

HMN FINANCIAL INC  
Form DEF 14A  
March 18, 2005

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OMB APPROVAL

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. )

Filed by the Registrant    
Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

HMN Financial, Inc.

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

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2) Aggregate number of securities to which transaction applies:

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3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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o Fee paid previously with preliminary materials.

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1) Amount Previously Paid:

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3) Filing Party:

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4) Date Filed:

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SEC 1913 (02-02)

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**1016 Civic Center Drive N.W.  
Rochester, Minnesota 55901-6057  
(507) 535-1200**

March 18, 2005

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders to be held at the Rochester Golf & Country Club, located at 3100 W. Country Club Road, Rochester, Minnesota on Tuesday, April 26, 2005 at 10:00 a.m., local time.

The Secretary's Notice of Annual Meeting and the Proxy Statement that follow describe the matters to come before the meeting. During the meeting, we also will review the activities of the past year and items of general interest about our company.

We hope that you will be able to attend the meeting in person and we look forward to seeing you. Please vote your proxy by telephone or mark, date and sign the enclosed proxy card and return it in the accompanying postage-paid reply envelope as quickly as possible, even if you plan to attend the Annual Meeting. If you later desire to revoke the proxy, you may do so at any time before it is exercised.

Sincerely,

Michael McNeil  
*President and Chief Executive Officer*

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**HMN FINANCIAL, INC.**

**Notice of Annual Meeting of Stockholders  
to be held on April 26, 2005**

Notice is hereby given that the Annual Meeting of Stockholders (the Meeting ) of HMN Financial, Inc. (the Company ) will be held at the Rochester Golf & Country Club, located at 3100 W. Country Club Road, Rochester, Minnesota, at 10:00 a.m., local time, on April 26, 2005.

A Proxy Card and a Proxy Statement for the Meeting are enclosed.

The Meeting is for the purpose of considering and acting upon:

1. the election of three directors of the Company;
2. the ratification of the appointment of KPMG LLP as the independent auditors of the Company for the fiscal year ending December 31, 2005; and such other matters as may properly come before the Meeting, or any adjournments or postponements thereof. As of the date of this Notice, the Board of Directors is not aware of any other business to come before the Meeting.

Any action may be taken on the foregoing proposals at the Meeting on the date specified above, or on any date or dates to which the Meeting may be adjourned or postponed. Stockholders of record at the close of business on March 1, 2005 are the stockholders entitled to receive notice of, and to vote at, the Meeting and any adjournments or postponements thereof.

A complete list of stockholders entitled to vote at the Meeting will be available for examination by any stockholder, for any purpose germane to the Meeting, between 9:00 a.m. and 5:00 p.m. central time, at HMN Financial, Inc., 1016 Civic Center Drive NW, Rochester, Minnesota 55901-6057 for a period of ten days prior to the Meeting.

**Your proxy is important to ensure a quorum at the Meeting. Even if you own only a few shares, and whether or not you expect to be present at the Meeting, please vote your proxy by telephone or mark, date and sign the enclosed proxy card and return it in the accompanying postage-paid reply envelope as quickly as possible. You may revoke your proxy at any time prior to its exercise, and returning your proxy will not affect your right to vote in person if you attend the Meeting and revoke the proxy.**

By Order of the Board of Directors,

Cindy K. Hamlin  
*Secretary*

Rochester, Minnesota  
March 18, 2005

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**PROXY STATEMENT**

This Proxy Statement is furnished in connection with the solicitation on behalf of the Board of Directors (the Board ) of HMN Financial, Inc. (the Company ) of proxies to be used at the Annual Meeting of Stockholders (the Meeting ), which will be held at the Rochester Golf & Country Club, located at 3100 W. Country Club Road, Rochester, Minnesota, on April 26, 2005 at 10:00 a.m., local time, and any adjournments or postponements of the Meeting. The accompanying Notice of Annual Meeting and this Proxy Statement are first being mailed to stockholders on or about March 18, 2005.

Certain information provided herein relates to Home Federal Savings Bank (the Bank ), a wholly owned subsidiary of the Company.

**Voting of Proxies**

All shares of the Company s common stock, par value \$.01 per share (the Common Stock ), represented at the Meeting by properly executed proxies, duly delivered to the Secretary of the Company prior to or at the Meeting, and not revoked, will be voted at the Meeting in accordance with the instructions specified on the proxies. If no instructions are indicated, properly executed proxies will be voted FOR the nominees for director listed below and

FOR the ratification of the appointment of the Company s independent auditors. As of the date of this Proxy Statement, the Board does not know of any matters, other than those described in the Notice of Annual Meeting and this Proxy Statement, that are to come before the Meeting. If any other matters are properly presented at the Meeting for action, the persons named in the enclosed form of proxy and acting thereunder will have, to the extent permitted by law, the discretion to vote on such matters in accordance with their best judgment.

**Required Vote**

Provided a quorum is present at the Meeting, (i) directors shall be elected by a plurality of the votes cast at the Meeting and (ii) a majority of the votes cast shall be the act of the stockholders with respect to all other matters considered at the Meeting. If you do not vote your shares, you will not have a say in the important issues to be presented at the Meeting.

**Effect of Abstentions and Broker Non-Votes**

If stockholders indicate on their proxy that they wish to abstain from voting on a particular proposal, including brokers holding their customers shares of record who cause abstentions to be recorded, these shares are considered present and entitled to vote at the Meeting. These shares will count toward determining whether or not a quorum is present. However, these shares will not be considered cast with respect to the proposal for which they abstain from voting and will not be taken into account in determining the outcome of any of those proposals.

If a stockholder does not give a broker holding the stockholder s shares instructions as to how to vote the shares, the broker has authority under New York Stock Exchange rules to vote those shares for or against routine matters, such as the election of directors and the ratification of KPMG LLP as the Company s independent auditors. Brokers cannot vote on their customers behalf on non-routine proposals. These rules apply to the Company notwithstanding the fact that shares of the Company s Common Stock are traded on The NASDAQ National Market. If a broker votes shares that are unvoted by its customers for or against a routine proposal, these shares are counted for the purpose of establishing a quorum and also will be counted for the purpose of determining the outcome of the routine proposals on which they cast. Shares held by a broker on behalf of a stockholder will not be considered cast with respect to any non-routine proposals and will not be taken into account in determining the outcome of any of non-routine proposals.

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**Quorum and Adjournment of Meeting**

One third of the shares of the Common Stock outstanding and entitled to vote shall constitute a quorum for purposes of the Meeting. If a quorum is not present at the Meeting, the chairman of the Meeting, or the stockholders present, by vote of a majority of the votes cast by stockholders present in person or represented by proxy and entitled to vote, may adjourn the Meeting, and at any such adjourned meeting at which a quorum is present any business may be transacted which might have been transacted at the Meeting as originally called.

**Revocation of Proxies**

A proxy given pursuant to this solicitation may be revoked at any time before it is voted. Proxies may be revoked by: (i) filing with Cindy K. Hamlin, the Secretary of the Company, at or before the Meeting a written notice of revocation bearing a later date than the date on the proxy or (ii) duly executing a proxy dated a later date than the earlier proxy and relating to the same shares and delivering it to the Secretary of the Company at or before the Meeting.

**Record Date and Number of Shares Entitled to Vote**

The Common Stock is the only authorized and outstanding voting security of the Company. Stockholders of record as of the close of business on March 1, 2005 will be entitled to one vote for each share of Common Stock then held. As of March 1, 2005, the Company had 4,402,432 shares of Common Stock issued and outstanding. The number of issued and outstanding shares excludes 4,726,230 shares held in the treasury of the Company.

**Expenses of Soliciting Proxies**

The cost of solicitation of proxies will be borne by the Company. The Company will reimburse brokerage firms and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending proxy materials to the beneficial owners of Common Stock. In addition to solicitation by mail, directors, officers and regular employees of the Company and the Bank may solicit proxies personally or by telephone without additional compensation.

**Security Ownership of Management and Certain Beneficial Owners**

The following table sets forth, as of March 1, 2005 (except as noted in the footnotes to the table), the beneficial ownership of: (i) each stockholder known by management to beneficially own more than five percent of the outstanding Common Stock, (ii) each of the executive officers listed in the Summary Compensation Table below (the Named Officers ) and (iii) all directors, director nominees and executive



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officers of the Company as a group. Unless otherwise indicated in the footnotes to this table, the listed beneficial owner has sole voting power and investment power with respect to the shares of Common Stock.

Name and Address (if required) of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percentage of Outstanding Shares
HMN Financial, Inc. Employee Stock Ownership Plan 1016 Civic Center Drive N.W. Rochester, Minnesota 55901-6057(1)	842,617	19.1%
Jeffrey L. Gendell Tontine Financial Partners, L.P. Tontine Management, L.L.C. Tontine Overseas Associates, L.L.C. 55 Railroad Avenue, 3rd Floor Greenwich, Connecticut 06830(2)	421,729	9.70%
Dimensional Fund Advisors, Inc. 1299 Ocean Avenue, 11th Floor Santa Monica, California 90401(3)	269,800	6.08%
<b><i>Directors, director nominees and executive officers</i></b>		
Duane D. Benson(4)	20,650	*
Allan R. DeBoer(5)	17,700	*
Jon J. Eberle(6)	10,172	*
Michael J. Fogarty(7)	9,500	*
Timothy R. Geisler(8)	13,500	*
Dwain C. Jorgensen(9) Karen L. Himle	62,455	1.42%
Susan K. Kolling(10)	59,079	1.34%
Bradley C. Krehbiel(11)	6,103	*
Malcolm W. McDonald(12)	400	*
Michael McNeil(13)	81,550	1.85%
Mahlon C. Schneider(14)	12,200	*
All directors, director nominees and executive officers of the Company as a group (12 persons)(15)	293,309	6.66%

\* Less than 1% Owned

(1) As reported on a Schedule 13G/ A dated February 10, 2005 and filed on February 14, 2005. The amount reported represents shares of Common Stock held by the HMN Financial, Inc. Employee Stock Ownership Plan (the ESOP). As reported on a Form 5 dated February 10, 2005 and filed February 14, 2005, 270,844 of the 842,617 shares of Common Stock beneficially owned by the ESOP have been allocated to accounts of participants. First Bankers Trust Services, Inc., Quincy, Illinois, the trustee of the ESOP, may be deemed to beneficially own the shares of Common Stock held by the ESOP. First Bankers Trust expressly disclaims beneficial ownership of such shares. Participants in the ESOP are entitled to instruct the trustee as to the voting of shares of Common Stock allocated to their accounts under the ESOP. Unallocated shares or allocated shares for which no voting instructions are received are voted by the trustee in the same proportion as allocated shares for which instructions have been received from participants.

- (2) As reported on a Schedule 13D/ A dated May 28, 2003 and filed on May 30, 2003. Tontine Financial Partners, L.P. ( TFP ) holds shares of Common Stock directly, and Tontine Management, L.L.C. ( TM ) is the general partner to TFP. Tontine Overseas Associates, L.L.C. ( TOA ), is the investment manager to TFP Overseas Fund, Ltd., which holds shares of Common Stock directly. Mr. Gendell serves as the managing member of TM and TOA.

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- (3) As reported on a Schedule 13G/ A dated February 9, 2005 and filed February 9, 2005. Dimensional Fund Advisors, Inc. is an investment adviser. The amount reported represents shares of Common Stock held in various advisory accounts. No such account has an interest relating to more than 5% of the outstanding shares of Common Stock. Dimensional Fund Advisors, Inc. exercises sole voting and dispositive power with respect to all the shares.
- (4) Includes 1,400 shares of Common Stock held directly, 4,250 shares of Common Stock held by Mr. Benson's spouse and 15,000 shares of Common Stock covered by options which are currently exercisable or exercisable within 60 days of March 1, 2005.
- (5) Includes 2,700 shares of Common Stock held directly and 15,000 shares of Common Stock covered by options that are currently exercisable or exercisable within 60 days of March 1, 2005.
- (6) Includes 808 shares of Common Stock held directly, 1,496 shares of Common Stock held under the Bank's 401(k) Plan, 6,654 shares of Common Stock allocated to Mr. Eberle's account under the Company's Employee Stock Ownership Plan and 1,214 shares of Common Stock covered by options that are currently exercisable or exercisable within 60 days of March 1, 2005.
- (7) Includes 500 shares of Common Stock held in a fiduciary capacity and 9,000 shares of Common Stock covered by options that are currently exercisable or exercisable within 60 days of March 1, 2005.
- (8) Includes 260 shares of Common Stock held jointly with his spouse, 1,115 shares of Common Stock held by Mr. Geisler's IRA account, 125 shares of Common Stock held in Mr. Geisler's spouse's IRA account and 12,000 shares of Common Stock covered by options which are currently exercisable or exercisable within 60 days of March 1, 2005.
- (9) Includes 38,482 shares of Common Stock held jointly with his spouse, 3,873 shares of Common Stock held by Mr. Jorgensen's IRA account, 1,877 shares of Common Stock held by the IRA account of Mr. Jorgensen's spouse, 3,606 shares of Common Stock under the Bank's 401(k) Plan, 13,423 shares of Common Stock allocated to Mr. Jorgensen's account under the Company's Employee Stock Ownership Plan and 1,194 shares of Common Stock covered by options which are currently exercisable or exercisable within 60 days of March 1, 2005.
- (10) Includes 42,499 shares of Common Stock held directly, 11,160 shares of Common Stock allocated to Ms. Kolling's account under the Company's Employee Stock Ownership Plan, 4,160 shares of Common Stock held under the Bank's 401(k) Plan and 1,260 shares of Common Stock covered by options which are currently exercisable or exercisable within 60 days of March 1, 2005.
- (11) Includes 1,048 shares of Common Stock held directly, 3,541 shares of Common Stock allocated to Mr. Krehbiel's account under the Company's Employee Stock Ownership Plan and 1,514 shares of Common Stock covered by options which are currently exercisable or exercisable within 60 days of March 1, 2005.
- (12) Includes 400 shares of Common Stock held directly.
- (13) Includes 7,290 shares of Common Stock held directly, 10,471 shares of Common Stock held by Mr. McNeil's IRA account, 6,495 shares of Common Stock allocated to Mr. McNeil's account under the Company's Employee Stock Ownership Plan, 6,044 shares held under the Bank's 401(k) Plan and 51,250 shares of Common Stock covered by options which are currently exercisable or exercisable within 60 days of March 1, 2005.
- (14) Includes 200 shares of Common Stock held directly and 12,000 shares of Common Stock covered by options that are currently exercisable or exercisable within 60 days of March 1, 2005.

- (15) Includes shares of Common Stock held directly, as well as shares of Common Stock held jointly with family members (if such shares are deemed to be beneficially owned by the director or officer), shares of Common Stock held in retirement accounts, shares of Common Stock held by such individuals in their accounts under the Bank's 401(k) Plan, shares of Common Stock allocated to the ESOP accounts of the group members, shares of Common Stock held in a fiduciary capacity or by certain family members and shares covered by options which are currently exercisable or exercisable within 60 days of March 1, 2005, with respect to which shares the persons included may be deemed to have sole or shared voting and/or investment power.

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The Company's Certificate of Incorporation provides that the Board shall fix the number of directors from time to time. On January 28, 2004, the Board adopted a resolution stating that the Board shall consist of up to nine members. The Board is divided into three classes. The term of two members of the Board recently expired and the Board has one vacancy. The Board has nominated Messrs. Geisler and DeBoer and Ms. Himle for election as directors to serve for the terms indicated. They have each been nominated to serve a term of three years, or until their respective successors shall have been elected and shall qualify.

It is intended that the proxies solicited on behalf of the Board (other than proxies in which the vote is withheld as to one or more nominees) will be voted at the Meeting for the election of the nominees identified in the preceding paragraph. If any nominee is unable to serve, the shares of Common Stock represented by all such proxies will be voted for the election of such substitute as the Board may recommend. At this time, the Board knows of no reason why any of the nominees, if elected, might be unable to serve. Except as described herein, there are no arrangements or understandings between any director or nominee and any other person pursuant to which such director or nominee was selected.

The business experience of each director and director nominee is set forth below.

**Director Nominees*****Term Expiring in 2005***

*Timothy R. Geisler, age 53.* Mr. Geisler has been chairman of the Board since 2001, and has been a director of the Company since 1996. He is currently a unit manager for Mayo Foundation and had previously been corporate tax unit manager for Mayo Foundation from 1986 to 2000. Mr. Geisler has been a certified public accountant since 1976 and has had eight years of public accounting experience with a major public accounting firm. Mayo Foundation provides medical care and education in clinical medicine and medical sciences and conducts medical research through hospitals and clinics in Rochester, Minnesota; Jacksonville, Florida; Scottsdale, Arizona and other cities in the United States.

*Allan R. DeBoer, age 62.* Mr. DeBoer has been a director of the Company since 1999. From 1988 until his retirement in 2001, Mr. DeBoer was the Chief Executive Officer of RCS of Rochester, Inc., which does business as Rochester Cheese/ Valley Cheese, a cheese processing company. Since January 2002, Mr. DeBoer has served as an independent business consultant.

*Karen L. Himle, age 49.* Ms. Himle was nominated to serve as a director of the Company by the Board upon the recommendation of Duane Benson and the Governance and Nominating Committee. Since 2004, she has served as the Executive Vice President of Children's Hospitals and Clinics and President of Children's Hospitals and Clinics Foundation. From 2002 to 2004, Ms. Himle served as an independent consultant. From 1985 to 2002, she held various positions at The St. Paul Companies, Inc. including Senior Vice President Corporate and Government Affairs. Ms. Himle serves on various other boards and commissions including the Minneapolis Club, Minnesota Chamber of Commerce, Minnesota Opera, Minnesota Orchestral Association, and the Commission on Judicial Selection.

**THE BOARD RECOMMENDS THAT STOCKHOLDERS VOTE FOR THE NOMINEES LISTED ABOVE.**

**Directors continuing in office after Annual Meeting*****Term Expiring in 2006***

*Michael McNeil, age 57.* Mr. McNeil has been a director of the Company since 1999, the President of the Company since November 2000 and the Chief Executive Officer of the Company since April 2004. Mr. McNeil has been the President and Chief Executive Officer of the Bank since January 1999 and a director of the Bank since April 1998. From April 1998 through December 1998, Mr. McNeil was the Senior Vice President Business Development of the Bank. Prior to joining the Bank, Mr. McNeil was the President and a director of Stearns Bank, N.A. in St. Cloud, Minnesota from August 1991 until March 1998.

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*Duane D. Benson, age 59.* Mr. Benson has been a director of the Company since 1997. From 1994 until his retirement in October 2003, Mr. Benson was the executive director of the Minnesota Business Partnership, a non-profit public policy foundation comprised of 105 member companies. Mr. Benson's primary responsibilities included the management of governmental and public affairs for that organization. Mr. Benson served as a member of the Minnesota Legislature for 14 years prior to assuming his duties at the Minnesota Business Partnership. Since his retirement from the Minnesota Business Partnership, Mr. Benson has served as an independent business consultant.

*Mahlon C. Schneider, age 65.* Mr. Schneider has been a director of the Company since 2000. From October 1999 until his retirement in December 2004, Mr. Schneider was Senior Vice President External Affairs and General Counsel of Hormel Foods Corporation. From October 1990 to September 1999, Mr. Schneider was the Vice President and General Counsel of Hormel Foods Corporation. Since 2003, he has been a director of the Hormel Foundation.

***Term Expiring in 2007***

*Michael J. Fogarty, age 66.* Mr. Fogarty has been a director of the Company since 2002. For over 20 years, Mr. Fogarty has been an insurance agent with C.O. Brown Agency, Inc., an insurance agency located in Rochester, Minnesota. He also currently serves as Chairman of the Board for C.O. Brown Agency, Inc.

*Susan K. Kolling, age 53.* Ms. Kolling has been a director of the Company since 2001. Ms. Kolling served as a Vice President of the Bank from 1992 to 1994 and has served as a Senior Vice President of the Bank since 1995. Ms. Kolling has served as a Vice President since June 1993 and a director since April 1996 of Osterud Insurance Agency, Inc., a wholly owned subsidiary of the Bank. In addition, from January 1997 through December 2003, Ms. Kolling was an owner of Kolling Family Corp. which is doing business as Valley Home Improvement, a retail lumber yard. Ms. Kolling became a director of Kolling Family Corp. in 2004. Since January 2000, Ms. Kolling has served as a director of KBM Developers LLC, a townhouse development company. Ms. Kolling began her employment with the Bank in 1969.

*Malcolm W. McDonald, age 68.* Mr. McDonald has been a director of the Company since 2004. From 1977 until his retirement in 2002, he served as a director and Senior Vice President of Space Center, Inc., an industrial real estate firm located in St. Paul, Minnesota. He also served as Vice President of First National Bank of St. Paul from 1960 to 1977. Mr. McDonald is a director of several private companies and a director or trustee of several nonprofit organizations.

**Directors Emeritus**

In 1996, the Board of the Company established a directors emeritus program. Any retiring director who has served as a director of the Company or the Bank for 12 or more years may be invited by the Board to be a director emeritus. Directors that retire or leave the Board after May 1, 2004 will not be offered the opportunity to participate in the emeritus program and it will cease to exist after the remaining terms of the current directors emeritus expire. A director emeritus attends and participates in regular meetings of the Board, but may not vote. Directors emeritus may not serve for more than five years. In consideration for serving as a director emeritus, such individual is paid a fee equal to the fee received by non-employee directors during such individual's last year of service to the Company or the Bank (excluding any fees paid for serving on any committee of the Board of the Company or the Bank). Each of Irma R. Rathbun and James B. Gardner has served as a director emeritus since 2000, M.F. Schumann began serving as a director emeritus during 2001 and Roger P. Weise has served as a director emeritus since 2004.

**Board Meetings and Committees**

*Board and Committee Meetings of the Company.* The Board held eight meetings during the year ended December 31, 2004. No incumbent director attended fewer than 75% of the total number of meetings held by the Board and by all committees of the Board on which the director served during the year. The Board has determined that each of Messrs. Geisler, Benson, DeBoer, Fogarty, McDonald and Schneider and Ms. Himle has no material relationship with the Company other than service as a director (either directly or as a partner,

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stockholder or officer of an organization that has a relationship with the Company) and is independent within the meaning of applicable NASDAQ listing standards.

The Board has standing Audit, Compensation, Executive and Governance and Nominating Committees.

*Audit Committee.* The Audit Committee was established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended (the Exchange Act). The Audit Committee oversees the Company's financial reporting process by, among other things, reviewing and reassessing the Audit Committee Charter annually, recommending and taking action to oversee the independence of the independent accountants and selecting and appointing the independent auditors. The Audit Committee consists of Messrs. Benson, DeBoer, Fogarty, Geisler (Chairman), McDonald and Schneider. The Board has determined that all members of the Audit Committee are independent as that term is defined in the applicable NASDAQ listing standards and regulations of the Securities and Exchange Commission and all members are financially literate as required by the applicable NASDAQ listing standards. In addition, the Board has determined that Mr. Geisler has the financial experience required by the applicable NASDAQ listing standards and is an audit committee financial expert as defined by applicable regulations of the Securities and Exchange Commission. The responsibilities of the Audit Committee are set forth in the Audit Committee Charter, which was amended and restated on January 28, 2004 and is available on the Company's website at [www.hmnf.com](http://www.hmnf.com). This committee met eight times during 2004.

*Compensation Committee.* The Compensation Committee reviews and reports to the Board on matters concerning compensation plans and the compensation of certain executives as well as administers the Company's 2001 Omnibus Stock Plan (the Omnibus Plan) and 1995 Stock Option and Incentive Plan (the 1995 Stock Option Plan). The current members of the Compensation Committee are Messrs. Benson, DeBoer (Chairman), Fogarty and Schneider. The Board has determined that all members of the Compensation Committee are independent as that term is defined in the applicable NASDAQ listing standards. The responsibilities of Compensation Committee are set forth in the Compensation Committee Charter, which was adopted by the Board on January 28, 2004 and is available on the Company's website at [www.hmnf.com](http://www.hmnf.com). This committee met seven times during 2004.

*Governance and Nominating Committee.* The Governance and Nominating Committee selects candidates as nominees for election as directors and advises and makes recommendations to the Board on other matters concerning directorship and corporate governance practices, including succession plans for the Company's executive officers. The current members of the Governance and Nominating Committee are Messrs. Benson, DeBoer, McDonald and Schneider (Chairman). The Board has determined that all members of the Governance and Nominating Committee are independent as that term is defined in the applicable NASDAQ listing standards. The responsibilities of the Governance and Nominating Committee are set forth in the Governance and Nominating Committee Charter, which was adopted by the Board on January 28, 2004 and is available on the Company's website at [www.hmnf.com](http://www.hmnf.com). This committee met five times during 2004.

*Executive Committee.* The Executive Committee of the Company acts on issues arising between regular Board meetings. The Executive Committee possesses the powers of the full Board between meetings of the Board. The Executive Committee is currently comprised of Messrs. Geisler and McNeil and Ms. Kolling. Messrs. Benson, DeBoer, Fogarty and Schneider serve as alternates on this committee. The Executive Committee did not meet during 2004.

### **Code of Business Conduct and Ethics**

The Company has adopted a Code of Business Conduct and Ethics. This code is available on the Company's website at [www.hmnf.com](http://www.hmnf.com).

### **Stockholder Communication with the Board**

The Board provides a process for stockholders to send communications to the Board or any of the directors. Stockholders may send written communications to the Board or any of the directors c/o Chief Financial Officer, HMN Financial, Inc., 1016 Civic Center Drive, Rochester, Minnesota 55901-6057. All

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communications will be compiled by the Chief Financial Officer and submitted to the Board or the individual directors on a periodic basis. Communications directed to the Board in general will be forwarded to the appropriate director(s) to address the matter.

**Director Attendance at Annual Meetings**

Directors are expected to attend the annual meeting of stockholders. In 2004, seven directors attended the Company's annual meeting of stockholders.

**Procedures Regarding Director Candidates Recommended by Stockholders**

The Governance and Nominating Committee will consider director candidates recommended by stockholders of the Company if the recommended director candidate would be eligible to serve as a director under the Company's By-laws. The Company's By-laws require that directors have their primary domicile in a county where the Bank has a full service branch. This requirement may be waived by a majority of the Board so long as a majority of the directors currently serving on the Board have their primary residence in a county where the Bank has a full service branch.

In order to be considered by the Governance and Nominating Committee, a stockholder recommendation of a director candidate must set forth all information relating to the candidate that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, pursuant to Regulation 14A under the Exchange Act and Rule 14a-11 thereunder (including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected).

The Governance and Nominating Committee will consider director candidates recommended by stockholders in the same manner that it considers all director candidates. This consideration will include an assessment of each candidate's experience, integrity, competence, diversity, skills and dedication in the context of the needs of the Board. Each candidate will be evaluated in the context of the Board as a whole, with the objective of recommending a group of nominees that can best perpetuate the success of the business and represent stockholder interest through the exercise of sound judgment based on a diversity of experience.

Rather than recommending director candidates to the Governance and Nominating Committee, stockholders may directly nominate a person for election to the Board by complying with the procedures set forth in the Company's By-laws, any applicable rules and regulations of the Securities and Exchange Commission and any applicable laws. For more information regarding the submission of stockholder nominations of director candidates, please refer to the section entitled "Stockholder Proposals."

**Compensation Committee Interlocks and Insider Participation**

During 2004, the Company's Compensation Committee was comprised of Messrs. Benson, Schneider, Fogarty and DeBoer (Chairman). None of the members is an executive officer, employee or former employee of the Company, and no interlocking relationship exists between the Board or Compensation Committee and the board of directors or compensation committee of any other company.



**Table of Contents****Director Compensation**

All directors of the Company also serve as directors of the Bank. During 2004, members of the Board of the Company and the Bank were paid the following fees for their services:

	<b>Description of Fees</b>			
	<b>Chairman of the Board</b>	<b>Non- employee Directors</b>	<b>Chairman of the Audit Committee</b>	<b>Other Committee Chairs</b>
The Company and the Bank:				
Monthly fee	\$ 2,500	\$ 1,250		
Board meeting attendance fee	\$ 1,000	\$ 500		
Audit Committee attendance fee		\$ 500	\$ 1,000	
Other committees of the Board attendance fee		\$ 300		\$ 600

For 2005, the only anticipated change to the fees paid to directors is an increase to the monthly retainer fee paid to the Chairman of the Board of the Company and the Bank from \$2,500 per month to \$3,333 per month.

The Company allows each member of the Board to elect to defer receipt of his or her fees until January 30 of the calendar year immediately following the date in which such member ceases to serve as a member of the Board. Deferred fees to be paid following a director's service are to be paid over a yearly period not to exceed ten years. The deferred fees earn interest at an interest rate equal to the Bank's cost of funds on November 30 of each year in which the fee is deferred. A director who is an officer or employee of the Company or the Bank receives no separate compensation for services as a director of the Company or the Bank.

**Report of the Audit Committee**

The Audit Committee has (i) reviewed and discussed the Company's audited financial statements for the fiscal year ended December 31, 2004 with the Company's management; (ii) discussed with the Company's independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61 regarding communication with audit committees (Codification of Statements on Auditing Standards, AU sec. 380); (iii) received the written disclosures and the letter from the Company's independent auditors required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees); and (iv) has discussed with the Company's independent auditors the independent auditors' independence. Based on the review and discussions with management and the Company's independent auditors referred to above, the Audit Committee recommended to the Board that the audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004 and filed with the Securities and Exchange Commission.

## The Audit Committee

Duane D. Benson  
Allan R. DeBoer  
Michael J. Fogarty  
Timothy R. Geisler  
Malcolm W. McDonald  
Mahlon C. Schneider

**Table of Contents****Independent Auditor Fees**

The following table presents fees for professional audit services rendered by KPMG LLP for the audit of the Company's annual financial statements for 2003 and 2004, and fees for other services rendered by KPMG LLP relating to such fiscal years.

Description of Fees	2004	2003
Audit Fees(1)	\$ 160,500	\$ 110,000
Audit-Related Fees(2)	8,000	8,000
Total Audit and Audit-Related Fees	168,500	118,000
<b>Tax Fees:</b>		
Tax Compliance Fees(3)	33,800	30,050
Tax Consultation and Advice Fees(4)	8,500	6,000
Total Tax Fees	42,300	36,050
All Other Fees(5)	5,000	20,924
Total	\$ 215,800	\$ 174,974

(1) Audit fees in 2003 and 2004 consisted of the annual audit and quarterly reviews of the Company's consolidated financial statements, statutory audit and assistance with and review of documents filed with the Securities and Exchange Commission. Audit fees in 2004 also included fees associated with the audit of internal controls over financial reporting.

(2) Audit-related fees in 2003 and 2004 consisted of employee benefit plan audits.

(3) Tax compliance fees in 2003 and 2004 consisted of preparation of federal and state income tax returns.

(4) Tax consultation and advice fees in 2003 and 2004 consisted primarily of tax planning and other tax related assistance. In January 2005, the Company engaged the accounting firm of McGladrey & Pullen, LLP to provide tax compliance and tax consultation to the Company. The Company no longer intends to engage KPMG LLP to provide these services.

(5) All other fees in 2003 and 2004 consisted primarily of information security consulting advice.

**Approval of Independent Auditor Services and Fees**

The Audit Committee pre-approved 100% of the services provided KPMG LLP, the Company's independent auditors. The Audit Committee has determined that the provision of the above non-audit services was compatible with maintaining the independence of the Company's independent auditors.

The Audit Committee's current practice on pre-approval of services performed by the independent auditors is to approve annually all audit services and, on a case-by-case basis, recurring permissible non-audit services to be provided by the independent auditors during the fiscal year. The Audit Committee reviews each non-audit service to be provided and assesses the impact of the service on the auditor's independence. In addition, the Audit Committee may pre-approve other non-audit services during the year on a case-by-case basis. Pursuant to a policy adopted by the Audit Committee, Mr. Geisler, the Chair of the Audit Committee, is authorized to pre-approve certain limited non-audit services described in Section 10A(i)(1)(B) of the Exchange Act. In 2004, he pre-approved \$8,500 of

services performed by KPMG, LLP that were subsequently ratified by the entire committee.

**Table of Contents****EXECUTIVE COMPENSATION**

The Company has not paid any compensation to its executive officers since its formation. The Company does not presently anticipate paying any compensation to these officers until it becomes actively involved in the operation or acquisition of businesses other than the Bank. The following table sets forth the compensation paid or accrued by the Bank during the fiscal years indicated for services rendered by the Named Officers.

**SUMMARY COMPENSATION TABLE**

Name and Principal Position	Year	Annual Compensation(1)		Long Term Compensation		
		Salary (\$)	Bonus (\$)	Restricted Stock Awards (\$)(2)	Securities Underlying Options (#)(3)	All Other Compensation (\$)(4)
Michael McNeil,	2004	250,000	120,150	74,425		42,161
<i>President and Chief</i>	2003	200,000	100,200		5,000	22,512
<i>Executive Officer</i>	2002	200,000	25,500		23,316	21,868
Jon J. Eberle,	2004	100,000	25,250	26,065		22,690
<i>Senior Vice President,</i>	2003	89,267	9,650		3,640	10,735
<i>Chief Financial</i>	2002	80,880	3,650		9,853	9,270
<i>Officer</i>						
<i>and Treasurer</i>						
Dwain C. Jorgensen,	2004	98,793	25,150	25,480		27,651
<i>Senior Vice President,</i>	2003	95,000	9,650		3,580	11,561
<i>Operations</i>	2002	95,000	500		12,500	11,968
Susan K. Kolling,	2004	104,300	26,500	26,585		27,665
<i>Senior Vice President,</i>	2003	108,289	10,150		3,780	12,289
<i>Branch Coordinator</i>	2002	75,433	3,020		9,189	8,176
Bradley C. Krehbiel	2004	126,458	31,450	33,540		28,418
<i>Executive Vice</i>						
<i>President,</i>	2003	100,000	30,200		4,540	15,874
<i>Business Banking</i>	2002	94,583	7,650		11,842	10,838

(1) During 2004, 2003 and 2002, none of Messrs. McNeil, Eberle, Jorgensen or Krehbiel or Ms. Kolling received any benefits or perquisites from the Company that, in the aggregate, exceeded 10% of their salary and bonus or \$50,000. The 2002 bonus amounts for Messrs. McNeil, Eberle, Jorgensen and Krehbiel and Ms. Kolling include \$500 for a bonus awarded pursuant to the Home Federal Savings Bank Employee Preferred Stock Bonus Plan.

(2)