date | Maturity Date | Amount | Int. Rate | Type | Call Dates |
|---|---|---|---|---|---|
| 11/07/02 | 11/07/12 | $5,000,000 | 3.354% | 1 Time Call | 11/07/07 |

| | | | | | |
|---|---|---|---|---|---|
| 10/24/03 | 10/24/08 | 10,000,000 | 2.705 | Multi-Call | 10/24/06 and quarterly thereafte |
| 02/20/04 | 02/20/14 | 5,000,000 | 3.225 | 1 Time Call | 02/20/09 |
| 04/16/04 | 04/16/14 | 3,000,000 | 3.330 | 1 Time Call | 04/16/08 |
| 09/16/04 | 09/16/09 | 5,000,000 | 3.090 | 1 Time Call | 09/17/07 |
| 06/24/05 | 06/24/15 | 5,000,000 | 3.710 | 1 Time Call | 06/24/10 |
| 06/24/05 | 06/24/10 | 5,000,000 | 4.092 | 1 Time Call | 06/24/06 |
| 07/22/05 | 07/22/15 | 5,000,000 | 3.790 | 1 Time Call | 07/22/08 |
| 10/21/05 | 10/21/10 | 5,000,000 | 3.864 | 1 Time Call | 10/23/06 |
| 11/10/05 | 11/10/15 | 5,000,000 | 4.400 | 1 Time Call | 11/10/09 |
| 11/23/05 | 11/23/15 | 5,000,000 | 3.933 | Multi-Call | 11/23/07 and quarterly thereafte |
| 11/29/05 | 11/29/13 | 5,000,000 | 4.320 | 1 Time Call | 05/29/09 |
| 12/14/05 | 12/14/11 | 5,000,000 | 4.640 | 1 Time Call | 09/14/09 |
| 01/12/06 | 01/12/16 | 5,000,000 | 4.450 | 1 Time Call | 01/12/11 |
| 03/24/06 | 03/24/16 | 5,000,000 | 4.120 | Multi-Call | 03/26/07 and quarterly thereafte |
| 03/24/06 | 03/25/13 | 5,000,000 | 4.580 | 1 Time Call | 03/25/08 |
| 03/01/06 | 03/03/14 | 5,000,000 | 4.720% | 1 Time Call | 03/03/10 |

Mandatorily Redeemable Financial Instrument - On June 30, 2006, the Company recorded a $1.4 million mandatorily redeemable financial instrument as a result of the acquisition of the Collier-Jennings Companies. See Note 4, "Acquisition". The shareholder of Collier-Jennings Companies received cash and was issued stock in the Company to settle the acquisition. The Company will release the shares to the shareholder of Collier-Jennings Companies over a three-year period. The stock is mandatorily redeemable by the shareholder of Collier-Jennings Companies in cumulative increments of 20% per year for a five-year period at the greater of $26 per share or one and one-half times the book value of the Company's stock.

Junior Subordinated Debentures - On September 21, 2006, Security Federal Statutory Trust (the "Trust"), a wholly-owned subsidiary of the Company, issued and sold fixed and floating rate capital securities of the Trust (the "Capital Securities"), which are reported on the consolidated balance sheet as junior subordinated debentures, generating proceeds of $5.0 million. The Trust loaned these proceeds to the Company to use for general corporate purposes, primarily to provide capital to the Bank. The debentures qualify as Tier 1 capital under Federal Reserve Board guidelines.

The Capital Securities accrue and pay distributions annually at a rate per annum equal to a blended rate of 6.97% at December 31, 2006. One-half of the Capital Securities issued in the transaction has a fixed rate of 6.88% and the remaining half has a floating rate of three-month LIBOR plus 170 basis points, which was 7.06% at December 31, 2006. The distribution rate payable on the Capital Securities is cumulative and payable quarterly in arrears. The Company has the right, subject to events of default, to defer payments of interest on the Capital Securities for a period not to exceed 20 consecutive quarterly periods, provided that no extension period may extend beyond the maturity date of December 15, 2036. The Company has no current intention to exercise its right to defer payments of interest on the Capital Securities.

The Capital Securities mature or are mandatorily redeemable upon maturity on December 15, 2036, and or upon earlier optional redemption as provided in the indenture. The Company has the right to redeem the Capital Securities in whole or in part, on or after September 15, 2011. The Company may also redeem the capital securities prior to such dates upon occurrence of specified conditions and the payment of a redemption premium

Equity - Shareholders' equity increased $4.0 million or 10.6% to $41.6 million at December 31, 2006 from $37.6 million at March 31, 2006. The employee stock ownership trust of the Company paid $216,000 of principal on the employee stock ownership plan loan during the nine-month period. Accumulated Other Comprehensive Loss, net of tax, decreased $991,000 to $1.1 million during the nine months ended December 31, 2006. The Company's net income for the nine-month period was $3.0 million. The Board of Directors of the Company declared the 62nd, 63rd, and 64th consecutive quarterly dividend, which was $.06 per share, in April, July, and October 2006, which totaled $467,000. Book value per share was $15.89 at December 31, 2006 compared to $14.82 at March 31, 2006.

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Security Federal Corporation and Subsidiaries
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

COMPARISON OF THE RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 31,2006 AND 2005

Net Income - Net income increased $19,000 or 2.0% to $977,000 for the three months ended December 31, 2006 compared to $958,000 for the three months ended December 31, 2005. The primary reason for the increased earnings was increases in net interest income and non-interest income and a decrease in provision for income taxes offset partially by an increase in non-interest expenses.

Net Interest Income - Net interest income increased $196,000 or 4.7% to $4.4 million during the three months ended December 31, 2006, compared to $4.2 million for the same period in 2005, as a result of an increase in interest income offset in part by an increase in interest expense. During the three months ended December 31, 2006, average interest earning assets increased $73.0 million to $670.6 million while average interest-bearing liabilities increased $76.5 million to $621.5 million. The interest rate spread decreased 19 basis points to 2.33% during the three months ended December 31, 2006 compared to the same period in 2005.

The Company's net interest margin was 2.63% and 2.78% for the quarters ended December 31, 2006 and 2005, respectively.

Interest Income - Total interest income increased $2.5 million or 29.6% to $10.8 million during the three months ended December 31, 2006 from $8.3 million for the same period in 2005. Total interest income on loans increased $2.0 million or 32.7% to $8.0 million during the three months ended December 31, 2006 as a result of the average loan portfolio balance increasing $70.3 million and the yield in the loan portfolio increasing 79 basis points. Interest income from mortgage-backed securities increased $124,000 or 9.3% as a result of an increase in yield offset partially by a $13.5 million decrease in the average balance of the portfolio. Interest income from investment securities increased $353,000 or 36.6% as a result of an increase in the yield and average balance of the investment securities portfolio.

The following table compares detailed average balances, associated yields, and the resulting changes in interest income for the three months ended December 31, 2006 and 2005:

| Three Months Ended December 31, | | |
|---|---|---|
| 2006 | 2005 | |
| | | Increase/ |

| | Average Balance | Yield | Average Balance | Yield | (Decrease) In Interest And Dividend Income From 2005 |
|---|---|---|---|---|---|
| Loans Receivable, Net | $419,446,443 | 7.62% | $349,191,412 | 6.83% | $1,969,143 |
| Mortgage-Backed Securities | 132,975,594 | 4.38 | 146,468,249 | 3.64 | 123,519 |
| Investments | 115,919,130 | 4.43 | 100,926,978 | 3.75 | 352,534 |
| Overnight Time | 2,080,466 | 5.15 | 941,216 | 4.60 | 15,951 |
| Security Federal Statutory Trust | 155,000 | 6.98 | - | - | 2,765 |
| Total Interest-Earning Assets | $670,576,633 | 6.43% | $597,527,855 | 5.54% | $2,463,912 |

Interest Expense - Total interest expense increased $2.3 million or 55.2% to $6.4 million during the three months ended December 31, 2006 compared to $4.1 million for the same period one-year earlier. The increase in total interest expense is attributable to the increases in short-term interest rates, interest-bearing deposits, and borrowings. Interest expense on deposits increased $1.6 million or 56.3% during the period as average interest bearing deposits grew $49.2 million compared to the average balance in the three months ended December 31, 2005 while the cost of deposits increased 112 basis points. Interest expense on advances and other borrowings increased $529,000 or 44.6% as the cost of debt outstanding increased 85 basis points during the 2006 period compared to 2005 while average total borrowings outstanding increased approximately $22.1 million. Interest expense on junior subordinated debentures was $92,000 for the three months ended December 31, 2006 compared to zero for the same period one year ago. The junior subordinated debentures are the result of the Company's $5.0 million trust preferred securities offering.





The following table compares detailed average balances, cost of funds, and the resulting changes in interest expense for the three months ended December 31, 2006 and 2005:

| | Three Months Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2006 | | 2005 | | |
| | Average Balance | Yield | Average Balance | Yield | Increase/ (Decrease) In Interest Expense From 2005 |
| Now And Money Market Accounts | $207,023,453 | 3.26% | $219,249,269 | 2.48% | $ 325,940 |
| Passbook Accounts | 16,683,742 | 0.99 | 17,474,460 | 0.99 | (1,954) |
| Certificates Accounts | 236,810,841 | 4.81 | 174,577,508 | 3.49 | 1,322,550 |

| | | | | | |
|---|---|---|---|---|---|
| FHLB Advances And Other Borrowed Money | 155,837,665 | 4.40 | 133,752,546 | 3.55 | 529,228 |
| Junior Subordinated Debentures | 5,155,000 | 6.98 | - | - | 91,983 |
| Total Interest-Bearing Liabilities | $621,510,701 | 4.10% | $545,053,783 | 3.02% | $2,267,747 |

Provision for Loan Losses - The amount of the provision is determined by management's on-going monthly analysis of the loan portfolio. Management uses three methods to measure the estimate of the adequacy of the allowance for loan losses. These methods incorporate percentage of classified loans, five-year averages of historical loan losses in each loan category and current economic trends, and the assignment of percentage targets of reserves in each loan category. Management has used all three methods for the past seven fiscal years.

The Bank's provision for loan losses was $150,000 during the three months ended December 31, 2006 compared to $165,000 for the quarter ended December 31, 2005. The $15,000 or 9.1% decrease reflects the Company's current credit quality and reduction in classified assets, impaired loans and net charge-offs. The following table details selected activity associated with the allowance for loan losses for the three months ended December 31, 2006 and 2005.

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| Beginning Balance | $ 6,994,623 | $ 6,532,667 |
| Provision | 150,000 | 165,000 |
| Charge-offs | (35,912) | (142,533) |
| Recoveries | 24,604 | 15,797 |
| Ending Balance | $ 7,133,315 | $ 6,570,931 |
| Allowance For Loan Losses As A Percentage Of Gross Loans Receivable And Loans Held For Sale At The End Of The Period | 1.66% | 1.82% |
| Allowance For Loan Losses As A Percentage Of Impaired Loans At The End Of The Period | 451.86% | 489.06% |
| Impaired Loans | 1,578,672 | 1,343,591 |
| Nonaccrual Loans And 90 Days Or More Past Due Loans As A Percentage Of Gross Loans Receivable And Loans Held For Sale At The End Of The Period | 0.25% | 0.46% |
| Loans Receivable, Net | $ 421,483,354 | $ 355,286,567 |





Non-Interest Income - Non-interest income increased $354,000 or 53.5% to $1.0 million for the three months ended December 31, 2006 from $661,000 for the same period one year ago. The following table provides a detailed analysis of the changes in the components of non-interest income:

| | Three Months Ended December 31, | | Increase/(Decrease) | |
|---|---|---|---|---|
| | 2006 | 2005 | Amounts | Percent |
| Gain On Sale Of Loans | 88,137 | 121,138 | (33,001) | (27.2)% |
| Service Fees On Deposit Accounts | 296,135 | 303,173 | (7,038) | (2.3) |
| Income From Cash Value Of Life Insurance | 62,037 | - | 62,037 | 100.0 |
| Commissions On Insurance | 198,772 | 6,966 | 191,806 | 2,753.5 |
| Other Agency Income | 46,494 | - | 46,494 | 100.0 |
| Trust Income | 110,211 | 81,579 | 28,632 | 35.1 |
| Other | 212,558 | 147,867 | 64,691 | 43.8 |
| Total non-interest income | $1,014,344 | $660,723 | $ 353,621 | 53.5% |

Income from cash value of life insurance was $62,000 for the three months ended December 31, 2006 compared to no income during the same period one year ago. This increase is the result of the Company's purchase of bank owned life insurance for certain officers of the Company. Commissions on insurance and other agency income increased $192,000 as a result of the Collier-Jennings Companies acquisition. Other miscellaneous income including credit life insurance commissions, safe deposit rental income, annuity and stock brokerage commissions, trust fees, and other miscellaneous fees, increased $64,000 to $213,000 during the three months ended December 31, 2006 compared to the same period one year ago.

Non-Interest Expense - Non-interest expense increased $612,000 or 19.1% to $3.8 million for the three months ended December 31, 2006 from $3.2 million for the same period one year ago. The following table provides a detailed analysis of the changes in the components of non-interest expense:

| | Three Months Ended December 31, | | Increase/(Decrease) | |
|---|---|---|---|---|
| | 2006 | 2005 | Amounts | Percent |
| Salaries And Employee Benefits | $2,361,104 | $1,847,482 | $ 513,622 | 27.8% |
| Occupancy | 359,530 | 331,501 | 28,029 | 8.5 |
| Advertising | 98,672 | 44,402 | 54,270 | 122.2 |
| Depreciation And Maintenance Of Equipment | 300,211 | 274,324 | 25,887 | 9.4 |
| FDIC Insurance Premiums | 4,624 | 14,561 | (9,937) | (68.2) |
| Other | 692,571 | 692,196 | 375 | 0.1 |
| Total Non-Interest Expenses | $3,816,712 | $3,204,466 | $ 612,246 | 19.1% |

Salary and employee benefits increased $514,000 to $2.4 million for the three months ended December 31, 2006 from $1.8 million for the same period one year ago. The majority of the increase is the result of hiring additional staff to handle the Company's growth and increased regulatory reporting requirements and integrating the Collier-Jennings Companies' employees. Advertising expense increased $54,000 to $99,000 for the three months ended December 31, 2006 from $44,000 for the same period one year ago. The increase is attributable to the Company using more print media advertising to attract deposits and consumer loans.

Provision For Income Taxes - Provision for income taxes decreased $66,000 or

12.2% to $479,000 for the three months ended December 31, 2006 from $545,000 for the same period one year ago. Income before income taxes was $1.5 million for the three months ended December 31, 2006 and 2005, respectively. The Company's combined federal and state effective income tax rate for the current quarter was 33.0% compared to 36.3% for the same quarter one year ago.





COMPARISON OF THE RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED DECEMBER 31, 2006 AND 2005

Net Income - Net income increased $189,000 or 6.7% to $3.0 million for the nine months ended December 31, 2006 compared to $2.8 million for the nine months ended December 31, 2005. The primary reason for the increased earnings was an increase in net interest income and non-interest income offset partially by an increase in non-interest expenses.

Net Interest Income - Net interest income increased $987,000 or 8.0% to $13.3 million during the nine months ended December 31, 2006, compared to $12.3 million for the same period in 2005, as a result of an increase in interest income offset in part by an increase in interest expense. Average interest earning assets increased $63.7 million to $649.9 million while average interest-bearing liabilities increased $66.6 million to $601.5 million. The interest rate spread decreased seven basis points to 2.44% during the nine months ended December 31, 2006 compared to the same period in 2005.

The Company's net interest margin decreased four basis points to 2.72% for the nine months ended December 31, 2006 from 2.76% for the same period last year.

Interest Income - Total interest income increased $6.9 million or 29.3% to $30.6 million during the nine months ended December 31, 2006 from $23.7 million for the same period in 2006. Total interest income on loans increased $5.8 million or 34.2% to $22.7 million during the nine months ended December 31, 2006 as a result of the average loan portfolio balance increasing $66.3 million and the yield in the loan portfolio increasing 87 basis points. Interest income from mortgage-backed securities increased $140,000 or 3.4% as a result of an increase in the yield in the mortgage-backed portfolio despite a decrease in the average balance of the portfolio of $19.5 million. Interest income from investment securities increased $1.0 million or 38.4% as a result of an increase in the yield and average balance of the investment securities portfolio.

The following table compares detailed average balances, associated yields, and the resulting changes in interest income for the nine months ended December 31, 2006 and 2005:

| Nine Months Ended December 31, | | |
|---|---|---|
| 2006 | 2005 | |
| | | Increase/ (Decrease) In Interest And Dividend |

| | Average Balance | Yield | Average Balance | Yield | Income From 2005 |
|---|---|---|---|---|---|
| Loans Receivable, Net | $402,113,832 | 7.52% | $335,809,808 | 6.65% | $5,773,289 |
| Mortgage-Backed Securities | 133,593,423 | 4.22 | 153,107,695 | 3.56 | 139,926 |
| Investments | 112,544,965 | 4.32 | 95,390,254 | 3.68 | 1,011,658 |
| Overnight Time | 1,561,374 | 5.03 | 1,871,946 | 3.36 | 11,835 |
| Security Federal Statutory Trust | 58,550 | 6.98 | - | - | 3,066 |
| Total Interest-Earning Assets | $649,872,144 | 6.28% | $586,179,703 | 5.35% | $6,939,774 |



Security Federal Corporation and Subsidiaries
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Interest Expense - Total interest expense increased $6.0 million or 52.3% to $17.3 million during the nine months ended December 31, 2006 compared to $11.4 million for the same period one year earlier. The increase in total interest expense is attributable to the increases in short-term interest rates, and the increase in the amount of interest-bearing deposits, and borrowings. Interest expense on deposits increased $4.4 million or 54.6% during the period as average interest bearing deposits grew $39.1 million compared to the average balance in the nine months ended December 31, 2005 while the cost of interest bearing deposits increased 109 basis points. Interest expense on advances and other borrowings increased $1.4 million or 43.4% as the cost of debt outstanding increased 68 basis points during the nine months ended December 31, 2006 compared to the same period in 2005 while average total borrowings outstanding increased approximately $25.5 million. Interest expense on junior subordinated debentures was $102,000 for the nine months ended December 31, 2006 compared to zero for the same period one year ago. The junior subordinated debentures are the result of the Company's $5.0 million trust preferred securities offering.

The following table compares detailed average balances, cost of funds, and the resulting changes in interest expense for the nine months ended December 31, 2006 and 2005:

| | Nine Months Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2006 | | 2005 | | |
| | Average Balance | Yield | Average Balance | Yield | Increase/ (Decrease) In Interest Expense From 2005 |
| Now And Money Market Accounts | $210,937,813 | 3.15% | $225,023,479 | 2.42% | $1,076,860 |
| Passbook Accounts | 16,926,574 | 0.99 | 17,892,564 | 0.99 | (7,167) |
| Certificates Accounts | 222,170,422 | 4.46 | 167,980,767 | 3.10 | 3,360,919 |
| FHLB Advances And Other Borrowed Money | 149,495,522 | 4.19 | 124,007,336 | 3.51 | 1,420,598 |
| Junior Subordinated Debentures | 1,947,000 | 6.98 | - | - | 101,985 |

| | | | | | |
|---|---|---|---|---|---|
| Total Interest-Bearing Liabilities | $601,477,331 | 3.84% | $534,904,146 | 2.84% | $5,953,195 |



Security Federal Corporation and Subsidiaries
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, Continued

Provision for Loan Losses - The amount of the provision is determined by management's on-going monthly analysis of the loan portfolio. Management uses three methods to measure the estimate of the adequacy of the allowance for loan losses. These methods incorporate percentage of classified loans, five-year averages of historical loan losses in each loan category and current economic trends, and the assignment of percentage targets of reserves in each loan category. Management has used all three methods for the past seven fiscal years.

The Bank's provision for loan losses was $450,000 during the nine months ended December 31, 2006 compared to $495,000 for the nine months ended December 31, 2005. The $45,000 or 9.1% decrease reflects the Company's current credit quality and reduction in classified assets, impaired loans and net charge-offs. The following table details selected activity associated with the allowance for loan losses for the nine months ended December 31, 2006 and 2005

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| Beginning Balance | $ 6,704,734 | $ 6,284,055 |
| Provision | 450,000 | 495,000 |
| Charge-offs | (111,191) | (263,752) |
| Recoveries | 89,772 | 55,628 |
| Ending Balance | $ 7,133,315 | $ 6,570,931 |
| Allowance For Loan Losses As A Percentage Of Gross Loans Receivable And Loans Held For Sale At The End Of The Period | 1.66% | 1.82% |
| Allowance For Loan Losses As A Percentage Of Impaired Loans At The End Of The Period | 451.86% | 489.06% |
| Impaired Loans | 1,578,672 | 1,343,591 |
| Nonaccrual Loans And 90 Days Or More Past Due Loans As A Percentage Of Gross Loans Receivable And Loans Held For Sale At The End Of The Period | 0.51% | 0.46% |
| Loans Receivable, Net | $ 421,483,354 | $ 355,286,567 |

Non-Interest Income - Non-interest income increased $764,000 or 38.2% to $2.8 million for the nine months ended December 31, 2006 from $2.0 million for the same period one year ago. The following table provides a detailed analysis of the changes in the components of non-interest income:

Nine Months Ended Increase/

| | December 31, | | (Decrease) | |
|---|---|---|---|---|
| | 2006 | 2005 | Amounts | Percent |
| Gain On Sale Of Investments, Net | $ - | $ 48,962 | $ (48,962) | (100.0)% |
| Gain On Sale Of Loans | 295,390 | 374,701 | (79,311) | (21.2) |
| Service Fees On Deposit Accounts | 865,638 | 875,237 | (9,599) | (1.1) |
| Income From Cash Value Of Life Insurance | 180,582 | - | 180,582 | 100.0 |
| Commissions On Insurance | 413,407 | 15,870 | 397,537 | 2,505.0 |
| Other Agency Income | 140,802 | - | 140,802 | 100.0 |
| Trust Income | 327,767 | 260,172 | 67,595 | 26.0 |
| Other | 539,354 | 424,079 | 115,275 | 27.2 |
| Total non-interest income | $2,762,940 | $1,999,021 | $ 763,919 | 38.2% |

Income from cash value of life insurance was $181,000 for the nine months ended December 31, 2006 compared to no income during the same period one year ago. This increase is the result of the Company purchasing bank owned life insurance for certain officers of the Company. Commissions on insurance and other agency income increased $398,000 as a result of the Collier-Jennings Companies acquisition. Other miscellaneous income including credit life insurance commissions, safe deposit rental income, annuity and stock brokerage commissions, and other miscellaneous fees, increased $115,000 to $539,000 during the nine months ended December 31, 2006 compared to the same period one year ago.





Non-Interest Expense - Non-interest expense increased $1.6 million or 17.3% to $11.0 million for the nine months ended December 31, 2006 from $9.4 million for the same period one year ago. The following table provides a detailed analysis of the changes in the components of non-interest expense:

| | Nine Months Ended December 31, | | Increase/ (Decrease) | |
|---|---|---|---|---|
| | 2006 | 2005 | Amounts | Percent |
| Salaries And Employee Benefits | $ 6,789,633 | $5,443,785 | $1,345,848 | 24.7% |
| Occupancy | 1,027,793 | 962,678 | 65,115 | 6.8 |
| Advertising | 234,622 | 113,392 | 121,230 | 106.9 |
| Depreciation And Maintenance Of Equipment | 908,006 | 784,443 | 123,563 | 15.8 |
| FDIC Insurance Premiums | 33,586 | 43,247 | (9,661) | (22.3) |
| Other | 1,995,577 | 2,024,699 | (29,122) | (1.4) |
| Total Non-Interest Expenses | $10,989,217 | $9,372,244 | 1,616,973 | 17.3% |

Salary and employee benefits increased $1.4 to $6.8 million for the nine months ended December 31, 2006 from $5.4 million for the same period one year ago. The majority of the increase is the result of hiring additional staff to handle the Company's growth and increased regulatory reporting requirements and integrating the Collier-Jennings Companies' employees. Advertising expense increased $121,000 to $235,000 for the nine months ended December 31, 2006 from $114,000 for the same period one year ago. The increase is attributable to the Company using more print media advertising to attract deposits and consumer loans.

Provision For Income Taxes - Provision for income taxes decreased $11,000 or 0.7% to $1.6 million for the nine months ended December 31, 2006 from $1.6 million for the same period one year ago. Income before income taxes was $4.6 million for the nine months ended December 31, 2006 compared to $4.4 million for the nine months ended December 31, 2005. The Company's combined federal and state effective income tax rate for the nine months ended December 31, 2006 was 34.2% compared to 35.8% for the same period one year ago.

Liquidity Commitments, Capital Resources , and Impact of Inflation and Changing Prices

Liquidity - The Company actively analyzes and manages the Bank's liquidity with the objective of maintaining an adequate level of liquidity and to ensure the availability of sufficient cash flows to support loan growth, fund deposit withdrawals, fund operations, and satisfy other financial commitments. See the "Consolidated Statements of Cash Flows" contained in Item 1 Financial Statements, herein.

The primary sources of funds are customer deposits, loan repayments, loan sales, maturing investment securities, and advances from the FHLB. The sources of funds, together with retained earnings and equity, are used to make loans, acquire investment securities and other assets, and fund continuing operations. While maturities and the scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage repayments are greatly influenced by the level of interest rates, economic conditions, and competition. Management believes that the Company's current liquidity position and its forecasted operating results are sufficient to fund all of its existing commitments.

During the nine months ended December 31, 2006 loan disbursements exceeded loan repayments resulting in a $46.4 million or 12.4% increase in total net loans receivable. During the nine months ended December 31, 2006, deposits increased $28.3 million and FHLB advances increased $17.0 million. The Bank had $65.9 million in additional borrowing capacity at the FHLB at the end of the period. At December 31, 2006, the Bank had $225.1 million of certificates of deposit maturing within one year. Based on previous experience, the Bank anticipates a significant portion of these certificates will be renewed.

The Company has plans to expand its branch network, which could cause earnings to level off or decline for a period of time. The leveling off or decline in earnings will be attributed the lag that exists from the time a branch is built to when it becomes profitable. In the next twelve months, we anticipate investing $5.0 to $6.0 million in land, buildings, and equipment. In the next twenty-four months, we anticipate investing $8.0 to $10.0 million in land, buildings, and equipment. The anticipated costs could be affected by increased construction costs, weather delays, and/or other uncertainties.

Results of Operations, Continued

Off-Balance Sheet Commitments - The Company 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 generally include commitments to originate mortgage, commercial and consumer loans, and involve to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Company's maximum exposure to credit loss in the event of nonperformance by the borrower is represented by the contractual amount of those instruments. Since some commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments. Collateral is not required to support commitments.

The following table sets forth the length of time until maturity for unused commitments to extend credit and standby letters of credit at December 31, 2006.

| (Dollars in thousands) | Within One Month | After One Through Three Months | After Three Through Twelve Months | Within One Year | Greater Than One Year | Total |
|---|---|---|---|---|---|---|
| Unused lines of credit | $5,864 | $ 4,375 | $33,151 | $ 43,390 | $35,794 | $79,184 |
| Standby letters of credit | - | 46 | 448 | 494 | - | 494 |
| Total | $5,864 | $ 4,421 | $33,599 | $ 43,884 | $35,794 | $79,678 |



Security Federal Corporation and Subsidiaries

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises principally from interest rate risk inherent in its lending, investment, deposit and borrowing activities. Management actively monitors and manage its interest rate risk exposure. Although the Company manages other risks such as credit quality and liquidity risk in the normal course of business, management considers interest rate risk to be its most significant market risk that could potentially have the largest material effect on the Company's financial condition and results of operations. Other types of market risks such as foreign currency exchange rate risk and commodity price do not arise in the normal course of the Company's business activities.

The Company's profitability is affected by fluctuations in the market interest rate. Management's goal is to maintain a reasonable balance between exposure to interest rate fluctuations and earnings. A sudden and substantial increase or decrease in interest rates may adversely impact the Company's earnings to the extent that the interest rates on interest-earning assets and interest-bearing liabilities do not change at the same rate, to the same extent or on the same basis. The Company monitors the impact of changes in interest rates on its net interest income using a test that measures the impact on net interest income and net portfolio value of an immediate change in interest rates in 100 basis point increments and by measuring the Bank's interest sensitivity gap ("Gap"). Net portfolio value is defined as the net present value of assets, liabilities, and off-balance sheet contracts. Gap is the amount of interest sensitive assets repricing or maturing over the next twelve months compared to the amount of interest sensitive liabilities maturing or repricing in the same time period. Recent net portfolio value reports furnished by the OTS indicate that the Bank's interest rate risk sensitivity has increased slightly over the past year. The Bank has rated favorably compared to thrift peers concerning interest rate sensitivity.

For the nine months ended December 31, 2006, the Bank's interest rate spread, defined as the average yield on interest bearing assets less the average rate paid on interest bearing liabilities was 2.44%. For the year ended March 31, 2006, the interest rate spread was 2.48%. The interest rate spread decreased due to the rates paid on deposits outpacing the rates received on loans. The rate differential was offset partially by the growth of loan receivables. Loan receivables earn a higher yield than investment securities. However, if interest rates were to increase suddenly and significantly, the Bank's net interest income and net interest spread would be compressed.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures: An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a - 15(e) of the Securities Exchange Act of 1934 ("Act")) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management as of the end of the period covered by this quarterly report. The Company's Chief Executive Officer and Chief Financial Officer concluded that at December 31, 2006 the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time period specified in the Securities and Exchange Commission's rules and forms.

(b) Changes in Internal Controls: In the quarter ended December 31, 2006, the Company did not make any significant changes in, nor take any corrective actions regarding, its internal controls or other factors that could significantly affect these controls.



Security Federal Corporation and Subsidiaries

Part II: Other Information

Item 1 Legal Proceedings

The Company is not engaged in any legal proceedings of a material nature at the present time. From time to time, the Company is a party to legal proceedings in the ordinary course of business wherein it enforces its security interest in mortgage loans it has made.

Item 1A Risk Factors

There have been no material changes in the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended March 31, 2006.

Item 2 Unregistered sales of Equity Securities and Use Of Proceeds

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid Per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Program | (d) Maximum Number of Shares that May Yet Be Purchased Under the Program |
|---|---|---|---|---|
| October 1- October 31, 2006 | - | - | - | 111,088 |
| November 1 - November 30, 2006 | 438 | $23.75 | 438 | 110,650 |
| December 1 - December 31, 2006 | 4,515 | 23.25 | 4,515 | 106,135 |
| Total | 4,953 | $23.29 | 4,953 | 106,135 |

In May 2004, the Company's Board of Directors authorized a 5% repurchase plan, or 126,000 shares of the Company's outstanding common stock. As of December 31, 2006, 19,865 shares have been repurchased under this program. The Company repurchased 4,953 shares of its outstanding Common Stock during the three months ended December 31, 2006.

Item 3 Defaults Upon Senior Securities

None

Item 4 Submission Of Matters To A Vote Of Security Holders

None

Item 5 Other Information

None





Part II: Other Information, Continued

Item 6 Exhibits

| | |
|---|---|
| 3.1 | Articles Of Incorporation, as amended (1) |
| 3.2 | Bylaws (2) |
| 4 | Instruments defining the rights of security holders, including indentures (3) |
| 10.1 | Executive Compensation Plans and Arrangements |
| 10.2 | 1993 Salary Continuation Agreements (4) |
| 10.3 | Amendment One to 1993 Salary Continuation Agreement (5) |
| 10.4 | Form of 2006 Salary Continuation Agreement(6) |
| 10.4 | 1999 Stock Option Plan (2) |
| 10.5 | 1987 Stock Option Plan (4) |
| 10.6 | 2002 Stock Option Plan (7) |
| 10.7 | 2004 Employee Stock Purchase Plan (8) |
| 10.8 | Incentive Compensation Plan (4) |
| 10.9 | Form of Security Federal Bank Salary Continuation Agreement (9) |
| 10.10 | Form of Security Federal Split Dollar Agreement (9) |
| 14 | Code of Ethics (10) |
| 31.1 | Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act. |
| 31.2 | Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act. |
| 32 | Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act. |

(1) Filed on June 26, 1998, as an exhibit to the Company's Proxy Statement and incorporated herein by reference.

(2) Filed on March 2, 2000, as an exhibit to the Company's Registration Statement on Form S-8 and incorporated herein by reference.

(3) Filed on August 12, 1987, as an exhibit to the Company's Registration Statement on Form 8-A and incorporated herein by reference.

(4) Filed on June 28, 1993, as an exhibit to the Company's Annual Report on Form 10-KSB and incorporated herein by reference.

(5) Filed as an exhibit to the Company's Quarterly Report on Form 10-QSB for the quarter ended September 30, 1993 and incorporated herein by reference.

(6) Filed on May 24, 2006 as an exhibit to the Company's Current Report on Form 8-K dated May 18, 2006 and incorporated herein by reference.

(7) Filed on June 19, 2002, as an exhibit to the Company's Proxy Statement and incorporated herein by reference.

(8) Filed on June 18, 2004, as an exhibit to the Company's Proxy Statement and incorporated herein by reference.

(9) Filed on May 24, 2006 as an exhibit to the Current Report on Form 8-K and incorporated herein by reference.

(10) Filed on June 29, 2006 as an exhibit to the Company's Annual Report on Form 10-K and incorporated herein by reference.

Signatures

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

SECURITY FEDERAL CORPORATION

Date: February 13, 2007 By:/s/Timothy W. Simmons

Timothy W. Simmons
President
Duly Authorized Representative

Date: February 13, 2007 By:/s/Roy G. Lindburg

Roy G. Lindburg
Treasurer/CFO
Duly Authorized Representative

31

EXHIBIT 31.1

Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act

32

Certification

I, Timothy W. Simmons, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Security Federal Corporation;

2. Based on my knowledge, this report does not contain any untrue statement

of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 13, 2007

/s/ Timothy W. Simmons
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Timothy W. Simmons
President and Chief Executive Officer

EXHIBIT 31.2

Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act



Certification

I, Roy G. Lindburg, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Security Federal Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

    c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent

functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 13, 2007

/s/ Roy G. Lindburg
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Roy G. Lindburg
Chief Financial Officer



EXHIBIT 32

Certification Pursuant to Section 906 of the Sarbanes Oxley Act



CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
OF SECURITY FEDERAL CORPORATION
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned hereby certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with this Quarterly Report on Form 10-Q that:

1. the report fully complies with the requirements of Section 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, and

2. the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of Security Federal Corporation.

| | |
|---|---|
| /s/Timothy W. Simmons | /s/Roy G. Lindburg |
| ------------------------------ | ------------------------------ |
| Timothy W. Simmons | Roy G. Lindburg |
| Chief Executive Officer | Chief Financial Officer |

Dated: February 13, 2007