TF FINANCIAL CORP
Form 10-Q
August 05, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the period ended June 30, 2005

- or -

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

For the transition period from **to**

Commission file number: 0-24168

TF FINANCIAL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**74-2705050** (I.R.S. Employer Identification No.)
3 Penns Trail, Newtown, Pennsylvania (Address of Principal Executive Offices)	**18940** (Zip Code)

Registrant s telephone number, including area code: **(215) 579-4000**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $.10 per share

(Title of Class)

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

Indicate by check mark whether the registrant is an accelerated filer as defined in Exchange Act Rule 12b-2. YES o NO ý

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date: July 27, 2005

Class		**Outstanding**	
	$.10 par value common stock		2,924,810 shares

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TF Financial Corporation and Subsidiaries

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

		Unaudited June 30, 2005		Audited December 31, 2004
		(in thousands)		
ASSETS				
Cash and cash equivalents	$	10,970	$	7,900
Certificates of deposit in other financial institutions		40		38
Investment securities available for sale at fair value		23,658		17,625
Investment securities held to maturity (fair value of $7,073 and $7,188 respectively)		6,992		7,027
Mortgage-backed securities available for sale at fair value		95,595		103,610
Mortgage-backed securities held to maturity (fair value of $12,966 and $15,546, respectively)		12,510		14,900
Loans receivable, net (including loans held for sale of $784 and $680, respectively)		464,382		442,195
Federal Home Loan Bank stock at cost		6,819		7,460
Accrued interest receivable		2,590		2,500
Premises and equipment, net		5,932		5,963
Core deposit intangible asset, net of accumulated amortization of $2,679 and $2,611, respectively		145		213
Goodwill		4,324		4,324
Other assets		15,876		15,211
TOTAL ASSETS	$	649,833	$	628,966
LIABILITIES AND STOCKHOLDERS EQUITY				
Liabilities				
Deposits	$	479,579	$	459,903
Advances from the Federal Home Loan Bank		101,130		102,747
Advances from borrowers for taxes and insurance		2,136		1,778
Accrued interest payable		1,984		1,638
Other liabilities		2,658		1,745
Total liabilities		587,487		567,811
Stockholders equity				
Preferred stock, no par value; 2,000,000 shares authorized at June 30, 2005 and December 31, 2004, none issued				
Common stock, $0.10 par value; 10,000,000 shares authorized, 5,290,000 shares issued, 2,730,951 and 2,742,345 shares outstanding at June 30, 2005 and December 31, 2004, respectively, net of shares in treasury 2,365,795 and 2,345,746 respectively		529		529
Retained earnings		59,520		57,428
Additional paid-in capital		51,832		51,675
Unearned ESOP shares		(1,932)		(2,019)
Treasury stock at cost		(47,060)		(46,081)
Accumulated other comprehensive loss		(543)		(377)
Total stockholders equity		62,346		61,155
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	649,833	$	628,966

The accompanying notes are an integral part of these statements

TF Financial Corporation and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in thousands, except per share data)			
Interest income				
Loans, including fees	$ 6,703	$ 5,960	$ 13,174	$ 11,950
Mortgage-backed securities	1,292	1,531	2,595	2,988
Investment securities	364	280	677	560
Interest-bearing deposits and other	12	4	22	7
TOTAL INTEREST INCOME	8,371	7,775	16,468	15,505
Interest expense				
Deposits	1,831	1,478	3,367	2,984
Borrowings	966	673	1,897	1,319
TOTAL INTEREST EXPENSE	2,797	2,151	5,264	4,303
NET INTEREST INCOME	5,574	5,624	11,204	11,202
Provision for loan losses	150	150	300	300
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	5,424	5,474	10,904	10,902
Non-interest income				
Service fees, charges and other operating income	669	681	1,309	1,390
Gain on sale of loans	8		30	
TOTAL NON-INTEREST INCOME	677	681	1,339	1,390
Non-interest expense				
Employee compensation and benefits	2,303	2,247	4,694	4,521
Occupancy and equipment	640	644	1,301	1,239
Federal deposit insurance premium	16	18	33	36
Professional fees	211	132	437	338
Marketing and advertising	186	163	362	326
Other operating	553	625	1,179	1,246
Amortization of core deposit intangible asset	34	40	68	80
TOTAL NON-INTEREST EXPENSE	3,943	3,869	8,074	7,786
INCOME BEFORE INCOME TAXES	2,158	2,286	4,169	4,506
Income taxes	553	630	1,088	1,241
NET INCOME	$ 1,605	$ 1,656	$ 3,081	$ 3,265

Earnings per share basic	$	0.59	$	0.62	$	1.12	$	1.23
Earnings per share diluted	$	0.57	$	0.58	$	1.09	$	1.15
Dividends paid	$	0.18	$	0.17	$	0.36	$	0.32

The accompanying notes are an integral part of these statements

TF Financial Corporation and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the six months ended June 30, 2005	2004
	(in thousands)	
OPERATING ACTIVITIES		
Net income	$ 3,081	$ 3,265
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of		
Mortgage loan servicing rights	2	
Deferred loan origination fees	(31)	(8)
Premiums and discounts on investment securities, net	42	41
Premiums and discounts on mortgage-backed securities, net	236	347
Premiums and discounts on loans, net	60	71
Core deposit intangibles	68	80
Provision for loan losses	300	300
Depreciation of premises and equipment	468	475
Increase in value of bank-owned life insurance	(252)	(270)
Stock-based benefit programs	258	274
Tax benefit arising from stock compensation	110	
Gain on sale of		
Real estate acquired through foreclosure		(1)
Mortgage loans available for sale	(30)	
(Increase) decrease in		
Accrued interest receivable	(90)	111
Other assets	(249)	604
Increase (decrease) in		
Accrued interest payable	346	(89)
Other liabilities	789	1,122
NET CASH PROVIDED BY OPERATING ACTIVITIES	5,108	6,322
INVESTING ACTIVITIES		
Loan originations	(61,280)	(71,106)
Purchases of loans		(3,546)
Loan principal payments	35,484	57,045
Principal repayments on mortgage-backed securities held to maturity	2,377	5,418
Principal repayments on mortgage-backed securities available for sale	16,484	17,242
Proceeds from loan sales	3,311	
Purchases and (maturities) of certificates of deposit in other financial institutions, net	(2)	117
Purchase of investment securities available for sale	(5,985)	(2,180)
Purchase of mortgage-backed securities available for sale	(8,956)	(27,701)
Proceeds from maturities of investment securities held to maturity		2,000
Redemption of Federal Home Loan Bank stock	641	84
Proceeds from sale of real estate		32
Purchase of premises and equipment	(437)	(294)
NET CASH USED IN INVESTING ACTIVITIES	(18,363)	(22,889)

	For the six months ended June 30, 2005		2004
	(in thousands)		
FINANCING ACTIVITIES			
Net increase in demand deposit/NOW accounts, passbook savings accounts and certificates of deposit	19,676		8,409
Net increase (decrease) in advances from Federal Home Loan Bank	(1,617)		6,822
Net increase in advances from borrowers for taxes and insurance	358		358
Treasury stock acquired	(1,668)		(1,226)
Exercise of stock options	565		1,281
Common stock dividends paid	(989)		(851)
NET CASH PROVIDED BY FINANCING ACTIVITIES	16,325		14,793
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,070		(1,774)
Cash and cash equivalents at beginning of period	7,900		8,241
Cash and cash equivalents at end of period	$ 10,970		$ 6,467
Supplemental disclosure of cash flow information			
Cash paid for			
Interest on deposits and advances from Federal Home Loan Bank	$ 4,918		$ 4,392
Income taxes	$ 60		$
Non-cash transactions			
Transfers from loans to real estate acquired through foreclosure	$		$

The accompanying notes are an integral part of these statements

TF FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - PRINCIPLES OF CONSOLIDATION

The consolidated financial statements as of June 30, 2005 (unaudited) and December 31, 2004 and for the six-month periods ended June 30, 2005 and 2004 (unaudited) include the accounts of TF Financial Corporation (the Company) and its wholly owned subsidiaries Third Federal Bank (the Bank), TF Investments Corporation and Penns Trail Development Corporation. The Company s business is conducted principally through the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

NOTE 2 - BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and, therefore, do not include all of the disclosures or footnotes required by accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for fair presentation of the consolidated financial statements have been included. The results of operations for the period ended June 30, 2005 are not necessarily indicative of the results which may be expected for the entire fiscal year or any other period. For further information, refer to consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2004.

NOTE 3 CONTINGENCIES

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

NOTE 4 - OTHER COMPREHENSIVE INCOME (LOSS)

The Company s other comprehensive income (loss) consists of net unrealized gains (losses) on investment securities and mortgage-backed securities available for sale. Total comprehensive income (loss) for the three-month periods ended June 30, 2005 and 2004 was $2,546,000 and $(99,000), net of applicable income tax expense (benefit) of $1,037,000 and $(275,000), respectively. Total comprehensive income for the six-month periods ended June 30, 2005 and 2004 was $2,915,000 and $2,309,000, net of applicable income tax expense of $1,003,000 and $748,000, respectively.

NOTE 5 EARNINGS PER SHARE

The following tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per share computations (dollars in thousands, except per share data):

	Three months ended June 30, 2005		
	Income (numerator)	Weighted average shares (denominator)	Per share Amount
Basic earnings per share			
Income available to common stockholders	$ 1,605	2,744,223	$ 0.59
Effect of dilutive securities			
Stock options		74,383	(0.02)
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	$ 1,605	2,818,606	$ 0.57

	Six months ended June 30, 2005		
	Income (numerator)	Weighted average shares (denominator)	Per share Amount
Basic earnings per share			
Income available to common stockholders	$ 3,081	2,746,625	$ 1.12
Effect of dilutive securities			
Stock options		74,444	(0.03)
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	$ 3,081	2,821,069	$ 1.09

There were options to purchase 27,594 shares of common stock at a price of $34.14 per share which were outstanding during the six months ended June 30, 2005 that were not included in the computation of diluted earnings per share because the options exercise prices were greater than the average market price of the common shares.

	Three months ended June 30, 2004				
		Income (numerator)	Weighted average shares (denominator)		Per share Amount
Basic earnings per share					
Income available to common stockholders	$	1,656	2,672,534	$	0.62
Effect of dilutive securities					
Stock options			166,559		(0.04)
Diluted earnings per share					
Income available to common stockholders plus effect of dilutive securities	$	1,656	2,839,093	$	0.58

	Six months ended June 30, 2004				
		Income (numerator)	Weighted average shares (denominator)		Per share Amount
Basic earnings per share					
Income available to common stockholders	$	3,265	2,660,871	$	1.23
Effect of dilutive securities					
Stock options			169,012		(0.08)
Diluted earnings per share					
Income available to common stockholders plus effect of dilutive securities	$	3,265	2,829,883	$	1.15

There were options to purchase 31,913 shares of common stock at a price of $34.14 per share which were outstanding during the the six months ended June 30, 2004 that were not included in the computation of diluted earnings per share because the options exercise prices were greater than the average market price of the common shares.

NOTE 6- STOCK BASED COMPENSATION

The Company has two fixed stock option plans. The Company s employee stock option plans are accounted for using the intrinsic value method under APB Opinion No. 25, as permitted by SFAS No. 123. No stock-based compensation expense is reflected in net income, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of the grant.

Had compensation cost for the plans been determined based on the fair value of options at the grant dates consistent with the method of SFAS No. 123, Accounting for Stock-Based Compensation, the Company s net income and earnings per share would have been reduced to the pro forma amounts indicated below (in thousands, except per share data):

	Three months ended June 30			
	2005		2004	
Net income				
As reported	$	1,605	$	$1,656
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects		15		26
Pro forma	$	1,590	$	1,630
Basic earnings per share				
As reported	$	0.59	$	0.62
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects		0.01		0.01
Pro forma	$	0.58	$	0.61
Diluted earnings per share				
As reported	$	0.57	$	0.58
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects				
Pro forma	$	0.57	$	0.58

Stock-based compensation expense included in net income is related to stock grants in lieu of salary and the Company s employee stock ownership plan. Such expense totaled $96,000 and $106,000 for the three-month periods ended June 30, 2005 and 2004, respectively.

	Six months ended June 30			
	2005		2004	
Net income				
As reported	$	3,081	$	$3,265
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects		34		51
Pro forma	$	3,047	$	3,214
Basic earnings per share				
As reported	$	1.12	$	1.23
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects		0.01		0.02
Pro forma	$	1.11	$	1.21
Diluted earnings per share				

As reported	$	1.09	$	1.15
Deduct: stock-based compensation expense determined using the fair value method, net of related tax effects				
Pro forma	$	1.09	$	1.15

Stock-based compensation expense included in net income is related to stock grants in lieu of salary and the Company s employee stock ownership plan. Such expense totaled $204,000 and $227,000 for the six-month periods ended June 30, 2005 and 2004, respectively.

On April 27, 2005, the Company s shareholders approved the 2005 Stock-Based Incentive Plan (the 2005 Plan) which provides for grants of stock options and/or restricted stock aggregating up to 240,000 shares of the Company s common stock, with a maximum of 40,000 shares of restricted stock. No grants may be issued from the 2005 Plan prior to June 1, 2005.

NOTE 7- EMPLOYEE BENEFIT PLANS

Net periodic defined benefit pension cost included the following (in thousands):

	Three months ended June 30	
	2005	**2004**
Components of net periodic benefit cost		
Service cost	$ 78	$ 57
Interest cost	53	51
Expected return on plan assets	(56)	(53)
Amortization of prior service cost	16	16
Amortization of transition obligation (asset)		1
Recognized net actuarial (gain) loss	11	8
Net periodic benefit cost	$ 102	$ 80

	Six months ended June 30	
	2005	**2004**
Components of net periodic benefit cost		
Service cost	$ 156	$ 115
Interest cost	106	95
Expected return on plan assets	(103)	(105)
Amortization of prior service cost	32	31
Amortization of transition obligation (asset)		2
Recognized net actuarial (gain) loss	22	12
Net periodic benefit cost	$ 213	$ 150

The employer contribution made for the six months ended June 30, 2005 and 2004 was $1,015,000 and $0, respectively.

NOTE 8- RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to the current period presentation.

TF FINANCIAL CORPORATION AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL POSITION AND RESULTS OF OPERATIONS

GENERAL

The Company may from time to time make written or oral forward-looking statements , including statements contained in the Company s filings with the Securities and Exchange Commission (including this Quarterly Report on Form 10-Q and the exhibits thereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements involve risks and uncertainties, such as statements of the Company s plans, objectives, expectations, estimates and intentions that are subject to change based on various important factors (some of which are beyond the Company s control). The following factors, among others, could cause the Company s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors products and services; the willingness of users to substitute competitors products and services for the Company s products and services; the success of the Company in gaining regulatory approval of its products and services, when required; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes, acquisitions; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

Financial Condition

The Company s total assets at June 30, 2005 and December 31, 2004 were $649.8 million and $629.0 million, respectively, an increase of $20.8 million, or 3.31%, during the six-month period. Cash and cash equivalents increased by $3.1 million. Investment securities available for sale increased by $6.0 million due to purchases of $3.0 million of tax free municipal bonds and purchases of $3.0 million corporate notes. Mortgage-backed securities available for sale decreased by $8.0 million as $9.0 million of security purchases was off-set by $16.5 million in principal pay-downs, a decrease in the market value of these securities totaling $0.3 million and net premium amortization of $0.2 million. Mortgage-backed securities held to maturity decreased by $2.4 million as a result of principal repayments. Loans receivable increased by $22.2 million for the first six months of 2005. Consumer and single-family residential mortgage loans of $37.7 million and commercial loans of $23.5 million were originated during the first six months of 2005. Proceeds from the sale of loans in the secondary market were $3.3 million during the six-month period. In addition, principal repayments of loans receivable were $35.5 million during this period.

Total liabilities increased by $19.7 million. Deposit balances increased by $19.7 million during the six-month period ended June 30,2005. Non-interest bearing demand deposits grew by $2.8 million and money market deposits increased by $31.3 million while savings and interest-bearing checking accounts decreased by a combined $14.2 million. Certificates of deposit decreased by $0.2 million. Advances from the Federal Home Loan Bank decreased by $1.6 million due to an $11.4 million increase in long-term fixed rate advances less $5.5 million repayment of short-term advances and scheduled amortization payments of $7.5 million.

Total consolidated stockholders equity of the Company was $62.3 million or 9.59% of total assets at June 30, 2005. During the first half of 2005 the Company repurchased 54,922 shares of its common stock and issued 34,873 shares pursuant to the exercise of stock options. As of June 30, 2005, there were approximately 98,523 shares available for repurchase under the previously announced share repurchase plan.

Asset Quality

During the first six months of 2005 and 2004, the Company s provision for loan losses was $300,000. As of June 30, 2005, the Company owned one parcel of foreclosed real estate. This parcel has been recorded as real estate owned at the lower of the recorded investment in the loan or estimated fair value in the amount of $0.7 million and is included in other assets in the statement of financial position at June 30, 2005. Management of the Company believes that there has not been any significant deterioration in its asset quality during the first six months of 2005.

The following table sets forth information regarding the Company s asset quality (dollars in thousands):

	June 30, 2005	December 31, 2004	June 30, 2004
Non-performing loans	$ 724	$ 960	$ 2,054
Ratio of non-performing loans to gross loans	0.16%	0.22%	0.48%
Ratio of non-performing loans to total assets	0.11%	0.15%	0.33%
Foreclosed property	$ 700	$ 700	$ 837
Foreclosed property to total assets	0.11%	0.11%	0.13%
Ratio of total non-performing assets to total assets	0.22%	0.26%	0.46%

Management maintains an allowance for loan losses at levels that are believed to be adequate; however, there can be no assurances that further additions will not be necessary or that losses inherent in the existing loan portfolio will not exceed the allowance. The following table sets forth the activity in the allowance for loan losses during the periods indicated (in thousands):

	2005	2004
Beginning balance, January 1,	$ 2,307	$ 2,111
Provision	300	300
Less: charge-off s (recoveries), net	147	207
Ending balance, June 30,	$ 2,460	$ 2,204

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2005 AND 2004

Net Income. The Company recorded net income of $1,605,000, or $0.57 per diluted share, for the three months ended June 30, 2005 as compared to net income of $1,656,000, or $0.58 per diluted share, for the three months ended June 30, 2004.

Average Balance Sheet

The following table sets forth information relating to the Company s average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated. Yield and cost are computed by dividing income or expense by the average daily balance of interest-earning assets or interest-bearing liabilities, respectively, at-or for the three month periods indicated.

	June 30,					
	2005			2004		
	Average balance	Interest	Average yld/cost	Average balance	Interest	Average yld/cost
ASSETS						
Interest-earning assets:						
Loans receivable(1)	$ 457,289	$ 6,703	5.88%	$ 418,545	$ 5,960	5.73%
Mortgage-backed securities	112,939	1,292	4.59%	132,144	1,531	4.66%
Investment securities(2)	35,635	441	4.96%	30,111	334	4.46%
Other interest-earning assets(3)	2,368	12	2.03%	1,648	4	0.98%
Total interest-earning assets	608,231	8,448	5.57%	582,448	7,829	5.41%
Non interest-earning assets	36,599			35,974		
Total assets	$ 644,830			$ 618,422		
LIABILITIES AND STOCKHOLDERS EQUITY:						
Interest-bearing liabilities						
Deposits	466,679	1,831	1.57%	471,402	1,478	1.26%
Advances from the FHLB	111,734	966	3.47%	82,984	673	3.26%
Total interest-bearing liabilities	578,413	2,797	1.94%	554,386	2,151	1.56%
Non interest-bearing liabilities	6,331			5,801		
Total liabilities	584,744			560,187		
Stockholders equity	60,086			58,235		
Total liabilities and stockholders equity	$ 644,830			$ 618,422		
Net interest income		$ 5,651			$ 5,678	
Interest rate spread(4)			3.63%			3.85%
Net yield on interest-earning assets(5)			3.73%			3.92%
Ratio of average interest-earning assets to average interest-bearing liabilities			105%			105%

(1) Nonaccrual loans have been included in the appropriate average loan balance category, but interest on nonaccrual loans has not been included for purposes of determining interest income.

(2) Tax equivalent adjustments to interest on investment securities were $77,000 and $54,000 for the quarters ended June 30, 2005 and 2004, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.

(3) Includes interest-bearing deposits in other banks.

(4) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(5) Net yield on interest-earning assets represents net interest income as a percentage of average interest-earning assets.

Rate/Volume Analysis

The following table presents, for the periods indicated, the change in interest income and interest expense (in thousands) attributed to (i) changes in volume (changes in the weighted average balance of the total interest earning asset and interest bearing liability portfolios multiplied by the prior year rate), and (ii) changes in rate (changes in rate multiplied by prior year volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately based on the absolute value of changes due to volume and changes due to rate.

	Three months ended June 30, 2005 vs 2004 Increase (decrease) due to		
	Volume	Rate	Net
Interest income:			
Loans receivable, net	$ 577	$ 166	$ 743
Mortgage-backed securities	(216)	(23)	(239)
Investment securities (1)	66	41	107
Other interest-earning assets	2	6	8
Total interest-earning assets	429	190	619
Interest expense:			
Deposits	(101)	454	353
Advances from the FHLB	248	45	293
Total interest-bearing liabilities	147	499	646
Net change in net interest income	$ 282	$ (309)	$ (27)

(1) Tax equivalent adjustments to interest on investment securities were $77,000 and $54,000 for the quarters ended June 30, 2005 and 2004, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.

Total Interest Income. Total interest income, on a taxable equivalent basis, increased by $0.6 million or 8.0% to $8.4 million for the quarter ended June 30, 2005 compared with the second quarter of 2004 primarily because of a $38.7 million increase in average loans outstanding. Additionally, there has been a rise in the yield on new loans added to the portfolio during the intervening period in part due to nine, 25 basis point increases in the Bank s prime rate during the period June 30, 2004 through June 30, 2005 corresponding to identical increases in the fed funds interest rate by the Federal Reserve Bank. The Bank has approximately $50.6 million in primarily construction loans and commercial and consumer lines of credit which are indexed to the prime rate. Interest income from mortgage-backed securities was lower during the second quarter of 2005 in comparison to the same period of 2004. This decrease is consistent with the reduction of balances maintained in mortgage-backed securities. Investment securities interest income reflected an increase between the quarters as a result of investment security purchases during the intervening period.

Total Interest Expense. Total interest expense increased by $0.6 million to $2.8 million during the three-month period ended June 30, 2005 as compared with the second quarter of 2004. The decrease in the average balance of deposits was more than offset by an increase in interest rates on the Bank s demand deposit accounts in order to remain in line with short-term market interest rates and the Bank s competitors. Increases in the advances from the Federal Home Loan Bank during 2004 and the first half of 2005 is the primary cause for the increase in the related interest expense between the two quarters.

Non-interest income. Total non-interest income was $677,000 for the three-month period ended June 30, 2005 compared with $681,000 for the same period in 2004. Loan prepayment and other loan fees decreased by $31,000 and mortgage brokered fees collected increased by $44,000 in the second quarter of 2005 versus the same quarter of 2004. Retail banking fees were $25,000 less in the second quarter of 2005 due to a decrease in demand deposit account fees. In contrast, during the second quarter of 2005 net gain on the sale of loans totaled $8,000 while there was no such gain during the second quarter of 2004.

Non-interest expense. Total non-interest expense increased by $74,000 to $3.9 million for the three months ended June 30, 2005 compared to the same period in 2004. Compensation and benefit expenses were higher by $56,000 mainly due to additional staffing as well as salary increases. Professional expenses of the Company were $79,000 higher mainly because of technology-related compliance and audit work.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004

Net Income. The Company recorded net income of $3,081,000, or $1.09 per diluted share, for the six months ended June 30, 2005 as compared to net income of $3,265,000, or $1.15 per diluted share, for the six months ended June 30, 2004.

Average Balance Sheet

The following table sets forth information relating to the Company s average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated. Yield and cost are computed by dividing income or expense by the average daily balance of interest-earning assets or interest-bearing liabilities, respectively, at-or for the six month periods indicated.

	June 30,					
	2005			2004		
	Average balance	Interest	Average yld/cost	Average balance	Interest	Average yld/cost
ASSETS						
Interest-earning assets:						
Loans receivable(1)	$ 451,983	$ 13,174	5.88%	$ 414,761	$ 11,950	5.79%
Mortgage-backed securities	115,861	2,595	4.52%	131,400	2,988	4.57%
Investment securities(2)	34,256	820	4.83%	30,282	663	4.40%
Other interest-earning assets(3)	1,755	22	2.53%	1,609	7	0.87%
Total interest-earning assets	603,855	16,611	5.55%	578,052	15,608	5.43%
Non interest-earning assets	34,870					